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The Malaysian Economy: Expanding In Turbulent Times?

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1. The World Economy is entering turbulent times characterized by five Megatrends

- A three-speed world
- A sluggish recovery
- Surging Debts and sovereign debt crises
- Inflation
- Political instability in resources-rich countries and run on commodities

2. Malaysia will be impacted and sustaining a rate of growth above 6% moving forward will be a daunting challenge

- The 7% GDP Growth in 2010 was driven by an inventories build up, likely to wane in 2011
- The easy choice is continuing the party by maintaining/increasing subsidies and other consumption-related expenditure instead of taking the tough decisions to avail resources for much needed investment
- Relying on domestic demand is not sustainable and fiscal injections are short-lived
- With Commodity rally will come increased exports but also pressure to cut subsidies and raise prices



America, the euro zone and the emerging world are heading in different directions

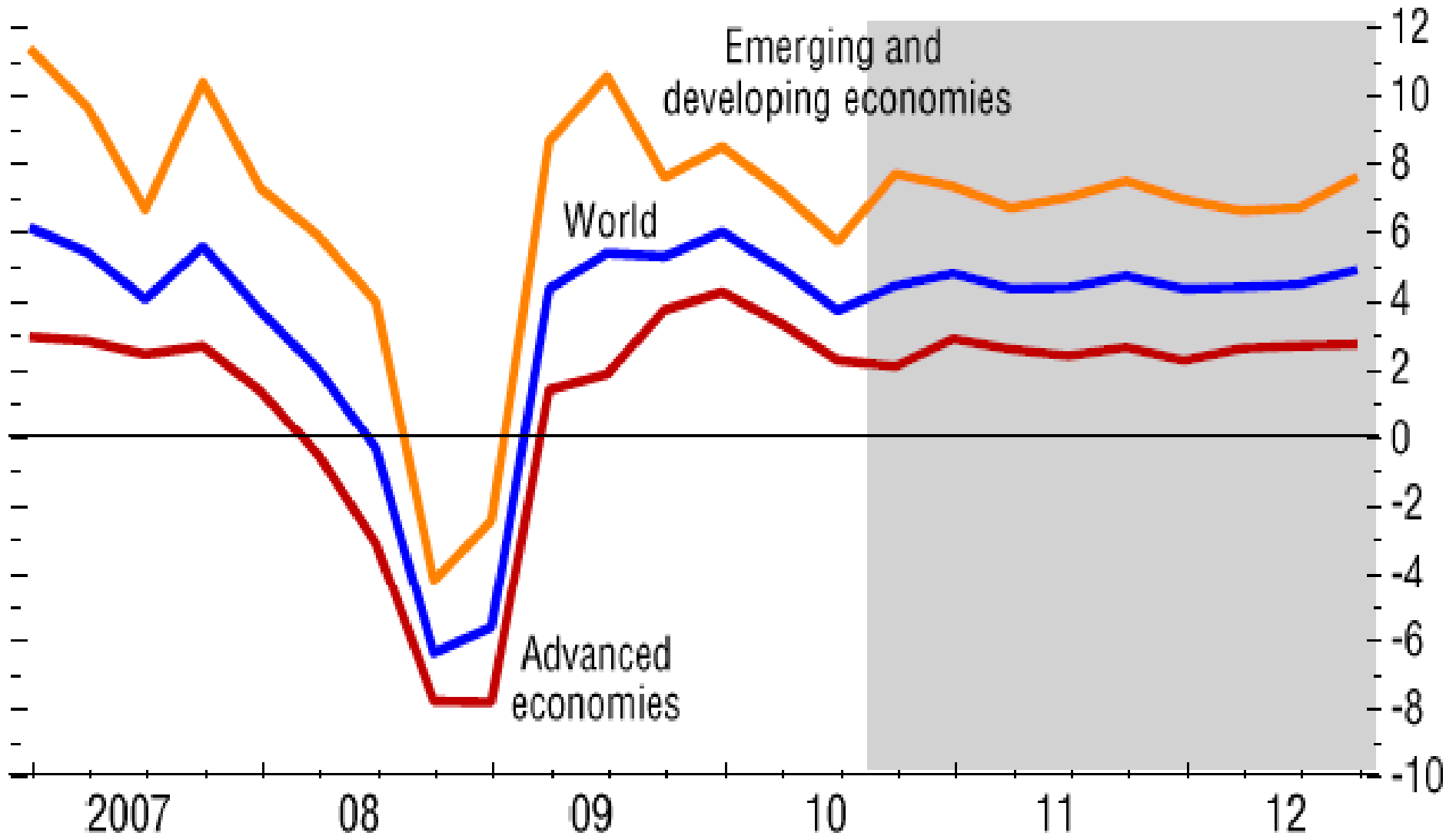
Different growth prospects

Contradictory policy choices





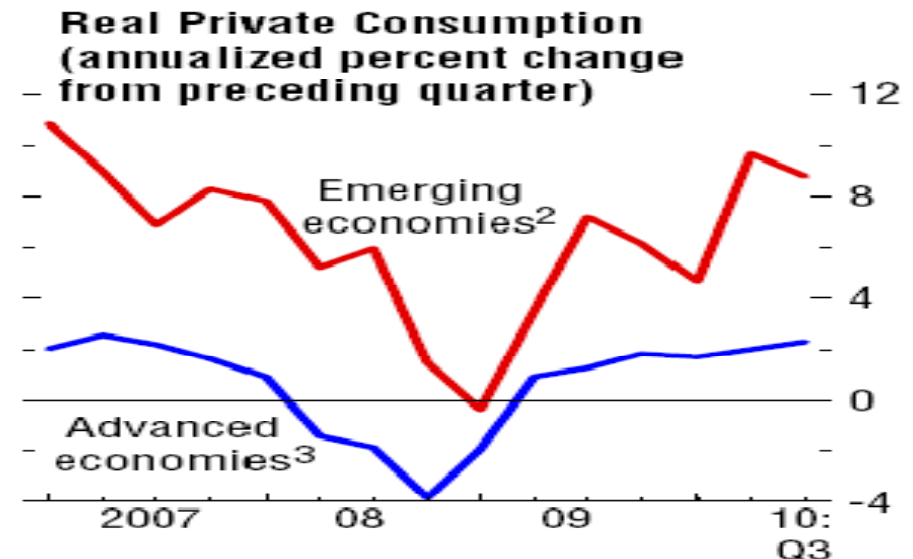
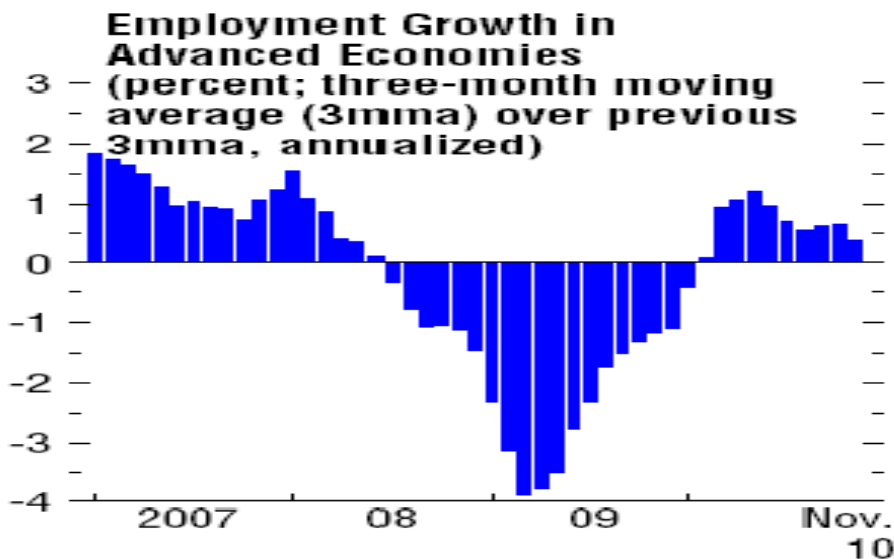
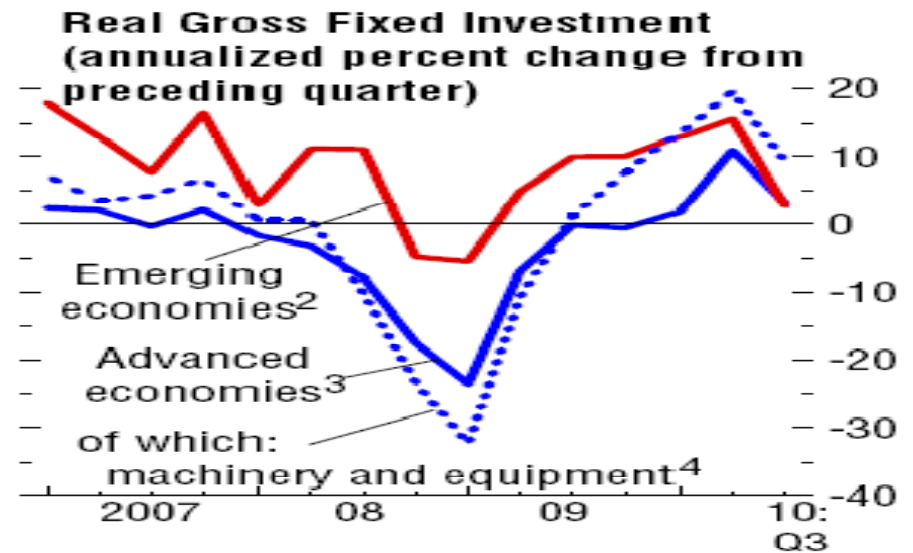
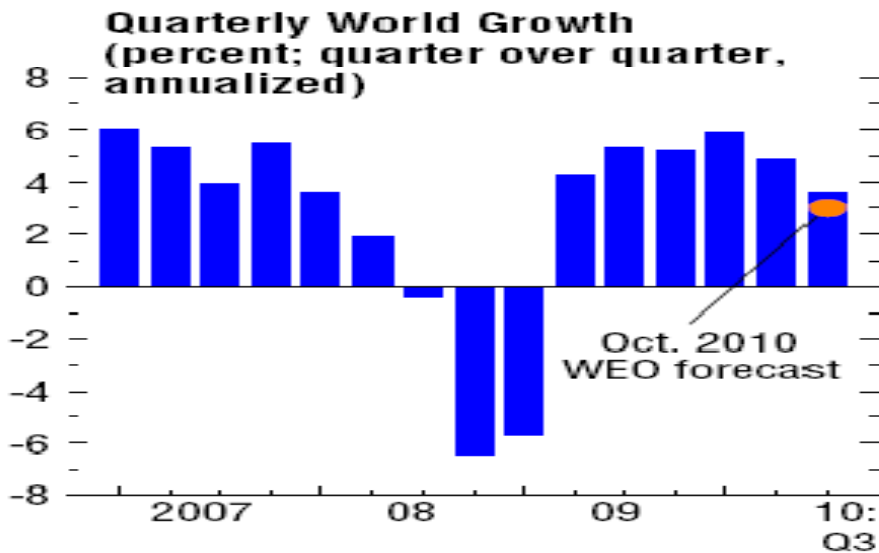
Global GDP Growth (% quarter over quarter, annualized)



