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The Performance of the Malaysian Economy in 2000 and Prospects for 2001

The Performance of the Malaysian Economy in 2000

The Malaysian economy rebounded strongly in 2000 after recovering from the sharp output decline in 1998 and early 1999 following the financial crisis. Economic turnaround, which began in the second quarter of 1999, has since become well-entrenched, underpinned by the return of confidence and a more stable economic environment made possible by the introduction of selective capital controls and the pegging of the ringgit. The economic recovery, initially led by the strong performance of external demand, has become broad-based, driven by the increase in aggregate domestic demand following the impact of expansionary fiscal and accommodative monetary policies. Reflecting these trends, real Gross Domestic Product (GDP) registered a growth of 10.3% in the first half, based on growth of 11.9% in the first quarter and 8.8% in the second quarter. Based on performance in the first half of the year and the sustained growth for the second half, real GDP is expected to register a growth of 7.5% in 2000, higher than the estimate of 5.8% announced in February this year when the 2000 Budget was retabled in Parliament. Following the expected increase in nominal Gross National Product (GNP) of 7.2%, GNP per capita is forecast to register growth of 4.7% to RM12,883 (US\$3,390) (1999: RM12,305 or US\$3,238). In terms of purchasing power parity, per capita income is estimated to increase by 6% to US\$7,716 (1999: US\$7,277).

On the supply side, growth is expected to remain broad-based with all sectors anticipated to register positive growth. Growth is expected to emanate mainly from the stronger expansion of the manufacturing and services sectors. Value added of the manufacturing sector is expected to register

a strong growth of 17% (1999: 13.5%), driven by the double-digit expansion of both export and domestic-oriented industries. Growth of the agriculture, forestry and fishing sector is anticipated to remain marginal at 0.5% (1999: 3.8%) as the production of crude palm oil is expected to register a marginal increase of 0.9% while production of rubber is expected to decline further (-8.9%). Meanwhile, following two years of contraction, the construction sector is expected to recover moderately to register positive growth of 3.1% (1999: -5.6%) underpinned by the stimulus provided by public sector projects, particularly privatised infrastructure as well as from the construction of schools and low-cost housing. Output of the mining sector, however, is estimated to turn around to expand at 0.6% (1999: -3.1%), due mainly to higher production of crude oil and natural gas. Consistent with the improvement in the overall economy, the services sector is expected to expand at 4.9% (1999: 3.3%).

In terms of demand, growth in aggregate domestic demand is expected to be broad-based driven by the expansion in both private and public expenditures. Aggregate demand at current prices is expected to expand strongly by 16% (1999: 1%). Robust growth of 17.6% is expected from the private sector (1999: -3.3%) while the public sector will continue to expand by 12.4% (1999: 12.5%), reflecting the strong fiscal stimulus. The higher public expenditure is mainly due to substantially higher public investment of 14.5% in nominal terms (1999: 7.9%) and moderate growth (10.1%) in public consumption (1999: 17.6%). The high growth in private expenditure is due to stronger consumption spending of 15.1% (1999: 5.6%), following a marked improvement in consumer confidence as the economy recovers strongly, disposable incomes rise and the export sector continued to perform favourably. With the

expected higher consumption, gross national savings to GNP is expected to decelerate to 37.2% (1999: 41.1%). The nation's resource position will, however, remain in surplus at 9.9% of GNP (1999: 17.1%) with total investment estimated at 27.3% of GNP (1999: 23.9%). The surplus is expected to emanate mainly from the private sector given that the overall Federal Government's financial position is expected to be in deficit.

The balance of payments is expected to remain favourable despite some narrowing of the current account surplus. The merchandise account is expected to register a narrower but nevertheless, large surplus of RM74,329 million (1999: RM86,535 million) due to the faster growth of imports vis-a-vis exports. The lower merchandise surplus, together with higher services deficit of RM37,106 million, due primarily to higher net outflows for freight and insurance and investment income and transfers, are expected to lead to a narrowing but nevertheless sizeable surplus of RM29,756 million or 9.9% of GNP (1999: RM47,902 million or 17.1% of GNP). The long-term capital account is expected to register a lower surplus of RM6,683 million (1999: RM12,598 million) in tandem with the anticipated smaller net inflows of official and private long-term capital and larger net outflows of short-term capital. After taking into account the expected capital outflows, the overall balance of payments position is expected to record a surplus of RM8,156 million (1999: RM17,819 million).

Inflation, as measured by the Consumer Price Index (CPI), is expected to remain low at 1.9% (1999: 2.8%) after taking into account the recent domestic price increases for petrol, diesel and liquefied petroleum gas (LPG). The Producer Price Index (PPI) is expected to increase by 4.4%. In consonance with the economic recovery, the economic situation is expected to have a favourable impact on employment generation, creating 186,000 new job opportunities while the number of retrenched workers is anticipated to decline to 14,600 persons (1999:24,036 persons).

Sectoral Output Performance

All sectors are expected to register positive growth in 2000 with the recovery becoming increasingly broad-based during the course of the year. The manufacturing sector is expected to lead growth

given the anticipated double-digit growth in both export and domestic-oriented industries. The services and construction sectors are also expected to register higher growth compared with 1999. Growth in the agriculture sector is expected to be lower than 1999 while marginal growth is anticipated for the mining sector.

Growth in the **manufacturing sector**, which began in 1999, accelerated well into 2000 with double-digit growth registered for 15 consecutive months to date. Underpinned by strong global demand in electronic products, economic recovery in Asia as well as the continued improvement in domestic demand, value added in the manufacturing sector is envisaged to record a significant growth of 17% in 2000. The export-oriented industries are expected to spearhead growth due to continued strong global demand in electronic products and sustained economic growth in the United States (US) and Asia. Output of the export-oriented industries is estimated to expand by 22.4% (1999: 10.8%). Likewise, the growth of domestic-oriented industries is also expected to be maintained in 2000, with growth estimated at 17% on the back of rising incomes, lower interest rates as well as accelerated public spending on infrastructure. As the sector's output growth is expected to surpass growth in GDP, its share to real GDP is expected to increase to 32.6% (1999: 30%).

