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ECONOMIC PERFORMANCE AND PROSPECTS

ECONOMIC REPORT **2013/2014**

Economic Performance and Prospects

Overview

Growth anchored by domestic demand

The Malaysian economy remains resilient despite facing a more challenging external environment. While advanced economies, particularly the US and Japan showed firmer signs of recovery, new challenges have emerged during the first half of 2013. The uncertainty over the strength of China's economic growth and the possible tapering of the quantitative easing (QE) programme in the US have given rise to greater global economic and financial uncertainties. Emerging economies were particularly affected over concerns whether China's economic strength was able to support intra-regional trade and commodity prices. Emerging markets were also hard hit by the US Federal Reserve's (Fed) announcement of QE3 tapering which created increased financial and currency volatility as a result of reversal in global capital flows.

Against this backdrop, Malaysia being a highly open economy was also affected, with gross exports recording a negative growth of 3.8% during the first half of 2013. Nevertheless, strong domestic demand was able to cushion the negative impact from the external sector. The economy registered real GDP growth of 4.2% during the period. However, during the third quarter of 2013, key economic indicators signalled to better near-term prospects and firmer growth in the US, euro zone and Japan. Meanwhile, fears of China experiencing a sharp downturn has somewhat faded as the Purchasing Managers' Index (PMI) in August 2013 rose to a five-month high. The prospects of stronger recovery in advanced economies coupled with a moderate, but steady GDP growth in China, are expected to create a positive outlook for Malaysia's exports. While the impact of the Fed tapering its QE remains a lingering concern, the Malaysian real GDP is expected to register a growth of 4.5% – 5% in 2013 (2012: 5.6%) supported by its resilient domestic economy and improving exports during the second half of 2013.

On the demand side, growth will be anchored by resilient private consumption, strong investment activity and reinforced by a gradually improving external sector. The continued strong domestic economic activity is underpinned by a more diversified and balanced economy, a stronger financial system and pragmatic macroeconomic policies. Private investment is envisaged to sustain its growth momentum supported by capital spending in all major sectors, particularly in domestic-oriented manufacturing and consumer-related services subsectors. Public investment is expected to increase, attributed to capital spending by Non-Financial Public Enterprises (NFPEs), particularly in the oil and gas (O&G) and utilities sectors. Meanwhile, private consumption will be supported by stable employment conditions, higher wage growth, especially in the domestic-oriented sectors and cash transfers to targeted households. Public consumption is expected to increase following the civil servants' recent salary increment in July 2013.

On the supply side, growth is expected to be supported by expansion in all economic sectors. In tandem with strong domestic demand, the services and manufacturing sectors are expected to drive growth. Strong domestic consumption is expected to boost growth in the services sector, especially in wholesale and retail trade, accommodation and restaurants as well as strong expansion in the telecommunication, finance and business services subsectors. Growth in the construction sector will continue to expand, supported by higher activity in the residential segment and key public infrastructure projects during the

TABLE 3.1

Gross Domestic Product (GDP) by Sector
2012 – 2014
(at constant 2005 prices)

	Change (%)			Share of GDP (%)			Contribution to GDP growth (percentage point)		
	2012	2013[1]	2014[2]	2012	2013[1]	2014[2]	2012	2013[1]	2014[2]
Agriculture	1.0	2.7	3.0	7.3	7.2	7.0	0.1	0.2	0.2
Mining	1.4	2.2	3.1	8.4	8.2	8.1	0.1	0.2	0.3
Manufacturing	4.8	3.2	3.8	24.9	24.5	24.2	1.2	0.8	0.9
Construction	18.1	10.6	9.6	3.5	3.7	3.9	0.6	0.4	0.4
Services	6.4	5.5	5.7	54.6	55.0	55.4	3.5	3.0	3.1
Add: Import duties	15.6	9.5	4.0	1.3	1.4	1.4	0.2	0.1	0.1
GDP	**5.6**	**4.5 – 5.0**	**5.0 – 5.5**	**100.0**	**100.0**	**100.0**	**5.6**	**4.5 – 5.0**	**5.0 – 5.5**

[1] Estimate.
[2] Forecast.

Note: Total may not add up due to rounding.
Source: Department of Statistics and Ministry of Finance, Malaysia.

second half of 2013. The manufacturing sector will be largely supported by strong expansion in domestic-oriented industries. The electrical and electronics (E&E) subsector is expected to stage a mild recovery in the later part of 2013 following the anticipated stronger recovery of advanced economies and continued efforts by E&E manufacturers to diversify their product range to cater to various consumer preferences. In the non-E&E segment, growth will be supported by construction and consumer-related industries, in particular the automotive subsector. Meanwhile, the agriculture sector is expected to expand further, reflecting higher output of crude palm oil (CPO) and food commodities. Given the strong investments in the upstream O&G sector in the past years, output of the mining sector is envisaged to expand supported by higher production of crude oil and natural gas.

Malaysia's external position is expected to remain resilient despite affected by the weak external demand during the first half of 2013. As a trading nation, Malaysia's current account is highly dependent on exports of goods and commodities. Given the weaker external demand and lower commodity prices amid the strong expansion in private consumption and investment, growth of imports will continue to outpace exports, resulting in a smaller trade surplus. Meanwhile, the primary and secondary income as well as services accounts are expected to remain in deficit. Hence, the current account surplus in 2013 is expected to narrow to RM26.6 billion or 2.8% of Gross National Income (GNI). In the financial account, inflows of foreign direct investment (FDI) are expected to increase, encouraged by renewed investors' confidence on the Malaysian economy after the 13th General Election and better prospects of the global economy during the second half of the year. However, short-term capital inflows are likely to be volatile amid concerns on the tapering of QE3 by the Fed.

Headline inflation is expected to increase and average 2% – 2.5% in 2013 (2012: 1.6%). The higher inflation is mainly driven by the 20 sen subsidy reduction in domestic fuel prices on 3 September 2013. Inflation is, however, expected to be mitigated by moderating energy and global food prices. The report by the Food and Agriculture Organisation (FAO) in June 2013