THE GLOBAL FINANCIAL CRISIS AND THE MALAYSIAN ECONOMY

Impact and Responses

UNIVERSITI MALAYA

A Joint ISIS and UM Report Commissioned by the UNDP

The Global Financial Crisis and the Malaysian Economy: Impact and Responses

A Joint Report by the Institute of Strategic and International Studies (ISIS) Malaysia and the
Faculty of Economics and Administration, Universiti Malaya (UM)
Commissioned by the United Nations Development Programme (UNDP)

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Executive Summary

As with most of the East and Southeast Asian economies, the impact of the global economic and financial crisis on Malaysia has been felt largely through a contraction in aggregate demand caused by a collapse in exports, either directly or indirectly, to the United States. GDP growth slowed down to 0.1% in the last quarter of 2008, and decelerated by -6.2% and -3.9% respectively in the first two quarters of 2009 as a consequence. This contraction has aggravated the already cooling Malaysian economy. Not only did manufacturing slow down substantially, but the overall GDP growth rate of Malaysia had fallen significantly below its targeted vision 2020 rate for 2000-2007, which was to achieve a per capita income of US$15,450 by 2020. The deceleration is expected to create a shortfall of 26% in 2010 in comparison with the vision 2020 GDP growth trajectory. This is despite the fact that price volatilities and commodity price swings have largely spared Malaysia from serious problems in the commodity sector, even though the subsidy amount borne by the Government to independent power plants and the domestic market increased each time world prices of petroleum and gas rose. Malaysia also did not absorb any direct destabilisation through either the currency or capital market, as it had little exposure to the financial derivatives that emerged from the sub-prime stocks. The Central Bank in the country, Bank Negara Malaysia, also managed the financial sector well following the bitter experience of the Asian financial crisis, and hence non-performing loans as a share of total loans fell to 2.2% in 2008 and remained at roughly that level in the first two quarters of 2009.

The Government introduced two rescue packages with attractive fiscal stimuli totalling RM67 billion (US$18.1 billion). The purpose of these packages was to absorb retrenchment and the destabilisation shocks faced by the people and to accelerate development expenditure to offset a fall in aggregate demand because of significantly reduced exports. The 2009-2010 budget went further in its attempt to transform Malaysia into a high-income country. While this is an excellent objective, what is unclear are the strategies required to achieve it. This report details the following steps that must be taken to achieve the 2020 vision:

1. Maintain strong macroeconomic fundamentals and the excellent financial policies undertaken by the Government and its key agencies.
2. Bring much greater balance between external and domestic sources of demand by significantly increasing the latter.
3. Ensure better targeting of stimulus and development packages.
4. Maintain stimulus and development packages to address and overcome the vision 2020 GDP growth path deficit.
5. Ensure a central focus on human resource development policies, prioritising the creation of a much larger pool of indigenous scientists and technologically skilled people.
6. Deepen the policy shift towards a knowledge-based economy.
7. Significantly increase research and development as a percentage of GDP.
8. Re-orientate FDI policy toward technological upgrading

1. Introduction

The global financial crisis of 2008-2009, with its epicentre in the United States, has brought enormous ramifications for the world economy. What started as an asset bubble caused by an array of financial derivatives that, *inter alia*, drove the sub-prime mortgage boom, exploded into a housing and banking crisis with a cascading effect on consumer and investment demand. From a housing crisis, it quickly grew into a banking crisis with the investment and merchant banks first absorbing the impact before it spread to the commercial banks (Krugman, 2009). With the United States' economy contracting sharply, it sent ripples across export-dependent Asian economies, which began to face a contraction as a consequence. Hence, although the Malaysian economy was insulated from the direct effects of financial exposure because the new derivatives were not allowed into the country, the global financial crisis has cast doubt on the Government's plans to achieve vision 2020 due to a collapse in exports and a slowdown in foreign direct investment (FDI).

The bitter experience of the Asian financial crisis had already provided the incentive for Bank Negara Malaysia (BNM) to regulate the financial sector without unduly affecting the stock market. Exposure to foreign loans had been kept to a minimum and non-performing loans (NPLs) as a share of financial assets in the country had been one of the lowest registered among Asian economies for 2008 (World Bank, 2008), which led the Government to confidently say in early 2009 that Malaysia's economic fundamentals were strong. While exposure to external financial markets has been successfully managed, there are concerns, however, over the fiscal stimulus designed to compensate for the contraction in exports.

Given Malaysia's high export to Gross Domestic Product (GDP) ratio, the contraction in external demand is the most serious factor burdening the economy. One direct source of problems comes from a contraction in export demand, particularly in manufacturing, as the target markets are primarily developed economies that are currently gripped by a recession. A second direct source is a contraction in FDI inflows, particularly from these developed countries. The indirect sources of contraction come from all sectors dependent on GDP growth – consumer and investment demand – that affect agriculture, construction and services. Falling demand has already driven firms to retrench workers. Although reported retrenchments from government sources are small, it is believed that both underemployment (and with it the consequent fall in incomes) and unemployment figures are much higher than those officially reported.

The contraction in aggregate demand should be examined alongside a slowdown in GDP growth from the late-1990s. Slow technological upgrading in the face of the rapidly growing economies of China, Vietnam and India is increasing the pressure on manufacturing in Malaysia. This report takes account of the crisis-induced effects as well as the longer-term slowdown in manufacturing productivity on human development. In addition, the extremely low levels of both public and overall investment in research and development (R&D) and the small number of R&D engineers and scientists per million people have already undermined the capacity of firms in the country to upgrade and compete with firms in the Republic of Korea, Taiwan, Province of China, and Singapore.

The report is organised as follows. Section 2 presents the analytical approach taken. Section 3 discusses the effects of the financial crisis as well as broader weaknesses in industrial promotion on the real sectors of the economy. It examines the effects of the financial crisis on the demand aggregates in the country. Section 4 evaluates the impact of both the global financial meltdown as well as the broader economic shortcomings on human development in the country. Section 5 critically discusses the impact of government interventions to check the crisis. Section 6 assesses the impact of policy decisions to mitigate the impact of the crisis. Section 7 provides views from the business community on the impact of the crisis, reactions to the stimulus packages, and employment and training aspects for human development. Section 8 presents the conclusions and recommendations.

2. Analytical Approach

The focus of this report is to identify the sources of contraction in aggregate demand as well as analyse their effects on the real sectors of GDP and human development and to evaluate the Government's response to lessen their negative impact on the Malaysian economy, including its plans to achieve vision 2020 goals. The first step is to examine the transmission mechanisms of the crisis to the real sectors. The second and third steps are to evaluate the impact of these mechanisms on the real sectors and human development in the country, including on the Government's vision 2020 plans. The fourth step is to discuss the impact of the rescue packages introduced by the Government.

The fall in aggregate demand arising from the economic contraction requires a departure from Friedman's (1976) neoclassical model of macroeconomic equilibrium between the money market (LM) and the goods and services market. Friedman's assumption that demand for money will be fairly interest inelastic in the short-run is the basis for the steep LM schedules, which makes any effort to lower interest rates and expand fiscal stimulus or government expenditure ineffective in increasing investment and income. The reasons for the departure are the following:

i. Market failure arising from a lack of regulation caused the sub-prime mortgage crisis in the United States (Krugman, 2009).
ii. Although financial risks will be high during times of crisis, rescue packages require expansionary policies to reverse the contraction in aggregate demand.
iii. Market equilibriums are achieved in developing economies such as Malaysia well before full employment can be established.

Hence, this report takes the fiscal policy arguments advanced by Keynesians and, therefore, views rescue packages as essential. The following represent the prime motivating assumptions for the adoption of the Keynesian model (Keynes, 1936):

i. Falling aggregate demand requires a solution through the stimulation of investment and income, which can only be done by lowering interest rates and expanding government expenditure.

ii. A fall in interest rates will help raise investment and, with that, income. During moments of high risk, the lowering of interest rates should be undertaken alongside directives for banks to lower collateral requirements for investment and essential purposes or through government-supported underwriting of such risks until the crisis is over.
iii. Crises cause markets to panic and, unless the relevant government intervention is handled effectively, the accompanying contagion can cause a depression (Krugman, 2009).
iv. Market-oriented policies had already reduced GDP growth rates in Malaysia after 2000 such that the growth path taken is projected to generate a shortfall of 26% from the growth trajectory envisaged to achieve vision 2020 GDP.

In seeking to formulate a set of policies to initiate a recovery, the first issue to be addressed will be to revive aggregate demand following the collapse in exports. However, a number of safety measures are necessary for ensuring that the specificity of the Malaysian economy is addressed in the implementation of Keynesian rescue packages. Malaysia is a highly open economy with large shares of exports and imports in GDP. Simply expanding government expenditure may cause leakage and may not produce the desired expansion in aggregate demand domestically. Hence, the direction of stimulus and government expenditure should target low import-oriented sectors, such as the non-tradables, one of which is infrastructure. Unlike Keynesian arguments in which little focus is placed on technical change, it is better to emphasise government expenditure and fiscal stimulus in supporting economic activities that drive technological catch-up (Kalecki, 1976).

It is also important to examine the impact of the financial crisis on the Malaysian economy, taking cognisance of arguments that premature deindustrialisation would lead to a fall in the share of manufacturing in GDP well before the sector has matured into high value-added activities (Rasiah 2008: 15). The average annual labour productivity had already declined in industries, such as food, textiles, footwear, wood, furniture, printing, paper, rubber, non-metal minerals, machinery and transport equipment, over the period 2000-2005. The average annual labour productivity of electrical products and electronics slowed down from 12.4% during 1990-95 to 7.9% during 1995-2000 and then to 1.4% during 2000-2005. An attempt to address this problem will help to identify salient shortcomings that must be resolved and to target government expenditure in sectors that can provide maximum development synergies to put Malaysia back on the vision 2020 growth path.

3. Macroeconomic Effects

Whereas the Government targeted an annual average GDP growth rate of 4.1% over the period 2006-2010 (EPU, 2009: 8), the International Monetary Fund (IMF) forecasted Malaysia's GDP per capita to contract by -5.1% in 2009 and -0.4% in 2010. This section examines the slowdown and contraction in the country's macroeconomic variables with an evaluation of the real GDP sectors, followed by a study of the demand aggregates.

3.1. GDP and Components

The contagion from a crash in global aggregate demand on the Malaysian economy can be seen from a number of sectors and markets. The overall GDP growth rate of Malaysia slowed down to 0.1% in the last quarter of 2008 and contracted by -6.2% in the first quarter of 2009 before falling further by -3.9% in the second quarter of the year. Malaysia's economy has clearly entered a recession following a decline in GDP over the first two quarters of 2009. The contraction is expected to further reduce Malaysia's capacity to achieve the 2020 per capita income of US$15,341 under the vision 2020 programme. Malaysia is already expected to record a 26% shortfall in GDP from its 2020 vision path (EPU, 2009: 13).

In comparison with developed and East Asian countries, Malaysia's GDP growth took a longer time to absorb the contagion, as its GDP growth rate only fell significantly from the third quarter of 2008 and its first negative growth rate was recorded only in the first quarter of 2009 (Table 1). However, the further contraction projected by BNM over the whole year suggests that the worst is not over and Malaysia will recover later than many other East Asian countries. This contraction is caused by a continued fall in exports, which has not only dampened industrial production in export-oriented sectors but has also gradually reduced demand indirectly from the domestic manufacturing as well as the services and other sectors. From the list of countries shown in Table 1, only the least developed among them, i.e. Indonesia and the Philippines, recorded positive GDP growth rates over the first two quarters of 2009. The United States' GDP slowed down by -1% only in the second quarter of 2009, suggesting that the world's leading economy may be coming out of a recession and could lead a potential recovery across the world through increased imports.

Table 1. Gross Domestic Product, Selected Economies, 2007-2009 (% Annual Change)

Country	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
United States	1.2	3.2	3.6	2.1	-0.7	1.5	-2.7	-5.4	-6.4	-1.0
United Kingdom	2.4	2.6	2.7	2.4	2.5	1.8	0.5	-1.8	-4.9	-5.6
Germany	3.7	2.5	2.5	1.6	2.9	2.0	0.8	-1.8	-6.7	-5.9
Japan	3.4	2.2	1.9	1.9	1.3	0.6	-0.3	-4.3	-8.7	-6.4
Hong Kong	5.6	6.1	6.8	6.9	7.3	4.1	1.5	-2.6	-7.8	-3.8
Malaysia	5.4	5.6	6.5	7.2	7.4	6.6	4.8	0.1	-6.2	-3.9
Singapore	7.6	8.6	9.5	5.5	6.7	2.5	n.a.	-4.2	-9.5	-3.5
Republic of Korea	4.5	5.3	4.9	5.7	5.5	4.3	3.1	-3.4	-4.2	-2.5
Taiwan, Province of China	3.8	5.5	7.0	6.4	6.3	4.6	-1.1	-8.6	-10.1	-7.5
Indonesia	6.0	6.6	6.6	5.9	6.3	6.4	6.4	5.2	4.4	4.0
Thailand	4.4	4.4	5.1	5.7	6.0	5.3	3.9	-4.2	-7.1	-4.9
Philippines	7.0	8.3	6.8	6.3	3.9	4.2	4.6	2.9	0.4	1.5

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

The intra-GDP changes show the biggest contraction in manufacturing with growth declining by -8.8% in the fourth quarter of 2008, -17.6% in the first quarter of 2009 and -14.5% in the second quarter (Table 2). Power and electricity, and mining and quarry were the other sectors similarly affected during the same periods. Construction recovered slightly in the first two quarters of 2009, while agriculture recovered by 0.3% in the second quarter of 2009. Malaysia's largest manufacturing industry, i.e. electrical machinery, recorded the highest reduction among the real sectors because of its high dependence on exports. Plunging exports had already brought down electronics production by -4.1% in the third quarter of 2008 and -27.8% in the fourth quarter of the same year (Table 3).

The manufacturing industry has, however, actually been experiencing a slowdown since 1990 (Rasiah, 2008). Annual average manufacturing value-added growth fell from 11.6% during 1990-1995 to 5.8% in 1995-2000 and then to 4.9% in 2000-2005 (Appendix 4). The biggest contraction between 2000 and 2005 was in non-electrical machinery and textiles. The annual average growth of the largest manufacturing sector, i.e. electrical machinery, slowed down from 26.8% in 1990-1995 to 12.1% in 1995-2000 and 0.5% in 2000-2005. Manufacturing value-added also contracted from 7% in the first quarter of 2008 to -8.8% in the fourth quarter, then to -17.6% and -14.5% in the first and second quarters of 2009 respectively (Table 2). Thus, the global financial crisis has only hastened the contraction of a rapidly cooling industry.

Table 2. Real GDP by Sectors, Malaysia, 2007-2009 (% Annual Change)

	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Sectors										
Agriculture	3.0	-2.3	1.1	3.9	6.5	6.3	3.3	0.5	-4.3	0.3
Mining and Quarrying	-1.1	5.9	0.6	2.9	3.6	-0.5	-0.3	-5.7	-5.2	-2.6
Manufacturing	2.1	1.6	3.3	5.5	7.0	5.6	1.8	-8.8	-17.6	-14.5
Construction	4.2	5.0	4.9	4.9	5.3	3.9	1.2	-1.6	0.6	2.8
Electricity, Gas and Water	4.3	4.5	2.9	4.3	4.7	4.1	2.5	-2.6	-8.2	-1.1
Service Sub-sectors										
Wholesale and Retail Trade	9.0	11.9	15.0	12.8	11.8	12.7	9.4	5.9	-1.7	0.4
Accommodation and Restaurant	7.8	10.4	12.6	12.3	10.0	7.3	4.7	7.4	2.1	2.9
Transport and Storage	5.5	8.9	12.8	12.3	9.9	8.1	5.9	1.0	-3.9	-6.4
Communication	5.3	8.0	7.1	7.1	7.5	7.9	7.4	6.3	4.9	5.8
Finance and Insurance	13.6	11.4	9.2	9.9	9.9	7.5	10.0	3.5	1.2	3.3
Real Estate and Business Services	21.4	18.9	21.4	11.2	4.8	3.8	-2.0	-0.6	-6.7	3.0
Government Services	6.9	3.6	4.2	4.5	7.0	7.9	10.5	18.2	2.8	0.5
Other Services	3.6	5.0	5.8	5.5	5.0	5.3	5.3	5.3	5.2	4.5

Source: Department of Statistics, Malaysia, 2007, 2008, 2009.

The contraction in manufacturing is steepest in export-oriented sectors that are facing the full brunt of the collapse in demand in developed markets. Overall, exports fell by -7.5% in the fourth quarter of 2008 and -20% in the first quarter of 2009, partly due to the high import content (intermediate goods) of the goods exported. Although the trade balance, which is measured by deducting imports from exports and dividing the balance with the total of exports and imports, improved to 15.6% in the first quarter of 2009 from 12.1% in the fourth quarter of 2008, the combined decline in trade has already led to a severe recession in manufacturing.

Manufactured exports dropped by -11.7% in the fourth quarter of 2008, -19% in the first quarter of 2009 and -14.5% in the second quarter (Table 2). Although semiconductors recovered, all other electronics sub-sectors contracted sharply in the first and second quarters of 2009: electronics equipment and parts, consumer electronics and parts, industrial and commercial electronics and parts, electrical industrial machinery and household appliances exports (Table 3). Electronics exports declined by -44.0% in the first quarter and -34.6% in the second quarter of 2009. The impact of this on aggregate demand is substantial, given that machinery (including electronics) accounted for over 50% of manufactured exports over the period 2000-2008. Consequently, the industrial production index of all export-oriented industries, except petroleum products, experienced a contraction in the first quarter of 2009. Textiles, wearing apparel and footwear plunged by -26.6% in the first quarter of 2009. Wood products and rubber products fell by -27% and -22.8% respectively in the same quarter. Large inward-oriented industries, such as chemicals, iron and steel, non-metallic mineral products, beverages and transport equipment, also contracted by -18.6%, -40.1%, -20.0%, -18.6% and -15.9% respectively (Table 3).

Accept for tobacco in the second quarter of 2009, domestic-oriented industries also fell sharply in 2009 (Table 3), particularly construction-related industries of non-metallic mineral products, iron and steel, and fabricated metals. Steps to revive these industries will be helpful during crisis periods, as they will not only prevent leakage through imports but also help expand infrastructure.

Table 3. Industrial Production Index, Malaysia, 2008-2009 (% Annual Change)

	2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
All divisions	7.2	3.1	1.4	-9.1	-16.3	-10.6
Mining	4.4	0.5	0.8	-5.6	-5.4	-3.1
Electricity	4.5	3.3	0.7	-3.5	-9.1	-0.9
Manufacturing	8.7	4.2	1.7	-11.1	-21.6	-14.9
Export-oriented Industries						
Electronics	9.8	4.6	-4.1	-27.8	-44.0	-34.6
Electrical products	0.1	4.5	6.7	-8.2	-34.9	-21.7
Chemicals and chemical products	3.9	-2.3	-0.9	-15.0	-18.6	-3.9
Petroleum products	17.2	4.0	1.0	2.0	2.9	-4.6
Textiles, wearing apparel and footwear	2.8	2.1	3.1	-7.6	-26.6	-19.3
Wood and wood products	-3.1	-3.0	0.6	-14.3	-27.0	-24.2
Rubber products	6.8	7.8	2.0	2.1	-22.8	-7.4
Off-estate processing	22.1	18.0	3.0	-0.2	-7.9	-4.5
Paper products	-17.3	-13.8	-9.2	-17.1	-20.2	-7.5
Domestic-oriented Industries						
Construction-related						
Non-metallic mineral products	21.1	4.1	7.1	5.3	-20.0	-13.8
Iron and steel	10.4	9.5	-2.6	-27.6	-40.1	-33.5
Fabricated metal products	5.3	15.3	8.2	-4.4	-8.1	-6.3
Consumer-related						
Food products	14.7	15.8	10.0	-0.3	-10.5	-0.8
Transport equipment	22.9	21.9	30.3	18.4	-15.9	-14.3
Beverages	8.3	2.9	6.7	-6.8	-18.6	-1.5
Tobacco products	12.1	-19.7	-4.3	-10.7	-15.1	14.8
Others	9.8	-14.9	-8.0	-15.3	10.4	18.0

Source: Department of Statistics, Malaysia, 2008, 2009.

3.2. Demand Aggregates

This section examines the impact of the global contraction on the demand aggregates of the Malaysian economy. The focus is on investment (including FDI and NPLs) and consumption.

3.2.1. Investment

It is important to direct government expenditure and the fiscal stimulus at reducing the impact of contracting aggregate demand from falling exports. Aggregate demand recovered sharply in the first quarter of 2009 before declining again in the second quarter. However, the stimulus should also ensure that it does not leak out through imports. Aggregate private investment indicators largely show a fall over the end of 2008 and the first quarter of 2009 (Table 4). Sales of commercial vehicles do not provide any significant clue, as there was a sharp fall in 2007 compared with positive expansion from the first quarter of 2008. Private investment in transport equipment and machinery for industry fell sharply in the third and fourth quarters of 2008. The most significant indicator of investment, i.e. capital goods, slowed down to 0.2% growth in the third quarter of 2008 before falling sharply by -8.9% in the fourth quarter, declining further by -12.4% in the first quarter of 2009 and -18% in the second quarter. Machinery for industry contracted by a massive -45.9% in the first quarter of 2009. Import of intermediate goods also fell sharply in the fourth quarter of 2008 and the first two quarters of 2009. Manufacturing project approvals were the worst affected, with figures falling by -47.8% in the fourth quarter of 2008, -100% in the first quarter and –50% in the second quarter of 2009. These are clear signs of recession and the investment tree is simply confirming that the Malaysian economy is facing a recession now.

