BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Statutory Requirements

In accordance with section 48 of the Central Bank of Malaysia Act 1958, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Annual Accounts for the year ended 31 December 2003, which have been examined and certified by the Auditor-General. The Annual Accounts will also be published in the Gazette.

Zeti Akhtar Aziz
Chairman
Board of Directors

26 March 2004

Board of Directors

Dr. Zeti Akhtar Aziz
D.K. (Johor), P.S.M., S.S.A.P., D.P.M.J.
Governor and Chairman

Dato' Mohd Salleh bin Hj. Harun
D.S.D.K.
Deputy Governor

Dato' Ooi Sang Kuang
D.M.P.N.
Deputy Governor

Tan Sri Dato' Seri Dr. Samsudin bin Hitam
P.S.M., P.N.B.S., D.C.S.M., S.S.A.P., S.M.J., D.P.M.T., D.P.M.P., J.S.M., K.M.N., A.M.N.
Secretary General to the Treasury

Datuk Oh Siew Nam
P.J.N.

Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor
P.S.M., D.A., P.N.B.S., J.S.M., J.B.S., A.M.N., P.B.J. P.P.D.(Emas)

Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee
P.S.M., D.I.M.P., D.M.S.M., D.G.P.N.

Dato' N. Sadasivan
D.P.M.P., J.S.M., K.M.N.

Governor	Dr. Zeti Akhtar Aziz
Deputy Governor	Dato' Mohd Salleh bin Hj. Harun
Deputy Governor	Dato' Ooi Sang Kuang
Assistant Governor	Datuk Zamani bin Abdul Ghani
Assistant Governor	Dato' Mohamad Daud bin Hj. Dol Moin
Assistant Governor	Datuk Latifah Merican Cheong
Assistant Governor	Dato' Mohd Razif bin Abd. Kadir
Secretary to the Board	Mohd Nor bin Mashor
Directors/Heads of Department	
Governor's Office	Ng Chow Soon
Internal Audit	Yahaya bin Haji Besah
Legal	Gopala Krishnan Sundaram
Economics	
Monetary Assessment and Strategy	V. Vijayaledchumy
Economics	Dr. Phang Hooi Eng
International	Wan Hanisah binti Wan Ibrahim
Foreign Exchange Administration	Mahdi bin Mohd. Ariffin
Statistical Services	Chan Yan Kit
Regulation	
Bank Regulation	Nor Shamsiah binti Mohd Yunus
Insurance Regulation	Donald Joshua Jaganathan
Islamic Banking and Takaful	Bakarudin bin Ishak
DFI Regulation	Che Zakiah binti Che Din
Risk Management	Teo Kee Tian
Supervision	
Bank Supervision I	Azizan bin Haji Abd Rahman
Bank Supervision II	Chung Chee Leong
Insurance Supervision	Sani bin Ab. Hamid
Payment Systems	Ahmad Hizzad bin Baharuddin
Information Systems Supervision	Ramli bin Saad
Special Investigation	Kamari Zaman bin Juhari
Financial Intelligence	Koid Swee Lian
Investment and Operations	
Investment Operations and Financial Market	Muhammad bin Ibrahim
Finance	Abdul Aziz bin Abdul Manaf
Organisational Development	
IT Services	Hong Yang Sing
Human Resource Management	Mainor bin Awang
Human Resource Development Centre	Lim Lai Hong
Corporate Services	Mohd Nor bin Mashor
Corporate Communication	Abu Hassan Alshari bin Yahaya
Strategic Planning	Mior Mohd Zain bin Mior Mohd Tahir
Currency Management and Operation	Hor Weng Keng
Security	Ahmad bin Mansur
Property and Services	Zulkifli bin Abd Rahman
Chief Representative	
London Representative Office	Lillian Leong Bee Lian
New York Representative Office	Shamsuddin bin Mohd Mahayiddin
Branch Manager	
Pulau Pinang	Ong Boon Teck
Johor Bahru	Ishak bin Musa
Kota Kinabalu	Yusoff bin Yahaya
Kuching	Nallathamby s/o Nalliah
Kuala Terengganu	Mokhtar bin Mohd Noh
Shah Alam	Hamzah bin Abu Bakar

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Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The more optimistic global environment and stronger domestic economic conditions have enhanced Malaysia's prospects as we advance into 2004. The renewed strength of the recovery of the world economy is now supported by a more synchronised expansion of the major industrial economies and the strong growth in the Asian region. While economic and financial policies have been important in providing the stimulus to the improved overall growth performance, the increasing significance of the private sector in driving this growth has increased the prospects for the sustainability of these positive trends.

Strong domestic demand has been particularly evident in the Asian region, reflecting the increased role of the private sector in driving the growth. This strong growth in regional demand has provided a rapidly expanding market for Asian goods and services. The increased regional integration is, however, not only occurring as a result of the growth in intra-regional trade, but also in the form of financial flows, with intra-Asian investments gaining greater significance, resulting in a growing amount of the savings in Asia being reinvested in the region. As these trends become more pronounced, they would not only contribute towards greater regional integration but would also reinforce further the regional growth momentum. In addition, the growing demand from the Asian economies has also been increasingly supportive of the global recovery. Indeed, this trend would contribute towards reducing the external imbalances existing in the global economy and increase the prospects for a more balanced global growth.

The Malaysian economy in 2003 benefited from the more robust external demand and increased private sector activity in the domestic economy. A better-than-expected economic performance of 5.2% was recorded during the year. The growth momentum is projected to strengthen further in the region of 6 – 6.5% in 2004, with the private sector assuming the lead role as the engine of growth. Private consumption and investment activity are projected to be stronger, underpinned by improved economic and employment conditions and stronger balance sheets in both the corporate and financial sectors. Growth is expected to be stronger across almost all sectors of the economy, with the services and manufacturing sectors being the main drivers of growth. While the role of the Government in the economy remains important, the focus of policy has now shifted to providing an enabling environment, including enhancing the Government delivery system to reduce the cost of doing business, and to providing a stable and sound macroeconomic environment.

The underlying economic and financial fundamentals have continued to strengthen in the early part of 2004, according monetary policy the flexibility to remain supportive of private sector activity. This is reflected in the near absence of inflationary pressures in both the consumer and asset markets and excess capacity in the system, evident in the gap between actual and potential output. Price stability has also been reinforced by productivity improvements and further capacity expansion. In addition, as the globalisation process intensifies, there is increased access to goods and services at lower costs. Moreover, as the corporate sector performance improves, higher costs will not always translate into higher prices in this more competitive environment. The Government's fiscal prudence has also been a factor in reinforcing price stability. Against this environment, low interest rates can remain for some time to come.

In this stable environment, and with the much strengthened banking system and progress achieved in the development of the financial infrastructure, it is timely to transition to the new interest rate framework. The aim is to achieve greater efficiency in the operations of the financial markets and thus facilitate more effective pricing in the financial system as well as enhance the effectiveness of the monetary transmission mechanism. The window of opportunity will therefore be taken during this period when the current interest rate policy will remain unchanged. This will provide the market with the opportunity to adjust to the new monetary operating procedures to achieve the desired outcome of more efficient functioning financial markets and increased effectiveness of monetary policy.

Liquidity has remained ample in an environment of a strong external balance, a steady inflow of foreign direct investment and increased portfolio inflows. Sterilisation operations, however, have been conducted, taking into consideration the need to ensure adequate liquidity to support financing of the private sector-led growth, while at the same time, ensuring that this does not result in any risks to the financial system and to the economy. Important to this process is that the Central Bank has the instruments and the capacity to absorb this liquidity. The costs involved in these operations are essentially covered by the returns on the investment of the increased inflows. The Central Bank will absorb such immediate-term costs of monetary policy to ensure the stability and sustainability of our medium and long-term prospects. In the current environment, the net position has continued to remain positive. In managing the reserves, a well-diversified reserves portfolio is maintained. Major considerations taken into account are capital preservation and liquidity, while optimising returns. This has ensured a sound financial position for the Central Bank.

On the exchange rate, the objective of our policy remains unchanged, that is, to achieve exchange rate stability, in particular, with our trading partners. As our trade with the region becomes increasingly significant, exchange rate stability in the region becomes increasingly important. At the very outset, when the pegged exchange rate arrangement was introduced almost six years ago, we have stated that we want an effective exchange rate mechanism that will efficiently facilitate international trade and investment. While there may be trade-offs, the benefits of the present system have far outweighed any costs. Consideration for an alternative system should only be made in the event of anticipated fundamental misalignment or structural change or if new regional arrangements can be evolved.

Extreme movements and high volatility in exchange rates have always been a concern, even to the major economies. For emerging market economies, the ramifications of such movements are even more pronounced and far-reaching. Recent pronouncements and pressures on Asian economies to adopt more flexible exchange rate regimes have been based on the view that adjustments in the exchange rate would correct structural imbalances in the global economy. It needs to be recognised that the comparative advantage that Asia possesses is not due to exchange rates but reflects other factors that have resulted in lower costs. Adjustments in exchange rates are therefore unlikely to correct such structural imbalances. In addition, whether exchange rate appreciation can address any signs of overheating needs to take into account the nature of the price pressures. In situations where the pressures are sectoral or localised, other measures, including prudential measures, may be more effective in addressing these developments. Indeed, the exchange rate should not be used for the purpose for which it may not be able to yield the desired results.

In strengthening our competitiveness, Malaysia has adopted a more comprehensive strategy, addressing all dimensions that will enhance competitiveness. This includes strategies to enhance labour quality and productivity, innovation, enterprise and the public delivery system, applied not only to the manufacturing sector but to all sectors of the economy. The strategy is essentially to assess costs on a more comprehensive basis. The strategy is towards achieving an enhanced overall cost competitiveness, leveraging on our low country risk, including the economic, social and political stability, reliable intellectual property protection framework, and our industrial maturity. Moving forward, efforts will therefore be focused on developing an efficient supply chain that is reinforced with local supporting industries, and on becoming more knowledge-based with the necessary skills and competencies.

An integral part of the strategy on competitiveness is to develop a robust Small and Medium-Scale Enterprises (SME) sector that will be able to contribute more significantly to the economy. Two years ago, Bank Negara Malaysia proposed a comprehensive framework for the development of SMEs to provide an enabling environment and to strengthen the infrastructure for SME development. The progress of the work achieved thus far will be deliberated by the National SME Development Council. The Council, which is being set up by the Government, will function as the highest policy-making body that will chart the future direction and strategies for SME development and ensure coordination and comprehensiveness of the policies.

As part of the efforts to enhance overall cost competitiveness, reduce country risks and sustain our position as a destination of choice for both local and foreign investors, a gradual liberalisation of rules and regulations will be undertaken by Bank Negara Malaysia to improve the delivery systems and reduce regulatory costs to business. Leveraging on technology to improve the surveillance system on capital flows has improved the ability to monitor the risks associated with these flows. This has therefore enabled the further deregulation and liberalisation of foreign exchange rules. In addition to the liberalisation in early 2003, further liberalisation of foreign exchange rules will take effect from 1 April 2004 to improve efficiency in the delivery system, while further reducing the cost of doing business.

In the development of the financial system, significant progress has been achieved during the first three years of the Financial Sector Master Plan. The efforts to evolve a more diversified financial structure that is complemented with the development of strengthened financial institutions have now yielded positive results. While the banking sector is still the main mobiliser and provider of financing, the more diversified financial infrastructure has increased the potential for new and alternative channels to mobilise savings as well as increased the alternative sources of financing. Financing from the capital market, in particular, the private bond market, specialised financial institutions and the insurance sector, have now become more significant. The provision of financial services to micro-enterprises has also been strengthened, while venture capital as an alternative form of financing has provided increased support to the new areas of growth that are more technology and knowledge intensive.

Significant progress has been achieved on institutional development and capacity building. The level of capitalisation, the capacity to lend to a wider range of activities, the level of operational efficiency, the level of skills, the more differentiated scope of business, the level of innovation, the standards of service quality and the risk management capacity have shown significant improvements. This is reflected, in particular, in the lower operating costs, the narrowing of margins, and the wider range of new products and services. These improvements are also reflected in the ability of the domestic institutions to maintain market shares in an environment of increased competition and narrowing margins.

The supporting infrastructure has also been strengthened to reinforce this trend. These include the consumer education programme, the strengthening of the Credit Guarantee Corporation, the establishment of the International Centre for Leadership in Finance to develop world-class leaders in the financial services sector and the new Financial Mediation Bureau to be established this year. Work is also underway to develop a deposit insurance scheme that will add another layer to the consumer protection framework, representing a further building block in our financial infrastructure. Of significance is that it is designed to take into account the structure and conditions in our financial system and economy. The deposit insurance system will have a broader mandate that will integrate the financial restructuring processes and structure within its operations. The system will also be the first to provide for the protection of Islamic deposits in line with Shariah principles. These developments have also been complemented by improvements in the regulatory and supervisory framework to ensure the soundness and resilience of the financial system.

Access to financing to a wider range of activities in the private sector, in particular, to the SMEs, continues to improve. Outstanding loans to SMEs grew at an annual rate of 10% in 2003. Financing to the private sector and to the SMEs is expected to remain robust in 2004. Other measures that have supported this trend include the establishment of the Small Debt Resolution Committee, supported by Bank Negara Malaysia's SME Special Unit and continued availability of Bank Negara Malaysia's special funds that currently amount to RM5.6 billion. New avenues are also being developed to increase the SMEs' access to capital market funding.

As the financial sector evolves to meet the needs of increasingly sophisticated consumers, attention has been directed to ensure that basic banking facilities are widely available and that these facilities are offered at minimal costs to all segments of society. In addition, as banking consumers become more empowered by their awareness of financial products and facilities, they will exercise their rights and ability to select between products and services offered by different institutions. This, combined with the transparency requirements, will ensure that pricing is commensurate with the financial products and services. The competitive process is also expected to result in more competitive pricing of products and services and encourage greater innovation.

The insurance industry continued to perform an important role in supporting economic growth as a mobiliser of long-term funds and as a risk transfer mechanism. An important aspect in the development of the insurance industry is also the increasing socio-economic role of insurance in meeting the demand for healthcare financing support. This is being realised through the increasing provision of medical and health insurance products. As major institutional investors, insurers have an increasingly important role in the development of the capital markets. The insurance fund assets have increased significantly in 2003 to account for the largest share of the total fund assets of the industry. During the year, the framework governing insurance market practices, including claims handling practices, standards of product disclosure and dispute resolution mechanisms, were further strengthened to ensure greater consumer protection. A comprehensive consumer education programme was also launched to promote a larger role for consumer activism in the insurance business and practices and to ensure competitive prices to consumers.

The comprehensiveness of the Islamic financial system in Malaysia, in terms of both the pool of Islamic financial players as well as the broad spectrum of innovative Islamic financial products have enhanced the role of the Islamic financial system as a financial intermediary and enabler of economic growth. Further progress in the development and expansion of the Islamic financial system was achieved in 2003. Policy initiatives have focused on liberalising the domestic Islamic banking system, increasing the level of competition, and promoting financial innovation. Other measures were also directed towards strengthening and broadening the legal framework for Islamic banking and finance. On the global front, the Islamic Financial Services Board (IFSB) has drawn wide participation and has made significant progress in fulfilling its mandated role. The promulgation of standards on the capital adequacy and risk management is progressing rapidly and work on establishing standards for corporate governance has already been initiated. The year has also seen further Islamic-based issues accessing the international capital markets. Cumulatively, these developments have enhanced the role of Islamic finance as an integral component of the international financial system.

Bank Negara Malaysia has continued its developmental role during the year, over and above our core mandate of monetary and financial stability. This broader mandate is outlined in our Financial Sector Master Plan and essentially takes a holistic approach in the development and management of the financial system. While efforts to address areas of vulnerability and identifying emerging risks are important, these need to be complemented with efforts to build the financial infrastructure. Institutional and capacity building are necessary foundations for the financial system. It is in this context that the Central Bank drives the development of the financial sector.

Zeti Akhtar Aziz
Governor

26 March 2004

The Malaysian Economy in 2003

The Malaysian Economy in 2003

The Malaysian economy demonstrated greater resilience in the face of uncertainties to expand by 5.2%, more rapidly than previously forecast.

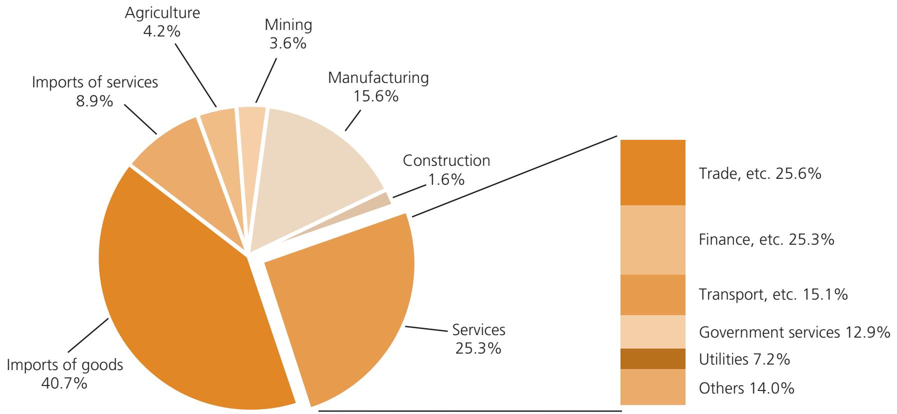
OVERVIEW

While events in the first half of the year had an impact on growth, the mutually reinforcing combination of strong economic fundamentals, supportive monetary and financial policies and decisive Government action provided the platform for growth to accelerate in the second half. For the year as a whole, real gross domestic product (GDP) expanded by 5.2% (2002: 4.1%), exceeding the official forecast of 4.5%.

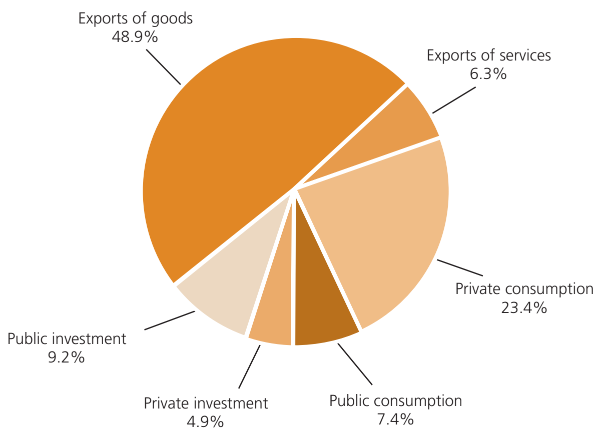
Growth in 2003 was broad based and balanced across sectors. The manufacturing sector grew by 8.2% on the back of strong production growth, both in the export-oriented and domestic-oriented industries. Export-oriented industries, particularly the electronics and chemicals industries, benefited from the recovery in the global electronics sector as investment demand picked up in most major economies. This growth was also seen in the strong expansion in manufactured exports (8.2%) and capacity utilisation levels that exceeded 80%. In

Graph 1.1
The Economy in 2003 (at 1987 Prices)

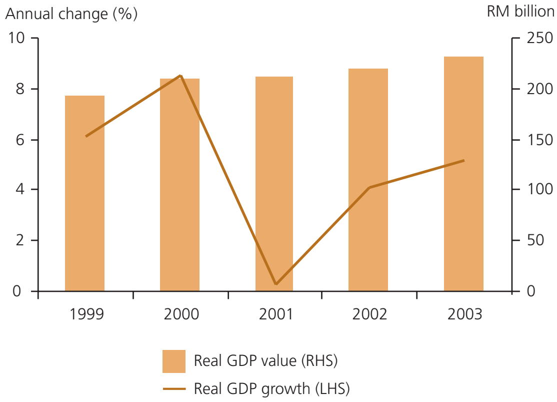
Supply of goods and services (RM458.3 billion)



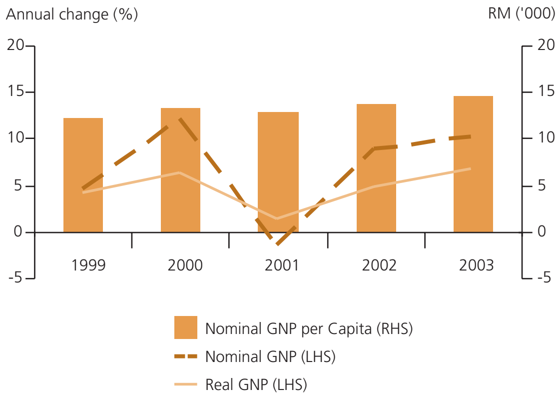
Demand for goods and services (RM458.3 billion)



Graph 1.2
Real GDP



Graph 1.4
GNP Growth and Nominal GNP per Capita



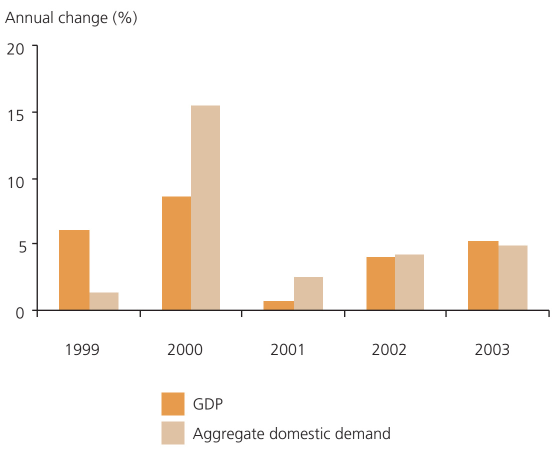
certain industries, the 90% utilisation level was breached in 2003, prompting an increase in capital expenditure.

The agriculture sector also enjoyed higher growth of 5.5% as higher production and prices, mainly of palm oil and rubber, drove growth. The mining sector, which grew by 4.8%, also enjoyed the benefits of higher prices. In addition, the production capacity in the sector was enhanced with the MLNG Tiga plant and four new oil and gas fields each coming on-stream. Higher prices and improving external demand conditions led to the strong growth in exports of primary commodities (30.4%).

The services sector experienced the greatest impact from the uncertainties in the first half, most notably the impact of the severe acute respiratory syndrome (SARS) outbreak on tourism and travel-related activities. The wholesale and retail trade, hotels and restaurants sub-sector and air passenger travel segment, in particular, were severely affected as the number of tourist arrivals dropped significantly from a pre-SARS monthly average of one million to about half that number in April. However, the impact of SARS proved transitory and these sub-sectors recovered rapidly in the second half. In addition, the strong loan growth, increased use of new services in the cellular telecommunications segment and sustained volume of international trade ensured that growth in the sector remained resilient. The sector recovered rapidly and for the year as a whole expanded by 4.1%.

Growth in the construction sector moderated to 1.9% due to slower growth in the civil engineering sub-sector as a result of the completion of several privatised projects. On the other hand, strong

Graph 1.3
Real GDP and Aggregate Domestic Demand



Graph 1.5
Contribution to Real GDP Growth:
Domestic Demand and Net Exports

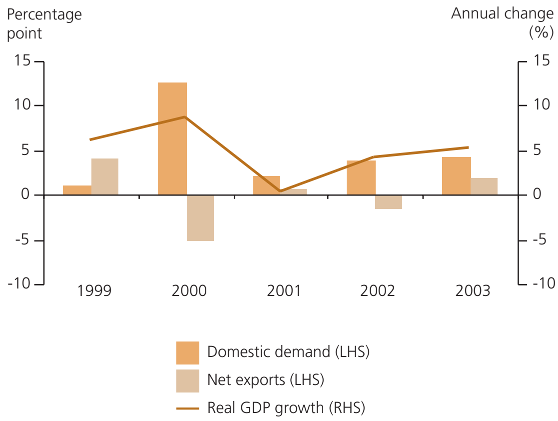


Table 1.1: Malaysia – Key Economic Indicators

		2001	2002	2003*p*	2004*f*
Population (million persons)		24.0	24.6	25.1	25.6
Labour force (million persons)		9.9	10.2	10.5	10.9
Employment (million persons)		9.5	9.8	10.2	10.5
Unemployment (%)		3.6	3.5	3.5	3.4
Per Capita Income	(RM)	12,855	13,683	14,592	15,376
	(US$)	3,383	3,601	3,840	4,046
NATIONAL PRODUCT (% change)					
Real GDP		0.3	4.1	5.2	6.0 – 6.5
(RM billion)		210.6	219.3	230.7	244.6
Agriculture, forestry and fishery		-0.9	3.0	5.5	2.6
Mining and quarrying		-0.8	3.7	4.8	5.5
Manufacturing		-5.8	4.0	8.2	10.2
Construction		2.1	2.3	1.9	1.5
Services		5.8	4.1	4.1	5.2
Nominal GNP		-1.6	8.7	10.1	6.5
(RM billion)		308.7	335.6	369.4	393.3
Real GNP		1.2	4.7	6.6	5.6
(RM billion)		193.0	202.1	215.4	227.5
Real aggregate demand[1]		2.5	4.2	4.8	5.0
Private expenditure[1]		-3.3	0.7	4.3	8.7
Consumption		2.4	4.4	5.1	8.1
Investment		-19.9	-13.1	1.1	11.5
Public expenditure[1]		15.6	10.8	5.5	-1.3
Consumption		17.0	12.2	7.9	4.2
Investment		14.5	9.8	3.6	-5.7
Gross national savings (as % of GNP)		34.9	34.4	36.9	35.8
BALANCE OF PAYMENTS (RM billion)					
Goods		69.9	72.1	97.7	96.4
Exports (f.o.b.)		334.3	357.7	398.9	443.3
Imports (f.o.b.)		280.2	303.1	317.7	366.8
Services balance		-8.4	-6.0	-15.0	-11.9
(as % of GNP)		-2.7	-1.8	-4.1	-3.0
Income		-25.6	-25.1	-22.6	-24.7
(as % of GNP)		-8.3	-7.5	-6.1	-6.3
Current tranfers		-8.2	-10.6	-9.3	-9.8
Current account balance		27.7	30.5	50.8	50.0
(as % of GNP)		9.0	9.1	13.7	12.7
Bank Negara Malaysia reserves, net[2]		117.2	131.4	170.5	–
(as months of retained imports)		5.1	5.4	6.8	–
PRICES (% change)					
CPI (2000=100)		1.4	1.8	1.2	1.5
PPI (1989=100)		-5.0	4.4	5.7	–
Real wage per employee in the manufacturing sector		1.6	3.2	2.6	–

Note: Figures may not necessarily add up due to rounding.

[1] Exclude stocks.

[2] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account.

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f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	2001	2002	2003*p*
FEDERAL GOVERNMENT FINANCE (RM billion)			
Revenue	79.6	83.5	92.8
Operating expenditure	63.7	68.7	75.2
Net development expenditure	34.2	35.1	38.5
Overall balance	-18.4	-20.3	-20.9
Overall balance (% of GDP)	-5.5	-5.6	-5.3
Public sector net development expenditure	59.7	69.1	72.0
Public sector overall balance (% of GDP)	-0.3	-0.7	-0.4
EXTERNAL DEBT			
Total debt (RM billion)	173.4	185.6	187.2
Medium and long-term debt	149.3	153.6	152.8
Short-term debt[1]	24.1	32.1	34.5
Debt service ratio (% of exports of goods and services)			
Total debt	6.8	6.7	6.1
Medium and long-term debt	6.6	6.5	6.0

	Change in 2001		Change in 2002		Change in 2003	
	RM billion	%	RM billion	%	RM billion	%
MONEY AND BANKING						
Money Supply M1	2.5	3.2	8.3	10.3	13.0	14.6
M2	7.8	2.2	21.0	5.8	42.5	11.1
M3	13.0	2.9	31.6	6.7	48.5	9.7
Banking system deposits	8.6	1.8	25.3	5.3	49.5	9.8
Banking system loans[2]	16.1	3.9	19.8	4.6	21.8	4.8
Manufacturing	…	…	-1.2	-2.0	-0.2	-0.3
Broad property sector	12.4	8.2	10.8	6.6	14.7	8.4
Finance, insurance and business services	0.7	2.2	-2.5	-7.7	-0.6	-1.9

	2001	2002	2003
Loan-deposit ratio	85.9%	84.9%	80.9%
Financing-deposit ratio[3]	95.7%	95.1%	91.7%

	2001 %	2002 %	2003 %
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)			
3-month interbank	3.27	3.13	2.87
Commercial banks			
Fixed deposit 3-month	3.21	3.20	3.00
Fixed deposit 12-month	4.00	4.00	3.70
Savings deposit	2.28	2.12	1.86
Base lending rate (BLR)	6.39	6.39	6.00
Finance companies			
Fixed deposit 3-month	3.22	3.20	3.00
Fixed deposit 12-month	4.01	4.00	3.68
Savings deposit	2.94	2.65	2.18
Base lending rate (BLR)	7.45	7.45	6.90
Treasury bill (3-month)	2.73	2.82	2.77
Government securities (1-year)	2.93	2.94	2.93
Government securities (5-year)	3.18	3.15	4.28

	2001 %	2002 %	2003 %
EXCHANGE RATES			
Movement of Ringgit (end-period)			
Change against composite	3.5	-3.4	-3.2
Change against SDR	3.8	-7.3	-8.5
Change against US$[4]	0.0	0.0	0.0

[1] Excludes currency and deposits held by non-residents with resident banking institutions.
[2] Includes loans sold to Cagamas.
[3] Adjusted to include holdings of private debt securities.
[4] Ringgit was pegged at RM3.80=US$1 on 2 September 1998.
p Preliminary

demand for housing sustained activity in the residential construction segment.

In 2003, GDP growth was private sector-driven. Private expenditure contributed 2.5 percentage points of the 5.2% growth rate. Both households and the corporate sector benefited from rising disposable incomes, the improving terms of trade for commodities and strengthening external demand. While household incomes increased as a result of growth in wages and higher commodity prices, the corporate sector generated higher profits and cash flows from rising productivity and higher export earnings. From a sample of 300 non-financial companies listed on the Kuala Lumpur Stock Exchange (KLSE), 54% recorded higher cumulative profits for the first three quarters of 2003 compared with the same period a year earlier and the annualised return-on-equity rose from 5.4% in the third quarter of 2002 to 7.3% in the third quarter of 2003.

As a result of higher disposable income, especially for households, private consumption increased by 5.1%. In addition, the low interest rate environment, coupled with the high savings rate, provided the impetus for households to increase their borrowings for consumption expenditure. Measures unveiled in the Economic Package in May improved consumer confidence, further supporting consumption expenditure.

A significant development in 2003 has been the turnaround in private investment, which increased by 1.1% after two years of contraction. The improved economic outlook, particularly in the second half, stronger corporate balance sheets and cashflow positions and high capacity utilisation, especially in the manufacturing sector, prompted increased capital spending. In addition, the low interest rate environment and the steps taken to improve companies', especially the small and medium enterprises' (SMEs), access to finance, provided the impetus for capital expansion.

The public sector continued to play an important role in sustaining domestic demand, especially in the first half. Real public consumption increased by 7.9% due to higher spending on supplies and services. On the other hand, real public investment growth moderated to 3.6% in line with the moderate increase in Federal Government development expenditure and lower capital spending by the non-financial public enterprises.

As a result, real aggregate domestic demand (excluding change in stocks), increased more rapidly by 4.8%. However, this pick-up in demand did not lead to an increase in inflation. The Consumer Price Index (CPI) increased more moderately by 1.2% during the year (2002: 1.8%), with core inflation – inflation that excludes price-volatile and price-administered items – amounting to 0.6% in spite of higher commodity prices. While stronger economic growth led to a narrowing of the output gap, it was not completely eliminated and reflected excess capacity in selected sectors.

In 2003, the external sector's contribution to growth turned positive (2 percentage points; 2002: –1.3 percentage points), primarily due to the acceleration of exports of goods in the trade account by 11.5% (2002: 7%). The trade surplus increased to RM81.1 billion (2002: RM54.6 billion). Sustained consumer demand and the pick-up in investment activity in the major industrial economies as well as higher commodity prices spurred the growth in exports of manufactures and primary commodities. On the other hand, import growth moderated to 4.8% (2002: 8.1%) as exports of primary commodities, unlike manufactured exports, had a low import content. Further, the changing pattern of investment, especially foreign direct investment (FDI), into the services sector were smaller in scale but had higher potential to generate value added. As a result, imports of capital goods remained relatively stable (0.7%).

The large trade surplus, coupled with a smaller income account deficit brought about by the repatriation of earnings from overseas investments by Malaysian firms, more than compensated for the larger services account deficit (RM15 billion) due to lower tourism receipts. As a result, the current account surplus increased to RM50.8 billion, equivalent to 13.7% of gross national product (GNP) (2002: 9.1% of GNP).

The financial account in the balance of payments remained stable, recording a deficit of RM12.1 billion (2002: -RM11.9 billion). Stronger inflows of funds for investment were balanced by higher repayments and prepayments of external debt by the public sector and overseas investments by Malaysian companies. FDI into Malaysia remained significant while funds for portfolio investment turned around to record an inflow as the KLSE staged a markedly improved performance, especially since the third quarter.

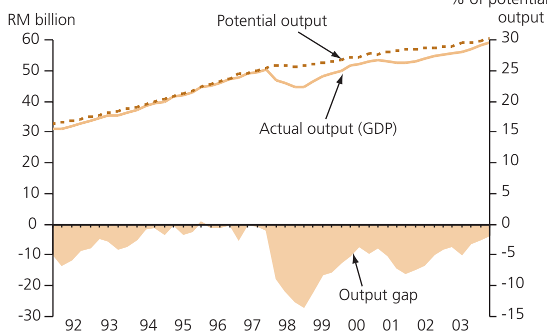
Potential Output of the Malaysian Economy

Potential output is output derived from the full use of available capital and potential employment, which is the level of employment that is consistent with the "natural" or "long run" rate of unemployment. Therefore, the potential output is defined as the maximum capacity of output that the economy can achieve without experiencing either inflationary pressures or external imbalances. The output gap is the difference between actual and potential output and is measured as a percentage of potential output. When actual output is lower than its potential, the output gap is negative and, theoretically, output can sustain an increase without exerting undue inflationary pressures on the economy.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential output	Investment	Labour	Output Gap
	Annual change (%)				(% of potential output)
1992-1997	9.2	8.2	14.1	3.9	-1.9
1998	-7.4	3.7	-43.0	-2.1	-11.4
1999	6.1	2.4	-6.5	3.7	-8.3
2000	8.5	4.0	25.7	4.3	-4.3
2001	0.3	3.2	-2.8	3.3	-6.9
2002	4.1	1.7	0.3	3.1	-4.8
2003	5.2	3.4	2.7	3.3	-3.1

Graph 1
Actual and Potential Output



During the high growth years of the early 1990s, actual output closely followed its potential, as shown in Table 1 and Graph 1. Amidst the pronounced contraction in output experienced after the Asian financial crisis, the output gap had widened significantly in 1998 but as the economy recovered, the gap narrowed. In 2002, the output gap was 4.8% compared to 6.9% in 2001. Subsequently, in 2003, the stronger pickup in economic activity compared to the growth in potential output led to a further narrowing of the output gap. Bank Negara Malaysia's latest estimates of potential output indicated that actual GDP increased at a faster pace (5.2%) compared to potential GDP (3.4%). Nevertheless, the faster growth of GDP did not exert inflationary pressures as actual GDP would have to increase by more than 8% before the output gap could be bridged in 2003.

The potential growth rate doubled in 2003, due mainly to stronger growth in capital investment (2.7%; 2002: 0.3%) as business sentiment improved amidst higher capital utilisation rates in selected sectors of the economy.

The estimated short-run elasticity of capital is significantly higher than the short-run elasticity of labour, implying that changes in capital have a greater impact on output and that returns to capital have continued to improve. This has encouraged firms to accelerate their investment activities, including the upgrading of technological capabilities that, in turn, could have had an immediate impact on output.

In line with previous findings, the long-run elasticity of capital, which is estimated to be 0.50, is higher than its short-run counterpart. This higher return to capital implies more efficient capital utilisation, as calculated by the ratio of output to capital, which has had a faster rate of increase compared to the ratio of output to labour. Previous supportive infrastructure investments, which have long gestation periods, have begun to show positive returns, while stronger investment activities were visible in the services sector, mainly in technology and logistics infrastructure. With the greater focus and emphasis placed on a knowledge-driven economy, expectations are for potential output to expand further.

As a result of the large current account surplus, sustained inflows of funds for investment, including FDI, and revaluation gains from the translation of non-US dollar assets into ringgit terms, the net international reserves of Bank Negara Malaysia increased to RM170.5 billion, or equivalent to US$44.9 billion at the end of 2003. This represented an increase of RM39.1 billion or US$10.3 billion during the year. The increasing trend in reserves continued into 2004. By 15 March, the reserves rose to RM194.9 billion or US$51.3 billion, sufficient to finance 7.8 months of retained imports and was 5.2 times the short-term external debt.

Malaysia's external debt position remained stable in 2003, standing at RM187.2 billion or 50.7% of GNP (2002: RM185.6 billion or 55.3% of GNP) in spite of a RM4.1 billion revaluation adjustment that resulted mainly from the appreciation of the euro and yen. Malaysia's external debt position remains sustainable with the debt service ratio improving from 6.7% in 2002 to 6.1% in 2003. In addition, the nation's debt profile remains healthy, with short-term debt accounting for only 18.4% of total external debt.

The health of the banking system improved in 2003, in tandem with stronger economic growth. Banks continue to be well capitalised with the risk-weighted capital ratio sustained at a high level at 13.4%, well above the prescribed 8% mark. The trend for non-performing loans (NPLs) also reversed with the ratio, on a 6-month basis, declining from 7.5% as at end-2002 to 6.8% as at end-2003.

Macroeconomic Management

Coming into 2003, the Malaysian economy was already in a strong position. Private sector activity was exhibiting an upward trend. Commodity prices remained high, providing a significant positive multiplier effect on rural incomes. Further, both the monetary and fiscal stance were conducive to sustaining growth without increase in risk, given the benign inflation outlook, strong external position and the sustainable public sector finances. Given this strength, it was assessed that the economy had the resilience to absorb the impact of uncertainties that could adversely affect growth prospects. Hence, the macroeconomic policy stance was left unchanged in the early part of the year.

By the second quarter, however, the unforeseen SARS outbreak and the weaker-than-expected global economic conditions prompted new policy measures. Economic and financial indicators for the first half-year also indicated that growth in the United States remained well below trend, mainly due to subdued investment. Deflationary concerns and continued financial market volatility cast doubt on the strength of global economic activity. This prompted the authorities to take pre-emptive measures in order to support economic activity. On 21 May, Bank Negara Malaysia reduced its policy rate, the 3-month Intervention Rate, by 50 basis points to 4.5%. This move was aimed at mitigating the effects of a more adverse external environment on domestic demand. A comprehensive economic stimulus and relief package, encompassing fiscal and financing measures, was announced by the Government. The package was designed to provide immediate relief to affected sectors, diversify economic activity and improve long-term competitiveness.

In the short term, the main stimulus measures were designed to provide relief to affected sectors and encourage private consumption in order to diversify the sources of growth. Hotels and restaurants were exempted from service taxes and received a discount on utility charges. Income tax payments for travel agencies were suspended, the road tax on taxis was reduced and import duties on selected items were lowered. In addition, a Special Relief Guarantee Fund of RM1 billion was set up by Bank Negara Malaysia to provide working capital to affected companies while existing funding facilities, especially for SMEs, were enlarged. To encourage consumer spending, employees' contribution to the Employees Provident Fund was reduced by two percentage points and civil servants were given an interim half-month bonus. In addition, measures targeted at construction activities, particularly measures to provide affordable housing to the lower income group, also had a positive effect on consumption.

With the additional expenditure, coupled with revenue foregone arising from the relief measures implemented, the overall Federal Government deficit was revised from the budgeted 4% of GDP to 5.3% of GDP. However, the higher deficit did not exert pressure on domestic consumer prices and interest rates as the high savings rate and excess liquidity in the banking system made it possible for the bulk of the deficit to be financed from non-inflationary domestic sources. While the deficit led to higher Federal Government debt (48.2% of GDP as at end-2003), this level was sustainable. Debt servicing remained low (14% of operating expenditure). Similarly, the Federal Government external debt declined to 9.5% of GDP, thus lowering exposure to external risks. Given the Government's target to achieve a balanced budget in the near term, the debt-to-GDP ratio is expected to decline in the medium term as growth accelerates.

The immediate effect of the measures was to strengthen domestic demand and hence, growth. After recording a 4.5% growth in the first half, real GDP accelerated to 5.2% in the third quarter. As conflict in the Middle East was resolved and SARS abated, domestic consumer and business sentiment improved markedly in the third quarter. Further favourable signs started to emerge from September as growth in the United States exceeded the trend rate in the third quarter following a recovery in investment and a build-up in inventories. In tandem, the other major economies also recorded stronger growth. The mutually reinforcing combination of fiscal expansion and monetary easing provided the platform on which the domestic economy was able to leverage on the accelerating global and regional growth momentum. In the fourth quarter, growth accelerated to 6.4%, the fastest rate since the fourth quarter of 2000.

The reduction in interest rates spurred loan growth, prompted by increased demand from both households and businesses, particularly SMEs. As a result, total financing from the banking system through loans and holdings of private debt securities increased by 5.9%. The demand for credit intensified in the latter part of the year as global economic conditions improved, consequently leading to a strengthening of the growth momentum in Malaysia. In particular, funding to the SMEs increased strongly with a large proportion of new loans directed to this segment. By end-2003, loans to SMEs had expanded by 10% and accounted for 38.4% of all loans outstanding to business enterprises.

As a result of the reduction in the Intervention Rate, ample liquidity and a competitive lending environment, lending rates charged by the banks declined during the year. The average lending rate charged by commercial banks declined further, and at end-year was 39 basis points lower than the end-2002 level. Liquidity remained ample during the year as BNM's operations stabilised inter-bank interest rates at low levels.

The ringgit peg has provided stability and predictability during a period of increased uncertainty in financial markets, thereby facilitating trade and investment activities. While the US dollar depreciated during the year, Bank Negara Malaysia's estimates indicate that the ringgit remains close to its fair value. The surplus in the current account remains large while reserves continue to rise. Domestically, inflation remains low at 1.2% and there appears to be no significant imported inflation. Hence, economic fundamentals continue to support the current exchange rate arrangement.

The proactive monetary and fiscal measures implemented by the Government in response to uncertainties in the first half supported growth and provided the platform for the private sector to take the lead in generating growth. For the longer term, Malaysia has formulated a comprehensive strategic framework to meet new challenges.

The importance of strong fundamentals was demonstrated in 2003. They allowed the Government to implement a wide-ranging and comprehensive response to adverse conditions without creating undue risks. In addition, the successful corporate sector restructuring undertaken in recent years provided the enabling conditions for a positive private sector response to the measures. Equally important, the comprehensive and balanced approach, with fiscal and monetary policy reinforcing each other, increased the likelihood of achieving the aims of the measures.

The May Economic Package did not only serve as a short-term stimulus package but was also an integral part of longer-term initiatives to meet emerging challenges. The Mid-Term Review of the Eighth Malaysia Plan (2001-2005) clearly identifies two major challenges that are becoming increasingly apparent: dealing with the changing dynamics of global competition and increasing capacity to manage risks from greater volatility. Thus, the May Economic Package and the 2004 Federal Government Budget laid out the following strategies to ensure that growth is sustained over the longer term while fundamentals are strengthened:

- **Increase competitiveness by enhancing productivity**
  Integral to achieving this objective is the move towards a knowledge-based economy. Some important strides have been made in enhancing the knowledge content of economic activity in 2003, especially by enhancing education and training and promoting higher value-added industries.

- **Strengthen resilience through sound economic fundamentals and strong financial and corporate sectors**
  The financial sector restructuring process undertaken following the Asian financial crisis has been completed and the corporate sector has begun to increase investments and expand operations. A major milestone in 2003 was Danamodal Nasional Berhad's redemption of bonds with a nominal value of RM11 billion on 21 October. Currently, Danamodal still has assets with a book value of RM2.2 billion. As proceeds from their disposal is expected to exceed book value, the net cost incurred by Danamodal in recapitalising the banking sector is estimated to be 0.15% of GDP. Notwithstanding the successful completion of the restructuring process, regulatory agencies will continue to ensure that Malaysian companies and financial institutions continuously upgrade governance and reporting standards.

- **Stimulate private domestic investment as well as attract quality FDI**
  To promote private investment, a number of measures were directly targeted at SMEs by improving their access to financing as well as making several tax and non-tax incentives available to them. The focus on domestic sources of investment, however, is not at the expense of foreign investors. A number of measures were announced under the economic package that liberalised regulations governing foreign investment.

- **Promote new sources of growth in the manufacturing and services sector**
  Apart from making Malaysia a more conducive location for existing businesses, several sectors were earmarked as new sources of growth. These included education, tourism and health services in the services sector; Islamic finance; and high-technology manufacturing.

- **Revitalise the agriculture sector**
  The agriculture sector recorded the fastest growth after manufacturing in 2003. While high commodity prices provided the incentive for higher production, the sector has deep and strong links with the rest of the economy. As such, measures taken to improve productivity and returns in this sector and develop new downstream activities will have a significant multiplier impact on the rest of the economy.

- **Pursue sound macroeconomic management with fiscal prudence**
  The Government is committed to a programme of gradual fiscal consolidation. Similarly, monetary policy has remained supportive of growth while ensuring risks, either in the form of inflation or external imbalances, are contained.

- **Improve the delivery system of the Government to create a pro-business environment**
  Improved efficiency, especially in the public sector, will effectively reduce costs, thereby boosting competitiveness. Therefore, the final strategic prong was aimed at enhancing the efficiency in the delivery of public services and effectiveness in implementing national development policies and strategies. These included eliminating bureaucratic delays, streamlining regulations and procedures, reducing duplication and shortening waiting periods.

Banking sector policies in 2003 were aimed at enhancing the infrastructure and environment for banking institutions to deliver quality products and services, encouraging greater innovation while maintaining financial stability. In addition, an important strategy was to ensure that the banking system continued to be a facilitator of growth, particularly in providing financing and other ancillary services to the SMEs.

- **Strengthening the capacity of domestic banking institutions**
  During the year, efforts were directed at developing and enhancing the quality of human capital in the banking sector. As the business

environment and consumer demands are constantly evolving, continuous upgrading of skills is necessary, particularly at the top management level. Recognising this, Bank Negara Malaysia initiated two important measures to enhance the quality of human capital in the banking sector. The International Centre for Leadership in Finance was established to accelerate the development of skilled and competent leaders of financial institutions and corporations. Work has also been initiated to reposition Institut Bank-Bank Malaysia to better meet the needs of the financial sector through more focused training and accreditation, particularly in specialised areas.

To provide a conducive environment for banking conglomerates to further improve their group structures, rationalise their operations and improve efficiency, the Banking and Financial Institutions Act 1989 was amended to allow the merger of the commercial bank and finance company within a domestic banking group into a single legal entity.

- **Safeguarding financial stability and fortifying the financial system**
  During the year, steps were taken to strengthen corporate governance practices in the banking institutions. These included enhancing the role of the board of directors, especially independent directors, and regulations covering the appointment of external auditors.

  To ensure that the activities of banking conglomerates do not introduce risks to the financial system, Bank Negara Malaysia is formalising and strengthening the existing infrastructure and regulatory framework. To strengthen the legal framework, the Central Bank of Malaysia Act 1958, the Banking and Financial Institutions Act 1989, the Islamic Banking Act 1983 and the Takaful Act 1984 were amended in 2003. A new Payment System Act 2003 was also enacted to formalise the Bank's oversight authority of the payment system.

- **Ensuring that all sectors of the economy have adequate access to finance**
  Policies were directed at facilitating improved access to credit for the various sectors of the economy, particularly the SMEs. In addition, a micro-financing programme that has an extensive outreach was also established for micro enterprises.

- **Strengthening the consumer awareness and protection framework**
  Active consumerism is a critical prerequisite in the transition towards greater market orientation. Therefore, an effective consumer education and protection framework is being developed to allow banking consumers to eventually take greater responsibility for their financial decisions. To assist consumers in making their decisions, the Bank is currently finalising the product transparency and disclosure rules. Bank Negara Malaysia has also initiated work on establishing a framework on basic banking services, which aims to ensure that the banking public, especially the low-income group, would have access to affordable basic banking services. To enable consumers to seek redress on a broad range of retail consumer issues raised against financial institutions regulated by the Bank, the Financial Mediation Bureau, a one-stop center for the resolution of these issues, will be established in the first half of 2004.

  The increased strength and resilience of the banking system has provided a positive environment for the effective implementation of a deposit insurance scheme in Malaysia. The implementation of the system will further strengthen the consumer protection framework by providing for the explicit protection of deposits as well as greater incentives for sound financial and business practices among banking institutions.

The rapid development of the domestic Islamic financial system, accentuated by significant progress on the global front in recent years, have set the stage for it to play a more prominent role in the economy. Currently, 33 banking institutions, including two Islamic banks, offer a comprehensive range of Islamic financial products and services to the Malaysian public. Similarly, the takaful industry has progressed rapidly, accounting for 5.6% of assets in the insurance sector in 2003. During the year, policy focused on strengthening the institutional infrastructure, enhancing the regulatory framework, strengthening the Shariah and legal infrastructure and developing intellectual capital and consumer education. In 2003, Bank Negara Malaysia brought forward liberalisation in Islamic banking to allow full-fledged foreign Islamic banks in Malaysia.

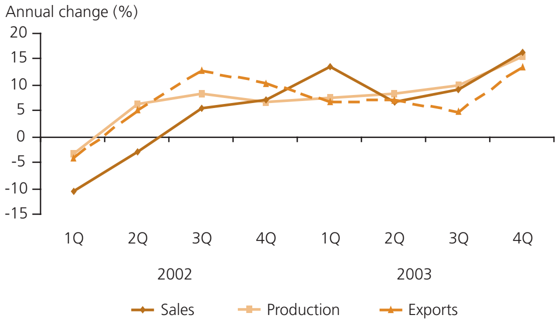
The strategies laid out for sustaining long-term growth will continue to be complemented by appropriate short-term measures. Conversely, taking steps to ensure the long-term sustainability of growth and strength of fundamentals would provide both the resources and platform on which shorter-term corrective measures may be taken. Thus, the interaction between short- and longer-term macroeconomic policies in Malaysia aims to be complementary in nature, one reinforcing the other, to achieve sustained economic development.

SECTORAL REVIEW

Manufacturing Sector

In 2003, output growth in the manufacturing sector gained momentum especially in the second half-year, following the broad-based recovery in the global economy and strengthening domestic demand. Manufacturing production growth strengthened to 10.5% (2002: 4.5%), with expansion across a wide range of products in both the export- and domestic-oriented industries. Consonant with the pick-up in production activities, value-added growth of the manufacturing sector doubled to 8.2% (2002: 4%), and contributed significantly to overall GDP growth. Consequently, the share of the manufacturing sector in GDP rose slightly to 30.9% (2002: 30.1%). The capacity utilisation rate in the manufacturing sector remained high at 82% in 2003 (2002: 82%), with the export- and domestic-oriented industries operating at 86% and 77% respectively (2002: 83% and 81% respectively).

Graph 1.6
Manufacturing Sector: Sales, Production and Exports



Export-oriented industries expanded by 11.9% in 2003, with stronger expansion in the second half-year, led by the cyclical upturn in global electronics demand, and further enhanced by the strong performance of the chemicals and rubber products industries. Given the strong inter-linkages, the chemical industry also benefited from the spillover effects of the upsurge in the electronics industry. Demand for chemical and rubber products were strong, particularly from the US and the Asia-Pacific region. Overall, the outbreak of SARS in the region during the early part of the year had a minimal impact on export-oriented industries, notwithstanding some slowdown in the regional economies.

Pick-up in exports and strengthening domestic demand led to stronger expansion in the manufacturing sector.

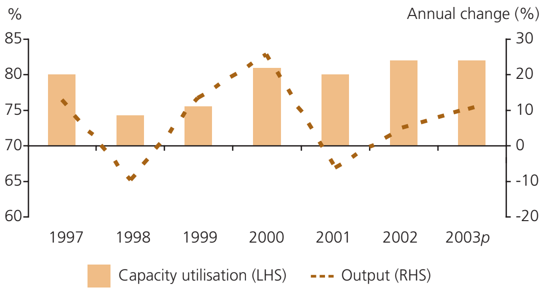
Table 1.3
Manufacturing Sector: Value Added and Production

	2002	2003
	Annual change (%)	
Value added (Constant at 1987 price)	**4.0**	**8.2**
Overall Production	**4.5**	**10.5**
Export-oriented industries	**5.0**	**11.9**
of which:		
Electronics	13.4	15.1
Electrical products	-5.1	-7.0
Chemicals and chemical products	2.7	20.8
Wood and wood products	-6.0	0.9
Textiles and wearing apparel	-6.2	-2.2
Off-estate processing	7.1	11.8
Rubber products	2.0	18.7
Domestic-oriented industries	**3.4**	**6.1**
of which:		
Construction-related products	3.8	10.2
Fabricated metal products	0.8	7.4
Food products	8.7	8.8
Transport equipment	6.2	-5.5
Petroleum products	-4.1	2.3

Source: Department of Statistics, Malaysia.

While the SARS outbreak had affected consumer demand, the Economic Package introduced in May

Graph 1.7
Capacity Utilisation in the Manufacturing Sector



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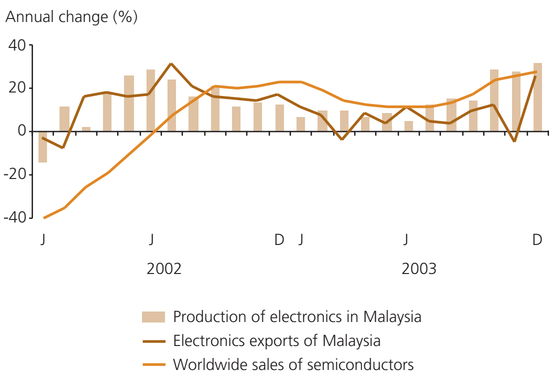
helped to stimulate domestic demand and support the growth of the **domestic-oriented industries** (6.1%). Output was higher in all sub-sectors, except for the transport equipment industry. Of significance, growth strengthened in the fabricated metal products, construction-related materials and food and beverages industries. These industries benefited largely from the improved domestic demand and continued growth in the construction sector. Only the automobile industry recorded lower output, affected by subdued sales of motor vehicles.

The **electronics industry** recorded another year of strong growth following the broad-based expansion in global demand across all geographical regions and products. Expansion in the first-half year was moderate and picked up strongly in the second-half year. Growth emanated mainly from the expansion in the wireless and personal computer (PC) markets as well as consumer electronics products. While growth in wireless products was driven by the rising demand for wireless applications and cell phones, the demand for PCs was led by the PC replacement cycle, which took place in the latter half of the year as companies invested to replace their equipment acquired during the Y2K period. The consumer electronics products experienced strong growth due to growing consumer interest in adopting new technology and multi-functional devices such as camera phones, personal digital assistants (PDAs) and digital video decoders (DVDs). In terms of export markets, the Asia-Pacific region continued to spearhead growth and remained the largest market for the global semiconductor sales. Demand was especially strong from the People's Republic of China (P.R.China), which became the largest importer of chips in the world.

Graph 1.8
Production and Exports of the Electronics Industry



Malaysian manufacturers were able to benefit from the emerging global electronics up-cycle, in view of the diversity in product mix and export markets. Local semiconductor manufacturers continued to move up the value chain from assembly and packaging activities to become full turnkey providers to maintain their competitiveness.

Amidst increased global competition, the performance of the **electrical products** sub-sector continued to deteriorate. The decline was mainly in the audio-visual and telecommunication products as producers who emphasised on low labour cost had relocated elsewhere. Nevertheless, output of air conditioners, refrigerators and other ventilating devices continued to increase in tandem with the improving external demand. Overall, the performance of the industry was also affected by lower offtake from most of the major importers of Malaysia's electrical products, particularly from the US, Japan, Hong Kong China, the United Kingdom and Netherlands. Nevertheless, exports to P.R.China increased strongly.

Growth in the **chemical products industry** accelerated in 2003, benefiting from the spillover effects of the strong pick-up in the electronics industry as well as the improved external demand for organic chemicals, and resins and plastic products. The expansion was further reinforced by the higher output of industrial gases following the commencement of the new MLNG plant in Sarawak. The resins and plastic products sub-sector continued to experience strong growth, driven by stronger domestic demand from the food, construction and packaging industries as well as increased demand from the Asia-Pacific region. In particular, exports of Malaysia's chemical products to major markets, namely P.R.China, Singapore and Japan, continued to expand strongly during the year.

The stronger performance of the **off-estate processing industry** was supported mainly by higher activity in palm oil processing, arising from improved offtake for processed palm oil products, particularly from Japan and Europe. Production of **rubber products** also increased strongly, driven by higher external demand for rubber gloves for medical examinations and surgery. Expansion in production capacity enabled the industry to meet the increased global demand for gloves following tensions in the Middle-East and outbreak of SARS. The industry's aggressive promotions to expand to new export markets also contributed to the increase in demand for gloves. While the US remained as Malaysia's largest export market for rubber products, exports to other countries, namely P.R.China, Hong Kong China, Japan and Singapore, also grew strongly to account for a bigger market share.

Output of **petroleum products** recovered, driven by strong demand from Asian countries, especially from P.R.China, Japan and Singapore. Similarly, output of **wood products** turned around to record positive growth due to higher output of plywood and particleboard. The increase was largely attributable to higher export demand for veneer and plywood arising from the recovery in construction activities in Malaysia's traditional markets, especially Japan, P.R.China and Chinese Taipei. Exports of furniture also increased due to higher demand from the US, Singapore, Saudi Arabia, Australia and P.R.China. While the export performance remained favourable, the furniture and wood products industries faced keen competition from other countries in the region and cheaper substitute products, such as PVC and steel.

The **textiles and wearing apparel industry** registered another year of lackluster performance due mainly to intensive competition from low cost countries. Shipments by major importers, particularly the US, the largest buyer of Malaysian textiles and apparel, continued to contract. Production in the **transport equipment industry** was subdued in 2003 due entirely to lower assembly of motor vehicles. Demand for motor vehicles in the domestic market slowed down as consumers held back purchases due to uncertainty over car prices following the phase-in of the automotive industry into the AFTA framework. The decline in assembly of motor vehicles was, to some extent, offset by higher production of motor vehicle parts and accessories, and assembly of motorcycles and scooters arising from the higher demand for locally-assembled motorcycles and scooters.

Output in the **construction-related materials industries** expanded strongly, supported by higher export demand and continued expansion in construction activity. Growth was particularly strong in the second half-year due to sharply higher production of iron and steel as manufacturers increased their exports to take advantage of the strong demand and higher prices in the export market. As a result, exports of metal products increased strongly, particularly to the US, P.R.China, Japan, Singapore, Thailand and Australia. Production of non-metallic mineral products also increased during the year due to increased demand from the construction sector, especially for production of cement, fabricated construction materials and structural clay products. However, production of glass declined as it was affected by lower export demand as well as subdued demand from the domestic car industry.

Production in the **fabricated metal products industry** increased further, reflecting higher production of structural metals, wire and wire products as well as tin cans and metal products. The expansion was supported mainly by on-going activity in the construction sector and increased demand for packaging materials from the food processing industry. On the other hand, production of brass, copper and aluminium declined due to the lower demand from the electrical products industry.

Meanwhile, growth in the **paper products industry** moderated during the year due to lower production of pulp, paper and paperboard, while the manufacture of containers, boxes of paper and paperboard remained flat. Performance of both the sub-sectors was affected by the oversupply in the market. Nevertheless, the production of the pulp, paper and articles sub-sector continued to expand strongly. Notwithstanding the moderation in production, exports of paper and pulp products increased further due to higher exports to Thailand, P.R.China, the Philippines, Australia and US. Output in the **food and beverages sub-sector** was higher, supported by consumer spending and higher demand from Singapore and Brunei.

Construction Sector

In 2003, the **construction sector** expanded at a more moderate pace of 1.9% (2002: 2.3%) due mainly to a slowdown in the civil engineering sub-sector following the completion of several privatised projects. Growth was mainly supported by the residential sub-sector, while activity in the non-residential sub-sector remained subdued amidst the continued overhang of office and retail space, although the excess supply was reduced during the year.

Activity in the **residential sub-sector** was higher as demand for houses remained strong, especially with the incentives introduced in the Economic Package. Favourable financing conditions, namely low interest rates and attractive loan packages offered by the banking institutions, helped support interest in the residential sub-sector both for new property as well as the secondary market. Construction of new houses gained momentum during the first nine months of the year, as reflected in a 17% increase in housing starts. Reflecting house purchasers' preference for bigger houses due to a rise in affordability following higher disposable income and lower interest rates, the average price of residential units transacted was higher at RM139,700 (2002: RM130,300). Prices of residential properties, including terraced houses as well as high-rise units, remained firm during the year, supported by continued demand for houses in prime locations.

Demand for residential houses was stimulated by innovative financing packages with attractive terms provided by financial institutions. To encourage home ownership, the Economic Package announced by the Government on 21 May 2003 provided the following incentives for one year, beginning 1 June 2003:

- Stamp duty waiver on the Sale and Purchase Agreements, loan and transfer documents for houses costing RM180,000 and below;
- Income tax relief on interest payments for new buyers of completed houses, and first time owners of houses costing between RM100,000 to RM180,000;
- Subsidy of RM600 for new buyers of houses costing below RM100,000; and
- Exemption from real property gains tax.

In line with the Government's objective to provide affordable houses to the low-income group, Syarikat Perumahan Negara Berhad (SPNB) has targeted to build at least 150,000 units of medium-cost and affordable houses within a five-year period. With the liberalisation of the Foreign Investment Committee (FIC) guidelines in 2001, the FIC has approved the purchase of 1,617 units of residential properties (representing an increase of 30.1%) valued at RM771 million by foreigners in Malaysia during the year. However, the purchase of commercial properties by foreigners declined.

Construction sector grew at a moderate rate due to slower growth in the civil engineering sub-sector.

Table 1.4
Residential Property Indicators

	2002	2003
	Units	
Residential property transactions		
Units	162,269	164,723
Value (RM billion)	21.1	23.0
Approvals[1]	198,970	205,518
Developers' licences		
New	1,170	1,062
Renewals	397	436
Sales and advertising permits		
New	1,134	1,103
Renewals	1,666	1,707
Loans by banking system - Value (RM billion)		
Outstanding	100.4	116.6
Approvals	29.2	30.0

[1] Units approved for construction by private developers.

Source: NAPIC, Valuation and Property Services Department, Ministry of Housing and Local Government and Bank Negara Malaysia

To reduce the cost of purchasing low-cost houses and to improve purchasers' access to financing, the following measures were announced during the year:

- EPF contributors who purchase low-cost houses built by SPNB will be provided with end financing from the Malaysia Building Society Berhad;
- State governments will exempt land premiums for the construction of low-cost houses; and
- The exemption from stamp duties in respect of Sale and Purchase Agreements for low-cost houses executed between the purchaser and the developer on or after 1 July 2002 was gazetted in February 2003. In this connection, loan and transfer documents associated with the Sale and Purchase Agreements were eligible for exemption.

On the supply side, housing units approved for construction by private developers in Peninsular Malaysia increased by 3.3% in 2003, with approvals picking up by 23% in the second half-year as developers anticipated higher demand in response to the incentives in the Economic Package. At the same time, new sales and advertising permits issued recorded a strong pick-up of 18% in the second half of the year (first half: -20.1%). However, renewals of permits continued to increase in 2003, reflecting a longer duration required to sell the properties.

In the **civil engineering sub-sector,** growth was significantly slower due to the completion of several privatised projects, mainly power generation plants. Nevertheless, ongoing road projects such as the Kajang Ring Road, Guthrie Corridor Expressway,

Table 1.5
Incoming Supply and Planned Supply of Property

	Incoming Supply[1]	Planned Supply[2]	Incoming Supply[1]	Planned Supply[2]
	June-03*p*		Sept-03*p*	
	Units/'000 sq.m.		Units/'000 sq.m.	
Residential (units)	573,117	533,784	569,994	537,919
Purpose-built office ('000 sq.m.)	1,969	1,890	1,945	1,865
Shopping complexes ('000 sq.m.)	1,479	1,715	1,535	1,639
Retail shops (units)	31,424	34,537	32,507	34,413
Industrial properties (units)	8,616	22,236	8,299	22,174

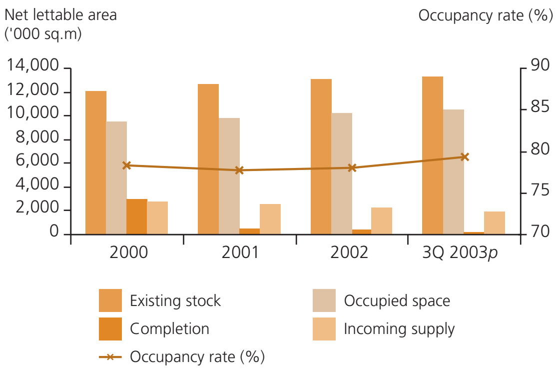
[1] Consists of properties that are under construction, including those where certificates of fitness/temporary certificates of fitness have not been issued.
[2] Approved but not started.
p Preliminary

Source: NAPIC, Valuation and Property Services Department

Penchala Link of the SPRINT Expressway, New Pantai Expressway, Kajang-Seremban Expressway and the Butterworth Outer Ring Road, supported civil engineering activity during the year. Construction work was also ongoing for projects related to water, ports, sewerage and power generation plants. In view of the experience acquired in the domestic civil engineering sub-sector, Malaysian construction companies have diversified their earnings base and expanded overseas, particularly in the construction of highway projects and other infrastructure projects. These companies are able to compete in the global market, particularly in India and the Middle East. Infrastructure projects by the public sector, as reflected in the Federal Government development expenditure, remained strong during the year, especially in the transportation sub-sector. Among the major ongoing public projects supporting growth was the SMART Intelligent Tunnel for Flood Mitigation in Kuala Lumpur and the Kuala Lumpur Convention Centre.

Construction activity in the **non-residential sub-sector** remained subdued as reflected in lower ongoing activity in projects related to purpose-built office and shopping complex. In particular, completion of new office space in the Klang Valley slowed down during the last three years. In the first nine months of 2003, only 93,000 square metres of office space were completed compared with 200,000 square metres in 2002 (2001: 178,000 sq. m; 2000: 1.4 million sq. m). Large shopping complexes that were completed in the Klang Valley include the Berjaya Times Square, Ikano Power Centre, IKEA, Maju Junction and the Great Eastern Mall. The share of new starts to total incoming supply for Malaysia as a whole increased from 2% to 8% in the first nine months of 2003. The average occupancy rate for office space and retail complexes stabilised at 79% and 78% respectively as at end-September 2003, reflecting continued demand, particularly for projects located in choice locations.

Graph 1.9
Supply and Occupancy Rate of Purpose-Built Office Space in Malaysia: 2000 - 2003



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Graph 1.10
Supply and Occupancy Rate of Retail Space in Malaysia: 2000 - 2003

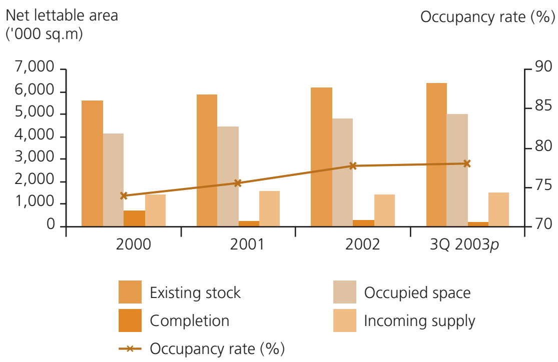

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Table 1.6
Office and Retail Space - Unoccupied Space, Incoming Supply and Planned Supply by State (as at end-September 2003*p*)

	Office Space			Retail Space		
	Unoccupied Space	Incoming Supply[1]	Planned Supply[2]	Unoccupied Space	Incoming Supply[1]	Planned Supply[2]
	('000 sq.m.)					
WP Kuala Lumpur	1,414	1,085	1,028	286	746	649
Selangor	488	55	0	186	138	63
WP Putrajaya	0	295	155	0	66	0
Johor	260	140	493	326	228	789
Pulau Pinang	292	45	39	279	172	52
Negeri Sembilan	24	28	118	41	61	64
Perak	41	49	6	50	4	0
Melaka	25	0	0	56	0	0
Kedah	21	34	1	64	51	14
Pahang	14	15	9	33	0	8
Terengganu	10	0	0	6	7	0
Kelantan	9	4	16	2	63	0
Perlis	1	34	0	0	0	0
Sabah	112	142	0	25	0	0
WP Labuan	38	0	0	15	0	0
Sarawak	57	20	0	40	0	0
Total	**2,806**	**1,946**	**1,865**	**1,409**	**1,536**	**1,639**

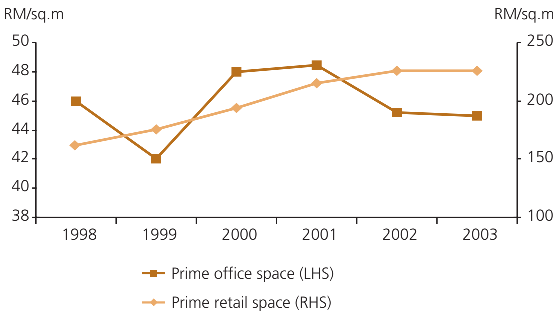
[1] Consists of properties that are under construction, including those where certificates of fitness/temporary certificates of fitness have not been issued.
[2] Approved but not started.
p Preliminary

Source: NAPIC, Valuation and Property Services Department

Rentals for prime office space in the Klang Valley stabilised at RM45 per square metre per month during the year. In the case of shopping complexes, the average monthly rental rates of prime retail space also remained stable at RM226 per square metre. Rentals of office and retail space in secondary locations remained low to attract tenants.

In the case of **hotels**, there were 111 new hotels completed during the year, providing 7,838 additional rooms. However, the hotel industry was adversely affected by SARS, especially during the second quarter of 2003, when tourist arrivals fell by 59% to below 500,000 in April. Arrivals for the year as a whole declined to 10.6 million from 13.3 million in 2002, thus resulting in the average occupancy rate of hotels declining to 53% (2002: 58%).

Graph 1.11
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley[1]



[1] Refers to Kuala Lumpur and Selangor

Source: CH Williams Talhar & Wong Sdn. Bhd.

Availability of adequate financing continued to play an important role in supporting growth of the construction sector. In recent years, there has been a discernible shift in the source of financing for the civil engineering sub-sector. The civil engineering sub-sector has increasingly tapped the capital market by issuing private debt securities (PDS) and also through recourse to Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIMB) to meet its financing requirements. PDS issued for infrastructure projects amounted to RM6 billion out of the total RM42.8 billion PDS issued for the year, representing 14% of total PDS issued (2002: 8%). Similarly, total loans approved by BPIMB for infrastructure projects rose to RM5 billion in 2003 (2002: RM2.8 billion). However, loans outstanding of the banking system for infrastructure projects declined to RM3.4 billion (2002: RM5.2 billion). For residential property, the banking system continued to be the main source of financing. Total housing loans approved by the banking system increased by 2.9% to RM30 billion.

In addition, loans approved by other housing credit institutions as a group also increased during the year. In tandem with higher approvals, housing loans outstanding of the banking system as well as other housing credit institutions rose by 16.1% and 10.4% respectively.

In 2003, construction activity was higher with the return of foreign workers who were repatriated in 2002. Nonetheless, over-dependence on foreign labour remained an issue in raising productivity in the sector. Meanwhile, the Construction Labour Exchange Centre Berhad was set up in 2003 to act as a centre for training and screening of foreign workers as well as supplying and transferring excess foreign workers to contractors who require these workers from time to time.

Another development during the year was the launch of the Building Materials Cost Index by the Construction Industry Development Board in collaboration with the Department of Statistics, Malaysia. The Index gives an indication of pressures arising from input cost. While the Index showed that overall prices of building materials have remained steady from the second half of 2002 until September 2003, some construction companies faced shortages of building materials. The shortage was mainly in steel bars as millers preferred to export their products to take advantage of the higher prices overseas.

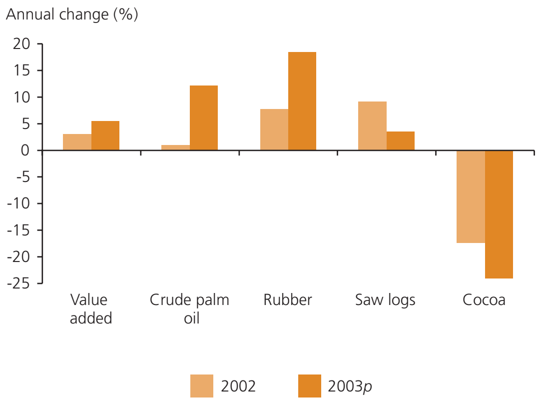
In line with the Government's efforts to streamline the approval and delivery process of the Government machinery, the Ministry of Housing and Local Government implemented a two-tier One-Stop Centre at the local authority and state government levels for building plan approvals and issuance of Certificate of Fitness for Occupation (CFO). In addition, the number of technical departments involved in certifying CFOs was also reduced from seven to four.

Agriculture sector

In 2003, the **agriculture, forestry and fishery** (agriculture) sector recorded the strongest growth in 11 years against a backdrop of robust exports and high prices. Value added growth picked up to 5.5% driven mainly by significant increases in crude palm oil and rubber output. Growth was also supported by increases in production of saw logs and, to a lesser extent, other agricultural commodities, namely vegetables, fruits, livestock and fish, reflecting the positive effects of measures taken by the Government to increase domestic sources of growth through increased food production. Meanwhile, cocoa output declined significantly during the year. Given the substantial increases of between 11-42% in the prices of major commodities during the year and improved export volume, export receipts from agricultural commodities rose significantly by 28.1%. Thus, the share of agriculture exports to total exports rose from an average of 6.5% in the period 2000-2002 to 8.4% in 2003.

The strong performance of the agriculture sector during the year was attributable to both supply and demand factors. Crude palm oil and rubber registered double-digit growth as farmers maximised production by increasing yields through good agriculture practices (including higher usage of fertilisers), encouraged by more favourable prices. Production of palm oil was also supported by favourable weather conditions as well as the coming on stream of new mature areas with high yielding

Graph 1.12
Agriculture Production



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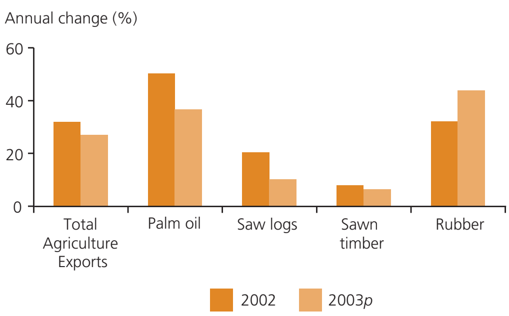
Graph 1.13
Agriculture Exports



p Preliminary

Table 1.7
Agriculture Sector: Value Added, Production and Exports

	2002		2003*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value Added (RM million at 1987 prices)	**18,438**	**3.0**	**19,453**	**5.5**
Production[1]				
of which:				
Crude palm oil	11,909	0.9	13,355	12.1
Rubber	589	7.7	698	18.4
Saw logs	20,649	9.1	21,381	3.5
Cocoa beans	48	-17.4	36	-24.0
Exports (RM million)	**26,327**	**31.9**	**33,728**	**28.1**
of which:				
Palm oil				
('000 tonnes)	10,854	3.7	12,509	15.2
(RM/tonne)	1,367	44.9	1,617	18.3
(RM million)	14,838	50.2	20,224	36.3
Rubber				
('000 tonnes)	928	12.9	945	1.9
(sen/kilogramme)	269	17.0	379	41.0
(RM million)	2,492	32.1	3,582	43.8
Saw logs				
('000 cubic metres)	5,104	5.6	5,508	7.9
(RM/cubic metre)	359	13.9	366	1.9
(RM million)	1,832	20.3	2,015	10.0
Sawn timber				
('000 cubic metres)	2,474	2.6	2,816	13.8
(RM/cubic metre)	990	5.0	926	-6.5
(RM million)	2,450	7.8	2,607	6.4

[1] All in '000 tonnes, except for saw logs in '000 cubic metres.
p Preliminary

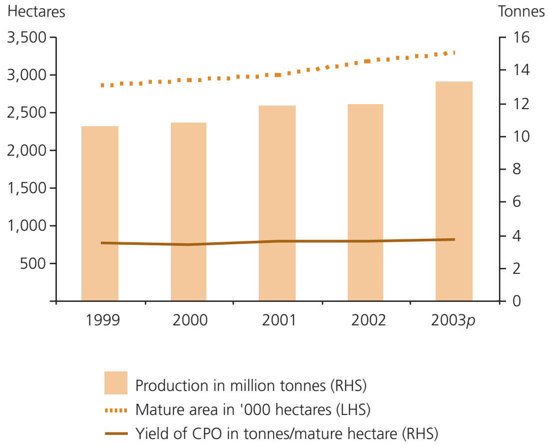
Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Forestry Departments (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board

trees. Meanwhile, higher rubber production was due to intensive tapping, including in areas that were previously abandoned. At the same time, external demand for these commodities was strong amidst supply shortages in the global market.

The stronger performance of the agriculture sector in 2003 generated significant spill-over effects, particularly on the rural population. Given that the agriculture sector employs about 14% of the total workforce in Malaysia and that a sizable proportion of them are smallholders, the higher incomes helped support the increase in consumption among the rural community. The plantation sector also benefited from the stronger economic performance, resulting in sharp increases in profits.

Crude palm oil (CPO) remained as the major commodity, accounting for about 4.1 percentage points of the increase in the value added of the agriculture sector in 2003. CPO recorded a bumper production of 13.35 million tonnes or an increase of 12.1%. Growth was primarily due to expansion in total mature area (3.1%), mainly in Sabah (6.3%) and Sarawak (13%) as well as good agriculture practices.

Graph 1.14
Oil Palm: Area, Production and Yield



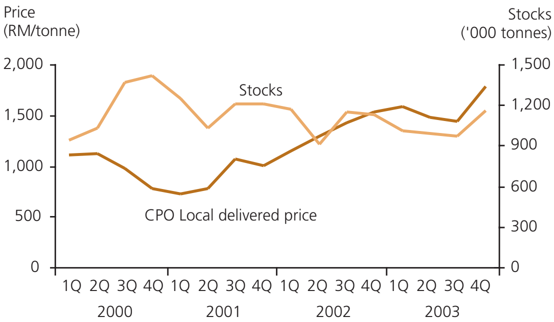
p Preliminary for mature area and yield

As a result, CPO output, which usually peaks in the third quarter in a normal year, recorded monthly production of above one million tonnes for an extended period during April – December 2003. On a regional basis, Peninsular Malaysia accounted for almost 60% of total national output, or 7.94 million tonnes of CPO, while Sabah and Sarawak produced the remaining 5.41 tonnes. In terms of global ranking, Malaysia maintained its position as the leading palm oil producer and exporter in 2003, accounting for 49% of the world's output and 58% of total exports.

Average export prices of Malaysian palm oil rose by 18.3% to RM1,617 per tonne in 2003. Against a backdrop of supply shortages in the global oils and fats markets, prices of most oilseeds, oils and meals rallied in 2003, especially since August 2003. In line with these developments, Malaysian CPO local prices averaged RM1,577 per tonne in 2003 (2002: RM1,364). The stronger prices reflected mainly imbalances in the global vegetable oils and fats markets arising from a marginal increase in output of major oilseeds, especially soybean, amidst stronger demand from major consumers of edible oils. Soybean harvest in the United States was adversely affected by drought during the year. The shortages in soybean, rapeseed and sunflower oils led to large price premiums of these oils over palm oil and this triggered import substitution by price sensitive buyers. Export demand for palm oil from the major buyers of soybean oil (palm oil's closest substitute), namely P.R.China, the European Union (EU) and Middle East, picked up strongly during the year.

Demand from P.R.China, the EU, Pakistan and emerging markets in the Middle East, rose between 4% and 29% during the year, on account of lower domestic production amidst an expansion in their refining capacities. In the case of P.R.China, the higher offtake was also due to its higher import quota for palm oil following its accession into WTO. However, imports by India, which is one of Malaysia's major buyers, declined in 2003 due to higher tariffs for palm oil products and imposition of new import regulations, which made palm oil less competitive against other major oilseeds. Nonetheless, with double-digit increases in price and export volume, palm oil generated an additional export revenue of RM5.4 billion in 2003, with total export receipts amounting to RM20.2 billion. Despite the strong external demand, Malaysian palm oil stocks remained almost unchanged at 1.17 million tonnes (end-2002 stocks: 1.14 million tonnes) given that output had also increased significantly during the year.

Graph 1.15
Palm Oil Price and Stocks



The palm oil industry made significant strides during the year. Malaysia gained market shares for palm oil-based products in five new markets, namely Chechnya, Antigua, Mayotte, Cape Verde and the Central African Republic. In the area of research and development, the Malaysian Palm Oil Board (MPOB) launched 35 new technologies and products for commercialisation in the palm oil industry in 2003. To enhance utilisation of palm oil products, MPOB together with local palm oil related agencies conducted research in collaboration with research organisations and institutional users in several consuming countries. Joint venture projects have been conducted with P.R.China, Egypt, Oman, Poland, Russia, Ukraine, South Africa, Pakistan, Turkey and Kuwait. In addition, Malaysia participated actively in the international scientific and trade meetings to promote facilitation of international trade for palm oil products.

Natural rubber production, which recorded its first positive annual growth in seven years in 2002, continued to expand strongly by 18.4% in 2003, to reach nearly 700,000 tonnes. Smallholders accounted for almost 90% of total national output as remunerative prices motivated intensive tapping activities, which led to a substantial increase in output of 23.3%. The increase in production was also contributed by tapping of trees that were previously abandoned. In contrast, production by estates declined further by 10.8% (2002: -14.7%) due mainly to continued conversion of rubber land into other economic activities during the year. Total tapped area for Malaysia expanded by about 48,000 hectares or 7% to 737,600 hectares.

In line with developments in the global natural rubber industry, the Malaysian rubber prices (RSS1) strengthened significantly by 37% to 401 sen per kilogramme in 2003 (2002: 292 sen). The increase in prices gained momentum during the course of the year, rising from 364 sen in the first quarter to 486 sen by the fourth quarter. RSS1 price peaked in November to record a monthly high of 512 sen, with the highest daily traded price at 543 sen on 5-6 November before consolidating to close the year at 473 sen. The strong price performance during the year was due to the surge in demand from P.R.China, active purchases by European traders as well as tight supplies in the major producing regions, which were affected by the wet weather, especially in the latter part of the year.

Purchases by P.R.China picked up significantly for the second consecutive year (60.2%; 2002: 51.4%), fuelled mainly by strong demand from the local automotive industry. The market was further supported by the decision of the Chinese government to raise the import quota for natural rubber by an additional 200,000 tonnes to accommodate the higher demand by the major tyre manufacturers. P.R.China remained as Malaysia's largest export market to account for 21.9% share of total rubber exports (2002: 13.9%). Besides P.R.China, the other major buyers were Korea, Germany and the Middle East, which together accounted for 52% of total rubber exports. Reflecting both higher prices and export volume, export receipts rose by 43.8% to RM3.6 billion in 2003.

A significant development in the international natural rubber sector in 2003 was the signing of the agreement for the establishment of the International Rubber Consortium Limited (IRCo) on 6 October by Malaysia, Thailand and Indonesia. IRCo was formed with the objective to undertake strategic market operations, as and when deemed necessary, as well as to complement agreed measures by these countries under the Supply Management Scheme and the Agreed Export Tonnage Scheme, which were endorsed earlier in 2001. These schemes have contributed positively to improving the overall sentiment of the rubber market.

Given the importance of the natural rubber sector in terms of employment of the rural community as well as its strong linkages to the downstream rubber-based industries, rubber has been identified as one of the strategic crops for sustainable growth of the Malaysian agriculture sector. In 2003, further measures were taken to develop the natural rubber sector, including a study on the medium-term master plan. An interim report of the study has been completed. Apart from traditional planting of rubber to produce latex to sustain the encouraging growth of the rubber wood-based industries, the Government has announced incentives to encourage private sector investment. This includes encouraging cultivation of latex-timber clone rubber for both latex and timber production. This clone would also assist in reducing anticipated shortage in the supply of rubber wood for the manufacture of furniture, as 80% of earnings from Malaysian furniture exports are rubber wood-based.

Logging activities in all regions, namely Sarawak, Sabah and Peninsular Malaysia, intensified in 2003. Total production of **saw logs** increased by 3.5% to 21,381 cubic metres in response to stronger external and domestic demand. Demand from the domestic wood-based industries turned around to record a growth of 0.9% in 2003 (2002: -6%), whilst shipments of logs increased by 7.9%. Exports increased despite strong competition from other hardwood producing countries such as Indonesia, Vietnam, Brazil and Africa. Purchases by the major regional buyers, namely Thailand, India, P.R.China and Chinese Taipei, which accounted for about 63% of total exports, rose by 24%. Amidst the strong regional demand and keen competition in the international markets, prices of Malaysian logs remained relatively stable at RM366 per cubic metre (2002: RM359). Consequently, export revenue from saw logs increased by 10% in 2003. Meanwhile, export volume of sawn timber rose by 13.8%, especially to markets in the EU, but growth in export receipts moderated during the year due entirely to lower export prices (-6.5%).

On the international front, the Malaysian timber industry continued to face pressures by the "green" sentiment in Europe, especially in the Scandinavian countries. This was reflected in the unilateral restriction imposed by the Norwegian government on imports of tropical timber for public projects, unless certified by the Forest Stewardship Council (FSC). The timber industry has also to contend with new regulations and standards that are imposed by developed countries ostensibly to protect the environment as well as the safety and health of consumers. Since October 2001, the Malaysian timber industry has responded to the "green" sentiment with the setting up of its own certification scheme operated by the Malaysian Timber Certification Council (MTCC). By end-2003, seven states have been awarded the Certificate for Forest Management, and 38 timber companies have been given permits to use the MTCC logo to provide the assurance of sustainable and legal source of forest products to buyers of Malaysian timber and timber products. Another significant development during the year was the acceptance of the MTCC scheme by Denmark as one of the accepted certification schemes in its Environmental Guidelines for Purchasing Tropical Timber. Given the wider acceptance and recognition of Malaysia's timber certification efforts, a total of 6,629 cubic metres of MTCC-certified sawn timber (2002: 732 cubic metres) and 45 cubic metres of mouldings were exported to a number of countries, particularly to Europe, in 2003.

Production of other **agriculture commodities**, comprising vegetables, fruits, livestock and fishery, registered a mildly positive growth during the year. The increase in vegetables (4.5%) and fruits (3.1%) production was supported mainly by an expansion in the cultivated area. The increase in cultivated area for these crops was in line with the expansion in the area allocated for the Permanent Food Production Park (PFPP) scheme. As at end-2003, more than 2,160 hectares of land were developed under the scheme, with the bulk or 1,681 hectares allocated for the planting of vegetables. Similarly, growth in the livestock sub-sector increased by 5.5%, mainly on account of higher poultry production, as demand, particularly from the domestic food processing industries was higher. The fishery sub-sector also expanded further by 2.6%, supported mainly by higher landings of marine fish.

Output of **cocoa beans** declined sharply by 24% to 36,240 tonnes, attributable mainly to lower cultivated area from 48,035 hectares in 2002 to an estimated 46,395 hectares in 2003. The reduction reflected mainly conversion of cocoa land to other crops as well as adverse effects from the wet weather conditions, particularly in the final quarter of 2003. Cocoa yields were lower as the higher amount of rainfall affected the fruit-setting period for the main crop and intensified the black pod infection. Amidst the need to increase production of cocoa beans to meet the requirements of local cocoa grinders as well as to reduce dependency on imported cocoa beans, rehabilitation programmes involving mainly smallholders continued during the year. Under the Cocoa Smallholders' Development Programme, a total of 6,916 hectares or 15% of total acreage under the cocoa smallholdings area were developed as at end-2003.

Export prices of cocoa rose further by 20.9% during the year to RM6,314 per tonne due to supply disruptions in a major producing country following unfavourable political developments. However, the Malaysian cocoa sector was unable to capitalise fully from the high prices of cocoa as domestic production also fell during the year. Hence, export revenue from cocoa declined to RM83 million (2002: RM110 million).

Mining Sector

The **mining sector** expanded by 4.8% in 2003, as strong domestic and external demand amidst expansion in production capacity stimulated higher production of crude oil and natural gas. Following higher shipments of oil and gas as well as the significant increase in export prices, gross foreign exchange revenue from exports of minerals increased substantially by 33.1% in 2003.

Crude oil production (excluding condensates) rose by 5% to 625,800 barrels per day (bpd) compared with 2002, close to the year's production target of 626,000 bpd under the National Depletion Policy. The increase in production during the year was driven by increased domestic demand for petroleum products and higher external demand, particularly from India, Australia, Thailand, P.R.China and US, which together accounted for about 65% of Malaysia's total export of oil. Exports to these countries increased by 34% during the year. Higher output emanated from existing oil fields as well as four new oil fields that came on stream during the year. The increase in export volume and sharply

Graph 1.16
Mining Production

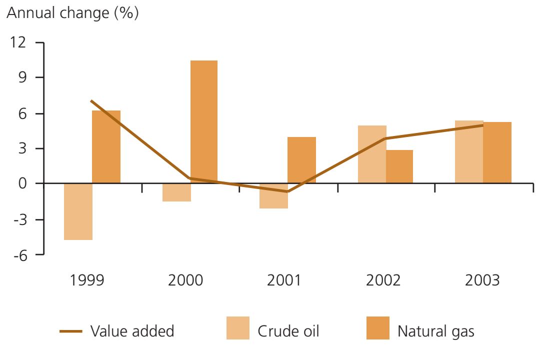


Table 1.8
Mining Sector: Value Added, Production and Exports

	2002		2003*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value added (RM million at 1987 prices)	**15,826**	**3.7**	**16,581**	**4.8**
Production				
Crude oil and condensates (barrels per day)	698,462	4.9	736,000	5.4
of which:				
Crude oil (barrels per day)	*596,216*	*2.9*	*625,775*	*5.0*
Natural gas - net (million standard cubic feet)	1,706,141	2.9	1,794,388	5.2
Tin-in-concentrates (tonnes)	4,215	-15.2	3,606	-14.2
Exports (RM million)	**22,364**	**-4.6**	**29,777**	**33.1**
of which:				
Crude oil				
('000 tonnes)	16,192	7.4	17,913	10.6
(US$/barrel)	24.81	-2.8	30.27	22.0
(RM million)	11,600	4.3	15,662	35.0
Liquefied natural gas				
('000 tonnes)	15,007	-2.7	17,402	16.0
(RM/tonne)	659	-8.6	766	16.2
(RM million)	9,888	-11.1	13,328	34.8
Tin				
('000 tonnes)	27,076	-0.7	15,164	-44.0
(RM/tonne)	15,713	-7.0	18,732	19.2
(RM million)	425	-7.7	284	-33.2

p Preliminary

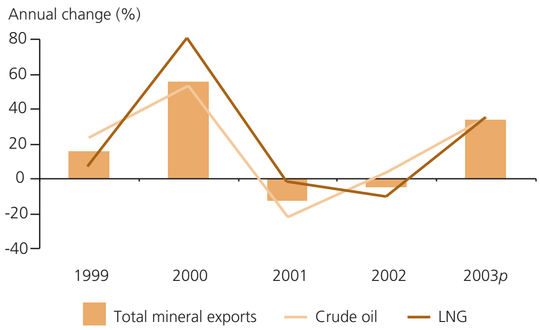
Sources: PETRONAS
Department of Statistics, Malaysia
Department of Minerals and Geoscience, Malaysia

higher export prices (22%), lifted gross receipts from crude oil exports by 35% to RM15.7 billion (2002: RM11.6 billion), to account for 4% of gross exports.

Malaysian crude oil prices (Tapis Blend) strengthened significantly to average US$29.79 per barrel (2002: US$25.55) in tandem with higher global crude oil prices. Prices during the year were, to a large extent, driven by market sentiments as well as fundamental factors. In early 2003, geopolitical concerns in the Middle East, supply disruptions in the major producing countries, namely, Venezuela, Nigeria and Iraq, and lean inventories in the major consuming countries, especially in the US, sustained Malaysian export prices at a high level of above US$30 per barrel in the first quarter of the year. In the second half-year, Malaysian crude oil prices averaged US$30 per barrel, in line with the international oil prices of West Texas Intermediate and North Sea Brent, which averaged US$30.64 and US$28.96 per barrel, respectively.

Decisions by the Organisation of Petroleum Exporting Countries (OPEC) in managing global oil supplies was a dominant factor in determining oil prices, particularly during the post-Iraq war period. In the first half of 2003, OPEC, which accounts for about

Graph 1.17
Mineral Exports



p Preliminary

40% of world supply, raised its output quota twice, by 1.3 million bpd and 2.4 million bpd respectively to 25.4 million bpd to ease the shortfall in supply. Subsequently, in November, OPEC reversed part of its earlier increases by cutting the output quota by 900,000 bpd to 24.5 million bpd amidst concerns of increasing supplies by non-OPEC members. This, together with the pick-up in global growth and the seasonally higher demand during the fourth quarter, helped to sustain the high oil prices towards end-year. P.R.China accounted for almost 35% of the increase in global oil demand during 2003. Reflective of these developments, the Malaysian crude oil prices remained relatively strong during the year to close at US$32.15 per barrel as at end-December.

Natural gas production expanded by 5.2% in 2003 as the sector was able to respond to the higher demand given an increase in production capacity, especially with the commencement of the MLNG Tiga plant in May 2003 and the coming on stream of four new gas fields during the year. Domestic demand remained favourable, particularly from the power generation sub-sector, which consumed 66% of total domestic gas production. Higher offtake by all LNG buyers, namely Japan, Korea and Chinese Taipei as well as the increase in export prices (RM766 per tonne; 2002: RM659) led to the sharp increase of 34.8% in export receipts generated from LNG.

Production of **tin-in-concentrates** declined by 14.2% in 2003, despite higher prices and an increase in the number of active tin mines. Decline in production was due mainly to depleting tin reserves in existing tin mines, which resulted in low productivity.

Table 1.9
Malaysia: Crude Oil and Natural Gas Reserves[1]

	As at end	
	2002	2003*p*
Crude oil		
Reserves (billion barrels)	3.61	3.69
Reserve/Production (year)	16.0	16.0
Natural gas		
Reserves (trillion standard cubic feet)	87.76	89.67
Reserve/Production (year)	35.7	30 - 40

[1] The National Depletion Policy was introduced in 1980 to safeguard the exploitation of the national oil reserves by postponing the development and control the production of major oil fields (with reserves of 400 million barrels or more).
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Source: PETRONAS

During the year, four new oil fields, two each in Peninsular Malaysia and Sarawak, commenced operations, thus bringing the total number of oil fields in production as at end-2003 to 51. With the commencement of four new gas fields in Peninsular Malaysia and Sarawak, a total of 18 gas fields were in operation by end-2003.

A significant development in the Malaysian oil sector in 2003 was the discoveries of deepwater oil reserves in offshore Sabah towards the latter part of the year. Prior to these discoveries, oil was also found in offshore Sabah in July 2002. A total of six new production-sharing contracts were signed in 2003.

Services Sector

In 2003, the **services sector** remained resilient, recovering rapidly from the adverse effects of the Severe Acute Respiratory Syndrome (SARS) that occurred in the early part of the year. Overall, the effects of SARS were found to be transitory and affected the retail, tourism and travel-related sectors, mainly in the second quarter of the year. Tourist arrivals fell significantly for a brief period in April-May (average of 500,000) before gradually picking up in the following months to reach the pre-SARS level of above one million tourists by November. Amidst the sharp decline in tourist arrivals and weaker consumer sentiment, growth in the services sector slowed down to 2.9% during the second quarter. The quick containment of the disease globally and the pro-active measures undertaken by the Government to assist the affected industries and to boost consumer confidence, contributed to the recovery in the services sector in the second half-year, which grew by 4.5% (first half-year: 3.7%). While growth in final services moderated largely due to the impact of SARS, growth in the intermediate services was more robust, supported by stronger trade-related activities. Overall, growth in the services sector was sustained at 4.1% during the year, but its share to GDP declined slightly to 56.4% from 57% in 2002.

The services sectors remained resilient despite the occurrence of SARS. Activity picked up strongly in the second half-year, largely due to stronger domestic demand, aided by the Economic Package.

Within the final services sector, growth in the **wholesale and retail trade, hotels and**

Table 1.10
Growth in the Services Sector at Constant 1987 Prices

	2002	2003p 1H	2003p 2H	2003p Year	2002	2003p
	Annual change (%)				% share of GDP	
Services	**4.1**	**3.7**	**4.5**	**4.1**	**57.0**	**56.4**
Intermediate services	4.3	4.2	6.1	5.2	22.8	22.8
Transport, storage and communication	2.6	4.5	6.6	5.6	8.5	8.5
Finance, insurance, real estate and business services	5.3	4.1	5.7	4.9	14.3	14.3
Final services	4.1	3.3	3.4	3.4	34.2	33.6
Electricity, gas and water	3.9	7.3	5.1	6.2	4.0	4.0
Wholesale and retail trade, hotels and restaurants	2.6	0.6	2.4	1.5	14.9	14.4
Government services [1]	6.7	6.4	4.9	5.6	7.2	7.3
Other services [2]	4.6	3.3	3.2	3.2	8.0	7.9

[1] Include general public services (general public administration, external affairs and public order and safety), defence, health, education and others.
[2] Include imputed rent from owner-occupied dwellings; community, social and personal services; products of private non-profit services to households and domestic services of households.
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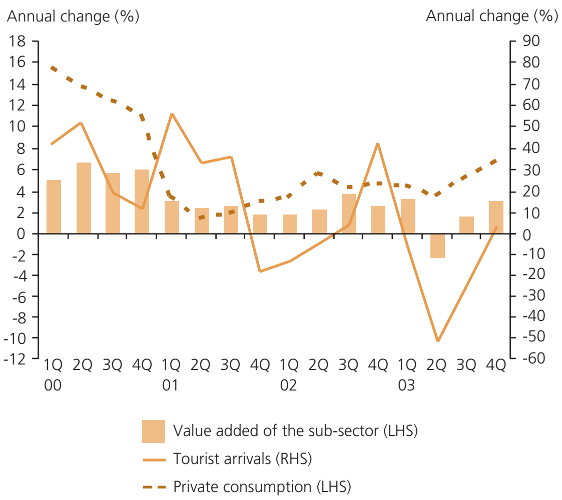
Source: Department of Statistics, Malaysia

restaurants sub-sector moderated to 1.5% in 2003. The sub-sector contracted in the second quarter by 2% as consumers avoided public places, whilst the hotel occupancy rate in some areas fell to 30% due to a decline in tourist arrivals and the cancellation of several meetings, incentives, conventions and exhibitions (MICE). Nevertheless, the Economic Package introduced in May helped the tourism and travel-related industries to tide over the difficult period as well as stimulate domestic demand. The strong pent-up demand, amidst the improving consumer confidence and recovery in tourist arrivals to the pre-SARS level, helped support the recovery in the sub-sector. By September, the average hotel occupancy rate rose above 50%. In addition, the upward trend in the equity market amidst stable employment conditions, disbursement of bonus payments and year-end festivities, further reinforced consumer sentiment, resulting in the expansion of the sub-sector in the second half-year.

Graph 1.18
Trends in Wholesale and Retail Trade, Hotels and Restaurants Sub-sector vis-a-vis Private Consumption and Tourist Arrivals



Value added growth was also affected by greater competition among retailers especially hypermarkets. Although the trend of lower prices had benefited consumers in general, the price competition had squeezed retailers' margins. Coupled with the evolving consumer preference to shop in hypermarkets and large multi-concept shopping centers, the year saw the exit of several small- and medium-sized retailers and rationalisation of existing retailers through mergers and acquisitions.

The **other services sub-sector** which includes community, social and personal services as well as imputed rent from owner-occupied dwellings, expanded at a moderate rate of 3.2% (2002: 4.6%). The moderation reflects slower growth in the community, social and personal services as entertainment and gaming activities were affected by SARS during the second quarter. Education and private healthcare services were also affected, albeit to a lesser extent. These sectors performed better for the year as a whole. The total number of students pursuing higher private education in Malaysia rose to almost 300,000 as at end-2003 (end-2002: 294,600), reflecting increases in students from both Malaysia and abroad. Similarly, the private healthcare industry continued to expand in response to increased demand by locals and foreigners for better healthcare services. The survey by the Association of Private Hospitals in Malaysia showed that the number of foreign patients treated in the private hospitals rose to 102,946 as at end-2003 (end-2002: 84,585).

The **Government services sub-sector** expanded by 5.6% in 2003 (2002: 6.7%). The growth reflected higher expenditure on emoluments following the salary adjustment for civil servants with the implementation of the *Skim Saraan Malaysia* in the last quarter of 2002. Consonant with the strengthening economic activity, the **utilities sub-sector** registered a higher growth of 6.2% (2002: 3.9%), reflecting mainly increased electricity demand, as well as higher gas and water consumption. The coming on stream of five power plants by the Independent Power Producers also contributed to the increase in electricity generation during the year.

Within the intermediate services sector, growth in the **transport, storage and communication sub-sector** picked up strongly by 5.6% in 2003 (2002: 2.6%), owing largely to robust activities in the telecommunications industry. The telecommunications industry benefited from economies of scale following the rationalisation of the cellular industry as well as the various measures undertaken to promote new areas of growth in telecommunications. In the cellular segment, growth accelerated in 2003 due to further expansion in the subscriber base (11 million; end-2002: 9 million) as well as increased usage of both traditional voice telephony and new applications in mobile data. During the year, Short Messaging Service (SMS) traffic rose significantly, boosted by the wider usage of SMS in various applications, such as entertainment and ticket reservation as well as the downloading of data and other information. Growth in mobile data was further reinforced by the introduction of the Multimedia Messaging Service (MMS) in the second half-year, which allows mobile phone users to enhance their messages by incorporating sounds and images. With the continued popularity of mobile phones, fixed line subscribers declined further.

Various measures undertaken to promote new areas of growth in the telecommunications industry, such as greater usage of e-commerce and on-line services for the purchase of goods and services, supported growth in the industry. In addition, the reduction in the access fee for broadband and strong demand for high-speed Internet access resulted in the number of broadband subscribers rising five fold to 110,400 as at end-2003, while the number of Internet subscribers increased by 10.1% to 2.9 million.

Table 1.11
Selected Indicators for the Services Sector

	2002	2003*p*
	Annual change (%)	
Electricity production index	10.3	5.8
Loans outstanding in the banking system	4.6	4.8
Insurance premiums	13.3	14.0
KLSE (turnover, volume)	12.0	101.7
LRT ridership[1]	3.5	8.8
Tourist arrivals	4.0	-20.4
Airport passenger traffic	4.2	1.3
Air cargo handled	16.3	6.9
Bulk cargo throughput at five major ports[2]	4.9	9.7
Container throughput at six major ports[3]	23.8	14.9
	%	
Hotel occupancy rate	57.9	53.3
Penetration rate:		
- Internet dial-up	10.5	11.4
- Broadband	0.08	0.44
- Mobile phone	36.9	43.9
- Fixed line	18.8	18.1

[1] Include STARline and PUTRAline.
[2] Include Port Klang, Johor Port, Penang Port, Sabah Ports and Bintulu Port.
[3] Include Port Klang, Johor Port, Port of Tanjung Pelepas, Penang Port, Sabah Ports and Bintulu Port.
p Preliminary

Source:
Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Kuala Lumpur Stock Exchange; Malaysian Communications and Multimedia Commission; Ministry of Finance; Port authorities; Syarikat Prasarana Negara Berhad; Malaysia Tourism Promotion Board; and Bank Negara Malaysia

In the transportation industry, lower tourist arrivals affected the air passenger segment. Growth in the other segments was supported by higher trade and domestic tourism activities, particularly in the second half of the year. Following the increase in both indigenous and transhipment cargo, activity at the ports continued to remain strong. Total container cargo handled at the six major ports increased by 14.9% in 2003 (2002: 23.8%). Air cargo business was also enhanced by the introduction of the I-port programme in the two major ports, facilitating more efficient transfer of goods between ports and airports in the country. Aggressive campaigns undertaken by the Government to promote domestic tourism as well as the rapid expansion of the no-frills budget airline to many local destinations led to the continued increase in domestic passengers, compensating for the decline in international passengers during the year.

Growth in the **finance, insurance, real estate and business services sub-sector** was sustained at 4.9% in 2003 (2002: 5.3%). Growth emanated from increased bank lending amidst lower lending rates, more robust insurance activities, as well as the pick-up in the stock market and real estate activities in the latter part of the year. The low interest rates and attractive financing packages offered by financial institutions, additional funds provided by the Government under the Economic Package, as well as improved infrastructure for the small- and medium-enterprises stimulated lending activities during the year. Value added growth in the finance sector was supported by interest income and strong growth in fee-based income of financial institutions. The significant increase in insurance premiums from both conventional insurance and takaful products further supported the growth in the sub-sector.

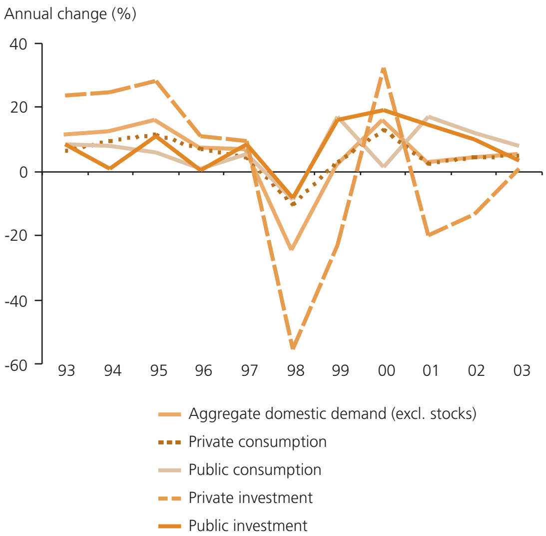
DOMESTIC DEMAND CONDITIONS

Domestic demand conditions strengthened further in 2003, as the economy successfully weathered the uncertainty in the external environment, including the outbreak of SARS and the geopolitical tensions in the first half of the year. Growth was driven mainly by stronger private sector activities and supported by public sector expenditure. The improved external environment in the second half-year, which led to rising consumer and business confidence, as well as the positive effects of the Government's Economic Package translated into higher private sector activities. The low interest rate environment, stable employment prospects, high commodity prices, improvement in corporate cash flow positions as well as further liberalisation of foreign equity ownership in the manufacturing sector reinforced the positive spill-over benefits from the Economic Package. As a result, the private sector resumed its role as the main driver of growth in 2003, led by the strengthening in consumer spending and a recovery in private investment. Meanwhile, growth in public sector expenditure moderated with the Government continuing to provide an enabling environment to support private sector activities. Overall, growth in **aggregate domestic demand** (excluding stocks) strengthened to 4.8% from 4.2% in 2002.

The **public sector** continued to play an important role in stimulating the economy. The pro-growth measures taken in early 2003 were instrumental in mitigating the impact of SARS and contributed towards the momentum of growth in the second half-year. Overall, the pace of expansion of public sector expenditure moderated to 5.5% in 2003, in line with the move towards gradual fiscal consolidation.

Domestic demand conditions strengthened further in 2003. The private sector resumed its lead role in driving growth, supported by higher consumption and the turnaround in private investment. Growth in public sector expenditure moderated but was supportive of private sector activities.

Graph 1.19
Real Domestic Demand Aggregates



Public consumption was sustained, increasing by 7.9% in 2003, due mainly to the continued high expenditure on supplies and services, emoluments and defence. The higher expenditure on supplies and services was largely due to the measures to improve the public sector delivery system. Meanwhile, the higher expenditure on emoluments was partly due to the implementation of the Malaysian Remuneration System for employees in the public sector (effective November 2002) as well as the special critical allowance for staff in Government hospitals who were directly involved in addressing SARS-related cases.

Reflecting the public sector's role of providing a supportive environment for private sector activities, **public investment** continued to increase in 2003, albeit moderately. The increase in public investment reflected higher outlays to improve and upgrade the country's infrastructure, including roads and highways, and rail, port and airport facilities. Higher outlays were also expended on the construction and upgrading of hospitals as well as rural and health clinics. In addition, expenditure on agriculture and rural development increased in 2003 in line with the Government's effort to modernise the agriculture sector and to narrow income disparities between urban and rural areas by encouraging agro-based industries. A large share of the expenditure continued to be channelled towards education and training, especially skills development and training in technical fields and on information and communication technology to facilitate the move towards a knowledge-based economy.

Total capital expenditure of the NFPEs remained high in 2003, on account of upgrading and capacity expansion programmes. Petroliam Nasional Berhad (PETRONAS) continued to invest in exploration and production projects as well as the construction of liquefied natural gas tankers and petroleum tankers. In the case of Tenaga Nasional Berhad, the bulk of the expenditure was for upgrading of the transmission system and power generation, while a large portion of Telekom Malaysia Berhad's expenditure was focussed on upgrading and capacity expansion to improve telecommunication infrastructure and services.

The private sector resumed its role as the main engine of growth for the Malaysian economy in 2003, contributing 2.5 percentage points to real GDP growth. **Private sector expenditure** increased significantly by 4.3% (2002: 0.7%), reflecting the up-turn in private investment and a further strengthening of consumer spending. **Private consumption** increased at a faster pace of 5.1% in 2003, after a hesitant start, particularly at the height of the geopolitical tensions and the SARS outbreak during the second quarter. Private consumption, which was less robust in April and May, regained strength from June as confidence improved following the containment of the SARS threat and the announcement of the Economic Package to promote domestic demand. Measures to enhance household disposable income included a voluntary reduction in the EPF contribution rate for employees and various tax exemptions. Lower interest rates following the reduction in the policy rate by Bank Negara Malaysia further improved consumer confidence. As a result, consumer spending gathered momentum and returned to its normal trend in the third quarter. The rise in consumer spending also reflected the effects of pent-up demand, with increased purchases of cars

Table 1.12
Private Consumption Indicators

	2002	2003				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars (incl. 4WD)						
'000 units	375.4	85.1	83.2	89.6	76.5	334.4
Annual change (%)	9.4	-7.4	-14.9	-9.5	-11.7	-10.9
Tax collection						
Sales tax (RM billion)	9.2	1.5	2.1	2.0	2.4	8.0
Service tax (RM billion)	2.2	0.4	0.7	0.4	0.6	2.0
Narrow Money (M1)						
Annual change (%)	10.3	8.4	10.0	11.9	14.6	14.6
Loans disbursed by banking system						
Consumption credit (excl. passenger cars) Annual change (%)	38.1	11.2	5.9	12.3	11.4	10.2
Retail trade, restaurants and hotels Annual change (%)	-1.4	6.5	7.8	6.9	12.1	8.4
MRA retail sales						
Annual change (%)	3.0	-0.1	-2.9	3.9	8.4	3.6
Credit card operation						
Turnover spending (RM billion)	26.8	7.2	7.1	8.0	8.6	30.9
Annual change (%)	25.0	18.8	13.8	15.5	14.2	15.5
MIER Consumer Sentiments Index	-	105.2	106.9	112.8	115.5	-
KLSE Composite Index	646.3	635.7	692.0	733.5	793.9	793.9
Commodity prices						
CPO (RM/tonne)	1,364	1,585	1,486	1,444	1,793	1,577
Crude oil (USD/barrel)	26	33	28	28	32	30
Rubber (sen/kg)	292	364	367	387	486	401

and consumer durables as well as higher expenditure on hotels and restaurants during the quarter. Retail sales also turned around to register a positive growth in the third quarter and strengthened further in the latter part of the year, reinforced by seasonal factors such as festivities, year-end bonus payments and back-to-school shopping. Other factors supporting higher consumer spending during the year included the positive wealth effect from the improved stock market performance as well as higher rural income due to the large multiplier impact of higher commodity prices.

Of significance, **private investment** turned around to record positive growth beginning from the third quarter of 2003. For the year as a whole, private investment increased by 1.1% following two years of contraction. The expansion in private sector investment reflected the improvement in business confidence, particularly in the second half-year. In addition, improved capacity utilisation due to rising external demand and higher production underpinned

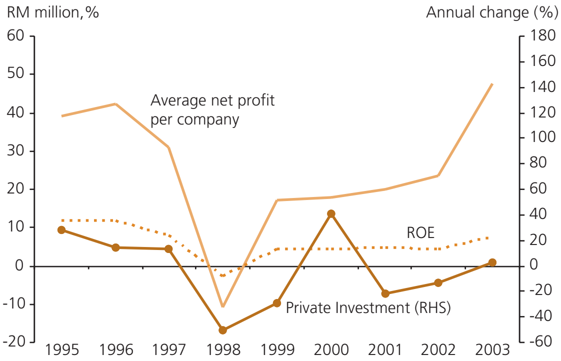
Table 1.13
Private Investment Indicators

	2002	2003 1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles (incl. 4WD)						
'000 units	59.6	14.9	16.2	19.4	20.1	70.6
Annual change (%)	12.2	4.2	7.4	24.5	37.2	18.5
Applications to MITI						
No. of projects	878	208	225	272	228	933
Capital investment (RM billion)	18.8	12.2	5.1	4.2	4.3	25.8
Foreign	11.7	5.7	1.7	1.8	2.3	11.6
Local	7.0	6.4	3.4	2.4	2.0	14.1
Approvals by MITI						
No. of projects	792	292	199	261	213	965
Capital investment (RM billion)	17.9	5.3	2.7	12.0	9.1	29.1
Foreign	11.6	2.1	1.7	6.0	5.8	15.6
Local	6.3	3.2	0.9	6.0	3.3	13.5
MSC-Status Companies						
No. of companies	191	41	42	39	39	161
Approved investment (RM billion)	2.7	0.3	0.4	0.3	0.5	1.6
Loans disbursed by banking system						
Manufacturing sector Annual change (%)	0.9	1.9	3.0	7.3	7.0	4.8
Construction sector Annual change (%)	41.8	-1.3	-34.3	11.2	3.5	-8.5
Business services Annual change (%)	-7.4	7.4	-20.6	27.1	22.9	6.7
Private Debt Securities						
Total funds raised (RM billion)	26.7	16.2	12.0	6.4	8.3	42.8
Initial Public Offerings (KLSE)						
Total funds raised (RM billion)	6.8	0.2	0.2	0.6	3.0	4.0
MIER Business Conditions Survey						
Business Conditions Index	-	99.3	104.9	109.8	109.9	-
Capacity Utilisation Rate (%)	-	79.6	78.0	79.6	81.1	-

capital spending activities, particularly in the manufacturing sector. Other factors supporting the improvement in investment activities were the low interest rates as well as improved profitability and cash flow positions of companies in line with higher sales and profits.

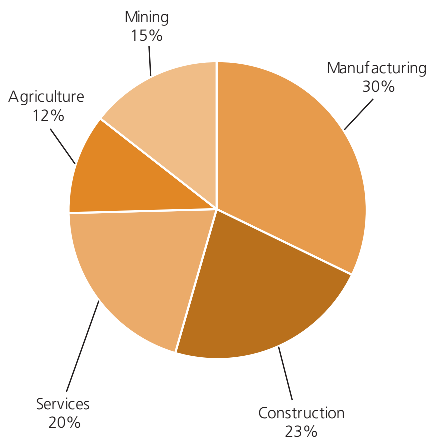
Business investment improved in most sectors of the economy except for the transportation sector where capital outlays had tapered off following the completion of large projects, and the telecommunication sector. **Manufacturing investment** turned around significantly to register a positive growth of 3.2% in 2003 (2002: -32.8%), reflecting the improvement in business conditions and the high capacity utilisation rates (82% in 2003).

Graph 1.20
Higher Investments with Higher Profits



Graph 1.21
Private Investment by Sector (% share)

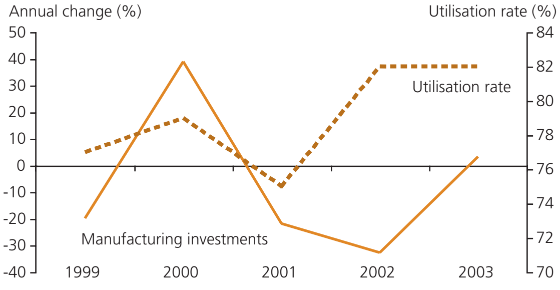
2003



Capital outlays in the manufacturing sector were mainly in the form of investment in machinery and equipment as industries needed to expand productive capacity in response to high demand and utilisation rates.

A positive development during the year was the significant improvement in the value of proposed investment applications and approvals in the manufacturing sector, signalling the improved business confidence and the need to add new capacity. The total value of applications received increased by 37.1% to RM25.8 billion, while the value of approved investment increased significantly by 62.8% to RM29.1 billion. Of the total value of investment approvals, approximately 77% was for new investment, while the balance was for reinvestment. Unlike in the past years when the electrical and electronics industry accounted for a large share of the total approved investment, a large

Graph 1.22
Manufacturing Investments and Capacity Utilisation Rates



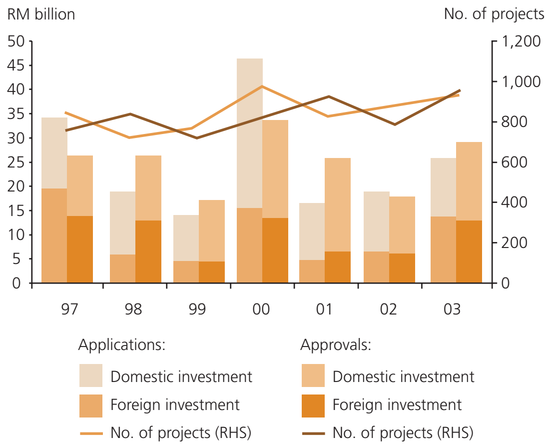
proportion of the approved investment in 2003 was in the basic metal products industry, which accounted for a significant share of 30% of total approved investment. This was followed by the transport equipment sector (24%) and the electrical and electronics industry (17%).

There has been some shift in the pattern of investment towards higher value added and higher technology projects, involving highly-skilled manpower and higher capital investment. For example, in the consumer electronics sub-sector, companies have shifted production from traditional products to higher value added products, such as digital audio-video equipment, multimedia speakers, plasma television sets and home theatres, while in the electronics sub-sector, approved projects were for high-end computer and computer peripheral products and high-end telecommunications equipment. Some companies have also set up their own research and development centres to improve design capabilities and reduce costs. This shift towards higher value added and higher technology is reflected in the gradual rise in the capital intensity as measured by the ringgit value of capital investment per employee (CIPE). The CIPE has increased from RM0.08 million in the 1980s to RM0.24 million in the 1990s and RM0.38 million in 2003.

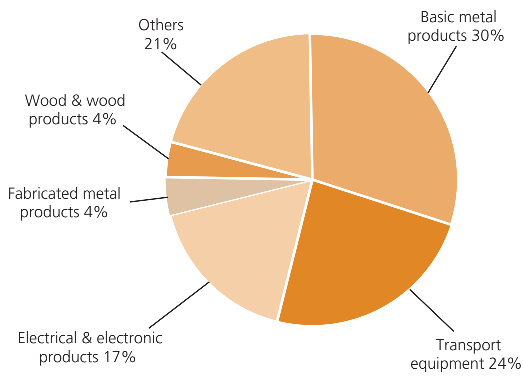
Reflecting the increased confidence of foreign investors, the value of approved foreign investment increased significantly by 35.1% to RM15.6 billion and accounted for 53.7% of the total approved investment. Of this amount, 28% was reinvestment by the existing foreign investors and 72% was for new activities. This indicated that Malaysia remained an attractive investment location despite the emergence of competition from other regional countries. The five most important sources of foreign investments in Malaysia in 2003 were United Arab Emirates, United Kingdom, the United States, Japan and Singapore, which together accounted for 80% of total foreign investments in approved projects. One of the approved projects includes a high technology project from the United Kingdom to develop a stratosphere-based high altitude surveillance and communication platform, which may eventually be a worldwide system of surveillance and communications as it complements contemporary satellite aerial infrastructure.

Meanwhile, local manufacturers have become more aggressive in their business expansion plans as their share of the value of investment applications have exceeded that of their foreign counterparts for the first time since 1997. The value of approved domestic investment more than doubled to RM13.5 billion, reflecting the positive response to the Government's

Graph 1.23
Private Investment in the Manufacturing Sector



Graph 1.24
Approved Manufacturing Investment by Industry, 2003 (% share)



policy to encourage domestic investment to drive growth. This development also reflected the success of the government's efforts in encouraging local manufacturers to upgrade their productive capacity as well as collaborate with foreigners in new business ventures. Excluding a single large investment in the basic metal products industry, local investments were concentrated in the high value-added non-resource based industries, namely, the transport equipment, electrical and electronics products and fabricated metal products industry.

Investment in the **construction sector** continued to register a moderate increase during the year. A large part of construction investment reflected activities in the residential sub-sector, which was supported by the conducive property market environment in response to the low interest rates offered by the banking institutions and the Government's Economic Package for the property sector. Meanwhile, capital investment in the sector was also supported by activity in several ongoing privatised road projects, namely the New Pantai Expressway, Kajang Ring Road, Guthrie Corridor Expressway, SPRINT Highway (Penchala Link), Kajang-Seremban Expressway, Jelutong Highway and Butterworth Outer Ring Road.

Stronger investment activities in the **services sector** were visible in the utilities as well as the retail, wholesale and business sub-sectors. Capital spending in the utilities sub-sector continued to increase in 2003, supported by activities in water supply projects as well as the development works of several power plants. The power plants that came onstream during the year included the Teknologi Tenaga Perlis Power Plant, Prai Power Plant and Panglima Power Plant, while the construction of the new 2,100MW power plant in Tanjung Bin was in progress. The consolidation of the telecommunications industry affected investment in this sub-sector. The rationalisation exercises of telecommunication operators and the merger of service providers contributed to lower capital spending. Investment in the sub-sector was mainly towards improving the existing network quality and increasing coverage areas in response to intense competition, particularly in the cellular services sector. Investment in the transport sub-sector was largely supported by the development of ports, reflecting mainly the capacity expansion of Port of Tanjung Pelepas, West Port and Kuantan Port. In recent years, capital spending in the sub-sector had been on a declining trend due to the completion of several major rail projects. The KL Monorail was completed and started commercial operations in the second half of 2003.

Capital spending in the retail business reflected the establishment of new outlets in the expansion programmes by major hypermarket operators and established retailers. Various incentives introduced by the Government have attracted companies to establish shared services centres in Malaysia, which provide information technology services, software development, customer management and data processing for the companies' global or regional operations. The setting up of these shared services centres includes additional capital spending in technology and logistic infrastructure. A major development project during the year was the intensification of the Proton City mixed development project.

New capital expenditure in the **mining sector** was largely by the oil and gas sub-sector, boosted by higher upstream activities in exploration and production. Higher demand for crude oil, coupled with the increase in crude oil prices, encouraged companies to increase capital expenditure for production facilities. Sustained investment in the **agriculture sector** was largely attributed to activities in crop plantation, with a larger contribution from palm oil plantations, buoyed by stronger demand for crude palm oil and high prices. The capital expenditure was mainly to improve efficiency in crop harvesting processes and for new planting as well as replanting activities. The increase in investment in the agriculture sector was also reflected in higher imports of agricultural equipment during the year. In addition, higher investment committed under the National Agricultural Policy continued to encourage participation from the private sector, primarily for food production.

Notwithstanding stronger consumption spending in 2003, **gross national savings (GNS)** increased by 18.1%. Higher incomes from the improvement in external demand and strong export earnings from high commodity prices led to a significant expansion in gross national income in nominal value.

In the private sector, both households and the corporate sector enjoyed stronger cash flows, benefiting from higher disposable incomes as a result of the measures in the Economic Package, the significant improvement in domestic activities and external demand, and sharply higher commodity prices. This enabled private consumption to strengthen further in 2003, while private sector savings registered a strong increase of 34.7% during the year, with the main contributor being corporate

Table 1.14
Savings-Investment Gap

	2002	2003*p*
	(RM million)	
Public gross domestic capital formation	53,698	56,304
Public savings	63,496	66,313
Deficit / surplus	9,798	10,009
Private gross domestic capital formation[1]	31,317	29,329
Private savings	52,013	70,081
Deficit / surplus	20,696	40,752
Gross domestic capital formation	85,015	85,633
(% of GNP)	25.3	23.2
Gross national savings	115,509	136,394
(% of GNP)	34.4	36.9
Balance on current account	30,494	50,761
(% of GNP)	9.1	13.7

[1] Includes the change in stocks. Previously, the change in stocks was distributed between the public and private sector gross domestic capital formation.
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

savings. Higher corporate savings was reflected in a marked increase of RM13.9 billion in new deposits placed by businesses in the banking institutions, compared with a net withdrawal of RM154 million in 2002. Despite higher public consumption, public sector savings increased further by 4.4% due mainly to better revenue performance of both the Federal Government and the non-financial public enterprises.

