SPECIAL REPORT

MALAYSIA COUNTRY REPORT

INSIDE: 21-PAGE SPONSORED SECTION IN CO-OPERATION WITH DISCOVERY REPORTS

Private consumption and household spending have helped the Malaysian economy to continue to expand in recent times. Photo: Bloomberg

Export-led growth to drive economy

Country banks on US recovery to sustain stability. Reports by Nazvi Careem

Malaysia's economy grew above expectations in the last quarter of 2013 and the outlook for this year is stable as long as the country is able to withstand internal and external factors, according to one analyst.

Reining in federal spending and streamlining taxation for individuals and corporations will be key, along with developments in the United States, Thailand and China, says Ramu Thannirmalai, director of Decision Insider, a research organisation focusing on Southeast Asian trade.

"The first quarter may experience volatility because of rising prices on consumer commodities such as oil and sugar and could have a strain on the domestic economy," Thannirmalai says. "However, export trade should counter these effects with the United States economy sustaining its course towards recovery."

Malaysia's economy grew 5.1 per cent in the final quarter of last year, according to Bank Negara Malaysia, the country's central bank. The figure was above economists' forecasts of 4.8 per cent with growth supported by stronger manufacturing and services sectors.

The central bank says that on a quarter-on-quarter seasonally adjusted basis, the economy expanded 2.1 per cent compared with 1.7 per cent in the third quarter of last year.

Year-on-year, the economy grew at a slower pace than the 6.5 per cent growth registered in the fourth quarter of 2012. For the whole of last year, the Malaysian economy grew 4.7 per cent compared with 5.6 per cent in 2012, Bank Negara says.

Thannirmalai says political unrest in Bangkok, Thailand may result in investors eyeing Malaysia although the region as a whole will be keeping a close eye on China's plans for Southeast Asia.

"Thailand's political instability gives the Malaysian economy additional leverage as investors could opt to park capital across the border in Malaysia," he says.

"Domestic consumption continues to increase, supporting the self-sustaining economic model as well. However, China's possible withdrawal of investment allocations across Southeast Asia could unravel Malaysia's current economic outlook for 2014."

According to the central bank, private consumption growth remained high in the fourth quarter, although the pace of expansion moderated at 7.3 per cent compared to the third quarter's 8.2 per cent.

Household spending continued to be supported by stable employment conditions and sustained wage growth, especially in the domestic-oriented sectors. Growth in public consumption moderated to 5.1 per cent from 7.8 per cent.

As the government tries to cut public spending, the private sector continued strong capital spending, helping gross fixed capital formation rise 5.8 per cent for the quarter, down from 8.6 per cent in the third quarter.

Private investment growth gained 16.5 per cent compared with 15.2 per cent in the previous quarter thanks to higher capital spending in the services and manufacturing sectors. Public investment fell by 2.7 per cent.

> **We're dependent on the American consumers. That works for Malaysia**
>
> PAUL DONOVAN, UBS INVESTMENT BANK

In line with manufacturing sector expansion, the services sector grew on the back of increased trade and manufacturing activities. While construction remained solid, commodities weakened because of lower production of rubber, palm oil and crude oil.

Bank Negara said the trade surplus widened in the fourth quarter to 27.4 billion ringgit (HK$64.9 billion) compared with 18.6 billion ringgit in the previous quarter, boosted by growth in the global economy and greater domestic demand.

"The global economy is expected to be on a path of moderate recovery. The sustained improvements in the advanced economies will be a positive impulse for international trade," the central bank says.

"However, ongoing uncertainties surrounding monetary and fiscal policy adjustments in the advanced economies remain a risk to growth. Growth in the Asian economies is expected to be supported by improving external conditions amid moderating domestic demand.

"For the Malaysian economy, domestic demand will remain supportive of growth. While domestic demand is expected to moderate following fiscal consolidation, the external sector is expected to benefit from the improving global conditions. The growth momentum is therefore expected to remain on a steady trajectory."

