ECONOMIC REPORT 2006/2007

1 ECONOMIC MANAGEMENT AND OUTLOOK

Overview

Malaysia has achieved significant progress in developing the economy and improving the quality of life of its people, despite the difficult and volatile external environment in recent years. Economic management in 2006 remains challenging amidst an environment of persistently high crude oil prices, rising global interest rates and increasing competition from China, India and other emerging regional economies. With pragmatic macroeconomic policies coupled with strong economic fundamentals, including robust private investment, low unemployment as well as steady consumer spending, real Gross Domestic Product (GDP) is projected to grow at 5.8% in 2006 (2005: 5.2%).

Growth in 2006 is broad-based, led by services, manufacturing and agriculture sectors. With continuing strong domestic demand and expanding trade-related activities, the services sector is estimated to expand by 5.7% (2005: 6.5%), with all sub-sectors recording positive growth. The manufacturing sector is envisaged to record a higher growth of 7.3% in 2006 (2005: 5.1%). The global uptrend in demand for electronics will impact positively on Malaysia's exports of electrical and electronic (E&E) products, leading to a stronger growth in manufacturing output. The agriculture sector continues to benefit from the Government's efforts to modernise and transform it into a large and commercially viable sector. Value added of the sector is expected to accelerate strongly by 5.3% (2005: 2.5%), underpinned by higher rubber output, strong growth in livestock, food crops and a turnaround in the fishing sub-sector. The high prices of commodities, in particular rubber and palm oil have helped to significantly boost income of about 490,000 smallholders. Rubber smallholders with an average holding of 5.6 hectares are expected to obtain a monthly income of RM3,800 in 2006 compared with RM2,500 in 2005. Government policies and strategies geared towards increasing food production have also assisted the agriculture sector to expand. Value added of the mining sector is, however, expected to be higher at 2.4% (2005: 0.8%), backed mainly by higher production of crude oil. Meanwhile, the construction sector is expected to turnaround this year, recording a positive growth of 0.7% (2005: -1.6%), mainly due to several public sector works and private civil engineering activities to be implemented during the second half of the year.

With increasing job opportunities following sustained expansion in domestic economic activities, unemployment is expected to remain below 4% for the year as a whole, reflecting the full employment situation that has prevailed since 1992. Continuing efforts are being undertaken to increase the number of skilled workers, minimise skills mismatch and to further improve the employability of new entrants to the labour market.

As for the external front, developments remain positive with Malaysia continuing to record a large current account surplus for the ninth consecutive year, underpinned by continued expansion in manufactured and commodity exports. In 2006, the overall balance of payments is expected to remain strong, backed by continued inflows of foreign capital. This in turn is anticipated to strengthen economic fundamentals and boost business confidence. Consistent with the expansion in economic activities, nominal Gross National Product (GNP) is estimated to increase by 11.6% to RM525,853 million, with per capita income rising by 9.4% to reach RM19,739 (2005: 10.7%; RM471,331 million; 8.4%; RM18,039). Taking into consideration the movement in foreign exchange and inflation, per capita income in terms of purchasing power parity (PPP) is expected to increase by 11.8%, to reach USD11,871 in 2006 (2005: 9.2%; USD10,614).

The key thrusts of macroeconomic policies in 2006 are aimed at further enhancing the nation's competitiveness and economic resilience while generating quality growth. The Government continues to address the demands of the growing economy whilst maintaining sustainability and flexibility in handling global and domestic challenges over the medium-term and at the same time further strengthening the economic fundamentals for long-term sustainable development. The measures adopted continue to support and facilitate the private sector as the main driver of growth.

Prudent financial management will continue to be emphasised, focussing on greater accountability and effective spending of government allocations. In order to facilitate and enhance private sector activities, measures adopted include among others, improving the government delivery system, providing tax incentives, modernising agriculture, identifying and developing new sources of growth as well as intensifying investment in human capital. The public sector will continue to review, streamline and revamp its implementation, monitoring and evaluation mechanisms to ensure timely and effective execution of all government programmes and projects.

Meanwhile, monetary policy in 2006 remains accommodative to further support economic activities while maintaining price stability. Despite three increases in the overnight policy rate (OPR) since November 2005, the monetary stance remains supportive of economic growth. The adjustment in the OPR was to align interest rates to the current economic environment and the OPR remains below its neutral level, without constraining economic growth. The Consumer Price Index (CPI), however, edged up in response to adjustments in retail prices of petroleum products following higher crude oil prices. Nevertheless, inflation is expected to remain manageable following gains in labour productivity as well as appreciation of the ringgit.

On the exchange rate front, the ringgit has strengthened against the US dollar (USD). Since the shift to a managed float regime on 21 July 2005, the value of the ringgit is now determined by market conditions and economic fundamentals. The firmer ringgit vis-à-vis the USD was supported by strong trade performance, sustained capital flows and positive economic prospects. In view of the current inflationary pressures, a stronger ringgit will help to mitigate inflation through cheaper imports of goods and services.

Major long-term policy initiatives to be implemented this year comprise the Ninth Malaysia Plan (9MP), 2006-2010 and the Third Industrial Master Plan (IMP3), 2006-2020. While the 9MP aims to achieve a stronger and higher value-added economy, it will also give substantial policy focus to socio-economic issues towards uplifting the quality of life for all Malaysians. The National Mission, as encapsulated in the 9MP, provides the framework for planning and implementation of the nation's development policies over the next 15 years to achieve the goals of Vision 2020. Additionally, the IMP3 provides the strategic direction in spearheading growth and competitiveness of the manufacturing sector and manufacturing-related services industry.

