



## Performance and Prospects of the Malaysian Economy

### Overview Of The Malaysian Economy In 2001

The performance of the Malaysian economy in 2001 has been adversely affected by the greater-than-expected slowdown in the world economy, particularly in the United States (US) as well as the continuing weak performance of the Japanese economy. The recent attack on the US has led to greater uncertainties with respect to the severity and duration of the recovery in the US. There are concerns on the risks of the US economy entering into a recession and its contagion on other industrialised and developing economies. In the light of the more difficult environment, real GDP growth of the Malaysian economy is projected to grow by 1-2% for 2001. Following the lower growth in nominal value, Gross National Product (GNP) of 1.8%, GNP per capita is forecast to be somewhat lower at RM13,333 or USD3,509 (2000: RM13,411 or USD3,529). In terms of purchasing power parity, however, per capita income is expected to increase by 1.3% to USD8,944 (2000: USD8,831), after taking into account lower domestic inflation.

All major sectors are expected to be adversely affected by the slower growth in the economy, particularly manufacturing which is estimated to record a sharp deterioration in output growth. The steep decline in value added of the manufacturing sector has, however, to some extent been offset by the better performance from the agriculture, construction and services sectors. The services sector has provided the lead in the growth of the economy on account of better performance of government services and other services sub-sectors. In the construction

sector, fiscal stimulus efforts by the Government, particularly for infrastructure projects coupled with the construction of low-and medium- cost residential houses, have contributed towards its higher growth. In the agriculture sector, the higher output from palm oil has resulted in a higher rate of growth for the sector.

Given the growing difficulties in the external environment, growth in real GDP has been largely domestic-led. Expansion in aggregate domestic demand is driven largely by public sector investment and consumption on account of larger fiscal expansion. Private sector demand in nominal value is expected to decline markedly, given the weaker-than-expected external demand which has affected investment in manufacturing activities as well as the continued reduction in investment in the property sector, particularly office space, hotels and retail outlets. Given the significant slowdown in private investment activities, the public sector implemented additional fiscal stimulus packages to stimulate domestic activities. Consequently, public expenditure, both investment and consumption, expanded significantly to continue registering double-digit growth. Notwithstanding the rapid expansion in public sector expenditure, the nation's resource position remains in surplus although gross national savings is estimated to decline on account of slower growth in income.

The balance of payments position continues to remain favourable. The current account surplus, while narrowing, remains strong. The lower surplus in the current account is partly attributable to a smaller surplus in the goods account against a widening deficit in the transfers account. The goods account is expected to register a smaller

surplus due to the sharp contraction in exports, while the transfers account deficit continue to widen as a result of higher remittance by foreign workers. Nevertheless, the services account deficit is likely to improve due to higher net inflow in the travel account and lower net outflow in the transport account. Consequently, the current account of the balance of payments is projected to record a smaller surplus of 7.9% of GNP. With the deficit in the financial account likely to improve due to smaller net outflows of portfolio and other investments, the overall balance of payments is expected to turn around to record a surplus of RM459 million.

Malaysia's economic growth continues to be achieved within an environment of low inflation and unemployment. Inflation remains subdued and stable largely on account of the moderation in private sector demand as well as measures implemented by the Government to contain price increases. In spite of higher retrenchments, the nation still enjoys full employment.

### Sectoral Output Performance

The output of major sectors in the economy is expected to register a slower growth, with the sharpest deterioration expected in the manufacturing sector. The performance of the primary sector is mixed, with agriculture registering higher growth and the mining sector almost stagnating. In the secondary sector, the most affected sector is manufacturing with growth deteriorating significantly, while the construction sector has benefitted from the fiscal expansion of the public sector. The services sector performance is also mixed with sub-sectors such as electricity and gas and transportation affected by the slowdown in the manufacturing sector to register moderate growth, while the government services and other services sub-sectors are anticipated to register higher rates of growth.

The **manufacturing sector** is expected to decelerate significantly to 0.2% in 2001 (2000: 21%) after seven consecutive quarters of robust double-digit growth. The decline is largely attributable to a depressed global market for electronic products. Given that electronics account for close to half of Malaysian manufactured

exports, the output performance of the electronics industry, which has deteriorated to 13.1% during the first seven months of 2001 (January-July 2000: 15.1%), has impacted significantly on the growth of the manufacturing sector. While the export-oriented industries have been adversely affected by weak external demand, the domestic-oriented industries have shown greater resilience, largely due to the expansion of output of industries producing construction-related materials, transport equipment and consumer products as well as resource-based industries. The growth in these industries has provided the support to growth and somewhat cushioned the contraction in the manufacturing sector. The overall deceleration in the sector's growth has resulted in its contribution to GDP declining sharply to 0.1 percentage point to real GDP growth (2000: 6.3 percentage points).

