

economic outlook

1.1 WORLD ECONOMY

Following a lacklustre performance in 2002, the global economy registered a slightly better performance in 2003 as economic activities, mainly in the US and East Asia picked up momentum in the second-half of the year. Forward-looking economic indicators released during the third quarter of 2003 showed that most advanced countries are on track of further acceleration in economic activities in 2004, with the US again being the main driver of global growth, supported by continued recovery in Japan and Europe. The International Monetary Fund (IMF) has maintained its projections for global GDP growth at 4.1% in 2004. World economic growth may then stabilise at around 3.5% - 4.0% in 2005 and 2006.

The US economy is expected to record an even faster growth of about 3.5 - 4.0% in the first half of 2004, before slowing down in the second half of the year. For the whole of 2004, the US economy is projected to grow by 3.5 - 4.0% (2003: 2.7%). The Federal Reserve is expected to begin undertaking gradual tightening moves in the second-half of 2004 and this may slow economic activity in 2005 and 2006, with real GDP growth projected to be within the range of 2.8% - 3.3%.

In Japan, the economy unexpectedly rebounded strongly in the first half of 2003, with growth in real GDP accelerating to 3.0% (2H 2002: 2.0%). However, the pace is expected to moderate to 1.0 - 1.5% in 2004 (2003: 2.1%) as final domestic demand is expected to remain weak and deflationary pressure to persist. However there is a potential for stronger economic growth in 2005 and 2006 as the structural reforms that have been put in place in the preceding few years would boost efficiency and productivity. Real GDP growth is projected to edge up to around 1.8% - 2.3% in the two-year period.

Meanwhile, in the euro-region, the economy slowed markedly in the first half of 2003 as exports growth dwindled and domestic demand turned weak. However, economic indicators suggested that the downturn will bottom out in the second half of 2003 before any meaningful recovery begins to take

place in 2004. Growth in real GDP is estimated to pick up to 1.5 - 2.0% in 2004 and 2.0% to 2.5% in 2005. However, growth in real GDP is expected to moderate back to 1.8% to 2.3% in 2006 on expectation of a monetary tightening by the European Central Bank (ECB) in 2004 and the following two years.

In the UK, the rate of growth in GDP may rebound to 2.0 - 2.5% in 2004 as global recovery strengthens. The Bank of England (BoE) has recently forecasted the nation's long-term growth trend in the East Asian countries slowed to 3.7% from the growth of 5.8% in the second half of 2002 while, in the ASEAN-5, real GDP grew by 3.4% during the period compared with the growth of 4.8% in the preceding half-year. However, with the SARS outbreak being contained and the war in Iraq concluded, the region's economies have begun to show signs of recovery in the third quarter of 2003 and this resulted in a stronger growth in the second half of 2003. The recovery is expected to gather further steam in 2004 as some encouraging signs have also emerged from the industrialised countries particularly the US. Furthermore, demand for technology products is expected to rebound in 2004 with Semiconductor Equipment and Materials International (SEMI) expecting total worldwide capital equipment market to grow by 23.9%. This would help real GDP growth in the East Asian region to strengthen to 5.2 - 5.4% in 2004 and is likely to gain further momentum in the next two years stabilising at 5.5% - 5.7%. Meanwhile, the ASEAN-5 is projected to record a stronger GDP growth of 4.8 - 5.0% in 2004 (3.8% in 2003) and this is expected to stabilise at about the 5.0% level in 2005 and 2006.

In the Asian region, after a series of interest rates reduction in 2002 and 2003, most countries are likely to continue to adopt accommodative monetary policy in the first half of 2004 to help support their economic recovery. However, most central bankers in the region are likely to raise their interest rates in the second half of 2004 as the recovery in their respective economy become firmly entrenched.

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Global Real GDP Forecast (y-o-y % change)

	2003 ^e	2004 ^f	2005 ^f	2006 ^f
World	3.2	4.1	3.5 - 4.0	3.5 - 4.0
US	2.7	3.5 - 4.0	2.8 - 3.3	2.8 - 3.3
Japan	2.1	1.0 - 1.5	1.8 - 3.3	1.8 - 2.3
Euro area	0.5	1.5 - 2.0	2.0 - 2.5	1.8 - 2.3
UK	1.7	2.0 - 2.5	2.0 - 2.5	2.0 - 2.5
East Asia	3.9	5.2 - 5.4	5.5 - 5.7	5.5 - 5.7
ASEAN-5	3.8	4.8 - 5.0	5.0 - 5.2	5.0 - 5.2

Source: World Economic Outlook September 2003 - International Monetary Fund, Global Economic Prospects September 2003 - World Bank, East Asia Update October 2003 - World Bank, Global Insight.

^e estimate, ^f forecast

1.2 THE MALAYSIAN ECONOMY

Despite uncertainties created by the geopolitical risks and the outbreak of the SARS disease, the Malaysian economy remained resilient in 2003, with real GDP growing by 4.5% in the first half of 2003. With the improving global economic environment and the containment of the SARS outbreak, the Malaysian economy is expected to continue to grow at a steady pace in the second half of the year. Thus, for the whole year, real GDP has grown by 5.3%.