The economic growth momentum in 2006 is expected to continue into 2007 at a stronger pace of 6%, supported by sound domestic economic fundamentals and a conducive business environment. However, several downside risks remain. High crude oil prices, further hikes in international interest rates, global economic imbalances and geopolitical tensions are likely to dampen world growth and trade. Despite these challenges, bolstered by a much improved oil-related revenue, the Goverment remains in a position to pursue a budgetary stance that supports further expansion in domestic economic activities.

Performance Review

The 2006 Budget was drawn up centred on four broad strategies: implementing proactive Government policies, providing a business-friendly environment, developing human capital and enhancing quality of life, consistent with the theme **"Strengthening Resilience, Meeting Challenges"**.

Fiscal Operations in 2006

The active role played by the Government in fostering economic activities has not jeopardised the pace of fiscal consolidation, given the relatively strong economic performance and significantly higher oil-related revenue. The fiscal deficit of the Federal Government, as a percentage of GDP, is expected to decline further to 3.5% in 2006, with the debt service ratio remaining low and manageable. This level is in tandem with the overall macroeconomic strategy of reinforcing the economic growth momentum without imposing pressure on Government financing or its debt position. While the bulk of Government's borrowing requirements continues to be sourced domestically, it will not crowd out the private sector's access to funds.

Federal Government revenue is higher at RM120,625 million compared with RM114,569 million estimated in the 2006 Budget due to much improved oil-related revenue, which increased to RM45,002 million or 37.3% of total revenue. The continued improvements in tax administration, particularly measures to reduce leakages and improve enforcement, have contributed to increasing revenue collection. As for Federal Government expenditure, a large proportion of the operating expenditure is for locked-in items such as emolument, debt service charges, transfers as well as supplies and services. In addition, operating expenditure remains focussed on programmes and projects aimed at improving the Government delivery system to enhance the overall efficiency and competitiveness of the economy. As for development expenditure, the priority is to build capacity in terms of infrastructure and utilities, rural and agriculture development and human resource development.

Enhancing Development of Small and Medium Enterprises

Efforts continue to be focussed on accelerating the development of small and medium enterprises (SMEs) to enable them to become a catalyst of growth. The measures specifically aim at strengthening the support infrastructure, building capacity and enhancing SME access to financing. A key initiative adopted recently by the National SME Development Council to expedite SME development was the National SME Development Blueprint, which outlined the Government's objectives, targets and strategies, action plans and programmes for 2006. A one-stop online information gateway for SMEs, the SMEinfo Portal, was also launched in February 2006. The portal provides comprehensive information to SMEs on access to financing, availability of support services including advisory, training programmes, marketing information as well as business and networking opportunities.

Many SMEs have taken advantage of the facilitative infrastructure, as reflected by the significant utilisation of existing SME specialised funds. To provide further access to financing for SMEs, the size of the Fund for Small and Medium Industries 2 and the New Entrepreneurs Fund 2 under Bank Negara Malaysia (BNM) was increased. Apart from such funds, the banking sector continues to support the financing needs of SMEs with lending to SMEs driving the growth of loans to the business sector. Loans to SMEs accounted for 44.4% of loans to the business sector and 17.7% of total outstanding loans of the banking system as at end-June 2006. Banking institutions have also launched two new trade finance products, namely the Multi Currency Trade Finance and the Indirect Exporter Financing Scheme, to encourage greater SME participation in the export markets.

Meanwhile, the dedicated SME Bank, which started operations on 3 October 2005, has been active in supporting the development of SMEs. As a one-stop financial services centre, the SME Bank is better placed to understand SME business and finance needs. During the first six months of 2006, the SME Bank approved loans amounting to RM861 million and disbursed RM606 million to SMEs, mainly in the manufacturing, construction, hotels and restaurants industries.

The National SME Development Council has also approved a comprehensive microfinance institutional framework to ensure SMEs, in particular, micro enterprises have adequate and continuous access to financing. In this regard, Bank Simpanan Nasional will be transformed into a specialised microfinance institution, while Bank Pertanian Malaysia will provide microfinance for agriculture and agro-based activities. Credit co-operatives which also provide microfinance will be strengthened through the establishment of the Co-operative Commission of Malaysia.

Modernising the Agriculture Sector

Malaysia has been able to utilise her resource endowments of fertile land, suitable climate and management expertise to excel in the cultivation of plantation crops such as oil palm, rubber and cocoa. The acquired experience and skills are now being extended into modernising the non-plantation agriculture sector, particularly in food production. Large-scale commercial production of food has been undertaken through the establishment of permanent food production parks. As at end-June 2006, 28 permanent food parks have been established, covering 2,007 hectares and involving 319 entrepreneur farmers. The parks are involved in a variety of activities ranging from cultivation of food crops, aquaculture and rearing of livestock for domestic consumption as well as for export.

Apart from the permanent food parks, the other high impact projects identified under the 9MP are the aquaculture industrial zone and the creation of 10,000 agro-based industry entrepreneurs. The aquaculture industrial zone will be first implemented in Sungai Chemor, Terengganu. It will cover an area of 2,800 hectares with a projected harvest of 9,000 tonnes with a market value of RM46 million. The modus operandi is based on the concept of an anchor company supported by a cluster of 240 aqua-entrepreneurs.

Taking cognisance of the importance of developing agro-entrepreneurs, the Government has formulated a blueprint for the nationwide development of agro-based food entrepreneurs. The Government will focus on providing basic infrastructure and incentives, besides developing a pool of skilled workers for the sector to ensure the successful implementation of this project.

The Government continues to give priority to increase productivity and improve the quality of food production for domestic and export markets. In this regard, the Fund for Food (3F) has been increased by an additional RM300 million in the 2006 Budget from the existing fund of RM1,300 million to enable funds to be provided at a reasonable cost, particularly to SMEs involved in food production and related food processing activities. As at end-July 2006, loans valued at RM1,742 million were approved, with RM1,624 million disbursed to 10,094 successful applicants.

