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Malaysia

Domestic demand remained buoyant in 2013, but external demand weakened. This year, stronger exports are projected to lift economic growth, even as higher inflation and fiscal tightening act to moderate domestic demand. Current account surpluses will likely rise after narrowing last year. Sharply rising household debt and housing prices pose risks for banks and for growth.

Economic performance

Buoyant domestic demand drove the economy in 2013, but weak external demand and subdued public investment constrained GDP growth to 4.7%, below the average of just over 5.0% since 2010 (Figure 3.26.1).

Private consumption rose by a vigorous 7.6%, similar to the pace in 2012, and it contributed most of the GDP growth in 2013. The expansion in consumption spending was underpinned by 4.8% growth in employment, a low 3.1% unemployment rate, and average real wages that rose by an estimated 0.9% in 2013. Also, a national minimum wage came into effect in January 2013. Additional factors were widespread cash transfers from the government and increases in public sector wages, bonuses, and pensions.

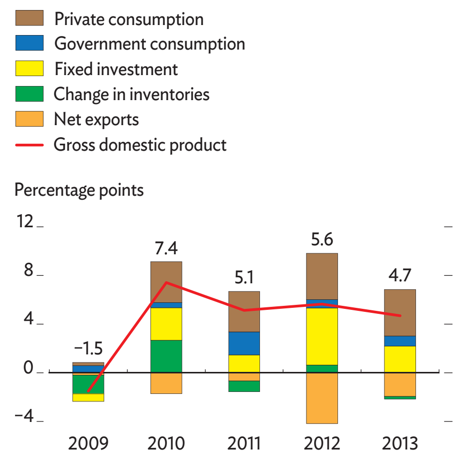
Fixed capital investment grew by 8.2% in 2013, but this was less than half the rapid 19.9% pace recorded in 2012. From its high base, fixed investment made a smaller but still significant contribution to GDP growth. The ratio of fixed investment to GDP increased to 26.9%, maintaining a gradual improvement over recent years.

Private fixed investment decelerated to a still-strong 13.6%, focused on mining, services, and manufacturing. Meanwhile, the government cut growth in public fixed investment to just 0.7% from 17.1% a year earlier (Figure 3.26.2). This largely reflected government reductions in development outlays.

Government consumption spending rose by 6.3% in 2013, an election year, and made a small contribution to GDP growth. By contrast, net exports contracted, which dragged on growth. Import volumes of goods and services rose slightly, spurred by the robust domestic demand, while export volumes fell, reflecting slack external demand.

From the production perspective, services grew by 5.9% and contributed nearly 70% of the increase in GDP on strong expansion in communications, real estate and business services, government services, and wholesale and retail trade. Growth in finance and insurance slowed sharply, however.

3.26.1 Demand-side contributions to growth



Sources: Department of Statistics Malaysia. http://statistics.gov.my; CEIC Data Company (both accessed 2 March 2014).
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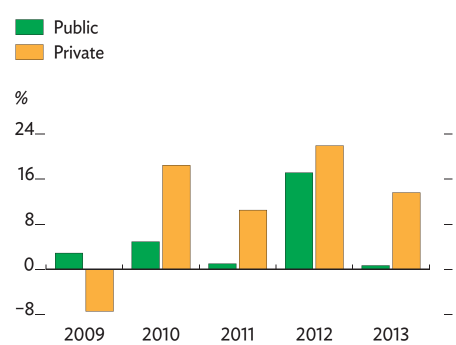
3.26.2 Fixed investment growth



Source: CEIC Data Company (accessed 21 March 2014).
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This chapter was written by Gary Krishnan of the Southeast Asia Department, ADB, Manila.

Manufacturing grew by 3.4%, the slowest pace in 4 years, in large part reflecting lackluster demand for exports of goods such as electronics and electrical products. Construction expanded by a buoyant 10.9%, though this too represented an easing of growth from 2012. Civil engineering in particular moderated as major projects were completed, including the Second Penang Bridge, Sabah–Sarawak gas pipeline, and Sabah oil and gas terminal.

Crude oil production fell last year as maintenance idled production facilities, but natural gas output rose. Growth in agriculture picked up to 2.1% with palm oil recovering and growth in food production strengthening. Producers of natural rubber reduced tapping, though, when global rubber prices fell.

