1 Global and Malaysia's Economic Performance

1.1 Global economic performance

Resilient growth in advanced and emerging economies

The world economy is estimated to exceed its growth potential, largely supported by the steady performances of most advanced economies except Japan. According to the April 2018 World Economic Outlook published by the International Monetary Fund (IMF), growth in advanced economies, as well as emerging market and developing economies (EMDEs) will continue to strengthen before levelling off in 2019. Therefore, it is important for policymakers to present appropriate economic plans and policies so that the growth can be boosted sustainably before the next downturn.

Real global GDP grew at 3.8% in 2017 (3.2% in 2016), and will grow slightly to 3.9% in 2018. This is led by the improved growth in advanced economies and EMDEs. Advanced economies are projected to surge by 2.5% in 2018 (2.3% in 2017), with faster rates of growth in the United States and the euro area, supported by the recovery in export commodities and the European Central Bank's (ECB) highly accommodative monetary policy.

The US domestic economy has shown improvement, where the unemployment rate shrank to 4.4% in 2017 – the lowest rate in nine years. The industrial production index rose by 1.5% in 2017 after a drop of 1.9% a year ago. Likewise, investment as a share of GDP increased to 19.8% in 2017, and is expected to increase to 20.2% in 2018 (Table 1.2). It is, however, projected that the US output expansion may not be sustainable due to external downside risks, namely increased protectionism and rising geopolitical tensions in North Korea and the Middle East, which could dampen confidence and lead to financial market volatility. Moreover, imports jumped to 4.0% growth in 2017 (versus 1.3% in 2016), and the volume of imports is predicted to increase further by 6.8% in 2018 amid an escalating protectionism trade policy.

Table 1.1 Real GDP growth for selected economies (%)

	2015	2016	2017	2018*	2019*
World	**3.5**	**3.2**	**3.8**	**3.9**	**3.9**
Advanced economies	**2.3**	**1.7**	**2.3**	**2.5**	**2.2**
United States	2.9	1.5	2.3	2.9	2.7
Euro area	2.1	1.8	2.3	2.4	2.0
Germany	1.5	1.9	2.5	2.5	2.0
France	1.1	1.2	1.8	2.1	2.0
Italy	1.0	0.9	1.5	1.5	1.1
Japan	1.4	0.9	1.7	1.2	0.9
South Korea	2.8	2.8	3.1	3.0	2.9
Emerging and developing economies	**4.3**	**4.4**	**4.8**	**4.9**	**5.1**
China	6.9	6.7	6.9	6.6	6.4
India	8.2	7.1	6.7	7.4	7.8
ASEAN	**4.9**	**5.0**	**5.3**	**5.3**	**5.4**
Singapore	2.2	2.4	3.6	2.9	2.7
Thailand	3.0	3.3	3.9	3.8	3.8
Indonesia	4.9	5.0	5.1	5.3	5.5
Philippines	6.1	6.9	6.7	6.7	6.8
Malaysia	5.0	4.2	5.9	5.3	5.0

* *Projections*
Source: World Economic Outlook database April 2018, International Monetary Fund (IMF).

Table 1.2 Investment to GDP for selected economies (%)

Percent of GDP	2015	2016	2017	2018*	2019*
World	**25.8**	**25.2**	**25.6**	**26.0**	**26.4**
Advanced economies	**21.2**	**21.0**	**21.2**	**21.5**	**21.8**
United States	20.4	19.7	19.8	20.2	20.8
Euro area	20.0	20.4	20.9	21.1	21.3
Germany	19.1	19.2	19.7	19.7	20.0
France	22.8	23.0	23.4	23.2	23.1
Italy	17.3	17.1	17.5	17.7	17.9
Japan	24.0	23.6	24.0	24.6	24.7
Emerging and developing economies	**32.9**	**32.1**	**32.3**	**32.9**	**33.0**
China	44.7	44.1	44.4	44.2	43.7
India	31.8	30.3	31.7	32.0	32.1
ASEAN	**28.0**	**28.3**	**28.5**	**29.2**	**29.6**
Singapore	27.1	27.0	27.6	27.7	27.6
Thailand	22.3	21.1	22.8	24.2	24.7
Indonesia	34.1	33.8	33.4	33.9	34.2
Philippines	21.2	24.3	25.0	26.2	27.0
Malaysia	25.1	25.9	25.5	25.4	25.7

** Projections*
Source: World Economic Outlook database April 2018, International Monetary Fund (IMF).

In contrast, Japan's economy is expected to stumble to a growth rate of 1.2% in 2018, compared to the 1.7% increase in 2017, due to the stalled exports of electronic parts and other items, as well as rising prices of goods. The planned consumption tax hike in 2019 will have negative effects on growth in 2020, along with the country's aging population and shrinking labour force. Japan will experience a full employment situation; its unemployment rate declined to only 2.8% in 2017.

In comparison to South Korea, the country's forecast for economic growth was lowered by 0.1 percentage point to 3% in 2018. Subdued employment and consumption are likely to contribute to the softer growth rate. These are offset by the investment in infrastructure and government spending to support public health insurance. South Korea's unemployment rate also increased by 0.1 percentage point to 3.8% in 2017, while the inflation rate surged by 1.9% in 2017, up from 0.97% in 2016, which resulted in lackluster private spending (Table 1.3).

EMDEs on the other hand are set to expand at 4.9% in 2018 (4.8% in 2017). This is largely supported by the relative solid expansion in China's and India's economies. Despite the fact that China's economy expanded to 6.9% in 2017, it is expected to experience lower rates of growth at 6.6% in 2018 and 6.4% in 2019, stemming from rapid credit growth and a diminishing fiscal stimulus. Apart from rising trade frictions in advanced economies, rising geopolitical tensions with North Korea will also pose downside risks to the world's second-largest economy.

China's exports peaked in 2017 at a 9.2% rate of growth while its imports spiked at a 6.9% growth rate. As the United States-China trade dispute looms, both exports and imports are expected to grow modestly in 2018 due to tariff barriers on 128 US products including soybeans, oranges, and cars, following the new US trade policy to impose duties on China's steel and aluminum. Box 1.1 discusses the state of affairs of the trade war between China and the United States.

India's economy is among the very few countries to show continued progress. It grew from an increase of 6.7% in 2017 to a forecast increase of 7.4% in 2018 and 7.8% in 2019. India is believed to become the fastest-growing major economy in the world, and it could potentially reach a double-digit growth rate as its medium-term prospects remain optimistic. This is attributed to its recovery from demonetisation and the introduction of the Goods and Services Tax (GST), as well as robust private consumption. The country's young demographics will lead to a better consumption pattern, since India is the world's second-most-populous nation after China.

Table 1.3 Inflation rate for selected economies (%)

Percent of GDP	2015	2016	2017	2018*	2019*
World	**2.8**	**2.8**	**3.0**	**3.5**	**3.4**
Advanced economies	**0.3**	**0.8**	**1.7**	**2.0**	**1.9**
United States	0.1	1.3	2.1	2.5	2.4
Euro area	0.0	0.2	1.5	1.5	1.6
Germany	0.1	0.4	1.7	1.6	1.7
France	0.1	0.3	1.2	1.5	1.6
Italy	0.1	-0.1	1.3	1.1	1.3
Japan	0.8	-0.1	0.5	1.1	1.1
South Korea	0.7	1.0	1.9	1.7	1.9
Emerging and developing economies	**4.7**	**4.3**	**4.0**	**4.6**	**4.3**
China	1.4	2.0	1.6	2.5	2.6
India	4.9	4.5	3.6	5.0	5.0
ASEAN	**3.3**	**2.4**	**3.1**	**3.2**	**2.9**
Singapore	-0.5	-0.5	0.6	1.2	1.0
Thailand	-0.9	0.2	0.7	1.4	0.7
Indonesia	6.4	3.5	3.8	3.5	3.4
Philippines	1.4	1.8	3.2	4.2	3.8
Malaysia	2.1	2.1	3.8	3.2	2.4

** Projections*
Source: World Economic Outlook database April 2018, International Monetary Fund (IMF).

Box 1.1 The US-China trade war, and the Belt and Road initiative

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The impact of US-China trade war on Malaysia's economy

Malaysia's trade is heavily dependent on China, with about 13.5% of exports trading into the country – making it Malaysia's second-largest export destination – and 19.6% of imports originating from China, highest among importing countries. Most of Malaysia's traded commodities are intermediate goods, with E&E products taking the lion's share (Nawawi et al., 2015). With a trade dependence on the Asia-Pacific region centering on China, Malaysia's trade position may be exposed to a short-term risk in the global supply chain.

