DEVELOPMENTS IN THE SECOND QUARTER OF 2004

International Economic Environment

Sustained GDP growth across all regions

Global economic activity remained firm in the second quarter, sustained by strong growth in the United States (US), continued economic revival in Japan and Europe and broad-based expansion in Asia. Meanwhile, growth in the People's Republic of China (P. R. China) moderated but continued to remain at a high level.

In the **US**, growth remained strong albeit at a less rapid pace in the second quarter, supported by higher business investment and inventory rebuilding while efficiency in energy usage mitigated the adverse impact of higher energy prices on consumer spending. Against the backdrop of sustained economic expansion and upturn in inflationary expectations, the Federal Reserve increased rates in June, signalling a less accommodative stance in monetary policy. In the **euro area**, despite weak consumer spending and uncertainty on structural reforms, economic recovery continued to be sustained by fiscal stimulus and strong export performance. Growth in the **United Kingdom** registered its fastest expansion in nearly four years, spurred by high consumer spending and strong activity in the services, manufacturing and housing sectors. In **Japan**, despite some moderation in capital spending, stronger export demand continued to drive economic recovery, while growth from domestic sources remained encouraging with private consumption improving in response to more stable labour market conditions.

Industrial Countries: Real GDP growth

	2003		2004		Key contributing factors for 2Q growth
	1Q	2Q	1Q	2Q	
	Annual change (%)				
US[1]	1.9[r]	4.1[r]	4.5[r]	3.0	Investment and inventory re-building,while consumer spending moderated
UK	2.1	2.0	3.4	3.7	Strong activity in manufacturing and services sectors. Fastest expansion in nearly four years.
Germany	0.4	-0.3	0.4	0.5	Strong export performance despite cautious consumer spending as well as uncertain sentiment on structural reforms.
Japan[1]	2.2	3.5[r]	6.6	1.7	Despite moderation in capital spending, rising exports coupled with improvements in private consumption continued to underpin the recovery.

1 annualised basis
r revision
Source: National authorities

In the **Asian** region, growth momentum remained robust during the second quarter, mainly supported by resilient export performance of the technology sector and strong intra-regional trade.

Regional Countries: Real GDP growth

	2003		2004		Key contributing factors for 2Q growth
	Q1	Q2	Q1	Q2	
	Annual change (%)				
P.R. China	9.9	7.9	9.8	9.6	Continued broad-based growth with strong retail sales and exports.
Singapore	1.7	-3.9	7.5	12.5	Double-digit expansion in the manufacturing and services sector.
Korea	3.7	2.2	5.3	5.5	Expansion in investment and robust exports.
Indonesia	5.5	4.8	5.0	4.3	Supported by private consumption and investment.

Source: National authorities

Inflation in the region trended markedly upwards during the quarter, mainly reflecting higher food prices and persistently high global crude oil prices. In Indonesia and Philippines, weaknesses in domestic currencies added further inflationary pressures. Meanwhile in Hong Kong China, deflationary trends further dissipated, following rising consumer spending, robust growth in the tourism industry and declining unemployment rate. Despite rising inflationary pressures, interest rates in the region remained relatively low, in view of ample liquidity in most of the regional economies.

Meanwhile, global equity market strength abated during the second quarter due to concerns on corporate earnings and interest rate hikes while Asian equity markets were also affected by concerns about a possible sharp slowdown in P.R. China.

Going forward, global economic expansion is expected to moderate somewhat as further momentum would likely be influenced by the extent to which consumption in industrialised countries would be affected by continued high oil prices. Meanwhile, growth prospects in the Asian region are expected to remain favourable amid buoyant intra-regional trade and strong underlying domestic demand in most regional economies.

Developments in the Malaysian Economy

Growth driven mainly by strong expansion in manufacturing and services sectors

In the second quarter, growth was sustained in most sectors, with robust expansion in the manufacturing and services sectors. The robust performance of the manufacturing sector was in line with strong demand from the current global electronics up-cycle and improved global economy. The buoyant growth in trade as well as transhipment and telecommunication activities also drove growth in the services sector, especially the transportation, storage and communication sub-sector, while the final services sub-sector grew at a higher pace, supported by strong consumption and tourism activities, thus contributing to the higher growth of 7.4% in the services sector. Besides the underlying strengths across the sub-sectors, growth in the services sector was also partly due to the low base in the corresponding period of 2003 due to SARS. While growth in the agriculture sector was sustained, the mining sector grew at a more moderate pace. The construction sector contracted during the quarter due to weaker civil engineering activity.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Agriculture	10.7	7.8	3.2	3.2	3.2
Mining	13.0	8.7	5.8	1.1	3.5
Manufacturing	6.5	6.2	12.7	12.1	12.3
Construction	1.4	1.3	0.6	-1.7	-0.6
Services	3.4	4.1	6.2	7.4	6.8
Real GDP (Ann. Chg.)	**4.6**	**4.6**	**7.6**	**8.0**	**7.8**
Real GDP (Preceding Chg.)	**4.3**	**-1.8**	**-3.7**	**4.6**	**-0.1**

Source: Department of Statistics, Malaysia

Continued strong growth in the manufacturing sector

The strong growth in the **manufacturing sector** was sustained with

value added expanding by 12.1% (1Q: 12.7%). Continued robust expansion was seen in both the export-oriented industries (18.3%; 1Q: 19.3%), and domestic-oriented industries (8%; 1Q: 7.6%). Despite high investment in capacity expansion, the overall capacity utilisation rate remained high at 81%, with export- and domestic-oriented industries operating at 85% and 74% respectively.

Capacity Utilisation in the Manufacturing Sector



The sustained strong expansion in the export-oriented industries was underpinned mainly by higher production in the electronics (32.7%), chemical products (18.7%) and rubber products (20.9%) industries. In particular, the electronics industry was supported by the strong global demand for semiconductors, due mainly to the wider applications of chips in communications and consumer electronics, such as DVD players and digital cameras. This also had a spillover effect on the chemicals industry especially industries which supply inputs for electrical and electronics products such as plastics and resins. As a result, output in the chemicals industry expanded further by 18.7% (1Q: 16.9%; growth exceeding 20% in 2003).