Fiscal policy was less stimulatory in 2013 as the government started to address its fiscal deficit, which exceeded 4% of GDP every year from 2008 to 2012. Fitch lowered its credit rating outlook on Malaysia from stable to negative in July 2013, citing the country's budget deficit, declining current account surplus, and rising household debt.

The task of curbing the fiscal deficit was complicated by the decline in prices for export commodities and oil, which held growth in government revenue to 2.6%. The government cut development expenditure by 8.2%, slowed growth in operating expenditure to 2.8%, and trimmed some subsidies. Further, it decided to stretch the construction of certain public projects out to relieve the strain on fiscal and external accounts alike. By year-end, the fiscal deficit had narrowed to 3.9% of GDP from 4.5% in 2012 (Figure 3.26.3).

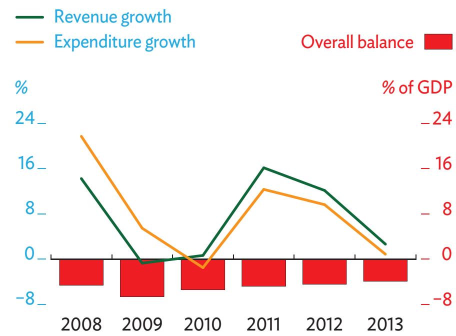
Bank Negara Malaysia, the central bank, kept its policy interest rate steady at 3.0%, as it has done since May 2011. The average base lending rate of commercial banks was unchanged at 6.5% in 2013. Lending to consumers maintained robust growth, increasing by 12.0% year on year in December 2013. Lending to businesses rose by a more sedate 8.3%.

Inflation edged higher to 3.2% in December 2013, nudged up by the impact of bad weather on food prices and government decisions in September to reduce subsidies for fuel and sugar and to increase the excise duty on tobacco (Figure 3.26.4). Another factor was a weaker Malaysian ringgit, which depreciated by 6.6% against the US dollar over 2013. For the year, inflation averaged 2.1%.

Slack external demand had a deep impact on Malaysia's trade accounts. Merchandise exports fell by 3.6% to $219.4 billion in 2013, reflecting reduced volumes and prices for the country's commodities, such as palm oil and rubber, as well as a soft global market for its manufactures, including electronics. Robust domestic demand contained to 0.1% the decline in merchandise imports, valued at $186.8 billion. The trade surplus fell by 19.8% to $32.6 billion, the smallest in 9 years. After accounting for deficits in services trade, income, and transfers, the current account surplus narrowed to $11.8 billion, equivalent to 3.8% of GDP.

The financial account posted net outflows. Malaysians' direct investment abroad totaled $12.9 billion, less than in the previous 3 years. Portfolio investment recorded a smaller net inflow while inward foreign direct investment rose to $11.6 billion. The balance of payments remained in surplus, and international reserves totaled $134.6 billion at year-end, cover for 7.0 months of goods and services imports.

3.26.3 Fiscal performance



Source: CEIC Data Company (accessed 21 March 2014).
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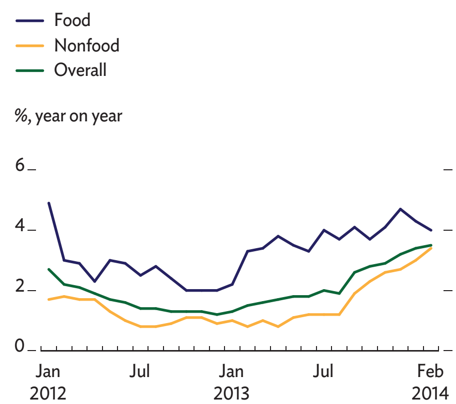
3.26.4 Monthly inflation



Source: CEIC Data Company (accessed 21 March 2014).
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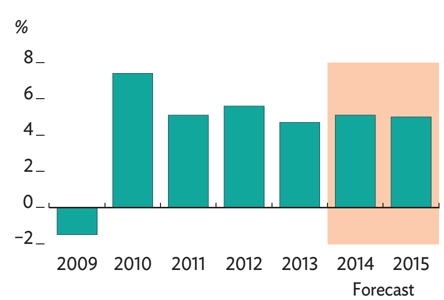
3.26.5 GDP growth



Source: Asian Development Outlook database.
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Economic prospects

Malaysia has high exposure to global trade conditions, with exports of goods and services equivalent to 83% of GDP. Thus, projected improvement in the economies of major industrial countries and in world trade bode well for its growth in 2014 and 2015. At the same time, rising inflation and fiscal tightening will moderate domestic demand.

