

### Summary

The Malaysian economy boasted a strong V-shaped recovery in 2010. It posted a GDP growth of 6.8% yoy last year and is expected to moderate in 2011 to 4-5%. While the fiscal position remains rather weak, the government has announced an ambitious new development plan for the next decade to achieve its goal of becoming a developed economy. Attracting sufficient private sector investment is the biggest challenge and risk for these plans. Increasing social tension between the country's various ethnic groups is a large point of concern. The external position is very healthy.

### Things to watch:

- Feasibility of the 10-year development plan
- Increasing social tension deteriorating the security situation
- Development of the fiscal position

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Malaysia			
<b>National facts</b>		<b>Social and governance indicators</b>	
Type of government	Constitutional monarchy	Human Development Index (rank)	57 / 169
Capital	Kuala Lumpur	Ease of doing business (rank)	21 / 183
Surface area (thousand sq km)	330	Economic freedom index (rank)	53 / 179
Population (millions)	26.6	Corruption perceptions index (rank)	56 / 178
Main languages	Bahasa Malaysia	Press freedom index (rank)	141 / 178
	English	Gini index (income distribution)	38
Main religions	Muslim (60%)	Population below \$1 per day (PPP)	1%
	Buddhist (19%)		
	Christian (9%)		
Head of State	Sultan Mizan Zainal Abidin	<b>Foreign trade</b>	
Head of Government (prime-minister)	Najib bin Abdul Razak	2010	
Monetary unit	Ringgit (MYR)	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
		Singapore	16
		US	13
		China	11
		Japan	10
		Singapore	22
		China	13
		Japan	12
		US	10
<b>Economy</b>		<b>2010</b>	
<i>Economic size</i>	<i>bn USD</i>	<i>% world total</i>	
Nominal GDP	235	0.38	
Nominal GDP at PPP	412	0.56	
Export value of goods and services	221	1.19	
IMF quatum (in mln SDR)	1487	0.68	
<i>Economic structure</i>	<b>2010</b>	<b>5-year av.</b>	
Real GDP growth	6.8	4.1	
Agriculture (% of GDP)	9	9	
Industry (% of GDP)	41	45	
Services (% of GDP)	50	46	
<i>Standards of living</i>	<b>USD</b>	<b>% world av.</b>	
Nominal GDP per head	8310	85	
Nominal GDP per head at PPP	14570	125	
Real GDP per head	6051	76	
		<i>Main export products (%)</i>	
		Machinery and transport equipment	49
		Mineral fuels	19
		Manufactured goods	10
		Chemicals	7
		<i>Main import products (%)</i>	
		Machinery & transport equipment	53
		Manufactured goods	14
		Mineral fuels	11
		Chemicals	10
		<i>Openness of the economy</i>	
		Export value of G&S (% of GDP)	94
		Import value of G&S (% of GDP)	76
		Inward FDI (% of GDP)	1

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

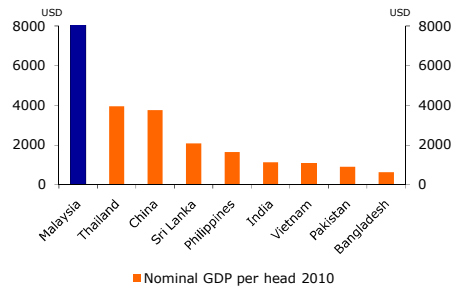
### Introduction and update

In our latest country report of February 2010, we expected the Malaysian economy to grow by 4-5% yoy in 2010. The recorded GDP growth of 6.8% yoy in 2010 was higher than our forecast as the economy experienced a strong V-shaped recovery. Going forward, we expect economic growth to stay strong but moderate to 4-5% yoy in 2011. The main weakness remains the fiscal position, as no consolidation plan is announced for coming years. The government announced an ambitious long-term development plan last year, we will discuss this plan in this update and the concomitant risks. We also mention the increase in social tensions in the country, which is becoming a large source of concern. As forecasted in our previous report, the external position remains in very good shape.

### The government is going for a developed economy...

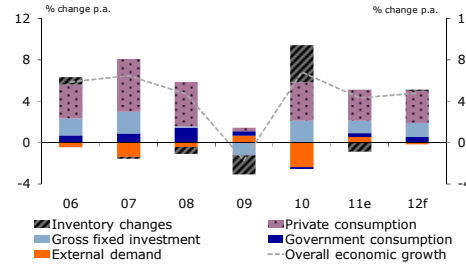
The Malaysian government has announced an ambitious development program for the next decade, aimed at breaking Malaysia out of a perceived "middle income" trap. Malaysia is already more developed than its regional peers with a nominal GDP per capita of USD 8,310 and has a relatively sound infrastructure and institutions. However, the government's goal is to become a developed economy by 2020. By then, it expects to have created 3.3m jobs and to have raised nominal GDP per capita to USD 15,000. The government intends to achieve this goal with a top-down planned and comprehensive two-pronged approach, which we view has numerous downside risks. The first part of the program is the Economic Transformation Plan (ETP), which is a USD 445bn investment plan for the next 10 years. This plan is very extensive and ambitious, as it is the first