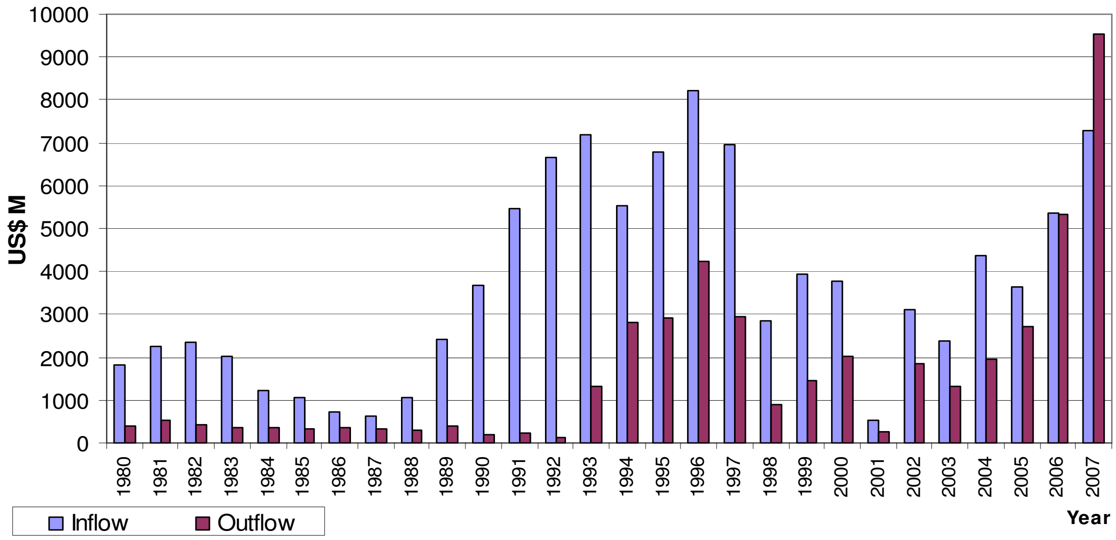
Table 4. Private Investment Indicators, Malaysia, 2007-2009 (% Annual Change)

	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Sales of commercial vehicles	-70.9	-60.1	-60.1	-55.3	13.0	20.3	11.2	13.3	5.4	-10.6
Capital goods (excl. transport equipment)	-4.9	6.1	10.4	9.7	13.8	6.6	0.2	-8.9	-12.4	-18.0
Machinery for industry	-5.6	-1.0	8.1	32.1	20.2	9.7	-15.8	-20.5	-45.9	n.a.
Transport equipment	-7.7	-38.7	95.3	78.6	-24.8	53.5	-17.9	-36.2	38.0	-15.5
Import of intermediate goods	9.0	6.5	-0.7	13.6	9.0	10.4	17.2	-12.2	-34.9	-27.1
Manufacturing Projects Approvals by MITI (value)	25.0	153.4	-60.5	87.2	247.6	-33.1	60.3	-47.8	-100.0	-50.5
Private Debt Securities	-9.5	133.3	52.0	255.0	60.4	-4.2	-8.8	-68.9	-7.4	-1.9

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

The crisis has also brought implications for investment flows, both inward and outward. Inward foreign investment had risen steadily over the period 2003-2007 (Figure 1) but, because outward investment from Malaysia has risen faster than investment inflows since 2003, Malaysia has experienced a negative net foreign investment over the period 2006-2007. The contraction is expected to affect inward FDI far more than outward FDI, suggesting that net FDI will only get worse over the period 2008-2010.

Figure 1. Inflow and Outflow of Foreign Direct Investment, Malaysia, 1980-2007



Source: UNCTAD (several issues).

It is critical to locate the sources of slowdown in FDI flows and where the outflows have gone. Table 5 shows FDI inflows to Malaysia by country of origin. Overall FDI inflows to Malaysia from the rest of the world started falling from the third quarter of 2008 until the second quarter of 2009. The prime sources of contraction were North America, Central and South America, and Northeast Asia. Inflows from the United States fell from RM1,100 million in the first quarter of 2007 to RM445 million in the first quarter of 2009. Singapore and Vietnam were the only countries that showed an increase in investments to Malaysia in the first quarter of 2009. However, investment inflows from Singapore fell in the second quarter of 2009. In light of a decline of FDI inflows from traditional sources, the Government has sought to seek inflows from other sources. Interviews suggest that large investments are expected from non-traditional sources, such as the Middle East and Brazil. But given the growing cost differentials between Malaysia and late-comer countries, such as China and Vietnam, it is important that the Government strengthens its high-tech infrastructure to attract FDI into high value-added and high income activities.

Table 5. Investment Inflow by Country, 2007-2009 (RM Million)

	2007				2008				2009	
Country	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Africa	**30**	**59**	**7**	**8**	**3**	**36**	**30**	**132**	**9**	**70**
Central & South	**890**	**963**	**625**	**653**	**688**	**694**	**343**	**218**	**59**	**49**
North America	1,243	1,318	1,308	1,904	1,143	1,470	1,147	623	572	1895
Canada	144	352	366	399	322	231	299	131	127	140
United States	1,100	967	941	1,504	822	1,239	848	492	445	1754
West Asia	74	57	542	475	380	684	624	1,031	275	232
South Asia	12	1,433	2,391	2,854	1,904	2,838	2,396	2,686	1,123	n.a.
Southeast Asia (Total)	**1,072**	**7,008**	**1,364**	**1,534**	**829**	**1,609**	**1,665**	**1,943**	**1,563**	**1419**
Brunei Darussalam	5	12	4	3	1	5	3	5	3	3
Indonesia	21	28	59	66	35	66	115	76	95	98
Philippines	2	3	10	15	3	8	1	20	6	16
Singapore	838	6,835	999	1,148	645	1,333	1,088	983	1,013	720
Thailand	94	62	166	76	63	33	235	707	276	400
Viet Nam	111	65	124	224	80	160	211	151	167	177
Northeast Asia	**1,228**	**1,625**	**1,495**	**2,006**	**1,840**	**1,505**	**663**	**756**	**871**	**520**
China, PRC	6	50	15	58	14	34	27	24	10	21
Hong Kong, SAR	346	645	646	1,092	411	914	253	340	317	180
Japan	775	648	732	636	570	401	292	263	487	257
Korea, Republic of	74	197	62	111	790	95	36	72	41	45
Chinese Taipei	26	81	40	109	56	57	54	40	16	16
Western Europe (Total)	**1,443**	**1,828**	**3,898**	**1,747**	**942**	**1,589**	**1,607**	**2,837**	**2,219**	**1290**
Switzerland	62	41	47	100	104	80	384	94	19	17
Germany	78	748	765	248	131	379	406	706	714	560
France	45	142	18	33	68	154	68	162	125	133
United Kingdom	706	240	1,734	211	242	140	144	1,352	159	105
Netherlands	450	83	398	817	295	743	419	304	327	386
Sweden	15	458	888	6	2	8	-	2	1	1
Commonwealth of Independent States	**76**	**1,851**	**213**	**130**	**105**	**106**	**114**	**100**	**58**	**n.a.**
Labuan IOFC	3,358	9,494	17,770	10,035	4,197	6,783	17,205	2,639	1,800	1083
Other countries	89	297	647	84	300	88	77	159	78	271
Total	**9,516**	**24,521**	**27,918**	**18,638**	**10,495**	**14,608**	**23,533**	**10,482**	**7,558**	**6899**

Note: Investment refers to equity investment and purchase of real estate in Malaysia/abroad, and loans drawdown/extended from/to non-residents. Excludes retained earnings, which is an important component in the balance of payments compilation on an accrual basis. Labuan IOFC is treated as a non-resident for Exchange Control purposes.
Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

Overall, Malaysian investments going abroad reached their height in the second quarter of 2008 before falling sharply thereafter (Table 6). Southeast Asia has become the leading destination of Malaysian investment outflows, with Indonesia and Singapore being the two most important destinations. Investments to Indonesia reached their peak in the second and third quarters of 2008 before falling, while those to Singapore were highest in the second quarter of 2008 before declining. Much of the acquisitions in Indonesia were related to banking. It appears that FDI did not face a worrying trend prior to the financial crisis, as they were increasing in each of the quarters since 2003. The negative net FDI are to a significant extent the result of increased outflows of capital from Malaysia. The slowdown trend in net FDI following the crisis is unavoidable and can only be reversed through inflows from non-traditional sources into resource-based industries as well as through upgrading the high-tech infrastructure in the country to attract FDI in high value-added activities.

Table 6. Investment Outflow, Malaysia, 2007-2009 (RM Million)

Country	2007				2008				2009	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Africa	**143**	**122**	**350**	**401**	**265**	**169**	**4,586**	**467**	**163**	**533**
Central & South America	**83**	**294**	**248**	**171**	**851**	**876**	**2,089**	**840**	**660**	**298**
North America	929	518	141	341	321	168	155	346	536	691
Canada	1	15	3	11	33	123	83	171	168	95
United States	928	503	137	330	287	44	72	175	368	596
West Asia	393	139	206	148	95	215	26	141	85	746
South Asia	1,716	796	552	637	511	598	207	628	707	n.a.
Southeast Asia	1,972	9,581	1,699	2,524	3,419	2,689	9,338	7,131	2,914	1,917
Brunei	3	18	2	60	3	…	9	2	34	1
Indonesia	398	711	338	220	496	1,009	4,542	4,876	399	477
Myanmar	86	56	20	30	14	18	58	75	63	113
Philippines	22	1	1	10	1	21	62	40	39	12
Singapore	1,216	8,640	1,020	1,771	2,551	1,134	3,998	1,006	898	1,056
Thailand	157	81	82	21	65	35	23	628	1,080	76
Viet Nam	87	73	197	358	249	241	633	502	400	181
Northeast Asia	**1,908**	**1,147**	**2,867**	**1,102**	**1,514**	**1,289**	**1,532**	**1,344**	**1,091**	**1,297**
China, PRC	272	218	329	170	130	184	105	228	158	337
Hong Kong, SAR	1,439	860	1,030	900	1,217	1,015	1,344	1,024	858	948
Japan	158	28	5	8	82	55	44	61	72	2
Korea, Republic of	…	4	…	18	36	18	4	…	1	1
Macau	-	7	1	…	1	2	6	-	1	-
Chinese Taipei	39	29	1,501	6	48	16	29	30	1	9
Western Europe	2,063	1,869	1,299	3,151	2,491	3,064	1,102	1,404	875	1243
Belgium	262	155	166	617	1,615	442	122	237	72	68
Switzerland	385	8	11	13	18	11	14	7	14	17
Germany	42	179	6	99	14	1,807	37	126	42	48
Finland	18	10	17	10	6	15	22	11	12	10
France	15	6	133	70	11	125	-	12	8	29
United Kingdom	371	76	236	139	118	14	116	109	158	364
Ireland	7	5	3	9	37	5	20	4	4	11
Luxembourg	43	9	78	10	33	141	134	172	146	174
Netherlands	920	1,420	620	1,806	606	499	619	722	366	506
Oceania	**79**	**115**	**105**	**113**	**128**	**101**	**107**	**108**	**105**	**341**
Labuan IOFC	**19,217**	**13,623**	**1,147**	**15,893**	**49,792**	**56,988**	**3,012**	**62,875**	**111,946**	**87,667**
Other countries	**500**	**381**	**4,371**	**472**	**258**	**259**	**625**	**294**	**114**	**185**
Total	**27,483**	**27,867**	**12,550**	**24,437**	**59,229**	**67,989**	**23,372**	**75,017**	**118,540**	**95,000**

Note: Investment refers to equity investment and purchase of real estate in Malaysia/abroad, and loans drawdown/extended from/to non-residents. Excludes retained earnings, which is an important component in the balance of payments compilation on an accrual basis. Labuan IOFC is treated as a non-resident for Exchange Control purposes.

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

3.2.2. Consumption

Final consumption expenditure fell gradually over the whole of 2008, but contracted in the first quarter of 2009 before recovering by 0.6% in the second quarter. While public consumption slowed down to 2.1%, growth of private consumption fell by -0.7% in the first quarter of 2009 (Table 7). A slowdown rather than an absolute contraction in public consumption has been due to the execution of government expenditure already committed through the Ninth Malaysia Plan. The RM7 billion fiscal stimulus is also expected to have a similar effect on public consumption. Given the trend expected when government finances are solid, public consumption is unlikely to hit negative growth rates. The commitment of the Government to stave off the crisis through initially a RM7 billion stimulus and then a second stimulus amounting to RM60 billion obviously means that government consumption is expected to rise to at least provide the short-term substitution effect for private consumption. It is hoped that the increase is confined to necessary consumption.

Table 7. Real GDP by Expenditure, Malaysia, 2007-2009 (% Annual Change)

	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Final consumption expenditure	7.4	10.2	12.5	8.4	11.8	9.6	7.9	7.1	-0.2	0.6
Private sector	7.5	10.2	14.2	9.9	11.3	9.4	8.2	5.3	-0.7	0.5
Public sector	7.2	10.3	6.0	4.0	14.1	10.3	6.4	12.7	2.1	1.0
Exports of goods and services	2.4	3.5	3.5	8.3	5.9	9.5	4.5	-13.3	-15.2	-17.3
Imports of goods and services	4.9	3.4	4.3	11.4	3.2	8.1	7.7	-10.2	-23.5	-19.7
Gross Domestic Product (GDP)	5.4	5.6	6.5	7.2	7.4	6.6	4.8	0.1	-6.2	-3.9

Source: Department of Statistics, Malaysia, 2007, 2008, 2009.

Sales of passenger cars fell by -10.5% in the fourth quarter of 2008, followed by a further contraction in the first (-10.5%) and second (-11.6%) quarters of 2009 (Table 8). Credit consumption stayed steady throughout 2007-2008 until the first quarter of 2009 before slowing down slightly in the second quarter. Imports of consumption goods contracted in the first two quarters of 2009, which is good for the trade balance given the fall in aggregate demand arising from a fall in exports. Household spending on imported consumption goods declined in the first two quarters of 2009. The market capitalisation of Bursa Malaysia has been contracting since the first quarter of 2008, although a slowdown in the fall in the second quarter of 2009 may suggest that the worst may be over in this area.

Table 8. Private Consumption Indicators, Malaysia, 2007-2009 (% Annual Change)

	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Sales of passenger cars	4.1	4.9	25.1	42.4	25.7	27.8	10.4	-10.5	-10.5	-11.6
Credit consumption	7.5	7.4	7.1	7.3	7.6	9.6	9.7	8.9	9.1	6.8
Import of consumption goods	8.9	1.1	1.2	3.8	5.6	21.3	16.2	4.5	-3.9	-8.3
Market capitalisation of Bursa Malaysia	34.4	50.8	38.3	30.3	-3.3	-17.2	-25.3	-40.0	-38.4	-9.2
Outstanding balance of credit cards	18.6	21.1	15.2	14.4	12.5	10.4	10.2	9.6	9.0	6.6

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

3.3. Commodity Prices

The international prices of Malaysian commodities have shown a mixed response. The effects of the financial crisis do not look obvious for a number of the commodities. Rubber prices, both local and export, fell from the second quarter of 2008 until the first quarter of 2009 but rose in the second quarter of the year (Table 9). Crude palm oil and sawn timber prices for local delivery and exports dropped sharply from the first quarter of 2008 until the fourth quarter of 2008, but have risen steeply over the first and second quarters of 2009. Export prices of tin declined in the fourth quarter of 2008 before increasing over the first and second quarters of 2009. Crude oil prices fell from the second quarter of 2008 until the first quarter of 2009 before going up in the second quarter of 2009. Export prices of oil show a slightly different pattern, with prices falling from the third quarter of 2008 and rising in the second quarter of 2009. Prices of liquefied natural gas (LNG) fell from the fourth quarter of 2008 until the second quarter of 2009.

The three most important commodities for Malaysia in terms of export value, i.e., palm oil, oil and LNG, show different price movements. The sharp recovery in palm oil prices, driven primarily by the revival in GDP growth in China and India, augurs well for the Malaysian economy. However, despite recovery in the last two quarters, oil and gas price trends provide the opposite effect. In addition, the growing deficit in net exports of gas suggests that the natural resource may soon be exhausted. Given the importance of oil and gas in the subsidisation of several government projects, it is likely to have a severe bearing on government finance in the medium to long-term.

While palm oil has been performing well again, oil and gas continue to face low prices and the growing demand-supply deficit in gas leaves government finances delicately placed. In addition to a need to rethink the subsidies on gas given to independent power suppliers, it is also important that the Government reduces its dependence on oil and gas, both of which are non-renewable commodities.

Table 9. Changes in Commodity Prices, Malaysia, 2007-2009

	2007				2008				2009	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Standard Malaysian Rubber (SMR20 - sen/kg)	707	741	715	783	842	927	983	563	505	564
Rubber (export unit value - sen/kg)	662	741	729	749	823	872	1,006	825	500	571
Crude palm oil (MPOB[1], local delivery - RM/tonne)	1,940	2,451	2,596	2,902	3,592	3,524	2,780	1,601	1,927	2,548
Palm oil (export unit value - RM/tonne)	1,903	2,183	2,597	2,630	3,158	3,126	3,224	2,245	2,164	2,372
Saw logs (export unit value - RM/cubic meter)	460	453	456	450	467	429	490	514	481	503
Sawn timber (export unit value - RM/cubic meter)	1,371	1,335	1,430	1,349	1,247	1,154	1,196	1,247	1,642	1,613
Tin[2] (KLTM – USD/tonne)	12,627	14,154	14,897	16,421	17,764	22,542	20,518	12,920	10,921	13,340
Tin (export unit value - RM/tonne)	39,578	46,032	49,579	54,301	56,495	68,199	69,358	49,032	38,811	42,281
Crude oil (USD/barrel) Weighted Average	64.52	76.35	76.67	96.08	99.08	127.90	123.90	56.79	46.45	56.67
Crude oil (export unit value - RM/tonne)	1,637	1,912	1,986	2,227	2,333	2,836	2,959	2,058	1,290	1,321
Liquefied natural gas (export unit value - RM/tonne)	1,039	1,099	1,226	1,277	1,277	1,546	1,873	2,463	1,867	1,110

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

3.4. Trade and Balance of Payments

Malaysia experienced a contraction in exports and imports from the fourth quarter of 2008. The fall continued in the first and second quarters of 2009 (Table 10). The trade balance improved marginally in the first quarter of 2009 but dropped again in the second quarter. The trend in falling exports is not encouraging, as it shows a continuous decline in aggregate demand from external effects, which is the main channel through which the global financial crisis has penetrated the Malaysian economy.

Table 10. Gross Exports, Imports and Trade Balance

Value (RM Million)	2007				2008				2009	
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Gross exports (f.o.b.)	138,125	145,005	158,532	163,492	151,798	175,169	185,234	151,293	121,472	129,128
Gross imports (c.i.f.)	117,065	122,383	130,273	135,093	124,972	134,525	143,474	118,639	88,802	102,611
Trade balance	21,059	22,622	28,259	28,399	26,826	40,644	41,759	32,654	32,670	26,517
% annual change										
Gross exports (f.o.b.)	1.0	1.3	0.9	7.6	9.9	20.8	16.8	-7.5	-20.0	-26.3
Gross imports (c.i.f.)	5.5	1.7	2.0	10.9	6.8	9.9	10.1	-12.2	-28.9	-23.7
Trade balance	-18.3	-1.0	-3.8	-5.9	27.4	79.7	47.8	15.0	21.8	-34.8

Source: Department of Statistics, Malaysia, 2007, 2008, 2009.

Exports faced a contraction of -11.7% in the fourth quarter of 2008 and -19% and –22.3% in the first and second quarter of 2009 respectively (Table 11). Disaggregating the data, semiconductor exports recovered slightly in the first quarter of 2009 but dropped sharply in the second quarter. Other electronics exports faced a severe contraction over both quarters of 2009. Wood products, petroleum products, toys and sporting goods, and chemicals also experienced a sharp fall in exports in the first two quarters of 2009. Given the significance of electronics to manufacturing employment, this decline is serious.

Table 11: Gross Exports by Major Sectors, 2007-2009

	2007				2008				2009	
Major Sectors	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Semiconductors	2.7	3.9	4.9	1.1	-24.7	13.2	0.1	-17.5	3.6	-18.4
Electronic equipment & parts	-7.3	-14.0	-12.6	0.4	-2.5	1.0	-5.5	-27.2	-30.8	-27.0
Consumer electrical products	-19.0	-16.8	-13.5	-7.1	16.2	36.0	50.5	14.7	-29.9	-13.9
Industrial & commercial electrical products	-2.3	-17.2	-14.6	-19.1	-9.3	19.8	18.1	-9.2	-22.4	-30.2
Electrical industrial machinery & equipment	17.4	11.1	8.9	3.8	-0.0	3.8	-1.5	0.9	-19.5	-23.1
Household electrical appliances	25.3	22.4	6.4	-2.6	9.2	-3.7	-2.7	-6.9	-29.2	-5.5
Total (Electronics & electrical)	-2.0	-6.7	-5.6	-2.1	-9.4	9.2	2.6	-17.2	-19.0	-22.8
Transport equipment	-32.6	-2.8	9.8	35.9	0.3	40.3	13.0	3.8	22.2	-17.0
Food	14.6	18.1	25.9	34.2	36.8	55.4	57.2	22.0	0.5	-20.7
Beverages & tobacco	18.0	7.8	13.4	17.4	12.5	6.6	23.3	-2.5	-5.5	18.2
Textiles, clothing & footwear	-9.2	-16.6	5.9	-0.4	3.3	5.7	3.1	-1.5	-6.2	-15.3
Wood products	15.3	8.2	-17.4	-23.7	-9.5	-4.3	14.6	3.7	-24.9	-22.8
Rubber products	31.0	6.0	1.3	20.6	23.3	26.4	32.4	1.5	-8.3	-4.7
Paper & pulp products	-1.2	34.0	16.3	22.0	16.2	17.2	19.5	-0.9	-10.9	-0.5
Petroleum products	-24.5	5.8	-5.7	43.7	96.7	56.3	67.8	-24.7	-40.8	-49.5
Chemicals & chemical products	33.8	13.5	3.2	9.1	6.8	27.3	23.0	-17.0	-29.8	-25.2
Non-metallic mineral products	23.1	7.4	8.5	12.7	14.2	42.0	55.1	28.8	14.3	6.1
Manufactures of metal	20.1	9.5	17.6	16.8	26.9	8.4	18.5	-8.3	-30.2	-21.8
Optical & scientific equipment	-7.8	13.3	-2.9	-0.0	7.2	22.1	-0.4	10.8	-13.0	-31.4
Toys & sporting goods	1.0	10.3	5.9	7.4	7.2	14.3	19.4	-2.0	-20.3	-17.9
Furniture & parts	7.9	14.3	1.0	1.5	0.6	-4.1	8.1	4.5	-13.5	-14.4
Other manufactures	31.9	17.8	9.9	-10.4	-15.3	-11.2	10.8	23.5	8.9	38.5
Total	1.4	-1.1	-2.0	3.0	1.0	14.4	11.4	-11.7	-19.0	-22.3

Source: Department of Statistics, Malaysia, 2007, 2008, 2009.

