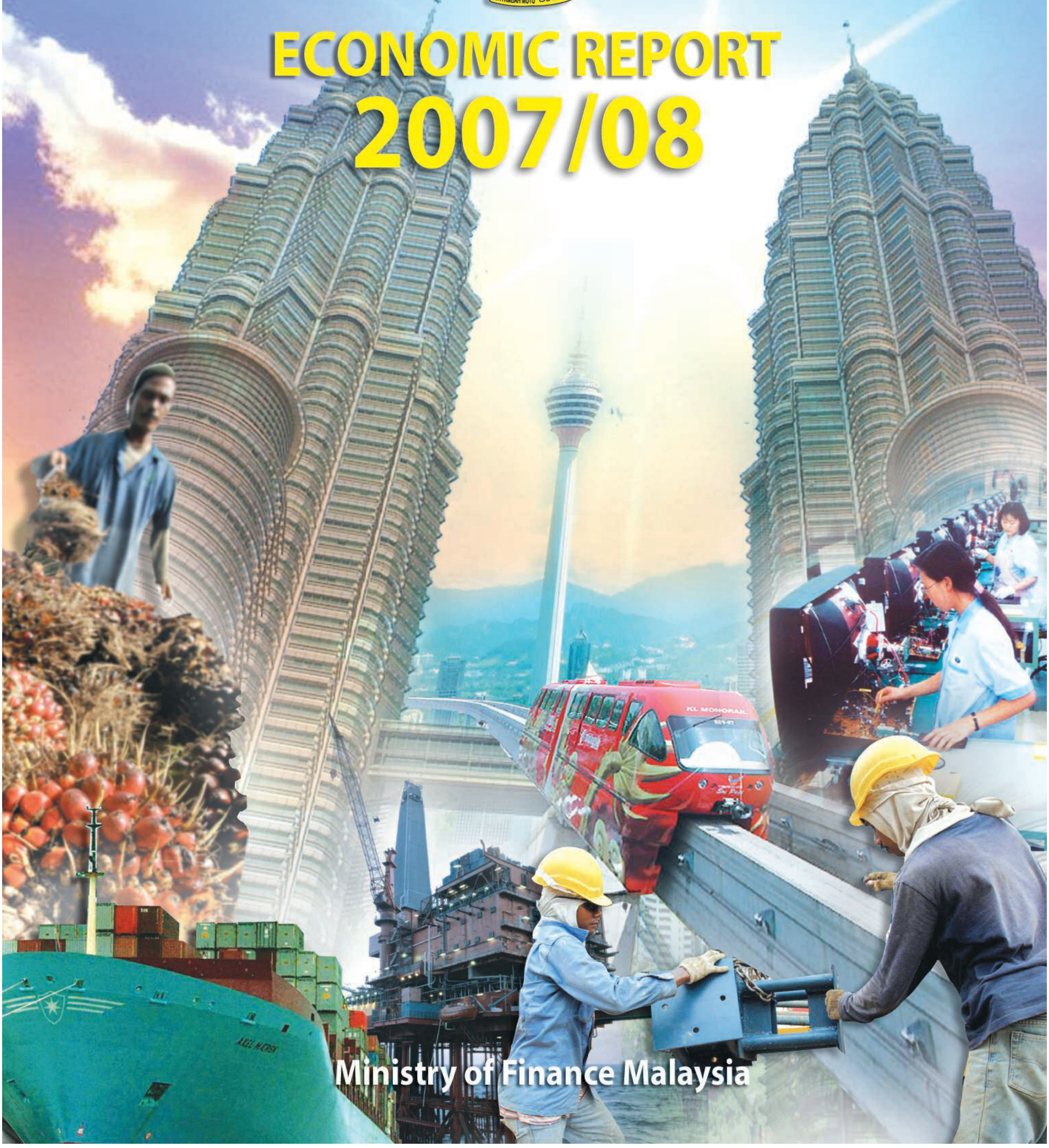
ECONOMIC REPORT 2007/08



Ministry of Finance Malaysia

Services to lead the way

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Services Sector Performance (in 2000 prices)

	Change (%)			Share of GDP (%)		
	2006	2007[1]	2008[2]	2006	2007[1]	2008[2]
Intermediate Sevices						
Transport and storage	5.2	7.6	7.8	3.6	3.7	3.7
Communication	6.8	7.2	7.7	3.7	3.8	3.8
Finance and insurance	7.7	10.7	9.2	10.2	10.7	11.0
Real estate and business services	9.9	15.6	9.8	4.6	5.0	5.1
Final Sevices						
Utilities (electricity, water and gas)	5.2	4.6	5.0	3.1	3.0	3.0
Wholesale and retail trade	7.1	11.6	10.0	11.6	12.2	12.6
Accommodation and restaurants	6.0	9.4	9.5	2.2	2.3	2.3
Other services	4.7	5.0	5.9	5.8	5.7	5.7
Government Sevices	9.8	4.6	8.6	7.1	7.0	7.1
Total	***7.2***	***9.0***	***8.6***	***51.8***	***53.2***	***54.3***

1 Estimate
2 Forecast
Source: Department of Statistics and Ministry of Finance, Malaysia

THE services sector is expected to lead steady growth of the economy in 2008 as all sub-sectors perform favourably, reinforced by the faster pace in construction activities and high global electronics demand.

The wholesale and retail trade as well as accommodation and restaurants are expected to enjoy growth, thanks to strong domestic consumption, higher tourist arrivals and the establishment of new retail outlets.

An improvement in property transaction and expansion in demand for information technology-related and financial services are likely to benefit real estate and business services in addition to the finance and insurance sub-sector.

Similarly, the transport and storage and communication sub-sectors are expected to sustain their performance following the upgrading of port facilities, higher investment in the air and land transportation segments, and enhancement in the telecommunications network.

All in, the services sector is expected to grow 8.6 per cent next year, compared with an estimated nine per cent growth this year.

This year's projection is expected to surpass that of the manufacturing sector and contribute 4.6 per cent point to gross domestic product growth (compared with 3.7 per cent in 2006), signalling the shift in the structure of the Malaysian economy from manufacturing to services.

The intermediate services group — comprising finance and insurance, real estate and business services, transport and storage, and communication sub-sectors — is estimated to grow 10.6 per cent this year compared with 7.6 in 2006.

Final services — which include utilities, wholesale and retail trade, accommodation and restaurants — are expected to grow 8.7 per cent this year compared with 6.1 per cent last year. The growth will be driven by strong household spending and tourism activities.

Malaysia will intensify efforts to attract tourists. — Reuters picture

Tourists to bring in big money

TOURISM, a significant component of the services sector, will continue to remain an important activity contributing significantly to the Malaysian economy.

The government is embarking on strategies to raise the image of Malaysia as a quality, premier and value-for-money destination.

Focus will be on longer-haul and higher-yield segments, supported by private-sector initiatives to develop niche products to meet the demands of high-end tourists.

With aggressive and focused promotional activities, tourist arrivals are expected to increase to 21.5 million next year and bring in receipts of RM49 billion.

This translates into a 7.2 per cent contribution to nominal gross domestic product (GDP).

By 2010, tourist arrivals are anticipated to jump to 24.6 million and generate receipts of RM59.4 billion, providing 520,700 jobs in the process.

This year, foreign exchange receipts are poised to contribute towards 7.1 per cent of GDP, up from 6.7 per cent in 2006.

Tourist arrivals in January-June rose 24.8 per cent to 10.7 million, and are on track to achieve this year's target of 20.1 million arrivals and RM44.5 billion revenue.

The main contribution from tourists is derived by the accommodation providers, who are expected to earn RM17.4 billion this year, up 35.4 per cent from RM12.8 billion last year.

Tourist spending on shopping, meanwhile, is expected to jump 26.3 per cent to RM11.8 billion from RM9.3 billion in 2006.

An emerging segment of tourism is the meeting, incentive, convention and exhibition (MICE) industry.

Some 8,375 international events planned for the year are expected to draw revenue of RM4.5 billion, up from RM2.6 billion last year.

Yet another segment of significant importance, on a long-term basis, is the "Malaysia My Second Home (MM2H) Programme", which, over the decade, has drawn 9,551 foreigners who are predominantly from China.

