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Economic Briefing To the Penang State Government (Special Issue)

PENANG ECONOMIC REPORT 2003

1. INTRODUCTION (By Dr. Chan Huan Chiang)

2003 has been an eventful year.

A year ago, business confidence and consumer sentiments were weak or at best mixed across much of the world, and the various sectors braced themselves for a difficult year ahead when 2003 rolled in. The events that unfolded could not have been worse, because the world was thrown into uncertainty with international travel brought nearly to a standstill as a result of the SARS outbreak that was traced to the world's fastest growing economy, China. Fortunately, thanks to the Internet, that has become integral to today's business, worldwide communications were able to remain open that not only kept business going, but the World Health Organization and public health agencies across the world were able to make use of the Internet to collaborate and share newly discovered knowledge in a timely and unprecedented manner. As a result, SARS, which is a disease that has never surfaced before, could be brought under control within a few months.

Geopolitical circumstance at present do not offer reasons for optimism given the prolonged instability in Iraq, many unknowns concerning North Korea and doubts over the *road-map* that was to form a basis for peace between Israel and Palestine. However, third quarter (Q3) 2003 numbers, that are beginning to come in country by country, have offered evidence that better times are ahead. Compared to a year before, with minor exceptions, the world's economies are reporting positive growth. Since fourth quarter (Q4) numbers traditionally show an improvement over the third quarter, further improvements might be expected before 2003 draws to a close allowing fairly firm numbers to be obtained for the year's GDP. Naturally, seasonal effects will bring moderating influences during the early parts of 2004 but from the longer cycle view, 2004 and 2005 might be expected to offer more comfortable times compared to the trials that all of us have gone through these last couple of years.

In Malaysia, the appointment of the new Prime Minister is a momentous event. Even though Prime Minister Abdullah Badawi has reiterated a continuance of the familiar policies, there is nevertheless fresh excitement about how the government will respond to the changing economic scenario, that is, one involving economic recovery to one of growth sustenance. Many important mechanisms introduced for the recovery are in place: the *ringgit* peg, asset management via Dana Modal, bank mergers, issuance of bonds, the capital markets master plan and restructuring of the role between the KLSE and the Securities Commission, including the introduction of competition policy and corporate governance measures. These will continue to play crucial roles in sustaining economic growth although some, like asset management, will need tweaking as they have successfully done the job that they were called to do.

2a. INTERNATIONAL ECONOMY (By Dr. Chan Huan Chiang)[1]

Forecasts by the Economic Intelligence Unit (EIU) show an average of 3.4% growth for the global economy in 2003 rising to a 4.1% average during the following two years. The economic performance of several large economies have picked up. The OECD *Economic Outlook* reports that its members are expected to grow by about 2% in 2003, rising to 3.0% in 2004 and 3.1% by 2005. Figures for Q3 2003 were the highest seen since 2000. The U.S., which is among the benchmark economies, is expecting 4% growth in 2004, which is upwards from the earlier forecast of 3.4%. Q3 year-on-year (y-o-y) growth turned out higher than the 7.2%, announced by the U.S. Department of Commerce in late October, by surging 8.2%, more than double the performance during the second quarter (Q2) of 3%, 8.2% is also the highest GDP growth recorded in 20 years.

In Europe growth rates may appear modest but figures through to Q2 2003 continue to indicate a down-trend. However, with Q3 2003, positive side numbers are beginning to come in. Germany's Q3 2003 performance also rose marginally by 0.9% y-o-y after three consecutive quarters of y-o-y decline. France and Italy did better with a 1.6% and 2.0% y-o-y growth, respectively in the third quarter. Britain's Q3 2003 figures looked even more buoyant at 3.1% y-o-y, fueled by strong consumer demand, outdoing the 2.3% previously projected.

Japan, which has had a good decade of recession, may have finally come around. Reports in November indicated 2.2% y-o-y growth in Q3 2003 marking up seven consecutive quarters of expansion. However, the latest figures released in early December showed only a modest 0.3% growth. Capital investment figures turned out lower than expected, because previously observed sharp rises in machinery orders did not sustain. Japanese deflationary tendency has still to be watched as nominal GDP fell by 0.4% in the third quarter. Deflation has also plagued Hong Kong for five years where consumer prices continue to fall even though Q3 2003 figures showed a 4.0% y-o-y expansion, after falling by a half percent point during the second quarter, indicating that SARS has, at last, released its grips on Hong Kong's economy. In South Korea there has been two consecutive quarters of decline but Q3 2003 figures showed a 2.3% y-o-y expansion largely attributed to better exports performance. China, as usual, continues to outpace its trading partners surging another 9.1% y-o-y during Q3 2003[2].

Closer to home, Singapore appeared to have hit bottom and gone on an upswing to expand by an enviable 17% between the second and the third quarter. Of course this huge growth is due to the small base of the second quarter numbers as Singapore's economy plummeted by 9.8% between the first and second quarter due to the crippling effects of the SARS outbreak. In response to the recovery, they are looking at 1.7% overall for 2003 which is upwards of the 1% growth rate previously projected.

While the improved economic circumstances are finally showing up in the numbers of most economies, particularly in Q3 2003 figures, a few continue to remain pinned down by internal difficulties. For example, Q3 2003 y-o-y figures show a sizable contraction of 7.1% in Venezuela.

2b. NATIONAL ECONOMY (By Dr. Chan Huan Chiang)

Bank Negara Malaysia announced the Q3 performance figures in the middle of November. In line with expectations, more encouraging numbers were seen given that the SARS crisis had, as hoped, receded as the economy moved into the second half (H2) of 2003. But the source of optimism was not based so much on the better showing of Q3 over Q2 numbers, since the Q2 numbers do not really count due to the peculiar circumstance brought about by SARS. The better gauge was that the year-on-year (y-o-y) change between Q3 2002 and Q3 2003 had registered 5.1% growth, revised upwards from the 3.5% previously projected. This was fueled partly by the growth of private consumption by 5.4% (y-o-y), even though public consumption had fallen marginally by 1.6% (y-o-y).

However, when these Bank Negara numbers were announced, it was baffling that Q3 2003 exports were reported to have fallen by 3.1%. Semiconductor export sales that constituted nearly a fifth of total exports, performed even worse, having dropped a hefty 10.8%. These numbers were counter-intuitive as market talk during the same period appeared to indicate that there had been a recovery in external demand from the beginning of the second half of the year. Furthermore, Governor Zeti had reported in her central bank press conference that shipments out of Malaysia had indeed risen during the third quarter. In fact several other East Asian economies have also reported stronger export growth during this period. It was imagined that an even larger drop of imports by 5.7% had helped offset the poor trade performance to keep overall GDP performance on the up side.

Finally the mystery cleared up in early December when the Ministry of International Trade and Industry announced that the earlier figures from the Department of Statistics might be incorrect. The department had been in the midst of overhauling its computer system and its interface with the data collection system. The New Straits Times reported that the Penang figure in E&E export has been inadvertently omitted. The October 2003 trade numbers were thus considered to be more indicative of those observations of the market made previously during the third quarter. October 2003 exports amounted to RM34.2 b., which is a three-year monthly high since the RM34.9 b. figure obtained in September 2000, and a respectable 7.2% y-o-y expansion from October 2002. Relative to imports, the trade numbers looked even better, because the RM6 b. trade surplus in October 2003 was an increase by 24% y-o-y from October 2002.

Much of exports performance is driven by the E&E sector, as it comprises about half of Malaysia's total exports in value and nearly half of manufacturing output. E&E exports started its decline in December 2002, after nearly a year of steady exports expansion, and continued to decline through this August when it plunged to negative 16.2% y-o-y relative to August 2002. Most observers are saying that the downtrend in electronics has bottomed out and the sector and the growth cycle is making headway. For example, October sales of electronic chips worldwide was 23.3% better than a year ago, a feat that has not been seen since 1990. The upswing in E&E suggests that Malaysian exports are likely to be buoyant during the months ahead.

Everybody is thus looking forward in anticipation to the Q4 numbers that would not appear for a few months yet, because Q4 numbers traditionally do better than those for Q3. Most northern hemisphere countries begin a new work-year each Fall, i.e. in September, that would bring forth a new round of investment and sales. For Western economies there is the surge towards Christmas before the economy does its seasonal retreat in the first quarter of the following year. Thus the 5.1% y-o-y Q3 growth already observed may lead to, say, a 5.4% growth y-o-y for Q4. These numbers would easily offset the weak numbers from the first part of the year and make the 4.5% government target for 2003 easily achievable. More likely, considering that it is already December 2003 and no peculiar downside events have occurred at home or worldwide, we might see GDP numbers about the 5% mark overall for 2003 in Malaysia.

The current weakness of the American dollar, to which the ringgit has been immovably locked since 1998, gives mixed feelings to Malaysian consumers and producers. Parents who are paying for the tuition fees of sons and daughters abroad are looking at having to reach down deeper into their pockets but exporters are likely to feel more optimistic due to the price competitiveness that the weaker dollar offers. The dollar has been steadily falling over the past three decades, except during brief periods of improvement, between 1980 and 1985 and again between 1995 and 2001. In early December 2003, the dollar slid past the $1.20 to the Euro mark, which is an all time low against the currency. How a weak dollar might affect the American economy in contrast with a stronger currency is an issue of debate but most economists agree that any improvements should be achieved through better economic fundamentals at home and not via exchange rate intervention, sometimes carried out as part of monetary policy.[3] The argument is the Federal Reserve Bank's interventions for decades prior to 1990 has met with little success simply because monetary authorities cannot process or influence information as well as the highly efficient forex market in which some $1.5 trillion are traded daily around the globe.[4]

Although most central banks do undertake measures as part of monetary policy to address exchange rate movements, the *ringgit*'s currency exchangeability has, by design, gone beyond the control of Bank Negara. Thus monetary policy in Malaysia is entirely on managing inflation and domestic interest rates without the usual consequential effects on the exchange rate. In other words, by giving up control on the *ringgit*'s exchangeability, inflation and interest rate management at home becomes almost totally effective, as there is no longer the need to balance, or constantly adjust, the movement of one against the other (see *Box 2b.1* for explanation). Such is the design behind the rock solid RM3.8 to the dollar peg.

Box 2b.1: How Exchange Rates Work and Malaysia's Currency Peg

Typically, monetary policy involves selling and buying government securities as part of open market operations to influence domestic interest rates, which then affect the rate at which money supply grows. If money supply matches demand by producers and consumers, inflation will be kept under control. However, if a mismatch did occur, then domestic inflation rates will differ from those abroad causing relative purchasing power parity or PPP to alter. The exchange rate then moves to reflect the new PPP. This sets off a vicious cycle of central bank interventions in the exchange rate that will inevitably affect, through the direct channels, the money supply. If sterilization is carried out to halt movements in the money supply, the relative amounts of government securities in the hands of the public is altered, consequently acting to move the exchange rate further and calling for more interventions. Understanding this, most economists today agree that sterilization is not helpful. Without it, the affected money supply will come in line with demand levels thus bringing all components into equilibrium. This means that monetary policy can either influence exchange rate by an interventionist policy, or inflation purely through open market operations without exchange rate interventions, but not both at the same time. In this regard, the unique design of the *ringgit*'s peg allows for the possibility of money supply targets without exchange rate movement difficulties in Malaysia.

See also, Goldfajn I and Gupta P (2003) "Does monetary policy stabilize the exchange rate following a currency crisis." *IMF Staff Papers,* 50:1, pp. 90-114.