Given the dominance of E&E in Malaysia's trade, and the Trump's administration's intention to decrease its dependence on China for manufacturing, US companies might experience a growth in the production of such goods within the country. If this is the case, Malaysia would face decreasing exports to China in the short term.

In the long run, this may create opportunities for US companies to increase their investment into establishing offshore corporations in Southeast Asia. Malaysia is thus predicted to see a boom in foreign investment, which may then allow the supply chain to vertically integrate, and potentially give Malaysia the capability to export more finished goods directly to the United States.

This is evidenced by the growth in Malaysia-United States trade of 16.3%, with the E&E sector driving more than half of the expansion in 2017 (Kana, 2018).

Penang will benefit from the escalation of trade tensions between the United States and China as the majority of the US E&E companies are concentrated in Penang. The increasing level of trade and investment is expected to further accelerate Malaysia's economy.

The Belt and Road initiative

Malaysia may be well positioned to take advantage of the escalating United States-China trade war spat in terms of trade, China's influence in Malaysia from a geopolitical standpoint is unlikely to wane, especially when its Belt and Road initiative (BRI) is taken into consideration.

Mooted in 2013 by President Xi Jinping, the BRI aims to invigorate the economies of more than 60 countries through the land-based Silk Road Economic Belt (SREB) and the sea-based Maritime Silk Road (MSR) (China's OBOR: opportunities and challenges, 2017). It seeks to enhance regional connectivity and economic cooperation through infrastructure investment, education, automobile, and real estate.

The BRI takes precedence, especially with the United States pulling out from the Trans-Pacific Partnership Agreement (TPPA). In fact, China has committed US$40 billion to its Silk Road Fund and led the establishment of the Asian Infrastructure Investment Bank (AIIB) (Lau, 2017). It is likely to use strategic investments and infrastructure development to place itself in a position of economic and political dominance within the region of its coverage.

Unveiled by the Shanghai Stock Exchange, the Association of Chartered Certified Accountants (2017), and Lau (2017), the five priorities of BRI can be explained in the context of Malaysia.

i. Policy coordination which aims to boost intergovernmental cooperation and build mechanisms for the facilitation of such processes. Malaysia received a good sum of BRI-related investment, with low levels of political barriers for regional projects.
ii. Connecting infrastructure that aims to align technical standards to link Asia, Europe, and Africa through an infrastructure network. Projects include the East Coast Rail Link (ECRL), the Malaysia-China Kuantan Industrial Park (MCKIP), the Melaka Gateway deep-sea port, and the upgrading of the Kuantan Port. However, the ECRL is being reviewed by the current Malaysian administration.
iii. Unimpeded trade which seeks to remove barriers for investment and trade. This can be observed with the establishing of a digital free trade zone by China's Alibaba Group Holding Limited in Malaysia. Apart from e-commerce, the unimpeded trade is also seen in the pineapple trade; exports to China are expected to double by 2020.
iv. Financial integration, which seeks to enhance the financial system by creating facilities for monetary stability, systems for investment, and financing. The AIIB and the Shanghai Cooperation Organisation (SCO) were set up to regulate the Silk Road Fund.
v. People-to-people bonds intends to bring people together to deepen partnerships through cultural, academic, and talent exchanges. For example, Malaysia's Xiamen University campus – the first overseas campus by a Chinese university – is a means of fostering academic and cultural ties.

Although the BRI initiative will bring positive spillover effects through the development of infrastructure projects – the property and tourism sectors in particular with significantly benefit – it is still too early to assess the benefits and risks of the BRI projects. The ability of the government to meet loan repayments of large-scale infrastructure projects is the key concern, highlighted by the present government.

The way forward

Looking at Malaysia's trade pattern and foreign policy, China has become the country's top trading partner. While the nation effectively remains focused on the Asia-Pacific region, it would be wise to consider diversifying trade destinations. Agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) may help facilitate market access and the movement of people and ideas beyond the ASEAN+6[1] region.

[1] ASEAN member countries are Brunei Darussalam, Burma, Cambodia, Indonesia, Philippines, Malaysia, Laos, Singapore, Thailand, and Vietnam. ASEAN+6 added China, Japan, South Korea, Australia, New Zealand, and India.

Presently, Malaysia faces substantial trade risks due to its dependence on a small set of countries. With China asserting its influence through its BRI initiative and its strong influence within the Regional Comprehensive Economic Partnership (RCEP), Malaysia risks falling deeper into China's influence, using its trade prowess as a bargaining tool.

With Malaysia experiencing a small but increasing trade with the United States, the United States-China trade war appears to be what the country needs to move up the production value chain. Furthermore, free trade agreements (FTAs) such as the Malaysia-Iran Preferential Trade Agreement (MIPTA) and the Malaysia-European Free Trade Area Economic Partnership Agreement (MEEPA) have the potential to balance Malaysia's trade relationships.

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Modest growth in ASEAN countries

A majority of ASEAN countries are projected to experience moderate growth in 2018, while a steady growth rate is estimated for the entire ASEAN economy. This is likely due to the regional cooperation agreements such as the ASEAN Free Trade Area (AFTA) agreement within the ASEAN community to foster regional integration. As the fourth-largest exporting region in the world, ASEAN accounts for only 3.3% of world output and more than 7% of exports, trailing the European Union and North America (Menon, 2018). Since both exports and imports grew at more than 9% in 2017, the forecast for the region's trade growth for 2018 and 2019 is optimistic. While the predicted growth in most ASEAN countries is slowing down, the real GDP is projected to maintain its growth at 5.3% in 2018. Among the five major ASEAN countries, Indonesia and Philippines are forecasted to sustain its growth momentum to 5.3% and 6.7% in 2018, respectively (2017: 5.1% and 6.7%).

As the most developed country in ASEAN, Singapore's economy peaked at 3.6% in 2017 (2016: 2.4%), which was predominantly attributed to solid manufacturing expansion. The sector's growth will continue to support economic expansion in 2018 with an estimated milder growth at 2.9%. However, the first quarter of 2018 showed a continued surge in the manufacturing sector, expanding by 10.1%, with electronics and precision engineering clusters as the biggest drivers. In addition, the services sector will continue to strengthen due to the positive spillover from the ongoing global recovery. The labour market continued to show improvements in terms of low retrenchment and unemployment rates. The downside risk is likely to persist due to protectionist sentiments and trade policies globally.

The Thai economy is expected to expand at 3.8% in 2018 (2017: 3.8%) with domestic demand recovery. The World Bank estimated that regulatory reforms and policy stability, including skills reform and quality infrastructure investments, are contributing to the improvements in business sentiment. The growth gains traction in the external sector are benefiting from buoyant tourist inflows and strong demand for merchandised exports. In terms of labour market conditions, Thailand recorded the lowest unemployment rate among ASEAN countries with just 1.1% in 2017. Nevertheless, policymakers will have to tackle the challenges of innovation breakthroughs to expand new industries, create jobs, and increase incomes.

