# Economic Performance and Prospects

## 2

ECONOMIC REPORT

## Overview

***Economic growth accelerates with strong domestic demand…***

Malaysia's growth momentum continues into 2004 after recording a strong growth in 2003. Unlike 2003, when the global economy was affected by the war in Iraq and Severe Acute Respiratory Syndrome (SARS) the external environment in 2004 has improved markedly with upswing in the global electronics demand as well as favourable commodity prices. This enabled the Malaysian economy to expand steadily from 7.6% in the first quarter of 2004 to 8% in the second quarter, the highest since the third quarter of 2000.

The robust domestic economic activities, which supported growth in 2002 through to 2004, are further augmented by favourable external environment. Of significance, the domestic sector is buoyed by the expansion in private consumption and investment activities. The manufacturing sector registered a solid growth of 12.3% during the first half of 2004, while the services sector expanded strongly by 6.8% in the same period. With the Leading Index pointing towards further expansion in the second half of the year, both sectors are envisaged to contribute significantly to the economic growth. The build-up in international reserves arising from larger current account surplus and inflows of foreign capital continues to strengthen Malaysia's macroeconomic fundamentals. Given this favourable scenario, the Malaysian economy is set to surpass its earlier estimate of 6.0 - 6.5% and post a stronger growth of 7% in 2004 (2003: 5.3%).

This impressive growth performance in an environment of low inflation helps to generate additional employment and new business opportunities. Consequently, national income in current prices is envisaged to increase by 10.8% to RM411,794 million, with per capita income rising by 8.5% to reach RM16,098 (2003: RM14,838). Similarly, per capita income in terms of purchasing power parity is estimated to increase by 9.3% to USD10,163 (2003: USD9,295).

## Domestic Demand Performance

***High growth supported by upbeat private sector activity…***

**Domestic demand,** led by the private sector, remains sturdy and contributes significantly to overall economic growth in 2004. As consumer sentiment remains positive and investor confidence gains momentum, domestic demand in real terms (excluding change in stocks) is expected to increase by 6.7% and contribute 6.1 percentage points to overall gross domestic product (GDP) growth (2003: 5.9%; 5.2 percentage points). The encouraging performance of the private sector is due, in part, to the Government's deliberate efforts over the years to stimulate a more vibrant and dynamic private sector by providing a better conducive business and investment environment for private sector initiatives to flourish.

**Private sector expenditure** is expected to expand at a greater pace of 10.3%, the highest since 2001, propelled by both consumption and investment spending. Private sector expenditure will contribute 5.8 percentage points to GDP growth (2003: 3.1 percentage points). The strong build-up of private sector activities, particularly higher capital spending since the second half of 2003, has provided the Government greater flexibility to further reduce its fiscal deficit. In line with consolidation efforts, **public sector expenditure** registers a slower growth of 0.7%

TABLE 2.1

**Gross Domestic Product (GDP) by Aggregate Demand**
**2003-2005**
(in 1987 real prices)

| | Change (%) | | | Share of GDP (%) | | | Contribution to GDP growth (percentage point) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2003 | 2004[1] | 2005 | 2003 | 2004[1] | 2005 | 2003 | 2004[1] | 2005 |
| **GDP** | ***5.3*** | ***7.0*** | ***6.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***5.3*** | ***7.0*** | ***6.0*** |
| **Domestic Demand[2]** | ***5.9*** | ***6.7*** | ***4.6*** | ***89.8*** | ***89.6*** | ***88.5*** | ***5.2*** | ***6.1*** | ***4.1*** |
| **Private Expenditure** | ***5.5*** | ***10.3*** | ***8.6*** | ***56.5*** | ***58.3*** | ***59.8*** | ***3.1*** | ***5.8*** | ***5.0*** |
| Consumption | *6.6* | *9.3* | *7.9* | *46.9* | *48.0* | *48.9* | *3.1* | *4.4* | *3.8* |
| Investment | *0.4* | *14.8* | *11.9* | *9.6* | *10.3* | *10.9* | *0.0* | *1.4* | *1.2* |
| **Public Expenditure** | ***6.6*** | ***0.7*** | ***-3.0*** | ***33.3*** | ***31.4*** | ***28.7*** | ***2.1*** | ***0.3*** | ***-0.9*** |
| Consumption | *10.0* | *9.8* | *2.5* | *14.9* | *15.3* | *14.8* | *1.4* | *1.5* | *0.4* |
| Investment | *3.9* | *-6.6* | *-8.1* | *18.4* | *16.1* | *13.9* | *0.7* | *-1.2* | *-1.3* |
| Change in Stocks | | | | *-0.8* | *0.7* | *0.7* | *-1.9* | *1.6* | *0.0* |
| **External Sector** | ***20.5*** | ***-6.6*** | ***20.0*** | ***11.0*** | ***9.6*** | ***10.8*** | ***2.0*** | ***-0.7*** | ***1.9*** |
| Export[3] | *6.3* | *14.6* | *9.7* | *109.2* | *117.0* | *121.1* | *6.9* | *16.0* | *11.3* |
| Import[3] | *5.0* | *17.0* | *8.8* | *98.2* | *107.4* | *110.3* | *4.9* | *16.7* | *9.4* |
| **GDP** (RM billion, current value) | **394.2** | **438.5** | **466.7** | | | | | | |
| *Change (%)* | *9.0* | *11.2* | *6.4* | | | | | | |

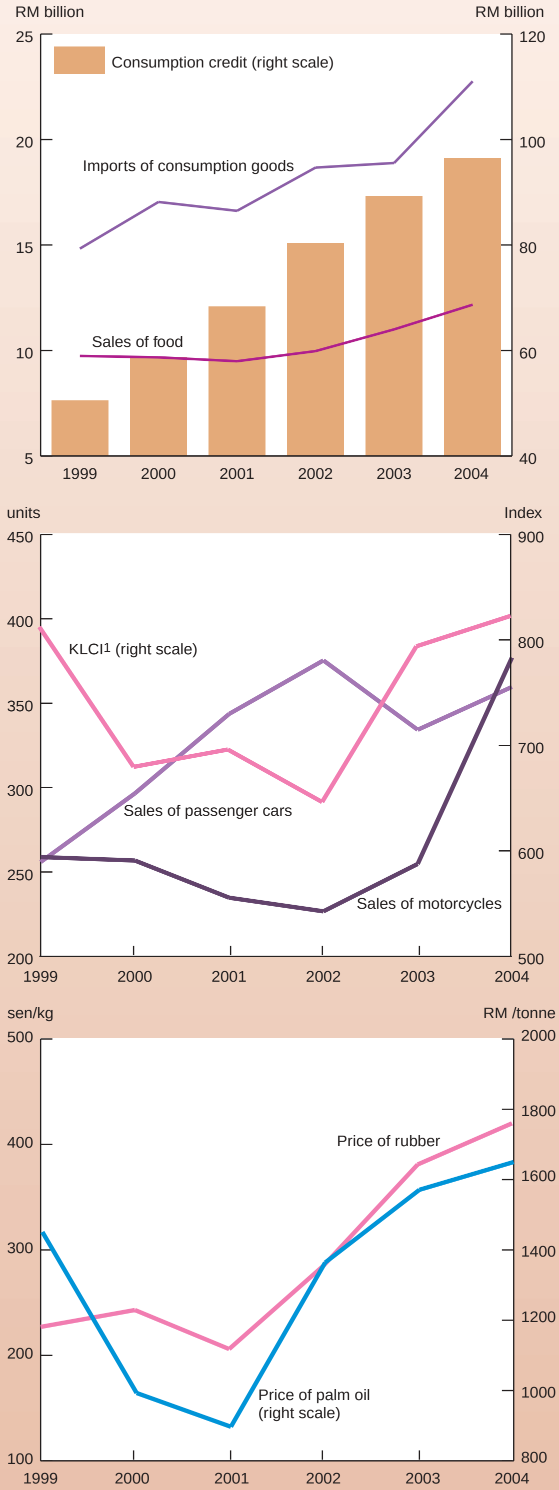
[1] Estimate.
[2] Excluding change in stocks.
[3] Goods and non-factor services.

(1999-2003: 12.3%) and contribute only 0.3 percentage points to GDP growth. Consequently, the share of public sector expenditure to GDP is set to decline to 31.4%, about half of the private sector's share of 58.3% in 2004 (2003: 33.3%; 56.5%).

Higher disposable income arising from firm commodity prices, stronger export earnings as well as better employment prospects and positive wealth effects from favourable stock market conditions, are the major contributing factors to the strong growth of 9.3% in **private consumption** (2003: 6.6%). The growth, which is more broad based, is also supported by low interest rates and benign inflation. To boost disposable income, workers contribution to the Employees Provident Fund (EPF) was reduced from 11% to 9% for one year from June 2003 to May 2004. These favourable conditions have generated a higher propensity to consume. Major consumption indicators, such as the sales of passenger cars and motorcycles have increased substantially by 7.6% and 62.9%, respectively in the first half of 2004. Several other key consumption indicators also showed similar trends during the period. These include imports of consumption goods, sales of food items and consumption credit, which increased significantly between 10.7% to 20.5%, as shown in *Chart 2.1.*

CHART 2.1

**Private Consumption Indicators**



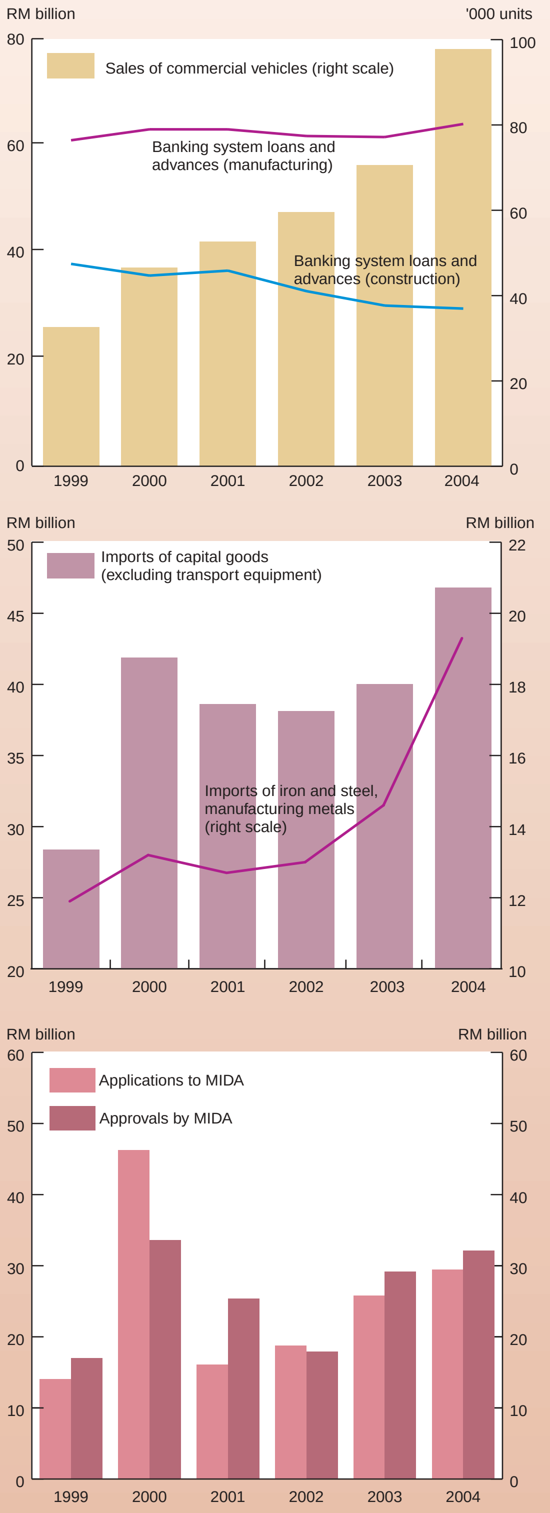

1 As at end of the year and as at 30 August 2004.

An important development that significantly contributes to the robustness of the overall economic growth is the expansion in **private investment**. Private capital outlay is anticipated to increase substantially by 14.8% in 2004. The strong growth is largely the result of the Government's successful strategies to encourage greater private sector initiatives in spearheading economic growth. Another factor is the more upbeat business confidence following positive impact of larger export earnings and higher domestic sale orders. As a result, capacity utilisation has reached near full capacity, especially in some manufacturing industries, which is expected to translate into higher cash flows and profitability for the corporate sector. Although still lower than the pre-Asian financial crisis level (1990-1997: 29.3%), the share of private investment to overall GDP is likely to record 10.3% in 2004 (2003: 9.6%), amidst a more favourable regional trade and investment environment.

Sustained inflows of foreign direct investment (FDI) in the oil and gas industry and greater interest in agriculture activity indicate private sector investment has become more entrenched. In addition, the current replacement cycle of the information and communication technology (ICT)-related equipment and software also helped spur investment. Higher capital outlays also correspond with other investment indicators, such as import of capital and intermediate goods, loan disbursements from the banking system and sales of commercial vehicles, which increased between 14.5% and 38.5% during the first half of the year. Imports of transport equipment for industrial purposes, in particular, turned around and increased markedly by 149.2% during the first seven months of 2004 (January-July 2003: -71.7%). The Government's recent move to simplify the application procedures of the Foreign Investment Committee (FIC) to be more investor-friendly is expected to boost investment activity. This, coupled with other measures aimed at making Malaysia the preferred investment destination, reflects the Government's commitment to improve further the public sector delivery system. Moreover, political stability, good infrastructure facilities and skilled workforce continue to be the key pillars in ensuring Malaysia's attractiveness to foreign investors.

CHART 2.2

**Private Investment Indicators**




The level of **public investment** expenditure is targetted to decline, for the first time since the crisis, by 6.6% in 2004 (2003: +3.9%) in tandem with the Government's policy to reduce fiscal deficit progressively without constraining overall economic growth. The lower public sector investment, however, is compensated by a more robust private sector expenditure. Consequently, the share of public sector capital outlay to overall GDP will decline slightly to 16.1% (2003: 18.4%). The lower public investment is also partly due to the accelerated implementation and completion of development projects during the period 2001-2003. Given the lower development expenditure in 2004, the Government will optimise existing resources, reduce wastage and encourage prudent and efficient spending to ensure more value for money.

**Public consumption,** similarly, is estimated to register a moderate growth of 9.8% (2003: 10%), mainly on account of higher expenditure for supplies and services, as there is a continuing need to maintain and improve the quality and efficiency of public sector delivery system.

## Sectoral Performance

### *Upswing in global electronics cycle, firm commodity prices and strengthened domestic demand continue to drive growth...*

Output of all sectors is envisaged to increase with the manufacturing and services sectors leading the economy. After expanding higher by 12.3% in the first half of 2004, the manufacturing sector is estimated to grow by a sturdy 10.5% for the year (2003: 8.3%), as shown in *Table 2.2*. The sector is expected to provide a strong impetus to the economy, given the overall better world economic outlook and continued global electronics demand. The services sector, with the largest GDP share of 57.1%, is envisaged to expand at a faster rate of 6% (2003: 4.4%), with all sub-sectors recording positive growth.

Output growth of the agriculture sector is envisaged to moderate to 2.8% (2003: 5.7%), largely on account of slower production of crude palm oil (CPO). Nonetheless, output of the rubber,

TABLE 2.2

**Gross Domestic Product (GDP) by Sector**
**2003-2005**
(in 1987 real prices)

| | Change (%) | | | Share of GDP (%) | | | Contribution to GDP Growth (percentage point) | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2003** | **2004[1]** | **2005** | **2003** | **2004[1]** | **2005** | **2003** | **2004[1]** | **2005** |
| Agriculture, forestry and fishing[2] | *5.7* | *2.8* | *2.4* | *8.7* | *8.3* | *8.1* | *0.5* | *0.2* | *0.2* |
| Mining | *5.9* | *5.0* | *5.5* | *7.2* | *7.1* | *7.0* | *0.4* | *0.4* | *0.4* |
| Manufacturing | *8.3* | *10.5* | *7.6* | *30.8* | *31.8* | *32.3* | *2.5* | *3.2* | *2.4* |
| Construction | *1.9* | *0.5* | *1.8* | *3.2* | *3.0* | *2.9* | *0.1* | *0.0* | *0.1* |
| Services | *4.4* | *6.0* | *5.8* | *57.6* | *57.1* | *57.0* | *2.6* | *3.5* | *3.3* |
| (–) Imputed bank service charges | *6.4* | *3.5* | *4.0* | *9.8* | *9.4* | *9.3* | *0.6* | *0.3* | *0.4* |
| (+) Import duties | *-3.7* | *0.8* | *-0.5* | *2.2* | *2.1* | *2.0* | *-0.1* | *0.0* | *0.0* |
| **GDP** | ***5.3*** | ***7.0*** | ***6.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***5.3*** | ***7.0*** | ***6.0*** |

[1] Estimate.
[2] Includes livestock and horticulture.

Source: Department of Statistics.

livestock and fishing sub-sector expanded to support growth in agriculture sector. Value added in the mining sector is forecast to grow by 5% (2003: 5.9%), underpinned by higher production of crude oil and natural gas, spurred by higher demand and prices. Growth in the construction sector will be slightly lower at 0.5% (2003: 1.9%), supported largely by the buoyant residential sub-sector and ongoing infrastructure projects.

## Manufacturing Sector

***Driven by broader manufacturing base...***

Growth of the manufacturing sector accelerated since September 2003, underpinned by double-digit and broad-based growth in both export and domestic-oriented industries. Favourable external environment with continued strong growth in China, coupled with the firm recovery in the US and sustained recovery in Japan, fuelled the higher demand for manufactured goods, particularly for electronic products. Meanwhile, growth in domestic-oriented industries strengthened on the back of the improved economic performance. With these positive developments driving the manufacturing sector, its contribution to GDP growth is expected to increase as shown in *Table 2.2*.

Overall capacity utilisation of the manufacturing sector was sustained at a high level with 42% of the manufacturers producing at near-maximum capacity (81%-100%) during the second quarter of 2004 compared with 35% in the first quarter of the year. The percentage of manufacturers with capacity utilisation in the range of 61%-80% has edged up to 40% from 37%, following stronger demand. The expansion in output is reflected in the 18.6% increase in manufacturing sales for the first half of 2004 to reach RM192,559 million (January-June 2003: RM162,331 million).

TABLE 2.3

**Manufacturing Production Index**
**January–June**
(1993=100)

| Sectors | Change (%) 2003 | Change (%) 2004 | Change (%) 2004 Q1 | Change (%) 2004 Q2 | Share (%) 2003 | Share (%) 2004 |
|---|---|---|---|---|---|---|
| **Export-oriented industries:** | ***4.6*** | ***21.5*** | ***21.5*** | ***21.2*** | ***50.8*** | ***53.1*** |
| Electrical, electronics and machinery: | *4.3* | *24.4* | *24.6* | *23.8* | *39.0* | *41.8* |
| *Semiconductors* | *7.8* | *33.4* | *34.1* | *32.7* | *30.5* | *34.9* |
| *Ventilating and air conditioning* | *10.4* | *16.3* | *17.3* | *15.5* | *2.6* | *2.6* |
| Professional, scientific, measuring and controlling equipment | *6.0* | *13.9* | *19.0* | *9.5* | *0.7* | *0.7* |
| Rubber-based products | *12.0* | *19.8* | *21.4* | *18.3* | *4.6* | *4.8* |
| Wood-based products | *1.8* | *17.4* | *13.8* | *20.8* | *3.5* | *3.5* |
| Textiles and apparel | *1.5* | *-8.5* | *-10.7* | *-6.4* | *2.8* | *2.2* |
| **Domestic-oriented industries:** | ***11.3*** | ***10.8*** | ***11.4*** | ***10.4*** | ***49.2*** | ***46.9*** |
| Plastic and chemical products: | *20.0* | *17.8* | *16.9* | *18.7* | *19.1* | *19.4* |
| *Plastic products* | *28.0* | *16.1* | *15.6* | *16.6* | *7.7* | *7.7* |
| *Chemical and chemical products* | *15.1* | *19.0* | *17.8* | *20.2* | *11.4* | *11.7* |
| *Industrial chemicals* | *16.5* | *18.7* | *17.3* | *20.3* | *9.7* | *9.9* |
| Food, beverages and tobacco | *12.3* | *2.0* | *4.4* | *-0.3* | *10.4* | *9.1* |
| Construction related industries: | *7.0* | *20.5* | *21.3* | *19.7* | *8.3* | *8.6* |
| *Iron and steel* | *8.7* | *7.1* | *5.5* | *8.6* | *3.0* | *2.8* |
| *Fabricated metal products* | *6.0* | *31.2* | *35.5* | *27.8* | *4.5* | *5.1* |
| *Non-metallic mineral* | *11.6* | *-5.5* | *-1.1* | *-9.6* | *4.1* | *3.4* |
| Transport equipment | *-10.1* | *4.4* | *0.8* | *8.0* | *4.0* | *3.6* |
| Paper and paper products | *5.1* | *6.8* | *-0.7* | *14.4* | *1.5* | *1.3* |
| Crude oil refineries | *9.5* | *-6.3* | *-2.1* | *-10.3* | *1.3* | *1.1* |
| Non-ferrous metal | *5.9* | *10.2* | *9.0* | *11.2* | *0.8* | *0.7* |
| Miscellaneous products of coal and petrol | *8.5* | *7.7* | *-0.9* | *15.7* | *0.3* | *0.3* |
| Glass and glass products | *1.5* | *-1.8* | *-4.1* | *0.4* | *0.4* | *0.3* |
| **TOTAL** | ***7.9*** | ***16.2*** | ***16.3*** | ***15.9*** | ***100.0*** | ***100.0*** |

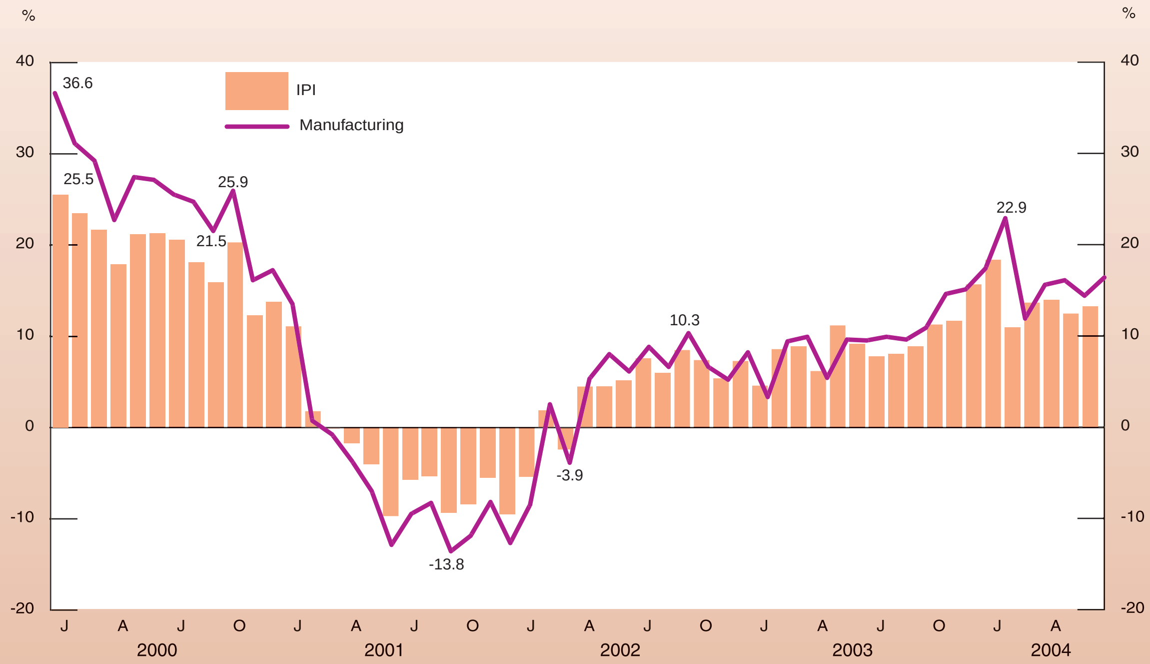
Source: Department of Statistics.

