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"The Role of Macroeconomic Policy and Energy Security in supporting Sustainable Development in the Pacific"

8-9 October 2012, Nadi, Fiji

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Session 1 – Stimulating and Sustaining Growth, Building Resilience: the Role of Macroeconomic Policies

Stimulating and Sustaining Growth, Building Resilience

by
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THE ROLE OF MACROECONOMIC POLICY AND ENERGY SECURITY IN SUPPORTING SUSTAINABLE DEVELOPMENT IN THE PACIFIC

Session 1 – Stimulating and Sustaining Growth, Building Resilience

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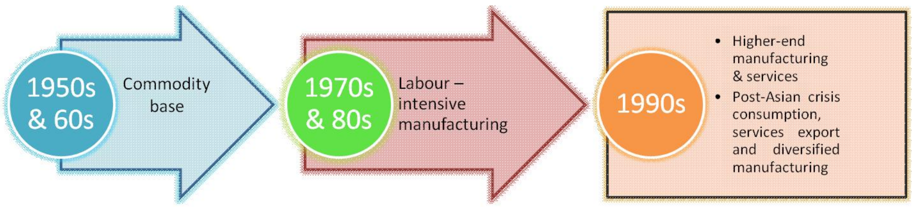
The Malaysian Economy : Various Stages of Transformation

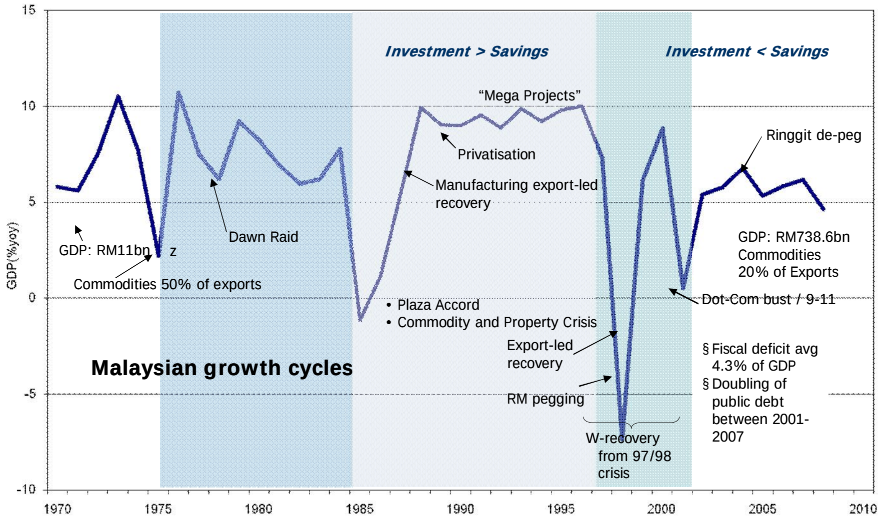


- Industrial policies & liberalisation facilitate structural shift
- Strong investment driven economic expansion raised living standards
- High savings balanced with rising domestic consumption to support growth

Higher per capita income				
Year	**Per Capita Y (USD)**	**Average Wage (USD)**	**Nominal GDP (USD)**	**External Reserves (USD)**
1980	**2,800**	**310**	**24.5 b**	**4.6 b**
1990	**2,800**	**310**	**44.1 b**	**10.0 b**
2000	**3,774**	**420**	**90.3 b**	**29.9 b**
2010	**9,755**	**600**	**280 b**	**140.0 b**

Malaysia has an open economy

We are affected by global events and external shocks



Source : Various MOF Economic Reports, EPU Malaysia, KRIS

Asian Crisis: Sequencing of Package of Macro-economic & Structural Reforms Included Restructure of Banks

Stage of Crisis Response	Macroeconomic	Structural
Stage 1 : Jan – Oct 1998	Stabilisation package : •Monetary policy •Liquidity management •Special funds to Priority Sectors •Counter – cyclical policies	Institutional set-up to restructure banks & cooperatives: •Consolidate finance companies •Set up Danaharta •Set up Danamodal •Set up CDRC •Enabling legislation
Stage II : Oct 1998 – mid 2000	Introduce selected exchange controls	Strengthen governance structures & enhanced bank supervision
Stage III : 2001 – 2004	Gradual liberalisation of exchange controls	Set up deposit insurance, new credit bureau framework

