The Malaysian Economy in 2007

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THE INTERNATIONAL ECONOMIC ENVIRONMENT IN 2007

Global growth was strong in 2007, driven by above-trend growth in most industrial economies and buoyant growth in emerging market economies, despite moderation in the United States (US) economy, higher oil prices and the onset of financial market turbulence in the second half-year. The economies of the People's Republic of China (PR China), India and other large emerging economies such as Brazil and Russia increased their contribution to global growth, spurred by strong consumption and rising investment activity. Record-high commodity prices also buoyed growth in many resource-producing economies. Benefiting from these trends, the strong growth momentum in the Asian region was further supported by rising domestic demand, which more than compensated for some moderation in electronics exports. In contrast, downside pressures on the US economy increased towards end-year, affected by the emergence of the subprime mortgage problem and further downturn in the US housing sector, with its spillover to the global financial markets.

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The **US** economy displayed an uneven growth trend in 2007, but overall expanded at a more moderate pace than in 2006. After a below-trend first quarter due mainly to the weaker housing market, growth in the second and third quarters recovered to some extent, supported by non-housing investment activity and net exports that benefited from robust global growth and a weaker US dollar. Meanwhile, consumption spending remained supported throughout the year by favourable labour market conditions as reflected in positive job creation, low unemployment rates and favourable income growth. This was achieved despite the continued slowdown in the housing market, where house prices declined across the country amid elevated levels of inventory, falling home sales and rising foreclosures. However, by the fourth quarter, economic growth moderated significantly, reflecting in part the more significant implications from the ongoing correction in the housing market and the emerging impact from financial market turbulence.

Among the other major industrial countries, above-trend growth was sustained in 2007. Growth in **Japan** was supported by favourable export performance and investment activity linked

Table 1.1
World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2006	2007*e*	2006	2007*e*
World Growth	**4.9**	**4.7**	**-**	**-**
World Trade	**9.2**	**6.6**	**-**	**-**
Major Industrial Countries				
United States	2.9	2.2	3.2	2.9
Japan	2.2	2.0	0.3	0.1
Euro Area	2.8	2.6	2.2	2.0
United Kingdom[1]	2.8	3.1	2.3	2.4
East Asia	**8.1**	**8.4**	**2.6**	**3.7**
Asian NIEs	**5.4**	**5.5**	**1.6**	**2.2**
Korea	5.0	4.9	2.2	2.5
Chinese Taipei	4.9	5.7	0.6	1.8
Singapore	8.2	7.7	1.0	1.7
Hong Kong SAR[2]	7.0	6.3	2.0	2.0
People's Republic of China	**11.1**	**11.4**	**1.5**	**4.8**
ASEAN[3]	**5.9**	**6.3**	**6.7**	**3.4**
Malaysia	5.9	6.3	3.6	2.0
Thailand	5.1	4.8	4.6	2.0
Indonesia	5.5	6.3	13.1	6.3
Philippines	5.4	7.3	6.2	3.0
India[4, 5]	**9.6**	**8.7**	**4.8**	**4.8**

[1] Inflation based on Eurostat's harmonized index of consumer prices
[2] Inflation refers to composite price
[3] Includes Singapore
[4] Real GDP growth refers to fiscal year
[5] Inflation refers to wholesale price index
e Estimates

Source: International Monetary Fund, National Authorities, BNM estimates.

to growing demand from PR China, which has now surpassed the US as Japan's largest trading partner. These developments more than offset muted consumption growth, which was restrained due to flat nominal wage growth throughout the year. Growth momentum in the **euro area** also remained favourable in 2007, driven by growth in export demand to emerging regions and higher investment spending. Consumption also contributed to growth, supported by falling unemployment rates which reached the lowest levels since 1999. Elsewhere in Europe, the economy of the **United Kingdom** was sustained by strong performance of business and financial services, underpinned by rising employment and positive wage developments. However, some signs of weakening emerged in these economies in late 2007. Japan's housing investment was significantly affected by tighter building standards. In Europe including the UK, business and consumer confidence indices fell as the US subprime problems triggered tighter credit conditions and the housing markets in several of the economies began to soften.

In contrast to the trends in the developed economies, the strong growth momentum in the **Asian region** accelerated in 2007 as domestic demand and other growth drivers more than compensated for moderation in external demand due to the adjustment in the global electronics cycle and developments in the US. Domestic demand was buoyant, sustained by favourable labour market conditions, rising commodity prices and increased infrastructure spending. Growth also benefited from growing intra-regional trade, driven in part by strong performance of the PR China economy which expanded strongly by 11.4%. The Chinese economy was driven not only by sustained high investment growth and strong export performance but further lifted by higher private consumption which was encouraged by positive sentiments from rising equity markets in the first half-year and government measures including the development of rural areas. Elsewhere, **India** continued its robust expansion in 2007, led mainly by private consumption as strong economic growth contributed to rising income levels. Growth was also driven by investments as high retained corporate earnings boosted private investment. Meanwhile on the external front in Asia, sustained large current account surpluses and capital flows continued to contribute to higher foreign currency reserves in the regional economies. Notwithstanding this, the slowing US economy and a weaker US dollar had contributed to a narrowing of global imbalances, with US current account deficit reducing to about 5.7% of GDP. Other contributing factors include the increasing role of domestic demand in emerging economies, and sustained growth in euro area and Japan.

The high growth of the economies in **Latin America**, the **Middle East** and **emerging Europe** also provided a new source of demand for Asia, thus broadening growth away from the major industrial economies. Economic performance of economies within these regions continued at a vigorous pace in 2007, supported mainly by strongly positive economic developments including buoyant commodity prices, healthy domestic demand and robust export performance.

The prolonged period of high global growth since 2003 has created pressures on resource utilisation and resulted in the high prices of **commodities**. Oil prices have surged to record highs and also contributed to higher food prices due to increasing demand for substitutes to conventional fuels, including renewable energy such as biodiesel and ethanol. Adverse weather conditions have also contributed to rising food prices. Among the precious metals, gold prices rose sharply by 31% to USD 833.20 an ounce, reflecting the increasing popularity of gold as a hedge against inflation and as an alternative investment against a weakening US dollar. Recent trends suggest that underlying demand conditions for commodities remain firm,

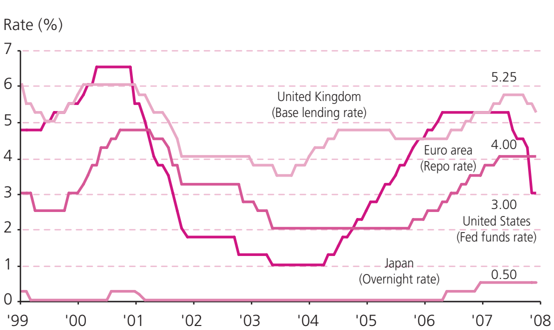
Chart 1.1
Crude Oil Prices: WTI 1-month

Source: Bloomberg

especially in fast-growing economic regions. Amid these developments, overall **global inflation** in 2007 began to rise. The US economy experienced increased pressure on price inflation, while the euro area continued to record rapid money and credit growth. Meanwhile, several countries in the Asian region faced price pressures from increases in food and fuel prices.

In the environment of rising inflationary pressures and generally favourable growth in the first half of 2007, **monetary authorities** in most major industrial and regional countries maintained a bias towards monetary tightening during this period. The US Federal Reserve Board (Fed) maintained policy interest rates at slightly above neutral levels throughout the early part of the year. However, the onset of financial market turmoil in August coupled with indications of a more significant deterioration in domestic demand amidst further weakness in the housing market prompted a marked shift towards easing, with the discount rate first being reduced in August followed by the easing of the federal funds rate beginning in September. In total, the Fed thus reduced the fed funds rate by 100 basis points during the last five months of 2007. Similarly, the Bank of England eased monetary policy in December 2007 to support growth as the impact of financial market turbulence intensified, after tightening in the first three quarters of the year. In the euro area, rising inflation prompted the European Central Bank (ECB) to also tighten in the first half-year to curb inflationary pressures but paused thereafter to assess the impact of volatile financial developments

Chart 1.2
Major Industrial Countries: Official Interest Rates



Source: National authorities

on growth. In the Asian region, PR China, Chinese Taipei, Korea and India also tightened monetary policy to contain inflation. However, the Philippines, Thailand and Indonesia reduced interest rates during the year to stimulate domestic demand as inflation moderated to within or below the governments' target ranges.

In the **financial markets**, equity markets especially in the emerging economies were generally buoyant in the first half of 2007. Thus many regional equity markets hit record highs, buoyed by strong capital inflows and optimism over the region's growth prospects. However, wider strains from the fallout of the US subprime mortgage sector began to intensify in the second half of 2007. Financial institutions, mainly in the US, undertook write-downs on subprime-related securities, and sought to repair their balance sheets by recapitalisation exercises. Financial institutions in the Asian region, on the other hand, were less affected due to the smaller direct exposure to the subprime-related markets. Nevertheless, rising uncertainty and concern over the problems in the global financial markets and the health of the global economy led to increased volatility in the regional equity markets, especially towards the end of the year.

In the **foreign exchange markets**, the US dollar broadly depreciated against all major and regional currencies in 2007. Dollar weakness was due mainly to the less favourable interest rate differentials and the relatively stronger performance of the other industrial and emerging market economies relative to the US. In addition to the more favourable growth in the euro area in 2007, the euro currency was also supported against the dollar as the ECB raised interest rates to the highest levels in six years. Pound sterling also advanced against the dollar especially in the first half-year due to the UK's stronger economic performance. Meanwhile, the yen appreciated significantly against the dollar in the second half of 2007 due to the unwinding of the yen carry trades in response to increased risk aversion following the subprime crisis. In the Asian region, most regional currencies also appreciated in 2007 against the dollar except for the Indonesian rupiah and Korean won. Regional currencies strengthened due to direct investments and portfolio inflows into the region and large trade surpluses amid sustained strong economic growth.

Table 1.2: Malaysia – Key Economic Indicators

	2005	2006	2007*p*	2008*f*
Population (million persons)	26.1	26.6	27.2	27.7
Labour force (million persons)	11.3	11.5	11.8	12.0
Employment (million persons)	10.9	11.2	11.4	11.6
Unemployment (as % of labour force)	3.5	3.3	3.3	3.2
Per Capita Income (RM)	18,966	20,841	23,103	24,651
(USD)	5,008	5,681	6,721	7,596[7]
NATIONAL PRODUCT (% change)				
Real GDP at 2000 prices[1]	5.0	5.9	6.3	5.0 - 6.0
(RM billion)	447.8	474.4	504.4	531.9
Agriculture, forestry and fishery	2.6	5.2	2.2	3.4
Mining and quarrying	-1.3	-0.4	3.2	6.0
Manufacturing	5.3	7.1	3.1	1.8
Construction	-1.8	-0.5	4.6	5.5
Services	6.7	7.2	9.7	7.7
Nominal GNI	10.2	12.0	13.1	8.9
(RM billion)	495.5	555.2	627.8	683.6
Real GNI	5.2	7.1	7.3	4.8
(RM billion)	423.7	453.8	486.7	510.0
Real aggregate demand[2]	7.3	7.0	10.5	5.6
Private expenditure[2]	7.6	7.0	11.8	6.5
Consumption	8.7	7.1	11.7	6.5
Investment	3.3	7.0	12.3	6.3
Public expenditure[2]	6.6	6.8	7.2	3.5
Consumption	6.4	5.0	6.4	6.0
Investment	6.8	8.9	8.0	0.5
Gross national savings (as % of GNI)	36.5	38.2	37.8	36.7
BALANCE OF PAYMENTS (RM billion)				
Goods balance	125.6	134.6	128.1	131.1
Exports (f.o.b.)	537.0	589.7	605.8	617.0
Imports (f.o.b.)	411.4	455.2	477.7	485.9
Services balance	-9.0	-6.9	1.0	1.0
(as % of GNI)	-1.8	-1.2	0.2	0.1
Income, net	-23.9	-17.4	-13.7	-16.1
(as % of GNI)	-4.8	-3.1	-2.2	-2.4
Current transfers, net	-17.0	-16.9	-16.1	-17.7
Current account balance[3]	75.7	93.4	99.3	98.3
(as % of GNI)	15.3	16.8	15.8	14.4
Bank Negara Malaysia international reserves, net[4]	265.2	290.4	335.7	-
(in months of retained imports)	7.7	7.8	8.4	-
PRICES (%change)				
CPI (2005=100)[5]	3.0	3.6	2.0	2.5 - 3.0
PPI (2000=100)[6]	5.9	5.1	6.7	-
Real wage per employee in the manufacturing sector	-0.02	-1.4	1.9	-

Note: Figures may not necessarily add up due to rounding.

[1] Begining 2007, real GDP has been rebased to 2000 prices, from 1987 prices previously

[2] Exclude stocks

[3] Figures for the year 2007 are estimates

[4] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account

[5] Effective from 2006, the Consumer Price Index has been revised to the new base year 2005=100, from 2000=100 previously

[6] Effective from 2006, the Producer Price Index has been revised to the new base year 2000=100, from 1989=100 previously

[7] Based on average USD exchange rate for the period of January-February 2008

p Preliminary

f Forecast

Table 1.3: Malaysia – Financial and Monetary Indicators

	2005		2006		2007*p*	
FEDERAL GOVERNMENT FINANCE (RM billion)						
Revenue	106.3		123.6		139.9	
Operating expenditure	97.7		107.7		123.1	
Net development expenditure	27.3		35.0		37.5	
Overall balance	-18.7		-19.1		-20.7	
Overall balance (% of GDP)	-3.6		-3.3		-3.2	
Public sector net development expenditure	66.1		86.5		103.2	
Public sector overall balance (% of GDP)	1.4		-0.3		-2.6	
EXTERNAL DEBT						
Total debt (RM billion)	197.7		184.5		187.4	
Medium- and long-term debt	150.7		141.7		133.0	
Short-term debt[1]	47.0		42.8		54.5	
Debt service ratio (% of exports of goods and services)						
Total debt	5.4		4.8		3.8	
Medium- and long-term debt	5.2		4.5		3.4	
	Change in 2005		**Change in 2006**		**Change in 2007**	
	RM billion	**%**	**RM billion**	**%**	**RM billion**	**%**
MONEY AND BANKING						
Money supply M1	9.8	8.5	17.0	13.7	27.6	19.6
M3	51.6	8.3	87.5	13	72.5	9.5
Banking system deposits	69.0	11.1	119.3	17.2	56.5	7.0
Banking system loans[2]	44.2	8.6	34.9	6.3	51.2	8.6
Loan-deposit ratio (end of year)	77.5%		70.5%		72.2%	
Financing-deposit ratio[3]	85.7%		79.0%		80.8%	
	2005		**2006**		**2007**	
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)	**%**		**%**		**%**	
Overnight Policy Rate (OPR)	3.00		3.50		3.50	
Interbank rates						
1-month	2.84		3.54		3.56	
Commercial banks						
Fixed deposit 3-month	3.02		3.19		3.15	
12-month	3.70		3.73		3.70	
Savings deposit	1.41		1.48		1.44	
Base lending rate (BLR)	6.20		6.72		6.72	
Treasury bill (3-month)	2.96		3.23		3.41	
Government securities (1-year)	3.30		3.55		3.53	
Government securities (5-year)	3.73		3.70		3.78	
	2005		**2006**		**2007**	
EXCHANGE RATES	**%**		**%**		**%**	
Movement of Ringgit (end-period)						
Change against SDR	8.9		1.8		1.7	
Change against USD[4]	0.5		7.0		6.8	

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Includes loans sold to Cagamas
[3] Adjusted to include holdings of private debt securities
[4] Ringgit was pegged at RM3.80=USD1 on 2 September 1998 and shifted to a managed float against a basket of currencies on 21 July 2005
p Preliminary

OVERVIEW

The Malaysian economy continued its strong growth momentum, expanding by 6.3% in 2007. Growth was driven by robust domestic demand despite a weaker external environment which led to moderation in export growth. Private consumption and investment activities expanded strongly during the year. Private consumption recorded the highest growth rate since 2000, buoyed by rising disposable income following high commodity prices, salary increments in both the public and private sectors, as well as favourable labour market conditions. Strong investment in the manufacturing, services, construction, and oil and gas industries, combined with positive business sentiment, supported expansion in private investment. This was further reinforced by large inflows of foreign direct investment.

The Malaysian economy continued its strong growth momentum, expanding by 6.3% in 2007. Growth was driven by robust domestic demand despite a weaker external environment

The stronger growth achieved reflected the benefits of a more diversified economic base, which has strengthened the economy's resilience to the external environment. While the contribution of the manufacturing sector remains substantial, of significance is the shift in the economic structure in the recent few years towards the services sector, which has become the main driver of growth. The services sector led growth in 2007 was supported by domestic demand activities and new growth areas in finance, business services and communications. The turnaround of the construction sector to record positive growth after three consecutive years of contraction, as well as the recovery in the mining sector added further impetus to growth. In contrast, reflecting weaker external demand, the manufacturing sector registered a more moderate growth, affected by the slowdown in the production and exports of electronics and electrical products, especially in the first half of the year. However, reflecting the relatively broad-based structure of the manufacturing sector, the overall manufacturing sector remained supported by sustained growth in the domestic-oriented and resource-based industries.

Labour market conditions strengthened during the year as a result of the strong economic growth. The economy was effectively at full-employment, with the unemployment rate remaining low at 3.3%. During the year, demand for workers increased, while fewer retrenchments were recorded. The firm labour market conditions exerted some upward adjustments in wages, but as labour productivity improved, wage pressure on inflation was contained.

The strong economic performance was achieved in an environment of relatively low inflation. Overall, the headline inflation rate increased at a slower pace of 2% in 2007, due mainly to price increases in the food and beverages category. Domestic food prices were largely influenced by higher global food prices, which were underpinned by structural and cyclical factors. Nevertheless, the pass-through from global prices to domestic prices were to some extent mitigated by the various policy measures undertaken by the authorities, and domestic factors such as the more competitive environment for retailers. Inflation, however, edged higher in the second half of the year as private consumption gathered further momentum while pressures from food and commodity prices also increased.

The external position strengthened in 2007 supported mainly by the large trade surplus, which was underpinned by strong growth of commodity exports and continued growth in non-E&E manufactured exports. Also contributing to the improved external position was that net outflows in the financial account moderated. For the first time, the services account recorded a surplus due mainly to higher tourism and transportation receipts. Reflecting improved economic prospects and investor confidence, inflows of foreign direct investment and portfolio investment were larger.

The strong growth performance in 2007 has generated significant economic momentum and the ongoing structural transformation has further strengthened Malaysia's macroeconomic fundamentals during the year. Resilient household and corporate sectors, strong banking system, prudent fiscal management, large trade account surplus as well as high international reserves, place the economy in a better position to weather uncertainties in the event of a more pronounced slowdown in global growth and increased volatility in the financial markets.

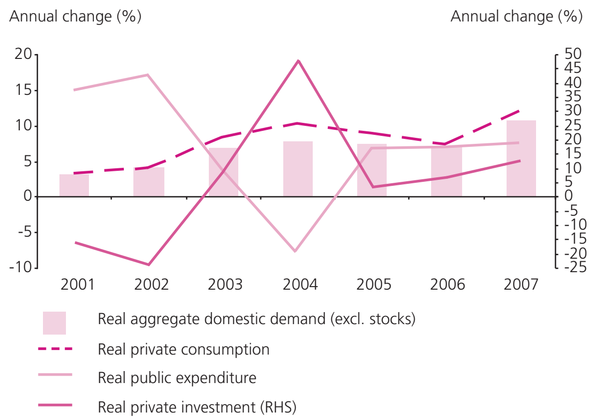
DOMESTIC DEMAND CONDITIONS

Domestic demand, especially private sector activities, led economic growth in 2007, in an environment of moderating external demand. **Domestic demand** grew strongly by 10.5% in 2007 (2006: 7%), driven mainly by the buoyant expansion in private consumption and investment. Consumer spending increased further, supported by the steady increase in disposable incomes, firm labour market and favourable financing conditions. Private investment activities remained strong, with higher levels of capital spending in the manufacturing, services and construction sectors as well as upstream oil and gas activities. The public sector, meanwhile, continued to be supportive of growth following implementation of projects and measures to enhance infrastructure and public sector delivery system.