Value added of the **agriculture, livestock, forestry and fishing sector** is expected to expand marginally at 0.5% (1999: 3.8%). After a substantial increase in output in 1999, production of crude palm oil is expected to moderate to 0.9% in 2000, mainly due to the downturn in the biological yield cycle of oil palm trees. Rubber production is expected to decline due to low prices and the continuing conversion of rubber land to commercial, industrial and residential uses. Similarly, production of saw logs is also expected to register a small increase of 1.2% to 22.06 million cubic meters (1999: 21.80 million cubic meters). The output of the fishing sub-sector, including marine landing and aquaculture, is envisaged to increase by 0.8% (1999: 3.4%), while livestock output is expected to expand by 7.9% due to higher domestic consumption. As a result, the share of the agriculture, forestry and fishing sector to overall GDP is forecast to decline to 8.8% (1999: 9.4%).

Chart 1.1
Key Economic Indicators



1/ End of March, June, September and December including Repos, except for 2000, which represents end of March, June and August).
2/ Malaysia (CPI up to September 2000).

In the **mining** sector, a marginal increase of 0.6% in output is expected (1999: -3.1%), reflecting the small increase of 0.4% in crude oil production to 695,718 barrels per day (bpd) (1999: 694,868 bpd). Natural gas production will, however, increase by 4.6% to 3,882 million standard cubic feet per day (mmscf/d) (1999: 3,720 mmscf/d), mainly to meet higher domestic consumption and improved external demand. Meanwhile, tin output is expected to decline by 16.9% to 6,100 tonnes (1999: 7,340 tonnes) on account of weak prices and the decline in areas worked by tin mines.

The performance of the **construction** sector is expected to turn around with value added growing by 3.1% in 2000 (1999: -5.6%). The growth is due mainly to the implementation of several large public and privatised infrastructure projects and new investment in the residential sector, in particular, low and medium-cost houses to meet underlying demand. Excess supply, however, still exists in several segments of the property market. In the non-residential sector, the oversupply situation and low occupancy rates for office and retail space continue to dampen building activity. Activities related to the construction of low and medium-cost residential properties are, however, expected to remain strong. Civil engineering activities are expected to continue to recover and strengthen given the fiscal stimulus and resumption of projects that were deferred. Consequently, the share of the construction sector to overall GDP is estimated at 3.4% (1999:3.6%).

In tandem with the significant improvement in economic activities in the major sectors of the economy, the **services sector** is expected to record a stronger growth of 4.9% (1999: 3.3%). Growth is expected to emanate primarily from the transport, storage and communications sub-sector which is estimated to increase by 6.7%, wholesale and retail trade, hotels and restaurants by 5.9%, while the finance-related services sector is projected to expand by 4.2% in 2000. The better performance of these sectors is underpinned by higher external trade, increasing momentum of manufacturing activities, increased consumer spending and higher tourist arrivals estimated at 8.5 million. Consequently, the services sector is envisaged to contribute 53% to overall GDP in 2000.

Domestic Demand

Domestic demand is expected to continue to expand driven by growth in both public and private sector demand. **Aggregate domestic demand** (excluding stocks) is expected to strengthen markedly by 16% to RM260,719 million at current prices (1999: 1%). The growth is expected to emanate from the turnaround and strong growth in **private sector expenditure** of 17.6% to RM184,396 million (1999: -3.3%). Meanwhile, **public sector expenditure** is expected to increase by 12.4% to RM76,323 million (1999: 12.5%), reflecting the strong fiscal stimulus.

The projected increase in private sector expenditure is primarily due to the anticipated double-digit growth of 27.2% in **private investment** activities to RM40,746 million in 2000, after two consecutive years of negative growth (1998: -50.9% and 1999: -27.3%). The higher investment anticipated reflects, among others, the revival of investor confidence across economic sectors as well as policy measures aimed at attracting investors through tailor-made Pre-Packaged Incentives for strategic projects. Since its announcement in the 2000 Budget, a total of six projects valued at RM8,620 million have been approved under the Pre-Packaged Incentives as at end-September 2000.

In tandem with improving investment sentiments and higher demand in export-oriented manufacturing industries, **proposed investment applications** to the Malaysian Industrial Development Authority (MIDA) increased significantly by 67.6% to RM17,477 million during the first seven months of 2000 (January-July 1999: -13.3%). Sentiments of investors, in particular local investors, improved markedly with proposed investment rising by 161.2% to RM8,781 million (January-July 1999: -31.8%) while that of foreign investors registered an increase of 23.1% to RM8,695 million (January-July 1999: -0.4%). Similarly, **proposed investments approved** by MIDA increased by 29.3% during the same period to RM12,142 million (January-July 1999: -43.6%). Approvals extended to local investors increased significantly by 270.8% to RM8,064 million (January-July 1999: -77.3%) while that given to foreign investors, however, declined by 43.5% to RM4,077 million (January-July 1999: 2.2%), reflecting partly selectiveness in approving applications to ensure quality investment and to promote high-end technology and knowledge-based activities.

Indicative of the higher investment activity is the 49.7% increase in imports of capital goods during the first eight months of 2000 (January-August 1999: -20.5%) and the rise in capacity utilisation to above 80% in the manufacturing sector to meet higher domestic and external demand. Other major investment indicators such as production of ready-mixed concrete and sales of primary iron and steel also increased by 40.7% and 31.7%, respectively during the first seven months of 2000 (January-July 1999: -29.1% and 2%, respectively).

Capital outlay in the services sector is also expected to increase significantly given that an increasing number of companies in the telecommunications, financial and business services sub-sectors are increasing capital expenditure on information and communications technology (ICT). Furthermore, capital expenditure on ICT-related purchases, aimed at the further development of the Multimedia Super Corridor (MSC), continue to be encouraging with RM2,800 million envisaged to be invested in 2000. The higher growth in private investment is also due to increases in the capital outlay of the oil and gas sector. Investment in upstream activities by six major oil companies is estimated to increase markedly by 20.6% to RM9,198 million (1999: 2.3%). Investment in downstream activities is, however, anticipated to decline by 2.3% to RM6,896 million (1999: 37.7%). The lacklustre performance of the construction sector, which contributed to a sizeable decline in private capital formation in 1999, is expected to reverse its trend in 2000, resulting from the revival of some deferred infrastructure projects, on-going highway projects as well as construction of new housing units to meet strong underlying demand.