Lessons from Malaysian Experience During Asian Crisis

1. Sequenced financial sector reforms- appropriate mix between foreign banks & domestic banks; core strong domestic banks to meet economic development needs " lending to priority sectors; Mix of foreign banks for technology, international links, investor needs for globalised operations
2. Align banking sector reform with economic transformation objectives & deregulation of current & capital accounts in the balance of payments
3. Focus on Financial Sector infrastructure " build strong institutions to manage K flows, implement MP, improve intermediation " support economic growth with FS stability
4. Liberalise capital flows " underpinned by stronger banks to manage flows & risk management framework on foreign currency exposure & currency mismatches
5. Institutional building precede liberalisation
6. At all times:
   - v Build capacity at BNM " strengthen supervision
   - v Ensure sound macro-policies
   - v Prudential rules on lending & foreign currency exposure imposed on individuals

Commodity and Property Crisis of 1980s

- Adjustments during this period can be more relevant to current state of development in PICs
- Crisis in Malaysia was not contagion; external shock exposed macro-economic imbalances in domestic economy; resolution required adjustments to correct domestic instability, no requirement to respond to external environment.
- Crisis response different on both fronts of macro-economic adjustments and restoring economic growth; domestic policy adjustments and liberalisation of economy led to rapid correction in BOP and Fiscal Accounts.

Responses to 1980s and Asian crises were significantly different—correct diagnosis of root causes is critical for effective adjustment measures

Commodity, property crisis in 1985

- External shock, but imbalance from inappropriate domestic macro-economic policies to hasten economic development—large fiscal and CA deficit, higher inflation which limited counter-cyclical policy adjustments
- Common thread in banking sector—large lending to property sector
- Recovery conditional on strong macro-economic adjustment policies—reduce fiscal deficit, liberalise interest rates; supply side policies for economic recovery, adjustment policies were mainly in the real sector
- Special funds to promote new investments, SMEs, export credit facilities
- Extensive fiscal incentives to attract FDI, liberalised ownership structures in manufacturing sector—watershed in making Malaysia integrated into global economy
- Banking sector regulation was changed post-crisis period

Asian crisis, 1997-98

- External shock, but sound macro-economic position with low inflation, policies responded to instability in forex and financial markets—fiscal surplus, market-based MP, strong BOP—support counter-cyclical macro-economic adjustments
- Common thread in banking sector—large loans to property sector, asset inflation
- Measures focused on expansionary macro-economic policies, adjustments in exchange rate regime and significant strengthening of financial sector
- Regional cooperation for cross-border liquidity support, monitoring capital flows
- Gave rise to financial sector surveillance and cooperation within ASEAN + 3.

Malaysia built resilience to shocks over time

10 examples:

1.Diversified supply side GDP growth;

2.Balanced consumption with investment on demand side;

3.FDI for innovation, export markets;

4.Low debt/GDP, manageable short-term liabilities;

5.Addressed maturity mismatch in financing—developed capital market for long-term financing;

6.Took significant measures to build sound banking system—strong capital, low NPL, observed international prudential standards;

7. Reformed financial sector regulation with good corporate governance;

8.Ensured macro-economic fundamentals support exchange rate and overall financial stability;

9.Put in place process for strict monitoring of capital flows, foreign presence in financial markets;

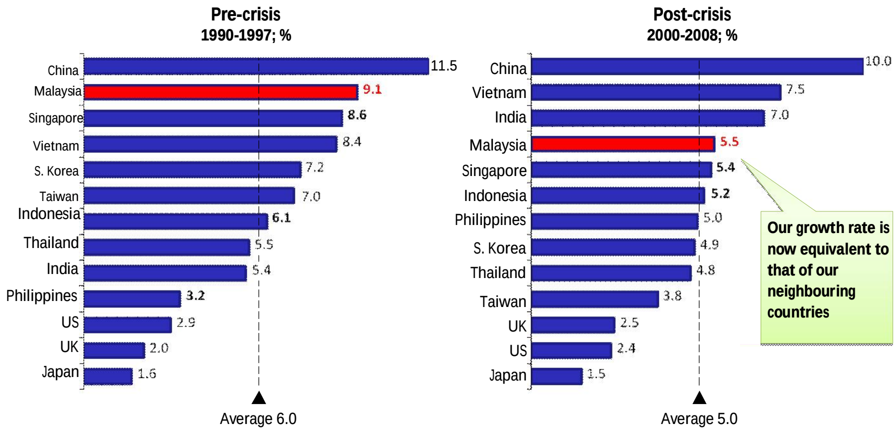
10.Need to continue measures to restore strength in fiscal position.

