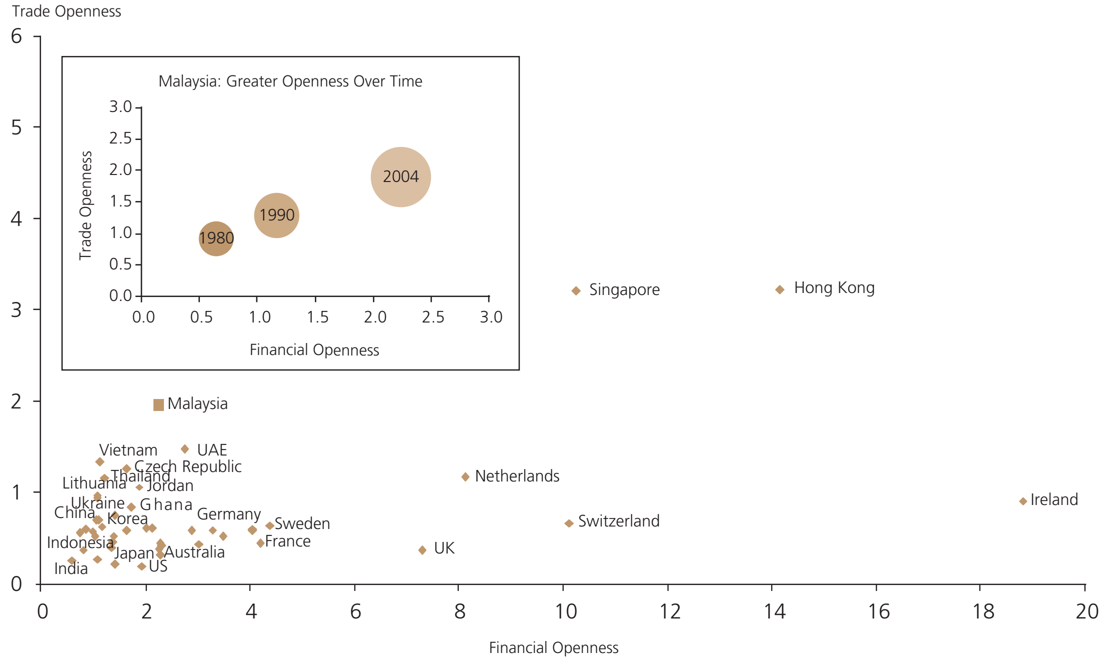
Openness of the Malaysian Economy

Chart 2.1
Trade and Financial Openness in 2004



Notes:
1 Trade Openness is the sum of exports and imports relative to GDP
2 Financial Openness is the sum of external assets and liabilities relative to GDP
3 Based on Bank Negara Malaysia calculations; Data from Lane and Milessi-Ferreti (2006); IMF Direction of Trade Statistics (2006, August)
4 Excludes *outlier* Luxembourg

A distinguishing feature of the Malaysian economy is its high degree of openness to trade and cross-border financial flows. As a measure of economic openness, the volume of trade was about twice the size of the economy in 2004. The corresponding measure for financial openness, the stock of external assets and liabilities, was also more than two times the size of the economy.[1]

To obtain a better perspective of the magnitude, Chart 2.1 maps out the openness of the Malaysian economy relative to 58 economies representing the 30 developed economies that make up the Organisation for Economic Co-operation and Development (OECD), as well as 28 emerging economies from Asia, Eastern Europe and Latin America.[2] Malaysia ranks high in terms of trade openness, with only Hong Kong and Singapore having a higher degree of openness.

Malaysia also ranks reasonably high in terms of financial openness, exceeding the median score of 2.03. Of significance is that Malaysia appears to be more open financially relative to more developed economies such as the United States and Japan. Malaysia is also the most financially open country

1 External assets and liabilities refer to claims between a country's residents and non-residents. International holdings are classified into Portfolio Investment (which is subdivided into equity and debt securities), Foreign Direct Investment (which refers to equity participation above 10 percent), Other Investment (which includes debt instruments such as loans, deposits and trade credit), Financial Derivatives and Reserve Assets.
2 The emerging economies included in the sample are Argentina, Brazil, Brunei, Cambodia, Chile, China, Colombia, Croatia, Cyprus, Estonia, Hong Kong, India, Indonesia, Lao PDR, Latvia, Lithuania, Malta, Myanmar, Peru, Philippines, Russia, Singapore, Slovenia, Thailand, Ukraine, Uruguay, Venezuela and Vietnam.

in East Asia after Hong Kong, Singapore and Brunei. Hong Kong and Singapore are highly open by nature of their role as financial centres.

