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10th Malaysia Plan: A step closer towards becoming a high-income nation

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Our Overall View

- An overall noteworthy blueprint – that's the first impression that we get from the Tenth Malaysia Plan (10MP) unveiled by the government last Thursday. The overall plan seems to jibe with the overall objectives and measures in the New Economic Model (NEM) presented by the Prime Minister last March as part of Malaysia's Economic Transformation Programme (ETP). The next critical step is the implementation, apart from detailed measures of the NEM which will be unveiled in the later part of the year.

- The targets set by the government in the 10MP seem to be ambitious, especially with regards to overall growth and private investments. Notwithstanding that, with proper execution and a little luck from favorable global economic conditions, they may indeed be achievable. We are of the opinion that the 6% growth target is achievable if the 12.8% targeted expansion in private investment is realised. This is a tall order considering the minuscule 2% estimated achievement under the Ninth Malaysia Plan (9MP) and the risk aversion that persists following the global financial crisis in 2009.

- Nevertheless, the high-impact projects underlined by the government may prove to be the key catalyst for stronger private investments under the 10MP. With further efforts to enhance the ease of doing business through faster approvals by relevant authorities as well as proper relaxations of regulations, the government is taking the right steps to improve its competitiveness. This is attested to by the latest *IMD World Competitiveness Scoreboard 2010* report which placed the country at the 10th position - a dramatic jump from its previous placing of 18th out of 58 world economies. However, the delay in the implementation of certain projects may dampen the positive effects on the economy in the near term.

- Despite the government's efforts to strengthen domestic demand, global economic conditions may still be the key determinant of Malaysia's growth profile in the next few years. Indeed, contrary to the widespread belief that the domestic and external sectors are mutually exclusive, they are not. The strength of the services sector (e.g. transport, logistics) is dependent on the vibrancy of the external sector. As such, strong global trade performance will be a crucial catalyst for the export sector and the vibrancy of the domestic sector as a whole. This is an important criterion to ensure the achievement of Malaysia's 6% growth target.

- As for the fiscal position, we think it is moving in the right direction. For one thing, the fiscal consolidation process has been instituted, and the nation's coffers continue to witness an improvement from a deficit of 5.5% of GDP in 2000 to 3.2% in 2007. However, the global economic crisis threw cold water on this consolidation process, causing the deficit to burgeon to 7.0% in 2009. Going forward, we foresee the emergence of two factors that will contribute to the improvement of the deficit level: rising nominal GDP (which will increase revenue collection), and careful and well-planned expenditure by the government. In addition, we opine that Malaysia's fiscal deficit will not lead to other macro imbalances such as an overblown debt position or hyperinflation.

Malaysia

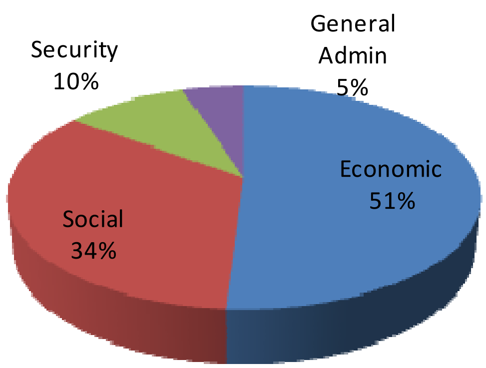
10th Malaysia Plan

Overview

The 10MP was unveiled in Parliament on June 10 by Prime Minister Dato' Seri Najib Tun Razak to spearhead the Malaysian economy over a period of five years beginning 2011 to achieve developed-nation status by 2020. It is one of the four pillars of the national transformation program (the others being 1Malaysia, the Government Transformation Programme (GTP), and the Economic Transformation Programme (ETP)).