The rubber products industry continued to record strong growth, supported by sustained export demand for rubber products such as examination and surgical gloves for the food, medical and industrial users. Meanwhile, the domestic-oriented industries strengthened further, due largely to strong growth in the food products (8.4%), fabricated metals (27.8%), and iron and steel (9.2%) as well as transport equipment industries (8%). Higher output in the food products industry largely reflected stronger private consumption, whereas the underlying strength of the metals industry arose from strong external demand from the US and Thailand. The transport equipment industry expanded moderately, benefiting from higher domestic sales of passenger vehicles.

Performance in the Manufacturing Sector

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual Change (%)				
Value Added (Constant Price)	**6.5**	**6.2**	**12.7**	**12.1**	**12.3**
Overall Production	**8.2**	**7.9**	**16.5**	**15.9**	**16.2**
Export-oriented industries	**10.0**	**9.0**	**19.3**	**18.3**	**18.8**
of which :					
- Electronics	7.0	7.8	34.1	32.7	33.4
- Electrical	-7.6	-6.1	-6.9	-7.1	-7.0
- Textiles & wearing apparel	2.3	1.6	-10.8	-6.6	-8.7
- Chemicals and chemical products	23.8	20.0	16.9	18.7	17.8
- Off-estate processing	27.3	16.0	3.3	-6.0	-1.8
- Rubber products	14.3	11.9	24.1	20.9	22.5
- Wood and wood products [1]	-0.4	1.8	13.9	20.8	17.4
Domestic-oriented industries	**3.3**	**4.8**	**7.6**	**8.0**	**7.8**
of which :					
- Transport equipment	-13.5	-10.1	0.8	8.0	4.4
- Fabricated metal products	7.9	6.0	35.4	27.8	31.2
- Iron & steel and non-ferrous metal	0.8	8.1	6.2	9.2	7.7
- Non-metallic mineral products	11.4	10.7	-1.2	-8.9	-5.2
- Petroleum products	17.5	9.3	-1.9	-5.5	-3.7
- Food	7.3	6.4	7.3	8.4	7.9
Total Manufactured Exports	**7.2**	**6.9**	**17.3**	**20.5**	**19.0**
- Electronics and electrical products	3.9	2.3	14.9	17.8	16.4
- Wood and wood products	5.5	9.1	28.2	32.3	30.3
- Furniture & parts	5.1	6.9	14.5	14.8	14.6
- Textiles, clothing & footwear	3.3	5.7	16.6	19.2	17.9
- Optical & scientific equipment	15.8	17.4	11.4	33.2	22.8
- Chemical and chemical products	22.6	27.7	25.2	27.2	26.3
- Petroleum products	23.8	44.5	20.0	25.3	22.4

[1] Output of furniture and parts are not captured in the wood production data.

Robust growth in the services sector

The **services sector** continued on its upward trend to record a robust growth of 7.4% in the second quarter, underpinned by higher trade-related activities, strong consumer spending and rapid growth in tourist arrivals. Of significance, the wholesale and retail trade, hotels and restaurants sub-sector recorded the strongest growth of 10% due partly to the low base effect arising from SARS during the corresponding quarter of the previous year (2Q 2003: -2.3%). The sub-sector also benefited from higher domestic demand and significant increase in international tourist arrivals (2Q 2004: 1.3 million tourists per month; 2Q 2003: 0.6 million per month). Of importance, there has been a discernable increase in high spending tourists mainly from P. R. China, Chinese Taipei and West Asia. On the domestic front, spending by Malaysians remained strong, as reflected in the increase in credit card spending and consumption credit disbursed during the quarter.

Meanwhile, the transport, storage and communication sub-sector continued to register a strong growth, due to increased trade- and travel-related activities as well as continued robust expansion in the telecommunications industry. The growing subscriber base and higher usage of mobile data services amidst launches of new products and inter-operability facility for Multimedia Messaging Services (MMS) supported growth in this sub-sector during the quarter.

Performance in the Services Sector (Value Added)

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Intermediate Services	**4.9**	**4.8**	**7.4**	**7.6**	**7.5**
Transport, storage & communication	4.0	4.6	7.8	8.4	8.1
Finance, insurance, real estate & business services	5.4	5.0	7.2	7.1	7.1
Final Services	**2.3**	**3.5**	**5.4**	**7.3**	**6.4**
Electricity, gas & water	5.2	6.3	8.8	8.8	8.8
Wholesale & retail trade, hotel & restaurants	-2.3	0.4	5.8	10.0	7.9
Government services	10.3	9.2	3.2	2.2	2.7
Other services	2.2	2.9	5.1	6.4	5.7
Total Services	**3.4**	**4.1**	**6.2**	**7.4**	**6.8**

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2003		2004		
Indicators	2Q	1H	1Q	2Q	1H
	Levels				
Electricity Production Index	244.4	237.7	248.9	266.8	257.9
KLSE CI (end-period)	692.0	692.0	901.9	819.9	819.9
MIER Consumer Sentiment Index	106.9	-	117.5	112.4	-
MIER Retail Survey Index	96.3	-	119.3	137.0	-
MIER Hotel Operators Index	81.3	-	134.5	142.5	-
MIER Travel Agencies Index	73.3	-	124.9	119.7	-
	Annual change (%)				
Tourist arrivals	-51.6	-30.7	38.4	127.4	71.7
Import of consumption goods	-2.7	0.8	14.3	26.5	20.5
Consumption credit disbursed	1.9	2.5	13.0	17.5	15.3
Total passenger traffic in all airports in Malaysia	-15.9	-3.7	10.9	44.6	26.0
Total TEUs handled [1]	18.9	19.0	15.8	17.8	16.9
Total loan outstanding (end-period)	4.2	4.2	5.7	6.2	6.2
Total property transactions (value)	-1.3	0.9	30.1	52.7	41.8

[1] For PTP and Port Klang
Source: Various sources

Growth in the finance, insurance, real estate and business services sub-sector remained strong. Bank lending rose further while sustained strong growth in the insurance industry was driven mainly by increased interest in investment-linked insurance products. The sub-sector was also supported

by increased activities in the stock market and higher property transactions to take advantage of relevant incentives under the May 2003 Economic Package, which ended in May 2004.