While other countries are estimated to post a weaker growth in real GDP, Indonesia will experience a persistent and solid growth rate at 5.3% in 2018 (2017: 5.1%) despite the unemployment rate dropping by 0.2 percentage point to 4.3% in 2017. This is largely led by strong investment and net exports resulting from recovering commodity prices and robust international trade. Indonesia's investment as a share of GDP is the largest among ASEAN countries, which proportionately accounted for at least one-third of the country's GDP. However, Indonesia's fiscal policy will need to address resource allocation on priority areas to enhance the effectiveness of government spending (The World Bank, 2018a).

The Philippine economy retained its growth momentum at a decent pace, and it posted the strongest real GDP growth rate among the world's fastest-growing economies. The country grew at 6.7% in 2017 (2016: 6.9%) with the IMF maintaining its growth projection for 2018. Robust external demand is the key contributor to the sustained growth rate. The exports increased by 11.4% in 2017 while imports rose by 7%. The double-digit growth in exports is projected to continue in 2018. As the inflation rate increased to 3.2% in 2017 (2016: 1.8%), the Philippine central bank mounted pressure by raising the interest rate to 3.25% in response to the rising inflation rate and the weakening peso.

1.2 Malaysia's Economic Performance

Domestic demand accelerates national growth

In 2017, the Malaysian economy grew at a faster rate of 5.9% compared to the past two years amid a challenging global trade environment. The growth, underpinned by domestic demand, continued to be the key driver of growth with strong private consumption and investment, and an improved external market. Bank Negara Malaysia (BNM) forecasted the GDP growth at between 5.5% and 6% in 2018. Meanwhile, the gross national income (GNI) measuring the contribution of Malaysian nationals to the output grew by about 10% in 2017, albeit with a continued increase in money flowing into foreign countries.

Private consumption surged by 7% in 2017, accounting for nearly 46% of total GDP, and it is expected to accelerate further to 7.2% in 2018 (Table 1.4). Meanwhile, private investment is projected to continue growing at a relatively high rate of 9.1% in 2018. Due to the new lineup in the federal government, the forecasted public investment will decelerate by more than 3.2% in 2018 in response to the reviews of several infrastructure projects, including the Kuala Lumpur-Singapore high-speed rail (HSR), gas pipeline projects, and the ECRL.

Private consumption is expected to increase from June to August 2018 following the zero-rated GST. During the three-month tax holiday period, consumers' purchasing power is estimated to improve. Moreover, the propensity to consume among consumers within this period may likely be lead the consumers' spending for the year, holding all else constant.

With a budgeted RM43.8 billion GST revenue, which is to be collected in 2018, Malaysians pay an average of RM3.65 billion per month in consumption tax, and they have an additional estimated RM3.65 billion or RM114 per person to spend every month from June to August before the Sales and Services Tax (SST) is reinstated in September. B40 and M40 income earners are likely to spend on durable products such

Table 1.4 Annual growth rate of GDP by demand components in Malaysia (at 2010 constant prices)

	2014	2015	2016	2017	2018f	Q1 2018
Final consumption expenditure	6.4	5.7	4.9	6.7	-	5.7
Private	7.0	6.0	6.0	7.0	7.2	6.9
Public	4.4	4.5	0.9	5.4	0.6	0.4
Gross fixed capital formation	4.8	3.6	2.7	6.2	-	0.1
Private	11.1	6.3	4.3	9.3	9.1	0.5
Public	-4.7	-1.1	-0.5	0.1	-3.2	-1.0
Export of goods and services	5.0	0.3	1.3	9.4	8.8	3.7
Import of goods and services	4.0	0.8	1.3	10.9	9.1	-2.0
GDP	6.0	5.1	4.2	5.9	5.5-6.0	5.4

f Forecast
Source: Bank Negara Malaysia and Economic Planning Unit, Malaysia.

as passenger cars, consumer electronics, and home appliances. No significant effect will be seen in consumption patterns among T20 income earners.

Headline inflation[2] rose steeply at 3.7% in 2017. This was mainly attributed to the increase in the prices of transportation and food and beverages, at about 14% and 4%, respectively. The rate softened to 1.8% y-o-y in Q1 2018 compared to 3.6% y-o-y in Q4 2017, which was lower than the full-year projection made by BNM at between 2–3%. A smaller increase in domestic fuel prices was the contributor to this reduction, where global oil prices rose marginally along with rebounded value of the Ringgit – as of April 2018, the Ringgit appreciated by about 10% against the dollar. Likewise, the three-month zero-rated GST, along with the reintroduction of the SST in September 2018, will essentially make consumable goods slightly cheaper; the projected headline inflation will potentially increase at a slower rate in 2018.

In contrast, the producer price is expected to increase in the final four months of 2018 as a result of the SST, which will have ripple effects in the cost of production, which will then translate into higher prices of goods. During the first three months of 2018, the producer price index for local production decreased by 2.3% y-o-y compared to a decrease of 4.4% in Q1 2017. The reduction was seen in agriculture, forestry, and fishing at an average rate of 13.8%, and the manufacturing sector contracted at 1.8%. In terms of stage of processing, all three stages had lower prices, which include crude materials for further processing (-2.5%), intermediate materials, supplies and components (-2.4%), and finished goods (-1.6%) (Figure 1.1).

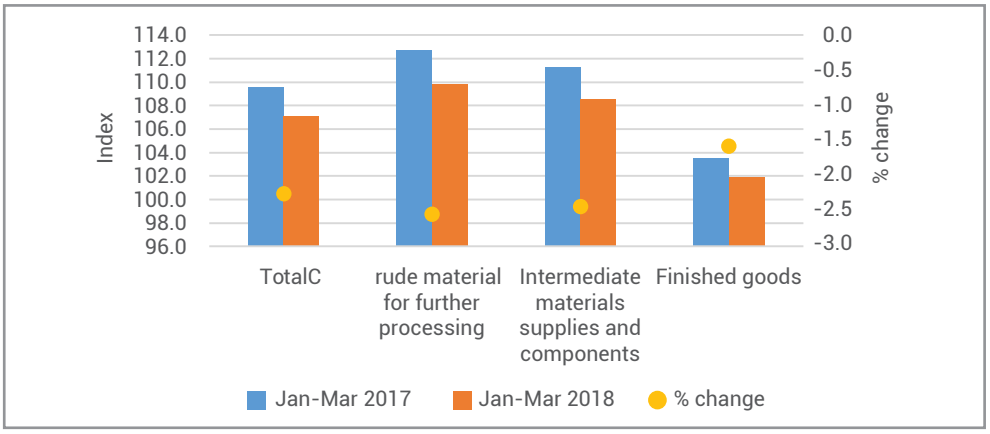
Given a weight of 56% for intermediate materials, supplies and components, the prices of materials for food manufacturing dropped significantly by 13.5% in the first quarter of 2018, while the price of processed fuels and lubricants rose by 5.3%. The weight for finished goods, on the other hand, is about 27.4%, and with the exclusion of foods, the prices of finished consumer goods plunged by 1.8%, with a significant hit specifically in durable goods (-4.8%). For example, the producer prices of computers, electronics, and optical products; and motor vehicles respectively slumped by 3.5% and 0.9%. The prices are expected to fall further from June to August 2018 due to the zero-rated GST, but will increase moderately after the return of the SST in September.

Within a relatively low interest rate environment, aggregate domestic demand is anticipated to increase through consumption and investment. Consumers have greater access to loans, and businesses take on debt at a low cost to boost spending and investment. While BNM raised its overnight policy rate from 3% to 3.25% in January 2018, the effect on consumers and borrowers is accommodative to balance the risk of excessive outstanding debt, surrounding with the low rate of inflation and steady outlook of domestic growth.

