Malaysia

Strong private consumption drove economic growth in 2011, supported by government spending and, less so, fixed investment. The weaker global environment is forecast to slow growth in this highly open economy in 2012, but the better global backdrop next year should help lift its performance. Moderating growth this year suggests that inflation will also ease. The external current account surplus will remain buoyant.

Economic performance

Expansion of 5.1% in 2011 was fueled mainly by private and government consumption on the demand side and by an expansion of the services sector on the production side. Slower global trade and growth weighed on exports and manufacturing.

Private consumption rose by 6.9%, accelerating from 2010 and contributing about two-thirds of total GDP growth in 2011 (Figure 3.26.1). This reflected a robust labor market (employment increased by 3.2% and unemployment fell to an 11-year low of 3.1%), favorable prices for agricultural commodities (supporting farm incomes), and availability of credit (household borrowing rose by 12.5%). Government consumption, too, made a significant contribution to growth. It surged by 16.8% as the government raised outlays on supplies and services, raised public service wages, and paid a 1-month bonus.

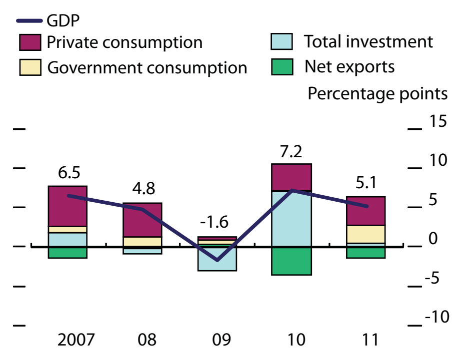
Fixed capital investment growth moderated to 6.0% in 2011. While private investment was strong for much of the year, government investment fell, reflecting the phasing out in 2010 of a fiscal stimulus package. Gross fixed capital investment as a ratio to GDP was flat at around 20%, well below levels seen in the mid-1990s (Figure 3.26.2). This reflects, in large part, rising costs of production and limited progress in attracting higher valued-added industries.

Imports of goods and services in real terms rose faster than exports, holding back GDP growth from the demand perspective.

In supply-side terms, services contributed the vast bulk of growth, expanding by 6.8%. The robust private consumption drove a solid gain in retail and wholesale trading. Finance and insurance services benefited from strength in bank lending and insurance sales, and real estate services from an upturn in the housing market.

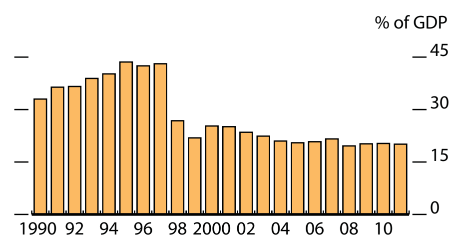
Manufacturing grew by only 4.5% as demand weakened in major industrial countries for manufactured products, particularly electronics. Supply disruptions caused by the March earthquake and tsunami in Japan and second-half floods in Thailand also dented manufacturing output (Figure 3.26.3). The electronics and electrical subsector contracted by 2.4% last year.

3.26.1 Contributions to growth (demand)



Source: Department of Statistics Malaysia. http://statistics.gov.my; CEIC Data Company (both accessed 16 March 2012).

3.26.2 Fixed investment ratio



Source: CEIC Data Company (accessed 20 March 2012).

This chapter was written by Gary Krishnan of the Southeast Asia Department, ADB, Manila.

Construction increased by a modest 3.5%, reflecting the end of the fiscal stimulus in 2010. The mining subsector (mainly oil), contracted by 5.7%, a result of maintenance shutdowns and output declines in mature fields.

The performance of agriculture—5.6% growth—was the strongest in 8 years. This was largely based on a sharp increase in crude palm oil production, which accounts for about one-third of the sector. Palm oil output rose by 11.3% to 18.9 million tons owing to good weather and firm international prices.

Higher food costs and increases in administered prices of electricity, fuel, and sugar nudged up inflation to 3.5% year on year in June (Figure 3.26.4). On a year-average basis, it accelerated to a 3-year high of 3.2%. House prices also turned up, by 8.6% in the first 3 quarters, a pace more than double the average of 2000–2010.