Private consumption, an important component of domestic demand, is envisaged to increase at a faster rate of 15.1% to RM143,650 million in 2000 (1999: 5.6%) attributable mainly to higher disposable income and wealth effect amidst an environment of low interest rates and inflation. This is in line with the significant improvement in consumer confidence and pent-up demand following the crisis years as well as continued favourable performance of the export sector. Major private consumption indicators such as imports of consumption goods and sales tax collection rose by 20.8% and 40.7%, respectively during the first eight months of 2000 (January-August 1999: 8.9% and 5.5%, respectively). Similarly, sales of passenger cars increased further by 21%

during the first eight months of 2000 (January-August 1999: 105.9%) while consumption credit provided by the banking system also improved, expanding by 9.7% at the end of July 2000 (end-July 1999: -6.6%).

Reflecting the stronger fiscal stimulus, **public investment** spending is envisaged to increase at a higher rate of 14.5% to RM39,469 million (1999: 7.9%). This is mainly attributed to a 15.7% (1999: 17.1%) increase in investment by the Federal Government for education and health as well as infrastructure projects. Similarly, total capital expenditure of Non-Financial Public Enterprises (NFPEs) for new projects and expansion of existing programmes is expected to increase further by 9.7% to RM 19,212 million, after recording a growth of 16.6% in 1999.

Similarly, **public consumption** is expected to increase further by 10.1% to RM36,854 million (1999: 17.6%). This is mainly due to the higher growth in expenditure for supplies and services of 22.2% to RM13,723 million in 2000 compared with 12.5% in 1999. At the same time, expenditure on emoluments is expected to increase by 7.2% to RM20,459 million (1999: 6.3%) due to the 10% upward adjustment in the salaries of civil servants as well as a 50% increase in housing allowances for selected categories of civil servants.

Net External Demand

Exports of goods and non-factor services are expected to continue to expand strongly by 12.4% in real terms (1999: 13.4%), given the continuing favourable global environment and strong external demand for electronic goods. Higher export earnings are expected not only due to strong external demand for goods, particularly from US and East Asian economies which comprise about three quarter of Malaysia's exports, but also due to higher exports of non-factor services rendered. After taking into account higher export prices, the nominal value of exports of goods and non-factor services is expected to record a further increase of 14.7% to RM419,266 million (1999: 11.5%).

Merchandise exports at free-on-board (f.o.b.) prices is envisaged to maintain its growth at 14.5% (1999: 13.2%) to RM365,223 million, underpinned by both higher export volume and prices, particularly for manufactured goods. The export value of

manufactured goods is expected to remain buoyant, registering annual growth of 15.9% to RM316,323 million in 2000 (1999: 14.7%) to account for more than 85% of total export value, given the strong demand for electronic and electrical products as well as chemical and petroleum products. Export earnings from agricultural commodities are, however, likely to decline further by 18.4% to RM19,965 million, due mainly to lower prices and declining export volume of palm oil arising from the further buildup of global supply of vegetable oils. The poor performance of agricultural products is expected to be offset by higher export proceeds from the mining sector, the value of which is expected to increase significantly by 36.5% to RM22,044 million on account of higher crude oil and liquefied natural gas prices.

Reflecting the higher volume of external trade, higher tourist arrivals as well as the impact of various measures to upgrade the services sector over the years, earnings from **exports of non-factor services** are expected to record a significant increase of 16.3% to RM54,043 million (1999: 0.6%). The provision of services such as education, freight and insurance, air and shipping transportation as well as travel are expected to contribute to Malaysia's increased foreign exchange earnings.

In tandem with the higher level of economic activity as well as strong external demand for exports, **imports of goods and non-factor services** are estimated to expand at a higher rate of 22.9% to RM356,415 million at current prices (1999: 9.3%). This is largely due to a significant increase in **merchandise imports** of 25.2% to RM290,894 million at f.o.b. prices (1999: 9.4%), comprising mainly higher imports of capital and intermediate goods. Most of the imports, which comprise parts and accessories of capital equipment and industrial supplies, are for the export-oriented manufacturing industries, in particular the electrical and electronic industries. Imports of capital goods are expected to increase strongly by 39.5% while that of intermediate goods are expected to expand at a lower rate of 27%. With higher incomes and improved consumer sentiments, imports of consumption goods are also expected to expand by 11.7%, due mainly to higher imports of semi-durable and durable consumer items as well as processed food. **Imports of non-factor services** in current prices are envisaged to increase strongly by 13.6% to RM65,521 million (1999: 8.7%). This

reflects higher payments anticipated for freight and insurance as well as for air and shipping transportation services, given the higher volume of merchandise imports and increasing number of Malaysians travelling abroad.

Net external demand is expected to register a surplus of RM62,851 million in current prices (1999: RM75,292 million), as the rate of expansion in imports of goods and non-factor services is higher than exports. Consequently, this surplus will account for 21% of nominal GNP (1999: 26.9%).

Balance of Payments

The position of the balance of payments is expected to continue to be strong in 2000, despite a narrowing of the current account surplus. The anticipated lower surplus is mainly on account of expectations of a slightly lower merchandise surplus as well as a larger deficit in services and transfer payments. The **current account** of the balance of payments is, therefore, expected to record a lower but sizeable surplus of RM29,756 million or 9.9% of GNP (1999: RM47,902 million or 17.1% of GNP).

The **merchandise account** of the balance of payments is expected to register a slightly lower surplus of RM74,329 million (1999: RM86,535 million) due primarily to a faster rate of expansion in imports (25.2%) compared with exports (14.5%). The **services account**, on the other hand, is expected to continue to record a larger deficit, estimated at RM37,106 million (1999: -RM32,134 million). This is mainly on account of anticipated higher net outflows of investment income (-RM24,978 million) following higher earnings by foreign companies, particularly from export-oriented industries. In addition, higher imports are expected to lead to larger net payments for freight and insurance (-RM12,202 million). Total net payments on other services such as professional and contractual services are expected to increase further by 8.9% to RM11,309 million. The travel account is, however, expected to record a bigger net inflow of RM8,999 million while other transportation services, including air travel, are expected to yield RM2,441 million. Net foreign exchange outflows, due to **unrequited transfers**, are envisaged to increase to RM7,468 million (1999: -RM6,499 million), largely due to an increase in remittances of foreign workers to their countries of origin.

The long-term capital account of the balance of payments is expected to experience a significantly lower net inflow of RM6,683 million (1999: RM12,598 million). This is largely due to smaller net inflows of official and private long-term capital of RM2,418 million and RM4,265 million, respectively. The smaller surplus anticipated in the long-term capital account, reflects among others, the increasing value of Malaysia's investment overseas, particularly by NFPEs. In addition, net foreign direct investment is expected to be lower as in other parts of the region. Consequently, the **basic account** of the balance of payments, which takes into account both the current account and long-term capital flows, is expected to register a smaller surplus of RM36,439 million (1999: RM60,500 million). After taking into account the net expected outflow in the short-term private capital of RM21,323 million (1999: -RM37,750 million) as well as net outflows of RM6,960 million (1999: -RM4,931 million) due to errors and omissions, the **overall balance of payments** position is estimated to continue to be in surplus of RM8,156 million (1999: RM17,819 million).