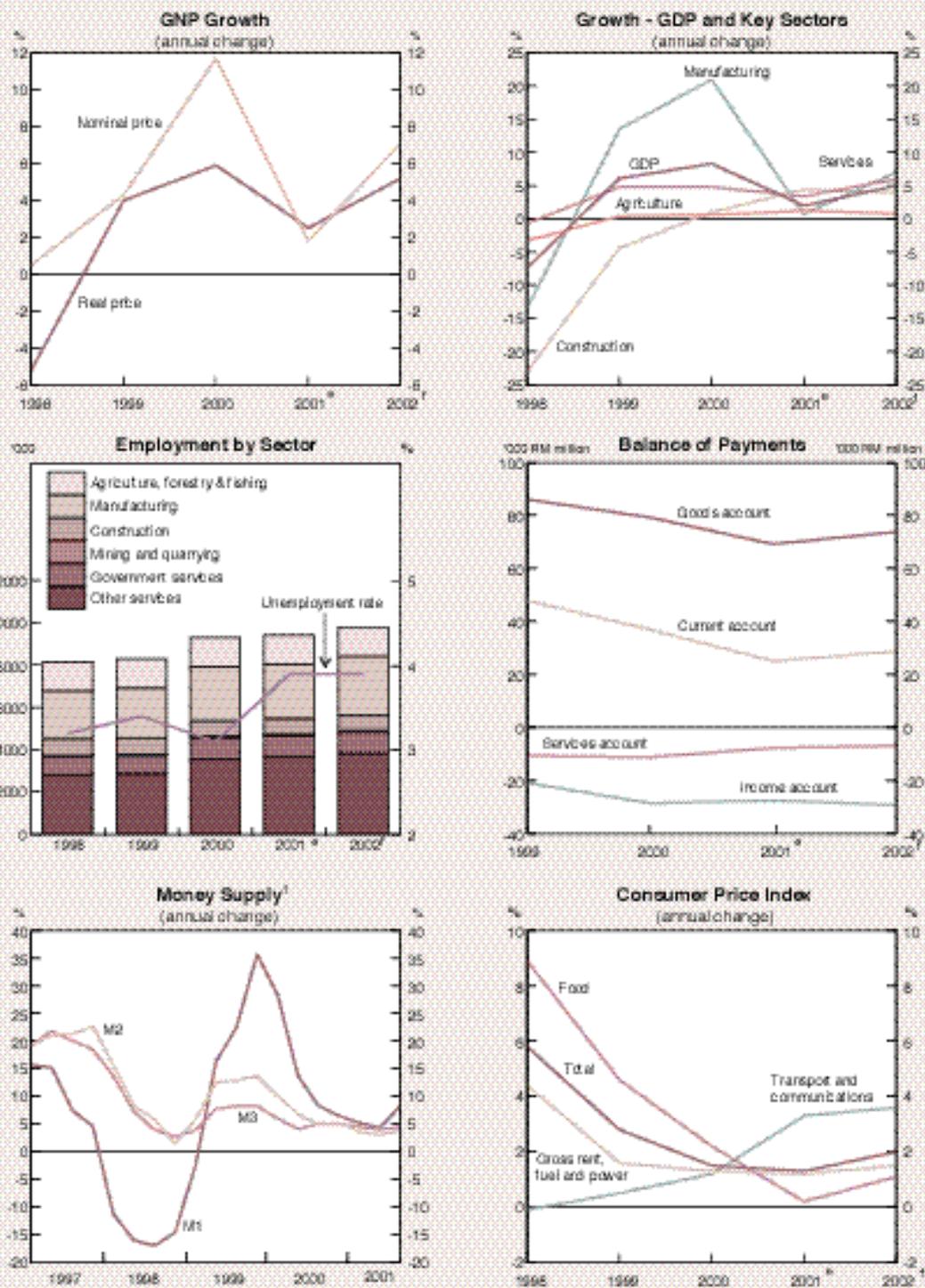
The **agriculture, livestock, forestry and fishing sector** is envisaged to expand at a higher rate of 1.2% (2000: 0.6%), largely on account of higher palm oil output. The output of rubber and saw logs, however, continues to decline.

In the **mining sector**, the higher production of natural gas is expected to offset the decline in crude oil production. As such, the sector's output is projected to increase marginally by 0.9% (2000: 3.1%).

Value added of the **construction sector**, on the other hand, is expected to expand at a higher rate of 4.9% (2000: 1.0%), spurred by the Government's fiscal expansion programme, particularly for infrastructure projects and the construction of low- and medium-cost residential housing.

The **services sector** is projected to continue to sustain its growth at 4.4% (2000: 4.8%). While the electricity, gas and water, wholesale and retail trade and hotels and restaurants sub-sectors are expected to record moderation in growth in tandem with the slowdown in the manufacturing sector and the generally subdued consumer sentiment, the finance, insurance, real estate and business services sub-sector is estimated to achieve strong growth, mainly attributable to the low interest rates which resulted in higher bank lending especially for housing and consumer

CHART 2.1  
Key Economic Indicators



<sup>1</sup> Estimated.

