3 ECONOMIC PERFORMANCE AND PROSPECTS

Overview

Malaysian economy remains resilient...

The Malaysian economy continues to be resilient amidst persistent high world crude oil prices, rising inflationary pressures and monetary tightening, especially in major advanced economies. The continued expansion of Malaysian economy is in tandem with strong global growth, particularly in the United States (US) and Asia despite earlier concerns associated with rising oil prices. Growth in the US remains favourable despite hikes in interest rates, while in the Asian region, growth continues to expand driven by strong domestic demand and supported by increasing intra-regional trade. China, in particular, is expected to register yet another year of strong growth at 10.4% with the Association of Southeast Asian Nations (ASEAN) economies, expanding at 5.8% in 2006.

The growth momentum in Malaysia remains strong, driven by robust domestic demand and favourable export performance. Growth is supported by favourable financing and stable labour market conditions. The Government's strategic decision to move from a fixed exchange rate regime to a managed float was well-received and contributed to further boosting investor and consumer confidence. These factors, coupled with pro-business policies and political stability, continue to provide the enabling environment for the economy. Real GDP expanded at a strong pace of 5.9% in the second quarter, following a growth of 5.5% in the first quarter of 2006, while growth in the fourth quarter of 2005 grew by 5.2%. This unabated growth is expected to continue in the coming quarters to average 5.8% for the year as a whole. Growth is expected to be stronger in the second half of 2006 as reflected in the rising trend of the Leading Index of the Department of Statistics (DOS) and the Business Conditions Index (BCI) of the Malaysian Institute of Economic Research (MIER). For the second quarter of 2006, the Leading Index registered a growth of 6.3% (January-March 2006: 2.9%), while BCI remained above the threshold level for the first half of 2006, reflecting continued strong investor confidence in the economy.

Growth in 2006 is expected to be broad-based with positive contribution by all sectors, led by services, manufacturing and agriculture. Strong domestic consumption and continued expansion in trade-related activities are expected to support growth in the services sector, especially in the wholesale and retail trade, hotels and restaurants; transport, storage and communication; and financial services sub-sectors. 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. Meanwhile, high commodity prices, in particular of rubber and palm oil, are expected to boost output and generate higher income for the smallholders and farmers as well as commodity-based companies.

Monetary policy in 2006 continues to emphasise on growth with price stability. The Government will continue to conduct its monetary policy in a manner that will constantly balance the need to rein in inflationary pressures while ensuring a conducive environment for investment and business activities. Inflation, maintained at below 2% annually during the 2000-2004 period edged up to 3% in 2005 and 3.9% in the first seven months of 2006, due largely to higher administered retail prices of petroleum products. This rise in inflationary pressures was mitigated somewhat by the appreciation of the ringgit, which helped to lower the cost of imports. Meanwhile, productivity gains contributed to reducing the costs of production. For 2006 as a whole, inflation is projected at 3.7%, after factoring in the Government's commitment to not raising further the retail prices of petroleum products in the remaining months of the year and also the modest impact of the upward revision in electricity tariffs.

Unemployment is expected to remain below 4% for the year as a whole, reflecting the full employment situation that has prevailed since 1992 and consistent with increasing job opportunities following sustained expansion in domestic economic activities. In addition, measures continue to be taken by Government to increase the number of skilled workers through training and retraining, minimise the skills mismatch as well as to address the gap between demand and supply in the labour market. However, unemployment among graduates continues to remain a problem, with about 73,000 graduates unemployed, reported in the first quarter of 2006, according Labour Force Survey. The majority of unemployed graduates are in the fields of business administration and human resource as well as computer science and information technology (IT). Various programmes are currently in place to address the problem.

On the external front, developments remain positive with Malaysia continuing to record a trade surplus notwithstanding the higher growth in imports relative to exports. With continued inflows of foreign capital, the overall balance of payments is expected to remain strong in 2006, further strengthening the nation's economic fundamentals as well as boosting investor confidence. In tandem with the expansion in economic activities, national income as measured by 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 account the movement in foreign exchange and inflation, per capita income in terms of purchasing power parity (PPP) is envisaged to increase by 11.8% to reach USD11,871 in 2006 (2005: 9.2%; USD10,614).

Domestic Demand Performance

Private sector continues to drive economic growth…

The Malaysian economy continues to be driven by the expansion in **domestic demand**, underpinned by robust private sector activities and strong export expansion. The private sector, which resumed its role as the key engine of growth since 2003, continues to drive domestic economic activities in 2006.

With favourable business and financing conditions, rising disposable incomes and a stable labour market environment, **private sector expenditure** is envisaged to expand strongly by 7.6% (2005: 9.1%), driven by higher investment and consumption spending. Private sector expenditure is anticipated to contribute 4.7 percentage points to real Gross Domestic Product (GDP) growth in 2006, as shown in *Table 3.1*. Accordingly, the share of private sector in the economy is expected to increase further to 63.2% in 2006. Meanwhile, the share of **public sector expenditure** to GDP is expected to increase slightly to 30.1% in 2006 (2005: 29.5%), due to increases in spending by 8% (2005: 3.6%), contributing 2.4 percentage points to GDP growth. As a result, growth in **aggregate domestic demand** in real terms (excluding change in stocks) is projected to increase by 7.8%. The contribution to growth from the external sector is due to strong growth in imports, particularly

TABLE 3.1

Gross Domestic Product (GDP) by Aggregate Demand
2005-2007
(in 1987 real prices)

	Change (%)			Share of GDP (%)			Contribution to GDP growth (percentage point)		
	2005	2006[1]	2007[2]	2005	2006[1]	2007[2]	2005	2006[1]	2007[2]
GDP	***5.2***	***5.8***	***6.0***	***100.0***	***100.0***	***100.0***	***5.2***	***5.8***	***6.0***
Domestic demand[3]	***7.3***	***7.8***	***7.1***	***91.5***	***93.3***	***94.2***	***6.5***	***7.1***	***6.6***
Private expenditure	***9.1***	***7.6***	***7.2***	***62.0***	***63.2***	***63.9***	***5.4***	***4.7***	***4.6***
Consumption	*9.2*	*7.1*	*6.4*	*50.0*	*50.7*	*50.9*	*4.4*	*3.5*	*3.3*
Investment	*8.5*	*10.1*	*10.5*	*12.0*	*12.5*	*13.0*	*1.0*	*1.2*	*1.3*
Public expenditure	***3.6***	***8.0***	***6.7***	***29.5***	***30.1***	***30.3***	***1.1***	***2.4***	***2.0***
Consumption	*5.4*	*5.5*	*5.4*	*14.7*	*14.7*	*14.6*	*0.8*	*0.8*	*0.8*
Investment	*1.9*	*10.6*	*8.0*	*14.8*	*15.4*	*15.7*	*0.3*	*1.6*	*1.2*
Change in stocks				***-0.3***	***0.2***	***0.3***	***-2.6***	***0.6***	***0.1***
External sector	***16.7***	***-22.0***	***-9.9***	***8.8***	***6.5***	***5.5***	***1.3***	***-1.9***	***-0.7***
Exports[4]	*8.6*	*7.7*	*7.4*	*121.2*	*123.4*	*125.0*	*10.1*	*9.3*	*9.1*
Imports[4]	*8.0*	*10.0*	*8.4*	*112.4*	*116.9*	*119.5*	*8.8*	*11.2*	*9.8*
GDP (RM billion, current value)	***495.2***	***548.4***	***596.8***						
Change (%)	*10.0*	*10.7*	*8.8*						

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

Source: Ministry of Finance and Department of Statistics, Malaysia.

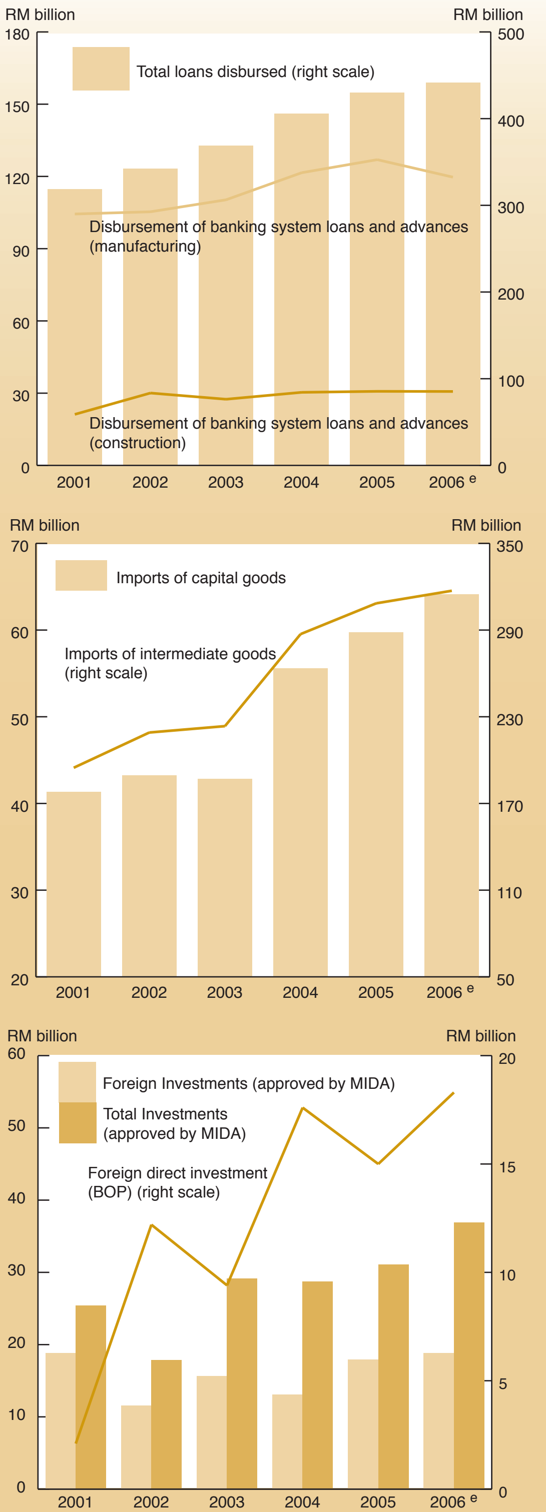
of capital and intermediate goods, largely for new investment and reinvestment activities. This is expected to further expand the productive capacity of the economy, thereby increasing Malaysia's potential output in the medium and long term.

Private investment is projected to strengthen further to 10.1% to account for 12.5% share to GDP in 2006 (2005: 8.5%; 12%) with investor confidence remaining positive. This optimism is reflected in BCI which stood at 102.4 points in the second quarter of 2006, above the threshold level of 100 points. The projected strong growth in private investment for 2006 is also reflected in several key investment indicators, as shown in *Chart 3.1*. These include higher growth in imports of capital and intermediate goods at 17.1% and 7.9% (January-June 2005: 8.8%; 8.1%), respectively. Meanwhile, total loan disbursements to the business sector from the banking system increased by 16.6% to RM101,351 million (January-June 2005: 11.1%; RM86,915 million).

Results from Business Expectation Survey conducted by DOS for the first half of 2006 also indicated higher capital outlays by the private sector, with the largest share of 52.8% in the services, manufacturing (25.8%) and mining

CHART 3.1

Private Investment Indicators



e Estimate.

(petroleum) and electricity (16.7%) sectors as well as agriculture sector (2.8%). Investment in the services sector is expected to be mainly in telecommunications, financial services, distributive trade, hotels and restaurants and manufacturing-related services sub-sectors. The upturn in the electronic activities as well as strong performance of the textiles and petroleum industries in response to higher global demand helped to boost investment spending in the manufacturing sector. Investment in the manufacturing sector was further enhanced with the establishment of SME Bank in October 2005. Loans disbursed to small and medium enterprises (SMEs) increased by 23.6% to RM65,575 million during the first six months of 2006, comprising 24.8% of total loan disbursement in the banking system (January-June 2005: 124.1%; RM53,036 million; 20.7%). The increase in loans disbursed to SMEs was in line with the Government policy to accelerate the development of SMEs as stated in national development plans, including the Ninth Malaysia Plan (9MP), 2006-2010. In the agriculture sector, investments were largely in new areas of growth, such as horticulture, agro-biotechnology as well as *halal* food industry, with strong participation from both domestic and foreign investors.

Malaysia continues to be a destination for foreign direct investment (FDI), despite stiff competition from low-cost centres and economies with large domestic markets in the Asian region and the emerging economies of Eastern Europe. During the first three months of 2006, total FDI registered a strong growth of 21.2% to RM3,696 million (January-March 2005: -13.4%; RM3,049 million) with the manufacturing sector accounting for 66.2%, followed by financial intermediation, 12.9% and mining and quarrying, 11.5%. Within the ASEAN region, Malaysia continues to be among the favoured destinations for investment as reflected in the cash balance of payments (BOP), which registered a net inflow of RM3.4 billion during the first five months of 2006 (January-May 2005: RM5.5 billion).

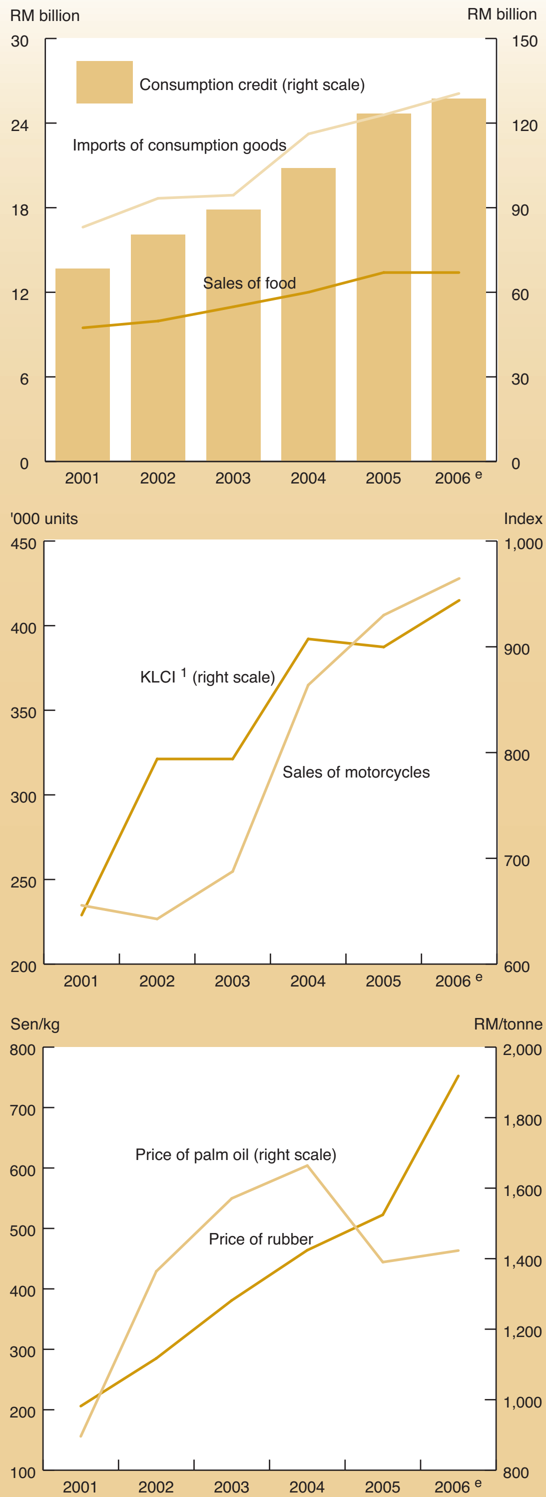
Approvals by Malaysia Industrial Development Authority (MIDA) for foreign investment in manufacturing projects increased by 5.4% to RM6.9 billion in the first six months of

2006 (January-June 2005: 115%; 6.5 billion). Meanwhile, approved projects for domestic investors increased significantly by 27.8% to RM8.3 billion in the same period (January-June 2005: 57.5%; RM6.5 billion), in tandem with Government's efforts to encourage domestic direct investment (DDI) and high quality FDI. As such, total investment approved increased further to 16.6% to reach RM15.2 billion (January-June 2005: 81.8%; RM13.1 billion), with a substantial proportion in new investments, particularly in E&E products, fabricated metal products, machinery manufacturing as well as furniture and fixtures. Capacity utilisation for manufacturing sector remained high at above 80% in the first half of 2006 (January-June 2006: 82.8%).

Private consumption, an important component of expenditure in GDP, with a share of 50.7%, is envisaged to sustain its growth momentum at 7.1% (2005: 50%; 9.2%). In terms of contribution, it is expected to generate 3.5 percentage points to GDP growth (2005: 4.4 percentage points). The major factors driving private consumption include rising household disposable incomes following higher commodity prices, favourable labour market and financing conditions. The significant increase in rubber prices, which reached a 20-year high of RM8.96 per kilogramme (kg) on 3 July 2006 and continued increase in palm oil prices, averaging RM1,422 per tonne for the first seven months, boosted incomes and purchasing power of rural households, including of about 200,000 rubber and 290,000 oil palm smallholders. In the first six months of 2006, key consumption indicators, especially imports of consumption goods showed an increasing trend with a growth of 13.6% while sales of motorcycles registered a moderate growth of 3.6% (January-June 2005: 7.3%; 15.1%) as shown in *Chart 3.2.* Other indicators such as service tax collection increased slightly by 0.3% and sales of food items by 1.4%, respectively, during the first half of 2006 (January-June 2005; 61.7%; 13.2%). However, credit card spending and consumption credit disbursed increased strongly by 15.3% and 5.9% (January-June 2005: 21%; 45.5%), respectively.

CHART 3.2

Private Consumption Indicators



[e] Estimate.
[1] As at end of the year and 15 August 2006.

TRENDS IN PRIVATE CONSUMPTION

Introduction

Private consumption expenditure (PCE), a component of Gross Domestic Product (GDP), is the final purchase of goods and services by households. It is also one of the major growth determinants and has a tendency to increase with income. For Malaysia, PCE has been rising strongly, averaging 5.9% annually in real terms, in line with the 6.1% increase in real income, as measured by Gross National Product (GNP) during the period 1991-2005. The size of PCE in Malaysia, although significant at about 43% of nominal GDP in 2004 was relatively low compared with other economies such as United States (70%), United Kingdom (65%) and Japan (57%) as well as other East Asian countries like the Philippines (69%), India (64%) and Indonesia (67%). Nevertheless, it was comparable in size with Singapore (44%) and China (43%).

PCE plays a more prominent role during periods of economic slowdown when inflows of foreign direct investment shrink and exports decline as was evident in the aftermath of the 1997/98 Asian financial crisis and September 11 incident in 2001. Arising from these crises, many Asian countries, including Malaysia, directed recovery efforts towards domestic driven growth through stimulating investment and consumption expenditure, apart from providing a conducive business climate and lower cost of doing business, thereby enhancing the nation's competitiveness. These measures were necessary to revive economic growth and strengthen economic fundamentals aimed at achieving sustainable economic development in the long run. This article highlights general trends in private consumption as well as its crucial role in supporting GDP growth in Malaysia during the 1991-2005 period.

Private Consumption and Income

Consumption theory states that generally PCE moves in tandem with income. This holds true in the case of Malaysia, as shown in *Chart 1*. During the 15-year period (1991-2005), overall growth trends for both real private consumption and income, as expected, moved closely and in the same direction except in 1994. For that year, private consumption trended upwards on account of better terms of trade, while income growth moderated due to larger net outflows of factor payments abroad and slower spending in public investment. Nevertheless, the overall performance of private consumption was strong during the period under review, registering an average real growth rate of 5.9% per annum as against a 6.1% increase in real income, as shown in *Table1*.

Expansionary Period: 1991-1997

During the period 1991-1997, PCE increased strongly at an average annual rate of 7.4% in real terms in line with the trend in real income growth of 8.7%. This was a period when the Malaysian economy continued to expand beyond its potential growth, following favourable external demand and robust domestic economic activities. Growth was driven by private sector (10.9%), although the public sector performed equally well (8.7%). The strong performance of PCE continued unabated, despite measures taken to reduce excess demand and mitigate the risk of an overheated economy, including a tight monetary policy and fiscal prudence to slow down conspicuous consumption and encourage savings. The unabated PCE was largely due to rising disposable incomes, high corporate profits and firm business sentiment as well as strong prices of most primary commodities, including rubber and crude palm oil, as shown in *Table 1*. The positive wealth effects resulting from a better stock market performance and increased earnings from strong housing property market were additional factors that sustained household spending during the period under review.

Unstable Four-year Period: 1998-2001

The Asian financial crisis of 1997/98 and September 11 incident in 2001 were two events that posed great challenges to the Malaysian economy during the four-year turbulent period of 1998-2001. During this period, private consumption registered a decline of 10.2% in real terms while real income fell by 5.2% in 1998. The downturn in private consumption, after expanding at an average annual rate of 7.4% in the first seven years of the 90s, was brought about by the contagion effect of the regional financial crisis which spilled over to the Malaysian economy. As a result, household spending was greatly affected with their financial wealth eroded by falling

Chart 1
Private Consumption and Income (GNP)
in Real Value, 1991 - 2005

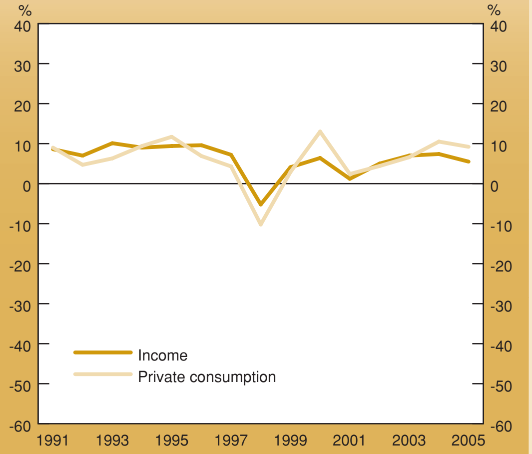
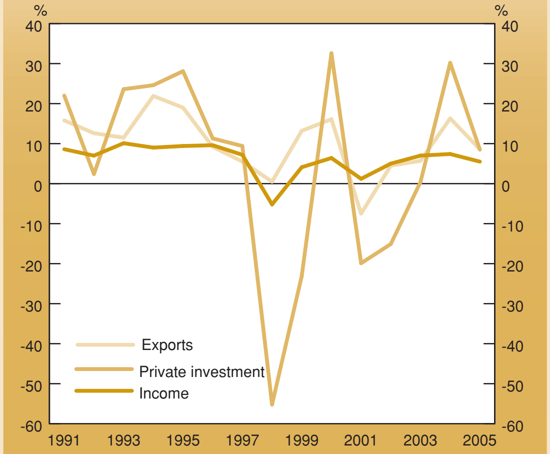


Chart 2
Private Investment, Exports and Income (GNP)
in Real Value, 1991 - 2005



stocks and asset prices as well as job uncertainties and higher interest rates, as shown in *Table 1*. In addition, nominal per capita income in US dollar declined by almost a third due to sharp depreciation of the ringgit.

The implementation of measures outlined in the National Economic Recovery Plan in July 1998, accompanied by the introduction of selective exchange controls and the pegging of ringgit to USD in September 1998 gradually revived consumer and business confidence. By 2000, PCE had picked up strongly by 13% consistent with a 6.4% increase in income following strong domestic economic activities. This was also attributable to the positive effects of expansionary fiscal and accommodative monetary policies as well as the favourable global and regional environment.

The recovery in PCE was again derailed in 2001, triggered by the slowdown in the US economy which was further aggravated by the September 11 incident. To mitigate the adverse impact of weaker external demand (-7.5%) and contraction in domestic private investment (-19.9%), the Government in 2001 introduced two fiscal stimulus packages in March and September. Consequently, the growth of PCE remained positive at 2.4% while income grew by 1.2%. Both these fiscal packages saw a significant increase in public sector expenditure to stimulate domestic economic activities and raise household disposable incomes. Furthermore, the Budget 2001 measures announced earlier, such as higher individual tax rebates for the low- and middle-income groups and higher allowances for civil servants in specific categories as well as reduction in employees' contribution to Employees Provident Fund (EPF), also helped stimulate PCE.