Malaysia's financial account recorded a net outflow of 9.7 billion ringgit in the fourth quarter compared to 11.5 billion ringgit in the previous quarter with net inflows of direct investment offset by outflows of other investments.

The overall balance of payments registered a deficit of 2.9 billion ringgit in the fourth quarter compared to a surplus of 11.8 billion ringgit in the third quarter of last year.

UBS Investment Bank global economist and managing director Paul Donovan says there is only a minimal risk of capital flight from Malaysia.

He says capital is increasingly focused on domestic spending with American and European investment less reliable.

He adds that Japanese companies that are increasingly investing in Asia and central banks that want to do the same are two areas where incoming capital can boost the Malaysian economy.

"Now, 30 per cent of central banks are allowed to invest in Asian government bonds," Donovan says. "Those banks are Asian central banks and they're fairly dependable and are likely to stay in the market."

Donovan says UBS expects Malaysia's gross domestic product to expand by 5.5 per cent to 5.7 per cent amid lively export growth and strong consumer spending in the United States.

"We're dependent on the American consumers," he says. "That works for Malaysia. We have export growth this year and will generate a growth rate of 5.5 per cent to 5.7 per cent, which is great, provided the US consumers keep shopping. And we think they will."

Melaka Gateway heralds new era

A 246-hectare area in the state of Melaka, comprising man-made eco-islands, entertainment resorts and theme parks, is Malaysia's next mega-project designed to boost the country's tourism industry by attracting high-end consumers.

Dubbed the Melaka Gateway, the 50 billion ringgit (HK$118 billion) development, which includes an international cruise terminal, is targeted to attract at least 2.5 million additional tourists to the state and create 15,000 jobs.

Hong Kong interests join those from the mainland, United Arab Emirates and the United States in investing in the project that is expected to be finished within the next 10 years.

"The Melaka Gateway is an innovative tourism product [and] complements the government's tourism target," Malaysian Prime Minister Najib Razak said at the announcement of the development.

Malaysia is shifting its tourism strategy to bring in high-yield travellers from all over the world, including rapidly growing markets such as China and India. The focus on affluent tourists comes after the government identified four global "mega trends" that it wants to tap into to become a high-income nation by 2020. "To achieve our 2020 goal, we have shifted our focus to growing yield per tourist," Najib said. "To attract the higher-yield segment, we are upgrading tourist offerings and services, as well as enhancing connectivity to key priority markets in the tourism sector.

"The Melaka Gateway, with its luxury offerings of an international cruise jetty and the largest marina in Asia, is, therefore, poised to bring in this crowd."

The development will add three more man-made islands to the existing Pulau Melaka off the state's shores on the west coast of the Malaysian Peninsula – making it the largest cluster of artificial islands in Southeast Asia.

Malaysia is already recognised as a world-class tourism destination, earning a top 10 place in the *Lonely Planet's* list while *The New York Times* puts the country as one of the top 40 places to visit.

Tourism is one of the main sectors in the government's National Key Economic Area, which is part of the overall Economic Transformation Programme. By 2020, Malaysia hopes to receive 36 million tourists bringing in 168 billion ringgit in receipts.

Najib said Malaysia hoped to boost its allure to high-end travellers by developing its Cruise Tourism potential. In this respect, the Melaka Gateway has a key role to play. The planned Melaka International Cruise Jetty is expected to bring in more big-spenders from around the world, and help to open up other cruise port terminals in the east coast of the peninsula and the West Malaysian states of Sarawak and Sabah.

"Cruise Tourism is now spreading its wings to a new frontier, Asia," Najib said. "Malaysia has done well in cargo and container ports, and it is now time that we focus on cruise ports. We are pleased that the cruise port is a critical component in the Melaka Gateway project, as international tourists have long highlighted that they wished to disembark at our port cities."

The terminal will be supported by the largest marina in Asia where the elite can moor their luxury yachts, residential and commercial properties, and a high-end repair and maintenance dockyard.