Correct crisis adjustment supports stability, BUT does not ensure sustainable growth

1. **The NEM – A Diagnostic of the Middle Income Trap**
2. What is the process to achieve fundamental changes?
   - Ø Leverage on advantages
3. The NEM--paradigm shift towards high income, sustainable growth & social justice

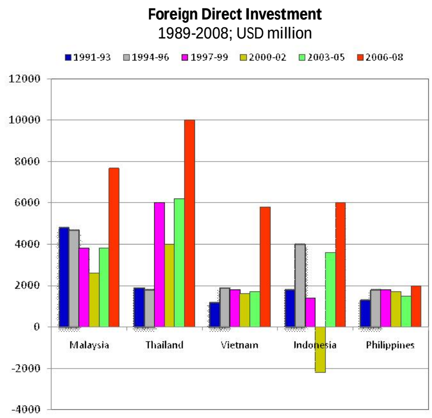
Post Asian Crisis—stronger resilience, but growth momentum slowed, affected regional lead position

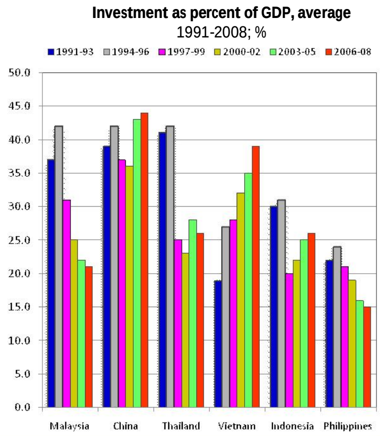
Average annual GDP growth



Source : BCG, The conference Board Groningan Growth and Development Centre, Total Economy Database 2009

Investment in Malaysia since the Asian crisis

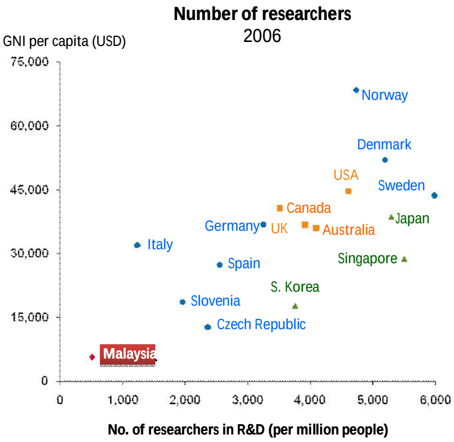


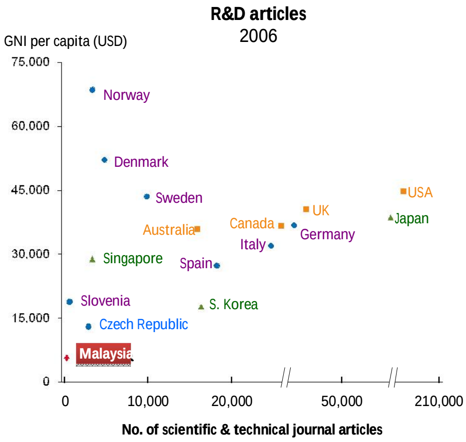


- Countries such as Indonesia have gained notable ground in investment recovery since the crisis
- The rebound of Malaysia's FDI is not as strong as desired, relative to its pre-Asian crisis level

Low innovation despite fiscal allocations

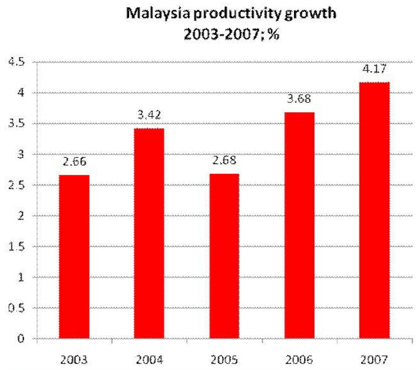
Our R&D capabilities has not caught up with the rest of the world

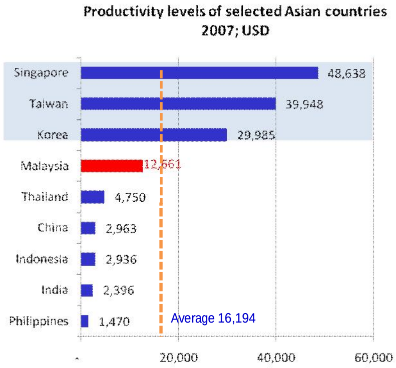




Source : World Bank Indicators 2008

Productivity is increasing, but we are still far behind other high income countries





Productivity in Malaysia

- Post-Asian crisis, Malaysia's productivity level and growth has slowed; the service sector has been a major contributor of productivity growth with a 9.7% increase in 2007, whereas manufacturing showed a 2.7% productivity growth
- Malaysia's productivity level continues to surpass that of neighbouring countries, but is still far from OECD levels, where more diversified economic structures, sophisticated technology, higher innovation, and more intensive R&D sectors can be found

We have not created enough high wage jobs – skills base is smaller than competing countries