During the difficult period of 1998-2001, overall real GDP growth averaged 1.8% with a contraction in private investment of 22.2% during the period. Real GDP growth would have been worse if not for the contribution from PCE which grew by 1.7%.

Recovery Period: 2002-2005.

For the remaining period under review, 2002-2005, real PCE grew at a faster pace of 7.7%, exceeding the 6.2% increase in real income as consumer confidence gained momentum. Despite the uncertainty in the external environment caused by the war in Iraq, outbreak of the Severe Acute Respiratory Syndrome (SARS) and persistently high crude oil prices, PCE was sustained, backed by strong domestic economic activities. During this period, private sector activities rebounded, reinforced by improved export performance, resulting in higher corporate profits and household disposable income that helped to sustain consumption spending. In addition, rural sector income also increased benefitting from higher commodity prices, especially rubber. The favourable performance

Table 1:

Private Consumption and Other Key Economic Indicators
Annual Growth (%) for Selected Years

	1991-05 (Average)	1991	1992	1995	1998	2000	2001	2004	2005
Private Consumption:									
Nominal value	8.7	14.3	7.4	13.3	-7.9	16.2	3.6	11.8	12.0
Real value	5.9	9.0	4.7	11.7	-10.2	13.0	2.4	10.5	9.2
Share to GDP (%)									
Nominal value	44.7	52.2	50.3	47.9	41.6	42.4	45.0	42.8	43.6
Real value	47.4	52.0	50.0	49.2	45.0	45.3	46.2	48.2	50.0
Income:									
Nominal GNP	9.9	12.5	11.2	14.0	0.5	12.3	-1.8	14.2	10.7
Real GNP	6.1	8.6	7.0	9.4	-5.2	6.4	1.2	7.4	5.5
Real GDP	6.2	9.5	8.9	9.8	-7.4	8.9	0.3	7.2	5.2
Per Capita Income:									
Nominal GNP (RM)	11,997	6,919	7,492	10,252	12,080	13,378	12,859	16,637	18,039
Nominal growth	7.3	9.8	8.3	10.8	-1.9	8.6	-3.9	11.8	8.4
Terms of trade	0.8	0.5	0.7	1.6	-1.2	1.3	-1.5	2.7	1.3
Rubber prices (Sen/kg)	300	213	208	385	261	243	206	461	523
Palm oil price (RM/tonne)	1,313	837	918	1,473	2,380	997	895	1,664	1,398
House price	6.2	25.5	12.2	18.4	-9.5	6.0	1.1	4.8	2.4
KL Composite[1] (Index)	820	556	644	995	586	680	696	907	900
Narrow money[1] (M2)	14.2	14.5	19.1	24.0	1.5	5.2	2.2	25.4	15.4
Employment	2.9	3.1	3.0	4.8	0.4	4.8	0.9	3.4	0.6
EPF net contribution (RM million)	7,232	2,986	4,612	7,298	1,191	10,555	-2,004	11,221	12,916
Inflation rate	3.0	4.4	4.6	3.4	5.3	1.6	1.4	1.4	3.0
Average lending rate (Commercial bank)	8.34	9.72	10.29	9.28	9.72	7.46	6.67	5.98	6.12
Consumption credit[1] (Commercial bank)	30.6	25.6	15.0	31.3	-5.0	6.1	7.7	168.5	54.0
Wholesale and retail trade (Real value)	6.8	16.9	12.4	10.9	-3.1	4.7	2.2	6.9	8.7
Imports of consumption goods	11.2	31.5	1.0	14.1	-6.4	14.9	-2.5	22.9	5.8
Sales of passenger cars	9.3	14.2	-10.9	43.1	-54.8	15.9	15.9	15.4	6.5
Sales of motorcycles:	2.8[2]	n.a.	n.a.	5.6	-38.8	-0.8	-8.6	48.2	11.3
Salaries and wages (Manufacturing sector)	11.7	18.6	21.1	19.6	-0.9	15.5	3.0	7.7	7.1
Corporate income[3]	13.7	19.0	15.4	19.5	5.4	30.4	-6.8	15.5	11.2

[1] Figures refer to end of period.
[2] Figures refer to average growth rate during 1995-2005 period.
[3] Figures refer to gross revenue of limited companies (Business Expectations Survey).

Source: Ministry of Finance and Department of Statistics, Malaysia.

was also reflected in the significant increase in durable goods purchases by households, particularly motorcycles and to a lesser extent, passenger cars as shown in *Table 1*. The rising consumption spending trend was also, in part due to the pent-up demand by consumers who might have held back their purchases during the unstable 1998-2001 period.

Moreover, both monetary and fiscal stance were supportive at sustaining PCE and economic growth, as Government put in place several economic packages, including the New Strategies Towards Stimulating the Nation's Economic Growth in May 2003. These measures, geared at easing the financial burden of the household and business sectors affected by SARS in 2003, include reducing EPF contributions by employees and providing additional bonus to civil servants, as well as reducing the cost of doing business, particularly for tourism and construction related industries. Measures in Budget 2004 and 2005 helped the private sector to resume its role as the main engine of growth and sustained PCE. They included full road tax exemption on motorcycles of engine capacity not exceeding 150 c.c., 50% road tax reduction on buses for workers, higher tax rebate for individual purchase of personal computer and books. Additional tax relief was also given for children studying at local institutions of higher learning, contributions to EPF and for disabled taxpayers as well as on life insurance and *takaful* premiums.

Future Direction of Private Consumption

As a whole, as expected, PCE trend increased following the rise in income over the period under review. There is, however, a slight shift in the consumption pattern over the years. This is reflected in the changing trend in expenditure as shown in the table below.

Table 2:

Average Monthly Expenditure Per Household, Malaysia
1993/94, 1998/1999 and 2004/05

	1993/94	1998/99	2004/05	1993/94	1998/99	2004/05
	Value (RM)			Share to Total (%)		
Food and Clothing	343	454	487	29.5	27.8	24.9
Food (includes beverages and tobacco)	302	398	428	26.0	24.4	21.9
Clothing and footwear	41	56	59	3.5	3.4	3.0
Housing	310	447	513	26.7	27.4	26.3
Housing, water, electricity, gas and other fuels	245	363	430	21.1	22.3	22.0
Furnishing, household equipment and routine maintenance	65	84	83	5.6	5.2	4.2
Transport and Communication	192	286	417	16.5	17.5	21.4
Transport	168	227	314	14.5	13.9	16.1
Communication	24	59	103	2.1	3.6	5.3
Education and Health	38	60	65	3.3	3.7	3.3
Education	17	31	38	1.5	1.9	1.9
Health	21	29	27	1.8	1.8	1.4
Outdoor	198	279	305	17.1	17.1	15.6
Recreation services and culture	53	70	92	4.6	4.3	4.7
Restaurants and hotels	145	209	213	12.5	12.8	10.9
Miscellaneous goods and services	80	105	166	6.9	6.4	8.5
TOTAL	1,161	1,631	1,953	100.0	100.0	100.0

Source: Report on Household Expenditure Survey, 2004/05, Department of Statistics, Malaysia.

Based on the recent Household Expenditure Survey, 2004/05, the proportion of income set aside for the purchase of transport and communication goods by households showed an increasing trend during the period 1993/94-2004/05, while purchase of necessity goods showed a declining trend, in particular food and clothing. The rising trend in expenditure on transport could be attributed to higher ownership of vehicles supported by rising income and attractive financing facilities, while the increasing popularity of innovative telecommunication devices encouraged consumers to spend more on these goods. The shift in expenditure pattern over the years also reflected the rising purchasing power of Malaysians as well as the changing lifestyle of consumers, whose preference are not limited to necessity goods, but also durable goods that were previously beyond their reach. The increasing expenditure on transport and communication goods can also be attributed to the increasing number of middle and high income households, consistent with the declining incidence of poverty in both rural and urban areas. If the above trend continues along with increasing number of ageing people and smaller size of household with dependent children, Malaysia's PCE in the future is likely to follow the transition path experienced by many other countries as their income increased. This can be illustrated by a scatter diagram that traces the relationship between PCE share to GDP and per capita income among selected countries at various stages of economic development, as shown in *Chart 3.*

Chart 3
Private Consumption and Per Capita Income of Selected Countries in Current Values, 2004

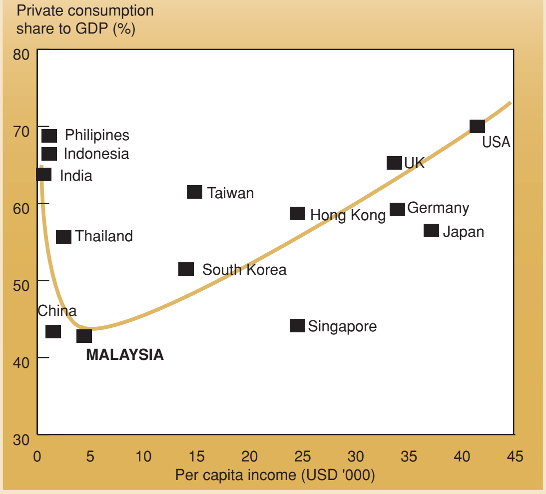


Chart 4
Private Consumption and Per Capita Income in Current Value, 1957-2005

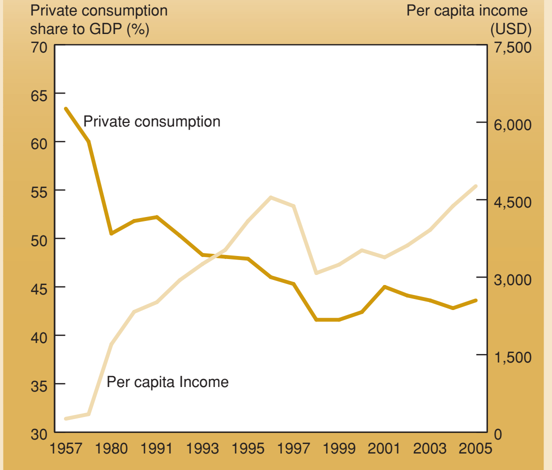


Chart 3 also shows the path that countries go through in becoming developed economies. At the initial stage of economic development, as per capita income rises, the share of PCE to GDP declines. With further increases in per capita income, the share of PCE to GDP will continue dropping up to a threshold level (trough) after which any further increase in per capita income will be accompanied by an increase in the share of PCE to GDP. In other words, at the initial stage of economic development when income level is very low, consumers generally spend more of their income on basic needs. As these countries move to a higher level of income, a relatively smaller proportion of their income will be spent on necessities while a higher portion would be retained as savings or invested. As a result, PCE as a proportion of GDP will continue to decline, as per capita income increases. Once the threshold level is reached, the share of PCE will rise as any increase in income will be more than enough to pay for necessities, thereby shifting the PCE pattern towards high quality and value-added goods and services.

Malaysia appears to be in the trough phase of the PCE and income curve, as shown in *Chart 3*. In fact, Malaysia has passed the initial period of very low income and high consumption as a proportion to GDP as shown in *Chart 4*. Consequently, any further increase in per capita income would most likely result in an increase in PCE share to GDP. As illustrated above, any increase in PCE henceforth would be towards high quality goods and services, including luxury items, following private consumption pattern of the more developed countries with higher per capita income.

Conclusion

From the overall trends in PCE and the consumer's behaviour pattern during the review period, PCE can be expected to remain one of the driving forces of domestic economic activities and a crucial factor in generating growth in the coming years. The role of PCE in supporting growth was clearly evident, particularly during the 1998-2001 period, when the Malaysian economy faced a challenging environment with weak external demand and contraction in domestic private investment activities. PCE will therefore continue to be one of the major growth determinants, considering its relatively stable performance and large contribution to GDP.

Public consumption expenditure is anticipated to sustain at 5.5% (2005: 5.4%) on account of higher spending for supplies and services, partly for upgrading the Government's administrative machinery and for maintenance of buildings and fixtures. **Public investment** expenditure is estimated to increase by 10.6% in 2006 (2005: 1.9%), spurred by the implementation of projects under the 9MP as well as higher investment by Non-Financial Public Enterprises (NFPEs). This expenditure is expected to improve the nation's productive capacity as well as enhance development of human capital to further facilitate transformation towards a knowledge-based economy.

Sectoral Performance

Services sector remains the key driver of growth…

Real GDP growth for 2006 is expected to be broad based with all sectors contributing positively to the overall economic expansion. The services sector, with a share of 58.2% to GDP, continues to drive growth, supported by steady expansion in wholesale, retail trade, hotels and restaurants; and transport, storage and communication sub-sectors. With continuing strong domestic demand and expanding trade-related activities, the sector is estimated to expand by 5.7% (2005: 6.5%) with all sub-sectors recording positive growth. Manufacturing, which accounts for 32% of GDP, remains the largest export earner and the second most important sector generating employment for the economy. This sector is envisaged to record a higher growth of 7.3% in 2006 (2005: 5.1%), following the anticipated better performance of the export-oriented industries, particularly E&E, textile and petroleum.

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 agriculture sector is expected to accelerate strongly by 5.3% (2005: 2.5%), underpinned by higher rubber output, strong growth in livestock and food crops as

TABLE 3.2

Gross Domestic Product (GDP) by Sector
2005-2007
(in 1987 real prices)

	Change (%)			Share of GDP (%)			Contribution to GDP growth (percentage point)		
	2005	2006[1]	2007[2]	2005	2006[1]	2007[2]	2005	2006[1]	2007[2]
Agriculture	2.5	5.3	4.7	8.2	8.2	8.1	0.2	0.4	0.4
Mining	0.8	2.4	4.5	6.7	6.4	6.4	0.1	0.2	0.3
Manufacturing	5.1	7.3	6.8	31.6	32.0	32.2	1.6	2.3	2.1
Construction	-1.6	0.7	3.7	2.7	2.6	2.6	0.0	0.0	0.1
Services	6.5	5.7	6.0	58.2	58.2	58.1	3.7	3.3	3.4
Less imputed bank service charges	3.6	2.9	3.5	9.3	9.0	8.8	0.3	0.2	0.3
Add import duties	-1.7	-11.9	-2.6	1.9	1.6	1.4	0.0	-0.2	0.0
GDP	**5.2**	**5.8**	**6.0**	**100.0**	**100.0**	**100.0**	**5.2**	**5.8**	**6.0**

[1] Estimate.
[2] Forecast.

Source: Department of Statistics, Malaysia.

well as a turn-around in fishing sub-sector. Government policies and strategies geared towards increasing food production have also assisted the agriculture sector to expand. Value added of the mining sector is also expected to be higher at 2.4% (2005: 0.8%), backed mainly by expansion in the production of crude oil and natural gas. The construction sector is expected to rebound 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.

Manufacturing Sector

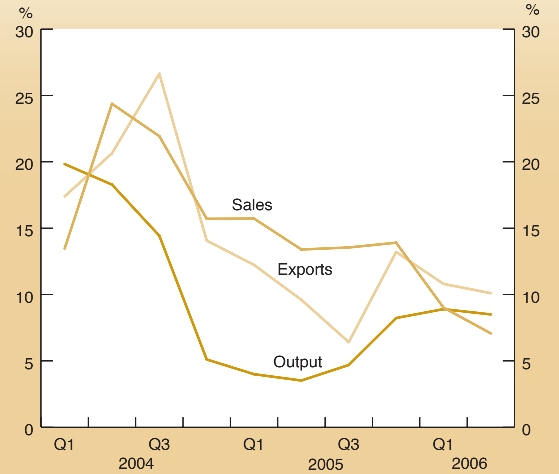
Manufacturing sector benefits from uptrend in global electronics demand...

Value added of the **manufacturing** sector is expected to expand further, increasing by 7.3% in 2006 (2005: 5.1%), with production in the export-oriented industries contributing 63.6% to total output. The robust performance of the manufacturing sector is based on higher output growth of 8.7% registered in the first six months of 2006 (January-June 2005: 3.8%) and anticipated continued expansion in the second half. The strong growth during the period was due primarily to the double-digit growth registered by the export-oriented industries of E&E, petroleum products and textiles. While export-oriented industries grew by 10.9%, growth in the domestic-oriented industries moderated to 5% (January-June 2005: 1.9%; 6.9%). Sales value of the manufacturing sector also increased 8.9% to RM239.7 million (January-June 2005: 14.1%; RM220.2 million) during the same period, mainly due to the improvement in prices as well as higher output of some industries, including iron and steel; and petroleum, which led to capacity utilisation sustained at above 80% during the first half of 2006.

Export-oriented industries registered a significant growth during the first half of 2006 following the upturn in global demand for **E&E products**, particularly for semiconductors and other electronic products. Growth in global demand for semiconductors, which rebounded since the second half of 2005, expanded by

CHART 3.3

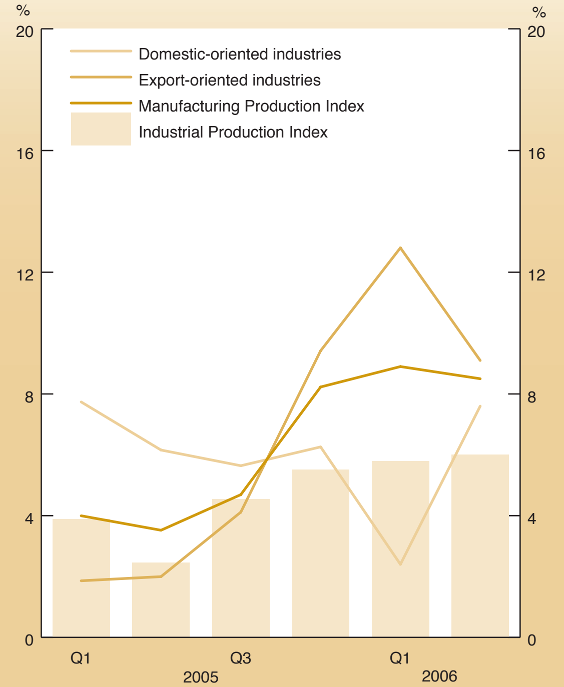
Performance of the Manufacturing Sector
(% annual change)



Source: Department of Statistics, Malaysia.

CHART 3.4

Output of the Manufacturing Sector
(% annual change)



Source: Department of Statistics, Malaysia.

TABLE 3.3

Manufacturing Production Index[1]
January-June
(2000=100)

Industries	Index 2005	Index 2006	Change (%) 2005	Change (%) 2006	Share (%) 2005	Share (%) 2006
Export-oriented industries	**123.4**	**136.9**	***1.9***	***10.9***	***62.4***	***63.6***
Electrical and electronic products	123.5	139.7	*2.0*	*13.1*	*37.9*	*39.5*
Petroleum products	140.2	157.2	*10.4*	*12.1*	*11.9*	*12.3*
Textiles, apparel and footwear	79.2	89.0	*-4.4*	*12.3*	*2.4*	*2.5*
Wood and wood products	110.1	110.8	*0.9*	*0.7*	*3.2*	*3.0*
Rubber products	137.3	137.7	*2.0*	*0.3*	*3.7*	*3.4*
Machinery and equipment	130.1	128.4	*-23.6*	*-1.3*	*2.1*	*1.9*
Medical, optical and scientific instruments	105.7	114.2	*-2.8*	*8.0*	*1.1*	*1.1*
Domestic-oriented industries	**130.0**	**136.6**	***6.9***	***5.0***	***37.6***	***36.4***
Chemicals and chemical products	137.1	139.9	*2.6*	*2.1*	*9.8*	*9.2*
Non-metallic mineral and other related products	115.1	112.9	*4.1*	*-1.9*	*4.3*	*3.9*
Plastic products	146.3	177.5	*16.5*	*21.3*	*4.8*	*5.3*
Food products	128.9	129.3	*9.0*	*0.3*	*3.8*	*3.5*
Transport equipment	148.4	156.7	*10.4*	*5.6*	*3.8*	*3.7*
Off-estate processing	126.4	128.3	*20.4*	*1.5*	*3.2*	*3.0*
Fabricated metal products	123.5	148.7	*-4.2*	*20.4*	*3.0*	*3.4*
Basic metals	111.1	103.1	*-0.2*	*-7.2*	*2.2*	*1.9*
Paper and paper products	122.0	126.9	*12.2*	*3.9*	*1.9*	*1.8*
Beverages	115.1	106.2	*11.8*	*-7.7*	*0.5*	*0.4*
Tobacco products	91.7	85.3	*-2.3*	*-7.0*	*0.3*	*0.2*
Total	**125.8**	**136.8**	***3.8***	***8.7***	***100.0***	***100.0***

[1] Growth in the manufacturing sector was measured based on the Industrial Production Index (IPI). Revision of IPI by the Department of Statistics has broadened the industries surveyed and reflects current industry's activities. As such, the changes also increased the weights of export-oriented industries to 44.9 points compared with 37.2 points under previous classification.

Source: Department of Statistics, Malaysia.

8.3% in the first half of 2006. This was reflected in the stronger book-to-bill (BTB) ratio of North American-based semiconductor equipment and Japan's chip-making devices industries. Meanwhile, development of cyber cities as well as rising levels of shared services and outsourcing (SSO) activities also contributed to increasing domestic demand for E&E products, which is anticipated to expand by more than 7% for the whole year.

At the industry level, output of semiconductors, which has the highest weightage in the Industrial Production Index (IPI), recorded a remarkable growth of 14.3% (January-June 2005: -0.5%). The industry operated at 93% capacity, well above the average capacity utilisation rate of the manufacturing sector. This trend is expected to continue as manufacturers capitalise on anticipated strong demand for telecommunication devices and consumer products, such as third generation (3G) cellular phones, MP3 devices, digital cameras, as well as liquid crystal display (LCD) and plasma televisions. Given these developments, the electronic products and components replacement cycle has been reduced significantly from 24 months to 18 months.

TABLE 3.4

Growth of the Electronic Industries
January-June
(2000=100)

	Change (%)		Share (%)	
	2005	2006	2005	2006
Total manufacturing	***3.8***	***8.7***	***100.0***	***100.0***
Total electronics	***2.0***	***13.1***	***37.9***	***39.5***
Semiconductors and other components	*-0.5*	*14.3*	*23.1*	*24.3*
Audio visual and comm. apparatus	7.0	*1.7*	*6.3*	*5.9*
Office, accounting and computing machinery	*4.1*	*26.0*	*6.4*	*7.4*
Electrical machinery and apparatus	*12.0*	*-7.9*	*1.8*	*1.6*
Domestic appliances	3.6	*11.2*	*0.3*	*0.4*

Source: Department of Statistics, Malaysia.

Concerted efforts are also underway to further enhance Malaysia's competitiveness in the electronics industry, facilitating the shift of E&E product, processes and production up the value chain. These efforts include, among others, developing Malaysia as a centre of excellence for semiconductors in the areas of design and development (D&D), upgrading capabilities in wafer fabrication, packaging and testing as well as increasing competencies of workforce through capacity building. In addition, collaboration is being further intensified between the private sector and institutions of higher learning and Government's research institutions to carry out research to development to commercialisation (R2D2C) activities. These ongoing efforts are expected to attract existing as well as potential manufacturers, including multinational corporations (MNCs), to invest in higher value-added activities of the E&E industries. The up scaling of investments is expected to further strengthen and enhance Malaysia's capabilities and ranking in semiconductors design and manufacturing activities.

Output of **petroleum products** increased by 12.1% in the first half of 2006 (January-June 2005: 10.4%), boosted by higher consumption, following robust domestic economic activities. This was complemented by higher external demand for refined petroleum products and rising sales of 23.7% during the period (January-June 2005: 48.2%).

