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June 18, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Malaysia - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Malaysia, which has been proposed for discussion on Friday, July 13, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. D. A. Scott, ext. (5)7607 or Mr. Choudhry, ext. (5)7333.

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INTERNATIONAL MONETARY FUND

MALAYSIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Malaysia

(In consultation with the Exchange and Trade Relations,
Fiscal Affairs, Legal, and Treasurers' Departments)

Approved by P.R. Narvekar and Manuel Guitian

June 15, 1984

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I. Introduction

The 1984 Article IV consultation discussions with Malaysia were held in Kuala Lumpur during April 6-20, 1984. The Malaysian delegation was headed by the Deputy Secretary-General of the Treasury. The mission had discussions with the Deputy Finance Minister and the Secretary-General of the Treasury, the Governor of Bank Negara Malaysia and other senior officials from the Treasury, Bank Negara Malaysia, the Economic Planning Unit, and Petronas. The staff team consisted of Messrs. Douglas A. Scott, Nurun N. Choudhry, Robert Di Calogero, In-Su Kim (all ASD), Robin Kibuka (FAD), and Mrs. Kamlesh Sehmi (ASD).

Malaysia has accepted the obligations of Article VIII, Sections 2, 3, and 4.

II. The Economic Background

1. The period 1980-82

The growth of the Malaysian economy was affected by the international recession and substantial weakening in external demand that began in mid-1980 and lasted through early 1983 (Chart 1 and Appendix Table 1). The authorities pursued expansionary financial policies to counter the domestic consequences of weakened external demand. The most important of these policies in 1980-81 and initially in 1982 was a rapid expansion in budgetary expenditures, initiated following the mid-term review of the Third Malaysia Plan in 1979. In mid-1982 the authorities initiated a reassessment of fiscal policy, especially expenditure policy, in response to the persistence and severity of the global recession and to the rapidly increasing fiscal and external imbalances. Notwithstanding this reassessment, the overall federal budget deficit rose from 3 percent of GNP in 1979 to 17 percent in 1982 as government expenditure rose to about 45 percent of GNP (Chart 2 and Appendix Table 2). The growth of revenue slowed after 1980 and remained relatively stable at about 28 percent of GNP. However, there was a marked shift in composition; revenues derived from production and export of petroleum, including dividends from the national oil company (Petronas), rose from less than 10 percent in 1979 to 32 percent of total fiscal receipts by 1982. There was a correspondingly sharp fall in other export tax revenues, reflecting weaker external prices and discretionary changes to sustain profitability in rubber and tin production. To finance the increasing fiscal deficits, the Government increased its recourse to external borrowing (which financed just under 40 percent of the cumulative deficits during 1980-82) and domestic savings from captive sources, principally the Employees Provident Fund. In 1981 and 1982,

the Government also borrowed from Petronas, 1/ and made increasing use of bank credit which became an important source of monetary expansion.

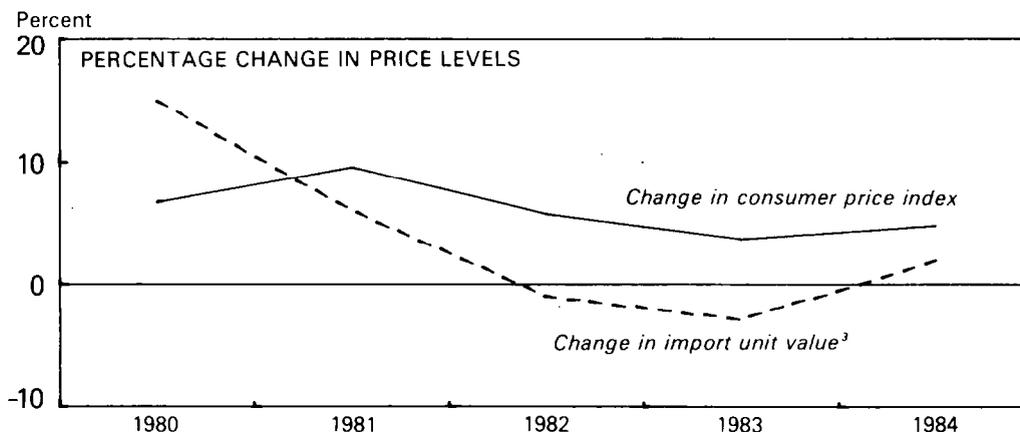
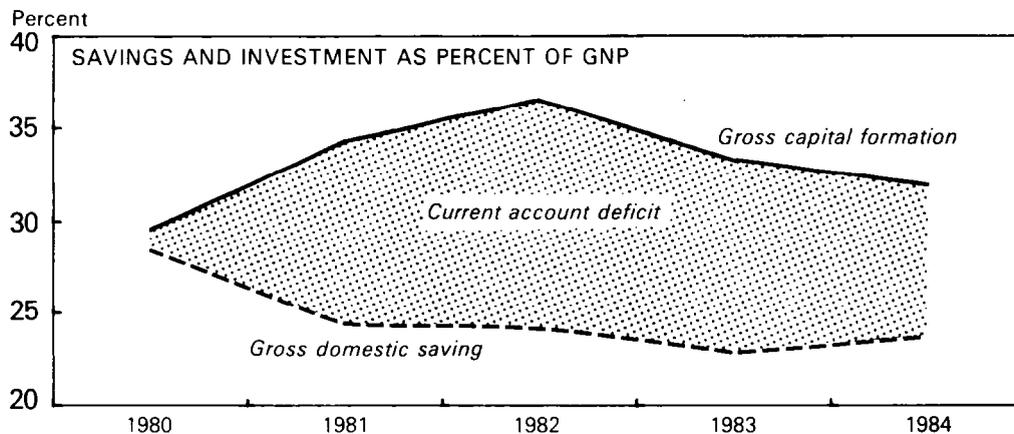
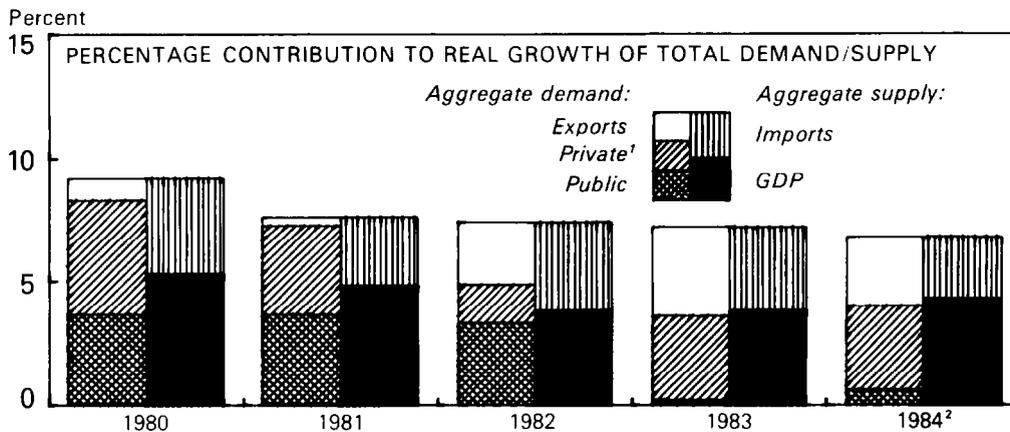
Monetary policy was generally accommodative of the demand for credit from the private sector, although concern began to emerge in 1982 that the extent of government borrowing might crowd out elements of the private sector from access to bank credit (Chart 3 and Appendix Table 3). Under the circumstances, the Central Bank bolstered bank liquidity--primarily through foreign exchange swaps with commercial banks on a temporary basis. Although domestic interest rates increased, a substantial difference in favor of domestic borrowing was maintained until late 1982, when the fall in international rates greatly reduced the differential.

The balance of payments came under increasing pressure, reflecting the large imbalances in the domestic economy; investment rose to about 37 percent of GNP in 1982, even as savings declined to 24 percent. The increasing domestic resource gap was reflected in the balance of payments where a sharp rise in imports, weakness in exports, and persistently large net payments on invisibles caused the current account to move from a surplus in 1979 to a deficit equivalent to somewhat more than 12 percent of GNP in 1982 (Chart 4 and Appendix Table 4). Imports grew at an annual average rate of about 17 percent, rising from 40 percent of GNP in 1979 to about 50 percent in 1982. For the period overall, the annual average volume of exports was lower than in 1979, notwithstanding the recovery that took place in 1982 in manufacturing and petroleum production and exports. Official borrowing accounted for about one half of the long-term capital inflows. 2/ At the end of 1982, total outstanding external debt (excluding short-term) rose to 41 percent of GNP from less than 20 percent in 1979. The overall debt service ratio remained low, because such major new borrowings after 1980 had substantial grace periods. Available data on short-term debt relate to financial institutions; their gross foreign liabilities amounted to US\$1.7 billion and foreign assets amounted to US\$1.9 billion. Interest payments in 1982 on the gross liabilities amounted to about 1 percent of exports of goods and services. Gross external reserves declined to the equivalent of just under four months of imports.

1/ The transfer of resources from the petroleum sector to the Federal Government through taxation, dividends, and borrowing in 1981 and 1982 was equivalent to 75 percent and 80 percent, respectively, of the gross value of Malaysia's oil production. An additional 5 percent of oil production was transferred to state governments as royalty payments.

2/ In the balance of payments, net official long-term capital comprises borrowings by the Federal Government, state governments and statutory authorities, and borrowings guaranteed by the Federal Government.

CHART 1 MALAYSIA SELECTED INDICATORS OF MACROECONOMIC DEVELOPMENTS, 1980-84



Source: Data provided by the Malaysian authorities.

