

Economic Research

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The State of Selangor



MALAYSIAN RATING CORPORATION BERHAD
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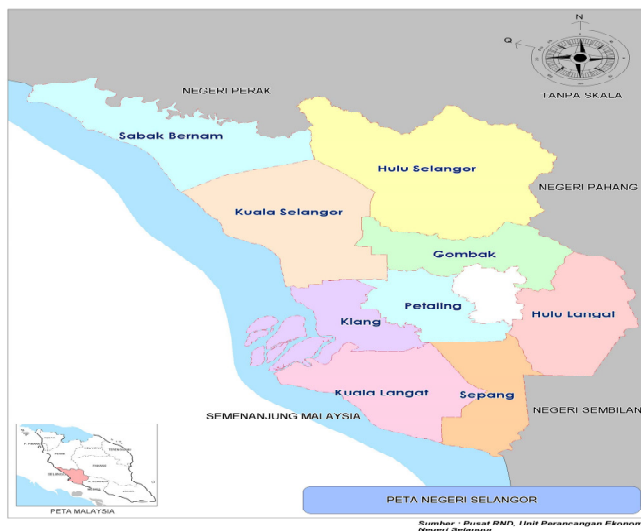
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Selangor state's economy

Introduction

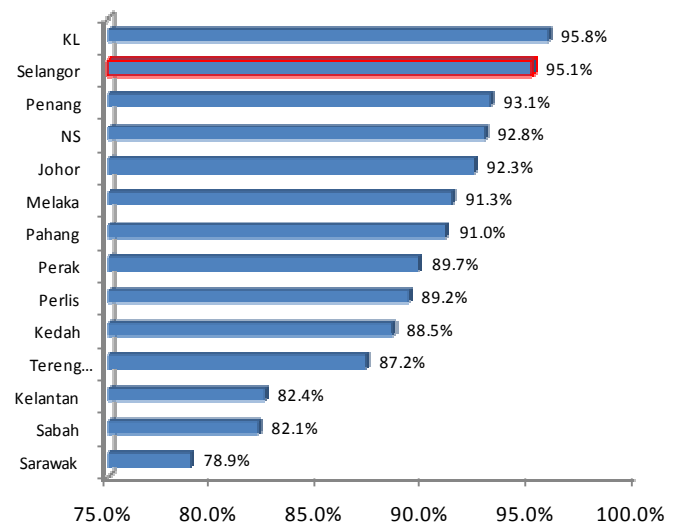
The state of Selangor, Malaysia's most developed state, is also one of the richest in the country. According to the United Nations Development Programme (UNDP), the state has a very high adult literacy rate of 95.1% (national average: 89.7%), providing an indicator of the competence of the state's workforce. The state is also home to the largest port in the country, i.e. Port Klang, and houses some of the nation's largest industrial operations. Tourism activities are important catalysts for the economy's growth, especially as both the Kuala Lumpur International Airport (KLIA) and Subang Airport are located within the state. Consequently, the state was the biggest contributor to national gross domestic product (GDP), having accounted for 22% of total GDP in 2009. Its economy is highly diversified, with sectors ranging from agriculture, industry, and commerce to tourism. While the manufacturing sector is rapidly expanding, the mainstays of the state's economy remain rubber, palm oil, and tin mining. Selangor is adjacent to the Federal Territory of Kuala Lumpur, and there are many resultant close economic and social ties between them.

Chart 1: The map of Selangor



Source: Selangor State Government Portal

Chart 2: Adult literacy rate by state



Source: United Nations Development Programme (UNDP)

Economic structure and growth performance

The state's economy is driven primarily by the manufacturing and services sectors, which typically cater to the export as well as domestic-oriented industries. Manufacturing and services accounted for 33.2% and 61.3% of total GDP respectively in 2009. The construction sector constituted 5.5% of total GDP, while agriculture and mining commanded smaller shares of 1.5% and 0.1% respectively. The state economy's susceptibility to changes in global demand surpasses the nation's, given the predominance of high-content, export-oriented businesses such as electrical and electronic (E&E) as well as palm oil products in the former. Indeed, the state in 2009 recorded a negative growth of 2.5%, while the nation experienced a 1.7% contraction in GDP.

