



MID-TERM REVIEW OF THE NINTH MALAYSIA PLAN, 2006-2010

MACROECONOMIC PERFORMANCE AND PROSPECTS



MACROECONOMIC PERFORMANCE AND PROSPECTS

I. INTRODUCTION

During the review period, 2006-2007, the Malaysian economy continued its growth momentum, driven by robust domestic demand. The resilience of the economy strengthened with a more diversified economic base and a shift towards a knowledge-based economic structure. The services sector was the main source of growth, mainly from new growth areas in finance, business services and communications, supported by robust domestic demand. The strong economic performance was achieved in an environment of low inflation.

The strong economic performance has promoted greater structural transformation and strengthened the country's macroeconomic fundamentals. Consequently, the economy is in a better position to weather uncertainties and risks arising from the world economic slowdown, global inflation, sub-prime issue and stiffer competition from emerging economies.

The macroeconomic strategies during the remaining Plan period 2008-2010, will focus on managing inflation, enhancing competitiveness and stimulating new sources of growth. The private sector will be the main driver of economic growth. The Government will provide a conducive environment for local and foreign investments.

II. KEY RESULTS, 2006-2007

Domestic Economy

Gross domestic product (GDP) in real terms grew at 6.1% per annum surpassing the Ninth Malaysia Plan target of 6.0%. Growth was supported by strong domestic demand, particularly private sector expenditure. Per capita income in current terms increased by 10.6% per annum to RM23,066 or US\$6,714 and per capita income in purchasing power parity increased by 14.2% per annum to US\$13,529 in 2007.

Real GDP growth surpasses target...

Productivity

The contribution of total factor productivity (TFP) to GDP growth increased to 34.8% during the 2006-2007 period compared with 29.0% achieved during the Eighth Malaysia Plan. Contribution from capital was 36.7% and labour 28.5%. Incremental capital output ratio (ICOR)¹ improved, averaging at 3.7 compared to the Plan target at 4.6. Productivity improvement was contributed by the increased intensity of research and development (R&D) and innovation activities as well as increased utilisation of technology and information and communications technology (ICT).

Increased TFP contribution to GDP growth...

¹ Based on a 3-year moving average.

Box M-1

Key Results, 2006-2007

Commitment	Output
<ul style="list-style-type: none"> ▪ Achieving a creditable growth rate while maintaining strong economic fundamentals 	<ul style="list-style-type: none"> ▪ Real GDP growth: 6.1% per annum ▪ Inflation rate: 2.8% per annum ▪ Unemployment rate: 3.2% in 2007 ▪ Balance of payments current account surplus increased from RM78.3 billion in 2005 to RM100.5 billion in 2007 ▪ Per capita income increased from RM18,840 in 2005 to RM23,066 in 2007
<ul style="list-style-type: none"> ▪ Strengthening competitiveness 	<ul style="list-style-type: none"> ▪ Malaysia's International Rankings: <ul style="list-style-type: none"> • World competitiveness ranking improved from 26th position out of 55 countries in 2005 to 19th position out of 55 countries in 2008 (<i>source: IMD World Competitiveness Yearbook 2008</i>) • Global competitiveness ranking improved from 25th position out of 125 countries in 2005 to 21st position out of 131 countries in 2007 (<i>source: WEF Global Competitiveness Report 2007-2008</i>) • Ease of doing business improved from 25th position out of 175 countries in 2006 to 24th position out of 178 countries in 2008 (<i>source: Doing Business 2008, World Bank</i>)
<ul style="list-style-type: none"> ▪ Enhancing higher contribution to growth from private sector and government-linked companies (GLCs) and attracting quality foreign direct investment (FDI) to accelerate progress towards higher technology activities and expand market linkages 	<ul style="list-style-type: none"> ▪ Share of private investment (nominal) to total investment increased from 50.1% in 2005 to 53.5% in 2007 ▪ Contribution of private investment to GDP increased from 11.3% in 2005 to 11.9% in 2007 ▪ Ministry of International Trade and Industry approved FDI increased from RM17.9 billion in 2005 to RM33.4 billion in 2007
<ul style="list-style-type: none"> ▪ Raising the efficiency of capital, productivity of labour and the contribution of TFP 	<ul style="list-style-type: none"> ▪ Contribution of TFP to GDP growth increased from 29.0% during Eighth Malaysia Plan to 34.8% during 2006-2007
<ul style="list-style-type: none"> ▪ Sustaining pragmatic fiscal management 	<ul style="list-style-type: none"> ▪ Fiscal deficit reduced from 3.6% to GDP in 2005 to 3.2% to GDP in 2007 ▪ Total debt of Federal Government reduced from 43.8% to GDP in 2005 to 41.6% to GDP in 2007

