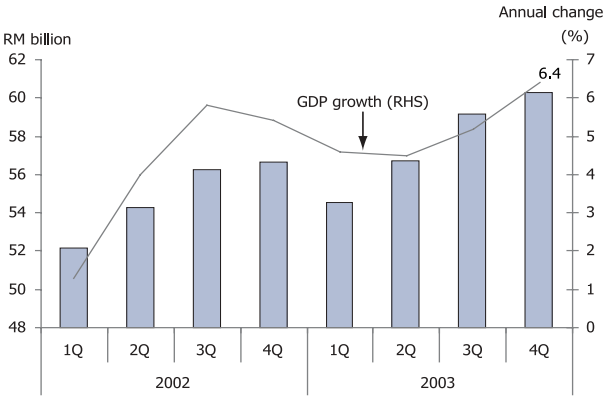
Economic and Financial Developments in the Malaysian Economy in the Fourth Quarter of 2003

OVERVIEW

Stronger growth momentum in the fourth quarter

Growth momentum in the Malaysian economy strengthened to 6.4% in the fourth quarter of 2003 from 5.2% in the third quarter. Growth was broad based, with positive contributions across all industries and demand components. A stronger upturn in exports gave added support to private sector activities and consumer spending. Rising consumer and business confidence, the strong underlying economic fundamentals and low interest rates contributed to the stronger growth momentum. An important development was the stronger expansion in investments. The combination of stronger domestic demand and rising exports resulted in a stronger-than-expected GDP growth of 5.2% for the whole of 2003.

Stronger real GDP growth in 4Q 2003



The main driver to the stronger growth performance was the manufacturing sector while most other sectors also recorded higher growth. Growth in the manufacturing sector accelerated to record a strong expansion of 12%, contributing 3.5 percentage points to GDP growth. Expansion was driven by strengthening domestic demand and reinforced by more robust exports. The stronger expansion was thus seen in both the export- and domestic-oriented industries (17.2% and 8.3% respectively; 3Q 2003: 11.5% and 6% respectively). Capacity utilization remained high across both sectors.

In the export-oriented industries, higher growth was recorded in the electronics, chemicals and rubber products industries. Production of electronics increased markedly following rising global demand across all markets and product segments. The spillover effects from the strong electronics performance as well as the improved external demand for resins and plastic products underpinned the growth in the chemical products industry. The strong expansion in the rubber products industry was attributed mainly to higher external demand for rubber gloves. In the domestic-oriented industries, the higher growth was supported by the increase in the construction-related industries and food and beverages.

Stronger performance in the manufacturing sector reinforced the recovery in the services sector, with growth strengthening to 4.5% (3Q 2003: 4.4%). Growth was underpinned by improved consumer sentiment, higher trade activity and resumption in tourist arrivals to pre-SARs levels of above one million since November. Of significance,

the wholesale and retail trade, hotels and restaurants sub-sector recorded a significant improvement during the quarter due to a pick-up in consumer spending during the Mega sales and year-end festivities.

The agriculture sector registered further expansion (2.2%) on higher production of crude palm oil and rubber, amidst the favourable prices. The mining sector also posted a stronger performance mainly on account of higher crude oil production.

Growth in the construction sector for the quarter was sustained by both civil engineering and the residential sub-sectors. In the latter, activities were supported by new housing starts as well as ongoing work on housing projects from previous launches. The incentives in the Economic Package, low interest rates and attractive financing packages sustained demand for houses. In the public sector, development expenditure remained high during the quarter.

On the demand side, growth in domestic demand was driven mainly by the private sector, with a stronger growth in household consumption. Supporting factors include low interest rates, increased access to financing, higher commodity prices, the positive wealth effect of higher equity prices and measures under the Economic Package which resulted in higher disposable incomes. Stronger external performance further raised consumer and business confidence during the quarter. For the first time since August 2002, sales of passenger cars turned around in December, reflecting in part some pent-up demand. The higher propensity to consume was encouraged by the annual year-end bonus payments amidst more favourable employment prospects, the seasonal festivities and higher export earnings. Consequently, private consumption recorded a stronger growth of 6.9% during the quarter. Public consumption was also higher, increasing by 11.1% due mainly to higher expenditure on supplies and services.