Continued contribution from the primary commodity sector

Growth in the agriculture sector was sustained at 3.2% due mainly to robust growth in rubber production as well as other agriculture activities, which more than offset the decline in crude palm oil production. Rubber, together with other agriculture account for about 65% of total value add of the agriculture sector. Meanwhile, the mining sector registered a moderate growth during the quarter, due mainly to lower crude oil production.

In the **agriculture sector,** production of rubber continued to expand strongly by 32.9% due to active tapping by smallholders, who account for almost 95% of total national rubber output, amidst remunerative prices averaging 476 sen per kilogram (2Q 2003: 325 sen per kg). The sector was further supported by strong growth in the other agriculture activities, namely livestock, fisheries and miscellaneous agriculture such as vegetables and fruits. In contrast, production of crude palm oil declined by 5.9% during the quarter (1Q 2004: +2.5%) due to lower yields. The average yield in terms of fresh fruit bunches during the quarter was significantly lower at 4.3 tonnes per mature hectare vis-à-vis 4.96 tonnes in the corresponding quarter in 2003. Thus, the monthly average production of crude palm oil was lower at 1.09 million tonnes (2Q 2003: 1.16 million tonnes).

Performance of the Agriculture Sector

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (at 1987 prices)	**10.7**	**7.8**	**3.2**	**3.2**	**3.2**
Production [1]					
Of which:					
Crude palm oil	27.4	14.2	2.5	-5.9	-2.3
Crude palm kernel oil	29.0	11.3	3.8	-10.9	-4.4
Rubber	9.7	12.7	23.4	32.9	27.6
Saw logs	10.6	12.6	-20.1	-16.4	-18.0
Cocoa beans	-14.4	2.8	-33.5	-8.5	-22.5
Exports (RM million)	**33.7**	**37.4**	**13.8**	**11.4**	**12.5**
Of which:					
Palm oil					
('000 tonnes)	15.6	12.7	5.1	-12.7	-4.8
(RM/tonne)	24.8	32.1	6.5	16.9	11.9
(RM million)	44.4	48.9	11.9	2.1	6.6
Palm kernel oil					
('000 tonnes)	7.1	-15.6	35.4	20.4	26.9
(RM/tonne)	17.2	33.2	27.8	61.6	45.6
(RM million)	25.6	12.4	73.1	94.5	84.8
Rubber					
('000 tonnes)	-5.4	3.0	23.4	12.1	17.7
(Sen/kilogramme)	51.0	53.6	36.5	35.9	36.1
(RM million)	42.9	58.2	68.4	52.3	60.1
Sawn timber					
('000 cu.metres)	57.7	34.0	2.8	-28.0	-16.7
(RM/cu.metre)	-34.0	-21.1	-9.6	31.9	12.9
(RM million)	4.0	5.8	-7.1	-5.0	-6.0
Saw logs					
('000 cu.metres)	24.2	19.0	-13.5	-11.0	-12.1
(RM/cu.metre)	9.1	15.1	1.0	19.6	11.3
(RM million)	35.5	36.9	-12.6	6.4	-2.1
Cocoa beans					
('000 tonnes)	-38.0	-11.8	-76.0	-8.3	-42.3
(RM/tonne)	37.2	43.3	-20.3	-12.9	-14.0
(RM million)	-14.9	26.4	-80.9	-20.1	-50.4

[1] In '000 tonnes, except for saw logs in '000 cubic metres

Lower production of crude oil led to a moderate growth in the **mining sector** of 1.1%. Production of crude oil (including condensates) declined marginally by 0.2%, to average 738,400 barrels per day (bpd) during the quarter (1Q 2004: 772,800 bpd; 2Q 2003: 740,100 bpd), due to the temporary shutdown of several oil and gas fields and plants for maintenance purposes. While the scheduled maintenance had also affected natural gas production, total output was still 4% higher than in the corresponding period of the previous year. The growth was due to expansion in output from the MLNG Tiga plant

amidst the higher demand for LNG, particularly from major buyers, namely Korea, Chinese Taipei and Japan.

Performance of the Mining Sector

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (at 1987 prices)	**13.0**	**8.7**	**5.8**	**1.1**	**3.5**
Production					
Of which:					
Crude oil and condensates ('000 barrels)	11.8	6.9	8.0	-0.2	3.8
Natural gas (net) (million standard cubic feet)	17.7	12.8	2.3	4.0	3.1
Exports (RM million)	**34.9**	**45.0**	**15.4**	**43.6**	**28.2**
Of which:					
Crude oil					
('000 tonnes)	1.7	3.9	4.1	4.5	4.3
(US$/barrel)	16.0	36.8	4.4	33.6	17.7
(RM million)	18.0	42.1	8.6	39.6	22.7
Liquefied natural gas					
('000 tonnes)	40.6	19.2	18.3	34.1	25.5
(RM/tonne)	26.3	31.5	-2.3	1.5	-0.5
(RM million)	77.6	56.8	15.6	36.0	24.8

Weaker construction sector

The **construction sector** contracted by 1.7% in the second quarter of 2004 (1Q 2004: 0.6%) due to lower civil engineering activity which was partly mitigated by higher activities in the residential and non-residential sub-sectors. Demand for houses continued to remain firm, supported by the low interest rates and stable labour market conditions. Expansion in the non-residential sub-sector was underpinned by activity in the retail shop and office segments. Overall, construction activity is expected to benefit from the additional allocation of RM10 billion for development expenditure under the Eighth Malaysia Plan.

