Pushing the Investment Rate Higher

There is a need to stimulate the domestic economy, particularly investment, as the economy has largely been driven by consumption and the external sector in the past several years. Now that the external segment has toned down, the domestic sector has little choice but to step up further.

Persistent surplus in the current account reflects excess savings over investment in the country. There is a glut of savings in Malaysia and there are limited avenues for savings to be utilised as investments. Another way to describe this is that there is ample liquidity in the banking system. The high liquidity situation is reflected by the low interest rates that have remained stable for sometime. The liquidity situation is compounded further by the short-term inflows into the vibrant stock market. Some relaxations have been given to allow local funds to invest abroad.

The current account balance has reverted to record surpluses since the 1998 crisis and has reached 16.9 per cent of GNP in 2006, contributing to increased liquidity in the system. During the crisis period, the level of investment had dropped significantly from 45.4 per cent of GNP in 1997 to 28.2 per cent of GNP in 1998. Despite the economic recovery and a moderate growth path, the investment rate continued to decrease to 20.8 per cent of GNP in 2006, while the savings rate has stayed high at 38.1 per cent of GNP.

Analysts have tried to explain why investment rate stays low even after the economy has recovered from the crisis. The pre-crisis investment rate was seen as too high and had caused overheating, pushing growth average to above 8.0 per cent. But the post-crisis investment rate appears to be on the low side, just enough to generate growth of between 5-6 per cent. This is despite a sounder banking system, the fiscal stimulus, the disposal of excess capacity and low interest rates.

The banks are bigger now, with fewer bad debts and are better capitalised, but the demand for business loans has been moderate. Although interest rates are close to historical lows, business loans are not picking up with much vigour. It is thought that once excess capacity is disposed off and efficiency improves, there will be more business expansion as the economy regains strength but this does not appear to be the case.

Some other possible explanations for the low investment rate are the relatively lower FDI inflows and the more cautious investment climate. FDI inflows have moderated compared to pre-crisis period due to rising competition from China and others, and fewer merger and acquisition (M&A) opportunities in Malaysia. The limited pool of skilled workers could have discouraged the more hi-tech investment from coming here. Raising the number and quality of human capital that meets industry needs can improve the chances of attracting higher value-added investments. Naturally, the investment climate has become more guarded after the painful experience of going through the crisis.

There is greater risk management being practised, meaning that firms would not invest until they have realistically figured out the risks and returns on a particular project. After the crisis, there is greater awareness among banks and firms on the project risks involved and this has made them more circumspect when doing business. There are fewer mega projects around relative to pre-crisis period and they are no longer closely bunched together. With limited opportunities at home, Malaysian companies have been going abroad to seek greener fields.

There is a need to stimulate the domestic economy, particularly private investment, as consumption and the external sector have largely driven the economy in the past several years. Measures in the pipeline could result in a rise in the investment ratio. As the 9MP gathers momentum, public investment would perk up and the spillover effects would likely boost private sector investment as well. Unprecedented measures applied to the Iskandar Development Region (IDR) are expected to appeal to foreign investors. The development of regional corridors could see the launching of more projects. A high level group has been set up to expedite the approval of high impact FDIs.

It is critical to raise the investment rate because Malaysia's longer-term economic growth depends on the continuous expansion of the productive capacity. Sensibly, some investments are viewed as more productive than others. Investment in property, for example, is a one-time investment that generates less multiplier effects through job creation and higher income compared to investment in plants and machinery. But at present times when Malaysia's investment level is relatively low, both kinds of investment are readily welcomed.

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