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## The Malaysian Economy in 1998 and Prospects for 1999

### The Malaysian Economy in 1998

#### An Overview

The performance of the Malaysian economy in 1998, as is the case with other East Asian economies, has been adversely affected by the deflationary impact of the financial crisis that beset the region since mid-1997. Domestic demand has declined as result of a variety of factors. These included the erosion of private sector wealth caused by falling stock and asset prices, higher interest rates prior to September 1998, initial difficulty faced by the private sector in accessing to bank credit, tight liquidity as well as uncertainties with regard to the near term economic and employment prospects. At the same time, with the economies of Malaysia's major trading partners, particularly in East Asia, either experiencing significant slowdown in real growth or contraction, external demand for Malaysia's exports was also affected in terms of real growth.

With the contraction in aggregate demand, output of the construction and manufacturing sectors declined while that of the services sector slowed down significantly. In the case of the agriculture and mining sectors, despite generally benefiting from higher ringgit export prices following the depreciation of the ringgit, the output of these sectors of the economy also contracted. However, this was largely due to supply constraints. As a result, in 1998, Malaysia's real Gross Domestic Product (GDP) contracted for the first time since 1985. The contraction was severe and unprecedented, that is by 2.8% in the first quarter and 6.8% in the second quarter. Nevertheless, as a result of counter-cyclical measures taken by the Government in the second half of the year, which included the implementation of the National Economic Recovery Plan submitted by the National

Economic Action Council, the easing of monetary policy and the injection of fiscal stimulus to invigorate the economy, as well as the imposition of selective exchange controls to insulate the economy from the contagion effects of global financial crisis, the contraction in real GDP is expected to be less severe in the fourth quarter of 1998. Consequently, overall **real GDP growth** for 1998 is estimated to contract by 4.8%, a reversal of 12.5 percentage points when compared with the 7.7% growth attained in 1997. In current prices, the GDP growth is at a significantly slower rate of an estimated 1.6% to RM279.8 billion when compared with the growth rate of 10.4% achieved in 1997.

After taking into account higher outflow of investment income payments, particularly interest payments, **nominal Gross National Product (GNP)**, which reflects national income, increases marginally by 0.4% to an estimated RM262.1 billion in 1998. This is significantly lower than the increase of 9.8% in 1997. With the population increasing by 2.4%, **per capita GNP** is, therefore, estimated to decline by 1.9% to RM11,817 (US\$3,013) in 1998, against RM12,051 (US\$4,284) in 1997. In terms of **purchasing power parity**, per capita income declines by 31.9% to US\$8,196 in 1998, against US\$12,043 in 1997. The sharp decline reflects the impact of weaker ringgit exchange rate as well as higher domestic inflation rate.

Reduced economic activities as well as lower real disposable income, however, have led to a significant reduction in the demand for imports. With import volume declining sharply against a marginal increase in export volume, the current account of the balance of payments recorded an unprecedented surplus of RM15 billion in the first half of 1998, the first surplus since 1989. For the

whole of 1998, a surplus of at least RM20 billion (7.7% of GNP) is achievable. This is a significant improvement when compared with the deficit of RM14.1 billion (5.4% of GNP) recorded in 1997. The overall financial position of the Federal Government records a deficit in 1998, the first deficit since 1993. In part, this is due to lower revenue collection especially indirect taxes, as a result of reduced economic activities. At the same time, the Federal Government expenditure is higher in 1998 in view of the need to invigorate the economy and prevent it from going into a prolonged recession.

### Sectoral Output Performance

The output of all major sectors of the economy have been adversely affected to varying degrees by declining demand, excess supply or supply constraints. As a result, the output of the primary and secondary sectors of the economy declined while the value-added of the tertiary sector increased at a much slower rate.

The **manufacturing sector**, which provided the main impetus to overall GDP growth for the past decade, experiences a reduction in its output by an estimated 5.8% in 1998 (1997: +12.5%). This is in view of shrinking domestic demand and poor overseas sales orders, especially due to the financial crisis affecting East Asia, as well as increasing competition in the global market for manufactured goods that is affected by slower growth in world demand. Output of the **domestic market-oriented industries** declines sharply, that is by an estimated 8.8%, in 1998 (1997: +15.4%), while the output of export market-oriented industries contracts moderately by an estimated 2.9% (1997: +9.7%). The sharp decline in the output of domestic-oriented industries is attributed largely to lower output of construction-related industries such as those producing non-metallic mineral, glass, basic metal products, as well as transport equipment industries such as those producing passenger cars and motorcycles, and petroleum products related industries. Nevertheless, the plastics industry continues to record double digit rate of output growth due to favourable demand as well as production capacity expansion.

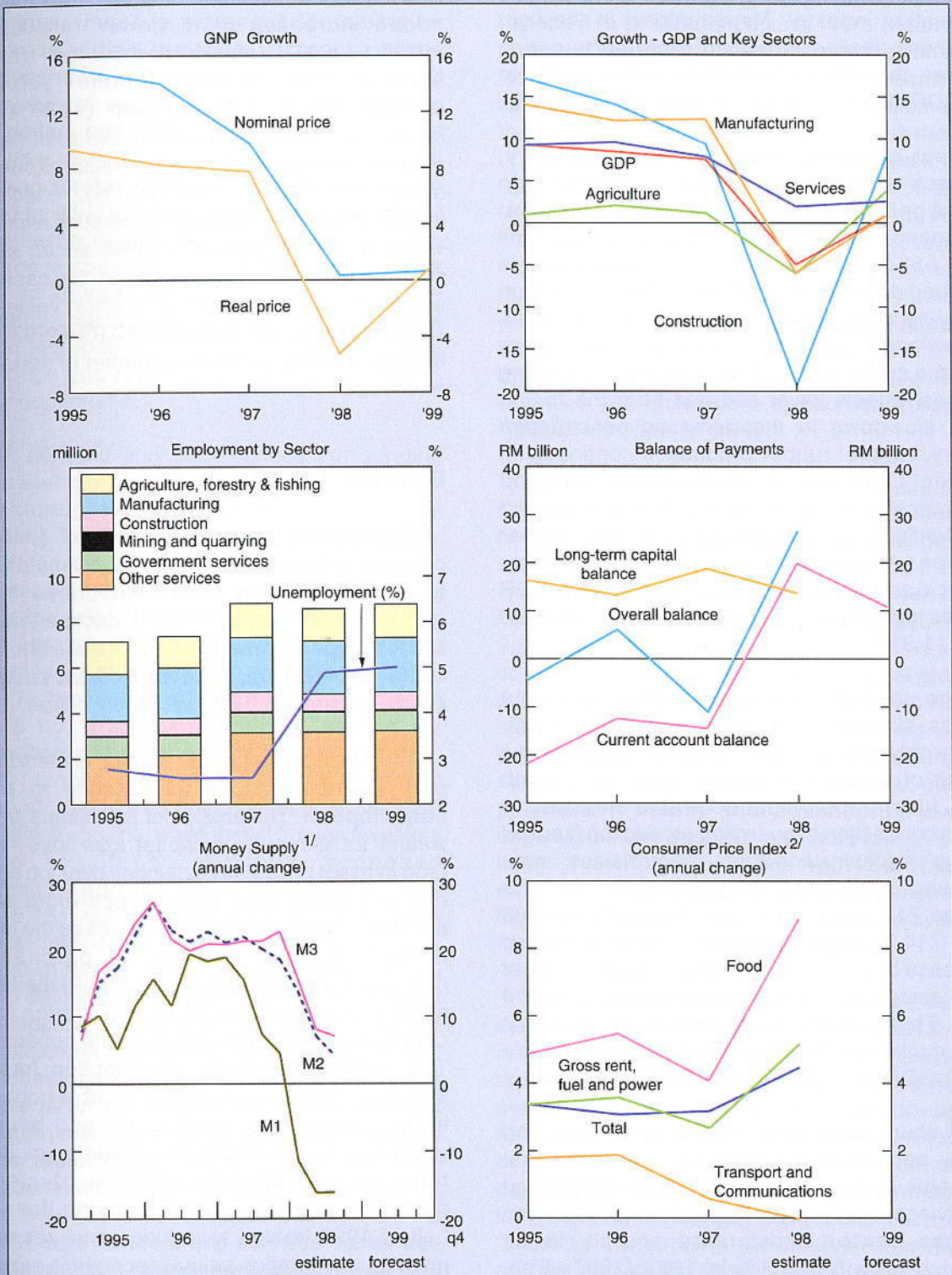
Output of **export market-oriented industries** declined moderately in 1998. Global oversupply in the face of weak demand especially from East