3. ECONOMIC DIRECTIONS FOR PENANG (By Tan Pek Leng)

A sense of crisis has permeated the manufacturing sector in Penang, brought about the declining trends in FDI, the gigantic challenge from China and the looming ones from India and other regional economies. The Penang Economic Competitiveness Committee (PECO) was set up two years ago to explore ways and means to enhance the competitiveness of Penang as a centre for the production of higher value-added products within manufacturing, in particular electronics and services. During the past year, the thinking caps of PECO members have been kept firmly on to figure out new directions, roadmaps and initiatives to ensure the continued competitiveness of Penang's manufacturing sector.

PECO has identified the following as the key structural problems faced by Penang's economy:

- Narrow GDP base
- Lop-sided manufacturing base
- Over-dependence on the US market
- High import content of manufactures

However, there remain major strengths that Penang can leverage to hold on to its competitive edge:

- Agglomeration economies arising from concentration of electronic firms
- Good supply chain of SMIs
- Skilled managerial class

The strategy that has been enunciated for some time now is to move up the value chain into higher value-added activities. Happily, this vague statement has been converted into more concrete strategies in the past year. The setting up of the Collaborative Research and Resource Centre (CRRC) was a crucial step in this direction. Through consultations amongst key industry players both within PECO and CRRC, a few niche areas have been identified as the focus for attention, viz., I.C. design, software development, automation and biotechnology. In addition, manufacturing services that will help propel the transition to the k-economy have also been given emphasis, such as call centres, packaging, marketing and logistics.

To effect this economic transformation, the state will promote more research and development (R&D); training of relevant skilled manpower, especially in design and development (D&D), management, marketing and ICT, and work towards offering more customised incentives to attract the targeted industries and services.

For the purposes of promoting R&D and D&D, CRRC has been exploring greater university-industry collaboration in research; greater commercialisation of research output; better training of skilled manpower through joint university-industry training and curriculum modification to better cater for the needs of industry. Discussions are on-going with the Multi-Media University to adapt the content of its micro-electronics course to better suit the needs of industry in Penang and hence to incentivise industry to sponsor their staff for such courses. Similar collaboration is being sought with other universities.

To cope with the current environment of extreme competition, the State Government has encouraged the formation of consortiums from Penang-based firms to combine resources for technology, training and global marketing. The two major consortiums which have been launched are the Software Consortium of Penang (ScoPe) and the Penang Electronics Consortium.

ScoPe is an alliance of Penang-based software companies with diverse products and service portfolios. It aims to position Penang as a software hub by promoting locally developed software within Malaysia, regionally and globally. Efforts, including the possibility of attaining certification of quality processes for their products and services, are being taken to help promote its member companies. It is an initiative to put local software developers on par with the software powerhouses through mutual support and synergy.

The Penang Electronics Consortium (PEC) envisions being a one-stop manufacturing consortium for the global electronics and electrical (E&E) cluster. PEC facilitates networking between its members and potential customers or technology partners abroad. It also builds bridges between local industry and MNCs undertaking localisation initiatives.

SMIs in Penang have been engaged in the supply chain for an extensive period of time, it is now incumbent that they migrate to the design chain. One strategy for facilitating this process is to help develop local design houses by creating opportunities for design outsourcing from MNCs operating in Penang to local SMIs. A pilot proposal is being formulated to seek R&D grants from the Malaysian government to enable local SMIs to design solutions for MNCs. The MNCs would be required to transfer technology in exchange for grants to support their projects which are not on the active lists due to priority and cost constraints.

Another initiative is to assist Penang-based firms with good technology to obtain venture-capital funding. Under the CRRC-Usains-MDC scheme for collaboration in technopreneur development, a venture capital mentoring session has been organized for ScoPe members, a talk on the Cradle Programme which provides pre-seed funds for start-ups was held and plans are afoot for further programmes in technopreneur networking and capacity building.

All these efforts will be very much boosted if Penang manages to impress upon the federal government the need to extend the Multimedia Super Corridor (MSC) provisions to Penang. The Penang Cybercity initiative is geared towards laying all the groundwork for the MSC rollout to Penang as soon as possible.

Evidently, those in the manufacturing sector have been abuzz with new initiatives. However, the same cannot be said about the Penang's other major economic pillar – tourism. Besides the coming on-stream of two new eco-tourism products: Pulau Jerejak and Pantai Acheh, the upgrading of bungalows in Penang Hill and some infrastructural works, not much is apparent in terms of innovations and new attractions. Quick thinking and quick action are urgently needed before the pearl loses further lustre.

4 PENANG'S ECONOMIC PERFORMANCE IN 2003 (By Lee Seok Yee)

Penang's economy had its share of ups-and-downs during the year of 2003, but as the year draws to a close, its economy is showing healthy signs of recovery. The first half of 2003 double-whammed the state as two major calamities dominated the horizon: SARS and the Iraqi war.

Worldwide, the first probably case of Severe Acute Respiratory Syndrome (SARS) was detected in China in November 2003, but the major effects were felt the most from February to April 2003. In Malaysia, the first probable case was detected in March 2003 and the last case was detected on 22 April 2003. A total of 5 people were diagnosed with SARS in Malaysia, of which 2 died. The tourism-related sector of Penang, which includes wholesale, retail, hotels, and restaurants (WRHR), however, received the brunt of the negative consequences among all sectors. Incessant news of cross-border contagions, the uncertainty of effective treatment method, and numerous travel warnings from the Americas and European countries brought many Asian economies to its knee. Penang's tourism, a major state revenue-earner, fell on its side. (Please refer to *April 2003's Economic Brief* for more detailed analysis of SARS and *Section 5.c* for analysis on Penang's tourism sector in 2003.)

The early part of the year also saw tremendous political disruptions. While the Afghanistan war ended in 2002, the Iraqi war erupted in March 2003. Across the world, terrorism exploded, spreading from Turkey to Saudi Arabia to the Philippines. Malaysian militants were arrested as preventive measures. In August 2003, the World Markets Research Center listed two of ASEAN's countries – Indonesia and the Phillippines

– on the top 10 list of "countries at risk." These political uncertainties, in turn, translated into economic uncertainties – investments and business spending slowed, consumer as well as business confidences were shaken, and foreign tourists shied away.

In 2003, contributions from the agriculture, forestry, and fishing sector remains small at 1.6%; similarly mining and quarrying only accounts for a mere 1% of Penang's GRP *(Table 4.1)*. Nationally, the agriculture sector grew by 6.7% due to high demand for palm oil and rising CPO prices. Penang's agriculture sector is expected to produce more dismal numbers in 2003 (3.4% growth) due to flooding and crop destructions during the rainy season in September / October. (Refer to *Section 5a: Agriculture*) Construction activities reversed its slide into the negative territory in 2003, buoyed by historically-low interest rates and improving economic outlook.

The manufacturing sector, which accounts for 41.3% of Penang's economy, is expected to grow by 4.1% in 2003. The 4.1% manufacturing growth in 2003 is marginally lower than the 4.5% increase observed in 2002. Penang's growth in the manufacturing sector was muted in the H1 2003. The state's heavy exposure in the electrical and electronics (E&E) sector, global weaknesses in semiconductor, and lower demands for E&E goods depressed the sector. The burgeoning Chinese economy also affected Penang adversely, as subcontractors and suppliers increasing follow their MNC customers to the middle kingdom. Had it not for the recovery in Q3 and continuing uptrend in Q4, Penang's manufacturing sector would have suffered more (Refer to *Section 5b: Manufacturing*).

To date, available data point towards a healthy recovery in the second half of 2003. The national industrial production index (IPI) touched a 34-month high. Malaysia's productivity growth grew 8.5% y-o-y in September. The Asia Pacific semiconductor market is growing strongly in the double digits. Several MNCs in Penang also continue to show confidence in the state. For example, Intel opened a US$40 million design and development centre in Penang, adding to the US$2.3 billion already invested here; Schmitter Group AG, a leading German steering wheel component manufacturer, set up its regional headquarters in Penang; and SCI-Sanmina extended its Netvista series of desktop PCs manufacturing agreement with IBM. Nonetheless, competitive threats arising from China and other emerging markets continue to be a counteracting factor.

The tertiary sector of Penang is expected to grow 4.5% in 2003, compared to 5% last year. The utilities sector is largely unchanged. Nine-month tourist arrivals in Penang dropped 14%, due to severe decrease in foreign visitor arrivals as a result of SARS and the Iraqi war. However, the decline is ameliorated by an increase in domestic tourists who opted for the safety of domestic tourism instead of the risk of global travel. The tourism sector also benefited from the 5% service tax waiver introduced under the economic stimulus package. Although badly ravaged by SARS, the tourism sector is beginning to experience some revival in the fourth quarter. Furthermore, the financial, insurance, real estate, and business services sector is rather robust. In Q3 2003, loan for this sector grew by 5.7% y-o-y. Though extremely competitive, the financial sector continues to experience strong demand due to growth of existing products, introduction of innovative offerings, rise in Islamic banking activities, and increased awareness of insurance relevancy for the population. (Refer to *Section 5c-5h: Tertiary*)

In short, Penang should see a 4.2% growth at the end of the year, dragged down by the depressed manufacturing market and unforeseen circumstances in the tertiary sector. The year 2004 will be much brighter (Refer to *Section 7: Outlook for 2004*).

Table 4.1 Penang's Gross Regional Product (GRP) by Economic Sectors

Value (RM Million in 1987 Prices)	**2001**	**2002**	**2003(e)**
Agriculture, forestry, fishing	268	277	287
Mining & Quarrying	202	196	187
Manufacturing	6,926	7,236	7,533
Construction	405	369	381
Tertiary	8,972	9,423	9,847
Overall GRP	16,773	17,502	18,235
% Share	**2001**	**2002**	**2003(e)**
Agriculture, forestry, fishing	1.6%	1.6%	1.6%
Mining & Quarrying	1.2%	1.1%	1.0%
Manufacturing	41.3%	41.3%	41.3%
Construction	2.4%	2.1%	2.1%
Tertiary	53.5%	53.8%	54.0%
% Growth	**2001**	**2002**	**2003(e)**
Agriculture, forestry, fishing		3.6%	3.4%
Mining & Quarrying		-3.1%	-4.6%
Manufacturing		4.5%	4.1%
Construction		-8.8%	3.3%
Tertiary		5.0%	4.5%
Overall GRP		4.3%	4.2%

Note: Projection for 2003 based on preliminary data. Data may be revised pending release of Q4 data.
Source: SERI's Forecast

5a. AGRICULTURE (by Khor Hung Teik)

The last quarter of 2003, especially the month of October, was bad news for the agriculture sector, heavy inter-monsoonal rains wreaked havoc and brought record high floods to many areas in Seberang Perai and Penang. The Muda River overflowed its banks and caused heavy crop losses especially to padi farmers. Altogether 12,739.45 acres of padi fields were affected, involving 2,976 farmers. The most damaged areas were the Northern District with 11,258.78 acres (88%) affected and Central District with 1,273.71 acres (10%). Padi yields will be greatly reduced for the 2003/04 season as many fields were still at planting stage when the floods hit. Farmers who had planted early suffered total crop loss whilst those who had not done so had their planting schedules delayed.

The aquaculture sector was also affected by the floods, involving 114 ponds covering 12.68 acres. Altogether 54 rearers were suffered losses. The Penang Department of Fisheries estimated that as much as RM507,000 was lost in the floods. Once again, the Northern and Central Districts more severely affected compared to other districts.

For the animal husbandry sector, the floods also caused much damage, with losses estimated at up to

RM2.17 million (Department of Veterinary Services, Nov 2003). The most affected animals were kampung chickens (206,225 heads, valued at RM1.24 million), swine (5,392 heads, valued at RM539,200) and broilers (22,000 chickens, valued at RM220,000). The most badly hit district was the Central District with losses up to RM1,248,685, followed by the Northern District at RM684,292 and the Southern District at RM232,800.

