Economic Management and Outlook

Overview

Malaysia's fifty years of nationhood marks another milestone in its economic development. Upon independence the nation was highly reliant on tin and rubber and more than half of the population were in poverty. Today, Malaysia is a broad-based and diversified economy. It is the 19th largest trading nation in the world, with trade in excess of RM1 trillion. Malaysia continues to enjoy political stability with a diverse yet united population. At the same time, per capita income has increased 26 times to RM20,841 and the incidence of poverty has also been reduced to less than 6.0%.

The Government's far-sighted and pro-business policies were instrumental in the transformation of the economy. This transformation enabled Malaysia to achieve a higher growth trajectory compared to the growth achievable as a primary commodity-based economy. Going forward, the Government has articulated the National Mission, which commits to continuing the structural transformation towards becoming a developed nation by 2020.

Towards this goal, economic management in 2007 is focussed on enhancing domestic resilience to facilitate growth and development as envisaged in the National Mission. In this context, initiatives were taken to encourage the private sector to assume a leading role in economic development. Efforts were taken to liberalise the Foreign Investment Committee (FIC) guidelines, reduce corporate tax to 26% in 2008 and attract investment through special incentives, particularly in the Iskandar Development Region (IDR). Towards strengthening human capital development, three key policy documents, namely the Education Blueprint 2006-2010, the Strategic Plan for Higher Education: Laying the Foundation Beyond 2020 and the Higher Education Action Plan 2007-2010 were launched, setting the stage for the creation of an innovative and skilful workforce. Efforts were also undertaken to address security and safety concerns as well as improve the public transportation system to enhance the quality of life of the population. To further improve the public delivery system, a special task force comprising high-level government officials and captains of industry (PEMUDAH) and the Public Delivery Monitoring Panel (Panel 3P), were established to review and improve Government processes and procedures. One such initiative is the setting up of one-stop centres (OSCs) to expedite approval and delivery of completed properties.

While pursuing these measures, the Government remains committed towards growth with equity and prudent fiscal management. Towards equitable and balanced growth, key initiatives include initiating five economic corridors across the country, intensifying efforts on the eradication of hardcore poverty and furthering the Bumiputera agenda, such as through the establishment of Pelaburan Hartanah Bumiputera Berhad (PHBB). The Government is both pragmatic and prudent in maintaining a sustainable deficit. The increase in Government spending is fully supported by higher revenues. The progressive consolidation of the fiscal deficit to 3.2% of nominal Gross

Domestic Product (GDP) in 2007, provides the Government with flexibility to respond to external shocks. Domestic consumption-led growth and the diversification of the economy continue to strengthen domestic resilience, particularly in the context of global uncertainties arising from global imbalances and the recent market volatility caused by the subprime mortgage issue.

Performance Review

The 2007 Budget was formulated as a building block towards achieving the targets set in the Ninth Malaysia Plan (9MP), and onwards to realise Vision 2020. Towards this, the National Mission articulates five key development policy thrusts namely; to move the economy up the value chain; to raise the capacity for knowledge and innovation and nurture 'first class mentality'; to address persistent socio-economic inequalities constructively and productively; to improve the standard and sustainability of quality of life; and to strengthen the institutional and implementation capacity. Therefore, 2007 Budget was formulated with the theme **'Implementing the National Mission towards Achieving the National Vision',** to translate the National Mission into programmes and projects to sustain economic growth.

Fiscal Operations in 2007

The 2007 Budget introduced several incentives to improve the country's attractiveness to foreign and domestic investors, enhance competitiveness and spur economic activities. The Government's expenditure helped to strengthen domestic demand, diversify sources of growth and augment private sector activity. These expenditures also brought about greater dispersion of wealth and income, particularly benefitting the less privileged groups in both rural and urban areas.

In 2007, total expenditure is expected to increase by 14.8% to RM164,743 million. The increased spending is based on better revenue performance from both tax and non-tax sources, which are expected to contribute RM96,196 million and RM45,593 million, respectively to total revenue in 2007. With increased expenditure matched by higher revenue, the Government will further consolidate the fiscal deficit at 3.2% of nominal GDP. This deficit will be secured by striking a balance between long-term economic growth and fiscal sustainability.