Asia has led to a contraction in the output of industries producing semiconductors, wire and cables, textiles, footwear and wood products. Nevertheless, some export-oriented industries such as those producing televisions as well as rubber products recorded moderate increases in output during the year. The higher output of rubber products reflects a pick up in demand for surgical gloves from the US and European countries. With the rate of output contraction in the manufacturing sector exceeding the average rate of decline in the real economy, the share of the manufacturing sector to overall real GDP declines in 1998 to 35.4% (1997: 35.7%).

Value-added in the **construction sector** declines sharply in 1998 by an estimated 19.2% (1998:+9.5%), reflecting a significant drop in construction starts of high-rise commercial buildings and higher-end condominiums in the face of weaker demand. In the case of landed properties, construction starts of higher priced residential units have been affected by weaker demand while construction of factory lots has been affected by the slowdown in investment in the manufacturing sector. Construction activities during the year were also subdued by the completion of major infrastructure projects. Nevertheless, construction starts of low and medium cost units as well as apartments, are sustained, as demand for these residential units remains strong as they are more affordable and mortgage rate remains at 9% for residential units costing RM100,000 and below. Furthermore, construction starts of these units are supported by the RM2 billion funding facility under the Special Scheme For Low and Medium Cost Houses established by the Government.

To a large extent, the weaker construction starts during the year can be attributed to the erosion of financial wealth of the population due to lower stock prices, difficulty in getting end-financing and bridging finance from the banking system and higher interest rates which have affected both demand and new supply of real estate properties. Reflecting the impact of a weaker demand for real estate properties, the Malaysian House Price Index declined by 9.3% during the first half of 1998 when compared with the second half of 1997. Recent measures aimed at reducing interest rates, exempting lending from the 20% limit on lending to the broad property sector for the construction or purchase of residential properties

Chart 1.1  
Key Economic Indicators



1/ End of March, June, September and December including Repos.  
(except for 1998, which represents end of March, June and August)

2/ Malaysia (CPI up to September 1998)

costing RM250,000 and below as well as for infrastructure, and the abolition of 60% maximum financing margin for the purchase of higher priced properties should provide some fillip to the construction industry. Nevertheless, in the light of a sharp decline in construction starts during the year, the share of the construction sector to real GDP drops to 4.1% in 1998 (1997: 4.8%).

Output growth in the **agriculture, forestry, livestock and fishery sector** is estimated to contract by 5.9% in 1998 (1997: 1.3%). The weaker performance is attributed to the lower palm oil output (-8%), as oil palm yield is affected by the prolonged dry weather and tree stress. Production of other agricultural commodities has also declined, with sawlogs dropping by an estimated 15%, rubber 7.3% and cocoa 15.5%. The slowdown in logging activities reflects lower demand from the region and a slowdown in the domestic construction industry. Natural rubber production continues its declining trend due to unattractive prices and labour constraints while cocoa output has dropped significantly during the year due to adverse weather condition. As a result, the share of agriculture, livestock and fishery sector to overall real GDP declines marginally to an estimated 11.8% in 1998 (1997:11.9%).

In the case of the **mining sector**, its output declines slightly by an estimated 0.8% (1997: 1%), largely due to lower output of gas (-1%) as a result of slower off-take by Japan and South Korea. In part, the output decline is attributed to a sharp contraction in quarrying production, caused by sluggish construction starts. Nevertheless, crude petroleum output increases slightly by 0.6% to average 718,300 barrels per day (bpd) in 1998 (1997: 714,300 bpd). Tin production is estimated to increase by 6.7% in 1998, encouraged by higher export prices following the depreciation of the ringgit. The relatively lesser decline in the output of the mining sector helps to increase its share to real GDP to 7.0% (1997: 6.7%).

The sharp contraction in the secondary and primary sectors of the economy and lower real disposable income have led to declining demand for services. As a result, the value added of the **services sector** decelerated sharply to an estimated growth of 2.1% in 1998 (1997:+8%). Most adversely affected by lower domestic demand is the wholesale and retail trade services sub-sector. Its value-added declines by 1.4%. The

finance, insurance, real-estate and business sub-sector is affected by slower credit growth, slackening business activities and a slowdown in real estate transactions. Consequently, its value-added increases at a slower rate of 4.1% (1997:+9.5%). Value-added of the transport, storage and communications sub-sector decelerates to 2.9% growth (1997:+8.4%), depressed by lower domestic and external trade volume. Government services also expand at a slower rate of 2.4% (1997:+6.1%), reflecting the impact of selective restraint in operating expenditure while expanding essential public sector services such as education and health. In the case of the electricity, gas and water sub-sector, value-added remains strong, with a growth of 7.0% (1997:+13%), underpinned by increasing number of households and establishments.

## Domestic Demand

**Aggregate domestic demand** (excluding changes in stocks) declines by an estimated 11.7% to RM240.5 billion at current prices in 1998 (1997:+9.6%), due to a 15.5% decline in **private sector expenditure** to RM177.5 billion. **Public sector expenditure**, however, increases marginally by an estimated 0.8% to RM63 billion.

The decline in private sector expenditure is partly attributed to a 5% decline in **private consumption**. The erosion of individuals' financial wealth as a result of capital loss following the drop in asset prices, uncertainties over job security, higher interest rates that induced more savings and discourage consumption as well as the difficulty in getting end-financing for purchases of consumption goods especially during the first half of the year are some of the major factors contributing to the decline in private consumption. The cutback in private consumption has been largely on the more expensive durable goods such as passenger cars, motorcycles and household refrigerators. However, the lowering of interest rates as well as the relaxation of credit for purchases of passenger cars during the second half of 1998 helped to induce some recovery in private consumption as evidenced by a significant pick up in sales of passenger cars from 5,641 units in February 1998 to 13,658 units in August 1998.

Discouraged by poor demand, higher cost of financing and tight liquidity as well as uncertainties created by the volatile financial markets especially during the first eight months of 1998, **private sector investment** is estimated to decline by 30.5% in 1998 (1997:+11.7%). Indicative of the lower investment is the 6.7% decline in the ringgit import value of capital goods (-36.5% in terms of US dollar) during the first seven months of 1998. Other investment indicators, such as output of iron and steel as well as mixed concrete which declined by 41.2% and 31.2% respectively during the first seven months of 1998, also reflected a sharp drop in investment during the year. A sizable decline in private capital formation is in the construction sector, particularly infrastructure projects, high-rise commercial buildings such as office space and retail outlets as well as higher-end condominiums.