The strong growth in sales value was mainly due to the significant increase in demand for semiconductors and basic metals.

Output of **export-oriented industries** recorded a robust growth of 21.5% for the first half of 2004 (January-June 2003: 4.6%) with broad-based expansion, as shown in *Table 2.3*. Electrical, electronics and machinery as a group registered the highest growth in tandem with the cyclical upturn in global electronics demand. This was followed by rubber and wood-based products on account of stronger global economic recovery.

CHART 2.3

**Industrial Production Index (IPI)**
(% annual change)




Source: Department of Statistics.

The uptrend in global demand for semiconductors pushed the output of **electrical and electronics** (E&E) sharply by 24.4% during the first six months of 2004 (January-June 2003: 4.3%). In addition, greater outsourcing activities as well as software development helped to enhance the sector's growth. Within the group, output of semiconductors, accounting for more than one-third of the total output of the manufacturing sector, increased sharply by 33.4% (January-June 2003: 7.8%). This was also reflected by the higher sales of semiconductors, which recorded 14.1% increase during the same period (January-June 2003: 6.9%). These strong increases were in line with the expansion of broadband infrastructure facilities in the ICT sector to support increasing demand for global supply network and back-office facilities. Given the importance of the semiconductor industry in terms of its contribution to GDP growth and exports, efforts are ongoing to further develop the industry, especially in advanced integrated circuits design and packaging.

Production of **non-electrical machinery** comprising of exhaust, ventilating and air-conditioning units, likewise expanded strongly by 16.3% (January-June 2003: 10.4%) in response to higher sales orders from both local and overseas markets. Malaysia remains the largest producer of air conditioners since the 1980's, with Japan, the US, UK and Middle East being the major export markets.

The **wood-based industry,** comprising both downstream and upstream activities, expanded significantly by 17.4% (January-June 2003: 1.8%). Growth was driven by production of plywood, hardboard and particleboard, which increased by 20.9%, largely on account of expansion in exports to major markets such as the US, UK and Japan. With increasing competition from low-cost producers, it is imperative for Malaysia to continuously improve its competitiveness. Towards this end, measures were taken to improve product quality through research and development (R&D), introduce new designs and products as well as enhance production processes with new technologies and greater automation. Examples of new products introduced include laminated scantlings for doors and wood frames as well as eco-friendly paper and fibre for building materials from kenaf.

Production of the **rubber-based industry,** comprising latex-based products, tyres and tubes and rubber footwear, expanded by 19.8% (January-June 2003: 12%) in the first six months of the year. All categories of rubber products recorded strong growth. In line with the higher production, sales of rubber products increased by 25.1% during the period compared to 23.9% in the corresponding period of last year, with tyres and tubes recording a 7% increase following buoyant external demand and higher automobile sales.

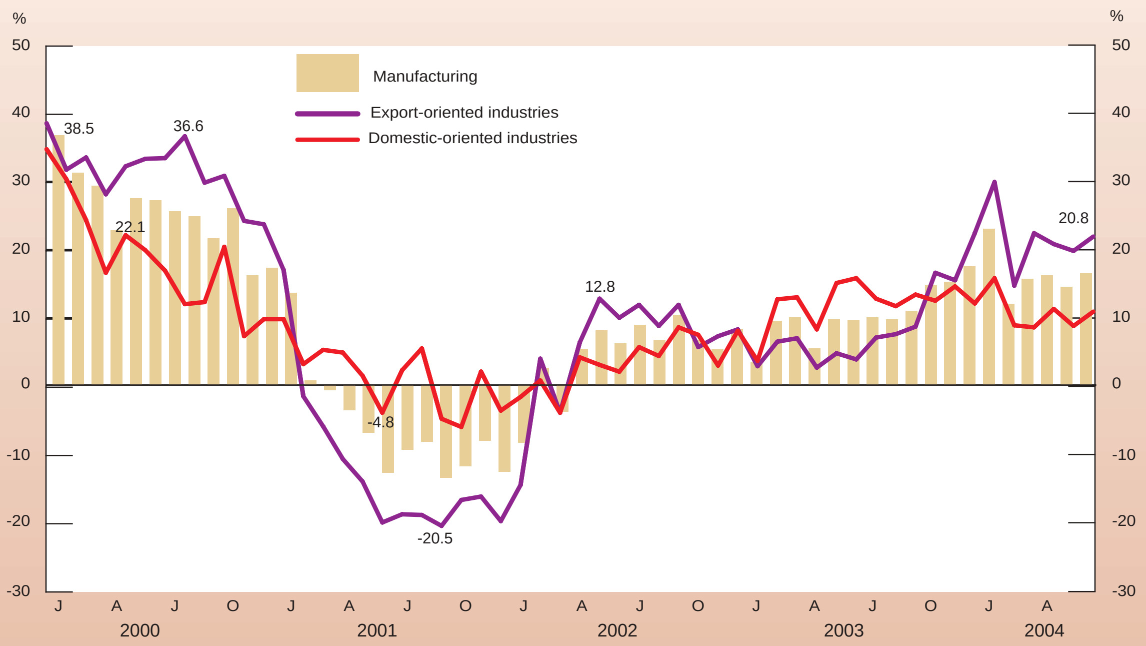
The **textile, apparel and footwear** industry is well positioned to meet market demand with more companies adopting the targetted marketing approach as markets become more segmented and demand for better designs as well as quality clothing and footwear. This approach has enabled manufacturers to focus on higher value-added production.

Production of **domestic-oriented industries** has been on the rising trend since May 2002. In the first half of 2004, output of the industry recorded a sustainable growth of 10.8% (January-June 2003: 11.3%) on account of increased output of plastics and chemicals, basic metals and transport equipment as well as food and beverages.

**Chemical and plastic products,** comprising chemicals and chemical products, industrial chemicals as well as plastic products, grew by 17.8% during the first six months of 2004 (January-June 2003: 20%)**.** Chemicals and chemical products remain the largest component of this sub-sector, with output increasing by 19% (January-June 2003: 15.1%), due to higher demand for pharmaceuticals, paints and lacquer. In tandem with the higher growth of production,

CHART 2.4

**Growth of Domestic and Export-Oriented Industries**
(% annual change)




Source: Department of Statistics.

the sales of these products also registered an increase of 20.2%. Likewise, increased uptake in the agriculture and plantation sectors resulted in a 62% improvement in the sales of fertilisers and pesticides sub-sector. Plastic products, which are also input components of the E&E and automotive industries, also recorded double-digit growth of 16.1% (January-June 2003: 28%) due to increasing demand for E&E products and motor vehicles as well as increased domestic demand for packaging materials in food processing industries.

Output of **construction-related industries** expanded strongly by 20.5% for the first six months of 2004 (January-June 2003: 7%), driven by favourable external demand for steel tubes and pipes. Production of fabricated metal products, in particular, rose sharply by 31.2% (January-June 2003: 6%) while iron and steel increased at a moderate growth of 7.1% (January-June 2003: 8.7%). In contrast, output of non-metallic mineral products, such as concrete and cement recorded a contraction of 5.5% (January-June 2003: 11.6%) with the completion of several major public development projects.

Buoyed by the expansion in domestic economic activities as well as improved consumer and business sentiments, output of **transport equipment** increased by 4.4% for the first six months of 2004, after recording a contraction of 10.1% in the same period last year. Higher disposable income and introduction of new models boosted the production of passenger cars by 7.8% (January-June 2003: -20.5%), while improved corporate performance propelled demand for commercial vehicles by 5.2% (January-June 2003: 0.9%). Similarly, production of motorcycles and scooters grew sharply by 56.9% (January-June 2003: 2.9%) in anticipation of better demand for motorcycles and scooters.

The **food, beverages and tobacco** industry, despite registering a lower output growth of 2% (January-June 2003: 12.3%), still accounted for 9.1% of total manufacturing output. Although food imports are rising, Malaysia's capability as a food producer and exporter is commendable with sales increasing by 11.9% to RM8,394 million. Sales of soft and carbonated drinks rose by 55.9% (January-June 2003: -3.7%) while cocoa, chocolate and sugar confectionary increased at a slower rate of 4.1% (January-June 2003: 34.6%).

Malaysia has been in the forefront in the certification of the ***halal* food** industry. The *halal* logo certified by Jabatan Kemajuan Islam Malaysia (JAKIM), as an accreditation standard in accordance with *Syariah* law, has been widely recognised. Malaysia will continue to take advantage of the potential in *halal* food, given the increasing global demand for this product. Production of *halal* food includes freshly packed (fruits and vegetables), chilled and frozen (seafood, poultry and meat) and processed and canned (ready-to-serve snacks and meals) food. Demand for *halal* food is expected to increase at a faster pace, given the increasing awareness of Muslims to comply with Islamic dietary obligations.

## Agriculture Sector

***Moderate growth in agriculture supported by rubber, fishing and livestock...***

The agriculture, forestry and fishing sector continues to register positive growth in 2004. However, the pace of expansion is envisaged to moderate to 2.8% (2003: 5.7%), largely due to slower growth in output of CPO after a strong increase in 2003. Overall agriculture sector growth of 3.2% during the first six months of 2004 was largely driven by the increase in output of rubber and food commodities, especially fish, livestock and fruits, reflecting the success of the Government's policy to reduce food imports and increase food production.

The growth in production of **CPO** is expected to slow down to 0.7% (2003: 12.1%) or 13.5 million tonnes in 2004, due to the downturn in the biological yield cycle of oil palm trees, after registering a double digit growth in production in 2003. During the first seven months of 2004, production of palm oil declined by 2.1% compared to an increase of 16.3% in the corresponding period of 2003. Improved oil extraction rate and expansion in matured areas in Sabah and Sarawak, however partly cushioned the lower yield production. Peninsular Malaysia continues to account for the bulk of the output of CPO

## MALAYSIA: THE MAKING OF A *HALAL* FOOD HUB

### Introduction

The global market for *halal* food is increasingly lucrative. The potential market for such products is estimated in the range of RM1,330 – RM1,520 billion (USD350 – USD400 billion) per year based on the world Muslim population of about 1.8 billion. The demand for *halal* food is expected to expand progressively, in view of the increasing trend among Muslims to observe their dietary obligations and the general interest on the part of other communities in such products as a safe, hygienic and healthy alternative source of food. The huge market certainly provides substantial opportunities for those who are interested to venture and develop the industry. In this regard, Malaysia is well placed to be a global hub for the *halal* food industry, given its credible standing as a progressive, moderate and dynamic Muslim nation.

### Policy Direction

An important policy direction for the development of the *halal* food industry in Malaysia is stipulated by various strategies and measures in the Second Industrial Master Plan (IMP2), 1996-2005. Under the IMP2, one of the strategic directions enumerated is to position Malaysia as an international *halal* food hub. Several potential sectors in food processing were identified, including the processing of *halal* meat and livestock products. The Small and Medium Industries Development Plan (SMIDP), 2001-2005, as well as the Third National Agricultural Policy (NAP3), 1998-2010 provide additional directions for the industry. The measures undertaken in gearing Malaysia towards becoming a *halal* food hub, among others, include capacity building efforts in inspection, monitoring, standardisation and certification of *halal* standards and promotion of *halal* industries.

Malaysia has, in fact, been actively involved in the establishment of the *halal* guidelines at the regional and international level. During the Second Session of the Codex Coordinating Committee for Asia meeting in Manila in 1979, discussion on food labelling in accordance with Islamic requirements was first initiated by Malaysia. The labelling provision for processed meat products in accordance with Islam and as practised in Malaysia was discussed at the meeting. In 1994, at the Ninth Session of the same meeting in Beijing, China, Malaysia's proposal on guidelines for use of the term *halal* was adopted by the Codex Committee on Food Labelling. The guidelines provide basic and general information necessary for the production of *halal* food.

On the domestic front, the Ministry of International Trade and Industry (MITI) has been tasked to coordinate and facilitate the *halal* food initiatives and efforts with the cooperation of the Ministry of Agriculture and Agro-Based Industry (MOA). While MITI coordinates and consults the industry on issues, practices and procedures as well as playing a major role in international cooperation, MOA through the Department of Veterinary Services (DVS) provides the technical services required for research and certification, especially for meat products. The Department of Islamic Development Malaysia (JAKIM) has been appointed as the sole authority for the issuance of *halal* certificates, for both domestic and international markets, with stringent *halal* accreditation standards. Whilst the Ministry of Health (MOH) is responsible for health quality control, the Department of Standard (DSM) is in charge of laboratory testing and accreditation system. SIRIM Berhad (formerly known as Standards and Industrial Research Institute of Malaysia), whose task is to promote excellence in technology and international acceptance of Malaysian products and services, is responsible for developing standards guidelines for *halal* food to ensure international acceptance.

### *Halal* Food Production in Malaysia

Currently, *halal* food production in Malaysia is relatively small as reflected by the value added of manufactured food products (including edible-oils and beverages) at RM10,876 million or 2.8% of

GDP in nominal value in 2003. However, based on the strong annual increase of 7.3% in its value added over the last decade (1994-2003), the potential for the industry to expand further is encouraging. In addition, the agriculture sub-sector of fisheries, livestock and miscellaneous (vegetable and fruits), that is partly associated with the *halal* food industry, contributed RM10,376 million or 2.6% of GDP in 2003, increasing at 6.6% per year during the same period. Livestock production of poultry in particular, appears to provide the best prospect for further export development as Malaysia is currently ranked the $12^{th}$ largest exporter, accounting for 1.5% of the global market share. In the case of beef and mutton, measures are being taken to further intensify local production as the industry contributes only about a quarter of the total domestic demand.

Malaysia is currently a net importer of food. In 2003, Malaysia's total trade in food products amounted to RM21,188 million, of which RM12,745 million or 60.2% were imports. In terms of export destinations, Singapore was the largest market absorbing RM2,146 million or 25.4% of such exports, followed by other ASEAN countries (excluding Singapore) as a group (RM1,712 million; 20.3%), EU (RM1,359 million; 16.1%), China/Hong Kong (RM569 million; 6.7%), US (RM504 million; 6%) and Japan (RM415 million; 4.9%). Although the value of exports to the West Asian market was relatively small (RM513 million; 6.1%), there is potential for further expansion, given the large number of Muslim consumers in the region.

**Certification: The JAKIM *Halal* Logo**

The existence of a huge market for *halal* food among Muslim consumers provides great opportunity for investors, entrepreneurs and exporters to participate and develop their market share. Although this segment of the market is highly competitive, Malaysia stands to gain in this foothold and seize the first-mover advantage as JAKIM's *halal* logo/certification is already recognised worldwide due to its stringent criteria employed. The fact that it is also much sought after by other countries reflects the confidence of consumers that a particular product complies with the *syariah* law and also of quality standards. In line with the *halal* status requirement, the Government has introduced several guidelines and control mechanisms to facilitate both local and international manufacturers in the production of *halal* food. To ensure and monitor the consistency and compliance of *halal* food in the domestic market, a *Halal-Haram* Committee under the Prime Minister's Department was established in 1982, comprising members from the Ministry of Domestic Trade and Consumer Affairs (MDTCA), MOH and DVS, as well as scientists from local universities. The authenticity and the quality of *halal* food and the whole production process are viewed seriously because of the religious sentiments involved, as reflected by the various legal instruments available for enforcement, such as:

a. The Trade Description (Use of Expression Halal) Order, 1975;

b. The Trade Description (Marking of Food) Order, 1975;

c. The Custom (Prohibition of Imports) Order, 1988;

d. The Animal (Importation) Order, 1962;

e. The Local Government By-Laws; and

f. Guidelines by JAKIM, DSM and SIRIM Berhad.

To further strengthen the development of the *halal* food industry, the Government on 10 July 2004 gazetted the Malaysian Standards MS1500 "General Guidelines on the Production, Preparation, Handling and Storage of *Halal* Foods". An important requirement under these guidelines is the need to comply with Good Manufacturing Practices (GMP) and Good Hygiene Practices (GHP). These new standards will further strengthen the premier position of JAKIM's *halal* certification, which is the longest established and most widely recognised registered *halal* logo in the world.

In the case of countries exporting *halal* food to Malaysia, only certificates issued by the competent authorities, recognised and endorsed by JAKIM, are acceptable. Exporters of *halal* food to Malaysia will have to undergo compliance inspections in their respective countries by bodies authorised by JAKIM. Recognition of certification bodies is based on their track records, competency and capability to conform to the standards and quality of production and processing for *halal* food.

### Malaysia's Comparative Advantages

Malaysia offers entrepreneurs and investors great potential to capture a sizeable portion of an expanding world market of *halal* food. The Government has already identified the *halal* food industry as new source of economic activity, in line with the current strategy to develop the agriculture sector as the third engine of growth. There are comparative advantages for Malaysia to propel the *halal* food industry to the forefront, and subsequently, secure international recognition as a "natural hub". Some of the enabling factors are as follows:

a. Malaysia is recognised as a progressive, moderate and dynamic Muslim country;

b. there is a strong *halal* production base in place with good industrial and commercial infrastructure, as well as strong inter-and intra-linkages between multinational companies (MNCs) and small-and medium-enterprises (SMEs);

c. there are availability of skilled manpower and processing technology;

d. there is worldwide acknowledgment of and recognition for JAKIM's *halal* logo due to its stringent verification and certification systems;

e. there is strong support by the Government for agricultural development, in particular *halal* food industry; and

f. Malaysia is a respected member of international Muslim community and currently holds the chairmanship of the Organisation of Islamic Conference (OIC).

Malaysia is also working closely with other members of the OIC to promote *halal* food worldwide. Towards this end, Malaysia has the opportunity to establish an International *Halal* Food Centre (IHFC) and emerge as not only the world *halal* food producer but also a centre for marketing, certification and reference. In terms of the trade preferential system of the OIC that could boost further the trade development of *halal* products among its members, a Framework Agreement was signed on 30 June 2004. The arrangement contains preferential tariff concessions among 23 participating countries. Likewise, the establishment of ASEAN-China Free Trade Area (FTA) in the next decade is also expected to enhance *halal* trade activity in the region. Both ASEAN and China present a lucrative market for *halal* products, as the region is home to a large Muslim population.

### Development of the *Halal* Food Industry: New Initiatives

Malaysia has a sizeable domestic *halal* food market industry and is ready to position itself as one of the main producers and suppliers. The domestic market is worth more than RM5 billion and there is a huge worldwide *halal* food market for Malaysian industry to tap. In view of positioning Malaysia as the international centre to gain first-mover competitive advantage and create its own *halal* niche market, some of the initiatives in the development of the *halal* food industry include:

a. developing and enhancing capacity to establish JAKIM as the international Islamic authority in the inspection, supervision and certification of *halal* products;

b. establishing consistent standards and quality to give greater confidence and assurance for the development of the *halal* industry, particularly upgrading processing technology as well as improving product quality, design and packaging;

c. complying with the international standards of food safety and quality. Several programmes have been implemented, including Good Agricultural Practices (GAP), good aquaculture and animal husbandry practices to ensure that local farm products are safe, as well as hygienic and healthy;

d. upgrading and modernising the logistic aspects of the *halal* industry, such as laboratories, abattoirs and cold storage centres; and

f. forging smart partnerships with other nations and the corporate sector in the development of *halal* industry.

Efforts in developing *halal* food centres are also on-going, where areas with relevant infrastructure and processing facilities have been demarcated for the establishment of *halal* food production zones. Among the areas are Pulau Indah in Selangor, Pantai Remis in Perak, Serkam in Melaka, Pedas in Negeri Sembilan, Paya Palawan in Kedah and Gambang in Pahang. In Sabah and Sarawak, initial programmes are in the pipeline.

To provide the industry with capable human resource, particularly in specialised skills of *halal* accreditation requirements, a special course was developed with JAKIM and conducted by the Malacca Industrial Skills Development Centre (MISDC) for graduates in Islamic study. A total of 30 students enrolled in 2004 and another 20 will undergo the course in 2005.

The Government has also provided various incentives that are directly and indirectly related to the development of the *halal* food industry. Among the incentives, are the provision of pioneer status and investment tax allowance, reinvestment allowance and accelerated capital allowance, import duty and sales tax exemption, R&D incentives to enhance quality, double tax deduction to promote exports and Malaysian brands, as well as a single tax deduction on expenses to obtain *halal* certification and quality certification and accreditation. While the Government continues to provide the necessary incentives and facilities to the industry, greater initiatives and positive response from the private sector are also needed to realise the goal of making Malaysia a recognised international hub for *halal* food.

## Conclusion

The *halal* food market is certainly large and waiting to be tapped and developed. Malaysia, a successful developing Muslim nation with strong industrial base and efficient economic management skills, is now poised to go global. With emphasis given to the agriculture sector as the third engine of economic growth, and greater efforts to transform the agricultural sector into a modern and vibrant sector, the prospects for the *halal* food industry are promising and will contribute significantly to the economy.

TABLE 2.4

**Value Added in the Agriculture, Livestock, Forestry and Fishing Sector**
**2003-2004**
(in 1987 real prices)

| | Growth (%) | | Share to Agriculture (%) | |
|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] |
| **Agriculture, forestry and fishing** | *5.7* | *2.8* | *100* | *100* |
| Oil palm | *11.3* | *0.5* | *35.3* | *34.5* |
| Forestry and logging | *2.0* | *-1.8* | *13.7* | *13.1* |
| Fishing | *3.7* | *3.2* | *12.5* | *12.6* |
| Rubber | *11.3* | *14.8* | *10.0* | *11.1* |
| Other agriculture[2] | *0.3* | *3.6* | *28.5* | *28.7* |

[1] Estimate.

[2] Including livestock, cocoa, *paddy* and miscellaneous agriculture such as fruits, copra, vegerables, tobacco, tea flowers, pepper and pineapples.

Source: Department of Statistics.

(58%), followed by Sabah (35%) and Sarawak (7%). Overall, the total hectarage planted including new areas in Sabah and Sarawak, is expected to increase by 2.1% to 3,883 million hectares. Of this total, 60% is under corporate ownership and 30% by Government entities, such as the Federal Land Development Authority (FELDA) and Federal Land Consolidation and Rehabilitation Authority Berhad (FELCRA), and the remainder by smallholders. The FELDA group is currently Malaysia's largest CPO producer with 2.53 million tonnes produced last year. In terms of global ranking, Malaysia maintained its position as the largest producer and exporter of CPO.

CPO prices have performed remarkably well in the first half of the year, averaging RM1,848 per tonne, on the back of supply shortages in the global vegetable oils and fats markets and continuing strong demand from China and the European Union. Nevertheless, CPO prices are expected to moderate in the second half of the year. The downward trend in the second half of 2004 is partly due to lower soybean oil prices arising from better soybean harvest expected in the US this year, barring any bad weather conditions. On average, the price of CPO is expected to hover around RM1,650 per tonne in 2004 (2003: RM1,544 per tonne).

To further boost Malaysia as the global market leader in CPO, the Government through the Malaysian Palm Oil Board (MPOB) is intensifying R&D efforts in raising oil palm productivity, oil extraction as well as increasing the shelf-life of palm oil-related products. More concerted efforts are made to introduce new products which use CPO as ingredient through intensive R&D including commercialisation, production and marketing. Among the products that were successfully commercialised, both locally and internationally, are red palm oil and palm oil-based non-hydrogenated creamer. Other R&D efforts include the development of high-value products from oil palm mesocarp, biomass and palm oil mill by-products for nutraceutical, pharmaceutical and cosmetic applications. To further enlarge market acceptance and the consumption of palm oil and related products overseas, more programmes and campaigns are

TABLE 2.5

**Oil Palm Area and Palm Oil Production**
**2003-2004**

| | | | Change (%) | |
|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] |
| Planted areas ('000 hectares) | 3,802 | 3,883 | *3.6* | *2.1* |
| Matured areas ('000 hectares) | 3,303 | 3,373 | *3.6* | *2.1* |
| Production ('000 tonnes) | | | | |
| Crude palm oil | 13,355 | 13,450 | *12.1* | *0.7* |
| Palm kernel oil | 1,644 | 1,680 | *11.6* | *2.2* |
| Yield (tonnes/hectare)[2] | 10.6 | 9.7 | *9.5* | *-8.7* |

[1] Estimate.