Source: IMF

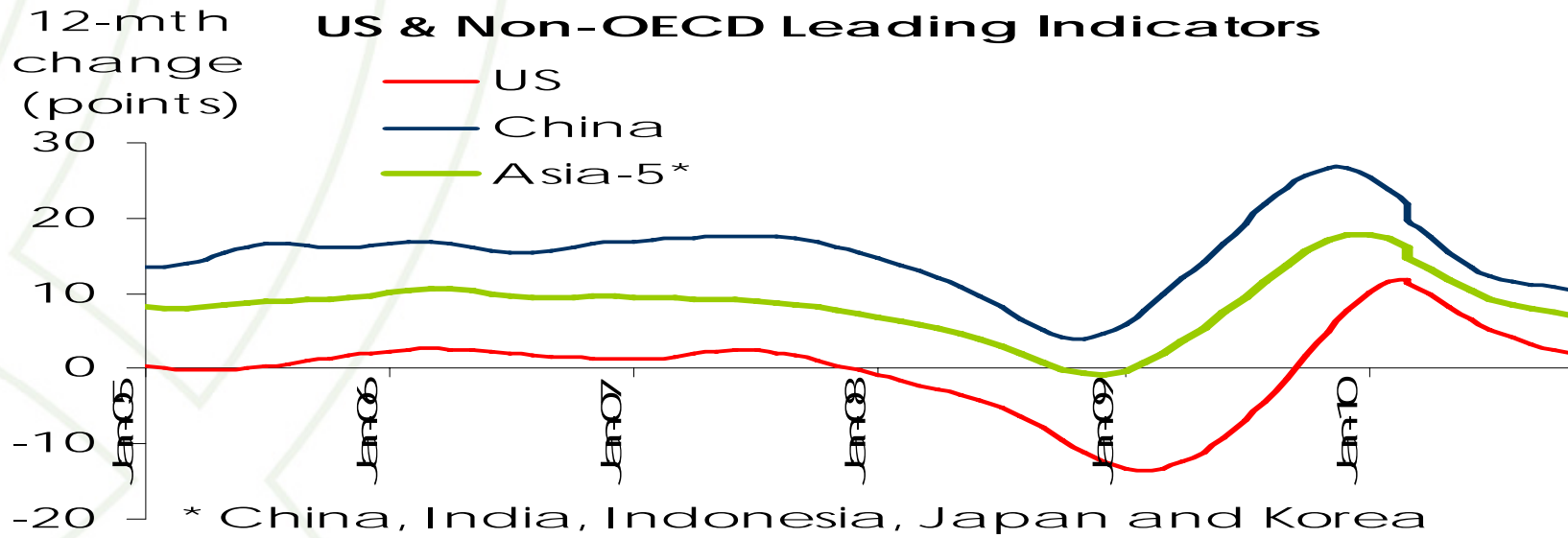


Recent Economic Indicators

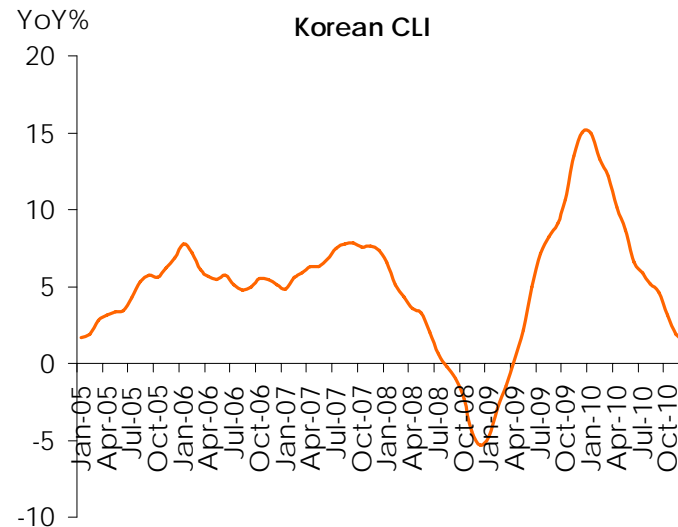
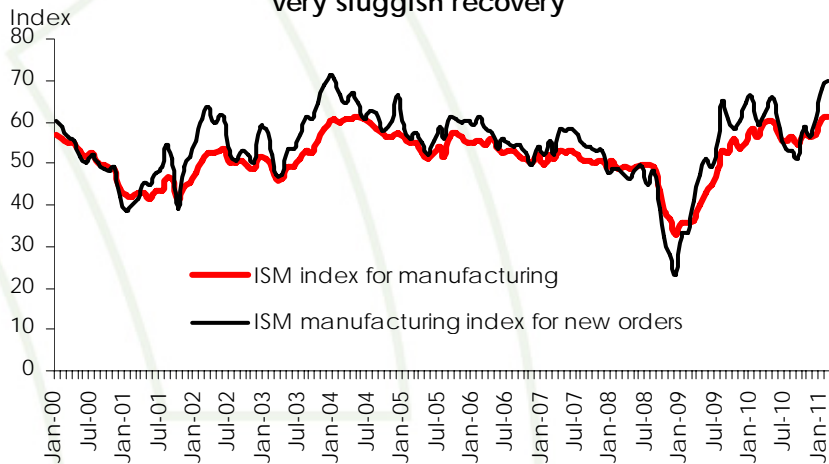




A Sluggish Recovery



US ISM index: Rebound in manufacturing expected, but likely to peak soon on the back of very sluggish recovery