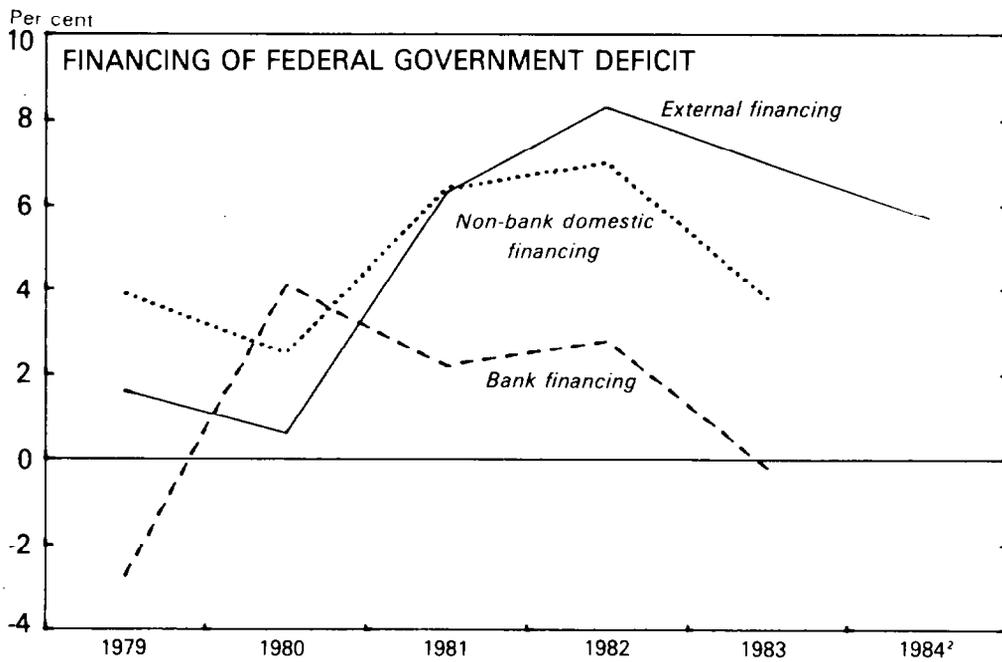
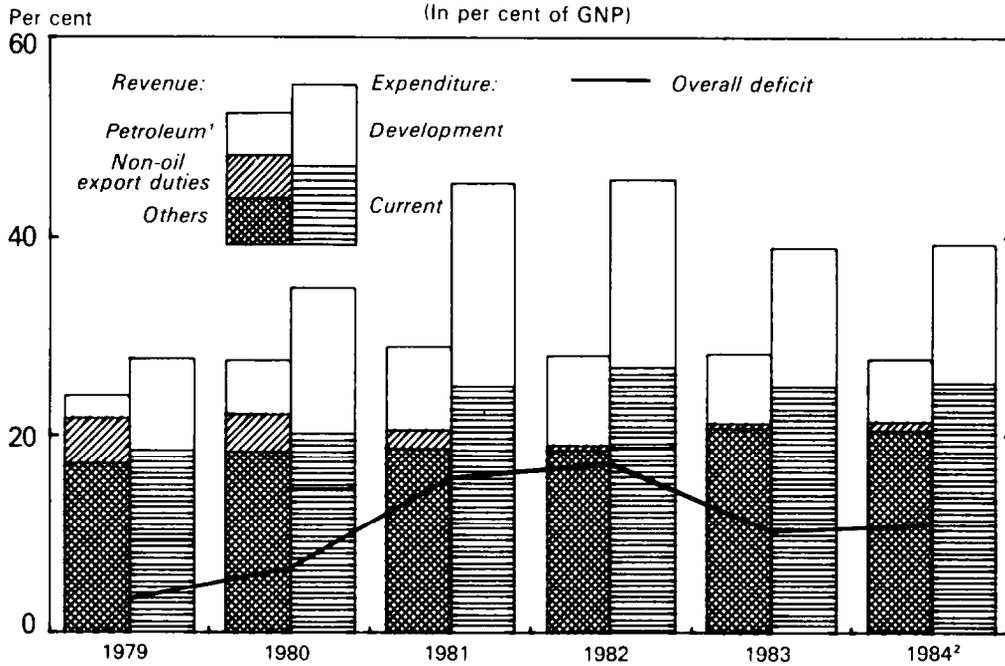
¹Includes changes in stocks. The private sector is defined to include the activities of 13 large non-financial public enterprises.

²Forecast.

³Based on 1980 trade weights.



CHART 2
MALAYSIA
FEDERAL GOVERNMENT OPERATIONS, 1979-84



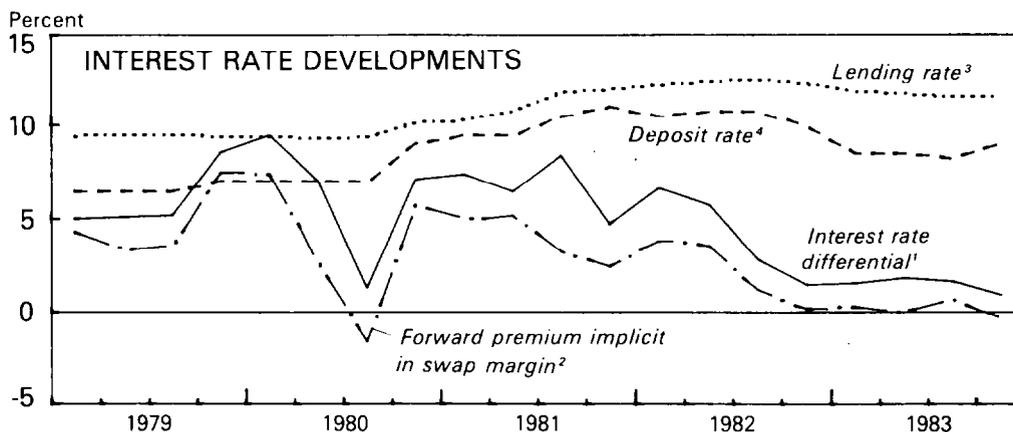
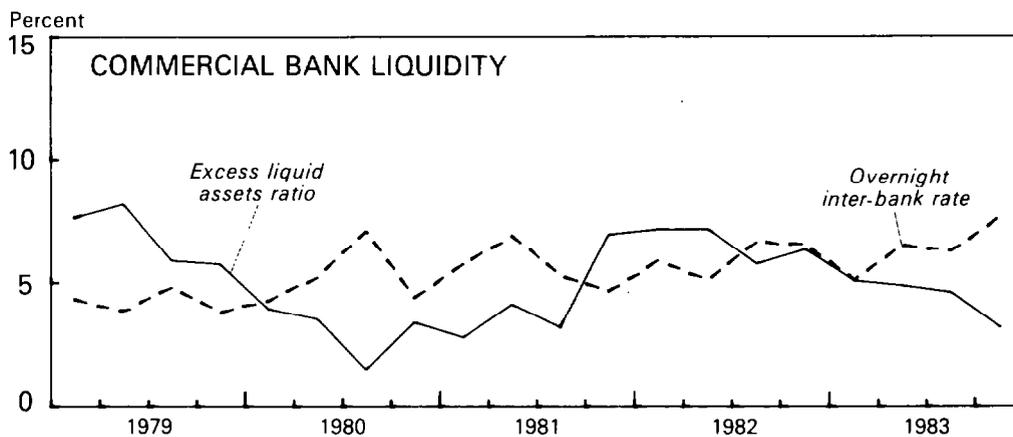
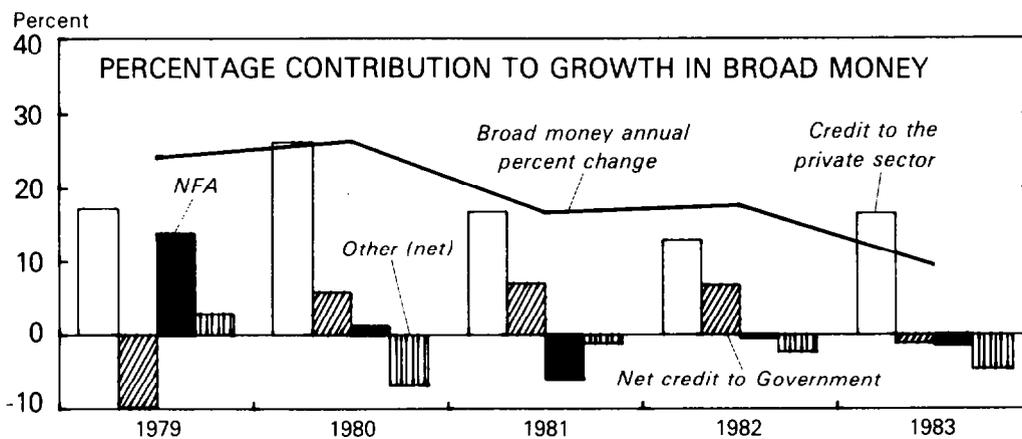
Source: Data provided by the Malaysian authorities.

¹Includes petroleum company tax, export duties, royalties and dividend paid by the national oil company.

²Revised estimates.



CHART 3 MALAYSIA MONETARY DEVELOPMENTS, 1979-83



Sources: Data provided by the Malaysian authorities, and staff estimates.

¹Three month LIBOR on U.S. dollar minus three month inter bank rate, period average.

²Representative three month swap effected through foreign exchange brokers, average of the end of month data.

³Weighted average lending rate of all commercial banks.

⁴Interest rate on one year time deposit of commercial banks, at end of period.