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 estimated to register a deficit of RM17,992 million or 5.9% of GNP in 2000, against a deficit of RM9,484 million or 3.4% of GNP in 1999. The Federal Government revenue performance is expected to improve further in tandem with the strong economic recovery. Total **Federal Government revenue** is estimated to record a growth of 8.2% to RM63,500 million or 20.9% of GNP compared with RM58,677 million in 1999. This is 6% higher than the budget estimate of RM59,897 million. The better-than-expected revenue position is attributable to improvements in tax collection, notably the current year assessment system, strong economic recovery and improved business activities. Tax revenue is expected to record a better performance with an increase of 7%, thus maintaining its share of 76.4% of the total revenue. Revenue from direct taxes is expected to record a strong growth of 9.4% to RM29,808 million after declining 9.2% in 1999. All major categories of direct taxes are estimated to record an increase, notably individual's income tax (12.4%) due to improved economic conditions

and petroleum tax (95.2%) following higher petroleum prices averaging US\$26 per barrel. Revenue from indirect taxes is also estimated to improve, in line with recovery in aggregate demand and higher petroleum prices. Indirect taxes, which comprise export and excise duties and sales and service taxes, increased by 3.3% to RM18,702 million, to account for a share of 29.5% of total revenue. Non-tax revenue, which mainly comprises receipts from investment income, licences and permits as well as petroleum royalty, is estimated to increase by 12.5% to RM14,990 million. Collection from non-revenue receipts, which include refunds of expenditure, receipts from Government agencies and receipts from the Federal Territories, are estimated to record a growth of 6% to RM1,329 million (1999: RM1,254 million).

Total **operating expenditure** is expected to increase by 24.6% to RM58,206 million in 2000 (1999: RM46,699 million). The increase is mainly due to upward salary adjustment for civil servants as well as higher pensions and gratuities and debt service charges. Expenditure on **emolument** is estimated to increase by 8.1% to RM15,608 million, due to the 10% salary adjustment and increase in housing allowances. Reflecting continued efforts to improve Government services, expenditure on **supplies and services** is estimated to increase at a double-digit rate of 30.6%, mainly for repairs and maintenance works as well as professional services. **Debt service charges**, comprising interest payments for domestic and external borrowings, are projected to increase by 21.3% to RM9,630 million due to large borrowings in 1998 and 1999 to finance the fiscal stimulus. Consequently, the **current account** of the Federal Government's financial position is expected to record a lower surplus of RM5,294 million (1999: RM11,978 million).

The fiscal stimulus undertaken by the Federal Government to reinvigorate the economy is largely through the development expenditure. Thus, the total **gross development expenditure** is expected to increase by 11.8% to RM25,286 million (1999: RM22,614 million). Priority is given to projects capable of generating economic activities with minimal leakage in terms of imports and that can further stimulate private investment. Thus, the bulk of the expenditure is, therefore, allocated the **economic sector** within which transport as well as trade and industry sub- sectors received the highest proportion. Total expenditure on the

economic sector is estimated to increase by 28.4% to RM11,514 million, maintaining its significant share (45.5%) of total development expenditure. The transport sub-sector accounts for the largest share, amounting to RM4,908 million or 42.6% of total expenditure of this sector. Within the transport sub-sector, expenditure for the construction and upgrading of roads as well as bridges remain significant, amounting to RM3,194 million. Expenditure on railways, ports and airports is expected to amount to RM1,714 million in line with Government's policy to improve the national transport network. The trade and industry sub-sector also account for a large proportion of development expenditure amounting to RM3,977 million, mainly for the provision of infrastructure facilities as well as research and development, to promote the development of the manufacturing sector. Expenditure on public utilities remain high, particularly to provide better water and electricity supplies, notably in rural areas. Meanwhile, outlays on agriculture and rural development (including land development) are higher, reflecting the Government's continued commitment to upgrade the standard of living in the rural area.

Expenditure on the social sector, notably for health and education, is also equally large reflecting continuous Government efforts to improve the social well-being of the people, particularly, the lower income group. Government efforts to embark on the K-economy and to bridge the digital divide through education and human resource development consumed the bulk of the allocation under this sector. Expenditure on health was mainly for the construction of rural health clinics and the upgrading of hospitals.

After taking into account estimated loan recoveries of RM2,000 million, the net development expenditure is estimated at RM23,286 million. With expenditure exceeding revenue, the Federal Government's overall financial position is projected to register a deficit of RM 17,992 million or 5.9% of GNP in 2000 (1999: -3.4%). This is the third consecutive year that the fiscal position is in deficit.

National Resource Position

National income is expected to increase at a higher rate of 7.2% (1999: 3.8%). Given the acceleration in the growth of total consumption of 14.1% (1999: 8%), **gross national savings** is envisaged

to decline by 2.8% to RM111,563 million (1999: 1.5%), as shown in *Chart 1.2*. The level of gross national savings as a percentage of GNP is thus estimated to decelerate from 41.1% in 1999 to 37.2% in 2000. Although total **gross fixed capital formation** (including the change in stocks) is expected to turn around to record a positive growth of 22.4% to RM81,807 million or 27.3% of GNP in 2000 (1999: -11.6% or 23.9% of GNP), the **nation's resource position** is still expected to register a surplus of RM29,756 million or 9.9% of GNP in 2000 (1999: RM47,902 million or 17.1% of GNP).

Private sector savings, which account for 59.8% of gross national savings, are envisaged to decline further by 3.9% to RM66,762 million to account for 22.3% of GNP (1999: -2.5% or 24.9% of GNP), reflecting mainly the marked increase in consumption. **Private sector** investment, on the other hand, is expected to turn around to register a significant growth of 29.1% to RM41,554 million or 13.9% of GNP (1999: -26.5% or 11.5% of GNP) mainly due to higher investment in new growth areas, particularly in ICT as well as the expansion of production capacity with rising capacity utilisation in the manufacturing sector in both the export and domestic-oriented industries. With the level of private sector savings lower than investment, the surplus in the **private sector resource position** is expected to reduce from RM37,265 million (13.3% of GNP) in 1999 to RM25,207 million (8.4% of GNP) in 2000.