The inset-diagram in Chart 2.1 meanwhile indicates that the degree of openness of the Malaysian economy has increased significantly over time. It is highly likely that this evolution is an outcome of the structural changes occurring in the economy arising from Malaysia's trade orientation, open current account and the liberalisation of the capital account. Thus, the domestic economy and financial system may have, over time, become more sensitive to external developments as Malaysia became more integrated with the global economy.

Chart 2.2
Gross Domestic Product Annual Change (2000 - 2006) (Selected Industrialised Economies)

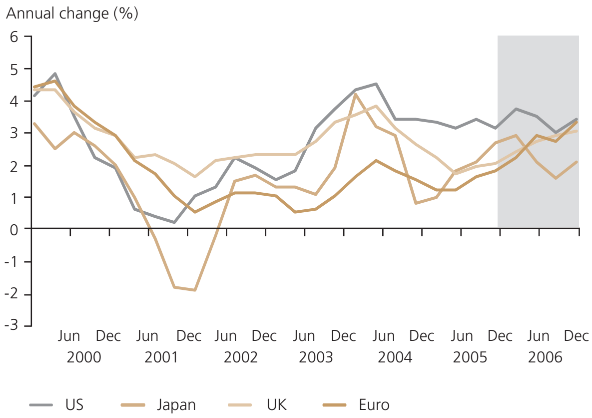


Chart 2.3
Consumer Price Index Annual Change (2000-2006) (Selected Industrialised Economies)

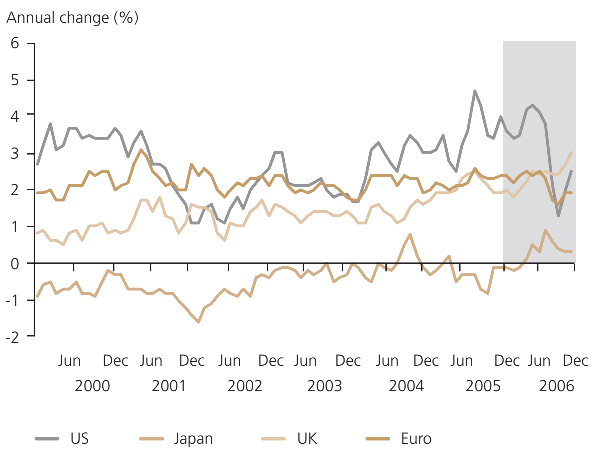
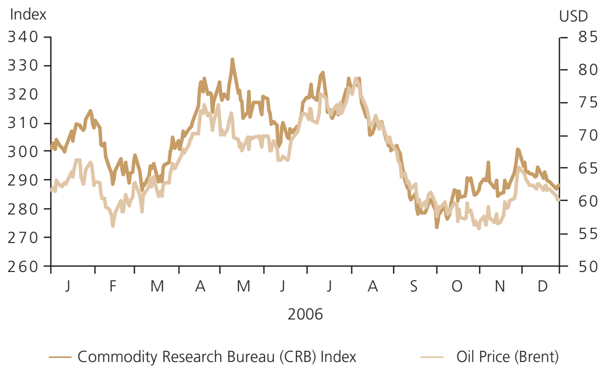


Chart 2.4
Commodities Index and Oil Price (2006)



would adopt a stance that is biased towards tighter monetary policy. Indeed, the major central banks maintained their tightening stance during the year. Since June 2004, the Federal Reserve Board raised rates on seventeen occasions to 5.25% by June 2006 and has now continued to maintain this rate while the Bank of Japan ended its zero interest rate policy in July. The European Central Bank and the Bank of England also raised interest rates to curb incipient inflationary pressures. Similarly, several Asian central banks tightened monetary policy during 2006.

However, despite the tighter monetary conditions and higher global interest rates, easy global liquidity remained the central theme in explaining financial market conditions in 2006. The environment of high global liquidity resulted in the continued search for higher returns across different asset classes and risk profiles. Investors' heightened appetite for risk coupled with the strengthening macroeconomic fundamentals and