Progress Towards a Knowledge-Based Economy

The knowledge-based economy development index, which monitors the progress of the economy towards becoming knowledge-based, increased by 227 points from 2,413 in 2000 to 2,640 in 2007. The most significant improvement was in computer infrastructure, which registered an increase of 220.5%; research and development and technology 24.1%; and education and training 6.5%. There was a decline in infostructure due to the reduction in the number of fixed telephone lines. Based on a comparison of 22 selected countries, Malaysia remained at the 17th position in 2007. Nonetheless, Malaysia was among the top five countries that registered the largest progression to a knowledge-based economy since 2000 after the Republic of Korea, the People's Republic of China, Japan and the United Kingdom.

Chart M-1
The Knowledge-Based Economy Development Index: Malaysia, 2000 and 2007

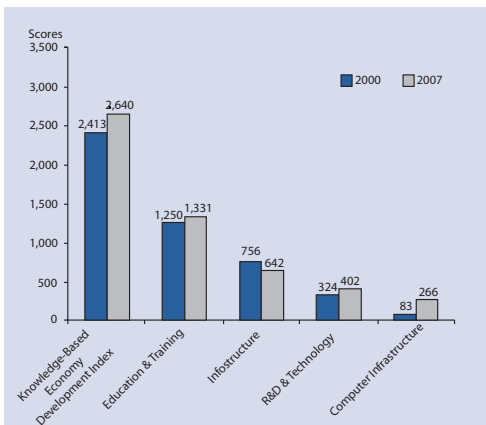
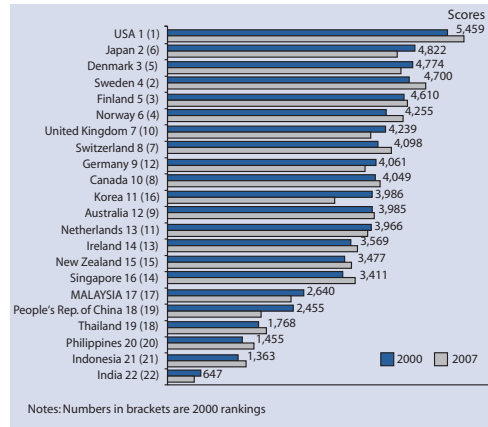


Chart M-2
The Knowledge-Based Economy Development Index by Country, 2000 and 2007



In addition, between 2002 and 2006, improvements have been recorded in all industries in terms of building knowledge competency and capability as well as embarking on some form of knowledge acquisition, generation and sharing activities. Overall, the telecommunications, information technology, chemicals and financial industries led in terms of knowledge readiness.

Aggregate Demand

Private investment grew by 8.6% per annum and its share of total investment increased to 51.1% in 2007. However, it fell short of the target of 11.2%. Increased capital spending was recorded in most economic sectors, particularly in manufacturing and services. Net FDI inflows also increased from RM15.0 billion in 2005 to RM29.1 billion in 2007. The Government continued to support and encourage private sector activities by reducing the cost of doing business and improving the efficiency of

Private sector led growth...

the public delivery system. This included reducing the corporate tax rate from 28% in 2006 to 27% in 2007.

Private consumption grew at 8.6% per annum exceeding the Plan target and its share to GDP increased to 50.5% in 2007. The increase in private consumption was attributed to the supportive financial environment, higher disposable income and positive wealth effect from strong commodity prices. In addition, the strong performance of the equity market and positive developments in the labour market further buoyed consumer sentiments.

