1 The Performance of the Malaysian Economy in 1999 and Prospects for 2000

The Performance of the Malaysian Economy in 1999

An Overview

The Malaysian economy has recovered in 1999 from the severe deflationary impact of the regional financial crisis which had resulted in a 7.5% contraction of the economy in 1998. Real Gross Domestic Product (GDP), which had contracted by an unprecedented 10.9% and 10.3% in the third and fourth quarters of 1998, registered a significantly milder contraction of 1.3% in the subsequent first quarter before recovering with a positive growth of 4.1% in the second quarter of 1999. Monthly analysis of the performance of the economy indicates that the downward trend reached its trough in January 1999 before bottoming out beginning in February. The recovery subsequently strengthened and real GDP growth is expected to further accelerate to an average annual rate of 7.2% during the second half of 1999, against 1.4% real growth in the first half.

The economic recovery has been underpinned by policies initiated by the National Economic Action Council in line with its National Economic Recovery Plan as well as other favourable domestic and external developments. The imposition of selective exchange controls and the pegging of the ringgit at RM1=US$0.2632 (US$1=RM3.80) since 2 September 1998 brought stability and, consequently, confidence in the financial markets. Fiscal stimulus provided through an expansionary budget in 1999, the easing of monetary policies as well as enhanced efforts to speed up the implementation of approved public sector projects have assisted in reviving domestic demand associated with public sector spending and private consumption. Reforms introduced by the Government to strengthen and restructure the banking system have enabled the banking sector to carry out its intermediation function more effectively and, thereby, support the economic recovery process. These policy initiatives, coupled with the strong pick up in external demand following improvements in economic conditions in East Asia as well as continued robust growth in the United States (US), have spurred output increases especially in the manufacturing sector. A recovery in agriculture output, underpinned by a significant improvement in palm oil yield, has also contributed towards the positive growth in the economy.

The turnaround in real GDP growth has been accompanied by a further strengthening of the balance of payments position as well as lower rate of inflation. Boosted by stronger volume off-take in exports which continued to outpace imports, the external trade position recorded a surplus of RM46.2 billion in the first eight months of 1999. Consequently, for the whole of 1999, a surplus of RM42 billion (15% of GNP) for the current account of the balance of payments is estimated (1998: + RM36.8 billion or 13.7% of GNP). As a result, the nation's external reserves held by Bank Negara Malaysia (BNM) is expected to strengthen to RM125.5 billion (US$33 billion), adequate to finance 6.5 months of retained imports, by end of 1999, against RM99.4 billion (US$26.2 billion) or an equivalent of 5.7 months of retained imports as at end of 1998.

The annual rate of inflation has decelerated from an average of 5.3% in 1998 to average 3% during the first nine months of 1999. The lower rate of inflation reflected a combination of factors which included the pegging of the ringgit since 2 September 1998 at an exchange rate stronger than the average exchange rate during the first eight months of 1998, subdued inflation rate in Malaysia's major trading partners, mild recovery in domestic demand, existence of excess production capacities as well as lower edible oil price due to higher palm oil output.

Reflecting the impact of higher real GDP growth and moderate increase in prices, GDP in current prices is expected to increase by 5.4% in 1999 to RM299.9 billion (1998: 0.9%). After taking into account net outflows associated with transfer payments due largely to remittances by foreign workers and repatriation of profits, dividends and interest payments, Gross National Product (GNP) is projected to increase by 4.4% in 1999 to an estimated RM280.9 billion in current prices (1998: 0.9%). With the population increasing by 2.4%, per capita GNP is, therefore, estimated to increase by 1.9% to RM12,369 (US$3,255) in 1999, against RM12,134 (US$3,093) in 1998. In terms of purchasing power parity, per capita income is estimated to increase by 4.4% from US$8,242 in 1998 to US$8,604 in 1999. The higher per capita income reflects improvement in employment opportunities as well as the better financial performance of the business sector following the economic recovery.

Sectoral Output Performance

Underpinned by a recovery in external and domestic demand, value added in the manufacturing and the services sectors turned around to record positive growth in 1999, while the contraction in the construction sector moderated. In the agriculture, livestock, forestry and fishing sector, value added recorded a strong recovery largely as a result of a surge in palm oil output. However, output of the mining sector contracted following lower crude petroleum and gas output.

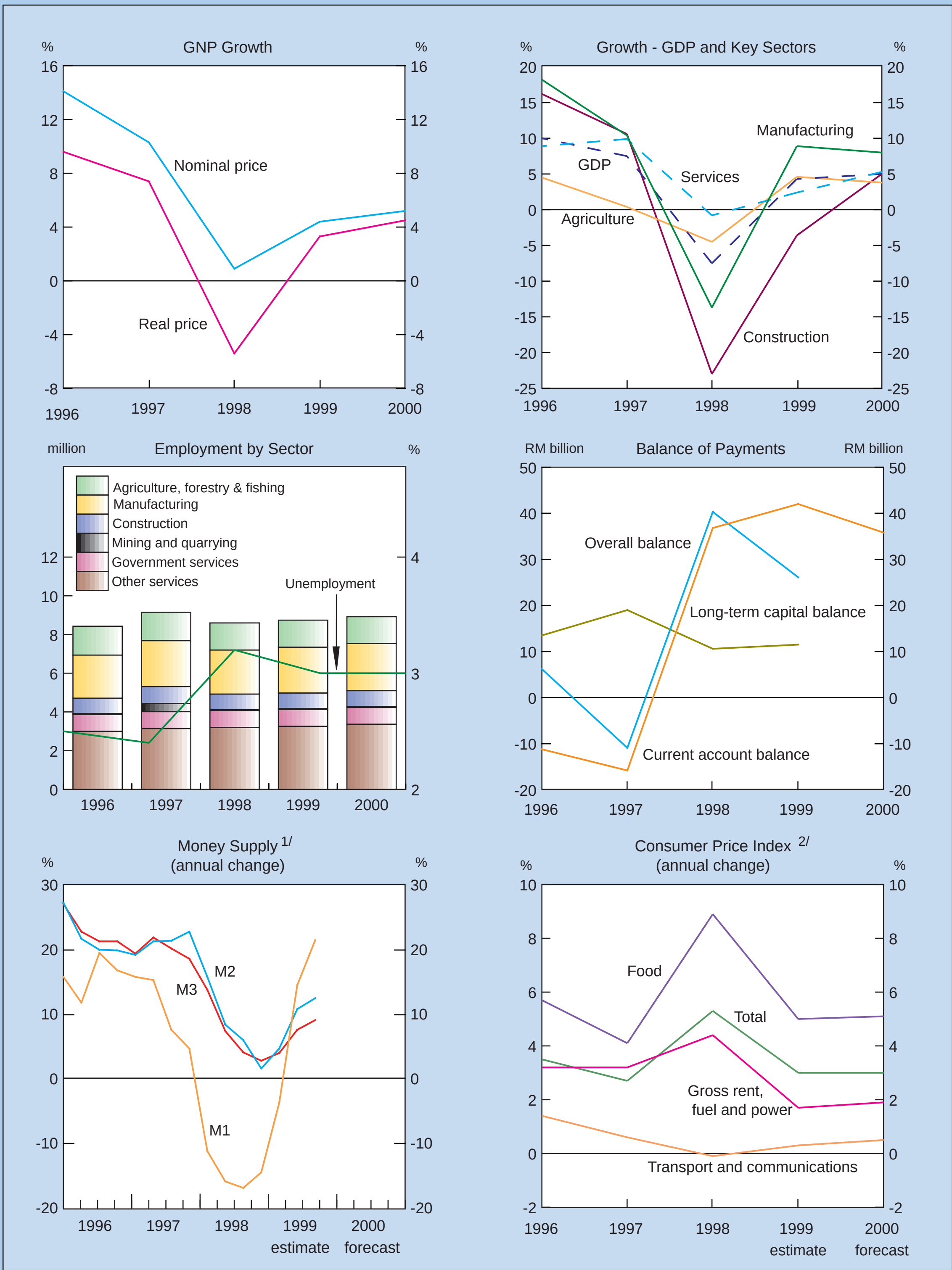
In response to a strengthening of overseas sales orders as well as the improvement in domestic demand, the output of the **manufacturing sector** recovered strongly since February 1999 to record a significant rate of growth averaging 10% through August. However, due to a 17.1% decline in output during January, the average output growth during the first eight months of 1999 was 6.4%. Output is expected to record double-digit rate of growth in the remaining four months of 1999 as external and domestic demand strengthen further. Value added in the manufacturing sector is, therefore, envisaged to record a growth of 8.9%, a 22.6 percentage points turnaround from the 13.7% contraction recorded in 1998. As a result, the sector's contribution to real GDP is estimated to increase to 29.2% in 1999, from 27.9% in 1998.