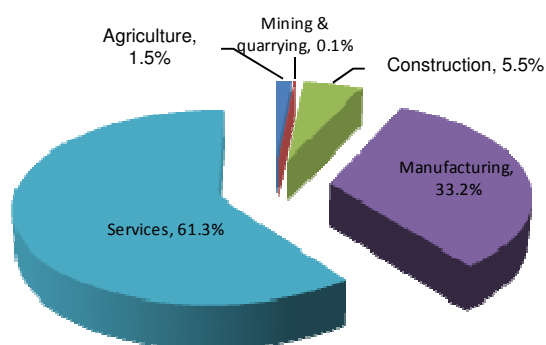
Needless to say, the manufacturing sector suffered the heaviest blow with its 5.8% drop in economic output in 2009 as a result of total manufacturing investment approvals having fallen by a massive quantum of 43.1% in 2009 (2008: +6.2%). This was led by lower investment approvals in the E&E sector (accounting for 20% of the overall figure) and has declined by 75% during 2009. Weak external demand impacted Selangor's external trade considerably, as reflected by the rapid 8.3% contraction in the number of Port Klang's total twenty-foot equivalent units (TEUs) – a stark contrast indeed with the past three years' TEUs which expanded at a strong pace of 12% to 14%. Fortunately, double-digit growth in the construction sector, coupled with the 6.6% expansion in the services sector, managed to prevent overall economic growth momentum from slipping further.

Table 1: Selangor's Gross Domestic Product

Growth %	2006	2007	2008	2009	2010
Agriculture	21.1%	-5.7%	17.8%	-2.6%	1.4%
Mining & quarrying	4.8%	3.3%	1.3%	-3.1%	-5.8%
Construction	-0.1%	10.9%	1.3%	19.1%	5.1%
Manufacturing	0.9%	1.4%	4.8%	-5.8%	3.6%
Services	10.0%	12.0%	9.9%	6.6%	4.5%
Gross Domestic Product (GDP)	4.7%	7.3%	8.3%	-2.5%	5.4%

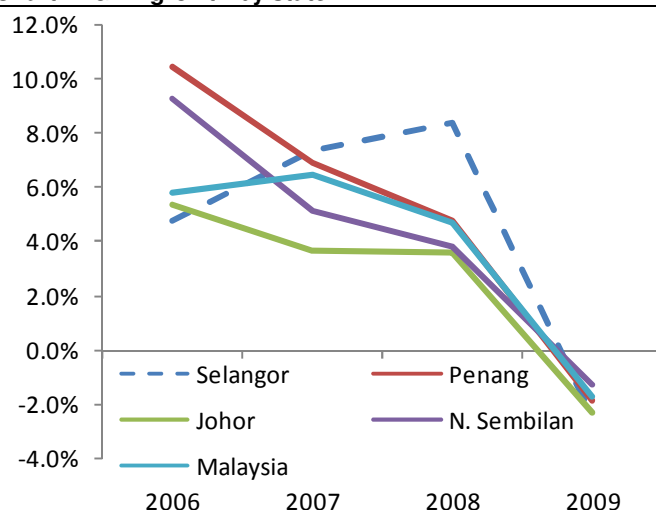
Sources: 10th Malaysia Plan (10MP) and MARC Economic Research