Public investment grew at 8.9% per annum, higher than the Ninth Plan target of 5.0% per annum, mainly due to the speedier implementation of development projects. *Public consumption* increased by 5.7% per annum due to higher expenditure on emoluments arising from the salary adjustment for civil servants in 2007 as well as supplies and services.

Sectoral Performance

Services sector as major source of growth...

All sectors registered positive growth, led by the *services sector*, which expanded by 8.5% per annum. Robust growth in the services sector was contributed by the finance, insurance, real estate and business services subsector, which grew by 10.8% per annum. Financial and business activities expanded in line with the implementation of the Financial Sector Master Plan and the diversification of financial products, especially Islamic banking and finance as well as shared services and outsourcing. Another major contributor to the expansion

of the services sector was the wholesale and retail trade, accommodation and restaurants subsector, which grew by 9.5% per annum due to the rapid expansion in tourism.

The *manufacturing sector* grew at 5.1% per annum, lower than the targeted growth due to sluggish global demand for electronics and weak domestic demand for transport equipment. However, strong performance was recorded by the domestic-oriented industries², growing at 6.6% per annum mainly attributed to the construction-related industries such as iron and steel, fabricated metal products and non-metallic mineral products. The overall capacity utilisation rate of the manufacturing sector was sustained at 76% in 2007.

Growth in the *agriculture sector* moderated to 3.8% per annum following the slow growth of 2.1% per annum in the output of industrial crops. Production of palm oil and rubber was affected by floods in early 2007 as well as biological stress. Production of crude palm oil declined by 0.5% in 2007 with average fresh fruit bunches yield per hectare falling by 2.9% to 19 tonnes. Production of rubber also declined by 6.5% in 2007 to 1.2 million tonnes. The food crop subsector grew at 6.3% per annum due to increase in productivity following large scale commercial activities and better agronomic practices.

The *construction sector* recorded an average growth of 2.0% per annum. The growth was mainly attributed to the civil engineering activities related to the implementation of the Plan projects. Demand for housing and commercial buildings also contributed to the growth of the sector.

² This comprises construction-related, fabricated metal, food processing, transport equipment, beverages and tobacco, petroleum products, paper products and other manufacturing industries.

The *mining sector* grew marginally at 0.2% per annum, due to a decline in the output of crude oil and gas in 2006. The production was affected by the closure of a number of oil fields for maintenance and the planned upgrading to expand the capacity at the Malaysia Liquefied Natural Gas 2 (MLNG2) plant in Bintulu, Sarawak. Mining activities picked up in 2007 with the coming on-stream of Malaysia's first deep sea oil field in Kikeh, Sabah and the re-opening of the MLNG2 plant.

Federal Government Account

The Federal Government continued to pursue a prudent fiscal policy as reflected by the narrowing of fiscal deficit from 3.6% to GDP in 2005 to 3.2% in 2007. Total revenue recorded strong growth at 14.7% per annum arising from higher revenue, particularly petroleum income tax and returns on investment income. On the other hand, operating expenditure also grew at a higher rate of 12.2% per annum due to salary adjustment for civil servants as well as subsidy payments. The development expenditure was financed by the increasing current surplus and manageable level of borrowings. The Federal Government debt stood at RM266.7 billion or 41.6% to GDP in 2007.

External Sector

Merchandise Trade

Trade surplus averaged RM100 billion a year in spite of a moderate growth of 6.2% per annum for *gross exports* due to the slowdown in the export of electrical and electronics products. Exports were sustained by primary commodities, mainly agriculture products and crude oil. *Gross imports* grew at 8.0% per annum attributed

by the increase in demand for capital and intermediate goods that support domestic activities. However, average import intensity declined to 47.3% in 2007 from 48.3% in 2005, indicating the improved capability of local industries in supplying capital and intermediate goods.

Balance of Payments

The *overall balance of payments* strengthened to RM45.3 billion or 7.2% of gross national product (GNP) in 2007, attributed to the large surplus in the *current account* arising from sustained surplus in goods, turnaround in services and reduced deficit in the income account. For the first time, the *services account* registered a surplus following lower deficit in transportation services and higher net receipts in the travel account. The deficit in the income account decreased from 4.8% of GNP in 2005 to 2.2% in 2007, mainly due to the inflow of profits and dividends accruing to Malaysian companies operating abroad.