Similarly, **public sector savings** is expected to decline by 1.1% to RM44,801 million or 15% of GNP (1999: 8.3% or 16.2% of GNP), mainly due to the continued expansionary budgetary operations of the Federal Government. With **public sector investment** expected to increase markedly by 16.2% to RM40,252 million or 13.4% of GNP (1999: 8.9% or 12.4% of GNP), particularly on account of higher investment in the education and health sectors as well as infrastructure development projects, the **public sector resource position** is envisaged to record a significantly lower surplus of RM4,549 million or 1.5% of GNP (1999: RM10,637 million or 3.8% of GNP).

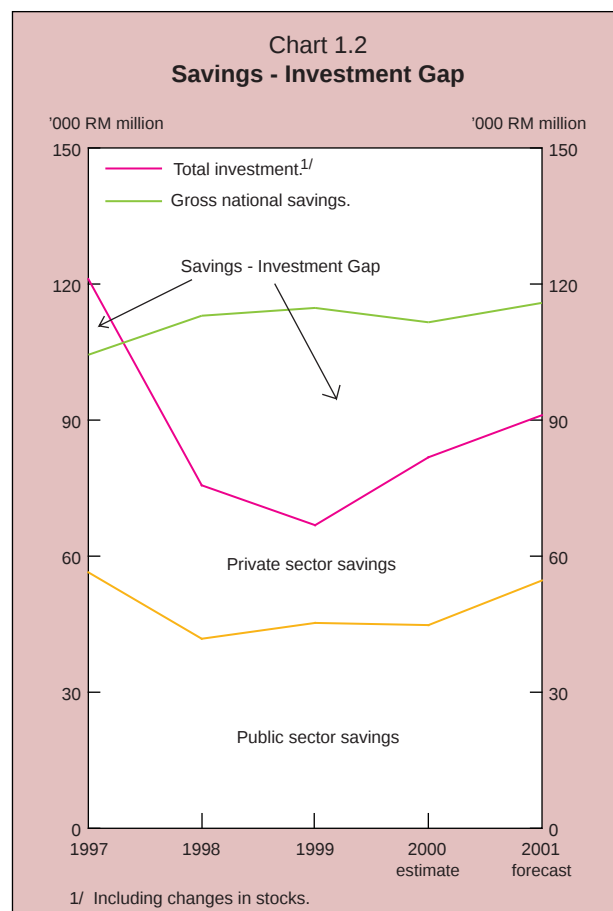
Monetary Developments

Monetary policy continued to remain accommodative aimed at complementing fiscal policy in strengthening growth. Consequently

monetary aggregates expanded further in the first eight months of 2000 with broad money, M3, increasing by RM 5,384 million or 1.2% (January-August 1999: RM19,074 million or 4.8%). The annual growth rate of M3 as at end-August 2000 was 4.6%. The sustained trade surplus and the pick-up in loan growth following the expansion in economic activities have contributed to the expansion in money supply. The main impetus to monetary expansion, however, shifted from external sources to claims on the private sector on account of the pick-up in loan growth.

Lending activities of the banking system have picked up in line with the expansion in economic activities. Loan approvals increased by 24.7% to a monthly average of RM10,848 million during the first eight months of 2000 against a monthly average of RM8,697 million in 1999. Similarly, loan disbursements continued to increase, averaging RM28,786 million a month in the same period (monthly average in 1999: RM26,526 million). Total loans outstanding (including loans

sold to *Cagamas* and *Danaharta*) has been on an uptrend since February and increased by RM13,867 million or 3.2% in the first eight months of 2000. On an annual basis, total loans outstanding increased by 3.6% at end-August with commercial banks recording an annual growth rate of 4.7%. Finance companies also registered a higher positive annual growth rate of 2.1% at end-August. The moderate increase was on account of higher loan repayments. The bulk of the increase in loans outstanding was mainly for the purchase of residential property (RM7,588 million), consumption credit (RM5,934 million) and manufacturing activities (RM2,727 million). Measures taken by the Government to develop the private debt securities (PDS) market have yielded positive results. There has been increasing recourse to PDS for financing. Total PDS outstanding increased by RM11,330 million in the first eight months of 2000. In aggregate, financing through loans extended by the banking system and PDS increased by RM25,197 million or 5% in the first eight months of 2000. On an annual basis, financing through loans and PDS increased by 12.4% at the end of August.



The ample liquidity situation continued to exert downward pressure on interest rates. The average base lending rate (BLR) of commercial banks declined to an all-time low of 6.75% in May 2000, while the BLR of finance companies has stood at 7.95% since August 1999. Similarly, the 3-month fixed deposit rates of both commercial banks and finance companies declined to 3.26% and 3.30%, respectively at end-July 2000 from 3.75% and 3.80%, respectively at end-July 1999. In early August, however, the banking institutions raised their deposit rates. Following this increase, the 1-month to 12-month fixed deposit rates of commercial banks ranged between 3.44% – 4.10% at end-September (end 1999: 3.24%–3.95%). With inflation relatively benign at 1.4% during the first nine months of the year, depositors continue to earn a positive real rate of return.

The Equity Market

The performance of the Kuala Lumpur Stock Exchange (KLSE) was mixed in the first nine months of 2000. KLSE began the year on a positive note with the Kuala Lumpur Composite Index (KLCI) reaching a peak of 1,013.27 points on 18 February.

In the first half of the year, the market remained bullish with KLCI staying above the 800 point level. This was due to improving economic data, better corporate performance and earnings as well as the reinstatement of Malaysia into the Morgan Stanley Capital International Indices (MSCI) in May 2000.

Market sentiments have, however, dampened since July, with KLCI dipping below the 800 point. However, it began to pick up in October to close at 766.18 points on 16 October. During the period 4 January to 16 October 2000, KLCI declined 8% while sharper declines were registered in other regional bourses, namely the the Stock Exchange of Thailand Index (-48.2%), Korean Composite Index (-48%), the Jakarta Composite Index (-41.2%), the Philippines Composite Index (-40%) and the Singapore Straits Times Index (-26%).

Total transactions declined by 17.3% to 62,490 million units during this period (January-mid-October 1999: 75,570 million units). However, market capitalisation increased by 6.6% to RM519,465 million at mid-October 2000 (mid-October 1999: RM487,210 million).