Chart 3: Selangor's 2009 GDP breakdown



Sources: 10MP & MARC Economic Research

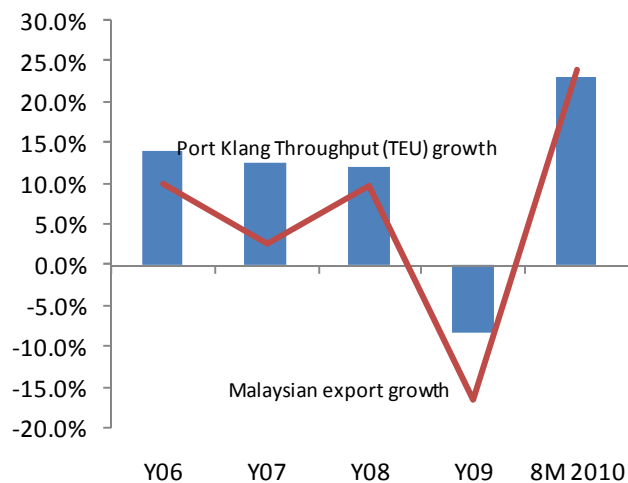
Chart 4: GDP growth by state



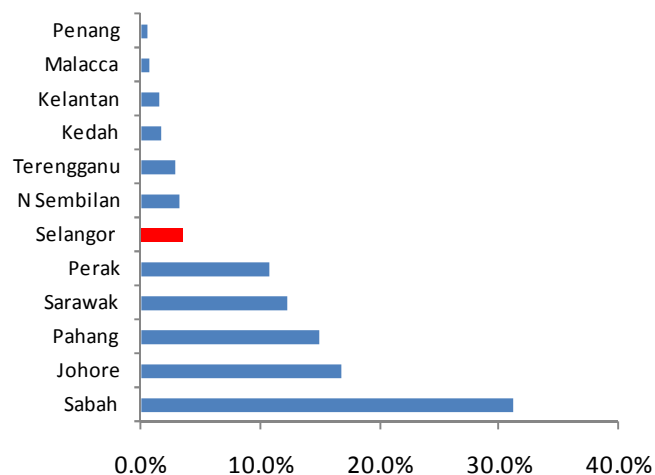
Sources: 10MP & MARC Economic Research

Thus far, the current trend in 2010 has been quite favourable - Port Klang TEUs increased dramatically by 23.1% y-o-y in the first eight months of this year, consistent with the improvement in Malaysia's external trade where exports and imports have risen by 22.2% and 28.1% respectively for the first eight months of the year. Apart from that, favourable crude palm oil (CPO) prices should support rural-area consumption, given that Selangor's CPO production is the sixth largest in the country. According to the 10MP, the state is expected to register positive growth of 5.4% in 2010, led by a sharp turnaround in the manufacturing and agricultural sectors as well as sustained growth in the services and construction sectors.

However, concerns about a double-dip contraction in the advanced economies have escalated recently amidst weak labour-market conditions in the United States as well as ongoing austerity measures being implemented in the Euro zone. These can have negative repercussions on Selangor in light of the state's high connectivity with Malaysia's external demand.

Chart 5: Port Klang throughput and Malaysian export growth (%)

Source: CEIC

Chart 6: CPO's share of production (% of total) in 9M2010

Source: CEIC

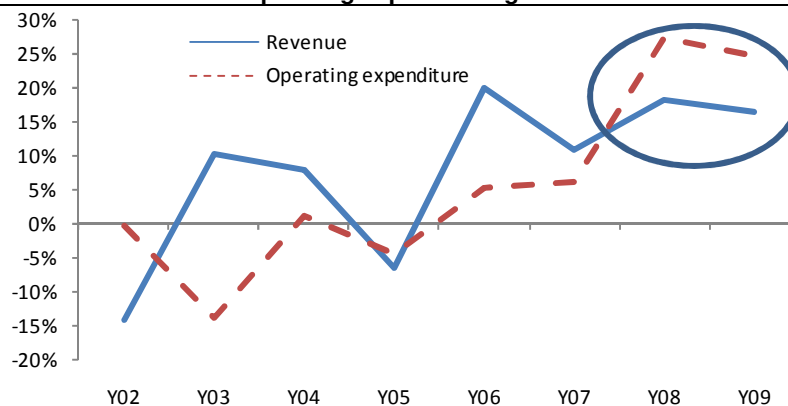
Government finances

After recording three years of operating surplus, the state government's finances fell back into the red when it registered a deficit of RM65.96 million in year 2009 due to growth in operating expenditure surpassing the expansion in state revenue. In 2009, operating expenditure rose 24.7% to stand at RM1.83 billion, led by higher grants and fixed charges which increased by 33.7% (see table 1). The growth in this category was attributed to state government grants to Menteri Besar Incorporated (MBI) amounting to RM392 million to take over the debts of Talam Corporation Berhad owed to the three state government enterprises of Kumpulan Hartanah Selangor Berhad (KHSB), Universiti Industri Selangor and Permodalan Negeri Selangor Berhad (PNSB). The state government, in its governance report *Urustadbir Selangor* issued in the early part of this year, has indicated that MBI will be responsible for the debt recovery; thus far, the institution has collected RM50 million in debts.

In our view, such developments are credit-positive, as the corporate exercise was a necessary step to restore the state's balance sheet via the hiving off of non-performing assets and the subsequent engagement of the debt-recovery process. Revenue growth could potentially be boosted should the debt-recovery process be effectively managed. Additionally, though a deficit, the negative 2009 budget balance should be viewed in the context of the state's prudential financial management - revenue collected amounted to RM1.76 billion, higher than the RM1.40 billion mentioned in the state's Budget 2009, while the RM242.9 million in emoluments (comprising mainly salaries and wages for the state's civil servants) was lower than the budgeted RM256.8 million.

