

01/03/2002

Keys for growth

Dr Ghazali Atan

MALAYSIA'S forecast real gross domestic product (GDP) growth for 2002 ranges from the official government forecast of three per cent to the more optimistic consensus forecast of five per cent by private sector economists. Earlier this year, Prime Minister Datuk Seri Dr Mahathir Mohamad stated that he expects the economy to grow by three per cent, lower than the previous government forecast of five per cent. Despite lowering the target, can the Malaysian economy record such growth for 2002? If so, how will Malaysia achieve this? In our opinion, the key factor lies in the external trade sector.

Malaysia's external trade is influenced by two major factors, namely, the situation with the US economy and the semiconductor industry. Malaysia's exports, valued at 109 per cent of GDP, consists mainly of manufacturing products, specifically, manufactured electrical and electronic goods (E&E). For 2001, as of November, manufactured goods contributed 85 per cent of total exports while E&E made up 70 per cent of total exports.

In addition, the United States is the largest single importer of Malaysia's goods, importing some 20 per cent, followed by Singapore. More importantly, the US economy, being the engine of growth for economies worldwide, will influence Malaysia's exports to other countries too.

Therefore, the robustness of the US economy and the global semiconductor industry are crucial factors in determining the performance of Malaysia's trade balance, which in turn determines economic growth. Both factors are also heavily linked to each other.

So, where are the US economy and the global semiconductor industry headed for? What is the correlation and coefficient of these two factors against Malaysia's exports?

In our studies, we found that there is a strong correlation between the US' GDP and Malaysia's manufacturing exports, based on year-on-year figures. The latest fourth quarter (Q4) results showed that the US economy grew by 0.3 per cent year-on-year. However, for 2002, US officials forecast growth to improve to 0.7 per cent, taking into consideration US rate cuts and fiscal stimulus. If US forecasts are true, it will bode well for Malaysia's exports in 2002.

In addition, the manufacturing sector in the United States has, as a whole, recently shown signs of recovery as indicated by the Institute of Supply Management's (ISM) New Orders, formerly known as the NAPM. New Order levels have surpassed the neutral level, 50, for the past two months, indicating strong growth. The index has some correlation and acts as a leading indicator to Malaysian exports. The index moves four months ahead of Malaysia's exports.

Bullish sentiments are also on the horizon for the semiconductor industry. There is a correlation between semiconductor new orders and Malaysian exports, based on three-month average figures. Currently, semiconductor new orders (three-month average) have stabilised at US\$ 5.6 billion for December 2001 while Malaysia's exports have also stabilised, signaling a bottoming out.

There are two early indications of bottoming out for the global semiconductor industry.

Firstly, the book-to-bill ratio of semiconductor equipment has steadily increased from its low of 0.44 in April 2001 to 0.78 in December 2001. A

ratio of above one indicates growth.

Secondly, inventory levels continue to decline amid stable orders. If the current trend persists, it may not take long for orders to exceed inventories. This occurred during the bullish years of 1994 till January 2001.

Now that we know there are early signs of a turnaround in the US economy and the global semiconductor industry, how will this in turn affect our exports, specifically the manufacturing sector of the Malaysian economy?

As stated earlier, Malaysian exports have a strong correlation with US economic growth. The value of manufacturing exports has increased gradually in Q4 in financial year 2000 (FY00), led by E&E exports which rose for the fourth consecutive month. The increase was in line with the 'surprise' quarter-on-quarter growth in the US economy after contracting in the third quarter.

Year-on-year, manufacturing exports are still declining but the pace has decelerated. Our research shows that for each US\$ 1 billion increase in the United States' real GDP, Malaysian exports of manufacturing goods increase by RM26 million.

The manufacturing sector is the second largest contributor to total GDP after the services sector. The sector contributes up to 34 per cent of total GDP, increasing from 26 per cent in 1991. The slowdown in the manufacturing sector is the main reason for the current economic slowdown as it is the only sector that has contracted in the first three quarters of 2001. Manufacturing sales figures for 2001 show a contraction of 7.3 per cent from 2000.

Increasing demand for our exports, especially for manufacturing goods, will help revive the manufacturing sector. The local Industrial Production Index (IPI) for manufacturing was in contracting mode in 2001, declining by six per cent. However, the index has been stabilising around the 195 to 200-point level in Q4 FY01, in line with the recovery of manufacturing exports and also the US economic recovery. Manufacturing sales continue to decline, dragged down by local sales. The pace of the decline, however, is decelerating as exports rise.

Coming back to the main question, can we record a growth of three per cent in 2002? In order to record a growth rate of three per cent for 2002, as mentioned by the Prime Minister, the manufacturing sector has to recover. Government growth policies will not be adequate in achieving the target without favourable external factors which have a direct impact on our manufacturing sector.

The US GDP growth forecast for 2002 range from 0.7 per cent by the United States Government to three per cent by economists. This will translate into a growth of between 1.8 per cent and 7.7 per cent for the manufacturing sector.

For Malaysia to achieve economic growth of three per cent, other sectors, especially the services and construction sectors, need to maintain 2001's growth rate at the very least. We feel with the ongoing corporate restructuring, low interest rates and the government fiscal stimulus implemented, the services and construction sector are more than capable of reaching 2001's growth rate. With reviving external factors, Malaysia's targeted GDP growth is indeed achievable.