Overall, the share of GNS to GNP rose to 36.9% in 2003 compared with 34.4% in 2002. This high rate of savings has enabled Malaysia to finance its economic growth from domestic sources. With the recovery in investment still in its early stage, gross domestic capital formation (including stocks) registered modest growth. The savings-investment balance as reflected in the current account of the balance of payments, therefore, recorded a higher surplus of RM50.8 billion or 13.7% of GNP. The savings-investment surplus is expected to moderate as the recovery in investments would strengthen in line with stronger economic growth.

PRICES AND EMPLOYMENT

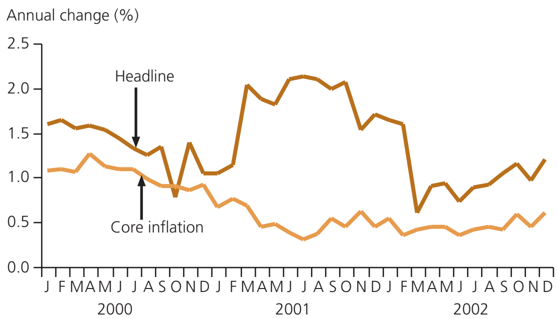
Consumer Prices

Inflation remained low and stable in 2003. The overall inflation rate, as measured by the annual change in the Consumer Price Index (CPI), was slightly lower at 1.2%, compared with 1.8% in the previous year. Core inflation, which is inflation excluding price-controlled and price-volatile items as well as items that are subject to one-off price adjustments, remained broadly stable at 0.6% in 2003 (2002: 0.5%). Several factors combined to ensure that inflation was benign. While domestic demand strengthened, excess capacity in selected sectors and the absence of wage cost pressures, amidst improving labour productivity, helped to contain price pressures. Small price adjustments, in March 2003, in retail prices of petrol, diesel and cooking gas and telephone rental contributed to about 0.4 percentage point to the overall inflation during the year.

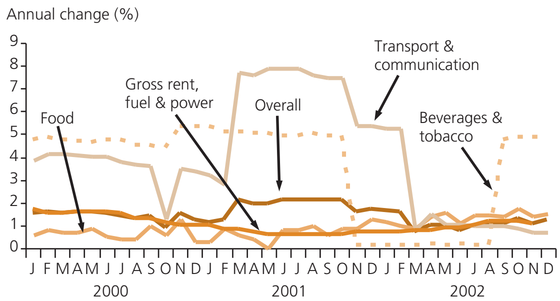
Transport and communication prices moderated significantly in 2003 due in part to the higher base in 2002, despite higher prices of petroleum and petroleum-related products. Prices for clothing and footwear, furniture, furnishing and household equipment continued to decline during the year

Graph 1.25
Inflation: Annual Rate of Change

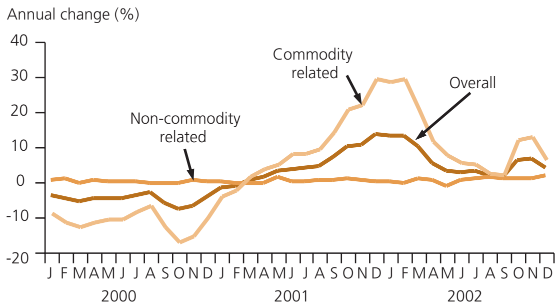
Measures of Consumer Price Inflation



Consumer Price Index



Producer Price Index



Graph 1.26
Contribution to Annual Change in the Consumer Price Index

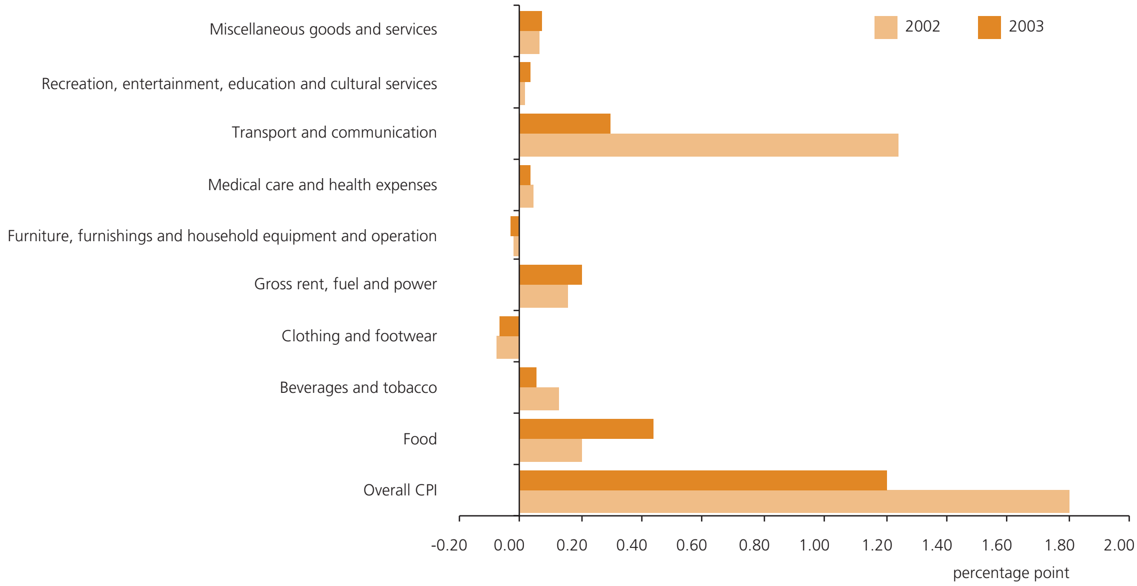


Table 1.15
Price Indicators

	Weight	2002	2003
	Annual change %		
Consumer Price Index (2000=100)	**100.0**	**1.8**	**1.2**
of which:			
Food	33.8	0.7	1.3
Beverages and tobacco	3.1	4.2	1.6
Clothing and footwear	3.4	-2.3	-2.0
Gross rent, fuel and power	22.4	0.7	0.9
Furniture, furnishings and household equipment and operation	5.3	-0.4	-0.6
Medical care and health expenses	1.8	2.4	1.7
Transport and communication	18.8	6.6	1.6
Recreation, entertainment, education and cultural services	5.9	0.2	0.6
Miscellaneous goods and services	5.5	1.1	1.3
Consumer Price Index			
Durable Goods	9.4	-0.8	-1.1
Semi-Durable Goods	5.4	-1.6	-1.4
Non-durable Goods	40.2	1.6	1.6
Services	45.0	3.0	1.3
Producer Price Index (1989=100)	**100.0**	**4.4**	**5.8**
of which:			
Local Production	79.3	5.7	7.0
Imports	20.7	-0.7	0.8
House Price Index (1990=100)		**-0.6**	**-**
of which:			
Klang Valley		-0.3	-
Johor Bahru		-6.0	-
Penang Island		-5.2	-

Source: Department of Statistics, Malaysia
NAPIC, Department of Valuation and Property Services

amidst increased capacity and rising competition from imported goods.

Stronger demand was reflected mainly in higher prices for food, rental, fuel and power. Generally, higher prices for food items reflected stronger demand amidst higher commodity prices, and higher prices for selected imported food items. Meanwhile, the increase in rental was moderate. Rental for lower-end houses rose by 1%, while the increase for the higher-end houses was 0.8%.

Producer Prices

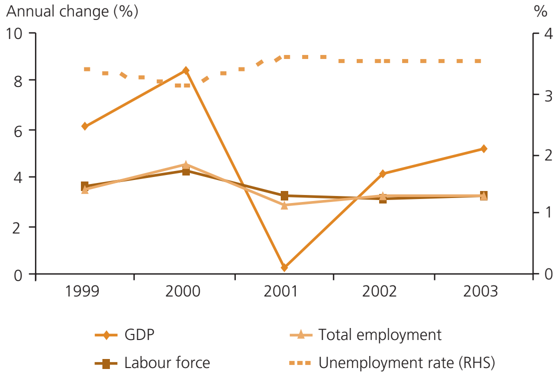
Producer prices, as measured by the Producer Price Index (PPI), rose at a higher annual rate of 5.7% in 2003 (2002: 3.7%), reflecting largely higher prices for commodity-related products, following higher prices of crude palm oil, rubber and crude petroleum. Excluding commodity-related products, producer prices remained subdued, increasing by 0.5% (2002: 0.1%). Prices paid for imported goods increased by 0.8% (2002: -0.7%), reflecting mainly higher petroleum prices and the appreciation of major currencies against the ringgit.

Labour Market Developments

The domestic **labour market conditions** remained stable and healthy. In 2003, overall growth in total employment and the labour force expanded moderately by the same rate of 3.3% to 10.2 million workers and 10.5 million persons respectively. The unemployment rate remained low at 3.5%. Further measures were undertaken in 2003 to improve the quality of labour, narrow the skills mismatches and address the changing demands of the economy.

The Beveridge Curve, which tracks the pattern of unemployment and vacancies in the labour market, shifted downwards and inwards in 2003, indicating lower turnover in the labour market and increased efficiency in the worker-job matching process. This was corroborated by the findings of other surveys. The Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the Federation of Malaysian Manufacturers (FMM) showed that the overall average monthly turnover rate was lower at 1.76% in 2003 (2002: 4.1%). Similarly, the Salary and Fringe Benefits Survey undertaken by the Malaysian Employers Federation (MEF), which also included firms from the non-manufacturing sectors, showed that the overall average monthly turnover rate remained low at 1.76% in 2003 (2002: 1.66%).

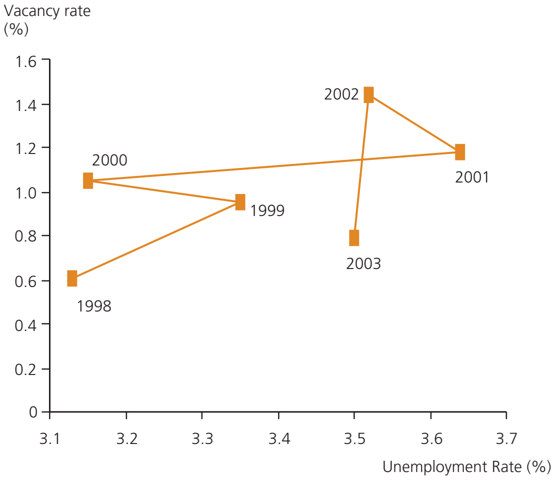
Graph 1.28
Output and Employment



Source: Department of Statistics, Malaysia
Economic Planning Unit
Bank Negara Malaysia

Labour market conditions remained favourable, supported by higher growth in productivity.

Graph 1.27
Beveridge Curve for Malaysia (1998 - 2003)



Source: Economic Planning Unit
Ministry of Human Resources
Bank Negara Malaysia

The low turnover in the labour market was also reflected in data on vacancies and retrenchment for 2003, while data on placements and unplaced job seekers mirrored the efficiency in the job matching process. Growth in the number of vacancies reported, which were mainly in the manufacturing, agriculture, services and construction sectors, moderated by 40% to 96,918 (2002: 162,787). Retrenchments, which occurred mainly in the manufacturing and tourism-related sectors, were also lower by 20% (21,206 persons; 2002: 26,452). The main reasons for retrenchment included reduction in demand for products, company reorganisation and closure of company. Other reasons included completion of projects, reduction in production and

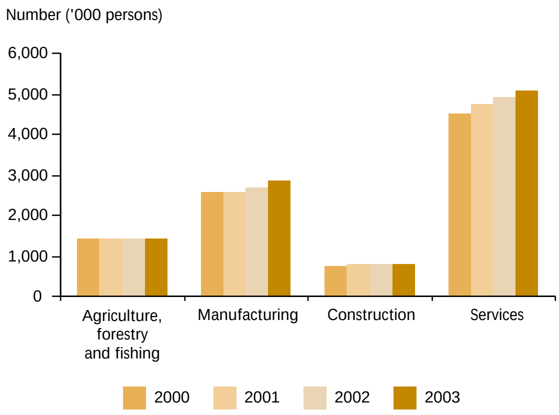
Table 1.16
Labour Market Indicators

	1999	2000	2001	2002	2003e
Labour force ('000)	9,177.8	9,572.5	9,892.1	10,198.8	10,535.3
(annual change in %)	3.7	4.3	3.3	3.1	3.3
Employment ('000)	8,869.6	9,271.2	9,532.5	9,840.0	10,166.2
(annual change in %)	3.5	4.5	2.8	3.2	3.3
Unemployment rate (%)	3.4	3.1	3.6	3.5	3.5
Labour productivity (GDP/Employment) (annual change in %)	2.6	3.9	-2.4	0.9	2.0
Real wage per employee in manufacturing sector (annual change in %)	3.1	5.0	1.6	3.2	2.6

e Estimate

Source: Department of Statistics, Malaysia, Economic Planning Unit and Bank Negara Malaysia

Graph 1.29
Total Employment by Sector



Source: Economic Planning Unit

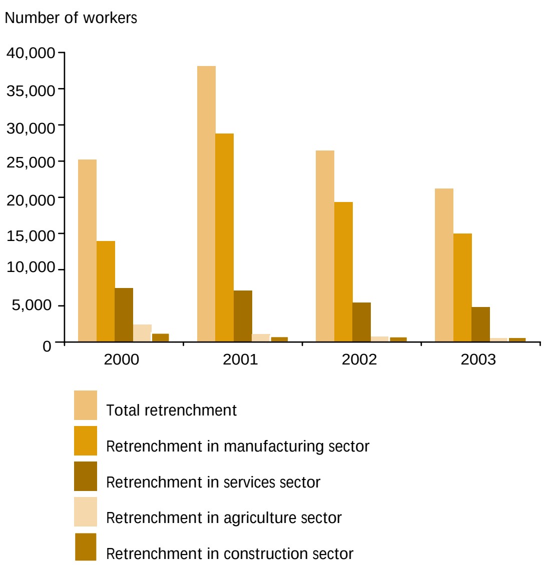
employment, and outsourcing. Growth in the number of placements during the year moderated by 16%, although the slowdown in the growth of vacancies was higher. Concurrently, the number of registered unplaced job seekers reached 28,404 at end-2003, the lowest since January 2001. Both developments indicate greater efficiency in the matching of workers to jobs available.

Given some underemployment in selected sectors, the pick-up in economic activity did not exert undue pressure on **wages** in 2003. Available indicators on wages showed that increases in wage rates continued to moderate in 2003:

- Data from the Monthly Manufacturing Survey conducted by the Department of Statistics indicated that, on an annual basis, real wage per employee increased by 2.6% (2002: 3.2%).
- The Salary and Fringe Benefits Survey undertaken by the MEF showed that the increase in the average private sector salary was slightly lower at 5.8% in 2003 (2002: 6%). On a sectoral basis, the average salary increase in the non-manufacturing sector was higher (6.1% in 2003 and 2002) than the manufacturing sector (5.5%; 2002: 5.9%). The average minimum monthly salary offered to those with a basic degree was marginally lower at RM1,669 (2002: RM1,675).
- The Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the FMM showed that the increase in overall average salary paid to employees was also moderate at 5.5% in 2003, while the average basic salary of a fresh graduate was RM1,861.
- There were only two industrial strikes relating to demand for higher wages in 2003, the same as in the previous year.

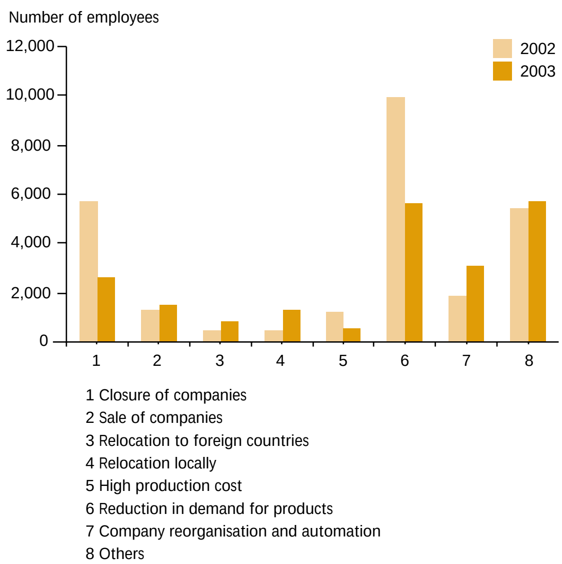
Labour productivity, as measured by the ratio of GDP to total employment, improved significantly with growth doubling to 2% in 2003 (2002: 0.9%). The productivity growth was attributed to the improvement in output across most major sectors in

Graph 1.30
Retrenchment in Selected Sectors



Source: Ministry of Human Resources

Graph 1.31
Reasons for Retrenchment



Source: Ministry of Human Resources

line with the stronger economic activities. Of significance, productivity in the manufacturing sector turned around to register a positive growth of 3% (2002: -0.8%) due to increased use of capital. The agriculture and services sectors recorded higher productivity growth of 5.7% and 0.7% respectively (2002: 3.1% and 0.5% respectively). Higher productivity in the agriculture sector was due to good weather, which is a critical factor in determining the output of agricultural produce, improved agricultural practices and greater automation.

Over the longer term, the Government continues to encourage firms to adopt better work practices, increase mechanisation and automation as well as introduce structural changes, in order to increase efficiency and productivity to alleviate the shortage of workers, particularly for the lower end jobs. In the interim, the Government continued to approve the recruitment of new **foreign workers** from designated countries, namely Bangladesh, Cambodia, P.R.China, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao People's Democratic Republic, Myanmar, Nepal, Pakistan, the Philippines, Sri Lanka, Thailand, Turkmenistan, Uzbekistan and Vietnam. During the year, the Government concluded a total of six Memoranda of Understanding, namely, with Bangladesh, P.R.China, Sri Lanka, Thailand, Pakistan and Vietnam to regulate the recruitment process and procedures, while agreements in principle were reached with Nepal and Kyrgyz Republic.

In 2003, approval was given for the recruitment of 516,355 new foreign workers (2002: 545,725) mainly in the agriculture, manufacturing and construction sectors. A large majority of the new workers originate from Indonesia, while the rest are mainly from Nepal, Vietnam, India, Myanmar and Thailand. In total, the number of registered foreign workers in the country increased by 17% to 1,239,862 (2002: 1,057,156) constituting about 12% of the total labour force. The majority are engaged in the manufacturing sector, followed by the agriculture, services (including domestic services) and construction sectors. About 70% of the foreign workers are from Indonesia, while those from Nepal and Bangladesh constitute the second and third largest group at about 8% and 7% respectively.

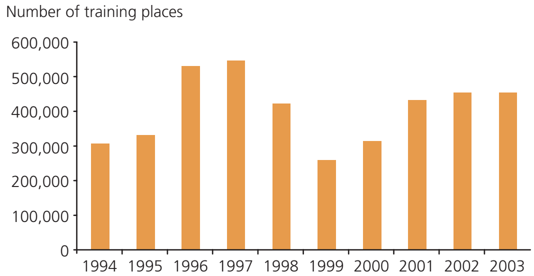
The policy on the employment of foreign nationals was further liberalized to address the need for certain specialized skills. In this regard, the period of employment of foreign workers engaged in the 3'D' areas (Difficult, Dirty and Dangerous) was extended from five years up to a maximum of ten years. Similarly, the policy on expatriate employment in the manufacturing sector was liberalised.

In view of the strategy to diversify into new growth areas, especially manufacturing related and research and design services as well as high-technology industries, employment opportunities were more abundant in higher value added sectors which require highly specialised skills. In this regard, the Brain-Gain programme was launched in 2001 to attract Malaysians overseas with special expertise in fields such as medicine and health, ICT, accountancy and finance, to return to work in Malaysia. The programme has attracted 599 professionals, of which 234 were approved.

Meanwhile, under the Economic Package, a Retraining Fund of RM100 million was established with the objective to provide **unemployed graduates** with training to acquire skills that are in demand, such as ICT and accountancy. As at end-2003, a total of 7,338 graduate trainees had benefited from training provided under the Fund, commonly known as the Graduate Training Scheme II (GTS II). Financial assistance granted to the trainees under the GTS II amounted to RM55.7 million. As funds under the earlier special schemes implemented in 2001 for unemployed graduates and retrenched workers were still available, the schemes were continued into 2003. As at end-2003, a total of 38,942 persons had participated in the various attachments and training schemes for unemployed graduates, commonly known as Graduate Training Scheme I, while another 11,135 participants benefited from the scheme for retrenched workers and the unemployed.

In line with the push for knowledge-based and services-led growth, the **Human Resource Development Fund (HRDF)** played an important role to foster increased training of staff by employers. In the period

Graph 1.32
HRDF: Number of Training Places Approved



Source: Pembangunan Sumber Manusia Berhad

1993-2003, a total of 3.9 million training places costing a total of RM1.4 billion were approved (2003: 441,721 training places with financial assistance of RM206 million). The scope of the HRDF has been expanded to meet changing demands. Reimbursement for promoted courses were increased to the full amount of the levy (85% previously), while additional schemes for smaller companies and the SMEs were introduced. The utilisation period of the HRDF by employers was extended to five years, from two years previously. The scope of the HRDF would be further expanded to include training in related services such as ports and logistics, health services, marketing, ICT and research and development.

The **Skills Development Fund (SDF)** is another skills training initiative that has been in place since 2001. Its aim is to enhance the participation of the private sector as training providers and increase accessibility to technical education and vocational training by providing financial assistance to the trainees. The SDF is open to all, including school leavers, retrenched workers as well as workers undergoing training at public and private training institutes. The objective is to ensure that the jobseekers acquire the skills required by employers. In 2003, besides an additional allocation of RM500 million under the Economic Package, guidelines on the provision of financial assistance were reviewed to enable more persons to pursue skills training under the SDF. As a result, using the existing allocation (excluding the RM500 million), the SDF was able to provide financial assistance to a total of 45,856 applicants compared with 36,700 applicants a year ago.

Apart from training polices, which are basically government driven, an encouraging development is that the private sector is also actively involved in the drive to raise the quality of labour through the adoption of productivity linked wage systems (PWLS). Besides embedding rewards with performance and higher productivity, such flexible practices have helped employers to better manage costs and share success with employees. The Salary and Fringe Benefits Survey undertaken by the MEF in 2003 showed that the majority of respondent companies adopted the PWLS.

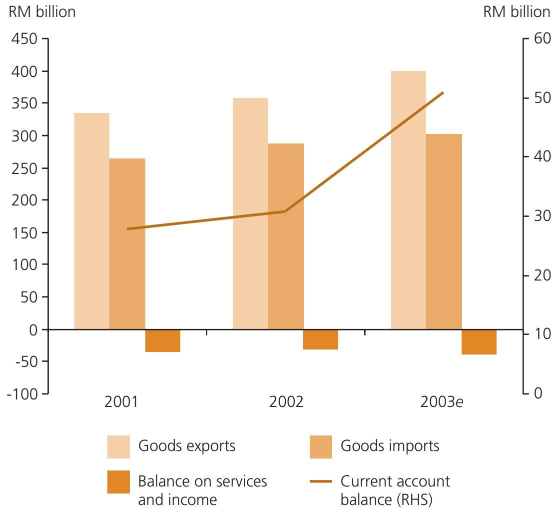
EXTERNAL SECTOR

Balance of Payments

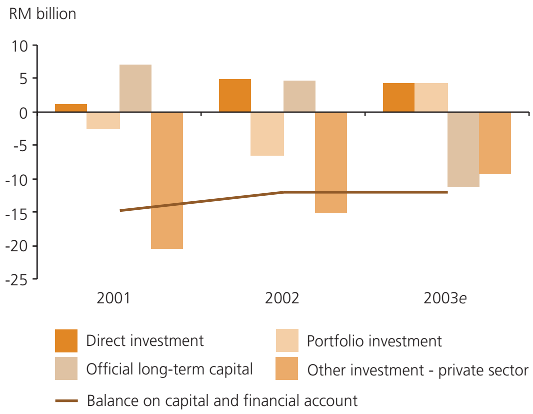
A stronger external environment and improved investor sentiment, particularly in the second half of the year, contributed to the strengthening of the external position in 2003. The **overall balance of payments** registered a significantly higher surplus on the back of a larger current

Graph 1.33
Malaysia: Balance of Payments

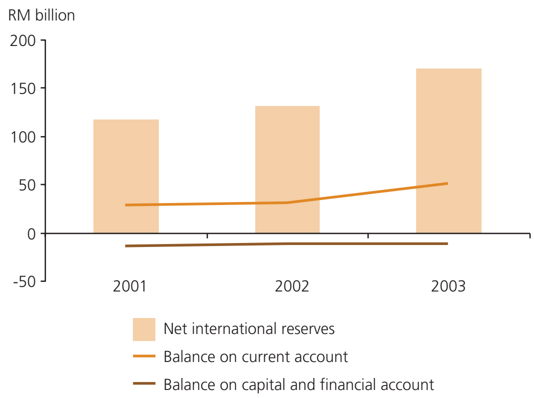
Current Account



Capital and Financial Account



Net International Reserves



e Estimate

Table 1.17
Balance of Payments

Item	2002			2003e		
	+	-	Net	+	-	Net
	RM million					
Goods	358,504	286,387	72,117	398,998	301,297	97,701
Trade account	*357,682*	*303,063*	*54,619*	*398,882*	*317,746*	*81,136*
Services	56,536	62,532	-5,996	51,594	66,620	-15,026
Balance on goods and services	**415,040**	**348,919**	**66,121**	**450,592**	**367,917**	**82,675**
Income	8,129	33,190	-25,061	13,116	35,730	-22,614
Current transfers	2,513	13,079	-10,566	1,929	11,229	-9,300
Balance on current account	**425,682**	**395,188**	**30,494**	**465,638**	**414,876**	**50,761**
% of GNP			**9.1**			**13.7**
Capital account			-			-
Financial account			-11,941			-12,063
Direct investment			4,935			4,242
Portfolio investment			-6,506			4,176
Other investment			-10,370			-20,481
Balance on capital and financial account			**-11,941**			**-12,063**
Errors and omissions			-4,362			360
of which:						
Exchange revaluation gain (+) or loss (-)			*6,627*			*11,927*
Overall balance			**14,191**			**39,059**
Bank Negara Malaysia international reserves, net			**131,394**			**170,453**
(US$ million)			**34,577**			**44,856**

e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

account surplus, sustained inflows of foreign direct investment and higher inflows of portfolio funds. Errors and omissions, including exchange gain from the revaluation of Bank Negara Malaysia's international reserves due to the appreciation of the major currencies against the US dollar (RM11.9 billion), was RM0.4 billion. After adjusting for the errors and omissions, the overall balance of payments recorded a large surplus of RM39.1 billion or US$10.3 billion. Consequently, the net international reserves of Bank Negara Malaysia increased to RM170.5 billion or US$44.9 billion at end-2003. The reserves increased further to RM194.9 billion or US$51.3 billion as at 15 March 2004. This level of reserves represented 7.8 months of retained imports and 5.2 times coverage of the short-term external debt. Malaysia's reserves are usable and unencumbered.

The external position strengthened further, supported by a stronger current account surplus. Inflows of FDI were sustained while inflows of portfolio investment were higher. The external debt of the official sector was reduced.

Current Account

In 2003, the **current account** recorded a larger surplus of RM50.8 billion or 13.7% of GNP due to a higher trade surplus. The stronger growth in manufacturing exports and robust expansion in export of commodities, which have low import content, contributed to the larger trade surplus. The larger surplus in the goods account generated more than sufficient foreign exchange earnings to finance the deficits in the services (4.1% of GNP), income and current transfers accounts. The services account deficit widened due to the impact of SARS, which lowered travel receipts. On the other hand, the income account deficit was reduced, reflecting higher profits and dividends accrued to Malaysian companies from their investments abroad and higher returns from other investment. Net outflows in the current transfers

Table 1.18
Gross Exports

	2003p		
	RM million	Annual change (%)	% share
Manufactured goods	**326,950**	**8.2**	**82.0**
Of which:			
Electronics, electrical machinery and appliances	223,547	5.2	56.0
Electronics	167,620	6.3	42.0
Semiconductor	*85,184*	*16.3*	*21.4*
Electronic equipment & parts	*82,436*	*-2.4*	*20.7*
Electrical machinery & appliances	55,927	1.9	14.0
Consumer electrical products	*19,747*	*-6.5*	*5.0*
Industrial & commercial electrical products	*20,414*	*3.5*	*5.1*
Electrical industrial machinery and equipment	*13,886*	*9.6*	*3.5*
Household electrical appliances	*1,880*	*36.7*	*0.5*
Chemicals & chemical products	21,236	23.3	5.3
Manufactures of metal	11,303	28.5	2.8
Petroleum products	9,416	23.6	2.4
Optical and scientific equipment	9,213	13.0	2.3
Textiles, clothing and footwear	8,771	2.3	2.2
Wood products	6,698	6.1	1.7
Rubber products	5,060	12.3	1.3
Agricultural commodities	**33,728**	**28.1**	**8.4**
Of which:			
Palm oil	*20,224*	*36.3*	*5.1*
Rubber	*3,582*	*43.8*	*0.9*
Sawn timber	*2,607*	*6.4*	*0.7*
Saw logs	*2,015*	*10.0*	*0.5*
Minerals	**29,777**	**33.1**	**7.5**
Of which:			
Crude oil	*15,662*	*35.0*	*4.0*
LNG	*13,328*	*34.8*	*3.3*
Tin	*284*	*-33.2*	*0.1*
Other exports	**8,427**	**25.5**	**2.1**
Total	**398,882**	**11.5**	**100.0**

p Preliminary

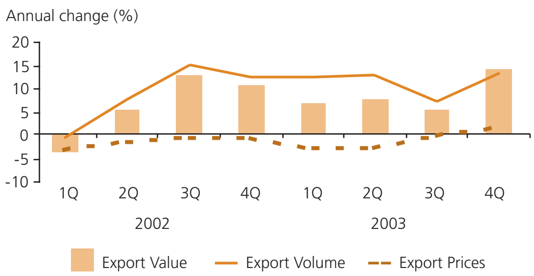
Source: Department of Statistics, Malaysia

account declined as a result of lower remittances by foreign workers.

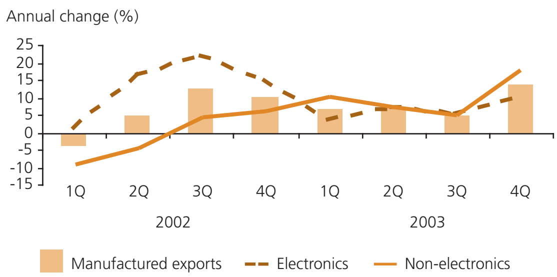
Amidst the improvement in the external environment, **gross exports** expanded strongly by 11.5% in 2003 (2002: 7%). The stronger export performance was due to higher manufactured exports, as well as robust growth in exports of primary commodities.

Growth in **manufactured exports** strengthened to 8.2% (2002: 5.9%), supported mainly by strong demand for electronics, chemical products, petroleum products, metal products and rubber

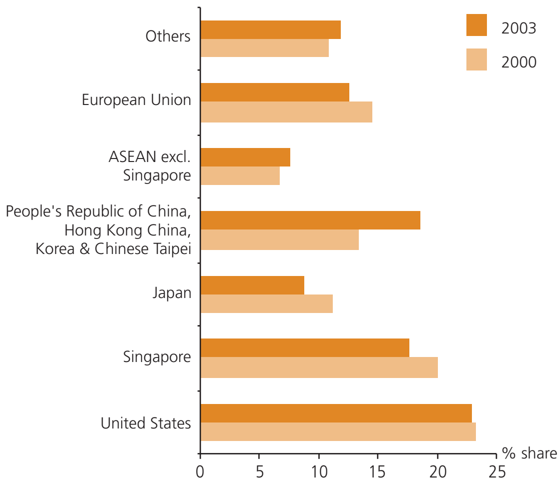
Graph 1.34
Export Performance of the Manufacturing Sector



Graph 1.35
Export Performance of Electronics and Non-electronics Industries



Graph 1.36
Export of Manufactured Goods by Destination



The significantly large trade surplus was due to stronger growth in manufacturing exports and robust expansion in commodity exports which have low import content.

products. Growth in electronics exports was largely driven by the upturn in the global electronics cycle, whilst the chemical products sector benefited from the spillover effects of the strong electronics performance as well as higher demand for organic chemicals, resins and plastic products. Higher exports of rubber products were driven largely by increased global demand for rubber gloves. Exports of metal products also rose strongly as manufacturers increased their export volume to take advantage of higher export prices for iron and steel. Overall, the increase in export receipts was attributed entirely to higher volume as prices continued to decline.

Table 1.19
External Trade

	2002	2003*p*	2002	2003*p*
	RM billion		US$ billion	
Gross export (f.o.b)	**357.7**	**398.9**	**94.1**	**105.0**
Annual change (%)	7.0	11.5	7.0	11.5
	Annual change (%)			
Volume[1]	6.1	7.2	6.1	7.2
Prices[1]	-0.4	1.0	-0.4	1.0
Gross import (c.i.f)	**303.1**	**317.7**	**79.8**	**83.6**
Annual change (%)	8.1	4.8	8.1	4.8
	Annual change (%)			
Volume[1]	6.1	1.1	6.1	1.1
Prices[1]	1.4	2.3	1.4	2.3
Trade balance	**54.6**	**81.1**	**14.4**	**21.4**

[1] Volume and prices for 2003 are estimates.

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Exports of **primary commodities** rose markedly by 30.4%, driven mainly by the strong export performance of agriculture (28.1%) and minerals (33.1%). Commodity exports was supported by stronger prices (17.1%) and higher export volume (11.9%) during the year. Strong demand for commodities amidst the tight global supplies of many major commodities during the year supported the rise in prices.

Total receipts from **agriculture** exports rose to RM33.7 billion with the main contributor to growth being palm oil, which generated RM20.2 billion foreign earnings following strong average export prices of RM1,617 per tonne and higher export volume of 12.5 million tonnes. Palm oil prices increased due mainly to imbalances in the global edible oils markets, arising from shortages in the supply of major oilseeds amidst rising demand. Malaysian palm oil also benefited from import substitution by several price sensitive buyers given the large price discounts of palm oil against other major oilseeds, particularly soybean oil, its closest substitute. The major export markets for Malaysian palm oil in 2003 were P.R.China, the Middle East, India and the EU, which together accounted for 60% of total Malaysian palm oil exports. With substantially higher revenue, palm oil accounted for about 60% of total agriculture export receipts and 5% of total gross exports. The strong agriculture exports during the year was also supported by increases in the exports of other commodities, including rubber and timber and timber products.

Export revenue from **minerals** turned around sharply to record a growth of 33.1% to RM29.8 billion, driven mainly by the significantly higher oil prices. Malaysian crude oil export prices strengthened significantly to average US$30.27 per barrel in tandem with higher global crude oil prices. In line with the upward trend in oil prices, liquefied natural gas (LNG) prices also trended upwards to average RM766 per tonne in 2003. The commencement of the MLNG Tiga plant during the year also boosted the exports of Malaysian gas. Thus, revenue from crude oil and LNG exports rose to RM15.7 billion and RM13.3 billion respectively.

Gross imports registered a moderate growth of 4.8% (2002: 8.1%) attributable to imports of capital and intermediate goods, which picked up in the fourth quarter. Import prices increased by 2.3%, reflecting higher prices of imports of manufactured goods, mineral fuel and chemicals.

Imports of **intermediate goods**, which were the main driver of import growth, continued to grow by 6.4%. Intermediate imports are inputs for the production of manufactured exports, particularly electronic and electrical products. **Capital imports**, excluding lumpy items, increased by 6%, reflecting growth in investment activity, particularly in the second half of the year. Imports of lumpy items were lower due to fewer deliveries of new aircraft. The continued strength of the services sector as well as increased automation of businesses induced the turnaround in imports of office equipment to record positive growth. Increased exploration activity in the oil and gas industry in the wake of higher prices of petroleum led to the increase in imports of construction and mining equipment. Imports of telecommunication equipment declined by 9.5% against a background of industry consolidation following the mergers of selected cellular service providers. In line with higher disposable income, imports of **consumption goods** increased by 1.1% reflecting higher imports of consumer goods and transport equipment.

The growth in intra-regional East Asian (excluding Japan) trade since 1997 has reshaped trading patterns, with P.R. China providing the main impetus to this growth. P.R. China is the sixth largest exporter in the world and 30% of the P.R. China's exports is exported to the region. Approximately 36% of P.R. China's imports are sourced from East Asia.

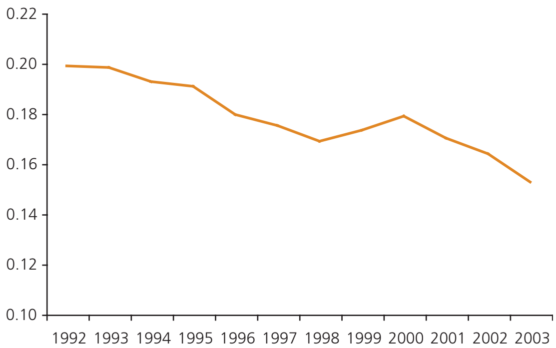
Table 1.20
Gross Imports by End Use

	2003*p*		
	RM million	Annual change (%)	% share
Capital goods	**43,508**	**0.7**	**13.7**
Capital goods (except transport equipment)	40,837	7.1	12.9
Industrial machinery and equipment	*9,862*	*-0.4*	*3.1*
Office equipment	*7,404*	*26.6*	*2.3*
Telecommunication equipment	*5,213*	*-9.5*	*1.6*
Transport equipment	2,671	-47.1	0.8
Intermediate goods	**233,046**	**6.4**	**73.3**
Food and beverages, mainly for industry	5,831	7.3	1.8
Industrial supplies, n.e.s.	66,130	3.4	20.8
Metals & metal products	*18,594*	*6.2*	*5.9*
Chemicals	*7,285*	*1.1*	*2.3*
Fuels and lubricants	13,623	23.2	4.3
Parts and accessories of capital goods (except transport equipment)	141,283	8.0	44.5
Electronics	*95,314*	*7.1*	*30.0*
Parts and accessories of telecommunication equipment	*6,587*	*-9.8*	*2.1*
Parts and accessories of transport equipment	6,179	-16.0	1.9
Consumption goods	**18,866**	**1.1**	**5.9**
Food and beverages, mainly for household consumption	6,777	-1.5	2.1
Transport equipment, non-industrial	337	90.9	0.1
Consumer goods, n.e.s.	11,752	1.3	3.7
Consumer durables	*2,646*	*-2.0*	*0.8*
Consumer semi-durables	*3,985*	*-5.1*	*1.3*
Consumer non-durables	*5,121*	*8.9*	*1.6*
Dual use goods	**7,057**	**15.2**	**2.2**
Motor spirit	2,981	17.2	0.9
Passenger motor cars	4,075	13.8	1.3
Others	**6,547**	**-4.4**	**2.1**
Re-exports	**8,722**	**-4.3**	**2.7**
Gross Imports	**317,746**	**4.8**	**100.0**

n.e.s. Not elsewhere specified.
p Preliminary

Source: Department of Statistics, Malaysia

Graph 1.37
Exports Diversification Index



The export diversification index is a modified version of Herfindahl-Hirschmann index. It is normalized to obtain a numeric range from 0 to 1. A lower index signifies higher degree of diversification.

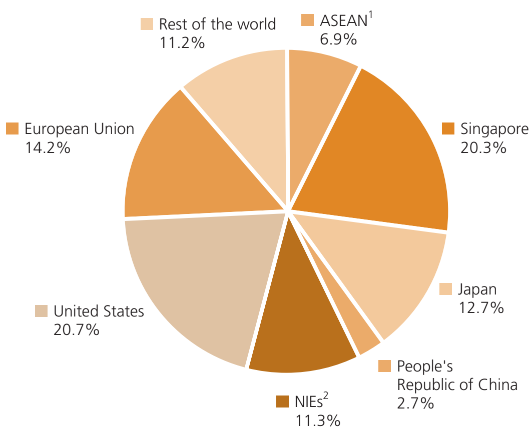
Consequently, Malaysia's share of trade with major trading partners, namely, the US and Japan, has declined, while the share with the EU remained unchanged. Malaysia's trade with the US, Japan and the EU as a group declined to account for a share of 43.1% of total trade (2002: 44.8%) while East Asian trade increased to 44.9% (2002: 44%) of total trade.

Efforts continue to be made towards diversifying markets particularly into non-traditional markets, such as the South Asia and West Asia regions, and increasing market share in East Asian countries. The diversification of markets, which is measured by the normalised Herfindahl-Hirschmann index, improved in 2003. In the normalised Herfindahl-Hirschmann index, a ratio closer to zero reflects increasing diversification. The index for exports declined to 0.15 in 2003 from 0.16 in 2002. Similarly, the index for imports also declined to 0.15 from 0.16.

The **United States** (US) remained as Malaysia's most important trading partner although its share of total trade declined to 17.7% (2002:18.8%). Exports to the US consist mainly of electronics components, in particular integrated circuits, rubber, optical and scientific instrument, furniture and parts and apparatus. Approximately 65% of imports from the US are intermediate inputs for the electrical and electronics industry. Other imports include optical and scientific instruments, plastics and chemicals. As exports to the US increased while imports declined, the bilateral trade surplus widened to RM29.2 billion (2002: RM20.1 billion).

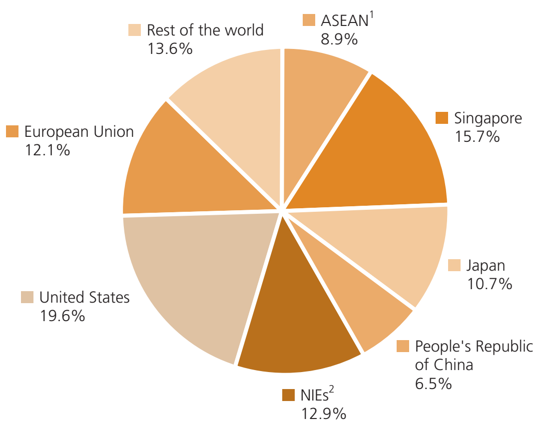
Singapore maintained its position as the second most important trading partner of Malaysia despite the decline in the share of trade to 14% (2002: 14.7%). The bulk of exports to Singapore were electronics, with integrated circuits and micro-assemblies accounting for 26%, parts and accessories 13% and diodes and transistors 4.8%. The lower share of exports to Singapore (15.7%; 2002: 17%) was attributable to the increased direct trade and usage of local ports. On the imports side, every one out of three imported products were electronics and electrical goods while petroleum and petroleum related products made up 18%. The trade surplus with Singapore increased to RM25.5 billion as exports grew at a faster pace relative to imports.

Graph 1.38
Direction of Exports: 1995



[1] ASEAN excluding Singapore
[2] Hong Kong China, South Korea and Chinese Taipei

Direction of Exports: 2003



[1] ASEAN excluding Singapore
[2] Hong Kong China, South Korea and Chinese Taipei

Table 1.21
Direction of External Trade

	2003*p*				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	RM million
ASEAN countries	**98,225**	**24.6**	**76,345**	**24.0**	**21,879**
Singapore	62,786	15.7	37,283	11.7	25,503
Thailand	17,538	4.4	14,549	4.6	2,989
Indonesia	8,091	2.0	11,168	3.5	-3,077
Philippines	5,459	1.4	11,835	3.7	-6,376
Other ASEAN countries	4,351	1.1	1,510	0.5	2,841
European Union (EU)	**48,264**	**12.1**	**37,216**	**11.7**	**11,047**
United Kingdom	8,872	2.2	5,991	1.9	2,881
Germany	9,145	2.3	14,787	4.7	-5,642
Netherlands	13,036	3.3	2,151	0.7	10,886
Other EU countries	17,210	4.3	14,287	4.5	2,923
United States	78,007	19.6	48,757	15.3	29,250
Japan	42,643	10.7	54,273	17.1	-11,630
The People's Republic of China	25,878	6.5	27,739	8.7	-1,861
Hong Kong China	25,778	6.5	8,580	2.7	17,199
Chinese Taipei	14,351	3.6	15,698	4.9	-1,347
South Korea	11,550	2.9	17,308	5.4	-5,758
India	9,629	2.4	2,555	0.8	7,074
Australia	9,932	2.5	4,803	1.5	5,129
Rest of the world	34,626	8.7	24,473	7.7	10,153
Total	**398,882**	**100.0**	**317,746**	**100.0**	**81,136**

p Preliminary

Source: Department of Statistics, Malaysia

Supported by a higher export growth relative to imports, the trade balance with **Japan**, which has been in Japan's favour, improved to register a smaller deficit of RM11.6 billion (2002: -RM14.1 billion). Export growth of 7.4% was underpinned by increased export receipts from LNG, petroleum and chemical products on the back of higher crude oil and LNG prices. Imports grew marginally by 0.9% reflecting growth in imports of machinery and transport equipment, manufactured articles and crude materials.

Trade with the **European Union** (EU) turned around to record a growth of 9.2% in the wake of an improvement in economic performance of EU countries. Malaysia continued to record a trade surplus of RM11 billion (2002: RM9.5 billion) with EU countries. Germany remained the leading trading partner, accounting for 3.3% of total trade.

Exports to the **North East Asia** region (excluding Japan), which accounted for 19.4% of total exports, expanded by 18.3%. The impetus to this growth stemmed from the continued strong export growth of 29.6% to the P.R.China and 26.7% to Hong Kong China. The driver of this growth was the continued relocation by multinational companies to the P.R.China and increased outsourcing activity. P.R.China remained the biggest trading partner of the region. About a quarter of Malaysia's exports to P.R.China consisted of integrated and printed circuits, semiconductor devices and light emitting diodes. Another source of increase in export growth came from demand for resource exports, particularly palm oil and rubber.

Reflecting increasing intra-regional trade and better economic performance of **ASEAN** countries (excluding Singapore), the share of trade with member countries expanded to 10.4% in 2003 (2002: 9.6%). The market share of imports from ASEAN countries rose to 12.3% against a background of increasing sourcing from low cost suppliers such as Thailand, Indonesia and the Philippines.

Services Account

Policies to promote exports of services have been successful in reducing the services deficit in the balance of payments to as low as -1.8% of GNP in 2002. In 2003, however, the **services account** deficit widened to RM15 billion or -4.1% of GNP due mainly to lower tourism receipts as travel, especially into the Asian region, was severely affected by SARS. Nevertheless, gross receipts from new sources of foreign exchange income, namely education,

Graph 1.39
Tourist Arrivals and Tourism Receipts

p Preliminary

computer and information services, as well as ports and airports continued to increase.

Despite the impact of SARS, travel remained the largest contributor to services receipts in 2003, accounting for 43.4% of total services receipts. Tourist arrivals totalled 10.6 million visitors in 2003 (2002: 13.3 million visitors) with lower tourist receipts of RM21.3 billion (2002: RM25.6 billion). This resulted in the net surplus of the **travel account** declining sharply to RM11.6 billion (2002: RM17.1 billion). The outbreak of SARS caused visitor arrivals to decline by 51.6% in the second quarter. Tourist arrivals from P.R.China and Singapore declined most significantly. Tourist arrivals recovered strongly in the fourth quarter with arrivals exceeding the monthly average of one million attained in the pre-SARS period.

Table 1.22
Services and Income Accounts

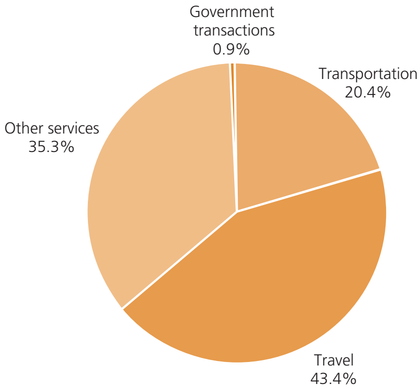
	2002	2003e		
	RM billion			
	Net	+	–	Net
Services Account				
Transportation	-11.6	10.5	23.8	-13.3
Travel	17.1	22.4	10.8	11.6
Other Services	-11.2	18.2	31.2	-13.0
Government services n.i.e.	-0.3	0.5	0.8	-0.3
RM billion	**-6.0**	**51.6**	**66.6**	**-15.0**
US$ billion	**-1.6**	**13.6**	**17.5**	**-4.0**
% of GNP	-1.8			-4.1
Income Account				
Compensation of employees	-1.2	2.2	3.1	-1.0
Investment income	-23.9	10.9	32.6	-21.7
RM billion	**-25.1**	**13.1**	**35.7**	**-22.6**
US$ billion	**-6.6**	**3.5**	**9.4**	**-6.0**
% of GNP	-7.5			-6.1

e Estimate

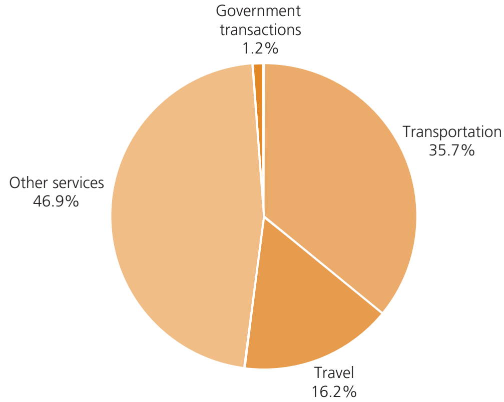
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

For 2003 as a whole, the decline in receipts from the tourism sector, however, was mitigated by new sources of services export income, namely earnings from education and healthcare services. The number of foreign students increased by 8.5% to 39,577 students in 2003. Foreign students were mainly from Indonesia and P.R.China. Receipts from education tourism are still small, accounting for about 1.4% of total travel receipts and 0.6% of total services receipts, although the spillover effects on the economy through consumption spending and travel are large. Revenue from 102,946 foreign patients seeking treatment in Malaysia in 2003 increased by

Graph 1.40
2003: Components of Gross Receipts in the Services Account (% share)



Graph 1.41
2003: Components of Gross Payments in the Services Account (% share)



64.2%. Foreign patients were mainly from Indonesia (72.5%), other ASEAN countries, West Asian countries and Japan.

On the payments front, travel outflows increased to RM10.8 billion (2002: RM9.9 billion), reflecting higher expenditure on business travel and education abroad. Payments for travel abroad by Malaysians, including business travel, expanded by 17.9% to RM7.7 billion in 2003 in line with the pick-up in economic activity. Meanwhile, education outflows increased by 1.3% with a larger number of students studying aboard.

There was a broadening of tourism products in 2003, with more niche products in areas such as sports, eco-tourism, agro-tourism and meetings, incentives, conventions and exhibitions being promoted. The main strategy of the new tourism products was to increase the length of stay of visitors. Promotion of tourism products and services was undertaken through joint collaboration by the public and private sectors. Connectivity of air services was facilitated through allowing greater use of charter flights and budget fares offered by no-frills airlines. More gateway points, such as Langkawi, Penang, Kuching and Kota Kinabalu, enabled the travel industry to expand into new as well as established markets. The new markets targeted for promotion included Pakistan and Iran.

The deficit in the **transportation account** widened to RM13.3 billion in 2003 (2002: -RM11.6 billion), as payments abroad increased while receipts were sustained. Gross outflows reflected higher freight charges as well as increased volume of trade. Gross receipts were sustained, supported mainly by earnings from cargo services and charter services provided by domestic shipping companies and airlines. The increase in cargo handled was underpinned by the increase in transhipment cargo sourced from India, P.R.China, Myanmar, Indonesia and Thailand.

In line with the improvement in the economy, the higher demand for other services led to a higher net payment of RM13 billion in the **other services account** (2002: -RM11.2 billion). In particular, imports of design, technical and project consultancy services related to infrastructure and oil and gas exploration resulted in higher payments for contract and professional charges. Payments for insurance and financial services increased as larger external trade transactions led to higher demand for imported support services. Receipts from computer and information services improved in line with the expansion in business process outsourcing and ICT services.

For the third consecutive year, the **income account** deficit declined by 9.8% to RM22.6 billion or -6.1% of GNP in 2003 (2002: -RM25.1 billion or -7.5% of GNP). This improvement was attributable to profits and dividends accruing to Malaysian companies from their investments aboard, particularly in the oil and gas and utilities sectors, which increased by 190.6% to RM2 billion (2002: RM0.7 billion). It accounted for 17.9% of the total gross investment income inflows. Secondly, income from other investments turned around to record a net inflow of RM2.4 billion (2002: -RM0.9 billion), reflecting largely the better returns from higher external reserves while interest payments on external debt declined.

Higher profits and dividends of Malaysian companies operating abroad contributed to an improvement in the income account.

On the payments side, gross profits and dividends accruing to foreign direct investors also increased. This was attributable mainly to higher earnings in the electronics and electrical industries following improved export performance, as well as the oil and gas sector on the back of higher oil prices. While profits and dividends accounted for 78.8% of the gross investment income outflow, a substantial portion is retained in Malaysia for further reinvestment. Retained earnings were estimated at 42.5% of total profits and dividends, and credited as inflows of foreign direct investment in the financial account.

In 2003, the net outflow in the **current transfers account** declined by 12% to RM9.3 billion. The significant decline in current transfers payments by 14.1% in 2003 (2002: +28%), was largely due to lower remittances by foreign workers following the return of the illegal workers under the Amnesty Program conducted in 2002. There were about 1.2 million registered foreign workers in Malaysia in 2003, more than half of whom were employed in the plantation and manufacturing sectors.

Financial Account

In 2003, the **financial account** remained stable with a net outflow of RM12.1 billion (2002: -RM11.9 billion). Outflows of short-term capital, comprising portfolio investment and other private sector investment, were significantly lower following improved investor sentiment in the equity market as well as interest differentials in Malaysia's favour. In the long-term capital account, large repayments of external loans by the official sector and modest drawdown of loans helped to contain the increase in Malaysia's external debt position. Private long-term capital, comprising mainly foreign direct investment, was sustained at a moderate level.

In terms of gross inflows, about half of the FDI continued to be in the form of reinvested earnings, particularly from the manufacturing sector. With respect to new inflows of FDI as recorded by the Cash BOP Reporting System of Bank Negara Malaysia, both the services and manufacturing sectors continued to receive significant shares of about 38% and 37% respectively, while the share of the oil and gas sector was about 15%. Large inflows into the services sector continued to be sustained. There was an increase in foreign participation in Malaysia's network of wholesale and retail trade sub-sector, ranging from automotive distribution, petrol station to hypermarkets. Foreign interests were also higher in the higher value-added

The financial account remained stable, reflecting sustained inflows of FDI and higher portfolio investment. The official sector reversed to record a large net loan repayment. Overseas investment generated higher profits and dividends to Malaysia.

Gross **foreign direct investment** (FDI) in Malaysia was higher in 2003 at RM21.8 billion (2002: RM20.5 billion), reflecting largely broad-based inflows into the services and manufacturing sectors, as well as the oil and gas sector. On a net basis, however, FDI moderated to RM9.4 billion or 2.5% of GNP in 2003 (2002: RM12.2 billion), due largely to the acquisition of foreign interests in the oil and gas sector by a Malaysian company upon the expiry of joint venture contracts, as well as large loan repayments to parent companies abroad.

Table 1.23
Balance of Payments: Financial Account

	2002	2003e	2002	2003e
	RM billion		US$ billion	
Financial Account	**-11.9**	**-12.1**	**-3.1**	**-3.2**
Direct Investment	**4.9**	**4.2**	**1.3**	**1.1**
In Malaysia	12.2	9.4	3.2	2.5
Abroad	-7.2	-5.2	-1.9	-1.4
Portfolio Investment	**-6.5**	**4.2**	**-1.7**	**1.1**
Other Investment	**-10.4**	**-20.5**	**-2.7**	**-5.4**
Official sector	4.7	-11.2	1.2	-3.0
Of which:				
Federal Government (net)	8.0	-3.7	2.1	-1.0
Gross borrowing	10.5	3.1	2.8	0.8
Repayment	2.5	6.9	0.6	1.8
NFPEs (net)	-3.3	-7.3	-0.9	-1.9
Gross borrowing	3.5	5.2	0.9	1.4
Repayment	6.8	12.4	1.8	3.3
Private sector	-15.1	-9.3	-4.0	-2.4

e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

services sector, especially the transport sub-sector, airlines and port management, as well as knowledge-based activities in the form of MSC-related investment and electronic data processing industries. In 2003, 219 regional facilities for foreign- and local-owned companies were established, encouraged by investment incentives provided by the Government. Of these, 12 were operational headquarters (OHQs), 37 regional offices, 32 international procurement centres (IPCs), 134 representative offices and 4 regional distribution centres (RDCs).

Foreign interests in the manufacturing sector continued to remain high, with larger new FDI inflows into electrical and electronics and petroleum-related industries. Inflows were also broad-based into food processing, industrial refrigeration and printing industries as well as high-end aerospace industry.

Malaysian **direct investment abroad** remained large, albeit at a moderately lower level, at RM5.2 billion in 2003 (2002: -RM7.2 billion) after several major overseas acquisitions in 2002. Investment abroad was mainly to diversify and reinforce principal activities in Malaysia. Notably, the scope of investment has become increasingly broad-based. A large share of overseas investments was channelled into both the oil and gas and services sectors, followed by the manufacturing sector. In the oil and gas sector, Malaysia continues to operate through

Recent Trends in Foreign Direct Investment in Malaysia

Introduction

Foreign investments continue to account for about one-third of total private investment in Malaysia. The trend in gross FDI has remained stable since 2000 after a moderation during the Asian financial crisis. This stability is largely due to existing multinational companies (MNCs) expanding and diversifying their operations, with funding mainly from retained earnings. The pattern of FDI flows has also changed in favour of the higher value-added services sector, as the services sector is transformed and accounts for a larger share of GDP. As the services sector tends to be less capital intensive, the scale of the gross value of new flows tends to be smaller while the value-added and contribution to growth is higher.

The Government continues to ensure that policies remain supportive of attracting new foreign investments and that Malaysia remains a place of choice for companies seeking opportunities in the Asian region. Policy initiatives include a series of Investment Guarantee Agreements (IGA), tax and non-tax incentives, sequential sector liberalization, improving administrative processes and the delivery system of the public sector and lowering the overall cost of doing business. Equally important is the commitment to sound macroeconomic policies.

Definition, Methodology and Compilation of FDI Data

In the compilation of FDI statistics in the balance of payments, Malaysia adopts international standards in terms of definition, methodology and measurement. FDI, based on the IMF's Balance of Payments Manual, Fifth Edition, is defined as "....foreign holdings of at least 10% ownership in the enterprise with a lasting interest".

Actual FDI flows are reported in the financial account of the balance of payments, released on a quarterly basis by the Department of Statistics, Malaysia (DOS). DOS data refers to actual investments that have taken place in Malaysia in all sectors. This data differs from the data on applications and approvals released on a quarterly basis by the Malaysian Industrial Development Authority (MIDA), which records mainly investments in the manufacturing sector and covers investors who have applied for the various tax incentives. MIDA's data also does not cover investments in the oil and gas sector.

Data in the financial account of the balance of payments covers all the three components of FDI, namely equity capital, reinvested earnings and other capital (mainly inter-company loans). In addition to the quarterly survey by DOS, Bank Negara Malaysia maintains the Cash Balance of Payments (CBOP) Reporting System. Under this system, Bank Negara Malaysia is able to provide data on actual FDI flows on all cross-border transactions between residents and non-residents which are effected through the banking system, inter-company accounts and overseas accounts.

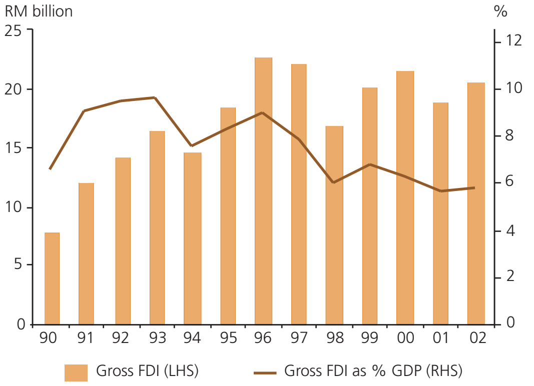
While the CBOP data does not capture the retained earnings by existing foreign enterprises in Malaysia (since there are no cross-border transfers through the banking system), it provides a good indicator on the trends of new FDI flows. The CBOP data is also available on a more timely basis, with a six-week lag.

Recent FDI Trends in Malaysia

On a **gross** basis, FDI continues to be sustained at a high level of about RM18-20 billion in recent years (Graph 1). Inflows of FDI have contributed to the establishment of new industries and products, introduction of new processes and production technology, the growth of support services, research and development and access to new markets.

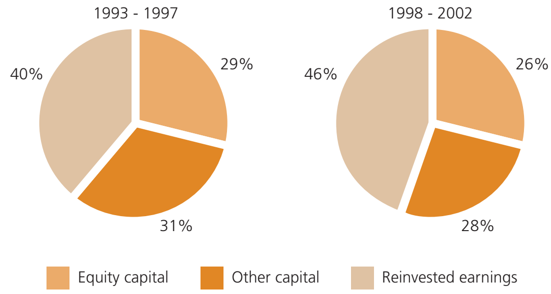
FDI flows during the post-crisis period remained stable as MNCs with operations in Malaysia continued to reinvest their retained earnings to expand, upgrade and diversify their production lines, in spite of the increased competition from low-wage economies in the region. Reinvested earnings accounted for nearly half of gross FDI for the period 1998 - 2002 (Graph 2).

Graph 1
Gross FDI Flows (1990-2002)



Source: Department of Statistics, Malaysia; Bank Negara Malaysia's estimates

Graph 2
Gross FDI Components



Source: Department of Statistics, Malaysia; Bank Negara Malaysia's estimates

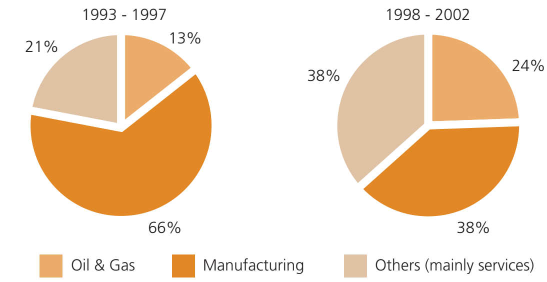
As a share of GDP, gross FDI has been sustained at 6% in the post-crisis years, compared with an average of 8% in the mid-1990s when FDI flows peaked. This was the result of two major developments:

- Between 1990 and 2002, the capital investment per employee (CIPE) in the manufacturing sector has increased by 66%, indicating a discernible trend towards higher value-added and high-technology projects and the employment of highly skilled manpower. However, in recent years (2001 - 2003), the CIPE in the manufacturing sector has declined as the **bulk of increased investment was mainly from the expansion, upgrading and diversification of existing projects.** Going forward, the growth in CIPE is likely to be sustained following the Government's efforts to promote investment in new high-growth sectors such as biotechnology and the agro-based industry.
- As a higher share of FDI flows are targeted at the higher value-added services sector and knowledge-based activities, **FDI inflows tend to be lower per investment project.** The value of FDI in services has tended to be on a smaller scale and low in import content but having a larger multiplier impact on income and employment. FDI in the services sector usually includes new technology and brings in specialised expertise that contributes towards raising productivity. The structural change in FDI flows is consistent with the transformation of the Malaysian economy towards services as another engine of growth and the move towards a knowledge-based economy.

Changing pattern of FDI flows

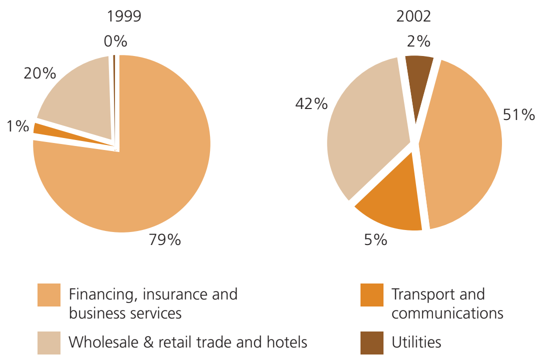
This trend, however, does not mean that FDI flows into the manufacturing sector have become less significant. FDI inflows into the manufacturing sector remain high, but the rapid growth of new inflows into other sectors has led to a relative decline in its share to 38% in 1998 - 2002, compared with 66% in 1993 - 1997 (Graphs 3 & 4). Both services and oil and gas sectors have experienced a significant increase in their share of FDI flows, accounting for 38% and 24% respectively in 1998 - 2002.

Graph 3
Gross FDI by Sector



Source: Department of Statistics, Malaysia; Bank Negara Malaysia's estimates

Graph 4
FDI in Services



Source: Cash BOP Reporting System, Bank Negara Malaysia

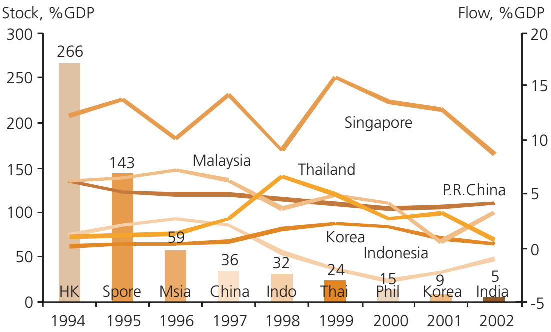
FDI in services is increasingly broad-based, extending beyond the financing, insurance and business services sub-sector into other major sub-sectors such as wholesale and retail trade and hotels, transport and communications as well as utilities. In the financial sector, a number of foreign banks have set up their treasury, back-office and data processing operations in Malaysia to facilitate their group operations in this region. Malaysia already hosts a number of regional facilities for both foreign and local companies. As of end 2003, the Government has approved 1,695 regional facilities for foreign- and local-owned companies. Of these, 71 are operational headquarters (OHQs), 473 regional offices, 141 international procurement centres (IPCs), 1,006 representative offices and 4 regional distribution centres (RDCs).

In the IT sector, Malaysia's IT hub, the Multimedia Super Corridor (MSC), has continued to expand. By February 2004, there were 283 foreign companies operating in the MSC, accounting for 29% of the MSC-status companies that employed more than 20,000 knowledge workers. To continue to attract greater foreign participation, the Multimedia Development Corporation, the MSC administrator, has offered a generous package of financial incentives. MSC-status companies also enjoy privileges in terms of administrative ease to source capital and borrow funds globally.

FDI in Regional Perspective

Regionally, with the exception of Hong Kong China and Singapore, Malaysia ranks ahead of many regional economies in terms of inflows of FDI despite declining FDI flows to emerging economies

Graph 5
FDI as at end-2002: stock (bar) and flow as % GDP (line)

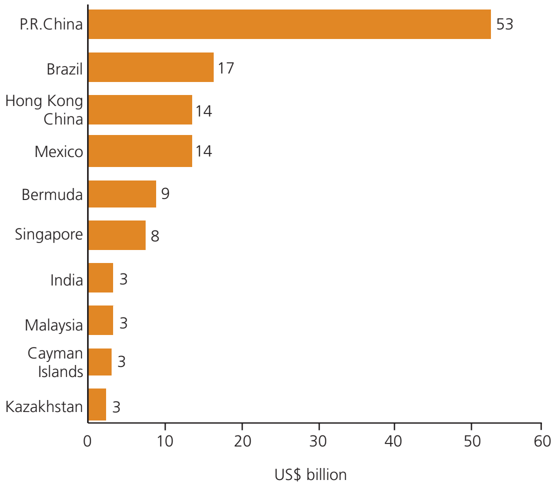


Note: HK figures were exaggerated by inflows redirected to P.R.China via Hong Kong China by Chinese Taipei investors as well as P.R.China's 'round-tripping capital' (UNCTAD)

Source: UNCTAD

(Graphs 5 & 6). The high presence of MNCs in Malaysia is testimony of the advantages Malaysia can offer in the global production or marketing chain. Based on the US data, the US non-bank MNCs have achieved a higher rate of return on their investment in Malaysia (5.6%), compared with an average of 3.5% in the Asian economies in 2000.

Graph 6
Top 10 Developing Economy FDI Recipients in 2002



Source: UNCTAD

The UNCTAD World Investment Report 2003 listed Malaysia as one of the top ten economies that had defied the global FDI slowdown in 2002. Similarly, the A.T.Kearney FDI 2003 report stated that Malaysia has enhanced its attractiveness as a destination for FDI, by improving to 23rd position (previous: 42nd) in the overall FDI confidence index. More specifically, Malaysia is in the top ten positions for FDI in primary industries as well as improving its standing in sectors such as electronics, mining, petrochemical, stone/glass and chemicals/plastics sectors and consultancy.

FDI Policies

Malaysia's strength in fundamentals such as trade openness, legal protection of patents, low tax rates, commitment to market pricing, a highly educated workforce, an efficient and diversified financial system for raising long-term capital, strong corporate governance, well-developed infrastructure and a wide array of tax incentives continue to be recognised as strong points in attracting FDI. While previous policies were more broad-based in nature, incentives have been repackaged and are increasingly customized and tailor-made for specific investors and industries. There are three broad philosophies governing policies specific to FDI:

- **Tax and non-tax incentives** to promote specific industries;
- Sequential **liberalization** of sectors in terms of market access, regulations governing employment of expatriates, equity ownership and relaxing rules and regulations; and
- **Improvement in the administrative processes and minimize costs** of establishing and operating a business enterprise in Malaysia.

Within this framework, there are a wide range of measures that are specific, targeted and, most importantly, benefit investors. Further, as the investment framework is goal-oriented rather than incentive-oriented, incentives are regularly fine-tuned to meet investor needs through the existing mechanism for consultation between the Government and the MNCs. This is acknowledged by the 2003 World Competitiveness Yearbook, which ranked Malaysia as second best in the world in terms of firms' perception of the ability of the Government to adapt policy to changes in the economy. In addition to fiscal and other specific incentives, the sequential sector liberalization measures offers new opportunities to foreign investors, in both the goods and services sectors.

The Government has adopted a holistic approach to lower the cost of doing business as well as to encourage efficiency and technological enhancement through strategic alliances with foreign investors in key economic sectors. The Government also recognizes the importance of forging closer links between indigenous small and medium enterprises (SMEs) and the large foreign-owned companies. Thus, the current policy emphasis on developing a strong and vibrant SME sector should be viewed as complementary efforts to attract FDI. By broadening the indigenous industrial base, the economy stands to gain by spreading the benefits of FDI more equitably. At the same time, foreign investors will have access to high quality goods and services that are provided by the domestic economy at low cost. Going forward, a balanced growth strategy involving the synergy between domestic- and foreign-owned companies will equip the country to respond effectively to an increasingly competitive global environment.

joint ventures in exploration and extraction. During the year, Malaysia's investments in the oil and gas sector were channelled mainly into the ASEAN and selected African countries.

In the services sector, overseas investments were made mainly in the utilities, transportation, retail and travel-related sub-sectors. There were also some investments by companies in the construction industry following their success in bidding for large infrastructure, roads and highway projects abroad. While the share of the manufacturing sector in overseas investment is smaller, investments were broad-based across sub-sectors, ranging from electrical and electronics, and textiles to high value-added activities such as petroleum-related manufacturing and aerospace industry. Several multinational companies from the electrical and electronics industry in Malaysia have also invested abroad, mainly through the extension of inter-company loans to their subsidiaries in lower-cost countries. Malaysia's investment abroad has continued to yield positive results. Profits and dividends accrued to Malaysian companies from their investments abroad increased to RM2 billion in 2003 (2002: RM0.7 billion).

Portfolio investment turned around to record a net inflow of RM4.2 billion in 2003 (2002: -RM6.5 billion). In the first half of the year, portfolio investment recorded a net outflow of RM1.3 billion as sentiments in the regional markets were dampened by uncertainties over the global economic outlook due to geopolitical tensions in the Middle East and SARS. Nonetheless, the net outflow was significantly lower compared with the first and second half of 2002.

The sharp increase in portfolio investment of RM5.5 billion in the second half of the year reflected improving investor confidence following news of better growth and more favourable prospects for the Malaysian economy. The bulk of the portfolio inflows was channelled into the equity market, following the sovereign upgrade by a rating agency in October.

The **other investment account** recorded a significantly higher net outflow of RM20.5 billion in 2003, mainly due to the reversal from a net drawdown of external debt in 2002 to a large net repayment in 2003. Meanwhile, net outflows by the private sector continued to moderate for the fourth consecutive year. The **official sector** recorded a large net repayment of RM11.2 billion in 2003, in line with the Government's prudent external debt strategy and commitment towards fiscal consolidation. Taking advantage of the favourable global interest rate regime, the Government also prepaid and refinanced some loans, thereby reducing its debt servicing cost. Similarly, the Non-financial Public Enterprises (NFPEs) also recorded a higher net repayment as their earnings capacity improved during the year.

In 2003, other investment by the **private sector**, comprising mainly borrowing and lending as well as placement and withdrawal of deposits by the banking and non-bank private sector with unrelated counterparties, improved markedly to record a lower net outflow of RM9.3 billion (2002: -RM15.1 billion). Significantly lower net outflows were recorded by the non-bank private sector while the banking sector sustained a smaller net inflow. The net borrowing of foreign currency by the banking sector, albeit lower, continued to reflect the arbitrage opportunities as interest rate differentials remained in favour of Malaysia. Similarly, there were lower outflows in the non-bank private sector due largely to lower trade credits extended by Malaysian exporters to importers abroad, representing a shift in exporters' decision to take advantage of the current favourable monetary and financial environment.

External Debt

Prudent external debt management strategy remained an integral part of macroeconomic policy in 2003. Malaysia continues to maintain an active external debt management strategy, which incorporates the guiding principles that minimise risk with balanced currency and maturity profile. Corporations sourcing external funds for operations in Malaysia are generally required to utilise the funds for productive activities that will generate foreign exchange income. This will provide a natural hedge for debt servicing. They are also encouraged to raise loans with longer maturity, while short-term borrowings by the non-bank private sector to finance long-term investment is discouraged. Prudential regulations to achieve these objectives have been effective in keeping the nation's external debt low and its risk profile balanced.

In 2003, total external debt outstanding increased marginally by 0.9% to RM187.2 billion (US$49.3 billion). The increase in external debt reflected mainly a small net borrowing by the private sector and the exchange revaluation loss, arising from the weakening of the US dollar. External debt of the public sector, comprising the Federal Government and NFPEs, declined in 2003 due to significantly higher net repayment and prepayment. The external debt to GNP and exports of goods and services ratios improved further to 50.7% and 40.4% respectively (2002: 55.3% and 44.3% respectively). Accordingly, the overall debt service ratio (excluding prepayments) declined to 6.1% in 2003 (2002: 6.7%). Of significance is that the share of short-term debt to total debt continued to remain low, accounting for only 18.4% of total external debt. The ratio of short-term debt to international reserves also improved further, to account for 20.2% of reserves (end-2002: 24.4%).

External debt remained stable at a manageable level. Higher repayments and moderate new borrowings by the public sector resulted in a lower share of public sector debt to total debt.

Table 1.24
Outstanding External Debt

	2002		2003*p*	
	RM million	US$ million	RM million	US$ million
Total debt	**185,643**	**48,853**	**187,250**	**49,276**
Medium and long-term	153,587	40,418	152,788	40,207
Short-term[1]	32,055	8,436	34,462	9,069
As % of total debt	*17.3*	*17.3*	*18.4*	*18.4*
As % of international reserves	*24.4*	*24.4*	*20.2*	*20.2*
As % of GNP				
Total debt	55.3	55.3	50.7	50.7
Medium and long-term debt	45.8	45.8	41.4	41.4
As % of exports of goods and services				
Total debt	44.3	44.3	40.4	40.4
Medium and long-term debt	36.6	36.6	32.9	32.9
Debt service ratio (%)	**6.7**	**6.7**	**6.1**	**6.1**

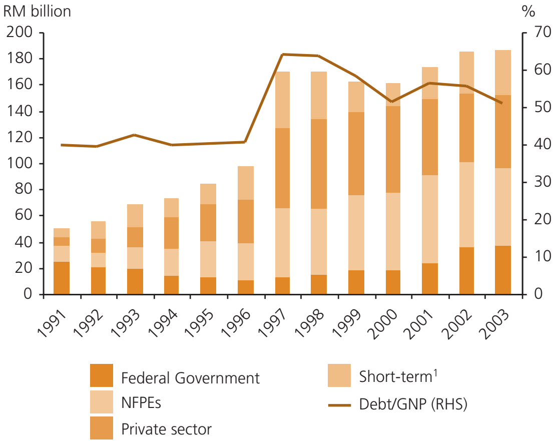
[1] Excludes currency and deposits held by non-residents with resident banking institutions.
p Preliminary

Source: Ministry of Finance and Bank Negara Malaysia

The outstanding **medium and long-term external debt** was sustained at RM152.8 billion (US$40.2 billion) at the end of 2003 (2002: RM153.6 billion). Amidst lower drawdown (-12.1%), repayment of medium and long-term loans increased significantly by 25.1%. For the first time since 1992, the public sector recorded a large net repayment of RM11 billion (2002: +RM4.7 billion), reflecting net repayments by both the Federal Government (-RM3.7 billion) and NFPEs (-RM7.3 billion). Meanwhile, the private sector debt turned around to register a net borrowing of RM3.1 billion (2002: -RM4 billion). Nevertheless, after taking into account an exchange revaluation loss of RM4.1 billion following the appreciation of major currencies, particularly the euro and yen against the US dollar, and a reclassification of a domestic foreign currency loan raised previously from an offshore bank in the Labuan International Offshore Financial Centre into an external loan, the medium and long-term loans declined only marginally by RM0.8 billion.

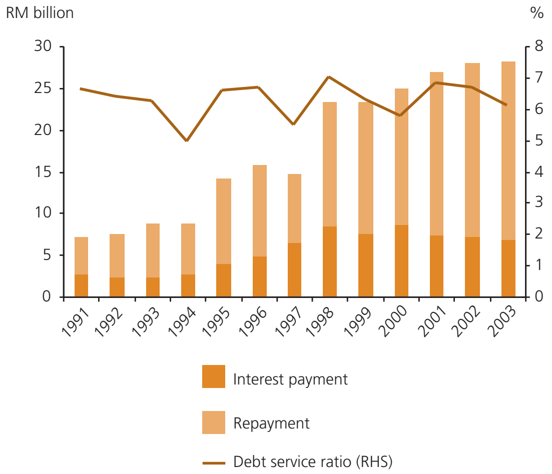
In 2003, **short-term external debt** (maturity of one year or less) rose by RM2.4 billion to RM34.5 billion (US$9.1 billion), reflecting largely the increase in external borrowing by the banking sector, particularly in the second quarter. The increase was attributed mainly to the hedging activities of banks in relation to trade-related transactions. Towards year end, as foreign currency deposits at commercial banks rose

Graph 1.42a
Outstanding External Debt



[1] Excludes currency and deposits held by non-residents with resident banking institutions

Graph 1.42b
Debt Servicing



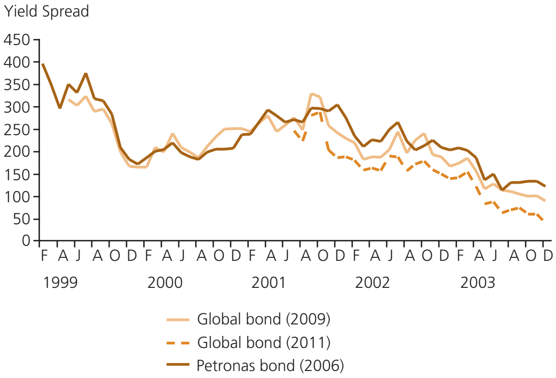
during the fourth quarter, banking institutions began to wind down the interbank foreign borrowings that were taken to cover the forward sales of foreign exchange by exporters. Meanwhile, short-term borrowings by the non-bank private sector, comprising mainly revolving credits, overdraft facilities and term loans, declined marginally in 2003. The decline was due mainly to the repayment of these facilities by several large companies, particularly from the oil and gas sector.

The bulk of the medium and long-term debt continued to be denominated in US dollars (stabilised at 77% as at end 2003), as settlements for trade and investment were mainly in US dollars. The appreciation of the yen and euro in 2003 has therefore led to only a small exchange revaluation loss equivalent to 2.6% of the total medium and long-term debt. In 2003, the share of yen denominated debt declined marginally to 13% (2002: 14%) due partly to a bullet payment of a yen denominated loan by the Federal Government, while that of the euro increased marginally to 5% (2002: 4%). The remaining 5% of the debt was denominated in other international currencies, including the pound sterling, Swiss franc and Singapore dollar.

Public sector external debt: The outstanding external debt of the public sector declined by RM3.8 billion to RM96.8 billion (US$25.5 billion), as at end 2003, reflecting higher repayment by both the Federal Government and NFPEs. Consequently, the share of the public debt to total external debt declined to 51.7% (2002: 54.2%). During the year, the Federal Government maintained its practice to source its funding requirements mainly from non-inflationary domestic sources.

In 2003, three main strategies were undertaken by the **Federal Government** to manage its external debt. Firstly, the Federal Government did not rely on new borrowings from the international capital market, despite the nation's low debt position. Thus, the Government's gross external borrowing declined significantly by RM7.3 billion (US$1.9 billion) to RM3.1 billion (US$0.8 billion) in 2003. Secondly, the Government increased its repayments, including the prepayments of external loans, to RM6.9 billion (2002: -RM2.4 billion). During the year, the Government prepaid two external loans, namely a Floating Rate Note due 2005 and a syndicated loan due 2005/07, which together amounted to RM1.6 billion. Thirdly, taking advantage of the tighter margins arising from improved credit position and investor confidence, the Federal Government refinanced a number of its more costly term and syndicated loans. In January, a ¥1.4 billion term loan due 2006 was raised at Libor + 57.5 basis points to refinance the 3.17% ¥4.1 billion term loan due 2006. In March, the Government refinanced a US$250 million and ¥54 billion dual currency syndicated loan at a lower margin of Libor + 38 basis points (previously Libor + 125 basis points). Nevertheless, after taking into account a reclassification of a domestic foreign currency loan into an external loan and the exchange revaluation loss during the year, the outstanding external debt of the Federal Government increased marginally to RM37.3 billion or US$9.8 billion (2002: RM36.3 billion).

Graph 1.43
Spread of Sovereign Bonds and Selected NFPE Bond Over US T-bills



Reflecting Malaysia's strong fundamentals, the interest spread on Malaysia's benchmark securities narrowed further in 2003. The spread on Malaysia's Global Bond due 2011 narrowed to 36 basis points at the end of 2003 (end-2002: 145 basis points). Similarly, the spread on the Global Bond due 2009 narrowed steadily in 2003 to 85 basis points at end-2003 (end-2002: 183 basis points). During the year, Standard & Poor's raised its long-term foreign currency sovereign credit rating on Malaysia to A- from BBB+ and assigned a stable outlook to the rating on 7 October 2003. Meanwhile, Moody's Investor Service, Fitch and Japan Credit Rating Agency Ltd. also reaffirmed the respective sovereign ratings for Malaysia. In addition, Rating And Investment Information Inc. upgraded Malaysia's long-term foreign currency rating to A- from BBB+, with a stable outlook on 30 January 2004. On 6 February 2004, Moody's also changed the outlook for Malaysia's foreign currency ratings to positive.

The **NFPEs**' external debt declined further to RM59.6 billion in 2003 (US$15.7 billion; 2002: RM64.3 billion). The low interest rate environment and continued strengthening of the NPFEs' earnings performance have allowed the NFPEs to streamline their debt position. The NFPEs recorded a higher net repayment of RM7.3 billion (2002: -RM3.3 billion), reflecting significantly larger repayments, including the prepayment and refinancing of several higher cost loans. These repayments (-RM12.4 billion), including the settlement of several large loans, were effected mainly by NFPEs in the oil and gas, transportation and telecommunication sectors. Inflows of external borrowing had also increased to RM5.2 billion (2002: RM3.7 billion). These loans were raised mainly to finance capital investment and overseas investment as well as for refinancing of more costly loans.

Private sector external debt: Private sector debt (including short-term debt) continued to account for a significant share of Malaysia's external debt, at 48.3% of total debt in 2003 (2002: 45.8%). The private sector medium and long-term external debt increased by 5.6% to RM55.9 billion (US$14.7 billion) as at end-2003. During the year, the larger drawdown of external debt, amounting to RM12.7 billion (2002: RM9.7 billion) was mainly by investment holding companies and companies in the manufacturing and plantation sectors. These funds were mainly to finance capital expenditure and overseas investment. Meanwhile, repayments by the private sector declined to RM9.6 billion in 2003 (2002: RM13.7 billion). While the medium and long-term external debt is marginally higher, the overall risk remains low as the bulk of private sector external debt has a natural hedge. Most of these loans were used to finance productive export-oriented activities with foreign exchange revenue to service the debt. In addition, about two-thirds of the private sector external borrowing were sourced by non-resident controlled companies from their shareholders or related companies abroad. These loans were generally provided on flexible terms, including longer maturity and at concessionary interest rates.

In addition to the existing published detailed information on external debt, Malaysia has subscribed to the **new IMF Special Data Dissemination Standard** (SDDS) on external debt since 30 September 2003. The new SDDS external debt data requirement is consistent with the framework for international investment position statistics in the fifth edition of the Balance of Payments Manual. Under the new template of external debt data, currency and deposits held by non-residents with resident banking institutions were included in the coverage of external debt. While Bank Negara Malaysia has adopted this coverage for external debt in the SDDS templates, for the time being, publications by Bank Negara Malaysia will not include currency and deposits held by non-residents with resident banking institutions. Instead, the Bank will continue to show this item as part of external liabilities of the banking system in its monthly statistics. However, to be consistent with the new SDDS format, adjustment to the external debt tables in all Bank Negara Malaysia's publications will be made during the course of 2004.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprises gold and foreign exchange holdings, IMF reserves position and holdings of

Table 1.25
Net International Reserves

	As at end			Change
	2001	2002	2003	2003
	RM million			
SDR holdings	487.8	585.0	685.0	100.0
IMF reserves position	3,193.5	3,315.5	3,652.0	336.5
Gold and foreign exchange	113,542.3	127,515.1	166,139.3	38,624.2
Gross International Reserves	**117,223.6**	**131,415.6**	**170,476.3**	**39,060.7**
Less Bank Negara Malaysia external liabilities	20.7	21.9	23.8	1.9
Net International Reserves	**117,202.9**	**131,393.7**	**170,452.5**	**39,058.8**
US$ million equivalent	**30,842.9**	**34,577.3**	**44,855.9**	**10,278.6**
Months of retained imports	5.1	5.4	6.8	
Reserves/Short-term external debt (times)	4.9	4.1	4.9	

The net reserves increased to US$51.3 billion as at 15 March 2004, and reflected the more robust economic activities, improved export performance and inflows of foreign direct investment and portfolio investment.

Special Drawing Rights (SDR). In 2003, net international reserves increased by RM39.1 billion, or US$10.3 billion, to a record level of RM170.5 billion or US$44.9 billion as at end-2003. This is the largest annual increase in the last decade. The significant build-up in international reserves over the course of 2003 reflected the more robust economic activities, improved export performance and inflows of foreign direct investment and portfolio investment.
As at 15 March 2004, reserves increased further to RM194.9 billion or US$51.3 billion. The level of international reserves is sufficient to finance 7.8 months of retained imports and to cover 5.2 times the short-term external debt.

More significant is that the international reserves held by the Bank are fully usable and unencumbered. There are no foreign currency loans with embedded options, and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in options in foreign currencies vis-à-vis the ringgit.

In 2003, foreign exchange inflows were largely generated by the sharp increase in trade surplus as well as early repatriation of export earnings in view of interest rate differentials that were in Malaysia's favour. The accumulation of reserves was also due to sustained inflows of foreign funds for direct investment as well as into the equity market. The net outflows of portfolio funds in the first half of the year due to geopolitical uncertainty and the SARS outbreak reversed in the second half of the year as economic performance strengthened and the corporate earnings outlook improved. The increase in reserves also reflected the net revaluation gains during the year.

The increase in reserves during the year occurred amidst higher outflows arising from larger payments for imports of goods and services and repatriation of profits and dividends underpinned by stronger economic activities. There was also a higher repayment of external loans by the public sector, including settlements of several large loans by the NFPEs in 2003. The outflows in terms of overseas investments by Malaysian companies, especially in the oil and gas sector, while remaining high, have yielded returns in the form of profits and dividends and interests earned amounting to RM2 billion in 2003 (2002: RM0.7 billion) and generated export revenues from new markets.

Malaysia's reserves also yielded revaluation gains arising from quarterly adjustments of the reserves in all quarters of 2003 as a result of the appreciation of the major currencies against the US dollar during the year. Net revaluation gain for the year amounted to

Graph 1.44
Net International Reserves (End-month)

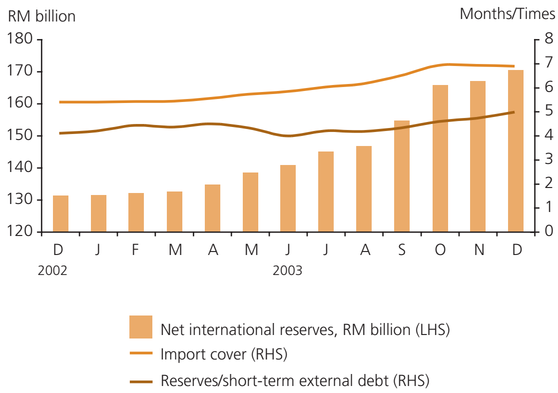


Table 1.26
International Reserves for Selected Regional Economies

Country	Reserves as at end-2003, (US$ billion)	Reserves in months of imports	Reserves as cover of short-term external debt*	Reserves as cover of total external debt*
Chinese Taipei	206.6	19.5	4.6	3.4
Hong Kong China	118.4	21.9	0.5	0.3
Indonesia	36.3	13.4	n.a.	0.3
Korea	155.4	10.4	2.6	1.0
Malaysia	**44.9**	**6.8**	**4.9**	**0.9**
Philippines	16.9	5.2	2.7	0.3
P.R. China	403.3	11.7	6.0	2.2
Singapore	96.3	9.0	n.a.	n.a.
Thailand	42.1	6.8	3.7	0.8

* Except for Malaysia, external debt data refers to amount outstanding as at end 3Q 2003.
n.a. Not available.

Source: National authorities; Asian Development Bank

reserves position. In ringgit terms, the reserves position with the IMF increased by RM336.5 million at the end of 2003. Meanwhile, the receipts of remuneration from the IMF resulted in Malaysia's SDR holdings increasing by SDR8 million to SDR121 million at the end of 2003.

Bank Negara Malaysia releases information on the international reserves position and the statement of the Bank's assets and liabilities on a fortnightly basis with a one-week lag. The Bank also fulfils the IMF's SDDS requirements of publishing the reserves data template at end-month with a one-month lag. The SDDS template not only covers detailed information on international reserves, but also includes the release of forward-looking information on the size, composition and usability of official reserves and

In managing the reserves, a prudent approach is adopted to achieve the objectives of ensuring capital preservation and liquidity while optimising returns.

RM11.9 billion or US$3.1 billion, compared with the net revaluation gain of RM6.6 billion or US$1.7 billion in 2002, exceeding the revaluation loss in 2001 (-RM4.1 billion or -US$1.1 billion) and 2000 (-RM5.3 billion or -US$1.4 billion).

In managing the reserves, a prudent approach is adopted to achieve the objectives of ensuring capital preservation and liquidity while optimising returns. The reserves, which comprise gold and major foreign currencies, are well diversified.

Malaysia, as a member of the IMF, can hold reserves with the Fund in the form of SDR, through participation in the Operational Budget. Under the Operational Budget, the Fund invites member countries which are viewed as 'strong' and have surpluses in their balance of payments to make resources available to members which are facing balance of payments difficulties. In return, the contributing members agree to receive a claim on the Fund (termed as the **reserves position with the IMF**) that can be drawn in the event of a balance of payments need.

During the year, reflecting Malaysia's strength in the balance of payments and gross reserves position, Malaysia was included in the IMF's Operational Budget. This was reflected in an increase in the net purchase of SDR5 million, resulting in an increase in Malaysia's net creditor position with the IMF, and the consequent increase in Bank Negara Malaysia's

other foreign currency assets, and the future and potential (contingent) inflows and outflows of foreign exchange of the Federal Government and the Bank over the next 12 months.

Flow of Funds

The economy registered a higher resource surplus of RM50.8 billion or 13.7% of GNP in 2003 (2002: a surplus of RM30.5 billion or 9.1% of GNP). In terms of balance of payments, the higher resource surplus reflected higher exports over imports following improved external demand in the second half of the year. While exports grew strongly by 8.6% (2002: 6.6%), imports rose at a slower pace of 5.4% (2002: 6.5%). From the perspective of the country's saving-investment gap, the higher resource surplus reflected the significantly higher net savings position of the private sector. The inter-sectoral flow of funds between various sectors of the economy for the year is shown in Tables 1.27 and 1.28.

The disposable income of the public sector increased by 5.9% to RM120.2 billion in 2003. However, this higher disposable income was offset by higher public consumption and investment expenditure arising from the government's efforts to sustain economic activity in the face of adverse external developments in the first half of 2003. Consequently, the resource surplus of the public sector was marginally higher at RM10 billion in 2003 (2002: RM9.8 billion). The resource surplus reflected entirely the surpluses from the NFPEs of

Table 1.27
Flow of Funds: 2002

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-325.0	113.5	211.5			0
Consumption	209.5	-50.0	-159.5			0
Investment	83.8	-53.7	-30.1			0
Change in Stocks	1.3		-1.3			0
Exports of Goods and Non-Factor Services	415.0				-415.0	0
Imports of Goods and Non-Factor Services	-348.9				348.9	0
Net Factor Payment Abroad	-25.1				25.1	0
Net Transfers	-10.6				10.6	0
Non-Financial Balance	0.0	9.8	20.7	0.0	-30.5	0
Foreign Financing						
Direct Investment			4.9		-4.9	0
Net Foreign Borrowings		4.7	-27.9		23.2	0
Net Change in Foreign Assets						
Bank Negara Malaysia				-14.2	14.2	0
Banking System				6.3	-6.3	0
Domestic Financing						
Change in Credit		11.5	27.7	-39.3		0
Change in Money Supply, M3			-31.6	31.6		0
Net Borrowings from Non-Bank Sector		-26.1	26.1			0
Net Errors and Omissions			-19.9	15.5	4.4	0
Sum		0	0	0	0	

Table 1.28
Flow of Funds: 2003

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-360.1	120.2	239.9			0
Consumption	223.7	-53.9	-169.8			0
Investment	87.1	-56.3	-30.8			0
Change in Stocks	-1.5		1.5			0
Exports of Goods and Non-Factor Services	450.6				-450.6	0
Imports of Goods and Non-Factor Services	-367.9				367.9	0
Net Factor Payment Abroad	-22.6				22.6	0
Net Transfers	-9.3				9.3	0
Non-Financial Balance	0.0	10.0	40.8	0.0	-50.8	0
Foreign Financing						
Direct Investment			4.2		-4.2	0
Net Foreign Borrowings		-11.2	-12.8		24.0	0
Net Change in Foreign Assets						
Bank Negara Malaysia				-39.1	39.1	0
Banking System				7.7	-7.7	0
Domestic Financing						
Change in Credit		12.9	32.4	-45.3		0
Change in Money Supply, M3			-48.5	48.5		0
Net Borrowings from Non-Bank Sector		-11.7	11.7			0
Net Errors and Omissions			-27.8	28.2	-0.4	0
Sum	0	0	0	0	0	

RM24.7 billion, which helped offset the resource gap of the general government of RM14.7 billion. The bulk of the resource gap of the general government was financed through net domestic borrowings (RM12.9 billion). Government borrowings and the resource surplus of the NFPEs were utilised to make a net repayment of foreign borrowings of RM11.2 billion, while RM11.7 billion was transferred to the private sector during the year.

The resource surplus of the private sector increased twofold to RM40.8 billion or 11% of GNP in 2003 from RM20.7 billion or 6.2% of GNP in 2002. Higher disposable income of RM239.9 billion during the year (2002: RM211.5 billion) following continued strong growth in economic activity, enabled the private sector to increase consumption expenditure (6.5%). At the same time, private investment expenditure turned around (2.4%), the first positive growth since 2000. The resource surplus of the private sector together with net inflows of FDI (RM4.2 billion), net borrowings from the banking system (RM32.4 billion) and net transfers from the public sector (RM11.7 billion), led to a larger increase of resources amounting to RM89.1 billion (2002: RM79.4 billion) being available to the private sector.

A sizeable pool of resources available to the private sector was placed with the banking system, resulting in a net placement of deposits of RM48.5 billion. Some of the excess resources were also utilised for repayments of foreign borrowings by the private sector (RM12.8 billion). For the economy as a whole, the large current account surplus and continued inflows of FDIs, were more than sufficient to accommodate these outflows. Consequently, the net international reserves of BNM rose by RM39.1 billion to RM170.5 billion as at the end of 2003.

Monetary and Fiscal Developments

Monetary and Fiscal Developments

MONETARY POLICY IN 2003

In 2003, Bank Negara Malaysia maintained an accommodative monetary policy to support growth. The assessment at the beginning of the year was that the economy was operating below potential. In an environment of the near absence of demand pressures and excess capacity in many sectors, inflation was forecast to remain low in 2003 with the output gap positive. The accommodative monetary policy therefore reinforced fiscal policy and other measures aimed at promoting domestic economic activities. The low inflation and stronger fundamentals provided the flexibility to the Central Bank to maintain this accommodative monetary stance. During the year, efforts were also intensified to improve access to financing to the private sector, in particular to the Small and Medium Enterprises (SMEs).

lending indicators during the first quarter. Stronger expansion was also seen in loans extended to small businesses.

Second, an important consideration to leave the policy rate unchanged in the first quarter was to provide a reasonable return to savers. In an environment of ample liquidity, maintaining a reasonable return to savers continued to remain an important consideration. During this period, consumer and business sentiment was affected by the uncertainties from tensions prior to the Iraq war and subsequently, greater uncertainty following the outbreak of the Severe Acute Respiratory Syndrome (SARS) in April. The stance of monetary policy in early 2003 was therefore aimed at balancing the need to promote consumption and investment while maintaining a reasonable real rate on savings.

With low and stable inflation, monetary policy remained accommodative to support economic growth.

The monetary framework in 2003 continued to operate under a pegged exchange rate regime. The ringgit remained fixed at RM3.80=US$1, an arrangement that has been in place since September 1998. In 2003, the ringgit remained close to its fair value and has been well supported by strengthened economic fundamentals.

During the year, the policy rate of Bank Negara Malaysia, the 3-month intervention rate, was reduced once on 21 May. Interest rate policy in the first quarter was based on two considerations. First, the cumulative reductions in interest rates by 600 basis points since 1998 had resulted in lower interest rates and ample liquidity. Liquidity conditions in the banking system created competitive pressures on banks to price loans at below the quoted base lending rates. The lower lending rates had been effective in raising demand for credit. Amidst stable employment and higher incomes, supported by higher commodity prices and strong performance in selected export sectors, the prevailing accommodative monetary policy reinforced fiscal policy in sustaining domestic demand. Growth in domestic demand was reflected in the further expansion in monetary aggregates and bank

Towards mid-2003, however, developments in the regional and global economies indicated increased risks on the growth prospects. Economic and financial indicators showed that the global economic recovery was slower than expected, with growth in the United States remaining well below trend in the first half-year due to subdued investment. Deflationary concerns and continued financial market volatilities pointed to a more modest recovery for the global economy for 2003. The dampened global outlook and the implication of SARS on a number of sectors threatened to weaken domestic demand and increase the downside risks to economic recovery in Malaysia. Given this, on 21 May, Bank Negara Malaysia reduced the policy rate by 50 basis points to 4.5% as a pre-emptive move to mitigate the effects of a more adverse external environment on the domestic economy.

The impact of SARS on economic recovery was expected to be transitory. Its impact was primarily on the services sub-sectors of tourism, transport and retail services. To ease the burden on the affected industries and workers in these sectors, other measures were implemented, including a Special Relief Guarantee Facility of RM1 billion and special relief for housing loan repayments to workers in these sectors. These specific measures were part of the overall package introduced on 21 May, to address the impact of SARS on the economy as well as to stimulate further structural changes. Implementation of the measures including the reduction in interest rates, as a comprehensive package was designed to give maximum impact to the package.

These coordinated policy measures promoted and reinforced a stronger recovery in the domestic economy in the second half-year when global and regional growth gained momentum. A number of positive developments on the global front lent further support to domestic policies. The reduction in geopolitical uncertainty in the Middle East and the abatement of SARS resulted in markedly strengthened domestic consumer and business sentiment in the third quarter. More favourable trends emerged in the third quarter, with indicators that the global economic growth was strengthening. Growth in the United States in the third quarter, picked up to well above trend following the recovery in investment and a build-up in inventory. On the domestic front, lower interest rates, amidst improving sentiment, led to stronger demand for credit. Demand for financing, which moderated in May on uncertainties of the effects of SARS, recovered strongly since June. Monetary indicators for the second half-year also expanded at a stronger pace, reflecting stronger demand for liquidity. Overall, the accommodative monetary policy reinforced other policies to contribute to stronger growth in output. For the year as a whole, real GDP growth strengthened to 5.2%, with the growth momentum into 2004 sustained. Inflation has continued to remain low at 1.2% while core inflation, that is inflation due to demand pressures, was lower at 0.6%.

Monetary Policy Statement

An important development during the year was the issuance of the Monetary Policy Statement (MPS) by Bank Negara Malaysia at pre-determined intervals. On 27 August 2003, Bank Negara Malaysia issued its first MPS together with the announcement of the second quarter GDP data. The second and third MPS was issued at the release of the third quarter GDP data on 19 November 2003 and the fourth quarter GDP data on 25 February 2004.

The MPS is a forward looking statement, outlining the monetary policy stance in the near term and the rationale for the policy thrust. The objective of issuing this statement is part of the overall strategy to provide greater understanding of the monetary policy objectives and measures in light of a more complex and dynamic environment. In particular, it would help anchor expectations on growth and inflation. Signalling the Bank's policy intent through direct communication is aimed at increasing the understanding and appreciation of money market participants, and thereby, facilitate a more rapid transmission of the policy rate in the pricing of credit and longer-term rates, and thus enhance the overall efficiency of the monetary transmission mechanism. The MPS is released four times a year and would coincide with the release of Malaysia's quarterly GDP performance. Between the fixed scheduled dates, additional press statements would be issued if a policy change is warranted.

The issuance of the MPS is part of the ongoing process to enhance market understanding of the Bank's financial and economic assessments, operations and policy objectives. Since 1998, in a drive to ensure symmetric information to the public, the Bank has disseminated a wider range of information, which included among others, on-line information on its daily liquidity forecasts and money market operations. Over the years, there has also been significant enhancement of the coverage of information available through the Bank's website, and reduction in the time lag of data releases to the public.

MONETARY DEVELOPMENTS IN 2003

In 2003, low interest rates, ample liquidity and a strengthened banking sector supported stronger economic activity. Funds available in the banking system increased during the year as a result of the expansionary fiscal operations and stronger balance of payments position. The underlying ample liquidity continued to result in competitive pricing of loans to selected sectors.

Monetary conditions remained supportive of economic expansion. Low interest rates, ample liquidity and a strengthened banking sector contributed to increased financing to the private sector.

Following the 50 basis point reduction in the policy rate in May, the lending rates of banking institutions declined further. The commercial banks reduced their Base Lending Rate (BLR) by 39 basis points. As the component of lower cost new loans increased relative to the existing loans, the average lending rate (ALR) declined further, and at end-year was 39 basis points lower than the end-2002 level. While the BLR of finance companies declined by 55 basis points, the ALR of finance companies, nevertheless, declined by a larger magnitude of 64 basis points as fixed rates on hire purchase for passenger cars had been on a declining trend. The lower hire purchase rates were due to greater competition for loans in the passenger car market.

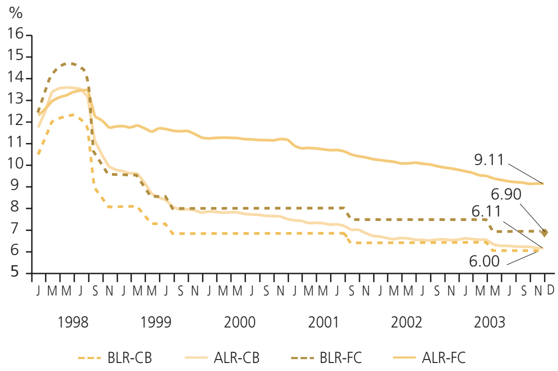
Deposit rates declined by a smaller margin, with the one to 12-month fixed deposit rates of the commercial banks declining by 20-30 basis points. Notwithstanding the reduction in nominal deposit rates, the real rates of return (end year nominal rates of return less inflation rate) on deposits with

Table 2.1
Interest Rates and Liquidity

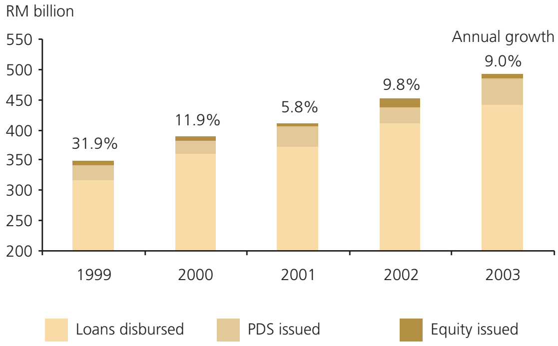
	2000	2001	2002	2003	2003
	At end period (%)				Change (%)
3-month Intervention Rate	5.5	5.0	5.0	4.5	-0.5
Interbank rates					
Overnight	2.77	2.76	2.71	2.72	0.01
1- month	3.05	2.97	2.99	2.99	0.00
Base lending rate (BLR)					
Commercial banks	6.78	6.39	6.39	6.00	-0.39
Finance companies	7.95	7.45	7.45	6.90	-0.55
Average lending rate (ALR)					
Commercial banks	7.46	6.67	6.50	6.11	-0.39
Finance companies	11.14	10.24	9.75	9.11	-0.64
Fixed deposit rates					
Commercial banks					
3-month	3.48	3.21	3.20	3.00	-0.20
12-month	4.24	4.00	4.00	3.70	-0.30
Finance companies					
3-month	3.52	3.22	3.20	3.00	-0.20
12-month	4.27	4.01	4.00	3.68	-0.32
Savings deposit rates					
Commercial banks	2.72	2.28	2.12	1.86	-0.26
Finance companies	3.44	2.94	2.65	2.18	-0.47
	Average during the period (%)				Change (%)
Nominal interest rate differential					
Malaysia - United States	-3.32	-0.49	1.31	1.66	0.35
Malaysia - Singapore	0.73	1.31	2.23	2.27	0.04
	At end period (RM billion)				Change (RM b)
Resource surplus (+)/gap (-)[1]	73.7	67.4	76.2	105.8	29.6
Adjusted resource surplus (+)/gap (-)[2]	36.1	20.8	24.6	45.8	21.2
	At end period (%)				Change (%)
Loan-deposit ratio	84.3	85.9	84.9	80.9	-4.0
Financing-deposit ratio[3]	92.3	95.7	95.1	91.7	-3.4

[1] Deposits less loans.
[2] Deposits less loans and holdings of private debt securities.
[3] Includes holdings of private debt securities.

Graph 2.1
Lending Rates: Commercial Banks and Finance Companies



Graph 2.3
Private Sector Gross Financing through the Banking System and the Capital Market

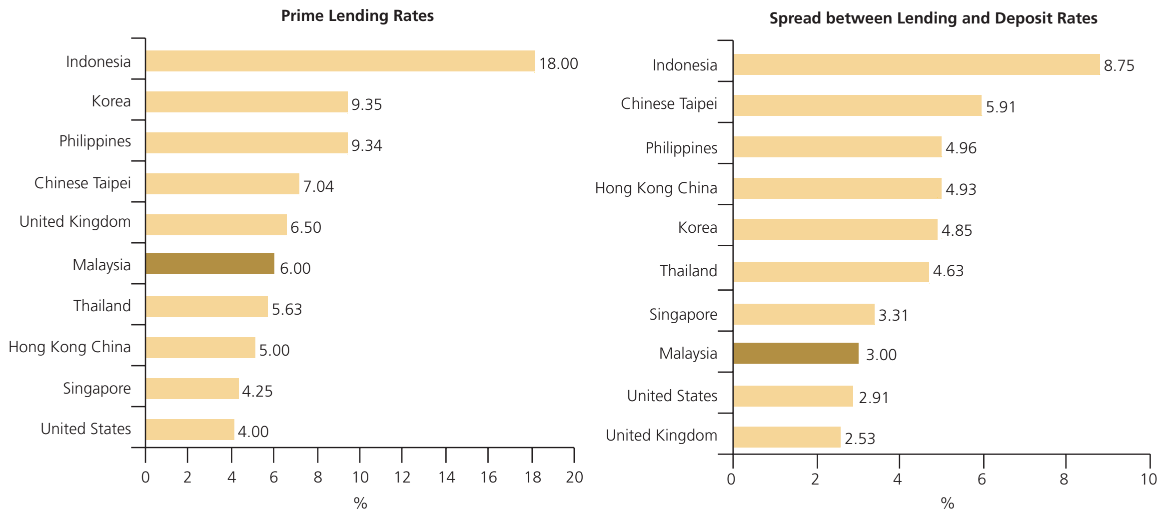


commercial banks were higher at end-2003, at 0.66% for savings deposits (at end-2002: 0.42%) and ranging from 1.8% for the 3-month fixed deposit to 2.5% for the 12-month maturity (1.5% and 2.3% at end-2002). Savings and fixed deposits of individuals increased by 8.8% in 2003 and as a share of GDP, remained stable at 57% at end-2003. Following significantly improving cash flows, total deposits of businesses increased significantly, by 14.9%, and as a share of GDP, rose to 46.9% at end-2003 (at end-2002: 44.4%).

By international standards, lending rates in Malaysia remained competitive, and the spread between lending and deposit rates was among the lowest.

Low interest rates, amidst higher disposable income, particularly in the second half-year, led to stronger demand for financing by the private sector from both the banking sector and the capital market to finance consumption and business expansion. In addition, a larger amount of funds was also raised by businesses in the PDS market to restructure and refinance debts, to strengthen their balance sheets and to prepare for future investment opportunities. Cumulatively, loans disbursed by the banking system for working capital, trade financing and fixed investment, and funds raised in the capital market increased by 9% compared with the previous year. While the banking system remained the main source of finance for the economy, there was further diversification in the sources of financing. Loan disbursements by the banking system which rose by 7.3%, accounted for 89.7% of total gross financing in 2003 while funds raised from the capital market rose at a stronger rate of

Graph 2.2
International Comparison of Interest Rates as at end-2003



26.6% to account for a small share of 10.3% of financing to the private sector.

The success of the measures to promote growth and depth in the PDS market was reflected in the rising ratio of PDS outstanding as a percentage of GDP to 34.7% at end-2003, while the ratio of bank loans to GDP trended down to 120.9%. This is a significant development compared to the 1998 level (PDS at 16.5% and banking system loans at 147.2% of GDP respectively). In 2003, businesses with strong credit profiles took advantage of the low interest rate environment to lock in their funds in long-term PDS. As a result, gross PDS financing increased significantly by 60.5% during the year (-15.4% in 2002).

With the expansion of the PDS market, banking institutions have also increased indirect financing of the business sector through holdings of PDS, accounting for approximately 7% of the loan base. On a net basis, banking system outstanding loans and holdings of PDS increased by 5.9%. The greater diversification in financing sources and the focus on promoting domestic sources of growth has led to a shift in the profile of banking system loans. In particular, with measures undertaken to enhance the contribution of SMEs in the domestic economy and the drive to promote private consumption growth, banking institutions have accorded emphasis on SMEs and the household sector.

Efforts by Bank Negara Malaysia to strengthen the SME financing infrastructure have been important in providing adequate and cost-effective funding to support the growth of SMEs. Reflecting this, outstanding loans to SMEs grew strongly by 10% in 2003 to reach a record high of RM82 billion. This amount represented 38.4% and 17.3% respectively of business and total loans outstanding. Meanwhile, disbursements to SMEs amounted to RM87.1 billion. Financing of SMEs via the special funds has expanded significantly. As at end-2003, RM5.3 billion had been approved to more than 14,000 borrowers, representing an increase of 58.5% for the year as a whole. Meanwhile, disbursements amounted to RM4.1 billion, an increase of 82.9% over the previous year. Excluding both the Special Relief

Table 2.2
Banking System[1]: Loan Indicators

	During the year (RM billion)				Annual growth (%)		
	2000	2001	2002	2003	2001	2002	2003
Total							
Loan applications	208.8	190.6	217.2	227.6	-8.7	14.0	4.8
Loan approvals	134.8	125.6	137.6	152.7	-6.8	9.5	11.0
Loan disbursements	360.7	373.5	411.6	441.7	3.5	10.2	7.3
Loan repayments	347.1	365.4	402.7	430.5	5.3	10.2	6.9
Change in loans outstanding[2]	21.2	16.1	19.8	21.8	3.9	4.6	4.8
Businesses							
Loan applications	n.a.	n.a.	135.3	124.9	n.a.	n.a.	-7.7
Loan approvals	79.1	63.5	68.5	77.2	-19.7	7.9	12.7
Loan disbursements	270.2	270.4	282.0	303.4	0.1	4.3	7.6
Loan repayments	269.4	276.8	275.8	299.6	2.8	-0.4	8.6
Change in loans outstanding[2]	2.0	-5.6	-3.1	-5.1	-2.5	-1.4	-2.3
SMEs							
Loan applications	n.a.	n.a.	n.a.	44.5	n.a.	n.a.	n.a.
Loan approvals	n.a.	n.a.	n.a.	25.7	n.a.	n.a.	n.a.
Loan disbursements	n.a.	n.a.	n.a.	87.1	n.a.	n.a.	n.a.
Change in loans outstanding[2]	2.9	4.0	…	7.4	5.7	…	10.0
Other businesses							
Loan applications	n.a.	n.a.	n.a.	80.4	n.a.	n.a.	n.a.
Loan approvals	n.a.	n.a.	n.a.	51.5	n.a.	n.a.	n.a.
Loan disbursements	n.a.	n.a.	n.a.	216.4	n.a.	n.a.	n.a.
Change in loans outstanding[2]	-0.9	-9.6	-3.1	-12.5	-6.1	-2.1	-8.7
Households							
Loan applications	n.a.	n.a.	81.9	98.5	n.a.	n.a.	20.2
Loan approvals	53.1	59.2	66.9	72.0	11.5	13.0	7.6
Loan disbursements	76.0	87.0	105.1	114.5	14.5	20.8	8.9
Loan repayments	65.1	71.5	83.7	94.1	9.9	17.0	12.4
Change in loans outstanding[2]	17.1	23.1	26.2	26.2	14.8	14.7	12.8

[1] Includes Islamic banks.
[2] The annual growth is for loans outstanding at end-period.
n.a. Not available.

Table 2.3
Special Funds for SMEs administered by Bank Negara Malaysia

Type of Fund	Allocations	Approvals	Disbursements	Repayments	Loans Outstanding	Utilisation Rate[2]	Ratio of undrawn portion to approvals
	RM million					%	
	As at end-2003						
Fund For Food	1300.0	1410.8	1298.8	600.8	698.0	108.5	7.9
New Entrepreneurs Fund 2	1150.0	1077.2	806.7	36.1	770.6	93.7	25.1
Fund For Small and Medium Industries 2	2000.0	2284.9	1588.4	177.9	1410.4	114.2	30.5
Bumiputera Entrepreneurs Project Fund	300.0	437.7	361.5	269.1	92.4	145.9	17.4
Special Relief Guarantee Facility[1]	1000.0	40.3	0.0	0.0	0.0	4.0	100.0
Rehabilitation Fund for Small Businesses	800.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	**6550.0**	**5250.9**	**4055.4**	**1083.9**	**2971.4**	**80.2**	**22.8**
	Change since end-2002						
Fund For Food	0.0	115.1	174.4	152.8	23.5		
New Entrepreneurs Fund 2	650.0	425.0	480.9	26.6	454.2		
Fund For Small and Medium Industries 2	1350.0	1236.0	1078.2	124.3	953.7		
Bumiputera Entrepreneurs Project Fund	0.0	121.0	104.1	122.7	-18.5		
Special Relief Guarantee Facility[1]	1000.0	40.3	0.0	0.0	0.0		
Rehabilitation Fund for Small Businesses	800.0	0.0	0.0	0.0	0.0		
Total	**3800.0**	**1937.4**	**1837.6**	**426.4**	**1412.9**		

[1] This is only a guarantee fund.
[2] As a percentage of total loans approved to the fund's total allocations.

Guarantee Fund (SRGF) and the Rehabilitation Fund for Small Businesses (RFSB), which were recently introduced in 2003, the allocations for the remaining four funds have been fully utilised, with a utilisation rate of 109.7%. With the Central Credit Reference Information System (CCRIS) in place, banking institutions have been able to accelerate loan processing and assess the viability of SMEs, given the comprehensive and current credit profiles of all borrowers available in the system.

Almost half the loan disbursements were channelled to large businesses in the main sectors of the economy, namely the manufacturing, wholesale and retail trade; agriculture; and finance, insurance and business services sectors. New loan approvals and loan disbursements to large businesses were significantly higher in the second half-year. Nevertheless, there was a decline in outstanding loans of large businesses. Better corporate health and improving cash flow positions led to a greater reliance on internal funds, and less on bank borrowings to fund business activities. In addition, the bulk of loans disbursed were primarily for short-term working capital purposes. As a result, the high level of disbursements was matched by a similar volume of repayments, which resulted in a neutral effect on loans outstanding.

Graph 2.4
Loan Disbursements by Sector: Value and Share

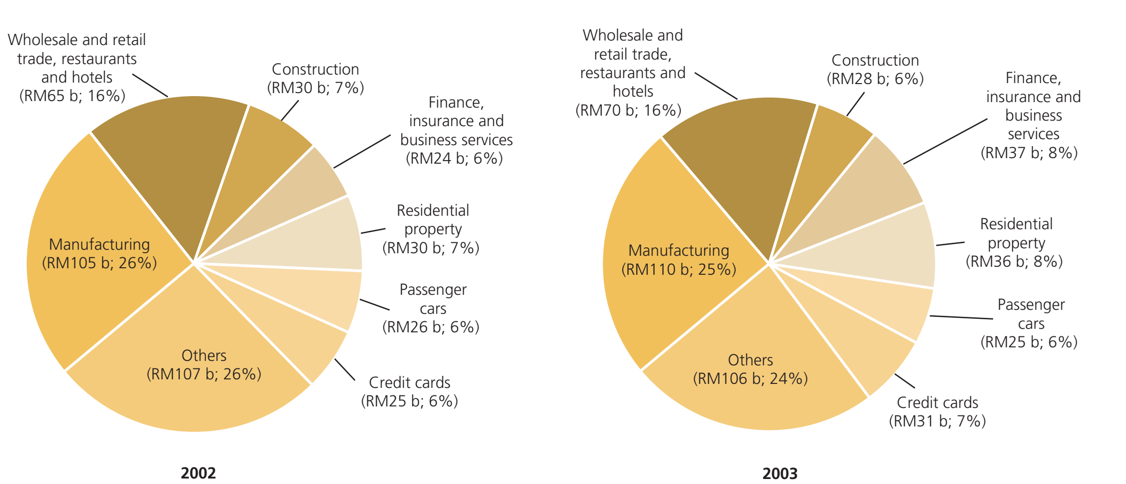


Table 2.4
Banking System[1]: Loans Outstanding

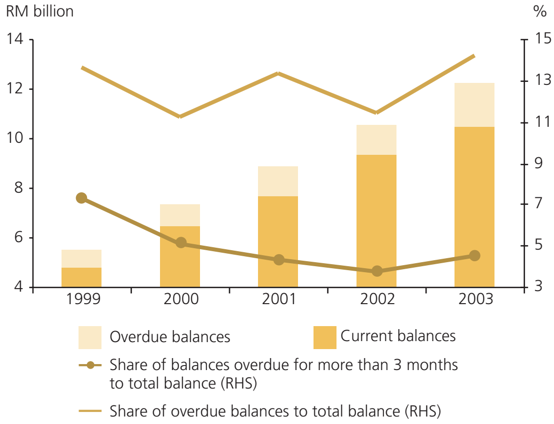
	Annual change 2002	Annual change 2003	% share of total loans at end-2003
	RM billion		
Banking system loans, of which extended to:			
Business enterprises	-3.1	-5.1	45.1
Individuals	26.2	26.2	48.8
By sector:			
Agriculture, hunting, forestry and fishing	-0.1	-1.1	2.2
Mining and quarrying	-0.3	0.1	0.2
Manufacturing	-1.2	-0.2	12.9
Electricity, gas and water supply	1.6	-1.7	1.1
Wholesale and retail trade, restaurants and hotels	1.0	2.1	8.3
Broad property sector	10.8	14.7	39.8
Construction	*-1.7*	*-2.7*	*6.2*
Purchase of residential property	*14.2*	*16.2*	*24.6*
Purchase of non-residential property	...	*1.1*	*6.1*
Real estate	*-1.6*	...	*2.9*
Transport, storage and communication	-0.4	1.0	2.3
Finance, insurance and business services	-2.5	-0.6	6.2
Consumption credit	12.0	8.9	18.8
Of which:			
Credit cards	*1.8*	*1.6*	*2.6*
Purchase of passenger cars	*9.6*	*6.5*	*13.0*
Purchase of securities	0.2	-1.7	4.2
Purchase of transport vehicles	-0.5	0.3	0.7
Community, social and personal services	-0.3	-0.7	1.0
Others	-0.4	0.9	2.3
Total loans outstanding [2]	**19.8**	**21.8**	**100.0**

[1] Includes Islamic banks.
[2] Includes loans sold to Cagamas.
Numbers may not add-up due to rounding.

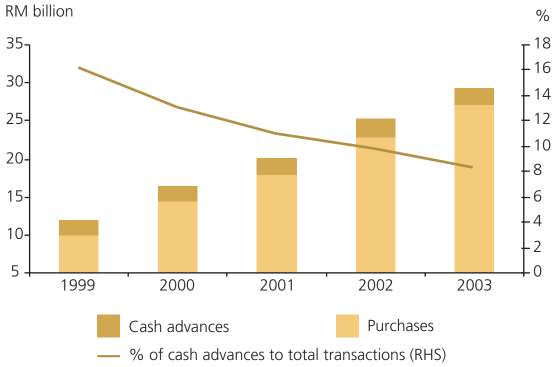
On an outstanding basis, bank lending to the household sector expanded at a high annual rate of 12.8% in 2003. The low interest rates and competitive financing packages offered by banking institutions continued to stimulate demand for loans from households, with the bulk of credit channelled towards the purchase of residential property. In the residential property market, the value of loan applications increased by 24.8% while loan disbursements were higher by 20%.

Credit card spending, as reflected by loan disbursements, grew at a rate of 20%. Outstanding balances on credit cards increased by 15.5% (2002: 19.5%) to RM12.2 billion, representing 2.6% of total loans outstanding at end-year (at end-2002: 2.3%). While credit card spending on goods and services continued to increase, households are not over leveraged. Total overdue balances amounted to 14.1% of outstanding credit card balances at end-2003, which was lower than the average over the previous five years of 14.6%. Similarly, balances overdue for more than 3 months were relatively contained at 4.4% compared to the average over the previous five years of 7.2%.

Graph 2.5
Banking System: Outstanding Credit Card Balances (at end-period)



Graph 2.6
Banking System: Credit Card Transactions

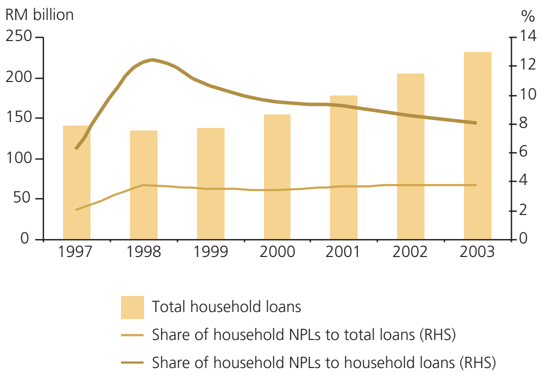


On the whole, as the majority of household loans were relatively long-term in nature, the continued growth in these loans has led to an increase in the share of household loans as a percentage of total loans outstanding to 48.8% at end-2003 (at end-2002: 45%) and as a percentage of GDP, to 58.9%. These percentages are similar to those recorded among regional countries, and lower than those registered in several of the advanced economies. While the household debt exposure has become a cause for concern in some countries, indicators suggest that the Malaysian household balance sheet has remained strong and debt servicing is sustainable with the potential for further expansion in consumption growth. Underpinning the resilience of the household balance sheet, is the high savings rate, increasing disposable income, a stable property market, an improvement in the stock market as well as stable labour market conditions. As a leverage indicator, the ratio of household deposits to loans remained at greater than one, demonstrating that households continued to accumulate wealth. Lower lending rates have also been instrumental in sustaining households' financial net worth and the capacity of the sector to service debt. With falling rates, interest payments incurred on new loans have been lower and refinancing activity has also increased, allowing consumers to pay down earlier higher cost loans.