Examined by geographical markets, the contraction in exports is most severe in the case of the United States, as exports to the country fell by -9.9%, -23.1%, -31% and -35.1% respectively over the third and fourth quarter of 2008, and first and second quarter of 2009 (Table 12). Exports to Japan experienced their first contraction in the first quarter of 2009 and continued into the second quarter. Exports to all ASEAN countries fell, except to Brunei in the first two quarters of 2009 and to Vietnam in the second quarter of 2009. The sharper decline in exports to key markets in the first two quarters of 2009 left the Malaysian economy in a precarious situation.

Table 12. Gross Exports by Major Destinations, 2007-2009 (% Annual Change)

	2007				2008				2009	
Major Destination	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*
Singapore	-11.4	-6.7	-3.2	12.2	16.4	23.0	16.5	-11.3	-30.3	-29.9
Thailand	1.6	-11.0	-8.0	2.0	2.6	28.9	17.8	-20.9	-19.4	-19.3
Indonesia	46.3	18.6	3.5	15.4	10.1	22.9	51.9	-11.7	-21.4	-20.2
Philippines	-3.0	5.7	-3.8	42.4	14.4	5.1	54.9	-19.0	-37.4	-17.4
Brunei Darussalam	-11.3	15.4	8.2	25.5	15.3	14.9	11.1	-6.8	12.7	14.3
Vietnam	-28.7	-14.4	78.8	95.4	48.5	42.7	-13.9	-33.8	-22.4	3.2
Total Selected ASEAN countries	-4.8	-4.8	-0.6	15.0	13.9	23.9	20.7	-15.0	-26.8	-24.1
United States	-3.2	-18.7	-18.6	-15.8	-17.5	0.0	-9.9	-23.1	-31.0	-35.1
Japan	-4.5	19.5	2.5	7.3	25.0	23.1	27.0	43.4	-6.9	-32.6
People's Republic of China	34.6	18.0	15.0	32.5	12.5	55.3	35.4	-18.4	-1.8	-16.0
Hong Kong China	-15.6	-10.2	-2.1	13.1	-13.7	34.9	9.3	-22.7	3.5	-23.8
Korea	5.9	14.3	1.0	11.5	9.5	17.9	38.1	-9.9	-14.3	-31.2
Australia	-12.0	32.8	48.2	27.1	37.9	18.7	20.0	5.1	-24.6	-26.8
Netherlands	5.0	21.5	5.4	9.9	7.0	-0.4	8.2	-14.4	-28.8	-25.2
India	7.1	13.9	8.3	2.5	24.1	39.8	19.1	9.8	-14.9	-38.9
Chinese Taipei	15.4	4.6	-7.5	1.6	-4.5	6.3	14.2	-22.1	-18.1	-29.6
Germany	21.9	19.9	12.8	11.1	0.6	3.9	11.7	-2.1	-10.9	-19.2
United Kingdom	9.7	-10.9	-13.5	-12.2	8.0	-1.5	-4.7	-18.2	-36.7	-25.3
France	1.3	-5.9	-9.1	-13.9	-10.0	-6.0	-15.8	-21.2	-24.2	-24.8
Other European countries	-2.5	-4.0	2.2	36.8	72.4	10.7	28.2	-20.1	-40.9	-11.1
New Zealand	-48.9	-18.7	60.3	78.8	163.2	60.8	45.6	-45.8	-67.9	-46.2
Spain	-21.1	-30.8	-1.0	-0.5	40.4	4.2	5.7	-17.2	-56.2	-49.2
Italy	5.0	9.3	4.0	-0.8	-6.9	-23.3	-10.4	-27.1	-10.7	-17.6
Canada	-1.8	-16.3	-23.0	-6.8	-10.4	1.8	10.3	-9.6	-17.4	-16.9

Source: Department of Statistics, Malaysia, 2007, 2008, 2009.

3.5. Currency and Financial Markets

In terms of Malaysia's financial sector, the direct effects from the implosion in the United States have been minimal because the sub-prime mortgage stocks did not enter the Malaysian financial system either directly or indirectly through collateral. Hence, the impact of the global crisis on the financial and currency markets has not been destabilising thus far.

3.5.1. Exchange Rates

The improving trend in the Singaporean dollar and Japanese yen has continued. The US dollar fell to its lowest mean of RM3.21 to a dollar in the second quarter of 2008 before recovering steadily to RM3.62 to a dollar in the first quarter of 2009 and RM3.52 to a dollar in the second quarter (Table 13). Although the trends are comfortable, it is important for the Finance Ministry to watch out for any signs of volatility to prevent the recurrence of the destabilising effects of 1997.

The lack of American-type hedge fund attacks on weakened economies suggests that the current government policy of keeping a floating peg is appropriate. American financial institutions, particularly shadow banks and hedge fund operators, have largely been paralysed from mounting such attacks. BNM should nonetheless always be vigilant to prevent speculation if exchange rate volatilities occur.

Table 13. Exchange Rates (RM)

		RM per unit of					*RM per 100 units of*			
		US$	**EUR**	**STG**	**SDR**	**S$**	**DM**	**SF**	**Yen**	**HK$**
Period		***Average for period***								
2007	**Q1**	3.4984	4.584	6.8407	5.2469	2.2834	230.603	283.5867	2.9293	44.8047
	Q2	3.4284	4.620	6.8061	5.1971	2.2488	236.212	280.4405	2.8401	43.8631
	Q3	3.4667	4.761	7.0039	5.3154	2.285	243.543	289.1605	2.9448	44.4061
	Q4	3.3567	4.861	6.8676	5.2807	2.3083	248.802	293.281	2.9722	43.1628
2008	**Q1**	3.2255	4.832	6.3834	5.159	2.2894	247.216	302.3749	3.066	41.3826
	Q2	3.2129	5.018	6.3291	5.2264	2.3518	256.649	311.5294	3.0735	41.1936
	Q3	3.3396	5.021	6.3186	5.3129	2.3906	256.720	311.7054	3.1073	42.8215
	Q4	3.5551	4.680	5.5957	5.3533	2.3891	239.348	307.1448	3.707	45.8497
2009	**Q1**	3.6259	4.726	5.2133	5.4197	2.3977	242.046	316.1158	3.8772	46.7581
	Q2	3.5225	4.969	5.8592	5.3908	2.4302	247.145	319.3671	3.6729	45.8037

Note: US$ rates are the average of buying and selling interbank rates at noon. Rates for foreign currencies other than US$ are cross rates derived from rates of such foreign currencies against the US$ and the RM/US$.
Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

3.5.2. Banking

Liquidity levels in the country remain high with low NPLs, which have given the Government considerable financial stability. The same prudent and conservative regulations on investment banks and finance houses, which were designed to reduce NPLs following the 1997-98 Asian financial crisis, have been retained to good effect.

Despite the gloomy investment environment, BNM has done well to keep NPLs low. The NPL over total loans ratio was already extremely low prior to the financial crisis (Table 14). The percentage of NPLs in total loans fell from 4.4% in March 2007 to 2.2% in December 2008, and March and June 2009. The trend is all the more interesting given that the fall has been sustained despite a contraction in GDP over the last two quarters. This fall obviously offers the Government the space to pursue expansionary policies to expand domestic demand.

Table 14. Non-Performing Loans, Malaysian Banks, 2007-2009 (RM Million)

	2007				2008				2009	
Month	**Mar**	**June**	**Sept**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Mar**	**June**
Non-performing loans	*49631*	*46641*	*44074*	*41763*	*40440*	*36977*	*36059*	*34983*	*33592*	*33188*
Non-performing loans/ Total loans (%)	*4.4*	*4.1*	*3.5*	*3.2*	*3.0*	*2.6*	*2.4*	*2.2*	*2.2*	*2.2*

Source: Bank Negara Malaysia, Monthly Statistical Bulletin, July 2009.

Despite the excellent NPL record achieved, the environment for investment has nevertheless continued to deteriorate because of falling aggregate demand.

3.5.3. Stock Market

Keynes (1936) had insisted that keeping exchange and stock markets flexible can seriously undermine the economy when confidence falls. Regulations by the Finance Ministry, despite the ending of capital controls during the premiership of Abdullah Ahmad Badawi, have ensured that the contraction in aggregate demand arising from a collapse in exports did not trigger a bearish run on the stock market. Bursa Malaysia has also remained fairly steady in 2009. The index fell in the months of January-March 2008, May-October 2008 and March 2009. After falling below 1000 percentage points from October 2008 until April 2009, the index has grown strongly over the period from May to July 2009 (Table 15). News of the Malaysian economy entering a recession following a second-quarter dip in GDP did not dampen the stock market very much.

Three reasons explain the lack of a run. Firstly, the Finance Ministry learnt a good lesson from the Asian financial crisis and had kept external borrowings low. Secondly, the regulatory framework and instruments have kept NPLs low. Despite such fundamentals, as Stiglitz (2000) had argued before, large attacks can still bring down small economies, no matter how well their macroeconomic conditions are managed. Thirdly, the lack of a run in the stock market reminiscent of the 1997-98 financial crisis is also to some extent a consequence of a lack of major global players providing the leadership for such attacks that were mounted by hedge funds, such as the Quantum Fund and Tiger Fund, a decade ago. The paralysis faced by the developed countries narrowed the space for such attacks in 2008-09. Hence, whereas massive capital flight took place in the 1997-98 financial crisis, such flight has been limited this time.

However, the Government should be ready to intervene if the situation changes and investors try to exit the stock market. Huge capital flight will not only have a severely negative impact on the real economy but also cripple the value of the ringgit.

Table 15. KLSE Composite Index, 2007-2009

2007			2008			2009		
Periods	**Composite Index**	**% Changes**	**Periods**	**Composite Index**	**% Changes**	**Periods**	**Composite Index**	**% Changes**
Jan.	1,189.35	-	Jan.	1,393.25	-3.58	Jan.	884.45	0.88
Feb.	1,196.45	0.60	Feb.	1,357.40	-2.57	Feb.	890.67	0.70
Mar.	1,246.87	4.21	Mar.	1,247.52	-8.09	Mar.	872.55	-2.03
Apr.	1,322.25	6.05	Apr.	1,279.86	2.59	Apr.	990.74	13.55
May	1,346.89	1.86	May	1,276.10	-0.29	May	1,044.11	5.39
Jun.	1,354.38	0.56	Jun.	1,186.57	-7.02	Jun.	1,075.24	2.98
Jul.	1,373.71	1.43	Jul.	1,163.09	-1.98	Jul.	1,174.90	9.27
Aug.	1,273.93	-7.26	Aug.	1,100.50	-5.38			
Sep.	1,336.30	4.90	Sep.	1,018.68	-7.43			
Oct.	1,413.65	5.79	Oct.	863.61	-15.22			
Nov.	1,396.98	-1.18	Nov.	866.14	0.29			
Dec.	1,445.03	3.44	Dec.	876.75	1.22			

Source: Bank Negara, Monthly Statistical Bulletin, July 2009.

The financial sector has, therefore, remained strong in Malaysia despite the collapse in exports, a fall in oil prices and a contraction in GDP over the first two quarters of 2009. The capital and currency markets have also remained steady over the first two quarters of 2009.

4. Human Development Infrastructure

Economic development has two critical and mutually reinforcing features involving human capital. One is that humans are the only ones in a material world who can create material value, while the other is that the focus of material development (including sustainable development) targets humans as the beneficiary of the processes they create. This section thus examines not only the employment and income effects of the 2008-2009 global crisis, but also whether existing policy targets meet the objective of enabling Malaysia's human capital to compete in global markets and sustain material improvements in their standards of living. A number of basic issues, e.g. poverty levels, and education and healthcare, are discussed in section 6.3 because of the lag effect of macroeconomic variables on such issues. Besides, because the financial exposure has been low, the crisis has not dampened public expenditure on these sectors and hence they have not experienced serious cutbacks so far.

4.1. Impact on Retrenchments and Income

Unemployment and wage levels are among the immediate variables to be affected in a recession. With exports falling and GDP contracting, the early problems faced by Malaysia include retrenchment, which has resulted in lay-offs, as well as temporary lay-offs and workers facing pay cuts (Tables 16 and 17). The worst hit sector has been manufacturing. Although the total retrenchments in manufacturing reported for 2008 were lower than those for 2007, the figure in the first quarter of 2009 alone rose sharply to exceed the total for 2008 (Tables 16 and 17). The numbers retrenched in the second quarter fell, but the figure was still high.

Table 16. Retrenchments, Malaysia, October 2008 until May 2009

	Firms involved	Local			Foreign			Overall total
		Male	Female	Total	Male	Female	Total	
Permanent	907	9472	8471	17943	4091	3094	7185	25128
VSS	202	4057	3544	7601	641	229	870	8471
Total	1109	13529	12015	25544	4732	3323	8055	33599
Temp. lay-off	22	2876	4346	7222	472	502	974	8196
Pay-cut	418	12506	12677	25183	5054	4147	9201	34384

Source: Ministry of Human Resource, Malaysia, 2009.

Table 17. Retrenchments, Malaysia, 2007-2009

	2007					2008					2009	
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2
No. of workers [5/]	**4,180**	**4,202**	**1,308**	**4,345**	**14,035**	**2,397**	**2,821**	**1,379**	**7,254**	**13,851**	**12,590**	**7470**
Agriculture, forestry & fishing	96	34	7	118	**255**	-	2	84	312	**398**	20	208
Mining	2	21	37	1	**61**	8	18	28	35	**89**	28	45
Manufacturing	3,401	2,950	659	2,960	**9,970**	1,415	2,080	2,618 [6/]	4,901	**8,396**	9,778	5307
Construction	17	204	33	37	**291**	42	44	32	81	**199**	100	336
Services of which:	664	993	572	1,229	**3,458**	932	677	1,235	1,925	**4,769**	2,664	1574
Electricity, gas and water supply	4	1	-	-	**5**	74	3	-	-	**77**	5	38
Wholesale and retail trade, hotels & restaurants	410	527	247	745	**1,929**	339	405	176	1,132	**2,052**	483	318
Transport, storage & communications	81	82	98	61	**322**	347	68	254	104	**773**	210	235
Finance, insurance, real estate	28	224	165	344	**761**	138	87	192	591	**1,008**	620	388
Other services [3/]	141	159	62	79	**441**	34	114	613	98	**859**	1,346	595

Notes:

1 As at end-period. Data is not comparable with past series. With effect from May 2005, the registration period during which jobseekers are deemed to be actively seeking jobs using the Electronic Labour Exchange was lengthened to six months (three months previously).

2 The number of job vacancies could have been under-reported as it is not compulsory for firms to report vacancies to the Manpower Department.

3 Includes public administration and defence, compulsory social security, education, health and social work, other community, social and personal service activities, private household with employed person, ex-territorial organisations and bodies.

4 Since 2004, classification of occupational groups is based on the Malaysia Standard Industrial Classification (MISC) 1998.

5 Since 1 February 1998, it is mandatory for employers to inform the Director-General of the Labour Department at least one month before any retrenchment exercise is undertaken.

6 Excludes 7,564 retrenched workers from a company that was taken over in the second half of the year and rehired immediately by the new owner.

Source: Ministry of Human Resources, 2009.

The unemployment rate rose from 3.2% in 2007 to 3.7% in 2008 and is expected to rise further to 4.5% in 2009 (EPU, 2009). These figures are, nevertheless, still within the Keynesian definition of full employment, which is 5%. The consumer goods and services inflation showed a falling trend from 8.51% in July 2008 to 3.05% in April 2009, which is a consequence of oil prices falling gradually (EPU, 2009). The fall in inflation to low levels removes the potential for stagflation. As long as inflation can be controlled at such low levels, which is very likely as oil prices are not expected to soar again in 2009, an expansionary budget to substitute for lost aggregate demand caused by falling exports in industries that show little leakage, such as infrastructure, can help revive GDP growth.

The contraction in GDP has translated into a fall in labour force participation rates from 2009. The unemployment rate is expected to rise to 4.5% in 2009 following a rise from 3.2% in 2007 to 3.7% in 2008 (Table 18). Given the strong exposure to export markets, the employment contribution of the manufacturing sector alone is expected to contract in 2009, which is lower than that experienced in Taiwan, Province of China, and the Republic of Korea only because of the buffer the country enjoys from foreign workers.

Table 18. Labour Force and Employment Indicators, 2003-2009

	2003	2004	2005	2006	2007	2008	2009*
Labour force ('000)	10,426	10,846	11,291	11,545	11,775	11,968	12,142
Labour fForce participation rates (%)							
Total[1]	65.6	66.1	66.7	66.9	67	67	66.9
Male[2]	85.4	86.2	86.6	86.7	87	87	86.9
Female[3]	47.7	47.3	45.9	45.8	46.4	46.1	46
Unemployment	3.6	3.5	3.58	3.3	3.2	3.7	4.5
Employment by industry ('000)							
Agriculture	1,416.6	1,402.2	1,405.2	1,439.5	1,424.8	1,383.0	1,385.6
Mining	40.2	41.9	43.6	44.6	45.6	46.1	46.2
Manufacturing	2,773.0	2,971.8	3,126.3	3,213.8	3,294.0	3,342.3	3,279.3
Construction	773.6	763.9	762.5	781.1	775.1	760.7	762.1
Services	5,043.6	5,273.9	5,555.4	5,691.1	5,870.0	5,993.0	6,073.7
Total	10,047.0	10,453.5	10,893.0	11,170.2	11,409.4	11,525.0	11,547.0

Note:
[1] Total number of people economically active as a percentage of total number in the working age population of 15 to 64 years.
[2] Total number of people economically active as a percentage of total number of males in the working age population.
[3] Total number of people economically active as a percentage of total number of females in the working age population.
* estimated values
Source: Economic Planning Unit, 2009, available at http://www.epu.my/New%20Folder/Figures2009/chapt2.pdf.

The year-on-year contraction in manufacturing sales, employment, remuneration and productivity is shown in Table 19. It can be seen that manufacturing employment over the one-year period fell by -7.8%, wages and salaries by -8.1% and productivity by a massive -19.6%. The contraction is expected to continue over the remaining months of 2009. Hence, the slowdown that ensued from the late-1990s and early-2000s quickly morphed into a recession when exports plunged in 2008-09. The retrenchments in the first two quarters of 2009 should be viewed seriously.

Table 19. Sales Value, Employment, Salaries & Wages and Productivity in Manufacturing, Jan-June 2008-2009

Period	Sales Value RM (Million)	Number of Employees (As at end of March)	Salaries & Wages	Productivity
Jan-June 2009	216,456.8	933,357	11,257.5	231,912
Jan-June 2008	291,991.2	1,012,655	12,252.0	288,342
Differences	-75,534.4	-79,298	-994.5	-56,430
%	-25.9	-7.8	-8.1	-19.6

Source: Department of Statistics, Monthly Manufacturing Survey, July 2009.

4.2. Human Capital, Research and Development Infrastructure, and Disposable Income

The declining trend in manufacturing labour productivity raises concerns, given that the sector accounted for 30.8% of GDP in 2000 before falling to 30.2% in 2005 (Rasiah, 2008). Although the sharp fall reported above was largely caused by falling exports, a slowdown was already occurring in the period 2000-2005, as pointed out in Section 2. The lack of technological upgrading, which is seen as paramount to ensuring that the sector will be able to catch up with the manufacturing sectors in the Republic of Korea, Taiwan, Province of China, and Singapore, has been already highlighted (Edwards and Jomo, 1999; Rasiah, 1999, 2003, 2007; and Felker and Jomo, 2007). The slowdown in manufacturing productivity will also restrict the country's capacity to achieve its vision 2020 goal of achieving developed status. The shortcomings of the manufacturing sector need to be rectified for the sector to start growing again. The only opportunity that the Government can grasp to launch a technological catch-up strategy to put the country back on its vision 2020 growth path is through injections of investment in technological deepening.

The slowdown in GDP growth from the late-1990s is, *inter alia*, a consequence of Malaysia's failure to upgrade into high value-added activities. The main innovation deficiency facing manufacturing firms in Malaysia relate to the lack of technological upgrading. Competition from the low-wage economies of China, the Philippines and Vietnam has intensified, as they have successfully started providing good infrastructure and security in export processing zones. In addition, they have developed resourcefulness in their human capital to support process technology changes that lower production costs, shorten delivery times, offer continuous improvements in product and service quality, and provide flexibility in the labour force to step production up and down, as appropriate. Malaysia needs to move to another stage of development to produce higher value-added products that can only be achieved in an innovation-driven economy dominated by technology-intensive operations.

In 1990, in launching the Action Plan for Industrial Technology Development, the Government embarked on building a knowledge-based economy as the main development thrust to accelerate economic and societal growth. However, it has been difficult for existing firms to shift activities to the higher value-added activities of design and R&D because of a combination of factors: a scarce supply of engineers and R&D scientists and technicians, the poor quality of those leaving universities in the country, low R&D investment, and the reluctance of most qualified Malaysians to return home from foreign sites (Rasiah, Hamdan and Gopalan, 2009). This has hindered the ability of these firms to upgrade and compete with firms in the Republic of Korea, Singapore and Taiwan, Province of China. Not only is the number of researchers and engineers per million persons in Malaysia extremely small compared with Japan, the Republic of Korea, Singapore and Taiwan, Province of China, the number fell sharply over the period 2004-2006 (Table 20). Also, the percentage of Malaysia's gross R&D expenditure in GDP is extremely small in comparison with Japan, the Republic of Korea, Singapore and Taiwan, Province of China, and has fallen over the period 2002-2006 (Table 21). The R&D support organisations in the country have also failed to adapt and coordinate their roles in effectively supporting the commercialisation of R&D output from Malaysian universities.

