

IMF-ADB-JICA

Conference on “Harnessing Natural Resources Wealth for Inclusive Growth and Economic Development”

Dili, Timor Leste

**Country Experience :
Diversification of Malaysia’s Economy**

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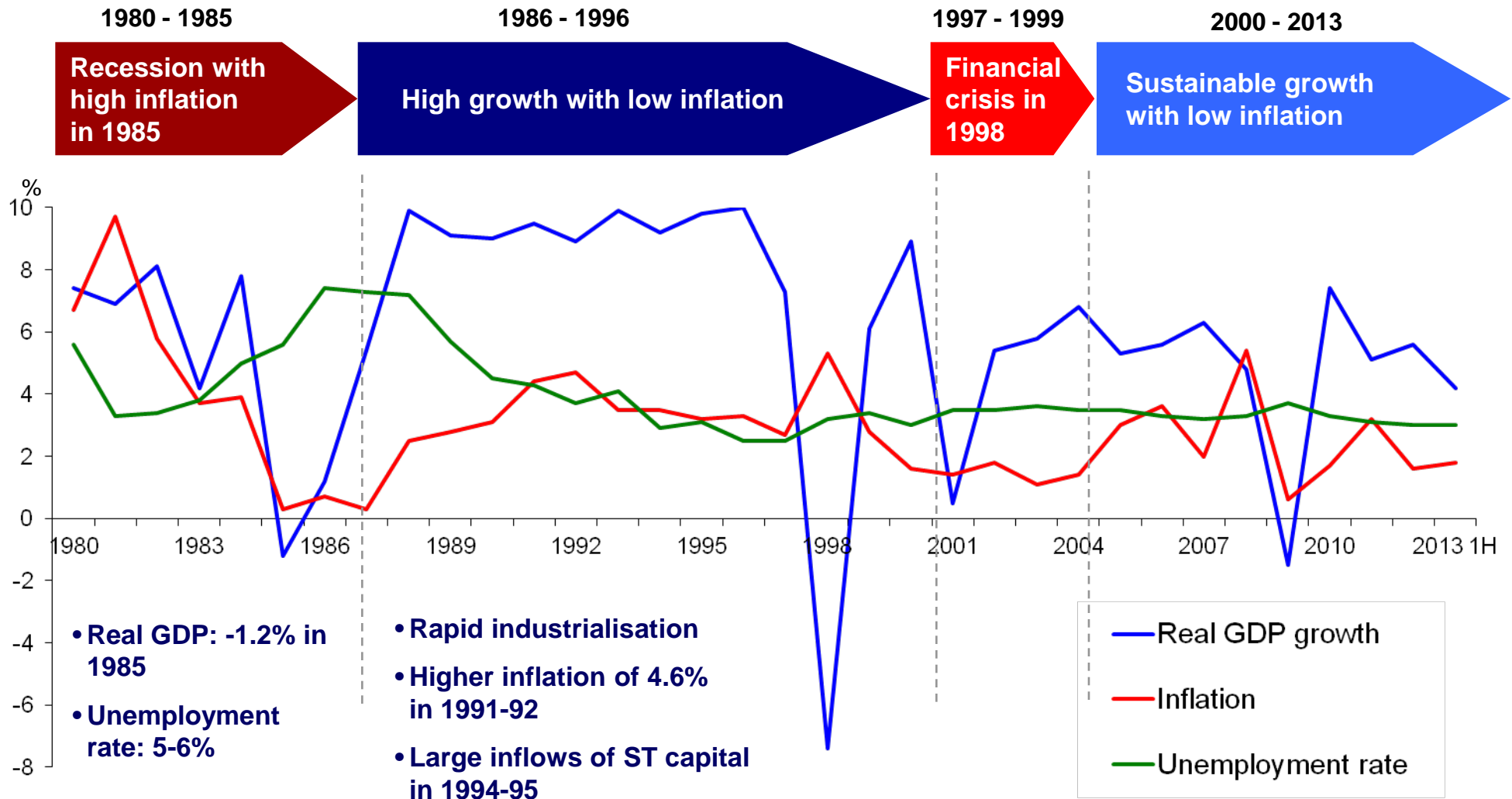


Stylised facts of Malaysia (as of 1H 2013)

- **Transformation into an upper middle income economy**
 - Per capita GDP of RM31,580 (USD10,270) (1980: RM3,700)
- **Significant reduction in poverty**
 - Low rate of 3.6% (1980:37.4%)
- **A small, highly open economy**
 - Total trade is 139% of GDP (1980: 97%)
 - Major trading partners include Asia, US and the Euro area
 - Manufacturing exports accounted for 76% of total exports (commodities: 23%)
- **Domestic demand and services the key drivers of growth**
 - Comprises 92% of GDP, with private consumption at 51%
 - Services is the largest sector (55% of GDP), followed by manufacturing (25% of GDP)

Source: Department of Statistics, Malaysia

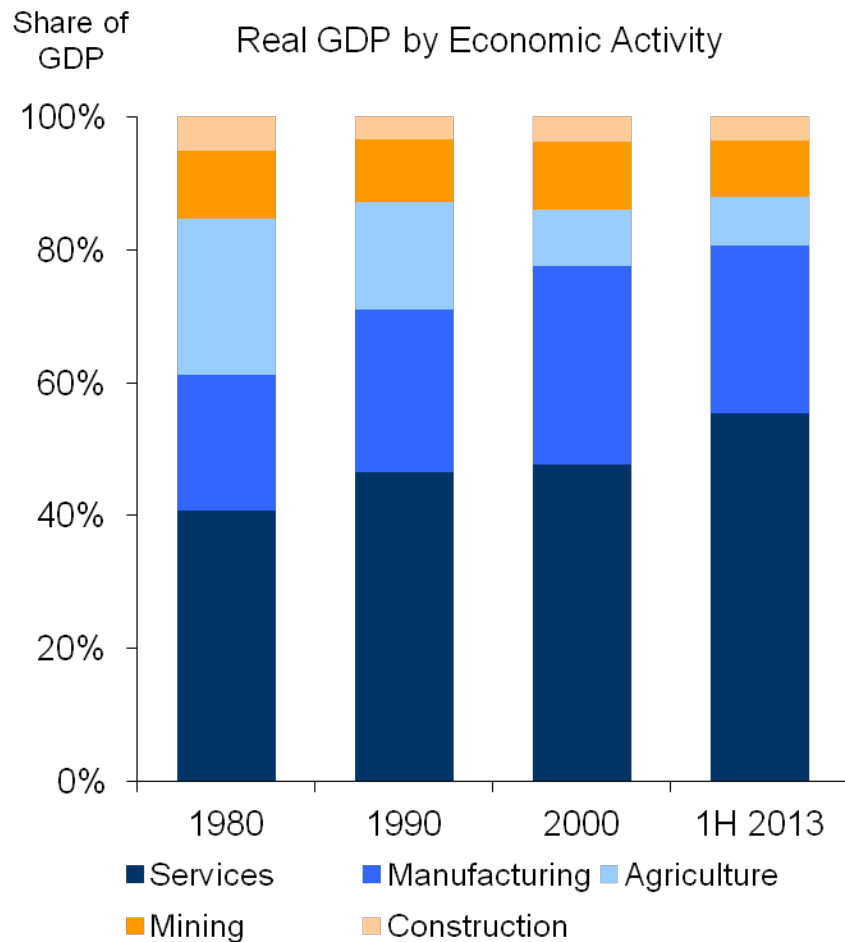
Malaysia has achieved sustained economic growth with low inflation and low rate of unemployment



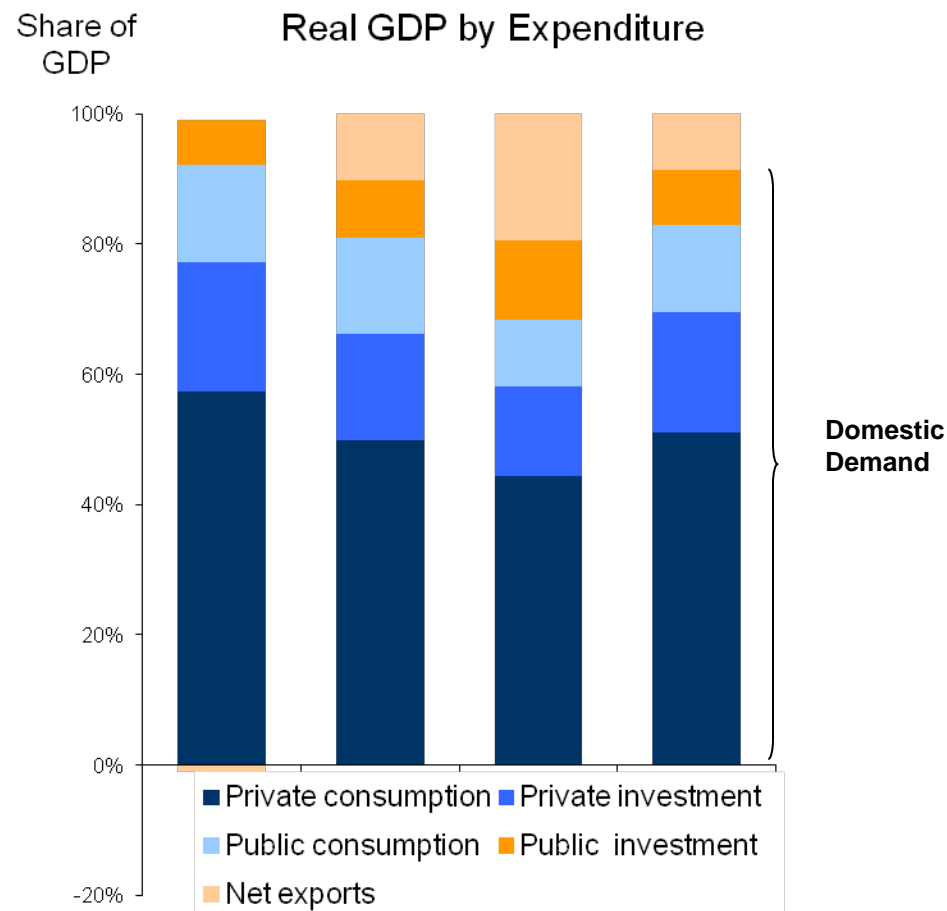
Source: Department of Statistics, Malaysia