Weak demand and uncertainties surrounding the financial markets have also discouraged the manufacturing sector to undertake additional investment for production capacity expansion, especially in the case of industries that cater for the domestic markets such as those producing construction-related materials as well as durable goods. Indicative of the subdued investment sentiment in the manufacturing sector is the 46.8% decline in the value of **proposed investment applied** by the manufacturing sector for consideration of MIDA during the first seven months of 1998 (January-July 1997: -38.8%). Proposed investment applied by local investors declined significantly by 58.2%, while that of foreign investors dropped by 30.7%. Similarly, **proposed investments approved** by MIDA declined by 7.8% to RM15,151 million. Approvals given to local investors dropped by 2.5% to RM9,391 million, while that of foreign investors declined by 15.2% to RM5,760 million. The speed of implementation of these approved projects is likely to be influenced by domestic and external demand prospects. The easing of monetary policy and the fiscal stimulus that have been put in place in the second half of 1998 to invigorate domestic demand should positively affect investment sentiment, especially among domestic market-oriented industries.

Capital expenditure in the services sector has also been affected by the more difficult business environment as companies focus on strengthening their cash-flow position, against a background of less favourable demand and delay in settling of

trade credits by debtors. Nevertheless, the capital outlay in information technology related to the development of Multimedia Super Corridor (MSC) has been encouraging, with RM384.6 million expected to be invested during 1998. Better export prices for some agriculture commodities have also led to selective increases in investment in the agriculture sector particularly in the oil palm sector. In the case of the oil and gas sector, the reduction of income tax from 40% to 38% as well as the rate of export duty on crude oil and condensate from 20% to 10% effective 1 January 1998 have induced a significant increase in investment in exploration and development activities. Investment in downstream activities has also increased markedly in both the oil and gas sector. Upstream investment by five major oil companies increased by 71% to RM9,341 million, while for downstream activities, the increase in investment is 62.2% to RM5,024 million in 1998.

**Public sector expenditure**, which covers consumption and capital expenditure undertaken by the Federal Government, state governments, statutory bodies and Non-Financial Public Enterprises (NFPEs), registers a slower rate of increase of an estimated 0.8% in 1998 (1997: 9.6%) to RM63 billion, in view of resource constraints. Underpinning this marginal growth is a 2.3% increase in public consumption to RM31.4 billion, largely due to higher emoluments paid by the Federal Government for additional manpower needed in the provision of essential services particularly health and education. However, expenditure on supplies and services is slightly lower than in 1997, in line with Government's efforts to reduce less essential expenditure so that more resources can be made available to finance expenditure of higher priority.

**Public sector investment**, however, declines marginally by an estimated 0.8% to RM31.6 billion in 1998, after an increase of 11.9% in 1997, mainly due to lower capital expenditure by the Federal and state governments as well statutory bodies. Although the Federal Government development expenditure is higher in 1998, part of this expenditure was not for capital expenditure but for financing off-budget obligations such as for financing Pengurusan Danaharta Nasional Bhd. and the Multimedia Development Corporation. Total capital expenditure of NFPEs, however, increases by 6.7% in 1998, largely due to additional investment by PETRONAS and Syarikat Telekom

Malaysia, but slower than the 10.9% increase recorded in 1997. The slower increase reflects the need to consolidate financial position in view of economic uncertainties.

## Net External Demand

**Exports of goods and non-factor services** (excluding investment income) increase by an estimated 26.5% in 1998 (1997: 13.7%) to RM330.4 billion. The stronger increase in export earnings is due to higher export prices as a result of ringgit depreciation and the fact that 76.2% of Malaysia's exports are settled in US dollar. **Merchandise exports** increase by an estimated 28.1% in 1998 to RM280.2 billion, underpinned by strong increases in the ringgit export value of manufactured goods and agriculture commodities. During the first seven months of 1998, export earnings from manufactured goods increased sharply by 43.6% (January-July 1997: 1.6%) to RM133.3 billion, contributed mainly by strong growth in the export of iron, steel and metal manufactures (73.8%), transport equipment (56.5%) as well as electrical and electronic goods (46%). The sharp increase in the export of output of traditionally domestic-oriented industries such as iron, steel and metal manufactures and transport equipment reflects efforts to venture into the overseas market to offset the weaker domestic demand. Export earnings from agricultural primary commodities also increased at a stronger rate of 36.9% during the first seven months of 1998 (January-July 1997: 0.9%) to RM15 billion. This is due to higher export earnings of crude palm oil, palm kernel oil, cocoa beans and pepper as a result of favourable prices. At the same time, mineral exports increased by 25% during the first seven months of 1998 (January-July 1997: 12.5%) to RM9.8 billion, largely as a result of strong growth of export earnings of liquefied natural gas. **Exports of non-factor services** increase by an estimated 18.1% to RM50.2 billion in 1998, largely due to higher earnings from services related to freight and insurance, air transportation, travel and professional and contractual services.

The value of **imported goods and non-factor services** (excluding investment income payments) increases at a slower rate of an estimated 12.5% in 1998 to RM289.5 billion (1997: 13.3%), despite higher prices of imports as a result of ringgit depreciation. The slower increase reflects partly the drop in the quantity of imports as a result of

contraction in domestic demand. In part, it also reflects the impact of measures introduced earlier to substitute imported goods such as heavy machinery with locally refurbished ones as well as services such as higher education through the expansion of local tertiary educational facilities. **Merchandise imports** increase by an estimated 14.5% in 1998 (1997: 13.3%) to RM237.5 billion, largely due to stronger growth in the import of intermediate goods. However, imports of consumption goods increase at a slower rate while imports of capital goods decline marginally in ringgit term. **Imports of non-factor services** increase by an estimated 3.8% to RM52 billion, in view of moderate increases in payments on freight and insurance, air transportation services as well as professional and contractual services. However, imports of services related to travel decline, as the number of Malaysians travelling and studying abroad is affected by ringgit depreciation, erosion of individual wealth due to decline in asset prices as well as lower disposable real income.

As exports of goods and non-factor services exceed imports of goods and non-factor services, the **external sector**, therefore, provides a net stimulus to nominal GDP by an estimated RM41 billion or 14.6% of GDP during 1998 against only 1.4% of GDP in 1997.

## Balance of Payments

With merchandise exports increasing at a significantly higher rate than that of imports, the **merchandise account** of the balance of payments is likely to record an unprecedented surplus of RM42.7 billion in 1998 (1997: RM11.3 billion). The **services account**, however, continues to record a large deficit, estimated at RM19.5 billion for the whole of 1998 (1997: -RM21.8 billion). The main contributors to the deficit in the services account are higher net outflow of investment income (-RM16.1 billion), freight and insurance (-RM9.7 billion) and other services such as professional and contractual services (-RM0.8 million). However, in the travel account Malaysia is expected to record a net receipt of RM5.3 billion in 1998, in part due to the holding of the Commonwealth Games and less Malaysians travelling and studying abroad. With regard to transportation services other than

freight such as transportation of air passengers, a net receipt of RM2 billion is estimated for 1998. After taking into account net unrequited transfers of RM3.2 billion, largely due to foreign workers working in Malaysia remitting their monies to their countries of origin, the **current account** is likely to record a surplus of at least RM20 billion or 7.7% of GNP in 1998. This is a significant turnaround from a deficit of RM 14.2 billion (5.4% of GNP) recorded in 1997.

The **long-term capital account** of the balance of payments is expected to record a lower net inflow of RM13.9 billion in 1998, largely as a result of the smaller net inflow of official long-term capital of RM1.6 billion and slightly smaller net inflow of foreign private long-term capital of RM12.2 billion. Consequently, the **basic account** of the balance of payments which records both the current account and long-term capital account could register a surplus of RM33.9 billion in 1998 (1997: RM4.9 billion). After taking into account the net outflow of short-term capital funds of RM31.8 billion and revaluation gains of foreign exchange reserves of RM24.6 billion due to ringgit depreciation, the **overall balance of payments position** is likely to record a surplus of RM26.8 billion. As a result, the amount of **net external reserves** expected to be held by Bank Negara Malaysia by the end of 1998 is RM85.9 billion or US\$22.6 billion which is sufficient to finance 4.4 months of retained imports.