Robust domestic demand was driven mainly by strong expansion in private sector activities

Private consumption increased at a faster pace of 11.7% in 2007 (2006: 7.1%). The robust consumer spending activities was reflected in favourable performance of major consumption indicators, such as imports of consumption goods, loans approved and disbursed for consumption, and credit card spending. Household spending was supported by the steady increase in disposable income and stable labour market conditions. Higher commodity prices, especially prices of crude palm oil and rubber, have led to rising disposable income of households in rural areas. The average monthly income of FELDA settlers in the palm oil scheme has doubled to RM2,800 per month (2006: RM1,386; 2001: RM700 per month), while rubber smallholders on average earned RM3,495 per month in 2007 (2006: RM3,486; 2001: RM650). In addition, the

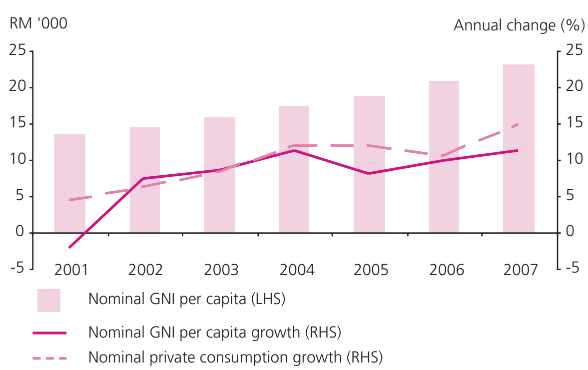
Chart 1.3
Real Domestic Demand Aggregates



upward salary adjustments for civil servants of between 7.5% to 35% further strengthened consumption in the second half of the year. Positive developments in the labour market such as rising job vacancies and declining retrenchment as well as the strong performance of the equity market further buoyed consumer sentiments.

During the year, the low interest rate environment and access to credit provided support for households' spending. Outstanding loans to households increased by 7.5% in 2007, driven mainly by loans for purchase of residential property and consumer durables. There was, however, no evidence of an increase in the vulnerability of household financial positions. The household debt to financial assets ratio was lower at 46.0% (2006: 49%), while the non-performing

Chart 1.4
GNI per Capita

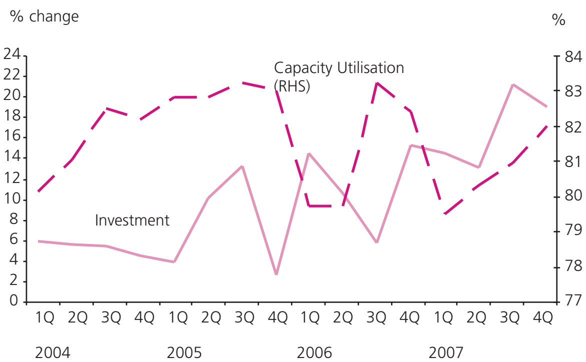


loan (NPL) ratio for household loans declined to 5.3% (2006: 7.1%). In addition, the NPL ratios for residential property, hire purchase and credit card loans were lower at 7.2%, 2.6% and 2.5% respectively (2006: 8.8%, 4.2% and 3.7% respectively).

Private investment expanded further in 2007, recording a higher growth rate of 12.3% (2006: 7%). Capital spending activities in most economic sectors, particularly manufacturing, services, construction and mining, accelerated further. The MIER's Business Conditions Index (BCI) which remained above the 100-point threshold level throughout the year, underscored positive business sentiment. In addition, the higher gross FDI inflows of RM46.1 billion in 2007 (2006: RM37.3 billion), mainly into the manufacturing, and oil and gas sectors, further reflected favourable investment climate. Healthy financial position of companies due to favourable corporate earnings over several years has also enabled them to fund the bulk of their capital expenditure from internal sources. Private investment activity also continued to be supported by favourable financing conditions. Loans approved and disbursed to businesses as well as private debt securities (PDS) issued for new activities continued to increase during the year. Loans disbursed to businesses increased by 9.5% while PDS issued for new activities rose to RM31.8 billion in 2007 (2006: RM21 billion).

Investment in the manufacturing sector was strong during the year, mainly supported by expenditure on new machineries and equipment.

Chart 1.5
Investment and Capacity Utilisation



Source: Malaysian Institute of Economic Research (MIER)

Sustained high level of capacity utilisation rate in the sector also underpinned additional capital spending activities. Major indicators such as imports of machineries and loans disbursed to the manufacturing sector indicated positive expansion in manufacturing investment. In 2007, the Ministry of International Trade and Industry approved a total of RM59.9 billion in 949 manufacturing projects (2006: RM46 billion), mainly for investment in electrical and electronics products, petroleum products and basic metal products industries. More than half of the approved investments were projects with foreign participation, indicating Malaysia's attractiveness as an investment destination. Foreign participation continued to be significant in the electronics sector, due largely to well established industry linkages and good infrastructure. In addition, capital investment per employee of the approved projects was higher, supporting a gradual shift towards higher capital-intensive projects.

Capital expenditure in the mining sector was driven mainly by robust activity in the upstream oil and gas sector, and reflected in the intensified exploration and production activities in deepwater oil fields. Investment in the services sector expanded mainly in the transportation sub-sector, attributable to expansion in air transport facilities. Capacity enhancement was also evident in the communications sub-sector due to ongoing network upgrading. Meanwhile, capital spending in the construction sector was supported by strong activities in high-end residential projects and the implementation of the 9MP projects.

The Government continued to play a prominent role in supporting and encouraging private sector activities. In Budget 2007, the Government reduced the corporate tax rate by two percentage points over two years, to 27% and 26% in 2007 and 2008 respectively. This helped reduce further the cost of doing business and accorded companies with greater capacity to expand capital spending.

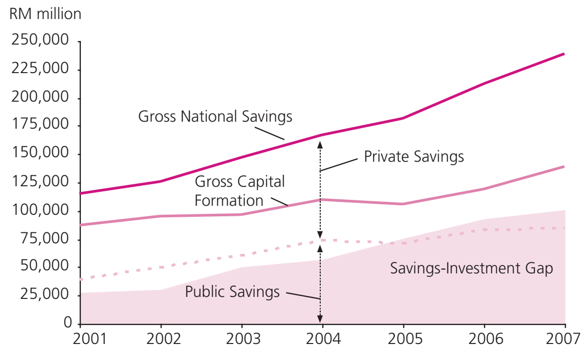
Public investment increased at a sustained rate of 8% in 2007 (2006: 8.9%). Public development expenditure continued to support growth, with large expenditure channelled into projects to further improve the economic and social services sectors of the economy as well as to reduce rural-urban and regional disparities. In the economic sector, expenditure was mainly for improving and upgrading both the industrial and public utilities infrastructure, enhancing the transportation system and increasing efficiency in agriculture production. In the social services sector, development expenditure continued to focus on the provision of essential services, namely education, healthcare and housing. Of importance, development expenditure on housing projects and healthcare facilities was accelerated during the year. In addition, the Government's commitment to develop human capital was evident in high disbursements to strengthen institutions of higher learning.

Capital expenditure by the non-financial public enterprises (NFPEs) continued to be high in 2007, attributed largely to exploration and production activities in the upstream oil and gas sector by PETRONAS. In addition, capacity expansion and upgrading programmes in the transportation, utilities and communication sectors also contributed to the growth in NFPEs' investment. Tenaga Nasional Berhad continued to spend on improving power generation and transmission systems to cater for rising demand for electricity. Capital spending in the communication sector focussed mainly on improving facilities in the area of broadband services. Meanwhile, investment in the transportation sector was largely for upgrading and capacity expansion exercise by both the port authorities and railway operator.

Public consumption increased steadily by 6.4% in 2007 (2006: 5%), largely on account of stronger growth in emoluments and higher expenditure on supplies and services and defence. The increase in emoluments expenditure was more pronounced in the second half-year as a result of the upward salary adjustment for civil servants of between 7.5% and 35%. Meanwhile, the increased expenditure for supplies and services was largely due to continued upgrading of public sector's administrative machinery and maintenance of buildings and fixtures.

In spite of higher public consumption, public sector savings remained high at RM83.8 billion in 2007 or 13.3% of GNI, with the main source of increase due to the large operating surpluses of the NFPEs. This increase was attributed to higher cash flows generated as a result of high commodity prices and strong export earnings.

Chart 1.6
Gross National Savings and Savings-Investment Gap



Meanwhile, private sector savings increased to RM153.4 billion or 24.4% of GNI in 2007 (23.2% of GNI in 2006), reflecting healthy household balance sheets. Banking sector deposits held by individuals rose to RM330.6 billion during the year (2006: RM299.1 billion). Overall, **gross national savings (GNS)** increased further by 11.9% to RM237.1 billion and the share of GNS remained high at 37.8% of GNI (2006: 38.2%). Despite higher investment by both public and private sector, the strong increase in the GNS led to a larger savings-investment surplus of RM99.3 billion or 15.8% of GNI in 2007.

SECTORAL REVIEW

Growth in 2007 was broad based, reflecting expansion across all key sectors of the economy. The growth was led by the strong performance in the services sector, and supported by the construction and mining sectors. Reflecting the increasing prominence of the services sector as a contributor to growth, the sector which grew by 9.7%, accounted for five percentage points of the total real GDP growth in 2007. After three years of decline, the construction sector turned around to register a positive growth of 4.6%, driven mainly by the civil engineering sub-sector which benefited from implementation of projects under the Ninth Malaysia Plan and in the oil and gas sector. The mining sector also recorded an improved performance led by higher production of crude oil following the coming on-stream of the Kikeh oil field. Meanwhile, the manufacturing and agriculture sectors recorded moderate expansion in 2007. The former was tempered by weak performance of export-oriented industries, especially electronics and electrical products, in an environment of subdued external demand, while the latter was weighed down by lower production of crude palm oil and rubber.

Services Sector

The **services sector** has, in recent years, emerged as a key driver of growth in the economy. The sector has been the most important contributor, expanding at an average annual growth rate of 6.8% between 2003-2007 and exceeding the average real GDP growth of 6%. In the recent two years, growth picked up substantially to above 7%, supported by robust domestic demand and tourism activities. Reflective of strong growth in the sector, total approved investments by MIDA in the services sector increased by 17.8% to RM65.4 billion in 2007 (2006: RM55.5 billion).

The services sector recorded the strongest growth in ten years reflecting broad-based expansion

Of importance, the strong performance of the services sector was broad based, with the key drivers being the real estate and business services; finance and insurance; communication; and wholesale and retail trade sub-sectors. These sub-sectors combined registered an average annual growth rate of 7.7% over the period 2003-2007. A notable development has been the prominence of new growth areas in the services sector which are mainly knowledge-intensive activities, such as telecommunications, Islamic finance, shared services and outsourcing (SSO) and IT services. The strong performance of these sub-sectors was due to rising demand and changes in consumer preference in line with improved income levels. The growth was also supported by policy initiatives to promote these areas. Given these developments, the services sector has developed its own endogenous strength and has become less reliant on the performance of other sectors.

The services sector continued on a strong growth momentum in 2007, expanding by 9.7%, the highest growth rate since 1997. It contributed five percentage points of the overall GDP growth of 6.3%, resulting in its share of total GDP rising to 53.4% in 2007 (2006: 51.8%). The growth was underpinned by strong domestic demand and further supported by tourism-related activities. Steady increases in incomes amidst the high commodity prices and revision to the civil service salary, as well as robust capital market activity and higher tourism activity as a result of the Visit Malaysia Year 2007 led to the strong demand for services during the year.

Table 1.4
Growth Performance of the Services Sector during 2003-2007 (at constant 2000 prices)

	2002	2007*p*	2003-2007
	RM million		CAGR[1] (%)
Total GDP	**377,559**	**504,408**	**6.0**
Services	**193,500**	**269,276**	**6.8**
Intermediate services	**82,833**	**117,564**	**7.3**
Finance and insurance	38,549	53,726	6.9
Real estate and business services	16,843	26,061	9.1
Transport and storage	14,637	18,942	5.3
Communication	12,805	18,834	8.0
Final services	**110,666**	**151,712**	**6.5**
Wholesale and retail trade	42,433	61,511	7.7
Accommodation and restaurant	8,553	11,515	6.1
Electricity, gas and water	11,759	15,137	5.2
Government services	24,816	34,890	7.1
Other services	23,105	28,659	4.4

p Preliminary
[1] Compound annual growth rate
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table 1.5
Emerging Areas of Growth in the Services Sector

	As at end	
	2006	2007*p*
Islamic Finance		
Islamic Banks in operation	10	11
Takaful companies in operation	8	9*
IT Services and SSO[1]		
No. of MSC-status companies approved	1,728	1,994
Amount of approved private investment in MSC (RM billion)	21.2	24.9
No. of Operational Headquarters	133	150
No. of International Procurement Centres	191	203
No. of Regional Distribution Centres	17	18
Private Higher Education		
No. of private higher educational institutes (IPTS)	515	525
No. of students in IPTS (For the year)	323,787	308,978
No. of foreign students in IPTS (For the year)	36,449	33,604
Private Healthcare		
No. of private hospitals	210	195
No. of private hospitals participating in promoting health tourism	35	35

[1] Shared services and outsourcing
p Preliminary
* Including one new retakaful operator that commenced operation in 2007

Source: Multimedia Development Corporation, Malaysian Industrial Development Authority, Ministry of Higher Education, Ministry of Health, Association of Private Hospitals of Malaysia and Bank Negara Malaysia

The growth in the new services sub-sectors, such as Islamic finance and ICT services is also a result of initiatives taken by the authorities to promote these activities.

Strong domestic demand supported growth in the wholesale and retail trade; accommodation and restaurant; and other services sub-sectors. The **wholesale and retail trade** sub-sector, which grew strongly by 12.2%, benefited from the robust expansion in private consumption activity during the year. Meanwhile, the **accommodation and restaurant** sub-sector was supported by increased tourism activity, arising from a sharp rise in foreign tourist arrivals of 19.5% and robust domestic tourism. As a result, the average occupancy rate of hotels in the country rose to 70% from 65.5% in 2006. Encouraged by the strong consumer spending and tourist arrivals, about 31 new shopping malls were opened in 2007. Only the distributive trade activity in the automotive sector remained soft, especially in the first half of the year, due to the weak second-hand car market. Meanwhile, rising disposable incomes led to increased demand for private healthcare, beauty care, entertainment-related activity and private education, which contributed to the sustained expansion in the **other services** sub-sector during the year.

A significant development during the year was the robust growth in both the finance and insurance; and real estate and business services sub-sectors, which grew by 10.7% and 20.6% respectively. The combined share of the two sub-sectors to overall GDP rose to almost 16% by end-2007, with the **finance and insurance** sub-sector accounting for a higher share of 10.7%. The growth was driven by increased bank intermediation and fee-based activity. Fee-based revenue grew strongly by 33% during the year

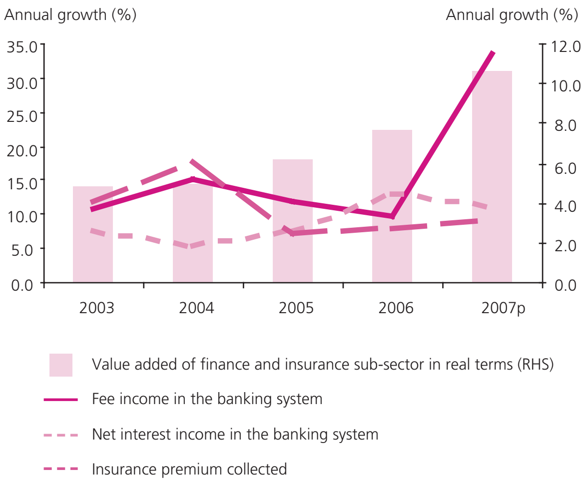
Table 1.6
Services Sector Performance at Constant 2000 Prices

	2006	2007*p*	2006	2007*p*
	Annual change (%)		Share to GDP (%)	
Services	**7.2**	**9.7**	**51.8**	**53.4**
Intermediate services	7.6	12.0	22.1	23.3
Finance and insurance	7.7	10.7	10.2	10.7
Real estate and business services	9.9	20.6	4.6	5.2
Transport and storage	5.2	10.2	3.6	3.8
Communication	6.8	6.9	3.7	3.7
Final services	7.0	7.9	29.6	30.1
Wholesale and retail trade	7.1	12.2	11.6	12.2
Accommodation and restaurant	6.0	10.9	2.2	2.3
Electricity, gas and water	5.2	4.0	3.1	3.0
Government services	9.8	4.2	7.1	6.9
Other services	4.7	5.0	5.8	5.7

p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.7
Performance of the Finance and Insurance Sub-sector vis-à-vis Related Indicators



p Preliminary
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

supported by underwriting and corporate advisory activity as well as innovation of products and services in wealth and portfolio management, remittances and trade finance services.

Growth in the finance segment was also supported by expansion in Islamic finance. Initiatives under the Malaysia International Islamic Financial Centre gathered momentum with approval given to Islamic banks to set up International Currency Business Units (ICBU). One foreign-owned Islamic bank and two takaful companies (including one retakaful operator) commenced operation in 2007, bringing the total to 11 Islamic banks and nine takaful companies in operation. In 2007, total Sukuk approved amounted to RM121 billion, an annual increase of 189%. Meanwhile, the introduction of new investment-linked as well as medical and health insurance products contributed to the growth in the insurance segment.

The **real estate and business services** sub-sector recorded a strong growth of 20.6% during the year. In particular, the business services segment was supported by strong brokerage activity in line with the increased turnover in the equity market. Growth was further supported by IT-related services, including SSO, as well as professional and consultancy services arising from robust construction, and oil and gas activity. During the year, 27 new SSO companies (including 19 wholly foreign-owned) started operations in the Multimedia Super Corridor (MSC) area, bringing the total SSO companies in the MSC to 123 (2006: 96 companies), while total spending on IT services grew by 24.9%. In addition, real estate activity also picked up momentum due to increased property transactions following several incentives announced by the Government, such as the exemption from the Real Property Gains Tax and liberalisation on property ownership by foreigners.

The **transport and storage** sub-sector registered a better performance due to improvements in air transportation and supporting services such as freight forwarding and warehousing. Higher travel among foreign and local tourists as well as aggressive expansion in the airline industry, especially in the low-cost carrier segment with the introduction of new destinations and competitive air

Table 1.7
Selected Indicators for the Services Sector

	2006	2007*p*
	Annual change (%)	
Utilities		
Electricity production index	5.1	3.9
Wholesale & Retail Trade and Accommodation & Restaurant		
Consumption credit disbursed	-0.5	9.2
Tourist arrivals	6.8	19.5
Total sales of motor vehicles	-11.1	-0.7
Finance & Insurance and Real Estate & Business Services		
Loans outstanding in the banking system	6.3	8.6
Insurance premiums	5.7	8.9
Bursa Malaysia turnover (volume)	93.3	82.2
Transport & Storage and Communication		
Total container handled at Port Klang and PTP (TEUs)	14.2	13.6
Airport passenger traffic	2.2	6.2
Air cargo handled	5.7	-5.5
SMS traffic	51.6	70.6
	%	
Penetration rate:		
- Internet dial-up	14.0	14.3
- Broadband	3.3	5.0
- Moblie phone	72.3	85.1
- Fixed line	16.1	16.3

p Preliminary

Source: Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Senai Airport Terminal Sdn. Bhd; Malaysian Automotive Association; Bursa Malaysia Berhad; Malaysian Communications and Multimedia Commision; Ministry of Finance; PTP, Port Klang Authority, Syarikat Prasarana Negara Berhad; Malaysia Tourism Promotion Board and Bank Negara Malaysia.

fares further boosted the passenger-related air transport. Meanwhile, the water transportation segment benefited from expansion in carriage of LNG exports and higher freight rates.

The stronger domestic demand supported growth in the **communication** sub-sector reflecting higher usage of voice and data services as well as an increase in the number of subscribers, particularly in the cellular segment. The overall blended average revenue per user (from both post-paid and pre-paid subscribers) increased by 14.5% to RM63 in 2007 (2006: RM55). The rapid developments in the ICT industry and the continued expansion in Internet and broadband services coverage nationwide have also encouraged increased subscriber base in the Internet and broadband segments.

Manufacturing Sector

The **manufacturing sector** expanded by 3.1% in 2007 (2006: 7.1%) as the growth in domestic-oriented and selected resource-based industries cushioned the effects of the subdued external demand for electronics and electrical (E&E) products. Resource-based industries such as rubber, petroleum, and chemicals and chemical products expanded further, supported mainly by robust demand from the Asia-Pacific region. Similarly, the domestic-oriented industries benefited from the recovery in the construction sector and strong growth in private consumption. Against this backdrop, the overall capacity utilisation rate in the manufacturing sector remained stable at 76% amidst the expansion in investment and regular maintenance of plants in several industries. In terms of contribution to the overall GDP, the manufacturing sector's share declined slightly to 30.2% (2006: 31.1%).