Significant structural shift in the economy in the 3 decades

From manufacturing-dependent to services-driven economy



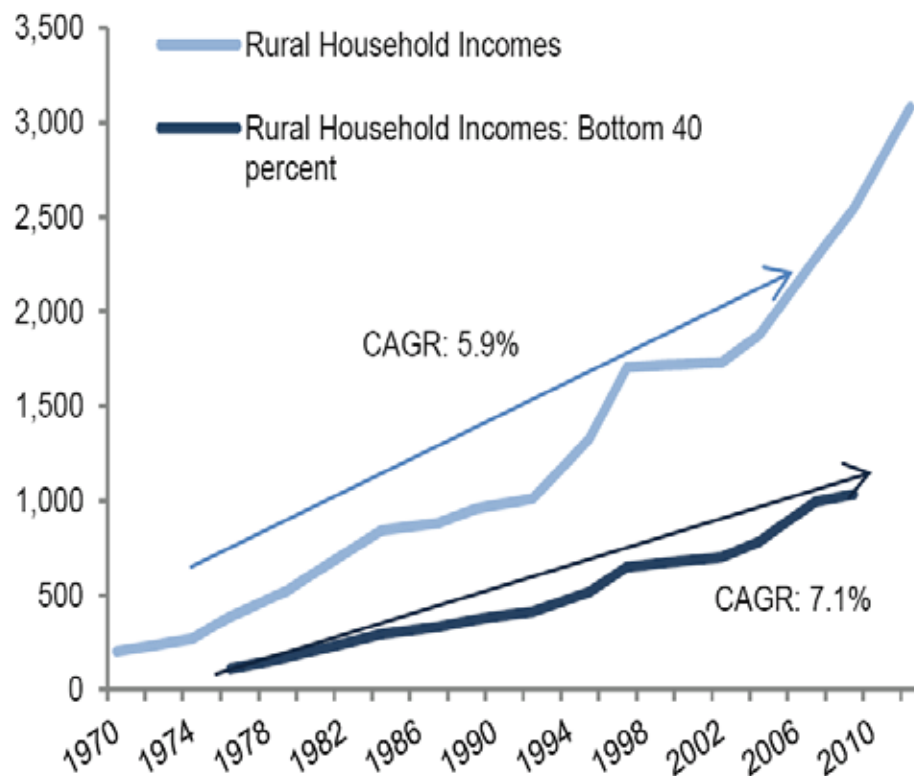
Domestic demand played an important role in driving growth



Source: Department of Statistics, Malaysia

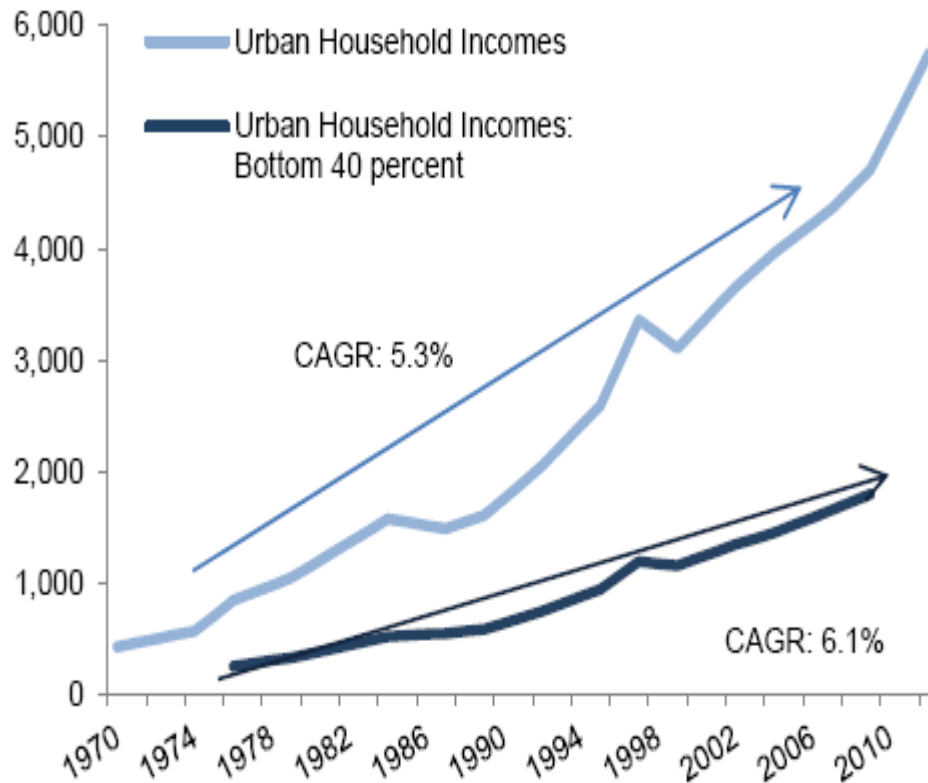
Income in both rural and urban have risen, especially the bottom 40% amid targeted social policy measures

Rural household incomes, RM per month



Source: CEIC, Department of Statistics, Malaysia, World Bank staff calculations

Urban household incomes, RM per month



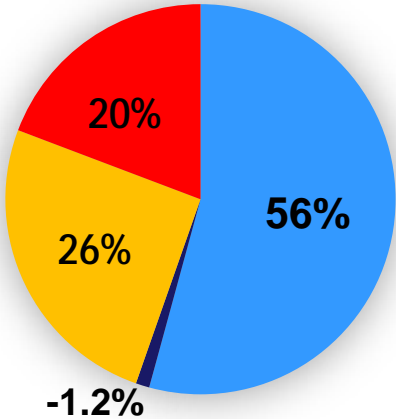
Source: CEIC, Department of Statistics, Malaysia, World Bank staff calculations



From an asset perspective, 20% of Malaysia's wealth is in natural capital, mostly oil & gas