To lean against inflation, Bank Negara Malaysia, the central bank, raised its policy interest rate in May 2011 by 25 basis points to 3.0%. It also lifted the reserve requirement for banks from 1.0% to 4.0% to drain excess liquidity from the banking system.

The government boosted public expenditure by about 13% in 2011 (it had declined slightly in the prior year). Revenue rose by 15%, propelled by the surge in oil prices. These outcomes compressed the federal budget deficit slightly to 5.3% of GDP (Figure 3.26.5). The ratio of federal government debt to GDP edged higher to 53.5%.

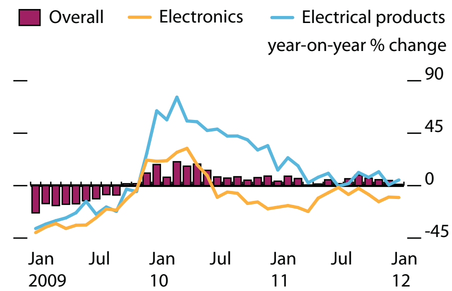
Growth in M2 money supply rose by 14.6% year on year in December 2011, double the rate of the prior-year month. Credit to the private sector accelerated to 12.2% in 2011.

The external position remained strong. Merchandise exports climbed by 14.5% to US$227.5 billion, largely a result of higher prices for export commodities. The value of palm oil shipments jumped by 32.6% and minerals (mainly oil) by just over 22%. By contrast, the weakness in global demand for electronics and electrical products, alongside supply disruptions, took down their exports by 5.4%. After a 13.9% increase in imports to US$178.7 billion, the trade surplus rose to US$48.8 billion (Figure 3.26.6). The current account surplus as a share of GDP remained large at 11.5%.

In the capital and financial accounts, net portfolio investment of US$9.9 billion in 2011 was lower than in 2010 owing to global investor risk aversion caused by the eurozone and United States fiscal and debt concerns in the second half of the year. Inward direct investment rose by nearly 19% to US$10.8 billion, exceeded by outward direct investment that rose by 11% to US$14.8 billion. Other investment outflows moderated and the overall balance of payments recorded a surplus of US$31.0 billion. That lifted international reserves to $138.4 billion at end-2011, sufficient to finance about 8 months of retained imports and 4.1 times short-term external debt. The ringgit depreciated against the US dollar by about 3% during the year.

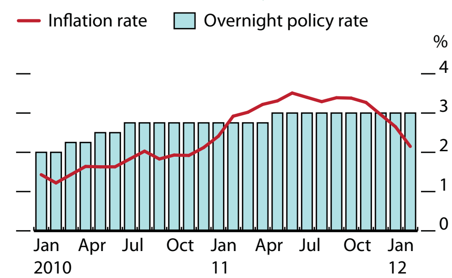
Concerned about high levels of household debt (equivalent to 76.6% of GDP in 2011), the central bank moved to damp speculation in housing and to tighten credit card issuance. For housing loans, it imposed a 70% loan-to-value ratio on individual borrowers with more than two housing loans, and ruled that housing loan approvals be based on net rather than gross household income. Capital charges on commercial banks were

3.26.3 Manufacturing production index



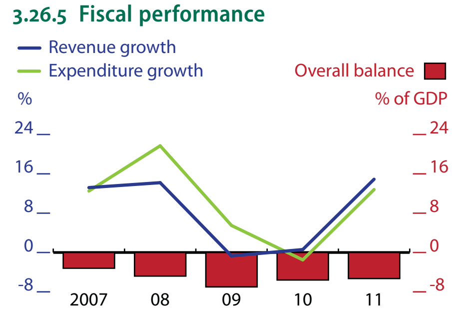
Source: CEIC Data Company (accessed 20 March 2012).

