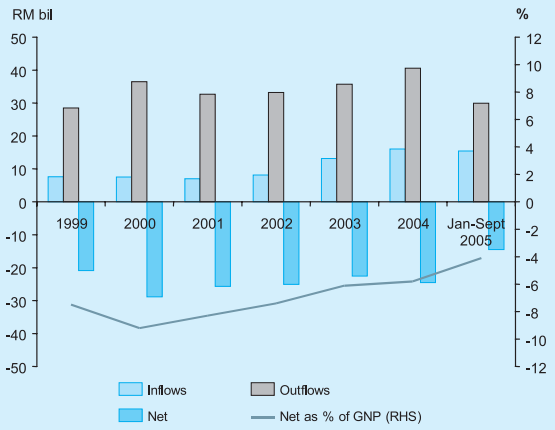
Malaysia: Income Account of Balance of Payments

I. Introduction

- Malaysia has adopted the IMF's Balance of Payments Manual, Fifth Edition's standard in its compilation of the income account since 1999. The income account has then been classified as a separate account from the services account. The components of the income account are **compensation of employees**, which are salaries and other benefits earned by the expatriates working in Malaysia and by Malaysians working abroad, and **investment income**, which refers to income (from direct investment, portfolio investment and other investment) accrued to foreign investors investing in Malaysia as well as income accrued to Malaysians investing abroad.

- The income account of balance of payments of Malaysia has always been in deficit, attributed mainly to profits and dividends accrued to foreign direct investors. This trend is in line with the large presence of multinational companies in the country, and it also reflected the successful operations of these companies in Malaysia. During the period 1999 to 2004, the deficit in income account averaged RM24.6 billion per annum. As a percentage share of GNP, the deficit has been in the range of -7.5% to -5.8%, which also takes into account the improvement in gross inflows of income from abroad particularly, from larger reserves as well as profits and dividends accruing to Malaysian companies investing abroad. In the period January to September 2005, the income account deficit amounted to RM14.5 billion or equivalent to -4.1% of GNP (January -

Income Account



Source: Department of Statistics, Malaysia

September 2004: -RM18.7 billion or -6% of GNP) again reflecting strong performance of Malaysian investments abroad.

- The notable features of the income account over the period are:

  - The strengthening of profits and dividends accrued to Malaysian investors investing abroad in recent years and higher revenue from larger external reserves contributed towards improvement in income account deficit when measured as a percentage of GNP.

  - The proportion of reinvested earnings by foreign direct investors in Malaysia remained high, averaging 55% during the period 1999 to 2004 and 56% for the period January to September 2005. This high ratio points to continued expansion and diversification in operations by existing multinational companies amidst a favourable domestic climate for foreign investment in Malaysia.

II. Developments in Income Account

Income Inflows

- Inflows of **compensation of employees**, which are salaries and other benefits earned by the Malaysians working abroad, more than doubled to RM2.6 billion in 2004 from RM1.2 billion in 1999. In the period January to September 2005, the inflows of compensation of employees amounted to RM3.2 billion. These inflows were mainly

Income Inflows

	1999	2000	2001	2002	2003	2004	Jan-Sept 2005	1999	2000	2001	2002	2003	2004	Jan-Sept 2005 1/
	RM billion							% Annual Change						
Total income inflows	**7.6**	**7.5**	**7.0**	**8.1**	**13.1**	**16.0**	**15.5**	**43.4**	**-0.9**	**-7.0**	**15.8**	**61.6**	**22.0**	**40.3**
* Compensation of employees	1.2	1.3	1.4	1.7	2.2	2.6	3.2	65.4	6.0	7.2	18.5	33.2	19.0	72.7
* Investment income	6.4	6.2	5.6	6.5	10.9	13.4	12.3	-	-2.2	-10.0	15.2	68.8	22.6	33.8
- Direct investment	**0.4**	**-0.8**	**-0.2**	**0.7**	**2.0**	**4.3**	**3.2**	**-**	**-298.4**	**-70.8**	**-373.6**	**192.0**	**117.7**	**22.8**
- Portfolio investment	0.3	0.3	0.2	0.2	0.3	0.4	0.3	-	7.7	-23.1	-30.4	114.3	15.5	12.9
- Other investment	5.7	6.8	5.6	5.6	8.6	8.7	8.7	-	19.5	-17.0	0.1	52.9	1.2	39.3

Source: Department of Statistics, Malaysia

1/ Annual change over the corresponding period of 2004

from Singapore, US and Hong Kong China.

- The **investment income**, comprising income earned from direct investment, portfolio investment and other investment abroad by Malaysians, increased steadily to RM13.4 billion in 2004 from RM6.4 billion in 1999. In the first nine months of 2005, the investment income earned was RM12.3 billion.

  - Of significance, inflows of *direct investment* income grew from RM0.4 billion in 1999 to RM4.3 billion in 2004. In the period January to September 2005, direct investment income amounted to RM3.2 billion. The improvement reflected mainly higher profits and dividends accrued to Malaysian companies investing abroad, particularly in the oil and gas, manufacturing as well as financial services sectors. The direct investment income earned accounted for about 29% of total investment income inflows during the period 2004 to September 2005 (1999: 7%).