### Public Sector Financial Position

After recording five consecutive years of strong fiscal surpluses since 1993, the overall **Federal Government** financial position registers a deficit in 1998. This reflects the impact of a lower level of economic activity on the Federal Government revenue as well as the effect of stepping up of Federal Government expenditure to stimulate the economy from being entrapped into a vicious circle of prolonged recession. Total revenue collected by the Federal Government declines by an estimated 16.2% to RM55,054 million in 1998 (1997: RM65,736 million), largely due to a 34% drop in indirect tax and 8.4% decline in direct tax collection. The decline in indirect tax collection is largely due to significantly lower export, import, excise duties and sales tax collected. In the case of direct tax, income tax, which contributes 94.2% to direct tax collection, registers a decline of 3.3%. The decline in income tax is attributable to a 4.1% drop in corporate tax and 5.4% drop in

individual income tax collections. **Operating expenditure** increases by an estimated 4.2% to RM46,563 million, mainly due to higher debt service charges following the depreciation of the ringgit. The **current account** of the Federal Government, therefore, records a lower surplus of an estimated RM8,491 million or 3.2% of GNP in 1998 (1997: RM21,071 million or 8.1% of GNP).

To revive the economy, the Federal Government changed its stance in fiscal policy by increasing its **gross development expenditure** by an estimated 23% in 1998 to RM19,378 million. This additional allocation includes RM1,000 million that has been made for social safety net projects to address and ameliorate the effects of economic crisis on the lower income group. However, some of the expenditure allocated are for off-budget purposes which are in line with the National Economic Recovery Plan put forward by the National Economic Action Council. These off-budget allocations include the RM1,500 million provided to Pengurusan Danaharta Nasional Bhd., a special fund set up to purchase non-performing loans of the banking sector, and RM654 million provided to Cyberview. After taking into consideration loan recovery of RM1,300 million, the **net development expenditure** of the Federal Government is estimated at RM18,078 million in 1998. As a result, the **overall financial position of the Federal Government** in 1998 records a deficit of an estimated RM9,587 million or 3.7% of GNP (1997: + RM6,626 million or 2.5% of GNP).

In view of the unfavourable economic conditions during the year, the overall position of the public sector (which comprises of NFPEs and the general government ) records a deficit. Revenue collection of the **general government** (consisting of the Federal, state and local governments and statutory bodies) declines by an estimated 13.6% to RM70,299 million in 1998 (1997: RM81,360 million). Operating expenditure, on the other hand, increases by an estimated 4.8% to RM54,497 million (1997: RM51,983 million). As a result, the **current account of the general government** records a lower surplus of an estimated RM15,802 million for 1998 (1997: RM29,377 million). Taking into account **NFPEs' operating surplus** of an estimated RM26,094 million (1997: RM25,713 million), the **consolidated public sector current account** for 1998 is estimated at RM41,896 million (16.0% of GNP), that is lower compared with the surplus of RM55,090 million (21.1% of GNP) recorded in 1997.

**Total public sector development expenditure**, on the other hand, increases by an estimated 17.1% to RM44,694 million, mainly as a result of a large rise in Federal Government development expenditure. Consequently, the **overall public sector financial account** runs into a deficit of an estimated RM2,798 million (-1.1% of GNP) in 1998, against a surplus of RM15,230 million or 5.8% of GNP attained in 1997.

### National Resource Position

Although the growth of gross national income, as reflected by the growth in nominal GNP, decelerates sharply from 9.8% in 1997 to an estimated 0.4% in 1998, the deceleration in the growth of **gross national savings** is less rapid, that is from 12.3% in 1997 to an estimated 6.8% in 1998. This reflects the combined impact of a more cautious consumption spending pattern in times of economic uncertainties, higher deposit interest rate during a large part of the year, lower corporate tax by 2 percentage points as well as other initiatives to promote national savings. Consequently, **gross national savings rate** as a proportion of GNP increases from 39.4% of GNP or RM102.8 billion in 1997 to an estimated 41.9% of GNP or RM109.8 billion in 1998. **Private sector savings**, which accounts for 70% of national savings, increase at a higher rate of an estimated 47.8% to RM76.8 billion in 1998 (1997: -2.6%). This in part reflects the efforts to replenish its financial wealth eroded earlier by falling asset prices, particularly share prices, as a result of the regional financial crisis. **Public sector savings**, on the other hand, decline significantly by an estimated 35.1% to RM33 billion in 1998 (1997:33%), as a result of lower current account surplus following a drop in revenue as against a higher operating expenditure.

With the level of **gross national investment** declining significantly by an estimated 23.3% to RM89.8 billion or 34.2% of GNP in 1998 (1997: +12.7% or 44.8% of GNP), the **nation's resource position**, that is the difference between gross national savings and investment, turns around with an estimated surplus of about RM20 billion (7.7% of GNP) in 1998 from a deficit of RM14.2 billion (5.4% of GNP) in 1997. This reflects mainly the positive turnaround of private sector resource position from a deficit of RM33.4 billion (12.8%

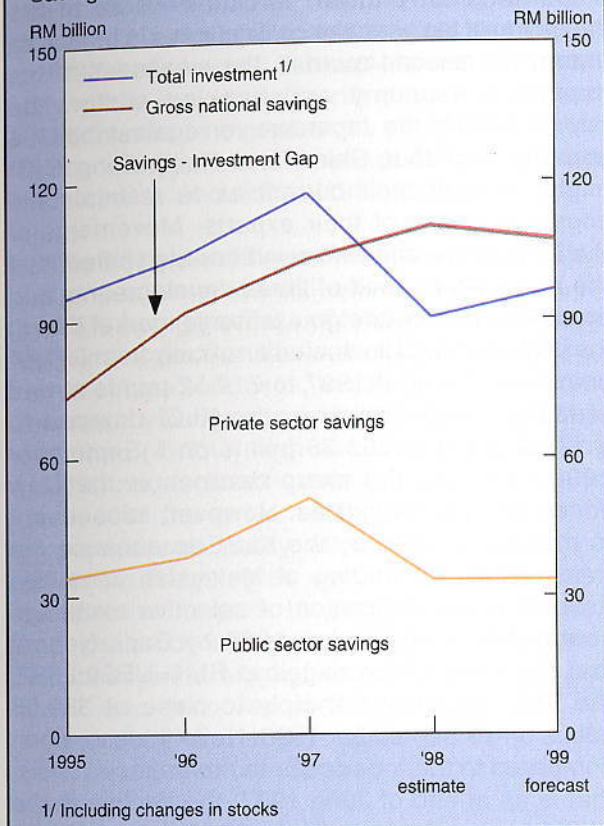
of GNP) in 1997 to a surplus of RM18.1 billion (6.9% of GNP) in 1998, while that of the public sector records a lower surplus of RM2 billion (0.8% of GNP) in 1998 as against a surplus of RM19.3 billion (7.4% of GNP) in 1997.

### Monetary Developments

Monetary expansion slowed down significantly during the first eight months of 1998, partly due to the impact of the contraction of the real economy. Growth in the **broad monetary aggregate**, M3, decelerated sharply from an annualised growth of 18.5% at end-1997 to 4.3% at end of August 1998. The significantly slower growth in money supply was the result of a decline in the lending by the banking system to the private sector in an environment of weak business expectations, high interest rates and cautious lending policies of the banking institutions. Total loans provided by the banking system increased only by 0.2% or RM1 billion from an outstanding amount of RM421 billion as at end of 1997 to RM422 billion as at end of August 1998. On the other hand, deposits with the banking system declined at a faster rate of 2.5% or RM10.7 billion during the first eight months of 1998, compared with an increase of 13.5% or RM48.4 billion during the corresponding period of 1997. As a result, the loan-deposit ratio of the banking system increased to 95.2% at end August 1998 (1997: 92.7%). Although this ratio indicated an overall tightening of the liquidity position of the banking system during the period, the tightening of the liquidity situation was largely attributed to the liquidity problems faced by some banking institutions.

