The Malaysian Economy in 2005

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OVERVIEW

Notwithstanding the persistently high oil prices and the downturn in the global electronics cycle, real gross domestic product (GDP) expanded by 5.3%. Growth was private-sector driven and was underpinned by supportive macroeconomic policies and favorable financial conditions. Private consumer demand was sustained at a strong pace while the resilience in private investment further supported economic expansion. The public sector continued to take the opportunity of a favourable environment to consolidate its finances to more sustainable levels.

Real GDP expanded by 5.3% in 2005. Appropriate macroeconomic policies and favourable financial conditions continued to enhance economic resilience and supported balanced economic expansion.

The estimates indicate that the economy was on a balanced growth path in 2005 as potential output growth was sustained at 5.7%. As a result, the output gap, (the difference between actual and potential output expressed as a percentage of the potential output level) was low at +0.7%. The data also showed that the contribution of productivity growth to total growth had improved, suggesting the gradual shift up the productivity ladder and the more efficient utilisation of factor inputs (Details in Box 1).

Graph 1.1
Real GDP, World Trade and Inflation Rate

Growth was balanced and broad based, with most sectors of the economy, (except the construction sector) registering positive growth rates. Value added in the manufacturing sector increased by 4.9%. The developments in the manufacturing sector were influenced by the cyclical turns in the global electronics industry. The first half-year experienced slower production growth, mainly as a result of the mild downturn in the global electronics cycle which was caused by accumulation of excess inventories in the second half of 2004. Domestic manufacturers undertook an inventory adjustment exercise and rationalised production at the beginning of the year. However, the subdued performance of the electronics and electrical (E&E) industry was cushioned by the strong growth in selected resource-based industries, namely the chemical products and off-estate processing industries, as well as strong performance in selected domestic-oriented industries.

The manufacturing sector was stronger in the second half-year as the export-oriented industries regained strength and other major domestic industries continued to expand. During this period, global semiconductor sales began to pick up as global demand from both businesses and consumers worldwide increased. Sales in the Asia Pacific region improved in the second half-year (18.5%; 1H2005: 14.1%) spurred by strong demand for mobile computers due to the increasing popularity of wireless systems as well as the pick-up in global demand for consumer electronic products such as mp3 players, digital cameras, digital televisions and cellular phones. Malaysian producers, who had completed their inventory adjustment in the earlier part of the year, were well-positioned to take advantage of the higher demand and as a result, production and sales expanded. In the domestic-oriented industries, output of the food products and transport equipment industries increased due to resilient domestic demand while output of the construction-related industries contracted due to the slow construction activities.

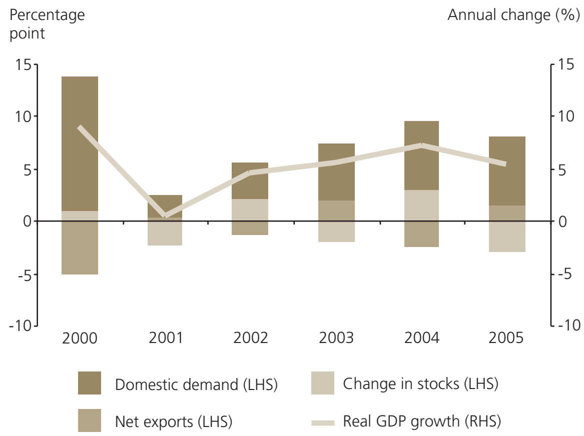
Growth in services sector was sustained at 6.5%, surpassing the overall GDP growth rate. Growth was underpinned by the strong private consumption and increased tourism and increased business activities. The expansion in the wholesale and retail trade, hotels and restaurants sub-sector (8%; 2004: 7.1%) was bolstered by strong consumer spending. Higher spending was particularly evident during certain periods of the year when there were the annual nationwide sales and the year-end festivities. In the intermediate services, the transport, storage and communication sub-sector expanded at a moderate pace of 6.3%, reflecting the lower spending of the new but less affluent mobile phone subscribers. Although world and regional trade performance was strong in 2005, it slowed from the exceptionally strong growth rates registered in 2004. This coupled with the more moderate growth in the domestic manufacturing sector tempered the growth in the transportation industry. The finance, insurance, real estate and business services sub-sector recorded a sustained growth at 5.4% during the year, as demand for funds and other financial and business services increased in tandem with economic activity. Furthermore, the new business services such as shared services and outsourcing activities continued to provide the impetus to growth in the sector.

Value added in the agriculture sector recorded a moderate increase of 2.1% in 2005. Palm oil production was markedly higher, growing by 7%, although higher yields were offset by the weaker performance in the other agriculture activities including rubber, fisheries and paddy. Growth in the mining sector also moderated (0.8%) due to lower production of crude oil, though natural gas output was substantially higher. The decline in crude oil production was a result of shutdowns of several oil installation facilities during the year for maintenance and repair purposes. In contrast, the increase in natural gas output was supported by the strong demand from the domestic power generators, industrial sectors as well as foreign buyers. The higher demand was accommodated by the increased capacity utilization at the MNLG plants.

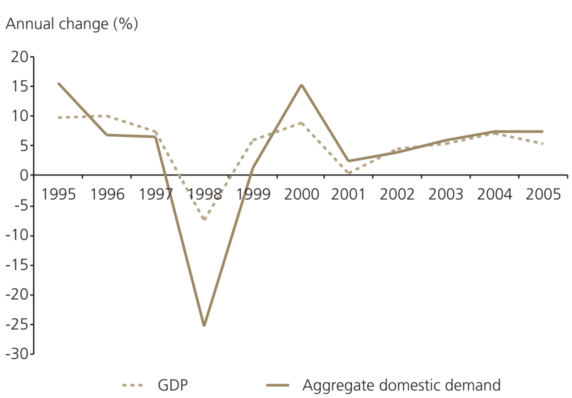
Value added in the construction sector contracted for the second consecutive year (-1.6%; 2004: -1.5%) as civil engineering activities were subdued following the completion of several large infrastructure projects in recent years. However, the residential and non-residential segments continued to expand due to resilient demand for houses and firm interest for office and retail space. Reflecting the increased demand, occupancy rates for office and retail space improved in 2005. In the residential sub-sector, continuing income growth and stable job prospects encouraged demand from households. In addition, the low interest rates and innovative property loans also supported this demand as they helped make purchases of houses affordable.

Aggregate domestic demand remained resilient, growing by 7.3%, as the economy was able to adjust to the impact of the escalating oil prices. The staggered increment of retail petrol prices did not have a disruptive effect on the cost structure of companies who continued to register reasonable profit margins. Producers had partly absorbed some of the price increases and thus moderated the increase in domestic prices. The cost-push increase was mainly seen in the transport and communications category while the core inflation remained at 2% (2004: 1%). As a result,

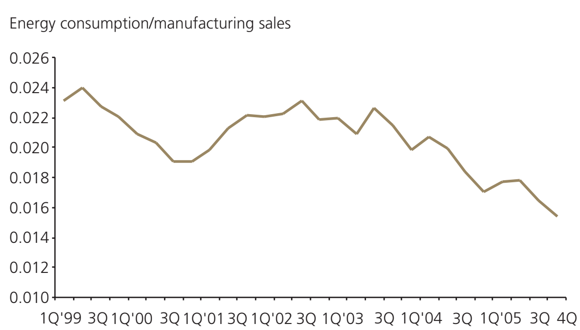
Graph 1.3
Contribution to Real GDP Growth



Graph 1.2
Real GDP and Aggregate Domestic Demand



Graph 1.4
Efficiency of Energy Usage



Source: Department of Statistics, Malaysia and Tenaga Nasional Berhad

Table 1.1: Malaysia – Key Economic Indicators

	2003	2004	2005*p*	2006*f*
Population (million persons)	25.3	26.0	26.7	27.2
Labour force (million persons)	10.4	10.8	11.3	11.5
Employment (million persons)	10.0	10.5	10.9	11.1
Unemployment (as % of labour force)	3.6	3.5	3.5	3.5
Per Capita Income (RM)	14,870	16,616	18,106	19,484
(USD)	3,913	4,373	4,781	5,145
NATIONAL PRODUCT (% change)				
Real GDP	5.4	7.1	5.3	6.0
(RM billion)	232.4	249.0	262.0	277.6
Agriculture, forestry and fishery	5.6	5.0	2.1	2.0
Mining and quarrying	5.8	3.9	0.8	5.0
Manufacturing	8.4	9.8	4.9	7.0
Construction	1.5	-1.5	-1.6	1.0
Services	4.5	6.8	6.5	6.0
Nominal GNP	10.5	14.1	11.3	9.7
(RM billion)	372.5	425.1	473.1	519.1
Real GNP	6.9	7.3	6.4	5.8
(RM billion)	217.2	233.1	248.0	262.5
Real aggregate demand[1]	6.1	7.5	7.3	5.9
Private expenditure[1]	5.5	13.1	9.5	7.4
Consumption	6.6	10.5	9.2	6.8
Investment	0.4	25.8	10.8	10.0
Public expenditure[1]	7.2	-2.1	3.1	3.0
Consumption	11.5	6.0	5.9	3.2
Investment	3.9	-8.7	0.4	2.7
Gross national savings (as % of GNP)	36.5	37.3	37.1	38.1
BALANCE OF PAYMENTS (RM billion)				
Goods balance	97.8	104.5	126.5	138.4
Exports (f.o.b.)	398.0	481.2	536.9	601.9
Imports (f.o.b.)	300.2	376.8	410.5	463.5
Services balance	-15.3	-8.8	-10.2	-10.3
(as % of GNP)	-4.1	-2.1	-2.2	-2.0
Income, net	-22.5	-24.5	-21.5	-23.7
(as % of GNP)	-6.1	-5.8	-4.5	-4.6
Current transfers, net	-9.3	-14.6	-17.0	-15.0
Current account balance	50.6	56.5	77.8	89.4
(as % of GNP)	13.6	13.3	16.4	17.2
Bank Negara Malaysia international reserves, net[2]	44.9	66.7	70.5	-
(in months of retained imports)	6.6	7.9	7.8	-
PRICES (% change)				
CPI (2000=100)	1.2	1.4	3.0	3.5 - 4.0
PPI (1989=100)	5.7	8.9	6.8	-
Real wage per employee in the manufacturing sector	2.9	1.9	0.8	-

Note: Figures may not necessarily add up due to rounding.

[1] Exclude stocks.

[2] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account.

p Preliminary

f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	2003		2004		2005*p*	
FEDERAL GOVERNMENT FINANCE (RM billion)						
Revenue	92.6		99.4		106.3	
Operating expenditure	75.2		91.3		97.7	
Net development expenditure	38.3		27.5		27.3	
Overall balance	-20.9		-19.4		-18.7	
Overall balance (% of GDP)	-5.3		-4.3		-3.8	
Public sector net development expenditure	83.3		56.7		71.0	
Public sector overall balance (% of GDP)	-4.9		4.1		1.4	
EXTERNAL DEBT						
Total debt (RM billion)	186.7		200.6		195.9	
Medium- and long-term debt	153.2		156.8		149.7	
Short-term debt[1]	33.5		43.7		46.2	
Debt service ratio (% of exports of goods and services)						
Total debt	6.4		4.6		4.7	
Medium- and long-term debt	6.3		4.4		4.5	
	Change in 2003		**Change in 2004**		**Change in 2005**	
	RM billion	**%**	**RM billion**	**%**	**RM billion**	**%**
MONEY AND BANKING						
Money supply M1	13.0	14.6	12.2	11.9	9.8	8.5
M2	42.5	11.1	108.1	25.4	82.0	15.4
M3	48.5	9.7	68.0	12.4	49.7	8.0
Banking system deposits	49.5	9.8	70.1	12.7	68.6	11.0
Banking system loans[2]	21.6	4.8	40.1	8.5	44.2	8.6
Manufacturing	-0.2	-0.3	1.9	3.2	-2.4	-3.7
Broad property sector	14.6	8.4	19.7	10.5	20.5	9.9
Finance, insurance and business services	-0.6	-2.1	1.7	5.7	-0.8	-2.6
Loan-deposit ratio (end of year)	80.9%		78.4%		77.5%	
Financing-deposit ratio[3]	91.7%		87.7%		85.8%	
	2003		**2004**		**2005**	
	%		**%**		**%**	
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)						
Overnight Policy Rate (OPR)	-		2.70		3.00	
Interbank rates						
3-month	2.87		2.80		3.20	
Commercial banks						
Fixed deposit 3-month	3.00		3.00		3.02	
12-month	3.70		3.70		3.70	
Savings deposit	1.86		1.58		1.41	
Base lending rate (BLR)	6.00		5.98		6.20	
Treasury bill (3-month)	2.77		1.96		2.96	
Government securities (1-year)	2.93		2.24		3.30	
Government securities (5-year)	4.28		3.64		3.73	
	2003		**2004**		**2005**	
	%		**%**		**%**	
EXCHANGE RATES						
Movement of Ringgit (end-period)						
Change against SDR	-8.5		-4.3		8.9	
Change against USD[4]	0.0		0.0		0.5	

[1] Excludes currency and deposits held by non-residents with resident banking institutions.
[2] Includes loans sold to Cagamas.
[3] Adjusted to include holdings of private debt securities.
[4] Ringgit was pegged at RM3.80=USD1 on 2 September 1998 and shifted to a managed float against a basket of currencies on 21 July 2005.
p Preliminary

Potential Output of the Malaysian Economy

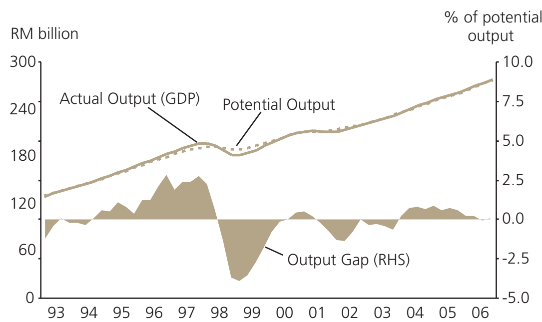
Potential output is the trend level of output that is consistent with the aggregate productive capacity of an economy. It traces the sustainable growth path of the economy. Conceptually, the growth in potential output is primarily determined by the expansion and non-inflationary utilisation of physical capital and the labour force, as well as total factor productivity (TFP) growth. TFP growth captures productivity increase arising from improvements in the utilisation of factor inputs due to technological progress and overall efficiency improvement. Therefore, the sustainability of long-term growth of an economy depends not just on factor accumulation but also crucially on improvements in skills, capital efficiency, the overall economic environment, as well as technological progress.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	(Annual change in %)				(% of potential output)
1994-1998	5.8	7.3	2.7	3.1	0.9
1999	6.1	1.0	-6.5	3.7	-3.1
2000	8.9	6.4	25.7	4.3	-0.1
2001	0.3	3.3	-2.8	1.6	0.0
2002	4.4	2.8	0.3	3.5	-0.8
2003	5.4	4.8	2.7	3.6	-0.4
2004	7.1	5.8	3.1	4.0	0.7
2005e	5.3	5.7	4.7	4.1	0.7

e Estimates

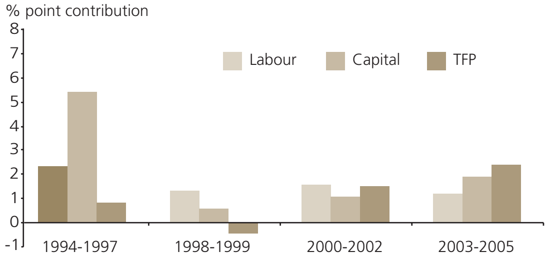
Graph 1
Actual and Potential Output



The latest estimates for Malaysia show that potential output grew at 5.7% in 2005, with the output gap[1] estimated at positive 0.7% of potential output. This indicated that the Malaysian economy was operating slightly above its potential in 2005. Overall, the period corresponding to the 8th Malaysia Plan (2001-2005) was characterised by relatively balanced growth, with the economy expanding close to its potential capacity. Amidst a backdrop of a recovering capital stock, potential output grew at an average annual rate of 4.6% compared with 4.5% for actual output during this period. The output gap, which captures the extent to which the economy is deviating from the non-inflationary trend of output, was on average less than ±1% of potential output. Despite numerous external shocks to the region and the growing global imbalances during this period, the economy did not experience any large deflationary or inflationary cycles, indicating Malaysia's growing economic resilience.

The period of 2001-2005 also witnessed a transition of the Malaysian economy in terms of factor contributions and the general level of economic efficiency. As shown in Graph 2, the growth in potential output was driven mainly by the accumulation of capital in the early 1990s, with moderate contributions from labour and TFP growth. However, beginning 1997, the contribution from capital accumulation began to decline and from 2001, TFP growth started to improve. This shift suggests that Malaysia has been moving from a factor-driven to a productivity-driven economy.

Graph 2
Factor Contributions and TFP Growth



Going forward, potential output of the economy is expected to grow at a pace of 6% in 2006 with the positive output gap closing towards the end of the year due to the continuous improvement in productivity and expansion of both capital stock and labour force. This trend of a balanced expansion of the Malaysian economy is expected to be sustained into the future, given the continued upward trend in productivity and increased resilience.

[1] The output gap is the difference between the levels of actual and potential output and the gap is measured as a percentage of potential output. A positive output gap indicates that actual output is above potential output, while a negative output gap indicates the reverse.

inflation which peaked at 3.7% in August, was lower than the increase in commodity prices. More importantly, higher energy prices also appeared to have increased the pace of transformation towards greater efficiency and drive for higher productivity in order to minimize costs, thereby helping to contain inflation at manageable levels. The data indicates a downward trend in the energy intensity of the manufacturing sector.

Private consumption increased at a strong pace of 9.2% as positive developments in the economy, in particular, the increase in job vacancies, rising disposable incomes and the accommodative financing conditions supported the growth. While consumers were affected by higher fuel prices, there was a willingness to moderate their savings rate in order to maintain their level of consumption, further underscoring their confidence on income growth and positive outlook for the economy. Reflecting this confidence, the Malaysian Institute of Economic Research (MIER)'s Consumer Sentiments Index remained over the 100-point threshold throughout 2005, rising to 116.1 by end-year. In addition, the Government took active measures, following the adjustment in administered prices by reinstating allowances to mitigate the increase in the cost of living and reducing road taxes on smaller vehicles used by the lower-income group.

Private investment registered a strong growth of 10.8% in 2005 as companies expanded their capacity, upgraded and replaced old and obsolete machinery. Although volatile energy prices may have increased the firms' uncertainty regarding the outlook for aggregate demand, this was balanced by positive factors, particularly the strengthening of the electronics cycle in the second half of the year as well sustained strength in domestic demand. Higher capital expenditure was seen in all sectors of the economy with services, mining and manufacturing sectors recording strong increases in capital expenditure. In contrast, the capital spending in the construction sector declined as a result of the end of the construction of several privatized roads.

While external demand expanded at more moderate pace compared to 2004, its contribution to growth turned positive in 2005 (1.5 ppt; 2004:-2.5 ppt). The positive contribution to growth was primarily due to exports growing (11%) at a faster rate than imports (8.5%). The expansion in exports was more subdued than in 2004 as a result of the softening of the IT sector, which was felt at the beginning of the year. Exports of primary commodities however remained strong (16%, 2004: 21.8%) reflecting the higher prices of crude oil and liquefied natural gas (LNG). Malaysian crude oil, which is of the "light sweet", grade commands a premium over the "heavy and sour" crude grade.

Import growth moderated to 8.5% (2004: 26.4%), resulting in a larger trade surplus. The slower growth in imports of intermediate goods reflected the subdued performance of the E&E sector. As a result, the trade surplus widened to RM99.8 billion (2004: RM80.7 billion).

The services account recorded a larger deficit of RM10.2 billion (2004: -RM8.8 billion) as the smaller deficit in the transportation account was offset by higher payments for travel abroad as well as a higher deficit in the other services account. Similarly, the income account also recorded a deficit in 2005, albeit smaller than in 2004 (-RM21.5 billion; 2004: -RM24.5billion). Outflows of profits and dividends accruing to foreign investors was partly offset by higher receipts from earnings accruing to Malaysian investors abroad as well as higher returns on the external reserve holdings. The combined effects of a wider trade surplus with a smaller income account deficit resulted in a higher current account surplus of 16.4% of GNP, the highest level achieved since 1999 (2004: 13.3%).

Given its strong fundamentals and the structural changes taking place in the region, Bank Negara Malaysia adjusted the exchange rate regime on 21 July 2005, moving from a pegged exchange rate against the US dollar to a managed float. The more flexible regime allows Malaysia to respond to changes in the international and domestic environment. The ringgit since appreciated to reach 3.7460 to the US dollar before closing the year at 3.78. Reflecting Malaysia's strong external conditions, the rate has continued to improve further to 3.7055 in 3 March 2006.

Speculative portfolio investment, which flowed in at the beginning of the year in anticipation of an appreciation of the ringgit, was unwound in the second half of the year. The portfolio flows have subsequently returned to normal levels in an orderly price discovery process. Apart from the portfolio funds, the larger repayment of external loans by the public sector and larger extension of trade credits by Malaysian exporters also contributed to the outflows in the financial account during the period. As a result of these outflows, the financial account recorded a net outflow of RM42 billion in 2005 (2004: +RM15.1 billion).

On a gross basis, foreign direct investment (FDI) increased to RM25 billion (2004: RM23.5 billion), or 5.3% of GNP. The FDI inflows were seen mainly in the services, oil and gas and manufacturing sectors. In the services sector, the FDI inflows were broad based, channeled mainly into the finance, insurance and business services as well as restaurants, hotels, wholesale and retail sub-sectors. Reflecting the increased interest by Malaysian companies to diversify abroad, outflows for overseas investment also increased.

The current account surplus remained and more than offset the net outflow in the financial account and foreign exchange revaluation losses arising from the strengthening of ringgit against the major currencies. As such, the international reserves increased further to RM266.3 billion or equivalent to USD70.5 billion at end 2005. By 28 February 2006, the international reserves level rose further to RM272.7 billion or USD72.2 billion, adequate to finance 7.6 months of retained imports and is 6.7 times the short-term external debt.

Malaysia's external debt declined to RM195.9 billion in 2005 (2004; RM200.6 billion), reflecting mainly the higher repayment of external loans by both the Federal Government and the non-financial public enterprises (NFPEs). The repayments by the Federal Government marked the maturity of a Euro bond issued in 2000 and some scheduled principal repayments of syndicated loans while in the case of the NFPEs, the maturity of US dollar-denominated bonds as well as prepayments of several loans. In contrast, the slight increase in short-term debt was due mainly to the increase in short-term debt of the banking sector arising from hedging activities on trade-related transactions and treasury activities. Malaysia's external debt position remains sustainable with the debt service ratio holding steady at 4.7% with its ratio to GNP declining to 41.4% (2004: 47.2%). Further, the short-term debt remained low, accounting for only 23.6% of total external debt.

In an environment of economic expansion and macroeconomic stability, financial sector soundness continued to improve. Capitalisation remained strong, accompanied by continued growth in profits and in the quality of loan portfolios. The capital position of the banking system remained strong with the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) at 13.1% and 10.2% respectively (2004: 14.4% and 11.4% respectively). In addition, the improvements in the asset quality of the banking system were evident, with the 6-month net non-performing loan (NPL) ratio improving to 4.6% (2004: 5.8%) while the 3-month net NPL improved to 5.8% (2004: 7.5%).

Macroeconomic Management

The prudent macroeconomic management by the Government further enhanced fundamentals of the Malaysian economy in 2005. The current account in the balance of payments remained in surplus, savings remained high, reserves increased, inflation remained at manageable levels and the external debt declined. In this context of sustained growth performance and fundamentals, the Government's continued commitment to strengthen its budgetary position was reflected in the narrowing of its budgetary deficit to 3.8% in 2005 from 4.3% of GDP in 2004. The Government's focus was on reallocating resources to smaller projects particularly in agriculture, construction, housing and for infrastructure development in rural areas. This progressive reduction in the deficit would provide the policy flexibility for the Government to mitigate potential adverse effects from uncertainties in the external sector. The Government recognised the need to help mitigate the higher international oil prices while ensuring price signals were transmitted efficiently, thus allowing economic agents to make the necessary adjustments to these developments. In 2005, the Government removed the price subsidies gradually, while in early 2006, a further adjustment was made to fuel prices effective 28 February. In order to improve predictability and allow agents to plan ahead, the Government also announced that no further adjustments would be made in 2006.

Macroeconomic management in 2005 focused on sustaining economic growth while improving the capacity of the economy to generate sustainable growth.

In managing the economy, public policy in 2005 focused on accelerating the shift towards higher value-added activities, strengthening the business environment to develop new sources of growth and enhancing competitiveness. In Budget 2005, the incentive structure was enhanced further to promote investment, particularly in new areas in the agriculture, manufacturing and services sectors, while efforts at improving the delivery system were intensified. In particular, the National Biotechnology Policy (NBP) was launched on 28 April 2005, to be implemented in three phases over 15 years. The objectives of NBP are to promote the establishment of new companies in order to develop the sector. When fully implemented, the biotechnology industry is expected to contribute up to 5% of GDP and provide strong links to upstream activities, most notably agriculture and manufacturing. Another important initiative taken was the setting up of the Tax Review Panel to ensure a more efficient tax system that is business-friendly and provides greater clarity and transparency.

To further enhance and promote the activities by small- and medium enterprises (SMEs), the National SME Development Council, which is chaired by the Prime Minister and with Bank Negara Malaysia acting as the

Secretariat, announced new initiatives to accelerate SME development. New trade financing products were introduced; SME info portal and online training portal were launched; a comprehensive definition for SMEs in various sectors for targeted development was released; and a framework for SME Development Planning and Evaluation was developed. The Council also endorsed the National SME Development Blueprint 2006, which includes a total of 245 programmes in all sectors to accelerate the development of SMEs. An allocation of RM3.9 billion has been committed by the Government to implement these programmes. The SME Bank commenced operations on 3 October 2005 to promote and expand SMEs contribution to the economy. The SME Bank specialises in providing both financial and non-financial assistance, including meeting business advisory needs, and providing education and training to SMEs. To further promote Malaysia's export of goods and services, the functions of Malaysia Export Credit Insurance Bhd (MECIB) has been absorbed by the Export Import Bank of Malaysia, in an effort to further improve the facilities for Malaysian exporters to enhance their competitiveness in the global market.

Development of Small and Medium Enterprises

The development of competitive small and medium enterprises (SMEs) is an important focus of Government policy. The efforts are aimed at:

- strengthening enabling infrastructure for SME development;
- building the capacity and capability of SMEs; and
- enhancing access to financing by SMEs.

The National SME Development Council[1] has provided the strategic direction for the Government policies on SME development so as to ensure coordination and effectiveness of Government programmes for SMEs.

(i) Strengthening Enabling Infrastructure for SME Development

(a) Framework for SME Development Planning and Evaluation

In view of the extensive SME programmes undertaken by a large number of Ministries and Agencies, it is important to ensure that the implementation of these programmes are coordinated and effective in developing the SMEs. A Policy Formulation and Evaluation Framework has been introduced to enhance the formulation and coordination of SME policies and programmes, as well as to monitor the implementation and outcomes of the programmes. The Framework involves the identification of broad strategic priorities, programmes and targets for SME development, as well as the establishment of comprehensive key performance indicators to evaluate effectiveness of the programmes on an annual basis.

(b) National SME Development Blueprint 2006

Following the adoption of the Framework for SME Development Planning and Evaluation, the National SME Development Blueprint for 2006 (Blueprint 2006) was endorsed by the Council in December 2005. The Blueprint 2006 is a one-year action plan of the Government to promote the development of SMEs. It outlines the following:

- Objectives and targets for SME development in 2006;
- Key strategies, programmes and financial commitments; and
- Ministries and Agencies involved in implementing these programmes.

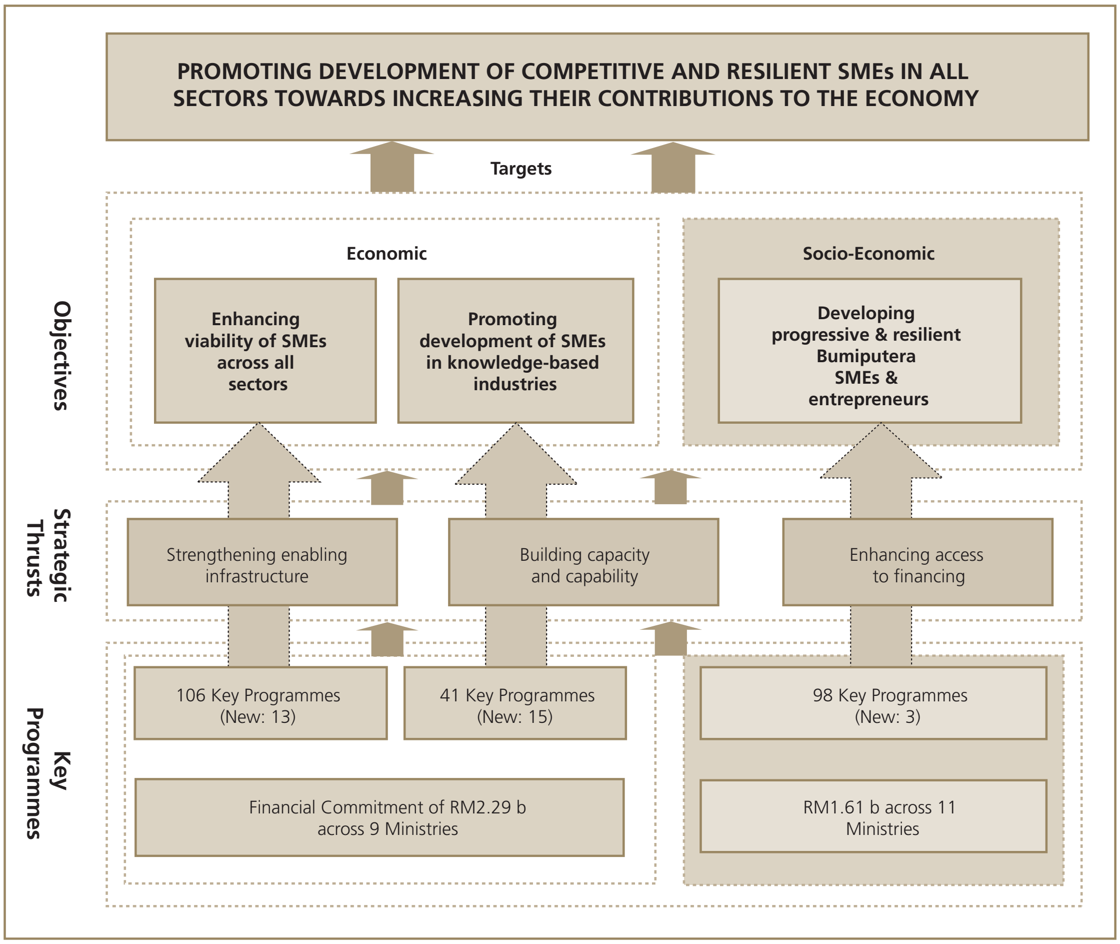
For 2006, a total of 245 programmes involving financial commitment of RM3.9 billion have been identified for implementation to accelerate the development of SMEs. These are aimed at strengthening the enabling infrastructure to support SME development; building the capacity and capability of SMEs; and enhancing SMEs' access to financing. The programmes will cover all sectors, including SMEs in agriculture and agro-based industries, and those involved in knowledge-based industries. Efforts will also be directed to developing progressive and resilient Bumiputera entrepreneurs and SMEs.