Chart 1: Income levels



Source: EIU

Chart 2: Growth performance



Source: EIU

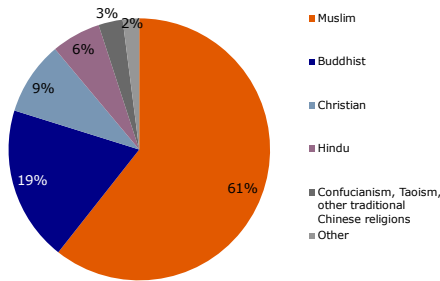
10-year plan made by the Malaysian government, as opposed to the usual 5-year plans. Twelve key development areas have been defined, with the most important being infrastructure, the financial sector and the energy sector. A total number of 131 “entry point” projects have been proposed by the government. Highlights include a mass rapid subway system for the capital region, Greater Kuala Lumpur. Another highlight is the construction of a USD 1bn 100-floor office tower, which will surpass the Petronas Twin Towers as the tallest building in Malaysia. The financial sector is also a major focus of new projects, with an emphasis on enhancing Malaysia’s role as a global hub for Islamic finance. The energy sector is another major beneficiary. The largest project is the construction of a mass regional oil-storage depot to compete with Singapore’s facilities. A nuclear power station is also planned along with further development of renewable energy facilities. While the proposals have been thoroughly researched and formulated after extensive consultation with all levels of business, ministries, government agencies and the general public, the assumptions on which the proposals are made are based on a very favourable scenario. Firstly, the government expects real GDP growth of 6% p.a. in the next decade, which is above the long-term trend growth of 5.5% in the past 17 years and very optimistic. The government also expects the majority of investments to come by private sector capital, both foreign and domestic. It intends to fund the USD 445bn investment plan for 60% by the private sector, 32% by government-linked companies and only 8% directly by the government. It remains to be seen whether enough private sector investment can be attracted as Malaysia has historically not been very successful in attracting private investment. In fact, it has one of the lowest private investment rates in Asia; around 10% of GDP. The investment rate fell rapidly during the 1997-98 Asian financial crisis and has since then never recovered.

To attract more private investment, the government needs to substantially improve the business and investment environment. It intends to do so via the second part of the program, the Government Transformation Plan (GTP). The GTP contains six “national result areas”, which include tackling corruption, improving education as well as basic infrastructure. The government has already relaxed a regulation that obliged companies to offer minority equity stakes in a number of services sectors to the *bumiputera*, the country’s indigenous Malays. The government will continue with similar reforms, hoping for greater inflows of FDI, but these could be met with strong opposition from the ruling elite which has vested interests in keeping the current policies and the indigenous Malays, which constitute 11% of the population. Overall, the government’s 10 year development plan is expected to meet many delays as implementation risks are high.

**...but must not forget to keep increasing social tensions in check**

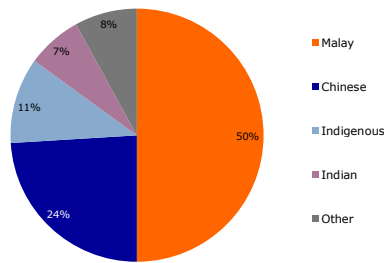
While Malaysia prides itself on maintaining peaceful relations between its various ethnic groups, tensions have risen in recent years due to a perceived “Islamization” of the country. Some segments of society have become radicalized, which has manifested itself in the promotion of a

Chart 3: Religious diversity



Source: CIA World Factbook

Chart 4: Ethnic diversity



Source: CIA World Factbook

moderate form of Islam known as *Islam Hadhari*. Conflict between the ethnic Malays and the Chinese and Indian minorities, which still account for 31% of the population, increased after December 2006. At an annual congress, the ruling United Malays National Organization (UMNO) made a racially charged speech directed against Malaysia’s minority groups. While the government tried to play down the tone of the speech afterwards, the damage had already been done. Successive mass demonstrations occurred in 2007 and tensions have remained high ever since. A key issue of controversy is the affirmative action policies of the government to favour the poor ethnic Malays. These were introduced in 1969 to narrow the income gap between the indigenous Malays and the wealthier and more educated Chinese minority. Such policies include a racially based quota system for university places, firms requiring to sell a minority stake to the ethnic Malays and favouring firms of ethnic Malays in awarding government contracts. However, these policies have failed to substantially increase the wealth levels of the ethnic Malays, due to corruptive practices and rent seeking, for example the re-selling of government contracts to foreign companies. An affirmative action policy reform is crucial to stem social unrest as it has marginalized the Chinese and Indian minorities, but will be contested by a large segment of the ruling elite wanting to protect their vested interests.