Export market-oriented manufacturing industries are expected to step up their output in 1999 by 6.7% (1998: -6.3%), in response to an improvement in global demand for electronics equipment and components, including semiconductors. In the case of domestic market-oriented manufacturing industries, output is expected to recover by 10.3% after recording a sharp contraction of 14.4% in 1998. The recovery is driven mainly by a significant increase in the production of transport equipment, following a surge in demand for passenger cars, as well as a positive turnaround in the output of manufactured food, chemical and plastics, paper and paper products as well as basic metal products.

Construction starts, however, remain subdued due to the large overhang of stocks of high rise commercial buildings offering office space, retail outlets and hotel rooms as well as higher-end condominiums. Nevertheless, activities related to the construction of low and medium-cost residential properties remain active as demand for this property segment remains strong, supported in part by the House Ownership Campaign from 12 December 1998 to 12 January 1999 where buyers were given exemption on stamp duties and easy access to bank credit. Civil engineering works related to public sector projects have picked up beginning the second quarter of 1999 in response to enhanced efforts to accelerate the pace of implementation of these projects which have been given additional budgetary allocations. Similarly, civil engineering activities in privatised projects have recovered, following the resumption of construction of several of these projects which have received loan facilities from the Development and Infrastucture Bank. These activities have helped to cushion the contraction in the value added of the **construction sector** to 3.6% in 1999, against a contraction of 23% in 1998. Thus, the sector's contribution to real GDP could further shrink to 3.7% in 1999, against 4% in 1998.

Output of the **agriculture, forestry, livestock and fishery sector**, which recovered during the first half of 1999, is expected to record a growth of 4.6%, after declining by 4.5% in 1998. This turnaround in output performance is due to a sharp rebound in palm oil output from a decline

Chart 1.1
Key Economic Indicators



1/ End of March, June, September and December including Repos.(except for 1999, which represents end of March, June and August)
2/ Malaysia (CPI up to September 1999)

of 8.3% in 1998 to an estimated increase of 19.4% in 1999. The robust performance is attributed to higher matured acreage coming into production from Sabah and Sarawak and an upturn in the biological yield cycle of the crop during the year. Production of cocoa and pepper is expected to increase moderately, with demand remaining favourable, while rubber output is expected to be adversely affected by poor demand and conversion of rubber land to other uses. Prices of non-oil primary commodities generally have weakened in ringgit terms due to exchange rate effects as well as supply and demand conditions. In the forestry sub-sector, a reduction is expected in sawlog production by 1.3% to 21.366 million cubic metres (1998: 21.656 million cu. metres), in line with the government's policy of sustainable forest management. Meanwhile, output of the fishery sub-sector is envisaged to be maintained at about 1.4 million tonnes, while output of livestock is estimated to decline by 3.5% in 1999 largely due to the problems faced by the pig breeding industry. As a result, the share of agriculture, forestry and fishery sector to overall GDP could remain at 9.4% in 1999.

In the **mining sector**, a marginal decline of 1.2% in output is expected in 1999 (1998: 1.8%). This reflects the impact of a 0.9% reduction in crude oil production to 712,700 barrels per day in support of the Government's National Depletion Policy as well as a drop in gas output of 4% to 3,975 mmscf per-day. However, tin output is projected to increase by 21.6% to 7,000 tonnes attributable to favourable tin prices.

The **services sector** is expected to benefit from stronger demand for services from the primary and secondary sectors of the economy as well as from the Federal Government. This coupled with improved consumer confidence, higher volume of external trade and increased tourist arrivals could contribute to a 2.4% increase in the value added of the sector in 1999 (1998:-0.8%). In the non-government services sector, a 2.3% increase in value added is envisaged, following stronger growth in the utilities (electricity, gas and water), transport, storage and communications sub-sectors and a mild but positive turnaround in the wholesale, retail trade, hotel and restaurant, finance and real estate businesses. Reflecting the impact of fiscal stimulus and the need to expand essential services, particularly in education and health, services provided by the government sector are expected to increase by an estimated 3.5% (1998:1.8%). The services sector accounts for an estimated 54.6% of real GDP in 1999.

Domestic Demand

Aggregate domestic demand for goods and services (excluding changes in stocks), which contracted by 20.3% in 1998 as a result of the deflationary impact of the regional crisis, is expected to turn around to record a 3.5% increase in 1999 to an estimated RM230.6 billion at current prices. The increase reflects the impact of higher public sector expenditure and private sector consumption. On the other hand, private sector investment will continue to decline, in view of excess production capacities particularly in domestic market-oriented industries.

Public sector expenditure on goods and services is expected to increase by 13.1% in 1999 to RM68.3 billion (1998:-3.4%), following the fiscal stimulus provided by the Federal Government to reinvigorate the economy. Part of the increase is attributed to a 16.7% rise in **public consumption** to RM33.2 billion (1998:-7.2%), as a result of higher expenditure on emolument, supplies and services as well as on defence. Public sector emolument in 1999 is estimated at RM19.3 billion, an increase of 7.3% over 1998, due to the higher wage bill of the Federal Government and statutory authorities, largely as a result of the special financial assistance of RM600 to each eligible government employee amounting to RM325 million and additional staffing to provide essential public services particularly in health and education. The increase in supplies and services is estimated at 20.8% to RM12.1 billion, mainly for purchase of equipment by the public sector which had reduced its expenditure on these items by 11.3% in 1998. Defence and other administrative expenditure, which account for 10% of public consumption expenditure, are envisaged to increase by 127.1% to RM3.3 billion after a cut of 32% in 1998.

Public investment is being stepped up by 9.9% to an estimated RM35.1 billion in 1999 (1998: 0.4%). Federal Government investment is increased by 15.5% to RM10.4 billion, as part of the fiscal measures to support the economic recovery process. Investments undertaken by Non-Financial Public Enterprises (NFPEs) are also expected to be higher at RM18.5 billion, an increase of 13.7% over 1998. Nevertheless, investments by state governments, local authorities and statutory bodies are estimated to decline by 7% to RM6.2 billion.