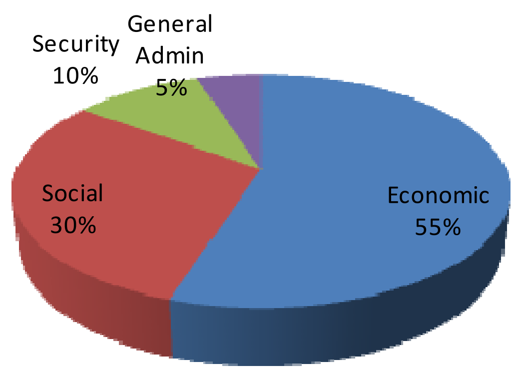
Under the 10MP, the Malaysian economy is envisaged to grow at an average clip of 6.0% per annum, higher than the 4.2% average growth achieved in the Ninth Malaysia Plan (9MP: 2006-2010). RM230 billion worth of development spending has been allocated under this plan (9MP: RM230 billion), with the economic sector getting the lion's share of the allocation (55%; 9MP: 51%), followed by the social sector (30%; 9MP: 34%), security sector (10%; 9MP: 10%) and general administration (5%; 9MP: 5%). The spending program is specially designed to enhance the role of the private sector in the economy, with the public sector acting as a catalyst or enabler to the growth process. In this regard, private expenditure (consumption and investment) is expected to expand by 8.6% per annum (9MP: 5.7%) while growth of public expenditure (consumption and investment) is foreseen to moderate to 4.9% per annum (9MP: 5.4%).

Chart 1: Spending allocation for 9MP = RM230 billion



Source: 10MP

Chart 2: Spending allocation for 10MP = RM230 billion



Source: 10MP

Table 1: Macro targets under 10MP

	9MP 2006 -10	10MP 2011-15
Private expenditure	5.7	8.6
-Consumption	6.5	7.7
-Investment	2.0	12.8
Public expenditure	5.4	4.9
-Consumption	4.8	4.8
-Investment	6.2	5.0
Exports	1.8	7.2
Imports	2.8	8.6
Gross Domestic Product	4.2	6.0
Per capita income	2010	2015
RM	26,420	38,845
USD	8,256	12,139

Source: 10MP

The Five Key Thrusts of 10MP

- ✓ **Designing government philosophy and approach to transform Malaysia using the National Key Result Area (NKRA) methodology**

  The main objective under this thrust is to transform the government machinery to support changes in the economic landscape. By this, the government will be focusing on developing non-physical infrastructure, i.e. human capital via skills as well as innovation-capability development. In line with this, the 10MP allocation for non-physical infrastructure will be increased to 40% from 21.8% in the previous plan. A world-class college will also be established to raise the competency of civil servants.

- ✓ **Creating a conducive environment to unleash economic growth**

  A strategy based on specialisation was identified as the key ingredient to sustain Malaysia's competitiveness level. In this respect, 12 national key economic areas (NKEAs) have been earmarked to propel the Malaysian economy to high-income status. The 12 NKEAs are oil & gas, palm oil and related products, financial services, wholesale and retail, tourism, information and communication technology (ICT), education services, electrical and electronic (E&E), business services, private healthcare, agriculture, and Greater Kuala Lumpur.

- ✓ **Moving towards inclusive socio-economic development**

  This thrust is a specific attempt to address the issues on equality and inclusiveness among races as well as geographical areas in order to enjoy the fruit of economic development. In this regard, Bumiputera participation in the economy will be enhanced to include financial and non-financial assets such as real estate, business premises and professional employment. Hardship faced by the citizenry in Sabah and Sarawak in terms of lack of electricity and water supply will be addressed by intensifying the implementation of economic programmes and the provision of basic amenities.

- ✓ **Developing and retaining a first-world talent base**

  Recognising the need to develop a competent labour force, special attention will be devoted to the education sector. To this end, the issue of the quality of teachers has been highlighted with an intention to raise the proportion of graduate teachers in primary schools to 60% from the current 58%. In order to make this a reality, programmes to enable non-graduate teachers to attain degrees will be intensified while the minimum qualification for pre-school teachers will be raised to diploma and bachelor's degree. In addition, The Talent Corporation will be established to address the pressing issue of brain drain. It aims to attract approximately 700,000 Malaysians working abroad to return to the country and fill vacant positions in the labour market.

- ✓ **Building an environment that enhances quality of life**

  The government is committed to achieving a balanced growth that promotes higher quality of life among citizens. Enhancing the livability of cities will take on greater importance, as 67% of the Malaysian population reside in urban areas. Hence, reducing crime rates as well as improving the state of transportation infrastructure and basic amenities such as electricity and water supplies are critical in achieving this objective. In tandem with the aforementioned Greater Kuala Lumpur NKEA, the Mass Rapid Transit (MRT) plan will be implemented to enhance the public transportation network in Kuala Lumpur. The MRT is expected to cover a radius of 20km from the city centre (with a total length of about 150km), and is envisaged to serve up to two million passenger trips per day from 480,000 trips on the prevailing urban rail systems.