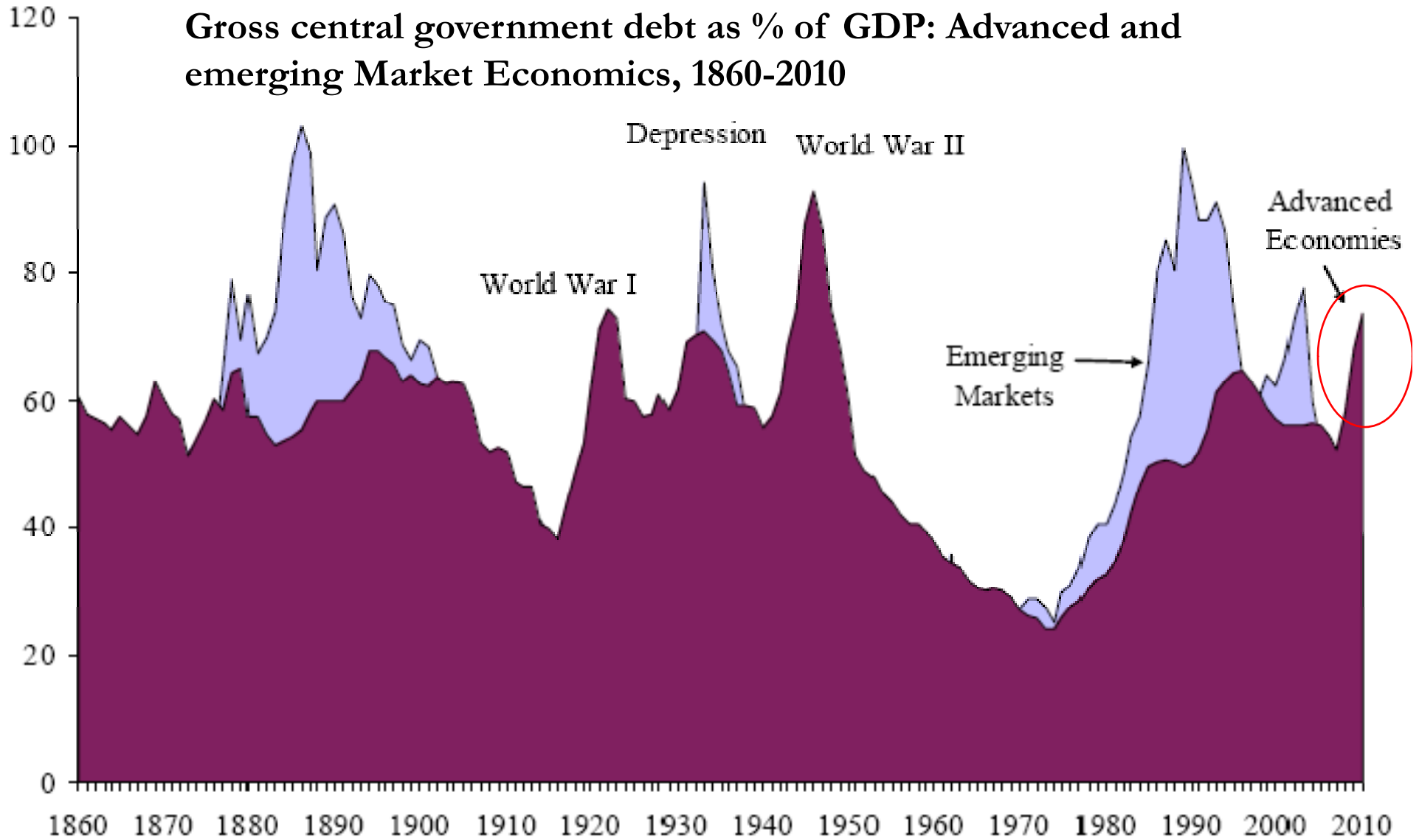
Surging Public Debts ("2008-2017: A Decade of Debt")

Reinhart and Rogoff (2011) in "*A Decade of Debt*", *NBER Working Paper 16827, February 2011* Argue that:

- Public Debts (a rising share held by central Banks) are rising at an alarming rate
- Historically, high leverage episodes have been associated with slower economic growth (with or without markedly higher interest rates).
- Surges in private debt lead to private defaults, which most often become manifest in the form of banking crises
- Banking crises are associated with mounting public debt which ultimately lead to sovereign default or more generally restructuring of public and private debts.
- Banking crises and surges in public debt help to predict sovereign debt crises.



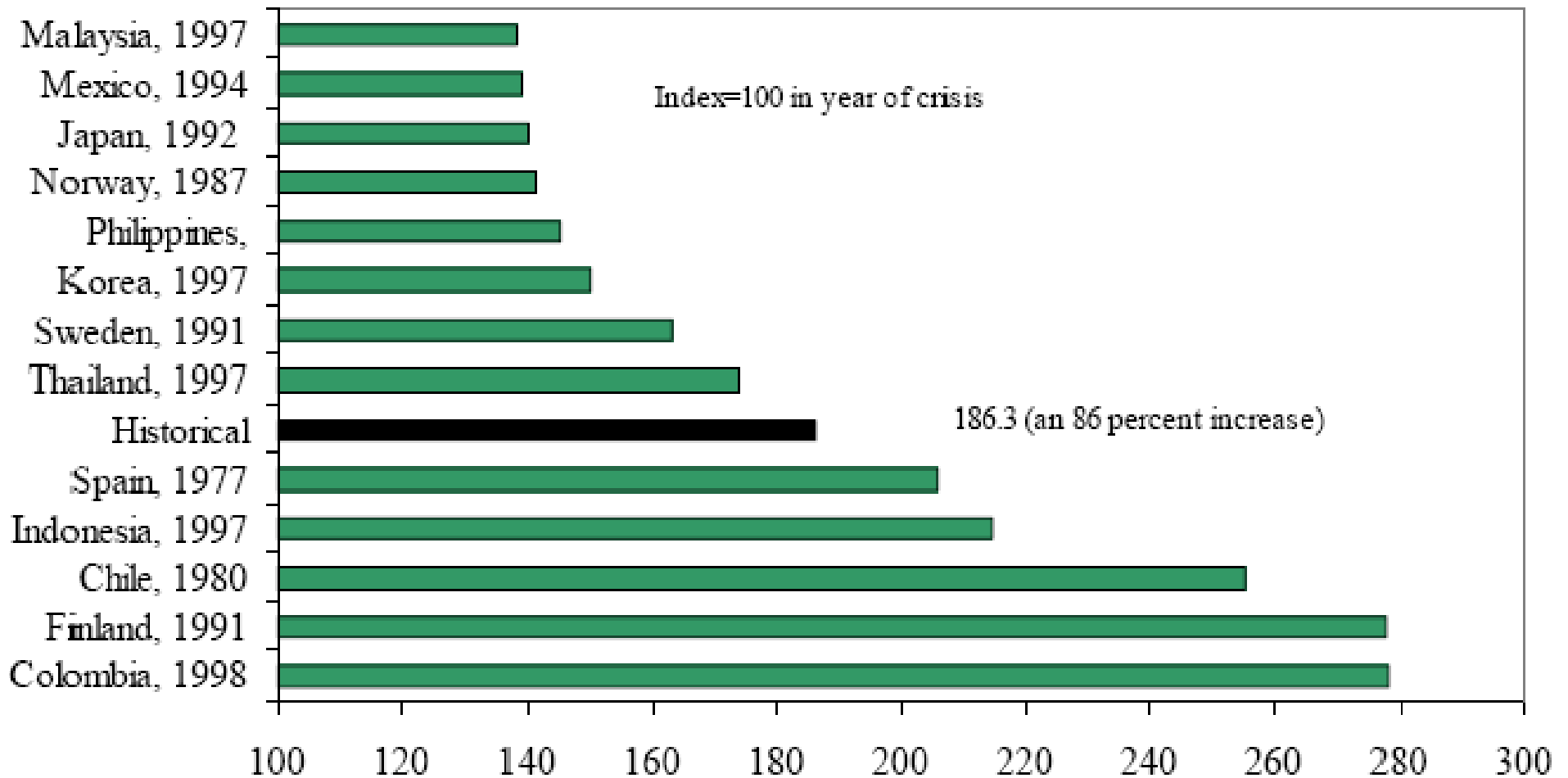
Public Debt: Historical Perspective



Sources: Reinhart and Rogoff (2011)