Manufacture of **textiles, apparels and footwear**, which turned around to record a double-digit growth of 12.3% in the first six months of 2006 (January–June 2005: -4.4%), is expected to further accelerate in the second half. Textiles and apparels, previously dubbed sunset industries, recovered to record a strong growth of 9.8% and 30.5% (January–June 2005: -4.7%; -2.5%), respectively. The upturn was due to liberalisation of the global textiles and apparel markets since 1 January 2005, enabling Malaysian manufacturers to compete more effectively. The thriving local fashion industry also contributed to the turnaround of the industry.

Output of **medical, optical and scientific instruments** posted strong recovery with 8% growth in the first six months of the year (January-June 2005: -2.8%), due to strong demand from private hospitals and clinics as well as rising external demand, particularly from the ASEAN region. Production of medical appliances and instruments registered double-digit growth of 17% (January-June 2005: 8.8%), following Government initiatives to upgrade healthcare facilities and services as well as the changing lifestyles of a more health conscious population.

Meanwhile, output of **rubber products** registered slower growth during the period largely on account of a contraction of 1.6% in the output of rubber gloves and 21.9% in latex-based catheters (January-June 2005: +6.2%; -6.7%). The lower output of rubber products was due primarily to rising cost of raw materials, which tripled over the last four years. Standard Malaysian Rubber 20 (SMR 20) soared to a record high of RM8.96 per kg on 3 July 2006 (2002: RM2.89 per kg). Local rubber product manufacturers, especially producers of rubber gloves and catheters, are also facing tight supply of latex from Thailand, Malaysia's major supplier. This is largely on account of Thailand's rising domestic consumption as well as increasing exports for China's expanding automotive industry.

The base year of the IPI was revised from 1993 to 2000 to better reflect current industrial activities and broaden its coverage. With the new index, the **machinery and equipment** (M&E) industries, previously grouped under E&E, was reclassified as a new industrial group. In the first six months of 2006, the M&E group registered a smaller contraction of 1.3% in output (January-June 2005: -23.6%), due mainly to higher production of air conditioning, refrigerating and ventilating machinery.

Domestic-oriented industries expanded by 5% in the first half of 2006 (January-June 2005: 6.9%). The expansion was led by plastic products and fabricated metal products while non-metallic minerals and basic metals contracted.

The **plastic products** industry registered a remarkable growth in output at 21.3%, spurred by strong demand in E&E and to a lesser extent, transport equipment industries. This was evident in the double-digit growth of plastic bags and films (44.3%), and plastic injection moulded products (17.5%) (January-June 2005: 43.4%; -1.2%), which are components used in the E&E and transport industries.

Output of **chemicals and chemical products,** which among others include industrial chemicals, agriculture chemicals, paints and personal care products, posted lower growth of 2.1% (January-June 2005: 2.6%), mainly due to a 17.9% contraction in output of industrial gases recorded in the first six months of 2006 (January-June 2005: -9%), following lower demand. However, this was mitigated by the increased output of fertilisers plastics in primary forms, which in turn contributed to a moderated growth of the group.

Output of fertilisers and nitrogen compounds expanded, albeit at a slower rate of 5.8% (January-June 2005: 36.6%) in the first half of the year, while its sales value increased by 24.5% during the period (January-June 2005: 34.3%). The increase in sales was contributed by rising demand, particularly in the plantation sub-sector and robust agricultural activities, in neighbouring ASEAN countries. Increase in global demand for oleochemicals from traditional markets (US, euro area and Japan) and new markets (India, China, Republic of Korea and United Arab Emirates), as well as incentivised intensive research and development (R&D) activities in downstream palm oil-based industries, led to higher production of oleochemicals. Malaysia continues to be a leading producer and exporter of basic oleochemicals (fatty acid, fatty alcohol, methyl esters and glycerine), accounting for about 25% of world output.

Output of two major groups of domestic-oriented industries, namely off-estate processing and food industries, moderated in the first half of 2006. **Off-estate processing** grew by 1.5% (January-June 2005: 20.4%), on account of lower output of crude palm oil (CPO) and contraction in palm kernel oil as shown in *Table 3.5*, while output of processed rubber products increased. The palm oil industry will receive a boost to its growth with a flagship project under the 9MP to develop a palm oil industrial cluster (POIC) in Lahad Datu, Sabah. The project, when completed, will see more upstream value added activities complementing the existing downstream activities. Similar POIC projects will be developed in Sandakan as well as in East Johor-South Pahang and South Kelantan-North Terengganu.

TABLE 3.5

Growth of Off-Estate Processing
January-June
(2000=100)

	Change (%) 2005	2006
Off-estate processing	***20.4***	***1.5***
Manufacture of crude palm oil	*20.5*	*1.2*
Manufacture of palm kernel oil	*26.1*	*-0.9*
Rubber remilling and latex processing	*13.7*	*7.0*

Source: Department of Statistics, Malaysia.

Similarly, output of **food products** moderated to 0.3% (January-June 2005: 9%), mainly due to the drop in output of refined palm oil, refined sugar as well as preserved fish and fish products, despite the significant increase in output of chocolate products and sugar confectionery, cocoa products and snacks. Output of refined palm oil was lower due to weaker demand, while higher cost of imported raw sugar constrained refined sugar production during the period. Malaysian sugar refineries, currently dependent on Brazil for 75% of their supply of raw sugar, now have to pay higher prices as Brazil is diverting its raw sugar to produce ethanol, which is used as biofuel.

The global market for *halal* products continues to offer bright prospects for the development of *halal* food industry. To improve market access, the Government has spearheaded a special initiative in collaboration with a major international distributor to enable Malaysian manufacturers to supply about one billion ringgit worth of *halal* products to the United Kingdom (UK). In addition, under the 9MP, several *Halal* Parks have been earmarked as centres for downstream activities in products ranging from food, beverages and herbs to processed marine-based and meat products. These parks will have easy access to raw materials and facilities for processing, testing laboratories, warehousing, cold storage and distribution. *Halal* parks are also aimed at facilitating the development of SMEs in the food and beverages sub-sector, which recorded 15.8% in value-added in 2005, the highest contributor in the SME sector.

Output of the **construction-related industries,** as shown in *Table 3.6,* increased during the period primarily due to a recovery in the fabricated metal products industry, particularly in production of structural metals and wire products. With the construction industry yet to fully recover, demand for construction materials continues to be weak. Production of basic metals, particularly iron and steel contracted, followed by output of non-metallic minerals (including cement and concrete). Consequently, average plant production capacity of cement and concrete as well as steel industries remained below 60%. However, with the roll-out of several infrastructure projects under the 9MP, as well as efforts by the industry to improve efficiency, growth prospects for the domestic cement and concrete as well as steel industries are expected to be favourable.

TABLE 3.6

Growth of the Construction-Related Industries
January-June
(2000=100)

	Change (%) 2005	2006
Construction-Related Industries	***1.3***	***4.5***
Glass and glass products	*23.6*	*-0.9*
Non-metallic mineral products	*-6.0*	*-2.6*
Structural metal products, tanks, reservoirs and steam generators	*24.8*	*41.6*
Wire, wire products and metal fasteners	*-26.5*	*36.2*
Basic iron and steel	*-6.7*	*-10.9*
Other basic precious and non-ferrous metals	*4.9*	*-3.0*

Source: Department of Statistics, Malaysia.

Output of **transport equipment** expanded moderately by 5.6% in the first six months of 2006 (January-June 2005: 10.4%), due largely to higher output of parts and components while output of motor vehicles declined. The significant increase in production of parts and accessories for motor vehicles and engines by 22.2% (January-June 2005: 20.1%) was primarily to meet the needs of the replacement market. The decline in motor vehicle production, on the other hand, is mainly attributed to a decline in demand on account of higher interest rates, tighter hire purchase loan conditions and the increase in prices of fuel.

Agriculture Sector

Higher growth expected from food commodities…

In 2006, value added of the **agriculture sector** is expected to grow stronger by 5.3% (2005: 2.5%), as shown in *Table 3.7*, partly on account of higher output of rubber from smallholders who are motivated by higher prices. Higher growth is also expected to emanate from the food commodities sub-sector, in particular livestock, fisheries, fruits and vegetables, in tandem with the various programmes and incentives initiated by the Government. These initiatives are consistent with the stated policy to make agriculture the third engine of growth, thereby reducing trade deficit in food as well as generating more income for rural households.

TABLE 3.7

Value Added in the Agriculture Sector 2005-2006

(in 1987 real prices)

	Change (%)		Share to Agriculture (%)	
	2005	2006[1]	2005	2006[1]
Agriculture	***2.5***	***5.3***	***100.0***	***100.0***
Oil palm	*7.2*	*4.2*	*36.3*	*35.9*
Forestry and logging	*2.0*	*1.4*	*13.9*	*13.4*
Rubber	*-2.9*	*6.4*	*10.5*	*10.6*
Fishing	*-7.0*	*8.6*	*11.4*	*11.7*
Other agriculture[2]	***3.2***	***7.0***	***28.0***	***28.4***

[1] Estimate.

[2] Including livestock, paddy, cocoa, fruits, vegetables, copra, tobacco, tea, flowers, pepper and pineapples.

Source: Department of Statistics, Malaysia.

Production of **CPO** is expected to increase by 4.3% to 15.6 million tonnes in 2006 (2005: 7.1%; 14.96 million tonnes), partly due to the anticipated uptrend in oil palm production in the second half of the year. High CPO prices, seasonal upcycle, yield improvement and expansion in matured areas are expected to contribute towards higher production. Production of CPO increased by 2.1% in the first seven months (January-July 2005: 17%) and is expected to expand further towards the end of the year. Improved agronomic practices and higher yielding clones resulted in improved average yield per hectare of fresh fruit bunches (FFB) to 10.72 tonnes during the first seven months of 2006 (January-July 2005: 10.64 tonnes FFB yield per hectare). The total cultivated area of oil palm is expected to increase by 3% to 4.1 million hectares in 2006, with 90% comprising matured areas. New areas coming into maturity from estates are mainly in Sabah (43,600 hectares), Sarawak (17,800 hectares) and Johor (19,000 hectares). Of the total planted area, 60% is owned by private sector, 30% by smallholders organised under the Federal Land Development Authority (FELDA) and FELCRA Berhad while the rest are owned by independent smallholders.

Other than for edible and industrial uses, palm oil is increasingly being promoted as a renewable source of energy. Selected Government agencies have started initial trials using ENVO Diesel, a diesel blend with 5% palm olein. Should these trials show promising results, more vehicles will be brought into this programme. In addition, several companies have collaborated with the Malaysian Palm Oil Board (MPOB) to set up plants to produce palm oil-based biodiesel (methyl ester) for export.

CPO is expected to trade at a relatively high price, averaging RM1,500 per tonne in 2006 (2005: RM1,394). Despite high stock levels, the price of CPO trended upwards averaging RM1,422 per tonne during the first seven months of 2006, compared to RM1,385 per tonne in the corresponding period of 2005. This is on account of tight supply of world vegetable oils and fats amidst rising demand from China and Europe as well as increasing demand for palm oil-based biodiesel. The stocks of palm oil stood at a record high of 1.65 million tonnes as at end-June 2006 (end-June 2005: 1.19 million tonnes). However, the stock is envisaged to decline as local demand and exports of CPO are expected to increase, following greater use of CPO as feedstock for biodiesel. In addition,

TABLE 3.8

Oil Palm Area and Palm Oil Production 2005-2006

			Change (%)	
	2005	2006[1]	2005	2006[1]
Planted areas ('000 hectares)	4,051	4,172	*4.5*	*3.0*
Matured areas ('000 hectares)	3,631	3,740	*5.2*	*3.0*
Production ('000 tonnes)				
Crude palm oil	14,962	15,600	*7.1*	*4.3*
Palm kernel oil	1,843	1,860	*12.2*	*0.9*
Yield (tonnes/hectare)[2]	18.9	19.0	*1.6*	*0.6*

[1] Estimate.

[2] Fresh fruit bunches yield.

Source: Ministry of Plantation Industries and Commodities.

exports of palm oil are also expected to increase following compulsory labelling of trans-fatty acids in food products in the US beginning January 2006 as food manufacturers switch to palm oil which is free from trans-fatty acids.

During the first six months of 2006, output of **rubber** increased significantly by 16.5% to 602,900 tonnes, largely due to recovery of rubber production, which was adversely affected by weather conditions during the same period in 2005. High rubber prices have also encouraged smallholders to intensify tapping of rubber trees. For the whole year, total production, however, is expected to increase by 7% to 1.205 million tonnes (2005: -3.6%; 1.126 million tonnes), despite a reduction in planted areas. This is due to the earlier conversion of rubber plantations to other activities. Total land area under rubber cultivation is estimated at 1.22 million hectares in 2006 (2005: 1.25 million hectares), registering a decline of 2.5%, as shown in *Table 3.9*. Although the total area under rubber cultivation has shrunk, higher rubber prices have led to rehabilitation of idle rubber smallholdings and wider adoption of Low Intensity Tapping System (LITS).

TABLE 3.9

Rubber Area, Yield and Production
2005-2006

	2005	2006[1]	Change (%) 2005	Change (%) 2006[1]
Total area ('000 hectares)	**1,250**	**1,219**	***-2.5***	***-2.5***
Smallholdings	1,135	1,113	*-1.7*	*-1.9*
Estate	115	106	*-8.7*	*-7.8*
Yield (kg per hectare)				
Smallholdings	1,320	1,350	*2.3*	*2.3*
Estate	1,381	1,435	*7.0*	*3.9*
Total production ('000 tonnes)	**1,126**	**1,205**	***-3.6***	***7.0***
Smallholdings	1,061	1,135	*-4.0*	*6.9*
Estate	65	70	-7.9	7.7
% of world production	***13.0***	***13.3***		

[1] Estimate.

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

The average price of SMR20 in the first seven months of 2006 increased strongly by 57.2% to RM7.50 per kg (January-July 2005: RM4.77 per kg). This is in line with the higher price of synthetic rubber following the rise in world crude oil prices and increasing demand for natural rubber from China and India, particularly for the tyre industry. China alone accounts for about one fifth of the global consumption of rubber. Firmer rubber prices can also be attributed to tight global supply, following unfavourable weather conditions in major rubber producing countries in early 2006. The higher prices of rubber are expected to increase the incomes of rural households with rubber smallholders earning about RM675 per hectare in 2006 compared to RM460 in 2005.

Value added in the **fishing sub-sector** increased by 10.2% in the first six months of 2006, mainly due to higher marine landings of 11.5% (January-June 2005: -14.7%). The strong increase can be attributed to Government's efforts in promoting this sub-sector, particularly with more effective implementation of the diesel and petrol subsidy programme for the fishing industry. Output of the fishing sub-sector is envisaged to increase by 8.6% in 2006, accounting for 13% of the overall value added of the agriculture sector. In order to further improve the performance of this sub-sector, particularly marine fish landings, the Government has initiated several programmes including the establishment of large-scale community-based marine fish farms and constructing artificial reefs and fish shelters. In addition, productivity in the marine fish industry is expected to increase in line with measures to upgrade fishing vessels and related equipment. A national fisheries consortium, a private sector initiative namely Konsortium Perikanan Nasional Berhad, has been established to encourage the development of the deep sea fishing industry and the growth of upstream and downstream activities. Meanwhile, aquaculture operators are encouraged to adopt new technologies and management systems, especially in intensive on-shore high value marine fish aquaculture to enhance output.

TOWARDS DEVELOPING AND PROMOTING BIOFUEL AS THE FUEL FOR THE FUTURE

Introduction

Biofuel is a natural and renewable fuel alternative for fossil fuels derived from vegetable oils and plants. Being renewable, nontoxic and biodegradable, it is environmentally friendly. Biofuels take two primary forms: bioethanol and biodiesel. Bioethanol is produced from plants with high sugar or starch content, such as sugar cane and corn. Biodiesel, on the other hand, is produced by converting vegetable oils such as palm, soya and rapeseed oils into methyl ester. However, up to 20% processed palm oil (refined, bleached and deodorized - RBD palm olein) without any conversion can be used as a blend with diesel.

Rationale for Developing Biofuel

Presently, non-renewable fossil fuels, such as petroleum and its derivatives, coal and natural gas, are the primary sources of energy worldwide. However, such fuels emit among others, carbon dioxide (CO_2) which gives rise to greenhouse effect in the atmosphere, causing global warming and long-term climate change. As a result, there are continuous global efforts and initiatives to protect the environment, notably commitment under the Kyoto Protocol (1997) to reduce greenhouse gas emission to an average of 5% below 1990 levels. The European Union (EU) too has set a target to gradually increase the use of biofuel in the transport sector from 2% of the total diesel consumption in 2005 to 5.75% by 2010. Consequently, world demand for biofuel has increased.

The implementation of biofuel programme is in line with the Government policy of ensuring sustainable development of the energy sector as well as promoting a cleaner environment. As such, the Government has embarked on the development of renewable energy as the fifth fuel after oil, gas, hydro and coal, initiated earlier under the Third Outline Perspective Plan (OPP3), 2001–2010 and the Eighth Malaysia Plan (8MP), 2001-2005. Biodiesel from palm oil was earmarked as a promising renewable energy in line with the Government's fifth fuel policy.

Malaysia is blessed with natural resources, particularly crude oil and natural gas, which are the main sources of energy. However, these are depleting energy resources and increasing demand has made it necessary for the Government to embark on alternative energy sources. Rising crude oil prices have led to higher government expenditures on subsidies to keep retail fuel prices at relatively low levels. Consequently, biodiesel as an alternative energy source has become more viable. In addition, palm oil is a more competitive alternative to rapeseed, soya bean and sunflower oils as feedstock in the production of biodiesel. In terms of oil yield per hectare per year, palm oil (3.8 tonne/hectare) is significantly higher than rapeseed oil (1.3 tonne/hectare) and soyabean oil (0.5 tonne/hectare). Hence, the palm oil-based biodiesel has enormous export potential as it can be competitively priced against its major competitors.

The price of crude palm oil (CPO) has been fluctuating from a low of RM579 per tonne in 1986 to a high of RM2,378 per tonne in 1998. Oversupply of CPO and other vegetable oils generally leads to depressed CPO prices. Hence, during a prolonged oversupply situation, the excess CPO stock can be utilised as feedstock for biodiesel. This will have a significant effect on stabilising CPO prices as Malaysia is the leading CPO producer. Further, the consumption and production of palm oil-based biodiesel would also help to diversify palm oil usage and boost export earnings in line with Government initiatives to ensure Malaysia remains the world leader for palm oil.

Development of Biodiesel in Malaysia

The biodiesel programme was initiated as early as 1982 when the Malaysia Palm Oil Board (MPOB) pioneered the technology to convert palm oil to biodiesel. Its 3,000-tonne capacity pilot plant, launched in October 1985, supplied palm biodiesel for field trials on vehicles that proved successful. Subsequently, MPOB developed and patented indigenous palm oil-based biofuel production technologies, including technology for producing palm biodiesel for cold weather. Spurred by the success, the Government mandated the Ministry of Plantation Industries and Commodities (KPPK) to spearhead measures to develop palm oil-based biofuel for local consumption and exports. To facilitate the production and use of palm oil-based biofuel, a National Biofuel Policy is being formulated. The policy which encompasses the formulation of a national industrial Biofuel Act as well as the provision of various incentives to encourage private sector involvement, is scheduled to be tabled in Parliament by the end of 2006. The Policy is underpinned by five strategic thrusts:

THRUST 1: BIOFUEL FOR TRANSPORT

Diesel for land and sea transport will be a blend of 5% processed palm oil and 95% petroleum diesel. This will be branded as ENVO Diesel and will be made available throughout the country.

THRUST 2: BIOFUEL FOR INDUSTRY

ENVO Diesel will also be supplied to the industrial sector, to be used amongst others, for firing boilers in manufacturing, construction machinery and generators.

THRUST 3: BIOFUEL TECHNOLOGIES

Research, development and commercialisation of biofuel technologies (including technologies for extraction of minor components therein) will be effected and adequately funded by both the government and private sectors, including venture capitalists to enable increased use of biofuel.

THRUST 4: BIOFUEL FOR EXPORT

Worldwide interest reflects the important role of biofuels in energy for sustainable development. Malaysia will have an edge to supply the growing global demand for biofuel. The establishment of plants for producing biofuel for export will be encouraged and facilitated.

THRUST 5: BIOFUEL FOR CLEANER ENVIRONMENT

The use of biofuel will reduce the use of fossil fuels, minimise the emission of green house gases (carbon dioxide), carbon monoxide, sulphur dioxide and particulates. Increased use of biofuel will enhance the quality of the environment.

Implementation of the ENVO Diesel Programme

In March 2006, the Government launched a campaign with a budget of RM7 million to create awareness, carry out voluntary trials and promote the use of ENVO Diesel. Initial trials were conducted on 130 vehicles from selected Government agencies. More vehicles will be brought into this programme should the trials show promising results. Commercial runs involving four deep-sea fishing boats started in June 2006 where fuel consumption, exhaust emission and trawling power will be monitored.

Independent tests on ENVO Diesel are presently being carried out to reassure interested parties such as the Automobile Association of Malaysia (AAM), oil companies, vehicles suppliers, engine manufacturers and the Department of Environment (DOE) on the acceptability of ENVO Diesel. The immediate goal is to obtain recognition and acceptance of B5 blend while the long-term objective is to increase the blending ratio from 5% to 20%.

Efforts are underway to introduce the use of ENVO Diesel for Government vehicles in Putrajaya by the end of 2006. To popularise its use, plans are also in the pipeline to introduce ENVO diesel to the public at selected stations. ENVO diesel will also be introduced to selected transport fleet operators, heavy machinery operators as well as power generation and industrial users. It is envisaged that when all diesel vehicles are involved in the ENVO diesel programme, annual imports of petroleum diesel can be reduced by 500,000 tonnes.

Progress of the Setting Up of Palm Oil-Based Biodiesel Plants

To date, three companies have collaborated with MPOB to set up palm oil-based biodiesel plants in the country using MPOB's technology. The annual capacity of each plant is estimated at 60,000 tonnes. The plants have also incorporated a demonstration plant for the production of winter palm oil-based biodiesel for export markets. Other companies have also shown interest in building biodiesel plants.

Conclusion

The National Biofuel Policy will provide the strategic direction and guide the development of biofuel industry while ensuring Malaysia's position as the centre for global palm oil industry. Towards this end, efforts are being intensified to fully realise the objectives of the Policy to make palm oil a new source of renewable energy in coming years.

Other agriculture, comprising livestock, cocoa, paddy and miscellaneous agriculture, is envisaged to expand by 7.5% in 2006, accounting for almost a third of the total value added in the agriculture sector. **Livestock**, the biggest contributor, is expected to grow by 6.5%, due to higher production of poultry (7.1%) and meat (7.0%), as shown in *Table 3.10*. Production of eggs and fresh milk are projected to increase by 3.1% and 34.3%, respectively. The increase in livestock production is attributed to several initiatives taken by the Government. These include integrated cattle rearing with oil palm plantation, systematic feedlot activities through National Feedlot Centre and establishing *Transformasi Usahawan Sektor Ternakan* (TRUST) Scheme, which is to develop beef production industry by transforming traditional livestock rearing into a modern and commercial activity. Feedlot activity and integrated cattle rearing with oil palm plantation are expected to contribute 30% and 23%, respectively, to national beef production.

The output of cocoa beans is envisaged to increase by 7.3% to 30,000 tonnes in 2006 (2005: -16.3%, 28,000 tonnes), mainly due to higher demand in both domestic and external markets. Although total planted area is expected to decline slightly by 0.9% to 33,000 hectares in 2006, the higher production is a result of improved productivity in the planted areas. Meanwhile, paddy production is expected to increase by 12.4%, partly due to higher productivity, following the implementation of 'ten tonnes per hectare project' in eight granary areas as well as paddy estate projects. These initiatives, together with the adoption of good agriculture practices (GAP) and better management techniques are expected to result in higher yield, averaging 4.1 tonnes per hectare in Peninsular Malaysia in 2006 (2005: 3.5 tonnes per hectare).