The operating expenditure continues to emphasise programmes and projects that have high impact on domestic demand while strengthening macroeconomic fundamentals to promote broad-based growth. With regard to development expenditure, the focus is on raising the capacity for economic expansion and enhancing social services. These include better access to education, human resource development as well as uplifting the quality of life and standard of living of the population. The fiscal deficit will continue to be financed largely by non-inflationary domestic sources. The high savings rate provides ample liquidity in the banking and financial system, sufficient to meet the needs of the Government and private sector borrowings.

Moving the Economy Up the Value Chain

Key Role for the Private Sector

The National Mission requires the private sector to play a leading role in moving the economy up the value chain. To facilitate this, the Government implemented many pro-business policies including reducing the corporate tax rate to 27% in 2007 and to 26% in 2008. To further reduce the cost of doing business, several incentives have been approved. These include a 10-year tax exemption for venture capital companies that invest at least 50% of their investments in seed capital. Cooperatives and trust bodies are given tax deductions of up to 2.5% of aggregate income paid as *zakat*. To bring certainty and transparency in tax administration, a Customs Tribunal was established in addition to advance rulings provided by both Royal Customs Malaysia and the Inland Revenue Board. In addition, the launch of economic corridors provides opportunities for higher private investment.

PEMUDAH was established to facilitate business activities through improving the public delivery system. At the same time, several initiatives are underway, including process improvements at the Immigration Department for expatriate positions. In addition, the Department of Environment undertakes to evaluate Environmental Impact Assessment Reports within five weeks of submission compared to about three months previously. Given these developments, private investment is envisaged to grow 7.1% and contribute 0.8 percentage points to real GDP growth.

Modern and Commercial Agriculture Sector

The agriculture sector will be revitalised as the third pillar of economic growth. In this regard, the sector will be transformed into a modern, commercial and competitive sector. Tangible achievements have been made in modernising the sector. Malaysia remains the leading palm oil producer and exporter, and efforts were taken to enhance value added activities in the industry. In this regard, the Biofuel Bill was passed in 2007 to kick-start the biodiesel industry. In addition, a RM500 million Biodiesel Fund was established to promote the production and use of biodiesel. As of 28 March 2007, approval was granted to nine companies and the projects are currently at various stages of implementation.

Efforts to encourage the private sector to venture into new sources of growth, in particular the agro-food sub-sector are ongoing. Large-scale commercial production of food was undertaken through the establishment of Permanent Food Production Parks (PFPP). These parks are aimed at creating entrepreneur farmers with a minimum income of RM3,000 per month. As of end-March 2007, 31 PFPP covering 2,426 hectares are in operation. In addition, the commencement of operations at the Integrated Deep Sea Fishing Port in Tanjong Manis, Sarawak, will boost the development and commercialisation of deep-sea fishing and related processing activities. Meanwhile, the establishment of the Aquaculture Industry Zone in Sungai Como, Terengganu will increase high quality aquaculture produce.

The Government continues with its efforts in developing a viable and competitive *halal* industry and to encourage Malaysian entrepreneurs to venture into this business. In this regard, the Government established the Halal Development Corporation as a lead agency to spearhead standards, increase production capacity, facilitate investment and promote the Malaysian *halal* brand. In addition, to alleviate poverty among traditional farmers and fishermen, the Government continues to promote agro-business as an alternative activity. This will enable them to be independent and generate a more stable income. In this regard, the Government is commited to develop 10,000 agro-entrepreneurs to help turn agriculture into a commercially viable sector. As of July 2007, a total of 2,600 agro-entrepreneurs with a minimum net income of RM2,000 per month were nurtured.