  - Income from *other investment* grew from RM5.7 billion in 1999 to RM8.7 billion in 2004, contributing to about 65% of the total investment income inflows in 2004. A significant part of these incomes were earnings from international reserves of Bank Negara Malaysia.

  - Reflecting the limited exposure of Malaysian investors to *portfolio investment* abroad, income from this investment has remained small, averaging RM281 million during the period 1999 to 2004.

Income Outflows

- Outflows of **compensation of employees** have increased steadily (2004: -RM3.8 billion; 1999: -RM1.8 billion) with payments mainly to the US, UK and Japan. In the period January to September 2005, compensation of employees amounted to RM3.4 billion (January-September 2004: RM2.8 billion).

- During the period 1999 to 2004, **investment income** outflows or accrued to foreign investors remained large, averaging RM31.8 billion per annum. In the period

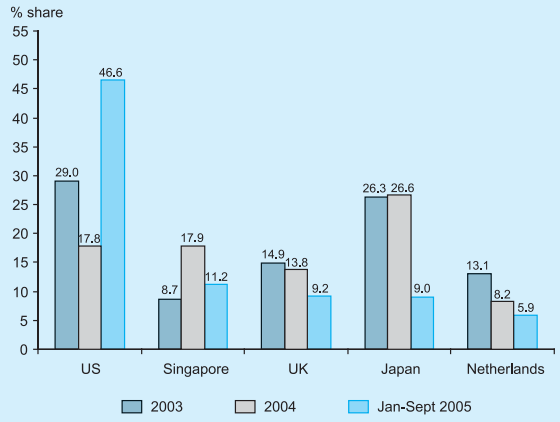
Income Outflows

	1999	2000	2001	2002	2003	2004	Jan-Sept 2005	1999	2000	2001	2002	2003	2004	Jan-Sept 2005[1/]
	RM billion							% Annual Change						
Total income outflows	**28.5**	**36.5**	**32.6**	**33.2**	**35.7**	**40.6**	**29.9**	**41.6**	**27.9**	**-10.5**	**1.7**	**7.5**	**13.7**	**0.7**
* Compensation of employees	1.8	2.3	2.4	2.8	3.2	3.8	3.4	47.4	23.8	5.8	17.6	11.6	19.0	23.3
* Investment income	26.7	34.2	30.2	30.4	32.5	36.8	26.5	-	28.2	-11.6	0.4	7.1	13.2	-1.7
- Direct investment	**20.5**	**27.3**	**22.5**	**23.3**	**25.6**	**29.5**	**21.0**	**-**	**32.8**	**-17.3**	**3.2**	**10.0**	**15.2**	**-3.3**
of which: Reinvested earnings	*13.1*	*20.8*	*9.5*	*13.1*	*10.8*	*14.1*	*11.8*	*-*	*59.3*	*-54.6*	*38.8*	*-18.1*	*30.8*	*14.7*
(as % of direct investment)	*63.7*	*76.4*	*42.0*	*56.5*	*42.0*	*47.8*	*56.3*							
- Portfolio investment	0.9	1.0	0.5	0.5	0.7	1.4	1.2	-	16.9	-51.7	5.8	46.5	94.0	37.8
- Other investment	5.3	5.9	7.2	6.6	6.2	5.9	4.3	-	12.2	21.5	-8.5	-6.4	-4.5	-1.3

Source: Department of Statistics, Malaysia

[1/] Annual change over the corresponding period of 2004

Retained Earnings by Major Destination



Source: Department of Statistics, Malaysia

January to September 2005, the outflow of investment income was RM26.5 billion.

- In line with the large presence of multinational companies and their continued expansion as well as diversification of their operations in Malaysia, *direct investment* income outflows, which accounts for about 80% of total investment income outflows in 2004, grew at a compounded rate of 7.5% per annum, increasing to RM29.5 billion in 2004 from RM20.5 billion in 1999. These outflows were mainly profits and dividends accruing to foreign direct investors. Nevertheless, a substantial portion of these profits and dividends are retained in Malaysia for reinvestment. During the period 1999 to 2004, retained earnings accounted for about 55% of total direct investment income outflows, and credited as inflows of foreign direct investment in the financial account of balance of payments. The profits were reinvested mainly in the manufacturing sector and services sector, particularly financial services and

wholesale and retail trade sub-sectors. Major investors which have retained their profits for investment are from the US, Singapore, UK, Japan and Netherlands.

- Outflows of income from *other investment* remained relatively stable at around RM6.2 billion per annum, reflecting mainly interest payments arising from external borrowings. This trend reflects Malaysia's low external debt position, averaging 53% of GNP during the period 1999 to 2004 (End-2005: 42.2% of GNP). The outflows of RM4.3 billion in the first nine months of 2005 was mainly due to interest payments on Federal Government and Non-Financial Public Enterprise loans.

III. Conclusion

- The developments in the income account of the balance of payments is a reflection of the dynamics of investment in Malaysia and the openness of the economy. The strengthening of profits and dividends accruing to Malaysian investors investing abroad in recent years and the higher revenue from external reserves have contributed to the improvement in the income account deficit as a percentage of GNP. While the profits and dividends that accrue to foreign direct investors investing in Malaysia have remained large, the proportion of reinvestment of these earnings by the foreign direct investors continued to be significant.