The Melaka Gateway will also cater to the three other designated megatrends – faster pace of life, selective spending and the rise of new market leaders from China, India and the Middle East.

Enjoying a faster pace of life means consumers prefer several short holidays in a year, rather than one long break, to reduce stress by visiting spa and wellness destinations. The Melaka Gateway Beacon Tower and prestigious waterfront residential addresses are designed to pamper visitors.

The gateway will offer various options to help visitors – from low, mid to the high range. This means an international designer street offering high-end consumer goods, traditional foods and antiquities.

With regard to the last megatrend, the country is hoping to attract from tourists from these areas as well as their investments.

"We have been doing well in penetrating a few of these markets, but more needs to be done especially to attract the increasingly wealthy Chinese, Indians, Arabs and Russians," Najib said. "I believe this mega developmental project with its partnerships with world-class international brands is a funnel for the influx of international investors."

The Melaka Gateway tourism development is poised to dramatically change the look of the Melaka River. Photo: Thinkstock

Nation charges into diversifying, expanding its energy sector

Malaysia has big plans to power up its energy sector with diversified investment in oil and gas, hydroelectric power in Borneo and rare earth.

The country is striving to become a major international centre for oil and gas production by 2017, having launched this vision in 2001 with the formation of the Malaysia Petroleum Resources under the department of Prime Minister Najib Razak.

Within the next three years, Malaysia hopes to build 10 million cubic metres of storage to meet rising demand from China and India, though domestic consumption is expected to remain largely stable over the next few years.

The International Energy Agency (IEA), in its "Southeast Asia Energy Outlook" report for this year, says energy consumption in Malaysia is expected to record moderate growth amid population growth of around 1.2 per cent.

"These factors help drive an increase in Malaysia's primary energy demand by an annual growth rate of 2.3 per cent," the agency says. "The prospects for continued exports remain strong in the medium term, with recent discoveries and new developments set to keep the liquefied natural gas (LNG) terminal operating at full capacity through at least 2018."

IEA says gas production should rise to about 70 billion cubic metres by 2020, with almost half of this catering to the export market, and Japan as a major buyer. The country's proven gas reserves stood at 2.4 trillion cubic metres. The agency also says Malaysia's oil supply is expected to grow to 740,000 barrels per day (bpd) in the short term compared with 670,000 bpd last year.

Ramu Thannirmalai, director of Southeast Asian trade research organisation Decision Insider, says Malaysian energy providers can leverage on the shortfall in global supply created by uncertainty in major Middle Eastern oil suppliers.

The Rajang River flows from the Bakun Dam project. Photo: Reuters

"Malaysian supply chain requirements and population expansion remain on a relatively flat gradient in terms of growth," Thannirmalai says. "However, global markets will require more energy providers to fill the gap created by sanctions on Iran and uncertainty in Libya. [The national oil company] Petronas has multiple projects in the pipeline to increase production and, with high energy prices, Malaysia's energy-related businesses should see higher profits and expansion from an export-driven point of view."

To encourage foreign companies to be part of Malaysia's energy programme, a zero per cent tax incentive is being offered to companies that handle LNG. There is also a 3 per cent corporate tax rate for multinational companies that use Malaysia as their base for trading oil and other commodities.

Hydroelectric power is becoming increasingly influential in the east Malaysian state of Sarawak, which more than 30 years ago targeted at least 150 potential sites for waterborne power. Subsequently, about 50 sites were shortlisted to provide up to 20,000mw of electricity with total energy output of 87,000gwh per year.

One of the biggest is the government-owned Bakun Dam on the Balui River. It features the second-tallest concrete-faced rockfill dam in the world and is expected to generate 2,400mw of electricity once fully completed. The 4 billion ringgit (HK$9.4 billion) Murum Dam has already been flooded and is expected to be fully operational by September. The dam, located upstream of Bakun, is expected to generate 944mw of electricity.

Another nine dams in Sarawak are expected to be built once feasibility studies are complete. These projects are designed to supply power to remote areas in largely rural Sarawak. The hydropower surge is also part of Sarawak's plan to boost industry and exports to Southeast Asian countries and in line with the Sarawak Corridor of Renewable Energy (Score) programme to modernise the state.