A Dynamic Services Sector

The Government will intensify its efforts in creating a dynamic services sector by targeting the tourism, information and communications technology (ICT), logistics, Islamic finance, education and health sub-sectors. As tourism contributes significantly to foreign exchange earnings, various programmes and incentives are in place to ensure that the 20.1 million tourist arrivals and revenue target of RM44.5 billion is achieved. The policy to promote Malaysia as an attractive Meetings, Incentives, Conventions and Exhibitions destination will result in receipts increasing by more than 70% to RM4.5 billion. To further promote tourism and make Malaysia a preferred travel destination, the Government reduced airport taxes for both domestic and international travel at the low-cost carrier terminals in Sepang and Kota Kinabalu.

As for the financial sector, measures taken over the years to build its capacity and capability have enhanced the resilience and ability of banking institutions to operate in a more challenging and competitive environment. The banking sector has strengthened with strong capitalisation and declining non-performing loans. Islamic finance, which was initially promoted as a niche area, experienced phenomenal expansion to become an important source of growth with total assets of RM143.7 billion and garnering 12.1% of total assets of the banking sector as at end-June 2007. In terms of Islamic bonds, Malaysia is the world's largest issuer of *sukuk,* accounting for about two-thirds of total *sukuk* issuance, while outstanding Islamic bonds constitute 52% of the domestic corporate bond market.

The Kuala Lumpur Composite Index charted new highs several times this year and reached a record all-time high of 1,392.18 points on 24 July 2007 with market capitalisation of RM1,081 billion or 188.8% of GDP. The Malaysian bond market, the largest in South East Asia and among the largest in Asia-Pacific accounted for RM527 billion as at end-July 2007 or 92.1% of GDP. Meanwhile, the inclusion of Malaysian Government bonds into the Citibank World Government Bond Index, an international benchmark for sovereign bonds on 1 July 2007, is expected to attract greater foreign interest in Malaysian bonds. In line with these positive developments, the services sector will register solid growth of 9.0%.

Stimulating the Construction Sector

The construction sector with its strong linkages was further boosted, following the announcement of several infrastructure projects under the 9MP. As of 30 June 2007, 26.0% of the RM44.5 billion allocation was spent with 29,913 projects in various stages of implementation. These include the Rawang-Ipoh Double Tracking Project, Integrated Transport Terminal in Bandar Tasik Selatan, widening of Penang Bridge and projects under the economic corridors. In addition, the sector was aided by more than 34,000 projects for building and maintenance of public infrastructure and small development projects in rural areas. Several Government initiatives enhanced the sector further. These include the exemption on Real Property Gains Tax, waiver of FIC guidelines on foreign ownership of properties above RM250,000, incentives for build-then-sell concept as well as the establishment of OSCs for building and development planning approvals. Given these initiatives, the construction sector is expected to expand by 5.2% in 2007.

Raising the Capacity for Knowledge and Innovation and Nurture 'First Class Mentality'

Priority continues to be accorded to further strengthen human capital development by undertaking a review and realignment of the education system. This is to produce a workforce that is knowledgeable, skilful and innovative and able to compete in a globalised environment. At the same time, character building continues to be given emphasis with greater student participation in co-curricular activities. Towards this, considerable resources have been set aside to ensure that educational infrastructure is adequate to raise the quality of teaching-learning process and the standard of schools, especially to uplift rural schools to be on par with urban schools.

Strengthening the Education System

To improve access and quality of education, particularly in rural areas, the Government allocated an additional RM2.6 billion to improve infrastructure, including in Sabah and Sarawak. About 2.2 million students and 14,000 teachers in rural areas are expected to benefit from this additional allocation. To reduce the dropout rate among Orang Asli and Penan children, six outreach programmes were introduced to increase the educational attainment of these groups. To increase the number of teachers in rural areas, two training institutes have been designated to produce graduates for rural postings. Teachers serving in rural areas will receive special allowances ranging from RM500-RM1,500 depending on the distance and difficulty in reaching their respective schools. Teachers and support staff serving in rural areas are also eligible for annual allowances to meet travel and accommodation expenses when they return to their hometowns. The Government will continue to build quarters for teachers and staff, particularly in rural areas to alleviate their housing problem. In addition, 432 of 728 schools in rural areas without access to 24-hour electricity have now been provided with this facility. At the same time, out of 153 schools, 141 now have access to potable water.