The non-performing loans (NPLs) of the household sector has also remained manageable. As a proportion of total household loans, the gross NPL ratio for the sector declined to 8% at end-2003 (12.2% at-end 1998 and 8.5% at end-2002). In particular, the gross NPL ratio for the purchase of residential property remained unchanged at 8.7%. The default rate on credit card loans, an emerging concern in some economies, had declined to a level less than one-third the rate registered at the height of the financial crisis in 1998.

Bank Negara Malaysia's efforts to improve the financial infrastructure to facilitate bank lending have also ensured that banking institutions assign appropriate risk evaluation in lending to this sector, thereby maintaining the quality of household debt. In particular, the implementation of risk-based measures included setting up CCRIS and effecting credit card guidelines. To facilitate the assessment of risks across non-bank credit institutions, such as charge card companies, the information in CCRIS is also extended to these institutions, with the necessary "firewalls" to protect customer information. These risk management measures have enhanced the capacity of lenders to extend loans without creating unnecessary vulnerabilities in the real and financial sectors.

Graph 2.7
Banking System: Loans to Households (at end-period)



In tandem with higher financing by the banking system, broad money, M3, expanded at a faster annual rate of 9.7% at end-2003 (at end-2002: 6.7%). The growth in M3 was also due to stronger external operations arising from a higher trade surplus, sustained foreign direct investment and higher portfolio inflows; as well as expansionary Government operations. Growth in M3 was broadly consistent with nominal demand during the year.

In terms of components, transaction balances, consisting of currency in circulation and demand deposits, grew strongly by 14.6% at end-2003 (at end-2002: 10.3%), in line with higher consumption spending, higher turnover of the KLSE CI, and improved business activity. Among broad quasi-money

Graph 2.8
Money Aggregates: Annual Growth

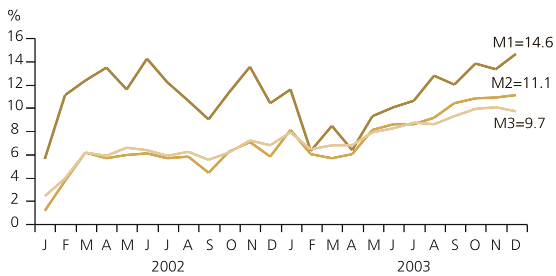


Table 2.5
Broad Money, M3

	Change (RM billion)	
	2002	2003
M3	31.6	48.5
Currency	1.8	2.2
Demand deposits	6.7	11.2
Broad quasi money	23.1	35.1
Fixed deposits	*12.6*	*17.1*
Savings deposits	*5.6*	*5.6*
NIDs	*3.6*	*2.0*
Repos	*2.5*	*8.0*
FX deposits	*-1.2*	*2.4*
Determinants of M3		
Net claims on Government	11.5	12.9
Claims on private sector	27.7	32.4
Loans	*19.3*	*21.7*
Securities	*8.4*	*10.7*
Net external operations	1.2	19.5
Bank Negara Malaysia	*7.6*	*27.1*
Banking system	*-6.3*	*-7.6*
Other influences	-8.9	-16.3

components, the increase was mainly in terms of fixed deposits and to a lesser extent, repos. The increase in fixed deposits was primarily in the 9-12 month maturity and was spread out during the year, reflecting to some extent, the desire of depositors to hold fixed deposits as an asset class.

In contrast to the previous year, business deposits recorded the biggest increase and were mainly short-term fixed deposits. The stronger financial position of corporations was in line with improving profitability and cash flow, higher trade surplus and faster repatriation of export proceeds. Meanwhile, higher personal disposable income and financial wealth of households sustained the growth in deposits of this sector, which grew at a stronger rate in 2003 compared to the previous year.

Developments in the ringgit foreign exchange market were driven mainly by the depreciation of the US dollar and the consequent realignments in the currencies of most major and several regional economies. Throughout the year, the US dollar was mainly affected by concerns over the large US current account deficit and the positive interest rate differentials in favour of other major economies. The corresponding adjustments to the US dollar were seen mainly in major currencies, including the Australian dollar, the Canadian dollar and the euro, which appreciated by 32.7%, 21.7% and 20% in 2003. The yen and pound sterling appreciated to a lesser degree of 11% and 11.1% respectively.

Given the pegged exchange rate regime, the ringgit depreciated against the euro (-16.7%), the pound sterling (-10%) and the yen (-9.9%), along with the US dollar in 2003. The ringgit depreciated to a lesser extent against most regional currencies in the range of 2 – 8%. Against the Korean won and the Philippine peso, the ringgit appreciated. The ringgit remained stable against the Chinese renminbi and the Hong Kong dollar, as these currencies are also pegged to the US dollar.

Despite considerable volatility in the foreign exchange market, the pegged exchange rate regime has remained sustainable with the ringgit close to

Amid considerable volatility in international currency markets, the ringgit peg continues to provide a stable and predictable environment to promote trade and investment as well as supporting the structural changes in the Malaysian economy.

EXCHANGE RATE DEVELOPMENTS

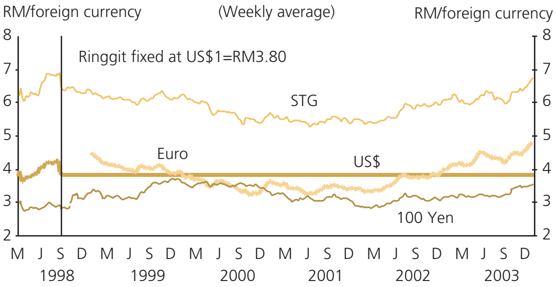
In 2003, the system of a fixed exchange rate for ringgit at RM3.80 to US$1 was maintained with strengthening economic fundamentals. The fixed exchange rate regime has been in place for the sixth year since it was introduced in September 1998. Amidst volatility in the foreign exchange markets and debates on effects of the volatility of major currencies on the ringgit peg, the ringgit continues to fulfil its intended objective of supporting the expansion of trade and investments in Malaysia.

Table 2.6
Movement of the Ringgit

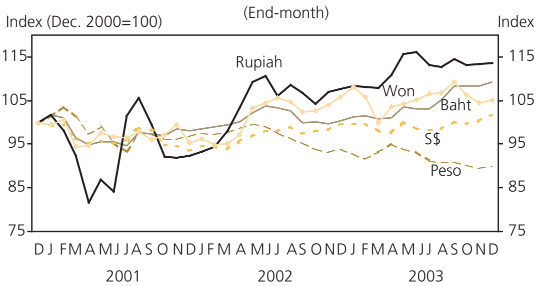
	RM to one unit of foreign currency[1]				Annual change (%)		Change (%)	
	1997	1998	2002	2003	2002	2003	End-June '97- End-Dec. 2003	2 Sep.'98 - End-Dec. 2003
	End-June[2]	Sept. 2[3]	End-Dec.					
SDR	3.5030	5.1177	5.1474	5.6264	-7.3	-8.5	-37.7	-9.0
US$	2.5235	3.8000	3.8000	3.8000	0.0	0.0	-33.6	0.0
S$	1.7647	2.1998	2.1887	2.2342	-6.2	-2.0	-21.0	-1.5
100 yen	2.2088	2.7742	3.2020	3.5546	-9.6	-9.9	-37.9	-22.0
Pound sterling	4.1989	6.3708	6.0924	6.7678	-9.5	-10.0	-38.0	-5.9
Swiss franc	1.7368	2.6450	2.7386	3.0632	-16.9	-10.6	-43.3	-13.7
Euro[4]	–	–	3.9811	4.7783	-15.4	-16.7	–	–
100 Thai Baht	9.7470	9.3713	8.8096	9.5947	-2.4	-8.2	1.6	-2.3
100 Indonesian rupiah	0.1038	0.0354	0.0425	0.0449	-14.1	-5.3	131.4	-21.1
100 Korean won	0.2842	0.2827	0.3197	0.3180	-9.8	0.5	-10.6	-11.1
100 Philippine peso	9.5878	8.8302	7.1462	6.8431	3.1	4.4	40.1	29.0

[1] US$ rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market.
Rates for foreign currencies other than US$ are cross rates derived from rates of these currencies against the US$ and the RM/US$.
[2] End-June 1997 represents pre-Asian Financial Crisis levels.
[3] Ringgit was fixed at US$1 = RM3.8000 on 2 September 1998.
[4] The euro began to be traded on 4 January 1999 (EUR 1= RM4.5050).

Graph 2.9
Exchange Rate of the Malaysian Ringgit against Major Currencies



Graph 2.10
Exchange Rate of the Malaysian Ringgit against Selected Regional Currencies



Note: An increase in the index represents an appreciation of the currency against the ringgit.

its fair value. There are no signs of the ringgit being misaligned. On the domestic front:

- Inflation and unemployment remained low;
- Current account surplus in the balance of payments remained at sustainable levels;
- Continued increase in reserves throughout 2003;
- External debt has been kept at manageable levels with low debt servicing to export ratio; and
- Highly capitalized banking system with further improvements to asset quality ratios.

On the external front, developments were benign on Malaysia's exchange rate regime:

- Depreciating with the US dollar had benefited exports, offsetting the impact on imports;
- Depreciation had a minimum impact on imported inflation since the ringgit did not depreciate against the US dollar and imports denominated in currencies other than the US dollar accounted for only a small share of total imports. In addition, the share of imported components in the CPI basket remained small, at about less than 10%; and
- Impact on overall external debt and debt servicing due to the ringgit depreciation had been manageable, given that only 23% of Malaysia's total external debt is denominated in currencies other than the US dollar.

Under these circumstances, the ringgit peg, on balance, continues to provide significant advantages to the overall economy. The stability of the exchange rate has been effective in improving the longer-term competitiveness of the Malaysian corporate sector by creating incentives for structural adjustments to increase productivity, thereby enhancing the country's future growth prospects.

FISCAL POLICY AND OPERATIONS

The Government presented on 20 September 2002 a moderately expansionary budget for 2003. The fiscal deficit was, therefore, budgeted at 4% of GDP, lower than the fiscal deficit of 5.6% in 2002. The Malaysian economy was expected to strengthen in 2003, benefiting from the recovery in the major industrial countries and stronger growth in the region, with the sustained growth in intra-regional trade. The private sector was envisaged in the Budget to play a larger role in sustaining domestic-driven growth. Private sector investment was projected to return to positive growth due to expected improvement in the financial position of corporations, following the structural adjustments undertaken since the crisis, emerging business opportunities in selected sectors as well as the improved business environment. A major thrust of the 2003 Budget was, therefore, designed to provide the enabling environment and incentives to revitalise the private sector to resume its role as the main engine of growth. Policies in the Budget thus focused on the enhancement of the supportive incentives to promote private sector ventures, especially into new growth areas.

The 2003 Budget contained both expenditure allocation and tax incentives to generate higher growth in the promoted sectors. In terms of budget allocation, emphasis was given towards enhancing the quality of education and upgrading manpower skills. The tax incentives included the reduction in corporate tax for small- and medium-scale enterprises (SMEs) from 28% to 20% for chargeable income of up to RM100,000 and tax incentives for manufacturers of machinery and auto parts makers to promote high value activities in the manufacturing sector. At the same time, an option was introduced

Fiscal policy remained supportive of growth in 2003. While budgetary operations remained expansionary, fiscal management focused at ensuring a balance between sustaining the near-term growth and achieving fiscal consolidation.

for pioneer status holders to qualify for reinvestment allowance if their Pioneer Status were surrendered for cancellation. For the agriculture sector, various incentives were introduced for consolidation of smallholdings, cultivation of rubber wood trees, deep-sea fishing, food processing and modernisation of poultry farming.

The actual outturn of fiscal deficit for 2003 was 5.3% of GDP, due mainly to counter-cyclical expenditure to support growth. Revenue performance was strong in 2003 with higher proceeds from the sale of Government's shares in selected public listed companies. During the year, the Government unlocked some of its assets to optimise returns from its ownership of high-value assets and to achieve greater flexibility in fiscal management. At the same time, such exercise would provide the opportunity towards gradual increases in the "free float" and liquidity of companies with large Government shareholdings and thus benefit trading in the Malaysia Securities Exchange Berhad.

Higher-than-expected expenditure in 2003 was due mainly to the increased expenditure to minimise the spill-over effects from the less favourable global and regional developments in the first half of 2003. An Economic Package amounting to RM7.3 billion was aimed at containing the adverse impact from tensions in the Middle East and the outbreak of Severe Acute Respiratory Syndrome (SARS) in the region.

The positive impact of the Economic Package measures coupled with other factors including low interest rates, high commodity prices and improved cashflow position of companies, strengthened aggregate domestic demand. Together with the recovery in external demand, the private sector's contribution to economic growth rose to 2.5 percentage points in 2003 (0.4% in 2002). Stronger consumption spending and recovery in external demand supported higher investment activities. Private sector investment turned around to register the first positive growth since 2000.

While fiscal expansion contributed to GDP growth, it did not exert pressure on domestic consumer prices and interest rates. Taking advantage of the high savings rate amidst ample liquidity in the banking system, the Government financed its fiscal deficit through non-inflationary domestic sources. Given the low interest rate environment, new issues of MGS with maturities of 5 and 10 years were raised at coupon rates ranging between 3.702-3.917% and between 4.24-4.41% for those with maturity of 15 years. As part of prudent debt management, the Government exercised vigilance on its external indebtedness. Recourse to external borrowings was limited to drawdown of loans committed earlier and refinancing of several loans at lower cost, thereby reducing future debt servicing obligations.

The Federal Government debt amounted to 48.2% of GDP as at end-2003 while the debt servicing remained low at 14% of operating expenditure or 2.7% of GDP. Similarly, external debt of the Federal Government declined in 2003 to 9.5% of GDP (2002: 10.1%), enhancing Malaysia's external position.

Consolidated Public Sector

In 2003, the consolidated public sector registered a slightly smaller overall deficit of 0.4% of GDP. The improved position emanated from better revenue performance of the general government and the non-financial public enterprises (NFPEs) as well as lower development expenditure of the NFPEs. Development expenditure of the general government was higher mainly to finance the Economic Package introduced in May 2003 to mitigate the adverse impact of global economic uncertainties and regional health threat on domestic economic activities.

Federal Government Finance

The Federal Government registered an overall deficit of 5.3% of GDP in 2003 (2002: -5.6%), higher than the 4% targeted in the 2003 Budget. The larger-than-planned deficit was due to higher counter-cyclical expenditure as well as proactive response to the risk of a private sector pull-back due to global political uncertainties and SARS. The threat of global slowdown in the first half of the year prompted the Government to implement stronger expansionary measures to sustain the growth momentum. Despite the higher fiscal deficit, the total debt of the Federal Government remained manageable at 48.2% of GDP as at

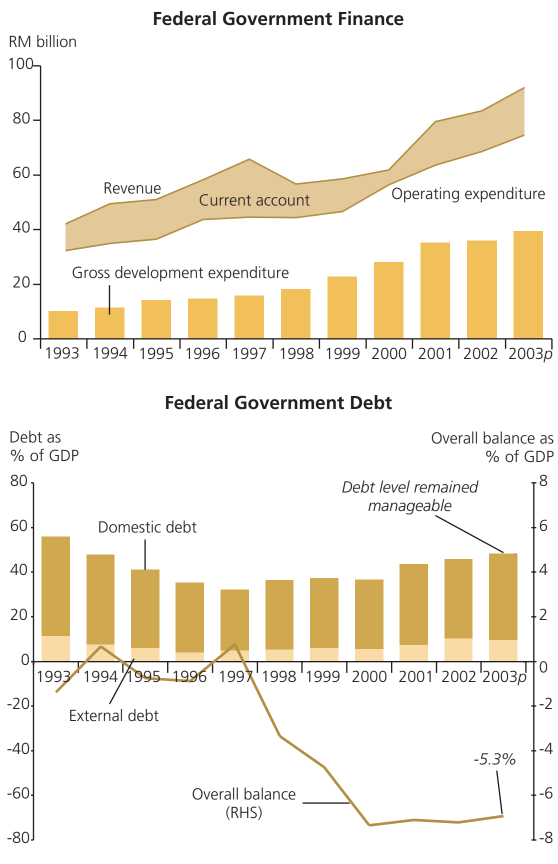
Table 2.7
Consolidated Public Sector Finance

	2002	2003*e*	2004*f*
	RM million		
General government[1]			
Revenue	96,763	110,408	109,389
Operating expenditure	75,450	84,809	88,538
Current surplus of general government	21,312	25,600	20,850
Current surplus of NFPEs[2]	45,324	44,627	41,890
Public sector current surplus	**66,637**	**70,227**	**62,741**
% of GDP	**18.5**	**17.9**	**15.0**
Net development expenditure	69,125	71,951	66,687
General government	*36,828*	*43,727*	*37,563*
NFPEs	*32,297*	*28,225*	*29,124*
Overall balance	**-2,488**	**-1,725**	**-3,946**
% of GDP	**-0.7**	**-0.4**	**-0.9**

[1] Comprises Federal Government, state governments, statutory bodies and local governments.
[2] Refers to 35 NFPEs in 2003 and 2004.
e Estimate
f Forecast

Source: Ministry of Finance, state governments and non-financial public enterprises

Graph 2.11



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end-2003. Debt servicing expenditure also remained low in terms of operating expenditure and GDP. External debt to GDP ratio declined in 2003 as the bulk of financing was raised from non-inflationary domestic sources.

In 2003, Federal Government **revenue** increased by 11.1% to RM92.8 billion, accounting for 23.7% of GDP. The better revenue performance was due to significantly higher non-tax revenue, which accounted for a larger share of total revenue (30%). Higher receipts were registered in almost all components; investment income, licence and permits, petroleum royalties and service fees . In particular, investment income was higher due to proceeds from the sale of the Government's shares in selected public listed companies. The Government disposed of some of its assets to optimise returns from the ownership of high-value assets and achieve a greater flexibility in fiscal management.

Collection from taxes declined slightly by 2.9% (-RM2 billion), mainly attributable to lower receipts

Table 2.8
Federal Government Finance

	2002	2003*p*	2004*r*
	RM million		
Revenue	83,515	92,804	89,966
Operating expenditure	68,699	75,224	79,642
Current account	**14,816**	**17,580**	**10,324**
% of GDP	**4.1**	**4.5**	**2.5**
Net development expenditure	35,069	38,508	29,084
Gross development expenditure	*35,977*	*39,353*	*29,960*
Less: Loan recoveries	*908*	*845*	*876*
Overall balance	**-20,253**	**-20,928**	**-18,760**
% of GDP	**-5.6**	**-5.3**	**-4.5**
Sources of financing:			
Net domestic borrowing	6,076	23,250	–
Gross borrowing	*18,000*	*41,850*	–
Less: Repayment	*11,924*	*18,600*	–
Net foreign borrowing	8,019	-3,709	–
Gross borrowing	*10,465*	*3,144*	–
Less: Repayment	*2,446*	*6,853*	–
Special receipts	62	0	–
Realisable assets[1] and adjustments	6,096	1,387	–
Total	**20,253**	**20,928**	**–**

[1] Includes changes in Government's Trust Fund balances. A positive (+) sign indicates a drawdown in the accumulated realisable assets.
p Preliminary
r Revised

Source: Ministry of Finance

from income taxes and sales tax on petroleum products. The collection of tax revenue was affected by the negative impact of geopolitical developments and the outbreak of SARS on business activities. Other contributory factors included tax incentives and exemptions introduced in the 2003 Budget and measures introduced in the May Economic Package. These tax initiatives included the reduction of the tax rate from 28% to 20% on chargeable income of up to RM100,000 for small and medium-scale companies and the suspension of income tax instalment payments for travel agencies beginning 1 June to 31 December 2003. Additionally, the lower company income tax collection was due to the implementation of the current year tax assessment system in 2000 and self-assessment system in 2001. As companies overpaid income taxes during the transition period, these were set off against tax expenses in 2003. Meanwhile, petroleum income tax rose by 10.9% due mainly to higher crude oil prices.

Import and excise duties collected were higher reflecting the stronger aggregate domestic demand. Other indirect taxes collected, namely sales and service tax, were lower. In particular, the lower sales tax was due to the higher tax exemption for petroleum products. In 2003, a higher tax exemption was provided to oil companies to stabilise the retail prices of petroleum products. The weighted average price of Malaysian crude oil was higher at US$30.30 per barrel in 2003, compared with US$25.24 per barrel in 2002. The decline in service tax collected (-7.9%) was mainly the result of tax exemption. In the restaurants and hotels sub-sector, the exemption on service tax was granted for the period June-December 2003. In the 2003 Budget, courier services and selected professional services provided to companies within the same group were given tax exemption.

The expansionary budgetary operations and the Government's Economic Package implemented in May to support growth and strengthen further the long-term productive capacity of the economy

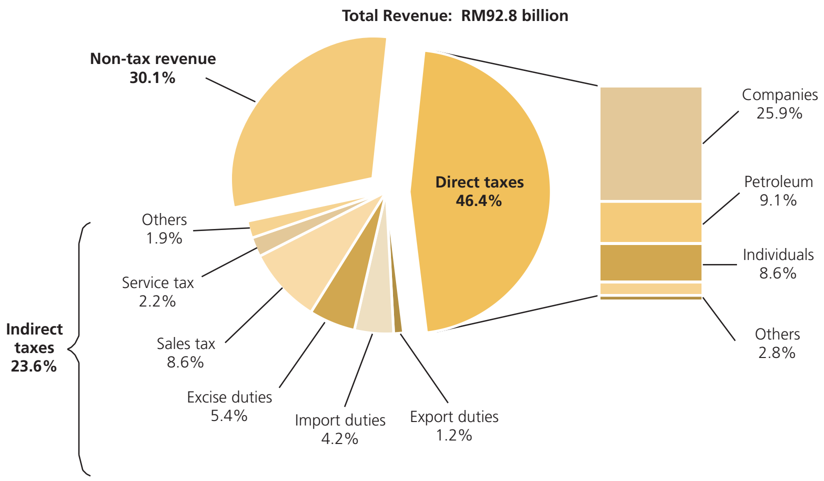
Table 2.9
Federal Government Revenue

	2002	2003*p*	2002	2003*p*
	RM million		Annual change (%)	
Tax revenue	**66,860**	**64,891**	**8.7**	**-2.9**
% of GDP	**18.5**	**16.6**		
Direct taxes	44,351	43,016	5.4	-3.0
Income taxes	42,237	40,690	5.2	-3.7
Companies	*24,642*	*23,990*	*18.6*	*-2.6*
Petroleum	*7,636*	*8,466*	*-22.5*	*10.9*
Individuals	*9,889*	*7,984*	*4.8*	*-19.3*
Others	*69*	*251*	*-1.4*	*263.5*
Real property gains tax	319	264	40.7	-17.1
Stamp duties	1,732	2,008	5.0	15.9
Others	63	53	-26.2	-15.9
Indirect taxes	22,509	21,875	16.1	-2.8
Export duties	803	1,157	-7.3	43.9
Import duties	3,668	3,919	14.9	6.9
Excise duties	4,745	5,031	14.9	6.0
Sales tax	9,243	7,965	25.7	-13.8
Service tax	2,214	2,038	14.9	-7.9
Others	1,836	1,765	-4.5	-3.8
Non-tax revenue	**16,655**	**27,913**	**-7.9**	**67.6**
Total revenue	**83,515**	**92,804**	**5.0**	**11.1**
% of GDP	**23.2**	**23.7**		

p Preliminary

Source: Ministry of Finance

Graph 2.12
Composition of Federal Government Revenue, 2003 (% share)



resulted in **gross expenditure** rising by 9.5% to RM114.6 billion.

Operating expenditure, which accounted for two-thirds of total Federal Government expenditure, increased by 9.5% to RM75.2 billion. The total wage bill, which was the largest component of operating expenditure (29%), was higher, due to the implementation of the Malaysian Remuneration System as well as the payment of monthly critical allowances for doctors and medical staff arising from the outbreak of SARS. While debt-service charges increased, their share to operating expenditure was contained at 14% (2002: 14.1%).

Outlays on supplies and services were higher due to measures introduced to enhance productivity and efficiency (increased expenditure for professional services and small repairs and maintenance). Other transfer payments were higher due mainly to grants and transfers to Government agencies for development and maintenance purposes. Payment for subsidies in 2003 was lower. As part of the Government's policy to reduce the subsidy on petroleum products, the retail prices of petrol, diesel and liquefied petroleum gas (LPG) were raised by two sen with effect from 1 March.

During the year, gross **development expenditure** rose by 9.4% to RM39.4 billion. The bulk of the outlays were extended to the social and economic services sectors (80%).

As in the past, the thrust of expenditure was on human resource development. In 2003, education and training expenses continued to be the largest component of development expenditure (26% of total). Expenses were channelled mainly towards constructing and upgrading schools, matriculation centres, polytechnics and other institutions of higher learning as well as for computerisation programmes and the acquisition of teaching aids. Meanwhile, the construction of new hospitals as well as upgrading existing hospitals and rural and health clinics were the main factors accounting for the increase in spending for health. Expenditure on housing was also higher as the Government continued to implement housing programmes for public sector personnel and the lower income group. The Government also increased spending on social and community services, mainly for youth programmes, small projects in new local housing estates, development work carried out in Putrajaya and Cyberjaya and acquisition of vehicles for community work.

Table 2.10
Federal Government Operating Expenditure by Object

	2002	2003*p*	2002	2003*p*
	RM million		% share	
Emoluments	20,242	21,721	29.5	28.9
Supplies and services	11,269	13,968	16.4	18.6
Asset acquisition	968	1,409	1.4	1.9
Debt service charges	9,669	10,546	14.1	14.0
Pensions and gratuities	5,134	5,870	7.5	7.8
Subsidies	3,677	2,679	5.4	3.6
Other grants and transfers[1]	15,949	16,324	23.2	21.7
Other expenditure[2]	1,791	2,706	2.6	3.6
Total	**68,699**	**75,224**	**100.0**	**100.0**
% of GDP	**19.0**	**19.2**		

[1] Includes grants and transfers to state governments as well as public agencies and enterprises.
[2] Includes grants to international organisations, insurance claims and gratuities and others.
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Source: Ministry of Finance

In the economic services sector, a higher amount was spent on transportation, mainly in constructing new roads and bridges, upgrading existing roads and improving and increasing the capacity of the railroad system, ports and airports. Spending under the trade and industry sub-sector was focussed on the provision of infrastructure facilities, promotion of small and medium-sized industries (SMIs), industrial research and technological development and promotion of tourism. Under the Economic Package announced in May, a total of RM500 million was allocated to development financial institutions (DFIs) as equity to support their efforts in financing small businesses. Outlays on agriculture and rural development remained high, reflecting flood- mitigation projects and the continuous modernisation programme involving the building and upgrading of infrastructure facilities such as rural roads, the water supply network and electrification.

The increase in expenditure for general administration was largely to cater for ICT development in various Government agencies to further improve the quality and delivery of services. Spending for defence and internal security was mainly under the modernisation programme for the armed forces and police.

Federal Government total **debt** outstanding increased by 14.4% to RM188.8 billion or 48.2% of GDP as at end-2003. Higher borrowings from the domestic market resulted in domestic debt outstanding rising to RM151.5 billion as at end-2003

Table 2.11
Federal Government Development Expenditure by Sector

	2002	2003*p*	2002	2003*p*
	RM million		% share	
Defence and security	4,333	6,026	12.0	15.3
Economic services	12,433	13,799	34.6	35.1
Agriculture and rural development	1,364	1,621	3.8	4.1
Trade and industry	3,474	3,463	9.7	8.8
Transport	5,401	7,354	15.0	18.7
Public utilities	1,808	920	5.0	2.3
Others	387	442	1.1	1.1
Social services	18,043	17,704	50.2	45.0
Education	12,436	10,194	34.6	25.9
Health	1,503	2,684	4.2	6.8
Housing	1,808	1,928	5.0	4.9
Others	2,296	2,897	6.4	7.4
General administration	1,168	1,824	3.2	4.6
Total	**35,977**	**39,353**	**100.0**	**100.0**
% of GDP	**10.0**	**10.0**		

Numbers may not add up due to rounding.
p Preliminary

Source: Ministry of Finance

Table 2.12
Federal Government Debt Outstanding

	Annual change		At end-2003*p*
	2002	2003*p*	
	Nominal value in RM million		
Domestic debt	**7,284**	**22,803**	**151,483**
Treasury Bills	0	0	4,320
Government Investment Issues	1,000	2,000	7,000
Malaysian Government Securities	6,100	21,250	130,800
Treasury Housing Loans Fund	1,180	2,628	9,363
Market loans	-996	-3,075	0
External debt	**11,955**	**1,001**	**37,284**
Market loans	10,992	-485	28,189
Project loans	963	1,486	9,095
Total	**19,239**	**23,804**	**188,767**
% of GDP			**48.2**

p Preliminary

Source: Ministry of Finance

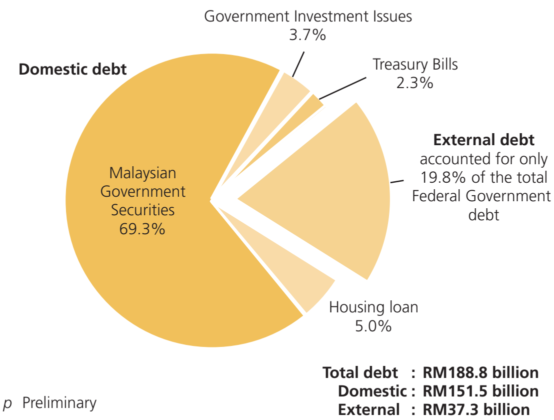
or 38.6% of GDP (35.7% of GDP). The bulk of Government's financing requirements (93%) was financed from domestic sources. Recourse to external borrowings was limited to the drawdown of loans while several external loans were refinanced to take advantage of tighter spreads arising from Malaysia's improved ratings. Overall, the prevailing low interest rate environment enabled the Government to raise funds at low cost and hence, minimised future debt servicing. The regular issue of Government securities in the domestic market also facilitated the development of a more reflective benchmark yield curve while deepening the domestic bond market.

In 2003, total gross borrowings of the Federal Government amounted to RM45 billion, compared with RM28.5 billion in 2002. The higher gross funds raised was to finance both the fiscal deficit as well as to roll-over maturing debt. **Net borrowings** of the Federal Government rose to RM19.5 billion, from RM14.1 billion in 2002. As revenue was more than adequate to finance operating expenditure, the net funds raised were used only to finance development expenditure. During the year, the Treasury Housing Loans Fund recorded a net borrowing to meet the higher demand for housing loans by civil servants.

The high domestic savings rate, coupled with ample liquidity in the banking system, allowed the Federal Government to raise funds required from the **domestic market**, without crowding out private sector. Malaysian Government Securities (MGS) with maturities of 5 and 10 years were issued at coupon rates ranging between 3.702-3.917% (3.15-4.053% for funds raised in 2002) and between 4.24-4.41% for those with a maturity of 15 years. There were no issues of 15-year MGS in 2002.

During the year, the Federal Government floated twelve issues of MGS totalling RM39.9 billion by open tender through principal dealers and private placements and raised a single issue of the Government Investment Issues (GIIs) amounting to RM2 billion. The Government reopened eight of its existing conventional issues to increase their respective issue sizes and enhance liquidity in order to develop the secondary market. The

Graph 2.13
Federal Government Outstanding Debt as at end-2003*p* (% share)



p Preliminary

issuance of Treasury Bills (TBs) facilitated the roll-over of maturing bills. MGS issued continued to be absorbed mainly by provident, pension and insurance funds (76% of the outstanding MGS), while the ownership of GIIs and TBs was mainly dominated by the banking sector (94% and 76% of the respective amounts outstanding). After taking into account repayments, the net domestic borrowing of the Federal Government as at end-2003 amounted to RM23.3 billion.

To contain the cost of debt servicing and minimise exposure to external risks, the Government kept its **external debt** level low in 2003 by prepaying and refinancing some of its existing loans. In this regard, new external borrowings were limited to project loans committed earlier. A total of RM1.7 billion was drawn down from bilateral sources, especially from Japan under the New Miyazawa Initiative, as well as multilateral sources. In line with its prudent debt management philosophy, the Government refinanced a number of its existing term and syndicated loans to take advantage of the tighter spreads. In January, a ¥1.4 billion Term Loan due 2006 was raised at Libor + 57.5 basis points to refinance the 3.17% ¥4.1 billion Term Loan due 2006. In March, the Government refinanced a US$250 million and ¥54 billion dual currency syndicated loan at a lower margin of Libor + 38 basis points (previously, Libor + 125 basis points). Another dual currency syndicated loan amounting to US$1.25 billion and ¥11.6 billion was rolled over in December with a tighter spread of 33 basis points (from 52 basis points). The Government also prepaid two of its external loans during the year, namely a Floating Rate Note due 2005 and a syndicated loan due 2005/07 totalling US$433 million. Overall, the Federal Government registered a net repayment of RM3.7 billion in 2003. During the year, the reclassification of a domestic syndicated foreign-currency loan raised in the Labuan International Financial Centre as external debt and exchange revaluation loss, led to a slightly higher external debt. However, with the Government's restraint on recourse to external borrowings and the prepayment exercise, the share of external debt outstanding to GDP declined to 9.5% of GDP (10.1% of GDP in 2002).

Table 2.13
Holdings of Federal Government Domestic Debt

	2002	2003*p*	2002	2003*p*
	Nominal value in RM million		% share	
Treasury Bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	65	67	1.5	1.6
Banking sector	3,744	3,266	86.7	75.6
Others	512	986	11.8	22.8
Government Investment Issues	**5,000**	**7,000**	**100.0**	**100.0**
Insurance companies	320	390	6.4	5.6
Banking sector	4,680	6,611	93.6	94.4
Malaysian Government Securities	**109,550**	**130,800**	**100.0**	**100.0**
Social security and insurance institutions	85,325	99,260	77.9	75.9
of which:				
Employees Provident Fund	*72,980*	*84,678*	*66.6*	*64.7*
Insurance companies	*9,313*	*11,597*	*8.5*	*8.9*
Banking sector	14,629	19,008	13.4	14.5
Others	9,597	12,532	8.8	9.6

Numbers may not add up due to rounding.
p Preliminary

The debt servicing expenditure remained within prudent levels. Debt charges as percentage of operating expenditure, revenue and GDP were kept low at 14%, 11.4% and 2.7% respectively in 2003 (2002: 14.1%, 11.6% and 2.7% respectively). The external debt service ratio of the Federal Government also remained low at 1.3% in 2003 (2002: 1%) while foreign exposure declined to account for 20% of the total debt outstanding (2002: 22%). Proactive and sound debt management enabled the Government to avoid a bunching of repayments. As at end-2003, about 60% of loans outstanding had a remaining maturity exceeding three years and most were at fixed interest rates, reducing exposure to fluctuations in interest rates.

State Governments

Based on preliminary estimates, the consolidated financial position of state governments recorded a small overall deficit of 0.6% of GDP in 2003. While the revenue performance remained strong, operating and development expenditures increased during the year. The overall deficit was financed by Federal Government loans and the drawdown of accumulated financial assets of the state governments.

During the year, the higher consolidated state revenue was derived from state sources. The higher commodity prices, particularly for crude oil and crude palm oil, had a positive impact on the states' own sources of revenue through petroleum royalty and sales tax on crude palm oil. Meanwhile, receipts from the Federal Government were sustained to assist the states in providing infrastructure, utilities and other essential amenities. The increase in operating expenditure reflected mainly higher payments for emoluments following the implementation of the Malaysian Remuneration System for public sector employees, as well as the acquisition of assets to facilitate higher efficiency in the delivery of services. A major portion of the higher development expenditure was on expanding and upgrading public utilities, housing, agriculture and on rural development as well as for industrial development.

Non-Financial Public Enterprises

Preliminary estimates of the consolidated financial position of the 35 NFPEs indicated a higher overall surplus position (4.4% of GDP). The improvement was due to higher revenue and lower development expenditure with the completion of several big projects and the reprioritisation of planned projects.

The higher consolidated revenue of the NFPEs reflected increased earnings from oil and gas-related services, utilities and agriculture-based sectors. These sectors benefited from stronger economic activities and higher commodity prices, especially for crude oil. Significant earnings were also recorded from overseas operations. Higher operating expenditure was due to increased raw material costs, especially crude oil and fuel, and measures taken to improve services, including the upgrading of technology.

The capital outlay of the NFPEs was channelled towards expanding capacities, both at home and abroad. Petroliam Nasional Berhad continued to invest in exploration and production projects in Malaysia and overseas, namely in Egypt, Sudan and Vietnam. The bulk of expenditure was also for Production Sharing Contracts within Malaysia. Other projects included the final stage construction of MLNG Tiga Plant and on-going building of liquefied natural gas and petroleum tankers. In the case of Tenaga Nasional Berhad, expenditure was mainly for generation capacity and transmission

Table 2.14
Consolidated State Government Finance

	2002	2003*e*	2004 Budget
	RM million		
Revenue	8,341	8,787	9,676
State sources	*6,239*	*6,729*	*7,120*
Federal grants and transfers	*2,102*	*2,058*	*2,556*
Expenditure	5,090	6,009	6,397
Current surplus	**3,251**	**2,778**	**3,278**
% of GDP	**0.9**	**0.7**	**0.8**
Net development expenditure	3,772	4,973	4,595
Gross development expenditure	*4,161*	*5,503*	*4,756*
Less: Loan recoveries	*389*	*530*	*161*
Overall balance	**-520**	**-2,196**	**-1,316**
% of GDP	**-0.1**	**-0.6**	**-0.3**
Sources of financing:			
Federal loans	752	773	496
Realisable assets[1]	-231	1,423	821
Total	**520**	**2,196**	**1,316**

[1] A positive (+) sign indicates a drawdown in the accumulated realisable assets.
e Estimate

Source: State governments

Table 2.15
List of NFPES, 2003[1]

1 1st Silicon (Malaysia) Sdn. Bhd.
2 Bintulu Port Sdn. Bhd.
3 Cement Industries (Sabah) Sdn. Bhd.
4 Central Spectrum (M) Sdn. Bhd.
5 Felda Agricultural Services Sdn. Bhd.
6 Golden Hope Plantations Bhd.
7 Indah Water Konsortium Sdn. Bhd.
8 Keretapi Tanah Melayu Bhd.
9 Kontena Nasional Bhd.
10 Kuching Port Authority
11 Kulim (Malaysia) Bhd.
12 Kumpulan Guthrie Bhd.
13 MA (Sepang) Sdn. Bhd.
14 Malaysia Airline System Bhd.
15 Malaysia Airports Sdn. Bhd.
16 Marconi (Malaysia) Sdn. Bhd.
17 Multimedia Development Corporation Sdn. Bhd.
18 Northport (Malaysia) Bhd.
19 Penang Port Sdn. Bhd.
20 Penerbangan Malaysia Bhd.
21 Petroliam Nasional Bhd.
22 PPES Works (Sarawak) Sdn. Bhd.
23 Rakyat Berjaya Sdn. Bhd.
24 Sabah Energy Corporation Sdn. Bhd.
25 Sabah Ports Sdn. Bhd.
26 Sarawak Electricity Supply Corporation
27 Sebor (Sabah) Sdn. Bhd.
28 Sergam Bhd.
29 Silterra Malaysia Sdn. Bhd.
30 Sinora Sdn. Bhd.
31 Syarikat Prasarana Negara Bhd.
32 Telekom Malaysia Bhd.
33 Tenaga Nasional Bhd.
34 TH Plantations Sdn. Bhd.
35 UDA Holdings Bhd.

[1] List of NFPEs for monitoring and reporting purposes was revised in 2003. NFPEs are defined as companies in which the Government has an equity of at least 51 per cent and sales turnover of at least RM100 million or having a significant impact on the economy, including large borrowing needs and capital expenditure.

Table 2.16
Consolidated NFPEs Finance[1]

	2001	2002	2003*e*
	RM million		
Revenue	105,075	126,562	149,970
Current expenditure	65,392	80,951	104,556
Current account	**39,683**	**45,611**	**45,414**
% of GDP	**11.9**	**12.6**	**11.6**
Development expenditure[2]	24,033	32,297	28,225
Overall balance	**15,651**	**13,313**	**17,188**
% of GDP	**4.7**	**3.7**	**4.4**

[1] Refers to 35 NFPEs in 2003.
[2] Includes grants from the Federal Government.
e Estimate

Source: Ministry of Finance and non-financial public enterprises

network. Major expenditure included the construction of the Port Dickson Phase 1 Combined Cycles Power Plant and the East-West Grid Interconnection in Sabah. A large share of the development expenditure of Telekom Malaysia Berhad was focussed on upgrading and expanding capacity to improve the telecommunication infrastructure and services. Projects undertaken included the underwater cable network connecting the Asia Pacific region, Phase VI of the Digitaline II project to facilitate data transmission for businesses and the Government Corporate Information Network Superhighway to support various information technology-related applications for businesses.

Outlook and Policy

Outlook and Policy

THE INTERNATIONAL ECONOMIC ENVIRONMENT

Developments in 2003

The global economy strengthened considerably in 2003, led by the United States (US). Growth has also been synchronised across major industrial economies, with the recovery in Japan and Europe adding support to global growth. Growth in 2003 was characterised by two distinct phases, with the first half-year dampened by uncertainties related to the Iraq war and the Severe Acute Respiratory Syndrome (SARS) outbreak in Asia. Since mid-2003, however, revival of growth in Japan and euro zone and stronger growth in the US led to a better-than-expected global growth of 3.2% for the year. Expansionary fiscal and accommodative monetary policies in the advanced economies and Asian countries supported growth. At the same time, the sources of growth have broadened from consumption-led to include an upturn in investment and inventory rebuilding.

Table 3.1
World Economy : Key Economic Indicators

	Real GDP Growth (%)			Inflation (%)		
	2002	2003*e*	2004*f*	2002	2003*e*	2004*f*
World Growth	**3.0**	**3.2**	**4.1**	–	–	–
World Trade	**2.9**	**3.5 - 4.5**	**5.0 - 6.0**	–	–	–
Major Industrial Countries						
United States	2.4	3.1	3.9	1.6	2.1	1.3
Japan	-0.4	2.7	2.0	-0.9	-0.3	-0.6
Euro Area	0.9	0.4	1.6	2.3	2.0	1.6
United Kingdom[1]	1.7	2.3	2.3	2.2	2.8	2.5
East Asia	**6.2**	**6.2**	**6.6 - 6.8**	**1.3**	**1.8**	**2.4 - 2.7**
Asian NIEs	**4.5**	**2.9**	**5.0 - 5.2**	**0.8**	**1.2**	**1.4 - 1.5**
Korea	6.3	2.9	5.2	2.7	3.5	3.0
Chinese Taipei	3.6	3.2	4.7	-0.2	-0.3	0.4
Singapore	2.2	1.1	3.5 - 5.5	-0.4	0.5	0.5 - 1.5
Hong Kong China[2]	2.3	3.3	6.0	-3.0	-2.6	-1.0
The People's Republic of China	**8.2**	**9.1**	**8.3**	**-0.8**	**1.2**	**3.0**
ASEAN[3]	**4.0**	**4.5**	**4.9 - 6.0**	**5.3**	**3.8**	**3.0 - 4.3**
Malaysia	4.1	5.2	6.0 - 6.5	1.8	1.2	1.5
Thailand	5.4	6.7	6.3 - 7.3	0.7	1.8	1- 2
Indonesia	3.7	4.1	4.0 - 5.0	11.9	6.6	4.5 - 6.5
Philippines	4.4	4.5	4.9 - 5.8	3.1	3.4	4.0 - 5.0

[1] Refers to retail price excluding mortgage interest.
[2] Refers to composite price.
[3] Includes Singapore.
e Estimate
f Forecast

Source: International Monetary Fund, Datastream, OECD Economic Outlook, National Sources

The global recovery was accompanied and supported by improvements in international trade and financial markets. World trade grew by 3.5-4.5% in 2003, largely attributable to import demand from developing countries. Reflecting the rising global demand, the international prices for non-oil primary commodities rose during the year. In the financial markets, major equity markets rallied, supported by rising investor confidence and improved corporate financial positions. The lower cost of capital amidst sustainable demand led to a revival in the global investment cycle. During the year, the global foreign exchange markets were dominated by the significant weakening of the US dollar due to the concerns on the widening US fiscal and current account imbalances. In Asia, there was strong expansion in domestic demand resulting in a significant increase in intra-regional trade.

In the **US**, the pace of recovery gained strong momentum in the second half to register a growth of 5.8% (first half: 2.1%). Despite weak labour market conditions, household spending remained an important driver of growth, with consumption increasing strongly by 4.9% in the second half-year. While the tax cuts provided a significant stimulus, spending also benefited from the low interest and mortgage rates as well as rising household wealth from renewed strength in the stock market. More important, business spending on equipment and software recovered following productivity-driven increases in profits and improved corporate balance sheets. Latest data showed real GDP sustaining its growth momentum to expand by 4.1% in the final quarter of 2003. Overall, the growth was well supported by positive contributions from consumption, investment, exports and inventory increases.

Growth in **Japan** picked up in the second quarter of 2003 and accelerated in the fourth quarter, led by strong growth in exports from rising regional trade and recovery in investment spending. The **euro area** recovered gradually, supported by fiscal spending and improvement in net exports. In the **United Kingdom** (UK), growth remained resilient, underpinned by both private and public consumption.

In the **Asian region**, despite geopolitical uncertainties and the negative impact of SARS in the first half of 2003, regional growth was sustained at 6.2%, twice the global average. The main impetus to growth emanated from exports, driven mainly by the upturn in the global electronics cycle and sustained favourable prices for non-oil primary commodities reinforced by strong domestic demand. In tandem with improvements in the global economic environment, the trade momentum accelerated in the second half, resulting in a doubling of the export growth rate to 18.6% for the year (2002: 9.5%). Of significance, intra-regional trade accounted for about half of the regional economies' export growth, with exports to the People's Republic of China (P. R.China) accelerating by 33%.

Global prospects have improved, supported by reinforcing and broad-based growth across major industrial countries.

During the year, regional growth was reinforced by the underlying strength in domestic demand, supported by accommodative monetary and fiscal policies. In several countries, economic stimulus packages that were introduced to mitigate the impact of SARS led to the broad recovery in private consumption and travel-related industries in the second half of the year. Of importance, financial indicators in the region improved during the year. Bank balance sheets strengthened while corporate sector debt levels were lower and external debt positions improved. The improved assessment of credit risk in the region in 2003 was reflected in the raising of ratings for P. R. China, Indonesia, Malaysia, Singapore and Thailand by international credit rating agencies.

Among regional countries, growth continued to be led by P. R. China, with a strong expansion of 9.1%, followed by Thailand and Malaysia at 6.7% and 5.2%, respectively. While growth was higher in Hong Kong China, the growth of the Asian Newly Industrialised Economies (NIEs) as a whole slowed down to 2.9% (2002: 4.5%), due mainly to a contraction in private consumption in Korea and the adverse impact of SARS on the economies of Singapore and Chinese Taipei.

Prospects for 2004

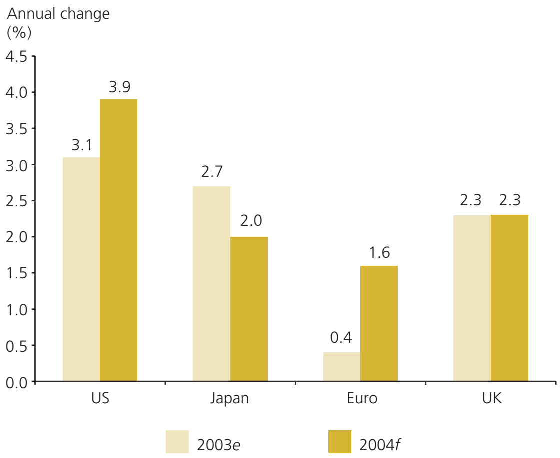
The outlook for the global economy has become increasingly optimistic, following the strong upturn in the second half of 2003. Amidst improved prospects, most growth projections have been revised upwards. For 2004, world output and world trade are projected to grow at a faster pace of 4.1% and 5-6%, respectively. The Asian regional economies' share in global trade has also increased. Measured in terms of the share of world exports of goods and services, the region's share has increased from 16.3% in 1994 to 19.6% in 2002. Favourable export performance, continued growth in private consumption and expansion in investment are expected to lead to higher growth for the Asian regional economies in 2004.

Amidst a low inflation environment, the growth momentum in the US is expected to be supported by expansionary monetary and fiscal policy that have been in place for some time, as well as productivity gains, investment and inventory rebuilding. Growth in the euro area is expected to recover gradually as expansionary fiscal policies continue to be adopted in major euro area economies. While the economic recovery in Japan is affected by long-term structural problems, deflationary pressures have begun to ease and signs of sustainable recovery have emerged since the second half of 2003. In the UK, economic growth is expected to remain resilient, underpinned by public and private consumption.

Industrial Countries

In 2004, growth of the **US** economy is expected to remain strong and more broad-based, with real GDP

Graph 3.1
Major Industrial Countries: Real GDP Growth (2003-2004)



e Estimate
f Forecast

growth strengthening to 3.9% from 3.1% in 2003. Consumption growth is expected to continue, albeit at a more moderate pace as benefits of mortgage refinancing and tax cuts abate. Investment is expected to provide a higher contribution to growth although excess capacity still remains in certain sectors of the economy. The upturn in equipment and software spending is expected to lead investment growth. Gains in corporate profits and capacity expansion are expected to stimulate business expenditure, while expected inventory rebuilding from decade low levels is expected to add to growth.

In the **euro area**, real GDP is expected to expand by 1.6% in 2004. Domestic demand has remained subdued due to weak labour markets and uncertainties related to social welfare reforms. However, the low interest rate environment coupled with rising real disposable income should provide some impetus for growth. In addition, investment activity is expected to recover owing to improvements in global demand and further inventory rebuilding. Despite improvements in business confidence, growth in Germany is expected to remain modest due to weak labour market conditions and moderate private consumption growth. While euro area exports are expected to grow further with strengthening global demand, a sharp and sustained appreciation of the euro could adversely affect exports, corporate profitability and growth. Sustainable recovery in the euro area would largely be dependent on a revival in domestic demand.

In **UK**, the economy is expected to remain resilient as the global economic recovery becomes more entrenched. Growth is estimated at 2.3%, growing above trend in 2004. Investment is expected to recover with increased corporate profitability, while fiscal expenditure is expected to rise modestly. Consumption is expected to continue to grow, but at a more moderate pace with the slowdown in growth of disposable income. Recovery of export growth will be influenced by exchange rate movements and demand conditions in the euro area. While house prices have been rising at a rapid rate, recent increases in borrowing costs are expected to mitigate further price increases.

Recovery in **Japan** is expected to be sustained. Major contributory factors are the robust exports, stronger investment activity supported by improved business confidence, corporate profitability as well as increased consumption arising from personal income growth and more stable employment conditions. Deflationary conditions and long-term structural weaknesses in the corporate and banking sectors are still being addressed.

Inflation is expected to remain benign in major industrialised countries in 2004. While inflation is projected to remain low at 1.3%, higher global crude oil prices could exert upward inflationary pressures, particularly in the US. Meanwhile, in the euro area, the stronger euro would contribute to offsetting the impact of higher crude oil prices. Despite improving growth prospects, deflationary pressures are expected to remain in the Japanese economy.

Overall, for 2004, oil prices are expected to remain marginally higher than the OPEC band (US$22-28 per barrel), attributable mainly to rising demand in tandem with the strengthening of global growth. In February 2004, OPEC announced that with effect from 1 April 2004, the production ceiling will be lowered by one million barrels per day, given a projected supply surplus in the second quarter of the year due to seasonally low demand. Also, uncertainties in oil production, particularly in Iraq, and positive investor sentiments on the commodities market, are expected to contribute to price increases.

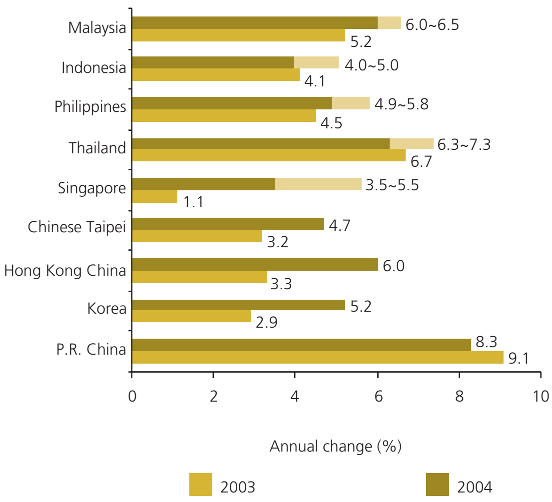
Growth momentum to continue in US, with recovery gaining strength in Japan and Europe and growth in Asia to be driven by recovery in investment.

East Asian Economies

Prospects are for **growth in the Asian region to be stronger** between 6.6-6.8% in 2004. The majority of regional countries are expected to register faster growth, with P. R. China leading growth in the region. Overall, regional growth is expected to be broad based, with both external and domestic demand providing the impetus to faster growth.

On the external front, growth is expected to benefit from the further strengthening of the electronics upcycle. Besides demand for consumer electronics, which was the main factor for growth of semiconductor sales in 2003, higher business spending on IT replacement and a revival of investment are projected to enhance sales. On the

Graph 3.2
Regional Countries: Real GDP Growth



supply side, the industry is expected to register strong capacity expansion, particularly in equipment investment, which was last seen during the electronics upturn in 2000. With capacity utilisation above 90% in 2003, investment in equipment and machinery is forecast to increase by 36-42% on an annual basis in 2004 (2003: 12.4%). The rise in investment activity during the year is envisaged to emanate from stronger foreign direct investment

Higher and broad based regional growth in 2004, with expansion in exports, consumption and investment.

inflows and the further strengthening of regional production networks. Therefore, intra-regional trade is expected to continue expanding.

On the domestic front, private consumption is expected to strengthen further in 2004, supported mainly by rising disposable incomes and low interest rates in most regional countries. With the exception of Korea, lending to the household sector in most other regional countries remains below pre-crisis levels, implying the potential for further expansion. The impact of the bird flu on economic growth would be marginal as the livestock industry accounts for a small share of GDP, ranging from 0.1% in Japan to 15% in Cambodia. A key development during the year is the expansion in investment activity, which began to pick up in the second half of 2003. The benefits of past restructuring of the corporate sector have led to higher profitability as well as increased bank lending and equity capital, all of which are expected to enhance investment activity during the year. Reflecting efforts to diversify the economy, a key measure taken in recent years by most regional countries is to spearhead investments in the services sector. Of importance, domestic investments through the promotion of small and medium enterprises (SMEs) are expected to pick up during the year. Consonant with higher growth, most regional countries are forecast to record fiscal improvements.

For 2004, the global outlook is biased on the upside, with stronger recovery in demand. Growth is expected to be supported by continued expansion in consumption and private investment and the strengthening of the labour market in the US and the positive impact of tax and labour market reforms in Europe. Hence, prospects for regional growth in Asia remain favourable.

In 2004, real GDP growth of the **Asian Newly Industrialised Economies (NIEs)** as a group, is expected to strengthen to 5-5.2%, underpinned by robust export performance and a pick up in domestic demand.

In **Korea**, real GDP is projected to register growth of 5.2% in 2004. Exports would remain the main driver of economic expansion. Tax incentives, increased investment expenditure, and measures to improve labour-management relations as well as nurture SMEs are expected to lead to the improvement in job prospects. Hence, private consumption is expected to improve in the second half of the year.

Growth in **Hong Kong China** is forecast to pick up further in 2004 to reach 6%, the highest in four years. A boost to economic expansion is expected to emanate from the Closer Economic Partnership Arrangement (CEPA) with P.R.China, which came into effect on 1 January 2004. The agreement, covering a wide range of goods and the opening up of 17 services sectors, is the first extensive bilateral FTA in the region. Further strengthening of the domestic economy and strong demand from P.R.China would support employment and the services sector including the tourism and financial sectors.

Led by investment and exports, growth in **Chinese Taipei** is expected to be higher at 4.7%. Higher investment spending is forecast for the year, due to government expenditure on construction projects and a rebound in private investments in the manufacturing sector. In line with the strengthening of the global electronics upcycle, exports are poised to benefit from the country's competitive advantage in contract manufacturing, namely in wafer fabrication, notebooks and consumer electronics.

In **Singapore**, growth is expected to strengthen in the range of 3.5-5.5% in 2004, attributable mainly to the recovery in global IT spending. A revival in consumer demand is projected to emanate mainly from positive sentiments arising from improvements in labour market conditions and the low interest rate environment.

The **ASEAN** economies as a whole is expected to expand at a faster pace of 4.9-6% in 2004, with higher contribution from the domestic and external sectors. Within the group, **Thailand** is forecast to record the strongest growth in output, with growth of 6.3-7.3%. Following rising capacity utilisation, faster investment growth is expected, with the bulk of investments comprising private sector investments in the manufacturing sector, and reinforced by public sector infrastructure projects.

In the **Philippines**, real GDP growth is projected to expand by 4.9-5.8%, attributable mainly to higher electronics exports. Continued strong overseas remittances as well as favourable farm output are expected to contribute to growth in private consumption. Growth in **Indonesia** is expected to increase between 4-5%, with private consumption to remain as the primary source of growth. With increased access to financing at lower interest rates amidst declining inflation, private consumption is expected to register a sustained rise.

P. R.China is forecast to register the highest growth of 8.3% in 2004. While exports and private consumption are expected to increase, investment expenditure is expected to moderate in line with the government's policy to achieve a more balanced and sustainable growth.

In 2004, inflation in the **regional countries** is expected to remain low between 2.4-2.7%. Inflation in the **Asian NIEs** as a group, however, is expected to increase marginally to between 1.4-1.5%. In Korea, inflation is projected to moderate, reflecting a stabilisation in food and oil prices and receding demand pressures. In all other NIEs, consumer prices are forecast to trend upwards, attributable to the pick up in general economic activity. While deflationary pressures are expected to ease in Hong Kong China, a turnaround is forecast for Chinese Taipei, with price increases in 2004, compared with price declines registered in the last two years.

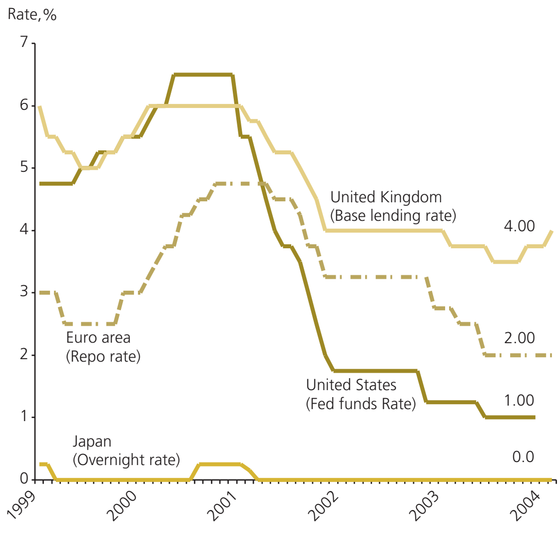
Meanwhile, inflation in the **ASEAN countries** as a group is expected to remain stable in the range of 3-4.3% in 2004. In Indonesia, price pressures are projected to subside further, with slower growth in wages amidst excess capacity conditions. In contrast, inflation in the Philippines is estimated to increase further, reflecting rising demand pressures as economic growth strengthens. In Thailand, modest price pressures are forecast, arising from continued buoyant domestic demand conditions.

Interest Rates and Exchange Rates

In 2003, the major industrial countries continued to maintain accommodative monetary policies. Weak economic conditions, particularly in the first half of the year, led several major central banks to reduce interest rates.

In the US, the **Federal Reserve Board (Fed)** reduced interest rates by 25 basis points on 25 June 2003 following heightened risk of deflation. The Fed's actions had brought the Federal funds rate to 1.0%, its lowest level in more than 40 years, and marked a cumulative reduction of 550 basis points since the Fed began its easing cycle in early 2001. By end-year, however, amidst a stronger recovery in growth, the threat of falling inflation had receded. Meanwhile, signs of economic weakness in the euro zone especially in early 2003 prompted the

Graph 3.3
Major Industrial Countries: Official Interest Rates



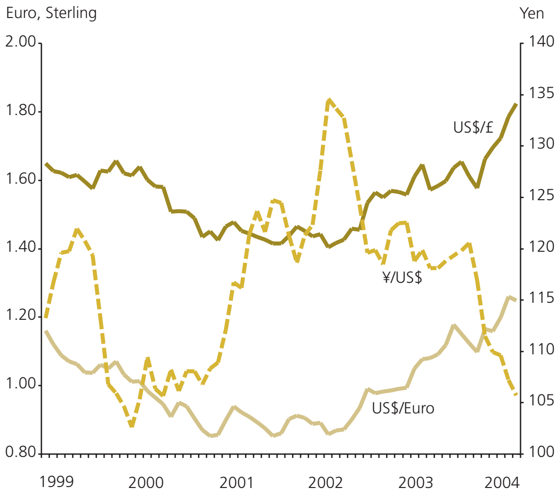
European Central Bank to reduce rates by 25 basis points in March 2003 and a further 50 basis points in June 2003. Consequently, the benchmark repo rate declined to 2%, reflecting a cumulative 275 basis point reduction since May 2001 to counter the slowdown in the euro area.

In the UK, the **Bank of England** (BOE) eased its base lending rate twice by 25 basis points in February and July 2003 on concerns about the downturn in the manufacturing sector and that domestic and external demand would be lower than earlier anticipated. However, with the sharp increases in house prices and rapid growth in consumer loans seen in the second half-year, the BOE raised rates in November 2003 and again in February 2004, mainly to constrain the pace of household debt accumulation. Meanwhile, in Japan, with official short-term interest rates virtually at zero, the **Bank of Japan** continued to engage in quantitative easing measures throughout 2003 to inject liquidity into the banking system in order to counter deflation and lend support to the economic recovery.

For the remaining part of 2004, while growth has gathered momentum, excess capacity still exists in the global economy. Excess capacity in the industrial sector and high unemployment in the labour markets are reflective of output gaps. Thus, despite rising commodity prices, inflation levels remain subdued in many economies. Nonetheless, in some countries, house price increases and excessive credit growth have surfaced to influence the stance of monetary policy. Overall, the timing and magnitude of monetary policy actions would depend on country-specific factors, including the strength of economic growth, inflation trends and developments in the currency and financial markets.

In the **foreign exchange markets**, the US dollar depreciated further against all major currencies in **2003**, extending its decline, which began in early 2002. Consequently, by end-2003 the US dollar depreciated further by about 20% against the euro and about 11% against both the Japanese yen and pound sterling. Underlying the depreciating trend has been the pressure from a widening current account deficit and declining capital inflows into US dollar assets. Against the backdrop of a weaker US dollar, the euro appreciated in 2003 and ended the year at a record high of E1=US$1.2595. This trend continued into early 2004, with the dollar weakening further against the other major currencies.

Graph 3.4
Movement of the US Dollar against Major Currencies



MALAYSIAN ECONOMY IN 2004

The Malaysian economy is expected to strengthen further in 2004, building on the strong growth momentum in the second half of 2003 and brighter prospects for global growth in 2004. Real GDP is expected to expand by 6-6.5% (2003: 5.2%), underpinned by stronger domestic demand and reinforced by more favourable external demand. Growth will mainly be private sector-driven, while the public sector gradually consolidates. The growing consumer and business confidence since the second quarter of 2003, strengthened economic fundamentals and the positive impact of pro-growth fiscal and monetary measures are expected to mutually reinforce robust consumer spending and the upturn in private investment activities.

The projections for growth in 2004 are based on a stronger global economic growth of 4.1% and led by synchronised recovery across all regions, an upturn in the global electronics cycle and firm prices for crude palm oil and crude oil. With the growth in Asia stronger than the global average, Malaysia is also expected to benefit from the continued expansion in intra-regional trade. The expectation of the stronger pace of growth is also premised on the strength and dynamism of the private sector performance, especially the strength of the upturn in domestic investment. Evidence of higher new investments and capacity expansion are indicative that the recovery in economic growth is sustainable.

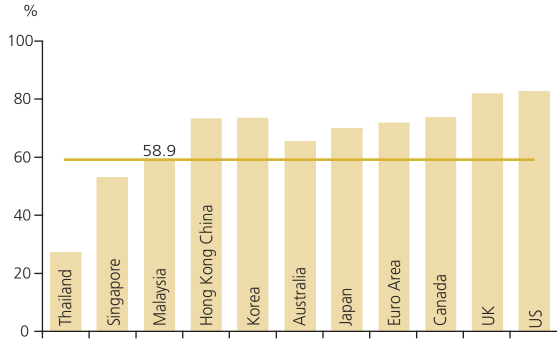
While possible downside risks remain, the strong underlying fundamentals will provide strong foundations for economic resilience and future growth.

While the external environment has improved significantly, Malaysia will continue to fine-tune the strategies to strengthen the domestic sources of growth to reduce vulnerability to external risks and strengthen economic resilience. Hence, while continuing to promote exports and foreign direct investment, greater focus has been directed at enhancing the contribution of domestic consumption and investment to growth.

Private consumption has become an important component of the economy. Measures to promote domestic consumption have resulted in a higher share of private consumption to GDP (46.4%; 1999: 43.6%). However, the share of private consumption to GDP is relatively low compared to other countries in the region, which have higher shares of between 50-70% of GDP. In terms of the average propensity to consume (APC), Malaysia's APC is also lower (within the range of 0.45-0.49 in the last five years) compared with that of the other countries in the region (above 0.55). Thus, given the steady income levels and the high savings rate, there is potential to further enhance the contribution of domestic consumption to growth, without increased risks to the economy.

As at end-2003, household debt to GDP accounted for 58.9% (end-2002: 56.8%). This level remains comparatively low compared with other countries. The debt service burden accounted for only 16.4% of GDP. Including credit card repayments, the ratio would be 24%. While household debt has increased, the repayment capability of households has continued to improve. This is reflected in the continued decline in the household NPLs to 8% as at end-2003, from 8.5% as at end-2002. The ability of the household sector to service their debts is also reflected in the sustained increase in disposable income and accumulation of savings. Household deposits, as a percentage of GDP, remained high at 66.6% at end-2003 (end-2002: 67.3%).

Graph 3.5
International Comparison - Household Debts[1]
(% of nominal GDP, 2003)



[1] Financial liabilities of households with the banking system

Meanwhile, private investment is expected to be an increasingly important driver of growth. Several measures have been implemented recently to enhance the contribution of investment to growth, particularly investment by the SMEs. The SME sector will continue to be developed and integrated into the mainstream of industrial and technological development to actively support the domestic industries. This will strengthen the inter-linkages in the economy and contribute towards the development of a more vibrant domestic economy.

In this regard, the key strategies in the 2004 Budget reinforced the measures in the Economic Package to strengthen the domestic sources of growth and to facilitate the private sector to assume its lead role as the engine of growth. The thrust of the 2004 Budget strategies focused on providing a supportive environment for private sector initiatives, while gradually cutting back public expenditure. Towards this end, various tax and non-tax incentives were directed at enhancing domestic sources of growth in niche areas, with continuing emphasis on the services sector (especially private education, health and tourism), developing SMEs as a key growth catalyst, and agriculture as the third engine of growth. Additional incentives were provided to encourage manufacturers to move up the value chain to undertake higher value-added activities such as research and development. Measures also continue

Real GDP to expand by 6-6.5% in 2004, underpinned by stronger domestic demand and reinforced by robust external demand. Private sector will lead growth, while the Government continues to provide a supportive environment.

to focus on enhancing the country's efficiency and productivity and overall competitiveness to enable Malaysian companies to compete globally. These include incentives directed at reducing the cost of doing business and increasing innovation through higher research and development activities.

Reflecting the gradual fiscal consolidation, the Government's fiscal deficit is expected to narrow to 4.5% of GDP in 2004 from 5.3% in 2003. With inflation remaining subdued, monetary policy in 2004 would continue to be directed at sustaining the growth momentum. The current low interest rate environment will remain to reinforce the private sector-led growth. In this regard, efforts would continue to focus on improving the flow of credit to sectors with growth potential, particularly the SMEs and to new growth areas. In addition to the banking system, new avenues are also being developed to increase the SMEs' access to capital market funding.

In 2004, growth would also be supported by higher productivity. Given the infrastructure in place and efforts to improve skills to better leverage on technology, productivity is expected to increase. An important factor that would enhance productivity is the efficiency of the delivery system for public sector services. In this regard, Bank Negara Malaysia further liberalised the foreign exchange rules as part of its continuous effort to reduce regulatory cost and improve overall efficiency of both businesses and banking institutions. The changes are to achieve three main objectives:

- To promote efficiency and risk management;
- To facilitate management of funds and risk diversification; and
- To deepen the capital market.

Domestic Demand

The positive factors that supported domestic demand in 2003 are expected to continue to drive the growth momentum in 2004. The pace of growth of private investment, which had turned positive in 2003, is expected to accelerate this year, with a more significant contribution to growth. Private consumption would strengthen further. The growth enhancing effects of fiscal policy and low interest rates will continue to support private sector activities.

Growth would also be reinforced by the improvement in external demand with the strengthening of the economies of Malaysia's main trading partners. While a more robust growth of exports is anticipated, the contribution from net exports to growth would be modest as a stronger increase in imports is expected with the recovery in private investment and stronger economic expansion. Against this backdrop, the private sector is expected to resume the lead role, with its contribution to growth doubling from 2.5 percentage points in 2003 to 4.9 percentage points in 2004. Reflecting the policy of fiscal consolidation, public expenditure would show a modest decline.

Growth in **private consumption**, which displayed resilience in 2003, is expected to strengthen to 8.1% in line with growing consumer confidence. The propensity to consume would be further enhanced by continued firm commodity prices,

Table 3.2
Real GDP by Expenditure (1987=100)

	2003*p*	2004*f*
	Annual change (%)	
Domestic Demand[1]	**4.8**	**5.0**
Private sector expenditure	4.3	8.7
Consumption	*5.1*	*8.1*
Investment	*1.1*	*11.5*
Public sector expenditure	5.5	-1.3
Consumption	*7.9*	*4.2*
Investment	*3.6*	*-5.7*
Net exports of goods and services	**20.5**	**0.8**
Exports	6.3	12.1
Imports	5.0	13.3
Gross Domestic Product	**5.2**	**6.0 - 6.5**

[1] Excluding stocks.
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 3.3
Contribution of Demand Components to Real GDP Growth

	2003*p*	2004*f*
	% point of contribution	
Domestic Demand[1]	**4.3**	**4.5**
Private sector expenditure	2.5	4.9
Consumption	*2.4*	*3.7*
Investment	*0.1*	*1.1*
Public sector expenditure	1.8	-0.4
Consumption	*1.1*	*0.6*
Investment	*0.7*	*-1.0*
Change in stocks	-1.1	1.5
Net exports of goods and services	**2.0**	**0.1**
Exports	6.9	13.3
Imports	4.9	13.2
Gross Domestic Product	**5.2**	**6.0 - 6.5**

Note: Figures may not necessarily add up due to rounding.
[1] Excluding stocks.
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

higher export earnings, the low interest rate environment, stable job market and the positive wealth effect of higher equity prices. The income levels of households are also expected to increase in line with the improvement in business conditions and productivity gains. The stimulus measures already in place would continue to filter through with positive effects on consumer spending capacity. The reduction in EPF contribution by employees would continue to enhance the disposable income of individuals in the first half-year. In addition to the improving income levels, the high savings rate would also provide the support for higher spending capacity.

Robust external demand, improved cash flow position of companies, higher capacity utilisation and low interest rates will reinforce and strengthen the pace of private investment, while firm commodity prices and stable job market continue to drive private consumption.

Private investment is expected to expand at a stronger pace of 11.5% in 2004 as the rise in private capital spending gains further momentum due to more positive business sentiment, improved corporate cash flow positions and high capacity utilisation rates. The IT replacement cycle would also lead to increases in investment in equipment and software. Private sector capital formation would be supported by higher capital outlay, particularly in the manufacturing, oil and gas and services sectors. Investments would also be supported by a steady inflow of new foreign direct investment and reinvestment.

Positive developments in the manufacturing sector, including the markedly higher approvals of manufacturing projects by the Ministry of International Trade and Industry (MITI) and high capacity utilisation rates are expected to drive investment activities in the sector. A contributory factor is the additional tax incentives given to local companies to reinvest in the production of machinery and equipment and heavy industries. Investment in the construction sector would be sustained, mainly from the development of several residential housing projects as well as ongoing privatised road projects. In addition, large capital spending would emanate from other major infrastructure projects in the transport and utilities sub-sectors such as building of new power plants, expansion of port facilities and development of water projects. Higher investment in the oil and gas sector is expected following the discovery of deep sea oil and for ongoing exploration work by the oil companies.

New investment activities are also expected in the new growth areas in the information and communications technology and shared services sub-sectors (such as operational headquarters and back-room operations) with the additional allocation of funds under Malaysian Venture Capital Management (MAVCAP), the expansion of Multimedia Development Corporation's role as a one-stop agency for selected services sectors and the additional incentives for operational headquarters. Meanwhile, investment in the agriculture sector is expected to be sustained with the measures announced in the Economic Package and the 2004 Budget to promote large-scale mixed farming and further modernise the agriculture sector.

In 2004, a modest decline in public sector expenditure is expected. The public sector, while gradually consolidating, would remain supportive of growth. **Public sector consumption** is budgeted to increase moderately by 4.2% due to increased spending on supplies and services to improve the quality and delivery of public services. Meanwhile, **public investment** would be reduced by 5.7% to a more sustainable level in 2004 following the accelerated implementation of development projects in 2001-2003. Although development expenditure would decline, its impact on growth would be compensated by private sector expenditure, which has a larger multiplier impact on the economy. Also, increased efficiency in expenditure allocation and improved effectiveness in the delivery of Government services would generate positive multiplier effects on private sector activities. More importantly, the Federal Government's development expenditure will be mainly channelled to projects and programmes with strong linkages and value added potential, including infrastructure facilities, agriculture and rural development as well as education and human resource development.

Liberalisation and Simplification of Foreign Exchange Administration Rules

Malaysia maintains a liberal foreign exchange administration system. Within this liberal system, approval requirements for inflows and outflows are mainly prudential in nature to ensure financial stability. Regulations are implemented in a transparent and pragmatic manner. Foreign exchange administration regulations are also applied where appropriate to prevent any recourse to the Malaysian banking system for money laundering and terrorism financing.

In line with the policy of gradual and progressive liberalisation of the financial sector, liberalisation and further simplification of several major foreign exchange administration policies aimed at enhancing the business environment as well as efficiency and competitiveness of business operations in Malaysia were made effective from 1 April 2004. These changes form part of Bank Negara Malaysia's (the Bank) on-going initiatives towards contributing to the deepening of the capital market and enhancing efficiency of the regulatory delivery system.

(i) Rules Affecting Reporting of Foreign Exchange Transactions

While maintaining the requirement for exporters to repatriate receipts arising from export of goods (export receipts) when contractually due, which must not exceed six months from the date of export, the rules on reporting of such transactions are being abolished or simplified to reduce the administration cost to businesses.

- completion of Forms P (for payments abroad) and R (for receipts from abroad) by residents was discontinued since 1 January 2004. Information as contained in Forms P and R is being provided by the remitting or receiving banks to the Bank through an on-line system.

- In simplifying business operations, the reporting requirement to the Bank is further relaxed effective 1 April 2004. The requirement for submission of annual reports for export of goods by all exporters is abolished. Only exporters with annual gross exports exceeding RM50 million need to submit quarterly reports. The process for submission of such reports is being simplified further. The reporting mechanism will be designed taking into account business operations of companies.

(ii) Foreign Currency Accounts of Residents

Rules on maintenance of foreign currency accounts (FCA) are liberalised further following the relaxation implemented in April 2003. The liberalisation of limits for companies is aimed at enhancing the cash flow management for supporting value chain expansion in Malaysia. Rules on FCA of individuals are also relaxed to provide flexibility in the management of income and saving.

- Effective 1 April 2004, the overnight export FCA limit for Approved Operational Headquarters is increased further to USD100 million from USD70 million.

- The overnight limits for export FCA of other resident exporters are also raised. The revised limits, based on the average monthly export receipts are as follows -

Average monthly export receipts	Overnight limits (USD million)
Exceeding RM100 million	100
Exceeding RM50 million up to RM100 million	60
Up to RM50 million or for new exporters	30

- In addition, resident exporters are given the option to merge their export and non-export FCA in accordance with overnight limits imposed on export FCA.

- Resident companies with domestic borrowings may also open FCA for non-export receivables (receivables other than from export of goods) to retain such receipts with onshore licensed banks with no overnight limit. For resident companies that do not have domestic borrowings, they may also maintain non-export FCA with licensed offshore banks in Labuan, but up to an aggregate overnight limit of USD500,000.

- In the case of resident individuals, FCA remains permitted to facilitate education and employment overseas. However, effective 1 April 2004, the limits for these FCA are increased from USD100,000 to up to an aggregate overnight limit of USD150,000 each with onshore licensed banks and licensed offshore banks in Labuan.

- Resident individuals with funds abroad (no conversion from ringgit) may maintain non-export FCA, onshore or offshore, including licensed offshore banks in Labuan, without any limit.

- Resident individuals in Malaysia who have foreign currency funds are free to invest in any foreign currency products offered by onshore licensed banks.

(iii) Ringgit Credit Facilities to Non-Residents

Rules on lending in ringgit to non-residents are liberalised effective 1 April 2004 to facilitate non-resident businesses in Malaysia. This liberalisation does not impact current rules on non-internationalisation of ringgit:

- To enhance access to ringgit funds for business requirement in Malaysia, all permitted ringgit lending limits for various purposes, by banking institutions to a non-resident (excluding stockbroking company, custodian bank and correspondent bank) are consolidated into one aggregate limit and raised to RM10 million.

  The non-resident may use the ringgit credit facilities for any purpose in Malaysia, excluding for financing or refinancing the purchase or construction of immovable properties.

- Effective 1 April 2004, residents (banks and non-banks) may extend ringgit credit facilities in aggregate up to three property loans to a non-resident to finance or refinance the purchase or construction of immovable properties in Malaysia, excluding the purchase of land only.

  Prior to 1 April 2004, only financial institutions and employers may extend property loans to a non-resident.

- In the case of non-resident stockbrokers or custodian banks, onshore licensed banks are now allowed to extend up to an aggregate overnight overdraft facility of RM200 million (RM10 million previously) to facilitate settlement for purchase of shares listed on Malaysia Securities Exchange Berhad.

(iv) Investment Abroad by Resident Individuals

- Effective 1 April 2004, to provide flexibility for better management of funds, resident individuals employed or staying abroad with own foreign currency funds may invest in any foreign currency assets, including those offered by onshore licensed banks and licensed offshore banks in Labuan.

(v) Investment Abroad by Domestic Institutions

- For greater geographical diversification and in simplifying approval process, unit trust management companies may, effective 1 April 2004, invest abroad up to the full amount of

Net Asset Value (NAV) subscribed by non-residents and up to 10% of the NAV per fund subscribed by residents. Different funds of a unit trust management company or of different companies may also be pooled to benefit from economies of scale when investing abroad. Such investments abroad are required to be in compliance with the Securities Commission's prudential guidelines.

- Insurance companies and takaful operators may also invest abroad up to 5% of their Margin of Solvency (MOS) and up to 5% of their total assets respectively. In addition, insurance companies and takaful operators may also invest abroad up to 10% of the NAV of investment-linked funds that they market. These investments are required to be in compliance with prudential insurance and takaful regulations issued by the Bank Negara Malaysia.

- Fund/asset managers may invest abroad up to the full amount of investments by their non-resident clients and up to 10% of investments by resident clients. These funds may be pooled to benefit from economies of scale when investing abroad. Such investments are required to be based on the mandate of their clients and in compliance with the Securities Commission's prudential guidelines.

(vi) Issuance of Bonds Denominated in Ringgit by Multilateral Development Banks and Foreign Multinational Corporations

To deepen the development of the domestic bond market, Multilateral Development Banks (MDB), where Malaysia is a member, and foreign multinational corporations (MNC) may, based on the merits of each case, issue ringgit-denominated bonds in Malaysia.

(vii) Forward Foreign Exchange Contracts

Effective 1 April 2004, rules on hedging are liberalised to facilitate overall economic management of currency risks as follows:

- MDB and MNC issuers of ringgit-denominated bonds, will be allowed to enter into forward foreign exchange contracts with onshore licensed banks to hedge their currency risks.

- Similarly, non-resident investors subscribing to these ringgit-denominated bonds issued by MDB and MNC can also enter into forward foreign exchange contracts with onshore licensed banks to hedge their currency risks arising from the investment in these ringgit-denominated bonds.

- Forward sales by residents of any foreign currency receivables for ringgit with onshore licensed banks or approved merchant banks can now be undertaken up to the tenure of the underlying transaction as long as the transaction is supported by firm underlying commitment to receive such currency (previously foreign currency receivables, other than export receipts, could be sold forward up to 12 months only).

- Residents may also enter into forward foreign exchange contracts to sell foreign currency yet to be received for another foreign currency with onshore licensed banks and approved merchant banks up to the tenure of the underlying transactions.

- Resident companies may temporarily retain up to the amount of foreign currency receipts received earlier than the maturity date of the forward foreign exchange contract in their onshore FCA, pending maturity of the forward foreign exchange contract.

- Residents may enter into interest rate swaps with onshore licensed banks, approved merchant banks and licensed offshore banks in Labuan.

Sectoral Outlook

On the production side, growth is expected to be supported by stronger performance across all sectors, except agriculture and construction. The manufacturing and services sectors are expected to remain as the main drivers of growth. The agriculture sector is also projected to expand although at a more moderate pace following the strong performance in 2003. Growth in the construction sector would be moderate amidst weaker civil engineering activities.

In the **manufacturing sector**, ongoing structural shift has become more evident as the sector's competitive advantages adjust from labour-intensive to higher technology-driven manufacturing processes. Greater efficiency in the use of resources is being realised through manufacturing companies operating more at a regional level, as seen in the relocation of some of the more labour-intensive industries to lower-cost countries. Key indicators such as the contribution of the manufacturing sector in terms of value added and employment, flows of investment as well as the retrenchment trend clearly suggest that the manufacturing sector continues to remain resilient.

The recent trend in overseas investment is a reflection of Malaysian companies seeking greater synergy based on locational advantages. Consequently, notwithstanding the investments abroad, the share of the manufacturing sector in terms of value added (GDP) and total employment have remained significant at 31% and 28% respectively in 2003. Employment in the manufacturing sector continues to expand, while retrenchments have moderated further in 2003. While retrenchments due to relocation accounted for one-fifth of total retrenchments in the manufacturing sector, it only amounted to 0.2% of total employment in the manufacturing sector for the period 2001-2003. Furthermore, new jobs created by approved foreign investment in the manufacturing sector (2003: 77,182 workers) have outpaced the retrenchment in the sector (2003: 14,967 workers). More importantly, outflows of overseas investment in the manufacturing sector (2003: RM2.3 billion) remain small compared with approved FDI in the sector in Malaysia (2003: RM15.6 billion).

Table 3.4
Real GDP by Sector (1987=100)

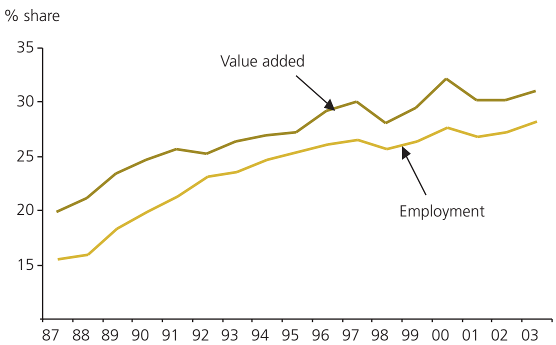
	2003*p*	2004*f*
	Annual change (%)	
Agriculture	5.5	2.6
Mining	4.8	5.5
Manufacturing	8.2	10.2
Construction	1.9	1.5
Services	4.1	5.2
Real GDP	**5.2**	**6.0 - 6.5**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

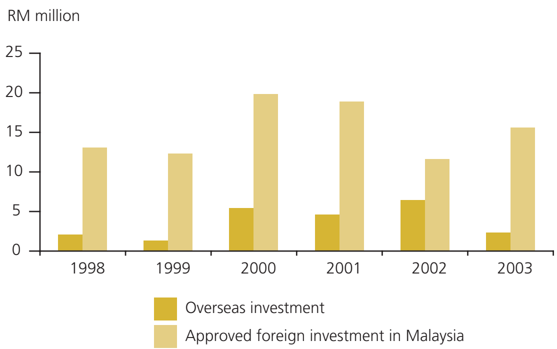
Broad based growth across sectors benefiting mainly from strengthening global electronics cycle, higher trade and tourist arrivals, as well as firm commodity prices.

Graph 3.6
Manufacturing Sector: Share of Value Added and Employment



Source: Department of Statistics, Malaysia
Economic Planning Unit

Graph 3.7
Manufacturing Sector: Overseas investment and Approved Foreign Investment in Malaysia



Source: Ministry of International Trade and Industry
Bank Negara Malaysia

Table 3.5
Approved Manufacturing-related Services

	2000	2001	2002	2003
	End-Period			
Operational Headquarters (OHQs)	41	50	59	71
International Procurement Centres (IPCs)	55	78	109	141
Regional Distribution Centres (RDCs)	-	-	-	4
Regional Offices	357	404	436	473
Representative Offices	673	783	872	1,006

Source: MIDA

As part of the efforts to expedite the structural shift, promotion of manufacturing-related services was intensified with the establishment of the Manufacturing Related Services Division in both MITI and MIDA. Consequently, there was an increase in the number of applications received and approvals in 2003 for the establishment of OHQs, IPCs, RDCs and regional offices (Table 3.5). Going forward, the manufacturing sector will continue to move away from labour-intensive production and give greater emphasis to higher value added production with knowledge-based labour of higher productivity and skills.

Value added in the manufacturing sector is projected to pick up further to 10.2% in 2004 (2003: 8.2%), supported by the pick up in the global electronics industry and improved domestic demand. Of significance, the global semiconductor industry is expected to strengthen, supported by broad-based expansion across all geographical regions and products. This is premised on expectations of a strong increase in the global semiconductor capital and investment spending of 27.9% in 2004 (2003: 5.7%). Most industry experts are more optimistic on the prospects for the industry and have revised upward their growth forecast for 2004. In the recent dialogues between Bank Negara Malaysia and the private sector, manufacturers in the electronics sector in Malaysia also expressed a more optimistic outlook for the industry in 2004.

Latest indicators suggest an upturn in the global semiconductor cycle. Global semiconductor sales, which have been expanding since the latter part of 2002, have strengthened sharply to register a growth of above 20% in the last quarter of 2003. In the US, shipment and sales of semiconductors have risen strongly, while the book-to-bill ratio has improved to above one since the fourth quarter of 2003. The unfilled orders of electronic products and communication devices in the US have also risen steadily since early 2003.

Growth in the electronics industry would be driven mainly by the wireless and PC markets, due to rising demand for wireless applications as well as the PC replacement cycle, as companies invest again following their huge spending prior to the Y2K period. This would be further augmented by the growth in the consumer electronics products segment as demand for new technology and multi-functional devices such as camera phones, PDAs and DVDs gains momentum.

Consonant with the pick up in the global electronics industry and the spillover effects on the chemical products industry, growth in the export-oriented industries is projected to expand at a more rapid rate of 13.8% (2003: 11.9%). Similarly, growth in the domestic-oriented industries is expected to strengthen to 8.3% (2003: 6.1%), due to improved demand for motor vehicles and construction-related materials.

The **services sector** is expected to expand at a faster rate of 5.2%, reflecting higher expansion across most sub-sectors. Growth would be supported by higher trade and tourism activities and improved consumer spending. Of significance, growth in the wholesale and retail trade, hotels and restaurants sub-sector is expected to pick up. Similarly, growth in the transport, storage and communications sub-sector is expected to trend higher in line with the robust expansion in trade, increased number of business and leisure passengers as well as the expected strong growth in the cellular segment of the telecommunications industry mainly induced by new innovations. With the expected increase in bank lending and other financial and business services activities, the finance, insurance, real estate and business services sub-sector is expected to record a stronger growth in 2004. The services sector will also be supported by the rapid expansion in new growth areas, such as the shared services industry, namely call centres, data centres, operational headquarters, regional distribution centres and international procurement centres, as well as specialised types of ICT services.

The **agriculture sector** is expected to expand further, albeit at a more moderate pace of 2.6% in 2004 as growth in the major commodities, particularly palm oil and rubber, is expected to moderate following the double-digit growth in 2003. While yields are likely to remain strong amidst sustained high prices for palm oil, increased production would emanate mainly from the expansion in mature areas. Rubber production is forecast to increase to above 700,000 tonnes, with the bulk of the increase contributed by the smallholdings sector, as continued high prices are likely to induce increased tapping activity. Within the other agriculture group, production of selected commodities is expected to increase, led by cocoa (24.3%) and livestock (6.5%). Growth is also expected to emanate from some of the food crops, such as vegetables and fruits, reflecting the efforts by the Government to increase domestic food crops production through the Permanent Food Production Park scheme. Meanwhile, paddy production is estimated to be higher on account of wider usage of high yielding paddy seeds.

Growth in the **mining sector** is expected to strengthen to 5.5% in 2004, led by higher gas output. The new Malaysian Liquefied Natural Gas (MLNG) plant is expected to operate at a higher capacity utilisation to meet the increased demand. Meanwhile, production of crude oil (including condensates) is expected to remain stable at 733,000 barrels per day (2003: 736,000 bpd).

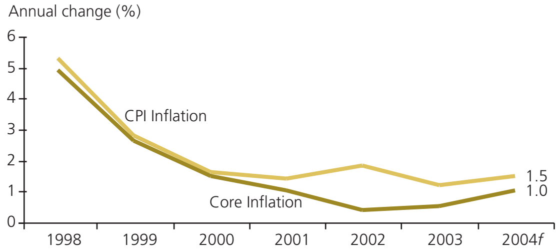
Growth in the **construction sector** is envisaged to increase at a moderate rate of 1.5%, due to lower activity in the civil engineering sub-sector following the completion of several infrastructure projects by both the Government and the private sector. Meanwhile, activities in the residential sub-sector is expected to remain strong in view of the increase in new housing starts during the first nine months of 2003, as well as ongoing work on projects under construction. Demand for residential property, especially for affordable housing, would remain favourable, encouraged by the incentives granted under the Economic Package, especially the stamp duty exemption, tax relief and the waiver on the real property gains tax until the first half of 2004. Meanwhile, activity in the non-residential sub-sector is expected to remain subdued, although on an improving trend, as the average occupancy rates for office space and retail complexes have stabilised since the third quarter of 2003.

Prices and Employment

Inflation is expected to remain low at 1.5% in 2004, while core inflation is estimated at 1%. Adequate capacity, increasing competition and low inflation abroad are expected to keep domestic inflation benign.

In line with the stronger GDP growth in 2004, overall growth in **employment** is also expected to strengthen with encouraging growth in new job opportunities. Consequently the unemployment rate

Graph 3.8
Consumer Prices



f Forecast

is expected to improve to about 3.4%. Meanwhile, efforts would continue to be focused on improving the quality and productivity of labour to ensure workers are constantly prepared to meet challenges associated with structural changes taking place in the economy, in particular with regard to enhancing skills in the higher value added manufacturing-related services as well as services-led and knowledge-led growth areas.

Balance of Payments

The balance of payments is expected to remain strong in 2004, with a sustained high **current account** surplus, reflecting the continued large surplus in merchandise trade and improvement in the services account. The current account of the balance of payments is expected to remain large at 12.7% of GNP in 2004 despite the projected stronger growth in imports (15.4%). Strong export growth (11.1%), underpinned by the systemic upswing in global demand, is expected to contribute to a large surplus in the trade account. The impetus to this growth stems from the strong expansion in manufactured exports (12%), in particular electronics exports, and continued growth in agriculture exports. The continued high level of agriculture and mineral exports, which have low import content, will provide further support to the large trade surplus.

In tandem with the pick up in global semiconductor demand and expanding intra-regional trade, growth in **manufactured exports** is expected to strengthen further to 12% in 2004 (2003: 8.2%), with higher exports from both electronics and non-electronics products. Exports of electronic products would expand at a more rapid rate of 14.7%, underpinned by increased demand for PC, wireless products and consumer electronic products such as DVDs and digital cameras. Similarly, non-electronics exports are

Table 3.6
Balance of Payments

	2003*e*	2004*f*	2003*e*	2004*f*
	RM billion		US$ billion	
Goods	97.7	96.4	25.7	25.4
Trade account	81.1	76.5	21.4	20.1
Exports (% change)	*11.5*	*11.1*	*11.5*	*11.1*
Imports (% change)	*4.8*	*15.4*	*4.8*	*15.4*
Services	-15.0	-11.9	-4.0	-3.1
Balance on goods and services	**82.7**	**84.5**	**21.8**	**22.2**
Income	-22.6	-24.7	-6.0	-6.5
Current transfers	-9.3	-9.8	-2.4	-2.6
Current account balance	**50.8**	**50.0**	**13.4**	**13.2**
(% of GNP)	***13.7***	***12.7***	***13.7***	***12.7***
Financial account	-12.1		-3.2	
Errors and omissions	0.4		0.1	
of which:				
Exchange revaluation gain	*11.9*		*3.1*	
Overall balance	**39.1**		**10.3**	

e Estimate
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Sustained balance of payments position with continued large current account surplus and long-term capital inflows. Trade surplus to remain large due to strong expansion in electronics exports and continued growth in agriculture exports.

expected to increase further by 9.2%, reflecting expansion in exports of rubber products, chemicals, paper and pulp products, and furniture and parts. Notwithstanding the strengthening external demand, export prices would continue to remain subdued due to global competition.

Exports of commodities, comprising agriculture and minerals, are expected to moderate to 5.5% in 2004, following two successive years of strong export growth averaging above 20%. **Agriculture export** earnings are projected to grow by 8.8% in 2004, supported by high prices and increases in volume. Palm oil and rubber exports will be the main contributors, accounting for almost 70% of total agriculture exports. Export prices of major agriculture commodities are expected to remain high due to favourable global demand amidst continued supply shortages of some commodities, especially during the first half-year. Of significance, export price of palm oil is projected to remain strong, averaging RM1,650 per tonne given the expected shortage in global supplies of major oilseeds, especially soybean oil. Similarly, rubber prices are expected to record a higher average of 385 sen per kilogramme in line with expectations of continued strong pick up in global rubber demand, particularly from the tyre manufacturers. In addition, the upliftment of import quotas by P.R.China, effective January 2004 in line with their commitments under the WTO, would lend further support to the international rubber market.

Exports of minerals are projected to grow marginally by 1.8%, as the higher receipts from LNG would be largely offset by the sharp decline in crude oil exports. Despite the relatively high crude oil prices of US$28.50 per barrel, prices would still be lower than in 2003. Malaysian crude oil prices would be broadly in line with trends in the global oil markets in 2004, which would be characterised by a more balanced demand and supply situation. Strict management of oil supplies by OPEC members would also influence global oil prices during the year. Meanwhile, LNG exports are projected to remain strong, expanding by 15.3%. The MLNG Tiga plant would be operating at a higher capacity to accommodate the increased demand.

Import growth is expected to emanate mainly from higher imports of intermediate goods (15.5%), consonant with forecast of stronger production and exports in the manufacturing sector, in particular the electronic segment. Capital imports are expected to make a strong recovery (12.7%) in line with the revival in investment activity. Higher capital goods imports are mainly for capacity expansion in the manufacturing, oil and gas, the airlines and shipping sectors. The stronger growth in consumption imports would reflect the projected higher consumer spending. The higher growth would also reflect the low base in consumption imports in 2003 due to the impact of SARS.

The large surplus in the goods account will be more than adequate to finance the net payments in the services, income and current transfers accounts. The **services account** deficit is envisaged to narrow to 3% of GNP, reflecting mainly the expected improvement in performance of the tourism sector. Earnings from the export of education and healthcare services are expected to be higher with improved quality of services and closer collaboration between the Government and the private sector in export promotion. Port earnings are expected to

Table 3.7
Exports and Imports

	2003*p*	2004*f*
	RM billion	
Gross exports	**398.9**	**443.3**
(% change)	***11.5***	***11.1***
Manufactures	327.0	366.3
(% change)	*8.2*	*12.0*
of which:		
Electronics	167.6	192.3
(% change)	*6.3*	*14.7*
Electrical products	55.9	60.8
(% change)	*1.9*	*8.7*
Chemical & chemical products	21.2	23.6
(% change)	*23.3*	*11.3*
Minerals	29.8	30.3
(% change)	*33.1*	*1.8*
Agriculture	33.7	36.7
(% change)	*28.1*	*8.8*
Gross imports	**317.7**	**366.8**
(% change)	***4.8***	***15.4***
Capital goods	43.5	49.0
(% change)	*0.7*	*12.7*
Intermediate goods	233.0	269.1
(% change)	*6.4*	*15.5*
Consumption goods	18.9	22.6
(% change)	*1.1*	*19.9*

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

increase in line with the increase in transhipment cargo, while freight income is expected to improve following the capacity expansion by Malaysian shipping companies and airlines. The higher volume of trade and increases in freight rates are also expected to lead to higher payments for transportation. Gross receipts in the other services account are expected to increase in line with the increasing trend in export of ICT products and services such as software and business process outsourcing services. The tax incentives for Operational Headquarters and International Procurement Centres and the widening of the range of activities to include research and development, design, marketing, distribution, quality control, testing, labelling and packaging that can be undertaken in free industrial zones or licensed manufacturing warehouses are expected to encourage higher export of value added services.

The **income account** deficit is projected to be sustained at 6.3% of GNP, reflecting higher profits and dividends accruing to multinational companies (MNCs) from their investments in Malaysia. The projected larger outflow in investment income is due to the strong export performance by the electronics industry as well as other export-oriented industries. Given the favourable international outlook, profits and dividends accruing to Malaysian companies investing abroad are also expected be on an upward trend.

The **financial account** is expected to improve on the back of continued long-term capital inflows, especially higher foreign direct investment (FDI). As reflected in higher approvals granted by MITI in 2003, FDI inflows are expected to remain sizeable with the implementation of major projects in the manufacturing sector. The bulk of the FDI in the manufacturing sector is expected to be in the form of reinvestment by the MNCs for capacity expansion in view of the strong upturn in electronics demand as this sector was already operating at near full capacity in 2003. The services sector is expected to continue to be a major recipient of new FDI inflows, especially in areas such as logistics, distribution and manufacturing-support services in view of the strong linkages between the growth of manufacturing and services sectors. Meanwhile, foreign investment in the oil and gas sector are likely to pick up on prospects of more joint-venture agreements with the national oil company.

Malaysia's overseas investment is likely to remain significant. These overseas investments will continue to be broad-based and channelled into the oil and gas, services and manufacturing sectors. These funds are likely to be targeted at both developing and developed countries in the form of acquisitions and new investments to provide greater synergy to their operations in Malaysia.

MONETARY POLICY IN 2004

Prospects for the global economy in 2004 have turned more favourable. Against the more broad-based growth in the industrial countries and stronger regional economies, the Malaysian economy is expected to grow at a faster pace of 6-6.5% in 2004. The firm recovery in export demand would further reinforce sustained growth in domestic demand. The increasing level of consumer and business confidence should lead to stronger private sector activities and further consolidation in fiscal expenditure. Notwithstanding rising aggregate domestic and external demand, the existence of excess capacity and ongoing capacity expansion allow for the increase in demand and output to be met without creating pressures on supply and prices. Conditions of continued low inflation provide flexibility for monetary policy in 2004 to continue to be supportive of the stronger growth momentum. With the investment cycle in its early stage, a low interest rate environment remains important to reinforce the private sector-led expansion, while providing flexibility for fiscal consolidation and strengthening growth.

Inflation risks for Malaysia remain low, as the economy is operating in an environment of excess capacity. Stronger economic expansion in 2004 is expected to narrow the output gap in some sectors while new investments will add on to output potential. With stronger recovery in demand and the return of business confidence, signs of a revival in business investment have emerged, with the expansion in capacity taking place in sectors experiencing high capacity utilization. Meanwhile, intense competition in the product market has induced producers to increase efficiency in the use of capital, labour and technology to contain costs. The intense competitive pressure has moderated wage increases while driving high productivity growth. Overall, stepped up capital investment and ongoing productivity improvements together with low inflation abroad would contribute to sustaining low inflation. The absence of inflationary expectations has accorded greater flexibility for interest rates to continue to remain low to ensure growth is soundly entrenched.

Stronger economic growth, a large surplus in the current account of the balance of payments and some capital inflows create challenges for the Central Bank to manage liquidity to maintain stable conditions in the money market. New liquidity is expected to emanate from the strong export performance and continued inflows of long-term capital. Given these expansionary influences on domestic liquidity, monetary management in 2004 will actively balance excess liquidity to maintain stable conditions in the money market. As in 2003, the Bank will rely on market-determined instruments and direct borrowings in its conduct of liquidity operations. The overall policy thrust is to ensure a stable and predictable environment to support business expansion. Over and above this, the objective of monetary policy will also aim at improving the efficient flow of credit to productive investments in sectors and industries that have the potential to raise the overall output and competitiveness of the Malaysian economy.

Going forward, risks and uncertainties remain. The twin deficits in the US and global current account imbalances continue to pose risks, such as disruptive global capital flows and exchange rate volatilities causing large changes in relative prices that affect the pace and spread of global economic recovery. Global growth in the short term is still heavily dependent on the growth in the US despite stronger growth in the Asian region. These factors could affect the consumer and business sentiments and disrupt the momentum of global and regional growth. The challenge to monetary policy therefore would be to respond proactively to emerging signals of impending developments in the macroeconomic conditions. In this regard, Malaysia enjoys a high degree of freedom for flexible responses and more importantly, monetary policy continues to have significant room to manoeuvre to cushion the impact of possible adverse external circumstances on domestic economy.

The Monetary Policy Statement (MPS), which was first released in August in 2003, will continue to be issued on a quarterly basis together with the announcement of the GDP data. This is part of the Bank's continuing effort to provide comprehensive information to the public on the Bank's policies. The issuance of the MPS would provide a direction of the Bank's policy intent and thus contribute towards stable and efficient conditions in the financial markets. It represents another mechanism to fulfil its objectives of maintaining monetary and financial stability to achieve sustained long-term growth.

With low inflation and growth in early cycle, the thrust of monetary policy in 2004 will continue to be directed at sustaining the growth momentum. The low interest rate environment will continue to provide support for private sector-led expansion.

FISCAL POLICY IN 2004

The 2004 Budget was formulated at a time when the outlook for the global growth was improving and domestic private sector demand gaining strength. Prospects of improved business and consumer confidence were expected to pave the way for the public sector to moderate its expansionary influence and the private sector to take the lead in driving growth. The Budget strategies announced on 12 September 2003, therefore, aimed at enhancing the macroeconomic fundamentals and ensuring a more broadly balanced economic structure with new domestic economic activities contributing towards sustainable longer-term growth. The thrust of the Budget strategies, therefore, focused on facilitating the private sector to assume its lead role as the engine of growth, while engineering a gradual cut-back in expenditure. Against this background, the overall financial position was budgeted to register a smaller deficit of RM13.8 billion or 3.4% of GDP in 2004, after factoring in the potential net revenue loss arising from the tax changes introduced in the 2004 Budget.

In a recent review of the 2004 Budget, it was estimated that tax revenue collection for 2004 projected in the Budget could be on the high side, given the lower actual tax collection for 2003. Notwithstanding the downward revision in revenue collection, it was deemed appropriate to maintain the Federal Government development expenditure (excluding contingent reserves) as budgeted in September 2003. Development expenditure was already scaled down to be significantly lower, a decline of 21.1% to RM30 billion from estimated expenditure of RM38 billion in 2003. With the revision to revenue, the fiscal deficit for 2004 is expected to be 4.5% of GDP, against the fiscal deficit of 5.3% registered in 2003. While the pace of deficit reduction is more gradual, the objective of fiscal consolidation remains on track. Given the ample liquidity in the financial system, the bulk of financing would continue to be raised from the domestic market with no risk of crowding out private sector financing. Recourse to external borrowings will be determined mainly by the need to establish international market presence and for benchmarking purposes.

While development expenditure would be lower, emphasis would be on improving productivity and the delivery systems of the government to reduce the cost of doing business and to support private sector investment and initiatives. Development expenditure during the year would be targeted at enhancing the longer-term productive capacity and competitiveness of the economy. The changing composition of fiscal spending is expected to generate higher multiplier effects on the economy. Given these strategies, the decline in public sector demand is projected to be marginal in 2004 (-0.4%), while private sector demand is expected to show a stronger growth. The private sector is expected to contribute 4.9 percentage points to real GDP growth.

In terms of budget allocation, emphasis would continue to be given towards enhancing the quality of education and manpower skills. Special attention would be directed towards modernising and nurturing the agriculture and rural sectors to position them as significant growth-generating sectors of the economy. Priority would also be placed on the implementation of programmes to improve the socio-economic well-being of Malaysians, especially those in the lower income group.

The 2004 Budget measures contained wide-ranging tax and non-tax incentives directed at accelerating growth in new growth industries; reducing the cost of doing business; and increasing innovation through higher research and development activities to enhance the ability of companies to compete internationally. In order to promote private sector activities, focus continued to be placed on the development of small and medium-sized enterprises (SMEs). Measures implemented included raising the threshold for chargeable income subjected to a corporate tax rate of 20% from RM100,000 to RM500,000, establishment of a SMEs debt restructuring committee and enhancement of the size of micro-credit schemes by RM1 billion. Other measures proposed to spur further domestic-led growth included various schemes to more aggresively promote Malaysian products, establishment of a one-stop agency to promote the services sector and tax incentives and financing schemes to further modernise the agriculture sector and promote investments in related downstream activities.

The 2004 Budget also contained various tax measures to reduce the cost of doing business. Measures included allowing deduction on entertainment expenses incurred in sales promotions; reducing or abolishing import duties of selected goods such as computer batteries, wooden and plastic goods; as well as reducing or abolishing export duties on several agricultural produce and commodities.

FINANCIAL SECTOR POLICY IN 2004

The policy thrust in 2004 will continue to focus on building capacity of domestic financial institutions and enhancing the resilience and stability of the financial sector while ensuring that all sectors of the economy continue to have adequate access to financing. Attention is also given to strengthening the framework for consumer protection and promoting greater consumer awareness on banking and insurance products and services.

The benchmarking exercise, initiated in 2000, which enables banking institutions and insurance companies to measure their performance by highlighting operational and strategic opportunities as well as areas for strategy building and skill enhancements will be further refined. Regular dialogues with the board and senior management of banking institutions will continue to be held to discuss on performance, trends and issues that may have impact on the competitiveness and overall strength of their respective institutions. Another area of focus is on improving the service quality of the banking institutions and insurance companies. The findings from the nationwide customer satisfaction survey that was conducted in 2003 will be discussed with the industry and strategies at the industry and institutional level will be formulated to elevate quality of service.

It is also expected that a number of domestic commercial banks will merge with their finance company subsidiaries with the coming into force of the amendments to the Banking and Financial Institutions Act 1989 allowing for such mergers. Domestic banking groups could improve operational efficiency by reaping higher economies of scale and enhance access to banking and finance companies business nationwide. The framework for creation of investment banks is also expected to be finalised in 2004. The framework would enable the investment banks to undertake the whole range of capital market activity under one entity, including equity brokerage business.

Initiatives to strengthen the capacity of domestic banking institutions will be complemented by enhancement to prudential regulations as well as a more comprehensive surveillance infrastructure. On the prudential front, efforts would be focused on the formulation of a comprehensive framework to regulate and supervise group structures involving financial conglomerates as well as to improve capability and expertise of the banking institutions and the supervisors to meet the challenges in implementing the new Basel Capital Accord. The surveillance infrastructure will be enhanced to provide early warning signal on any imbalances in the financial sector.

As the banking sector remains the main source of financing in the economy, initiatives would be taken to further improve access to financing by all segments of the economy. Focus would be towards strengthening existing infrastructure to enhance access to financing by the SMEs. Initiatives to encourage consumer activism and enhance the consumer protection framework would remain a priority. The Financial Mediation Bureau (FMB), would be established during the year. This is a one-stop centre to provide customers with avenue of legal redress against all financial institutions to deal with their grievances on banking institutions, insurance companies, development financial institutions under Bank Negara Malaysia supervision and payments system operators. A framework to improve the level of transparency and disclosure on all retail financial products offered by the banking institutions to facilitate a more effective and well informed decision making by customers would be introduced during the year. To further strengthen the consumer protection framework in an increasingly market-oriented financial system, the legislation that will introduce a deposit insurance system in Malaysia is expected to be tabled before Parliament in 2004.

Bank Negara Malaysia is also mandated to ensure that the payment systems and instruments in the country are safe and efficient and that there is continued public confidence in the use of payment instruments. This would entail mitigating risks in the financial system, promoting efficiency of the payment systems, enhancing security features of payment systems and instruments as well as exercising oversight over such systems and instruments. In addition, Bank Negara Malaysia will encourage and educate consumers to avail themselves of the wide variety of electronic payment facilities and products in line with the move towards a cashless society.

In the Islamic banking sector, key policy thrusts in 2004 will continue to focus on enhancing the effectiveness and efficiency of the Islamic banking system as an enabler of economic growth and development. The policy thrusts in 2003 to strengthen the financial infrastructure, enhance the regulatory framework, strengthen the Shariah and legal infrastructure as well as enhancing intellectual capital development and consumer awareness will continue to be pursued in 2004. In the development of the financial infrastructure, the window institutional structure of banking institutions participating in the Islamic Banking Scheme would be further strengthened to provide for the effective regulation of Islamic banking operations based on its unique characteristics. The Islamic banking landscape will also be transformed with the issuance of up to three new Islamic banking licences to foreign financial institutions in 2004.

To enhance the effectiveness of the Shariah governance framework, Guidelines on the Shariah Committee for Islamic banking institutions would be introduced to delineate the roles and responsibilities, qualifications and the terms of appointment of the Shariah advisory body at Islamic banking institutions. To support the sound and progressive development of the Islamic banking industry, initiatives in strengthening the legal infrastructure would continue to be pursued in 2004. These initiatives include expanding the scope of arbitration framework for Islamic banking and finance cases, the review of the Islamic Banking Act 1983 to strengthen the legal framework for Islamic banking operations and the finalisation of tax issues on Islamic banking and finance under the Law Review Committee to accord a neutral tax treatment between Islamic financial products and conventional financial products. Promoting financial soundness and building financial resilience of the Islamic banking system will be emphasised through the refinement of prudential regulatory standards to incorporate specific features of Islamic banking and enhancing market depth through the introduction of variable rate financing mechanism and the *mudharabah* and *musyarakah* implementation framework as well as the development of an Islamic reference rate.

Policy thrusts for development financial institutions (DFIs) will be guided by the strategic directions set out in the Financial Sector Masterplan. The focus of policy is to strengthen further the foundation on which DFIs can operate efficiently and effectively, through building the capacity of the DFIs and providing the enabling environment for the DFIs to operate efficiently and effectively. Emphasis will be accorded towards ensuring DFIs remain committed and focussed on mandated roles, to increase the responsiveness of DFIs to the developmental requirements, especially of the SMEs and identified priority sectors. In addition, current initiatives to enhance the capability and capacity of DFIs as specialised institutions in providing advisory services to their targeted clients, in particular, SMEs, would continue in 2004. This will be complemented with initiatives to strengthen the risk management practices of the DFIs.

Financial sector policies in 2004 will continue to focus on strengthening the resilience, stability, efficiency and effectiveness of the financial system to ensure that the financial sector continues to play an effective role in supporting economic growth as well as meeting the nation’s social objectives. Efforts are focussed not only on the creation of a sound and resilient financial sector but also on capacity building of the financial sector to elevate it to a higher level of performance, efficiency and excellence.

Report on SME Development Framework

In October 2002, an Inter-Ministry SME Steering Committee was formed to take forward the recommendations by Bank Negara Malaysia contained in its report, Proposed Comprehensive Framework for the Development of Small and Medium Enterprises (SMEs). The proposed framework outlines recommendations for the creation of an enabling environment for development of SMEs across all sectors of the economy. The proposals are aimed at strengthening the infrastructure for SME development, building the capacity of the SMEs and improving their access to financing towards increasing their capacity to contribute to the economy.

Strengthening the Infrastructure for SME Development

Since its inception, the Steering Committee has conducted assessments on the existing infrastructure for SME development. The underlying objective was to identify areas of resource duplication among the various Government ministries and agencies, and to address gaps in the existing infrastructure for SME development. This undertaking involved: -

- A review of the roles and responsibilities of the ministries and agencies involved in SME development;
- An assessment on the need to form a central coordinating body for SME development;
- An evaluation of the feasibility of enacting an SME Law to coordinate efforts for SME development.

For greater focus and enhanced coordination, the Steering Committee proposed that a permanent institutional framework be established in order to enhance the Government's capacity and ability to continuously promote the development of competitive and resilient SMEs across all sectors. Having a formal structure dedicated to the development of SMEs would result in greater synergies and synchronisation of efforts among the various stakeholders involved in SME development, while ensuring that SME development issues across all sectors are appropriately identified and addressed.

Following the Steering Committee's presentation of its recommendations to the Cabinet Committee for National Competitiveness, the Government will establish a National SME Development Council. The SME Council will function as the highest policy-making body to chart the future direction and strategies for SME development and will be chaired by the Prime Minister. Membership to this high-level SME Council will comprise Ministers from stakeholder ministries, as well as appointed representatives of private sector organisations involved in SME development, with Bank Negara Malaysia serving as the Secretariat.

Bridging the Gap

To further enhance the coordination and comprehensiveness of SME development, the Steering Committee has embarked on several initiatives to address the gaps in the current infrastructure for SME development: -

- Establishment of a standard definition for SMEs across all sectors. Currently, the definition of an SME varies amongst the various Government ministries and agencies based on their respective criteria. Standardising the definition of SMEs within the national context will enable effective policy setting to target sectors within the economy, facilitate the provision of technical assistance and improve the channeling of financial benefits and other incentives under various policies. It allows for the physical identification of SMEs at the micro-level, encourages the formation of SME associations at the macro-level, and facilitates better articulation of the problems and prospects of the sector. The standardisation of definition of SMEs will also support the collection of relevant and comparable SME data for database-building purposes.

- Establishment of a comprehensive national SME Database. The absence of a central database with relevant SME and entrepreneurship statistics makes it difficult to gauge the present stage of SME development, their operating conditions, financial viability and developmental needs. To cultivate the potential of SMEs as a source of endogenous growth, and to facilitate informed policy decision-making with regard to SME development, SME policymakers need to be able to measure, monitor and evaluate the performance and contribution of SMEs to the nation's overall economic growth process. The availability of a comprehensive national SME Database will greatly assist in the process of monitoring and evaluating the level of SME development, determining their development needs and providing critical input for the formulation of development policies.

- Formulation of a coordinated framework for the marketing and promotion of SMEs across all sectors. The emphasis is on the overall marketing and promotion of SMEs in terms of products, services, and the SMEs themselves. SMEs also need special assistance in the areas of product development and improvement, design, packaging and branding of their products. The formulation of a comprehensive and coordinated framework will ensure the efforts of the various stakeholders are concerted towards assisting SMEs to penetrate new markets, increase awareness on branding and intellectual property, enhance business networking, linkages and strategic alliances between SMEs and other larger firms.

The Financial Sector

The Financial Sector

SOURCES AND USES OF FUNDS OF THE FINANCIAL SYSTEM

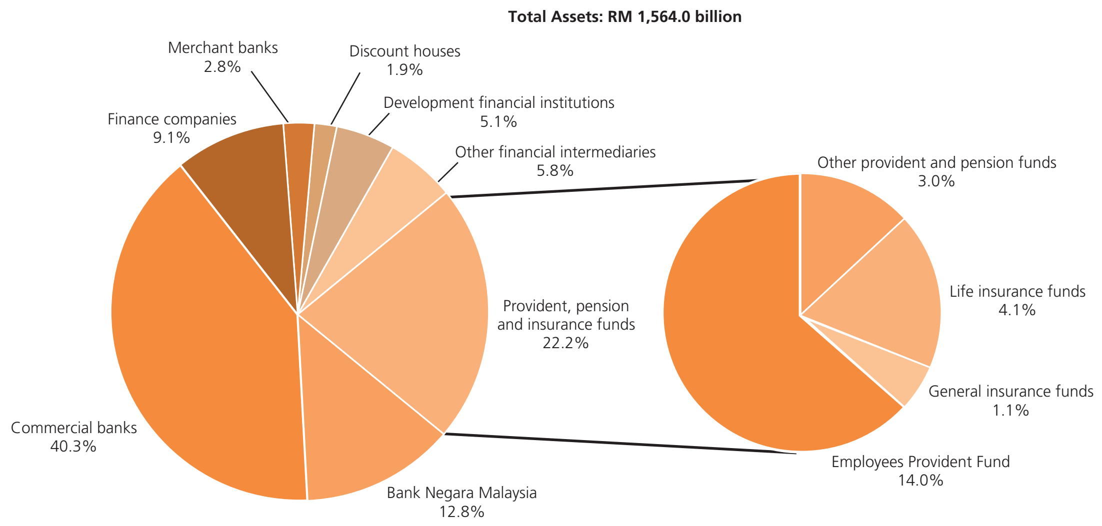
Total assets of the financial system expanded significantly by 12.1% to RM1,564 billion in 2003 in line with the improvement in overall economic performance. As a share of GDP, total assets of the financial system increased to 399% of GDP (2002: 386%).

Assets of both the banking system and the non-bank financial intermediaries (NBFIs) expanded in 2003. Total assets of the banking system increased by 13.2% (2002: 6.8%), while assets of the non-bank financial intermediaries (NBFIs) grew by 8.4% (2002: 8.6%). The bulk of the increase in assets within the banking system was due to the stronger growth in assets of the commercial banks. This reflected mainly the increase in deposits with other financial institutions (19.5%), investment in securities (15%) and loans and advances (7.2%). The growth in assets of the NBFIs was driven principally by an expansion in the assets of the provident, pension and insurance funds (+RM30.5 billion), which accounted for 65.1% of the increase in the total assets of NBFIs.

During the year, the bulk of new resources was contributed by deposits placed with the financial institutions and contributions to the provident, pension and insurance funds. Deposits mobilised by the financial institutions grew at a higher rate of 11.8% in 2003, compared with 6% in 2002. The banking institutions (comprising commercial banks, finance companies, merchant banks and discount houses) continued to be the largest mobiliser of deposits in 2003, accounting for 71.1% of the increase in deposits raised by the financial system in 2003 (2002: 83.5%) and 81.4% of total outstanding deposits of the financial system as at end-2003 (2002: 82.6%). The strong deposit growth was due to improved economic conditions, which resulted in higher disposable income and financial wealth of households and business enterprises.

In terms of holders, deposits were mainly held by the non-financial private sector (comprising individuals and business enterprises), which accounted for 71.2% of the total outstanding deposits as at end-2003 (79.6% as at end-2002). The deposits of this group grew by 16.6% in 2003, with higher deposits by individuals (47.2% of total outstanding deposits). In 2003, deposits of business enterprises also increased significantly by 14.6% (2002: 2.7%), while deposits by individuals grew at 7.7% (2002:6.9%). As in previous years, fixed deposits continued to account for the bulk of the increase in deposits

Graph 4.1
Assets of the Financial System as at end-2003*p* (% share)



p Preliminary

Table 4.1
Assets of the Financial System

	Annual change 2002	Annual change 2003*p*	As at end-2003*p*
	RM billion		
Banking system	**58.5**	**122.2**	**1,046.7**
Bank Negara Malaysia	12.5	38.6	200.8
Commercial banks[1]	33.2	66.7	629.6
Finance companies	8.9	11.3	142.0
Merchant banks	0.3	2.8	44.1
Discount houses	3.6	2.8	30.2
Non-bank financial intermediaries	**42.6**	**46.8**	**517.3**
Provident, pension and insurance funds	27.0	30.5	347.7
Employees Provident Fund	*15.2*	*18.0*	*220.2*
Other provident & pension funds	*4.5*	*1.5*	*46.2*
Life insurance funds	*6.7*	*9.8*	*64.1*
General insurance funds	*0.6*	*1.2*	*17.2*
Development financial institutions[2]	11.1	6.7	79.1
Other financial intermediaries[3]	4.5	9.6	90.5
Total	**101.1**	**169.0**	**1,564.0**

[1] Includes the Islamic banks (since 1999).
[2] Includes Bank Simpanan Nasional (National Savings Bank), Bank Kerjasama Rakyat Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad (MIDF), Borneo Development Corporation, Sabah Development Bank Berhad, Sabah Credit Corporation, Export-Import Bank Malaysia Berhad, Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri dan Teknologi Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Credit Guarantee Corporation Malaysia Berhad (CGC) and Lembaga Tabung Haji (Pilgrims' Funds Board).
[3] Includes unit trusts run by Amanah Saham Nasional Berhad (ASNB) and Amanah Saham Mara Berhad, cooperative societies, leasing and factoring companies, venture capital companies and housing credit institutions (comprising of Cagamas Berhad, Borneo Housing Mortgage Finance Berhad and Malaysia Building Society Berhad).
p Preliminary

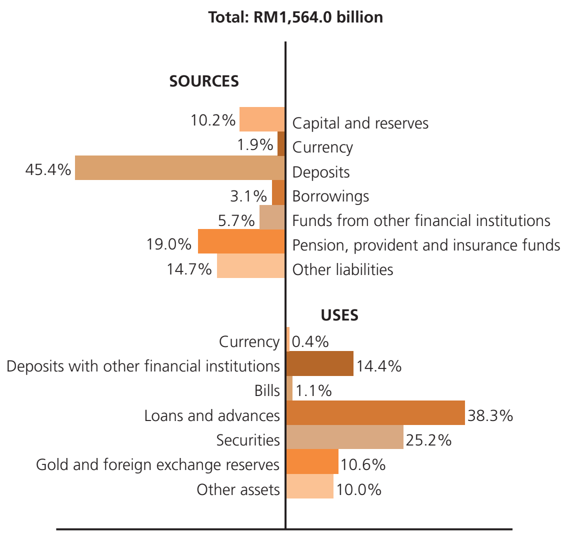
Table 4.2
Sources and Uses of Funds of the Financial System

	Annual change 2002	Annual change 2003*p*	As at end-2003*p*
	RM billion		
Sources:			
Capital and reserves	12.6	24.0	158.8
Currency	1.8	2.3	29.4
Deposits	36.3	74.8	709.4
Borrowings	9.7	3.1	48.0
Funds from other financial institutions[1]	2.3	18.0	88.9
Insurance and provident funds	23.0	22.7	297.1
Other liabilities	15.5	24.1	232.4
Total	**101.2**	**169.0**	**1,564.0**
Uses:			
Currency	0.3	-1.1	6.3
Deposits with other financial institutions	13.9	36.7	224.6
Bills	2.7	-2.2	16.7
Treasury	*1.6*	*-2.1*	*3.5*
Commercial	*1.1*	*-0.1*	*13.2*
Loans and advances[2]	35.2	40.4	600.8
Securities	24.0	51.2	393.4
Malaysian Government	*0.9*	*19.9*	*124.3*
Foreign	*0.5*	*0.3*	*3.5*
Corporate	*21.2*	*32.3*	*259.0*
Others	*1.4*	*-1.3*	*6.6*
Gold and foreign exchange reserves	14.0	38.6	166.1
Other assets	11.1	5.4	156.1

[1] Includes statutory reserves of banking institutions.
[2] Excludes loans sold to Danaharta.
p Preliminary

placed by the non-financial private sector, with holders continuing to exhibit preference for deposits with shorter maturities, given the smaller interest differentials between short- and longer-term deposit rates.

Graph 4.2
Sources and Uses of Funds of the Financial System as at end-2003*p* (% share)



p Preliminary

Contractual savings with provident and pension funds, as well as contributions to insurance funds, continued to be one of the major sources of funds for the financial system, expanding by 8.3% to account for 19% of the total funds mobilised by the financial system as at end-2003. Meanwhile, capital and reserves of the financial system increased by 17.8% in 2003 (2002: +10.2%), reflecting mainly improved financial performance of the banking institutions.