Construction Indicators

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
New sales and advertising permits	-16.7	-20.1	42.0	0.7	18.1
Housing approvals	0.8	-13.6	48.5	-15.2	8.2
Production of construction-related materials	6.5	9.5	2.2	-0.9	0.6
Loans approved for construction	-44.3	-20.8	-36.8	30.7	-6.7
Imports of construction materials & mineral products	-20.1	-9.2	14.5	42.8*	25.6**

* *April-May'04*
** *Jan-May'04*
Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Domestic demand strengthened further, led by the private sector

Amidst further consolidation in the public sector, the private sector was the main engine of growth, contributing significantly to GDP growth. Robust expansion of private sector led domestic demand growth in the second quarter of 2004 to outperform the first quarter (8.1%; 1Q 2004: 7%). Evidence of robust growth in household consumption and stronger private investment activities indicates that the sustainability and quality of growth have improved significantly.

GDP by Expenditure Components (at Constant 1987 prices)

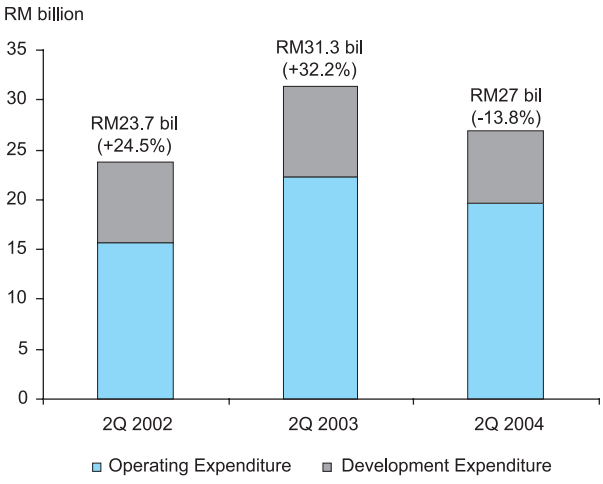
	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	4.0	5.3	7.0	8.1	7.6
Consumption	5.9	6.9	8.6	10.4	9.5
Private sector	*5.0*	*5.5*	*8.4*	*11.4*	*9.9*
Public sector	*8.9*	*12.6*	*9.2*	*7.1*	*8.0*
Gross Fixed Capital Formation	0.4	2.0	3.5	3.5	3.5
Exports of Goods and Services	4.4	4.9	15.6	19.3	17.5
Imports of Goods and Services	-0.5	1.1	19.4	25.3	22.4
GDP	**4.6**	**4.7**	**7.6**	**8.0**	**7.8**

Source: Department of Statistics, Malaysia

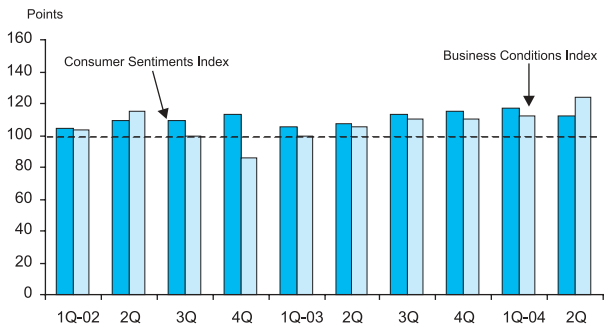
Private consumption remained robust in the second quarter, with the pace of expansion strengthening to 11.4% (1Q 2004: 8.4%). Consumer confidence strengthened with sustained increase in disposable incomes, improving business conditions, high export earnings, continued firm commodity prices as well as the low interest rate environment. As a result, strong expansion was recorded in all major consumption indicators such as credit card spending, imports of consumption goods, loans approved to households and consumption credit and loans disbursed to wholesale, retail, restaurants and hotels. Sales of passenger cars were also markedly higher during the quarter, after declining for six consecutive quarters. Meanwhile, **public consumption** increased moderately in the second quarter, with sustained expenditure on supplies and services as well as defence.

The **gross fixed capital formation** continued to record a strong growth of 3.5% (1Q 2004: 3.5%) in the second quarter, driven entirely by stronger private investment activities as Federal Government development expenditure continued to decline. Private investment expanded strongly during the quarter, as reflected mainly in the continued investment in machinery and equipment and capacity expansion due to continued improvement in business confidence, high capacity utilisation as well as favourable financing conditions and improving corporate profitability. In addition, domestic investment was also supported by the sustained inflow of foreign direct investment. The higher investment during the quarter was reflected across most sectors, particularly in manufacturing, oil and gas and telecommunication sectors. The improved business confidence during the quarter was reflected in the higher Business Condition Index, which rose significantly by 12.1 points to 124.1 points (1Q 2004: 112), indicating strong local and export orders and sales performance as well as higher capacity utilisation rate. In addition, major indicators such as sales of commercial vehicles, imports

Lower Federal Government Spending



Business confidence strengthened further

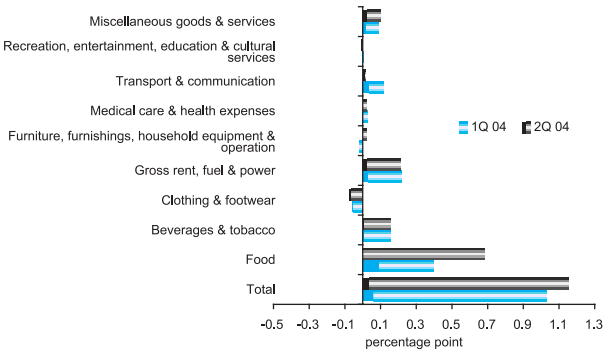


of capital goods, loans approved and loans disbursed to businesses and manufacturing increased significantly, pointing towards stronger growth in business activity. Meanwhile, the bulk of the Federal Government development expenditure continued to be disbursed to transportation infrastructure, education, health and agriculture.