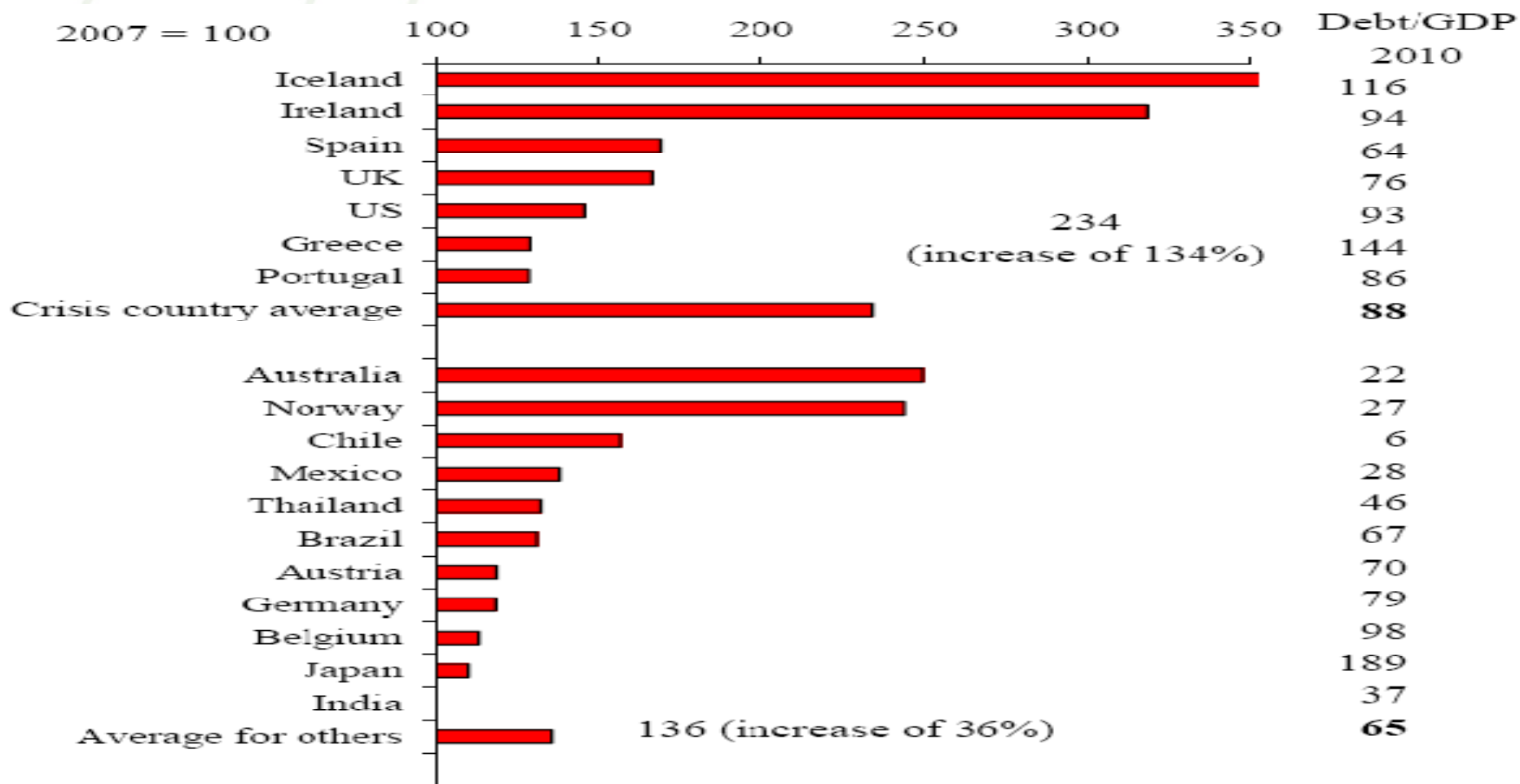
Cumulative Increase in Public Debt In The Three Years Following A Systemic Banking Crisis



Sources: Reinhart and Rogoff (2011)

However, The Cumulative Increase in Real Public Debt Since 2007 Has Been Dramatic!

