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Near miss

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THE Malaysian economy's second quarter growth of 0.5 per cent confirms what analysts had been expecting - a weakening that is going to persist for at least another quarter.

On a quarter-to-quarter basis, the economy grew by one per cent, narrowly avoiding a technical recession now being experienced by neighbouring Singapore for the same period. The strong 6.1 per cent growth recorded by the services sector surprised many as it did not seem to be in conformity with the rate of deceleration in the overall economy.

More importantly, economic growth that has been powered by exports for the past couple of years was dragged down by a sharp fall in external demand. This means growth will have to come from within. External demand in the second quarter plummeted by 6.8 per cent on a yearly basis compared to the 6.6 per cent growth recorded in the first quarter when the economy grew by 3.1 per cent.

Electronics exports, which make up about 45 per cent of total exports, contracted by 9.1 per cent exposing weaknesses to cyclical swings of a small and open economy like Malaysia's.

Although the second quarter growth numbers came in above market expectations of a 0.1 per cent contraction, 'the underlying trend remains weak,' says HLG Research economist Lee Heng Guie.

Industrial capacity utilisation figures suggest problems with excess capacity that has not been helped by weak domestic demand which only grew by 1.5 per cent in the second quarter compared to 6.4 per cent in the previous quarter.

Downsizing by export-based manufacturers and the financial sector saw retrenchments figures rise to 10,621 workers in the second quarter, up from 5,470 workers in the first quarter. This pushed the unemployment rate to above four per cent of the labour force, further aggravating the weakening cycle.

Prime Minister Datuk Seri Dr Mahathir Mohamad is confident the economy will grow by about two to three per cent for the year. The initial projection was for five to six per cent growth.

The Malaysian Institute of Economic Research expects the country's real gross domestic product (GDP) growth to reach 2.2 per cent at best assuming the global economy does not weaken further.

HLG Research believes there is greater risk of further weakness. Lee expects the economy to contract by two per cent in the third quarter and then grow by 1.5 per cent in the fourth quarter, yielding an annual growth rate of 0.7 per cent for the year.

On the positive side, macro indicators such as balance of payments, international reserves and debt levels are manageable while pressure on the ringgit peg to the US dollar has eased as the greenback has come off its high against the major currencies on the foreign exchange market while the low inflation rate allows for flexibility on interest rate policy management.

Foreign direct investments continue to flow into the country with a net inflow of RM2.4 billion in the second quarter with most of it going into capital intensive investments.

The construction sector, benefiting from the fiscal stimulus programme, posted growth of 3.2 per cent after struggling to grow at about 1 per cent in 2000 and 0.9 per cent in the first quarter of 2001.

Lee believes the government's pump priming efforts will help cushion the impact of the external slowdown on domestic growth.

The good news for Malaysia going forward is that the government has faced up to the reality for change in the way business is done and has begun the politically difficult process of trying to remove the problems of the corporate and financial sectors in a more purposeful manner.

Previously, the strong external economies helped propel the export-based recovery of economies like Malaysia after the 1997 currency crisis and gave the government some time to delay reforms as the economy began to grow.

This allowed the corporate sector to delay making hard restructuring decisions and keep their corporate interests intact. But now, with the major export markets flirting with recession or sluggish growth prospects for some time to come, economic growth will have to be generated domestically and the corporate sector will have to be revitalised.

The weakening economy has also seen the non-performing loans (NPL) figures creep back to the 8.1 per cent level in the banking system as of July 2001, up from 6.3 per cent last December, thus eating away at earnings as banks provide for loss provisioning. The bad loans discourage new credit offtakes as banks dig their heels in waiting for the total redemption of loans while companies are unable to access fresh lending.

For NPLs buried at the national asset agency Pengurusan Danaharta Nasional Bhd, the government has plans to securitise and sell them in the process thus improving the banking sector's balance sheets and allowing them to get back into the intermediation business again. This will take a little time.

For now, the fortunes of the economy depend on continued government stimulus in the upcoming budget and hopes that the global economy starts to improve faster.

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