TABLE 3.10

Production of Other Agriculture
2005-2006
('000 tonnes)

	2005	2006[1]	Change (%) 2005	Change (%) 2006[1]
Cocoa	28	30	*-16.3*	*7.3*
Paddy	2,403	2,700	*5.7*	*12.4*
Livestock				
Meat[2]	239	256	*3.6*	*7.0*
Poultry	980	1,039	*5.7*	*6.1*
Eggs (million)[3]	7,381	7,610	*2.1*	*3.1*
Milk (million)[4]	41	55	*6.0*	*34.3*
Miscellaneous agriculture				
Fruits[5]	1,338	1,389	*17.2*	*3.8*
Pepper	19	20	*-5.0*	*5.2*
Tobacco[6]	80	72	*-4.5*	*-15.6*
Tea	12	10	*-26.6*	*-16.7*
Vegetables	608	643	*4.5*	*5.8*
Copra	12.0	13.0	*16.5*	*8.3*
Flowers (million)[7]	102	105	*3.0*	*2.9*

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

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

Output of **miscellaneous agriculture**, which includes vegetables, fruits, flowers, pepper, pineapple, copra, tea and tobacco, is expected to increase markedly by 7.9% in 2006 (2005: 0.5%), largely due to higher production of vegetables and fruits. The production of vegetables is envisaged to grow higher by 5.8% (2005: 4.5%), underpinned by expansion in cultivated areas, opening up of more large-scale farms, adoption of good farming practices as well as improvements in post-harvest handling. The farmers are also encouraged to focus their activities on high value vegetable varieties to cater for the local market as well as for exports.

Likewise, fruit production is expected to increase by 3.8% in 2006 on account of expansion in fruit cultivation areas, especially for 15 types of fruits that are in demand, such as papaya, star fruit, banana as well as seedless guava and watermelon. In addition, greater utilisation of higher yielding and disease resistant clones are also expected to boost output.

Mining Sector

Higher output expected in the second half...

Growth in value added of the **mining sector** is envisaged to accelerate by 2.4% in 2006 (2005: 0.8%), mainly on account of the anticipated higher production of crude oil and natural gas in the second half of the year.

TABLE 3.11

Production and Reserves of Crude Oil and Natural Gas
2005-2006

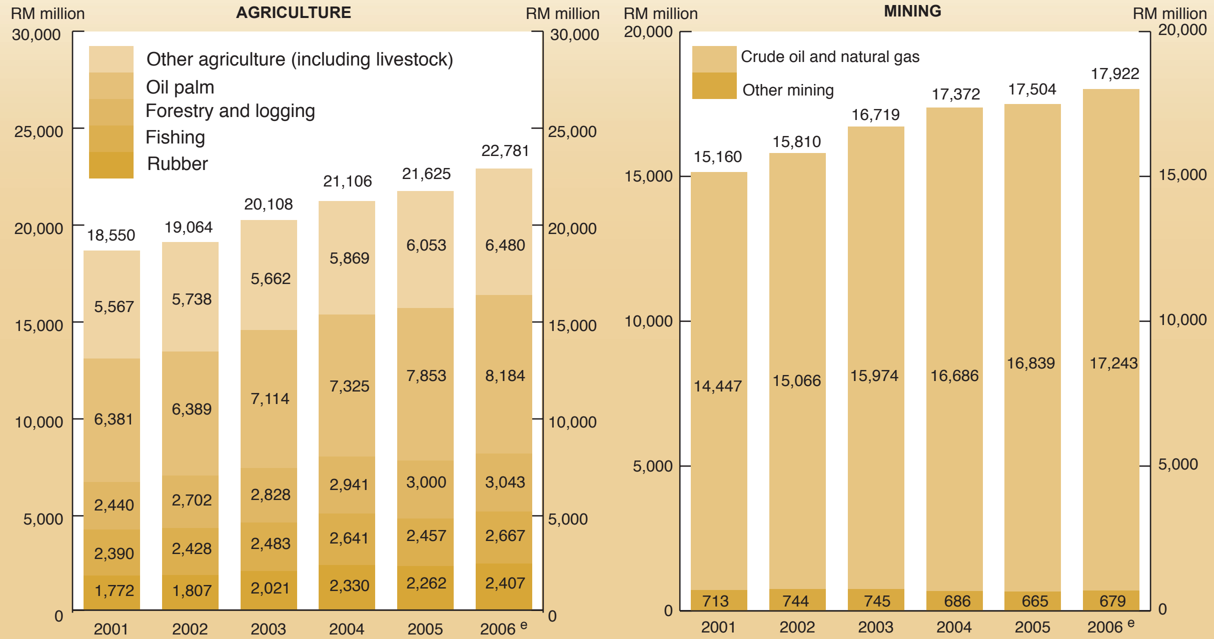
	2005	2006[1]	Change (%) 2005	Change (%) 2006[1]
Crude oil				
Production ('000 barrels per day)[2]	703	725	*-7.9*	*3.0*
Reserves (billion barrels)	5.16	5.25	*-2.0*	*1.7*
Reserves/ production (years)	19	20		
Natural gas				
Production (million standard cubic feet per day (mmscfd))[3]	5,797	6,000	11.6	*3.5*
Reserves (trillion standard cubic feet)	85.2	87.9	*0.0*	*3.2*
Reserves/ production (years)	33	34		

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

Source: Petroliam Nasional Berhad (PETRONAS).

CHART 3.5

Value Added of Major Commodities



[e] Estimate.
Source: Department of Statistics, Malaysia.

Crude oil production (including condensates) averaged 690,610 barrels per day (bpd) during the first six months of 2006, representing an increase of 1.1% over 682,961 bpd in the corresponding period of 2005. Production of condensates, which accounted for 21.1%, increased 6.6% to 145,883 bpd during the period (January-June 2005: 8.6%; 136,807 bpd). For the year as a whole, oil production is expected to record an increase of 3% at 724,500 bpd (2005: -7.9%; 703,300 bpd) in anticipation of higher production capacity and demand amidst high world oil prices that averaged USD71.31 per barrel (Tapis Blend) during the first seven months of 2006. On 1 January 2006, crude oil and condensates reserves stood at 5,250 million barrels with the lifespan of 20 years (1 January 2005: 5,160 million barrels; 19 years).

Natural gas production, on the other hand, declined by 3.7% to 5,781 million standard cubic feet per day (mmscfd) during the first six months of 2006 (January-June 2005: 27.2%; 6,004 mmscfd), mainly due to high base effect in 2005 where there was a higher feed gas demand from MLNG Complex in Sarawak. Production of natural gas, however, is projected to increase by 3.5% to 6,000 mmscfd in 2006 (2005: 11.6%; 5,797 mmscfd) on expectation of higher production in the second half of the year. Gas reserves stood at 87.9 trillion cubic feet as at 1 January 2006 and are expected to last for another 34 years (1 January 2005: 85.2 trillion cubic feet; 33 years). There is significant potential for higher production of gas due to the increase in gas reserves and the discovery of new deepwater gas fields at Kikeh, off Sabah.

Construction Sector

Construction activities to benefit from 9MP projects…

Value added of the construction sector contracted by 1.1% during the first six months of 2006 (January-June 2005: -2.2%), mainly due to continued slowdown in the civil engineering sub-sector. However, this sub-sector is expected to recover in the second half of the year, benefitting from the implementation of 9MP projects scheduled in 2006. Overall, the sector is envisaged to register a positive growth of 0.7% in 2006 (2005: -1.6%).

The **civil engineering sub-sector** is envisaged to pick up with the roll-out of infrastructure projects under the 9MP and ongoing projects such as Kuala Lumpur-Putrajaya Expressway, Senai-Desaru Expressway, Duta-Ulu Kelang Expressway as well as upgrading works at the Kota Kinabalu International Airport (KKIA). Among the 9MP projects are the 880 new construction projects, totalling RM15 billion announced by the Government in July 2006. Implementation of some of these projects is expected to begin in the fourth quarter of the year. In addition, growth in the sub-sector is expected to be also underpinned by higher private investment in oil and gas, communications and utilities.

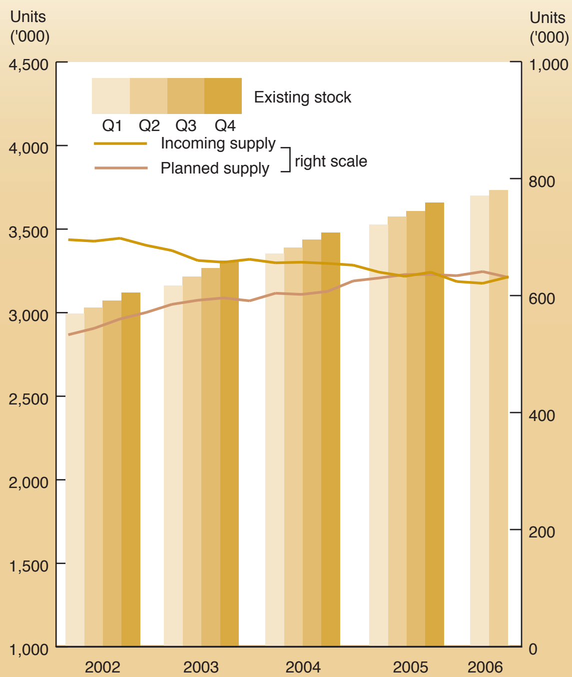
In the light of limited construction opportunities and excess capacity in the domestic market, several established local construction companies have ventured abroad, mainly to India and the Middle East, where they have secured projects mainly to construct roads, highways and buildings. Data from the Construction Industry Development Board (CIDB) indicated that local contractors are currently undertaking 48 projects worth RM15.3 billion in 36 countries, with 293 projects valued at RM18.5 billion already completed.

Activities in the **residential sub-sector** softened during the first six months of 2006 amidst rising costs of building materials and transportation. Private developers completed a total of 77,027 houses during the period, increasing the existing stock level to 3,734,280 units at end-June 2006. Incoming supply, that is residential units under construction, sustained at 631,790 units during the period (end-June 2005: 632,627 units), backed by a 12% increase in housing starts of mainly condominium and terraced units. On the demand side, sales of new launches slowed, due partly to concern over further interest rate hikes. Sales of landed properties at prime locations, however, remained strong with support from local and foreign buyers. In the second quarter of 2006, the Malaysian Annual House Price Index edged up 1.4%, lifting the all houses price to RM163,559 (April-June 2005: 3.4%; RM161,492).

The Government, through Syarikat Perumahan Negara Berhad (SPNB), continues to build affordable houses priced below RM70,000 to help meet the needs of the low income group. This housing segment is still undersupplied as private developers tend to focus on the more profitable medium and high-end units. SPNB is currently involved in developing 16 projects at an estimated cost of RM2,116 million in various locations throughout the country. In addition, in the first six months of 2006, SPNB has rehabilitated seven abandoned projects costing RM172 million as part of its efforts to help affected buyers.

CHART 3.6

Residential Supply Indicators



Source: National Property Information Centre (NAPIC).

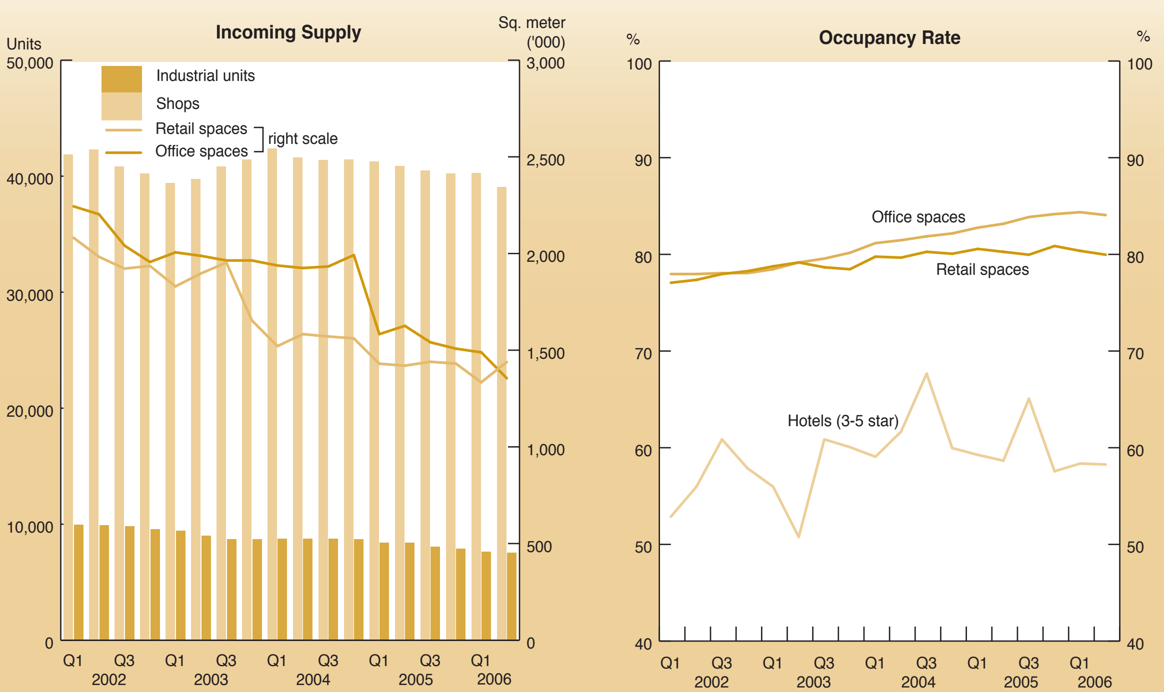
In the **non-residential sub-sector**, activities were generally lower compared to the same period in 2005. Construction of **office spaces** contracted further during the period with a 16.6% decline in the incoming supply at end-June 2006 (end-June 2005: -15.6%). Ten properties with a combined area of 162,536 square meters (sq. m.) were completed during the period, bringing the existing stock level of office space to 14,384,266 sq.m. Buoyed by growing business and services activities as well as limited new supply, overall occupancy rate of office space remained high at 84.2% at end-June 2006. As for the construction of **industrial** and **shop** units, the incoming supply recorded a drop of 10.6% and 3.4%, respectively at end-June 2006.

Retail spaces, on the other hand, recorded higher activity with a 1.4% pick-up in the incoming supply at end-June 2006 (end-June 2005: -10.3%), bolstered by a strong increase in starts in Kuala Lumpur. Eight new shopping complexes were completed during the period, adding 132,339 sq.m to the existing stock level to reach 7,515,531 sq.m. Overall occupancy rate of retail space sustained at 80.1%, boosted by steady consumer spending and business activities. The incoming retail space includes expansion activities by existing major hypermarket operators, reflecting the continued optimism in retail trade business.

In the hospitality segment, a total of five new **hotels** with 713 rooms were completed during the first six months of 2006 (January-June 2005: 2 hotels; 155 rooms), bringing the nationwide stock level to 2,134 hotels and 143,745 rooms. Despite the presence of new hotels and higher room rates since January 2005, average occupancy rate of 3–5 star hotels sustained at 58.4% during the period, spurred by higher tourist arrivals, more international meetings, conferences and exhibitions as well as various

CHART 3.7

Non-residential Supply Indicators



Source: National Property Information Centre (NAPIC).

domestic festivities.

Overall property transactions declined by 4.1% to reach 131,322 transactions during the first six months of 2006 (January-June 2005: 0.5%; 136,945 transactions) with negative growth registered across the board. Residential transactions, comprising 64.5% of the total transactions, slipped by 3.4% during the period, followed by agricultural (-6.6%), commercial (-1%), development (-6.6%) and industrial (-9.8%) transactions. The value of overall transactions, however, edged-up 1.1% bolstered by higher values in the development, agricultural and industrial transactions.

Services Sector

Services sector set to expand further…

The services sector continues to be the key driver of growth in 2006 and is expected to expand at a steady pace, led by growth in the **wholesale and retail trade, hotels and restaurants; transport, storage and communication** as well as **finance, insurance, real estate and business services** sub-sectors. Trade-related services will continue to benefit from sustained exports, while resilient private spending will also render additional impetus to the continued expansion of the services sector as shown in *Table 3.12*. Growth of the services sector in 2006 is expected to increase by 5.7% (2005: 6.5%), in tandem with the expansion of other major sectors of the economy. Its share to GDP is expected to be sustained at 58.2% in 2006 (2005: 58.2%), reflecting concerted efforts by the Government to promote trade in services and to encourage the sector to move up the value chain. Of significance are efforts to further improve transportation and tourism with emphasis on health and education tourism as well as expedite the development of the information and communications technology (ICT) industry.

Growth of the **wholesale and retail trade, hotels and restaurants** sub-sector is estimated at 6.5% (2005: 8%), supported by favourable consumer sentiment and strong business confidence as well as healthy labour market conditions. The strong growth in wholesale and retail activities

TABLE 3.12

Services Sector Performance
2005-2007
(in 1987 real prices)

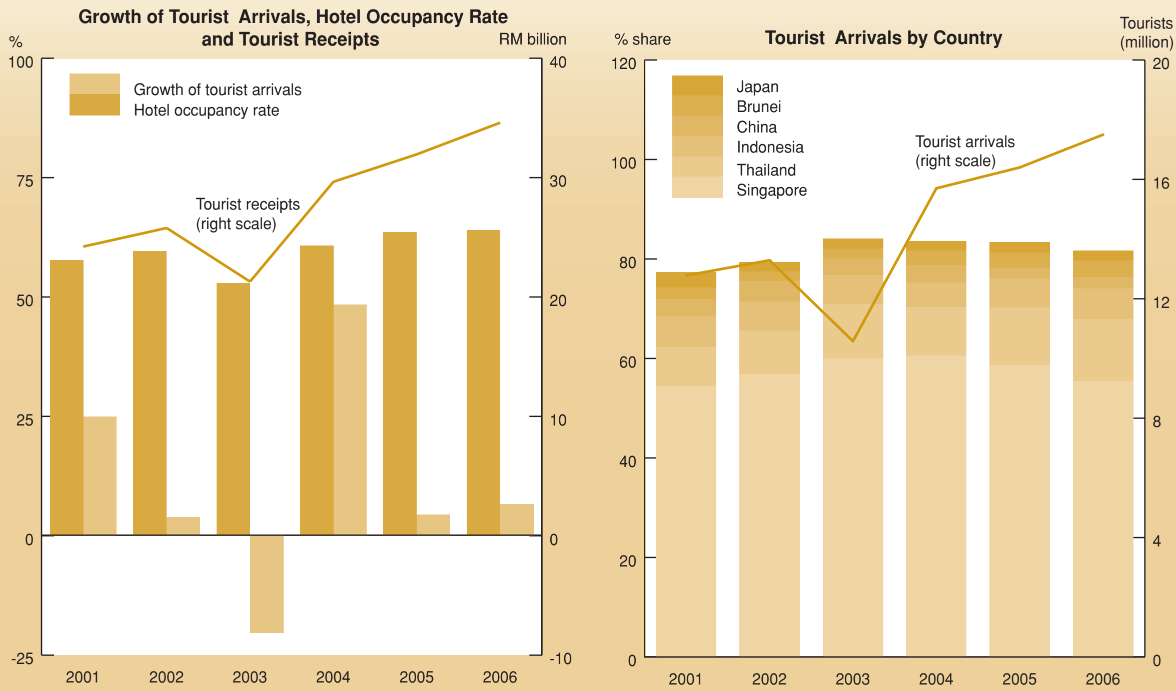
	Change (%)			Share of GDP (%)		
	2005	2006[1]	2007[2]	2005	2006[1]	2007[2]
Electricity, gas and water (utilities)	5.6	4.4	4.7	4.1	4.1	4.0
Transport, storage and communication	6.2	5.9	5.9	8.8	8.8	8.8
Finance, insurance, real estate and business services	5.7	6.0	5.9	15.4	15.4	15.4
Wholesale and retail trade, hotels and restaurants	8.0	6.5	7.3	14.7	14.8	14.9
Government services	7.6	5.8	5.5	7.5	7.5	7.4
Other services	4.9	4.4	4.8	7.7	7.6	7.6
Total	**6.5**	**5.7**	**6.0**	**58.2**	**58.2**	**58.1**

[1] Estimate.
[2] Forecast.

Source: Department of Statistics, Malaysia.

CHART 3.8

Tourism Industry



Source: Malaysia Tourism Promotion Board.

is reflected in the establishment of new retail complexes and expansion activities of major hypermarkets, superstores and specialty stores. Making their debut in the mid-1990s, foreign-owned hypermarkets have gained popularity and have since expanded rapidly. As at end-July 2006, four foreign-owned hypermarkets operate 45 outlets in the country, providing employment to about 12,100 local workers. The expansion in the retail industry also benefitted from the rapidly growing tourism industry, in particular the high spending tourists from the Middle East.

Consistent with the overall improvement in the global tourism market, the domestic **tourism industry** also strengthened further, supported by strong growth in the inbound tourist traffic, particularly from ASEAN countries. Tourist arrivals are expected to increase by 6.7% to reach 17.5 million in 2006, generating a revenue of RM34.6 billion (2005: 16.4 million; RM31.9 billion). During the first five months of the year, total tourist arrivals increased by 5.4% to 7.2 million visitors (January–May 2005: 4.9%; 6.8 million visitors), with a historical record of 1.54 million visitors in March 2006 in conjunction with major international events. In terms of market share, Malaysia remains a popular destination for ASEAN tourists, accounting for about 77% of total tourist arrivals. The launch of Visit Malaysia Year (VMY) 2007 campaign in January 2006 in conjunction with the celebration of Malaysia's Golden Independence Anniversary is expected to further boost tourist arrivals to 20.1 million in 2007.

The Meetings, Incentives, Conventions and Exhibitions (MICE) industry has become an important component of the tourism sector. A total of 3,500 international MICE events are scheduled in 2006, involving an estimated 984,000 foreign delegates with total receipts anticipated to increase strongly by 45% to RM3.5 billion (2005: 3,230 events; 780,000 foreign delegates; 11.9%; RM2.4 billion). Given its immense potential, the Government will continue to promote Malaysia as a choice destination for MICE through aggressive marketing, promotions and provision of attractive incentives.

Fuelled by the strong expansion in manufacturing activity and significant growth in the telecommunication services industry, in particular, the cellular phone segment, value added of the **transport, storage and communication** sub-sector expanded further in the first six months of the year and is anticipated to register a growth of 5.9% in 2006 (2005: 6.2%). The mobile phone segment remains the main contributor to growth in the telecommunications industry, recording significant increases in the subscriber base as well as usage of voice and data services. As at end-June 2006, the number of mobile subscribers rose markedly by 28.4% to 21.3 million with a penetration rate of 80.8% (end-June 2005: 33.5%; 16.6 million; 63.3%). Affordably priced handsets, low starter kit prices and aggressive marketing strategies by service providers contributed to the strong growth in the subscriber base. Despite a saturating market, the number of mobile subscribers is expected to reach 23 million with penetration rate of 85.4% by the year-end. During the first six months of 2006, usage of short message services (SMS) rose sharply by 80.1% to reach 15.1 billion (January-June 2005: 104.7%; 8.4 billion), spurred by aggressive SMS-based promotional activities for radio programmes, TV reality and interactive shows as well as popular international sporting events. The industry is also expected to benefit from the increase in content and coverage of 3G services. The number of internet subscribers increased by 4.5% to 3.73 million as at end-June 2006 (end-June 2005: 14.5%; 3.57 million), translating to a penetration rate of 14% (end-June 2005: 13.7%). Internet subscription is expected to reach four million by the end of the year.

Stiff competition from electronic modes of communication such as SMS and e-mails as well as from courier companies resulted in a 2% contraction in the mail volume handled by Pos Malaysia Berhad (PMB) to 605 million items in the first six months of the year (January-June 2005: 7.9%; 617.2 million) although the parcel segment continued to register a robust growth of 26.1%. Supported by several new initiatives to promote operational excellence in mail services, optimise postal supply chain as well as to improve customer relationships, mail volume for the year is anticipated to stage a turnaround to record a growth of 3.7% to 1.28 billion items (2005: -0.4%; 1.23 billion).