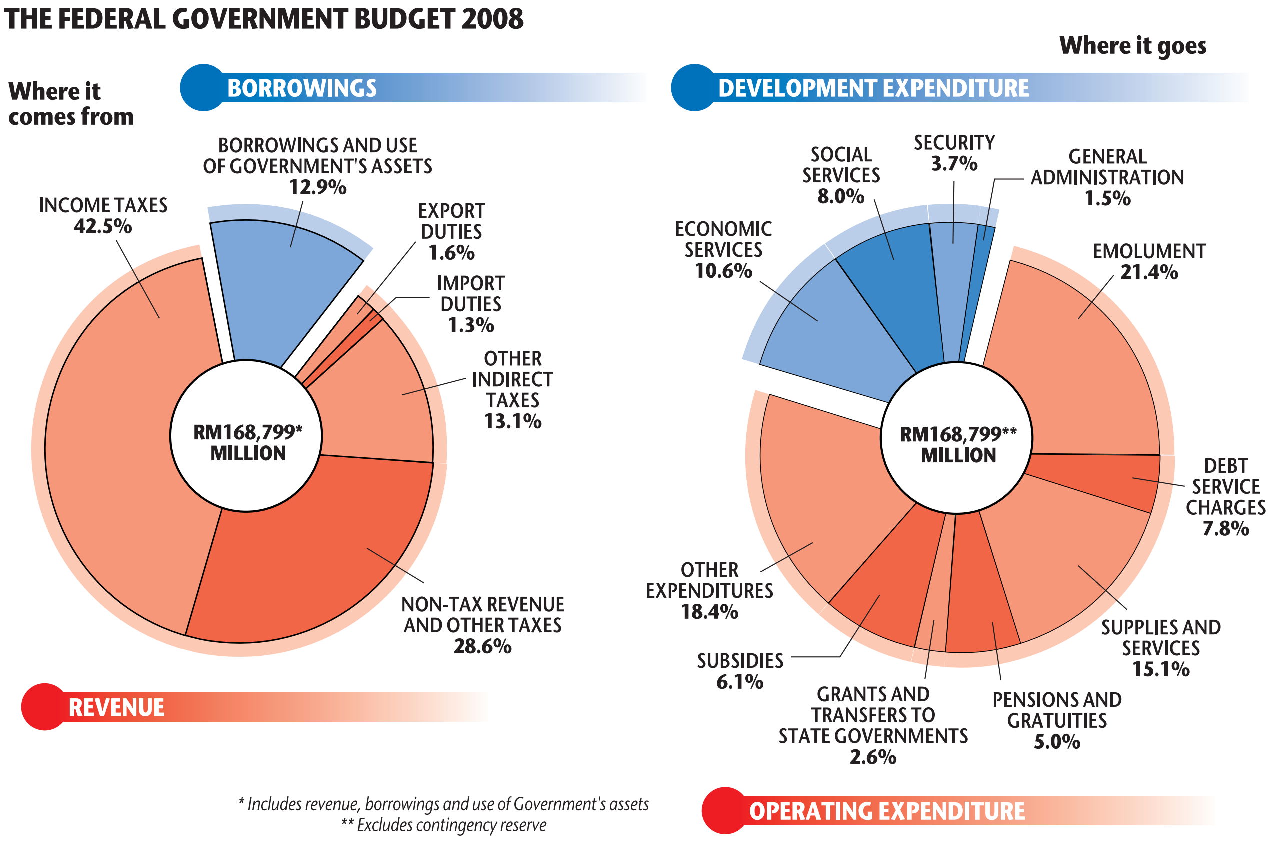
In the first six months of 2007, MM2H attracted 940 participants.

Tourist spending remains the main contributor to earnings in the services account, generating an average of 45.3 per cent of gross receipts annually.

The deficit in the services account is forecast to improve with intensive efforts under way to woo touristsduring the Visit Malaysia Year campaign.

Robust growth ahead

Balance of payments position is also expected to remain strong in 2008 with the current account registering a surplus for the eleventh consecutive year



* Includes revenue, borrowings and use of Government's assets
** Excludes contingency reserve

MALAYSIA is set to register robust gross domestic product (GDP) growth in 2008 with the economy operating under full employment and fiscal deficit trimmed further, the Finance Ministry says.

Real GDP next year is seen expanding at between 6.0-6.5 per cent, after growing at an estimated six per cent in 2007, it said in its Economic Report for 2007/2008.

The services sector will continue to be the major contributor to real GDP on the back of robust activities in finance and insurance, real estate and business services, transport and storage as well as the communications industry.

Besides domestic challenges, the report warned that downside risks to the Malaysian economy in 2008 could come from external sources.

"These risks include geopolitical tensions in the Middle East and other oil producing countries which continue to be a concern causing volatility in the supply and prices of crude oil," the report said.

Although the US was set to continue growing, the wider impact of the subprime mortgage financial crisis on the real sector and the weak US dollar could pose as other risks.

There were also fears of disorderly and sharp adjustments in financial markets on global imbalances, increasing asset prices and financial volatility, it added.

The Malaysian unemployment rate is seen at a mere 3.3 per cent next year signaling full employment, almost unchanged from 2007.

The fiscal deficit is set to fall to 3.1 per cent of GDP in 2008, after dropping from 3.3 per cent in 2006 to 3.2 per cent in 2007, the report said.

Total government expenditure in 2008 is due to expand to RM 176.36 billion on higher revenues projected at RM147.09 billion.

In 2007, expenditure is expected to increase by 14.8 per cent to RM164.74 billion on estimated revenues of RM141.79 billion.

Malaysia's balance of payments position is also expected to remain strong in 2008 with the current account registering a surplus for the eleventh consecutive year.

The report projected a current account surplus amounting to 13 per cent of GDP next year, emanating from the goods and travel account.

Per capita income is set to rise in 2008 to RM23,864 (US$14,206) from RM22,345 (US$13,289) in 2007.

To enhance Malaysia's competitiveness, given rising competition from emerging Asian neighbours such as Vietnam, China and India, the Government plans in 2008 to further expand and extend value-added activities locally.

Emphasis would be given to growth of small and medium enterprises, measures will be introduced to enable existing manufacturers to migrate to higher-end technology and new investments in high-end manufacturing will be promoted.

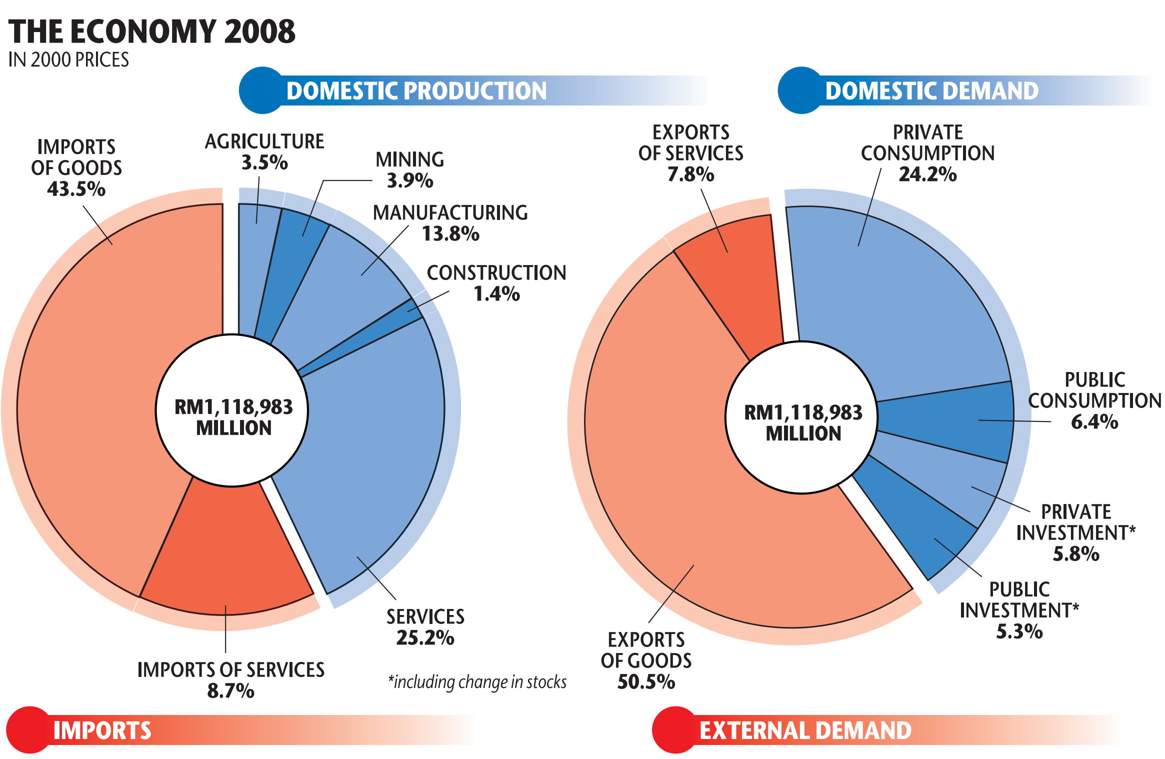
The report said the services sector and agriculture as well as biotechnology would be given emphasis to move up the value chain.