Table 20. Researchers and Engineers (FTE) per Million Populations

Country	1996	1998	2000	2002	2004	2006
Japan	4907	5162	5098	5072	5299	5148
Republic of Korea	2190	2005	2317	3002	3276	4162
Singapore	2538	2986	4140	4352	4997	5713
Taiwan, Province of China	3326	3794	3922	3103	3579	4159
Malaysia	90	154	276	295	503	367

Source: UNESCO, 2008.

Table 21. Gross R&D Expenditure in GDP, 1990-2000 (%)

Country	1990	1992	1994	1996	1998	2000	2002	2004	2006
Japan	3.1	2.8	2.8	2.8	2.8	2.9	3.17	3.17	3.40
Republic of Korea	1.9	2.03	2.44	2.6	2.55	2.69	2.53	2.85	3.23
Singapore	0.9	0.97	1.13	1.45	1.76	1.92	2.16	2.24	2.39
Taiwan, Province of China	1.7	1.75	1.82	1.88	1.98	1.96	2.2	2.44	2.58
Malaysia	0.37	0.37	0.34	0.22	0.39	0.49	0.69	0.63	0.64

Source: MOSTI, 2008, and UNESCO, 2008.

To make matters worse, there has been a steady decline in information technology (IT) enrolments at public and private universities, which fell from 119,556 in 2002 to 79,667 in 2007 (Rasiah and Wong, 2009). New entrants fell from 57,934 in 2002 to 24,102 in 2007. There was also a marked fall in the supply of IT graduates over the period 2002-2007, as output dropped from 53,712 graduates in 2002 to 19,496 graduates in 2007.

Unless the Government spends enough to build the public infrastructure to support R&D on a scale comparable to the developed countries as well as Singapore, Taiwan, Province of China, Republic of Korea and China, the Malaysian economy will not be able to enjoy the innovation synergies necessary to compete with firms from these countries, other than those in resource-based industries such as palm oil. Evidence from the developed countries, Taiwan, Province of China, Republic of Korea, Singapore and China, show that there are no substitutes for R&D expenditure to stimulate long-term technological catch-up efforts. Incremental engineering through creative duplication can only be a complement to investment in R&D. The fiscal stimulus should indeed take the crisis as an opportunity for correcting this problem.

5. Government Responses: Mitigating the Negative Effects

The major challenge Malaysia had to contend with was the transmission of the global financial crisis from the monetary to the real sector of the world's major economies, which had caused exports to collapse. Another important challenge was presented by the sharp decline in FDI inflows that further constrained aggregate demand and the private sector. The Government's approach to the present crisis is similar to that of the 1997-98 Asian financial crisis, with the public sector taking a dominant role in reviving the economy. The difference lies in the size of the stimulus packages due to the drop in export demand. Another difference is that the banking sector has been largely unaffected in the present crisis, unlike in 1998 when it needed a massive rescue. In addition, the effect on exchange rates has not been as severe as in 1998 when the ringgit depreciated sharply, prompting Malaysia to impose capital controls and fix the exchange rate. This time, however, the nominal ringgit exchange rate deteriorated only by approximately 11%. In the present crisis, therefore, the Government needs to focus on reviving growth by expanding domestic demand and does not have to deal with a banking sector or exchange rate crisis. The role of monetary policy is to expand credit and increase access to financing.

One difference that is not in Malaysia's favour, however, is the role of exports. The severe contraction of world trade in the current crisis is not helping the Malaysian recovery, resulting in the public sector having to take the lead role in boosting domestic economic activities. The state of world trade has influenced the size of the stimulus packages during the two crises. In 1998, the size of the stimulus package was smaller at RM7 billion (US$1.8 billion) or 2.5% of GDP, creating a fiscal deficit of 1.8% of GDP. The fiscal measures at that time included selective infrastructure spending, establishment of funds to support small and medium-scale enterprises (SMEs) and reduction in taxes. RM1 billion was allocated for social development expenditure, including improving the social safety net. There are suggestions that the global crisis, which is still underway, may be worse than the Great Depression. Thus, in anticipation of a more serious and damaging one with long-term effects, a larger fiscal stimulus of US$18.1 billion, or 10.4% of GDP, has been introduced during the current crisis. In the first three quarters of 2009, GDP growth had decelerated by -6.2%, -3.9% and -1.2% respectively, bringing the overall growth for the first nine months to -3.8%. The Government has forecasted GDP to range from –4% to –5% in 2009. GDP performance in 1998 had been much worse at -7.4% but Malaysia was able to provide a smaller fiscal stimulus then because of the prospect that exports could help the recovery process.

Since the 1997-98 crisis, domestic consumption has increased its contribution (58% in 2008 as shown in Table 22) in supporting growth. With a likely fall in private consumption and investment arising from export reduction during the present crisis, the public sector will need to expand its consumption and investment to compensate.

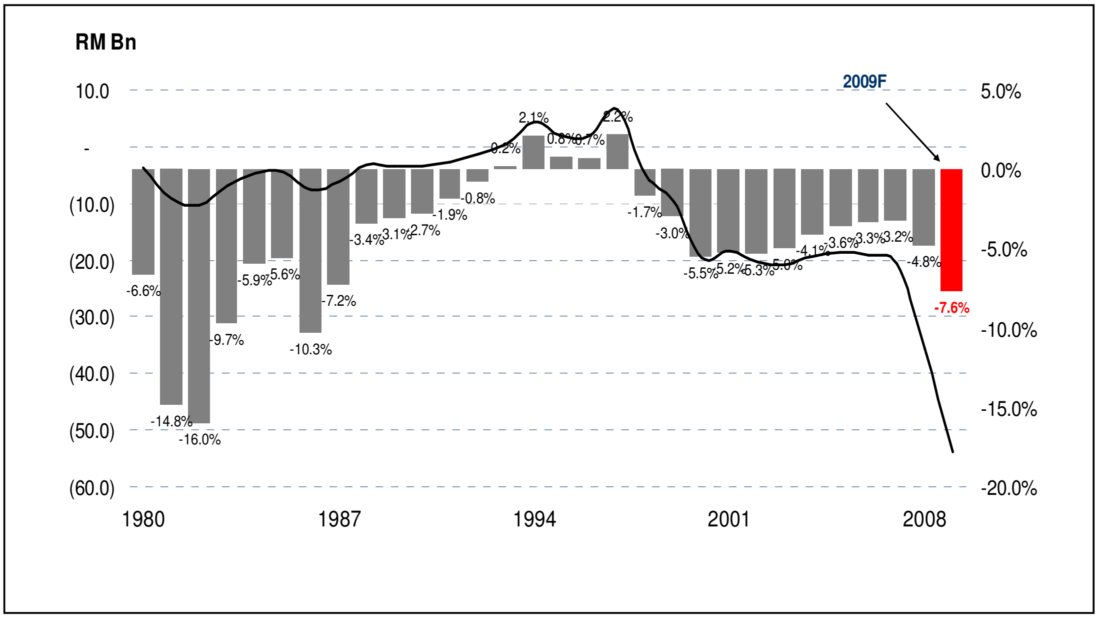
Table 22. GDP by Demand Aggregates, 2004 & 2008

	2004		2008*	
	Total (RM m)	**%**	**Total (RM m)**	**%**
Consumption	268,206	56.57	427,286	57.68
• Private consumption	208,571	44.0	334,219	45.12
• Public consumption	59,635	12.57	93,067	12.56
Investment	99,336	20.96	146,127	19.73
• Private investment	50,592	10.67	79,797	10.77
• Public investment	48,744	10.28	66,330	8.95
Change in stocks	9930	2.10	-4532	-0.61
Domestic demand	**377,473**	**79.63**	**568,881**	**76.8**
Net exports of goods and services	96,575	20.37	171,840	23.20
• Exports of goods and services	546,925	-	766,360	-
• Imports of goods and services	450,350	-	594,520	-
GDP (current price)	474,048	100	740,721	100

Source: BNM Annual Report 2008.
* preliminary.

Malaysia has been running annual fiscal deficits since 1980, except for a period in the mid-1990s, as shown in Figure 2. The Government was unable to maintain a fiscal surplus due to the 1997-1998 crisis, even after the economy recovered in 1999. Private investment was lacklustre and the public sector had to continue with its consumption and investment. Attempts were made to address this situation and the fiscal deficit was reduced to 3.2% in 2007. Although the Government's financial position has not been strong, the country's relatively low level of domestic debt (42.8% of GDP) has provided it with the flexibility to raise funds from domestic sources, which have ample liquidity with the national savings rate at 38% in 2008. Nonetheless, the annual fiscal deficits do constrain the Government's ability to commit large amounts for actual spending. Thus, it is important to analyse the types of stimulus measures in order to gauge their impact on growth as well as on the Government's long-term fiscal position.

Figure 2. Fiscal Deficits, 1980-2008



Source: BNM Annual Report 2008.

5.1. Monetary and Financial Policies

5.1.1. Monetary Policy

Rising global commodity and food prices built up inflationary expectations in early 2008. Inflation peaked in July and August that year and, as a result, headline inflation recorded an increase of 8.5%. The removal of fuel subsidies in June 2008 further pushed up domestic fuel price by 40.4%. In the Monetary Policy Committee meeting in July, the forecasted inflation rate for 2008 was revised upwards to 5.5-6.0% from the earlier rate of 2.5-3.0%. Even with rising inflationary pressures, BNM kept interest rates unchanged at 3.5% until late-November 2008. The interest rate had been maintained at this level since 2006. The Bank was reluctant to increase interest rates because it had not yet seen the secondary effect of price increases being transmitted into the system. Moreover, it feared that any interest rate increase would push inflation higher.

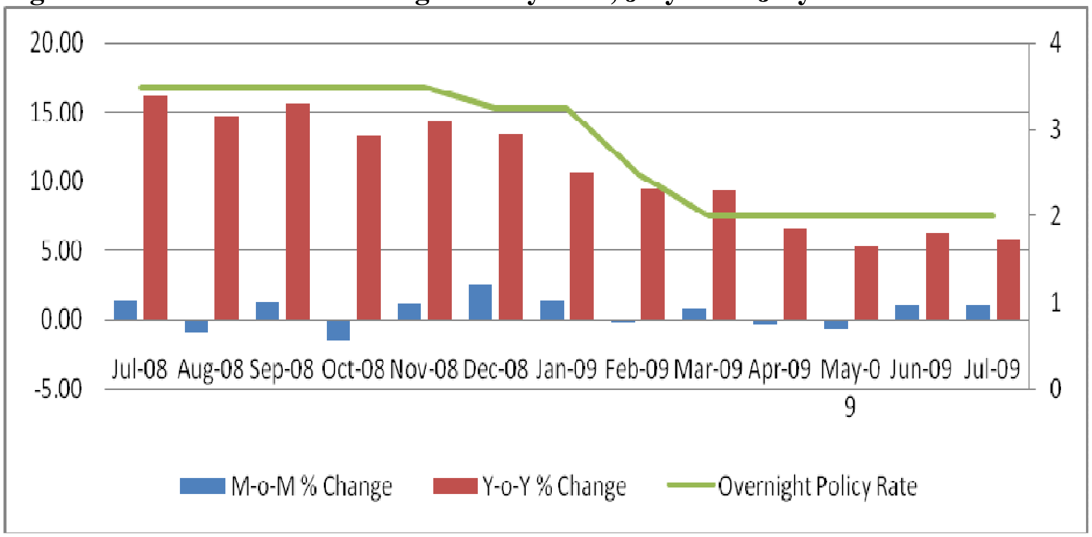
Table 23. Changes in Interest Rates

	2007	Dec 2008	Jan 2009	Feb 2009
OPR	3.5	3.25	2.5	2
SRR	3.5	3.5	2	1
BLR	6.72	6.48	5.53	-

Source: Bank Negara Malaysia, 2009.

The lowering of the Overnight Policy Rate (OPR) in November 2008 by 25 basis points to 3.25% and in January and February 2009 by 75 and 50 basis points respectively to the current level of 2% was done only after the full impact of the global crisis began to be felt in Malaysia (Table 23). By that time, inflationary pressures had dissipated with the collapse of oil and other commodity prices. This expansionary monetary policy was to support the fiscal stimulus introduced earlier. The interest rate reduction was accompanied by a lowering of the Statutory Reserve Requirement (SRR) of 50 basis points to 3.5% to reduce the cost of intermediation.

Figure 3. M2 Growth & Overnight Policy Rate, July 2008-July 2009



Source: Bank Negara Malaysia, 2009.

The easing of interest rates does not seem to have been particularly successful in maintaining the velocity of money supply (as measured by M2) at the 2008 levels as shown in Figure 3. After flattening out in the first quarter of 2009, year-on-year M2 growth fell until May 2009 although it has since risen slightly. From July 2008 to January 2009, M2 grew by more than 10% per month. Since February 2009, however, the M2 monthly growth rate has moderated substantially. Interest rate reductions had a positive influence on the domestic private debt securities market. Between July and December 2008, the value of new private debt securities issued had dropped, with the month of November recording the worst slump. However, since March 2009, the value of bond issues almost doubled compared with the preceding six-month period as shown in Table 24.

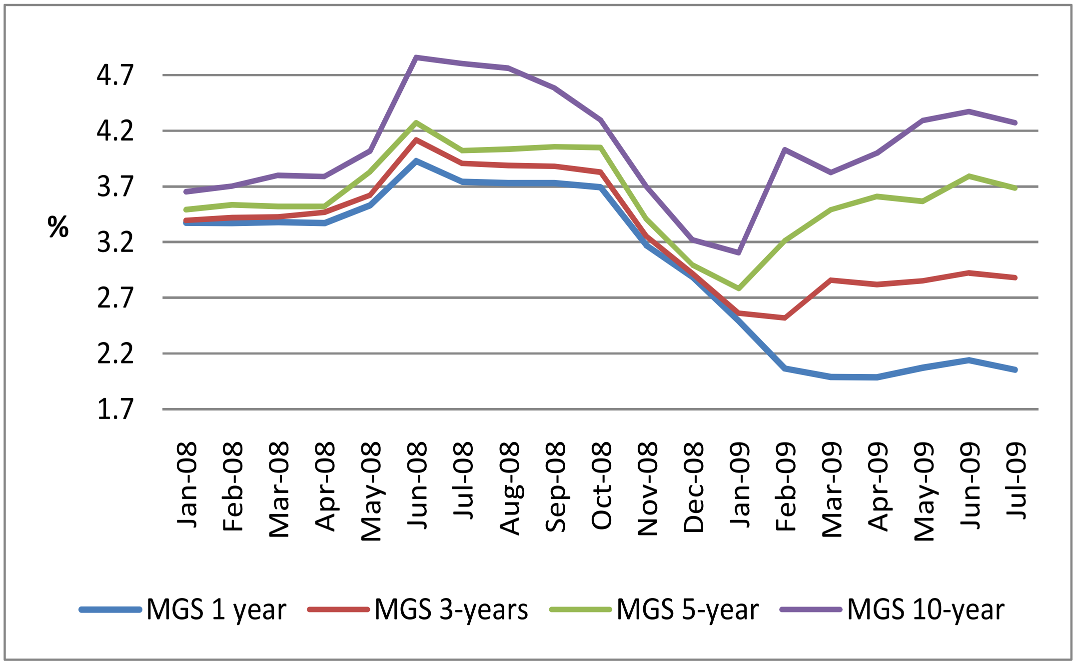
Table 24. Private Debt Securities, 2007-June 2009

.	2007	2008	Jul–Dec 2008	Jan–Jun 2009
Total (RM million)	67,605	49,659	19,953	28,599.8

Source: Bank Negara Malaysia, 2009.

The OPR reductions did not appear to have had much impact on debt of longer maturities. As Figure 4 shows, yields across all tenures of Malaysian Government Securities (MGS) have generally risen while their spreads have increased markedly. The sharpest increases were posted by the 10-year bond in early-2009 although these have moderated or even declined marginally since the middle of the year. MGS yields can be an indicator of inflationary expectations and future growth concerns. The yields exhibited a rising trend in the first half of 2008 due to increasing inflationary expectations but, following a reduction in OPR rates, the yields started to decline along with narrowing spreads. The second stimulus package and the recent OPR cuts have helped to arrest the decline in yields and spreads, allowing for better risk-taking and encouraging optimistic views for the future. However, short-term MGS are at an all-time low, reflecting a high-risk aversion for the near future.

Figure 4. Malaysian Government Securities Yields, Jan 2008-July 2009



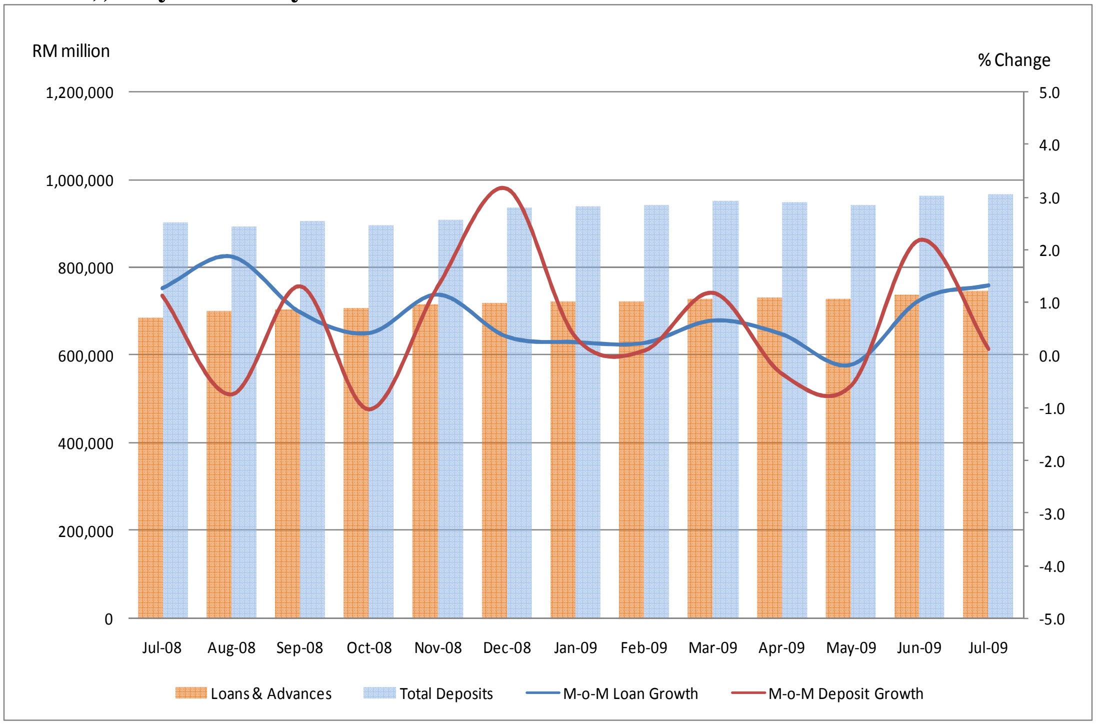
Source: Bank Negara Malaysia, 2009.

5.1.2. Financial Policy

The domestic banking sector was strengthened after the 1997-1998 crisis and, being more resilient now, is preparing for further liberalisation. To support this effort, the Government introduced a deposit insurance scheme run by Perbadanan Insuran Deposit Malaysia (PIDM). In 2008, some countries in the region introduced guarantees for bank deposits to allay fears of the collapse of financial institutions and to discourage capital outflows. Malaysia experienced large capital outflows from March until September 2008. As a result, as a pre-emptive measure, a full guarantee of all ringgit and foreign currency deposits in financial institutions was implemented. Regulated by BNM, this guarantee is managed by PIDM and will run until December 2010.

The lending activities of commercial banks had been lethargic despite lower OPR, lower SRR and additional funds available for loans to SMEs. Loan growth could have benefited from much earlier interest rate reductions as shown in Figure 5. The decline in loan growth began in September 2008 and reached a serious depth between November 2008 and January 2009. Loans began to grow again in June 2009, with the loan-deposit ratio for commercial banks improving from 76.27 in July 2008 to 77.35 in July 2009.

Figure 5. Total Loans & Deposits of Commercial Banks and Their Growth (RM million), July 2008-July 2009

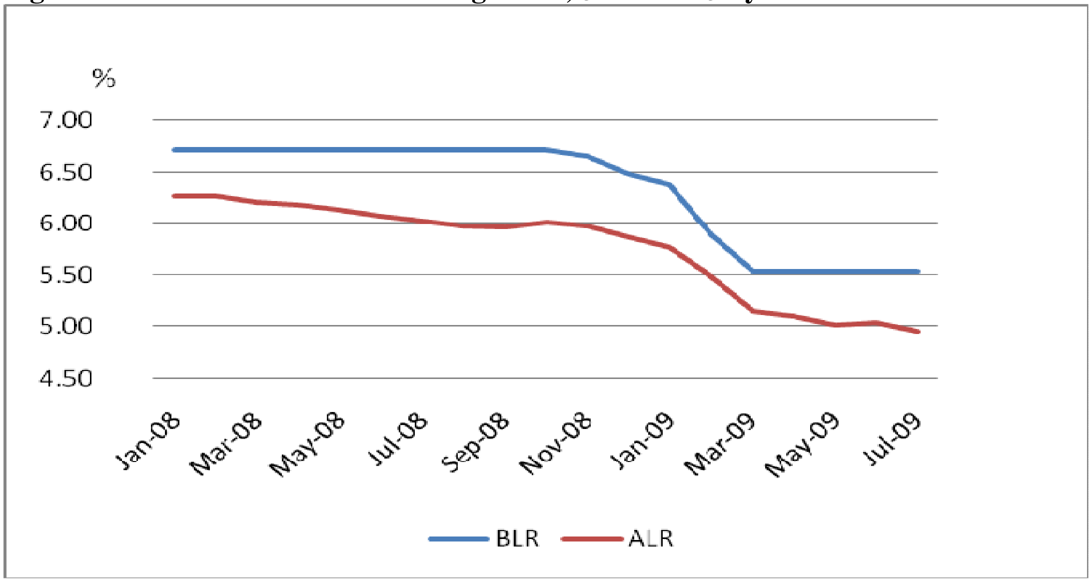


Source: BNM Monthly Report 2009.