[1] The National SME Development Council is chaired by the Prime Minister and comprises of Ministers and Heads of 18 key Ministries and Agencies involved in SME development.

A total of 170 key programmes will be implemented to build capacity and capability of SMEs, mainly in the areas of entrepreneurial and human resource development, as well as marketing and promotion. These include programmes to inculcate entrepreneurship at schools and institutes of higher learning, as well as initiatives to assist SMEs in expanding their market network, through market expansion programmes and developing linkages with large corporations, government-linked companies and hypermarkets.

Forty-two key programmes will be implemented to strengthen the infrastructure to support SME development, which include incentives to encourage SMEs to upgrade their business premises as well as establishment of incubation centres. For greater access to financing, 33 key programmes will be

Overview of SME Development: Objectives, Strategies, Key Programmes and Financial Commitment in 2006



implemented in 2006. These include the establishment of a RM300 million venture capital fund for agriculture, an additional RM300 million allocation for the Fund for Food, pre-seed funding for the ICT sector and the transformation of the Credit Guarantee Corporation Berhad to further strengthen the infrastructure for SME financing.

(c) Adoption of Definitions for SMEs in Malaysia

All Ministries, Agencies and financial institutions involved in the development of SMEs have adopted the new definitions of SMEs in the primary agriculture, manufacturing, manufacturing-related services and services sectors. The definitions are based on the criteria of annual sales turnover or number of full-time employees. The adoption of a common identifier for SMEs in these sectors will facilitate the identification of issues and prospects of the sectors concerned to enable appropriate policy actions to be taken. It will also allow for closer monitoring of SME performance and contribution to the economy.

(d) Profile and Contribution of SMEs to the Economy

The availability of relevant data on the development and performance of SMEs is critical to facilitate the formulation of effective policies to support the creation and growth of SMEs. As a result, the Census of Establishment and Enterprise for the agriculture, manufacturing and services sectors was launched in March 2005, covering about 1.7 million companies and businesses. At end-December 2005, 492,806 completed responses were received. A preliminary assessment of responses from 349,617 companies and businesses (including large enterprises) highlighted the following:

- Of the 349,617 establishments, 99% or 346,211 respondents are SMEs (including microenterprises). Of this, 81% are microenterprises operating with less than 5 full-time employees, while 17% and 2% are small and medium enterprises respectively; and
- The SMEs contributed to 38% of total output and accounted for 55% of total workforce of these 349,617 business establishments.

The preliminary findings reinforced the need for aggressive efforts to be undertaken in a strategic and coordinated manner to support the expansion of SMEs and strengthen their capacity and competitiveness, given the potential for them to contribute more effectively to the nation's economy. A detailed analysis of the profile and performance of SMEs will be provided in the first Annual Report on SME Development 2005, scheduled to be released in June 2006.

(ii) Building Capacity and Capability of SMEs

(a) SMEinfo Portal: A One-Stop Online Information Gateway for SMEs

The SMEinfo Portal (www.smeinfo.com.my), launched in January 2006, is a one-stop online information gateway to provide comprehensive information on all aspects of SME development. The SMEinfo Portal provides SMEs with convenient access to information on Government support and development programmes, financing, advisory services and training programmes. In addition, the Portal also provides links to relevant websites that contain useful information for SMEs, including websites of financial institutions. An important feature of the Portal is the free SME Directory, which offers an opportunity for SMEs to advertise their companies and products to large potential customers.

(b) Online Training Portal for SMEs

To facilitate SMEs to obtain information and register for training, the Human Resource Development Portal (HRD Portal), a web-based training portal developed by Pembangunan Sumber Manusia Berhad, was launched in March 2005. The HRD Portal, www.hrdportal.com.my, will assist employers to search, identify and register for training programmes online, and at the same time, allow training providers to offer their training programmes and activities online. By providing access to a central pool of training information, the HRD Portal will facilitate and encourage employers, particularly SMEs, to retrain and upgrade the skills of their employees in order to enhance productivity and competitiveness.

(c) Publication of Annual Report on SME Development

A report on SME development, that will provide a comprehensive assessment on the status and performance of SMEs in all sectors, as well as details and achievements of the Government's programmes for SMEs, will be published every year. The publication is part of the initiatives to enhance the dissemination of information on SMEs, and therefore, increase the awareness among SMEs and others on the status of SME development and programmes to support SMEs. The Annual Report on SME Development 2005 is scheduled for release in June 2006.

(iii) Enhancing Access to Financing by SMEs

Banking institutions are the largest provider of financing to SMEs. In 2005, the banking system approved RM35.8 billion of new loans to more than 85,000 SME accounts, representing an increase of 13.1% from 2004 (2004: RM31.6 billion; 92,000 SME accounts). Loan disbursements grew by 10.2% to RM110.7 billion (2004: RM100.4 billion), while loans outstanding to SMEs expanded by 8.7% to RM96 billion as at end-2005 (end-2004: RM88.3 billion). Loans to SMEs accounted for 42.6% of business loans outstanding as at end–2005, compared with 40.3% as at end 2004. On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to distributive trade, manufacturing and construction sectors. Gross non-performing loans (NPLs) of SMEs declined marginally to RM10.2 billion and the gross NPL ratio declined to 10.6% (end-2004: RM10.6 billion; 12%).

A number of development financial institutions (DFIs) also provide financing to SMEs. In 2005, the DFIs approved RM2.3 billion of loans to 5,223 SME accounts (2004: RM2.4 billion to 5,397 SME accounts), and disbursed RM1.5 billion (2004: RM1.2 billion). The loans outstanding of DFIs to SMEs increased by 3.3% to RM3.1 billion as at end-2005 (end-2004: RM3 billion). Another source of financing for SMEs is the leasing and factoring companies, which provide an alternative mode of financing to finance equipment and working capital requirements. In 2005, RM819 million of financing was extended by leasing and factoring companies to businesses in services, manufacturing and general commerce sectors (2004: RM996 million). For newly established businesses, especially in the ICT sector, financing could also be obtained from venture capital companies. The total available funds for venture capital investments increased by 14.3% to RM2.6 billion as at end-2005 (end-2004: RM2.3 billion). The funds were invested in 380 companies as compared with 332 companies as at end-2004.

Special Funds for SMEs

Bank Negara Malaysia has five special funds to assist SMEs to have access to financing at reasonable costs (lending rates ranging from 3.75% to 5.00%). The funds are channeled through participating institutions comprising banking institutions, DFIs and ERF Sdn. Bhd.:

- Fund for Small and Medium Industries 2 (fund size: RM4.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.35 billion);
- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

Due to strong demand, allocations for the Fund for Small and Medium Industries 2 and New Entrepreneurs Fund 2 had been increased in 2005 by RM250 million and RM350 million to RM4.75 billion and RM2.35 billion respectively.

Initiatives to Improve Access to Financing by SMEs

The policy on enhancing access to financing by SMEs during the year continued to focus on:

- Strengthening the existing infrastructure to ensure a more effective intermediation of funds to SMEs;
- The provision of advisory support and awareness programmes; and
- Assisting in debt restructuring of financially distressed SMEs with viable business.

Among the new initiatives introduced in 2005 are:

(a) Transformation of Credit Guarantee Corporation Malaysia Berhad

One of the initiatives to strengthen the infrastructure of SME financing is the transformation of Credit Guarantee Corporation Malaysia Berhad (CGC) involving the enhancement of its role and expansion in the range of products and services offered by CGC. In enhancing SMEs' access to financing, CGC will take a holistic approach by providing wider range of credit enhancement products, advisory services on financial and business development, and credit information services. These services are aimed at facilitating greater lending to SMEs while promoting sound financial management practices by SMEs. To meet its new expanded role, the composition of the Board of CGC has been broadened to include members with experience in business and finance, while efforts are being taken to strengthen the resources of CGC.

(b) Venture Capital for Agriculture Sector

To support the Government's objective of realising the potential of the agriculture sector as the third engine of growth, Bank Negara Malaysia is establishing two venture capital funds of RM150 million each for the agriculture sector in 2006. The objective of the funds is to create and develop an integrated agricultural business through the provision of venture capital financing, as well as technical and business support, with its spill over effects that will benefit and enhance the whole value chain of the agriculture sector. The targeted areas for investments are integrated farming and fisheries, as well as biotechnology-related ventures.

(c) Establishment of the SME Bank

The SME Bank commenced operations on 3 October 2005 as a result of integration and rationalisation exercise between Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad, to support the development of the SME sector. The SME Bank will complement the banking institutions through the provision of financial and business support services to the SMEs. These include equity financing, working capital, term loans, industrial hire purchase, leasing, factoring, contract financing as well as bank guarantees. In addition, the SME Bank will also provide business and consultancy support services, such as advisory services and preparation of business plans.

(d) New Trade Finance Products for SMEs

Two new trade finance products for SMEs were introduced in January 2006, namely the Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS), under both conventional and Islamic financing. These products are aimed at encouraging SMEs to export their goods and services, particularly to the non-traditional markets such as members of the Organisation of Islamic Countries. The MCTF provides financing to Malaysian direct exporters in Ringgit and major foreign currencies in the form of pre and post shipment financing. The IEFS provides Ringgit financing to indirect exporters without recourse, whereby the participating banks will discount their trade invoices arising from the supply of goods and services to direct exporters. These products benefit the SMEs by lowering financing costs, without collateral requirements. Under the arrangements, the SMEs can obtain financing from the participating banks, with the credit risks being shared between the bank and Export-Import Bank of Malaysia Berhad.

Financial Advisory Service

Bank Negara Malaysia provides financial advisory services to SMEs in the following areas:

- information on various sources of financing;
- assistance in facilitation of loan application process; and
- advice on financial requirements and problems of SMEs.

In 2005, the number of enquiries and assistance sought by SMEs increased to 4,019 cases (2004: 1,399 cases) reflecting heightened awareness among SMEs as well as a result of the establishment of Laman Informasi, Nasihat dan Khidmat (LINK), in Bank Negara Malaysia, Kuala Lumpur. Of these, 81% were enquiries on special funds provided by the Government and advice on loan matters, and 19% were complaints against financial institutions, mainly for cases of loan rejection and poor response on SMEs' loan applications.

Performance of Small Debt Resolution Scheme

The Small Debt Resolution Scheme was established on 1 November 2003 to facilitate the restructuring of non-performing loans (NPLs) of SMEs with on-going business. Under the mechanism, a Small Debt Resolution Committee undertakes independent assessments on the viability of the businesses, loan restructuring and financing requirements of the SMEs.

As at end-2005, 394 applications with NPLs of RM278 million were received under the scheme (end-2004: 228 applications with NPLs of RM180.2 million). Of these, 286 applications, involving NPLs of RM183 million, have been approved for restructuring and RM16 million new financing was approved under the Rehabilitation Fund for Small Businesses. A total of 83 cases, with total NPLs of RM83 million, were rejected due to non-viability. Another 25 cases involving NPLs of RM12 million are being evaluated as some of the cases could not be processed due to the inability of applicants to provide the necessary information required to facilitate evaluation. The performance of the scheme has shown that the restructuring of NPLs is more important than the provision of new financing in ensuring the viability and sustainability of financially distressed SMEs.

In addition to new initiatives, the Government implemented further new measure to improve delivery system and quality of services. A number of customer service offices and one-stop centres were established, leveraging on ICT to expand public sector's reach and response time to investors, businesses and consumers.

Moving forward, the 2006 Budget put forth various pro-active measures to enhance national resilience and the ability to face external challenges, arising from higher oil prices, higher global interest rates and increasing global competition. Incentives have been given to develop new growth areas such as biotechnology, high technology manufacturing and ICT industries. The National Biofuel Policy was launched at the end of 2005 to encourage private sector involvement in the production of biodiesel. In terms of special development funds, the Government has announced an increase of RM300 million for the Fund for Food; the creation of Malaysian Life Sciences Capital Fund for investment in biotechnology with RM100 million contribution from the Government; and an RM1 billion fund to assist and encourage local entrepreneurs, especially *bumiputeras*, to venture abroad via facilities such as trade financing, overseas projects financing and credit insurance guarantee. In addition, selected companies undertaking ICT and multimedia services will be given Pioneer Status, which allows for tax exemption or tax allowances of up to 50% for five years. The Government increased the pace of developing the Multimedia Super Corridor (MSC) by awarding the status to cybercities of Bayan Lepas, Pulau Pinang and the Kulim High Technology Park in Kedah. The Government also continues to support the development of soft infrastructure by providing a large allocation to the education and training sector, focusing on developing skills in order to increase productivity and value-add from the workforce.

The overall motivation of macroeconomic management of Malaysia is the policy of pursuing balanced growth in an environment of social and political stability. At end-March 2006, the Government will launch the Ninth Malaysia Plan (9MP), 2006-2010, which provides the foundation for further development and strengthening the prospects for the Malaysian economy. The Plan will also focus on the importance of making progress in the new growth areas in order to achieve the successful transformation of Malaysia into a more resilient knowledge-based economy, while re-emphasising the Government's commitment to maintaining macroeconomic stability.

The monetary policy stance in 2005 aimed to promote sustainable growth in an environment of price stability. In formulating the stance of monetary policy, Bank Negara Malaysia undertakes a careful assessment of the risks to inflation and economic growth. In 2005, a particular challenge was to respond appropriately to the higher oil prices, recognising that price increases arose due to a multitude of factors with cost-push factors being dominant. Following the increases in transportation charges and retail prices of petrol and diesel in May, the inflation rate breached the 3% level. Demand-driven inflation, as measured by core inflation, was however well contained and registered a more gradual increase in the first half of the year. Real and monetary indicators did not suggest that demand pressures were a source of inflationary concern. Growth, which had been high at 6.2% in the first quarter, had also slowed to 4.4% in the second quarter.

Consumption and investment activity appeared to hold steady while financing activities and money supply continued to increase at relatively stable rates. In the second half of the year, the growth momentum picked up, with private sector demand growth becoming more entrenched. In the third quarter, real GDP growth accelerated to 5.3%, with the outlook for external demand becoming more optimistic. Growth in the global economy had remained relatively resilient to the higher oil prices while the semiconductor down-cycle had reached its trough by mid-year, with global sales and shipments picking up thereafter. Consequently, the Overnight Policy Rate (OPR) was raised by 30 basis points to 3% on 30 November 2005 to align the rates to the prevailing monetary conditions. At 3%, the OPR continued to remain below its neutral level, and therefore, continued to remain supportive of economic activity. With the release of the fourth quarter GDP data, which showed that the growth momentum was sustained at 5.2% while the underlying pressure on prices remained strong, Bank Negara Malaysia raised the OPR by another 25 basis points on 22 February 2006.

The institutional framework for developing, implementing and communicating monetary policy was further enhanced in 2005. Starting in December 2005, the Monetary Policy Committee (MPC) decided that the Monetary Policy Statement (MPS) would be issued after every MPC Meeting, further enhancing the transparency in communicating monetary policy. The December announcement also included the schedule of MPC meetings for 2006. This would allow market participants to better anticipate and understand Bank Negara Malaysia's policy stance and direction.

On the external front, there was an increase in net portfolio flows in the first half year, following speculation that there would be a revaluation of the Chinese yuan resulting in an appreciation of regional currencies including the ringgit. These inflows were at manageable levels and Bank Negara Malaysia sterilised the additional liquidity. On 21 July, Bank Negara Malaysia announced the change from a fixed exchange rate system to a managed float exchange rate regime. The ringgit's value is now based on a basket of currencies of major trade partners and regional countries. The new arrangement would enhance economic flexibility without sacrificing the stability accorded by the previous arrangement. Following the floating of the ringgit, speculative portfolio positions that had been built-up in the first half of the year were unwound. The unwinding of these flows was orderly, indicating that the price discovery process in the financial markets has been able to function efficiently. The strong reserves level provided an added cushion for these outflows, some of which were large, while the domestic financial system continued to operate in an environment of ample liquidity.

Of significance, the change to the floating rate regime was preceded with the setting up of the necessary risk management infrastructure to ensure a smooth transition. Rules on hedging were liberalised in April 2004 to allow both residents and non-residents to enter into hedging arrangements with licensed onshore banks. The rules allow greater flexibility to residents in managing their investments by facilitating wider options and avenues for risk management. In addition, Bank Negara Malaysia took steps to further liberalise the foreign exchange administration rules in order to improve the delivery system and enhance flexibility in the financial system and the economy. Effective 1 April 2005, further changes were made to give greater flexibility for overseas investment, including changing the thresholds for investment abroad, extension of credit facilities to non-residents and placement of funds by residents. Residents are also now allowed to open foreign currency accounts onshore or offshore, without requiring the approval from the Central Bank. Similarly, limits on foreign currency credit facilities that can be obtained by residents have been increased.

In managing the financial sector, the year saw further progress in implementing the longer-term development plans for the sector. With the Financial Sector Masterplan (FSMP) entering the second of its three phases, the stages was set in 2005 to create investment banks. Investment banks would mainly be involved in capital market activities and would be formed by the rationalisation of merchant banks, stock-broking companies, and discount houses. Similarly, universal brokers would also be allowed to seek partners to form investment banks. This integration will enhance the efficiency and effectiveness of capital market players by minimising duplication of resources and overlapping of activities, leveraging on the common infrastructure and reaping benefits of synergies and economies of scale. The framework is among the key initiatives to strengthen the capacity and capabilities of domestic banking and financial groups to contribute towards economic transformation and developing a more resilient, competitive and dynamic financial system. Another sign of the growing maturity of the financial system was the announcement that the limits to foreign ownership in local investment banks was now raised to 49%, compared with 30% for domestic banking groups.

To further increase competition in the banking industry, operational flexibility has been awarded to the locally incorporated foreign banking institutions (LIFBs) operating in Malaysia. LIFBs are allowed to establish four additional branches in 2006, which represents the first of a phased approach of branching liberalisation. This will allow greater participation of LIFBs in financial intermediation to all segment of the Malaysian society and economy. The wider dispersion of LIFB's branches across the country will further enhance consumers' access to a wider range of banking services and increase competition in providing wider spread of products to less developed areas of the country. The policy of gradually deregulating and liberalising the banking system is complementary with the objectives of bringing increased benefits by lowering the cost of intermediation and increasing the quality of financial services provided.

In the capital market, the launch of RM760 million Wawasan Bond by the International Bank of Reconstruction and Development (IBRD) in April 2005 was a significant development. This issuance further widened and deepened the domestic bond market. The Government has also issued short-term Islamic Treasury Bills and longer-term Islamic bonds to meet investor demand and diversify further Islamic financial instruments. Ensuring tax neutrality between Islamic and conventional capital market products would further facilitate the development of the Islamic bond market. To further enhance market turnover, Bank Negara Malaysia has actively used repurchase agreements (repo) since January as a monetary instrument, introduced the Institutional Custodian Programme to enable borrowing and lending of securities, and provided a securities lending facility for principal dealers. The implementation of these measures are also aimed at improving the price discovery process and increasing liquidity in the financial market and the development of a reflective benchmark yield curve. The ringgit bond market has continued to become an increasingly important source of financing to the economy.

In 2005, Bank Negara Malaysia adopted a multi-pronged approach in empowering consumers. In strengthening the consumer protection and education infrastructure various initiatives were implemented, and these include the establishment of Bank Negara Malaysia LINK *(Laman Informasi Nasihat dan Khidmat)*, the introduction of Basic Banking Services Framework, the establishment of the Financial Mediation Bureau, the introduction of a Deposit Insurance System and the establishment of the Credit Counselling and Debt Management (CCDM) Agency. In particular, the Bank Negara Malaysia LINK aims to enhance the effectiveness of Bank Negara Malaysia's interface with the public and is established as a centralised point of contact with the public on issues that relates to Bank Negara Malaysia's policies and operations, the financial sector and consumer education in the area of finance. Bank Negara Malaysia LINK also assists SMEs on issues that relate to access to financing by providing a centralised point of contact, and thereby contributing towards enhancing their contribution to the economy. These initiatives involve both infrastructure and institutional capacity development that includes financial education, advisory services, distress management, rehabilitation and putting in place avenues for redress. These steps are part of the efforts to ensure stability of the financial system as promoting a sound and progressive financial system is a pre-requisite to achieving sustainable economic growth and development.

SECTORAL REVIEW

Manufacturing Sector

Value added in the manufacturing sector grew at a moderate pace of 4.9% in 2005 (2004: 9.8%), as the domestic electronics and electrical product (E&E) segment experienced a soft patch in the first half of the year following the mild downturn in the global semiconductor industry. However, the slowdown was brief and by the second half of the year, the recovery in the E&E segment led to a stronger performance of the manufacturing sector (2H: 6.4%; 1H: 3.8%). The impact was also cushioned by continued growth in selected resource-based industries, such as the chemical products and off-estate processing industries. In the domestic-oriented industries, food and beverages and paper products industries also strengthened further during the year, while the transport equipment industry was firm supported by the strong domestic consumption. However, industries that are related to the construction sector, namely basic metal, non-metallic mineral products and fabricated metal products remained weak affected by the subdued performance of the construction sector.

The manufacturing sector continued to contribute to growth despite the slowdown in the electronics and electrical (E&E) product segment. The E&E recovery in the second half-year improved the performance in the manufacturing sector.

In 2005, the share of the manufacturing sector to overall GDP was largely unchanged at 31.4% (2004: 31.6%). Given the continued additions in capacity amidst the new investments, the overall capacity utilisation rate of the manufacturing sector was lower at 75% in 2005 (2004: 79%). The export-oriented industries operated at 77%, while the domestic-oriented industries operated at 73% during the year (2004: 81% and 75% respectively).

Based on the latest statistics from the revised Industrial Production Index (2000=100), manufacturing production grew by 5.1% in 2005 (2004: 12.8%). Of significance, output growth of the **electronics and electrical products (E&E)** industry

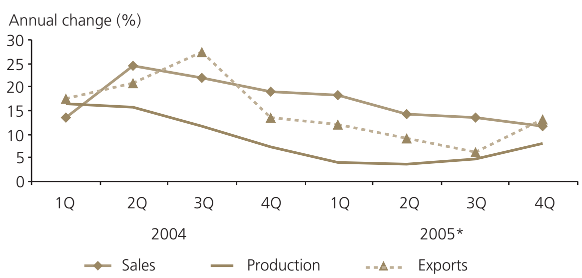
Table 1.3
Manufacturing Sector: Value Added and Production

	2004	2005
	Annual change in (%)	
Value-added		
(Constant at 1987 prices)	**9.8**	**4.9**
Overall Production	**12.8**	**5.1**
Export-oriented industries	**14.8**	**5.7**
of which:		
Electronics	25.6	5.2
Electrical products	5.5	-0.8
Chemicals and chemical products	15.1	11.0
Petroleum products	9.8	10.8
Textiles, wearing apparel and footwear	-4.8	3.4
Wood and wood products	12.8	1.5
Rubber products	8.1	-0.4
Off-estate processing	2.7	8.1
Domestic-oriented industries	**5.2**	**2.8**
of which:		
Construction-related products	1.3	-0.5
Food products	2.0	7.6
Transport equipment	11.7	8.5
Fabricated metal products	11.4	-4.9

Source: Department of Statistics, Malaysia

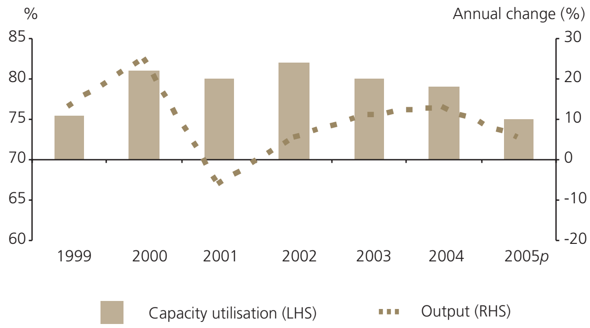
slowed down to 3.5% in 2005 (2004: 19.3%) affected by the global semiconductor down-cycle in the first half of the year. In an environment of an oversupply situation, while world demand continued to remain relatively steady, an early inventory adjustment by industry players across the various segments helped in the speedier recovery process during the second half of the year. Of significance, producers in the computer segment had normalised their inventory levels by the end of first quarter of 2005. Furthermore, global demand for computers was also supported by a structural shift in consumer demand from desktop computers to mobile and

Graph 1.5
Manufacturing Sector: Sales, Production and Exports



* 2005's production data were based on the new IPI figures (2000=100).

Graph 1.6
Capacity Utilisation in the Manufacturing Sector



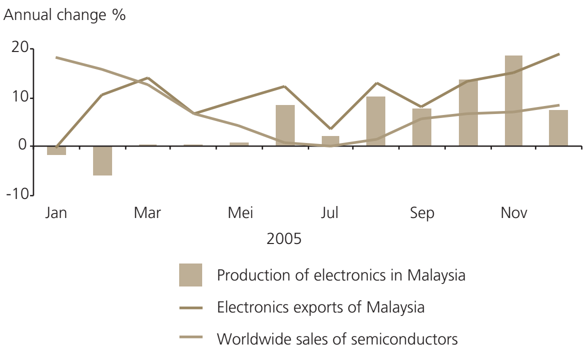
p Preliminary
Output data from 2001 onwards is based on the new Industrial Production index (2000=100)
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

portable computers, such as laptops, pocket personal computers (PCs) and handheld PCs with wireless connectivity function. Being a major exporter of computers with renowned multinational companies operating in Malaysia, the country had benefited from the positive developments in the computer segment throughout 2005. Computers and parts accounted for 27.5% of total manufactured exports and 41.8% of the E&E exports.

Despite the slowdown, domestic E&E manufacturers continued to invest and upgrade to higher value-added products. Of significance, major European electronics manufacturers continued to shift some of their production lines of more advanced semiconductors to Malaysia to benefit from the cost-efficient and matured manufacturing base. The move had broadened and deepened the industrial linkages within the sector.

By the second half of 2005, the global semiconductor industry began to show signs of recovery. Global semiconductor sales compiled by the Semiconductor Industry Association (SIA) gradually picked up to record a growth of 8.6% by December 2005 after bottoming out in July 2005. The US book-to-bill ratio of semiconductor equipment also rebounded to 0.93 by-end 2005 from its low of 0.77 recorded in February and the US new and unfilled orders continued to register positive growth. Industry experts expect the recovery to become more entrenched in 2006 and to continue into 2007. Growth would be increasingly broad based, supported by expansion in all categories of semiconductors, particularly consumer electronics which is expected to be the next driver of growth in the E&E industry.

Graph 1.7
Production and Exports of the Electronics Industry



The **chemicals and chemical products** industry continued to register a double-digit growth in 2005 (11%; 2004: 15.1%), led mainly by the strong growth in production of plastic products (21.5%; 2004: 19%) and other chemical products (10%; 2004: 25.5%). Higher domestic and external demand, emanating from the packaging, household and automotive segments supported the stronger expansion in the output of plastic products. Meanwhile, production of other basic industrial chemicals expanded further in 2005 due mainly to higher production of oleochemicals, which is a derivative of crude palm oil.

The **off-estate processing industry** recorded a robust growth in 2005, expanding by 8.1% (2004: 2.7%) benefiting from the higher output of crude palm oil during the year. Production of palm oil expanded at a faster rate of 7% (2004: 4.7%) attributable to increases in mature areas as well as higher yields.

Growth in output of **rubber products** declined marginally by 0.4% in 2005 (2004: 8.1%), due mainly to a decline in production of tyres and tubes, while the rubber gloves industry continued to expand. The production of tyres and tubes during the year was affected by a number of factors, including shortage of raw materials in line with the lower rubber production, temporary disruption in production of a major tyre manufacturer due to upgrading of machineries as well as competition from other regional producers.

Output growth of **wood and wood products** meanwhile moderated in 2005 (1.5%; 2004: 12.8%) due partly to weaker demand for Malaysian products from the major industrial countries such as the US, United Kingdom (UK) and Japan. During the year, the industry also faced shortages in supply of raw materials, particularly rubber wood. Subsequently, the Government took measures to alleviate the supply shortage by banning the export of rubber wood sawn timber as of 8 June 2005.

Output growth of the **textile, wearing apparels and footwear** industry recovered to expand by 3.4% in 2005 (2004: -4.8%) as Malaysia was one of the countries that benefited from the diversion of demand from China following the exhaustion of US import quota on China's textile products. Initially, in the early part of the year, production was soft as the expiry of the Agreement on Textile and Clothing (ATC), which came into effect on 1 January 2005, had an adverse effect on demand as industrial countries shifted their orders for textile and wearing apparels to lower-cost countries, particularly China. However, following the influx of textile import from China, the US authorities responded by imposing a growth limit on imports of Chinese textile goods to the US. As China's import quota for the year was filled up by July 2005, the excess new orders of textile products from the US were diverted to other textile-exporting countries in the region, including Malaysia, hence benefiting the textile output of these countries particularly towards the end of the year.

Production of **petroleum products** was also favourable during the year due mainly to robust oil refining activities amidst the higher domestic demand. Growth was also supported by activities related to liquefaction of natural gas for the export market.

In the **domestic-oriented industries**, production of **transport equipment** continued to expand strongly in 2005 due to the rapid growth in the car assembly activities and the spillover effects on production of parts and accessories for motor vehicles. Assembly of motor vehicles expanded by 7.5% (2004: 12.6%), led by the sustained demand for passenger cars which was supported by increases in household incomes and attractive financing packages offered by financial institutions, together with the introduction of new and affordable car models during the year. Meanwhile, the increasing localisation of the new models introduced during the year had also benefited the local production of car parts and accessories (12.1%; 2004: 1.1%).