[2] Fresh Fruit Bunch Yield (January-July)

Source: Ministry of Plantation Industries and Commodities.

being implemented to increase awareness of its health attributes.

During the first six months of 2004, output of **rubber** rose sharply by 27.6% to 582,000 tonnes, partly due to improved yield. Strong rubber prices also motivated higher production from smallholders. Total land area under rubber cultivation is estimated to be 1.28 million hectares in 2004 (2003: 1.32 million hectares), a decrease of 2.5%, as shown in *Table 2.6*. However, improved tapping technologies such as Low Intensity Tapping System (LITS) and better rubber tree clones, help raise the output of rubber. Consequently, total production of rubber is expected to increase by 17.6% to 1.16 million tonnes in 2004 (2003: 10.6%; 986,000 tonnes). About 70% of total consumption of rubber was used by rubber industries such as in gloves, catheters, tyres and tubes. R&D efforts to improve high-yielding clones are important to ensure long-term sustainable supply of natural rubber for downstream rubber-based industries. The Government also initiated the Rubber Forest Plantation programme to provide sustainable and renewable supply of rubber wood for the expanding furniture industry. Currently, 1,800 acres of trial plots under the programme has been planted with improved latex timber clones such as the RRIM 2000 series. The programme will ensure that about 25,000 hectares are planted annually for a duration of 15 years. To optimise land utilisation and achieve economies of scale for smallholders, the Government continues to implement land consolidation and rehabilitation programmes.

The price of rubber has been on the uptrend since the second half of 2002. The average price of SMR20 in January-July 2004 rose by 39.3% to RM4.71 per kilogram (kg) compared with RM3.38 during the same period in 2003. This was underpinned by strong external demand, particularly from China, amidst tight world stocks and effective intervention by the International Tripartite Corporation (ITRCo) to stabilise prices at a competitive level for producers. In April this year, Vietnam joined ITRCo, which further enhanced its effectiveness.

In the forestry and logging sub-sector, total hectarage for the annual allowable cut in permanent forests is expected to be rationalised to ensure that the extraction of forest resources remains within specific limits as stipulated under the International Tropical Timber Agreement (ITTA). Hence, the overall production of **saw logs** is expected to decline, with the production of Sarawak and Sabah declining by 2% to 11.9 million cubic metres ($m^3$), and 2.3% to 4.2 million $m^3$, respectively in line with the sustainable forest management policy.

Value added in the **fishing** sub-sector, comprising marine landing and aquaculture harvest, is envisaged to increase by 3.2% and accounts for 12.6% of the total agriculture sector for 2004. This is largely attributed to efforts by the Government to promote aquaculture activities and increase marine fish landings, such as the modernisation of fishing methods and expansion of Aquaculture Industrial Zones. To further develop the fishing sub-sector, the Government introduced

TABLE 2.6

**Rubber Area, Yield and Production 2003-2004**

| | | | Change (%) | |
|---|---|---|---|---|
| | **2003** | **2004[1]** | **2003** | **2004[1]** |
| **Total area ('000 hectares)** | **1,315** | **1,282** | ***-2.4*** | ***-2.5*** |
| Smallholdings | 1,176 | 1,156 | *-1.6* | *-1.7* |
| Estate | 139 | 126 | *-9.2* | *-9.4* |
| **Yield (kg per hectare)** | | | | |
| Smallholdings | 1,270 | 1,290 | *14.8* | *1.6* |
| Estate | 1,334 | 1,365 | *9.3* | *2.3* |
| **Total production ('000 tonnes)** | **986** | **1,160** | ***10.6*** | ***17.6*** |
| Smallholdings | 909 | 1,090 | 12.9 | 19.9 |
| Estate | 77 | 70 | -10.6 | -9.0 |
| **% of world production** | ***12.3*** | ***13.8*** | ***1.7*** | ***12.2*** |

[1] Estimate.

Source: Ministry of Plantation Industries and Commodities and Department of Statistics.

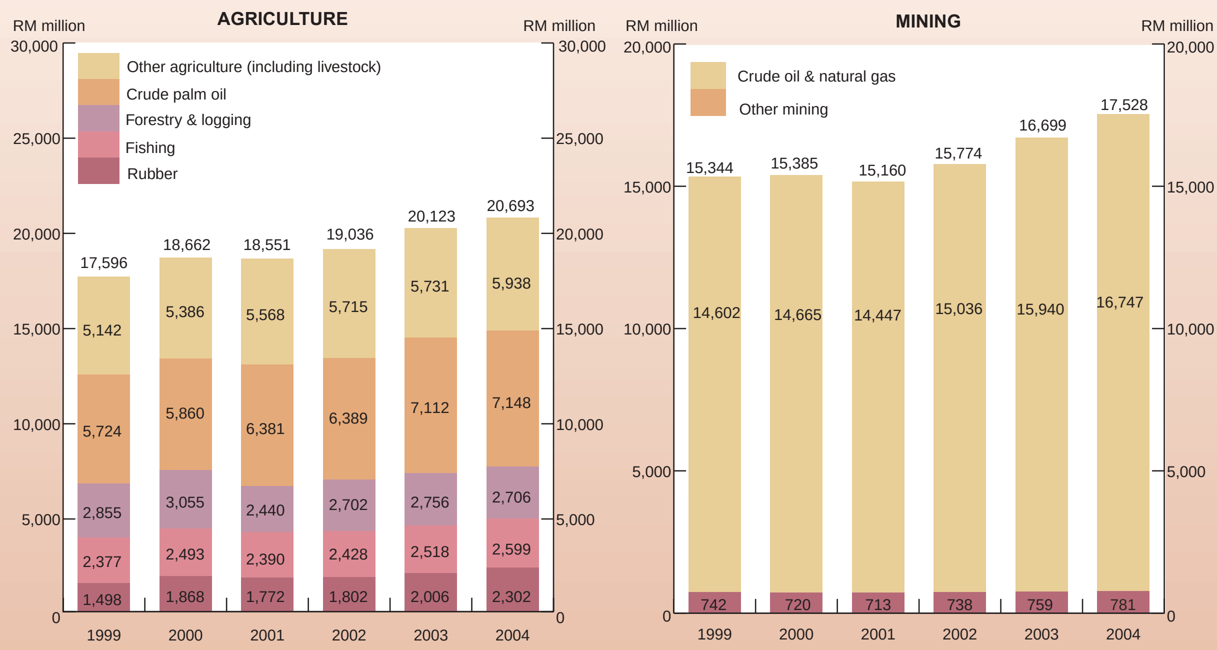
specific measures for coastal and deep-sea fishing. Deep-sea fishing is given priority due to its higher returns and vast fishing areas. Measures undertaken include upgrading support facilities and infrastructures, such as fish landing complexes and ice factories, upgrading the Kuantan and Tok Bali ports in Peninsular Malaysia and the new integrated Tanjung Manis Port, Sarawak as dedicated deep-sea ports. In addition, new technologies and equipment were introduced and training was extended for deep-sea fishermen to enhance their catch.

**Other agriculture**, comprising livestock, cocoa, paddy and miscellaneous agriculture, is envisaged to expand by 3.6% and contribute 28.5% of total value added in agriculture in 2004. **Livestock**, the largest component, is expected to grow by 7.5% (2003: 4.9%), partly contributed by the increase in the production of beef and mutton, especially through integrated cattle farming in oil palm and rubber plantations. The production of poultry is anticipated to increase by 7.9% (2003: 13.6%), following the importation ban on poultry and poultry products from Avian flu-infected countries. **Cocoa** production is set to grow by 10.5 % in 2004 as against a decline of 24.1% last year due to the strengthening of dry cocoa prices and favourable weather conditions. Prices are projected to be between RM4,500 to RM5,500 per metric tonne in 2004. The export ratio of cocoa beans and cocoa products increased to 6.5% and 93.5%, respectively in 2003 compared with 12% and 88% in 2002, reflecting increasing downstream processing activities.

**Paddy production** is expected to decline by 3.3%, as shown in *Table 2.7*, due to lower paddy yield from 3 tonne per hectare in 2003 to 2.8 tonne per hectare in 2004. This is despite the increase in paddy cultivated areas which is expected to increase slightly by 0.4% to 674,800 hectares in 2004 through various projects, namely projects undertaken by the Muda Agriculture Development Authority (MADA) in Kedah, Kemubu

CHART 2.5

**Value Added of Major Commodities**




Source: Department of Statistics.

Agricultural Development Authority (KADA) in Kelantan as well as projects under Integrated Agricultural Development Project (IADP) in Seberang Prai in Penang, Seberang Perak and the *Projek Barat Laut Selangor* and North Terengganu Agriculture Development Project (Ketara) in Terengganu. The lower yield was on account of the emergence of the weedy paddy, commonly known as *padi angin*. Measures undertaken to increase paddy yield per hectare include development of large scale, commercial paddy farms, enhancing private sector involvement and entrepreneur development. In addition, Government agencies and relevant organisations, including *Pertubuhan Peladang Kawasan* (PPK) and cooperatives, are tasked to encourage mergers and amalgamation of small farms into mini paddy estates to reduce costs, optimise production and improve economies of scale. The private sector is encouraged to venture into paddy cultivation in new areas, especially in Sabah and Sarawak, where large tracts of land are available. Following this, a private company has embarked on the cultivation of organic paddy as a new niche product for the domestic rice market.

Output of **miscellaneous agriculture** products, such as fruits, copra, vegetables, tobacco, tea, flowers, pepper and others is projected to increase by 1.6% this year (2003: -0.7%). Fruit production is expected to rise by 13.1% in 2004, due to greater efforts by the Government to promote local fruit consumption through food fairs and various campaigns. In addition, the Government also launched the "Malaysia's Best" label in June 2004 to promote quality and safe fruits to ensure better access to more lucrative overseas markets. The Government has also introduced the *Skim Akreditasi Ladang Malaysia* (SALM) for the certification of farms to ensure that the cultivation process of fruits is in accordance with good farm practices. Currently, 'Malaysia's Best' products are mango, papaya, starfruit, watermelon and pineapple, which are available at 13 hypermarkets and supermarkets. To date, a total of 102 selected farms are accredited with SALM certification. The recent approval by Australia to allow Malaysian fruits to be imported into the country is testament of the success of the Government's efforts to promote Malaysia as a producer of safe and quality fruits. The approval is significant as Australia observes stringent safety and quality standards for imported fruits.

TABLE 2.7

**Production of Other Agriculture 2003-2004**
('000 tonnes)

| | | | Change (%) | |
|---|---|---|---|---|
| | **2003** | **2004[1]** | **2003** | **2004[1]** |
| Paddy | 2,259 | 2,184 | *3.6* | *-3.3* |
| Cocoa | 36.2 | 40.0 | *-24.1* | *10.5* |
| Pepper | 18.2 | 15.0 | *-19.8* | *-17.6* |
| Tobacco[2] | 120 | 123 | *18.2* | *2.5* |
| Fruits[3] | 1,689 | 1,910 | *31.4* | *13.1* |
| Livestock | | | | |
| Meat[4] | 1,096 | 1,158 | *10.9* | *5.7* |
| Eggs('000)[5] | 7,165 | 7,883 | *8.2* | *10.0* |
| Milk ('000)[6] | 38.6 | 38.8 | *7.3* | *0.5* |
| Tea | 17 | 12 | *-19.9* | *-27.3* |
| Vegetable | 813 | 658 | *4.5* | *-19.1* |
| Copra | 14.1 | 14.0 | *3.7* | *-0.7* |

[1] Estimate.
[2] Green and dry tobacco leaves.
[3] Consists of starfruit, papaya, jackfruit, ciku, durian, guava, langsat, mango, mangosteen, pineapple, banana, rambutan, watermelon and other tropical fruits
[4] Including beef, poultry, swine and mutton.
[5] Number.
[6] Litre.

Source: Ministry of Agriculture and Agro-Based Industry and Ministry of Plantation Industries and Commodities.

Cut flowers, another fast growing agriculture produce, are presently exported to Thailand (25%), Japan (20%), Singapore (20%) and Hong Kong (15%). Total value of production is expected to increase by 12.5% to RM117 million in 2004(2003: RM104 million). To further boost exports, MARDI has developed a new technology for shipping cut flowers by sea, which reduces transportation costs and allows larger quantities per shipment.

## Mining Sector

***Oil price peaked, contribute to mining growth...***

The **mining sector** is set to expand moderately by 5% in 2004 (2003: 5.9%), despite strong demand from both domestic and overseas markets and higher crude oil and natural gas prices. This is in line with the National Depletion Policy to ensure sustainable energy resources.

TABLE 2.8

**Value Added in the Mining Sector 2003-2004**
(in 1987 real prices)

| | RM million | | Change (%) | |
|---|---|---|---|---|
| | **2003** | **2004[1]** | **2003** | **2004[1]** |
| Mining sector | 16,699 | 17,528 | *5.9* | *5.0* |
| Crude oil & natural gas | 15,940 | 16,747 | *6.0* | *5.1* |
| Other mining | 759 | 781 | *2.8* | *2.9* |

[1] Estimate.

Source: Department of Statistics.

During the first seven months of 2004, **crude oil** production, including condensates, which averaged 754,014 barrels per day (bpd) rose by 3.3% compared with 6% in the corresponding period of 2003. Production for the whole year is targetted to increase by 2% with an average of 753,000 bpd (2003: 738,000 bpd) based on the planned work programme for 2004. The increase in production is attributed to higher oil prices this year, as reflected by the increase in the average price of the Asian benchmark Tapis Blend to USD37.53 per barrel in the first seven months of 2004 (January-July 2003: USD28.40 per barrel). The highest price recorded was USD50.08 per barrel on 20 August 2004. Petroliam Nasional Berhad (PETRONAS) is continuing its efforts to increase the country's oil reserves by venturing into deep-sea exploration and investing in advanced technologies to identify new fields as well as enhancing the oil recovery rate in existing fields. These efforts resulted in new oil field discoveries in Kakap and Kikeh, offshore Sabah, and also Kenarong, offshore Terengganu.

The production of **natural gas** expanded by 2.3% to 5,098 million standard cubic feet per day (mmscfd) in the first seven months of 2004 (January-July 2003: 9.5%; 4,985 mmscfd). Total production for the year is projected to increase by 11.3 % to 6,094 million standard cubic feet per day (mmscfd) (2003: 17.3%; 5,488 mmscfd) with anticipated increase in new operational gas fields. Petronas Serai offshore gas field began

TABLE 2.9

**Production and Reserves of Crude Oil and Natural Gas 2003-2004**

| | | | Change (%) | |
|---|---|---|---|---|
| | **2003** | **2004[1]** | **2003** | **2004[1]** |
| **Crude oil** | | | | |
| Production ('000 barrels per day)[2] | 738 | 753 | *5.7* | *2.0* |
| Reserves (billion barrels) | 4.5 | 4.8 | *25* | *6.7* |
| Reserves/Production (year) | 16 | 17 | *0* | *6.7* |
| **Natural gas** | | | | |
| Production (million meter standard cubic feet per day (mmscfd))[3] | 5,488 | 6,094 | *17.3* | *11.3* |
| Reserves (trillion standard cubic feet) | 89.02 | 87.02 | *1.4* | *-2.4* |
| Reserves/Production (year) | 44.4 | 39.1 | *24* | *-11.9* |

[1] Estimate.
[2] Including condensates.
[3] Excluding flaring and reinjection.

Source: PETRONAS.

production in June this year with an estimated capacity of 8 million cubic meters per day. In terms of gas reserves, the discovery of Kakap, the offshore gas field in Sabah, will add further to Malaysia's gas reserves of 87.02 trillion standard cubic feet. Malaysia is the largest LNG producer at a single location, Bintulu LNG Complex with a total production capacity of 23 million tonnes per annum.

## Construction Sector

### *Growth underpinned by robust housing activity...*

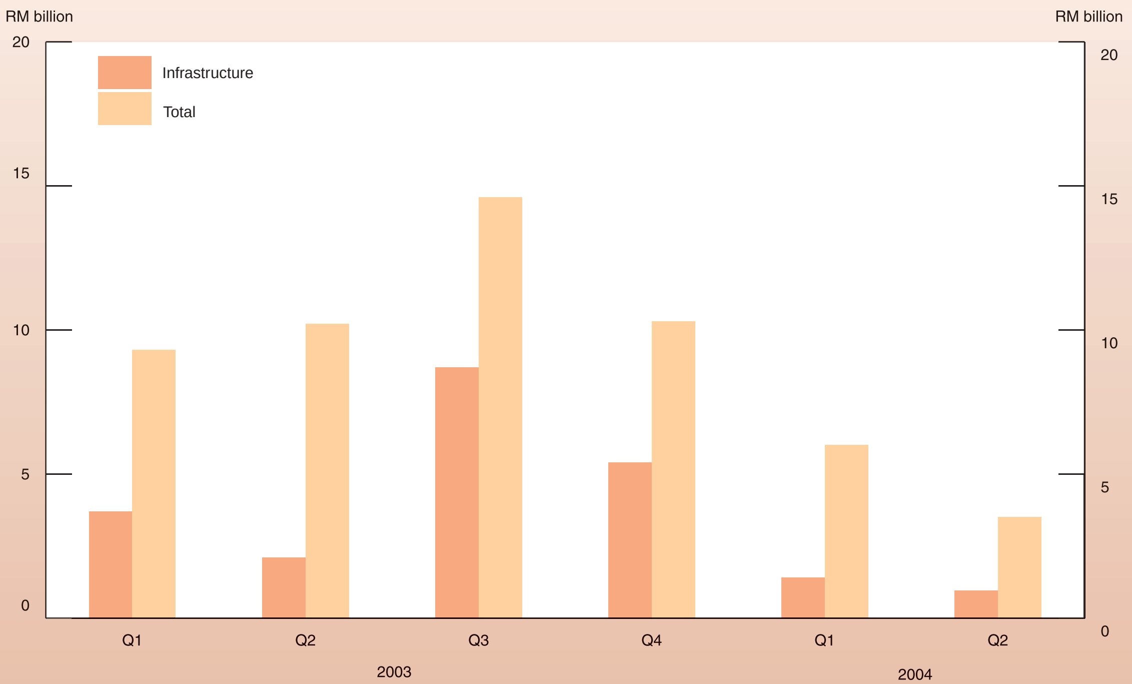
The **construction sector** recorded a marginal decline of 0.6% during the first half of 2004 largely due to lower public sector construction activity, especially in infrastructure projects. However, higher residential construction activity following stronger growth of housing starts of 36.8% during the second half of 2003 and some on-going infrastructure projects will provide sufficient support for the sector to record a positive growth of 0.5% in 2004 (2003: 1.9%).

The completion of several large infrastructure projects and the accelerated completion of the 8MP projects, coupled with a lower number of new contracts awarded by the Government have contributed to slower activity in **civil engineering** works. Among the infrastructure projects completed in 2004 are Phase One of the East Coast Highway, SILK Highway, Penchala Link, New Pantai Expressway and Guthrie Corridor Expressway. Ongoing projects include the power station in Tanjung Bin, Johor, Bakun Hydro-Electric power project in Sarawak, Integrated Customs, Immigration and Quarantine (CIQ) Complex and Stormwater Management and Road Tunnelling (SMART) for flood mitigation and traffic dispersal in Kuala Lumpur.

Activity in the **residential** sub-sector, on the other hand, is expected to surge further in 2004, following strong growth in housing starts and higher number of housing approvals in the second half of 2003. Demand for houses remain strong during the first six months of 2004 with brisk sales registered, particularly for affordable properties in locations with good accessibility and public amenities. The demand was spurred

CHART 2.6

**Value of Contracts Awarded**




Source: Construction Industry Development Board (CIDB).

in part by incentives offered under the Package of New Strategies, introduced in May 2003. High-end units in prime locations also recorded good sales, reflecting changing tastes and quality lifestyles, following higher incomes. The sentiment was also boosted by low interest rates and attractive loan packages that helped raise the affordability of houses. Housing loans disbursement increased by 18.5% during the first six months of 2004. In addition, the new interest rate framework, which promotes healthy competition among banks and financial institutions, is expected to benefit house buyers.

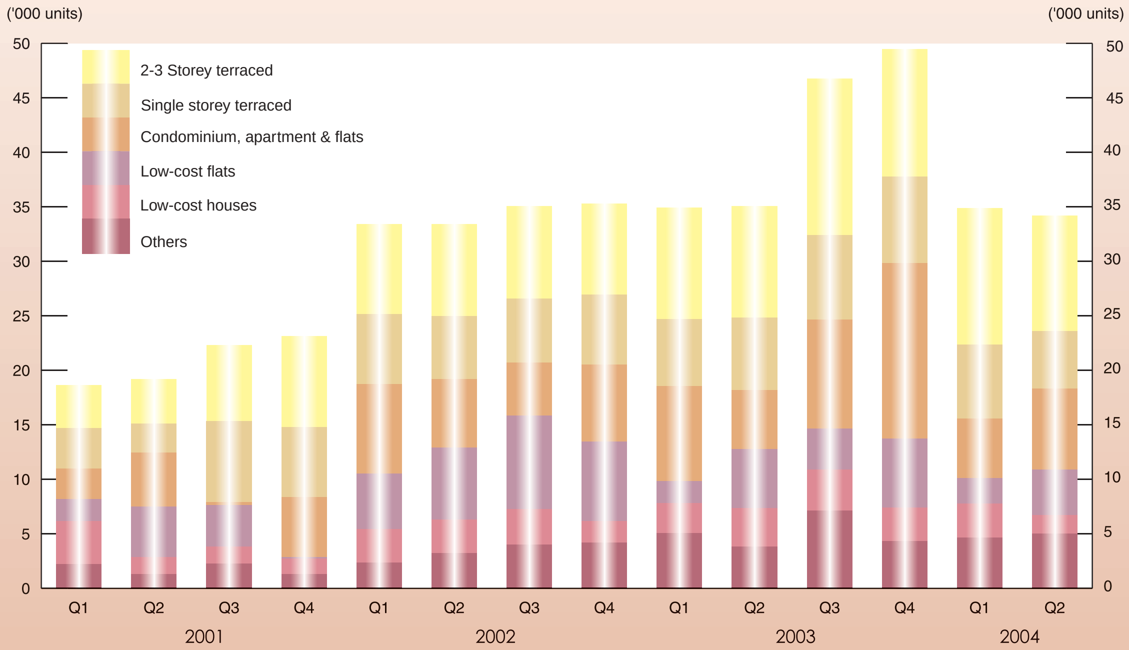
On the supply side, housing developers remain positive on the residential sub-sector, motivated by favourable economic outlook. Confidence of developers is evident from the strong pick-up in housing approvals as well as new sales and advertising permits issued, which increased by 8.2% and 18.1%, respectively.

The liberalisation of FIC rules, allowing foreigners to acquire landed properties exceeding RM150,000, has increased foreign buyers contribution towards housing transactions by 94.6% during the first half of 2004. A total of 1,306 units of houses with a value of RM700 million were transacted by foreigners during the period, particularly for condominiums and apartments.

In the non-residential sub-sector, the occupancy rate for **purpose-built offices** improved to 81.7% in the first six months of 2004 (January-June 2003: 79%) due to less new office space available. Total existing space in the first half of the year was 13,362,028 square meters (sq.m.), 2.4% higher than the corresponding period in 2003. Among the new office buildings available in the Klang Valley are Menara Marinara, Menara Axis and Yayasan Tun Razak Building. Rentals for purpose-built offices were stable in tandem with the improved occupancy rate.