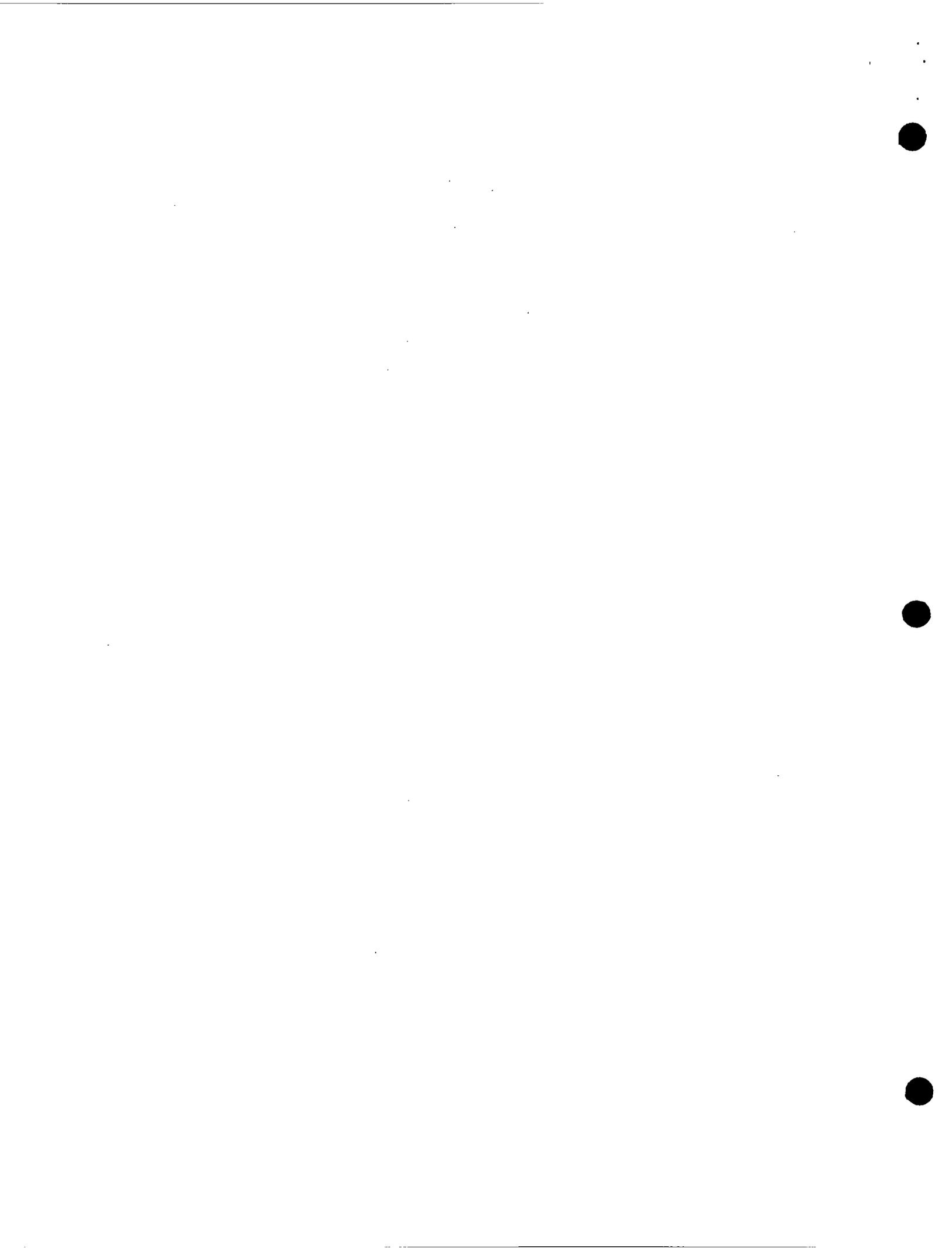
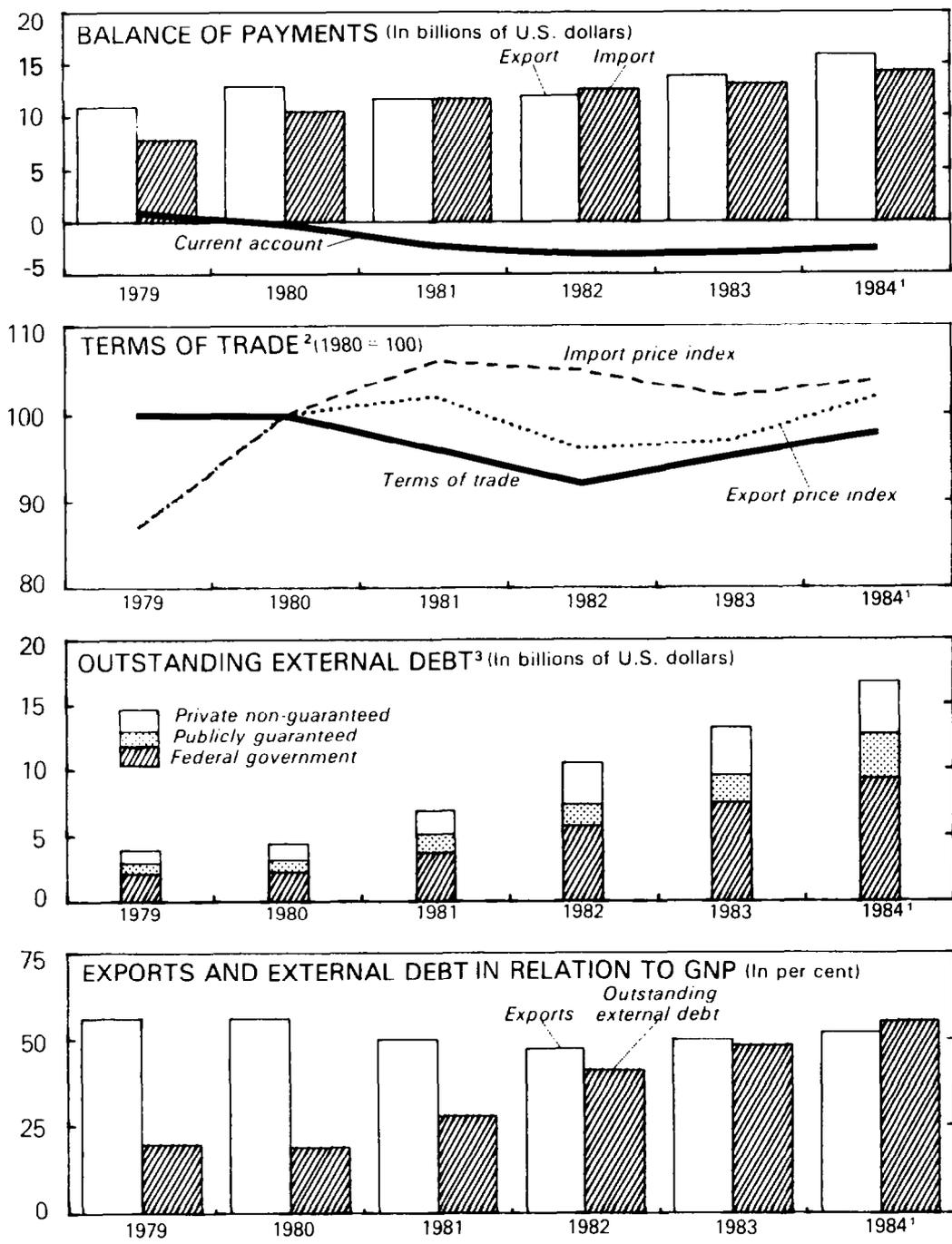


CHART 4
MALAYSIA
EXTERNAL INDICATORS, 1979-1984



¹Source: Data provided by the Malaysian authorities and staff estimates
²Forecast
³based on 1980 weights, indices are in terms of U.S. dollar
⁴Outstanding external debt of original maturity of one year and over



2. Developments in 1983

Economic growth increased to somewhat below 6 percent in 1983 because of the strengthening of demand for Malaysia's exports. Adjusted for the terms of trade, real gross national income increased by about 7 percent, compared with only about 3 percent in 1982. The growth of domestic demand slowed further due to the leveling-off of public sector demand; 1/ the latter reflected the substantial expenditure cutbacks implemented by the Federal Government in 1983. The growth in private demand reflected primarily the impact of the improving external terms of trade on agricultural incomes and consumption and also the sharp increase in investment by the "off-budget" agencies (OBAs). 2/ Nevertheless, reflecting retrenchment in development expenditures, total investment declined to about 33 percent of GNP. Although the savings proportion declined somewhat further, the domestic resource gap was reduced to about 10 percent of GNP.

The stronger growth in output came largely from the mining and construction sectors and was associated with further moderation in inflation. Activity in the petroleum sector was particularly strong because of the continued rise in crude oil production and the coming on stream of liquefied natural gas production and export in January. The sharp acceleration in construction activity came from building and property development and implementation of several large projects under the aegis of off-budget agencies. Agricultural growth declined as palm oil output fell due to weather conditions and the effects of tree stress incurred in 1982; output of rubber increased after four consecutive years of decline. Domestic inflation, in terms of consumer prices, declined to less than 4 percent. This reflected the slowing of domestic demand and a small decline in import prices. Available data point to increases in the range of 8-12 percent in wage and labor costs in the industrial and service sectors during 1983, somewhat higher than in the previous year.

The Government continued to pursue policies aimed at encouraging foreign direct investment which has been instrumental in establishing Malaysia's role as producer and exporter of oil and natural gas and also in the rapid growth of manufactured exports. Approvals of foreign direct investment outside the oil sector declined to about

1/ This refers to the traditional public sector which is defined as the Federal Government, 13 state governments, four local governments and 10 nonfinancial public enterprises. It excludes a large number of non-financial public enterprises among which the most important are 13 so-called off-budget agencies, some of which are partially funded through the budget.

2/ In addition to transfers from the budget, the operations of the off-budget agencies are partially funded by external borrowings guaranteed by the Government; however, these agencies are included as a part of the private sector in Malaysia's national accounts statistics.

US\$140 million in 1983, compared with about US\$230 million in 1982, mainly reflecting the adverse impact of the recent international recession and three large joint public-private projects approved in 1982. Total direct investment approvals during the first three years of the Fourth Malaysia Plan (1981-83) were about US\$580 million, most of which has been concentrated in the manufacturing industry, particularly chemicals and chemical products, machinery products, and electrical and electronic products. Japan, Australia, and the United Kingdom continued to dominate non-oil sector foreign investment in Malaysia, accounting for more than half of the total approvals during the period.

The overall budget deficit declined to M\$6.6 billion, or about 10 percent of GNP in 1983, reflecting new revenue measures and the substantial fiscal adjustment undertaken during the year, especially following a comprehensive review of expenditure policy in July-September. Total expenditure declined by about 8 percent to less than 39 percent of GNP, due primarily to a sharp reduction in development spending through cancellation or rephasing of projects. ^{1/} Consumer subsidies on diesel oil and kerosene also were reduced in March when the authorities decided not to pass on the full effects of the decline in crude oil prices. Government revenue rose by 9 percent, due mainly to a M\$1.2 billion package of tax measures, including a doubling of sales tax rates to 10 percent, and to greater than anticipated increases in income tax collections, including M\$500 million from Petronas in respect of repatriated investment income. A decline of M\$1 billion in dividends received from Petronas partly offset the rise in tax revenues.

Financing of the fiscal deficit continued to come chiefly from captive sources of domestic savings and foreign capital markets. As borrowings principally from these sources exceeded financing requirements, the Treasury redeemed a part of government securities held by Petronas and built up substantial deposits, initially with the Central Bank. Domestic and external debt of the Government rose to 70 percent of GNP in 1983; interest payments in the federal budget increased to about 22 percent of total current expenditures. External obligations guaranteed by the Government rose to 8 percent of GNP.

The main thrust of monetary policy was to maintain stable conditions as business activity and private sector credit demand strengthened over the course of the year. Although the growth of domestic credit slowed to 17 percent, commercial bank credit to the private sector rose by 21 percent, much of it going to the construction and real estate sectors. These sectors also accounted for a substantial part of the credit extended to the private sector by other financial institutions, which rose by 34 percent. The growth of broad money slowed appreciably during the latter part of 1983, reflecting both a reduction in private holdings of currency during September-December following introduction of

^{1/} In some cases payment terms were renegotiated, which resulted in a shift in cash expenditure from 1983 into 1984.

new currency notes and a slowing in the growth of commercial banks' fixed deposits. Deposit growth was more robust in other financial institutions and in commercial bank negotiable certificates of deposit, where interest rates were more attractive. However, the issue of new currency had only a temporary effect on the demand for money and by January 1984 the expansion of narrow money had increased to 12 percent, only somewhat below the growth in 1982. The strong demand for credit and slowing of deposit base expansion caused the liquidity position of commercial banks to tighten appreciably after August. In these circumstances Bank Negara moved to ease the situation through open market operations and recycling of government deposits to the commercial banks; net lending to the Government by commercial banks fell by somewhat over M\$2 billion during July-December.

Interest rates in the interbank market rose during the latter part of the year, but nevertheless remained in the range of 7-8.5 percent, somewhat lower than in the previous year. A new system of interest rate determination for commercial banks came into effect in November. Commercial banks are now required to anchor all lending rates, except those on loans to priority sectors, or where the rates are prescribed by law, to a declared base lending rate (BLR). The rate charged to a particular borrower is now a function of the BLR and a margin reflecting the customer's credit standing. The BLR declared by each bank is expected to move more closely with the cost of bank funds, making lending rates more responsive to market conditions. During the year commercial bank lending rates, except for designated purposes, remained relatively stable; the average lending rate tended to be in the range of 11.5-12.0 percent.

Stronger external demand and retrenchment of budgetary expenditures contributed to an improvement in the balance of payments, as the current account deficit narrowed to about 10 percent of GNP. Non-oil exports rose by almost 21 percent, reflecting a substantial rise in volume and increases in rubber and palm oil prices. The value of net crude oil exports showed only a small increase; the 30 percent rise in production was largely offset by the 14 percent decline in oil prices and higher domestic consumption. However, the export of liquefied natural gas (1.7 million tons) commenced and resulted in some increase in export earnings from this sector. The growth in exports of manufactured goods was partially offset by an accompanying increase in imports of intermediate goods for processing or assembly. ^{1/} The increase in imports of investment goods reflected largely the rise in import-intensive expenditure by off-budget agencies and other nonfinancial public enterprises. Net payments on invisibles increased substantially, due mainly to larger net investment income payments--interest on foreign debt and profits--and a sharp increase in fees and payments in respect of foreign contractors.

^{1/} For the largest and most dynamic elements of manufactured exports, e.g., electrical and electronic goods, the domestic value added is estimated at up to only 20 percent.