Private sector expenditure, on the other hand, is expected to remain stable at RM162.3 billion in 1999, after declining by 25.2% in 1998. Nevertheless a further drop in **private sector investment** by 21.5% to RM34.8 billion is envisaged. This is partly due to the construction sector recording a lower level of investment, given the excess stocks of high rise commercial buildings offering office space, retail outlets and hotel rooms as well as higher-end condominiums. In the domestic market-oriented manufacturing industries, a decline in the level of investment is also anticipated, in view of excess production capacity in industries producing construction materials such as non-metallic mineral products. However, private sector investment in export-oriented manufacturing industries is expected to pick up moderately in 1999 especially in the second half. This is expected to be underpinned by higher investment in the electrical and electronics industries which have registered a steady increase in production capacity utilisation, following increasing stronger overseas sales orders for electronic equipment and parts, including semiconductors especially since April 1999. In the area of information technology, investments have been stepped up by the private sector in order to be Y2K ready. While the overall private sector investment in 1999 is envisaged to be lower than in 1998, there are already signs of recovery in fixed capital formation, including the strong monthly increases in imports of capital goods beginning June 1999.

In view of excess production capacity in the manufacturing sector, **investment applications** declined by 21.6% to RM11,036.6 million during the first eight months of 1999, following a 35.5% decline during the corresponding period of 1998. Applications from domestic investors declined by 28% during the period to RM3,787.2 million while applications from foreign investors declined by 17.7% to RM7,249.4 million. **Proposed investment approved by MIDA** similary declined by 43% to RM9,729.2 million during the first eight months of 1999 compared with a total of RM17,055.5 million approved during the same period of 1998. All major categories of industries recorded lower approvals with the exception of electrical and electronics industries which recorded an increase of 283.7% to RM6,576.7 million. The sharp increase in approved investment for the electrical and electronics industries reflects increased applications for capacity expansion to meet rising overseas sales orders for electronic equipment, parts and semiconductors.

Proposed investment approved to local investors declined by 77.4% to RM2,225.3 million during the first eight months of 1999. In contrast, approvals given to foreign investors rose by 3.9% to RM7,503.9 million or by 11.3% in US dollar terms to US$1,974.7 million during the period. Proposed investment approved for investors from the US, which received the highest approvals, declined by 1.6% to US$739.9 million or 37.5% of total investment approved to foreign investors. In the case of Japanese investors which accounted for the second highest approvals, the decline in approved investment was 47.8% to US$211.7 million or 10.7% of total approved investment. However, approved investment for investors from Singapore, which ranked third, increased marginally by 0.1% to US$166.2 million or 8.4% of total approved investment. Proposed investment approved for investors from other countries rose sharply by 74.8% to US$856.9 million, with Netherlands recording an increase of 725.5%, Switzerland, 438% and India 352.9%. Almost 80% of the proposed investment approved for foreign investors was in the electrical and electronics industries.

Investment in the services sector is expected to be subdued as existing capacity is generally sufficient to meet the present level of demand. This is particularly so in the utilities, transport and hotel industries. Additional investment is also not expected in the financial sector, given the ongoing efforts to consolidate the banking institutions to take advantage of economies of scale. Nevertheless, capital outlay in information technology related to the development of Multimedia Super Corridor (MSC) remains encouraging, with a total of RM2.1 billion expected to be invested in 1999, against RM1.5 billion in 1998.

In the agriculture sector, the level of private investment during 1999 is expected to be constrained by reduced revenue due to weaker prices of major commodities such as palm oil and rubber. Meanwhile, in the oil and gas sector, five major oil companies have reported that they would be increasing their investment by 52.9% to RM18.5

billion in 1999, against RM12.1 billion in 1998. Investment related to upstream activities by these companies would be raised by 40.8% to RM10 billion while investment in downstream activities would be increased by 69.5% to RM8.5 billion.

With output growth of the economy expected to accelerate during the second half of 1999, the overall level of excess production capacity would correspondingly decline. Foreign and domestic investors will, therefore, need to gradually increase their investments to enhance production capacity in response to rising sales orders. In fact, this has already occurred as evidenced by the reversal of imports of capital goods from negative growth prior to June 1999 to record an annual average rate of growth of 25.6% between June and August 1999 in terms of US dollar. Nevertheless, for the whole of 1999, investment from local investors is envisaged to decline by 28.5% to RM24.1 billion, while net foreign direct investment is expected to increase by 0.9% to RM10.7 billion.

Private consumption has recovered in 1999 and is expected to increase by 7.9% during the year to RM127.5 billion at current prices, after declining by 7.5% in 1998. Consumer confidence was boosted by higher disposable income and better employment opportunities following better economic conditions. Other factors that have induced a higher level of consumption include recovery of financial wealth following the improvement in the prices of shares traded in the local bourse, the prevailing low interest regime and a special financial assistance to eligible government employees. The higher level of consumption for both goods and services is reflected in the sale of passenger cars which has increased by 105.9%, motorcycles by 3.7%, import volume of consumption goods by 13.8% as well as collection of sales tax by 5.5% during the first eight months of 1999, after recording declines in the corresponding period of 1998.

Net External Demand

Exports of goods and non-factor services (excluding investment income) in real terms are expected to strengthen by an estimated 5.1% during 1999, after stagnating in 1998. This is largely due to higher volume of merchandise exports to the US and to the East Asian economies which import half of Malaysia's exports. However, the current value of exports of goods and non-factor services is expected to record a slower rate of increase of 6% to RM344.9 billion in 1999 (1998: 23.8%). The slower rate of increase is due to the effect of the exchange rate conversion of Malaysia's exports, of which 90% are settled in US dollar. The average exchange rate of the ringgit against the US dollar in 1999 was 3.2% stronger than in 1998. Conversely, it was 28.3% weaker in 1998 when compared with the average ringgit exchange rate against the US dollar in 1997.

The ringgit value of **merchandise exports** at free on board (f.o.b) prices is envisaged to increase at a slower rate of 6.7% in 1999 (1998: 29.5%) to RM300.9 billion. In US dollar terms, however, the increase would be 10.2% (1998: -2%) to US$79.2 billion, reflecting a stronger export volume off-take, largely of manufactured goods. Driven by exports of electronic equipment and parts as well as semiconductors, the export value of manufactured goods is expected to increase by 10.6% to RM263.5 billion in 1999 to account for more than 85% of total export value. On the other hand, weaker non-oil commodity prices for palm oil, rubber and cocoa is expected to affect export earnings from agriculture produce, which could decline by 15.4% to RM22.8 billion. However, in the case of exports from the mining sector, the value is expected to increase by 4% to RM14.5 billion due to higher crude oil prices.

Earnings from the export of **non-factor services** are also expected to turn around to record an increase of 1.4% to RM44 billion in 1999 (1998: -3.8%) due to the higher external trade volume, increased tourist arrivals by air transportation and larger number of foreign students studying in Malaysia. These factors are expected to contribute to Malaysia's increased foreign exchange earnings from the provision of services such as freight and insurance, air and other transportation as well as travel.

Imports of goods and non-factor services are estimated to increase at a faster rate of 5.1% to RM276.9 billion at current prices in 1999 (1998: 1.2%). This is due to **merchandise imports** increasing by 6.5% to RM226.8 billion at f.o.b prices (1998: 2.7%), as a result of higher import volume of consumption goods and intermediate goods, following improved consumer confidence and more active manufacturing sector activitity. **Imports of non-factor services** in current prices are envisaged to increase marginally by 0.6% to RM50.1 billion in 1999 (1998:-4.4%). This reflects higher payments for freight and insurance as well as on air transportation services borne by residents in view of the higher volume of merchandise imported and increased number of Malaysians traveling abroad.