Additionally, the Government has identified *halal* food production as a new source of growth within the sector. In line with this emphasis, production of *halal* food has been further promoted given the vast potential of the *halal* export market. For a start, areas with appropriate infrastructure and processing facilities for the establishment of *halal* food production zones have been identified. To date, two *halal* food production zones are operating in Selangor and Johor, covering 432 hectares. The Halal Industry Development Corporation (HDC), established recently, will be the key driver and coordinator for all initiatives to promote Malaysia as a global hub for the production and distribution of halal products. The Malaysia International Halal Showcase (MIHAS) and the World Halal Forum (WHF) held annually are other initiatives aimed at promoting the growth of the *halal* industry. MIHAS and WHF bring together *halal* products and services producers from around the world and provide the opportunity for strategic cooperation and alliances to be forged in growing the global trade in *halal* products.

New sources of growth in the agriculture sector which have yet to be fully exploited include ornamental fish farming, seaweed farming as well as tuna and deep-sea fishing. Ornamental fish farming being undertaken in three regional clusters specialising in specific species, contributed towards increasing its market value from RM72 million in 2000 to RM103 million in 2005. Production of seaweed has also increased significantly following aggressive cultivation based on the estate concept, particularly off the coast of Sabah. In addition, the integration between production and processing activities has provided the impetus for further expansion in output of seaweed.

Ongoing efforts to develop palm oil-based biodiesel will further boost the growth of the agro-based industry. Several companies have utilised the technology developed by the Malaysian Palm Oil Board (MPOB) to process palm oil into biodiesel (methyl ester) for export. In addition, ENVO Diesel, a diesel blend with 5% processed palm oil and 95% petroleum diesel, has been promoted for local consumption in the effort to encourage the use of alternative fuels to reduce dependence on petroleum. Meanwhile, the National Biofuel Policy will provide the strategies and legislative framework for the coordinated and comprehensive development of biofuel industry. The policy also aims to strengthen Malaysia's position as a centre for the global palm oil industry.

Enhancing the Services Sector

Given the enormous potential that can be derived from the services sector, the Government has focussed on developing this sector as a key driver of growth and source of employment, with special emphasis on higher value-added activities in the information and communications technology (ICT), tourism and transport sub-sectors. Within the ICT sub-sector, the Multimedia Super Corridor was rebranded as the Multimedia Super Corridor Malaysia (MSC Malaysia) to reflect its status as a national project as well as to improve and rejuvenate itself, consistent with domestic and external developments. Meanwhile, its management agency, the Multimedia Development Corporation took on a new acronym of MDeC with greater focus on its role as an enabler to implement the nation's ICT agenda along with the other stakeholders in the public as well as private sector. During the first seven months of 2006, 131 companies were granted MSC Malaysia-status, bringing the total to 1,552. In all, these companies will be able to provide about 48,240 high value jobs in 2006 (2005: 44,170). At the same time, the roll-out of MSC Malaysia continued to Malacca as well as Johor and is expected to be extended to Perak within the year.

As a key component of MSC Malaysia, Cyberjaya will continue to be developed as the national ICT hub as well as a multimedia innovation, services and operations centre. Additional measures were taken during the year to further develop and enhance its facilities and amenities. These include providing more housing and a dedicated public transport system as well as other social amenities. Internet access has been upgraded to provide coverage for the entire area with high-speed wireless connection. An additional incentive has been introduced to attract the setting up of more MSC Malaysia-status companies. With this incentive, new buildings in Cyberjaya will enjoy the Industrial Building Allowance (IBA) for ten years.

In addition to attracting ICT companies, Malaysia has emerged as a preferred destination for shared services and outsourcing (SSO) globally.

As at end-June 2006, the Malaysian Industrial Development Authority (MIDA) had approved 2,176 regional establishments. These include 115 operational headquarters (OHQs), 187 international procurement centres (IPCs) and 13 regional distribution centres (RDCs) while the rest are regional offices (ROs) and representative offices (REs). To provide international exposure to Malaysia's potential in the SSO industry, Outsourcing Malaysia (OM) was launched in early May 2006 in conjunction with the World Congress on Information Technology (WCIT) held in Texas. OM is a collaborative initiative between the Government and the industry, comprising MDeC, the Association of Computer and Multimedia Industry of Malaysia (PIKOM), Malaysia Debt Ventures Berhad (MDV) and industry players. The focus of OM is on business development, branding and marketing as well as building capacities for SSO companies across the country. At the same time, Malaysia initiated the International Multilateral Partnership Against Cyber-Terrorism (IMPACT). This initiative will provide a platform for Government and the international business community to collaborate on enhancing cyber security. IMPACT, housed in Cyberjaya, will focus on security certification, research and development (R&D) and establishing a global emergency response centre.

To further boost the local communications and multimedia industry as well as bolster its competitiveness globally, the Government launched the Malaysian Information, Communications and Multimedia Services 886 (MyICMS 886) strategy in December 2005. Spanning five years, the strategy encompasses the provision of **eight** services, utilising **eight** essential infrastructure in **six** growth areas. The services range from high-speed broadband, digital multimedia broadcasting to universal service provision (USP). The infrastructure includes among others, hard infrastructure such as third generation (3G) technology cellular networks and soft infrastructure such as information and network security. Meanwhile, the growth areas include content development, an ICT education hub as well as embedded component and devices. The award of two more 3G licences in March 2006 is also expected to boost activity within the telecommunications sub-sector.