The diversified manufacturing base cushioned the impact of the slowdown in the electronics and electrical industry

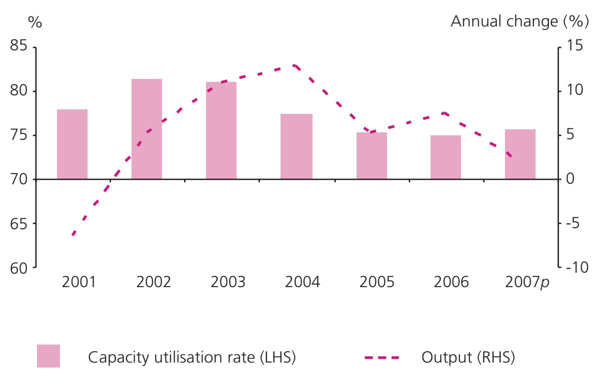
Despite the decline in output of E&E products, the **export-oriented industries** continued to expand, albeit marginally by 0.7%. The **E&E** performance was affected particularly in the first half of the year by the subdued external demand for computers and parts from the US, and lower production of semiconductors as a result of excess supply in the global semiconductor market. In the early part of the year, the slowing investment in equipment and software by the US corporate sector, which was due mainly to uncertain business environment as well as the delayed release of the service pack for the new operating system, affected the production of computers and parts segment as more than half of Malaysia's exports of these products are to the US. Nevertheless, production of computers and parts turned positive in the second half of the year in line with the improvement in US investment in equipment and software.

Table 1.8
Performance of the Manufacturing Sector

	2006	2007
	Annual change (%)	
Value-added (at constant 2000 prices)	**7.1**	**3.1**
Overall Production	**7.5**	**1.9**
- Export-oriented industries	**7.5**	**0.7**
of which:		
Electronics and electrical products (E&E)	7.9	-0.9
Chemicals and chemical products	3.2	1.8
Petroleum products	13.6	5.4
Rubber products	7.2	5.9
Off-estate processing	5.7	-0.5
- Domestic-oriented industries	**7.2**	**6.8**
of which:		
Construction-related products	3.2	5.0
Fabricated metal products	26.5	19.4
Exports	**10.1**	**0.3**

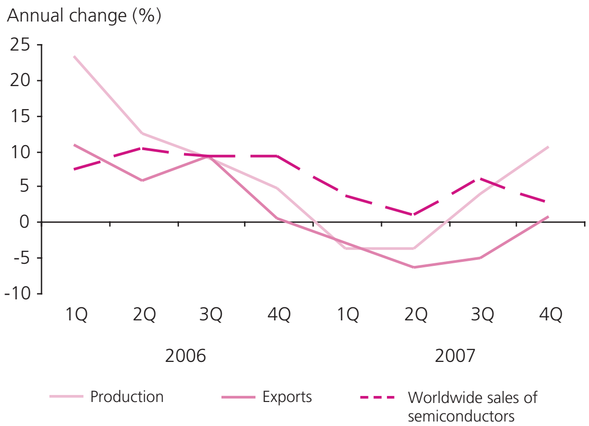
Source: Department of Statistics, Malaysia

Chart 1.8
Capacity Utilisation Rate in the Manufacturing Sector



p Preliminary
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Chart 1.9
Production and Exports of Electronics



Source: Department of Statistics, Malaysia
Semiconductor Industry Association (SIA)

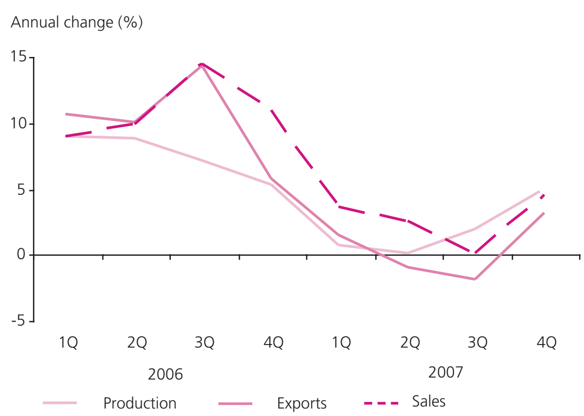
Meanwhile, production of semiconductors slowed down in the early part of the year as major manufacturers adjusted their excess inventories in some segments. Thereafter, production picked up gradually due to demand from the non-US market, particularly the euro area, Japan and PR China, driven by demand for end-products in the consumer and telecommunication segments. Meanwhile, the performance in the electrical products segment continued to be affected by the transition from old products like cathode-ray tube televisions and VCD players to higher value-added products like high definition LCD televisions, DVD recorders and Blu-ray players.

The E&E industry also faced declining average selling prices for both memory chips and microprocessors due to strong competition among major global producers. Amidst the more challenging environment, the E&E manufacturers in the country continuously moved up the value chain to produce higher value-added products to remain competitive. These included intensification of research and development efforts and in-sourcing activities for their related companies worldwide.

In the resource-based industries, output growth in the **rubber products** sector was sustained as the better performance in the tyre and tube segment offset the moderate growth in rubber gloves. The strong growth in the tyre and tube sub-sector was due to a major producer moving up the value chain to produce higher value added tyres. Meanwhile, output of rubber gloves moderated in the second half of the year after a strong performance in early 2007 due partly to rising input price. The **petroleum products** sector continued to benefit from increased production of liquefied natural gas amidst the strong domestic demand from the power generation sector and energy-intensive industries such as steel, cement and rubber industries.

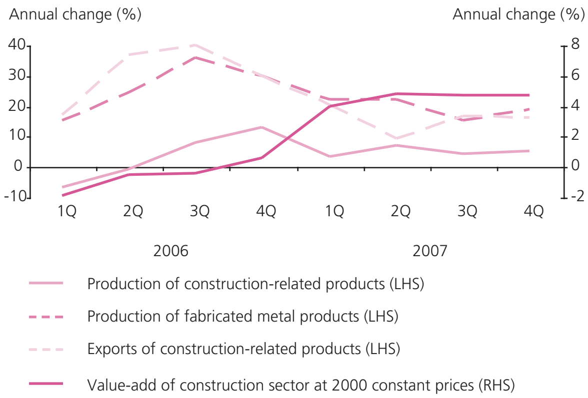
In the **chemicals and chemical products** industry, while the basic chemicals and other chemical products recorded stronger increases, the development was weighed down by weaker performance in the plastic products segment. The basic chemicals sector was driven by higher output of industrial gases owing to demand from related industries such as steel and petrochemicals which use gas as feedstock. In addition, the recovery in the construction sector had also contributed to the increased demand for industrial gases used for welding. The other chemical products segment, particularly pharmaceuticals, medicinal chemicals and botanical products were supported by increased external demand during the year. Meanwhile, output of plastic products was dampened by weaker demand from the E&E sector as well as the automotive industry. The increasing price of raw materials, especially resins which is a derivative of crude oil, also influenced the production of plastic products during the year. However, the recovery in the automotive sector in the second half of the year helped to cushion part of the impact.

Chart 1.10
Manufacturing Sector: Production, Exports and Sales



Source: Department of Statistics, Malaysia

Chart 1.11
Industries Related to the Construction Sector were Supported by Domestic and External Demand



Source: Department of Statistics, Malaysia

Output of **off-estate processing** contracted during the year, broadly in line with the performance of upstream activities of crude palm oil and rubber, while the **textiles and wearing apparel** industry was affected by weaker external demand.

Growth in the **domestic-oriented industries** was supported by strong domestic demand during the year. Production of **construction-related materials** picked up in tandem with the increased activity in the construction sector. Growth in these industries, particularly iron and steel, and cement was also reinforced by strong external demand from neighbouring countries such as Singapore, Indonesia and Vietnam, where construction activities have been robust. At the same time, local steel millers also increased exports to take advantage of higher international prices relative to domestic prices. The pick-up in construction activity had also led to higher demand for related fabricated metal products such as metal fixtures and furniture.

Consumer-related products, such as food, beverages and tobacco, showed an improvement underpinned by strong private consumption. Another notable development was that measures taken to promote the Halal food industry began to yield results as there was a discernable increase in exports of Halal food to the Middle East market. Meanwhile, the **transport segment** was affected by the continued sluggish second-hand car market in the first half year. Nevertheless, demand for new motor vehicles picked up in the second half of the year, supported by rising incomes, the launch of new models, and the continued access to financing at competitive rates.

Agriculture Sector

The agriculture, forestry and fishing **(agriculture) sector** expanded at a moderate pace of 2.2% in 2007, supported by food-related activity, particularly livestock, paddy, and vegetables. The strong performance in food-related activity more than offset the weaker performance in key industrial crops, namely crude palm oil and rubber, which account for about 36% of the total value-add in the agriculture sector. Biological yield down-cycle and inconsistent weather patterns were the main contributory factors for the less favourable performance of these industrial crops during the year.

The agriculture sector continued to expand mainly supported by food-related activity

Table 1.9
Agriculture Sector:
Value Added, Production and Exports

	2006	2007*p*
	Annual change (%)	
Value-added	**5.2**	**2.2**
Industrial crops	**4.1**	**0.4**
Production of which:		
Crude palm oil	6.1	-0.4
Rubber	14.0	-6.4
Saw logs	-4.7	-5.3
Cocoa beans	14.2	10.2
Food crops	**6.8**	**4.9**
Production of which:		
Fish	11.4	0.2
Livestock[1]	18.0	9.9
Vegetables	3.8	8.6
Fruits	5.3	-2.8
Exports (RM million)	**12.5**	**24.4**

[1] Refers to Peninsular Malaysia only
p Preliminary

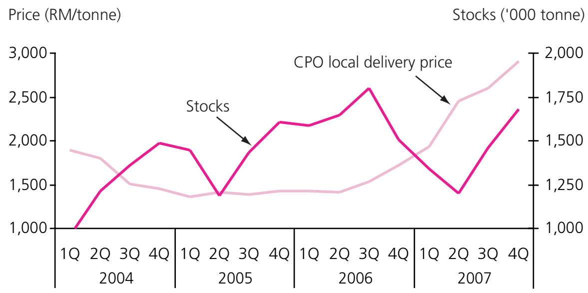
Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Malaysian Rubber Board
Forestry Department (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Fisheries Department, Malaysia
Veterinary Services Department, Malaysia
Department of Agriculture, Malaysia

Crude palm oil production declined, albeit marginally by 0.4%, to 15.8 million tonnes in 2007. This was the first decline in output since 1998 and was due to the biological yield down-cycle, which normally occurs every three to four years. Average national yields, as measured by fresh fruit bunches, declined by 2.9% to 19 tonnes per hectare in 2007. This was further exacerbated by damage in harvest in the southern region of Peninsular Malaysia due to floods in the early part of the year. Consequently, overall production in Peninsular Malaysia declined by 3.8%, which was partially mitigated by higher output in Sabah and Sarawak, which rose by 2.9% and 8.8% respectively.

A major development was the sharp increase in crude palm oil (CPO) prices of 62.6% to reach a historic average high of RM2,472 per tonne in 2007. This was driven by strong demand for palm oil, both for edible oil as well as for use as biofuel, which caused the CPO prices to be more closely correlated to crude oil prices. Prices increased sharply despite the increase in stocks, which rose by 11.6% to 1.68 million tonnes in 2007. Given this development, the price discount of palm oil to soybean oil and rapeseed oil narrowed to USD101 per tonne and USD189 per tonne respectively (2006: USD121 per tonne and USD316 per tonne respectively).

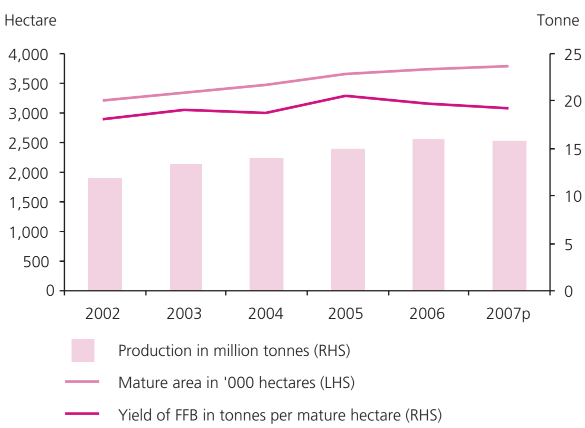
Production of **natural rubber** contracted by 6.4% to 1.2 million tonnes in 2007 due to weather-related factors. In the early part of the year, drier-than-usual weather conditions resulted in a severe wintering of rubber trees and subsequently by frequent instances of heavy rainfall which disrupted tapping activities, especially amongst the smallholders. The lower output was also influenced by the continued reduction in the total acreage of rubber areas. In 2007, total acreage of rubber land declined by 1.8% due to conversion to other crops, while about 98,300 hectares or 9% of total mature area was left idle. It is estimated that if the idle land was to be brought into production, the rubber output could have increased by about 9%. Despite these developments, Malaysia remained as the third largest producer of natural rubber in the world in 2007 after Thailand and Indonesia.

Chart 1.13
Palm Oil Price and Stocks



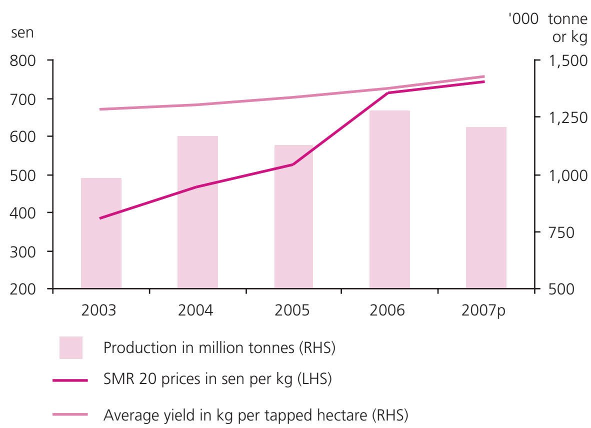
Source: Malaysian Palm Oil Board (MPOB)

Chart 1.12
Oil Palm: Area, Production and Yield



p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

Chart 1.14
Natural Rubber: Production, Prices and Yield



p Preliminary
Source: Malaysian Rubber Board (MRB) and Department of Statistics, Malaysia

The Malaysian benchmark rubber price, SMR20, rose further by 3.9% to average 737 sen per kilogramme in 2007. The movement in rubber prices during the year was strongly correlated with crude oil and synthetic rubber prices. In tandem with a strong upward trend in crude oil prices, rubber prices ended the year at 837 sen per kilogramme. Prices were also influenced by the surge in global demand, particularly in PR China.

The **food crops** sub-sector continued to perform favourably in 2007, with the value-added growth expanding by 4.9% (2006: 6.8%). The commencement of several large companies undertaking deep-sea tuna fishing, as well as the commercial livestock rearing activity helped enhance output in the food sub-sector.

In the **forestry** sub-sector, logging activities declined further in 2007, with output of logs contracting by 5.3%. The development is in tandem with the conservation efforts implemented as part of sustainable forest management. As a result of this and combined with lower demand for saw logs from Japan, export volume of saw logs and sawn timber declined during the year. The lower demand of logs from Japan was due to an abrupt change in the housing regulation which affected construction activity. As a result, export prices of logs fell by 4% to RM455 per cubic metre.

In ensuring sustainable forest management and continued supply of raw materials for wood-based downstream activities, the Government accelerated efforts to increase the size of forest plantation, with the aim of having 270,000 hectares planted. As at end-2007, 16 companies have been identified to take part in the scheme, which involved the development of 58,935 hectares of forest plantations, mainly rubberwood. These companies have received soft loans of RM267.6 million from the Government to undertake the forest plantation activities.

Cocoa output grew at a strong pace for the second consecutive year, rising by 10.2%, due mainly to favourable weather conditions. Output was further enhanced by the strong increase in productivity, especially in the rehabilitated areas under the Cocoa Rehabilitation Programme which came into maturity in 2007. Average national productivity increased by 18.3% during the year to an estimated 1,204 kilogrammes per hectare (2006: 1,018 kilogrammes per hectare).

Mining Sector

The **mining sector** rebounded to record a positive growth of 3.2% in 2007 due to higher output of both crude oil and natural gas, in an environment of stronger energy prices. Crude oil benefited from the coming on-stream of Malaysia's first deepwater oil field in Kikeh, Sabah, while natural gas output picked up following the recommencement of part of the MLNG2 plant after an upgrade exercise in the previous year. Following higher energy prices during the year, export revenue from minerals rose further to account for a larger share of 10.1% of total gross exports (2006: 9.7%).

The mining sector rebounded on increased production capacity amidst the higher prices

Production of **crude oil (including condensates)** averaged 695,276 barrels per day in 2007, representing an increase of 4.3%. The higher production was mainly driven by the 10.7% increase in crude oil output in Sabah to 90,394 barrels per day arising from the coming on-stream of the Kikeh oil field in August 2007. Production in Peninsular Malaysia, which contributes about 55% of total output of crude oil of the country, increased by 2.3% in 2007. Meanwhile, condensates continued to contribute significantly, accounting for about 19% of the total production of crude oil in the country.

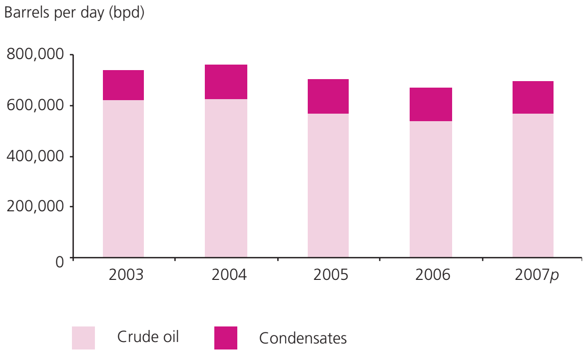
Table 1.10
Mining Sector:
Value Added, Production and Exports

	2006	2007*p*
	Annual change (%)	
Value-added	**-0.4**	**3.2**
Production		
of which:		
Crude oil and condensates	-5.2	4.3
Natural gas	-0.4	1.4
Exports	**8.6**	**7.5**

p Preliminary

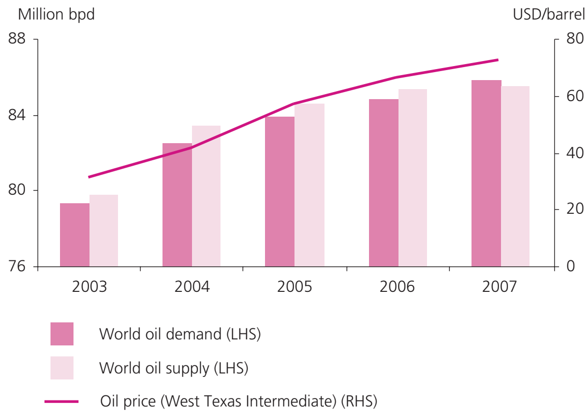
Source: PETRONAS
Department of Statistics, Malaysia

Chart 1.15
Production of Crude Oil and Condensates



p Preliminary
Source: PETRONAS

Graph 1.17
World Oil Supply and Demand

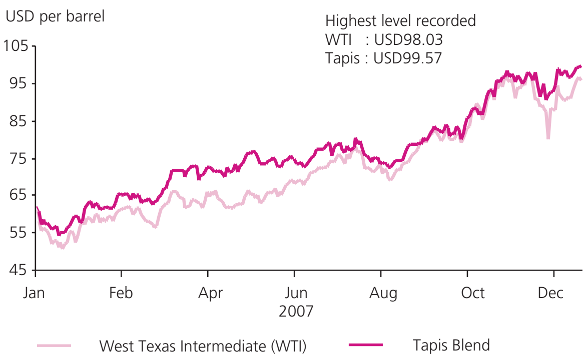


Source: International Energy Agency (IEA)

Output of **natural gas** expanded by 1.4% to 5,854 million standard cubic feet per day (2006: -0.4%). The increase was due to the recommencement of a gas liquefaction train at the MLNG2 plant in Sarawak after a capacity upgrade. As a result, natural gas production in Sarawak, which accounts for around 60% of total output in Malaysia, saw an increase of 4.7% (2006: -0.5%). The increase was mainly to cater for higher demand from Korea, one of the world's largest importers of LNG.

During the year, the global energy market continued to be characterised by strong upward pressure on prices. The price of the Malaysian benchmark oil grade, Tapis Blend, rose further by 11.5% to average USD76.46 per barrel, marking the sixth consecutive year of increase since 2001. The Tapis Blend, which opened the year at USD57.44 per barrel, increased continuously during the course of the year to reach its highest level of USD99.57 per barrel at end-year, before proceeding to breach the psychological threshold of USD100 per barrel on the first day of trading in 2008, at USD101.40 per barrel.

Chart 1.16
Crude Oil Prices (1-Month Futures) in 2007



The upward momentum in prices occurred against a backdrop of strong global demand amidst tight supply conditions. A significant development was that in 2007, world oil demand (85.8 million bpd) had exceeded world oil supply (85.5 million bpd), driven by robust global economic growth, especially in emerging market economies. Prices were also influenced by the involvement of speculative funds and asset managers in the global oil futures market, amidst continued geopolitical concerns in major oil-producing regions during the year. In line with developments in the global oil prices, the Malaysian natural gas prices also rose by 6.7% to RM1,154 per tonne.

