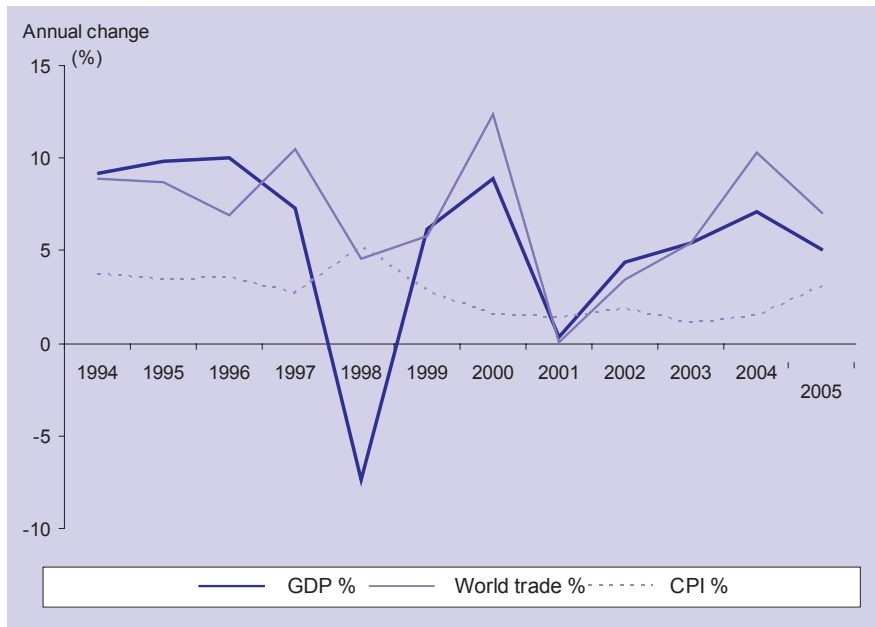


:: The Malaysian Economy

The underlying growth of Malaysian economy has remained solid following an expansion by 5.2% in 2005. Supportive macroeconomic policies and favourable financial conditions enabled the Malaysian economy to remain resilient with the private sector continuing to be the major driver of economic expansion.

Real GDP, Inflation Rate and World Trade



Source : Department of Statistics, Malaysia and Bank Negara Malaysia

Major Developments in 2005

All sectors of the economy, except the construction sector, registered positive growth in 2005. Value added in the **manufacturing sector** increased by 5.1%. Developments in the manufacturing sector were influenced mainly by the cyclical turns in the global electronics industry. In the first half-year, producers in the electronics and electrical (E&E) industry undertook adjustments in their inventories by lowering production in response to the overproduction in 2004. As global demand for semiconductors from both businesses and consumers worldwide increased in the second half-year, production and sales increased. In the domestic-oriented industries, the resilient domestic demand provided impetus for growth in the food and beverage; paper products; and transport equipment industries. However, the subdued performance in the construction sector led to the continued contraction in output of the construction-related industries.

The **services sector** recorded a strong expansion of 6.5%, surpassing the overall gross domestic product (GDP) growth rate. Growth was supported by strong consumer spending as well as measures taken by the Government in promoting new areas of growth in the services sector.

Growth in the **agriculture sector** expanded at a moderate rate of 2.5% in 2005. While the palm oil sector benefited from high yields and increase in mature areas, the performance of the other agriculture crops were affected by the unfavourable weather conditions during the year.

Real GDP by Sector (1987=100)			
	2004	2005	2006 ^f
	Annual change (%)		
Agriculture	5.0	2.5	2.0
Mining	3.9	0.8	5.0
Manufacturing	9.8	5.1	7.0
Construction	-1.5	-1.6	1.0
Services	7.0	6.5	6.0
Real GDP	7.2	5.2	6.0
^f Forecast			

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Growth in the **mining sector** moderated to 0.8% due mainly to lower production of crude oil, though the production of natural gas and condensates were higher. The decline in crude oil production was a result of shutdowns in several oil installation facilities during the year for maintenance and repairs. The increase in natural gas output was supported by the rising demand from domestic power generators, industrial users and major foreign buyers.