On the other hand, output of industries in the **construction-related products** remained subdued (-0.5%; 2004: 1.3%), in line with the performance of the construction sector. In particular, production of **iron and steel** was affected by the slowdown in the domestic civil engineering segment, which is the major user of iron and steel. On the export front, external demand for iron and steel also softened substantially in 2005, due to the excess production in China, thus resulting in an overcapacity situation in the global market. Meanwhile, output growth in the **non-metallic mineral products** recovered during the year aided by the turnaround in the output of glass products. However, production of cement, structural clay and ceramic products continued to decline in line with the subdued performance of the construction sector.

Production of **fabricated metal** contracted for the first time since 2001, declining by 4.9% (2004: 11.4%) in 2005. The weak performance of this industry was caused mainly by the contraction in product segments such as wire products, metal fasteners, pewter and aluminium products. Meanwhile, the performance of other segments remained positive, particularly for structural metal products such as tanks, boilers, pressure vessels and heaters which are used mainly in the petroleum, food and off-estate processing industries.

Output growth in the **paper products** industry strengthened to 7.5% in 2005 (2004: 4.2%), supported by demand for pulp and paper products and continued growth of containers and paperboards, led by the increase in packaging activities emanating from the food and beverages industry.

Output of the **food and beverages industries** was higher in 2005, underpinned by strong private consumption. Of significance, the higher growth in the food industry was led mainly by the improvements in the segments related to dairy products as well as chocolate and sugar confectionary. The **tobacco industry** contracted by 3% (2004: 2.9%) due to lower demand for cigarettes arising from the higher prices following the increase in sales tax on cigarettes.

Services Sector

In 2005, the **services sector** continued to be the major driver of growth, contributing to 3.8 percentage points of the 5.3% GDP growth. Value-added growth of the services sector remained high at 6.5% (2004: 6.8%), surpassing the overall GDP growth during the year. As a result, the share of the sector to overall GDP increased further to 58.1% (2004: 57.4%; 1995: 51.2%).

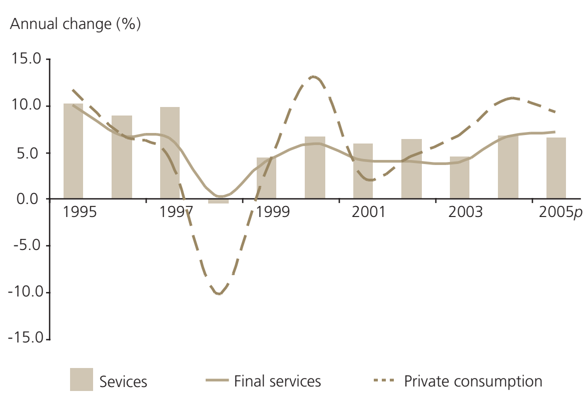
An important contributing factor for the continued lead performance of the services sector in 2005 was the strong growth in private consumption. Correlation between final services and private consumption is significant (1Q 2000 – 4Q 2005: 0.66). Besides the robust private consumption, the services sector was also driven by higher tourism and business activities and, to a lesser extent by trade-related activities, which picked up towards the latter part of the year in line with the upward momentum in manufacturing production and exports.

The services sector remained the key driver of growth underpinned by strong growth in private consumption.

In addition, efforts by the Government in recent years in promoting new areas of growth in the services sector also began to yield results and contribute towards the services sector's growth. These are high value-added activities such as information technology (IT) services; shared services and outsourcing (SSO); Islamic finance; investment banking; and health and medical tourism.

Given the strong private consumption, the **final services** segment (comprising the utilities; wholesale and retail trade, hotels and restaurants; Government services and other services sub-sectors) registered a higher growth of 7.1% (2004: 6.6%), the highest recorded since 1995. Meanwhile, the **intermediate services** segment (comprising the transport, storage and communication; and finance, insurance, real estate and business services sub-sectors) grew at a moderate pace of 5.7% (2004: 7.1%). The impact of the moderation in manufacturing growth and regional trade was to some extent offset by stronger performance of other business activity.

Graph 1.8
Growth in Private Consumption, Final Services and the Overall Services Sector



p Preliminary

Table 1.4
Growth in the Services Sector at Constant 1987 Prices

	2004	2005*p*	2004	2005*p*
	Annual change (%)		% share of GDP	
Services	**6.8**	**6.5**	**57.4**	**58.1**
Intermediate services	7.1	5.7	23.8	23.9
Transport, storage and communication	8.5	6.3	8.8	8.8
Finance, insurance, real estate and business services	6.3	5.4	15.1	15.1
Final services	6.6	7.1	33.5	34.1
Electricity, gas and water	8.2	5.5	4.1	4.1
Wholesale and retail trade, hotels and restaurants	7.1	8.0	14.3	14.7
Government services [1]	6.5	8.8	7.3	7.6
Other services [2]	4.9	4.9	7.8	7.8

[1] Include general public services (general public administration, external affairs and public order and safety), defence, health, education and others.
[2] Include imputed rent from owner-occupied dwellings; community, social and personal services; products of private non-profit services to households and domestic services of households.
p Preliminary

Source: Department of Statistics, Malaysia

The **wholesale and retail trade, hotels and restaurants sub-sector**, which accounts for one-fourth of the services sector recorded another year of strong growth of 8% (2004: 7.1%). The strong performance was supported by higher spending by domestic households and foreign tourists. In particular, the distributive trade (wholesale and retail) industry strengthened significantly. The motor vehicles trading and related accessories stores, one of the major components of the distributive trade industry recorded a robust performance supported by the 13% growth in vehicle sales.

Increase in domestic tourism activity following the full adoption of the five-day working week for the civil service since July 2005 was another contributory factor for the robust performance of the wholesale and retail trade, hotels and restaurants sub-sector. In addition, the various promotions and strategies undertaken by the Ministry of Tourism and the private sector, the change in the Mega Sales Carnival from twice previously to once a year (23 July 2005 to 4 September 2005) and the Year-end Sales (new programme: 1 December 2005 to 31 January 2006) resulted in increased shopping activities during the year. The strong consumer sentiment and confidence in the economy also contributed to the higher consumer spending during the year.

Besides higher domestic tourism, the country also saw an increase in foreign tourist arrivals, which contributed to the growth of the wholesale and retail trade, hotels and restaurants sub-sector in terms of increase in revenue from shopping, dining and hotel accommodation. The increased number of high-spending and long-haul tourists from the Oceanic (Jan-Nov 2005: 28.9%), Southern Asian (27%), West Asian (15.6%) and European (13%) countries contributed to the growth in the sector. As a result, the average hotel occupancy rate rose to 63.6% in 2005 (2004: 60.8%).

In addition, there was also an increase in long-term tourists as reflected by the 36.4% growth in the number of 'Malaysia, My Second Home' (MMSH) programme participants (2004: 16.5%). The higher number of new participants was a result of the increased efforts taken by the Government in promoting the programme. Among the key measures taken by the Government to make the programme more attractive to foreigners include extending the social visa from five years to ten years. Under the current MMSH programme (2002 – 2005), close to 7,000 foreign participants have been able to travel and live in Malaysia for an extended period, as well as to bring their families, purchase residential property and send their children to Malaysian schools.

Growth in the **finance, insurance, real estate and business services sub-sector** was sustained at 5.4% in 2005 (2004: 6.3%). Growth emanated from expansion in bank lending activities as well as increased collection of insurance premiums. Despite the narrowing spreads between the lending and deposit rates amidst the competition as well as mergers between commercial banks and finance companies, the increase in total loans outstanding by 8.6% contributed to the higher net interest income during the year. The finance segment has also been increasingly supported by fee-based income arising from the introduction of new banking services and products. Islamic banking gained further prominence during the year with the establishment of three new Islamic banking subsidiaries and one foreign Islamic bank. As a result, growth in total loans (16.5%), deposits (15.1%) as well as assets (17.7%) of the Islamic banking system continued to remain firm.

Insurance activity was also strong amidst the increase in the penetration rate in the life insurance industry (38.7%; 2004: 37.9%), led mainly by strong growth in premiums collected from new businesses from endownment; and medical and health insurance, and stronger growth in general insurance, particularly the motor vehicles industry. The increase in net premiums was also contributed by the higher net contribution from the takaful industry, emanating from both the family and general takaful funds.

The performance of the business services segment that includes the SSO industry and IT services was also encouraging. During the year, an additional 19 operational headquarters, 15 international procurement centres and three regional distribution centres were approved. In addition, 37 new SSO companies were granted Multimedia Super Corridor (MSC) status during the year, thus bringing the total to 57 as at end-2005. These entities undertake various types of shared services activities with their related and unrelated companies within and outside Malaysia.

With regards to IT services, the Government continued to promote MSC as a global ICT hub and to increase the usage and adoption of innovative domestic ICT products and services. As part of the gradual rollout of the MSC to the rest of the country, Penang and Kulim Hi-tech Park in Kedah were declared cybercity status in 2005, thus enabling new MSC-status companies to be based in the northern region. In the second phase of the rollout (2004 - 2010), the focus is on accelerating the MSC flagship applications, increasing adoption and introducing new initiatives to increase its competitiveness. As at end-2005, a total of 1,421 companies have been given MSC-status with total approved investment of RM18.2 billion.

The **transport, storage, and communication** sub-sector continued to expand by 6.3% in 2005 (2004: 8.5%). In the telecommunications industry, growth was mainly contributed by the cellular segment where the number of cellular subscribers and usage of both voice and data services continued to increase strongly during the year. Cellular subscribers rose by 33.8% (2004: 31.3%) to 19.5 million (74.1% penetration rate), while short messaging system (SMS) traffic rose significantly by 130.8%. During the year, SMS was increasingly used as a means of communication and to substitute for telephone voice calls; and in various applications, especially in the entertainment and leisure industry. Demand in the telecommunications industry was also induced by the introduction of 3G cellular phones services during the year. Meanwhile, the number of Internet subscribers rose to 3.7 million at end-2005, representing a growth of 11.5% (2004: 14.3%). As at end-2005, the penetration rate for Internet stood at 13.9% (2004: 12.7%). In the case of broadband, its usage continued to increase with the penetration rate rising to 1.9% as at end-2005 (end-2004: 1%).

Nevertheless, growth in the telecommunications industry was more moderate compared to 2004, following the downward trend in average revenue per user (ARPU) of cellular phones during the year. This was due to the keen competition among telecommunication players, as well as lower spending by new cellular subscribers, consisting mainly students and other lower income groups attracted by the introduction of low-priced starter packs.

Table 1.5
Selected Indicators for the Services Sector

	2004	2005*p*
	Annual change (%)	
Electricity production index	8.2	5.8
Loans outstanding in the banking system	8.5	8.6
Insurance premiums	16.3	7.7
Bursa Malaysia (turnover, volume)	-4.2	-4.7
Bulk cargo throughput at five major ports[1]	9.2	3.4
Container throughput at six major ports[2]	10.7	4.6
Airport passenger traffic	18.9	4.8
Air cargo handled	10.5	4.3
Consumption credit outstanding	16.4	18.7
Imports of consumption goods	24.1	5.9
Tourist arrivals	48.5	4.3[3]
SMS traffic	54.7	130.8
	%	
Hotel occupancy rate	60.8	63.6
Penetration rate:		
- Internet dial-up	12.7	13.9
- Broadband	1.0	1.9
- Mobile phone	56.5	74.1
- Fixed line	17.2	16.6

1 Port Klang, Johor Port, Penang Port, Sabah Ports and Bintulu Port
2 Port Klang, Johor Port, Port of Tanjung Pelepas, Penang Port, Sabah Ports and Bintulu Port
3 Refers to Jan-Nov data
p Preliminary

Source: Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Bursa Malaysia Berhad; Malaysian Communications and Multimedia Commission; Ministry of Finance; Relevant port authorities; Malaysia Tourism Promotion Board and Bank Negara Malaysia.

Meanwhile, the transportation segment grew moderately in line with the slower expansion in trade-related activities and moderate growth in passenger travel. Total container throughput at the five major ports increased by 4.6% in 2005 (2004: 10.7%), while the air cargo volume increased by 4.3% (2004: 10.5%). After a significant increase in tourist arrivals in 2004 in the post-SARs recovery period, air passengers at all airports grew moderately by 4.8% in 2005 (2004: 18.9%). Total passenger traffic at the Kuala Lumpur International Airport recorded a growth of 10.2% (2004: 20.6%) to reach 23.2 million passengers in 2005, supported by new landings and increase in flight frequencies of several international airlines as well as growth in the budget airlines. Passengers carried by the domestic budget airline rose by 30.1% or 1.1 million to a total 4.8 million in 2005. The significant increase was in response to new routes introduced by the budget carrier during the year. The year also saw a higher growth in land and rail passenger traffic as reflected by an increase in toll revenue from major highways as well as higher light rail transit riderships.

In the **Government services** sub-sector, the introduction of new allowances and increase in existing allowances for selected civil servants, yearly increments as well as bonus payments led to higher emoluments, with the sub-sector recording a higher growth of 8.8% (2004: 6.5%).

Growth in the **other services** sub-sector was sustained at 4.9% supported by expansion in other private services, namely entertainment and new areas such as private medical and healthcare services, private higher education services and multimedia broadcasting services. Malaysia is increasingly becoming a choice centre for medical tourism, particularly in niche areas such as cardiology, radiology, general surgery and wellness programme. Revenue from the private healthcare services, including private hospitals, recorded a strong growth as a result of more Malaysians and foreigners seeking medical treatment and health screenings in private hospitals and clinics. As at end-2005, 35 private hospitals are recognised by the Ministry of Health for the promotion of health tourism. In the private higher education services industry, there are more than 550 private higher educational institutions in 2005, including 11 private universities, 12 university colleges, five foreign university branch campuses and 537 private colleges, serving around 312,000 local students and 27,000 foreign students. The majority of the foreign students were from PR China and Indonesia, which accounted for a combined share of about 53.5% of total foreign students.

Meanwhile, the **utilities** sub-sector expanded by 5.5% (2004: 8.2%), supported by continued strong expansion in the economy, which resulted in sustained demand for electricity, particularly from the commercial and household sectors.

Agriculture Sector

Growth in the **agriculture, forestry and fishing (agriculture)** sector expanded at a more moderate pace of 2.1% in 2005 (2004: 5%). The growth was mainly supported by strong performance in the palm oil sector and higher growth in livestock, particularly poultry. Meanwhile, output of other agriculture activities including rubber, fisheries, saw logs, cocoa and paddy, declined during the year affected by factors related to nature. During the year, the Government together with the private sector continued in efforts to revitalise the agriculture sector and to sustain its importance as the third largest economic sector in the country. This was reflected in terms of the share of the sector to overall GDP (8.2%) as well as employment, with 12.9% of the overall labour force or 1.41 million people involved in the activity. On the external front, foreign exchange earnings from agriculture exports grew by 3.4% to account for 7% of total gross exports during the year.

The agriculture sector continued to expand, led mainly by strong performance in the palm oil sector amidst the favourable commodity prices.

While the palm oil sector benefited from high yields and an increase in mature areas, performance of the other agriculture crops were affected during the year by unfavourable weather conditions. In the initial part of the year, the after-effects of the Tsunami as well as the dry weather spell affected fishing and rubber activities. This was subsequently followed by rainy conditions towards the end of the year which disrupted rubber tapping and harvesting activities of many crops. Nevertheless, plantation companies and farmers continued to be encouraged by the favourable commodity prices in the global market. At the same time, yields continued to rise as a result of Good Agriculture Practices, which placed

Table 1.6
Agriculture Sector: Value Added, Production and Exports

	2004		2005*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value Added (RM million at 1987 prices)	**21,137**	**5.0**	**21,585**	**2.1**
Production[1]				
of which:				
Crude palm oil	13,976	4.7	14,961	7.0
Rubber	1,169	18.6	1,124	-3.8
Saw logs	21,509	-0.1	21,334	-0.8
Cocoa beans	33	-7.8	28	-16.3
Fish landings	1,528	3.2	1,424	-6.8
Exports (RM million)	**36,176**	**7.4**	**37,421**	**3.4**
of which:				
Palm oil				
('000 tonnes)	11,788	-5.6	13,073	10.9
(RM/tonne)	1,706	5.5	1,456	-14.6
(RM million)	20,107	-0.4	19,036	-5.3
Rubber				
('000 tonnes)	1,105	16.7	1,128	2.1
(sen/kilogramme)	470	24.3	513	9.0
(RM million)	5,198	45.1	5,787	11.3
Saw logs				
('000 cubic metres)	5,207	-5.9	5,759	10.6
(RM/cubic metre)	398	8.9	428	7.7
(RM million)	2,070	2.5	2,465	19.1
Sawn timber				
('000 cubic metres)	3,166	13.5	3,685	16.4
(RM/cubic metre)	1,015	-10.4	1,099	8.3
(RM million)	3,214	1.7	4,051	26.0

[1] All in '000 tonnes, except for saw logs in '000 cubic metres.
p Preliminary

Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Forestry Departments (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Fisheries Department, Malaysia

emphasis on intensive application of agricultural inputs such as fertilizers and utilisation of labour-saving technologies among estates and smallholders.

During the year, the Government continued to intensify its efforts to deepen and broaden the agriculture base as well as to encourage downstream activities to strengthen the linkages to the other sectors of the economy. Government ministries and agencies have begun implementing plans to transform and modernise the agriculture sector through higher productivity, accelerated private sector involvement (including government-linked companies) and deeper linkages between upstream activities and downstream agro-based industries.

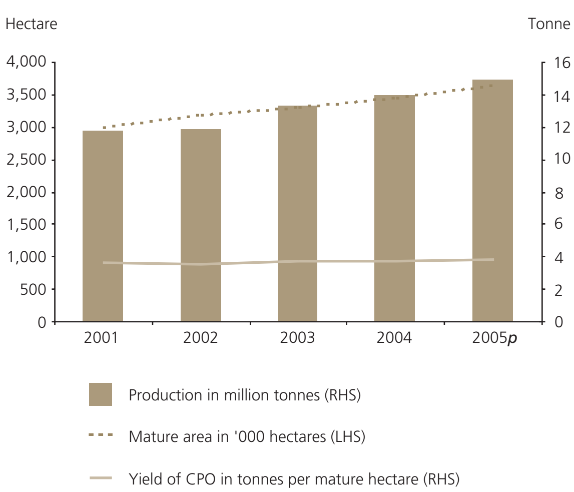
Of significance, the food crops sub-sector, which accounts for about 40% of the value added in the agriculture sector, has vast potential for creation of downstream value-adding activities such as processed and manufactured products for both domestic consumption and exports. These new activities would not only accentuate the growth potential of the economy and increase export earnings, but would also ensure that the rural communities involved in the agriculture sector enjoy higher and more stable income.

Crude palm oil (CPO), which is the most important crop in terms of value added in the agriculture sector (37%), saw another year of strong expansion, growing by 7% to reach a record high of 14.96 million tonnes in 2005. This represented the third consecutive year of strong growth (2004: 13.98 million tonnes, +4.7%; 2003: 13.36 million tonnes, +12.1%). The increase in production was mainly in the first half-year (20.3%) due to a bumper harvest. The substantial increase was attributed to two main factors.

First, during the year, the mature oil palm acreage rose substantially by 5.2% (179,790 hectares) to 3.63 million hectares (2004: +4.5%). The increase was reflected across all regions, with mature acreage in Peninsular Malaysia rising by 5.3% to 2.07 million hectares, Sabah's acreage increasing by 3.9% to 1.12 million hectares, while Sarawak's was higher by 8.3% to 0.44 million hectares. Of significance, production in Sabah (the largest producer by state accounting for 5.33 million tonnes or 35.6% of total production) and Sarawak recorded double-digit increases of 11.9% and 19.7%, respectively, while production in Peninsular Malaysia rose by 2.4%. Overall, Peninsular Malaysia continued to account for a majority share of about 55% to total Malaysian CPO production (2004: 58%).

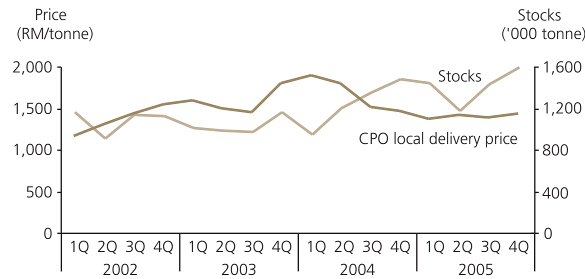
The second factor contributing to the strong production was the continued uptrend in palm oil yield productivity as reflected by the increase in oil extraction rates (OER) and output of fresh fruit bunches (FFB). The Malaysian OER continued to remain above the critical 20% threshold for the second straight year, rising to 20.15% (2004: 20.03%). This is a key performance indicator in the industry as every 1% increment in OER translates to an estimated

Graph 1.9
Oil Palm: Area, Production and Yield



p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

Graph 1.10
Palm Oil Price and Stocks



Source: Malaysian Palm Oil Board (MPOB)

increase of about 500,000 tonnes in CPO output. FFB yields were also higher by 1.5% to 18.88 tonnes per mature hectare (2004: 18.60 tonnes per mature hectare). In the light of these positive developments, Malaysia continued to maintain its status as the world's largest palm oil producer and exporter, accounting for 45% of world output and 51% of world exports.

Prices of palm oil remained supportive of the industry in 2005 with the CPO local delivery price averaging RM1,398 per tonne. Nevertheless, compared with the previous year, the price was lower by 16% (2004: RM1,664 per tonne). Palm oil prices began to consolidate since the second half of 2004 due to the increase in the supply of global edible oils as well as the increase in domestic palm oil stocks. The trend continued into 2005 with the price declining in the first half-year by 24.7% to RM1,391 per tonne before stabilising at RM1,405 per tonne in the second half-year. The sharp increase in palm oil harvests (1H 2005: +20.3%; 1H 2004: -2.3%) and the attendant increase in domestic palm oil stocks (May: 1.48 million tonnes) led to softer prices. Nevertheless, prices remained relatively stable in the second half-year supported by other mitigating factors such as the sluggish soybean harvest in the Latin American region as well as expectations of future demand for palm oil-based biodiesel. Overall, CPO remained competitive against other major edible oils, as the price discount of CPO to that of soybean oil and rapeseed oil widened further during the year to USD123 per tonne and USD237 per tonne, respectively.

The People's Republic of China (PR China) remained as the largest importer of Malaysian palm oil in 2005, accounting for 22.1% of the total exports. However, export growth to PR China grew at a more moderate pace (2005: 2%; 2004: 13.1%) despite the fact that PR China's import quota for palm oil was raised from 2.7 million tonnes in 2004 to 3.2 million tonnes in 2005. The moderation in demand was due to Chinese importers reducing their purchasing activities in the second half-year in anticipation of the impending changes in import duties. In line with PR China's commitment under the World Trade Organisation, effective 1 January 2006, the quota for edible oil imports was abolished and a standardised import tariff of 9% was imposed across all edible oils. This would be a positive development for palm oil exports to PR China.

Meanwhile, demand for palm oil from the US increased substantially by 79.4% (534,137 tonnes; 2004: +28.7%), as US food manufacturers began to increase the usage of palm oil as a substitute to other edible oils. Beginning 1 January 2006, the US Food and Drug Administration (FDA) would require food manufacturers to label products that contain *trans* fatty acid as clinical studies have linked *trans* fatty acid to serious diseases. Palm oil, which is *trans* fatty acid free, has benefited from this regulation. During the year, purchases from India declined further (-28.2%; 2004: -44%) as the discriminatory increase in import tariff rates for palm oil compared to soybean oil had resulted in higher import prices and, consequently, lower demand from Indian buyers.

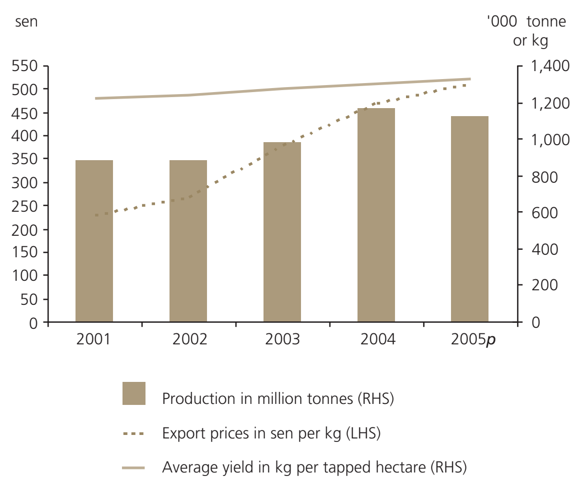
The Malaysian palm oil industry continued to make significant progress in terms of research and development. The Malaysian Palm Oil Board (MPOB) introduced 43 new technologies and products for commercialisation in the industry, and undertook 312 research projects during the year. The new breakthroughs were mainly in developing cost-effective milling and refining techniques, improving yields, minimising wastage, eradicating diseases and creating higher value-added palm-based products, as well as palm-based biomass.

Another important development in the palm oil industry in 2005 has been the commercialisation of palm oil-based biofuel at a global level. Amidst the increase in energy prices, countries began to seek alternative sources of energy, particularly from renewable resources. Among the renewable energy resources, palm oil has distinct advantages over other sources both in terms of price competitiveness as well as ready availability as Malaysian palm oil stocks have consistently been above 1 million tonnes over the last three years. Malaysia has pioneered the development of this technology through sustained research and development efforts which began a few years ago. The current high energy price environment has made it both feasible and necessary for Malaysia to embark on palm oil-based biofuel on a large scale. This would help to meet the higher demands in energy consumption from domestic users, create a new source of export earnings and stabilise the volatility in CPO price movements.

In line with this development, in August 2005, the Government announced the formulation of the National Biofuel Policy, which will be completed in 2006. The policy would provide guidelines on biofuel usage for all related sectors (particularly transportation, petroleum companies and palm oil industries), in addition to standardising the B5 biodiesel mixture for the domestic market (5% from processed palm oil, 95% from petroleum diesel), and ensuring that the palm biodiesel (chemically known as methyl ester) produced for the external markets conform to international standards. As part of the biofuel policy, attractive incentives would also be provided to encourage the growth in the biodiesel industry in Malaysia. To date, the interest in this industry has been tremendous with five palm biodiesel plants in the pipeline to commence operations in late 2006. At the same time, a pilot project to utilize B5 biofuel in transportation vehicles would be implemented by selected Government agencies.

After expanding at a strong pace in the last two years, **natural rubber** production declined in 2005 by 3.8% to 1.12 million tonnes (2004: 1.17 million tonnes). Nevertheless, the output level remained above the key threshold mark of 1 million tonnes. The decline in production during the year was due entirely to adverse weather conditions. Usually rubber trees produce less latex during the wintering months of February to April,

Graph 1.11
Natural Rubber: Production, Prices and Yield



p Preliminary for average yield
Source: Malaysian Rubber Board (MRB) and Department of Statistics.

but in 2005, exceptionally dry weather conditions during this period further aggravated the situation, thus resulting in declines in output on a year-on-year basis. In the last two months of the year, adverse weather, namely excessive rain, reduced tapping activity by smallholders, who account for almost 95% of total Malaysian rubber output. At the same time, the total tapped areas continued to decline, by 4% to 767,340 hectares, as more rubber land holdings were either being replanted with new rubber trees (2005: 23,000 hectares, with 94% replanted by smallholders), or in the process of being converted into other economic activities during the year. Nevertheless, Malaysia retained its position as the third largest producer of natural rubber after Thailand and Indonesia, with a 13% share of world output.

On the price front, Malaysian natural rubber prices continued on a strong upward trend in 2005 in line with developments in the global market. Prices of SMR20, the Malaysian benchmark, showed a double-digit growth for the third consecutive year, rising by 13.4% to average 523 sen per kilogramme in 2005 (2004: 461 sen/kg). In particular, prices rose significantly in the second half of the year to reach the highest daily traded price of 632 sen per kilogramme on 30 December 2005, while the monthly high of 588 sen per kilogramme was recorded in October 2005. The firming of rubber prices was supported by seasonal and fundamental factors. On one hand, global rubber supply was constrained due to adverse weather conditions in the key producing regions. Meanwhile, global demand continued to remain strong, particularly from PR China, driven by the rapid expansion in the automotive industry.

The strong demand coupled with the low production resulted in a significant fall in global stocks to reach a record low level, especially in the latter half of the year, thus exerting upward pressure on prices. In addition, natural rubber's closest substitute, synthetic rubber, which is a petrochemical product continued to record higher prices in line with higher crude oil prices. For the first time in 23 years, natural rubber prices rose above synthetic rubber prices.

Export proceeds from rubber rose markedly by 11.3% to RM5.8 billion in 2005, accounting for 1.1% of total gross exports. Almost one-third of the rubber exports during the year comprised shipments to PR China (2004: 26.1%). For the fourth consecutive year, PR China continued to increase its rubber purchases at a double-digit rate (33.7%; 2004: 39.2%). The higher off-take was fuelled by strong demand from tyre manufacturers arising from the rapid expansion in the domestic automotive industry. Apart from PR China, the other major buyers were the European Union (EU) countries, particularly Germany and France, accounting for 28.3% of total rubber exports.

In recent years, natural rubber has regained its status as one of the key commodities in the Malaysian agriculture sector due to its strong linkages to the overall economy, both to the rural-based smallholders, as well as to key export-oriented downstream rubber industries, such as rubber glove and tyre manufacturing. The strong natural rubber prices have benefited the smallholders in terms of raising their income levels, and this has been a significant factor in reviving interest in the sector. Besides increasing tapping activities, smallholders have also adopted better exploitation technologies such as the low frequency tapping system (LITS) and Good Agricultural Practices by using stimulants to improve yields in order to take advantage of the high prices.

In addition, the Government has also encouraged rubber smallholders to undertake replanting activities to ensure sustainable production in the coming years. As of end-2005, the programme has succeeded in replanting of rubber trees covering 23,000 hectares of land, supported by rising confidence among smallholders and the effects of high rubber prices. Smallholders were also encouraged to replant latex timber clones (LTC) which yield higher latex and also ensure an adequate supply of rubber wood, once the trees become too aged to produce latex. This would help meet the expected increase in domestic demand from the local furniture industry in the coming years.

