

Global turmoil and the Malaysian economy in 2012

At this time of the year, crystal balling the economy is popular. Anticipating what lies ahead is crucial for both the public and private sectors to make better decisions. With this in mind, the Praxis seminar held last month, organised by the Institute of Strategic and International Studies (ISIS) Malaysia, analysed the global, regional and domestic developments that will shape the Malaysian economy in 2012. Feedback from the seminar was unanimously encouraging and this article seeks to share a personal take of the salient points raised.

There are five critical factors that must be carefully watched over the next year to determine if the Malaysian economy will perform better in 2012 than in 2011. The first factor has received a great deal of attention, that is, the eurozone sovereign debt crisis and the fate of the euro.

Despite the European Financial Stability Fund being enlarged and the European Central Bank buying bonds to drive down yields, much uncertainty remains. Not only do the 17 eurozone countries have to contain the sovereign debt problem from spreading to the rest of Europe, they also have to shore up confidence in the euro by moving towards fiscal union.

Even if they are able to achieve these outcomes, they still face the problem of having to scale back on public debt and spending while maintaining positive economic growth rates. Turbulence in the eurozone is unlikely to be resolved soon and will continue into 2012.

With world growth forecasts being cut — some are even forecasting a recession in some eurozone countries — demand for Malaysian exports will undoubtedly be dampened. Malaysia's exports to the EU, however, have dropped from an average of 9.4% of GDP from

2001 to 2008 to 7.4% between 2009 and 2010 (ADB, *Asia Economic Monitor* 2011). Exports to the US have declined even more dramatically — from 17.6% to 9.6% in the same periods. In contrast, China grew as an export market, from 6.7% to 14.6%.

Weaker demand from the eurozone is certainly a worry but a slowdown in the Chinese economy is cause for greater anxiety. China is forecasting lower but still high growth in 2012 due to domestic constraints such as power shortages, rising wages, threat of inflation and a property bubble.

But every cloud has a silver lining and for Malaysia, it is the continued strong growth of commodity exports, which can offset the manufacturing slowdown. Moreover, the share of manufacturing in total Malaysian exports has shrunk from 74.1% (2001-2008) to 69.7% (2009-2010).

Another aspect of the eurozone problem is financing, investment and capital flows. Financial institutions in the eurozone and the US may roll back lending to East Asia in the event of a new global financial crisis, creating tighter credit conditions and affecting the liquidity of the banking system. Malaysia still has sizeable exposure to credit from European banks, although not as large as that of Hong Kong, China and Singapore.

As at June 2011, loans from European banks were about 16.7% of total domestic credit. Overall though, Malaysian banks are sound with strong balance sheets and low levels of non-performing loans. Volatile capital flows can, nonetheless, impact the stock market and investment. In the light of the more challenging global environment, the Iskandar Regional Development Authority, for example, is re-strategising its plans to win investment.

Second, with the external outlook darkening, the burden of growth is increasingly falling on domestic demand. The importance of this is clearly indicated by Malaysia's higher than expected GDP growth in 3Q, which was

mostly driven by domestic consumption. The backloading of the 2011 spending and front-loading of Budget 2012 transfer payments would boost consumption well into 1H2012. The government also realises the importance of ensuring that the implementation of the Economic Transformation Programme is on track and it has taken serious steps towards this end.

Although Budget 2012 is considered an election budget, the government has exercised greater fiscal discipline by restraining its budget deficit growth. Fiscal expansion ability is increasingly constrained as public debt is in excess of 55% of GDP. Therefore, further public stimulus packages to counterbalance the downturn in the global economy in 2012 will be limited. Another factor that restricts domestic demand is the limitation of household consumption. Further expansion of household consumption will depend on a revival in income-generating private investments and the level of household debt, which remains high at around 70%.

An announcement on a minimum wage, much anticipated by workers, trade unions and employers, will be the third factor to watch. Views about the right level of minimum wage among these three groups are still wide apart. A fundamental disagreement is over the aim of a minimum wage: reduction of poverty or getting a decent living (which is the objective of workers while for companies it is about enhancing productivity).

Workers and trade unions regard the minimum wage as not high enough while employ-



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ers are concerned about competitiveness and company survival. Trade unions argue that setting a minimum wage should not be based on productivity and that this link should be made only for subsequent revisions to the minimum wage.

There is also the issue of coverage. Trade unions are in favour of just one national minimum wage — and not a sectoral-based wage that employers want — to cover all workers, including foreign workers. Employers, on the other hand, want non-basic wage benefits, such as overtime and productivity bonuses, to be included. This issue definitely has major implications for the Malaysian economy and investors want to be kept informed about the situation.

The fourth factor is food inflation. In 1Q2011, food inflation hogged the headlines. Although this issue has since died down and inflation is not a serious threat, an increase in food prices may rear its ugly head again. La Nina and climate change, which caused recent unprecedented heavy rain and widespread flooding, are likely to trigger a shortage in the supply of perishable food such as vegetables and fish. This weather-induced food price hike, although short-term, can cause a public outcry because in the last decade, food and beverages contributed the largest share of CPI increase — 51%.

The other sources of CPI increase were transport (20.7%) and housing, utilities and fuel (19%). Fortunately, the possibility of a surge in the price of rice due to Thailand setting a floor price, is low. In anticipation of this move, rice distributors have already

increased their stock, which means the situation is manageable even if there is an escalation in world rice prices.

Last but not least, the domestic game changer for the Malaysian economy is the 13th general election. There has been much speculation about the date but the consensus is that it will take place in 2012. In the run-up to the election, programmes will be introduced to ensure that economic conditions are favourable and the business climate is conducive.

The average voter is interested in day-to-day issues such as the rising cost of living, subsidies, crime rate, affordable housing, too many foreign workers, employment opportunities and public transport services. Programmes to address some of these concerns may be fast-tracked. Conversely, fundamental measures such as renormalising or normalising fiscal and monetary policies as well as other structural reform issues may be dealt with after the election.

All things considered, the Malaysian economy seems capable of weathering the uncertain external conditions. It is more resilient than in the past, has the resources and policy capacity to mitigate any potential economic downside with the possibility of the general election X factor boosting growth. Economic growth in 2012 may not outperform that of 2011 but it will be comfortable.

However, we need also look beyond 2012. What if the global economy goes into a long period of very low growth? The solution is to implement structural transformation, albeit painful, to boost growth and competitiveness. **E**

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