The financing of the current account deficit was met chiefly by nonmonetary capital inflows, largely reflecting the sustained high level of government and government-guaranteed borrowings. Short-term capital inflows, although small on a net basis, rose, reflecting the increased requirement by commercial banks to ease the strain on their liquidity. Overall, net official reserves declined by US\$40 million after accounting for the increase in reserve-related liabilities arising from transactions with the Fund under the Buffer Stock Financing Facility. At the end of 1983, gross external reserves, including gold holdings amounting to 2.33 million fine troy ounces, ^{1/} remained unchanged at US\$4 billion and represented somewhat less than four months of imports. Outstanding medium- and long-term external debt increased to US\$13 billion, equivalent to about 48 percent of GNP. Debt service in relation to exports of goods and services, which had increased to 9 percent in 1982, remained at that relative level in 1983. Short-term foreign assets and liabilities of financial institutions other than Bank Negara amounted to US\$2.3 billion and US\$3.0 billion, respectively, at year-end and interest payments on the liabilities would add 1 percentage point to the debt service ratio.

The ringgit, which depreciated by about 7 percent vis-a-vis the U.S. dollar (the intervention currency) from the end of 1980 through the end of 1982, appreciated by less than 1 percent subsequently through the end of 1983 (Chart 5). In real effective terms, the ringgit appreciated against the composite currencies of trading partners and major competitors by about 8 percent from the end of 1980 through the end of 1982 and by another 4 percent during 1983. ^{2/} The real effective appreciation since 1980 has returned the index to the level that prevailed during the period 1975-77, ^{3/} thus reversing the real effective depreciation which occurred during the late-1970s.

III. Report on Discussions

The discussions focused on the intensification of adjustment policies in 1983, the economic outlook and stance of policies for 1984, and prospects for the medium term. They took place just after the presentation to Parliament of the Mid-term Review of the Fourth Malaysia Plan, 1981-85. Projections prepared by the staff and Malaysian officials provided background for assessing policies in relation to possible developments in the domestic economy, the balance of payments, and the growth and burden of servicing Malaysia's external debt.

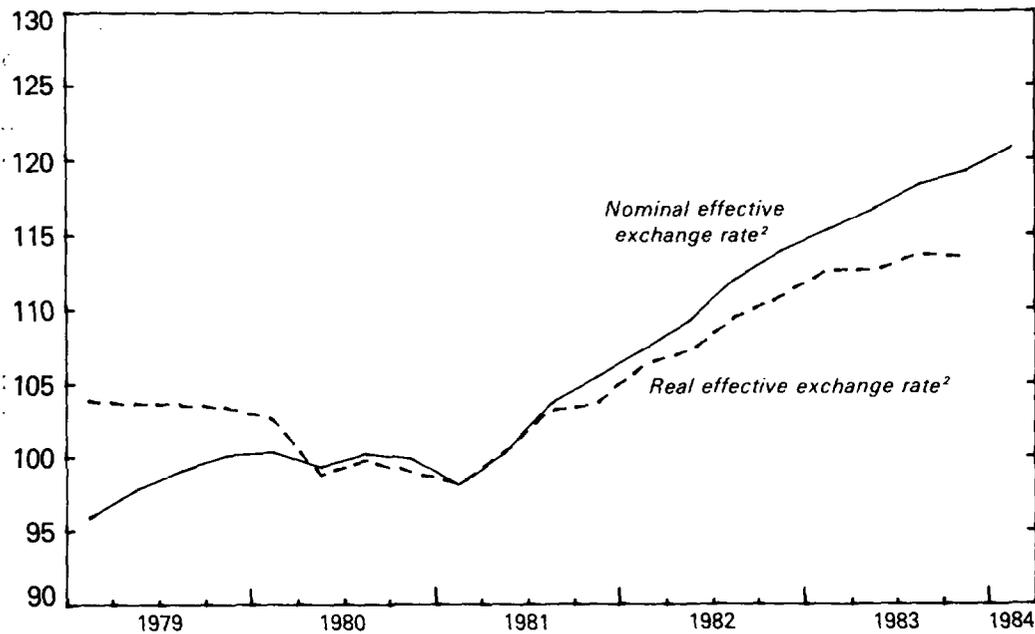
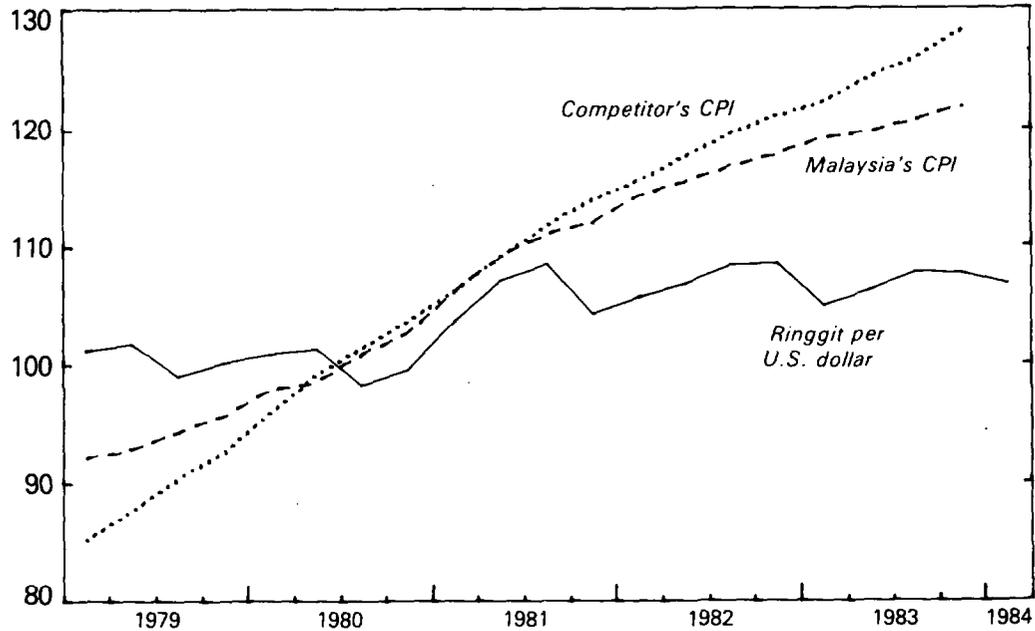
^{1/} The national valuation of gold holdings is at SDR 35 per fine troy ounce.

^{2/} Based on effective exchange rate indices computed by the Research Department as provided in "Indicators of Real Effective Exchange Rate", EBS/84/116, 5/23/84.

^{3/} During the period 1975-77, Malaysia's balance of payments on current account was broadly in equilibrium after taking into account the strength of petroleum exports; and the relationship between domestic and external prices was consistent with sustained external stability.

CHART 5
MALAYSIA
DEVELOPMENTS IN RELATIVE PRICES AND
EXCHANGE RATE INDICES¹, 1979-1984

(1980 = 100)



Sources: Data provided by the Malaysian authorities; IMF, *International Financial Statistics*, and staff estimates.

¹Indices calculated using period average quarterly data.

²Increase in the index indicates appreciation of the ringgit.



1. Adjustment policies in 1983

The original budget for 1983 aimed to reduce the overall deficit through new tax measures and restraint in development expenditure. However, during July-September 1983, the authorities undertook a more comprehensive review of fiscal policy in view of heightened concern about the steadily widening deficit of the public sector and the balance of payments. Their concern was not substantially different from that expressed by Executive Directors in their discussion of the 1983 consultation report on Malaysia. The slackening growth of fiscal revenue and uncertainties regarding both the international outlook for oil prices and the domestic outlook for oil production and exploration activity were important factors in the decision to reassess fiscal, and particularly expenditure, policies.

The review focused on restraining operating expenditures, often through administrative measures taken in advance of program reappraisal, and reassessing development expenditure priorities against the goals of the New Economic Policy. Nonstatutory operating expenditures, especially travel, transport, and purchases of goods and services, were restricted sharply after mid-year. In certain cases initial cutbacks in services, e.g., reduction in customs surveillance, police patrols, etc., had to be partially restored to maintain essential services at adequate levels. Reassessment of development expenditures was undertaken on a comprehensive basis for all important projects and programs funded through the Federal Government budget. Initially, priority was accorded to sustaining programs aimed at poverty alleviation and those leading to substantial short-term gains in output. However, during the course of the review the authorities compiled a more comprehensive picture of contractual expenditure obligations, often associated with major infrastructure projects. The extent of such obligations, not only affecting 1983, but stretching into 1984 and 1985, was much larger than previously assessed. The sanctity of contractual obligations became another important determinant of expenditure priorities. This did not, however, rule out negotiations with numerous contractors to stretch out project schedules and, in some cases, to rephase payments. These negotiations were carried out at high levels, sometimes at the ministerial level, and were time-consuming. Their often slow progress meant that the attainable degree of expenditure reduction and rephasing remained uncertain, even by October, when the budget for 1984 was presented.

In strengthening the fiscal adjustment, the authorities initially aimed to reduce the overall budget deficit to the equivalent of 12.5 percent of GNP in 1983, compared with 15 percent envisaged in April, and further to 6 percent in 1985, primarily through reducing expenditure. ^{1/} Similarly, the current account deficit of the balance

^{1/} The decisions taken regarding the extent of adjustment were conveyed in an informal memorandum circulated to the Executive Board on October 7, 1983.

of payments was envisaged to be reduced to US\$2.6 billion, or 9.5 percent of GNP in 1983, and further to about 5 percent in 1985. These adjustments would lead to substantial reductions in external borrowing and were believed to be consistent with limiting external debt and its servicing to a sustainable level by 1985.

The authorities were successful in effecting substantial adjustment within the Federal Government budget. Overall expenditures were reduced by 8 percent from estimates at the time of the 1983 consultation discussions. The overall deficit fell to M\$6.6 billion, or 10 percent of GNP. The authorities indicated that in certain areas the reductions were unsustainably sharp and some restoration of services and increased expenditure were required.

Two important reservations emerged regarding expenditure retrenchment in 1983: (a) projects of major off-budget agencies were not reviewed concurrently to allow a comprehensive assessment of public sector program and expenditure priorities; and (b) constraints imposed by contractual obligations have resulted in a skewing of public investment toward large, capital-intensive projects with relatively long gestation periods; this is also a basic characteristic of much of the off-budget agency investment. The authorities emphasized that the former would be corrected partially through a review of all major new projects planned by off-budget agencies in 1984. Accordingly, increased responsibilities have been assigned to the Economic Planning Unit for this purpose. However, the capital intensity of public investments could only be altered over time; this would be an objective of the Fifth Malaysia Plan. The authorities agreed that a more comprehensive and consistent delineation of public sector entities was needed, particularly with regard to those nonfinancial enterprises whose investment, production, or pricing policies are determined by the Government. ^{1/} Such a comprehensive definition of the public sector would be the framework for the Fifth Plan and would be reflected in major economic and financial statistics.