Performance of **other agriculture commodities**, comprising fisheries, livestock, as well as miscellaneous agriculture (which includes paddy, fruits and vegetables) showed a mixed trend in 2005. Value added in the **livestock** sub-sector increased by 4.7%, led mainly by higher growth in output of poultry (+5.7%), as many large-scale poultry operators, primarily public-listed companies took advantage of the incentives provided by the Government to modernise their operations. Thus, these companies have invested substantially on poultry rearing techniques using the climate-controlled closed house system that not only increased production, but most importantly, maintained internationally-recognised hygiene conditions. The increase in poultry output and the assurance on quality have been the main factors behind the substantial rise seen in external demand, in addition to meeting demand from the domestic food processing industries.

Meanwhile, output in the **fisheries** sub-sector declined by 6.8% in 2005 to 1.42 million tonnes (2004: 1.53 million tonnes), due mainly to lower marine landings (2005: -9.2%; 2004: 3.8%) as a result of the after-effects of the Tsunami, as well as the rise in diesel prices which affected fishing activities. However, this was partially mitigated by the increase in aquaculture harvests, which accounted for about 15% of the total output in the fisheries sector (2005: +9.8% to 215,475 tonnes). Aquaculture products such as seaweed, surimi and ornamental fish are high value-added activities mainly targeted for the export market. Meanwhile, output of **paddy** also declined in 2005 due to adverse weather conditions.

In the **forestry** sector, logging activities declined in 2005 in line with Malaysia's policy on conservation by implementing sustainable forest management practices. Production of saw logs declined slightly by 0.8% to 21,334 million cubic metres (2004: 21,509 million cubic metres). Nevertheless, global demand for Malaysian logs and sawn timber strengthened significantly during the year, particularly from PR China and the EU countries. The strong demand was also due partly to the continued ban on exports of logs and sawn timber by Indonesia since 2004. Consequently, average Malaysian log prices reached a record high of RM428 per cubic metre in 2005. Amidst the increase in export prices (7.7%) and the rise in volume of 10.6%, export receipts from saw logs rose significantly by 19.1% to RM2.5 billion. In terms of sawn timber, export proceeds strengthened by 26% to RM4.1 billion, due to higher volume (16.4%) and prices (8.3%).

With regards to the environment, Malaysia has been at the forefront in driving initiatives on responsible trade in tropical timber products. In the last few years, the Malaysian timber industry has taken vital steps in addressing the issue of illegal logging, unsustainable forest management and trade in endangered tropical species. Malaysia has developed its own timber certification scheme that assures importers and consumers that Malaysian timber products are from legal and sustainable sources. By end-2005, the Malaysian Timber Certification Council (MTCC) has awarded the Certificate for Forest Management to eight states in Peninsular Malaysia and the Upper Ulu Baram region in Sarawak, covering a total of 4.73 million hectares of permanent reserve forests.

In addition, 83 timber companies had been certified for 'chain-of-custody', ensuring that the timber products are sourced from MTCC-certified forests and are legally harvested. The credibility of these certification efforts has been recognised by major buyers of Malaysian timber products, most recently by a number of EU countries (United Kingdom, Germany, France, Belgium and the Netherlands) that have a public procurement policy aimed at eradicating imports of timber from illegal sources. In addition, the Government has also been vigilant in enforcing regulations on trade in endangered timber species (such as *Ramin, Karas* and *Gaharu*) from neighbouring countries, in accordance with the regulations under the Convention for International Trade of Endangered Species of Wild Flora and Fauna (CITES). As part of the strategy on implementing sustainable forest management, the Government also continued its efforts on forest plantation. During the year, it was announced that a RM200 million grant would be given to establish a forest plantation programme to reduce the dependence on tropical timber.

Meanwhile, output of **cocoa** declined further by 16.3% to 27,964 tonnes (2004: 33,423 tonnes). The decline in production was mainly attributable to continued reduction in cultivated area to 33,313 hectares (2004: 41,612 hectares; 1990: 393,000 hectares) mainly reflecting active conversion of cocoa land into other crops. The lower production was also attributable to the lack of application of inputs such as fertilizers and pesticides by cocoa farmers as a result of the rising cost of these inputs. To encourage cocoa planting among smallholders, the Malaysian Cocoa Board implemented the Cocoa Smallholders' Development Programme. Currently, there are 4,860 farmers who are actively involved in the programme, with a total area of 5,368 hectares. The Government has also announced that cocoa smallholders will be given a 100% replanting grant, in addition to the prevailing assistance given in the form of high-yielding clones, disease-resistant planting materials as well as technological assistance.

Mining Sector

The **mining and quarrying (mining)** sector expanded by 0.8% in 2005 due entirely to higher production of natural gas and condensates, while crude oil production was lower. Production of tin-in-concentrates rose slightly by 2% to 2,800 tonnes. During the year, the global energy market was characterised by high prices arising from the continued fine balance between demand and supply of energy sources amidst the lack of spare output capacity in the major oil producing countries. As a net energy-exporting nation, Malaysia benefited from the high prices, leading to a significant increase in export proceeds from minerals for the third consecutive year (+27.1% to RM52.3 billion; 2004: +38.2% to RM41.2 billion). Of significance, the proportion of mineral exports to total gross exports rose further to 9.8% (2004: 8.6%), further underlining the significance of the oil and gas industry to the Malaysian economy.

Value added in the mining sector was sustained, supported by strong performance in natural gas amidst the high energy prices.

Production of **crude oil including condensates** averaged 726,860 barrels per day (bpd), representing a decline of 4.9% from the level recorded in 2004 (762,318 bpd or +3.6%). The lower output was due mainly to the decline in production of crude oil, while condensates rose sharply in line with the upward trend in natural gas production. The lower production of **crude oil** to 571,359 bpd (2004: 623,957 bpd) was caused by shutdown of several oil installation facilities during the year for repair and maintenance purposes. Nevertheless, the production was within the range set for the year under the National Depletion Policy, which has been

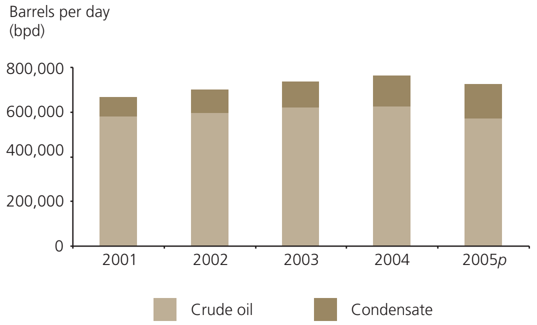
Table 1.7
Mining Sector: Value Added, Production and Exports

	2004		2005*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value added (RM million at 1987 prices)	**17,372**	**3.9**	**17,504**	**0.8**
Production				
Crude oil and condensates (barrels per day)	762,318	3.6	726,860	-4.9
of which:				
Crude oil (barrels per day)	*623,957*	*0.6*	*571,359*	*-8.7*
Condensates (barrels per day)	*138,361*	*19.6*	*155,501*	*12.1*
Natural gas - net (million standard cubic feet per day)	5,196	4.0	5,800	11.3
Tin-in-concentrates (tonnes)	2,745	-18.3	2,800	2.0
Exports (RM million)	**41,177**	**38.2**	**52,321**	**27.1**
of which:				
Crude oil and condensates				
('000 tonnes)	18,090	1.0	17,719	-2.0
(USD/barrel)	40.81	34.8	55.93	37.0
(RM million)	21,318	36.1	28,508	33.7
Liquefied natural gas (LNG)				
('000 tonnes)	20,729	19.7	21,948	5.9
(RM/tonne)	824	6.8	947	15.0
(RM million)	17,079	27.9	20,790	21.7
Tin				
(tonnes)	29,966	96.6	33,610	12.2
(RM/tonne)	31,585	68.6	27,827	-11.9
(RM million)	947	231.5	935	-1.2

p Preliminary

Source: PETRONAS
Department of Statistics, Malaysia
Department of Minerals and Geoscience, Malaysia

Graph 1.12
Production of Crude Oil and Condensates



p Preliminary
Source: PETRONAS

implemented since 1980 to ensure a sustained and regulated development of the country's oil resources. The depletion policy and discoveries of new oil fields over the years has led to the expansion in Malaysia's oil reserve lifespan to 20 years (2002: 15 years).

Meanwhile, production of **condensates** increased at a double-digit rate (12.1%) for the fourth consecutive year, to a record high of 155,501 bpd (2001: 86,855 bpd). Condensates, which in its natural state is in gaseous form but condenses to liquid upon production, shares the same properties as that of the Malaysian light, sweet crude oil. In recent years, the contribution of condensates to total Malaysian oil production has increased significantly. Condensates now account for 21.4% of the total oil output of 726,860 bpd in 2005 (2001: 13%), thus complementing the country's production of crude oil as the source of liquid fuel for purposes of exports and fulfilling the domestic consumption requirements. In 2005, export proceeds from crude oil and condensates rose further by 33.7% to RM 28.5 billion (2004: +36.1% to RM21.3 billion), thus accounting for an increased share of 5.3% of total exports (2004: 4.4%).

Prices of the Malaysian benchmark crude oil grade, Tapis Blend, continued to strengthen by 39.3% to USD57.26 per barrel in 2005 (2004: USD41.12 per barrel) in line with developments in the global energy markets. In particular, there was a strong demand for "light sweet" crude oil, primarily from the US market. US refineries are mainly catered to process light sweet crude that has low sulphur content which enables uncomplicated and cost-effective refining processing. Tapis Blend, a "light sweet" variety, which has always commanded a premium over other "sour" crude, benefited further during the year, as the premium widened in 2005.

The increase in global crude oil prices during the year was supported by strong fundamentals. The market was influenced by a combination of high global demand and tight supply amidst lack of spare production capacity (2005: 1.5 million bpd; 2001: 4.5 million bpd) as a result of under-investment by major oil producing countries in the last few years. According to the International Energy Agency, global demand for crude oil in 2005 rose to 83.3 million bpd, mainly fuelled by demand from the US and PR China, while global supply was only slightly higher at 84.1 million bpd. Despite the Organisation of Petroleum Exporting Countries (OPEC)'s decision in July 2005 to effectively suspend its output quota system among the member countries by producing at 28 million bpd, the highest level in over 25 years, prices continued to remain high. The high prices were also partly due to the lack of refining capacities in the major consuming nations, particularly in the US, which had resulted in an inability to sufficiently produce refined petroleum products (such as gasoline and distillates) to meet the high demand during the summer and winter seasons. Consequently, the market was sensitive to movements in stock levels, particularly in the US, as it was a reflection of the risk of short supply.

During the year, market sentiment was also highly susceptible to events that could potentially disrupt supply given that the major producing countries were operating at close to full capacity. Thus, when Hurricane Katrina struck the US in late August, which saw the shutdown of about 70% of the supply in the Gulf of Mexico region, oil prices (West Texas Intermediate and Tapis Blend) soared close to the USD70 per barrel threshold. Market participants also remained highly sensitive during the year to geopolitical events occurring

Graph 1.13
Crude Oil Prices (1-Month Futures) in 2005

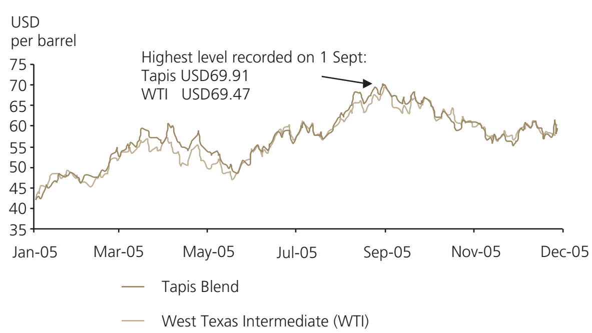


Table 1.8
Malaysia: Crude Oil and Natural Gas Reserves[1]

	As at end	
	2004	2005*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.29	5.38
Reserve/Production (year)	19	20
Natural gas		
Reserves (trillion standard cubic feet)	85.20	84.92
Reserve/Production (year)	33	33

[1] The National Depletion Policy was introduced in 1980 to safeguard the exploitation of the national oil reserves by postponing the development and controlling the production of major oil fields (with reserves of 400 million barrels or more).
p Preliminary

Source: PETRONAS

in major producing countries. The global benchmark oil prices, namely West Texas Intermediate and North Sea Brent, averaged higher at USD56.59 and USD54.86 per barrel, respectively (2004: USD41.40 and USD38.34 per barrel, respectively). The Tapis Blend ended the year at USD62.05 per barrel, which was almost USD20 higher than the price at 1 January 2005 (USD42.11 per barrel).

Natural gas production continued to strengthen in 2005, growing by 11.3% to a record high of 5,800 million standard cubic feet per day (2004: 5,196 mmscfd). The rise in output was driven by increasing demand from traditional buyers, consisting of domestic power generators (accounting for about 70% of total domestic gas users) and industrial users (primarily in the manufacturing sector), as well as major importers of liquefied natural gas (LNG). This has subsequently led to increased utilisation rate at the MLNG plants in Sarawak, as well as the Gas Processing Plants (GPPs) in Peninsular Malaysia.

During the year, LNG prices also rose significantly in line with developments in the global energy markets. In the second-half of 2005, natural gas prices in the global market strengthened sharply following the disruption in supply in the US in the aftermath of Hurricane Katrina. The Malaysian LNG export price rose to breach the RM1,000 per tonne threshold for the first time in September, and peaked at RM1,066 in December. For the year as a whole, the Malaysian LNG export prices averaged RM947 per tonne, an increase of 15% (2004: 6.8%).

Given the higher prices and increase in export volume, LNG export proceeds for the year rose substantially by 21.7% to RM20.8 billion (2004: RM17.1 billion), resulting in its share to total exports rising to 3.9% (2004: 3.6%). The higher export volume (5.9% to 21.9 million tonnes; 2004: 20.7 million tonnes) was mainly due to higher offtake from traditional buyers, particularly Japan and Korea which rose by 9.1% and 3.8% respectively to cater for their power generation industry.

The Malaysian oil and gas industry received further boost in 2005 with new **discoveries of oil and gas resources** following some major discoveries offshore Sabah from 2002 through 2004. During the year, seven new offshore oil fields were discovered, of which four were in Sabah, two in Sarawak and one in Peninsular Malaysia. This brought the total number of oil fields discovered in Malaysia to 153. In addition, 12 new production sharing contracts (PSCs) were signed during the year, thus resulting in the total number of PSCs in Malaysia to increase to 59. In 2005, 54 exploration wells and 78 development and production wells were drilled.

Production of **tin-in-concentrates** rose slightly by 2% to 2,800 tonnes in 2005 (2004: 2,745 tonnes). Average prices of tin, as traded on the Kuala Lumpur Tin Market, remained relatively high at USD7,356 per tonne (2004: USD8,494 per tonne), supported by high demand from the electronics industry. In recent years, arising from the environmental guidelines set by the European Union, lead has been gradually replaced with tin as the main material in soldering activities in the electronics industry.

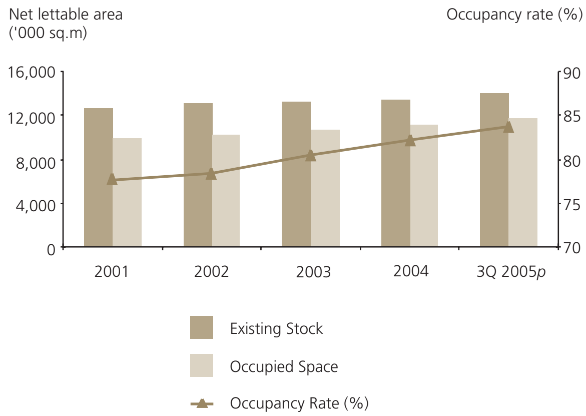
Construction Sector

Value added in the **construction sector** declined by 1.6% in 2005. The contraction was due to weak activity in the civil engineering sub-sector following the completion of many privatised infrastructure projects in recent years. However, the residential and non-residential sub-sectors continued to expand during the year. The residential sub-sector was supported by favourable demand, particularly in choice locations amidst the attractive financing environment. Meanwhile, the non-residential sub-sector benefited from the buoyant business and retail activities.

Activity in the construction sector was supported by the residential and non-residential sub-sectors. Civil engineering meanwhile, continued to contract.

The **civil engineering sub-sector** remained weak, in the absence of new large infrastructure projects. The excess capacity in this sub-sector encouraged many Malaysian construction companies to venture abroad. Among the successfully secured contracts were in road

Graph 1.14
Supply and Occupancy Rate of Purpose-Built Office Space in Malaysia: 2001 - 2005



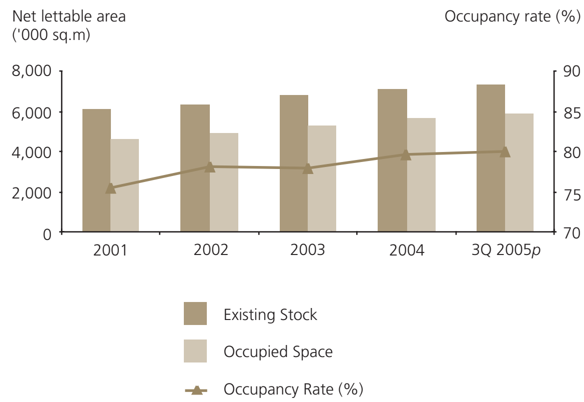
p Preliminary
Source: NAPIC, Valuation and Property Services Department.

building, housing, power generation and airport projects in the regional and Middle Eastern nations. In particular, India continued to be the major destination for Malaysian contractors given its current huge spending on infrastructure development. On the domestic scene, ongoing projects related to power generation plants, roads, ports, water and sewerage continued to support the civil engineering activity. Furthermore, construction activity in the oil and gas sector was high, supported by investments in oil rigs, following recent oil discoveries in Malaysia.

Activity in the **non-residential sub-sector** continued to improve in 2005, underpinned by firm demand for office and retail space amidst the robust business activities. Overall occupancy rates for office and retail space improved to 83.8% and 80% respectively as at end-September 2005, from 82.1% and 79.6% respectively at end-2004. Reflecting the increased demand, average monthly rentals for prime office space in the Klang Valley edged up slightly from RM46 per sq. metre in 2004 to RM48 per sq. metre in 2005, while rentals for retail space in shopping complexes rose from RM242 per sq. metre to RM254 per sq. metre.

In the office segment, 17 new office buildings, mainly Government buildings, with a total space of 605,000 square metres were added on to the market. As a result, total stock of office space as at end-September 2005 was 14.1 million sq. metres (end-2004: 13.5 million sq. metres). Meanwhile, in the retail segment, an additional 209,000 sq. metres were completed,

Graph 1.15
Supply and Occupancy Rate of Retail Space in Malaysia: 2001 - 2005



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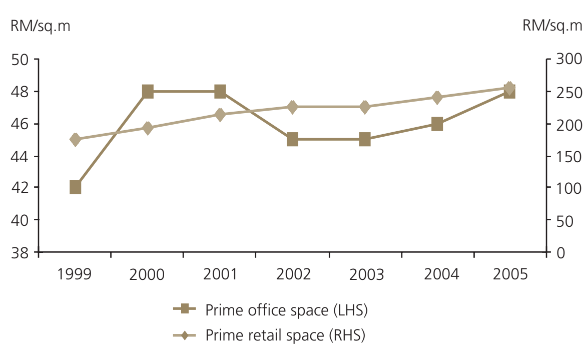
Source: NAPIC, Valuation and Property Services Department

bringing the total stock to 7.3 million sq. metres. Demand for retail space was encouraged by the strong growth in the retail segment, supported by buoyant private consumption activities during the year.

In the case of hotels, 15 new hotels were completed during the year, bringing the total sum to 2,239 hotels in the country, providing 149,106 rooms. Average occupancy rates for hotels improved to 63.6% from 60.8% in 2004, supported by increased tourist arrivals and domestic tourism activity.

The **residential sub-sector** remained important in supporting construction activity during the year. Demand for residential property was sustained by interest in new properties, especially in prime locations. The increase in

Graph 1.16
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley [1]



[1] Refers to Kuala Lumpur and Selangor.
Source: CH Williams Talhar & Wong Sdn. Bhd.

Table 1.9
Residential Property Indicators

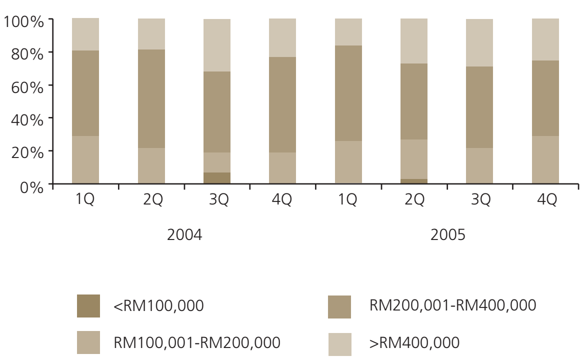
	2004	2005
	Units	
Residential property transactions		
Units	195,241	181,762
Value (RM billion)	29.3	28.4
Approvals[1]	174,671	169,960
Developers' licences		
New	1,071	1,209
Renewals	353	407
Sales and advertising permits		
New	1,038	1,203
Renewals	1,510	1,726
Loans by banking system - Value (RM billion)		
Outstanding	132.9	149.2
Approvals	35.7	36.6

[1] Units approved for construction by private developers.

Source: NAPIC, Valuation and Property Services Department, Ministry of Housing and Local Government and Bank Negara Malaysia

income levels amidst the stable employment market, low interest rates and attractive financing packages offered by financial institutions supported buying interest. Nevertheless, activity was more moderate than the growth seen in 2004, which was induced by the incentives provided under the 2003 Economic Package. This was evidenced by the lower take-up rates in the first half of 2005 of 32.7% compared to 48% in 2004. Purchasers became more discerning in buying properties, due to the intense competition among developers and the wide choice of new concepts and products offered in the market. Among the concepts that were well-received include the gated community concept and focus on green landscaping.

Graph 1.17
New Launches of Residential Property[1] in Klang Valley by Prices



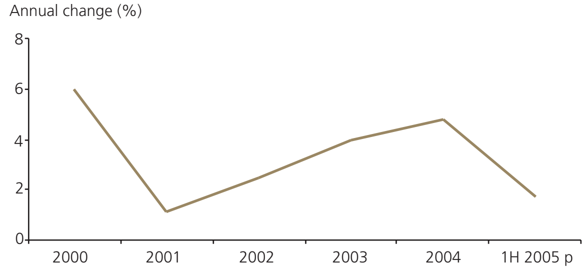
[1] Landed property only
Source: Jones Lang Wooton

On the supply side, 130,000 more new residential units came on stream in the first nine months of 2005, bringing the total stock to 3.59 million units. While approvals of new housing projects continued to decline in 2005, new sales and advertising permits increased markedly by 15.9% (2004: -5.9%). Among the new launches, houses priced above RM400,000 on average accounted for 24% of the total launches in the Klang Valley (average for 2004: 23%), indicating the sustained interest for higher-end properties in the city area. Nevertheless, providing affordable housing remained a priority to the country. In Budget 2006, the Government allocated RM1 billion for low-cost housing programmes, namely *Program Perumahan Rakyat Dimiliki*, *Program Perumahan Rakyat Disewa and Program Perumahan Rakyat Bersepadu.* The Ministry of Housing and Local Government (KPKT) had also taken the initiatives to improve the application procedure for low-cost housing. Among the key changes instituted included liberalising the ceiling of the monthly salary of applicants from RM1,500 to RM2,500, reducing the number of supporting documents for applications and standardising the procedure for all states. In 2005, a total of 55,209 low-cost housing units were constructed.

Given the above developments, the Malaysian House Price Index increased moderately by 1.7% in the first half of 2005 (2004: 4.8%). The slowest increase in prices was recorded in the high-rise and semi-detached categories. Among the states, Selangor, Terengganu, Kelantan, Sabah and Sarawak registered lower prices, while in other areas, prices continued to increase.

Meanwhile, the **overhang** situation of new properties showed a mixed trend. Latest data compiled by the National Property Information Centre (NAPIC) of the Valuation and Property Services Department showed that the overhang in residential property, retail shops

Graph 1.18
Malaysian House Price Index



p Preliminary
Source: NAPIC, Valuation and Property Services Department

Table 1.10
Overhang of Residential Property in Malaysia by Price Range

RESIDENTIAL Price Range	Units	Share (%)	Units	Share (%)
	As at end-2004		As at end-Sept 2005*p*	
RM50,000 Or Less	5,245	33.7	3,397	19.8
RM50,001 - RM100,000	3,546	22.8	5,196	30.2
RM100,001 - RM150,000	3,063	19.7	3,523	20.5
RM150,001 - RM200,000	1,774	11.4	2,336	13.6
RM200,001 - RM250,000	651	4.2	974	5.7
More Than RM250,000	1,279	8.2	1,753	10.2
Total	**15,558**	**100**	**17,179**	**100**

p Preliminary

Source : NAPIC, Valuation and Property Services Department

and shopping complexes worsened, while that of purpose-built office improved. In the case of residential property, the overhang increased to 17,179 units, with a total value amounting to RM2.3 billion as at end-September 2005 (end-2004: 15,558 units; RM1.8 billion). These units were mainly concentrated in Johor and Selangor. The bulk of the properties were priced between RM50,001-RM150,000.

Financing remained important in supporting the construction sector. Loans approved by the banking system for the broad property sector rose by 8.2% in 2005 (2004: 18.8%), while loans disbursed increased by 4.3% (2004: 12.6%). Loans outstanding to the broad property sector as at end-2005 was RM229 billion, representing an increase of 9.9% over 2004 (2004: 10.5%). Meanwhile, loans approved for the housing sector by other housing credit institutions as a group increased by 11.6% to RM7.6 billion in 2005 (2004: 15.7%).

In the early part of the year, activity in the construction sector was temporarily affected by the amnesty program for illegal foreign workers that began in late 2004 and ended on 28 February 2005. The slow return of legal foreign workers caused some delays in projects, but the situation improved after prompt measures taken by the Government to alleviate the problem. During the year, the Government also announced the decision to expedite projects worth RM2.4 billion from the Ninth Malaysia Plan to rejuvenate the civil engineering segment.

Another important development that influenced activity in the property sector during the year was the release of the Guidelines on Real Estate Investment Trusts (REITs Guidelines) on 3 January 2005 by the Securities Commission. This marked the rebranding of property trust funds (PTF) that have existed since the late 1980s as REITs, in an effort to accelerate the growth and to establish a competitive REITs industry in Malaysia. In the last three years, the Government had also taken measures to create a more conducive environment for the development of REITs with the granting of special incentives. These measures include the following:

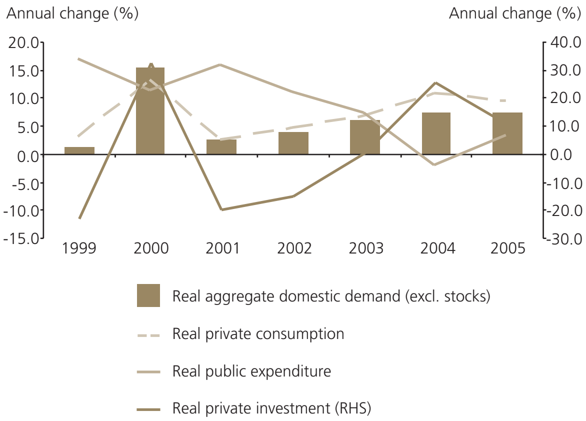
i. Exemptions from Real Property Gains Tax for gains from disposal of real property to REIT or PTF;
ii. Exemptions from stamp duty for instruments of transfer of real property from individuals or companies to REIT or PTF;
iii. Exemptions from income tax on chargeable income distributed to unit holders of REIT or PTF;
iv. Income distributed to unit holders is taxed at their respective tax rates. For non-residents, tax payable is at 28% and is withheld by REIT or PTF;
v. The accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hands of unit holders; and
vi. Allowing selected fees (consultancy, legal and valuation services) incurred in the establishment of REITs to be tax deductable.

As at end-2005, three REITs funds were listed on Bursa Malaysia. Assets of these REITs consist of office and retail buildings in the Klang Valley.

DOMESTIC DEMAND CONDITIONS

Domestic demand conditions remained favourable in 2005, registering a strong growth of 7.3% during the year (2004: 7.5%). Growth in **aggregate domestic demand** was supported mainly by the buoyant expansion in private sector activities. Despite concerns arising from rising oil prices and the uncertain external outlook in the early part of the year, consumer spending was sustained at a high level throughout the year. Consumers benefited from the

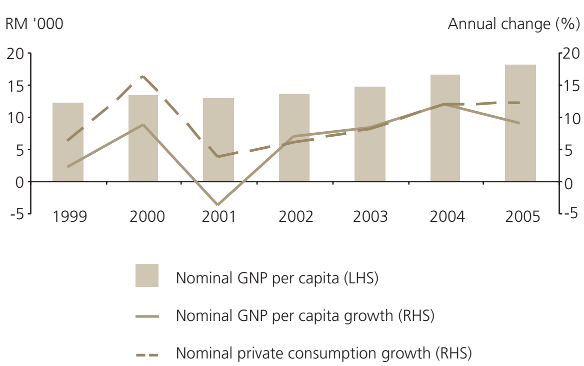
Graph 1.19
Real Domestic Demand Aggregates



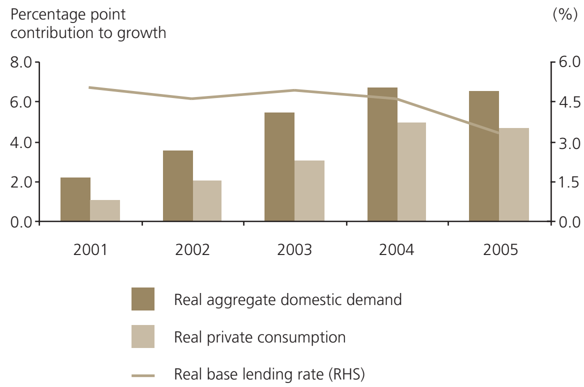
Domestic demand conditions remained favourable in 2005, supported mainly by the buoyant expansion in private sector activities. Public sector expenditure remained supportive of private demand.

continued increase in disposable incomes arising from high export earnings and favourable job market conditions. Measures by the Government to contain inflationary pressures and the competitive credit environment provided further support to household spending. Private investment, which has been on a positive trend since the second half of 2003, strengthened further in 2005, with positive growth in all sectors except construction. Business confidence was

Graph 1.20
GNP per Capita



Graph 1.21
Real Interest Rate and Domestic Demand



sustained throughout the year, while positive cash flows enabled companies to utilise internally-generated funds to finance their capital expenditure. Nevertheless, the surplus narrowed somewhat in 2005 and companies also accessed the financial system for funds, encouraged by the low cost of financing. Meanwhile, the Government continued to focus on developmental efforts while improving essential services and the public delivery system in order to enable the private sector to sustain the growth momentum. As a result, the Government was able to maintain its policy of a gradual consolidation of its fiscal position.