The increase in the total resources of the financial system in 2003 was invested mainly in loans and advances and securities. Total loans and advances grew by RM40.4 billion or 7.2% in 2003 (2002: RM35.2 billion or 6.7%). This development was due mainly to increased demand from the household sector, as reflected by the higher demand for loans for the purchase of residential property and consumption credit. In addition, financing available to SMEs was also higher during the year, with outstanding loans increasing by

Table 4.3
Non-Financial Private Sector Deposits[1] with the Financial System[2]

	Annual change 2002	Annual change 2003*p*	As at end-2003*p*
	RM billion		
Deposits[3] with:			
Commercial banks	16.1	37.3	355.2
Finance companies	3.0	0.2	64.1
Merchant banks	0.2	2.4	13.9
Discount houses	3.2	2.3	10.7
Bank Simpanan National	0.7	0.2	8.3
Others[4]	0.1	6.6	29.9
Total	**23.3**	**49.0**	**482.1**
Demand deposits	5.9	13.5	77.5
Fixed deposits	9.5	17.8	300.0
of which:			
Up to 1 year	*15.5*	*14.3*	*258.1*
More than 1 year	*-6.0*	*3.5*	*41.9*
Savings deposits	5.8	11.3	75.4
NIDs[5]	0.5	0.3	2.7
Repos[6]	1.6	6.1	26.5

[1] Refers to deposits placed by business enterprises (excluding NFPEs) and individuals.
[2] Excludes provident and pension, insurance and unit trust funds.
[3] Refers to demand, savings and fixed deposits, negotiable instruments of deposits and repos.
[4] Includes development financial institutions, cooperative societies and housing credit institutions.
[5] Refers to negotiable instruments of deposits.
[6] Refers to repurchase agreements.
p Preliminary

Table 4.4
Direction of Credit[1] to the Non-Financial Private Sector

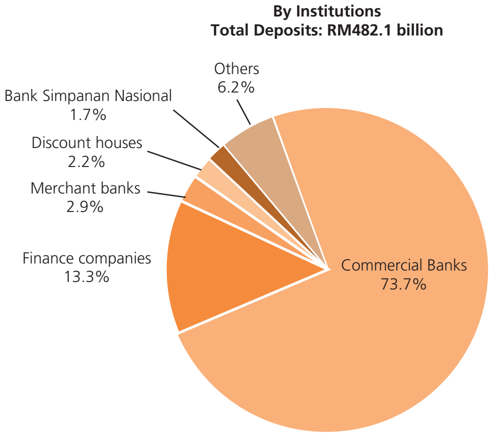
	Annual change 2002	Annual change 2003*p*	As at end-2003*p*
	RM billion		
Loans and advances	**20.8**	**31.2**	**563.1**
Agriculture	0.0	-0.4	13.6
Mining and quarrying	-0.2	0.1	1.1
Manufacturing	0.1	0.9	55.8
Construction and real estate	-1.5	4.4	80.9
Purchase of residential properties	17.1	16.8	147.8
Retail, wholesale, restaurants and hotels	2.3	-0.3	21.0
Transport, storage and communications	1.3	0.5	14.7
Business services	-2.6	1.7	21.6
Consumption credit	0.1	10.1	96.4
Purchase of shares	0.1	-1.7	19.3
Others	4.1	-0.9	90.9
Investments in corporate securities	**48.1**	**2.1**	**259.0**
Total	**68.9**	**33.3**	**822.1**

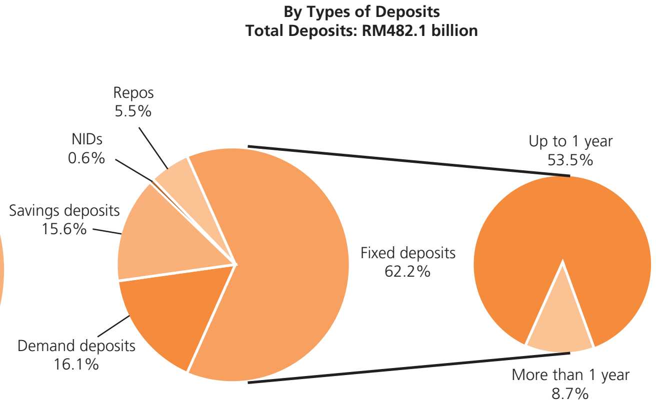
[1] Excludes credit to non-financial public enterprises.
p Preliminary

10% on annual basis, the highest growth registered since July 2001.

Investment in securities by the financial system continued to expand in 2003, recording a significant increase of 15% in 2003 (2002: 7.5%). The bulk of the increase was in equities and reflect improving optimism and opportunity for high returns in the equity market. Provident, pension and insurance funds continued to be the main investors in securities, accounting for 51.4% of the increase in investments in securities. Meanwhile, gross holdings of gold and foreign exchange reserves also recorded a significant rise of RM38.6 billion or 30.3% in 2003 (2002: RM14 billion or 12.3%), on account of larger foreign exchange inflows generated from the large trade surplus, short and long-term capital inflows, and unrealised revaluation gains on reserves.

Graph 4.3
Non-Financial Private Sector Deposits with the Financial System as at end-2003*p* (% share)





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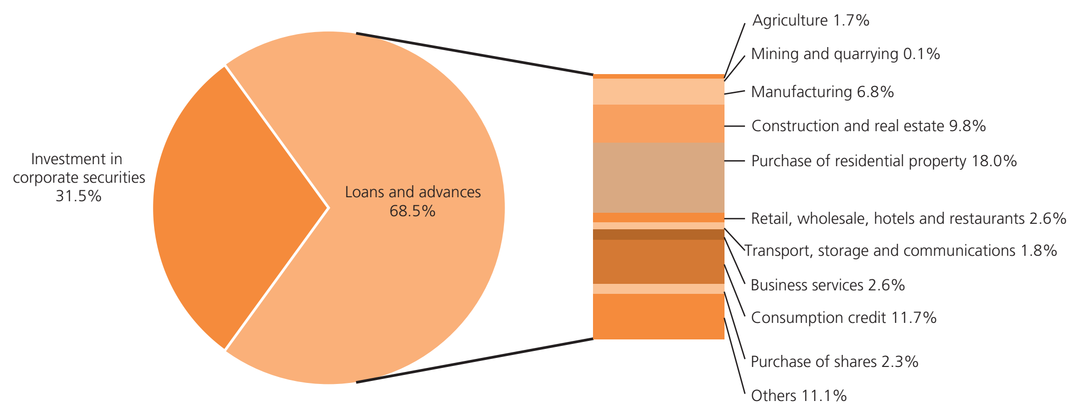
Graph 4.4
Direction of Credit to the Non-Financial Private Sector as at end-2003*p* (% share)



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MANAGEMENT OF THE BANKING SYSTEM

The thrust of banking policies in 2003 continued to focus on enhancing the efficiency and competitiveness of the domestic banking institutions while reinforcing the resilience of the banking system to preserve financial stability. Policies implemented over the years to restructure and strengthen the banking system, supported by improved economic performance contributed to the strengthening of the banking system in 2003. The risk weighted capital ratio of the banking system remained above 13% throughout 2003, while non-performing loans were on a declining trend. This had enabled the banking system to effectively support economic activities. New loan approvals and disbursements expanded strongly by 11.2% and 7.2% respectively, while total outstanding loans grew by 4.8% in 2003. Overall, financing provided by the banking system through extension of loans and its holdings of private debt securities expanded at an annual rate of 5.9%.

The completion of financial restructuring and stronger balance sheets have enabled the banking institutions to focus on harnessing their operational efficiency and meeting the needs of their customers. In this regard, the design of banking policies in 2003 was aimed at enhancing the foundations and environment for the banking institutions to efficiently deliver quality products and services, encouraging greater innovation and maintaining financial stability. An important strategy was to ensure that the banking system continued to be a facilitator of growth, particularly in providing financing and other ancillary services to the small and medium enterprises (SMEs).

Progress of Financial Sector Restructuring

The financial sector restructuring that started during the Asian financial crisis is virtually completed. Following the closure of Corporate Debt Restructuring Committee in August 2002, another important landmark in the financial sector restructuring process in 2003 was the winding-down of the operations of Danamodal Nasional Berhad on 31 December 2003, five years after its establishment in 1998. During its operations, Danamodal injected a total of RM7.6 billion into 10 banking institutions affected by the Asian financial crisis, significantly lower than the initial budget allocation of RM16 billion. Danamodal has recovered RM6.6 billion of the capital investment, while the remaining RM1 billion capital in one institution is expected to be fully divested in 2004. Prior to the winding-down,

The design of banking policies in 2003 was aimed at enhancing the foundations and environment of the banking institutions to efficiently deliver quality products and services, encouraging greater innovation and maintaining financial stability.

Table 4.5
Danaharta: Loan Recovery as at 31 December 2003

	Adjusted loan rights acquired[1] (RM billion)		Expected recovery rate (%)	
	Acquired NPLs	Managed NPLs	Acquired NPLs	Managed NPLs
Plain loan restructuring	2.2	5.5	62	87
Settlement	2.7	6.7	89	78
Schemes of arrangement	2.9	6.9	66	77
Schemes under Special Administrators	2.5	2.9	51	35
Foreclosure	9.9	4.5	28	46
Others	1.7	3.0	60	53
Legal action	0.2	1.0	-	-
Total	**21.9**	**30.5**	**49**	**66**
Overall	**52.4**		**58**	

[1] Comprising total loan rights acquired of RM47.7 billion and accrued interest of RM4.7 billion.
Note: Total may not add-up due to rounding.

Source: Pengurusan Danaharta Nasional Berhad.

Danamodal had redeemed its entire RM11 billion 5-year zero-coupon unsecured redeemable bonds on 21 October 2003. As at end-2003, Danamodal had remaining assets of RM2.2 billion.

The timely establishment of Danamodal ensured the success of the overall resolution of banking sector problems arising from the Asian financial crisis. The funds injected by Danamodal helped to increase the capital of weak but viable banking institutions. With the improved capital position, coupled with operational restructuring, these institutions were able to resume their lending activities. Danamodal's early action and strict adherence to the "first-loss" principle where the existing shareholders absorbed all the losses before the recapitalisation, has kept the total cost of recapitalisation low, at approximately 0.2% of GDP.

Danaharta, which completed acquiring non-performing loans (NPLs) from the financial sector in 2001, has made significant progress in its recovery operations. Of the RM52.4 billion adjusted loan rights acquired in its portfolio, Danaharta expects to recover RM30.6 billion over its lifespan, which translates into an overall expected recovery rate of 58%. As at end-2003, RM22.4 billion or approximately 73% has been collected, of which RM19 billion has been converted into cash, whilst the rest are still in the form of non-cash assets, namely restructured loans, securities and properties. The remaining expected recoveries totalling RM8.2 billion is still pending implementation of the respective recovery strategies. In 2003, Danaharta has cumulatively distributed recoveries amounting to RM13.4 billion in cash and 66,472,441 units of securities to the Government and 36 financial institutions. The distribution to the financial institutions is done in respect of the 80:20 surplus recovery sharing agreement between the financial institutions and Danaharta.

Given the progress of its operations and the commendable recovery rate achieved, Danaharta has paid in full, its RM1.3 billion loans from Khazanah Nasional Berhad and Employees' Provident Fund by June 2003, earlier than scheduled. In addition, Danaharta has also successfully redeemed the first two tranches of zero-coupon bonds with a total face value of RM2.6 billion on 31 December 2003. The remaining 13 tranches, with a total face value of RM8.5 billion, would be maturing in every subsequent quarter up to 31 March 2005. As at end-2003, Danaharta has cash and cash equivalents amounting to RM5.9 billion. With its existing financial position and the remaining assets to be recovered, Danaharta is in the position to redeem its remaining bonds of RM8.5 billion without having to call upon the Government guarantee.

Thrust of Policy Measures in 2003

The main thrust of policy measures in 2003 was the continuation of efforts to strengthen the capability and capacity of domestic banking institutions. In particular, efforts to enhance the efficiency and competitiveness of domestic banking institutions were further intensified during the year, with particular focus on harnessing human capital in the banking institutions. These initiatives were complemented by measures taken to safeguard financial stability.

Given the importance of financing in ensuring sustainable and balanced economic growth, the thrust of policy in 2003 was also to ensure that all sectors of the economy had adequate and continued access to financing. Towards this end, policies were directed at facilitating access to credit by developing the financial infrastructure to meet the financing needs of various sectors of the economy, particularly the SMEs which are important in generating domestic investment and growth. In addition, a microfinancing programme with an extensive outreach was established during the year for microenterprises.

The growing sophistication of the financial markets and products requires consumers to have greater awareness and understanding of banking products and services, so that they can make well-informed financial decisions. In this regard, the framework for consumer awareness and protection was further strengthened in 2003. The work on this area is aimed at laying the foundation for a more competitive operating environment and where banking consumers will be able to make well-informed decisions and be fully responsible for their decisions.

Enhancing Domestic Capacity

In a more competitive environment, domestic banking institutions need to be aware and understand the drivers of performance to meet consumer demands in an effective and efficient manner. More importantly, the banking institutions need to be in a position to provide high quality services at competitive prices to benefit the overall economy. Against these objectives, Bank Negara Malaysia continued to accord priority towards strengthening the capability of domestic banking institutions as well as improving the efficiency of the overall banking system. After three years, the capacity building efforts is showing positive results, with the domestic banking institutions improving not only their financial performance but equally important, their quality of services and product innovativeness as well as increasing usage of technology in delivering products and managing risks.

To gauge the level of service quality of the banking institutions, Bank Negara Malaysia implemented a 4-year programme to assess the requirements, expectations and satisfaction level of consumers on the quality of the products and services provided by banking institutions and insurance companies. As part of the programme, a nationwide survey was conducted in 2003 involving 5,000 banking and insurance customers, comprising individuals, SMEs, large corporations and multinationals. The survey covers various aspects of banking products and services, both conventional and Islamic banking, as well as insurance and takaful products and services. The analysis of the survey result will provide a snapshot of the current level of customers' needs and satisfaction, and highlight the areas for improvement to enhance the level of customer service in the banking and insurance sectors.

The domestic banking groups are also concentrating on maximising the benefits of consolidation, particularly through rationalising and streamlining their internal operations and improving operational efficiency. This had led to the offering of a broader range of financial products and services to meet various customer needs under one roof. Towards this end, an important policy initiative in 2003 was the amendment to the Banking and Financial Institutions Act 1989 to allow the merger of commercial bank and finance company within a domestic banking group into a single legal entity. This single entity will hold two licences, one to carry on banking business and the other to carry on finance company business. This change in the legal framework provides an opportunity for the banking groups to further improve their group structure and rationalise their operations, and thus enhancing their efficiency.

As a service provider, the banking institutions rely significantly on human intellectual capital. At the top level of the management, highly skilled senior managers are vital to drive the strategic direction and position the banking institutions to maximise opportunities presented by the continuously evolving financial landscape. At the same time, staff with appropriate skills at all levels of the institution is necessary to implement the business strategies as well as realise the improvements in business processes and systems. As the business environment and consumer demands are constantly evolving, continuous upgrading of skills of staff is necessary. Recognising this, Bank Negara Malaysia initiated two important measures to provide avenues for continuous learning for the banking institutions to utilise in order to strengthen the competency of their staff. The establishment of the International Centre for Leadership in Finance (ICLIF) was aimed at achieving this objective, to accelerate the development of skilled leaders of financial institutions and corporations. Towards this end, ICLIF is working with renowned international business schools and leading institutions to provide executive management programmes tailored to developing leadership capability and leaders in the financial services sector.

Equally important is the need to provide an avenue for the other levels of staff in the banking institutions to continuously upgrade their skills and expertise in the face of evolving financial market conditions. Increasingly, staff in banking institutions need to possess specialised skills, particularly in the areas of risk management, credit assessment and system development. Towards this end, work has been initiated to reposition the Institut Bank-Bank Malaysia (IBBM) to continuously meet the learning needs of the middle managers, executives and non-executives of banking institutions. In addition,

The International Centre For Leadership In Finance

The financial sector has a vital role in promoting growth and economic transformation towards a more diversified economic structure. These aspirations on the financial sector formed the main thrusts of the Financial Sector Masterplan (FSMP), a ten-year plan that was launched in 2001 to develop a more resilient, competitive and dynamic financial sector with best practices that supports and contributes positively to the growth of the economy. In the first phase of the FSMP, efforts are focused on enhancing the capability and capacity of the domestic financial institutions to face the challenges in the changing and more demanding economic and financial environment. This is vital in ensuring that the domestic financial institutions become more innovative, technology-driven and strategically more focused, and able to compete effectively and efficiently, thereby remaining relevant and meeting the changing needs of the economy.

As the financial services sector becomes increasingly more complex and competitive, financial institutions need to make the necessary adjustments to become more productive and innovative in order to meet the greater demands from businesses and individuals and remain competitive. In this respect, the quality of human resource and leadership capability in the financial sector becomes increasingly crucial in defining the success of the institutions. The training needs of middle management and staff of financial institutions are well served by learning institutions such as Institut Bank-Bank Malaysia (IBBM) and Malaysian Insurance Institute (MII). To complement this, there is a critical need for avenues for leaders and senior management of financial institutions to pursue continuous training, particularly in strategic and leadership management, and thereby drive the strategic direction of the institutions and transform the institutions into high-performing organisations. For this, requisite leadership skills for the changed environment require continuous learning. This includes having the ability to create a culture of high performance within the organisation to drive the institution towards excellence and contribute towards the long-term growth of the institution and the financial sector as a whole. The leadership needs to be able to identify and capitalise on new emerging opportunities so that they can adapt rapidly to changes and maximise on the opportunities presented by the changing environment. This was the motivation for developing the infrastructure for high-level training for top management of organisations to create a high quality human resource pool of top management for the financial sector and corporations.

Bank Negara Malaysia established the International Centre for Leadership in Finance (ICLIF) with the objective of providing a focused and coordinated approach towards the development of world class leaders in the financial and business sectors in Malaysia and the region. ICLIF was officially launched on 28 October 2003 and is established as a company limited by guarantee with a trust fund of RM500 million (USD132 million), whereby the income generated from the fund will be utilised to finance the operations of ICLIF. The establishment of ICLIF represents one of Bank Negara Malaysia's contributions in providing an avenue for top management of financial institutions and corporations to seek continuous learning whilst having the opportunity to network, participate in shared learning experiences and able to form strong alumni contacts. In this connection, the mandate for ICLIF is to develop excellence in leaders with regional insights by providing learning opportunities and experience through effective development programmes. ICLIF also strives to serve the needs of the financial institutions in the region and thus, complements efforts in promoting Malaysia as a regional training centre of excellence for the financial services sector.

As ICLIF aims to accelerate the development of intellectual capital and managerial capabilities of senior management of financial institutions and corporations, it adopts a multi-disciplinary approach and offers programmes on strategic management as well as those that are relevant across the whole spectrum of the financial services industry, covering banking, insurance and Islamic financial industry. ICLIF aims to take a proactive approach in identifying the needs of the industry, which then serve as input in designing the programmes. ICLIF's planned programmes are divided into three broad categories:

- Structured executive management programmes, in the areas of strategic management, customer and marketing management, people management, business technology and knowledge management, and risk management;
- Seminars and workshops on topical issues, as well as providing a platform for the top management of financial industry and corporations, regulators and academicians to discuss current economic and financial issues; and
- Specialised programmes in Islamic financial services and other specialist areas.

A distinctive feature of ICLIF is the strategic alliances it has formed with renowned international business schools and learning institutions to provide programmes that are adapted to the regional context and to the needs of the financial industry and corporations. Through these partnerships, ICLIF has entered into arrangements with a number of international business schools to design and deliver structured executive management programmes at ICLIF. The strategic partners provide the resource persons for the programmes while ICLIF provides the necessary infrastructure and facilities. This approach will enable the participants to have access to high quality management programmes at reasonable cost and thereby provide greater opportunities for the leaders from the financial and corporate sectors to benefit from world-class knowledge sharing and networking.

As part of achieving these objectives, ICLIF has developed a unique leadership competency model to analyse and understand competencies that are necessary towards the development of excellent corporate leaders in the regional context. These skills and behaviours will form the foundation in the design and delivery of ICLIF's leadership development learning programmes. One of these programmes is the Global Leadership Development Program (GLDP), which is ICLIF's flagship programme. The GLDP represents ground-breaking design in terms of an executive education programme by drawing faculty from leading learning institutions and consultants, which enables ICLIF to combine the best ideas and thoughts on the various key leadership issues and concerns. These participating institutions and consultants are the Peter F. Drucker Graduate School of Management-Claremont Graduate University, Marshall School of Business-University of Southern California, Stanford Graduate School of Business and Tower Perrins. The GLDP primarily focuses efforts on developing the best leaders across industries by combining an optimal mix of theory and practical application in its leadership development techniques. The programme also provides an opportunity for the participants to strengthen their networking circle and participate in shared learning experiences and discussions with leaders of other organisations. The GLDP will be held twice a year and comprise three parts, with Part 1 and 2 conducted in Malaysia while Part 3 comprises a focused two-week study programme to the United States of America to provide a unique experience for the participants to be exposed to the best learning institutions and corporate organisations in the United States of America. The first GLDP was held from 9 to 13 February 2004 and attended by 20 top management of financial institutions and corporations in Malaysia and from the region.

ICLIF is governed by its own Board of Directors, with the Governor of Bank Negara Malaysia as its Chairman. In addition to the Board of Directors, ICLIF also has an Advisory Council, comprising eminent persons from Malaysia and abroad, to provide strategic direction on training matters and the development of high quality programmes. It evaluates the learning needs of the financial services and corporate sectors in the region in developing programmes that meet the objectives of ICLIF.

The establishment of ICLIF aims to reinforce the notion that investments in human capital, including the pursuit of leadership excellence, is a continuing process in this ever-changing environment. ICLIF will therefore be focused on making positive contributions towards developing excellent leaders and become a regional centre of excellence for leadership training in finance.

IBBM, as a training provider, aims to complement professional institutes, universities and management consultancy firms. Thus, to remain effective as a premier training provider for the financial sector, IBBM is giving priority to two broad areas, namely provision of focused training and accreditation, particularly in the specialised areas, and to act as an effective training adviser to the banking institutions. To achieve this objective, IBBM has developed several broad strategies, which include building a new education and qualification portfolio, improving the institutional structure to support future requirements and building capacity to deliver specialised courses.

Another initiative pursued to strengthen the banking institutions is the setting up of investment banks. Policy proposals have been developed with a view to place the new institutions in a stronger and more competitive position vis-à-vis the regional and global players. At the same time, a prudential regulatory framework is being formulated, taking into consideration existing regulations, the different nature of the new institution and international regulatory frameworks for comparable institutions. This includes the envisaged structure for the investment banks and their permissible activities. Central to this is defining the appropriate capital and liquidity frameworks that seek to converge the manner in which risks are measured under the existing frameworks. The capital and liquidity frameworks are being formulated to best reflect the nature of risks to be undertaken by the new institution in order to give a fair representation of the solvency position and risks undertaken by investment banks.

Ensuring Continuous Access to Financing

With policy priority being accorded to generate domestic sources of economic growth, access to financing is critical to promote and sustain both private consumption and investment. As the banking system remains the largest provider of funds in the economy, policy initiatives during the year were directed at ensuring that the lending activities of the banking system were supportive of economic growth as well as facilitating access to financing to all sectors of the economy. Indeed, the increased demand for loans from both the household and businesses, driven by the low interest rate environment and improved economic outlook, was effectively met by the banking institutions.

There has been a marked shift in the lending pattern of the banking institutions to the household sector and small businesses. The share of loans to the household sector has increased from 33.4% at end-1997 to 48.7% at end-2003. This shift in lending pattern has supported the growth in private consumption and has positive spillover effect on the other sectors of the economy. From the financial stability perspective, the shift towards high-volume low-value loans also diversifies the distribution of credit risks within the banking system, minimising the potential occurrence of large losses stemming from the failures of a few large borrowers. At the same time, Bank Negara Malaysia is mindful that a continuous build up in household debts that is not accompanied with an increase in the level of household income could affect the sustainability of the debt servicing capacity of the household sector with destabilising effects on the banking system. Bank Negara Malaysia has in place a surveillance mechanism to monitor the banking system's exposure to the household sector and the debt servicing capacity of the household sector. The exposure to the household sector has thus far remained within prudential levels. With rising income levels, the household sector in Malaysia has continued to accumulate net financial savings, as reflected in higher accumulation of deposits against debt accumulation. In addition, while the level of NPLs for the household sector has increased, the NPL ratio has remained at manageable levels. Equally important is the ability of the banking institutions to manage these risks. Since the crisis, the banking institutions have enhanced their risk management infrastructure and capabilities to better cope with the changing risk profile of their assets. This was further reinforced with the availability of complete positive and negative credit information of all borrowers in the banking system on a real time basis provided by the Central Credit Reference Information System.

In line with the policy priority of strengthening the support to SMEs to promote endogenous sources of growth, particular attention was directed at providing improved access to financing by SMEs.

To promote endogenous sources of growth, attention was directed at providing improved access to financing by SMEs.

Although the Government, through various ministries and agencies, have established various financing schemes, it was evident that the awareness among SMEs of these schemes was low. To address this, Bank Negara Malaysia established the SME Special Unit in May 2003 to assist SMEs to obtain information on the various financing schemes available to them and to provide financial advisory services. In addition, the SME Special Unit also assists in facilitating SMEs in their loan application process. As at end-2003, the Unit has received 1,789 enquiries from SMEs, of which 82% were enquiries on sources of financing, whilst the remainder was related to problems on access to financing and requests for loan restructuring. While the Unit strives to assist viable SMEs, SMEs themselves need to ensure satisfactory financial records are maintained to facilitate the process.

One of the problems faced by SMEs is the existing NPLs, which constrained their ability to obtain new loans despite having on-going and viable businesses. Bank Negara Malaysia has, therefore, established a small debt resolution mechanism in October 2003 to support viable SMEs that are constrained by NPLs by facilitating loan restructuring with their banks. A Small Debt Resolution Committee (SDRC) has been established to undertake independent assessments on the viability of the businesses, and propose the loan restructuring and assess new financing requirements of the affected SMEs. This mechanism is open to SMEs with on-going businesses that have aggregate NPLs of not more than RM3 million. As the debt restructuring may involve new financing, Bank Negara Malaysia has established the Rehabilitation Fund for Small Businesses with an allocation of RM800 million.

As part of the efforts to enhance access to financing, the Fund for Small and Medium Industries 2 (FSMI2) and the New Entrepreneurs Fund 2 (NEF2) were increased further. In 2003, Bank Negara Malaysia provided additional allocations of RM1.35 billion for FSMI2 and RM650 million for NEF2. Consequently, the total allocation of these two Funds increased to RM2 billion and RM1.15 billion respectively. Apart from setting up special funds, Bank Negara Malaysia also required the banking institutions to set their lending targets to SMEs. Where the individual institutions' targets were deemed insufficient, appropriate targets were imposed.

In addition, banking institutions have also undertaken various initiatives to support SMEs in obtaining financing. These initiatives include the establishment of dedicated SME units, provision of financial advisory services and display of client charters. The display of the client charter by all banking institutions enhances the efficiency of loan approval process by disclosing the necessary documentation for submission to the banking institution to support the loan applications, eligibility criteria, definition of project viability, and duration taken by a banking institution to process the loan application. Banking institutions are also required to inform applicants of reasons for their loans being rejected. Bank Negara Malaysia monitors the compliance of the client charter through the on-site inspection process.

The unexpected outbreak of Severe Acute Respiratory Syndrome (SARS) in early 2003 had adversely affected the tourism and other related sectors. Two specific measures were introduced to provide relief to ease the financial burden of affected businesses and their employees. A Special Relief Guarantee Facility of RM1 billion was established in May 2003 to alleviate the cash flow problems faced by businesses directly affected by the SARS outbreak. Under the scheme, affected businesses could obtain working capital loans from banking institutions, up to an aggregate amount of RM2.5 million, at low interest rates. In addition, this was reinforced by the guarantee facility of up to 80% of these loans by the Credit Guarantee Corporation Malaysia Berhad. Banking institutions also provided financial relief to borrowers in the SARS-affected industries by restructuring or rescheduling loans for all types of borrowings and credit facilities. In the case of employees whose remuneration were reduced by their employers, banking institutions extended similar financial relief on the housing loans taken by the employees.

A significant initiative undertaken in 2003 was the strengthening of the existing infrastructure and institutional arrangements to extend the outreach of financial services to microenterprises. In February 2003, Bank Negara Malaysia proposed to leverage on the extensive branch network of Bank Simpanan Nasional and Bank Pertanian Malaysia to provide microfinancing. To equip these development financial institutions with the necessary best practices and skills to provide microfinancing, initiatives were undertaken to develop microfinance products, operating manuals and systems as well as training programmes for loan officers and branch managers. Meanwhile, to promote microcredit, the Government allocated RM1 billion, channelled through Bank Pertanian Malaysia (RM500 million), Bank Simpanan Nasional (RM300 million) and Amanah Ikhtiar Malaysia (RM200 million). Due to the encouraging response from microenterprises, the Government announced in the 2004 Budget an additional allocation of RM1 billion to Bank Pertanian Malaysia and Bank Simpanan Nasional to finance microenterprise activities. Bank Negara Malaysia is also working with the Ministry of Land and Cooperative Development and Department of Cooperative Development to strengthen the cooperative movement as a potential source of financing for microenterprises and low-income groups. Efforts are underway to enhance the infrastructure and regulatory and supervisory frameworks to achieve this objective.

Promoting Active Consumerism

A vital aspect in the transition towards greater market orientation is promoting active consumerism. Consumers can be an important force to drive the performance and efficiency of the banking institutions. Towards this, consumers need to be well informed of the different products and services offered, and their rights and responsibilities. There must also be an effective avenue for consumers to seek protection and redress. Efforts during the year continued to focus on increasing consumer awareness and further strengthening the consumer protection infrastructure, including ensuring accessibility to affordable banking services.

for their decisions. However, this does not absolve the banking institutions from their responsibilities to ensure that their products deliver what is promised and that customers will obtain fair value for their money.

The Consumer Education Programme, which has now entered into its second year of implementation, has received encouraging response from the public. As at end-2003, the BankingInfo website has received 6.4 million hits and 1.2 million booklets have been taken up by the public. During the year, another six booklets were published, bringing the total number of consumer booklets published to 18. Two of the new booklets aim to provide information to assist SMEs in preparing loan applications as well as the different types of financing products available. The other new booklets provide information on the role and responsibilities of guarantors, the Credit Guarantee Corporation Malaysia Berhad, house financing-i and charge cards.

Bank Negara Malaysia is also finalising the product transparency and disclosure rules. The objective of such rules is to provide comprehensive, clear and fair information about the risks and liabilities of financial products and services to consumers to facilitate informed decisions. The disclosure standards focuses on four main items deemed most essential for making informed decisions, namely the form and timing of disclosure, items to be disclosed and disclosure requirements in advertisements. To facilitate and reduce the cost of information search by consumers, Bank Negara Malaysia is also developing "Comparative Tables" on the yield and cost of financial products and services

Efforts continued to focus on increasing consumer awareness and strengthening the consumer protection infrastructure, including ensuring accessibility to affordable banking services.

As outlined in the Financial Sector Masterplan, an effective consumer education and protection framework is being developed to set the foundation for an environment where ultimately, banking consumers will need to take greater responsibility for their financial decisions. Once the relevant information and risks have been appropriately disclosed and explained, consumers must be actively involved in comparing, examining and deciding on investments or purchases to be made, and assume responsibility

offered by the banking institutions. These tables would serve as a one-stop reference centre for information on the costs and features of financial products and services offered. Initially, the focus will be on developing comparative tables on the commonly offered deposit and credit products.

As consumers become more discerning, competition will drive banking institutions to increasingly offer greater product differentiation and value added services to gain competitive advantage. Banking institutions are increasingly leveraging on advances in technology to introduce and market new products, services as well as new delivery channels. This dynamic environment will see the introduction of an increasingly broader array of financial products and services to consumers. However, as these innovations require substantial investments, costs of the more sophisticated products and services will result in fees and charges. While this development may be inevitable, attention has been given to ensure that the public has access to basic banking services at minimal cost while the more complex and sophisticated products and services reflect their appropriate costs. This is to ensure appropriate pricing of banking services. In achieving this objective, a balance is made between providing an operating environment that promotes innovation while also taking into account consumer interests. Therefore, while Bank Negara Malaysia is committed to a market driven approach to pricing, this will be undertaken under an environment where the interests of consumers are also protected.

In this connection, Bank Negara Malaysia has initiated work on establishing a framework on basic banking services, which aims to ensure that the banking public, especially the low-income group, would have access to affordable basic banking services. Under this framework, all banking institutions would be required to offer a basic bank account that would provide a prescribed minimum level of services and transactions to all Malaysians at minimal cost. The basic banking services framework is being finalised for implementation in 2004.

Attention has also been directed at enhancing dispute resolution mechanisms for consumers to seek redress. Towards this end, Bank Negara Malaysia has finalised the structure and operating framework of the new Financial Mediation Bureau (FMB), which will commence operations in the first half of 2004. This new entity will function as a one-stop centre for the resolution of a broad range of retail consumer issues raised against the financial institutions that are regulated by Bank Negara Malaysia. The enlarged scope of FMB will provide the public with a prompt and more effective resolution mechanism. In addition, regional offices of FMB will be set up to enhance access to its services nationwide. The expanded scope of operations of the new bureau and the increased maximum quantum of claim awards are illustrated in the following table:

Elements	**Banking sector**	**Insurance sector**
Limit	Losses suffered not exceeding RM100,000	Claims not exceeding: • RM200,000 (motor and fire insurance); • RM100,000 (others); and • RM5,000 (3rd party property damage)
Nature of dispute	All retail banking complaints except those involving policies, credit decisions, quality of service and cases that have been or are referred to court. This would include complaints on the following: • Personal Loans • Housing Loans • Automatic Teller Machine • Credit Card • Hire Purchase • Savings Account • Current Account • Fixed Deposits • Remittances	All disputes between policyholders/ claimants and their own or third party insurers except those involving pricing of insurance product and underwriting issues, fraud cases and cases that have been or are referred to court.

Maintaining Financial Stability

The increasingly complex and dynamic financial activities demand continuous enhancements to the regulatory and supervisory frameworks to maintain financial stability. The soundness of the banking system is important to safeguard the interest of depositors and ensure that the banking system is strong and well capitalised to support the growth process through robust lending activities. In this regard, due attention continues to be given to enhance prudential regulations, to ensure that the regulations are relevant in the face of rapid change in the financial markets. At the same time, Bank Negara Malaysia is mindful of the need to ensure that new regulations would not stifle innovation and competition amongst players in the financial market.

To further strengthen the regulatory framework, the Central Bank of Malaysia Act 1958, the Banking and Financial Institutions Act 1989, the Islamic Banking Act 1983 and the Takaful Act 1984 were amended in 2003. A new Payment Systems Act 2003 was also enacted during the year to provide for a comprehensive legal framework to ensure that the payment systems are protected from disruptions that may affect financial stability, and that public confidence in the payment systems and instruments is preserved.

Among the key amendments under the Central Bank of Malaysia (Amendment) Act 2003 are:

- The enhancement of the regulatory and supervisory framework for the over-the-counter Ringgit bond market. This enables Bank Negara Malaysia to carry out its functions in providing infrastructure for the Ringgit bond market, which includes the power to issue regulations necessary for the regulation and operation of the systems for the debt securities market;
- The provision for Bank Negara Malaysia to promote reliable, efficient and smooth operation of national payment systems and payment instruments. This is consequential to the enactment of the Payment Systems Act 2003, which provide the regulatory powers of Bank Negara Malaysia over the designated payment systems and payment instruments; and
- The enhancement of the Shariah Advisory Council of Bank Negara Malaysia *[Please refer to Islamic banking section for details]*.

Corporate governance practices in the banking institutions were also enhanced during the year. Good corporate governance reinforces sound regulation and supervision. In most instances, corporate governance forms the first line of defence against any crisis. For corporate governance to work, good corporate practices need to be instilled and embedded in all aspects of the operations and at all levels within the organisation. Sound corporate governance would lead to greater responsibility and accountability of the board and senior management of the banking institutions. Therefore, the banking institutions need to be headed by an effective board with sufficient skills and a high degree of professionalism. To help achieve this, Bank Negara Malaysia issued in May 2003 the Guidelines on the Establishment of Board Committees, Minimum Qualification and Training Requirement for Directors, and Definition and Responsibilities of Independent Directors. The Guidelines set the requirements on the establishment of three board committees, namely the nominating committee, remuneration committee and risk management committee, and the terms of reference of each of the committee.

The nominating committee is responsible to ensure that only the most competent individuals who can contribute and discharge their responsibilities are appointed to the board and key management position. Among others, the committee is required to provide a formal and transparent procedure for the appointment of directors and chief executive officer, and a mechanism to assess the effectiveness of individual directors, the board, chief executive officer and senior management officers. The remuneration committee oversees the remuneration matters of directors and senior management officers. The committee is responsible for recommending the remuneration framework for directors, chief executive officer and senior management officers. It should ensure that the remuneration framework of the institution is competitive and consistent with the institution's culture, objectives and strategy, and reflects the responsibilities of board members, chief executive officer and senior management officers. The risk management committee is responsible for overseeing senior management's activities in managing credit, liquidity, operational, legal and other risks, and ensuring that the risk management infrastructure and process is in place and functioning.

Given the increased complexity of banking businesses and the heavy responsibilities of the board of directors, directors need to have the necessary qualifications and experience to effectively discharge their duties. In this regard, the Guidelines also focus on the required skills and experience for this purpose. In addition, recognising the critical role of independent directors in spearheading corporate governance and upholding independence of the board, the Guidelines also set out the definition of independent directors, and their expected roles and responsibilities. As their primary responsibility is to protect the interest of minority shareholders and the general public, independent directors are expected to provide effective oversight and ensure a strong independent element on the board. To complement these measures, the Guidelines on the Appointment of External Auditor by banking institutions was issued in August 2003 to mitigate potential conflicts of interest arising from the long-term relationship with an external auditor.

The increasingly complex group structures involving financial conglomerates has called for the development of a comprehensive regulatory and supervisory framework for financial conglomerates. The objective of the framework is to ensure that the financial health of the financial groups can be adequately assessed and monitored by supervisors. Regulation is, therefore, to balance between allowing group synergy and efficiency, and ensuring that the activities of the financial conglomerates do not introduce excessive risks to the financial system. Towards this end, a concept paper on the Consolidated Supervision of Financial Conglomerates was issued in December 2003 with the aim of formalising and strengthening the existing infrastructure and regulatory framework for financial conglomerates. Given the diverse risks associated with the different activities undertaken by the different entities within the financial conglomerates, the proposed framework does not prescribe common prudential requirements for all entities within the financial conglomerate. Instead, the framework emphasises on developing prudential guidelines and principles to ensure that the financial holding companies are financially strong and able to lend support to its subsidiaries.

The framework focuses on five main areas, namely group structures, corporate governance, risk management, intra-group exposures and reporting requirements. On group structures, the framework outlines the main principles that would form the basis for financial groups to determine their optimum group structure, both from a commercial as well as regulatory perspective. While it is recognised that the financial groups would organise their group structures according to their strategies and market niches, sufficient safeguards need to be in place to ensure that the group structure does not pose systemic risk to the banking system. In particular, regulation is required to ensure minimal transmission of financial distress from unregulated entities to the regulated entities within the group, which could destabilise the banking system. In addition, there is a need to ensure that the obligation of the Government in assuring the safety of deposits would not be extended to other non-depository institutions within the group. The framework also establishes basic principles of good corporate governance, which focuses on the processes and structures used to manage the business and affairs of a financial holding company (FHC) and its related entities, placing greater emphasis on the roles and responsibilities of the board of directors and management of the FHC.

As the FHC is expected to provide financial support to all entities within the group, the framework also sets out the capital adequacy requirements for the group. In assessing financial strength of the conglomerate, Bank Negara Malaysia will focus on the capital adequacy of the individual banking institutions on an individual and consolidated basis (if the institution has subsidiaries), as well as on the capital adequacy at the group and holding company level. On risk management, the framework requires the board of the FHC to establish a Group Risk Management Committee to oversee the overall management of the group's risks, review the senior management's control and procedures in managing these risks, as well as ensuring that remedial actions are taken. To ensure that all potential sources of contagion risks, other than cross-selling, are identified and addressed promptly, the framework also requires that written policies on intra-group exposures be incorporated into the risk management at group level. Subsequently, the FHC is required to submit periodic reports to Bank Negara Malaysia to facilitate the continuous assessment of the financial conglomerate.

Bank Negara Malaysia is also reviewing the current Guidelines on the Credit Limit to a Single Customer (GP5) to expand the coverage of exposures to a single customer to include exposures other than credit facilities. This exposure would include amongst others, exposures to holdings of shares and debt securities, and off-balance sheet items. This revision would also entail the streamlining of several existing regulations pertaining to exposures to large customers into a single comprehensive guideline for easy compliance and reference by banking institutions.

As banking institutions make greater use of sophisticated financial instruments, they are increasingly exposed to higher market risk. In this regard, a concept paper on the Incorporation of Market Risk into the Risk Weighted Capital Ratio (RWCR) was issued in mid-2003 to principally assess the impact of incorporating market risk into the RWCR. The study indicated that the RWCR of the banking system would decline marginally by 0.12 percentage points, with all banking institutions maintaining a RWCR of more than 8%. Among the banking institutions, merchant banks exhibited the largest decline in their RWCR primarily due to their principal activities in the capital market. Following a series of discussions with the Market Risk Industry Working Group, the framework was further refined and the second concept paper was issued in January 2004. Among the significant changes made to the framework include the definition of trading and banking books, treatment on holdings of securities resulting from debt/loan restructuring, and valuation of illiquid papers. Banking institutions are required to assess the quantitative impact of the revised framework by February 2004.

The market surveillance also detected incidences of unhealthy trading practices in the domestic bond market. To preserve market integrity, banking institutions were reminded to tighten their risk management practices. The lack of transparency and information gap in the over-the-counter bond market is one of the factors that contributed to the occurrence of irregular trading. To address the information gap and lack of transparency, Bank Negara Malaysia is working with the Securities Commission to enhance the infrastructural development of the bond market. These measures include electronic trading platform to improve price discovery mechanism and the automation and integration of trade-related processes to allow for further improvements in operational efficiency.

On the international front, work on the New Basel Capital Accord or Basel II continued to be the focus of the Bank for International Settlements (BIS). Following the issuance of the second consultative paper in January 2001 and after consultation with the global financial industry, BIS issued the third consultative paper (CP3) in April 2003. Among the main changes in CP3 include a lower risk-weight for residential mortgages, recognition of "past due" loans with significant levels of provisioning, the introduction of an alternative "Standardised" approach for operational risk at supervisory discretion, and fine-tuning some of the elements of the Internal Ratings Based (IRB) approach. Before issuing CP3, the BIS conducted the third quantitative impact study (QIS3) in October 2002 to gauge the impact of Basel II proposals on minimum capital requirements. The results of QIS3, which was released in May 2003, showed marginal increase in credit risk capital requirements relative to the current Accord for banking institutions adopting the "Standardised" approach, while for banking institutions adopting the IRB approaches, substantial reductions in credit risk capital requirements were reported. However, the new operational risk capital requirement more than outweighed the reduction in credit risk capital requirements, resulting in an overall increase in capital for banking institutions adopting the "Standardised" approach. In comparison, the minimum capital requirements of banking institutions intending to adopt the more sophisticated IRB approach were broadly unchanged. The new rules are expected to be finalised by mid-2004.

Bank Negara Malaysia has conducted a preliminary impact study in October 2002 to ascertain the impact of Basel II on the local banking industry using the "Standardised" approach. The results of the impact study indicated that, using the "Standardised" approach, the RWCR of the banking system would decline marginally, but still well above the 8% regulatory requirement. The decline in RWCR was mainly due to the new operational risk capital requirements, which more than offset the increase in the RWCR due to credit risk capital requirements. In addition, the preliminary survey findings indicated that unrated corporate loans and past due loans contributed to the increase in risk-weighted assets.

In tandem with this impact study, a study was also undertaken to determine the readiness of domestic banking institutions to adopt the IRB approach, which requires banks to use internal ratings to calculate the capital adequacy requirements. The main challenge in the adoption of the IRB approach is the availability of clean or usable data, which is required to meet the minimum historical 5-year data requirement. The task of data collection, cleansing and verification is time-consuming. For some banks, the recently concluded merger and consolidation programme and the impending merger between commercial banks and finance companies may further complicate this task as the 5-year historical data could only be developed post-merger to reflect the current risk profile of the institutions. Data storage will become a major factor under Basel II as banking institutions will require data warehouses with sufficient capacity to cater for the data intensive IRB systems. To facilitate implementation, banking institutions will also be required to invest in staff training to gain the technical expertise to assist with Basel II implementation.

In the case of banking institutions that already have internal ratings systems, the challenge is that the systems are relatively new and the results are untested. Some of the banking institutions are also in the process of upgrading their internal rating systems to be two-dimensional, covering the borrower risk as well as the facility risk. Other expected challenges faced by banking institutions include being able to fully utilise the capital relief gained through credit risk mitigation and risk management techniques under Basel II.

To facilitate the implementation of Basel II in Malaysia, a Basel II Task Force would be formed to promote greater consistency and understanding among banking institutions. The task force, comprising Bank Negara Malaysia officials and resource persons from the banking sector will discuss experiences and build on the best practices and approaches to capital regulation.

Moving Forward

Significant progress has been achieved in financial sector restructuring and efforts to strengthen the resilience and capability of the banking system. Meanwhile, the Malaysian economy continues to evolve, with new sources of growth emerging. This, combined with changes in the global financial environment will demand greater efficiency, competitiveness and resilience from the domestic banking sector. Hence, moving forward, the strategies aimed at improving the efficiency of the domestic banking sector while preserving financial stability will continue to be pursued. At the same time, given the important role of the banking sector in promoting sustainable and balanced economic growth, due emphasis will continue to be given to ensure that the banking sector remains supportive of meeting the socio-economic agenda of the country.

SUPERVISORY ACTIVITIES

The supervisory activities throughout the year 2003 were focused on multi-pronged strategies to further promote the stability of the banking system in tandem with the evolving financial industry and increasing complexities of the financial landscape. These activities involved on-site examination, off-site surveillance, market assessment through formal and informal dialogue sessions with industry players, as well as further strengthening the capacity building and assessment methodologies of the supervisors. The on-site examination and off-site surveillance in supervising banking institutions continued to be premised on the risk-based supervisory approach. The overall thrust of this approach is to identify and assess key risks encountered by banking institutions and their capacity to manage these risks. Based on this assessment, a supervisory plan is formulated for each banking group, so that supervisory resources can be optimally allocated in supervising the institutions, with particular focus on areas of high risk.The financial and operating conditions of all entities within a banking group and activities undertaken by these entities are taken into account to ensure that these do not adversely affect the performance of the banking group concerned and pose a systemic threat to the banking system as a whole.

The supervisory activities in 2003 were focused on multi-pronged strategies to further promote the stability of the banking system.

In 2003, Bank Negara Malaysia conducted 93 on-site examinations on banking institutions, including the Islamic banks, as well as development financial institutions. These examinations covered head offices, local and overseas branches, bank holding companies and related companies of banking institutions. The supervisory scope has also included the examination of Islamic banking operations and anti-money laundering measures undertaken by banking institutions. In addition to the enhanced supervisory scope, Bank Negara Malaysia has, in recent years, accorded greater supervisory resources in evaluating banking institutions' market and operational risk management practices, besides credit risk.

To complement the on-site examination of banking institutions, on-going monitoring of the financial health of these institutions was conducted through off-site surveillance. Banking institutions were monitored closely through regular reporting and rigorous financial analysis accompanied by periodic stress testing for the early detection of emerging problems. The off-site surveillance function also included the review and approval of the financial accounts of banking institutions to ascertain compliance with accounting standards and Bank Negara Malaysia regulations, with particular emphasis on the adequacy of provisions for impairment of assets, particularly loans and investments. The off-site surveillance function has been intensified, to include credit and fraud surveillance through electronic information database.

The soundness of banking institutions has been evaluated based on the CAMELS rating framework which encompasses the review of a banking institution's capital adequacy, asset quality, management capability, earnings performance, liquidity and sensitivity to market risk. With the inclusion of the "sensitivity to market risk" component to the CAMELS framework in 2003, the Bank has developed a more structured supervisory framework to assess banking institutions' market risk management processes and modeling techniques. During the year, a measurement tool kit for market risk was developed to enable bank supervisors to validate the market risk models used in banking institutions. An essential element of banking supervision included the supervision of banking groups on a consolidated basis. In this regard, the Bank conducted regular examinations of bank holding companies as well as related non-banking entities within the banking groups. These examinations enabled the Bank to identify sources of vulnerability and assess the strength and ability of the holding company in providing financial support to the banking institutions within the group. It also enabled the Bank to evaluate the potential impact that other non-bank entities within the group may have on the banking institutions' solvency.

In engaging the risk-based supervision approach, Bank Negara Malaysia implemented a structured risk assessment framework to evaluate the risk profile of each banking institution and the adequacy of the institution's risk management processes. While banking institutions have mainly focused on implementing credit and market risk management, they have also been moving towards a fully integrated risk management system, which provides the management with a holistic view of risk management so that interactions amongst risks can be identified and managed more effectively. In this regard, banking institutions have also begun developing a more structured process in managing their operational risk. Given that banking institutions are still in different stages of developing their respective integrated risk management framework, the Bank continues its developmental role in monitoring and evaluating the individual banking institution's progress and plans in this area.

In promoting sound corporate governance in banking institutions, bank supervisors conduct assessments of the corporate governance practices of banking institutions to ensure that these practices are indeed instilled and embedded in all aspects of operations and at every level of the institutions. A major part of this assessment is focused on evaluating the effectiveness of the board of directors who are ultimately responsible for the overall management of the banking institutions. The assessment also provides valuable input for the purpose of approving the appointment and reappointment of directors.

In line with the Financial Sector Masterplan, an Enforcement Actions Framework has been developed to provide a comprehensive and incremental approach towards enforcing actions to be taken following supervisory exercise on banking institutions. The first phase of the framework involving the Informal Enforcement Actions Framework (IEAF), has been implemented since September 2002. The IEAF has facilitated Bank Negara Malaysia in taking pre-emptive measures not only on banking institutions but also on related companies of banking institutions to address emerging weaknesses in a timely and effective manner. The Bank is working on the second phase where a Formal Enforcement Actions Framework (FEAF) is being developed as an extension of the existing informal framework. Actions under the formal framework will be taken for institutions with problems or where informal actions have been unsuccessful in achieving the desired outcome. While the legal framework is already in place, the FEAF will refine the mechanism to make the process more transparent. In addition, in enforcing pre-emptive measures on a problem banking institution, the FEAF will incorporate prompt corrective actions, which will be taken once specified thresholds for supervisory intervention are triggered.

Another important supervisory area that has been given greater emphasis since the enactment of the Anti-Money Laundering Act in 2002, was Bank Negara Malaysia's assessment of anti-money laundering measures taken by banking institutions. The framework that has been put in place focuses on five broad functional areas of an institution's operations, namely quality of board and management oversight, comprehensiveness of policies and procedures, effectiveness of internal controls, adequacy and accuracy of the management information system, as well as, quality of the human resource and availability of training.

As part of the Bank's supervisory activities, regular consultative dialogues are held with the board of directors and management of banking institutions, to provide an effective forum for two-way communication on supervisory issues. Through these interactions, the Bank was better positioned to evaluate the institutions' capacity and readiness to meet impending challenges.

The Bank has also long recognised the importance of maintaining the integrity of Information Technology (IT) infrastructure deployed by the banking institutions, which forms the backbone of all banking operations. In order to promote a safe and sound IT environment in banking institutions, to maintain public confidence and minimise service interruptions, supervisory attention is given to the Information System (IS) functions of these institutions through both the on-site examinations and off-site monitoring mechanisms, that ensure the adoption of best IT practices and compliance with regulations. In the year 2003, the Bank had conducted 18 on-site IS examinations on banking institutions including overseas branches and subsidiaries of domestic banking institutions. This is to ensure relevant controls are in place and appropriate systems are deployed in their operations particularly for high risk banking products and services such as Internet Banking, Mobile Banking, Credit Cards and Automated Teller Machine.

In an effort to improve the IS supervisory function and promote supervisory transparency, the Bank has embarked on several strategic measures in line with international standards to improve the quality and effectiveness of its on-site IS examinations. Firstly, a new IS examination methodology has been developed and will be fully implemented for all on-site IS examinations beginning in 2004. The new methodology provides a more balanced appraisal to enhance the quality and standard of IS examinations. It also employs a structured and guided tool for risk assessment and provides a foundation for IT benchmarking. Secondly, an enhanced version of the examination report has been implemented. The Bank is also developing a new guideline that aims to strengthen the level of IT management in banking institutions, which will be enforced in 2004.

In 2003, Bank Negara Malaysia embarked on upgrading its MS ISO 9002:1994 Quality Management System certification for the planning and monitoring of the performance of routine on-site examinations on banking institutions to MS ISO 9001:2000. The scope of registration for the new standard was expanded to include Malaysian banking institutions' branches and subsidiaries, operating outside Malaysia and the incorporation of new quality standards. The new certification reaffirmed Bank Negara Malaysia's commitment to maintain the highest level of professionalism in undertaking its supervision responsibilities. In addition, the Bank is also in the process of obtaining the MS ISO 9001:2000 certification for its on-site IS examinations on domestic banking institutions.

Recognising the increasing challenges of banking supervision, Bank Negara Malaysia is committed to ensure that the knowledge and skills of bank supervisors are continually enhanced to meet the demands of an increasingly sophisticated financial environment. Besides structured training for bank supervisors, bank supervisors are trained in several specialised key areas of banking supervision such as risk modeling and Syariah principles, to keep abreast with market developments; and function as sources of reference and capacity building for the Bank. These measures have further enhanced the capacity of the Bank to perform its supervisory function in a more effective manner as well as provide value-add recommendations to the banking institutions.

With the rapid changes in the financial environment, particularly with the New Basel Capital Accord, the Bank is faced with increasing supervisory challenges. As a pre-requisite for effective supervision, supervisors are provided with continuous training and exposure to keep pace with the developments taking place globally to ensure that Malaysia is at par with international best practices. In meeting the challenges of the New Accord, bank supervisors are being equipped with the necessary knowledge and skills, particularly in effectively evaluating the more sophisticated methodologies to determine capital requirements. These initiatives range from participation in regional and international training programmes, dialogues with other supervisory agencies and international bodies on implementation issues and discussions with the banking industry to facilitate understanding of their level of readiness towards implementing the requirements of the New Accord.

In 2003, the Bank continued to strengthen its working relationship with other domestic and foreign supervisory agencies to facilitate enhanced co-operation and information exchange. This collaboration process has been very valuable to the Bank in facilitating its efforts to undertake effective consolidated supervision of banking institutions. In this context, Bank Negara Malaysia carried out nine examinations of overseas branches and subsidiaries of domestic banks. The assessment of the financial and general conditions of these entities was discussed with the respective host supervisory agencies to identify any common issues of concern and facilitate their resolution. The Bank also jointly conducted two examinations on offshore subsidiaries of domestic banks with the Labuan Offshore Financial Services Authority (LOFSA).

Bank Negara Malaysia is committed in its role in preserving the safety and soundness of the banking system through effective bank supervision. In the Bank's pursuit towards this objective, efforts will continue to be directed at strengthening our supervisory resources and processes. These efforts include a more intensive training in specialized areas of expertise, developing specialists in core banking operations, closer co-operation with other regulatory and supervisory agencies, and international bodies, as well as automation of work processes to achieve greater efficiency.

Banking Measures Introduced in 2003

Measures implemented in 2003 were aimed primarily at enhancing the efficiency, competitiveness and soundness of the financial sector. Initiatives were also taken to improve access of businesses, in particular the small and medium enterprises (SMEs), to financing. Institutional arrangements to strengthen consumer protection and to increase the awareness of consumers were also introduced.

Measures to Enhance Safety and Soundness

Guidelines on the Establishment of Board Committees, Minimum Qualifications and Training Requirements for Directors and Definition and Responsibilities of Independent Directors
The Guidelines were issued in May 2003 as part of Bank Negara Malaysia's continuous efforts to enhance the corporate governance standards among the licensed institutions. The Guidelines outlined the following:

- The requirement on the establishment of board committees comprising nominating committee, remuneration committee and risk management committee, and the terms of reference for each of the committee. The main objectives of the committees are as follows:
  Nominating Committee
  To provide formal and transparent procedures for the appointment of directors and chief executive officer and assessment of effectiveness of individual directors and board as a whole and performance of chief executive officer and key senior management officers.
  Remuneration Committee
  To provide formal and transparent procedures for developing remuneration policy for directors, chief executive officer and key senior management officers and ensuring that compensation is competitive and consistent with the licensed institution's culture, objectives and strategy.
  Risk Management Committee
  To oversee senior management's activities in managing credit, market, liquidity, operational, legal and other risks and to ensure that the risk management process is in place and functioning effectively.

- To ensure that only qualified individuals are appointed to serve on the boards of licensed institutions, the Guidelines set out the minimum qualifications and continuous learning requirements for the directors.

- Recognising the critical role played by independent directors in corporate governance, the Guidelines also set out the definition of independent directors and their expected roles and responsibilities.

Auditor's Independence and Appointment of External Auditors
A number of corporate scandals overseas, which involved irregularities in accounting practices, issues on auditors' independence and the role of auditors, have raised the concerns of various regulators

worldwide. In this regard, Bank Negara Malaysia issued Guidelines on the Appointment of External Auditor by licensed institutions which cover:

- The imposition of mandatory rotation of engagement partner after a period of 5 years. The engagement partner relinquishing the assignment would not be allowed to resume the role of audit engagement partner for the licensed institution until after a period of 5 years has lapsed;
- Provision of non-audit services by the same audit firm would require the prior approval of the respective licensed institution's Audit Committee; and
- The approval for the re-appointment of external auditors by Bank Negara Malaysia on an annual basis. There should not be any compromise on auditor's independence in the interim period before the 5 years rotation requirement takes effect.

Prudential Standards on Asset-Backed Securitisation

Although significant benefits could be derived from securitisation activities, participation of banking institutions in securitisation activities could potentially increase the overall risk profile of the institutions. In this regard, Bank Negara Malaysia has issued the Prudential Standards on Asset-Backed Securitisation Transactions which outline the general risk management framework as well as specific regulatory treatment relating to asset-backed securitisation transactions undertaken by banking institutions. The Prudential Standards were issued on 10 March 2003.

Credit Card Guidelines

The Guidelines were issued in March 2003 to all credit card issuers. The Guidelines were intended to promote active consumerism and consumers' understanding of credit card usage and protecting their interest as card users.

The Guidelines specify the minimum requirements on credit card operations that need to be complied with by all credit card issuers. Among others, the Guidelines set the following:

- Minimum eligibility criteria on credit card application.
- RM250 limit as the cardholders' liability for unauthorised transactions as a consequence of lost and stolen credit cards.
- Barring of credit card usage for unlawful activities.
- The requirement for credit card issuers to undertake prudent credit assessment and verification of credit worthiness of the card applicants using the Central Credit Reference Information System (CCRIS) and other sources of credit information.

Migration to Chip-based Automated Teller Machine (ATM)

In an effort to enhance the security of payment cards, banking institutions were required to migrate to chip-based payment card technology. The domestic banking institutions were required to fully upgrade their ATM infrastructure to be fully chip-enabled and convert their customers' ATM card to chip-based by end-September 2003, and the locally incorporated foreign banks, by March 2004.

Minimum Security Standards for Cheques

A concept paper on the proposed Guidelines on Minimum Security Standards for Cheques was issued to the banking industry in November 2003. The proposed Guidelines set the minimum standards for security features on cheques, cheque fraud detection facility, security management in cheque printing and consumer advice on best practices.

Accounting Treatment of Handling Fees for Hire Purchase Loans (HPL)

To standardise the accounting treatment of handling fees for HPL across the finance company industry, all handling fees for HPL approved and disbursed after 1 January 2004 by finance companies have to be expensed off in the period they are incurred. For HPL approved and disbursed before

1 January 2004 where the amortisation method had been adopted, finance companies were allowed to continue amortising the outstanding handling fees. Accordingly, in the event of prepayment or the HPL turning non-performing, the balance of the unamortised handling fees would be expensed off.

Recognition of Deferred Tax Assets (DTA) and Treatment of DTA for Risk Weighted Capital Ratio (RWCR) Purposes

In line with MASB 25 which was issued by the Malaysian Accounting Standards Board (MASB), licensed institutions had to account for all DTA in their financial reports. For RWCR purposes, however, such deferred tax income or expense is excluded from the computation of Tier-1 capital and calculation of risk-weighted assets.

Concept Paper on Incorporation of Market Risk into the RWCR Framework

In April 2003, the first concept paper (CP1) on the incorporation of market risk into the RWCR Framework was issued to the industry for comments. CP1 adopted and customised recommendations issued by the Basel Committee on Banking Supervision (BCBS) according to the environment of the local banking industry.

Following a series of discussions with the Market Risk Industry Working Group, the second concept paper (CP2) was issued in January 2004. CP2 incorporated significant changes to CP1, in particular on the following areas:

- Classification of securities in the trading and banking book;
- Holdings of securities resulting from debt/loan restructuring;
- Hedging policy;
- Underwriting positions; and
- Valuation of illiquid papers.

CP2 also aims to gauge the level of readiness for incorporation of the revised market risk framework and assess the quantitative impact of the latest proposal on the financial institutions.

Concept Paper on Consolidated Supervision of Financial Conglomerates

In line with Recommendation 3.26 of the Financial Sector Masterplan (FSMP), Bank Negara Malaysia has developed a framework for the Consolidated Supervision of Financial Conglomerates. This is to ensure that the financial health of financial groups may be adequately assessed and monitored by supervisors on a group-wide basis so as to minimise risks emanating from the financial group that could destabilise the financial system.

A concept paper was issued to the banking industry in December 2003. The proposed framework outlines the underlying regulatory principles of consolidated supervision. Specific recommendations were made in five areas, namely group structures, corporate governance, risk management, intra-group exposures, and reporting requirements.

Implementation of the Anti-Money Laundering Act 2001 (AMLA) Compliance Programme

To combat money laundering activities, banking institutions were required to put in place a comprehensive compliance programme to comply with AMLA. The compliance programme includes an effective transaction monitoring system that is implemented at all operations of banking institutions including the branches and subsidiaries. There should also be regular on-going employee training and regular independent audit.

Measures to Enhance Competition and Efficiency of the Banking Industry

Guidelines on New Product Approval Requirements

The Guidelines were issued in March 2003 as part of the measures to promote Bank Negara Malaysia's regulatory philosophy of "what is not prohibited is allowed" as stated in the FSMP. The main essence of the Guidelines is the replacement of the existing product pre-approval requirements with a simple new product notification and approval process that is expected to promote greater incentive for banking institutions to increase their investment in developing more innovative products. The requirements for greater product transparency and consumers to have access to product information are embodied in the Guidelines.

Investments Linked to Derivatives

Effective 12 May 2003, banking institutions were allowed to offer additional yield enhancing investment products linked to derivatives, other than investments linked to Ringgit denominated interest rate derivatives. Blanket approval was granted to all banking institutions to offer the following additional investment products linked to derivatives:

- Investment products linked to interest rate, commodity, equity and fixed income derivatives, denominated in both Ringgit and foreign currency; and
- Investment products linked to foreign currency derivatives denominated in foreign currency only.

Nevertheless, banking institutions are required to meet the general conditions when offering investment products linked to derivatives and comply with all exchange control rules. However, investment products linked to credit derivatives would still require specific approval from Bank Negara Malaysia.

Amendments to the Central Bank of Malaysia Act 1958 (CBA) and Banking and Financial Institutions Act 1989 (BAFIA)

Both the CBA and BAFIA were amended to incorporate provisions to support the efforts to develop the bond market and to enhance competitiveness and efficiency of the banking industry. The amendments came into force on 1 January 2004 for the CBA and 15 January 2004 for the BAFIA.

The CBA was amended, among others to empower Bank Negara Malaysia to carry out its functions in providing the infrastructure for the Ringgit bond market, including the power to establish and operate systems for the bond market and to make the necessary regulations for the operation of the systems.

The BAFIA was amended to provide for the establishment of a banking and finance company, an entity which will hold two licences, one for banking business and the other for finance company business.

Measures to Improve Access to Financing

Establishment of Bank Negara Malaysia SME Special Unit

As part of the initiatives to enhance access to financing to SMEs, Bank Negara Malaysia established the SME Special Unit in May 2003 to assist SMEs in the following areas:

- To provide information on the various sources of financing for SMEs;
- To facilitate loan application process for SMEs;
- To deal with problems faced by viable SMEs in accessing financing; and
- To provide advisory services on other SMEs financial requirements.

The role of the SME Special Unit will be expanded to include:

- Coordinating, monitoring and evaluating the financing needs of the SMEs;
- Formulating policies and strategies to enhance access to financing by SMEs;
- Establishing and maintaining database on SME financing;
- Enhancing SMEs awareness on various financing sources; and
- Formulating structured training programmes for SMEs.

Additional Allocation for Special Funds for SMEs

As part of efforts to ensure availability of adequate funds at reasonable cost to the SMEs, Bank Negara Malaysia increased the allocation, twice in 2003 for Fund for Small and Medium Industries 2 (FSMI2) and the New Entrepreneurs Fund 2 (NEF2) by RM1,350 million and RM650 million, respectively. Consequently, the total funds available for FSMI2 and NEF2 rose to RM2 billion and RM1.15 billion respectively.

Small Debt Resolution Mechanism

To facilitate the restructuring of non-performing loans (NPLs) of SMEs with on-going businesses and to assist in their financing requirements, Bank Negara Malaysia established a Small Debt Resolution Mechanism in November 2003.

Under the mechanism, an 11-member Small Debt Resolution Committee (SDRC) was established to undertake independent assessment on the viability of the businesses, and propose the loan restructuring and financing requirements of the affected businesses. The SME Special Unit at Bank Negara Malaysia serves as the Secretariat to the committee.

This mechanism is open to SMEs with on-going businesses which have aggregate NPLs of not more than RM3 million with the commercial banks, finance companies, Islamic banks, Bank Pembangunan dan Infrastruktur Malaysia Berhad, and Bank Industri & Teknologi Malaysia Berhad.

As the debt restructuring process may involve the provision of new financing to the businesses, Bank Negara Malaysia established the Rehabilitation Fund for Small Businesses with an allocation of RM800 million. In this regard, eligible businesses may obtain new financing up to RM1.5 million at a financing rate of 5% per annum for a maximum of 5 years.

With the introduction of this new mechanism, the existing restructuring and financing mechanisms under Tabung Pemulihan dan Pembangunan Usahawan, and Tabung Pemulihan Industri Kecil dan Sederhana were discontinued.

Access to Financing by Priority Sectors

As in previous years, Bank Negara Malaysia continued to place due emphasis on lending by the commercial banks and finance companies to the priority sectors, namely the Bumiputra community, SMEs and purchase of low and medium cost houses. Targets set were based on various factors taking into consideration the capacity of the respective institutions.

Establishment of a Special Relief Guarantee Facility for Severe Acute Respiratory Syndrome (SARS) Affected Businesses

As part of the Economic Package announced by the Government in May 2003 to assist businesses affected by the SARS outbreak, Bank Negara Malaysia established the Special Relief Guarantee Facility with an allocation of RM1 billion in the form of guarantee fund provided through the Credit Guarantee Corporation Malaysia Berhad (CGC).

The salient features of the Facility are as follows:

- The Facility is implemented through all commercial banks, Islamic banks, finance companies, Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad;
- The maximum loan amount allowable under the facility is RM2.5 million for a maximum tenure of 2 years;
- The financing rate is capped at 3.75% p.a for the first year and not more than the 3-month KLIBOR rate plus 1 percentage point for the subsequent year; and
- CGC will guarantee 80% of the loans taken from the implementing institutions.

Financial Relief Provided by Banking Institutions to Borrowers in SARS-affected Industries
In response to the SARS outbreak, banking institutions were also requested to formulate appropriate rescheduling or restructuring schemes to reduce the financial burden of borrowers whose businesses and cash-flows were affected by the SARS. The rescheduling/restructuring programme should be implemented on a pre-emptive manner.

To facilitate this measure, the requirement stipulated in the Guidelines on Classification of Non-Performing Loans and Provisions for Sub-Standard, Doubtful and Bad Debts that requires banking institutions to obtain specific approval from Bank Negara Malaysia to reschedule a performing loan account more than once within a 2-year period, was waived.

Measures Related to Consumerism

BankingInfo
To promote greater financial literacy among the public and enhance public understanding of the roles and functions of the different segments in the financial system, Bank Negara Malaysia launched the Consumer Education Programme (CEP), known as "BankingInfo" in January 2003.

In summary, BankingInfo aims to:

- Disseminate information on features of banking products and services, including the rights and responsibilities of consumers and financial institutions in a clear and simple manner;
- Promote public understanding on the role and functions of the different segments in the financial system;
- Alert consumers on illegal transactions and financial scams;
- Provide information on basic financial management and importance of savings and financial planning; and
- Provide consumers with information on how they can seek redress in the event that they have suffered monetary losses.

To date, 18 booklets have been introduced and are available at all branches of banking institutions. Information on BankingInfo is also available at the Internet website www.bankinginfo.com.my.

Formation of Financial Mediation Bureau (FMB)
In line with Recommendation 3.37 of the FSMP, a concept paper on the Formation of the Financial Mediation Bureau (FMB) with the objective of expanding the current role of both the Banking Mediation and Insurance Mediation Bureaus was issued in April 2003.

The members of FMB will comprise:

- Commercial banks, finance companies, merchant banks, and Islamic banks;
- Development financial institutions regulated under the Development Financial Institutions Act 2002;
- Payment systems operators and issuers of designated payment instrument under the Payment Systems Act 2003; and
- Insurance companies, Takaful operators and Malaysian Nasional Reinsurance Berhad.

The formation of the FMB is expected to facilitate the financial institutions in enhancing their customer service level and would cover a broad range of retail consumer complaints against all financial institutions regulated by Bank Negara Malaysia.

PERFORMANCE OF THE BANKING SYSTEM

Overview

The financial position of the banking system in 2003 was strong. The key financial indicators of the banking system remained favourable with no signs of vulnerabilities. The level of capitalisation was high, non-performing loans (NPLs) declined whilst profitability improved. Amidst ample liquidity and continued recovery in business and consumer sentiments, the banking institutions registered strong lending activities. The strong performance of the banking system was characterised by:

- High level of capitalisation attributable to higher profit and capital injections;
- Ample liquidity in the financial system throughout the year;
- Strong resumption in lending activities driven primarily by lending to the small and medium enterprises, and household sector;
- Higher profitability due to higher net interest income, lower provisioning and high recoveries;
- Narrowing of interest margins as competition continued to exert downward pressure on lending rates amidst a more stable return on deposits;
- Improvement in NPLs. There was a decline in new NPLs, whilst recoveries and reclassifications to performing accounts remained strong; and
- Exposure to market risks remained within prudential levels.

Profitability

Against the backdrop of improving economic conditions, gross operating profits of the banking system increased by 7% to RM11.8 billion in 2003, driven primarily by higher net interest income. Commercial banks and finance companies posted growth in gross operating profits of 7.7% and 9.7% respectively, while those of merchant banks declined by 18.5%, mainly due to lower net interest income and income generated from fee-based activities.

Total loan loss provisions of the banking system declined by 4% during the year, attributed mainly to higher recoveries which grew by 10.1% or RM384.8 million. The improved economic conditions and debt restructuring exercises undertaken over the years had strengthened the debt servicing capacity of borrowers, thus contributing to the higher recoveries. The decline in loan loss provisions, coupled with the higher gross operating profits, resulted in the preliminary unaudited pre-tax profits to increase by 10.2% to RM10.3 billion in 2003. Consequently, the return on equity of the banking system increased to 17.1%, whilst the return on assets was 1.4%.

Given the strong competition in the loan market and greater disintermediation from the capital market, interest income from loans and financing declined marginally by 1.1% in 2003. However, this was offset by higher interest income earned from debt securities held and lower interest-in-suspense. By type of institution, the commercial banks and finance companies recorded increases in net interest income of 6.4% and 5.9% respectively in 2003. The net interest income of merchant banks declined by 7.7%, a trend that has been prevalent for a number of years as merchant banks started to shift their business focus from traditional fund-based activities to fee-based activities.

Although fee-based income grew strongly by 9.9%, as a percentage of total assets, it remained stable at 0.5%. Fee-based income from loan and financing activities rose by 11.8%, in tandem with the growth in lending activities. Nevertheless, fee-based income

Table 4.6
Banking System[1]: Income and Expenditure

	For the calendar year			
	2002	2003*p*	Annual change	
	RM million			%
Interest income net of interest-in-suspense	35,481	37,420	1,940	5.5
(Interest-in-suspense)	*5,578*	*4,752*	*-826*	*-14.8*
Less: Interest expense	17,763	18,673	910	5.1
Net interest income	17,718	18,748	1,030	5.8
Add: Fee-based income	3,314	3,642	328	9.9
Less: Staff cost	4,698	4,981	284	6.0
Overheads	5,315	5,614	299	5.6
Gross operating profit	11,019	11,795	776	7.0
Less: Loan loss provisions	5,497	5,276	-220	-4.0
Gross operating profit after provisions	5,523	6,518	996	18.0
Add: Other income	3,805	3,759	-46	-1.2
Pre-tax profit	9,328	10,278	950	10.2
Of which:				
Commercial banks	6,357	6,908	550	8.7
Finance companies	2,379	2,678	298	12.5
Merchant banks	591	692	101	17.0
Return on assets (%)	1.3	1.4		
Return on equity (%)	16.3	17.1		
Cost to income[2] (%)	47.6	47.3		

[1] Excludes Islamic banks.
[2] Only taking into account staff cost, overheads, net interest income and fee-based income.
p Preliminary.
Note: Total may not add-up due to rounding.

from loans and financing only accounted for 0.2% of total outstanding loans, far lower than the average level recorded by foreign banks of around 0.5%. In the case of merchant banks, their total fee-based income declined marginally by 3.1% to RM327.6 million. This was mainly due to lower income from corporate advisory and underwriting activities, which declined by 12.4% and 9.6% respectively, partly due to lower number of debt restructuring exercises undertaken in 2003.

The rationalisation efforts undertaken consequent to the merger programme to improve operational efficiency have begun to yield positive results, with gross operating profits per employee improving from RM125,500 in 2002 to RM134,800 in 2003. Marketing expenses, however, increased by 7.4% as banking institutions intensified efforts to enhance market share. Staff cost per employee also increased marginally from RM53,500 in 2002 to RM56,900 in 2003 given the better remuneration packages offered by banking institutions to retain and reward their staff.

Interest Margin

Reflecting the banking system's role as the main provider of funds to the economy, interest income from loans and financing activities constituted 66% of gross operating income of the banking system in 2003 (2002: 69%).

Gross interest margin narrowed further in 2003 as intense competition surrounding the bank lending activities continued to exert downward pressure on lending rates amidst a more stable return on deposits. The gross interest margin, defined as difference between the average lending rate (ALR) banking institutions charged on loans and advances and the rate banking institutions paid on deposits and borrowed funds (average cost of funds or ACF), declined by 21 basis points to 3.69 percentage points for the commercial banks (2002: 3.90 percentage points). Similarly, the gross interest margins for the finance companies narrowed to 5.70 percentage points from 6.08 percentage points at end-2002.

The narrowing of the gross interest margin was due to the larger decline in ALR, offsetting the marginal decline in the ACF. At end-2003, the ALR of the commercial banks stood at 6.11% per annum, whilst that of the finance companies was 9.11% per annum (2002: 6.51% per annum and 9.75% per annum, respectively). The decline in ALR reflected the 50 basis points reduction in the Bank Negara

Table 4.7
Weighted Average Lending Rates for New Loans Approved

	Commercial banks		Finance companies	
	Average for the year (% per annum)			
	2002	2003	2002	2003
Business loans	6.16	5.97	7.46	7.30
of which: SMEs	*6.55*	*6.40*	*7.40*	*6.99*
Household loans[1]	4.78	4.81	7.02	6.53
of which:				
Purchase of residential properties	*4.42*	*4.46*	*4.49*	*4.00*
Purchase of passenger cars	*n.a.*	*n.a*	*7.16*	*6.70*

[1] Excluding credit card loans.
n.a. Not applicable.

Malaysia intervention rate in May 2003 that led to a decline in the base lending rate of 40 basis points. Notwithstanding the 50 basis points reduction in the policy rate, the ACF declined by a lower margin (20 and 26 basis points for commercial banks and finance companies, respectively) as bulk of the commercial banks' and finance companies' funds comprises mainly fixed deposits, the interest rates of which declined only marginally.

The lending rates (excluding credit cards) on new loans approved by the commercial banks averaged 5.59% per annum in 2003. Meanwhile, the average lending rates on new loans approved by the finance companies declined by 44 basis points to an average of 6.64% per annum. During the year, the average lending rates on newly approved business and SME loans by the commercial banks declined to an average of 5.97% per annum and 6.40% per annum, respectively (2002: 6.16% and 6.55% per annum, respectively).

The ALR, however, overstates the interest income earned by the banking institutions as it recognises the accrued but unearned interest on non-performing loans (NPLs) (that is interest-in-suspense or IIS) even though the banking institutions continue to incur costs on funds that are borrowed, mainly deposits, to finance these loans. In addition, the banking institutions also incur administrative costs in managing and monitoring these loans. Net interest margin (gross interest margin after adjusting for IIS and administrative costs) improved marginally for the commercial banks to 1.31 percentage points (2002: 1.25 percentage points) while the net interest margin for the finance companies remained at 3.14 percentage points. The improvement was due to lower IIS and administrative costs. In tandem with declining NPLs, the amount of IIS declined from

1.16% to 0.93% of loans for the commercial banks, and from 1.56% to 1.28% of loans for the finance companies. In addition, both commercial banks and finance companies recorded lower overheads and staff cost of 1.46% of interest-related assets for the commercial banks and 1.28% for the finance companies in 2003 (2002:1.49% and 1.38% of interest-related assets, respectively).

With growing competition in the loan market amongst the banking institutions as well as with the non-traditional players, the challenge is for the banking institutions to further improve operational efficiencies and risk management capabilities. This is important to sustain their revenue performance and hence their returns.

Lending Activity
Lending indicators demonstrated increasing trends during the year despite the outbreak of the as well

Table 4.8
Banking System[1]: Financing Activities

	For the year		
	2002	2003	Annual growth (%)
	RM billion		
Loan approvals	136.1	151.4	11.2
Loan disbursements	404.3	433.6	7.2
Loan repayments	396.1	422.8	6.8
	As at end		
	2002	2003	Annual growth (%)
	RM billion		
Outstanding loans	443.0	464.2	4.8
Total banking system financing[2]	468.9	496.5	5.9
Total financing for the economy[3]	546.1	600.2	9.7

[1] Excludes Islamic banks.
[2] Outstanding banking system loans plus private debt securities held by the banking system.
[3] Outstanding banking system loans plus outstanding private debt securities.

Strengthened financial position of banking system enabled increased financing for private consumption and business activities.

as the uncertainty regarding the structure of excise duty on cars. The issuance of new private debt securities during the year also increased. The diversification in sources of financing, especially for the corporate sector, has resulted in a greater proportion of lending by the banking system being channelled to the retail customers and small and medium enterprises, thus supporting the growth in private consumption and business activity. The pre-emptive actions by the Government contributed to mitigate the effects of SARS on the economy. As consumer and business sentiments recovered, business activities regained growth momentum whilst consumer spending increased, thus stimulating demand for additional financing.

New loan approvals by the banking system expanded strongly backed by sustained demand. In 2003, the banking system received loan applications totalling RM220 billion. At the close of the year, more than 2.2 million applications amounting to RM151.4 billion were approved by the banking system, 11.2% higher than the amount approved in 2002. Averaging at RM12.6 billion a month, this is the highest monthly average recorded for loan approvals since the Asian financial crisis, exceeding the level recorded in 2002. Loan applications rejected amounted to RM26 billion, or 11.8% of applications received. Loan disbursements expanded during the year at an annual rate of 7.2% to amount to RM433.6 billion. With disbursements surpassing repayments, outstanding loans expanded by 4.8% to RM464.2 billion as at end-2003. The amount of undrawn loans rose by 3.6% to RM134.3 billion.

Lending to Households
Outstanding loans for the household sector expanded by 12.5% to RM226.1 billion to account for 48.7% of outstanding loan portfolio of the banking system. As in the previous year, the lending activities were mainly in mortgage financing, purchase of passenger cars and credit card loans. Demand for new financing remained strong, due mainly to the low interest rates, stable employment conditions and competition among car manufacturers. This was further boosted with the various incentives provided by the Government to house purchasers, including tax relief on interest payments for first-time house owners who purchased properties priced between RM100,000 to RM180,000 from developers, a RM600 cash payment to borrowers in the lower income category and the stamp duty exemption on loan

documents for purchases of houses costing not more than RM180,000. In meeting the demand, banking institutions offered attractive financial packages and adopted aggressive promotion strategies.

Higher applications were received during the year totalling RM95.8 billion (+19.4%), the bulk of which were applications to finance the purchase of residential properties and passenger vehicles as well as credit card applications. New approvals expanded by 7.4% to amount to RM71.4 billion at interest rates averaging between 4.32% and 5.09% per annum for the commercial banks and between 6.29% and 6.82% per annum for the finance companies. Approvals for hire purchase financing and credit cards recorded strong increases of 15.2% and 14.1%, respectively. Approvals for house purchases, however, rose only by 2.4% to RM29.7 billion, mainly for the high-end properties, which saw a number of new launches during the year. Similar to the increasing trend in approvals, there was higher disbursements to the household sector. Totalling RM113 billion, this was an increase of 8.6% over the amount disbursed in the preceding year. A notable trend was the high utilisation of credit card lines during the year as card-based payments continued to gain greater acceptance by consumers and retailers. Utilisation of credit card lines increased by 19.6% to RM30.4 billion during the year. Despite the high utilisation, outstanding credit card loans remained a small proportion of 2.6% of outstanding loans.

Lending to Businesses

Lending to businesses remained encouraging throughout the year, supporting the stronger economic activities. The various forms of relief introduced by the Government to minimise the effects of SARS had contributed favourably towards sustaining demand for financing by the private sector. To complement these measures, the banking institutions stepped in to reschedule/restructure loans amounting to RM2.5 billion as well as extended new facilities for the affected businesses. The establishment of the RM1 billion Special Relief Guarantee Facility in May 2003 also enabled businesses affected by the SARS outbreak to access new financing at concessionary rates. At end-2003, a total of RM40.3 million in working capital lines were extended to 76 borrowers with guarantees totalling RM32.2 million *[Please refer to the Box on Banking Measures Introduced in 2003 for details]*.

For the year as a whole, approvals for credit facilities to businesses increased by 13.5% to RM76.5 billion, despite a decline of 5.1% in loan applications. Loan approvals to businesses were broad-based, with approvals to businesses in the manufacturing (20.8%), construction (14.5%), and wholesale and retail (13.3%) sectors accounting for the bulk of the new credit lines. Notably, approvals to the wholesale and retail businesses rose by 28.6% to RM10.2 billion, whilst new facilities granted to hotels and restaurants grew by 83.4% demonstrating the continued support of the banking sector for these businesses amidst the SARS outbreak. Lending rates on new business loans remained favourable averaging between 5.51% and 6.42% per annum for the commercial banks and between 6.94% and 7.64% per annum for the finance companies.

Stronger economic activity led to higher disbursements to businesses. Disbursements to the business sectors of RM296.8 billion (+7.6%) accounted for 68.5% of total loans disbursed by the banking system. Most of the funds were channelled to the manufacturing sector (36.3%), and wholesale and retail trade sectors (22.9%). Disbursements to these sectors rose by 4.9% and 9.2%, respectively. While funds utilised by the construction sector were generally lower during the year, funds utilised by the general and civil engineering contractors expanded by 18.1% to RM9.4 billion. At end-2003, outstanding loans to the business sectors declined slightly by 2.2% on account of loan conversions into debt securities and large repayments (+8.4%). Meanwhile, unutilised business lines declined by 3.6% at end-2003.

Lending to Small and Medium Enterprises (SMEs)

The banking system continued to support the SMEs, channelling more funds for their activities as evidenced by the level of new financing extended during the year. This commitment was further reinforced by the availability of dedicated SME units in almost all the commercial banks. For some institutions, the SME unit undertakes activities beyond the provision of financing, to include developmental and support services such as identifying and structuring financial products and services to meet the requirements of the SMEs, conducting training and workshops, and providing other advisory services such as financial and cash management.

Disbursements were also exceptionally strong, constituting 29% (RM86 billion) of total disbursements to the business sectors. This amount represented an increase of 75.5% over the amount disbursed in the preceding year. Meanwhile, outstanding loans to SMEs expanded by 8.8% to RM80.2 billion, to account for 38.4% of outstanding business loans at end-2003. During the year, nearly 75,000 SMEs obtained new credit facilities totalling RM25.5 billion at favourable lending rates which averaged between 5.96% and 6.87% per annum for the commercial banks, and between 6.57% and 7.38% per annum for the finance companies. This accounted for a third of total approvals to the business sectors.

In 2003, the allocations for two special funds were increased twice to meet the increased demand. The allocation for the Fund for Small and Medium Industries 2 expanded by RM1.35 billion to RM2 billion and the New Entrepreneurs Fund 2 by RM0.65 billion to RM1.15 billion. On aggregate, Bank Negara Malaysia has allocated a total of RM5.6 billion for five[1] special funds for the SMEs in the different segments. Of this amount, a total of RM5.2 billion has been approved as at end-2003.

In tandem with efforts to improve the accessibility of SMEs to financing, the SME Special Unit was established in Bank Negara Malaysia in May 2003. The Unit began its operations focusing on disseminating information on the various sources of financing available to SMEs; facilitating loan application process by SMEs; assisting viable SMEs facing difficulties in securing financing; and providing advisory services on their other financial requirements. In addition, the Unit looks into loan related problems and complaints from SMEs. As at end-2003, the Unit has received 1,789 requests for assistance from the SMEs, of which 82% were enquiries on information and sources of financing and on the details relating to the special funds. To coordinate and further develop access to financing by the SME sector, the scope of the Unit will be expanded to be the one-stop centre responsible for all initiatives on SME financing and financial services *[Please refer to the Box on Banking Measures Introduced in 2003 for details on the expanded role of the Unit].*

To resolve the NPLs of SMEs, the Small Debt Resolution Committee (SDRC) was established to facilitate the restructuring of NPLs of SMEs with viable on-going businesses. Similar to the Corporate Debt Restructuring Committee, the SDRC undertakes an independent assessment on loan restructuring requests by SMEs. Complementing the independent assessment by the SDRC was the setting up of the Rehabilitation Fund for Small Businesses with an allocation of RM800 million *[Please refer to the Box on Banking Measures Introduced in 2003 for details].*

Loan Profile

The structure of the banking system loan portfolio has undergone significant changes since the Asian crisis, in terms of greater proportion of smaller-sized loans and more diversified customer base as a result of the greater focus on retail and SME sectors. This has improved the risk distribution within the banking system in particular, and the financial sector in general. The proportion of outstanding loans below RM100,000 constituted 30.9% of total outstanding loans as at end-2003. Outstanding loans of between RM100,000 to RM500,000 grew by 14% to account for 24.4% of total loans at end-2003. On aggregate, outstanding loans of below RM1 million now accounted for 60% of total banking system loans, as compared to 48% during the pre-crisis period of 1996.

Banking Institutions and the Bond Market

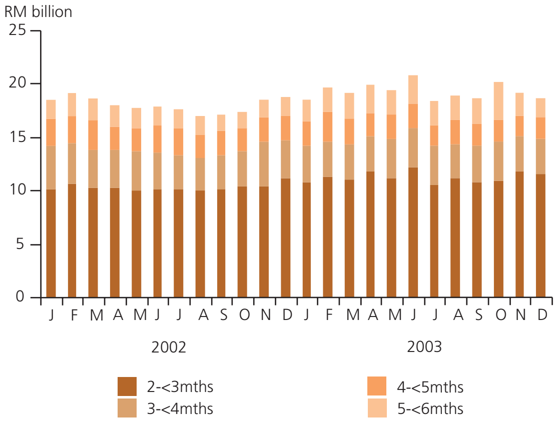
Net proceeds from new PDS issued by corporations rose substantially to RM45.8 billion, compared with RM26.7 billion in the previous year. More than 60% of the new issues took place in the first half of the year as the higher bond yields in the second half of 2003 resulted in many corporations deferring their proposed issuance. At end-2003, outstanding PDS recorded a strong growth of 30.8% to RM136 billion. Of this amount, 23.7% were held by the banking system. On aggregate, outstanding banking system loans and outstanding PDS grew at 9.7% to RM600.2 billion as at end-2003.

Asset Quality

NPLs declined further owing to the favourable economic conditions. The year saw a decline in new NPLs, whilst recoveries and reclassifications to performing accounts were strong. The outbreak of the SARS impacted the cash flows of some businesses, particularly those in the tourism-related industries. The prompt actions from the Government and the banking institutions, however, contributed towards averting a protracted negative impact on the domestic economy.

[1] Fund for Small and Medium Industries 2 (RM2 billion), New Entrepreneurs Fund 2 (RM1.15 billion), Fund for Food (RM1.3 billion), Bumiputera Enterpreneurs Project Fund (RM0.3 billion) and Rehabilitation Fund for Small Businesses (RM0.8 billion)

Graph 4.6
Banking System¹: Ageing Profile of Loans in Arrears 2-<6 months



¹ Excludes Islamic banks

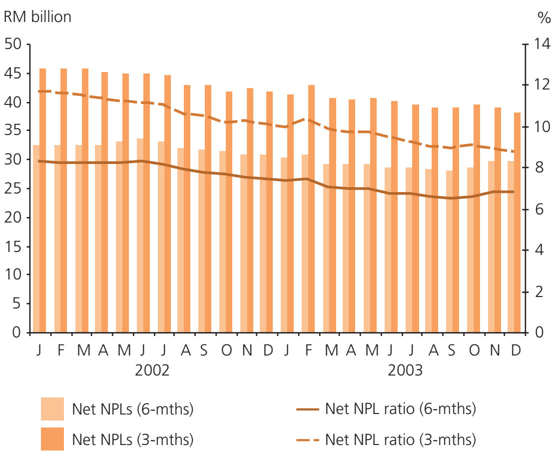
Enhanced credit assessment infrastructure and practices ensure banking system exposure to households remain within prudential level.

Net NPLs based on the 3-month classification declined by 8.2% to RM38.3 billion as at end-2003. Consequently, the net NPL ratio improved by 1.4 percentage points to 8.7%. On a 6-month classification, the decline in net NPLs was more gradual at 3.1% to RM29.9 billion to account for 6.8% of total net loans at end-2003, compared with 7.4% as at end-2002. The loan loss coverage ratio also strengthened to 53.9% on the 3-month basis and 59.1% on the 6-month basis. Including the value of collateral, the coverage ratio strengthened further to 157.9% on the 3-month basis and 163.8% on the 6-month basis.

Improvements in the level of NPLs were due to lower incidence of new NPLs, write-offs of bad loans coupled with strong recoveries and reclassifications of NPLs to performing loans. Reflecting the favourable economic conditions, the amount of new NPLs for the year fell by 3.2% to RM24.5 billion. Recoveries and reclassifications remained strong at RM22.6 billion in 2003 despite a slight decrease of 3.5%. This was due to high recoveries and reclassifications of RM23.5 billion recorded in the preceding year. Lower provisioning requirements following the declining NPLs, had enabled banking institutions to write-off RM8 billion of loans in 2003.

During the year, two restructuring schemes under the Corporate Debt Restructuring Committee (CDRC) involving debts totalling RM9.3 billion were implemented. At end-2003, 14 cases with debts totalling RM7.3 billion have yet to be implemented.

Graph 4.5
Banking System¹: Net Non-performing Loans



¹ Excludes Islamic banks

Total loans in arrears excluding NPLs, remained stable throughout the year, except for the temporary increase in June, possibly due to the effects of SARS. As such, loans in arrears remained almost unchanged at RM78.1 billion at end-2003. Of this amount, 23.9% were loans in arrears of between 2 and less than 6 months. During the year, loans in this category recorded a small decline of RM0.1 billion or 0.6% to RM18.7 billion to account for 4% of gross loans at end-2003.

Unlike the banking crisis in the late 1980s where the pace of decline in the NPL ratio was more rapid, recovery in the NPLs since the Asian crisis has been more gradual. This was partly due to the more stringent reclassification rules that were put in place to prohibit evergreening of loans. In addition, growth in the outstanding loans post-Asian crisis has been much slower relative to the periods following the mid-1980s economic recession primarily due to the deepening of the bond market.

NPLs for the business sectors declined substantially to account for 16.2% of total business loans as almost all sectors recorded improvements. Sectors that recorded increase in NPLs include the retail trade, restaurants and hotels (+15.6%), and electricity, gas

Table 4.9
Banking System[1]: Non-performing Loans and Loan Loss Provisions

	As at end			
	2002		2003	
	Classification			
	3-month	6-month	3-month	6-month
	RM million			
Banking system[1]				
Non-performing loans	69,760.4	57,488.3	63,566.7	53,428.0
General provisions	8,520.1	7,599.8	9,050.7	8,000.3
Interest-in-suspense	9,855.4	9,502.9	9,226.2	8,859.3
Specific provisions	18,149.0	17,150.7	16,014.9	14,696.9
Net NPL ratio (%)[2]	10.1	7.4	8.7	6.8
Total provisions/NPL (%)	52.4	59.6	53.9	59.1
Commercial banks[1]				
Non-performing loans	47,957.3	40,012.4	44,649.2	37,669.8
General provisions	6,423.7	5,503.0	6,895.7	5,844.6
Interest-in-suspense	6,686.2	6,483.0	6,237.1	6,071.0
Specific provisions	12,970.8	12,392.2	11,737.8	10,845.2
Net NPL ratio (%)[2]	9.1	6.8	8.1	6.3
Total provisions/NPL (%)	54.4	60.9	55.7	60.4
Finance companies				
Non-performing loans	17,345.3	13,487.0	15,713.0	12,939.5
General provisions	1,819.8	1,820.4	1,909.3	1,909.8
Interest-in-suspense	2,621.8	2,485.7	2,536.4	2,346.0
Specific provisions	4,209.6	3,804.2	3,675.4	3,264.6
Net NPL ratio (%)[2]	11.2	7.6	9.4	7.2
Total provisions/NPL (%)	49.9	60.1	51.7	58.1
Merchant banks				
Non-performing loans	4,457.8	3,989.0	3,204.5	2,818.6
General provisions	276.6	276.5	245.7	245.9
Interest-in-suspense	547.4	534.1	452.6	442.3
Specific provisions	968.7	954.4	601.8	587.1
Net NPL ratio (%)[2]	24.6	20.8	21.5	17.9
Total provisions/NPL (%)	40.2	44.2	40.6	45.2

[1] Excludes Islamic banks.
[2] Net NPL ratio = {(NPL less IIS less SP) / (Gross loans less IIS less SP)} x 100%.
Note: Total may not add-up due to rounding.

and water (+240%). The higher NPLs for these sectors was due to the effects of SARS and delay in the implementation of a borrower's restructuring scheme respectively. These increases did not pose any systemic risks as they accounted for only 5% of banking system NPLs. Gross NPL ratio for both the manufacturing and construction sectors declined significantly to 16.5% and 27.8% respectively following the implementation of the debt restructuring scheme of a conglomerate. Nonetheless, outstanding NPLs remained concentrated in these sectors, constituting 45.5% of total business NPLs.

NPLs of SMEs also declined by RM0.6 billion to RM11.7 billion as at end-2003 to account for 14.6% of total loans to SMEs (Jan 2003: 16.4%). Significant improvement was registered by the construction sector which experienced a substantial decline of 55.2% in NPLs since end-January 2003. About 42.9% of the NPLs of SMEs were loans in the manufacturing and construction sectors.

While household sector NPLs increased by RM0.9 billion, the magnitude remained small. This largely reflected the higher NPLs for mortgage loans (+15.6%) and credit cards (+32.1%). However, the gross NPL ratios for household sector and mortgage loans improved to 7.9% and 8.6% respectively. Meanwhile, the gross NPL ratio for credit cards remained small despite the increase to 4.7%. Higher NPLs for mortgage loans and credit cards were however moderated by lower NPLs for the purchase of transport vehicles which declined by 10.3%. In the current environment, exposure to the household sector still remains within prudential levels. In addition, banking institutions now have real time access to comprehensive credit information of borrowers, including retail borrowers, and therefore the risk of over-indebtedness of the retail customers is mitigated.

With prospect of stronger economic growth in 2004, the declining trend in NPLs is expected to continue. As the growth in outstanding loans is envisaged to

Table 4.10
Banking System[1]: Non-performing Loans by Sector

	As at end				
	NPL by sector		Change	As percentage of total loans to the sector	
	2002	2003	2002/2003	2002	2003
	RM million			%	
Business enterprises	**44,598.0**	**38,806.3**	**-13.0**	**18.4**	**16.2**
of which SME loans	***n.a.***	***11,692.9***	***n.a.***	***n.a.***	***14.6***
Households	**16,053.4**	**16,907.3**	**5.3**	**8.4**	**7.9**
Others	**1,628.6**	**1,181.2**	**-27.5**	**16.8**	**11.1**
Total	***62,279.9***	***56,894.8***	***-8.6***		
Agriculture, hunting, forestry and fishing	932.9	749.3	-19.7	8.2	7.3
Mining and quarrying	158.9	143.1	-9.9	16.1	13.2
Manufacturing	12,509.0	9,817.4	-21.5	21.0	16.5
Electricity, gas and water supply	422.5	1,440.7	241.0	6.6	28.7
Wholesale and retail trade, restaurants and hotels	4,316.7	4,577.6	6.0	11.8	11.8
Wholesale trade	*1,851.8*	*1,728.8*	*-6.6*	*9.0*	*8.0*
Retail trade	*1,202.5*	*1,407.0*	*17.0*	*10.4*	*11.7*
Restaurants and hotels	*1,262.4*	*1,441.8*	*14.2*	*27.5*	*28.9*
Broad property sector	26,817.5	25,802.1	-3.8	15.8	14.1
Construction	*9,404.6*	*7,831.4*	*-16.7*	*30.5*	*27.8*
Purchase of residential property	*8,484.1*	*9,808.3*	*15.6*	*8.7*	*8.6*
Purchase of non-residential property	*4,801.3*	*4,618.0*	*-3.8*	*17.9*	*16.5*
Real estate	*4,127.6*	*3,544.5*	*-14.1*	*29.9*	*25.7*
Transport, storage and communication	1,406.5	1,139.2	-19.0	14.6	10.8
Finance, insurance and business services	3,105.3	2,328.1	-25.0	10.5	8.0
Consumption credit	2,359.4	2,497.0	5.8	9.5	9.2
Personal use	*1,867.6*	*1,879.0*	*0.6*	*13.4*	*12.9*
Credit cards	*434.2*	*573.8*	*32.1*	*4.1*	*4.7*
Purchase of consumer durable goods	*57.6*	*44.2*	*-23.2*	*15.9*	*13.3*
Purchase of transport vehicles[2]	3,023.5	2,713.3	-10.3	5.2	4.2
Purchase of securities	4,372.8	3,777.5	-13.6	20.4	19.2
Community, social and personal services	1,226.3	728.3	-40.6	21.6	14.8

[1] Excludes Islamic banks.
[2] Includes commercial vehicles.
n.a. Not available.
Note: Total may not add-up due to rounding.

remain steady and as bulk of the large problem loans have already been addressed, the magnitude of the decline in NPL ratio will depend on the strategies adopted by banking institutions. This is with respect to the writing-off of legacy NPLs, in particular, where recovery prospects are limited and with respect to the recovery efforts by the special loan rehabilitation units of banking institutions. While risk management practices have improved, the capacity of the banking institutions to effectively manage risks, the changes in the structure of loan portfolio and the nature of risks as a result of greater focus on retail and SME loans, as well as the emergence of new growth areas, would however, necessitate increased resources to monitor the performance of the smaller-sized loan accounts. Thus, a more robust and sound risk management framework would be critical to ensure that the risk management standards are able to effectively manage these risks at all times and under all economic conditions.

Liquidity Management

Liquidity in the banking system remained ample throughout 2003, mainly due to improved export performance and continued inflow of foreign direct investments. Bank Negara Malaysia conducted liquidity operations to absorb the excess funds through direct borrowings in the interbank market and issuance of Bank Negara papers. Total funds absorbed from the banking system rose

Graph 4.7
Liquidity in the Banking System in 2003

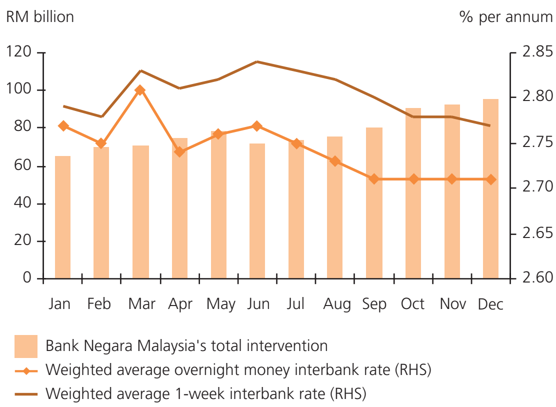


Table 4.11
Banking System[1]: Liquidity Projection as at 31 December 2003

	Cumulative liquidity surplus (RM billion)		Buffer as % of total deposits	
	1 wk.	1 mth.	1 wk.	1 mth.
Commercial banks	44.4	77.4	12.1	21.0
Finance companies	8.6	12.1	10.4	14.5
Merchant banks	6.7	6.0	35.5	31.5
Banking system[1]	**59.7**	**95.5**	**11.4**	**18.2**

[1] Excludes Islamic banks.

steadily during the course of the first nine months of 2003, but picked up significantly towards the last quarter of the year. As at end-2003, the total outstanding interbank borrowings by Bank Negara Malaysia and issuance of Bank Negara Bills and Negotiable Notes amounted to RM95.4 billion as compared to RM64.7 billion as at end-2002. As a result of the liquidity operations conducted by Bank Negara Malaysia, interest rates remained stable throughout 2003, with the weighted average overnight interbank rate ranging from 2.71% to 2.81% per annum and weighted average one week interbank rate ranging from 2.77% to 2.84% per annum.

In terms of liquidity management by the banking institutions, the banking system as a whole projected sufficient liquidity to meet any unexpected withdrawals for a period up to one month. As at end-2003, the cumulative liquidity surplus in banking system (excluding the two Islamic banks) was projected at RM59.7 billion to meet demands up to one week and RM95.5 billion for demands up to one month. Commercial banks, finance companies and merchant banks projected large surpluses in the 1-month bucket amounting to 21%, 15% and 32% of their total deposit base respectively.

Interest Rate Risk

A significant portion of the banking system's assets and liabilities is interest rate sensitive. To assess the banking system's exposure to interest rate risk, the duration-weighted net position (DWP) approach was used to estimate the potential impact on economic value for a 100 basis point shift in interest rates. The DWP approach generates a larger potential loss as it attempts to evaluate on a present value basis all current and future cash flow earnings of banking institutions' on- and off-balance sheet items across each item's entire life. In 2003, the banking system's DWP increased by 9.1% to RM4.6 billion. The increase, however, had minimal impact on the banking system's strong capital position as shown in the table.

For the banking system as a whole, interest rate risk was concentrated in the more than five years to maturity bucket, accounting for more than RM3.1 billion or 68% of total DWP as at end-2003. However, there was a shift in the interest rate risk concentration to the shorter term maturity spectrum in 2003, particularly in the more than one to five years maturity bucket. There was a significant increase of RM13.6 billion or 23% in fixed-rate loans with remaining maturities of one to five years, while fixed-rate loans with remaining maturities of more than five years rose moderately by RM3 billion or 7.2%.

For the commercial banks, the marginal increase of their DWP of 3.6% to RM2.2 billion as at end-2003 resulted from a higher level of fixed-rate loans in the more than three years remaining maturity bucket, which rose by 18.3% in 2003. The higher level of fixed-rate loans extended by the commercial banks comprised primarily Islamic housing loans. Holdings of fixed-rate securities with remaining maturities greater than two years had also increased by 23% to RM28.9 billion as at end-2003. Some of these exposures were offset by increased long-term funding strategies particularly through the issuance of long-term notes and the sale of loan assets to Cagamas.

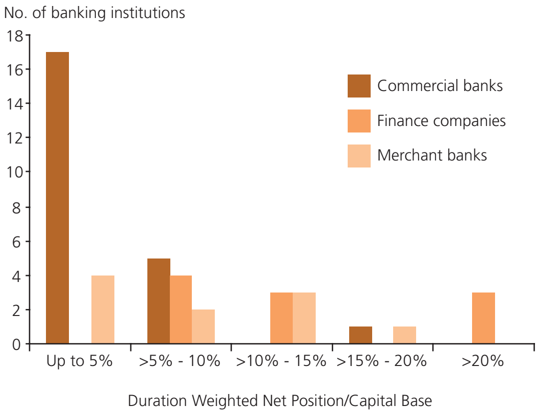
The finance companies' higher DWP of RM200 million in 2003, was mainly attributed to hire purchase loans. These exposures were partially offset by long-term fixed-rate funding sourced primarily from the sale of loan assets to Cagamas. The interest

Table 4.12
Banking System[1]: Impact of 1% Rise in Interest Rate on Capital Strength

	Duration-weighted net position					
	RM million		As a percentage of Capital base (%)		Impact on Risk Weighted Capital Ratio (percentage point)	
	As at end					
	2002	2003	2002	2003	2002	2003
Commercial banks	-2,117	-2,194	-4.6	-4.2	-0.9	-0.9
Finance companies	-1,710	-1,911	-16.1	-16.7	-2.2	-2.2
Merchant banks	-392	-499	-8.9	-11.1	-3.2	-3.7
Banking system[1]	-4,219	-4,604	-6.9	-6.8	-1.3	-1.4

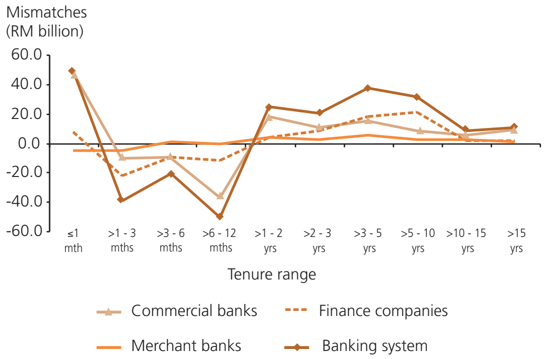
[1] Excludes Islamic banks.
Note: Total may not add-up due to rounding.

Graph 4.8
Banking System[1]: Distribution of Duration-Weighted Net Position as a Percentage of Capital Base as at 31 December 2003



[1] Excludes Islamic banks

Graph 4.9
Banking System[1]: Net Interest Rate Position Mismatches as at 31 December 2003



[1] Excludes Islamic banks

rate exposure arising from fixed-rate hire purchase loans of the finance companies can be further mitigated by greater utilisation of Cagamas facilities. Mergers between commercial banks and finance companies would also allow such exposures to be better managed. Simulating the exposures of the commercial banks and finance companies on the basis of their impending rationalisation, the impact on risk-weighted capital ratio (RWCR) was reduced to 1.4 percentage points compared with 2.2 percentage points if the finance companies operated on a stand alone basis.

Within the banking system, the merchant banks registered the highest percentage increase in DWP of 27% in 2003. This was due to the structural transformation of merchant banking business towards investment banking activities from the traditional loan-based institutions. Hence, as the merchant banking industry runs down its loan books, the significant increase in its holding of debt securities with remaining maturities of above one year contributed to the increase in DWP. The merchant banks' holding of the more than one year debt securities rose by 25% or RM2.5 billion to RM12.2 billion as at end-2003. Almost half of the increase was concentrated in the more than five years maturity bucket. Although long-term funding positions to match these exposures remained at RM3.8 billion, the relatively liquid nature of these exposures would allow the merchant banks to adjust the profile of their interest rate exposure accordingly.

In line with the Basel Committee on Banking Supervision (BCBS)'s recommendation, banking institutions will be required to incorporate their market risk into the RWCR framework using the "Standardised" approach, which include interest rate and equity risks for trading book positions, and foreign exchange rate risk for the entire banking institution's position. Based on the impact study of the proposed framework conducted on positions as at end-2003, the potential loss from exposures to

Table 4.13
Banking System[1]: Impact of Market Risk Capital Framework on Capital Strength as at 31 December 2003

	RM million				Impact on Risk Weighted Capital Ratio (percentage point)	Total market risk/Capital base (%)
	Total market risk	of which: Interest rate position risk	Equities position risk	Foreign exchange risk		
Commercial banks	1,434	972	62	377	-0.3	2.8
Finance companies	71	35	36	n.a.	-0.1	0.6
Merchant banks	828	644	123	14	-2.3	18.4
Banking system[1]	2,333	1,644	221	392	-0.3	3.4

[1] Excludes Islamic banks.
n.a. Not applicable.
Note: Total may not add up due to rounding.

market risk amounted to RM2.3 billion or 3.4% of capital base, while the impact on the RWCR of the banking system as a whole was marginal.

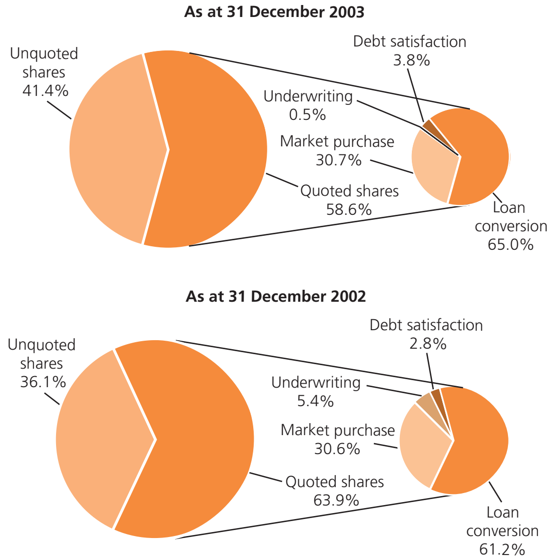
Banking institutions' interest rate risk in their trading books accounted for over 70.8% or RM1.7 billion of total market risk, of which 58.9% and 39% were attributed to the commercial banks' and merchant banks' trading activities respectively. Equities and foreign exchange risks of banking institutions accounted for approximately 26.3% of total market risk.

Equity Risk

Exposure of the banking system to equity risk remained insignificant, with overall outstanding equity holdings representing only 0.4% of the banking system's total assets as at end-2003. Banking institutions increased their equity investments by 30.6%, to RM3.5 billion as at end-2003 from RM2.6 billion as at end-2002. This was attributed largely to the conversion of loans into equity as a result of debt restructuring activities.

Investments in quoted shares by the banking system increased by 19.7% to RM2 billion from RM1.7 billion during the year while investments in unquoted shares registered a significantly higher increase of 50%. These were reflective of the restructuring activities undertaken by banking institutions in 2003. As at end-2003, holdings of unquoted shares accounted for 41.4% of the total equity investments by the banking system compared to 36.1% as at end-2002. In addition, banking institutions' holdings of quoted shares were purchased directly from the market, which increased by RM105 million or 20.3%. Shares held as a result of underwriting declined by RM80 million or 88.6%, reflecting the better performance of the stock market in 2003.

Graph 4.10
Banking System[1] : Composition of Equity Investments



[1] Excludes Islamic banks

The finance companies registered the highest increase in the holding of equity investments within the banking system, that is by RM329 million, of which 62.7% were unquoted shares. 94.7% of the increase in the holding of quoted shares by finance companies was as a result of loans-to-equity conversion. The same was true for the commercial banks as a group, where 54.6% of the increase in equity holdings comprised unquoted shares, and the 25.7% increase in holdings of quoted shares was almost entirely due to loan conversion and debt satisfaction.

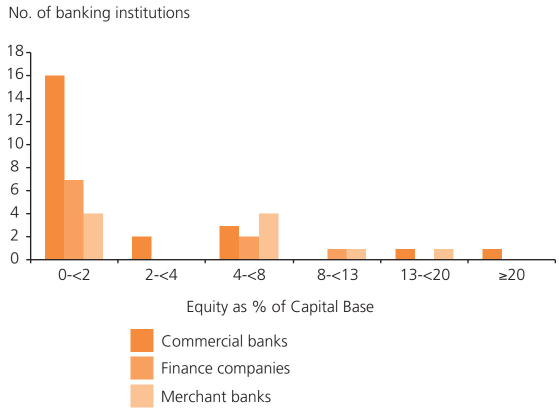
With respect to the merchant banks, the substantial decline in equity holdings resulting from underwriting and loan conversion had offset the significant increase of 96.7% in quoted shares

Table 4.14
Banking System[1]: Equity Exposure

	Equity[2] holdings (RM million)		Equity[2] / Capital base (%)		Potential equity[2] loss / Capital base (%)	
	As at end					
	2002	2003	2002	2003	2002	2003
Commercial banks	853.8	1,073.3	1.8	2.1	0.1	0.2
Finance companies	429.0	551.7	3.9	4.8	0.3	0.4
Merchant banks	410.7	402.3	9.0	8.9	0.7	0.7
Banking system[1]	1,693.5	2,027.3	2.7	3.0	0.2	0.2

[1] Excludes Islamic banks.
[2] Amount of investment in quoted shares.

Graph 4.11
Banking System[1]: Distribution by Equity as a Percentage of Capital Base as at 31 December 2003



[1] Excludes Islamic banks

purchased directly from the market during the year. Collectively, the merchant banks' equity holdings were marginally lower in 2003 than in 2002.

Even as the equity holdings of the merchant banks remained unchanged, they continued to record the highest level of equity exposure as their holdings of quoted shares accounted for 8.9% of capital base as against 2.1% for the commercial banks and 4.8% for the finance companies as at end-2003. Individually, most banking institutions had less than 2% of their capital base exposed to equity risk.

As at end-2003, the potential maximum loss for the banking system as a whole was lower at 7.9% compared to 8.2% in 2002. This was in terms of equity value based on a 10-day volatility of the Kuala Lumpur Stock Exchange Composite Index (KLSE CI) in 2003. Based on the estimated potential maximum loss of KLSE CI, therefore, potential loss to the banking system was estimated to remain at 0.2% of capital base despite the increase in the holdings of quoted shares. The potential loss for the commercial banks and finance companies remained insignificant, at 0.2% and 0.4% of their capital base respectively. The potential loss for the merchant banks was maintained at 0.7% of the capital base.

Table 4.15
Banking System[1]: Foreign Currency Exposure

	NOP (RM million)		NOP/Capital base (%)	
	As at end			
	2002	2003	2002	2003
Commercial banks	2,786	2,574	5.8	5.0
Merchant banks	73	50	1.6	1.1
Banking system[1]	2,859	2,624	5.5	4.7

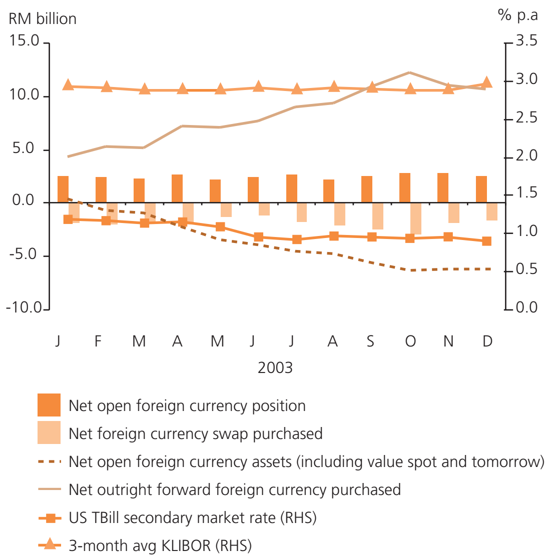
[1] Excludes Islamic banks.

Foreign Exchange Risk

The exposure of the banking system to foreign exchange risk in 2003 remained within prudential levels. Throughout the year, the net open foreign currency position (NOP) of the banking system moved within a narrow range of RM2.2 billion to RM2.8 billion. As a percentage of the banking system's capital base, the NOP registered a decline from 5.5% as at end-2002 to 4.7% as at end-2003.

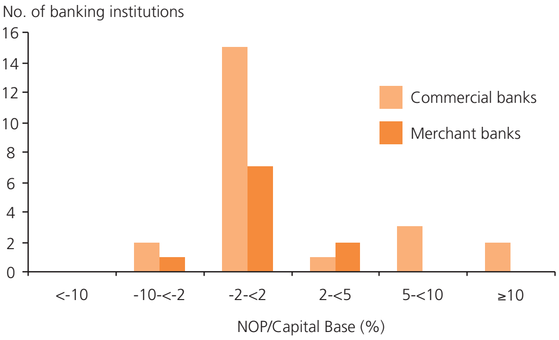
The banking institutions remained net foreign currency forward purchasers in 2003 as exporters capitalised on the forward premiums which ranged between 42 to 52 basis points for the one-month forward rates. However, as the forward premiums stabilised in 2003, the increase in the amount of forward contracts purchased by the banking institutions during the year was sustained at about the same level as in 2002. Forward foreign currency contracts purchased by the banking institutions rose by RM7.2 billion or 53.2% in 2003 compared with an increase of RM6.7 billion or 98.3% in 2002. Demand for forward contracts by exporters remained strong in 2003.

Graph 4.12
Banking System[1]: Components of Foreign Currency Exposure



[1] Excludes Islamic banks

Graph 4.13
Banking System[1] : Distribution of Net Open Foreign Currency Position as at 31 December 2003



[1] Excludes Islamic banks

To manage their forward purchases and capitalize on the relatively cheaper USD borrowings, banking institutions increased their foreign currency liabilities by RM4.3 billion or 10.1% to RM46.7 billion as at end-2003. Banking institutions, however, reduced their foreign currency assets by RM3.3 billion to RM40.4 billion as at end-2003 on account of diminishing returns. On a net basis, the banking system had a net foreign currency liability of RM6.3 billion as at end-2003 as against a net foreign currency asset position of RM1.2 billion as at end-2002.

The banking system is expected to maintain a net foreign currency liability position and remain a net forward foreign currency purchaser in an environment in which the interest rate differential between USD and Ringgit is expected to remain positive resulting in continued favourable forward premiums.

Capital Strength

The banking sector remained resilient and well-capitalised, with RWCR and core capital ratio sustained consistently above 13% and 10% respectively throughout the year. The capital base of the banking system increased by RM4.5 billion, of which audited profits contributed RM1.2 billion, while capital raising exercises by a number of banking institutions contributed another RM3.3 billion. These new capital injections offset the reduction in capital as a result of a merger of two large commercial banks during the first half of 2003. In line with higher financing activities, risk-weighted assets of the banking system grew by RM28.3 billion or 5.9% to RM506.6 billion at end-2003.

In tandem with the higher profits and new issuance of shares, total Tier-1 capital increased by 2.8% or RM1.6 billion, to RM59.3 billion as at end-2003. Nevertheless, a higher increase in the risk-weighted assets caused the core capital ratio to decline marginally to 10.7%. Meanwhile, total Tier-2 capital recorded a stronger growth of 14.4%, following the issuance of subordinated debt by four banking institutions, mainly to strengthen their capital position. Combined with the reduction in investment in subsidiaries as a result of the merger of two large commercial banks, the RWCR of the banking system strengthened further to 13.4% (end-2002: 13.3%).

The RWCR of commercial banks increased to 13.6% due to higher capitalisation and reduction in investment in subsidiaries, while there was a decline in capital base for merchant banks due to a significant increase in the holdings of other banking institutions' shares by one merchant bank. This, combined with an increase in risk-weighted assets of 2.4%, resulted in the RWCR of the merchant

Table 4.16
Banking System[1]: Constituents of Capital

	As at end		Annual change	
	2002	2003		
	RM million		RM million	(%)
Tier-1 capital	57,662.0	59,282.5	1,620.5	2.8
Tier-2 capital	16,756.7	19,174.4	2,417.7	14.4
Total capital	74,418.7	78,456.9	4,038.2	5.4
Less:				
Investment in subsidiaries and holdings of other banking institutions' capital	11,016.4	10,591.9	-424.5	-3.9
Capital base	63,402.4	67,864.9	4,462.5	7.0
Risk assets:				
0%	139,125.1	170,856.6	31,731.5	22.8
10%	15,544.0	16,849.8	1,305.8	8.4
20%	96,968.9	119,938.6	22,969.7	23.7
50%	102,628.2	117,511.0	14,882.9	14.5
100%	406,009.8	422,137.2	16,127.4	4.0
Total risk-weighted assets	478,272.1	506,565.5	28,293.5	5.9
Risk-weighted capital ratio (%)				
Banking system[1]	**13.3**	**13.4**	**0.1**	
Commercial banks	13.2	13.6	0.4	
Finance companies	12.0	11.3	-0.7	
Merchant banks	19.0	18.4	-0.6	

[1] Excludes Islamic banks.
Note: Total may not add-up due to rounding.

FINANCIAL SECTOR MASTERPLAN

The Financial Sector Masterplan (FSMP) which was launched in March 2001 sets out the broad strategies for the development of the financial sector over a ten year period. The end objective is to evolve the financial system into one which is competitive, resilient and dynamic. Efforts that were undertaken during the initial stage of the implementation of the FSMP were predominantly directed towards enhancing the capacity and capability of domestic financial institutions in order to enhance their level of effectiveness and competitiveness, strengthening the regulatory and supervisory framework, promoting a safe and efficient payments system as well as developing the framework on consumer education and protection.

During the first three years of the implementation of the FSMP, a total of 31 out of the 119 recommendations have been fully implemented, with an additional 24 recommendations are being implemented on a continuous basis. Details of the recommendations which have been fully implemented are as listed in the accompanying table.

Completed Recommendations

Banking Sector	
R3.4	Liberalise restrictions on salaries and staff mobility in the banking industry to enable the industry to attract the best talent and reward them accordingly
R3.5	Uplift restriction on employment of expatriates to attract the best international talents to meet the demand for expertise in specific areas of banking
R3.6	Establishment of board committees, namely Nominating, Compensation and Risk Management Committees to further enhance corporate governance standards
R3.7	Allow group rationalisation through cross-selling of products and consolidation of back-office processes as well as facilitate the merger of commercial banks and finance companies to further enhance efficiency and competitiveness
R3.12	Encourage outsourcing of non-core functions to gain greater strategic focus and efficiency
R3.14	Encourage the development of new delivery channels to increase the range of products and services to further enhance competitiveness
R3.15.1 and R3.15.2	Introduction of a simpler product notification process to provide incentive for development of new and innovative products, and outline clear set of guidelines providing criteria for product notification and specific product approval requirements
R3.21	Issuance of examination manuals for implementation of risk-based supervision with supervisory focus on high risk areas and greater attention on weak institutions
R3.28	Allow market forces to shape developments in the payments system to allow greater competition and increase innovation in payments system
Insurance Sector	
R4.1	Remove restrictions on outsourcing to enable insurers to further develop core competencies and effective business strategies
R4.2	Allow eligible insurers to use the internet as a distribution channel to enhance competitiveness and efficiency of the insurance industry
R4.6	Relax the restrictions on employment of expatriates to accelerate the development of skills and expertise in the industry
R4.16	Increase the statutory minimum paid-up capital of insurers to enhance their financial resilience and to accelerate the consolidation of the industry in order for domestic insurers to capture the size and scale needed to compete effectively in a more deregulated and liberalised market
R4.18	Establish board committees with specific responsibilities and enhance disclosure of compensations to directors and senior management to ensure they act in a manner that will increase shareholder value

R4.19	Raise the entry requirements for the agency force to ensure the recruitment of more qualified and competent agency force
R4.20	Introduce additional compulsory exams as part of continuing education programmes for agents to upgrade their knowledge and skills
R4.21	Further strengthen performance-based supervision to maintain stability under more deregulated and competitive market conditions
R4.26	Introduce 'best advice' regulations to enhance consumer protection and professionalism in the sale of life insurance products by insurance intermediaries
R4.27	Strengthen regulations on unfair trade practices to ensure sound business practices and fair treatment of consumers
R4.29	Allow financial and non-financial institutions to acquire interests in direct insurers to create business synergies
Islamic Banking and Takaful	
R5.3	Build strong management through the establishment of board committees, benchmarking and employment of experienced and qualified staff
R5.6	Increase the number of takaful operators to accelerate the expansion of takaful industry
Development Financial Institutions (DFIs)	
R6.4	Introduce a systematic framework for sourcing funds to ensure the appropriate and adequate funding for the operations of DFIs.
R6.7	Establish a legislative framework to provide for the regulation and supervision of DFIs to ensure that DFIs' policies and objective are consistent with the national policy objectives
Alternative Modes of Financing	
R7.2	Establish a RM500 million Venture Capital Fund to increase the availability of Venture Capital financing and stimulate new ventures
R7.3	Introduce further tax incentives for the Venture Capital industry to promote the growth of Venture Capital
R7.4	Liberalise the MESDAQ listing requirements to facilitate the exit of Venture Capital companies from their investments
Labuan International Offshore Financial Centre	
R8.3	Adopt a consultative and market driven approach to create a conducive tax and business environment to enhance the competitiveness and attractiveness of Labuan
R8.6	Strengthen Islamic banking and finance as well as takaful to develop Labuan with a strategic focus on Islamic products and services
R8.7	Enhance Labuan International Financial Exchange (LFX) to be a one stop financial exchange for residents and global companies

The recommendations implemented and the various initiatives undertaken during the first three years of implementation have contributed towards enhancing capacity and capabilities of domestic financial institutions, as well as providing a robust infrastructure to ensure overall stability of the financial sector.