Services sector continues to be the key economic driver

From the supply side, all sectors exhibited strong expansion, except for the mining and quarrying sector (1%). Agriculture grew at 7.2%, followed by construction (6.7%), services (6.2%), and manufacturing (6%). The services sector remained

Figure 1.1 Producer price index and y-o-y change for local production, Malaysia



Source: Estimated from Bank Negara Malaysia and Department of Statistics, Malaysia.

[2] Headline inflation rate is a measure of total inflation within an economy, which includes commodities such as food and energy prices (e.g. oil and gas).

Table 1.5 GDP performance by economic sectors, Malaysia (at 2010 constant prices)

Sector	y-o-y change (%)					Share (%)
	2015	2016	2017	2018f	Q1 2018	2017
Agriculture	1.4	-5.2	7.2	3.6	2.8	8.2
Mining and quarrying	5.3	2.1	1.0	1.8	0.1	8.4
Manufacturing	4.8	4.4	6.0	5.9	5.4	23.0
Construction	8.4	7.4	6.7	7.3	4.9	4.6
Services	5.3	5.7	6.2	6.1	6.5	54.4
GDP at purchasers' value	5.1	4.2	5.9	5.5-6.0	5.4	100.0

f Forecast
Source: Bank Negara Malaysia and Economic Planning Unit, Malaysia.

as the main economic driver for the country. In 2017, this sector accounted for nearly 55% of the total national GDP, followed by manufacturing activity (23%), mining and quarrying (8.5%), agriculture (8.2%), and construction (4.6%) (Table 1.5). While the total GDP during Q1 2018 grew slightly slower than in Q1 2017, the services sector expanded by 6.5% during the first quarter of 2018, registering a higher rate of growth compared to the targeted rate of growth of 6.1% made by BNM. The growth was largely underpinned by wholesale and retail trade, insurance, and information and communication, which respectively grew at 7.9%, 9.8%, and 8.3% (Table 1.6).

Accounting for 23% of the national GDP, the growth in the manufacturing sector was supported by E&E products; optical products; and petroleum, chemical, rubber, and plastic products. This expansion corresponds to the production performance of export- and domestic-oriented industries. Based on the industrial production index, export-oriented production grew by 6.7% in 2017, up from 5% a year ago. During the first quarter of 2018, growth was high (5.8%) compared to domestic-driven industries such as food products (4.3%), beverages (5.4%), and transport equipment (1.6%). Among export-oriented industries, primary-related clusters such as chemical products (6.0%) and textiles wearing apparel and footwear (6.6%) outpaced the growth in electrical products (4.9%) from the E&E cluster—except electronics (6.1%) and machineries (7%). Nevertheless, for the full-year 2018, growth in the manufacturing sector will continue to be led by the E&E cluster and primary-cluster cluster from export-oriented industries.

Table 1.6 GDP growth rate for services sub-sectors, Malaysia (at 2010 constant prices)

Services sub-sector	y-o-y change (%)			
	2015	2016	2017	Q1 2018
Electricity and gas	3.1	5.0	2.0	3.9
Water	5.8	6.7	6.0	5.9
Wholesale trade	9.3	8.3	6.5	7.9
Retail trade	5.5	7.1	9.4	7.4
Motor vehicles	4.2	-3.0	1.2	-0.5
Accommodation	3.5	4.5	5.2	5.7
Food and beverage	7.2	7.8	8.1	8.2
Transport and storage	5.8	5.7	6.2	5.7
Information and communication	9.5	8.1	8.4	8.3
Finance	-0.1	1.3	4.9	6.8
Insurance	-1.7	6.6	3.7	9.8
Real estate and business services	6.5	6.9	7.4	7.4
Government services	4.2	4.9	4.9	4.8
Other services	4.8	4.9	5.1	5.3
Total	5.3	5.7	6.2	6.5

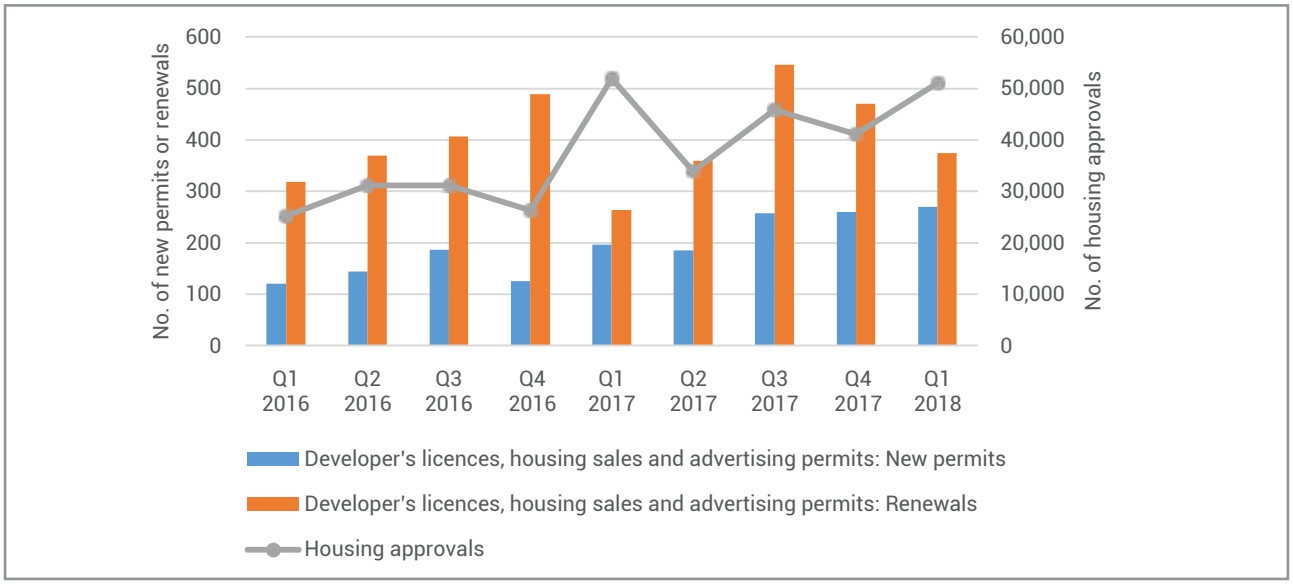
Source: Bank Negara Malaysia and Economic Planning Unit, Malaysia.

Table 1.7 Production of major agricultural and mining commodities

Commodities		2016	2017	Q1 2017	Q1 2018	y-o-y change	
						2016/17	Q1 2017/18
Rubber	('000 tonnes)	673.5	740.2	235.0	164.4	9.9%	-30.0%
Crude palm oil	('000 tonnes)	17,320.0	19,919.6	3,999.4	4,503.4	15.0%	12.6%
Crude palm kernel oil	('000 tonnes)	1,959.4	2,280.9	462.9	563.0	16.4%	21.6%
Saw logs	('000 cubic metres)	13,933.8	11,046.2	2,776.3	n.a.	-20.7%	-
Cocoa	(tonnes)	1,756.7	1,028.8	359.3	218.0	-41.4%	-39.3%
Tin-in-concentrates	(tonnes)	4,123.0	4,819.0	973.0	n.a.	16.9%	-
Crude oil and condensates	('000 barrels per day)	666.5	647.9	665.5	669.6	-2.8%	0.6%
Natural gas (net)	(mmscfpd)	6,536.2	6,904.2	7,076.0	6,858.5	5.6%	-3.1%

Source: Bank Negara Malaysia.