With tourist arrivals of 16.4 million contributing towards foreign exchange receipts of RM31.9 billion in 2005, the tourism industry has become a major source of foreign exchange revenue. To further realise the full potential of the industry, the Government has targetted 2007 as Visit Malaysia Year (VMY) in conjunction with the 50^{th} anniversary of Malaysia's independence. The VMY 2007 campaign, launched in January 2006, is aimed at drawing tourists from short haul markets such as the Association of Southeast Asian Nations (ASEAN) region, medium haul markets like East Asia, India and the Gulf region as well as the long haul markets of Europe and North America. These promotional efforts are expected to attract 17.5 million tourists in 2006 and 20.1 million tourists in 2007.

Health and education tourism have also been accorded greater emphasis. With immigration procedures simplified and better coordination among government agencies, flight operators and related service providers, entry by tourists for health and education purposes is better facilitated. A special unit has been established in the Ministry of Health to promote health tourism and to develop Malaysia as a regional centre for healthcare services. To encourage education tourism, tax incentives have been granted to private higher education institutions to improve the quality and variety of the courses offered.

As for air transportation, the recent domestic air services rationalisation exercise is expected to help Malaysia Airlines (MAS) and AirAsia Berhad to become more competitive by leveraging on strengths in their respective niche areas. Segmentation between the premium and the low cost market will ensure healthy competition leading to efficient as well as affordable air services in the domestic aviation sector. Effective 1 August 2006, Fly Asian Xpress Sdn. Bhd. (FAX) has started operations of rural air services in Sabah and Sarawak, with AirAsia Berhad managing and providing resources as well as support services to FAX. Yet another development in the transport sector is the establishment of a low-cost carrier terminal (LCCT) in Sepang in March 2006 to cater for the rising number of budget travellers.

Strengthening the Government Delivery System

Strengthening the Government delivery system remains a focus of proactive government policies. Well-articulated strategies have been implemented to ensure more efficient, effective and timely services to the public as well as to stimulate private sector activities. Continuous improvements to the delivery system have been made through further strengthening of district and local authority administration, streamlining rules and procedures of regulatory framework and leveraging on the greater use of various electronic channels to better serve the public. Other measures include greater delegation of power, increasing the level of professionalism, instituting key performance indicators (KPIs) among the front-line agencies as well as filling vacancies in strategic ministries and agencies.

These improvements, among others, help to expedite the approval and payment processes and thus provide a more conducive environment for the private sector to conduct businesses. In December 2005, the Government launched the myGovernment portal, enabling the public to have direct access to a comprehensive range of online services through a single window. This portal provides links to the websites of 900 government agencies, offering 388 online services and 3,285 downloadable forms. To provide greater convenience and enable taxpayers to file income tax returns on time, the Inland Revenue Board (IRB) introduced electronic filing (e-filing) of individual tax returns from year of assessment 2005. New passports are issued by the Immigration Department within three days, while renewals are now processed within 24 hours. e-Passport kiosks have also been established at strategic locations to further facilitate renewals. Other examples of the enhancement in government services through ICT include the *e-Hakmilik, e-Daftar* and *e-Insurans* applications introduced by the Road Transport Department (RTD), to simplify and expedite motor vehicle registrations and road tax payments.

As for district administration, significant improvements were achieved through measures to strengthen the staffing level and revamp the work processes. A total of 334 posts were filled to manage one-stop centre established in all local authorities, to expedite the issuance of licences and permits as well as collection of assessment fees and fines. A flying squad unit was established in 2003 under the Department of Director General of Lands and Mines to address the large number of backlog cases in land administration in all land offices. In 2006, an additional 600 personnel have been deployed to strengthen the capacity of the unit which has led to considerable improvements in resolving outstanding cases. As at end-July 2006, 44.7% of a total of 254,200 outstanding cases of land alienation in the country were resolved. Outstanding cases of land alienation in Penang, Malacca and the Federal Territory of Kuala Lumpur have all been resolved. Regarding the issuance of strata titles, 84.6% of outstanding development schemes were resolved.

Furthermore, much has been done to facilitate the entry of professionals in establishing Malaysia as a global ICT and multimedia hub. The Immigration Department has expedited the issuance of employment permits and professional visit passes, especially for knowledge workers and professionals in the fields of ICT, financial services and high-technology industries. For instance, a one-stop facility has been established at the MDeC to assist knowledge workers and professionals employed in the MSC Malaysia-status companies.

Further improvements in the government delivery system are also featured in the Malaysia My Second Home (MM2H) Programme. These include the strengthening of the one-stop centre to facilitate and coordinate applications as well as to expedite approvals and extension of the social visit pass with multiple entry visa from five to ten years, exemption from Foreign Investment Committee (FIC) approval for the purchase of residential properties and the flexibility to partially withdraw the required fixed deposit after a period of one year. With the provision of these attractive incentives, participation in the MM2H Programme rose by 2,058 in the first six months of 2006, bringing the total to 9,914 participants since it was launched in 1996. Of this total, 21.1% were from Bangladesh, China

(20%), followed by Britain (9.1%), Taiwan (6.4%) and Singapore (5.8%). As part of further initiatives to promote higher tourist arrivals from China and India, more immigration attaché offices are expected to be established.

Transformation of the Financial System

The financial sector continues to be progressively transformed following the restructuring and reform initiatives undertaken since the Asian financial crisis. Measures adopted include the rationalisation of existing institutions as well as the introduction of new institutions and foreign competition. The scheduled winding up of Danaharta in December 2005 marked the successful conclusion of the financial restructuring exercise initiated in 1998. The consolidation of finance companies and commercial banks into single entities was successfully completed by January 2006, leading to more efficient use of capital and resources as well as enhanced capacity and capability to meet the increasingly differentiated and sophisticated demands of customers. Another strategic initiative involved the development of investment banks through mergers between merchant banks, stockbroking companies and discount houses. The transformation process into investment banks is expected to be completed by end-2006.