Table 2: Selected sectors to benefit from measures introduced in 10MP

Sector	Measures
Construction / Infrastructure	❖ 52 high-impact projects worth RM63 billion have been identified for implementation. Projects include 7 highway projects (RM19 billion), 2 coal electricity generation plants (RM7 billion) and an LNG regasification plant (RM3 billion) and 2 aluminum smelters (RM18 billion). ❖ Development of Phase 2 of the East Coast Expressway from Kuantan to Kuala Terengganu (RM3.7 billion), electrified double track trail project from Gemas to Johor Bahru (RM8 billion) ❖ A Facilitation Fund of RM20 billion will be provided, and is expected to attract private sector investment of RM200 billion. ❖ The government will build 6,300km of paved roads in Peninsular Malaysia, 2,500km in Sabah and 2,800km in Sarawak. This will benefit 3.3 million people. ❖ The implementation of the high capacity Mass Rapid Transit system which is expected to cover a radius of 20km from the city centre with a total length of about 150km. ❖ The construction of bus and rail terminals such as the Gombak Integrated Transport Terminal. ❖ A Bus Rapid Transit system will be introduced in Iskandar, Johor while the number of busses in Penang will be increased by 200 busses to enable the expansion of 26 routes with an added capacity of 75,000 passengers per day. ❖ The construction of 8 hospitals, including specialist hospitals, 197 clinics and 50 additional 1Malaysia clinics.
Property	❖ Development of the Malaysian Rubber Board's land in Sungai Buloh (RM10 billion), Kuala Lumpur Strategic Development covering the Sungai Besi Airport area, KL International Financial District. ❖ 78,000 affordable houses will be built to ensure an adequate supply of affordable houses for the low income group. ❖ A fund of RM500 million will be established for the repair and maintenance works of public and private low-cost housing.
Water	❖ Water supply will be provided to 182 estates (RM109 million) in order to improve the quality of life of workers in estates. ❖ To improve water supply in rural areas with a target of 99% in Peninsular Malaysia, 98% in Sabah and 95% in Sarawak.
Power	❖ The provision of electricity supply in rural areas will be extended to 6,000 homes in Peninsular Malaysia, 59,000 homes in Sabah and 76,000 homes in Sarawak.
Small and medium enterprises (SMEs)	❖ The government will provide an additional RM3 billion to the Working Capital Guarantee Scheme, resulting in a total fund under the existing facility of RM10 billion. ❖ The government will consider increasing the financial resources of SME and Agro Bank to enable them to provide effective services to SME entrepreneurs.

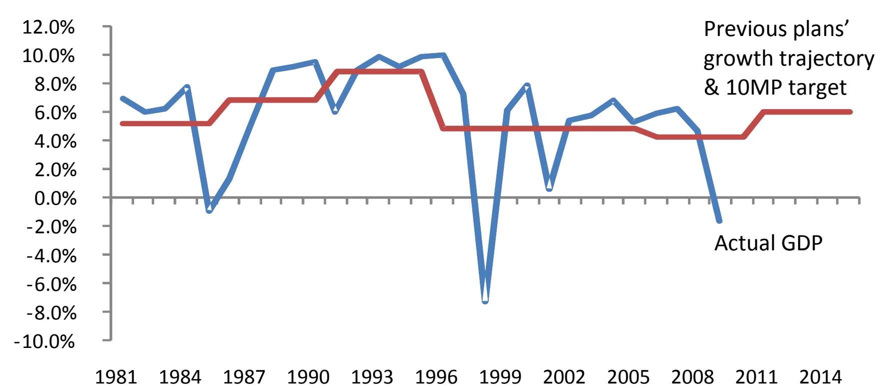
The Way We See It

i) GDP growth target

The growth target is somewhat ambitious in light of the risks associated with China's property bubble, current developments in the debt-ensnared European countries and the embitterment between the two Koreas. The economy was expected to grow at 6.0% per annum during the previous plan. However, the US subprime crisis that reared its ugly head in 2008 took a serious toll on Malaysia's economic growth. As a result, an average growth of only 4.2% was achieved during the 9MP. To be fair, Malaysian policymakers' efforts to enhance domestic economic capabilities in the past few years have paid off handsomely – during the recent global crisis, the country sustained minimal impact on its overall macro conditions. The recession in 2009, which saw the country's growth coming in at -1.7% for the year, was mild compared with the 1997/98 Asian Financial Crisis when the economy contracted by a massive 7.5%.