The Government had implemented a number of measures to improve access to financing for SMEs over the years and these have helped them during the present crisis. In July 2008, an SME Credit Bureau was established between Credit Guarantee Corporation of Malaysia (CGC) and Dunn and Bradstreet, a premier global provider of credit information on SMEs. Credit ratings of SMEs provided by the Bureau are expected to increase the prospects of financing from financial institutions as well as lead to faster and more accurate decisions on loan applications. Another measure to support viable enterprises is the Small Debt Resolution Scheme that facilitates the restructuring and rescheduling of NPLs of SMEs.

Between August 2008 and January 2009, BNM introduced three additional financing incentives and schemes for SMEs. The Assistance Facility aims to help viable SMEs with temporary cashflow problems by offering loans with interest rates as low as 4% per annum. The Modernisation Facility is an incentive for SMEs to modernise their operations. In November 2008, RM200 million was channelled to the Micro Enterprise Fund, which can be accessed by SMEs through nine participating financial institutions subject to the normal credit approval process. A BNM-driven SME Assistance Guarantee Scheme was introduced in January 2009 with an allocation of RM2 billion for SME financing. An 80% guarantee cover for this financing was provided by CGC free-of-charge with the cost borne by BNM. For individuals dependent on income from deposits, the Government issued the RM2 billion Merdeka Savings Bond in March 2009. The higher return offered by the bond helped to compensate depositors affected by lower deposit interest rates.

Figure 6. Commercial Banks Lending Rates, Jan 2008-July 2009



Source: BNM Monthly Report 2009.

Table 25. Banking Sector – Solvency, Profitability & Asset Quality

	2000 (%)	2009 (%)
Solvency Position		
Risk-weighted capital ratio	12	14
Core-capital ratio	11	12.5
Comfortable Profitability		
Run on assets	1.75	2
Return on equity	19.5	20
Healthier asset quality		
Net NPL ratio	8	2.5

Source: Bank Negara Malaysia, 2009.

Table 25 gives the key indicators for the banking sector, which shows its sound position. The numbers have actually improved over the last six months. BNM's Small Debt Resolution Scheme that was introduced in 2003 greatly helped to facilitate the restructuring and rescheduling of NPLs and non-performing financing of SMEs with ongoing businesses. Between July 2008 and July 2009, the three-months NPLs peaked in August 2008 at 2.5% while the six-months NPLs were 2% in July 2008. Based on the latest figures, the July 2009 NPLs for three and six months were 2.1% and 1.5% respectively. In June 2009, the highest incidence of NPLs rose as a result of working capital requirements and the purchase of residential property, with the household sector recording the highest number of NPLs.

The stable OPR maintained by BNM stabilised both the base lending rates (BLR) and average lending rates (ALR). The BLR, an indicator of retail lending rates, stood at 6.72% over the years. However, with the reduction of the OPR in November 2008, both the BLR and ALR have been declining. The low BLR and ALR have been the result of an accomodative monetary policy and ample liquidity in the banking system. In addition, there has been intense competition amongst banks to offer the best rates. Within two weeks of the November 2008 OPR cut, twenty banks reduced their BLR.

5.2. Economic Stimulus Package (ESP)

The Government introduced two stimulus packages; the first one (ESP 1) was RM7 billion (US$1.9 billion) or 1.04% of GDP launched in November 2008, and the second (ESP 2) was RM60 billion (US$16.2 billion) or 9% of GDP in March 2009. ESP 1 was targeted to cover the year 2009 while ESP 2 was meant for 2009 as well as 2010. ESP 2 became necessary amidst heightened concerns that the economic deterioration was going to be very severe as indicated by estimates from the IMF and World Bank, both of which had downgraded their world GDP forecast many times. Countries such as China and Japan had also anticipated a severe downturn and had introduced much larger stimulus packages. Some felt that the Government had been slow in introducing the first stimulus package, as other affected countries had embarked on similar programmes much earlier. However, for Malaysia, the introduction of the first stimulus package in November 2008 was logical because its economy was still growing at a reasonable rate until the third quarter of 2008. ESP 1 and 2 are expected to result in a much higher fiscal deficit for Malaysia compared with other countries in ASEAN. In 2008, the country's fiscal deficit was 4.8% and this has risen significantly to 7.6% in 2009.

5.2.1. ESP 1

Almost 43% of Malaysia's first stimulus package is for infrastructure, such as the upgrading, repair and maintenance of public amenities (including schools, hospitals, roads, dwelling quarters for police and armed forces, and police stations); building of low-cost houses; public transport; and high-speed broadband infrastructure. ESP 1, funded by savings from a reduction in petrol subsidies, is being directed to ensuring the well-being of citizens, developing quality human capital and strengthening national resilience (Table 26).

Table 26. Thrusts & Allocations in ESP 1

	Thrust	**Allocation (RM million)**
1	Ensuring citizens' well-being	2,600
2	Developing quality human capital	1,000
3	Strengthening national resilience	3,400
	Total Operational Expenditure	7,000

Source: Ministry of Finance, Malaysia, 2009.

While projects relating to the three thrusts above vary in nature, they focus primarily on construction and infrastructure, transport, banking and finance, and education (Table 27).

Table 27. Specific Programmes & Allocations in ESP 1

	Programmes	Allocation (RM million)
1	Upgrading, repair and maintenance of public amenities including schools, hospitals and roads	500
2	Upgrading, repair and maintenance of rural roads	500
3	Upgrading, repair and maintenance of police stations/camps and quarters for armed forces and police personnel	500
4	Building additional low and medium-cost houses and enhancing housing programmes	1,200
5	Abandoned housing projects	200
6	Establishing investment funds to attract private investment	1,500
7	Accelerating the implementation of the High Speed Broadband project	400
8	Upgrading and maintenance of public transportation (LRT system, Commuter and Bus)	500
9	Additional business premises for small and medium entrepreneurs (MARA)	100
10	Skills Training Funds	300
11	Youth skill training programmes in private training institutions	200
12	Enhancing Youth Programme	100
13	Preschool Education (PERMATA, KEMAS, *Tadika Perpaduan* and preschool classes)	200
14	Financial assistance to missionary and vernacular schools	200
15	Others - small infrastructure maintenance projects (PIA and PIAS)	600
	Total Operational Expenditure	7,000

Source: Ministry of Finance, Malaysia, 2009.

5.2.2 ESP 2

While the entire allocation of ESP 1's RM7 billion will be spent in 2009, ESP 2 will only spend RM5 billion in 2009 and another RM5 billion in 2010 out of the RM60 billion package announced. The balance of the package will be in the form of guarantees, tax deductions and allocations to the National Sovereign Fund. Almost half (48%) or RM25 billion of the package will be directed towards assisting the private sector as bank guarantees for SMEs. Another 32% was allocated to infrastructure but of this sum, a substantial portion is for maintenance rather than new spending on public facilities. Food, toll and fuel subsidies, support for low-cost housing and for retrenched workers will take up 17% of the spending while the remaining 3% will work towards reducing unemployment and increasing job and training opportunities. A sum of RM3 billion has been allocated for tax incentives and RM10 billion for strategic investments by the National Sovereign Fund.

ESP 2 aims to reduce unemployment and increase employment opportunities, ease the burden of citizens, assist the private sector in facing the crisis, and build capacity for the future (Table 28).

Table 28. Thrusts & Allocations in ESP 2

	Thrust	Allocation (RM million)
1	Reducing unemployment and increasing employment opportunities	2,000
2	Easing the burden of citizens	10,000
3	Assisting the private sector in facing the crisis	29,000
4	Building capacity for the future	19,000
	Total Operational and Development Expenditure	60,000

Source: Ministry of Finance, Malaysia, 2009.

The four thrusts are non-mutually exclusive. As such, their implementation will involve several ministries and/or agencies in most of the identified projects.

The focus of the first thrust is to curb the ripple effect of increasing unemployment through training and creating employment opportunities. Accordingly, the Government is working jointly with the private sector to create 100,000 training and employment opportunities for retrenched workers and unemployed graduates. In addition, there are 50,000 existing vacancies and 13,000 newly created vacancies to be filled on a contractual basis. Other measures include providing welfare assistance for retrenched workers, creating more job opportunities in the public sector, extending opportunities for graduates to further their education at Masters and PhD levels, and introducing the graduate PROSPER scheme to develop young entrepreneurs.

The second thrust is targeted at low and middle-income earners through efforts to increase household disposable income. These cover subsidies to avert increases in the prices of daily food staples, measures to encourage home ownership, issuance of Syariah-compliant Government Savings Bonds, and improvements in public infrastructure. In Sabah and Sarawak, basic amenities will be provided in the states' rural areas and there will be infrastructure projects, such as the expansion of Sibu Airport and deepening of Miri Port. Measures encompassed in the second thrust will also aim to improve school facilities, provide micro-credit programmes for farmers and agro-based businesses in rural areas, improve facilities at daycare centres for children and the elderly as well as women shelters, ensure the welfare of retrenched workers through tax incentives, and provide incentives for banks to defer repayments of housing loans.

The third thrust is focused on the business community. Initiatives include the creation of the Working Capital Guarantee Scheme and the Industry Restructuring Loan Guarantee Scheme. The levy for the Human Resource Development Fund (HRDF) has been reduced. A new organisation, Danajamin National Berhad, has been established to help private companies access the bond market. There are more concerted efforts at attracting high net-worth and skilled individuals for human capital development. In the transport sector, measures include promoting the automotive sector through an auto-scrapping scheme and assisting the aviation industry through a rebate of 50% on landing charges for all airlines. In addition, an accelerated capital allowance has been introduced to encourage investment and companies are allowed to carry back their losses to the immediate preceding year to improve cash flow. The threshold for the windfall profit levy on palm oil has been increased. Tourism is being promoted through diversifying tourism products, upgrading infrastructure, improving homestay programmes, and approving work permits for skilled spouses under the Malaysia My Second Home Programme.

The fourth thrust refers to capacity building for the future covering investments, off-budget projects, creative arts, and the effective management of government financial resources. Specific measures on investment include increasing the funds of Khazanah National Berhad for domestic investments, dedicating more funds to projects in telecommunication, technology, tourism, agriculture and life sciences, as well as those in Iskandar Malaysia. Also covered are PFI projects such as those in infrastructure and biotechnology.

Please refer to Appendix 3 for details of the four thrusts.

5.3. Additional Policy Measures

Other than the stimulus packages, the Government has also embarked on restructuring the economy and improving its competitiveness. Recently, policy announcements have been made to, amongst others, liberalise 27 services sub-sectors, remove the 30% Bumiputra participation quota in certain businesses and 25% Bumiputra requirement for listing purposes, and deregulate the Foreign Investment Committee guidelines. In addition, the Government is setting up Ekuiti Nasional Berhad as a private equity fund to ensure meaningful and effective participation by Bumiputras (Table 29).

Table 29. Additional Measures to Support Economic Recovery & Enhance Competitiveness

	Policy
1	Fund management, unit trust and stockbroking
	• Ownership in the wholesale segment of the fund management industry will be fully liberalised to allow 100% for qualified and leading fund management companies to establish operations in Malaysia • For the retail segment, the foreign shareholding limits for the unit trust management companies is raised to 70% from its current level of 49% • Foreign ownership of shareholding limits in existing stockbroking companies is increased to 70% from its current level of 49%
2	Attracting human capital
	• BNM and SC will review all visa applications for the financial and capital market industries
3	Deregulation of FIC guidelines
4	Establishment of Ekuiti National Berhad
5	Removal of 25% Bumiputra public shareholding spread requirement for companies seeking listing

6	Liberalisation of 27 services sub-sectors
7	Removal of 30% Bumiputra participation quota
8	Institutional framework
	• Establishment of the Economic Council which consists of 40 members from the business community and policy makers • Establishment of the Economic Advisory Council which consists of 9 members who will be responsible for sustaining long-run economic growth

Source: Ministry of Finance, Malaysia, 2009.

5.4. Human Development and Social Safety Nets

Social safety nets (SSNs) have become more pronounced in Malaysia since the financial crisis of 1997-1998. To mitigate the effects of the crisis on the poor and low-income groups, the Government reallocated the budget to support these social sectors and set up targeted programmes. Budget resources were redistributed to retain the original 1998 budget allocation for the Development Programme for the Hardcore Poor and limit cuts to the 1998 budget of ministries providing social, rural development, and agriculture programmes targeting the poor and low-income groups. Micro-credit funds were set up to promote income-generating activities and job opportunities were created for the low-income segments of the population, including the most vulnerable groups, through public works.

Developing countries, such as Malaysia, introduce SSNs to mitigate the social impact of structural adjustment measures on specific low-income groups. They are formulated to serve three objectives: to alleviate poverty, make adjustment programmes more politically acceptable, and undertake institutional reforms. On the other hand, SSNs in developed countries cover basic arrangements to ensure that any person in a society can obtain financial and material help from the state to avoid absolute poverty and ensure survival (WHO, 1998). The proportion of GDP for SSNs is usually about 1-2% but may increase to 4% (Indonesia, 1998-1999) during an economic crisis. There are no statistics on this issue for Malaysia but it is estimated that the value is less than 1% of GDP based on the allocations in ESP 1 and 2.

The government mechanism that provides social support to the poor and needy is the Malaysia Social Safety Net or Jaringan Keselamatan Sosial Malaysia programme. It involves various ministries and government agencies, including the Ministries of Health, Education, Housing and Local Government, Human Resources, Agriculture and Agro-based Industry, Entrepreneur and Cooperative Development, Rural and Regional Development, and Women, Family and Community Development.

The social support given comes in various forms, which include financial aid; food, fertiliser and fuel subsidies; free education, textbooks and uniforms; affordable hospital care; and skills training. The allocation for the Malaysia Social Safety Net programme was raised from RM350 million to RM850 million in 2008. An important aspect of this social support is the Federal Welfare Aid given via the Social Welfare Department under the Women, Family and Community Development Ministry.

A revised Malaysia Social Safety Net programme and a new Social Safety Net Card were introduced in February 2009. Welfare aid was given to the hardcore poor who, according to the Economic Planning Unit, were those with a household monthly income of less than RM430 in Peninsular Malaysia, RM520 in Sarawak and RM540 in Sabah. In 2009, these were revised to RM720 in Peninsular Malaysia, RM830 in Sarawak and RM960 in Sabah. These amounts, however, form an unregulated standard as the poverty line income only serves as a guide or as the initial entry point for aid eligibility. Final approval will depend on investigations by welfare officers who will look into factors like the living condition of the families, the number of children and dependants, age of applicant or head of household, physical disability, and health conditions due to disease or illness. There are doubts as to the efficiency and effectiveness of this programme as it is based on discretion instead of steadfast regulation.

Several measures are focused specifically on human development. These include providing training and creating employment opportunities, extending financial support for education at Masters and PhD levels, and attracting skilled workers by granting permanent residence status. In addition, there will be subsidies for basic food items, improvement of healthcare facilities in the rural areas of Sabah and Sarawak, financial assistance to and improvement of daycare centres, shelter homes and childcare centres, and access to financial capital through government guarantee schemes, such as the Working Capital Guarantee Scheme and Industry Restructuring Loan Guarantee Scheme.

An allocation of RM700 million for training and creating employment opportunities is expected to provide 100,000 training opportunities and job placements through collaboration between the Government and private sector. In addition, Special Training and Re-Training Programmes for retrenched workers and the Dual National Training Scheme to enhance the skills of those currently employed have been introduced through the following:

i. On-the-job training for 1,000 unemployed graduates in the financial sector by the Securities Commission and BNM for a two-year period.
ii. 2,000 training opportunities and job placements in government-linked companies, particularly in the services sector.
iii. Attachment training programmes by Perbadanan Usahawan Nasional Berhad for 2,000 graduates and those with skills certificates for a period of six months to one year. Qualified participants will receive financial assistance to venture into business.
iv. 500 graduates to be encouraged by Tunas Mekar to venture into business and to add value to existing SMEs.

Malaysia lacks a nationwide social protection system. Formal sector employees are covered by an Employee Provident Fund (EPF), a contributory pension programme, and by an insurance programme (SOCSO) that helps workers who are victims of industrial accidents. There is no programme that offers minimum income protection against adverse business cycles or other shocks to income. The non-existence of comprehensive SSNs for the formal and informal sector is a cause of concern as this may exacerbate economic and social instability in times of economic shocks.

5.5. Government's Responses and the Millennium Development Goals

The targets of the Millennium Development Goals (MDGs) are also taken into consideration in policy decisions. Malaysia is committed to achieving these targets as they are in line with the National Vision Policy. The thrusts in the Government's policy responses may not be directly associated with the MDGs but the measures and programmes may be identified with specific targets of the various goals (Table 30). In regard to monetary and financial policies, the measures may appear to favour the business community but, in reality, they affect household income as well as business opportunities and contribute to the eighth MDG, i.e. developing a global partnership for development. ESP 1 and 2 are focused on expanding the domestic economy, as the global crisis has affected the disposable income of workers due to retrenchments and the economic slowdown. Nonetheless, measures relating to employment, welfare of people, education, and infrastructure development such as hospitals, roads and broadband facility, amongst others, are closely associated with the MDGs.

Table 30. Matching Selected Government Responses with the MDGs

	Government responses	Selected measures	MDG *
1	Monetary and financial policies	Credit enhancement via Danajamin National Berhad	8
		Industry Restructuring Loan Guarantee Scheme	8
		SME special funds and guarantee schemes	8
		Small Debt Resolution Scheme	8
		Instalment moratorium for retrenched workers	1
		Reduced credit card interest rates	1
2	ESP 1	Upgrading, repair and maintenance of public amenities including schools, hospitals and roads	4, 5, 6,7
		Upgrading, repair and maintenance of rural roads	5, 7
		Upgrading, repair and maintenance of police stations/camps and quarters for armed forces and police personnel	1
		Building additional low and medium-cost houses and enhancing housing programmes	7
		Revitalising abandoned housing projects	7
		Establishing an investment fund to attract private investment	8
		Accelerating the implementation of the High Speed Broadband project	
		Upgrading and maintenance of public transportation (LRT system, Commuter and Bus)	7
		Additional business premises for small and medium entrepreneurs (MARA)	8

		Skills Training Funds	1
		Youth skill training programmes in private training institutions	1,3
		Enhancing Youth Programme	3
		Preschool Education (PERMATA, KEMAS, *Tadika Perpaduan* and preschool classes)	2,3
		Financial assistance to missionary and vernacular schools	2
		Others - small infrastructure maintenance projects (PIA and PIAS)	1
3	ESP 2	Reducing unemployment and increasing employment opportunities	1
		Easing the burden of citizens	1,2,3
		Assisting the private sector in facing the crisis	8
		Building capacity for the future	7, 8

Source: Constructed by ISIS Malaysia, 2009.
* targets in MDGs.

6. Assessing the Strategies and Measures

Two factors should be noted in attempting to assess the effects of the strategies and measures taken by the Malaysian Government since March 2009. First, there is a lack of a commonly accepted framework to analyse the economic and social effects of stimulus strategies and measures. A major reason for this is that programmes have tended to be dissimilar in terms of their composition, which, in turn, is a function of differing policy requirements, priorities and capacities. Second, there are time lags between government initiatives and their impact at ground level, as well as second and subsequent round effects. Public spending projects obviously take a longer time to roll-out than cash transfers, which are more immediate. It is extremely difficult to determine the impact of the strategies and measures on a contemporaneous basis.

6.1. Funds Allocated and Projects Awarded

Based on total allocation, the first stimulus package has achieved 97.3% of its allocation targets, which is considerable given the eight-month timeframe involved (Table 31). There is an emphasis in ESP 1 on strengthening national resilience for funds allocation as well as the number of projects. This may be explained by the fact that the projects under this thrust cover infrastructure, investments and technology development, which benefit thrusts 1 and 2.

Table 31. Assessing the Strategies in ESP 1 – Operational Expenditure (as at 3 July 2009)

	Thrust	Allocation (RM)	Awarded projects	Completed/on-going projects	Funds disbursed (RM)
1	Ensuring citizens' well-being	2,565,000,000	12	11	1,996,661,000
2	Developing quality human capital	960,080,000	12	12	678,848,000
3	Strengthening national resilience	3,281,642,294	25	21	2,498,722,000
	Total	6,806,722,294	49	44	5,174,231,000

Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

Of the total 46,358 projects under the various ministries and agencies, 37% are currently undertaken or completed, representing a payment amount of RM2,304,966,000 or 38% of total project cost (Table 32). There is a discrepancy between targeted and actual expenditure. This divergence is pronounced from May 2009 (Figure 7) and the probable reasons are delays in issuance of warrants, institutional capacity in relevant agencies and implementation problems, for example, the actual number of participants for a training programme is less than the proposed number; for construction projects, the issue may be related to site change due to unforeseen circumstances.