With exports of goods and non-factor services expected to exceed imports by RM68 billion in current prices in 1999 as against a surplus of RM62 billion in 1998, the **external sector** is, therefore, envisaged to contribute an additional net stimulus of RM6 billion. This will account for 39% of the expected 5.4% increase in nominal GDP, which is equivalent to 30% of the 4.3% increase in real GDP expected in 1999. Thus, in 1999, the external sector is expected to contribute an increase of 2.1 percentage points in nominal GDP or 1.3 percentage points increase in real GDP. Changes in domestic demand, on the other hand, is expected to contribute 3.3 percentage points increase in nominal GDP and 3 percentage points increase in real GDP for the year.

Balance of Payments

The balance of payments position is expected to strengthen further in 1999, driven by a more favourable external trade balance and larger net inflow of long-term capital. The external trade balance which recorded a larger surplus of RM46.2 billion during the first eight months of 1999 (January-August 1998:+RM32.5 billion) is expected to continue to record surpluses for the remaining months of the year, as exports are envisaged to surpass imports. Consequently, the **merchandise account** of the balance of payments is envisaged to register a surplus of RM74.1 billion in 1999, 7.4% higher than the RM69 billion surplus registered in 1998.

The **services account**, on the other hand, is forecast to record a larger deficit, amounting to RM25.1 billion (1998: -RM22.3 billion). This is due to a larger net payment of investment income amounting to RM17.6 billion (1998:-RM14.8 billion), as a result of higher level of profits and dividends following higher earnings by foreign companies, especially from exports. Expanded volume of external trade in 1999 will also contribute to the continued large deficit in the services account through higher net payment on freight and insurance of RM9.8 billion (1998:-RM8.4 billion). At the same time, total net payments on professional, contractual and other services is expected to remain stable at RM4.3 billion. The travel account, however, is anticipated to record a higher net total receipts of RM4.4 billion (1998:+RM3.1 billion), resulting from increased tourist arrivals, higher number of foreign students studying in Malaysia and lower number of Malaysian students studying abroad. Net foreign exchange outflow due to **unrequited transfers** is envisaged to be lower in 1999, at RM7 billion, against RM9.9 billion in 1998. This is largely the result of the reduced number of foreign workers in the country and, consequentially, a lower amount of foreign exchange that is expected to be remitted by foreign workers.

The **current account** of the balance of payments is, therefore, expected to record an unprecedented surplus of about RM42 billion, equivalent to 15% of GNP in 1999 (1998: RM36.8 billion or 13.7% of GNP).

The **long-term capital account** of the balance of payments is likely to record a slightly higher net inflow of RM11.5 billion in 1999 (1998:+RM10.6 billion). This is attributed mainly to a higher net inflow of **official long-term capital** of RM5.3 billion (1998:2.1 billion), as the Federal Government and the Non-Financial Public Enterprises (NFPEs) draw down a larger amount of external loans and bonds that have been raised earlier. **Private long-term capital** is expected to record a lower net inflow of RM6.2 billion, against a net inflow of RM8.5 billion in 1998. The lower net inflow is attributed to the increase in external loans repayment by the private sector following the debt restructuring exercise and a slight increase in Malaysian investment abroad. Net foreign direct investment in Malaysia is estimated to increase to RM10.7 billion from RM10.6 billion in 1998. As a result, the surplus in the **basic account** of the balance of payments is expected to increase to RM53.5 billion in 1999 (1998:+RM47.4 billion). On the assumption that net outflow of **short-term capital** would be higher at RM22 billion in 1999 (1998:-RM20.6 billion) due to foreign investors booking in their capital and exchange gains as well as taking into account a net outflow of RM5.4 billion due to the errors and omissions such as exchange rate revaluation loss, the **overall position** of the balance of payments could register a slightly lower surplus of RM26.1 billion in 1999 (1998+RM40.3 billion).

Public Sector Financial Position

As a result of the expansionary fiscal stance adopted by the Government, the **overall financial position** of the Federal Government is expected to record a larger deficit in 1999. In part, the expected larger deficit is attributed to a stagnation in **Federal Government revenue** at RM56.7 billion, as a result of a 10.3% decline in direct tax collection to RM26.9 billion, following lower income tax revenue due to lower individual and corporate income recorded in 1998. With economic recovery now on track, indirect tax collection, on the other hand, is estimated to increase by 14.1% to RM17.5 billion, boosted by increased collection from excise and import duties as well as sales taxes. Similarly, non-tax revenue and other receipts are expected to increase by 8.1% to RM12.3 billion in 1999, largely due to increases in dividend and interest income.

To stimulate domestic demand, the Federal Government has targeted a total gross expenditure of RM74.9 billion in 1999, 19.5% higher than the actual expenditure of RM62.7 billion in 1998. **Operating expenditure** is expected to increase by 9.6% to RM48.9 billion (1998:-0.2%), largely due to higher allocations for emolument, supplies and services as well as debt service charges. Expenditure on emolument, which accounts for 29.2% of total operating expenditure, is envisaged to increase by 2.2% to RM14.3 billion. The increase is attributed partly to the special payment of RM600 to each eligible Government employee, amounting to RM325 million. Expenditure on supplies and services is being stepped up by an estimated 20.7% to RM6.3 billion to cater for repair and maintenance works as well as for professional services. Due to higher borrowings by the Federal Government in 1998 and in 1999 to finance its deficit, expenditure for debt service charges is expected to increase by 30.4% to RM9 billion, accounting for 18.5% of total operating expenditure. As a result, the **current account** of the Federal Government's financial position is expected to record a smaller surplus of RM7.8 billion in 1999, against a surplus of RM12.1 billion in 1998.

The fiscal stimulus undertaken by the Federal Government to reinvigorate the economy during 1999 is largely through its development expenditure. Thus, the total **gross development expenditure** allocated increased by 43.8% to RM26 billion (1998: 14.9%). The economic sector receives the largest portion (50.9%) of the development expenditure, amounting to RM12.7 billion, an increase of 37.7% over actual expenditure allocated to the sector in 1998. This is mainly to finance the upgrading and construction of roads, bridges and light rail projects, supply of water and electricity to rural areas as well as agriculture and rural development projects. The social services sector is also given a 20.9% increase in allocation for development expenditure amounting to RM7 billion, largely for the construction of schools and skills training institutions as well as for health amenities.

After taking into account loan recoveries and possible expenditure shortfall, **net development expenditure** is expected to increase by 25.7% in 1999 to RM21.5 billion against an actual net development expenditure of RM17.1 billion in 1998. With expenditure exceeding revenue, the Federal Government's overall financial position is expected to register a deficit of RM13.7 billion or 4.9% of GNP in 1999, against a deficit of RM5 billion or 1.9% of GNP in 1998. This is the second consecutive year that the fiscal position is in deficit, after having recorded yearly surpluses since 1993 through 1997. Given ample liquidity in the economy as a result of a larger trade surplus, 75.5% of the 1999 fiscal deficit would be financed through domestic borrowing, mostly through the issuance of Government Securities.

The **consolidated public sector account** largely reflects the Federal Government's financial position. The **revenue of the general government** (comprising Federal Government, state governments, local governments and statutory bodies) is expected to decline by 1.1% in 1999 to RM68.6 billion (1998: RM69.4 billion). On the other hand, the **consolidated operating expenditure** is expected to increase by 11.5% to RM56.1 billion (1998: RM50.3 billion), largely on account of higher debt service charges. Consequently, the current account surplus of the general government could be lower in 1999, at RM12.5 billion (1998: RM19.1 billion). After taking into consideration the lower current account surplus of RM19.6 billion of the **NFPEs** (1998:+RM22.5 billion), the **consolidated current account** of the public sector in 1999 is expected to register a lower surplus of RM32.1 billion (1998: +RM41.6 billion).