Inflation continued to remain low

While growth remained robust in the second quarter, **inflation**, as measured by the change in the Consumer Price Index (CPI, 2000=100), remained low at 1.2% (1% in 1Q 2004). Higher price increases for food taken away from home, perishable food items and transport services following the increase in the price of petrol on 1 May 2004, were partially offset by the lower prices in communication. For the first six months of 2004, the average annual inflation rate stood at 1% (1.1% in the first six months of 2003).

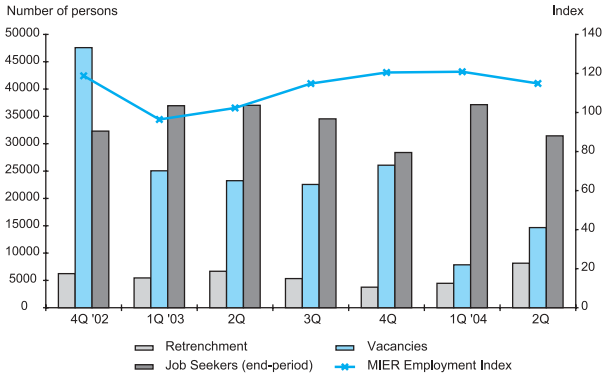
Contribution to Inflation



Labour market conditions remained stable

Labour market conditions remained stable. Stronger GDP performance was reflected in higher growth in productivity and a decline in unplaced job seekers. In the manufacturing sector, in the second quarter, labour productivity, as measured by real sales value of products per employee rose by 19.5%, exceeding the 3.9% increase in real wage per employee. Reflecting the prevailing stable conditions, vacancies as reported to the authorities during the quarter outpaced retrenchment (14,660 positions and 8,155 persons respectively).

Stable Labour Market Conditions

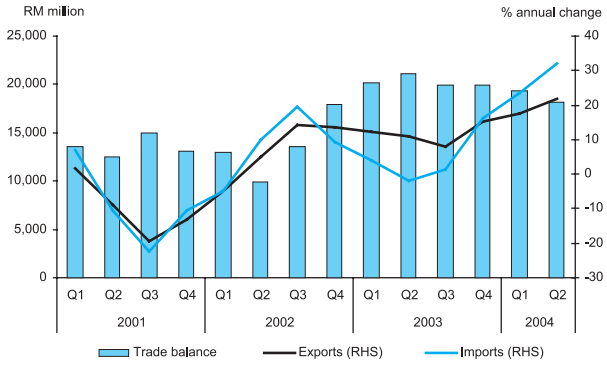


Narrowing of trade balance as exports matched by strong imports

The **trade surplus** narrowed, but remained large at RM18.1 billion (1Q 2004: RM19.3 billion). Consistent with more robust economic activities, gross imports expanded at a stronger pace of 32.1%. Gross exports continued to expand at a strong pace of 22%.

Growth in **gross exports** strengthened further in the second quarter of 2004, reflecting higher exports of manufactured goods and commodities. The stronger export performance reflected mainly increases in export volume (15.8%), while export prices rose moderately due mainly to higher prices of crude oil, rubber and palm oil. The increase in export volume was mainly in manufacturing, as well as LNG, crude oil and rubber.

Trade balance



Amidst favourable developments in the global economy, **manufacturing exports** strengthened further by 20.5% (1Q: 17.3%), driven by strong external demand for electronics and electrical products, chemical products and rubber products. Exports of electronic products benefited largely from higher demand from the Asia-Pacific region and the US, whilst the higher exports of chemical products, rubber products and metal products are a reflection of broad-based demand from the regional countries, EU and the US. Higher exports were also recorded for other items such as petroleum products, paper and pulp products, textiles and clothing and food products. While the export prices of non-resource based industries continued to decline, this has been more than offset by rising export prices for the resource-based industries. Overall, export prices registered a marginal increase (0.8%; 1Q: -1.1%), while volume of manufactured exports expanded further by 20.5% (1Q: 19.5%).

Exports of **agriculture commodities** expanded further by 11.4% during the quarter (1Q 2004: 13.8%), attributable to increased palm oil and rubber exports. Palm oil exports (RM5.1 billion) were driven entirely by strong prices, which averaged RM1,835 per tonne (1Q 2004: RM1,766 per tonne). Meanwhile, export volume of palm oil declined by 12.7%, following lower offtake by Malaysia's major buyers, namely India and Pakistan, given better domestic harvests of oilseeds during the period. Reflecting continued supply constraints in the global edible oils markets, particularly soybean oil (palm oil's closest substitute), against the favourable demand, prices of palm oil remained relatively high during the quarter. Similarly, exports of rubber remained strong during the quarter, growing by 52.3%, driven by both strong increases in prices (35.9%) and export volume (12.1%). Demand for rubber, especially from major buyers including P.R. China, Middle East and the European Union which together accounted for two-thirds of Malaysia's total rubber exports, grew strongly during the quarter, increasing between 6 to 42%.

Exports of **minerals** increased at a rapid pace of 43.6% due mainly to higher crude oil prices. During the quarter, export prices of Malaysian crude oil rose by 33.6% to

US$37.86 per barrel (1Q 2004: US$34.06 per barrel), in line with developments in the international crude oil markets. Meanwhile, LNG exports increased by 36% on higher purchases by three major buyers, namely Korea, Chinese Taipei and Japan, in line with their improved economic performance.