As foreign and local investment played a key role in stimulating the economy, the Government would move to promote greater coherence and clarity in policies and procedures in 2008.

"The goal next year is to develop a performance driven public sector guided by transparent decision making process and integrity," the report said.

Human capital development will remain a focus next year to respond to increasing demand for skilled and knowledge workers.

Infrastructure facilities will be improved with efforts focused on affordable housing and healthcare for the poor, elderly and disabled.



*including change in stocks

CONSTRUCTION

9MP, corridors pave way to better building sector

THE construction sector is poised to strengthen further on the back of ongoing infrastructure projects under the Ninth Malaysia Plan (9MP) and the development of growth corridors.

Growth would also come from the implementation of major transport-related projects such as the second Penang bridge, Penang Monorail, Ipoh-Padang Besar Double Tracking Rail Project and the extension of the Ampang and Kelana Jaya Light Rail Transit lines.

Efforts to develop southern Johor as one of the world's largest integrated petroleum logistics hub and the Northern Corridor Economic Region will add more jobs to the sector.

With all these new developments, the construction industry is expected to grow by 6.3 per cent in 2008 compared with 5.2 per cent in 2007.

The residential and non-residential sub-sectors are also expected to strengthen due to bullish consumer sentiment and better foreign demand.

The removal of real property gains tax and easier approval rules is expected to support the sector.

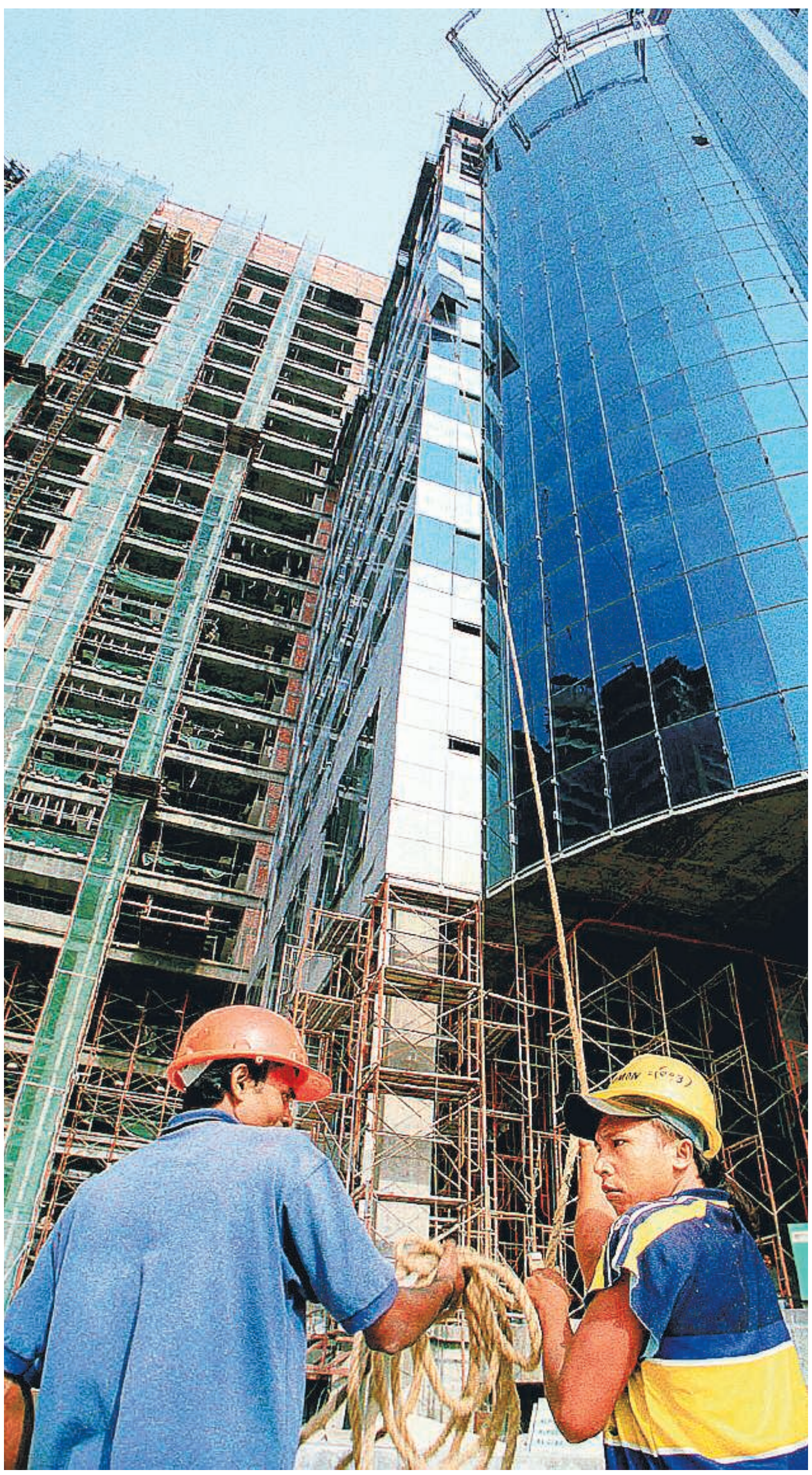
The non-residential sub-sector also registered better performance in line with the strong economic performance in the first half of 2007.

This was reflected by increased construction activity especially for office buildings.

Eight new hotels with 967 rooms were also completed, increasing the existing stock level to 2,180 hotels with 149,820 rooms.

The value of property transactions increased 12.4 per cent to RM32.3 billion.

Residential transactions accounted for 63.6 per cent of the total, agricultural, 20 per cent; commercial, 8.8 per cent, development, 4.9 per cent and industrial, 2.6 per cent.



The construction industry is expected to grow by 6.3 per cent in 2008 compared with 5.2 per cent in 2007. — AP picture

Major Ongoing Construction Projects

9MP Construction Project

- Pantai Timur (Phase II) Highway, Terengganu
- Duta-Ulu Kelang Expressway
- Kuala Lumpur-Putrajaya Highway
- Upgrading of Kota Kinabalu Airport, Sabah
- Goverment Quarters in Putrajaya Phase III
- Universiti Teknologi MARA - Puncak Alam Campus
- Construction of Istana Negara, Jalan Duta, Kuala Lumpur
- Sentul-Batu Caves Double-Tracking project

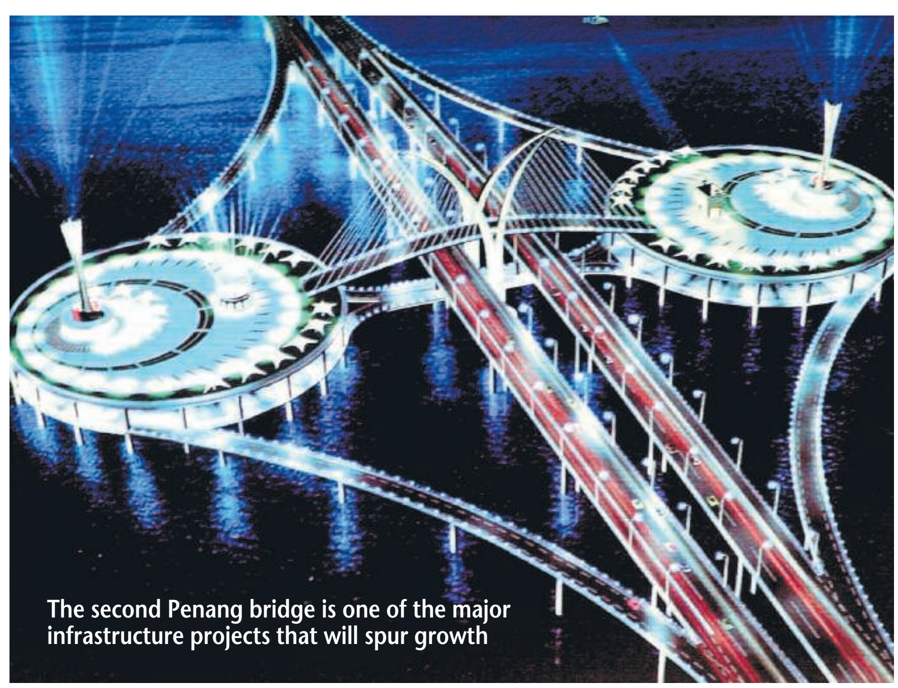
Iskandar Development Region (IDR) Projects

- State Administrative Centre, Nusajaya
- Cleaning of Seget River, Skudai River and Tebrau River
- Construction of two elevated interchanges in Jalan Tampoi
- Construction of Senai Interchange
- Upgrading of Perling Interchange

Northern Corridor Economic Region (NCER) Projects

- Second Penang Bridge
- Upgrading of Penang Bridge

Source: Economic Planning Unit, Malaysia



The second Penang bridge is one of the major infrastructure projects that will spur growth

ECONOMIC REPORT 2007/2008

MANUFACTURING

Rising global demand to push production

Growth will be supported by domestic-oriented industries, particularly chemicals and chemical products, food- and construction-related industries.