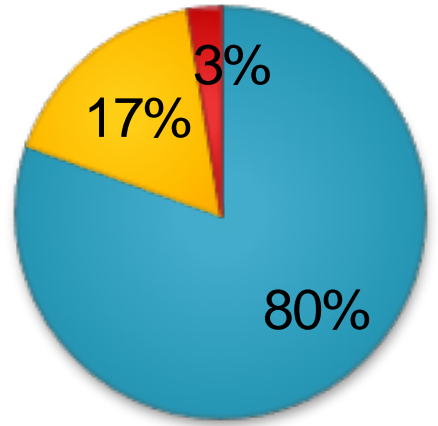
Malaysia's wealth composition*

16% of Malaysia's wealth is in oil & gas reserves

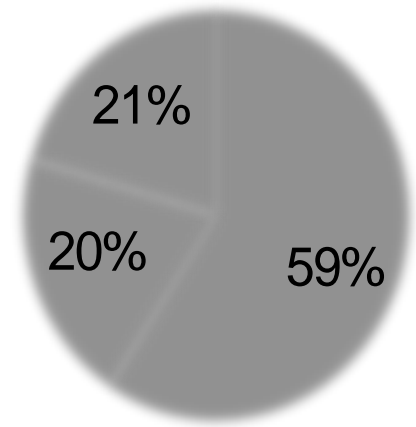


- Intangible Capital
- Net Foreign Assets
- Produced Capital
- Natural Capital

Average wealth composition of a high income nation*



Average wealth composition of a middle income nation*



* Latest available wealth data is in 2005

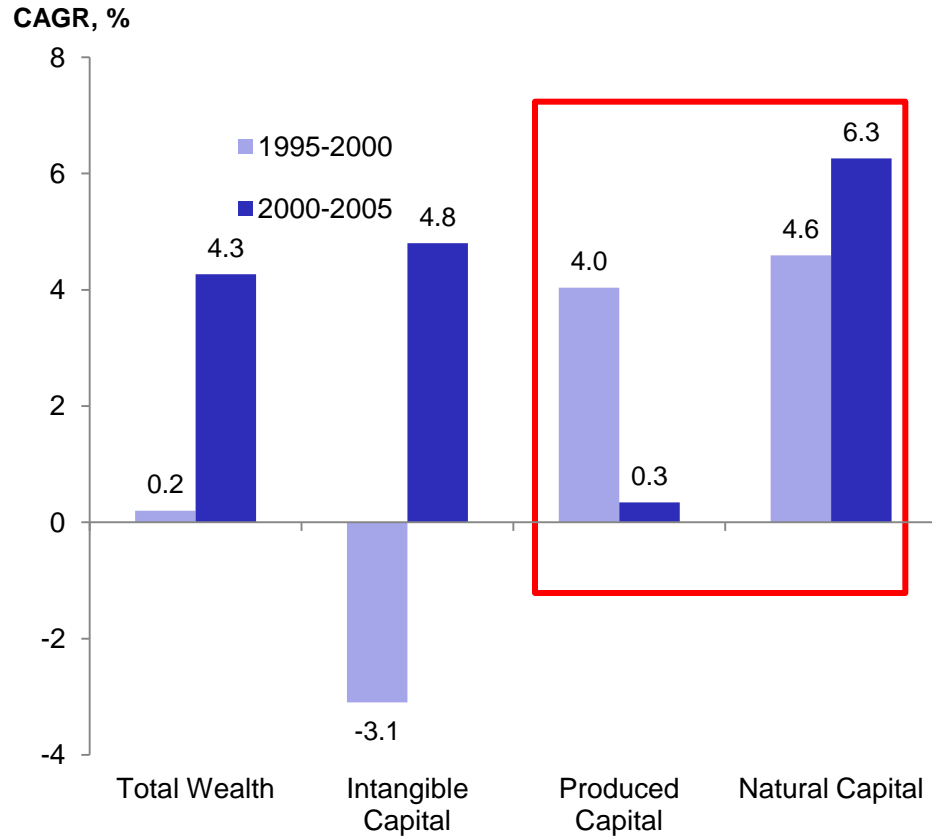
Source: World Bank



Most commodity-based nations, including Malaysia, tend to grow its wealth largely through its natural capital

Wealth growth is mostly driven by natural capital in Malaysia, but intangible capital was high post-2000

Commodity-based nations (except Canada) tend to also see higher growth from natural capital



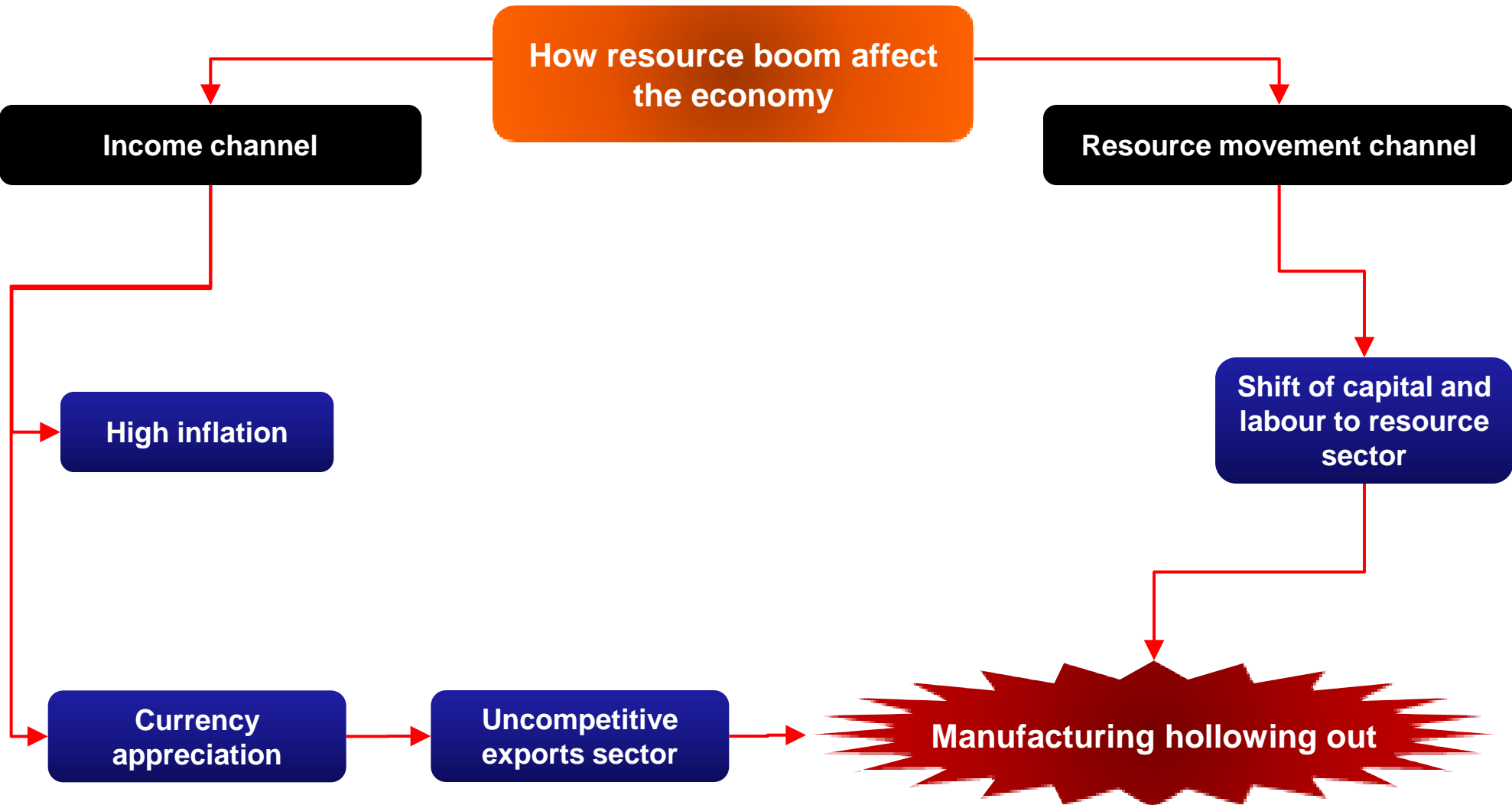
CAGR, % (1995-2005)	Total wealth	Intangible capital	Produced capital	Natural capital
Malaysia	2.2	0.8	2.2	5.4
Australia	2.2	2.2	2.1	3.1
Canada	1.7	1.5	1.6	1.3
Chile	2.1	0.7	4.7	5.4
Brazil	0.9	0.8	-0.4	3.5
Indonesia	2.1	1.2	1.8	3.8
Korea	4.6	4.7	4.7	-0.7

* Latest available wealth data is in 2005

Source: World Bank

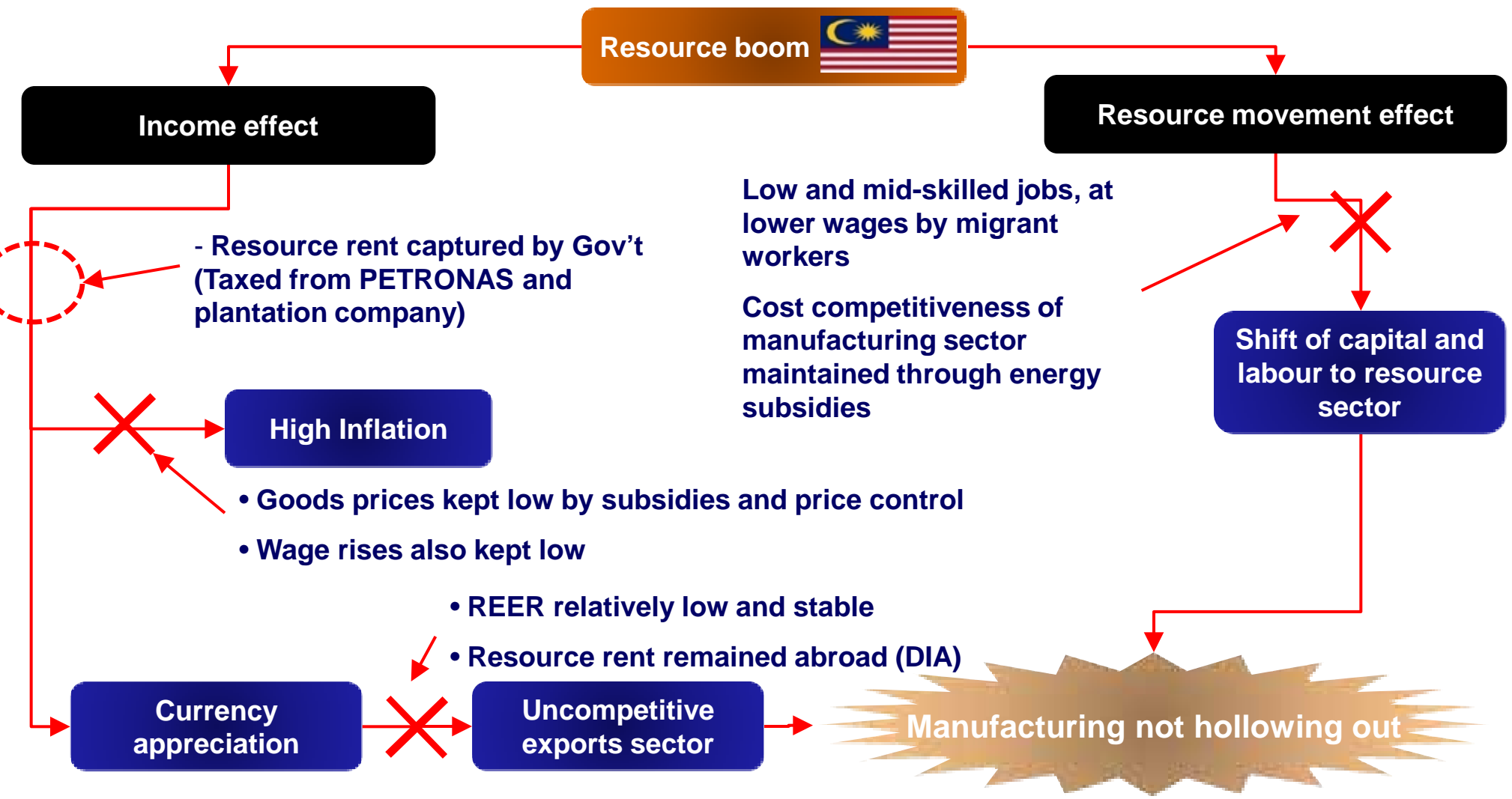


Resource-endowed nations face policy choices in managing resource price booms



* Based on Corden & Neary (1983)

