Malaysia

A surge in fixed investment combined with buoyant private consumption underpinned stronger economic growth in 2012, overriding weakness in exports. Government cash transfers and spending on infrastructure contributed to domestic demand. GDP growth is forecast to ease this year before picking up in 2014, while inflation is seen edging up from last year's low rate. Rising imports and subdued exports have eroded the surplus in the current account.

Economic performance

Strong expansion in private consumption and fixed investment lifted GDP growth to 5.6% in 2012, close to the average growth rate in the 5 years before the global financial crisis. Growth accelerated to 6.4% in the fourth quarter.

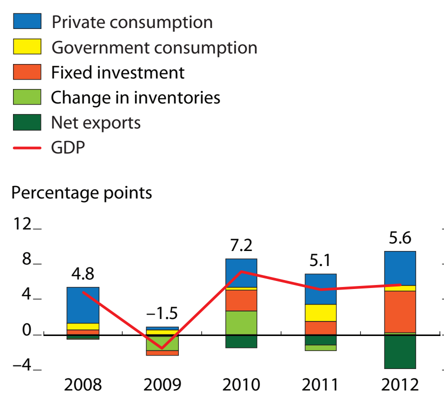
Private consumption increased by 7.7% and made a major contribution to GDP growth (Figure 3.26.1). It was driven by a robust labor market, growth in credit, and several government decisions during the year. Employment grew by 3.6%, mostly in domestic-oriented sectors such as services, and the unemployment rate declined to 3.0%. Average wages in the private sector rose by a robust 5.0%. The government's contribution to private consumption came from a 13.0% increase in public sector wages in March 2012 (directly benefitting 10% of the workforce), higher public sector pensions, and a range of cash transfers to low- and middle-income households.

Fixed investment surged by 19.9%, its best performance in 12 years (Figure 3.26.2). Much of the investment was related to the government's Economic Transformation Programme, which aims to lift Malaysia into the ranks of high-income nations by 2020 by upgrading industry and infrastructure. Private sector investment was particularly strong, climbing by 22.0%, while public sector investment rose by 17.1%. Major investment projects under way in 2012 included an $11.5 billion mass rapid transit rail system in Kuala Lumpur, expansion of oil and gas processing and other energy projects, and a high-speed broadband network. This surge in investment was an important source of GDP growth last year.

The ratio of fixed capital investment to GDP was, at 25.6% in 2012, the highest in 14 years, though still well below the 40% pace of the mid-1990s.

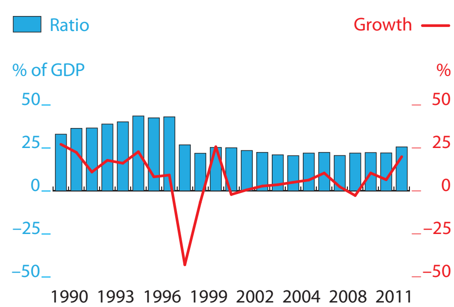
Government consumption spending decelerated from 2011 but still made a small contribution to economic growth last year. However, the external sector acted as a drag on GDP growth, as weak global demand flattened exports of goods and services in real terms while buoyant domestic demand fueled growth in imports.

3.26.1 Demand-side contributions to growth



Sources: Department of Statistics Malaysia. http://statistics.gov.my; CEIC Data Company (both accessed 2 March 2013).
Click here for figure data

3.26.2 Fixed investment



Source: CEIC Data Company (accessed 20 March 2013).
Click here for figure data

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

From the supply side, services grew by 6.4% such that the sector, which provides 55% of GDP, made the biggest sector addition to total growth. Major contributors were wholesale and retail trading and financial services. Construction soared by 18.5% as government-led infrastructure and industrial projects gained momentum. Residential construction was also buoyant. Manufacturing grew by a relatively modest 4.8%, weighed down by weakness in global demand for electronics. Mining rebounded after a contraction in the previous year to grow by 1.4% in 2012 on higher oil production.

Agriculture, by contrast, had a poor year owing to declines in the production of rubber because of bad weather and of palm oil that reflected a steady decline in yield. The agriculture sector grew by just 0.8%.