At Kampung Selamat – a renowned, pig rearing area – at least 600 pigs drowned and an estimated 1,000 newborn piglets perished in the floods. Farmers sold more than 8,000 pigs below costs to prevent them from drowning or starving to death in the floods. It is believed that this is the most severe flood to hit the area in the last 50 years. (The Star, 10 October 2003)

Crop Agriculture

The area under crop agriculture continues to decline over the years, as shown in Table 5.a.1. This trend will continue as long as areas presently under agriculture are converted into other land uses. However, the area under padi cultivation is expected to hover around 12,500 hectares as the Integrated Agriculture Development Project (IADP) continues to upgrade the padi area for the maximization and intensification of land use resulting in better yields provided there are no natural disasters like flood, drought or pests attacks. Overall, the change in agriculture land use per annum since 2000 is as high as 13%.

Table 5.a.1: Area of Agriculture Commodities in Penang 2000 - 2003 (hectares)

Type	Agriculture Areas (Hectares)				CAGR 2000-2003
	Year				
	2000	2001	2002	2003f	
Rubber	13,013.00	12,758.20	12,758.20	12,632.68	-1%
Oil Palm	13,018.00	12,988.00	12,988.00	12,973.03	0%
Padi	28,125.00	13,448.00	13,448.00	9,299.09	-31%
Coconut	2,364.00	2,339.10	2,309.10	2,282.13	-1%
Cocoa	104.00	103.50	75.40	64.20	-15%
Vegetables	1,566.00	1,718.00	1,544.96	1,534.55	-1%
Fruits	7,283.00	6,830.00	6,760.00	6,512.76	-4%
Cloves	67.00	52.20	41.20	32.31	-22%
Nutmeg	82.00	75.40	70.40	65.23	-7%
Cash Crops	197.00	246.70	190.11	186.76	-2%
Others	438.00	86.70	55.10	19.54	-65%
Total	**66,257.00**	**50,645.80**	**50,240.47**	**43,748.65**	-13%

Note: CAGR denotes "Compound Annual Growth Rate."
Source: Dept of Agriculture, Penang

Livestock Husbandry

Livestock husbandry in Penang consists mainly of poultry and swine. Chicken meat remains the biggest income earner, raking in a total of RM230 million in 2002 followed by pork, RM110mil. Chicken eggs ranked third with RM53 million. Total growth rate per annum since 1996 remained at 2% for the whole livestock industry (Table 5.a.2).

Table 5.a.2: Production and Value of Livestock in Penang

	2001			2002		
Commodity	**Production**	**Value**	**Percentage**	**Production**	**Value**	**Percentage**
	(Tonne Metric)	**(RM Million)**	**%**	**(Tonne Metric)**	**(RM Million)**	**%**
Meat						
Cow	1,065.96	12.68	3.20	977.65	11.63	2.79
Buffalo	32.87	0.39	0.10	33.09	0.39	0.09
Goat / Lamb	40.75	0.49	0.12	28.17	0.34	0.08
Pig	18,922.75	103.13	26.04	20,343.60	110.87	26.58
Chicken	48,222.76	221.82	56.02	50,201.00	230.92	55.35
Duck	448.24	2.17	0.55	492.66	2.39	0.57
Quail	110.50	0.96	0.24	72.96	0.63	0.15
Rabbit	2.78	0.03	0.01	0.30	0.00	0.00
Eggs	**(No. of eggs)**			**(No. of eggs)**		
Chicken	282,045,266	50.77	12.82	280,846,89	53.36	12.79
Duck	16,000,000	3.20	0.81	28,024,000	6.17	1.48
Quail	0	0	0	1,600,000	0.14	0.03
Milk	**(Liter)**			**(Liter)**		
Fresh milk	455,440	0.34	0.09	455,440	0.34	0.08
TOTAL		**396.00**	**100.00**		**417.20**	**100.00**

Source: Dept of Vet Services, Penang

The forecasted production values of livestock for the year 2003 are found in Table 5.a.3 below. The big floods in October 2003 affected especially the poultry and the swine industries.

Table 5.a.3 : Value of Livestock in Penang from 1996 - 2003

Commodity	1996	1997	1998	1999	2000	2001	2002	2003f*
Beef	10.05	11.21	10.05	10.93	11.60	12.68	11.63	11.92
Buffalo	1.87	1.75	1.87	0.81	0.62	0.39	0.39	0.30
Mutton	1.04	0.95	1.04	0.49	0.51	0.49	0.34	0.28
Pork	105.22	102.89	105.22	102.49	101.39	103.13	110.87	111.84
Chicken	183.38	173.84	173.84	161.83	200.35	221.82	230.92	239.96
Duck	1.62	2.29	2.29	6.19	2.08	2.17	2.39	2.55
Quail	0.31	0.5	0.5	1.79	0.81	0.96	0.63	0.71
Rabbit	0.09	0.05	0.05	0.05	0.04	0.03	0.00	0.00
Chicken Eggs	53.32	54.79	54.79	51.91	50.72	50.77	53.36	53.37
Duck Eggs	3.56	1.85	1.85	2.01	3.48	3.2	6.17	6.76
Quail Eggs	0.29	1.52	1.2	1.74	0.68	0.40	0.14	0.12
Milk	0.34	0.34	0.34	0.27	0.34	0.34	0.34	0.34
Total	361.09	351.98	353.04	340.51	372.62	396.38	403.84	411.44

** Forecasted*
Source: Dept of Veterinary Services Penang

Fisheries

Data from the Penang Department of Fisheries indicates that marine landings fell from 35.9 thousand metric tons in 2001 to 31.9 thousand metric tons in 2002. This represents a decrease of 35%. Landings are forecasted to fall too for 2003 due to heavy inter-monsoonal rains during the last quarter of the year.

Table 5.a.4: Landings of Marine Fish in Penang (1990-2003)

Year	Quantity ('000 tons)	Value (RM million)
1990	52.36	90.54
1991	28.42	91.44
1992	33.77	119.97
1993	33.77	111.43
1994	40.80	130.71
1995	46.18	151.24
1996	37.61	154.88
1997	37.53	158.79
1998	35.47	189.18
1999	34.79	137.84
2000	35.90	148.27
2001	49.37	145.27
2002	31.99	152.15
2003f	30.71	158.88
CAGR Since 1991	-4%	4%

Source: Dept of Fisheries, Penang

Table 5.a.5 shows the aquaculture production and value in Penang from 1991 – 2003. The production from brackish water pond culture continues to grow, followed by brackish water cage culture. The production value for brackish water pond culture and brackish water cage culture in 2002 were RM14.82 million and RM33.04 million respectively. Cockle culture raked in RM6.73 million in 2002 and freshwater pond culture, RM0.94 million. Aquaculture production continues to grow positively with brackish water pond culture leading the sector. For the year 2003, the production of brackish water pond culture, freshwater pond aquaculture and brackish water cage culture are expected to rise to 961.03 metric tons (23% increase), 315.68 metric tons (17% increase) and 2,553.13 metric tons (11% increase) respectively. Overall, the aquaculture sub-sectors seem to be showing a positive growth annually.

Table 5.a.5: Aquaculture Production & Value in Penang 1991 –2003

	Freshwater Pond Aquaculture		Brackishwater Cage Culture		Cockle Culture		Brackishwater Pond Culture	
Year	**MT**	**RM Mil**	**MT**	**RM Mil**	**MT ('000)**	**RM Mil**	**MT**	**RM Mil**
1991	49.29	0.15	762.46	10.56	8.29	3.22	78.76	0.80
1992	45.06	0.13	862.48	10.39	7.59	2.95	401.80	10.39
1993	54.03	0.16	1,642.93	19.47	14.62	6.47	555.86	6.12
1994	50.44	0.19	1,173.36	16.03	14.59	7.26	567.32	5.92
1995	31.10	0.12	1,105.10	15.29	15.30	7.61	606.37	10.91
1996	76.30	0.25	1,090.69	13.43	16.43	8.13	835.65	13.98
1997	108.01	0.38	1,145.67	14.61	13.11	9.59	643.05	11.96
1998	106.96	0.41	1,836.16	17.70	13.17	9.14	957.12	15.08
1999	110.68	0.33	1,247.42	14.45	13.99	9.73	498.76	8.82
2000	236.49	0.67	1,313.56	19.14	13.12	9.18	407.96	7.57
2001	191.39	0.60	2,093.25	28.84	11.60	8.12	778.02	12.74
2002	270.42	0.81	2,308.53	33.04	9.05	6.33	780.19	14.82
2003f	315.68	0.94	2,553.13	36.65	9.12	6.73	961.03	19.32
CAGR	17%	17%	11%	11%	1%	6%	23%	30%

Note: MT = Metric Tonne, CAGR = Compound Annual Growth Rate
Source: Dept of Fisheries, Penang

5.b MANUFACTURING (By Lee Seok Yee)

Manufacturing is a significant sector in Penang. As shown in Table 4.1, manufacturing accounts for 41.3% of Penang's gross regional product (GRP).

Nationally, the newly-released Bank Negara's Gross Domestic Product (GDP) data for the Q3 2003 showed that manufacturing grew 8.5% y-o-y. The Malaysian Institute of Economic Research (MIER), meanwhile, projected that the Malaysian manufacturing sector will expand by 6.4% in 2003. In Penang, we project a 4.1% growth in the manufacturing sector for 2003.

2003 was a challenging year for Penang. Amidst global problems – such as SARS, the Iraqi war, and ASEAN region security problems – that have shaken the state as well the country, Penang also encountered various other adversities. Semiconductor market billings, as tracked by the Semiconductor Industry Association (SIA), showed an alarming growth plunge in the Asia Pacific market from February until August 2003. Penang's semiconductor industry, a major engine of growth in manufacturing, naturally followed the same fate as it was highly integrated into the world market. While some major MNCs, such as Intel and Dell, are growing their presence in Penang, many others are facing a challenging year in the E&E sector. Several reported marginal to flat profits, even though revenue is growing. Foreign direct investments (FDI) inflow to Penang (Table 5.b.1) is mediocre and is more depressed than the previous year. Local players are unable to fill the void as most are still small or competitively-challenged. For many of such local companies, their fortunes are tied to the business cycles of the MNCs. To make matters worse, some of these manufacturers are increasing forced to look externally, e.g. to China, as a result of their customers' (MNCs) shift in manufacturing strategy away from Penang. In short, Penang's export-oriented manufacturing, a jewel during the global economic growth in the 1990s, encumbered growth in 2003.

Nonetheless, the second half of 2003 witnessed stronger demand internally and externally. A multitude of national indicators point towards brighter times in the manufacturing sector. Business confidence and consumer sentiments have gone up. Production volume increased due to lowering of inventory level especially in food and beverage (F&B), plastics and plastics products, and electronics and electrical (E&E) products. Semiconductors export grew. Growth of intermediate goods imports reversed its slide.[5] Given that this is already December and we have only heard positive developments in the field, we believe that manufacturing has climbed onto the growth ramp again – and the H2 2003 will compensate for the lacklustre development in H1.

In 2003, the state government took a step forward when it launched the Collaborative Research and Resource Center (CRRC) in February 2003 with a grant of RM300,000. Through CRRC, better matchmaking and influencing could be made between the industry and the universities in the areas of R&D participation and manpower training. Four months later, in June 2003, the local industries received recognition when the Local Industry / SMI cluster was set-up, established specifically to address their competency and competitive issues.