<sup>2</sup> Forecasts.

<sup>3</sup> End of March, June, September and December including Repos (except for 2001, which represents end of March, June, and August).

durables as well as higher demand for insurance products. Given that the services sector accounts for 54.6% of GDP, the overall stronger growth from the sector and the anticipated marked deterioration in the contribution from the manufacturing sector will result in the services sector providing the leading contribution to overall growth of 2.3 percentage points to GDP growth (2000: 2.6 percentage points).

### Domestic Demand

After registering a strong growth of 19.5% in 2000, **aggregate domestic demand** (excluding changes in stocks) is expected to moderate significantly to 7.1%. The relatively slower growth is attributable to weaker **private sector expenditure**, with growth deteriorating sharply to 3.6% compared with 20.4% in the previous year. The deterioration in private sector spending was somewhat offset by the large fiscal expansion of the public sector with **public sector expenditure** projected to expand strongly by 15.4% (2000: 17.6%).

**Public investment** is envisaged to maintain its double-digit growth of 15.4% (2000: 26.6%). The Federal Government expenditure in Budget 2001 was further augmented by the implementation of a pre-emptive package of RM3 billion in March as well as an additional RM4.3 billion in September, in response to the anticipated growing difficulties following the attack on the US. Apart from the Federal Government, the non-financial public enterprises (NFPEs), in particular Petroliaam Nasional Berhad, Tenaga Nasional Berhad and Telekom Malaysia Berhad, also expanded their expenditure in new investments for purposes of upgrading services and capacity expansion. The expansion in public sector expenditure is expected to result in the share of public sector investment increasing to 53.2% in 2001 from 50.1% in 2000 of total investment, and accounting for 2.4 percentage points of GDP growth (2000: 2.8 percentage points).

**Public consumption** which accounts for 45.3% of total public expenditure is expected to register higher growth of 15.3% (2000: 8.3%) to support the expansion in public investment. The increase

is largely for supplies and services and emolument. The stronger growth in public consumption is expected to increase its share of total consumption to 21.7% in 2001 (2000: 20%).

**Private sector investment** has been adversely affected, particularly by the deterioration in the output growth of the manufacturing sector as well as the continued reduction in investment outlay in the property sector, especially in office space, hotels and retail outlets. Consequently, growth in private investment is expected to decelerate sharply to 2% from its strong double-digit growth of 35.9% in 2000. Its share of total investment is, therefore, expected to decline to 46.8% compared with 49.9% in 2000.

**Private consumption** spending is also expected to expand by 4.1% (2000: 16.4%). This is on account of the slight contraction in private sector's disposable income attributable to the lower corporate earnings of the export-oriented industries and the negative wealth effect from the subdued stock market as well as greater uncertainties in employment prospects, which have led to more cautious consumer sentiment. To promote private consumption, the Government has introduced several measures in Budget 2001, including providing higher tax rebates to individual taxpayers, relaxing Government employees' eligibility for car loans, reducing employees' contribution to the Employees Provident Fund (EPF) as well as removing the RM50 charge on credit cards.

### External Demand

The performance of the nation's external demand has been severely affected by the marked slowdown in the industrialised economies, particularly by the sharper-than-expected downturn in the global electronics cycle. **Export of goods and non-factor services** is expected to contract sharply by 9.3% (2000: 17%), after fifteen years of sustainable strong growth. Consequently, the share from external demand to GDP is expected to reduce to 112.3% (2000: 125.5%).

**Export of goods** is envisaged to decline by 10.8% to RM333,464 million after a strong double-digit growth of 17% in 2000, led by a significant contraction in the exports of manufactured goods, particularly electronics. The weak global demand for electronics has led to sales of electronics declining sharply, resulting in a large inventory overhang. The export performance of major commodities is also expected to remain unfavourable, primarily attributable to lower prices for all major commodities, including palm oil and crude oil. **Export of non-factor services** is expected to decelerate to 1.7% compared with 16.8% in 2000. This is in tandem with lower exports of goods. Within the non-factor services, the stronger contribution from tourism has, however, continued to support the sector's output. For the period January-August 2001, tourist arrivals totalled 9.5 million, an increase of 44.1% over the same period in 2000.

Similarly, the **import of goods and non-factor services** is expected to reduce by 9.2% compared with a strong double-digit of 23.9% in 2000. The decline reflects mainly moderation in domestic demand conditions as well as the reduction in imports of intermediate inputs for the manufacturing sector. The slower growth in private investment also resulted in lower imports for capital goods, while the more cautious consumer sentiment has led to a more subdued import of consumption goods. The import of intermediate goods is expected to register a significant contraction of 11.4%, while the import of capital and consumption goods are anticipated to register a relatively smaller decline of 1% and 5.3%, respectively.