Malaysia is also hoping to leverage on the increased demand for rare earth as an energy option. Australian company Lynas has been operating in the east coast town of Gebeng, near Kuantan, for more than a year despite opposition from some quarters.

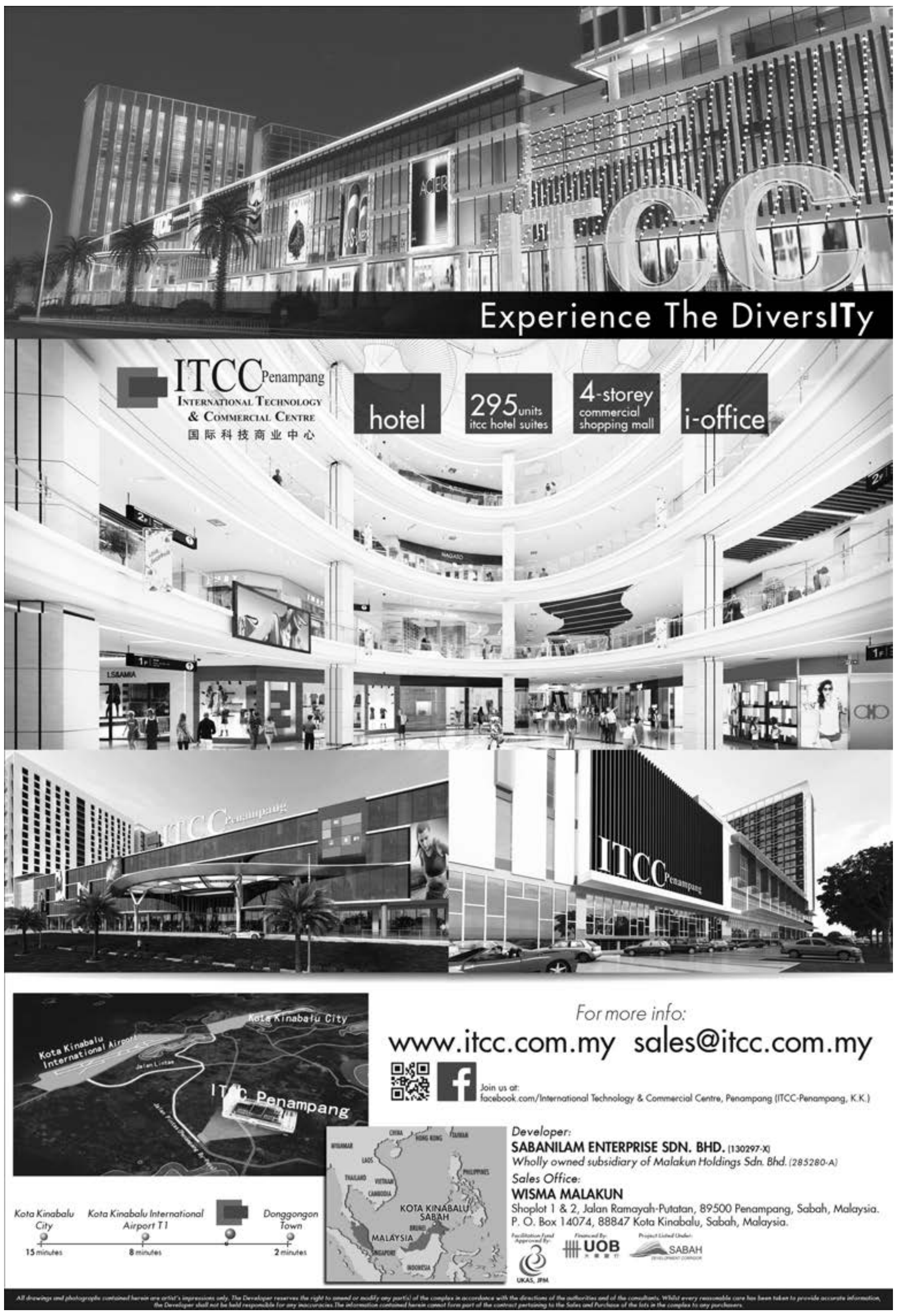
Demand for rare earth energy is rising, even though there has been no new discovery of rare earth for the past 20 years.

