managing risk, enabling trade

Atradius Country Report

Malaysia – December 2010

Overview

General information

Capital: Kuala Lumpur
Government type: Constitutional monarchy
Currency: Ringgit (MYR)
Population: 25.7 million
Status: Upper middle income country (GDP/capita: US$ 8,378 in 2010)

Most important sectors (% of GDP, 2009)

Services: 44 %
Industry: 48 %
Agriculture: 8 %

Main import sources (2009)

China: 14.0 %
Japan 12.5 %
USA: 11.2 %
Singapore: 11.0 %

Main export markets (2009)

Singapore: 14.0 %
China: 11.2 %
USA: 11.0 %
Japan: 9.8 %

Main expenses of foreign exchange

Capital goods (51 % of total imports), chemicals (9%), food (6 %)

Main sources of foreign exchange

Electronics & electrical machinery (37 % of total exports), chemicals (6 %), palm oil (3 %), fuels (15 %), rubber, timber, food (3 %)

Key indicators

	2007	2008	2009	2010*	2011**
GDP (US$ million)	186,113	222,278	192,840	236,390	273,024
Real GDP growth (%)	6.2	4.7	-1.7	6.8	4.3
GDP per capita (US$)	6,850	8.071	6.912	8.378	9.540
Inflation p.a. (%)	2.0	5.4	0.6	1.8	2.7
Fiscal balance (% of GDP)	-3.2	-4.8	-7.0	-5.6	-5.5
Total foreign debt (US$ million)	53,717	66,182	58,785	62,818	64,165
Foreign debt/GDP (%)	29	30	30	27	24
Foreign debt/XGS (%)	25	27	30	27	24
Short-term debt/inter. reserves (%)	15	25	20	24	23
Debt service ratio (%)	5	4	6	5	4
Current account balance (US$ m.)	28,932	38,913	34,078	34,827	43,393
Current account/GDP (%)	16.0	16.0	17.7	14.7	15.9
Nom. exchange rate to US$ (average)	3.44	3.33	3.52	3.22	3.0
International reserves (US$ million)	101,019	91,149	95,432	102,774	110,959
In months of merchandise imports	8.3	7.0	9.3	7.9	7.2

* estimate **forecast Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Stable

Head of state:	Sultan Mizan Zainal Abidin (since December 2006)
Head of government:	Prime Minister Mohamed Najib bin Abdul Razak (since April 2009)
Form of government:	Last general election in March 2008. The United Malays National Organization (UMNO) is the leading party in a 13-party coalition-government of National Front (Barisan Nasional, BN)

Internal political situation

The Malaysian population is an ethnic and religious mix of Muslim Malay (50 %), Buddhist Chinese (24 %), Hindu Indians (7 %) and indigenous people (11 %). Despite its majority, the Malay population possesses only about 19 % of the wealth. Racial tensions have always simmered under the surface, but have not erupted since more than 40 years, due mainly to a massive affirmative action policy favouring ethnic Malays.

The Barisan National (BN) coalition has been in power since independence in 1957. But in the March 2008 parliamentary elections the BN suffered a severe setback by winning only 63.5 % (140 out of 222) of the parliamentary seats, thus failing to obtain the crucial two-thirds majority in parliament. At the same time, 5 out of 12 state legislatures were won by the opposition parties.

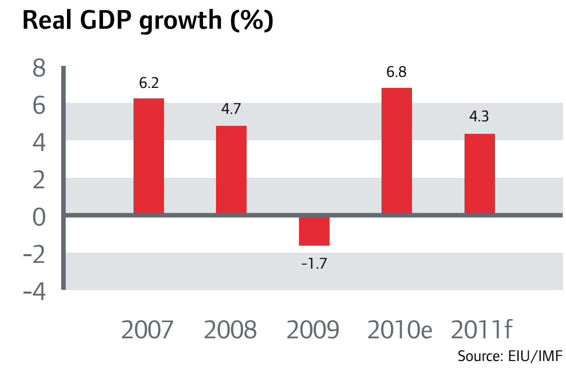
The opposition is organised in a heterogeneous informal coalition called the People's Alliance (Pakatan Rakyat, PR), comprising the People's Justice Party (PKR), the secular/social democratic Democratic Action Party (DAP) and the Islamist Pan-Malaysian Islamic Party (PAS), headed by former deputy prime minister Anwar Ibrahim. However, Anwar faces trial on sodomy, which would result in years of imprisonment if he were to be found guilty. Anwar claims that the case is politically motivated and aimed at destroying his political career (indeed, in 1999 Anwar was sacked and charged with a similar offense after he, as deputy prime minister, had fallen out with prime minister Mahathir on economic policy issues.