Oil reserves in the country continued to increase in 2007, rising to 5.35 billion barrels or 22 years of lifespan, following the discovery of several deepwater oil fields off-shore Sabah, including Kikeh. The deepwater fields now account for about one-quarter of the oil reserves. These discoveries have led to higher investments in the sector, particularly from multinational oil companies and domestic service providers related to oil and gas.

Table 1.11
Malaysia: Crude Oil and Natural Gas Reserves[1]

	As at 1 January	
	2006	2007*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.25	5.35
Reserve/Production (year)	20	22
Natural gas		
Reserves (trillion standard cubic feet)	87.95	88.92
Reserve/Production (year)	35	38

[1] The National Depletion Policy was introduced in 1980 to safeguard the exploitation of the national oil reserves by postponing the development and controlling the production of major oil fields (with reserves of 400 million barrels or more).
p Preliminary

Source: PETRONAS

Construction Sector

Following three consecutive years of decline, the **construction sector** turned around to record a positive growth of 4.6%. The expansion was driven mainly by the civil engineering sub-sector, and supported by expansion in the non-residential and residential sub-sectors.

Recovery in the construction sector led by civil engineering activity

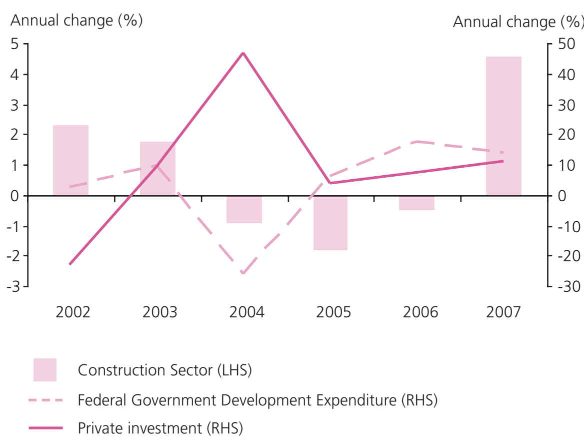
In the **civil engineering** sub-sector, the positive effects from the increased implementation of projects under the Ninth Malaysia Plan (9MP) gradually filtered through the economy during the course of the year. Federal Government development expenditure rose by 13.3% to RM40.6 billion in 2007 (2006: RM35.8 billion), to finance construction of new projects and upgrading of existing infrastructure facilities, such as roads, schools, hospitals and government quarters. The civil engineering sub-sector also benefited from increased construction activity in the oil and gas industry, comprising development and production of new oil facilities including rigs, platforms and storage terminals.

In addition, the order books of some domestic construction companies were also augmented by overseas projects, especially in the Middle East, India and Thailand. The projects include construction of highways, airport terminals and hydropower plants. The turnaround in the construction sector and increase in the order books of some construction companies led to the re-rating of construction companies listed on Bursa Malaysia. The Bursa Malaysia Construction Index increased significantly by 56.5% to 313.04 points at end-2007.

Growth in the **non-residential** segment picked up further during the year in tandem with robust business activity. Increased demand from new businesses as well as expansion by existing companies in the financial services, information technology, and oil and gas-related sectors caused a sharp increase in demand for office space, particularly in Kuala Lumpur. The strong demand was further reinforced by interests from foreign institutional investors. Meanwhile, new incoming supply of office space increased to 1.6 million square metres as at end-September 2007, of which almost half was recorded in Kuala Lumpur. Despite the increase in supply, the occupancy rate of office space increased further to 83% as at end-September 2007 (end-2006: 81.8%). The strong demand was also evidenced by increases in rentals.

The strong growth in private consumption had stimulated demand for retail properties. During the year, about 31 new shopping complexes were completed, of which nine were in the Klang Valley, resulting in the total number of lettable commercial space in the Klang Valley to increase to about 40 million square feet (2006: 36.4 million square feet). The new retail space was mainly towards high-end facilities. Given the rise in supply, rentals broadly remained unchanged,

Chart 1.18
Value-add Growth in Construction Sector versus Growth in Federal Government Development Expenditure and Private Investment



Source: Department of Statistics, Malaysia and Accountant General's Department

Development of a Vibrant and Sustainable Microfinance Industry

Importance of microfinance

The 2005 Census of Establishments and Enterprises (Census) showed that micro enterprises formed about 80% of the small and medium enterprises in Malaysia. Given its significance, the development of micro enterprises is critical to ensuring equitable and balanced economic growth that would lead to wealth and economic growth that are distributed and enjoyed by all segments of society, particularly the low income individuals who represent the largest constituents of micro entrepreneurs.

The Census also revealed that financial institutions contributed only 13% of the source of financing for micro enterprises. This indicated the enormous potential for the banking system to contribute to the development of micro enterprises to bring them into the economic mainstream. Access to microfinance[1] will enable more micro enterprises the opportunity to start and expand their businesses. This in turn will create more job opportunities, generate more income and thereby improve the overall standard of living. Micro enterprises that are brought into the formal financial and economic mainstream will also contribute towards achieving balanced and sustained economic development.

Roll out of microfinance

The development of a vibrant and sustainable microfinance industry is part of Bank Negara Malaysia's strategic objective of achieving greater financial inclusion, ensuring that all economic sectors, regions and communities have access to a full range of financial products and services. The development of a pool of microfinance providers amongst existing financial service providers was a strategy adopted to promote sustainable access to financing by micro enterprises.

In August 2006, the National SME Development Council (NSDC) approved a comprehensive microfinance institutional framework proposed by Bank Negara Malaysia, comprising banking institutions, development financial institutions (DFIs) and credit cooperatives to develop a sustainable microfinance industry. Bank Simpanan Nasional was mandated to provide microfinance, while Bank Kerjasama Rakyat Malaysia Berhad would provide microfinance to members of cooperatives and Bank Pertanian Malaysia would continue to provide microfinance to micro enterprises in the agriculture and agro-based sector. The banking institutions will be a further source of funding with its extensive nationwide network of branches to ensure widespread outreach of microfinance.

There has been considerable progress in the participation of financial institutions in providing microfinance. Currently, nine financial institutions (six banking institutions and three DFIs) have launched microfinance products. These financial institutions have adopted various business models to meet the diverse financial needs of the micro enterprises involved in various economic activities and sectors. The business models are:

- the **mass market model** where microfinance is provided through the financial institutions' nationwide branches;
- the **distributor network model** that involves financial institutions forming strategic partnerships with other institutions, and leveraging on the partner's customer base, key capabilities and infrastructure network;

[1] Defined by Bank Negara Malaysia as the provision of small loans/financing (up to RM50,000), to micro enterprises or self-employed individuals, for their business activities.

- the **community banking model**, where microfinance is provided to selected communities or target segments;
- the **cooperative model** that leverages on the infrastructure and capabilities of the cooperative movement; and
- the **monoline model** involving the formation of dedicated microfinance branches with branding, business model and processes separate from the parent financial institution to provide microfinance.

To strengthen the role of credit cooperatives in providing credit to micro enterprises, Bank Negara Malaysia proposed the establishment of the Cooperative Societies Commission to provide the supervisory oversight on the cooperatives to ensure prudential standards and best practices. The Act for its establishment was passed by Parliament in April 2007 and it commenced operations on 1 January 2008.

Practices from other countries with vibrant microfinance industries and research findings by Malaysian financial institutions have shown that micro enterprises value simple, easily accessible and timely provision of financing to cater to the needs of the small businesses. In this regard, microfinance products offered by the financial institutions have been made simple, fast and convenient. Microfinance is easy to obtain as there is no collateral required, documentation is minimal and the financing procedure is simple. The time taken by the financial institutions to approve and disburse microfinance is also kept short. Microfinance can also be obtained at branches and various distribution channels of financial institutions and their strategic partners to ensure extensive outreach and to provide convenience to the customers.

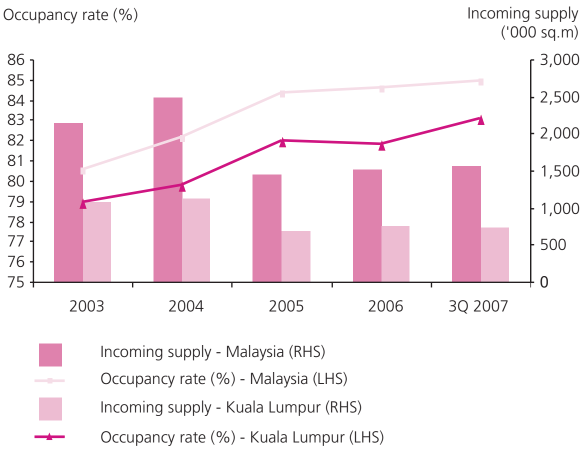
There are more than nine microfinance products, both conventional and Islamic, that are already available in the market. As at end-2007, total financing outstanding of RM224.7 million was provided to 22,788 microfinance customer accounts, with an average financing size of RM9,800.

Promoting awareness among the microfinance customers and the public

A national microfinance logo was launched by YAB Prime Minister at the 7th NSDC meeting held on 13 September 2007. Since the launch of the logo, financial institutions that offer microfinance have displayed the logo and a microfinance client charter to signify commitment in providing easy, fast and convenient microfinance services. Microfinance customers who have successfully obtained microfinance are encouraged to display the logo at their business premises.

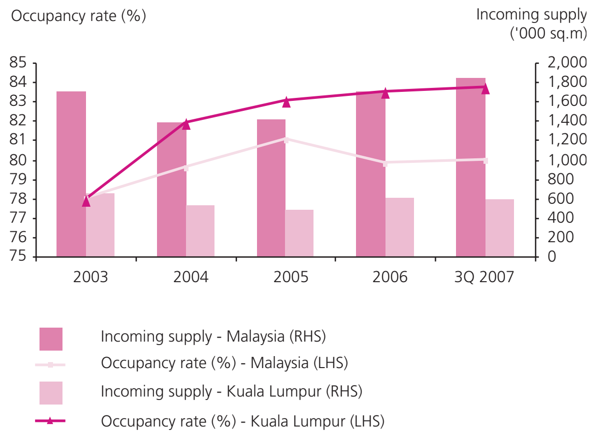
To further promote and create public awareness on the availability of microfinance, Bank Negara Malaysia has embarked on various promotion and awareness programmes such as the distribution of microfinance flyers at strategic locations, through various chambers of commerce, trade associations and local councils. The media have also been an important channel to inform and educate the public on the availability and benefits of microfinance. Financial institutions that provide microfinance are also encouraged to promote and advertise microfinance products and services to the general public.

Chart 1.19
Incoming Supply and Occupancy Rate of Purpose-Built Office Space in Malaysia and Kuala Lumpur (as at end period)



Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

Chart 1.20
Incoming Supply and Occupancy Rate of Retail Space in Malaysia and Kuala Lumpur (as at end period)



Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

except for choice properties. With the growing attraction of this sector, several shopping complexes were bought by foreign-based Real Estate Investment Trusts (REITs) in 2007.

Activity in the **residential** sub-sector remained positive during the year following several policy measures introduced by the Government since December 2006. These included the liberalisation of the Foreign Investment Committee (FIC) ruling on foreign purchases, the exemption from Real Property Gains Tax and relaxation on the number of residential or commercial property loans that foreigners could obtain. Findings from a survey by the Real Estate and Housing Developers Association showed that these liberalisations and the attractive valuation of high-end properties in the Klang Valley contributed to increased foreign interest in this segment. Residential property transactions by foreigners rose by about 30% in the first half of 2007 (2006: 13.9%). Demand was also supported by the availability of end-financing as reflected in higher housing loan applications, approvals and disbursements of 47.6%, 45.6% and 11.1% respectively during the year.

Developers were generally cautious in launching new projects in the past two years to prevent accumulation of unsold properties. Incoming supply declined by 8% to 580,883 units as at end-September 2007. However, given the renewed enthusiasm in 2007, future planned supply rose by 1.5% to 644,354 units. In line with the demand and supply trends, overhang of residential properties declined from a high of 28,827 as at end-September 2006 to 24,488 units at end-September 2007.

Table 1.12
Property Transactions in the Residential and Commercial Segment

	2005	2006	2007	2006	2007
				% Annual change	
Residential					
Value (RM million)	28,407.3	29,446.9	36,490.6	3.7	23.9
Volume	181,762	182,555	199,482	0.4	9.3
Commercial					
Value (RM million)	11,631.3	11,520.1	16,350.8	-1.0	41.9
Volume	24,151	25,687	27,900	6.4	8.6

Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

Table 1.13
Overhang of Residential Property in Malaysia by Price Range

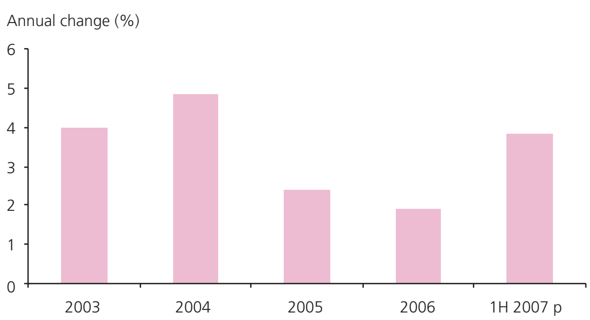
Residential Price Range	Units	Share (%)	Units	Share (%)
	As at end-2006		As at end-September 2007	
RM50,000 or less	3,419	13.5	3,353	13.7
RM50,001 - RM100,000	6,735	26.6	7,114	29.1
RM100,001 - RM150,000	5,473	21.6	4,349	17.8
RM150,001 - RM200,000	3,394	13.4	3,734	15.2
RM200,001 - RM250,000	1,870	7.4	1,994	8.1
More than RM250,000	4,440	17.5	3,944	16.1
Total	**25,331**	**100**	**24,488**	**100**

Source : National Property Information Centre (NAPIC), Valuation and Property Services Department

Overall, national house prices as measured by the Malaysian House Price Index increased by 3.8% in the first half of 2007 (2006: 1.9%). One of the factors that contributed to the increase is the rising cost of building materials. Prices of steel bars were revised upwards three times during the course of the year by a total of 45%, while the price of cement was revised at end-2006, and for the first time, was differentiated across the states based on transportation and other costs, with the quantum of increase varied between 10-78%.

During the year, the Government undertook several measures to enhance the public delivery system related to the construction sector. A One-Stop Centre was established to enable "fast-lane" approval for certain categories of projects such as those under the build-then-sell concept, Government projects, high-impact projects, and those that have potential to attract foreign investment. The framework enables simultaneous processing by the different local, state and federal departments, thus shortening the approval process substantially to four months. In addition, the Certificate of Fitness for Occupation was replaced with the Certificate of Completion and Compliance during the year, enabling faster occupation of completed projects.

Chart 1.21
Malaysian House Price Index



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Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

PRICES AND EMPLOYMENT

Consumer Prices

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), increased at a slower pace of 2% in 2007 (2006: 3.6%). The level of inflation was within the forecast range of 2-2.5%. While supply factors remained important, their contribution to overall inflation moderated, as the impact of earlier adjustments to administered prices waned in the first quarter of 2007. The absence of major adjustments to price-administered items during the year also mitigated the impact of supply factors on domestic prices. Meanwhile, core inflation, which proxies the demand-induced pressures on domestic prices, averaged 1.8% during the year (2006: 2.1%). Core inflation, however, edged higher in the second half of 2007.

Rising global prices of primary and food commodities posed a serious challenge to policymakers globally in 2007. These developments, in varying degrees, affected price inflation across the globe. Being a small and highly open economy, Malaysia was not spared from these developments. Nevertheless, the pass-through of global prices into domestic prices was somewhat

Chart 1.22
Consumer Price Inflation

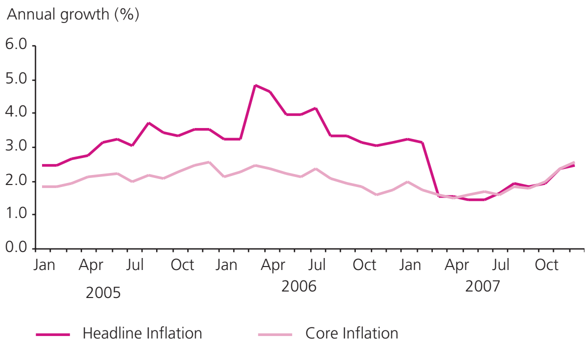


Table 1.14
Price Indicators

Consumer Price Index (2005=100)	Weight	2007 Annual change (%)	% of Total Inflation
Total	**100.0**	**2.0**	
Food and Non-Alcoholic Beverages	31.4	3.0	47.1
Transport	15.9	2.3	18.3
Housing, Water, Electricity, Gas and Other Fuels	21.4	1.3	13.9
Alcoholic Beverages and Tobacco	1.9	7.8	7.4
Restaurants and Hotels	3.0	3.7	5.6
Recreation Services and Culture	4.6	1.4	3.2
Miscellanous Goods and Services	6.0	1.0	3.0
Furnishings, Household Equipment and Routine	4.3	1.1	2.4
Education	1.9	1.8	1.7
Health	1.4	1.6	1.1
Clothing and Footwear	3.1	-1.4	-2.2
Communication	5.1	-1.2	-3.1
Non-durables goods	40.6	2.7	54.8
Services	47.1	2.1	49.5
Semi-durables goods	4.3	-0.8	-1.7
Durables goods	8.0	-1.4	-5.6
Producer Price Index (2000=100)	**100.0**	**6.7**	
Local Production	65.6	7.5	73.4
Import	34.4	4.7	24.1

Source: Department of Statistics, Malaysia

mitigated by a number of factors including the various policy measures put in place by the authorities, as well as domestic factors such as strong competition among retailers and the substitution by consumers in response to the higher prices.

Of the CPI components, price increases in the food and non-alcoholic beverages category were the main contributors, accounting for 47.1% of the headline inflation rate compared to 29.7% in the previous year. Domestic food prices were largely influenced by the higher world prices for food commodities, including household essentials such as rice, wheat flour and palm oil-based cooking oil. The higher global food prices were underpinned by both structural and cyclical factors. These included the stronger demand for food commodities from emerging market economies such as India and China, the use of food crops for the production of alternative fuels such as bio-diesel and ethanol, speculative demand, and adverse weather conditions in major producing countries such as Australia. As a result, in many countries, the contribution of food prices to headline inflation was higher than in the previous year. Domestic food prices were also affected by seasonal purchases during the festive seasons and transitory adverse weather conditions which affected farming activities and disrupted supplies.

Although the global price of crude oil advanced towards the USD100/barrel mark in 2007, domestic fuel and gas prices remained unchanged because of the fuel subsidy provided by the Government. Consequently, the contribution of the transport sector to the overall headline inflation, at 18.3%, was lower compared to the 48.6% in the previous year when there was a fuel price adjustment. The restaurants and hotels; and recreation services and culture categories registered a higher contribution to the headline inflation rate, as prices of hotel accommodation and tour packages rose due to higher demand following the very high number of tourist arrivals in response to the Visit Malaysia Year 2007 campaign (2007: 21.0 million, 2006: 17.5 million). The contribution of the alcoholic beverages and tobacco category to the CPI was also higher following the Government's decision to impose additional excise duties on tobacco products in July.