BANKING SECTOR

Initiatives that were undertaken during Phase 1 of the implementation of the FSMP were primarily focused on building the capacity and capabilities of domestic banking institutions to enhance their competitiveness and building the infrastructure within which the banking institutions operate to promote the development of a more robust banking system. Attention was also accorded towards creating the necessary infrastructure for a more market-based consumer protection framework.

One of the key milestones for Phase 1 of the FSMP is to drive performance improvement. The industry-wide benchmarking programme which was initiated in 2002 provided banking institutions with a tool to enable more effective strategic focus and business planning and provided the relative ranking of each institution in all areas of performance. The benchmarking exercise also enabled Bank Negara Malaysia to assess the progress of the industry, particularly the performance improvements recorded by the domestic financial institutions thereby determining the speed of transition and progress.

The domestic banking institutions have steadily recorded improvements over the past three years yielding desirable results. The consolidation programme has resulted in larger and better capitalised domestic banking institutions. The average total assets and shareholders' funds per domestic commercial banks have more than doubled from RM18.1 billion as at end-1999 to RM44.9 billion as at end-2003 and from RM1.4 billion as at end-1999 to RM3.8 billion as at end-2003 respectively. The profitability levels have increased over the past three years. Return on average assets and return on average equity of the domestic banks have increased from 0.7% and 8.4% in 2001 to 1.2% and 13.4% in 2003 respectively. Pre-tax profit per employee had also increased significantly from RM50,196 in 2001 to RM108,728 in 2003. The cost to income ratio also declined from 41.2% in 2001 to 40.1% in 2003. Improved management of the operating costs had stabilised the operating expenses as a percentage of average assets at RM1.42 per every RM100 of assets over the same time period.

The banking institutions in Malaysia operate in an open environment. Both the domestic and foreign controlled banking institutions are governed by the same set of legislations and regulations, with the only remaining restriction on foreign banks being in the area of branching. Foreign controlled banking institutions nevertheless have a strong presence in the market, accounting for 26%, 27% and 25% of the commercial banking assets, loans and deposits markets respectively.

Competition has resulted in the narrowing of gross interest margins of commercial banks from 4.14 percentage points in 2001 to 3.69 percentage points in 2003. In this more competitive environment, the domestic banking institutions have been able to sustain their market share at 80%. The foreign banking institutions have expanded their loan market share mainly in housing loans. The domestic banking institutions continue to be the main provider of financing for businesses, particularly for the small and medium enterprises, where 83% of the loans to this sector were extended by the domestic banking institutions. The domestic commercial banks have also expanded their market share in the credit card business, which was previously the domain of the foreign controlled commercial banks to 47% of the market (2000: 43%).

To enhance the level of operating efficiency and allow greater strategic focus on business operations, banking institutions can now outsource non-core operations to third party service providers. They are also permitted to rationalise common internal operations such as treasury function and human resource management. A number of banking institutions also cross-sell products and services within the same banking group. Strategic alliances between banks and other banking institutions as well as non-banking institutions have also taken place to further enhance competition and innovation. One example is in the area of bancassurance and the sale of unit trusts. In addition, domestic banking institutions have also introduced new services such as wealth management and structured deposit products.

To enhance the delivery of products and services to customers, banking institutions have embraced innovative technology-based delivery channels such as internet and mobile banking. This widens the accessibility of banking services and facilitates seamless connectivity in the delivery of financial products and services to customers through the operation of one-stop financial centres. Efficiency of the banking sector has also improved, with the average time taken by commercial banks to process housing loan applications having declined from 4 days in March 2002 to 3.1 days and from 11 days to 9.5 days for new credit card applications. With greater emphasis on customer relationship, the percentage of customer complaints that are resolved within 14 days have improved from 82.1% in March 2002 to 87.6% in December 2003.

As a result of the significant progress made by the domestic banking institutions, liberalisation of the system has been brought forward in several areas. While the domestic banking institutions were allowed to offer full internet banking services beginning 1 June 2000, the locally-incorporated foreign banks were permitted to offer such services beginning 1 January 2002, earlier than was announced. The requirement for a non-resident controlled company to source at least 50% of its financing requirements from domestic banking institutions was also uplifted with effect from 1 April 2003.

A smooth functioning payments system which is efficient and effective is also important. As the payments technology and the structure of the financial services industry change rapidly, it is necessary to have a payments system which responds to this new environment. To encourage greater innovation and competition, Bank Negara Malaysia has shifted its role from being directly involved in the development process to a more facilitative role, particularly in the retail payments system. Bank Negara Malaysia will however, continue to ensure that minimum security standards are applied when any new systems are introduced. The Payment Systems Act 2003 was enacted to facilitate the development of payments system and to ensure that it is secure and efficient.

An important aspect of stability in the financial system relates to the ability of the system to undergo the transition to deregulation and increasing competition with no disruption in the level or reliability of services to customers. The customers also play an important role to drive performance improvement of the financial institutions. Crucial to this is active consumerism, which can only be attained with the public having the necessary information and understanding of financial products and services. Towards this, a 10-year consumer education programme was launched to disseminate information to consumers including information on consumer rights and responsibilities. In addition, efforts have also been put in place to encourage consumers to pursue formal administrative and legal redress for their grievances. Banking institutions are required to set up dedicated complaint units to manage complaints received from customers.

The banking system remains the largest provider of funds to the private sector, providing support to the various sectors of the economy. In line with the objective to develop a well-diversified financial system with well-functioning, deep and liquid markets, Bank Negara Malaysia continued to take an active role in the development of the bond market to meet the changing needs of the Malaysian economy. As a result, the bond market experienced a rapid growth since the Asian financial crisis. As at end-2003, the size of the bond market was equivalent to 87.6% of GDP, compared with 46.9% in 1996. The private debt securities (PDS) market has emerged as an important source of financing for the private sector since 1998. PDS outstanding represented 34.3% of GDP at end-2003.

To enhance the liquidity in the secondary bond market, the Guidelines on Securities Borrowing and Lending (SBL) Programme under the Real Time Electronic Transfer of Funds and Securities System were issued to support trading strategies for principal dealers and enhance the return on bond portfolio investment for investors. Through SBL, principal dealers (PDs) can now participate as both borrower and lender, which allow PDs to quote two-way prices more effectively and at the same time able to meet commitments of their treasury activities. In addressing the captive bond market issue and to promote the secondary trading, greater investment flexibility was accorded for insurance companies to invest in Malaysian Government Securities and PDS.

To increase the availability of risk management tools for market participants, more players were allowed to undertake repo transactions with the licensed financial institutions. The Prudential Standards on Asset Backed Securities Transactions by Licensed Institutions issued by Bank Negara Malaysia in 2003 helped in creating greater awareness and participation in securitisation transactions. Universal brokers have been allowed to participate in fixed income market and thus engage the services of money-brokers. A broader investor base is an important factor in contributing to liquidity in the secondary market.

Concerted efforts were also made to develop the Islamic financial markets to meet the demands of institutional investors such as the issuance of Islamic based Government investment issues and the development of a risk-free benchmark Islamic yield curve to help in the pricing and trading of Islamic securities. To further develop the Islamic capital market, the Government had provided incentives such as tax exemption for expenses incurred on the issuance of Islamic PDS. As a result of these efforts, the Islamic PDS market has grown significantly. Total outstanding of Islamic PDS stood at RM69.1 billion, or 46% of total PDS outstanding as at end-2003.

Measures that have been put in place over the past three years were implemented to ensure that the banking system will continue to support sustainable economic growth and to prepare the Malaysian banking sector for a more liberalised and global operating environment. The strategy for the banking system on the latter has been one of gradualism. A managed and sequenced deregulation and liberalisation process is adopted to ensure that financial reforms will be effectively implemented without destabilising implications on the system.

INSURANCE SECTOR

The recommendations implemented in the first phase of the FSMP are aimed at building the capabilities of domestic insurers to compete more effectively, strengthening the consumer protection framework and raising corporate governance standards to further enhance the protection of policyholders and shareholders value.

The capacity-building initiatives and measures implemented under Phase 1 of the FSMP have brought about positive developments in the industry over the last three years. Significant progress was achieved in the consolidation of the industry, particularly in the more fragmented general insurance sector, following the increase in the minimum paid-up capital requirement for insurers from RM50 million to RM100 million in 2001. A total of 15 mergers and acquisitions involving a total of 28 general insurers (including four composite insurers) have been successfully completed since 1999. As a result, the average capitalisation of general insurers strengthened by 54.4% from RM92.2 million in 2000 to RM142.3 million in 2003, improving the competitive position, and therefore better able to take advantage of the opportunities presented in the more open market environment.

Domestic insurers continued to maintain their dominant position in the general insurance sector, while also achieving productivity and profitability gains. As at end-2003, domestic insurers accounted for 73.3% of gross general insurance premiums, with the top five domestic insurers collectively controlling 31.8% of the total gross premiums in the industry. Employee productivity rose from RM498,857 in 2000 to RM797,923 in 2003. Overall profitability, as measured by gross premiums generated per employee, also improved, with domestic insurers sustaining a higher return on equity over foreign insurers (24.7% as against 20.4% by foreign insurers for the year 2003).

In the life insurance sector, significant attention was directed at developing new growth opportunities to increase the market penetration, and hence economies of scale. In this respect, domestic insurers secured a dominant position in bancassurance business, accounting for 76.6% of the total new insurance premiums generated through banking institutions in 2003. The commitment of domestic insurers to the development of bancassurance was supported by the encouraging sales of non-credit related products. Domestic insurers accounted for more than 80% of total non-credit related bancassurance business in 2003.

As at end-2003, a total of 12 life insurers had been given approval to enter into bancassurance arrangements with banking institutions. Business generated through this alternative distribution channel has quadrapled since 2000 to reach RM1,859 million in 2003. Two domestic insurers have successfully leveraged on the banking distribution network to become market leaders in bancassurance, with a combined market share of 36% of total bancassurance premiums generated in 2003. Bancassurance currently accounts for more than 38% of total new life business premiums in the market and has been a major factor contributing to the higher penetration of life insurance business in Malaysia which increased from 31.5% in 2000 to 36.4% in 2003.

Domestic life insurers succeeded in making further inroads in investment-linked business, which has emerged as a new growth area. The market share of investment-linked business attributed to domestic insurers has increased progressively from 16% in 2001 to 27.9% in 2003, contributing to a higher overall new business growth rate of 31.5% achieved by domestic life insurers in 2003, compared with 19.4% registered by foreign insurers.

The capacity building initiatives under Phase 1 of the FSMP also introduced a more flexible operating regime aimed at enabling domestic insurers to innovate, develop expertise and enhance efficiency levels. In this respect, the transfer of expertise to domestic insurers was facilitated by a more flexible policy on the appointment of expatriates. As at end-2003, a total of 42 expatriates were employed in the insurance industry to provide technical support in the areas of information technology, underwriting, actuarial and agency development. In the more flexible operating environment, an increasing number of insurers also leveraged on effective outsourcing strategies to lower costs while delivering higher service quality to their customers.

As at end-2003, more than 30 insurers were engaged in outsourcing arrangements, primarily in back-end support functions related to management information systems, data processing and customer service support. Consumer access to insurance was also made more convenient with approval given to 18 insurers to provide insurance over the internet, including eight insurers which are now able to offer motor insurance policies on-line through an interactive website. The process improvements enabled by these developments resulted in an overall improvement in the efficiency levels of domestic insurers. Domestic life insurers registered a lower expense rate of 34.2% in 2003 (2000: 36.8%), while the combined management expense ratio of domestic general insures improved to 24% in 2003 (2000: 24.4%).

Notwithstanding the positive developments in the industry, domestic players with significant overall market share have yet to emerge in the life insurance sector. In the transition to the second phase of the FSMP which envisages a level playing field between domestic and foreign players, the focus of policy will continue to be directed at developing domestic insurers, in particular life insurers, to consolidate domestic strengths in the penetration of alternative distribution channels, promote further innovation and facilitate strategic alliances.

The implementation of specific measures under Phase 1 of the FSMP to promote greater market discipline and strengthen corporate governance will support further performance improvements by domestic insurers. Enhanced disclosure requirements and the implementation of a comprehensive consumer education programme will empower consumers to make informed decisions on their choice of financial products and services which in turn, will serve as a strong incentive for improved product and service offerings by insurers. The strengthened corporate governance framework underpinning these initiatives will also serve to ensure that the board of directors posses the appropriate qualifications and experience to enable them to provide effective strategic direction to insurers in the more challenging environment. These measures supplement the changes being made to the regulatory framework and constitute important elements of a comprehensive approach to develop a robust, stable and dynamic insurance sector.

ISLAMIC BANKING AND TAKAFUL

The Islamic banking and takaful sector strengthened and expanded significantly during the first phase of the FSMP. The Islamic banking market share increased to account for 9.7% (2000: 6.9%) of total assets, 10.4% (2000: 7.4%) of total deposits and 10.3% (2000: 5.3%) of total financing of the banking system.

The takaful sector also expanded rapidly to constitute 5.7% (2000: 3.9%) of total assets and 6.0% (2000: 3.9%) of total contributions of the insurance industry. Phase 1 also witnessed significant progress being achieved in the development of the financial infrastructure for Islamic banking and takaful to function efficiently and effectively in parallel with conventional banking and insurance.

A significant milestone was achieved in the legal infrastructure development with the assignment of a dedicated High Court in 2003 to adjudicate all Islamic banking and finance cases. This development, reinforced by the formation of the Law Review Committee to undertake a holistic review of the present common law-based legislations will serve to establish an effective legal structure to cater for the unique nature of transactions in Islamic banking and finance. To complement these initiatives, a preliminary review of the Islamic Banking Act 1983 and Takaful Act 1984 was also undertaken.

The Shariah advisory structure was also strengthened with the amendment of the Central Bank of Malaysia Act 1958 which conferred a legal stature to the Shariah Advisory Council at Bank Negara Malaysia as the sole authority to decide on Shariah matters on Islamic banking and finance that fall under the purview of Bank Negara Malaysia. Guidelines will be issued to strengthen the structure of the Shariah Committees at the Islamic banking institutions and takaful operators and to define the composition, roles and responsibilities of these Shariah Committees. With the guidelines in place, the overall effectiveness of Shariah governance framework will be significantly enhanced.

The regulatory framework has been enhanced to address the characteristics of Islamic banking and takaful as well as to strengthen institutional capacity and financial resilience of Islamic banking and takaful players. The introduction of the standard framework for the computation of the rate of return in Islamic banking operations in 2001 provided greater transparency in the derivation of the rate of return to ensure a more equitable distribution of income between the bank and its depositors. The framework enhanced the capability of Islamic banking institutions to manage volatility in the rate of return more effectively and to remain competitive relative to the conventional banking institutions. The issuance of the Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks (GP8-i) in 2003 further increased financial disclosure to promote a more effective role of market discipline.

The capital position and financial resilience of the Islamic banking system strengthened significantly as a result of the regulatory requirement for conventional banking institutions participating in the Islamic Banking Scheme (IBS banks) to observe the minimum risk-weighted capital ratio for their Islamic banking portfolios. The minimum capital requirement of takaful operators would be raised from RM35 million to RM100 million with effect from 31 December 2004 to position takaful operators at par with conventional insurers.

The benchmarking programme for performance measurement has also been put in place to enhance the ability of Islamic banking institutions and takaful operators to assess their relative efficiency and formulate strategies to improve operational efficiency and to be at par with international best practices. In the area of corporate governance, the issuance of guidelines on the establishment of board committees, minimum qualifications and training requirements for directors, as well as the roles and responsibilities of independent directors in 2003 aim to strengthen the management of Islamic banking institutions and takaful operators as shareholders play a more active role in overseeing the effectiveness of the board of directors and management.

The issuance of the Guidelines on the Sell and Buy Back Agreement in 2002 enhanced the capacity of Islamic banking institutions to better meet their liquidity requirements as part of the efforts to develop a deep Islamic financial market structure. The variable rate financing mechanism introduced in 2003 provided a competitive tool for Islamic banking players in pricing product offerings to sustain their competitive position in a dual banking environment and concurrently assist Islamic banking institutions to effectively manage risks in pricing arising from asset and liability mismatches. The detail implementation framework for *mudharabah* (profit-sharing) and *musyarakah* (profit and loss sharing) financing is in the final stage of completion and is expected to further promote greater diversity in the mode of financing as the Islamic banking system advances into Phase 2 of FSMP.

The establishment of the Islamic Banking and Finance Institute Malaysia (IBFIM) in 2002 as an industry-owned training and research institute was another important progress achieved. IBFIM will spearhead the development of a pool of knowledgeable and competent Islamic bankers and takaful operators to meet the requirements of the Islamic financial industry. The organisation of the Islamic Banking and Takaful Week in 2001 and 2003 as well as the launching of the Consumer Education Programme have also played an important role in enhancing the level of public literacy in Islamic banking and takaful. Consumers are now more aware of the characteristics of Islamic banking and takaful, its underlying Shariah principles and concepts as well as the range of products and services offered by Islamic banking institutions and takaful operators.

Progress has also been achieved in the development of the institutional infrastructure. Two additional takaful operators have been licensed. In Islamic banking, a review of the existing "window" institutional structure of the IBS banks is being undertaken to prepare an enabling structure that can assimilate these developments and thus strengthen the prudential regulatory and supervisory regime.

As the progress of development has exceeded initial expectations in Phase 1, Bank Negara Malaysia has brought forward the liberalisation for the Islamic banking sector from Phase 3 to Phase 2, three years earlier than envisaged by the FSMP. The liberalisation of the Islamic banking sector will further hasten the pace of development and strengthen global integration to prepare the enabling environment for Malaysia to evolve as a regional centre for Islamic banking and finance.

DEVELOPMENT FINANCIAL INSTITUTIONS

In tandem with the strategic directions outlined in the FSMP, efforts undertaken during Phase 1 of the FSMP were focused on fostering a pool of efficient and effective DFIs to complement banking institutions in providing financing to identified priority and strategic sectors in the economy.

During Phase 1 of FSMP, strategies undertaken were centred mainly on strengthening the regulatory framework and capacity building of the DFIs. These strategies and initiatives include the legal infrastructure and policy development to support an orderly and sound development of effective DFIs.

A comprehensive regulatory and supervisory framework to facilitate the overall policy development of DFIs, especially in strengthening the financial and operational soundness of the DFIs was completed with the enactment of the Development Financial Institutions Act 2002 (the Act) in February 2002. The Act provides comprehensive mechanisms to ensure DFIs perform their mandated socio-economic functions. Following the enactment of the Act, six DFIs were subjected to the regulatory and supervisory framework embedded in the Act.

The major policy framework on building the capacity of DFIs aimed to ensure that as specialised development institutions, the institutions would have an effective role in supporting developmental needs of the nation. The DFIs are required to prepare and submit statement of corporate intent which highlight the planned business activities, implementation strategies and performance target within the mandated roles and Government's development objectives to ensure that DFIs remained focused on their mandated roles.

Prudential measures, namely, the classification of impaired loans and loan loss provisioning requirement have been introduced to ensure that the impaired loans and potential losses are identified and recognised in a timely manner, and loan assets and income are fairly and prudently stated. The maintenance of minimum liquidity has been introduced to enhance the financial soundness of DFIs. The policy on minimum capital requirement has been initiated to ensure DFIs have the financial capacity to sustain their operations. During Phase 1, regular on-site examinations of the six DFIs were conducted to assess the DFIs' performance in meeting the mandated roles.

To further equip DFIs as specialised development institutions, measures were undertaken to enhance their role in providing non-financial services. A joint project with the Japan International Cooperation Agency and selected DFIs was initiated to enhance the provision of advisory services of these DFIs to SMEs. The project will formulate action and implementation plans to enhance the institutional capability, including human resource skills.

To strengthen corporate governance, guidelines were issued to assist the DFIs and their stakeholders in instituting effective governance structure and oversight of Board of Directors. The main areas addressed in the guideline are duties and responsibilities of the board of directors, minimum requirements and rules governing the appointment of directors and chief executive officers as well as the establishment of board committees.

Moving forward, measures implemented will continue to be focussed on providing the enabling environment for the DFIs to operate efficiently and effectively. Strategies in the near term will focus on institutional development of the DFIs in the areas of risk management and the advisory and consultancy capability for other targeted customers, besides the SMEs. At the same time, efforts to promote institutional efficiency of the DFIs through the formulation of performance indicators will also be intensified to strengthen their financial and operational conditions.

MOVING FORWARD

The measures that have been implemented thus far were aimed towards providing a strong foundation on which the financial sector will be developed in the future. In addition to the measures that were implemented in the banking, insurance, Islamic banking and takaful, and development financial institutions sectors, significant strides have also been recorded in introducing alternative modes of financing in the domestic financial system. Significant progress has also been made in the development of Labuan as an international offshore financial centre. On the former, the Government has been in the forefront in the development of the venture capital (VC) industry, a key step towards transforming Malaysia into a knowledge-based economy. Initiatives such as the establishment of a one-stop centre for the VC industry, tax incentives and VC fund will continue to spur development in the industry. With the rapid recognition and growing demand for Islamic finance, Labuan has strategically promoted itself as an Islamic financial centre. Supported by the strong onshore Islamic financial sector, Labuan is well positioned to participate in the growing global Islamic financial market.

As we move forward, further efforts in institutional development will be undertaken, in particular, for the domestic financial institutions. This will be accompanied by gradual liberalisation, with the balance being made to ensure that the benefits will be maximised while any destabilising implications minimised. In addition, a more diversified financial services landscape will emerge with the capital market, insurance and venture capital having a significant role in the financial sector.

The Proposed Deposit Insurance System in Malaysia

In 2003, substantial progress was made towards finalising the features of the proposed deposit insurance system for Malaysia, thus paving the way for its establishment. The improved strength, competitiveness and resilience of the banking system following the comprehensive restructuring and capacity building initiatives support a positive environment for the effective implementation of a deposit insurance system that will contribute to the stability of the financial system.

As an integral component of the financial safety net, the deposit insurance system will further strengthen incentives for financial institutions to adopt sound financial and business practices and enhance public confidence in the financial system by providing explicit protection of deposits. The proposed features underpinning the Malaysian deposit insurance system fully support these objectives.

In developing the design features, Bank Negara Malaysia has considered various models adopted in other countries that operate explicit deposit insurance systems, adapting them as appropriate, in order to achieve a system that will function efficiently, equitably and in a manner that provides the appropriate economic incentives for all participants within the Malaysian context. Key elements of the proposed design features include:-

(a) a **legislated mandate** for the agency responsible for the administration of the deposit insurance system (hereafter referred to as 'Agency'). This will ensure clarity of its role and responsibilities within the financial safety net and provide the basis for the statutory powers to be accorded to the Agency;

The proposed mandate for the Agency is to:-
(i) administer the deposit insurance system;
(ii) protect depositors from the loss of their deposits up to the insured limit in the event of a bank failure;
(iii) strengthen incentives for sound risk management in the banking industry; and
(iv) promote or otherwise contribute to the stability of the financial system.

Within its proposed mandate, the Agency will have the role, in certain circumstances, to undertake the resolution of banking institutions, as may be required based on the assessment of Bank Negara Malaysia. In this role, the Agency will also be responsible to minimise the costs of bank resolutions to the financial system, taking into account factors affecting financial system stability.

(b) **compulsory membership for commercial banks** (including subsidiaries of foreign banks operating in Malaysia) and **finance companies** licensed under the Banking and Financial Institutions Act 1989, and **Islamic banks** licensed under the Islamic Banking Act 1983, to accept deposits (hereafter referred to as 'member institutions'). This will avoid risks associated with adverse selection whereby only small and perceived weaker institutions participate in the system. This is important to enhance the viability of the deposit insurance system;

(c) **protection** up to the prescribed limit (for eligible deposits) for **all depositors** of member institutions. Provisions will be made for the Agency to approve additional financial instruments as being eligible for deposit insurance to accommodate new types of deposit products that may be introduced in future. Deposits that are not payable in Malaysia, foreign currency deposits, negotiable instruments of deposit or other bearer deposits, repurchase agreements and money market placements would not be insured;

(d) an **adequate basic level of protection** provided **for every depositor's deposits in *each* member institution.** Depositors with deposits in more than one member institution will be insured separately for their deposits in each institution. Joint and trust deposits will also be separately insured, providing additional coverage within the system for depositors with such accounts. The deposit insurance limit will be set at a level that is sufficient to protect the vast majority of depositors in full. At the same time, the deposit insurance limit will retain sufficient incentives for the larger and institutional depositors to monitor the financial condition of member institutions. This is important to promote sound financial and business practices, thereby further enhancing financial stability;

(e) **equivalent protection for Islamic and conventional deposits** which will be separately insured up to the deposit insurance limit to avoid any competitive distortions between the Islamic and conventional banking systems. In this respect, extensive consultations have been held with the National Shariah Advisory Council on elements of the deposit insurance system relating to Islamic deposits to ensure consistency and compliance with Shariah principles;

(f) **annual premiums** to be paid by member institutions to the deposit insurance fund to be **based on** the institution's total **insured deposits**. The annual premiums will be borne entirely by member institutions and should not result in the imposition of additional service charges, either explicitly or implicitly, on consumers. The deposit insurance fund may be used to reimburse the depositors of a member institution that is unable to meet its obligations to depositors or otherwise provide financial assistance for the resolution of the institution. The annual premiums may be supplemented by additional premiums imposed on member institutions to cover any loss resulting from the implementation of resolution schemes; and

An Islamic deposit insurance fund, funded by premiums collected on insured Islamic deposits, will be separately maintained to ensure that the coverage accorded to Islamic deposits fully comply with Shariah principles.

(g) the implementation of a **differential premium system** to determine the premiums payable by each member institution. Consistent with the Agency's mandate to strengthen sound risk management practices among member institutions, financial consequences (through higher premium rates) will be attached to practices of member institutions that increase the risk of loss to the deposit insurance system. In line with the basic structure of proven and tested rating systems employed in other countries, both qualitative and quantitative criteria will be taken into account to determine the premium category in which a member institution is classified.

It is envisaged that the deposit insurance system will be administered by a separate statutory body established under an Act of Parliament to accord greater focus and clarity to the fulfilment of the deposit insurance mandate. The Agency will be supported by an independent board comprising relevant representatives from the public and private sectors. As separate components of the financial safety net, appropriate institutional arrangements will also be put in place to facilitate effective co-operation and co-ordination of actions between Bank Negara Malaysia and the Agency.

Following a consultation process with the banking industry, the deposit insurance system will be implemented subsequent to the passing of legislation in Parliament, and the establishment of the necessary infrastructure.

bank industry to decline to 18.4% (end-2002: 19%). In the case of finance companies, the continued strong demand for hire purchase financing during the year led to a higher growth in risk-weighted assets as compared with the moderate growth in capital base, resulting in the RWCR declining to 11.3% (end-2002: 12%).

The higher expansion in loans contributed to the increase in total risk-weighted assets of the banking system, which grew by 5.9% to RM506.6 billion. The increase was noted across all risk categories, especially at the 0% and 20% category. The increase in the 0% category by 22.8% to RM170.9 billion, was mainly due to Bank Negara Malaysia's liquidity operations. In line with the higher lending for the purchase of residential properties, the assets in the 50% risk-weight category increased by 14.5% to RM117.5 billion. Risk-weighted assets in the 100% risk-weight category grew by 4% or RM16.1 billion, attributable to other loan financing.

Given its strong level of capitalisation, the banking system is well placed to efficiently and effectively support economic activities, which augurs well for the growth of the economy in 2004.

OTHER FINANCIAL INSTITUTIONS

Discount Houses

Amidst ample liquidity in the financial system, total resources mobilised by the discount houses increased further during the year by 10.3% or RM2.8 billion (2002: 15% or RM3.6 billion). Deposits (primarily in the form of short-term fixed deposits) continued to be the main source of funds, increasing by 19.3% (2002: 32.1%). With the stronger growth in deposits, discount houses were able to further wind down their interbank borrowings, which declined by 24.7% (2002: -22.5%).

There was a marked shift in the allocation of funds mobilised by the discount houses. A significant decline in holdings of banker's acceptances (BAs), together with lower holdings of MGS and Khazanah bonds, were offset by a large increase in holdings of PDS. PDS investments increased by RM3.2 billion or 27.7% in 2003 (2002: -RM0.9 billion or -0.9%) as discount houses took advantage of the low PDS prices in the second half of the year when market sentiment turned more cautious on bonds. The increase in deposit funds was also placed in the interbank market. Interbank placements rose by RM1.9 billion or 49.4%, partly due to the temporary placement of funds in the interbank market at the end of 2003 by a discount house, whose holdings of Danaharta bonds matured at the same time.

Table 4.17
Discount Houses: Sources and Uses of Funds

	Annual change		As at end-2003
	2002	2003	
	RM million		
Sources:			
Approved capital funds	300	153	2,443
Deposits	4,834	3,847	23,751
Interbank borrowings	-1,370	-1,169	3,559
Others	-185	-13	448
Total	**3,578**	**2,818**	**30,201**
Uses:			
Investment in securities:	2,876	809	24,055
Government debt securities	*112*	*-571*	*1,329*
MGS held	*-364*	*-262*	*835*
Khazanah bonds	*-281*	*123*	*497*
BNM bills	*229*	*16*	*365*
Private debt securities	*-104*	*3,197*	*14,730*
Bankers acceptances	*2,754*	*-2,752*	*3,237*
Negotiable instruments of deposit	*-125*	*752*	*848*
Cagamas debt securities	*471*	*610*	*2,168*
Others[1]	*-181*	*-567*	*882*
Interbank placements	1,031	1,921	5,809
Others	-329	87	337
	2001	**2002**	**2003**
Number of discount houses	7	7	7

[1] Includes Danaharta and Danamodal bonds.
Total may not add up due to rounding.

Discount houses continued to expand their fee-based activities during the year. The industry arranged, lead-managed and co-managed the issuance of PDS worth RM9.8 billion (2002: RM8 billion), while the total amount underwritten increased to RM2.6 billion (2002: RM1.9 billion) for 31 PDS issues (38 issuances in 2002).

Provident and Pension Funds

Total resources of the 13 provident and pension funds (PPF) surveyed by Bank Negara Malaysia increased by 7.9% to RM266.4 billion in 2003. Accumulated contributions, which accounted for 90.2% of the total resources of the PPF, grew by 9.2% in 2003 (2002: 8.5%). The increment was due to increases of 16.2% in net contributions and 15.7% in dividends credited to contributors' accounts during the year. The latter was made possible by higher investment income in 2003. The Employees Provident Fund (EPF) remains the largest PPF, accounting for 82.6% of the total resources of the PPF.

The strong increase in net contributions in 2003 was the result of both higher gross contributions and lower withdrawals. Gross contributions increased by 1%, due mainly to the increase of 12.4% in the number of contributors, which more than offset the reduction in the employee contribution rate to EPF to 9% from 11% for a year, effective June 2003. The reduction in the employee contribution rate was one of the measures under the Economic Package announced by the Government in May 2003 to stimulate consumption.

Meanwhile, withdrawals declined by 10.5% during the year due to the significant decline in withdrawals by pensionable employees under the EPF's Pensionable Employees Withdrawal Scheme, which was launched in 2000. The bulk of these withdrawals was made in 2001. Withdrawals for investment and housing purposes, however, increased by 8.7% and 2.1% respectively.

Investment income of the EPF increased by 3.4% to RM11.1 billion in 2003 due mainly to the increase in investment income from fixed income instruments by 3.4%. Investment in fixed income instruments contributed 77.4% of the total investment income of the EPF in 2003. In line with the strong performance of the equity markets, investment income from equities (including income from external equity fund managers) registered the highest increase (17.1%) among all asset classes in 2003.

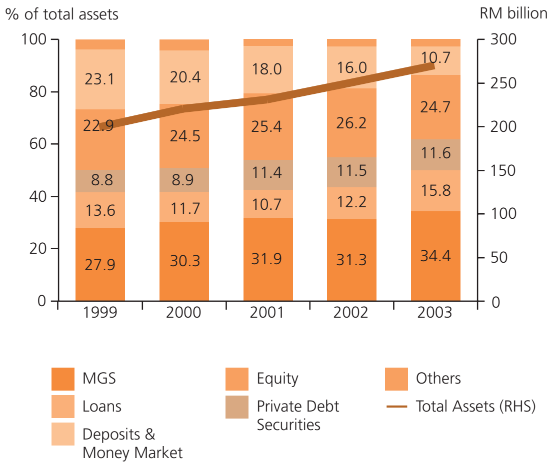
Table 4.18
Provident and Pension Funds: Selected Indicators

	2002	2003*p*
	RM million	
As at end-year		
Number of contributors ('000)	18,436	20,718
of which:		
EPF	*10,335*	*10,490*
SOCSO	*7,912*	*9,997*
Accumulated contributions	220,094	240,238
Assets	246,974	266,438
of which:		
Investments in MGS	*77,387*	*91,589*
During the year		
Gross contributions	24,000	24,233
Withdrawals	13,689	12,249
Net contributions	10,311	11,984
Dividends credited	8,117	9,393
Investment income	10,553	12,200

p Preliminary

Source: Employees Provident Fund, Pension Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and seven other private provident and pension funds.

Graph 4.14
Provident and Pension Funds: Major Asset Composition



Holdings of all asset classes, except deposits and money market instruments, increased in 2003. Given the low interest rate environment, the decline in the holdings of deposits and money market instruments of PPF was part of an investment strategy to shift into assets which offered higher returns. In line with this strategy, the shares of loans and Malaysian Government Securities (MGS) in total assets of the PPF rose in 2003. The increase in the PPFs' holdings of MGS was also due to the higher issuance of MGS in 2003. Investments in equities by PPF increased marginally by 1.6%, while overseas investment increased by 14.5%. The share of overseas investment in total assets of the PPF, however, remained small at 0.3%.

Venture Capital

In 2003, the venture capital (VC) industry continued to expand as an alternative source of financing to the economy. As a result of efforts taken by both the Government and the private sector, the VC industry recorded further growth in terms of fund size, number of investee companies, number of venture capital fund management companies (VCFMCs) and venture capital companies/funds (VCCs). Total funds available for VC investment grew by 10.5% to RM2.1 billion. As at end-2003, investee companies that received funding from VC sources, increased to 298 companies, with higher net investment of RM878.7 million.

The Government remained supportive of the development of the VC industry through the provision of financing and incentives, which were

Table 4.19
Key Statistics of Venture Capital Industry

	As at end-year	
	2002	2003
Venture capital funds (RM million)	1,953.1	2,118.1
Net investment[1] (RM million)	862.6	878.7
Local sources (RM million)	*n.a.*	*769.0*
Foreign sources (RM million)	*n.a.*	*109.6*
No. of venture capital companies/ funds	38	43
No. of venture capital fund management companies	29	31
No. of investee companies	183	298
	During the year	
	2002	2003
Gross investment (RM million)	191.4	227.2
Local sources (RM million)	*n.a.*	*192.5*
Foreign sources (RM million)	*n.a.*	*34.8*
No. of investee companies	80	115

[1] Gross investment less divestment activities.
n.a. Not available.

Source: Securities Commission

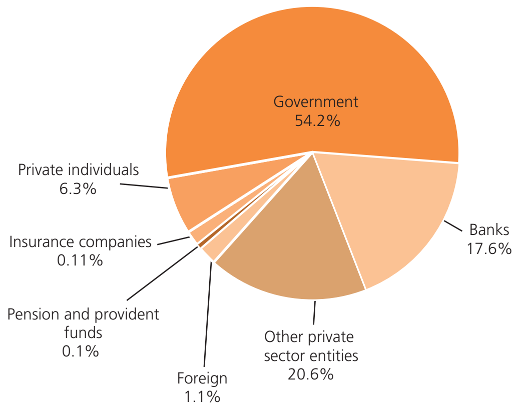
announced in the Economic Package and the 2004 Budget. The Cradle Investment Programme (CIP), a programme initiated under the Economic Package announced in May, was launched with an allocation of RM100 million and was administered by the Malaysia Venture Capital Management Berhad (MAVCAP). The CIP was established in mid-2003 to provide pre-seed funding and entrepreneurial support to generate new ideas and innovations by individuals, research institutes and institutions of higher learning. As at mid-March 2004, a total amount of RM1.2 million had been disbursed to finance 93 ideas and innovations.

MAVCAP continued to offer and subsidise the "Ignite the Technopreneur Fire" series of workshops to interested technopreneurs, which was aimed at addressing issues of entrepreneurship like technology assessment, commercialisation and financing. These workshops helped to address technopreneurs' concerns on management, human resources and operations. Another initiative was the "Three M" (Monday Meeting of the Month) meeting, which was initiated and sponsored by MAVCAP and jointly organised with the Malaysian Venture Capital Association (MVCA). The monthly forums were aimed at providing the opportunity for technopreneurs and financiers to interact and discuss issues of concern. Venture Accelerate 2003 took on a new approach which aimed at accelerating the development of promising entrepreneurs into successful start-ups, via a strong focus on intensive mentoring and skills-building over a 6-month period. The main objective was to produce quality entrepreneurs and, in turn, generate a more vibrant and sustainable entrepreneurial environment in Malaysia. The programme was launched on 17 September 2003 and is expected to end in June 2004.

The Venture Capital Consultative Council (VCCC), which was established in 2002, contributed effectively in developing further the VC industry. By providing a consultative forum for both public and private sectors involved in the VC industry, the VCCC has addressed several areas of concern, which affected the development of the industry. Among others, key areas of improvement attributable to the VCCC were addressing tax incentive-related issues, streamlining data collection, ensuring constant dialogues between the public and private sector involved in the VC industry and initiating educational programmes.

A greater level of private sector involvement was reflected in the increased funding for VC

Graph 4.15
Sources of Venture Capital
(% share, as at end-2003)



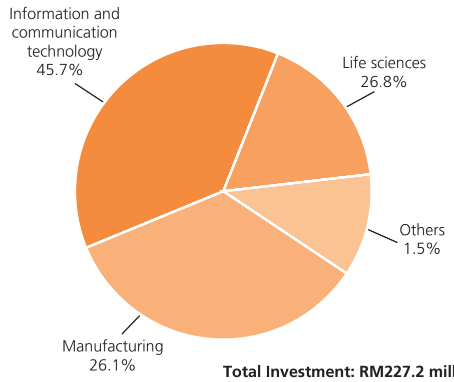
Source: Securities Commission

Table 4.20
Investment by Stages during 2003

No. of Investee Companies	115	
Business Stage	RM million	% share
Seed capital	19.9	8.7
Start-up capital	47.9	21.1
Early stage	17.2	7.6
Expansion, Growth	81.4	35.8
Bridge, Mezzanine, Pre-IPO	20.3	8.9
Management buy-out	11.7	5.1
Management buy-in	16.8	7.4
Cashing-out (Secondary purchase)	…	…
Other types of investment	12.1	5.3
Total	**227.2**	**100.0**

Source: Securities Commission

Graph 4.16
Gross Investment in 2003 (% share of total)



Total Investment: RM227.2 million
Number of Investee Companies: 115

Source: Securities Commission

Table 4.21
Investment by Sectors

	As at end-2003	
	RM million	% share
Manufacturing:	304.8	34.7
Of which,		
Wood and wood products, including furniture	*39.5*	*4.5*
Transport equipment, automotive components	*10.3*	*1.2*
Advanced manufacturing: electronics, automation systems, electro-optics, advanced materials	*65.3*	*7.4*
Fabricated metal products, machinery and equipment	*19.9*	*2.3*
Electrical and electronic products (manufacture, assemble)	*19.1*	*2.2*
Others	*150.7*	*17.2*
Information and communication technology	326.0	37.1
Life sciences	147.3	16.8
Electricity, power generation, gas and water	15.6	1.8
Wholesale, retail trade, restaurant and hotels	5.0	0.6
Education	4.0	0.5
Construction	0.1	0.0
Transport, storage and communications	1.4	0.2
Financing, insurance, real estate and business services	9.8	1.1
Others	64.7	7.4
Total	**878.7**	**100.0**

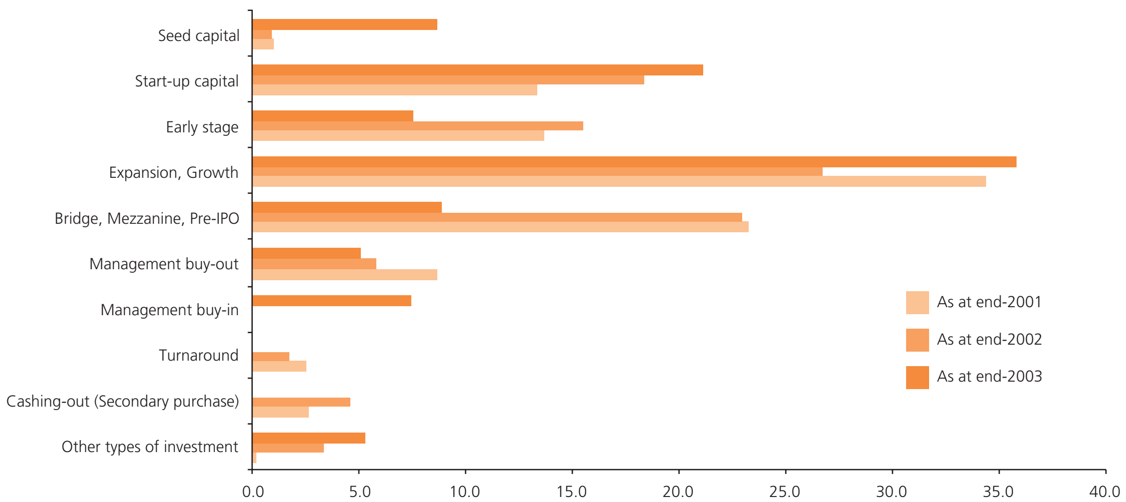
Source: Securities Commission

investments. Contributions from the private sector rose by 18.9% to account for 45.8% of total funds raised during the year (38.5% in 2002). VC funds from foreign sources were small, amounting to RM109.6 million as at end-2003. Almost 75% of VC funds from foreign sources were invested in the ICT and life sciences sectors.

In 2003, private sector initiatives undertaken to promote VC investment were substantial, with the total number of investee companies at the start-up stage remaining high at 21.1% of total VC investments in 2003. While remaining small, the cumulative investment in the seed-capital stage also increased in 2003, reflecting an increase in the risk appetite within the VC industry. At the same time, the Kuala Lumpur Stock Exchange (KLSE) provided an effective exit mechanism for VC investments. This was evident with the higher number of initial public offerings (IPOs) in 2003, by small companies with high-growth potential.

During the year, most of the VC investments were channelled to the new growth sectors of information and communication technology (ICT), life sciences

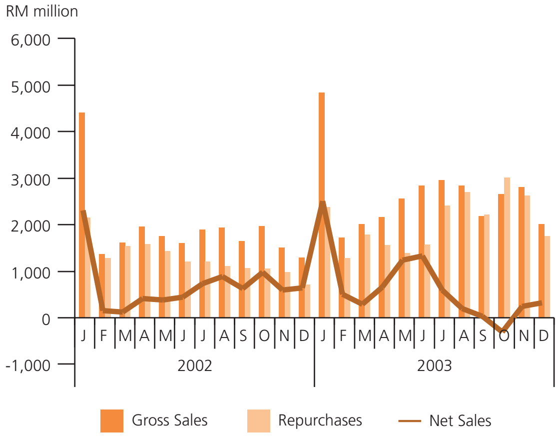
Graph 4.17
Outstanding Investment by Stages (% share)



Source: Securities Commission

and advanced manufacturing. In value terms, the software, internet services and e-businesses sub-sector received the highest amount of funding (21.1% of total), followed by medical and biotechnology sub sector (15.5%). As at end-2003, the bulk of total outstanding investments of VCCs (61.3%) were concentrated in the new growth sectors of ICT, life sciences and advanced manufacturing sectors. Investments in other sectors amounted to RM340.1 million, with the manufacturing sector (excluding advanced manufacturing) accounting for 27.3% of total outstanding VC investments. While domestic VC funds were mostly invested in the manufacturing (38.1%), ICT (36.7%) and life-sciences (14.2%), foreign VC investments concentrated on ICT (39.9%) and life-sciences (34.8%) only.

Graph 4.18
Unit Trust Industry - Gross Sales, Repurchases and Net Sales



Unit Trust Industry

The unit trust industry continued to expand in 2003, with a larger number of new funds launched and continued increase in the number of units in circulation. In line with the significant improvement in the performance of the KLSE, the net asset value (NAV) of the industry expanded by 30.5% in 2003. As a result of the intensified marketing efforts and the introduction of a greater variety of products by the unit trust management companies to cater to the diverse investor needs and preferences, gross sales of unit trust funds increased by 37.5% in 2003. The gross sales level remained consistently high throughout the year. However, due to high repurchases made during the second half of the year, net sales were slightly lower compared with 2002. This development was the result of portfolio rebalancing exercises by investors in view of the better performance of the equity market in the third quarter. In September and October, net repurchase positions were recorded. Nevertheless, given the continued favourable sentiments and expectations of better performance in equity investments, net sales were recorded in the fourth quarter.

One segment of the unit trust industry that has grown significantly in recent years was the Islamic unit trust. In 2003, 14 new Islamic funds were launched (8 in 2002), bringing the total number of Islamic funds to 50. The NAV for Islamic funds grew substantially by 47.8% in 2003. The share of Islamic funds of total NAV of the unit trust industry rose to 6.7% from 6% in 2002.

In the development of unit trust activities, Bank Negara Malaysia has liberalised regulations pertaining to investment abroad by the unit trust industry,

Table 4.22
Unit Trust Industry (Including Islamic Unit Trust Funds) - Selected Indicators

	2002	2003	2002	2003
			Growth (%)	
Number of Unit Trust Management Companies	39	36	5.4	-7.7
Number of Unit Trust Funds*	175	217	17.4	24.0
Number of New Funds Launched	26	42		
Units in Circulation (billion)	84.5	97.4	18.4	15.2
Number of Accounts ('000)	10,175	10,221	1.9	0.5
Net Asset Value (RM billion)	53.7	70.1	13.4	30.5
Average Monthly Gross Sales (RM billion)	1.9	2.6		
Average Monthly Repurchases (RM billion)	1.3	2.1		
Net Sales (RM billion)	7.6	6.9		
Ratio of NAV to KLSE market capitalisation (%)	11.1	10.9		

* Refers to funds already launched.

Source: Securities Commission.

Table 4.23
Islamic Unit Trusts

	2002	2003	2002	2003
			Growth (%)	
Number of Unit Trust Management Companies	27	27	17.4	0.0
Number of Unit Trust Funds*	36	50	28.6	38.9
Units in Circulation (billion)	5.8	8.6	35.1	49.1
Number of Accounts	303,000	346,000	13.5	14.2
Net Asset Value (RM billion)	3.2	4.7	32.6	47.8
Net Sales (RM million)	980.4	1,169.9		
Ratio of NAV to KLSE Syariah Index market capitalisation (%)	1.2	1.3		

* Refers to funds already launched.

Source: Securities Commission.

which would accord flexibility for unit trust management companies to diversify their portfolio in order to improve returns to investors. Effective 1 April 2004, unit trust management companies can freely invest in foreign assets up to 10% of NAV per fund for funds subscribed by residents, and up to the full amount of NAV for funds subscribed by non-residents. Unit trust funds of different companies may also be pooled to benefit from economies of scale when investing abroad.

In addition, the Securities Commission also revised the Guidelines on Unit Trust Funds on 1 April 2003. Key improvements introduced included greater flexibility for the issuance of specialised unit trust products, faster assessment of applications for the issuance of unit trust products, faster prospectus registration, streamlining approval process, and enhancing disclosure and reporting requirements.

FINANCIAL MARKETS

Overview

Increased activities in the money market reflected higher trading in both interbank deposits and money market papers. The volume of transactions in the interbank market increased more significantly with the shift in market preference towards shorter-term money market instruments.

In the Kuala Lumpur interbank foreign exchange market, the average daily volume of transactions increased during the year due to greater trade and investment flows, as well as increased hedging activities to mitigate the impact from greater volatility in international foreign exchange markets. While trading activity continued to be dominated by transactions in the ringgit against the US dollar, the share of euro and Japanese yen transactions against the US dollar increased in line with the higher transactions and hedging needs by market participants to manage the volatility of the G3 currencies.

Trading activities were also higher in the equity, bond and exchange-traded derivatives market. The KLSE Composite Index (KLSE CI) rose by 22.8% while the average daily trading activities rose significantly by 103.3% in terms of volume, and by 58.5% in terms of value. In the bond market, low interest and ample liquidity situation were significant factors that caused increased trading in the private debt securities (PDS) market, particularly in the first half-year.

Higher turnover was also recorded in the derivatives markets with the Crude Palm Oil (CPO) Futures market emerging as the best performer. The stronger performance was due to imbalances in the global vegetable oil market as production of major oilseeds increased only marginally, while demand, particularly from India and People's Republic of China, increased significantly. Active trading of KLIBOR Futures was influenced by expectations on the interest rate outlook. Two new derivatives products, the 3-year and 10-year MGS Futures contracts, were introduced in 2003.

Total funds raised in the capital market in 2003 were significantly higher, with gross proceeds amounting to RM105.1 billion, compared with RM69 billion in 2002. After accounting for redemptions, net funds raised in the capital market were significantly higher, amounting to RM54 billion (2002: RM23 billion). Net funds raised through the PDS market accounted for a majority share of 69.6% (2002: 13.4%). The Federal Government continued to tap the domestic market to finance most of its financing requirements, given the ample liquidity situation. Gross proceeds of RM41.3 billion were raised, mainly through 13 issuances of Government Securities. The private sector raised RM58.7 billion from the PDS and

Strengthening economic fundamentals and improved prospects for the Malaysian economy led to substantially higher trading activities across all segments of the financial markets.

Graph 4.19
Net Funds Raised in the Capital Market by the Public and the Private Sectors

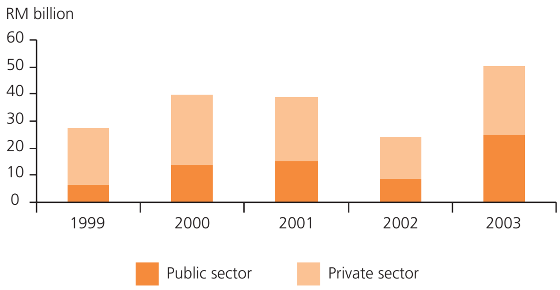


Table 4.24
Funds Raised in the Capital Market

	2002	2003*p*
	RM million	
By Public Sector		
Government Securities (gross)	16,266	41,262
Less Redemptions	8,900	18,600
Less Government holdings	0	0
Equals Net Federal receipts	7,366	22,662
Khazanah Bonds (net)	0	346
Government Investment Issues (net)	738	1,729
Malaysia Savings Bond (net)	464	-9
Net Funds Raised by Public Sector	**8,568**	**24,728**
By Private Sector		
Shares	13,291	7,772
Debt securities		
Issuance (gross)	36,195	50,975
Less Redemptions	34,137	33,189
Equals Net Issues	2,058	17,786
Net Funds Raised by Private Sector	**15,349**	**25,558**
Total Net Funds Raised	**23,917**	**50,286**
Short-term papers and notes (net)[1]	-880	3,753
Total	**23,037**	**54,039**

[1] Refers to Commercial Papers, Cagamas Notes and Medium Term Notes.
p Preliminary

equity markets (RM49.5 billion in 2002). Companies with strong credit profiles continued to lock-in low financing costs through the issuance of PDS. There was also an increase in issuance of asset-backed bonds as well as convertible bonds, in light of improving interest in the equity market. The equity market remained an important source of financing, especially for small and high-growth potential companies. The number of IPOs offered on the KLSE was 58, the highest since 1998 and RM7.8 billion were raised from these new issues.

The Government remains strongly committed to the further development of a broad and liquid capital market. Several measures and initiatives were taken in 2003 to improve retail investors' participation and protection, enhance market liquidity and efficiency, ease capital-raising exercise and listing policies and strengthen intermediation in the Malaysian capital market. Details are contained in the box "Key Capital Market Measures in 2003".

Money Market

Increased activities in the money market in 2003 were reflected mainly in higher trading of interbank deposits. Trading of money market papers increased marginally.

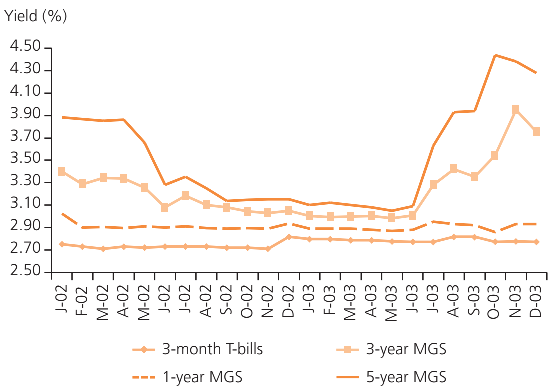
Table 4.25
Money Market[1]

	2002		2003	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total money market transactions	**1465.1**	**-2.4**	**1538.4**	**5.0**
Interbank deposits	**1011.7**	**-4.1**	**1084.7**	**7.2**
Money market papers	**453.4**	**1.8**	**453.7**	**0.1**
Bankers Acceptances (BAs)	51.3	-15.2	37.3	-27.3
Negotiable Instrument of Deposits (NIDs)	36.7	7.0	43.1	17.4
Malaysian Government Securities (MGS)	244.1	11.0	231.4	-5.2
Khazanah bonds	15.5	-13.4	18.8	21.3
Treasury bills	8.4	-37.3	9.9	17.9
Bank Negara Bills	54.4	-1.4	71.5	31.4
Cagamas bonds	29.2	12.7	25.6	-12.3
Cagamas notes	13.8	-25.0	16.1	16.7

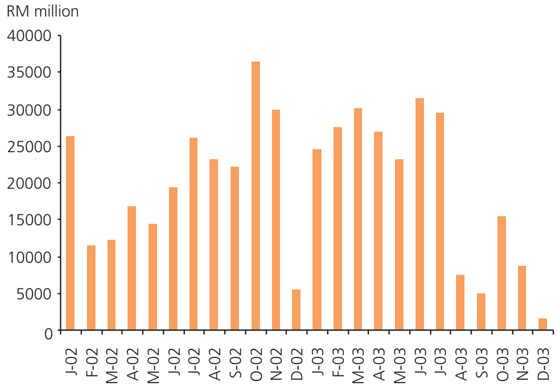
[1] All data are sourced from the Bond Information and Dissemination System, except BAs and NIDs which are sourced from money market brokers.

Activities in the interbank money market in 2003 were marked by two periods of changing market expectations. In the first half, trading in the market was largely influenced by concerns regarding the adverse impact of increased geopolitical uncertainties on economic growth following the war in Iraq. The outbreak of SARS in the region further aggravated this uncertain environment. As a result, most of the market players took a view that the existing accommodative monetary policy stance will remain for an extended period. Against the background of a low inflation, the prevailing uncertainty increased the market's preference for fixed-income instruments, especially in the higher-yielding longer dated papers. From January to July 2003, the average monthly MGS volume traded was higher at RM27.6 billion compared with RM18.1 billion in the same period of 2002. Nevertheless, the overall

Graph 4.20
Yields of Money Market Instruments



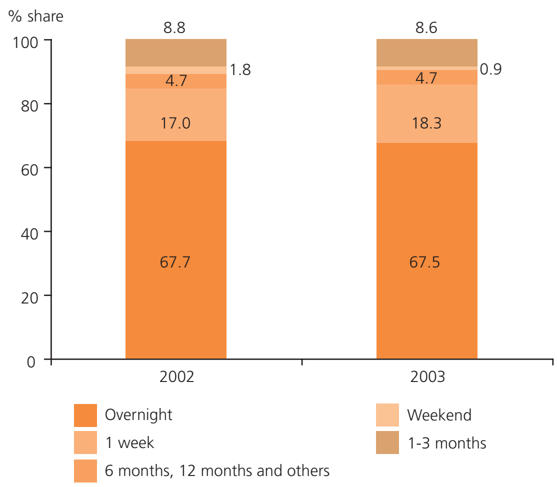
Graph 4.21
Volume of Traded MGS



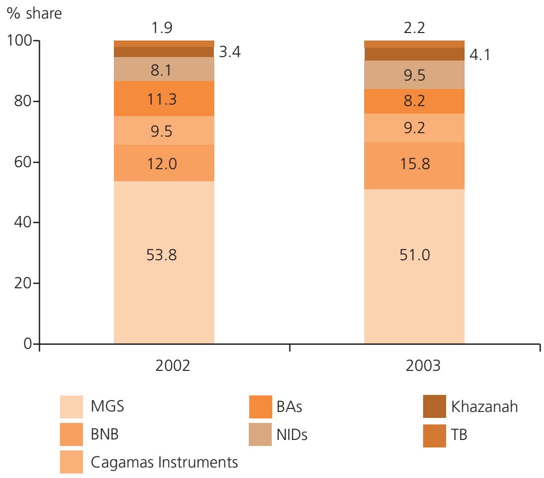
MGS yields remained stable during this period as the greater demand for the longer dated papers, was offset by the steady supply of the MGS to the market. During the first half of the year, net issuance of MGS amounted to RM13.3 billion.

Nevertheless, the uncertain outlook proved to be temporary as business activities picked up steadily in the second half of the year. This prompted market players to factor-in an expectation for an earlier turnaround in the interest rate cycle in the near future. The improving corporate performance amidst strengthening financial position of corporations and the better-than-expected GDP growth in the third quarter, led to a shift in asset allocation towards equity. The rising perception of market risk resulted

Graph 4.22
Share of Total Volume Traded: Interbank Deposits



Graph 4.23
Share of Total Volume Traded: Money Market Instruments



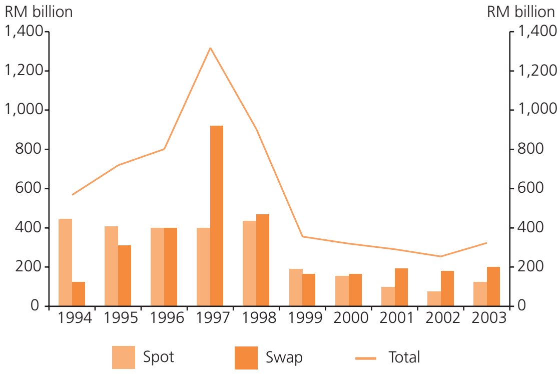
in lower volumes traded in the money market. Trading in MGS was also relatively subdued during the period of August to November. This was caused by concerns over the direction of interest rates following the upward adjustment in policy rates by two central banks (Australia and United Kingdom) and the brighter prospects for the US economy. These factors contributed to the upward shift in the MGS term structure, with the yields on the 3-year and 5-year MGS increasing by 94 and 129 basis points respectively.

The volume of transactions in the interbank deposit market also rose significantly in the second half of 2003. Trading on interbank deposits increased by 21.5% (-3.7% during the same period in 2002) in the second half of 2003 with a shift in the market's preference towards shorter-term money market instruments.

Foreign Exchange Market

In the Kuala Lumpur interbank foreign exchange market, the average daily volume of interbank foreign exchange transactions (spot and swap transactions) increased by 27% compared to 2002, arising from higher trade and investment flows. The higher volume of transactions also reflected higher spot and swap trades following increased activity by market participants to manage their exposure due to greater volatility in international foreign exchange markets. Trading activity comprised mainly trade-related transactions, as position-taking activity on the

Graph 4.24
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



Note: Data from 2002 onwards is based on the new Ringgit Operations Monitoring System (ROMS), whereas observations for previous years are based on transactions of the eight Authorised Dealers

ringgit has been contained through the elimination of the offshore ringgit market and through guidelines governing the operating framework of banking institutions.

By composition, the Kuala Lumpur foreign exchange market continued to be dominated by transactions in the US dollar against the ringgit, with the share of such transactions increasing to 81.7% of total transactions in 2003 from 80.8% in 2002. The dominance of US dollar transactions against the ringgit reflects the significance of the US dollar in the Kuala Lumpur foreign exchange market as well as the high usage of US dollars in the settlement of trade, services and capital account transactions. A notable development in 2003 was the significant increase in the share of euro and yen transactions against the US dollar. The share of Euro transactions against the US dollar more than doubled, while the share of yen transactions also increased markedly by 33%. These increases can be attributed largely to the higher transaction and hedging needs of market participants to manage the significant volatility among the G3 currencies during the course of the year.

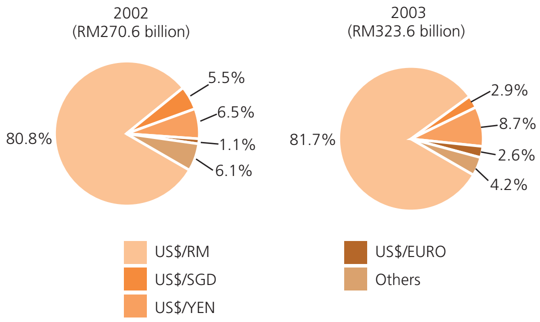
Equity Market

In 2003, the Kuala Lumpur Stock Exchange Composite Index (KLSE CI) ended the year on a stronger note, following stronger economic growth and improved economic outlook. For the year as a whole, the KLSE CI registered a strong annual growth of 22.8%, while average daily trading activities rose significantly by 103.3% in terms of volume and by 58.5% in value. The higher turnover was supported by both higher retail and institutional participation.

The performance of the KLSE in the first four months was subdued, with sentiments affected by uncertainties on the global economic outlook. Market sentiments turned more positive since May, driven by improved economic outlook, stronger corporate earnings and significant progress achieved in corporate restructuring.

KLSE CI registered its strongest performance since 1999. Increased domestic participation was evident following the standardisation of board lot sizes to 100 units.

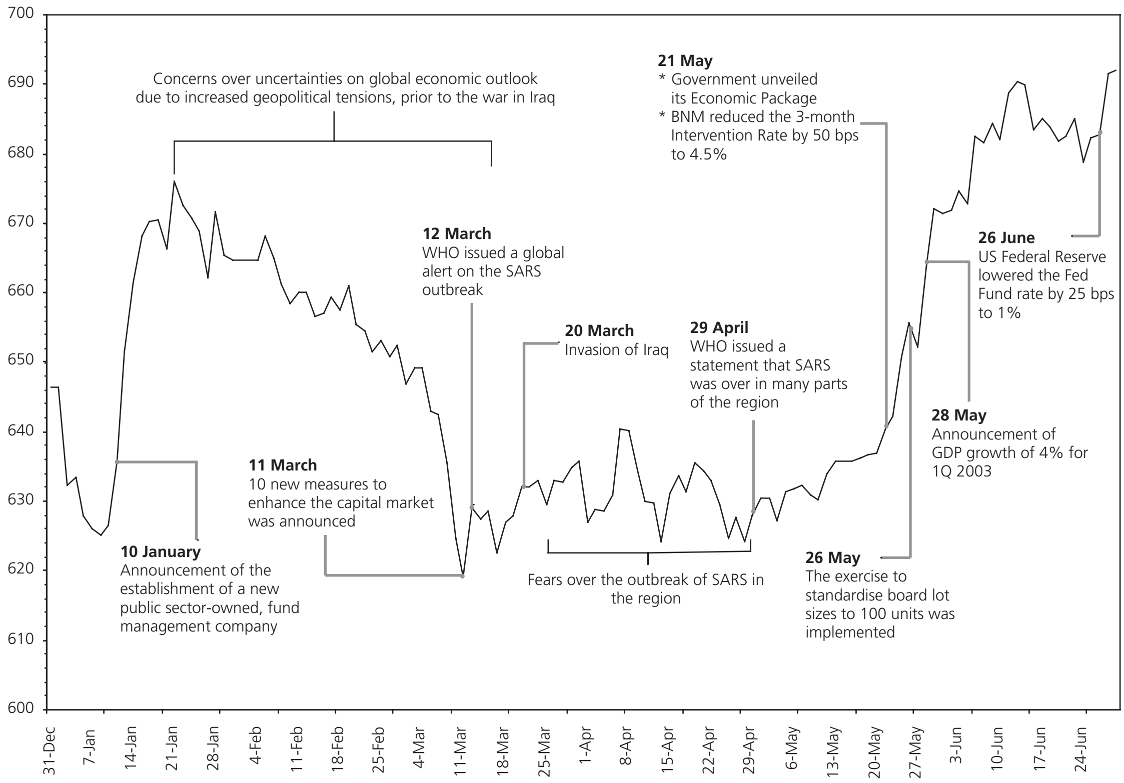
Graph 4.25
Transactions in the Kuala Lumpur Foreign Exchange Market by Currency



Policy measures introduced by the Government to promote capital market developments also created a more conducive environment for investors.

The Malaysian Exchange of Securities Dealing & Automated Quotation (MESDAQ) Market Composite Index (MCI) was the best performing index in 2003. The MCI posted a substantial gain of 82.9% (-5.5% as at end-2002). The strong performance of the index and higher trading activities were due to increased new listings of small but high-growth potential companies. The Second Board Index also posted a significant gain of 43.2%, reflecting investors' preference for

Graph 4.26: Performance of the KLSE Composite Index (31 December 2002 - 30 June 2003)



Graph 4.27: Performance of the KLSE Composite Index (1 July - 31 December 2003)

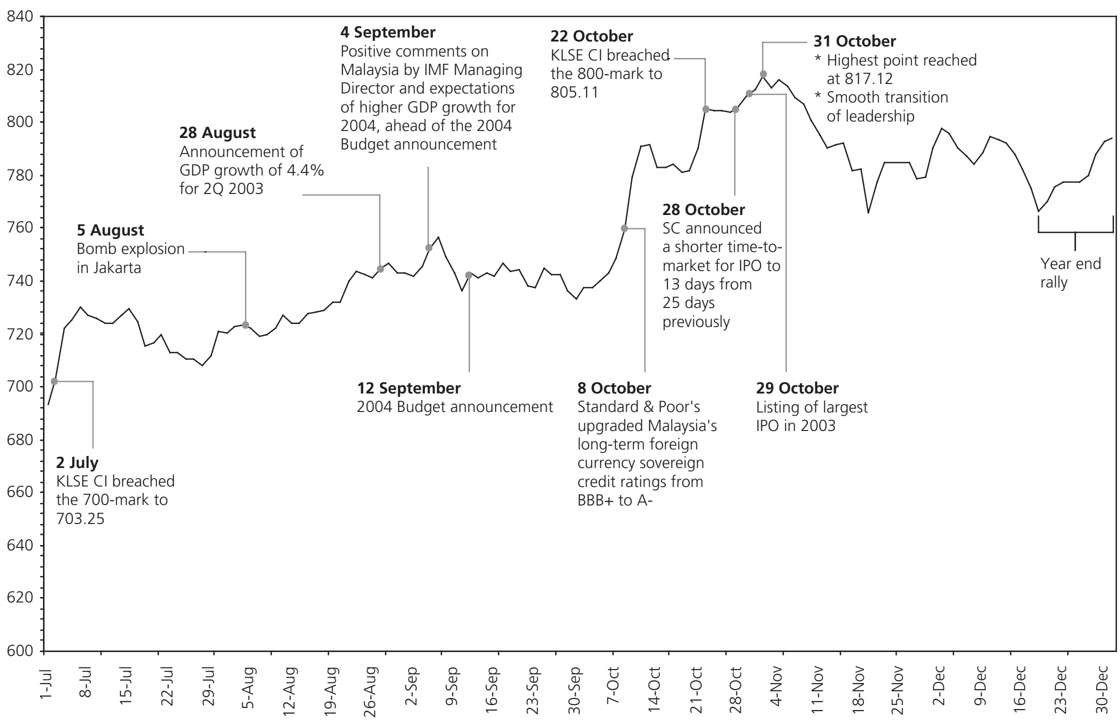


Table 4.26
Kuala Lumpur Stock Exchange: Selected Indicators

	2002	2003
Price Indices:		
Composite	646.3	793.9
EMAS	157.3	195.6
Second Board	98.2	140.6
MESDAQ	83.3	152.3
Total Turnover:		
Volume (billion units)	55.6	112.2
Value (RM billion)	117.0	183.9
Average Daily Turnover:		
Volume (million units)	224.3	456.0
Value (RM million)	471.6	747.5
Market Capitalisation (RM billion)	481.6	640.5
Market Capitalisation / GDP (%)	133.5	163.4
Total No. of Listed Companies:	865	906
Main Board	561	598
Second Board	292	276
MESDAQ	12	32
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	23.2	33.4
Turnover Volume / Number of Listed Securities (%)	24.3	43.4
Market Concentration:		
10 Most Highly Capitalised Stocks[1] / Market Capitalisation (%)	34.0	31.6
Average Paid-Up Capital of Stockbroking Firms (RM million)	164.2	170.9

[1] Based on market transactions only.

Source: Kuala Lumpur Stock Exchange

smaller companies with higher potential for earnings growth. Listed stocks on the Main Board saw more moderate price performances across all sectors.

The strong performance of the equity market was supported by improvements in earnings outlook and sound financial health of corporates. From a sample of 300 listed non-financial corporations (representing almost 75% of total KLSE market capitalisation), cumulative profits for the first three quarters were 54% higher in 2003, compared with the same period in 2002. Annualised return-on-equity for the sample rose to 7.3% in the third quarter of 2003, from 5.4% in the third quarter of 2002. Stronger corporate earnings were observed in most sectors as the impact of the SARS outbreak and geopolitical uncertainties on businesses in the first half of 2003 was only confined to a few tourism-related companies.

Other indicators of corporate health also showed positive developments. Corporate indebtedness remained stable, with aggregate debt-equity ratio

Table 4.27
KLSE: Performance of Sectoral Indices

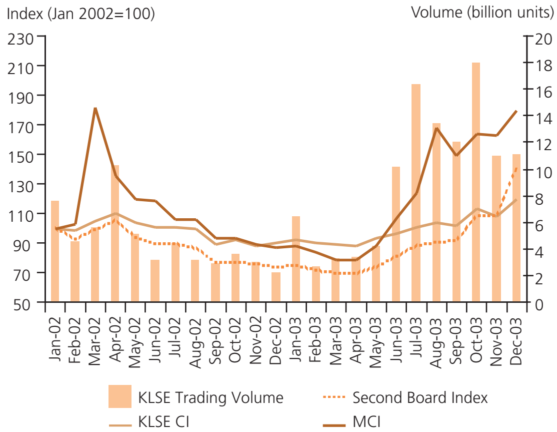
	2002	2003
	Annual change (%)	
KLSE Composite Index	-7.1	22.8
EMAS	-4.8	24.4
Second Board	-26.8	43.2
MESDAQ Composite Index	-5.5	82.9
Industrial	0.1	31.3
Consumer Products	0.5	28.8
Industrial Products	-2.5	23.4
Construction	-14.9	24.6
Trading/Services	-6.1	18.3
Finance	-4.7	33.2
Properties	-9.8	38.8
Mining	-5.1	74.8
Plantation	14.7	19.3
Syariah	-7.4	23.2
Technology	-17.9	33.9

Source: Kuala Lumpur Stock Exchange

at 0.62 in the third quarter of 2003 (average of 0.61 between the third quarter of 1999 and the third quarter of 2003). The improvements in profitability, together with stable leverage and low interest rates, resulted in stronger debt servicing capacity of the corporate sector. The interest coverage ratio, which measures the number of times a company's earnings before interest and tax exceeds its interest expense, rose to 4.7 times in the third quarter of 2003, its highest level recorded since the third quarter of 1999.

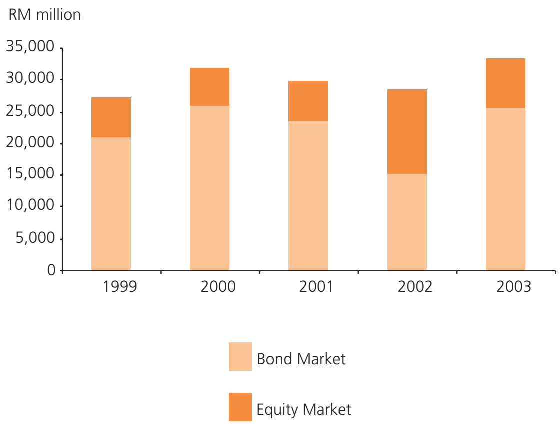
Encouraged by improved market performance and more favourable investor sentiments in 2003, a larger number of smaller firms raised funds in the

Graph 4.28
Kuala Lumpur Stock Exchange Composite Index, Second Board Index, MESDAQ Market Composite Index and KLSE Trading Volume

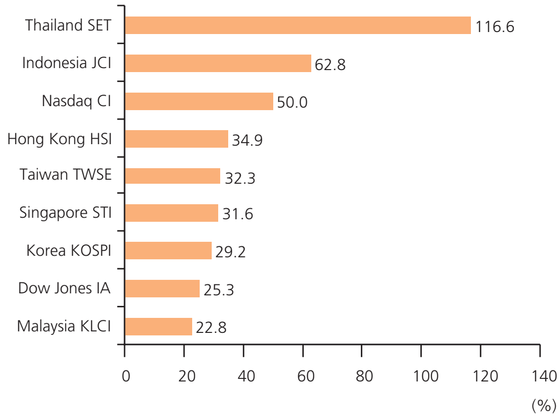


Source: Kuala Lumpur Stock Exchange

Graph 4.29
Funds Raised by the Private Sector in the Capital Market



Graph 4.30
Performance of Selected Stock Market Indices (% change from end-2002 to end-2003)



Source: Kuala Lumpur Stock Exchange

equity market. Total funds raised were, however, lower at RM7.8 billion compared with RM13.3 billion in 2002 due to the small size of the initial public offerings (IPOs). The new funds were mainly raised through IPOs (51%) and rights issues (29.4%). A total of 58 new companies was listed, the highest number since 1998. Of this total, 16 companies were listed on the Main Board, 22 on the Second Board and 20 on the MESDAQ Market. Prices of 52 new listings traded at a sizeable premium over the offer prices at the end of the first day of trading, influenced mainly by widespread investor interests and more active retail trading activities. The total number of companies listed on the KLSE was 906 as at end-2003, the second largest number of listed companies on a stock exchange after Hong Kong China in the East Asian region, excluding Japan.

In 2003, 58 new companies were listed on the KLSE, the highest since 1998. Significantly improved market performance encouraged smaller companies with growth potential to raise funds in the equity market.

The liberalisation of the listing policy to allow the listing of Malaysian businesses abroad and foreign-based businesses with Malaysian operations resulted in the listing of a large foreign company on the KLSE. The IPO, which raised RM2.03 billion, was the largest in 2003.

Recognising the importance of the capital markets in raising capital to facilitate growth of the Malaysian economy, the Government and relevant authorities introduced new measures to improve retail investors' participation and protection, enhance market liquidity and efficiency, ease the process for capital-raising activities and strengthen intermediation in the Malaysian capital market. Details of these measures are contained in the box "Key Capital Market Measures in 2003".

As part of the demutualisation plan, the KLSE completed on 5 January 2004 its conversion into a public company limited by shares, from a company limited by guarantee. The demutualisation was in line with a recommendation in the Capital Market Masterplan to enhance corporate, organisation and governance structures. While there was no significant diversion of the usual business practice, KLSE's stock exchange businesses were transferred to a wholly-owned subsidiary, Malaysia Securities Exchange Berhad (MSEB). The demutualised KLSE became the exchange's holding company with plans for listing on the exchange.

Key Capital Market Measures in 2003

Capital market measures introduced in 2003 were aimed at improving retail investors' participation and protection, enhancing market liquidity and efficiency, easing the process for capital-raising and listing, and strengthening intermediation in the Malaysian capital market. The key measures were as follows:

Enhancing Investor Participation

- Effective 17 March, the cap on **stamp duty for all securities traded on the Kuala Lumpur Stock Exchange (KLSE) was reduced to RM200 per contract** (previously capped at RM1,000 per contract).

- On 26 May, the **exercise to standardise board lot sizes to 100 units** from the previous 1000 units for all securities listed on the KLSE was completed.

Increasing the Efficiency of the Capital-Raising Process

- In line with the **reduction in the processing time for IPOs** to less than three months from the present six to eight months, the time-to-market period (period beginning from the issue of prospectus to the first day of listing) was also reduced to 13 days (from 25 days previously), effective 1 December 2003.

- Beginning 12 March, all corporate proposals which required **approvals from both the Foreign Investment Committee (FIC) and the Securities Commission (SC) would be processed by the SC only.** In cases where the SC's approval was not required, the approval remained with FIC.

- On 18 November, a set of **guidance notes on share splits** for public listed companies was introduced. Among others, liberalisation included abolishing the requirements for the appointment of a principle adviser to submit proposals and for the approved share split exercise to be implemented within three months.

Strengthening Investor Protection and Corporate Governance

- On 3 June, the SC issued the "**Guide on Areas of Compliance and Internal Controls for Management Companies and Trustees**" to assist fund management companies and trustees in establishing effective internal controls within their respective organisations. The Guide identified key areas of compliance and internal controls.

Enhancing Restructuring of Distressed Companies

- On 18 June, the SC issued a set of **criteria for delisted PN4 companies to seek re-listing on the KLSE.** The criteria, among others, allowed delisted PN4 companies to seek re-listing without the requirement for a general public offering, provided that the application was submitted within 12 months from the date of delistment.

- On 19 November, the SC announced **a six-month extension of the deadline for under-capitalised public listed companies to increase their paid-up capital to at least RM60 million for Main Board companies and RM40 million for Second Board companies.** The new deadline is 30 June 2004.

Liberalisation of KLSE Listing Policies

- Effective 11 March, the **moratorium on the shareholding period for promoters (which includes original owners and stakeholders of the companies) for all new IPOs/ Reverse Takeovers (RTO) was reduced from four years to one year.**

- On 11 March, the SC issued a set of **new guidelines to ease the listing process for large companies.** The new guidelines exempted large companies (with a minimum market capitalisation of RM250 million and after-tax profits of at least RM8 million for the latest financial year) from the three to five profits record requirement.

- On 19 September, the SC announced further liberalisation of the Guidelines on Issues/Offer of Securities to widen the breadth of listings in the Malaysian equity market. The revised listing policy **allowed Malaysian businesses abroad and foreign corporations with Malaysian operations to list on the KLSE.** The companies must also obtain the approval of Bank Negara Malaysia, where applicable, for the use of proceeds from the issue/offering of securities.

- **Amendments to the share buy-back guidelines** were made to allow flexibility for companies to undertake share buy-back activities. With effect from 7 October, a listed company would be allowed to appoint up to two stockbroking companies for the purpose of purchasing its own shares or reselling treasury shares on the exchange.

Strengthening the Role of Intermediaries

- Effective 9 June, the SC implemented the **minimum stockbroking commission rates structure.** The minimum commission rates would only apply to retail trades, while the rates applicable to institutional and inter-broker trades would remain fully negotiable. The minimum commission rates announced were as follows:

Category of trade	Minimum rate per contract
Inter-broker and Institutional trades	Fully negotiable
Retail trades valued above RM100,000	0.30%
Retail trades valued up to RM100,000	0.60%
E-broking transactions	Up to 30% discount

- On 20 November, the SC refined the **Capital Adequacy Requirement (CAR) framework for stockbroking companies**. The enhancement was aimed at facilitating the re-engineering of business models in the stockbroking industry and would enable stockbroking companies to utilise their capital more efficiently.

- On 10 December, the SC introduced the **Guidelines on the Offering of Structured Products**. The aim was to facilitate universal brokers, merchant banks, commercial banks, including Islamic banks, and performance-guaranteed Special Purpose Vehicles to issue "structured products" to meet the needs of an increasingly sophisticated Malaysian capital market.

Further Relaxation on the Uses of PDS Proceeds

- On 1 August, the SC liberalised **rules on use of proceeds from private debt securities (PDS)** to allow such funds to be used to finance the development of hypermarkets. Prior to this, the "construction of hypermarkets" fell under the definition of the "construction of shopping complexes" which was previously not allowed to be funded through PDS proceeds.

Enhancing Skills and Professionalism

- On 1 April, the SC launched the **Capital Market Graduate Training Scheme** which was aimed at increasing the pool of graduates with skills and knowledge on the capital market.

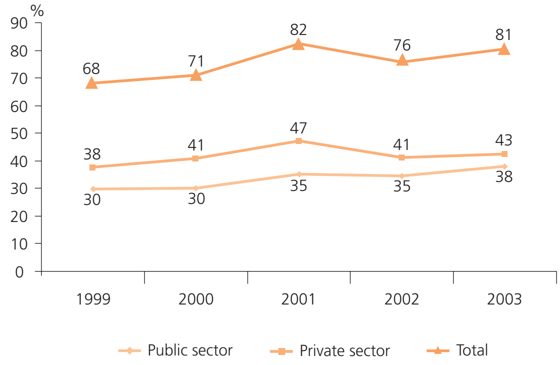
Bond Market

Total funds raised in the ringgit bond market were significantly higher in 2003. Gross issuance increased by 74.8% due to higher issuance by both the public and private sectors. After netting off redemptions during the year, total net funds raised in the bond market amounted to RM42.5 billion (RM10.6 billion in 2002). As a result, outstanding ringgit bonds rose by 16.7% to RM319.4 billion, equivalent to 81.5% of GDP. As corporate borrowers stepped up their net issuances during the year, the outstanding Private Debt Securities (PDS) increased by 14.4% to RM170.2 billion or equivalent to 43.4% of GDP, and accounted for 53.3% of total bonds outstanding. The low interest rate environment and ample liquidity situation were significant factors influencing the growth of the PDS market in 2003. Corporations, particularly those with strong credit profiles capitalised on the low interest rates through the issuance of long-term debt securities at competitive costs. The favourable market conditions, particularly in the first half of 2003 also prompted corporations to refinance their existing debt through PDS.

Total funds raised in the ringgit bond market were significantly higher in 2003. The low interest rate environment and the ample liquidity situation were the main factors influencing the growth of the private debt securities market in 2003.

Issuance of Malaysian Government Securities (MGS) was significant as the Government sourced the bulk of its financing requirements from the domestic

Graph 4.32
Ratio of Bonds Outstanding to GDP



Graph 4.31
Bonds Outstanding

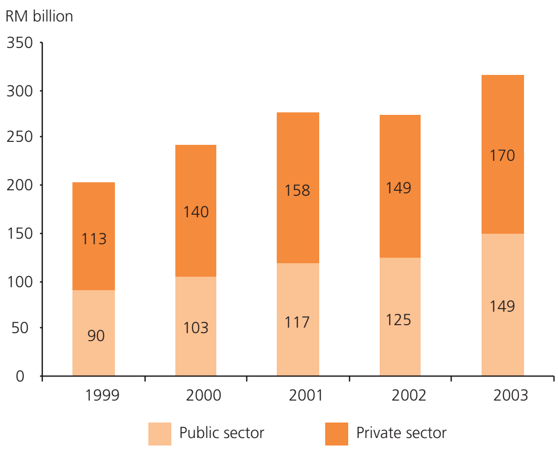


Table 4.28
Funds Raised in the Bond Market

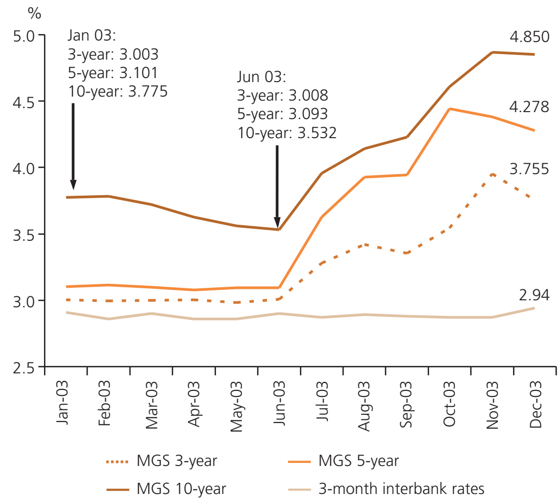
	2002	2003*p*
	RM million	
By Public Sector		
Government Securities (gross)	16,266	41,262
Less Redemptions	8,900	18,600
Equals Net Federal Receipts	7,366	22,662
Government Investment Issues (net)	738	1,729
Khazanah Bonds (net)	0	346
Malaysia Savings Bond (net)	464	-9
Net Funds Raised	**8,568**	**24,729**
By Private Sector		
Private Debt Securities (gross)	36,195	50,975
Straight Bonds	7,763	27,983
Bonds with Warrants	300	0
Convertible Bonds	2,852	3,177
Islamic Bonds	13,829	8,143
Asset Backed Securities	1,916	3,487
Cagamas Bonds	9,535	8,185
Less Redemptions	34,137	33,189
Private Debt Securities	28,770	28,037
Cagamas Bonds	5,367	5,152
Net Funds Raised	**2,058**	**17,786**
Net Funds Raised in the Bond Market	**10,626**	**42,515**
Private Debt Securities, excluding Cagamas (gross)	*26,660*	*42,790*
Net Funds Raised in the Bond Market, excluding Cagamas	*-2,110*	*14,753*
Net Issues Short Term Securities, Commercial Papers / Medium Term Notes[1]	-880	3,753
Total	**9,746**	**46,268**

[1] Refers to Cagamas Notes, Commercial Papers, Medium Term Notes.
p Preliminary

market. The ample liquidity situation enabled the Federal Government to do so without crowding out the private sector. The Federal Government made twelve Malaysian Government Securities (MGS) issuances, with gross proceeds totalling RM41.3 billion. In addition, the size of the Government Investment Issues (GII) was gradually enlarged to meet the increasing market demand for such Islamic instruments. Including net issuances of Khazanah bonds, the total outstanding public sector bonds rose to RM149.3 billion, or equivalent to 38.1% of GDP.

The bond market in 2003 could be dichotomised into two distinct periods of market developments. Commencing the year on a strong note, the underlying market conditions were favourable to both issuers and investors during the first half-year.

Graph 4.33
Trends in MGS Yields

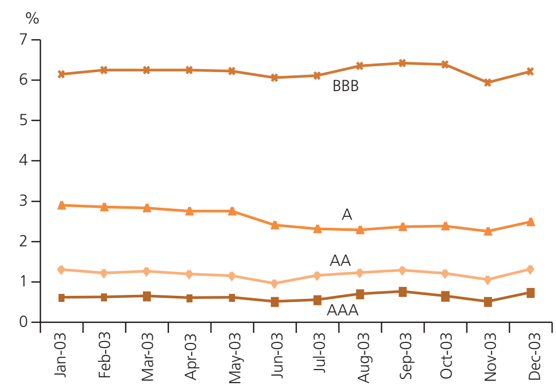


Bond yields trended downwards, influenced largely by concerns regarding the adverse impact of increased geopolitical uncertainties on the global economic outlook. The SARS outbreak further fuelled market expectations that interest rates would remain low for an extended period. Demand for long-dated and higher yielding bonds was high which resulted in a decline of 10-year MGS yields by 53 basis points and in turn caused the narrowing of the PDS credit spreads. With the declining yields and strong demand for debt securities, corporations increased bond issuances during this period. As a result, the bulk of the corporate bonds (65.8%) were issued in the first half-year, with a large portion of the proceeds being utilised for refinancing purposes.

Bond yields, however, reversed direction and trended upwards in the second half-year. Concerns over geopolitical risks and SARS outbreak proved to be short-lived. As signs of strengthening economic growth became evident with market expectations that interest rate might rise, investors reduced bond holdings. The rising yields of the US Treasury securities also influenced the domestic bond yields. Asset allocation shifted to the equity market following improved market sentiments in the equity market. As a result, bond trading activities turned subdued with a 47.2% reduction in the trading volume, compared with the first half of the year. Consequent from the sharp increase in the bond yields, fund-raising activities through the PDS market weakened in the third quarter of 2003, as some impending corporate issues were deferred.

Nevertheless, the weak demand for bonds and the fall in issuance were temporary. Bond yields stabilised

Graph 4.34
Yield Differentials for 3-year PDS vis-a-vis the 3-year MGS



Graph 4.35
Utilisation of Proceeds

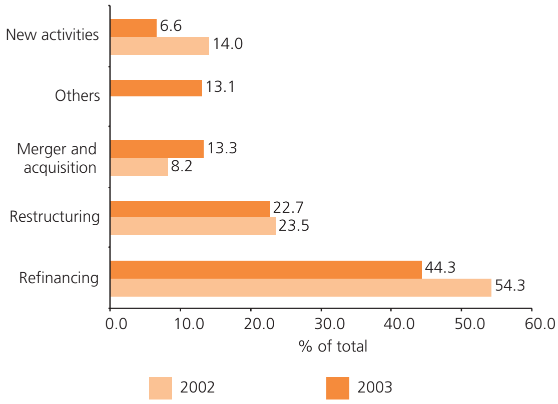


Table 4.29
New Issues of Private Debt Securities by Sector

Sector	2002		2003*p*	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	971.9	3.6	993.1	2.3
Mining and quarrying	0.0	0.0	0.0	0.0
Manufacturing	1,776.8	6.7	9,072.4	21.2
Construction	2,174.1	8.2	6,049.7	14.1
Electricity, gas and water supply	1,349.0	5.1	3,410.5	8.0
Transport, storage and communication	9,099.5	34.1	8,603.8	20.1
Financing, insurance, real estate and business services	5,513.8	20.7	8,372.8	19.6
Government and others	4,644.5	17.4	6,288.1	14.7
Wholesale and retail trade, restaurants and hotels	1,130.8	4.2	0.0	0.0
Total	**26,660.3**	**100.0**	**42,790.4**	**100.0**

p Preliminary

in December following portfolio rebalancing activities and strong buying interests of quality papers. The rebound in issuances in December was partly due to the corporate issues which were postponed earlier.

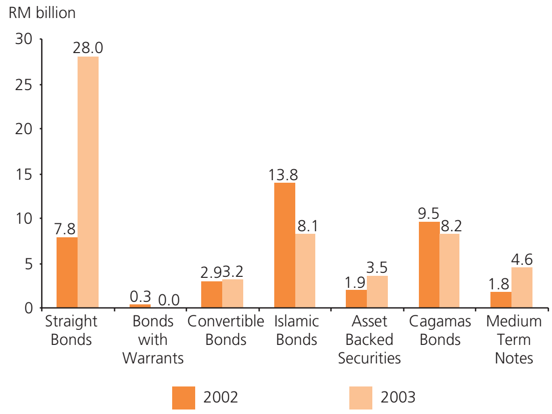
The low interest rate environment was the dominant factor influencing financing decisions of the corporate sector during the year, as reflected in the higher bonds issued for refinancing purposes (44.3% of total bonds issued). The issuers were companies from the transport, infrastructure, utilities and construction sectors. The bulk of funds raised for restructuring purposes was raised by a conglomerate in the manufacturing sector. During the year, total funds raised for merger and acquisition purposes accounted for 13.3% of the total, and were mainly raised by companies in the utilities and telecommunication sectors. Meanwhile, funds raised for new activities were lower and were mainly channelled to utilities-related infrastructure projects, the construction sector and, to a smaller extent, the manufacturing sector. The construction and real-estate property companies utilised the proceeds mainly for land acquisition, refinancing and working capital purposes.

During the year, the bulk of the new issues (52% of total value) were for tenures between five to ten years, in response to investors' preference for short to medium-end PDS. On average, the issue size for PDS increased to RM602.5 million per issuer in 2003 from RM494.7 million per issuer in 2002. Nevertheless, the maturity profile of the domestic market lengthened further, with the longest tenure issued reaching 28 years, compared with 26 years recorded in 2002.

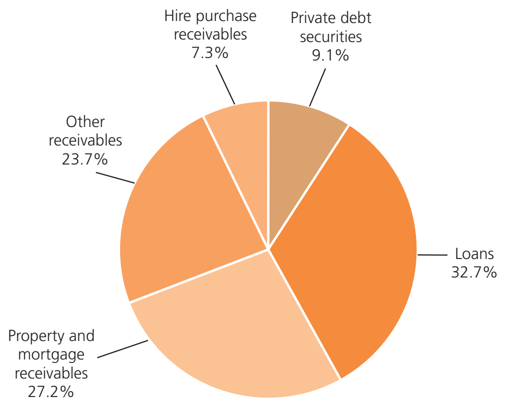
In terms of types of instruments, straight bonds were the most preferred form of debt securities, accounting for 50.4% of total bonds issued. Meanwhile, the improved sentiment in the equity market led to higher issuance of convertible bonds. In recent years, commercial papers/medium-term notes gained more prominence, especially for the purposes of financing working capital requirement.

Graph 4.36
PDS Issues by Tenure

Graph 4.37
PDS Issues by Type of Instrument



Graph 4.38
ABS: Types of Underlying Assets (2001-2003)

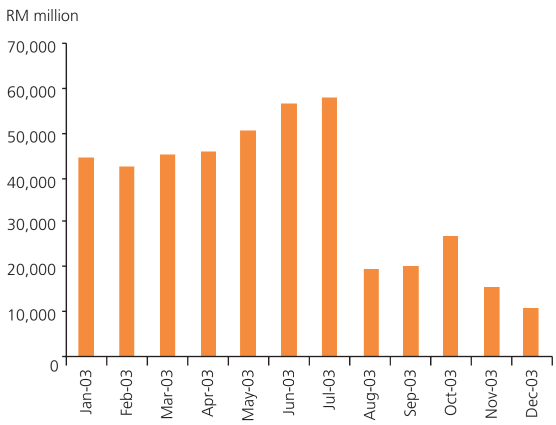


These instruments allowed more flexibility for issuers to take advantage of the low interest rates in the shorter term by issuing commercial papers, while waiting for opportunities to lock-in favourable rates in the medium-term as and when the yields began to trend upwards.

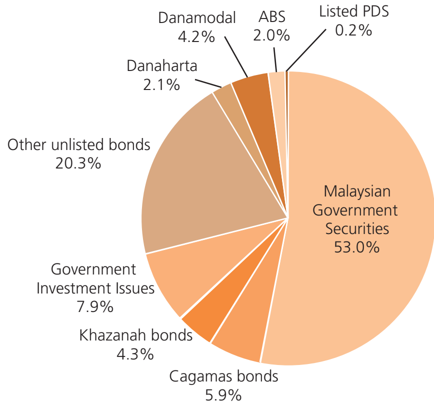
A wide range of Asset Backed Securities (ABS) were issued during the year, which included those backed by hire-purchase receivables, loans and innovative issuance of Islamic principle ABS backed by mortgage assets. In total, there were ten ABS (including one commercial paper ABS) amounting to RM7 billion, since the first issuance of ABS in 2001. The ABS market is expected to develop further, given the tax incentives announced in 2004 Budget.

Despite a challenging operating environment with ample liquidity in the banking system, Cagamas

Graph 4.39
Monthly Trading Volume



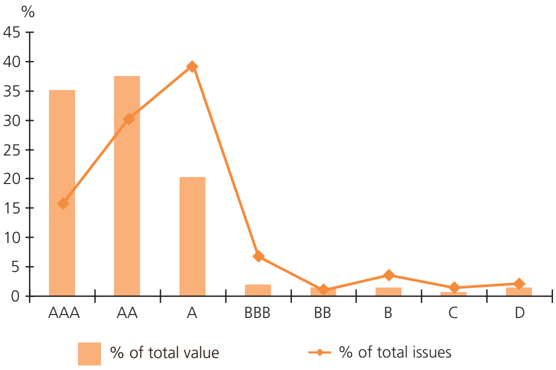
Graph 4.40
Turnover of Selected Debt Securities (Jan-Dec 2003)



Berhad maintained its position as an active issuer. In 2003, Cagamas issued 33 issues of debt securities at a total value of RM17.9 billion (including 15 short-term Cagamas notes of RM9.7 billion). Most of the Cagamas bond and notes were issued during the second half of 2003, due to the rising bond yields which had prompted the financial institutions to be more active in hedging their portfolios through the sale of loans and debts to Cagamas. Taking into consideration the less favourable market sentiments during the second half-year, Cagamas spaced out the issuances in order to ensure an orderly market performance. Investors' demand for Cagamas bonds throughout the year was firm, as evidenced by the weighted average over-subscription rate of 1.83 times and 2.38 times for Cagamas notes and Cagamas bonds respectively.

Total trading activities in the ringgit bond market increased by 11.6% to RM436.8 billion, with higher activities in the first half of the year. In the second half-year, trading activities were concentrated in shorter-end papers, given the higher risk premium and price volatility of long-dated papers. The most actively traded papers were MGS, accounting for 53% of total trading activities and a liquidity ratio of 1.89 times its outstanding amount. Demand for corporate bonds increased, and accounted for 22.6% of the total trading activities, compared with 14% in the previous year. Nevertheless, the corporate bond market remained less liquid, with a liquidity ratio of only 0.81 times, and trading activities were centred on bonds with high ratings and good credit quality.

Graph 4.41
Rating Distribution of Outstanding PDS
(As at end-December 2003)



Source: RAM and MARC

Rating profiles of long-term debt securities remained healthy. Both the Rating Agency Malaysia (RAM) and the Malaysian Rating Corporation Berhad (MARC) undertook 116 new ratings, with total gross value of RM41.9 billion. In terms of rating profiles, the issues were mainly distributed throughout the AAA, AA and A categories, with the heaviest concentration in the single A category. During the year, RAM and MARC conducted 204 rating reviews on the existing long-term debt securities, of which 161 issues were affirmations/reaffirmations, 10 issues were upgrades and 18 issues were downgrades. The higher number of downgrades were partly due to companies in the tourism-related sector, whose financial positions were adversely affected by the outbreak of SARS.

On the international front, market sentiments for the Malaysia's foreign currency sovereign bonds and corporate bonds remained positive due to expectations of an upgrade in sovereign ratings as economic fundamentals strengthened. Spreads for Malaysian sovereign bonds narrowed significantly during the year. The first Malaysian sovereign Sukuk bond issue which was listed in Luxembourg Stock

Table 4.30
Sovereign Spread Over US Treasury Benchmark

	Dec-02	Mar-03	Jun-03	Sep-03	Dec-03
MALAYSIA 09	183	180	123	101	85
MALAYSIA 11	145	150	83	70	36
CHINA 11	61	65	29	28	29
INDONESIA 06	348	288	284	173	185
KOREA 08	110	162	84	69	45
PHILIPPINES 10	478	500	382	343	353
THAILAND 07	108	90	53	18	5
PETRONAS 06	204	198	145	126	117

Source: Bloomberg

Exchange and Labuan International Financial Exchange in July 2002 was also listed on the Bahrain Stock Exchange on 24 September 2003. The listing helped to raise the profile of Malaysia to West Asian investors.

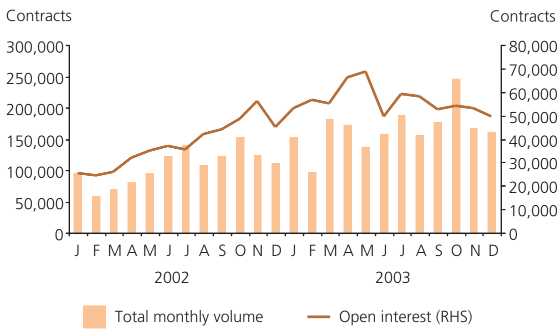
In line with enhancing the development of the bond market, efforts were taken in 2003 to accord greater investment flexibility to insurance companies in investing in debt securities, as well as to provide more risk management products. In November, Bank Negara Malaysia increased the insurers' limits on investment in secured and unsecured credit facilities which includes PDS. In addition, the Malaysian Derivatives Exchange introduced two new products, the 3-year and 10-year MGS futures, which added more hedging instruments in the domestic financial markets.

Exchange-traded Derivatives Market

In 2003, higher turnover was recorded for all exchange-traded derivative products on the Malaysian Derivatives Exchange (MDEX), except for trading in the Kuala Lumpur Stock Exchange (KLSE) Options. Total turnover increased significantly by 55.3% to reach more than two million contracts. Following the launch of two new products, the 3-year and 10-year MGS Futures Contracts, which enhanced risk management opportunities for investors, the MDEX now offers seven derivative products.

As in the previous year, the Crude Palm Oil (CPO) Futures market emerged as the best performer on the MDEX in 2003. During the year, the price range for the benchmark 3-month CPO Futures contract widened to RM622 (2002: RM587), with the highest daily traded price at RM1,865 per tonne on 9 December.

Graph 4.42
MDEX: Total Monthly Volume and Month-end Open Interest



Source: Malaysian Derivatives Exchange

Table 4.31
Performance of MDEX Products

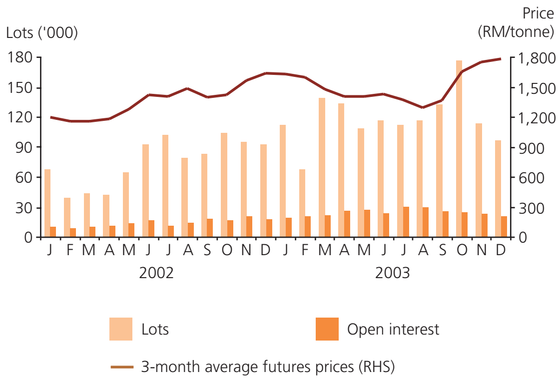
Products	Turnover 2002 Number of lots	Turnover 2002 Annual change (%)	Turnover 2002 Average daily volume	Turnover 2003 Number of lots	Turnover 2003 Annual change (%)	Turnover 2003 Average daily volume	Share of total MDEX volume (%) 2002	Share of total MDEX volume (%) 2003	Factors affecting performances
CPO Futures	909,073	89.5	3,666	1,429,959	57.3	5,813	70.6	71.5	• Strong CPO Futures prices. • Better trading platform with switch to electronic-based system in 2002.
KLSE CI Futures	233,863	-18.7	943	331,218	41.6	1,346	18.2	16.6	• Higher trading with implementation of cost-cutting measures.
Open interest position (as at end-year)	*1,346*			*8,993*					
KLSE CI Options	1	-99.8	…	0	…	0	…	…	• Lack of liquidity and knowledge by participants.
3-month KLIBOR Futures	64,307	17.1	259	119,659	86.1	486	5.0	6.0	• Higher turnover mainly in the second half of 2003, reflected the shift in market preference from bond market to short-term money and interbank markets instruments.
Open interest position (as at end-year)	*21,114*			*18,977*					
3-year MGS Futures	n.a	n.a	n.a	781	-	3	n.a	…	• Introduced in September 2003.
5-year MGS Futures	80,419	n.a	324	118,635	32.2	482	6.2	5.9	• Physical bond and bond futures markets experienced a correction in July 2003 following expectations over the direction of global interest rates.
Open interest position (as at end-year)	*4,860*			*127*					
10-year MGS Futures	n.a	n.a	n.a	11	-	…	n.a	…	• Introduced in September 2003.

n.a. Not available.

Source: Malaysian Derivatives Exchange

CPO futures prices began the year on a strong note, with the monthly prices averaging around RM1,600 – RM1,635 per tonne before consolidating in the following months to average around RM1,300 - RM1,480 per tonne. In the final quarter of the year, CPO prices regained its strength to record the highest level in four years, to average around RM1,660 - RM1,790 per tonne. The strong price performance in 2003 was a reflection of the imbalances in the global vegetable oils and fats markets, as the production of major oilseeds, especially soybean, rapeseed and sunflower increased marginally, whilst demand from the major consumers of edible oils had increased substantially during the year.

Graph 4.43
Crude Palm Oil Futures



Trading activities in the KLSE Composite Index (KLSE CI) Futures rose significantly in 2003. The Derivatives Liquidity Ratio (DLR), which represents the ratio between the turnover value of futures against the turnover value of underlying KLSE CI component stocks, increased significantly by 40.3% in 2003. The modification of the contract size from RM100 to RM50 and the increase in the tick sizes for the prices of the products effectively reduced the margin requirements and the cost of trade and thus encouraged more participation in the market. Trading activities by both domestic and foreign institutional players accounted for 76% of total trades.

Total volume of the 3-month KLIBOR Futures improved significantly following the sharp fall in bond prices and expectations that interest rates may increase. The higher turnover, mainly in the second half-year, reflected the shift in market preference from the bond market to short-term money market and the interbank market instruments. Meanwhile, the total turnover of 5-year MGS Futures registered an increase of 32.2% amidst expectations on the direction of global interest rates. Market sentiment turned cautious in the second half of 2003. Domestic institutions continued to be the major players in the MGS and 3-month KLIBOR futures markets.

DEVELOPMENTS IN PAYMENT AND SETTLEMENT SYSTEMS

Developments in 2003

In November 2003, the Payment Systems Act was enacted by Parliament and is a landmark achievement for the Bank as it sets out a comprehensive regulatory oversight framework, which is essential in governing the changing payment landscape. The primary objective of the Bank is to ensure the security, safety and efficiency of the important payment systems in the country, and that there is continued public confidence in the use of payment instruments. Of significance also is the migration towards the use of advanced technology such as chip cards to provide safer payment modes.

During the year, domestic banking institutions had replaced their magnetic stripe ATM cards with the chip based Bankcard, and with effect from 1 October 2003, all ATM transactions are carried out using the Bankcard. The Bankcard has three standard applications, that is, an ATM function, an e-debit function and the MEPS Cash e-purse. The locally incorporated foreign banks are expected to replace their ATM cards with chip based cards by March 2004. Presently, there has been no report of any ATM fraud through the use of cloned chip ATM cards.

In implementing a long-term measure to prevent the fraudulent skimming of credit cards, the banking industry is currently conducting an industry wide Europay-Mastercard-Visa (EMV) chip migration of their magnetic stripe credit cards. The magnetic stripe cards are going to be replaced by end-2004, and upgraded card acceptance devices will be deployed to accept EMV chip cards by end-2005. As at end-2003, there were about 243,000 EMV chip credit cards issued and about 18,000 card acceptance devices have been deployed to accept these EMV cards.

In addition to the enhancement of security features in the payment systems and instruments, technology also facilitates the development of more efficient payment modes, compared to paper-based payment instruments such as cheques. Electronic funds transfer systems (EFT) are more efficient and faster than cheque processing systems, as well as, being more secure and capable of effecting finality of payment with greater certainty. The Malaysian Electronic Payment System (1997) Sdn Bhd, has developed several electronic payment systems, one of which is the Financial Process Exchange (FPX) which is targeted to be completed in early 2004. The FPX will enable users to make online payments to facilitate electronic commerce transactions using a multi-bank payment platform.

The primary objective of the Bank is to ensure the security, safety and efficiency of the payment systems in the country, and that there is continued public confidence in the use of payment instruments.

Due to its many benefits, the promotion of the migration from paper-based payment instruments to electronic payments is being accelerated. In December 2003, this was discussed at the National Payment Advisory Council, followed by a consultation exercise with financial institutions. Three broad areas were proposed for the industry to consider on the measures that would promote the migration to electronic payments.

(i) Financial institutions should offer efficient and cost effective electronic payments that are accessible and convenient for their customers to use.

(ii) Strategic incentives including pricing should be in place to facilitate the investment and development of the e-payment infrastructure, and make e-payments widely acceptable.

Payment Systems Act 2003

Introduction

The Payment Systems Act 2003 (the Act) was gazetted on 7 August 2003 and came into effect on 1 November 2003. The introduction of the Act is in line with the recommendation in the Financial Sector Masterplan for the adoption of a flexible, proactive and effective regulatory framework for the oversight of payments system and to increase efficiency in the payment system. The introduction of the Act reflects the significance of payments system to the country's economic activities and recognizes Bank Negara Malaysia as the sole authority responsible for its oversight. An efficient and well functioning payments system would support the creation of social and economic efficiency and is crucial for the smooth functioning of the financial markets and in maintaining financial stability. In addition, the smooth operation of the payments system is also essential for Bank Negara Malaysia to effectively conduct monetary policy.

The objective of the Act is to ensure the safety and efficiency of the payment related infrastructure, and to safeguard public interest. The Act provides the legal framework to ensure that the financial system, and the public's confidence in the payment systems is well protected. The Act provides the specific legislative authority for a more comprehensive and effective oversight of the payment system. Banking institutions as well as non-bank players offering payment systems and instruments would be governed by the Act.

New oversight framework on payment system

The Act was drafted to provide a balanced regulatory framework for the oversight of the payment system in line with Bank Negara Malaysia's objective and to promote market innovation. The Act outlines two different oversight regimes for two types of players namely, the operator of payment systems and the issuer of designated payment instruments.

Oversight on the operator of payment systems

The Act defines a payment system as "any system or arrangement for the transfer, clearing or settlement of funds or securities". Several arrangements including the clearing house recognised under the Securities Industry Act 1983 or clearing house licensed under the Futures Industry Act 1993 are excluded from the definition of payment system. An operator of the payments system is required to submit documents and obtain notification from Bank Negara Malaysia. These documents and information are important for the establishment of a surveillance mechanism that is capable of monitoring developments in the payment system for the formulation of appropriate policies as and when required. Bank Negara Malaysia is also empowered to prohibit the operation of any payment system in the event that it is necessary in the interest of the public, or the operation of such system is detrimental to the reliable, safe, efficient and smooth operation of the country's payment systems.

The Act empowers Bank Negara Malaysia to designate a payment system as a designated payment system (DPS) if such a system poses systemic risks, or if the designation is necessary to protect the interest of the public. Only fit and proper persons can accept appointment as a director or chief executive officer of an operator of a DPS. The operation of a DPS would be subjected to closer oversight by Bank Negara Malaysia, including the requirement to establish good corporate governance. In addition, an operator of a DPS is required to ensure that adequate operational arrangements are in place to ensure the smooth functioning of these payment systems. This includes the establishment of rules and procedures setting out the rights and liabilities of the relevant parties including the financial risks that the parties might incur, as well as procedures for the management of credit risk and liquidity risk and measures to ensure the safety, security and operational reliability of the DPS.

To ensure that a DPS can work effectively, it is necessary for all payment and settlement instructions that are sent through the DPS be considered as final and irrevocable. The Act, therefore, provides that a payment or settlement instruction sent through a DPS shall be final and shall not be revoked or reversed from the time such an instruction is entered into the DPS. The operator of a DPS is required to establish rules that determine the point of time that a payment or settlement instructions is deemed as final.

In acknowledging that a DPS may also adopt netting arrangements in order to reduce settlement risks, the Act gives legislative recognition to any netting arrangements that are entered into, in relation to the DPS, to avoid any uncertainty with regards to such netting arrangements. The Act provides that netting arrangements adopted by participants of a DPS as well as finality of payment and settlement instructions in a DPS prevail over insolvency laws.

Oversight on the issuance of designated payment instruments
The Act empowers Bank Negara Malaysia to designate a payment instrument as a designated payment instrument (DPI). These are instruments that are widely used or that should be regulated by Bank Negara Malaysia in the interest of the public. Issuance of a DPI requires the prior approval of Bank Negara Malaysia. Three payment instruments have been designated as a designated payment instrument, namely, electronic money, credit and charge instruments.

Similar to DPS, issuers of DPIs are required to implement adequate corporate governance and operational arrangements to ensure the safety and reliability of these payment instruments. This includes the requirement to establish measures to ensure prudent management of funds collected from the users of the designated payment instruments and to ensure that such funds are available for repayment to the users.

Powers of Bank Negara Malaysia under the Act
Bank Negara Malaysia is empowered under the Act to require an operator of a payment system or issuer of a payment instrument to be an incorporated company. This requirement may be imposed where the corporate structure is necessary to provide more permanence, credibility and stature to the entity that will be required to comply with the Companies Act 1965 as well. To ensure effective supervision and monitoring of the payment systems in the country, Bank Negara Malaysia may require the operator of a payment system or the issuer of a payment instrument to submit information on the payment system operated or the payment instrument issued by them. Other powers conferred by the Act to Bank Negara Malaysia include: -

i. *Powers of examination*
   The Act empowers an examiner authorised by Bank Negara Malaysia to examine the premises and offices, apparatus or documents, of an operator of a payment system or an issuer of a payment instrument or any other person falling within the purview of the Act.

ii. *Control over DPS*
   The Act imposes a duty on an operator of a DPS who is insolvent to immediately inform Bank Negara Malaysia. Bank Negara Malaysia, by order published in the Gazette, may assume control of, or to carry on, the whole or part of a DPS's property, business and affairs, as the case may be. Bank Negara Malaysia may appoint a person to carry out such powers on its behalf by making an application to the High Court to appoint a receiver or a manager to manage the company.

iii. *Investigation, search and seizure*
   The Act empowers Bank Negara Malaysia to appoint its employee or any person as its investigating officer for offences under the Act. The investigation officer has the powers of entry into any premise, search and seize property, apparatus, or documents and search of persons. The Act also empowers Bank Negara Malaysia to investigate, with the concurrence of the Securities Commission, clearing houses recognised under the Securities Industry Act 1983 or those licensed under the Futures Industry Act 1993.

iv. Offences and enforcement

In order to ensure an effective regulatory regime, the Act includes a schedule of offences that provides for penalties in the event that identified provisions of the Act are contravened. Offences under the Act are assigned penalties in accordance with the severity of their potential effects, including systemic and other risks.

Conclusion

The enactment of the Act serves to strengthen Bank Negara Malaysia's oversight over payment systems and instruments. The Act enables Bank Negara Malaysia to identify and monitor systemically important payment systems and important payment instruments, which will be closely regulated under the Act, while giving regulatory flexibility to operators of payment systems and issuers of payment instruments to encourage innovation.

(iii) The financial industry should promote awareness of the electronic payment options and encourage consumers to use electronic payments and instruments by enhancing their confidence in using these means of payments.

General Payment Profile in Malaysia

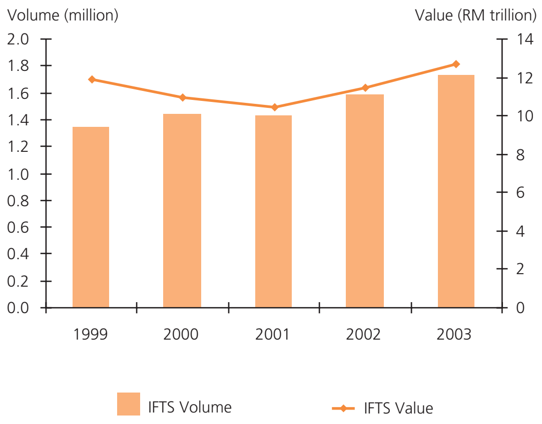
In the financial system, Malaysian consumers are notably heavy users of cheques compared to other payment instruments. The breakdown by percentage for the value and volume of non-cash payment transactions in 2003 is as shown in Table 4.32.

Whilst the banking industry continues to invest significantly in e-payment infrastructures, cheques remained a significant payment instrument. In 2003, cheques accounted for 96.7% of the total non-cash payment value. Although the value of e-purse transactions is negligible in terms of total non-cash payments, its volume accounted for 36.4% of total non-cash payments in 2003. E-purse transactions in Malaysia constituted mainly toll payments, where the Touch 'n Go contactless card was used. Settlement of retail related payments were made through the financial institutions, whereby interbank fund transfers are mainly undertaken through the real-time gross settlement system (RENTAS).

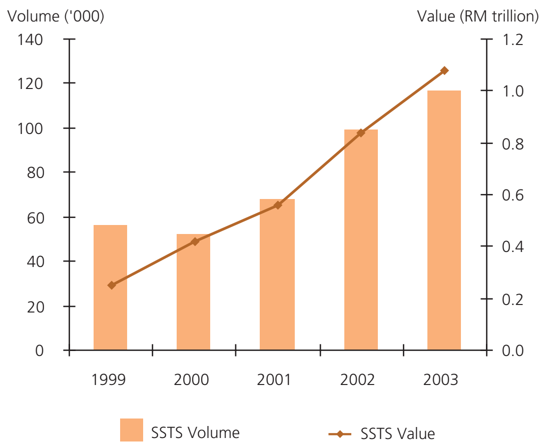
Table 4.32
Non-Cash Payments in Malaysia

	Value (%)	Volume (%)
Cheques	96.67	34.04
Credit cards	2.48	27.68
Credit transfers (Giro)	0.63	0.24
Charge cards	0.16	1.42
E-purse - Toll payments	0.05	36.40
- Retail	0.00	0.00
Debit cards	0.01	0.22

Graph 4.44
RENTAS – IFTS Turnover



Graph 4.45
RENTAS – SSTS Turnover



In 2003, in terms of value and volume, Interbank Funds Transfer System (IFTS) saw an increase of 10.9% and 9.1% respectively, while Scripless Securities Trading System (SSTS) transactions saw a significant increase of 28.6% and 18.3% respectively, when compared with 2002.

Efficiency Improvements

Bank Negara Malaysia had introduced several enhancements to improve RENTAS in 2003. These include the following:

(i) RENTAS-STP

The 'Straight Through Processing' (STP) module which is linked to the RENTAS system was introduced to enable all processes in a payment cycle beginning from payment initiation by customers to interbank settlement is integrated electronically. Members are advised to implement RENTAS-STP to improve the efficiency of their banking operations. The RENTAS-STP will reduce human intervention, enabling operational cost savings and resulting in improved customer service. Presently, four members have implemented RENTAS-STP.

(ii) Intra-day credit enhancement

In August 2003, the RENTAS system was enhanced to allow intra-day collateral securities to be valued on the net price basis after taking into account market price movements, credit rating changes and margin requirement. This method replaced the earlier method of calculating the 'haircut' which was based on the nominal value and did not reflect the fair value of the security. The intra-day credit enhancement has improved risk management, as the collaterals are now valued based on its fair value derived from the current market prices.

(iii) Enhancement of RENTAS i-LINK

In September 2003, Bank Negara Malaysia completed Phase 2 of the RENTAS i-LINK implementation. This system provides a timely and accurate real-time settlement information, allows monitoring, enquiring and analysing information pertaining to management of liquidity, cash and security positions. With the implementation of these modules, the RENTAS members are better able to monitor incoming and outgoing cash/securities flows, to extend vital RENTAS data to the front office for value-added analysis and to prepare management reports and updating the RENTAS members' directory online. This has allowed active management of information by members.

(iv) Universal Brokers (UBs) membership

As a measure to support the development of the capital market, the UBs were allowed access to the SSTS modules of the RENTAS system, which enables them to deal directly in the unlisted debt securities together with the other members of the RENTAS system. Since October 2003, two UBs have been admitted as members.

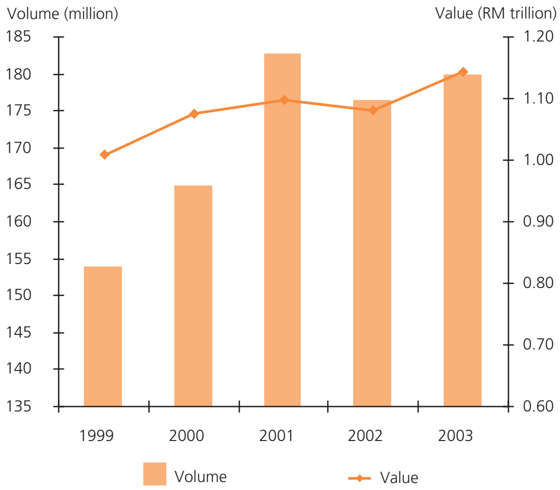
Payment Instruments and Channels

Cheques

The volume of cheques processed through the three Sistem Penjelasan Imej Cek Kebangsaan (SPICK) cheque clearing centres operated by Bank Negara Malaysia increased marginally by 2.0% from 176.4 million cheques in 2002 to 179.9 million cheques in 2003. The value of cheques cleared, however, remained at about RM1.1 trillion in both years.

In May 2003, the SPICK-KL (the largest of the SPICK centres, the others being in Pulau Pinang and Johor Bahru) was awarded the ISO 9001:2000 certification for another three years, reflecting the commitment of the Bank towards providing quality service. During the year, efforts were continued to further improve the efficiency of SPICK operations, such as the replacement of the Compact Disc Production subsystem and upgrading the operating system to Windows 2000. After the enhancements, the overall SPICK operation for the

Graph 4.46
Volume and Value of Cheques Cleared by SPICK Centres



three centres showed an improvement in performance with the reduction of clearing time by an average of 1.5 to 2 hours.

As part of the Bank's on-going effort to curb cheque fraud, the Bank had in October 2003 issued a consultative paper on "Guideline on Minimum Security Standards for Cheques" to the banking institutions with the objective of enhancing the security features on cheques, cheque fraud detection facilities, security management in cheque printing and the necessary advise to consumers on best practices. The Guideline also covers the related governance processes. Banking institutions will be required to make the necessary changes to their work processes and upgrade their systems. The Guideline will be enforced later in 2004.

In 2003, the number of blacklisted offenders in Biro Maklumat Cek (BMC) remained constant. As at end-2003, the number of offenders stood at 49,389, including 32,408 individuals compared with 48,814 offenders including 32,351 individuals at end-2002. Account holders, therefore, need to monitor their account balances carefully and ensure that sufficient funds are available before issuing cheques, as the consequences of being blacklisted in the BMC can be damaging.

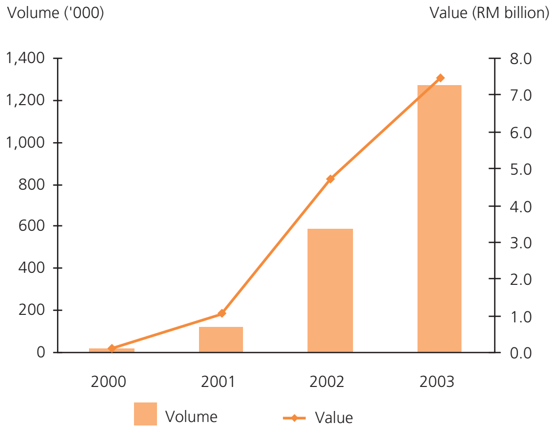
Giro

Besides cheques, consumers can also use the Giro credit transfer to make payments. Giro transactions in 2003 are less significant compared to the cheque volume and value. Nevertheless, the volume and value of Giro transactions as at end-2003 had increased markedly by 114.8% and 57.8% when compared to end-2002. Details on the credit transfer transactions via the Giro system are shown in Graph 4.47.

Credit, Charge and Debit cards

The number of credit cards issued by the financial institutions had increased in the recent three years, from 2.8 million cards at end-2000 to 5.1 million cards at end-2003. From 2002 to 2003, the total value of credit card transactions rose by 16% and credit card remains as a preferred payment card. The usage of charge and debit cards was insignificant compared to credit cards as shown in Table 4.33.

Graph 4.47
Interbank Giro Transactions



As part of the Bank's effort to ensure an adequate level of prudential measure, consumer protection and consumer education, the Bank had issued a "Credit Card Guideline" in March 2003. The requirements in the Guideline among others, stipulates a RM250 limit for consumers' liability for unauthorised transactions, bars credit card usage for unlawful activities such as illegal online betting, requires banks to provide an advisory to their cardholders on the consequences of paying only the minimum repayment amount and requires the banking institutions to utilise the Central Credit Reference Information System (CCRIS) in their credit evaluation for processing applications.

Electronic Purse - MEPS Cash

Marketing programmes and awareness campaigns have been undertaken during the year to promote the use of electronic purse and electronic payment channels in the country. During 2003, the banking institutions progressively upgraded their existing card

Table 4.33
Payment Cards

	2002			2003		
	No. of cards (million)	Volume (million)	Value (RM million)	No. of cards (million)	Volume (million)	Value (RM million)
Credit cards	4.4	126.9	25,304.7	5.1	146.3	29,359.9
Charge cards	0.3	7.8	1,860.6	0.3	7.5	1,895.7
Debit cards	n.a.	1.0	74.2	2.8	1.2	87.4

n.a. Not available.

acceptance devices on a nationwide basis for merchants to accept MEPS Cash electronic purse. More than 12,000 terminals have been deployed at various merchants by the financial institutions and third party acquirers. As the MEPS Cash scheme has only recently been deployed on a widespread basis, the volume of transactions has yet to reach a significant level.