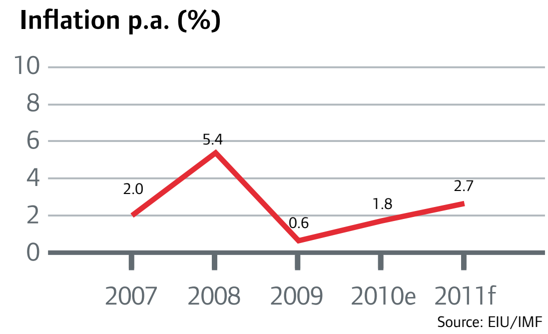
Although its grassroots support is eroding, the Barisan Nasional is still firmly in power. Since its electoral success in 2008, the opposition has suffered some defeats, as efforts to persuade a group of BN parliamentarians to defect to the PR have failed, while some PR members of parliament recently left the party to stand as independents, and Anwar is facing growing dissent within his party. In most of the state and parliamentary by-elections that have taken place since 2008, the BN has prevailed.

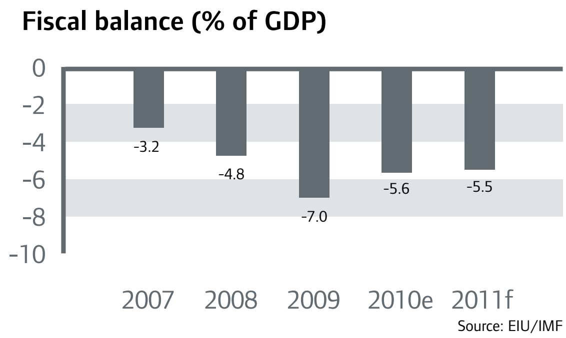
External political situation

The traditionally strained relations with neighbouring Singapore have improved significantly over the last few years, with increased cooperation between the two countries in the joint business development and tourism sectors.

Internal economic situation: Strong economic recovery







General situation

The export-oriented Malaysian economy (commodities and electronics) was hard hit by the global economic crisis; in particular by the sharp fall in foreign demand for electronics. Real GDP contracted by 1.7% in 2009. However, the recovery started in the last quarter of 2009, as oil and palm oil prices again started to rise, manufacturing industry inventories were exhausted and the government launched a massive stimulus package to boost activity - especially in the construction sector.

Growth accelerated in the first half of 2010, by 10.1% and 8.9% year-on-year in the first and the second quarter, as private consumption, gross fixed capital formation and exports all picked up. Exports increased 20.4% year-on-year between January and September, due to increased demand for electrical and electronic products, which amounted to 40% of total exports, and for palm oil and liquefied natural gas. Imports surged by as much as 26.4%, mainly of machinery and transport equipment and manufactured goods. Production in manufacturing rose 12.7% year-on-year.

As demand for electronic products softened, exports of goods and services increased just 6.6% in the third quarter, according to the Central Bank of Malaysia, and GDP growth slowed to 5.3%. Growth in Q3 and Q4 of 2010 is however sustained by continued buoyant private consumption and private investment, driven by increased capital spending in the domestic oriented sectors. Overall, the Malaysian economy will grow by 6.8% this year.

Inflation is traditionally rather low, because of price subsidies. In Q3 of 2010, the consumer price index increased to 1.9% year-on-year (Q2: 1.6%), as higher prices for food and transports fuelled inflation. For the whole of 2010, an inflation rate of 1.8% is expected.

Economic policy

Weak fiscal discipline and huge expenditure on fuel subsidies (7 % of GDP) have led to structurally large budget deficits. The country has not had a surplus since 1997, and, with two large stimulus packages, the deficit increased to 7 % of GDP in 2009. As any improvement of Malaysia's credit rating and to more long-term investment is constrained by the weak fiscal position, the government has committed itself to reducing the budget deficit to below 3 % by 2015, by widening the tax base and cutting subsidies. A reduction of subsidies for food and gasoline this year will help to bring the deficit down to 5.6 % of GDP. However, measures necessary to widen the tax base will meet strong resistance from businesses and consumers alike. The government has committed itself to introduce a goods and service tax, which would make it less dependent on oil and gas revenues, but would boost inflation in the short-term.

As a reaction to the strong economic rebound in the first half of 2010, the Bank Negara Malaysia (central bank) has tightened monetary policy by raising the overnight interest rate three times since March 2010, by a total of 75 basis points, to 2.75 %. However, it left the interest rate unchanged in November in response to the expected economic moderation in the coming months and to curb the inflow of short-term investment into the country, as capital flows to emerging markets like Malaysia have increased substantially in the course of 2010.

The ringgit is pegged to a basket of currencies, and a ban on 'off-shoring' ringgits was in place until recently. However, in August 2010 the central bank relaxed currency controls, permitting local firms to use the ringgit to settle cross-border transactions.

In the Tenth Malaysia plan, a five-year development plan implemented by the Malaysian government covering the period 2011 to 2015, 12 national key economic areas for special promotion have been defined: oil and gas, palm oil, finance, retail, wholesale, tourism, information communication technology, education, electricity and electronic, commerce, private healthcare, and agriculture.

