

Abdullah rests his campaign on the economy

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NEWS ANALYSIS

Growth has been resilient but is now under threat from inflation and rivals, China and Vietnam, writes

John Burton

The economy is proving to be a double-edged sword for Abdullah Badawi and his National Front government as Malaysia heads for the polls.

Mr Abdullah is hoping the resilient economy, which grew by 6.3 per cent last year, will be a key factor in securing a second term as prime minister.

But inflation has also risen and is a source of public discontent.

Although the current inflation rate of 2 per cent compares favourably with neighbouring Singapore's 6.6

per cent, rising prices are falling heaviest on the poor and inflation could accelerate to nearly 3 per cent this year. "There is a growing gap between rich and poor and inflation is accelerating the trend," says Anil Netto from Aliran, a social reform group.

"The national inflation rate may be low, but it is approaching those of Singapore in the urban areas. That is the problem," says a senior aide to Mr Abdullah. Ethnic minorities - concentrated in the cities - are already unhappy about the government's preferential treatment of the ethnic Malay majority.

The government has launched an advertising campaign highlighting the M\$43bn (\$13.5bn, €9bn, £7bn) it spent on subsidies last year to keep the cost of fuel, flour, sugar and cooking oil lower than in many other south-east Asian countries. Malaysia spends more than 10 per cent of its budget on

fuel subsidies. Many believe the government will cut fuel subsidies after the election to reduce its budget deficit below 3 per cent of gross domestic product. However, Mr Abdullah played down those expectations.

The recent boom in palm oil prices has benefited the country, as the world's second-largest producer of the commodity, with sales accounting for 15 per cent of GDP last year, up from 8 per cent in 2006. But it has added to inflationary pressure, since it is a key ingre-

redient in cooking oil and household products. There are worries that Malaysia has become too dependent on palm oil for recent growth when the rest of the economy, one of the world's most export-dependent, could be hurt by a slowdown in important markets such as the US, which is the biggest customer for the mainstay electronics industry.

Analysts believe Mr Abdullah decided to call an early election in anticipation that growth might slow later this year owing to weak glo-

bal demand, although he insists in public that the economy could perform better than expected in 2008.

The government has resorted to pump-priming measures to boost the economy. The nation's 1.2m civil servants were given a pay rise of up to 35 per cent last year to support consumer demand. Large infrastructure projects have also been launched.

But there are signs that Malaysia may be close to a cyclical peak in resources and construction.

Economists warn that the pump-priming is masking a fundamental problem that Malaysia is losing its competitiveness against China and Vietnam, which have lower labour costs.

Mr Abdullah says he wants to move Malaysia up the value chain, but his critics say this is unlikely to happen as long as the country's industries are shielded by a weak currency and strong state intervention.

Prime minister's agenda of reforms

- Establish growth corridors to attract foreign investment and help develop neglected rural areas.
- Expand service industries to reduce dependence on manufacturing, with an emphasis on financial services and tourism.

- Cut the budget deficit to at least 3 per cent, from more than 5 per cent when Abdullah Badawi took office as prime minister in 2003.
- Restructure state companies, which make up a third of the Kuala Lumpur stock exchange.