Resource Balance

Gross national savings remained high, averaging 38.4% to GNP in 2006-2007, enabling Malaysia to finance its economic activities from domestic sources. *Gross national investments*, including change in stocks, stood at 22.0% of GNP. Thus, the resource balance recorded a surplus of 16.4% to GNP.

Price Development

Inflation rate increased by 2.8% per annum in 2006-2007. The increase was mainly due to higher food and energy prices while prices of textile products and telecommunications

Trade surplus of RM100 billion a year...

Services account in surplus for the first time...

services declined. Despite world oil prices remaining high in 2007, domestic fuel and gas prices were increased only once in March 2006. Producer prices grew at a faster rate of 5.9% per annum, due largely to buoyant prices of commodity-related products.

expected to remain high as a result of protracted increase in oil prices as well as other commodities, including food. World trade is expected to grow at 6.2% per annum, supported by steady demand-driven expansion in global high-tech products and increasing liberalisation.

III. MOVING FORWARD, 2008-2010

Macroeconomic Strategies

The world economic environment is expected to be more challenging arising from slower growth in the advanced economies, high energy and commodity prices and geopolitical uncertainties as well as increased competition from emerging economies. To ensure that Malaysia moves towards achieving Vision 2020, the macroeconomic strategies, in line with the five thrusts of the National Mission, will be as follows:

- *Managing price stability;*
- *Enhancing competitiveness;*
- *Stimulating new sources of growth;*
- *Raising productivity; and*
- *Maintaining prudent fiscal management.*

International Economic Outlook

The world economy is projected to grow at 4.1% per annum during the 2008-2010 period. Despite moderation in the growth of the United States of America, Europe and Japan, the strong growth in the People's Republic of China, India and emerging Asia is expected to sustain the projected growth. Inflation is projected to remain moderate at 2.2% per annum in the advanced economies and at 5.9% per annum in the emerging markets and developing countries. Global inflation is

Malaysian Economy

GDP in real terms is expected to grow at 6.0% per annum during the 2008-2010 period. Growth is expected to be driven by domestic demand, particularly private sector expenditure. On the supply side, the services, manufacturing and agriculture sectors will remain as the main sources of growth. Per capita income in current terms is projected to increase by 8.8% per annum to RM29,711 (US\$9,285) and per capita income in purchasing power parity to US\$18,439 in 2010.

Total Factor Productivity

During the remaining Plan period, TFP contribution to growth is expected

Sustaining macroeconomic stability...

