Bank Negara 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 First Minister of Finance and the Second Minister of Finance a copy of this Annual Report together with a copy of its Annual Accounts for the year ended 31 December 1998, which have been examined and certified by the Auditor-General. The Annual Accounts will also be published in the Gazette.

Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman
Chairman
Board of Directors

31 March 1999

Bank Negara Malaysia

Board of Directors

Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman
P.S.M., S.S.M.T., D.G.P.N., D.G.S.M., D.S.P.N., J.S.M., D.J.N., A.M.N., Hon. DCL (Northumbria)
Governor and Chairman

Dr. Zeti Akhtar Aziz
D.P.M.J.
Deputy Governor

Datuk Dr. Aris bin Othman,
P.J.N., K.M.N.
Secretary-General to the Treasury

Encik Oh Siew Nam

Dato' Muhammad Ali bin Hashim,
S.P.M.J., D.P.M.J., J.S.M., S.M.J., P.P.B.

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.

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

Tan Sri Kishu Tirathrai,
P.S.M.

Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman was appointed as the Governor of Bank Negara Malaysia, with effect from 7 September 1998 to replace Tan Sri Dato' Ahmad Mohd Don who resigned from the Bank on 1 September 1998. Dr. Zeti Akhtar Aziz was appointed as the Deputy Governor of Bank Negara Malaysia, with effect from 7 September 1998 to replace Dato' Fong Weng Phak who resigned from the Bank on 1 September 1998. Mr. Oh Siew Nam, Dato' Muhammad Ali bin Hashim, Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor and Tan Sri Dato' Dr. Mohd. Noordin bin Md. Sopiee were reappointed as members of the Board effective 1 March 1999.

Senior Staff

Governor	Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman
Deputy Governor	Dr. Zeti Akhtar Aziz
Adviser	Dato' Nor Mohamed bin Yakcop
Assistant Governor	Datuk Zamani bin Abdul Ghani
Assistant Governor	Dr. Awang Adek Hussin
Assistant Governor	Mohamed Yusof bin Ahmad Muhaiyuddin
Assistant Governor	Huang Sin Cheng
Assistant Governor	Latifah Merican Cheong
Director/Head of Department	
Economics I	Ismail bin Alowi
Economics II	Dr. Phang Hooi Eng
Bank Regulation	Nor Shamsiah Mohd Yunus
Investment and Treasury	Lillian Leong Bee Lian
Bank Supervision I	Zakaria Ismail
Bank Supervision II	Wong Yew Sen
Insurance Regulation	Muhammad bin Ibrahim
Insurance Supervision	Yahaya bin Haji Besah
Exchange Control	Md. Radzi bin Haji Kechik
Payment Systems	Che Sab bin Ahmad
Information Services	Ramli bin Saad
Finance	Azizan bin Haji Abd Rahman
Human Resource Management	Mohamed Yusof bin Ahmad Muhaiyuddin
Corporate Services	Mohd Nor bin Mashor
Legal	Gopala Krishnan Sundaram
Statistical Services	Chan Yan Kit
Internal Audit	Zainul Abidin bin Nazir Ahmad
Human Resource Development Centre	Essah binti Yusoff
Special Investigation	S. Indralingam
Information Systems Supervision	Norainy binti Mohd Sahid
Risk Management	Teo Kee Tian
Currency Management and Operation	Low Koon Seng
Property and Services	Maksom bin Kasan Widi
Security	Che Norudin bin Che Alli
Manager	
London Representative Office	Ab Razak bin Che Yusoff
New York Representative Office	Tan Sook Peng
Branch Manager	
Pulau Pinang	Kamalullail bin Ramli
Johor Bahru	Ahmad bin Ismail
Kota Kinabalu	Radin Nor Azam bin Radin Suhadi
Kuching	Marlene Margaret Ak John Nichol
Kuala Terengganu	Md. Daud bin Dahar

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Foreword

In 1998, Bank Negara Malaysia was confronted with the most difficult and challenging year in managing the financial system and the economy. The Asian financial crisis led to changes in the Bank's monetary and exchange rate policies that triggered widespread debate and concerns on policy responses to the crisis. The Bank and the Malaysian authorities would, however, be judged by the results these measures bring as the year 1999 unfolds.

Although there was general consensus that the economic fundamentals and banking supervisory standards in Malaysia were much stronger, real output declined sharply by 6.7% in 1998. The crisis also had resulted in the deterioration of regional demand by such an unforeseen magnitude that conventional fiscal and monetary policies to address the external current account deficit and inflation resulted in an over-adjustment of the economy. The tight fiscal and monetary policies adopted in late 1997 and early 1998 caused aggregate demand to fall more sharply than anticipated which then led to a curtailment of business and commercial activities and an increase in non-performing loans (NPLs). When the demand in East Asia collapsed, export performance was affected which in turn had consequences on overall growth. In the face of all these risks, Malaysia had to act quickly and decisively to protect its economy. In July 1998, the National Economic Action Council announced a comprehensive National Economic Recovery Plan to bring about stability and expedite economic recovery.