CHART 2.7

**Housing Starts[1]**




[1]Comprises units which at least have physical foundation work started.
Source: NAPIC, Valuation & Property Services Department.

Total existing space within **shopping complexes** stood at 6,907 million sq.m. as at end-June 2004, representing an increase of 8.3% (530,500 sq.m.) compared to the same period last year. Meanwhile, the occupancy rate improved to 79.4%, in line with expansion in business activities. New retail locations in 2004 include the extension of One Utama, Prima Jusco, Giant Kelana Jaya and Alamanda Putrajaya in the Klang Valley as well as Travilion@Padungan in Kuching, Sarawak. In general, the take-up rates of office and retail outlets in prime commercial locations have been good, following bullish business and consumer sentiments. In addition, a total of 123 **industrial** units and 2,920 **shop** units were completed, increasing existing stocks by 1.1% and 3.9%, respectively. Four new **hotels** with a total of 2,343 rooms were also completed. The average occupancy rate for three to five star hotels rose significantly to 61.8% during the first half of 2004 (January-June 2003: 50.9%) due to higher tourist arrivals.

**Property transactions** increased sharply by 20.1% in the first half of 2004 (January-June 2003: -4.6%). All property sub-sectors recorded higher number of transactions, ranging from 14% (industrial) to 38.6% (development land). The residential sub-sector continued to spearhead growth of the property market, contributing 65.5% of the total transactions (136,224), followed by the agriculture (19.2%), commercial (8.1%), development land (4.5%) and industrial sub-sectors (2.6%). In terms of value, the market expanded strongly by 41.8% to RM28,119 million during the period (January-June 2003: RM19,832 million).

TABLE 2.10

**Services Sector Performance 2003-2004**

(in 1987 real prices)

| | Change (%) | | Share of GDP (%) | |
|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] |
| Utilities (electricity, gas and water) | *5.7* | *7.4* | *4.1* | *4.2* |
| Transport, storage and communications | *5.7* | *7.3* | *8.6* | *8.7* |
| Wholesale and retail trade, hotels and restaurants | *1.5* | *6.6* | *14.3* | *14.3* |
| Finance, insurance, real estate and business services | *5.4* | *6.3* | *15.1* | *15.0* |
| Government services | *7.6* | *2.6* | *7.4* | *7.1* |
| Other services | *3.3* | *5.3* | *8.0* | *7.9* |
| **Total** | ***4.4*** | ***6.0*** | ***57.6*** | ***57.1*** |

[1] Estimate.

Source: Department of Statistics.

## Services Sector

***Services sector strengthens backed by higher consumption, trade and tourism activities...***

The services sector is set to achieve higher growth of 6% in 2004 and contribute 57.1% to GDP, driven mainly by higher consumer spending amidst rising disposable income and a record level of tourist arrivals. Growth is expected to emanate from strong expansion in most sub-sectors with the utilities sub-sector in the lead at 7.4%, as shown in *Table 2.10*. Steady increases in the transport, storage and communications; wholesale and retail trade, hotels and restaurants; and finance, insurance, real estate and business services sub-sectors will further reinforce overall growth. The expansion in new growth areas in supply chain management such as operational headquarters (OHQs), regional distribution centres (RDCs), international procurement centres (IPCs) as well as shared information technology (IT) services will further support the growth of the sector.

The expansion in the **utilities sub-sector** is supported mainly by strong growth in demand for electricity from industrial and commercial sectors as well as improved operational efficiency. The maximum demand for electricity peaked at 12,024 megawatts (MW) in May 2004. Electricity sales rose by 8.9% during the first six months of 2004 (January-June 2003: 7.3%), in tandem with increasing demand from expanding industrial and commercial activities.

**Transport, storage and communication sub-sector** is envisaged to record a higher growth of 7.3% in 2004. The strong performance is on account of an increase in transport services, supported by higher trade and domestic economic activities, particularly tourism as well as increased demand and competitiveness in the communications industry. All modes of transportation are expected to expand, especially air transport of passengers and cargo as a result of aggressive marketing, increased capacity, improved productivity and efficiency.

Growth in container volume remained strong with major ports recording a growth of 17.5% to reach 5.6 million twenty-foot equivalent units (TEUs) (January-June 2003: 4.8 million TEUs). Increase in local and transshipment traffic as well as worldwide box movements, additional services and ship calls, particularly at Port Klang and Tanjung Pelepas Port (PTP), and higher productivity contributed to the uptrend. PTP handled a record level of 2 million TEUs during the first half of 2004, a staggering 25.3% increase over the 1.6 million TEUs in the corresponding period of 2003. PTP is optimistic of handling between 4 to 4.5 million TEUs in 2004, backed by increased productivity and capacity from the completion of an additional 720 meters of wharf in mid-2004, adding another 1.5 million TEUs to the port's capacity. Port Klang's throughput increased by 11% to 2.6 million TEUs (January-June 2003: 2.4 million TEUs), with whole year throughput estimated at 5.2 million TEUs. Efforts to encourage industries in the vicinity of ports such as the establishment of the Pulau Indah Free Zone will contribute towards throughput growth. PTP is also upgrading and aggressively marketing its free zone to encourage multinational companies to set up their procurement and distribution centres within its vicinity.

The air passenger transport segment recovered in the first seven months of the year, owing largely to high tourist arrivals. The number of passengers on Malaysia Airlines rose sharply by 17%, compared with a decline of 10.1% recorded in the same period last year. The no-frills budget airline, AirAsia Sdn. Bhd. continued to make its presence felt by recording an impressive growth of 74.8% or 1.9 million passengers during the first seven months of 2004 as against 1.1 million passengers in the corresponding period of 2003. This was achieved in an environment of heightened competition through its aggressive strategy to expand into regional markets in Indonesia, Thailand, Brunei and Macau. Air cargo handling at Malaysian airports picked up by 8.5% to 451.9 million tonnes during the period. This increase is attributed largely to strong growth in trade as well as participation of new airlines and aggressive marketing by Malaysia Airlines Cargo Sdn. Bhd. (MASkargo), especially through its I-Port initiative, linking three major ports (Northport, PTP and Kuantan Port), and ensuring a seamless movement of cargo between seaports and airports.

The growth in land transportation is supported by improved roads, rail transport and the integration of public transport services. The number of vehicles on tolled highways increased by 4% to 468 million during the first six months (January-June 2003: 19.6%, 450 million), while Light Rail Transit (LRT) ridership increased by 6.4% to 48.4 million (January-June 2003: 6.3%, 45.5million). Revenue of intercity train and commuter services of Keretapi Tanah Melayu Bhd (KTMB) also registered an impressive growth of 22.6% and 13.8% in the same period (January-June 2003: -16.1%; 15.1%) or RM31.1million and RM31.7 million (January-June 2003: RM25.2 million; RM27.9 million), respectively arising from extensive promotional packages as well as rising demand during various festivals and celebrations.

The communication industry continues to expand strongly due to an increase in cellular phone and Internet users. The number of cellular phone subscribers increased by 24.8% to 12.4 million at end-June 2004 (end-June 2003: 23.8%; 9.9 million), registering a 48.5% penetration rate (January-June 2003: 39.6%). Short Messaging Services (SMS) increased significantly from 1,437.8 million messages in the first half of 2003 to 2,087.7 million in the corresponding period of 2004 due to lower charges, wider range of information products, attractive graphic application of sounds and images as well as increased promotional activities. However, the number of fixed line subscribers moderated by 1.5% to 4.55 million (January-June 2003: 4.62 million) as a result of higher preference for the use of mobile phones due to its convenience and competitive pricing. The number of Internet subscribers increased by 14.2% to 3.12 million (January-June 2003: 18.9%, 2.73 million), resulting in a 12.2%

TABLE 2.11

**Wholesale Trade**
(In current prices)

| | 2003 | Q1 2003 | Q1 2004 | Change (%) |
|---|---|---|---|---|
| **Total value of sales (RM million)** | 124,936 | 30,063 | 33,538 | *11.6* |
| of which: | | | | |
| Motor tradings and motor accessories | 42,624 | 10,225 | 11,844 | *15.8* |
| Industrial, agricultural, business equipment and materials | 25,285 | 6,374 | 6,471 | *1.5* |
| Household and personal goods | 19,545 | 4,591 | 5,168 | *12.6* |
| Food, drinks and tobacco | 17,883 | 4,260 | 4,700 | *10.3* |
| Palm oils | 2,194 | 507 | 844 | *66.4* |

Source: Department of Statistics.

penetration rate (January-June 2003: 10.9%). In consonance, the number of broadband subscribers increased from 53,594 in the first half of 2003 to 174,018 in the same period of 2004, attributed to reduced access fee and stronger demand for high-speed Internet access.

The **finance, insurance, real estate and business services sub-sector** is expected to expand by 6.3% in 2004, underpinned by higher loans growth, stronger performance of the insurance business and improved real estate and stock market activities. All loan indicators registered double-digit growth, backed by higher business activities and strong private consumption. Total loan applications, approvals and disbursements by the banking system rose by 18.4%, 13.6% and 14.6%, respectively (January-June 2003: 2.2%, 10.3% and 0.1%). This encouraging trend is also reflected in the insurance industry, whereby total premium from both conventional and *takaful* products increased by 21.5 % and 6.8% (January-June 2003: 11.6%; 23.1%), respectively. In the equity market, Bursa Malaysia remained active despite market concerns of rising interest rates in the US and the impact of rising oil prices. Trading volume and value rose sharply by 22.5% and 59.4%, respectively to 81,734 million units and RM104,845 million during the first eight months of 2004 (January-August 2003: 66,711 million units; RM67,170 million). The Kuala Lumpur Composite Index (KLCI) closed higher at 827.98 points at end-August 2004 (end-2003: 793.43 points) with market capitalisation at RM654,260 million (end-2003: RM640,280 million).

Rising disposable income, sophisticated lifestyle and changing preferences of consumers as well as higher tourist arrivals spurred the growth of the **wholesale and retail trade, hotels and restaurants sub-sector**. The sub-sector is anticipated to achieve a significantly higher growth of 6.6% in 2004 compared with 1.5% in 2003. Sales value of wholesale trade grew by 11.6% to RM33,500 million in the first quarter of 2004 (January-March 2003: 10.4%, RM30,000 million) following higher sales of stores dealing in motor trading and motor accessories; household and personal goods; industrial, agricultural, business equipment and materials; food, drinks and tobacco; and trading of palm oils. Retail trade recorded sales totalling RM14,100 million in the first quarter of 2004 (January-March 2003:

TABLE 2.12

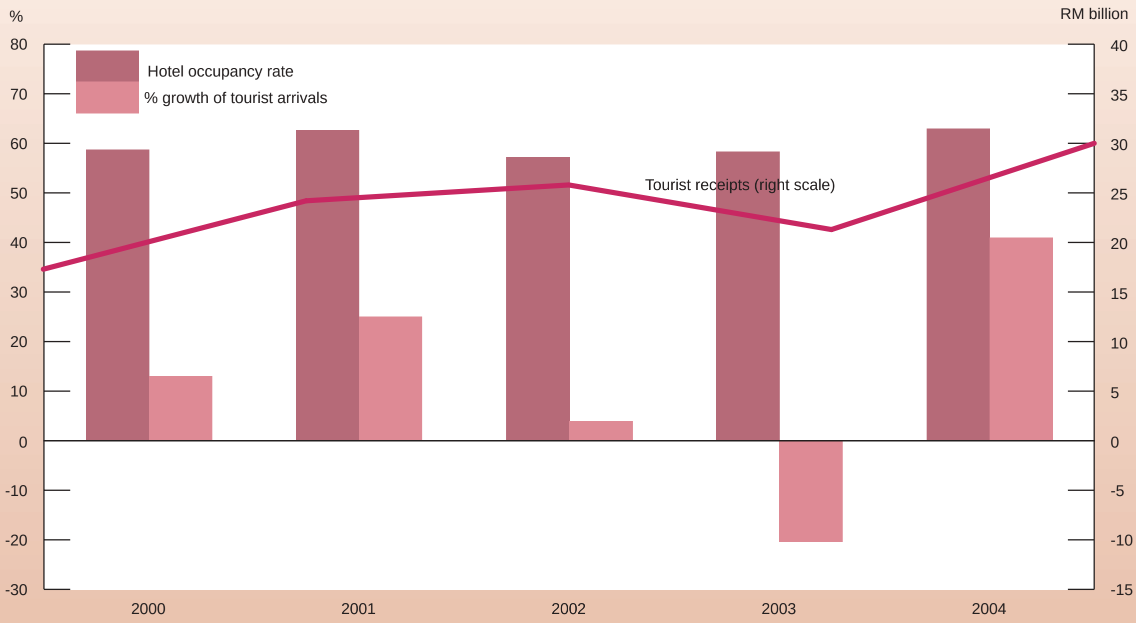
**Retail Trade**
(In current prices)

| | 2003 | Q1 2003 | Q1 2004 | Change (%) |
|---|---|---|---|---|
| **Total value of sales** (RM million) | 56,597 | 14,262 | 14,129 | -0.9 |
| of which: | | | | |
| Motor trading and motor accessory stores | 26,557 | 6,634 | 6,509 | -1.9 |
| Household and personal goods | 13,499 | 3,388 | 3,591 | 6.0 |
| Petrol, diesel, lubricants and others | 6,426 | 1,555 | 1,620 | 4.2 |
| Clothing, textile, linen, towels, blankets and footwear | 2,564 | 697 | 623 | -10.7 |
| Food, drinks and tobacco | 2,448 | 583 | 664 | 13.9 |
| Industrial, agricultural, business equipment and materials | 2,709 | 641 | 584 | -8.8 |

Source: Department of Statistics.

CHART 2.8

**Growth of Tourist Arrivals, Hotel Occupancy Rate and Tourist Receipts**




Source: Malaysia Tourism Promotion Board.

RM14,300 million), reflecting a slight decline of 0.9% as shown in *Table 2.12*. Nonetheless, improved consumer sentiment, increased domestic economic activities, new retail concepts which combine various business activities under one roof, and new establishments, are expected to spur sales for the rest of the year.

The **tourism industry** remains upbeat with tourist arrivals surpassing the one million mark since November 2003, with the highest arrivals recorded in January 2004 at 1.4 million visitors. During the first seven months of 2004, total tourist arrivals rose by 71.7% to 9.1 million compared with the sharp decline of 31.2% or 5.3 million in the corresponding period of 2003, when the industry was adversely affected by the war in Iraq, SARS and security threats. In terms of composition by country of origin, the highest tourist arrivals were from Singapore with 5.5 million tourists, constituting 60.8% of total tourists. Other significant markets include Thailand, which constitutes 9.3%, Indonesia (5%) and China (3.7%). In addition, aggressive and intensive promotion in West Asian countries, including Saudi Arabia, Lebanon, United Arab Emirates and Syria has created new emerging markets.

Tourist arrivals are expected to increase further by the end of this year in conjunction with various carnivals, events and festivities planned for the year, such as “Colours of Malaysia” *(Citrawarna Malaysia),* Food and Fruit Festivals, National Open House Celebrations of major religious festivals as well as international exhibitions and conventions. Tourism remains a significant foreign exchange earner and contributed a total of RM21.3 billion in revenue with total tourist arrivals amounting to 10.6 million in 2003. Based on current trends, Malaysia’s targets of 15 million arrivals and RM30 billion in foreign exchange earnings for 2004 are likely to be achieved.

The **government services sub-sector,** which accounts for 7.1% of GDP, is expected to record a growth of 2.6% in 2004. The moderate performance of this sub-sector mainly reflects the lower annual expenditure on emolument for civil servants in 2004 as opposed to the higher expenditure incurred in 2003, due to salary adjustments for Sistem Saraan Malaysia (SSM).

Value added of the **other services** sub-sector, comprising community, social, and personal services as well as imputed rent from owner-occupied dwellings, is expected to increase by 5.3% in 2004. Rising demand for **private healthcare** and **education** is expected to contribute significantly to the growth of this sub-sector. Currently, there are 519 private institutions of higher learning, including 23 with university status. The National Accreditation Board has accredited a total of 348 courses offered by these institutions as at end-August 2004. The Government's efforts to promote education and health tourism have also benefitted the sub-sector. The number of foreign students in private institutions of learning is projected to increase from 31,000 at end-2003 to 43,000 by end of 2004. Similarly, the number of health tourists is estimated to increase markedly from 103,000 in 2003 to 140,000 this year, given the competitive pricing and quality of healthcare available in the country. A total of 35 private hospitals is involved in offering medical treatment and healthcare services to foreign patients, of which 14 hospitals have received MS:ISO 9001 accreditation while six have been accorded with Malaysian Society for Quality in Healthcare accreditation.

## Export Performance

### *Exports bolstered by synchronised expansion across the globe…*

Exports represent a vital component of Malaysia's economic growth and development. The Government has aggressively pursued trade opportunities and 2003 marks a record setting year for exports. In the first seven months of 2004, Malaysia's gross export earnings (free-on-board or f.o.b. prices) expanded strongly by 21.1% (January-July 2003: 10.7%) to RM268,462 million. The strong growth is attributable to higher earnings from manufacturing products, mining commodities as well as agriculture produce. Malaysia's external sector is expected to maintain its upward momentum in the second half of the year. As in the past, manufactured goods are expected to contribute significantly to Malaysia's total export earnings and account for 82.6% of the total gross value of exports in 2004 (2003: 82%).

### Export of Manufactured Goods

#### *Manufacturing exports continue to surge…*

Manufactured goods have been a major contributor to Malaysia's total exports since the early 1990s, with its share to total exports sustained at more than 80%. Overall manufactured exports surged by 21.1% during the first seven months of 2004 (January-July 2003: 6.1%), as most of the export-led industries benefitted strongly from rising global demand. E&E products remained the largest contributor to manufactured exports with a share of 65.4%. Exports of non-E&E products also expanded strongly, as shown in *Table 2.13*, spurred by higher export of chemicals and chemical products, iron, steel and metal products as well as transport equipment.

Export earnings of E&E increased sharply by 17.4% during the first seven months of 2004 (January-July 2003: 1.9%). Higher export earnings were attributed to positive increases in all major sub-sectors such as semiconductors, electronic equipment and parts as well as electrical products. The moderation in export growth of semiconductors by 7.1% (January-July 2003: 26.1%) was partly due to base year effect. The semiconductor sub-sector, which gained from higher spending on ICT industry, has moved along the technology value chain and is now producing the latest generation of integrated circuits using advanced technologies in its packaging. Demand for Malaysia's semiconductors is expected to increase further as the book-to-bill (BTB) ratio of North America's electronics equipment industry has continued to stay above one point since October last year, as shown in *Chart 2.9*. The US remains the largest market, importing more than one-quarter of Malaysian-made semiconductors.

As for electronic equipment and parts, a significant turnaround of 21.4% (January-July 2003: -11.1%), was achieved mainly due to higher exports of automatic data processing machines and parts as well as printed circuit boards. Similarly, value of electrical products recorded a substantial increase of 27.9% (January-July 2003: -6%), contributed by strong export earnings in industrial and commercial electrical products, machinery and equipment as well as consumer electrical products.

TABLE 2.13

**Export of Manufactured Goods**
**January-July**

| | RM million | | Change (%) | | Share (%) | |
|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 |
| **Electronics, electrical and machinery appliances** | **123,753** | **145,279** | ***1.9*** | ***17.4*** | ***67.4*** | ***65.4*** |
| Semiconductors | 48,328 | 51,748 | *26.1* | *7.1* | *26.3* | *23.2* |
| Electronic equipment and parts | 45,696 | 55,494 | *-11.1* | *21.4* | *24.9* | *24.9* |
| Electrical products | 29,729 | 38,037 | *-6.0* | *27.9* | *16.2* | *17.1* |
| **Non-electronics and electrical products** | **59,743** | **76,875** | ***16.1*** | ***28.7*** | ***32.6*** | ***34.6*** |
| Chemicals, chemical and plastic products | 13,181 | 17,335 | *21.6* | *31.5* | *7.2* | *7.8* |
| Petroleum products | 6,393 | 8,086 | *40.7* | *26.5* | *3.5* | *3.6* |
| Iron and steel, and metal products | 6,449 | 9,034 | *26.5* | *40.1* | *3.5* | *4.1* |
| Wood-based products | 5,459 | 6,843 | *3.5* | *25.4* | *3.0* | *3.1* |
| Textiles, apparel and footwear | 4,985 | 5,989 | *4.4* | *20.1* | *2.7* | *2.7* |
| Food, beverages and tobacco | 4,093 | 4,987 | *12.6* | *21.8* | *2.2* | *2.2* |
| Rubber-based products | 2,948 | 3,559 | *11.7* | *20.7* | *1.6* | *1.6* |
| Transport equipment | 1,869 | 2,683 | *1.7* | *43.6* | *1.0* | *1.2* |
| Non-metallic mineral products | 1,616 | 1,796 | *-0.2* | *11.2* | *0.9* | *0.8* |
| Miscellaneous manufactured products | 12,748 | 16,563 | *13.7* | *29.9* | *6.9* | *7.5* |
| **TOTAL** | **183,496** | **222,154** | ***6.1*** | ***21.1*** | ***100.0*** | ***100.0*** |

Source: Department of Statistics.

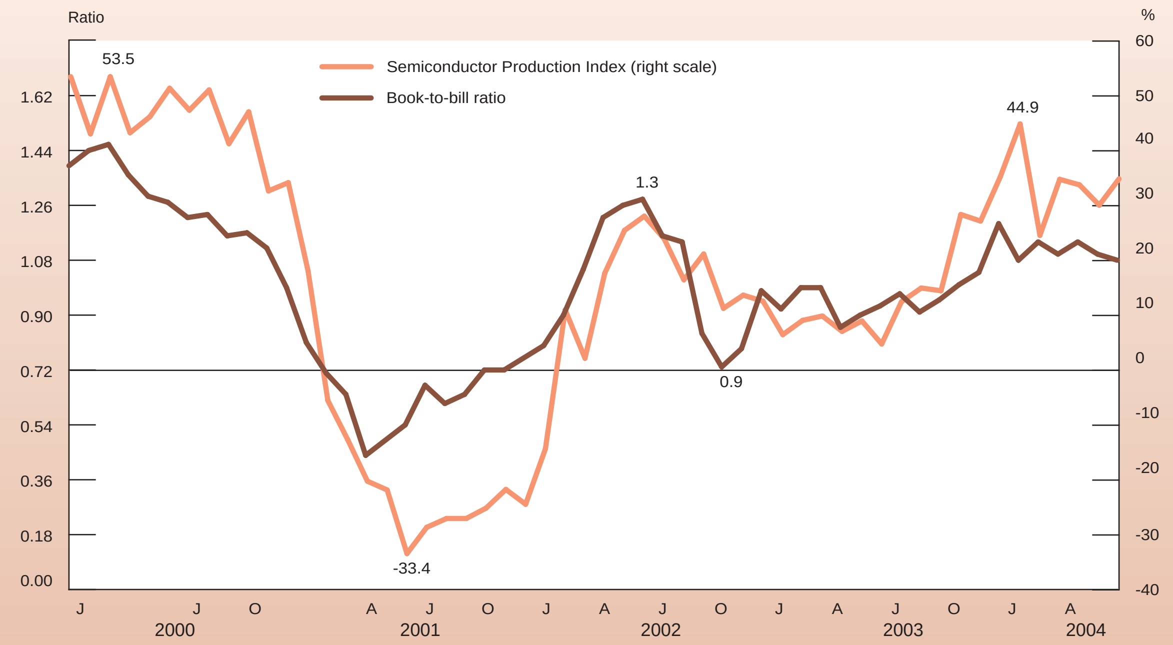
The increase in exports of electronics boosted demand for **chemicals, chemical products and plastics**. The spillover effect enabled the second largest manufacturing export to grow by 31.5% (January-July 2003: 21.6%) and sustained its double-digit growth for 27 consecutive months since April 2002, increasing its share to 7.8% to total manufacturing exports. The sustained growth was also due to an increase in exports of organic chemicals and plastics in primary and secondary forms, which accounted for 64% of total exports of the product group. Exports of plastic products expanded in response to positive developments in E&E, automotive, construction and medical devices industries. The pharmaceutical industry has also benefitted from innovations of production-related technologies, particularly in biotechnology. Notably, exports of pharmaceuticals surged by 36.1% (January-July 2003: 5%) on the back of higher growth of medicaments.