The tight liquidity position has led to higher **interest rates**. The average 3-month inter-bank rates rose from 8.60% at end 1997 to 9.80%-11.0% at the end of the first quarter of 1998 before peaking at 11.07% at end of June 1998. Consequently, the base lending rate (BLR) of commercial banks and finance companies increased to 12.27% and 14.70% at end of June 1998 respectively from 10.33% and 12.22% at end of 1997. As the high interest regime as well as the significant slowdown in bank credit could exacerbate further the contraction of economic activities already felt during the first half of 1998, a number of measures were subsequently taken to enhance the liquidity and, therefore, the lending

Chart 1.2  
Savings - Investment Gap



that of finance companies and merchant banks continued to be retained at 10% (12.5% for those not issuing negotiable instruments of deposits) aimed at further reducing the holding cost of liquid assets by banking institutions.

Correspondingly, the 3-month BNM inter-bank intervention rate was reduced from 11.0% to 10.5% and later to 10% in early August, 9.5% on 28 August, 8.0% on 3 September and 7.5% on 5 October. As a move to ensure that the cost of funds was further reduced, the banking institutions were required to calculate the BLR based on the BNM intervention rate instead of the Kuala Lumpur Inter-bank Rate (KLIBOR) effective September 1. In addition, the administrative margin of financial institutions allowed in the BLR computation was reduced to 2.25% from 2.5%, while the maximum margin above BLR allowable was reduced from 4 percentage points to 2.5 percentage points. With all these measures, the BLR of commercial banks declined from a peak of 12.27% at end June 1998 to a maximum rate of 8.92% by the end of September and an expected 8.50% by end of October, bringing the rate below the level prevailing before the financial crisis (end-June 1997: 8.93%).

capacity of the banking system as well as to reduce the interest rate. These measures were aimed at expediting the revival of the economy.

One of the measures was reducing further the statutory reserve requirement ratio (SRR) which had earlier been reduced from 13.5% to 10.0% on 16 February 1998. Consequently, the SRR was further reduced to 8% on 1 July 1998 and, subsequently, to 6% on 1 September and 4% on 16 September 1998. The reduction in SRR is aimed at improving the distribution of liquidity among the banking institutions, thereby reducing the cost of funds. In addition, BNM revised the permissible daily variation in the average balances required to meet the SRR to  $\pm 2\%$  from  $\pm 0.5\%$  to allow for greater flexibility in managing daily liquidity operations. The liquid asset ratio requirement of commercial banks was also reduced from 17% to 15% of total eligible liabilities while

## Foreign Exchange and Stock Markets

On the **foreign exchange market**, the movement of the ringgit during the first eight months of 1998 was generally volatile. However, following the imposition of selective exchange controls on 1 September 1998 to insulate the economy from the contagion effects of the global financial crisis, the ringgit has since 2 September 1998 been fixed at RM1=US\$0.2632.

At the start of 1998, the ringgit as well as other regional currencies came under severe selling pressures as a result of developments in South Korea, Japan and Indonesia as well as market perception that China and Hong Kong SAR might also devalue their currencies to maintain their

export competitiveness. These developments were taken advantage of by highly leveraged speculative funds to manipulate both the stock and foreign exchange markets in order to reap quick profits. As a result, the ringgit depreciated against the United States dollar (US\$) to an unprecedented low of RM1=US\$0.2049 on 7 January 1998. Nevertheless, following the announcement of Malaysia's favourable external trade position and the introduction of further market stabilisation measures by the Government, against a background of positive external developments relating to resolution of corporate debt situation in South Korea and Indonesia, the ringgit recovered to close at RM1=US\$0.2745 at end of March. This is 6.7% higher than the rate as at end of 1997 (RM1=US\$0.2572). Against the composite of major currencies, the ringgit appreciated by 6.4% as at end of March 1998 when compared with end of 1997.

However, by end of June 1998, the ringgit weakened to close at RM1=US\$0.2395, a depreciation of 12.7% when compared with its closing rate at end of March. The depreciation was attributed to contagion effects of external developments, particularly the political unrest in Indonesia and the weakening of the Japanese yen and economy as well as the difficulty faced by the Japanese Government to effectively overcome the problems faced by its banking sector. Reflecting the contagion impact of the continued weakening of the Japanese yen on regional currencies, the ringgit touched an intra-day low of RM1=US\$0.2312 on 10 July but recovered moderately in line with the movement of the Japanese yen to trade at RM1= US\$0.2369 as at end of August 1998. On 1 September 1998, the ringgit appreciated to RM1=US\$0.2618, following the introduction of selective capital control measures to contain speculation on the ringgit and minimise the impact of short-term capital flows on the domestic economy. The following day the ringgit strengthened further to RM1=US\$0.2632, after which the ringgit exchange rate was fixed at RM1=US\$0.2632 effective 2 September 1998.

As in the foreign exchange market, the prices of shares traded in the **Kuala Lumpur Stock Exchange** (KLSE) were largely affected by the contagion effects of the regional and global financial crisis. In fact, regional and domestic developments that influenced the movements of the ringgit during the first eight months of 1998 similarly affected

the movements of the Kuala Lumpur Composite Index (KLCI). These developments included the corporate debt problem in South Korea at the beginning of the year, the political crisis in Indonesia during the second quarter, the weakness of the Japanese economy and banking sector, the depreciation of the Japanese yen against the US\$ and the fear that China and Hong Kong SAR might devalue their currencies to maintain the competitiveness of their exports. Movements of the Dow Jones and Nikkei indices also influenced the KLCI. As a result of these developments and pressures on the foreign exchange market during the year, the KLCI fluctuated erratically from 594.44 points as at end of 1997 to 719.52 points at end of March 1998. However, the KLCI dropped to a 11 year low of 261.33 points on 1 September 1998, following the sharp declines in the Dow Jones and Nikkei indices. However, subsequent to measures taken by the KLSE to enhance the transparency of trading of Malaysian securities as well as the imposition of selective exchange controls on 1 September 1998 by Bank Negara and the fixing of the ringgit at RM1=US\$0.2632, the KLCI recovered sharply to close at 389.08 points on 15 September 1998. Nevertheless, when compared to the index prior to the financial crisis, that is as at end of June 1997, the decline in the KLCI remained large, that is by 63.9% from 1,077.30 points to 389.08 points. In the case of market capitalisation loss, the decline was 65.7%, that is from RM744 billion to RM255 billion during the same period. As a percentage of GNP, the loss in market capitalisation of RM489 billion is equivalent to 186% of 1998 GNP, that is almost 2 years of national income.

### **Inflation and Property Prices**

Reflecting largely the impact of ringgit depreciation on prices of imported food as well as exportable commodities produced locally such as palm oil, inflation rate was higher during 1998. Indicative of this is the 5.2% increase in the Consumer Price Index (CPI) during the first nine months of 1998, against an increase of 2.6% during the corresponding period in 1997. Underpinning this higher rate of inflation is the 8.9% increase in the CPI for food items. Excluding food, the CPI rose at a slower rate of 3.1% during the first nine months of 1998 (January-September 1997:1.7%). On a monthly basis, the annualised rate of increase in overall CPI has decelerated,

from a peak of 6.2% in June to 5.5% in September, reflecting the absence of demand pressures in the economy. With ringgit being fixed at RM1=US\$0.2632 for the remaining four months of 1998 and domestic demand expected to recover only mildly during the fourth quarter of the year, inflation rate is expected to decelerate further. Consequently, for the whole of 1998, inflation is expected at about 5% (1997:2.7%).

