

MALAYSIA

2002: STRONG RECOVERY

The Malaysian economy made a strong recovery in 2002 following the slump in 2001. Real gross domestic product (GDP) grew by 4.2 per cent in 2002 compared with 0.4 per cent in 2001.

In fourth-quarter 2002, real GDP growth expanded by 5.4 per cent year-on-year. Growth in the previous three quarters was revised upwards to 5.8 per cent in the third quarter (from the original estimate of 5.6 per cent), 4.1 per cent in the second quarter (from 3.9 per cent) and 1.3 per cent in the first quarter (from 1.1 per cent).

During the year, the main impetus to growth came from domestic demand, reinforced by favourable export performance. Growth in domestic demand was driven by the expansion of public sector expenditure, strong consumer spending and the continued recovery of investment.

Expansionary fiscal stimulus a year before led public sector consumption to expand by 13.8 per cent in 2002 while private consumption grew by 4.2 per cent in 2002. This was supported by low interest rates, higher incomes, greater access to credit and higher commodity prices. Gross fixed capital formation (comprising public and private investment) grew by 0.2 per cent in 2002 compared to a drop of 2.8 per cent in 2001.

All sectors of the economy recorded positive growth in 2002, ranging from 0.3 per cent for agriculture to 4.5 per cent for both mining and services. Notably, the value-added sectors of manufacturing, making up about 30 per

cent of GDP, increased by 4.1 per cent in 2002 compared with a 6.2 per cent decline in 2001. The recovery of this sector was supported by strong expansion in the export-oriented industries (2002: 5.1 per cent) compared with domestic-oriented industries (2002: 3.5 per cent).

The trade surplus in 2002 narrowed to RM50.9 billion compared to the RM54.1 billion for 2001. Overall, exports expanded by 6.1 per cent and imports by 8.1 per cent, in line with the stronger growth in domestic demand.

Inflation was slightly higher in 2002 with the Consumer Price Index (CPI) increasing by 1.8 per cent in 2002. The unemployment rate was kept below 4 per cent.

ECONOMIC PROSPECTS FOR 2003

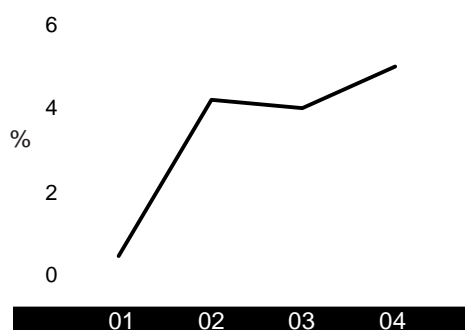
Despite increasing uncertainties in the global and regional environment, underlying growth prospects for Malaysia remain reasonable with sustained domestic demand and the expansion in intra-regional trade providing a floor to growth. Gross fixed capital formation, which rose 9.8 per cent in the fourth quarter of 2002, is also an encouraging indicator of near-term growth prospects.

We are anticipating growth to moderate to 4.0 per cent in 2003 (from 4.2 per cent in 2002) as a result of the downward pressures. The SARS virus will most immediately hit tourism and related services—tourism receipts amounted to 7.2 per cent of GDP in 2001—and this is likely to be the most affected sector.

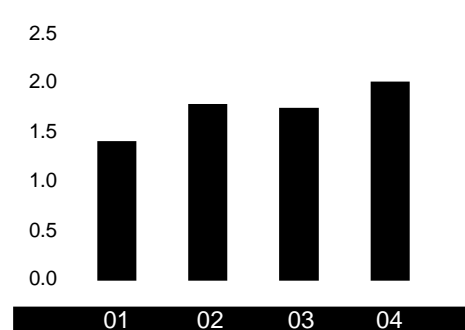
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Development Bank of Singapore

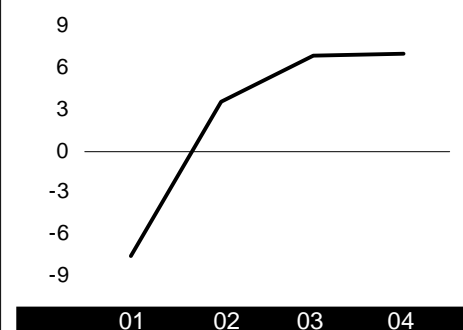
GDP growth



CPI inflation



Export growth



Merchandise exports are expected to grow by about 5.9 per cent—higher than in 2002, a key beneficiary of the weak US dollar as a result of the ringgit peg, which could provide an upside surprise as global recovery takes stronger hold—and imports by 7.7 per cent, with the trade balance anticipated of RM67.8 billion—higher than in 2002. The services account will continue to be in deficit and could reach RM35.0 billion. Outflows in investment income and for the payment of freight and services still account for the bulk of the services deficit in the balance of payments. The current account is expected to remain in surplus, but will be smaller than in 2002, reaching about RM22.0 billion (US\$5.8 billion).