Nevertheless, as with the preceding year, the increase in the headline inflation rate was partly mitigated by the decline in the prices of items in the communication, and clothing and footwear categories as a result of strong global and domestic competitive pressures. In the case of communication equipment, the lower prices also reflected the benefits of technological

Chart 1.23
World Prices for Selected Food Commodities

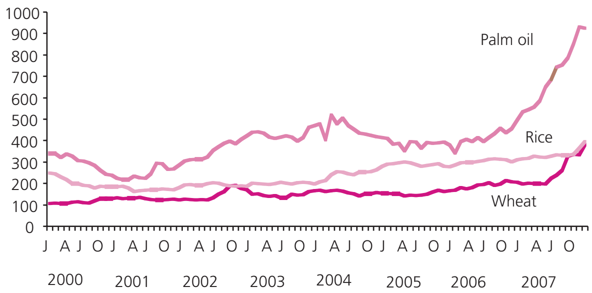
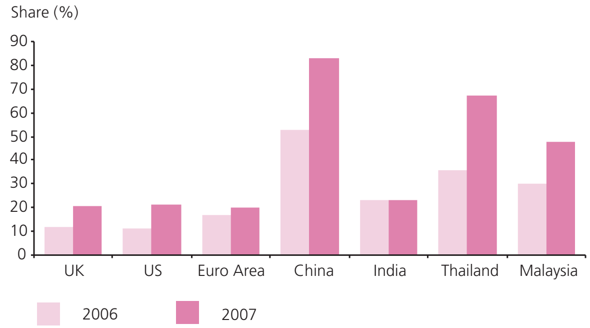


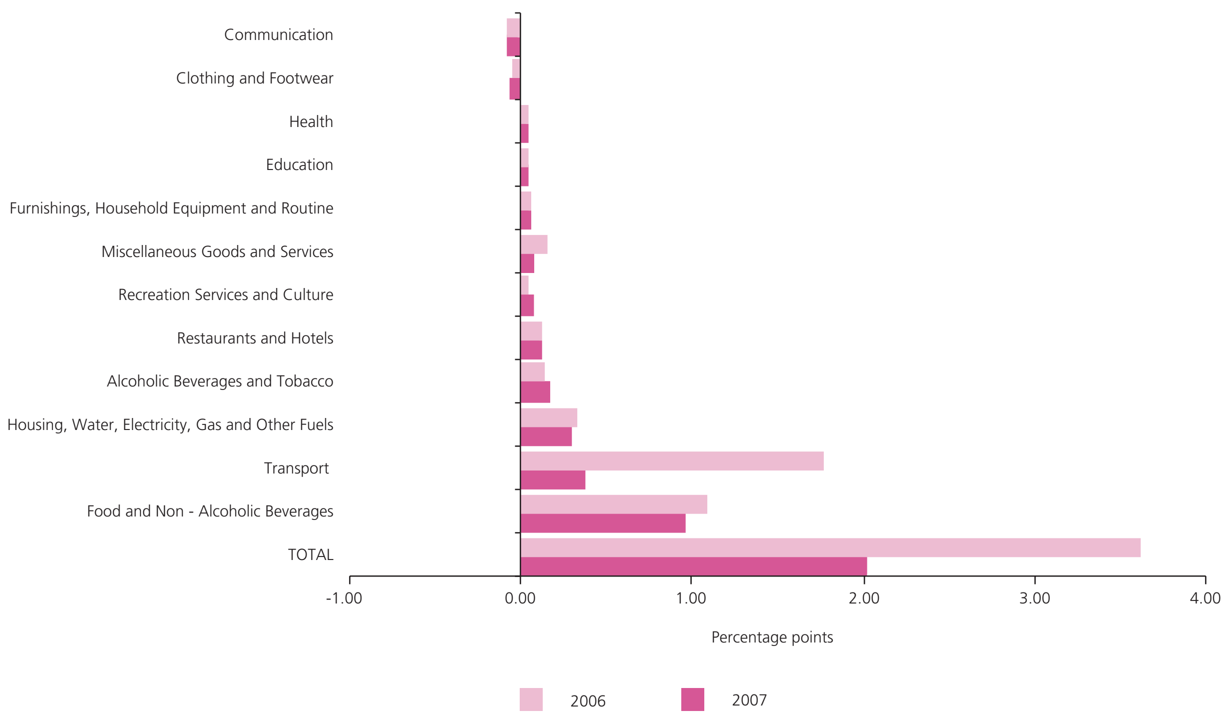
Chart 1.25
Share of Contribution of Food Prices to Headline Inflation



advancement. The appreciation of the ringgit exchange rate had also, to some extent, mitigated some of the higher prices of imports.

There is also a growing perception that the actual inflation may be higher. There could be a number of explanations to this divergence from the statistics that are compiled by the Department of Statistics. As a statistical construct, the CPI comprises a basket of goods that is typically consumed by Malaysian households based on surveys done by the Department of Statistics every five years. The compilation of the statistics averages out the changes in the prices of different types of goods and services, as well as regional differences in the prices of goods and services. Based on the prices of selected food items that are monitored weekly by the Ministry of Domestic Trade and Consumer Affairs, and which are published by the local newspapers, the variances across regions, and over time, tend to be quite substantial. The CPI, thus is an average

Chart 1.24
Contribution of CPI Components to Headline Inflation



change of movements in prices for the country as a whole, and will not be reflective of the cost of living in a specific locality or the income category of a specific group. Moreover, while the CPI basket comprises more than 400 goods, different brands of the same item often have different price behaviour.

Finally, it is important to note that there is a certain degree of asymmetry in the way price changes are perceived. Prices that are increasing tend to receive more attention than prices that are declining. Since 2005, prices for the clothing and footwear, and communication categories of the CPI, on the average, have fallen annually by 1.2% and 0.9% respectively. These declining prices helped to offset the impact of price increases in other categories on the overall CPI.

Producer Prices

The impact of higher global commodity prices was more evident in the Producer Price Index (PPI), which increased by an annual rate of 6.7% in 2007 (2006: 5.1%). The commodities component of the PPI rose by 12.4% (2006: 9.6%) following higher global prices of commodities such as rubber, crude palm oil and crude oil. Excluding commodities, the PPI rose at an annual rate of 4.5% compared to 3.6% in the previous year.

Both the domestic and external components of the PPI registered increases. The prices of local component of the PPI increased at an annual rate of 7.5% (2006: 6.7%). The increase reflected higher prices for machinery and transport equipment; mineral fuels, lubricants and related material; food and live animals; and animal and vegetable oils and fats. Meanwhile, the annual growth rate of the imported component of the PPI was also higher at 4.7% (2006: 2.2%) and was attributed to increases in prices of items such as machinery and transport equipment; manufactured goods classified chiefly by material; chemical and related products; animal and vegetable oils and fats; and food and live animals.

Labour Market Developments

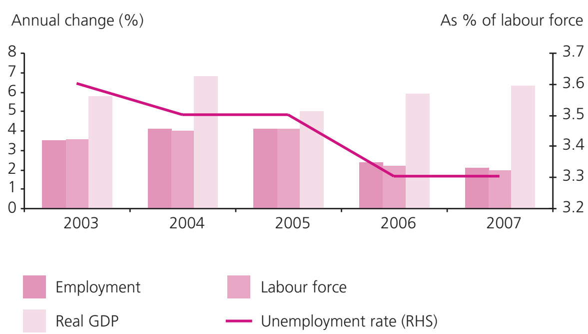
The domestic labour market continued to improve in 2007, in line with the stronger economic performance. The unemployment rate remained low at 3.3% as demand for workers increased and fewer retrenchments was recorded during the year. Total employment grew at a rate of 2.1% to 11.4 million workers compared to the labour force growth of 2.0% to 11.8 million persons. Accordingly, the labour force participation also increased to 67%. The average MIER Employment Index was 13.5 points higher in 2007 or 120.8 points (2006: 107.3 points).

Stronger labour market in 2007

There were positive job creations for all key sectors, except agriculture which recorded a marginal decline. Overall, **employment** continued to be highest in the services sector, with the distributive trade, hotel and restaurant sub-sector continuing to be the largest employer in the sector. Recruitment activities were active in the retail segment and financial sector in view of the launch of several large retail outlets and the opening of several foreign bank branches and Islamic banks during the year. Of significance, the construction sector, after recording job losses for three consecutive years, expanded its workforce by 2,066 persons in tandem with the recovery in the construction sector. Meanwhile, the moderation in manufacturing activities led to slower hiring and smaller job gains.

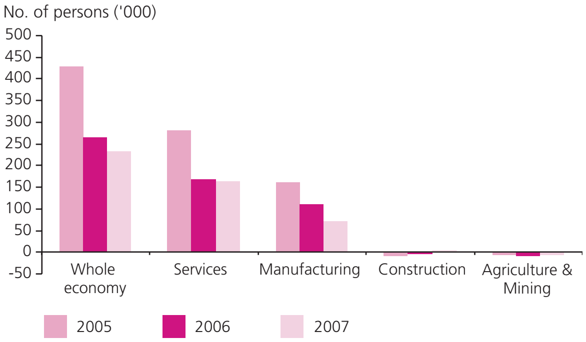
In 2007, total **retrenchments** continued its downward trend seen since 2001. Retrenchments totaled 14,035 persons or 8.6% lower (2006: 15,360 persons). The bulk of the retrenched workers was mainly involved in the lower-skilled jobs. Layoffs in the manufacturing sector (71% share of total

Chart 1.26
Output and Employment



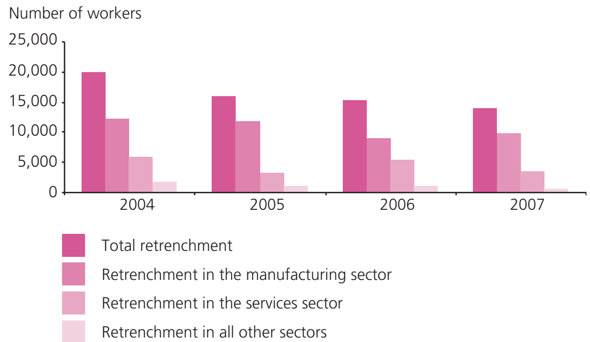
Source: Economic Planning Unit
Department of Statistics, Malaysia

Chart 1.27
Additions to Employment by Sector



Source: Economic Planning Unit

Chart 1.28
Retrenchment in Selected Sectors



Source: Ministry of Human Resources

retrenchments) were higher, but retrenchments in all other sectors were noticeably lower, resulting in a lower overall total. Given its weak performance, retrenchments in the E&E industries more than doubled that of 2006. Meanwhile, the services sector accounted for another 25% of those retrenched, occurring mainly in the distributive trade, hotel and restaurant sub-sector.

Total **active vacancies** reported via the Electronic Labour Exchange (ELX) remained high at 825,182 positions (2006: 834,675 positions). Labour demand from the manufacturing sector was the highest (33% share), followed by the agriculture and services sectors (27% and 25% share respectively). The bulk of job openings was for elementary occupations suitable for lower skilled workers. Of significance, vacancies for jobs requiring higher education and technical qualifications such as managers, professionals and technicians rose significantly, reflecting more demand for skilled labour.

Active jobseekers registered via ELX increased by 10% to 92,508 persons (2006: 84,046 persons). The strong growth environment coupled with high employment led to a positive outlook on job prospects. About 41% of these jobseekers were already employed but had re-entered the job market for career and salary progression. Corresponding to the increased demand for workers with higher education level and technical skills, the number of graduate jobseekers (diploma and degree holders) rose by 3.2%, accounting for about 45% of the total active jobseekers. Meanwhile, there were fewer jobseekers that registered for jobs requiring lower-end skills. As a result, more migrant workers were hired during the year.

Table 1.15
Selected Labour Market Indicators

	2003	2004	2005	2006	2007e
Employment[1] ('000 persons)	10,047.2	10,463.7	10,892.8	11,159.0	11,392.4
Labour force[1] ('000 persons)	10,426.4	10,846.0	11,290.5	11,544.5	11,775.1
Retrenchments (persons)	21,206	19,956	16,109	15,360	14,035
Active jobseekers (persons)	28,404	27,227	72,573	84,046	92,508
Active vacancies (positions)	96,918	49,975	304,500	834,675	825,182
Unemployment rate[1] (%)	3.6	3.5	3.5	3.3	3.3
Labour force participation rate[1] (%)	65.6	66.1	66.7	66.9	67.0
Real labour productivity growth[2] (%)	2.2	2.5	0.9	3.4	4.1

e Estimate
[1] Based on estimates by Economic Planning Unit
[2] Based on estimates by Bank Negara Malaysia

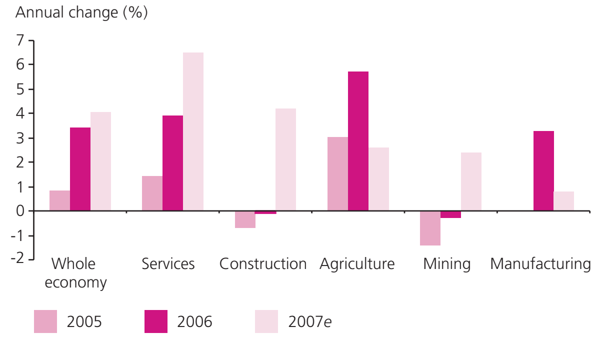
Source: Bank Negara Malaysia
Economic Planning Unit
Ministry of Human Resources

In 2007, total **foreign workers** (including foreign expatriates) in Malaysia rose by 9.3% to 2.08 million persons. As at year-end, there were 2.04 million migrant workers and 34,822 foreign expatriates. The majority of the ***migrant workers*** were in the manufacturing, agriculture and construction sectors (36% share, 25% and 14% respectively), as these sectors continued to face labour shortages, while domestic maids accounted for another 15% share. While most manufacturing companies indicated plans to reduce foreign workers by moving towards greater automation and the adoption of new technologies, they cited high cost of automation and the lack of skilled workers to operate and maintain the more complex equipment as key constraints in scaling up their operations. Meanwhile, ***foreign expatriates*** rose by 5.7% to 34,822 persons, reversing the downward trend since 2000. Most of the expatriates were engaged in the services and manufacturing sectors (60% share and 33% respectively). Recognising that employment of expatriates could facilitate companies to strengthen their operations, the Government reduced the time taken to approve expatriates' employment passes to within a week, as well as extended the work permits to 5-10 years (previously 2 years).

Labour productivity, as measured by the real value added per worker, recorded a higher growth of 4.1% (2006: 3.4%), with all key sectors recording a positive growth in labour productivity. Labour productivity growth was the highest in the services sector (6.5%), supported by higher productivity growth in the finance, insurance, real estate and business services segment (9.2%), and distributive trade, hotel and restaurant sub-sector (8.3%). Of significance, labour productivity in mining and construction sectors recovered in 2007, as output for oil and gas, and construction-related activities were stepped-up. In the manufacturing sector, despite lower additions to the workforce, labour productivity growth moderated (0.8%) on weaker sales and output performance.

The stronger expansion of economic activities and labour demand resulted in some **wage** pressures, with executives in the private sector receiving a higher salary increase (5.9%) compared to the non-executives (5.6%) (2006: 5.9% and 5.7% respectively). The higher average salary increase reflected in part companies' policy

Chart 1.29
Labour Productivity Trends



e Estimate
Source: Bank Negara Malaysia
Department of Statistics, Malaysia

in rewarding performance, and use of salary to attract and retain talents.

The **supply of talents**, however, has not matched the pace of its demand, resulting in skill shortages. Skilled shortages are felt more acutely in the area of experienced and professional workers. Some of the skills that are in high demand include engineers, machinists, geologists, architects, accountants, Islamic bankers, IT specialists as well as mid- and senior-level managers. Demand for these skilled workers has increased and is expected to remain high in the medium term. In Malaysia, although the shortage has not yet reached critical levels, efforts are being made to alleviate this problem.

One issue that the Government is actively addressing is the unemployment among graduates. According to the Ministry of Human Resources, total unemployed graduates has declined to 49,406 as at end-2007, equivalent to about 13% of total unemployed persons in Malaysia (2006: 65,700 unemployed graduates or 17% share). The Ministry of Higher Education has instituted several measures to ***improve the employability of local graduates***. One of the measures was the full introduction of soft-skills (including mastering the English language and presentation techniques) and entrepreneurship modules for the 2007/2008 academic session in all public universities. Secondly, the Curriculum Committee (with industry representatives) was given the flexibility to fine-tune the content of courses to keep them current and in sync with market needs. In addition, plans are also underway for a compulsory six months industrial training for critical courses (three months for other courses) to better expose undergraduates to the working environment and help develop their competency.

More companies are now more willing to send their staff for ***training and skills upgrading courses***. Total financial assistance and training places approved by Pembangunan Sumber Manusia Berhad increased by 14.4% and 13.4% respectively. More manufacturing workers were sent for training (61% share), especially from the E&E and transport-equipment industries (21% and 4% of total), while in the services sector, workers from supermarkets and hypermarkets as well as hotels accounted for another 6% and 5% of total training places. Overall, quality-control courses were more popular (22%), followed by safety and health (14%), management and technical courses (9% each).

In the ***financial services sector***, Bank Negara Malaysia has embarked on several initiatives to develop the talent pool to further support and enhance the dynamism of the sector. Firstly, the International Centre for Education in Islamic Finance (INCEIF) was set up in March 2006, to develop and enhance human capital in Islamic finance. As at 12 March 2008, a total of 721 students from 44 countries have enrolled for INCEIF's professional certification in Chartered Islamic Finance Professional, which is the world's first certification on Islamic finance, while another 29 students have signed up for the PhD in Islamic Finance. In addition, the Financial Sector Talent Enrichment Programme (FSTEP) was launched in January 2008. The programme, developed by the financial services industry together with the Central Bank, is designed to develop new entrants into the industry. Participants of the programme will receive training and gain exposure in commercial banking, investment banking, Islamic banking as well as insurance and takaful through rigorous classroom and on-the-job training. The first batch of participants for the one-year programme involved 297 candidates selected from a total of 2,900 applicants from a diverse academic background and with excellent academic credentials.

EXTERNAL SECTOR

Balance of Payments

Malaysia's external position strengthened in 2007. The **overall balance of payments** was larger, due to a larger current account surplus, while net outflows in the financial account moderated. The sustained large trade surplus, underpinned by strong growth in commodity exports, and an improvement in the services and income accounts contributed to the larger current account surplus. In particular, the services account recorded its first surplus due mainly to higher tourism and transportation receipts. Higher profits and dividends accruing to Malaysian companies investing abroad as well as higher returns from external reserves led to a lower income account deficit.

Malaysia's external position remained strong, supported by a large current account surplus underpinned by strong commodity exports. Of significance, the services account recorded its first surplus

In the financial account, improved economic prospects and investor sentiment contributed to higher net inflows of both foreign direct investment (FDI) and portfolio investment. However, these inflows were offset by higher direct investment abroad by Malaysian companies, and net outflows of other investment. After adjusting for errors and omissions, which include the foreign exchange revaluation loss arising from the revaluation of Bank Negara Malaysia's international reserves due to the strengthening of the ringgit against major currencies, the net international reserves increased by RM45.3 billion to RM335.7 billion or equivalent to USD101.3 billion as at 31 December 2007. The reserves increased further to RM384.1 billion or equivalent to USD116.3 billion as at 29 February 2008. This reserves position is adequate to finance 9.6 months of retained imports and covers 7.1 times the short-term external debt. Malaysia's reserves remained usable and unencumbered.

Table 1.16
Balance of Payments

Item	2006 +	2006 -	2006 Net	2007e +	2007e -	2007e Net
	RM billion					
Goods	589.7	455.2	134.6	605.8	477.7	128.1
Trade account	*589.0*	*480.8*	*108.2*	*605.2*	*504.8*	*100.3*
Services	80.0	87.0	-6.9	97.1	96.1	1.0
Balance on goods and services	**669.8**	**542.2**	**127.6**	**702.9**	**573.8**	**129.1**
Income	31.0	48.3	-17.4	38.8	52.5	-13.7
Current transfers	1.1	18.0	-16.9	1.2	17.3	-16.1
Balance on current account	**701.9**	**608.5**	**93.4**	**742.9**	**643.5**	**99.3**
% of GNI			**16.8**			**15.8**
Capital account			–			-0.1
Financial account			-43.5			-37.0
Direct investment			…			-8.8
Portfolio investment			12.9			18.4
Other investment			-56.4			-46.6
Balance on capital and financial accounts			**-43.5**			**-37.1**
Errors and omissions			-24.8			-16.9
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*-6.9*			*-5.6*
Overall balance			**25.2**			**45.3**
Bank Negara Malaysia international reserves, net			**290.4**			**335.7**
USD billion equivalent			**82.5**			**101.3**

Note: Numbers may not necessarily add up due to rounding
e Estimate
… Negligible

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

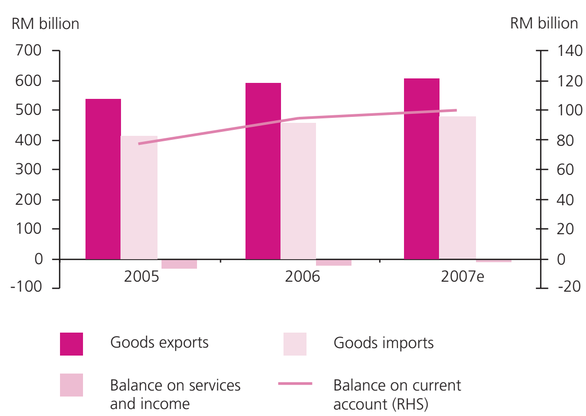
Current Account

The **current account** recorded a larger surplus of RM99.3 billion or 15.8% of GNI (2006: RM93.4 billion or 16.8% of GNI), supported by a large trade surplus and improvement in the services and income accounts. The trade surplus was underpinned by strong commodity exports as a result of high prices of palm oil and minerals. During the year, commodity exports, which have low import content, contributed to 73% of the trade surplus.

Gross exports grew at a moderate pace of 2.7% in 2007 (2006: 10.3%) as weak demand for manufactured exports was partially mitigated by strong growth in exports of primary commodities.