Chart M-3

Total Factor Productivity, 2006-2010

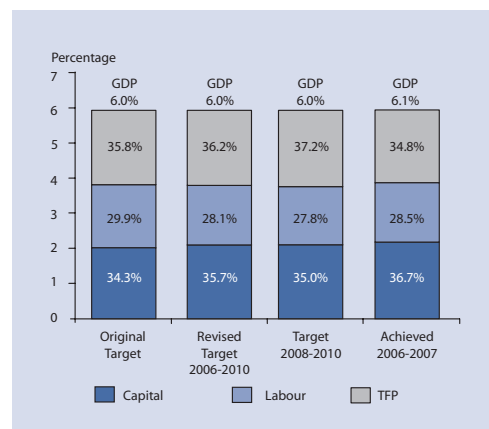


Table M-1

Key Economic Indicators

<i>Item</i>	<i>9MP Target 2006-2010</i>	<i>Achieved 2006-2007</i>	<i>Target 2008-2010</i>	<i>Revised 9MP Target 2006-2010</i>
Real GDP (% growth per annum)	6.0	6.1	6.0	6.0
Per Capita Income in Current Price (RM) ¹	23,573	23,066	29,711	29,711
Annual Growth Rate (%)	5.9	10.6	8.8	9.5
Per Capita Income in Purchasing Power Parity (US\$) ¹	13,878	13,529	18,439	18,439
Demand Side, in 2000 Constant Prices (% growth per annum)				
Consumption	6.5	8.0	7.4	7.6
Private	6.9	8.6	7.6	8.0
Public	5.3	5.7	6.6	6.2
Gross Fixed Capital Formation	7.9	8.7	8.5	8.6
Private	11.2	8.6	10.6	9.8
Public	5.0	8.9	6.3	7.0
Exports of Goods and Services	7.1	5.6	4.3	4.8
Imports of Goods and Services	7.9	6.9	6.0	6.4
Supply Side, in 2000 Constant Prices (% growth per annum)				
Agriculture	5.0	3.8	4.4	4.1
Mining and Quarrying	3.4	0.2	3.4	2.1
Manufacturing	6.7	5.1	3.5	4.1
Construction	3.5	2.0	5.8	4.3
Services	6.5	8.5	7.9	8.2
External Trade (% growth per annum)				
Gross Exports	8.5	6.2	8.1	7.4
Gross Imports	9.8	8.0	9.8	9.1
Balance of Payments (RM billion) ²				
Goods	149.8	127.7	134.1	134.1
Services	-4.5	2.4	3.8	3.8
Income	-39.5	-13.8	-21.4	-21.4
Current Account Balance	91.2	100.5	95.7	95.7
% to GNP	13.4	16.0	11.4	11.4
Savings (% to GNP)	36.2	38.4	37.2	37.6
Consumer Price Index (% growth per annum)				
Headline	-	2.8	3.0 ~ 4.0	-
Rural	-	2.9	-	-
Urban	-	2.8	-	-
Producer Price Index (% growth per annum)				
Domestic Economy	-	5.9	-	-
Local Production	-	7.1	-	-
Imports	-	3.5	-	-

Notes: ¹ End period.² End period, net.

Source: Economic Planning Unit and Department of Statistics Malaysia

to increase. TFP contribution will be increased by focusing on enhancing skills and knowledge and providing an enabling environment for creativity and innovation.

Aggregate Demand

Private sector driving growth...

Private investment is projected to grow at 10.6% per annum. In nominal terms, private investment is estimated to reach RM121.0 billion or 56.4% to total investment in 2010. Total private investment in the remaining Plan period is estimated to be RM305.8 billion. Private investment will be promoted by providing a conducive environment for investment, including enhancing the delivery system, removing regulatory impediments and addressing skills shortages. In addition, dedicated incentive packages will be provided for high technology and knowledge-intensive investments. The privatization programme and private finance initiatives (PFI) will also contribute towards increasing private investments.

Public investment is anticipated to grow at 6.3% per annum, taking into account the expected additional capital expenditure of non-financial public enterprises and the general government. The Government will continue to implement programmes and projects to expand the productive capacity of the economy. Focus will be on people-centred projects such as poverty eradication, reducing disparities and the provision of social and physical infrastructure.

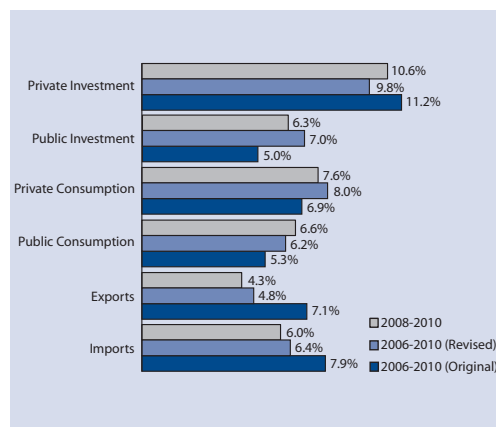
Private consumption will continue to be a major source of growth and is expected to grow at 7.6% per annum with its share to GDP increasing to 52.9% in 2010. Consumer confidence is anticipated to improve further with increasing employment opportunities and higher disposable income. Public consumption is expected to grow at 6.6% per annum, reflecting higher expenditure on emoluments to improve the delivery system.

Sectoral Output

The services sector is expected to sustain its growth momentum at 7.9% per annum. Growth will be led by the financial and business services subsector growing at 9.8% per annum with Islamic banking, *takaful* and *re-takaful*, shared services and outsourcing as the main contributors. ICT services such as software and content development as well as Internet-based services and e-commerce solutions are expected to gain more prominence.