The country’s minorities have not only a financial disadvantage due to government policies, but also feel threatened on the religious front by the aforementioned “Islamization” of the country. Malaysia is a secular country as the constitution dictates freedom of religion. But on state level, Sharia law is enforced and in some states deviation from the Muslim faith is punishable in court. This contradiction in federal and state law is a source of unrest between the country’s religious groups. In January 2010, the country was shocked by an unprecedented religious arson attack on Christian churches. As long as the population remains insecure on the government’s religious stance and continues to feel their religious beliefs are under attack, the risks for further unrest will stay high.

Malaysia							
Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
<i>Key country risk indicators</i>							
GDP (% real change pa)	5.8	6.5	4.7	-1.7	6.8	4.3	4.8
Consumer prices (average % change pa)	3.6	2.0	5.4	0.6	1.8	2.7	3.2
Current account balance (% of GDP)	16.7	15.9	17.5	16.5	12.5	13.7	11.2
Total foreign exchange reserves (mln USD)	82132	101019	91149	95432	98396	105850	116940
<i>Economic growth</i>							
GDP (% real change pa)	5.8	6.5	4.7	-1.7	6.8	4.3	4.8
Gross fixed investment (% real change pa)	7.5	9.4	0.7	-5.6	10.1	5.6	6.1
Private consumption (real % change pa)	6.8	10.5	8.5	0.7	6.8	5.6	5.8
Government consumption (% real change pa)	5.0	6.6	10.7	3.1	-1.4	3.1	3.7
Exports of G&S (% real change pa)	6.6	4.1	1.6	-10.4	11.2	6.6	8.2
Imports of G&S (% real change pa)	8.1	5.9	2.2	-12.3	15.4	6.7	9.2
<i>Economic policy</i>							
Budget balance (% of GDP)	-3.3	-3.2	-4.8	-7.0	-5.6	-5.5	-4.8
Public debt (% of GDP)	42	42	41	53	53	55	56
Money market interest rate (%)	3.6	3.6	3.6	2.3	2.6	3.0	3.5
M2 growth (% change pa)	17	11	13	10	8	10	14
Consumer prices (average % change pa)	3.6	2.0	5.4	0.6	1.8	2.7	3.2
Exchange rate LCU to USD (average)	3.7	3.4	3.3	3.5	3.2	3.0	3.0
Recorded unemployment (%)	3.3	3.2	3.3	3.7	3.5	3.3	3.2
<i>Balance of payments (mln USD)</i>							
Current account balance	26200	29770	38914	31801	29377	36980	33160
Trade balance	37441	37727	51261	40254	42855	50580	46830
Export value of goods	160916	176220	199733	157655	189293	212950	227950
Import value of goods	123474	138493	148472	117402	146438	162370	181120
Services balance	-1970	794	51	1297	-311	980	720
Income balance	-4712	-4082	-7137	-4169	-6844	-7570	-7020
Transfer balance	-4560	-4668	-5262	-5580	-6323	-7010	-7360
Net direct investment flows	53	-2551	-7827	-6627	-4230	-1950	-1110
Net portfolio investment flows	3436	5388	-23961	-291	-3506	1490	2380
Net debt flows	396	8517	-1378	-8624	3300	1990	3230
Other capital flows (negative is flight)	-17812	-22237	-15533	-11074	-21727	-31110	-26640
Change in international reserves	12273	18887	-9785	5185	3214	7400	11020
<i>External position (mln USD)</i>							
Total foreign debt	55026	61567	66182	58316	62065	64390	67530
Short-term debt	11803	23100	22800	18677	23946	25380	26840
Total debt service due, incl. short-term debt	18483	19660	29398	32469	27546	31380	31580
Total foreign exchange reserves	82132	101019	91149	95432	98396	105850	116940
International investment position	-6650	-4573	32982	35068	n.a.	n.a.	n.a.
Total assets	157297	224898	219182	251339	n.a.	n.a.	n.a.
Total liabilities	163947	229471	186200	216271	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	23.9	20.2	23.1	20.9	18.3	18.7	15.9
Current account balance (% of GDP)	16.7	15.9	17.5	16.5	12.5	13.7	11.2
Inward FDI (% of GDP)	3.9	4.6	3.3	0.7	1.2	2.1	2.3
Foreign debt (% of GDP)	35	33	30	30	26	24	23
Foreign debt (% of XGSIT)	29	28	27	29	27	25	24
International investment position (% of GDP)	-4.2	-2.4	14.8	18.2	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	10	9	12	16	12	12	11
Interest service ratio incl. arrears (% of XGSIT)	0	0	0	0	0	0	0
FX-reserves import cover (months)	6.7	7.3	6.1	7.9	6.6	6.5	6.5
FX-reserves debt service cover (%)	444	514	310	294	357	337	370
Liquidity ratio	157	167	150	157	153	153	152

Source: EIU

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