3.26.4 Inflation and policy interest rate



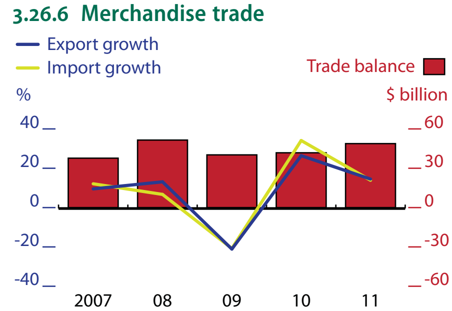
Source: CEIC Data Company (accessed 20 March 2012).

3.26.5 Fiscal performance



Source: Asian Development Outlook database.

3.26.6 Merchandise trade



Source: Asian Development Outlook database.

increased for housing loans with loan-to-value ratios exceeding 90%, and on personal loans of more than 5 years.

On credit cards, the central bank put limits on the number of cards and the amount of credit available for people earning less than RM36,000 (US$11,760) a year. That comes on top of a RM50 annual tax on credit cards.

3.26.1 Selected economic indicators (%)

	2012	2013
GDP growth	4.0	5.0
Inflation	2.4	2.8
Current account balance (share of GDP)	12.1	11.9

Source: ADB estimates.

Economic prospects

Given the country's close integration with the world economy—exports and imports of goods and services are equivalent to over 100% of GDP—weakness in the global outlook clouds Malaysia's prospects in 2012. Growth is seen moderating to about 4.0% in 2012, then quickening to 5.0% in 2013 as the external environment improves (Figure 3.26.7).

Domestic demand will again anchor growth. Private consumption will get support from government decisions in the 2012 budget to raise wages for the public sector and to make a one-time cash payment to low- and middle-income groups (53% of all households). Government plans to introduce a minimum wage in 2012 are expected to lift incomes for the low paid.

Still, the labor market is likely to soften in 2012, particularly in trade-exposed industries. Job vacancies in January 2012 declined steeply from the prior-year period. Consumer sentiment weakened late in 2011 (Figure 3.26.8).

Private investment in export-oriented industries such as electrical and electronics products will be subdued by the weak global outlook this year, although investment will likely be relatively buoyant in industries that depend on domestic demand.

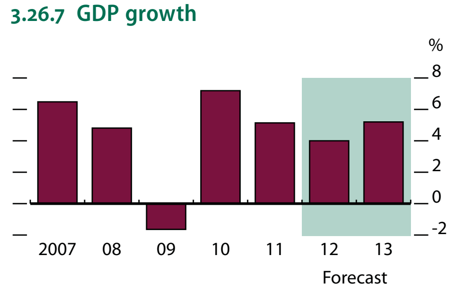
The government is pressing ahead with its Economic Transformation Programme, launched in 2010, to develop higher value-added industries and infrastructure in partnership with private investors. According to government officials, investment totaling US$58 billion has been committed through 2020 under the program. Several large projects associated with this initiative will start construction during the forecast period, including an $11.5 billion mass rapid transit rail system in Kuala Lumpur and redevelopment of the Sungai Besi military airbase and a large site near the center of the capital for residential and commercial purposes.

The leading index of economic activity in January 2012 suggested slower economic growth in the near term, and the forward-looking Business Conditions Index, compiled from a survey of manufacturers, fell late last year (Figure 3.26.8).

From the production side, services are likely to continue to drive growth in 2012. The government is relaxing some restrictions on foreign investment in 17 services subsectors, including accounting, education, legal, and medical services, following a similar easing for 27 services subsectors in 2009. Tax breaks have been offered to encourage treasury management, Islamic, and other financial services.

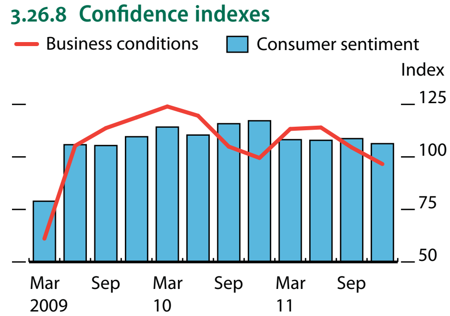
Construction will gain from work on major projects and on an US$2.0 billion off-budget government program to upgrade infrastructure. The impact on construction from the curbs on credit

3.26.7 GDP growth



Source: Asian Development Outlook database.