ICT is an important tool in improving the quality of teaching and learning. In this regard, under the National Education Blueprint 2006-2010, various projects are in progress covering ICT infrastructure, software and training. In this regard, 247,804 teachers were provided with ICT training. In terms of hardware support, 7,162 computer laboratories are in place while a total of 123,725 personal computers and 173,000 laptops were supplied to schools. These efforts will ensure that students will have adequate ICT knowledge and are able to build on this knowledge, making them more relevant to the needs of an increasingly ICT-driven economy.

In addition, the Strategic Plan for Higher Education: Laying the Foundation Beyond 2020 and the National Higher Education Action Plan 2007-2010 was launched and is geared towards transforming the landscape of higher education with the ultimate objective of creating world-class institutions in the country. Among others, the Action Plan calls for the creation of apex universities where only the best academics and students will be admitted. In addition, public universities will be given greater autonomy while the education standard will be assessed by independent committee, comprising experts.

Improving the Employability of Graduates

In order to improve the employability of graduates, public universities are required to review their curriculum every three years instead of five previously. In undertaking this review, universities will introduce soft skills, such as presentation, personal grooming and entrepreneurial skills as well as industry attachment to provide early workplace exposure. Under the Capital Market Graduate Training Scheme, 517 graduates have been trained since its inception in 2003 while 500 graduates will be trained in 2007. The Graduate Industry Skills Training, which started as a pilot programme for a thousand students was targetted at increasing the employability of information technology (IT) graduates. This programme, a public-private sector partnership with reputable multinational companies, offers a range of IT professional certificates. In addition, to ensure adequate supply of trained ICT graduates relevant to the requirements of MSC Malaysia companies, a select group of IT graduates from local universities underwent training in India under the 'Campus Connect' Programme. Apart from strengthening their basic IT knowledge, participants were also able to hone their agility and flexibility, the two key traits sought by MSC Malaysia companies. At the same time, the GREEN Programme under Khazanah Nasional, the Young Executive Scheme under UEM Group and the ELITE Programme under Pos Malaysia are some of the initiatives undertaken by Government Linked Companies (GLCs) to provide job and industry training to enhance graduate employability.

Facilitating Life-Long Learning

The setting up of community colleges in the country will provide school leavers with an opportunity to equip themselves with appropriate skills. To date, there are 37 colleges, of which nine were established in 2007. There are 22,950 students in these 37 colleges. Courses offered in these community colleges are largely geared towards vocational training, particularly in electrical technology, hotel and catering, computer technology as well as fashion and apparel with emphasis on practical training. In tandem with Government efforts to promote life-long learning, community colleges also provide opportunities to residents in the neighbourhood to undergo short-term trade and skills courses to improve themselves.

Upgrading Skills

Technological skills and innovative capacity are key elements in enhancing the nation's competitiveness and resilience. The 2007 Budget reinforced programmes to enhance skills development as well as upgrade polytechnics and skills training centres to meet the requirements of a knowledge-based economy. Industrial training institutes under the Ministry of Human Resources are expected to train 19,631 students in 2007. State skills development centres expanded their training capacity to increase the number of skilled workers with emphasis on hands-on experience through industry attachments. New courses like robotics and automation system were introduced to meet the demands of emerging industries. Under this programme, 56,994 individuals are expected to be trained in 2007. In addition, under the Human Resources Development Fund, 351,167 employees were trained in the first six months of 2007.

Addressing Persistent Socio-Economic Inequalities Constructively and Productively

The Government will ensure that the benefits of economic growth will be equitably distributed to ensure social stability and national unity. To realise this, the development agenda continues to focus on reducing socio-economic imbalances among regions as well as between rural and urban areas. Amongst others, two economic corridors were launched with specific programmes and projects to address these imbalances.