Cumulative Increase in Real Public Debt Since 2007, Selected Countries

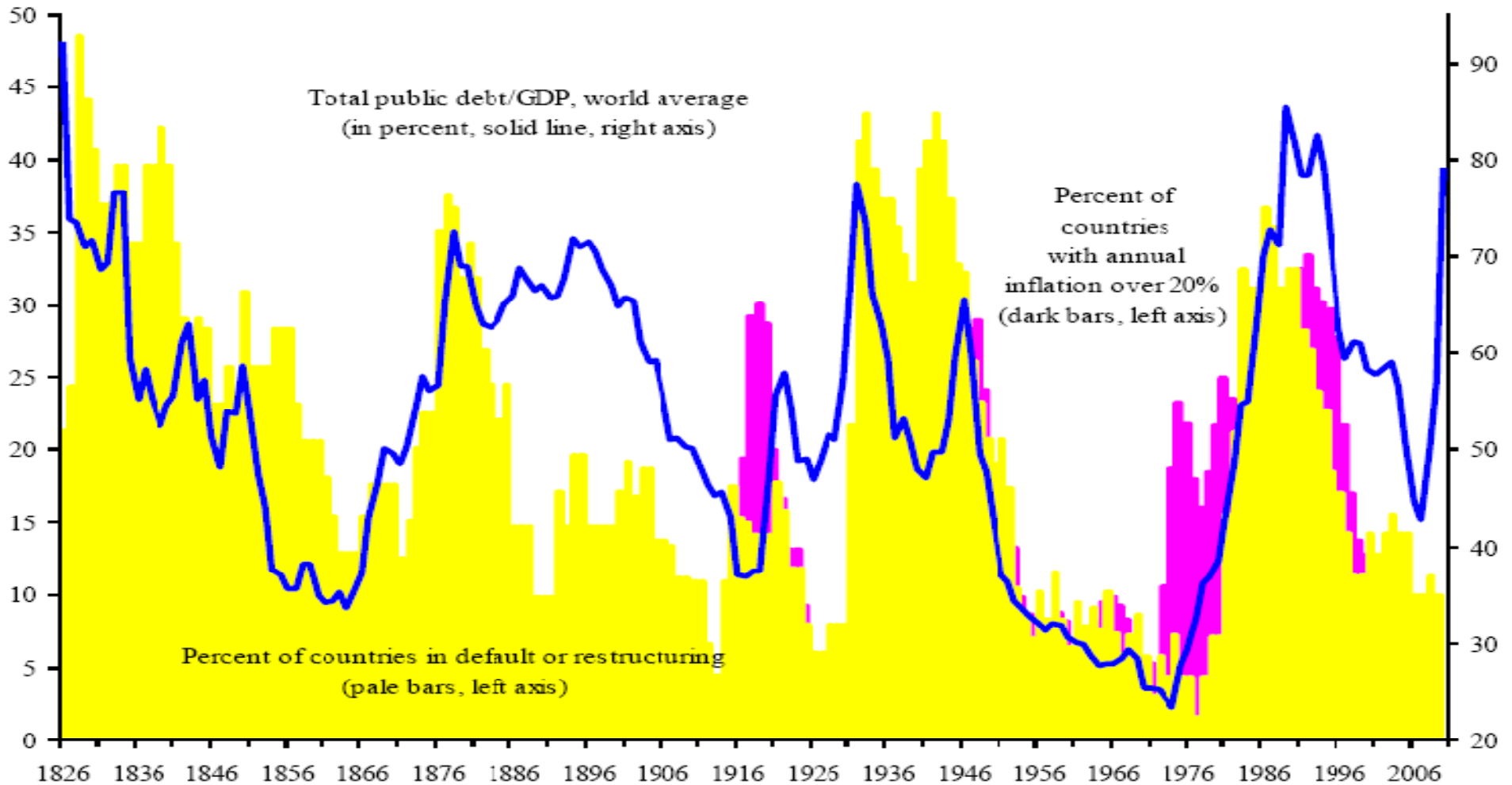


Sources: Reinhart and Rogoff (2011)



Sovereign Defaults And Inflation Are Likely To Increase

Sovereign Default on External Debt, Total Public Debt, and Inflation Crises: World Aggregates, 1826-2010 (debt as a percent of GDP)



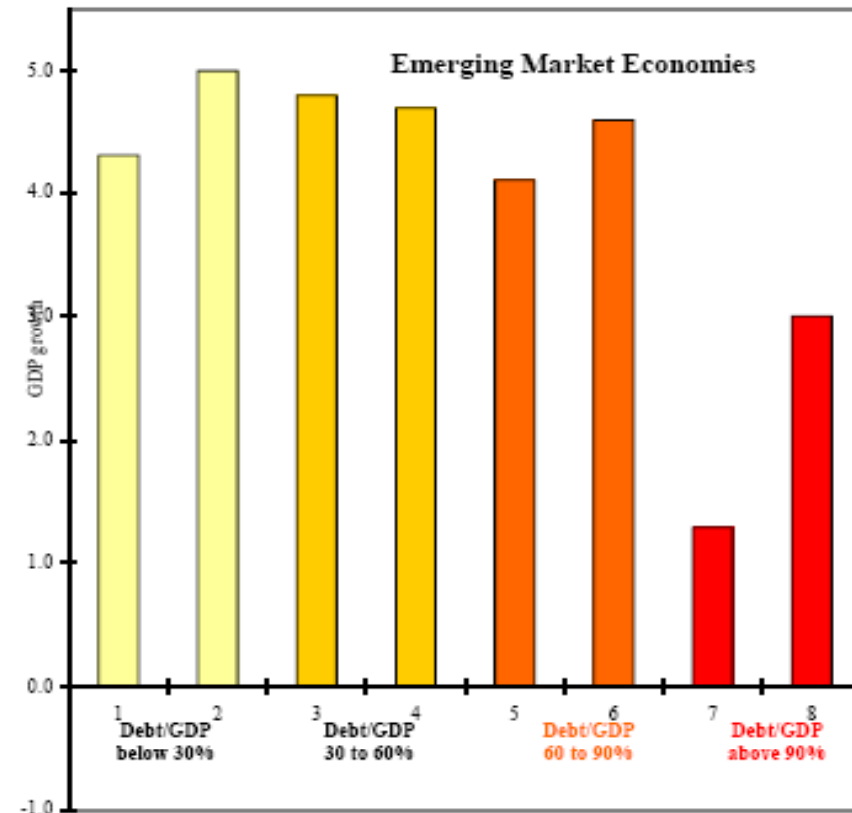
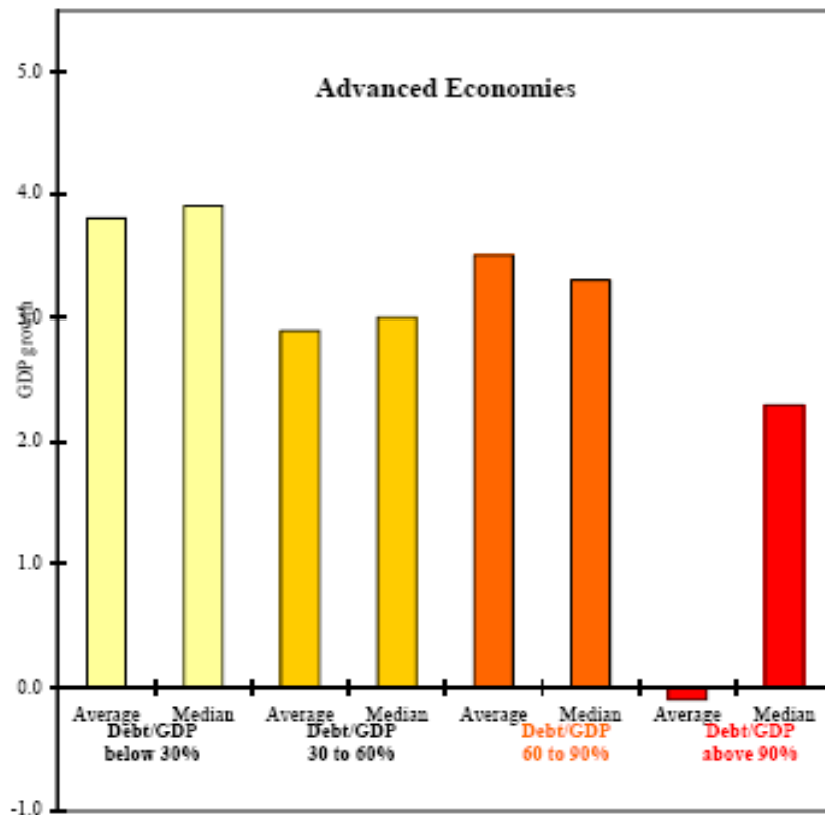
Sources: Reinhart and Rogoff (2011)



