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Abstract

The article presents the economic outlook for Malaysia from 2007 to 2010. Islamic financial services products are expected to increase by 73% in 2007 and are projected to strengthen in coming years. The country is forecast to maintain its position as the world's leader in Islamic banking and finance. The country introduced a number of tax exemptions and incentives to all Islamic banking and takaful (Islamic acceptable insurance) companies to help in an increasingly competitive industry.

RISK SUMMARY

POLITICAL RISK

Reshuffle Attempts To Revamp Government's Image

Prime Minister Abdullah Ahmad Badawi has begun the task of rebuilding shattered voter confidence in his administration by overhauling his cabinet. The reshuffle has seen a new head appointed to every ministry barring finance, defence, education and plantations, and the number of positions within the cabinet streamlined from 90 to 68. There has, however, been little change at the top, with Abdullah retaining his duel role as finance minister, Najib Razak once again being appointed deputy prime minister and defence minister and the country's economic team left largely unchanged.

Malaysia's short-term political rating is 83.8.

ECONOMIC RISK

Electronic Exports Remain Under Pressure

Malaysian exports grew 14.5% y-o-y in February – their quickest pace since November 2006. Exports of crude oil were up 55.4% y-o-y, while palm oil shipments expanded by a massive 103.8%, but while this is indeed a positive development, downside risks to exports still remain. Crude oil accounts for only 7.6% of total exports while palm oil contributes just 8.0%. Electronic exports – accounting for 37.3% of overall shipments – dropped 6.0% y-o-y in February, boding ill for export performance going forward.

Malaysia's short-term economic rating is 82.7.

BUSINESS ENVIRONMENT

DMA To Enhance Derivatives Market

Bursa Malaysia has announced the introduction of Direct Market Access (DMA) for the derivatives market, in line with the exchange's efforts to enhance market accessibility and trading efficiency. DMA is a 'zero-touch electronic trading' solution which enables investors to route orders directly to the exchange for immediate execution, and will significantly reduce the time for orders to be sent and matched. It will also provide greater access to international investors as it facilitates the introduction of internet trading for the derivatives market.

Malaysia's overall business environment rating is 61.5. It scores 65.7 for infrastructure, 59.4 for institutions and 59.3 for market orientation.

ECONOMIC OUTLOOK

Bright Future For Islamic Finance

BMI View: Demand for shari'a-compliant financial products continues to boom amid rapidly rising incomes across the Islamic world. Malaysia remains among the world's leaders in Islamic finance, and its position as a global hub for the industry should only strengthen going forward.

The burgeoning market for Islamic finance products continues to go from strength to strength, with global sukuk issuances (the benchmark asset class among Islamic finance products) rising 73% in 2007 to a record US$47.1bn, despite a slowdown across virtually all other finance sectors. Malaysia retained its position as the world's leader in this field (both by volume and value), accounting for approximately US$25bn of the global total.

Malaysia has Islamic banking assets totaling MYR113.5bn (US$30.9bn), takaful (Islamically acceptable insurance) assets worth MYR6.2bn (US$1.7bn) and an Islamic private debt securities (IPDS) market valued at MYR125bn (US$34bn) – equivalent to 45.5% of total domestic corporate bonds. It is also estimated that active Islamic money markets in Malaysia channel about MYR30-40bn a month. Furthermore, Malaysia also has a very diversified base of Islamic finance market participants, with Islamic banks, investment banks, takaful companies, development financial institutions, savings institutions, stock brokers and unit trusts all actively trading in shari'a-compliant products.

The secret of Malaysia's success in creating such a vibrant market lies in the government's progressive attitude towards developing and nurturing Islamic banking and finance. Prime Minister Abdullah Ahmad Badawi's administration has actively pursued its goal of establishing Malaysia as a key Islamic finance centre by combining a comprehensive regulatory and supervisory framework that caters to the unique characteristics of Islamic finance.

The Islamic Banking Act of 1983 and Takaful Act of 1984, enacted to govern the conduct of Islamic banking institutions and takaful operators, have established strong standards for corporate governance, transparency, disclosure, accountability, market discipline, risk management and customer protection, and allow Islamic finance firms to operate in an environment that offers a conducive and effective legal and shari'a framework. Additionally, the creation of the Institute of Islamic Banking and Finance Malaysia (IBFIM), the International Centre for Leadership in Finance (ICLIF) and the International Centre for Education in Islamic Finance (INCEIF) has greatly benefited the development of human capital in regards to Islamic banking and finance, vastly enhancing the level of skill and knowledge within the sector.

In order to cement its place at the top of the Islamic finance world, however, Malaysia has also moved to introduce a number of tax exemptions and incentives as it seeks to gain the upper hand in an increasingly competitive industry. Abdullah, who also acts as the country's finance minister, announced in this year's budget a number of new measures aimed at helping the sector move forward:

Income tax exemption for 10 years will be given to all Islamic banking and takaful companies that conduct their business in foreign currencies.

An additional 20% stamp duty exemption will be given on instruments related to Islamic financing for three years. This additional exemption is given after providing for tax neutrality between conventional and Islamic financing.

Income tax exemption for 10 years will be given to local and foreign fund managers who manage Islamic funds for foreign investors. Islamic fund management companies will also be allowed to be 100% owned by foreigners, and Islamic fund managers will be allowed to invest all of their assets abroad.

Personal tax relief on study fees, up to a maximum of MYR5,000 per year, will be extended to Islamic studies conducted in institutions of higher learning, including the International Centre for Education in Islamic Finance. In addition, income tax exemption will now be given to non-resident consultants with expertise in Islamic finance.

Tax deductions will be given on expenses incurred in establishing an Islamic stock broking firm, and will also be extended (from year of assessment 2008 to 2010) for all other firms on expenses incurred in the issuance of Islamic products.