THE manufacturing sector is expected to grow faster next year, in line with the expansion in global trade.

Robust global demand for manufactured goods, particularly electrical and electronics (E&E) products, is expected to boost export-oriented industries in 2008.

The rise in global demand will be supported by sustained world growth and strengthening US economy.

Value added in the manufacturing sector is anticipated to grow by 3.8 per cent in 2008, compared with a projected 3.1 per cent in 2007.

For this year, the manufacturing sector's growth will be supported by domestic-oriented industries, particularly chemicals and chemical products, food- and construction-related industries.

The sector's overall performance in the first half of the year was affected by softer external demand, particularly for E&E products, textiles and apparels, and machinery and equipment.

During the period, output in domestic-oriented industries grew 5.3 per cent (January-June 2006: 5 per cent), while export-oriented industries contracted 1.9 per cent (January-June 2006: 11.1 per cent).

Despite contraction in output, export-oriented industries remained as a major contributor to total manufactured output.

The sector's sales rose 2.9 per cent to RM248 billion in the first half of the year (January-June 2006: 9.4 per cent, RM241 billion), contributed mainly by the increase in sales of electronic valves and tubes, and basic iron and steel products.

Chemicals and chemical products industry

Despite higher crude oil prices, the industry's output grew 9 per cent (January-June 2006: 1.7 per cent), which boost its share of the overall manufacturing sector to 10 per cent during the period.

The industry includes agricultural and industrial chemicals, cosmetics and toiletry products, paint and soaps.

Construction-related industry

The industry recorded a 30.8 per cent growth (January-June 2006: 4.3 per cent) due to strong expansion in basic iron and steel and structural metal products, driven by an upturn in construction activities following the implementation of projects under the Ninth Malaysia Plan.

Prospects remain favourable with the expected increase in demand from the property market and new plants coming into operation.

Food products industry

During the period, the industry grew by 12.7 per cent compared with 1.1 per cent in the first half of 2006, driven by higher output in processing and preserving of fish and fish products; and increased output of dairy and grain mill products.

The better overall performance is attributed to the industry's efforts to keep pace with technological advancements and changes in consumer preference.

Wood-based industry

Comprising veneer, panel products, mouldings, furniture and fixtures, this sector expanded by 3.3 per cent, up from 0.9 per cent in the same period 2006. Higher exports to major markets like Japan and the European Union contributed to the growth.

Export-oriented industries remain a major contributor to total manufactured output

Rubber-based industry

The industry continued to grow by 8 per cent in the first half this year (January-June 2006: 0.4 per cent), contributing 3.9 per cent share of total manufacturing output.

Rubber gloves, the largest component of the rubber-based industry, rebounded to 3.6 per cent growth from a contraction of 1.8 per cent in the same period last year, driven by higher usage in the health services industry.

Likewise, sales of latex-based catheters registered double-digit growth of 66.5 per cent from 21.9 per cent contraction the previous corresponding period.

Medical, optical and scientific instruments

The industry recorded a 10 per cent growth, from 8.3 per cent growth in the previous corresponding period, mainly contributed by higher demand for medical and surgical equipment and orthopaedic appliances.

Within the optical and scientific instruments group, output of watches and clocks rebounded by growing 10 per cent from a contraction of 0.4 per cent.

Petroleum products

The industry grew moderately at 8.6 per cent (January-June 2006: 11.9 per cent), in line with lower production of crude oil.

Refined petroleum products registered slower sales of 0.9 per cent from 23.7 per cent last year, due to lower supply of feedstock and weak external demand.

Meanwhile, the plastic products industry registered lower growth in output and sales due to lower supply of petroleum feedstock and weak demand for components from E&E and transport equipment industries.

The production of automotive parts and components, affected by the depressed used car market, contracted by 13.4 per cent.

EXPORTS/EMPLOYMENT

Exports to gather steam in H2

EXPORT growth is expected to pick up momentum towards the second half of the year, supported by firm commodity prices and an upswing in the global demand for electrical and electronics products (E&E).

For 2007, gross exports are expected to remain strong despite a moderate expansion in global trade.

Gross export earnings are projected to grow at 4.8 per cent contributed by manufactured goods which comprise 79.3 per cent of total exports.

Robust global demand for major commodities such as palm oil, crude petroleum and liquefied natural gas is set to boost export receipts of agriculture and mineral products by 33.6 per cent and 8.3 per cent respectively.

Exports moderated to 1.1 per cent in the first six months of the year amid continued soft external demand for E&E products, particularly semiconductor devices, automatic data processing and parts as well as telecommunications equipment and parts.

Export earnings of manufactured goods rose marginally by 0.5 per cent during the first half of 2007 but strong growth in the exports of resource-based manufactured goods cushioned the moderation of E&E exports.

Gross export earnings are projected to grow, contributed by manufactured goods which comprise 79 per cent of total exports

Exports of manufacturing goods (January-July)

	Value (RM million) 2006	Value (RM million) 2007	Change (%) 2006	Change (%) 2007	Share (%) 2006	Share (%) 2007
Electronic, electrical machinery and appliances	**143,088**	**136,759**	**6.9**	**-4.4**	**62.9**	**59.8**
Semiconductors	44,976	46,453	1.0	3.3	19.8	20.3
Electronic equipment and parts	61,294	54,811	13.8	-10.6	26.9	24.0
Machinery and electrical products	36,817	35,495	3.7	-3.6	16.2	15.5
Non-E&E	**84,532**	**92,073**	**16.1**	**8.9**	**37.1**	**40.2**
Chemicals, chemical and plastic products	16,488	20,128	2.4	22.1	7.2	8.8
Petroleum-based products	12,098	11,473	34.9	-5.2	5.3	5.0
Iron, steel and metal products	11,081	12,674	29.3	14.4	4.9	5.5
Wood-based products	6,713	7,363	5.2	9.7	2.9	3.2
Textiles, apparel and footwear	5,408	4,954	8.9	-8.4	2.4	2.2
Food, beverages and tobacco	5,448	6,287	13.3	15.4	2.4	2.7
Rubber-based products	4,249	4,961	28.1	16.7	1.9	2.2
Transport equipment	5,067	4,003	80.0	-21.0	2.2	1.7
Non-metalic mineral products	1,587	1,824	12.0	14.9	0.7	0.8
Other manufactured goods	16,394	18,407	6.2	12.3	7.2	8.0
Total	***227,619***	***228,832***	***10.1***	***0.5***	***100.0***	***100.0***

Source: Department of Statistics, Malaysia

Non-E&E exports grew 8.9 per cent in the first half, supported by higher growth in exports of resource-based products like chemicals, plastics, rubber as well as iron, steel and metal.

Firm demand for food, beverages and tobacco was reflected in double-digit growth in export earnings of the industry. Concerted efforts to develop Malaysia as world halal hub to capture new markets worldwide would provide impetus for further growth of the local food industry.

Gross imports are expected to expand 7.6 per cent in 2007 to RM517.26 million from RM480.77 billion in 2006. During the first six months of the year, gross imports increased 3.5 per cent to RM239.39 billion following strong demand for intermediate goods.

Imports of consumption goods grew with resilient household spending and increased tourist arrivals.

In terms of product sectors, imports included mainly E&E products, machinery, appliances and parts, chemical and chemical products, manufactures of metal as well as iron and steel products.

Malaysia's overall balance of payments position is expected to remain favourable with the current account posting a surplus for the 10th consecutive year.

The surplus in the current account is projected to narrow to 14.8 per cent of the gross national product, with continued expansion in manufacturing and investment activity.

While the surplus in the goods account is poised to be marginally lower, increased tourist receipts and higher earnings in the transportation account are expected to significantly improve the deficit in the services account.

The most number of vacancies was registered in the manufacturing at 33.5 per cent. — AP picture

More jobs in store

THE number of jobs this year is estimated to reach 11.8 million, a two per cent rise over 2006, in line with strong domestic economic activities.