In spite of concerns on high oil prices and some uncertainty on the external outlook in the early part of the year, **private consumption** was sustained at a high level throughout 2005, growing by 9.2% for the year (2004: 10.5%). Consumer confidence remained buoyant as income continued to grow due to high export earnings and

Graph 1.22
Household Debt and Deposit/Loan Ratio

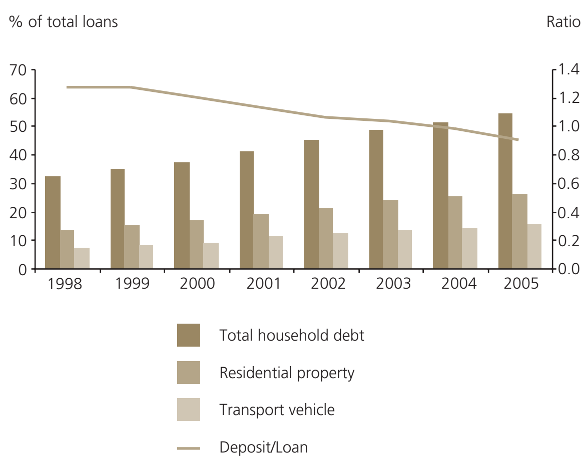


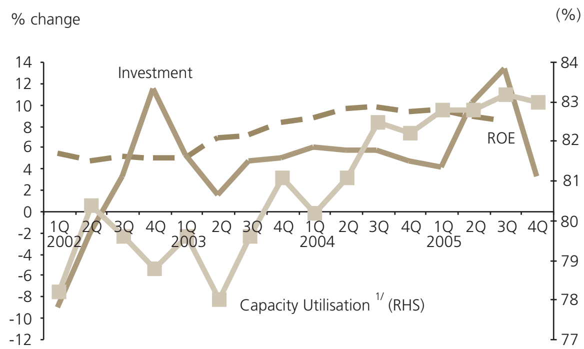
Table 1.11
Private Consumption Indicators

	2004	2005				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars (incl. 4WD)						
'000 units	392.1	101.5	103.1	110.0	111.2	425.8
Annual change (%)	17.0	19.5	3.0	0.8	13.5	8.6
Imports of consumption goods						
RM billion	23.2	5.6	6.0	6.4	6.6	24.6
Annual charge (%)	24.1	10.7	4.3	5.2	4.2	5.9
Tax collection						
Sales tax (RM billion)	6.4	1.2	1.9	1.6	2.3	7.1
Service tax (RM billion)	2.3	0.5	0.7	0.5	0.9	2.6
Narrow money (M1)						
Annual change (%)	11.9	9.4	11.0	9.9	8.5	8.5
Loans disbursed by banking system						
Consumption credit (excl. passenger cars) Annual change (%)	16.8	7.0	12.6	10.4	10.7	10.2
Retail trade, restaurants and hotels Annual change (%)	19.5	21.8	21.1	19.1	6.3	16.5
MRA retail sales						
Annual change (%)	8.0	4.8	10.2	n.a.	n.a.	n.a.
Credit card operation						
Turnover spending (RM billion)	36.8	9.9	9.8	10.8	11.4	41.8
Annual change (%)	19.2	15.7	12.8	12.2	13.0	13.4
MIER Consumer Sentiments Index	-	120.9	109.8	102.5	116.1	-
KL Composite Index	907.4	871.4	888.3	927.5	899.8	899.8
Commodity prices						
CPO (RM/tonne)	1,664	1,363	1,418	1,387	1,423	1,398
Crude oil (USD/barrel)	41	49	54	65	60	57
Rubber (sen/kg)	461	468	467	552	604	523

favourable employment conditions. The MIER Consumer Sentiment Index (CSI), which reflects consumers' assessments of their personal finances and the economy, peaked at 120.9 in the first quarter of 2005. However, higher oil prices started to impact consumer sentiments, which softened in the second and third quarters of the year. To a large extent, consumers were insulated from large increases in oil prices through the Government's subsidy for fuel, though a portion of the subsidies was removed. The Government also announced a temporary halt on price increases on fuels and toll rates, and a reduction in road tax.

In the second half-year, improvements in labour market conditions were also accompanied by higher commodity prices, especially prices of rubber, leading to rising disposable income of households in both urban and rural areas. This, together with the bonus payments to

Graph 1.23
Investments, Capacity Utilisation and Profitability



1/ Source: Malaysian Institute of Economic Research (MIER)

civil servants at the end of the year, boosted consumer confidence. The improved sentiment was reflected by the increase in the CSI in the fourth quarter.

The increase in the Overnight Policy Rate (OPR) on 30 November 2005 has not hampered households' ability to borrow, as interest rates remained below neutral levels. Households continued to borrow, mainly for the purchase of residential properties and transport vehicles. Consumers' willingness to spend by accumulating debt was evidenced by the deposit-to-loan ratio staying below 1 for the second consecutive year. Nevertheless, this increase in household debt remained manageable. The financial position of the household sector remained relatively healthy with the non-performing loan (NPL) ratios for both consumption credit and credit card debt declining further to 7.3% and 4.5% respectively in 2005 (2004: 8.1% and 4.7% respectively).

Following the robust growth in the previous year, the strong momentum of private sector capital spending continued into 2005, despite the tougher business climate due to rising crude oil prices and the mild down-cycle in the electronics sector in the early part of the year. **Private investment** continued to expand strongly during the year, posting a growth of 10.8% (2004: 25.8%), spurred by higher investment in the manufacturing, services and upstream oil and gas sectors. Companies were able to take advantage of their strong financial positions to fund the bulk of the investment through internally generated funds. In addition, the supportive financing environment also promoted investment activities as evidenced by the loans disbursed to businesses, which increased by 7.4% during the year. Investment indicators such as

Table 1.12
Private Investment Indicators

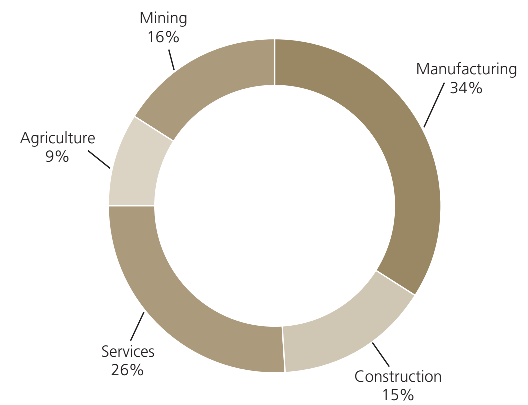
	2004	2005				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles (incl. 4WD)						
'000 units	95.5	30.5	34.8	40.3	34.5	140.2
Annual change (%)	35.1	57.1	47.1	65.6	23.1	46.8
Import of capital goods (RM billion)	55.5	12.3	15.5	17.0	15.9	60.7
Annual change (%)	36.0	0.7	16.3	21.0	0.3	9.5
Approvals by MITI (manufacturing sector)						
No. of projects	1,101	181	306	276	263	1,026
Capital investment (RM billion)	28.8	2.4	10.6	6.9	11.0	31.1
Foreign	13.1	0.7	5.9	3.9	7.5	17.9
Local	15.6	1.8	4.8	3.0	3.6	13.2
Loans disbursed by banking system						
Manufacturing sector Annual change (%)	10.2	13.9	4.9	2.5	-2.0	4.5
Construction sector Annual change (%)	10.4	4.5	0.8	5.8	-8.6	0.3
Business services Annual change (%)	19.0	-12.4	1.5	24.2	9.4	5.1
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	28.0	5.3	6.8	9.7	13.8	35.7
New activities	13.0	1.2	3.6	5.6	7.3	17.7
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	4.0	1.9	2.0	0.7	0.8	5.3
MIER Business Conditions Survey						
Business Conditions Index	-	104.1	106.0	102.7	100.5	-
Capacity Utilisation Rate (%)	-	82.8	82.8	83.2	83.0	-
MSC-Status Companies						
No. of companies	190	55	56	80	67	258
Approved investment (RM billion)	2.0	0.2	0.6	0.6	0.3	1.8

import of capital goods and sales of commercial vehicles also indicated that private investment continued to increase in 2005. Throughout the year, the MIER's Business Conditions Index remained above the 100-point threshold level, reflecting the generally positive business sentiment, particularly in the manufacturing sector.

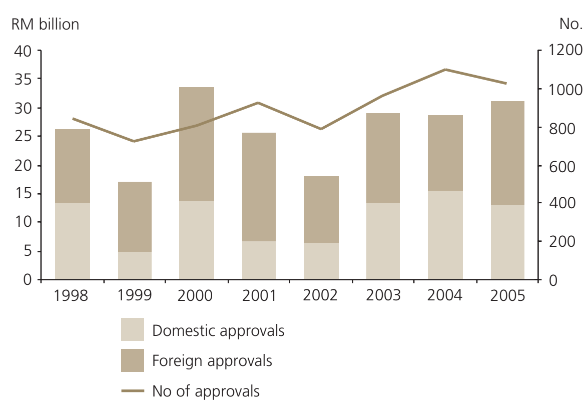
Investment in the **manufacturing sector** remained strong during the year, mainly driven by expenditure on new machineries and equipment. In 2005, MITI approved a total of RM31.1 billion in 1,026 manufacturing projects. Of the total, more than half were joint projects with foreign partners, pointing to continued interest from foreign investors in the manufacturing sector. Approved capital spending for expansion or diversification activities are higher than for new projects, signifying that manufacturers were also venturing into high value-added manufacturing activities. The approved projects were mainly concentrated in the electrical and electronic products, basic metal products, and chemical and chemical products industries. Of importance, the approved investments, particularly in the electronics segment, have continued to move towards technology and skill-intensive projects. The emphasis and promotions on high value-added manufacturing-related activities have also attracted R&D projects into the country, where a number of electronics

Graph 1.24
Private Investment by Sector (% share)

2005

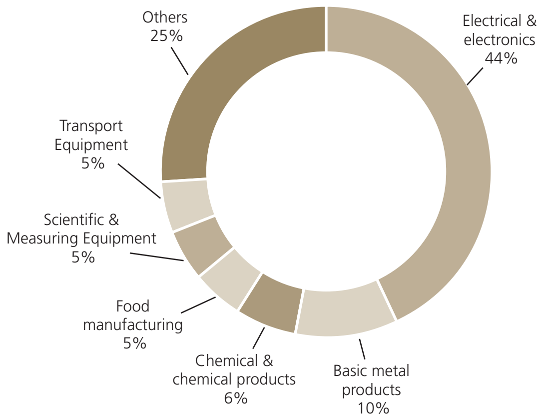


Graph 1.25
Private Investment in the Manufacturing Sector



Source: Malaysian Industrial Development Authority

Graph 1.26
Approved Manufacturing Investment by Industry, 2005 (% share)

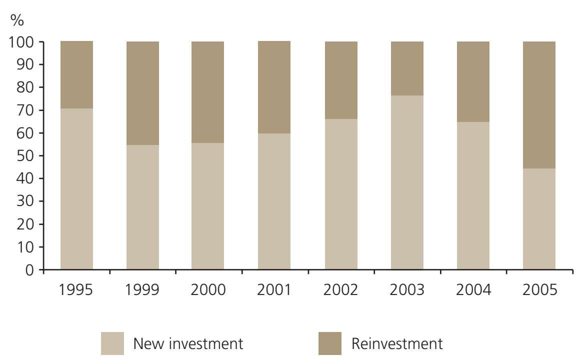


Source: Malaysian Industrial Development Authority

companies were planning to set up R&D centres, and design and test operations in the country.

Investment was substantially stronger in the **services sector** due to notable development of utilities infrastructure and capacity expansion by transportation companies. Higher capital spending for the utilities sub-sector was attributed to the development of power plants and water projects. The independent power plant (IPP) projects include IPP Tanjung Bin, IPP Jimah, IPP Sepangar Bay and IPP Teluk Salut. Meanwhile, the spending on water projects was largely for the Sungai Selangor Project Scheme 3 (SSP3), the Stormwater Management and Road Tunnel (SMART) project as well as the expansion and upgrading of water treatment plants and water distribution in several states. In the transport sub-sector, port operators such as PTP, North Port and West Port continued to invest in improving port facilities and equipment arising from the need to increase port capacity. At the same time, investment on air transport was higher as companies embarked on fleet expansion programmes. Meanwhile, in the telecommunication sub-sector, cellular operators continued to spend on improving the reliability and efficiency of networks, as well as optimising and upgrading existing network equipment to cater for high-speed mobile services. In the retail sub-sector, a number of new outlets were established during the year, particularly buoyed by strong consumer spending activities.

Graph 1.27
Share of Approved New Investments and Reinvestments in the Manufacturing Sector



Source: Malaysian Industrial Development Authority

In the **mining sector**, higher capital expenditure was predominantly in the upstream oil and gas segment. During the year, production-sharing contractors accelerated exploration and production capital spending due to rising oil prices and increasing demand for crude oil. Of importance, intensified exploration during the year was spurred by aggressive exploration campaign in deepwater and ultra-deepwater oil fields. In addition, discoveries of new oil and gas resources since 2002 continued to support capital spending in production facilities and development projects.

In 2005, a large part of investment in the **construction sector** reflected activities from residential construction, arising from the development of new townships and urban centres, with the emphasis on high-end property projects. On the other hand, capital spending on roads was lower due to the completion of two major projects, namely the Butterworth Outer Ring Road and Guthrie Corridor Expressway, as well as the delay in the construction of the Kajang-Seremban Expressway. Nevertheless, ongoing development of several privatised road projects such as the Senai-Desaru Expressway and Jelutong Expressway continued to support investment in the sub-sector.

Capital expenditure in the **agriculture** sector remained largely driven by activities in commercial crop plantation. The expenditure for the development of commercial crop plantations remained at high levels, especially for palm oil, as stronger demand and firm CPO prices have encouraged further capital spending by private plantation companies. The expenditure was mainly to expand and upgrade milling capacity and support replanting activities.

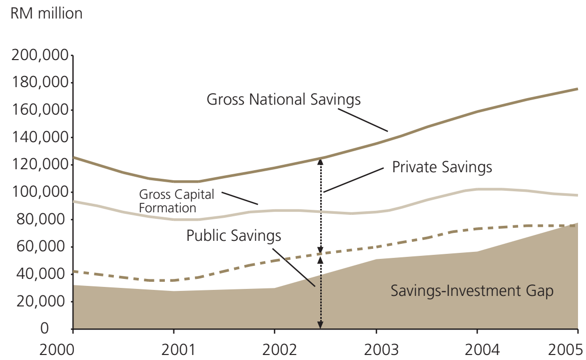
Public consumption increased by 5.9% in 2005, mainly on account of the continued high expenditure on supplies and services, defence as well as emoluments.

The increased expenditure for supplies and services was largely to further improve the administrative machinery and delivery system of the public sector. Reflecting the Government's efforts to continue enhancing human resource development in strengthening the nation's productivity and competitiveness, expenditure on emoluments remained high.

Public investment turned around to register a marginal growth of 0.4% in 2005 (2004: -8.7%). The Federal Government continued to focus on developmental projects that improved economic and social services sectors of the country. Most importantly, these programmes were implemented based on the emphasis of achieving a greater balance between the development of urban and rural areas. In the economic sector, expenditures were mainly focussed on modernising the agriculture sector, improving infrastructure in rural areas, enhancing industrial growth and improving transportation infrastructure. At the same time, capital expenditures for the social services sector were mainly allocated towards enhancing and upgrading of essential services, namely education, training and health and medical services as well as provision of affordable houses to the people. Meanwhile, capital expenditures by the NFPEs were stronger during the year, largely attributed to capacity expansion efforts and commitment to improve efficiency by the NFPEs, such as Petroliam Nasional Berhad (PETRONAS) and Telekom Malaysia Berhad (TM). During the year, investment by PETRONAS increased largely due to intensified exploration activities in the upstream oil and gas sectors as well as expansion of shipping fleet to cater for stronger demand for LNG and petroleum-related products. Capital spending by TM was also higher, mainly for the deployment of new infrastructure for residential and business premises as well as provision of infrastructure in new areas with high demand for broadband services. Meanwhile, Tenaga Nasional Berhad's investment continued to focus on maintenance activities and improvement projects, such as upgrading and replacement programmes of power transmission and distribution systems.

Despite sustained growth in consumption, **gross national savings (GNS)** increased further by 10.9% in 2005, in line with the expansion in nominal gross national income. In the private sector, both households and the corporate sector continued to enjoy better disposable incomes and cash flows, as a result of higher export earnings and better employment growth during the year. This enabled private sector savings to continue to increase by 17.9% in spite of the strength of private consumption. The main source of the increase was due to higher corporate savings. New deposits placed by

Graph 1.28
Gross National Savings and the Savings-Investment Gap



business enterprises with banking institutions were higher at RM37 billion in 2005, compared with RM31.6 billion in the previous year. Meanwhile, public savings continued to expand by 2.8% in 2005, due mainly to the strong performance of the major NFPEs during the year.

Overall, the share of GNS to Gross National Product (GNP) remained high at 37.1% (2004: 37.3%). This high rate of savings has enabled Malaysia to continue to finance its growth primarily from domestic sources. Given a lower gross domestic capital formation (including stocks), the savings-investment balance, therefore, recorded a larger surplus of RM77.8 billion or 16.4% of GNP in 2005.

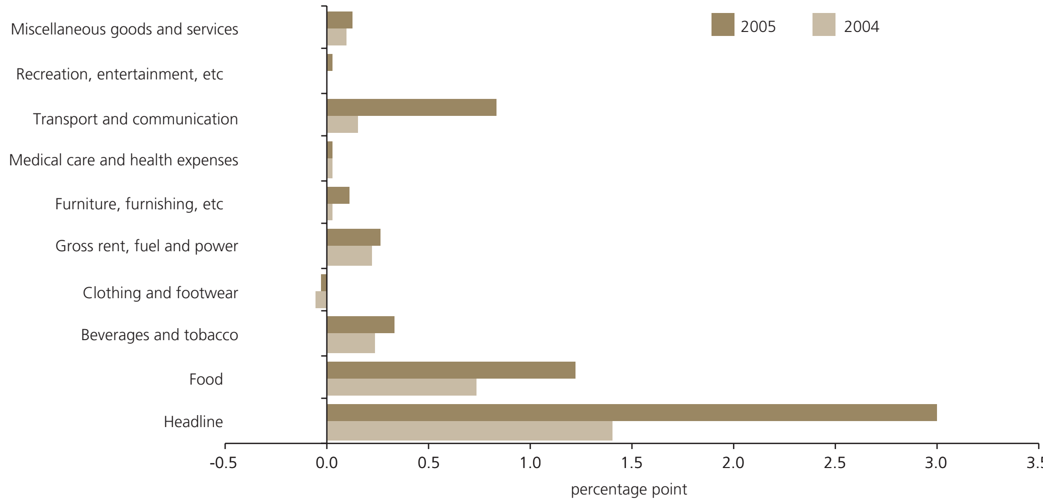
PRICES AND EMPLOYMENT

Consumer Prices

In 2005, inflation emerged as one of the areas of macroeconomic concern in the global economy. A key factor behind this development was the significant increase in international oil prices over the course of the year. Malaysia, as a small open economy, was not insulated from this global phenomenon.

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), increased from 1.4% in 2004 to 3% in 2005. The increase in inflation during the year was primarily due to the supply-related factors following the increase in international oil prices. Core inflation, which is CPI inflation excluding price-volatile items and price-administered items, rose to 2% (1% in 2004) during the period. The rise in core inflation was driven by strong domestic demand, as favourable labour market

Graph 1.29
Contribution to CPI inflation



conditions, a competitive credit environment and high commodity prices supported income and spurred consumer spending.

All categories in the CPI registered higher increase in 2005. The most significant increase in prices during the year was seen in the transport and communication and food categories, both of which are sensitive to the fluctuations in the prices of energy and non-energy commodities. It should be noted that although the uptrend in international oil prices gained momentum in late 2004, the upward pressure on domestic inflation was relatively less. This was partly due to the buffer provided by the subsidy on retail fuel prices and controls on gas prices and power rates. The escalation on the global price of crude oil however has exerted an increasing burden on the Government's operating expenditure, while raising concerns over the misallocation of resources and costs of enforcement. In addressing this issue, the Government has removed part of the oil subsidy, thereby limiting the inflationary impact on consumers. Domestic retail fuel prices were adjusted three times during 2005 (Table 1.13), contributing approximately 0.4 percentage points to the inflation rate for the year.

Although there were concerns that the increase in domestic oil prices would cascade down into the prices of other goods, the subsequent outturn for inflation was rather moderate. This could be attributable to several factors. Firstly, labour productivity, as measured by the real sales per employee in the manufacturing sector increased by 10% in 2005, surpassing the 0.8% growth in the real wages per employee in the manufacturing sector. This, coupled with the intensification of competition amongst producers and from imports have somewhat contained the secondary effects from higher oil prices. In addition, capacity expansion amongst businesses played a role in increasing supply and mitigating possible demand pressures. Active surveillance and enforcement efforts undertaken by the relevant Government agencies also ensured that prices of controlled essential goods and services are transparent and not raised opportunistically.

Table 1.13
Changes in Prices of Administered Goods and Services in 2005

Effective date	CPI items (weight: 12%)	% increase	Contribution to 2005 inflation (in pct. points)
Jan-05	Chicken prices	14.6%*	0.29
Jan-05	Toll charges	10%	0.04
Mar-05	Diesel prices	6%	0.01
May-05	Public transport fares[1]	6.7%*	0.10
May-05	Prices of retail petrol & diesel	7.4%	0.24
Aug-05	Prices of retail petrol products[2]	6.8%	0.15
Sep-05	Prices of alcoholic beverages & tobacco	7.1%**	0.05
Total Contribution to Headline Inflation		**6.50%**	**0.88**

1 Includes public transport fares such as railway, ship (ferry), airlines, bus and taxi.
2 Includes retail petrol, diesel and cooking gas (LPG).
* Average increase in 2005.
** Average increase post Budget-2006.

Source: Department of Statistics, Malaysia.

Table 1.14
Price Indicators

Consumer Price Index (2000=100)	Weight	2004	2005
	Annual change (%)		
	100.0	**1.4**	**3.0**
of which:			
Food	33.8	2.2	3.6
Beverages and tobacco	3.1	7.8	10.5
Clothing and footwear	3.4	-1.8	-1.0
Gross rent, fuel and power	22.4	1.0	1.2
Furniture, furnishings and household equipment and operation	5.3	0.4	2.0
Medical care and health expenses	1.8	1.4	1.6
Transport and communication	18.8	0.8	4.4
Recreation, entertaiment, education and cultural services	5.9	-0.1	0.5
Miscellaneous goods and services	5.5	1.8	2.4
Consumer Price Index			
Durable goods	9.4	0.2	0.4
Semi–durable goods	5.4	-0.9	-0.1
Non-durable goods	40.2	2.4	5.0
Services	45.0	1.0	2.1
Producer Price Index (1989=100)	**100.0**	**8.9**	**6.8**
of which:			
Local Production	79.3	10.3	7.9
Imports	20.7	2.0	1.5

Source: Department of Statistics, Malaysia

In the Monetary Policy Statement (MPS) released in August 2005, the Bank stated that the cumulative effect of previous price adjustments was expected to translate into inflation peaking in the third quarter of 2005, and to moderate thereafter. However, it was highlighted that there remained considerable uncertainty on the direction of oil prices. Monetary policy would therefore take into account the need to ensure that the level of monetary accommodation is balanced with the need to ensure price stability. In the third quarter of the year, the economy began to show evidence of stronger economic growth, with indications that the momentum would continue into the fourth quarter and into 2006. As the risk of slower economic growth diminished, the balance tipped towards the increased risks to inflation. Consequently, on the 30 November 2005, BNM raised the Overnight Policy Rate (OPR) by 30 basis points to 3 percent.

Producer Prices

Producer price inflation, as measured by the annual change in the Producer Price Index (PPI), moderated to 6.8% in 2005 (8.9% in 2004). Despite the strong increase in crude oil prices during the year, the commodity-related categories registered a slower annual growth of 10.8% (15.6% in 2004). This was largely due to the consolidation in the prices of crude palm oil and rubber in the first half of the year. Excluding these commodity-related categories, producer prices increased slightly by 2.2% (2% in 2004) due mainly to the higher prices for food and live animals; and machinery and transport equipment. Meanwhile, the annual growth in the PPI for imported goods moderated to 1.5% (2% in 2004), in part due to the increased global competition, increased supply from low cost producing countries and the stronger ringgit against Malaysia's trading partners during the year.

Labour Market Developments

The domestic labour market continued to be healthy and stable in 2005. The **unemployment rate** remained steady at 3.5% as both total employment and labour force increased by 4.1% to 10.9 million and 11.3 million respectively. Total retrenchments declined by 19%,

Labour market conditions remained healthy as vacancies rose and retrenchments declined.

Table 1.15
Labour Market Indicators

	2001	2002	2003	2004	2005e
Labour force ('000)	9,724.2	10,064.3	10,426.4	10,846.0	11,290.5
(annual change in %)	1.6	3.5	3.6	4.0	4.1
Employment ('000)	9,378.8	9,709.0	10,047.2	10,463.7	10,894.8
(annual change in %)	1.1	3.5	3.5	4.1	4.1
Unemployment rate (% of labour force)	3.6	3.5	3.6	3.5	3.5
Labour productivity (GDP/Employment) (annual change in %)	-0.8	0.8	1.9	2.9	1.1
Real wage per employee in manufacturing sector (annual change in %)	1.7	3.2	2.9	1.9	0.8

e Estimate

Source: Economic Planning Unit
Department of Statistics, Malaysia
Bank Negara Malaysia

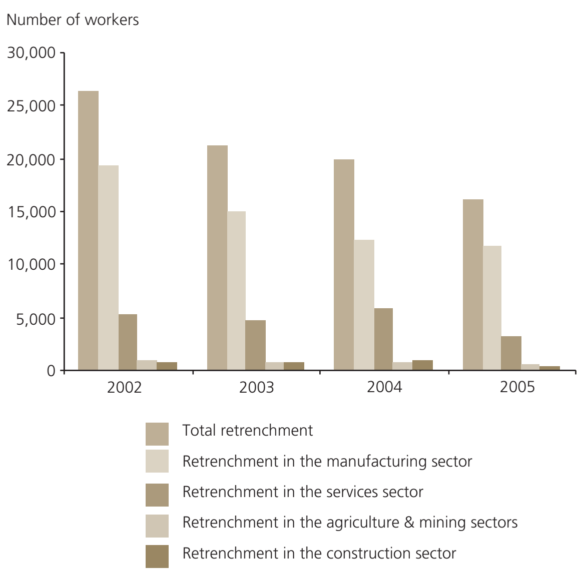
reflecting the recovery in economic activities in the second half-year following slower growth in the second quarter and the flexibility accorded to the employers to take alternative measures such as temporary layoffs and instituting pay cuts. In 2005, the number of job vacancies increased to a record high of 304,500 positions (previous high, 2002: 162,787 positions). Nevertheless, the number of unplaced job seekers was also higher, though the situation improved towards year-end. Meanwhile, job placements were stronger, reflecting increased efficiency in labour-matching process.

In 2005, lower **retrenchments** were recorded following the pick-up in economic activities in the second half-year. Total retrenchments declined by 19% to 16,109 persons (2004: 19,956 persons), with the bulk occurring in the manufacturing and selected services sectors, in particular, the wholesale and retail trade. Most of the retrenched workers were production-related workers (53%) as well as those in the professional and technical positions (17%), and sales and service workers (11%). Among key reasons cited for retrenchments during the year were high costs of production, reduction in demand for products, and sale of companies.

More jobs were available in 2005, especially during the second half-year. Total **job vacancies** reported to the Manpower Department of the Ministry of Human Resources surged to 304,500 positions (2004: 49,975) due in part to a new ruling that makes it compulsory for employers to report job vacancies to the Electronic Labour Exchange before they can apply for foreign workers. Higher job openings were recorded across all key sectors, especially in the agriculture, forestry and fishery, construction and manufacturing sectors. In terms of total positions available, the manufacturing sector continued to generate the highest number of vacancies, accounting for 37% of total job vacancies, followed by the services sector (21%). The bulk of vacancies were for elementary occupations, plant and machine operators and assemblers as well as for clerical, managerial and professional positions.

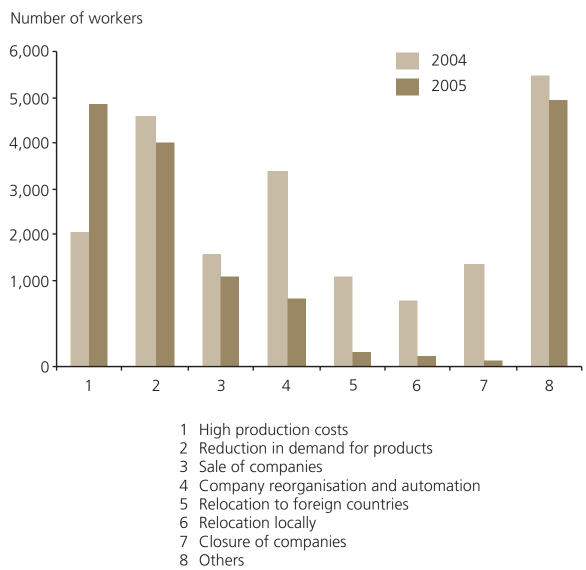
Meanwhile, the number of **unplaced job seekers** registered with the Manpower Department increased to 72,573 persons in 2005. However, the data is not comparable with previous years because from May onwards, the registration period during which job seekers are deemed to be actively seeking jobs was lengthened from three months to six months. Based on the new definition, the number of active job seekers that were still unplaced as at end-year has moderated from May (78,546 persons) and from the peak recorded in August of 104,714 persons. **Job placements** also increased, rising from 6,192 persons in 2004 to 17,459 persons in 2005, reflecting in part an improved labour-matching process, as well as some success in the Government's initiatives to increase the employability and marketability of job seekers via skills

Graph 1.30
Retrenchment according to economic sectors



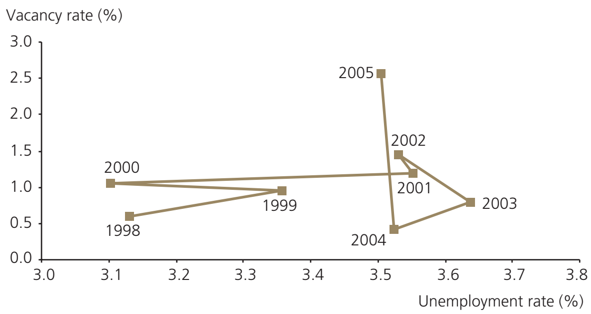
Source: Ministry of Human Resources

Graph 1.31
Reasons for Retrenchment



Source: Ministry of Human Resources

Graph 1.32
Beveridge Curve for Malaysia (1998-2005)



Source: Economic Planning Unit
Ministry of Human Resources
Bank Negara Malaysia

retraining programmes and the nation-wide job fairs to raise awareness regarding job opportunities. A large proportion of successful job placements continued to be recorded in the manufacturing (38%) and the services (30%) sectors.