Table 32. Assessing the Measures in ESP 1 – Operational Expenditure (as at 3 July 2009)

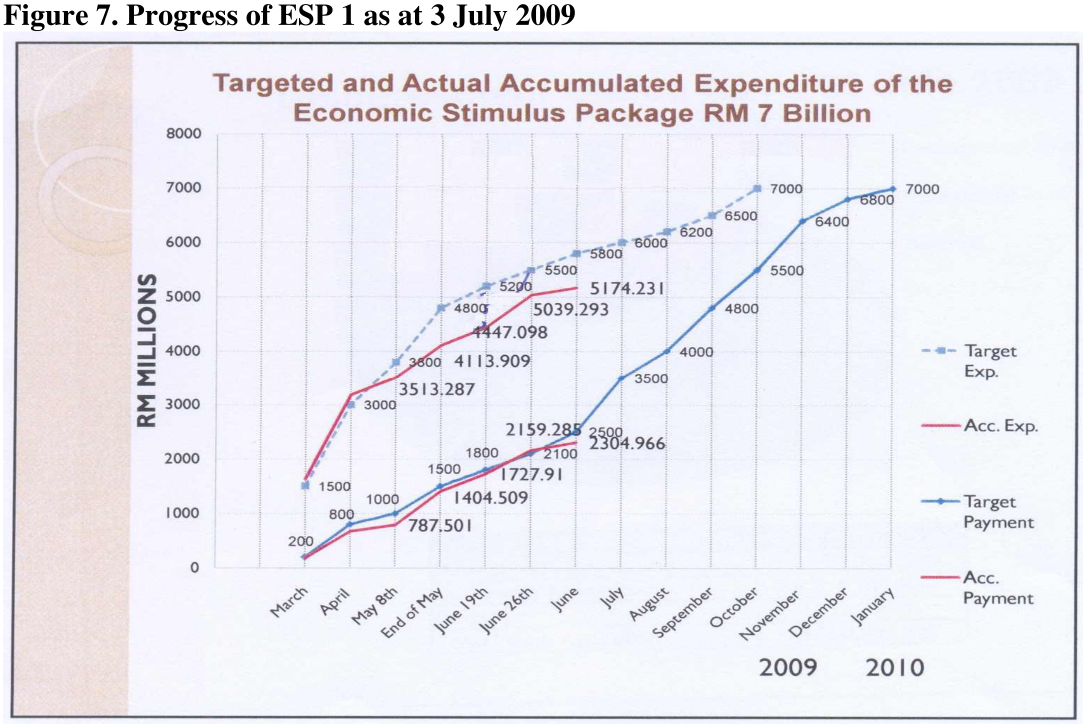
Ministry/Agency	Allocation (RM million)	Awarded projects	Completed/on-going projects	Funds disbursed (RM million)
KPKT	205	65	0	16.55
KKLW	1350	14503	4669	394.334
MOT	160	25	0	11.397
KPM	450	5021	1005	134.241
KBS	150	7204	1263	16.295
Permata (JPM)	130.68	409	9	7.934
ICU (JPM)	604	9594	6787	395.94
KDN	250	966	0	12.472
MINDEF	250	2071	900	68.346
MOH	200	3003	1604	91.263
KSM	280	129	1	23.846
KKR	95	428	361	72.483
KTTHA	60.904	1	1	60.904
MITI	142.4	198	40	23.93
EPU (JPM)	300	0	0	128.2
KPKK	374.6	1	0	118
SPNB	630	1883	92	77.425
PRASARANA	340	794	448	184.352
INPENS	5	3	0	1.583
CYBERVIEW	213.04794	2	2	200.856
KHAZANAH	100	8	1	25.664
JKP S/B	5	1	0	1.942
Kolej Negeri S/B	2	1	1	2
PUNB	50	46	0	0.01

PKNP	150	0	0	0
SJPP	50	1	1	50
PKENPs	10	0	0	0
SUNPOWER	185	1	1	185
SMIDEC	29.09	0	0	0
KDRM	35	0	0	0
TOTAL	6806.722294	46358	17176	2304.966

Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

One of the problems of stimulus measures is the timeliness of implementation. Organisational and administrative procedures are not typically developed with speed in mind. In Malaysia, a Project Management Unit has been established within the Treasury to expedite the disbursement of funds. This helps to ensure that financing is not a constraint although there are other possible implementation bottlenecks that can render stimulus measures less effective. For example, although project funds were reported to have been disbursed, 16% of the ministries/agencies have not awarded their projects while 40% have not started theirs. This is usually due to procedural and compliance requirements more than any bureaucratic inertia. In addition, it has also been reported that the funds that have been disbursed as advance or progressive payments or for purchases made by the ministries/agencies are not part of the project classification definition, which reduces the overall reported amount of funds disbursed.

Figure 7. Progress of ESP 1 as at 3 July 2009



Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

Much emphasis has been placed on easing the burden of the people, i.e. thrust 2, in the second stimulus package of RM60 billion in terms of completed/ongoing projects. This is supported by the amount of funds disbursed for this purpose under development as well as operational expenditure (Tables 33 and 34). On the one hand, this reflects the Government's commitment to ensuring the well-being of citizens during this crisis. On the other hand, it has overshadowed the primary objective of reducing unemployment and increasing employment opportunities.

Table 33. Assessing the Strategies in ESP 2 – Development Expenditure (as at 3 July 2009)

	Thrust	Completed/ongoing projects	Funds disbursed
1	Reducing unemployment and increasing employment opportunities	1	8,000,000
2	Easing the burden of citizens	163	5,459,825,769
3	Assisting the private sector in facing the crisis	28	1,753,705,000
4	Building capacity for the future	52	2,272,500,500

Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

Table 34. Assessing the Strategies in ESP 2 – Operational Expenditure (as at 3 July 2009)

	Thrust	Completed/ongoing projects	Funds disbursed
1	Reducing unemployment and increasing employment opportunities	17	1,106,800,000
2	Easing the burden of citizens	31	3,279,300,000
3	Assisting the private sector in facing the crisis	1	500,000,000
4	Building capacity for the future	7	111,000,000

Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

There are 22,773 projects awarded under the various ministries/agencies, of which 1,146 projects or 5% are completed/ongoing (Table 35). This represents a value of RM1.1 billion or 8% of the funds allocated. While 3.0% of the ministries/agencies have not awarded any project, 60% reported zero completed/ongoing projects. However, only a fraction of the total funds have been disbursed. It is assumed that the awarded projects are construction-based and advance or progress payments have been made of not more than 25% of the contract price as agreed in government contracts.

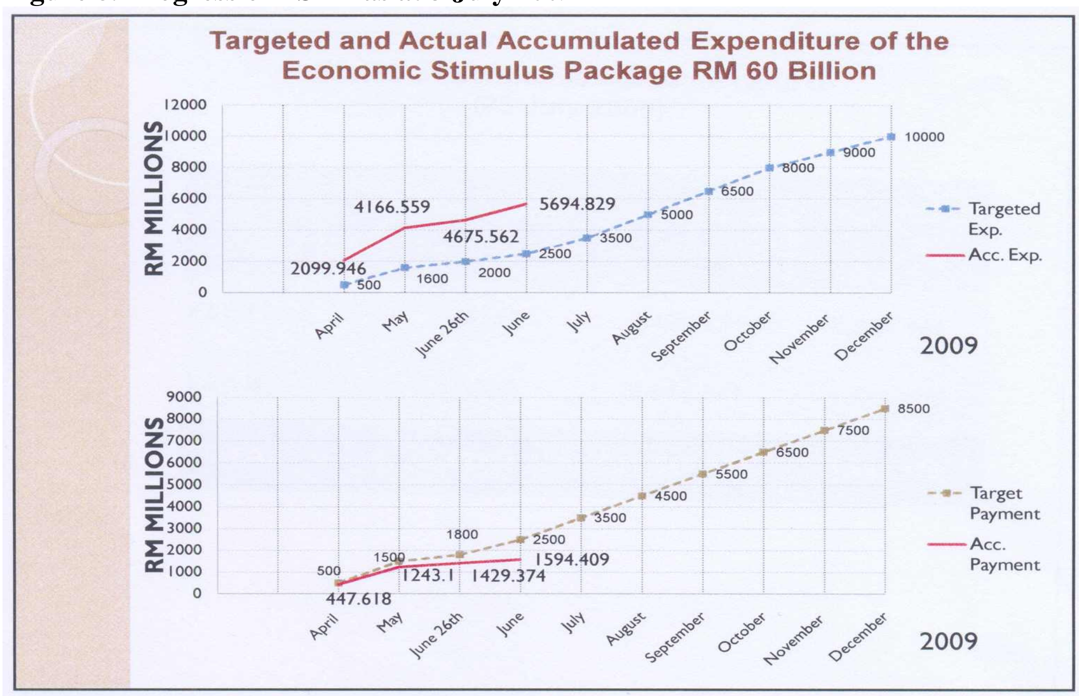
Table 35. Assessing the Measures in ESP 2 (as at 3 July 2009)

Ministry/Agency	Allocation (RM million)	Awarded projects	Completed/on-going projects	Funds disbursed (RM million)
JPM	606	7	0	82.8
ICU (JPM)	520	4186	784	44.504
MOF	1810	1	1	500
KPPK	151.371	7	0	2.586
MOA	608	301	11	41.672
KKLW	767.863	11	0	13.24
NRE	323	198	4	0.038
MITI	1200	61	14	95.445
KKR	1433.7	22	9	446.673
MOT	381	1	0	0
KTTHA	475.77	6	0	16.171
MOSTI	383.88	12	0	35.842
MOTOUR	223.205	155	60	7.238
KWP	233	2	0	6.01
MOE	2093.699	301	0	8.9
MOH	706.927	15534	0	7.92
KPKK	232.5	1	0	0
KBS	60	0	0	1.974
KPWKM	201.1	381	36	21.999
MOHE	220	13	0	1.734
MINDEF	26.88	0	0	0
KDN	224.237	6	0	0.82
KPDNHEP	827	72	63	244.844
KPKT	329	1485	164	11.459
MOHR	370	0	0	3.54
TOTAL	14,408.132	22,773	1,146	1,154.409

Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

The trend in Figure 8 indicates that actual expenditure, which relates to number of projects awarded, is higher than the targeted expenditure. This is favourable to the business community as well as the employment sector. However, actual payment is lower than targeted payment, which in general suggests that the projects are not completed within the stipulated time, hence the delay in amount disbursed. The difference in expenditure amounts at the end of 2009, between allocation and payment, is due to projects that are expected to spill over into 2010. This suggests that the target for 2009 has not been achieved thus depriving the economy of RM1.5 billion of economic benefit for the year, in which the impact of the crisis is expected to be the greatest.

Figure 8. Progress of ESP 1 as at 3 July 2009



Source: Project Management Unit, Ministry of Finance, Malaysia, 2009.

6.2. Short-Run Measures and Long-Run Gains

Fiscal stimulus programmes are primarily designed to revive the nation's slumping economy in the immediate term. Measures to ensure the nation's long-term sources of growth and reduction of vulnerable areas can only be taken over time and are thus the responsibility of the five-year Malaysia Plans. ESP 1 and part of ESP 2 should therefore be viewed as mitigating the shorter-term effects of the recession by supporting the business community and households. Nevertheless, the two are linked.

The country can be expected to gain from GDP contributions as well as corporate and personal income taxes raised as a result of various economic activities. From the business perspective, the availability of disposable income promotes consumer spending, which in turn leads to positive growth in domestic trade. Continuous business operations will create ongoing demand for human capital and labour, thus providing employment for the country's growing population. As the business sector is acknowledged to be a significant catalyst for economic growth, the operational and development expenditure allocated as a result of the stimulus measures and the introduction of government guarantee schemes should contribute to the sustainability and development of SMEs in the short and long-run. Large corporations are not expected to face much difficulty where financing is concerned due to reliable financial security and the good rapport that they usually maintain with their financial institutions.

Several countries have resorted, amongst other measures, to bail-outs of their business corporations and disbursing cash to the population. Malaysia has shied away from these measures, as they are neither suitable nor appropriate for the country. Furthermore, these are short-term measures that do not ensure short or long-run gains.

Measures in the stimulus packages relating to training, skills development, and education opportunities are specific areas that can provide long-run gains to the country. Apart from the development of human capital, these measures may also address issues such as ‘brain-drain’, reducing migrant workers and moving out of the ‘middle-income’ trap (Ohno, 2008). Improvements in healthcare and infrastructure development in the rural areas provide long-run gains to the nation as these are essential requirements for human development and the economy to prosper, leading to higher productivity and reduced healthcare expenditure in the long-run, specifically among the aging population. Furthermore, healthcare awareness may deter the spread of infectious diseases, which may affect the nation’s productive workforce and thus deprive the country from capitalising on its demographic dividend.

6.3. Sustaining Human Development

Human development relates to expanding the choices that people have to lead the life that they value. Fundamental to enlarging these choices is building human capabilities - the range of things that people can do or be in life. The most basic capabilities for human development are to lead long and healthy lives, be knowledgeable, have access to the resources needed for a decent standard of living and be able to participate in the life of the community. Without these, many choices are not available and many opportunities in life remain inaccessible.

Many of the projects/programmes identified under the Ministry of Women, Family and Community Development, Ministry of Rural Development, Ministry of Health, Ministry of Education and Ministry of Higher Education, and Ministry of Human Resource Development are targeted specifically at sustaining human development during the current crisis. Over the period 2006-2009 (Tables 36 and 37), the allocated operating expenditure for the health, women, family and community development, and housing and local government ministries has increased by an average 49%, while the actual expenditure for the period 2006-2008 rose by an average 41%. The allocation for developmental expenditure for the three ministries over the same period grew by an average 247%, contributed mainly by the Ministry of Women, Family and Community Development. The actual expenditure for the period 2006-2008 increased by an average 140%. The higher allocations for these ministries suggests, amongst others, a recognition of the need to improve human development in the country and an acknowledgement of existing problems in this area.

Table 36. Operating Expenditure, 2006 to 2009 (RM billion)

Ministry	Allocation				Actual		
	2006	2007	2008	2009	2006	2007	2008
Health	8.205	9.571	10.879	11.433	8.693	9.771	11.569
Women, Family and Community Development	0.560	0.668	0.708	0.807	0.530	0.637	0.715
Housing and Local Government	0.676	0.744	0.911	1.267	0.659	0.723	0.901

Source: Economic Planning Unit, Ministry of Finance, Malaysia, 2009.

Table 37. Development Expenditure, 2006 to 2009 (RM billion)

Ministry	Allocation				Actual		
	2006	2007	2008	2009	2006	2007	2008
Health	1.296	1.628	2.222	2.567	1.209	1.471	1.467
Women, Family and Community Development	0.024	0.114	0.118	0.227	0.023	0.031	0.110
Housing and Local Government	1.705	1.665	1.719	1.529	1.215	1.628	1.364

Source: Economic Planning Unit, Ministry of Finance, Malaysia, 2009.

The allocation of funds in the stimulus packages for these ministries indicates the Government's commitment towards human development and overcoming the negative impact of the global crisis on the population (Table 38). Although the amount allocated is quite small in relation to the total stimulus package, the aspect of human development cuts across all economic sectors. The total allocation for human development is therefore larger but it is difficult to quantify in the other ministries.

Table 38. Allocation Under the Stimulus Packages (RM million)

Ministry	Allocation	
	ESP 1	ESP 2
Health	200*	566
Women, Family and Community Development	-	150
Housing and Local Government	200*	5*
Human Resource	280	370

Source: Economic Planning Unit, Ministry of Finance, Malaysia, 2009.
* amount allocated for operating expenses.

In recognition of the importance of human development, various measures in the stimulus packages cover areas such as employment opportunities, educational development, promotion of healthcare and social benefits, improvement of housing requirements, and upgrading roads and the transport infrastructure. For the Ministry of Human Resource Development, its allocation is accordingly focused on providing income to unemployed graduates through training and skills development programmes as well as minimising retrenchments through job placement programmes (Table 39).

Table 39. Human Development Allocation in the Stimulus Packages

Programmes	ESP 1 (RM million)	ESP 2 (RM million)	Total (RM million)
Retrenched workers	100		
Unemployed graduates	70		
Youth	50		
PTPK (Loan)	60		280
CESS		70	
SLDN		70	
Modular courses / self-employment		35	
Job creation		100	
PTPK (Proposal)		95	370
Total human development allocation			650

Source: Ministry of Human Resource Development, Malaysia, 2009.

The number of retrenchments until June 2009 was reported to be 38,307. The measures implemented by the Ministry of Human Resource Development were reported to have provided 25,596 jobs for graduates and non-graduates through JobsMalaysia and other activities. In sustaining human development during this crisis, the Ministry set up an operation rooms that monitors retrenchments through a tripartite approach involving the Ministry, employers and workers. Through this approach, discussions are held with employers and workers on measures to avoid retrenchment and steps are taken to assist workers in getting rightful compensation and finding alternative jobs as well as facilitating their training before their placement in new jobs. Retraining in skills desired by employers so that workers could be retained in their present jobs is also prioritised. In addition, the Ministry has established committees and technical working groups and implemented the Jobs Re-emplacement Programme and Train and Place Programme in the following manner:

i. The Labour Department obtains the names of employers with vacancies who are willing to participate in the programmes.
ii. These employers need to provide the candidates with training prior to their absorption in employment.
iii. Training providers and consultants who have secured contracts with prospective employers can undertake training and placement on their behalf.

It is difficult to gauge the impact of the stimulus packages on other social areas, such as health (number of patients in hospitals, nutritional status and health centre utilisation) and education (changes in school attendance), as the required information is not currently available. Dramatic changes, however, would not be expected, as both public health and primary education are heavily subsidised and accessible in Malaysia. Nevertheless, there should be added pressures on government clinics and hospitals because the unemployed and lower income families would not be able to afford private healthcare. Also, the school drop-out rate might rise due to economic pressures. As yet, there is no clear data or confirmation of any of these trends. Media reports have suggested, however, that households are changing their spending patterns to cope with their lower disposable income.

Table 40. Mean Monthly Wages by Occupation and Industry

Occupation	Wages [a] (RM)		
	2007	2008*	Diff. [b]
Senior Officials & Managers	4,147	3,742	-405
Professionals	4,763	4,772	9
Technicians & Associate Professionals	2,826	2,997	171
Clerical Workers	2,309	2,439	131
Service, Shop and Market Sales Workers	1,600	1,656	56
Skilled Agriculture and Fishery Workers	489	449	-40
Craft and Related Trades Workers	1,643	1,565	-78
Plant & Machine-Operators & Assemblers	1,647	1,688	41
Elementary Occupations	1,240	1,243	3
Industry			
Agriculture, Hunting & Forestry	656	608	-48
Fishing	578	670	92
Mining & Quarrying	3,175	3,823	649
Manufacturing	2,501	2,540	39
Electricity, Gas & Water	2,868	3,073	205
Construction	2,144	2,086	-58
Wholesale & Retail Trade; Repairs of Motor Vehicles, Motorcycles and Personal & Household Goods	1,827	1,594	-233
Hotels & Restaurants	1,252	1,317	64
Transport, Storage & Communication	2,275	2,135	-140
Financial Intermediation	4,180	4,605	425
Real Estate, Renting & Business Activities	3,378	3,254	-124
Public Administration & Defence; Compulsory Social Security	2,468	2,808	340
Education	3,346	3,390	44
Health & Social Workers	2,667	2,995	328
Other Community, Social & Personal Service Activities	1,695	1,643	-52
Private Households with Employed Persons	1,115	1,023	-92

Source: Household Income Survey (HIS) 2008 (refer Appendix 5), which is conducted by the Department of Statistics twice in five years.

[a] The reference period for information on wages in HIS was the last twelve months. Wages refer to the wages/salaries before deduction for income tax, EPF contribution, etc.

[b] Difference between 2008 and 2007.

* preliminary.

The impact of the steep downturn in economic activity cannot have been positive on incomes and the poverty level although the current data available does not allow a serious analysis of how severely these have been affected. Table 40 shows that 33.3% of the various occupational groups suffered a decline in their mean monthly wages between 2007 and 2008, with senior officials and managers recording the highest decline. Ironically, occupations related to the manufacturing sector, such as technicians and associated professionals, plant and machine-operators and assemblers, reported an increase in their mean monthly wage in 2008, despite a high retrenchment rate in this sector. The decline in monthly wages in the agricultural sector is not contributed by the global crisis but was due to weather conditions and price fluctuations of commodities, and palm oil in particular.

Even before the recession was evident, there was already an indication of a worsening in income distribution. Although income at all levels of households showed a positive change for 2008, those in the top and middle-income brackets increased their share by 1.2% and 0.6% respectively, while those in the bottom 40% showed a decline of 5.5%

(Table 41). The situation of those in the lower income group could only have grown worse in the subsequent months.

The average growth of mean monthly gross household income for the population in the urban and rural areas was, nevertheless, positive (Table 42). Despite a higher average annual growth of household income for Bumiputras in 2008, Chinese and Indians recorded the highest mean gross household income by ethnic group over the last decade (Table 43). In analysing poverty, Bumiputras were most disadvantaged in 2008 compared with Chinese and Indian, based on the Gini Coefficient Index (Table 44). In addition, the poverty level in rural areas increased in 2008, despite the positive change in cumulative income distribution over the period 1999-2007. The national income distribution index indicated a minor positive change in 2008 and a gradual positive change in the last decade.

Table 41. Income Share of Households by Population Group, 1999, 2007 and 2008*

Household	1999	2007	2008
Top 20%	50.5	49.8	50.4
Middle 40%	35.5	35.7	35.9
Bottom 40%	14.0	14.5	13.7

Source: HIS 2008.
* preliminary.

Table 42. Mean Monthly Gross Household Income (RM) and Disparity Ratio, 1999, 2007 and 2008*

Strata	1999	2007	2008	Ave. annual growth rate (%)	
				1999/2007	2007/2008
Malaysia	2472	3686	3828	5.1	3.9
Urban	3103	4356	4487	4.3	3.0
Rural	1718	2283	2429	3.6	6.4
Rural:Urban	1:1.81	1:1.91	1:1.85		

Source: HIS 2008.
* preliminary.

Table 43. Mean Monthly Gross Household Income (RM) by Ethnic Group, 1999, 2007 and 2008*

Ethnic Group	1999	2007	2008	Ave. annual growth rate (%)	
				1999/2007	2007/2008
Bumiputras	1984	3156	3412	6.0	8.1
Chinese	3456	4853	4823	4.3	-0.6
Indians	2702	3799	3739	4.4	-1.6

Source: HIS 2008.
* preliminary.

Table 44. Gini Coefficient by Ethnic Group and Strata, 1999, 2007 and 2008*

Ethnic Group/Strata	1999	2007	2008
Bumiputras	0.433	0.430	0.436
Chinese	0.434	0.432	0.427
Indians	0.413	0.414	0.404
Urban	0.432	0.427	0.425
Rural	0.421	0.388	0.391
Malaysia	0.452	0.441	0.439

Source: HIS 2008. * preliminary.