Taking these factors into account, GDP is forecast to grow by 5.1% this year, quickening from 2013, and by 5.0% in 2015 (Figure 3.26.5).

Merchandise exports were trending up late in 2013, and that trajectory was maintained in early 2014 (Figure 3.26.6). For the year, exports are forecast to rise by 6.3% in US dollar terms, spurred by ringgit depreciation and stronger demand, in particular from the US and the euro area as their economies gather momentum. Prospects for growth in exports to the PRC are clouded by softer economic growth there. Still, in January 2014, exports rose by 12.2% year on year, with significant increases in shipments of electrical and electronic products.

Private consumption and fixed investment are projected to expand in 2014, but both at more moderate paces than in 2013. Private consumption will benefit from the firm labor market and rising wages. Cash transfers from the government's 1Malaysia People's Aid program (known as BR1M) have been increased and extended to as many as 7.9 million Malaysians in 2014. However, rising inflation and other concerns have dented consumer confidence, which will temper growth in consumption spending. The index of consumer sentiment declined last year (Figure 3.26.7). The business conditions index compiled from a survey of manufacturers also declined.

Fixed investment is expected to be slightly dampened by the government's fiscal consolidation, by the ringgit's depreciation, and possibly by higher borrowing costs. Nevertheless, 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, is generating a pipeline of investment projects. Also, recovery in exports will spur investment in export-oriented manufacturing.

Government consumption spending is seen decelerating. The government has narrowed its fiscal deficit target to 3.5% of GDP. Among other measures, the budget for 2014 raised electricity tariffs by 15.0% from January.

A 6.0% goods and services tax (GST) is scheduled to come into effect from April 2015. This is a broad-based tax that will replace existing sales and service taxes. It should be an important revenue source that reduces current heavy reliance on revenue from oil production.

One likely effect of the GST schedule is that consumers bring forward into 2014 and early 2015 planned spending on costly items such as automobiles and household appliances and furniture. Personal income tax rates will likely be trimmed in 2015 and cash transfers expanded to mitigate the impact of the GST on households.

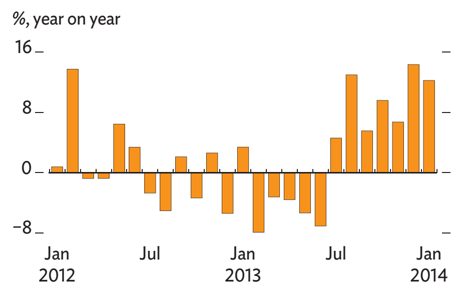
As the government plans to narrow the fiscal deficit to 3.0% in 2015, fiscal tightening could weigh on GDP growth next year, as could higher inflation. But the export recovery is projected to continue in 2015.

3.26.1 Selected economic indicators (%)

	2014	2015
GDP growth	5.1	5.0
Inflation	3.2	3.5
Current account balance (share of GDP)	4.1	4.6

Source: ADB estimates.

3.26.6 Merchandise exports growth



Source: CEIC Data Company (accessed 24 March 2014).
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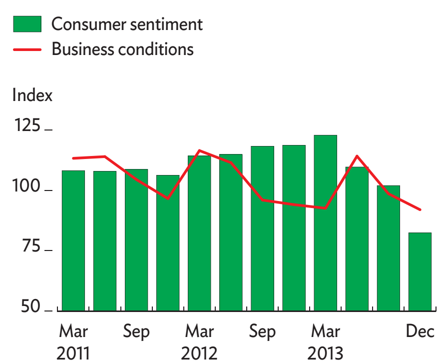
3.26.7 Business and consumer confidence indexes



Note: Above 100 indicates expansion for manufacturing and option among consumers.
Source: CEIC Data Company (accessed 21 March 2014).
Click here for figure data

Monetary policy may become less accommodating during the forecast period, particularly if inflationary expectations build and second-round effects emerge after reductions in subsidies and the implementation of the GST. Rising inflation has made the policy interest rate negative in real terms.