Export receipts from **iron, steel and metal products** jumped 40.1% in the first seven months of 2004 (January-July 2003: 26.5%) on account of higher demand from major importing countries, such as China, as well as higher export prices. Among major items exported were iron and steel (tubes and pipes), non-ferrous metal and fabricated metal products. Exports of iron and steel increased strongly by 48.1% to RM3,917 million (January-July 2003: 58.1%; RM2,644 million), thus increasing its share to 4.1% of total manufacturing exports. Meanwhile, exports of fabricated metal products grew markedly higher by 34.2% (January-July 2003: 13.7%) on account of greater demand for base metal products by the major importing countries.

Export receipts from **rubber-based products** picked up significantly, dominated by higher exports of rubber gloves. Malaysia maintained her position as the leading exporter of rubber gloves (include medical gloves), which constitute more than 60% of the total export of rubber products. The advancement in production of high quality new generation gloves such as low protein, powdered or powder-free gloves and dry rubber products including conveyor belts, rubber rollers

CHART 2.9

**Book-to-Bill Ratio[1] and Malaysia's Semiconductor Output Growth**




[1]Source: North America Semiconductor Equipment Association.

and moulded rubber parts for automotive and E&E industries, has boosted the industry's performance.

Tyres and tubes showed a significant increase of 30% (January-July 2003: 16%) on the back of higher demand in local and export markets. The increase is also due to higher demand for **transport equipment.** The export receipts of the transport equipment accelerated as manufacturers and exporters took advantage of the reduced duty to 5% effective from January 2003 under AFTA, which made it feasible for expansion into ASEAN markets.

## Export of Primary Commodities

***Firm prices contribute to higher earnings...***

Export earnings from primary commodities, comprising agriculture produce and mineral products, is estimated to increase by 13.2% to RM66,351 million in 2004 (2003: 32.2%; RM58,630 million). Growth emanates from higher export receipts of palm oil, crude oil as well as LNG on account of higher prices and strong external demand. Export earnings from **agriculture commodities** for the first seven months of 2004 increased by 8.2% to RM18,085 million from RM16,727 million in the same period of 2003. Growth is expected to moderate to 7.3% for the year as a whole to RM32,584 million due to lower export prices of some of the agriculture commodities in the second half of the year. Export earnings from the **mining** sector increased by 17.3% in the first seven months of 2004, on account of stronger demand and higher prices for crude oil and natural gas. The share of primary commodities to total exports was maintained at 14.7% in the first seven months of 2004 (January-July 2003: 14.9%).

Export value of **CPO** increased by 1.2% during the first seven months of 2004 (January-July 2003: 50.2%) and remain the largest contributor to total agriculture exports with a share of 69%. The higher export receipts were largely driven by stronger prices. The average export price of

CHART 2.10

## Primary Commodity Exports

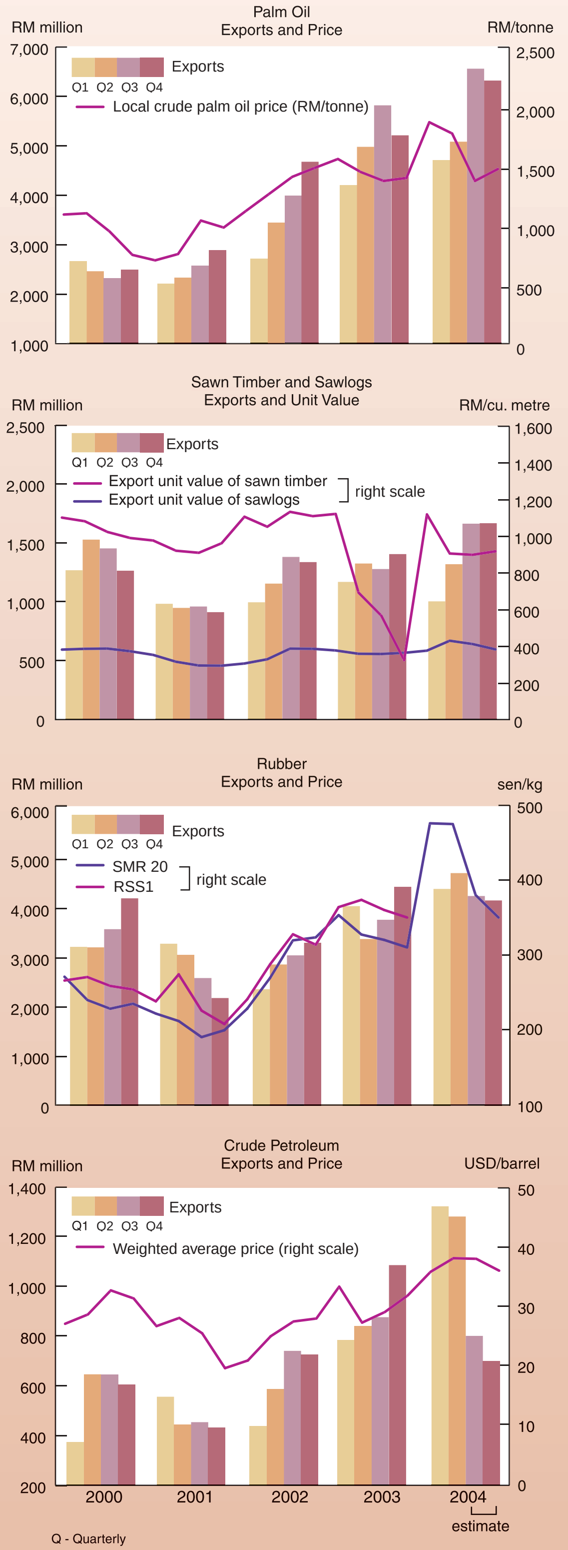



TABLE 2.14

## Primary Commodity Exports
### January-July

| | RM million | | Change (%) | |
|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] |
| **Palm Oil[2]** | | | | |
| Volume( '000 tonnes) | 7,035 | 6,687 | *16.5* | *-4.9* |
| Unit Value(RM/tonne) | 1,612 | 1,716 | *29.0* | *6.4* |
| Value(RM million) | 11,342 | 11,475 | *50.2* | *1.2* |
| **Palm Kernel Oil** | | | | |
| Volume ('000 tonnes) | 399 | 522 | *-3.4* | *30.7* |
| Unit Value (RM/tonne) | 1,833 | 1,717 | *29.2* | *-6.3* |
| Value(RM million) | 732 | 897 | *24.8* | *22.5* |
| **Saw Logs** | | | | |
| Volume ('000 tonnes) | 3,072 | 3,092 | *8.5* | *0.7* |
| Unit Value(RM/tonne) | 371 | 371 | *11.8* | *0.0* |
| Value(RM million) | 1,139 | 1,146 | *21.2* | *0.6* |
| **Sawn Timber** | | | | |
| Volume ('000 tonnes) | 1,730 | 1,687 | *-34.9* | *-2.5* |
| Unit Value (RM/tonne) | 852 | 1,000 | *63.8* | *17.4* |
| Value(RM million) | 1,474 | 1,689 | *6.6* | *14.5* |
| **Rubber** | | | | |
| Volume ('000 tonnes) | 541 | 845 | *6.7* | *56.1* |
| Unit Value (RM/tonne) | 352 | 360 | *42.0* | *2.2* |
| Value (RM million) | 1,906 | 3,040 | *51.5* | *59.5* |
| **Pepper** | | | | |
| Volume ('000 tonnes) | 9.6 | 10.7 | *-12.9* | *12.4* |
| Unit Value (RM/tonne) | 7,094 | 6,253 | *18.7* | *-11.9* |
| Value(RM million) | 68 | 67 | *3.4* | *-1.0* |
| **Cocoa** | | | | |
| Volume ('000 tonnes) | 10.0 | 5.9 | *-23.5* | *-40.3* |
| Unit Value (RM/tonne) | 6,535 | 5,659 | *37.9* | *-13.4* |
| Value(RM million) | 66 | 34 | *5.4* | *-48.3* |
| **Crude Petroleum** | | | | |
| Volume ('000 tonnes) | 9,966 | 10,673 | *5.8* | *7.0* |
| Unit Value (RM/tonne) | 869 | 1,025 | *32.3* | *18.0* |
| Value (RM million) | 8,660 | 10,949 | *40.0* | *26.4* |
| **Liquefied Natural Gas** | | | | |
| Volume ('000 tonnes) | 9,687 | 11,846 | *19.0* | *21.4* |
| Unit Value (RM/tonne) | 781 | 787 | *27.6* | *0.5* |
| Value (RM million) | 7,563 | 9,324 | *51.7* | *22.0* |
| **Tin** | | | | |
| Volume ('000 tonnes) | 5.8 | 13.7 | *-71.3* | *132.5* |
| Unit Value (RM/tonne) | 17.7 | 29.8 | *13.4* | *68.3* |
| Value (RM million) | 104.1 | 407.1 | *-67.4* | *291.2* |
| **Total Value (RM million)** | **33,054** | **38,766** | ***41.6*** | ***17.3*** |

[1] Estimate.
[2] Includes crude palm oil, processed palm oil and stearin

Source: Department of Statistics.

CPO rose by 17.1% to RM1,788 per tonne during the first seven months of 2004. While demand is expected to increase moderately during the second half of 2004, the export receipts of CPO is projected to increase by 6.2% for the whole year in anticipation of firmer prices. Local price per tonne is expected to average RM1,650 in 2004 (2003: RM1,544). China remains the largest market for Malaysian palm oil, accounting for 21% of total exports of CPO, followed by India (13.8%), EU (13%), Pakistan (9%) and Egypt (4.6%).

Export receipts from **palm kernel oil** increased by 22.5% to RM897 million during the first seven months of 2004 and is expected to increase by 11.3% to RM1,626 million for the whole year. Efforts taken to increase CPO exports include promoting its techno-economic advantage and nutritional value to widen its consumption, especially in new markets through participation in seminars and trade missions. Going forward, Malaysian producers are expected to make greater inroads into non-traditional markets, such as West Asia and Eastern Europe. The optimism can be attributed to the awareness in developed countries regarding the harmful effects of transfatty acids content in food products, in which the trans-free palm oil has a marked advantage in food formulation.

Exports of **rubber**, the bulk of which is Standard Malaysian Rubber (SMR), are expected to increase by 0.5% to 950,000 tonnes in 2004 (2003: 1.9%; 945,000 tonnes). The uptrend in rubber prices, since early last year accounts for the increase in exports receipts. A combination of factors affecting both supply and demand is expected to push up the price of rubber by 10.2% to RM4.20 per kilogram. Demand is expected to increase on account of recovery in the tyre and automotive industries as well as the relaxation of import quota by China.

Export volume of **crude oil** increased by 7% to 10.7 million tonnes in the first seven months of 2004 (January-July 2003: 5.8%; 10 million tonnes). With stronger export prices, averaging USD38 per barrel (RM1,025 per tonne), revenue rose by 26.4% to RM10,949 million (January-July 2003: 40%; RM8,660 million). Major importers of Malaysia's crude petroleum are India (18.4%), Thailand (17.7%), China (13.1%), Australia (12.9%) and South Korea (8%). Driven by higher volume, export earnings of **LNG** expanded by 22% (January-July 2003: 51.7%). Malaysia is presently the third largest LNG exporter in the world with total exports of 18.4 million tonnes in 2003 after Indonesia and Algeria.

## Import Performance

***Imports grow in tandem with robust economic activities…***

Gross value of imports including cost, insurance and freight (c.i.f.) swelled by 27.6% to RM223,538 million during the first seven months of 2004 (January-July 2003: 1%; RM175,168 million). The strong growth, underpinned by robust domestic investment activities, buoyant export as well as burgeoning household disposable income was evident in all categories of imports. With the external sector shifting from recovery into expansion phase and the domestic sector propelling forward, import growth is presaged to continue in the remaining months of the year.

The main driver of import growth was **intermediate goods** rising sharply by 26.8% (January–July 2003: 2.4%), following stronger manufacturing production and exports, specifically in the electronics industry. Similarly, imports of parts and accessories of capital goods (excluding termionic valves and tubes) increased significantly by 34.7% (January-July 2003: 1.7%), indicative of the return of double-digit private investment growth after a lapse of three years. Industrial supplies, essentially used as component parts in manufactured exports, surged by 38.4% to RM51,068 million (January-July 2003: -0.5%; RM36,901 million). Despite the spectacular growth, the share of intermediate goods to total imports remained stable at 72.2% (January-July 2003: 72.7%).

Import of **capital goods** rebounded strongly by 22.6% during the same period (January-July 2003: -6.1%), consequential of capacity expansion in manufacturing, oil and gas, airlines and shipping sectors. Following the strong performance of the motor assembly industry and passenger car sales, imports of transport equipment for industrial purposes turned around and accelerated strongly by 149.2% (January–July 2003: -71.7%). In tandem with entrenched domestic investment activities, import of capital goods (other than

TABLE 2.15

## Gross Imports by End Use
**January-July**

| | RM Million | | % Change | | % Share | |
|---|---|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] | 2003 | 2004[1] |
| **Capital goods** | **24,675** | **30,254** | ***-6.1*** | ***22.6*** | ***14.1*** | ***13.5*** |
| Capital goods (except transport equipment) | 23,621 | 27,626 | *4.7* | *17.0* | *95.7* | *91.3* |
| Transport equipment (industrial) | 1,055 | 2,628 | *-71.7* | *149.2* | *4.3* | *8.7* |
| **Intermediate goods** | **127,385** | **161,463** | ***2.4*** | ***26.8*** | ***72.7*** | ***72.2*** |
| Food and beverages, primary and processed mainly for industry | 3,329 | 5,479 | *12.6* | *64.6* | *2.6* | *3.4* |
| Industrial supplies, primary and processed | 36,901 | 51,068 | *-0.5* | *38.4* | *29.0* | *31.6* |
| Fuel and lubricants primary, processed, others | 7,953 | 9,146 | *28.3* | *15.0* | *6.2* | *5.7* |
| Parts and accessories of transport equipment | 3,300 | 4,742 | *-21.3* | *43.7* | *2.6* | *2.9* |
| Parts and accessories of capital goods (except thermionic valves and tubes) | 23,733 | 31,970 | *1.7* | *34.7* | *18.6* | *19.8* |
| Thermionic valves and tubes | 52,170 | 59,059 | *3.0* | *13.2* | *41.0* | *36.6* |
| **Consumption goods** | **10,564** | **12,837** | ***0.0*** | ***21.5*** | ***6.0*** | ***5.7*** |
| Food and beverages, primary and processed mainly for household consumption | 3,801 | 4,942 | *-3.7* | *30.0* | *36.0* | *38.5* |
| Transport equipment (non-industrial) | 178 | 198 | *89.5* | *11.3* | *1.7* | *1.5* |
| Other consumer goods | 6,584 | 7,697 | *0.9* | *16.9* | *62.3* | *60.0* |
| Durables | 1,523 | 1,722 | *11.8* | *13.1* | *23.1* | *22.4* |
| Semi-durables | 2,154 | 2,559 | *-12.7* | *18.8* | *32.7* | *33.3* |
| Non-durables | 2,907 | 3,415 | *7.9* | *17.5* | *44.2* | *44.4* |
| **Others (including dual use goods)** | **7,937** | **9,375** | ***7.4*** | ***18.1*** | ***4.5*** | ***4.2*** |
| **Imports for re-export** | **4,607** | **9,608** | ***-3.9*** | ***108.6*** | ***2.6*** | ***4.3*** |
| **Gross Imports** | **175,168** | **223,538** | ***1.0*** | ***27.6*** | ***100.0*** | ***100.0*** |

[1] Estimate.

Source: Department of Statistics.

transport equipment) maintained its upward trend and expanded significantly by 17% (January–July 2003: 4.7%). Despite the spectacular growth in capital goods, its share to total imports declined to 13.5% of total imports (January-July 2003: 14.1%).

Growing affluence generated by higher export earnings and higher disposable income was partly reflected by the 21.5% (January-July 2003: 0%) growth in import of **consumption goods.** Imports of food and beverages as well as semi-durables rebounded strongly by 30% and 18.8%, (January-July 2003: -3.7%; –12.7%) respectively. Import bills on **dual use goods** trended upwards by 28.1% (January-July 2003: 16.9%), mainly due to higher imports of processed fuel, lubricants and motor spirit, as well as transport equipment and passenger cars. Likewise, **imports for re-export**, comprising mainly packing and assembling activities of E&E at major ports rose sharply by 108.6% (January-July 2003: -3.9%).

## Direction of Trade

***Trade surplus remains large on the back of robust manufacturing exports…***

As a small open economy and trading nation, Malaysia continues to take advantage of trade opportunities by diversifying and deepening further its trade. Malaysia's external trade is twice the size of its GDP and currently is the 17th largest trading nation. Malaysia trades with more than 200 countries and efforts are being taken to expand into non-traditional markets such as West Asia and Central and Eastern Europe.

Malaysia's major trading partners are the US, Singapore, Japan, and China accounting for 51.1% of total trade. In terms of intra-regional trade, North East Asia, ASEAN and the European Union (EU) accounted for 70.7% of total trade. Trade with these regions increased significantly by 25.7%, 22.6% and 24.4%, respectively in the first seven months of 2004.

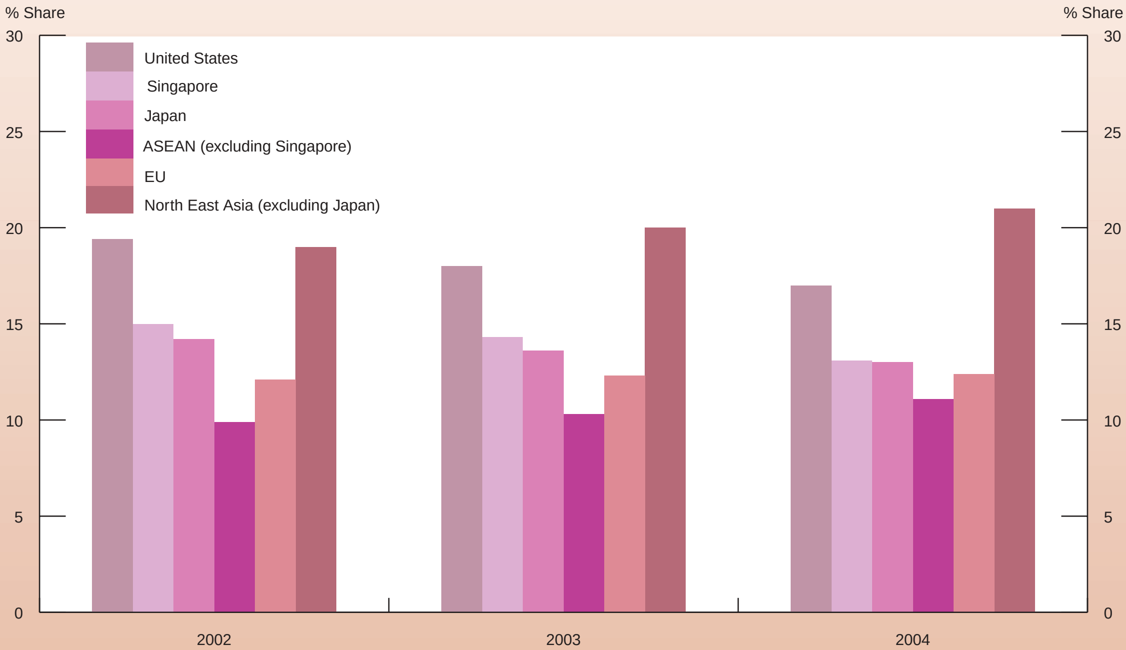
The balance of trade which is in Malaysia's favour totalled RM81,136 million in 2003 and is the highest achieved in the history of Malaysia. In the first seven months of 2004, Malaysia's trade balance amounted to RM44,924 million (January-July 2003: RM46,605 million), with exports and imports expanding by 21.1% and 27.6% (January-July 2003: 10.7%; 1%), respectively. Major countries contributing to the surplus were the US, Singapore, Hong Kong SAR, Netherlands and Australia. On the other hand, trade with Japan, Germany, China and Indonesia recorded deficits.

The **US** remains Malaysia's largest trading partner, contributing a trade surplus of RM17,309 million (January-July 2003: RM16,305 million). The surplus was mainly on account of higher exports of E&E products as well as textiles and clothing. These two products constituted 80% of total exports to the US (January-July 2003: 81%). Imports were mainly E&E, machinery, appliances and parts as well as optical and scientific equipment, representing 79% of Malaysia's imports from the US.

**Singapore** maintained its position as Malaysia's second largest trading partner with 13.1% of

CHART 2.11

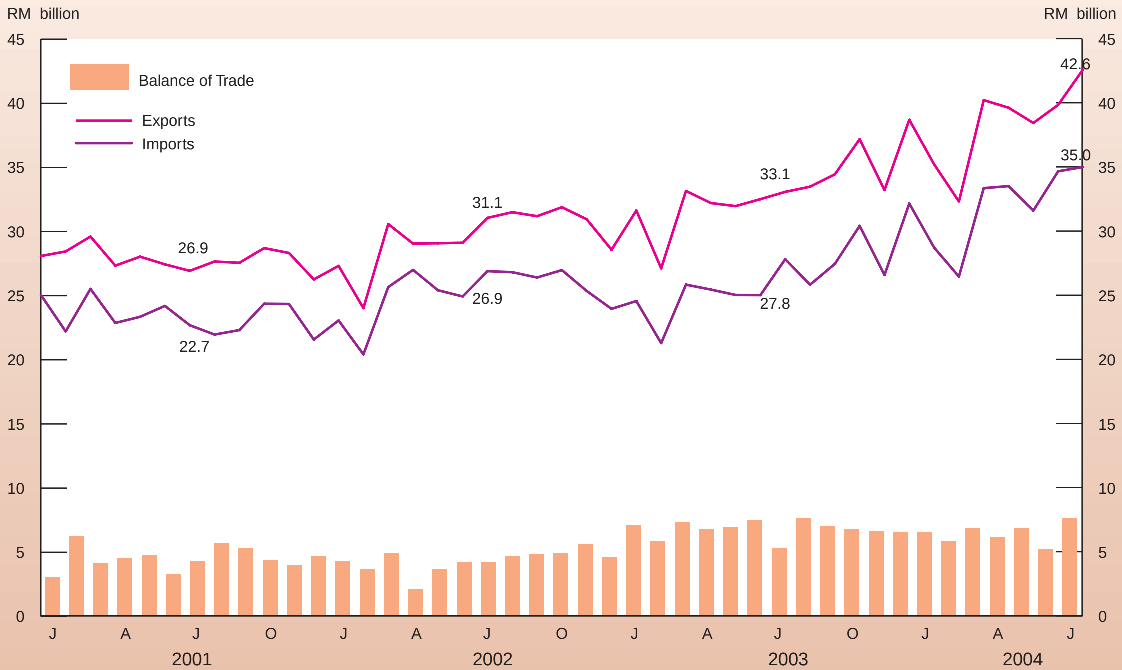
**Direction of External Trade**
**January-July**




Source: Department of Statistics.

CHART 2.12

**Balance of Trade**




Source: Department of Statistics.

Malaysia's total trade. Exports of E&E increased by 8.3% and remained as Malaysia's largest export earner, yielding receipts of RM23,171 million or 57.9% of exports to Singapore. Meanwhile, E&E and refined petroleum products, with a combined value of RM15,344 million or 62.7% of total imports, were the main products imported. Despite imports outpacing exports in growth terms, the trade surplus with the Republic increased further to RM15,532 million (January-July 2003: RM14,747 million).