The financial landscape has also witnessed greater regional and international integration. Three new foreign Islamic financial institutions were approved to operate Islamic banking in Malaysia, with one already in operation. In addition, the foreign participation limit was raised from 30% to 49% for Islamic subsidiaries, investment banks and *takaful* operators. The locally incorporated foreign banking institutions operating in Malaysia have also been allowed to establish four additional branches within a one-year period effective 1 January 2006. A number of Malaysian banking institutions has also penetrated foreign markets, with presence in 20 countries.

Further efforts continued to be taken to enhance Malaysia as an Islamic financial centre. A key initiative was the establishment of the International Centre for Education in Islamic Finance (INCEIF) in March 2006 to develop human capital for the Islamic financial industry. Meanwhile, the *takaful* industry is set to expand with the entry of four new *takaful* operators in 2006.

Following the implementation of several measures to strengthen the banking sector, the more resilient and competitive domestic banking sector is better positioned to operate in an environment of increased liberalisation and competition. Currently, the domestic banking institutions account for 78% of total loans, 68.3% of housing loans, 84.7% of SME loans and 78.3% of business loans. Consumer protection in Malaysia has also been strengthened with the establishment of the Malaysia Deposit Insurance Corporation (MDIC) in August 2005 and the Credit Counselling and Debt Management Agency (CCDMA) in April 2006. The MDIC protects savers by providing insurance against loss of part or all deposits of a banking institution as well as contributes towards the stability of the financial system. The CCDMA provides free advisory services, counselling and assistance to individuals in areas relating to credit, financial management and education as well as debt restructuring.

Building a World-Class Capital Market

The capital market remains an integral component of the Malaysian financial system, amounting to RM1.1 trillion as at end-2005. Of this amount, the equity market accounted for RM695 billion and the debt market RM416 billion. Measures taken over the years, particularly under the Capital Market Masterplan (CMP), have contributed towards building an efficient, resilient, dynamic and competitive capital market to support the economy. Notably, the Malaysian bond market with outstanding value of USD119,765 million as at end-June 2006 is the largest in Southeast Asia. Malaysia is also an internationally recognised Islamic capital market, being among the world's most active issuers of Islamic bonds. It has also successfully attracted supranational agencies to raise *syariah*-compliant ringgit-denominated bonds in the domestic capital market. In addition, competition and international integration have been enhanced with the presence of five foreign brokers and one foreign fund manager in Malaysia since the end of 2005.

Among new initiaves taken towards developing Malaysia into a world-class capital market include the introduction of foreign listings. Foreign companies will be allowed to list on Bursa Malaysia, while Main Board Malaysian companies are allowed to seek secondary listings abroad. This will enable domestic companies to finance cross-border mergers and acquisitions through the equity market. In addition, other initiatives in the pipeline include the consolidation of the securities and futures laws and a one-stop processing of visas and work permits for foreigners in the financial sector to be centralised at BNM and the Securities Commission (SC).

As part of efforts to boost the Malaysian stock exchange among global investors, Bursa Malaysia launched the new FTSE Bursa Malaysia Index Series in June 2006. The new index series developed in collaboration with the FTSE group focusses on investability and transparency. Apart from promoting the visibility of the domestic stock market, the new index will also help spur the creation of new investment products, such as exchange traded funds (ETFs), new derivatives and over-the-counter (OTC) products.

The introduction of Real Estate Investment Trusts (REITs) in 2005 has provided investors with an alternative investment tool as well as help unlock the value of properties. To date, there are eight listed REITs with another three approved but pending listing. Total turnover of REITs has been significant, reaching RM342 million in 2005 and RM311 million in the first six months of 2006. The recent move to allow REITs to have a higher gearing limit of up to 50% from 35% previously is expected to stimulate renewed interest in REITs, besides enhancing the competitiveness of Malaysian REITs vis-à-vis REITs of regional bourses.

Developing Human Capital

Given that human capital development is one of the key thrusts identified in the 9MP to move the economy up the value chain and transform it into a knowledge-based economy, high priority continues to be accorded to improving the quality of human capital. To enhance capacity building, efforts will be strengthened to develop human capital that is knowledgeable, skilled and innovative to meet the requirements of the highly competitive labour market. Consistent with the objective to ensure that manpower supply meets the ever changing needs of industries, efforts continue to be undertaken to further improve the education and training systems as well as lifelong learning programmes to facilitate the acquisition of knowledge and skills.

Towards this end, the education system will be continuously reviewed and improved. The curriculum and co-curriculum programmes will be constantly evaluated to develop creativity, innovativeness and thinking skills among students. Schools and communities will continue to place greater emphasis on nurturing a lifelong learning culture. At the same time, linkages between universities and industries will be strengthened to ensure that courses offered remain relevant to industry requirements. For instance, MDeC has established the MSC Malaysia K-Workers Development Institute to address the skills shortage faced by the MSC Malaysia-status companies. The institute collaborates with the institutions of higher learning to develop skills in demand. It also has programmes to encourage MSC Malaysia companies to hire fresh graduates, develop the global competitiveness of k-workers in MSC Malaysia and assist investors to recruit k-workers.

As part of continuous efforts to provide learning opportunities and to develop adequate human capital for the nation, the Government remains committed to provide the infrastructure for learning through building of schools, universities, community colleges, polytechnics and training colleges. Presently, there are 18 public universities, 20 polytechnics and 34 community colleges in the country. The Government continues to allocate a large percentage of its budget each year to human capital development. Concomitant with the increase in the allocation for education and training, the percentage of population with access to education, at all levels, has increased. For instance, the enrolment rate at the primary level in public schools increased from 92.1% in 2001 to 96% in 2005, while the enrolment rate at the secondary level increased from 77.7% to 79.3%, during the same period.