Figure 1.2 Selected construction indicators in Malaysia, Q1 2016–Q1 2018



Source: Bank Negara Malaysia.

For primary economic sectors, the growth in agricultural activity was mainly supported by crude palm oil and crude palm kernel oil, which expanded by 12.6% and 21.6%, respectively, in Q1 2018 compared to Q1 2017 (Table 1.7). For the same period, production of rubber and cocoa substantially declined by 30% and 39.3% y-o-y, respectively. This is likely attributed to unstable weather conditions, resulting in supply disruptions and increased rubber and cocoa prices. Meanwhile, saw log production is estimated to considerably decrease due to environmental concerns over forest degradation. In 2018, the primary sectors are expected to grow insignificantly due to unpredictable weather conditions.

The construction sector made up the smallest share of the national GDP, of less than 5%, with a rate of growth of 4.9% y-o-y in the first three months of 2018 (Q1 2017: 6.6%). According to the Department of Statistics, the sector's growth was primarily attributed to expansion in civil engineering and specialised construction activities. The former posted a double-digit growth of 19.5%, which was enhanced by transportation and utilities-related projects, while the latter expanded by 8.6%. There was also an expansion in the production of concrete, cement, and plaster; and basic iron and steel products, as well as increases in new permits issued to developers, housing sales, and advertisements (Figure 1.2). In contrast, loans approved for construction recorded a decline of 28.3% to RM5.7 billion in Q1 2018 (Q1 2017: 83.3% and RM4.3 billion). For full-year 2018, growth in construction sector is anticipated to slow down due to a number of infrastructure projects undergoing assessment by the new federal administration.

Labour market remains stable

Malaysia's labour market remained buoyant in the first three months of 2018, with a favourable unemployment rate at 3.3% compared to 3.5% in the first three months of 2017. Total labour force participation increased by 2.2% y-o-y in the first quarter of 2018 with an increased employment rate of 2.3% y-o-y. In terms of occupational groups, service workers and shop market sale workers remained the largest employment composition, accounting for 22.4% of the total employed persons in Q1 2018, followed by elementary operators (12.8%), machine operators and assemblers (12.3%), and professionals (12.2%).

According to the Ministry of Human Resources, total job vacancies declined by 2.5% y-o-y for Q1 2018, likely due to reduced movement among employees between jobs. This can be seen in the reduced number of active job seekers, with a drop of 18.3% to 254,177 persons for Q1 2018 as compared to 311,276 job seekers registered in Q1 2017. The manufacturing sector had the highest number of job vacancies in the country, accounting for more than 40% of total vacancies, followed by wholesale and retail trade (7.8%). Among the occupational groups, elementary occupations, and plant and machine operators and assemblers were reported to have the most job vacancies compared to mid- and high-skill occupations.

Malaysian labour productivity, measured by value added per employee, recorded an increase of 3.6% in 2017 compared to 3.5% in 2016. This was attributed to an improved growth in value-added labour of 5.9% and total employment of 2%. However, the growth is lower than the rise in average salaries and wages (8.4%), with 1.8 million low-skilled foreign workers hired in Malaysia. Labour productivity in general should be boosted further if Malaysia is to move up the value chain by reducing the number of low-skilled foreign workers and increasing the number of high-skilled workers along with high quality jobs.

Despite its relatively small GDP contribution, mining and quarrying made up the highest rate of productivity growth at 6.3%, followed by services (4.7%) and manufacturing (4.2%) (Figure 1.3). Within the manufacturing sector, the production of transport equipment was the most productive, registering a growth of 8.8%, followed by the production of vegetables, animal oils and fats, and food at 7.0%. Meanwhile, among the services activities, retail trade saw the strongest increase in labour productivity at 7.4%, followed by transportation and storage (5.1%) and electricity and gas (4.5%). Labour productivity in motor vehicles and water, sewerage and waste management, on the other hand, declined by 3.6% and 4%, respectively.

The growth in mean salaries and wages outpaced the growth in labour productivity in all sectors except agriculture and manufacturing (Figure 1.3). This in turn reflects the productivity gap between how much employees are being paid and their productivity levels – the productivity level is not keeping pace with wages. Scarcity of labour, particularly in the areas of mining and quarrying and construction, may contribute to the growth of salaries in these sectors in order to make the jobs attractive to workers.

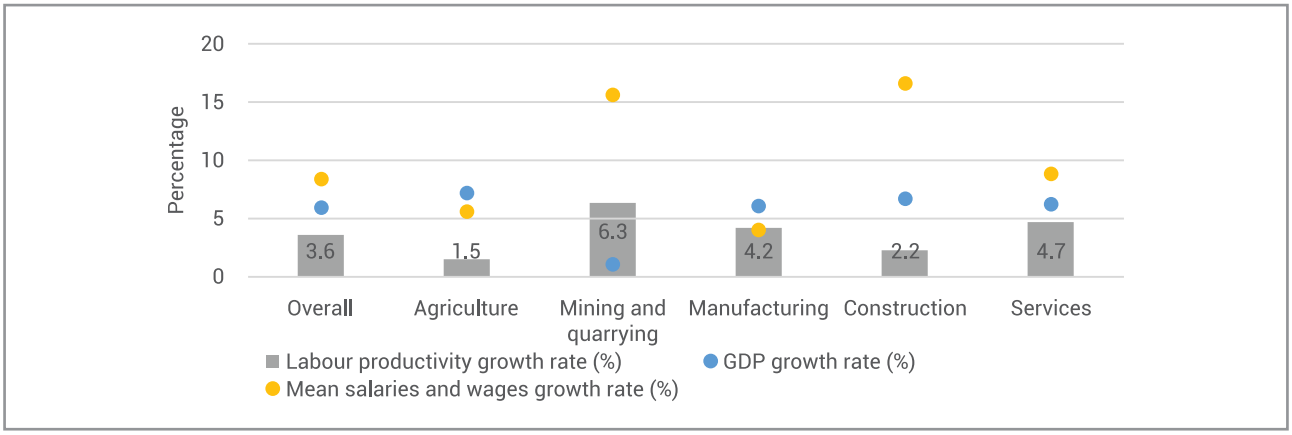
The productivity level among small and medium enterprises (SMEs) remained low compared to the labour productivity growth in large enterprises. According to the Malaysia Productivity Blueprint, SME productivity rate had been declining at 0.6% per year between 2010 and 2015, while large enterprises grew at a rate of 2.9% per year. The five key challenges hindering productivity growth include shortage of talent, low level of investment in technology and digitisation, lack of government incentive structure, inconsistent interpretation of regulations, and limited understanding of the importance of productivity among enterprises.

Rebounded external trade environment

Malaysia's external trade rebounded in 2017 after a subdued surplus a year ago. Total trade improved by nearly 20% in 2017 compared to 1.5% in 2016, which was largely due to robust global demand (Table 1.8). Both exports and imports had double-digit rates of growth at 18.9% to RM935.4 billion and 19.9% to RM838.1 billion, respectively. This gives a moderate growth in trade surplus of 10.3% (2016: -3.7%).

During the first four months of 2018, total trade grew mildly by nearly 5% y-o-y, with growth rates of 7.8% in exports and 1.6% in imports amid a stronger Ringgit and competitive trade environment (Table 1.8). The trade performance is complemented by the strong growth in trade surplus at 68.7% y-o-y for January–April 2018. Moving forward, Malaysia is expected to experience a double-digit growth in trade surplus.

Figure 1.3 Growth rates of labour productivity, mean salaries, and GDP in Malaysia, 2017



Source: Bank Negara Malaysia.