Fiscal policy stimulated the economy with the cash transfers and other benefits for consumers and incentives for business expansion. The government introduced a supplementary budget in June to fund additional spending, which rose by 9.5% from 2011. High global oil prices contributed to an 11.8% increase in government revenue. The fiscal deficit narrowed slightly to 4.5% of GDP in 2012, which was the fifth consecutive year of deficits above 4% of GDP (Figure 3.26.3). Federal government debt has increased over the past 5 years from 40.1% of GDP to 53.5%.

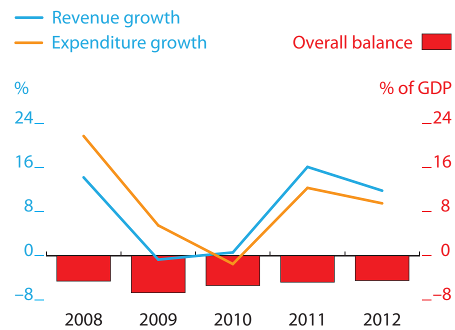
Bank Negara, the central bank, kept its policy interest rate at 3.0% through last year and into 2013 as it balanced buoyant domestic demand and fiscal stimulus on the one hand against low inflation and a subdued global outlook on the other. Credit to the private sector picked up to grow by 12.5% on average in 2012. The weighted average lending interest rate of commercial banks declined over the year to 4.7%. The Malaysian ringgit appreciated by 3.9% against the US dollar.

Inflation slowed as prices of food and fuel decelerated in 2012 (Figure 3.26.4). On a year-average basis, inflation was almost halved to just 1.7%. Subsidies on fuel, staple foods, and electricity, which cost the government the equivalent of 4.5% of GDP in 2012, helped to curb inflation.

Merchandise exports fell marginally to $227.6 billion as a consequence of sluggish demand in global markets and soft prices for export commodities such as rubber and palm oil. Exports of electronics fell, but not as steeply as in 2011. Commodity exports declined by about 7%. By contrast imports rose by 4.3% to $187.0 billion, reflecting the strength of private consumption and investment. These developments lowered the trade surplus by 16.2% to $40.5 billion (Figure 3.26.5). The deficit in services trade widened sharply, mainly due to a higher deficit in transportation services and slower growth in tourism, and the income deficit deteriorated on higher payments of dividends and interest to foreign companies. Consequently, the current account surplus fell to $19.4 billion, or 7.9% of GDP, the lowest share since 2001.

The capital and financial account recorded net outflows last year. Inward foreign direct investment totaled $9.4 billion, coming off an unusually high level in 2011. The balance of payments recorded a small surplus, and international reserves rose 4.8% to $139.7 billion, cover for 7.3 months of goods and services imports.

3.26.3 Fiscal performance



Source: *Asian Development Outlook* database.

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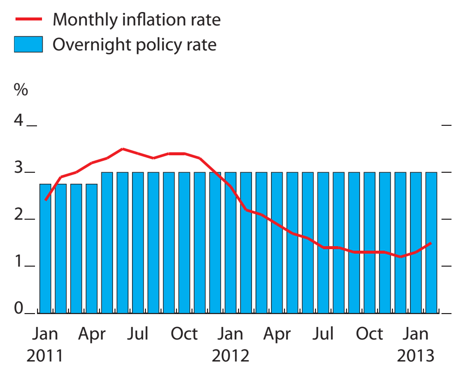
3.26.4 Inflation and policy interest rate



Source: CEIC Data Company (accessed 20 March 2013).

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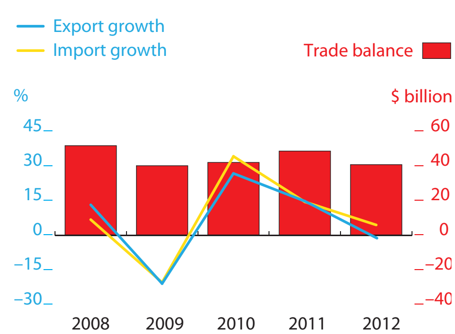
3.26.5 Trade indicators



Source: *Asian Development Outlook* database.