The services sector will continue to provide the most employment opportunities, followed by manufacturing and agriculture.

The unemployment rate is projected to remain low at 3.3 per cent, the Finance Ministry said.

For the second half of the year, new jobs are expected to rise 2.1 per cent to 232,600.

Given the positive employment conditions, job vacancies reported by the electronic labour exchange at the Manpower Department, Ministry of Human Resources, increased by 379,945 during the first half of this year.

The most number of vacancies were registered in the manufacturing and the services sector at 33.5 per cent and 23.6 per cent each respectively.

The number of active job seekers rose to 32 per cent to 93,314 persons during the first six months of this year mainly due to employed persons seeking better jobs.

Retrenchment declined by 18.2 per cent in the first half of this year with 8,382 workers mainly from the manufacturing sector (76.9 per cent) followed by the service sector (19.8 per cent).

Overall, the retrenchments were due to firms rationalising their operations to improve productivity and profits.

Efforts are on-going to reduce the dependence on foreign workers by encouraging employers to adopt new technology and introducing mechanisation and automation in the production process.

The plan is to reduce the number of foreign workers in the country to 1.5 million by 2010.

As at end May 2007, there were 1.91 million registered foreign workers in Malaysia which account for 16.8 per cent of total employment in the country.

Of the total, 34.7 per cent were employed in manufacturing, 25.5 per cent in plantation, and 16.7 per cent as domestic maids.

More than a third of foreign workers were from Indonesia, while the rest came from Nepal and India.

As at end-July 2007, a total of 35,052 expatriates were employed in the country as professionals, specialists and skilled workers, mainly in the services and manufacturing sectors. The majority are from India, Japan and China.

Higher prices set to lift Petronas revenue

NATIONAL oil and gas corporation Petroliam Nasional Bhd (Petronas) is set to post better revenue in years ahead, as it sells more oil and gas at higher prices.

Petronas, which draws its natural gas supplies from Bintulu, has secured liquid natural gas supply contracts to Japan and China.

Shanghai LNG Co Ltd is investing US$900 million (RM3.1 billion) to build a terminal to receive Petronas' liquid natural gas from 2009, for a period of 25 years.

The deal, being the largest trade contract between China and Malaysia, will see Shanghai LNG receive 1.1 million tonnes of liquid natural gas in the first three years, rising to 3 million tonnes after 2012.

Petronas has also secured a 15-year contract to supply 420,000 tonnes of liquefied natural gas per year to Japan's Shikoku Electric Power Co from April 2010.

In the year ended March 31 2007, Petronas made RM76.3 billion in pre-tax profit on RM184.1 billion revenue.

However, operating and capital costs are higher due to shortage in experienced technical personnel and drilling rigs.

Kikeh, Malaysia's first deepwater field, started its oil production last month with an initial rate of 20,000 barrels per day (bpd) and is estimated to peak at an average of 120,000 bpd by the end of 2008.

Petronas' other significant investment include buying 10 per cent of Cairn India Ltd which has several oil exploration and production facilities in India.

The Kikeh deepwater field is expected to boost Malaysia's production of crude oil

Oil and gas to fuel mining activities

MALAYSIA'S mining sector is forecast to grow by 4 per cent in 2008, driven by the oil and gas sector as Malaysia's first deepwater field, Kikeh, started production last month.

The mining industry is estimated to grow by 3.3 per cent this year.

The production of crude oil is due to increase with the completion of major maintenance and rejuvenation of several oil wells over the past few years.

This will rise with expanded capacity from the Kikeh oil field.

Similarly, the production of liquefied natural gas is expected to increase as facilities in MLNG Dua plant in Bintulu, Sarawak, is upgraded and expanded.

In the first six months of this year, production of crude oil, including condensate increased 2.7 per cent to 678,207 barrels per day (bpd), compared with 660,589 bpd.

As a result, production of crude oil is expected to increase 3.5 per cent to 690,000 bpd this year, against 666,925 bpd last year.

As high crude oil prices are expected to remain firm in the medium term, more exploration activities, especially for deepwater oil and gas fields are being carried out.

This year alone, four new fields were discovered in Peninsular Malaysia, Sabah and Sarawak.

Reserves for crude oil and condensate now stands at 5.4 billion barrels and is estimated to last 22 years, while gas reserves are at 88.92 trillion standard cubic feet that can last 34 years.

Production and Reserves of Crude Oil and Natural Gas

	2006	2007[1]	Change (%) 2006	Change (%) 2007[1]
Crude oil				
Production *('000 barrels per day)*[2]	666.9	690.0	-5.2	3.5
Reserves *(billion barrels)*	5.3	5.4	1.7	2.1
Reserves/production *(years)*	21	22		
Natural gas				
Production[3] *(million standard cubic feet per day) (mmscfd)*	6,258.9	6,439.6	8.0	2.9
Reserves *(trillion standard cubic feet)*	87.95	88.92	3.2	1.1
Reserves/production *(years)*	34	39		

1 Estimate 2 Including condensates 3 Excluding flaring and reinjection
Source: Petroliam Nasional Bhd

More exploration activities have also spurred demand in related industries, including chemical industry, equipment manufacturing, steel fabrication as well as air and sea charter services.

Although global crude oil prices continue to rise due to supply constraints, there is a lack of skilled manpower while the cost of exploration and production is higher.

For instance, daily charter rates for drilling rigs have increased by more than 200 per cent, while prices of steel and line pipes increased by about 40 per cent.

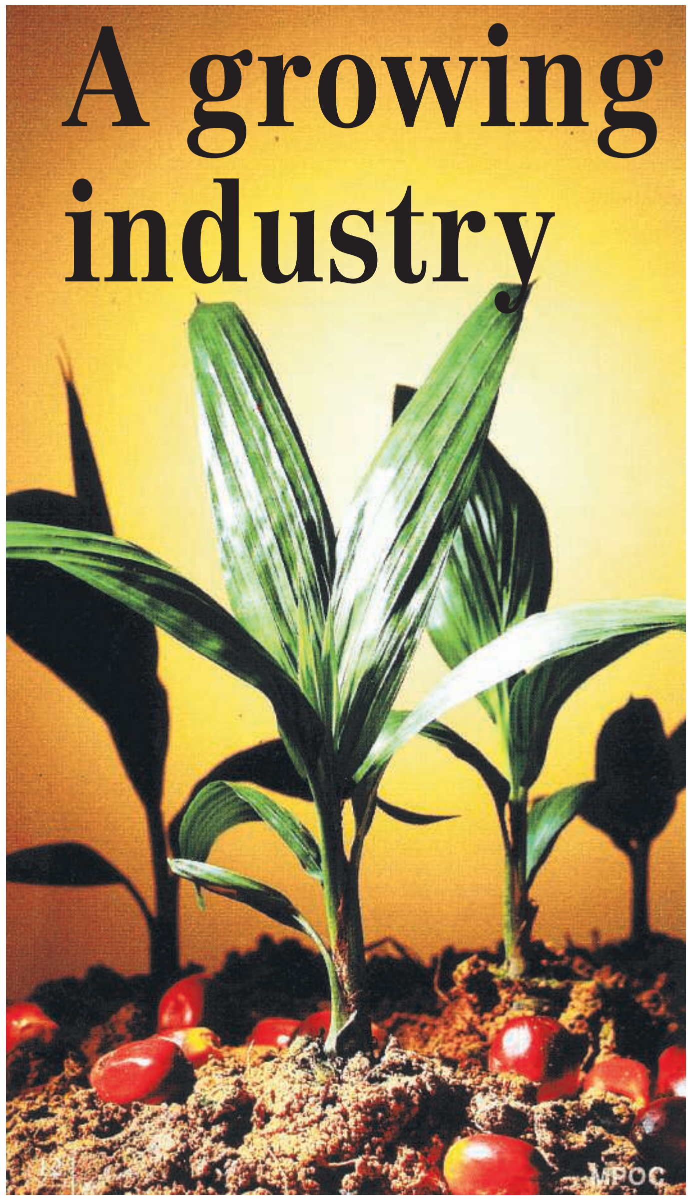
At the same time, demand for oil, particularly from China and US, is strengthening.

Against this backdrop, global oil prices were sustained at above US$65 (RM227) per barrel levels during the first seven months of this year.

In line with this, the average export price of Malaysia's Tapis blend crude oil remained high at US$70.98 (RM248.43) per barrel.