The country's income inequality index recorded a contraction of 0.45% or 0.002 in 2008, suggesting a positive outcome in light of the global crisis (Table 44). The declining income share of the bottom 40% (Table 41) is consistent with the increase in income equality index in the rural areas of 0.003 or 0.76%. A possible explanation for this is the population distribution in rural areas where the majority of the people are Bumiputras, which is consistent with their position in regard to income share and the income equality index. This is an ongoing concern and is not directly associated with the global crisis. Government efforts to narrow the income inequality among the ethnic groups have resulted in a favourable change of a mere 2.5% for the nation over the last decade.

Despite growing evidence of an economic recovery, changes in the fortunes of the low-income group cannot be assumed. While inflation has moderated significantly over the past six months, food prices, especially for staples, and petrol and diesel prices continue to remain high. This will eventually translate into higher costs and reduced real purchasing power. With moves to remove subsidies (notably, of natural gas) and raise revenues to control the fiscal deficit, a further erosion of purchasing power and disposable income may be unavoidable. The Government appears to want to delay these decisions until such time as economic conditions improve but this presumes that there will be a sharp upturn of economic activity. If the economic recovery turns out to be less-than-dramatic or transient as many experts still predict, human development cost may be expected to mount.

7. Response from Industry Players

Views from captains of industry were sought on the impact of the global crisis and measures announced in the stimulus packages. There were mixed views on the impact of the crisis and the stimulus packages. Details on the responses from the various sectors interviewed are attached in Appendix 1.

7.1. Policy Measures

The general consensus from the business community is that the measures in the stimulus packages by the Government are sufficient to mitigate the negative impact of the global crisis. The business community has recommendations and suggestions relating to further policy considerations, but most of these are general in nature and are not specifically related to overcoming the global crisis in the short-term.

The monetary and fiscal measures announced by the Government benefit both the business community and consumers. Although a large allocation of the stimulus packages is directed toward the construction sector, the impact of jobs created from this sector helps to reduce social problems arising from unemployment. The development of human capital through training and education incentives will contribute to a better quality of life, increase domestic demand on products and services, and reduce dependence on the Government's SSNs. The Government's credit guarantee scheme for working capital and industrial restructuring, policy revisions to promote economic competitiveness, and expansion of investment outflows, are expected to contribute to domestic and international businesses, which are regarded as catalysts for economic growth.

The underlying purpose of the various policies announced by the Government to mitigate the global crisis, as reflected in the various thrusts, allows for easy monitoring of the impact of the measures. The establishment of the Project Monitoring Unit provides the transparency aspect to good governance. This is new to Malaysia's political scene, although the degree of transparency is to be seen.

7.2. Human Capital Development and Profitability

Training and skills development facilitators are of the opinion that Malaysia has to enhance its human resource capabilities if it is to move out of the middle-income trap and into higher value-added activities. More allocation needs to be given to training by local skills development centres, especially for fast-tracking engineering graduates so that they are industry-ready. Furthermore, engineering skills are changing rapidly and engineers need to upgrade their skills constantly. Alternatively, the Government can make its graduates industry-ready through collaboration between the manufacturing industry and universities. Grants can be provided for this purpose. It is also being suggested that, instead of concentrating resources and conducting training centrally in Kuala Lumpur or Cyberjaya, it may be more effective to set up shared services regionally. Rather than build more facilities, the nation should improve existing facilities and promote the use of shared facilities. On the issue of industrial attachment of students from higher institutions, there is a need for industries to standardise training for these students in the time allocated for their attachment. Accordingly, each industry needs to have a module outlining the various aspects of training that complement classroom learning and expose students to actual problems and solutions related to working environments.

The Federation of Trade Unions is of the view that JobsMalaysia, a one-stop-shop concept, is not effective because it does not provide job-matching for retrenched workers. While training and skills development is a thriving industry, the recipients of trainees through programmes such as graduate industrial attachments will benefit as these individuals may contribute to increasing the productivity of the business with no additional cost.

Given Malaysia's limited resources, it is suggested that resources be diverted from producing mass graduates to training postgraduates for both research purposes and the workforce. Apart from engineers, the country needs more accountants, scientists and professionals.

The business community is of the opinion that the limitations on HRDF training should be revised, if not removed, as they prevent training companies from bringing in foreign expertise. As a country with a relatively small population, Malaysia may have little choice but to grant permanent residence status to attract the additional talent it needs. The difficulty to strike a balance between policies on human development and commercial profits is a concern to many economies, and Malaysia is not an exception. Thus, more efforts are needed to ensure the quality of human development through appropriate government policies and participation from the business community.

8. Conclusions and Recommendations

Malaysia has avoided a financial meltdown during the 2008-2009 global crisis but the contraction in export demand has driven the economy into a recession. In weathering the crisis, most macroeconomic fundamentals have remained strong but the recession has further widened the gap between actual GDP growth and the rate targeted for the achievement of Vision 2020. The Government's response through the injection of a fiscal stimulus and the acceleration of development expenditure has shown some signs of stabilising the economic contraction. The construction sector has registered growth in the second quarter of 2009 but the other sectors are still contracting. Greater benefits from the stimulus packages can only be derived once projects awarded under the packages are fully implemented and the funds disbursed efficiently without any discrepancy between targeted and actual expenditure. Effective policy implementation is, therefore, of utmost importance, without which the full impact of the stimulus packages will be felt much later than originally planned. Implementation weaknesses may work against the desirable goals of the fiscal stimulus, although the transparent monitoring process set up for this crisis has helped to expedite project implementation.

This crisis has also reinforced the importance of Malaysia's integration with the global economy and its implications. The improving prospects of the Malaysian economy since the middle of 2009 are partly due to the upturn in the global economy. In a rapidly changing global economy, it is important that Malaysia maintains strong fundamentals and a robust financial sector. This will enable Malaysia to respond effectively to volatility in international markets while the domestic resources available can be mobilised to mitigate the adverse impact of a worldwide crisis. Global swings will continue to pose a challenge for many countries, particularly a small open economy such as Malaysia. The recent increases in commodity prices have raised concerns about the possibility of high inflation once the global economy recovers due to massive fiscal injections by many countries. While high inflation is an unlikely prospect in the short-term, the Malaysian Government should be prepared for possible measures to prevent sharp price rises, especially for essential goods. Likewise, monitoring of strategic global developments that can affect Malaysia significantly will be crucial in this rapidly changing environment.

In addition, the current crisis has highlighted the urgent need for Malaysia to restructure its economy to stimulate a shift towards a high income and high value-added economy and society. In earlier crises, Japanese, Taiwanese and South Korean firms used the Schumpeterian-type 'creative destruction' cycle to catch up and leapfrog in critical high technology industries, such as electronics and automobiles (Johnson, 1982; Amsden, 1989; Mathews and Cho, 2000). Strengthening technological competency and capacity through R&D is an essential part of such economic upgrading. Similarly, human capital is another enabler that needs to be strengthened if Malaysia is to successfully achieve the type of economic restructuring it needs.

8.1. Maintain Strong Macroeconomic Fundamentals

The last time that countries had to deal with a globally synchronised recession of the current magnitude was more than five decades ago. Malaysia's response to the ongoing event, however, has been conditioned by two previous localised events: the recession of 1985-86, which was initiated by a collapse in primary commodities, and the Asian financial crisis of 1997-98, which began as a result of portfolio capital and currency movements. In many ways, the decade leading up to the present crisis has been characterised by efforts to ensure that the economy will be able to withstand strong financial shocks to the system. For an open economy like Malaysia, maintaining a flexible exchange rate and monetary independence in the face of increasingly large capital flows is important. To better manage the surges in capital flows, which have become more prevalent, the range of market-based instruments for monetary policy operations has been increased. Given the rise in intra-regional trade and investment flows, greater importance has also been accorded to stability of the exchange rate against regional currencies. Policymakers have tended to err on the side of caution since the Asian financial crisis, and evidence of this (and the direct consequence) is the large amount of excess savings and international reserves accumulated. While the Government did run continuous budget deficits in the 2000s, these were juxtaposed by inordinately large balance of payments surpluses of up to 15% of GDP.

In the financial sector, following the Asian financial crisis, consistent efforts have been taken to consolidate the banking sector through mergers and acquisitions and increased capitalisation. When the global crisis finally manifested itself in late-2008, the balance sheets of Malaysia's financial institutions were one of the strongest as NPLs only accounted for 2% of overall loans and the loan-deposit ratios were well below 90%. As a result, the financial institutions did not face the threat of collapse as in the United States and Europe. As reported by BNM (2008), the indebtedness of corporations and households relative to the value of financial assets was falling rather than rising at that time. The issue of over-leverage and over-exposure was not serious, therefore, which made containing the negative effects of the global crisis much easier. On the regulatory front, BNM should continue to direct significant effort and resources to strengthening its surveillance capabilities to detect, monitor and deal pre-emptively with emerging risks and vulnerabilities in the global and regional financial system.

Moving forward, there must be efforts to develop the financial sector as an engine of growth. Studies have shown that banks play an important role in promoting the creation of new industries as well as in generating spill-over effects for other sectors of the economy. A well-developed financial sector is also able to play an important role in mobilising talent and business activities to strengthen R&D efforts leading to increased productivity, which can drive endogenous growth in other economic sectors.

8.2. Balance External and Domestic Sources of Demand

Malaysia was fortunate to have entered the global crisis with a significant proportion of its economic growth contributed by domestic sources, particularly private consumption. Even though domestic demand did not adequately insulate the economy from recessionary effects, it did help to blunt the force of the shocks to trade and investment. Private consumption turned out to be a highly resilient factor, dropping the least among demand aggregates. Final consumption contracted by 0.2% over 2008 in the first quarter of 2009, but increased by 0.6% in the second. Imports of consumption goods fell by a mere 4% in the first quarter of 2009, while the food and beverages component actually rose overall by 11%. Other private consumption indicators, such as sales and service taxes, registered large increases in the first quarter of 2009, although these seem to have slumped in the second. In contrast, investment goods imports were down by almost 8% and intermediate goods imports were down by 35%. The toll of the crisis was thus clearly felt by corporations and producers much more than households and consumers.

The question therefore arises as to what the appropriate level of private consumption should be for an economy, especially one such as Malaysia. Economists are still unclear about whether private consumption increases or decreases during periods of economic contraction. There are case studies suggesting that it increases during contractions, as government spending is cut. Other empirical evidence seems to bear out the more intuitive argument that private consumption falls during downturns. The answer appears to hinge on the degree of substitutability of private and government consumption and empirical studies vary in terms of their findings. Short of definitive conclusions, it would be safe to say that this will depend greatly on factors such demographics, initial endowments and equality, and is best determined on a case-by-case basis. At an average 65% of GDP, Malaysia's consumption ratio appears to be within the general proximity of countries with comparable per capita income and size. Given the precarious state of the world economy, there is seemingly also limited scope to appreciate exchange rates or raise levels of protection. There is, however, room to grow domestic consumption and effective purchasing power in a sustainable manner by effectively dealing with inequality through tackling the obvious disparities that exist in income and wealth distribution. Allowing real wages at the lower end to rise by equalising compensation of foreign and domestic labour, for example, would help to boost consumption while increasing the incentives to shift towards capital-intensive activities to boost productivity.

At the same time, domestic demand can be expanded by diversifying into the "extended domestic" economy, i.e. the external Asian and especially ASEAN markets. Several preconditions are already in place to support the strengthening of domestic demand in Asia, such as rising income levels, favourable demographic structures, low unemployment levels and relatively low levels of leverage by households, all of which are likely to contribute to higher consumption. The relatively sound financial position of households in Asia, with high savings rates that exceed 30% of GNP in most Asian economies together with their relatively low debt levels, provide the potential for rising consumption to be sustained. In addition, Asia's relatively strong and resilient financial systems are in a sound position to provide financing to support domestic economic activity.

Further diversification of export markets and increasing intra-ASEAN and intra-Asian trade can also widen the domestic demand base. Intra-regional trade as a share of total trade of the region rose from 25% in 1980 to 45% in 2006. Going forward, the composition of trade from intermediate inputs for the production of goods for final demand in traditional markets in Europe and the United States needs to shift towards meeting the increasing final demand within Asia itself.

8.3. Better Targeted Stimulus and Development Packages

No two economies are identical in all respects. Thus, policy stances will and should differ and stimulus packages will be tailored to fit the contexts and circumstances of the countries concerned. Towards the end of 2008, for example, some countries such as Hungary, Ukraine and Pakistan in Asia, had no option but to ask the IMF for loan assistance, which subjected them to the IMF's loan conditions. Others that were in better financial shape announced one or more packages of varying sizes. In the case of Japan and China, a total of over 16% and 14% of GDP respectively have been devoted to increasing economic activity, while for Germany and the Republic of Korea, the figures are closer to 2% of GDP. As highlighted in this report, Malaysia's allocation is about 10% of GDP, about the same as that of Singapore. Other countries have either not been in a position or have been unwilling to commit substantial amounts to public spending.

The stimulus packages, however, differ in their content with regard to the types of measures and their combination. **First**, some include direct cash transfers. Where these are untargeted, there may be a tendency for households to save these transfers instead of spending them and some economies, such as Taiwan, Province of China, and Singapore, have undertaken consumption voucher schemes. Targeted transfers can take the form of grants for first-time home buyers and trade-ins for automobile purchases. **Second**, there are tax breaks. These do not stimulate consumption as directly as income transfers, as they are received only after a delay, but they are easier to administer. In the United States, for example, low-income working families are given earned income tax credits as an incentive for them to work and to increase their disposable income. **Third**, there are government spending programmes, which are mainly for infrastructure and social programmes because these are large enough to have detectable effects. **Fourth**, many contain special loans and loan guarantees to make access to credit easier and more affordable. Malaysia, in particular, has a high component of guarantees in its stimulus packages. **Fifth**, other measures can also be taken, such as the provision of incentives for SMEs to employ workers as well as reduction of road toll rates. These tend to have smaller direct and indirect impact, which nonetheless can still be significant.

Based on their respective needs and policy priorities, countries will adopt various combinations of these measures. In Malaysia, the various percentages of allocations show that the main concern of the Government has been to assist the private sector (RM29 billion), increase productive capacity (RM19 billion), ease the burden of vulnerable groups (RM10 billion) and reduce unemployment (RM2 billion). The underlying philosophy seems to be to act primarily on the supply side and avoid increasing the already extensive and costly subsidies for items such as petrol and diesel, food, education and transport. This is, no doubt, conditioned by the need to ensure that the additional money spent is economically productive and justifiable. As with many government programmes, however, time lags and distributional impact are critical issues. The Government has often been criticised by the private sector for bureaucratic delays in rolling out projects. National leaders are aware of this and have been at pains to emphasise the importance of policy implementation. This, however, does not guarantee that there will be no execution gaps.

Therefore, while it is important to actually spend the stimulus packages, these should be targeted to ensure that essential consumption, in particular that which directly affects the poor, is not compromised. Monitoring to guarantee that those most affected are protected should be carried out more closely. One of the main foci of stimulus packages is retrenchments and economic activities that can substitute for fallen aggregate demand. Basic infrastructure, which normally does not generate large amounts of leakage, should also be an important focus.

8.4. Central Focus on Human Resource Policies

The ability of economies to recover after falling into a deep trough is not merely dependent on investment but on income multipliers as they work their way through the economy, households and private corporations. In all cases, this will involve humans as agents of change. In virtually all countries, it is households at the lower end of the ladder that are most at risk. This group often has not only the least but also the most variable income. Most are dependent on unskilled or semi-skilled work, either on a self-employed or wage employment basis. In Malaysia, the bottom 40% of households had a monthly income of only about RM1,200 (2007). Those involved in agriculture were hit hard in the second half of 2008 when the prices of palm oil and rubber fell significantly. Overtime earnings at factories fell dramatically as some factories closed and worker retrenchments soared. Sales and service personnel jobs may have been more resilient in comparison but incomes have stagnated and the number of new jobs created will be limited.

For Malaysian policymakers, efforts to reduce poverty and increase earnings among lower income households have been vastly undermined by the fact that it is this group that experiences the greatest adverse competition from migrant labour. The Government has had to struggle and balance the need to create jobs for Malaysians and demands by employers facing a very difficult business environment who have advocated for cheaper and more flexible sources of labour, such as foreign unskilled and semi-skilled labour. At the unveiling of the second stimulus package, two decisions were taken. First, to double the foreign worker levy for all sectors, except for construction and plantation workers and domestic maids. This was subsequently rescinded. Second, to freeze the issuance of licences to foreign labour recruitment agencies and tighten conditions for recruitment. The number of work visas issued has been reduced but this appears to apply only for certain sectors, such as services, while those in manufacturing, agriculture and construction can still be approved on a case-by-case basis.

Until and unless Malaysia's migrant labour policy is comprehensively addressed, it is debatable whether the welfare of Malaysian workers at the lower end can be effectively addressed. This is particularly important from a socio-economic point of view because many of those who work in factories and service outlets are typically young, unskilled and female, and the source of a second income for households. The effects of industrial adjustments that have been taking place as a result of the opening up of China and other more cost-competitive countries, such as Vietnam, have already had negative repercussions, such as stagnating wages, a fact that has been picked up by World Bank consultants working in Malaysia. Moreover, without efforts to control the number of foreign workers, there are insufficient incentives to upgrade the skills and earnings of Malaysian workers in the bottom half of the domestic labour force pyramid.

8.5. Financing for Economic Growth, Restructuring and Development

In 2008, Malaysia's budget deficit reached a (then) record high of 4.8% of GDP. For 2009, the official forecast is for the deficit to reach 7.6%. In any other circumstances, this fact alone would be cause for great concern, not least to financial markets and foreign investors. This has not been so at a time when almost all countries are spending at historically high levels, unlike in the past when such deficits were regarded as a major determinant of country risk. Nevertheless, with expectations that there will be a bottoming-out of the decline in economic activity in the second half of 2009 and recovery in 2010, it may be only a matter of time before the question of fiscal sustainability is back on the table.

Now is not an opportune time to develop an exit strategy because recovery is still nascent. Prudent fiscal management, when introduced, should be pursued by trimming operational expenditure while development expenses should be maintained or even increased because of the additional expenditure required to stimulate Malaysia's transition towards a high value-added and income economy. Technological upgrading into high value-added activities will require massive investment in technological skills, human capital, R&D and other knowledge-intensive goods and services, all of which have strong public good characteristics. Nevertheless, there should be an exit strategy at some point in time.

8.6. High Value-added Economic Activities and a Knowledge-based Economy

The Government has expressed concern over the sources of economic growth that the country has relied on since the late 1980s. The rise of China and India has posed a competitive threat on the investment and technology fronts, while the digital revolution has further enhanced the borderless nature of economies and the mobility of knowledge workers as countries compete for the best and brightest brains. The Action Plan for Industrial Technology Development of 1990 provided the first government blueprint to stimulate technical progress in the country, which led to the introduction of the HRDF and establishment of the Malaysian Technology Development Corporation, Multimedia Development Corporation, Malaysian

Industry-Government Group for High Technology, Small and Medium Industries Development Corporation and Multimedia Super Corridor in the 1990s. The Eighth and Ninth Malaysia Plans, as well as the Second and Third Industrial Master Plans, stressed the need to take economic activities to the next level of the value chain. In the mid-2000s, the drive towards biotechnology was made with the Biotechnology Master Plan to open yet another source and axis of growth. This was accompanied by significant public allocations towards human capital development, including schools, training institutes, universities and colleges, and in R&D. The adoption of a National Innovation System in 2007 was another attempt to climb up the value-added ladder and, in late 2009, a new economic model is being prepared to dramatically change the nature of value-added activities in Malaysia. However, for a number of reasons, these initiatives have not stimulated a catch-up by firms or an acceleration to the growth path achieved by the Republic of Korea, Singapore and Taiwan, Province of China.

To do so, the Government should take on the Keynesian strategy of expanding human capital development in the country to provide the basis for raising wages and, in that way, support the upgrading of the Malaysian economy into higher value-added activities. Wages should reflect the quality of labour expected as well as provide the motivation for workers to not only perform at the workplace but also continuously seek skills upgrading to drive competitiveness.

The Government should consider two labour market strategies to achieve its goal of reaching developed status by 2020.[1] Firstly, there must be systematic efforts to raise the number of R&D scientists and engineers from the 367 per million recorded in 2006 to exceed 2,000 by 2012 and 3,000 by 2015, with a commensurate expansion in R&D investment in GDP to rise from 0.64% in 2006 to 1.5% in 2012 and 2% in 2015. Such investment is critical for the Government to arrest the growing deficit in GDP growth against the 2020 vision targets. These targets should be achieved through both a stepping-up of domestic supply capacity as well as attracting foreign talent in the short to medium-term, including from the pool of Malaysian diaspora, without compromising quality. Secondly, there must be a policy shift from low-end, low value-added activities to high-end, high value-added activities in all sectors: agriculture, manufacturing and services.

8.7. Re-orientating FDI Strategies to Support Technological Upgrading

Although the primary sectors helped support the emergence and growth of manufacturing, FDI has been the engine of export-oriented industrialisation in Malaysia over the period 1972-2008 (Rasiah, 1995, 2009; Ariff, 1990).[2] Liberal capital market policies, both towards FDI and portfolio equity flows, have attracted considerable foreign capital to Malaysia since the early 1970s. However, net FDI inflows have slowed down significantly since the turn of the millennium and have

[1] Initiatives to create a knowledge economy in the country have been taken since the 1990s but the lack of a clear focus has meant that the country has yet to generate sufficient knowledge synergies to drive technological upgrading.
[2] FDI does not cover portfolio equity investment other then share acquisitions exceeding 10% of overall share value. The focus here is on FDI and not on private portfolio flows.

begun to record negative growth from 2007. Although capital outflows strongly account for the shift to negative growth, Malaysia no longer manages to attract large-scale FDI inflows, apart from those going to resource-based industries. Also, Malaysia's largest share of capital outflows in 2007-2008 came from mergers and acquisitions of Southeast Asian banks. Unless there are significant returns exceeding those of both static as well as dynamic outflows (the multiplier effect of servicing business units in Malaysia), such outflows may not be productive for Malaysia.