Malaysia preserved manufacturing competitiveness through consistent policy management



Malaysian competitiveness has been preserved by the following factors:

Intergenerational equity

Malaysia was one of the very few resource-rich nations that invested more than the resource wealth extracted

Successful horizontal and vertical diversification of economy

Horizontal shift from primary sectors to manufacturing
Vertical shift from upstream (raw) to downstream rubber and oil & gas
Ensuring strong backward and forward linkage for commodities

Stable and low REER boosting competitiveness

Low REER, with rising savings, boosting competitiveness and capacity of the economy

Inflation and wage pressures contained

Lower inflation compared to its peers (CAGR: +2.3%) *
Productivity growth (+3.2%^) exceeded wage growth (+2.7%^)

PETRONAS providing institutional strength

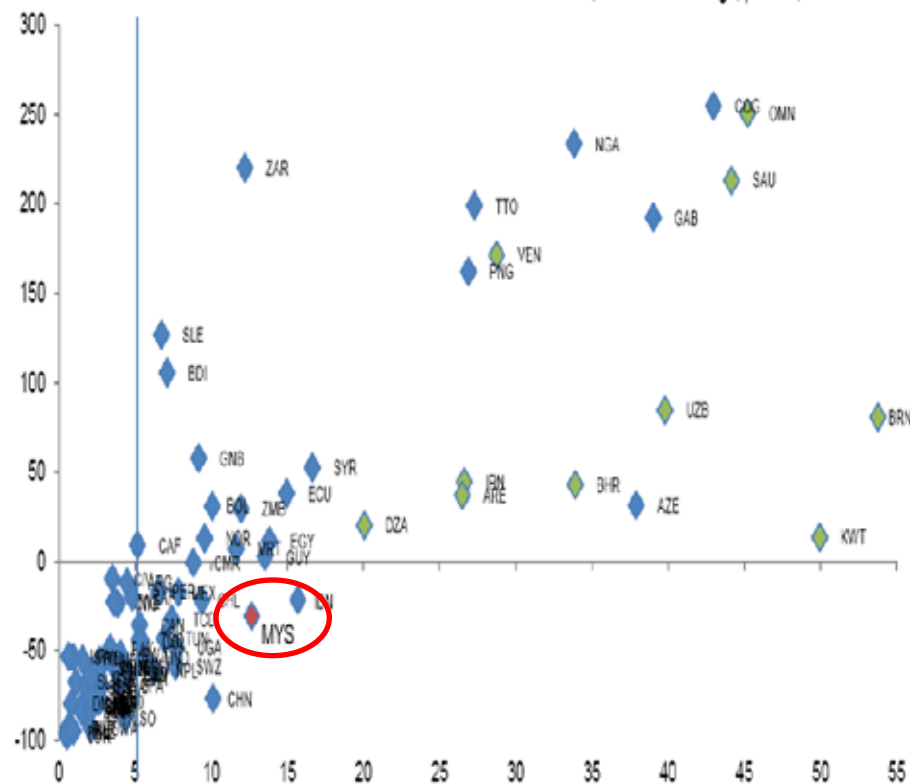
Malaysia's de facto resource fund , building a solid reputation for good governance

* refers to period between 2002 - 1Q 2013 ^ CAGR, refers to period between 2001 – 1Q 2013

Successful recycling of resource rent toward capital spending and less for consumption

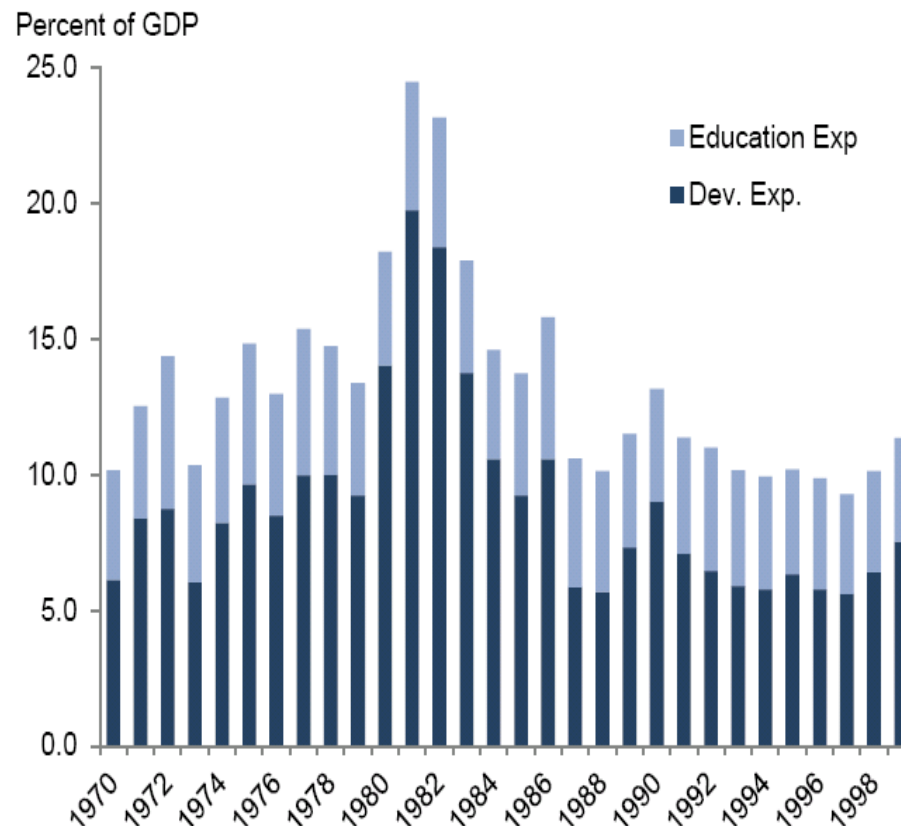
Malaysia is one of the few resource nations that have recycled its resource rents toward investment

Increase in produced capital if Hartwick Rule followed, percent, vertical axis;
Total natural resource rents as a share of GDP, 1970-2005 average, percent, horizontal axis