To counter the losing battle of competitive advantage to lower-cost countries, Penang is preparing a move towards higher value-add manufacturing. The Penang Photonics Consortium, consisting of 19 companies, is an example of such move. The potential for Penang to make an impact is large because the photonics market is fragmented and Penang could reasonably count on its "reputation for volume manufacturing, highly trainable workforce, established training centers, pro-business government incentives and supply chain infrastructure already in place.[6]" Penang's foray into biotechnology, supported by the presence of three institutions – the Fisheries Research Institute (FRI), Universiti Sains Malaysia's Centre for Marine & Coastal Studies, and the World Fish Centre – is also an appropriate extension of the state's competitive strategy. The state's foray into biotech is guided by a three-pronged strategy of marine biotech research works, bio-ICT development and biotech education.

Apart from pushing the manufacturing and technology boundary, Penang is also trying to grow the market in more traditional ways. There has been much effort to increase overseas partnerships among Malaysian companies. In November 2003, 15 Penang companies, guided by the Penang's Chief Minister, signed MOUs with their counterparts in software and hardware manufacturing from Karnataka, India.

Selected National Manufacturing Indicators

The latest industrial production index (IPI) (October 2003) beats market expectation by registering a y-o-y growth of 11.3% and touching a 34-month high. In the first ten months, IPI rose by 8.5% due to strong domestic demand and a pick-up in external demand. CIMB predicts IPI to touch 9% in 2003, and between 11 and 12 percent in 2004. National manufacturing sales also grew by 10.9% y-o-y in September, to RM30.51 billion.

Productivity figure for manufacturing was very encouraging. In September 2003, y-o-y productivity growth is 8.5%. Productivity growth was achieved by running a leaner operating environment (i.e. number of employees per establishment dropped 0.4%) and squeezing more output from the remaining workers (i.e. sales per establishment increased 8.3%). Unit labour cost actually fell by 4.5% because sales growth outpaced wage increase.

In terms of production, 40% of manufacturers surveyed by MIER reported production increases in Q3 2003. The improvement was broad-based, from plastics and plastics-products to E&E products. Capacity utilization has also risen to 79.6% in Q3 2003 from 78% a quarter ago. Several sectors, such as plastics and plastic products, textiles and apparel, nonmetallic products, and chemicals and chemical products are operating close to full capacity. Capital spending is up with E&E being the biggest spenders. And finally, inventory level is dropping with 26% responded that stock is lower in Q3, against a corresponding 22% in Q2.

Approved Manufacturing Projects in Penang

Up until October 2003, 117 manufacturing projects were approved in the state of Penang (see Table 5.b.1). In the entire year of 2002, only 111 projects were approved.

However, even though there are more projects, they are smaller in scale both in terms of investment and potential employment. Potential employment of the approved projects in 2003 is expected to fall short of that in 2002: currently available figure up until October demonstrates that possibility. Of the 117 projects approved, only 8,461 new jobs will be generated. Last year, the 111 projects generated 13,523 jobs. Total capital investment from January to October 2003 is RM 1.59b. If the trend continues, investment will be less than RM2b by the end of 2003, compared to RM 2.42b in 2002.

Penang's dependence on foreign investment is evident from Table 5.b.1. Foreign investment accounts for three-quarters (76%) of total capital investment in 2003. This is an improvement from the 82% foreign stake in 2002, which means lesser dependency on foreign capital.

Table 5.b. 1 – Total Approved Projects in 2002 and Jan-Oct 2003

Industry	# of Projects	Potential Employment	% Domestic Investment	% Foreign Investment	Total Capital Investment
Jan-Oct 2003	117	8,461	24%	76%	RM 1.59b
Entire year 2002 (Jan-Dec)	111	13,523	18%	82%	RM 2.42b

Source: MIDA

The nature of local vs. foreign investments differs in the sense that domestic investments are more geared toward new projects, whereas foreign investments are more focused on expansion and diversification. As evident in Table 5.b.2, 73% of domestic investments go towards new projects whereas only 25% of foreign investments go towards new projects; nonetheless, the 25% foreign share figure in new projects (aforementioned) is an improvement over the 7% figure in 2002.

Table 5.b. 2 – Type of Investments by Domestic vs Foreign Investors

Industry	Domestic		Foreign	
	New	Expansion / Diversification	New	Expansion / Diversification
2002	78%	22%	7%	93%
2003	73%	27%	25%	75%

Source: MIDA

The dominance of foreign investment in Penang's manufacturing strategy is further illustrated in Table 5.b.3. Apart from Terengganu, which benefited heavily from petrochemical-related investment, Penang is a premier FDI destination in Malaysia in 2003. In 2002, Penang was also on the second rung of the ladder, albeit trailing Selangor. Judging by the amount of investment and number of projects approved, Penang is the third-highest ranked among Malaysian states.

Table 5.b. 3 Ranking of Approved Investments, Jan-Oct 2003

Industry	# of Projects	Foreign Investment (FDI)	Investment Approved
1	Selangor	Terengganu	Terengganu
2	Johor	Penang	Selangor
3	Penang	Selangor	Penang
4	Kedah	Johor	Johor
5	Negeri Sembilan	Negeri Sembilan	Kuala Lumpur

Source: MIDA

According to the Penang Development Corporation's (PDC) *Industrial Survey* for the H1 2003, top foreign investments for Penang were from Japan, United States, and Taiwan[7]. They individually accounted for 36%, 24%, and 19% of FDIs into Penang. Other major foreign investors were from Singapore, Germany, Hong Kong, and United Kingdom.

Further statistics from MIDA shows that the top five manufacturing projects approved in Penang in 2003 – measured in terms of total capital investment – are electrical and electronic products (74%), fabricated metal products (7%), scientific & measuring equipment (5%), machinery manufacturing (4%), and basic metal products (3%) (see Table 5.4.b). Together, they accounted for 93% of all capital investments, translating into RM1.48 billion. Machinery manufacturing and scientific & measuring equipment are new additions to the 2003 top five list, while furniture & fixtures as well as chemical & chemical products dropped out of contention.

Table 5.b. 4 – Top 5 Manufacturing Sectors in Penang by Total Capital Investment (% of Total Approvals), Jan – Oct 2003

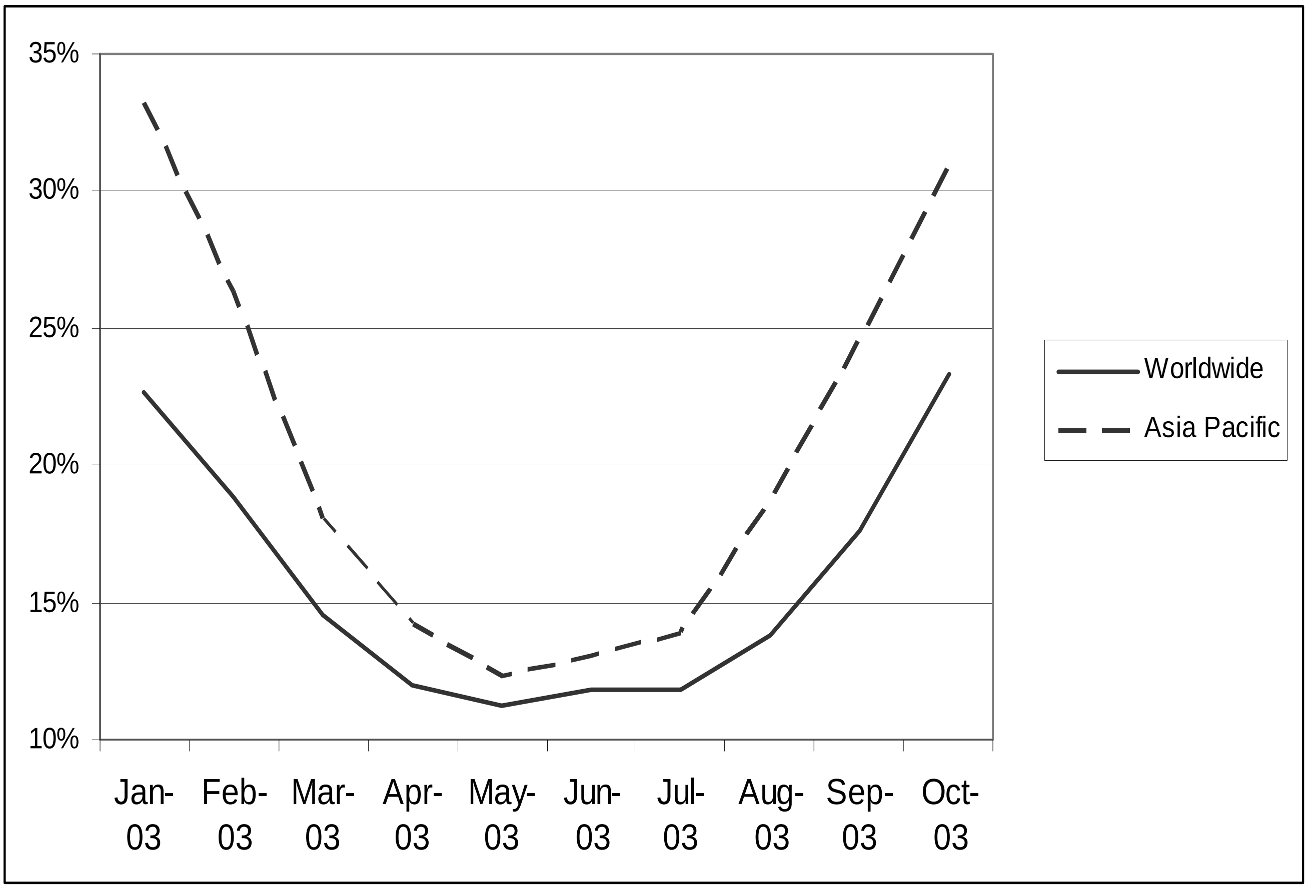
Industry	# of Projects	Potential Employment	Total Capital Investment	% Domestic Investment	% Foreign Investment
E&E Products	45%	62%	74%	7%	93%
Fabricated Metal Products	17%	16%	7%	72%	28%
Scientific & Measuring Equipment	4%	3%	5%	44%	56%
Machinery Manufacturing	11%	7%	4%	90%	10%
Basic Metal Products	3%	1%	3%	88%	12%
Total for Top 5 Industries	94	7555	RM1.48 Bil	RM 0.3 Bil	RM1.18 Bil
Total Approvals	117	8461	RM1.59 Bil	RM 0.39 Bil	RM1.21 Bil
Top 5 Industries' % of Total	80%	89%	93%	77%	93%

Source: MIDA

Global Semiconductor Demand

Semiconductor, a key export of Penang, is showing some sparks again. Worldwide semiconductor market billings in 2003 rebounded following prolonged demand depression since the end of 2001. The y-o-y growth has been double-digit for both worldwide and Asia-Pacific for the entire 2003.

Chart 1 – y-o-y Change of Semiconductor Market Billings Based on 3-Month Moving Average



Source: Semiconductor Industry Association (SIA)

Overall, y-o-y semiconductor growth in 2003 followed a U-shape curve, with lower growth in Q2 and sharp turnaround beginning Q3. As evident in Chart 1, the Asia Pacific region's semiconductor market out-paced worldwide growth. The October 2003 y-o-y growth was a high 31% for Asia Pacific, while global growth was 23% -- 8% lower.

In November 2003, the Semiconductor Industry Association (SIA) revised its global sales forecast for 2003 to $163 billion, or equivalent to 15.8% y-o-y growth. 2004's revenue is projected at $194.6 billion, or 19.4% growth. Meanwhile, the World Semiconductor Trade Statistics (WSTS) projected 14.2% growth in 2003 and 19.4% in 2004.

Regionally, technology research house Gartner predicted that Malaysia will generate $10.1 billion worth of semiconductors sales in 2007, with an annual growth rate of 11.4%. China and South Korea will be the growth leaders in Asia Pacific, supported by cellular phone, digital consumer electronics, and flat panel display demands. New technologies such as next generation mobile communications infrastructure, wireless LAN and wireless personal area networks will be emerging in the next 5 years.