AGRICULTURE

A growing industry



Rapid developments in the agro-food industry and promotion of other sources of growth in agriculture, including aquaculture, horticulture, seaweed, deep sea fishing as well as kenaf planting will further boost the output of the sector.

MALAYSIA'S agriculture sector is expected to grow 3.5 per cent this year compared to 3.1 per cent in 2006 on the back of rising output in food commodities, higher oil palm and rubber production, as well as the Northern Corridor Economic Region-led projects.

Agriculture remains an important contributor to the economy, estimated to account for 7.7 per cent of Malaysia's gross domestic product (GDP) in 2007 compared to 7.9 per cent in 2006.

Related developments in the Northern Corridor could further boost the sector's contribution to GDP growth.

Palm oil output, for instance, is expected to increase two per cent following improved yields and expansion in matured areas.

In addition, measures are being taken to boost output through the wide use of high-quality seedlings and latest technologies, as well as knowledge-based production systems, which will result in higher palm oil output.

Rubber production is also expected to expand supported by firm prices, which is likely to encourage smallholders to increase tapping activities and the utilisation of better clones, stimulants and low-intensity tapping systems.

Rapid developments in the agro-food industry and promotion of other sources of growth in agriculture, including aquaculture, horticulture, seaweed, deep sea fishing as well as kenaf planting will further boost the output of the sector.

Livestock industry output is also envisaged to increase, contributed by integrated farming projects involved in rearing of goats and cattle in oil palm and rubber plantations.

With modern rearing systems, poultry and eggs production is expected to rise to meet local and external demand.

Value-added activities in the agriculture sector is estimated to ease at 3.1 per cent this year compared to 5.2 per cent in 2006, coming from higher output in food commodities, including livestock, fishing and other agriculture sub-sectors.

Higher value-added of the agro-food sub-sector is in line with the Government's efforts to reduce the food import bill and increase meat and dairy products' self sufficiency level — supported by initiatives to set up the National Feedlot Centre and Permanent Food Production Parks.

Crude palm oil production is expected to be lower this year at 15.7 million tonnes compared with 15.9 million tonnes in 2006 due to major floods that destroyed crops in the early part of the year.

Nevertheless, the new matured areas coming onstream, better estate management and higher quality agricultural inputs are expected to partially offset the negative impact of unfavourable weather.

Despite strong rubber prices, rubber production declined 3.5 per cent to 589,379 tonnes in the first six months of this year compared with 17.9 per cent to 610,512 tonnes in the comparable period in 2006.

The fall was mainly due to the wintering season and excessive rainfall which disrupted rubber tapping activities. As a result, rubber production in 2007 is expected to expand 1.3 per cent compared with 14 per cent in 2006.

Value-added activities in the fishing industry expanded by four per cent in the first six months of 2007 compared with 9.4 per cent in the same period a year ago, attributed to higher marine fish landings due to expansion in deep-sea fishing.

Value-added livestock is also projected to expand strongly by 10.1 per cent in 2007 compared with 6.9 per cent in 2006 led by integrated farming with rearing of cattle and goats in oil palm and rubber plantations.

Other agriculture sub-sectors — which include paddy, pineapples, tobacco, coconut, vegetables, fruits, tea, flower and pepper — is projected to increase strongly by five per cent this year compared with 4.2 per cent in 2006 on the back of higher production of vegetable and fruits, expansion in cultivated areas, organic and modern farming.

Value Added in the Agriculture Sector (in 2000 prices)

	Growth (%)		Share to Agriculture (%)	
	2006	2007[1]	2006	2007[1]
Agriculture	5.2	3.1	100.0	100.0
Oil palm	5.8	-0.6	30.5	29.4
Rubber	12.6	1.0	6.9	6.7
Forestry and logging	-0.4	2.8	22.2	22.1
Other agriculture[2]	5.3	7.0	24.6	25.7
Fishing	9.3	5.2	15.8	16.1

1 Estimate

2 Including livestock, paddy, cocoa, fruits, vegetables, copra, tobacco, tea, flowers, pepper and pineapples

Source: Department of Statistics and Ministry of Finance, Malaysia

Rapid developments in agriculture will further enhance agriculture output

Resilient capital markets

MALAYSIA'S capital markets should be able to withstand any fallout from troubles in the US low-quality housing loan market.

Corporate debt issues will be driven by new investment activity, mergers and acquisitions and government-driven projects, like the Iskandar Development Region.

International competition in Islamic finance is expected to intensify, and Malaysia will continue to build on its Malaysia International Islamic Financial Centre initiative.

In the first six months of 2007, gross funds raised in the capital market jumped 53.3 per cent to RM56.1 billion.

The issue of government securities increased significantly by 81 per cent to RM26.2 billion to finance development projects.

New private debt securities (PDS) issued by companies expanded 33.7 per cent to RM28.6 billion in the January-June period.

Islamic bonds continued to dominate the PDS market, with Islamic medium-term notes and bonds contributing 52.3 per cent of PDS issued.

Meanwhile, funds raised in the equity market rose 71 per cent to RM1.3 billion in the first six months this year as companies took advantage of a rising market.

In the first half of this year, the Securities Commission approved 35 takeover offers valued at RM66.2 billion, significantly higher from the 15 proposals, worth RM8.3 billion, approved in the same period last year.

The robust merger and acquisitions were supported by ample liquidity and driven by the need for economies of scale and new export markets.

Banking System: Direction of Lending

	End-2006	End-Jun 2007	End-Jun 2007
	RM million		Share (%)
Primary agriculture	13,224.6	13,690.6	2.2
Mining and quarrying	1,380.8	1,531.9	0.2
Manufacturing *(including agro-based)*	66,125.0	70,825.3	11.5
Electricity, gas and water supply	4,659.6	3,439.3	0.6
Wholesale and retail trade, hotels and restaurants	52,690.8	52,563.3	8.6
Construction	31,410.9	31,597.8	5.1
Real estate	16,907.1	17,539.1	2.9
Transport, storage and communications	11,385.5	13,931.0	2.3
Finance, insurance and business activities	34,183.6	38,593.5	6.3
Education, health and others	6,157.3	6,758.7	1.1
Household sector	334,812.5	344,521.2	56.1
Other sectors	20,024.3	19,011.7	3.1
Total	***592,962.0***	***614,003.4***	***100.0***

Source: Bank Negara Malaysia

In the first five months of this year, 45 new unit trusts were launched, bringing the total to 435 funds at the end of May this year compared with 392 funds at the end of last year.

The Islamic unit trust segment continued to grow with 12 new funds started, bringing the total to 106 funds at the end of May.

Net asset value of the unit trust industry rose 18 per cent to RM143.7 billion, which accounted for 13.5 per cent of Bursa Malaysia's market value.

As at May this year, 128 unit trust funds worth a combined RM10.8 billion invested in foreign markets as a result of more relaxed rules from the regulator.

Four real estate investment trusts (REITs) were listed in the first half of 2007, bringing the total to 13.

The development of exchange traded funds (ETF) has, however, been slow with only two listed on Bursa Malaysia so far.

More are expected to come in the near future, following the call to government-linked investment companies to sell part of their portfolio in exchange for units in ETFs.

Keen interest in Islamic finance

BANK Negara Malaysia has so far received one application to set up an international Islamic bank under the Malaysian International Islamic Financial Centre (MIFC) initiative.

Under the initiative, an international Islamic bank is allowed to carry out Islamic banking services for non-residents in local and foreign currencies.

There has been strong interest from local and foreign financial institutions to be part of Malaysia's Islamic finance industry. This is particularly seen in the setting up of International Islamic Banks, international takaful operators and international currency business units (ICBUs).

As of July 2007, eight financial institutions comprising three takaful operators and five Islamic banks have approvals to set up ICBUs. The MIFC initiative was launched in August 2006 and is supported by attractive tax incentives under Budget 2007.

A major progress is the proposed sukuk issuance by Japan Bank for International Cooperation, which will be the first by a Japanese government agency.

The ringgit-denominated sukuk will be issued soon in the Malaysian capital market, said the report.

Bloomberg reported early this year that the sukuk, to be offered to international investors, will be between US$200 million (RM702 million) and US$300 million (RM1.05 billion).

On the development of Islamic financial sector, the report said it continues to grow as an integral part of the Malaysian financial system.

As of July 2007, there were 11 Islamic banks (formerly Islamic banking windows), two domestic banks and three foreign banks.

The foreign Islamic banks, it added have rapidly expanded their branch network to a total of 15 branches.

Meanwhile, 70 per cent of the recommendations under the 10-year Financial Sector Masterplan (FSMP) have been implemented, strengthening the position of financial institutions to compete in a more liberalised environment.