To meet the increasing demand for skilled and competent workers, more training and retraining courses have been provided by the State Skills Development Centres (SSDCs). Programmes conducted by these SSDCs are expected to reduce the mismatch in skills and enhance employability of graduates. As at end-June 2006, an additional 14,727 trainees have benefitted from the technical skills training courses under the Workforce Technical Transformation Programme (WTTP) and Industrial Skills Enhancement Programme (INSEP) offered by the 12 SSDCs in the country. In addition, employers have utilised the Human Resource Development Fund (HRDF) to upgrade the skills capacities and capabilities of their employees. As at end-June 2006, an additional 300,745 employees have benefitted from these programmes.

Continuing the Social Agenda

The Government will continue to address socio-economic disparities to maintain social harmony and stability, a key component for further improving economic development. This will be carried out through programmes to eradicate poverty, generate balanced development especially in less-developed regions as well as to ensure that the benefits of growth and development are more equitably distributed. The incidence of poverty was reduced from 22.8% in 1990 to 5.7% in 2004. However, pockets of hardcore poor remain, totalling about 67,300 households, of which 14,100 are in urban areas and 53,200 in rural areas. The Government's commitment to improving the quality of life is evident in the target to eradicate hardcore poverty by 2010.

Intensified efforts have been made to enhance the earning capacity of the rural poor. In line with this, a total of RM100 million was provided in the 2006 Budget to implement income-enhancing, capacity building as well as skills training programmes under the *Skim Pembangunan Kesejahteraan Rakyat* (SPKR). As at end-May 2006, about RM7.7 million was spent under the *Program Peningkatan Pendapatan* to enhance income, benefitting some 7,100 new participants. Meanwhile, an additional 2,000 participants have benefitted from capacity building initiated through the *Program Pembangunan Minda Insan*. Further efforts have also been undertaken to improve the welfare of the rural poor through provision of affordable housing. Out of the RM27 million allocated under the *Program Bantuan Rumah* this year, a total of RM6.4 million was spent on renovating dilapidated houses as well as building new ones.

The Government remains committed to ensuring public utilities are made more accessible. In this regard, the Government has allocated RM140 million in 2006 to extend rural electricity coverage. As at end-June 2006, a total of 6,642 additional households benefitted from the rural electrification programme. Meanwhile, a sum of RM151 million was allocated this year to provide and upgrade water supply facilities in rural areas, which benefitted an additional 32,216 households as at end-June 2006, particularly in Sabah and Sarawak.

In addition, efforts in bridging the knowledge and digital divide between the urban and rural areas are ongoing. To date, 42 rural internet centres have been established by the Ministry of Energy, Water and Communications to provide ICT-based opportunities to rural communities. Currently, 58 community communications development centres have also been initiated and funded by the Malaysian Communications and Multimedia Commission (MCMC) to increase community access to network services and facilities. Meanwhile, 30 *Medan InfoDesa* have been established by the Ministry of Rural and Regional Development with 12 more to come on-stream by the end of the year to provide computer and internet facilities.

At the same time, more programmes and projects will be channelled to provide assistance to the *Orang Asli* community and disadvantaged groups, such as the disabled, the elderly and single mothers to ensure that they are not left out of the mainstream of national development. In line with this, the Government has allocated RM488 million in the 2006 Budget to conduct various programmes to benefit the target groups. Currently, the assistance for the old and needy has been increased from RM135 to RM200 per month, while the assistance for orphans and poor children has been increased from RM80 to RM100 per month for each child. The maximum assistance given per family has been increased from RM350 to RM450 per month. To improve the welfare of children in rural areas, the daily contribution for food to pre-schools *(TABIKA)* under *KEMAS* has been increased from 60 sen to RM1.50 per student.

Given that Malaysia has achieved all the Millennium Development Goals (MDGs) except for the target set for combating HIV/AIDS, the Government is committed to addressing the challenges associated with halting and reversing the spread of HIV/AIDS. Consistent with this commitment, the Government has set up the Cabinet Committee on HIV/AIDS to address the problem. Meanwhile, the Government has also approved the National Strategy Plan on HIV/AIDS (2006-2010) in April 2006 to enhance coordination in implementing multi-sectoral approaches to HIV/AIDS prevention.

MILLENNIUM DEVELOPMENT GOALS: MALAYSIA'S ACHIEVEMENTS

Background

In September 2000, world leaders issued the United Nations (UN) Millennium Declaration, affirming their determination to "spare no effort to free our fellow men and children from abject and dehumanising conditions of extreme poverty" and committing their nations to a set of time-bound and measurable goals and targets called the Millennium Development Goals (MDGs). The eight MDGs, to be achieved by 2015, are as follows:

i. ***eradicate extreme poverty and hunger*** – to halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day, or who suffer from hunger;

ii. ***achieve universal primary education;***

iii. ***promote gender equality and empower women*** – to eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015;

iv. ***reduce child mortality*** – to reduce by two-thirds, between 1990 and 2015, the under-five mortality rate;

v. ***improve maternal health*** – to reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio;

vi. ***combat HIV/AIDS, malaria and other diseases*** – to have halted by 2015 and begun to reverse the spread of HIV/AIDS and the incidence of malaria and other major diseases;

vii. ***ensure environmental sustainability*** – to integrate the principles of sustainable development into country policies and programmes as well as reverse the loss of environmental resources and to halve by 2015 the proportion of people without sustainable access to safe drinking water and basic sanitation; and to have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers; and

viii. ***develop a global partnership for development.***

The MDGs are now part and parcel of the work programmes of not only the UN agencies but also the Bretton Woods Institutions and other international organisations as well as groupings such as the World Trade Organisation (WTO) and the Commonwealth.