Notwithstanding that, Malaysia's growth profile in the next five years is still likely to be largely influenced by global economic conditions, as trade accounts for twice the country's GDP. What needs to be stressed is the fact that the domestic and external sectors are not mutually exclusive, and that the sustainability of the former is contingent on the vibrancy of the latter. This is due to the deep linkages between the domestic and international economic activities. For instance, ports, transportation and even banking activities are important functions of international trade activities. Therefore, vibrant global international trade is critical for the achievement of Malaysia's envisaged growth trajectory.

Chart 3: Actual GDP vs. previous plans' growth trajectory & 10MP target



Sources: CEIC & 10MP

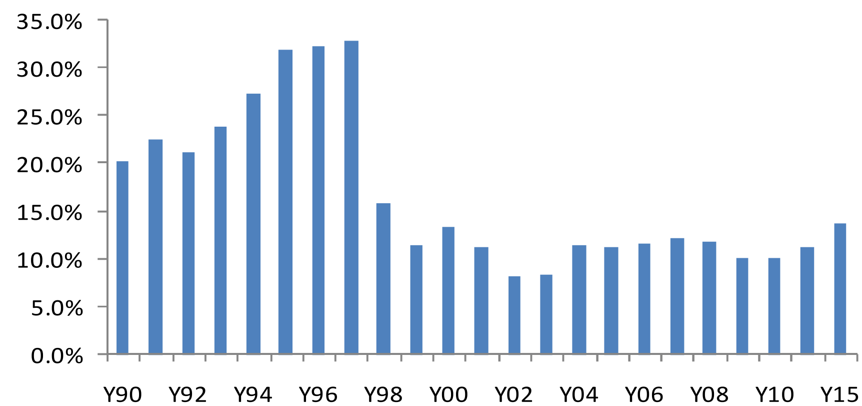
ii) Spurring private investment

In the second strategic thrust, the government has identified 52 high-impact projects worth RM63 billion. These projects will be implemented through public-private partnerships (PPP) which will ensure equitable sharing of risks and returns. In addition, a Facilitation Fund of RM20 billion will be provided under the 10MP, and is expected to attract private investments worth at least RM200 billion. The government is thus seen to be taking necessary steps to ensure that the private sector will eventually take over the reins to drive growth. At the same time, this will help the government keep closer tabs on its finances. If the projects go as planned, the share of private investment to GDP will improve from 10% in 2010 to 13.9% in 2015.

We are cautiously confident that the targets for private investments can be achieved, and we acknowledge that they are the major drivers for overall growth. Without such achievements, it would be very challenging for the government to realise the overall growth target needed to achieve the ultimate goal of becoming a high-income country by 2020. One positive attribute of the economy today is the liquidity-flushed financial system which can be tapped to finance various types of investments as and when needed. In fact, the savings-investment gap as a percentage of GDP in 1Q2010 stood at 16.6% (4Q2009: 14.8%), or RM30.4 billion. The high-impact projects underlined by the government may prove to be the key catalyst for stronger private investments under the 10MP. Among the projects that have been identified are:

- Seven highway projects costing an estimated RM19 billion, including the West Coast Expressway, Guthrie-Damansara Expressway, Sungai Juru Expressway and Paroi-Senawang-KLIA Expressway
- Two coal electricity generation plants worth an estimated RM7 billion
- Development of the Malaysian Rubber Board's land in Sungai Buloh with an estimated cost of RM10 billion
- Projects led by government-linked companies (GLC) such as the Kuala Lumpur Strategic Development, the KL International Financial District, the LNG regasification plant with an estimated cost of RM3 billion, and two aluminum smelters in SCORE Sarawak worth RM18 billion.