Manufacturing Employment

When we last wrote about manufacturing in the "2002 Penang Economic Report," labour-saving processes were going full-swing. Retrenchments, lay-offs, and voluntary separation schemes (VSS) were often heard on the street.

The good news is that most of the manufacturing sectors have started picking up again in the first half of 2003 after a poor performance during the latter half of 2002 when the world economy nosedived, global political situation see-sawed, and manufacturing companies relocated elsewhere.

Data from the Penang Development Corporation's (PDC) *Industrial Survey for January – June 2003*[8] shows that a total of 154,121 workers worked in the PDC industrial area (see Table 5.b.1). This represents a 14% increase over the second half of 2002 but a 7% y-o-y reduction (i.e. between the first halves of 2003 and 2002). We expect manufacturing employment to continue its upward trend during H2 2003, in line with rising manufacturing workers employment nationally.

Consistent with the economic positioning of Penang, resource-dependent manufacturing sectors such as timber / wood, mineral, animal feeds, and agriculture, make up a small percentage of total employment. Conversely, the electrical and electronics (E&E) sector – accounting for 56% of manufacturing workers – is the largest employer in the manufacturing field. Hiring 8% of manufacturing workers, the fabricated metal sector is a distant second largest employer, while textiles and garment is third at 7%. The percentage breakdown as well as the ranking is unchanged from the same period in 2002 (i.e. Jan-June 2002).

All of the manufacturing sectors have increased their employment numbers in H1 2003 (compared to H2 2002). Three of the smaller sectors (machinery, timber-based/wood products, and rubber-based products), whose absolute employment figure is small, have doubled their employment. The two biggest employers, E&E and fabricated metals, also recorded double digit growth at 11% and 17% respectively.

Table 5.b. 5 Employment in the PDC Industrial Area

Sector	Employment in '000			Y-o-Y Change - H1'02 - H1' 03	H-o-H Change - H2'03- H1'03	% Share in 2003	% Share in 2002
	Jan-Jun '03	Jan-Jun '02	Jan-Dec '02				
Electronics / Electrical (E&E)	86.53	91.17	84.64	-5%	11%	56%	55%
Fabricated Metal Products	12.32	12.99	11.74	-5%	17%	8%	8%
Textiles & Garments	10.85	11.82	11.20	-8%	3%	7%	7%
Plastic & Plastic Products	8.12	7.96	7.11	2%	30%	5%	5%
Paper & Paper Products / Printing Works	5.19	6.06	5.32	-14%	13%	3%	4%
Prof, Scientific,Measuring, Contrlling Equip & Optical Goods	4.88	5.43	4.64	-10%	27%	3%	3%
Chemicals / Fertilizers	4.60	5.16	4.54	-11%	18%	3%	3%
Others	4.57	4.60	4.41	-1%	8%	3%	3%
Rubber-based Products	3.79	7.11	4.31	-47%	150%	2%	4%
Transport Equipment	3.10	3.00	3.06	3%	0%	2%	2%
Basic Metal Industries	2.79	2.36	2.25	18%	31%	2%	1%
Food processing / Canning	2.71	2.50	2.14	8%	52%	2%	2%
Machinery	2.16	2.72	1.88	-21%	109%	1%	2%
Processing of Agricultural Products	.91	.99	.95	-8%	1%	1%	1%
Non-metallic Mineral Products	.86	.80	1.24	8%	-49%	1%	0%
Timber based / Wood Products	.39	.40	.29	-2%	113%	0%	0%
Animal Feeds	.37	.42	.38	-13%	13%	0%	0%
TOTAL	**154.12**	**165.48**	**150.08**	**-7%**	**14%**	**100%**	**100%**

*Note : * Figures for 2nd half of 2002 reverse calculated by SERI from available data for periods Jan-Dec '02 and Jan – June '02.*

Source : PDC, SERI calculation

Challenges in Manufacturing

The prospect for manufacturing in Penang is rather favourable in 2004. Regardless, there are wrinkles.

The forward-looking project approval figure from MIDA shows that despite a growth in investment projects, there could be a dent in the size of future investments. Increasingly, investments are targeted towards expansions and diversifications as opposed to fresh projects.

SERI's informal survey among the MNCs in Penang found that price competition is a problematic issue, especially for the low-end, mass manufacturers and subcontractors dependent on MNCs. The double-sword attack of AFTA liberalization and China's emergence has opened the floodgate for global competition. As a result, even though revenue is growing, profit is marginal to flat.

In addition, the government could support the manufacturing sector further by improving infrastructures such as immigration (i.e. ease of hiring foreign labours and skilled professionals) and customs clearance. The difficulty of obtaining local engineers and technicians with adequate skills was often highlighted by big and small players alike. Even MNCs, which are the traditional employers of choice, have difficulties hiring adequately-skilled technical workers locally. Furthermore, the alternative solution of inviting foreign experts to train local workers is made irrelevant due to tough immigration laws.

Given Penang's increasing push towards high value-added manufacturing activities, it is imperative to increase linkages between universities and industries and also to improve the labour force's adaptability and interest towards research. There cannot be progress up the value chain without an accompanying upgrade of human skills. Reskilling is also vital as low-skilled, labor-intensive employments flow outwards to lower-cost countries. To bolster the claim of HR inadequacy, the bi-annual National Productivity Centre (NPC) survey found that the top three problems affecting the quality of labour nationally are English language proficiency, IT, and creativity / innovation skills.

Continuous focus towards cluster-based manufacturing and R&D development should spell Penang's direction forward. Industrial R&D is in its infancy stage and hence nurturing – through firm government support as well as creation of support structures and supporting industries -- is an important ingredient for success.

Finally, the state government must shed its reliance on FDI and stimulate domestic investment. Budget 2003 is a good start, but must be followed by efficient implementation true to the spirit of the stated policy. As one of the manufacturers in Penang commented, "Penang's attractiveness as an FDI investment focus will be degraded because of China. It's going to be imperative that Malaysia starts investing in the development of local SMEs especially in the area of product development."

In concurrence with that, a recently-concluded survey of Penang's SMIs by SERI discovered that the state's small- and medium-sized industries lack mental and strategic preparation for global competition. In the report, seven core problems were highlighted and ten recommendations were put forward to help redress the situation *(Table 5.b.6)*.

Table 5.b. 6 Survey of SMIs in Penang, 2003

7 Core Problems Among Penang's SMIs	10 Recommendations To Improve SMIs
1. Poor knowledge and interest in knowledge acquisition, 2. Lackadaisical mentality among SMIs, 3. Inadequate credit and financing, 4. Constraints in human resources, 5. Technological challenges, 6. Restricted marketing and distribution reach, and 7. Institutional red tapes.	1. Better capture list of all SMIs in Penang through a Penang SMIs / SMEs Census; 2. Consider the needs of Chinese-speaking SMIs; 3. Centralize information access to provide efficiency in administrative processes (SMI portal, One-Stop Centre, or One-Day Open Day); 4. Improve promotion of trade missions, facilitate trade matching, and increase trade exhibitions; 5. Set up a Penang SMI Council to discuss and debate the intended direction for SMI development; 6. Provide financial assistance and explore alternative financing; 7. Conduct continuous tracking and research; 8. Identify and modify labour-related activities (low-skilled workers and high-skilled professionals); 9. Increase SMIs' competitiveness through mergers, partnerships, joint-ventures, technology transfers, and improved commercialization of research; and 10. Identify industrial focus areas to shift towards higher value chain.

Source: SERI

Without doubt, the manufacturing sector of Penang still has many years of vibrant life ahead. In the last 30 years, Penang has established itself well in the arena of manufacturing. Its manufacturing positioning is an envy of developing and developed countries alike. The wrinkles aforementioned are more likely to need preventive rather than resuscitative solutions to smooth them out.

TERTIARY SECTORS

5c. TOURISM (by Tan Yin Hooi)

It has been a dreadful year for the tourism industry – the worst of all economic sectors. Tourist arrivals plunged this year, following the occurrence of the Severe Acute Respiratory Syndrome (SARS), the war in Iraq and multiple terrorist bombings worldwide. These developments dampened the sector just as it was re-gaining tourist confidence after the September 11th and Bali bombing tragedies.

Table 5c.1: Penang: Estimated Total Visitor Arrivals

	Jan - Jun 2002	Jan - Jun 2003	% change	Jul - Sept 2002	Jul - Sept 2003	% change
Estimated Total Visitor Arrivals	1,492,917	1,319,456	-11.6	990,024	811,433	-18.0
Estimated Domestic Visitor Arrivals	727,051	809,288	11.3	430,660	496,466	15.3
Estimated Intl Visitor Arrivals	765,866	510,168	-33.4	559,364	314,967	-43.7
Estimated Domestic Share	48.70%	61.30%		43.50%	61.20%	
Estimated International Share	51.30%	38.70%		56.50%	38.80%	

Source: DCT Consultancy Services Sdn. Bhd.

As the figures show in Table 5c.1, the estimated visitor arrivals has dropped 11.6%, from 1,492,917 people in the H1 2002 to 1,319,456 for the same period in 2003. According to the Penang International Hoteliers Association (PIHA), the tourism industry had started out strongly in the first two and a half months of 2003. It went downhill thereafter until July or August, when there was a slight recovery. However, on a y-o-y basis, total visitor arrivals still recorded a drastic drop in the July to September period, equivalent to an 18% annual decline.

Estimated international visitors arrival plummeted the most – by 33.4% y-o-y in the first half and 43.7% y-o-y in the third quarter. Meanwhile, the share of international visitors shrunk from 51.3% in the first half of 2002 to 38.7% in the equivalent period in 2003; in the third quarter, the share shrunk from 56.5% to 38.8%.

However, the silver lining was that there is a significant increase in the number of domestic visitors to Penang. Fear of contracting the SARS virus had prevented many locals from going abroad for their holidays, hence they turned to local destinations instead. Credit has to be given to the Cuti-Cuti Malaysia campaign that has encouraged more Malaysians to travel domestically. Indeed, the numbers confirm that. Positive growths in domestic visitor arrivals were witnessed in H1 as well as Q3 2003 at 11.3% and 15.3% respectively.

Table 5c.2: Penang: Average Hotel Occupancy Rate (%)

	BEACH HOTELS			CITY HOTELS			TOTAL		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
1st Quarter	61.5	50.5	48.6	50.8	50.6	50.3	55.1	50.5	49.6
2nd Quarter	52.2	48.2	31.8	54.3	51.8	43.7	53.5	50.5	38.8
3rd Quarter	65.4	63.9	51.7	56.0	55.1	55.8	54.8	58.4	54.1

Source: DCT Consultancy Service Sdn. Bhd.

Average hotel occupancy rate (AOR) has been rather disappointing in 2003 (Table 5c.2). Historically, AOR for the first and second quarters were 50% and above; however, AOR decline to 49.6% in Q1 2003 and dwindled to 38.8% in the second quarter. Beach hotels, which tend to attract leisure vacationers, (as opposed to city hotels which attract business travelers) saw lower AOR all three quarters this year compared to city hotels.

The second quarter was a period of dire straits for the tourism industry as it was the peak of the SARS pandemic. The major players, namely the hoteliers, the tour operators, restaurant operators, and retailers, were hard hit. PIHA acknowledged that revenue dropped dramatically in April and May. A survey that was done among 10 tour agencies in Penang revealed an estimated loss of RM2.47 million. Hotel room cancellations was said to have totaled 888 in March, 6486 in April and 2542 in May[9]. Thankfully, the threat of SARS died down significantly by the third quarter and AOR climbed back up again for both the beach and the city hotels.