Table 1.8 Exports, imports and balance of trade in Malaysia

RM million	2016	2017	% change	Jan–Apr 2017	Jan–Apr 2018	% change
Export	786,964	935,393	18.9%	298,560	321,872	7.8%
Import	698,819	838,145	19.9%	271,029	275,431	1.6%
Total trade	1,485,783	1,773,538	19.4%	569,589	597,303	4.9%
Balance of trade	**88,145**	**97,249**	**10.3%**	**27,531**	**46,441**	**68.7%**

Source: Authors' own calculations based on the Department of Statistics, Malaysia.

The manufacturing sector continued to form the largest growth in exports in 2017. It grew at nearly 19%, and accounted for about 82% of total exports in Malaysia, followed by mining (8.6%) and agriculture (8.4%) (Figure 1.4). Among manufactured goods, E&E products expanded by about 19%, making them the largest exports commodity (36.7%), boosted by higher global demand in semiconductors that are used to produce smartphones and tablets. The manufacture of petroleum products had the second-largest composition in the manufacturing sector, accounting for 7.7% of the total exports. A similar trend is expected for 2018 following a stable export demand for E&E products worldwide.

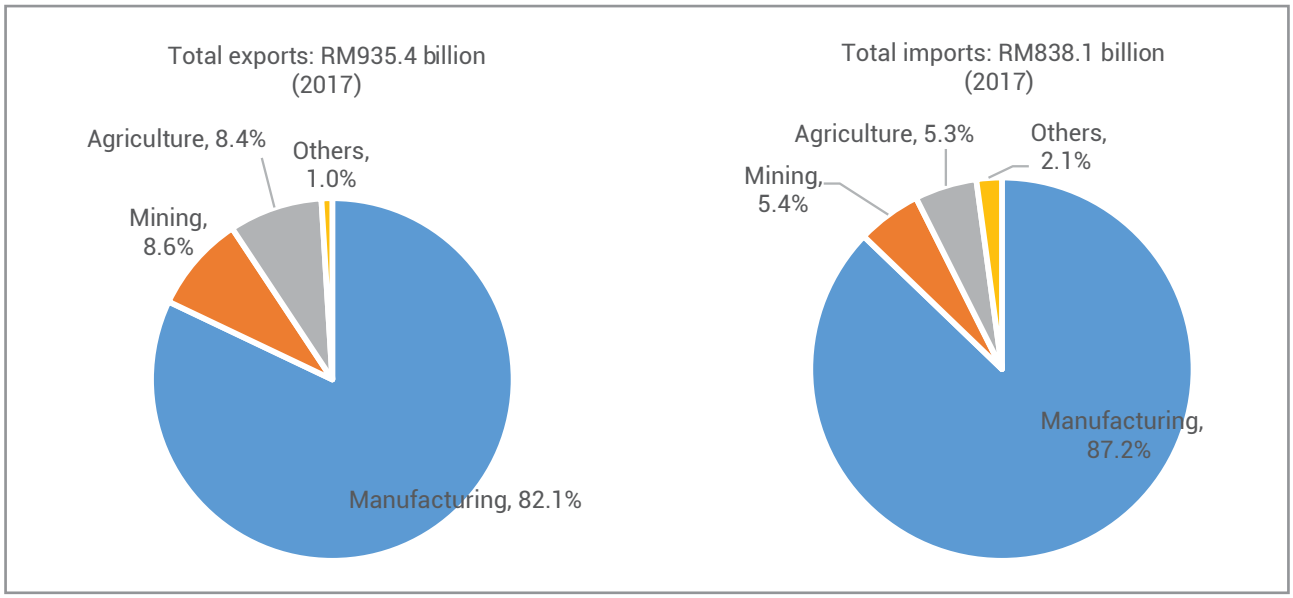
For imports, about 87% of total imports were from manufactured products, which were the largest imported commodity in the country. E&E products contributed 30.2% of total import value, growing at a rate of 20.5% in 2017. For the first four months of 2018, the commodity expanded modestly by 3.5%, supported by the importing of semiconductors, particularly in electronic integrated circuits. Nevertheless, the majority of trade surplus are from E&E products.

Agriculture and mining products registered positive rates of growth in export receipts at 10.9% and 23.9%, respectively. This is a positive sign because more products in the agriculture and mining sectors are exported versus imported. In contrast, Malaysia imports more chemical products, petroleum products, machinery equipment, and transport equipment than it exports, reflecting a trade deficit for these products. Therefore, in 2018, Malaysia is estimated to continue importing more petroleum products and machinery equipment, despite the fact that Malaysia is one of the largest producers of petroleum in Southeast Asia, and exporting more E&E products and agriculture products.

The majority of export destinations were to countries in AFTA (29.2%), followed by countries participating in the North American Free Trade Agreement (NAFTA, 10.9%) and the European Union (10.2%) (Figure 1.5). Based on the Malaysia Economic Report 2017/2018, Singapore, Indonesia, and Thailand were the major export markets for E&E products; petroleum products; and machinery, equipment, and parts.

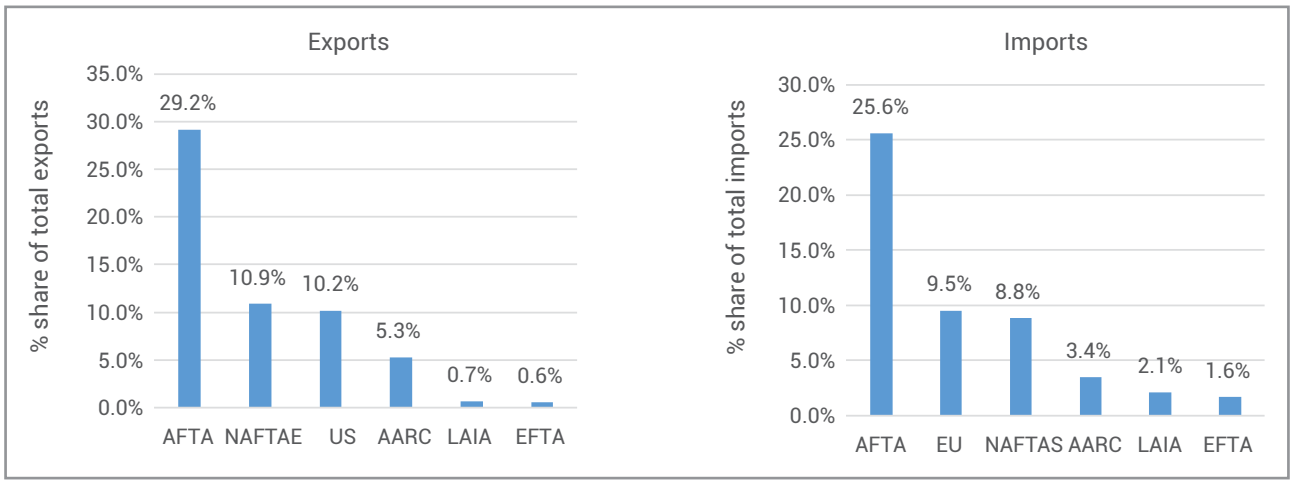
As part of ASEAN, Malaysia benefits from the regional trade agreements. Trade barriers with China, South Korea, India, Japan, Australia, New Zealand, and the European Union are estimated to further decrease as a result of RCEP under AFTA. In addition, bilateral FTAs with Pakistan, Australia, Japan, India, Turkey, and Chile will continue to strengthen economic ties (See Box 1.2).

Figure 1.4 Exports and imports by sector, 2017



Source: Department of Statistics, Malaysia.

Figure 1.5 Direction of external trade by economic grouping, 2017



Note: AFTA refers to ASEAN Free Trade Area; EU refers to European Union; NAFTA refers to North American Free Trade Agreement; SAARC refers to South Asian Association for Regional Cooperation; LAIA refers to Latin American Integration Association; and EFTA stands for European Free Trade Association, which includes Iceland, Norway, Switzerland, and Liechtenstein.