Chart 4: Private investment as a percentage of GDP



Sources: CEIC & 10MP

iii) Implementation risks

There are, of course, implementation risks. Tardiness in awarding contracts and implementation deadlines being pushed forward may delay the multiplier effects on the economy (potential examples of this include the LRT line extension and remaining packages of the Interstate Raw Water Transfer). We believe that the number of projects being announced under the 10MP has been commendable and will likely have a positive effect on the economy if implemented within reasonable timeframes.

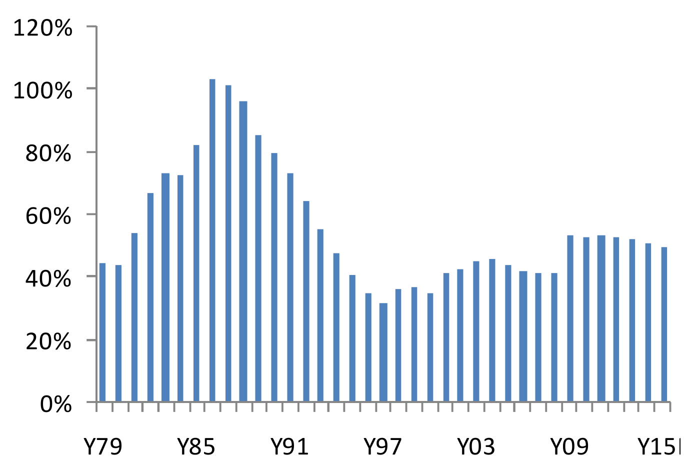
iv) Government finances

In view of the recent brouhaha about the prospects of government finances in the near term, we deem the current fiscal position as fairly reasonable, given the prevailing circumstances. For one thing, the fiscal consolidation process has been instituted, and the nation's coffers continue to witness an improvement from a deficit of 5.5% of GDP in 2000 to 3.2% in 2007. Only when the global economic crisis erupted in 2008 was the process interrupted, resulting in the deficit bloating to a whopping 7.0% in 2009. In the same vein, the federal government debt level burgeoned to 53.7% of GDP in 2009 after persistently falling to as low as 41.5% in 2008.

The major causes for the rising deficit in 2009 are none other than the two fiscal stimulus measures introduced by the government in 2008 and 2009. To some extent, the sharp decline in nominal GDP by 8.3% explained why the deficit looked sizeable when expressed as a ratio to the size of the economy. Hence, the rise in deficits as well as the debt level should be viewed as the "necessary evils" needed to prevent the economy from slipping into deeper recession. The measures have thus far been fruitful in turning around the economy, judging by the latest GDP print in the first quarter of this year which grew at the fastest clip since 1Q 2000.

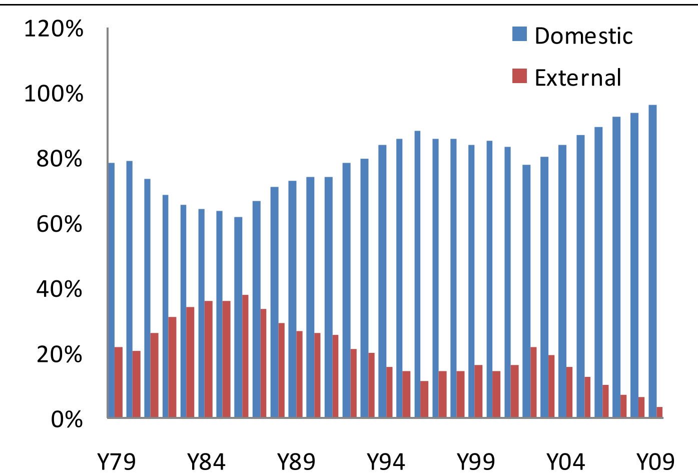
Arguably, the stimulus measures will need to be reversed as the economy grows stronger. Bank Negara Malaysia (BNM) has accordingly taken such steps by raising the overnight policy rate (OPR) by a total of 50 basis points (bps) in the year to date. In terms of fiscal policy, the government will likely be extra careful in its expenses as it is committed to bringing down the deficit level to below 3% of GDP and reduce the government debt level to 49.9% of GDP by the end of 10MP.

Chart 5: Federal government debt level as a percentage of GDP



Sources: CEIC & 10MP

Chart 6: Composition of federal government debt



Source: CEIC

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