Inflation

Inflation continues to be subdued in 2000 as reflected in the marginal increase of 1.4% in the Consumer Price Index (CPI), during the first nine months of 2000 (January-September 1999: 3%). The Producer Price Index (PPI), however, registered a marked increase of 4.8% for the first eight months of 2000 (1999: -4.8%). The increase was largely on account of higher prices (5.7%) charged by local producers (1999: -5.7%) and to a lesser extent (1.1%) by importers (1999: -0.9%). In terms of components, the increase was highest for mineral fuels, lubricants and related materials group (41.8%) due largely to higher global crude oil prices.

The moderation in CPI is reflected in most of the major sub-indices, including food, which rose by 2.1% in the first nine months of 2000, and transport and communications (1.3%), which together account for 52.8% of the total CPI weights. The gross rent, fuel and power sub-index, however, increased at a lower rate of 1.3% (January-September 1999: 1.8%). The growth in CPI was more moderate in the first nine months of 2000.

The sustained strong momentum of economic growth and increase in world oil prices are, however, expected to result in a slightly higher rate of price increase during the latter part of 2000. CPI for the year as a whole, is therefore, estimated to increase by an average of 1.9% (1999: 2.8%).

Labour Market

Reflecting the continued recovery of the economy, the demand for labour is expected to increase by 2.1% to 8.9 million persons in 2000 from 8.7 million persons registered in 1999. A significant proportion (80%) of the new jobs created will be from the main economic sectors of manufacturing, construction, wholesale and retail trade and the hotel and restaurant services. As the supply of labour is, however, expected to expand at 2%, the unemployment rate is envisaged to decline from 3% in 1999 to 2.9 % of the labour force in 2000.

With low unemployment prevailing in the economy, nominal wages are expected to increase due mainly to the anticipated increase in salaries of the private sector as the economy continues to recover and labour demand increases. Malaysia's productivity growth for this year is expected to be 4.2% due largely to higher capacity utilisation boosted by potential increases in both domestic demand and exports, as well as productivity increases due to ICT utilisation.

Prospects for 2001

The economic outlook for 2001 continues to be favourable. Growth is expected to be sustained by the stronger performance of the private sector which will provide the primary stimulus for growth. The Government will, however, continue to support the private sector in ensuring that growth in economic activities is sustained. In addition to the fiscal stimulus, the Government will continue to support economic growth through measures that promote expansion in domestic demand, development of new sources of growth, strengthen the nation's competitiveness and resilience whilst improving further the quality of life.

The international economic environment is expected to continue to be conducive with world growth remaining strong at 4.2% (2000 : 4.7%). The slower growth anticipated for US (3.2%), is expected to be mitigated by continued growth of Malaysia's other major trading partners of Japan (1.8%) and the European Union (EU) (3.4%). Regional growth is expected to moderate but remain strong at 6% (2000: 6.5%). Growth in world trade is expected to continue to be robust at 7.8%. Given the favourable external outlook, real GDP growth for Malaysia is forecast at 7% in 2001. Despite the strong indications that sustainable growth is achievable, some downside risks exist. These risks include the possibility of a larger-than-anticipated slowing down of US economy, which in turn could affect the electronics sector, a slower-than-expected strengthening of private consumption and lower private investment, both domestic and foreign.

Sectoral Output Performance

All sectors of the economy are expected to continue to register positive growth in 2001. Against a background of sustained world economic growth and trade expansion, the manufacturing sector is projected to continue to register double-digit growth of 12% (2000: 17%) to retain its position as the leading sector in the economy. The construction sector is also envisaged to expand more strongly at 5.5% (2000: 3.1%), given the anticipated higher private sector investment in privatised infrastructure projects and higher budgetary allocation for social amenities. Growth in the agriculture sector is projected at 1.8% (2000: 0.5%) on account of higher production from palm oil and rubber, while growth of the mining sector is projected at 1.7% (2000: 0.6%) due to higher gas output. Driven by the higher level of economic activities, the services sector is projected to register higher value-added growth of 5.2% (2000: 4.9%) supported mainly by sustained growth in the transport, storage and communications and finance, insurance, real estate and business services sub-sectors.

The agriculture, livestock forestry and fishing sector is forecast to expand at a higher rate of 1.8%. Palm oil production is expected to increase by 7.5% due mainly to an expected 3.7% increase in mature area. Rubber production is expected

to increase marginally by 1.4% as prices are not expected to increase significantly. Sawlog production is envisaged to contract by 6.9% due to an expected reduction in output from Peninsular Malaysia and Sabah, consistent with efforts aimed at ensuring sustainable forest management. The share of the agriculture sector to real GDP is, therefore, envisaged to decline to 8.3% (2000: 8.8%).

The **mining sector** is forecast to expand marginally by 1.7% mainly due to the increase in gas output of 12.6% to 4,384 mmscf/d (2000: 3,882 mmscf/d) to meet increasing demand for natural gas. Crude petroleum production is expected to decline by 0.8% to 692,109 bpd (2000: 695,718 bpd) based on the production targets set. Tin production is also expected to decline by 16.4% to 5,100 tonnes. Hence, the share of the mining sector to real GDP is expected to decline to 6.4% (2000: 6.8%).

The outlook for the sustained expansion of the **manufacturing sector** remains encouraging. Output growth is expected to continue to remain robust, mainly on account of continued strong growth from both the export and domestic-oriented industries. Manufacturing output is forecast to sustain double-digit growth of 12% in 2001 (2000: 17%). Despite concerns that the growth of export-oriented industries may slacken due to prospects of a slowdown in the expansion of US economy and sales of personal computers, output of Malaysia's export-oriented industries are expected to expand by 12.3% (2000: 22.4%) given the continued growth in demand anticipated from Malaysia's other trading partners. The projection takes into account the continued strong global demand for electronic products given the rapid growth in ICT infrastructure and the wireless telecommunications sector. In addition, some of the new investments and capacity expansion in the electronics sector is expected to come onstream in 2001. Likewise, output of the domestic-oriented industries is expected to increase by 11.7% (2000: 17%), underpinned by the revival of a number of deferred infrastructure projects and expected increase in domestic consumption that will contribute to the output expansion in both the construction-related materials and transport equipment industries. Similarly, output of the chemical products industry, particularly plastic industry, will benefit largely from the continued

strong growth in the electrical and electronics sector. It is, therefore, envisaged that the sector's contribution to real GDP will expand to 34.1% (2000: 32.6%).