### Balance of Payments

Malaysia's balance of payments position is envisaged to remain strong despite continued weakening in the external environment. The surplus in the **current account** remains large at RM25,070 million or 7.9% of GNP (2000: 10.2% of GNP), registering the fourth consecutive surplus since 1998. The smaller surplus is partly due to a lower net inflow in the goods account and the continued larger net outflow in the transfers account.

The **goods account** is expected to continue to register a surplus of RM69,175 million, albeit smaller than RM79,247 million in 2000. The smaller surplus is attributable to the sharper decline in exports (10.8%) relative to imports (10.3%). In the **services account**, lower imports as well as the contraction in exports are expected to reduce the outflow in transportation and other services. At the same time, the higher receipt from travel, largely from the significant increase in the number of incoming tourists, is expected to contribute to the significant narrowing of the deficit in the services account to RM7,694 million (2000: -RM11,212 million).

With lower corporate earnings arising from weaker exports, especially of multinational companies in the electronics industries, the **income account** (mainly investment income) is expected to register a smaller deficit of RM27,627 million (2000: -RM28,554 million) on account of lower repatriation of profits. The deficit in the **transfers account** is, however, envisaged to increase to RM8,784 million (2000: -RM7,522 million), following higher remittances abroad by foreign workers.

The **financial account**, which comprises direct, portfolio and other investments, including loans, trade credits and bank deposits, is expected to perform better with a smaller net outflow of RM17,948 million (2000: -RM23,848 million). The better outcome is attributable to continuing net inflows of direct investment (RM5,642 million) as well as the lower net outflows of portfolio investment (-RM3,329 million) and other investment (-RM20,261 million). The net inflow of direct investment reflects continuing investment commitment by foreign investors as well as foreign equity acquisition in selected services sub-sectors, such as shipping and transportation industries. As for other investment, the smaller net outflow is partly due to narrowing interest differentials between domestic and international rates, particularly in the US, thus reducing the incentive for Malaysians to retain funds abroad over a longer period. Reverse investment by Malaysian companies is expected to decline due to the stringent approval criteria by Bank Negara Malaysia (BNM) as well as liquidation of business overseas, following corporate restructuring exercises undertaken by Malaysian companies.

The **overall position of the balance of payments** is expected to improve slightly to register a surplus of RM459 million after experiencing a large deficit of RM3,703 million in 2000. This surplus is significant considering that net outflows due to errors and omissions, which included foreign exchange revaluation loss, amounted to RM6,663 million (2000: -RM11,814 million). Thus, the net international reserves is expected to remain strong during the year. As at 29 September 2001, the level of reserves amounted to RM112,934 million or USD29,720 million, a significant increase from its lowest level in May 2001 (RM98,536 million or USD25,931 million). The current reserves position is adequate to finance 4.6 months of retained imports and is 6.2 times the short-term external debt.

### Federal Government Financial Position

The continued weakening in the external environment and its adverse impact on domestic private demand necessitated the Government to pursue a stronger expansionary fiscal stimulus to revive domestic economic activities. Consequently, the overall deficit of the Federal Government is estimated to register a larger deficit of RM22,379 million or 6.5% of GDP, compared with RM19,715 million or 5.8% of GDP in 2000. Despite the larger deficit, the Government remains prudent and ensures financial discipline in managing its financial resources. The deficit is still manageable and sustainable, given that it is mainly financed from non-inflationary domestic sources and, hence, external debt and debt servicing ratio remain low.

**Federal Government revenue** is expected to register a strong performance of 11.6% to reach RM69,011 million, the highest growth achieved since 1998, mainly attributable to higher collection of corporate and petroleum income taxes. The higher corporate income tax is due to fewer losses carried forward from previous years to offset current year profits, while the higher collection from petroleum income tax is on account of better petroleum prices, which increased from USD18 per barrel in 1999 to USD30 per barrel in 2000. Other major revenue sources include

sales tax, excise duties and service tax are also expected to increase moderately. Non-tax revenue, which includes investment income and fees from licenses and permits, is expected to perform well given the improved performance of government companies and buoyant sales of motor vehicles.

**Operating expenditure** is expected to increase by 8.1% (2000: 21.2%), largely for emoluments, debt service charges and supplies and services. The bulk of expenditure is for **supplies and services** as well as the increase in **emolument** resulting from increased allowances, particularly for the police and armed forces personnel as well as nurses, doctors and headmasters. The expenditure for **debt service charges** remains low, mainly for domestic interest payments. Given the stronger performance in revenue and the smaller increase in operating expenditure, the **current account** of the Federal Government is, therefore, expected to record a higher surplus of RM7,879 million (2000: RM5,317 million). The Federal Government has always maintained a surplus in its current account, reflecting continued fiscal prudence and discipline in the management of its finance.