The Beveridge Curve, which tracks the pattern of unemployment and vacancies in the labour market, moved almost vertically upwards in 2005, reflecting the fact that in spite of higher vacancies, the unemployment rate did not decline. This could mean that further improvements in the labour-matching process were needed. Despite efforts made by the Government to publicise the Electronic Labour Exchange Programme (ELX), which has been in place since 2002, many job seekers (employed and unemployed) were still unaware of the facility. The ELX provides free services to job seekers from school leavers to graduates, and helps them secure jobs. In order to increase the awareness of ELX to the job seekers, the Ministry of Human Resources plans to set up ELX booths in selected shopping malls and two mobile units equipped with computers and Internet access to traverse the country especially in rural areas, to register job seekers and to provide them with career guidance. Meanwhile, the job clearing system within the ELX also helps employers to look for potential workers. In 2005, 17,625 employers utilised the ELX to advertise a total of 304,500 job vacancies (2004: 5,553 employers and 49,975 positions). Although successful matches via the Exchange increased to 308,291 positions in 2005 (2004: 37,295 positions), only 17,459 persons were recruited (2004: 6,192 persons). This could be due to the tendency of employers to be more selective in filling vacancies, as reflected in the Curve's lower elasticity, and also to the fact that that the number of job placements could be under-reported as it is not compulsory for employers and job seekers to report successful job placements.

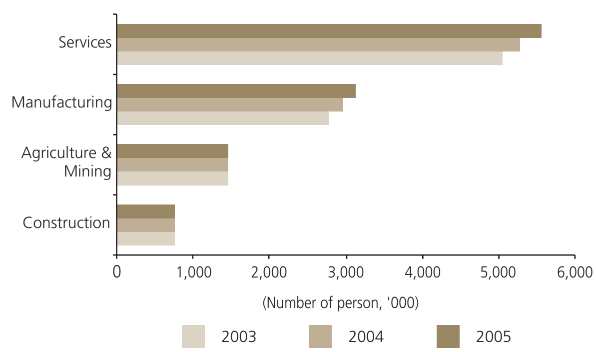
Overall, most key economic sectors recorded higher employment in 2005, except for the agriculture and construction sectors. The services sector continued to be the largest employer, engaging slightly more than 50% of total workers, particularly the wholesale and retail trade, hotels and restaurants (18%) and government services (10%) sub-sectors, followed by the manufacturing (29%) and agriculture, forestry and fishery (13%) sectors.

In 2005, nominal **wages** were higher as more employers linked their employees' annual increments and bonuses to performance or productivity. Wages also rose in part due to improved labour market conditions as well as to reflect the higher cost of living.

Graph 1.33
Output and Employment

Source: Economic Planning Unit
Department of Statistics, Malaysia

Graph 1.34
Total Employment by Sector



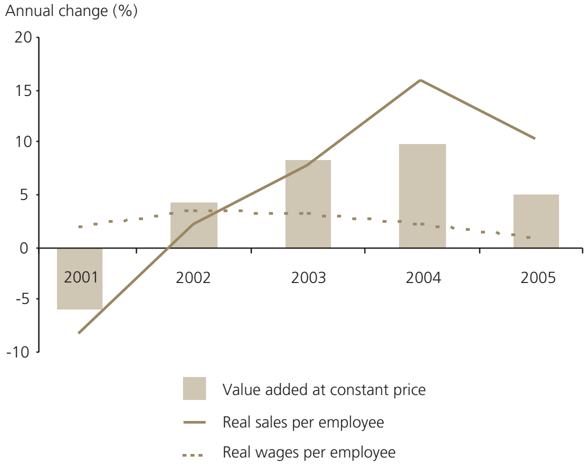
Source: Economic Planning Unit

- The Salary and Fringe Benefits Survey undertaken by the **Malaysian Employers Federation** (MEF) showed a higher increase in the average private sector salary of 5.8% in 2005 (2004: 5.6%), with both categories of employees, executives (5.9%) and non-executives (5.7%), receiving higher salary increases. On a sectoral basis, the average salary increase in the non-manufacturing sector (5.9%) continued to outpace that of the manufacturing sector (5.7%) (2004: 6.1% and 5% respectively). The average minimum monthly salary offered to those with a basic degree without prior working experience was marginally higher at RM1,707 (2004: RM1,666).

- Similarly, findings from the Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the **Federation of Malaysian Manufacturers** also revealed higher salary increments to employees in 2005. The average salary increment given to employees was 6.3% (2004: 5.6%). Meanwhile, the average basic salary offered to a fresh graduate with a degree qualification was RM1, 917 (2004: RM1, 799).

Productivity is a measure of the efficiency with which inputs are transformed into outputs within the production process. **Total factor productivity** growth captures productivity increase arising from improvements in utilisation of factor inputs due to technological process and overall efficiency improvement. Recent estimates by Bank Negara

Graph 1.35
Manufacturing Sector: Output and Productivity



Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Malaysia showed that total factor productivity improved in 2005, registering a growth of 3% (2004: 2.7%), indicating more efficient use of resources and technology. At the same time, data from the Monthly Manufacturing Survey conducted by the Department of Statistics, Malaysia showed that labour productivity, as measured by real sales per employee, rose by 10%, surpassing the 0.8% growth in real wage per employee. Almost all the manufacturing industries such as petroleum and chemicals, basic metal, E&E, textiles, transport and off-estate recorded higher growth in labour productivity vis-à-vis wages. Meanwhile, real labour productivity for the whole economy, as measured by real GDP per worker rose by 1.1% during the year.

In order to enhance flexibility in the labour market to improve competitiveness, the Government has advocated the use of a productivity-linked wage system (PLWS). By implementing PLWS, companies would be able to put in place a flexible and competitive wage system that would enable them to respond quickly and effectively to changing business conditions, leading to higher productivity gains, lower costs and improvement in competitiveness. In addition, a PLWS would also provide a clear incentive to workers to upgrade their performance and productivity. For employees, high performers would reap more benefits. PLWS components include non-contractual bonuses, bonuses based on profits, and salary increments based on merit or performance. Industry data showed that more companies are adopting PLWS. According to the MEF's 2005 Survey, about 80% of its respondent companies linked salaries to performance for the executives, and 74% for non-executives. Similarly, latest available data from the National Productivity Corporation showed that out of 322 collective agreements (CAs) signed in 2004, a total of 201 or 62% contained PLWS components (2003: 45% out of 367 collective agreements). In the agriculture sector, all of the eight CAs contained PLWS components, compared to 83 (77%) in the services sector, and 110 (53%) in the manufacturing sector.

Although the Government has always encouraged employers to hire more local workers and to adopt labour-saving devices such as increased mechanisation and automation to achieve higher efficiency and productivity, **foreign workers** still play a major role in alleviating labour shortages in selected sectors of the economy. As such, in 2005, the Government allowed registered foreign workers whose contracts have expired to change employers within the same economic sector as long as their work permits were still valid. In addition, to ensure a more efficient system of recruiting foreign workers, the Government established a One-Stop Centre to expedite processing of applications for foreign workers, eliminate the use of middlemen or agents and to reduce red tape in the Government sector. The Centre would process applications within 24 hours, thereby speeding up the administrative processes significantly. The Centre commenced operations in August 2005 and was manned by officers from relevant government agencies, including Ministry of Home Affairs, Ministry of International Trade and Industry, Ministry of Agriculture and Agro-based Industry, Ministry of Plantation Industries and Commodities, Construction Industry Development Board and Ministry of Human Resources. The major changes in the process of hiring foreign workers are as follows:

- New levy system for foreign workers, whereby rates differ according to the location (Peninsular Malaysia or East Malaysia) and sector of economic activity. For instance, foreign workers employed in the services sector in Peninsular Malaysia are subjected to a higher levy compared to that in Sabah and Sarawak.
- An increase in the levy for each foreign worker engaged in the plantation and services sector in Peninsular Malaysia to RM540 and RM1,800 per annum respectively (previously: RM360 and RM1,200 respectively). The levy for hiring more than one maid is also increased to RM540 per person (previously: RM360).
- To ensure that employers hire only the required number of workers, employers are required to pay the levy at the Centre based on the number of foreign workers approved.
- Employers are required to register with the Manpower Department before applying for foreign workers. Employers also need to advertise job openings in the Job Clearing System to give local job seekers priority in applying for jobs. If the positions remained unfilled, then companies are allowed to engage foreign workers.
- Employers need to attend an interview at the Centre, thereby eliminating the need for middleman and the potential for fraud.

Meanwhile, beginning 1 February 2006, the Government also requires all non-professional foreign workers (except Indonesians) to attend an induction course on communication skills, Malaysian culture and laws, conducted at centres in the source countries in collaboration with MLVK-approved training centres in Malaysia. Foreign workers who completed the course would be given the Certificate of Eligibility, which is a pre-requisite for a working visa in Malaysia.

In 2005, the Government undertook measures to reduce the number of **illegal foreign workers** and to improve the security of the population. The Amnesty Programme that was launched on 29 October 2004 was extended to end-February 2005. Altogether, about 89,510 illegal workers left Malaysia in the first two months of the year (October - December 2004: 309,248 persons), the majority of whom were Indonesians (84%), followed by Indian nationals (5%) and Bangladeshis (3%). Nevertheless, there were still some illegal migrant workers who chose to remain in Malaysia despite Government efforts to legitimise them. Thus, on 1 March, the Government mounted a full-scale operation called *Ops Tegas* involving stricter enforcement. During the period from 1 March to 31 December, 11,916 more illegal migrants were arrested.

Although the Amnesty Programme was designed to allow the speedy return of the now-legitimised foreign workers to Malaysia, delays emerged due to some administrative bottlenecks in the major source country, Indonesia. In March, the slow return of legal foreign workers created a temporary shortfall in labour in the manufacturing, construction and plantation sectors. Hence, the Government lifted the two-month freeze on hiring of new foreign workers in April, and allowed foreign workers from a number of different countries such as Vietnam, Pakistan, India, Nepal and Myanmar to work in Malaysia.

As at end-year, total **registered foreign workers** in Malaysia numbered 1,815,238 persons, representing an increase of 23.5% from the previous year (2004: 1,470,090 persons). The large increase reflected in part new hires as well as the success of the Government's Amnesty Programme whereby some illegal migrant workers returned to Malaysia as registered foreign workers. In total, foreign workers account for about 16.7% of total employment and are engaged mainly in the manufacturing (32%), plantation (24%) and construction (16%) sectors, as well as domestic helpers (18%). In terms of nationalities, Indonesian workers still constitute the largest group with 67%, followed by Nepalese (11%) and Indian nationals (7%).

In 2005, the Government intensified efforts to address the rising number of **unemployed graduates**. According to a week-long survey conducted by the Economic Planning Unit in September, nearly 60,000 graduates were jobless, with most being unemployed for more than one year. Among key reasons cited for being jobless include no job experience; weak command of the English language and a lack of communication skills; and possessing university degrees that were not relevant to market needs. The large number of unemployed graduates is a concern as it could hamper the country's aim to be a knowledge-based economy. Therefore, in 2005, the Government continued to focus on training and embarked on various programmes to address the issue of mismatch of skills between the unemployed graduates and market requirements. The status of some of the programmes and training schemes are as follows:

- **Graduate Training Scheme III**: Launched in August 2005, the Scheme aims to equip local graduates who have been unemployed since year 2003, with specialised skills such as web publishing and application, tourism (tourist guide) and event management, ICT and English language among others. A total of 11 courses were offered, each running for about two-and-a-half to five months. About RM100 million has been allocated for this Scheme, with plans to train 15,500 unemployed graduates. In 2005, 7,992 unemployed graduates enrolled in the programme, mainly in English language courses, followed by executive development and web-based courses.

- **Graduate Reskilling Scheme**: This Scheme targets engineering and selected technical graduates with no previous employment history. The objective of the Scheme is to upgrade skills and knowledge of graduates in related technical fields, such as manufacturing-plant operation and maintenance in the automotive industry, semiconductor chip design, and supply chain management. Courses are of Certificate level, and conducted in skills development centres and selected participating colleges and universities. As at end-2005, a total of 2,370 graduates have participated in the courses.

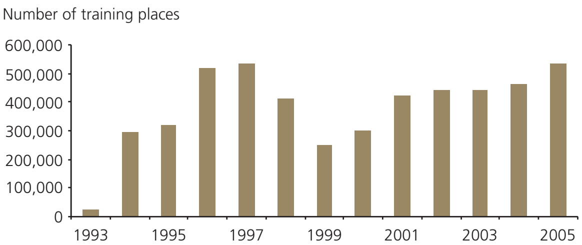
- **Graduate Apprenticeship Programme**: This programme was initiated in 2005 and managed by the Ministry of Higher Education. A total of 79 skills-related courses are offered in various public universities, with apprenticeship in selected private companies. Up till mid-September, a total of 9,225 graduates benefited from this programme.

- **National Dual Training Scheme**: The programme's overarching objective is to produce knowledge workers that match industry needs. The two-year training programme, similar to that implemented in European countries, consists of two components – 20-30% of training being theoretical in nature, conducted in selected National Vocational Training Council (*Majlis Latihan Vokasional Kebangsaan*, MLVK) training institutes; and the balance in the form of practical training in various companies, including Government-linked ones as well as multinational firms. Launched in July 2005, participants would be trained in four specialised areas, namely automotive mechatronic; plant operation in the petrochemical, oil and gas industry; process automation in industrial electronics industry; as well as tool making (mould and dye). The first intake has benefited about 71 school leavers, university graduates and employed workers. Upon completion of the 2-year training programme, participating companies can choose to absorb the trainees into their workforce.

- **Attachment and Training Scheme**: Introduced in 2001, the Scheme seeks to provide unemployed diploma and degree graduates with work experience, thereby improving their chances of getting jobs. Trainees were attached to Government departments and agencies and were exposed to ICT, English language and statistics or research methodologies courses. As at end-2005, seven out of eight programmes under this scheme were completed, benefiting about 38,210 graduates.

The cost of the training programmes is wholly borne by the Government and to attract further participation, trainees were provided with monthly allowances of RM350. In October, in view of the higher cost of living, the allowance was increased to RM500 per month. To further encourage the private sector to provide employment opportunities to unemployed graduates, the 2006 Budget proposed that double deduction be given on the allowances paid by companies listed on Bursa Malaysia to participants of Unemployed Graduate Training programme. This incentive would be available for three years and is expected to benefit at least 1,000 unemployed graduates. The Government also approved additional RM100 million for training of unemployed graduates. Meanwhile, Skills Training Centres at the state levels would increase student intakes and introduce new courses under the Industrial Skills Enhancement Programme. For unemployed graduates who are interested in participating in economic activities, the Government intends to implement 'Young Entrepreneurs' Scheme' that focuses on ICT, tourism, *halal* products, and food processing and packaging. In addition, the PROSPER Graduate Programme seeks to encourage graduates to become entrepreneurs. An initial batch of 200 graduates is expected to benefit from the programme in 2006, each getting RM50,000 in financing aid to assist them in setting up businesses.

Graph 1.36
HRDF: Number of Training Places Approved



Source: Pembangunan Sumber Manusia Berhad

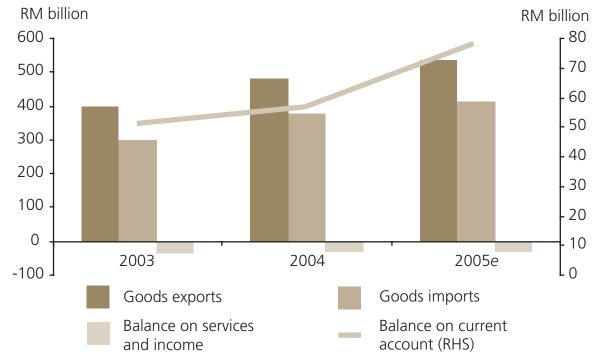
In 1993, the **Human Resource Development Fund** (HRDF) was established with matching grant from the Government to encourage the private sector employers in the manufacturing and services sectors to retrain and upgrade the skills of their employees. The HRDF operates on the basis of levy system, whereby employers who have paid the levy will qualify for training grants from the Fund to defray or subsidise training costs for their Malaysian employees. The rate of financial assistance is 100% of the allowable costs incurred for training in Malaysia and up to 50% for costs incurred overseas, subject to the availability of levy in the employers' accounts with *Pembangunan Sumber Manusia Berhad* (PSMB) which administers the Fund. In 2005, the PSMB approved 535,266 training places, with financial assistance of RM228.7 million. Among others, the PSMB offers training for retrenched and unemployed workers as well as run apprenticeship programme for SPM school leavers. Given the increasing importance of the services sector in terms of its contribution to the economy and its need for knowledge workers, the scope of the PSMB Act 2001 was expanded to include more services industries such as port services; warehousing services; R&D; support services and maintenance engineering; hypermarkets, supermarkets and department stores; security services; private hospitals; and direct sales. With the inclusion, employers in these industries would need to contribute to the development levy for the purpose of training, retraining and upgrading the skills of their employees so as to be in line with business needs and the country's economic strategy.

EXTERNAL SECTOR

Balance of Payments

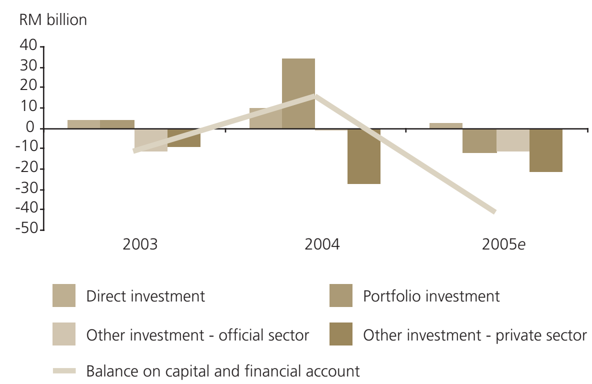
The **overall balance of payments** remained strong and recorded a surplus in 2005. The larger current account surplus was due mainly to a stronger goods surplus, reflecting sustained expansion in commodity

Graph 1.37a
Current Account



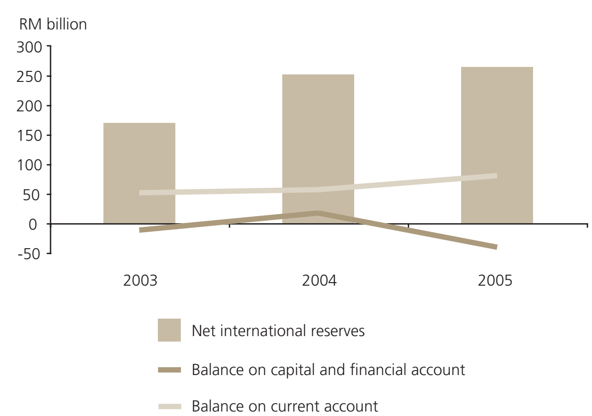
e Estimate

Graph 1.37b
Capital and Financial Account



e Estimate

Graph 1.37c
Net International Reserves



exports and continued growth in manufacturing exports. Meanwhile, the financial account recorded a net outflow attributed mainly to the unwinding of portfolio positions in the fourth quarter and higher external loan repayments by the official sector. Errors and omissions, including exchange loss from revaluation of Bank Negara Malaysia's international reserves due to the strengthening of the ringgit against major currencies, was RM23 billion. Revaluation losses on reserve holdings arising from the appreciation of the ringgit against the major currencies amounted to RM15.5 billion. After adjusting for errors and omissions, the overall balance of payments recorded a surplus of RM12.8 billion. As a result, the net international reserves of Bank Negara Malaysia increased by RM12.8 billion to RM266.3 billion (USD70.5 billion) as at 31 December 2005. The reserves increased further to RM272.7 billion or equivalent to USD72.2 billion as at 28 February 2006. This reserves position is adequate to finance 7.6 months of retained imports and cover 6.7 times the short-term external debt. Malaysia's reserves remained usable and unencumbered.

Current Account

In 2005, the **current account** continued to record a large surplus of RM77.8 billion, equivalent to 16.4% of GNP (2004: RM56.5 billion or 13.3% of GNP), due to a larger surplus in the trade account and, to a lesser extent, an improvement in the income account. The export growth was underpinned by an expansion in manufacturing exports and higher prices for commodity exports. A larger outflow in other services account and higher payments for travel abroad led to a larger deficit in the services account. The income account recorded an

The larger current account surplus was due mainly to a strong trade surplus, driven by the continued expansion in manufactured and commodity exports, and an improvement in the income account.

Table 1.16
Balance of Payments

Item	2004			2005e		
	+	-	Net	+	-	Net
	RM million					
Goods	481,240	376,766	104,474	536,931	410,476	126,455
Trade account	*480,740*	*400,077*	*80,663*	*533,788*	*434,010*	*99,778*
Services	63,717	72,496	-8,780	72,202	82,452	-10,249
Balance on goods and services	**544,958**	**449,264**	**95,694**	**609,133**	**492,928**	**116,205**
Income	16,023	40,572	-24,549	20,469	41,937	-21,470
Current transfers	1,700	16,333	-14,633	1,131	18,094	-16,963
Balance on current account	**562,681**	**506,169**	**56,511**	**630,734**	**552,960**	**77,772**
% of GNP			**13.3**			**16.4**
Capital account			–			–
Financial account			15,083			-41,952
Direct investment			9,739			2,711
Portfolio investment			33,829			-11,881
Other investment			-28,485			-32,782
Balance on capital and financial account			**15,083**			**-41,952**
Errors and omissions			11,467			-23,000
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*7,997*			*-15,496*
Overall balance			**83,061**			**12,820**
Bank Negara Malaysia international reserves, net			**253,513**			**266,334**
USD million equivalent			**66,714**			**70,483**

Note: Numbers may not necessarily add up due to rounding.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia improvement during the year due mainly to higher earnings from larger reserves as well as sustained profits and dividends accruing to Malaysian companies investing abroad. The current transfers account recorded a higher outflow attributable to the one-off remittance by illegal foreign workers under the Amnesty Programme in the first two months of 2005.

Despite the global semiconductor down-cycle in the first half of the year, **gross exports** expanded at a double-digit rate of 11% during the year (2004: 20.8%). The growth was due to the strong performance in the commodities sector, particularly mineral exports (27.1%) underpinned by the higher energy prices. Receipts from manufacturing exports also remained relatively strong during the year, expanding by over 10%, while agriculture exports rose at a moderate rate of 3.4%. The increase in overall exports was reflected both in terms of higher volume (8%) as well as unit value (3.2%).

Receipts from **manufactured goods** grew by 10.1% in 2005 (2004: 19.7%). Arising from the slowdown in the global semiconductor cycle, growth in exports of E&E products grew moderately by 10% (2004: 15.3%). The slowdown in exports of semiconductors and electrical products was cushioned by the continued strength in shipment of computers and parts. Exports of chemical products expanded at a slower pace of 7% in 2005 (2004: 31%) due mainly to the slowdown in exports of organic chemicals, particularly demand for oleochemicals from the People's Republic of China (PR China). However, external demand for plastic products continued to remain strong during the year. The top two export

Table 1.17
Gross Exports

	2005*p*		
	RM million	Annual change (%)	% share
Manufactured goods	**429,873**	**10.1**	**80.5**
of which:			
Electronics, electrical machinery and appliances	282,779	10.0	53.0
Electronics	208,232	10.4	39.0
Semiconductor	*89,967*	*0.7*	*16.9*
Electronic equipment & parts	*118,265*	*19.1*	*22.2*
Electrical machinery & appliances	74,547	8.9	14.0
Consumer electrical products	*22,632*	*2.1*	*4.2*
Industrial & commercial electrical products	*28,608*	*11.0*	*5.4*
Electrical industrial machinery and equipment	*20,476*	*15.1*	*3.8*
Household electrical appliances	*2,831*	*3.9*	*0.5*
Chemicals & chemical products	29,718	7.0	5.6
Manufactures of metal	17,157	6.3	3.2
Optical and scientific equipment	12,318	6.5	2.3
Textiles, clothing and footwear	10,520	1.9	2.0
Wood products	8,860	2.1	1.7
Food	8,488	9.2	1.6
Furniture & parts	7,666	6.1	1.4
Transport equipment	6,993	31.3	1.3
Rubber products	6,777	12.3	1.3
Agricultural commodities	**37,421**	**3.4**	**7.0**
of which:			
Palm oil	19,036	-5.3	3.6
Rubber	5,787	11.3	1.1
Sawn timber	4,051	26.0	0.8
Saw logs	2,465	19.1	0.5
Minerals	**52,321**	**27.1**	**9.8**
of which:			
Crude oil and condensates	28,508	33.7	5.3
LNG	20,790	21.7	3.9
Tin	935	-1.2	0.2
Other exports	**14,173**	**9.5**	**2.7**
Total	**533,788**	**11.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table 1.18
External Trade

	2004	2005*p*
	RM billion	
Gross exports (f.o.b)	**480.7**	**533.8**
Annual change (%)	20.8	11.0
	Annual change (%)	
Volume[1]	25.1	8.0
Prices[1]	0.7	3.2
Gross imports (c.i.f)	**400.1**	**434.0**
Annual change (%)	26.4	8.5
	Annual change (%)	
Volume[1]	27.6	3.5
Prices[1]	2.7	4.9
Trade balance	**80.7**	**99.8**

[1] Volume and prices for 2005 are estimates.
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

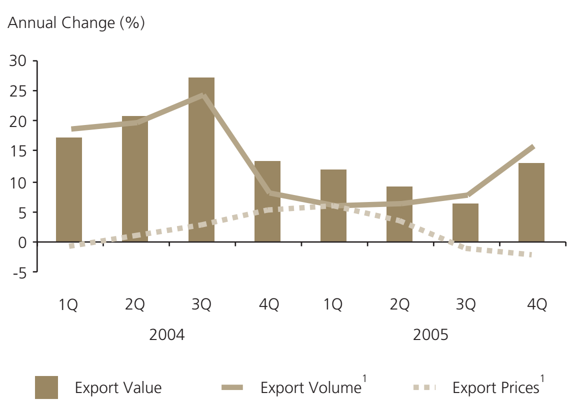
destinations for Malaysian made plastics were Europe and Japan. Among the resource-based industries, exports of rubber products continued to expand by a double-digit rate in 2005, driven largely by the strong global demand for rubber gloves. Meanwhile, exports of other resource-based products such as petroleum products, food, beverages and tobacco continued to expand during the year. In the case of metal products, after experiencing a strong expansion in 2004 (43.6%), growth slowed down to 6.3%, due to global oversupply of steel arising from aggressive capacity expansion by Chinese steel millers which led to lower prices. Overall, both increases in volume (8.8%) and unit value (1.2%) resulted in the higher export proceeds from the manufacturing sector in 2005.

The **primary commodities** sector continued to remain an important source of foreign exchange earnings in the Malaysian trade account with its share to total gross exports rising further during the year to 16.8% (2004: 16.1%). Commodity exports grew by 16% (2004: 21.8%), reflecting the strong growth in exports of energy products, while agriculture exports continued to grow at a moderate rate. The growth in commodity exports was largely driven by higher export prices (13.1%), and further supported by an increase in volume (4.3%).

Mineral exports grew strongly for the third consecutive year, rising by 27.1% to RM52.3 billion (2004: +38.2% to RM41.2 billion). Exports of crude oil and condensates rose significantly by 33.7% to RM28.5 billion, driven entirely by the marked increase in crude oil prices, which rose by 37% to an average of USD55.93 per barrel for 2005 (2004: USD40.81). However, export volume declined by 2% in line with the lower output of crude oil for the year. LNG export performance was also favourable, rising by 21.7% to RM20.8 billion, due to both higher prices (15%) as well as volume (5.9%).

Export receipts from **agriculture** rose at a more moderate pace of 3.4% to RM37.4 billion in 2005. Despite the higher export volume of palm oil (10.9%), earnings from palm oil fell by 5.3% during

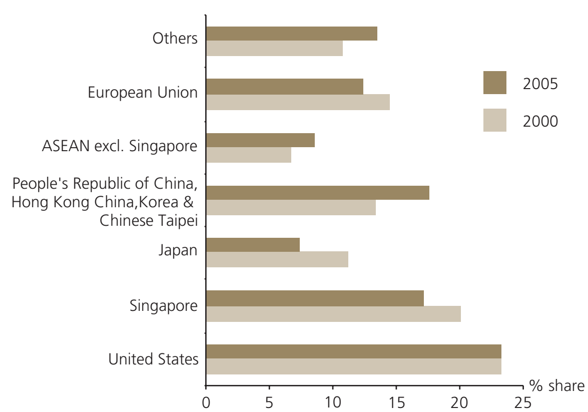
Graph 1.38
Export Performance of the Manufacturing Sector



[1] Volume and prices are estimates based on Bank Negara Malaysia's survey of selected companies.