Boosted by strong international trade and trade-related activities, capacity expansion in port facilities and equipment as well as improvements in productivity, container traffic at seven major ports namely Port Klang, Penang, Johor including Port of Tanjong Pelepas (PTP), Kuantan, Kuching, and Bintulu rose to 6.3 million twenty-foot equivalent units (TEUs) in the first six months of the year (January–June 2005: 3.3%; 5.8 million TEUs), an increase of 9.5% over the corresponding period last year. Port Klang, comprising Northport and Westports, handled 3.1 million TEUs or 48.3% (January–June 2005: 2.7 million TEUs; 46.8%) of the total volume handled while PTP's share of container throughput rose to 2.2 million TEUs during the same period (January–June 2005: 2.1 million TEUs). Meanwhile, the number of ships calling on the seven major ports increased by 704 ships to 21,603 in the same period with Port Klang dominating 37.3% of the ship calls (January–June 2005: 20,899; 36%).

Growth in land transportation continued at a steady pace, led by improvements in land and rail infrastructure as well as increased connectivity to other modes of transport and supported by sustained growth in economic activities. The number of vehicles on tolled highways increased by 5.2% to 545.1 million in the first six months of the year (January-June 2005: 7.3%; 518.1 million). The opening of several new interchanges along the PLUS highways, coupled with upgrading works on major highways is expected to ease traffic congestion, facilitate access as well as boost toll collection.

The ongoing revamp of the public transport system (PTS) in the Klang Valley saw ridership on the urban rail services (Ampang/Sri Petaling Line, Kelana Jaya Line, KL Monorail, express rail link (ERL) and the *Komuter)* increase by 4% to 79.4 million in the first six months of 2006 (January-June 2005: 76.4 million). Patronage of the urban rail services is set to increase by 3.1% to 162.6 million in 2006 (2005: 9.1%; 157.7 million) as efforts are underway to streamline the operational and regulatory framework, improve transport infrastructure and introduce new incentives for commuters as well as increase connectivity, frequency and efficiency among the various modes of PTS. Meanwhile, passenger traffic on inter-city trains posted a robust growth of 8.5% to 1.9 million passengers (January-June 2005: -3.2%; 1.7 million) whilst revenues remained firm at 1.3% in the first six months of 2006 at RM33.9 million (January–June 2005: 1.3%; RM33.4 million).

As freight services is the main revenue earner for Keretapi Tanah Melayu Berhad (KTMB), the fully commissioned 20 units of high-powered locomotives are expected to further enhance volume capacity. KTMB's growth prospects will also be targetted to carry long haul with higher yield goods, such as containerised cargo which accounts for 65% of freight services revenue. Land feeder services between ports have also increased to enable KTMB handle an estimated 450,000 TEUs for the year (2005: 380,000 TEUs). Further, pit stop operations (PSO), which call for close monitoring and review of all critical operations at terminals such as time taken for shunting, loading, refuelling and inspection have also expedited work processes and improved productivity. The PSO, implemented in Padang Besar and Butterworth since September 2005, aims to enhance volume and revenues by ensuring strict adherence to departure schedules of trains from terminals.

Growth prospects in the air transport segment remain favourable in 2006. The Kuala Lumpur International Airport (KLIA), which was voted the Best Airport in the 15-25 million passengers per annum category by AETRA Survey 2005, continues to chalk healthy growth in passenger and cargo traffic on account of top flight facilities, equipment and services provided at competitive rates. In the results announced in March 2006, KLIA also bagged the third place for Best Airport Worldwide and Best Airport in Asia Pacific categories. The AETRA Survey is an airport customer satisfaction benchmarking programme jointly conducted by Airports Council International (ACI) and International Air Transport Association (IATA).

Air cargo handled at KLIA surged to 315.9 million tonnes posting a strong growth of 20.6% in the first six months of 2006 (January-June 2005: -15.3%; 262 million tonnes) while passenger traffic increased by 4.9% to 11.6 million (January-June 2005: 12%; 11.1 million passengers). Similarly, all airports in the country, including the privatised Senai International Airport, recorded impressive growth in both categories during the same period. Total cargo and passenger movements expanded by 31.5% and 4% to 519.4 million tonnes and 21.4 million passengers (January-June 2005: -13%, 395.1 million tonnes; 6%, 20.6 million passengers), respectively. The steady growth in air passenger traffic has been underpinned by the growing popularity and demand for budget travel. Aggressive marketing, new destinations and increased flight frequencies as well as enhanced seating capacity through fleet expansion have seen marked passenger uplift on the no-frills airline AirAsia Berhad by 37.3% to 3.2 million passengers in the first six months of the year as against 2.3 million passengers for the same period in 2005.

Budget travel and tourism received a further boost when Asia's first low-cost carrier terminal (LCCT) began operations in March 2006. Currently a hub for AirAsia Berhad and its partners, Thai AirAsia and PT Indonesia AirAsia, an estimated 4.1 million passengers are expected to use the LCCT by year-end (March-July 2006: 1.9 million passengers). As more foreign budget airlines are expected to fly into the LCCT next year, passenger uplift is anticipated to accelerate at a faster pace, spurring further developments in the budget travel industry. In addition, Terminal Two of KKIA is being upgraded into the second LCCT and is expected to be completed by the end of the year. The budget terminal, which aims to capture the growing passenger and tourist traffic to Sabah and Sarawak, is expected to draw an estimated 832,000 passengers in its first year of operation.

The **finance, insurance, real estate and business services** sub-sector is expected to register a strong growth of 6% in 2006 (2005: 5.7%) in consonance with the overall economic expansion. Growth of the sub-sector is supported by sustained bank lending, positive performance of the insurance industry and higher turnover in the equity market. The expansion in Islamic financial services, following the establishment of additional Islamic subsidiaries and *takaful* operators, is envisaged to further support growth of the sub-sector. Loans outstanding of the banking system rose by 8.6% to RM579.3 billion as at end-June 2006 (end-2005: 8.6%; RM558.1 billion), with loans to SMEs and households accounting for 17.7% and 55.2%, respectively of total loans outstanding, reflecting the steady growth of SME and consumption activities. Life and general insurance premiums increased, albeit more moderately, by 2.4% during the first six months of 2006. The equity market also registered higher turnover of 112.3 billion units during the period (January-June 2005: 65.4 billion units). Meanwhile, the growth of the business services sub-sector is expected to be supported by shared services, business process outsourcing and IT-related services.

Malaysia is recognised as a favourable location for SSO activities. During the first six months of 2006, 79 additional regional establishments were approved (end-2005: 2,097), comprising nine operational headquarters (OHQs), ten international procurement centres (IPCs), three regional distribution centres (RDCs), 18 regional offices (ROs) and 39 representative offices (REs). The regional establishments are mainly foreign companies involved in finance, E&E, construction, food and beverages, chemicals, logistics and automotive activities. Apart from this, 14 SSO companies were awarded Multimedia Super Corridor Malaysia (MSC Malaysia) status during the first seven months of 2006.

IT-related activities continued to benefit from the drive by the Government to further develop MSC Malaysia as well as upgrade the access, adoption and usage of ICT. The MSC Malaysia was further rolled out to KL Sentral and the Melaka International Trade Centre (MITC), which were awarded MSC Malaysia cyber-centre status in February and June 2006, respectively. Nine MSC Malaysia-status companies are currently operating in KL Sentral. With the addition of 131 companies in the first seven months of 2006, the number of MSC Malaysia-status companies totalled 1,552 (end-2005: 1,421). Intensive computerisation of government agencies, electronic government applications as well as programmes to bridge the digital divide, such as the setting up of *Medan InfoDesa* in rural areas will further boost IT-related industries. The increasing use of IT in banking and finance, communications, media, manufacturing, education and health will also contribute to further expansion in the IT industry.

The **utilities** sub-sector is envisaged to grow at 4.4% (2005: 5.6%), in tandem with sustained demand for electricity and water from the commercial, industrial and the household segments. Sales of electricity grew by 3.5% in the first six months of 2006 (January-June 2005: 5.8%), while maximum demand for electricity peaked at 14,116 megawatts (MW) in June 2006 (May 2005: 13,705 MW), reflecting a firm uptrend in demand from expanding manufacturing and commercial activities. Water supply to customers, comprising 66% households, is expected to register a 2.2% increase to 7,113 million litres per day (mld) in 2006 (2005: -2.1%; 6,960 mld), while metered consumption in the first six months of the year rose by 2.2% to 3,558 mld (January-June 2005: -2.1%; 3,480 mld).

The **government services** sub-sector is set to expand by 5.8% in 2006 (2005: 7.6%). Growth in the sub-sector is on account of continuous efforts by the Government to improve productivity as well as streamline the public sector delivery system to make it more conducive for private sector initiatives.

Other services sub-sector is expected to increase by 4.4% (2005: 4.9%) supported by the expansion in private services such as education and healthcare. The private education industry, presently comprises more than 550 private higher education institutions, including

11 private universities and five foreign university branch campuses. Efforts to promote Malaysia as a centre of educational excellence in the region has resulted in a 27.8% increase in foreign students in private learning institutions to 44,709 as at end-2005 (end-2004: 16.1%; 34,991 students). Of the total, 10,806 students were in international and private schools. Meanwhile, the number of foreign patients treated in private hospitals under the health tourism programme is envisaged to record a healthy growth of 35.3% in 2006 (2005: 33.3%) with over 75% patients from Indonesia, 6% from Japan, 3% from Europe and the rest from India, Singapore, Australia, China and the US. The expected strong growth is consistent with Government's continuous efforts to promote Malaysia as a regional hub for healthcare services.

Export Performance

Global economic expansion drives exports further…

Since 1998, Malaysia has consistently recorded substantial trade surpluses, due primarily to the competitiveness of Malaysian products as well as the Government's relentless efforts in export promotion. Malaysia's trade position remains fundamentally strong in 2006, with yet another trade surplus expected, for the ninth consecutive year. In the first six months exports registered growth of 10.6% (January-June 2005: 12.2%). The pace of growth is, however, expected to be stronger for the rest of the year, benefitting from the uptrend in the electronic industry and high commodity prices. Malaysia's gross export earnings free on board (f.o.b) is forecast to grow by 12.4% in 2006 (2005: 11%). By category, exports of manufactured goods which comprise 80.8% of total exports, are projected to increase by 11.3% (2005: 81.6%; 10.4%), following stronger demand for electronic products, especially ICT. Likewise, firm commodity prices are expected to further boost export earnings with exports of major minerals and agriculture produce increasing by 17.3% and 16.3% (2005: 28.8%; 3.5%), respectively.

Exports of Manufactured Goods

Global electronic demand sustains exports…

Exports of manufactured goods sustained its strong growth performance, expanding by 10.4% in the first half of 2006 (January-June

TABLE 3.13

Gross Exports
2005-2006

	RM million		Change (%)		Share (%)	
	2005	2006[1]	2005	2006[1]	2005	2006[1]
Manufactured goods	435,742	484,862	*10.4*	*11.3*	*81.6*	*80.8*
Agricultural goods	33,181	38,592	*3.5*	*16.3*	*6.2*	*6.4*
Mining goods	51,085	59,902	*28.8*	*17.3*	*9.6*	*10.0*
Others	13,780	16,603	*-3.6*	*20.5*	*2.6*	*2.8*
Gross Exports	**533,788**	**599,959**	***11.0***	***12.4***	***100.0***	***100.0***

[1] Estimate.

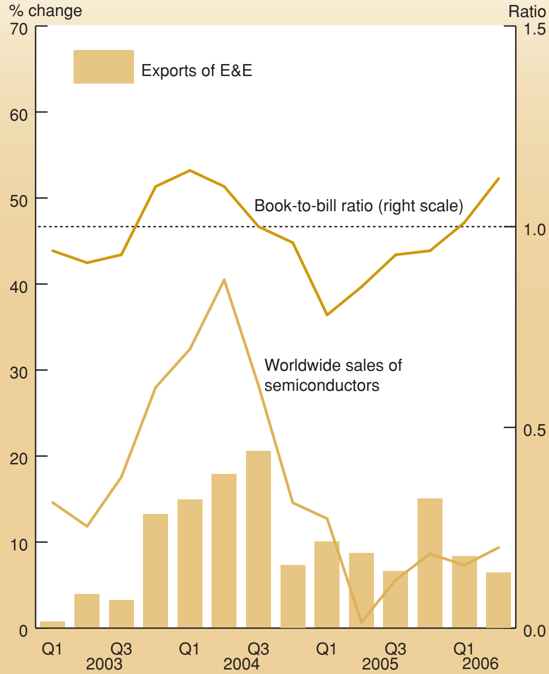
Source: Department of Statistics, Malaysia.

2005: 10.9%), contributed largely by increase in exports of E&E products. Non-E&E exports also registered a strong growth, in particular resource-based products of petroleum, rubber as well as iron and steel.

Export earnings of **E&E** strengthened further by 7.3% (January-June 2005: 9.3 %), constituting 63% of total manufactured exports, bolstered by the 12.7% growth in exports of electronics equipment and parts and 7% growth registered for machinery and electrical products (January-June 2005: 15.9%; 10.6%). Malaysia will continue to benefit from an uptrend in global demand for consumer electronic products, particularly for wireless communication devices and digital equipments, such as 3G cellular phones, personal digital assistants (PDA), digital cameras, PCs and flash memory devices. Meanwhile, semiconductors, another major component of E&E, accounted for 19.7% or RM45 billion of total manufactured exports (January-June 2005: 21.5%; RM44.5 billion). Better growth in global electronic products is anticipated for the second half of 2006 as the global demand for semiconductors is projected to grow by 9.8% in 2006 (2005: 6.8%).

CHART 3.9

Exports of E&E, the Book-to-Bill Ratio and Worldwide Sales of Semiconductors



Source: Department of Statistics, Malaysia, Semiconductor Industry Association (SIA) and Semiconductor Equipment and Materials International (SEMI).

Non-E&E exports registered a stronger growth of 16.2% during the first half of 2006 (January-June 2005: 13.8%), with all industries registering positive growth. Exports of iron and steel, petroleum products and rubber products all benefitted from rising prices. Exports receipts from iron, steel and metal products, particularly to Thailand, Viet Nam, Russia, Italy and Singapore recorded a strong growth of 29.1%. Similarly, export receipts from **petroleum products** registered higher growth of 34.9%, due to both higher export volume and prices.

Exports of **rubber products** recorded stronger growth of 28.1% during the first six months of 2006 (January-June 2005: 10.9%). This is on account of impressive growth in export of rubber materials which surged by 104.4% (January-June 2005: 10.7%), while exports of rubber gloves, in particular surgical and other rubber gloves benefitted from higher external demand and rising prices, to record significant growth of 15.5% (January-June 2005: 8.7%). During the same period, external demand, particularly to meet China's expanding automotive industry, led to a sterling growth of 393.7% in exports of rubber products to the country.

Exports of **textiles, apparels and footwear** also recorded strong performance, as shown in *Table 3.14.* Malaysia's manufacturers and exporters of textiles and apparels have benefitted from the liberalisation of the industry, following the complete phasing out of the Multi-Fibre Arrangement (MFA) and the World Trade Organisation (WTO) Agreement on Textile and Clothing (ATC), which took effect on 1 January 2005. In addition, the lifting of quotas by the European Union (EU) also boosted exports of textiles and apparels.

Exports of **chemicals and chemical products**, accounting for 7.2% of total manufacturing exports, recorded lower growth of 2.1% during the period (January-June 2005: 11.6%), largely due to a 17.5% contraction in exports of organic chemicals, the largest component in the group. **Plastic products,** another major component, achieved impressive growth in line with the sustained growth in the E&E industry. Plastic products are mostly exported as parts and components for E&E and automotive industries.

Exports of **iron, steel and metal products** with a share of 4.9% to total manufactured exports also increased significantly by 29.3% (January-June 2005: 12.8%). This was due to higher exports to Thailand, Viet Nam and Russia as producers actively sought to expand their export markets due to weak domestic demand particularly for construction-related products since the second half of 2005.

Similarly, exports of **transport equipment** recorded an impressive growth of 80% in the first half of 2006 (January-June 2005: 42.3%). This expansion was due to strong export growth of 188.7% in the category of other vehicles, including planes, ships, boats and floating structures. Meanwhile, export of road vehicles recorded a small increase of 0.5% (January-June 2005: 43.7%).

Strong growth was also seen in exports of **other non-E&E** products, such as food, beverages and tobacco, and non-metallic mineral products**,** which

TABLE 3.14

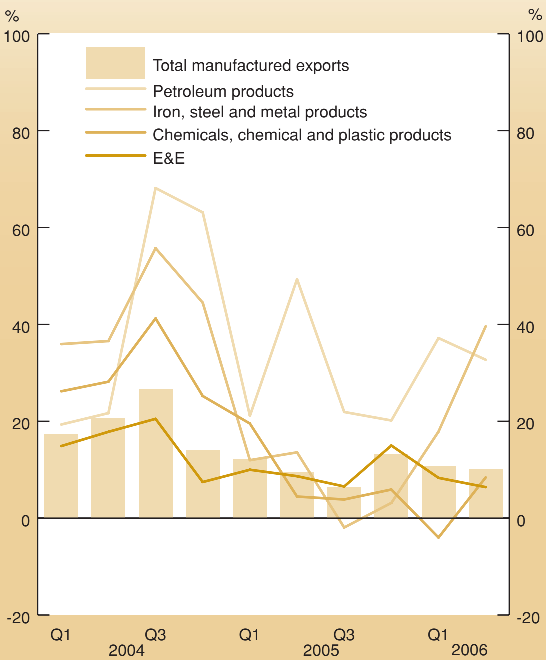
Exports of Manufactured Goods
January-June

	RM million		Change (%)		Share (%)	
	2005	**2006**	**2005**	**2006**	**2005**	**2006**
Electronics, electrical machinery and appliances	**133,888**	**143,673**	***9.3***	***7.3***	***64.8***	***63.0***
Semiconductors	44,523	44,972	*1.3*	*1.0*	*21.5*	*19.7*
Electronic equipment and parts	53,878	60,714	*15.9*	*12.7*	*26.1*	*26.6*
Machinery and electrical products	35,488	37,987	*10.6*	*7.0*	*17.2*	*16.6*
Non-E&E	**72,779**	**84,543**	***13.8***	***16.2***	***35.2***	***37.0***
Chemicals, chemical and plastic products	16,105	16,439	*11.6*	*2.1*	*7.8*	*7.2*
Petroleum products	8,970	12,098	*34.3*	*34.9*	*4.3*	*5.3*
Iron, steel and metal products	8,569	11,082	*12.8*	*29.3*	*4.1*	*4.9*
Wood based products	6,382	6,689	*11.3*	*4.8*	*3.1*	*2.9*
Textiles, apparel and footwear	4,967	5,408	*-0.5*	*8.9*	*2.4*	*2.4*
Food, beverages and tobacco	4,808	5,504	*9.9*	*15.1*	*2.3*	*2.4*
Rubber products	3,317	4,249	*10.9*	*28.1*	*1.6*	*1.9*
Transport equipment	2,814	5,067	*42.3*	*80.0*	*1.4*	*2.2*
Non-metallic mineral products	1,416	1,589	*-7.5*	*12.2*	*0.7*	*0.7*
Other manufactured goods	15,430	16,418	*13.3*	*5.8*	*7.5*	*7.2*
Total	**206,667**	**228,215**	***10.9***	***10.4***	***100.0***	***100.0***

Source: Department of Statistics, Malaysia and MATRADE.

CHART 3.10

Performance of Selected Manufactured Exports
(% annual change)



Source: Department of Statistics, Malaysia.

increased by 14.5% and 12.2%, respectively. Meanwhile, exports of **other manufactured goods** comprising professional and scientific instruments, miscellaneous manufactured articles as well as furniture and parts (except wooden furniture), continued to expand by 6.2% to account for 7.2% of total manufactured export earnings (January-June 2005: 13.3%; 7.5%). Professional and scientific instruments as well as furniture and components are the major contributors to exports in this category.

Exports of Primary Commodities

Export growth supported by price increases and favourable external demand...

Export earnings from primary commodities, comprising agriculture produce and mineral products, are estimated to increase strongly by 16.9% to RM98,494 million in 2006 (2005: 17.5%; RM84,266 million). Growth is expected to emanate from higher export receipts of palm oil, rubber, crude oil as well as liquefied natural gas (LNG) as prices remain firm, supported by strong external demand. Export earnings from **agricultural commodities** increased by 7.5% to RM17,637 million in the first six months of 2006 (January-June 2005: 6.5%; RM16,402 million) and for the year as a whole is expected to grow by 16.3% to RM38,592 million, due to higher prices anticipated in the coming months. Similarly, export receipts from the **mining** sector increased by 17.6% during the same period on account of stronger demand and higher prices of crude oil and natural gas. For the whole year, export earnings from mining are expected to increase by 17.3% to RM59,902 million from RM51,085 million in 2005, mainly on account of higher crude oil prices. Overall, the share of exports of primary commodities to gross exports increased to 15% in the first six months of 2006 (January-June 2005: 11%).

Palm oil exports increased 0.4% to 7.84 million tonnes during the first seven months of 2006 (January-July 2005: 17.2%; 7.8 million tonnes) and remained the largest contributor to total agriculture export earnings with a share of 43.8%. Export volume has generally been on the downtrend in the first half due to lower off-takes from South Asian countries. However, exports rebounded markedly by 13.1% in July on account of strong buying from China and surge in exports to US and EU, particularly the Netherlands, Germany and Denmark. For the whole year, with the anticipated increases in exports and prices, export receipts are projected to grow by 8.4% in 2006.