The **Malaysian House Price Index**, which tracks the prices of residential houses transacted, fell by 9.3% during the first half of 1998 when compared with the index for the second half of 1997. In terms of type of houses, the steepest decline was recorded by bungalows (-10.2%), followed by semi-detached (-6.7%), high-rise residential buildings (-5.6%) and terrace houses (-5.1%). The sharper decline in the price of higher-end residential properties was partly attributed to difficulty in procuring financing as well as the reluctance of prospective buyers to commit themselves in anticipation of further decline in property prices. Regionally, the biggest drop in the house price index was recorded in Johor Bahru (-21.7%), followed by Penang (-12.5%), Klang Valley (-12.1%), Seremban-Sepang (-5.0%) and Ipoh-Kinta (-4.1%).

## Labour Market

The contraction of the real economy has affected the pace of job creation and led to increased incidence of structural unemployment. **Total employment** declines by an estimated 2.7% during the year to 8.563 million (1997:4.6%). The lower rate of job creation is also reflected in a decline in the number of net additional contributors to the Employees Provident Fund by 17.5% to 154,029 contributors during the first eight months of 1998, as against 186,805 net additional contributors during the corresponding period of 1997. With the **labour force** declining by an estimated 0.4% to 9.01 million at end of 1998 due to reduced number of foreign workers, the **unemployment rate** is estimated to increase to 4.9% of labour force or 443,200 workers (1997:2.6%). As of 5 September 1998, 59,970 workers were reported to be retrenched. This is significantly higher than the 18,863 workers reported to be retrenched for the whole of 1997. Of the workers retrenched, 88.1% were locals while the remaining 11.9% were foreign workers.

Notwithstanding the retrenchment, the plantation sector as well as some sub-sectors within the manufacturing and the services sectors continued to experience shortages of workers. This arose, in part, due to skill mismatches as well as unwillingness of job-seekers to take up vacant jobs for a variety of reasons, including job preference. As a result, the total number of unfilled vacancies reported to the Manpower Department remained large at 46,202 as at end of July 1998, compared with 64,463 unfilled vacancies reported as at end of 1997. To reduce job vacancies due to skill mismatches, the Ministry of Human Resources has provided training for job-seekers to enhance their occupational mobility.

Reflecting the easier labour market, the average monthly wage of all categories of workers in the manufacturing sector increased at a slower annualised rate of 6.4% to RM1,280 per month during the first seven months of 1998 (January-July 1997:+11.1% to RM1,203). With the cutback in output as a result of poor sales orders, output per worker in the manufacturing sector declined by 2.9% during the same period. Sales value per employee, which is a broad indicator of labour productivity, nevertheless, increased by 14.6% to RM20,130 per month during the first seven months of 1998 (January-July 1997:+3.6% to RM17,570 per month), due to higher selling price for internationally tradeable manufactured goods as a result of ringgit depreciation. As a result, the cost of labour per RM100 of sales declined to RM6.36 during the first seven months of 1998 from RM6.85 during the corresponding period of 1997.

## Prospects for 1999

The prospective performance of the Malaysian economy in 1999 hinges on two major developments. Firstly, it depends on the speed and the extent of the implementation of the fiscal and monetary measures that have been put in place to revitalise the domestic economy. These measures include the provision of fiscal stimulus, the establishment of Pengurusan Danaharta Nasional Bhd. to purchase the non-performing loans of the banking system, the setting up of the Danamodal Nasional Bhd. - the special purpose vehicle to recapitalise the banking system, as well as other recommendations put forward in the National Economic Recovery Plan. Early

implementation of some of these measures will help to stimulate the economy. In this regard, agencies involved in the implementation of the National Economic Recovery Plan are required to report fortnightly to the Secretariat of the National Economic Action Council the progress they have made in implementing the Plan. In implementing some of these measures, successful mobilisation of the necessary financing at reasonable costs will have to be put in place first. This may require some lead time. Nevertheless, the easing of monetary policy particularly through the lowering of the SRR recently has injected liquidity into the system and already led to the lowering of interest rates. In addition, the exchange control measures have resulted in the off-shore ringgit being repatriated into the banking system. These measures coupled with the relaxation of the credit guidelines should help to induce some recovery in domestic spending in 1999.

Secondly, the prospective performance of the Malaysian economy in 1999 is also dependent on the extent of the recovery in external demand for Malaysia's goods and services. However, indications are that external demand will remain weak, although a mild recovery can be expected. This in part is due to expected stagnation or a mild recovery in real GDP growth of Malaysia's major trading partners, particularly the United States of America, Japan and other East Asian nations. Underlying this expectation is that the volatility currently affecting the global financial markets may take awhile to settle. Thus, the global economy and, therefore, world trade will continue to be affected by the deflationary impact of the crisis. The International Monetary Fund, in its latest World Economic Outlook, projected that growth in world output to improve marginally to 2.5% in 1999 from 2% in 1998 while world trade is projected to increase by 4.6% in 1999 (1998: 3.7%). However, output growth from advanced economies, which are Malaysia's major trading partners, is expected to decelerate to 1.9% (1998: 2%). There are risks that the projections made by the IMF may not be achievable, if the current financial crisis is further prolonged or turns for the worse, in the event the international community lacks the resolve to undertake cooperative efforts to deal with the crisis effectively.

In the light of the unsettling international financial environment and prospective sluggish growth of Malaysia's major trading partners, it is envisaged

that the Malaysian economy could recover only mildly in 1999. **Real GDP growth** is, therefore, expected to increase by 1% in 1999. The main source of growth is expected to be generated through domestic demand, stimulated by the measures that have been put in place by the Government recently to revive the economy. The external sector is expected to exert a lower net expansionary impact on real GDP and nominal GNP growth, as the surplus in the external payments current account position is envisaged to be smaller. Although exports are forecast to improve mildly, imports are expected to increase at relatively stronger rate in tandem with the recovery in domestic demand and the need to replenish stocks.

With the mild recovery in overall aggregate demand, output of all sectors of the economy, with the exception of the construction sector, are expected to record mild to moderate growth. In view of the moderate recovery in domestic demand, inflation is expected to be low in 1999, especially if the ringgit continues to be fixed at RM1=US\$0.2632. Both export and import prices could decline marginally in 1999. With lower prices, **GNP in current prices** is forecast to increase by only 0.7% to RM264 billion. **Per capita GNP** is envisaged to decline by 1.6% to RM11,626 in 1999 (1998: RM11,817). Nevertheless, in terms of US dollar, per capita GNP is expected to increase by 1.5% to US\$3,059 (1998: US\$3,013), in view of the stronger ringgit.

### Sectoral Output Performance

Against a background of a slight recovery in both domestic demand and overseas sales orders from Malaysia's major trading partners amid more intense global competition, the **manufacturing sector** is envisaged to step up its output marginally in 1999 by 1.0% (1998: -5.8%). This is largely due to expected recovery in the output of domestic market-oriented industries by 1.3% (1998: -8.8%). Domestic market-oriented industries that are expected to step up their output are those producing plastics, chemicals and chemical products, petroleum refineries, food and beverages as well as consumer durables such as passenger cars, in view of easier credit terms. In part, some of the increased output to be realised from domestic market-oriented industries are meant for the

overseas market, reflecting the impact of recent efforts to boost sales overseas. As external demand for manufactured goods is anticipated to remain weak, given the sluggish growth of Malaysia's major trading partners as well as more intense competition in the global market, the output of export-oriented industry is expected to increase only marginally, that is by 0.8% in 1999 (1998: -2.9%). Contributing to this growth is the increase in the production of semiconductors in response to a likely recovery in world demand. Other export market-oriented industries that should record higher output are those producing rubber products and textiles, in view of sustained demand from overseas. However, output of wood product industry will continue to decline due to oversupply in the world market in the face of weak demand especially from Japan.