Source: Authors' own calculation based on external trade data published by the Department of Statistics, Malaysia.

Box 1.2 The Free Trade Agreements in Malaysia

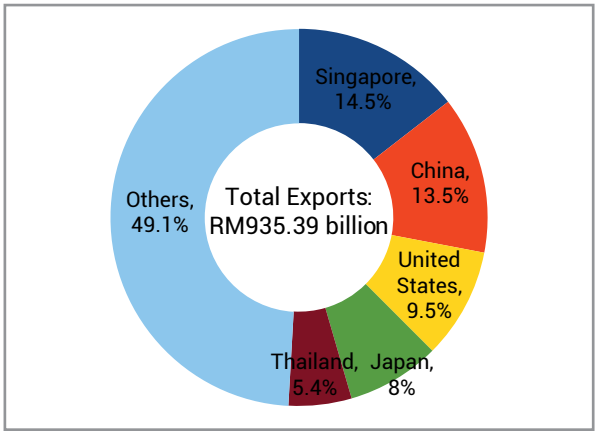
by Jonathan Dason, Socioeconomics & Statistics Programme

Trade composition

In 2017, Malaysia's total trade stood at RM1.7 trillion, up from RM1.4 trillion in 2015. Malaysia had a positive balance of trade with exports standing at RM935 billion and imports at RM838 billion. The top three export products were E&E products at 36.7%, petroleum products at 7.7%, and chemicals and chemical products at 7.3%.

Slightly more than 50% of Malaysia's total exports were split between its top five trading partners, with Singapore accounting for the largest share at 14.5% and China trailing at 13.5% (Figure 1.6). The bulk of Malaysia's exports were destined for the Asia-Pacific region and the United States. Among these export destinations, the United States is the only destination without a bilateral or regional FTA with Malaysia. Table 1.9 summarises FTAs of Malaysia's top 10 export destinations. Likewise, about 70% of total imports originated from the Asia-Pacific region and the United States (Figure 1.7). Among Malaysia's top 10 importing countries, Malaysia has FTAs with seven of them, excluding the United States, Taiwan, and Germany.

Figure 1.6 Malaysia's major export countries, 2017 (%)



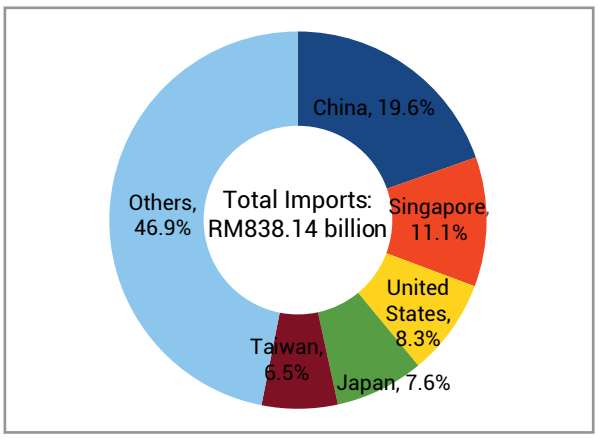
Source: Malaysia External Trade Development Corporation (MATRADE).

Table 1.9 List of top 10 export countries and trade agreements

Country*		FTAs
1.	Singapore	AFTA
2.	China	ASEAN-China Free Trade Agreement (ACFTA)
3.	United States	Nil
4.	Japan	Malaysia-Japan Economic Partnership Agreement (MJEPA)
		ASEAN-Japan Comprehensive Economic Partnership (AJCEP)
5.	Thailand	AFTA
6.	Hong Kong	ASEAN-Hong Kong Free Trade Agreement (AHKFTA): Under negotiation
7.	Indonesia	AFTA
8.	India	ASEAN-India Free Trade Agreement (AIFTA)
9.	Australia	Malaysia-India Comprehensive Economic Cooperation Agreement (MICECA)
10.	South Korea	Malaysia-Australia Free Trade Agreement (MAFTA)

** All countries are involved in RCEP except the United States, which is still under negotiation.*
Source: Malaysia External Trade Development Corporation (MATRADE).

Figure 1.7 Malaysia's major import countries, 2017 (%)



Source: Malaysia External Trade Development Corporation (MATRADE).

ASEAN Free Trade Area (AFTA)

ASEAN is the world's sixth-largest economy, featuring rapid urbanisation and a young and growing population, and the region is forecast to grow healthily (Yusof, 2017). Signed in 1992, the AFTA agreement sought to reduce the region's inter-trade tariffs and non-tariff barriers, and it became the precursor to the ASEAN Economic Community (AEC). So far, trade within ASEAN has taken a dominant role in comparison to trade going out of the region, with close to 25% of exports staying within Southeast Asia (Reed and Romei, 2018).

AFTA's main objectives are to:

i. Create a single market and an international production base.
ii. Attract foreign direct investments.
iii. Expand intra-ASEAN trade and investments.

AFTA followed the thread set by other regional FTA deals around the world such as the EU and the North American Free Trade Area (NAFTA). Such an agreement would foster the critical links that would allow SMEs in ASEAN to scale (ASEAN, 2008). AFTA however, differed from other FTAs in that it does not impose a common external tariff. This means that if a country had a lower tariff for a certain item and the cost of transporting the goods to the destination country would be low, this item would enter via the member state and then be transported to the destination state. There would be advantages should a country be a transit point or a value-added producer, which then exports to the rest of ASEAN.

For example, the Thai automotive industry is one of the benefactors of the AFTA, much to the detriment of the Malaysia's own automotive industry (though Proton arguably did not compete in the same market segment as Thailand). As the world's 12th largest automobile production – where most of the global automotive manufacturers had a presence (Thailand Board of Investment, 2016), Thailand is further aided by the bilateral AFTA agreement with China and Japan, which reduces the production cost of assembling cars in Thailand. As a result, Indonesia and Malaysia would use the tariffs set by AFTA to import the vehicles, the latter of which would suffer from a lack of liberalisation and competitive advantage of its national automotive market.

Despite benefiting exporters from market access, there are limitations to the AFTA agreement. Adapting exported products to local market requirements such as making changes in terms of packaging (e.g. language) could make potential exporters hold back from marketing their products in member countries. Another factor is a fluctuating exchange rate, since many FTAs are held between countries with different

macroeconomic policies (Zahariah et al., 2008). Nevertheless, the issues faced by the exporters are more pronounced with SMEs, which may lack the capital to adapt or to deal with such risk, and may not benefit from an FTA.

An ecosystem to help SMEs adapt and effectively sell their products abroad needs to be in place to fully take advantage of such agreements.

Trade agreements with Japan: AJECP and MJEPA

While having in-force a pre-existing bilateral FTA with Japan, Malaysia also benefits from multilateral trade agreements resulting from the ASEAN-Japan Comprehensive Economic Partnership (AJCEP) in 2008. All member countries within the agreement would enjoy preferential tariffs; potential traders would have a larger base to source their materials – under the regional accumulation principle relating to Rules of Origin (ROO) – compared to the bilateral Malaysia-Japan Economic Partnership Agreement (MJEPA). For scale, the MJEPA allows for progressive liberalisation over a 5–10 year period, while the AJCEP would speed up the process for 91 tariff lines. With the immediate elimination of tariffs for 11 tariff lines, Malaysian products such as chemicals, textiles, and agriculture may be marketed more competitively.

The progress from TPPA to CPTPP and RCEP

The TPPA is now known as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) after the United States' withdrawal in 2017. Given that the CPTPP is in the midst of ratification, RCEP will be the world's largest economic bloc for trade integration. Compared to CPTPP, RCEP involves ASEAN member states and six other countries – including China, India, New Zealand, South Korea, Australia, and Japan, which make up over half of the world's population and 30% of global GDP (Ministry of International Trade and Industry, 2018). This would be more than half of the total output and population of the CPTPP.