Establishment of Economic Corridors

The IDR was launched on 4 November 2006 to generate economic activities in the region. The Iskandar Regional Development Authority Act was gazetted, paving the way for the speedy implementation of projects envisaged for the region. This includes projects that will transform the region into a logistics and tourism hub. The Government will inject RM4.3 billion to fund several critical infrastructure projects to enhance the attractiveness of the region to private investors. These include security, highways, roads, river improvement and sewerage projects.

The Master Plan for the Northern Corridor Economic Region (NCER) was launched on 30 July 2007 and encompasses Kedah, Perlis, Penang and northern Perak. The Plan focusses on services, agriculture, manufacturing and infrastructure. Projects to be undertaken under the NCER include the Penang Second Bridge, Penang Monorail as well as commercial and business centres. A high-yield seed producing centre will be established in Perlis to help boost agricultural activity, while efforts to promote Langkawi as a tourist destination will continue. Hulu Perak, on the other hand, is earmarked for herbal farms and biotechnology research.

The corridor development plans were drawn up after consultation with the private sector to ensure complete buy-in of the plans. The local population is expected to benefit from improvements in infrastructure, opportunities for skilled jobs and entrepreneurial activity. The Masterplan for the remaining economic corridors, namely the East Coast corridor, the Sabah corridor and Sarawak corridor are under development.

Developing Bumiputera Commercial and Industrial Community

The Government is committed to promote a more competitive and productive Bumiputera Commercial and Industrial Community to enable the community to equally contribute and benefit from economic growth. Towards this, efforts were taken to create self-reliant and sustainable Bumiputera entrepreneurs, resilient Bumiputera small and medium enterprises as well as expanding education and training opportunities to Bumiputera managers and professionals, particularly in the private sector. To inculcate an entrepreneurial culture, 310,000 Bumiputera will be trained in various fields while 55,000 entrepreneurs and corporations will be nurtured under the business development programme. Programmes are also underway to encourage the growth of business linkages and clusters among Bumiputera enterprises and between Bumiputera and non-Bumiputera enterprises and between GLCs and Bumiputera enterprises. The role of trust agencies, GLCs and cooperatives will continue to be strengthened. To encourage greater participation of Bumiputera in niche growth areas, particularly the services, manufacturing, agriculture and agro-based sectors, Bumiputera entrepreneurs are encouraged to build their capacity and business acumen to enable them to venture into these areas. In addition, to increase the participation and property ownership of Bumiputera in major urban business locations, PHBB was established to acquire several prime properties in various locations.

Improving the Standard and Sustainability of Quality of Life

Improving the standard and sustainability of quality of life, among others, involve improving urban transportation, public safety, environmental stewardship and corporate social responsibility. Towards this, concrete programmes and projects will continue to be given priority.

Efficient Public Transportation System

The Government embarked on various initiatives to improve the efficiency of the public transportation system. The Government acknowledges that an efficient, safe and integrated network of transport systems is necessary to meet the transportation needs of the public, reduce congestion and emissions as well as increase productivity. In the Klang Valley, rationalisation of routes and services is ongoing with Syarikat Prasarana Negara Berhad, a wholly-owned Government company, entrusted to plan and implement the 15 km extension of the Ampang Line (formerly known as STAR) from Seri Petaling to Puchong/ USJ and the 15 km extension of the Kelana Jaya Line (formerly known as PUTRA) from Kelana Jaya to Subang/USJ. These extensions will enhance connectivity, create alternative modes of travel and alleviate congestion in Kuala Lumpur city centre and its suburbs.

At the same time, in April 2007, Keretapi Tanah Melayu Berhad (KTMB) extended the KTM Komuter service from Rawang to Rasa, and in 2008, it will be extended to Tanjong Malim. The construction of double-tracks from Sentul to Batu Caves is also underway. KTMB is also refurbishing 50 sets of KTM Komuter trains to improve capacity and comfort for its commuters. At the same time, several stations and halts along the route at Shah Alam, Subang Jaya, Bank Negara, Serdang, Kajang and Seremban will be upgraded. Work on the Integrated Transport Terminal in Bandar Tasik Selatan is in progress and will be completed in three years.

