ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2014

Regional Connectivity for Shared Prosperity

UNITED NATIONS ESCAP

Economic and Social Commission for Asia and the Pacific

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MALAYSIA

Country briefing notes

Economic growth moderated

- The economy expanded at a slower, but still relatively robust, pace of 4.7% in 2013, compared with 5.6% in 2012. Contribution from net exports was small as trade surplus fell by some 20% in 2013 relative to 2012.

- Growth was primarily driven by private consumption, which benefited from low inflation, solid employment growth, cash transfers to lower-income households, a public sector pay hike, and the introduction of minimum wages in 2013.

- Fixed investment growth moderated in 2013 albeit from a high base in 2012, when it surged to a multi-year high pace. Private investment growth was robust, in contrast to a sharp drop in public outlays, and contributed to a higher fixed investment-to-GDP ratio of 27%. The Government's Economic Transformation Programme is helping to generate a pipeline of infrastructure investment projects.

- On the supply side, growth in the export-oriented manufacturing sector and in certain services sectors like finance was sluggish. Communications, real estate and business services expanded rapidly in 2013.

- In 2014, growth is projected to rise to 5% with additional support from stronger exports, and solid domestic demand, including fixed investment.

Inflation picked up

- Although inflation in 2013 was low at 2.1%, prices trended upwards in the second half of the year, reaching 3.2% in December. This was due to higher food prices from adverse weather conditions, reduced subsidies for fuel and sugar, and a higher excise duty on tobacco, among others. The introduction of minimum wages does not seem to push up inflation significantly.

Exports faltered but overall external accounts proved resilient

- Merchandise export growth contracted in 2013, as commodity exports such as palm oil and rubber suffered from softer global prices. Shipments of electronics items also faced weak global demand. The current account surplus narrowed further to 4% of GDP in 2013, from 11.6% of GDP in 2011. Entering 2014, exports bounced back in the first quarter on improved external conditions.

- FDI inflows in 2013 surpassed the earlier 2011 record and reached $12.3 billion. Investments were broad-based across the manufacturing, services and mining sectors. Within the services industry, finance, insurance and telecommunications were among the top recipients.

- Capital flow volatility in mid-2013 was mitigated to some extent by a strong domestic institutional investor base and the flexible exchange rate regime. Still, the events highlighted vulnerabilities related to the relatively high level of public debt and large foreign holdings of government securities.

Policy developments and challenges

- The central bank raised the policy interest rate by 25 basis points to 3.25% in July 2014, the first rate adjustment in three years. Stronger macroeconomic conditions and inflation prospects that are above its long-run trend are key underlying factors. Asset price build-ups in certain sectors have been dealt with by macro-prudential measures.

- Fiscal policy was expansionary in the first half of 2013 in the wake of the general elections in May. A series of consolidation measures were introduced in the second half, including a cut in subsidies on fuel, electricity and sugar. To mitigate the impact on the poor, existing cash transfer programmes were expanded.

- A 6% tax rate on goods and services will come into effect in 2015, offering a broader tax base. This should help reduce the public debt, which came near the official ceiling of 55% of GDP in 2013.

- Taking into account Malaysia's economic structure, ESCAP analysis suggests that tax revenue could be raised by about 8%. Among others, policies to enhance domestic resource mobilization include rationalizing the tax system to create a larger tax base, tackling tax evasion and tax fraud, and strengthening tax administration. The government is already addressing some of these issues.

- With a goal of achieving a high-income country status by 2020, the Government has been proactively promoting structural reforms across the economy. In addition to a new pipeline of infrastructure investments, the Government created a strategic fund to facilitate technology acquisition by local firms while adopting a green technology policy to improve energy efficiency.

- Going forward, it is important to ensure equitable opportunity for all citizens to benefit from economic growth and structural shifts of the economy, particularly in light of the high level of income inequality. ESCAP analysis suggests that income inequality is positively correlated with household debt level – which has increased rapidly to 87% of GDP in 2013. Unless properly addressed, inequality and debt could hamper sustainable economic development.