The conduct of monetary policy allowed a higher rate of credit expansion to the private sector than envisaged in April 1983. Undue pressure on prices or international reserves was avoided through larger-than-required external borrowing by the Government and the consequential reduction in the banking system's net claims on Government. Most of the growth in domestic credit was absorbed by the expansion of private expenditures, mainly through the boom in the construction and real estate sectors, which have a high import content of goods and services, the latter being associated with the use of foreign contractors and expertise on large projects. The Malaysian authorities indicated that

^{1/} A report prepared in 1983 following a technical assistance visit by a Bureau staff member has been discussed with the authorities and may provide a framework for this important task to improve economic and financial statistics.

in retrospect, credit expansion to the private sector had been somewhat on the high side considering the need to enhance external adjustment. However, there had been concern at the time that a more restrictive credit stance would have choked off the recovery in private investment and business confidence that was beginning to emerge during the first half of the year.

The degree of external adjustment realized in 1983 was somewhat less than targeted in September and even less than forecast at the time the 1984 budget was presented in October. The current account deficit declined only to US\$2.9 billion. This was somewhat larger than the forecast made in April 1983 before decisions were taken to intensify fiscal adjustment policies and also larger than the US\$2.6 billion target sought in September 1983. This progressively less favorable outlook regarding the current account deficit reflects the much stronger than perceived growth in private demand, including particularly the activities of off-budget agencies which accounted for three fourths of the growth in private sector investment expenditure in 1983. It also points to the incomplete information available to economic policymakers regarding activities of important public entities. 1/

2. Outlook and policies for 1984

The authorities expect the current favorable expansion of economic activity in the industrial countries to be sustained in 1984. Largely because of the anticipated strengthening of external demand, real growth is expected to exceed 6 percent. Growth of domestic demand is also projected to be higher, reflecting some expansion in public demand, arising mainly from an increase in consumption even as the authorities seek to consolidate their fiscal adjustment policies. Private demand is anticipated to slow, as investment in the oil and gas sector levels off; the important off-budget agencies plan large investment expenditures in 1984, but there is uncertainty over their realization because the Government is expected to review such plans during the year. Somewhat higher growth is expected in agriculture, reflecting primarily increased output of palm oil. Real growth in the mining sector is expected to continue at a high rate due to increased output of crude petroleum and liquefied natural gas; lower growth is expected in most nonagricultural sectors. The rate of increase in consumer prices is expected to be moderately higher because of somewhat higher import prices and stronger domestic demand.

a. Petroleum policy

The petroleum sector's importance has grown at a brisk pace. Since 1982 production policy has been determined largely by the financial

1/ The staff believes that data on public sector external debt is generally complete. An IBRD mission visited Malaysia during May-June 1984 to review the reporting of external debt information.

needs of the Government, which have tended to gain in importance relative to the objectives of the National Depletion Policy ^{1/} which came into force in June 1980. After two consecutive years of increase from 249,000 barrels per day (bpd) in 1981, production in 1984 is expected to average 440,000 bpd. This is approximately the maximum level that can be sustained from existing oil fields over the next three to four years. The level of exploration activity declined sharply in 1982, when exploration rights were relinquished by some major foreign oil companies after expiration of the initial five-year agreement periods. Subsequently, the lower level of exploration--which now is seen as insufficient to sustain further production increases--has persisted. The authorities are currently reassessing the adequacy of incentives under production-sharing arrangements in light of higher exploration and development costs associated with drilling in deeper and more distant waters. The staff representatives noted that even if present production levels are maintained, rising domestic consumption of oil products will cause the net export of oil and oil products to fall steadily after 1984. Consequently, conservation measures could receive higher priority as a means to retard the expected fall in net oil exports.

b. Fiscal policy

The 1984 budget was framed during the period of intensive review of government expenditure. In presenting the budget, the Minister of Finance observed that government expenditures constitute about 40 percent of GNP, and that such spending had a strong bearing on the outcome of the balance of payments. The 1984 budgetary strategy aimed to (i) improve and strengthen the balance of payments; and (ii) further consolidate and strengthen the Government's financial position, by aligning expenditures more closely to available resources. Changes in tax policy were expected to yield in aggregate only about M\$242 million in 1984. On a cash basis, the budget aimed at an overall deficit of M\$7.4 billion (11 percent of projected 1984 GNP), with total expenditures and revenues of M\$26.8 billion and M\$19.4 billion, respectively. When the budget was presented the estimated outturn for 1983 indicated an overall deficit of M\$9.8 billion.

By the time of the discussions in Kuala Lumpur, both the outturn for 1983 and the outlook for 1984 had undergone substantial change, reflecting both the continuing process of expenditure review and also additional policy changes. The negotiated shift in timing of payments in relation to progress on certain projects resulted in a further expenditure saving in 1983 of M\$855 million which was shifted into 1984. Other important changes affecting the 1984 outlook included provision of M\$1.2 billion for certain new projects where cancellation of external financial commitments was not possible, a major new project in the telecommunications field, and additional provision for projects

^{1/} For a summary of the National Depletion Policy, see Malaysia: Recent Economic Developments (SM/81/130, 6/8/81).

being undertaken by off-budget agencies. Largely because of this unexpected increase in expenditure, the authorities decided, with effect from the beginning of January, to eliminate the remaining subsidies on domestic sales of petroleum products, thereby saving an estimated M\$400 million in operating expenditures. Concurrently, provision was made for Petronas to pay M\$450 million in dividends during the year--the same level as in 1983. These adjustments and a downward revision in estimated interest payments on public debt brought the estimated fiscal deficit for 1984 to M\$7.9 billion. Financing of the deficit is expected to come mainly from external and captive domestic sources.

The Malaysian authorities indicated that despite their strong commitment to effective fiscal adjustment, the process had proven to be difficult and would require persistent efforts over a longer period than originally envisaged. Expenditure growth in 1984, for example, now included a 14 percent rise in wages and salaries, reflecting, in part, the costs of additional staff required for new health and education facilities and for certain functions being transferred from other levels of government. Demographic factors would continue to exert pressure for increased social services and without a major reshaping of policies, or an extensive privatization of public services, a trend increase of about 7 percent in expenditure on emoluments should be expected in future years. Similarly, the inexorably rising trend in interest payments on the public debt could be reversed only through intensified efforts to reduce the fiscal deficit or, possibly, a major decline in interest rates. The Malaysian authorities indicated that while there was scope to broaden the tax base, particularly for certain indirect taxes, tax rates in Malaysia were generally higher than in neighboring countries and the ratio of total revenues to GNP (28 percent during 1980-84) was already high. Excluding revenues associated with production and export of oil, the revenue proportion had shown little trend within the range of 19 percent to 22 percent. The stability in the revenue proportion from nonpetroleum sources, notwithstanding important discretionary tax measures in 1983 and 1984, and the production and world market outlook for oil, indicated that the major thrust of fiscal adjustment would have to be made through expenditure reduction. The upward pressure on statutory expenditure and limited scope for reducing other operating expenditures effectively meant that the burden of fiscal adjustment would fall on development expenditure and more broadly on public sector investment projects and programs.

Analysis of public sector financial developments was hampered by lack of statistical coverage of numerous nonfinancial public enterprises. A partial consolidation of public sector operations (excluding the major off-budget agencies) indicates that the overall deficit declined from 17.1 percent of GNP in 1982 to 13.7 percent in 1983; a further decline to 12.8 percent is estimated for 1984. Consolidated development expenditure remained relatively stable in 1983, but is projected to rise by 14 percent in 1984 to M\$13.7 billion. However, tentative estimates of investment expenditure by 13 off-budget agencies indicate a rise of almost 75 percent in 1984 to M\$5.5 billion. The

authorities indicated that considerable uncertainty existed about the magnitude of such investments in 1984 because higher levels of expenditure were actually being planned within these agencies. However, the Economic Planning Unit had been instructed to evaluate all new major projects of such agencies and it was expected that a comprehensive review and reassessment of project priorities would be initiated before mid-year.

The staff representatives noted that the degree of expenditure and overall fiscal adjustment achieved within the federal budget in 1983 had been substantially greater than in other areas of the public sector and that a similar outlook was emerging in 1984. Most of the investments in the large off-budget agencies reflected public policy decisions taken at various levels of government, creating competing claims on domestic or external resources. Consequently, a more comprehensive view should be taken in appraising public sector priorities which should extend beyond the federal budget or the historically defined public sector.

c. Monetary policy

The objectives of credit and monetary policies in 1984 are to moderate the growth of domestic demand, maintain stable conditions in money markets, and facilitate the sound development of financial institutions. The authorities stated that the continued rapid expansion of credit to the private sector during the first quarter of 1984 has given rise to a dilemma in the conduct of monetary and credit policy: how to nurture and support the pace of private activity, while strengthening the overall stance of policies to achieve external adjustment. During the remainder of the year, the Central Bank intended to pursue a more restrictive credit policy. Overall, monetary expansion for the year is envisaged to be somewhat higher than in 1983, with the growth of narrow money in the range of 10-12 percent and broad money in the range of 16-17 percent; these targets are about the same as the rates of expansion during January 1983-January 1984, but also reflect an expected higher growth of longer-term deposits with banks. Domestic credit expansion is anticipated to provide the major stimulus to the growth of broad money. The authorities intend to limit the rate of expansion of commercial bank credit to the private sector to 18 percent, implying an appreciably slower growth of such credit during the remainder of the year. The staff urged that the expansion of lending by finance companies and merchant banks be similarly slowed.

Adjustment to lower rates of credit expansion to the private sector, by banks and other financial institutions, has been made more complex by the rapid growth in lending for property development in 1983. More than one third of the total rise in lending by banks, finance companies, and merchant banks was directed to real estate, property development, and construction during the year; at year-end, 36 percent of total credit of these institutions was directed into the property sector. In addition, a large part of undrawn loan commitments was in respect of term lending to these sectors. This concentration of

lending and undisbursed loan commitments in property development could somewhat limit flexibility in the conduct of credit policy, and the authorities' concern has been heightened by an emerging excess supply of commercial property which has had a depressing effect on rental markets. The staff representatives noted that demand management and prudential considerations pointed in the direction of greater restraint and increased diversification of lending, increased term deposit mobilization, and a strengthening of the capital base of financial institutions. In these circumstances interest rates should be encouraged to rise and the capital to risk asset ratio of financial institutions should be broadened to include that portion of undisbursed loan commitments related to term lending. This latter action could help to slow the growth in lending to the property development sector and to strengthen the capital base of financial institutions.

d. Balance of payments outlook and policies

The improvement in the balance of payments in 1984 is now expected to be significantly less than anticipated in September; the current account deficit is projected to decline to US\$2.5 billion, equivalent to 8 percent of GNP, compared with the estimates of US\$1.6 billion in September and US\$2.0 billion in October. This less favorable than targeted outlook reflects a stronger momentum of investment than earlier foreseen, particularly in public entities, and mainly on projects with a long gestation period and high import intensity. The Malaysian representatives stated that the balance of payments outlook for 1984 was a source of concern and indicated the need to strengthen policies aimed at external adjustment. The highest priority should be accorded to a comprehensive reassessment of the investment programs of public entities whose activities were currently outside the scope and purview of the Federal Government budgetary process. 1/

The improvement now expected in the current account of the balance of payments in 1984 derives primarily from the anticipated strong performance of rubber and manufactured exports, as well as the increase in production and export of liquefied natural gas. The gains in exports, however, are expected to be substantially offset by the increase in imports, reflecting partly the high import content of manufactured exports and also the rising payments on invisibles.