Growth in **exports of manufactured goods** moderated to 0.3% in 2007 (2006: 10.1%), as a result of the decline in E&E exports (-4.2%; 2006: 6.4%) and moderation in non-E&E exports (8.1%; 2006: 17.2%). The weak performance in E&E exports was mainly attributable to the slowdown in demand for computers and parts from the US market following weaker investment in equipment and software by the corporate sector, especially in the early part of the year. The E&E exports were also affected by lower prices during the year arising

Chart 1.30
Current Account



e Estimate

Table 1.17
Gross Exports

	2006	2007p
	Annual change (%)	
Gross exports	**10.3**	**2.7**
Manufactures	**10.1**	**0.3**
of which:		
Electronics and electrical products	*6.4*	*-4.2*
Chemicals and chemical products	*10.7*	*13.8*
Manufactures of metal	*33.0*	*15.7*
Petroleum products	*27.2*	*3.8*
Agriculture	**12.5**	**24.4**
of which:		
Palm oil	*13.7*	*47.8*
Rubber	*42.3*	*-10.9*
Minerals	**8.6**	**7.5**
of which:		
Crude oil and condensates	*8.1*	*3.5*
LNG	*12.0*	*12.3*

p Preliminary
Source: Department of Statistics, Malaysia

from the excess inventories of certain segments of semiconductor chips and strong competition among major global producers. Exports of electrical products continued to remain weak due to the transition from lower-end products such as the cathode-ray tube televisions and VCD players to higher value-added products like high definition LCD televisions, DVD recorders and Blu-ray players. Nevertheless, there were signs of improvement in exports of E&E products towards year-end led by the computer and parts segment.

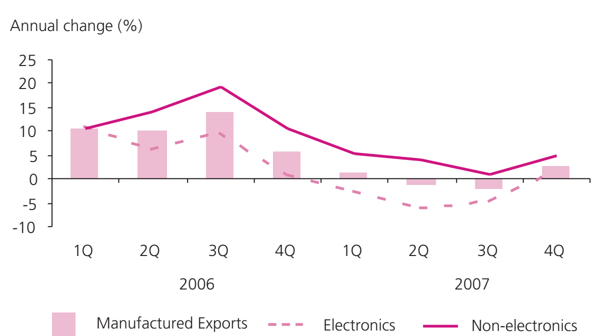
In the **non-E&E segment**, exports of chemicals and chemical products expanded by 13.8% in 2007 (2006: 10.7%). The better export performance was supported by demand from the US, EU and the Asian region as well higher prices in line with the increase in input prices of commodities. Meanwhile, exports of food products showed a strong growth of 23.6% due partly to the increase in demand for Halal food from the Middle East countries. Exports of textiles and wearing apparel and petroleum products declined due to weaker demand from Malaysia's major buyers.

Exports of **primary commodities** continued to expand by double-digit rate for the fifth consecutive year, rising by 14.7%. Total commodity exports surpassed the RM100 billion mark in 2007, thus resulting in its share of gross exports to rise to 18.8% (2001: 13%). The favourable performance was due to the effect of higher commodity prices which rose on average by 18.5% in 2007.

Agriculture exports grew by 24.4% in 2007, led mainly by the significant increase in exports of palm oil. Palm oil exports strengthened further by 47.8%, due wholly to higher prices, which averaged RM2,368 per tonne (2006: RM1,544 per tonne). Strong demand, especially for biofuel uses resulted in palm oil prices to be closely correlated with movements in crude oil prices. Meanwhile, export volume declined by 3.7% due to lower offtake by India and the EU as a result of shifting to other cheaper oils such as rapeseed. Nevertheless, exports to PR China continued to expand, accounting for 28% of Malaysia's total palm oil exports. In addition, demand from the US remained strong as US food manufacturers continue to switch to using palm oil in their food products. Similarly, exports of other agriculture commodities such as rubber, saw logs and sawn timber experienced declines in 2007. In line with the decline in output of rubber in Malaysia, export volume saw a decline of 10.9%. PR China remained Malaysia's largest importer of rubber, accounting for 36.4% of total rubber exports in 2007, followed closely by the European Union, with a total share of 28.9%.

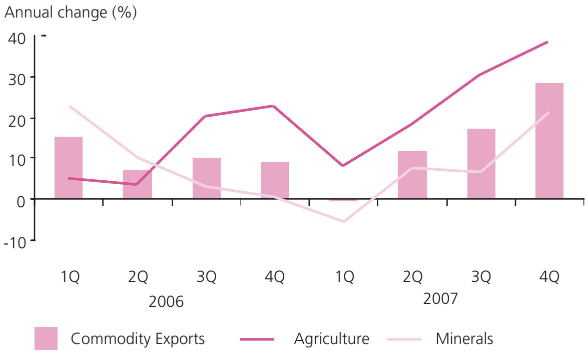
Growth in **mineral exports** was relatively sustained at 7.5% in 2007, driven mainly by higher prices and, to a lesser extent, by increases in export volume. The increase in crude oil exports was supported by the increase in prices (2.9%) as well as turnaround in export volume (0.5%) after

Chart 1.31
Export Performance of Electronics and Non-electronics Industries



Source: Department of Statistics, Malaysia

Chart 1.32
Commodity Export Performance



Source: Department of Statistics, Malaysia

a decline of 8% in the previous year. The latter was supported by the strong global oil demand, as well as the increase in production from the Kikeh field which began operations during the year. This was further supported by sustained growth in LNG exports, which expanded by 12.3% amidst the higher prices and increased offtake from Korea, a major LNG importer.

Gross imports increased by 5%, reflecting mainly imports of inputs for manufactured exports as well as higher demand for consumer and capital goods. Imports of **intermediate goods**, the main component of imports, expanded by 6.9%. This reflected the growth in imports of processed industrial supplies, particularly metals, chemicals and chemical products, and semi-manufactured gold. Increased demand for materials used by the construction industry underpinned imports of metals while demand for plastics from the EU spurred the imports of chemicals. Consistent with strong domestic demand, intermediate imports relating to the manufacture of goods for the domestic market also expanded. Strong domestic consumption supported the growth of imports of primary and processed materials for the food and beverages industry.

Of significance, further expansion in investment activity resulted in higher imports of **capital goods** (7.2%). Capital imports were channelled mainly into the manufacturing, services and mining sectors, primarily for capacity expansion and upgrading for new technologies. Investments to expand capacity in the manufacturing sector, particularly in metals and higher-end electronics, and the drive for fuel efficiency led to higher imports of machinery as well as generators and turbines. Increased exploration and development activities in the oil and gas sector, and implementation of projects under the 9MP lifted imports of construction and mining equipment as well as imports of offshore support vessels.

Table 1.18
Imports by End-Use

	2006	2007*p*
	Annual change (%)	Annual change (%)
Capital goods	**7.4**	**7.2**
Capital goods (except transport equipment)	5.4	5.6
Transport equipment	23.5	17.8
Intermediate goods	**8.8**	**6.9**
Food and beverages, mainly for industry	24.9	21.0
Industrial supplies, n.e.s.	11.1	17.0
Fuel and lubricants	25.7	2.0
Parts and accessories of capital goods (except transport equipment)	5.1	0.4
Consumption goods	**13.4**	**3.6**
Food and beverages, mainly for household consumption	4.8	6.8
Consumer goods, n.e.s.	18.8	1.8
Re-exports	**50.6**	**-22.4**
Gross Imports	**10.8**	**5.0**

n.e.s. Not elsewhere specified
p Preliminary

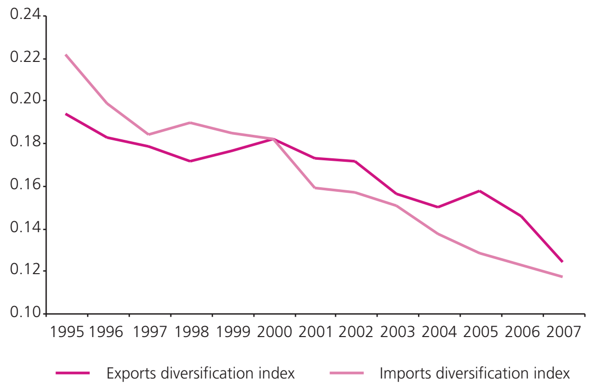
Source: Department of Statistics, Malaysia

Following continued growth in private consumption, **consumption imports** expanded by 3.6%. The growth in consumption imports reflected higher imports of food and beverages for household consumption. Nevertheless, imports of semi-durables, such as leather goods, tapes and records, declined.

Malaysia's export markets continued to be diversified. Reflecting this, the export and import diversification indices, as measured by the normalized Herfindahl-Hirschmann indices declined further to 0.124 and 0.116 respectively in 2007 (2006: 0.145 and 0.122 respectively). The improvement in trade diversification was reflected in the further strengthening of trade links to India, West Asia and Australia. Exports to Australia and India were driven by demand for petroleum-related and E&E products while exports to West Asia were more varied, comprising E&E products, jewellery and palm oil. The enlarged trade share with the EU reflected increasing trade links with Southern Europe. Diversification within the traditional ASEAN markets has also shown improvement with increased trade penetration into emerging new markets such as Vietnam.

The **US** continued to be Malaysia's largest trading partner despite a decline in share to 15.6% of Malaysia's total exports (2000: 20.5%). While exports of computer and parts as well as office machine components declined, exports of palm oil has increased. The increase in palm oil exports by 13.4% was underpinned by higher prices as well as increased usage of palm oil by US food manufacturers. **Singapore** remained as Malaysia's second largest trading partner.

Chart 1.33
Exports and Imports Diversification Indicies



The exports and imports diversification indices are modified version of Herfindahl-Hirschmann index. It is normalised to obtain a numeric range from 0 to 1. A lower index signifies a higher degree of diversification.

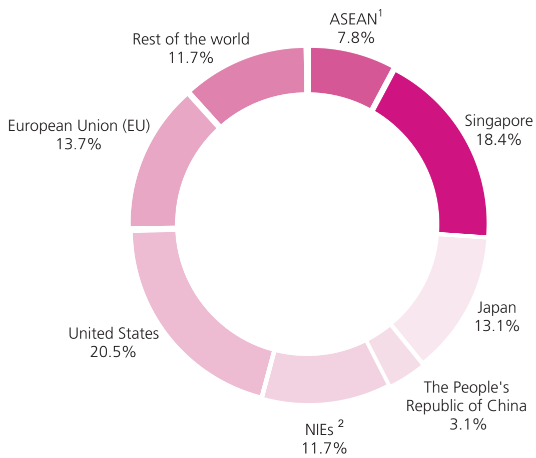
Table 1.19
Direction of External Trade

	2007*p*				
	Exports		Imports		Trade balance
	RM billion	Annual change (%)	RM billion	Annual change (%)	RM billion
Total	**605.2**	**2.7**	**504.8**	**5.0**	**100.3**
of which:					
United States	**94.5**	**-14.5**	**54.7**	**-9.2**	**39.8**
European Union (EU)	**77.8**	**3.6**	**59.9**	**9.5**	**17.9**
Selected ASEAN countries[1]	**154.3**	**1.2**	**122.7**	**5.2**	**31.6**
Selected North East Asia countries	**120.5**	**10.4**	**133.2**	**8.3**	**-12.7**
The People's Republic of China	*53.0*	*24.3*	*64.9*	*11.5*	*-11.9*
Hong Kong SAR	*28.0*	*-4.0*	*14.7*	*16.0*	*13.3*
Chinese Taipei	*16.5*	*2.6*	*28.7*	*9.5*	*-12.3*
South Korea	*23.0*	*8.2*	*24.9*	*-3.8*	*-1.9*
West Asia	**18.9**	**18.1**	**17.4**	**-13.0**	**1.6**
Japan	**55.2**	**5.8**	**65.5**	**3.1**	**-10.3**
India	**20.2**	**7.6**	**7.1**	**44.7**	**13.1**

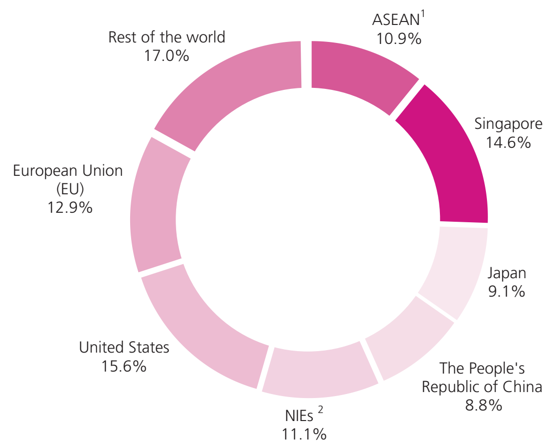
Note: Numbers may not necessarily add up due to rounding
[1] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam
p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.34
Direction of Exports (% share)



2000



2007

[1] Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

[2] Hong Kong SAR, South Korea and Chinese Taipei

Higher exports of chemicals and crude petroleum following growing demand by Singapore's petrochemical industry mitigated the decline in the E&E exports. Meanwhile, exports to **Japan** continued to strengthen, underpinned by demand for LNG and palm oil. Japan remained as Malaysia's most important source of imports, comprising mainly substrates for integrated circuits, semiconductor devices, transport equipment and ships.

Increased trade with markets in Southern Europe led to an increase in the share of Malaysia's trade with the **EU**. Exports to the growing market in Italy was largely air conditioners, radio and TV parts. Trade with Belgium also strengthened, with exports comprising mainly automatic data processing machines and cameras while imports were mainly chemicals and medicine. Nevertheless, the United Kingdom, Germany, the Netherlands and France remained as Malaysia's major trading partners in the EU.

Exports to North East Asia (excluding Japan) expanded by 10.4%, underpinned by the growth in exports to PR China and South Korea. Strong economic activity in PR China and expansion of intra-regional trade through production networks induced demand for exports of integrated circuits, office machine parts, chemicals and palm oil from Malaysia. PR China emerged as the largest market for Malaysia's palm oil, accounting for 28% of total palm oil exports. Meanwhile, PR China became Malaysia's second major source of imports, with imports comprising mainly E&E components and chemicals. Exports to South Korea were underpinned by strong growth in LNG and crude petroleum, attributable to increasing energy consumption and demand by South Korea's petrochemical industry.

Trade with **ASEAN** (excluding Singapore) remained resilient, with exports expanding by 6.6% in 2007. Notably, trade with Vietnam and Indonesia recorded robust growth of 23.8% and 19% respectively. Vietnam's increased openness to trade after its accession to the World Trade Organisation in November 2006 contributed towards an increase in Malaysia's export share to Vietnam. Higher exports reflected exports of iron and steel products for the construction industry and E&E products. Meanwhile, exports to Indonesia were supported by demand for petroleum and chemical products.

The strong performance of the services industry in 2007 was reflected in the turnaround in the **services account** deficit to a surplus position (RM1 billion or 0.2% of GNI). The improvement in the services account was

Table 1.20
Services and Income Accounts

	2006	2007e		
	RM billion			
	Net	+	–	Net
Services Account	**-6.9**	**97.1**	**96.1**	**1.0**
% of GNI	*-1.2*			*0.2*
Transportation	-19.6	24.2	37.7	-13.5
Travel	23.5	44.3	18.0	26.3
Other services	-10.4	28.3	39.7	-11.4
Government transactions n.i.e.	-0.4	0.3	0.7	-0.4
Income Account	**-17.4**	**38.8**	**52.5**	**-13.7**
% of GNI	*-3.1*			*-2.2*
Compensation of employees	-0.3	5.4	5.9	-0.5
Investment income	-17.1	33.4	46.6	-13.2

Note: Numbers may not necessarily add up due to rounding
n.i.e. Not included elsewhere
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

attributed mainly to the rise in exports of travel and transportation services, which together accounted for more than two-thirds of total gross services receipts. Of significance, the travel account recorded a larger surplus of RM26.3 billion, reflecting mainly higher foreign exchange earnings as a result of significant increase in tourist arrivals in conjunction with the Visit Malaysia Year (VMY) 2007.

The surplus in services account was attributable to higher tourism and transportation receipts

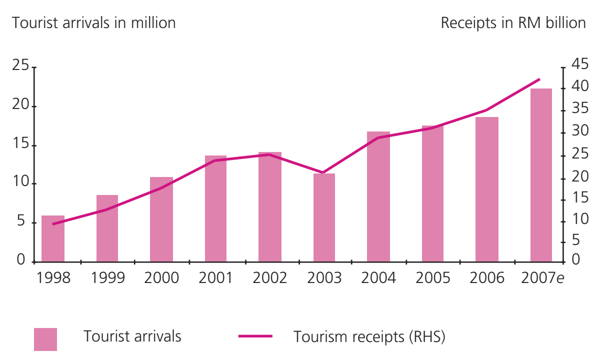
Tourist arrivals expanded strongly by 19.5% to 21 million visitors attributable to the VMY 2007 campaign. Tourists were mainly from ASEAN, PR China, India and the Middle East. Greater air services connectivity and rising income levels spurred the growth of tourists from regional countries, while the simplified processes and relaxation of visa requirements continued to support growth of tourists from PR China and India. Similarly, mid- to long-haul tourists from the Americas, Europe and Oceania also increased during the year.

The other contributing factor to the improvement in the services account was the lower deficit in the transportation account (RM13.5 billion), due to higher earnings from passenger, cargo and charter services. Of significance, earnings from passenger fares doubled, supported mainly by greater travel demand in the region. Higher volume of transshipment cargo originating largely from Hong Kong SAR, PR China, Chinese Taipei, Japan and Singapore led to increased earnings from transshipment activities. On the payments side, outflows for freight charges, the bulk of which was for sea transportation, grew at a slower pace following the moderate growth in trade.

The other services account recorded a marginally higher deficit of RM11.4 billion, reflecting mainly continued net outflows for royalties and licence fees as well as payments for professional and financial services, while demand for imported communication and construction services increased. Outflows for royalties and licence fees reflected the continuing acquisition and usage of intellectual property rights. The net outflows for financial and insurance services were attributable mainly to the payment of custodian charges, loan commitment fees, as well as the reinsurance of high and specialised risks. Higher demand for roaming, images transmission and teleconferencing services led to a higher net outflow in communication services. Meanwhile, larger payments for construction services reflected increased imports of services for power and petrochemical plants as well as development of deepsea wells for the oil and gas industry.

The outflows in the other services account were mitigated by inflows attributable to commissions earned from the procurement of goods abroad for re-sale to non-residents as well

Chart 1.35
Tourist Arrivals and Tourism Receipts

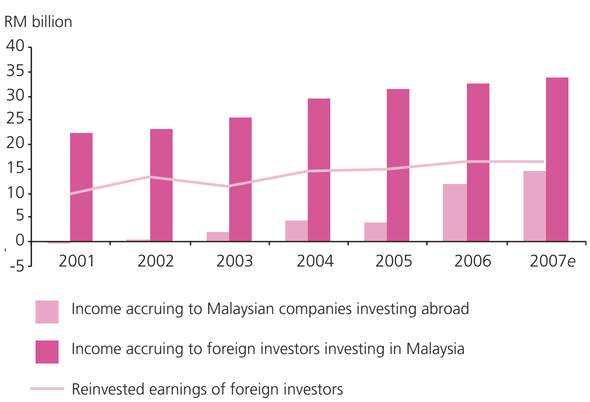


e Estimate
Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia

as exports of computer and IT services. Reflecting the continuous participation of Malaysian traders in the international market, the commissions earned from international trading activities were sustained. Trading was mainly in electrical and electronics, palm oil as well as petroleum-related products, with the bulk of the receipts from the US and Singapore. In line with the expansion in SSO industry and the development of new software application products for the ICT sector, receipts from exports of computer and IT services improved. The growth was supported by the SSO centres of financial institutions, as well as the regional IT centres of the oil and gas companies providing technical support, engineering, research and development solutions to their affiliates. Regional countries, in their efforts to upgrade IT services, have emerged as major export markets for Malaysia's software and IT support services.

The **income account** improved further in 2007, with the deficit narrowing to RM13.7 billion or 2.2% of GNI. Reflecting the successful operations of Malaysian companies investing abroad, profits and dividends accruing to Malaysian companies, particularly in the manufacturing, mining and financial sectors, increased to RM14.7 billion. The improvement in the income account was also attributable to returns on higher external reserves holdings. Meanwhile, profits and dividends accruing to foreign investors in Malaysia remained large as Malaysia continued to be a profitable center for global MNCs. About half of these profits and dividends were retained in Malaysia for reinvestment.

Chart 1.36
Direct Investment Income



e Estimate
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Financial Account

In 2007, the **financial account** recorded a smaller net outflow of RM37 billion, as net outflows of other investment moderated, while the larger net direct investment abroad by Malaysian companies was partially offset by higher net inflows of FDI and portfolio investment. The strong current account surplus was more than sufficient to finance the outflows in the financial account.