Trade Account

	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Gross Exports	**11.1**	**11.7**	**17.4**	**22.0**	**19.7**
Manufacturing	*7.2*	*6.9*	*17.3*	*20.5*	*19.0*
Agriculture	*33.7*	*37.4*	*13.8*	*11.4*	*12.5*
Minerals	*34.9*	*45.0*	*15.4*	*43.6*	*28.2*
Gross Imports	**-2.0**	**0.8**	**23.5**	**32.1**	**27.9**
Capital goods	*-10.8*	*-5.0*	*23.2*	*27.6*	*25.4*
Intermediate goods	*-0.4*	*1.4*	*22.5*	*31.6*	*27.2*
Consumption goods	*-2.7*	*0.8*	*14.3*	*26.5*	*20.5*
Trade balance (RM bil)	**21.2**	**41.4**	**19.3**	**18.1**	**37.5**

Source: Department of Statistics, Malaysia

The market share of exports to the region remained high in the second quarter at 44%. Export growth to the East Asian region outpaced that of the major industrial countries, driven mainly by the expansion in exports of electrical and electronics products, LNG and palm oil. Exports to P. R. China and Hong Kong China grew by 30.2% and 25.3%, thus expanding Malaysia's export share to these markets to 6.8% and 6.4%, respectively. Supported by higher exports of electrical and electronic products, chemical and wood products, exports to the United States grew by 15.5% to account for a higher market share of 19.3%. Meanwhile, in tandem with rising economic activity, exports to the EU countries and Japan grew by 14.8% and 18.6% respectively.

Gross imports grew by 32.1% to RM99.8 billion. Higher import growth reflected sustained growth in production and exports of electrical and electronic products, stronger domestic demand and investment activities. Imports of **intermediate goods**, which are mainly inputs for manufactured exports, grew by 31.6%. Higher imports during the quarter also reflected increased sourcing for low cost inputs from Thailand, Indonesia, and P.R. China. Components, including imports of industrial supplies and parts and accessories of capital goods (except transport equipment), which are inputs for the electrical and electronics industry, recorded significant increases. Reflecting the strong growth in

Malaysia: Direction of exports

	2003		2004			2003		2004			2003		2004		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	RM billion					Share of total exports (%)					Annual change (%)				
United States	**19.7**	**36.9**	**19.3**	**22.8**	**42.0**	**20.4**	**19.6**	**17.8**	**19.3**	**18.6**	**4.4**	**3.9**	**11.9**	**15.5**	**13.8**
European Union	**12.0**	**23.4**	**13.3**	**13.7**	**27.0**	**12.4**	**12.4**	**12.3**	**11.7**	**12.0**	**16.0**	**11.5**	**16.0**	**14.8**	**15.4**
Selected ASEAN countries [1]	**23.9**	**46.9**	**26.9**	**28.8**	**55.7**	**24.7**	**24.9**	**25.0**	**24.4**	**24.7**	**4.1**	**6.2**	**17.3**	**20.3**	**18.8**
North East Asia	**18.2**	**36.0**	**21.9**	**23.1**	**45.0**	**18.8**	**19.1**	**20.3**	**19.6**	**19.9**	**17.7**	**22.2**	**23.0**	**26.8**	**24.9**
People's Republic of China	*6.2*	*11.5*	*7.2*	*8.1*	*15.3*	*6.4*	*6.1*	*6.7*	*6.8*	*6.8*	*32.8*	*30.2*	*34.9*	*30.2*	*32.4*
Hong Kong China	*6.0*	*11.9*	*6.4*	*7.5*	*14.0*	*6.2*	*6.3*	*6.0*	*6.4*	*6.2*	*31.6*	*39.4*	*8.6*	*25.3*	*17.0*
Chinese Taipei	*3.5*	*6.8*	*3.6*	*3.8*	*7.4*	*3.6*	*3.6*	*3.3*	*3.3*	*3.3*	*-3.6*	*3.3*	*6.4*	*11.2*	*8.8*
Korea	*2.6*	*5.8*	*4.7*	*3.7*	*8.4*	*2.7*	*3.1*	*4.4*	*3.1*	*3.7*	*-3.4*	*5.4*	*47.5*	*43.1*	*45.5*
India	**2.5**	**4.7**	**2.7**	**2.7**	**5.4**	**2.6**	**2.5**	**2.5**	**2.3**	**2.4**	**45.2**	**59.1**	**21.3**	**10.9**	**15.8**
Total exports	**96.7**	**188.7**	**107.9**	**118.0**	**225.9**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**11.1**	**11.7**	**17.4**	**22.0**	**19.7**

1 Include Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam
Source: Department of Statistics, Malaysia

private consumption, imports for the food and beverages processing industry grew by 109.5%.

Consonant with strong expansion in private investment, imports of **capital goods** expanded at a robust rate of 27.6%. Capital imports, excluding lumpy import items, grew by 26.2%. The increase is reflective of capacity expansion in the manufacturing and oil and gas sectors. Investment in machinery and equipment and capacity expansion in the manufacturing sector strengthened as business sentiment improved while capacity utilisation was at near full capacity. Reflecting the increase in exploration activities in the oil and gas industry, imports of construction and mining equipment recorded significant growth. In line with higher disposable incomes, imports of **consumption goods** increased by 26.5%. Higher imports of consumption goods reflected imports of food and beverages for household consumption and consumer goods. Another significant development during the quarter was the strong growth in imports for re-exports arising from packing and assembling activities at distribution parks located in the free commercial zones at the major ports.

Malaysia: Imports by Economic Function: Broad Economic Categories (BEC) Classification