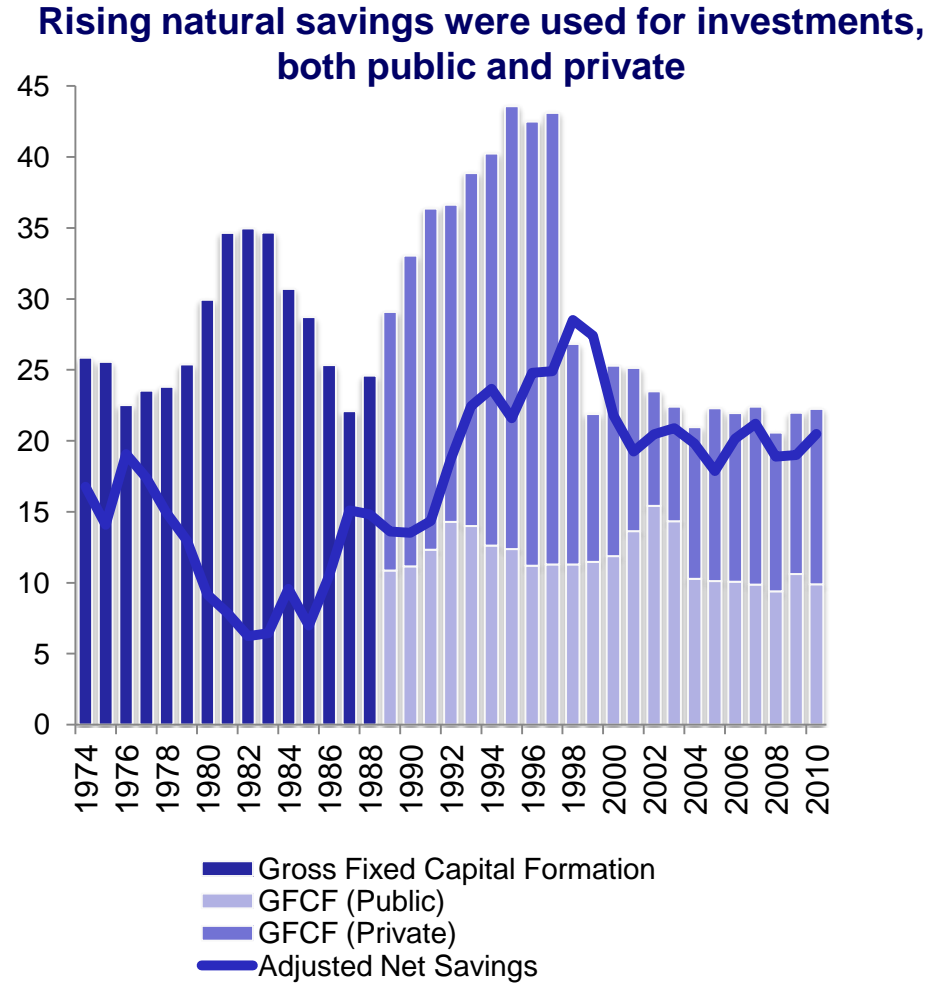
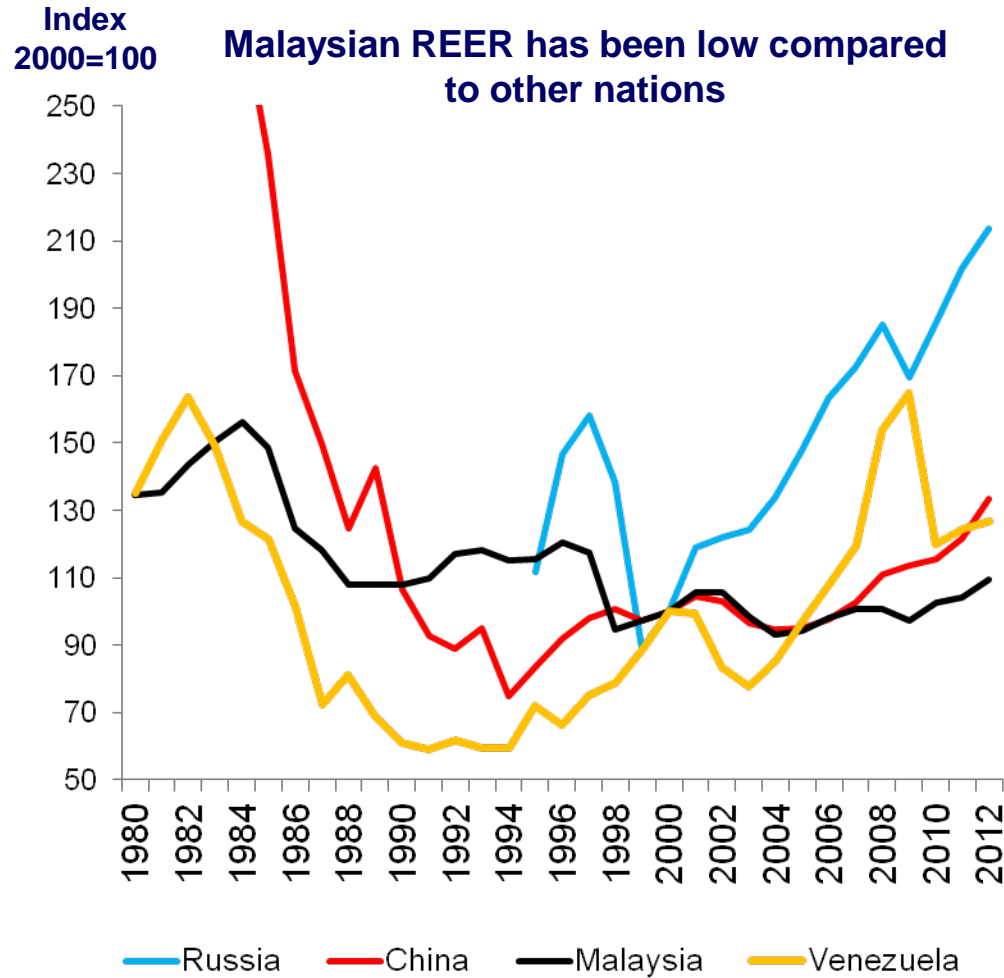
Source: World Development Indicators, World Bank staff calculations.

Spending on capital expenditure was high, financed by the resource rent from PETRONAS



Source: CEIC, World Bank staff calculations

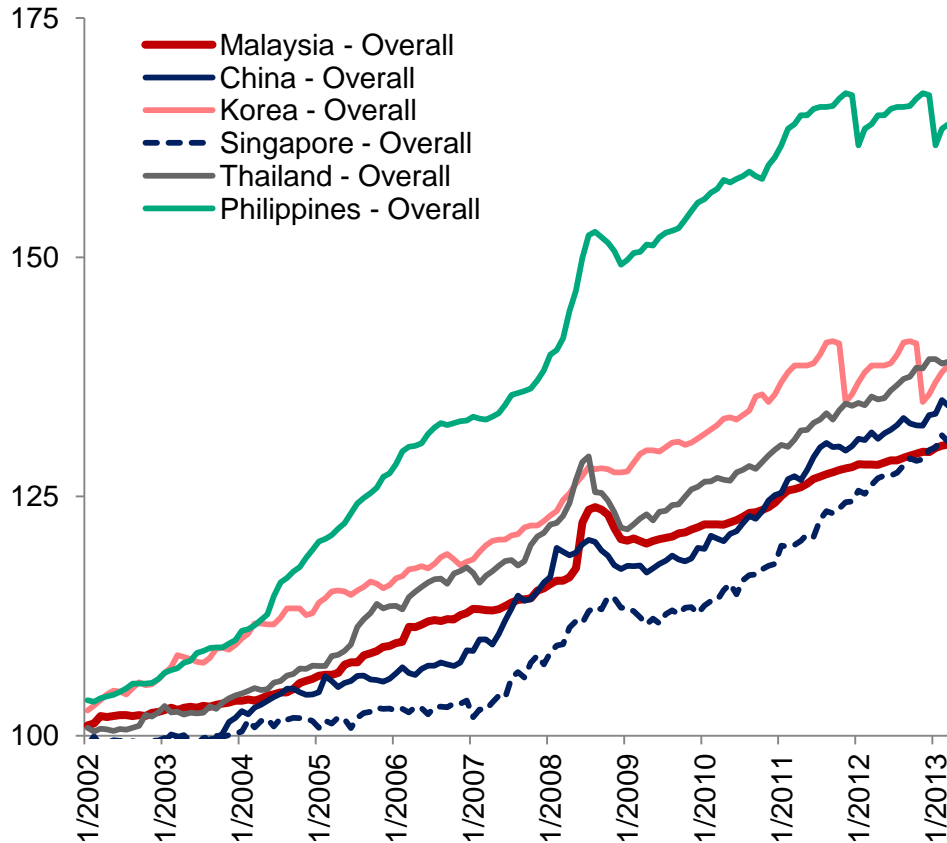
Stable and low REER, supported by rising savings, boosts competitiveness and capacity of economy



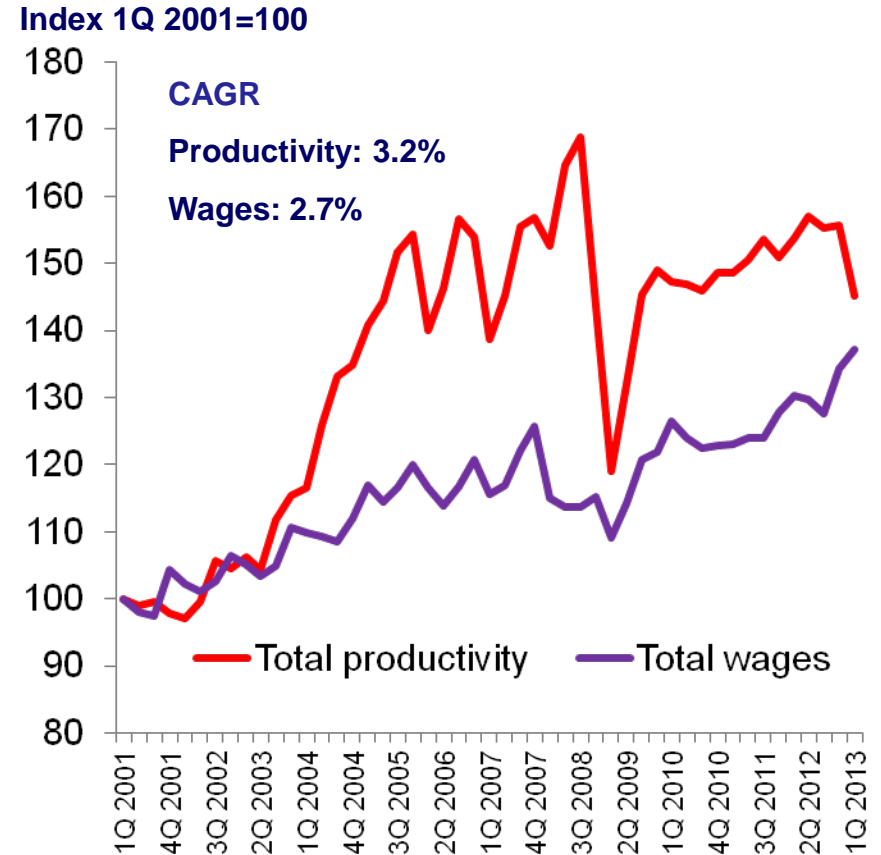
Source: World Bank & CEIC

Inflation and wage pressures were contained

Inflation rates have been low compared to peers



Wage growth in manufacturing has been relatively stable, and lower than productivity growth