As of June 30 2007, 53 recommendations of the FSMP, which was launched in 2001, have been fully implemented, while another 30 are being implemented.

The FSMP has a total of 119 recommendations, with two additional completed during the first half of this year.

The two extra ones were on the issuance of prudential risk management standards and the removal of investment restrictions.

The progress of the FSMP has been satisfactory, the Finance Ministry said.

The Islamic financial sector continues to grow as an integral part of the Malaysian financial system.

Improvements in GLC performance

The 20 biggest GLCs have shown stronger financial results, particularly in terms of shareholder value

THREE years on since embarking on a transformation programme, Government-linked companies (GLCs) and their stakeholders have derived significant benefits.

"Many GLCs have experienced changes, particularly their business policies and practices, thereby resulting in performance improvements," according to the Economic Report.

The Government had initiated the transformation programme — encompassing four phases and spanning a 10-year period till 2015 — in May 2004. The programme is now in its third phase.

The first phase of the programme, completed in 2005, had focused on efforts to enable top management and employees to understand the direction and expectations of the Government.

Measures that were taken included constructing key performance indicators (KPIs), reforming the composition of board directors, revamping Khazanah Nasional Bhd (the entity spearheading the transformation programme) and enhancing the leadership capabilities of GLCs.

The second phase, completed in December 2006, had the key objective of generating momentum for GLC transformation.

For the third and current phase, spanning 2007 to 2010, the target is to entrust GLCs to deliver tangible and sustainable results over the medium term.

This is the period where there is expected to be large-scale strategic and financial changes made to GLCs and where there should be visible benefits to all stakeholders such as customers, vendors and employees.

By the final phase of the programme, from 2010 to 2015, it is expected that two to three of the GLCs will have become true regional champions. Most GLCc are expected to be operating competitively by then, like their counterparts in the private sector.

"Currently, the progress of GLC transformation is in line with the initial targets," the report said.

FOUR PHASES OF THE GLC TRANSFORMATION PROGRAMMES

PHASE 1: Mobilisation, Diagnosis and Planning	**PHASE 2: Generate Momentum**	**PHASE 3: Tangible Results**	**PHASE 4: Full National Benefits**
Period: Middle 2004-2005 (14 months)	Period: Middle 2005-2006 (12-17 months)	Period: 2007-2010 (3 years)	Period: 2010-2015 (5 years)
Measures: • KPI-PLCs • Performance Contracts • Board Composition Reform • Revamp of Khazanah • GLC Leadership Change	***Measures:*** • Issuance of Transformation Manual (July 29 2005) • Laying out Policy Guidelines • Implementation of Programmes and Initiatives laid out in the Transformation Manual	***Measures:*** • Continuation of the implementation of programmes and initiatives laid out in the Transformation Manuals and guidelines	***Measures:*** • Continuation of the implementation of programmes and initiatives laid out in the Transformation Manuals and guidelines
Targeted outcomes: • Diagnosis of GLCs conducted • Determination of Policy Principles • Initial 2004 initiatives launched	***Targeted outcomes:*** • 2005/06 initiatives implemented • Full roll-out in place • Key policies endorsed and executed upon • Early fruits of sustainable improvements	***Targeted outcomes:*** • Tangible and sustained benefits across all GLCs • Visible benefits to all stakeholders, e.g. customers, vendors, employees, etc • Large scale strategic and financial changes made • Material changes to boards	***Targeted outcomes:*** • 2-3 GLCs will be true regional champions • Most GLCs performing at par with competitors

Source: Adaptation from Summary of Transformation Manual, the PCG, March 2006

The final phase (phase 4) will commence in 2010 and is scheduled for completion in 2015. It is envisaged by then some of the GLCs will become regional champions, operating competitively like their counterparts in the private sector.

The 20 biggest GLCs held by government-linked investment companies — known as the G20 — have shown improved financial performance, particularly in terms of shareholder value, thereby gaining further market acceptance.

As at May 31 2007, the G20 total shareholder return index outperformed the benchmark Kuala Lumpur Composite Index by 2.7 per cent.

In 2006, the G20 registered a 52 per cent increase in earnings to RM10.52 billion from RM6.7 billion before. This compares to an earnings contraction of 32 per cent in 2005.

Nine of the G20 managed to achieve all their targetted KPIs, while 10 other companies met almost all. These KPIs generally focus on improving turnover, profit and return-on-equity.

The Economic Report also highlighted that while the transformation programme has brought about a positive impact on the GLCs, there are also some downside effects. However, it did not elaborate on these effects.

"To strike a right balance between benefits and challenges, the Putrajaya Committee for GLC Transformation together with GLCs are actively engaging stakeholders to reach a common understanding on the objectives and the long-term benefits of GLC transformation," it said.

There are 47 GLCs listed on Bursa Malaysia as at May 18 2007, accounting for 7.2 per cent of total listed companies and 34.9 per cent of market capitalisation.

TNB operating expenses expected to rise

TENAGA Nasional Bhd's (TNB) operating expenses is expected to rise, partly due to additional payments to independent power producers.

This follows the commissioning of the second unit of the Tanjung Bin power plant.

However, lower general expenses and better recovery of bad debts should counter the effect.

TNB will spend to upgrade existing power stations in Port Dickson and Paka, substations, intake stations, transmission lines and power distribution through northern and east-west grid in Sabah.

About 55 per cent of TNB's borrowings are for domestic projects while the remaining foreign debt are denominated in US dollars and Japanese yen.

TM focusing on mobile ops

TELEKOM Malaysia Bhd (TM) is focusing on international and domestic mobile operations to improve its financial results in the immediate years.

In recent years, it expanded its mobile operations to Indonesia, Bangladesh, Sri Lanka and India, resulting in higher operating expenditure.

TM will continue to invest abroad. One major project is the Asia-America Gateway (AAG) Cable Network System linking the southeast Asian region directly to the US.

The AAG is an alternative link for Internet traffic to the existing Asia Pacific Cable Network 2 which was disrupted by the Taiwan earthquake in 2006.

TM is leading the consortium of 17 major international telecommunication service providers on this project which is expected to be operational by December 2008.

ECONOMIC REPORT 2007/2008

ECONOMIC PERFORMANCE

Private sector key engine of growth

THE growth momentum for domestic demand is expected to strengthen in 2008, driven mainly by strong spending and investment by the private sector.

The private sector expenditure and investment will be driven by positive developments supporting domestic economic activity this year, including the implementation of the Iskandar Development Region and the Northern Corridor Economic Region.

Private sector expenditure is likely to grow at a higher pace next year, at 8.2 per cent, compared to public sector spending growth of 3.2 per cent. Overall, the domestic demand expenditure is expected to expand 6.8 per cent.

The private sector's role as the key engine of growth is reflected in its projected high contribution of 5.1 percentage points to GDP growth in 2008, against the public sector's contribution of 0.8 percentage point.

Private consumption should also increase in 2008, due to higher disposable income as a result of firm commodity prices, sustained domestic economic activity and stable employment condition.

The public sector consumption growth, meanwhile, will be driven by higher expenditure for emolument in tandem with increased productivity in the public service.

Investment activity is expected to strengthen as well, following various measures taken by the government to improve the business climate, including further reduction of another one percentage point in corporate tax to 26 per cent in 2008.

Also, the government's measures to strengthen intellectual property rights, including the setting up of additional special courts, are expected to boost investors' confidence and generate more research and development activities.

A Statistics Department survey indicated higher capital outlay by the private sector for the first half of this year, increasing by 16.6 per cent.

The services sector is expected to contribute the largest share to capital outlay at 48.6 per cent, followed by mining and electricity (23.7 per cent), manufacturing (23.1 per cent) and agriculture (2 .6 per cent).

Malaysia also continues to attract foreign direct investment (FDI) amid a competitive environment. In the first quarter this year, the total net FDI recorded growth of 54.1 per cent to RM5.7 billion, contributed mainly by the manufacturing sector at 52.2 per cent of total FDI.

Private investment is expected to increase 9.5 per cent next year, accounting for 11.9 per cent of GDP. In 2007 it grew 7.1 per cent to account for 11.6 per cent of Malaysia's GDP.

Public investment growth is expected to be at 0.5 per cent next year, with a share of 10.8 per cent to GDP.

For 2007, private sector expenditure is envisaged to strengthen further by 8.6 per cent in line with positive consumer sentiment and a favourable business environment.

Growth in private consumption is expected to increase by 9 per cent this year, driven by stable interest rates, higher disposable income as well as positive wealth effect from a bullish stock market and strong commodity prices. Public consumption is expected to expand 10.8 per cent this year.