Average export unit value of palm oil is likely to increase from RM1,453 per tonne in 2005 to RM1,550 per tonne in 2006, due in part to higher demand in Europe, particularly as a substitute for rapeseed oil as feedstock for biodiesel. In addition, efforts are being stepped up to increase awareness of CPO's techno-economic advantages and nutritional value,

TABLE 3.15

Primary Commodity Exports
2005-2006

	2005	2006[1]	Change (%) 2005	Change (%) 2006[1]
Palm oil[2]				
Volume ('000 tonnes)	13,320	14,000	*14.4*	*5.1*
Unit value (RM/tonne)	1,453	1,550	*-15.6*	*6.7*
Value (RM million)	19,351	21,700	*-3.5*	*12.1*
Palm kernel oil				
Volume ('000 tonnes)	761	750	*11.4*	*-1.4*
Unit value (RM/tonne)	2,546	2,533	*0.9*	*-0.5*
Value (RM million)	2,181	1,900	*26.5*	*-12.9*
Saw logs				
Volume ('000 cubic metres)	5,759	5,183	*10.6*	*-10.0*
Unit value (RM/cubic metres)	428	470	*7.6*	*9.9*
Value(RM million)	2,464	2,465	*19.0*	*0.0*
Sawn timber				
Volume ('000 cubic metres)	3,303	3,249	*15.0*	*-1.6*
Unit value (RM/cubic metres)	1,051	1,093	*5.4*	*4.0*
Value (RM million)	3,471	3,550	*21.2*	*2.3*
Rubber				
Volume ('000 tonnes)	1,126	1,160	*-3.6*	*2.8*
Unit value (RM/tonne)	513	754	*9.2*	*47.0*
Value (RM million)	5,787	8,750	*11.3*	*51.2*
Pepper				
Volume ('000 tonnes)	18	21	*-6.3*	*16.8*
Unit value (RM/tonne)	6,733	5,714	*10.3*	*-15.1*
Value (RM million)	121	120	*3.3*	*-0.9*
Cocoa				
Volume ('000 tonnes)	9.3	20	*-2.4*	*115.7*
Unit value (RM/tonne)	5,422	5,370	*-1.5*	*-1.0*
Value (RM million)	50	107	*-3.9*	*113.7*
Crude petroleum				
Volume ('000 tonnes)	18,223	18,405	*-2.4*	*1.0*
Unit value (RM/tonne)	1,611	1,880	*39.1*	*16.7*
Value (RM million)	29,359	34,600	*35.7*	*17.9*
Liquefied natural gas				
Volume ('000 tonnes)	21,948	23,000	*5.9*	*4.8*
Unit value (RM/tonne)	947	1,054	*15.0*	*11.3*
Value (RM million)	20,790	24,242	*21.7*	*16.6*
Tin				
Volume ('000 tonnes)	33.6	34.0	*12.2*	*1.2*
Unit value (RM/tonne)	28	31	*-11.9*	*12.0*
Value (RM million)	935	1,060	*-1.2*	*13.3*
Total value (RM million)	**84,266**	**98,494**	***17.5***	***16.9***

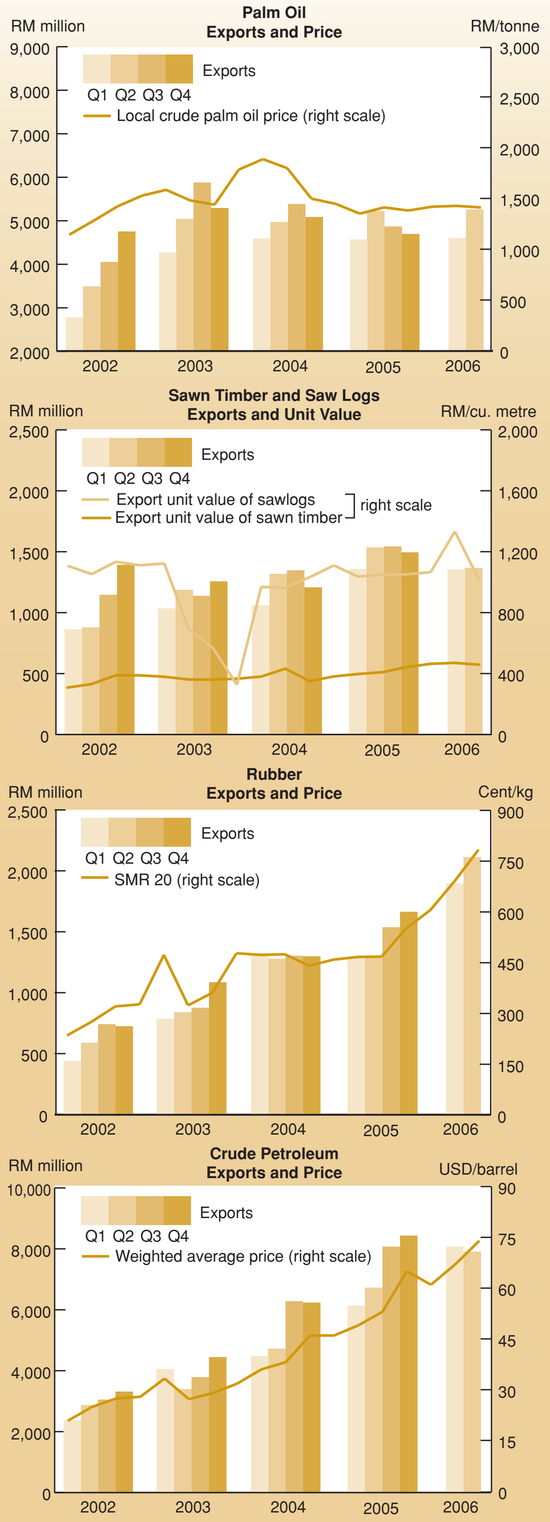
[1] Estimate.

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

Source: Department of Statistics, Malaysia.

CHART 3.11

Primary Commodity Exports



Q - Quarterly.

especially in non-traditional markets through trade promotions, seminars and exhibitions. The lifting of palm oil import quota by China in early 2006 is expected to boost exports as China is currently the leading importer of CPO (24%), followed by the euro area (17.8%) and Pakistan (5.6%). Meanwhile, export receipts from **palm kernel oil** declined by 14.8% to RM1,113 million during the first seven months of 2006 (January-July 2005: 29%; RM1,307 million). Total export earnings of palm kernel oil in 2006, however, is expected to decline by 12.9% to RM1,900 million (2005: 26.5%; RM2,181 million) due to lower export volume.

Export receipts of rubber increased by 55% to RM4,010 million in the first six months of 2006 (January-June 2005: -0.5%; RM2,587 million), following record high prices averaging RM7.19 per kg during the period. With growth in export volume estimated at 2.8% and price remaining high, total export receipts in 2006 are expected to surge by 51.2%. to reach RM8,750 million (2005: 11.3%; RM5,787 million). The export price of rubber is projected to remain high, increasing by 47% to average RM7.54 per kg in 2006 (2005: 9.2%: RM5.13 per kg). The positive outlook on prices is due to a combination of factors, including tight supply and rising external demand, particularly for the expanding automotive industries in China and India as well as for rubber gloves. In addition, total demand for natural rubber is also expected to increase further as manufacturers substitute higher cost crude oil-derived synthetic rubber with natural rubber. Further, the supply of rubber is expected to remain tight with projected low stock levels for the whole year, following unfavourable weather conditions in major producing countries.

Export receipts of **crude petroleum** continued to increase by 24.3% to RM15,976 million (January-June 2005: 38.9%; RM12,855 million) with export prices averaging USD68.9 per barrel (RM1,912 per tonne) in the first six months of 2006 (January-June 2005: USD50.4 per barrel; RM1,455 per tonne). However, export volume declined by 5.4% to 8.357 million tonnes (January-June 2005: -3.8%; 8.834 million tonnes), consistent with lower production due to scheduled maintenance stoppages and increased domestic consumption. Crude petroleum is exported mainly to Australia (20.4%), India (18.7%), Thailand (14.6%), Republic of Korea (11%) and Indonesia (10.5%).

Export earnings of **LNG** continued to expand with a growth of 11.4% (January-June 2005: 24.9%), on account of a 17.6% increase in export prices notwithstanding a decline in export volume. Major importers of LNG continued to be Japan (62%), Republic of Korea (22%) and Taiwan (15%). Malaysia, accounting for 15.7% of global LNG exports, is presently the world's second largest exporter of LNG after Indonesia, with a total export volume of 20.8 million tonnes.

Import Performance

Imports accelerate following strong investment activity…

During the first six months of 2006, gross imports of goods valued at cost, insurance and freight (c.i.f.), registered a 12.6% growth (January-June 2005: 9%), driven by strong demand for capital and intermediate goods following increased investment, particularly in the manufacturing sector as well as oil and gas industries. For the whole of 2006, gross imports are expected to increase at a faster pace of 12.5%, compared with 8.5% in 2005, with imports of capital and intermediate goods growing by 13.3% and 9.3%, respectively. Consistent with recent trends, imports of consumption goods are also expected to register a growth of 13.1%, in line with increasing disposable incomes.

During the first six months of 2006, imports of **intermediate goods** expanded by 7.9% (January-June 2005: 8.1%). This was largely due to higher production activities in the electronics industry, which continued to enjoy strong external demand following the uptrend in the electronics cycle. On a disaggregated basis, imports of parts and accessories of capital goods increased by 6%, (January-June 2005: -0.7%), while imports of industrial supplies increased marginally by 1.1% (January-June 2005: 11.4%). Higher petroleum prices saw the import bill of fuel and lubricants

TABLE 3.16

Gross Imports by End Use
January-June

	RM million		Change (%)		Share (%)	
	2005	2006	2005	2006	2005	2006
Capital goods	**27,794**	**32,550**	***8.8***	***17.1***	***13.5***	***14.1***
Capital goods (except transport equipment)	25,083	27,335	*8.1*	*9.0*	*90.2*	*84.0*
Transport equipment (industrial)	2,711	5,215	*15.8*	*92.4*	*9.8*	*16.0*
Intermediate goods	**147,390**	**159,049**	***8.1***	***7.9***	***71.7***	***68.8***
Food and beverages, primary and processed mainly for industry	4,159	5,344	*-10.4*	*28.5*	*2.8*	*3.4*
Industrial supplies, primary and processed	48,006	48,515	*11.4*	*1.1*	*32.6*	*30.5*
Fuel and lubricants primary, processed, others	12,390	16,196	*63.9*	*30.7*	*8.4*	*10.2*
Parts and accessories of transport equipment	6,003	5,975	*49.0*	*-0.5*	*4.1*	*3.7*
Parts and accessories of capital goods (except thermionic valves and tubes)	26,866	28,466	*-0.7*	*6.0*	*18.2*	*17.9*
Thermionic valves and tubes	49,966	54,553	*0.1*	*9.2*	*33.9*	*34.3*
Consumption goods	**11,610**	**13,190**	***7.3***	***13.6***	***5.7***	***5.7***
Food and beverages, primary and processed, mainly for household consumption	4,440	4,636	*6.0*	*4.4*	*38.2*	*35.2*
Transport equipment (non-industrial)	126	150	*-18.5*	*19.6*	*1.1*	*1.1*
Other consumer goods	7,044	8,403	*8.8*	*19.3*	*60.7*	*63.7*
Durables	1,658	1,859	*15.8*	*12.1*	*23.5*	*22.1*
Semi-durables	2,149	2,899	*-0.2*	*34.9*	*30.5*	*34.5*
Non-durables	3,237	3,646	*12.0*	*12.6*	*46.0*	*43.4*
Others (including dual use goods)	**9,135**	**10,096**	***14.8***	***10.5***	***4.5***	***4.3***
Imports for re-exports	**9,511**	**16,365**	***21.2***	***72.1***	***4.6***	***7.1***
Total	**205,439**	**231,251**	***9.0***	***12.6***	***100.0***	***100.0***

Source: Department of Statistics, Malaysia.

increasing by 30.7% (January-June 2005: 63.9%). Imports of primary and processed materials by the food and beverages industry increased strongly by 28.5% (January-June 2005: -10.4%). Intermediate goods, with a share of 68.8% of total imports (January-June 2005: 71.7%), remained Malaysia's major import component.

Following strong domestic investment activities, imports of **capital goods** surged 17.1% during the first six months of 2006 (January-June 2005: 8.8%). Imports of transport equipment for industrial purposes almost doubled, at 92.4% (January-June 2005: 15.8%), while imports of goods excluding transport equipment increased by 9% (January-June 2005: 8.1%). The strong growth was partly attributed to higher demand for machinery (10.2%) and office equipment

(3.2%).

With rising household income, imports of **consumption goods** increased further by 13.6% to RM13,190 million during the period (January-June 2005: 7.3%; RM11,610 million). Imports of both consumer durables and non-durables grew strongly by 12.1% and 12.6% (January-June 2005: 15.8%; 12%), respectively. Despite its strong growth, the share of consumption goods to total imports remained stable at 5.7% (January-June 2005: 5.7%).

Imports for re-exports, comprising mainly E&E, telecommunication equipment as well as iron and steel products, expanded significantly by 72.1% (January-June 2005: 21.2%). However, it only accounts for 7.1% of total imports (January-June 2005: 4.6%). These imports were mainly reassembled, packed and labelled in the free commercial zones at major ports and airports and were re-exported largely to Singapore, Thailand, the US, China and Hong Kong.

Trade Performance

Trade surplus in 2006 is expected to remain substantial...

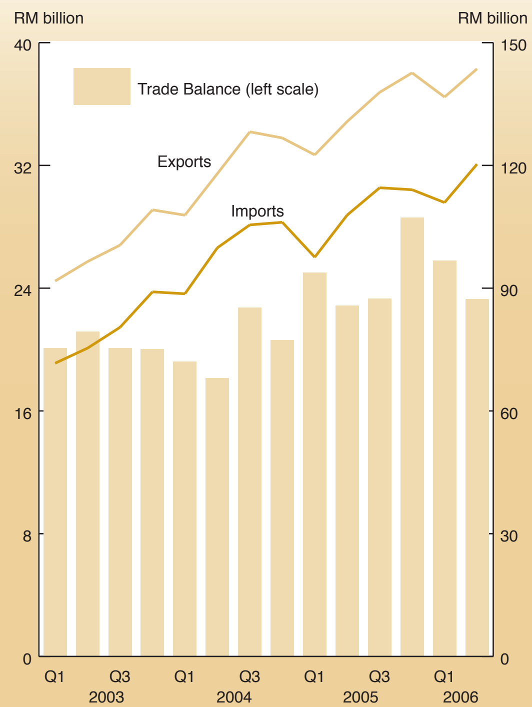
Following higher global growth, Malaysia's total trade increased further by 11.5% to RM511,514 million during the first six months of 2006 (January-June 2005: 10.7%; RM458,748 million). Exports accounted for more than half (54.8%) of total trade, while the trade balance with the rest of the world remained large at RM49,013 million during the period (January-June 2005: RM47,870 million). As in the past, the US, Singapore and Japan were Malaysia's largest trading partners and trade with these countries accounted for 41.4% of total trade (January-June 2005: 42.1%). In tandem with increasing intra-regional trade among ASEAN members, total trade with these economies (not including Singapore) expanded further by 12.7% in the first half of 2006, accounting for 12.3% of Malaysia's total trade (January-June 2005: 16.7%; 12.2%).

The **US** maintained its position as Malaysia's main trading partner with a total trade of RM84,516 million or 16.5% of total trade (January-June 2005: RM75,310 million; 16.4%). Exports to the US expanded by 9% (January-June 2005: 15.6%), while imports from the US turned around and grew strongly by 18.1% (January-June 2005: -5.4%). With imports outpacing export growth, Malaysia recorded a lower trade surplus of RM21,365 million (January-June 2005: RM21,847 million) in the first six months of 2006. Manufactured goods, in particular office and automatic data processing machines as well as electrical machinery, apparatus, appliances and parts, were the main products exported, while imports were mainly parts for electronic integrated circuits and micro assemblies, electrical machinery and parts as well as optical and scientific equipment.

Malaysia's total trade with **Singapore,** the second most important trading partner, with a share of 13.9% of total trade or RM71,112 million expanded by 12.4% (January-June 2005: 17.1%), with exports picking up by 13.8% (January-June 2005: 18.9%) and imports increasing by 10% (January-June 2005: 14%). Export items

CHART 3.12

Balance of Trade



Source: Department of Statistics, Malaysia.

TABLE 3.17

Direction of External Trade

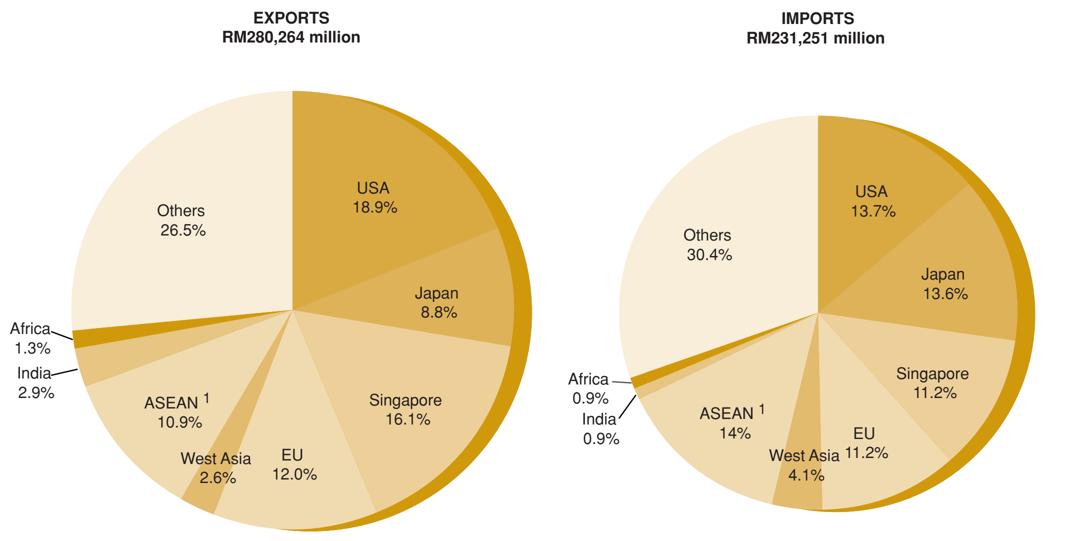
January-June

	Exports Change (%)		Exports Share (%)		Imports Change (%)		Imports Share (%)		Trade Balance RM million	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
United States	***15.6***	***9.0***	***19.2***	***18.9***	***-5.4***	***18.1***	***13.0***	***13.7***	**21,847**	**21,365**
Singapore	***18.9***	***13.8***	***15.7***	***16.1***	***14.0***	***10.0***	***11.5***	***11.2***	**16,148**	**19,290**
Japan	***8.0***	***-0.5***	***9.7***	***8.8***	***-4.5***	***5.0***	***14.6***	***13.6***	**-5,286**	**-6,911**
North East Asia (not including Japan)	***5.7***	***7.8***	***18.8***	***18.3***	***16.7***	***17.1***	***23.9***	***24.8***	**-1,452**	**-6,115**
China	*6.4*	*12.1*	*6.4*	*6.5*	*26.2*	*21.7*	*10.9*	*11.8*	-6,116	-9,000
Hong Kong SAR	*7.3*	*-1.2*	*5.9*	*5.3*	*-4.7*	*20.0*	*2.3*	*2.5*	10,171	9,031
Republic of Korea	*13.6*	*15.4*	*3.8*	*3.9*	*6.0*	*22.4*	*5.0*	*5.4*	-721	-1,552
Taiwan	*-7.7*	*6.9*	*2.7*	*2.6*	*21.3*	*2.2*	*5.7*	*5.2*	-4,808	-4,594
ASEAN (not including Singapore)	***18.7***	***12.3***	***10.7***	***10.9***	***15.0***	***13.1***	***14.0***	***14.0***	**-1,564**	**-1,984**
Thailand	*30.7*	*7.3*	*5.6*	*5.4*	*10.4*	*14.7*	*5.4*	*5.5*	3,107	2,512
Indonesia	*21.8*	*4.4*	*2.4*	*2.3*	*6.6*	*18.5*	*3.8*	*4.0*	-1,674	-2,848
Philippines	*-1.7*	*7.2*	*1.4*	*1.4*	*27.8*	*-12.7*	*3.0*	*2.3*	-2,503	-1,458
Viet Nam	*-5.1*	*82.8*	*0.8*	*1.3*	*81.5*	*46.6*	*0.7*	*1.0*	550	1,548
Brunei	*-12.8*	*12.1*	*0.2*	*0.2*	*77.3*	*271.2*	*0.0*	*0.0*	534	533
European Union	***4.0***	***13.6***	***11.7***	***12.0***	***7.9***	***4.8***	***12.0***	***11.2***	**4,937**	**7,785**
Germany	*4.2*	*11.8*	*2.1*	*2.1*	*2.0*	*7.0*	*4.4*	*4.2*	-3,701	-3,703
Netherlands	*13.3*	*15.1*	*3.2*	*3.3*	*-14.2*	*22.9*	*0.7*	*0.8*	6,678	7,576
United Kingdom	*-8.3*	*6.5*	*1.8*	*1.8*	*0.3*	*-1.8*	*1.6*	*1.4*	1,307	1,674
France	*-6.2*	*13.8*	*1.2*	*1.3*	*16.8*	*14.1*	*1.4*	*1.5*	183	201
Italy	*-11.5*	*34.4*	*0.5*	*0.7*	*45.5*	*0.7*	*1.2*	*1.0*	-999	-540
Ireland	*70.3*	*-18.5*	*0.4*	*0.3*	*37.8*	*0.2*	*0.7*	*0.6*	-515	-687
South Asia	***23.9***	***14.5***	***3.9***	***4.0***	***-24.3***	***10.5***	***1.0***	***1.0***	**7,722**	**8,926**
India	*27.9*	*16.5*	*2.7*	*2.9*	*-25.8*	*9.5*	*1.0*	*0.9*	4,946	5,903
West Asia	***4.1***	***15.9***	***2.5***	***2.6***	***63.8***	***50.3***	***3.0***	***4.1***	**70**	**-2,070**
United Arab Emirates	*20.4*	*6.3*	*1.3*	*1.3*	*47.0*	*26.0*	*0.6*	*0.7*	2,103	1,998
Saudi Arabia	*8.4*	*-4.9*	*0.4*	*0.3*	*91.2*	*57.3*	*1.2*	*1.7*	-1,589	-3,073
Iran	*0.1*	*22.7*	*0.2*	*0.3*	*132.7*	*59.5*	*0.3*	*0.4*	-19	-249
Oman	*28.5*	*6.1*	*0.1*	*0.1*	*27.7*	*106.0*	*0.4*	*0.8*	-685	-1,576
Australia	***16.9***	***8.0***	***3.2***	***3.2***	***35.9***	***-6.3***	***2.0***	***1.7***	**4,033**	**4,951**
New Zealand	***-15.3***	***115.8***	***0.3***	***0.5***	***-3.1***	***-6.8***	***0.3***	***0.3***	**58**	**925**
Africa	***31.9***	***5.1***	***1.4***	***1.3***	***14.5***	***68.2***	***0.6***	***0.9***	**2,281**	**1,593**
Rest of the world	***11.7***	***28.3***	***2.9***	***3.4***	***20.9***	***-1.5***	***4.1***	***3.5***	**-925**	**1,258**
Total	***12.2***	***10.6***	***100.0***	***100.0***	***9.0***	***12.6***	***100.0***	***100.0***	**47,870**	**49,013**
RM billion			**253.3**	**280.3**			**205.4**	**231.3**		

Source: Department of Statistics, Malaysia.

CHART 3.13

Direction of Trade
January-June 2006



[1] Not including Singapore.

Source: Department of Statistics, Malaysia.

comprised mainly electrical machinery, apparatus, appliances and parts, while intermediate E&E and refined petroleum were the main imports. Malaysia registered a higher trade surplus of RM19,290 million in the first six months of 2006 compared with RM16,148 million in the corresponding period of 2005.

Japan remained Malaysia's third most important trading partner. Total trade with Japan expanded further to RM56,011 million or 2.5%, representing 11% of Malaysia's total trade (January-June 2005: RM54,652 million; 0.8%; 11.9%). Exports, consisting mainly electrical machinery, apparatus, appliances and parts, telecommunication and sound equipment as well as LNG, contracted by 0.5%. Total import bill from Japan, on the other hand, grew by 5% to RM31,461 million, comprising mainly digital monolithic integrated units, machinery, appliances and parts as well as transport equipment. With imports outpacing exports, Malaysia's trade deficit with Japan widened further to RM6,911 million (January-June 2005: -RM5,286 million).

Malaysia's trade with **China** grew by 17.7%, accounting for 8.9% of Malaysia's total trade during the first six months of 2006 (January-June 2005: 17%; 8.4%). China remained as Malaysia's fourth most important trading partner with exports registering a growth of 12.1% during the period. Electrical machinery, apparatus, appliances and parts as well as chemicals and chemical products were the major export items. Imports from China, comprising mainly E&E products, increased steadily by 21.7% to reach RM27,189 million (January-June 2005: 26.2%; RM22,341 million). Hence, trade deficit with China widened further to RM9,000 million (January-June 2005: -RM6,116 million).

Trade with **ASEAN** (not including Singapore) expanded further by 12.7% (January–June 2005: 16.7%), reflecting increasing intra-regional trade among member countries. Exports, comprising mainly electrical machinery, apparatus, appliances and parts, chemicals and chemical products as well as crude petroleum, grew by 12.3% (January-June 2005: 18.7%) while imports, consisting mainly E&E, chemicals and chemical products, as well as palm oil increased further by 13.1% (January-June 2005: 15%). With imports exceeding exports, Malaysia registered a trade deficit of RM1,984 million with ASEAN (January-June 2005: -RM1,564 million), largely on account of trade deficits with Indonesia (RM2,848 million) and the Philippines (RM1,458 million).