Total **development expenditure of the public sector** is estimated to increase by 9.7% to RM48.6

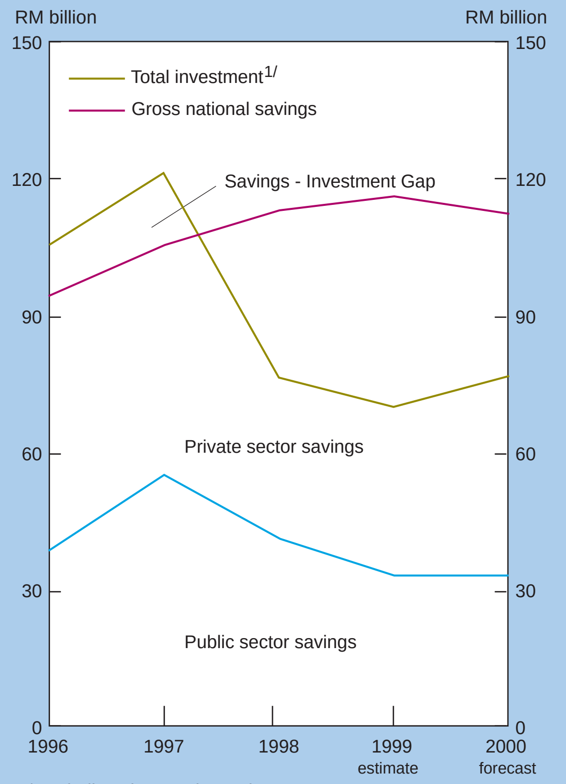
billion in 1999 (1998: RM44.3 billion) due to a significant increase in general government development expenditure. However, development expenditure of NFPEs is envisaged to decline by 14% to RM23.4 billion (1998: RM27.2 billion) as major NFPEs consolidate their position. As a result, the **overall public sector financial position** in 1999 is expected to record a higher deficit of RM16.4 billion or 5.8% of GNP (1998: deficit of RM2.7 billion or 1% of GNP).

National Resource Position

Against a background of national income increasing at a relatively faster rate than the rate of increase in aggregate domestic expenditure and lower net unrequited transfer payments, the **nation's resource position** is anticipated to record a bigger surplus of RM42 billion in 1999 or 15% of GNP (1998:+RM36.8 billion or 13.7% of GNP). This surplus is indicative that the level of **gross national savings,** which is expected to increase by 0.4% in 1999 to RM113.2 billion (40.3% of GNP), is more than sufficient to finance the level of **gross fixed capital formation** (including changes in stocks), which is expected to decline by 6.2% to RM71.2 billion (25.3% of GNP).

The increase in the nation's resource surplus is attributed largely to the private sector. **Private sector savings** are expected to increase at a slower rate of 16.6% to RM83.9 billion (1998: +45.5%) due to the recovery in consumption. The level of private sector investment, however, is estimated to decline by 19.7% to RM35.4 billion, given the prevailing excess production capacity. Consequently, the **private sector resource position** is anticipated to register a surplus of RM48.5 billion or 17.3% of GNP in 1999 (1998 : 10.3% of GNP). The **public sector resource position**, however, is expected to register a deficit of RM6.5 billion or 2.3% of GNP in 1999 (1998: +3.4% of GNP). This reflects the impact of increased public sector capital formation by 12.5% to RM35.8 billion, amidst a 28% decline in **public sector savings** to RM29.3 billion as a result of the lower current account surplus. Given the large surplus resource position of the private sector, much of this surplus can and have been mobilised through institutions such as the Employees Provident Fund to finance the public sector deficit through the purchases of fixed income Government Securities.

Chart 1.2
Savings - Investment Gap



1/ Including changes in stocks

Monetary Developments

The continued easing of monetary policy, a recovery in economic activities and an improving balance of payments position have contributed to the expansion of money supply in the first eight months of 1999. The **broad monetary aggregate, M3**, increased at a faster rate of 4.7% or RM18.9 billion during the period against an increase of 2.7% or RM10.6 billion for the whole of 1998. The main contribution to the growth of money supply was the external sector, given a larger external trade surplus, external borrowing by the Government and private sector capital inflows. However, the private sector exerted a contractionary impact on money supply due to the decline in loans extended to the sector, resulting from higher loan repayments to the banking system and the sale of non-performing loans (NPLs) by the banks to Pengurusan Danaharta Nasional Berhad (Danaharta).

Total **loans outstanding** (including loans sold to Cagamas and Danaharta) provided by the banking system declined by RM2.4 billion or 0.6% during the first eight months of 1999, that is from an outstanding amount of RM426.6 billion as at end 1998 to RM424.2 billion as at end August 1999. On an annual basis, the outstanding loans at the end of August 1999 was 0.5% higher compared with the amount at end of August 1998. The marginal loan growth reflected higher payments. More recently, total loans outstanding had also been adversely affected by write-offs of loans and conversions into bonds and equities. Hence, approvals and disbursements of loans are currently more reflective of lending activities than loans outstanding. In this regard, both approvals and disbursements of loans had improved significantly in the first eight months of 1999. Loans approved averaged RM8.2 billion a month during the first eight months of 1999 (RM5.4 billion a month in 1998), while loans disbursed averaged RM26 billion a month (RM20.9 billion a month in 1998). In view of the higher loans approved as well as the improvement in economic activities, loan growth is expected to increase further during the remaining months of 1999. Deposits with the banking system increased at a rate of 2.1% or RM9.2 billion during the first eight months of 1999, from RM431.4 billion at the end of 1998 to RM440.6 billion at the end of August 1999, while on an annual basis, the increase was 4.2%. As a result, the loan-deposit ratio of the banking system declined from 91.4% as at end 1998 to 85.7% as at end August 1999, reflecting increasing liquidity in the system.

The easier liquidity position has been accompanied by the deceleration in inflation rate from 5.2% in January 1999 to 2.1% in September. In the absence of inflationary pressures, **BNM's intervention rate** was gradually reduced during the year from 7.00% to 6.50% on 5 April 1999; to 6% on 3 May; and to 5.5% on 9 August. The reduction is to provide greater flexibility to banking institutions to reduce lending rates to support the economic recovery process. With the reduction in BNM's intervention rate and the easing of liquidity, the average **base lending rates (BLRs)** of both the commercial banks and finance companies declined from 8.04% and 9.50% at end of 1998 to a historical low of 6.79% and 7.95% respectively at end August. These rates have remained unchanged up to end September. At the same time, average 3-month **deposit rates** of both the commercial banks and finance companies continued their downward trend from 5.83% and 6.43% respectively at end of 1998 to 3.75% and 3.81% in September, the lowest level since 1988. However, as these rates remained above the inflation rate which averaged 3.0% during the first nine months of 1999, depositors still received positive real rates of return.

Stock Market

The benchmark Kuala Lumpur Composite Index (KLCI) rose by 23% to 721.18 points as at 15 October 1999 from 586.13 points at the end of 1998. The total volume traded on the Kuala Lumpur Stock Exchange (KLSE) rose by 83.2% to 72.9 billion units during the first nine months of 1999, against 39.8 billion units during the corresponding period of 1998. The continued recovery in the KLCI reflected increased investor confidence, indications of a broader based economic recovery, strengthening of economic fundamentals and expectations of better corporate results. Although the KLSE began the first quarter on a weaker note, the KLCI turned around in the second quarter to close at 811.10 points at end-June 1999. The upward trend in the KLCI was further boosted by growing confidence in the sustainability of the country's economic recovery, large monthly external trade surpluses, net inflow of funds following the introduction of a graduated exit levy since 15 February 1999, the reduction in interest rates as well as the return of stability to regional financial markets.