Arising from the additional stimulus packages implemented by the Government, **development expenditure** is expected to increase significantly by 14.7% to RM32,058 million (2000: 23.6%, RM 27,941 million). The Government announced the first pre-emptive package in March of RM3 billion for enhancing training capacity through building universities, community colleges and single-session schools as well as topping up funds for the development of small- and medium-scale enterprises. In September, an additional package of RM4.3 billion was announced, largely for rural and selected urban development projects and training of unemployed graduates and retrenched workers. After taking into account the higher expenditure, the overall deficit is expected to increase to 6.5% of GDP. Given the ample liquidity in the financial system, about 82.2% of the deficit will be financed from domestic sources, largely Malaysian Government Securities (MGS) and Government Investment Issues (GII), with the balance from external borrowings.

## National Resource Position

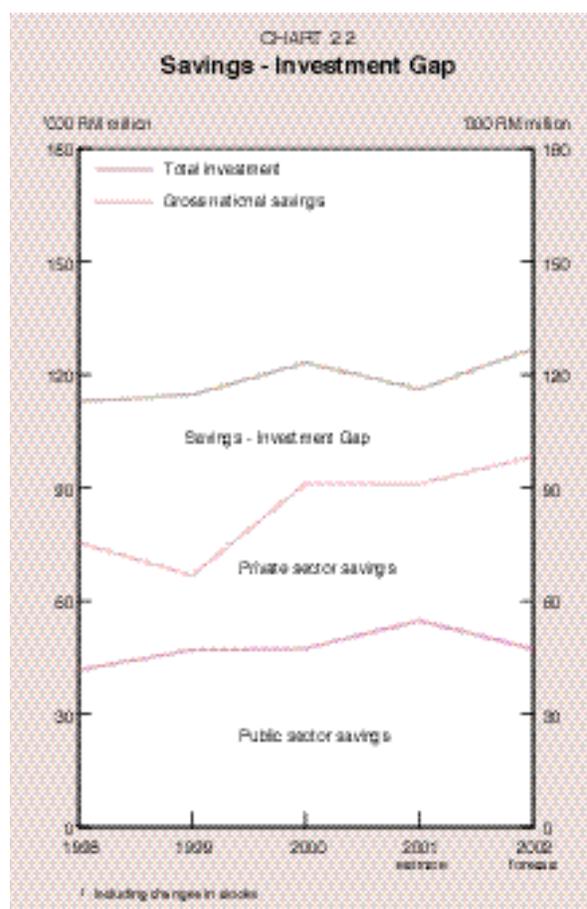
The national resource position remains strong with the **savings-investment gap** registering a surplus of RM25,070 million or 7.9% of GNP. The surplus is, however, lower compared with RM31,959 million or 10.2% of GNP in 2000. The reduced resource surplus is largely the outcome of the decline in savings by the private sector. **Gross fixed capital formation**, on the other hand, is expected to register a moderate increase, largely emanating from the Government's expansionary fiscal policy.

**Private sector savings** is expected to be affected by lower income resulting from weaker export earnings as well as greater uncertainties in employment opportunity. With private consumption continuing to remain large at 47.5% of GNP, private sector savings is expected to moderate to 19.3% of GNP (2000: 24.3%). With strong performance in Government revenue, **public sector savings** is projected to increase significantly by 15.6% to RM54,875 million or 17.3% of GNP (2000: 15.2% of GNP). **Gross national savings** is, therefore, envisaged to decline to RM116,212 million or 36.6% of GNP in 2001 (2000: 39.5% of GNP).

## Monetary Developments

Given the weak external environment, monetary policy in 2001 continues to remain accommodative to support domestic growth and mitigate the adverse impact from the global economic slowdown on the economy. The low inflationary environment as well as global easing of interest rates have enabled the Government to ease monetary policy to support its larger fiscal stimulus without putting pressures on prices and wages. Interest rates remain low while ample liquidity continues to prevail in the financial system, reflecting the easier monetary stance.

Lending activities continue to improve with total loans outstanding extended by the banking system increasing by 5.6% to RM468,391 million at end-August 2001, driven by higher credit growth in the business and household sectors. Loan disbursements remained high in the first eight months of 2001, increasing by 7.5% against the



corresponding period in 2000. The bulk of loans was for the purchase of residential property, in particular low- and medium-cost houses, taking advantage of the incentives offered by the Government, such as stamp duty exemption and waiver of processing fee. Higher loans were also channelled to the manufacturing sector as well as for consumption credit, particularly for the purchase of passenger cars. Meanwhile, financing through the private debt securities market (PDS) also increased, largely to finance long-term projects. Subsequently, aggregate financing through loans from the banking sector and PDS rose by 8% as at end-August 2001.