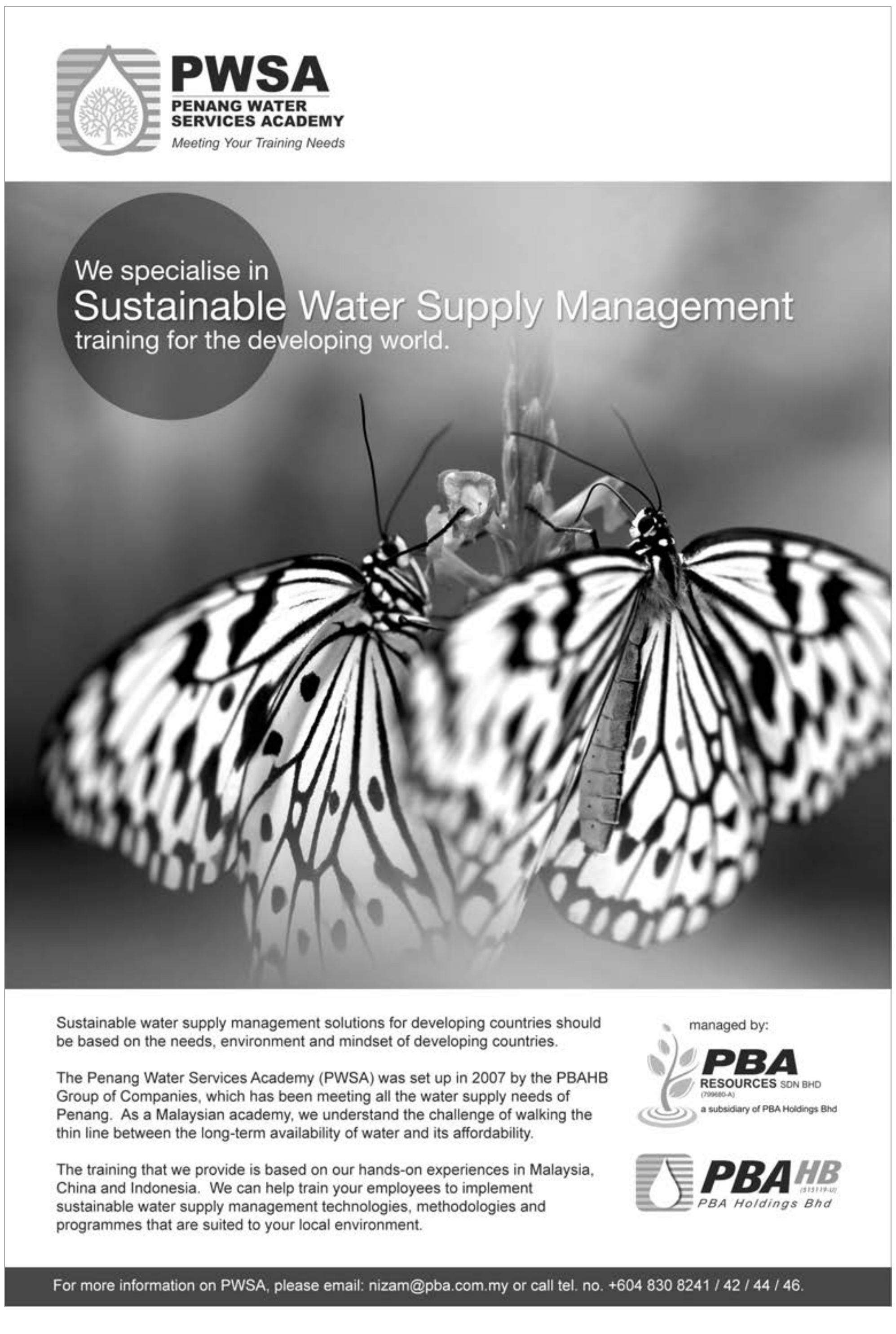
The Lynas plant is expected to fulfil 20 per cent of global demand once it reaches its full capacity of 22,000 tonnes of rare earth oxide equivalent. It produces 700 tonnes. China is the world's largest producer and consumer of rare earth energy.