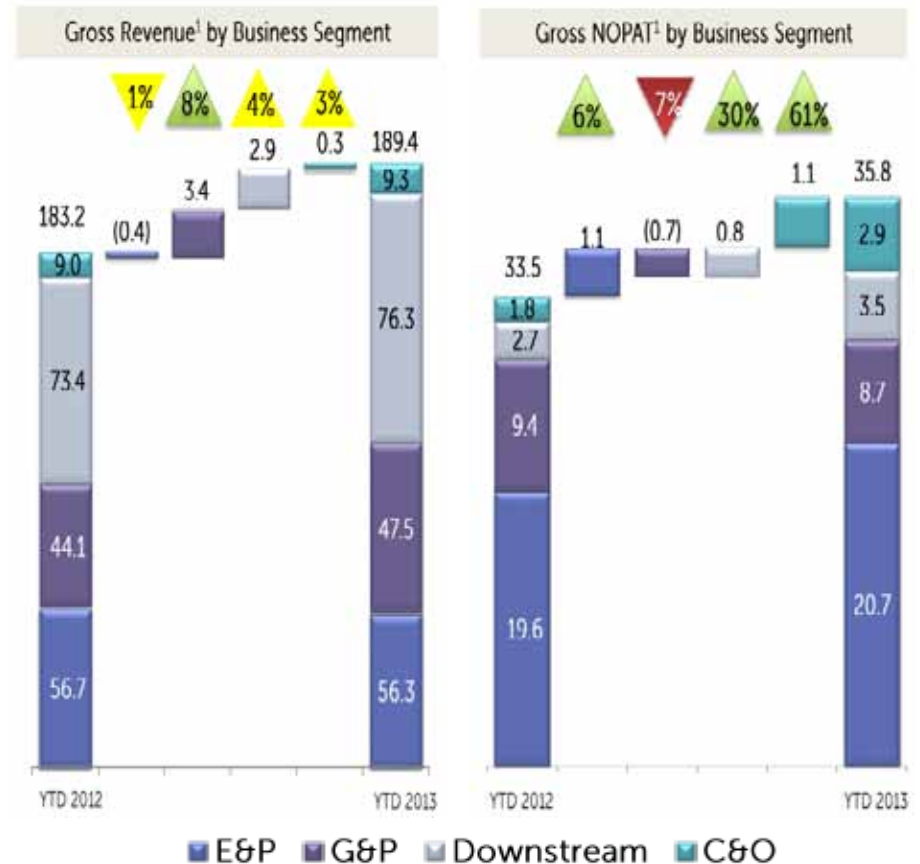
Source: Department of Statistics, Malaysia, CEIC & BNM staff calculations

PETRONAS is Malaysia's de facto resource fund

PETRONAS has assets nearing USD156 billion, high cash balance, low debt and high returns

	As of end-2Q 2013	As of end 2012
Total Assets	USD 155.9 b	USD 160.4 b
Shareholders' Equity	USD 94.6 b	USD 100.7 b
Cash Balance	USD 44.9 b	USD 45.6 b
Ratio of debt to assets	7.6%	8.3%
Return on Average Capital Employed	17.2%	17.2%

A diversified revenue and profit base, with the latter dominated by downstream activities

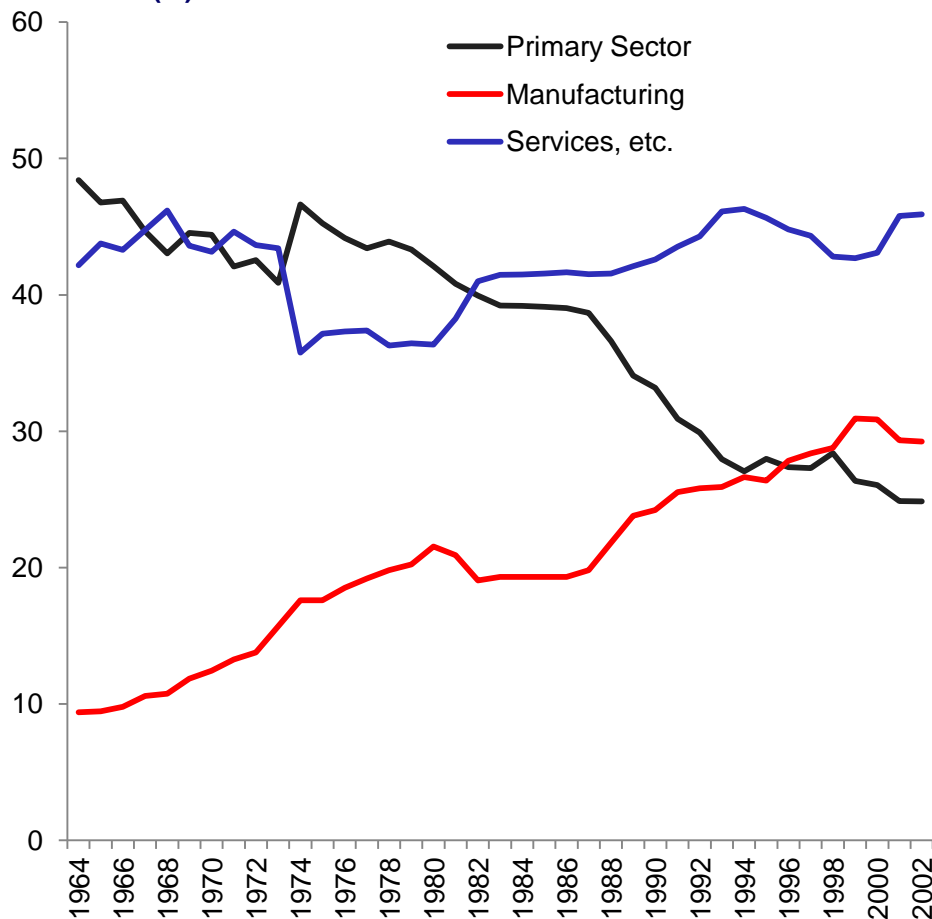


Source: PETRONAS (August 2013)

Successful horizontal and vertical diversification of the economy away from commodities

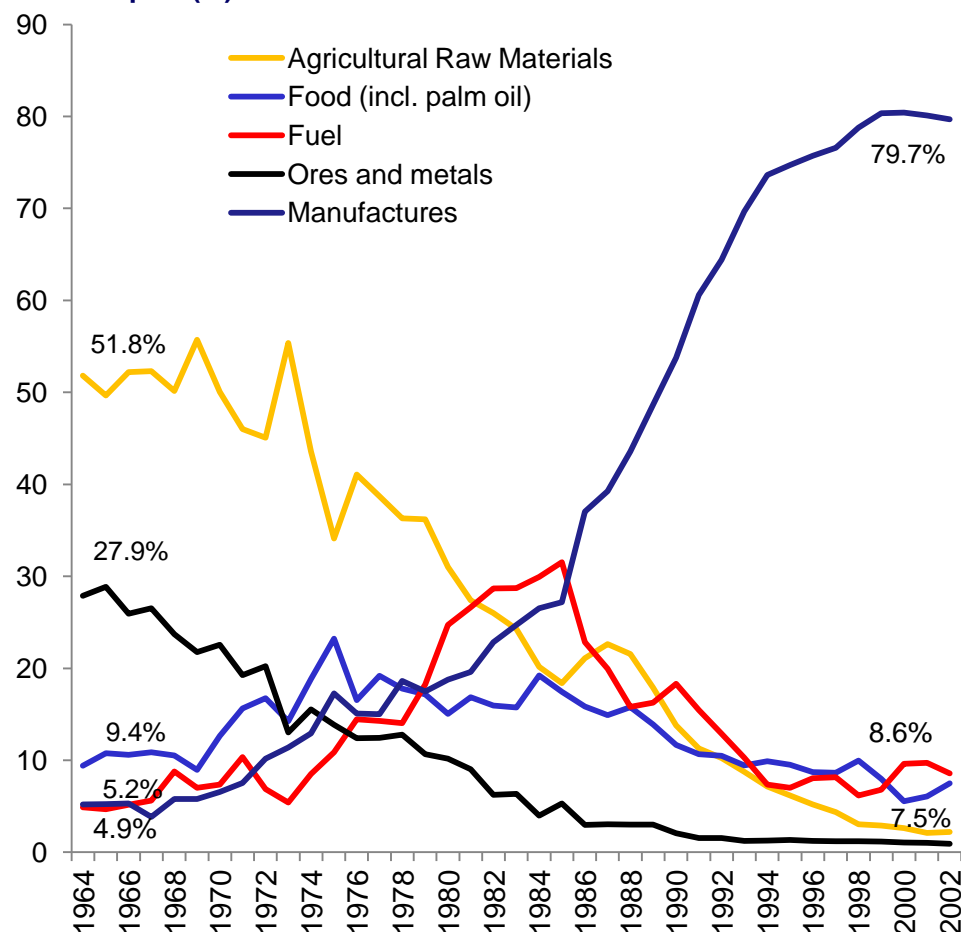
Horizontal shift from primary sectors to manufacturing