In the **construction sector**, activities in the residential and non-residential segments expanded but the overall activity was subdued, due to lower activities in the civil engineering sub-sector following the completion of a number of privatised infrastructure projects in recent years.

In 2005, domestic demand conditions remained favourable, despite concerns arising from rising oil prices and the uncertain external outlook in the early part of the year. **Consumer spending** was sustained at a high level throughout the year, growing by 9.2% for the year. Consumers benefited from the continued increase in disposable incomes arising from high export earnings and favourable job market conditions. The competitive credit environment provided further support to household spending.

Private investment, which has been on a positive trend since the second half of 2003, strengthened further by 10.8% in 2005, with positive growth in all sectors except construction. Business confidence was sustained throughout the year, while positive cash flows enabled companies to utilise internally generated funds to finance their capital expenditure. Nevertheless, the surplus narrowed somewhat in 2005 and companies also accessed the financial system for funds, encouraged by the low financing cost.

Meanwhile, the Government continued to focus on developmental efforts while improving essential services and the public delivery system in order to enable the private sector to sustain the growth momentum. As a result, the Government was able to maintain its policy of a gradual consolidation of its fiscal position. The overall Federal Government deficit declined to 3.8% of GDP in 2005 (2004:-4.3%). The Government, while consolidating, remained supportive of growth with policies targeted at enhancing the business environment for the economy.

Real GDP by Expenditure (1987=100)			
	2004	2005	2006 ^f
	Annual change (%)		
Domestic Demand ^{1/}	7.5	7.3	5.9
Private sector expenditure	13.1	9.5	7.4
<i>Consumption</i>	10.5	9.2	6.8
<i>Investment</i>	25.8	10.8	10.0
Public sector expenditure	-2.1	2.8	3.0
<i>Consumption</i>	6.2	5.4	3.2
<i>Investment</i>	-8.7	0.4	2.7
Net exports of goods and services	-22.4	16.7	-5.4
Exports	16.3	8.6	8.9
Imports	20.7	8.0	10.0
Gross Domestic Product	7.2	5.2	6.0

^f Forecast ^{1/} Including stock

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Notwithstanding the escalating oil prices, **inflation** remained at manageable levels in 2005. The consumer price index (CPI) rose by 3% in 2005, driven mainly by adjustments to administered prices. The cost-push price increase was mainly seen in the transport and communication category as the CPI peaked at 3.7% in August, before trending lower to 3% by end-2005. The staggered adjustments to retail petrol and diesel prices and the partial absorption of the price increases by producers due to competition moderated the increase in domestic prices. In addition, greater efficiency of energy usage and continued improvements in productivity helped contain price pressures. As a result, core inflation, or inflation as a result of demand pressures, remained low at 2%.

The domestic **labour market** continued to be healthy and stable in 2005. The unemployment rate remained steady at 3.5%. In 2005, retrenchments declined, reflecting the pick-up in economic activities in the second half-year and the flexibility accorded to the employers to take alternative measures such as temporary layoffs and instituting pay cuts. Similarly, job vacancies rose strongly throughout 2005. Reflecting increased efficiency in labour matching process, job placements were also stronger.

The **external sector** continued to strengthen. The **current account** recorded a larger surplus of RM75.7 billion, equivalent to 16.1% of gross national product (GNP). Exports of goods expanded at a faster rate (11%) than import growth (8.5%). Commodity exports, in particular crude oil and liquefied natural gas, increased significantly by 16% in 2005, reflecting high energy prices, while growth in manufactured exports recovered in the second half-year, driven by the recovery in the global electronics sector. Meanwhile, a larger outflow in the other services account and higher payments for travel abroad led to a larger deficit in the services account.