Table 5c.3: Penang: Market Mix of Tourists

	1st Half			3rd Quarter		
	2002 (in %)	**2003 (in %)**	**Change (%)**	**2002 (in %)**	**2003 (in %)**	**Change (%)**
Malaysia (Domestic)	48.7	61.3	12.6	43.5	61.2	17.7
Middle East	2.4	1.1	-1.3	13.5	6.1	-7.4
Indonesia	4.0	4.3	0.3	4.6	4.6	0
United Kingdom	9.7	7.8	-1.9	6.7	4.3	-2.4
Singapore	5.6	4.2	-1.4	4.4	3.5	-0.9
Japan	6.1	4.5	-1.6	6.1	3.1	-3
Australia	4.6	2.5	-2.1	5.6	2.8	-2.8
Hong Kong	1.5	1.5	0	1.4	2.3	0.9
Taiwan	1.3	1.0	-0.3	1.2	2.3	1.1
USA	2.6	1.7	-0.9	2.0	1.6	-0.4
Netherlands	2.1	1.7	-0.4	2.1	1.5	-0.6
Thailand	2.3	1.8	-0.5	1.6	1.4	-0.2
Mainland China	2.1	1.2	-0.9	1.6	1.0	-0.6
Germany	1.5	0.8	-0.7	1.0	0.5	-0.5
Others	5.5	4.6	-0.9	4.7	3.8	-0.9
TOTAL	**100.0**	**100.0**		**100.0**	**100.0**	

Source: DCT Consultancy Service Sdn. Bhd.

Looking at the market mix in Table 5c.3, domestic visitors constitute the biggest share of tourists. The percentage share of domestic visitors soared 12.6% y-o-y in H1 2003, i.e. from 48.7% to 61.3%. Correspondingly, the third quarter saw 17.7% y-o-y growth. In H1, Indonesia was the only country to record positive share growth (apart from domestic tourists); all other countries saw zero to negative growths. In the third quarter, tourists from Hong Kong and Taiwan began to increase their presence but unfortunately Middle Eastern tourists drastically reduced their visits due to escalating political disturbances in that region. Visitors from three other countries – the UK, Australia, and Japan – have also gone down significantly.

The launch of direct flights from London to Penang in October 2003 was an exciting step towards bringing English tourists to Penang. It is a vital step towards reviving Penang's tourism as the English have more purchasing power than those from other countries. Direct flights have also been launched between Penang and Xiamen and Kunming in China. At the moment, there are only a handful of Mainland Chinese visitors coming to Penang. In 2003, their market share only stood at 1.2% and 1.0% in the 1st half and 3rd quarter respectively. With a population that exceeds 1 billion people and a burgeoning economy, China is definitely a market full of potential. As 2004 will see the commencement of the Malaysia-China Friendship Year, Penang must make full use of it to attract Chinese tourists to the state. Given the fact that Penang has already established good and close ties with some of the Chinese provinces through trade relations, success should be within grasp.

Prospects and Challenges in the Tourism Sector

PIHA estimates that it would take at least up to the end of Mar 2004 for the tourism industry to return to historically-competitive levels. They are, however, uncertain whether their existing long-haul market will ever recover to the level enjoyed in the late 1990s and early 2000s. Development of new markets presents much-needed opportunities for the tourism sector, but the hoteliers must learn from the past and work in more diverse ways to cover the eventualities, should something untoward happen in the future.

Generally, there is renewed hope in reviving the tourism sector in 2004. The tourism sector should be able to do fairly well, barring any significant incidences or epidemic outbreaks. Recent news about suspected re-emergences of the SARS in Taiwan and Mainland China will keep those in the tourism sector on their toes. It is definitely hoped that there will not be any emergence or re-emergence of infectious diseases that will put the tourism sector in jeopardy again.

Eco-tourism will definitely continue to be an area of attraction for international visitors and local visitors. There will be great opportunities for growth in this area as Penang is richly blessed with natural heritage trails such as in Teluk Bahang, Pantai Acheh, Sungai Tukun, Pantai Kerachut, Pulau Jerejak, Pulau Aman and not forgetting Penang Hill. According to the Chief Minister of Penang, Tan Sri Dr. Koh Tsu Koon, the awaited Tropical Island Resort on Pulau Jerejak, accessible via a 15-minute ride on a 50-seater ferry, will be opened by Chinese New Year 2004. The resort is part of the RM207 million Pulau Jerejak International Eco-Tourism Project covering 32.7ha targeted for completion by 2010. Meanwhile, work on the Penang National Park in Teluk Bahang and Pantai Acheh will start soon.[10]

Health tourism and education tourism are two other areas that are expected to draw tourists to Penang. The state has the facilities, equipment, technology and the specialists needed to become a world class health as well as education centre. With comparative cost advantage over developed countries with the same kind of facilities, Penang may well become a hotspot for tourists looking for high quality and affordable health and education services.

Credit has to be given to the Penang State Tourism Action Council for its promotional activities but much more still has to be done to woo more tourists to visit Penang and to make constant return visits. The state has not only to think of new attractions and programmes to draw tourists to Penang, but also to solve fundamental problems, such as flash floods, inefficient and insufficient transportation linkages, traffics jams, dirty toilets and rubbish-strewn facilities, that drove tourists away. The local authorities must continue to improve on the sanitation system and the level cleanliness in our state. Having said that, the task of keeping our surroundings clean does not only lie in the hands of our local authorities but also upon each individual, to make Penang a better place to live in and an alluring tourist destination.

Finally, transportation linkage is a tourism problem yet to be fully resolved, as noted in SERI's "*Economic Brief*" in February 2003. We have highlighted the importance of direct flights; happily, we saw in the year 2003 initiation of direct flights to the UK and China. Charter flights could also be the bridge to make up for the lack of regular commercial direct flights. Within the city, trishaws are a viable alternative public transportation for the tourists. They get around the problem of pollution and cordoned-off roads and they are also a cultural treasure. Finally, water-related transportation such as water taxis and cruises have been proposed for a number of years but are still not in sight.

5.d FINANCE (by Khor Hung Teik)

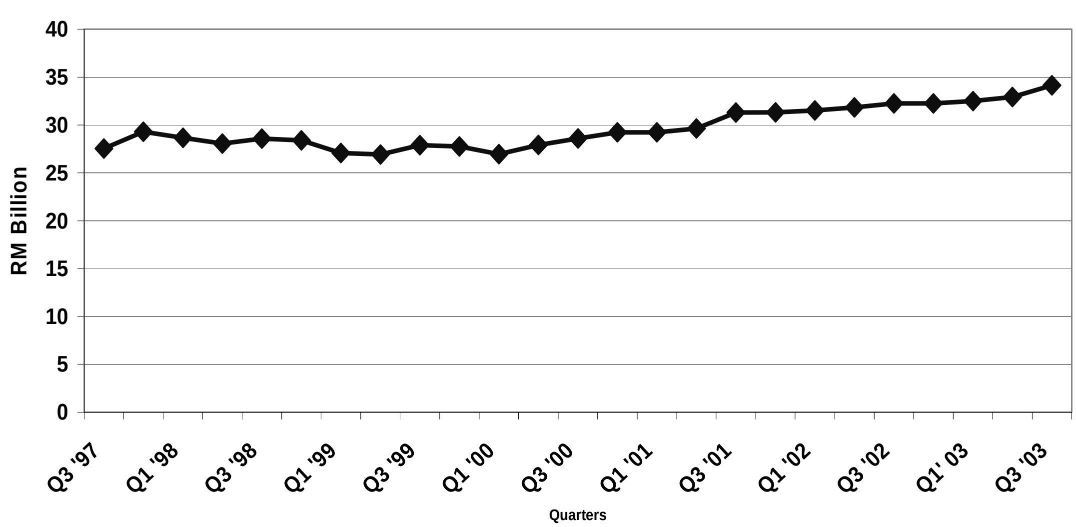
Loan Disbursements

Bank Negara statistics for Q3 2003 show marked increase in total loans disbursed. This upward trend has been evident since the beginning of 2000 (see Chart 5.d.1). This increase represents a 3.7% hike over the last quarter and a 5.8% increase compared to the same quarter last year(Table 5.d.2). The increase is fueled by positive growth in all sectors except for non-residential sectors, purchase of consumer durable goods, mining & quarrying, manufacturing, utilities, community, social and personal services. The total value of loans disbursed in Penang for the third quarter stood at RM34.14 billion.

Sectors registering y-o-y double-digit growths include construction (26.8%), purchase of securities (22.8%), agriculture, fishing, and hunting (16.7%), purchase of residential properties (13.7%), and credit card (12.7%). Conversely, the utilities and mining & quarrying sectors witnessed significant declines, approximating 30% or more.

In Table 5.d.1, we see that loans disbursed to the residential property sector which constituted 27.6% of total loans in the third quarter, continues to head the list. This is followed by loans to the manufacturing sector (20.4%), transport vehicles sector (14.3%) and WRRH (10.9%). Loans to the construction industry only constituted 4.6% of total loan disbursements.

Chart 5.d.1: Total Loans Disbursed in 1997 to 2003 for Penang



Source: Bank Negara Malaysia

Table 5.d.1: Amount of Loans By Sectors for Q3'03 in Penang

Sectors	Amount (RM Millions)	% Share
Purchase of securities	624.044	1.8
Purchase of transport vehicles	4,897.695	14.3
Purchase of residential property	9,424.349	27.6
Purchase of non-residential property	2,042.420	6.0
Personal use	1,105.176	3.2
Credit card	827.315	2.4
Purchase of consumer durable goods.	15.514	0.0
Agri.,hunting,forestry & fishing	326.460	1.0
Mining & quarrying	16.277	0.0
Manufacturing	6,977.543	20.4
Electricity,gas & water supply [utilities]	15.702	0.0
Construction	1,556.598	4.6
Wholesale,retail, restaurants & hotels	3,710.919	10.9
Transport,storage & communication	493.961	1.4
Financial, insurance,real estate & bus. services	1,423.021	4.2
Community,social & personal services	417.654	1.2
Sectors n.e.c. (not otherwise classified)	270.830	0.8
Total	**34,145.478**	**100%**

Source: Bank Negara Malaysia

Table 5.d.2: Changes in Sectoral Loans Compared to the Previous Quarter and Same Quarter Previous Year

Sectoral Loans	Previous Quarter (q-o-q)	Same Quarter Previous Year (y-o-y)
Purchase of securities	4.4%	22.8%
Purchase of transport vehicles	6.8%	9.7%
Purchase of residential property	4.0%	13.7%
Purchase of non-residential property	0.0%	-2.7%
Personal use	0.7%	1.6%
Credit card	5.1%	12.7%
Purchase of consumer durable goods.	-6.5%	-21.8%
Agri.,hunting,forestry & fishing	4.6%	16.7%
Mining & quarrying	-5.2%	-29.8%
Manufacturing	0.4%	-4.2%
Electricity,gas & water supply [utilities]	-19.7%	-32.2%
Construction	23.2%	26.8%
Wholesale,retail, restaurants & hotels	1.5%	5.2%
Transport,storage & communication	-1.6%	8.5%
Financial, insurance,real estate & bus. services	10.2%	5.7%
Community,social & personal services	2.8%	-24.5%
Sectors n.e.c. (not otherwise classified)	-14.5%	-21.8%
Total	3.7%	5.8%