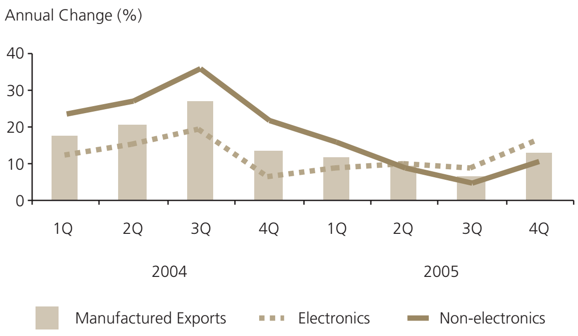
Source : Department of Statistics, Malaysia
Bank Negara Malaysia

Graph 1.39
Exports of Manufactured Goods by Destination



Source : Department of Statistics, Malaysia

Graph 1.40
Export Performance of Electronics and Non-electronics Industries



Source : Department of Statistics, Malaysia

the year to RM19 billion due entirely to lower prices (-14.6% to RM1,456 per tonne from RM1,706 per tonne in 2004). Prices consolidated during the year amidst the increase in global production and stocks of crude palm oil (CPO), coupled with the increase in harvests of soybean, which is palm oil's closest substitute in the global edible oil market. Nevertheless, offtake by major buyers of Malaysian palm oil, namely the European Union (EU), Pakistan and PR China with a combined share of almost 46% of total palm oil exports, increased by 14.7%, 10.8% and 2% respectively. Rubber exports continued to perform favourably, rising by 11.3% to RM5.8 billion (2004: RM5.2 billion) driven by both higher prices (9%) and volume (2.1%). External demand for rubber remained strong, led by PR China, which increased its purchase by 33.7% to 386,058 tonnes (2004: 288,732 tonnes). The sharp upward trend in demand has enabled PR China to become the largest purchaser of Malaysian rubber, surpassing the EU (2005: 319,612 tonnes) for the first time in 2005.

Gross imports increased by 8.5% (2004: 26.4%), reflecting mainly imports of inputs for manufactured exports as well as higher demand for consumer and investment goods. Import prices increased by 4.9%, attributed to higher prices across most goods, particularly, manufactured goods, crude materials, mineral fuels as well as chemicals.

Imports of **intermediate goods**, which accounted for 71% of imports, grew by 7.2%, due mainly to demand for electrical and electronics, and resource-based products, particularly from the US and regional countries. Increased sourcing of intermediate inputs from PR China, Singapore and Thailand was underpinned by the manufacturing supply chain as well as extensive production network and linkages in the region. These imports comprised mainly computer components and machine parts, and industrial supplies such as metals and chemicals. Intermediate imports relating to the manufacture of goods for the domestic market also expanded. Consistent with the strong performance of the motor assembly industry in line with higher demand for passenger cars, imports of parts and accessories of transport equipment recorded a strong growth. In tandem with higher oil prices, imports of fuel and lubricants grew strongly.

Reflecting the further expansion in private investment, imports of **capital goods** increased by 9.5%. Capital imports excluding lumpy items grew by 9.3%. The impetus for growth came from capacity expansion and upgrading for new technologies. Capital imports were channelled mainly into the manufacturing and services sectors. The higher level of business activity and investment to improve the quality and efficiency of the infrastructure in the services industry led to the increase in imports of office equipment and generators, turbines and electric motors for power generation. Imports of industrial machinery and equipment in the manufacturing sector remained strong. Continued capacity expansion in the manufacturing sector occurred in areas such as higher-end electrical and electronics products, metals and plastics. New technologies and products as well as the extension of network infrastructure underpinned the growth in imports of telecommunication equipment. Growing intra-regional trade between ASEAN and North Asia and firm external demand for commodity exports led to higher imports of ships to service these markets.

In line with higher disposable income, imports of **consumption goods** increased by 5.9%. Import growth reflected demand for food and beverages as well as consumer goods particularly durable and non-durable consumer goods, namely, sound and video reproducing equipment, household electrical goods, jewellery and medicine. The share of consumption goods imports to total imports remained low, accounting for 5.7% of total imports.

Consonant with increasing intra-regional trade, imports for **re-exports** expanded by 26.9%. These imports were mainly electrical and electronic products, telecommunication equipment and iron and steel products which were packed, labeled and assembled in the free commercial zones at major ports and airports. These imports were largely re-exported to Singapore, Thailand, US, PR China and Hong Kong China.

Table 1.19
Gross Imports by End Use

	2005p		
	RM million	Annual change (%)	% share
Capital goods	**60,734**	**9.5**	**14.0**
Capital goods (except transport equipment)	53,939	10.0	12.4
Industrial machinery and equipment	*14,419*	*9.1*	*3.3*
Office equipment	*11,291*	*23.5*	*2.6*
Telecommunication equipment	*6,999*	*0.6*	*1.6*
Transport equipment	6,795	5.3	1.6
Intermediate goods	**308,335**	**7.2**	**71.0**
Food and beverages, mainly for industry	8,352	-5.6	1.9
Industrial supplies, n.e.s.	96,599	6.0	22.3
Metals & metal products	*31,870*	*15.6*	*7.3*
Chemicals	*11,667*	*9.6*	*2.7*
Fuels and lubricants	27,492	42.3	6.3
Parts and accessories of capital goods (except transport equipment)	163,660	2.7	37.7
Electronics	*105,710*	*2.7*	*24.4*
Parts and accessories of telecommunication equipment	*7,249*	*-2.5*	*1.7*
Parts and accessories of transport equipment	12,232	34.8	2.8
Consumption goods	**24,600**	**5.9**	**5.7**
Food and beverages, mainly for household consumption	9,280	4.0	2.1
Transport equipment, non-industrial	318	-4.9	0.1
Consumer goods, n.e.s.	15,002	7.4	3.5
Consumer durables	*3,514*	*12.3*	*0.8*
Consumer semi-durables	*4,671*	*0.4*	*1.1*
Consumer non-durables	*6,817*	*10.2*	*1.6*
Dual use goods	**11,308**	**21.5**	**2.6**
Motor spirit	6,424	35.4	1.5
Passenger motor cars	4,884	7.0	1.1
Others	**7,171**	**0.8**	**1.7**
Re-exports	**21,862**	**26.9**	**5.0**
Gross Imports	**434,010**	**8.5**	**100.0**

Note: Numbers may not necessarily add up due to rounding.
n.e.s. Not elsewhere specified.
p Preliminary

Source: Department of Statistics, Malaysia

Malaysia's total external trade expanded by 9.9% to RM967.8 billion in 2005. The share of Malaysia's trade with the major trading partners, namely the US, Singapore, Japan and the EU declined slightly and accounted for 53.8% of total trade. However, trade with regional countries (excluding Japan) grew, and accounted for 44.4% of Malaysia's exports and 49% of imports. Trade links with Australia and India strengthened, driven mainly by higher demand for electrical and electronics and petroleum-related products.

Exports to the **US**, Malaysia's largest trading partner, grew by 16.5% to account for an increased share of 19.7% of total exports. The impetus to the export growth stemmed from higher demand induced by the replacement cycle for wireless computers and computer-related items. Exports of optical and medical instruments and resource-based products, namely wood, rubber and chemical products, strengthened further. The US remained the second largest source of imports for Malaysia. Approximately 80% of imports were intermediate inputs for the electrical and electronics industry. As exports to the US increased while imports declined, the bilateral trade surplus widened to RM49.1 billion (2004: RM32.3 billion).

Singapore remained the second most important trading partner with a share of 13.9% of total trade (2004: 13.2%). Electrical and electronic products continued to be the largest export receipts, accounting for 57.8% of total exports to Singapore. Other export items which recorded strong growth include crude petroleum and

Table 1.20
Direction of External Trade

	2005*p*				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	RM million
ASEAN countries	**139,208**	**26.1**	**106,976**	**24.6**	**32,232**
Singapore	83,333	15.6	50,828	11.7	32,505
Thailand	28,723	5.4	22,889	5.3	5,834
Indonesia	12,580	2.4	16,566	3.8	-3,986
Philippines	7,476	1.4	12,192	2.8	-4,716
Other ASEAN countries	7,096	1.3	4,501	1.0	2,595
Selected North East Asia countries	**99,184**	**18.6**	**106,254**	**24.5**	**-7,070**
The People's Republic of China	35,221	6.6	49,880	11.5	-14,659
Hong Kong China	31,205	5.8	10,797	2.5	20,409
Chinese Taipei	14,813	2.8	23,974	5.5	-9,160
Korea	17,945	3.4	21,604	5.0	-3,659
European Union (EU)	**62,629**	**11.7**	**50,512**	**11.6**	**12,117**
United Kingdom	9,470	1.8	6,522	1.5	2,948
Germany	11,259	2.1	19,265	4.4	-8,007
Netherlands	17,452	3.3	3,351	0.8	14,101
Other EU countries	24,449	4.6	21,374	4.9	3,075
United States	105,033	19.7	55,918	12.9	49,115
Japan	49,918	9.4	62,982	14.5	-13,064
India	14,972	2.8	4,164	1.0	10,808
Australia	18,042	3.4	8,171	1.9	9,872
Rest of the world	44,801	8.4	39,033	9.0	5,769
Total	**533,788**	**100.0**	**434,010**	**100.0**	**99,778**

Note: Numbers may not necessarily add up due to rounding.
p Preliminary

Source: Department of Statistics, Malaysia

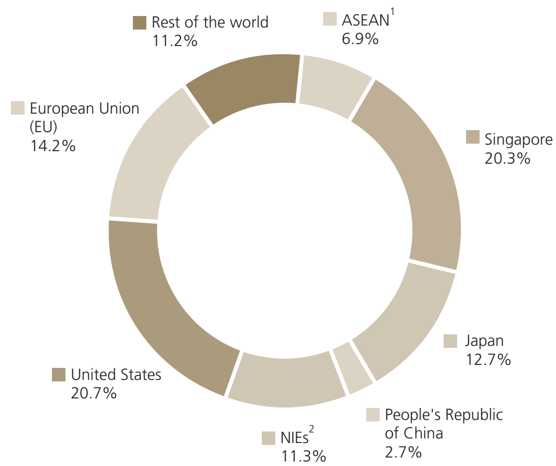
resource-based products, namely petroleum, chemical, iron and steel products. On the imports side, Singapore was the third largest source for Malaysia with imports comprising mainly electrical and office machinery, chemical products as well as refined petroleum products.

Despite a decline in the share of trade to 11.7% (2004: 12.7%), **Japan** continued to be the third largest trading partner of Malaysia. The trade balance with Japan, which has been in Japan's favour, improved to register a smaller deficit of RM13.1 billion as imports declined while exports continued to grow. Export growth of 2.8% was underpinned by increased export receipts from LNG, manufactures of plastics and metals. Imports declined by 1.2%, reflecting lower imports of transport equipment, optical, medical and surgical instruments. Japan remained the principal source of imports for Malaysia, accounting for 14.5% (2004: 15.9%) of total imports, although its share of imports has been declining as Malaysia diversifies its trade and intensifies its trading link with other regional countries.

The growth in trade with countries in the **EU** moderated to 4.4% in 2005, reflecting the slowdown in economic activity in the EU. A trade surplus of RM12.1 billion (2004: RM12.4 billion) was recorded, attributed mainly to trade surplus with the Netherlands (RM14.1 billion), UK (RM2.9 billion), France (RM1.3 billion) and Spain (RM1.2 billion) while trade deficits were recorded in trade with Germany and Italy of RM8 billion and RM2 billion respectively. Within the group, Germany, the Netherlands and the UK remained the leading trading partners. Exports to the EU comprised mainly integrated circuits and furniture while imports were mainly iron and steel products, passenger cars and electrical machinery.

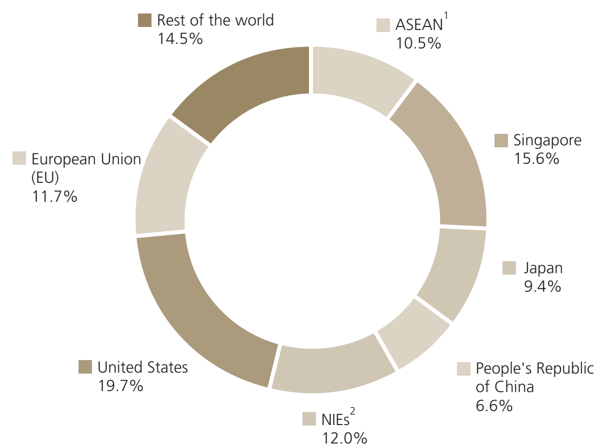
Trade with economies in **North East Asia** (excluding Japan), which accounted for 21.2% of total trade,

Graph 1.41
Direction of Exports (% share): 1995



[1] ASEAN excluding Singapore
[2] Hong Kong China, Korea and Chinese Taipei

Direction of Exports (% share): 2005



[1] ASEAN excluding Singapore
[2] Hong Kong China, Korea and Chinese Taipei

expanded by 11%. Increased sourcing of cheaper inputs caused import growth from these countries to continue to outpace exports. Consequently, the trade balance recorded a deficit of RM7.1 billion in 2005. PR China was Malaysia's fourth major source of imports, with imports comprising mainly intermediate components such as integrated circuits, machinery, appliances and parts, chemical and metal products. Exports to PR China which recorded growth were electronic and electrical products, iron and steel and rubber products. Imports from Korea was underpinned by imports of integrated circuits, office machine parts and passenger cars while exports were largely supported by LNG, computer and components and chemical products.

Increasing intra-regional trade and better economic performance of **ASEAN** countries resulted in Malaysia's trade with ASEAN countries (excluding Singapore) expanding by 12.3% in 2005. Exports to ASEAN were supported mainly by exports of electrical and electronics and resource-based products such as chemicals, iron and steel as well as plastic products. Imports from this region comprised mainly electrical and electronic products, chemical products and manufactures of metal.

The **services account** deficit widened to RM10.2 billion or 2.2% of GNP (2004: -RM8.8 billion or –2.1% of GNP). Higher demand for imported services as the economy moved up the production value chain, led to a higher net payment of RM12.3 billion (2004: -RM9.7 billion) in the **other services account**. The outflows were attributable mainly to higher payments for royalties and license fees, construction services, and other business services. Royalties and license fee payments continued to increase, reflecting acquisition of intellectual property rights for design and development of new products by the manufacturing sector, particularly in the E&E industry, and services sector. More than 70% of payments for royalties and license fees were made to the UK, US and Japan. Net payments for

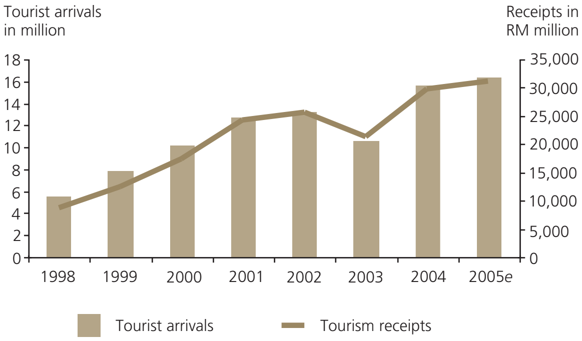
Table 1.21
Services and Income Accounts

	2004	2005e		
	RM billion			
	Net	+	–	Net
Services Account	**-8.8**	**72.2**	**82.5**	**-10.2**
% of GNP	*-2.1*			*-2.2*
Transportation	-17.8	16.2	31.9	-15.7
Travel	19.4	32.4	14.2	18.1
Other services	-9.7	23.3	35.6	-12.3
Government transactions n.i.e.	-0.7	0.4	0.8	-0.4
Income Account	**-24.5**	**20.5**	**41.9**	**-21.5**
% of GNP	*-5.8*			*-4.5*
Compensation of employees	-1.1	4.2	4.7	-0.5
Investment income	-23.4	16.2	37.2	-21.0

Note: Numbers may not necessarily add up due to rounding.
n.i.e. Not included elsewhere.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia.

Graph 1.42
Tourist Arrivals and Tourism Receipts



e Estimate
Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia

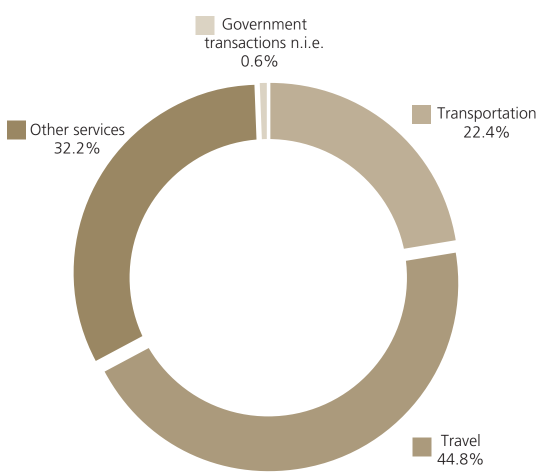
construction services increased, despite higher earnings from construction projects abroad, due mainly to higher imported services for power as well as oil and gas exploration projects. The large outflows for 'other business services' reflected mainly payments for professional services as well as operational leases for ships, tugs and aircrafts. Meanwhile, computer and information services receipts improved, underpinned by the expansion in business process outsourcing and provision of group network support services. About half of these earnings were from Singapore, the UK and US.

Despite a marginally smaller net inflow, the **travel account** remained the largest contributor to services receipts, accounting for 44.8% of gross services receipts in 2005. Tourist arrivals in Malaysia grew by 4.4% to 16.4 million visitors (2004: 15.7 million), with gross foreign exchange earnings amounting to RM31 billion. Visitors from Singapore, Thailand and Indonesia accounted for 76.1% of tourist arrivals. While visitors from PR China and Hong Kong China declined, the growth in tourist arrivals was supported by tourists from West Asia, Korea, India, Australia and New Zealand as well as long-haul tourists from the US and UK. Malaysia has benefited from the expansion in regional travel, particularly from countries such as Vietnam, Thailand and Indonesia, as well as various strategies to promote tourism products including hosting of meetings, international conventions and events (MICE) such as Formula One Petronas Malaysia Grand Prix and Malaysia Mega Sale Carnival.

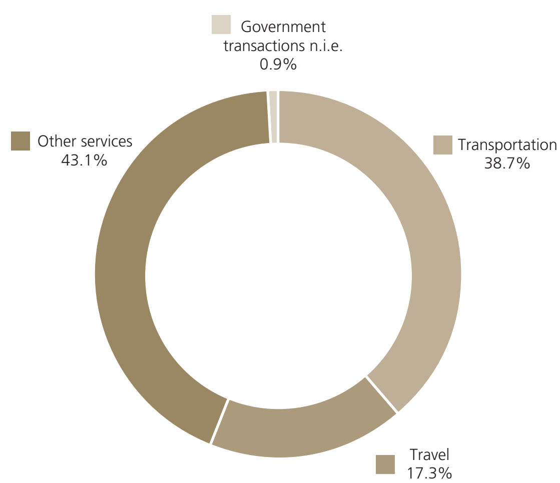
On the payments side, higher income and increased business activities overseas led to travel outflows increasing by 21.1% to RM14.2 billion (2004: RM11.8 billion). These outflows were attributable to the higher number of Malaysians traveling as well as higher payments for education abroad. Payments for travel to border towns increased by 24.2% to RM3 billion. Education outflows increased by 16.5% due mainly to an increase in the number of Malaysian students studying abroad, particularly, in Australia, the US and UK.

The **transportation account** recorded a smaller deficit of RM15.7 billion (2004: -RM17.8 billion), as the increase in receipts by major domestic shipping companies and airlines

Graph 1.43
2005: Components of Gross Receipts in the Services Account (% share)



Graph 1.44
2005: Components of Gross Payments in the Services Account (% share)



Higher returns from larger external reserve holdings together with sustained profits and dividends accrued to Malaysian companies from their investment abroad contributed to an improvement in income account.

outpaced the increase in payments abroad. Gross receipts were supported by earnings from shipments of petroleum, LNG and carriage of cargo following the expansion in intra-regional trade between North Asia and ASEAN, as well as higher freight rates. Gross outflows reflected higher freight charges as well as increased volume of trade.

The **income account** recorded an improvement, with the deficit narrowing to RM21.5 billion or 4.5% of GNP (2004: -RM24.5 billion or –5.8% of GNP). The smaller deficit reflected mainly higher returns from larger external reserve holdings of Bank Negara Malaysia. Meanwhile, the profits and dividends accruing to Malaysian companies from their investment abroad were sustained at RM4.1 billion. The bulk of the receipts were from the oil and gas, utilities and manufacturing sectors.

The profits and dividends accruing to foreign investors in Malaysia remained large, in line with the expansion in exports of electrical and electronics industry and the oil and gas sector. Nevertheless, a substantial portion of these profits and dividends was retained in Malaysia for reinvestment, and credited as inflows of foreign direct investment in the financial account of the balance of payments. A profile of Malaysia's income account from 1999 to September 2005 is published under the Special Feature in the Bank Negara Malaysia's Fourth Quarter 2005 Quarterly Bulletin.

In line with the continued efforts by the Government to reduce illegal foreign workers in Malaysia, a total of 398,758 illegal workers returned to their home countries during the Amnesty Programme from 29 October 2004 to end-February 2005. Reflecting the one-time lump sum repatriation by these workers returning home under this Programme, the **current transfers account** recorded a larger net outflow of RM17 billion (2004: -RM14.6 billion). About 58% of the registered foreign workers in Malaysia were employed in the manufacturing and agriculture sectors.

Financial Account

In 2005, the **financial account** recorded a net outflow of RM42 billion (2004: +RM15.1 billion), attributed mainly to the unwinding of speculative short-term positions in the fourth quarter, larger repayment of external loans by the official sector and higher extension of trade credits by Malaysian exporters. Reflecting the increased interests by Malaysian companies to diversify abroad, outflows for overseas investment also increased. Meanwhile, foreign direct investment was sustained at a high level.

On a gross basis, **foreign direct investment (FDI)** increased to RM25 billion (2004: RM23.5 billion), or 5.3% of GNP, with broad-based inflows across the major sectors such as the oil and gas, services and manufacturing sectors. Of significance, there was a marked increase in FDI from the major investing economies, namely the US, Hong Kong China and Germany. The bulk of FDI continued to be in the form of reinvested earnings, reflecting continued expansion and diversification of operations by existing MNCs, particularly in the manufacturing and oil and gas sectors, amidst favourable investment conditions in Malaysia. After taking into account the adjustments for higher outflows due largely to loan repayments to parent companies abroad, net FDI recorded an inflow of RM15.6 billion (2004: RM17.6 billion) or 3.3% of GNP.

FDI into the oil and gas sector increased significantly, particularly in the upstream activities, encouraged by rising oil prices and greater global demand for crude oil

Table 1.22
Balance of Payments: Financial Account

	2004	2005e
	RM billion	
Financial Account	**15.1**	**-42.0**
Direct Investment	**9.7**	**2.7**
In Malaysia	17.6	15.6
Abroad	-7.8	-12.9
Portfolio Investment	**33.8**	**-11.9**
Other Investment	**-28.5**	**-32.8**
Official sector	-1.1	-11.1
of which:		
Federal Government (net)	0.1	-3.5
Gross borrowing	1.1	0.7
Repayment	-1.0	-4.2
NFPEs (net)	-1.3	-7.6
Gross borrowing	11.4	6.3
Repayment	-12.7	-13.9
Private sector	-27.3	-21.7

Note: Numbers may not necessarily add up due to rounding.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The financial account recorded a net outflow, attributed mainly to the unwinding of speculative portfolio investment, larger repayment of external loans by the official sector and higher extension of trade credits. Overseas investment by Malaysians was also higher, while FDI was sustained at a high level.

during the year. These activities were mostly undertaken by the national oil and gas company in joint venture with its international partners, for deepwater and ultra-deepwater oil explorations, particularly in offshore East Malaysia, as well as for the extraction operations from existing and new oil fields.

In the services sector, foreign investments were received mainly in the finance, insurance, real estate and business services sub-sector, followed by the wholesale and retail trade, hotels and restaurants sub-sector and the transportation and communication sub-sector. Inflows into the finance, insurance, real estate and business services sub-sector reflected mainly investments received by investment holding companies, while one of the three foreign banks which were awarded licenses for Islamic banking in 2004 commenced its operations during the year. Of significance, Malaysia maintained the attraction for MNCs to locate their shared services and outsourcing activities, thus, encouraging higher value-added activity and establishing linkages across the different segments of the services sector. This was reflected in the *A.T. Kearney 2005 Offshore Location Attractiveness Index*, which ranked Malaysia as the third most attractive investment destination for Shared Services & Outsourcing (SSO) for the second consecutive year, citing favourable factors such as world-class infrastructure, attractive fiscal incentive packages and availability of skilled labour. During the year, there was an increase of 169 international and regional facilities, of which 19 were operational headquarters (OHQs), 132 regional and representative offices, 15 international procurement centres (IPCs) and three regional distribution centres (RDCs). Investments in the wholesale and retail trade, hotels and restaurants sub-sector remained firm, supported by strong domestic consumption in trade and tourism-related services. Meanwhile, investments in the transportation and communication sub-sector were mainly for the expansion of activities in the courier as well as air and ocean freight services.

The manufacturing sector continued to be a major recipient of FDI. About one-half of the investments were concentrated in the electrical and electronic industry, primarily for plant expansion as well as upgrading of machinery and equipment, to enlarge capacity as well as for production of higher-end products. Significant investments were also channelled into the downstream petroleum refining and petroleum-related product industry, in line with the higher investment in the upstream oil and gas activities. Meanwhile, investments in the other manufacturing industries were varied, ranging from industrial chemicals and other chemical-related products, plastic-based products to the manufacturing of fabricated metal products and machinery and equipment.

Direct investment abroad by Malaysians increased to RM12.9 billion in 2005 (2004: -RM7.8 billion), reflecting increased interests by Malaysian companies to acquire foreign interests as well as to exploit opportunities to diversify their operations abroad. The top destination for the investment was the ASEAN countries, which accounted for about half of total direct investment abroad. Other major destinations include PR China, US and Hong Kong China although some of Malaysia's investments were channelled through international offshore financial centres before re-directed to its final destination. The scope of investment has become increasingly broad-based, ranging from the oil and gas and manufacturing sectors, to the services sector. On a sectoral basis, a large share of overseas investments was effected by companies in the services sector, in particular, the transport and communication sub-sector as well as the financial services sub-sector. Most of these investments were undertaken through equity acquisitions by several large Malaysian companies, including the takeover of an Indonesian mobile telephone operator, as well as the acquisition of a shipping company in Singapore. In addition to the investments that were carried out by large corporations, many small and medium-sized Malaysian companies also invested in low-cost economies, taking advantage of cheap labour, availability of raw materials and new market base.

In the oil and gas sector, the national oil company continues to forge joint venture partnership with several foreign oil companies for exploration and extraction, lending technical expertise and providing working capital for investment. Meanwhile, overseas investments in the manufacturing sector were led by companies in the semiconductor and other electronic component, and ship building- and repairing-related industries. Apart from the provision of equity capital financed mainly from internal funds, higher overseas investments were also effected through higher loans extension by the parent companies in Malaysia to their subsidiaries abroad. These companies sought to expand production facilities in new markets for entry into the new and often fast-growing markets. Several big companies from furniture and wood-related products, as well as basic metal industries in Malaysia have also invested abroad to achieve cost effective production while at the same time, enhanced the prospects for new export outlet for business expansion. Meanwhile, investments abroad by construction companies continued to be significant following their earlier success in bidding and on-going work of several large infrastructure, roads and highway projects abroad.

Malaysia's investments abroad continued to yield positive results. Reflecting the success of their operations abroad, the net profits and dividends accruing to Malaysian companies investing abroad, particularly from the oil and gas sector and financial services sub-sector, was sustained at RM4.1 billion in 2005 (2004: RM4.3 billion).

In 2005, **portfolio investment** registered a net outflow of RM11.9 billion (2004: +RM33.8 billion). In the first half-year, portfolio investment recorded a net inflow of RM8.1 billion, reflecting mainly foreign interest in short-term money market papers, debt securities as well as equities. The strong interest observed in Malaysia's capital market since last year was partly associated with the periodic anticipation of exchange rate realignments in the region. However, the flows reversed in the second half of the year, recording a net outflow of RM20 billion. The outflows, which commenced in September and continued into October and November, arose mainly from the liquidation of short-term money market papers and debt securities, and to a lesser degree, equity securities. These outflows subsided in December.

The **other investment** recorded a higher net outflow of RM32.8 billion (2004: -RM28.5 billion), reflecting mainly larger repayment of external loans by the official sector while net outflows by the private sector declined. The **official sector** recorded a net repayment position for the third consecutive year, amounting to RM11.1 billion (2004: -RM1.1 billion), in line with Malaysia's prudent external debt management strategy and the Government's commitment towards fiscal consolidation. Meanwhile, other investment by the **private sector**, which comprises mainly borrowing and lending, placements and withdrawals of deposits by the banking sector as well as non-bank private sector transactions with unrelated counterparties, recorded a lower net outflow of RM21.7 billion (2004: -RM27.3 billion). The improvement was due largely to a reversal in the banking sector position registering a net inflow during the year, arising mainly from the withdrawal of deposits placed abroad. These inflows had partially offset the higher outflows by the non-bank private sector, due mainly to higher trade credits extended by Malaysian exporters, as well as larger repayments of external loans by the private sector.

External Debt

Malaysia's external debt management strategy continues to focus on providing a stable foundation for a sustainable debt environment over the longer term. The country's manageable debt situation is achieved through prudent debt management practices supported by a well-functioning debt reporting and monitoring system. The prudential safeguards include efforts to minimise risk exposure against global interest rate shocks, adverse exchange rate movements and shift in investor sentiment. Meanwhile, the debt monitoring system enables the authorities to monitor the overall debt level, the structure of the debt as well as servicing obligations of both the public and private sectors.

External debt position improved, reflecting continued net repayment by the public sector. The share of short-term debt to total debt remained low.