A priority of policy was to ensure that the payments system and the intermediation function continued to operate efficiently without interruption. This was crucial to maintain confidence and to ensure that economic activity did not grind to a halt. The guarantee by the Government for deposits placed with the banking institutions was issued in late 1997. This was an important decision that provided the necessary stability for the effective implementation of policies and reforms aimed at addressing the potential deterioration in asset quality and capital strength of banking institutions, in an environment of regional financial market turmoil that did not seem to abate. It was recognised very early on that it was important to put in place appropriate mechanisms to deal with potential banking sector problems to contain its severity and to ensure market confidence. In January 1998, the merger programme for finance companies was announced, based on market principles, to consolidate and strengthen the industry as this segment was the most vulnerable to the adverse effects of the economic downturn. This was reinforced with the establishment of Pengurusan Danaharta Nasional Berhad (Danaharta) in June, followed by Danamodal Nasional Berhad (Danamodal) and the Corporate Debt Restructuring Committee (CDRC) in August.

Stability in Malaysia was also threatened by the growing internationalisation of the ringgit. In this environment, the traditional policies would not guarantee

stability in the domestic market. External risks threatened to erode the gains achieved under earlier policies and result in further contraction of the economy. If not addressed, further loss of incomes could threaten the social fabric. A sense of social responsibility to the general public prompted Malaysia to consider other viable policy options to protect Malaysians from further economic hardship. Given the lack of response from the international community to address inherent weaknesses in the international monetary system, the Malaysian authorities moved on 1 September 1998 to impose the selective exchange controls to prevent the internationalisation of the ringgit. The controls were selective, aimed at achieving specific objectives, and designed not to affect foreign direct investment, while the current account remained fully convertible.

The authorities have taken full advantage of the period of stability accorded by the controls to ensure an economic recovery. Contrary to market expectations that the controls would delay economic reforms, the restructuring of the financial and the corporate sectors has been accelerated. Danaharta has acquired and managed NPLs from the banking institutions amounting to RM15.1 billion, equivalent to about 20% of total NPLs in the banking system. Including NPLs acquired from the other financial institutions, total NPLs acquired and managed amounted to RM21.7 billion. Danamodal has injected RM6.15 billion into 10 institutions. Of the 10, seven have signed Definitive Agreements to convert Exchangeable Subordinated Capital Loans into permanent Tier-1 and/or Tier-2 capital. Of the 48 applications received involving RM22.7 billion of debt, the CDRC has successfully implemented debt restructuring schemes for two companies. In addition, the CDRC had recently announced the restructuring proposal for one of the largest conglomerates involving debts of RM8.4 billion. These schemes have been achieved without the involvement of any Government funds. The restructuring process will continue to be accelerated. By end-June 1999, Danaharta would have completed the acquisition process and Danamodal would have completed the recapitalisation of those banking institutions whose shareholders are unable to inject the required capital. The progress to date and the acceleration of the restructuring process augur well for the ability of the banking system to respond effectively to support the recovery process during the course of 1999.

Following these developments, consumer confidence has been revived. While investor sentiment remains cautious given the uncertain regional and global outlook, it has not worsened. There are indications that the trough in the growth cycle had been reached in the third quarter of 1998 and prospects are for a gradual recovery in 1999. The balance of payments and the external reserves position have strengthened. Higher loan approvals do not indicate pressures of a credit crunch. Inflation continues to moderate and the fiscal deficit is manageable, funded mainly by the high domestic savings. Greater stability in terms of the foreign exchange and stock markets and the financial system has encouraged a steady revival in consumer and investor confidence. These pre-conditions should support a positive growth in 1999.

Export performance has improved significantly in recent months, rising by 12% in United States dollar terms. However, production has lagged, with the manufacturing sector still contracting in January 1999. This is largely due to the high inventories that were built up in the first half of 1998. Indicators, however, point towards a progressive easing of excess capacity in the near term, which will enable production growth to respond with some lag.

In the uncertain global environment, Malaysia cannot depend on export demand alone to lead the economic recovery. Hence, in 1999, the counter-cyclical fiscal policy would continue. Of importance is the need for the full implementation of projects financed by the fiscal deficit of 6% of GNP. Monetary policy will continue to be accommodative in 1999. Interest rate policy will continue to depend on domestic developments, in particular the efforts to contain inflation and to provide adequate incentives to promote deposit mobilisation to finance new lending. The Bank will also continue to persevere with its efforts to encourage banking institutions to respond and support the reform and recovery process.

