

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 and is primarily determined by the expansion and non-inflationary utilisation of the available physical capital and labour force, as well as total factor productivity (TFP) growth. TFP growth captures productivity increases arising from improvements in the utilisation of factor inputs due to technological progress and overall economic efficiency. The output gap is the difference between the levels of actual output and potential output. It is a measure of the cyclical deviation from the non-inflationary trend of output, and thus provides an assessment of the position of an economy in the economic cycle.

Amidst a challenging global environment, the latest estimates indicate that the growth rate of potential output of the Malaysian economy moderated to 2.5% in 2009, the slowest pace since the Asian financial crisis. This was mainly due to the decline in investment activity and moderation of TFP growth, consistent with the experience during previous economic downturns. Given a sharper decline in actual gross domestic output (GDP), the output gap¹ was a negative 1.4% of potential output, indicating that the economy was operating below its potential in 2009.

However, with the expected recovery of the Malaysian economy going forward, driven by the strengthening of domestic activity and an improving external environment, the output gap is projected to narrow in 2010, and potential output is expected to return to its trend growth of about 5% over the medium term with the expected recovery in investment and continued improvement in productivity.

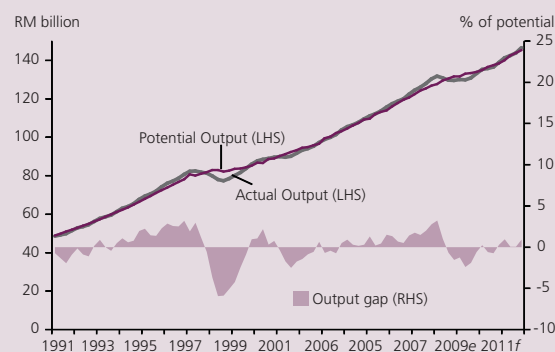
Table 1
Actual Real GDP and Potential Output

Period	Actual	Potential	Investment	Labour	Gap
	Annual change (%)				% of potential output
1993-1999	6.5	6.5	4.3	4.1	0.1
2000	8.9	4.2	26.0	4.4	1.1
2001	0.5	4.6	-2.1	1.5	-1.6
2002	5.3	4.0	0.6	1.9	-0.6
2003	5.8	6.1	2.8	3.6	-0.4
2004	6.8	5.5	3.6	1.0	0.4
2005	5.3	5.0	5.0	0.6	0.8
2006	5.8	5.6	7.5	2.1	1.0
2007	6.2	5.2	9.6	2.5	2.1
2008	4.6	4.0	0.8	1.3	0.7
2009e	-1.7	2.5	-5.5	2.7	-1.4

e Estimate

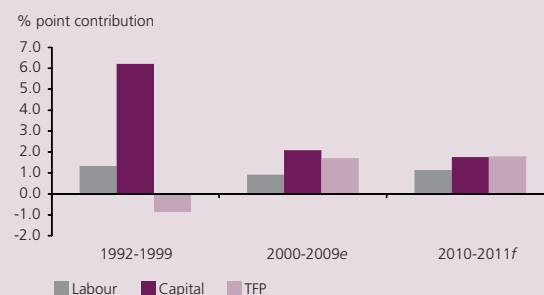
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 1
Actual and Potential GDP



e Estimate
f Forecast

Chart 2
Factor contributions and TFP growth
Shift from a factor-driven to a productivity-driven economy



e Estimate
f Forecast

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.