The wholesale and retail trade, accommodation and restaurants subsector is projected to expand by 8.4% per annum with a robust performance expected from tourism and tourism-related sectors. The transport and communication subsector is projected to expand with further promotion of Port Klang, Selangor and Port of Tanjung Pelepas, Johor as cargo transshipment centres as well as the further development of low-cost carrier services.

Chart M-4
Gross Domestic Product by Expenditure, 2006-2010
 (% growth)



The *manufacturing sector* is expected to record moderate growth at 3.5% per annum, arising from sluggish global demand of electrical and electronics products. Growth will be led by the domestic-oriented industries expanding at 5.5% per annum, mainly the construction-related industries, in line with the expected expansion of construction activities.

The *agriculture sector* is expected to grow at 4.4% per annum with the food crop subsector growing at 6.2% per annum and the industrial crop subsector growing at 3.0% per annum. Emphasis will be given to increasing productivity through replanting activities with new and high-yield clones, land consolidation, good farm management practices as well as maximising the use of technology and mechanisation.

The *mining sector* is expected to grow at 3.4% per annum. The oil and gas subsector will continue to be the main source of growth contributing 98.7% to the sector.

The *construction sector* is expected to record a robust growth of 5.8% per annum, contributed mainly by civil engineering activities as well as the residential and commercial property subsector. The implementation of social and physical infrastructure projects will generate growth in this sector. The development of regional growth corridors will further stimulate the expansion of this sector.

Construction sector to resume its growth momentum...

Federal Government Account

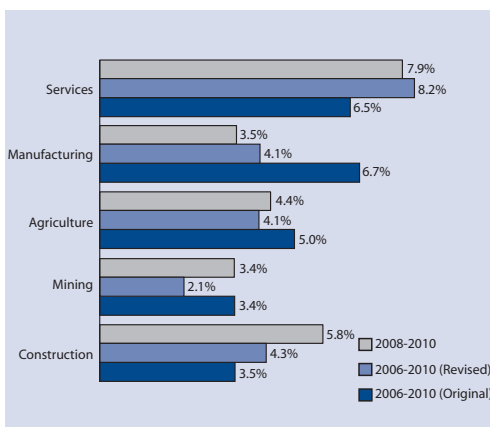
The Government will continue to practise fiscal prudence. The fiscal deficit is expected to be sustained at 3.2% of GDP in 2010. Measures will be taken to enhance the revenue base by reviewing tax incentives and improving tax collection.

Sustainable fiscal deficit...

During the remaining Plan period, the *operating expenditure* of the Federal Government is targeted to moderate to 6.9% per annum. Subsidy on petroleum products will be reduced gradually as the Government will introduce a fairer system for the benefit of the poor and the lower income group.

Chart M-5

Gross Domestic Product by Industry Origin, 2006-2010
(% growth)



Development expenditure ceiling for the Ninth Plan will be increased by RM30 billion to RM230 billion. The additional ceiling is to take into account additional development requirements and the increase in construction-related materials cost. Development projects will also be reprioritised giving priority to people-centred projects. In addition, the privatization program and the PFI will be used to complement public investment to provide better quality services to the public and ensure value for money. Fiscal discipline will be strengthened through competitive bidding and promoting best practices in the implementation of projects.

People-centred development projects...

Table M-2
Federal Government Fiscal Position, 2005-2010

Item	RM billion			% to GDP				
	2005	2007	2010	2005	2007	2010	2006-2010	
							Original	Revised
Revenue	106.3	139.9	179.0	20.3	21.8	20.8	21.9	21.5
Operating Expenditure	97.7	123.1	150.3	18.7	19.2	17.5	19.1	18.4
Current Surplus	8.6	16.8	28.7	1.6	2.6	3.3	2.8	3.1
Net Development Expenditure	27.3	37.5	56.6	5.2	5.8	6.6	6.2	6.3
Overall Deficit	-18.7	-20.7	-27.9	-3.6	-3.2	-3.2	-3.4	-3.2

Source: Economic Planning Unit and Ministry of Finance

External Sector

Merchandise Trade

Gross exports is projected to grow at 8.1% per annum. Malaysian producers and exporters are expected to benefit from the continuing liberalisation of trade in goods and services under the World Trade Organization (WTO) and ASEAN Free Trade Area, regional trade agreements and bilateral free trade agreements.