Share to GDP (%)



Vertical shift from upstream (raw) to downstream

Share to total export (%)

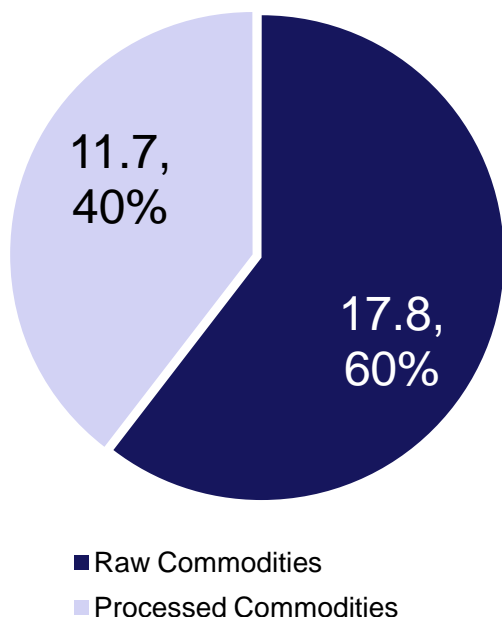


Source: Department of Statistics, Malaysia

Vertical diversification was particularly high in oil & gas and rubber, leading to strong backward and forward linkage

The share of processed commodities in GDP almost equaled that of raw commodities by 2002

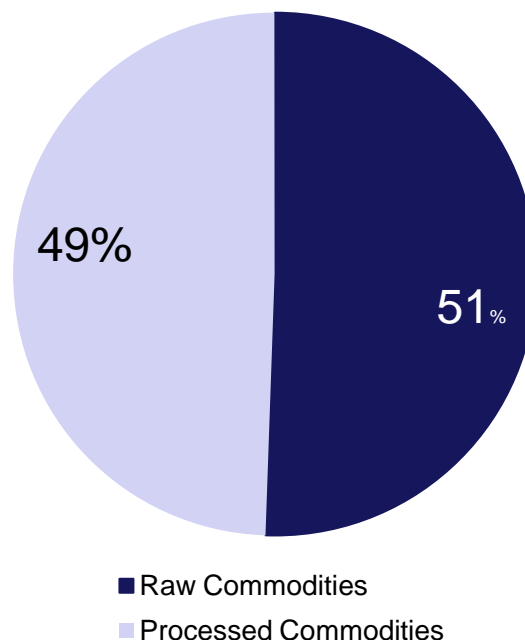
Sectoral shares in GDP, percentage points



Note: Processed commodities include food, beverages and tobacco; petroleum products.

Half of the value of commodity-related exports came from processed commodities

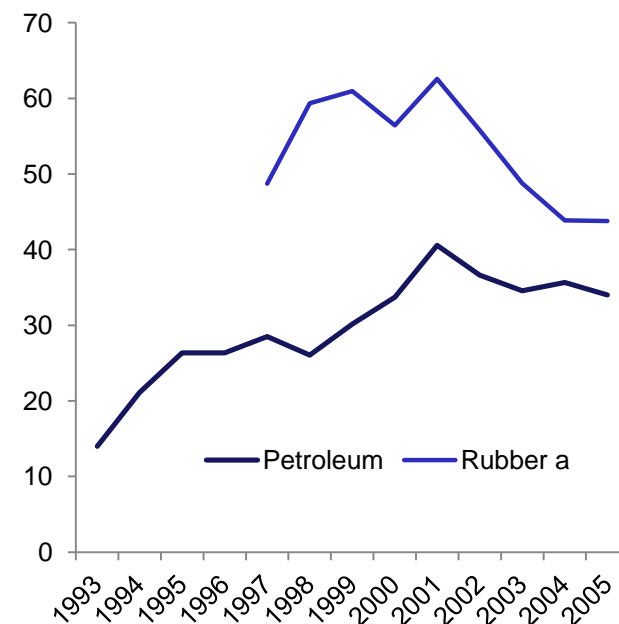
Shares in commodity-related exports



Note: Processed commodities include rubber gloves and other rubber products; petroleum products, fertilizers and plastics; and minerals and metals manufactures.

High share of processed exports for both oil and gas and rubber

Shares of processed exports in total exports of petroleum and rubber products, percent

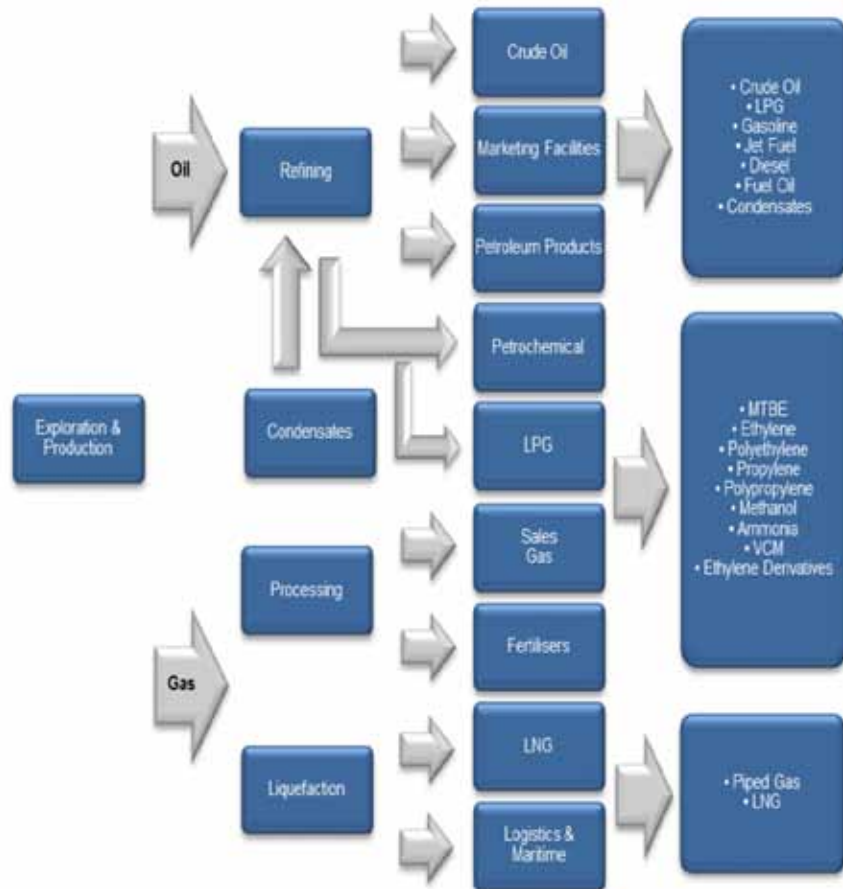


Note: a. Rubber gloves only.

Source: CEIC and World Bank staff calculations.

Oil & gas: PETRONAS-driven vertical diversification in the 1980s/90s, leading to strong domestic downstream

PETRONAS has led the oil and gas diversification toward downstream



Diversification driven by:

Strong institutional support from PETRONAS, championing investments in downstream industry, by partnering with foreign oil & gas firms (technology transfer)

Low PETRONAS dividend payments to Government facilitating the diversification (RM1 – 3 billion in 1980-1998)

Lower crude oil and natural gas prices in 1980-2004, ensuring higher margins at downstream

Higher taxes for upstream activities (38%), while downstream saw zero effective/lower tax

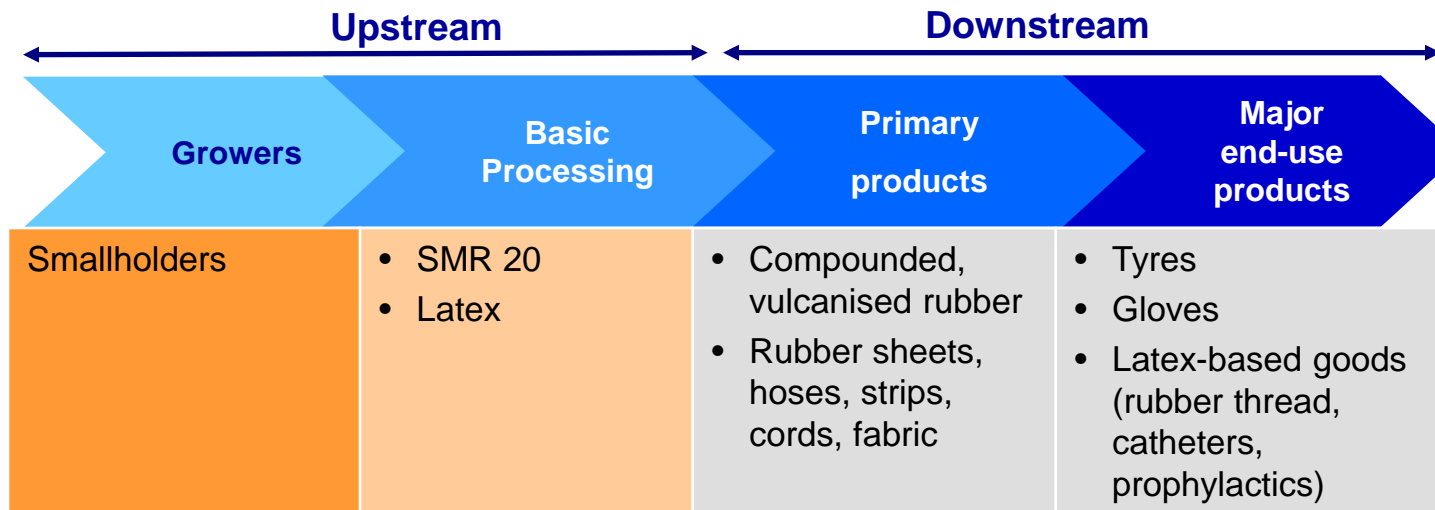
Result:

Downstream account for largest share of PETRONAS revenue (2Q 2013: 40.3%)

Many homegrown firms created in oil and gas services, deepening domestic capabilities, retention of value add and high skilled jobs (SapuraKencana, Bumi Armada, Dialog)

Source: PETRONAS

Rubber industry: SME-led vertical diversification, creating world-leading firms in selected products



Product	Global share		
	2000	2010	Rank
Rubber gloves	45.3	49.6	1
Prophylactics	6.6	18.4	1
Thread & cord	38.7	33.0	2

SMEs took advantage of lower rubber prices in the 1980s/1990s to spearhead higher downstream activity

Even as Malaysia declined in producing natural rubber, firms have diversified into synthetic rubber

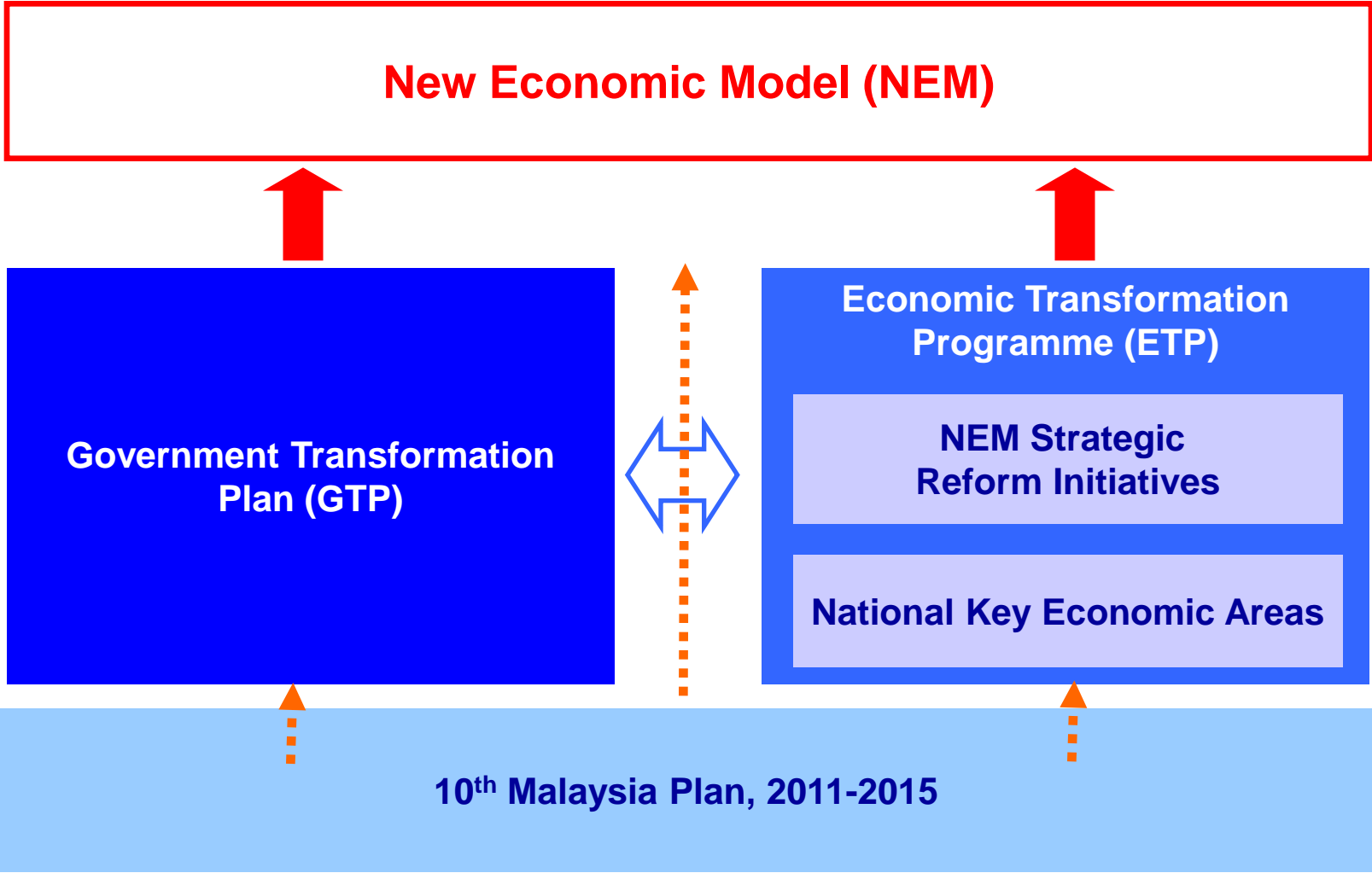
Malaysia now has several leading firms, dominating the world in the downstream rubber industries:

Rubber gloves (Top Glove, Kossan, Hartalega, Supermax)

Prophylactics (Karex)

Source: Department of Statistics, Malaysia

Malaysia's challenge: Transform into a high-income economy by 2020, by upgrading and deepening its diversification



Source: NEM 2010

Rubber is diversifying further forward toward higher value add, R&D driven & automated downstream industry

Vulcanized rubber



- Primary isolator and anti vibrator components for railways & vulcanized rubber
- R&D with RRI and local university



- Industrial rubber hose and rubber moulded products for construction, pharmaceutical, marine and mining industry
- R&D to improve quality

Synthetic rubber



- Nitrile latex and synthetic latex which is an input for nitrile gloves
- R&D in specialty polymers

Malaysia Synthetic Rubber Sdn Bhd

- Produce synthetic rubber polybutadiene to be used by tyre and shoe manufacturers

Dry natural rubber



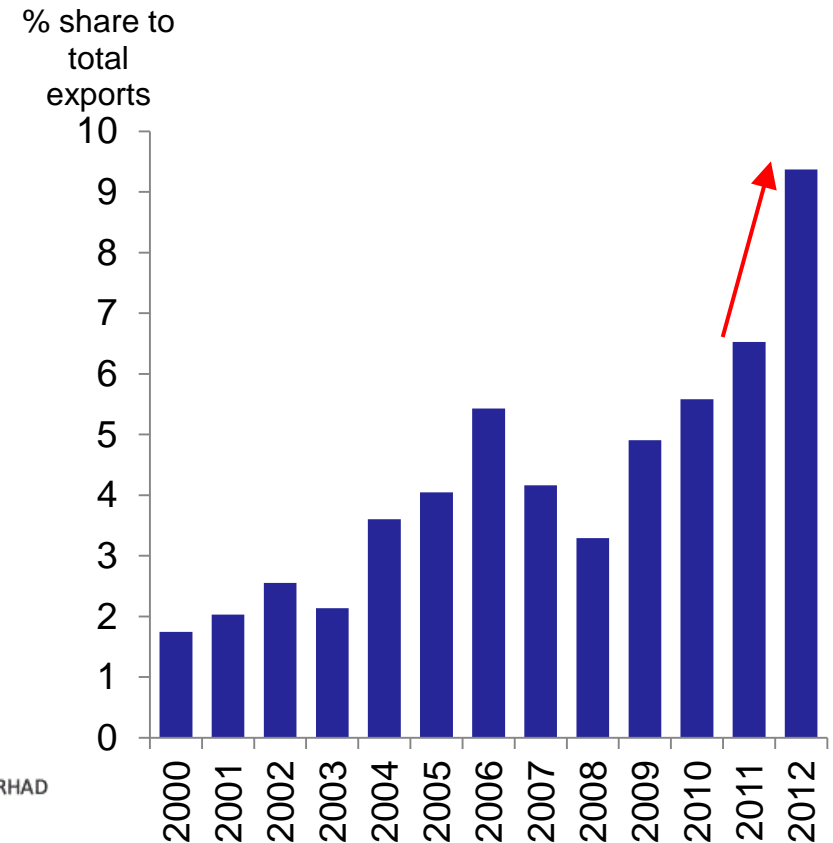
- Invest RM 713million in a new fully automated tyre plant
- Produces 2.5 times more tyres in less than 20% of the time
- 13th largest tyre producer in the world (global market share: 1.6%)

Source: Malaysian Investment Development Authority

Forward diversification to services: Malaysia is fast becoming a hub for transshipments of commodities

Malaysia is an attractive place for transshipment due to location, cost and trade financing advantages

Re-exports rising significantly as a result



Source: Department of Statistics Malaysia

Thank you

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