Foreign direct investment was sustained at a high level at RM25.7 billion or 5.4% of GNP (2004: RM23.5 billion), with broad-based inflows across the major sectors such as the oil and gas, services and manufacturing sectors. Of significance, there was a marked increase in FDI from the major investing economies, such as the US, Hong Kong China and Germany. The bulk of FDI continued to be in the form of reinvested earnings, reflecting continued expansion and diversification of operations by existing MNCs, particularly in the manufacturing and oil and gas sectors. In the services sector, FDI flows were channelled mainly to the financing, insurance, real estate and business services as well as restaurants, hotels, wholesale and retail sub-sectors.

Balance of Payments			
	2004	2005	2006f
	RM billion		
Goods	104.5	125.6	138.4
Trade account	80.7	99.8	108.3
<i>Exports (% annual change)</i>	20.8	11.0	12.5
<i>Imports (% annual change)</i>	26.4	8.5	13.4
Services	-8.8	-9.0	-10.3
Balance on goods and services	95.7	116.6	128.1
Income	-24.5	-23.9	-23.7
Current transfers	-14.6	-17.0	-15.0
Current account balance	56.5	75.7	89.4
% of GNP	13.3	16.1	17.2
Financial account	16.8	-37.0	-
Errors and omissions	10.5	-25.0	-
of which:			
<i>Exchange revaluation gain (+)/loss(-)</i>	8.0	-15.5	-
Overall balance	83.8	13.6	-
Note: Numbers may not necessarily add up due to rounding.			
f Forecast			

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

As the larger current account surplus more than compensated for the net outflow in the financial account and foreign exchange revaluation losses arising from the strengthening of ringgit against the major currencies, net international reserves increased to RM265.4 billion or USD70.2 billion as at end-2005. The reserves rose further to RM288.5 billion or USD78.4 billion as at 15 June 2006; sufficient to finance 8.1 months of retained imports and is 6.5 times the short-term external debt.

Outlook and Policy in 2006

For 2006, **global economic outlook** is expected to remain positive. World output and trade are projected to expand more rapidly by 4.9% and 8% respectively. Growth is expected to be more balanced, with most major economies, including Japan and the European economies, showing positive expansion. Growth will be supported by an uptrend in investment and the electronics cycle as well as continued favourable liquidity conditions.

Global economic outlook is expected to remain positive

In tandem with the expected improvement in world trade and continued favourable global environment, growth in the Asian region is, therefore, expected to expand at a strong pace of 7-7.2%. Growth will be supported by the recovery in the electronics sector and continued strength in domestic demand.

Given these positive developments, the **Malaysian economy** is expected to expand at a faster pace of 6%, supported by strengthening exports and sustained domestic demand. The global semiconductor upcycle, sustained global growth and higher prices for primary commodities are expected to have positive effects on exports, as well as private consumption and investment. Current indicators suggest that the upturn in the global semiconductor industry, which began in the second half of 2005, would gain momentum in 2006.