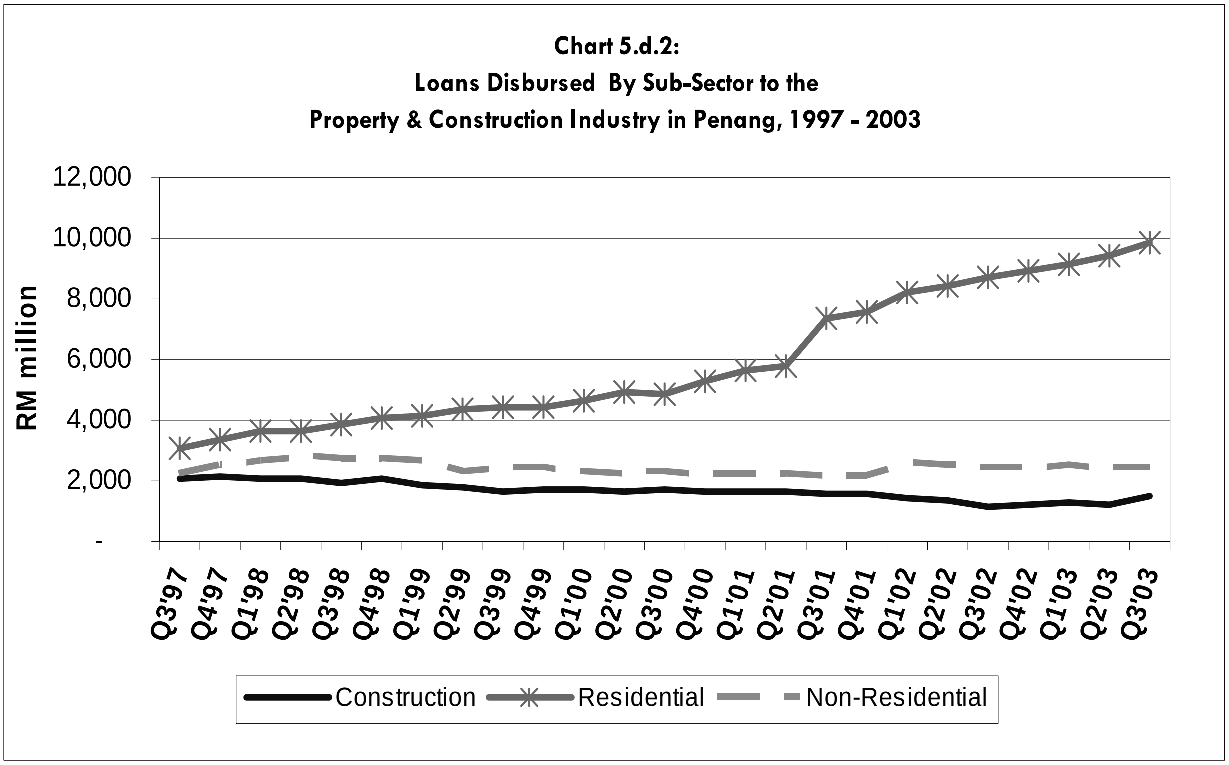
Source: Bank Negara Malaysia

Loans to the Property & Construction Sector

Loans to the residential property sector rose 13.7% y-o-y this quarter, to RM 9.42 billion. On a q-o-q basis, the Q3 2003 was 4% higher (Chart 5.d.2).

This rising trend of residential property loans has been on-going many years, i.e. since the Q4 1997. It shows that the purchase of residential property in Penang continues to be steady and sustainable compared to the non-residential sector and the construction sector. Chart 5.d.2 shows that loans to the residential sub-sector stands in sharp contrast over marginal growths witnessed in the other two sub-sectors. However, house buyers are still cautious and prefer to choose high-rise residential units and properties in selected locations. The prices for such properties in choice locations remained steady.

Loans to the non-residential property sector rose by a dismal 0.5%, valued at RM2.04 billion compared to the last quarter (Q2 ‘03) but shrunk by 2.7% when compared to the same quarter last year (Q3 ‘03). This clearly shows that the overhang of non-residential property such as commercial and office space, especially in George Town (for example, the new EPF building at Jalan Sultan Ahmad Shah) and its suburbs, have not yet been taken up. The uptake of these properties will continue to be slow as investor sentiments remain cautious.

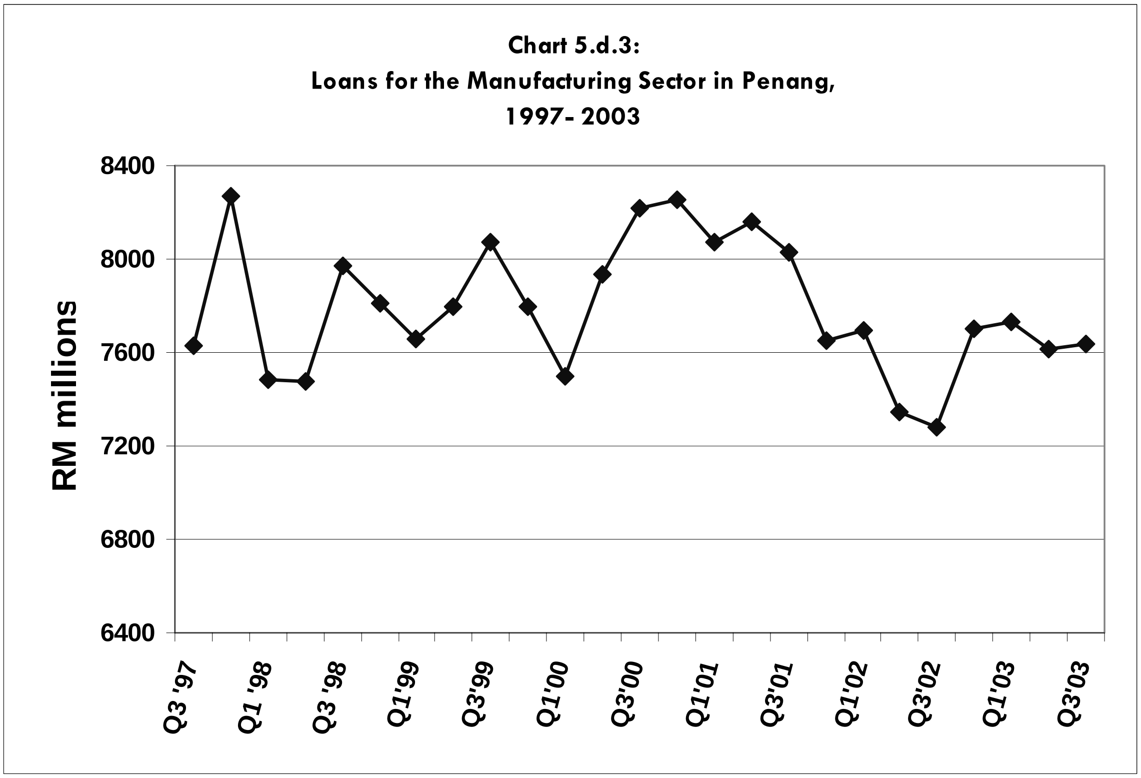


Source: Bank Negara Malaysia

Loan disbursements to the construction sector in Penang fared better this quarter and saw a sharp rise of 23.2% over the last quarter (Q2 '03) and did even better when compared to the same quarter last year (Q3 '02) at 26.8%. This was evidently not true last year when the sector experienced negative growth in terms of loans disbursement, both on a q-o-q as well as y-o-y basis. The value of loans disbursed was RM1.56 billion. This shows that the construction industry has finally picked up with the completion of projects like the Jelutong Expressway, the Tanjung Tokong to Tanjung Bungah expressway, the continuation of Butterworth Outer Ring Road and the elevated highway along Jalan Sultan Azlan Shah.

<u>Loans to the Manufacturing Sector</u>

On a q-o-q basis, loans disbursed to the manufacturing sector in Penang rose 0.4%, from RM6.95 billion to RM6.98 billion. There is however, a decrease of 4.2% on a y-o-y basis. Chart 5.d.3 below shows that the amount of loans disbursed has risen sharply after the third quarter following a slight dip beginning the first quarter. This is due to brighter global economic outlook and a return of positive consumer sentiments.

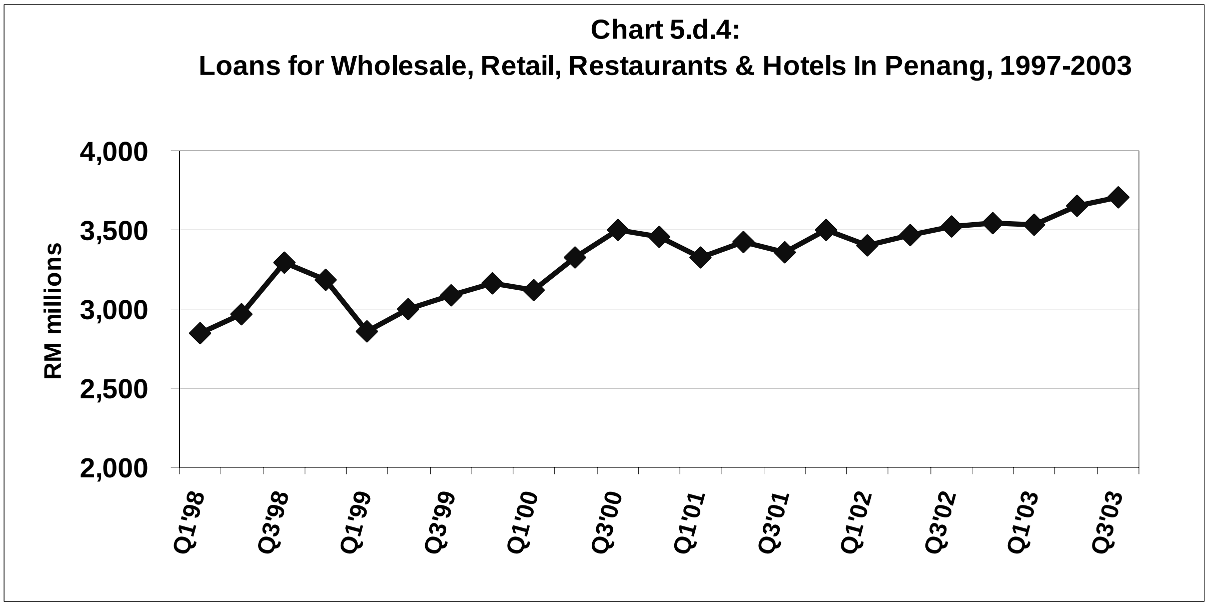


Source: Bank Negara Malaysia

<u>Loans to the Wholesale, Retail, Restaurants and Hotels (WRRH) Sector</u>

Loan disbursement to the wholesale, retail, restaurants and hotels (WRRH) sub-sectors rose by 1.5% in the third quarter on a q-o-q basis and by 5.2% y-o-y. Total loan disbursement to this sector amounted to RM3.7 billion.