The **construction sector** is projected to grow more strongly at 5.5%, on account of higher investment by the private sector, particularly in the privatised infrastructure projects, and higher budgetary allocations for education, health and social amenities. Sustained economic growth and continued expansion in incomes are also expected to continue to underpin demand and growth of construction activities. The share of the sector to real GDP is envisaged to be maintained at 3.4% (2000: 3.4%).

The value added of the **services sector** is expected to register a sustainable growth of 5.2% (2000: 4.9%) in view of the moderate expansion anticipated for other major sectors. Growth in the transport and communications sub-sector is envisaged to expand at a higher rate compared with 2000, on account of the anticipated higher contribution ensuing from the continued investments in ICT by the telecommunications companies and the spillover of a higher trade volume. More broad-based and better performance of the real sectors are also expected to continue to contribute towards enhancing the performance of the financial sector, particularly in strengthening the activities of the banking sector in terms of capitalisation, quality of assets and profitability. As economies in the region are expected to sustain growth in 2001, Malaysia is envisaged to continue to benefit from higher tourist arrivals. The share of the services sector to real GDP is however, expected to be marginally lower at 52.1% (2000:53%).

Domestic Demand

Aggregate domestic demand in current prices is expected to increase, albeit at a moderate rate of 12.5% to RM293,394 million in 2001 (2000: 16%), given the anticipated moderation in export growth as well as the reduced size of fiscal stimulus in generating domestic economic activities. **Public sector expenditure** is estimated to increase at a slower pace of 11.9% to RM85,413 million (2000: 12.4%). Nevertheless, the slowdown in public sector activities is expected to be mitigated by the private sector's resumption of its role as the engine of growth. As such, growth in **private sector**

expenditure will continue to remain high, expanding by 12.8% to RM207,981 million (2000: 17.6%).

Private consumption is expected to be sustained in 2001, expanding at a lower but fairly strong pace of 12.3% to RM161,299 million (2000: 15.1%). On-going Government policies is expected to continue to encourage private sector spending. The expansion in private consumption reflects further improvements in consumer confidence and higher disposable incomes, due partly to the continued favourable performance of the export sector. Similarly, **private investment** is projected to increase further by 14.6% to RM46,682 million (2000: 27.2%). This is in tandem with the anticipated further strengthening of the investment activities underpinned by Government's continuous policy efforts in order to ensure a conducive environment for private sector investment, on-going incentives including the Pre-Packaged Incentives and the resumption of implementation of the privatised infrastructure projects. In addition, investment activities by the private sector are expected to pick up consistent with better business conditions and a strong momentum in domestic economic activities. Continuing economic growth is expected to induce further private sector investment, particularly in the electrical and electronics sectors as well as ICT-related industries, and the construction of houses and infrastructure development activities. Similarly, capital expenditure on the oil and gas sector is also expected to increase further. Given the anticipated investment, the potential growth rate of the economy is expected to be sustained in 2001.

With the private sector resuming its role to spearhead growth, **public investment** is envisaged to increase at a slower rate of 12.5% to RM44,394 million compared with 14.5% in 2000. This is mainly due to an expected decline in investment by the NFPEs by 4.8% to RM18,288 million (2000: 9.7%). The investment expenditure of the Federal Government, however, which constitutes 34.8% of the total public investment, is expected to increase significantly by 27.1% to RM15,462 million (2000: 15.7%). **Public consumption** is expected to increase by 11.3% to RM41,019 million (2000: 10.1%). The increase in public consumption will be mainly for emolument, which will account for 54% of the total public consumption as well as expenditure on supplies and services (38.9% of the total public consumption).

Net External Demand

In tandem with the moderating economic growth of Malaysia's major export markets particularly US, **exports of goods and non-factor services** in nominal value is forecast to increase at a lower but nevertheless, strong growth rate of 8.5% to RM454,859 million (2000: 14.7%). The lower value of exports is also partly due to the anticipated continued weakening of prices of most of the major commodities as well as the down-cycle projections for global semi-conductor sales in 2001. In addition, supply constraints are expected to emerge in selected sectors of the economy. **Merchandise exports** are, however, estimated to increase further by 8.3% to RM395,579 million (2000: 14.5%), supported largely by a 10.5% increase in the export of manufactured goods, which constitutes 87% of total exports. However, a decline in export earnings is anticipated for agricultural products and export receipts from the mining sector. At the same time, exports of **non-factor services** are forecast to increase by 9.7% to RM59,280 million (2000: 16.3%), with higher earnings anticipated from freight and insurance, travel and other transportation.

Imports of **goods and non-factor services** are similarly projected to increase at a more sustainable rate of 10.8% to RM395,035 million (2000: 22.9%), reflecting an anticipated higher volume of imports amidst stable import prices. Growth is expected to emanate from all categories of merchandise goods particularly for imports of intermediate goods for use in the export-oriented manufacturing industries while a higher pace of investment activities is expected to generate demand for capital goods. As such, **merchandise imports** are expected to increase at a higher rate of 11.1% to RM323,120 million compared with merchandise exports (8.3%). The growth in the value of **imports of non-factor services** is estimated at 9.8% to RM71,915 million (2000: 13.6%). Payments for freight and insurance as well as for air transportation services will continue to be large, although the rate of increase in imports of non-factor services is expected to be lower.

On aggregate, exports of goods and non-factor services are expected to continue to exceed imports by RM59,824 million in current prices (2000: RM62,851 million). With the narrower margin of surplus, the decreasing net stimulus provided by the external sector to economic growth in 2001

is likely to be mitigated by the stronger performance of domestic demand expenditure.

Balance of Payments

As merchandise imports are expected to increase at a relatively stronger rate compared with merchandise exports in 2001, the **merchandise account** of the balance of payments is envisaged to continue to record a smaller surplus of RM72,459 million (2000: RM74,329 million). The **services account**, on the other hand, is forecast to register a higher deficit of RM39,781 million (2000: -RM37,106 million), given the higher net payments in investment income forecast at RM26,419 million (2000: -RM24,978 million). This is largely attributed to expectations of higher repatriation of profits and dividends as well as interest payments by foreign investors. The deficit is also due to the expected increase in net payments for freight and insurance (-RM13,136 million) and other services which include contract and professional services (-RM12,831 million). An increase in net receipts is, however, envisaged from other transportation (RM2,831 million) due to higher earnings expected from the transportation of air passengers and travel (RM9,839 million) in view of the anticipated improvement in the performance of the tourism sector. Net unrequited transfer payments is also expected to increase further to RM7,911 million (2000: -RM7,468 million), mainly on account of higher remittances by 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 RM24,767 million or 7.6% of GNP (2000: RM29,756 million or 9.9% of GNP).

