Economic Review during the 1H2008

Defying all odds, the Malaysian economy started the year 2008 with a bang, with a Gross Domestic Product (GDP) growth of 7.4% year-on-year (YoY) in the first quarter of 2008, the fastest pace since the second quarter of 2004. Despite cooling off to 6.7% YoY in the second quarter of 2008, the economic expansion remained rock solid in the first half of 2008 (1H2008), to average at 7.1% YoY, even slightly faster compared to the 7.0% YoY pace in the previous 6-month period. Notwithstanding broad-based positive growth across all sectors, activities of the mining and quarrying as well as services sectors eased significantly in the 1H2008.

During the 1H2008, the 5.3% YoY increase in crude oil production to 699, 214 barrels was barely enough to offset the 4.0% YoY decline in natural gas output to 1,053,452 million standard cubic feet (mmscf), causing growth of the mining and quarrying sector to be more than halved to 1.6% YoY from 3.5% YoY in the second half of 2007 (2H2007).

Despite the apparent slowdown in output in the 1H2008 (+8.4% YoY vs. +9.9% YoY in the 2H2007), the services sector remained the "star performer", outperforming the broad economy and all other sectors. Major growth leaders among the services sub-sectors were the Wholesale & Retail Trade, Hotels & Restaurants (+11.7% YoY); Transport & Storage (+9.0% YoY); Finance & Insurance (+8.7% YoY) and Communication (+7.7% YoY) on the back of vigourous consumer spending and higher tourist arrivals; increased travel and trade-related activities; expansion in banking, insurance and capital market operations including Islamic finance and higher usage of cellular and broadband services.

The manufacturing sector reinforced its strength in the 1H2008 (+6.3% YoY compared to +4.4% YoY in the 2H2007) as export-oriented industries (+2.7% YoY) in particular machinery & equipment (+17.6% YoY) and electrical & electronics products (E&E) (+2.4% YoY) reversed the downtrend, in line with gains in global demand for Malaysian goods and services while domestic-oriented industries (+9.9% YoY) such as transport equipment (+27.1% YoY), construction-related products (+13.3% YoY) and food products (+10% YoY) gained further grounds.

The sharp rebound in crude palm oil output (+22.8% YoY) and increases in the production of livestock (+6.1% YoY), fishing (+1.5% YoY) and miscellaneous agriculture (+3.7% YoY) proved to be more than sufficient to take up the slack in output of cocoa (-21.6% YoY), rubber (-3.6% YoY) and forestry & logging (-4.6% YoY) in the 1H2008, catapulting the agriculture sector (+6.1% YoY) to expand at the fastest clip since the 2H2006.

In the 1H2008, the growth rate of the construction sector (+4.6% YoY) maintained above the 4% YoY-level for three consecutive half-yearly periods, largely spurred by increased building and civil engineering activities (+6.3% YoY) for the oil and gas sub-sector (of the mining sector) as well as in carrying out projects under the Ninth Malaysia Plan (9MP) and five growth corridors. Accelerated implementation of the Government's low-and-medium housing programs, liberalisation of the Foreign Investment Committee's ruling on foreign purchases of properties and promotion of Malaysia, My 2nd Home (MM2H) helped the residential sub-sector to advance by 3.5% YoY.

Outlook for 2H2008 and 2009

The confluence of domestic and global macroeconomic headwinds such as the global economic slowdown as a result of a housing slump-led US downturn; global financial turmoil and liquidity crunch as a consequence of US subprime woes; still high commodity prices in particular related to food, energy and building materials and price stickiness of basic necessities in particular food items due to steep fuel price hikes in June 2008 (despite six price rollbacks ever since), among many others, is anticipated to heave the Malaysian economy along a moderating growth trend in the near-to-medium term, in particular in the 2H2008 and 1H2009. Against this backdrop, while Malaysia's full-year GDP growth is likely to be between 5% and 6% in 2008, there is a high likelihood that it will decelerate further to a very modest range of 3.0% and 4.0% in 2009, far below the long-run underlying potential, estimated to be in the vicinity of 6%. Still, Bank Islam foresees remote probability of an outright recession.

There is mounting evidence that the global economy is "re-coupling" as the US slowdown, aggravated by the latest round of the global financial crisis that broke out in mid-September 2008, has in fact spread to the rest of the world, increasing the risks of a synchronised slump in developed economies. Even China's red-hot economy has not been spared, forecast to trend down to below 10% in 2008 and to slightly above 8% in 2009 from the record-smashing 11.9% pace in 2007, partially reflecting the post-Olympics vacuum in economic activities.

Based on the International Monetary Fund's November 2008 forecasts for 2009, the world economy is anticipated to grow by 2.2%, dragged by a 0.3% contraction in advanced economies. This global downturn is expected to result in a much reduced overseas demand for Malaysian goods and services. At the same time, stubbornly high prices of goods and services in particular food stuffs at the consumer level and rather cheerless consumer sentiment are anticipated to negatively affect household spending patterns in Malaysia going forward.

Despite the anticipated easing in retail spending of domestic consumers and foreign tourists, Malaysia's largest sector, the services sector, will continue to play the role of a major growth driver in the 2H2008 and 2009, albeit at a much subdued pace compared to 2007 on account of sustained trade-related and financial activities as well as further output gains in transport (in particular land transportation segment), communication, utilities, health and education.

Notwithstanding fairly restrained expansion in export-oriented industries in particular the E&E segment, still robust domestic-oriented industries across all segments, especially transport equipment, off-estate processing, food and beverages, basic metals, fabricated metal products and non-metallic mineral and other related products should be adequate to ensure a very decent uptick for the manufacturing sector in 2008 and 2009.

The three main construction sub-sectors, namely civil engineering, residential and non-residential will continue to display the effects of sustained demand for residential and non-residential properties as well as the implementation of various projects under the 9MP, the five growth corridors and those related to the Economic Stimulus Package, announced on 4 November 2008. As a result, the construction sector is slated to stage positive growth for three years in a row from 2007 through 2009, a departure from three consecutive years of contraction between 2004 and 2006. Still, the risks of the yet-to-commence projects being deferred or shelved altogether remain a clear and present danger to the construction sector.

The retreat in global commodity prices in particular oil and gas since mid-July 2008 could trigger a pullback in output of commodity sectors, namely agriculture and mining as a response to shore up prices. Nonetheless, the anticipated continued uptrend in production of oil palm, livestock and other agricultural produce such as paddy, fruits, vegetables, coconut, tobacco, tea, flowers, pepper and pineapples should uphold a commendable performance by the agriculture sector, Malaysia's third engine of growth. To a certain extent, mining output is expected to benefit from higher crude oil production from Kikeh oilfield, off-Sabah and Abu oilfield, off-East Coast, Peninsular Malaysia, increased production of natural gas across gas fields as well as intensified exploration and development activities in deepwater and marginal fields.