With geopolitics taken into consideration, Malaysia's participation in FTAs such as CPTPP and RCEP involve potential gains that are not covered by its current trade agreements. With RCEP, 61.7% of Malaysia's trade in 2016 were within the coverage area of the partnership. Briefly, for the CPTPP its greater market access to Canada, Mexico and Peru; while for the RCEP, it is a tidying-up exercise.

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Zahariah, Z., Jamaliah, K., and Marziah, M. (2008). Export Problems Among Small and Medium Scale Industries in Klang Valley: A Preliminary Finding. *Gading Business and Management Journal*, 12(1), 23-39.

A large proportion of Malaysia's exports were made through seaports, followed by airports and land transportation. Among the three modes of transport, goods exported through airports recorded the largest hike at 25.3%, rising from RM213 billion in 2016 to RM267 billion in 2017 – the second-largest share of total export value (Table 1.10). For the first four months of 2018, exports expanded further by 26.4%, corresponding to about 32% of total exports. In terms of air channels, air cargo carriers at Bayan Lepas outperformed air cargo carriers in Kuala Lumpur International Airport (KLIA); about 19% of total exports were transported through the Bayan Lepas air channel, compared to 8.8% at KLIA in 2017. The former's share increased to 23% y-o-y from January to April 2018 while the latter dropped to 7.9% y-o-y. E&E products are estimated to remain the main exported goods at Bayan Lepas.

For sea transport, while it stood at over half of all exports, the increase was not as significant as those exported through airports. Exports through seaports increased by 17.3% to RM530.6 billion in 2017, accounting for about 57% of total exports. In addition, the exports swung upwards by 2.2% y-o-y for the first four months of 2018. Port Klang remained as the main exporting seaport in Malaysia, accounting for about 18% of total exports. Meanwhile, Penang's North Butterworth Cargo Terminal ranked as the fourth-largest seaport transporting exported goods.

Exports through land transport on the other hand saw a decrease in export value for the January–April period in 2017 and 2018. It dropped by 4% y-o-y from January to April 2018, with checkpoints at both Johor Bahru and Tanjung Kupang, Johor showing negative growth rates of 10.4% and 6.4% respectively. For the same period, however, Bukit Kayu Hitam checkpoint registered a boost of about 12%. This suggests that more goods are estimated to carry into Thailand compared with the value of exported goods transporting into Singapore.

Likewise, sea transport continued to be the most popular mode of transport for imports. Over half of total imports were contributed by sea channels (57.3%), followed by air (29.3%) and land channels (13.4%) (Table 1.11). For the first four months of 2018, while the North Butterworth Cargo Terminal

Table 1.10 Exports by mode of transport for selected channel in Malaysia

Exports (RM million)	2016	2017	% change	% share
Sea	**452,473**	**530,558**	**17.3%**	**56.7%**
Port Klang	148,722	171,188	15.1%	18.3%
Bintulu	53,369	68,471	28.3%	7.3%
Pasir Gudang, Johor	46,483	57,542	23.8%	6.2%
North Butterworth Cargo Terminal	45,008	50,724	12.7%	5.4%
Tanjung Pelepas Port	34,274	38,903	13.5%	4.2%
Tanjung Gelang/Kuantan Port	11,973	9,842	-17.8%	1.1%
Others	112,644	133,888	18.9%	14.3%
Air	**213,146**	**267,092**	**25.3%**	**28.6%**
Bayan Lepas	142,827	176,805	23.8%	18.9%
Kuala Lumpur International Airport (KLIA), Sepang	64,846	82,743	27.6%	8.8%
Others	5,473	7,544	37.8%	0.8%
Land	**121,345**	**137,743**	**13.5%**	**14.7%**
Tanjung Kupang, Johor	79,308	92,445	16.6%	9.9%
Johor Bahru (Tambak/Causeway)	20,260	20,764	2.5%	2.2%
Bukit Kayu Hitam	15,586	16,945	8.7%	1.8%
Others	6,191	7,589	22.6%	0.8%
Total	**786,964**	**935,393**	**18.9%**	**100.0%**

Source: Department of Statistics, Malaysia.

Table 1.11 Imports by mode of transport for selected channel in Malaysia

Imports	2016	2017	% change	% share
Sea	**402,365**	**479,855**	**19.3%**	**57.3%**
Port Klang	201,284	220,924	9.8%	26.4%
Bintulu	9,627	8,587	-10.8%	1.0%
Pasir Gudang, Johor	55,058	66,611	21.0%	7.9%
North Butterworth Cargo Terminal	32,635	39,572	21.3%	4.7%
Tanjung Pelepas Port	16,188	16,417	1.4%	2.0%
Tanjung Gelang/Kuantan Port	6,255	11,500	83.9%	1.4%
Others	81,319	116,244	42.9%	13.9%
Air	**203,398**	**245,744**	**20.8%**	**29.3%**
Bayan Lepas	118,665	139,639	17.7%	16.7%
Kuala Lumpur International Airport (KLIA), Sepang	73,875	96,025	30.0%	11.5%
Others	10,859	10,080	-7.2%	1.2%
Land	**93,056**	**112,545**	**20.9%**	**13.4%**
Tanjung Kupang, Johor	57,158	74,052	29.6%	8.8%
Johor Bahru (Tambak/Causeway)	18,119	17,368	-4.1%	2.1%
Bukit Kayu Hitam	13,787	16,116	16.9%	1.9%
Others	3,992	5,009	25.5%	0.6%
Total	**698,819**	**838,145**	**19.9%**	**100.0%**

Source: Department of Statistics, Malaysia.

seaport recorded the third-largest exports in the country, the value of imports grew minutely by 1.5% y-o-y compared to the same period in 2017. For air transport, Bayan Lepas was the biggest channel for imports. While its share lingered at about 16%, the import value decelerated by 2.4% y-o-y from January to April 2018.

1.3 Prospects for 2018

The Malaysian economy is projected to flourish in 2018 with strong support from domestic demand and a favourable external environment. BNM forecasts the GDP growth to be between 5.5% and 6% in 2018. Despite the solid growth momentum, structural reforms under the new administrative regime are necessary to tackle the high level of national debt. Stable oil prices and a rebounded Ringgit are impetuses to the growth of fiscal and current accounts of the country. The impact of a trade war between China and the United States is yet to be felt by Malaysia. However, the focus to bring in quality investment and infrastructure is important to strengthen the country's economic growth.

On the demand side, private consumption is expected to boost from June to August 2018 following the zero-rated GST and stable labour market condition, but will potentially moderate after September 2018 with the reintroduction of the SST. The three-month tax holiday will essentially increase the purchase of durable goods such as motor vehicles and merchandised goods. However, the projected headline inflation and producer price index will increase at a slower rate in 2018 due to higher producer prices for the final four months of 2018, which will then translate into higher prices of goods. For external consumption, Malaysia is expected to experience double-digit growth in trade surplus.

On the supply side, the economic growth is expected to continue, driven by the services sector, followed by the manufacturing sector. Wholesale and retail merchandised goods continue to play a key role in strengthening consumption growth in response to the zero-rated GST. Meanwhile, the E&E cluster and primary cluster from export-oriented industries continue to be responsible for the growth in the manufacturing sector. Approved manufacturing investment for Penang recorded about RM12.5 billion for Q1 2018, accounting for more than one-third of total investment approved in 2017. Investor confidence continues to be robust and hopeful despite the change in federal government. While it is the smallest contributing economic sector, the construction sector is anticipated to slow down due to a number of infrastructure projects requiring further review.