

Overall Balance Leading to A Large Accumulation in Int'l Reserves

Despite the initial uncertainties amidst market expectations of some moderation in growth, the Malaysian economy recorded a higher growth of 8.5% in 1993, compared with 7.8% in 1992. The stronger growth emanated mainly from the impressive performance of the manufacturing, construction and services sectors. Growth in the agriculture sector also expanded but mining activity

deteriorated to register a decline of 1.3%.

On the demand side, real aggregate domestic demand picked up to register a growth of 6% in 1993 (2.5% in 1992). The improvement was due to higher expenditure in both the public and private sectors. The increase in public sector expenditure was in line with the Government's emphasis to expand infrastructure and support facilities to relieve supply constraints and moderate

price pressures.

In the private sector, consumer spending picked up amidst an environment of improved corporate profits and a booming stock market. The continued expansion in private investment outlays also contributed to the increase in private spending during the year.

On the price front, the domestic price situation improved slightly in 1993 after rising steadily since 1987. For the year as a whole, growth in the Consumer Price Index (CPI, 1990=100) moderated to 3.6% from 4.7% in 1992 and 4.4% in 1991.

To a large extent, the success in containing price pressure in 1993 was attributable to the Government's commitment to a comprehensive package of anti-inflationary policies. Coupled with a restrictive monetary policy stance, the Government continued to maintain fiscal prudence to ensure that public

spending did not aggravate the inflation situation.

At the same time, other administrative measures including compulsory price tagging on all retail items were introduced while more frequent and stricter price checks were carried out to ensure that the benefit of lower price following the reduction of abolition of import duties on more than 1,100 food and other essential items in the 1993 and 1994 Budgets, were passed on to the consumers. Consequently, food prices moderated to 2.2% in 1993 from 6.6% in 1992.

On the employment front, the labor market tightened further with the rate of unemployment declining to 3% in 1993, implying that the economy was operating at or near full employment level. The tighter labor market was reflected in the higher incidence of job-hopping, staff pinching and wage pressures during the year.

As a temporary relief to the problem of labor shortages, the Government continued to allow the recruitment of foreign labor. Over the longer term, however, efforts to resolve the problem of labor shortages will focus on the efficient utilization on the existing labor force, particularly female workers as well as promoting more labor-saving and skill-intensive industries.

Turning to the external sector, Malaysia's overall balance of payments position was exceptionally strong in 1993, leading to a large accumulation in net international reserves of the central Bank. The large overall surplus was mainly attributable to strong net inflows in the capital account.



Newly-built North-South highway, linking with Singapore.

In contrast, the current account showed a larger deficit of RM5.4 billion, reflecting the sharp acceleration in import growth relative to export growth, which yielded a merchandise surplus of RM8.8 billion that was insufficient to finance the larger services deficit of RM14.4 billion.

Nevertheless, the current account deficit may not be altogether adverse as a substantial portion of the sharp increase in imports was associated with investment in infrastructure and public utilities as well as production capacity expansion. These investments would facilitate rapid economic growth in Malaysia over the medium term.

In the capital account, the net long-term capital inflow increased substantially to RM11.7 billion in 1993. This reflected

the continued high net inflow of corporate investment and net inflow of official long-term capital. The short-term capital inflows were also exceptionally strong in 1993, attracted mainly by sound economic fundamentals, interest rate differentials in favor of Malaysia and the buoyant performance of the stock market.

Consequently, the net international reserves of the Central Bank rose by RM29.2 billion to a new peak of RM76.4 billion at the end of 1993, which was sufficient to finance about 7.8 months of retained imports.

A most notable success was achieved in Government finance. Sustained fiscal consolidation and the robust economy contributed to an exceptionally large current account surplus of RM9.5 billion, while the overall balance realized a small surplus of RM354 million or 0.2% of GNP in 1993. The results exceeded expectations and represented the Government's first overall budget surplus in more than three decades.

While the Federal Government continued to prepay several expensive loans, overall there was greater recourse to external borrowing in 1993 arising from the need to meet the large financing requirements for infrastructure development and other investment programs by the non-financial public enterprises (NFPEs) and the private sector. Coupled with revaluation losses, the nation's external debt turned around to record for the first time in many years, a double digit increase of 20.9% to reach RM51.7 billion (US\$19.1 billion) at the end of 1993.

However, the external debt stabilized at about 33% of GNP, a significant improvement from the peak of 76% in 1986.



Well planned infrastructure criss-crossing the country including the newly completed North-South Highway.

In addition, the external debt remained well below the stock of international reserves of RM76.4 billion for the second successive year. Similarly, the debt service ratio stabilized at 6.3% in 1993.