Interest rates remained stable in an environment of ample liquidity. The average base lending rates (BLRs) of commercial banks and finance companies have remained at historical lows since August 1999 while their average lending rates remained relatively stable. Nevertheless, in the light of weakening global economic growth and

in response to similar interest rate cuts by other central banks, BNM has reduced its 3-month intervention rate by 50 basis points to 5% on 20 September 2001. With the reduction, the BLR ceiling of commercial banks and finance companies will decline to 6.42% and 7.46%, respectively (from 6.83% and 7.98%). The reduction is aimed at enhancing business and consumer sentiment to support economic activities.

### Equity Market

In tandem with the developments in major world and regional bourses, the performance of the Kuala Lumpur Stock Exchange (KLSE) during the first nine months of 2001 was affected by weaker investor sentiment on concerns of the global economic slowdown. KLSE began the year with a Chinese New Year rally, with the Kuala Lumpur Composite Index (KLCI), closing at 727.73 points at end-January. It trended downwards from April before recovering to close at 659.40 points at end-July, following several optimistic developments in corporate mergers and acquisitions. The attack on the US, however, triggered a fall in share prices worldwide, including the KLCI, which declined to 615.34 points as at end-September. Nevertheless, the KLCI continues to outperform other selected regional bourses. During the period end-2000 to end-September 2001, the KLCI declined by 9.5% against the Philippines Composite Index (-24.6%), the STI (-31.5%) and the Nikkei Index (-29.1%).

### Inflation

Inflation continues to remain subdued at below 2% since 1999. The Consumer Price Index (CPI) registered a small increase of 1.5% during the first eight months of 2001, the lowest since 1999, attributable mainly to the relative stability of the exchange rate, low inflation abroad, lower oil and commodity prices as well as excess capacity in several sectors of the domestic economy. The expectation of continued moderation in economic activities, the less favourable employment prospects and relatively weaker consumer confidence will continue to have a moderating effect on domestic prices. As such, inflation is expected to decline to 1.3% in 2001.

The moderation in CPI is reflected in most major sub-indices, largely for food, which accounts for more than a third of the total weightage of the CPI. The food sub-index increased marginally by 0.6% during the first eight months of 2001 while that of gross rent, fuel and power by 1.6%. The marginal increase in food prices is largely on account of favourable weather conditions as well as the success of the Government's measures to contain price increases of essential goods, particularly food items.

### Labour Market

The slower economic activities have somewhat affected labour market conditions. With employment creation projected to increase by 1.5% and labour force rising by 2.4%, the unemployment rate is expected to increase to 3.9% from 3.1% in 2000. Although higher, the unemployment rate is below 4% and as such, the nation is still at its full employment level. The number of workers retrenched stood at 20,038, mainly in the electronics sub-sector. Notwithstanding these retrenchments, the nation continues to experience shortage of workers, reflecting skill mismatches, job preferences as well as labour immobility in some regions.

The nation still continues to depend on foreign workers with the number of registered foreign workers increasing to 810,695 from 732,588 in 2000. Reflecting the easier labour market conditions, wage pressures were subdued, as reflected by the slower rate of increase in the wages of all categories of workers in the manufacturing sector.

### Prospects for 2002

The outlook of the external sector in 2002 remains uncertain, particularly in the light of the aftermath of the attack on the US. While it is generally viewed that the US may avoid a recession, the recovery would be delayed with an upturn taking place gradually in the later part of 2002. The prospect for a growth in Japan continues to be discouraging, with the economy not expected to witness a rapid growth. Given the weaker performance of the US and Japan, world growth

has subsequently been revised downwards to 2.6%, with the GDP growth for the major industrialised countries decelerating to 1.3%.

Taking cognisance of the uncertainties in the external environment, growth for the Malaysian economy will continue to be spearheaded by domestic activities. In this regard, the Government will continue to adopt an expansionary fiscal policy to further strengthen domestic demand to generate growth. At the same time, to increase business confidence and commitment, the Government will ensure a more conducive business environment for the private sector's expansion and initiatives.

### Sectoral Performance

The Malaysian economy is forecast to grow by 4-5% in 2002, led by stronger performances in the manufacturing and services sectors. The recovery in global electronics demand will contribute towards growth in the manufacturing sector while the pace of expansion in the services sector will be driven by higher economic activities and the Government fiscal stimulus.

Slower growth is projected in the **agriculture sector** at 0.8% (2001: 1.2%) due to declines in production of crude palm oil, rubber and saw logs. Crude palm oil production is expected to decline by 2.1% on account of low biological yield cycle of the crop and the large hectareage which has been taken out of production due to replanting. Rubber production is also projected to contract by 1.7% in line with Malaysia's obligation to the tripartite agreement between Malaysia, Indonesia and Thailand to reduce output by 4%, aimed at reducing oversupply and increasing prices. Saw logs production, meanwhile, is envisaged to decline by 2.9% in tandem with the policy of sustainable forest management. On the other hand, other agriculture such as aquaculture, fishing and miscellaneous crops like tobacco, pepper and herbs is expected to register higher output.