Value added in the **construction sector** is forecast to decline further by 8% in 1999. This is largely due to sluggish construction starts in some segments of the property market particularly commercial buildings and higher-end condominiums, as excess supply of office space, retail outlets as well as high-end condominiums are not expected to be taken up fully in 1999. Low occupancy of hotel rooms as a result of the recent increase in supply partly to meet the demand of the Commonwealth games will discourage construction of additional hotels. Nevertheless, construction starts of landed residential properties particularly low and medium-cost houses are likely to be sustained, given the relaxation on bank lending recently for purchases and construction of properties. Lower mortgage rate will also provide some fillip for the residential construction industry, particularly of lower end. However, in view of the anticipated decline in disposable income as well as uncertainty with regard to employment prospects given that the economy is forecast to recover only mildly, demand for residential properties is expected to stagnate at about 1998's level. In part, speculative buying of these properties is expected to be minimal, due to the recent decline in prices of houses.

Construction activities with regard to public works as well as infrastructure projects will get a boost from the fiscal stimulus announced by the Government recently which includes the establishment of Infrastructure Development Fund.

In the pipeline for construction in 1999 are small infrastructure projects such as roads, bridges, railworks and drainage system as well as the continuation of bigger infrastructure projects such as Light Rail Transit System, KL Sentral, Kuala Lumpur Monorail System, the development of Tanjung Pelepas Port and Kuantan Ports, sewerage system, water works as well as several highway projects.

Output of the **agricultural sector** in 1999 is forecast to turn around positively to achieve a growth of 3.9% (1998: -5.9%), as output from oil palm is estimated to improve by 7% after contracting by 8% in 1998 following a recovery from tree stress. Similarly, output from the cocoa industry is expected to recover strongly by 10%. Output from rubber will continue to decline by an estimated 1.1%, largely due to conversion of rubber land to oil palm as the latter provides better returns. In the case of sawlogs, the 1999 output is likely to contract by 4.5% in view of the need to ensure the exploitation of the forest resources is kept well within sustainable level, especially when the price of the commodity is anticipated to remain weak.

Output in the **mining sector** is similarly expected to recover in 1999, with a growth of 1.3% (1998: -0.8%), underpinned by a 7.5% increase in gas output. Output of crude oil is also projected to increase, but by a small margin of 0.6% to 722,500 barrels per day. Due to depletion of resources, tin output, which rose by 6.7% in 1998, is envisaged to decline by 1.9%. As a result of the continued sluggish construction starts, demand for quarrying output will decline moderately.

In response to a gradual pick up in real domestic demand for services following the easing of monetary policy as well as injection of fiscal stimulus, value-added in the **services sector** is forecast to accelerate mildly to 2.7% growth in 1999 (1998: 2.1%). Services industries that are anticipated to record above average rate of increase in value-added are the electricity, gas and water sub-sector (7.2%), finance, insurance, real estate and business services (4.2%) and transport, storage and communications sub-sector (3%). Other sub-sectors such as the wholesale and retail trade, hotels and restaurants subsector will record lower growth rates, as demand for these services will be affected by the anticipated drop in per capita income of the population.

## Domestic Demand

**Aggregate domestic demand** (excluding changes in stocks) in 1999 is expected to turn around to record a moderate growth of 3.9% in nominal terms to RM249.8 billion, after recording a contraction of 11.7% in 1998. This turnaround in domestic demand largely reflects the positive impact of the measures taken by the Government to stimulate domestic economic activities such as through the easing of monetary policy, the provision of fiscal stimulus as well as addressing the non-performing loans and the capital requirement of the banking system.

After a cutback in its spending by 15.5% in 1998, **private sector spending** is forecast to increase moderately by 3.7% in 1999 to RM184.1 billion. Lower interest rates, easier access to bank credit as well as recovery in financial wealth, as stock prices should recover gradually following the measures introduced in September 1998 to enhance the transparency of the KLSE, are major underlying factors that can help to encourage private sector spending. **Private consumption** is estimated to increase moderately by 3.7% in nominal terms in 1999 (1998:-5%), reflecting, on one hand, the impact of normal population growth, lower mortgage rate and the relaxation of credit guidelines for purchases of passenger cars. On the other hand, it reflects a restrained consumption spending pattern on the part of the private sector, in view of uncertainties with regard to employment as well as earnings prospects. Similarly, private capital outlay is expected to turn around moderately with a growth of 3.7% in 1999, after an estimated 30.5% cutback in 1998. Economic activities that should attract increased private sector investment in 1999 are manufacturing projects which have been approved by MIDA during 1998, infrastructure projects that have been identified by the Government as part of the economic recovery efforts, the construction of low and medium cost houses which still enjoy good demand and the agriculture sector, particularly oil palm.

**Public sector expenditure** is budgeted to increase at a moderately higher rate of 4.4% to RM65.8 billion in 1999 (1998:0.8%), reflecting largely the 6.1% increase in **public sector capital**

**expenditure** associated with fiscal stimulus targeted for the year. The increase in public sector fixed capital formation to RM33.5 billion will be underpinned by a 30% increase in investment undertaken by the Federal Government which amounted to RM9.5 billion or 28.4% of total public sector investment. These capital expenditure include the construction of roads, bridges, rural amenities as well as agriculture, health and educational facilities. The increase in capital expenditure by the state and local governments as well as statutory bodies is, however, envisaged to average only 2% in 1999. In the case of capital expenditure by NFPEs, it is expected to decline by 2.3% to RM17.3 billion (51.7% of total public sector capital expenditure), after increasing by an estimated 6.7% in 1998.

**Public sector consumption expenditure** is envisaged to increase by 2.8% in 1999, that is slightly higher than the 2.3% increase estimated for 1998. The increase is to cater for higher emoluments of the civil service particularly for essential services such as health and education as well as for additional supplies and services needed by the public sector, in particular the Federal Government.

## Net External Demand

The value of **exports of goods and non-factor services** in ringgit terms is forecast to increase at a significantly slower rate of 0.8% to RM333.2 billion in 1999 (1998:26.5%). This sharp deceleration in export value growth reflects largely lower export prices, as a result of ringgit appreciation following the fixing of the ringgit exchange rate at RM1=US\$0.2632. In part, the deceleration in the growth of export value is also due to a mild recovery in volume off-take, as demand from Malaysia's major trading partners is expected to remain weak. **Merchandise exports** are estimated to increase by 0.4% in 1999 to RM281.3 billion (1998:28.1%), supported largely by 6.2% increase in the export of agriculture commodities particularly palm oil, palm kernel oil and cocoa beans. Exports of manufactured goods, however, are forecast to increase by 1% to RM231.4 billion, 67% of which are electrical and electronics products and machinery. The value of mineral exports is, however, likely to decline, largely as a result of lower earnings from liquefied natural

gas due to anticipated drop in export price. However, **exports of non-factor services** are forecast to increase to RM 51.9 billion or by 3.5% in 1999 (1998:18.1%), with higher earnings anticipated from freight and insurance, air transportation and travel.