In the capital market, a milestone was reached with the formation of a single regulatory body, namely the Securities Commission, on March 1, 1993 to oversee the overall development of the securities, options and financial futures industries. In addition, the Futures Industry Act 1992 was enacted to set the regulatory frame work for the introduction of trading in options and financial futures.

The Kuala Lumpur Stock Exchange (KLSE) had an outstanding year in 1992. It achieved unprecedented record-breaking performances in terms of prices, turnover and market capitalization. Within a year the market indicator, the Kuala Lumpur Composite Index (KLCI), doubled from 644 points to 1275 points.

Total turnover rose to 107.8 billion units valued at RM387 billion, surpassing the cumulative volume and value of shares traded over the past 20 years. The KLSE's market capitalization expanded by 152% from RM 246 billion to RM 620 billion or four times the size of GNP. The KLSE is currently the largest bourse in ASEAN and the fourth biggest in Asia.

However, trading activities in the KLSE experienced a sharp correction in the first five months of 1994. The KLCI fell to 994 points, while the market capitalization dropped to RM473 billion by the end of May 1994.

Activity in the primary market was less vibrant in 1993. Net funds raised fell by one-half from the previous year's level of RM13.8 billion to RM6.5 billion, reflecting mainly the absence of the privatized companies seeking listing on the KLSE and the improved cash flow positions of both the Government and private corporations. In the first four months of 1994, a further RM4.8 billion was raised in the capital market.

The thrust of monetary policy in 1993 continued to center on maintaining price and exchange rate stability in order to provide an environment conducive for sustainable output growth. However, the strong economic fundamentals and significant interest rate differentials in Malaysia's favor attracted inflows of short-term capital, particularly towards the end of the year.

These massive inflows presented a significant challenge to monetary management. Not only was there a need manage the overhang of excess liquidity from previous years, there was also the question of managing the additional

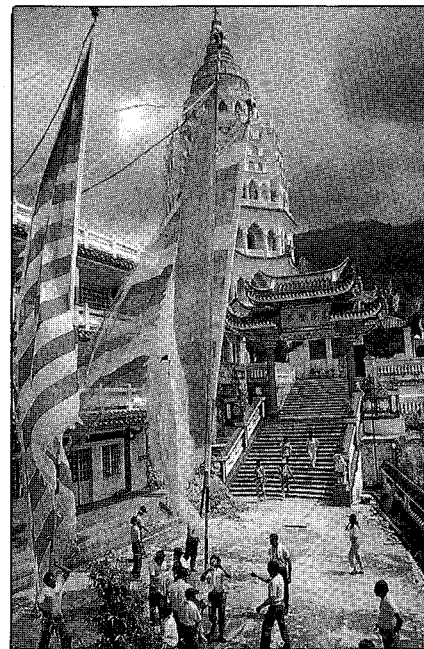
liquidity sourced externally.

Monetary management was complicated by the limited number of monetary instruments available to the Central Bank in its effort to mop up excess liquidity. The government's favorable financial position, together with the privatization of the NFPEs, dispensed with the need for large issues of MGS to finance development expenditure.

As such, the Central Bank increasingly relied on direct short-term borrowing in the money market, absorbing about RM27 billion in excess liquidity. Two other major developments during the year were the issues of Bank Negara Bills and the introduction of the Malaysia Savings Bond, which together mopped up RM6.9 billion. Concomitantly, excess funds of the Government and the Employees Provident Fund continued to be placed with the Central Bank in 1993.

Despite the restrictive monetary stance, all the monetary aggregates showed strong double digit increases by the end of 1993. M1 and M2 rose at an annual rate of 37.5% and 23.6% respectively while the growth of M3, which moderated in April to 16.5%, rebounded in Oct. before settling at 24.4% at the end of the year.

Liquidity remained ample in 1993. Excessive liquidity from abroad necessitated the implementation of several measures in early 1994. These measures included raising the statutory reserve requirement (SRR) to 9.5% from 8.5% of the eligible liabilities (EL) base; redefining the EL base to include foreign inflows; imposing limits on the net external liabilities position of the banking institutions; restricting the sale of short-term monetary instruments to non-



Tourist attraction in Malaysia, Penang: Kek Lok Si Temple.

residents; placing vostro account balances with the Central Bank and including these balances in the EL base; and restricting commercial banks from undertaking non-trade related swap and outright forward transactions on the bid side with foreign customers.

By the end of the first quarter of 1994, these measures had begun to take effect on moderating the liquidity situation. As a result, the Central bank allowed the exclusion of vostro account balances from the EL base with effect from May 16, 1994. The SRR was simultaneously raised to 10.5% to partially absorb the expected increased in liquidity arising from the exclusion of the vostro balances. ★



Efficient facilities of Port Kelong.