Some domestic sectors (the car industry and services) are still protected by high tariffs. Despite quite a favourable business climate in Malaysia, foreign direct investment (FDI) is still discouraged by the affirmative action policy, which has also triggered emigration of highly skilled non-Malay Malaysians (Chinese and Indians). The government has started to relax the affirmative action rules: in April 2009 it announced the abolition of the 30 % bumiputera (indigenous Malay) equity requirement in 27 trade sectors. Under the so-called Economic Transformation Programme (ETP) the government has reinstated its reform commitment, to further relax the affirmative action rules, curb red tape and liberalise the economy to attract more FDI and maintain economic growth.

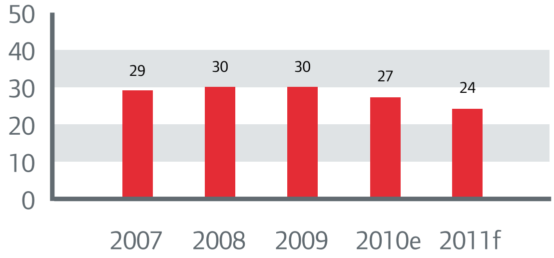
In September 2010 the government specified its development plans under the ETP. Kuala Lumpur wants to launch mainly private-sector led projects worth US$ 444 billion in the next 10 years to spur private investments. The plans include the construction of new highways, a rapid train system, factories and a financial centre.

Energy situation

Excellent. Malaysia is a net oil exporter, and also exports liquid natural gas. Oil production of 727,000 barrels per day (bbl/d). Proven reserves: 4.0 billion bbl (15 years production). Although Malaysian oil production peaked in 2004, liquefied natural gas (LNG) production is rising.

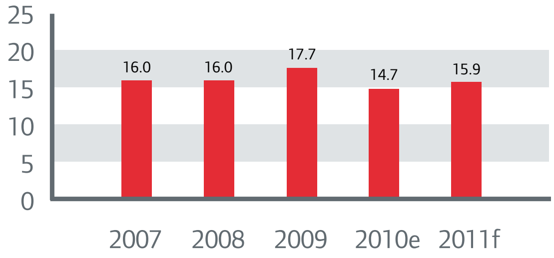
External economic aituation: Decreasing external demand

Foreign debt/GDP (%)



Source: EIU/IMF

Current account/GDP (%)



Source: EIU/IMF

Foreign debt

Level:	Low (27 % of GDP; 27 % of exports of goods and services in 2010)
Structure:	Unfavourable (40 % short-term debt, 4 times covered by reserves)
Debt service ratio:	Very low (5 %, including short-term debts 13 % in 2010)

Remarks:
Malaysia’s solvability is quite good with a foreign debt level of 27 % of GDP and 27 % of exports. Moreover Malaysia has never defaulted on its foreign debt.

Balance of payments

Trade balance:	Very large surplus
Current account:	Structurally large surpluses (15 % of GDP in 2010)
Capital account:	Volatile
Total account:	Positive

International reserves

In months of imports (cif): Good, at 9.2 months of import cover in 2010

Outlook: More reforms needed

Internal political situation

Relatively stable, but racial tensions remain an issue. There is also a tendency towards a greater Islamic influence on society, and Anwar's potential conviction could trigger protests from his supporters. Internal wrangling within the UMNO is the biggest potential threat to political stability.

Economic situation

The economic slowdown registered in the third quarter of 2010 will continue into 2011 as global demand decreases further. GDP will grow by 4.3 % next year, sustained by household consumption and private and government investments, while exports (electronics) will decline. At 5.5 % of GDP, the budget deficit will decrease only modestly, while inflation is expected to increase to 2.7 % due to continued growth in domestic demand and as some more subsidies are cut. Despite a slowdown in export growth and rising imports, the trade and current account balance will continue to show large surpluses in 2011.

Malaysia's sovereign payment capacity is guaranteed by a low foreign debt level and good liquidity. Like other Asian currencies, the ringgit will remain under appreciation pressure, as the recent US Federal Reserve decision to start another round of quantitative easing will probably decrease the yields on American assets, driving even more short-term investment capital to emerging markets like Malaysia. In contrast to its neighbours Indonesia and Thailand, Malaysia has to date not taken measures to restrict capital flows.

In the medium-term, further diversification of the economy towards higher value added sectors like technology, tourism, and Islamic banking is necessary to cope with increased competition from other countries. This should include an improvement of the education system and the provision of more incentives for research and development.

Additionally, to maintain high growth rates and attract more foreign direct investment, more structural reforms are necessary. This encompasses the cleaning-up of the large number of Government Linked Companies by selling stakes (in terms of market capitalization, currently 36% of the Malaysian stock exchange consists of such businesses), reducing red tape, and further reforms of the affirmative action policy, thus moving towards a liberalization of rules and quotas.

However, as such reforms would threaten the government with losing the ethnic Malays as its main support base, it seems rather unlikely that it will completely abolish the affirmative action in the near future, especially ahead of the next general elections, which is likely to be held in 2012. The same applies to a comprehensive revamp of the subsidy system and a tax reform, as both would be highly unpopular.

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