Higher inflows of FDI and portfolio investment reflected increased opportunities and strengthened confidence in the Malaysian economy. Increased capacity and rising interest by Malaysian companies to expand and diversify operations abroad led to larger outflows of overseas investment

During the year, gross inflows of **FDI** increased further to RM46.1 billion or equivalent to 7.4% of GNI. The gross inflows of FDI were broad-based and channelled mainly into the manufacturing (38%), services (24%), agriculture (20%) and oil and gas (18%) sectors. The larger gross FDI during the year was attributed mainly to higher inflow of equity capital, emanated largely from increased acquisition of local interests by foreign

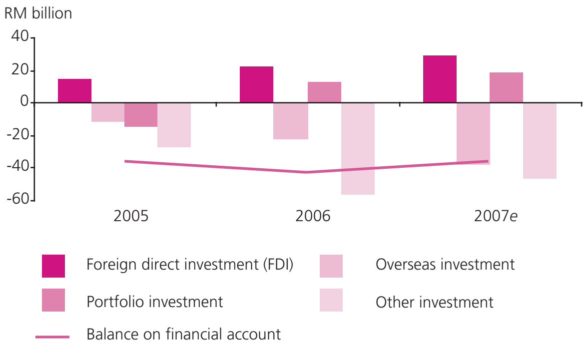
Table 1.21
Balance of Payments: Financial Account

	2006	2007*e*
	RM billion	
Financial Account	**-43.5**	**-37.0**
Direct Investment	**...**	**-8.8**
In Malaysia	22.2	29.1
Abroad	-22.2	-37.9
Portfolio Investment	**12.9**	**18.4**
Other Investment	**-56.4**	**-46.6**
Official sector[1]	-8.0	-5.8
Federal Government	*-3.1*	*-2.3*
NFPEs	*-5.0*	*-3.5*
Private sector	-48.4	-40.8

Note: Numbers may not necessarily add up due to rounding
[1] Excludes bonds and notes raised abroad by the Federal Government and NFPEs
e Estimate
… Negligible

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.37
Financial Account



e Estimate

companies. Meanwhile, earnings of existing MNCs retained for reinvestment and inflows arising from drawdown of inter-company loans were sustained. This development reflected confidence of foreign investors in the Malaysian economy, and that the country remained as an attractive investment destination. After taking into account the adjustments for outflows due largely to loan repayments to parent companies abroad, net FDI inflow increased to RM29.1 billion or 4.6% of GNI.

The *manufacturing sector* continued to attract a sizeable inflow of FDI despite a slowdown in exports of E&E products. The FDI in the E&E industry was funded mainly by retained earnings, and largely for upgrading of equipment and technology as well as establishing new product lines and capacity. The buoyant upstream activity in the oil and gas sector provided further impetus to growth of investment in the petroleum refining and petroleum-related product industry. New inflows of equity capital were attributed mainly to acquisitions of substantial interest in Malaysian companies in the paper and paper-related industry by the Indian- and Australian-based investors.

FDI in the *services sector* remained strong and channelled mainly into the finance and insurance; real estate and business services as well as wholesale and retail trade sub-sectors. The Malaysia International Islamic Financial Centre (MIFC) initiative, including liberalisation of the foreign ownership in the Islamic finance, have yielded positive results as manifested in the increased foreign interest and investment in both Islamic banking and takaful during the year. Of significance, new banking and takaful licenses were awarded to an international Islamic bank and a foreign takaful company respectively to operate in Malaysia. Meanwhile, there were also acquisitions of significant interests in two local banking institutions by foreign banks from Hong Kong SAR and Australia. Increased foreign interest to establish shared services and outsourcing (SSO) operations in Malaysia was reflected in the commencement of operations by 19 new wholly foreign-owned SSO companies under Multimedia Super Corridor (MSC) status in 2007. Foreign investment in the wholesale and retail trade sub-sector is reflected in the expansion of existing retail outlets and establishment of new outlets in the cities and emerging townships in tandem with strong domestic consumption and tourism activities.

The strong crude oil prices and firm global demand as well as the discovery of several offshore deepwater oil and gas fields in Sabah and Terengganu in recent years led to a significant inflow of FDI into the *oil and gas sector*. The investments, ranging from exploration and extraction operations to production and development activities, were undertaken mostly by PETRONAS in joint venture with its international partners through production sharing contracts. Meanwhile, the inflows of FDI into the *agriculture sector* were attributed mainly to the merger and restructuring of a Malaysian oil palm plantation company with its Singapore-based counterpart.

During the year, the Government continued to undertake policy measures and implement initiatives to enhance the business and investment climate in Malaysia and thus, further attracted FDI. The Special Taskforce to Facilitate Business (PEMUDAH) was established to review and improve the services delivery system of the public sector to enhance its efficiency and reduce cost of doing business. Several key areas of the delivery system pertaining to investment and business operations were streamlined and improved during the course of the year. These included the processing of work passes for expatriates, registration of business, environmental impact assessment as well as tax refunds to businesses.

Meanwhile, the Government has also announced generous tax incentive and flexibilities for foreign investors to invest and operate in the three economic corridors, namely the Iskandar Development Region (IDR), the Northern Corridor Economic Region (NCER) and East Coast Economic Region (ECER). The supportive business and investment environment was in tandem with the objective to boost investment in new services sub-sectors such as healthcare and education, high value-added manufacturing and agriculture activities, tourism as well as oil and gas industry. In the Budget 2008, the Government announced further liberalisation of foreign ownership in Islamic fund management business and simplification of issuance of visa and permits for expatriates to facilitate the hiring of highly-skilled and professional workers to meet industries' need.

While FDI continues to be important for Malaysia's long-term development plan, the Government has also played an active role to support initiatives by Malaysian companies to diversify and expand their operations abroad. In this respect, Bank Negara Malaysia had, in April 2007, further liberalised the foreign exchange administration measures in relation to overseas investment.

During the year, net **direct investment abroad** by Malaysian companies increased significantly to RM37.9 billion, reflecting increased capacity and rising interest of Malaysian companies to seize opportunities abroad. These investments were effected mainly through acquisition of large interests in existing operations or businesses abroad. In the *services sector,* a local gaming and resort company has increased its presence in the region as well as in the more developed market via acquisition of existing operations and participation in the development of new operation. Domestic shipping and telecommunication companies have also increased their investments in emerging markets such as Indonesia, Bangladesh and Brazil. The expansions and new investments reflected the growing competitiveness and sophistication of Malaysian companies to become regional or global players. Meanwhile, in the *oil and gas sector,* PETRONAS continued to forge partnerships with several foreign oil companies for exploration and extraction activities. Investment abroad in the *construction sector* remained significant following the success of Malaysian companies in bidding and on-going work of several large infrastructure, roads and highway projects abroad, especially in the Middle East, South Asia and ASEAN.

In 2007, there were substantial two-way flows of portfolio funds, with episodes of reversals largely due to external developments. For the year as a whole, **portfolio investment** recorded a larger net inflow of RM18.4 billion. Large net inflows in the first half of the year, driven mainly by strong positive investor sentiment, more than offset net outflows in the second half of the year due largely to concerns related to the US sub-prime problems. In the first quarter of the year, strong inflows of foreign portfolio funds were for purchases of both equity and debt securities, supported by improved investor sentiment due to stronger economic fundamentals and a confluence of positive pull factors, including announcements of special incentives to promote investment in the IDR, removal of real property gains tax as well as expectations of appreciation of the ringgit. In the second quarter, foreign investors liquidated some holdings of equities and shifted their asset allocation to highly rated debt securities. The heightened uncertainty in the global financial markets arising from the US sub-prime problems led to net liquidation of both equity and debt securities by foreign investors in the third quarter. Nevertheless, inflows of foreign funds for investment in the debt market resumed in the fourth quarter as foreign investors remained cautious with investments in the equity market.

The **other investment** recorded a lower net outflow of RM46.6 billion in 2007, reflecting lower net outflows by both the official and private sectors. The **official sector** registered another net repayment of external loan, reflecting net repayments of loans by both the Federal Government and the non-financial public enterprises (NFPEs). Meanwhile, the other investment by the **private sector**, which comprises mainly borrowing and lending and placement and withdrawal of deposits by the banking sector as well as the non-bank private sector transactions with unrelated counterparties, recorded a lower net outflow. The outflows by the banking sector, albeit lower, reflected mainly placement of assets abroad amidst increased portfolio diversification by banks and ease of sourcing foreign exchange from domestic market. Meanwhile, outflows by the non-bank private sector was attributed mainly to trade credits extended by Malaysian exporters, repayment of trade credits by importers and placement of deposit with financial institutions abroad.

External Debt

Malaysia continues to adopt prudent external debt management strategies while facilitating business operations. In this regard, the rules on foreign currency borrowing by residents have been progressively liberalised to enable residents to source foreign currency financing at competitive costs. Given the dynamic and rapidly evolving global business environment, greater emphasis is placed by the Central Bank on enhancing risk management capabilities to minimise risk exposures against global interest rate and exchange rate movements and shift in investors' sentiment. The management of the nation's external debt is supported by a comprehensive debt monitoring system which enables the authorities to monitor the overall debt level, the structure of debt as well as debt-servicing obligations of both the public and private sectors.

The external debt position remains at prudential levels, with the debt profile biased towards a longer maturity structure. The public sector continued to record net repayments

As at end-2007, Malaysia's total external debt amounted to RM187.4 billion (or USD56 billion), or equivalent to 29.9% of GNI. Notwithstanding a moderate increase in the total external debt, the nation's debt servicing capacity continued to improve. This was reflected in the decline in the ratios of total external debt to the international reserves and the exports of goods and services to 55.8% and 26.7% respectively (end-2006: 63.5% and 27.5%, respectively). The overall debt service ratio (excluding prepayment) improved (3.8%; 2006: 4.8%). In addition, the external debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 70.9% of the total debt. The short-term external debt remained low, accounting for only 8.7% of GNI, 16.2% of international reserves and 7.7% of exports of goods and services.

Table 1.22
Outstanding External Debt

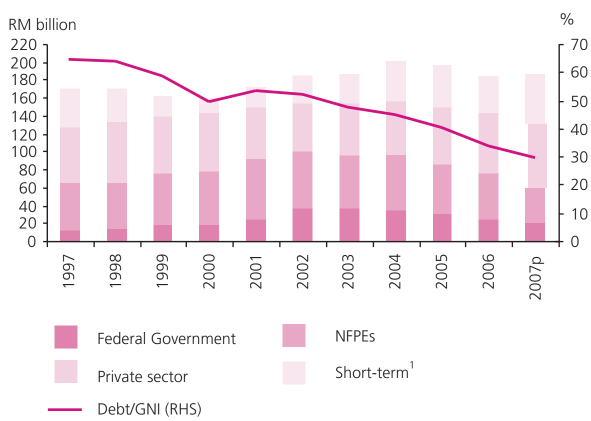
	2006	2007*p*	2006	2007*p*
	RM billion	RM billion	USD billion	USD billion
Total debt	**184.5**	**187.4**	**51.7**	**56.0**
Medium- and long-term	141.7	133.0	39.7	39.7
Short-term[1]	42.8	54.5	12.0	16.3
As % of total debt	*23.2*	*29.1*		
As % of net international reserves	*14.7*	*16.2*		
As % of GNI				
Total debt	33.2	29.9		
Medium- and long-term debt	25.5	21.2		
As % of exports of goods and services				
Total debt	27.5	26.7		
Medium- and long-term debt	21.2	18.9		
Debt service ratio (%)	**4.8**	**3.8**		

[1] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary

Source: Ministry of Finance and Bank Negara Malaysia

During the year, the **medium- and long-term external debt** declined, due mainly to lower external debt of the public sector. The public sector, comprising both the Federal Government and non-financial public enterprises (NFPEs), registered its fifth consecutive year of net repayment of external debt (-RM10.4 billion). During the year, the **Federal Government**

Chart 1.38
Outstanding External Debt



[1] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary

maintained its practice of sourcing funding requirements mainly from non-inflationary domestic sources. For the fourth consecutive year, no market loan was raised from the international capital market. The drawdown of external loans was attributed entirely to project loans committed earlier from official bilateral sources and multilateral development banks. Meanwhile, external loan repayment increased, attributable mainly to the maturity of the sovereign Global Sukuk of USD600 million and prepayments of project loans. The **NFPEs** recorded its sixth consecutive year of net repayment in 2007. The larger net loan repayments reflected mainly the maturity of bonds issued by companies in the electricity, gas and water sub-sector, oil and gas sector as well as finance and insurance sub-sector, and higher prepayments of loans. Conscious efforts to reduce exposure to external debt through prepayments were effected mainly by companies in the manufacturing sector and communication sub-sector.

Meanwhile, the **private sector** registered a net drawdown of external debt amounting to RM8.6 billion in 2007, reflecting mainly higher loan drawdown particularly by companies in the transport and storage; and communication sub-sectors. The larger drawdown was largely to finance capital expenditure in line with higher private investment activity during the year. The repayment during the year was primarily by companies in the finance and insurance; and real estate and business services sub-sectors as well as the manufacturing sector. While the private sector medium- and long-term debt accounted for 53.8% of the total medium- and long-term debt, about two-third of these loans were inter-company loans that have flexible terms and concessionary interest rates.

In 2007, the **short-term external debt** outstanding increased to RM54.5 billion (end-2006: RM42.8 billion), attributed primarily to the inter-bank borrowings arising from treasury operations. Meanwhile, the short-term external debt of the non-bank private sector, comprising mainly revolving credits and overdraft facilities, was lower, accounting for a smaller share of the total short-term external debt (22.6%; end-2006: 32.7%).

Malaysia's external debt continued to benefit from the appreciation of the ringgit against the major currencies during the year. The exchange revaluation gain amounting to RM6.7 billion has contributed to a lower medium- and long-term debt outstanding. In addition, the stronger ringgit had also reduced the debt servicing payments in 2007.

International Reserves

The international reserves held by Bank Negara Malaysia comprise the holdings of foreign exchange and gold, reserve position with the IMF and holdings of Special Drawing Rights (SDR). For the year of 2007, the net international reserves increased by RM45.3 billion to RM335.7 billion (equivalent to USD101.3 billion) as at 31 December 2007. The increase in reserves was due to large trade surplus underpinned by strong commodity exports as well as larger inflows of both FDI and portfolio investment, reflecting improved economic prospects and strengthened investor confidence. The reserves increased further to RM384.1 billion (equivalent to USD116.3 billion) as at 29 February 2008, adequate to finance 9.6 months of retained imports and is 7.1 times the short-term external debt.

The increase in reserves was due to large trade surplus underpinned by strong commodity exports as well as larger inflows of both FDI and portfolio investment, reflecting improved economic prospects and strengthened investor confidence

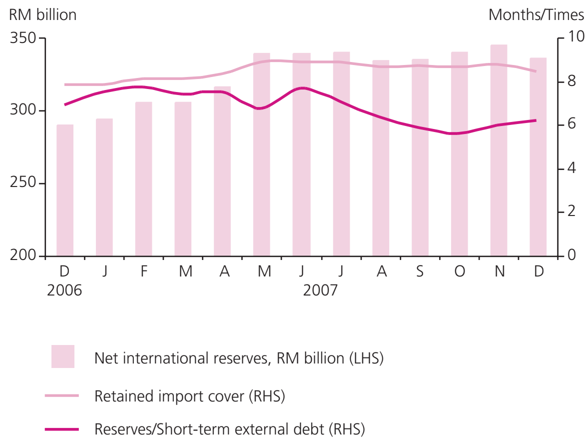
During 2007, foreign exchange inflows were generated from the higher repatriation of export earnings, supported by strong commodity exports, and the larger inflows of FDI and portfolio investment following the improved economic prospects and investor confidence. Meanwhile, stronger economic activity and better corporate performance led to higher outflows through increased payments for imports of goods and services, as well as repatriation of profits and dividends accruing to foreign companies operating in Malaysia. The higher overseas investments by Malaysian companies during the year also contributed to the outflows.

Table 1.23
Net International Reserves

	As at end			Change
	2005	2006	2007	2007
	RM million			
SDR holdings	748.3	756.9	760.9	4.0
IMF reserve position	1,186.3	793.4	617.5	-175.9
Gold and foreign exchange[1]	263,328.0	288,871.2	334,338.6	45,467.4
Gross International Reserves	**265,262.7**	**290,421.5**	**335,717.0**	**45,295.5**
Less Bank Negara Malaysia external liabilities	22.5	22.9	22.2	-0.7
Net International Reserves	**265,240.2**	**290,398.6**	**335,694.8**	**45,296.2**
USD million equivalent	**70,193.4**	**82,450.8**	**101,338.1**	**18,887.3**
Months of retained imports	7.7	7.8	8.4	
Reserves/Short-term external debt (times)	5.6	6.9	6.2	

[1] 'Other Foreign Currency Claims on Residents' is reclassified from 'Gold and Foreign Exchange' to 'Other Assets' of Bank Negara Malaysia

Chart 1.39
Net International Reserves (end-month)



During the year, the cumulative foreign exchange revaluation loss amounted to RM5.6 billion, following the strengthening of ringgit against the major currencies, particularly in the first and fourth quarters of 2007.

Malaysia, as a country with a strong balance of payments position, remains a participating member in the Financial Transactions Plan of the IMF, which makes resources available to member countries facing short-term balance of payments difficulties. The decline in **reserve position with the IMF** in 2007 was due mainly to the repayment to the ringgit account by various member countries under the Financial Transactions Plan. Meanwhile, the increase in international reserves held in the form of **SDRs** was attributed mainly to the receipt of remuneration arising from Malaysia's net creditor position with the IMF.

The Bank has continued to maintain diversified portfolio in the management of the international reserves. This is in addition to the traditional objectives of capital and liquidity preservation. The Bank continued to review and assess new asset classes, instruments and currencies for inclusion into the investment portfolio in order to improve the risk adjusted returns on the reserves. The Bank also introduced a new investment benchmark in early 2007 that included some of the additional new asset classes and currencies, incorporating a more strategic and longer-term approach in reserve management. Complementary to this, new risk management techniques, utilising more quantitative tools such as value-at-risk and tracking error were adopted to enhance the market risk management of reserves, while the governance framework was further strengthened to enable a more efficient and effective investment management structure. In addition to these, as part of an overall diversification strategy, the Bank also awarded new investment mandates to selected global fund managers for more specialised asset classes.

The international reserves held by the Bank are usable and unencumbered. There are no foreign currency loans with embedded options; and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in options-related activity in the foreign currency markets.

Development of Small and Medium Enterprises

The development of a strong and dynamic SME sector is an important national agenda towards creating sustainable and balanced economic growth. During the year, the National SME Development Council[1] (Council) had taken further steps to spur the development of SMEs to the next level by strengthening the enabling infrastructure for SME development, building SMEs' capacity and capabilities, and improving access to financing by SMEs.

Profile and Contribution of SMEs to the Economy

The Baseline Census of Establishments and Enterprises was conducted in 2005 (Census 2005) and provided important data on the profile and performance of SMEs to facilitate the formulation of effective policies and strategies to support SME development. Based on the responses of 552,804 business enterprises, SMEs formed 99.2% or 548,267 of the business establishments in Malaysia, of which almost 80% or about 435,300 are micro enterprises. The findings revealed that 87% of SMEs are in the services sector, followed by 7.2% of SMEs in the manufacturing sector and 6.2% in the agriculture sector.

Achievements of SME Development Initiatives

Since the establishment of the Council in 2004, the foundations for SME development have been strengthened considerably. Various initiatives have been implemented by the Council and have benefited policymakers by improving policy formulation, monitoring and assessment of SME development programmes. This in turn has strengthened the capacity and capability, enhanced access to financing and provided comprehensive dissemination of relevant and important information to SMEs.

Key Initiatives and Achievements in 2007

The Council has implemented several key initiatives towards SME development in 2007:

(i) Establishment of SME Central Coordinating Agency

During the 7th Council meeting held in September, it was agreed that an SME Central Coordinating Agency (SME CCA), a dedicated Government agency would be established to spearhead SME development in Malaysia. A key role of the SME CCA is to coordinate the policy formulation and SME development programmes to ensure that comprehensive and effective programmes are implemented across all sectors. The SME CCA will also act as a one-stop information centre for SMEs to obtain comprehensive information and advisory services in the areas of development of business plans, marketing, technology adoption, information services, and financial advisory. In addition, the SME CCA will disseminate information on SME performance and statistics, and conduct research on SME-related issues and development. With the establishment of the SME CCA, Bank Negara Malaysia will hand over the role of the Secretariat of the Council to the Agency.

(ii) SME Annual Report 2006

On 13 September 2007, the Council released the SME Annual Report 2006. The Report is an important initiative to disseminate information on the strategies and programmes that have been implemented by the Government to support the development and growth of the SME sector. The report also showcased success stories of the SMEs.