In line with the expected increase in economic activities and the greater utilisation of gas as a source of energy, natural gas output is expected to expand significantly to 11.4% to meet the

anticipated increase in demand from both local as well as export markets. This, together with higher crude oil output of 2.4% to 695,900 barrels per day will contribute to the higher value added growth in the **mining sector** of 4.3%.

**Manufacturing sector** is projected to expand by 6.5% (2001: 0.2%), following the recovery in global electronics demand which is already reflected in the considerable reduction in the stock overhang of chips. The recovery process will be further enhanced by higher US fiscal spending on military electronic equipment for surveillance and communications network which will lead to higher demand for chips in the light of the 11 September attack. Improved domestic demand arising from the fiscal stimulus will also enhance output from the sector, in particular construction-related industries. Consumer spending on passenger cars and household durables such as washing machines, refrigerators and audio visual products is also envisaged to be higher with the improvement in the overall economy. The manufacturing sector, therefore, is expected to contribute to 2.1 percentage points to real GDP growth.

The recovery in private sector investment and fiscal expansion will contribute to growth in the **construction sector** by 4.3%. The demand for housing, in particular low- and medium-cost units as well as infrastructure projects in the health and education sub-sectors and rural development from the RM3 billion pre-emptive measures in March and the recent RM4.3 billion package in September will also contribute towards further growth in this sector.

Value added of the **services sector** is expected to grow by 5.3% (2001: 4.4%) in line with the generally better performance of the primary and secondary sectors of the economy. Higher output from the manufacturing sector will contribute towards the expansion in the related services sub-sectors, in particular electricity, gas and water which is expected to increase by 6.9% and transportation, storage and telecommunications, by 7%. With higher public sector expenditure to be generated from the fiscal stimulus, growth from the Government services sub-sector is

expected to expand by 6.1% while higher tourist arrivals, in particular from this region, will generate greater activities in the wholesale and retail trade, hotel and restaurants sub-sector of 3.9%. The finance, insurance, real estate and business services sub-sector is also expected to expand by 5.6% as the low interest rate environment is expected to sustain the demand for housing and consumer durables in addition to the growing demand for insurance products. Consequently, the services sector is expected to contribute to 2.9 percentage points to real GDP growth.

### Domestic Demand

**Aggregate domestic demand** (excluding changes in stocks) in current prices is expected to increase by 5.5% in line with the anticipated improvement in export earnings and the fiscal stimulus in supporting domestic economic activities. **Private consumption** is estimated to increase by 5.5% given higher incomes from the improvement in the economy. **Private investment** is also projected to register a strong growth of 10% after a slow growth of 2% in 2001. The increase in private investment is reflected in the approvals in manufacturing investment by the Malaysian Industrial and Development Authority, which increased to RM18,183 million during the first seven months of 2001 (January-July 2000: to RM17,316 million). Investment in Information and Communications Technology (ICT) and related industries is also expected to increase. The number of companies given MSC-status has expanded to 563 as at end-September 2001 (end-2000: 429 companies), reflecting the increasing investment in ICT activities.

Although fiscal policy remains expansionary, the size of the development allocation is projected to be smaller as part of a deliberate policy to ensure prudence and sustainability of public sector finance. **Public investment** is, therefore, expected to contract slightly by 0.4% to RM50,147 million (2001: 15.4%) on account of lower Federal Government expenditure. However, **public consumption** is envisaged to increase by 7.4% (2001: 15.3%) on account of higher expenditure for supplies and services as well as emolument.

### External Demand

Contribution from the external sector is expected to turn positive, contributed by improvements in the trade sector. **Export of goods and non-factor services** is envisaged to turn around by 6.4% (2001: -9.3%), while that of imports by 5.9% (2001: -9.2%). With the growth of exports exceeding imports, the net external demand is expected to contribute positively by 0.8 percentage point to GDP growth (2001: -1.5 percentage points).

**Export of goods** is envisaged to recover moderately by 6% (2001: -10.8%), supported largely by an increase in export of manufactured goods. The increase in exports will largely emanate from electronics, in view of the recovery in global electronics demand as well as from primary commodities, particularly palm oil and liquefied natural gas. **Export of non-factor services** is also expected to increase by 8.6% (2001: 1.7%), with higher earnings anticipated from transportation and travel, mainly from regional tourists, despite some moderation expected in tourist arrivals, especially from the US and Europe, following the September attack on the US.

**Import of goods and non-factor services** is expected to increase by 5.9% (2001: -9.2%). In line with stronger domestic economic activities and higher exports, **import of goods**, is envisaged to increase by 5.8%, comprising largely intermediate goods. Higher pace of investment activities is expected to generate demand for capital goods. **Import of non-factor services** is projected to increase by 6.5% (2001: -4.1%), mainly on account of higher payments from transportation and other services.

