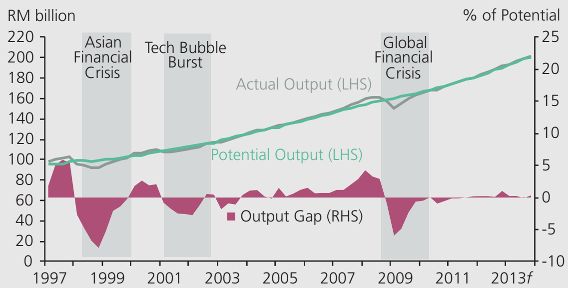
Potential Output of the Malaysian Economy

Potential output is an estimate of the highest level of output that an economy is capable of producing in a non-inflationary environment. It indicates the economy's sustainable growth path that is consistent with its available inputs for production – capital, labour and technology. When actual output is above potential output, the utilisation of productive inputs is high and inflationary pressures tend to build. Conversely, inflationary pressures usually abate when actual output falls below potential output.

Chart 1

Actual and Potential GDP



f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

The latest estimates[1] indicate that Malaysia's potential output growth increased from a range of 4.5-5.0% in 2011 to 5.0-5.5% currently. Strong growth in both private and public investment in 2012 contributed to the robust pace of capital accumulation and, in turn, to the further expansion of potential output as the productive capacity of the economy was raised. Labour conditions also improved slightly as the labour force grew at a faster rate of 3.5% in 2012 (2011: 3%). The output gap, which captures deviations of actual output from potential output, remained close to zero. This indicates that the economy did not experience substantial price pressures, consistent with the stable inflation of 1.6% registered during the year.

In 2013, potential output is projected to continue growing within the 5.0-5.5% range, with the output gap remaining small. Potential output growth is expected to be driven by a growing labour force as well as an expansion in capital stock, due to sustained growth of private investment.

[1] Interested readers may refer to the technical note entitled 'Potential Output and the Output Gap in Malaysia' in the 2Q 2012 BNM Quarterly Bulletin (Pg. 59-65) for a detailed explanation of the methodology used to estimate potential output.