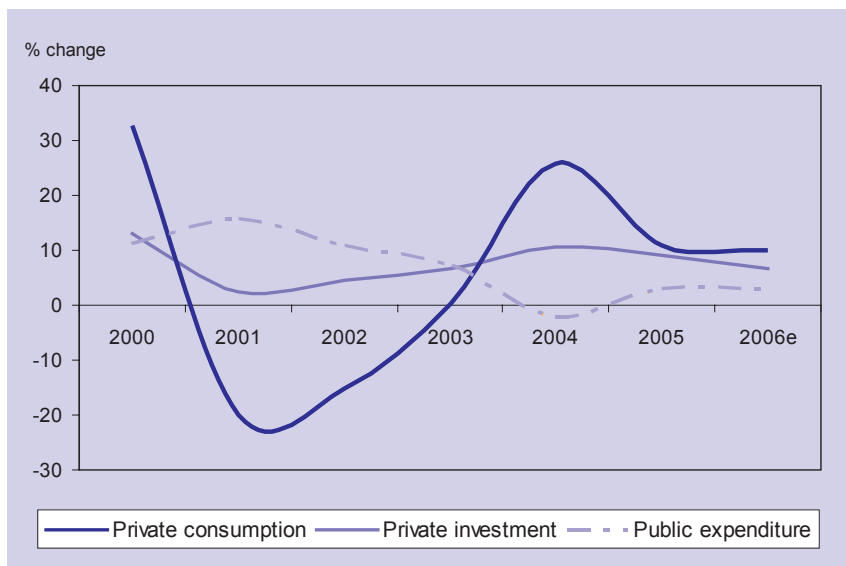
Malaysia is expected to benefit from this favourable development with a stronger growth in manufactured exports, particularly in the computer and semiconductor segments. As a result, the **manufacturing sector** is expected to expand at a stronger rate of 7% in 2006. A recovery in crude oil production and higher output of natural gas is expected to raise value-added growth in the **mining sector** to 5%.

Growth in the **construction sector** is also set to recover, expanding by 1% after two successive years of negative performance. The growth would mainly be driven by a recovery in the civil engineering segment as a result of construction work being undertaken in the oil and gas industry and further supported by new public projects launched as part of the Ninth Malaysia Plan.

Growth in the services and agriculture sectors would be sustained in 2006, thereby contributing positively to growth. The **services sector** is expected to expand by 6%, led by the intermediate services segment, in line with the higher growth in manufacturing and trade activity. In the **agriculture sector**, higher growth in output of rubber and other agricultural produce would be balanced by lower output in palm oil following three successive years of high yield, and the slower increase in mature areas.

Domestic demand would be driven by the private sector for the fourth consecutive year as **private consumption** (6.8%) remains an important source of growth. Equally significant, the continued expansion in **private investment** (10%) would ensure the long-term sustainability of growth by expanding the stock of productive capital. In this regard, efforts will be intensified to enhance the contribution of private investment to growth. Government expenditure would be focused on improving the public sector delivery system while prioritising rural development. As a result, **public consumption** is forecast to increase moderately by 3.2%. On the other hand, **public investment** is expected to rise more strongly by 2.7% as selected non-financial public enterprises increase their capital expenditure in 2006.

Growth in Domestic Demand Components



Source: Bank Negara Malaysia

The strengthening exports would ensure that the surplus in the **current account** of the balance of payments would remain sizeable at RM89.4 billion or 17.2% of GNP. The larger surplus would be driven by the further improvement of the trade account, which is expected to record a surplus of RM108.3 billion. **Manufactured exports** are expected to strengthen to 12%, driven by the upturn in the global demand for electronics, particularly for mobile computers with wireless functions and semiconductors due to the wider application of chips in a variety of devices. Exports of resource-based products are also expected to perform favourably, expanding at a strong pace due to both global demand as well as higher prices. **Commodity exports** would also provide significant support to export growth, due to increase in export volumes and higher prices particularly for crude oil, natural gas and rubber.

In the **services account**, the deficit is projected to increase due mainly to the larger deficit in the transportation account as a result of the higher trade volumes projected. Tourism, on the other hand, would continue to be the main contributor to services earnings. In addition, the other services deficit is expected to improve due to higher exports of communications, business and computer information services. This trend is consonant with the increasing importance of outsourcing activities, the provision of group support and back-office processing services.

The deficit in the **income account** is expected to be sustained at 4.6% of GNP, attributable to higher profits and dividends accruing to multinationals from their investments in Malaysia, in line with the strong export performance. Malaysian companies investing abroad, mainly in the oil and gas, plantation, infrastructure and utilities sectors, are also expected to record higher profits and dividends, thereby contributing to income inflows.