The Malaysian government is also banking on Lynas operations to help the country become a centre for energy-efficient vehicles (EEV).

A key product of the factory is lanthanum, a chemical needed to make batteries for hybrid and electric-powered vehicles.

The company recently said its presence in Malaysia had convinced some of its customers to consider the country and other hubs in Southeast Asia as their focus of expansion.





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ITCC ushers Penampang into modern age

After a 10-minute drive going south from the Kota Kinabalu International Airport, a huge construction site on the left side of the Jalan Pintas Penampang highway breaks the skyline. Covering more than four hectares, property developer Sabanilam Enterprise is building the International Technology and Commercial Centre (ITCC Penampang). It will combine a shopping complex, hotel, office tower, exhibition centre and banquet hall in one state-of-the-art development project.

"It will be a complete package under one roof," says Hugo Malakun, group general manager of Malakun Holdings, parent company of Sabanilam Enterprise. "We are bringing higher standards, from shopping mall operations to office space development, to push Sabah further ahead."

ITCC Penampang will be everything but ordinary. To be equipped with a fibre optic technology backbone, its internet, audio-visual and other communication links will be on par with the best in the world. ITCC Penampang's open network set-up will also allow companies to connect directly with their respective headquarters overseas.

The centre is among the first in Sabah to apply for Multimedia Super Corridor (MSC) status, which promotes the growth of information and communications technology (ICT) companies in Malaysia. MSC offers members special benefits, which include an income tax break for up to 10 years, duty-free importation of multimedia equipment, competitive telecommunications tariffs and intellectual property protection.

"We would like ITCC Penampang to be a catalyst for growth in the ICT sector in Sabah and the whole region," says Mandela Malakun, group general manager of Sabanilam Enterprise and a brother of Hugo. "We bring technology to Penampang so local companies can benefit and learn from it and access the rest of the world."

To support this goal, ITCC Penampang will offer the 16-storey i-Office Tower, a technology and science centre, small office/home office units and incubator spaces for start-up companies in areas such as animation and game development.

Hugo Malakun, group general manager of Malakun Holdings, and Mandela Malakun, group general manager of Sabanilam Enterprise

ITCC Penampang will also support tourism, catering to meetings, incentives, conferences and exhibitions. Its 63,000 square feet of exhibition space in the mall including the convention hall will be able to accommodate thousands of trade shows, while its banquet hall will be one of Sabah's largest with 170 dining tables. The four-storey shopping complex with more than 600 retail outlets will cover all the needs of the tenants and visitors.

> *ITCC Penampang will offer foreign businesses comprehensive assistance and an avenue to penetrate the Sabah market*
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> *Hugo Malakun*
> *Group general manager, Malakun Holdings*

To develop its hotel block, ITCC Penampang welcomes strategic partners in building four- and five-star hotel amenities. The centre plans to put up a four-star, 295-room hotel, offering a distant view of Mount Kinabalu, a Unesco World Heritage Site.

ITCC Penampang's hotel section holds significant economic potential as the town abounds with tourists and business travellers.

With direct routes to 13 major world destinations, the nearby Kota Kinabalu Airport is Malaysia's second-largest, with more than 5 million international passengers annually and growing. Sabah's pristine rainforests and renowned dive sites continue to attract tourists while its growing role in the East ASEAN Growth Area is pulling business traffic into the state.

"The Sabah economy is booming, and this is the best time to invest," Hugo Malakun says. "ITCC Penampang will offer foreign businesses comprehensive assistance and an avenue to penetrate the Sabah market."