**Japan** remained as Malaysia's third largest trading partner with a share of 13% of Malaysia's total trade. E&E, optical and scientific equipment and LNG were the main items exported, contributing 62.1% of total exports to Japan. Imports comprised mainly of E&E, machinery, appliances and parts and transport equipment representing 62.6% of imports. With imports continuing to outpace exports, Malaysia's trade deficit with Japan widened further to RM9,801 million (January-July 2003: -RM5,873 million). The deficit position was mainly due to higher imports of E&E and machinery, appliances and parts.

**The People's Republic of China** emerged as Malaysia's fourth largest trading partner in 2001, and has since maintained its position. Exports, comprising mainly chemicals and chemical products, E&E and palm oil surged by 46.8%, 32.6% and 23.6%, respectively accounting for 67.5% of total exports to China in the first seven months of the year. E&E, representing 59.7% of total imports from China swelled by 57.6%. Malaysia's trade deficit with China continued to widen further to reach RM3,611 million (January-July 2003: -RM619 million). Higher imports of machinery, appliances and parts as well as textiles and clothing contributed to the deficit.

Total trade with other economies in **North East Asia**, namely Taiwan, South Korea and Hong Kong SAR increased by 24.4% or 13.1% of total trade (January-July 2003: 8.3%; 12.9%). Exports, comprising mainly of E&E and LNG expanded by 21.7%, while imports, largely E&E increased by 27.8%. Malaysia registered a surplus position with Hong Kong SAR (RM10,539 million) but encountered trade deficits with Taiwan (RM2,749 million) and South Korea (RM1,874 million).

TABLE 2.16

## Direction of External Trade

### January-July

| | Exports | | | | Imports | | | | Trade Balance | |
|---|---|---|---|---|---|---|---|---|---|---|
| | % Change | | % Share | | % Change | | % Share | | RM million | |
| | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 |
| **United States** | ***2.9*** | ***15.2*** | ***19.8*** | ***18.8*** | ***-7.2*** | ***20.5*** | ***15.7*** | ***14.9*** | **16,305** | **17,309** |
| **Singapore** | ***2.9*** | ***12.1*** | ***16.1*** | ***14.9*** | ***-1.4*** | ***16.9*** | ***12.0*** | ***10.9*** | **14,747** | **15,532** |
| **Japan** | ***6.2*** | ***13.2*** | ***10.8*** | ***10.1*** | ***-2.4*** | ***23.8*** | ***17.0*** | ***16.5*** | **-5,873** | **-9,801** |
| **North East Asia (excl. Japan)** | ***21.0*** | ***24.7*** | ***19.1*** | ***19.7*** | ***2.7*** | ***36.5*** | ***21.1*** | ***26.6*** | **5,385** | **2,332** |
| China, PR | *26.1* | *30.7* | *6.1* | *6.6* | *12.1* | *50.4* | *8.1* | *9.6* | -619 | -3,611 |
| Hong Kong SAR | *39.5* | *16.2* | *6.4* | *6.1* | *9.6* | *23.5* | *2.7* | *2.7* | 9,370 | 10,539 |
| South Korea | *3.8* | *47.0* | *2.9* | *3.6* | *4.9* | *21.8* | *5.4* | *5.1* | -2,887 | -1,874 |
| Taiwan | *3.4* | *10.9* | *3.6* | *3.3* | *-14.6* | *36.8* | *4.8* | *5.2* | -504 | -2,749 |
| **European Union** | ***11.4*** | ***20.3*** | ***12.7*** | ***12.6*** | ***4.0*** | ***30.0*** | ***11.9*** | ***12.1*** | **7,331** | **6,819** |
| Netherlands | *-1.5* | *17.3* | *3.3* | *3.2* | *-11.5* | *53.0* | *0.7* | *0.9* | 6,013 | 6,596 |
| Germany | *20.4* | *17.0* | *2.3* | *2.3* | *23.5* | *37.6* | *4.3* | *4.7* | -2,411 | -4,379 |
| United Kingdom | *3.5* | *21.3* | *2.2* | *2.2* | *-7.3* | *16.7* | *1.9* | *1.8* | 1,616 | 2,118 |
| France | *36.8* | *7.4* | *1.7* | *1.5* | *10.0* | *19.4* | *1.5* | *1.4* | 1,155 | 933 |
| Italy | *53.7* | *23.2* | *0.7* | *0.7* | *-11.3* | *47.9* | *0.7* | *0.9* | 169 | -112 |
| Ireland | *7.6* | *1.0* | *0.3* | *0.3* | *-18.3* | *-14.1* | *0.8* | *0.5* | -721 | -519 |
| **ASEAN (excl. Singapore)** | ***7.6*** | ***37.7*** | ***8.9*** | ***10.1*** | ***11.7*** | ***31.8*** | ***12.0*** | ***12.4*** | **-1,431** | **-724** |
| Thailand | *10.0* | *35.2* | *4.3* | *4.8* | *6.7* | *58.5* | *4.3* | *5.4* | 1,886 | 791 |
| Indonesia | *11.5* | *40.1* | *2.0* | *2.3* | *8.3* | *51.5* | *3.4* | *4.0* | -1,475 | -2,737 |
| Philippines | *0.1* | *43.1* | *1.4* | *1.6* | *21.9* | *-15.1* | *3.8* | *2.5* | -3,604 | -1,299 |
| Brunei | *15.6* | *16.0* | *0.3* | *0.3* | *639.3* | *-69.8* | *0.0* | *0.0* | 583 | 728 |
| Myanmar | *-32.5* | *-1.7* | *0.1* | *0.1* | *13.0* | *18.9* | *0.1* | *0.1* | 148 | 108 |
| **South Asia** | ***44.5*** | ***19.3*** | ***3.6*** | ***3.5*** | ***-6.2*** | ***115.7*** | ***0.9*** | ***1.4*** | **6,448** | **6,250** |
| India | *50.1* | *21.6* | *2.4* | *2.4* | *-6.5* | *129.2* | *0.8* | *1.4* | 3,972 | 3,397 |
| **West Asia** | ***22.6*** | ***39.7*** | ***2.3*** | ***2.7*** | ***50.7*** | ***7.3*** | ***2.5*** | ***2.1*** | **875** | **2,623** |
| Saudi Arabia | *6.0* | *16.5* | *0.4* | *0.4* | *53.8* | *33.7* | *0.7* | *0.8* | -426 | -722 |
| United Arab Emirates | *24.3* | *45.9* | *1.0* | *1.2* | *203.4* | *47.3* | *0.4* | *0.4* | 1,584 | 2,302 |
| Yemen | *59.8* | *1.0* | *0.1* | *0.1* | *-5.0* | *-98.1* | *0.5* | *0.0* | -525 | 265 |
| Oman | *26.2* | *41.9* | *0.0* | *0.1* | *295.0* | *-33.7* | *0.6* | *0.3* | -896 | -513 |
| Australia | *22.4* | *51.4* | *2.4* | *3.1* | *-12.2* | *35.3* | *1.6* | *1.7* | 2,662 | 4,471 |
| New Zealand | *30.4* | *15.3* | *0.4* | *0.4* | *-4.8* | *11.6* | *0.4* | *0.3* | 140 | 187 |
| Central & Eastern Europe (excl. EU members) | *37.4* | *32.2* | *0.1* | *0.1* | *207.1* | *-21.5* | *0.0* | *0.0* | 75 | 129 |
| Africa | *40.2* | *11.7* | *1.4* | *1.3* | *14.6* | *72.6* | *0.4* | *0.6* | 2,257 | 2,064 |
| Rest of the world | *15.3* | *36.7* | *2.5* | *2.9* | *-1.9* | *25.4* | *4.5* | *4.5* | -2,315 | -2,266 |
| **% Change/Share** | ***10.7*** | ***21.1*** | ***100.0*** | ***100.0*** | ***1.0*** | ***27.6*** | ***100.0*** | ***100.0*** | | |
| **RM million** | | **268,462** | | | | **223,538** | | | **46,605** | **44,924** |

Source : Department of Statistics.

Malaysia's trade with **ASEAN** (excluding Singapore) expanded by 34.7% and comprised 11.1% of the country's total trade (January-July 2003: 10.3%). Exports comprising mainly E&E, chemicals and chemical products and crude petroleum grew by 32.5% and accounted for 55.4% of total exports. E&E, chemicals and chemical products and palm oil, which represents 54.2% of total imports, rose by 24.4% during the first seven months of 2004. Malaysia recorded trade surpluses with Vietnam (RM1,523 million), Thailand (RM791 million) and Brunei (RM728 million), while trade with Indonesia and Philippines recorded deficits of RM2,737 million and RM1,299 million, respectively.

Total trade with the **EU** was sustained at 12.4% (January-July 2003: 12.3%) of Malaysia's total trade. EU's demand for Malaysia's products increased 20.3% (January-July 2003: 11.4%), 57.6% of which comprised E&E. About 12.1% of Malaysia's total imports were procured from the EU, the bulk of which (68.8% of total imports) were E&E, machinery, appliances and parts as well as chemicals and chemical products. In terms of total trade, Germany leads the pack with 3.3%, followed by the Netherlands (2.1%) and United Kingdom (UK) (2%). A trade surplus of RM6,819 million was recorded (January-July 2003: RM7,331 million), mainly with the Netherlands (RM6,596 million) and UK (RM2,118 million), while deficits with Germany and Sweden amounted to RM4,379 million and RM913 million, respectively.

## Balance of Payments

***Record level of international reserves as overall balance of payments strengthens further...***

Malaysia's promising performance in the first seven months of 2004, supported by growing optimism in the external scene, is envisaged to sustain Malaysia's overall balance of payments in the positive territory for the fourth consecutive year. The current account of the balance of payments is forecast to record a surplus for the seventh consecutive year. The deficit in services account is expected to narrow, although the deficits in the income and transfer accounts are expected to continue in 2004. Higher surplus in the goods account, however, will be more than adequate to finance net payments in the services, income and current transfer accounts. The financial account is expected to record a smaller net outflow in 2004, mainly due to the higher inflows of foreign direct investment and portfolio investment. With the higher surplus in the current account and lower net outflow in the financial account, 2004 is set to witness another round of substantial surplus in the overall position of Malaysia's balance of payments.

The cyclical upswing in global demand, underpinned by significant expansion in demand for manufactured goods provides great potential for exports of goods to expand by 17.5% in 2004 (2003: 11.3%). Import bills for goods are estimated to grow strongly by 21.3% (2003: 5.2%), emanating mainly from higher imports of intermediate and capital goods, to support stronger production and exports in the manufacturing sector. Despite the higher import bill, the **goods account** is expected to register a larger surplus of RM103,453 million in 2004 (2003: RM97,701 million), the highest thus far to be recorded in the history of Malaysia.

The **services account** deficit is expected to improve to RM8,828 million in 2004 (2003: -RM15,026 million). The narrowing deficit is largely due to higher surplus in the travel account. Inflows in the travel account are envisaged to grow strongly by 35.6% (2003: -17.1%), in consonance with the increasing number of tourist arrivals, including from West Asia for their summer holidays. Likewise, with increasing disposable income, more Malaysians are expected to travel abroad resulting in a 17.5% increase (2003: 8.7%) in the debit side of the account. Inflows in the transportation account is expected to turn around by 22.7% in 2004 (2003: -3.1%), mainly due to an increase in transshipment cargo and capacity expansion by Malaysian shipping companies and airlines.

The **income account** is projected to record a larger deficit of RM26,751 million in 2004 (2003: -RM22,527 million). The widening deficit is mainly due to higher repatriation of profits and dividends accruing to multinational companies (MNCs) operating in Malaysia. Consequently, outflow is expected to expand by 14.3% (2003: 7.1%). With the favourable international environment, profits and dividends accruing to Malaysian

TABLE 2.17

**Current Account of the Balance of Payments 2003-2004**
(RM million)

| | 2003 | | | 2004[1] | | |
|---|---|---|---|---|---|---|
| | Receipts | Payments | Net | Receipts | Payments | Net |
| **Goods** | **398,998** | **301,297** | **97,701** | **468,874** | **365,421** | **103,453** |
| **Services** | **51,595** | **66,621** | **-15,026** | **62,931** | **71,759** | **-8,828** |
| Transportation | 10,514 | 23,787 | -13,274 | 12,902 | 29,034 | -16,132 |
| Travel | 22,423 | 10,816 | 11,607 | 30,395 | 12,710 | 17,685 |
| Other services | 18,206 | 31,225 | -13,019 | 19,186 | 29,092 | -9,906 |
| Government transactions | 452 | 793 | -341 | 448 | 923 | -475 |
| **Income** | **13,103** | **35,630** | **-22,527** | **13,209** | **39,960** | **-26,751** |
| Compensation of employees | 2,170 | 3,120 | -950 | 2,103 | 2,799 | -696 |
| Investment income | 10,933 | 32,510 | -21,577 | 11,106 | 37,161 | -26,055 |
| **Current transfers** | **1,929** | **11,229** | **-9,300** | **1,899** | **11,806** | **-9,907** |
| **Current account** | **465,625** | **414,777** | **50,848** | **546,913** | **488,946** | **57,967** |

[1] Estimate.

companies investing abroad are also expected to grow albeit at a moderate rate of 1.6% (2003: 68.8%).

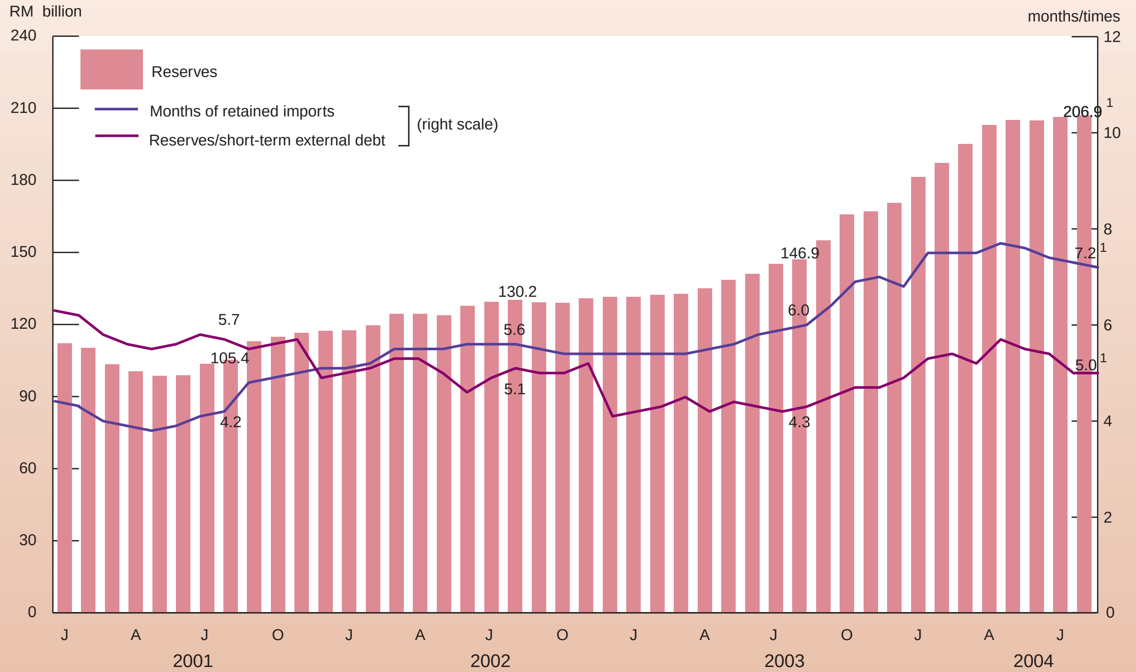
Net outflow associated with **current transfers** is projected to increase to RM9,907 million in 2004 (2003:-RM9,300 million). Current transfer payments are likely to increase by 5.1% in 2004 (2003: -14.1%), mainly due to higher remittances by foreign workers. Receipts from current transfer, largely on account of Malaysians working abroad, are estimated to decline by 1.5% in 2004 (2003: -23.2%). Despite the deficits in the services, income and current transfer accounts, the **current account** of the balance of payments is expected to record a significant surplus of RM57,967 million or 14.1% of GNP (2003: RM50,848 million; 13.7% of GNP).

In the **financial account**, a lower net outflow of RM5,895 million is expected in 2004 (2003: -RM12,146 million). This is largely attributable to higher net inflows from portfolio investments amounting to RM17,575 million (2003: RM4,168 million). In addition, net inflows from direct investments are also expected to increase, the bulk of which is in the manufacturing sector. Nevertheless, Malaysia continues to receive investments in the services sector as well as in the oil and gas industries. The other investment account, including loans, trade credits and bank deposits is expected to record a net outflow of RM28,270 million (2003: -RM20,508 million) arising mainly from the repayments of external loans. After taking into account errors and omissions, the **overall position** of the balance of payments is expected to record a stronger surplus of RM42,340 million in 2004 (2003: RM39,059 million).

Malaysia's **international reserves** continued to increase to a new record level of RM206,893 million (USD54,446 million) as at 14 August 2004 (31 December 2003: RM170,476 million; USD44,862 million). Higher export earnings and inflows of foreign direct investment as well as

CHART 2.13

**International Reserves**




[1] As at 14 August 2004.

Source: Bank Negara Malaysia

portfolio investment are the major contributors to the strengthened reserve position. The inflows were more than sufficient to cover outflows, which were mainly for goods and services as well as repayment of external loans. The reserves level as at 14 August 2004 is sufficient to finance 7.2 months of retained imports and to cover 5 times the short-term external debt. Malaysia's strong international reserves remain usable and unencumbered.

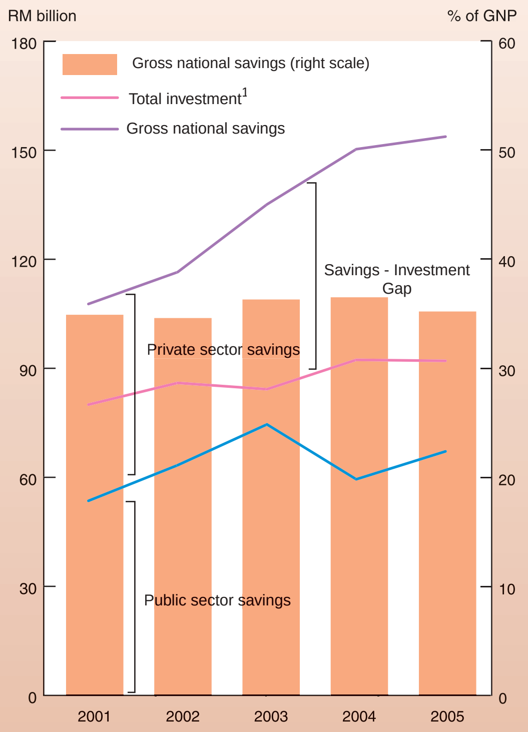
## National Resource Position

***Stronger resource position with better export earnings...***

With significant improvement in export earnings and vigorous domestic economic activities, national income in nominal value continues to record strong growth of 10.8% in 2004 (2003: 10.4%). Taking into account a much higher consumption spending growth rate of 10.7% (2003: 8.5%), **gross national savings (GNS)** are projected to increase by 11.2% to RM150,288 million or 36.5% of GNP (2003: 16%; RM135,094 million; 36.4% of GNP). The bulk of the savings is from the private sector, accounting for 60.4% (2003: 44.8%), which can be mobilised to finance domestic investments. In terms of share to GNP, overall investment expenditure (including change in stocks) remains at a sizeable level of 22.4% or RM92,321 million (2003: 22.7% of GNP; RM84,246 million). This is mainly due to strong build-up in private investment expenditure, amidst the progressive reduction in spending and rationalisation of Federal Government's development expenditure. As the level of gross national savings continues to exceed total investment expenditure, the **savings-investment gap** continues with another year of substantial surplus of RM57,967 million or 14.1% of GNP (2003: RM50,848 million; 13.7% of GNP), reflecting the country's strong economic fundamentals.

CHART 2.14

**Savings - Investment Gap**




[1] Including change in stocks

## Prices

***Inflation remains tame despite growing demand and higher oil prices...***

**Inflation** continues to remain low in 2004. Although domestic demand has strengthened and commodity prices firmed up, higher productivity and stable unit labour cost in the manufacturing sector as well as stable wage environment helped contain the general increase in prices. For comparison, the forecast inflation rates in some ASEAN countries such as Indonesia, Philippines and Thailand range between 2% and 5%. Higher commodity prices, especially crude oil have minimal effect on the general price level due to the fact that retail prices of petroleum products, notably gasoline, diesel and LPG are controlled through the automatic pricing mechanism (APM) to ensure price stability.

Inflation remained stable at 1.1% during the first seven months of 2004, (January–July 2003: 1.1%). More than half (53.1%) of the Consumer Price Index (CPI) increase is attributed to the food group, the largest component in the CPI, which edged up 1.7% (January-July 2003: 1.2%). The higher prices of meat (3.8%), fish (2.7%) and milk and eggs (2.7%) resulted in the 1.8% increase in the price of food at home (January-July 2003: 1.3%). Higher prices of these products were due to stronger demand for fish and meat arising from concerns over the bird flu scare in some regional countries, which resulted in tight supply condition for these products. Prompt measures by the Government to isolate the local poultry industry from the contagious effects of the Avian flu has boosted confidence regarding the consumption of chicken meat in February and March 2004 and helped cushion the increase in prices of milk and eggs, fish and meat.

Gross rent, fuel and power also inched up marginally by 0.9% (January-July 2003: 0.8%) and contributed 20.7% of the increase in the CPI, the second largest contributor after food. The rise in the CPI was, however, offset by a moderation in the prices of transport and communications group, which decelerated significantly from 2.3% to 0.4%, partly due to more competitive environment in the communications, transport and retail groups. Given its large weightage (18.8%), the slower increase has helped to lower the overall increase in the CPI.

The price of beverages and tobacco grew by 5% (January-July 2003: 0.1%), following higher import and excise duties on cigarettes and tobacco. Nevertheless, its impact on CPI was not significant, given its low weightage. The prices of clothing and footwear continued to decline partly due to stiffer competition, particularly from imports from China and Thailand.

In terms of CPI breakdown by rural and urban areas, price movements were not significantly different, increasing by 1% and 1.1%, respectively (January-July 2003: 1% and 1.1%). The inflation rate in Peninsular Malaysia, at 1.2%, was slightly higher than the national average, while Sabah and Sarawak registered lower rates of 0.8% and 0.6%, respectively mainly due to lower prices of seafood and meat.