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Economic prospects

Forecasts assume that national elections to be held in May 2013 go smoothly and that the government pursues prudent economic and fiscal policies.

Private consumption will get support from robust labor market conditions, low inflation, higher incomes, and, from the 2013 budget, further transfer payments and tax concessions. New minimum wages of RM900 a month for Peninsular Malaysia and RM800 for East Malaysia came into effect from January 2013 and benefit 27% of all workers. The tight labor market suggests that job losses resulting from the new minimum wage will likely be temporary.

Nevertheless, growth in private consumption will likely moderate from 2012. Softer global commodity prices will weigh on incomes and consumption spending, particularly in rural areas. Further, the government is expected to resume phasing down subsidies on fuel and other items or move to a system that better targets subsidies. A proposed broad-based consumption tax that aims to reduce the government's reliance on the oil sector for public revenue could also dampen consumption growth temporarily if introduced.

Consumer sentiment remains positive: the index of consumer sentiment compiled by the Malaysia Institute of Economic Research edged higher in the fourth quarter of 2012 (Figure 3.26.6). However, the business conditions index compiled from a survey of manufacturers declined on concerns about the outlook for domestic and export sales.

Investment, too, is expected to moderate this year. Private investment is forecast to grow at a double-digit pace, but below last year's 22.0%. Large investments are planned for the oil and gas industry, for property developments, and to expand services. Credit to the private sector accelerated to 12.3% in January 2013 (Figure 3.26.7). As for public investment, the government is pushing ahead with its Economic Transformation Programme while also proposing to gradually rein in its fiscal deficit. The result is expected to be somewhat slower growth in public investment in the forecast period.

On the production side, solid growth in private consumption will boost the service sector, assisted by investments being made in high-speed broadband and wireless technologies, but the pace of growth is expected to decelerate from 2012. Manufacturing will get a lift, mainly in 2014 when recovery gathers momentum in major industrial economies. Production of natural gas and oil will increase this year as investment to develop new fields and enhance recovery at existing oil fields pays dividends. Agriculture is forecast to recover this year, but growth in construction will subside from last year's high rate.

Fiscal policy is expected to start to tighten later this year. The government has targeted a narrower fiscal deficit equivalent to an estimated 4% of GDP in 2013. The central bank will likely keep interest rates at levels supportive to economic growth into 2013 while standing ready to raise rates if price pressures gather steam.

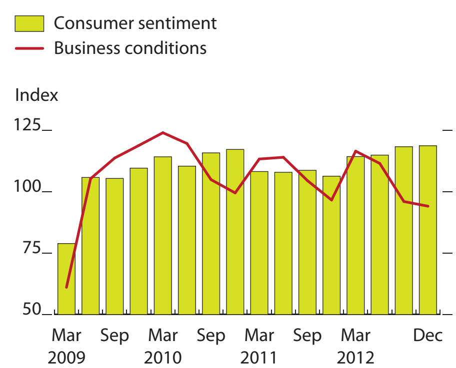
Robust domestic demand and a foreseen gradual reduction of subsidies during the forecast period will nudge prices up, with moderating factors anticipated to be soft global food and fuel prices and a firm ringgit. The impact of the new minimum wage on companies' total costs is expected to be modest. Inflation is projected to pick up to average 2.2% in 2013 and

3.26.1 Selected economic indicators (%)

	2013	2014
GDP growth	5.3	5.5
Inflation	2.2	3.0
Current account balance (share of GDP)	5.8	5.6

Source: ADB estimates.

3.26.6 Business and consumer confidence indexes



Note: Above 100 indicates expansion for manufacturing and optimism among consumers.
Source: CEIC Data Company (accessed 20 March 2013).
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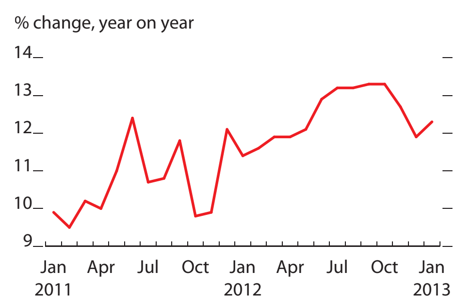
3.26.7 Credit to the private sector



Source: CEIC Data Company (accessed 4 April 2013).
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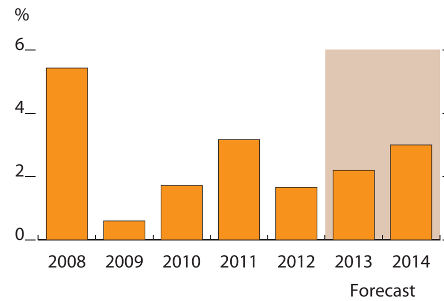
3.0% next year (Figure 3.26.8). For the first 2 months of 2013 inflation was just 1.4%.