The authorities plan to continue financing the external deficit through large-scale foreign borrowing by the Government and by public enterprises with government guarantees. The net capital inflow is projected to decline to US\$3.6 billion, with net government and government-guaranteed borrowing amounting to US\$2.4 billion. The authorities' reserves policy is dictated by the need to maintain an adequate level in

1/ During May-June 1984 an IBRD mission visited Malaysia to review and assess public sector investment expenditures in anticipation of preparatory work for the Fifth Malaysia Plan.

light of the openness of the economy, the liberal exchange system, and the fact that Malaysia's export earnings vary with fluctuations in the prices of primary commodities. The level of reserves, however, has declined steadily since 1980. In 1984, gross official reserves, relative to imports, are projected to decline marginally to 3.6 months of imports.

e. Exchange rate policy

During the 1983 Article IV consultations, the staff took the view that a further real effective appreciation of the ringgit should be avoided. Although the 4 percent real effective appreciation in 1983 is small, it was in the wrong direction. The Malaysian representatives stated that the present level of the ringgit appears to be adequate to maintain the competitiveness of export-oriented industries, particularly in view of the strong growth of manufactured exports since 1982. However, there was some concern that wages in manufacturing industry might be rising more rapidly than the consumer price index and gains in productivity. If such a trend existed and were to be sustained over several years, it could weaken the competitiveness of Malaysia's manufacturing sector and further exacerbate labor shortages in primary producing sectors. The authorities indicated that sustaining the competitiveness of the export sector was an important objective in assessing exchange rate policy.

3. Medium-term outlook

a. Mid-term Plan review

The mid-term review of the Fourth Malaysia Plan (FMP) includes an analysis of recent macroeconomic developments. The review points out that Malaysia's external imbalance, evident since 1980, resulted not just from cyclical factors but from the underlying structural weakness in the economy. The major structural problems are: the declining productivity in agriculture except for palm oil; a narrow manufacturing base, dependent on the export of a few products with low domestic value added; a strong bias in favor of imports in the structure of domestic demand; and the increasing size of the public sector arising from the expansionary fiscal policies pursued since 1980. The latter has resulted in large and increasing deficits in the budget and the balance of payments.

The review highlights the role of the presently defined public sector in the implementation of the Plan. About 94 percent of total Plan expenditure for the period 1981-85 was achieved by the public sector, excluding the off-budget agencies, during 1981-83. This was due to a desire to accelerate development, resulting partly from the poor performance of private investment brought on by the global recession.

The review stresses that the primary objective of economic policy in 1984 and 1985 is to reduce the domestic and external imbalances. To

achieve this, government policy must shift in order to consolidate and strengthen public sector finances, improve domestic savings in relation to GNP, and promote the expansion of exports through production policies. In view of the internal and external resource constraints, which are expected to continue, such a shift in government policy requires that public sector expenditure be reduced in 1984-85 and that progress be made toward eradicating poverty and restructuring the pattern of corporate ownership in an economic environment where the private sector generates the dynamism for growth. In this regard it was noted that the Plan review encompasses neither the investment priorities nor resource requirements for the off-budget agencies, an omission that existed when the Fourth Malaysia Plan was prepared. As a consequence the review does not provide a framework for evaluating competing claims on public sector resources. The Malaysian authorities indicated that a more comprehensive approach to assessing public sector investment priorities would be adopted for the fifth Plan.

b. External outlook

The external outlook for the medium term was discussed against the background of important uncertainties regarding external developments and the stance of Malaysia's economic policies. The tentative balance of payments estimates through 1988 are based on the assumptions that real growth beyond 1985 will be maintained at about 6 percent and the international economy will evolve approximately in line with the central scenario in the staff's recently issued World Economic Outlook. Among major balance of payments items, exports are projected to grow at an average annual rate of about 12 percent and imports to expand at an average annual rate of about 11 percent. The terms of trade are projected to improve about 1 percent annually, maintaining the present petroleum prices in nominal terms through 1985 and thereafter, oil prices are assumed to remain unchanged in real terms. The trade account is thus projected to register a surplus equivalent to 8 percent of GNP by 1988. However, much of the improvement in the trade account is forecast to be more than offset by a sizable increase in the service account deficit, mainly reflecting a sharp rise in interest payments. In projecting interest payments, an average interest rate of about 10 percent on outstanding debt is applied. Market borrowing is assumed to be the principal form of external borrowing. Grace periods on new loans are assumed to remain unchanged from recent experience, i.e., about five years. In this setting, the deficit on the current account is projected to decline gradually to about 5 percent of GNP by 1987, while external debt rises to about US\$24 billion, which would be higher than total exports and about 60 percent of GNP (Appendix Table 5). The debt service ratio would rise from about 13 percent in 1984 to 17 percent by 1987. In 1988, gross external borrowing would be US\$5.6 billion; of this, gross public sector borrowing would be US\$4.6 billion.

Two aspects of this outlook deserve mention. First, the export level reflects decisions to increase oil production to the approximately maximum capacity in 1984 and maintain it thereafter at this level. With

petroleum production constrained by capacity, net exports of petroleum are expected to decline over the remainder of this decade because of the increase in domestic consumption of petroleum products. In this context, the staff representatives indicated that conservation policies, including increased taxation of domestic oil consumption, could help to ameliorate a substantial decline in the exportable surplus of crude oil and products. Second, the level of imports and service payments assumes further reductions in public sector investment, particularly in the off-budget agencies. Without such assumptions, alternative projections indicate that the deficit on the current account would remain about 7 percent of GNP through 1988. Such a level would accelerate the accumulation of external debt and the burden of its servicing at today's interest rates to levels the staff and authorities consider unsustainable.

4. Statistics

The Malaysian authorities are intensifying efforts to improve economic and financial statistics. Economic analysis for public policy is severely hampered by an inadequate delineation of the public sector and, consequently, insufficient statistical information on production, investment and financial flows related to nonfinancial public enterprises. Macroeconomic statistics are deficient in several other areas, including data on wages and labor costs. The authorities have identified these and other limitations in national economic and financial statistics and have initiated steps, including assistance from the IBRD and IMF, to remedy the most important deficiencies.

IV. Staff Appraisal

The rapid expansion of the Malaysian economy during the 1970s slowed appreciably as a result of the international recession that began in mid-1980. To sustain the momentum of growth and accelerate the restructuring of asset ownership, the authorities pursued expansionary financial policies in 1980-81 and initially in 1982, principally through a rapid increase in budgetary expenditures. From mid-1982, the stance of fiscal policy was shifted toward expenditure restraint in response to the prolongation and severity of the global recession and the strains of increasing domestic and external imbalances; this initiative was reflected in the 1983 budget.

Economic performance in 1983 improved as external demand strengthened and the authorities intensified the fiscal adjustment to reduce domestic and external imbalances. The degree of fiscal adjustment achieved within the Federal Government budget was larger than expected, but this was to some extent offset by the expansion in the rest of the public sector so that the degree of overall fiscal adjustment was substantially less than intended. Consequently, the adjustment in the deficit of the balance of payments on current account was less than envisaged.

The outlook for 1984 anticipates continued expenditure restraint in the Federal Government, but revenue prospects are not sufficiently strong so that the budget deficit in relation to GNP is expected to increase somewhat. The difficulty of achieving further restraint in government expenditure and reducing the overall deficit reflects the painful realities of trying to adjust from the high expenditure levels of the recent past. Also, the heavy dependence of the tax system on the petroleum sector has become worrisome in view of the outlook for production and net exports of oil. In this context, the staff would encourage efforts to improve the elasticity and broaden the base for taxes on domestic transactions and income and profits.

The outlook for the broader public sector reflects the same predicament that was observed in 1983. Restraint in expenditures of the Federal Government is likely to be offset by a rapid planned increase in investment spending by nonfinancial public enterprises, particularly the off-budget agencies. This dichotomy warrants early remedial measures, including a more comprehensive periodic review of economic objectives and investment priorities within the broad public sector. Investment priorities for major off-budget agencies should be assessed periodically in the context of priorities of all other public investment projects, taking account also of the macroeconomic and balance of payments outlook over an extended period of 3-4 years. It is also essential that domestic and external resource requirements and constraints be similarly assessed, because the expected benefits of major projects frequently materialize over a longer period. The overly accelerated investment program since 1980, even if consisting of projects which appear viable in the long run, is causing undue strains on the balance of payments in the medium term.

Monetary policy in 1984 must contend with the conflicting goals of nurturing and supporting the pace of activity in the private sector, while strengthening the overall stance of policies to achieve external adjustment. In view of the rapid expansion in credit to the private sector in 1983 and thus far in 1984, the staff believes that credit policies should be tightened to give greater support to moderating domestic demand growth and strengthening the balance of payments than was the case in 1983. The lending activities of finance companies and merchant banks should also be moderated. The staff recognizes that the conduct of a restrictive credit policy is complicated by the degree of undrawn credit commitments, particularly where the underlying lending is of a long-term nature. In view of the declining trend in the savings proportion and the slower growth of the deposit base of commercial banks, the staff believes that there is scope to facilitate a rise in lending and deposit rates. Also, to help restrain lending and strengthen the capital base of financial institutions, active consideration should be given to including undrawn term loan commitments within the capital to risk asset ratio.

The balance of payments outlook for 1984, taking into account growth in external debt and debt service, remains disquieting. The

current account deficit is now expected to decline to about 8 percent of GNP. As in the previous year, much of the gains in merchandise trade are being offset by rising payments on invisibles--interest on the foreign debt and payments in respect of foreign contractors. Two aspects of this outlook may be viewed with concern. First, oil production is approximately at the maximum level that can be sustained from existing fields over the next 3-4 years. Second, the level of import and service payments anticipates further rephasing of the public sector investment program, particularly by the off-budget agencies; without such rephasing, the outlook is for a larger external deficit. The staff urges that such rephasing be accorded high priority and greater weight be given to the need for external adjustment in assessing the broad public sector investment priorities.

The medium-term balance of payments outlook suggests that external debt in relation to GNP and debt service in relation to current account receipts will continue to increase. At the end of 1979, Malaysia's outstanding public and private medium- and long-term foreign debt was US\$3.8 billion, or about 20 percent of GNP, and the debt service ratio was about 6 percent. By 1983 external debt had risen to 48 percent of GNP and the debt service ratio was 9 percent. The medium-term outlook anticipates that by 1987 these ratios will have increased to about 60 percent and 17 percent, respectively. The sharply rising debt service ratio during the coming several years partly reflects expiration of grace periods on the large market borrowings after 1980. These trends are disquieting. Furthermore, they are based on an outlook which assumes that additional but as yet unspecified measures will be taken in 1984 to reduce the broad public sector deficit. Because of the relatively large balance of payments deficit on current account projected for 1987-88 (about 5 percent of GNP), the burden of external debt service is projected to increase even further by 1990. The prospective trends of a rising debt burden and only small improvements in the balance of payments during the second half of this decade leave little room for unforeseen adverse developments. This is an important factor influencing the staff's view that Malaysia should move further in an orderly and planned way to reduce and reorient public investment expenditure, especially in the off-budget agencies, giving greater priority to activities with a relatively short gestation period and high economic returns.

The mid-term Plan review stresses that the major objective of economic policies in 1984-85 is to reduce the external deficit. Toward this objective, the review calls for a diminution in the size and role of the public sector and emphasizes the goal of privatization. The absence in the Fourth Malaysia Plan and the recent Plan review of explicit consideration of the policies and investment programs of the off-budget agencies, other than the traditional statutory authorities, is a weakness in economic planning that should be quickly remedied.