In an effort to improve the compilation of the external debt data for better risk assessment and to be in line with the international standards and practices, the Bank initiated the compilation of external debt data with the offshore financial entities in Labuan International Offshore Financial Centre (Labuan IOFC) being treated as residents. Under this approach, data on debt transactions and exposure of the offshore financial entities in Labuan IOFC vis-à-vis the rest of the world are included as part of Malaysia's external debt. Meanwhile, debt transactions and exposure of residents with offshore financial entities in Labuan IOFC, which were currently included in the nation's external debt, are excluded. The aggregated data of offshore financial entities in Labuan IOFC was obtained

Table 1.23
Outstanding External Debt

	2004	2005*p*	*2004*	*2005p*
	RM million	RM million	USD million	USD million
Total debt	**200,586**	**195,865**	**52,786**	**51,310**
Medium- and long-term	156,849	149,682	41,276	39,212
Short-term[1]	43,737	46,183	11,510	12,098
As % of total debt	*21.8*	*23.6*	*21.8*	*23.6*
As % of net international reserves	*17.3*	*17.3*	*17.3*	*17.3*
As % of GNP				
Total debt	47.2	41.4		
Medium- and long-term debt	36.9	31.6		
As % of exports of goods and services				
Total debt	36.8	32.2		
Medium- and long-term debt	28.8	24.6		
Debt service ratio (%)	**4.6**	**4.7**		

[1] Excludes currency and deposits held by non-residents with resident banking institutions.

p Preliminary

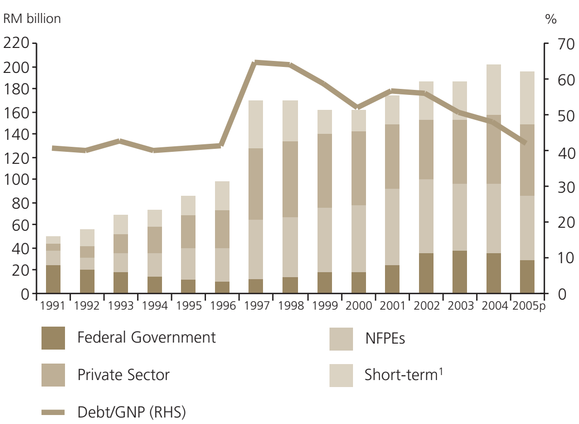
Source: Ministry of Finance and Bank Negara Malaysia

from the Labuan Offshore Financial Services Authority (LOFSA). The external debt position under this new definition is provided in the Box Article titled "Compilation of Malaysia's External Debt: Treatment of Offshore Financial Entities in Labuan IOFC as Residents". In the transition period, the official external debt data published by Bank Negara Malaysia for 2005 and 2006 would continue to follow the existing definition of treating offshore financial entities in Labuan IOFC as non-residents. The Bank would simultaneously compile the external debt position under the new definition i.e. treating offshore financial entities in Labuan IOFC as residents for 2006, with the target of fully adopting and publishing only the external debt position under the new definition starting with reporting period of first quarter of 2007 for release in May 2007. Thus, the development of Malaysia's external debt position in 2005 in this section was analysed and reported based on the data compiled using existing definition i.e. treating offshore financial entities in Labuan IOFC as non-residents.

In 2005, the total external debt outstanding declined by 2.4% to RM195.9 billion (USD51.3 billion), due largely to lower gross borrowings while repayment increased. The improvement in the external debt position was also reflected in the decline in ratios of external debt to GNP and to exports of goods and services to 41.4% and 32.2% respectively (2004: 47.2% and 36.8% respectively). The ratio of short-term debt to international reserves was stable at 17.3% while both the overall debt service ratio (excluding prepayment) and the share of short-term debt to total debt remained low at 4.7% and 23.6% respectively.

The **medium- and long-term external debt** declined by 4.6% to RM149.7 billion (USD39.2 billion) as at end of 2005 (2004: RM156.8 billion), due mainly to a significantly larger net repayment of external loans of RM11.1 billion (2004: -RM1 billion) by the public sector. The decline was also due partly to the exchange revaluation gain of RM3.3 billion following the appreciation of the ringgit against major currencies. Meanwhile, as the increase in gross borrowings outpaced a higher loan repayment during the year, the private sector registered a larger net drawdown of RM4.2 billion (2004: RM2.9 billion).

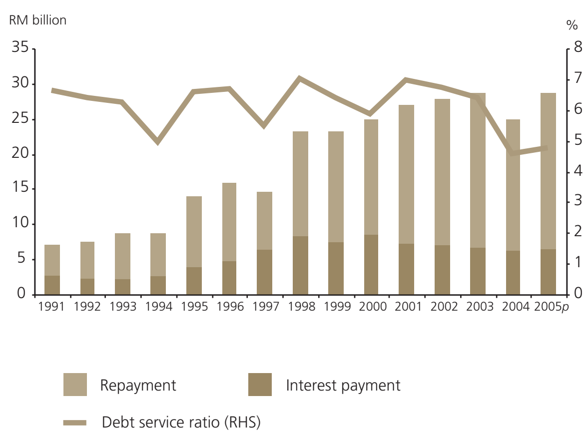
Graph 1.45a
Outstanding External Debt



[1] Excludes currency and deposits held by non-residents with resident banking institutions.

p Preliminary

Graph 1.45b
Debt Servicing



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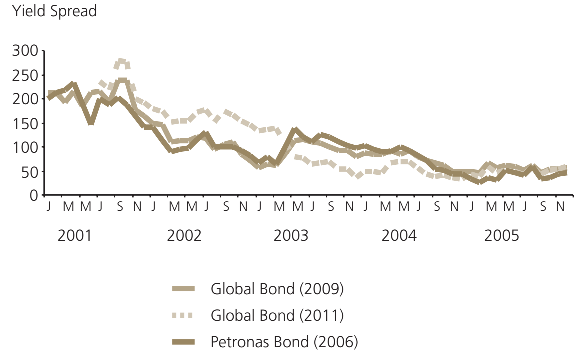
The medium- and long-term debt continued to be largely denominated in the United States dollar, accounting for 80.1% of total medium- and long-term debt outstanding as at end-2005. The share of yen-denominated debt declined marginally to 11.9% (2004: 12.8%) while the euro-denominated debt accounted for only 2.2% (2004: 5.2%) due largely to the settlement of a euro-denominated bond by the Federal Government in the fourth quarter. The remaining 5.8% of the medium- and long-term external debt was denominated in other international currencies, including the pound sterling, Singapore dollar and Hong Kong dollar.

The **public sector** recorded its third consecutive year of net external debt repayment in 2005, reflecting lower gross borrowings by both the Federal Government and NFPEs while the repayment was higher following the maturity of several large borrowings and prepayment of some external loans. Consequently, the outstanding external debt of the public sector declined sharply by 11.1% to RM86.2 billion (USD22.6 billion) as at end-2005 (2004: RM96.9 billion) to account for a lower share of 44% (2004: 48.3%) of total external debt.

In 2005, the **Federal Government** maintained its practice to source its funding requirements mainly from non-inflationary domestic sources. For the second consecutive year, no new market loan was raised from the international capital market. The gross external borrowings by the Government were lower (RM0.7 billion; 2004: RM1.1 billion) while repayments increased significantly to RM4.2 billion (2004: -RM1 billion), reflecting mainly the maturity of a Euro bond of RM2.9 billion in November 2005 and some scheduled principal repayments of syndicated loans. The drawdown of external loan was attributed entirely to project loans committed earlier from the bilateral sources such as under the Miyazawa Initiative, as well as from multilateral sources, such as the World Bank, Islamic Development Bank and Asian Development Bank. Accordingly, the Federal Government external debt declined further to RM30 billion (USD7.9 billion) or 15.3% of total external debt as at end-2005 (2004: RM34.7 billion or 17.3% of total external debt).

Reflecting Malaysia's strong economic fundamentals, the interest spread on Malaysia's benchmark securities remained low in 2005 while Malaysia's sovereign ratings on long-term foreign currency obligations were generally maintained by the international rating agencies. The spread on Malaysia's Global Bond due 2011 over comparable US Treasury Securities stood at

Graph 1.46
Spread of Sovereign Bonds and Selected NFPE Bond Over Comparable US Treasury Securities



56 basis points at the end of 2005 while the spread on the Global Bond due 2009 remained stable at 55 basis points at end-2005. On 25 April 2005, Rating and Investment Information Inc. affirmed Malaysia's foreign currency rating at A- and revised the rating outlook from stable to positive. Moody's Investor Services affirmed Malaysia's long-term foreign currency rating at A3 and maintained a rating outlook of stable on 28 April 2005. In a similar move, on 25 May 2005, Standard & Poor's affirmed Malaysia's long-term foreign currency ratings at A- and maintained a rating outlook of stable. On 18 November 2005, Fitch affirmed Malaysia's long-term foreign currency ratings at A- and maintained a rating outlook of stable.

In 2005, the **NFPEs** registered a markedly higher net repayment of RM7.6 billion (2004: -RM1.1 billion), reflecting mainly a higher gross repayment of external debt of RM13.9 billion (2004: -RM12.6 billion) due partly to the maturity of US dollar-denominated bonds issued by companies in the oil and gas and manufacturing sectors as well as prepayments of several loans. In contrast, gross borrowings was significantly lower at RM6.3 billion (2004: RM11.5 billion). Consequently, the outstanding external debt of NFPEs declined to RM56.2 billion (USD14.7 billion) or 28.7% of total external debt as at end-2005 (2004: RM62.2 billion or 31% of total external debt).

As at end-2005, the **private sector** external debt (including short-term debt) increased to RM109.7 billion or USD28.7 billion (2004: RM103.7 billion), and accounted for 56% of the total external debt. The medium- and long-term external debt recorded a larger net borrowing of RM4.2 billion (2004: RM2.9 billion) as the increase in gross borrowings outpaced a higher repayment of loans during the year. The larger drawdown of external loans was mainly by companies in the services, plantation, manufacturing and oil and gas sectors. Despite a higher borrowing, the overall risk profile of the private sector medium- and long-term debt remained low as the bulk of these loans have a natural hedge. Most of these loans were used to finance export-oriented activities and overseas investment with foreign exchange earnings and income. Furthermore, a large share of these loans was sourced from the offshore shareholders and parent or associate companies with more flexible terms and at concessionary interest rates. Meanwhile, the bulk of the repayments was effected by companies in the plantation, services and manufacturing sectors. Thus, the private sector medium- and long-term external debt outstanding increased to RM63.5 billion (USD16.6 billion) as at end-2005 (2004: RM60 billion).

The outstanding **short-term external debt** (maturity of one year or less) rose by RM2.4 billion to RM46.2 billion (USD12.1 billion) in 2005, due entirely to an increase in the short-term external borrowing by the banking sector, mainly for hedging activities on trade-related transactions and treasury activities. Meanwhile, short-term debt by the non-bank private sector, comprising mainly term loans, revolving credits and overdraft facilities, declined further to RM7.3 billion in 2005 (2004: RM8.4 billion).

Compilation of Malaysia's External Debt: Treatment of Offshore Financial Entities in Labuan IOFC as Residents

The Fifth Edition of the Balance of Payments Manual (BPM 5) of the International Monetary Fund classifies offshore entities in an economy as residents for compilation of external data, including external debt data. Similarly, the External Debt Statistics Guide for Compilers and Users[1] (2003), also states that '***The residence of offshore enterprises*** *— including those engaged in the assembly of components manufactured elsewhere, those engaged in trade and financial operations, and those located in special zones —* ***is attributed to the economies in which they are located***.' As such, the debt liabilities of offshore entities that are owed to non-residents are to be included as part of an economy's external debt.

In the current definition of external debt in Malaysia, the offshore entities in Labuan International Offshore Financial Centre (Labuan IOFC) are treated as non-residents for foreign exchange administration purposes. Thus, these entities are not subject to the foreign exchange administration rules applicable to residents, including statistical reporting to Bank Negara Malaysia. As a result, while the external debt data compiled and disseminated by Malaysia include debt transactions and exposure of residents with offshore entities in Labuan IOFC, they exclude debt transactions and exposure of the offshore entities vis-à-vis the rest of the world.

As part of our continuous efforts to improve the compilation of external debt data for better risk assessment as well as in conformity with international best practices, Bank Negara Malaysia, with the assistance of the Labuan Offshore Financial Services Authority (LOFSA) has compiled the new external debt data of Malaysia, starting with position as at end-2004. This data includes borrowings by the offshore financial entities in Labuan IOFC from non-residents, while the borrowings by residents from these offshore financial entities are excluded. A comparison of the existing definition of external debt and the new definition is given in Diagram 1.

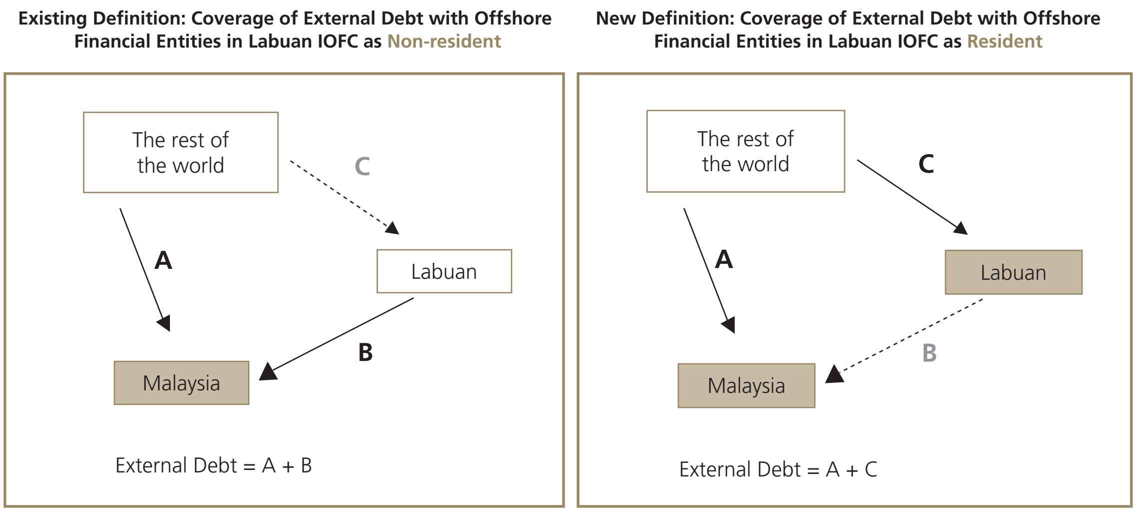
Implication on Malaysia's External Debt

(i) Comparison of newly defined external debt with existing definition for 2004 position

Table 1 provides a comparison of Malaysia's external debt levels with offshore financial entities in Labuan IOFC being treated as non-resident (existing definition) and as resident (new definition)

[1] A guide jointly prepared by the Bank for International Settlements (BIS), Commonwealth Secretariat, Eurostat, International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), Paris Club Secretariat, United Nations Conference on Trade and Development (UNCTAD) and World Bank.

Diagram 1
Malaysia's External Debt Compilation



respectively. The shift from the existing definition in compilation of external debt to the new definition in accordance with BPM 5 has resulted in some changes in level and profile of external debt as follows:

- Under the new definition, Malaysia's **total external debt** as at end-2004 was higher at RM209.9 billion (USD55.2 billion) or equivalent to 49.4% of GNP compared with the existing level of RM200.6 billion (USD52.8 billion) or 47.2% of GNP.

- **The medium- and long-term external debt** was lower at RM146.4 billion under the new definition (RM156.8 billion under existing definition) due largely to lower external debt of the Federal Government following the reclassification of several market loans sourced from offshore financial entities in Labuan IOFC as part of domestic borrowings. Some of these loans were reflected instead in the medium- and long-term external debt of the banking sector. Consequently, the share of public debt to total external debt was lower at 41.1% compared with 48.3% under existing definition.

- Correspondingly, the share of the private sector debt (medium- and long-term plus short-term debt) to total external debt was larger at 58.9% compared with 51.7% under existing definition. Within this sector, the external debt of the non-bank private sector was lower at RM54.8 billion (RM67.7 billion under existing definition), following the reclassifications of the external loans from the offshore financial entities into domestic borrowings. Some of these loans were reflected in the external debt of the banking sector. As a result, the share of the external debt of the non-bank private sector to total debt declined to 26.1% from 33.7%.

- Meanwhile, the external debt of the banking sector was higher at RM68.7 billion (RM36 billion under existing definition) with its share to total external debt increasing to 32.8% from 18%, reflecting mainly short-term interbank borrowings by offshore financial entities in Labuan IOFC from financial institutions outside Malaysia arising from their investment and treasury operations. As a result, the total **short-term external debt** was higher at RM63.4 billion (RM43.7 billion under existing definition), accounting for a larger share of 30.2% of total external debt (21.8% under existing definition).

Table 1
Outstanding External Debt

	Offshore Financial Entities in Labuan IOFC as		
	Non-Resident	Resident[1]	
	2004	2004	2005
	(RM billion)		
Total external debt (ED)[2]	**200.6**	**209.9**	**220.0**
Medium- and long-term (MLTD)	156.8	146.4	150.6
Federal Government	*34.7*	*23.8*	*22.5*
NFPEs	*62.2*	*62.4*	*60.0*
Private Sector	*60.0*	*60.3*	*68.1*
Bank	*0.7*	*11.0*	*12.4*
Non-Bank	*59.3*	*49.2*	*55.6*
Short-term (STD)	43.7	63.4	69.4
Bank	*35.3*	*57.7*	*64.0*
Non-Bank	*8.4*	*5.7*	*5.4*
Memorandum items:			
Private sector debt (MLTD + STD)	103.7	123.5	136.9
Bank	*36.0*	*68.7*	*76.4*
Non-Bank	*67.7*	*54.8*	*60.5*
	(percent)		
ED/GNP	47.2	49.4	46.5
STD/ED	21.8	30.2	31.6
STD/Reserves	17.3	25.0	26.1
Public debt/ED	48.3	41.1	37.8
Private debt/ED	51.7	58.9	62.2
MLTD	*29.9*	*28.7*	*30.9*
STD	*21.8*	*30.2*	*31.3*
Non-Bank	33.7	26.1	27.5
MLTD	*29.5*	*23.5*	*25.3*
STD	*4.2*	*2.6*	*2.2*
Bank	18.0	32.8	34.7
MLTD	*0.3*	*5.2*	*5.7*
STD	*17.6*	*27.5*	*29.1*

[1] The treatment of offshore financial entities in Labuan IOFC as residents is applicable only to the compilation of the above external debt data by the Bank. Debt transactions and exposure by sector (public, banking and non-bank private sectors) with offshore financial entities in Labuan IOFC will continue to be treated as external debt for other publications until the end of the interim period in mid-2007
[2] Excludes currency and deposits held by non-residents with resident banking institutions

(ii) Developments in 2005 based on new definition

As at the end of 2005, Malaysia's **total external debt** increased by RM10.1 billion to RM220 billion (USD57.6 billion). Nevertheless, the newly defined external debt position accounted for 46.5% of GNP at the end of 2005 compared with 49.4% of GNP at the end of 2004.

The higher external debt level was due to an increase in **short-term debt** to RM69.4 billion (USD18.2 billion), reflecting mainly the higher inter-bank borrowings by offshore banks in Labuan IOFC arising from their investment and treasury operations. Accordingly, the ratio of short-term debt of the banking sector to total debt also increased to 29.1% as at end-2005 compared to 27.5% as at end-2004. Including the short-term debt of the non-bank private sector, the overall ratio of short-term debt to total external debt increased to 31.6%.

Meanwhile, the **medium- and long-term external debt** increased marginally to RM150.6 billion (USD39.4 billion) as at end-2005, reflecting net repayment of loans by the public sector, comprising the Federal Government and NFPEs, being offset by net borrowing by the private sector. Consequently, the share of the public sector debt to total external debt declined to 37.8% while the share of the private sector debt increased to 62.2%.

Risk Assessment of External Debt

Despite a higher total outstanding external debt, Malaysia's external debt position continues to be within the prudent level of 46.5% of GNP in 2005. The higher short-term debt was attributed entirely to borrowings by offshore financial entities in Labuan IOFC, particularly from their head offices and branches abroad, arising from their investment and treasury operations. A large share of these borrowings was on lent to residents in Malaysia. Including the short-term debt of the non-bank private sector, the overall ratio of short-term debt to international reserves and the share of short-term debt to total debt at the end of 2005 remained low at 26.1% and 31.6% respectively.

The increase in medium- and long-term external debt was moderate and reflects the increase in the private sector external debt. The bulk of these loans have a natural hedge as they were used to finance export-oriented activities and overseas investment with foreign exchange earnings and income. Furthermore, a large share of these loans was sourced from the offshore shareholders and parent or associate companies with more flexible terms and at concessionary interest rates.

Conclusion

The compilation of Malaysia's external debt under the new definition, with offshore financial entities in Labuan IOFC being treated as residents, has facilitated a more accurate assessment of the external exposure, including credit, foreign exchange and liquidity risks faced by the Malaysian economy, especially in the light of the increasing trend of residents and non-residents establishing offshore entities in Labuan IOFC to facilitate their financing and investment activities. In addition, the shift towards the new definition underscores Malaysia's commitment to international standard and best practices in external debt compilation and dissemination to facilitate international comparison and assessment.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprises holdings of foreign exchange and gold, the IMF reserve position and holdings of Special Drawing Rights (SDR). For the year 2005 as a whole, net international reserves increased by RM12.8 billion to RM266.3 billion (USD70.5 billion) as at 31 December 2005. The net increase in the reserves in 2005 reflected the fundamentals of the economy with foreign exchange inflows generated mainly from export earnings and foreign direct investment. The reserves level amounted to RM272.7 billion or equivalent to USD72.2 billion as at 28 February 2006. The reserves position is adequate to finance 7.6 months of retained imports and cover 6.7 times the short-term external debt.

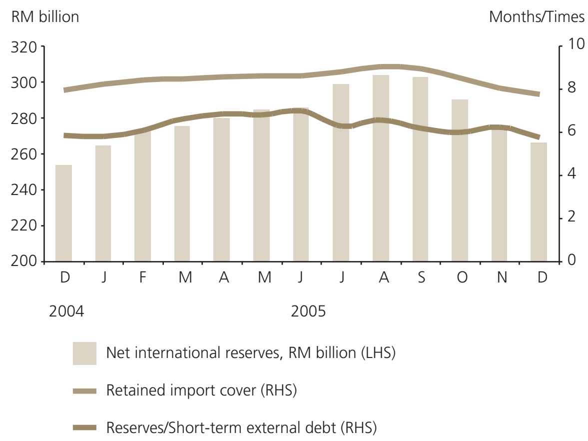
In the first half of 2005, the sustained repatriation of export proceeds and foreign direct investment was reinforced by significant inflows of portfolio investment. The large inflows of short-term funds during the period were partly in anticipation of a change in the exchange rate regime. Following the Bank's announcement of the change in the exchange rate regime to a managed float on 21 July 2005, reserves increased further, driven by significant inflows of short-term funds. The flows normalised subsequently amidst an orderly price discovery process. The decline in reserves, from September to November, reflected mainly the unwinding of the speculative short-term positions. Nevertheless, the outflows of short-term funds subsided by December. The outflows during this period also reflected higher import payments associated with stronger domestic demand, larger repayment of external loans by the official sector as well as higher year-end repatriation of profits and dividends by foreign corporations.

During the year, the cumulative foreign exchange revaluation loss amounted to RM15.5 billion (2004: +RM8 billion), following the strengthening of ringgit against the major currencies.

Net international reserves increased by RM12.8 billion in 2005, reflecting the fundamentals of the economy with foreign exchange inflows generated mainly from export earnings and foreign direct investment.

In managing the reserves, Bank Negara Malaysia continued to adopt a prudent approach to ensure capital preservation and liquidity of reserves whilst optimising returns. The reserves are held in the form of foreign currency deposits and sovereign and quasi-sovereign papers of high investment grade.

Graph 1.47
Net International Reserves (end-month)



Reflecting Malaysia's strong balance of payments position, Malaysia was included in the Financial Transactions Plan of the IMF by making resources available to member countries that are facing short-term balance of payments difficulties. Nevertheless, the **reserve position with the IMF** declined by RM1,882 million in 2005, due to the repurchase of SDR300.3 million (RM1,655.5 million) following repayment to the ringgit account by various member countries under the Financial Transactions Plan, while the exchange revaluation loss amounted to RM226.5 million. Malaysia's holdings of reserves in the form of **SDRs** also declined by RM17 million. Exchange revaluation loss on holdings of SDRs amounting to RM66.8 million was partially offset by net receipt of remuneration worth RM49.8 million arising from Malaysia's net creditor position with the Fund.

The international reserves, held by the Bank remains usable and unencumbered. There are no foreign currency loans with embedded options; and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in options in foreign currencies with regard to the ringgit. Repo and securities lending activities and financial derivative assets are also insignificant.

Table 1.24
Net International Reserves

	As at end-			Change
	2003	2004	2005	2005
	RM million			
SDR holdings	685.0	765.3	748.3	-17.0
IMF reserve position	3,652.0	3,068.4	1,186.3	-1,882.0
Gold and foreign exchange	166,139.3	249,704.1	264,421.6	14,717.5
Gross International Reserves	**170,476.3**	**253,537.8**	**266,356.2**	**12,818.4**
Less Bank Negara Malaysia external liabilities	23.8	24.5	22.5	-2.0
Net International Reserves	**170,452.5**	**253,513.3**	**266,333.7**	**12,820.4**
USD million equivalent	**44,855.9**	**66,714.0**	**70,483.3**	**3,769.3**
Months of retained imports	6.6	7.9	7.8	
Reserves/Short-term external debt (times)	5.1	5.8	5.8	

Table 1.25
International Reserves for Selected Regional Economies

Country	Reserves as at end-2005 (USD billion)	Reserves in months of imports	Reserves as cover of short-term external debt[1]	Reserves as cover of total external debt[1]
Chinese Taipei	253.3	16.7	4.0	3.1
Hong Kong China	124.3	5.0	0.4	0.3
Indonesia	34.1	7.2	3.5	0.2
Korea	210.4	9.7	3.1	1.1
Malaysia	**70.5**	**7.8**	**5.8**	**1.4**
Philippines	18.5	4.9	3.0	0.3
PR China	818.9	14.9	5.7	3.1
Singapore	116.6	7.0	0.6	0.5
Thailand	52.1	5.3	3.1	1.0

[1] External debt data refers to amount outstanding as at end-September 2005, except for Chinese Taipei (end-June 2005) and Malaysia (end-2005).

Source: National authorities; Asian Development Bank; SDDS, International Monetary Fund

Bank Negara Malaysia releases information on the international reserves position and the statement of the Bank's assets and liabilities on a fortnightly basis, with a one-week lag. In addition, the Bank also fulfills the IMF's Special Data Dissemination Standard (SDDS) requirements on detailed disclosure of international reserves and foreign currency liquidity information at the end of each month, with a one-month lag. The reserves data template also provides forward-looking information on the size, composition and usability of reserves and other foreign currency assets, and the future and potential (contingent) inflows and outflows of foreign exchange of the Federal Government and the Bank over the next 12-month period.

FLOW OF FUNDS

The economy registered a higher resource surplus of RM77.8 billion, representing 16.4% of GNP in 2005 (2004: RM56.5 billion or 13.3% of GNP). In terms of the balance of payments, the higher resource surplus reflected the increase in net exports of goods and services to RM116.2 billion (2004: RM95.7 billion). From the perspective of the country's savings-investment balance, the higher resource surplus mainly reflected the higher net savings position of the private sector. The flow of funds between various sectors of the economy in 2004 and 2005 are shown in Tables 1.26 and 1.27.

The resource surplus of the public sector was slightly higher at RM19.9 billion in 2005 (2004: RM18.4 billion). The resource surplus reflected entirely the surpluses from the NFPEs of RM34.1 billion, which helped to offset the resource gap of the general government of RM14.2 billion. The higher resource surplus of the public sector was due to the increase in disposable income, which more than offset the increase in public consumption by the general government and higher investment by the NFPEs. The disposable income of the public sector increased by 6.5% to RM139.6 billion in 2005. This was mainly on account of higher petroleum-related revenue registered in the consolidated public sector. In addition, the Federal Government also recorded higher tax revenue amid sustained economic growth and efforts taken to enhance tax collection. The resource gap of the general government was mainly financed

Table 1.26
Flow of Funds: 2004

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-410.4	131.1	279.3		0	
Consumption	252.1	-59.3	-192.8			0
Investment	91.8	-53.4	-38.4		0	
Change in stocks	10.0		-10.0		0	
Exports of Goods and Non-Factor Services	545.0				-545.0	0
Import of Goods and Non-Factor Services	-449.3				449.3	0
Net Factor Payments Abroad	-24.5				24.5	0
Net Transfers	-14.6				14.6	0
Non-Financial Balance	0.0	18.4	38.2	0.0	-56.5	0
Foreign Financing						
Direct Investment			9.7		-9.7	0
Net Foreign Borrowings		-1.1	20.3		-19.2	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-75.1	75.1	0
Banking System				-6.9	6.9	0
Domestic Financing						
Change in Bank Credit		4.1	31.0	-35.1		0
Change in Deposits[1]		-20.5	-67.9	88.4		0
Net Borrowings from Non-Bank Sector		-0.8	0.8			0
Other items (Net)			-32.1	28.7	3.5	0
Sum		0	0	0	0	

[1] Includes currency in circulation.

Table 1.27
Flow of Funds: 2005

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-456.1	139.6	316.5			0
Consumption	280.5	-64.6	-215.9			0
Investment	98.9	-55.2	-43.8			0
Change in Stocks	-1.1		1.1			0
Exports of Goods and Non-Factor Services	609.1				-609.1	0
Imports of Goods and Non-Factor Services	-492.9				492.9	0
Net Factor Payments Abroad	-21.5				21.5	0
Net Transfers	-17.0				17.0	0
Non-Financial Balance	0.0	19.9	57.9	0.0	-77.8	0
Foreign Financing						
Direct Investment			2.7		-2.7	0
Net Foreign Borrowings		-11.1	-45.3		56.3	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-28.3	28.3	0
Banking System				11.8	-11.8	0
Domestic Financing						
Change in Bank Credit		-1.5	44.6	-43.2		0
Change in Deposits[1]		-7.9	-45.0	52.9		0
Net Borrowings from Non-Bank Sector		0.5	-0.5			0
Other items (Net)			-14.4	6.8	7.6	0
Sum		0	0	0	0	

[1] Includes currency in circulation.

through domestic borrowings. Some of the financing obtained by the general government as well as the resource surplus of the NFPEs were partly utilised for the repayment of foreign debt, while the rest were placed with the banking system.

The resource surplus of the private sector increased to RM57.9 billion or 12.2% of GNP in 2005 compared with RM38.2 billion or 9% of GNP in 2004. The favourable resource surplus position of the private sector was supported by improvement in domestic income and exports growing at a faster rate than imports in the external sector. These factors contributed to the increase in disposable income of the private sector to RM316.5 billion (2004: RM279.3 billion), which in turn, supported the continued growth in private consumption and investment activities. In addition to the resource surplus, net inflows of FDI (RM2.7 billion), and loans from the banking system (RM44.6 billion) also contributed to the pool of funds available to the private sector. Some of the funds were channelled towards the net payment of foreign obligations, including portfolio outflows, and the extension of trade credit; while a portion was also placed as deposits with the banking system.

The current account surplus remained large enough to more than offset private and official sector outflows in the financial account of the balance of payments. As such, Bank Negara Malaysia's international reserves (excluding net foreign exchange revaluation losses) increased further, by RM28.3 billion.