The ITCC Penampang project has been described by Sabah Chief Minister Musa Aman as "a new landmark for Penampang". To support this vision, the Sabah Economic Development and Investment Authority provides generous fiscal incentives to investors going into Penampang's tourism sector. These include income tax exemptions, investment tax allowances and import duty and sales tax exemptions on equipment used for hotel and tourism projects.

Despite its promising economic potential, ITCC Penampang is more than a business undertaking for the Malakuns. "My parents' vision is to transform Penampang from a sleepy town into a more vibrant place to live in," Mandela Malakun says.

PBAHB Group shares sustainable water supply management experience

As the need for managing resources sustainably becomes increasingly critical for communities worldwide, prudent management of water supply is becoming just as valuable as water itself.

"We are genuinely interested in sharing our expertise in sustainable water supply management in Asia," says Jaseni Maidinsa, CEO of PBA Holdings Group of Companies (PBAHB). "You can buy equipment from anywhere, but not our knowledge or mindset."

PBAHB ensures continuous good water supply in Penang, a highly industrialised but water-stressed state in Malaysia. It received an international award for consultancy work in Palembang, Indonesia, in 2011. The company also jointly manages a water treatment plant that it helped to build in Yichun, China. PBAHB's wholly owned subsidiary, Perbadanan Bekalan Air Pulau Pinang (PBAPP), received the Malaysian Ministry of Energy, Green Technology and Water's inaugural Efficiency Award and was recognised as the Water Services Operator of the Year in November last year.

PBAHB is a Malaysian publicly-listed company that specialises in holistic water supply management with emphasis on sustainability. PBAPP focuses on the entire water supply value chain in Penang.

Leveraging its experience as a resource- and cost-conscious water operator, PBAPP supplies potable quality water at affordable tariffs, thereby enhancing Penang's quality of life and its competitive edge as a global manufacturing hub. It has also helped the Malaysian state to achieve the lowest percentage of non-revenue water, or water loss, in the country.

PBAHB has also managed to sustain profitability since its listing in 2002. With the Penang state government as its majority shareholder, it is one of the few water companies in Malaysia that pays annual dividends.

"Water supply is an industry of the future because water will always be essential for daily life. We need water, yet it is not valued as the precious resource that it is in many Asian communities. Inevitably, its value will grow in the future in an increasingly crowded world," Jaseni says. "While it seems logical to consistently expand infrastructure to meet growing demand, you have to think about the cost to the consumer. Having less dollars in Asia, it makes more sense to optimise the resources at hand, and to create and implement sustainable solutions. The challenge is to successfully walk the thin line between water availability and its long-term affordability. This is not easy, but it is possible."

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>
> *Jaseni Maidinsa*
> *CEO*

PBAHB Group's joint-venture modular treatment plant in Yichun has increased output from 5 million litres per day (MLD) in 2009 to 40 MLD in 2012 without significant additional development costs. PBAPP is also a mentor to Indonesian water operators through the Indonesian Water Supply Association, PERPAMSI.

PBAPP and PDAM Tirta Musi Palembang were jointly given the coveted WaterLinks Award for Best Water Operator Partnership in 2011. WaterLinks represents the International Water Association, Asian Development Bank and United States Agency for International Development.

To share its expertise in sustainable water supply management, the PBAHB Group established the Penang Water Services Academy (PWSA). PWSA trains Malaysian school-leavers and employees from water supply operators throughout the Asean. Through the academy, trainees benefit from the group's proven water management practices that are based on the "appropriate" – though not necessarily the latest – technologies and methodologies.

"PWSA provides appropriate training for water industry professionals in developing countries, because we are in a developing country. The difference between us and a first-world consultant is that we understand Asian needs and sensitivities, and we deliver results that are suited to the Asian environment," Jaseni says. "We need to implement sustainable water supply management solutions in Asia now because we need to think about the future. We need to ensure that our children and grandchildren will continue to enjoy good quality and affordable water supply."