Malaysia's total trade with the **EU** increased by 9.6% to RM59,580 million and accounted for 11.6% of Malaysia's total trade (January-June 2005: 5.7%; RM54,348 million; 11.8%). Exports increased by 13.6% (January-June 2005: 4%) and comprised mainly high quality value-added E&E products. Imports also followed the same trend and increased by 4.8% (January-June 2005: 7.9%). The bulk of imports were parts for electronic integrated circuits and micro assemblies as well as chemicals and chemical products. In the first six months of 2006, the EU contributed 15.9% or RM7,785 million (January-June 2005: 10.3%; RM4,937 million) of Malaysia's total trade surplus.

Balance of Payments

Balance of payments position strengthens further...

Malaysia's robust domestic economic fundamentals and prospects for further improvements are reflected in its strong current account balance. In 2006, the current account surplus is expected to remain high at 16.7% of GNP. In addition, higher inflows of FDI are expected to further strengthen Malaysia's overall BOP position. Consistent with these developments, the nation's international reserves are expected to continue to remain strong, usable and unencumbered.

With nominal exports continuing to outpace imports, the **goods account** is estimated to record a substantial surplus of RM137,879 million in 2006 (2005: RM125,562 million). The projected 12% growth in exports (f.o.b) is mainly on account of the improvement in global demand for semiconductors, following the upturn in the industry. At the same time, firm commodity prices and demand for resource-based products, such as chemicals, rubber and

TABLE 3.18

Current Account of the Balance of Payments
2006-2007
(RM million)

	2006[1]			2007[2]		
	Receipts	**Payments**	**Net**	**Receipts**	**Payments**	**Net**
Goods	**601,212**	**463,333**	**137,879**	**655,215**	**509,463**	**145,752**
Services	**77,071**	**88,472**	**-11,401**	**83,577**	**96,918**	**-13,341**
Transportation	13,663	35,529	-21,866	14,997	40,211	-25,214
Travel	36,255	14,538	21,717	40,362	15,990	24,372
Other services	26,691	37,571	-10,880	27,727	39,811	-12,084
Government transactions	462	834	-372	491	906	-415
Income	**22,272**	**44,841**	**-22,569**	**23,683**	**45,296**	**-21,613**
Compensation of employees	4,709	5,135	-426	5,106	5,448	-342
Investment income	17,563	39,706	-22,143	18,577	39,848	-21,271
Current transfers	**1,162**	**17,197**	**-16,035**	**1,219**	**17,298**	**-16,079**
Current account	**701,717**	**613,843**	**87,874**	**763,694**	**668,975**	**94,719**

[1] Estimate.
[2] Forecast.

petroleum products, are expected to further support export growth. Meanwhile, imports of goods (f.o.b) are envisaged to increase by 12.6% to RM463,333 million in 2006 (2005: 9.2%; RM411,393 million), largely due to higher imports of capital and intermediate goods.

The **services account,** which comprises transportation, travel, government transactions and other services, is expected to register a higher deficit of RM11,401 million (2005: -RM9,010 million). Travel receipts, the main contributor to the services account earnings, are envisaged to grow further by 8.2% to reach RM36,255 million (2005: 7.5%; RM33,500 million) in tandem with the Government's vigorous efforts in promoting Malaysia as the premier destination for holidays, seminars, education and health tourism. On the payments side, rising affluence and increasing business activities are expected to result in travel outflows, increasing by 3.5% to RM14,538 million (2005: 19.5%; RM14,051 million). Meanwhile, other components in the services account will continue to record net outflows, contributing to the overall deficit in the services account.

The **income account** is expected to improve further to record a lower deficit of RM22,569 million (2005: -RM23,908 million) in 2006, mainly due to an increase in profits and dividends accruing to Malaysian companies operating abroad. As in past years, these receipts are mainly from the oil and gas, utilities and manufacturing activities abroad. In addition, returns from external reserve holdings is expected to raise gross receipts of the income account by 9.5% to RM22,272 million (2005: 27%; RM20,346 million). Meanwhile, profits and dividends accruing to foreign direct investors are expected to increase marginally, leading to gross outflow of RM44,841 million (2005: RM44,255 million) in the income account. Nevertheless, a substantial portion of these profits and dividends is expected to be retained in Malaysia and reflected as inflows in the financial account of the balance of payments.

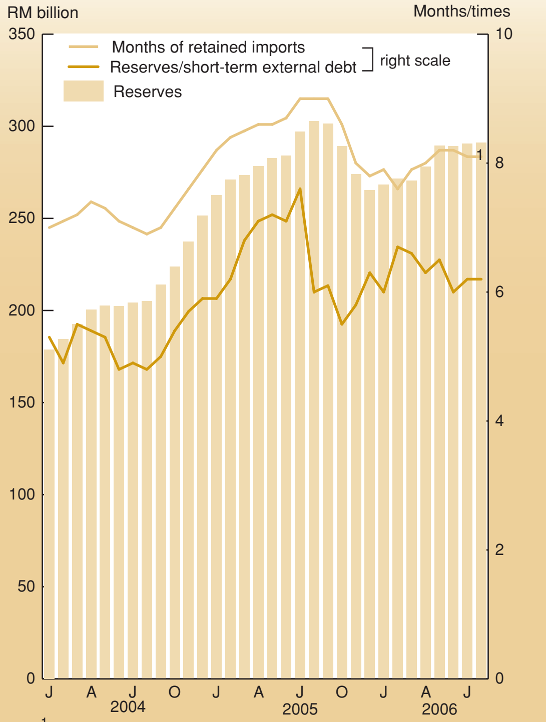
The **transfers account** mainly records the remittances by Malaysians working abroad as well as the repatriation of earnings by foreigners in Malaysia. In line with Government efforts to reduce the number of illegal workers in the country, gross payments are expected to decline by 5% to RM17,197 million in 2006 (2005: 10.8%; RM18,095 million), while gross receipts from Malaysians working abroad are expected to rise by 2.7% to RM1,162 million (2005: -33.5%; RM1,131 million). Accordingly, net outflows in the transfers account are estimated at RM16,035 million in 2006 (2005: -RM16,963 million).

The **financial account** is expected to improve following higher inflows of FDI in the form of new and reinvestments credited from the income account. FDI in the manufacturing sector is projected to increase with the implementation of approved projects, mainly in the high-end electrical and electronic activities, particularly electrical products and consumer electronics. Likewise, investment in the services sector is also expected to rise following the liberalisation and entry of new players in the finance, insurance, real estate and business services sub-sector as well as the expansion of operations in the wholesale and retail trade, hotels and restaurants sub-sector. A sizeable inflow of investment into the oil and gas industry is also expected, following the discovery of several oil fields. In tandem with the strategic efforts of Malaysian companies to diversify business activities and have a strong global presence, investments abroad by Malaysian companies is expected to increase further in 2006. Such investments are mainly in the oil and gas, manufacturing, utilities, construction and services sectors.

International reserves is one of the key determinants of the strength of an economy and reflects the value of its currency. Malaysia's international reserves remained strong, reaching RM291,051 million as at 15 August 2006 compared to RM265,263 million as at end-December 2005. The increase in reserves was on the back of sustained repatriation of export earnings and steady inflows of foreign capital. The reserves position as at 15 August 2006 is adequate to finance 8.1 months of retained imports and is 6.2 times Malaysia's short-term external debt, compared to 7.8 months and 6.3 times as at end-December 2005.

CHART 3.14

International Reserves

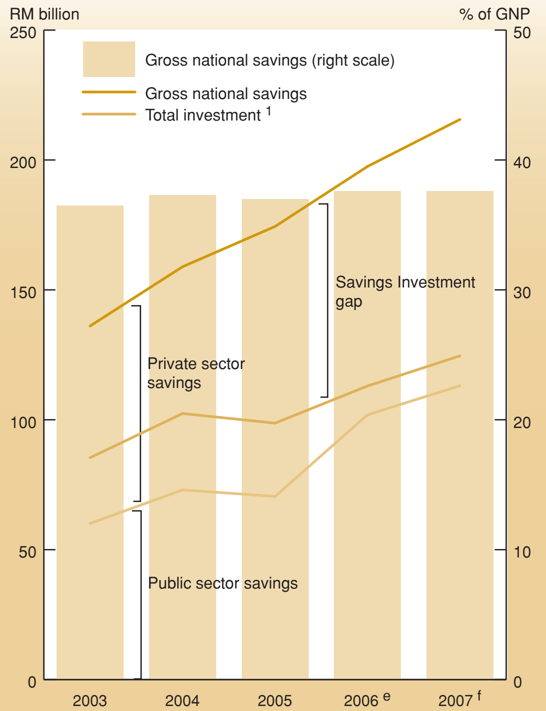


[1] As at 15 August 2006.

Source: Bank Negara Malaysia.

CHART 3.15

Savings Investment Gap



[e] Estimate.

[f] Forecast.

[1] Including change in stocks.

National Resource Position

Savings-investment gap remains strong…

Domestic economic fundamentals are expected to improve further with the **savings-investment gap** projected to record a significant surplus, totalling RM87,874 million or 16.7% of GNP in 2006 (2005: RM75,681 million; 16.1% of GNP). The favourable position is attributable to higher **Gross National Savings (GNS)** estimated at 38.2% of GNP, expanding by 15.2% to RM200,836 million (2005: 9.8%; RM174,410 million). With a strong growth of 11.6% (2005: 10.7%) in GNP, GNS is expected to increase further as total consumption is projected to expand moderately. The public sector is expected to contribute about 51% to total GNS, partly due to high oil revenue (2005: 40.4%). Meanwhile, total investment expenditure is estimated (including change in stocks) at RM112,962 million, contributing 21.5% to GNP (2005: RM98,729 million; 20.9%), which is projected to be lower than GNS. Hence, with the projected surplus in the national resource position, there is ample liquidity in the financial system which can be mobilised to finance domestic economic activities, helping to reduce pressure on interest rates.

Prices

Higher energy costs fuelled inflationary pressures…

Effective January 2006, the Consumer Price Index (CPI) was rebased to 2005 with nine existing groups reclassified into 12 groups in order to reflect changes in household expenditure pattern. The three new groups are transport, communication and education. A comparison between the old and revised groupings is shown in *Table 3.19.*

TABLE 3.19

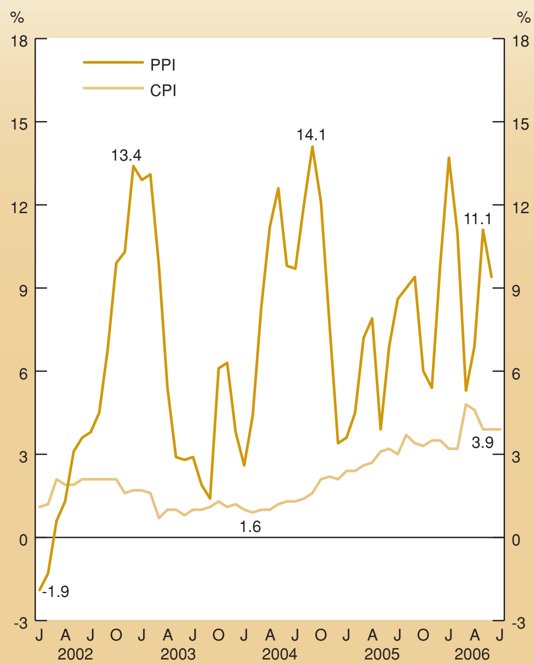
Reclassification of Consumer Price Index (CPI)

2000=100	Weight	2005=100	Weight
Total	**100.0**	**Total**	**100.0**
Food	33.8	Food and non-alcoholic beverages	31.4
Beverages and tobacco	3.1	Alcoholic beverages and tobacco	1.9
Clothing and footwear	3.4	Clothing and footwear	3.1
Gross rent, fuel and power	22.4	Housing, water, electricity, gas and other fuels	21.4
Furniture, furnishing and household equipment and operation	5.3	Furnishings, household equipment and routine household maintenance	4.3
Medical care and health expenses	1.8	Health	1.4
Transport and communication	18.8	Transport	15.9
Recreation, entertainment, education and cultural services	5.9	Communication	5.1
Miscellaneous goods and services	5.5	Recreation services and culture	4.6
		Education	1.9
		Restaurants and hotels	3.0
		Miscellaneous goods and services	6.0

Inflation, as measured by the CPI (2005=100), edged up to a record high of 4.8% in March 2006, the highest since the 1997/98 Asian Financial Crisis. During the first seven months of 2006, CPI rose by 3.9% following higher energy costs, due to the effects of adjustment in administered retail prices of petroleum products and electricity tariffs. The international benchmark of crude oil price, West Texas Intermediate (WTI) spot price increased sharply to peak at USD68.35 per barrel on 30 January 2006 compared with an average spot price of USD56.59 per barrel in 2005. Following this, effective 28 February 2006, the Government announced a 30 sen per litre/kg increase in retail prices of premium petrol (18.5%), diesel (23.4%) and liquefied petroleum gas (LPG) (20.7%). The full effect is, however, expected to moderate towards the later part of the year as the second round effects are expected to subside. This comes with an assurance from the Government that there will be no further price increases in administered petroleum products in 2006. Meanwhile, the Government will continue to focus on efforts to curb unjustified price hikes, profiteering as well as hoarding activities.

CHART 3.16

Trend of CPI and PPI
(% annual change)



Source: Department of Statistics, Malaysia.

TABLE 3.20

Consumer Price Index (CPI)
January-July
(2005=100)

	Weight	Change (%) 2006	Contribution to CPI growth (%) 2006
Total	**100.0**	***3.9***	***100.0***
Food and non-alcoholic beverages	31.4	*3.5*	*29.9*
Alcoholic beverages and tobacco	1.9	*7.0*	*3.5*
Clothing and footwear	3.1	*-1.2*	*-1.0*
Housing, water, electricity, gas and other fuels	21.4	*1.5*	*8.4*
Furnishings, household equipment and routine household maintenance	4.3	*1.2*	*1.4*
Health	1.4	*2.6*	*0.9*
Transport	15.9	*12.6*	*50.2*
Communication	5.1	*-1.3*	*-1.9*
Recreation services and culture	4.6	*0.8*	*0.9*
Education	1.9	*1.4*	*0.7*
Restaurants and hotels	3.0	*4.2*	*3.3*
Miscellaneous goods and services	6.0	*2.4*	*3.7*

Source: Department of Statistics, Malaysia.

To assist those adversely affected by price increases, the Government has introduced a special diesel subsidy scheme for fishermen and transport operators. Two schemes, the Fishermen *e*-Diesel System and the Fleet Card System, were introduced in March 2006 to enable fishermen and eligible transport operators to purchase diesel at subsidised prices.

Transport, food and utilities together contributed 88.5% to the CPI increase during the first seven months of 2006. The **transport** group with a weightage of 15.9% registered a strong increase of 12.6%, contributing 50.2% to the total increase in the CPI during the period. The sub-group of fuels and lubricants recorded a marked increase of 25.6% during the same period, mainly attributed to the rise in retail prices of petroleum products.

Food and non-alcoholic beverages as a group, with the highest weightage of 31.4%, contributed 29.9% towards the CPI increase during the first seven months of 2006. This group, however, registered an increase of only 3.5%, mainly due to rising prices of fresh seafood (9.7%), fresh fish (8.8%) and fresh vegetables (7.1%). This resulted in the price of **food at home** edging up to 3.5%, and **food away from home** by 3.8%. Excessive rain and floods affected supplies of selected vegetables. Prices of seafood and fresh fish also increased in the first seven months of 2006 on account of inclement weather conditions in Peninsular Malaysia. Strong consumer demand during festive seasons as well as the numerous social and cultural activities during school holidays also added pressure to prices in the sub-sector.

Meanwhile, the **housing, water, electricity, gas and other fuels** group, with a weightage of 21.4%, registered a marginal increase of 1.5% during the period, contributing 8.4% to the increase in CPI. The increase was mainly due to the higher prices of cooking gas and kerosene, with rent, water and sewerage charges and electricity tariffs remaining relatively stable. However, **clothing and footwear** group and the **communication** group registered a decline of 1% and 1.3%, respectively, during the period due to greater competition, cheaper imports and intensive promotional activities. The remaining groups registered relatively small price increases.

By region, the CPI for **Peninsular Malaysia** registered an increase of 3.9% while **Sabah** and **Sarawak** recorded 4.1% and 4.4%, respectively in the first seven months of 2006. The higher CPI in Sabah and Sarawak was largely due to the increase in the prices of transport and food.

TABLE 3.21

Producer Price Index (PPI)
January-June
(1989=100)

	Weight	Change (%)		Contribution to PPI growth (%)	
		2005	2006	2005	2006
Domestic economy	**100.0**	***5.7***	***9.4***	***100.0***	***100.0***
Food and live animals chiefly for food	14.9	*3.6*	*1.2*	*11.0*	*2.6*
Beverages and tobacco	2.1	*2.0*	*1.6*	*0.9*	*0.5*
Crude materials, inedible except fuels	18.0	*0.0*	*11.7*	*0.0*	*30.8*
Mineral fuels, lubricants and related materials	18.8	*27.6*	*24.6*	*108.9*	*67.6*
Animal and vegetable oils and fats	8.5	*-19.6*	*-1.6*	*-34.8*	*-2.0*
Chemicals and related products	4.4	*3.6*	*-1.8*	*3.3*	*-1.2*
Manufactured goods, classified chiefly by material	10.8	*3.3*	*0.7*	*7.5*	*1.1*
Machinery and transport equipment	18.3	*0.6*	*0.0*	*2.1*	*0.0*
Miscellaneous manufactured articles	3.6	*1.5*	*1.1*	*1.1*	*0.6*
Commodities and transactions not classified elsewhere in the SITC[1]	0.6	*0.0*	*0.8*	*0.0*	*0.1*
Local production	**79.3**	***6.4***	***11.1***	***87.2***	***74.5***
Imports	**20.7**	***1.9***	***0.5***	***12.8***	***25.5***

[1] Standard International Trade Classification.

Source: Department of Statistics, Malaysia.

Producer Price Index (PPI) accelerated to 9.4% in the first six months of the year (January-June 2005: 5.7%) as a result of high crude oil prices, leading to double-digit increases in the **mineral fuels, lubricants and related materials** group by 24.6% (January-June 2005: 27.6%) and **crude materials, inedible except fuels** group by 11.7% (January-June 2005: 0%). Nevertheless, the **animal and vegetables oils and fats** group posted a relatively lower negative growth of 1.6% (January-June 2005: -19.6%) largely on account of significant decline of palm kernel oil prices. Meanwhile, the PPI for **imports** registered lower growth at 0.5% (January-June 2005: 1.9%), in part due to ringgit appreciation, rendering imports cheaper. PPI for local production was, however, higher at 11.1% during the period (January-June 2005: 6.4%) due to rising energy costs.

Labour Market

Greater emphasis on human capital development...

Labour market conditions are expected to remain favourable in 2006, especially in the second half with rising employment opportunities underpinned by stronger domestic economic activities and positive business sentiment. **Total employment** in 2006 is expected to increase further by 2.3% to reach 11.1 million (2005: 4.1%; 10.9 million) in tandem with **labour force** growth of 2.3% as shown in *Table 3.22*. The services sector will continue to provide the highest employment opportunities, followed by manufacturing and agriculture. The unemployment rate is projected to remain low at 3.5%, maintaining full employment for 15 consecutive years.

TABLE 3.22

Labour Market Indicators

	('000)		Change (%)	
	2005	2006[1]	2005	2006[1]
Labour force	11,290.5	11,544.5	*4.1*	*2.3*
Employment	10,892.9	11,142.4	*4.1*	*2.3*
Unemployment	397.6	402.1	*3.5*[2]	*3.5*[2]

[1] Estimate.

[2] Percentage of labour force.

Source: Economic Planning Unit.

The overall **labour force participation** rate is expected to remain high at 66.9% in 2006 (2005: 65.7%). Participation by males is expected to increase to 86.7%, and females to 46.1% (2005: 86.6%; 45.7%). Although the overall female participation rate is still low compared with advanced countries, participation of women with tertiary education has been on the uptrend in recent years. The proportion of overall labour force with tertiary education is projected to increase to 21.2% in 2006 (2005: 20%), in line with the Government's concerted efforts at enhancing the quality of human capital in the country.

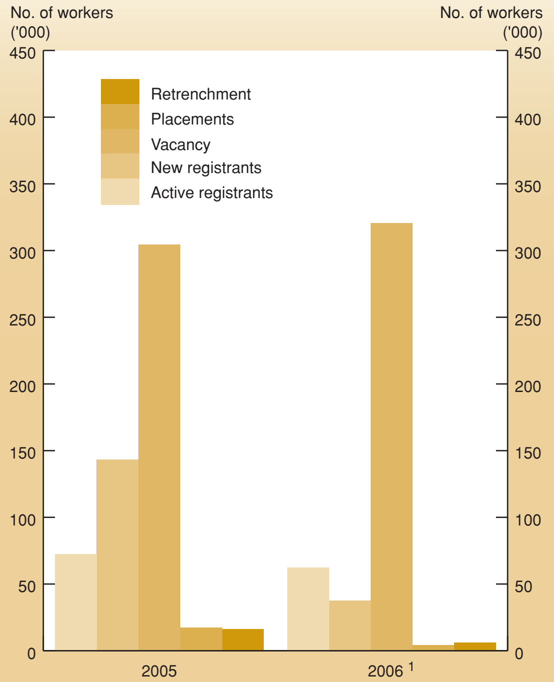
Given a strong employment market, the number of **job seekers** registered with the Electronic Labour Exchange (ELX) at the Manpower Department of the Ministry of Human Resources (MOHR) declined to 70,718 persons as at end-June 2006 (end-June 2005: 78,546 person). Over half the job seekers (40,057) were in the 20-24 years age group, with another 24.2%, in the 25-29 years age group. Female job seekers (59.6%; 42,155) outnumbered the males. Among the job seekers, 52.9% were *Sijil Tinggi Persekolahan Malaysia* (STPM), diploma and degree holders.

Job vacancies registered with the ELX as at 2005 increased to 304,500, following strong domestic economic activities, positive business sentiment and better growth prospects of the economy. Out of the total registered, vacancies for diploma and degree holders numbered 24,779 (8.1%). Job vacancies during the first six months of 2006 increased significantly to 396,745 (January-June 2005:44,084), including 12,468 posts for graduates. The most number of vacancies were registered in the manufacturing (42.5%) and the services sectors (20.3%).

The Industrial Relations Department (IRD) reported only one case of industrial strike in the first five months of 2006, involving 172 workers and 516 'man-days' lost (2005: 3 cases; 1,020 workers; 4,793 'man-days' lost). IRD continues to play its role in maintaining a harmonious environment in the labour market. Industrial action is normally resolved through active intervention, consultations as well as negotiations between parties, thereby ensuring high productivity.

CHART 3.17

Job Market Indicators



[1] January-June.

Source: Ministry of Human Resources.

TOTAL FACTOR PRODUCTIVITY AND INVESTING IN HUMAN CAPITAL

Introduction

Malaysia is gradually shifting from input-driven to productivity-driven growth with increasing contribution from Total Factor Productivity (TFP), of which the quality of human capital is an important component. In this regard, the Government is committed to further enhance human capital development by undertaking comprehensive improvement in the education system, encouraging Research and Development (R&D) and adopting new technologies.