However, during the third quarter of 1999, the KLCI trended downward in tandem with the decline in regional indices due to a number of adverse external developments. These developments included concern about China-Taiwan political tensions, political instability in East Timor, fears of a further hike in US interest rates as well as the widening US trade deficit and the appreciation of the yen which could derail Japan's economic recovery. Market sentiments in the local bourse during the third quarter were also affected by the prospect of a massive withdrawal of foreign funds beginning 1 September 1999 when the one-year moratorium on the repatriation of portfolio capital expired. However, actual outflow beginning early September was lower than expected. Subsequent announcement on the introduction of a flat 10% exit levy on 21 September was well received by investors, leading to a 4.1% or 29.27 points jump in the KLCI to close at 739.30 points on the day of the announcement. However, adverse external developments in the region affected the local bourse in September, causing the KLCI to close at 675.45 points at end-September 1999. The KLCI has since recovered, following announcements of a larger external trade surplus and a stronger growth in Industrial Production Index for August to close at 721.18 points on 15 October 1999. The market capitalisation of the KLSE stood at RM487 billion on the same day, 30% higher than market capitalisation of RM374.52 billion at the end of 1998.

Inflation and Property Prices

Inflation rate, as measured by the annual rate of increase in the Consumer Price Index (CPI), continued to decelerate from a high of 6.2% in June 1998 to 2.1% in September 1999. On average, the CPI increased by 3.0% during the first nine months of 1999, against 5.2% during the corresponding period of 1998. Major factors that have contributed to the relatively low inflation rate are the mild recovery in domestic demand against a background of excess production capacity; lower cost of production as indicated by the 4.8% decline in Producer Price Index during the first eight months of 1999 largely as a result of lower non-oil primary commodity prices such as palm oil and rubber; stronger ringgit exchange rate since 2 September 1998 when compared with the ringgit average exchange rate during the first eight months of 1998; and subdued rate of inflation among Malaysia's major trading partners.

Food continued to record an above average rate of increase in CPI during the first nine months of 1999, of 5.0% (January-September 1998:+8.9%), partly due to supply constraints. The price of fish recorded the most significant increase of 11.2%, while other food items such as rice, bread and other cereals, coffee and tea, and milk and eggs registered increases of 5.3%, 4.6% and 4.3% respectively. The CPI for non-food increased at below average rate of 1.9% (January-September 1998: 3.1%), although the CPI for beverages and tobacco registered a 9.4% increase due to higher duties imposed on these items in the 1999 Budget. For the whole of 1999, the increase in the CPI is estimated at about 3.0%.

Prices of residential properties on the average was lower in the first half of 1999 when compared with the corresponding period of 1998, as indicated by the 12% annual rate of decline in the **Malaysian House Price Index.** Among the various types of houses, detached houses recorded the steepest price decline (-13.4%), followed by semi-detached houses (-10.9%) and terrace houses (-7.8%). Comparison by states indicate residential properties in Selangor recorded the sharpest decline (-16.4%), followed by Malacca (-12.1%) and Kuala Lumpur (-6.8%). The drop in the price of residential properties reflects the continuing high level of stocks of higher priced properties, which forced developers to sell at a lower price to reduce holding costs; reduced affordability on the part of purchasers to buy higher priced properties as a result of erosion of their financial wealth due to sharp decline in share prices from pre-crisis level; and developers shifting their focus to development of low and medium-cost houses where demand remains encouraging.

Labour Market

The employment situation has improved in tandem with the recovery of the economy. Indicative of this is the 11.7% increase in the number of outstanding contributors to the Employees Provident Fund to 9.45 million contributors as atend of September 1999, against 8.46 million outstanding contributors a year earlier. At the same time, based on the survey by the Department of Statistics, the number of workers employed in the manufacturing sector has increased by 4.3% to 943,976 workers in July 1999, from 905,304 workers in July 1998. Job vacancies reported to the Manpower Department on a monthly basis has more than doubled to 12,876 vacancies in August 1999 from 6,005 vacancies a year earlier, reflecting increasing demand for labour, especially skilled labour. With the economy expected to further strengthen in the fourth quarter, **total employment** in 1999 is, therefore, estimated to increase by 1.7% to 8.741 million workers, after a decline of 2.5% in 1998. As the size of the **labour force** is expected to increase by 1.5% to 9.01 million, the **unemployment rate** is expected to decline to 3.0% of the labour force, that is about 270 thousand workers, slightly lower than 1998's level of 3.2% or 284 thousand workers. Indicative of the lower unemployment rate, the number of workers reported to have been retrenched declined from a high of 12,335 workers in July 1998 to 1,328 workers in August 1999.

In line with the moderate increase in demand for labour, wage pressure is generaly subdued during 1999. During the first nine months of 1999, the average monthly basic wage of contributors to the Employees Provident Fund declined by an estimated 10.8% to average RM652 per employee, against RM731 per employee during the corresponding period of 1998. In the manufacturing sector which is the main source of demand for additional workers, the average monthly wage of all categories of employees decreased at an annual rate of 1% during the first seven months of 1999 to RM1,268 per employee (January-July 1998: 6.4% to RM1,280). Manufacturing industries which recorded sharper average monthly wage increases were food, beverages and tobacco industry by 1.9% to RM1,411 and rubber products industry by 1.1% to RM1,076. Labour productivity in the manufacturing sector during the period has also improved, largely due to increased utilisation of excess production capacity as sales orders picked up, leading to a more efficient use of workforce. Average output per employee, for instance, increased by 0.4%, compared with a decline in average monthly wage, while sales per employee rose by 4.6% to RM21,082 per month during the first seven months of 1999 (January-July 1998:RM20,147), following a 4.3% increase in average unit selling price. Consequently, cost of labour per RM100 of sales in the manufacturing sector has declined by 5.4% to RM6.01 during same period from RM6.36 during the first seven months of 1998.

Prospects for 2000

Malaysia's economic recovery is expected to gather further momentum in 2000. Underlying this positive outlook is an economy that is becoming increasingly more resilient to external shocks and systemic risks, made possible by recent policy measures to strengthen the nation's external reserves position, financial system and the corporate sector. In addition, the prevailing low rate of inflation and the nation's large surplus resource position allow further demand stimulus measures to be taken in 2000 to sustain the economic recovery process within the context of maintaining macroeconomic stability. At the same time, the international economic outlook, as projected by the International Monetary Fund, will continue to remain favourable. World output is expected to expand at a faster rate of 3.5% (1999: 3.0%) due to stronger recovery in regional economies, while major industrial economies are forecast to sustain an average growth rate of 2.4% (1999: 2.6%) due to firmer growth in Japan and Europe which would offset an anticipated slowdown in US growth. World trade volume is, therefore, expected to accelerate to 6.2% growth in 2000 (1999: 3.7%).

Consequently, barring any major downside risks that could derail the favourable world economic outlook, these developments should provide the necessary impetus for Malaysia's real GDP to expand at a faster rate of 5% in 2000. Underpinning the expected higher output growth would be domestic demand which is forecast to strengthen further due to stronger growth in private consumption and a recovery in private sector investment as well as through additional fiscal stimulus. On the other hand, the contribution to growth from the external sector is expected to be less expansionary. This will be largely due to expected stronger growth in imports as a result of stronger domestic demand, leading to a lower though still significant surplus in the current account position of the balance of payments.