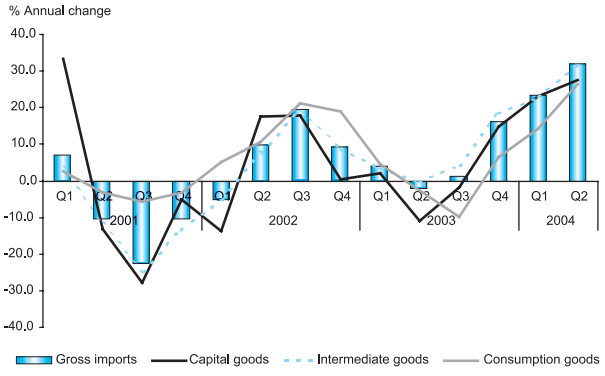
	2003		2004		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
CAPITAL GOODS	**-10.8**	**-5.0**	**23.2**	**27.6**	**25.4**
Capital goods (except transport equipment)	9.7	9.0	12.9	25.5	19.4
Transport equipment	-84.2	-74.2	205.1	79.9	150.8
INTERMEDIATE GOODS	**-0.4**	**1.4**	**22.5**	**31.6**	**27.2**
Food and beverages, mainly for industry	13.4	26.2	31.8	109.5	64.8
Industrial supplies, n.e.s.	-3.2	2.5	25.1	47.7	36.4
Fuel and lubricants	44.1	37.6	-2.1	23.3	11.4
Parts and accessories of capital goods (except transport equipment)	-0.4	-1.3	23.2	20.4	21.7
Parts and accessories of transport equipment	-40.5	-24.8	24.6	74.3	46.4
CONSUMPTION GOODS	**-2.7**	**0.8**	**14.3**	**26.5**	**20.5**
Food and beverages, mainly for household consumption	-13.1	-8.3	19.8	37.8	28.5
Transport equipment, non-industrial	108.9	106.8	-8.5	15.2	3.4
Consumer goods,n.e.s.	2.5	5.4	11.5	20.6	16.2
Durables	*22.4*	*22.4*	*8.1*	*14.5*	*11.4*
Semi-durables	*-15.3*	*-12.6*	*15.8*	*22.2*	*19.2*
Non-durables	*10.8*	*14.4*	*10.2*	*22.5*	*16.6*
DUAL USE GOODS	**17.0**	**22.6**	**22.2**	**26.3**	**24.2**
OTHERS	**-1.5**	**0.9**	**7.5**	**5.2**	**6.3**
RETAINED IMPORTS	**-1.9**	**0.8**	**21.7**	**30.0**	**26.0**
RE-EXPORTS	**-8.4**	**0.9**	**89.6**	**107.7**	**99.0**
GROSS IMPORTS	**-2.0**	**0.8**	**23.5**	**32.1**	**27.9**

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

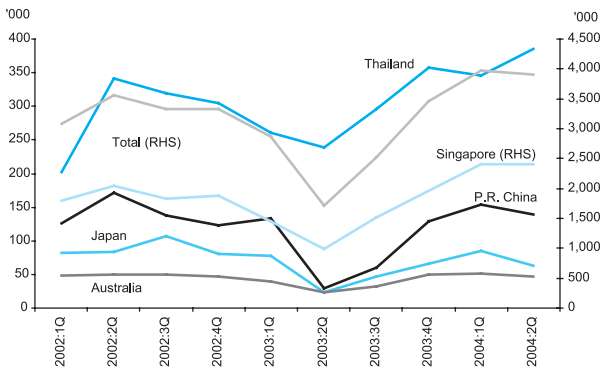
Sustained high level of tourist arrivals

Tourist arrivals were sustained at a high level of 3.9 million tourists (1Q 2004: 4 million) for the quarter. A significant share of arrivals was from Singapore, Thailand,

Import growth



Quarterly Tourist Arrivals



Indonesia and P. R. China, in line with the increase in flights and strong economic performance of regional countries. Tourists from ASEAN countries accounted for 80.3% of tourist arrivals. Reflecting the increased number of flights to East Malaysia and promotional campaigns, tourist arrivals from UK, Australia and US remained high.

Sustained inflows of FDI, while portfolio investment moderated

On a cash basis, gross inflows of **foreign direct investment (FDI)** were sustained in the second quarter (RM3.6 billion; 1Q 2004: RM3.5 billion). The FDI inflows were channelled mainly to the services sector, specifically the business and support services and wholesale and retail trade sub-sectors. Investment flows into the manufacturing sector remained large, particularly in the petroleum-related, electrical and electronics and chemicals activities, as well as the oil and gas sector. After adjustments for outflows due mainly to loan repayment to related companies, FDI recorded a higher net inflow of RM0.9 billion (1Q 2004: RM0.6 billion).

Gross outflows for **overseas investment** were higher at RM2.7 billion (1Q 2004: RM2.1 billion). The bulk of the investments was effected by companies in the services sector, particularly business and support services and wholesale and retail trade. There were also significant investments by the oil and gas sector, followed by companies in the manufacturing sector, particularly from the petroleum-related and electrical and electronics industries. Overseas investment, after adjusting for inflows from repayment of inter-company loans from abroad, recorded a higher net outflow of RM1.7 billion (1Q 2004: - RM1.1 billion).

Net inflows of **portfolio investment** moderated but remained large at RM3 billion (1Q 2004: RM16.3 billion), in line with consolidation in the KLSE and several regional bourses during the quarter.

External debt remains within prudential limits

Malaysia's total external debt increased to RM193.7 billion or US$51 billion as at end-June 2004, equivalent to 49.3% of GNP. The **medium and long-term external debt** increased by 1.4% to RM152.1 billion or US$40 billion (1Q 2004: RM150 billion), reflecting net borrowing of external loans by the non-financial public enterprises (NFPEs). The NFPEs, which recorded eight consecutive quarters of net repayments, reversed to register a net drawdown of RM3.3 billion during the quarter. The higher gross drawdown of external loans by the NFPEs, particularly from the transportation sector, was mainly for capital expenditure. Meanwhile, both the Federal Government and the private sector registered net repayments of external loans during the quarter.

The total **short-term external debt** rose to RM41.7 billion or US$11 billion (1Q 2004: RM35.2 billion), attributable to an increase in short-term debt of the banking sector, due mainly to their hedging activities in relation to trade-related transactions and money market operations involving regional treasury activities. This development is

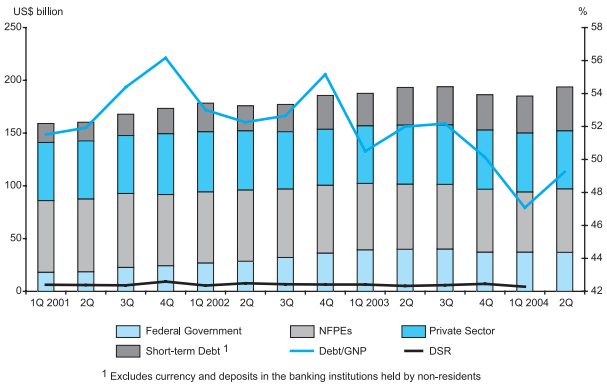
transitional and will be reversed upon maturity. Nonetheless, short-term debt are at low levels, accounting for 21.5% of total external debt, and is about 20.3% of the net international reserves (as at end-June).