Internet Banking

The Internet is becoming an increasingly important channel for banks to provide banking services to both individual consumers and businesses. During the year, an Islamic bank and a locally incorporated foreign bank began offering Internet banking services, making the number of banks offering transactional Internet banking services to 13 as at end-2003. Consumers and businesses continued to show a growing interest in using the Internet as a bill payment medium and for conducting interbank fund transfers.

Accordingly, in their efforts to increase the adoption of this self-direct channel, the banks have increased the range of services offered via Internet banking including free online bill payment services and the ability to transfer funds to accounts in other banks. With more households and businesses realising the convenience of Internet banking, the number of Internet banking subscribers grew from 1 million as at end-2002 to 1.7 million as at end-2003. The total value of transactions conducted through Internet banking by individual consumers had increased significantly from RM0.9 billion for the quarter ended 31 December 2002 to RM3.5 billion for the quarter ended 31 December 2003.

Business Continuity Management

Business Continuity Management is the act of anticipating incidents that will affect critical functions and processes in the organisation and ensuring that it is able to respond to any incident in a planned and prepared manner. The Business Continuity Plan is the processes and procedures an organisation put in place to ensure that essential functions can continue after and during a crisis. As part of the Business Continuity Plan, the RENTAS, SPICK-KL and SWIFT operations has a prescribed plan to ensure that these services, if disrupted, can be re-established swiftly and smoothly.

In 2003, monthly testing and several extended live runs have been carried out to ensure that all operation staff is familiar with the procedures at the alternate site. During the testing periods, the Bank worked closely with member banking institutions to ensure that operations run smoothly, despite a change in location. This encourages close co-operation among the members to ensure that these systems operated by Bank Negara Malaysia are well supported.

MALAYSIA'S ANTI-MONEY LAUNDERING AND COUNTER FINANCING OF TERRORISM (AML/CFT) PROGRAMME

Overview

The global community continues to intensify efforts to enhance measures to detect and deter money laundering and terrorism financing. There has been greater co-operation among national agencies to put in place the appropriate statutes and continue to build capacity of personnel involved in implementing the AML/CFT initiatives.

In Malaysia, Bank Negara Malaysia (the Bank) leads various law enforcement agencies in combating money laundering and terrorism financing. The Bank is the secretariat to the National Co-ordination Committee to Counter Money Laundering (NCC), which was established in 2000 to formulate AML/CFT measures, co-ordinate the implementation of these measures and to ensure that the national efforts are aligned with regional and international initiatives. Representatives of member agencies in the NCC meet several times a year to co-ordinate their concerted efforts in fighting money laundering and in countering terrorism financing. Each NCC member is responsible to study and report on pertinent AML/CFT issues to the NCC as well as implement, and report on the development of, any NCC decision.

UN International Convention for the Suppression of the Financing of Terrorism

Malaysia is committed to criminalise the financing of terrorism as called for under the UN International Convention for the Suppression of the Financing of Terrorism. Malaysia proposes to accede to the UN Convention by making appropriate amendments to, and provide new legislative provisions in, five pieces of legislation, namely the Penal Code, Criminal Procedure Code, Subordinate Courts Act 1948, Courts of Judicature Act 1964 and the Anti-Money Laundering Act 2001 (AMLA).

Anti-Money Laundering (Amendment) Act 2003

In November 2003, the Parliament passed the Anti-Money Laundering (Amendment) Act 2003, which was gazetted as law on 25 December 2003. When this legislation is brought into force by a Ministerial order, the short title of the AMLA would be changed to "Anti-Money Laundering and Anti-Terrorism Financing Act 2001". The amending legislation extends the Bank's money laundering reporting mechanism to include the reporting of suspected terrorism financing, provides for measures to be taken for the detection and prevention of terrorism financing as well as provides for the freeze, seizure and forfeiture of terrorist property.

Implementation of the Anti-Money Laundering Act 2001

The money laundering reporting mechanism under the AMLA covers financial institutions and certain categories of non-financial institutions, which are considered to be of higher risk to money laundering or terrorist financing activities. Our implementation approach of extending the reach of the law incrementally ensures that the reporting institutions are well prepared and able to effectively comply with their obligations under the AMLA.

Recent AML/CFT Measures under the AMLA

Extending the List of Reporting Institutions

Since the AMLA came into force on 15 January 2002, the requirement to report suspicious transactions was invoked on banking and Islamic banking institutions, insurance companies and takaful operators, money changers and offshore entities. In 2003, several other categories of businesses have been included as reporting institutions. To date, the reporting institutions under the AMLA are as follows.

Table 4.34
Reporting Institutions under the AMLA

Invocation date	Type of Reporting Institution	Number of Institutions (as at 31 December 2003)
15-Jan-02	Commercial banks	23
	Finance companies	11
	Merchant banks	10
	Islamic banks	2
15-Apr-02	Discount houses	7
	Offshore banks	54
	Offshore insurance companies	101
	Offshore trust companies	18
	Insurance companies	44
	Reinsurance companies	10
	Insurance brokers	35
	Takaful operators	4
1-Jun-02	Money-changers	649
15-Jan-03	Bank Kerjasama Rakyat Malaysia	1
	Bank Simpanan Nasional	1
	Lembaga Tabung Haji	1
	Pos Malaysia Berhad	1
	Genting Casino	1
Total reporting institutions		**973**

Other non-financial institutions that are vulnerable to money laundering and terrorism financing will be brought under the AMLA in stages.

Increase Reporting Obligations

The full-fledge reporting obligations under the AMLA, such as record-keeping, retention of record, compliance programme and customer identification requirements have been invoked on the following institutions:

- Commercial banks, finance companies, merchant banks and Islamic banks with effect from 15 January 2003;
- Discount houses, offshore banks, offshore trust companies, offshore insurers, reinsurers, insurers, insurance brokers and takaful operators with effect from 15 April 2003; and
- Money changers with effect from 1 October 2003.

The Bank continues to work in collaboration with these reporting institutions through regular dialogue sessions to ensure effective implementation of the AMLA compliance programme. The banking industry has set up a Compliance Officers Networking Group (CONG), which meets regularly to discuss AML/CFT compliance issues at the premises of the Institute of Bankers Malaysia. Officers of the Financial Intelligence Unit (FIU) in the Bank attend CONG meetings by invitation only.

Increase Predicate Offences

In 2003, the number of money laundering predicate offences has increased from 122 to 150 serious crimes from 23 pieces of legislation.

Suspicious Transaction Reports (STRs)

As the competent authority mandated by the Minister of Finance, the Bank receives STRs pursuant to section 14(b) of the AMLA. Section 14(b) requires the reporting of suspicious transactions to the FIU in the Bank. The STRs are analysed and, where applicable, shared with the relevant enforcement agencies, which conduct their own surveillance and investigations into these cases based on the Bank's financial intelligence.

Capacity Building

Awareness Programme

The Bank continues to promote awareness among relevant stakeholders to ensure effective implementation of the AML/CFT measures. A nationwide awareness programme for the banks, including Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional and Lembaga Tabung Haji were conducted in August-October 2003. Dialogue sessions with reporting institutions were also conducted regularly to update and clarify any issues relating to the development of the AML/CFT measures.

Training Initiatives

The Bank hosted several workshops to enhance the knowledge and skills of both domestic and regional stakeholders in the AML/CFT initiatives. Financial sector experts from the United States, Australia, the United Kingdom and international and regional bodies such as the IMF, the World Bank and the Asia/Pacific Group on Money Laundering (APG) were invited to share their experiences and expertise at these workshops. The international training programmes organised and hosted by the Bank were:

(i) The ASEAN Anti-Money Laundering Workshop 2003, held from 28–30 July 2003. The workshop formulated strategies for the creation of a comprehensive anti-money laundering regime in each ASEAN country, which included defining the core functions of a financial intelligence unit, identification of the agencies and the role of enforcement agencies in the AML/CFT framework.

(ii) The Basic Analysis and Suspicious Transaction Reporting Workshop 2003, held on 25-29 August 2003. The workshop was co-hosted by the South East Asia Regional Centre to Counter-Terrorism and the Bank. It focused on techniques in basic analytical skills on collection, analysis and sharing of information on suspected money laundering and terrorism financing submitted by reporting institutions.

(iii) The APG Typologies Workshop, held from 8–9 December 2003. The workshop was attended by participants from 34 member and observer jurisdictions of the APG. The workshop focussed on the sharing of trends and cases relating to money laundering and terrorist financing. In addition, various working groups to conduct in-depth study on cash couriers, terrorism financing and corruption related issues were established.

(iv) The APG AML/CFT Assessment Training Workshop, held on 10–12 December 2003. This workshop trained the financial sector experts from the APG member jurisdictions to conduct assessment based on the IMF/ World Bank Methodology for Assessing Compliance with AML/CFT Standards.

Challenges Ahead

The Financial Action Task Force reviewed its 40 Recommendations in June 2003. The revision extended the reporting entities to designated non-financial business and professions (DNFBP). The DNFBP includes real estate agents, dealers in precious metals, dealers in precious stones, lawyers, notaries, other independent legal professionals, accountants and trust and company service providers. The Bank will invoke the AMLA reporting obligations on DNFBP in stages taking into consideration the readiness of these entities. The Bank recognises that the consultative process with the DNFBP and the relevant regulatory and supervisory authorities of the DNFBP as significant to the successful implementation of the AMLA reporting obligations.

The amendments to the Penal Code to criminalise terrorism financing and the amendments to the AMLA require the development of appropriate counter-financing of terrorism mechanisms and procedures to ensure effective implementation of the UN International Convention for the Suppression of the Financing of Terrorism. The Bank will work in collaboration with the NCC members to effectively implement the new legislative provisions.

Money laundering trends constantly evolve and hence, necessitate continuous training of law enforcement personnel to upgrade their knowledge and skills. The Bank will continue its leadership role in the fight against money laundering activities.

The Islamic Financial System

The Islamic Financial System

GROWING SIGNIFICANCE OF THE ISLAMIC FINANCIAL SYSTEM

The Islamic financial system has evolved into a viable and vibrant component of the overall financial system, complementing the conventional financial system. The Financial Sector Masterplan (FSMP) provides clear strategic focus to develop and promote the expansion of the Islamic banking system. Against the backdrop of a stronger economy and strong macroeconomic fundamentals, Islamic banking activity experienced rapid growth to account for 9.7% of the total assets of the banking system in 2003 from 6.9% in 2000. The market share of deposits and financing also increased markedly to account for 10.4% (2000: 7.4%) and 10.3% (2000: 5.3%) of the total banking system respectively. The rapid progress of the domestic Islamic banking system, accentuated by significant expansion and developments in Islamic banking and finance has become increasingly more important in meeting the changing requirements of the new economy.

The rapid progress of the domestic Islamic banking system, accentuated by significant expansion and developments in Islamic banking and finance has become increasingly more important in meeting the changing requirements of the new economy.

In Malaysia's dual banking environment, the Islamic financial system operates in parallel with the conventional financial system. The Islamic financial system encompasses the Islamic banking system, Islamic money market, Islamic insurance or takaful, Islamic capital market and the specialised financial institutions which provide alternative sources of financing. The intra-dependency of these key structural components creates a comprehensive enabling environment for the Islamic financial system to effectively play its role as an efficient conduit to mobilise resources and provide financing for productive economic activity. This structure also enhances the resilience and robustness of the Islamic financial system to withstand financial shocks and contributes to the overall stability of the Islamic financial system.

- The Islamic banking system which forms the backbone of the Islamic financial system plays an important role in mobilising deposits and providing financing to facilitate growth. The Islamic banking system is currently represented by 33 Islamic banking institutions, comprising two Islamic banks and 31 conventional banking institutions (nine commercial banks, four foreign banks, seven finance companies, four merchant banks and seven discount houses) offering Islamic banking products and services under the Islamic Banking Scheme. These Islamic banking institutions offer a comprehensive and broad range of Islamic financial products and services ranging from savings, current and investment deposit products to financing products such as property financing, working capital financing, project financing, plant and machinery financing, hire purchase, education financing and other financing products including trade finance products. The ability of the Islamic banking institutions to arrange and offer products with attractive and innovative features at prices that are competitive with conventional banking products, has appealed to both Muslim and non-Muslim customers, reflecting the capacity of the Islamic banking system as an effective means of financial intermediation. The extensive distribution network of Islamic banking institutions, comprising 152 full-fledged Islamic banking branches and 2,065 Islamic banking counters (offering Islamic banking products), that is also well supported by an efficient, secure and effective payment system, has enhanced access to banking services for the various sectors of the economy.

- The existence of an active Islamic interbank money market is another important component in the Islamic financial system. Under the *mudharabah* (profit-sharing) interbank investment (MII) mechanism, Islamic banking institutions are able to raise funds to meet their short-term funding requirement based on profit-sharing arrangement. Since its inception in 1994, the volume of MII increased from only

Table 5.1
Islamic Banking System: Key Data

	As at end		Annual change (%)
	2002	2003*p*	2003*p*
Number of financial institutions	**35**	**33**	**-5.7**
Commercial banks	14	13	-7.1
Finance companies	9	7	-22.2
Merchant banks	3	4	33.3
Islamic banks	2	2	0.0
Discount houses	7	7	0.0
Total assets (RM million)	**68,070**	**82,196**	**20.8**
Commercial banks	29,109	36,824	26.5
Finance companies	12,623	17,875	41.6
Merchant banks	1,430	1,716	20.0
Islamic banks	20,160	20,955	3.9
Discount houses	4,748	4,826	1.6
Total deposits (RM million)	**53,306**	**60,212**	**13.0**
Commercial banks	23,476	26,519	13.0
Finance companies	9,094	10,965	20.6
Merchant banks	684	852	24.6
Islamic banks	16,421	17,584	7.1
Discount houses	3,631	4,292	18.2
Total financing (RM million)	**36,718**	**48,615**	**32.4**
Commercial banks	16,706	22,324	33.6
Finance companies	10,050	15,746	56.7
Merchant banks	804	781	-2.9
Islamic banks	9,158	9,764	6.6
Discount houses	n.a.	n.a.	n.a.
Financing-deposits ratio (%)	**68.9**	**80.7**	**11.8**
Commercial banks	71.2	84.2	13.0
Finance companies	110.5	143.6	33.1
Merchant banks	117.5	91.7	-25.8
Islamic banks	55.8	55.5	-0.3
Discount houses	n.a.	n.a.	n.a.
Number of branches	**138**	**152**	**10.1**
Commercial banks	8	13	62.5
Finance companies	2	7	250.0
Islamic banks	128	132	3.1
Number of counters	**2,065**	**2,065**	**0.0**
Commercial banks	1,335	1,410	5.6
Finance companies	730	646	-11.5
Merchant banks	–	9	–

n.a. Not applicable.
p Preliminary

RM0.5 billion in 1994 to RM283.8 billion in 2003. The availability of a broad spectrum of short and long-term Islamic financial instruments such as Government Investment Issues (GII), Bank Negara Negotiable Notes (BNNN) and Islamic private debt securities as well as the active trading of these instruments allow Islamic banking institutions to meet their investment and liquidity needs. The GII and BNNN are also among the instruments used by Bank Negara Malaysia to manage liquidity in the Islamic banking system. The efficiency of the Islamic money market is enhanced by the Real-Time Gross Settlement System (RENTAS) and the Fully Automated System for Tendering (FAST). RENTAS facilitates larger value interbank funds transfers and scripless securities while FAST facilitates the tendering process for Islamic securities including government securities, commercial papers and private debt securities.

- In the Islamic capital market, funds are raised to finance long-term infrastructure and development projects through the issuance of Islamic private debt securities. The Islamic capital market reduces over-dependence on the Islamic banking system for long-term financing and allows Islamic banking institutions to diversify part of the risks emanating from asset and liability mismatches. The existence of the Islamic capital market plays an important role in reducing potential source of financial vulnerabilities and contributes to enhance the robustness and resilience of the Islamic financial system, leading to greater financial stability. The issuance of diverse Islamic financial instruments ranging from short-term Commercial Papers and Medium Term Notes to long-term Islamic bonds facilitates Islamic banking institutions in meeting their investment and liquidity needs. The different financial structures of the Islamic instruments also provide flexibility to issuers in managing their distinct financing requirements. Moreover, the Islamic financial instruments attract a wider investor base, encompassing both Islamic and conventional institutional investors, and thereby the funds raised can be tapped at competitive cost. In addition, the active participation of Islamic banking institutions in deal origination, underwriting and corporate advisory services expands the breadth and depth of the Islamic capital market, contributing to increased effectiveness and efficiency of the Islamic financial system.

The availability of credit ratings by the external credit rating agencies such as the Rating Agency Malaysia (RAM) and Malaysian Rating Corporation Berhad (MARC) enhance price discovery and efficiency of the market and facilitate efficient investment and financing decisions. The efficiency of the Islamic debt securities market is further augmented by settlement and tendering systems such as RENTAS and FAST as well as the Bonds Information Dissemination System that provides comprehensive market information on domestic debt securities.

- In the Islamic equity market, Islamic institutional investors participate in capital raising exercise to finance business expansion of corporations. The Islamic unit trusts provide investors access to professional management of funds to maximise returns on different risk profiles. The comprehensiveness of the Islamic financial system creates significant investment opportunities for both Islamic and conventional investors in managing their portfolios to meet financial needs.

- The takaful industry adds significant synergies to the overall Islamic financial system. Takaful operators, particularly in general takaful business, contribute to mitigate part of the risks of the banking system emanating from financing transactions and hence strengthen the resilience of the Islamic financial system. In the family takaful business, takaful operators assume an important role as economic agents that mobilise long-term savings for long-term investments and economic growth. The role of takaful operators as institutional investors has contributed to stimulate the development of Islamic financial instruments and consequently adds depth to the Islamic financial markets.

- Specialised non-bank institutions offering Islamic financial products and services such as the development financial institutions (DFIs) and Pilgrims Fund Board complement the Islamic banking system in expanding its reach to specific strategic economic sectors thereby enhancing the capacity of the Islamic financial system in its overall contribution to economic growth and development. Meanwhile, the existence of ancillary institutions such as the National Mortgage Corporation (Cagamas Berhad) contributes to enhance resilience of the Islamic financial system through securitisation of the Islamic house financing and Islamic hire purchase receivables in the portfolios of Islamic banking institutions.

Ensuring Financial Soundness and Stability

The Islamic financial system operates under a robust and comprehensive legal, regulatory, supervisory and Shariah framework. The Islamic banks are regulated and supervised by Bank Negara Malaysia under the Islamic Banking Act 1983 (IBA), while the conventional banks participating in the Islamic Banking Scheme (IBS banks) are regulated under the Banking and Financial Institutions Act 1989 (BAFIA). Islamic banking institutions operate under a robust regulatory and supervisory framework based on international standards and best practices, at par with conventional banking institutions. For the IBS banks, the robustness of the regulatory and supervisory framework includes the establishment of effective firewalls to ensure that there is complete segregation between Islamic banking and conventional banking portfolios in line with the dictates of the Shariah. This is to preserve the integrity and confidence in the Islamic banking system.

- Islamic banks observe the Basel Capital Accord in maintaining a minimum risk-weighted capital ratio (RWCR) of 8% and a minimum core capital ratio of 4%. The IBS banks observe the compliance to the RWCR framework for the Islamic banking portfolio in addition to the compliance on a consolidated basis (for both Islamic banking and conventional banking portfolios).

- To ensure Islamic banks maintain sufficient liquidity at all times, Islamic banks are required to observe the liquidity framework. Under this framework, Islamic banks are required to manage their liquidity positions in a dynamic manner through the matching of short-term liquidity requirements arising from maturing obligations with maturing assets. In addition, Islamic banks are required to maintain adequate liquidity surpluses to be able to sustain unexpected heavy withdrawals for at least one month. In the case of the IBS banks, this liquidity framework is observed on a consolidated basis.

- Prudent management of the Islamic banking portfolio is pertinent to protect the interest of depositors in view of the profit and loss sharing nature of Islamic banking operations. To inculcate prudent financing practices, Islamic banking institutions are required to provide adequate

The comprehensiveness of the Islamic financial system creates significant investment opportunities for both Islamic and conventional investors in managing their portfolios to meet financial needs.

provisioning for potential deterioration in asset quality and observe the credit limit to a single customer and its related corporations.

- Islamic banking institutions observe the Central Bank's guidelines on best practices in credit risk management and prohibition of financing to directors, staff and their interested corporations to prevent abuses, conflicts of interests and irregular practices.

- Strong corporate governance is essential to ensure that Islamic banking institutions are managed by competent management who are able to provide the strategic direction for the institution as well as manage the operations of Islamic banking institutions in an effective and prudent manner. Islamic banks adhere to the Central Bank's guidelines on corporate governance pertaining to the appointment of directors, the structure of the board, limitation on the number of directorships of directors and chief executive officers, code of conduct for directors and employees of banking institutions as well as guidelines on minimum audit standards. To further strengthen the corporate governance structure of Islamic banks, additional measures were introduced in 2003 requiring Islamic banks to establish a nominating committee, remuneration committee and risk management committee to ensure that the shareholders play a more active role in overseeing the effectiveness of the board of directors and management. The guidelines highlighted the roles and responsibilities of independent directors, which include *inter alia*, to provide effective oversight and enhance the independence of the board. The guidelines also specified the minimum qualifications and training requirements for directors.

- In the preparation of financial statements, Islamic banks are required to observe the Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks (GP8-i). The IBS banks disclose their Islamic banking operations in the Notes to the Accounts of the principal financial statements as part of GP8 of the conventional banks. To further enhance transparency in the derivation of the rate of return in Islamic banking business, Islamic banking institutions are required to observe a standard framework for the calculation of the rate of return.

- Another important dimension in Islamic banking operations is Shariah compliance. Under the IBA, Islamic banks need to establish Shariah advisory bodies. Central to these bodies is the Shariah Advisory Council (SAC) at Bank Negara Malaysia as the sole authority to decide on Shariah matters on Islamic banking and financial business that fall under the purview of the Central Bank. The SAC at Bank Negara Malaysia also serves as the ultimate reference for Shariah ruling in court proceedings on Islamic banking and finance cases.

- The Anti-Money Laundering Act 2001 (AMLA) and guidelines on money laundering and "know your customer policy" protect the Islamic banking system from money laundering activities. AMLA provides comprehensive laws for the prevention, detection and prosecution of money laundering, the forfeiture of property derived from, or involvement in money laundering and the requirements for record keeping and reporting of suspicious transactions by Islamic banking institutions.

- To reinforce the regulatory framework that has been established to preserve financial stability, Islamic banking institutions are subject to a rigorous supervisory framework. Supervisory activities emphasise the vigilant monitoring of the financial condition and soundness of Islamic banking institutions, the adoption of pre-emptive strategies to address any adverse trend or weakness identified and the instilling of best practices to enhance corporate governance structures as well as risk management systems. The supervisory process is premised on a forward-looking proactive risk-based model encompassing both dynamic off-site surveillance and on-site examinations. The off-site surveillance process includes the review and approval of financial statements to ascertain compliance with Bank Negara Malaysia's guidelines as well as close monitoring of Islamic banking institutions through regular reporting and rigorous financial and non-financial analysis for early detection of any emerging problems. In 2003, on-site examinations were conducted on the Islamic banks, comprising the head offices, local and offshore branches, based on the CAMELS rating framework. In addition, stress testing remains an on-going exercise where the Islamic banking institution's current financial condition is subjected to simulated stress under alternative adverse scenarios in order to detect potential areas of vulnerability. The results of this stress test form the basis for the implementation of pre-emptive actions.

Global Integration of Islamic Financial System
The significant progress achieved by the domestic Islamic financial system has set the stage for its integration with the global market place. The initiatives on the global front to position the Islamic financial system as a credible component of the global financial system will contribute to further strengthen the development of the domestic Islamic financial system.

- The establishment of the Islamic Financial Services Board (IFSB) in Kuala Lumpur to develop international prudential regulatory standards in accordance with the distinct features and risks of Islamic financial institutions will contribute towards ensuring the soundness and stability of the Islamic financial system. Since its establishment in 2002, the IFSB has attracted wide participation. As at end-2003, the number of IFSB members has increased to 13 full members, three associate members and 20 observer members. The IFSB has made progress in developing prudential standards on capital adequacy and risk management and will commence preparation of an additional standard on corporate governance. The participation of the International Monetary Fund, the World Bank, the Asian Development Bank and the Bank for International Settlements in the IFSB will enhance co-operation towards achieving the common goal of international monetary and financial stability.

- The establishment of the International Islamic Financial Market (IIFM) in 2002 constitutes part of the overall efforts to strengthen the efficacy of the Islamic financial system as a component of the global financial system in achieving balanced growth and development. The IIFM provides the infrastructure to facilitate the mobilisation of foreign capital according to Shariah principles, stimulate the creation and trading of Islamic financial instruments, enhance investment opportunities for global investors and facilitate efficient liquidity management by Islamic financial institutions. Malaysia spearheaded the issuance of the first sovereign global Islamic *sukuk* to give impetus to the development of the IIFM. The global Islamic bond served as a benchmark and catalyst that spurred the issuance of subsequent global Islamic bonds. The development of Islamic finance as an important niche activity in Malaysia's International Offshore Financial Centre in Labuan complements the development of the IIFM in the issuance, listing and trading of foreign currency-denominated Islamic financial instruments as well as in forging linkages with other Islamic financial centres to further expand the global reach of Islamic banking and finance.

POLICY THRUST IN 2003

In tandem with the overall objective of the FSMP to create an efficient, progressive and comprehensive Islamic financial system that can contribute significantly to the effectiveness and efficiency of the Malaysian financial sector, the Islamic financial policy thrust in 2003 continued to be directed at further strengthening the fundamental underpinning foundations of the Islamic banking system to support the development of a sound and progressive Islamic banking industry. The focus was on strengthening the institutional financial infrastructure, enhancing the regulatory framework, strengthening the Shariah and legal infrastructure as well as enhancing intellectual capital development and consumer education.

The Islamic financial policy thrust in 2003 continued to be directed at further strengthening the fundamental underpinning foundations of the Islamic banking system to support the sound and progressive development of the Islamic banking industry.

Strengthening Institutional Financial Infrastructure
Institutional Development
A comprehensive and well-developed financial infrastructure is key to enhancing the capacity and effectiveness of the Islamic banking system premised on its own principles, uniqueness and characteristics.

- One feature of a well-developed financial infrastructure is the diversity of the players, including the participation of foreign players in the Islamic financial landscape. Cognisant of this, Bank Negara Malaysia has brought forward the liberalisation of the Islamic banking sector. The presence of full-fledged foreign Islamic banks in Malaysia will generate spill over effects that will enhance product diversity, spur financial innovation and support the overall development of the Islamic financial system. It will also act as a bridge between Malaysia and other global Islamic financial markets, thus providing the enabling environment for Malaysia to become a regional hub for Islamic banking and finance.

- As the domestic Islamic banking industry progresses into a more advanced stage of development, significant developments are shaping the industry's financial regulatory infrastructure, both on the domestic and international fronts.
  - On the domestic front, these included the emergence of a different set of accounting standards for Islamic financial business to be issued by the Malaysian Accounting Standards Board (MASB) and the introduction of the Deposit Insurance Scheme.
  - On the international front, the Islamic Financial Services Board (IFSB) will be issuing a specific set of prudential regulatory and supervisory standards to govern Islamic banking operations globally.
- Against this backdrop, Bank Negara Malaysia has conducted a review of the existing "window" institutional structure of the IBS banks to prepare an enabling structure that can assimilate these developments and thus strengthen the prudential regulatory and supervisory regime.

Risk Management

The enhancement of risk management capabilities of the Islamic banking institutions is another important aspect in developing the institutional financial infrastructure.

- A variable rate financing product under the concept of *bai' bithaman ajil* (deferred payment sale) was introduced in 2003 as an instrument to diversify the financing portfolio of the Islamic financial institutions from over-reliance on fixed-rate financing as well as to mitigate the risk associated with funding mismatch.
- Moving forward, to complement the *bai' bithaman ajil* (BBA) floating rate financing

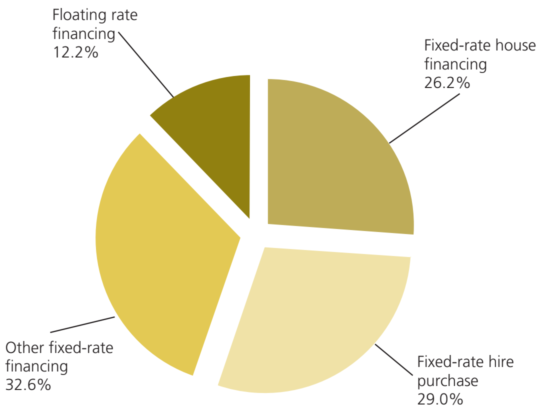
Introduction of Islamic Variable Rate Mechanism

A significant achievement was made in 2003 in the area of risk management when the first variable rate financing product was developed for the Islamic banking industry under the concept of *bai' bithaman ajil* (deferred payment sale), or in short, BBA. This Shariah-compliant product was structured by a working group comprising representatives from Bank Negara Malaysia and the industry to enable the Islamic financial institutions which operate in a dual banking environment to constantly match the current market financing rate in order to provide matching returns to their depositors, thereby alleviating any mismatch risk. By doing this, the Islamic financial institutions are able to receive varying income streams from their financing activities, which will be distributed to the depositors at a more competitive rate.

The new instrument is an alternative to the existing mode of financing portfolio which is predominantly fixed-rate in nature. In recent developments, the high leverage on fixed-rate financing became a topical issue in Islamic banking as there has been an inadequate hedging mechanism through which Islamic financial assets could grow and be protected from exposure to fluctuations in the financing rate. As at end-December 2003, total fixed-rate financing accounted for 87.8% of total Islamic financing and a large proportion of this financing, namely, house and other property financing-i and term financing-i, were predominantly on a longer term tenure, constituting 58.8% of total Islamic financing, as shown in Graph 1. (The current method of variable rate financing offered by a few Islamic financial institutions is impractical as it involves multiple sub-agreements to reflect a change in the rate).

This fixed-rate regime has resulted in a funding mismatch to the Islamic financial institutions because their long-term financing was funded by short-term bank deposits which can give variable returns. As

Graph 1
Total Financing by Mode of Financing as at end-2003



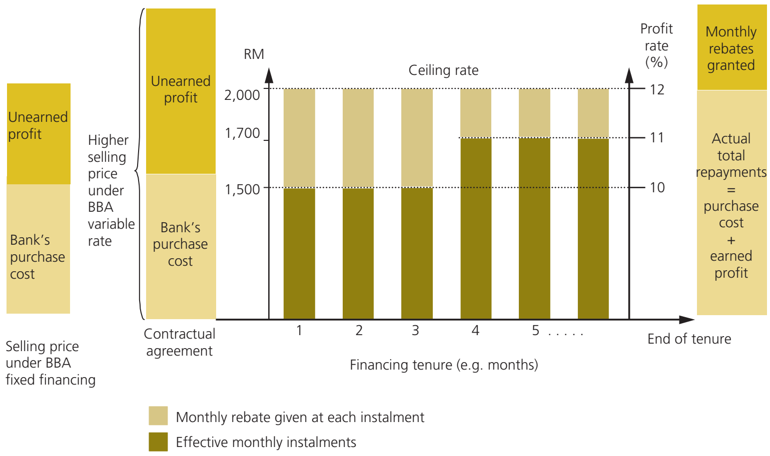
the banks had locked in their profit rates for the financing over a long period, any upward movement in the market rates, therefore, may result in the Islamic banking institutions finding it difficult to give a satisfactory return to their depositors. This is because the constant income stream from the financing is tied to a fixed profit rate which is relatively lower when compared to a conventional floating rate loan whose rate has risen. Inevitably, this situation would cause a switching of Islamic funds to conventional funds.

The variable rate financing is designed to mitigate the mismatch risk currently faced by the Islamic financial institutions by allowing them to vary the profit rate for the financing in order to raise the deposit rates. As a result, the depositors will obtain satisfactory returns vis-à-vis that in the conventional banking market, and hence, would not switch their deposits which otherwise could adversely affect the Islamic banking operation. This new option reduces the vulnerabilities of the Islamic financial institutions to exposure in market risk in a banking environment where the Islamic banking system and conventional banking system operate side-by-side.

The variable rate financing is an innovation to the existing BBA financing concept which is fixed-rate in nature. Under the BBA, the selling price of the asset sold to the customer on deferred terms would be fixed at a profit rate known as the ceiling profit rate which is higher than the profit rate under the fixed-rate BBA financing where, in principle, the contractual selling price and instalments would be higher. However, rebate known as *ibra'* (a waiver of right to claim unearned profit) is required to be granted at every instalment, for example on a monthly basis, in order to reduce the monthly instalments to match that of the current market level.

As illustrated in Graph 2, the financing is created upon the bank purchasing the asset from the customer for cash which will be immediately sold back on deferred terms. Computed at a ceiling rate of 12% per annum as in the example, the selling price (which is higher than under BBA fixed financing) will be agreed upon and the contractual repayment is to be made in equal monthly instalments of RM2,000 over the agreed period. If the base lending rate (BLR) plus margin used as benchmark in the pricing calculation is 10% per annum for the first month, the bank would give a monthly rebate of RM500, which represents the difference between the ceiling profit rate of 12% per annum and effective profit rate of 10% per annum. If in the fourth month, the market rate rises to 11% per annum, the bank would then only grant a monthly rebate of RM300.

Graph 2
BBA Variable Rate Financing



In practice, the rebate would be varied so that the effective profit rate (ceiling profit rate less rebate) reflects the fluctuating market financing rate. Accordingly, the bank would be able to raise the financing rate when there is a rise in market rate, hence, it can give better returns to its depositors. As such, this justifies the setting of a high ceiling profit rate to buffer any rise in the market rate. However, if the market rate rises beyond 12% per annum, the effective profit rate would remain at the ceiling rate. The ceiling rate would provide some comfort to the customer that the effective profit rate would be capped at that rate.

To govern this mode of financing, such rates are subject to a ceiling profit rate of four percentage point above the market's BLR unless supported by findings that the market rate is forecasted to be volatile and escalating. In setting the effective profit rate, the banks are required to observe the maximum profit spread of 2.5 percentage point above the BLR. However, as a matter of policy, the effective profit rate cannot transgress the ceiling profit rate even if the market rate rises above the latter, while any change to the effective profit rate would need to be communicated to the customer prior to the change.

At maturity, any difference in the amount between the selling price and the total repayments plus the monthly rebates granted, would be rebated. In addition to the rebates on instalments and at maturity which have been made mandatory to be included in the financing agreement, rebates must also be granted in the event of early settlement or redemption, or termination of contract. Bank Negara Malaysia has allowed rescheduling of the financing (where the period of financing can be extended) if the bank wishes to grant the option that the effective monthly instalment need not be increased if the effective profit rate rises, on the condition that the financing agreement contains a rescheduling clause and the total repayments are not in excess of the original selling price. The computation of capital adequacy for the BBA variable rate financing will be accorded the same risk-weight as under the BBA fixed-rate financing.

Currently, this new mode of financing is applicable to house, property and term financing only and would be extended to other types of financing in due course. Undoubtedly, this new product is expected to grow significantly as it is a natural hedging product, particularly in view of the risk exposure issues prevalent in Islamic banking today.

mechanism, another variable rate financing product based on the concept of *ijarah muntahia bittamleek* (leasing ending with ownership) is being explored.

Enhancing Regulatory Framework

The growing significance of the Islamic banking industry requires the development of an effective regulatory framework to provide the enabling environment to support the development of the industry.

- In 2003, Bank Negara Malaysia conducted a review on the Framework of the Rate of Return. The purpose was to further strengthen the methodology for deriving the rate of return to depositors, whereby the revised framework is to provide a greater degree of flexibility in the implementation of the framework.

- The Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks (GP8-i) was issued in August 2003. The objective was to promote consistency and standardisation amongst the Islamic banks in complying with the provisions of the IBA and approved accounting standards, specifically MASB *i*-1 and the Shariah requirements. The Guidelines prescribed the minimum requirements of the financial statements that the Islamic banks need to disclose.

- In the development of accounting standards for Islamic financial business, the Malaysian Accounting Standards Board has embarked on the preparation of standards on leasing *(ijarah)*, deferred payment sale (BBA) and cost-plus *(murabahah)* in relation to the recognition, measurement and disclosure of these Islamic financial transactions.

The Framework of the Rate of Return

Towards standardising the methodology on the calculation of distributable profits and the derivation of the rates of return to depositors in Islamic banks, Bank Negara Malaysia introduced the "Framework of the Rate of Return". Among others, the objectives of the framework are to: -

(i) Set the minimum standard in calculating the rates of return;
(ii) Level the playing field and provide the terms of reference for the Islamic banking institutions (IBIs) in deriving the rates of return; and
(iii) Provide Bank Negara Malaysia with an effective yardstick to assess the level of efficiency of the IBIs.

Prior to the introduction of the framework, the IBIs adopted various methods in deriving the rates of return. Such practice has led to large variations in the results and implications. For example, some IBIs include all types of income in their computation while some exclude certain type of incomes. These variations have led to the following impediments in terms of: -

(i) Assessment of the rates of return by Bank Negara Malaysia specifically to ascertain whether the rates genuinely reflect the true performance of the IBIs or otherwise;
(ii) Regulation and supervision by Bank Negara Malaysia, particularly in assessing the prudence and fairness in the distribution of profits to the depositors; and
(iii) Assessment by the IBIs of their funding cost, which in turn led to the distortion of rates of return in the retail and inter-bank markets.

The standardisation of the rates of return was also aimed at addressing the information asymmetry between the IBIs and the depositors by enhancing the level of transparency and ensuring that depositors would receive fair returns on their investment. The framework would detail the items, for example, the income and expense items that need to be reported and incorporated for the purpose of the calculation. In particular, the calculation table lists the expense items that need to be shared by the depositors and the bank; and items that are to be solely borne by the bank.

The introduction of the framework is also to effectively support the application of *mudharabah* (profit-sharing) contract in Islamic banking deposit-taking activities. Unlike conventional banking, which is based on a lender-borrower relationship, the *mudharabah* contract is based on an investor-entrepreneur relationship. In this system, the depositor assumes the role of capital provider while the bank assumes the role of the entrepreneur. The depositors' funds are utilised for financing and investment activities, and the profits generated from these activities are shared between the depositor and the bank based on the pre-agreed profit sharing ratio. In the event of a loss, it will be borne by the depositors. As the bulk of the deposits in Islamic banking are in the form of *mudharabah* deposits, it places a higher degree of fiduciary risk on the management of the IBIs to ensure that the funds are utilised in the most efficient manner, as profits generated from the financing and investments are distributed to the depositors in the most equitable manner. Towards this end, the framework was introduced, not only to standardise the methodology for the calculation of returns, but also to ascertain the actual and fair distribution of income to the depositors.

The Framework

The Framework of the Rate of Return comprises two main components, that is, the calculation and distribution tables. The **calculation table** prescribes the income and expense items that need to be reported and sets out the standard calculation in deriving the net distributable income. Among the important items in the calculation table is the provisions. Prior to the issuance of the framework, the provisions of the banking institutions participating in the Islamic Banking Scheme (IBS banks) were provided by the conventional banking operations. Under conventional banking operations, the provisions are solely borne by the bank. However, under the framework, the IBS banks are required to distinguish their general and specific provisions, in accordance with the *mudharabah* contract, whereby the provisions in Islamic banking operations are shared by both the depositors and the bank.

Table 1
Calculation Table

	RM million
Income generated from asset items	
(+) Net trading income	
(+) Other income	
Total gross income	
(-) Provisions and income-in-suspense	
(-) Profit equalisation reserve	
(-) Direct expenses	
Net gross income	
(-) Income attributable to:	
Specific investment account	
IBCF/SHF[1]	
Net income	
(-) Income attributable to:	
Amount due to designated FIs	
Islamic negotiable instruments	
Net distributable income	

[1] Islamic banking capital funds/ shareholders' funds.

The calculation table also introduced a new item known as **Profit Equalisation Reserve (PER)**. The PER is an item that acts as a mechanism to mitigate the fluctuation of rates of return arising from the flux in income, provisioning and total deposits. This would ensure that the rates of return of the IBIs remained competitive and stable. The PER is appropriated out of the total gross income and is shared by both the depositors and the bank.

The second component of the framework is the **distribution table**. The table sets out the distribution of the net distributable income, derived from the calculation table among demand, savings and general investment deposits according to their structures (*mudharabah* or non-

Table 2
Distribution Table

Type of deposit	ADA[1]	Weightage	WADA[2]	Distributable profits		Depositors' portion		
				RM	%	PSR[3]	RM	%
Current account								
Savings account								
GIA[4]								
1-month								
3-month								
6-month								
9-month								
12-month								
Above 12-month								
				NDI[5]				

[1] Average daily amount of each type of deposit.
[2] Weighted average daily amount.
[3] Profit sharing ratio agreed by the bank and depositors.
[4] General investment account.
[5] Net distributable income transferred from Calculation Table.

mudharabah), maturities and the pre-agreed profit sharing ratios between the bank and depositors. Under the framework, Bank Negara Malaysia allowed the IBIs to adopt either the weightage or without the weightage method, primarily to accord the system capacity of the IBIs.

The IBIs are required to calculate their rates of return on a monthly basis and to declare their monthly rates of return on a specified date. The following month would be the effective period of the declared rates of return.

The introduction of the framework has provided the IBIs with a standard approach in deriving the rates of return and has enhanced the level of transparency. The framework has also improved the efficiency level of the IBIs given that the rates of return are now reflective of the business acumen of the IBIs rather than the methodology of deriving the rates of return. The introduction of the PER has also reduced the volatility of the rates of return of the Islamic banking industry and enabled the IBIs to manage their portfolio more efficiently. In tandem with the introduction of the framework, the scope of the statistical submission has been broadened further to provide Bank Negara Malaysia with an effective measurement tool to assess the efficiency of the IBIs in terms of profitability, prudent management and fairness.

Bank Negara Malaysia has also undertaken a review of the framework in 2003 to promote capacity enhancement and efficiency among the IBIs in managing their business operations. While the foundation of the framework remained unchanged, the revised framework will provide, among others, flexibility in determining the weightage assigned to each group of deposits, the profit sharing ratio of investment deposits, the provisioning of PER and the segregation of income from the funds that are managed under a consolidated fund or managed separately between shareholders' and depositors' funds. The reviewed framework will provide greater flexibility to the IBIs in managing their portfolios and remain competitive in the market place.

Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks (GP8-i)

The Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks or GP8-i was issued to the Islamic banks (IBs) in August 2003. It sets out the minimum requirements for the presentation and disclosure of reports and financial statements of IBs. The GP8-i is to be adopted by the IBs for annual accounts commencing 2004.

The objective of the GP8-i is to provide the basis for presentation and disclosure of reports and financial statements of the IBs. GP8-i is also aimed at ensuring consistency and comparability of the reports and financial statements amongst the IBs in complying with the provisions of the Islamic Banking Act 1983, Companies Act 1965, Shariah requirements and other Bank Negara Malaysia guidelines. As a comprehensive guideline, GP8-i also incorporated the new requirements of MASB standards, specifically the MASB *i*-1: Presentation of Financial Statements of Islamic Financial Institutions. The standard, which came into effect in 2003, was issued to streamline the disclosure and presentation of financial statements of the IBs and the conventional banks that participate in the Islamic Banking Scheme (IBS banks).

Prior to the issuance of the GP8-i, the IBs observed the various provisions of the Companies Act 1965, the applicable accounting standards and the Guidelines on the Specimen Financial Statement for the Banking Industry (GP8) which was formulated to facilitate the conventional banking operations. Some of the requirements have been modified for the IBs, particularly those under the GP8, to reflect the Islamic banking operations such as the disclosure on the various Shariah concepts applied in financing.

Salient Features of GP8-i

The salient features of the GP8-i, amongst others, are as follows:

a) *Performance Overview and Statement of Corporate Governance*

In promoting good corporate governance, IBs are required to report their performance overview and corporate governance practices. The performance overview requires the IBs to disclose their review on performance, measures, business plans and strategies, whilst the statement of corporate governance requires IBs, among others, to disclose the composition and responsibilities of the Board, internal audit and control activities and risk management strategies and policies. These report requirements are important in providing additional information to users in evaluating the performance and conduct of an IB.

b) *Disclosure of Shariah Advisory Board/ Committee and Zakat Obligations*

The Shariah Advisory Board or Committee plays an important role in monitoring the compliance of Islamic banking activities with the Shariah requirements. Given its importance, the IBs are required to disclose the functions and duties of their Shariah Advisory Board or Committee in monitoring the activities pertaining to Shariah matters under the Directors' Report. With respect to the *zakat* obligations disclosure, IBs are required to disclose the responsibility towards payment of *zakat* either on the business or shareholders or on behalf of depositors.

c) *Report of the Shariah Advisory Board/ Committee*

The IBs are required to report the conformity of the IB's operations with the Shariah principles under the Report of the Shariah Advisory Board/Committee. The Report, which is akin to the Auditors' Report, will enhance the credibility of the IB's operation in complying with the Shariah principles.

d) *Profit Equalisation Reserves (PER)*

PER is a mechanism introduced in the Framework of the Rate of Return to stabilise the rate of return to depositors. Disclosure of PER would reflect the capability of the IBs in managing the level of profit distribution to the *mudharabah* depositors. The IBs are required to disclose their policy on PER as well as its movement (provision and write-back) during the financial year.

e) Classification of Deposits from Customers and Placements from Banks and Other Financial Institutions

The IBs are required to disclose their deposits into two categories i.e. *mudharabah* and non-*mudharabah* deposits. As the manager of public funds, the disclosure would provide additional information on the risk profile of the IBs' deposits portfolio to the public.

f) Presentation of the Income Statement

Presentation of the Income Statement of the IBs is structured to reflect the nature of the Islamic banking operation, mainly on the application of *mudharabah* concept in the deposit-taking activities. The statement discloses the incomes and expenses that are either shared by the bank and depositors or solely belonged to the bank.

Product Approval

- In tandem with the gradual progression towards a market-driven regulatory environment, Bank Negara Malaysia issued the Guidelines on New Product Approval Requirements for Islamic Banking Institutions (the Guidelines). These replace the existing product pre-approval requirements and came into effect on 2 January 2004. The Guidelines outline the notification and specific approval process for new products submitted by Islamic banking institutions.

  In formulating the Guidelines, Bank Negara Malaysia adopted the approach that "what is not prohibited is allowed" on new Islamic banking products. This was to provide greater clarity, transparency and speedy product approval. For a new product to qualify for automatic approval (under notification process), the submission to Bank Negara Malaysia must be made at least 21 days before its launch date. The definition of a new product has also been widened to include an existing approved product or service that is applying a different or a new combination of Shariah concepts. In addition, the Islamic banking institutions are required to submit a detailed explanation on the Shariah concepts used in the product as endorsed by their Shariah committee. This is to ensure that a thorough research on the product has been carried out by the Islamic banking institutions and thus, would not lead to any detrimental effect on the customers and on the stability of the financial system. A new product that does not qualify for automatic approval would require specific approval from Bank Negara Malaysia and may require, among others, the deliberation of the Shariah Advisory Council of Bank Negara Malaysia. The Guidelines place significant emphasis on self-regulation, where the Islamic banking institutions are required to ensure consistency of the products introduced with the Guidelines.

- In line with efforts to streamline the regulatory framework of the credit card industry, Bank Negara Malaysia issued the Credit Card-i Guideline (the Guideline) in January 2004. This was an extension to the Credit Card Guideline issued to the conventional banks in March 2003. Under the Guideline, the credit card-i can apply either *bai' inah* (sell and buy back arrangement) or BBA (deferred payment sale) Shariah concept. Under the *bai' inah* concept, the fund for the cardholder's spending limit is created upon the bank buying back the asset from the cardholder for cash which it previously sold to the cardholder on deferred terms. Under the BBA concept, the fund is created upon the bank purchasing the asset from the cardholder for cash which will be sold back to the cardholder on deferred basis.

  The Guideline also prescribes the treatment on penalty and fee structure according to the Shariah principles. In terms of late payment charges, issuers of credit card-i are allowed to impose a compensation fee on the defaulters subject to specific terms and conditions imposed by Bank Negara Malaysia. The terms and conditions, among others, prohibit the Islamic banking institutions from compounding the compensation fee for late payment and monthly charges. This provision was intended to protect the customers as well as to streamline the penalty structure of credit card-i.

Strengthening Shariah and Legal Infrastructure

One of the pre-requisites for a strong and stable Islamic banking system is the existence of a comprehensive Shariah and legal infrastructure. A strong Shariah framework combined with a sound legal structure would accelerate the pace of development and innovation of the Islamic banking industry.

- As part of the efforts to strengthen the Shariah framework for the Islamic financial industry, Bank Negara Malaysia amended the Central Bank of Malaysia Act 1958 (CBA) in 2003 to position the Shariah Advisory Council (SAC) of Bank Negara Malaysia as the sole authority on Shariah matters pertaining to Islamic banking and finance that fall under the purview of Bank Negara Malaysia. With that stature, the SAC will serve as the reference point for the court or arbitrator in dispute resolution that involves Shariah issues on Islamic banking and finance cases.

- Consequent to this development, the role of the Shariah advisory bodies and Shariah consultants at the Islamic banks, the IBS banks and takaful companies will be rationalised accordingly. Bank Negara Malaysia is preparing a comprehensive guideline on the new structure, roles and functions of the Shariah committees of the Islamic banks, the IBS banks and the takaful operators. The guideline would specify among others, the requirements for the appointment of the Shariah committee members. In this regard, the Islamic financial institutions are required to seek Bank Negara Malaysia's approval prior to the appointment of the Shariah committee members. The duties and responsibilities of the Islamic financial institutions would also be outlined in order to assist the Shariah committee in carrying out its roles and functions effectively. The guideline is expected to be issued in the first quarter of 2004.

- A significant development in respect of legal infrastructure was the establishment of a dedicated High Court to adjudicate all muamalat cases in the Commercial Division of High Court Kuala Lumpur. In this regard, a directive (Practice Direction No. 1 of 2003) was issued by the Chief Judge Malaya to all legal practitioners in the country to register Islamic banking and finance cases at both the High Courts and the lower courts using a special code number. The establishment of the dedicated High Court for Islamic banking and finance will expedite the hearing of Islamic banking and finance cases and further increase public confidence in Islamic banking and finance.

- To complement the court system, Bank Negara Malaysia has identified arbitration as an alternative dispute resolution mechanism for Islamic banking and finance. Arbitration has been acknowledged as an appropriate dispute resolution mechanism especially for high-scale financing facilities to reduce the court process which can be time consuming. Towards this end, Bank Negara Malaysia is finalising an arrangement with an existing institutional arbitration centre to administer Islamic banking and finance arbitration.

- The Financial Mediation Bureau (FMB) has been established as a single mediation centre for both banking and insurance, including Islamic banking and takaful. This Bureau replaces existing bureaus for the banking and insurance industry. The FMB is expected to provide speedy and cost-effective mediation for consumers to redress complaints on products and services offered by the financial institutions.

- In addition to the dispute resolution mechanism, there is also a need to create a conducive legal environment to cater for the unique nature of transactions in Islamic banking and finance. Bank Negara Malaysia has formed the Law Review Committee in June 2003, comprising representatives from the Attorney General's Chambers, Ministry of Finance, Malaysian Bar Council, industry players and legal practitioners. The Committee will review the existing laws and make recommendations to the relevant authorities to enable smooth execution of Islamic banking and financial contracts. The review covers tax and stamp duty laws, company laws, land laws and procedural laws.

Enhancing Intellectual Capital Development and Consumer Education

The creation of a large pool of talented bankers is critical for the development of a dynamic and competitive Islamic banking industry.

- To achieve this objective, Islamic Banking and Finance Institute Malaysia (IBFIM) has been earmarked to spearhead efforts to create the pool of bankers who are both knowledgeable and competent in Islamic banking and finance. In this respect, IBFIM will focus on enhancing its capacity in three key areas encompassing education and training, consultancy and advisory as well as research and publications.

- As part of the objective to elevate consumer education and awareness in Islamic banking and finance, the Association of Islamic Banking Institutions Malaysia, under the auspices of Bank Negara Malaysia, organised the Islamic Banking and Takaful Week (IBTW 2003) from 26 September to 2 October 2003. Activities organised during the week included a three-day exposition on Islamic banking and finance.

- In conjunction with the IBTW 2003, Bank Negara Malaysia, together with participating Islamic financial institutions, jointly hosted the production of a television documentary programme on Islamic banking and finance, entitled "Kewangan Islam" (Islamic Finance). The 11-episode documentary programme, produced by a local broadcasting station, portrayed the development of the Islamic financial system in Malaysia as well as products and services offered by the Islamic financial institutions.

  To further increase public literacy in Islamic banking and finance, information booklets were published on "What is Islamic Banking?" and "House Financing-i" as part of the Consumer Education Programme through "BankingInfo". The booklets provide consumers with basic knowledge and understanding on Islamic banking, the underlying Shariah principles and concepts, the range of Islamic banking products and services as well as information on the mechanics of house financing based on Shariah principles.

PERFORMANCE OF THE ISLAMIC BANKING SYSTEM

The Islamic banking industry continued to register strong expansion during the year with increasing market share in terms of assets, financing and deposits of the total banking system. The improved performance was characterised by strong capitalisation levels attributable to increases in capital and profits as well as higher financing activities with significant growth in financing for the purchase of transport vehicles and residential property. In addition, asset quality recorded further improvement with a declining trend in net non-performing financing ratio and high financing loss provisions.

Capital Strength

The total capital base of the Islamic banking institutions increased from RM5.1 billion as at end-2002 to RM6.8 billion as at end-2003. New capital injections contributed RM1 billion to the increase in capital base in 2003 whilst the audited profits contributed another RM414.6 million. The new capital injections were due to the participation of a merchant bank in the IBS and the maintenance of adequate capital by IBS banking institutions.

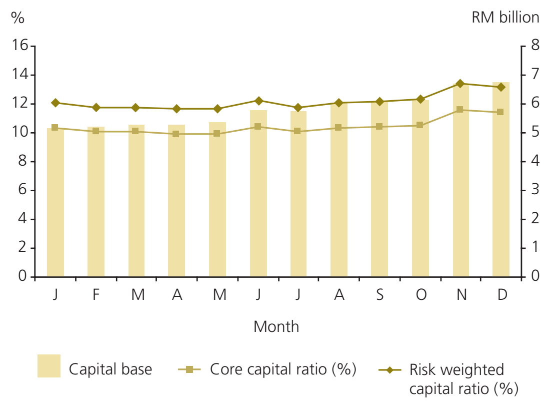
In tandem with the new capital injection, total tier-1 capital increased by RM1.4 billion or 31.1% to RM5.9 billion, while total tier-2 capital recorded an increase of RM215.9 million following an increase in general provision for bad and doubtful financing. As at end-2003, the Islamic banking system recorded a strong risk-weighted capital ratio (RWCR) of 13.1% and core capital ratio of 11.4%.

Table 5.2
Islamic Banking System: Sources and Uses of Funds

	Annual change		As at end 2003*p*
	2002	2003*p*	
	RM million		
Sources			
Capital and reserves	1,269	2,081	6,784
Deposits	6,200	6,906	60,212
Funds from other financial institutions	271	2,541	6,985
Other liabilities	1,401	2,598	8,215
Total	**9,141**	**14,126**	**82,196**
Uses			
Cash	39	15	255
Reserve with Bank Negara Malaysia	318	321	1,517
Deposits with other financial institutions	-3,767	1,247	8,982
Financing	8,517	11,897	48,615
Securities	4,014	3,277	22,554
Other assets	20	-2,631	273

p Preliminary

Graph 5.1
Islamic Banking System: Capital Adequacy in 2003



The RWCR of Islamic banks and IBS commercial banks stood at 11.8% and 14.3% respectively. The RWCR of the IBS merchant banks as a group increased from 10.9% to 13.5% due to the increase in the Islamic banking fund by two merchant banks amounting to RM80 million as well as the participation of an additional merchant bank in the Islamic Banking Scheme. As for the IBS finance companies, the capital base increased by 33.2% or RM479 million to RM1.9 billion during 2003. Meanwhile, the risk-weighted assets expanded by 47.9% or RM4.9 billion to RM15.1 billion, mainly from hire purchase financing, which resulted in a marginal decline in the RWCR by 1.4 percentage point to 12.7%.

Total risk-weighted assets of the Islamic banking system grew by 24.4% or RM10.1 billion to RM51.5 billion as at end-2003. The increase was seen across the risk categories except for the 10% category where there was reduction in interbank placements with discount houses and Cagamas *mudharabah* bonds held. A large increase was recorded in the 100% and 50% risk categories (RM8.3 billion and RM2.9 billion respectively) due to other financing and end-financing of residential properties.

Reflective of the strong capital position of the Islamic banking system in 2003, the RWCR and core capital ratio of the system remained consistently above 11% and 9% respectively throughout the year.

Assets

As at end-2003, the total assets of the Islamic banking sector increased by RM14.1 billion or 20.8% to RM82.2 billion. A significant portion of the increase in total assets was attributable to the growth in total financing of IBS commercial banks (33.6%) and IBS finance companies (56.7%), constituting 78.3% of total financing. As in previous years, a notable trend observed during the year was the shift of funds from interbank deposits to investment in securities to secure a higher rate of return. Investment in securities of RM22.6 billion accounted for 27.4% of total assets and marked an increase by RM3.3 billion or 17% during the year. In terms of market share, the largest portion of Islamic banking assets remained with the IBS commercial banks with a share of 44.8%, followed by Islamic banks (25.5%) and the IBS finance companies (21.8%). In terms of the growth in assets, IBS finance companies recorded the highest growth of 41.6%, followed by IBS commercial banks (26.5%) and merchant banks (20%).

Financing Activities

Total financing extended by the Islamic banking system expanded by 32.4% or RM11.9 billion (2002: 30.2% or RM8.5 billion). The growth in financing was largely attributable to the significant growth in the financing for the purchase of passenger vehicles and residential property of 60.8% and 33.3% respectively. The higher consumer demand was further expanded by the attractive and competitive financing packages offered by the Islamic banking institutions. Financing based on *bai' bithaman ajil* (deferred payment sale) concept remained dominant, constituting 47.7% of total financing while *ijarah thumma al-bai'* (hire purchase) constituted 27.6%.

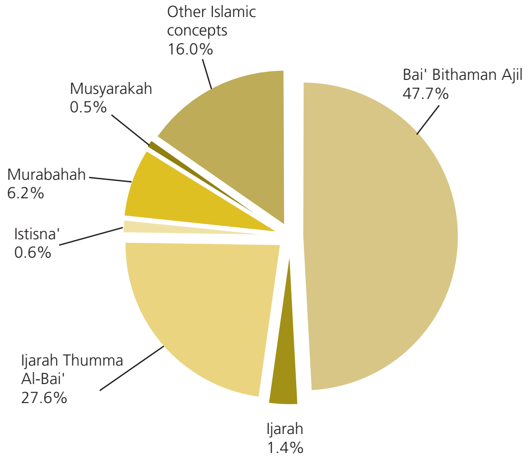
Against the backdrop of strong demand from consumer spending and corporate financing, the value of financing applications received by the Islamic banking institutions in 2003 increased by 8.8% to RM26.3 billion. Responding to the strong demand for new financing, RM16.7 billion of new financing was approved during the year, whilst disbursements posted a growth of 49.5%. Meanwhile, financing

Table 5.3
Islamic Banking System: Direction of Financing

	Annual change		As at end 2003*p*
	2002	2003*p*	
	RM million		
Agriculture, hunting, forestry and fishing	-45.6	267.6	1,861.6
Mining and quarrying	10.5	-11.0	63.5
Manufacturing	807.8	505.6	4,386.8
Electricity, gas and water	-9.9	-284.8	248.9
Community, social and personal services	-139.2	89.4	303.3
Broad property sector	4,953.2	4,747.0	20,482.7
Real estate	*103.5*	*142.6*	*811.9*
Construction	*579.9*	*655.3*	*2,933.5*
Purchase of residential property	*3,916.9*	*3,581.4*	*14,344.2*
Purchase of non-residential property	*353.0*	*367.7*	*2,393.1*
Wholesale and retail trade, restaurants and hotels	251.2	410.6	1,797.0
Transport, storage and communication	61.8	199.5	1,024.3
Finance, insurance and business services	42.2	661.6	1,933.3
Purchase of securities	62.4	-14.1	920.9
Consumption credit	2,474.5	5,584.9	14,872.1
Credit cards	*57.5*	*95.7*	*156.2*
Personal uses	*374.7*	*575.5*	*1,637.1*
Purchase of consumer durables	*8.1*	*-9.2*	*54.1*
Purchase of transport vehicles	*2,034.1*	*4,922.9*	*13,024.7*
Others	47.5	-258.7	720.9
Total	**8,516.4**	**11,897.6**	**48,615.3**

p Preliminary

Graph 5.2
Islamic Banking System:
Financing Concepts as at end-2003



repayments increased by 26.3% during the year. On average, RM3 billion of financing were disbursed monthly in 2003, compared with RM2 billion in 2002. Given the favourable economic outlook, strong capital position and ample liquidity in the Islamic banking system, the Islamic banking institutions are well positioned to sustain the growth momentum in financing activities in 2004.

Given the favourable economic outlook, strong capital position and ample liquidity in the Islamic banking system, the Islamic banking institutions are well positioned to sustain the growth momentum in financing activities in 2004.

The Islamic banking sector also focused on providing financing to small and medium-sized enterprises (SMEs). The total financing provided by the Islamic banking institutions to the SMEs increased by 77.1% from RM3.5 billion as at end-2002 to RM6.2 billion as at end-2003. Islamic financing contributed 7.5% of the total financing extended by the banking system to the SMEs as at end-2003 as compared to 4.7% as at end-2002.

Table 5.4
Islamic Banking System: Financing Activities

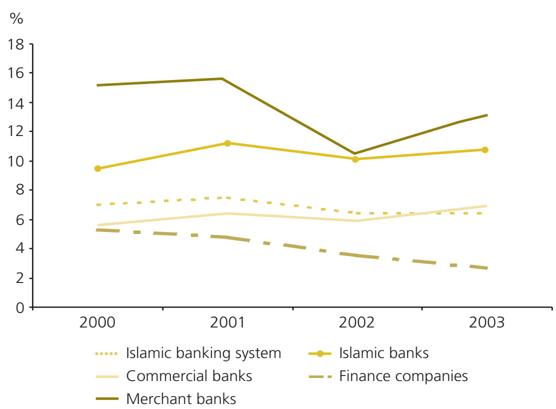
	For the year		Annual change (%)
	2002	2003*p*	
	RM million		
Financing approvals	12,310	16,739	36.0
Financing disbursements	24,187	36,162	49.5
Financing repayments	20,776	26,241	26.3
	As at end		Annual change (%)
	2002	2003*p*	
	RM million		
Outstanding financing	36,718	48,615	32.4

p Preliminary

Asset Quality

The asset quality of the Islamic banking industry continued to improve during the year. As at end-December 2003, the gross and net NPF ratios stood at 8.6% (2002: 8.9%) and 5.5% (2002: 5.7%) respectively based on a 6-month classification. The net NPF ratio of the Islamic banking institutions was sustained within the range of 5.3% to 5.6% throughout the year. Financing loss coverage remained high at 53.7% of total NPF as at end-December 2003. In terms of absolute amount, financing loss coverage increased to RM2.4 billion from RM2 billion in 2002. The income-in-suspense, general provision and specific provision set aside by Islamic banking institutions increased by 43.7%, 33.7% and 3.9% respectively during the year. Overall, the average general provision for Islamic banking industry stood at 1.9% of total net financing reflecting the prudent stance of a number of Islamic banking institutions in setting aside higher provisions for financing. This was further reinforced through the separate apportionment of general provision for the Islamic banking financing portfolio of IBS banks following the introduction of the standard framework for the calculation of the rate of return.

Graph 5.3
Islamic Banking System:
Net Non-performing Financing Ratio[1]



[1] Based on actual classification

Table 5.5
Islamic Banking System: Non-performing Financing and Financing Loss Provisions

	As at end					
	2002			2003*p*		
	Actual[1]	Classification		Actual[1]	Classification	
		3-month	6-month		3-month	6-month
	RM million					
Islamic banks						
General provisions	209.1	209.1	209.1	170.5	170.5	170.5
Income-in-suspense	133.2	142.2	133.2	178.2	186.9	178.2
Specific provisions	395.4	436.4	395.4	406.7	434.9	406.7
Non-performing financing	1,396.4	1,933.0	1,396.4	1,575.5	2,002.2	1,575.5
Net NPF ratio (%)[3]	10.1	15.8	10.1	10.8	15.1	10.8
Total provisions/ NPF (%)	52.8	40.8	52.8	47.9	39.6	47.9
Commercial banks[2]						
General provisions	250.0	226.5	247.9	400.9	379.7	300.8
Income-in-suspense	113.0	78.1	111.4	213.3	130.1	207.1
Specific provisions	222.4	222.4	222.3	280.3	284.4	309.3
Non-performing financing	1,300.0	1,604.2	1,085.0	1,991.7	2,274.4	1,653.7
Net NPF ratio (%)[3]	5.9	7.9	4.6	6.9	8.5	5.2
Total provisions/ NPF (%)	45.0	32.9	53.6	44.9	34.9	49.4
Finance companies[2]						
General provisions	202.2	202.2	202.2	316.7	316.6	318.7
Income-in-suspense	129.8	158.7	126.3	150.8	155.8	149.8
Specific provisions	279.4	748.9	238.3	274.9	296.7	274.5
Non-performing financing	751.5	919.0	671.1	832.3	1,058.7	805.1
Net NPF ratio (%)[3]	3.6	0.1	3.2	2.7	4.0	2.5
Total provisions/ NPF (%)	81.4	120.8	84.5	89.2	72.6	92.3
Merchant banks[2]						
General provisions	12.2	12.2	12.2	12.1	12.1	12.1
Income-in-suspense	15.6	15.6	15.6	20.6	20.7	20.6
Specific provisions	33.6	33.6	33.6	5.4	5.4	5.4
Non-performing financing	127.7	127.7	127.7	125.6	128.3	125.6
Net NPF ratio (%)[3]	10.4	10.4	10.4	13.2	13.5	13.2
Total provisions/ NPF (%)	48.1	48.1	48.1	30.3	29.8	30.3
Islamic banking system						
General provisions	673.5	649.9	671.3	900.2	879.0	802.0
Income-in-suspense	391.7	394.6	386.6	562.9	493.5	555.6
Specific provisions	930.7	1,441.3	889.6	967.2	1,021.4	995.8
Non-performing financing	3,575.5	4,583.9	3,280.2	4,525.1	5,463.6	4,159.9
Net NPF ratio (%)[3]	6.4	7.9	5.7	6.4	8.4	5.5
Total provisions/ NPF (%)	55.8	54.2	59.4	53.7	43.8	56.6

1 Financing classified as NPF based on individual banking institution's NPF classification policy i.e. 3-month or 6-month classification.
2 Refers to Islamic banking portfolio of conventional banking institutions participating in Islamic Banking Scheme and represents a subset of the figures reported under the total banking system for commercial banks, merchant banks and finance companies.
3 Net NPF ratio = (NPF less IIS less SP) / (Gross financing less IIS less SP) x 100%.
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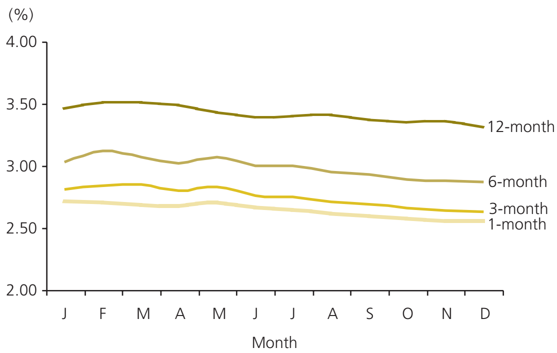
The broad property sector continued to account for the largest share, at 62.3% of the total NPF (2002: 59.7%). The high NPF in the broad property sector reflected the increase of NPF in the residential property and construction sectors of RM451 million and RM174.5 million respectively. In addition, there was also an increase in NPF in transport, storage and communication sector of RM108.2 million.

Rates of Return

The rates of return on investment deposits were influenced by the asset yield, asset quality and the level of total deposits of the Islamic banking institutions. During the year, in tandem with favourable financing growth and asset quality, the rates of return to the investment account depositors recorded stable

Graph 5.4
Islamic Banking System:
Trend of Rate of Return to Depositors



movement across the different tenures. The rates for 1-month and 3-month ranged between 2.56% to 2.72% and 2.63% to 2.85% respectively. The stable movement was also influenced by the changes made to the profit sharing ratio of each deposit tenure and the existence of the Profit Equalisation Reserve that enabled Islamic banking institutions to manage the volatility of the rates.

Profitability

In line with the moderate growth in total financing, the Islamic banking sector recorded an increase in net finance income of RM555 million at the operating level. Notably, the non-finance income of the Islamic banking sector registered an increase of RM232 million or 46.9%. The Islamic banking sector posted higher profit before provision that amounted to RM2.3 billion (2002: RM1.7 billion). After allocating financing loss provisions, the Islamic banking sector recorded profit before tax for the calendar year 2003 that amounted to RM977.2 million (2002: RM947.8 million). Despite the increase in provisions that amounted to RM1.3 billion, a higher profit before tax was recorded as the increase in finance and non-finance income more than offset the increase in provisions. The higher financing loss provisions charged by the Islamic banking institutions were partly due to the increase in NPF and Profit Equalisation Reserve.

Liquidity

There was ample liquidity in the Islamic banking system throughout 2003. Total deposits recorded a moderate growth of 13% or RM6.9 billion to reach RM60.2 billion as at end-2003. The IBS commercial banks and the Islamic banks accounted for the major share (73.2%) of total deposits in the Islamic banking sector (2002: 74.8%). The IBS merchant banks recorded the highest growth rate in deposits (24.6%) followed by the IBS finance companies (20.6%).

Investment deposits (general and special) continued to capture a major portion of the deposits, accounting for 58.5% of the total. During the year, savings and demand deposits grew by 26.6% and 19.6% respectively mainly due to the increase in the retail customer base. In terms of the maturity profile of general investment deposits, 52.6% of the general investment deposits continued to be concentrated at the shorter end of the spectrum, mainly in the one- to three-month tenure as the incremental return between the shorter and longer placement tenures remained small. The average deposit rates remained stable in year 2003.

In terms of liquidity position, the two Islamic banks had sufficient liquidity to meet any unexpected withdrawals for a period of up to one month. This represented surplus liquidity above the minimum requirement of 3% and 5% for the up-to one-week and one-week to one-month time buckets respectively. The financing-to-deposits (FD) ratio of

Table 5.6
Islamic Banking System: Income and Expenditure

		For the calendar year		Annual change	
		2002	2003*p*	2003*p*	
		RM million		RM million	%
Finance income net of income-in-suspense		3,196	3,870	674	21.1
(Income-in-suspense)		*373*	*306*	*-67*	*-18.0*
Less:	Finance expense	1,569	1,688	119	7.6
Net finance income		1,627	2,182	555	34.1
Add:	Non-finance income	495	727	232	46.9
Less:	Staff cost	199	229	30	15.1
	Overheads	269	384	115	42.8
Profit before provisions		1,654	2,296	642	38.8
Less:	Financing loss & other provisions	706	1,319	613	86.8
Pre-tax profit		948	977	29	3.1
Return on assets (%)		1.4	1.2		
Return on equity (%)		20.2	14.4		

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Table 5.7
Islamic Banking System:
Deposits by Type and Institution

	Annual change				As at end 2003*p*
	2002		2003*p*		
	RM million	%	RM million	%	RM million
Demand deposits	**2,727**	**42.2**	**1,796**	**19.6**	**10,980**
Islamic banks	834	31.9	693	20.1	4,143
Commercial banks	1,893	49.3	1,103	19.2	6,837
Savings deposits	**1,275**	**30.7**	**1,442**	**26.6**	**6,866**
Islamic banks	308	21.2	190	10.8	1,952
Commercial banks	897	42.1	1,145	37.8	4,175
Finance companies	70	12.5	107	16.9	739
Investment deposits	**2,463**	**7.4**	**-741**	**-2.1**	**35,227**
Islamic banks	909	8.9	93	0.8	11,183
Commercial banks	-1,032	-7.6	-2,351	-18.7	10,227
Finance companies	1,419	20.3	614	7.3	9,019
Merchant banks	7	1.9	213	56.5	590
Discount houses	1,160	49.2	690	19.6	4,208
Other deposits	**-266**	**-8.9**	**4,410**	**161.6**	**7,139**
Islamic banks	-5	-4.0	187	157.1	306
Commercial banks	-314	-12.8	3,148	147.6	5,281
Finance companies	-59	-50.9	1,150	2,017.5	1,207
Merchant banks	4	1.3	-46	-15.0	261
Discount houses	108	2,160.0	-29	-25.7	84

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the Islamic banking institutions has shown a favourable trend. The FD ratio increased from 68.9% as at 31 December 2002 to 80.7% as at end-2003 due to the more rapid increase in the total financing base compared with deposits during the period.

Islamic Interbank Money Market (IMM)

During the year, liquidity in the IMM was ample. The excess liquidity, however, was maintained at an appropriate level following a series of liquidity operations undertaken by Bank Negara Malaysia. Apart from using *wadiah* interbank deposits to absorb liquidity, the RM2 billion worth of Government Investment Issues (GIIs) and RM1 billion in Bank Negara Negotiable Notes (BNNNs) were issued, which helped stabilise liquidity conditions. The active management of the surplus liquidity position through the issuance of government and Bank Negara Islamic papers has correspondingly reduced the amount of funds absorbed by Bank Negara Malaysia through direct acceptance of *wadiah* interbank deposits. The average daily amount outstanding absorbed through *wadiah* interbank deposits declined by 61.3% from RM6.2 billion in 2002 to RM2.4 billion in 2003.

The increase in the supply of GII and BNNN contributed significantly to higher trading in these instruments. Trading in GIIs recorded an increase of 511.9% (RM30.2 billion) and in BNNNs recorded an increase of 300% (RM6.6 billion). The increase in the supply of Government papers has promoted active secondary market trading in the IMM. In addition, Bank Negara Malaysia also introduced a new measure whereby principal dealers are required to perform the role of market makers for GIIs and BNNNs. This measure has put in place the price discovery process to facilitate trading in the primary and secondary market.

Trading in interbank deposits and other instruments such as trade bills in the IMM also registered positive growth. During the year, the *mudharabah* interbank investments recorded a moderate increase of 14.9% totalling to RM283.8 billion (2002: RM247 billion). Trading of Negotiable Islamic Debt Certificates (NIDCs) also registered a positive growth. Islamic banking institutions have intensified the issuance of Islamic negotiable instruments of deposit to mobilise longer-term deposits (a maturity tenure of more than 6 months) by issuing NIDCs. This initiative spurred active trading of NIDC in the IMM, which recorded a triple-digit growth of 425%. However, in absolute terms, the trading of NIDC remained relatively small. The trading of short-term trade bills also showed an encouraging growth of 40.3%, from RM24.8 billion in 2002 to RM34.8 billion in 2003, emanating from the increase in trade financing activities.

During 2003, the trading of Islamic private debt securities (IPDS) increased by 59.7% to RM60.7 billion from RM38 billion in 2002. This higher increase emanated from new issues of IPDS amounting to RM8.1 billion, and strong trading sentiments in the first half of the year. The year 2003 also witnessed the issue of the first asset-backed securities that were structured on Islamic principles amounting to RM986 million.

Table 5.8
Islamic Interbank Money Market

	2002	2003*p*	Annual change	
	RM billion		RM billion	%
Islamic Funds				
Mudharabah Interbank Investments*	247.0	283.8	36.8	14.9
Islamic Papers				
Government Investment Issues	5.9	36.1	30.2	511.9
Bank Negara Negotiable Notes*	2.2	8.8	6.6	300.0
Short-term Trade Bills*	24.8	34.8	10.0	40.3
Negotiable Islamic Debt Certificates*	0.8	4.2	3.4	425.0
Total	**280.7**	**367.7**	**87.0**	**31.0**

* Volume transacted through brokers.
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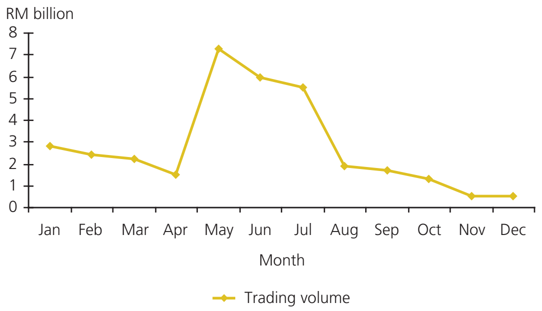
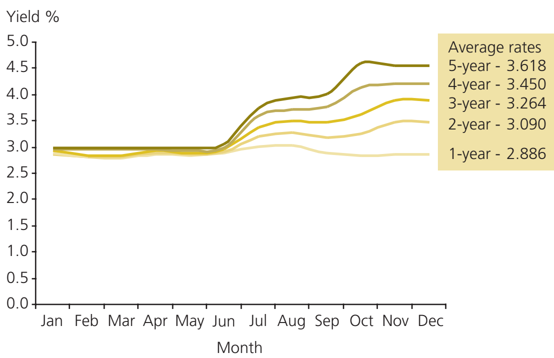
Graph 5.5
GII - Trading Volume



Graph 5.6
GII - Average Yield to Maturity



Development Financial Institutions

Development Financial Institutions

INTRODUCTION

Guided by the main strategic directions and road map for development financial institutions (DFIs) in the Financial Sector Masterplan (FSMP), continued efforts were made to further develop the DFIs under the Bank's purview in 2003. Policy strategies undertaken during the year remained focused on areas related to enhancing the regulatory framework and capacity building of the DFIs. Several initiatives formulated in 2002 to further strengthen the financial soundness and operational structure of the DFIs were implemented during the year.

Adopting the phased and prioritised approach, a number of prudential measures were put in place to enhance the financial and operational soundness of the DFIs, to ensure efficient and effective implementation of their mandated roles in the economy. These include Guidelines on Liquidity Requirements, Corporate Governance Standards on Directorship, Credit Card Operations, and Classification of Impaired Loans and Provisioning for Bad and Doubtful Debts. In addition, as part of the initiatives to further enhance the monitoring of activities and financial performance of the DFIs, a computerised reporting system would be implemented in early 2004.

To further equip the DFIs for their role as specialised institutions, initiatives on enhancing advisory capability of DFIs to small and medium enterprises (SMEs) were commenced in 2003. At the same time, policy on minimum capital requirement was initiated to ensure DFIs have the financial capacity to sustain their operations. Recognising the wide outreach of selected DFIs, a programme to enhance access to financing for micro enterprises was also launched and implemented by these DFIs. The objective of this programme is to unlock the potential of the large number of small businesses in promoting domestic sources of economic growth.

Several prudential measures and initiatives were undertaken in 2003 to enhance the financial and operational soundness of DFIs and to ensure effective implementation of their mandated roles.

POLICIES AND MEASURES

Building capacity and capability of DFIs

- **Enhancing advisory capacity of DFIs to SMEs**
  As specialised institutions mandated to promote certain identified economic sectors, DFIs need to complement financing facilities with non-financing facilities, in particular advisory and consultancy services to their targeted customers. To build capacity of the DFIs in providing advisory services, the Bank initiated a joint project with the assistance of the Japan International Cooperation Agency and selected DFIs to enhance the capacity of the institution to provide advisory services to SMEs. The project aims to provide action and implementation plans to improve the advisory services provided by DFIs to the SMEs.

Monitoring of DFIs' Activities and Performance

- **Development Financial Institutions Statistical System**
  To enhance the ability to measure the performance of DFIs, accurate information in a timely manner is important. Towards this end, the Bank had, in mid-2003, embarked on a project to develop a computerised reporting system to capture and generate statistical data on DFIs. The system known as the Development Financial Institutions Statistical System or DFISS, will collect relevant information from DFIs via online. To address the uniqueness of each DFI, the DFISS will capture both generic and specific information relating to their businesses.

- **Supervisory Activities**
  The Bank adopts a two-pronged risk-based supervisory approach encompassing regular on-site examinations and off-site surveillance. With the risk-based approach, supervisory attention and resources were directed to areas that pose higher degree of risks. Supervisory efforts were

primarily concentrated on ensuring that the DFIs were operationally and financially sound.

The on-site examinations by the Bank on the DFIs in 2003, inclusive of their subsidiaries, have enabled the Bank to assess the operating conditions and financial positions of the DFIs. As a result of these examinations, measures have been taken to promote the efficiency and effectiveness of individual DFIs. Capital adequacy was also assessed to ensure sustainability of the DFIs in performing their mandated roles.

The on-site examinations had in addition, focused on building institutional capacity and placing sound infrastructures in the DFIs. In this regard, emphasis was placed on instilling best practices in corporate governance structures and risk management systems. The importance of corporate governance cannot be over-emphasised for the overall health of the DFIs, as it would ensure accountability and provide incentives for the Board and management to put in place effective risk management systems. As part of establishing the effectiveness of the Board, an essential ingredient in corporate governance, interviews were conducted with the directors of DFIs to promote understanding of the roles and responsibilities as well as the commitment of the directors to the development of the institutions. As most DFIs were involved in lending activities, DFIs were also required to give attention to discipline in risk management, especially in credit risk management. The DFIs were strongly encouraged to have in place a comprehensive risk management system with appropriate management oversight to identify, measure, control and monitor risks with emphasis on the uniqueness of the targeted sectors. Data integrity and information technology capacity were also assessed to ensure safe and sound information technology operations in supporting the DFI's business activities.

To complement the on-site examinations, on-going off-site surveillance was undertaken to regularly monitor the financial health of the DFIs for early detection of any problems arising in these institutions. This included rigorous analysis of financial data, ratios and trends concerning the important areas of capital adequacy, asset quality, management, earnings performance and liquidity position. For a more effective and consultative supervisory process, arising from the examination of the DFIs, the Bank also conducted and engaged in dialogues and meetings with the Board of Directors and management of the DFIs to discuss issues following the supervisory findings.

Achievement of the DFIs' mandated roles was also assessed particularly as these DFIs were established as specialised development financial institutions to achieve national socio-economic and developmental goals. The DFIs needed to be more dynamic and proactive in enhancing the range of facilities offered through product and service innovation as well as broaden their activities by providing value-added advisory/ consultancy services and technical assistance to their customers. The DFIs were also encouraged to proactively develop key productivity indicators and other financial analysis for self-assessment on their achievement of mandated roles.

A rating framework was used in the supervisory process to assess the DFIs, both in terms of performance of their mandated objectives as well as the overall financial condition. A structured rating framework for the DFIs was developed taking cognisance of the mandated core business activities and the underlying impact on the management and financial elements of the institutions.

Strong corporate governance and risk management practices would enable DFIs to be more dynamic in the performance of the identified mandated roles. In supervising the DFIs, attention is given to the need to balance the high risk inherent in the portfolios with effective risk management, the fulfilling of the mandated roles and at the same time remaining financially viable.

Strengthening Financial Conditions and Operational Structure

During the year, the Bank also issued the following prudential policies and measures to enhance the soundness of the financial conditions of the DFIs:

- **Guideline on Liquidity Requirements**
  In 2003, minimum liquidity requirements were imposed on two DFIs, namely Bank Simpanan Nasional (BSN) and Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), given both

institutions mobilise substantial funds through their deposit-taking activities from the public. These DFIs were required to maintain a minimum level of liquid assets as part of the measures to mitigate liquidity risks. The Bank has formulated two types of liquidity frameworks to be used in determining the minimum level of liquid assets to be maintained by Bank Rakyat and BSN.

Under the Liquid Assets Ratio Framework, BSN is required to maintain at all times a minimum liquidity ratio of at least 10% of designated assets in proportion to its total eligible liabilities.

For Bank Rakyat, the New Liquidity Framework (NLF) which is similar to that imposed on banking institutions, is used to determine the level of liquid assets to be maintained. Under this framework, the liquidity needs of Bank Rakyat are assessed based on its ability to match its short-term liquidity requirement arising from maturing obligations against maturing assets. The NLF is designed to assess liquidity at three levels. The first level assesses the sufficiency of liquidity in the normal course of business over the next one week to 12 months. The second level assesses whether a financial institution has sufficient liquidity surplus and reserves to meet sudden liquidity withdrawal shocks. The third level assesses a financial institution's general funding structure, in particular, assesses the degree of dependency on particular markets. To ensure that there is sufficient liquidity to meet its liability obligations in the near term, Bank Rakyat is required to maintain adequate liquidity surplus not only to meet expected obligations but also to sustain unexpected heavy withdrawals for at least one month.

The minimum liquidity requirement for the other DFIs will be imposed in stages.

- **Guideline on Corporate Governance Standards on Directorship**
  As part of the on-going efforts to promote strong corporate governance structures and practices in DFIs, the Guideline on Corporate Governance Standards on Directorship for DFIs was issued on 23 September 2003. This guideline aims to assist the DFIs and their stakeholders in instituting effective governance structure and oversight of board of directors. The guideline outlines the duties and responsibilities of the board of directors, minimum requirements and rules governing the appointment of directors and chief executive officer (CEO) and the establishment of board committees.

Duties and responsibilities of the Board
The guideline specifies the main duties and responsibilities of the Board. The Board is responsible for supervising the affairs of the DFIs and to be fully informed of the institution's condition and management policies in ensuring that the institution is soundly managed. In this regard, the Board is responsible for the selection and appointment of qualified and competent senior executives to administer the affairs of the institution. Specific for DFIs, the Board is responsible in steering the institution in achieving its mandated roles to provide financial services and facilities for which the institution was established for. Other main duties and responsibilities of the board of directors include ensuring that DFI's strategic focus are clearly defined, establishing and ensuring the effective functioning of Board committees, and setting up effective internal control system and internal audit functions to improve accountability.

Minimum qualification standard and training requirements for directors
This minimum qualification standard and training requirements for directors aim to ensure that board of directors of DFIs possess the necessary qualifications, skills and experience to effectively discharge their governance responsibilities. Directors of DFIs are expected to have an understanding of the nature of business and the current issues and the regulatory changes in their identified targeted sectors.

Appointment of CEO and directors
This guideline emphasises the need to appoint appropriate candidates as CEO or directors to ensure the sound operation of a DFI. Candidates must be suitably qualified with appropriate experience, calibre and impeccable integrity, in addition to being familiar with the operations, state of the internal controls, requirements of regulations and current policies affecting the DFI to ensure smooth running of the day-to-day operations of the institution. The guideline also clarifies the 'fit and proper' criteria as set out in the Development Financial Institutions Act 2002 (DFIA).

On the policy with regard to appointing practising lawyers and accountants as directors of a DFI, the guideline indicates that such appointments can be made provided that they are not employed by or are not partners in a legal firm or accounting firm, which are on the panel of lawyers or engaged to conduct audit of or consultancy work for that particular DFI.

Directorship in other corporations
The CEO is not permitted to hold any executive position in another corporation to ensure focus on the management of the institution. Directorships in subsidiaries and associate companies of the DFI should not exceed five at any one time. The Board should set policies on the maximum number of directorships that can be held by other staff of the DFI. To ensure that the non-executive director participates and is actively involved in the management and affairs of the DFI, attendance must be at least 75% of the Board meetings.

Size and composition of the Board
The guideline prescribes that DFIs are required to have at least seven directors on its board to ensure adequate number of directors to represent the interest of various stakeholders. In addition, there must be sufficient number of independent directors to provide a balanced view and opinion in the Board. The guideline also restricts the maximum number of executive directors on the Board to two.

Board committees
To assist the Board in discharging its responsibilities effectively, the Board is required to set up four board committees with specific functions and responsibilities. The setting up of these committees at the board level facilitates active involvement of the Board in various policy formulation and to provide oversight and direction on critical aspects of the organisation. The four committees are: Audit and Examination Committee, Nomination Committee, Remuneration Committee, and Risk Management Committee. The guideline provides the terms of reference, composition, minimum qualification where necessary and conducts of the respective committees.

- **Guideline on Credit Card Operations for Bank Simpanan Nasional**
  As part of the process to further increase the awareness with regard to the products and banking services and to implement the measures on consumer protection, a Guideline on Credit Card Operations which was issued to the banking institutions was also extended to BSN being one of the credit card issuers. The guideline was effective from 28 July 2003.

  Under the guideline, BSN is required to comply with the requirements on the minimum age and income requirements, placement of fixed deposit, prudent lending, minimum monthly payment, fees and charges, and classification of impaired loans/financing and provisioning for bad and doubtful debts with immediate effect. The compliance with the requirements pertaining to terms and conditions, statement on minimum monthly payment, minimum disclosure on fees and charges, supplementary cardholder's liability, liability for lost or stolen credit card, and consumer awareness and education program were effective from 28 January 2004.

- **Guideline on Classification of Impaired Loans and Provisioning for Bad and Doubtful Debts**
  This guideline was issued pursuant to Section 41 of DFIA to all DFIs under the Bank's purview excluding the Malaysia Export Credit Insurance Berhad (MECIB) on 13 March 2003. The guideline sets out the minimum standards on classification of impaired loans and advances and provisioning requirements for such assets of DFIs. The guideline aims to ensure that impaired assets and potential losses are identified and recognised in a timely manner, and loan assets and income are fairly and prudently stated.

  The guideline stipulates minimum categories of classification for impaired loans, amount of specific provision to be set aside for different categories of impaired assets, treatment of interest income of impaired assets, and general provision to be set aside for the loan portfolio. The impaired assets are categorised according to the degree of recoverability of the loans. Loans with no probability of recovery are accorded with 'bad' classification, 'doubtful' when the chances of recovery are improbable and with high risk of ultimate default, and 'substandard' when there is more than the normal risk of loss.

  The guideline requires DFIs to suspend all interest accrued when the loan/financing is classified. On minimum provisioning requirements, the guideline requires the DFIs to maintain loan loss provision at a level that is adequate to absorb potential loan/financing losses. The provisions required are in the form of specific provision and general provision. While specific provision refers to provision for loan losses of specific loan accounts, general provision refers to provision for loan losses of the overall loan portfolio. For the specific provision, the DFIs are required to gradually build up the provision for potential loan losses according to the degree or category of classified assets. DFIs are required to provide 10% of the uncovered exposure for loans classified substandard, 50% for doubtful classification, and eventually full provision for loans classified bad. The DFIs are also required to set aside provisions for off-balance sheet items where the DFIs face credit risk from failure of counter-parties to fulfill their contractual obligations.

The guideline requires the DFIs to review the adequacy of both specific and general provision regularly at least every 6 months. This is to ensure that the provisions set aside are consistent with current information on the collectibility of the loans. In addition, the DFIs' assessment of the adequacy of the provisions need to be performed in a systematic and consistent manner, in conformity with the objective criteria and be supported by adequate documentation.

The guideline also emphasises active involvement of the Board of Directors and management in ensuring that approval and formulation of policy on classification of impaired loans and provisioning policy of the DFIs is consistent with the minimum standards that have been set.

- **Circular on Use of Generic Names and "i" Indicator for Islamic Banking Products**
  To increase awareness in Islamic products and services offered by banking institutions and to streamline and standardise the generic names for Islamic banking products, the Bank issued a guide on the use of standardised generic names to financial institutions offering Islamic banking products. The Bank requires all banking institutions including DFIs that provide Islamic banking products and services to use standardised generic names as set out in the list and to use "i" indicator for marketing and advertising of Islamic banking products in all media, brochure and product pamphlet, and other printed forms or promotion events.

- **Circular on Permission for New Products and Services**
  On 26 April 2003, a Circular on Permission for New Products and Services was issued with the objectives to ensure that DFIs remained focus on their mandated activities and at the same time avoid undertaking unnecessary risks in performing their mandated role. In addition, it aimed to ensure that the products meet the customers' requirements.

PERFORMANCE OF DEVELOPMENT FINANCIAL INSTITUTIONS

The financing activities of the DFIs improved in 2003, in tandem with the overall growth of the economy.

Table 6.1
Development Financial Institutions[1] : Sources and Uses of Funds

	Annual Change		As at end 2003
	2002	2003	
	RM million		
Sources:			
Shareholders' funds	999	1,592	9,498
Paid-up capital	*596*	*1,180*	*7,193*
Reserves	*321*	*-122*	*1,395*
Retained earnings	*82*	*534*	*910*
Deposits accepted	492	2,585	42,383
Borrowings	1,111	2,100	16,076
Government	*2,250*	*2,481*	*11,356*
Multilateral / International agencies	*113*	*-399*	*3,036*
Others	*-1,252*	*18*	*1,684*
Others	1,779	369	11,135
Total	**4,381**	**6,646**	**79,092**
Uses:			
Deposits placed	3,456	1,393	17,113
Investments	-2,700	1,874	21,142
of which:			
Government securities	*-219*	*66*	*3,562*
Shares	*1,328*	*-629*	*5,799*
Quoted	*847*	*-3*	*5,323*
Unquoted	*481*	*-626*	*476*
Loans and advances	4,956	3,106	32,548
Fixed assets	595	99	3,706
Others	-1,926	174	4,583
Total	**4,381**	**6,646**	**79,092**
Contingencies:			
Guarantee	-182	493	3,653
Export credit insurance	3	-26	125
Total	**-179**	**467**	**3,778**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

The DFIs provided financing to strategic sectors and sub-sectors of the economy. These included agriculture, capital-intensive and high technology industries, shipping, infrastructure, manufacturing, export, Bumiputera entrepreneurs, co-operatives as well as home ownership and property development at the state level, namely in Sabah and Sarawak. In 2003, two DFIs, namely BSN and Bank Pertanian Malaysia (BPM), were appointed by the Government to implement the micro credit scheme, which was part of the Government's Economic Package announced in May 2003.

Financing Activity

Total loans outstanding of the DFIs increased at an annual rate of 10.5% or RM3.1 billion (2002: 20.2% or RM5 billion) to RM32.5 billion as at end-2003, led by lending to the infrastructure sector by Bank Pembangunan dan Infrastruktur Malaysia Berhad (Bank Pembangunan) and retail financing by Bank Rakyat.

In terms of overall sectoral distribution, consumption credit rose strongly by 20.1% representing 24.8% of total loans outstanding of the DFIs. Loans outstanding to the construction, and transport, storage and communication sectors as a group increased by 3.8%, representing 26% of total loans. Growth was also recorded in the agriculture and manufacturing sectors, at 10.2% and 8.9% respectively, contributing 21.3% to total loans outstanding of the DFIs. In regard to credit insurance and credit guarantee, total outstanding insurance and guarantee coverage provided by the relevant DFIs increased by 14.1% to RM3.8 billion as at the end of the year, contributed by significantly higher guarantee coverage provided by the Credit Guarantee Corporation Malaysia Berhad (CGC).

Lending by six DFIs that are under the purview of DFIA increased during the year. Bank Pembangunan's financing of the infrastructure sector and Bumiputera SMEs increased by 11% and 4.6% respectively. In addition, the bank provided advisory services and training to the SMEs. Retail financing provided by Bank Rakyat to its members rose strongly by 20.8% while BSN registered a strong increase of 15.8% in its lending activities due to loans extended under the micro credit scheme. Meanwhile, the Export-Import Bank of Malaysia Berhad (EXIM Bank) recorded growth of 2.1% in its lending activities. Declines in lending/underwriting activities were, however, recorded by Bank Industri & Teknologi Malaysia Berhad (Bank Industri) and MECIB by 7.6% and 9.9% respectively, due primarily to capital constraints. For the deposit-taking DFIs, savings mobilised by BSN increased by 0.1% whilst that by

Table 6.2
Development Financial Institutions[1] : Direction of Lending

	Annual Change		As at end
	2002	2003	2003
	RM million		
Agriculture, forestry and fishery	214	302	3,266
Mining and quarrying	44	6	96
Manufacturing	209	298	3,654
Electricity, gas and water supply	119	170	624
Import and export, wholesale and retail trade, restaurants and hotels	-378	166	406
Broad property sector	2,140	567	8,408
Construction	*1,444*	*228*	*4,019*
Purchase of residential property	*191*	*162*	*2,948*
Purchase of non-residential property	*124*	*50*	*443*
Real estate	*381*	*127*	*998*
Transport, storage and communication	1,502	80	4,443
Finance, insurance and business services	480	96	1,876
Consumption credit	1,312	1,351	8,067
Others	-686	70	1,708
Total	**4,956**	**3,106**	**32,548**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

Table 6.3
Development Financial Institutions[1] : Non-performing Loans and Loan Loss Provisions

	As at end	
	2002	2003
	RM million	
General provisions	614	667
Interest-in-suspense	1,152	1,224
Specific provisions	2,163	2,135
Non-performing loans	5,028	4,934
	Percent (%)	
Gross NPL ratio[2]	17.7	15.7
Net NPL ratio[3]	6.8	5.6
Total provisions/NPL	78.1	81.6

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad and Sabah Credit Corporation.

[2] Gross NPL ratio = (NPL / Gross loans*) x 100%.
 * Excluding loans under ECR scheme.

[3] Net NPL ratio = (NPL less IIS less SP) / (Gross loans* less IIS less SP) x 100%.
 * Excluding loans under ECR scheme.

Bank Rakyat increased strongly by 16.8% partly due to attractive returns offered by the bank.

Gross NPLs of the DFIs declined by RM94.1 million to RM4.9 billion as at the end of the year, resulting in an improvement in the gross NPL ratio to 15.7% compared with 17.7% a year ago. Nevertheless, the gross NPL levels of most DFIs remained high, ranging from 9% to 46.1% of total loans outstanding. All DFIs under the purview of DFIA classified a loan or financing account in default for six months or more as non-performing.

As a group, the DFIs have made provisions amounting to RM4 billion to cover potential loan losses. The net NPL amount and ratio of the DFIs stood at RM1.6 billion or 5.6% respectively as at end-2003 (2002: RM1.7 billion or 6.8%).

Sources of Funding

Total deposits mobilised by the deposit-taking DFIs increased by 6.5% to RM42.4 billion as at end-2003. Deposits from individuals recorded a growth of 5.4% (RM1.1 billion), accounting for the largest share of total deposits mobilised (51.2%). Lembaga Tabung Haji and BSN remained dominant in mobilising savings from individuals, with the former recording an increase of 9.9%, while the latter registering a decline of 5.8% in 2003. Deposit placements by business enterprises, and the Government and Government agencies accounted for 33.9% and 12.1% respectively of total deposits.

Borrowings from the Government, which amounted to RM11.4 billion as at end-2003 (2002: RM8.9 billion), represented 14.4% of total resources. Borrowings from the Government were used primarily to enhance access to financing. The operations of the DFIs were also funded by shareholders' funds totalling RM9.5 billion or 12% of total resources.

In 2003, four DFIs recorded pre-tax/zakat losses totalling RM34.8 million, mainly due to poor asset quality. The remaining 10 DFIs recorded pre-tax/zakat profits totalling RM715.7 million.

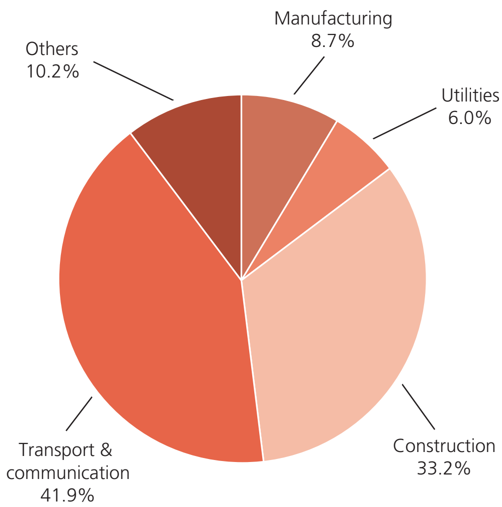
Bank Pembangunan dan Infrastruktur Malaysia Berhad

Bank Pembangunan dan Infrastruktur Malaysia Berhad's (Bank Pembangunan) primary roles are promoting the participation of the Bumiputera community in business and industry, and providing financing for infrastructure projects, in particular Government-identified projects. Bank Pembangunan registered an increase in its lending activities in 2003.

Bank Pembangunan also provides advisory services, entrepreneurial training and project consultancy services to enhance the business capabilities of Bumiputera SMEs. As part of the efforts to promote the development of a viable and resilient Bumiputera Commercial and Industrial Community, Bank Pembangunan introduced two new packages known as "Premis SMI" or "SMI Premises" and "Groombig" in 2003. Under the "SMI Premises" package, apart from low rental rates for its factory complexes, Bank Pembangunan also provides loans, advisory services (which include financial, corporate and technical advice), training and matching grants (whereby Bank Pembangunan provides grants amounting to 70% of total project cost). As at end-2003, Bank Pembangunan rented 229 of the 368 factory units to SMEs. In the case of the "Groombig" package, which is aimed at enhancing the performance of the larger sized SMEs, the entrepreneurs were provided with loans, advisory services and training. In 2003, a total of 29 companies were identified to participate in this programme.

Total loans outstanding to Bumiputera SMEs increased by 4.6% (2002: -5.6%) to RM1.3 billion as at end-year. Overall, including lending to non-Bumiputera SMEs, total loans outstanding to SMEs stood at RM1.6 billion, an increase of 5.9% over the level at end-2002.

Graph 6.1
Bank Pembangunan dan Infrastruktur Malaysia Berhad:
Direction of Lending as at 31 December 2003



Loans to finance infrastructure projects recorded a slower growth of 11% in 2003 compared with 56.5% in 2002. The outstanding loans for infrastructure projects totalled RM8.6 billion as at end-2003, accounting for 84.5% of total loans outstanding. These were mainly to finance Government-identified infrastructure projects. The loan increase was attributed largely to loans extended to the transport and communication (RM80.8 million), construction (RM331.2 million) and utilities (RM163.3 million) sectors. Overall, the loan portfolio of Bank Pembangunan increased by 10.2% to RM10.2 billion as at end-2003, representing 68.5% of Bank Pembangunan's total assets.

As at end-2003, Bank Pembangunan managed 26 Government funds. Loan approvals and loan disbursements under these funds increased by 203.8% (+RM334.6 million) and 63.4% (+RM82 million) respectively. The Tourism Infrastructure Fund and Special Tourism Fund 2 were the main beneficiaries with approvals of RM132.5 million and RM187.2 million respectively.

Gross NPLs increased to RM912.6 million representing 9% of total loans as at end-2003 (2002: RM769.8 million or 8.3%), attributed largely to higher NPLs for infrastructure loans. The gross NPL ratio of infrastructure loans rose to 4.2% (2002: 2.6%), while the level of NPLs for SME loans declined to 35% (2002: 38.2%). The net NPL ratio of Bank Pembangunan showed a marginal decline from 3.2% to 3.1%.

During the year, the investment portfolio decreased by 36.6% (RM574.4 million) following the disposal of private debt securities (PDS) and Government debt securities. Investments in PDS of RM757.5 million formed the largest component of Bank Pembangunan's investment which stood at RM995.4 million as at end-2003. Deposits placed with financial institutions increased to RM2.6 billion (2002: RM1.5 billion) to account for 17.5% of total assets.

The main sources of funding were borrowings from the Government (RM4.2 billion), deposits from Government agencies and public enterprises (RM3.8 billion), borrowings from multilateral and international agencies (RM1.4 billion), debt securities issued (RM1 billion) and Government grants and subsidies (RM644.7 million), accounting for 74.3% of Bank Pembangunan's total resources. During the year, Bank Pembangunan's shareholders' funds increased by RM234 million to RM2.5 billion. Bank Pembangunan's paid-up capital rose to RM1.6 billion following additional capital injection of RM400 million by the Government.

Bank Industri & Teknologi Malaysia Berhad

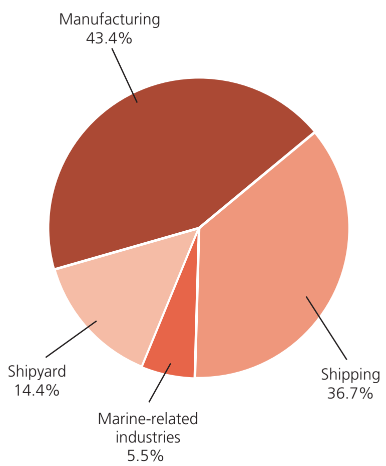
The lending activities of Bank Industri & Teknologi Malaysia Berhad (Bank Industri) declined in 2003, by 7.6% (2002:-9.3%) to RM837.3 million as at end-year. The maritime sector (comprising shipping, shipyard and marine-related industries) was the main recipient of the loans, representing 56.6% of total loans outstanding, while the manufacturing sector accounted for the remaining loans. As at end-2003, total loans outstanding accounted for 19.8% of Bank Industri's total assets of RM4.2 billion.

Loan approvals declined by 4.7% (2002: +17.7%), given that in 2003, the utilisation of the New Ship Financing Facility was restricted to financing of merchant vessels only. The approvals for the manufacturing sector meanwhile continued to record positive growth. During the year, lending activities of Bank Industri were also constrained by the level of its shareholders' funds.

Bank Industri managed 13 Government funds during 2003, representing 34.9% of the total loans of Bank Industri. Loan approvals and loan disbursements under the funds continued to fall markedly, by 31.3% and 28% respectively, as most of the funds have been fully utilised.

Gross NPLs decreased by RM1.4 million to RM323.6 million as at end-2003. However, due to a significant

Graph 6.2
Bank Industri & Teknologi Malaysia Berhad: Direction of Lending as at 31 December 2003



contraction in the loan base, the gross NPL ratio increased to 38.6% (2002: 35.8%). Loans to the maritime sector accounted for 56.6% of total NPLs while the manufacturing sector accounted for the balance. The net NPL ratio fell marginally to 18.4% from 18.9% a year ago.

Investment in subsidiaries (RM1 billion) and loans and advances to subsidiaries (RM840.7 million) formed the largest component (44.2%) of the bank's assets as at end-2003. The investment and advances were mainly in four subsidiaries, namely MECIB, EXIM Bank, Global Maritime Ventures Berhad and BI Credit and Leasing Berhad.

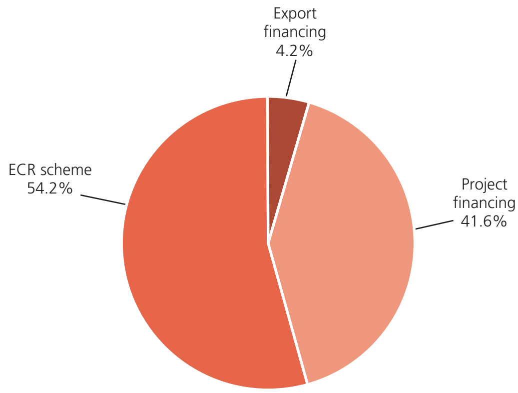
Borrowings formed the largest source of funding for Bank Industri, amounting to RM2.3 billion (54% of total resources) as at end-2003, of which 52.7% from the Government and 47.3% from multilateral and international agencies. Another major source of funding was deposits placed by Government and Government agencies, totalling RM678.3 million. The shareholders' funds of Bank Industri rose to RM280.2 million as at end-2003 (2002: RM164.3 million) mainly from the capital injection of RM80 million by the Government in June 2003 as part of the Government's Economic Package.

Export-Import Bank of Malaysia Berhad

Financing activities of Export-Import Bank of Malaysia Berhad (EXIM Bank) to promote the export of Malaysia's goods and services recorded an increase of 2.1% to RM2.1 billion in 2003. New loans approved, however, recorded a marked increase of 24.5% or RM92.8 million, reflecting the significant growth of Malaysian exports during the year. The two major activities were financing provided under the Export Credit Refinancing (ECR) scheme (54.2% of total loans) and financing of overseas projects (41.6%), while export financing constituted 4.2%. The bank also provided export guarantee of RM172.3 million, a decline of 2.1% from the previous year.

During the year, financing of overseas projects fell further to RM866.2 million, constrained by the small size of the bank's shareholders' funds. Nearly half of the total was channelled to projects undertaken in countries in the African continent and another 36.9% in South-East Asia. Meanwhile, the sole guarantee issued was for a project undertaken in South-East Asia. Consistent with its mandated role to promote the diversification of Malaysia's export markets, loans to non-traditional markets accounted for 60.4% of the total principal loans outstanding

Graph 6.3
Export-Import Bank of Malaysia Berhad: Credit Facilities as at 31 December 2003



as at end-2003. For project financing, 63.7% was channelled to non-traditional markets, while 32.4% of the export financing was channelled to the same markets.

EXIM Bank is the designated agency to manage the ECR scheme which is funded by the Government as part of the efforts to promote exports. Competitive rates are offered to banks participating in the scheme for on-lending to exporters. EXIM Bank disbursed a total of RM6.6 billion to exporters under the ECR scheme, an increase of 7.5% from the level in 2002,in line with the growth in Malaysia's exports and the increase in the customer base by 7% to 1,760 exporters. The major users of the facility were exporters in the palm oil products, rubber products, chemical products and textiles industries.

Loans outstanding formed the largest asset of EXIM Bank amounting to a share of 60.3% whilst deposit placements accounted for 37.5% of EXIM Bank's total assets.

Gross NPLs improved during the year, to RM439.9 million (2002: RM450.9 million), representing 46.1% of total loans outstanding, excluding loans provided under the ECR scheme (2002: 46.7%). Project financing accounted for the largest component of NPLs at 92.6%. The net NPL ratio declined to 2.3% after significant provisioning of RM436.3 million.

The bank sourced its funds through borrowings from the Government, international agencies and its parent company, apart from its shareholders' funds of RM238.2 million. As at end-2003, borrowings from the Government amounted to RM2 billion, international agencies RM298.2 million and, its parent company RM369.7 million. These borrowings accounted for 78% of the bank's total resources. Borrowings from the Government were utilised solely for the ECR scheme.

Following the signing of Multilateral Letter of Credit Confirmation Facility Agreements with seven Asian export-import financing institutions in 2002 in order to promote trade within the region, EXIM Bank signed Bilateral Letter of Credit Confirmation Facility Agreements with Korea EXIM Bank and India EXIM Bank, to further enhance Malaysia's bilateral trade with the respective countries.

Malaysia Export Credit Insurance Berhad

The activities of the Malaysia Export Credit Insurance Berhad (MECIB), which provides insurance cover and guarantee facilities to facilitate exports and overseas investment, continued to decline in 2003. Total insurance coverage and guarantees issued amounted to RM496.6 million as at end-2003, a decline of 9.9% (2002: -13.3%), although coverage under short-term credit insurance facilities increased by 12.9% in tandem with Malaysia's export growth. Of the total coverage, 74.7% was guarantees issued and the remaining were export credit insurance covers. The guarantee coverage were largely medium- and long-term exposures while the export credit insurance cover was mainly short-term in nature. MECIB faced capital constraints to engage in large medium- and long-term business.

Non-traditional markets accounted for 40.8% of the total guarantee and insurance coverage, reflecting MECIB's role in supporting Malaysia's export market diversification efforts. Exposure to countries in East Asia accounted for 46.9% of the total exposure, followed by Africa 12.7% and South Asia 12%. MECIB funded its activities solely from its shareholders' funds, which improved slightly to RM76.6 million as at end-2003 (2002: RM45.6 million). The loss percentage, indicating the ratio of claims paid to premiums received, improved to 29.3% as at the end of 2003, compared with the level of 55.3% recorded at the end of 2002.

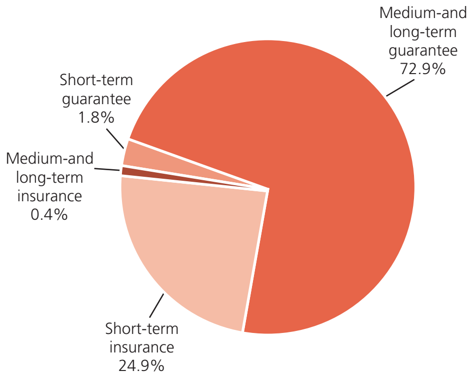
The main assets of MECIB were investments in securities and deposits placed with financial institutions, accounting for 45.1% and 40.3% of total assets respectively.

Bank Kerjasama Rakyat Malaysia Berhad

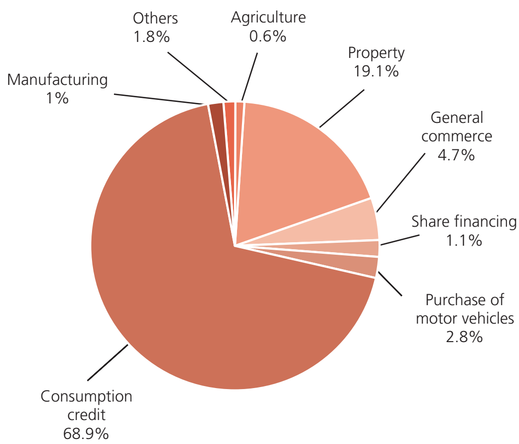
Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat) or People's Cooperative Bank of Malaysia registered strong growth both in financing and deposit mobilisation activities. Bank Rakyat's assets increased significantly by 17.7% to RM17.1 billion as at the end of the year. Financing formed the major portion (58.2%) of total assets, followed by deposit placements (24.5%) and investment in securities (14.2%).

Financing activities grew strongly by 16.9% to RM10 billion, with borrowings by members, which accounted for 77.7% of total financing outstanding, increasing by 20.8%. Demand for consumption credit continued to register a significant growth of 18.6% to RM6.9 billion as at end-year. Financing extended to the property sector grew by 15.8% to RM1.9 billion, reflecting primarily

Graph 6.4
Malaysia Export Credit Insurance Berhad: Contingent Liabilities as at 31 December 2003



Graph 6.5
Bank Kerjasama Rakyat Malaysia Berhad: Direction of Financing as at 31 December 2003



strong demand for residential properties. Financing of motor vehicles also registered strong growth of 136% although its share remained small at only 2.8%. In terms of sectoral distribution, consumption credit accounted for 68.9% of the financing outstanding whilst 19% and 4.7% were extended to the property sector and general commerce respectively. New financing approved and disbursed remained relatively unchanged at RM3.6 billion and RM3.7 billion respectively (2002: RM3.6 billion and RM3.5 billion respectively).

The gross non-performing financing (NPF) ratio fell marginally to 10.7% from 11.4% while the outstanding gross NPF increased slightly to RM1.1 billion from RM974.2 million. The property sector and consumption credit contributed 39.8% and 35.4% respectively, to total gross NPF. In terms of net NPF, the ratio was 5.2%.

Bank Rakyat's financing operations were largely funded by deposits, totalling RM13.1 billion and representing 76.6% of the bank's total resources. Deposits placed by business enterprises accounted for a major share (66.7%), of which two-thirds was from private enterprises while the remaining from public enterprises. Deposits mobilised from individuals saw a significant growth of 39.3% (RM454.9 million), raising its share of total deposits to 12.3% (2002:10.3%), attracted by the high rate of return offered by Bank Rakyat. Similarly, deposits of cooperatives rose strongly by 54.1% in 2003 although its share was only 2.6% at RM339 million. Overall, deposits mobilised by Bank Rakyat continued to register a strong growth of 16.8% (RM1.9 billion) due primarily to the favourable returns offered by the bank.

Bank Rakyat's shareholders' funds rose from RM1.8 billion to RM2.5 billion as at end-2003. This was attributed to higher members' shares and subscription funds, which increased to RM1.3 billion (2002: RM0.9 billion). Bank Rakyat's improved profitability in 2003 further enlarged the bank's shareholders' funds. During the year, the individual membership of Bank Rakyat increased by 86,770 to 629,907 while cooperative membership increased by 84 to 1,067. The high dividend rate of 15% declared by Bank Rakyat in 2002 and the privilege loan rate offered to members attracted additional membership.

Bank Simpanan Nasional

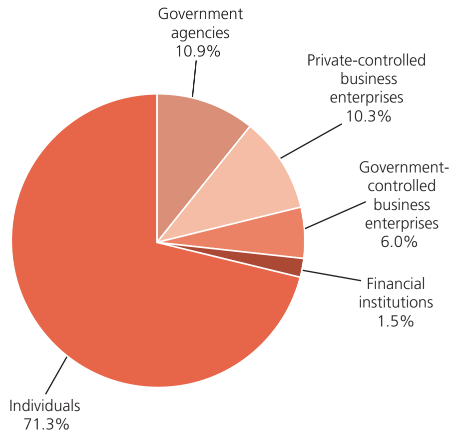
Savings mobilised from small savers by Bank Simpanan Nasional (BSN) or National Savings Bank declined while deposits from business enterprises rose sharply by 54.9%. Retail loans to small borrowers increased in 2003, consistent with the role of the savings bank to meet the financing needs of small borrowers. In June 2003, BSN was appointed by the Government to implement the micro credit scheme. As at the end of 2003, BSN operated through 398 branches covering both the urban and rural areas, and supported by 591 ATMs.

Total deposits outstanding increased marginally by 0.1% or RM4.9 million during the year to RM9.4 billion. Savings from individuals continued to account for the largest component (71.3%) of the deposit base although such savings declined by 5.8% or RM411.4 million to RM6.7 billion, compared with growth of 4.1% or RM284.1 million in 2002. The increase of deposits from business enterprises was in part due to the requirement for micro credit borrowers to open an account with BSN. In terms of type, more than one-half of the deposits was in the form of savings deposits, 36.3% fixed deposits and the remaining in the form of general investment deposits.

The deposits were mainly invested in securities, which amounted to RM5.5 billion (49.8% of total assets) as at end-2003, of which RM2.8 billion were investments in Government securities. The balance was utilised to finance lending operations.

Total loans outstanding registered strong increase of 15.8% (2002: -7.4%) to RM2.4 billion, reflecting the loans provided under the micro credit scheme which

Graph 6.6
Bank Simpanan Nasional:
Total Deposits Accepted as at 31 December 2003



was launched in June 2003 as part of the Government's Economic Package. As at end-2003, a total of RM415.6 million had been extended under the micro credit scheme, accounting for 17% of total loans outstanding. BSN received 102,432 loan applications under the scheme, of which 60,364 applications amounting to RM541.8 million and RM430.8 million were approved and disbursed respectively. The micro credit borrowers were involved mainly in food stall business, retail trading and business services. Meanwhile, more than 90% of the loans outstanding, excluding micro credit, was extended to individuals mainly in the form of consumer loans and for purchase of residential property.

Gross NPLs decreased marginally by RM21.9 million to RM297.4 million as at the end of 2003, attributed to a decline in NPLs of credit card loans. NPLs of Giro Housing Loans increased marginally by 1% to RM158.6 million while NPLs of motor vehicle loans fell slightly by 1.2% to RM112.5 million. The gross NPL ratio improved to 12.2% as at end-2003 (2002: 15.1%) largely due to an expansion in the loan base. Net NPLs decreased to 6.6% amounting to RM154.6 million.

In 2003, BSN's reserves strengthened following the capital injection of RM100 million by the Government under the Economic Package.

Bank Pertanian Malaysia

Financing activities of Bank Pertanian Malaysia (BPM) or Agriculture Bank of Malaysia increased significantly in 2003. Under the Eighth Malaysia Plan (8MP), BPM had been mandated to manage various agricultural financing schemes with the objective to enhance the performance of the agriculture sector in the economy. In 2003, BPM received an allocation of RM44.5 million for three financing schemes namely, Food Production Credit, Bumiputera Commercial and Industrial Community Scheme and Agricultural Mechanisation and Automation Scheme. In addition, as part of the Government's Economic Package, BPM was appointed to implement the micro credit scheme.

Total loans outstanding increased strongly by 16.2% to RM2.7 billion as at end-2003 following the launching of the micro credit scheme. Since its launch in June 2003, BPM received a total of 30,004 applications under the scheme and approved 17,237 applications with a value of RM199.3 million as at end-2003. A total of RM194 million had been disbursed to borrowers, mainly involved in agrobased projects, agriculture marketing, crop cultivation and livestock rearing.

Of the loans outstanding, a major part (60.5% or RM1.7 billion) was extended to the oil palm, food crop and livestock industries. Meanwhile, small farmers accounted for 43.8% (RM1.2 billion) of loans outstanding. As at end-2003, loans outstanding represented 45.6% of BPM's total assets of RM6 billion.

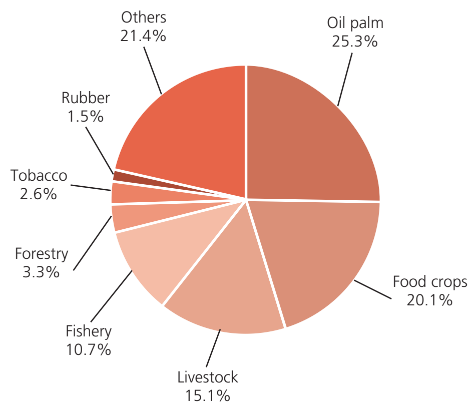
BPM approved 27,735 loan accounts, and disbursed a total of RM709.2 million during the year. Small farmers continued to be the main target group with 98.4% of the total loan applications approved. Although the number of applications approved increased during the year, in terms of value, the amount approved showed a decline of 7.9% to RM709.2 million, as most of the loans were small in size.

Gross NPLs amount and ratio on a 12-month classification basis improved further to RM889.2 million and 32.4% respectively (2002: RM894.3 million and 37.8% respectively). Net NPLs stood at RM326.4 million or 15% of total net loans.

Investments formed the second largest component of the total assets of BPM at 31.9% or RM2 billion mainly in PDS (37.2% of total investment), unit trusts (29.6%) and promissory notes/commercial papers (25.3%).

The major source of funds for BPM was deposits of RM3.8 billion mobilised through its network of 119 branch offices and 4,907 mobile units nationwide.

Graph 6.7
Bank Pertanian Malaysia:
Direction of Lending as at 31 December 2003



This represented 62.5% of BPM's total resources. Borrowings from the Government totalled RM1.1 billion, accounting for 18.7% of total resources. These were mainly to fund the various financing schemes introduced by the Government. As at end-2003, BPM managed 11 funds with loans outstanding amounting to RM206.4 million or 10.8% of the total loans of BPM.

In 2003, BPM's shareholders' funds strengthened following the capital injection of RM200 million by the Government under the Economic Package and the profit recorded in the financial year 2003.

Malaysian Industrial Development Finance Berhad

Financing activities of Malaysian Industrial Development Finance Berhad (MIDF) recorded a marginal increase in 2003. During the year, MIDF was appointed as the implementing agency for the new Soft Loan Scheme for Factory Relocation administered by the Small and Medium Industries Development Corporation (SMIDEC). Consistent with the growing demand for Islamic financing products, MIDF introduced Islamic financing in October 2003, offering a wide range of Shariah compliant schemes.

Loans outstanding grew by 6.4% to RM1.1 billion as at end-2003. Loan disbursements increased significantly to RM312.3 million (2002: RM240.6 million). The loans outstanding were mainly for the manufacturing sector (82.4%), with the major beneficiaries being the fabricated metal products and machinery industry (17.2%), basic iron and steel and non-ferrous products industry (16%), and wood products industry (15.4%). Meanwhile, loans outstanding to SMEs accounted for 50.1% of total loans.

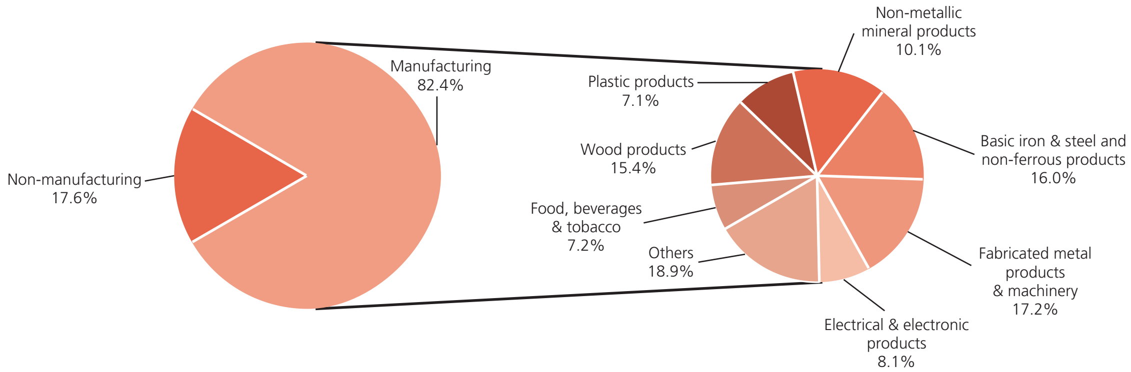
During the year, loan approvals increased to RM493.7 million (2002: RM409.6 million), of which 85.3% was for manufacturing establishments and 19.1% was for Bumiputera projects.