Public Sector Financial Position

Fiscal policy will continue to be expansionary in 2001 to stimulate economic activities and further strengthen the economic recovery. Fiscal policy has remained in deficit for three years. The Government, however, continues to be committed to fiscal prudence to ensure long-term sustainability. In this regard, the Government continues to ensure that the current account remains in surplus, while the overall deficit is kept at a sustainable level. In addition the deficit will be financed mainly from non-inflationary domestic sources that will not crowd out the private sector's accessibility to funds.

Revenue collection in 2001 is projected to increase by 9.6%, mainly on account of higher tax revenue collection, notably income tax brought about by better business prospects as well as higher crude oil prices that will benefit both direct and indirect taxes. Direct taxes, a main component of Federal Government revenue, is projected to increase by 13.4% while indirect taxes is expected to increase by 6.3%. **Operating expenditure** allocation is to increase by 4.3% on account of higher allocation for supply and services. As a result, the Federal Government's **current account** is estimated to record a surplus of RM8,900 million. **Gross development expenditure** increase to RM26,836 million, development projects aimed at supporting domestic demand, generating productive capacity and enhancing social well being. Overall, the **Federal Government budgetary deficit** is expected to amount to RM16,136 or 4.9% of GNP.

Total operating budget for increase by 4.3% to RM60,710 million. Allocation for emolument remains the largest component, accounting for 27.9% or RM16,921 million following higher annual salary increments as a result of the recent salary adjustment. Allocation for supply and services will increase to 27.2% or RM10,088 million due to higher maintenance charges and purchase of supplies while allocation for debt service charges will increase by 5.7% to RM10,175 million.

Development expenditure in 2001 is projected to remain large at RM26,836 million, or 6.1% higher than that in 2000. In tandem with the moderate increase in overall allocation for development expenditure, allocation for the **economic sector** will decline 18.1% to RM9,429 million. The largest allocation in this sector is for transport and infrastructure (47%), followed by trade and industry (26.4%), and agriculture and rural development (15.6%).

The allocation for the **social services** sector will increase by 38.3% to RM10,934 million. Of this, a total of RM5,923 million or 54.2%, is allocated for the education sub-sector while expenditure on the health sub-sector will increase by 1.5% to RM1,220 million due to several on-going projects as well as new projects that have been earmarked for implementation. Allocation for housing will increase by 40.9% to RM1,706 million, mainly for the construction of houses under the Integrated Housing Programme to be undertaken by the Ministry of Housing and Local Government.

Allocation for the **security sector** will increase by 13.4% to RM3,158 million, of which the bulk will be for the defence sub-sector, amounting to RM2,542 million. The larger allocation for defence will mainly be for the purchase of military hardware and construction of military camps as part of the modernisation efforts. Allocation for internal security will increase by 13.6% to RM616 million for the Royal Police Department for the construction of new police stations and the purchase of equipment. Allocation for **general administration** sector will remain large, amounting to RM3,315 million. The development of flagship applications under MSC and public utilities for new Government administrative centre in Putrajaya will account for the bulk of this allocation.

National Resource Position

As growth in GNP (8.9%) in nominal terms is likely to be outpaced by the anticipated strong growth in total consumption expenditure (12.1%), **gross national savings** is envisaged to increase by 3.8% to RM115,843 million or 35.5% of GNP (2000: -2.8% or 37.2% of GNP), as shown in *Chart 1.2*. Growth in **gross fixed capital formation** is expected to increase further by 11.3% to RM91,076 million or 27.9% of GNP (2000: 22.4% or 27.3% of GNP), largely due to an anticipated higher increase in private capital outlays. As the level of national savings is expected to continue to exceed investment expenditure, the **savings-investment gap** is, therefore, expected to continue to register a sizeable surplus of RM24,767 million or 7.6% of GNP (2000: 9.9% of GNP). Of the total gross national savings, 52.8% is expected to be generated by the private sector with the balance from the public sector. The private sector, on the other hand, is envisaged to contribute 51.3% of the total gross fixed capital formation while the public sector will account for the remaining. As savings are likely to exceed investment, the **public sector** resource position will continue to be in surplus of RM10,237 million or 3.1% of GNP (2000: 1.5% of GNP). Likewise, the **private sector** is also expected to attain a resource surplus of RM14,530 million or 4.5% of GNP (2000: 8.4% of GNP).

Inflation

CPI is expected to remain low in 2001, on account of stable world prices as well as moderation in

petroleum prices. World inflation is expected to remain subdued and is not likely to impact on growth prospects, as imported inflation is also expected to remain low. PPI is expected to stabilise, in line with the anticipated moderation in crude oil prices and more moderate price increases for most other commodities.

Employment Situation

With the economy forecast to grow at 7%, new job opportunities will be generated with employment projected to increase by 6.2% from 8.9 million to 9.5 million in 2001. The economy will continue to operate virtually under full employment, with the unemployment rate remaining low at below 3%. The labour market will continue to be stable. New employment prospects are likely to be seen in ICT-related areas even though the manufacturing sector is expected to continue to employ the highest number of registered workers in the country.

Conclusion

As macroeconomic fundamentals continue to strengthen, growth in GDP is expected to be sustained at 7% for 2001. The continued expansion in economic activities is expected to be achieved

in an environment where external demand will continue to support aggregate domestic activities generated by a broad-based recovery. A conducive environment for the expansion in aggregate domestic demand will continue to be provided by fiscal stimulus and an accommodative monetary policy stance. In addition, measures will be focused on accelerating economic growth through the expansion of domestic demand, developing new sources of growth, particularly in ICT and knowledge-based activities and further enhancing the nation's competitiveness.

Macroeconomic fundamentals are, therefore, envisaged to strengthen further. The external payments current account position is projected to continue to remain favourable recording a lower albeit large surplus, thereby, sustaining the nation's external reserves position. Although some downside risks may emerge, in particular some slowing down of US and the world economy due mainly to the oil price hike, this is expected to be mitigated by the strength of domestically-generated demand. The thrust of macroeconomic management in 2001 will, therefore, be on managing risks that may emerge whilst ensuring the continuation of efforts to enhance the nation's competitiveness and resilience.