GROSS DOMESTIC PRODUCT (GDP) BY AGGREGATE DEMAND

(in 2000 prices)	Change (%)			Share of GDP (%)			Contribution to GDP growth (percentage point)		
	2006	2007[1]	2008[2]	2006	2007[1]	2008[2]	2006	2007[1]	2008[2]
GDP	5.9	6.0	6.0-6.5	100.0	100.0	100.0	5.9	6.0	6.0-6.5
Domestic demand[3]	7.0	9.0	6.8	84.1	86.5	86.9	5.8	7.6	5.9
Private expenditure	7.0	8.6	8.2	60.1	61.5	62.7	4.2	5.2	5.1
Consumption	7.1	9.0	7.9	48.6	49.9	50.8	3.4	4.4	4.0
Investment	7.0	7.1	9.5	11.5	11.6	11.9	0.8	0.8	1.1
Public expenditure	6.8	10.1	3.2	24.0	25.0	24.2	1.6	2.4	0.8
Consumption	5.0	10.8	5.5	12.9	13.5	13.4	0.6	1.4	0.7
Investment	8.9	9.3	0.5	11.1	11.5	10.8	1.0	1.0	0.1
Change in stocks				-0.2	-0.2	0.4	0.1	-0.1	0.7
External sector	0.1	-9.6	-1.9	16.1	13.7	12.7	0.0	-1.5	-0.3
Exports[4]	7.4	4.1	5.7	125.0	122.7	122.0	9.1	5.2	6.9
Imports[4]	8.6	6.2	6.6	108.9	109.0	109.3	9.1	6.7	7.2
GDP *(RM billion, current value)*	572.6	625.1	681.7						
Change (%)	10.2	9.2	9.1						

[1] Estimate [2] Forecast [3] Excluding change in stocks [4] Goods and services
Source: Department of Statistics and Ministry of Finance, Malaysia

Private consumption is expected to increase in 2008 due to higher disposable income

Fiscal position to remain manageable

A MORE favourable economic outlook will help maintain the fiscal position of the federal government at a manageable level in 2008.

The thrust will be on efficiency and effectiveness and value-for-money spending, while fiscal consolidation will not be at the expense of economic growth.

In 2008, the fiscal deficit is projected to further decline to 3.1 per cent of the gross domestic product.

Economic management strategies in 2008 will focus on three main areas — enhancing the nation's competitiveness, strengthening human resource development and ensuring the well-being of the people.

To achieve this, the Budget will allocate RM168.79 billion, up 2.5 per cent from that in 2007. Of this, RM128.79 billion is for operating expenditure and the balance of RM40 billion, development expenditure.

Operating expenditure is projected to increase 4 per cent over last year's, mainly for charged and locked-in items.

Emoluments will receive the biggest allocation amount of RM36.18 billion to further improve the public sector delivery system as well as to enhance the efficiency and productivity of government employees.

Other major allocations include RM63.96 billion in grants, transfers, subsidy payments (mainly for petroleum and diesel products), and supply and services (RM25.48 billion).

Agriculture, considered as a high-growth potential area, has been allocated RM6.52 billion, while RM40 million will go to the development and promotion of a halal hub and a halal park.

With tourism being recognised as a major source of foreign exchange earnings, the Ministry of Tourism will be given RM858 million.

Apart from the promotion of tourism domestically and abroad, emphasis will be on the development of eco-tourism products, provision of tourism infrastructure and promotion of the MalaysiaKitchen Programme.

Some RM6.54 billion is allocated for construction and maintenance of roads, bridges and rail. Airports and ports are given RM1.28 billion and water supply and sewerage, RM2.82 billion.

A further RM9.18 billion is allocated to all ministries and agencies for maintenance of government assets.

Tax administration will improve and there will be efforts on enforcement to boost revenue collection. Revenue is expected to increase by 3.7 per cent to RM147.09 billion in 2008 compared to 2007 as a result of a robust economy with revenue from taxes increasing by 6 per cent to RM101.99 billion.

The collection of direct and indirect tax will increase by 6.8 per cent to RM74.92 billion and by 3.8 per cent to RM27.08 billion respectively.

GLOBAL PROSPECTS

China is expected to be one of the leading recipients of foreign direct investments. — Bloomberg picture

Economies to expand despite challenges

THE world economy is expected to continue expanding in 2008, amid a challenging environment of high crude oil prices, subprime mortgage crisis in the US and other risks.

Global growth next year is expected to be generally more broad-based across regions and countries, and will continue to spur world trade and investment flows.

Global foreign direct investments (FDIs) will remain strong, driven by rising merger and acquisition activities, sustained economic growth and an increase in fixed capital spending.

Leading FDI recipients among the developed countries would be the US, Belgium, Luxembourg, France and the UK, while China, Hong Kong, Singapore and India are expected to be the top four among newly-industrialised and emerging economies.

Growth in world trade volume is projected at 7.4 per cent in 2008 compared with 7.1 per cent this year, supported by steady demand-driven expansion in global high-technology industries, commodities and services.

The positive outlook, however, could be affected by a fallout of the US subprime mortgage crisis, impacting on the real economy of the US and the global economy.

The ensuing credit crunch had prompted US central bank intervention early last month to ease pressures on the global financial system, but how effective these measures are remains to be seen.

Other near-term risks include the possibility of a disorderly unwinding of global imbalances and global inflationary pressures arising from higher crude oil prices.

In the longer term, risks that could undermine growth include trends such as ageing population and rising protectionist sentiments, as well as environmental consequences of rapid development.

These issues will continue to be discussed at various regional and multilateral forums, with a view to ensuring economic stability and sustainable development.

Notwithstanding these risks, the global economy is anticipated to continue expanding at 5.2 per cent in 2008 with Japan, Europe and emerging Asia, in particular China and India, counterbalancing a possible moderation of the US economy.

Malaysia is well positioned to take advantage of the growing external market as well as the increasing trade and investment opportunities, supported by continuous efforts to enhance national competitiveness and resilience.

Real Gross Domestic Product (GDP) Growth for Selected Countries
(% change)

	2006	2007[1]	2008[2]
World	**5.5**	**5.2**	**5.2**
Advanced Countries	**3.1**	**2.6**	**2.8**
US	3.3	2.0	2.8
Euro area	2.8	2.6	2.5
UK	2.8	2.9	2.7
Japan	2.2	2.6	2.0
Asia			
China	11.1	11.2	10.5
Hong Kong SAR	6.8	5.5	5.0
South Korea	5.0	4.4	4.4
Taiwan	4.6	4.2	4.3
India	9.7	9.0	8.4
Asean 5	5.4	5.5	5.8
Indonesia	5.5	6.0	6.3
Thailand	5.0	4.5	4.8
Singapore	7.9	7.0	5.7
Philippines	5.4	5.8	5.8
Malaysia	**5.9**	**6.0**	**6.0-6.5**

1 Estimate
2 Forecast
Source: IMF and national authorities

Initiative will enhance region's financial stability

THE Chiang Mai Initiative (CMI), a regional liquidity support facility, will help enhance financial stability in the region.

Under this arrangement, the central banks of Asean, together with those of Japan, South Korea and China, agree to make available lines of credit to each other in the event of a temporary balance of payments or liquidity crisis.

A task force has been set up to study the possible options and, as an initial step, will focus on establishing a self-managed reserve pooling arrangement governed by a single contractual agreement.

An offshoot of the 1997/98 Asian financial crisis, the CMI was launched in recognition of the need to collaborate more cohesively, both as a buffer against the recurrence of a similar crisis as well as to meet the challenges posed by globalisation and liberalisation.

The CMI comprises the Asean Swap Arrangement (ASA) and a network of bilateral swap arrangements (BSA).

The ASA, launched in 1977 with a total facility of US$100 million (RM350 million), has since expanded to include all Asean member countries, with a total sum of US$2 billion (RM7 billion) now at members' disposal.

A member country can request to swap its domestic currency for US dollars, yen or euro up to twice its committed amount and for up to six months. Drawdown from the ASA can be made within seven business days upon request to the designated agent bank managing the facility.

For the BSA, the size of the swap arrangement under each agreement signed between Asean + 3 member countries is determined through bilateral negotiations. To date, 16 BSAs totalling US$80 billion (RM280 billion) have been signed involving eight member countries.

Recognising the importance of macroeconomic and financial surveillance in the early detection of system risks within the region, the CMI also provides for timely data exchanges and regular reviews.

The biannual Informal Asean + 3 Finance and Central bank Deputies Meeting sees exchange of information and encourages frank and candid discussions on regional issues.