An important development was the stronger growth in investment during the quarter with gross fixed capital formation rising by 3.6%. Private investment in machinery and equipment strengthened as business sentiment improved and capacity utilization remained high, especially for the export-oriented industries in the manufacturing sector. Meanwhile, development expenditure of the Federal Government, though lower than in the corresponding quarter of 2002, remained high in the fourth quarter due mainly to expenditure on transportation and health facilities. The fiscal deficit, however, narrowed in the fourth quarter.

Revisions to the trade data (following the changeover to the Electronic Data Interchange System) show strong contribution of the export sector to expansion in output and improved overall business sentiments. As the trade data is still being reviewed, further statistical revisions in the demand components is expected. Accordingly, the demand components in the national accounts, in particular, the items "change in stocks" and "net exports", will be adjusted when the revisions to the trade data have been finalised.

Stronger economic growth in the fourth quarter was achieved with low inflation. Consumer prices registered a benign increase of 1.2%. A combination of rising capacity, higher productivity and more competitive pricing of goods and services continued to contain pricing power despite strengthening demand. The increase in property

prices had also been marginal and mainly for properties in choice locations.

In the external sector, revised data indicated that the trade surplus in the fourth quarter was larger at RM19.8 billion (3Q 2003: RM19.4 billion). Gross exports expanded strongly by 14.9% while imports increased at a faster rate of 16% (3Q 2003: 7.9% and 1.9% respectively). The expansion in gross exports was due to the significant increases in exports of manufactured goods and continued strong growth in exports of primary commodities. In the manufacturing sector, higher exports were due mainly to the upswing in the electronics cycle. Exports of agriculture and minerals remained strong, supported by high prices and export volume of palm oil, LNG and crude oil.

Rising domestic demand and exports lifted imports, with strong expansion across all categories of imports. In line with the pick-up in electronics exports, imports of intermediate goods, which are inputs for manufactured goods, recorded a strong growth. Imports of consumption goods expanded due mainly to higher consumption for the festive season. Improving consumer confidence also induced strong expansion in imports of consumer goods. Imports of capital goods grew at a robust rate, reflecting continued improvement in investor sentiment.

In the financial account, foreign direct investment was sustained. New long-term equity inflows doubled during the fourth quarter to RM2.8 billion, on a cash basis. The bulk of the foreign direct investment was channelled into manufacturing, particularly electrical and electronic and petroleum-related activities, and the oil and gas sector. Foreign direct investment in the services sector was mainly in financing and business services and wholesale and retail trade.

Gains in the external sector was reflected in an increase in reserves by US$4.2 billion to US$44.9 billion at the end of the quarter, due largely to long-term inflows associated with trade and investment activities. Net inflows of portfolio capital also rose in line with the more robust economic activity and improved investor sentiment. International reserves have risen further to US$48.4 billion as at 14 February 2004, enough to finance 7.6 months of imports and is 5.4 times the short-term external debt.

The ringgit exchange rate continues to be well supported by rising trade and investment flows, the gradual increase in foreign exchange reserves, low inflation, sustainable surplus in the current account, low external debt as well as a strong and resilient banking system.

Monetary policy supported stronger economic activity

Monetary conditions further support the strengthening growth momentum. There was stronger demand for credit, non-performing loans declined and the financial system continued to be supportive of private sector activities. Loans disbursed by the banking system rose at a strong annual rate of 14.3%. Compared with the previous quarter, loans disbursed to the household sector remained strong and the amounts disbursed to the business sector were higher.