TABLE 2.18

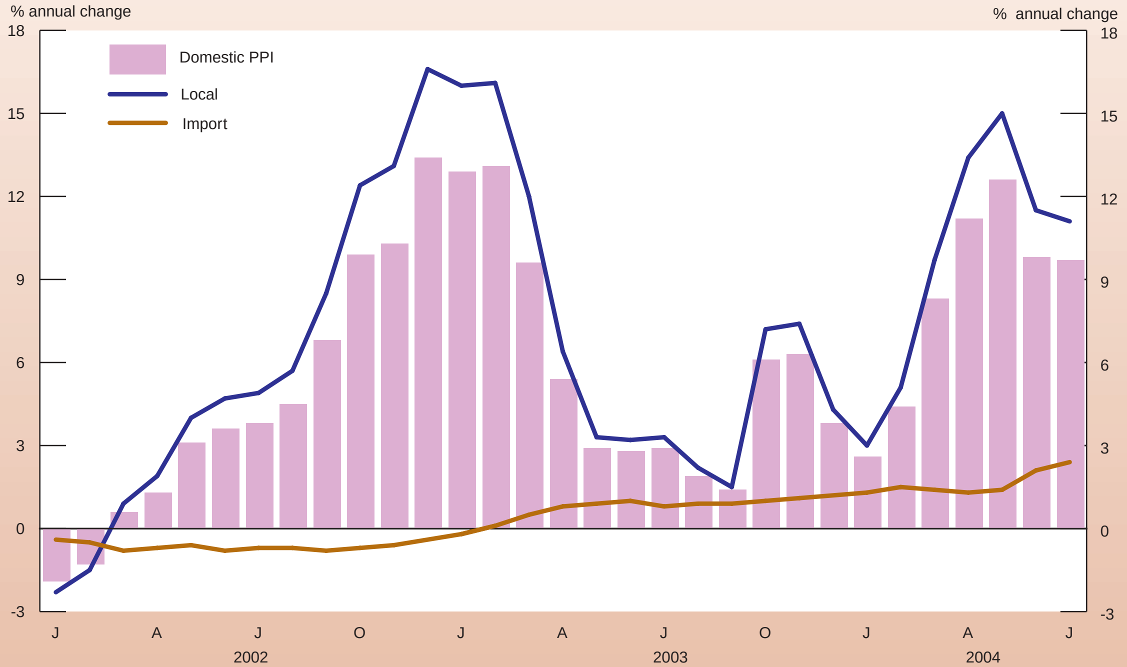
## Consumer Price Index
## January–July
(2000=100)

| | Weights | Annual Change (%) 2003 | Annual Change (%) 2004 | Contribution to Growth (%) 2003 | Contribution to Growth (%) 2004 |
|---|---|---|---|---|---|
| **Total** | **100.0** | ***1.1*** | ***1.1*** | ***100.0*** | ***100.0*** |
| Food | 33.8 | *1.2* | *1.7* | *40.0* | *53.1* |
| Beverages and tobacco | 3.1 | *0.1* | *5.0* | *0.3* | *14.8* |
| Clothing and footwear | 3.4 | *-2.1* | *-2.0* | *-6.6* | *-6.2* |
| Gross rent, fuel and power | 22.4 | *0.8* | *0.9* | *16.2* | *20.7* |
| Furniture, furnishings and household equipment and operation | 5.3 | *-0.5* | *0.1* | *-2.5* | *0.5* |
| Medical care and health expenses | 1.8 | *1.9* | *1.3* | *3.2* | *2.2* |
| Transport and communication | 18.8 | *2.3* | *0.4* | *39.6* | *6.4* |
| Recreation, entertainment, education and cultural services | 5.9 | *0.6* | *-0.1* | *3.3* | *-0.6* |
| Miscellaneous goods and services | 5.5 | *1.2* | *1.7* | *6.5* | *9.1* |

Source: Department of Statistics.

CHART 2.15

## Trend of PPI
**2002 - July 2004**




Source: Department of Statistics.

The **Producer Price Index (PPI)** showed a rising trend during January to May 2004 in tandem with higher world commodity prices, but moderated to 9.7% in July, as shown in *Chart 2.15*. The moderating trend is due to lower CPO prices in the world market. The higher PPI did not translate into higher CPI, cushioned by strong productivity gains and producers absorbing part of the increased costs.

The PPI for local production, which constitutes 79.3% of the weightage in the aggregate PPI, grew at 9.7% during the first seven months of 2004, attributable to higher prices for palm oil, rubber and crude oil (January-July 2003: 8.4%). The import category, which accounts for 20.7%, on the other hand, rose by 1.6% (January-July 2003: 0.6%). Consequently, the overall PPI recorded a growth of 8.3% (January-July 2003: 7%).

TABLE 2.19

**Producer Price Index January–July**
(1989=100)

| | Weights | Change (%) 2003 | Change (%) 2004 |
|---|---|---|---|
| **Domestic economy** | **100.0** | ***7.0*** | ***8.3*** |
| Food and live animals chiefly for food | 14.9 | *-1.7* | *4.2* |
| Beverages and tobacco | 2.1 | *1.1* | *1.4* |
| Crude materials, inedible except fuels | 18.0 | *8.7* | *8.8* |
| Mineral fuels, lubricants and related materials | 18.8 | *15.7* | *14.5* |
| Animal and vegetable oils and fats | 8.5 | *21.7* | *20.5* |
| Chemical and related products n.e.c | 4.4 | *1.6* | *3.3* |
| Manufactured goods, classified chiefly by material | 10.8 | *1.6* | *2.0* |
| Machinery and transport equipment | 18.3 | *0.1* | *0.1* |
| Commodities and transactions not classified elsewhere in the SITC | 3.6 | *0.7* | *0.9* |
| Miscellaneous manufactured articles | 0.6 | *0.8* | *0.2* |
| **Local Production** | **79.3** | ***8.4*** | ***9.7*** |
| **Import** | **20.7** | ***0.6*** | ***1.6*** |

Source: Department of Statistics.

## Labour Market

***Labour market conditions remain stable and healthy…***

The stronger economic growth and rising demand for labour with recovery in private investment activities and better export performance are expected to result in better employment prospects and lower retrenchments. The **labour market** for 2004 is, therefore, envisaged to remain stable with the unemployment rate marginally declining to 3.5% (2003: 3.6%), below the generally accepted 4% unemployment rate for full employment level. Labour productivity, particularly in manufacturing sector is envisaged to remain higher than the increase in unit labour cost (ULC) amidst subdued wage level. The higher productivity augurs well for the nation in terms of competitiveness.

TABLE 2.20

**Labour Market Indicators**

| | ('000) 2003 | ('000) 2004[1] | Change (%) 2003 | Change (%) 2004[1] |
|---|---|---|---|---|
| Labour force | 10,565.9 | 10,925.2 | *3.6* | *3.4* |
| Employment | 10,181.1 | 10,545.6 | *3.5* | *3.6* |
| Unemployment | 384.8 | 379.6 | *3.6* [2] | *3.5*[2] |

[1] Estimates.
[2] % to Labour force.

Source: Economic Planning Unit.

**Labour force** is expected to grow by 3.4% in 2004. The overall labour force participation rate is envisaged to increase from 67.3% in 2003 to 68.2% in 2004, mainly due to higher female participation. This is due to ICT development, which enables women to work from home with more flexible hours. The labour force is increasingly characterised by more educated entrants into the job market. Currently, more than 50% of the total labour force has attained secondary school education, while the proportion

## PRODUCTIVITY-LINKED WAGE SYSTEM (PLWS)

### Introduction

Globalisation necessitates quick responses to its challenges to ensure national and corporate survival. Corporations need to constantly improve their competitiveness through greater product innovation as well as lowering costs. This can be achieved through greater productivity in labour and capital. In terms of labour productivity, wage increases must commensurate with productivity increases for corporations to remain competitive, which is the underlying principle of productivity-linked wage systems (PLWS). The implementation of PLWS has been identified as an important and critical instrument towards the performance-based culture currently being emphasised by the Government.

### Rationale for Adopting PLWS

The Malaysian wage system is currently based on a pre-determined annual increment negotiated every three years by individual company unions. Acknowledging the importance of linking wage increases directly with productivity gains to ensure wage increases commensurate with productivity so as to enhance competitiveness, the Government has intensified efforts to accelerate the implementation of PLWS.

A tripartite task force comprising the Government, trade unions and employers was formed to develop Guidelines on the Wage Reform System to establish a closer link between wages and productivity. The Guidelines on the Wage Reform System was adopted by the National Labour Advisory Council (NLAC) in 1996 and provided three basic models on linking wages to productivity for companies to adopt and adapt. These three models were further developed and incorporated into the PLWS. The PLWS also takes into account workers basic need and recommends rewarding the productive.

The importance of PLWS has been mentioned in several National Development Plans. The Eighth Malaysia Plan (8MP) emphasised the need to accelerate the implementation of PLWS to ensure that wages are closely linked with productivity. The Mid-Term Review of the 8MP re-emphasised the need to further intensify the implementation of PLWS and encourage companies to share best practices of the system for others to emulate.

In the public sector, the Government recently introduced a set of initiatives towards promoting a culture of high performance among Government Linked Corporations (GLCs). A key initiative is the implementation of Key Performance Indicators (KPIs) and the introduction of Performance Linked Compensation for all GLCs. The purpose is to drive GLCs towards higher performance and global competitiveness, with just rewards for GLC employees. By driving GLCs towards higher performance and global competitiveness, GLCs will lead the private sector in generating long term sustainable growth for Malaysia.

### Models of PLWS

The PLWS comprises fixed and variable components. This type of wage structure will ensure that wages will not increase faster than productivity. The fixed component comprises of the basic wage which provides income stability, acts as an indicator of the job value in the market and reflects the cost of living. The variable component provides the variability determined by performance of the economy, worker’s productivity and company profitability. Three generic models have been developed for companies to emulate. These are the Profitability Model, the Productivity Model and the Productivity/Profitability Matrix or the Combined Model, which links productivity to profitability.

**Profitability Model**

The profitability model comprises variable performance bonus payment that is dependent on the company's profit level. The quantum of profits to be paid will be determined by a profit-sharing formula that is agreed upon by management and workers which is reviewed periodically. The level of profits to be used can either be in absolute or relative form, while historical data will determine the threshold profit level. Wage incentives are paid if profits exceed a pre-determined or threshold level.

**Example of Profitability Model:**

| Profit after tax (RM million) | Bonus Salary (months) |
|---|---|
| < 1.5 (threshold) | 0 |
| 1.5 – 1.99 | 0.5 |
| 2.0 – 2.49 | 1.0 |
| 2.5 – 2.99 | 1.5 |
| 3.0 and above | 2.0 |

Based on the table above, if profit after tax is between RM2.0 – 2.49 million, a bonus of one month will be paid. However, if profits fall below RM1.5 million, no bonus will be given for that year.

**Productivity Model**

In the productivity model, the variable productivity payment will be paid based on productivity improvement of the company or individual. Wage incentives for the year would, therefore, commensurate with productivity increases.

**Example of Productivity Model:**

Formula: T = A + P

Where T = total wage increase

A = annual increment

P = variable productivity payment

<u>Year 1</u>

If basic wage = RM1,000 per month, A = 2% and P = 4%
Basic wage + A = RM1,000 + 2% (RM1,000) = RM1,020 per month (built into basic wage)
P = 4% x RM1,000 x 12 months = RM480.00 per annum

<u>Year 2</u>

If basic wage = RM1,020 per month, A = 2% and P = 4%
Basic wage + A = RM1,020 + 2% (RM1,040) = RM1,040 per month
P = 4% x RM1,020 x 12 months = RM489.60 per annum

Annual Variable Payment at the end of year 2:

P for year 1 RM480.00

P for year 2 RM489.60

Cumulative for 2 consecutive years RM969.60

**Productivity/Profitability Matrix**

This two-dimensional approach links profitability to productivity. The bonus payment made is thus dependent on both the company's profitability and worker's productivity.

**Example of the Combined Model:**

TABLE 1

**Payment of Bonus According to Profitability and Productivity Growth**

| ***Annual Profit* (RM million)** | **Months of basic wage** | | | | | |
|---|---|---|---|---|---|---|
| **Above 1.49** | 1.00 | 1.00 | 1.25 | 1.50 | 1.75 | 2.00 |
| 1.00 - 1.49 | 0.75 | 0.75 | 1.00 | 1.25 | 1.50 | 1.75 |
| 0.70 - 0.99 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 | 1.50 |
| 0.50 - 0.69 | 0.25 | 0.25 | 0.50 | 0.75 | 1.00 | 1.25 |
| Below 0.50 | 0 | 0 | 0.25 | 0.50 | 0.75 | 1.00 |
| **Productivity ratio** | **<1** | **1-2.49** | **2.5-4.99** | **5-7.49** | **7.5-9.99** | **>10** |

For example in Table 1, if the annual profit of the company is between RM1-1.49 million and productivity is between 2.5-4.99, then the bonus payment for that year will be one month basic wage. If profit is below RM0.5 million and productivity is between 1-2.49, no bonus will be paid for that year.

**Benefits of PLWS**

By implementing PLWS, companies will be able to enhance productivity, contain costs and improve competitiveness. Some of the benefits that can be derived from the system are as follows:

a. Ensures that employees obtain a fair share of the gains from productivity and improvement in company's performance;

b. Provides motivation for peak performance;

c. Provides a more flexible wage structure that is able to withstand economic changes;

d. Helps enhance firm's competitiveness in the global economy; and

e. Improves labour management relations.

### Implementation of PLWS

The National Productivity Corporation (NPC) has been actively involved in the development, promotion, provision of research output, wages and productivity data, advisory services as well as system development on PLWS since the early nineties. From 2000 to June 2004, a total of 101 companies were assisted by the NPC to implement the PLWS. In 1998, NPC published the handbook "The Productivity-Linked Wage System", documenting models and case experiences of companies.

*Table 2* shows the distribution of collective agreements with productivity-linked component in three major sectors, namely manufacturing, services and agriculture for the period of 2001 – 2003. In 2003, 367 collective agreements were signed, of which 64.2% of the manufacturing sector's collective agreements contained element of productivity linkages, while for services sector 29.7%.

TABLE 2

**Distribution of Collective Agreements With Productivity Linked Component By Sector 2001-2003**

| Sector | Total Number of Collective Agreements (CA) | | | Number of CA with Productivity-Linked Components | | | Percentage of CA with Productivity-Linked Components | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2001** | **2002** | **2003** | **2001** | **2002** | **2003** |
| Manufacturing | 227 | 129 | 216 | 121 | 64 | 106 | *59.0* | *53.3* | *64.2* |
| Services | 139 | 98 | 141 | 77 | 47 | 49 | *37.6* | *39.2* | *29.7* |
| Agriculture | 7 | 9 | 10 | 7 | 9 | 10 | *3.4* | *7.5* | *6.1* |
| **Total** | **373** | **236** | **367** | **205** | **120** | **165** | ***100.0*** | ***100.0*** | ***100.0*** |

### Issues and Challenges of PLWS

Among the issues and challenges in implementing the PLWS are as follows:

a. Companies are aware that PLWS is important for enhancing competitiveness. However, to ensure smooth transition of the system, there must be a strong commitment and cooperation from top management and employees. Information sharing of relevant information pertaining to the system by management is necessary to ensure that the system works;

b. The general concern of workers is job and income stability. Most workers perceive that a new wage system that is productivity/performance based will create uncertainty in terms of income. Nevertheless, PLWS provides for the fixed and variable components, whereby the fixed component provides the element of stability;

c. There is a need to have a fair and equitable performance measurement system, as this will ensure that productivity and performance is enhanced. The measurement system and key indicators to be used should be collectively developed by both employers and employees and agreed upon by both parties;

d. The system should be reviewed periodically and improvements made when necessary. This would require feedback and participation from both employers and employees and therefore create a sense of responsibility, ownership and commitment from both parties to ensure that the system is beneficial and viable; and

e. Employees need time to adjust to the new system. They also need to be made aware of the benefits of the system. It is, therefore, essential that a reasonable transition period be allowed, to encourage the implementation of PLWS. During this period, the PLWS can be reviewed if necessary, to ensure the system is fair to both employers and employees;

## The Wage Systems in Selected Asian Countries

Wage systems based on seniority with a fixed salary range that are not reflective of economic or individual performance have been a major concern among developed economies, such as Japan, Korea and Singapore. In addition, escalating labour costs and economic uncertainties led these countries to change to performance-based wage systems. The success factors and benefits of performance-based wage systems in these countries are listed below:

a. Close collaboration between the government, employers and employees was instrumental in ensuring success of its implementation. In these countries, the governments adopted a stance of non-interference in wage negotiations and mainly supported in the promotion of the system. However, it is evident that in countries such as Singapore and Japan, where close collaboration among the three parties exists, the implementation of a performance-based wage system is most successful;

b. Harmonious labour-management relations at a firm level contributed to the successful development of the system in these countries. Employees were receptive of the new system, while the sincerity of employers to share pertinent information created an element of trust between management and workers and reduced the fear of exploitation;

c. A realistic measurement formulae should be developed and agreed upon by both management and workers. Workers were found to be more receptive of the system when they were consulted and involved in the development of the measurement formula; and

d. Shorter wage review period and adjustments are practised in Japan, Korea, Taiwan, Hong Kong, India, Thailand and Singapore. Wage adjustments in these countries are on an annual basis instead of locked in the whole period of the collective agreement. This is to allow wages to be sensitive to economic changes and make speedy adjustments to wages.

## Role of Government

The Government is committed towards the implementation of PLWS. Current efforts by the Government is focussing on promoting the system and enhancing awareness to accelerate its acceptance and thus implementation. For the public sector, the GLCs have already been directed to embark on a more performance-driven culture through the implementation of KPIs and performance-linked compensation. To date, about 50 Malaysian companies including 7 GLCs have implemented the PLWS.

## Conclusion

With greater competition from new emerging economies, Malaysian companies cannot afford to be complacent and should strive to carve a niche for themselves internationally by enhancing their competitive edge. There is no other choice; either corporations through their employees perform and be rewarded or become redundant and irrelevant.

The Government will continue, through NPC, intensify efforts to enhance awareness of the PLWS through seminars, workshops, dialogues and publications. To further intensify implementation, NPC will continue to provide advisory services and system development to companies intending to adopt PLWS. As the success of PLWS and its wider adoption and implementation by Malaysian companies will depend very much on collaboration between government, employers and employees, there should be more discussions among the three parties to eradicate the last of the concerns.

of labour force with tertiary education is expected to increase from 17.5% in 2003 to 18% in 2004, as a result of higher enrolment in institutions of higher learning.

The stronger economy and brisk business activities have enhanced **employment opportunities**. Total employment is expected to increase by 364,500 in 2004. The secondary and tertiary sectors are expected to account for about 36.6% (or 3.8 million) and 49.7% (or 5.24 million) of new jobs created, respectively. The primary sector comprising agriculture, forestry and fishing and mining is, however, not expected to contribute substantially to employment creation in view of the initiatives aimed at intensifying mechanisation in the sector.

The Electronic Labour Exchange (ELX) recorded 28,327 **vacancies** during the first seven months of 2004, following the requirement for employers to register job vacancies through the Job Clearing System (JCS), established by the Ministry of Human Resource since January 2004. This figure could be understated as employers are still unfamiliar with the ELX system. The bulk (32.2%) of the vacancies were concentrated in the manufacturing sector, particularly in the E&E sub-sector, services sector such as finance (15.5%), wholesale and retail trade (6.1%), education (5.7%) and construction (5.3%). The highest vacancies were recorded in Selangor (16.4%) followed by Wilayah Persekutuan (13.7%), Kedah (10.4%) and Perak (10.1%).

The Employment Confidence Index (ECI), published by Jobstreet.com indicates that **job seeker's** confidence in securing employment in the labour market increased to 43.5% in July 2004 (July 2003: 32.5%). This is also supported

TABLE 2.21

**Employment by Sector**

| | ('000) | | Share (%) | | Change (%) | |
|---|---|---|---|---|---|---|
| | 2003 | 2004[1] | 2003 | 2004[1] | 2003 | 2004[1] |
| **Agriculture, forestry, livestock and fishing** | **1,402.6** | **1,400.3** | ***13.8*** | ***13.3*** | ***-0.2*** | ***-0.2*** |
| **Mining and quarrying** | **42.8** | **43.4** | ***0.4*** | ***0.4*** | ***1.4*** | ***1.4*** |
| **Manufacturing** | **2,857.8** | **3,064.5** | ***28.0*** | ***29.0*** | ***6.6*** | ***7.2*** |
| **Construction** | **791.9** | **798.2** | ***7.8*** | ***7.6*** | ***1.3*** | ***0.8*** |
| **Services Sector** | **5,086.0** | **5,239.2** | ***50.0*** | ***49.7*** | ***3.1*** | ***3.0*** |
| Electricity, gas and water | 89.5 | 93.5 | *0.9* | *0.9* | *5.9* | *4.5* |
| Transport, storage and communications | 528.3 | 550.1 | *5.2* | *5.2* | *3.9* | *4.1* |
| Wholesale and retail trade, hotels and restaurant | 1,719.3 | 1,777.2 | *16.9* | *16.9* | *1.2* | *3.4* |
| Finance, insurance, real estate and business services | 651.8 | 677.1 | *6.4* | *6.4* | *7.4* | *3.9* |
| Government services | 1,026.1 | 1,037.4 | *10.1* | *9.8* | *7.7* | *1.1* |
| Other services | 1,071.0 | 1,103.9 | *10.5* | *10.5* | *3.3* | *3.1* |
| **TOTAL** | **10,181.0** | **10,545.6** | ***100.0*** | ***100.0*** | ***3.5*** | ***3.6*** |
| Primary sector | 1,445.4 | 1,443.7 | *14.2* | *13.7* | *1.2* | *1.2* |
| Secondary sector | 3,649.7 | 3,862.7 | *35.8* | *36.6* | *7.9* | *8.0* |
| Tertiary sector | 5,086.0 | 5,239.2 | *50.0* | *49.7* | *3.1* | *3.0* |

[1] Estimate.

Source: Economic Planning Unit.

## FOREIGN WORKERS AND THE MALAYSIAN ECONOMY

### Introduction

The Malaysian economy has consistently recorded impressive and sustained high growths over the period 1990-1997, i.e prior to the Asian financial crisis. The robust growth led to substantial job creation, with employment expanding faster compared with the labour force growth. Consequently, the unemployment rate remained low, reflecting a full employment situation, which remains until today.

### Labour Market Scenario

Following recovery and sustained economic expansion after the crisis, the economy continues to be in a full employment situation. The tight labour market spread to the manufacturing and services sectors and permeated across the Klang Valley and major towns like, Penang and Ipoh. This attracted the influx of both legal as well as illegal foreign workers. Total foreign workers rose from 4% of total employment in 1990 to about 10.7% in 1997 and 9% in 2001. As at July 2004, there are about 1.3 million registered foreign workers, constituting 12% of total employment in the country.

Despite rapid industrialisation and corporate operational restructuring towards more capital intensive manufacturing activities, strong growth in the economy resulted in labour shortages at all levels. Other major economic sectors, namely agriculture, construction and services faced the same problem.

Several measures were taken to ease the tight labour market conditions, including increasing the supply of skilled manpower and greater mechanisation of operations. As an immediate solution to the problem, foreign workers are allowed to be employed in the plantation, construction and selected services sectors as well as the manufacturing sector. This is to avoid disruption to the economic growth process.

### Foreign Labour Policy

Various policy measures pertaining to foreign workers have been instituted to regulate and administer their employment in selected sectors of the economy and to control the influx of illegal foreign workers. These include the Foreign Worker Rationalisation Programme to legalise illegal workers, amendments to the Immigration Act, 1977 and imposition of an annual levy. In addition, several Memorandum of Understanding (MOUs) were signed with labour exporting countries to authorise legal recruitment of foreign workers. Currently, Malaysia allows recruitment of foreign workers from several countries including Indonesia, Nepal, Bangladesh, India and Myanmar.

Export-oriented manufacturers (with more than 50% of their output meant for export market) are eligible to hire foreign workers, while those with domestic-oriented businesses are also allowed to hire foreign workers with certain conditions. Companies with a minimum paid up capital of RM100,000 and with a total sales of RM2 million are permitted to hire foreign workers on the ratio of 1 foreign worker for 1 domestic worker. In the services sector, foreign workers are allowed to work in various industries, including laundry and cleaning, charity houses, golf clubs and resorts.

Foreign companies like MNCs are allowed to bring in required expatriates in areas where there is a shortage of trained Malaysians to do the job. For example, any company with a foreign paid-up capital of USD$2 million and above will automatically be allowed five expatriate posts including key posts.

### Profile of Foreign Workers

The Annual Labour Force Survey conducted by the Department of Statistics, revealed that the number of foreign workers has increased to 1.1 million in 2000 compared to about 136,000 persons in the early 1980s. Latest immigration statistics indicate that the number of legal foreign workers in Malaysia rose to 1,359,632 as at July 2004. The majority of foreign workers are from Indonesia, averaging 66.5% of total foreign workers, followed by Nepal (9.2%), Bangladesh (8.0%), India (4.5%) and Myanmar (4.2%), as shown in *Table 1*. In 2001, male foreign workers accounted for 66% of total foreign workers and they dominated all major sectors, except services.