Going forward, the pickup in activities in the global economy is expected to raise the upside potential for Malaysia's external demand. Being a country which is highly dependent on trade, an improvement in economic performance of Malaysia's trading partners will benefit the country's exports performance in 2004. The expectation of a buoyant world trade as well as moderate increase in prices of commodities suggest that Malaysia's export performance will remain favourable in the subsequent two years (2005-2006). On the domestic side, the various measures and incentives announced by the government in the Budget 2004 as well as in the new economic package unveiled in May 2003 will contribute towards stimulating private sector spending. Both private sector investment and consumption expenditures are projected to grow by a higher rate of 6.9% and 7.0%

respectively, against their respective growths of 2.0% and 5.2% in 2003. Growth in both private sector investment and consumption expenditures is expected to remain strong in the next two years benefiting from the measures introduced by the government to accelerate domestic economic activities. On the public sector side, the government is expected to gradually pull back from being the main engine of growth in the economy, thus, public sector contribution is expected to be less than in the previous year. Public sector investment expenditure is expected to decline by 4.1% in 2004 (4.6% in 2003) while public sector consumption expenditure is expected to grow by 4.9% (7.2% in 2003). Given the government's commitment to achieve a balance budget in 2006, growth in public sector final consumption expenditure is expected to be minimal in both 2005 and 2006.

On the back of the accommodative fiscal and monetary policy and the government's role in providing an enabling environment for the private sector to take on a leading role in driving the economy, we expect real GDP to pick up pace and grow within the range of 5.0% - 5.5% in 2004. This is however, less optimistic than the government's projection of 5.5% - 6.0%. With world economic growth expected to moderate and stabilise in 2005 - 2006, growth in Malaysia's real GDP is also expected to stabilise at about 5.0% during the two-year period.

	2003	2004	2005 ¹	2006 ¹
	(y-o-y % change)			
Real GDP	4.5	5.0 - 5.5	4.75 - 5.0	4.75 - 5.0

Source: EIU, Global Insights¹

On the supply side, the **manufacturing sector** will remain the key driver in generating economic growth in 2004. The sector, which is projected to grow by about 7.0% in 2004 (6.5% in 2003), is expected to benefit from the stronger recovery in the global technology industry and the resilient domestic demand. Within the sector, strong growth is expected to be recorded in the export-oriented industries, in particular, the electronics industry in line with the expected pick-up in technology spending. Supporting industries such

as plastic, chemicals and fabricated metals and machinery will benefit from the strong growth in the electronics industry. Activities of the domestic-oriented industries are expected to strengthen, gaining momentum from the stronger business as well as consumer confidence. With the anticipation that the global technology industry will remain firm in 2005 before trending down slightly in 2006, the manufacturing sector is expected to continue to maintain its growth at an average rate of 7.0% in 2005 - 2006. The **construction sector** is likely to grow by 2.0% in 2004 (2.5% in 2003), benefiting from the on-going construction projects and stronger activities in the housing segment. Several large projects that will commence in 2004 include an upgrade of the Kuching airport, expansion in the Bintulu and Kuching ports, a new port in Semalanjung, Phase 2 of the Universiti Malaysia Sabah and the construction of the UNIMAS permanent campus in Samarahan. In the years 2005 - 2006, the construction sector is expected to remain strong, benefiting from the construction of the electrified double-tracking rail projects which is expected to take four years to complete. The **agriculture sector** is likely to record a steady growth of 2.5% in 2004 (2.3% in 2003), supported largely by an increase in output of palm oil following the increase in matured areas in Sabah and Sarawak. The **mining sector** is expected to continue to grow at a modest pace of 3.0% in 2004 (4.5% in 2003) due to lower production of crude oil. However, output of natural gas is expected to increase due to higher demand for gas as the economy recovers. As industries affected by the SARS outbreak gradually recovers and in tandem with the overall rebound in the general economy, the **services sector** is expected to register a higher growth of 4.5% in 2004 (4.2% in 2003). The services sector is expected to maintain its steady pace of 4.5% in 2005 - 2006 in line with the growth in the primary and secondary sectors.

Inflation is expected to remain relatively subdued, though the consumer price index (CPI) is likely to increase by a higher rate of about 2.0 - 2.5% in 2004 - 2006 compared with the increase of 1.2% in 2003. General prices are expected to be under mild pressure in 2004 following the faster recovery momentum as well as due to the low base effect in 2003.

Situation in the **labour market** is expected to improve further in line with the improving economic activities. The country will continue to operate under a full employment situation with the unemployment rate expected to remain stable at about 3.5% in 2004 - 2006.

In the **external sector**, the merchandise balance is expected to remain in surplus in 2004 - 2006. The surplus in 2004 is likely to be in the region of RM60 billion, slightly smaller than the surplus of RM62.9 billion in 2003 on anticipation that the growth in imports is likely to exceed the growth in exports. Growth in imports is likely to strengthen in 2004 - 2006 in line with the expected pick-up in investment activities in the country as well as stronger domestic demand. On the export side, growth is likely to strengthen in 2004 on the back of strong recovery in the global technology industry. The strong growth in exports is likely to continue in the subsequent years, supported by the recovery in exports of manufactured goods and moderate increase in agriculture and mineral prices.

BNM will continue to maintain its easy **monetary policy** to support the expansion in domestic economic activities. With inflation remaining low and with liquidity remaining ample, the low interest rate regime is expected to be sustained at least into the first half of 2004 until recovery is firmly entrenched in the economy. In line with the expectation of an uptrend in global interest rates, domestic interest rates are expected to gradually rise to 3.5 - 4.0% in 2005 and 2006.

In the banking sector, with real GDP expected to grow by about 5.0 - 5.5% in 2004, **loan growth** can be expected to be in the region of 7.5 - 8.0%. With real GDP expected to stabilise at about 5.0% in 2005 - 2006, loans growth in the banking system is projected to be within the range of 7.0 - 7.5% during the two-year period.

(Source: BCB's economic research department)