With Mounting Public Debt Comes Slower GDP Growth

Debt and Real Per Capita GDP Growth: Selected Advanced and Emerging Economies, 1946-2009

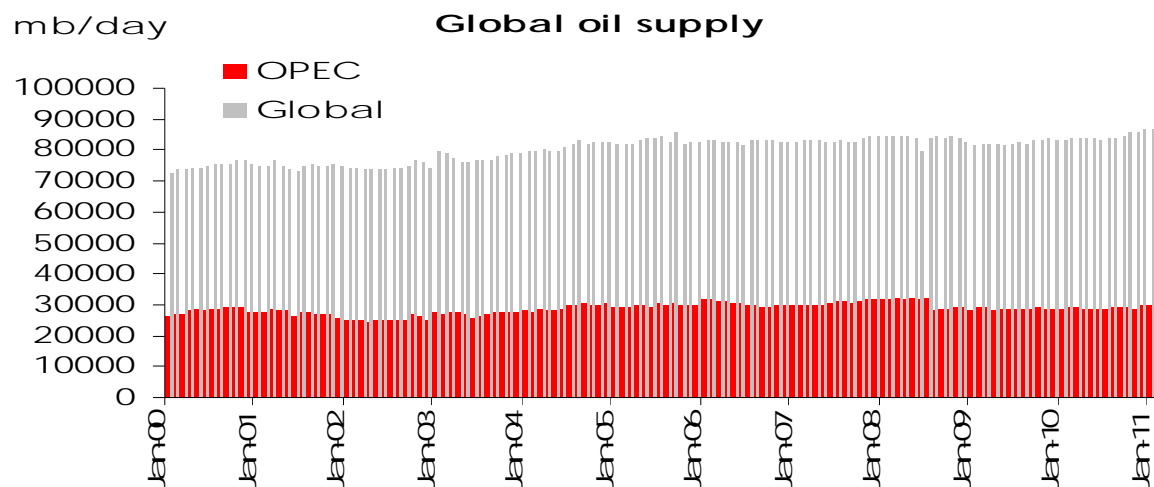
Gross Central Government Debt



Sources: Reinhart and Rogoff (2011)

Political Instability In Resources Rich Countries And Commodities' Rally

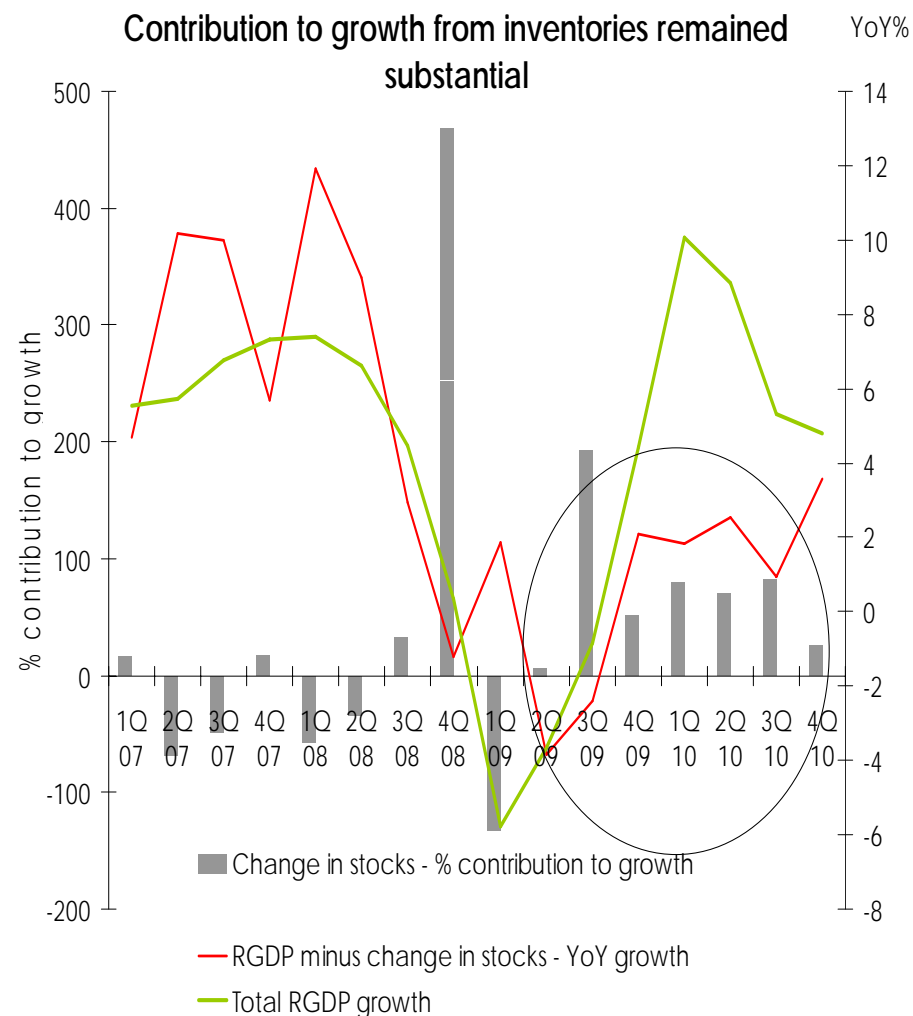
Political crisis in North Africa and Middle-East could prolong and spread to Sub-Saharan Africa, exacerbating supply constraints for oil and other commodities