In the northern region, the Penang Monorail Project and commencement of public bus services by RapidPenang on 31 July 2007 will further improve the transportation system in the region. These projects are expected to significantly improve public transport utilisation and lead to better productivity and quality of life in Penang.

Enhancing Public Safety

The Government is committed to ensure a safe and secure environment for both businesses and the public. Towards this, several measures to address concerns on public safety, including improving the capacity and efficiency of Polis DiRaja Malaysia (PDRM) are in place. Closed circuit televisions have been installed in crime-prone areas and an additional 2,000 police patrol cars were provided to increase the visible presence of the police force and improve response time. In addition, PDRM took measures to forge closer partnership with the public through community policing strategy to reduce crime. To improve efficiency, PDRM introduced e-aduan to enable the public to provide feedback, while serving as an additional mode to report crime. These efforts are expected to enhance the delivery system and reduce the crime rate.

Environmental Preservation

The Government continues to promote environmental conservation to ensure a more integrated and sustainable management of natural resources. To promote the 3Rs (reduce, recycle and reuse) concept in solid waste management and reduce pressure on natural resources, the recently passed Solid Waste and Public Cleansing Management Bill mandates the sorting of solid waste at source. The Bill also allows for the introduction of the deposit rebate scheme as well as the take-back system to further enhance the recycling and reuse industries. With the establishment of the Department of National Solid Waste Management as well as the Solid Waste and Public Cleansing Management Corporation, solid waste management will be streamlined, and resources, effectively and efficiently utilised. At the same time, these initiatives will help address environmental problems and issues associated with non-sanitary landfills.

Promotion of Renewable Energy (RE) is one of the strategies to reduce emission levels, improve air quality and reduce dependence on fossil fuels. The Government encourages the use of solar energy as RE and one such initiative is the National SURIA 1000 Programme. Jointly promoted by the Government, the United Nations Development Programme and the Global Environment Facility, this programme enables residential and commercial property owners to enjoy between 40% to 75% rebates on the installation of Building Integrated Photovoltaic (BIPV) equipment and installation cost. The adoption of this programme will create a market for BIPV technology, reduce carbon emissions and address long-term energy diversification objectives.

Inculcating Corporate Social Responsibility

Taking cognisance of the positive contributions by corporations through Corporate Social Responsibility (CSR) activities, the Government increased the ceiling of tax deductions from 5% to 7% of aggregate income on contributions to charitable organisations. Among activities encouraged under CSR are adopt-a-school and adopt-a-charitable institution programmes. Corporations continue to respond well to this, and contribute generously to causes, such as education, sports, community development and environment. Some corporations link aspects of CSR to their key performance indicators and integrate it as their corporate culture. Khazanah Nasional and several GLCs pioneered PINTAR (Promoting Intelligence, Nurturing Talent and Advocating Responsibility), a programme to improve the educational attainment of students in rural areas, especially among Bumiputera. Initially involving 42 schools in Penang, the programme will be extended to other states.

Strengthening Institutional and Implementation Capacity

The Government is committed to improve the public sector delivery system, given that an efficient and transparent delivery system is essential in ensuring national development. The Government embarked on several initiatives to ensure the public delivery system meets the expectations of the population. PEMUDAH was established to facilitate business activity in Malaysia. Online services through the myGovernment portal were introduced to increase the efficiency, effectiveness, productivity and the overall quality of public service. Currently, agencies such as the Road Transport Department, PDRM, City Hall Kuala Lumpur, Insolvency Department and the National Registration Department provide a variety of services that can be accessed through the portal. These include checking and payment of summons; scheduling and taking highway code test and renewal of driving licences; and checking of bankruptcy status. In addition, some services are also available through short message services.