Asset quality of MIDF improved significantly. Based on 3-month classification, the gross NPL amount and ratio improved to RM337.9 million (2002: RM524.9 million) and 29.8% (2002: 49.2%) respectively, due to resolution of some NPL cases totalling RM195.4 million.

MIDF managed a total of ten Government and Government agencies funds with total loans outstanding of RM328.6 million, an increase of 34.3%. Loans approved under the special loan schemes decreased to RM151.4 million (2002: RM190.2 million) while loans disbursed increased to RM134.8 million (2002: RM116.6 million).

The main sources of funds were shareholders' funds and borrowings. As at end-2003, total shareholders' funds increased by 26.8% to RM1.3 billion (2002: RM1 billion) following the issue of new shares, accounting for 46.1% of total resources. Meanwhile, borrowings accounted for another 40.2% of total resources. This included RM641.6 million sourced directly or indirectly from the Government to be on-lent for socio-economic purposes. MIDF also raised funds from the capital market amounting to RM528.8 million as at end-2003 for its other corporate lending activities.

Graph 6.8
Malaysian Industrial Development Finance Berhad: Direction of Lending as at 31 December 2003



Credit Guarantee Corporation Malaysia Berhad

The principal objective of the Credit Guarantee Corporation Malaysia Berhad (CGC) is to assist SMEs enhance their access to credit facilities. There was a significant increase in guarantees issued in 2003, contributing to facilitating financing to SMEs by banking institutions.

In 2003, CGC launched the revised and liberalised New Principal Guarantee Scheme and Islamic Banking Guarantee Scheme to facilitate SMEs obtain higher financing. CGC also introduced the Special Relief Guarantee Scheme to provide coverage for working capital provided by banking institutions for businesses affected by the Severe Acute Respiratory Syndrome, especially those involved in the tourism industry. In addition, CGC has engaged consultants under its Business Advisory Service Entity plan to assist SMEs, particularly in preparing business plans and financial documents. Meanwhile, an online posting of Direct Access Guarantee Scheme (DAGS) loans for bidding by the banking institutions was launched to facilitate financing to SMEs.

Total guarantees outstanding recorded a strong growth of 18.3% (2002: –3.9%) to RM3 billion as at end-2003. This was mainly attributed to the strong performance of DAGS and the Flexi Guarantee Scheme (Flexi Guarantee). Since the introduction of DAGS in 2000, guarantees outstanding of this scheme continued to rise markedly, by 120.4% in 2003 to RM718.3 million, as the revised programme enabled more SMEs to gain access to the scheme. Guarantees outstanding for the Flexi Guarantee also expanded significantly, by 108.5% or RM262.6 million to RM547.6 million as at end-2003. This was a turnaround from a decline of 25.4% or RM89.2 million experienced in 2002. The high growth of Flexi Guarantee reflected mainly the higher demand for loans extended under the Fund for Small and Medium Industries 2 (FSMI 2) and New Entrepreneurs Fund 2 (NEF 2).

Borrowers with loan size of below RM250,000 continued to be the main beneficiary, accounting for 41.2% of total guarantees outstanding. They were followed by borrowers with loans of between RM250,000 and RM500,000 (25.5%) and those with loan size of between RM500,000 to RM1 million (24.7%). Guarantees for loans of above RM1 million formed 8.6% of guarantees outstanding.

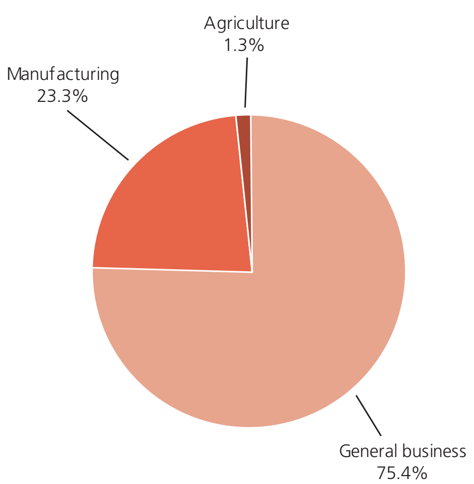
The general business sector remained the largest group that benefited from guarantee coverage, accounting for three quarters of total loans guaranteed, followed by the manufacturing (23.3%) and agriculture (1.3%) sectors.

Total provisions for claims increased by 38.1% or RM119.5 million to RM433.5 million as at end-2003, resulting from higher loans guaranteed turning non-performing which increased by 28.4%. Meanwhile, claims payable by CGC decreased by 16% to RM96.3 million (2002: RM114.6 million).

In addition to providing guarantee coverage, the CGC also implemented a number of loan schemes created by the Government for the SMEs. These loans were extended by CGC to banking institutions for on-lending to the SMEs. As at end-2003, loans outstanding under the schemes declined to RM915.8 million (2002: RM988.7 million). Of this, four major special loan schemes namely, FSMI 2, Fund for Small Entrepreneurs, NEF 2, and Islamic NEF 2 as a group amounted to RM908.7 million or 99.2% of loans outstanding. Of the total loans outstanding under these schemes, 73.2% or RM670.1 million were channelled to SMEs in the business services sector, while 22.4% or RM205 million was for SMEs in the manufacturing sector.

Gross NPL amount and ratio for the loans extended by the banking institutions under the schemes declined to RM86.8 million (2002: RM139.6 million) and 9.5% (2002: 14.1%) respectively. The major

Graph 6.9
Credit Guarantee Corporation Malaysia Berhad: Guarantee by Sector as at 31 December 2003



component of the gross NPLs was contributed by loans to the business services sector, accounting for 66.3%.

The shareholders' funds remain unchanged at RM2.1 billion as at end-2003, with paid-up capital of RM1.6 billion.

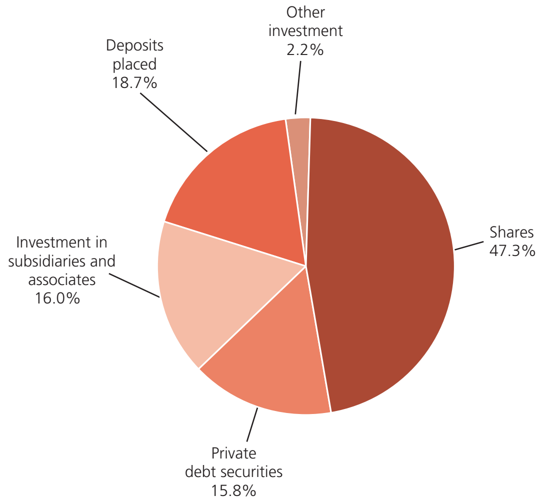
Lembaga Tabung Haji

The deposit mobilisation activities of Lembaga Tabung Haji (LTH) or Pilgrims Fund Board increased significantly in 2003, in tandem with the improved performance of the economy. To further improve services to its depositors, LTH has recently teamed up with four major banks to provide Internet banking facilities to its customers, enabling depositors with these banks to transfer funds into their savings accounts with LTH. LTH signed a Memorandum of Understanding with an estate agent company to provide accommodation for the pilgrims during Haj pilgrimage through a long-term tenure arrangement. This was part of continuous efforts by LTH to enhance the quality of its services.

Total deposits mobilised by LTH increased by 9.9% to RM11.3 billion while the number of its depositors increased by 4.1% to 4.7 million. For the year 2003, LTH had announced a bonus payout of 4% to its depositors (2002: 3.5%).

Meanwhile, total investments made up RM8.1 billion or 66.2% of total assets. Investment in shares, amounting to RM3.8 billion, formed the largest component in investment portfolio, followed by deposit placements with financial institutions of RM1.5 billion, investments in subsidiaries and associate companies and investment in PDS of RM1.3 billion each. LTH also provided financing to its subsidiaries involved in agriculture and construction activities, and other companies totalling RM1.7 billion, an increase of 24.2%.

Graph 6.10
Lembaga Tabung Haji:
Investments as at 31 December 2003



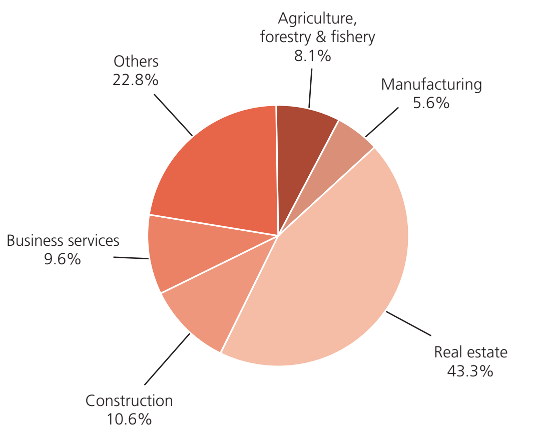
Sabah Development Bank Berhad

After a year of strong expansion, the lending operations of the Sabah Development Bank Berhad (SDB) slowed down by 5.6% to RM1.2 billion as at end-2003 (2002: RM1.3 billion). The decline in loans outstanding was mainly attributed to the decline in loans extended to Government-controlled business enterprises. Significant declines were registered in loans extended to the business services, manufacturing and agriculture sectors.

While the number of loan approvals remained relatively unchanged, the total value of loans approved was substantially lower at RM250.6 million (2002: RM794.3 million), as credit facilities were extended mainly for small development projects. Total loans disbursed also declined to RM184.3 million (2002: RM271.3 million). Meanwhile, loan repayments increased to RM316.3 million (2002: RM223.7 million), contributing to the decline in loans outstanding.

A total of 43.3% of the loans outstanding was extended to the real estate sector, while 10.6% was channelled to the construction sector and 9.6% to the business services sector. Loans remained the

Graph 6.11
Sabah Development Bank Berhad:
Direction of Lending as at 31 December 2003



largest asset component of SDB, accounting for 75.3% of total assets of RM1.6 billion.

Gross NPL amount and ratio improved to RM492 million and 39.7%, respectively (2002: RM542.2 million or 41.3%). A major share (69%) of the NPLs comprised loans extended to the real estate and business services sectors. The net NPL ratio was lower at 4.6% (2002: 5.8%).

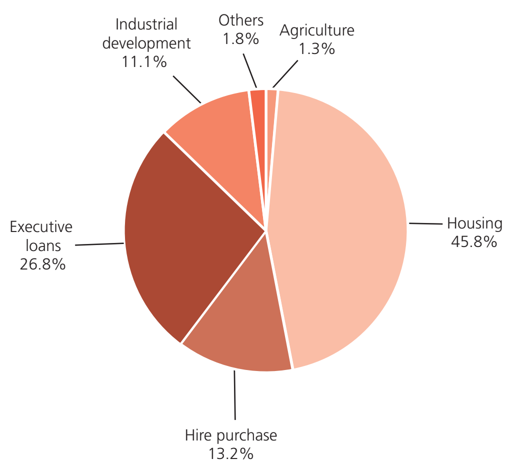
The main source of funds were deposits from the Government and Government-controlled business enterprises (RM354 million) and borrowings from financial institutions (RM536.6 million). These amounted to RM890.6 million or 54.1% of total resources. The bank's shareholders' funds increased to RM251.5 million (2002: RM233.2 million).

Sabah Credit Corporation

The lending activities of the Sabah Credit Corporation (SCC) picked up strongly in 2003. Loans outstanding increased by 18.9% (2002: -1.8%) to RM632.8 million. Total loans approved and disbursed increased significantly to RM236.5 million (2002: RM80.1 million) and RM223.8 million (2002: RM84.8 million) respectively.

The strong expansion of 70.9% or RM253.6 million in the lending operations was mainly on account of a strong demand for consumption credit, of which about two-thirds were executive loans and the remaining was channelled for hire purchase facilities. Housing loans, which declined marginally by 1.2% to RM289.6 million, remained the largest loan

Graph 6.12
Sabah Credit Corporation:
Direction of Lending as at 31 December 2003



component. Loans outstanding accounted for 94.5% of total assets (RM658.8 million) as at end-2003.

Gross NPL ratio, based on a 4-month classification, improved to 13.6% (2002: 16.1%). A substantial share of the NPLs (61.1%) was attributed to loans extended to low cost housing. On a net basis, the NPL ratio was slightly higher at 4.6% (2002: 4.1%).

Borrowings from the State Government (RM328.8 million) and banking institutions (RM156.2 million), accounted for a combined share of 73.3% of total resources.

Borneo Development Corporation (Sabah) Sendirian Berhad

Property development activities in Sabah undertaken by the Borneo Development Corporation (Sabah) Sendirian Berhad (BDC Sabah) slowed down in 2003. This was reflected in the decline of 2.1% in property development expenditure and progress billings to RM98.2 million.

As experienced in the previous two years, no new loan applications were received by BDC Sabah due to competitive lending rates offered by banking institutions. Loans outstanding declined to RM9.5 million, following repayments of RM1.9 million in 2003 (2002: RM1.7 million). Of the amount outstanding, 75.2% was accounted for by loans to individuals, while business enterprises accounted for the balance.

Gross NPLs, which stood at RM2.4 million or 25.4% of loans outstanding, increased from the previous year (2002: RM2.1 million or 20.1%). Loans for the purchase of non-residential property constituted 94.7% of total NPLs.

BDC Sabah sourced its funding mainly through borrowings from financial institutions, which amounted to RM75.7 million or 77.1% of total resources. The shareholders' funds declined to RM5.2 million.

Borneo Development Corporation (Sarawak) Sendirian Berhad

Property development and construction activities undertaken by the Borneo Development Corporation (Sarawak) Sendirian Berhad (BDC Sarawak) for the State Government, recorded a significant increase in 2003. The amount of stocks and work-in-progress increased sharply by 49.9% (2002: -18.1%) to RM50.3 million as at end-2003, representing the largest (58.2%) asset component of BDC Sarawak.

The end-financing activities declined further as borrowers continued to redeem their loans due to competitive lending rates offered by banking institutions. As a result, loans outstanding declined to RM1 million as at end-2003 (2002: RM1.4 million). Meanwhile, the investment portfolio, which accounted for 12.4% of total assets of RM86.4 million, increased by 6.4% (2002: -38.8%) to RM10.7 million.

Shareholders' funds (RM38.7 million) and borrowings from financial institutions (RM20.3 million) remained the major source of funds to BDC Sarawak, with a combined share of 68.3% of total resources.

External Relations

External Relations

Discussions at regional and international fora during 2003 focussed on promoting growth, enhancing macroeconomic surveillance, strengthening capacities, and deepening regional financial collaboration. To take these agenda forward, Bank Negara Malaysia continued to participate actively in all key international and regional fora.

Economic Surveillance

The surveillance initiatives undertaken by the regional groupings, including the ASEAN+3, South-East Asian Central Banks (SEACEN), and Executives Meeting of East-Asia and Pacific (EMEAP), were aimed at complementing surveillance activities of the international financial institutions. The meetings focussed on macroeconomic policy management, monetary and financial stability issues as well as exchange of experiences in financial sector reforms.

Economic surveillance discussions covered macroeconomic policy management, monetary and financial stability issues and strengthening banking systems. Further progress was seen in the area of developing codes and standards to strengthen financial systems.

In addition to the regional fora, surveillance issues were also discussed at meetings of the Bank for International Settlements (BIS).

Bank Negara Malaysia hosted the Sixth Meeting of the Working Party on Monetary Policy in Asia in Kuala Lumpur on 5-7 November 2003. The Meeting, chaired by the BIS, was attended by senior officers from 20 central banks and monetary authorities from the Asian and G10 economies. The Working Party, a group initiated by the BIS, meets annually to review recent global and regional economic developments and outlook, and its implications for monetary and financial policies.

Malaysia participated in several initiatives by the multilateral financial institutions to strengthen the financial sector, in particular, in the work to strengthen risk management in financial institutions. At the International Monetary Fund (IMF), Malaysia led the South-East Asia (SEA) Voting Group Office in the meeting of experts on the guide for compiling financial soundness indicators. The compilation would provide guidance to member countries on the concepts, definitions, data sources and techniques for the compilation and dissemination of the core and encouraged sets of financial soundness indicators. The set of data that member countries are encouraged to compile and disseminate include 27 indicators on deposit taking institutions, other financial corporations, non-financial corporate sector, households, market liquidity and real estate markets.

At the BIS, Malaysia was part of the regional initiative to enter into a consultative process in relation to the Basel Accord to take account of the special characteristics of banking operations in emerging market economies, particularly those from the region. Bank Negara Malaysia, as Chairman of the EMEAP Working Group on banking supervision, compiled and conveyed the views of member countries of the EMEAP group to the Basel Committee on Banking Supervision (BCBS). In August 2003, Bank Negara Malaysia organised dialogue sessions between the BCBS and regulators from EMEAP member countries and India, as well as between the banking industry of these countries and the BCBS. The Bank also facilitated the participation of the domestic banking sector in the Quantitative Impact Survey that was conducted by the BIS during the year.

International Financial Architecture

The work on reform of the International Financial Architecture (IFA) during 2003 focussed mainly on crisis prevention measures, particularly through developing a voluntary code of conduct for crisis resolution. While there was continued opposition to the IMF proposal of sovereign debt restructuring, efforts to develop a Code of Good Conduct for parties involved in sovereign debt restructuring made some progress on including collective action clauses (CACs) in international sovereign bonds. While there was no general acceptance to the inclusion of the CACs, members were willing to accept such inclusions provided the Code could accommodate country-specific circumstances, by providing a degree of flexibility in its application. Malaysia had, since 2000, issued bonds that included CACs.

A set-back in the IFA reform process was in the area of up-front IMF liquidity support. After the 1997 Asian Financial Crisis, the IMF introduced the Contingent Credit Line (CCL) facility. The objective was to provide front-loaded financial support. Access, however, was confined only to member countries with strong economic policies, which face short-term balance of payments problems arising from unexpected external developments. The facility has not been used by member countries since it was introduced in 1999. The IMF finally conceded to discontinue the CCL from end-November 2003 when all efforts to improve the design, access and implementation procedures had not resulted in a scheme that would be practical in assisting member countries.

Another area lacking progress in the IFA reform efforts was in redressing the governance of the IMF. Lack of consensus on according higher representation in IMF decision making process to non-G10 countries resulted in the 12th General Review of Quotas being concluded in January 2003, without any adjustment to the IMF quotas. Developing and emerging economies continued to view adjustment of the IMF's quota structure as critical since the current IMF quotas did not reflect the increased significance and importance of the emerging market economies in the world economy. This issue would be pursued during the 13th General Review of Quotas, which covers the period from February 2003 to January 2008. Developing and emerging economies are expected to maintain their position on the realignment of the IMF quotas to promote a more balanced voting structure at the IMF, in line with the principle that relative voting strength of members must reflect their relative economic position in the global economy.

Notwithstanding the failure of developing countries to secure higher quotas in the IMF, the SEA Voting Group in the IMF and the World Bank set up two focus groups to improve the effectiveness and efficiency of the Voting Group Offices in representing members' interests and in participating in policy discussions at the IMF and the World Bank Executive Boards. Bank Negara Malaysia was tasked to lead in the area of improving the work process at the IMF SEA Group Office. The final report of the Focus Group was endorsed by the Governors of the SEA Group at the IMF/World Bank meeting in Dubai in September 2003. A new rotation scheme, commencing from November 2004 to October 2016, was also approved with Malaysia securing greater representation at senior positions. Under this rotation framework, Malaysia will assume the post of Executive Director and lead the SEA Group Office for a period of two years from November 2004 to October 2006.

External Relations with the IMF

Malaysia continued to engage the IMF during the annual Article IV consultations on Malaysia's macroeconomic performance and policy issues for 2003 and expectations for 2004. The IMF's assessment of the management of the economy for 2003 was published as a public information notice following the conclusion of the IMF Executive Board's discussions on Malaysia. The Managing Director of the IMF visited Malaysia in September. He noted the progress of reforms had enabled Malaysia to sustain economic growth in spite of weaknesses in the external environment.

The IMF's Article IV report on Malaysia concluded that the country was well placed in the near term to benefit from the projected global upturn, with the outlook biased on the upside.

Malaysia continues to maintain its net creditor status in the IMF. Since September 2002, in line with Malaysia's strong balance of payments and international reserves position, Malaysia has been included in the IMF's operational budget's Financial Transaction Plan (FTP). Under the FTP, selected IMF members with strong balance of payments and international reserve positions may be called upon to provide foreign exchange resources to support the IMF's financial operations. Under the FTP, Malaysia was called upon to transfer SDR45 million for the period March to May 2003.

Islamic Banking

In the area of Islamic banking and finance, Bank Negara Malaysia played an active role in the Islamic Financial Services Board (IFSB), particularly through the IFSB Council and Technical Committee meetings. During the year, the IFSB finalised the guidelines for the preparation of prudential standards for Islamic financial institutions, and initiated the process of preparing two standards, namely the standard on risk management and standard on capital adequacy. In this connection, the IFSB conducted two workshops on risk identification in October 2003 in order to improve the understanding of the risks faced by Islamic financial institutions. These workshops were attended by participants from Islamic banking institutions in Bahrain, Iran, Jordan, Kuwait, Malaysia, Pakistan, Qatar, Saudi Arabia and Sudan.

In 2003, the Central Bank of Egypt, Central Bank of Jordan, Qatar Central Bank and Ministry of Finance, Brunei Darussalam, became full members of the IFSB. Three international organisations, namely, the Bank for International Settlements, International Monetary Fund and the World Bank, became associate members of the IFSB, while the Asian Development Bank became an observer. At end February 2004, the IFSB had 36 members, comprising 13 full members, 3 associate members and 20 observers.

Combating Money Laundering and Terrorist Financing

Malaysia continued to be at the forefront of global efforts to combat money laundering activities and the financing of terrorism. During the year, the Malaysian Parliament passed the Anti-Money Laundering (Amendment) Act 2003 to extend the scope of the Anti-Money Laundering Act 2001 (AMLA) to include measures to be taken to prevent terrorism financing offences and provisions to freeze, seize and forfeit terrorist properties.

In July 2003, Bank Negara Malaysia was admitted as a member of the Egmont Group of Financial Intelligence Units. The Egmont Group provides a forum to expand and exchange information on financial intelligence, improve expertise and capabilities of personnel, and foster better communication among financial intelligence units.

Within the Asia/Pacific Group on Money Laundering (APG), Malaysia became a member of the APG Steering Group for a period of one year, up to June 2004. The Steering Group plays an advisory role in the areas of key governance issues in the APG, which include the revision of the Financial Action Task Force (FATF) standards and modalities to meet the increased international pressure for countries to comply with the revised standards.

Malaysia participated in the training and technical assistance needs analysis that was conducted by consultants commissioned under the Asia-Europe Meeting (ASEM) Anti-Money Laundering Project. The report on Malaysia was finalised in February 2003, with the ASEM consultants' conclusion being that Malaysia's anti-money laundering system was well developed, integrated and supported by capable and professional staff across a number of agencies. The ASEM consultants had acknowledged Malaysia's efforts in constructing an effective system as well as the development of sound legislation, effective institutions and well-trained staff.

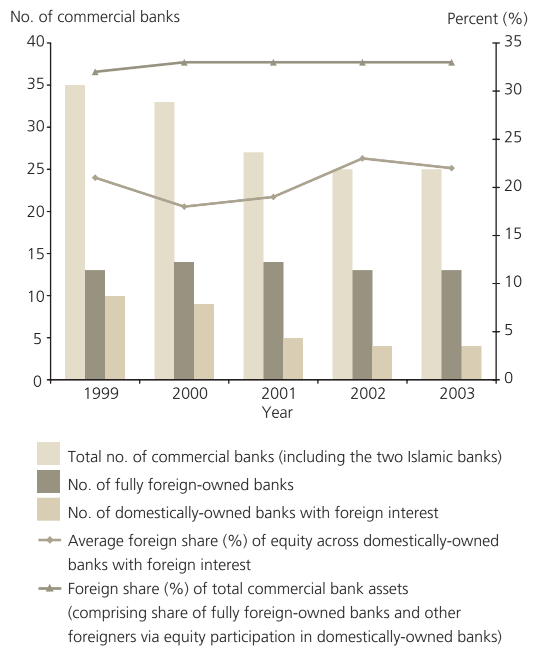
Financial Sector Liberalisation

World Trade Organisation

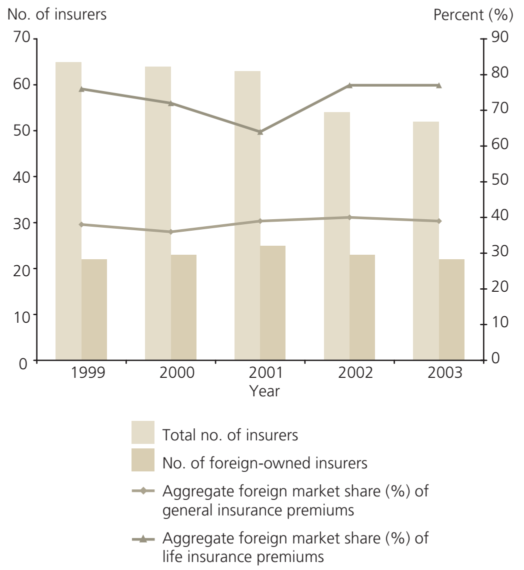
In 2003, negotiations to further liberalise the services sector, including financial services, at the World Trade Organisation (WTO) continued to focus on the "request and offer" phase, which began on 28 March 2001. The negotiations were generally based on requests for market opening submitted by member countries to a trading partner and offers submitted by the trading partner. These were conducted through bilateral discussions between

In line with the liberalisation path charted under the Financial Sector Masterplan, Malaysia implemented further unilateral liberalisation in the banking and insurance sectors in 2003.

Graph 7.1
Foreign Participation in the Malaysian Commercial Banking Sector



Graph 7.2
Foreign Participation in the Malaysian Insurance Industry



members. The deadline for completion of negotiations is 1 January 2005.

The Fifth Ministerial Conference (5^{th} MC) to undertake a mid-term review of the progress of multilateral trade negotiations under the Doha Development Agenda (DDA), including for negotiations on trade in financial services, ended without consensus. There were wide differences in the positions of developed and developing country members on the new issues of trade and investment, trade and competition policy, transparency in government procurement and trade facilitation. Notwithstanding this outcome, the 5^{th} MC agreed on the need for member countries to continue working on outstanding issues of the DDA. These negotiations are ongoing among trade negotiators in Geneva.

Malaysia has maintained an undertaking of progressive liberalisation of financial services as part of the overall measures to further develop the domestic financial sector. In line with the liberalisation path charted under the Financial Sector Masterplan, Malaysia has taken several steps to unilaterally liberalise the banking and insurance sectors in 2003 (see Table 1).

Table 1:
Financial Services Liberalisation Measures Since 2000

Year	
	Banking Sector
2000	• The maximum total credit facilities that could be obtained by non-resident controlled companies (NRCCs) from foreign-owned banking institutions in Malaysia was increased from 40% to 50% in December 2000. • Licensed Offshore Banks in the Labuan International Offshore Financial Centre (Labuan Offshore Banks) would be allowed to invest in ringgit assets/instruments in Malaysia for their own accounts, though not on behalf of their clients. • Licensed commercial banks, including the foreign-owned banks, and Bank Islam Malaysia Berhad in Malaysia (licensed banks) were allowed to extend in aggregate an intra-day overdraft facility of not exceeding RM200 million and an overnight facility of not exceeding RM10 million to non-resident stockbroking companies and non-resident global custodian banks to finance funding gaps due to inadvertent delay in relation to settlement for trade on the KLSE. In addition, they can also enter into short-term currency swap and/or outright forward contracts to cover for purchase of shares on the KLSE.
	Non-banking financial sector (excluding insurance)
	• The maximum foreign equity limits in a stockbroking company and a financial leasing company were increased to 49% from 30% effective 1 July 2000.
	Banking Sector
2001	• Foreign-owned banking institutions were allowed to set up communicative websites from 1 January 2001.

- Banking institutions (including the foreign-owned banks) in Malaysia were allowed to extend credit facilities in ringgit to finance the purchase and/or construction of one immovable property for non-residents who participate in the Silver Hair Programme implemented by the Immigration Department of Malaysia.
- Financial institutions (including the foreign-owned banks) were allowed to extend up to three credit facilities in ringgit to non-residents to finance the purchase or construction of any property in Malaysia (excluding for the purchase of land), subject to their own internal credit assessment guidelines.
- Banking institutions (including the foreign-owned banks) in Malaysia were allowed to effect transfers involving External Accounts and another External Account and/or Resident Account of different account holders by way of:
  (a) Automated Teller Machine transfer up to RM5,000 per person/company, per day, per bank for any purpose;
  (b) Internet-bank transfers up to RM5,000 per person/company, per day, per bank for any purpose; and/or
  (c) Cheques up to RM5,000 per cheque for any purpose.

Insurance sector

- All insurers with the requisite minimum risk management and security systems in place were allowed to offer the full range of life and general insurance products through the internet with effect from April 2001.

Banking Sector

2002

- Foreign-owned banking institutions were allowed to offer transactional internet banking from 1 January 2002.
- Internal credit lines used solely to facilitate drawing against uncleared cheques, granted by licensed banks (including the foreign-owned banks) to NRCCs, were excluded from the computation of the NRCC's total domestic credit facilities. Licensed banks were also permitted to allow NRCCs to overdraw their current accounts for amounts of up to RM500,000 per account for a period not exceeding 2 working days.
- Banking institutions (including the foreign-owned banks) in Malaysia were allowed to extend additional ringgit credit facilities to any non-resident up to an aggregate of RM5 million per non-resident to finance projects undertaken in Malaysia. Prior to this, credit facilities in ringgit to a non-resident, for purposes other than purchases of three immovable properties or a vehicle, were limited to RM200,000.

Insurance sector

- The areas in which insurers may employ expatriates were expanded to include, in addition to the fields of specialised underwriting, actuarial and information technology previously provided for, other areas involving product research and development, risk management and investment.

Banking Sector

2003

- Licensed banks (including the foreign-owned banks) in Malaysia were allowed to extend overdraft facilities in ringgit not exceeding RM500,000 in aggregate to a non-resident customer, provided such overdraft facilities are covered by fixed deposits placed by the non-resident customer with the licensed banks in Malaysia. These overdraft facilities were in addition to all ringgit credit facilities allowed to be extended freely by banking institutions since 21 November 2002.

	• The 50% limit on the maximum total credit facilities that could be obtained by NRCCs from foreign-owned banking institutions in Malaysia was removed on 1 April 2003. • The overnight limit for foreign currency account (FCA) to retain receipts arising from export of goods (export receipts) for Approved Operational Headquarters (OHQ) was increased to USD70 million from USD10 million. The maximum overnight limit on export FCA of other resident exporters was also raised to USD70 million. • Residents may invest in investment products that are linked to foreign currency denominated derivatives that are offered by licensed banks (including the foreign-owned banks) in Malaysia. The foreign currency funds used for the investment that are utilised from the residents' FCA will be earmarked and computed as part of the aggregate overnight balances of the FCA of the residents. • Allow up to three new Islamic banking licences to qualified foreign players. **Insurance sector** • Effective 17 April 2003, foreign-owned insurers with foreign shareholding not exceeding 51% were allowed to open not more than two branch offices in one year.
2004	**Banking Sector** • To enhance cash flow management for supporting value chain expansion in Malaysia, licensed banks (including foreign-owned banks) can retain higher amount of foreign currency funds for residents in FCA: - Up to a maximum of USD100 million (previously USD70 million) of export receipts. - Any amount of non-export receipts for residents with domestic borrowing (previously need approval). - Up to USD150,000 for education/employment purpose (previously USD100,000). • Labuan Offshore Banks are allowed to maintain FCA for residents: - Up to USD0.5 million of non-export receipts for residents without domestic borrowing (previously need approval). - Up to USD150,000 for education/employment purpose (previously USD100,000). - Any amount overseas foreign currency funds for resident individuals. • To enhance access to ringgit funds for business requirements in Malaysia, the various limits for banking institutions lending to non-residents in ringgit have been consolidated to one single aggregate limit of RM10 million for use in Malaysia for any purpose (excluding stockbroking company, custodian bank and correspondent bank). • The extension of property loans in ringgit by residents, including licensed banks, to non-residents now includes the purchase of land (previously not allowed). • Licensed banks are allowed to extend an aggregate overnight overdraft facility of RM200 million (increased from RM10 million) to a non-resident stockbroking company or a non-resident custodian bank to facilitate settlement for purchase of shares listed on the KLSE. • Resident individuals employed or staying abroad with foreign currency funds sourced from abroad are allowed to invest in any foreign currency assets, including those offered by licensed banks, approved licensed merchant banks and Labuan Offshore Banks. • Multilateral Development Bank and foreign multinational corporation issuers of ringgit-denominated bonds in Malaysia may enter into forward foreign exchange contracts with onshore licensed banks to hedge their currency risks arising from the issuance of the ringgit denominated bonds. Non-resident investors subscribing to these issues can also hedge their foreign exchange risks.

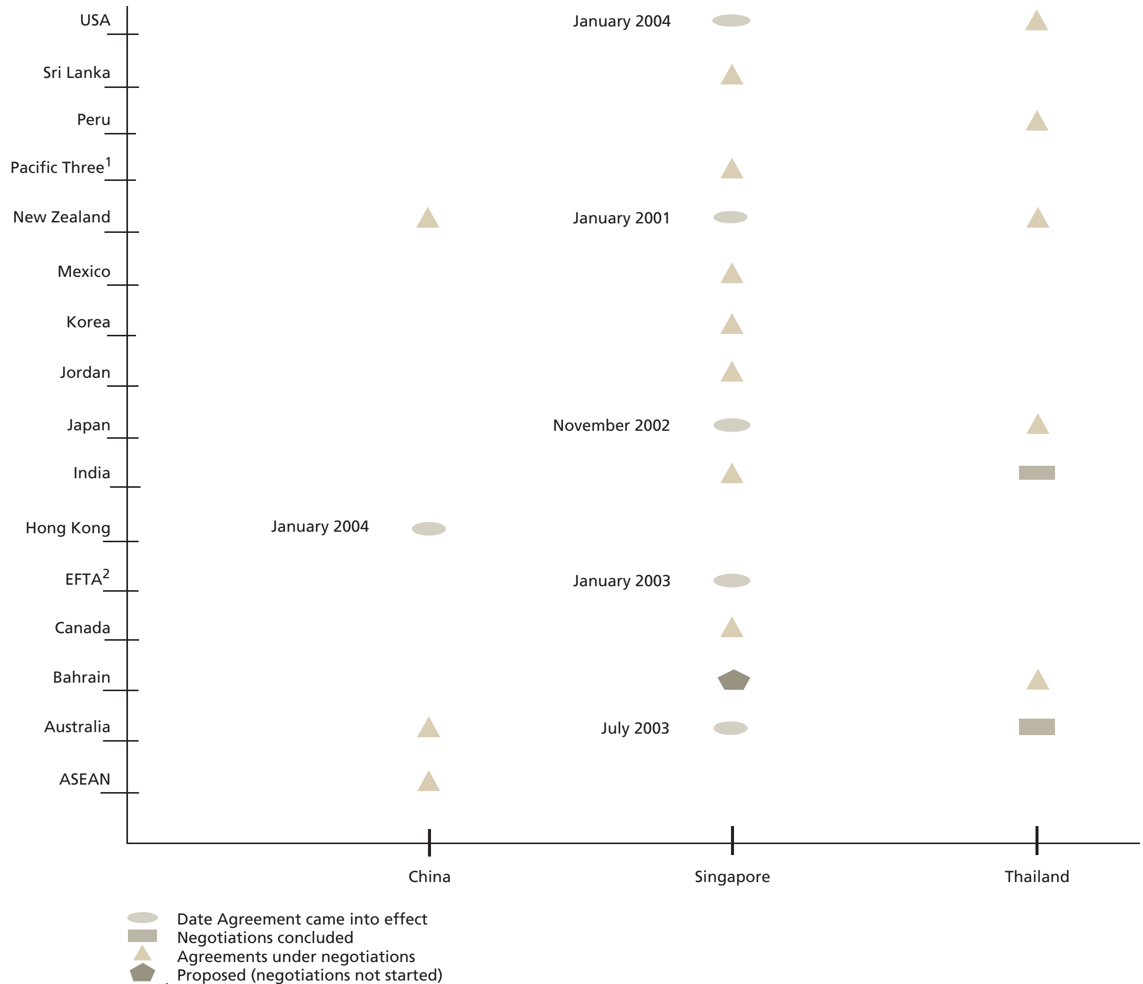
Increased foreign presence is also through strategic alliances between foreign players and local entities. These included bancassurance and outsourcing arrangements undertaken by domestic-owned financial institutions with foreign partners.

ASEAN Framework Agreement on Services and Proposed Free Trade Arrangements

Liberalisation of financial services among the ASEAN countries is also being effected under the ASEAN Framework Agreement on Services (AFAS). A third round of negotiations on financial services under the AFAS which began in 2002 is expected to be concluded by 2004. Under this round, ASEAN member countries will make further General Agreement for Trade in Services (GATS)-plus commitments on financial services, that is, undertake liberalisation measures beyond those made under the GATS.

Apart from the AFAS, financial services liberalisation would be covered within the scope of trade arrangements currently pursued by Malaysia with partner countries to promote freer trade and investment regimes. Malaysia has commenced negotiations on establishing free trade arrangements (FTA)s with the People's Republic of China (under the proposed ASEAN-China free trade area) and Japan. The proposed FTAs would complement existing trade liberalisation initiatives under the WTO and other regional economic integration arrangements, namely, the ASEAN Free Trade Area for goods, the AFAS for services and the ASEAN Investment Area for investment liberalisation.

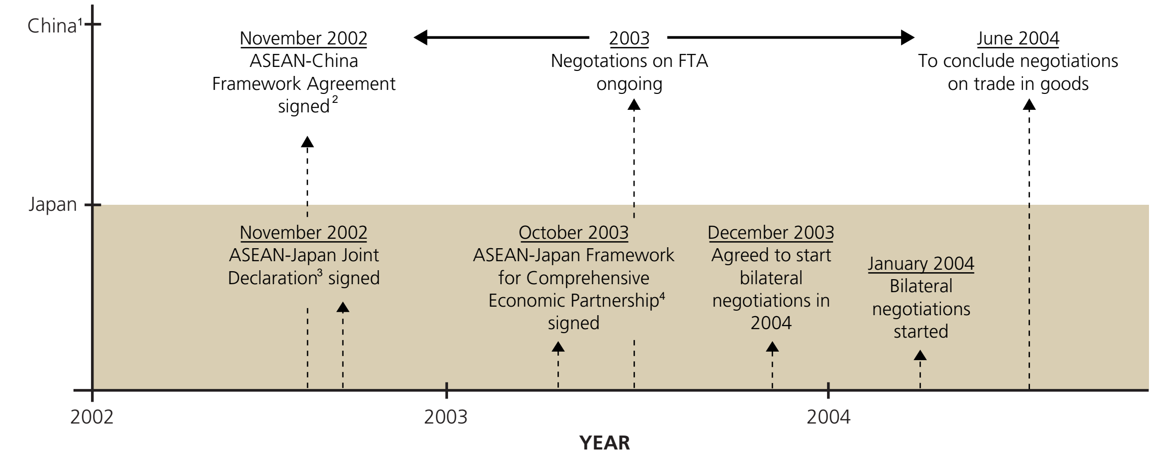
Bilateral Free Trade Arrangements (FTA)s for Selected Regional Countries since 2001



1 Chile, New Zealand and Singapore
2 European Free Trade Association (EFTA) comprises Switzerland, Iceland, Liechtenstein and Norway

Source: Various publications

Progress of Malaysia's Negotiations on Proposed Free Trade Arrangements (FTA)s with China and Japan



1 Malaysia participates with other ASEAN countries in negotiations on the proposed ASEAN-China Free Trade Area.
2 The ASEAN-China Framework Agreement on Comprehensive Economic Co-operation was signed on 4 November 2002 to serve as a basis for the countries to start negotiations on establishing a free trade area between ASEAN and China.
3 The ASEAN-Japan Joint Declaration on Comprehensive Economic Partnership (CEP) was signed on 5 November 2002 to develop a concrete framework to realise such a partnership between ASEAN and Japan. While considering a framework for the realisation of the CEP between ASEAN and Japan as a whole, the Joint Declaration does not preclude bilateral economic partnerships between Japan and individual ASEAN countries.
4 The Framework was signed on 8 October 2003 and provides for consultations among ASEAN and Japan to start from early 2004 on areas of facilitation, co-operation, and trade and investment liberalisation, among others.

Regional Co-operation

The momentum of collaborative efforts to strengthen and deepen regional co-operation picked up in 2003, with much of the focus being on developing regional financial markets and enhancing regional financial stability. These efforts include the strengthening of short-term financial support, particularly through the bilateral swap arrangement; regional surveillance under the ASEAN+3 forum; and initiatives to meet the region's long-term funding requirements through the development of bond markets.

Further progress was made among the ASEAN+3 countries in the expansion of the bilateral swap arrangement network under the Chiang Mai Initiative (CMI). To date, 16 bilateral swap arrangements with a combined value of US$35.5 billion have been concluded, and would be available to ASEAN+3 member countries. Of the 16 bilateral swap arrangements, Malaysia had signed three agreements. The three, together with Malaysia's US$2.5 billion agreement with Japan under the New Miyazawa Initiative, provide Malaysia with access to a total of US$6 billion in financing.

An effective surveillance mechanism is essential to the effectiveness of the CMI arrangement. To improve regional surveillance, the ASEAN+3 finance forum adopted new mechanisms to enhance the surveillance processes undertaken under the CMI arrangement. In this connection, the exchange of economic reviews and policy dialogues among the ASEAN+3 countries were further deepened and broadened with an in-depth analysis of topical regional issues that would strengthen the region's peer review process. Meanwhile, regional surveillance of capital flows in the Asian region was further strengthened in 2003 and in early 2004 through data exchange and assessments of developments among members of the SEACEN Expert Group on Capital Flows.

The year 2003 witnessed two significant events towards the development of bond markets in Asia

Further strengthening of regional co-operation with the expansion of bilateral swap arrangements under the Chiang Mai Initiative (CMI); enhanced regional surveillance; and new initiatives to deepen and broaden Asian bond markets.

Bilateral Swap Arrangement Agreements under the Chiang Mai Initiative

Dates indicate when the agreements were signed. The maximum drawing amount for each agreement is indicated in parentheses. The combined total size of the 16 bilateral swap arrangement (BSA) agreements is US$35.5 billion (based on the overall availibility under the BSAs, where the maximum drawing amount under two-way swap arrangements is counted twice to reflect the swap amount available to both parties under the agreement).

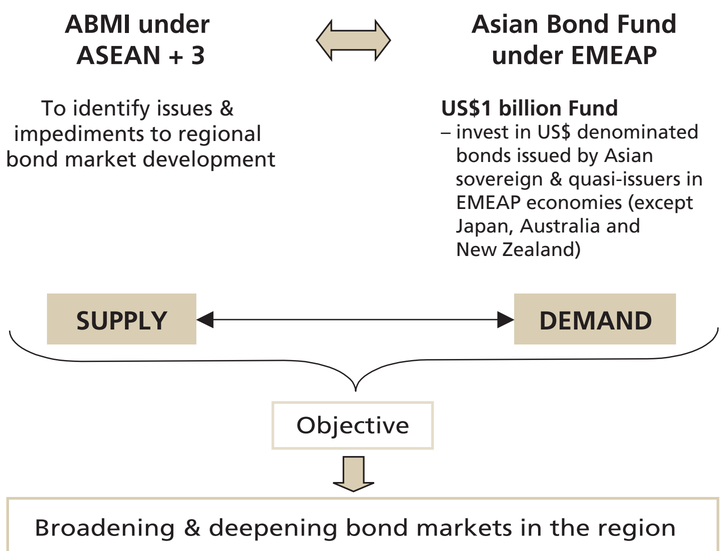
[1] A one-way swap arrangement where the requesting country under the agreement can request the swap-providing country to enter into a swap transaction.
[2] A two-way swap arrangement where either party could request the other party to enter into a swap transaction under the agreement.

Agreements signed between the Plus Three countries (People's Republic of China, Japan and Korea) and ASEAN countries

Agreements signed among the Plus Three countries

with the launch of the US$1 billion Asian Bond Fund (ABF) and the Asian Bond Market Initiative (ABMI). The development of deeper and more liquid bond markets will assist in channelling the large pool of savings in Asia to fund productive investment in the region. Together, these initiatives signal strong official support to expand regional bond markets. Under the ABMI, six working groups have been tasked to identify the necessary infrastructure and impediments that need to be removed in order to encourage the growth of regional bond markets.

While the voluntary working groups under the ABMI aim to address supply-side measures deemed necessary for active participation of both bond issuers and investors, the ABF complements the ABMI on the demand-side by taking the first step towards facilitating the channelling of a portion of official reserves held by the Asian economies back into the region. The ABF concept is being studied to include bonds denominated in regional currencies. Together, the ABMI and the ABF reflect strengthened efforts by the public sector to broaden and deepen the regional bond markets.



Asian Bond Market Initiative

Significance of the ABMI

The Asian Bond Market Initiative (ABMI), launched under the ASEAN+3 Finance Ministers' forum, is a comprehensive approach to develop a regional bond market in East Asia. Its aim of creating a deep, broad and liquid bond market in Asia would further enhance the efficiency of channelling Asian savings into long-term investments in the region. A deeper Asian bond market will also improve the management of maturity mismatches present in financing economic activities, facilitate management of currency and interest rate risks, and improve the overall efficient allocation of capital.

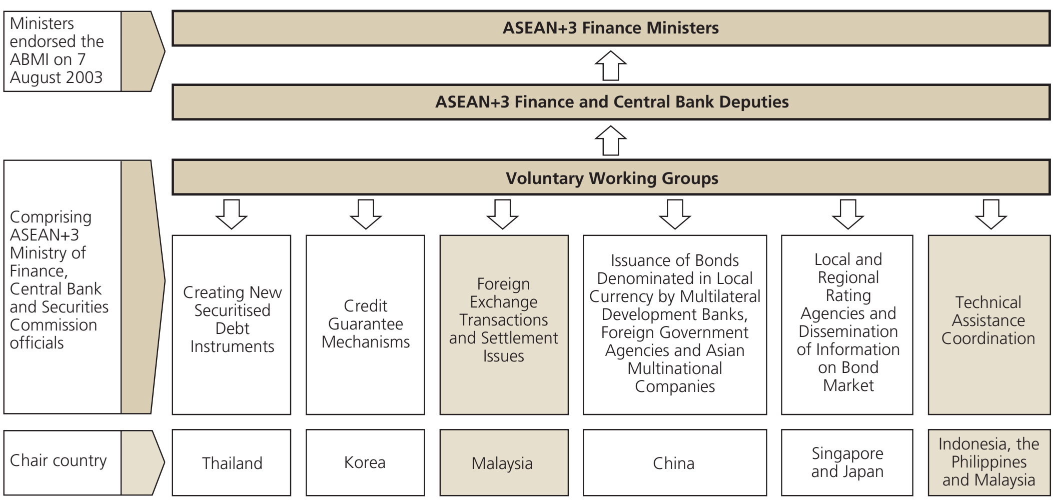
Following the Chiang Mai Initiative, the ABMI is the most significant ASEAN+3 regional financial co-operation project. Essentially, it reflects the collective effort of the ASEAN+3 finance, central bank and monetary authorities to improve the financial infrastructure and initiate appropriate policies in supporting regional bond market development. Implementation of the ABMI is through a structured approach. Six voluntary working groups have been set up to identify issues and impediments to bond market development in a range of areas through regular meetings (see chart). Studies are also being undertaken by these working groups to recommend modalities for regulatory and legal frameworks that will facilitate cross-border issuance and investment within the region. The working groups also consult regularly with key private sector stakeholders, such as multilateral development banks, financial intermediaries and market participants.

Malaysia's commitment

Malaysia is fully committed to the successful development of the ABMI and Bank Negara Malaysia is an active member in all the working groups. Malaysia chairs the Working Group on Foreign Exchange Transactions and Settlement Issues (Bank Negara Malaysia), and co-chairs the Working Group on Technical Assistance Co-ordination with Indonesia and the Philippines (Securities Commission). In leading the Working Group on Foreign Exchange Transactions and Settlement Issues, it has been acknowledged that the creation of a deep and liquid bond market in Asia needs to be complemented with a sound and efficient bond settlement system mechanism. Efforts are, therefore, being directed towards establishing a conducive and enabling environment to facilitate foreign exchange transactions and to address issues related to timely and cost-effective settlement of cross-border transactions.

As part of the work programme, the Working Group organised a Symposium on Foreign Exchange Transactions and Settlement Issues in Kuala Lumpur on 20 October 2003 to deliberate on issues pertaining to foreign exchange transactions and settlement issues in cross-border bond transactions.

Asian Bond Market Initiative (ABMI)



Malaysia accords a high priority to regional co-operation in training to strengthen domestic capacities in the financial sector and macroeconomic management. In this regard, Bank Negara Malaysia has supported the activities of the SEACEN Research and Training Centre, which undertakes intensive central banking training, especially in bank supervision, macroeconomic policy formulation, financial stability assessment, and financial reforms. In 2003, the SEACEN Centre extended its training to 16 non-members while continuing to provide training to its members, which expanded to 12, with the admission of the Ministry of Finance, Brunei Darussalam[1]. The SEACEN Centre also extended its collaboration with Japan, and regional groupings and international institutions such as the Asia-Pacific Economic Co-operation (APEC), BIS, IMF and the World Bank. The closer collaboration with a wider group of countries and institutions has facilitated the Centre's work in ensuring broad-based training of central bankers given the rapid changes in the global financial markets.

Increased focus of bilateral co-operation was in the area of trade and financing, including the use of gold in financing bilateral trade.

Bilateral Co-operation

In enhancing bilateral co-operation in trade and financing, progress was made on Malaysia's proposal for the Gold-based Trade Payments Arrangement (GTPA). The GTPA enables a debtor country to settle its bilateral trade balance using gold.

Promotion of the GTPA was also undertaken through collaboration with the Islamic Development Bank (IDB). As a result of this collaboration, member countries of the IDB unanimously endorsed the GTPA and agreed to enter into bilateral negotiations in order to operationalise the scheme. Subsequently, the GTPA was adopted by the Organisation of the Islamic Conference (OIC) countries' Heads of State/ Government at the 10th OIC Summit in October 2003, as contained in the Putrajaya Declaration. On-going discussions with bilateral trading partners on GTPA commenced in 2003.

Technical Assistance and Information Exchange

Bank Negara Malaysia continued to encourage capacity building through technical assistance and information exchange among central banks and monetary authorities. In 2003, Bank Negara Malaysia received 14 foreign participants from 13 central banks, under the sponsorship of the Malaysian Technical Co-operation Programme (MTCP), to attend Bank Negara Malaysia's central banking and banking supervision courses.

Bank Negara Malaysia also participated in collaborative capacity-building efforts under various regional fora in areas such as banking supervision, alternative remittance systems, domestic bond market development, and Islamic banking and insurance. The development of takaful and retakaful in Islamic countries was actively promoted by Bank Negara Malaysia, particularly through the organisation of international seminars and workshops, provision of training and consultancy services as well as sharing of technical expertise by the Malaysian takaful operators. These initiatives had contributed to the establishment of takaful operators in several Developing-8 (D-8) member countries, namely Bangladesh, Indonesia and Nigeria.

[1] Effective 1 April 2004, SEACEN's membership will increase to 13 members, with the admission of the Reserve Bank of Fiji. The other SEACEN members are the Ministry of Finance, Brunei Darussalam; Bank Indonesia; The Bank of Korea; Bank Negara Malaysia; The Bank of Mongolia; Central Bank of Myanmar; Nepal Rastra Bank; Bangko Sentral ng Pilipinas; Monetary Authority of Singapore; Central Bank of Sri Lanka; Central Bank of China, Taipei; and Bank of Thailand.

Organisation and Human Resource

Organisation and Human Resource

ORGANISATION DEVELOPMENT - OVERVIEW

2003 marked the third year of the Bank's 5-year Knowledge-Based Organisation (KBO) strategic development initiative. The initiative was launched in 2000 to enable the Bank to leverage on the application of knowledge as a critical resource to enhance productivity and organizational performance. The Bank's KBO development efforts incorporate human resource management, training and learning management, knowledge management, information and communication technology management, corporate governance, information security management and office space management.

New initiatives implemented in 2003 focused on content management, improvements to the facilities and systems available for learning and training, integration of key and critical information and communication technology systems as well as the conceptualization of the organisation performance measurement system.

The Bank also conducted an independent organisation climate survey to assess the progress achieved over the previous three years. The results indicated that the Bank's organisation development initiatives had created a more effective organisation in terms of leadership, operational efficiency, knowledge management, communications, career development, compensation and work-life balance.

Human Resource Management
The Bank continued to enhance the existing human resource policies and practices, in particular, placed sharper focus on performance measurement and rewards management. With the increase in the Bank's responsibilities over the recent three years, the staff strength has also increased. Also, arising from the changing composition of the workforce in terms of background, experience and age structure, the human resource policies have been realigned to the changing requirements to be relevant.

Cognizance of the changing challenges, there has been a gradual shift to greater emphasis on performance-based rewards, opportunities for learning and development and improved amenities to enhance the quality of working life. Greater flexibility and wider choice of reward options were developed to better position the institution to retain top talent, improve staff productivity, and at the same time be flexible enough to meet changing staff aspirations at different stages in their career paths. The introduction and implementation of flexi benefits plan, mentoring programmes and active recognition programmes aim to accommodate these objectives. In 2003, the Bank introduced new awards for Cultural and Professional Development while a Career Management Unit was established to structure and assist long-term career planning by staff. The list of approved professional qualifications for sponsorship by the Bank was also expanded. Together with the other organisation development initiatives, such as competency and knowledge management, more personalized training and wider availability of learning resources, the human resource management approach has constantly evolved to meet the varied priorities of a dynamic workforce. Consequently, a performance-based culture has increasingly been embedded in the Bank.

In terms of capacity, the total staff strength of the Bank increased by 3.5% to 2,295 as at end of 2003. Staff turnover rate remained low at less than 2%.

In terms of occupational safety and health, the Bank recognizes that while work and career fulfillment can have an effect on employee productivity and commitment, health and safety also contributes to enhancing the effectiveness of an organisation. During 2003, the Bank embarked on and completed more structured safety audit programmes. Apart from ensuring high standards of safety in the office environment, the Bank provided more avenues for staff to improve their health and fitness. The Bank conducted health talks to enhance awareness on issues related to stress management, SARS, diabetes and osteoporosis. A long-term programme covering the environment, personal resources and health practices is also being initiated. This five-year programme will be implemented in stages, beginning from 2004.

Training and Learning Management
The Bank's drive to promote organisational learning to facilitate a performance-based culture is reflected through a number of initiatives implemented in 2003. A programme is now in place that ensures that the workforce in the organisation has a responsibility to learn and develop. The learning experience and training is integrated with performance planning and evaluation to ensure that the returns on expenditure

on staff development is maximised. Technology has been, and will be used more extensively in improving the delivery of content for learning throughout the Bank. A Learning Management System has been put in place to provide tools for staff to gauge their learning requirements, explore the type of content available, design a personal learning agenda and conduct learning more effectively. The anticipated outcome is the development of a culture more inclined to online learning, and the capacity to integrate individual learning with individual staff performance management.

The Bank's investment in staff training amounted to RM8 million during the year 2003, an increase of 45% compared to 2002. On average, this amounted to RM3,500 per employee, an increase of 40% from 2002. An average of 12 training man-days per staff was achieved for year 2003 (2002 - 11 training man-days). Bank-wide training programmes organised by the Human Resource Development Centre (HRDC) accounted for 46% of total investment in staff training with the programmes oriented towards the building of core functional and management skills and ICT and leadership skills.

Information and Communication Technology Management

The use of Information and Communication Technology (ICT) solutions was expanded and enhanced to facilitate the development of a performance driven Knowledge Based Organisation (KBO). The Bank has embarked on a technology blueprint for central ICT-Knowledge Management (KM) services. This framework is to provide focus for action to address ICT and KM infrastructure needs and include information and technology integration. The emphasis is not only in automating the organisation, but more importantly, connecting people to people, and more rapid access to well-organised information across all relevant spectrum for sound analysis and decision-making. The ultimate aim is to create an organisation with highly knowledgeable and collaborative people where ICT is leveraged extensively to serve stakeholders.

The Virtual Discussion Room (VDR), Departmental Homepages (DHP) and other collaboration and communication services introduced in 2002 continue to mature with steady growth in usage and content. In 2003, a new channel – the Corporate Portal (Kijang.Net) – was introduced to provide a single window that facilitates awareness and communication through access to on-line electronic information services and application systems in the Bank, as well as polls and surveys.

The Bank will continue to strengthen the security, reliability and resilience of the ICT infrastructure. Towards this end, a new state-of-the-art Data Centre offsite from the Bank's Head Office is being planned. Remote access facilities were also implemented to provide greater flexibility for work and improved lifestyles among staff as part of the Bank's Work-Life Balance initiative.

Information Security Management

In 2003, a revised Information Security Policy was introduced to optimize the use of the Bank's intellectual capital and to facilitate easy access to information and widespread knowledge sharing to add value to the Bank without compromising on controls governing use of sensitive data.

The Information Security policy was benchmarked against the British Standard 7799 and other international best practice. The broad framework encompasses three decision drivers, namely Technology, Strategy and Usage; Business Initiatives and Processes; and Risk Management. The three drivers define the Information Security framework used in safeguarding the Bank's information assets. The framework will guide security standards within the information and communication technology environment, and in the adoption of appropriate business rules, procedures and staff education programmes to raise awareness about information disclosure practices.

The Information Security Management Unit was established in 2003 to implement the Information Security policy through appropriate enforcement, monitoring and recovery processes. The Unit collaborates closely with the Corporate Governance Unit as well as the Information Technology Services Department, which is responsible for data and communications network management. The Information Security Policy is expected to promote greater knowledge sharing within the Bank by defining the rules of disclosure for restricted information.

Knowledge Management

The Bank's knowledge management practices achieved another milestone in 2003 with the implementation of a Knowledge Management Measurement Framework. The framework will be used to guide future efforts in designing the Bank's KM practices by measuring the Bank's progress against four criteria – Continuity & Stability, Competency and Productivity, Innovation & Responsiveness. The framework reinforces the Bank's existing processes for promoting the identification, acquisition, application and retention of knowledge in the organisation.

During 2003, the Bank initiated a series of knowledge audits to assess knowledge gaps within the Bank. The knowledge audits, as well as various other indicators are fed into the KM measurement framework to enable more effective monitoring of the progress of KM initiatives. The Bank's Library Unit leads the knowledge audits, as well as review and implement programmes to improve content management. This includes the Corporate Taxonomy project which is now under way to map

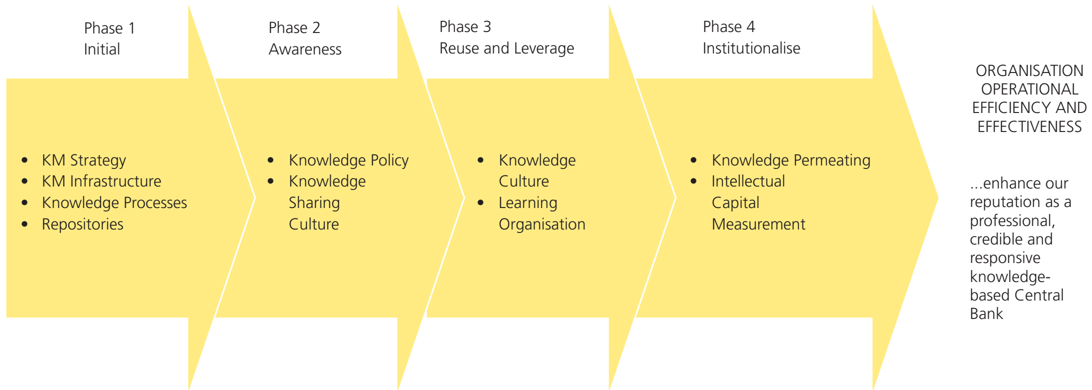
The successful implementation of new ICT tools, changes to HR practices, development of a 'knowledge centric' library and re-engineering of training and learning methodologies marks the Bank's transition into Phase 3 of the KM Roadmap. Changes to behavior and culture oriented towards the proactive use of personal and organisation knowledge to deliver concrete results in a prompt manner are expected to yield the desired results over the next few years.

Office Space Management

The Bank has begun to implement a new office space design and layout that incorporates elements of flexibility, efficiency, comfort and ergonomics that will improve the working conditions for the staff, as well as provide enabling and broader range of facilities to assist a knowledge worker.

An open plan office concept was adopted to

KM ROADMAP 2001 - 2005



ACHIEVING SUSTAINABLE SUPERIOR PERFORMANCE BY LEVERAGING ON KNOWLEDGE

and structure the 'information domain' of the Bank. The 'information domain' refers to all the types of information relevant to the Bank, in terms of subject, media (document or digital database), confidentiality (public, confidential or secret) and relationship with other information within the Bank. The corporate taxonomy will enable effective and efficient searching, storing and communication of information within the Bank. Given the exponential growth in information today, this project will be a major milestone in enabling the ease of access and productive use of the knowledge-bank within the Bank.

enhance flexibility, effective use of space and harmonisation as part of space management. The restrictions to individual and acoustical privacy were managed through low partitions and creation of additional spaces for small group discussions.

Facilities for teamwork and collaboration were made widely available by having dedicated projectors and network devices in all meeting spaces. Variable lighting, ergonomically structured chairs and workstations with ample storage space contributed to workplace safety and staff convenience.

The Bank's approach in dealing with office space management as an issue integral to organisation development has led to solutions that not only address space requirements, but also ensure that the physical space within the Bank reflects the values espoused by the Bank as a knowledge-based organisation.

Corporate Governance

In performing its functions as decreed by the Central Bank of Malaysia Act 1958, the Bank is guided by its overall mission, aspiration and shared values. In addition to the Central Banking Act, other legislations have also extended the objects and powers of the Bank as well as the specific manner in which the functions are undertaken. Collectively, the legislative framework shapes the Bank's governance and functional structure that enables the institution to undertake its roles and responsibilities.

In compliance with the Act, 12 Board Meetings were held during the year. In addition, the following senior management meetings were held - 4 Board Audit Committee Meetings, 54 Management Committee Meetings, 4 Reserve Management Committee Meetings, 4 Risk Management Committee Meetings, 8 Monetary Policy Committee Meetings, 17 Financial Stability Committee Meetings and 6 Payment System Meetings. During the year, 2 Board Briefings to the Prime Minister and Minister of Finance were conducted to present the Bank's assessment of the banking system, the financial sector and outlook for the economy. The Bank also provided an assessment of the developments and challenges facing the banking system, the financial sector and the overall economy, and proposed recommendations to address these challenges.

Awards

The Board congratulates the Governor, Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz for the award as **'The Asia's Best Central Bank Governor'** for 2003 by Euromoney Institutional Investor plc, a UK-based financial publication house and **'Global Central Bank Governor'** for the year 2004 by The Banker, a monthly magazine published by the Financial Times Business Limited.

The Board extends its congratulations to Dato' Ooi Sang Kuang on being conferred the **Darjah Yang Mulia Pangkuan Negeri (D.M.P.N.)** on the occasion of the birthday of His Excellency, the Yang Terutama Yang di-Pertua Negeri Pulau Pinang on 12 July 2003.

The Board also congratulates Encik Yahaya bin Haji Besah on being conferred the **Darjah Johan Negeri (D.J.N.)**, Puan Woo Seok Hooi and Puan Khairani binti Rejab on being conferred the **Pingat Jasa Kebaktian (P.J.K.)** on the occasion of the birthday of His Excellency, the Yang Terutama Yang di-Pertua Negeri Pulau Pinang on 12 July 2003, Encik Mohd Yunos bin Haji Salih, Encik Abdullah bin Lebai Ahmad, Puan Helen Jeniffer Buma and Encik Loh Kam Fatt on being conferred the **Pingat Mahkota Perlis (P.M.P.)** on the occasion of the birthday of His Royal Highness, the Tuanku Raja of Perlis on 17 May 2003, Encik Abdul Rajap bin Abidin on being conferred the **Pingat Jasa Kebaktian (P.J.K.)** on the occasion of the birthday of His Excellency, the Yang di-Pertuan Negeri Melaka on 11 October 2003, Encik Yap Bee Fatt, Encik Saari bin Rajap dan Encik Nasaruddin bin Zakaria on being conferred the **Pingat Jasa Kebaktian (P.J.K.)** on the occasion of the birthday of His Royal Highness, the Sultan of Pahang Darul Makmur on 24 October 2003 and Encik Kunchi Raman a/l C V Kluva Chary on being conferred the **Pingat Jasa Kebaktian (P.J.K.)** on the occasion of the birthday of His Royal Highness the Sultan of Kedah Darul Aman on 19 January 2003.

As in previous years, the Bank continued to reward deserving staff with its formal Recognition Awards. During the Bank's annual dinner held on 13 September 2003, a total of **eight awards** were issued for Academic Achievement, Excellent Performance, Excellent Team Performance, Leadership, Innovation, Quality Service, Sport and Cultural.

Retirement

The Board wishes to place on record its appreciation and gratitude to the 24 retirees who have rendered loyal and dedicated service to the Bank. The staff who retired from the services of the Bank in 2003 are listed in Table 8.1.

The Board of Directors would also like to extend its gratitude to all Bank staff for their dedication and commitment in the year 2003. The Board looks forward to the continued commitment and professionalism of all staff in the year ahead in striving for performance excellence in this challenging and fast changing economic and business environment.

Table 8.1
List of Retirees

No	Name	Department/Branch
1	Puan Rafiah binti Salim	Governor's Office
2	Encik Che Sab bin Ahmad	Special Investigation
3	Encik Low Koon Seng	Governor's Office
4	Cik Tan Sook Peng	International
5	Encik Wong Yew Sen	Insurance Supervision
6	Puan Gan Choon @ Gan Soo Mei	Statistical Services
7	Puan Ti Thiow Chen @ Ti Teow Kim	Foreign Exchange Administration
8	Encik Mukhtar bin Yusof	Malaysian Electronic Payment System
9	Encik Che Norudin bin Che Alli	Security
10	Puan Fahimah binti Haji Yaacob	Foreign Exchange Administration
11	Encik Ismail @ Awang Sulong bin Abu Bakar	Human Resource Management
12	Encik John Teo	Foreign Exchange Administration
13	Encik Sidek bin Sabli	Insurance Regulation
14	Encik Tan Ewe Lee	Payment Systems
15	Puan Maznah binti Haji Ali	Bank Regulation
16	Encik Md Hanafiah bin Mohd Zin	Bank Regulation
17	Encik Abdul Rajap bin Abidin	Security
18	Encik Aladdin bin Ibrahim	Security
19	Cik Loo Yuk Ng @ Loh Yee Ee	Statistical Services
20	Puan Siti Norzini binti Abdullah @ Joyce Koh	IT Services
21	Encik Thyagarajah a/l Gurusamy	PPPM Shah Alam
22	Encik Yap Bee Fatt	Foreign Exchange Administration
23	Encik Doraimuthu a/l Changlimuthu	BNM Pulau Pinang
24	Puan Fatimah binti Moin	Finance
25	Encik Sol Ong @ Mohamad Sol bin Sebli	BNM Kuching
26	Encik Sulaiman bin Abu Kassim	Human Resource Development Centre

RISK MANAGEMENT IN BANK NEGARA MALAYSIA

The Bank's risk management framework provides for independent oversight at the supervisory and operational levels; establishes policies and processes for good practices; promotes organisation wide communication; and emphasises continuous improvement.

Risk Management Structure

With the formation of the Risk Management Committee (RMC) in 2002, the risk management structure had evolved further. In 2003, the role of the departments in operationalising the risk management framework was brought into greater focus. At the same time, the relationship of the Risk Management Unit (RMU) with the departments and its support functions for the RMC were sharpened. The other key components of the risk management structure are the Middle Office and the Internal Audit Department. During 2003, the RMU assumed the function of a centralised business continuity management of the Bank.

Risk Management Practices

In providing supervisory risk management oversight, the RMC sets the standards and imposes requirements that ensure that appropriate risk management practices are embedded into strategic initiatives, policy formulation and operations of the Bank. In 2003, the RMC continued the assessments of departmental reports on the areas of potential risk and controls, risk issues, risk events that occurred and their management. The RMC also engaged in discussion with the Department Heads on policy and strategic focus and the approaches to managing existing and potential risks.

At the functional level, the Department Heads have direct responsibility for ensuring that risk management practices are integral to daily operations. The departments are required to make an annual declaration to Management on their review of the risk profiles of their operations to form an assessment of the adequacy of departments' risk management.

During the year, the RMU provided technical support and performed its coordination and oversight role. Specifically, the RMU assisted the departments in their management reporting by providing guidance on the approach and reporting requirements. It also continued to monitor and report on the status of the annual declaration. Regular audit by the Internal Audit Department ensured that policies and procedures were being adopted. The aim is to provide Management with timely and relevant information, to ensure that the key risks are identified and addressed and that decisions are implemented to achieve their objectives.

Policy Risk

Policy risk is managed through a structured framework and process for policymaking and implementation. Major components of the framework are the internal committees and working groups for cross-functional consultation and deliberation. The high-level committees include the Monetary Policy Committee, Financial Stability Committee and Management Committee which are chaired by the Governor. The working groups, whose membership comprises Assistant Governors and Department Heads, ensure that all information and expertise are tapped in the design and formulation of policy. In certain cases, the consultation process includes external stakeholders. A policymaking checklist is also in place to ensure that all implications have been taken into account in the deliberation of the policy content and that the procedural requirements have been met.

The policymaking mechanism is designed to increase the prospect of achieving balanced and well-considered policies. It has provided a formal channel for the alternative perspectives to be taken into account at all stages of the policy formulation from the conceptualisation through to the development and the issuance of a policy. Since 2002, the communication aspects of policy implementation have been centralised in the Corporate Communication Department and have continued efforts to strengthen and extend the external communication to become an integral part of the work to enhance the effectiveness of policy.

Financial Risk

The main risks in managing the external reserves, including market, credit and operational risk, are monitored independently by the Middle Office, a unit separate from the dealing function. The Middle Office assesses the risks by monitoring economic and financial developments affecting major asset classes and sizable market developments that could have implications on the Bank's external reserves portfolio. The Middle Office also monitors compliance with the investment guidelines, credit policies and operational procedures. This is carried out through periodic review and evaluation of reserve management activities, taking into account market developments and dynamics. Reserve management activities are also subjected to independent checks by the Back Office, and compliance checks of the internal and the external auditors.

Enterprise Operational Risk

The operational risk management approach of the Bank requires ownership of risks, self-assessment, continual review, escalation of key risk issues and accountability for control improvement and issue resolution.

Management fosters the risk management culture and its risk tolerance levels for the operational control environment. The RMU establishes and maintains the overall operational risk management framework. The Department Heads have the primary responsibility for managing the risks arising from their operations and ensuring that an effective operational control environment is in place in their business areas. Management considers the periodic department reports derived from self-assessment and drawn up from a line perspective, against the overall Bank perspective and goals. The resulting comprehensive coverage of operational risk and event database is a valuable source of information for in-depth risk analysis and control effectiveness evaluation.

During the year, the risk management methodology and toolkit for risk identification, assessment and reporting were reviewed. Several proposals for revision were made to incorporate current best practices. The changes were to enhance the robustness of the self-assessment methodology and improve the reporting process as well as the monitoring of risks and action plans to control risks.

Knowledge management initiatives continued to be pursued, leveraging on information technology, to harness implicit and explicit information and to allow for greater accessibility to the users. More extensive use was made of the Bank's and the departments' websites to disseminate information. At the same time, the Information Security Policy and Standards was enforced to enhance maintenance of information integrity and confidentiality.

Business Continuity Management

The Bank has established procedures for business continuity across all critical departments. The threat of disruption to monetary and financial system stability resulting from unexpected events is managed through the running of a remote recovery centre and the maintenance of a dedicated Command Centre at the Head Office. During crisis, essential personnel are divided into two teams. One team operates from the Head Office, while the other team operates at the Bank's Recovery Centre. The back up facilities of key systems undergo regular live-run exercises to provide continuous assessment of the Bank's state of readiness to respond to unforeseen situations. The facilities and procedures, together with the crisis management machinery are in place to deal with unexpected disruptions and challenges. This aspect of risk management is given priority recognising the growing need to expect the unexpected. As part of the strengthening of the Bank's business continuity management the Business Continuity Unit (BCU) is now placed under the RMU. The BCU would have full-time staff with the necessary expertise to supervise, coordinate and maintain the Bank's contingency arrangements, plans and programmes.

BANK NEGARA MALAYSIA
Organisation Structure

BOARD OF DIRECTORS

GOVERNOR
Dr. Zeti Akhtar Aziz

- Secretary to the Board — Mohd Nor bin Mashor
- Governor's Office — Ng Chow Soon
- Corporate Communications — Abu Hassan Alshari bin Yahaya

DEPUTY GOVERNOR
Dato' Ooi Sang Kuang

- Legal — Gopala Krishnan Sundaram

ASSISTANT GOVERNOR
ECONOMICS
Datuk Latifah Merican Cheong

- Monetary Assessment and Strategy — V. Vijayaledchumy
- Economics — Dr. Phang Hooi Eng
- International — Wan Hanisah binti Wan Ibrahim
- Foreign Exchange Administration — Mahdi bin Mohd. Ariffin
- Statistical Services — Chan Yan Kit

ASSISTANT GOVERNOR
INVESTMENT AND OPERATIONS
Vacant

- Investment Operations and Financial Market — Muhammad bin Ibrahim
  - New York Rep. Office
  - London Rep. Office
- Finance — Abdul Aziz bin Abdul Manaf

ASSISTANT GOVERNOR
ORGANISATIONAL DEVELOPMENT
Dato' Mohamad Daud bin Hj. Dol Moin

- IT Services — Hong Yang Sing
- Human Resource Management — Mainor bin Awang
- Human Resource Development Centre — Lim Lai Hong
- Strategic Planning — Mior Mohd Zain bin Mior Mohd Tahir
- Corporate Services — Mohd Nor bin Mashor
- Security — Ahmad bin Mansur
- Currency Management and Operation — Hor Weng Keng
  - Branches (6)

DEPUTY GOVERNOR
Dato' Mohd Salleh bin Haji Harun

- Internal Audit — Yahaya bin Haji Besah

ASSISTANT GOVERNOR
SUPERVISION
Datuk Zamani bin Abdul Ghani

- Bank Supervision I — Azizan bin Haji Abd Rahman
- Bank Supervision II — Chung Chee Leong
- Insurance Supervision — Sani bin Ab. Hamid
- Information Systems Supervision — Ramli bin Saad
- Payment Systems — Ahmad Hizzad bin Baharuddin
- Property and Services — Zulkifli bin Abd Rahman
- Special Investigation — Kamari Zaman bin Juhari
- Financial Intelligence — Koid Swee Lian

ASSISTANT GOVERNOR
REGULATION
Dato' Mohd Razif bin Abd. Kadir

- Bank Regulation — Nor Shamsiah binti Mohd Yunus
- Insurance Regulation — Donald Joshua Jaganathan
- Islamic Banking and Takaful — Bakarudin bin Ishak
- DFI Regulation — Che Zakiah binti Che Din
- Risk Management — Teo Kee Tian

Balance Sheets as at 31 December 2003

Annual Accounts

CERTIFICATE OF THE AUDITOR GENERAL
ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA
FOR THE YEAR ENDED 31 DECEMBER 2003

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2003. These financial statements are the responsibility of the management. My responsibility is to express an opinion on these financial statements based on my audit.

2. The audit has been conducted in accordance with the Audit Act 1957 and in accordance with approved auditing standards. Those standards require the audit be planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement. This audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Evaluation is also made on the accounting principles used and the overall financial statements presentation.

3. In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2003 and of the results of its operations for the year then ended in accordance with approved accounting standards.

(DATUK DR. HADENAN BIN ABDUL JALIL)
AUDITOR GENERAL

PUTRAJAYA
10 MARCH 2004

STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Zeti Akhtar Aziz and Oh Siew Nam being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the financial statements are drawn up so as to give a true and fair view of the state of affairs of Bank Negara Malaysia as at 31 December 2003 and of the results of operations for the year ended on that date.

On behalf of the Board,

ZETI AKHTAR AZIZ

CHAIRMAN

5 MARCH 2004
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM

DIRECTOR

5 MARCH 2004
KUALA LUMPUR

DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

I, Abdul Aziz Abdul Manaf being the officer primarily responsible for the financial management of Bank Negara Malaysia, do solemnly and sincerely declare that the financial statements, are to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 5 March 2004.)

Before me,

PESURUHJAYA SUMPAH
No. W080
Nama:
ISMAIL BIN IBRAHIM
MALAYSIA

28th Floor, Menara Maybank
100, Jalan Tun Perak
50050 Kuala Lumpur

Bank Negara Malaysia

Balance Sheet as at 31 December 2003

LIABILITIES		**Note**	**2003 RM**	**2002 RM**
Authorised Capital	RM200,000,000			
Paid-up Capital		3	100,000,000	100,000,000
General Reserve Fund		4	5,864,876,290	5,398,963,841
Other Reserves		5	36,442,290,538	24,744,032,881
Currency in Circulation			29,445,445,674	27,137,417,900
Deposits:				
Commercial Banks, Finance Companies and Merchant Banks			98,498,572,386	69,864,345,027
Federal Government			4,905,179,432	13,827,163,949
Others		6	6,312,202,946	5,613,870,679
Bank Negara Papers			13,385,045,306	12,280,763,725
Allocation of Special Drawing Rights		7	785,160,395	718,346,440
Other Liabilities			5,093,884,077	2,512,656,290
			200,832,657,044	162,197,560,732

Profit and Loss Appropriation Account for the Year Ended 31 December 2003

	2003 RM	**2002 RM**
Transfer to General Reserve Fund	465,912,449	331,941,108
Amount Payable to Federal Government	1,000,000,000	500,000,000
	1,465,912,449	831,941,108

Notes on the following pages form part of these financial statements.

ASSETS	Note	2003 RM	2002 RM
Gold and Foreign Exchange	8	166,139,324,237	127,515,059,930
International Monetary Fund Reserve Position		3,652,006,672	3,315,547,927
Holdings of Special Drawing Rights		684,961,188	585,019,336
Malaysian Government Papers	9	98,521,225	29,384,948
Deposits with Financial Institutions		2,893,714,989	2,902,228,350
Loans and Advances		8,946,108,379	8,015,270,790
Deferred Expenditure	10	-	570,720,918
Other Assets	11	18,418,020,354	19,264,328,533
		200,832,657,044	162,197,560,732

	2003 RM	2002 RM
Net Profit	1,465,912,449	831,941,108
	1,465,912,449	831,941,108

Notes To The Financial Statements - 31 December 2003

1. **Principal Activities of the Bank**

   The Bank's principal roles and responsibilities are as follows:
   (a) achieving monetary stability;
   (b) promoting a stable financial system;
   (c) ensuring an efficient payment system;
   (d) issuing currency in Malaysia; and
   (e) acting as a banker and a financial adviser to the Federal Government.

2. **Accounting Policies**

   (a) **Gold, Securities and Investments**

   Gold, securities and investments are stated at cost and provisions have been made for diminution in value as at 31 December 2003.

   (b) **Foreign Currency Translation**

   Assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date. Transactions in foreign currencies during the year have been translated into ringgit at rates of exchange ruling on value dates.

   The International Reserves comprising Gold and Foreign Exchange, International Monetary Fund Reserve Position and Holdings of Special Drawing Rights at 31 December 2003 was RM170,476.3 million equivalent to US$44,862.2 million.

3. **Paid-up Capital**

   The entire issued and paid-up capital of RM100 million is owned by the Government of Malaysia.

4. **General Reserve Fund**

	2003	**2002**
	RM	**RM**
As at 1 January	5,398,963,841	5,067,022,733
Transfer from Net Profit	465,912,449	331,941,108
As at 31 December	5,864,876,290	5,398,963,841

5. **Other Reserves**

   Other reserves comprise the Exchange Rate Fluctuation Reserve and the Contingency Reserve.

6. **Deposits - Others**

   A substantial part of these deposits comprises deposits from Federal Statutory Authorities.

7. **Allocation of Special Drawing Rights**

   International Monetary Fund (IMF) member countries are allocated Special Drawing Rights (SDR) in proportion to their subscriptions to the IMF. The allocation represents a dormant liability of the Bank to the IMF, against which assets are received in SDR from the IMF. The net cumulative of the allocation was RM785,160,395 equivalent to SDR139,048,000.

8. **Gold and Foreign Exchange**

	2003 RM	2002 RM
Foreign Securities	131,488,613,346	100,151,230,400
Foreign Deposits	20,113,541,612	14,195,692,918
Balances with Other Central Banks, Bank for International Settlements (BIS) and IMF	2,510,527,105	2,696,527,431
Others	12,026,642,174	10,471,609,181
	166,139,324,237	127,515,059,930

9. **Malaysian Government Papers**

	2003 RM	2002 RM
Malaysian Government Securities	98,521,225	29,384,948

10. **Deferred Expenditure**
This represents the net deficiency arising from foreign exchange transactions in 1993. The Government has undertaken to make good this deficiency as and when required to do so by the Bank. As at 31 December 2003, the amount has been fully amortised over a period of 10 years beginning from 1994.

11. **Other Assets**
Other assets include investments in shares and bonds of RM18,306,865,784 acquired under section 30(1)(j) and section 30(1)(oo)(i) of the Central Bank of Malaysia Act 1958 (Revised - 1994).

12. **Contingent Liabilities**
Total contingent liabilities as at 31 December 2003 amounted to RM5,128,030,073. These comprise:
(a) an amount of RM5,045,320,650 which represents the obligation of the Bank to pay in full, in SDR or other convertible currencies, the amount of Malaysia's quota in the IMF under the Articles of Agreement; and

(b) an amount of RM82,709,423 which represents the uncalled portion of the 3,000 units of shares held by the Bank in BIS. The amount is based on the nominal value (in gold francs) of the uncalled portion and gold price as at the balance sheet date.

13. **Income Tax**
The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989.

Annex

Contents

Chapter 4: The Financial Sector

Chapter 5: Development Financial Institutions

Foreign Exchange Administration Policies

Foreign exchange administration rules were further liberalised and simplified in April 2004 (refer to the White Box: "Liberalisation and Simplification of Foreign Exchange Administration Rules" in Chapter 3). All regulations continue to be applied uniformly to transactions with all countries, except Israel, Serbia and Montenegro for which special restrictions apply. Foreign exchange administration regulations are also applied where appropriate to prevent recourse to the Malaysian banking system for money laundering and terrorist financing. With the latest changes, the following are the rules affecting foreign exchange transactions:

I Current Account Transactions

(a) Payments for Import of Goods and Services

- There is no restriction on payments to non-residents for import of goods and services. Such payments must be made in foreign currency except currencies of Israel, Serbia and Montenegro.
- There is no restriction for residents to enter into a forward foreign exchange contract with onshore licensed banks or approved merchant banks to buy foreign currency against ringgit to make payment for import from a non-resident.

(b) Proceeds Arising from Export of Goods (Export Proceeds)

- All export proceeds are required to be repatriated back to Malaysia in accordance with the payment schedule as specified in the sales contract, which should not exceed six months from the date of export.
- Export proceeds must be received in foreign currency and must be sold for ringgit or retained in export foreign currency account (FCA) with onshore licensed banks. The aggregate overnight limits range between USD30 million and USD100 million, depending on the average monthly export receipts. Higher limits may be allowed on a case-by-case basis.
- Residents may enter into a forward foreign exchange contract with an onshore licensed bank to sell foreign currency export proceeds for ringgit or another foreign currency, provided the maturity of the forward contract is not later than six months after the intended date of export.
- Only resident exporters with annual gross exports exceeding RM50 million equivalent are required to submit quarterly reports to the Controller of Foreign Exchange (the Controller).

(c) Import and Export of Currency by Travellers

- Import and export of ringgit up to RM1,000, including demonetised RM1,000 and RM500 notes, and export of foreign currency up to an equivalent of RM10,000 by residents are allowed. Resident travellers are required to obtain permission from the Controller and declare in the Traveller's Declaration Form (TDF) when they –

  - Carry into or out of Malaysia, ringgit notes exceeding RM1,000.

  - Carry out foreign currency notes including traveller's cheques, exceeding the equivalent of RM10,000.

  Permission is given within one day of application.
- There is no restriction for non-residents to bring in any amount of foreign currency and/or traveller's cheques. Declaration in the Arrival/Departure Card (IMM.26) issued by the Immigration Department is only required for amounts in excess of the equivalent of USD2,500.

- Non-residents would need to seek permission from the Controller if the amount of foreign currency to be carried abroad exceeds the amount brought into Malaysia, provided the amount to be taken out is more than the equivalent of USD2,500.
- Non-residents must obtain permission from the Controller and declare ringgit exceeding RM1,000 being brought into or out of Malaysia.

II Capital Account Transactions

(a) Foreign Direct Investment

- There is no restriction on repatriation of capital, profits, dividends, interest and rental income by foreign direct investors.

(b) Investment Abroad by Residents

- Onshore licensed banks and approved merchant banks may invest abroad as long as they comply with the Banking and Financial Institution Act 1989 or Islamic Banking Act 1983 and their approved foreign currency net open position limit. Remittances for investment abroad must be made in foreign currency.
- Residents, other than onshore licensed banks and approved merchant banks, are required to seek prior permission from the Controller to remit funds in excess of RM10,000 equivalent in foreign currency for overseas investment purposes. Permission is based on a set of transparent criteria.
- However, resident individuals may invest any amount in foreign currency in securities under the Employee Share Option/Purchase Scheme offered by their employers' overseas parent or related companies.
- Resident individuals employed or staying abroad with own foreign currency funds sourced from abroad may invest in any foreign currency assets, including those offered by onshore licensed banks and licensed offshore banks in Labuan.
- Resident unit trust management companies may invest abroad up to the full amount of the Net Asset Value (NAV) subscribed by non-residents and up to 10% of the NAV per fund subscribed by residents. Different funds of a unit trust management company or funds of different companies may be pooled to benefit from economies of scale when investing abroad. Such investments are required to be in line with the Securities Commission's prudential guidelines.
- Resident insurance companies and takaful operators may invest abroad up to 5% of their margin of solvency (MOS) and up to 5% of their total assets respectively.
- Resident insurance companies and takaful operators may also invest abroad up to 10% of the NAV of the investment-linked funds that they market. These investments are required to comply with prudential insurance and takaful regulations issued by Bank Negara Malaysia.
- Resident fund/asset managers may invest abroad up to the full amount of investments by their non-resident clients and up to 10% of investments by resident clients. These funds by different companies may be pooled to benefit from economies of scale when investing abroad. Such investments should be based on the mandate of their clients and in compliance with the Securities Commission's prudential guidelines.

(c) Foreign Currency Credit Facilities Obtained by Residents

- Residents may obtain credit facilities in foreign currency up to the equivalent of RM5 million in aggregate from onshore licensed banks, licensed merchant banks and non-residents. Any amount exceeding the permitted limit would require the prior permission of the Controller. Where the aggregate amount exceeds the equivalent of RM1 million, the resident is required to provide the Controller with information on the credit facilities.

- Residents may also obtain trade financing of any amount in foreign currency from onshore licensed banks and licensed merchant banks provided the tenure of the credit does not exceed 12 months.

- There is no restriction for repayment of credit facilities obtained as long as such credit facilities have been obtained in accordance with the relevant foreign exchange administration rules.

(d) Extension of Credit Facilities to Non-Residents
Foreign Currency Credit Facilities

- Onshore licensed banks may extend credit facilities in foreign currency to non-residents for any purpose. However, credit facilities extended for the purchase or construction of immovable property in Malaysia would be subject to similar requirements as for ringgit credit facilities outlined below.

Ringgit Credit Facilities

- Non-bank residents may extend credit facilities in ringgit to a non-resident not exceeding an aggregate of RM10,000.

- Resident stockbroking companies may extend margin financing facilities to non-resident clients for the purchase of shares listed on Malaysia Securities Exchange Berhad (MSEB), provided they comply with all the relevant regulations imposed by MSEB.

- Onshore licensed banks may extend ringgit overnight overdraft facilities in aggregate not exceeding RM200 million to a non-resident stockbroking company or a non-resident custodian bank. The facilities are strictly for financing funding timing gaps due to unforeseen or inadvertent/technical administration errors or time zone delays in relation to settlement of trades on MSEB.

- Residents, bank or non-bank, may extend up to a maximum of three property loans in ringgit to a non-resident to finance/refinance the purchase or construction of any immovable property in Malaysia, excluding for the purchase of land only, subject to their own internal credit assessment guideline. All purchases of immovable properties are subject to the guidelines issued by the Foreign Investment Committee (FIC). Details of the guidelines can be found at http://www.epu.jpm.my/.

- In addition, banking institutions may extend credit facilities in ringgit up to the aggregate limit of RM10 million to a non-resident (excluding a non-resident stockbroking company, custodian bank and correspondent bank) for any purpose for use in Malaysia, other than to finance the purchase or construction of immovable property.

  Prior permission of the Controller is required for the extension of credit facilities exceeding the aggregate limit.

Swap/Forward

- Onshore licensed banks are allowed to enter into –

  (i) Short-term currency swap arrangements with non-resident stockbrokers and non-resident custodian banks to cover payment for their share purchases on MSEB; and

  (ii) Outright ringgit forward sales contract with non-residents for the same purpose.

  The permission is subject to the condition that such contracts are based on firm commitment and not on anticipated purchases, and for maturity period of up to three working days with no rollover option.

- Onshore licensed banks and approved merchant banks may enter into forward foreign exchange contracts with residents to purchase any foreign currency receivables against ringgit from the residents up to the tenure of the underlying transaction, provided the transaction is supported by firm underlying commitment to receive such currency.

- Onshore licensed banks and approved merchant banks may also enter into forward foreign exchange contracts with residents to purchase any foreign currency yet to be received by the resident for another currency up to the tenure of the underlying transaction, provided the transaction is supported by firm underlying commitment.

- For forward purchase of export proceeds, the maturity date of the forward foreign exchange contract should not be later than six months after the intended date of export.

- For forward foreign exchange contract involving two foreign currencies, the use or retention of the foreign currency being purchased must comply with the current foreign exchange administration rules.

- Onshore licensed banks, approved merchant banks and licensed offshore banks in Labuan may enter into interest rate swaps with residents, provided the transaction is supported by firm underlying commitment.

- A resident company which has sold forward foreign currency receivables for ringgit, may temporarily retain up to the amount of foreign currency receipts received earlier than the maturity date of the forward foreign exchange contract in its FCA with onshore licensed banks, pending maturity of the forward foreign exchange contract.

- Multilateral Development Banks (MDBs), where Malaysia is a member, and foreign multinational corporations (MNCs) wishing to enter into forward foreign exchange contracts with onshore licensed banks to hedge the currency risks of the MDB and MNC issuers arising from the issuance of ringgit-denominated bonds would be considered based on the merits of each case.

- Onshore licensed banks may enter into forward foreign exchange contracts with non-residents who invest in ringgit-denominated bonds issued by MDBs and MNCs to hedge their currency risk arising from the investment in the ringgit-denominated bonds.

(e) Portfolio Investments

- There is no restriction for non-resident portfolio investors to repatriate their principal sum and profits out of the country at any time.

III Ringgit Credit Facilities to Non-Resident Controlled Companies

- There is no restriction for residents, including foreign-owned banking institutions in Malaysia, to extend credit facilities in ringgit to a Non-Resident Controlled Company (NRCC) operating in Malaysia up to an aggregate limit of RM50 million per corporate group or on single entity basis and any amount of short-term trade financing where the tenure does not exceed 12 months. Residents are required to obtain prior permission from the Controller to extend ringgit credit facilities exceeding RM50 million in aggregate to a NRCC. The NRCC has to comply with the 3:1 gearing ratio requirement between its domestic debt and eligible capital funds only for amounts that exceed RM50 million. Higher gearing will be allowed on a case-by-case basis.

IV Issuance of Ringgit Private Debt Securities

- Residents may raise domestic credit facility through the issuance of ringgit Private Debt Securities regardless of amount, provided the proceeds are not used for financing of investment abroad and/or for refinancing of offshore borrowing. The issuance of Private Debt Securities must also be in accordance with the Exchange Control Guideline on Private Debt Securities. The amount issued by the NRCC would be included as part of the NRCC's total domestic credit facilities and the rule on the 3:1 gearing ratio would apply.

- Applications for issuance of ringgit bonds in Malaysia by MDBs, where Malaysia is a member, and MNCs would be considered based on the merits of each case.

V Foreign Currency Accounts of Residents

- Resident exporters may open foreign currency accounts (FCA) with onshore licensed banks to retain between USD30 million and USD100 million foreign currency export proceeds depending on their average monthly export receipts.

- The permissible aggregate overnight limits are as follows –

Average Monthly Export Receipts	Aggregate Overnight Limit (USD million)
Exceeding RM100 million	100
Exceeding RM50 million up to RM100 million	60
Up to RM50 million or for new exporters	30

- In addition, resident exporters are given the option to merge their export and non-export FCA in accordance with overnight limits imposed on export FCA.

- Resident companies with or without domestic credit facilities may open FCA with onshore licensed banks to retain foreign currency receivables, other than export proceeds, with no overnight limit.

- Resident companies with or without domestic credit facilities may open FCA to retain foreign currency receivables, other than export proceeds, up to an aggregate overnight limit of USD500,000 with licensed offshore banks in Labuan.

- Resident companies may also temporarily retain in their onshore FCA, proceeds that have been sold forward for ringgit and received earlier than maturity date of the said forward contract.

- Resident individuals may open FCA solely to facilitate education and employment overseas up to an aggregate overnight limit of –

  (i) USD150,000 with onshore licensed banks;
  (ii) USD150,000 with licensed offshore banks in Labuan; and
  (iii) USD50,000 with overseas banks.

- Resident individuals with foreign currency funds overseas may maintain FCA, onshore or offshore, without limit imposed on the overnight balance of the accounts.

- Resident individuals in Malaysia who have foreign currency funds are free to invest in any foreign currency products offered by onshore licensed banks.

VI Foreign Currency Accounts of Non-Residents

- Onshore licensed banks and licensed merchant banks may open FCA for non-residents.

- There are no limits on the FCA of non-residents and no restrictions on the inflow and outflow of funds through the FCA of non-residents.

VII External Accounts of Non-Residents

- Financial institutions may open accounts in ringgit known as External Accounts for non-residents. There is no overnight limit on External Accounts. A non-resident may make ringgit cash withdrawal of any amount from the External Account.

- Non-residents may use ringgit funds in the External Account for the following purposes –

  - Purchase of foreign currency excluding the currencies of Israel, Serbia and Montenegro;

  - Purchase of ringgit assets in Malaysia;

- Payment for goods and services for own use in Malaysia;
- Payment of administrative and statutory expenses incurred in Malaysia;
- Payment under a non-financial guarantee (where the External Account holder is making payment upon the guarantee being called upon);
- Extension of ringgit credit facilities to staff in Malaysia in accordance with the terms and conditions of employment;
- Repayment of ringgit credit facilities permitted by the Controller or in accordance with terms and conditions of employment; and
- Payments to resident beneficiary for any purpose other than the following –
  - ▶ Payment for the import of goods and services;
  - ▶ Extension of ringgit credit facilities to residents other than as permitted by the Controller;
  - ▶ Settlement under financial guarantees; and
  - ▶ Payment on behalf of a third party.

- The sources of funds in the ringgit External Accounts may be from –
  - Sale of foreign currency excluding the currencies of Israel, Serbia and Montenegro;
  - Sale of ringgit assets;
  - All income derived in Malaysia including salaries, wages, royalties, commissions, fees, rental, interest, profits or dividends;
  - Proceeds from ringgit credit facilities permitted by the Controller or in accordance with the terms and conditions of employment;
  - Proceeds from repayment of ringgit credit facilities permitted by the Controller or in accordance with the terms and conditions of employment;
  - Transfers from -
    - ▶ another External Account of the same account holder of any amount;
    - ▶ another External Account and/or Resident Account of different account holders by way of –
      - o Automated Teller Machine transfer up to RM5,000 per person/company, per day, per bank for any purpose;
      - o Internet-bank transfers up to RM5,000 per person/company, per day, per bank for any purpose.
  - Deposit of ringgit notes of an aggregate not exceeding RM10,000 per day; and
  - Deposit of cheques up to RM5,000 per cheque for any purpose.
- Ringgit funds in the External Accounts may be converted into foreign currency and repatriated or used in Malaysia for permitted purposes.
- There is no restriction on the operation of the External Accounts of non-residents working or studying in Malaysia (including their spouse, children and/or parents who are currently residing in Malaysia), Central Banks, Embassies, Consulates, High Commissions, Supranational or International organisations recognised by the Malaysian Government. Such persons or organisations can use funds in the External Accounts for all purposes, including the permissible purposes referred above.

VIII Special Status Granted to Selected Companies

(a) Offshore Entities in the Labuan International Offshore Financial Centre

- Entities incorporated or registered under the Offshore Companies Act 1990 in the Labuan International Offshore Financial Centre are declared as non-residents for foreign exchange administration purposes.
- Offshore entities in Labuan may deal in foreign currency other than the currencies of Israel, Serbia and Montenegro with non-residents.
- All offshore entities may maintain External Accounts with resident banks to facilitate the defrayment of statutory and administrative expenses in Malaysia.

  Offshore insurance entities in Labuan may also use their External Accounts to facilitate the receipt of insurance premiums and for payment of claims arising from insurance and reinsurance of domestic insurance business.
- Licensed offshore banks in Labuan may receive payments in ringgit from residents arising from fees, commissions, dividends or interest from deposit of funds.
- Licensed offshore banks in Labuan may invest in assets/instruments in Malaysia for their own account provided investments are transacted directly with resident banking institutions or resident brokers. The investments must not be financed by ringgit borrowings.

(b) Multimedia Super Corridor Companies

- Companies operating in Multimedia Super Corridor (MSC) which are incorporated as separate legal entities, are given exemption from foreign exchange administration regulations upon the companies being awarded the MSC status by the Multimedia Development Corporation. The exemption granted to the MSC companies is solely for transactions undertaken on their own account. However, prior permission should be obtained to deal with Specified Persons and in Restricted Currencies of Israel, Serbia and Montenegro. In addition, the MSC companies are also required to submit the necessary statistical forms/reports/statements for monitoring purposes.

(c) Approved Operational Headquarters

- Approved Operational Headquarters (OHQs) may –

  (i) Open FCA with onshore licensed banks to retain export proceeds in foreign currency up to an aggregate overnight balance equivalent to USD100 million, regardless of the amount of export receipts.

  (ii) Open FCA with onshore licensed banks, licensed offshore banks in Labuan or overseas banks for crediting foreign currency receivables, other than export proceeds, with no limit on the overnight balances.

  (iii) Obtain domestic credit facilities in ringgit not exceeding RM50 million, provided the ringgit funds are used in Malaysia.

  (iv) Obtain any amount of foreign currency credit facilities from onshore licensed banks and licensed merchant banks in Malaysia, and from any non-resident, provided the OHQ does not on-lend to, or raise the funds on behalf of, any resident. Proceeds from such foreign currency credit facilities can be extended to their related companies overseas or invested abroad provided their aggregate domestic credit facilities in ringgit does not exceed RM50 million.

(d) Approved International Procurement Centres

- Approved International Procurement Centres (IPCs) may –

  (i) Retain any amount of export proceeds in FCA maintained with onshore licensed banks for approved IPC activities only.

  (ii) Enter into forward foreign exchange contracts with onshore licensed banks to hedge exchange risk based on projected volume of export.

(e) Approved Regional Distribution Centres

- Approved Regional Distribution Centres (RDCs) may –

  (i) Retain any amount of export proceeds in FCA maintained with onshore licensed banks for approved RDC activities only.

  (ii) Enter into forward foreign exchange contracts with onshore licensed banks to hedge exchange risk based on projected volume of import and export.

Funds and Guarantee Facility Administered/Funded by Bank Negara Malaysia: Fund Utilisation

Funds / Guarantee Facility	Date established	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disburse-ments as at end 2003 (RM m)	Outstanding as at end 2003[7] (RM m)
			Total as at end		Annual change	Total as at end		Annual change		
			2002	2003		2002	2003			
Ship Financing Facility	30-Oct-92	600	38	38	0	577	577	0	543	341
Fund for Food	04-Jan-93	1,300[3]	6,946	8,176	1,230	1,296	1,411	115	1,299	698
Bumiputera Entrepreneurs Project Fund	10-Feb-00	300[3]	596	893	297	317	438	121	362	92
Fund For Small and Medium Industries 2	15-Apr-00	2,000[1,3]	1,929	3,527	1,598	1,049	2,285	1,236	1,588	1,410
New Entrepreneurs Fund 2	15-Jul-01	1,150[2,3]	1,336	1,952	616	652	1,077	425	807	771
Rehabilitation Fund for Small Businesses	01-Nov-03	800	–	0	0	–	0	0	0	0
Special Relief Guarantee Facility[8]	21-May-03	1,000	–	73	73	–	40	40	–	–

Terminated Funds	Date established	Date terminated	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disburse-ments as at end 2003 (RM m)	Outstanding as at end 2003[7] (RM m)
				Total as at end		Annual change	Total as at end		Annual change		
				2002	2003		2002	2003			
Enterprise Rehabilitation Fund	06-Feb-88	01-Jan-91	500[3]	764	764	0	894	896	2[6]	850	109
Abandoned Housing Projects Fund	18-Jun-90	29-Feb-92	600	74	74	0	331	331	0	346	12
Fund to Accelerate the Construction of Low-Cost Houses	29-Oct-93	31-Oct-95	500	54	54	0	297	297	0	297	0
Special Fund for Tourism	10-Mar-90	31-Dec-97	200[3]	194	194	0	203	203	0	203	43
Industrial Adjustment Fund	05-Feb-91	04-Aug-99	100	25	25	0	95	95	0	95	14
Special Scheme for Low and Medium Cost Houses	01-May-98	04-Aug-99	1,000	98	96	-2[5]	660	604	-56[5]	579	13
Bumiputera Industrial Fund	04-Jan-93	03-Apr-00	100	99	99	0	95	95	0	91	51
Fund for Small and Medium Industries	02-Jan-98	03-Apr-00	1,850[3]	5,426	5,420	-6[5]	3,825	3,776	-49[5]	3,724	2,097
New Entrepreneurs Fund	12-Dec-89	15-Jul-01	1,250[3]	3,140	3,126	-14[5]	1,432	1,421	-11[5]	1,396	445
Rehabilitation Fund for Small and Medium Industries	23-Nov-98	01-Nov-03	330[3,4]	297	322	25	323	352	29	306	236
Entrepreneurs Rehabilitation and Development Fund	03-Jul-01	01-Nov-03	10[4]	21	33	12	2	3	1	1	1

[1] The allocation was increased from RM650 million to RM2,000 million in 2003
[2] The allocation was increased from RM500 million to RM1,150 million in 2003
[3] Revolving funds
[4] Unutilised allocations were transferred to Rehabilitation Fund for Small Businesses
[5] Approval withdrawn by banks/borrowers and/or amount required were reduced by banks/borrowers
[6] Additional funding requirements
[7] Borrowers' outstanding loan balances with the lending institutions
[8] A guarantee scheme through Credit Guarantee Corporation Malaysia Berhad funded by Bank Negara Malaysia to assist businesses affected by the Severe Acute Respiratory Syndrome (SARS)

Licensed Banking Institutions (as at 31 December 2003)

Commercial Banks

1. ABN AMRO Bank Berhad
2. Affin Bank Berhad
3. Alliance Bank Malaysia Berhad
4. AmBank Berhad
5. Bangkok Bank Berhad
6. Bank of America Malaysia Berhad
7. Bank of China (Malaysia) Berhad
8. Bank of Tokyo-Mitsubishi (Malaysia) Berhad
9. Bumiputra-Commerce Bank Berhad
10. Citibank Berhad
11. Deutsche Bank (Malaysia) Berhad
12. EON Bank Berhad
13. Hong Leong Bank Berhad
14. HSBC Bank Malaysia Berhad
15. J.P. Morgan Chase Bank Berhad
16. Malayan Banking Berhad
17. OCBC Bank (Malaysia) Berhad
18. Public Bank Berhad
19. RHB Bank Berhad[1]
20. Southern Bank Berhad
21. Standard Chartered Bank Malaysia Berhad
22. The Bank of Nova Scotia Berhad
23. United Overseas Bank (Malaysia) Berhad

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad

[1] Merged with Bank Utama (Malaysia) Berhad with effect from 1 May 2003

Finance Companies

1. AFFIN-ACF Finance Berhad
2. Alliance Finance Berhad
3. AmFinance Berhad
4. Bumiputra-Commerce Finance Berhad
5. EON Finance Berhad
6. Hong Leong Finance Berhad
7. Kewangan Bersatu Berhad
8. Mayban Finance Berhad
9. Public Finance Berhad
10. RHB Delta Finance Berhad
11. Southern Finance Berhad

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Aseambankers Malaysia Berhad
5. Commerce International Merchant Bankers Berhad
6. Malaysian International Merchant Bankers Berhad
7. Public Merchant Bank Berhad
8. RHB Sakura Merchant Bankers Berhad
9. Southern Investment Bank Berhad
10. Utama Merchant Bank Berhad

Financial Institutions Offering Islamic Banking Services (as at 31 December 2003)

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad

Participating Banks in the Islamic Banking Scheme

Commercial Banks

1. Affin Bank Berhad
2. Alliance Bank Malaysia Berhad
3. AmBank Berhad
4. Citibank Berhad
5. EON Bank Berhad
6. Hong Leong Bank Berhad
7. HSBC Bank Malaysia Berhad
8. Malayan Banking Berhad
9. OCBC Bank (Malaysia) Berhad
10. Public Bank Berhad
11. RHB Bank Berhad
12. Southern Bank Berhad
13. Standard Chartered Bank Malaysia Berhad

Finance Companies

1. Affin-ACF Finance Berhad
2. AmFinance Berhad
3. EON Finance Berhad
4. Hong Leong Finance Berhad
5. Mayban Finance Berhad
6. Public Finance Berhad
7. Southern Finance Berhad

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Commerce International Merchant Bankers Berhad

Discount Houses

1. Abrar Discounts Berhad
2. Affin Discount Berhad
3. Amanah Short Deposits Berhad
4. CIMB Discount House Berhad
5. KAF Discounts Berhad
6. Malaysia Discount Berhad
7. Mayban Discount Berhad

Development Financial Institutions Offering Islamic Banking Facilities

1. Bank Kerjasama Rakyat Malaysia Berhad
2. Bank Simpanan Nasional
3. Bank Pembangunan dan Infrastruktur Malaysia Berhad
4. Bank Industri & Teknologi Malaysia Berhad

National Shariah Advisory Council Members for Islamic Banking and Takaful – Session 2001-2003

1. Yang Amat Arif Dato' Sheikh Ghazali Abdul Rahman Director General Shariah Judiciary Department Malaysia	-	Chairman
2. Datuk Haji Md. Hashim Haji Yahaya Academic Fellow International Islamic University Malaysia	-	Deputy Chairman
3. Sohibus Samahah Dato' Haji Hassan Haji Ahmad Mufti of Pulau Pinang	-	Member
4. Dato' Dr. Abdul Monir Yaacob Director General Institute of Islamic Understanding Malaysia	-	Member
5. Dato' Dr. Abdul Halim Ismail Executive Director BIMB Securities Sdn. Bhd.	-	Member
6. Assoc. Prof. Dr. Mohd Daud Bakar Deputy Rector Student Affairs & Discipline International Islamic University Malaysia	-	Member
7. Assoc. Prof. Dr. Joni Tamkin Borhan Department of Shariah and Economics Academy of Islamic Studies University of Malaya	-	Member

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Kind of Economic Activity in Constant 1987 Prices

	1999	2000	2001	2002	2003*p*	2004*f*
	RM million					
Agriculture	17,596	18,062	17,897	18,438	19,453	19,952
Mining and quarrying	15,344	15,385	15,258	15,826	16,581	17,494
Manufacturing	56,840	67,250	63,346	65,908	71,311	78,550
Construction	6,926	6,964	7,108	7,275	7,417	7,525
Services	106,293	113,409	119,962	124,939	130,030	136,727
Less: Imputed bank service charges	14,896	15,832	17,678	18,614	19,570	20,851
Plus: Import duties	5,319	4,721	4,746	5,537	5,489	5,158
GDP at purchasers' prices[1]	**193,422**	**209,959**	**210,640**	**219,309**	**230,710**	**244,555**
	Annual change (%)					
Agriculture	0.5	2.6	-0.9	3.0	5.5	2.6
Mining and quarrying	6.9	0.3	-0.8	3.7	4.8	5.5
Manufacturing	11.7	18.3	-5.8	4.0	8.2	10.2
Construction	-4.4	0.6	2.1	2.3	1.9	1.5
Services	4.5	6.7	5.8	4.1	4.1	5.2
Less: Imputed bank service charges	6.7	6.3	11.7	5.3	5.1	6.5
Plus: Import duties	20.1	-11.2	0.5	16.7	-0.9	-6.0
GDP at purchasers' prices	**6.1**	**8.5**	**0.3**	**4.1**	**5.2**	**6.0 ~ 6.5**

[1] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2
Growth in Manufacturing Production (1993=100)

	2000	2001	2002	2003	2001	2002	2003
	Index				Annual change (%)		
Export-oriented industries	**223.3**	**200.1**	**210.2**	**235.3**	**-10.4**	**5.0**	**11.9**
Electrical machinery, apparatus appliances and supplies	272.4	229.2	247.8	271.7	-15.9	8.1	9.6
Electronics	337.2	269.1	305.2	351.3	-20.2	13.4	15.1
Electrical products	171.2	166.6	158.2	147.1	-2.8	-5.1	-7.0
Radio and television sets	*186.3*	*170.6*	*157.4*	*134.4*	*-8.4*	*-7.8*	*-14.6*
Cables and wires	*172.6*	*180.6*	*145.8*	*128.8*	*4.6*	*-19.2*	*-11.7*
Manuf. of office, computing and accounting machinery	*261.2*	*227.1*	*176.1*	*156.6*	*-13.1*	*-22.5*	*-11.1*
Manuf. of refrigerating, exhaust, ventilating and air-conditioning machinery	*113.2*	*132.3*	*161.8*	*180.6*	*16.9*	*22.2*	*11.6*
Textiles and wearing apparel	129.6	118.8	111.4	109.0	-8.3	-6.2	-2.2
Wood and wood products	103.6	104.9	98.6	99.5	1.2	-6.0	0.9
Chemicals and chemical products[1]	247.9	228.7	235.0	283.8	-7.7	2.7	20.8
Rubber products[1]	174.2	180.0	183.5	217.9	3.3	2.0	18.7
Off-estate processing	186.6	200.9	215.1	240.5	7.7	7.1	11.8
Others	129.1	106.2	115.1	120.9	-17.7	8.3	5.1
Domestic-oriented industries	**172.1**	**184.1**	**190.4**	**202.0**	**7.0**	**3.4**	**6.1**
Construction-related products	168.4	176.1	182.9	201.6	4.6	3.8	10.2
Non-metallic mineral products	*156.3*	*171.3*	*180.0*	*197.5*	*9.6*	*5.1*	*9.7*
Basic iron and steel and non-ferrous metal	*183.5*	*182.3*	*186.6*	*206.7*	*-0.7*	*2.4*	*10.8*
Transport equipment	199.3	237.1	251.9	238.0	19.0	6.2	-5.5
Food products	148.3	154.7	168.2	183.0	4.3	8.7	8.8
Beverages	134.2	138.5	121.9	147.3	3.2	-11.9	20.8
Tobacco products	174.9	164.4	148.0	153.8	-6.0	-10.0	3.9
Petroleum products	166.3	198.3	190.2	194.7	19.3	-4.1	2.3
Fabricated metal products	192.6	200.0	201.7	216.5	3.9	0.8	7.4
Paper products	162.0	165.0	186.2	201.2	1.9	12.8	8.0
Total	**209.7**	**195.8**	**204.7**	**226.1**	**-6.6**	**4.5**	**10.5**

[1] As of second quarter of 2001, chemicals and chemical products and rubber products were reclassified as export-oriented industries rather than domestic-oriented industries given that about three-quarters of the total output are related to export demand

Source: Department of Statistics, Malaysia

Table A.3
Production of Primary Commodities

	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	Volume					Annual change (%)				
Crude palm oil ('000 tonnes)	10,554	10,842	11,804	11,909	13,355	26.9	2.7	8.9	0.9	12.1
Rubber ('000 tonnes)	769	615	547	589	698	-13.2	-20.0	-11.1	7.7	18.4
Saw logs ('000 cu. metres)	21,776	23,074	18,923	20,649	21,381	0.5	6.0	-18.0	9.1	3.5
Cocoa ('000 tonnes)	84	70	58	48	36	-7.2	-16.0	-17.9	-17.4	-24.0
Crude oil ('000 bpd)	691	681	666	698	736	-4.7	-1.5	-2.1	4.9	5.4
Natural gas (mmscfd)	3,952	4,367	4,542	4,674	4,916	6.2	10.5	4.0	2.9	5.2
Tin-in-concentrates ('000 tonnes)	7.3	6.3	5.0	4.2	3.6	27.6	-14.1	-21.2	-15.2	-14.2

p Preliminary

Source: Malaysian Palm Oil Board
Department of Statistics, Malaysia
Forestry Departments (Peninsular Malaysia, Sabah & Sarawak)
Malaysian Cocoa Board
PETRONAS
Minerals and Geoscience Department Malaysia

Table A.4
GNP by Demand Aggregates

	1999	2000	2001	2002	2003*p*	2004*f*
	at Current Prices (RM million)					
Consumption	158,100	181,031	192,741	209,521	223,706	242,669
Private consumption	*125,056*	*145,355*	*150,644*	*159,506*	*169,813*	*186,244*
Public consumption	*33,044*	*35,676*	*42,097*	*50,015*	*53,893*	*56,425*
Investment	65,841	87,729	83,345	83,764	87,089	87,807
Private investment	*31,375*	*44,102*	*34,528*	*30,066*	*30,785*	*34,479*
Public investment	*34,466*	*43,627*	*48,817*	*53,698*	*56,304*	*53,328*
Change in stocks[1]	1,476	5,378	-3,268	1,251	-1,456	3,048
Exports of goods and services	364,861	427,004	389,256	415,040	450,592	502,550
Imports of goods and services	289,514	358,530	327,765	348,918	367,918	418,030
GDP at purchasers' value	300,764	342,612	334,309	360,658	392,012	418,044
Net factor payments abroad	-20,886	-28,909	-25,623	-25,061	-22,614	-24,715
GNP at purchasers' value	279,878	313,703	308,686	335,597	369,398	393,329
	at Constant 1987 Prices (RM million)					
Consumption	107,862	119,238	125,549	133,282	140,927	150,968
Private consumption	*84,377*	*95,370*	*97,630*	*101,946*	*107,111*	*115,739*
Public consumption	*23,485*	*23,868*	*27,919*	*31,336*	*33,816*	*35,229*
Investment	51,568	64,840	63,050	63,249	64,960	65,202
Private investment	*24,574*	*32,596*	*26,120*	*22,702*	*22,956*	*25,596*
Public investment	*26,994*	*32,244*	*36,930*	*40,547*	*42,004*	*39,606*
Change in stocks[1]	1,254	2,785	-1,778	1,677	-607	2,742
Exports of goods and services	212,085	246,158	227,685	237,904	253,006	283,598
Imports of goods and services	179,347	223,062	203,866	216,802	227,577	257,954
GDP at purchasers' value	193,422	209,959	210,640	219,309	230,710	244,555
Net factor payments abroad	-13,628	-19,271	-17,642	-17,253	-15,302	-17,020
GNP at purchasers' value	179,794	190,688	192,998	202,057	215,408	227,535

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5
Savings-Investment Gap

	1999	2000	2001	2002	2003*p*	2004*f*
	(RM million)					
Public gross domestic capital formation	34,466	43,627	48,817	53,698	56,304	53,328
Public savings	50,694	55,391	53,534	63,496	66,313	61,305
Deficit/surplus	16,228	11,764	4,717	9,798	10,009	7,977
Private gross domestic capital formation[1]	32,851	49,480	31,260	31,317	29,329	37,527
Private savings	64,517	69,969	54,230	52,013	70,081	79,596
Deficit/surplus	31,666	20,489	22,970	20,696	40,752	42,068
Gross domestic capital formation	67,317	93,107	80,077	85,015	85,633	90,855
(as % of GNP)	24.1	29.7	25.9	25.3	23.2	23.1
Gross national savings	115,211	125,360	107,764	115,509	136,394	140,900
(as % of GNP)	41.2	40.0	34.9	34.4	36.9	35.8
Balance on current account	47,895	32,252	27,687	30,494	50,761	50,045
(as % of GNP)	17.1	10.3	9.0	9.1	13.7	12.7

[1] Includes the change in stocks. Previously, the change in stocks was distributed between the public and private sector gross domestic capital formation

p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6
Balance of Payments

Item	2000			2001		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**374,033**	**294,889**	**79,144**	**334,326**	**264,472**	**69,854**
Trade account	*373,270*	*311,459*	*61,811*	*334,284*	*280,229*	*54,055*
Services	**52,971**	**63,641**	**-10,670**	**54,929**	**63,295**	**-8,366**
Transportation	10,646	22,382	-11,736	10,443	21,795	-11,352
Travel	19,043	7,885	11,158	26,081	9,933	16,148
Other services	22,794	32,824	-10,030	17,932	31,119	-13,187
Government services n.i.e.[3]	488	550	-62	473	448	25
Balance on goods and services	**427,004**	**358,530**	**68,474**	**389,255**	**327,767**	**61,488**
Income	**7,547**	**36,456**	**-28,909**	**7,018**	**32,641**	**-25,623**
Compensation of employees	1,301	2,276	-975	1,395	2,409	-1,014
Investment income[2]	6,246	34,180	-27,934	5,623	30,232	-24,609
Current transfers	**2,872**	**10,185**	**-7,313**	**2,040**	**10,218**	**-8,178**
Balance on current account	**437,423**	**405,171**	**32,252**	**398,313**	**370,626**	**27,687**
% of GNP			**10.3**			**9.0**
Capital account			**–**			**–**
Financial account			**-23,848**			**-14,791**
Direct investment			6,694			1,091
Abroad			*-7,699*			*-1,014*
In Malaysia			*14,393*			*2,105*
Portfolio investment			-9,395			-2,466
Other investment			-21,147			-13,416
Official sector			*3,936*			*7,114*
Private sector			*-25,083*			*-20,530*
Balance on capital and financial account			**-23,848**			**-14,791**
Errors and omissions			**-12,107**			**-9,234**
of which:						
Exchange revaluation gain (+) / loss (-)			-5,335			-4,060
Overall balance (surplus + / deficit -)			**-3,703**			**3,662**
Bank Negara Malaysia international reserves, net[4]						
RM million			113,541			117,203
US$ million			29,879			30,843
Reserves as months of retained imports			4.5			5.1

[1] Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data
[2] Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account
[3] Include transactions of foreign military and diplomatic establishments
[4] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
e Estimate
f Forecast
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2002			2003e			2004f		
+	-	Net	+	-	Net	+	-	Net
RM million								
358,504	**286,387**	**72,117**	**398,998**	**301,297**	**97,701**	**443,429**	**346,991**	**94,438**
357,682	*303,063*	*54,619*	*398,882*	*317,746*	*81,136*	*443,297*	*366,765*	*76,532*
56,536	**62,532**	**-5,996**	**51,594**	**66,620**	**-15,026**	**59,121**	**71,039**	**-11,918**
10,847	22,419	-11,572	10,514	23,787	-13,273	12,410	27,034	-14,624
27,049	9,947	17,102	22,423	10,816	11,607	27,127	12,084	15,043
18,166	29,408	-11,242	18,206	31,225	-13,019	19,120	31,267	-12,147
474	758	-284	452	793	-341	464	654	-190
415,040	**348,919**	**66,121**	**450,592**	**367,917**	**82,675**	**502,550**	**418,030**	**84,520**
8,129	**33,190**	**-25,061**	**13,116**	**35,730**	**-22,614**	**13,700**	**38,415**	**-24,715**
1,653	2,832	-1,179	2,170	3,120	-950	2,164	3,125	-961
6,476	30,358	-23,882	10,946	32,610	-21,664	11,537	35,290	-23,753
2,513	**13,079**	**-10,566**	**1,929**	**11,229**	**-9,300**	**2,062**	**11,823**	**-9,761**
425,682	**395,188**	**30,494**	**465,638**	**414,876**	**50,761**	**518,312**	**468,267**	**50,045**
		9.1			**13.7**			**12.7**
		–			**–**			
		-11,941			**-12,063**			
		4,935			4,242			
		-7,238			*-5,172*			
		12,173			*9,414*			
		-6,506			4,176			
		-10,370			-20,481			
		4,720			*-11,210*			
		-15,090			*-9,271*			
		-11,941			**-12,063**			
		-4,362			**360**			
		6,627			11,927			
		14,191			**39,059**			
		131,394			170,453			
		34,577			44,856			
		5.4			6.8			

Table A.7
Principal Markets for Manufactured Exports

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
ASEAN	**65,004**	**23.9**	**85,210**	**26.8**	**72,140**	**25.3**	**78,859**	**26.1**	**82,705**	**25.2**
Singapore	*48,390*	*17.8*	*63,768*	*20.1*	*52,483*	*18.4*	*55,996*	*18.5*	*57,647*	*17.6*
Thailand	*8,396*	*3.1*	*10,166*	*3.2*	*9,816*	*3.4*	*12,355*	*4.1*	*13,513*	*4.1*
Indonesia	*3,415*	*1.3*	*5,064*	*1.6*	*4,983*	*1.8*	*5,629*	*1.9*	*6,287*	*1.9*
Philippines	*4,170*	*1.5*	*5,537*	*1.7*	*4,113*	*1.4*	*4,171*	*1.4*	*4,324*	*1.3*
Brunei Darussalam	*633*	*0.2*	*675*	*0.2*	*745*	*0.3*	*708*	*0.2*	*934*	*0.3*
EU	**44,837**	**16.5**	**46,057**	**14.5**	**40,894**	**14.3**	**38,493**	**12.7**	**41,194**	**12.6**
Netherlands	*13,880*	*5.1*	*13,843*	*4.4*	*13,609*	*4.8*	*11,084*	*3.7*	*10,336*	*3.2*
United Kingdom	*11,438*	*4.2*	*11,067*	*3.5*	*8,355*	*2.9*	*7,836*	*2.6*	*8,123*	*2.5*
Germany	*6,955*	*2.6*	*8,682*	*2.7*	*7,176*	*2.5*	*7,064*	*2.3*	*8,065*	*2.5*
Others	*12,564*	*4.6*	*12,465*	*3.9*	*11,754*	*4.1*	*12,509*	*4.1*	*14,670*	*4.4*
United States	68,058	25.0	74,165	23.3	65,830	23.1	72,427	24.0	75,035	22.9
Japan	28,027	10.3	35,763	11.2	32,413	11.4	28,253	9.3	28,818	8.8
Hong Kong China	13,395	4.9	15,795	5.0	14,327	5.0	19,031	6.3	24,765	7.6
The People's Republic of China	5,660	2.1	7,979	2.5	11,266	3.9	13,994	4.6	17,445	5.3
Chinese Taipei	12,835	4.7	11,421	3.6	9,767	3.4	11,409	3.8	11,575	3.5
Korea	5,481	2.0	7,363	2.3	6,692	2.3	7,867	2.6	7,143	2.2
Australia	5,924	2.2	7,054	2.2	5,862	2.1	5,906	2.0	7,123	2.2
Canada	2,262	0.8	2,900	0.9	1,977	0.7	1,991	0.7	2,160	0.7
West Asian Countries	5,042	1.9	5,717	1.8	6,885	2.4	5,992	2.0	7,549	2.3
Latin American Countries	2,242	0.8	4,169	1.3	3,436	1.2	3,022	1.0	2,959	0.9
Rest of the World	12,963	4.9	14,315	4.6	13,827	4.9	15,031	4.9	18,479	5.8
Total	**271,730**	**100.0**	**317,908**	**100.0**	**285,316**	**100.0**	**302,275**	**100.0**	**326,950**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.8
Principal Export Markets for Electronics