Cost-push inflation is expected to rise following the increase in the price of petroleum products on 28 February 2006, with the CPI peaking in the first half of the year. Following the lapse of price adjustments implemented in 2005 in the second half-year, the inflation rate is expected to trend downwards. As a result, the average rate of inflation is expected to be in the range of 3.5-4%.

Monetary policy will continue to focus on ensuring sustaining growth with price stability. Given the prospects for an improved growth outlook, the overnight policy rate (OPR) has been raised twice in 2006, by 50 basis points to 3.50% as it was judged that risks to growth had diminished. The upward movement represents a step towards the normalisation of interest rates. Nevertheless, the current OPR remains below neutral levels, that is, the rate at which monetary policy is neither expansionary nor contractionary on growth. As such, monetary policy remains supportive of further expansion of the economy.

The Government expects to reduce the fiscal deficit further in 2006 to 3.6% of GDP from 3.8% in 2005. Nevertheless, Government expenditure would continue to be targeted at supporting economic growth by improving the delivery system and enhancing the infrastructure for sustained private sector demand. **Fiscal policy** would therefore continue to be focused on ensuring long-term growth with sustainability.

Overview of the Ninth Malaysia Plan

In order to pursue balanced growth in an environment of social and political stability, the Government launched the **Ninth Malaysia Plan, 2006-2010** on 31 March 2006. The Plan represents the first five-year blueprint of the National Mission¹, outlining policies and key programmes aimed at fulfilling the Mission's main thrusts and objectives. The overall macroeconomic management during the Plan period will focus on sustaining growth by strengthening the resilience of the economy.

The key macroeconomic strategies to be implemented during the Plan period are as follows:

- Achieving a credible growth rate while maintaining strong economic fundamentals;
- Strengthening competitiveness to sustain demand for Malaysian products and services;
- Enhancing higher contribution to growth from private sector and government-linked companies and attracting quality foreign direct investment (FDI) to accelerate progress towards higher technology activities and expand market linkages;
- Promoting the development of new sources of growth in the agriculture, manufacturing and services sectors as well as broadening the knowledge-based economy;
- Raising the efficiency of capital, productivity of labour and the contribution of total factor productivity (TFP); and
- Sustaining pragmatic fiscal management and implementing appropriate monetary policy to support domestic economic activities.

During the Plan period, the Malaysian economy is projected to grow at an average rate of 6% per annum with price stability, in line with its potential output. The growth prospects are based on favourable developments in the domestic and external environment. On the international front, global output and world trade are projected to grow at an average rate of 4.3% and 7.1% per annum.

¹ National Mission is a framework aimed at obtaining greater impact and performance from the country's development efforts towards achieving Vision 2020.

On the domestic front, growth is expected to be supported by further expansion in private investment and consumption. **Private consumption** is expected to increase at an average rate of 6.9% due to continued increase in income, supported by favourable employment growth and commodity prices.

Private investment is projected to increase at an average rate of 11.2% during the Plan period. To achieve the private investment target, efforts will be targeted on enhancing the investment climate while streamlining the public sector delivery system to reduce cost of doing business. Private financing initiatives, namely schemes where the private sector would undertake development projects on behalf of the Government, are also expected to spur private investment growth. Meanwhile, greater efforts will be undertaken to attract FDI, particularly in high value-added and technology-intensive industries.

The Government will adopt a pragmatic

approach in fiscal management while remaining supportive of private sector initiatives. As a result, the fiscal deficit is projected to decline gradually from 3.8% in 2005 to 3.4% of GDP in 2010. More importantly, growth will be stimulated by greater efficiency, improved skills and higher productivity, as the economy becomes more knowledge and technology-based. On the public expenditure front, **public investment** is expected to grow by 5% per annum with the Government's development expenditure focusing on projects that will generate maximum multiplier effects and extensive geographical spillovers. Reflecting prudent fiscal management, **public consumption** is projected to increase at an average rate of 5.3% per annum during the Plan period.