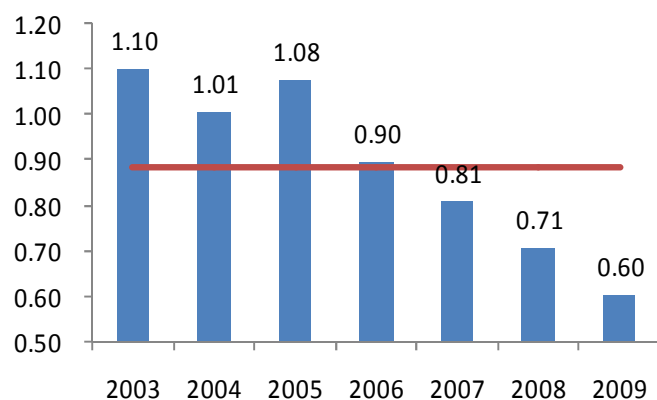
For 2009, public debt has been reduced from RM1.07 billion to RM1.06 billion on the back of loan repayments for public low-cost houses, forestry and sewerage projects that totalled RM9.43 million. In terms of debt sustainability, the state government continued to exhibit commendable resilience - its debt-to-revenue and debt-to-cash ratios have been persistently lower than their historical averages, hinting at the state's strong revenue base and cash position, as well as its resultant lower credit risk.

Chart 7: Revenue and operating expenditure growth



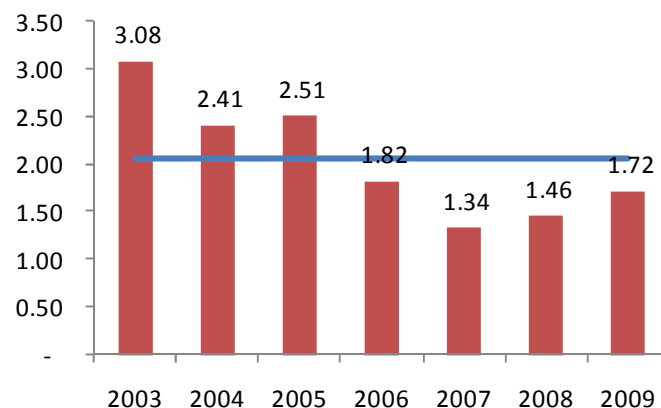
Source: National Audit Department & MARC Economic Research

Chart 8: Selangor's public debt-to-revenue ratio (x)



Sources: National Audit Department & MARC Economic Research

Chart 9: Selangor's public debt-to-cash ratio (x)



Sources: National Audit Department & MARC Economic Research

Table 2: Selangor's financial statement

RM Million								
State revenue & Expenditure	% chg	2006	% chg	2007	% chg	2008	% chg	2009
Tax revenue	25.3%	452.2	-1.4%	446.1	11.2%	495.8	-4.9%	471.6
Non tax revenue	4.2%	494.7	13.2%	559.8	20.9%	676.9	-30.4%	471.2
Non revenue receipts	61.2%	213.3	30.9%	279.2	23.0%	343.6	139.0%	821.2
Total Revenue	19.9%	1,160.2	10.8%	1,285.1	18.0%	1,516.3	16.3%	1,763.9
Emolument	6.9%	171.9	-1.5%	169.3	31.9%	223.3	8.8%	242.9
Supplies & Services	19.6%	253.7	12.8%	286.1	-4.6%	272.9	6.8%	291.5
Assets	-16.6%	13.7	-18.0%	11.3	-74.8%	2.8	-57.7%	1.2
Grants & fixed charges	0.6%	638.3	5.8%	675.2	42.1%	959.7	33.7%	1,283.1
Other expenditure	-3.0%	10.1	12.1%	11.3	-24.5%	8.6	30.1%	11.1
Operating expenditure	5.1%	1,087.7	6.0%	1,153.2	27.2%	1,467.2	24.7%	1,829.8
Surplus / (Deficit)		72.5		131.9		49.1		(66.0)

Source: National Audit Department & MARC Economic Research

Issues and concerns

The state of the global economy – as has been the case, this will continue to be the main determinant of the state's economic growth going forward. Thus far, the downside risks are very much prevalent, with the advanced economies growing worrisomely at sub-par levels. This could translate into weaker Malaysian exports and subsequently crimped demand for services offered by ports, air transport operators and the manufacturing sector. Indeed, slower economic growth can be significantly detrimental to the state government's revenue in more ways than one.

State-federal government relationship – in the state's Budget 2010 speech, the Menteri Besar (Chief Minister) claimed that payments from the federal government have been on the decline. In addition, he also voiced his concern that infrastructure projects are now being executed directly by the Implementation and Coordination Unit (ICU), a unit set up under the Prime Minister's Office, without requiring the consult of the state's land offices. These scenarios indicate that the relationship between the two governments needs to be improved in order to maintain resource-allocation efficiency, particularly with regards to projects initiated by the federal government but implemented on Selangor soil. The project delays that could arise would result in unnecessary wastage of resources.

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