Progress at the Gobal Level

The attainment of the MDGs has, thus far, not been encouraging, particularly against the following backdrop:

- millions of sub-Saharan Africans continue to sink deeper into poverty, and millions more in both sub-Saharan Africa and South Asia suffer from chronic hunger, while half the total number of children under the age of five are malnourished;

- universal primary education remains unattainable in sub-Saharan Africa, South Asia and Oceania;
- women, who continue to represent a small portion of wage earners, are often relegated to insecure and poorly-paid jobs and lack equal representation at the highest levels of government;
- 11 million children – or 30,000 a day – perish annually from preventable or treatable causes;
- half-a-million women continue to perish every year either during pregnancy or from childbirth;
- HIV/AIDS has become leading causes of premature death in sub-Saharan Africa, while HIV is spreading at an alarming rate in the Commonwealth of Independent States (CIS) and parts of Asia, and tuberculosis (TB) is on the rise;
- environmental degradation and continued depletion of natural resources; and
- developed countries have not fulfilled their commitments to assist the developing countries through aid and debt relief, which could be accompanied with better opportunities for trade, accelerated transfer of technologies and enhanced employment opportunities for the growing number of young people in developing regions.

Malaysia's Achievement of MDGs

Malaysia, as a signatory to the Millennium Declaration, has made great strides towards fully achieving the MDGs, which are very much in line with Malaysia's social and economic agenda towards improving the quality of life of the *rakyat*. Consequently, Malaysia's attainment of the MDGs is well ahead of the 2015 target, with the exception being the goal of combating HIV/AIDS which requires more concerted action.

In **eradicating poverty and hunger**, the number of households living below the poverty line in Peninsular Malaysia has significantly been reduced from 49.3% in 1970 to 3.6% in 2004 (Malaysia: 5.7% in 2004). The Government is fully committed to this goal and will continue to strive towards further lifting the living standards of the *rakyat*.

Universal primary education provides the foundation for the Government's effort in harnessing human capital to achieve developed nation status by 2020. The provision of free and easily accessible primary education enabled the country to achieve the goal of universal primary education as early as 1990, well ahead of the MDG target. The achievement was not only in terms of student enrolment but more importantly, 97% of primary school children completing their education. The provision of adequate educational infrastructure and support measures have helped ensure that even the poorest in rural areas are not deprived of education opportunities. Access to schooling is facilitated by specific programmes such as the textbook loan scheme, school health programme, school milk programme, provision of hostels and scholarships as well as other financial assistance.

The Government continues to **promote gender equality and empower women**. Through various measures undertaken since 1970, the gender gap in enrolment at all levels of education, which previously favoured male students, has improved significantly. In fact, female students currently outnumber males by more than 2:1 in public universities. Besides education, women's interests are also given more focused attention through the Ministry of Women, Family and Community Development, which was established in 2001. The Ministry has embarked on a number of programmes to promote a better balance between workplace, childcare and household duties as well as changing men's attitudes towards sharing family responsibilities. There are many other programmes which have been implemented specifically for women's empowerment through the provision of financial assistance, training, healthcare services and legislation as well as the establishment of the Cabinet Committee on Gender Equality and the National Advisory Council on Women.

A well-developed primary healthcare system, which encompasses infant immunisation and child nutrition, combined with better education and an improved reproductive health system, is key to Malaysia's success in **significantly reducing the infant and child mortality** rates. In the under-five group, for example, the mortality rate (U5MR), dropped from 57 per 1,000 live births in 1970 to 17 in 1990 and 0.5 in 2005.

Malaysia also recorded a significant improvement in **maternal health**, as indicated by the maternal mortality ratio (MMR) which declined to 30 per 100,000 live births in 2005, from 141 per 100,000 in 1970. This improvement in the MMR is largely due to improved access to quality maternal health services as well as a significant increase in births attended by skilled health personnel.

Malaysia has accomplished all the MDG targets except in relation to **HIV/AIDS**. More concerted efforts are now being taken to halt the spread of HIV/AIDS by 2015 through a multi-sectoral approach. These include collaboration and cooperation among the various ministries and agencies covering health, education and information as well as involving the non-governmental organisations (NGOs) in the many aspects of AIDS prevention, treatment, care and support.

Malaysia has also made remarkable strides in controlling a number of infectious diseases including malaria. Public health measures implemented by the Government have successfully controlled infectious diseases, including through the provision of safe drinking water, child immunisation programme, proper sanitation and waste disposal, improved nutrition and quality food control as well as improvements in the network of community-based primary healthcare facilities. Poverty-reduction programmes have also reinforced the success of the public health measures undertaken by the Government.

Malaysia continues to adopt a systematic approach with regard to integrating **sustainable development** principles into national development plans. This integration includes sector-specific policies and legislation, such as the requirement for an Environmental Impact Assessment (EIA) study prior to approval of major and environment-sensitive projects.

In addition, concerted and coordinated efforts between Federal and State Governments in the area of land development, as well as forestry, water resource and energy management have also been intensified. At the regional level, Malaysia continues to engage in reviewing environmental issues and, as testament to its commitment, has ratified major multilateral agreements. Among the agreements are the Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES) signed in 1977, United Nations Convention on the Law of the Sea (UNCLOS; 1982), Convention on Biological Diversity (CBD; 1992) and Cartagena Protocol on Biodiversity (2003).