With regard to improving the approval of development proposals, the development planning and approval process has been revamped and fast-tracked with the setting up of OSCs. Applications for land development, permits for planning and building plans are processed concurrently, thus reducing processing time considerably. Further, to expedite the delivery of completed units, the Certificate of Fitness for Occupation is now replaced with the Certificate of Completion and Compliance, which is certified by relevant professionals.

Efforts taken to date have thus far brought about significant improvements in the service. This was evident in the World Bank's Governance Matters 2007: Worldwide Governance Indicators 1996-2006 Report, where Malaysia recorded improvements in government effectiveness, regulatory quality and control of corruption. The Government remains committed to improving its delivery system further and thus, create a conducive environment for businesses to thrive and to benefit Malaysians.

Economic Performance

With these measures and initiatives, all sectors of the economy will continue to expand. In an environment of low inflation and unemployment, high savings, favourable exchange rate as well as strong current account balance, the macroeconomic fundamentals of the country remain strong. The Malaysian economy is expected to expand strongly by 6.0% in 2007. The services sector, with an anticipated growth of 9.0%, will continue to be the major contributor to real GDP on the back of robust activities in intermediate services comprising finance and insurance, real estate and business services, transport and storage as well as the communications industry. The manufacturing sector is expected to pick up gradually and expand by 3.1%, following the anticipated recovery in global electronics demand in the second half. On the demand side, growth will be driven by resilient public and private sector expenditure, following stronger consumer sentiment, business confidence and higher Government spending. Nominal Gross National Product (GNP) is estimated to increase by 9.4% to RM607,212 million, with per capita income increasing by 7.2% to RM22,345 (2006: 9.9%; RM20,841). In terms of Purchasing Power Parity (PPP), per capita income is expected to increase by 13.9% to reach USD13,289 in 2007 (2006: 13.0%; USD11,663).

Moving Forward into 2008

Issues and Opportunities

Building on the growth momentum over the first two years of 9MP, economic management in 2008 will essentially focus on policies and strategies to promote sustainable growth. In the domestic economy, efforts to sustain competitiveness require both the private and public sectors to enhance efficiency and productivity. In addition, moving up the value chain is *sine qua non* to enable the economy to remain on its growth trajectory. In this regard, continuous efforts to improve education, skills and training systems will lay the foundation for the creation of skilful and knowledge workers, which are prerequisites in a knowledge-based economy. In addition, there is a greater need for more research and development as well as innovation activities to push the nation towards the frontier of knowledge and technology.

Given the conducive investment climate and competitive operating environment, Malaysia continues to attract foreign direct investment. The Government introduced several measures, including relaxing foreign exchange rules, improving the environment for foreign investments in the property market as well as improving public service delivery to reduce the cost of doing business. However, there are still opportunities for redoubling efforts in formulating more innovative and focussed strategies to attract investors.

Strengthening economic resilience is an important strategic objective of the nation which requires a broad-based economy and a sustainable fiscal policy to withstand downturns in the external environment. Efforts to diversify export destinations towards more intra-regional markets will help cushion weak export demand in traditional markets while higher value added exports will help mitigate competitive pressures from emerging economies. Maintaining a sustainable fiscal policy is paramount in managing the economy while a comfortable level of international reserves will cushion the negative impact of short-term capital outflows.

Balanced economic growth and equitable distribution of income continues to be the Government's strategy in ensuring that all segments of the society benefit from economic development. In this regard, the public-private sector partnership is crucial to realise the nation's socio-economic objectives. This will ensure political stability and racial unity, which are the two key pillars for sustained long-term growth.

The Government will ensure a balance between economic development and environmental management. Environmental pollution imposes a real cost to the economy. This calls for proper management of the environment, including managing waste generated by economic activity and households. Education and public awareness programmes to reduce, recycle and reuse materials can help to mitigate the increase in waste products. In addition, there is a need to preserve ecological balance and splendour as well as increase public awareness on the importance of environmental quality. There are opportunities to co-opt all stakeholders to work together in undertaking sustainable management of natural resources.