Real GDP by Expenditure (1987=100)		
	8MP	9MP
	Average annual growth rate (%)	
Consumption	7.4	6.5
<i>Private sector</i>	6.6	6.9
<i>Public sector</i>	10.2	5.3
Gross Fixed Capital Formation	1.6	7.9
<i>Private sector</i>	-1.0	11.2
<i>Public sector</i>	3.9	5.0
Exports of goods and services	5.2	7.1
Imports of goods and services	5.6	7.9
Real GDP	4.5	6.0

Source: Department of Statistics, Malaysia and Economic Planning Unit

On the production side, growth will be underpinned by expansion in the manufacturing, services and agriculture sectors via enhancing productivity and competitiveness as well as moving into higher value-added and knowledge-based activities.

The **manufacturing sector**, which will be guided by the Third Industrial Master Plan, 2006-2020, is expected to expand at an average rate of 6.7% per annum during the Ninth Malaysia Plan period. While existing industries will be strengthened, new sources of growth focusing on niche products for selected markets will be harnessed. Improvement in research and development capacity, technical and managerial skills as well as development of new high value products with export potential would be encouraged. A competitive, innovative and technologically strong SME sector will be developed. In the resource-based industries, food processing, biotechnology, chemicals and other chemical products industries will be strengthened further. In the non-resource based industries, E&E sector is expected to strengthen, while automotive-related industries will be stimulated by the liberalization of the automotive industry.

Growth in the **services sector** is expected to be sustained at an average rate of 6.5% per annum, with impetus emanating from finance, insurance, real estate and business services as well as the wholesale and retail trade, hotels and restaurants sub-sectors.

The **agriculture sector** is expected to grow by 5% per annum with palm oil, rubber and activities related to food being the main sources of growth. In the food sub-sector, emphasis will be given to production of livestock, fish, particularly deep-sea fishing and aquaculture as well as high value fruits and vegetables. The Government will also lay emphasis on New Agriculture, involving large-scale commercial farming and participation in high quality and value-adding activities. Meanwhile, the **mining sector** is expected to expand at an average rate of 3.4% per annum reflecting production of crude oil and condensates as well as natural gas.

The **construction sector** is expected to grow by an average rate of 3.5% per annum during the Plan period, with impetus for growth from the implementation of infrastructure projects as well as residential and commercial development. Among the new infrastructure projects that will be implemented are construction works on roads, airports, water supply and rail-based transportation.

Real GDP by Sector (1987=100)				
	8MP	9MP	8MP	9MP
	Average annual growth rate (%)		Contribution to growth (%)	
Agriculture	3.0	5.0	0.3	0.4
Mining	2.6	3.4	0.2	0.2
Manufacturing	4.1	6.7	1.3	2.1
Construction	0.5	3.5	0.0	0.1
Services	6.1	6.5	3.4	3.8
Real Gross Domestic Product	4.5	6.0	4.5	6.0

Source: Department of Statistics, Malaysia and Economic Planning Unit

The current account of the **balance of payments** is expected to remain strong, registering a surplus equivalent to 14.9% of GNP in 2010. The goods account is projected to record a surplus equivalent to 21.9% of GNP at end-Plan period partly due to better commodity prices and terms of trade. The services deficit is expected to improve further during the Plan period, due to concerted efforts in promoting tourism and export of services including education, health-care and computer and information services. Nevertheless, the income account is expected to remain in deficit at RM39.5 billion in 2010, mainly due to higher profits and dividends accruing to foreign investors.

In view of the increasingly competitive and dynamic global environment, the main challenge during the Plan period is to ensure long-term growth sustainability by generating a higher contribution from the private sector, particularly through domestic investment. As such, enhancing the development of SMEs will be a key priority during the Plan period. The strategy will be to focus on creating high performance and resilient SMEs, equipped with strong technical and innovation capability as well as managerial and business skills in order to be competitive in the global market.