In the international arena, Malaysia continues to support efforts to **develop a global partnership for development**. This is reflected in the RM341.3 million contributed in the Eighth Malaysia Plan (2001-2005) to multilateral organisations such as the Asian Development Bank (ADB), Islamic Development Bank (IDB), UN, World Health Organisation (WHO) and WTO. Malaysia also endeavours to assist other developing countries by sharing knowledge and experience in economic and social transformation through the Malaysian Technical Cooperation Programme (MTCP). Malaysia also participates actively in regional and multilateral groupings such as the Association of Southeast Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC), Non-Aligned Movement (NAM) and Organisation of Islamic Conference (OIC) to enhance inter-regional trade, investment opportunities, and financial and industrial cooperation among countries in the region as a means to raise income levels and eradicate poverty.

Conclusion

The 21st century, an era of globalisation and rapid economic development, requires fresh and innovative approaches to maintain the momentum towards attaining all the MDGs. In this context, Malaysia continues to pursue strategies at the national and international levels not only to maintain the level achieved, but more importantly to tackle and address emerging challenges through, among others, the public-private sharing of responsibilities. This approach will provide Malaysia with a solid foundation to spearhead its socio-economic development agenda in fulfilment of the Vision 2020 aspiration to become a fully developed nation.

Moving Forward into 2007

Issues and Challenges

The challenges confronting the economy in 2006 are expected to persist in 2007. On the external front, concerns over high crude oil prices following strong demand and tight refining capacity as well as heightened geopolitical tensions in the Middle East are expected to remain. This could lead to a sustained rise in global inflation and subsequent hikes in global interest rates, impacting both trade and growth. The current global imbalances can also have a disorderly effect on the financial markets and hamper world trade as well as investment flows. Given these uncertainties, global growth is expected to moderate slightly to 4.7% in 2007 (2006: 4.9%), backed by sustained world trade and investment flows. However, given Malaysia's endowment of crude oil resources and with prevailing high oil prices, the nation is in a better position to weather the moderation in global growth to achieve a strong growth of 6% in 2007 (2006: 5.8%). The Government will continue to focus on supporting economic growth with price stability, increasing employment opportunities, especially for graduates as well as addressing issues of rapid urbanisation and regional imbalances.

Towards Realising the National Mission

Going forward, the 2007 Budget will translate the policy thrusts of the National Mission into programmes and projects to be implemented expeditiously and effectively. Hence, the 2007 Budget strategies will focus particularly on encouraging the private sector to play a lead role in economic development; generating new sources of wealth in technology-and knowledge-intensive sectors; improving access to quality education and training at all levels; eradicating poverty and reducing regional disparity; improving the standard and sustainability of quality of life; and enhancing the public service delivery system. These strategies are expected to boost domestic economic activities, as well as strengthen the nation's competitiveness to enable the country to seize opportunities arising from globalisation and liberalisation.

In efforts to enhance the private sector's role as the main driver of growth, the Government remains committed to providing a more conducive business environment to accelerate both foreign and domestic private investment. In addition, private finance initiatives (PFIs) announced in the 9MP will provide more opportunities for the private sector to participate in the implementation of development projects. In generating new sources of wealth, programmes and projects in technology-and knowledge-intensive sectors will be implemented and build upon existing capabilities and capacities to create economic value especially in ICT, biotechnology and skills-based services. In the move to further develop quality human capital, a more holistic approach will be adopted whereby, knowledge and skills, ethical values and cultural awareness will be given due emphasis. In addressing socio-economic and regional disparities, priority will be accorded to reducing hardcore poverty, improving access to basic needs and stimulating regional development. In enhancing the public service delivery system, further initiatives will be introduced to simplify work processes while improving as well as simplifying existing rules and regulations. Meanwhile, to secure the well-being of the *rakyat,* the Government will accord greater attention to ensure that all the programmes are implemented effectively through better coordination, monitoring and evaluation mechanisms.

The Malaysian economy is expected to remain resilient, supported largely by private sector activities and the Government's continuing efforts to support growth through effective macroeconomic policies and liberalisation measures. Investment in high value-added activities and the use of cutting-edge technologies will further enhance productivity, efficiency and competitiveness. Productivity gains, capacity expansion, interest rates supportive of investments and a prudent fiscal stance as well as ensuring that inflation is contained, will remain the focus of macroeconomic management. The conduct of monetary policy in 2007 will continue to balance the risks of inflation, while remaining supportive of economic growth. However, rising inflation due to higher crude oil prices could pose a challenge to the monetary stance. Nevertheless, the nation's strengthening macroeconomic fundamentals and diversified economic structure will provide flexibility for the Government to respond appropriately, in the event of significant changes in inflation and growth prospects.

In addition to tackling the current challenges, the 2007 Budget is also formulated to serve as the foundation for achieving the National Mission and targets set in the 9MP. To reap greater benefits from the development policies, the framework provided by the National Mission focusses on key areas, namely the nation's global competitiveness; human capital development; national integration; ethnic relations; income and wealth distribution; as well as quality of life. Based on these priority areas, the National Mission comprises five main thrusts: to move the economy up the value chain; to raise the capacity for knowledge and innovation and nurture 'first class mentality'; to address persistent socio-economic inequalities constructively and productively; to improve the standard and sustainability of quality of life; and to strengthen the institutional and implementation capacity. All future socio-economic development plans, including the annual budget, will be premised on these five thrusts.

The 9MP is the first of the three phases of five-year development plans under the National Mission. The main objective of the 9MP is to build an advanced economy with balanced social development and a progressive society with high moral and cultural values. Key macroeconomic strategies of the 9MP to achieve the target average real GDP growth of 6% include among others, stimulating private sector investment, encouraging greater contribution from government-linked companies (GLCs) in generating growth, sourcing high quality FDI and leveraging on high technology and diverse markets. At the same time, the Government will ensure that fiscal and monetary policies continue to support growth with price stability, whilst gradually reducing the Federal Government deficit. The 9MP coupled with other sectoral development plans such as IMP3 will provide the direction for further progress of the Malaysian economy in the medium and longer term.