As a consequence of the larger disbursements, total loans outstanding increased at an annual rate of 4.8% at end-December. Loans outstanding to the SMEs, which accounted for 17.3%

of all outstanding loans and 38.3% of total loans outstanding to businesses, rose more rapidly at an annual rate of 10%, the highest since July 2001. Outstanding loans to the SMEs expanded by RM2.4 billion and RM7.4 billion during the quarter and in 2003 respectively. Overall, financing provided by the banking system through extension of loans and its holdings of PDS expanded at a higher rate of 5.9% as at end-December. Total gross private sector financing raised through the banking system and from the capital market increased by 12.8% during the quarter.

The increase in all three monetary aggregates was also reflective of the significantly improved consumer and business sentiments. While stronger expansion in M1 (14.6%) reflected increased seasonal demand for liquidity from consumers and businesses, higher growth in M3 (9.7%) reflected the expansionary external sector and Government operations.

Despite the stronger demand for loans, average lending rates continued to decline given the more competitive environment with surplus savings. Notwithstanding larger capital inflows, BNM's liquidity operations ensured that money market rates remained stable. The sterilization cost continues to remain manageable. As a result, growth in money supply has been supportive of the higher level of economic activities.

Sound banking system

The banking system remained sound with the risk-weighted capital ratio (RWCR) at 13.4% as at end-December 2003. The profitability of the banking sector improved during the quarter with a higher gross operating profit of RM3.2 billion in the fourth quarter. Higher income, both interest (11.6%) and fee-based (+17.8%), offset the increase in operating costs during the quarter. Improving economic conditions resulted in lower additional loan loss provision by banking institutions. Recoveries also rose strongly by RM1.5 billion during the quarter.

The net NPL ratio (3-month basis) declined to 8.9% at end-December 2003. The level of NPLs for almost all the business sectors recorded improvements. The gross NPL ratio for the SMEs continued to decline to 14.7% at the end of December 2003. NPLs for the household sector were also lower at 8.1%.

Forward-looking indicators point to sustained stronger growth

The outlook for the global economy for 2004 has improved significantly with growth more broad-based in the major industrial countries and reinforced by strong growth in the Asian region. In the fourth quarter of 2003, growth in the US economy was sustained at a relatively strong pace of 4%, resulting in a stronger-than-expected overall growth of 3.1% for 2003. In Europe, the upturn in business sentiment and improving net exports provide positive indications of firmer economic recovery. In Japan, economic expansion from rising exports and capital expenditure and a consequent improvement in the unemployment rate have strengthened sustainable growth prospects.

The significantly improved external environment will reinforce stronger domestic demand in Malaysia. Higher consumer and business confidence is expected to reinforce the stronger momentum of growth in private consumption and investment while the public sector gradually consolidates.

Leading indicators continue to support strong and sustainable growth in the near to medium term. The Malaysian Institute of Economic Research Consumer Sentiments Index rose by 2.7 points to 115.5 points in the fourth quarter. This is the highest since 2001 and suggests that the upward trend in consumer spending is likely to continue into the coming months.

Similarly, the outlook for investment, especially private investment, also shows an up cycle. Rising investor sentiments in equities and larger funds raised by public listed companies through initial public offerings, stronger loan applications and higher investment approvals in manufacturing point to expanded business activities moving forward. In addition, the economy continues to enjoy the positive effects of strong commodity prices and rising intra-regional trade and a sharper up cycle in the electronics industry.

The improvement in sentiment is supported by strong underlying fundamentals that not only provide stable conditions for future growth but also allow risks to remain contained. The outlook for inflation remains low and stable while the increase in international reserves has been largely due to sustainable inflows from trade and long-term investment activities. In addition, the banking system is well capitalized with NPLs on a declining trend, suggesting a more resilient banking sector. Despite stronger consumer spending and higher debts by households, debt-servicing capability remains strong and sustainable due to faster growth of disposable income.

The current accommodative monetary policy stance will be maintained to provide support for the growth momentum to be sustained. In the meantime, excess capacity allows for economic expansion to continue without creating pressures on supply and inflation.