



MALAYSIA
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Bated Breath

Malaysia's economy was *just recovering when the Sars outbreak* and the Iraq war knocked the bottom out

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In mid-April, Kuala Lumpur quietly ordered all state-owned companies to seek permission in writing from the Finance Ministry if they wanted to shed any staff. Government-owned companies comprise a large chunk of the economy and the government can't afford to have unemployment rise.

"Malaysia is an economy waiting for the other shoe to drop," says Cliff Tan, a director of Asian economies at Citigroup in Singapore.

Between the Iraq war and Severe Acute Respiratory Syndrome (Sars) now sweeping Asia, the prognosis for the Malaysian economy is uncertain. The latter, especially, has almost crippled tourism, Malaysia's second-largest foreign-

OUT OF JOINT

In spending their way out of recession, Asian governments have allowed fiscal deficits to swell

| | -Fiscal balance (% of GDP) -- | | | |
|--------------------|-------------------------------|-------------|-------------|-------------|
| | 1999 | 2000 | 2001 | 2002* |
| China | -4.0 | -3.6 | -3.2 | -3.3 |
| Hong Kong | 0.8 | -0.6 | -5.0 | -5.5 |
| Indonesia | 0 | -2.7 | -2.4 | -1.6 |
| South Korea | -2.7 | 1.1 | 1.3 | 1.0 |
| Malaysia | -3.2 | -5.8 | -5.5 | -5.6 |
| Philippines | -3.8 | -4.1 | -4.0 | -5.6 |
| Singapore | 3.4 | 2.5 | -1.8 | -0.1 |
| Thailand | -2.9 | -2.4 | -2.1 | -2.2 |

*Estimates Source: Morgan Stanley

exchange earner after oil and gas. According to an early May survey by the Association of Tour and Travel Agencies, domestic tourism is down 60%. Meanwhile, visitors from China, one of Malaysia's fastest growing markets, dropped to near zero while those from Hong Kong and Taiwan declined 90%. Singapore arrivals, the largest single source of visitors, contracted 80% while those from all other markets fell by 50%-60%.

The government has already revised 2003 growth projections down to 4.5% from 6%-6.5% and economists anticipate further downgrades as the effect of Sars becomes clearer. But other economists have already jumped the gun: In late April, Morgan Stanley cut Malaysia's 2003 GDP growth forecast to 3% from **4.1%**.

How Sars affects the economies of Malaysia's trading partners will be critical. Singapore, for instance, is one of Malaysia's largest trading partners while exports to China are the fastest growing. Both countries are severely affected by the disease and this will have knock-on effects on Malaysia.

It's already showing. Private economists say that industrial production for the first quarter of 2003 will decline **1.6%** quarter-on-quarter while both imports and exports, according to official statistics, have been dropping. Economists expect that to translate into falling employment and slowing private spending—exactly what the government hopes to avoid.

Kuala Lumpur is expected to address the problems with a so-called "stimulus" package set to be announced in mid-May. Even so, analysts don't expect a big pump-priming exercise. This year will mark the sixth straight year of budget deficits and Prime Minister Mahathir Mohamad, who's also finance minister, has indicated that he'd like to balance the books by 2005.

It may not happen. The fiscal deficit has risen from 1.8% of GDP in 1998 to an estimated 5.6% in 2002, a fact that's consistently pinpointed as worrying by international rating agencies. And it doesn't appear to be improving. Analysts think that the deficit will remain at around the 2002 level—which is already comparable to the Philippines and one of the highest in East Asia. Interest-rate cuts are also thought unlikely as the central bank thinks it would deter savers.

What could happen, however, is a sharp reduction in the rates both employers and employees compulsorily contribute to the Employees Provident Fund, a national pension plan. Now the contributions are 12% and 11% of salaries respectively. Cutting them would do two things: reduce the cost of business while giving employees more disposable income. It could be one way out. ☐