The stronger real GDP growth and moderate increase in domestic demand may lead to a moderate increase in the inflation rate from a low of 2.1% recorded in September 1999 to average at 3.0% in 2000. This takes into account that the inflation rate in Malaysia's major trading partners will remain low and imported inflation will not be fully transmitted through the economy, given that 73% of Malaysia's merchandise imports are intermediate goods which are largely re-exported after processing.

With stronger output growth and relatively stable prices, GNP in current prices is projected to increase by 5.3% to RM295.8 billion in 2000. Consequently, the nation's per capita income is forecast to increase by 2.9% to RM12,724.

Sectoral Output Performance

The **manufacturing sector** will benefit from the stronger growth expected in world trade, a robust recovery in the East Asian economies and stronger domestic demand. Manufacturing output is therefore, forecast to sustain a robust growth of 8% in 2000. Export-oriented manufacturing industries are expected to step up their output by an average of 7.9%, driven largely by continued strong overseas sales orders for electronic products and parts, underpinned by rapid advancement in information technology applications, including e-commerce. Domestic market-oriented manufacturing industries are forecast to continue to record significant output growth of 9.2%, underpinned by stronger domestic demand. The transport equipment industry is expected to remain a major source of growth among the domestic market-oriented manufacturing industries, as firms producing passenger cars and motorcycles are likely to benefit from the anticipated strengthening in consumer confidence. Meanwhile, manufacturing industries producing construction related materials such as non-metallic mineral products should see a recovery in output growth, as construction activity is expected to recover in 2000.

Although construction activity of high-rise buildings will continue to be affected by excess supply of office space and retail outlets as well as high-end condominiums, the **construction sector** could recover by 5% in 2000. Underpinning this recovery will be the acceleration in civil engineering works, following higher budgetary allocation for the construction and upgrading of roads, bridges, ports and airports, drainage and irrigation, schools, industrial training institutions, hospitals and other health facilities. In addition, activity-related to the construction of low and medium cost properties is expected to pick up. This is in view of higher budgetary allocation for housing projects as well as expected increase in demand for these properties against a background of higher disposable income, expected continuation of a low interest rate regime and easy access to bank credit. With private sector investment expected to recover in view of the need of some industries to expand capacities to meet stronger sales orders, activity related to construction of new factories and extension of existing production facilities should also pick up, thereby, providing a fillip to the construction sector. Consequently, the value added growth in the secondary sector of the economy is anticipated to accelerate to 7.7% in 2000 (1999:7.3%).

In the primary sector, value-added is expected to continue to expand but at a lower rate of 2%, with agriculture output growth decelerating and mining sector output declining by a narrower margin. A slowdown in agriculture output growth to 3.8% is forecast, attributed mainly to a sharp deceleration in the output growth of the oil palm industry to 4.5%, compared with 19.4% in 1999, as well as further 2% decline in rubber production. However, other crops such as cocoa and pepper are expected to record stronger growth due to continued favourable, albeit, lower prices, while a mild recovery in output of livestock and forestry output is expected as demand improves.

In the **mining sector**, value added is projected to decline marginally by 0.2% in 2000 due to a 3.5% planned cutback in the production of crude petroleum from 712,700 barrels per day in 1999 to 685,600 barrels per day. However, a recovery in gas output by a projected 11.9%, in tandem with recovery of demand from East Asian economies is expected. This coupled with higher output of the quarrying industry, following a recovery in the construction sector, would provide a boost to the mining sector.

Value-added of the **services sector** is forecast to increase at a faster rate of 5.3%, with all services providing industries projected to record stronger growth. The transport, storage and communications sub-sector is anticipated to register the most robust growth, that is by 6.5%, in view of expected higher volume of goods and passengers transported and increased demand for telecommunications services as economic activities further pick up. The sub-sector is also expected to get a boost from Telekom Malaysia Berhad which is planning to upgrade and expand its TM Net services capacity from the current 364,000 dial-up customers to 1.5 million customers by the end of 2000 through additional investment of RM644 million. The value added of the finance, insurance, real estate and business sub-sector is expected to register a growth of 5.6%. In part, this is attributed to the emergence of a stronger and a well capitalised banking system, following the success of Danaharta, Danamodal Nasional Berhad (Danamodal) and the Corporate Debt Restructuring Committee in addessing the NPL and capital adequacy problems. Higher level of economic activities and increasing number of households expected in 2000 should also boost the demand for utilities, enabling the electricity, gas and water sub-sector to register a growth of 5.5%. In the wholesale and retail trade, hotel and restaurant sub-sector, the value-added of services provided is projected to increase by 4.5%, in response to stronger demand following higher disposable income of customers and expected increase in inflow of tourists, particularly from East Asia. As a result, the overall value added of non-government services is forecast to increase by 5.4%, while that of the government services by 4.8%. The increase in the value added of the latter is largely due to further upgrading and expansion of health, education and skills training services.

Domestic Demand

Aggregate domestic demand for goods and services (excluding changes in stocks) is projected to expand at a faster rate of 9.2% in 2000 to RM251.8 billion in current prices. This is attributed to anticipated turnaround in **private sector expenditure**, with an increase of 11.8% to RM181.4 billion. **Private consumption** is envisaged to increase by 12.6% to RM143.5 billion, reflecting strengthening of consumer confidence as employment prospects and disposable income improve. It also reflects the impact of ongoing public policy stance of encouraging private sector spending through measures such as maintaining a low interest rate regime. **Private investment** is projected to turn around to register a positive growth of 9% in 2000 to RM37.9 billion. The increase in investment is largely from the export market-oriented manufacturing industries such as the electrical and electronics industries which have been given higher investment approvals by MIDA in 1999. In the oil and gas sector, five major oil companies have indicated their plans to step up investment by 10.5% to RM20.5 billion. Investment in upstream activities is projected to increase by 15.3% to RM11.6 billion, while for downstream activities, a further 4.8% increase in investment to RM8.9 billion is planned. Due to excess capacities, the domestic market-oriented manufacturing industries as well as the construction and services sectors are not expected to undertake any major investment in 2000. Similarly, no significant change is expected in the level of investment in the agriculture sector, as palm oil price on the average is expected to be lower than in 1999 while prices of other commodities are expected to remain at around the 1999 levels.

Public sector expenditure, on the other hand, is expected to increase further but at a slower rate of 3% to RM70.4 billion, after recording a substantial increase of 13.1% in 1999. **Public sector consumption** of goods and services is budgeted to increase by 0.8% to RM33.5 billion, following an increase of 16.7% in 1999. The slower increase is attributed to a 36.2% reduction in defence expenditure and a slower increase in general government emolument. Nevertheless, public sector consumption of supplies and services is projected to sustain a growth of 11.2% to RM13.4 billion.

Public investment is similarly forecast to increase at a slower rate of 5% to RM36.9 billion, after recording an increase of 9.9% in 1999. This is attributed largely to a 6.8% contraction in investment by NFPEs to RM17.2 billion. As a continuing effort to stimulate the economy through budgetary allocations, the Federal Government plans to increase its investment by another 20.7% to RM12.5 billion in 2000, following an increase of 15.5% in 1999. Investments by state governments, local authorities and statutory bodies are projected to increase by 14.2% to RM7.1 billion, following a decline of 7% in 1999.