Inflation is forecast to trend up to average 3.2% in 2014 (Figure 3.26.8). Reductions in subsidies and the spillover effects on other goods and services has put upward pressure on prices. Last year's depreciation of the ringgit has contributed to inflation. In the first 2 months of this year, inflation rose to 3.4%, the highest since July 2011.

Next year, inflation is seen rising to 3.5% and perhaps higher if inflationary expectations and second-round effects are not contained as the GST is introduced. The government plans further reductions in subsidies, which means higher prices for consumers, to help address its fiscal pressures, as the cost of subsidies has grown to 4.7% of GDP. However, it is unclear when subsidies will be reduced further.

Imports are seen growing at a similar pace to exports this year. The expansion of export-oriented manufacturing will draw in greater volumes of intermediate goods, but moderating domestic demand will dampen some other categories of imports. The trade surplus is forecast to turn up in both 2014 and 2015, contributing to larger current account surpluses (Figure 3.36.9).

Policy challenge—high household debt

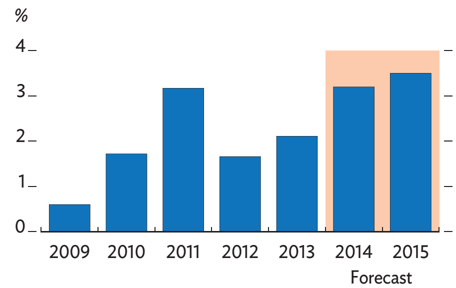
Malaysian households are among the most highly indebted in Asia. Household borrowing for houses, automobiles, and other home and personal expenditures increased at an average annual rate of 12.1% over 2003–2013 to reach the equivalent of 86.8% of GDP in 2013 (Figure 3.26.10). Furthermore, increased borrowing has contributed to sharply higher housing prices. These trends heighten risks to the banking system and the sustainability of household spending.

The central bank has addressed this issue with a range of macroprudential regulations aimed at slowing property price inflation and credit growth. They include moves last year to set the maximum tenor for personal loans at 10 years and for property loans at 35 years, and to prohibit banks from offering to households preapproved personal financing such as unrequested credit cards.

For its part, the government has raised the capital gains tax on property transactions and the minimum price of properties that foreign investors can buy, to curb speculation in real estate. The policies seem to be working, as the increase in household debt slowed in 2013. Banks are generally in good financial shape, and loan impairments are low at this time.

Still, rising debt could test household debt-servicing capacity when interest rates rise or growth in employment and incomes falters. Also, the higher housing prices rise, the greater the scope for them to deflate. Such developments could erode the strength of the banks and hurt their ability to finance the economy.

3.26.8 Inflation



Source: *Asian Development Outlook* database.

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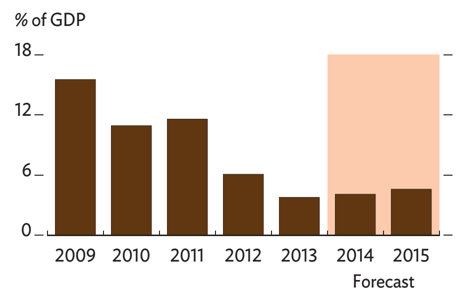
3.26.9 Current account balance



Source: *Asian Development Outlook* database.

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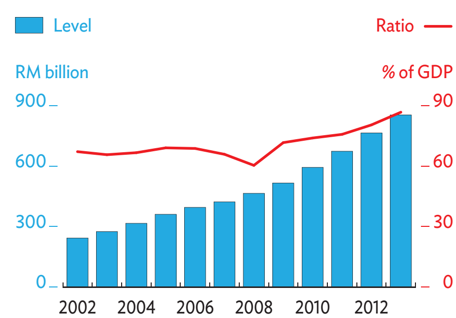
3.26.10 Household debt



Source: CEIC Data Company (accessed 24 March 2014).

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