The exports of manufactures is projected to expand by 8.1% per annum, reflecting the sustained expansion in demand from traditional and new markets. Exports of agricultural and mining commodities are expected to grow by 14.2% and 9.2% per annum respectively, mainly attributed to higher export prices.

Gross imports is projected to grow at 9.8% per annum arising mainly from imports of intermediate and capital goods, which

together constitute 85.3% of total imports. This is in line with the sustained demand for imported components with the expansion in the manufacturing sector. Imports of consumption goods is expected to grow at 9.7% per annum. As a result, trade balance is projected to decline from RM100.3 billion in 2007 to RM97.0 billion in 2010.

Balance of Payments

The *overall balance of payments* is expected to remain strong due to high surplus in the goods account as well as the bigger surplus in the services account. The *current account* surplus is projected to reach RM95.7 billion or 11.4% of GNP in 2010, supported by the sustained strong position in the goods account, partly due to better commodity prices and terms of trade. The services account surplus is projected to improve to RM3.8 billion or 0.4% of GNP in 2010, mainly contributed by higher net travel receipts. This is in tandem with the

Government's efforts to position Malaysia as a premier tourist destination and the increase in exports of services such as education, health care and outsourcing.

The *income account* is expected to remain in deficit, mainly due to repatriation of profits and dividends accruing to foreign investors. Gross outflow of profits and dividends is estimated to be RM21.4 billion or 2.6% of GNP in 2010. Foreign investors will continue to be encouraged to reinvest in Malaysia.

economic activities and strong commodity prices. Despite higher consumption spending growing at 11.0% per annum, gross national savings is expected to expand by 8.9% per annum, constituting 37.2% of GNP. Investment, including changes in stocks is expected to be robust and expand by 15.3% per annum. Consequently, the resource position is expected to be in surplus at RM292.2 billion or 12.8% of GNP during the 2008-2010 period, reflecting the country's capacity to finance domestic investment without relying on foreign borrowings.

Healthy resource position to support investment growth...

Resource Balance

Gross national product in current prices is projected to grow at 10.1% per annum, in line with the expansion in domestic

Price Development

High world oil and commodity prices will continue to put pressure on domestic

Table M-3

Balance of Payments, 2005-2010

Item	RM billion			% to GNP		
	2005	2007	2010	2005	2007	2010
Balance on Goods	128.9	127.7	134.1	25.9	20.3	16.0
Exports	539.4	605.9	765.8	108.2	96.5	91.3
Imports	410.5	478.2	631.7	82.4	76.1	75.3
Balance on Services	-9.6	2.4	3.8	-1.9	0.4	0.4
Transportation	-15.9	-13.2	-13.5	-3.2	-2.1	-1.6
Travel	18.7	29.1	31.7	3.7	4.6	3.8
Others	-12.4	-13.6	-14.4	-2.5	-2.2	-1.7
Balance on Income	-24.0	-13.8	-21.4	-4.8	-2.2	-2.6
Balance on Current Account	78.3	100.5	95.7	15.7	16.0	11.4
Financial and Capital Account	-37.0	-37.2	-	-7.4	-5.9	-
Overall Balance of Payments	13.6	45.3	-	2.7	7.2	-

Notes: As at 30 May 2008

Source: Economic Planning Unit and Department of Statistics Malaysia

inflation. To maintain a stable and low price level, efforts will be taken to ensure sufficient supply of essential goods and services to meet the growing demand. This includes measures to increase productivity of the food subsector, the implementation of the National Food Security Policy and better distribution network. The Government will continue to closely monitor price movements, adopt an accommodative monetary stance and encourage consumers to practise prudent spending and avoid wastage. Efforts will also be taken to adopt market-oriented pricing mechanism in the long-term.

IV. CONCLUSION

During 2006-2007, the Malaysian economy achieved a robust growth, driven by domestic demand. During the remaining Plan period, 2008-2010, macroeconomic strategies will focus on enhancing resilience, productivity and competitiveness to sustain the rate of economic growth. Growth will be accompanied by low inflation and unemployment as well as healthy external balance and sustainable fiscal deficit. The private sector will continue to be the engine of growth while the public sector will provide the enabling environment.