On the supply side, 4.1 per cent growth of the manufacturing sector in 2002 should be sustained in 2003, with the pick-up in exports and the domestic market. The manufacturing index for the month of April 2003 indicated a slower expansion in this sector, but growth in manufacturing is projected to be about 8 per cent in the second half of 2003.

Growth momentum in the construction sector is likely to remain moderately healthy, supported by ongoing implementation of government-backed infrastructure related projects, as anticipated in the 8th Malaysian Plan.

Aggregate demand is anticipated to be stronger in 2003. Private consumption, which registered stronger growth in the second half of 2002, will continue to be supported by higher disposable income, low interest rates and better employment prospects. It is projected to register growth of 5.0 per cent, and this should be matched by public consumption growth of 5.3 per cent.

Investment is anticipated to grow moderately in 2003, with private investment expected to increase by 5.7 per cent and public investment by 2.1 per cent.

At the same time, capital investment approvals amounted to RM16.5 billion with the bulk going to electronic and electrical products. Most of the applications (about 80–85 per cent) are expected to reach commercial production stage in 2003 and the remaining applications are expected to do so in 2004.

MACROECONOMIC POLICIES: CONTINUING RELIANCE ON FISCAL STIMULUS

The overall macroeconomic policy stance of the country in 2003 will be expansionary. With subdued inflation, monetary policy will remain accommodative to support recovery. The Bank Negara reduced its intervention rate by another 50 basis points to 4.5 per cent in May 2003—the first cut since September 2001. The consumer price index (CPI) increased by 1.8 per cent in 2002. Liquidity will be sufficient in 2003 and interest rates are not likely to be raised. Fiscal policy will also remain moderately expansionary in 2003. Recognising the larger-than-expected damage coming from the external front—US slowdown, the Iraq war and the latest terrorist attacks in the Middle East, and fears of a SARS outbreak—the government unveiled a total RM7.3 billion economic stimulus package with greater emphasis on consumption-led growth as a short-term measure.

There are no indications that the peg to the US dollar will either be lifted or revised in 2003. The official stand is that

the currency is not misaligned at RM3.80 to the dollar and that the peg will only be re-examined seriously if the competitiveness of Malaysia's exports is undermined.

Compared to the second half of 2001, the external reserves of the Central Bank rose during 2002. Net international reserves increased by RM14.3 billion (US\$3.7 billion) and by end-December 2002 reached RM131.5 billion (US\$34.5 billion), sufficient to cover 4.3 times the short-term debt and to finance 5.3 months of retained imports.

2004: MODERATE PICK UP

Growth prospects for 2004 remain uncertain. Assuming that the brunt of economic adjustments for the Iraq war and the SARS infection will occur in 2003, a pick-up of 5 per cent in 2004 is possible, with a percentage point addition to real GDP growth as an upside surprise arising from the undervalued ringgit, continued recovery in capex and better-than-expected expansion in global semi-conductor sales. Inflationary pressures are unlikely to pick up sharply in 2004, and the inflation rate will probably remain around 2 per cent. On the external side, the trade balance in 2004 and the current account will be in surplus but smaller when compared with 2003. Having said that, the key risks to our short-term expectations are slippage in global reflationary efforts by G-3 economies, unexpected collapse of the current upwards trend in the commodity-led cycle, upward revision of the ringgit peg and, a rising security threat in Malaysia and neighbouring countries.

In the longer perspective, structural factors are also expected to influence the pace of growth. The implementation of the various recommendations contained in the Capital Market Plan, the Financial Services Master Plan and the Knowledge-based Economy Masterplan should provide the foundation for better growth environment.

Manufacturing capacity utilisation

Manufacturing capacity utilisation averaged a relatively high 82 per cent in 2002, putting some pressure on production facilities.