Net External Demand

Exports of goods and non-factor services are projected to sustain a stronger growth of 8% in 2000 to RM372.5 billion at current prices. This is partly due to a further pick-up in the growth of **merchandise exports** to 8% (1999:6.7%) with a value of RM325 billion at f.o.b. prices. Stronger demand from East Asia and the US is anticipated to stimulate the growth of manufactured exports by 11.4% while a turnaround in the export value of gas due to higher export volume and better export prices should help to boost exports of the mining sector by 8.1%. However, the export value of agriculture commodities are projected to decline by 6.7%, mainly due to an expected reduction in the export earnings of crude palm oil and palm kernel oil on account of weaker prices, as well as lower export earnings from rubber and sawlogs due to declining export volume. At the same time, **exports of non-factor services** are projected to increase moderately by 7.7% to RM47.4 billion, due to expected increase in foreign exchange earnings from provision of shipping, insurance, air transportation, tourism, education and professional services to non-residents.

With the expected pick up in aggregate demand, **imports of goods and non-factor services** are projected to increase at an accelerated rate of 11.5% (1999:5.1%) to RM308.7 billion. **Merchandise imports** at f.o.b. prices are forecast to increase at a double-digit rate of 12.6% to RM255.3 billion, reflecting stronger growth in the import of consumption, intermediate and capital goods. Similarly, **imports of non-factor services** are projected to increase at a faster rate of 6.6% to RM53.4 billion, as higher imports of merchandise will lead to increased payments on freight and cargo insurance, while increased economic activities and higher disposable income will lead to higher demand and, therefore, payments for services provided by non-residents such as for air transportation, travel and professional services.

With the value of exports expected to exceed imports of goods and non-factor services by a narrower margin of RM63.8 billion, the net stimulus provided by the **external sector** to economic growth in 2000 will be less expansionary.

Balance of Payments

As the value of merchandise imports is projected to increase at a relatively faster rate than merchandise exports, the **merchandise account** surplus is expected to narrow to RM69.8 billion in 2000, against a surplus of RM74.1 billion in 1999. At the same time, the **services deficit** is forecast to widen further to RM27.5 billion. This is largely attributed to higher net payments on investment income of an estimated RM20 billion as a result of expected increase in the repatriation of profits and dividends due to higher earnings by foreign investors. The deficit is also due to the expected increase in net payments for freight and insurance (-RM10 billion) and contract and professional services (-RM4.1 billion). Nevertheless, an increase in net receipts is envisaged from “other transportation” (+RM2.6 billion) due to higher earnings expected from transportation of air passengers, and travel (+RM4.3 billion) in view of expected larger inflow of tourists and foreign students studying in Malaysia. After taking into account net unrequited transfer payments of RM6.5 billion, mainly due to remittances by foreign workers, the **current account** of the balance of payments is projected to record a smaller surplus of RM35.8 billion or 12.1% of GNP in 2000.

Public Sector Financial Position

The fiscal stance of the Federal Government in 2000 is to continue to support the economic recovery process through an expansionary budget, while, at the same time, maintaining fiscal prudence by ensuring the current account of its financial position remains at least in balance and that overall deficit does not exceed 6% of GNP. In managing the deficit, the over-riding objective is to achieve sustainable growth within the context of macroeconomic stability and, at the same time, avoid crowding out the private sector’s access to resources.

Reflecting its expansionary fiscal stance, the **Federal Government** has budgeted 7% increase for its **operating expenditure** in 2000 to RM52.4 billion to stimulate economic activities through higher consumption expenditure. With **revenue** expected to improve by 5.7% to RM59.9 billion due to higher collections of both direct and indirect taxes, the **current account** of the Federal Government is expected to record a surplus of RM7.5 billion. **Gross development expenditure** of the Federal Government is budgeted at RM24.7 billion, 2.7% lower than the allocation for 1999. Although the budgeted level of development expenditure is lower, the potential demand stimulus to the economy from the development expenditure is larger. Discounting transfer payments, investment undertaken by the Federal Government is projected to increase by 20.7% to RM12.5 billion, against RM10.4 billion in 1999. After netting out loan recoveries, **net development expenditure** is forecast at RM20.5 billion. As a result, the **overall budgetary deficit** is anticipated to increase to RM13 billion but, in terms of GNP, it will be lower at 4.4%.

However, the **consolidated public sector financial account** is projected to record a lower deficit, due to the higher operating surplus of the NFPEs. The **general government consolidated revenue** is projected to increase by 5.7% to RM72.5 billion while its **operating expenditure** is projected to increase by 9.4% to RM60.6 billion, largely on account of increased spending by the Federal Government. As a result, the current account of the general government is projected to record a lower surplus of RM11.9 billion (1999:+ RM13.2 billion). As earnings by major NFPEs such as

PETRONAS and Telekom Malaysia Berhad are expected to improve, the current account surplus of the NFPEs is projected to increase by 10.7% to RM21.7 billion. Thus, the **consolidated current account position** of public sector finance is projected at RM33.6 billion. Development expenditure of the public sector is projected to increase by 1% to RM48.4 billion, attributed mainly to higher development expenditure of the general government. The public sector is, therefore, forecast to record a lower financial deficit of RM14.8 billion or 5% of GNP in 2000 (1999:-5.4% of GNP).

National Resource Position

With total consumption expenditure expected to increase at a faster rate of 10.1% than the 5.3% increase projected for gross national income, **gross national savings** could decline by 0.7% to RM112.4 billion or 38% of GNP in 2000. Nevertheless, this level of savings would be sufficient to finance the expected level of **gross fixed capital formation** (including accumulation of inventory) which could increase by 7.6% to RM76.6 billion. However, the **national resource position** would register a lower surplus of RM35.8 billion or 12.1% of GNP, on account of the lower resource surplus expected to be recorded by the private sector, that is RM41.9 billion or 14.1% of GNP. Private sector savings are expected to decline by 3.8% to RM80.7 billion, while its investment is envisaged to increase by 9.6% to RM38.8 billion in 2000. As for the public sector, its resource deficit is projected to narrow slightly to RM6.1 billion or 2% of GNP. The level of its savings is anticipated to increase by 8.2% to RM31.7 billion, while its investment is forecast to increase at a slower rate of 5.6% to RM37.8 billion.

Inflation

The inflation rate is expected to be stable, with CPI increasing by an average of 3% in 2000. Factors contributing to the stable inflation outlook are the subdued inflation rate forecast among Malaysia's major trading partners, a moderate increase in real aggregate domestic demand which by 2000 would still be below 1997 absolute level and the continuing slack in production capacities among domestic market-oriented industries. Wage pressures are also not expected to be a major issue, as the labour market in 2000 is not expected to be as tight as in pre-crisis level.

Employment Situation

With the real economy projected to record a higher growth of 5%, employment opportunities should continue to improve, with the number of people employed increasing by 2.1% to 8.92 millions. Given that the size of the labour force is expected to expand by 2% to 9.194 million workers, unemployment rate in 2000 is forecast at 3%.

Conclusion

The Malaysian economy has recovered from the deflationary impact of the regional financial crisis and is poised to achieve a real GDP growth of 4.3% in 1999. This recovery is accompanied by a strengthening of the nation's resilience to potential external shocks and systemic risks as well as macroeconomic stability. The current account position of the balance of payments has further improved during the year, with external reserves position surpassing the 5 months of retained imports targeted under the National Economic Recovery Plan. The banking system has been fully recapitalised by end June 1999 while its non-performing loans is at a manageable level. Inflation has also decelerated.

The year 2000 should see a stronger and a more broadbased recovery of the Malaysian economy, if the external environment remains favourable. Macroeconomic stability will be sustained, with the external payments current account position projected to continue to record a large surplus, thereby, increasing further the nation's external reserve position, while inflation rate is expected to stabilise at the 1999 level. Nevertheless, there are downside risks associated with external developments that could pose a threat to Malaysia's economic recovery process. Thus, the focus of macroeconomic policy would continue to be the promotion of economic growth, while enhancing the resilience and competitiveness of the economy.