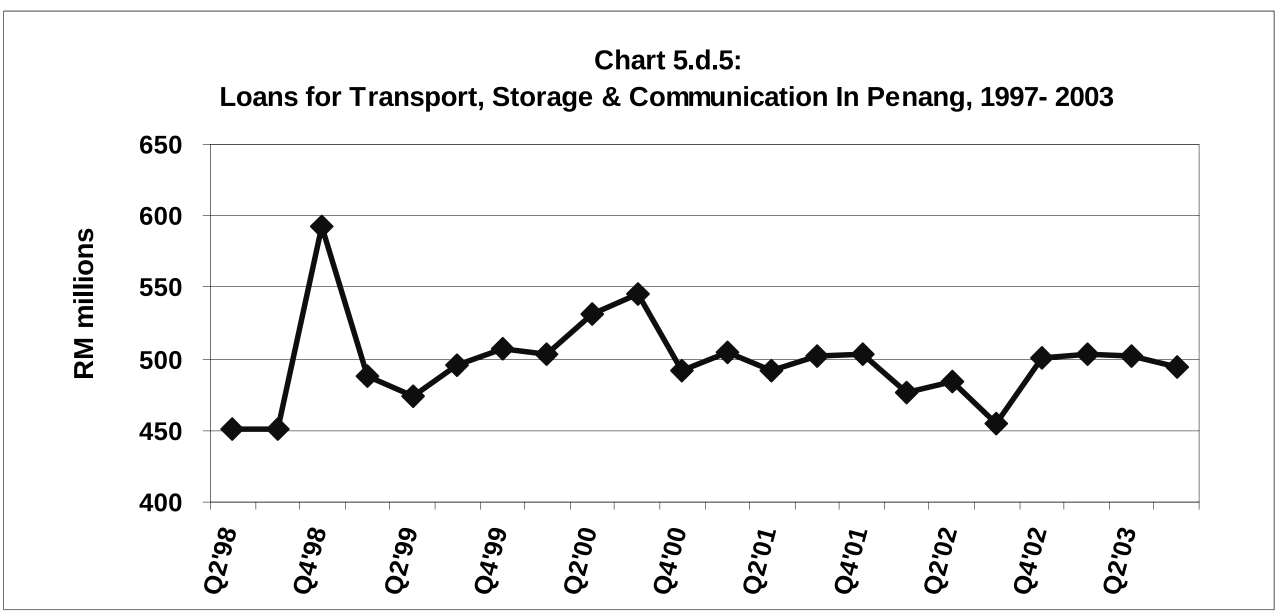
The WRRH sector is doing much better compared to the previous quarter (Q2 '03) during which the SARS outbreak caused hotels to suffer from substantive room cancellations from both domestic and foreign tourists. Local wholesale business, retail outlets, restaurants and hotels have seen a pick up in business as domestic consumption returned. The prevailing Mega Sales continue to have a positive impact on this sector.



Source: Bank Negara Malaysia

Loans to the Transport, Storage and Communication Sector

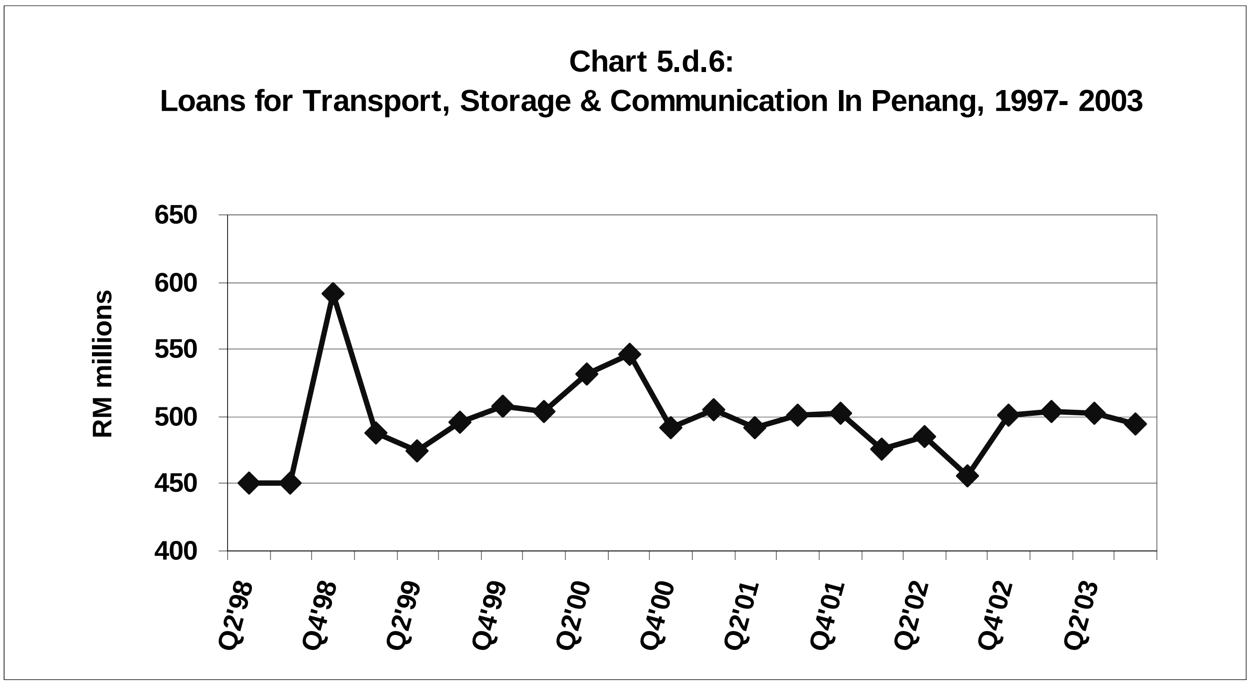
Loans to the transport, storage and communication sub-sectors declined by 1.6% q-o-q but rose by 8.5% y-o-y. Since the first quarter of 2002, loans to this sub-sector have been hovering slightly under RM500 million. Total amount of loans for this year is RM493 million. The transport, storage and communication sub-sector is influenced by development in other related sectors such as manufacturing and WRRH.



Source: Bank Negara Malaysia

Loans to the Vehicular Sector

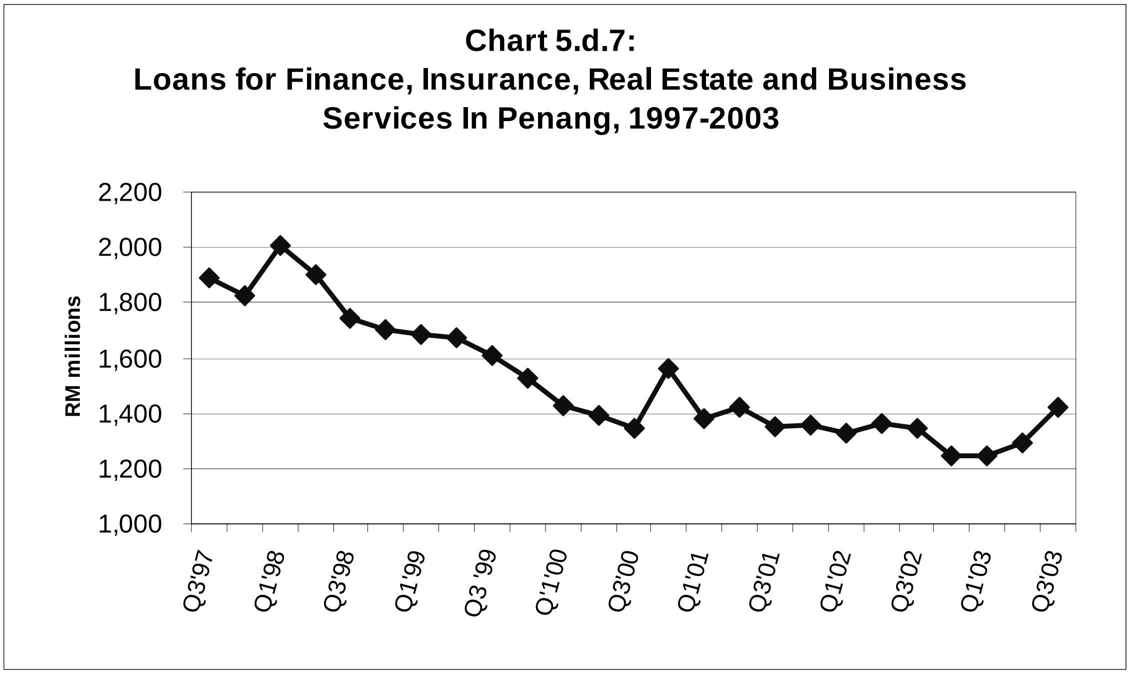
Overall there is a rising trend in loans disbursed for the vehicular loans sector. Vehicular loans increased sharply by 6.8% compared to the previous quarter (Q2 '03) and by 9.7% compared to the same quarter last year. The rise could be traced to the low interest rate environment that has been present since last year. Value of loans for this sector was RM4.9 billion in Q3 2003, as compared to RM4.6 billion during the previous quarter.



Source: Bank Negara Malaysia

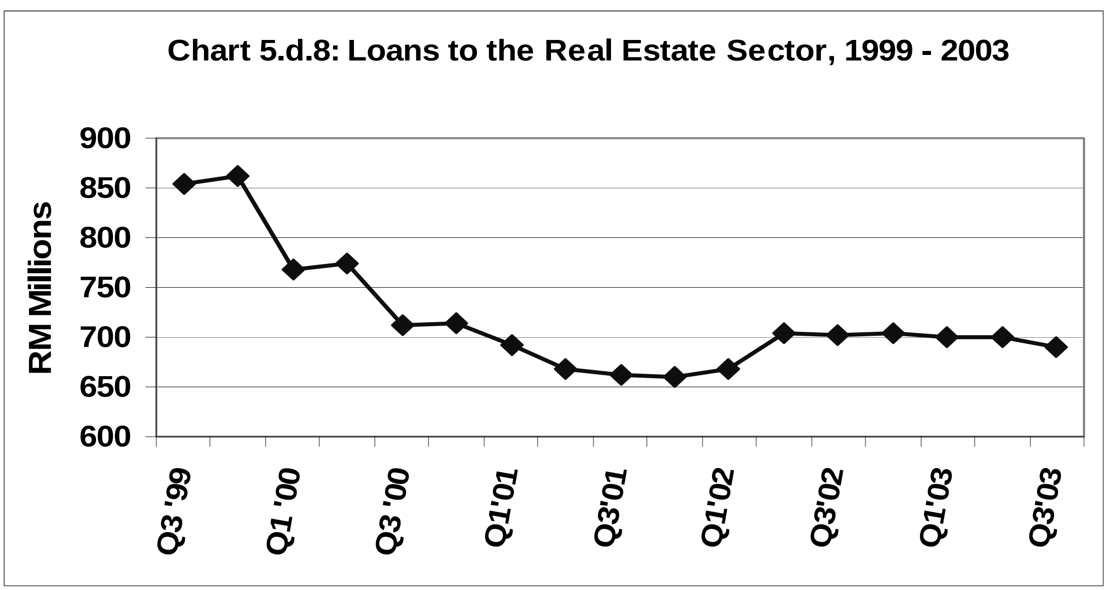
Loans to the Finance, Insurance, Real Estate & Business Services (FIREBS) Sector

Loans to the FIREBS sub-sector rose sharply by 10.2% in comparison to the last quarter and 5.7% on a y-o-y basis (Chart 5.d.7). This situation stands in contrast to that of last year where declines were recorded for the same periods. The value of loans for the latest quarter is RM1.42 billion.



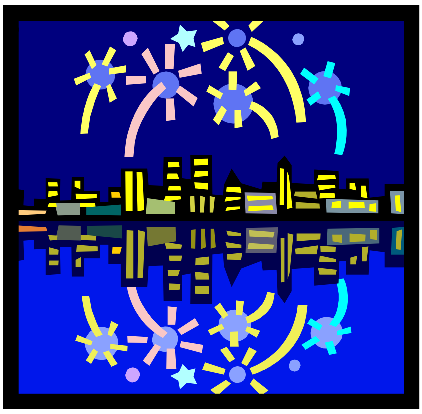
Source: Bank Negara Malaysia

From Chart 5.d.8, we see that the real estate sub-sector under the FIREBS category saw a marginal decline of 1.4% q-o-q and 2% y-o-y. The decline, however, is not a cause for concern as the change is very slight and probably reflects seasonal cycles. The overall trend shows that loans picked up since Q1 2002 after marked decline since Q4 1999. This means that more people are borrowing money for the purchase of properties other than the residential and non-residential properties. The scarcity of land in the state is a driving factor.



Source: Bank Negara Malaysia

Section 5e to 9 available on "Part 2." Plea



SERI would like to wish its readers a belated **Happy New Year.**

To those who are celebrating Chinese New Year, ***"Gong Xi Fa Chai."*** May the year of Monkey bring prosperity to you, your family, and the state of Penang.

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