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**Abstract**

The article reports on the fuel price increase implemented by Malaysian administration under Prime Minister Abdullah Ahmad Badwai. This action caused thousands of Malaysians to gather in Kuala Lumpur to protest against fuel hikes, giving more pressure for the prime minister and giving support to a restored opposition. Cost-cutting measures were carried out in an effort to mollify detractors.

## RISK SUMMARY

### POLITICAL RISK

#### Territorial Dispute Remains Unresolved

The long-running dispute between Malaysia and Singapore over the sovereignty of Pulau Batu Puteh islet (also known as Pedra Branca islet) looks set to continue following an International Court of Justice (ICJ) ruling over the disputed territory. The ICJ ruled on May 23 Pulau Batu Puteh to be under the sovereignty of Singapore, while the Middle Rocks belong to Malaysia. Meanwhile, the other outcrop, South Ledge, was judged to belong to the state in the territorial waters of which it is located, and is consequently now subject to further negotiations.

Malaysia's short-term political rating is 83.8

### ECONOMIC RISK

#### Commodities Boost Exports

Malaysian exports continue to find substantial support from soaring commodity prices, leaping from 5.5% y-o-y growth in March to 20.9% in April, marking the fastest expansion in three-and-a-half years, as shipments of crude petroleum and palm oil climbed by 53.3% y-o-y and 71.3%, respectively. Meanwhile, exports of electrical and electronic products snapped a five-month streak of declines to post growth of 12.8%. However, strong commodity prices also served to push up imports, which grew 10.0% y-o-y in April, up from 2.9% in March, substantially exceeding a consensus forecast for a 5.1% expansion.

Malaysia's short-term economic rating is 84.0.

### BUSINESS ENVIRONMENT

#### Petronas Expansion Plans Unveiled

Malaysia's state-controlled oil and gas company, **Petroliam Nasional Berhad** (Petronas), has agreed to pay US$2.51bn to purchase 40% of Australian gas producer **Santos**' Gladstone liquefied natural gas (LNG) project. The move to bring in technical expertise and finance from a major LNG producer will strengthen Santos' development plans for the facility. The deal also supports Petronas' strategy of acquiring overseas assets that can be used to supply gas to the Asia Pacific region, the most rapidly growing gas market in the world.

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.

POLITICAL OUTLOOK

# Fuel Price Hikes Underscore Policy Dilemma

**BMI View:** Prime Minister Abdullah Ahmad Badwai's tenure continues to look increasingly fragile following the government's unpopular fuel price hike on June 4. While the 41% and 63% price increases for petrol and diesel, respectively, were necessary steps to prevent Malaysia from sliding towards fiscal disaster, the inflationary impact of the policy moves threatens to pile yet more pressure on the ruling Barsian Nasional (National Front) coalition, and further undermine its beleaguered leader.

June 8 saw thousands of Malaysians gather in Kuala Lumpur to protest against the recent fuel hikes implemented by Abdullah's administration, piling on yet more misery for the prime minister and his National Front coalition and giving further support to a rejuvenated opposition. Already at a 14-month high, having reached 3.0% y-o-y in April, central bank Governor Zeti Akhtar Aziz has said that consumer price inflation may jump to a nine-year high in June after the fuel-price rise, and that full-year inflation is now expected to average 4.2% this year, up from 2.0% in 2007. Zeti has also suggested that price growth would not peak until 'sometime in the early part of next year', a reality that has riled consumers across the country.

In an effort to placate detractors, Abdullah unveiled an MYR2.0bn (US$612.6mn) cost-cutting package on June 9, the main feature of which was a reduction in allowances for government ministers. As part of the package, entertainment allowances of cabinet ministers will be cut by 10%, paid annual vacations will be limited to Association of Southeast Asian Nations (ASEAN) countries and government seminars and workshops will now be held on government premises rather than at private hotels. There will also be a partial hiring freeze in the civil service and a 10% cut on services and supplies provided to the government.

In addition, the government has said that it will continue to review planned 'mega-projects', with only those deemed essential to proceed, while the date for a cash rebate for owners of small- and medium-sized vehicles – designed to partially offset the fuel price hike – will be brought forward by two weeks to June 14. Furthermore, in an effort to prevent industrial action by public transport operators, Abdullah has announced that such companies will be allowed to buy diesel at the old subsidised rate, while the government will also increase the threshold of the poverty rate – which currently stands at a monthly income of MYR691 (US$212) – so that more people have access to social welfare.

However, such efforts are at risk of being overlooked as the attention of consumers, who have long been accustomed to some of the cheapest pump prices in the region, are drawn solely towards the sharp fuel price increases. This has placed yet more pressure on Abdullah, who only narrowly avoided another crisis just two weeks previously following the resignation of the influential Mahathir Mohamad from the ruling United Malays National Organisation (UNMO) on May 19. Abdullah was forced to call an emergency meeting of Malaysia's top policymaking body, the supreme council, after the former prime minister, who led the UMNO for 22 years before stepping down in 2003, and who still holds great sway in Malaysian politics, said that he would not return to the UNMO while Abdullah was still in charge. Lawmakers rejected Mahathir's calls for other UNMO members to quit in favour of rallying behind Abdullah, but if the government's popularity continues to pall, the support of party members will likely follow suit.

Thus, Abdullah is increasingly finding himself between a rock and a hard place. The current testing economic climate calls for tough decisions and decisive action, yet such decisions will inevitably prove unpopular among an increasingly disenchanted electorate. The recent fuel hikes are a case in point. The price increases of petrol and diesel will save the government an estimated MYR13.7bn (US$4.23bn), without which its fiscal deficit would reach clearly unsustainable levels. However, the decision to do so has met with vehement opposition. It is inconceivable that this will be the last unpopular yet ultimately necessary call Abdullah and his administration will be forced to make this year, meaning that either key economic actions will be left untaken, or that the Barisan Nasional must gird itself for a further waves of backlash.