In addition to domestic challenges, downside risks emanating from the external environment are issues to reckon with. These risks include geopolitical tensions in the Middle East and other oil producing countries which continue to be a concern causing volatility in the supply and prices of crude oil. Though the United States (US) is expected to continue on a growth trajectory, the wider impact of the subprime mortgage financial crisis on the real sector, the weak US dollar, the burgeoning twin budget and current account deficits remain risk factors. Global imbalances, increasing asset prices and financial market volatility have heightened fears of disorderly and sharp adjustments in the financial markets.

Economic Management in 2008

The challenges facing the economy will be addressed in a comprehensive manner to enable the nation to continue on its growth trajectory. Economic management in 2008 will focus on maintaining macroeconomic stability and enhancing competitiveness to place the economy on a sustainable growth path towards achieving the distributional objectives. The emphasis on income distribution flows from the realisation that economic growth must benefit everybody. Equal opportunity should be provided to all Malaysians to participate gainfully in social and economic activities, prosper along with wealth creation and enjoy a higher standard of living and quality of life. The equitable sharing of prosperity by all segments of society is crucial to ensure long-term growth, hence fostering social unity and harmony.

To enhance competitiveness, the Government will continue to further expand and extend the potential for value added activities in the country. In this regard, measures will be introduced for existing manufacturers to migrate to higher technology and new investments in high-end manufacturing. Emphasis will be given to promote the growth of small and medium enterprises, including access to finance, technology acquisition, research and development and product promotion and export. In the same light, the services and agriculture sectors, including biotechnology will be given equal emphasis to enable the sectors to move up the value chain.

Investment plays an important role in moving the economy up the value chain and requires public-private partnership to maximise its benefits. In this regard, the Government will ensure a conducive environment by promoting greater coherence and clarity in policies and procedures, which will provide more certainty and enable the private sector to take a longer term view on key investment decisions. Efforts will also focus on harmonising the investment and incentive framework and reviewing the applicability of rules and regulations to ensure consistency between policy intent and implementation.

Strengthening the public sector delivery system is an ongoing strategy to ensure that the sector plays a facilitative role to support private sector-led growth while ensuring essential services are delivered to the highest standards. The goal is to develop a performance-driven public sector guided by transparent decision making process and integrity. Emphasis will also be given to enhancing the institutional capacity and expertise to manage critical public facilities and infrastructure. In addition, PEMUDAH's recommendations will be implemented vigorously towards improving the public delivery system.

Economic management in 2008 will also focus on strengthening human capital development. In this regard, strategies will respond to the increasing demand for skilled and knowledge workers to support and accelerate economic growth. Accordingly, measures will be directed towards improving the education system, particularly the quality of teaching and learning as well as facilities in schools and universities. In addition, efforts will be intensified to enhance skill and industrial training institutes to meet the demand for skilled workers. For the less academically inclined students, opportunities to pursue skills-oriented courses will enable them to be gainfully employed in the future. In emphasising the importance of education, the Government will ensure that every child is assured of basic education.

The Government will continue to ensure the well-being of all Malaysians by expanding and improving infrastructure facilities. Efforts will also be focussed on affordable housing and healthcare for the poor, elderly and persons with disabilities. In addition, the Government will intensify efforts to eradicate hardcore poverty through income-generating activities.

Prospects

The Malaysian economy is expected to register robust growth in 2008, with real GDP expanding between 6.0% and 6.5%. This translates to a 6.8% growth in nominal per capita income, rising from RM22,345 in 2007 to RM23,864 in 2008 or in PPP terms from USD13,289 to USD14,206. With an unemployment rate of 3.3%, the Malaysian economy will continue to operate under full employment. In tandem with the Government's efforts to ensure fiscal sustainability, the fiscal deficit will continue to decline to 3.1% of GDP. Malaysia's balance of payments position is expected to remain strong with the current account recording a surplus for the eleventh consecutive year. The current account surplus amounting to 13.0% of GDP will emanate from the goods and travel account. These developments augur well for all Malaysians and keep the nation on track towards realising Vision 2020.