Exchange rate policy has been implemented in the context of an open economy with an exchange system free of restrictions on payments and

transfers for current international transactions and a liberal trade system. The staff welcomes and strongly supports this orientation of trade and exchange policies in light of the importance accorded to market forces in influencing the allocation of resources. The real effective exchange rate index for the ringgit showed a further small appreciation in 1983. The staff believes that weakness in the balance of payments, including the medium-term outlook, indicates that exchange rate policy should be used more actively to strengthen the external adjustment effort. However, because the persistent external imbalances have their origin in excessive growth of public sector expenditures, the sustainability of any particular exchange rate level will depend on correcting the fundamental domestic imbalances.

The strength of the Malaysian economy and the as yet still moderate burden of external debt provide time to reduce and reorient public investment expenditure in an orderly way so as to strengthen domestic and external adjustment policies. The staff urges that such a process, which was intensified in the 1983 budget, be extended to all aspects of the public sector.

It is recommended that the next Article IV consultation with Malaysia be held on the standard 12-month cycle.

Table 1. Malaysia: Output, Demand, Prices, and Foreign Trade, 1980-84
(Percent change from previous year)

	1976-80 Average	1980	1981	1982	1983	1984 <u>1/</u>
Real GDP	8.6	7.8	7.1	5.6	5.8	6.7
Agriculture	5.4	3.1	4.2	7.4	0.5	4.3
Mining	8.1	-2.2	2.0	2.8	16.2	14.7
Manufacturing	11.3	9.1	4.9	3.8	6.0	7.0
Construction	14.6	17.7	15.1	9.5	15.0	11.0
Domestic demand	10.8	12.1	10.3	6.8	5.0	5.7
Private	10.4	15.9	7.0	2.1	7.7	6.7
Consumption	(9.8)	(10.8)	(2.5)	(2.7)	(6.3)	(6.5)
Investment	(12.9)	(24.1)	(22.2)	(0.3)	(11.6)	(6.8)
Public	11.2	20.3	18.2	14.9	0.8	2.9
Consumption	(10.5)	(20.1)	(15.0)	(7.1)	(8.6)	(3.5)
Investment	(12.5)	(20.6)	(24.2)	(28.5)	(-10.7)	(1.6)
Consumer prices	4.5	6.7	9.7	5.8	3.7	4.5-5.0
Merchandise exports <u>2/</u>	27.8	17.0	-9.1	2.3	15.7	14.9
Volume	12.5	1.8	-11.2	9.0	14.3	9.4
Prices	13.6	14.9	2.4	-6.2	1.2	5.0
Merchandise imports <u>2/</u>	24.7	33.5	12.0	6.6	5.3	8.8
Volume	16.4	16.5	5.4	7.9	8.0	6.7
Prices	7.1	14.5	6.2	-1.2	-2.5	2.0
Terms of trade	6.1	0.3	-3.6	-5.0	3.8	3.0

Sources: Data provided by the Malaysian authorities; and staff estimates.

1/ Estimates.

2/ In U.S. dollars.

Table 2. Malaysia: Summary of Federal Government Operations, 1979-84

	1977-80 Average	1979	1980	1981	1982	1983 Prelim. Actual	1984 Rev. Est.
<u>(In billions of ringgit)</u>							
Total revenue and grants	10.2	10.4	13.8	15.7	16.6	18.0	19.7
Total expenditure and net lending <u>1/</u>	12.6	11.9	17.1	24.3	26.7	24.6	27.6
Of which:							
Current	8.3	8.0	10.1	13.6	15.8	16.0	18.1
Development	2.9	2.5	5.3	8.9	7.1	5.2	5.8
Net lending	1.6	1.5	2.0	2.2	4.1	3.7	4.0
Overall deficit	-2.4	-1.5	-3.3	-8.6	-10.1	-6.6	-7.9
Financing (net)							
External	0.5	0.7	0.3	3.4	4.9	4.5	...
Domestic <u>2/</u>	1.9	0.5	3.3	4.7	5.8	2.3	...
Of which							
Banking system	(0.4)	(-1.2)	(2.0)	(1.2)	(1.7)	(-0.2)	...
<u>(As percent of GNP)</u>							
<u>Memorandum items:</u>							
Total revenue	25.7	24.0	27.6	28.9	28.1	28.2	27.7
Total expenditure	31.6	27.4	34.2	44.7	45.2	38.4	38.8
Of which:							
Current	20.7	18.5	20.2	25.0	26.8	25.0	25.4
Development	7.3	5.8	10.5	16.3	12.0	8.2	8.2
Net lending	4.0	3.5	4.1	4.1	6.9	5.8	5.6
Overall deficit	6.1	3.4	6.6	15.8	17.2	10.3	11.0
External financing	1.4	1.6	0.6	6.3	8.3	7.0	...
Domestic financing	4.8	1.6	6.6	8.6	9.8	3.6	...

Sources: Data provided by the Ministry of Finance and staff estimates.

1/ Includes adjustments for accounts payable.

2/ Includes statistical discrepancy that arises mainly from the differences in timing of recording transactions in the Treasury and the Central Bank.

Table 3. Malaysia: Monetary Aggregates, 1980-84

(Percentage change during the year)

	1980	1981	1982	1983	1984 <u>1/</u>
Net foreign assets	2.7	-17.7	-0.6	-6.8	...
Domestic credit	49.9	31.2	23.4	17.1	...
Net claims on government <u>2/</u> (absolute change in billions of ringgit)	(1.2)	(1.9)	(2.2)	(0.4)	(...)
Credit to the private sector	39.0	22.7	16.9	21.3	18.0
Broad money	26.2	16.6	17.6	9.4	16.0-17.0
Narrow money	15.0	12.9	13.3	7.7	10.0-12.0
Quasi-money	33.4	18.7	19.8	10.3	19.0-20.0

Sources: Data provided by the Malaysian authorities; and IMF, IFS.

1/ Official projections.

2/ Includes State governments.

Table 4. Malaysia: Balance of Payments and External Debt, 1979-84

(In billions of U.S. dollars)

	1979	1980	1981 <u>1/</u>	1982 <u>1/</u>	1983	1984 <u>2/</u>
Balance of payments						
Current account	0.9	-0.3	-2.3	-3.1	-2.9	-2.5
Trade balance (f.o.b.)	3.2	2.4	--	-0.5	0.7	1.6
Exports	(11.0)	(12.9)	(11.7)	(12.0)	(13.9)	(15.9)
Imports	(7.8)	(10.5)	(11.7)	(12.5)	(13.2)	(14.3)
Services and transfers (net) <u>3/</u>	-2.2	-2.7	-2.3	-2.6	-3.6	-4.1
Capital account (net)	0.2	1.4	2.6	3.4	3.7	3.6
Of which:						
Official long-term	(0.4)	(0.1)	(1.3)	(2.2)	(2.4)	(2.9)
Private long-term	(0.6)	(0.9)	(1.2)	(1.3)	(1.2)	(1.1)
SDR allocation	0.1	0.1	0.1	--	--	--
Errors and omissions	-0.3	-0.8	-0.9	-0.7	-0.8	-0.8
Overall balance	0.9	0.4	-0.5	-0.4	--	0.3
Outstanding external debt						
Total	3.8	4.4	6.9	10.5	13.2	16.7
Public sector	2.8	3.1	5.1	7.3	9.7	12.7
Private sector	1.9	1.3	1.8	3.2	3.5	4.0
Memorandum items:						
Gross official external reserves <u>4/</u>	4.3	4.7	4.4	4.1	4.1	4.4
(In months of imports)	(6.5)	(5.4)	(4.5)	(3.9)	(3.7)	(3.6)
Current account/GNP ratio <u>5/</u>	4.7	-1.2	-10.0	-12.4	-10.5	-8.2
Outstanding debt/GNP ratio <u>4/</u> <u>5/</u>	19.5	19.4	28.3	41.2	48.4	55.0
Debt service ratio	5.6	3.6	7.1	9.2	9.2	13.3
Amortization	3.8	1.9	3.4	4.5	3.7	6.3
Interest payments	1.8	1.7	3.7	4.7	5.5	7.0

Source: Data provided by the Malaysian authorities.

1/ Four LNC tankers delivered in 1981 and one delivered in 1982 to the Malaysian National Shipping Company at a cost of about US\$800 million are not included in imports and the capital account.

2/ Estimates.

3/ Includes payments of factor services.

4/ End of period.

5/ In percent.

Table 5. Malaysia: External Debt Projections, 1983-88

	1983	1984	1985	1986	1987	1988
(In millions of U.S. dollars)						
Current account (Ratio to GNP)	-2,892 (-10.5)	-2,497 (-8.2)	-2,028 (-6.0)	-1,986 (-5.3)	-2,228 (-5.4)	-2,469 (-5.4)
External debt <u>1/</u>						
External debt outstanding <u>2/</u>	<u>13,234</u>	<u>16,737</u>	<u>19,207</u>	<u>21,647</u>	<u>24,356</u>	<u>27,344</u>
Public sector	9,668	12,743	14,785	16,797	19,079	21,639
Of which: Federal Govt.	(7,533)	(9,350)	(10,446)	(12,030)	(13,884)	(16,017)
Private sector	3,567	3,994	4,422	4,850	5,277	5,705
Gross disbursements	<u>3,578</u>	<u>4,695</u>	<u>3,450</u>	<u>3,826</u>	<u>5,165</u>	<u>5,599</u>
Public sector	2,842	3,514	2,614	2,883	3,577	4,563
Of which: Federal Govt.	(2,130)	(2,117)	(1,514)	(2,200)	(2,704)	(3,540)
Private sector	736	1,181	836	943	1,588	1,036
Amortization	<u>614</u>	<u>1,192</u>	<u>980</u>	<u>1,387</u>	<u>2,455</u>	<u>2,611</u>
Public sector	296	439	572	872	1,295	2,003
Of which: Federal Govt.	(211)	(321)	(418)	(616)	(850)	(1,407)
Private sector	318	753	408	515	1,160	608
Interest payments	<u>891</u>	<u>1,331</u>	<u>1,650</u>	<u>1,888</u>	<u>2,141</u>	<u>2,440</u>
Public sector	666	998	1,267	1,458	1,661	1,909
Of which: Federal Govt.	(529)	(758)	(900)	(1,011)	(1,169)	(1,372)
Private sector	225	333	383	430	480	531
(In percent)						
Debt service ratio <u>3/</u>	<u>9.2</u>	<u>13.3</u>	<u>12.3</u>	<u>13.5</u>	<u>17.1</u>	<u>16.8</u>
Amortization	3.7	6.3	4.6	5.7	9.1	8.7
Interest payments	5.5	7.0	7.7	7.8	8.0	8.1
External debt/GNP ratio	<u>48.4</u>	<u>55.0</u>	<u>57.0</u>	<u>58.0</u>	<u>58.8</u>	<u>59.5</u>
Public sector	35.4	41.9	43.9	45.0	46.1	47.1
Of which: Federal Govt.	(27.7)	(30.7)	(31.0)	(32.2)	(33.5)	(34.8)
Private sector	13.0	13.1	13.1	13.0	12.7	12.4

Sources: Data provided by the Malaysian authorities; and staff projections.