3.26.8 Confidence indexes



Note: The business conditions index is derived from a quarterly survey of over 350 manufacturing firms. The consumer sentiment index is from a quarterly survey of over 1200 households in peninsular Malaysia. Above 100 indicates expansion for manufacturing and optimism among consumers.

Source: CEIC Data Company (accessed 20 March 2012).

for speculation in housing and an increase in the tax on profits from selling properties within 5 years of acquisition is expected to be modest. Sluggish external demand will weigh on manufacturing and on trade-related services. Growth of agriculture will decelerate from the rapid pace seen last year.

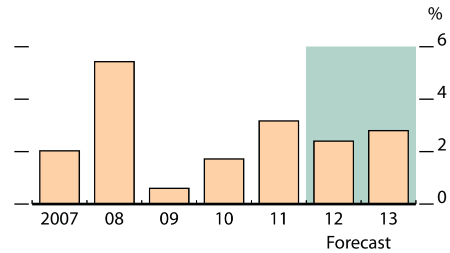
Fiscal policy is targeted at stimulating domestic demand again this year. The federal deficit is expected to be broadly similar to that recorded for 2011 as a share of GDP. The central bank has signaled that it has the flexibility to increase monetary stimulus if the global economy deteriorates.

Inflation is forecast to recede to 2.4% (Figure 3.26.9) in light of moderating domestic demand and generally lower prices for imported commodities. This forecast assumes that subsidies on electricity, food, and fuel will not be cut ahead of national elections due in 2013. The ringgit appreciated by 3.4% against the US dollar in the first quarter of 2012, helping to damp inflation. In 2013, inflation is seen picking up to 2.8%, in line with domestic demand.

Growth in merchandise exports is expected to be subdued in 2012 owing to torpid global trade and softer prices for export commodities, including palm oil. Similarly, imports will increase at a modest rate, in tandem with weakness in manufacturing industries and more moderate growth in private domestic demand. The current account will continue to record substantial surpluses through the forecast period.

Lower than expected growth in global trade would put the 2012 growth forecast at risk, given the country's reliance on exports. Domestically, the high level of household debt poses a risk if the labor market is weaker than anticipated.

3.26.9 Inflation



Source: Asian Development Outlook database.

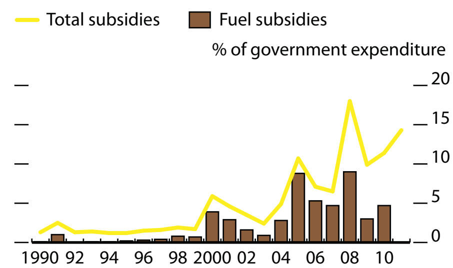
Policy challenge—reining in subsidies

The cost of government subsidies on fuel, staple foods, electricity, health, and education has climbed from 1.3% of total government spending in 1990 to 14.3% in 2011 (about 4% of GDP). Fuel subsidies alone amounted to 4.7% of total government spending in 2010 (Figure 3.26.10). Mainly for this reason, Malaysians consume 450 liters of fuel a head each year, 4.5 times as much as Thais and nine times Indonesians, according to the government.

Subsidies suppress inflation, but also contribute to the chronic fiscal deficit, reduce budget funding available for social and economic development, and distort resource allocation. The vast bulk of the subsidies benefit consumers, students, and companies in general, rather than the poor, because of inadequate targeting.

The government started to gradually reduce subsidies in 2010 on gasoline, cooking gas, electricity, and road tolls, and committed to better target remaining subsidies to lower income groups. It offered partial compensation for the upward impact on inflation, including cash rebates to owners of motorcycles and small cars (below 1,000cc). Budget savings estimated at about US$33 billion in the 5 years that subsidies were to be phased down were to have been applied to reining in the fiscal deficit. However the phase-down plan has since been suspended and it is unclear when it will resume.

3.26.10 Subsidies



Sources: Ministry of Finance. *Economic Report 2011/2012*. http:// www.treasury.gov.my; CEIC Data Company (accessed 20 March 2012).