TABLE 1

**Composition of Foreign Workers by Country of Origin (%)**

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 Jan-July |
|---|---|---|---|---|---|---|---|
| Indonesia | *53.3* | *65.7* | *69.4* | *68.4* | *64.7* | *63.8* | *66.5* |
| Nepal | *0.1* | *0.1* | *0.1* | *7.3* | *9.7* | *9.7* | *9.2* |
| Bangladesh | *37.1* | *27.0* | *24.6* | *17.1* | *9.7* | *8.4* | *8.0* |
| India | *3.6* | *3.2* | *3.0* | *4.0* | *4.6* | *5.6* | *4.5* |
| Myanmar | *1.3* | *0.9* | *0.5* | *1.0* | *3.3* | *4.3* | *4.2* |
| Philippines | *2.7* | *1.8* | *1.2* | *1.0* | *0.8* | *0.6* | *1.1* |
| Thailand | *0.7* | *0.5* | *0.4* | *0.4* | *2.4* | *0.9* | *1.0* |
| Pakistan | *1.0* | *0.6* | *0.5* | *0.4* | *0.2* | *0.2* | *0.1* |
| Others | *0.2* | *0.2* | *0.3* | *0.4* | *4.6* | *6.5* | *5.4* |
| **Total** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** |

Source: Department of Immigration.

In the early 1970s, foreign workers were mostly employed in the agriculture sector. By 1990 it accounted for 48% of total foreign workers employed. As at July 2004, foreign workers are employed in all major sectors of the economy, with manufacturing accounting the largest share at 30.5%, services (25%), agriculture (24.7%) and construction (19.8%), as shown in *Table 2*. Foreign workers in the services sector are mainly employed in restaurants, hotels and as domestic maids. The number of domestic maids rose sharply by more than three times from 75,300 persons in 1997 to 261,006 persons as at July 2004. In terms of educational attainment, foreign workers with no formal education or primary education background accounted for 67% of the total.

TABLE 2

**Sectoral Distribution of Foreign Workers**

| | Number of workers ('000) | | | | | % Share | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1990 | 1995 | 2001 | 2003 | July 2004 | 1990 | 1995 | 2001 | 2003 | July 2004 |
| Agriculture | 115.8 | 173.0 | 284.1 | 185.9 | 335.2 | *47.9* | *36.1* | *32.9* | *16.5* | *24.7* |
| Mining | 1.4 | 1.8 | 2.1 | - | - | *0.6* | *0.4* | *0.2* | - | - |
| Construction | 25.1 | 64.8 | 99.0 | 265.9 | 269.1 | *10.4* | *13.5* | *11.5* | *23.6* | *19.8* |
| Manufacturing | 23.7 | 115.7 | 213.0 | 355.4 | 414.3 | *9.8* | *24.1* | *24.7* | *31.5* | *30.5* |
| Services | 76.0 | 124.0 | 265.6 | 319.6 | 340.9 | *31.3* | *25.9* | *30.7* | *28.4* | *25.0* |
| **Total** | **242.0** | **479.3** | **863.8** | **1,126.8** | **1,359.5** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** | ***100.0*** |

Source: Department of Statistics and Department of Immigration.

**Implications on the Malaysian economy**

It is undeniable that foreign workers have contributed to the economic growth of the country, in particular by alleviating labour shortages in selected sectors of the economy. However, their presence has also put stress on public amenities and services, such as the provision of public services, health and education facilities.

Remittances by foreign workers have also increased steadily as reflected in the outflow of the current transfers in the country's balance of payments. In 2003, the account recorded gross outflow of RM11,229 million compared to RM6,957 million recorded in 1997, as shown in *Chart 1*.

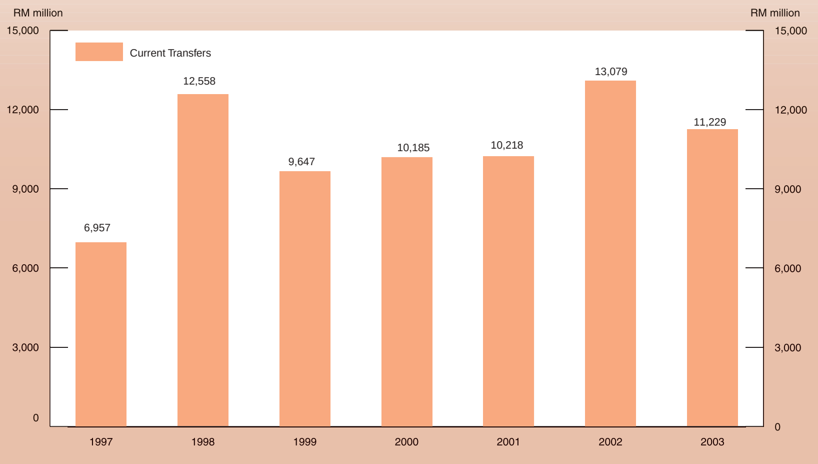
Since 1992, an annual levy is imposed on foreign workers to reduce the economy's over dependence on foreign workers and to safeguard employment opportunities for Malaysians. The levy rate for workers in manufacturing, services and construction sectors was increased by 186 % from RM420 per annum in 1992 to RM1,200 per annum in 1996. However, the levy rate for workers in plantation and household sectors remained the same at RM 360 per annum. Revenue collected including visa fees increased significantly from RM245.3 million in 1995 to RM1,218.8 million in 2003, as shown in *Table 3*.

Total medical fees collected from non-citizens rose by 7.5% annually since 1994 to RM23.2 million, in 2003, reflecting the rising number of foreign workers seeking treatment from public hospitals. This has not only stretched public health care services but also public sector finance. The imputed cost of providing medical care to foreigners now amount to RM578 million per annum. Migrant workers also compete with the poor for low cost accommodation in the squatter settlements and in the Malay Reservation areas, especially in the Klang Valley. The illegal occupation of land and housing, and the congested living conditions have resulted in environmental and social problems. Similarly, the children of foreign workers put pressure on the limited space available in public schools.

Preventive measures to stop illegal workers are very costly, time consuming and involve a large number of enforcement personnel from the Police, Immigration, Armed Forces and RELA, as shown in *Table 4*. Enforcement operations to reduce illegal workers faced many obstacles, such as space constraint at the twelve detention camps, which can only accommodate about 12,000 detainees at any one time. The Government spends about RM3-RM4 million per year providing meals to the detainees.

CHART 1

**Outflow of Current Transfers Account, 1997-2003**




Source: Bank Negara Malaysia

TABLE 3

**Revenue From Foreign Workers**
**(RM million )**

| | 1995 | 1997 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|
| Annual Levy | 218.6 | 1,321.8 | 614.1 | 637.1 | 783.9 | 1,109.4 |
| Visa Fees | 26.7 | 51.7 | 53.5 | 68.4 | 84.4 | 109.4 |
| **Total** | **245.3** | **1,373.5** | **667.6** | **705.5** | **868.3** | **1,218.8** |

Source: Department of Statistics.

### Expatriates, Professionals and Skilled Workers

Expatriates, who are largely professionals and highly skilled workers, account for about 3% of the foreign workers in the country. The majority of them are employed in the manufacturing, petroleum, construction and services sectors, such as health, education and ICT related industries. Currently, there are about 700 expatriates employed in the Multimedia Super Corridor. Of this total, 70% of them are software developers, system analysts, web designers and system engineers. Another 20% hold higher management posts while the remainder are employed as support staff. As at July 2004, there are 711 expatriates employed in public hospitals, comprising 478 medical officers and 233 medical specialists. These highly skilled professionals play an invaluable role in enhancing national productivity and competitiveness. They bring with them knowledge, skill and experience which synergise with local talents and enrich the Malaysian labour force.

### Measures

A clear policy direction has been set recently by the Government in cognizance of the over-dependence of the economy on foreign labour. The Cabinet Committee on Foreign Workers has agreed to form a technical body to review and improve the present system of hiring workers especially the less skilled as well as to attract skilled foreign labour. The Government will also study ways to reduce the country's dependence on foreign workers by encouraging more labour-saving devices such as construction methods using Industrialised Building System (IBS) and through greater automation and mechanisation. This will, however, be implemented in a phased and gradual manner so as not to disrupt the growth momentum.

### Conclusion

TABLE 4

**Number of Enforcement Operations**

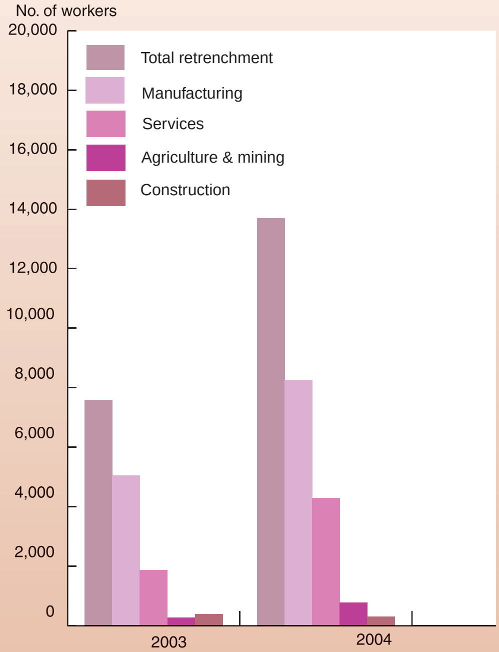
| | 2000 | 2001 | 2002 | 2003 Jan-May |
|---|---|---|---|---|
| Number of operations | 1,097 | 1,455 | 1,872 | 474 |
| Number arrested (persons) | 32,700 | 33,021 | 28,320 | 14,228 |
| Number of officers involved (persons) | 5,485 | 7,275 | 9,360 | 2,370 |

Source: Department of Immigration.

Foreign workers have increased over the past decade due to sustained economic growth and the tight labour market situation. As a long term measure to ensure sustainable growth as well as minimise socio-economic implications, a medium to longer-term policy on foreign workers will be devised with the view to reducing the over-dependence on foreign workers while attracting the more skilled and trained professionals.

CHART 2.16

**Retrenchment in Selected Sectors**
**January - July**




Source: Ministry of Human Resources.

by the 26.4% decline in the number of job seekers registered (27,514 persons) with the Manpower Department during the first seven months of 2004. Of these, about 47.7% (13,118 persons) sought employment in professional categories while the remainder, in other lower skilled occupational categories, such as clerical, machine operators, sales, agriculture and fisheries, and elementary occupations.

The number of **retrenched workers** declined by 4.2% to 13,693 in the first seven months of 2004 (January-July 2003: -11%; 14,288). Strong economic activity and higher demand for labour resulted in the lower number of workers retrenched. The retrenched workers were mainly in the manufacturing sector (60.3%) and services sector (31.3%). Among reasons cited for retrenchment include reduction in demand for products due to obsolescence and termination of product life cycles, company reorganisation restructuring and rationalisation, consolidation, mergers and acquisition as well as greater automation.

The trends in **productivity growth, labour cost per employee** and **unit labour cost** (ULC) in the manufacturing sector shows positive improvements. In 2003, labour productivity increased by 5.3%, outstripping the 4.4% growth in labour cost per employee. This led to a remarkable improvement in ULC by 3.4% (2002: 0.7%). Consequently, the IMD World Competitiveness Yearbook 2004 placed Malaysia as the 6$^{th}$ world's most competitive country in terms of ULC, among 60 countries.

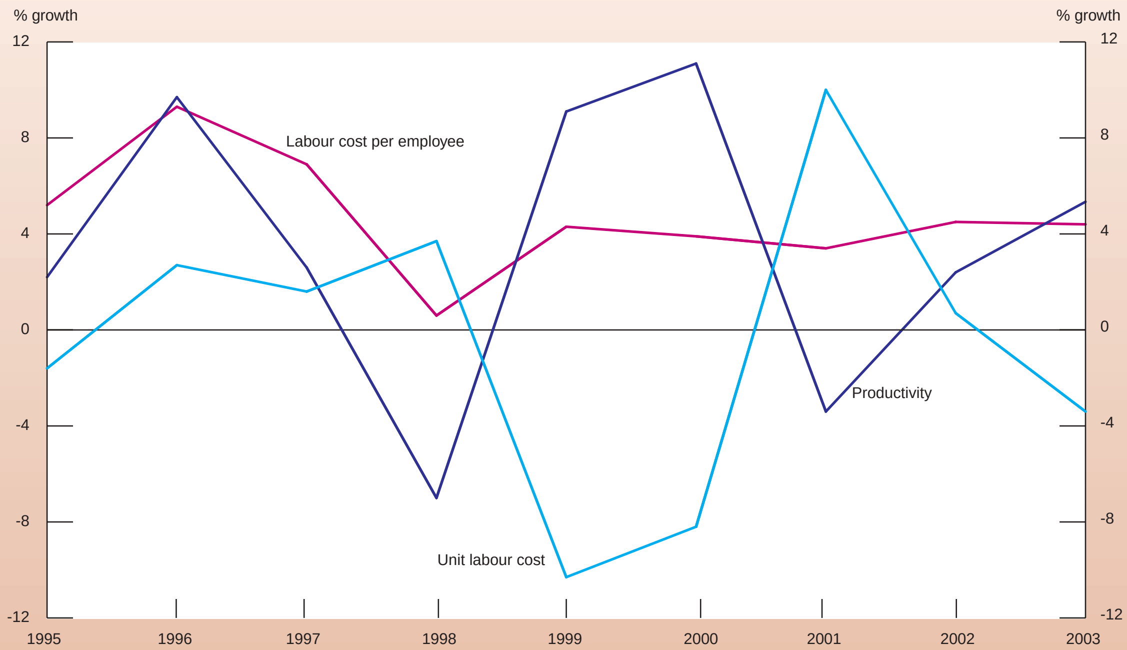
Labour productivity in the manufacturing sector recorded a 13.1% growth during the first six months of 2004 due to improvements in output of export-oriented industries, following increased global demand for semiconductors and higher value-added activities. Productivity increases were highest in E&E (18.7%), followed by the rubber (17.7%), wood (14.8%) and transport and equipment (5.9%) industries. Arising from manufacturing output growth of 16.2% (January-June 2003: 7.9%), sales value gained by 18.6%, while real wage per worker rose only by 5.1%. Consequently, the ULC declined from 88.2 sen per unit in 2003 to 79.8 sen per unit in 2004. Wage pressure in the labour market is expected to remain subdued in 2004.

In the public sector, including government-linked companies (GLCs), the Government implemented Key Performance Indicators (KPIs) to enhance productivity. In this context, the private sector is encouraged to implement productivity-linked wage system (PLWS) as one of the measures to improve labour productivity.

**Foreign labour** constitutes about 10% of the total labour force in 2004. The Technical Committee on Foreign Workers under the Ministry of Home Affairs approved more than 92,800 applications during the first seven months of 2004. Of this total, 59% are employed in the construction, 18% in plantation, 14% in services and 9% in manufacturing sectors. Consequently, the total number of foreign workers increased to 1.36 millions, of which 30.5% is in the manufacturing sector. A total of 33,446 illegal foreign workers were deported during the first seven months of 2004.

CHART 2.17

**Manufacturing Sector: Growth in Productivity and Labour Cost**




Source: Department of Statistics.

**Expatriates**, who are largely professionals and highly skilled workers, account for about 3% of the foreign workers in the country. To facilitate the process of recruiting expatriates, the Department of Immigration implemented a new procedure effective from 1 June 2004, whereby applications are processed through a one-stop approval system. As at 17 May 2004, a total of 34,519 expatriates were employed in the country. These expatriates are mainly employed in the manufacturing (14,595) and services sector (14,139), with the majority of them from India, Japan and China.

## Outlook for 2005

*Economy buoys by positive growth on all fronts...*

Entrenched domestic economic activities, coupled with a fairly favourable external environment, are expected to drive growth into 2005. Strong output growth is expected to emanate from all sectors, led by manufacturing and services with an increasingly higher contribution from private sector expenditure. Consequently, Malaysia is set to achieve another year of healthy growth of 6% in 2005. With an estimated population of 26.1 million, per capita income in current prices is projected at RM16,693 (2004: RM16,098). In terms of purchasing power parity, it is estimated at USD10,560 (2004: USD10,163).

### Domestic Demand

*Private sector expands further, driven by strong investment activity...*

The positive outlook for 2005 is premised on a more resilient **domestic demand**, driven by greater private sector spending. The strong private sector performance, amidst a favourable external environment will enable the public sector to progressively consolidate its overall financial position, whilst confirming private sector's entrenched role as the engine of economic growth. Domestic demand expenditure (excluding change in stocks) in real terms is, thus, forecast to continue to increase favourably by 4.6% (2004: 6.7%).

**Private sector expenditure** is expected to remain bullish, expanding by 8.6% (2004: 10.3%), consistent with the upward trend in private investment activities and sustained consumption spending. Meanwhile, **public sector expenditure** is budgetted to marginally decline by 3% (2004: +0.7%), in line with the policy towards a manageable and sustainable deficit.

**Private investment** expenditure is projected to increase strongly by 11.9% and account for 10.9% of GDP (2004: 14.8%; 10.3% of GDP). The projected increase is based on improved business confidence, arising from favourable external demand, heightened domestic economic activities supported in part by the Government's effort to promote investment in targetted growth areas. In addition, the concept of public-private partnership presently being promoted and nurtured through better collaboration in R&D and innovations, good governance and productivity enhancement will further stimulate investment activities. This initiative will accelerate the move towards a competitive economy backed by high value-added products and services.

High value-added manufacturing and ICT-related industries will continue to attract stronger investment activities, particularly those that are able to provide inter and intra-linkages between MNCs and SMEs. In addition, the services industries, including professional services, logistics, healthcare, education and tourism as well as other knowledge-based industries are areas providing immense potential for economic growth. Following the recent discovery of large oil fields and better oil prices, investment in the oil and gas sector is also expected to increase. Likewise, investment in the agriculture and related agro-based industries is projected to accelerate, following the Government's initiatives to revitalise and modernise the sector.

To promote investment as well as provide a more business friendly environment, the Government will continue to review related legislation, rules, regulations and procedures as well as existing investment incentives. In addition to the recent liberalisation of the FIC rules on improvements to application and approval procedures, amendments to the Promotion of Investments Act, 1986 will be made to widen the scope to include the services sector. In line with these positive developments, private investment is expected to expand further in 2005, thus increasing the potential output of the economy.

**Private consumption** expenditure will continue to expand by 7.9%, after displaying a vibrant growth of 9.3% in 2004. The increase in disposable income and stronger consumer confidence spurred by buoyant domestic economic activities are expected to be the main factors contributing to the favourable private consumption spending. In addition, easier access to credit, accommodative interest rates, low inflation and better employment prospects are also envisaged to support greater private consumption spending.

Contrary to the strong pace of private investment activity, **public investment**, as a deliberate policy, is anticipated to decline further by 8.1% (2004: -6.6%), after taking into consideration lower development allocation amounting to RM28,304 million in 2005 (2004: RM31,131 million). Most of the development expenditure will be channelled to projects and programmes with higher value-added potential, low import content and strong inter-industry linkages. These include agriculture and rural development, infrastructure facilities as well as education and human resource development. The Government will continue to invest in projects and programmes that will support private sector activities. Nevertheless, **public consumption** is expected to register a moderate growth of 2.5% (2004: 9.8%), mainly on account of higher spending on supplies and services to improve further the quality and effectiveness of public sector delivery system.

## Sectoral Outlook

***The economy continues to grow on a firmer footing, led by manufacturing and services sectors, with the emergent potential of agriculture...***

Output growth in 2005 is expected to be broad based with the manufacturing and services sectors remaining the growth drivers. The **manufacturing sector** is envisaged to expand strongly, propelled by strengthened domestic demand and sustained performance of the external sector. Overall production is expected to grow more than 10%, while exports at 11.3%. Buoyed by the upswing in the electronics market, E&E will continue to grow at a steady rate despite the overstated fears of an electronics slowdown. Domestic-oriented industries are also expected to expand further, particularly in food and transport equipment.

Growth in the **agriculture sector** is forecast to be sustained with output increasing by 2.4% (2004: 2.8%). CPO production is projected to reach above 13.8 million tonnes, mainly due to the coming on stream of matured areas. Measures taken by the Government to increase food production is envisaged to result in higher fish landing and output of livestock, vegetables and fruits, which will contribute significantly to the sector's growth.

Output of crude oil and gas is anticipated to continue to rise on account of firm prices and expansion of new oil and gas fields. Natural gas output is expected to increase by 12.1%, following higher production capacity to meet increasing demand. Production of crude oil is projected to increase to 776,000 bpd (2004: 753,000 bpd) in tandem with higher demand. As a result, growth of the **mining sector** is anticipated to record a strong increase of 5.5% in 2005 (2004: 5%).

The **construction sector** is forecast to increase by 1.8% (2004: 0.5%), contributed partly by the civil-engineering sub-sector, following the implementation of new and on-going infrastructure projects such as the Phase Two of the East Coast Highway and Tanjung Bin Power Station in Johor. The housing sub-sector is also envisaged to remain robust, underpinned by higher incomes, low interest rates and easy access to loans. The housing sector is expected to be further boosted by the construction of 7,000 units of low-and-medium cost houses by Syarikat Perumahan Negara Berhad.

Prospects for the **services sector** remains upbeat with growth sustained at 5.8% in 2005. Growth is expected to emanate from robust activities across major sub-sectors. The transport, storage and communications sub-sector is poised to record a strong growth arising from capacity expansion plans of airlines and investment by communications companies. Strong expansion in tourism and trade activities supported by rising incomes will contribute to the high growth in the wholesale and retail trade, hotels and restaurants sub-sector. Increased bank lending, buoyed financial activities will boost growth of the finance, insurance, real estate and business services sub-sector.

## External Trade

***Trade balance remains sturdy...***

The uptrend in the global economy amidst improving world growth and trade environment is expected to spur export and import growth by 9.9% and 10.2%, respectively in 2005 (2004: 17.3% and 22.1%). This will lead to a higher trade surplus of RM86,450 million (2004: RM79,739 million). Malaysia's **current account balance** is envisaged to remain large, recording a surplus for the eighth consecutive year. The higher surplus of RM112,029 million in the goods account will be more than sufficient to offset the combined deficits in the services, income and current transfer accounts. The services deficit will increase marginally to RM8,855 million (2004: -RM8,828 million), mainly due to higher net outflows in the transportation account.

The income account is projected to register a higher net outflow of RM30,521 million (2004: -RM26,751 million), arising from better corporate performance. After taking into account the net outflows of RM10,967 million in the transfer account (2004: -RM9,907 million) due to higher repatriation by foreign workers, the current account is envisaged to register a surplus of RM61,686 million or 14.1% of GNP (2004: RM57,967 million or 14.1% of GNP).

## National Resource Position

*Strong resource balance to support growth…*

National income in current prices is forecast to expand further by 5.9% (2004: 10.8%) in expectation of strong growth in economic activities in 2005. With total consumption spending expected to increase by 7.9% (2004: 10.7%), and outpacing the growth rate of national income, **GNS** is projected to increase at a lower rate of 2.3% to RM153,743 million in 2005 (2004: 11.2%; RM150,288 million). Consequently, the share of GNS as a percentage to GNP is likely to decline marginally, though remaining at a fairly strong level of 35.2% (2004: 36.5% of GNP). After taking into account the total investment expenditure (including change in stocks) at 21.1% of GNP or RM92,056 million (2004: 22.4% of GNP; RM92,321 million), the **savings-investment gap** is expected to remain at 14.1% of GNP or RM61,686 million (2004: 14.1% of GNP; RM57,967 million). Hence, the national resource position will continue to be favourable and further support the nation's economic growth.