

### Potential Output of the Malaysian Economy

Potential output is the level of output that is consistent with the aggregate productive capacity of the economy. It provides an indication of the sustainable pace of economic growth, given the available productive inputs. The growth in potential output is determined by the expansion and non-inflationary utilisation of physical capital and labour, as well as growth of total factor productivity (TFP), which captures productivity gains from improvements in factor inputs as well as overall economic efficiency.

The latest estimate indicates that the potential output of the Malaysian economy was close to 5.1% in 2008, with the output gap<sup>1</sup> of positive 0.5% of potential output. The small positive output gap suggests that the Malaysian economy was performing close to its potential with minimal demand-driven inflationary pressure. Overall, since the year 2000, the Malaysian economy has been experiencing this trend of relatively balanced growth as shown by the output gap, which was on average less than  $\pm 1\%$  of potential output.

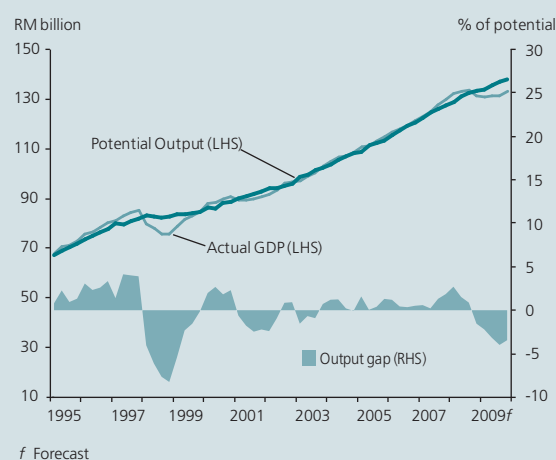
**Table 1**  
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	Annual change (%)				(% of potential output)
1993-1999	6.5	6.6	4.3	3.2	0.0
2000	8.9	4.0	26.0	4.3	2.2
2001	0.5	4.6	-2.1	1.6	-1.8
2002	5.3	3.9	0.6	3.5	-0.4
2003	5.8	6.0	2.8	3.6	-0.6
2004	6.8	5.5	3.6	4.0	0.6
2005	5.3	5.1	5.0	4.1	0.8
2006	5.8	6.0	7.9	2.2	0.6
2007	6.3	6.0	9.6	2.0	0.9
2008e	4.6	5.1	1.1	1.2	0.5

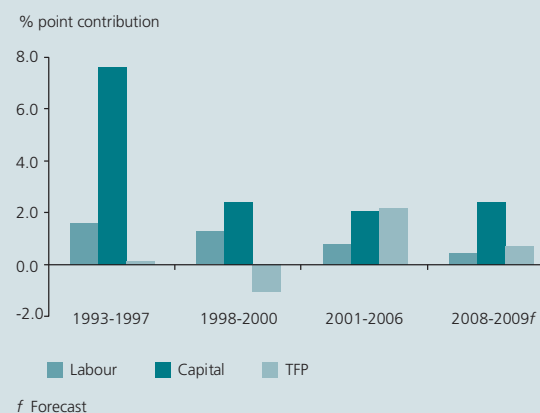
e Estimate

As a small open economy, Malaysia is being affected by the severe global financial and economic crisis. Under this environment, potential output is therefore projected to moderate in 2009 due to an expected decline in overall productivity (TFP) and labour force participation as well as stagnation in capital stock growth, consistent with the experience during previous periods of slowdown. However, the output gap is projected to be negative in 2009 given the larger expected moderation of actual output.

**Chart 1**  
Actual and Potential GDP



**Chart 2**  
Factor contributions and TFP growth



<sup>1</sup> 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.