1/ Original maturity of one year and over.

2/ End of period.

3/ Ratio to gross current receipts.

Malaysia--Fund Relations
(As of June 5, 1984)

I. Membership Status

- (a) Date of membership: March 7, 1958
- (b) Status: Article VIII

(A) Financial Relations

II. General Department

- (a) Quota: SDR 550.6 million
- (b) Fund holdings of ringgit: SDR 660.5 million
(120.0 percent of quota)
- (c) Fund credit: SDR 269.2 million
(48.9 percent of quota)
 - Compensatory financing facility: SDR 145.6 million
(26.4 percent of quota)
 - Buffer stock financing facility: SDR 123.6 million
(22.5 percent of quota)
- (d) Reserve tranche position: SDR 159.3 million
- (e) Current operational budget: An early repurchase of SDR 45.9 million has been made in the period March-May 1984.
- (f) Lending to the Fund: None

III. Current Stand-By or Extended Arrangement and Special Facilities

- (a) Current stand-by or extended arrangements: None
- (b) Special facilities: Compensatory financing facility: SDR 189.8 million (September 1981)
Buffer stock financing facility: SDR 58.5 million (June 1982); SDR 67.8 million (March 1983)

IV. SDR Department

- (a) Net cumulative allocations: SDR 139.05 million
- (b) Holdings: SDR 105.6 million (75.9 percent of quota)
- (c) Current Designation Plan: SDR 21.7 million (March-May 1984)

Malaysia--Fund Relations (continued)

V. Administered Accounts

- (a) Trust Fund loans: None
- (b) SFF Subsidy Account: None

VI. Overdue Obligations to the Fund

None

VII. Use of Fund Resources To Date: Yes

B. Nonfinancial Relations

VIII. Exchange Rate Arrangement:

The ringgit is pegged to an undisclosed composite of currencies of Malaysia's major trading partners, and the weighting reflects the importance of currencies used in settlement as well as trade shares. Margins of 2.25 percent are maintained, but occasionally and for relatively short periods, the rate has been allowed to exceed margins. The representative exchange rate of the ringgit under Rule 0-2 is the mid-point between the buying and selling rates for the U.S. dollar quoted at noon on the Kuala Lumpur foreign exchange market; the mid-point at May 21, 1984 was 2.311 per US\$1. Malaysia has accepted the obligations of Article VIII, Sections 2, 3, and 4. Payments and transfers for current international transactions are free of restrictions except to Israel and South Africa. Capital transactions above certain limits require prior approval; approvals are freely given except for investments by Malaysian residents in Israel and South Africa.

Malaysia--Fund Relations (concluded)

- IX. Last Article IV Consultation: The Executive Board discussed the staff report on July 8, 1983. Staff discussions were held during April 2-14, 1983 (SM/83/128; SM/83/144).
- X. Technical Assistance
(from 1982 to date):
- (a) CBD: None
 - (b) Fiscal: Study on tax system (January-February 1982)
Study on fiscal reporting and cash management (May 1982)
 - (c) Bureau of Statistics: Statistical assistance on government finance (June-July 1983)
 - (d) Other: None
- XI. Resident Representative/Advisor: None

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Malaysia: Relations with the IBRD

(In millions of U.S. dollars)

IBRD lending (as of March 31, 1984):

Total loans approved	1,541.5
Repaid:	280.2
Total commitments in 1983:	86.2
Total disbursements in 1983:	116.5
Total commitments (1978-83):	

		(Percent)
Agricultural and rural development	348.3	51.3
Power	136.3	20.0
Education	78.6	11.6
Transportation	99.2	14.6
Urbanization
Sewage
Population	<u>17.0</u>	<u>2.5</u>
Total	679.4	100.0

Technical assistance:

The IBRD provides technical assistance to Malaysia through its standard lending operations for projects. In addition, it is the executing agency for a number of studies related to industrial sector planning and agricultural data analysis, both funded by UND.

Recent economic and sector missions:

Macroeconomic Development Mission in June 1982 and 1983; the Malaysian Statistical System Mission, April 1983; Incentive Policies in Agriculture, May 1983 and March 1984; Public Expenditures Mission in May 1984; External Debt Monitoring and Coordination in June 1984.

Malaysia: Reporting and Coverage of Statistics--IFS

1. Coverage, currentness, and reporting of data in IFS

		<u>Latest Date in June 1984 IFS</u>
Real sector	- National accounts	1982
	- Prices	January 1984
	- Production	November 1983
	- Employment	n.a.
	- Earnings	n.a.
Government finance	- Deficit/Surplus	December 1982
	- Financing	December 1982
	- Debt	December 1982
Monetary accounts	- Central Bank	February 1984
	- Deposit money banks	February 1984 (partial)
	- Other financial institutions	November 1983
External sector	- Merchandise trade: Values	December 1983
	- Merchandise trade: Prices	December 1983
	- Balance of payments	1982
	- International reserves	March 1984
	- Exchange rates	April 1984

During the past year, the reporting record of the IFS correspondent has been generally good, although on occasions the data reported for the monetary system's accounts have been incomplete.

2. Outstanding statistical issues

General

There was a technical assistance mission in June 1983 to discuss the institutional coverage of the public sector. A report containing the recommendations of the mission was sent to the Malaysian authorities in October 1983. The implications of these recommendations, which will affect most areas of statistics, were discussed with the authorities during the consultation mission and their implementation is under active consideration.

Monetary accounts

Monetary data in IFS and consultation reports differ from national source data in several minor areas including treatment of Fund accounts, but these differences are readily reconcilable. There are a number of substantive issues with respect to monetary data which the staff is

continuing to discuss with the authorities, in particular, the inclusion of certain noncentral government deposits in the money supply and the sectorization of credit granted by the Central Bank.

3. Technical assistance

A balance of payments technical assistance mission is scheduled for June 1984 and a technical assistance mission to review statistics of prices, production, and external trade, is scheduled for August 1984.

MALAYSIABasic Data 1/

Area:	127,581 square miles
Population (1983):	14.1 million
Population growth rates (1978-82):	2.5 percent per annum
Per capita GNP (1983):	US\$1,863

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
<u>Selected aggregates</u>						
<u>as percent of GNP 2/</u>						
Gross domestic investment 3/	27.7	29.5	34.3	36.5	33.3	31.9
Gross savings	32.5	28.3	24.3	24.1	22.8	23.7
Narrow money 4/	19.6	19.5	20.3	21.2	21.0	20.8-21.2
Broad money 4/	49.9	54.7	58.9	63.8	64.4	67.1-67.7
Federal Government revenue and grants	24.0	27.6	28.9	28.1	28.2	27.7
Federal Government expenditure and net lending	27.4	34.2	44.7	45.2	38.4	38.8
Federal Government overall deficit	3.4	6.6	15.8	17.2	10.3	11.0
Exports of goods and nonfactor services	60.3	61.2	55.8	54.2	57.5	60.0
Imports of goods and nonfactor services	50.3	58.1	62.4	62.7	62.3	61.7
Current account balance	4.7	-1.2	-10.0	-12.4	-10.5	-8.2
Outstanding external debt 4/ 5/	19.5	19.4	28.3	41.2	48.4	55.0

Annual percentage changes of selected economic indicators 2/

Gross domestic product (1970 prices)	9.3	7.8	7.1	5.6	5.8	6.7
GNP deflator	8.9	6.6	3.6	1.3	-1.5	5.1
Consumer price index	3.5	6.7	9.6	5.8	3.7	4.5-5.0
Federal Government revenue and grants	18.2	32.9	13.5	5.5	8.7	9.5
Federal Government expenditure and net lending	6.4	44.2	41.8	9.8	-8.0	12.2
Narrow money	17.2	15.0	12.9	13.3	7.7	10.0-12.0
Broad money	24.1	26.2	16.6	17.6	9.4	16.0-17.0
Net domestic credit	10.3	49.9	31.2	23.4	17.1	...
Government 6/	-13.6	9.0	9.1	7.9	-1.2	...
Private 6/	23.9	40.9	22.1	15.5	18.3	18.0
Merchandise exports, f.o.b.	41.7	17.0	-9.1	2.3	15.7	14.9
Merchandise imports, f.o.b.	30.4	33.5	12.0	6.6	5.3	8.8
Terms of trade	8.8	0.3	-3.6	-5.0	3.8	3.0

Malaysia: Basic Data (Concluded)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
<u>Federal Government budget 7/</u>	(In billions of ringgit)					
Revenue and grants	10.4	13.8	15.7	16.6	18.0	19.7
Of which: petroleum revenue	(1.0)	(2.8)	(4.6)	(5.4)	(4.0)	(...)
Expenditure and net lending	11.9	17.2	24.4	26.8	24.7	27.7
Of which: development expenditure	(4.0)	(7.3)	(11.1)	(11.2)	(8.9)	(9.8)
Financing requirement <u>8/</u>	<u>1.5</u>	<u>3.3</u>	<u>8.6</u>	<u>10.1</u>	<u>6.6</u>	<u>7.9</u>
External borrowing	<u>0.7</u>	<u>0.3</u>	<u>3.4</u>	<u>4.9</u>	<u>4.5</u>	...
Domestic borrowing	0.5	3.3	4.7	5.8	2.3	...
Of which: banking system	(-1.2)	(2.0)	(1.2)	(1.7)	(-0.2)	(...)
<u>Balance of payments 7/</u>	(In billions of U.S. dollars)					
Trade balance	3.2	2.4	--	-0.5	0.7	1.6
Exports, f.o.b.	11.0	12.9	11.7	12.0	13.9	15.9
Imports, f.o.b.	-7.8	-10.5	-11.7	-12.5	-13.2	-14.3
Invisibles (net)	-2.2	-2.7	-2.3	-2.6	-3.6	-4.1
Current account balance	0.9	-0.3	-2.3	-3.1	-2.9	-2.5
Capital movements (net)	0.2	1.4	2.6	3.4	3.7	3.6
Overall balance	0.9	0.4	-0.5	-0.4	--	0.3
<u>Reserves and external debt 7/</u>						
Gross official reserves <u>4/</u>	4.3	4.7	4.4	4.1	4.1	4.4
(In months of imports)	(6.5)	(5.4)	(4.5)	(3.9)	(3.7)	(3.6)
Total external debt <u>4/</u>	<u>3.8</u>	<u>4.4</u>	<u>6.9</u>	<u>10.5</u>	<u>13.2</u>	<u>16.7</u>
Public sector	<u>2.8</u>	<u>3.1</u>	<u>5.1</u>	<u>7.3</u>	<u>9.7</u>	<u>12.7</u>
Private sector	1.0	1.3	1.8	3.2	3.5	4.0
Debt service ratio (in percent) <u>9/</u>	5.6	3.6	7.1	9.2	9.2	13.3

Sources: Data provided by the Malaysian authorities; and staff estimates.

- 1/ Components may not add up to totals because of rounding.
2/ Data for 1983 are estimates and forecasts for 1984.
3/ Includes changes in stocks.
4/ End of year.
5/ Debt of maturity of one year and above; includes the existing coverage of private debt.
6/ Percentage contribution to the increase in net domestic credit.
7/ Data for 1984 are staff forecasts based on preliminary official data.
8/ Components may not add to totals because of discrepancy items.
9/ Relative to exports of goods and services.