Commodity prices outlook					
			Forward market		
	Spot	End-2010	End 1H 2011	End 2H 2011	End 2012
West Texas Intermediate	98.87	79.36	101.22	101.93	100.72
Coal	119.2	83.60	117.84	120.50	121.26
Gold	1411	1,096.95	1,401	1,418	1,429
CPO	3610.50	3758.50	n.a.	n.a.	n.a.

Malaysia: Sustaining GDP Growth Above 6% Will Be A Daunting Challenge

- **2010 GDP Growth was driven by an inventories build up, likely to wane in 2011**
- **Domestic consumption Vs Investment. The choice is continuing the party by maintaining/increasing subsidies and other consumption-related expenditure or taking the tough decisions to avail resources for much needed investment**
- **With Commodity rally will come increased exports but also pressure to cut subsidies and raise prices**

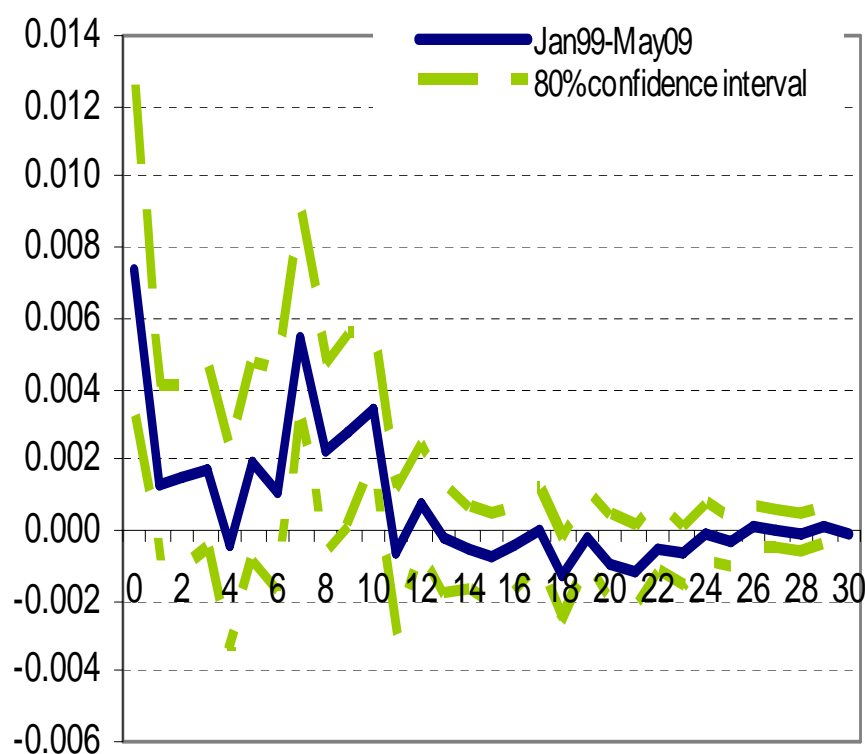
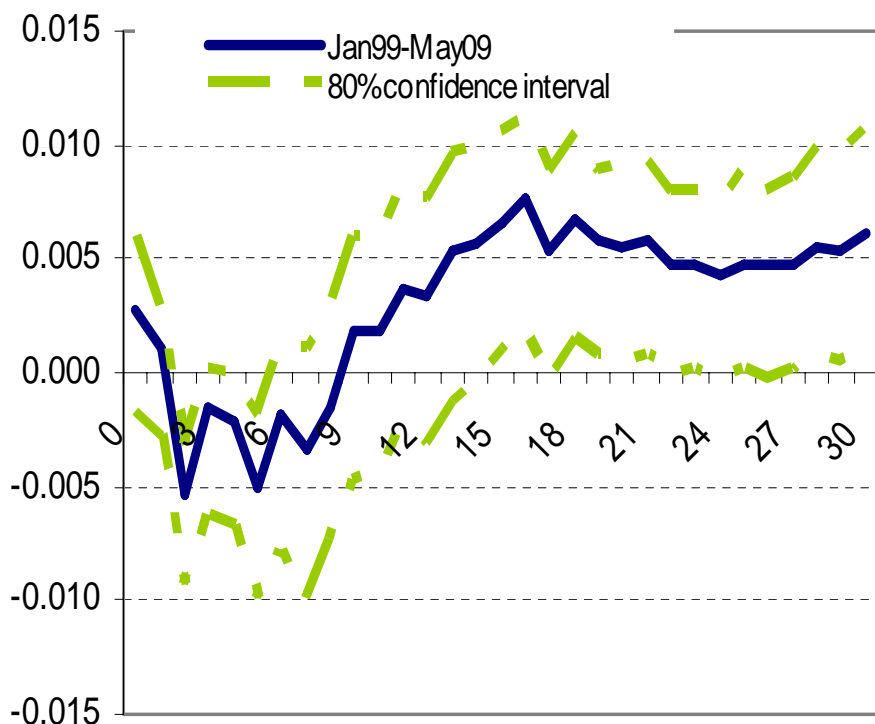


Fiscal Injections To Boost Domestic Demand Are Short-Lived

Results from a SVAR model suggest that:

US production shock has a cumulative impact on Malaysian IPI up to more than 3 years.

A fiscal injection to boost real domestic demand has a limited impact (10-12 months)



Source: Azrai and Zeufack (2010) "Malaysia: Postcrisis growth prospects depend on restoring fiscal discipline and private investor confidence" The World Bank



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Thank You