A combination of labour scarcity vis-à-vis China, India, Vietnam and the Philippines, and the lack of a critical mass of human capital have prevented Malaysia from adopting the Singaporean and Irish strategy of leveraging to drive technological upgrading. Even the traditionally low-FDI-based economies of the Republic of Korea and Taiwan, Province of China, have begun receiving FDI off-shoring for their R&D activities. Malaysia must strengthen its high-tech institutions to obtain positive synergies from the incentives and grants extended to promote design and R&D activities in the country.

Ireland and Singapore have relied on strengthening their embedding environment, generating the requisite human capital, developing high-tech organisations such as R&D laboratories and standards organisations, and providing grants to foreign firms capable of engendering high-tech synergies. The electronics industry in Singapore has managed to continue to upgrade technologically through leveraging with foreign direct investors. Japan, the Republic of Korea and Taiwan, Province of China, strengthened their technology transfer mechanisms to ensure that actual diffusion of scarce foreign knowledge took place from foreign to local firms through *ex ante* screening, monitoring and *ex post* appraisal (Johnson, 1982; Edquist and Jacobssen, 1987; Fransman, 1986). The automotive and electronics industries in these three countries all reached the technology frontier through such transfer agreements.

Malaysia has a technology transfer unit in the Ministry of International Trade and Industry but its tasks are only limited to registering applications (Rasiah, 1999). Given the strategic focus of the Industrial Master Plans 2 and 3, Malaysia should pursue both strategies and remove incentives given to labour-intensive, low-technology and non-strategic firms. Such strategies are paramount to driving technological catch-up in the high-tech industries of semiconductors, biotechnology and avionics, as there are path-dependent and cumulative dimensions to technological deepening (Rasiah, Lin, Kong and Song, 2010, forthcoming). Also, the world's successful automotive experiences show that the only way for Malaysian manufacturers to reach the technology frontier is through the mechanisms used by Japan, the Republic of Korea and Taiwan, Province of China. However, unlike what took place in Japan and the Republic of Korea during the catch-up period, Malaysia should not regulate strategic sectors. Malaysia cannot do this because of the World Trade Organisation agreements that were not in place at the time Japan and the Republic of Korea pursued these strategies, but this is also undesirable because of the implications for the ownership structure of the country's manufacturing industry.

Appendix 1. The Global Crisis and Business Operations – Survey Findings

Interviews were conducted with industry associations representing the various economic sectors. This exercise was undertaken with the assumption that the associations represent the views of their members, and hence, provide a collective perspective from the business community.

The following is the statistical analysis of the basic responses in three main areas:

Responses from the Industry as at 17 June 2009

	Question	Yes (%)	No (%)
1	Global crisis Is there an impact on the industry?	64	36
2	Stimulus package Are the stimulus packages sufficient for the economy?	92	8
3	Human development Does the global crisis have an impact on the human capital capacity of the industry?	29	71
	Sample size = 14		

Questions relating to these three areas included (1) the impact of the global crisis on output, cash flow, rate of employment, main concerns of members, and efforts undertaken to look into new areas of business opportunities in the downturn; (2) the impact of the stimulus packages on service quality/quantity, financing/credit facility, workforce turnover, concerns, and suggestions to support economic recovery; and (3) the impact on human capital based on decisions by companies relating to termination, wage revisions, reduction of working hours, utilisation of the HRDF, and revisions in bonus payments.

Responses from spokespersons of the industries were analysed based on their effects on business operations, the Government's policy decisions, and business focus vis-à-vis the Government's policy on human capital development.

Manufacturing

The manufacturing export sector has been hit the worst during this global crisis. This is supported by BNM's first quarter 2009 report, which stated that the electrical and electronics industry declined sharply by 41.4% in the first quarter of 2009 compared with a fall of 22.5% in the last quarter of 2008, due to a contraction in export-oriented industries and weaker support from domestic-oriented industries. In addition, value-added in the manufacturing sector declined by 17.6% in the first quarter of 2009 compared with a drop of 8.8% in the fourth quarter of 2008.

There are hardly any measures that address this sector in the stimulus packages. While foreign multi-national corporations have deep pockets to withstand the global downturn, SMEs have been most affected by the crisis and face serious cash flow problems. Although banks claim that they have not pulled back on lending, they are more careful in extending new loans and are monitoring payments closely.

In the 2009 SME Survey undertaken by the Association of Chinese Chambers of Commerce and Industry Malaysia (ACCIM), the majority of respondents indicated that their businesses had yet to benefit or see any impact from the various assistance programmes and stimulus packages offered by the Government. This was despite the RM2 billion Loan Assistance Guarantee Scheme to enable SMEs to obtain financing of up to RM500,000 for up to five years in the second stimulus package. The ACCIM has suggested that special soft loans or interest-free loans be given to SMEs to retain staff during this critical period. More concerted assistance needs to be given to SMEs, for example, SME manufacturing companies could be provided with grants or soft loans for design and development, and measures could be introduced to encourage foreign firms to buy designs from local entities. The findings of the ACCIM may, however, be premature given that the stimulus measures would not have filtered down to the ground at the time the survey was taken. Furthermore, in the absence of specific business data, it is difficult to gauge the actual outcomes of the measures. Policy targets and lags are always concerns in regard to stimulus plans.

Agriculture

Palm oil is the country's main agricultural product for domestic as well as export markets. Malaysia currently accounts for 41% of world palm oil production and 47% of world exports. In addition, the country accounts for 11% and 25% of the world's total production and exports of oils and fats respectively.

There appears to be less worry regarding the impact of the global crisis on this sector. This is in line with BNM's first quarter 2009 report, in which palm oil production was reported to have declined by 3.9% due to lower fresh fruit bunches and not because of the global crisis. The industry has acknowledged that prices of some products in this sector tend to fluctuate in a trend similar to crude oil prices. Thus, the decline in palm oil prices since the first quarter of 2008 followed the trend for crude oil prices since late 2008.

The increasing interest in renewable energy from bio-fuel has contributed to the growing importance of palm oil, which is already recognised for its nutritional value and as a valuable commodity for sustainable economic growth. The industry is nonetheless concerned that production of crude palm oil from palm oil flesh and palm kernels is subject to weather conditions, which may affect fruit production and harvesting. Recent floods and draught that have been occurring on an unprecedented scale in the country have been a reason for the industry to expand investments in palm oil plantations in Indonesia. However, weather conditions such as El Nino are expected to contribute to an increase in palm oil prices based on demand and supply, with Malaysia as one of the beneficiaries. The Malaysian Palm Oil Board has reported a gradual increase in the local prices of palm oil products from January 2009 to April 2009, compared with a declining trend from June 2008 to December 2008.

The ongoing concern for the industry is the shortage of plantation workers. Malaysia has been heavily dependent on foreign unskilled workers for its plantation industry. Many employers are unwilling to train workers and invest in capital-intensive equipment because they are still able to bring in low-cost unskilled foreign labour. This situation is in contrast to the Government's response to the global crisis by temporarily freezing the hiring of foreign labour in the manufacturing and service industries. Thus, for the agricultural sector, the global crisis has had no impact on its local and foreign workers in terms of human capital capacity and remuneration issues.

Services

In the ICT industry, the impact of the crisis is significant in its retail sector. Growth in this industry is expected to decline by 30% in 2009, with growth in the retail sector declining by 30-40%. It is difficult to substantiate these numbers as they are based on an in-house survey conducted by the Association of Computers and Multimedia Industries, Malaysia, using a sample size of about 10% of the total number of member companies. While cash flow is not a major issue, the survey reported that SMEs in this industry are experiencing difficulty in securing financial assistance due to the banks' stringent and cautious stand. To overcome the negative effects of the global crisis, the industry is exploring outsourcing opportunities through exporting their services to Singapore, China, the Middle East and the United States of America, and diversifying towards value-added services.

There is no significant impact from the stimulus packages on the ICT industry. It is, however, acknowledged that the allocations and incentives for training may benefit the industry relating to the quality of its labour force. In its recommendations to encourage the use of ICT, the industry has suggested the introduction of tax incentives for online tax filing and discounted amounts for online payment of traffic offences, summons and fines.

In the logistics industry, Malaysia's trans-shipment ports are being significantly affected due to their large exposure to electrical and electronics exports as well as consumer goods. The ports have felt the impact of a 3% decline in volume in the last quarter of 2008, which was followed by a drop of 4% in the first quarter 2009. Volume improved in the second quarter of 2009 due to initiatives taken by Maersk Line. This involved, amongst others, a sharing programme for larger and more economical vessels with the CMA-CGM shipping group, an exercise that has reduced costs and increased benefits through economies of scale.

Property and Construction

The real estate and construction industry indicated that it is shielded from any direct impact of the global crisis. The slowdown in this industry has been due to developers cautiously keeping new launches in abeyance or resorting to small-scale launches in light of the economic uncertainty and declining consumer spending on big ticket items. BNM's 2009 Quarterly Report showed 0.6% of value-added growth for the construction sector. Cash flow does not appear to be a concern for big companies but the smaller ones have complained of difficulty in securing funds from banks.

The impact of the stimulus packages on the industry has not been felt, as it is perceived that there are leakages in the funds allocation. The view of the industry is that the Government does have at its disposal the ability to stimulate more house purchases through temporary reduction or waiver of stamp duties as implemented during the Asian financial crisis. In addition, it has suggested that the Government adopt the assistance provided to first-time house buyers in Australia by giving a grant of RM10,000 for new houses for the next two years.

Automotive

The Automotive Association of Malaysia (AAM) reported an average decline of 12% in the retail industry and the demand for cars in the period between the first quarter of 2008 and second quarter of 2009. The industry has not been as badly affected by the current global crisis as during the Asian financial crisis, when it suffered a contraction of about 50%. This contradicts the general understanding of the impact of the global crisis on this sector, which is based on the perception that the decline in disposal income due to an increase in the number of retrenched workers would affect consumer behaviour on big ticket items, such as motor vehicles. The contradiction can probably be explained by the fact that retrenched workers are mainly from the manufacturing sector, and these workers, with their limited income, do not see the purchase of motor vehicles as a priority. The rest of the work force, of which the majority constitutes private sector employees and civil servants, still retain their jobs and possess the disposable income to support their expenditure.

The AAM is of the view that Malaysia has yet to explore the option of making greater use of employees' contributions to the EPF. For instance, workers can be given options to withdraw from the EPF to make initial downpayments for car purchases for a temporary period during the global crisis. The car scrapping policy currently applicable to national cars may be more effective if extended to all types of cars. The AAM thinks that the implementation of these suggestions may contribute to the growth of the automotive industry.

Further suggestions include a reduction in the BLR and subsequent reduction in interest rates by financial institutions, as hire purchase rates have risen due to a reassessment of the higher risk profile of car purchasers. It is being recommended that hire purchase companies reduce hire purchase rates and relax their more stringent requirements, such as lowering the maximum margin of financing for car purchasers from 90% to 80%. In addition, the Government has the option of reducing the sales tax on cars to stimulate demand in this industry.

Mining

While the petroleum sector is affected by the global crisis, production from other areas of the mining industry does not appear to be affected. However, an indirect impact is seen in extraction activities that involve non-metal elements, such as the production of cement from limestone, glass from silica, and sand and clay. Cement and sand production is affected by the crisis due to a decline in the construction sector. While financing and cash flow are of no concern, the industry is unhappy with the stringent standards relating to environmental issues. This, however, is independent of the global crisis. In general, the stimulus packages do not have any impact on this industry, as there are no specific measures targeted for this area.

The industry is nonetheless worried about the depletion of skilled workers, such as geologists and engineers. There is a ten-year cycle in the availability of skilled workers based on education and experience requirements. Despite the high demand for such skilled workers, there is a decline in emphasis in this area in higher educational institutions. As a result, the cycle may be extended, leading to staff-pinching especially in the oil and gas sector. It is suggested that the Government may wish to consider this as an area for consideration in human capital development.

Financial Institutions

The banking sector is well protected from the impact of the global crisis. Islamic banking institutions have recorded an increase in asset value compared with conventional banking institutions. This may be due to a perception that the conventional financial system is unreliable, hence the increased confidence in the Islamic financial system. According to BNM, the insurance and takaful sector maintained its solvency during 2008. Total income for the life insurance sector fell in 2009, while family takaful income rose to RM2.834 billion from RM2.376 billion in 2008. The insurance and takaful sector has been affected by lower demand and higher competition, with motor insurance and takaful being hit by the expected decline in vehicle sales. There are concerns of higher surrender rates, lower sums assured (i.e. smaller policies), and higher incidences of theft and fraud due to lower disposable income arising from the global crisis.

Appendix 2. Economic Stimulus Package 1

1	**Ensuring citizens' well-being**
	• Build additional low and medium-cost houses and enhance housing programmes • Abandoned housing projects • Upgrading and maintenance of public transportation (LRT system, Commuter and Bus) • Additional business premises for small and medium entrepreneurs (MARA) • Others - small infrastructure maintenance projects (PIA and PIAS)
2	**Developing quality human capital**
	• Skill Training Funds • Youth skill training programmes in private training institutions • Enhancing Youth Programme • Preschool education (PERMATA, KEMAS, *Tadika Perpaduan* and preschool classes) • Financial assistance to missionary and vernacular schools
3	**Strengthening national resilience**
	• Upgrading, repair and maintenance of public amenities including schools, hospitals and roads • Upgrading, repair and maintenance of rural roads, *jalan kampung* and *jalan pertanian* • Upgrading, repair and maintenance of police stations/camps and quarters for armed forces and police personnel • Establish investment fund to attract private investment • Accelerate the implementation of High Speed Broadband project

Appendix 3. Economic Stimulus Package 2

1	**Reducing unemployment and increasing employment opportunities**
	• Create 163,000 training and employment opportunities 100,000 training and employment opportunities jointly by the Government and private sector under the following programmes: ✓ Special Training and Retraining Programmes as well as the Dual National Training Scheme; ✓ Training in electrical and electronics as well as construction areas, and more industrial and technical skills training in the Skills Training Centres; ✓ On-the-job training in the Securities Commission and Bank Negara Malaysia for two years; ✓ Training opportunities and job placements in GLCs (services sector); ✓ Attachment programmes for graduates and skills certificate-holders by PUNB; and ✓ Programme *Tunas Mekar* (for small and medium enterprises). • Recruit 63,000 staff to fill 50,000 vacancies and create 13,000 positions for contract officers: ✓ Contract positions include graduate teachers, *Program Cari* workers, public health assistants, enumerators, nurses and hospital support staff. • Post-graduate studies for 10,000 to pursue Masters degrees and 500 PhD degrees. • 400 graduate entrepreneurs under the PROSPER Scheme. • Employers to be given double deduction on remuneration paid for workers retrenched from 1 July 2008 (applicable to workers employed from 10 March 2009 to 31 December 2010).
2	**Easing the burden of citizens**
	• Subsidies provided to avert price increases of daily food staples ✓ Additional allocation of RM674 million for subsidies on sugar, wheat flour and bread, as well as an additional RM480 million for toll subsidies. • Increasing home ownership ✓ Additional RM200 million to SPNB to build more *rumah mesra rakyat;* ✓ Tax relief on interest paid on housing loans up to a maximum of RM10,000 a year for 3 years, for house buyers from 10 March 2009 to 31 December 2010. • Issuance of *syariah*-compliant Government Savings Bonds amounting to RM5 billion, and open to all citizens aged 21+, with a minimum investment of RM1,000 and a maximum of RM50,000. • Improving public infrastrusture ✓ Accelerate implementation of 9MP projects with high local content and multiplier effect (RM8.4 billion) and establish a fund (RM1.6 billion) to promote investments;

	✓ Repair and maintain drains, roads as well as surroundings of public flats (RM200 million); ✓ Renovate, maintain and repair welfare homes, hospitals, schools as well as fire and rescue stations (RM150 million). • Basic amenities in rural areas including electricity and water supply to rural areas, particularly in Sabah and Sarawak (RM580 million). • Infrastructure projects in Sabah and Sarawak totalling RM1.2 billion, including expansion of Sibu Airport and deepening of Miri Port. • Improving school facilities, building and upgrading schools, particularly in rural areas, including in Sabah and Sarawak (RM1.95 bilion), with RM300 million from this allocation used to improve facilities in government-aided religious schools, national-type Chinese and Tamil schools as well as mission schools. • Micro-credit programmes to assist farmers and agro-based businesses in rural areas (RM300 million). • Assisting the less fortunate (RM20 million) ✓ Improve facilities of daycare centres for elderly, shelters for women and childcare centres. • Ensuring welfare of retrenched workers ✓ Increase tax relief on compensation paid for retrenchment from RM6,000 to RM10,000 effective 1 July 2008. • Incentives for banks to defer repayments of housing loans ✓ Retrenched workers can defer repayment for one year and banks to be taxed on interest income only when such interest is received.
3	**Assisting the private sector in facing the crisis**
	• Working Capital Guarantee Scheme (RM5 billion) as working capital for companies with shareholder equity less than RM20 million ✓ 80% guaranteed by Government; 20% by financial institutions; ✓ Maximum loan amount will be RM10 million for a period of five years. • Industry Restructuring Loan Guarantee Scheme to increase productivity and value-added activities as well as the use of green technology (RM5 billion) ✓ Companies with shareholder equity below RM20 million will be guaranteed by Government and financial institutions with a ratio of 80:20; ✓ For companies with shareholder equity RM20 million or more, the guarantee ratio is 50:50; ✓ The maximum amount will be RM50 million for a period of 10 years. • Reducing cost of doing business ✓ Reduce Human Resource Development Fund levy payment rate from 1% to 0.5% for all employers for the period 1 April 2009 to 31 December 2010. • Facilitating access to capital market ✓ Establish financial guarantee institution for credit enhancement to private companies to access bond market.

- Attracting high net-worth and skilled individuals
  - ✓ Ease existing requirements to obtain PR status for high net-worth individuals bringing USD2 million or more to be invested in Malaysia;
  - ✓ Highly skilled foreign professionals will be considered for PR status.
- Promoting automotive sector
  - ✓ Additional RM200 million for the Automotive Development Fund;
  - ✓ Auto scrapping scheme for cars 10 years old or more to purchase new Proton/Perodua cars.
- Promoting aviation industry with a rebate of 50% on landing charges for all airlines.
- Accelerated Capital Allowance – to encourage investment
  - ✓ For expenses incurred on plant and machinery (two years);
  - ✓ For expenditure incurred on renovation and refurbishment (two years).

  (*This treatment is applicable to investments incurred between 10 March 2009 and 31 December 2010)*
- Carry back losses
  - ✓ Allow company's current year losses to be carried back to the immediate preceding year to improve cash flow (up to RM100,000).
- Profit levy on palm oil
  - ✓ Threshold for windfall profit levy increased to RM2,500 per tonne in Peninsular and RM3,000 per tonne for Sabah and Sarawak (previously RM2,000).
- Promoting tourism (RM200 million)
  - ✓ Diversify tourism products and upgrade infrastructure as well as improve homestay programmes, as well as organise more international conferences and exhibitions;
  - ✓ Issue work permits to skilled spouses of programme participants under Malaysia MySecond Home (MM2H) Programme.

4 **Building capacity for the future**

- Investments by Khazanah Nasional Berhad
  - ✓ Increase investment funds of Khazanah Nasional Berhad (RM10 billion) for domestic investments over two years;
  - ✓ Investments in strategic sectors: telecommunications, technology, tourism, agriculture, life sciences and projects in Iskandar Malaysia.
- Off-budget projects
  - ✓ LCCT at KLIA (RM2 billion) and expansion of Penang Airport (RM250 million) by MAHB;
  - ✓ Telecommunication infrastructure by MCMC (RM2.4 billion).
- Private Finance Initiative (PFI)
  - ✓ RM2 billion fund for PFI projects (provided by the government);
  - ✓ Projects:
    - Biotechnology cluster in Iskandar Malaysia
    - Upgrading traffic infrastructure system around KL

	Sentral • . Infrastructure for Tanjung Agas industrial park; ✓ Corporate social responsibility for GLCs in private education. • Liberalisation of the services sector ✓ Attract more investments, professionals and technology as well as strengthen competitiveness of the services sector. • Role of Foreign Investment Committee (FIC) ✓ FIC will adopt a more liberal approach in the process of formulating new policy guidelines. • Development of creative arts industry ✓ Radio Televisyen Malaysia to implement projects to develop the local music industry (RM20 million). • Effective management of government financial resources ✓ Implement approach to enhance elements of competition in government procurement – open tenders are encouraged, while design-and-build will not be allowed; ✓ The role and effectiveness of the Standards and Costs Committee will be strengthened.

Appendix 4. Manufacturing Growth, Malaysia, 1990-2005

Industry	90-95	95-00	00-05
Food	12.2	10.7	3.0
Beverages	-3.0	5.5	20.0
Tobacco products	15.2	-13.7	4.4
Textiles	17.1	6.8	-11.5
Footwear (except rubber footwear)	10.2	7.3	-2.7
Wood products	16.4	3.8	-0.3
Furniture and fixtures	35.8	19.3	2.6
Printing, publishing and allied industries	17.9	5.1	4.5
Paper and paper products	20.3	15.0	-3.3
Leather and leather products	29.4	-2.4	2.9
Rubber products	13.6	7.6	-1.6
Chemicals and chemical products	12.5	12.0	12.3
Products of petroleum and coal	25.3	37.4	11.1
Non-metallic mineral products	16.7	4.4	1.3
Basic metal industries	8.7	10.2	4.4
Metal products	23.9	9.9	1.7
Machinery except electrical machinery	26.0	25.3	-16.5
Electrical machinery and Electronics	26.8	12.1	0.5
Transport equipment	17.6	6.5	4.6
Miscellaneous manufacturing industries	21.7	13.9	0.0
Manufacturing	11.6	5.8	4.9

Source: Computed from Malaysia Industrial Surveys (1996, 2001, 2007)

Appendix 5. Implementation of HIS, 2007 and 2008

	Households	
Methodology	2007	2008
Sample size	38,083	25821
Coverage	Nationwide	Nationwide
Survey months	July, September, November	July, September, November
Level of reliability	National, State, Region, Strata	National, Strata

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