Importance of TFP

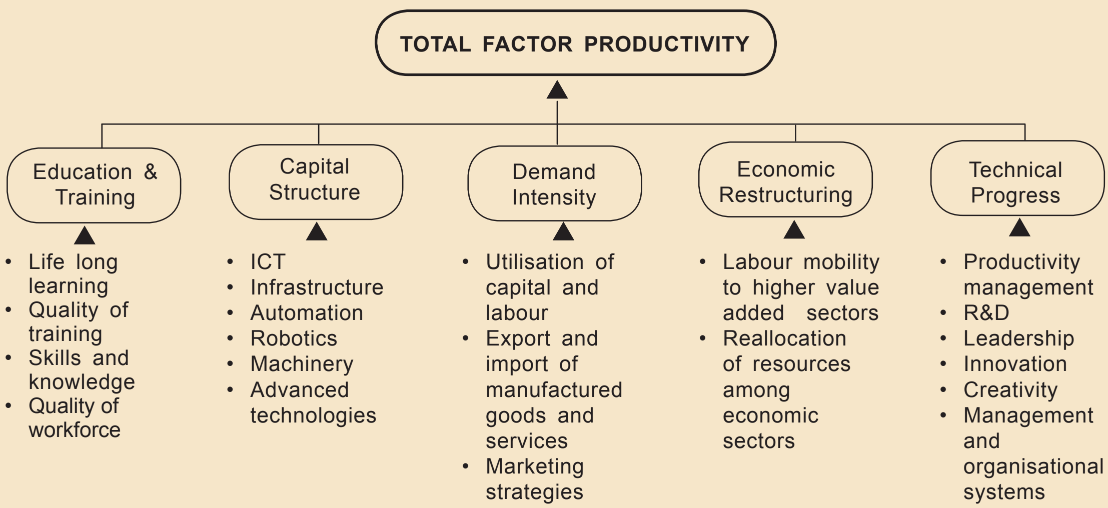
TFP is a measure of the efficiency with which an economy's productive inputs and technology are used in the production process. TFP improvement is realised through increasing output without a corresponding increase in the quantity of inputs, achieved by efficient and effective utilisation of both labour and capital.

Economic development strategies that are overly dependent on the use of physical inputs are not sustainable. Hence, long term growth requires greater emphasis on TFP, where improvements through use of knowledge, skills and technology are essential. Recognising this, since the Seventh Malaysia Plan (1996-2000), Malaysia has shifted its economic development strategy from one of input-driven to productivity-driven growth. For the period 1996-2005, TFP grew by 1.6% per annum.

Components of TFP

In Malaysia, the components of TFP[1] can be classified into 5 categories as shown in *Chart 1.*

Chart 1: Sources of Total Factor Productivity Growth



[1] Components of TFP as categorised by Malaysia's National Productivity Corporation (NPC)

a) **Education and training***:* Investment in human capital helps enhance the capacity and capability of the workforce. Generally, better trained workers are more productive and produce more quality goods and services. In addition, educated and skilled workers are more adaptable as they have a steep learning curve, enabling them to operate new systems and use advanced technologies. For the period 1996-2005, tertiary enrolment in public institutions of higher learning increased to 390,388 students in 2005 from 114,390 in 1996, while training under Human Resource Development Fund (HRDF) has benefited an average of some 400,000 workers each year. The large number who had received training during this period, helped push the contribution of education and training to TFP growth to 30.6%.

b) **Demand intensity***:* The extent to which productive capacity of the economy is utilised is another contributor to TFP growth. Buoyant demand for Malaysia's products and services, both locally and internationally, increased capacity utilisation, thereby helping to bring up demand intensity's contribution to 29.9% during 1996-2005.

c) **Capital structure***:* Capital structure, which refers to the proportion of investment in productive capital inputs, contributed 17.4% to TFP growth during 1996-2005 (1991-1995: 29.8%), indicating a shift to a higher level of technology The more intensive application of ICT, usage of advanced machinery and adoption of capital intensive processes had enhanced production efficiencies, leading to a more competitive and resilient economy. In 2005, total investment in the manufacturing sector was RM31.1 billion. With increased R&D and innovation activities as well as adoption of new emerging technologies, capital structure will continue to be a significant source of TFP growth. Investments in new and advanced machinery and equipment can increase output quality and help to reduce the costs of production.

d) **Economic restructuring***:* Economic restructuring involves inter and intra-movement of resources among industries and economic sectors. The reallocation of resources to more productive industries or sectors will lead to efficient and effective utilisation of resources, contributing to higher TFP growth. Economic restructuring, which contributed 12.2% to TFP growth, reflected the movement of workers among economic sectors. The economy has been successful in reallocating the workforce from low value added activities of traditional sectors to modern sectors.

e) **Technical progress***:* Technical progress indicates the effective and efficient utilisation of appropriate technologies, innovation, R&D and good organisational system. Improvements in technical progress will create higher value-added products and services. It contributed 10.2% to TFP growth, largely attributed to the implementation of productivity and quality initiatives, such as Quality Assurance, Standardisation, Total Quality Management, Productivity Linked Wage System and Benchmarking. Good management practices coupled with creative, innovation and positive mindset are crucial for creating high value-added products and services that will contribute to enhance TFP growth.

Human Capital Development

The Ninth Malaysia Plan (2006-2010), has reiterated the importance of shifting towards productivity-driven growth to move the economy on a faster growth track. During the Plan period, labour productivity is expected to grow by 3.8% per annum, while TFP is expected to grow at 2.2%. To achieve this growth, productivity and competitiveness across all sectors of the economy must be enhanced. From the human capital perspective, there is a need to raise capacity for knowledge and innovation as well as nurture a productive mindset. The adoption and application of new technology is crucial for value creation and rationalising costs. Over time, there is a need to manage costs of doing business in view of rising input prices. Industries must continuously seek more creative and innovative ways to remain competitive through operational efficiencies and effectiveness. The Government will continue to improve the public sector delivery system, so as to facilitate an environment conducive for doing business.

In the early 1990s, Malaysia was one of the countries that experienced high economic growth, backed by strong inflows of foreign direct investment (FDI). A relatively lower labour cost, stable socio-political environment and business friendly Government policies were the main attributes that attracted FDI to Malaysia. However, after the 1997/98 Asian financial crisis, countries such as China, India and Vietnam have emerged as strong contenders for FDI given their abundant low cost labour, giving them a competitive edge over Malaysia. In order to remain competitive, Malaysia needs a highly educated, skilled and trainable labour force.

In this regard, the thrusts of human capital development under the 9MP are as follows:

i. undertaking comprehensive improvement of the education and training delivery systems;

ii. strengthening national schools to become the school of choice for all Malaysians to enhance national unity;

iii. implementing measures to bridge the performance gap between rural and urban schools;

iv. creating universities of international standing and ensuring that tertiary institutions meet the needs of employers;

v. providing more opportunities and access to quality education, training and lifelong learning at all levels;

vi. nurturing an innovative society with strong science and technology capabilities and the ability to acquire and apply knowledge;

vii. strengthening national unity and developing a society with a progressive outlook, exemplary value system and high performance culture as well as with an appreciation for tradition and heritage; and

viii. enhancing the forum of engagement and consultation between the Government, private sector, parents and community in human capital development.

The above thrusts are supported by several fiscal incentives to encourage education and training. They are as follows:

i. automatic child relief for each child studying in local or recognized overseas institutions of higher learning;

ii. relief to disabled child pursuing tertiary education;

iii. individual tax relief of RM5,000 for pursuing further education in professional courses, such as accountancy and law;

iv. tax deductions on expenses incurred for development and regulatory compliance of new courses by private institutions of higher learning; and

v. double tax deduction to public listed companies on allowances paid to participants under the Unemployed Graduates Training Programme.

Education

Education is key to developing human capital and increases the skills and knowledge of individual workers, allowing them to accomplish particular tasks better and to adapt more easily to changing job requirements. Skills and knowledge base of the labour force improves productivity and defines the competitive profile of industry and business in an increasingly competitive global economy. It is now a leading public policy theme in Organization for Economic Cooperation and Development (OECD) countries as it reduces unemployment and income inequality, and is a key determinant of economic growth. Given its importance, Malaysia allocates a large portion of its expenditure for human capital development. Total allocation for education and training under the 9MP is RM50.6 billion or 23% of total development allocation.

Training and Retraining

Many countries are beginning to realise the importance of equipping their labour force with the right skills in a modern and diverse workplace so that they are able to do a range of jobs and are capable of working in a knowledge-based economy. The introduction of new technologies is also likely to require a highly educated and skilled workforce. Therefore, opportunities for on-the-job training and skills upgrading are crucial to ensure the workforce remains productive in a rapidly changing environment. Malaysia, therefore, places great emphasis in providing ample opportunities for its labour force to improve skills and know-how on a continuous basis.

Lifelong Learning

Lifelong learning has become a prerequisite for economic development in a knowledge-based economy. The acquisition of new knowledge and competencies will enhance an individual's employability and adaptability. For the organisation and the country, educated and trained workers will keep them ahead of competition. Lifelong learning is, therefore, one of the crucial components of a coordinated strategy to promote a skilled, knowledgeable, trained and flexible workforce. Creating learning opportunities at all stages of life involves all parties, such as Government, the private sector, non-governmental organisations (NGOs), communities, families and individuals. For example, at the organisational level, investments in lifelong learning programmes should be a part of continuous efforts to enhance overall competency of each employee to ensure that they are ready to face the challenges in their work environment. The Government, on the other hand, will continue to provide the physical infrastructure and facilities for learning, training and skills upgrading and encourage all Malaysians to make full use of these facilities to fully realise their potential.

Conclusion

Achieving higher TFP growth is an integral aspect of enhancing quality growth and development. At its core is human capital development, which encompasses educational attainment, skills upgrading and ability to adopt and adapt new technologies as well as to innovate and generate new ideas. Education, training and retraining as well as lifelong learning are factors that enhance the quality of human capital and are crucial in producing a highly productive workforce to meet challenges as Malaysia progresses towards its target of achieving a developed nation status by 2020.

TABLE 3.23

Employment by Sector

	('000)		Change (%)		Share (%)	
	2005	2006[1]	2005	2006[1]	2005	2006[1]
Agriculture, forestry, livestock and fishing	**1,401.4**	**1,387.2**	***-0.4***	***-1.0***	***12.9***	***12.4***
Mining and quarrying	**42.7**	**42.8**	***0.2***	***0.2***	***0.4***	***0.4***
Manufacturing	**3,133.3**	**3,238.0**	***5.4***	***3.3***	***28.8***	***29.1***
Construction	**759.6**	**762.7**	***-1.0***	***0.4***	***7.0***	***6.8***
Services	**5,555.9**	**5,711.6**	***5.3***	***2.8***	***51.0***	***51.3***
Electricity, gas and water	93.0	95.2	*3.4*	*2.4*	*0.9*	*0.9*
Wholesale and retail trade, hotels and restaurants	1,927.0	1,990.8	*7.9*	*3.3*	*17.7*	*17.9*
Finance, insurance, real estates and business services	734.4	762.0	*5.7*	*3.8*	*6.7*	*6.8*
Transport, storage and communication	630.6	646.4	*6.1*	*2.5*	*5.8*	*5.8*
Government services	1,052.8	1,064.0	*1.1*	*1.1*	*9.7*	*9.5*
Other services	1,118.1	1,153.2	*4.8*	*3.1*	*10.3*	*10.3*
Total	**10,892.9**	**11,142.3**	***9.5***	***5.7***	***100.0***	***100.0***
Primary	1,444.1	1,430.0	*-0.4*	*-1.0*	*13.3*	*12.8*
Secondary	3,892.9	4,000.7	*4.1*	*2.8*	*35.7*	*35.9*
Tertiary	5,555.9	5,711.6	*5.3*	*2.8*	*51.0*	*51.3*

[1] Estimate.

Source: Economic Planning Unit.

Increasing overall labour **productivity** contributed to reducing the unit labour cost (ULC), keeping wages stable. In 2005, labour productivity grew by 3% and is expected to increase further to 3.3% in 2006. Productivity growth in the manufacturing sector increased by 3.8% in 2005. Monthly Manufacturing Statistics (MMS) showed that productivity of the manufacturing sector in the first six months of 2006 recorded a slower decline of -1.4% (January-June 2005: -2.4%). Wage pressures in the short term are expected to remain subdued, given the negative growth in average wage by 2% and a decline in real unit labour cost by 0.6% (January-June 2005: -11.2%).

Efforts are underway to reduce the dependence on **foreign workers** by encouraging greater automation and mechanisation of labour intensive industries. It is envisaged that by 2010 the number of foreign workers in the country will be reduced to 1.5 million, with 250,000 remaining in the manufacturing sector and 200,000 in the construction sector. As at end-June 2006, there were 1.84 million registered foreign workers (end-March 2006: 1.85 million). Of this total, 33.3% were employed in manufacturing, plantation (20.2%), services (25.9%) (including domestic maids) and construction (15.1%) sectors. The majority of foreign workers were from Indonesia (64.7%), Nepal (10.7%), India (7.4%) and Myanmar (5.2%). In the services sector, about 317,391 (66.5%) were employed as domestic maids, of whom 90% were Indonesians.

Recently, Malaysia through bilateral agreements, eased employment conditions for hiring foreign maids with the implementation of an 'open market system', where employment terms are negotiated between the employer, employee, and the employment agency. The open system is applicable to all maids irrespective of their country of origin.

Foreign workers are also employed in the hospitality industry, especially in hotels, restaurants and other business services outlets. As part of ongoing efforts to encourage local workers in this industry, the Government has allocated RM30 million under the 9MP to *Pembangunan Sumber Manusia Berhad* (PSMB) to train 5,000 Malaysians annually to meet industry needs. This programme is expected to, among others, offer more apprentice training schemes designed to focus on developing multi-tasking skills in the hospitality industry.

The Government has made it mandatory for all employers in the construction, manufacturing and services sectors to advertise their vacancies through the ELX to create greater awareness of existing job opportunities. Employers in the three main sectors are required to advertise vacancies for a duration of one week for the plantation sector, two weeks for services and a month for the manufacturing sector to provide ample opportunities for Malaysians to take up the vacancies, failing which foreign workers may be considered.

As at end-June 2006, a total of 33,448 **expatriates** (end-2005: 33,062) were employed in the country as professionals, specialists and skilled workers, mainly in the services (45.1%) and manufacturing (39.5%) sectors. The majority of them were from India (20.8%), Japan (11.2%) and China (10.7%). Expatriates from India were mainly engaged in the ICT-related sector, while those from Japan and China were employed in manufacturing. The Government is actively promoting the 'Brain Gain' programme to encourage qualified Malaysians working abroad to return home.

Outlook 2007

Malaysian Economy

Continuation of broad-based growth with positive contribution from sustained domestic demand...

The Malaysian economy is expected to strengthen in 2007, despite a more challenging external environment. This optimism is underpinned by continued expansion of private sector activities, complemented by Government's pragmatic policies and strategies to diversify and promote the new sources of growth. Overall, real GDP growth is envisaged to expand at 6% in 2007 (2006: 5.8%), consistent with the growth targets outlined in the 9MP. Growth will continue to be broad-based with positive contribution from all sectors of the economy. With the encouraging economic prospects, nominal GNP per capita is projected to rise by 7.2% to reach RM21,168 (2006: 9.4%; RM19,739), reflecting improvements in the well-being of the *rakyat*. In terms of PPP, per capita income is expected to increase by 6.7% to reach USD12,666 (2006: 11.8%; USD11,871).

Domestic Demand

Private sector continues to spearhead growth...

Consistent with the favourable growth prospects of the economy, **aggregate domestic expenditure** (excluding change in stocks) in real terms is expected to continue to increase by 7.1% in 2007 (2006: 7.8%), underpinned largely by higher investment spending and sustained consumption. **Private sector expenditure,** which is envisaged to grow by 7.2% (2006: 7.6%), will continue to support domestic economic activities. On the other hand, **public sector expenditure** is expected to moderate to 6.7% in 2007 (2006: 8%), supported by Government expenditure as well as capital expenditure of the Non-Financial Public Enterprises (NFPEs), particularly for programmes and projects in infrastructure, human capital and social development. The public sector is therefore projected to contribute a lower 2 percentage points to GDP growth in 2007 (2006: 2.4 percentage points), while the private sector's contribution remains high at 4.6 percentage points (2006: 4.7 percentage points).

With strengthening business sentiment, **private investment expenditure** is projected to post strong growth of 10.5%, to account for 13% of GDP (2006: 10.1%; 12.5% of GDP). Continued robust investment is anticipated in the manufacturing and manufacturing-related services sectors following Government's continuing efforts to promote the deepening and further diversification of the manufacturing sector in the production of high value-added products. Furthermore, as part of measures to encourage DDI, SMEs are also expected to participate actively in domestic economic activities as outlined in the Third Industrial Master Plan (IMP3), 2006-2020.

Investment activities in the agriculture sector are expected to gain momentum in consonance with the Government's renewed emphasis on revitalising the sector through large-scale mechanisation and modernisation in farm management. Meanwhile, investment in the services sector is expected to further expand capitalising on recent advances in technology, particularly in the telecommunications, banking and finance sector, as well as in trade and logistics. Spurred by the persistently high crude oil prices and expectations of increasing global demand amidst tight supply, investment activities in the oil and gas industries are expected to further accelerate in 2007. Recent discoveries of oil and gas reserves will also boost investments in the industry.

As consumer confidence is expected to remain buoyant with rising disposable incomes, in part due to higher export earnings and better employment prospects, **private consumption** expenditure is projected to increase by 6.4% in 2007 (2006: 7.1%). Meanwhile, **public consumption** is projected to remain firm at 5.4% (2006: 5.5%), following anticipated increases in expenditure for supplies and services as part of ongoing efforts to further improve the Government's administrative machinery and delivery system. In the medium and long term, these initiatives are expected to further enhance the nation's productivity and competitiveness, thereby providing impetus to growth. With 9MP underway, the RM44,510 million allocated for development expenditure in 2007 (2006: RM35,814 million) will drive **public investment** in real terms to increase by 8% (2006: 10.6%). The expected increase will also be supported by capital outlays of NFPEs.

Sectoral Outlook

Higher growth with brighter outlook in construction sector…

On the supply side, all sectors are projected to record positive growth, led by the manufacturing and services sectors. The manufacturing sector is expected to expand in line with sustained global electronics demand and the continuing strong pace of domestic economic activities. The services sector is forecast to strengthen, benefitting from VMY 2007, which will intensify tourism activities and generate higher earnings, in particular from the wholesale and retail trade, hotels and restaurants sub-sector. Capacity expansion in transport infrastructure, higher investment in communication services industry as well as robust finance and business-related activities will also continue to support the growth momentum in the services sector. Meanwhile, the expansion of the agriculture sector is projected to continue, spurred by favourable commodity prices and Government's committed and focused efforts to diversify and modernise the sector, particularly the production of food commodities to help reduce the high food import bill. Growth in the construction sector is expected to accelerate, boosted by the implementation of infrastructure projects under the 9MP.

In consonance with growing intra-regional trade and strong domestic economic activities, growth of the **manufacturing sector** is envisaged to expand by 6.8% (2006: 7.3%). This growth is also supported by new developments and the shift towards technology-driven manufacturing processes amidst greater intensity in R&D activities. The establishment of the electronics cluster in the northern corridor of Peninsular Malaysia, including expansion of Kulim Hi-Tech Park, will meet the growing demand for hi-tech electronics manufacturing activities. Industrial cluster developments in other corridors outlined in the 9MP will further stimulate growth in the manufacturing sector, particularly the development of petrochemicals cluster in the East Coast Development Corridor (ECDC) and the South

Johor Economic Region (SJER) as well as POIC in Sabah. Trickle-down effects are expected to benefit industries linked to these developments. They include among others, industries relating to construction, such as iron and steel; cement and concrete as well as chemical and chemical products such as LPG and fertilisers.

The **agriculture sector** is envisaged to grow by 4.7% in 2007 (2006: 5.3%), largely supported by sustained production of palm oil and higher output of food crops. Expansion in matured areas and improvements in yield as well as higher oil extraction rates are expected to contribute to higher output of palm oil in 2007. Production of rubber is expected to register a moderate increase largely due to increased tapping following higher demand and prices. Food production is envisaged to expand further with the Government's policy to reduce the food import bill and promote self sufficiency by 2010 through expansion of cultivated areas, utilisation of idle lands and mechanisation of farming methods as well as promotion of good farming practices. Areas of activity that will boost growth of the agriculture sector include aquaculture, deep sea fishing, seaweed farming, ornamental fish breeding, floriculture as well as herbs cultivation.

The growth of the **mining sector** is expected to increase strongly by 4.5% in 2007 (2006: 2.4%), due to higher production of **crude oil and gas**, following capacity expansion in upstream activities. Output of crude oil is projected to be higher by 5.5% (2006: 3%), on account of the expected increase from new oil fields coming on stream in 2007. Production of natural gas is anticipated to grow by 3.3% (2006: 3.5%), supported by higher capacity utilisation of the MLNG2 and MLNG3 plants in Sarawak.

Meanwhile, the **construction sector** is anticipated to grow at a higher rate of 3.7% in 2007 (2006: 0.7%), spurred by the acceleration in civil-engineering activities, following the implementation of new infrastructure projects under the 9MP. Major projects that are expected to boost growth of the sector include the Pulau Pinang Second Bridge, Pulau Pinang Monorail System as well as the SJER projects. Activities in the residential and non-residential sub-sectors are also envisaged to remain active, supported by sustained demand for housing as well as buoyant business and industrial activities.

In tandem with favourable developments in the economy, the **services sector** is poised to register a higher growth of 6% in 2007 (2006: 5.7%). Growth will be broad-based, propelled by demand for retail and hospitality services, telecommunications, transport as well as business and financial services. Growth in the tourism sector is expected to emanate from higher tourist arrivals, special promotional activities and programmes in conjunction with VMY 2007. A total of 20.1 million tourist arrivals are expected in 2007 (2006: 17.5 million). Meanwhile, increased bank lending and other financial activities will boost growth of the finance, insurance, real estate and business services sub-sector. The transport, storage and communication sub-sector is forecast to record strong growth from capacity expansion in the transport infrastructure, investment by telecommunication companies as well as higher business and trade-related activities. In addition, significant developments taking place in the vicinity of Port Klang will further stimulate port activities, transport logistics and business-related activities and provide additional impetus to growth in the sub-sector.

External Trade

Current account surplus remains substantial...

Malaysia's BOP in 2007 is expected to remain robust with the current account recording a substantial surplus for the tenth consecutive year since 1998. The current account balance will be underpinned by a strong surplus amounting to RM145,752 million in the goods account. With sustained global E&E demand

and firm commodity prices, exports (f.o.b.) are expected to grow by 9% to RM655,215 million, while imports (f.o.b.) are anticipated to pick up by a further 10% to RM509,463 million. As in previous years, manufactured goods will contribute the highest proportion of total exports with intermediate goods constituting the bulk of total imports.

The **services account** is expected to record a higher deficit in 2007. In contrast, the deficit in the income account is envisaged to narrow on account of higher repatriation of profits and dividends from Malaysian companies operating overseas. Net outflows in the transfers account, comprising mainly remittances by foreign workers, are envisaged to increase marginally in 2007. The surplus in the goods account will be more than sufficient to offset the net outflow in the services, income and transfers accounts. Consequently, the current account will continue to record a large surplus equivalent to 16.5% of GNP in 2007 (2006: 16.7% of GNP).

National Resource Position

Savings-investment surplus continues to remain large...

In line with the anticipated expansion in domestic economic activities and higher export earnings, GNP in current prices is projected to register a strong growth of 9.4% in 2007 (2006: 11.6%). Taking into account the 9.3% growth in total consumption spending, GNS will increase by 10.3% to reach RM221,544 million in 2007 (2006: 15.2%; RM200,836 million). Thus, the share of GNS as a percentage of GNP will remain high at 38.5% (2006: 38.2%). Although total investment expenditure (including change in stocks) is projected to increase strongly by 12.3% to RM126,825 million to account for 22% of GNP (2006: 14.4%; RM112,962 million; 21.5%), the **savings-investment gap** in 2007 is expected to remain substantial at RM94,719 million or 16.5% of GNP (2006: RM87,874 million; 16.7%).