The value of **imports of goods and non-factor services** is similarly forecast to increase at a significantly slower rate of 3.9% to RM300.8 billion in 1999 (1998:12.5%), reflecting largely lower import prices as a result of ringgit appreciation and partly a moderate recovery in domestic demand. **Merchandise imports** could increase by 4.4% to RM247.9 billion in 1999, that is at a relatively stronger rate than the growth rate of merchandise exports. This is a reversal of the situation experienced in 1998 when merchandise exports increased at a relatively faster rate than imports. This reversal of trend reflects largely the impact of domestic demand stimulus and partly a mild recovery in manufactured exports which is expected to lead to stronger import volume intake, especially that of intermediate goods which currently account for 67% of total import value. As a result of lower prices following ringgit appreciation, the growth in the value of **import of non-factor services** is estimated at 1.9% to RM52.9 billion. Although the value of all imports of non-factor services is expected to show varying rate of increase, payments for freight and insurance as well as air transportation services are anticipated to record larger absolute increases.

With exports of goods and non-factor services forecast to exceed imports of goods and non-factor services by RM32.4 billion in 1999, that is by a narrower margin than the surplus of RM41 billion in 1998, the **external sector** will exert a net contractionary impact on GDP growth in 1999.

### Balance of Payments

As merchandise imports are expected to increase at a relatively stronger rate than merchandise exports during 1999, the **merchandise account** of the balance of payments is envisaged to record a smaller surplus of RM33.4 billion in 1999. The **services account**, on the other hand, is forecast

to register a slightly narrower deficit of RM19.4 billion, as a result of higher net earnings from travel and air passenger transportation services. As in recent past, the main contribution to the services account deficit is the deficit in the investment income sub-account which include repatriation of profits and dividends as well as interest payments. In 1999, the net investment income payment is forecast at RM16.3 billion in 1999 (1998:-RM16.1 billion). Net unrequited transfer payment is expected to be lower in 1999, that is RM3 billion (1998:-RM3.2 billion). The lower net unrequited transfer payment is attributed to the recent requirement that foreign workers have to contribute to the Employees Provident Fund as well as lower number of foreign workers in the country. After taking into account the net outflow of unrequited transfers, the **current account** of the balance of payments is expected to record a smaller surplus of RM11 billion or 4.2% of GNP in 1999 (1998:RM20 billion or 7.7% of GNP).

### Public Sector Financial Position

The **Federal Government overall financial position** in 1999 will reflect the impact of lower revenue collection as well as the need to manage the level of expenditure by taking into consideration: firstly, the need to revive economic growth; secondly, to keep the current account of the Federal Government financial position at least in balance; thirdly, the availability of both domestic and external financing; fourthly, to avoid crowding out the private sector in terms of access to loanable funds; and fifthly, to keep the overall fiscal deficit at a sustainable level so that the nation's external debt servicing ratio is within prudential limit. As the total expenditure requirement for 1999 is expected to exceed the financial resources that can be mobilised, only projects and programmes of higher priority in terms of revitalising economic growth and improving the efficiency of the economy are given the necessary expenditure allocations.

In 1999, the **Federal Government revenue** is projected to decline by 14.3% to RM 47,160 million. This is largely due to a 27.9% drop in direct tax collection to RM 20,099 million, as corporate and individual earnings are expected to be affected

by the difficult economic environment in 1998. As economic activities are expected to improve slightly in 1999, indirect tax collection is estimated to increase by 6% to RM16,219 million. **Federal Government operating expenditure** will be allowed to increase by only 1% to RM47,042 million, in view of the need to ensure that the current account position of the Federal Government position achieve at least a small surplus, that is RM118 million, in 1999.

In line with the amount of resources that can be mobilised without crowding out the private sector in terms of access to financing as well as to ensure the overall fiscal deficit is sustainable, the Federal Government proposes to contain its **gross development expenditure** to RM17,553 million in 1999, that is 9.4% lower when compared with an estimated RM19,378 million allocated for 1998. The bulk of the development expenditure will be allocated for projects that can help to revitalise the economy and improve the efficiency of the economy. These include the construction of roads, bridges and light rail transit project, ungrading of industrial training institutes and educational facilities as well as agriculture and rural development. After taking into account loans of RM1,300 million expected to be recovered in 1999, the **net development expenditure** will decline by 10.1% to RM16,253 million. As a result, the overall financial position of the Federal Government is expected to record a larger deficit of RM16,135 million or 6.1% of GNP in 1999.

The **consolidated financial position of public sector** is similarly envisaged to record a larger deficit in 1999. Revenue collection of the general government is forecast to decline by 12.0% to RM61,845 million (1998: RM70,299 million), largely as a result of the anticipated decline in the Federal Government revenue. Operating expenditure, on the other hand, is expected to increase by 0.2% to RM54,596 million, compared with RM54,497 million in 1998. Consequently, the current account of the general government is estimated to be lower at RM7,250 million (1998: RM15,802 million). However, the operating surplus of NFPEs in 1999 is forecast to increase by 4.4% to RM27,250 million (1998: RM26,094 million). Thus, the consolidated public sector current account is estimated to record

a smaller surplus of RM34,500 million (1998: RM41,896 million). With the public sector development expenditure expected to decline by 8.2% to RM41,042 million, public sector overall financial position will record a larger deficit of RM6,543 million or 2.5% of GNP in 1999 (1998: -RM2,798 million or 1.1% of GNP).

### National Resource Position

With growth in the nation's consumption expenditure likely to outpace the growth of GNP in nominal terms, **gross national savings** is forecast to decline by 2.7% to RM106.8 billion (40.5% of GNP) in 1999. Of the total gross national savings, 69.2% is expected to be generated by the private sector and the balance of 30.8% by the public sector. On the other hand, growth in investment expenditure is expected to increase by 6.7% to RM95.8 billion (36.3% of GNP) in 1999. As a result, the nation's savings will exceed the nation's investment expenditure by RM11 billion or 4.2% of GNP in 1999. This is smaller than the savings-investment surplus of about RM20 billion (7.7% of GNP) recorded in 1998. Private sector savings in 1999 is likely to exceed its investment by RM11.7 billion or 4.4% of GNP (1998 : 6.9% of GNP) while public sector savings could be lower than its investment by an estimated RM0.6 billion or 0.2% of GNP (1998 : 0.8% of GNP).

### Inflation

Inflation is forecast to be lower, that is in the region of 3.5% in 1999 if the ringgit continues to be fixed at RM1=US\$0.2632. At this exchange rate, prices of imports could decline marginally. Consequently, imported inflation is not expected to be a cause for concern. Although domestic demand is set to recover moderately in 1999, there is still excess production capacity that can be utilised to generate additional output to meet the increasing demand. Thus, inflationary pressures due to supply bottlenecks or demand pressures are not expected to arise. As unemployment rate could increase in 1999, the prospect of wage-push inflation is also unlikely. Thus, inflationary pressures will not be a major concern in 1999.

## Conclusion

The financial crisis that beset the region since mid-1997 has exerted severe deflationary impact on the Malaysian economy in 1998. As a result, the real economy underwent a sharp contraction during the first half of the year. The extent of the contraction is unprecedented in recent history. The erosion of financial wealth of the nation has been severe, as reflected by the sizable loss of market capitalisation of the local bourse since the crisis emerged. All these developments have severe ramifications on the health of the economy and the socio-economic well-being of the population. To deal with this difficult situation,

measures have been put in place to insulate the economy from the contagion effect of the regional and global financial crisis as well as to speedily invigorate the economy. These measures are expected to pave the way for a mild recovery of the Malaysian economy in 1999 largely through the stimulation of domestic demand. In the event the global financial markets can be stabilised in early 1999 through the much needed resolve of the international community to bring the financial crisis to an early end, the growth of the world economy and global trade could turn out to be better than currently forecast. This should provide an added impetus to the growth of Malaysian economy in 1999 through a much stronger external demand.