(iii) SME Business Adviser Network

The establishment of the SME Business Adviser Network, a one-stop web-based directory in the SMEinfo Portal (www.smeinfo.com.my) provides a platform for SME business advisers in the various Government agencies and financial institutions to connect and leverage on

[1] The National SME Development Council is chaired by the Prime Minister and comprised Ministers and Heads of 15 key Ministries and Agencies involved in SME development. Bank Negara Malaysia is the Secretariat to the Council.

each other in their respective areas of expertise. The network enables SMEs to put forward enquiries and issues online, directed to the SME business advisers. This enables a timely and comprehensive range of high-quality advisory services in the areas of marketing, technology and operations management, human resource, financing, and business and product development to be made available to SMEs. Currently, there are more than 200 business advisers from financial institutions and SME-related Government agencies connected through the network to provide comprehensive, online advisory services to SMEs.

(iv) Brand-SME Development Programme
The Brand-SME Development Programme, spearheaded by the Ministry of International Trade and Industry, aims to promote, reinforce and sustain the value of individual SME brands through a National Mark. The acceptability of SMEs' products and services in the domestic and foreign markets will be enhanced through this programme which targets to promote the recognition of the National Mark. The aim of the programme is to establish 100 SME brands overseas within four years. Under the programme, selected SMEs from targeted sectors will be assisted in developing the branding of their products. SMEs will be certified and granted the use of the National Mark upon successfully undergoing the auditing process to ascertain the adequacy, readiness and commitment in the branding.

(v) Establishment of the National SME Innovation Focal Point
The National SME Innovation Focal Point was established in March 2007. This focal point is a collaboration between industry associations, entrepreneurs, research institutions, financiers (including venture capitalists) and relevant Government agencies to formulate initiatives and programmes for the development of innovation-driven SMEs. Since inception, the focal point has established a database which stores technology related research findings and through the Technology Foresight Programme, SMEs are kept abreast with the latest information on best practice technologies. A Technology and Innovation Showcase was organised in June 2007 whereby a total of 53 ready-to-commercialise research projects were showcased and 22 of these projects were adopted by SMEs. Under the Global Supplier Programme, SMEs are encouraged to develop and commercialise new and innovative products and services for international markets.

Enhancing Access to Financing by SMEs

Comprehensive SME Financing Landscape
The financing landscape has been continuously evolving to meet the needs of SMEs for the three key stages of a business life-cycle, namely start-up, business expansion and rehabilitation. There are various sources of financing for SMEs from the financial institutions which includes the banking institutions, development financial institutions, leasing and factoring companies, as well as venture capital companies which provide equity financing. In addition, various special funds and schemes for the SMEs have been set up by the Government.

Financial institutions remain as the largest source of funding for SMEs. As at end-2007, total financing outstanding from banking institutions and development financial institutions amounted to RM128 billion and was provided to 625,167 SME accounts. Banking institutions are the main providers of financing to SMEs, accounting for over 89% or RM114.2 billion of total financing outstanding provided by banking institutions and development financial institutions.

A Comprehensive SME Financing Landscape

625,167 SME accounts[1] have RM128b worth of financing as at end 2007

Banking Institutions
- **47** banks with **3,359** branches
- **RM114.2b** financing outstanding to **518,446** SME accounts at end-2007
- 2007: **RM55.1b** financing approved to **109,497** SME accounts

Development Financial Institutions (DFIs)
- **6** DFIs with **677** branches
- **RM13.8b** financing outstanding to **106,721** SME accounts at end-2007
- 2007: **RM8.1b** financing approved to **23,477** SME accounts

Venture Capital (VC)
- **52** VC companies
- Outstanding **RM1.8b** investment in **433** companies at end-2006
- 2007: **RM479m** invested

Leasing and Factoring
- **RM2.0b** loans outstanding at end-2007
- 2007: **RM792.3m** approved

Financing by Banking Institutions and Development Financial Institutions include:

5 Bank Negara Malaysia Special Funds
- Approved **RM16.1b** financing to **33,717** SME accounts
- **RM7.6b** outstanding at end-2007
- 2007: **RM2.7b** approved to **4,859** SME accounts

100 Government Funds and Schemes[2]
- Approved **RM85.5b** to **1.3m** SME accounts at end-2007
- **RM7.0b** financing outstanding at end-2007
- 2007: **RM13.7b** approved to **243,203** SME accounts

Small Debt Resolution Scheme
- Since establishment, restructured NPLs of **565** SMEs amounting to **RM324m**
- 2007: Restructured NPLs of **141** SMEs amounting to **RM56.9m**

Credit Guarantee Corporation Malaysia Berhad
- Guaranteed **RM39.1b** financing to **373,665** SME accounts since 1972
- Outstanding guarantee of **RM14.68b** financing to **90,437** SME accounts at end-2007
- 2007: Guaranteed **RM4.0b** financing to **13,008** SME accounts

Note 1: Consist of accounts maintained with banking institutions and development financial institutions

Note 2: Only part of the Government funds and schemes are disbursed through development financial institutions.

Significant Expansion of Financing to SMEs

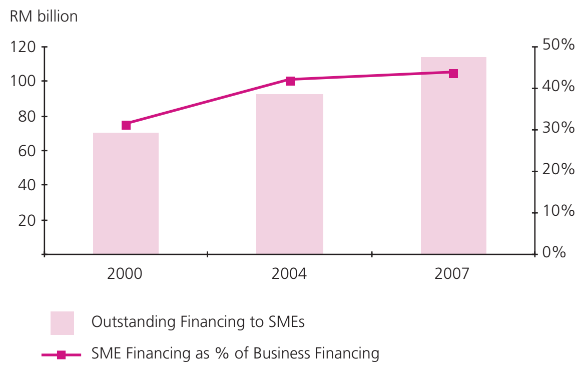
Financing to SMEs continued to expand significantly in 2007. The banking institutions and development financial institutions had approved RM63.2 billion to more than 132,000 SME accounts in 2007. This significant achievement had exceeded the 2007 projected financing approval target of RM51 billion to 110,000 SME accounts.

Banking Institutions: Main SME Financing Indicators

	During		
	2007	**2006**	**2007 (% annual growth)**
Applications (RM billion)	99.1	71.4	38.8
Number of Accounts ('000)	*158.2*	*106.0*	*49.2*
Approvals (RM billion)	55.1	40.2	37.1
Number of Accounts ('000)	*109.5*	*83.7*	*30.8*
Disbursements (RM billion)	141.5	134.1	5.5
Repayments (RM billion)	126.6	122.5	3.4
	As at end		
	2007	**2007 (% annual growth)**	**2006 (% annual growth)**
Financing Outstanding (RM billion)	114.2	9.1	5.1

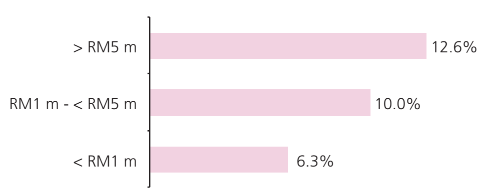
Banking institutions continued to expand financing to the SME sector. Financing applications from SMEs and approvals by banking institutions grew strongly in 2007. Applications and approvals increased by 38.8% year-on-year (yoy) to RM99.1 billion and 37.1% yoy to RM55.1 billion respectively. Disbursements grew by 5.5% yoy to RM141.5 billion, primarily reflecting disbursements to the construction and manufacturing sectors. The moderate disbursements as compared to strong approvals could be due to lower take-up of financing approved to SMEs. SMEs could have submitted multiple financing applications to a number of banks while only accepting financing offers from the bank that offers the most competitive financing rate, despite obtaining multiple approvals from banks on their applications. Alternatively, another possible reason could be the lower utilisation of approved financing lines by SMEs.

Increase in Financing to SMEs

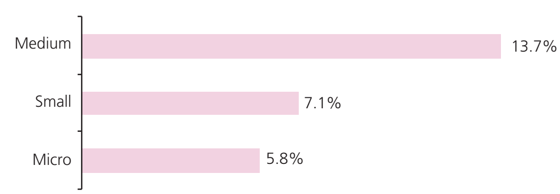


The total SME financing outstanding of RM114.2 billion accounted for 17.7% of the total banking institutions financing and 43.6% of the total business financing as at end-2007. Meanwhile, the number of outstanding SME accounts increased by 10,805 accounts to 518,446 accounts at end-2007. In 2007, larger sized financing were granted to larger sized SMEs. The growth of financing sizes larger than RM5 million (+12.6% yoy), was higher than that of those smaller than RM1 million (+6.3% yoy). Similarly, the growth of financing to medium-sized SMEs (+13.7% yoy) was higher than that of financing to small-sized SMEs (+7.1% yoy) and microenterprises (+5.8% yoy).

Financing Outstanding (By Financing Size, 2007, % yoy)

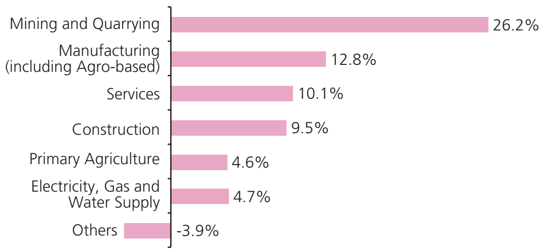


Financing Outstanding (By SME Size, 2007, % yoy)

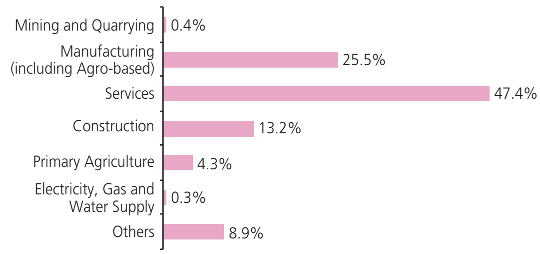


Financing outstanding grew by 9.1% yoy at end-2007, as compared to end-2006 of 5.1% yoy growth. This was mainly driven by higher growth in the construction (9.5%), primary agriculture (4.6%) and mining sectors (26.2%) and continued high growth in the services (10.1%) and manufacturing sectors (12.8%). Of the total financing outstanding at end-2007, almost 73% was

Financing Outstanding (By Sector, 2007, % yoy)



Financing Outstanding (By Sector, 2007, % Share)



extended to the services (47.4%) and manufacturing (25.5%) sectors, while the balance was extended to other sectors including construction (13.2%) and primary agriculture (4.3%).

Non-performing loans (NPLs) by SMEs continued to improve due to full or partial settlements and higher reclassification of NPLs to performing status, as well as efforts by banking institutions to achieve healthier balance sheets through loan write-offs and sale of NPLs. This has resulted in the decline of NPLs by 3.1% to RM10.4 billion as at end-2007 from RM10.7 billion as at end-2006. Similarly, gross SME NPL ratio has improved to 9.1% from 10.2% as at end-2006. On a sectoral basis, the decline in SME NPLs was mainly recorded in agriculture (-30% yoy), construction (-15% yoy) and services (-7.1% yoy) sectors.

The development financial institutions continued to complement the banking institutions in expanding the provision of financing to SMEs. In 2007, financing approvals and disbursement of the six development financial institutions[2] under the purview of Bank Negara Malaysia increased by 17.9% yoy to RM8.1 billion and 15.5% yoy to RM4.3 billion respectively, indicating consistent take-up and utilisation of the approved financing lines by SMEs. As at end-December 2007, development financial institution's financing outstanding grew by 6.8% yoy to RM13.8 billion, accounting for about 11% of total financing outstanding of the banking institutions and development financial institutions. 72% of the development financial institution's financing outstanding as at end-December 2007 were extended to the services (42.7%) and construction (29.3%) sectors. The balance was extended to other sectors including agriculture (11.7%) and manufacturing (8.3%).

Special Government Funds for SMEs

There are 105 Special Government Funds for SMEs with a total allocation of RM31.8 billion as at end-2007. The funds, mainly for nurturing and developmental purposes, are channelled to SMEs through the appointed financial institutions as well as various ministries and government agencies. Five of the Special Government Funds with a total allocation of RM11.4 billion, are administered by Bank Negara Malaysia. These are:

- Fund for Small and Medium Industries 2 (fund size: RM6.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.85 billion);
- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

Following a recommendation by Bank Negara Malaysia, a comprehensive study is currently being conducted by the Government to enhance the effectiveness of the Government funds, including where appropriate, to rationalise the number of existing funds to be more focused in meeting the financing needs of the SMEs.

[2] Comprise of Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional.

Progress of Major Initiatives to Improve Access to Financing by SMEs in 2007

Although the SME financing trend has continued to grow, initiatives continued to be taken to strengthen finance providers, widen the avenues of financing and address specific issues faced by SMEs in accessing adequate financing, to ensure that SMEs at various stages of their business life-cycle are able to have access to the necessary amount and type of financing. The specific issues that are being addressed currently include insufficient collateral, insufficient financial track record, and insufficient financing sizes. The focus of the initiatives continues to be in four broad areas, that is, (i) strengthening financial service providers, (ii) strengthening the financial infrastructure, (iii) developing new financial products for SMEs, and (iv) strengthening the provision of advisory services:

(i) Strengthening Financial Service Providers

(a) Development of a Vibrant and Sustainable Microfinance Industry

Please refer to the box article on 'Development of a Vibrant and Sustainable Microfinance Industry'.

(b) Transformation of Credit Guarantee Corporation Malaysia Berhad (CGC)

CGC has embarked on a transformation exercise in 2005 to enhance its role in supporting the growth and development of competitive SMEs. The following are some key initiatives undertaken by CGC in 2007:

- Broadened the scope of guarantee beneficiaries to include selected Islamic banks and development financial institutions to allow wider outreach to SMEs;
- Established an equity financing arm, Aureos-CGC Advisers Sdn. Bhd. to provide equity financing for SMEs;
- Introduced new products and services for SMEs (see section on 'Developing new financial products for SMEs' below); and
- Embarked on an initiative to establish a SME Credit Bureau (see section on 'Strengthening the financial infrastructure' below).

(c) Transformation of Bank Pertanian Malaysia

The intiative to restructure and strengthen Bank Pertanian Malaysia (Bank Pertanian) in a comprehensive manner has achieved significant progress, with the approval of the Bill to corporatise Bank Pertanian in Parliament in December 2007. Following this, the corporatised Bank Pertanian, with a paid-up capital of RM1 billion, is expected to be operationalised in the first half of 2008.

With strengthened institutional and financial capacities, Bank Pertanian is envisaged to be more effective and instrumental in supporting and promoting the development of the agriculture and agro-based sector, by providing a broader range and more innovative financial and non-financial products and services to meet the financing and developmental needs of the sector. In addition, Bank Pertanian is currently embarking on a series of enhancement measures to strengthen its capacity and capability, particularly in the areas of product development, risk management and information technology systems enhancement.

(ii) Strengthening the Financial Infrastructure

(a) CGC's SME Credit Bureau

To enhance access to financing by SMEs, CGC has embarked on an initiative in 2007 to establish the SME Credit Bureau, through a strategic partnership with a premier global provider of credit information on SMEs. The Bureau is a credit databank that would facilitate financing to SMEs by providing financial institutions and trade creditors with convenient, timely and efficient access to credit information on SMEs. Through its operations, the Bureau will assist SMEs build a track record, which financing institutions can use in evaluating financing applications. In addition, SMEs could also enjoy more favourable terms from trade creditors and suppliers, with the access to third party information on the SMEs' businesses. The Bureau is also expected to play a significant role in inculcating prudent and sound financial management practices among the SMEs, whereby SMEs could initiate adequate remedial actions to address weaknesses highlighted through the rating provided. The Bureau is expected to be in operation in the second half of 2008. SMEs can register as members of the Bureau at www.smecreditbureau.com.my.

(b) The Small Debt Resolution Scheme

The Small Debt Resolution Scheme, established in 2003, continued to facilitate the restructuring of NPLs of SMEs with on-going businesses. As at end-2007, 726 applications with total NPLs of RM486 million have been received. Of these, 565 applications involving NPLs of RM324 million were approved for restructuring, while RM18 million new financing was approved for 38 applications. To enhance the outreach of the Scheme, Bank Negara Malaysia included Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), Bank Pertanian and Export-Import Bank of Malaysia Berhad (EXIM Bank) as participating financial institutions in the Scheme in January 2008, whereby their customers with NPLs of less then RM3 million will also be eligible to be considered under this Scheme.

(iii) Developing New Financial Products for SMEs

(a) New Products and Services by CGC

To enhance access to financing by SMEs, the following new products and services were introduced by CGC in 2007:

- A guarantee scheme for start-ups (DAGS Start-up) to assist new SMEs which have difficulties in obtaining bank financing, due to insufficient collateral and insufficient financial track record. Under the Scheme, eligible SMEs which have been in operation for less than one year may obtain 100% guarantee for financing of up to RM2 million.
- A Syariah-based guarantee scheme, the Credit Enhancer Islamic (Enhancer-*i*) was launched in January 2008.

(b) Synthetic Securitisation of SME Loans

In May 2007, Cagamas Bhd. introduced Malaysia's first securitisation of SME loans amounting to RM600 million through its wholly-owned subsidiary, Cagamas SME Bhd, with loans originating from a Malaysian banking institution. The transaction is the first synthetic securitisation transaction in the country. Through such securitisation, banking institutions will have greater flexibility in managing their SME loans portfolio and will have enhanced capacity to provide financing to SMEs.

(c) The Special Relief Guarantee Facility for Flood Affected Businesses

In 2007, Bank Negara Malaysia established a Special Relief Guarantee Facility of RM500 million to alleviate the problems faced by businesses affected by the floods which hit the country in December 2006 and January 2007. Under the facility, flood-affected businesses were able to obtain financing at subsidised rates from all commercial banks, Islamic banks, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Bank Rakyat and Bank Pertanian. CGC provided 80% guarantee for the financing obtained. As at end-2007, 4,640 applications were approved with total financing amounting to RM471.9 million.

(d) Venture Capital Funds for the Agriculture Sector

Two venture capital funds totalling RM300 million were established in 2006 by Bank Negara Malaysia and two banking groups. The funds are aimed at creating and developing an integrated agriculture business, particularly in farming, fisheries and livestock, as well as to finance new technology-intensive agriculture projects, including biotechnology. As at end-2007, investments totalling RM72.9 million were made in seven companies.

(e) New Trade Financing Arrangements and Overseas Project Financing by EXIM Bank

The Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS) were established in January 2006, aimed at encouraging SMEs to export their goods and services, particularly to the non-traditional markets such as members of the Organisation of Islamic Conference. As at end-2007, RM106.9 million was approved under MCTF and RM1.8 million was approved under IEFS.

To facilitate funding for Malaysian companies with overseas projects, a RM1 billion Overseas Project Fund was established by Bank Negara Malaysia at EXIM Bank in December 2006. A total of RM190.9 million financing were approved with guarantee coverage of RM143 million as at end-2007.

(iv) Strengthening the Provision of Financial Advisory Services

To complement the financial infrastructure, initiatives have also been taken to ensure that a comprehensive financial advisory services infrastructure is in place. SMEs have utilised the various avenues made available to channel queries and complaints and take the opportunity to improve understanding of financial issues and seek assistance to rehabilitate problematic businesses. On this front, Bank Negara Malaysia has continued to provide relevant services through the following:

(a) BNMLINK

Bank Negara Malaysia's *Laman Informasi Nasihat dan Khidmat* (BNMLINK) continues to provide financial advisory services to the SMEs in the following areas:

- Information on various sources of financing available to SMEs;
- Assistance in facilitation of the financing application process; and
- Advice on SME financial requirements and problems.

At end-2007, more than 16,600 enquiries and assistance were sought by the SME sector, reflecting continued awareness among SMEs of the availability of such services at Bank Negara Malaysia. Of these, 79% were enquiries on special funds provided by the Government and advice on financing matters, while the remaining were for assistance, mainly on loan restructuring and loan rejections.

(b) BNMTELELINK

To complement the walk-in counter services offered by BNMLINK, the BNMTELELINK, Bank Negara Malaysia's dedicated Contact Centre, was launched in 2007. BNMTELELINK facilitates members of the public including SMEs, to bring their queries and complaints to the Bank via telephone, or in writing via fax, email or post. As at end-2007 (within seven months of operation), BNMTELELINK has attended to 677 enquiries by SMEs. BNMTELELINK can be contacted at:

Tel. : 1300 88 5465 (Toll-Free Line)
Fax : 03 – 2174 1515 / 03 – 2174 1616
Email : bnmtelelink@bnm.gov.my

In addition to the above services, financial advisory services are also being provided to SMEs by all commercial banks through the SME Units at the respective financial institutions; the SME Bank through its Advisory Centre (SAC); and the CGC through its Business Advisory Services Entity (BASE) panel consultants.