External Debt Outstanding

	2003	2004	
	End-June	End-March	End-June [p]
	RM billion		
Medium & Long-term debt	157.4	150.0	152.1
Public sector	101.7	94.3	97.2
Private sector	55.7	55.7	54.9
Short-term debt[1]	35.8	35.2	41.7
Total external debt	193.2	185.2	193.7
- US$ billion equivalent	50.9	48.7	51.0

[1] Excludes currency and deposits held by non-residents with banking institutions.
[p] Preliminary
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

External Debt Outstanding

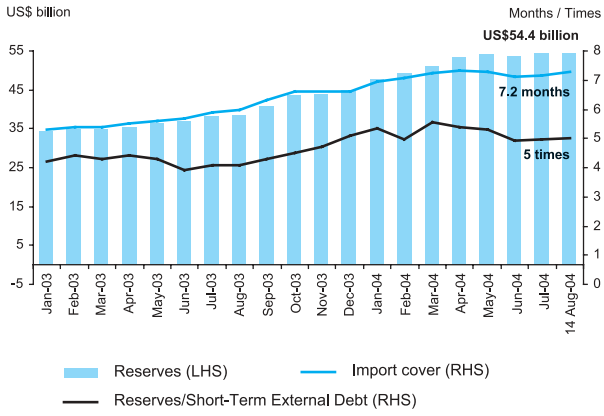


International reserves strengthened further

The **international reserves** of Bank Negara Malaysia strengthened further in the second quarter of 2004, increasing by RM9.7 billion (US$2.5 billion) to stand at RM204.8 billion (US$53.9 billion) as at 30 June 2004. The increase in reserves during the quarter arose mainly from the continued high repatriation of export earnings, inflows of FDI and portfolio funds and drawdown of external loans. The reserves level has also taken into account the quarterly foreign exchange revaluation adjustment amounting to a loss of US$506 million.

The reserves increased further to RM206.9 billion (US$54.4 billion) as at 14 August 2004, reflecting the sustained repatriation of export earnings and inflows of portfolio investment. The reserves level is sufficient to finance 7.2 months of retained imports and is 5 times the short-term external debt.

Net International Reserves (as at end period)

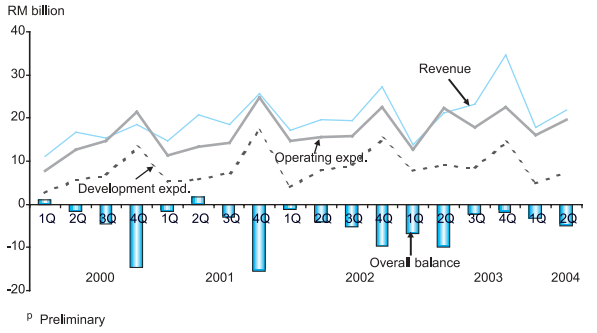


Lower fiscal deficit

Stronger revenue collection and lower expenditure resulted in a lower fiscal deficit for the Federal Government of RM4.9 billion or 4.5% of GDP in the second quarter (2Q 2003: -10.5% of GDP). For the first half of the year, the fiscal deficit amounted to 3.8% of GDP.

Revenue collection during the quarter was higher from both petroleum income tax and most major categories of indirect taxes. In line with its fiscal consolidation stance, total expenditure of the Federal Government

Federal Government Finance [p]



[p] Preliminary

declined at an annual rate of 13.8%. The bulk of the development expenditure was channelled to transport, education, health as well as agriculture and rural development. Given the ample liquidity in the domestic market, funds were raised entirely from domestic sources to finance the deficit. As at end-June 2004, total outstanding debt of the Federal Government amounted to RM197.8

Federal Government Finance [p]

	2003		2004		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	21.2	34.9	17.7	21.8	39.6
% growth	*8.1*	*-5.0*	*29.3*	*2.9*	*13.3*
Operating expenditure	22.2	35.0	16.2	19.7	35.9
% growth	*42.2*	*15.3*	*26.7*	*-11.4*	*2.5*
Current account	**-1.0**	**...**	**1.6**	**2.1**	**3.7**
% of GDP	***-1.1***	***...***	***1.5***	***1.9***	***1.8***
Gross development expenditure	9.1	16.9	4.9	7.3	12.1
% growth	*12.7*	*41.6*	*-38.0*	*-19.9*	*-28.3*
Loan recoveries	0.1	0.2	0.1	0.2	0.3
Overall balance	**-10.0**	**-16.8**	**-3.2**	**-4.9**	**-8.1**
% of GDP	***-10.5***	***-8.9***	***-3.1***	***-4.5***	***-3.8***
Memo item:					
Total gross expenditure	**31.3**	**51.9**	**21.0**	**27.0**	**48.0**
% growth	*32.2*	*22.7*	*2.1*	*-13.8*	*-7.5*
Total Federal Government debt (as at end period)	182.1	182.1	194.3	197.8	197.8
% of GDP	*46.2*	*46.2*	*46.5*	*47.3*	*47.3*
Domestic debt	142.3	142.3	157.0	160.8	160.8
% of GDP	*36.1*	*36.1*	*37.6*	*38.5*	*38.5*
External debt	39.9	39.9	37.3	37.0	37.0
% of GDP	*10.1*	*10.1*	*8.9*	*8.9*	*8.9*

p Preliminary

billion or 47.3% of GDP. The external debt of the Federal Government continue to remain low, accounting for 19.1% of the nation's outstanding external debt.