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	41,660	28.8	42,378	25.4	34,793	24.9	42,281	26.8	45,352	27.1
Singapore	28,621	19.8	41,048	24.6	30,335	21.7	33,079	21.0	32,067	19.1
Hong Kong China	6,506	4.5	8,017	4.8	7,470	5.3	12,525	7.9	18,041	10.8
Japan	12,621	8.7	15,970	9.6	13,502	9.7	11,209	7.1	10,479	6.3
The People's Republic of China	2,192	1.5	3,494	2.1	6,012	4.3	7,792	4.9	9,028	5.4
Chinese Taipei	9,153	6.3	7,289	4.4	6,520	4.7	7,863	5.0	8,061	4.8
Others	44,132	30.4	48,595	29.1	41,000	29.4	42,914	27.3	44,592	26.5
Total	**144,885**	**100.0**	**166,791**	**100.0**	**139,632**	**100.0**	**157,663**	**100.0**	**167,620**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.9
Principal Export Markets for Electrical Products

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	13,817	27.5	17,358	27.3	17,324	28.6	17,427	31.7	16,379	29.3
Singapore	7,958	15.9	8,665	13.6	8,120	13.4	7,442	13.6	8,539	15.3
Japan	6,778	13.5	9,337	14.7	9,207	15.2	7,584	13.8	6,848	12.2
Hong Kong China	2,263	4.5	2,992	4.7	2,534	4.2	2,483	4.5	2,403	4.3
The People's Republic of China	865	1.7	1,428	2.2	1,770	2.9	1,579	2.9	2,137	3.8
Thailand	1,059	2.1	1,480	2.3	1,566	2.6	1,558	2.8	1,665	3.0
Germany	1,662	3.3	1,794	2.8	1,865	3.1	1,410	2.6	1,438	2.6
United Kingdom	1,542	3.1	1,601	2.5	1,435	2.4	1,400	2.6	1,351	2.4
Others	14,218	28.4	18,983	29.9	16,854	27.6	14,007	25.5	15,167	27.1
Total	**50,162**	**100.0**	**63,638**	**100.0**	**60,675**	**100.0**	**54,890**	**100.0**	**55,927**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.10
Principal Export Markets for Chemicals and Chemical Products

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
The People's Republic of China	647	5.8	1,054	7.0	1,533	10.3	2,294	13.3	2,929	13.8
Singapore	1,454	13.1	1,900	12.7	1,646	11.1	1,736	10.1	2,165	10.2
Japan	1,199	10.8	1,586	10.6	1,566	10.5	1,750	10.2	2,125	10.0
Thailand	680	6.1	976	6.5	1,164	7.8	1,387	8.0	1,771	8.3
Hong Kong China	993	8.9	1,373	9.1	1,176	7.9	1,239	7.2	1,551	7.3
Indonesia	617	5.6	1,153	7.7	999	6.7	1,302	7.6	1,532	7.2
United States	922	8.3	1,426	9.5	1,218	8.2	1,042	6.1	1,060	5.0
Chinese Taipei	409	3.7	671	4.5	620	4.2	882	5.1	960	4.5
Others	4,184	37.7	4,872	32.4	4,957	33.3	5,596	32.4	7,143	33.7
Total	**11,105**	**100.0**	**15,011**	**100.0**	**14,879**	**100.0**	**17,228**	**100.0**	**21,236**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11
Principal Export Markets for Manufactures of Metal

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	2,155	27.4	2,270	26.3	2,020	23.2	2,134	24.3	2,289	20.3
The People's Republic of China	341	4.3	445	5.2	476	5.5	665	7.6	1,016	9.0
Japan	667	8.5	755	8.8	736	8.5	594	6.8	837	7.4
United States	633	8.0	687	8.0	644	7.4	486	5.5	714	6.3
Thailand	458	5.8	495	5.7	501	5.8	504	5.7	558	4.9
Indonesia	314	4.0	374	4.3	360	4.1	398	4.5	443	3.9
Korea	279	3.5	288	3.3	240	2.8	217	2.5	432	3.8
Hong Kong China	447	5.7	310	3.6	240	2.8	368	4.2	403	3.6
Others	2,568	32.8	2,994	34.8	3,475	39.9	3,430	38.9	4,611	40.8
Total	**7,862**	**100.0**	**8,618**	**100.0**	**8,692**	**100.0**	**8,796**	**100.0**	**11,303**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.12
Principal Export Markets for Optical and Scientific Equipment

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	1,141	23.6	1,999	29.3	2,132	27.3	1,874	23.0	2,007	21.8
Singapore	696	14.4	859	12.6	1,110	14.2	1,572	19.3	1,749	19.0
Japan	765	15.8	1,004	14.7	1,163	14.9	1,186	14.6	1,393	15.1
Netherlands	140	2.9	291	4.3	415	5.3	511	6.3	649	7.0
The People's Republic of China	84	1.7	173	2.5	232	3.0	199	2.4	455	4.9
Hong Kong China	284	5.9	342	5.0	408	5.2	429	5.3	442	4.8
Germany	361	7.5	584	8.6	437	5.6	408	5.0	405	4.4
Others	1,363	28.2	1,573	23.0	1,905	24.5	1,972	24.1	2,113	23.0
Total	**4,834**	**100.0**	**6,825**	**100.0**	**7,802**	**100.0**	**8,151**	**100.0**	**9,213**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13
Principal Export Markets for Petroleum Products

Country	1999		2000		2001		2002		2003*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	1,337	29.6	2,457	30.2	2,906	34.6	3,043	39.9	3,605	38.3
Japan	576	12.8	1,371	16.9	991	11.8	1,001	13.1	1,836	19.5
United States	505	11.2	746	9.2	921	11.0	412	5.4	525	5.6
Australia	108	2.4	239	2.9	276	3.3	188	2.5	408	4.3
The People’s Republic of China	249	5.5	119	1.5	201	2.4	188	2.5	274	2.9
Korea	355	7.9	231	2.8	110	1.3	257	3.4	274	2.9
Hong Kong China	101	2.2	41	0.5	366	4.4	257	3.4	270	2.9
Others	1,282	28.4	2,927	36.0	2,637	31.2	2,274	29.8	2,224	23.6
Total	**4,513**	**100.0**	**8,131**	**100.0**	**8,408**	**100.0**	**7,620**	**100.0**	**9,416**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.14
Export Prices of Major Commodities

	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
						Annual change (%)				
Palm oil (RM/tonne)	1,615	1,122	944	1,367	1,617	-31.8	-30.5	-15.9	44.9	18.3
Rubber (sen/kg)	238	263	230	269	379	-16.7	10.4	-12.7	17.0	41.0
Saw logs (RM/cu. metre)	395	384	315	359	366	14.8	-2.9	-17.9	13.9	1.9
Sawn timber (RM/cu. metre)	996	1,050	943	990	926	5.8	5.4	-10.2	5.0	-6.5
Crude oil (US$/barrel)	18.18	29.58	25.53	24.81	30.27	29.9	62.7	-13.7	-2.8	22.0

p Preliminary

Source: Department of Statistics, Malaysia

Table A.15
Principal Export Markets for Palm Oil

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 tonnes)					% share				
The People's Republic of China	783	1,023	1,364	1,940	2,502	8.7	11.5	13.0	17.9	20.0
India	2,402	2,029	2,066	1,670	1,650	26.8	22.9	19.7	15.4	13.2
European Union	1,071	988	1,610	1,478	1,648	12.0	11.1	15.4	13.6	13.2
Netherlands	*637*	*530*	*1,028*	*847*	*974*	*7.1*	*6.0*	*9.8*	*7.8*	*7.8*
Italy	*100*	*121*	*155*	*127*	*98*	*1.1*	*1.4*	*1.5*	*1.2*	*0.8*
Sweden	*67*	*76*	*100*	*102*	*106*	*0.8*	*0.8*	*1.0*	*0.9*	*0.8*
United Kingdom	*39*	*25*	*51*	*50*	*90*	*0.4*	*0.3*	*0.5*	*0.5*	*0.7*
Others	*228*	*236*	*276*	*352*	*380*	*2.6*	*2.6*	*2.6*	*3.2*	*3.1*
Middle East	1,217	1,168	1,236	1,449	1,749	13.6	13.2	11.8	13.4	14.0
Pakistan	1,028	1,075	1,143	1,059	1,105	11.5	12.1	10.9	9.8	8.8
Singapore	468	358	423	441	489	5.2	4.0	4.0	4.1	3.9
United States	124	178	208	270	231	1.4	2.0	2.0	2.5	1.8
Japan	356	353	379	434	430	4.0	4.0	3.6	4.0	3.4
Bangladesh	53	98	178	230	272	0.6	1.1	1.7	2.1	2.2
Korea	190	198	241	218	211	2.1	2.2	2.3	2.0	1.7
Myanmar	145	124	115	114	159	1.6	1.4	1.1	1.1	1.3
Others	1,127	1,271	1,503	1,551	2,063	12.5	14.5	14.5	14.1	16.5
Total	**8,964**	**8,863**	**10,466**	**10,854**	**12,509**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.16
Principal Export Markets for Rubber

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 tonnes)					% share				
European Union	356	350	318	309	305	36.2	35.8	38.7	33.3	32.3
Germany	*100*	*107*	*119*	*119*	*129*	*10.2*	*10.9*	*14.5*	*12.8*	*13.7*
Belgium	*48*	*51*	*44*	*30*	*19*	*4.8*	*5.2*	*5.4*	*3.2*	*2.0*
Italy	*36*	*33*	*30*	*28*	*29*	*3.7*	*3.4*	*3.6*	*3.0*	*3.1*
United Kingdom	*51*	*35*	*25*	*24*	*22*	*5.2*	*3.6*	*3.0*	*2.6*	*2.3*
Netherlands	*17*	*17*	*12*	*15*	*12*	*1.7*	*1.7*	*1.5*	*1.6*	*1.3*
Others	*104*	*107*	*88*	*93*	*94*	*10.6*	*11.0*	*10.7*	*10.1*	*9.9*
The People's Republic of China	66	94	85	129	207	6.7	9.6	10.3	13.9	21.9
United States	111	101	66	81	76	11.3	10.3	8.0	8.7	8.0
Korea	84	73	58	59	69	8.5	7.5	7.1	6.4	7.3
Iran	39	43	60	45	48	4.0	4.4	7.3	4.8	5.1
Turkey	26	30	24	24	25	2.7	3.1	2.9	2.6	2.6
Chinese Taipei	15	11	12	14	14	1.6	1.1	1.5	1.5	1.5
Japan	25	21	18	14	10	2.5	2.1	2.2	1.5	1.1
Others	262	255	181	253	191	26.5	26.1	22.0	27.3	20.2
Total	**984**	**978**	**822**	**928**	**945**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.17
Principal Export Markets for Saw Logs

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 cubic metres)					% share				
Japan	2,280	2,184	1,375	1,641	1,356	33.9	33.7	28.4	32.2	24.6
The People's Republic of China	1,680	1,405	1,071	1,106	1,338	25.0	21.7	22.2	21.7	24.3
India	838	873	985	998	1,371	12.4	13.5	20.4	19.5	24.9
Chinese Taipei	919	898	669	651	694	13.6	13.8	13.8	12.7	12.6
Hong Kong China	440	541	417	188	103	6.5	8.3	8.6	3.7	1.9
Korea	393	301	175	159	140	5.8	4.6	3.6	3.1	2.5
Thailand	95	102	28	39	60	1.4	1.6	0.6	0.8	1.1
Others	93	180	114	322	446	1.4	2.8	2.4	6.3	8.1
Total	**6,738**	**6,484**	**4,834**	**5,104**	**5,508**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.18
Principal Export Markets for Sawn Timber

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 cubic metres)					% share				
Thailand	490	563	532	590	627	17.4	19.6	22.1	23.8	22.2
Chinese Taipei	213	226	170	183	214	7.6	7.9	7.0	7.4	7.6
Netherlands	273	270	197	194	222	9.7	9.4	8.2	7.8	7.9
The People's Republic of China	149	137	151	173	177	5.3	4.8	6.3	7.0	6.3
Japan	237	239	187	200	196	8.4	8.3	7.8	8.1	7.0
Hong Kong China	143	132	135	151	108	5.1	4.6	5.6	6.1	3.8
Singapore	247	219	185	160	188	8.8	7.6	7.7	6.5	6.7
Korea	144	129	120	98	92	5.1	4.5	5.0	4.0	3.3
Republic of Yemen	70	114	83	59	70	2.5	3.9	3.4	2.4	2.5
Belgium	71	69	52	64	97	2.5	2.4	2.2	2.6	3.4
United Arab Emirates	78	82	66	59	55	2.8	2.9	2.7	2.4	1.9
United Kingdom	69	55	52	55	52	2.4	1.9	2.2	2.2	1.8
Germany	39	31	23	30	43	1.4	1.1	1.0	1.2	1.5
Others	595	610	458	458	675	21.0	21.1	18.8	18.5	24.1
Total	**2,818**	**2,876**	**2,411**	**2,474**	**2,816**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.19
Principal Export Markets for Crude Oil

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 tonnes)					% share				
India	2,387	2,161	1,690	2,462	3,396	13.5	13.0	11.2	15.2	19.0
Thailand	2,306	2,890	2,797	2,358	3,097	13.0	17.3	18.6	14.6	17.3
Japan	2,004	1,299	1,457	2,131	1,440	11.3	7.8	9.7	13.2	8.0
Korea	2,540	2,292	2,190	1,838	1,271	14.3	13.7	14.5	11.4	7.1
The People's Republic of China	299	705	838	1,723	2,013	1.7	4.2	5.6	10.6	11.2
Australia	2,087	1,760	1,852	1,687	2,248	11.8	10.6	12.3	10.4	12.5
Indonesia	1,658	1,060	753	956	1,290	9.4	6.4	5.0	5.9	7.2
New Zealand	603	565	487	604	321	3.4	3.4	3.2	3.7	1.8
Myanmar	633	595	453	561	–	3.6	3.6	3.0	3.5	–
Philippines	553	527	362	511	466	3.1	3.2	2.4	3.2	2.6
Sri Lanka	353	473	400	485	425	2.0	2.8	2.7	3.0	2.4
United States	1,143	1,054	704	412	839	6.4	6.3	4.7	2.5	4.7
Singapore	626	626	215	203	467	3.5	3.8	1.4	1.3	2.6
Others	533	665	879	261	640	3.0	3.9	5.7	1.5	3.6
Total	**17,725**	**16,672**	**15,077**	**16,192**	**17,913**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.20
Principal Export Markets for LNG

Country	1999	2000	2001	2002	2003*p*	1999	2000	2001	2002	2003*p*
	('000 tonnes)					% share				
Japan	10,070	11,076	11,308	10,782	12,494	66.7	71.8	73.3	71.8	71.8
Korea	3,210	2,498	2,255	2,304	2,687	21.3	16.2	14.6	15.4	15.4
Chinese Taipei	1,753	1,802	1,860	1,857	2,167	11.6	11.7	12.1	12.4	12.5
Others	55	54	–	64	54	0.4	0.3	–	0.4	0.3
Total	**15,088**	**15,430**	**15,423**	**15,007**	**17,402**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.21
External Debt and Debt Servicing[1]

	1999	2000	2001	2002	2003*p*
	RM million				
Medium and long-term debt:					
Gross borrowing	**21,410**	**23,390**	**31,550**	**23,853**	**20,969**
Federal Government	*4,763*	*4,767*	*7,030*	*10,465*	*3,144*
NFPEs	*6,080*	*7,719*	*11,311*	*3,655*	*5,157*
Private sector	*10,567*	*10,903*	*13,209*	*9,732*	*12,668*
Repayment and prepayment	**16,152**	**17,941**	**22,323**	**23,104**	**28,892**
Federal Government	*1,840*	*3,903*	*735*	*2,445*	*6,854*
NFPEs	*2,230*	*3,836*	*10,447*	*6,942*	*12,437*
Private sector	*12,082*	*10,203*	*11,141*	*13,717*	*9,602*
Net borrowing	**5,259**	**5,448**	**9,227**	**749**	**-7,923**
Federal Government	*2,923*	*864*	*6,295*	*8,020*	*-3,710*
NFPEs	*3,850*	*3,883*	*865*	*-3,287*	*-7,279*
Private sector	*-1,515*	*701*	*2,068*	*-3,985*	*3,066*
Outstanding debt	**139,706**	**143,465**	**149,346**	**153,587**	**152,788**
Federal Government	*18,369*	*18,821*	*24,328*	*36,283*	*37,284*
NFPEs	*57,021*	*59,566*	*67,415*	*64,330*	*59,558*
Private sector	*64,315*	*65,077*	*57,604*	*52,974*	*55,946*
Currency composition (% share)	**100**	**100**	**100**	**100**	**100**
U.S. dollar	*74*	*75*	*78*	*77*	*77*
Japanese yen	*20*	*18*	*15*	*14*	*13*
Others	*6*	*7*	*7*	*8*	*10*
Short-term debt:					
Outstanding debt	**22,427**	**17,600**	**24,072**	**32,055**	**34,462**
Banking sector[2]	*12,661*	*9,271*	*11,926*	*21,894*	*24,597*
Non-bank private sector	*9,766*	*8,329*	*12,147*	*10,162*	*9,865*
Total external debt:	**162,133**	**161,065**	**173,419**	**185,643**	**187,250**
Total external debt (US$ million)	**42,667**	**42,385**	**45,636**	**48,853**	**49,276**
% GNP	*57.9*	*51.3*	*56.2*	*55.3*	*50.7*
Annual change (%)	*-4.6*	*-0.7*	*7.7*	*7.0*	*0.9*
Total servicing (including short-term interest payment)	**23,312**	**25,043**	**26,954**	**28,020**	**28,287**
of which:					
Medium and long-term debt					
Repayment (excluding prepayment)	**15,726**	**16,370**	**19,612**	**20,780**	**21,491**
Federal Government	*1,840*	*3,903*	*735*	*2,445*	*3,861*
NFPEs	*2,230*	*2,506*	*7,886*	*6,942*	*10,017*
Private sector	*11,656*	*9,962*	*10,991*	*11,393*	*7,612*
Interest payment	**6,058**	**7,117**	**6,345**	**6,484**	**6,149**
Federal Government	*883*	*1,187*	*1,150*	*1,879*	*1,930*
NFPEs	*2,755*	*3,408*	*3,574*	*3,430*	*3,287*
Private sector	*2,420*	*2,522*	*1,621*	*1,174*	*932*
Debt service ratio (% of exports of goods and services)					
Total debt	**6.3**	**5.8**	**6.8**	**6.7**	**6.1**
Medium and long-term debt	5.8	5.4	6.6	6.5	6.0
Federal Government	*0.7*	*1.2*	*0.5*	*1.0*	*1.2*
NFPEs	*1.3*	*1.4*	*2.9*	*2.5*	*2.9*
Private sector	*3.8*	*2.9*	*3.2*	*3.0*	*1.8*

[1] Data on MAS was included under private sector up to 2000 and under NFPEs from 2001
[2] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance and Bank Negara Malaysia

Table A.22
Gross Overseas Investment by Country[1]

Countries	1999	2000	2001	2002	2003
	RM million				
United States	513	3,924	4,014	5,714	994
Singapore	1,635	2,920	2,082	1,057	844
Chinese Taipei	28	30	10	34	666
Sudan	...	...	15	125	600
Hong Kong China	435	158	100	410	520
United Kingdom	553	532	270	400	492
Indonesia	398	536	1,683	900	356
Namibia	1	...	–	...	266
The People's Republic of China	201	153	313	306	243
Thailand	151	292	134	45	225
Egypt	...	...	...	28	215
Australia	104	73	304	172	167
Chad	–	–	–	1,099	138
Japan	159	83	58	142	137
Bahrain	–	...	–	46	120
Korea	14	16	14	2	117
Pakistan	192	156	209	28	100
Netherlands	104	2	531	928	87
Vietnam	142	50	88	77	79
Philippines	100	109	54	59	66
India	101	22	43	76	57
Germany	33	28	21	29	54
Ireland	4	5	...	122	51
Others	8,523	4,720	3,164	4,625	3,996
of which:					
Cayman Islands	*125*	*349*	*37*	*906*	*1,622*
Bermuda	*2*	*1*	*36*	*7*	*420*
Mauritius	*787*	*59*	*82*	*420*	*386*
Isle of Man	–	–	–	–	*175*
Labuan[2]	*2,392*	*2,972*	*1,130*	*1,647*	*933*
Total	**13,391**	**13,809**	**13,107**	**16,424**	**10,590**

[1] Refers to direct equity investment, purchase of real estate and extension of loans to non-residents abroad. Includes capital invested or loans extended by the foreign-owned companies in/to their parent companies abroad. For the purpose of compiling balance of payments statistics, capital invested in or loans extended to parent companies abroad must be offset against the capital invested in or loans extended to Malaysia by the parent companies abroad. At present, the Cash BOP Reporting System is not able to segregate this type of transaction

[2] Labuan IOFC is treated as a non-resident for exchange control purposes

Source: Cash BOP Reporting System, Bank Negara Malaysia

Table A.23
Consumer Price Index (2000=100) Sub-groups of Food

	Weights (%)	2000	2001	2002	2003
		Annual change (%)			
Food	33.8	1.9	0.7	0.7	1.3
of which:					
Food at Home	24.1	1.7	0.4	0.2	1.6
Rice, bread and other cereals	5.5	0.3	0.2	0.1	0.4
Meat	3.4	3.8	0.0	-1.3	2.4
Fish	4.9	5.4	3.5	1.0	1.3
Milk and eggs	2.1	-1.4	-0.2	1.0	2.2
Oils and fats	0.8	-1.5	-6.4	1.8	4.4
Fruits and vegetables	5.0	-0.7	-1.0	0.2	2.5
Sugar	0.5	-0.2	-0.1	-1.9	0.2
Coffee and tea	0.8	0.0	0.1	0.4	1.6
Other foods	1.1	1.1	-0.2	0.3	0.5
Food away from home	9.7	2.6	1.3	2.0	0.7

Source: Department of Statistics, Malaysia

Table A.24
Producer Price Index (1989=100)

	Weights (%)	1999	2000	2001	2002	2003
		Annual change (%)				
Domestic Economy	100.0	-3.3	3.1	-5.0	4.4	5.7
of which:						
Food and live animals chiefly for food	14.9	-2.3	0.4	0.4	0.4	-0.2
Beverages and tobacco	2.1	10.2	0.4	1.8	3.9	0.9
Crude materials, inedible except fuels	18.0	-2.7	1.3	-5.9	7.0	7.5
Mineral fuels, lubricants and related materials	18.8	14.2	33.9	-10.6	0.0	11.4
Animal and vegetable oils and fats	8.5	-29.4	-31.9	-17.6	46.5	15.7
Chemicals and related products N.E.C.	4.4	1.5	1.0	-1.1	-0.7	1.4
Manufactured goods classified chiefly by material	10.8	-0.9	0.9	-0.5	-0.2	1.8
Machinery and transport equipment	18.3	-0.5	-0.1	-0.1	-0.3	0.1
Miscellaneous manufactured articles	3.6	1.4	0.9	-0.6	-0.3	0.9
Commodities and transactions not classified elsewhere in the S.I.T.C.	0.6	-0.9	0.4	10.3	2.6	0.5
Local Production	79.3	-3.9	3.6	-6.1	5.7	6.8
Imports	20.7	-0.6	1.1	-0.3	-0.7	0.8

Source: Department of Statistics, Malaysia

Table A.25
Supply of Office Space, Retail Space, Condominiums and Apartments in the Klang Valley[1]

Year	Office Space		Retail Space		Condominiums and Apartments
	Square metres	Occupancy rate[2] (%)	Square metres	Occupancy rate[2] (%)	Units
1993	332,246	91.5	130,345	97.3	18,232
1994	192,808	94.3	117,340	98.5	9,331
1995	362,851	94.9	341,091	96.1	17,822
1996	296,742	95.5	136,964	92.8	14,568
1997	869,394	94.9	362,574	90.5	5,473
1998	1,158,776	79.9	364,027	61.7	14,151
1999	265,645	76.2	89,787	76.6	9,547
2000	1,374,452	76.9	218,562	78.5	5,466
2001	177,576	74.7	95,663	79.9	17,067
2002	200,195	75.5	141,644	83.0	20,465
2003 (Jan-Sep)	92,800	77.2	190,175	83.3	19,060

[1] Refers to Kuala Lumpur and Selangor
[2] Refers to end period

Source: NAPIC, Valuation and Property Services Department

Table A.26
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley[1]

Year	Prime Office Space		Prime Retail Space	
	RM/sq.m	Annual change (%)	RM/sq.m	Annual change (%)
1998	46	-19.3	162	-39.3
1999	42	-8.7	175	8.0
2000	48	14.3	194	10.9
2001	48	0.9	215	11.0
2002	45	-6.7	226	5.0
2003	45	0.0	226	0.0

[1] Refers to Kuala Lumpur and Selangor

Source: CH Williams Talhar & Wong Sdn. Bhd.

Table A.27
Broad Money (M3)

	Annual change					As at end 2003
	1999	2000	2001	2002	2003	
	RM million					
Broad money (M3)[1]	33,131	21,906	13,022	31,607	48,502	549,627
Currency[2]	6,019	-1,949	-92	1,751	2,232	25,943
Demand deposits	12,403	7,623	2,882	6,718	11,187	77,358
Broad quasi-money	14,709	16,232	10,232	23,138	35,083	446,326
Fixed deposits	*29,745*	*8,207*	*-358*	*12,648*	*17,065*	*327,308*
Savings deposits	*7,908*	*6,380*	*4,454*	*5,590*	*5,602*	*62,458*
NIDs	*-21,864*	*-932*	*600*	*3,575*	*1,965*	*10,977*
Repos	*-2,461*	*-314*	*4,186*	*2,507*	*8,016*	*33,177*
Foreign currency deposits	*1,382*	*2,890*	*1,350*	*-1,182*	*2,435*	*12,406*
Factors Affecting M3						
Net claims on Government	2,248	4,388	-1,542	11,538	12,878	8,494
Claims on Government	*-2,906*	*3,326*	*4,165*	*-867*	*3,890*	*32,836*
Less: Government deposits	*-5,155*	*-1,062*	*5,707*	*-12,405*	*-8,988*	*24,342*
Claims on private sector	-9,792	25,968	20,335	27,737	32,424	567,482
Loans	*-20,377*	*21,566*	*17,081*	*19,288*	*21,723*	*475,605*
Securities	*10,585*	*4,402*	*3,255*	*8,449*	*10,701*	*91,877*
Net external operations	31,391	7,336	6,741	1,237	19,467	136,271
Bank Negara Malaysia[3]	*19,164*	*1,633*	*7,722*	*7,564*	*27,131*	*138,097*
Banking system	*12,227*	*5,703*	*-980*	*-6,327*	*-7,664*	*-1,826*
Other influences	9,284	-15,786	-12,513	-8,905	-16,267	-162,620

[1] Excludes interplacements among banking institutions
[2] Excludes holdings by banking system
[3] Includes exchange rate revaluation loss/gain

Table A.28
Money Supply: Annual Change and Growth Rates

	M3[5]													
			M2[3]										Deposits with other banking institutions[4]	
					M1[1]									
	Total		Total		Total		Currency		Demand deposits		Narrow quasi-money[2]			
	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%
1999	33,131	8.3	40,666	13.7	19,313	35.7	6,534	35.8	12,778	35.6	21,354	8.8	-7,535	-7.2
2000	21,906	5.0	17,564	5.2	4,769	6.5	-2,517	-10.2	7,287	15.0	12,795	4.9	4,342	4.5
2001	13,022	2.9	7,810	2.2	2,512	3.2	-115	-0.5	2,627	4.7	5,298	1.9	5,213	5.1
2002	31,607	6.7	21,030	5.8	8,344	10.3	1,749	7.9	6,595	11.3	12,686	4.5	10,577	9.9
2003	48,502	9.7	42,497	11.1	13,009	14.6	2,204	9.2	10,805	16.6	29,488	10.0	6,005	5.1

[1] Currency in circulation and demand deposits of the private sector placed with commercial banks and Islamic banks
[2] Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks
[3] M1 plus narrow quasi-money
[4] Comprising fixed deposits and repos of the private sector placed with finance companies, merchant banks and discount houses. Also includes saving deposits with finance companies, NIDs with finance companies and merchant banks, foreign currency deposits placed with merchant banks and call deposits with discount houses. Excludes interplacement among the banking institutions
[5] M2 plus deposits placed with other banking institutions

Table A.29
Interest Rates (%)

	Average rates at end-year				Average rates at end-month in 2003											
	1999	2000	2001	2002	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
3-month interbank	3.18	3.25	3.27	3.13	2.91	2.86	2.90	2.86	2.86	2.88	2.88	2.90	2.86	2.88	2.87	2.87
Commercial banks																
Fixed deposit:																
3-month	3.33	3.48	3.21	3.20	3.20	3.20	3.20	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
12-month	3.95	4.24	4.00	4.00	4.00	4.00	4.00	4.00	3.69	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	2.76	2.72	2.28	2.12	2.10	2.07	2.04	2.04	1.95	1.92	1.92	1.87	1.87	1.87	1.86	1.86
Base lending rate (BLR)	6.79	6.78	6.39	6.39	6.39	6.39	6.39	6.39	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Finance companies																
Fixed deposit:																
3-month	3.49	3.52	3.22	3.20	3.20	3.20	3.20	3.20	3.02	3.01	3.00	3.00	3.00	3.00	3.00	3.00
12-month	4.13	4.27	4.01	4.00	4.00	4.00	4.00	4.00	3.72	3.72	3.68	3.68	3.68	3.68	3.68	3.68
Savings deposit	3.50	3.44	2.94	2.65	2.58	2.58	2.57	2.51	2.25	2.22	2.22	2.23	2.23	2.22	2.19	2.18
Base lending rate (BLR)	7.95	7.95	7.45	7.45	7.45	7.45	7.45	7.45	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90
Treasury bills (91 days)	2.71	2.98	2.73	2.82	2.80	2.80	2.79	2.79	2.78	2.77	2.77	2.82	2.82	2.77	2.78	2.77
Government securities (1 year)	3.37	3.36	2.93	2.94	2.89	2.89	2.89	2.88	2.87	2.88	2.95	2.93	2.92	2.86	2.93	2.93
Government securities (5 years)	5.21	4.80	3.18	3.15	3.10	3.12	3.10	3.08	3.05	3.09	3.63	3.93	3.94	4.44	4.38	4.28

Table A.30
Consolidated Public Sector Finance

	1999	2000	2001	2002	2003*e*
	RM million				
General government					
Revenue	70,887	76,002	91,633	96,763	110,408
% growth	*2.2*	*7.2*	*20.6*	*5.6*	*14.1*
Operating expenditure	54,274	64,445	72,299	75,450	84,809
% growth	*8.0*	*18.7*	*12.2*	*4.4*	*12.4*
Current surplus	16,612	11,556	19,334	21,312	25,600
NFPEs					
Revenue	98,242	112,929	104,876	126,275	149,183
% growth	*33.8*	*14.9*	*-7.1*	*20.4*	*18.1*
Operating expenditure	61,596	71,725	65,392	80,951	104,556
% growth	*24.4*	*16.4*	*-8.8*	*23.8*	*29.2*
Current surplus	36,646	41,204	39,484	45,324	44,627
Public sector current surplus	**53,258**	**52,761**	**58,818**	**66,637**	**70,227**
% of GDP	*17.7*	*15.4*	*17.6*	*18.5*	*17.9*
Net development expenditure	46,422	50,439	59,724	69,125	71,951
% growth	*-0.8*	*8.7*	*18.4*	*15.7*	*4.1*
General government	20,964	27,079	35,692	36,828	43,727
% growth	*22.4*	*29.2*	*31.8*	*3.2*	*18.7*
NFPEs	25,458	23,360	24,032	32,297	28,225
% growth	*-14.2*	*-8.2*	*2.9*	*34.4*	*-12.6*
Overall balance	**6,835**	**2,322**	**-906**	**-2,488**	**-1,725**
% of GDP	***2.3***	***0.7***	***-0.3***	***-0.7***	***-0.4***
General government	-4,352	-15,522	-16,358	-15,515	-18,127
NFPEs	11,187	17,844	15,452	13,026	16,402

e Estimate

Source: Ministry of Finance, state governments and non-financial public enterprises

Table A.31
Major Industrial Countries: Key Economic Indicators

	1999	2000	2001	2002	2003*e*	2004*f*
	Annual change (%)					
REAL GDP						
Major Industrial Countries	**3.4**	**3.9**	**1.0**	**1.5**	**2.2**	**2.9**
United States	4.1	3.8	0.3	2.4	3.1	3.9
Japan	0.2	2.8	0.4	-0.4	2.7	2.0
Euro Area	2.8	3.5	1.5	0.9	0.4	1.6
Germany	*2.0*	*2.9*	*0.8*	*0.2*	*-0.1*	*1.2*
United Kingdom	2.4	3.1	2.1	1.7	2.3	2.3
INFLATION						
Major Industrial Countries	**1.4**	**2.2**	**2.2**	**1.5**	**1.8**	**1.3**
United States	2.2	3.4	2.8	1.6	2.3	1.3
Japan	-0.3	-0.9	-0.7	-0.9	-0.3	-0.6
Euro Area	1.1	2.1	2.4	2.3	2.0	1.6
Germany	*0.6*	*1.4*	*1.9*	*1.3*	*1.0*	*0.6*
United Kingdom[1]	2.3	2.1	2.1	2.2	2.8	2.5
	(% of labour force)					
UNEMPLOYMENT						
Major Industrial Countries						
United States	4.2	4.0	4.8	5.8	6.0	5.7
Japan	4.7	4.7	5.0	5.4	5.3	5.4
Euro Area	9.4	8.5	8.0	8.4	9.1	9.2
Germany	*8.4*	*7.8*	*7.9*	*8.6*	*9.5*	*9.8*
United Kingdom	6.0	5.5	5.1	5.2	3.0	5.2
	(% of GDP)					
CURRENT ACCOUNT BALANCE						
Major Industrial Countries						
United States	-3.2	-4.2	-3.9	-4.6	-5.1	-4.7
Japan	2.6	2.5	2.1	2.8	2.9	2.9
Euro Area	0.4	-0.5	0.2	0.9	0.8	0.8
Germany	*-1.1*	*-1.4*	*0.0*	*2.3*	*2.4*	*2.1*
United Kingdom	-2.2	-2.0	-1.3	-0.9	-1.0	-0.9
FISCAL BALANCE						
Major Industrial Countries						
United States	1.2	2.1	0.7	-2.2	-4.3	-4.2
Japan	-8.7	-7.2	-6.7	-6.3	-6.1	-5.4
Germany	-1.3	1.3	-1.1	-1.5	-1.9	-1.7
United Kingdom	1.2	4.1	0.9	-1.4	-2.6	-2.8

[1] Refers to Retail Price Index excluding mortgage interest
e Estimate
f Forecast

Source: IMF World Economic Outlook, September 2003
OECD Economic Outlook, December 2003
Datastream, National Sources

Table A.32
East Asia: Key Economic Indicators

	1999	2000	2001	2002	2003*e*	2004*f*
REAL GDP	Annual change (%)					
Regional Countries	**6.7**	**7.8**	**4.1**	**6.2**	**6.2**	**6.6 ~ 6.8**
The People's Republic of China	7.1	8.0	7.3	8.2	9.1	8.3
Korea	10.9	9.3	3.1	6.3	2.9	5.2
Chinese Taipei	5.4	5.9	-2.2	3.6	3.2	4.7
Singapore	6.4	9.4	-2.4	2.2	1.1	3.5 ~ 5.5
Hong Kong China	3.4	10.2	0.5	2.3	3.3	6.0
Malaysia	6.1	8.5	0.3	4.1	5.2	6.0 ~ 6.5
Thailand	4.4	4.6	1.9	5.4	6.7	6.3 ~ 7.3
Indonesia	0.8	4.9	3.4	3.7	4.1	4.0 ~ 5.0
Philippines	3.4	4.4	3.0	4.4	4.5	4.9 ~ 5.8
CONSUMER PRICES	Annual change (%)					
Regional Countries	**1.3**	**1.2**	**2.4**	**1.3**	**1.8**	**2.4 ~ 2.7**
The People's Republic of China	-2.9	0.4	0.7	-0.8	1.2	3.0
Korea	0.8	2.3	4.1	2.7	3.5	3.0
Chinese Taipei	0.2	1.3	0.0	-0.2	-0.3	0.4
Singapore	0.0	1.3	1.0	-0.4	0.5	0.5 ~ 1.5
Hong Kong China[1]	-4.0	-3.8	-1.6	-3.0	-2.6	-1.0
Malaysia	2.8	1.6	1.4	1.8	1.2	1.5
Thailand	0.3	1.6	1.6	0.7	1.8	1.0 ~ 2.0
Indonesia	24.0	3.8	11.5	11.9	6.6	4.5 ~ 6.5
Philippines	6.7	4.4	6.1	3.1	3.4	4.0 ~ 5.0
CURRENT ACCOUNT BALANCE	(% of GDP)					
Regional Countries						
The People's Republic of China	1.6	1.9	1.5	2.8	1.4	1.3
Korea	6.0	2.7	1.9	1.3	1.6	1.8
Chinese Taipei	2.9	2.9	6.4	9.1	8.5	8.8
Singapore	25.9	16.7	19.0	21.5	23.7	23.0
Hong Kong China	7.3	5.4	7.5	10.8	13.9	14.3
Malaysia	15.9	9.4	8.3	8.5	12.9	12.0
Thailand	10.2	7.6	5.4	6.0	5.3	4.8
Indonesia	4.1	5.3	4.9	4.3	2.7	1.9
Philippines	10.0	11.3	1.8	5.4	2.6	1.9
FISCAL BALANCE[2]	(% of GDP)					
Regional Countries						
The People's Republic of China	-2.1	-2.8	-2.6	-3.0	-2.7	n.a.
Korea	-2.6	1.4	1.8	1.0	1.3	n.a.
Chinese Taipei	-1.3	-3.2	-6.6	-3.0	-2.3	n.a.
Singapore	3.4	2.5	-1.8	0.1	-1.1	n.a.
Hong Kong China	0.8	-0.6	-5.0	-4.9	-4.0	n.a.
Malaysia	-3.2	-5.8	-5.5	-5.6	-5.3	n.a.
Thailand	-3.3	-2.2	-2.4	-1.4	0.3	n.a.
Indonesia	-2.1	-5.1	-2.3	-1.7	-1.9	n.a.
Philippines	-3.8	-4.0	-4.0	-5.2	-4.6	n.a.

1 Refers to composite prices
2 Refers to central government balance
e Estimate
f Forecast
n.a. Not available

Source: National Sources
CEIC
IMF World Economic Outlook, September 2003

Table A.33
Sources and Uses of Funds of the Financial System

	1999	2000	2001	2002	2003*p*
			RM million		
Sources of Funds:					
Capital, reserves and profit	113,197.9	120,990.7	123,863.2	134,871.7	158,808.6
Currency	30,483.1	26,708.9	25,385.4	27,137.4	29,445.4
Demand deposits	75,077.8	83,205.3	92,129.0	87,539.5	92,094.8
Other deposits[1] (of which):	486,187.1	503,079.1	508,836.0	547,135.3	617,353.0
Public sector	*49,282.5*	*45,385.0*	*44,971.3*	*44,767.7*	*40,583.0*
Other financial institutions[2]	*117,586.8*	*110,791.5*	*102,161.7*	*122,405.2*	*161,350.9*
Private sector	*312,338.3*	*339,770.3*	*354,996.6*	*372,884.1*	*406,032.3*
Foreign	*6,979.5*	*7,132.3*	*6,706.4*	*7,078.3*	*9,386.8*
Borrowings	31,949.8	34,820.5	37,380.8	44,948.0	48,035.6
Funds from other financial institutions	69,576.7	67,603.3	68,552.4	70,836.8	88,877.7
Domestic[2]	*52,792.3*	*51,355.6*	*53,448.2*	*46,973.0*	*61,867.4*
Foreign	*16,784.4*	*16,247.7*	*15,104.2*	*23,863.8*	*27,010.3*
Insurance, provident and pension funds	213,892.6	236,640.1	256,000.6	274,384.5	297,068.8
Other liabilities	153,893.9	190,138.4	193,163.0	208,266.6	232,378.1
Total Liabilities	**1,174,258.9**	**1,263,186.3**	**1,305,310.4**	**1,395,119.8**	**1,564,062.0**
Uses of Funds:					
Currency	9,417.1	8,834.4	5,336.7	7,369.8	6,264.4
Deposits with other financial institutions	178,785.1	183,470.2	177,108.1	187,883.0	224,560.8
Domestic	*164,139.5*	*162,274.1*	*156,669.0*	*166,670.3*	*209,345.0*
Foreign	*14,645.6*	*21,196.1*	*20,439.1*	*21,212.7*	*15,215.8*
Bills	16,458.1	16,572.4	16,286.0	19,001.8	16,751.2
Treasury	*3,702.3*	*4,260.4*	*4,063.5*	*5,680.0*	*3,539.8*
Commercial	*12,755.8*	*12,312.0*	*12,222.5*	*13,321.8*	*13,211.4*
Loans and advances	489,449.9	512,428.5	531,745.7	560,459.4	600,844.8
Public sector	*4,418.4*	*5,529.4*	*5,188.8*	*10,191.1*	*8,816.3*
Other financial institutions	*25,672.1*	*26,450.3*	*25,984.9*	*23,746.4*	*23,436.8*
Private sector	*456,557.7*	*477,954.0*	*498,374.6*	*524,393.4*	*566,251.7*
Foreign	*2,801.7*	*2,494.8*	*2,197.4*	*2,128.5*	*2,340.0*
Securities	244,851.6	281,460.8	321,280.5	342,111.4	393,321.3
Malaysian government	*75,441.0*	*88,197.3*	*103,714.8*	*104,354.9*	*124,285.8*
Foreign	*1,516.1*	*1,233.9*	*2,183.0*	*3,189.7*	*3,469.4*
Corporate	*162,996.8*	*186,728.5*	*208,854.7*	*226,671.9*	*258,980.3*
Others	*4,897.7*	*5,301.1*	*6,528.0*	*7,894.9*	*6,585.8*
Gold and forex reserves	113,765.9	109,835.5	113,542.3	127,515.1	166,139.3
Other assets	121,531.2	150,584.5	140,011.1	150,779.3	156,180.2
Total Assets	**1,174,258.9**	**1,263,186.3**	**1,305,310.4**	**1,395,119.8**	**1,564,062.0**

[1] Equals savings, fixed and other (NIF, LPHT, etc.) deposits + NIDs + repos
[2] Effective 1998, the statutory reserves of banking institutions have been reclassified as "Funds from other financial institutions" instead of "Other deposits from other financial institutions"
p Preliminary

Table A.34
Commercial Banks[1]: Commitments and Contingencies

	As at end									
	1999		2000		2001		2002		2003	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	12,091.4	4.7	12,249.3	4.0	11,282.3	3.3	11,440.7	2.7	13,818.0	2.9
Credit extension commitments	131,915.7	50.8	137,597.3	44.4	159,824.0	46.4	167,530.0	39.9	169,490.0	35.8
Direct credit substitutes	17,296.9	6.7	14,999.8	4.8	13,894.6	4.0	12,705.8	3.0	14,156.4	3.0
Foreign exchange related contracts	48,348.1	18.6	84,506.6	27.3	81,445.1	23.6	85,361.0	20.4	101,331.6	21.4
Interest rate related contracts	13,174.3	5.1	15,987.1	5.2	32,667.8	9.5	90,528.5	21.6	121,497.6	25.7
Trade-related contingencies	6,914.2	2.7	14,785.5	4.8	13,465.3	3.9	17,438.5	4.2	19,404.9	4.1
Transaction-related contingencies	17,959.4	6.9	18,485.7	6.0	19,025.6	5.5	20,639.0	4.9	20,448.1	4.3
Underwriting obligations	1,858.1	0.7	1,664.4	0.5	1,768.1	0.5	1,952.0	0.5	1,818.4	0.4
Others	9,954.6	3.8	9,518.3	3.1	11,293.9	3.3	11,838.6	2.8	11,600.3	2.4
Total	**259,512.7**	**100.0**	**309,794.0**	**100.0**	**344,666.6**	**100.0**	**419,434.0**	**100.0**	**473,565.2**	**100.0**

[1] Excludes Islamic banks
Note: Numbers may not necessarily add up due to rounding

Table A.35
Finance Companies: Commitments and Contingencies

	As at end									
	1999		2000		2001		2002		2003	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	5,536.1	32.3	8,186.1	41.8	9,990.7	48.9	13,983.8	53.0	13,010.2	51.4
Credit extension commitments	9,654.0	56.3	9,640.4	49.2	8,779.9	43.0	9,136.1	34.6	9,241.1	36.5
Direct credit substitutes	968.6	5.6	611.0	3.1	198.3	1.0	141.6	0.5	136.3	0.5
Foreign exchange related contracts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest rate related contracts	667.0	3.9	1,007.0	5.1	1,389.0	6.8	3,109.0	11.8	2,929.0	11.6
Trade-related contingencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transaction-related contingencies	18.8	0.1	41.6	0.2	40.7	0.2	29.1	0.1	15.9	0.1
Underwriting obligations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	306.5	1.8	105.4	0.5	32.6	0.2	0.0	0.0	0.0	0.0
Total	**17,150.9**	**100.0**	**19,591.7**	**100.0**	**20,431.3**	**100.0**	**26,399.5**	**100.0**	**25,332.6**	**100.0**

Note: Numbers may not necessarily add up due to rounding

Table A.36
Merchant Banks: Commitments and Contingencies

	As at end									
	1999		2000		2001		2002		2003	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	302.0	1.4	161.0	0.6	1,425.5	2.9	1,736.0	2.2	1,595.2	1.3
Credit extension commitments	4,967.8	23.1	4,114.8	16.0	2,639.7	5.4	2,089.1	2.7	2,444.0	2.0
Direct credit substitutes	4,310.6	20.1	2,111.4	8.2	1,325.1	2.7	1,039.3	1.3	1,228.6	1.0
Foreign exchange related contracts	707.7	3.3	964.7	3.8	1,320.1	2.7	1,506.6	1.9	1,459.9	1.2
Interest rate related contracts	9,372.8	43.7	15,686.3	61.0	39,658.8	81.2	70,701.1	89.7	115,332.1	93.0
Trade-related contingencies	0.1	0.0	1.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Transaction-related contingencies	1,014.5	4.7	886.0	3.4	790.4	1.6	749.0	1.0	818.2	0.7
Underwriting obligations	717.0	3.3	1,653.5	6.4	1,617.5	3.3	937.5	1.2	1,138.9	0.9
Others	76.5	0.4	118.3	0.5	80.0	0.2	44.1	0.1	55.4	0.0
Total	**21,469.1**	**100.0**	**25,697.1**	**100.0**	**48,857.2**	**100.0**	**78,802.7**	**100.0**	**124,072.3**	**100.0**

Note: Numbers may not necessarily add up to rounding

Table A.37
Commercial Banks[1]: Income and Expenditure

	For the financial year			For the calendar year		
	2000	2001	2002	2001	2002	2003*p*
	RM million					
Interest income net of interest-in-suspense	25,416.7	24,969.7	25,157.7	25,472.5	25,055.5	26,533.4
(Interest-in-suspense)	*3,148.8*	*3,488.2*	*3,959.0*	*4,087.2*	*3,759.7*	*3,169.2*
Less: Interest expense	13,455.8	12,961.4	12,876.2	13,341.4	12,808.6	13,505.2
Net interest income	11,960.9	12,008.4	12,281.5	12,131.0	12,247.0	13,028.2
Add: Fee-based income	2,304.3	2,429.6	2,827.1	2,552.7	2,871.8	3,213.2
Less: Staff cost	3,299.6	3,624.3	3,635.1	3,768.7	3,688.1	3,907.9
Overheads	3,288.6	3,641.8	4,116.4	3,881.9	4,175.3	4,521.8
Gross operating profit	7,677.0	7,171.9	7,357.1	7,033.2	7,255.3	7,811.8
Less: Loan loss provisions	4,204.3	6,003.2	3,984.2	6,195.6	3,807.4	3,556.3
Gross operating profit after provision	3,472.8	1,168.7	3,372.8	837.6	3,447.9	4,255.5
Add: Other income	2,648.7	3,475.6	2,986.8	3,669.4	2,909.4	2,652.3
Pre-tax profit	**6,121.4**	**4,644.3**	**6,359.7**	**4,507.1**	**6,357.3**	**6,907.8**

[1] Excludes Islamic banks
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.38
Finance Companies: Income and Expenditure

	For the financial year			For the calendar year		
	2000	2001	2002	2001	2002	2003*p*
	RM million					
Interest income net of interest-in-suspense	9,002.4	7,637.4	9,299.7	8,865.2	8,824.1	9,250.6
(Interest-in-suspense)	*1,153.7*	*1,161.5*	*1,452.4*	*1,330.6*	*1,521.6*	*1,361.7*
Less: Interest expense	4,867.1	3,375.8	4,094.5	3,947.5	3,884.2	4,020.8
Net interest income	4,135.3	4,261.6	5,205.1	4,917.7	4,939.8	5,229.8
Add: Fee-based income	116.9	224.8	103.0	132.9	104.2	101.1
Less: Staff cost	683.6	663.0	802.1	772.9	783.0	812.7
Overheads	907.9	786.8	1,093.9	1,017.8	1,018.5	959.8
Gross operating profit	2,660.7	3,036.6	3,412.2	3,259.9	3,242.6	3,558.4
Less: Loan loss provisions	1,681.7	1,371.6	1,524.4	1,659.1	1,370.9	1,397.3
Gross operating profit after provision	979.0	1,664.9	1,887.8	1,600.8	1,871.7	2,161.1
Add: Other income	482.5	369.2	524.2	520.0	507.7	516.6
Pre-tax profit	**1,461.5**	**2,034.1**	**2,412.0**	**2,120.8**	**2,379.4**	**2,677.7**

p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.39
Merchant Banks: Income and Expenditure

	For the financial year			For the calendar year		
	2000	2001	2002	2001	2002	2003*p*
	RM million					
Interest income net of interest-in-suspense	1,803.4	1,783.7	1,714.3	1,728.8	1,601.0	1,636.5
(Interest-in-suspense)	*421.7*	*313.8*	*328.1*	*311.9*	*296.8*	*220.9*
Less: Interest expense	1,205.2	1,176.9	1,138.7	1,146.7	1,070.1	1,146.6
Net interest income	598.2	606.8	575.5	582.1	530.9	489.9
Add: Fee-based income	288.3	296.3	306.2	277.8	338.2	327.6
Less: Staff cost	147.3	204.9	214.8	204.2	226.5	260.6
Overheads	116.9	118.1	117.0	118.6	121.3	132.2
Gross operating profit	622.2	580.1	549.9	537.1	521.2	424.6
Less: Loan loss provisions	513.4	894.7	371.6	942.6	318.2	322.7
Gross operating profit after provision	108.8	-314.6	178.3	-405.5	203.1	101.9
Add: Other income	439.6	624.6	488.3	700.3	388.3	590.2
Pre-tax profit	**548.4**	**310.0**	**666.6**	**294.8**	**591.3**	**692.1**

p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.40
Commercial Banks[1]: Lending Guidelines to the Priority Sectors

	Compliance Date of 31 December 2002				2003/2004 Lending Guidelines (Compliance Date of 31 December 2004)	
	2000 Lending Guidelines		2002 Lending Guidelines			
	Target	Achieved	Target	Achieved	Target	Achieved[3]
Loans to Bumiputera community						
Total outstanding loans (RM billion)			94.8	93.1		
Total outstanding loans (%)			30.0	29.4		
Non-compliance (no. of institutions)				12		
Housing Loan Commitments[2]						
Total number of houses (units)	112,515	170,571			78,114	32,825
Non-compliance (no. of institutions)		3				
Loans to Small and Medium Enterprises						
Total loans approved (RM billion)					20.6	9.07

[1] Excluding performance of Islamic banks
[2] Compliance date for 2000 Lending Guideline in respect of housing loan commitments has been extended from end-December 2001 to end-December 2002
[3] Target achieved as at 31 December 2003

Table A.41
Finance Companies: Lending Guidelines to the Priority Sectors

	Compliance Date of 31 December 2002				2003/2004 Lending Guidelines (Compliance Date of 31 December 2004)	
	2000 Lending Guidelines		2002 Lending Guidelines			
	Target	Achieved	Target	Achieved	Target	Achieved[2]
Loans to Bumiputera community						
Total outstanding loans (RM billion)			27.8	44.4		
Total outstanding loans (%)			30.0	47.9		
Non-compliance (no. of institutions)				1		
Housing Loan Commitments[1]						
Total number of houses (units)	31,200	46,989			18,935	5,675
Non-compliance (no. of institutions)		3				
Loans to Small and Medium Enterprises						
Total loans approved (RM billion)					6.8	1.92

[1] Compliance date for 2000 Lending Guideline in respect of housing loan commitments has been extended from end-December 2001 to end-December 2002
[2] Target achieved as at 31 December 2003

Table A.42
Commercial Banks[1]: Direction of Lending

Loans by Sectors	As at end			
	2002		2003	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	10,278.1	3.0	9,292.4	2.6
Mining and quarrying	835.1	0.3	942.1	0.3
Manufacturing	56,750.3	16.8	56,666.8	15.9
Electricity, gas and water supply	5,985.7	1.8	4,630.5	1.3
Wholesale and retail trade, restaurants and hotels	32,892.1	9.7	34,878.6	9.8
Wholesale trade	*19,351.1*	*5.7*	*20,472.9*	*5.8*
Retail trade	*9,868.3*	*2.9*	*10,448.7*	*2.9*
Restaurants and hotels	*3,672.7*	*1.1*	*3,957.0*	*1.1*
Broad property sector	144,345.1	42.7	160,346.9	45.0
Construction	*24,189.9*	*7.2*	*22,453.8*	*6.3*
Purchase of residential property	*86,246.4*	*25.5*	*101,829.3*	*28.6*
Purchase of non-residential property	*22,551.3*	*6.7*	*24,240.1*	*6.8*
Real estate	*11,357.5*	*3.4*	*11,823.7*	*3.3*
Transport, storage and communication	7,608.2	2.3	8,233.1	2.3
Financial, insurance and business services	27,524.0	8.1	27,296.2	7.7
Financial services	*19,830.7*	*5.9*	*19,990.1*	*5.6*
Insurance	*588.4*	*0.2*	*192.1*	*0.1*
Business services	*7,104.9*	*2.1*	*7,113.9*	*2.0*
Consumption credit	23,436.5	6.9	25,627.6	7.2
Personal uses	*13,541.7*	*4.0*	*14,188.3*	*4.0*
Credit cards	*8,990.2*	*2.7*	*10,577.6*	*3.0*
Purchase of consumer durables	*368.5*	*0.1*	*351.5*	*0.1*
Purchase of passenger cars	*536.0*	*0.2*	*510.1*	*0.1*
Purchase of securities	15,707.8	4.6	14,546.8	4.1
Purchase of transport vehicles	465.5	0.1	726.4	0.2
Community, social and personal services	4,552.2	1.4	3,807.7	1.1
Others	7,860.9	2.3	9,014.0	2.5
Total loans outstanding[2]	**338,241.5**	**100.0**	**356,009.1**	**100.0**

[1] Including Islamic banks
[2] Including loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.43
Finance Companies: Direction of Lending

Loans by Sectors	As at end			
	2002		2003	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	562.9	0.6	569.4	0.5
Mining and quarrying	113.0	0.1	106.3	0.1
Manufacturing	2,513.9	2.5	2,766.3	2.6
Electricity, gas and water supply	50.1	0.1	50.8	0.1
Wholesale and retail trade, restaurants and hotels	3,466.0	3.5	3,638.1	3.4
Wholesale trade	*1,361.7*	*1.4*	*1,428.8*	*1.3*
Retail trade	*1,576.1*	*1.6*	*1,626.0*	*1.5*
Restaurants and hotels	*528.1*	*0.5*	*583.3*	*0.6*
Broad property sector	25,880.9	25.8	25,533.5	23.9
Construction	*5,504.1*	*5.5*	*5,333.9*	*5.0*
Purchase of residential property	*14,042.2*	*14.0*	*14,647.6*	*13.7*
Purchase of non-residential property	*4,895.8*	*4.9*	*4,409.8*	*4.1*
Real estate	*1,438.7*	*1.4*	*1,142.1*	*1.1*
Transport, storage and communication	1,785.2	1.8	1,651.8	1.5
Financial, insurance and business services	1,419.2	1.4	1,381.0	1.3
Financial services	*271.5*	*0.3*	*237.3*	*0.2*
Insurance	*16.5*	*0.0*	*14.5*	*0.0*
Business services	*1,131.2*	*1.1*	*1,129.2*	*1.1*
Consumption credit	56,880.5	56.6	63,585.1	59.5
Personal uses	*789.5*	*0.8*	*958.9*	*0.9*
Credit cards	*1,601.2*	*1.6*	*1,658.8*	*1.6*
Purchase of consumer durables	*38.9*	*0.0*	*21.3*	*0.0*
Purchase of passenger cars	*54,450.9*	*54.2*	*60,946.1*	*57.0*
Purchase of securities	3,950.5	3.9	3,637.4	3.4
Purchase of transport vehicles	2,570.1	2.6	2,577.4	2.4
Community, social and personal services	962.0	1.0	1,065.8	1.0
Others	317.6	0.3	366.7	0.3
Total loans outstanding[1]	**100,471.7**	**100.0**	**106,929.6**	**100.0**

[1] Including loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.44
Merchant Banks: Direction of Lending

Loans by Sectors	As at end			
	2002		2003	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	807.4	6.0	652.3	5.9
Mining and quarrying	69.2	0.5	47.7	0.4
Manufacturing	2,012.1	14.9	1,667.9	15.1
Electricity, gas and water supply	779.8	5.8	384.7	3.5
Wholesale and retail trade, restaurants and hotels	705.2	5.2	655.3	5.9
Wholesale trade	*156.5*	*1.2*	*97.4*	*0.9*
Retail trade	*148.3*	*1.1*	*92.8*	*0.8*
Restaurants and hotels	*400.4*	*3.0*	*465.1*	*4.2*
Broad property sector	3,859.9	28.6	2,858.8	25.9
Construction	*2,495.3*	*18.5*	*1,708.0*	*15.5*
Purchase of residential property	*77.1*	*0.6*	*78.2*	*0.7*
Purchase of non-residential property	*209.0*	*1.6*	*150.0*	*1.4*
Real estate	*1,078.4*	*8.0*	*922.6*	*8.3*
Transport, storage and communication	363.0	2.7	845.3	7.7
Financial, insurance and business services	938.3	6.9	633.1	5.7
Financial services	*768.2*	*5.7*	*535.2*	*4.8*
Insurance	*0.0*	*0.0*	*0.0*	*0.0*
Business services	*170.2*	*1.3*	*97.9*	*0.9*
Consumption credit	40.3	0.3	57.0	0.5
Personal uses	*21.1*	*0.2*	*35.5*	*0.3*
Purchase of consumer durables	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of passenger cars	*19.1*	*0.1*	*21.5*	*0.2*
Purchase of securities	1,981.6	14.7	1,709.4	15.5
Purchase of transport vehicles	0.3	0.0	0.5	0.0
Community, social and personal services	203.9	1.5	98.4	0.9
Others	1,720.0	12.8	1,432.6	13.0
Total loans outstanding[1]	**13,481.0**	**100.0**	**11,042.9**	**100.0**

[1] Including loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.45
Commercial Banks[1]: Non-performing Loans by Sector

	As at end									
	NPL by sector					As percentage of total loans to the sector				
	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003
	RM million					%				
Business enterprises	**26,337.1**	**28,164.7**	**37,022.8**	**32,900.4**	**28,993.1**	**12.6**	**13.2**	**17.6**	**15.9**	**14.0**
Households	**6,436.8**	**6,865.3**	**8,616.2**	**9,882.3**	**11,017.8**	**8.6**	**7.9**	**8.7**	**8.6**	**8.4**
Others	**677.6**	**630.6**	**1,273.1**	**1,150.0**	**866.9**	**10.5**	**6.9**	**15.6**	**15.0**	**9.8**
Total	**33,451.5**	**35,660.6**	**46,912.1**	**43,932.7**	**40,877.8**					
Agriculture, hunting, forestry and fishing	533.8	556.3	737.6	825.7	672.1	7.3	6.0	7.4	8.2	7.4
Mining and quarrying	160.4	150.4	173.8	109.2	101.3	14.8	13.1	17.4	13.6	10.9
Manufacturing	6,765.7	7,714.6	10,662.9	10,857.5	8,634.9	12.5	13.7	19.1	19.7	15.7
Electricity, gas and water supply	31.0	179.5	208.7	196.3	1,316.8	0.5	2.6	4.8	3.5	28.7
Wholesale and retail trade, restaurants and hotels	3,633.1	4,021.8	4,219.0	3,524.6	3,823.9	12.1	12.9	13.4	10.8	11.1
Wholesale trade	*1,656.6*	*1,869.6*	*1,924.1*	*1,630.5*	*1,570.5*	*9.9*	*10.5*	*10.6*	*8.6*	*7.8*
Retail trade	*1,081.3*	*1,057.6*	*1,127.9*	*1,007.9*	*1,248.2*	*12.2*	*11.5*	*12.0*	*10.3*	*12.1*
Restaurants and hotels	*895.2*	*1,094.6*	*1,166.9*	*886.2*	*1,005.2*	*19.6*	*25.6*	*29.5*	*24.2*	*25.5*
Broad property sector	12,598.3	13,818.5	18,951.2	18,635.3	17,713.1	11.7	11.8	14.7	13.3	11.4
Construction	*5,185.6*	*5,395.4*	*7,366.9*	*6,508.3*	*5,065.8*	*19.9*	*21.3*	*30.3*	*28.5*	*24.0*
Purchase of residential property	*3,198.2*	*3,342.8*	*4,939.3*	*6,425.2*	*7,523.5*	*6.6*	*5.7*	*7.0*	*7.7*	*7.6*
Purchase of non-residential property	*2,143.5*	*2,540.4*	*2,839.0*	*2,785.1*	*2,584.9*	*10.0*	*12.0*	*13.3*	*12.8*	*11.1*
Real estate	*2,071.0*	*2,539.9*	*3,806.0*	*2,916.7*	*2,538.9*	*17.8*	*21.4*	*30.1*	*25.8*	*21.6*
Transport, storage and communication	1,289.0	1,090.8	796.1	751.5	776.7	12.6	12.5	10.5	10.0	9.6
Finance, insurance and business services	2,997.1	2,387.7	3,856.6	2,361.8	1,808.7	11.0	8.4	13.0	8.7	6.7
Consumption credit	1,809.2	2,016.7	1,986.3	2,082.7	2,198.4	10.7	10.8	9.9	9.3	9.0
Personal use	*1,433.6*	*1,661.6*	*1,621.2*	*1,675.4*	*1,681.5*	*12.1*	*13.8*	*13.2*	*12.8*	*12.3*
Credit cards	*212.5*	*290.6*	*312.6*	*364.1*	*477.7*	*5.0*	*4.9*	*4.3*	*4.1*	*4.6*
Purchase of consumer durable goods	*163.0*	*64.5*	*52.5*	*43.1*	*39.2*	*21.1*	*9.3*	*12.1*	*13.3*	*12.6*
Purchase of transport vehicle[2]	450.6	409.8	226.7	179.7	135.1	26.4	37.4	18.9	30.8	27.1
Purchase of securities	1,957.4	2,192.1	2,927.7	2,389.6	2,321.6	12.9	14.4	20.7	15.5	16.2
Community, social and personal services	548.0	491.7	892.3	868.8	508.4	9.9	10.5	19.5	19.3	13.6

[1] Excludes Islamic banks
[2] Includes commercial vehicles
Note: Numbers may not necessarily add-up due to rounding

Table A.46
Finance Companies: Non-performing Loans by Sector

	As at end									
	NPL by sector					As percentage of total loans to the sector				
	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003
	RM million					%				
Business enterprises	**8,012.4**	**7,904.3**	**9,026.6**	**8,474.9**	**7,498.8**	**25.4**	**28.2**	**33.6**	**34.3**	**31.3**
Households	**6,318.2**	**6,205.9**	**6,046.7**	**5,747.9**	**5,605.6**	**13.0**	**11.2**	**9.2**	**7.6**	**6.8**
Others	**84.6**	**145.2**	**220.7**	**135.6**	**94.0**	**12.5**	**30.9**	**56.4**	**42.7**	**25.6**
Total	**14,415.2**	**14,255.4**	**15,294.0**	**14,358.4**	**13,198.4**					
Agriculture, hunting, forestry and fishing	117.2	120.3	100.0	59.9	55.2	14.8	16.4	15.6	10.6	9.7
Mining and quarrying	70.0	59.4	70.3	45.6	37.5	27.4	31.8	40.0	40.4	35.3
Manufacturing	1,031.5	768.1	870.8	859.1	644.4	31.6	26.6	29.0	34.2	23.3
Electricity, gas and water supply	16.8	15.9	16.7	17.8	5.9	22.6	26.9	35.5	35.6	11.7
Wholesale and retail trade, restaurants and hotels	546.4	511.8	568.2	610.7	536.1	15.3	15.6	17.0	17.6	14.7
Wholesale trade	*255.1*	*153.9*	*158.0*	*191.5*	*148.5*	*21.2*	*13.7*	*11.8*	*14.1*	*10.4*
Retail trade	*174.8*	*210.0*	*203.4*	*189.1*	*152.3*	*11.2*	*13.0*	*13.5*	*12.0*	*9.4*
Restaurants and hotels	*116.5*	*147.9*	*206.7*	*230.1*	*235.3*	*14.7*	*27.3*	*40.9*	*43.6*	*40.3*
Broad property sector	4,979.5	5,910.6	6,919.0	6,900.2	7,084.4	18.9	23.3	26.6	26.7	27.7
Construction	*1,989.4*	*2,060.3*	*2,328.8*	*2,139.7*	*2,234.4*	*27.3*	*33.6*	*38.7*	*38.9*	*41.9*
Purchase of residential property	*1,211.9*	*1,712.2*	*1,801.9*	*2,058.7*	*2,284.7*	*10.2*	*13.8*	*13.8*	*14.7*	*15.6*
Purchase of non-residential property	*1,227.8*	*1,551.1*	*1,998.5*	*1,945.2*	*1,967.1*	*22.0*	*29.2*	*36.8*	*39.7*	*44.6*
Real estate	*550.3*	*587.0*	*789.8*	*756.6*	*598.3*	*32.2*	*38.4*	*51.2*	*52.6*	*52.4*
Transport, storage and communication	564.0	750.2	735.3	616.7	339.5	24.1	36.1	39.5	34.5	20.6
Finance, insurance and business services	841.4	554.7	637.0	604.0	433.8	37.8	28.2	43.7	42.6	31.4
Consumption credit	268.0	313.7	354.7	264.6	287.1	12.0	13.8	14.4	10.9	10.9
Personal use	*178.8*	*210.8*	*239.4*	*180.0*	*186.0*	*17.9*	*26.3*	*26.5*	*22.8*	*19.4*
Credit cards	*62.7*	*87.2*	*96.8*	*70.1*	*96.1*	*5.7*	*6.4*	*6.4*	*4.4*	*5.8*
Purchase of consumer durable goods	*26.5*	*15.8*	*18.5*	*14.5*	*5.0*	*19.4*	*15.1*	*46.8*	*37.2*	*23.3*
Purchase of transport vehicle[1]	3,973.5	3,507.6	3,203.0	2,843.7	2,578.1	12.7	9.2	6.7	5.0	4.1
Purchase of securities	1,729.6	1,344.7	1,374.2	1,161.7	911.5	25.1	22.8	28.7	29.4	25.1
Community, social and personal services	192.6	253.2	224.2	238.8	190.7	19.6	27.5	23.5	24.8	17.9

[1] Includes commercial vehicles
Note: Numbers may not necessarily add-up due to rounding

Table A.47
Merchant Banks: Non-performing Loans by Sector

	As at end									
	NPL by sector					As percentage of total loans to the sector				
	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003
	RM million					%				
Business enterprises	**3,131.7**	**2,464.6**	**3,597.7**	**3,222.7**	**2,314.5**	**20.2**	**17.7**	**30.4**	**30.3**	**26.8**
Households	**562.1**	**464.1**	**453.4**	**423.2**	**283.9**	**35.1**	**26.4**	**37.2**	**38.2**	**28.7**
Others	**70.6**	**155.5**	**333.3**	**343.0**	**220.2**	**4.0**	**9.3**	**21.2**	**19.9**	**15.4**
Total	**3,764.4**	**3,084.2**	**4,384.4**	**3,988.9**	**2,818.6**					
Agriculture, hunting, forestry and fishing	39.5	25.9	86.5	47.3	22.0	5.3	2.5	10.0	5.9	3.4
Mining and quarrying	0.0	0.4	0.5	4.1	4.4	0.0	0.5	0.5	5.9	9.1
Manufacturing	475.7	383.1	891.5	792.5	538.1	20.3	17.2	40.4	39.4	32.3
Electricity, gas and water supply	54.2	57.5	133.4	208.4	118.0	6.8	8.2	29.3	26.7	30.7
Wholesale and retail trade, restaurants and hotels	93.1	195.9	197.4	181.4	217.6	7.8	20.7	24.5	25.7	33.2
Wholesale trade	*48.4*	*35.2*	*45.4*	*29.8*	*9.8*	*14.1*	*12.6*	*26.3*	*19.0*	*10.0*
Retail trade	*20.0*	*32.8*	*33.1*	*5.6*	*6.5*	*8.5*	*15.4*	*17.4*	*3.7*	*7.0*
Restaurants and hotels	*24.7*	*127.9*	*118.8*	*146.1*	*201.3*	*4.0*	*28.2*	*26.8*	*36.5*	*43.3*
Broad property sector	1,372.0	1,144.9	1,477.3	1,282.0	1,004.6	24.1	23.9	33.7	33.2	35.1
Construction	*852.0*	*565.5*	*807.5*	*756.6*	*531.2*	*23.6*	*18.3*	*28.8*	*30.3*	*31.1*
Purchase of residential property	*25.9*	*0.4*	*0.7*	*0.2*	*0.1*	*24.8*	*0.5*	*0.9*	*0.3*	*0.2*
Purchase of non-residential property	*76.2*	*68.2*	*91.3*	*70.9*	*65.9*	*22.4*	*30.2*	*36.9*	*33.9*	*43.9*
Real estate	*417.9*	*510.8*	*577.8*	*454.3*	*407.3*	*25.5*	*36.1*	*45.8*	*42.1*	*44.1*
Transport, storage and communication	229.0	79.6	63.6	38.4	22.9	18.2	8.2	10.7	10.6	2.7
Finance, insurance and business services	354.2	87.9	187.2	139.4	85.6	22.2	7.1	18.2	14.9	13.5
Consumption credit	6.7	12.9	13.2	12.2	11.5	17.9	35.2	40.4	57.4	32.4
Personal use	*6.7*	*12.9*	*13.2*	*12.2*	*11.5*	*18.0*	*35.3*	*40.5*	*57.5*	*32.5*
Credit cards	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of transport vehicle[1]	0.1	0.0	0.1	0.1	0.1	0.6	0.3	1.1	0.6	0.4
Purchase of securities	1,058.9	901.8	878.9	821.5	544.4	36.5	27.5	40.0	41.5	31.8
Community, social and personal services	10.4	38.9	121.6	118.7	29.2	2.3	10.2	33.1	58.2	29.7

[1] Includes commercial vehicles

Note: Numbers may not necessarily add-up due to rounding

Table A.48
Islamic Banking System: Sources and Uses of Funds

	As at end							
	2002				2003*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Sources								
Capital and reserves	1,398	3,305	4,703	6.9	1,523	5,261	6,784	8.3
Deposits	16,421	36,885	53,306	78.3	17,584	42,628	60,212	73.2
Funds from other financial institutions	555	3,889	4,444	6.5	113	6,872	6,985	8.5
Other liabilities	1,786	3,831	5,617	8.3	1,734	6,481	8,215	10.0
Total	**20,160**	**47,910**	**68,070**	**100.0**	**20,954**	**61,242**	**82,196**	**100.0**
Uses								
Cash	200	40	240	0.3	231	24	255	0.3
Reserves with Bank Negara Malaysia	549	647	1,196	1.8	587	930	1,517	1.9
Deposits with other financial institutions	3,215	4,520	7,735	11.4	3,239	5,743	8,982	10.9
Financing	9,158	27,560	36,718	53.9	9,764	38,851	48,615	59.2
Securities	5,721	13,556	19,277	28.3	5,764	16,790	22,554	27.4
Other assets	1,317	1,587	2,904	4.3	1,369	-1,096[1]	273	0.3
Total	**20,160**	**47,910**	**68,070**	**100.0**	**20,954**	**61,242**	**82,196**	**100.0**

[1] Denotes the interbranch balances pending settlement
p Preliminary

Table A.49
Islamic Banking System: Commitments and Contingencies

	As at end							
	2002				2003*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Assets sold with recourse and commitments with drawdown	48	1,483	1,531	8.9	45	1,950	1,995	8.6
Credit extension commitments	1,215	5,348	6,563	38.1	1,418	8,287	9,705	42.0
Direct credit substitutes	448	373	821	4.8	503	357	860	3.7
Foreign exchange related contracts	156	–	156	0.9	189	–	189	0.8
Trade-related contingencies	986	5,290	6,276	36.5	1,103	6,429	7,532	32.6
Transaction-related contingencies	899	443	1,342	7.8	1,157	634	1,791	7.8
Underwriting obligations	–	315	315	1.8	60	510	570	2.5
Others	31	181	212	1.2	64	392	456	2.0
Total	**3,783**	**13,433**	**17,216**	**100.0**	**4,539**	**18,559**	**23,098**	**100.0**

p Preliminary

Table A.50
Islamic Banking System: Income and Expenditure

	For the financial year						For the calendar year					
	2002			2003*p*			2002			2003*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million											
Finance income[1] net of income-in-suspense	627.9	1,768.6	2,396.5	596.9	2,266.5	2,863.4	1,096.0	2,300.9	3,195.7	925.1	2,944.8	3,869.9
(Income-in-suspense)	*201.1*	*154.0*	*355.1*	*51.6*	*141.9*	*193.5*	*201.2*	*171.9*	*373.1*	*95.0*	*210.8*	*305.8*
Less: Finance expense	291.2	848.2	1,139.4	265.4	966.5	1,231.9	625.2	1,144.8	1,568.8	403.0	1,285.5	1,688.5
Net finance income	336.7	920.4	1,257.1	331.5	1,300.0	1,631.5	470.8	1,156.1	1,626.9	522.1	1,659.3	2,181.4
Add: Non-finance income	77.2	215.5	292.7	82.5	356.9	439.4	116.1	378.9	495.0	111.9	615.4	727.3
Less: Provisions	129.4	377.4	506.8	125.6	759.2	884.8	143.7	562.3	706.0	163.3	1,155.7	1,319.0
Staff cost	105.9	51.2	157.1	104.7	73.5	178.2	139.0	60.0	199.0	145.2	83.3	228.5
Overheads	102.3	83.1	185.4	131.3	144.0	275.3	148.5	120.6	269.1	196.0	188.0	384.0
Pre-tax profit	**76.3**	**624.2**	**700.5**	**52.4**	**680.2**	**732.6**	**155.7**	**792.1**	**947.8**	**129.5**	**847.7**	**977.2**

[1] Finance income includes income from securities
p Preliminary

Table A.51
Islamic Banking System: Financing Activities

	For the year					
	2002			2003*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Financing approvals	2,056.1	10,253.7	12,309.8	1,999.2	14,740.0	16,739.2
Financing disbursements	7,242.9	16,944.4	24,187.3	8,114.9	28,046.6	36,161.5
Financing repayments	6,561.0	14,214.9	20,775.9	7,680.7	18,560.6	26,241.3
	As at end					
	2002			2003*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Outstanding financing	9,158.2	27,559.5	36,717.7	9,764.5	38,850.8	48,615.3

p Preliminary

Table A.52
Islamic Banking System: Financing to Small and Medium-Sized Enterprises

	As at end					
	2002			2003*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Total outstanding financing	823.2	2,674.4	3,497.6	1,759.0	4,407.2	6,166.2
Total non-performing financing	–	–	–	322.9	289.1	612.0

p Preliminary

Table A.53
Islamic Banking System: Direction of Financing

	As at end							
	2002				2003*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Agriculture, hunting, forestry and fishing	267.3	1,326.7	1,594.0	4.3	202.2	1,659.4	1,861.6	3.9
Mining and quarrying	29.5	45.0	74.5	0.2	15.0	48.5	63.5	0.1
Manufacturing	1,659.5	2,221.7	3,881.2	10.6	1,529.7	2,857.1	4,386.8	9.0
Electricity, gas and water	390.6	143.1	533.7	1.5	43.0	205.9	248.9	0.5
Community, social and personal services	39.5	174.4	213.9	0.6	63.7	239.6	303.3	0.6
Broad property sector	4,682.6	11,053.1	15,735.7	42.8	5,305.2	15,177.5	20,482.7	42.1
Real estate	*52.5*	*616.8*	*669.3*	*1.8*	*90.6*	*721.3*	*811.9*	*1.7*
Construction	*1,318.2*	*960.0*	*2,278.2*	*6.2*	*1,328.5*	*1,605.0*	*2,933.5*	*6.0*
Purchase of residential property	*2,451.9*	*8,310.9*	*10,762.8*	*29.3*	*3,022.2*	*11,322.0*	*14,344.2*	*29.5*
Purchase of non-residential property	*860.0*	*1,165.4*	*2,025.4*	*5.5*	*863.9*	*1,529.2*	*2,393.1*	*4.9*
Wholesale, retail, restaurants and hotels	391.6	994.8	1,386.4	3.8	405.9	1,391.1	1,797.0	3.7
Transport, storage and communication	100.1	724.7	824.8	2.2	152.8	871.5	1,024.3	2.1
Finance, insurance and business services	158.0	1,113.7	1,271.7	3.5	261.6	1,671.7	1,933.3	4.0
Purchase of securities	248.0	687.0	935.0	2.5	226.7	694.2	920.9	1.9
Consumption credit	900.7	8,386.5	9,287.2	25.3	1,431.4	13,440.7	14,872.1	30.6
Credit cards	*27.8*	*32.7*	*60.5*	*0.2*	*90.3*	*65.9*	*156.2*	*0.3*
Personal uses	*409.9*	*651.7*	*1,061.6*	*2.9*	*562.0*	*1,075.1*	*1,637.1*	*3.4*
Purchase of consumer durables	*44.7*	*18.6*	*63.3*	*0.2*	*40.3*	*13.8*	*54.1*	*0.1*
Purchase of transport vehicles	*418.3*	*7,683.5*	*8,101.8*	*22.1*	*738.8*	*12,285.9*	*13,024.7*	*26.8*
Others	290.8	688.8	979.6	2.7	127.3	593.6	720.9	1.5
Total	**9,158.2**	**27,559.5**	**36,717.7**	**100.0**	**9,764.5**	**38,850.8**	**48,615.3**	**100.0**

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Table A.54
Islamic Banking System: Non-performing Financing by Sector[1]

	As at end								
	NPF by sector						Change	As percentage of total financing to sector	
	2002			2003*p*				2002	2003*p*
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total			
	RM million						%		
Agriculture, hunting, forestry and fishing	34.4	42.2	76.6	32.0	44.4	76.4	-0.3	4.8	4.1
Mining and quarrying	4.7	0.2	4.9	4.8	0.2	5.0	2.0	6.6	7.9
Manufacturing	208.3	165.5	373.8	202.2	163.9	366.1	-2.1	9.6	8.4
Electricity, gas and water	1.7	0.1	1.8	4.1	...	4.1	127.8	0.3	1.6
Community, social and personal services	13.0	28.7	41.7	27.8	17.2	45.0	7.9	19.5	14.8
Broad property sector	706.9	1,426.5	2,133.4	865.3	1,955.6	2,820.9	32.2	13.6	13.8
Real estate	*0.9*	*267.9*	*268.8*	*0.1*	*285.4*	*285.5*	*6.2*	*40.2*	*35.2*
Construction	*278.8*	*144.3*	*423.1*	*359.8*	*237.8*	*597.6*	*41.2*	*18.6*	*20.4*
Purchase of residential property	*256.9*	*737.0*	*993.9*	*317.6*	*1,127.3*	*1,444.9*	*45.4*	*9.2*	*10.1*
Purchase of non-residential property	*170.3*	*277.3*	*447.6*	*187.8*	*305.1*	*492.9*	*10.1*	*22.1*	*20.6*
Wholesale, retail, restaurants and hotels	88.6	56.3	144.9	66.4	139.9	206.3	42.4	10.5	11.5
Transport, storage and communication	31.4	79.1	110.5	51.3	167.4	218.7	97.9	13.4	21.4
Finance, insurance and business services	25.9	4.3	30.2	31.6	9.4	41.0	35.8	2.4	2.1
Purchase of securities	88.4	111.3	199.7	59.5	81.5	141.0	-29.4	21.4	15.3
Consumption credit	178.8	256.3	435.1	226.8	294.3	521.1	19.8	4.7	3.5
Credit cards	*0.2*	*2.2*	*2.4*	*4.8*	*3.1*	*7.9*	*229.2*	*4.0*	*5.1*
Personal uses	*126.3*	*39.2*	*165.5*	*140.9*	*53.7*	*194.6*	*17.6*	*15.6*	*11.9*
Purchase of consumer durables	*6.3*	*0.6*	*6.9*	*4.3*	*0.2*	*4.5*	*-34.8*	*10.9*	*8.3*
Purchase of transport vehicles	*46.0*	*214.3*	*260.3*	*76.8*	*237.3*	*314.1*	*20.7*	*3.2*	*2.4*
Others	14.3	8.6	22.9	3.7	75.8	79.5	247.2	2.3	11.0
Total	**1,396.4**	**2,179.1**	**3,575.5**	**1,575.5**	**2,949.6**	**4,525.1**	**26.6**		

[1] Based on actual classification
p Preliminary

Table A.55
Banking System[1,2]: Selected Indicators

	Commercial banks[1]					Finance companies					Merchant banks					Banking system[1]				
	As at calendar year end																			
	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003	1999	2000	2001	2002	2003
Pre-tax profit / Average assets (%)	1.3	1.4	0.9	1.2	1.2	-0.8	1.7	1.8	1.9	2.0	-0.4	1.5	0.8	1.4	1.6	0.8	1.4	1.0	1.3	1.4
Pre-tax profit / Average shareholders' funds (%)	16.5	17.4	10.7	14.3	14.7	-14.5	33.2	31.0	29.1	32.9	-4.9	16.8	7.4	13.1	14.4	10.5	19.3	13.1	16.3	17.2
Pre-tax profit / Average employee (RM'000)	84.1	94.5	63.4	95.4	103.9	-43.1	91.6	102.9	127.0	143.7	-70.1	248.6	124.8	244.5	284.9	50.7	97.7	73.9	106.3	117.4
Cost[3] incurred per ringgit of revenue earned[4] (sen)	38.1	39.0	41.5	43.6	44.6	37.9	31.2	32.1	32.5	30.3	26.0	19.6	20.7	27.7	27.9	37.4	36.2	38.2	40.3	40.5
Cost[3] incurred per ringgit of net interest income[4] (sen)	54.9	54.7	62.6	64.2	64.7	44.5	35.7	36.4	36.5	33.9	60.4	43.6	55.5	65.5	80.2	52.6	49.3	55.0	56.5	56.5
Overheads to staff cost ratio (%)	104.2	98.4	101.0	113.2	115.7	162.4	123.5	131.7	130.1	118.1	125.2	70.0	58.1	53.6	50.7	114.6	101.7	104.2	113.1	112.7
Staff cost per employee (RM'000)	41.4	49.8	54.8	55.4	58.8	27.8	36.7	37.5	41.8	43.6	56.5	70.0	86.4	93.6	107.3	38.6	47.4	51.8	53.5	56.9
Loan deposit ratio[5] (%)	87.9	87.7	89.6	88.4	83.3	88.5	100.4	108.0	111.1	115.8	72.9	70.1	57.6	51.3	37.6	87.2	89.0	91.2	90.6	86.4
Loans per office (RM million)	164.3	175.4	190.7	201.7	205.6	84.3	90.2	106.0	133.1	146.7	857.7	789.1	768.8	792.9	649.4	141.9	151.1	166.1	184.3	191.1
Deposits per office[5] (RM million)	186.8	200.1	213.0	228.1	246.7	95.2	89.8	98.2	119.8	126.6	1,175.9	1,125.5	1,334.6	1,547.1	1,725.4	162.7	169.7	182.1	203.4	221.0

[1] Excludes Islamic banks
[2] Based on Malaysian operations only
[3] Cost = Staff cost and overheads (excluding loan loss provisions)
[4] Net of interest-in-suspense
[5] Including NIDs and repos

Table A.56
Banking System[1]: Key Data

	As at end				
	1999	2000	2001	2002	2003
Number of institutions	68	62	47	45	44
- *Commercial banks*[1]	*33*	*31*	*25*	*24*	*23*
- *Finance companies*	*23*	*19*	*12*	*11*	*11*
- *Merchant banks*	*12*	*12*	*10*	*10*	*10*
Risk-weighted capital ratio (%)	12.5	12.5	13.0	13.2	13.4
- *Commercial banks*[1]	*12.8*	*12.3*	*12.8*	*13.2*	*13.6*
- *Finance companies*	*10.8*	*11.5*	*12.1*	*12.0*	*11.3*
- *Merchant banks*	*14.5*	*17.1*	*19.6*	*19.0*	*18.4*
Office network	2,749	2,713	2,557	2,403	2,430
- *Commercial banks*[1]	*1,767*	*1,758*	*1,664*	*1,631*	*1,684*
- *Finance companies*	*960*	*933*	*874*	*755*	*729*
- *Merchant banks*	*22*	*22*	*19*	*17*	*17*
ATM network	3,883	3,906	3,983	4,027	4,184
- *Commercial banks*[1]	*3,302*	*3,346*	*3,378*	*3,476*	*3,707*
- *Finance companies*	*581*	*560*	*605*	*551*	*477*
Number of banks with internet services	–	3	8	12	12
- *Commercial banks*[1]	–	*3*	*8*	*12*	*12*
Persons served per office					
- *Commercial banks*[1]	*12,854*	*13,256*	*13,959*	*14,899*	*15,026*
- *Finance companies*	*23,659*	*24,920*	*26,474*	*32,185*	*33,536*
Number of employees	92,630	93,290	90,288	87,747	87,521
- *Commercial banks*[1]	*69,714*	*70,226*	*67,398*	*65,866*	*66,458*
- *Finance companies*	*20,543*	*20,725*	*20,488*	*19,430*	*18,634*
- *Merchant banks*	*2,373*	*2,339*	*2,402*	*2,451*	*2,429*

[1] Excludes Islamic banks

Table A.57
Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2002	2003	2002	2003
Commercial banks	–		4.4[1]	4.5[1]	1,594	1,700
Finance companies	–		4.5[1]	4.0[1]	746	672
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0	4.0	–	–
Malaysia Building Society Berhad	1950	To be the nation's single largest provider of property finance and to contribute to the continuous growth of the nation	3.5 ~ 8.5	2.0 ~ 6.5	22	22
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	4.5 ~ 8.9	7.5 ~ 8.5	2	2
Sabah Credit Corporation	1955	To improve the social economic development of Sabah through loans mainly to the property, agriculture and business sectors	8.0 ~ 10.5	8.0 ~ 10.5	11	11
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides conventional banking facilities as well as according to Syariah principles	7.1[1]	7.4[1]	98	100
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	4.7[1]	4.0[1]	421	398

[1] Average

Source: Bank Negara Malaysia and various housing credit institutions

Table A.58
Outstanding Housing Loans

	2002	2003*p*	2002	2003*p*	2002	2003*p*
	RM million		Annual change (%)		% share	
Commercial banks	86,246	101,829	18.0	18.1	68	70
Treasury Housing Loans Division	22,172	24,754	13.9	11.6	17	17
Finance companies	14,042	14,648	7.7	4.3	11	10
Bank Kerjasama Rakyat Malaysia Berhad	1,108	1,371	-13.0	23.7	1	1
Bank Simpanan Nasional	1,133	1,058	-11.7	-6.6	1	1
Malaysia Building Society Berhad	1,236	1,207	-1.0	-2.4	1	1
Borneo Housing Mortgage Finance Berhad	650	680	3.9	4.7	1	…
Sabah Credit Corporation	293	290	-0.8	-1.0	…	…
Total	**126,880**	**145,837**	**15.0**	**14.9**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.59
Approved Housing Loans

	2002	2003*p*	2002	2003*p*	2002	2003*p*
	RM million		Annual change (%)		% share	
Commercial banks	26,795	27,943	6.8	4.3	77	78
Treasury Housing Loans Division	5,051	4,738	23.6	-6.2	15	13
Finance companies	2,410	2,090	26.2	-13.3	7	6
Bank Kerjasama Rakyat Malaysia Berhad	403	567	-3.1	40.6	1	2
Malaysia Building Society Berhad	113	364	-67.7	221.4	…	1
Borneo Housing Mortgage Finance Berhad	85	88	12.9	3.4	…	…
Bank Simpanan Nasional	78	65	-51.0	-16.4	…	…
Sabah Credit Corporation	30	19	-19.2	-36.3	…	…
Total	**34,965**	**35,874**	**8.9**	**2.6**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

As at the end of 2003, 292 leasing companies and 28 factoring companies had registered with Bank Negara Malaysia. However, only 114 leasing companies and 15 factoring companies submitted statistics pertaining to their operations to the Bank. Total assets of the 114 leasing companies and 15 factoring companies amounted to RM21.2 billion and RM2.1 billion respectively at the end of 2003. Nevertheless, of the 114 leasing companies, only 37 were pure leasing companies, while of the 15 factoring companies, only 10 were pure factoring companies. The remaining companies only undertook leasing and factoring business as part of their overall business activities.

Table A.60
Leasing Companies[1]: Sources and Uses of Funds

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Sources					
Capital and reserves	654	839	839	770	1,554
Borrowings from financial institutions	1,898	1,711	1,923	2,141	1,759
Inter-company borrowings	1,296	1,316	1,343	1,454	1,375
Others	2,400	2,447	2,400	2,684	2,342
Total	**6,248**	**6,313**	**6,505**	**7,049**	**7,030**
Uses					
Cash and bank balances	266	191	229	225	198
Investments	308	279	309	323	387
Receivables	3,056	3,107	3,014	3,118	2,370
Leasing	*1,537*	*1,495*	*1,423*	*1,420*	*1,508*
Factoring	*4*	*8*	*17*	*209*	*204*
Hire purchase	*1,261*	*1,331*	*1,275*	*1,307*	*503*
Others	*254*	*273*	*299*	*182*	*155*
Others	2,618	2,736	2,953	3,384	4,074

[1] Statistics shown are for pure leasing companies only
Note: Numbers may not necessarily add up due to rounding

Table A.61
Leasing Companies[1]: Income and Expenditure

	During the period				
	1999	2000	2001	2002	2003
	RM million				
Income					
Income from	329	315	313	302	326
Leasing	*225*	*223*	*217*	*212*	*226*
Factoring	*1*	*0*	*2*	*3*	*6*
Hire purchase	*102*	*90*	*85*	*76*	*75*
Others	*1*	*2*	*9*	*11*	*20*
Others	265	224	188	306	200
Total	**594**	**539**	**501**	**607**	**526**
Expenditure					
Interest paid	289	180	187	165	141
Financial institutions	*253*	*156*	*166*	*155*	*134*
Block discounting	*36*	*24*	*21*	*10*	*7*
Bad debts written off and provision	195	33	108	35	5
Others	183	168	165	199	183
Total	**667**	**381**	**460**	**398**	**329**
Pre-tax Profit	**-73**	**158**	**41**	**209**	**197**

[1] Statistics shown are for pure leasing companies only
Note: Numbers may not necessarily add up due to rounding

Table A.62
Leasing Companies[1]: Financing by Sector

	During the period				
	1999	2000	2001	2002	2003
	RM million				
Sector					
Agriculture	8	25	17	14	25
Mining and quarrying	0	17	3	3	9
Manufacturing	111	317	172	102	126
Electricity	3	3	1	0	0
General commerce	27	89	266	125	106
Property sector	29	61	50	38	207
Construction	*24*	*57*	*46*	*36*	*179*
Real estate	*5*	*4*	*4*	*2*	*28*
Residential property	*0*	*0*	*0*	*0*	*0*
Transport and storage	16	83	805	54	53
Business, insurance and other services	35	147	113	121	116
Consumption credit	0	3	0	0	0
Others	83	26	108	128	53
Total	**312**	**771**	**1,535**	**585**	**695**

[1] Statistics shown are for pure leasing companies only
Note: Numbers may not necessarily add up due to rounding

Table A.63
Factoring Companies[1]: Sources and Uses of Funds

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Sources					
Capital and reserves	89	116	164	164	81
Borrowings from financial institutions	247	324	445	293	267
Inter-company borrowings	256	697	600	416	267
Others	385	896	658	1,092	425
Total	**977**	**2,033**	**1,867**	**1,964**	**1,040**
Uses					
Cash and bank balances	30	255	202	234	14
Investments	5	25	45	35	24
Receivables	928	1,458	998	1,170	602
Leasing	*0*	*0*	*0*	*0*	*0*
Factoring	*808*	*1,312*	*872*	*1,111*	*542*
Hire purchase	*2*	*4*	*4*	*4*	*4*
Others	*118*	*142*	*122*	*55*	*57*
Others	14	295	622	525	401

[1] Statistics shown are for pure factoring companies only
Note: Numbers may not necessarily add up due to rounding

Table A.64
Factoring Companies[1]: Income and Expenditure

	During the period				
	1999	2000	2001	2002	2003
	RM million				
Income					
Income from	47	47	37	38	31
Leasing	*0*	*0*	*2*	*0*	*0*
Factoring	*38*	*38*	*29*	*29*	*24*
Hire purchase	*0*	*0*	*0*	*0*	*0*
Others	*9*	*9*	*6*	*8*	*6*
Others	15	99	129	297	75
Total	**62**	**146**	**166**	**335**	**106**
Expenditure					
Interest paid	42	8	28	17	15
Financial institutions	*42*	*28*	*28*	*17*	*15*
Block discounting	*0*	*0*	*0*	*0*	*0*
Bad debts written off and provision	202	14	28	14	5
Others	41	49	33	45	17
Total	**285**	**91**	**89**	**76**	**37**
Pre-tax Profit	**-223**	**55**	**77**	**259**	**68**

[1] Statistics shown are for pure factoring companies only
Note: Numbers may not necessarily add up due to rounding

Table A.65
Factoring Companies[1]: Financing by Sector

	During the period				
	1999	2000	2001	2002	2003
	RM million				
Sector					
Agriculture	0	0	0	0	1
Mining and quarrying	0	0	0	0	0
Manufacturing	71	76	66	57	46
Electricity	3	4	3	2	3
General commerce	133	127	140	179	120
Property sector	222	245	270	103	43
Construction	*174*	*195*	*222*	*76*	*36*
Real estate	*48*	*50*	*48*	*27*	*1*
Residential property	*0*	*0*	*0*	*0*	*6*
Transport and storage	6	8	5	3	1
Business, insurance and other services	86	77	51	50	37
Consumption credit	23	22	20	20	17
Others	23	25	541	513	18
Total	**567**	**584**	**1,096**	**927**	**286**

[1] Statistics shown are for pure factoring companies only
Note: Numbers may not necessarily add up due to rounding

Table A.66
Capital Market Debt Securities[1]: Amount Outstanding

	As at end				
	1999	2000	2001	2002	2003*p*
	RM million (nominal value)				
Malaysian Government Securities	78,336	89,050	103,450	109,550	130,800
Government Investment Issues	2,000	4,000	4,000	5,000	7,000
Khazanah Bonds	8,980	10,000	10,000	10,000	11,000
Malaysia Savings Bonds	379	359	0	464	455
Danaharta Bonds	10,344	11,140	11,140	11,140	8,539
Danamodal Bonds	11,000	11,000	11,000	11,000	–
Cagamas Bonds	13,019	17,312	18,427	22,595	25,628
Other Corporate Bonds	78,632	100,494	117,674	103,951	136,002
Medium Term Notes	681	1,726	2,910	4,450	8,596
Total	**203,370**	**245,081**	**278,601**	**278,150**	**328,021**

[1] Refer to debt securities with an original maturity period of more than one year
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Table A.67
Urban Credit Co-operative Societies[1]

	Annual change 2002	Annual change 2003	As at end 2003	Annual change (%)	% share
	Number				
Total co-operative societies	41	11	424	2.7	100
Deposit-taking co-operatives	*0*	*0*	*6*	*0*	*1.4*
Other credit co-operatives	*41*	*11*	*418*	*2.7*	*98.6*
	('000)				
Total members	92	-18,166	1,274,473	-1.7	100.0
Deposit-taking co-operatives	*1*	*1,506*	*345,834*	*0.4*	*27.1*
Other credit co-operatives	*91*	*-19,672*	*928,639*	*-2.1*	*72.9*
	RM million				
Sources of funds					
Share subscriptions	123.0	71.7	1,096.8	7.0	32.5
Reserves	71.9	27.9	242.7	13.0	7.2
Borrowings	85.2	15.3	155.6	10.9	4.6
Sundry creditors	17.3	7.1	115.2	6.5	3.4
Savings and deposits	13.5	22.1	177.5	14.3	5.3
Surplus	8.9	988.6	1,588.2	164.9	47.0
Total	**319.8**	**1,132.7**	**3,376.0**	**216.6**	**100.0**
Uses of funds					
Investments	74.8	50.7	462.9	12.3	13.7
Shares	*39.5*	*3.1*	*136.1*	*0.8*	*4.1*
Fixed and savings deposits	*28.5*	*41.3*	*197.1*	*2.1*	*5.8*
Real estates	*3.9*	*8.7*	*106.2*	*10.0*	*3.1*
Others	*2.9*	*-2.4*	*23.5*	*-0.6*	*0.7*
Loans to members	114.3	61.4	1,513.7[2]	4.2	44.9
Fixed assets	72.7	11.9	224.9	5.6	6.7
Other assets	37.2	0.8	34.7	2.2	1.0
Cash and bank balances	7.8	1,035.0	1,129.0	11.0	33.4
Others	13.0	-26.8	10.8	-71.3	0.3

[1] Urban credit co-operative societies, which comprise of employees credit societies, thrift and loan societies and thrift and investment societies, were established primarily to provide consumer credit and serve as an investment channel for members
[2] Refers to total loans outstanding

Source: Department of Co-operative Development Malaysia

Table A.68
Development Financial Institutions[1]: Sources and Uses of Funds

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Sources:					
Shareholders' funds	4,701.3	6,314.2	6,906.6	7,905.3	9,497.6
Paid-up capital	*4,168.9*	*5,258.5*	*5,416.9*	*6,012.4*	*7,192.3*
Reserves	*1,054.6*	*1,216.6*	*1,196.2*	*1,517.0*	*1,395.1*
Retained earnings	*-522.2*	*-160.9*	*293.5*	*375.9*	*910.2*
Deposits accepted	27,492.1	34,752.2	39,305.7	39,797.6	42,382.6
Borrowings	11,058.1	11,825.4	12,866.0	13,977.0	16,076.5
Government	*6,140.2*	*6,238.3*	*6,625.7*	*8,875.4*	*11,356.3*
Multilateral/International agencies	*2,760.9*	*3,034.8*	*3,321.7*	*3,434.3*	*3,035.7*
Others	*2,157.0*	*2,552.3*	*2,918.6*	*1,667.3*	*1,684.5*
Others	6,543.5	8,470.4	8,987.6	10,766.5	11,135.3
Total	**49,795.0**	**61,362.2**	**68,065.9**	**72,446.4**	**79,092.0**
Uses:					
Deposits placed	7,210.5	11,493.2	12,265.2	15,720.7	17,113.4
Investments	16,352.5	17,506.6	21,968.0	19,268.1	21,141.7
of which:					
Government securities	*2,072.0*	*2,497.1*	*3,715.0*	*3,495.8*	*3,562.0*
Shares	*4,250.9*	*4,759.8*	*5,099.4*	*6,427.4*	*5,798.6*
Quoted	*3,885.1*	*4,203.5*	*4,478.5*	*5,325.6*	*5,322.5*
Unquoted	*365.8*	*556.3*	*620.9*	*1,101.8*	*476.1*
Loans and advances	18,736.8	21,998.0	24,486.3	29,442.4	32,548.1
Fixed assets	1,870.2	2,090.2	3,011.6	3,606.7	3,706.0
Others	5,625.0	8,274.2	6,334.8	4,408.5	4,582.8
Total	**49,795.0**	**61,362.2**	**68,065.9**	**72,446.4**	**79,092.0**
Contingencies:					
Guarantee	4,228.3	4,211.8	3,342.4	3,160.1	3,652.7
Export credit insurance	136.1	204.5	148.3	151.5	125.6
Total	**4,364.4**	**4,416.3**	**3,490.7**	**3,311.6**	**3,778.3**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysian Export Credit Insurance Berhad, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.69
Development Financial Institutions[1] under DFIA[2]: Sources and Uses of Funds

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Sources:					
Shareholders' funds	3,188.8	3,417.0	3,942.7	4,739.6	5,977.6
Paid-up capital	*2,526.4*	*2,552.0*	*2,675.5*	*3,246.0*	*4,125.0*
Reserves	*637.0*	*732.7*	*885.1*	*863.0*	*745.9*
Retained earnings	*25.4*	*132.3*	*382.1*	*630.6*	*1,106.7*
Deposits accepted	15,953.1	20,911.6	25,102.5	25,869.3	26,977.3
Borrowings	6,802.3	7,822.4	8,283.4	8,865.4	10,723.4
Government	*3,177.8*	*3,310.8*	*3,420.3*	*5,261.7*	*7,541.7*
Multilateral/International agencies	*2,247.0*	*2,562.9*	*2,891.7*	*3,135.1*	*2,811.1*
Others	*1,377.5*	*1,948.7*	*1,971.4*	*468.6*	*370.6*
Others	3,330.1	4,656.5	5,418.8	6,848.4	7,184.7
Total	**29,274.3**	**36,807.5**	**42,747.4**	**46,332.7**	**50,863.0**
Uses:					
Deposits placed	4,282.4	6,585.6	7,849.9	10,257.2	10,836.0
Investments	7,376.4	7,126.4	10,713.7	9,981.2	10,962.9
of which:					
Government securities	*1,731.2*	*1,920.1*	*3,340.0*	*3,216.2*	*3,370.5*
Shares	*1,492.3*	*1,511.4*	*2,282.9*	*2,040.6*	*1,775.1*
Quoted	*1,444.1*	*1,433.9*	*2,203.8*	*1,939.8*	*1,705.2*
Unquoted	*48.2*	*77.5*	*79.1*	*100.8*	*69.9*
Loans and advances	13,643.5	16,866.4	18,962.1	22,827.5	25,515.4
Fixed assets	855.0	865.4	836.8	1,377.4	1,433.3
Others	3,117.0	5,363.7	4,384.9	1,879.4	2,115.4
Total	**29,274.3**	**36,807.5**	**42,747.4**	**46,322.7**	**50,863.0**
Contingencies:					
Guarantee	998.3	806.8	673.4	575.4	543.3
Export credit insurance	136.1	204.5	148.3	151.5	125.6
Total	**1,134.4**	**1,011.3**	**821.7**	**726.9**	**668.9**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad and Malaysia Export Credit Insurance Berhad

[2] Development Financial Institutions Act 2002

Table A.70
Development Financial Institutions[1]: Direction of Lending

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Agriculture, forestry and fishery	2,260.3	2,584.9	2,750.2	2,964.3	3,265.9
Mining and quarrying	44.7	47.4	46.1	90.0	96.1
Manufacturing	3,272.8	3,086.1	3,147.6	3,356.6	3,654.4
Electricity, gas and water supply	34.8	265.0	335.0	453.8	624.2
Import and export, wholesale and retail trade, restaurants and hotels	532.6	522.1	618.0	240.4	406.3
Broad property sector	4,097.8	4,687.0	5,700.3	7,840.6	8,407.9
Construction	*1,151.6*	*1,613.7*	*2,346.9*	*3,790.5*	*4,019.0*
Purchase of residential property	*2,102.5*	*2,090.6*	*2,593.7*	*2,785.2*	*2,947.7*
Purchase of non-residential property	*188.8*	*163.1*	*268.8*	*393.4*	*443.0*
Real estate	*654.9*	*819.6*	*490.9*	*871.5*	*998.2*
Transport, storage and communication	1,166.4	2,028.9	2,860.6	4,362.1	4,442.5
Maritime	992.0	801.5	733.1	530.4	473.3
Finance, insurance and business services	1,053.0	1,213.0	1,300.7	1,780.5	1,876.0
Consumption credit	4,006.6	5,084.5	5,404.2	6,716.1	8,066.6
of which:					
Purchase of motor vehicles	*674.0*	*997.6*	*819.2*	*816.5*	*884.0*
Credit card	*33.5*	*42.9*	*47.8*	*48.0*	*23.7*
Purchase of securities	290.1	330.0	356.2	173.2	136.2
Others	985.7	1,347.5	1,234.3	934.4	1,098.7
Total	**18,736.8**	**21,997.9**	**24,486.3**	**29,442.4**	**32,548.1**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.71
Development Financial Institutions[1] under DFIA[2] : Direction of Lending

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Agriculture, forestry and fishery	301.7	397.0	454.4	459.6	395.1
Mining and quarrying	29.5	33.5	34.5	80.5	79.5
Manufacturing	2,118.2	2,154.2	2,204.2	2,130.2	2,375.4
Electricity, gas and water supply	34.8	265.0	335.0	453.8	624.2
Import and export, wholesale and retail trade, restaurants and hotels	235.9	135.2	129.0	125.9	307.3
Broad property sector	3,415.7	4,054.7	5,078.2	6,846.8	7,402.1
Construction	*943.9*	*1,427.6*	*2,192.1*	*3,641.3*	*3,852.1*
Purchase of residential property	*1,783.8*	*1,779.8*	*2,288.0*	*2,480.3*	*2,648.1*
Purchase of non-residential property	*186.3*	*160.9*	*267.3*	*391.3*	*440.6*
Real estate	*501.7*	*686.3*	*330.8*	*333.9*	*461.3*
Transport, storage and communication	974.9	1,871.1	2,746.5	4,321.6	4,398.7
Maritime	992.0	801.5	733.1	530.4	473.2
Finance, insurance and business services	944.6	1,096.8	1,198.0	877.6	1,077.4
Consumption credit	3,959.3	5,037.5	5,339.6	6,567.8	7,813.0
of which:					
Purchase of motor vehicles	*626.7*	*950.6*	*754.6*	*741.2*	*800.2*
Credit card	*33.5*	*42.9*	*47.8*	*48.0*	*23.7*
Purchase of securities	290.1	330.0	356.2	173.2	136.2
Others	346.8	689.8	353.4	260.1	433.3
Total	**13,643.5**	**16,866.3**	**18,962.1**	**22,827.5**	**25,515.4**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional and Export-Import Bank of Malaysia Berhad
[2] Development Financial Institutions Act 2002

Table A.72
Bank Industri & Teknologi Malaysia Berhad

Year of establishment	1979			
Objectives	The principal activity of Bank Industri & Teknologi Malaysia Berhad is to finance capital intensive and high technology industries in priority sectors such as shipping industry and manufacturing.			
Sector	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2002	2003	2002	2003
Maritime	202.1	76.3	47.0	83.7
Shipping industry	*143.2*	*57.4*	*20.2*	*52.8*
Shipyard industry	*25.5*	*1.2*	*17.1*	*17.5*
Marine-related industries	*33.4*	*17.7*	*9.7*	*13.4*
Manufacturing	99.9	211.4	79.7	54.6
of which:				
High technology	*22.2*	*16.8*	*14.5*	*6.1*
Total	**302.0**	**287.7**	**126.7**	**138.3**

Source: Bank Industri & Teknologi Malaysia Berhad

Table A.73
Export-Import Bank of Malaysia Berhad

Year of establishment	1995			
Objectives	Establishing an institutional support mechanism to facilitate the exports of goods and services by providing medium and long term credit to Malaysian exporters and investors, as well as foreign buyers of Malaysian goods. Effective January 1998, the Export Credit Refinancing facility was transferred from Bank Negara Malaysia to Export-Import Bank of Malaysia Berhad.			
Facility	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2002	2003	2002	2003
Buyer credit facility	144.4	22.8	43.0	10.7
Overseas investment credit facility	50.9	239.4	17.3	40.7
Supplier credit facility	168.2	209.1	190.6	109.4
Export of services financing facility	15.0	–	–	–
Export credit refinancing	6,149.0	6,611.2	6,149.0	6,611.2
Others	–	–	–	–
Total	**6,527.5**	**7,082.5**	**6,399.9**	**6,772.0**

Source: Export-Import Bank of Malaysia Berhad

Table A.74
Malaysia Export Credit Insurance Berhad

Year of establishment	1977			
Objectives	Support and strengthen Malaysian exports through the provision of export credit insurance facilities to exporters to cover against commercial and non-commercial risks and issuing guarantees for banks and financial institutions to facilitate access to export finance, and encouraging reverse investment by Malaysian investors through the provision of political risk insurance for investment.			
	Contingent Liabilities (RM million)		Business Coverage (RM million)	
	As at end-2002	As at end-2003	2002	2003
Short-term Policies				
Comprehensive policies	114.8	121.4	844.0	1,077.3
Banker's export finance insurance policy	1.5	2.3	–	–
Bank letter of credit policy	0.6	8.9	3.2	24.9
Specific policies	0.5	–	–	–
Bond indemnity support	–	–	–	–
Sub-total	117.4	132.6	847.2	1,102.2
Medium and Long-term Policies				
Specific policies	34.7	1.9	2.0	2.0
Buyer credit guarantee	375.7	331.4	375.7	276.5
Bond indemnity support	23.1	23.2	0.2	23.1
Oversea investment insurance	–	7.5	–	8.4
Sub-total	433.5	364.0	377.9	310.0
Total	**550.9**	**496.6**	**1,225.1**	**1,412.2**

Source: Malaysia Export Credit Insurance Berhad

Table A.75
Bank Simpanan Nasional

Year of establishment	1974
Objectives	Bank Simpanan Nasional is a savings bank, incorporated under the National Savings Bank Act 1974 and focuses on retail banking and personal finance especially for small savers.

Deposits facility	Deposits Accepted (RM million)		Interest Rate / Rate of Return (%)	
	As at end-2002	As at end-2003	2002	2003
Savings deposits	1,231.7	1,163.9	1.30 ~ 4.50	1.30 ~ 4.50
Fixed deposits	3,741.6	3,478.6	3.20 ~ 4.00	3.00 ~ 3.70
GIRO deposits	3,341.4	3,595.9	1.30 ~ 2.30	1.30 ~ 2.30
Islamic deposits	294.0	292.4	2.21 ~ 4.88	1.96 ~ 3.40
Premium savings certificates	821.5	904.4	1.50	1.50
Total	**9,430.2**	**9,435.2**		

Investments	RM million	
	As at end-2002	As at end-2003
Quoted shares	1,639.6	1,510.5
Malaysian Government Securities	1,478.2	1,923.7
Private debt securities	785.6	671.1
Subsidiary companies	437.8	437.8
Associate companies	231.8	231.8
Total	**4,573.0**	**4,774.9**
Number of branches	421	398
Number of account holders ('000)	11,230	11,365
Number of automatic teller machine (ATM)	593	591

Source: Bank Simpanan Nasional

Table A.76
Bank Kerjasama Rakyat Malaysia Berhad

Year of establishment	1954
Objectives	Bank Kerjasama Rakyat Malaysia Berhad mobilises savings and provides financing services to its members as well as non-members.

Sector	Financing Outstanding (RM million)			
	As at end-2002		As at end-2003	
	Members	Non-members	Members	Non-members
Agriculture	48.0	14.0	45.2	11.7
Purchase of property	980.1	658.6	1,228.3	670.1
General commerce	33.5	487.7	46.4	424.7
Purchase of securities	21.8	119.8	15.8	101.5
Purchase of motor vehicles	117.6	0.6	278.3	0.7
Consumption credit	5,078.4	700.2	6,120.0	735.3
Manufacturing	–	–	–	100.3
Construction	122.3	9.8	–	–
Others	–	124.7	–	178.4
Total	**6,401.7**	**2,115.4**	**7,734.0**	**2,222.7**

Source: Bank Kerjasama Rakyat Malaysia Berhad

Table A.77
Bank Pembangunan dan Infrastruktur Malaysia Berhad

Year of establishment	1973
Objectives	To increase the participation and involvement of the Bumiputera community in business and industry through financing and equity participation and to provide financing for infrastructure projects, in particular Government-identified projects.

Sector	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2002	2003	2002	2003
Infrastructure	2,790.1	4,753.8	2,997.6	1,589.8
Government programmes	*1,551.1*	*2,883.0*	*2,177.2*	*853.9*
Private programmes	*1,239.0*	*1,870.8*	*820.4*	*735.9*
SME	728.8	1,086.8	534.8	649.7
of which:				
Bumiputera	*638.2*	*1,059.6*	*449.4*	*526.4*
Total	**3,518.9**	**5,840.6**	**3,532.4**	**2,239.5**

Source: Bank Pembangunan dan Infrastruktur Malaysia Berhad

Table A.78
Other Development Financial Institutions[1]: Core Activities

	As at end				
	1999	2000	2001	2002	2003
	RM million				
Lending Activity					
Agriculture	1,958.6	2,187.9	2,295.8	2,504.8	2,870.9
Manufacturing	1,154.6	931.8	943.3	1,226.4	1,279.1
Broad property sector	682.2	632.3	622.2	993.8	1,005.8
Construction	*207.6*	*186.1*	*154.8*	*149.2*	*166.9*
Purchase of residential property	*318.7*	*310.7*	*305.7*	*305.0*	*299.6*
Purchase of non-residential property	*2.7*	*2.2*	*1.5*	*2.1*	*2.4*
Real estate	*153.2*	*133.3*	*160.2*	*537.5*	*536.9*
Consumption credit	47.3	47.0	64.6	148.4	253.6
Others	1,250.6	1,332.6	1,598.3	1,741.6	1,623.3
Total	**5,093.3**	**5,131.6**	**5,524.2**	**6,615.0**	**7,032.7**
Other Activities					
Deposits accepted	11,538.9	13,840.6	14,203.2	13,928.3	15,405.3
of which:					
Savings	*8,471.4*	*10,066.9*	*11,161.9*	*11,134.4*	*12,160.4*
Guarantee issued	3,230.0	3,405.0	2,669.0	2,584.7	3,109.4

[1] Refers to Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Bank Pertanian Malaysia, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.79
Development Financial Institutions: Selected Data

	As at end					
	2002			2003		
DFIs under DFIA[1]:	Branch	ATM	Staff	Branch	ATM	Staff
Bank Pembangunan dan Infrastruktur Malaysia Berhad	13	–	603	13	–	640
Bank Kerjasama Rakyat Malaysia Berhad	98	104	2,752	100	111	2,804
Bank Simpanan Nasional	421	593	5,043	398	591	5,069
Bank Industri & Teknologi Malaysia Berhad	–	–	276	–	–	303
Export-Import Bank of Malaysia Berhad	–	–	80	–	–	73
Malaysia Export Credit Insurance Berhad	–	–	63	–	–	60
Sub-total	532	697	8,817	511	695	8,949
Other DFIs:						
Bank Pertanian Malaysia	143	144	2,309	119	142	2,349
Malaysian Industrial Development Finance Berhad	7	–	224	7	–	228
Sabah Development Bank Berhad	–	–	82	–	–	83
Borneo Development Corporation (Sabah) Sdn Bhd	–	–	23	–	–	18
Borneo Development Corporation (Sarawak) Sdn Bhd	–	–	41	–	–	37
Credit Guarantee Corporation Malaysia Berhad	12	–	251	17	–	272
Sabah Credit Corporation	11	–	207	11	–	206
Lembaga Tabung Haji	119	–	1,408	119	–	1,543
Sub-total	292	144	4,545	273	142	4,736
Total	**824**	**841**	**13,362**	**784**	**837**	**13,685**

[1] Development Financial Institutions Act 2002.

Table A.80
Development Financial Institutions: Government Special Funds

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end	
	2002	2003	2002	2003	2002	2003
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
Fund for Publication	0.5	–	0.3	–	0.7	0.2
Fund for Film Industry	16.7	–	17.4	1.5	13.0	4.0
Venture Capital Fund	0.2	–	4.7	0.6	6.6	7.6
Tourism Infrastructure Fund	10.0	132.5	6.8	9.2	6.8	16.3
Small Scale Enterprises[1]	–	–	–	–	5.9	4.9
New Entrepreneurs Fund 2	53.6	–	59.2	118.7	43.1	90.1
Fund for Small and Medium Industries 2	8.5	8.9	6.0	5.9	6.2	4.6
Seed Capital Scheme	20.3	27.1	23.3	13.8	57.8	56.1
Graduate Entrepreneurs Fund	1.0	5.4	2.7	2.8	7.2	8.0
Terengganu Entrepreneurs Fund	15.1	11.0	5.2	17.3	3.3	10.6
Financing Scheme for Indian Rural Economic Development	0.5	–	0.2	0.2	0.2	0.3
Financing Scheme for Rural Economic Development	6.1	5.6	8.0	5.3	29.1	29.5
Food and Furniture Scheme	–	2.4	0.6	1.6	20.3	19.9
Special Fund for Tourism	–	187.2	–	33.4	–	33.2
Third Window Financing Scheme (Tanmiah1)	–	14.5	–	–	–	–
Financing Programme for Wholesalers and Distributors (Tanmiah2)	–	3.5	–	–	–	–
Bank Kerjasama Rakyat Malaysia Berhad						
Financing Scheme for Rural Economic Development	8.9	11.0	7.3	9.0	8.9	15.6
Bank Industri & Teknologi Malaysia Berhad						
New Ship Financing Facility	54.7	4.2	22.2	21.4	39.0	49.9
High Technology Fund	22.3	16.8	14.5	6.1	33.0	34.3
Easy Financing Scheme - PAKSI	2.5	–	3.7	0.8	10.2	7.8
Women Entrepreneurs Fund	7.0	–	4.7	3.2	7.5	8.3
New Technology Investment Fund	–	30.0	–	–	–	–
Export-Import Bank of Malaysia Berhad						
Export Credit Refinancing (ECR) Scheme[2]	6,149.0	6,611.2	6,149.0	6,611.2	1,076.1	1,128.7
Malaysian Industrial Development Finance Berhad						
Soft Loan for Small and Medium Enterprises	78.8	46.8	30.0	37.5	30.0	62.9
Modernisation Automation Scheme[1]	–	–	–	–	16.0	15.3
Special Fund for Terengganu-based Small and Medium Enterprises	–	1.2	–	0.8	–	0.8
Malaysian Industrial Energy Efficiency Improvement Project	–	2.0	–	–	–	–
Bank Pertanian Malaysia						
Agricultural Mechanisation and Automation Scheme	3.0	1.6	2.3	4.0	6.1	9.0
Bumiputera Commercial & Industrial Community Scheme	8.9	16.7	9.2	9.5	11.0	16.2
Credit Scheme for Paddy	32.7	4.4	31.6	31.2	29.5	27.3
Commercial Agriculture Graduate Entrepreneurs Scheme	0.7	0.5	0.3	0.6	0.7	0.9
Special Fund for Fishery	7.6	1.1	9.9	1.1	17.1	16.2
Low Intensity Tapping System	0.6	0.2	0.1	0.2	0.1	0.2
Oil Palm Replanting Scheme	32.9	31.6	17.5	10.9	19.7	30.0

[1] Fund has been fully utilised
[2] Inclusive of funds from Bank Negara Malaysia and these funds are channelled through 24 participating banks

Table A.81
Development Financial Institutions: Bank Negara Malaysia Funds[1]

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end	
	2002	2003	2002	2003	2002	2003
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
New Entrepreneurs Fund[2]	–	–	5.8	0.3	141.2	128.9
New Entrepreneurs Fund 2	81.7	106.5	38.7	115.1	58.2	167.6
Fund for Small and Medium Industries[2]	–	–	1.3	0.9	119.5	108.2
Fund for Small and Medium Industries 2	12.6	–	9.1	4.2	11.1	13.8
Bumiputera Industrial Fund[2]	–	–	–	–	21.1	19.9
Industrial Adjustment Fund[2]	–	–	–	–	0.3	0.3
Rehabilitation Fund for Small and Medium Industries[3]	–	3.1	3.9	5.1	36.4	39.9
Fund for Food	–	–	1.6	–	5.7	5.1
Special Fund for Tourism[2]	–	–	–	–	9.6	8.1
Bank Industri & Teknologi Malaysia Berhad						
New Entrepreneurs Fund[2]	–	–	–	–	6.0	2.2
New Entrepreneurs Fund 2	1.1	1.8	–	0.5	–	0.5
Fund for Small and Medium Industries[2]	–	–	0.1	0.3	46.6	22.9
Fund for Small and Medium Industries 2	5.1	4.1	0.6	4.4	2.1	6.5
Bumiputera Industrial Fund[2]	–	–	–	–	0.1	–
Industrial Adjustment Fund[2]	–	–	–	–	14.6	9.9
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	8.0	4.6
Ship Financing Facility	3.4	–	0.7	0.9	356.4	341.1
Malaysian Industrial Development Finance Berhad						
New Entrepreneurs Fund[2]	–	–	0.7	–	9.1	7.9
New Entrepreneurs Fund 2	11.3	17.9	5.1	20.2	5.5	25.5
Fund for Small and Medium Industries[2]	–	–	1.8	1.2	47.6	31.4
Fund for Small and Medium Industries 2	13.1	22.1	8.6	15.9	7.9	19.4
Bumiputera Industrial Fund[2]	–	–	–	–	2.5	1.7
Industrial Adjustment Fund[2]	–	–	–	–	3.7	3.7
Rehabilitation Fund for Small and Medium Industries[3]	0.2	–	–	–	3.9	2.9
Bank Pertanian Malaysia						
Fund for Small and Medium Industries[2]	–	–	8.8	0.5	90.1	84.9
Fund for Small and Medium Industries 2	–	6.8	–	3.1	–	3.0
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	15.2	14.1
Fund for Food	282.2	121.0	195.9	171.0	464.2	551.1
Credit Guarantee Corporation Malaysia Berhad[4]						
New Entrepreneurs Fund 2	418.0	–	243.1	71.4	299.2	350.4
Fund for Small and Medium Industries 2	569.3	–	294.4	99.9	452.1	450.0

[1] Bank Negara Malaysia fund for the ECR scheme administered by EXIM Bank is merged with the Government fund in Table A.83
[2] Funds have been fully utilised
[3] Fund was closed on 1 November 2003 and replaced by Rehabilitation Fund for Small Businesses
[4] Administers and channels the funds through various lending institutions

Table A.82
Development Financial Institutions: Funds from Multilateral and International Agencies

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end	
	2002	2003	2002	2003	2002	2003
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	20.3	6.0	15.1	25.1	64.3	78.5
Japan Bank for International Cooperation-Fund for Small and Medium Scale Industry Promotion Programme[1]	3.1	16.9	10.5	17.8	45.0	50.5
Japan Bank for International Cooperation-Fund for Small and Medium Industries	3.6	48.8	33.2	33.2	92.6	110.5
Japan Bank for International Cooperation 1- JEXIM[1]	–	–	742.5	44.1	1,182.1	1,191.5
Islamic Development Bank	–	–	14.9	15.7	48.9	49.0
Bank Industri & Teknologi Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	–	–	8.8	5.1
The Export-Import Bank of Japan[1]	–	–	–	–	26.9	29.3
Overseas Economic Cooperation Fund-Fund for Small and Medium Scale Industry Promotion Programme[1]	–	–	–	–	25.9	21.6
Japan Bank for International Cooperation 300[1]	143.3	52.3	27.0	39.5	151.8	161.8
Japan Bank for International Cooperation 200[1]	30.8	-	15.2	6.4	55.8	43.9
Japan Bank for International Cooperation-Fund for Small and Medium Industries[1]	60.5	45.9	23.6	26.0	52.2	64.3
Export-Import Bank of Malaysia Berhad						
Japan Bank for International Cooperation 300[1]	–	–	–	–	268.9	227.5
Japan Bank for International Cooperation 200[1]	–	–	–	–	168.0	142.2
Malaysian Industrial Development Finance Berhad						
Japan Bank for International Cooperation-Fund for Small and Medium Industries	46.0	22.0	53.5	47.4	136.2	152.3
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund	37.8	30.8	14.0	24.2	40.8	51.1
Japan Bank for International Cooperation-Fund for Small and Medium Scale Industry Promotion Programme	3.0	–	5.4	–	20.3	12.1
Bank Pertanian Malaysia						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	2.7	–	134.0	48.7

[1] Fund has been fully utilised