### Balance of Payments

Malaysia's current account is envisaged to continue to register a sizeable surplus for the fifth consecutive year. The higher surplus of RM73,775 in the **goods account** is more than sufficient to offset the deficit in the services, income and transfer accounts. The **services** deficit is expected to improve slightly to RM7,013 million (2001: -RM7,694 million), mainly attributable to

higher net inflows in the travel account of RM14,168 million (2001: RM12,782 million).

The **income account**, however, is projected to register a higher net outflow of RM29,120 million (2001: -RM27,627 million), arising from better corporate performance in the light of the anticipated improvement in economic activities. After taking into account the net outflows of RM8,966 million in the **transfers account** (2001: -RM8,784 million) due to higher repatriation by foreign workers, the **current account** is expected to register a higher surplus of RM28,676 million or 8.4% of GNP (2001: RM25,070 million or 7.9% of GNP).

### Federal Government Financial Position

The Government will continue with its fiscal stimulus, marking its fifth year of deficit budgetting, as a measure to support domestic economic activities. The expansionary budget will be financed mainly from non-inflationary domestic sources. The strong revenue growth is anticipated to result in a larger **current account** surplus despite higher operating expenditure. After taking into consideration development expenditure, the overall fiscal deficit is expected to improve to 5% of GDP (2001: 6.5% GDP).

Growing strongly at 6.4%, **revenue** growth is expected to emanate mainly from higher corporate and individual income taxes as well as services and sales tax collections resulting from better corporate performance, higher income and increased consumption. Apart from emoluments, supplies and services and debt service charges, the higher **operating expenditure** will be for purposes of upgrading and maintenance work, training assistance to unemployed graduates and retrenched workers as well as increased welfare payments.

In terms of development allocation, priority will continue to be given to human resource development, agriculture and rural development and social services. The smaller gross **development expenditure**, amounting to RM28,382 million, will be expended for education and training, particularly training for K-workers, enhancing computer literacy and the use of ICT,

agriculture development, upgrading of basic amenities and facilities such as rural and village roads as well as water and electricity supply, housing, medical and health services and infrastructure projects including highways, bridges and rail-based projects.

### National Resource Position

In line with higher export earnings and greater domestic economic activities, GNP is expected to increase strongly by 7.3% in 2002 (2001: 1.8%). Consumption expenditure is envisaged to increase by 5.9% (2001: 6.3%), attributable to the fiscal expansion and greater private consumption, following higher disposable income. As a result, the share of **gross national savings** to GNP is expected to improve slightly to 37.4% (2001: 36.6% of GNP). Subsequently, the **savings-investment gap** is expected to register a higher surplus of RM28,676 million or 8.4% of GNP (2001: RM25,070 million or 7.9% of GNP).

### Monetary policy

Monetary policy will continue to remain accommodative to complement the fiscal stimulus in supporting economic growth in the light of the deteriorating external developments. Following the greater uncertainty of global economic recovery, an easier monetary stance is necessary to support domestic economic activities. The recent further global easing in interest rates will permit greater flexibility for the pursuit of an accommodative domestic monetary policy. In addition, Malaysia's strong economic fundamentals and sound financial system will also provide greater policy flexibility in pursuing an easier monetary stance.

With regard to the ringgit exchange rate, the prevailing peg of RM3.80 to the US dollar will continue to be closely monitored against both domestic and external developments to ensure that it remains consistent with macroeconomic fundamentals. Given the volatility in international currency markets, the Government's policy is to maintain a stable and fundamentally sound exchange rate so as to provide stability and predictability in facilitating planning and investment decisions.

### Inflation

Inflation is expected to continue to remain low with the increase in CPI anticipated to be less than 2%. However, the recent hike in freight rates, insurance premiums and other transportation-related costs is of concern as they may translate into higher costs. Strong domestic demand could also generate inflationary pressures if supply shortages, particularly food, are not immediately resolved. Given these risks, the Government will remain vigilant to take the necessary measures in containing inflation. Among the measures already in place include efforts to increase domestic food production and reduce the cost of doing business.

### Employment Situation

With the economy forecast to grow moderately, employment is projected to increase by 4% from 9.4 million in 2001 to 9.8 million in 2002. The economy will continue to experience full employment, with the unemployment rate remaining low, while the labour market continues to remain stable. New employment prospects

are likely to be from IT-related areas, with the manufacturing sector continuing to contribute the bulk of employment.

### Conclusion

Growth in real GDP in 2001 has been adversely affected by the unfavourable external environment, precipitated by the slowdown in the US economy. Despite this, the Malaysian economy, supported by domestic demand, is expected to record GDP growth of 1-2%.

Prospects for an improved world economic performance remain uncertain with world recovery expected to be delayed to the later part of 2002. Although uncertainties regarding the US recovery and, hence, world growth have increased, the setback has been minimised through concerted actions taken by the major economies in enhancing liquidity as well as adopting continued monetary and fiscal easing. For the Malaysian economy, it is expected to recover from a slower growth in 2001 to register a higher real GDP growth of 4-5% in 2002.