External demand is seen improving only gradually. A better outlook this year for the People's Republic of China and India, two important export markets, will benefit Malaysia's commodity exports though prices of commodities such as palm oil and liquefied natural gas will remain under downward pressure. The anticipated recovery in industrial economies in 2014 will improve prospects for electronics and other manufactured exports. Import growth will likely moderate in 2013 but still outpace growth in exports, given strong domestic demand. The drag on GDP growth exerted by net exports will lessen this year.

On the balance of these influences, GDP growth is forecast at 5.3% in 2013, accelerating a little to 5.5% next year as the global economic environment improves. The current account surplus is forecast to decline further as trade surpluses subside and deficits persist in the income and services accounts (Figure 3.26.9).

3.26.8 Inflation



Source: *Asian Development Outlook* database.
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Policy challenge—maximizing women's contributions

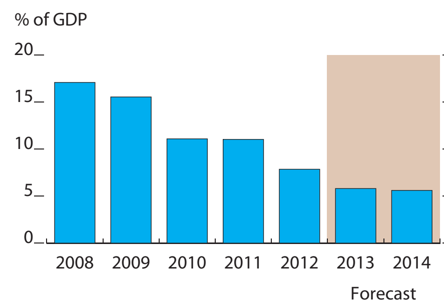
Women's rate of participation in Malaysia's labor force is well below that for males and the lowest in Southeast Asia (Figure 3.26.10). Only 48% of Malaysian women of working age reported that they were working, in either the formal or the informal sector of the economy, or looking for work in 2011.

Increasing the female participation rate to levels comparable with other countries would expand the workforce by at least 500,000 and perhaps by 2.3 million, the World Bank estimated in an economic report published in November 2012. It also estimated that Malaysia's GDP growth would have been 0.4 percentage points higher in 2000–2010 if the female participation rate had been lifted by 11 percentage points to 57%. Higher workforce participation would help overcome skills shortages, enlarge the pool of entrepreneurs, and improve the welfare of women.

One reason for the low participation rate is that Malaysian women generally find it difficult to reconcile family with work commitments. Fewer of them re-enter the workforce after childbirth than do women elsewhere. The 2013 budget introduced tax incentives to encourage more childcare centers to open, which should go some way toward addressing this issue. Another factor is the secondary education enrollment rate for Malaysian girls, which is relatively low compared with countries that have comparable income. The government is spending more on education, and it funds retraining women after a career break.

Policies that have produced results in other countries include more generous parental leave policies, encouraging part-time work, tax incentives, improved arrangements for childcare and tending to the elderly, raising the retirement age, and a greater focus on education and training for women. The government's 10th economic plan targets increasing the female workforce participation rate to 55% by 2015.

3.26.9 Current account balance



Source: *Asian Development Outlook* database.
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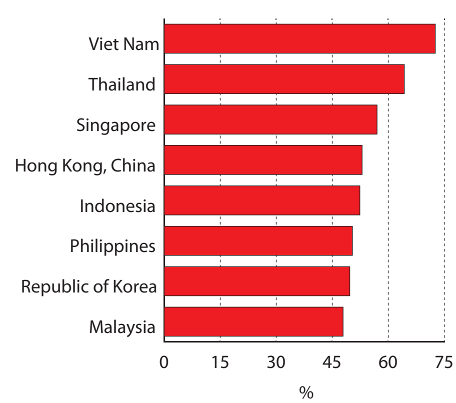
3.26.10 Female labor force participation rate, 2011



Source: ADB Statistical Database System (accessed 4 April 2013).
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