The funding of the fiscal deficit and the restructuring of the financial sector has remained manageable. The fiscal deficit will be financed by both domestic and foreign funds, with sources for the latter comprising mainly borrowings from multilateral and bilateral sources. Financing for the recapitalisation of the banking institutions and the acquisition of NPLs has mainly been drawn from the excess liquidity in the banking system that has been generated by the current account surplus and the high savings rate. The contingent liability of the Government has also remained manageable. A significant part of the bond issues that had been taken up by the banking institutions did not require Government guarantee.

Although the high savings and the current account surplus will provide adequate sources of funds in the economy, Malaysia continues to welcome foreign direct investment. The level of foreign participation in the Malaysian economy has always remained high, particularly in the manufacturing, oil and gas sectors. In the financial services sector, the foreign share in the banking sector is more than 30%, and in the insurance sector, the foreign share of life insurance premiums is more than 70%, and for general insurance premiums, more than 30%. In attracting foreign players into the financial system, consideration will be given to the role they can play to make the sector more dynamic and competitive. In the meantime, the focus of policy will be to strengthen the Malaysian-owned financial institutions in terms of capacity and capability so that they would be ready to compete in a more liberalised environment. Foreign banking institutions have and will continue to play an important role in supporting Malaysia's economic development and in sharing both its prosperity and difficult times.

While the current emphasis is to expedite the resolution of the NPL problem, the banking sector must also be developed to meet the challenges of the globalised financial markets. Hence, efforts would be directed towards developing an early warning system to better anticipate future shocks, promoting a competitive banking sector that would support future growth as well as increase its own contribution to this growth. Emphasis is also being given to accelerating the development of the bond market to reduce the concentration of risks in the banking sector. A master plan is being charted that would identify the steps and policy direction to develop the banking industry in the next decade. While Danaharta and Danamodal are instrumental in addressing the sources of systemic risk in the banking system, a more holistic approach is also being adopted to instil greater discipline, promote a change in management culture and, more importantly, inculcate sound risk management practices in the banking institutions. These measures will be reinforced with more intensive and regular supervision of banking institutions by Bank Negara Malaysia with emphasis on early detection of potential areas of vulnerabilities and the implementation of timely corrective actions. In addition, a programme is being launched to

upgrade the technical expertise of regulators and supervisors to keep abreast of developments in the financial markets.

In the real sector, additional measures at the micro level to accelerate recovery will be introduced. To reduce the over dependence on just a few export-oriented industries and in order to contain the vulnerability to external shocks, new areas of growth with high economic linkages with the rest of the economy, low import content and high value added should be more actively encouraged and promoted. These include resource-based industries and selected services sectors, such as education, port services, recreation and tourism. Existing infrastructure would enable Malaysia through a concerted promotion effort to increase tourist arrivals in 1999. Similarly, efforts to expedite corporate debt restructuring would enable affected companies to remain viable and contribute towards reviving other related businesses. While growth in GDP in the longer term would require continued increases in investment, the past build-up in capital formation and slow growth in external demand would also require increases in domestic consumption. The private sector, therefore, needs to respond favourably to measures to promote consumption of domestic goods in order to ensure recovery in 1999.

Malaysia's experience has shown that policies must be flexible and proactive rather than rigid and reactive. In being flexible, however, it is equally important to take cognisance of the long-term objectives of policies. As has been demonstrated by the recent regional financial turmoil, adjustment efforts by individual economies alone are not sufficient to address the challenges of an increasingly integrated global financial market place. The international community has also a role to play in strengthening the global financial system to ensure responsible behaviour by both governments and markets. Malaysia will continue to support the efforts to develop a new global financial architecture. A new framework that allows better management of volatility of short-term capital flows, including regulating the activities of hedge funds and the work of international rating agencies, and safeguards for liberalisation of capital account transactions would provide the requisite requirement for countries like Malaysia to revert to liberal policies on portfolio flows. Malaysia remains committed to the market mechanism and liberalisation.

31 March 1999 ***Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman***
Governor

1 The Real Economy

Overview

The full effect of the regional financial crisis on the Malaysian economy was felt in 1998. For the year as a whole, real output declined by 6.7% after 12 years of uninterrupted expansion averaging 7.8% per annum. Per capita income in nominal terms declined to RM11,835 (US$3,018) in 1998 from RM12,051 in 1997 (US$4,284).

Malaysia's strong initial conditions and the adjustment measures pursued in 1997 did not restore stability in the domestic financial markets. Instability in the international financial markets intensified in 1998, particularly in the early part of the year, which in turn spilled over into the domestic markets. Continued waves of adjustment in both the currency and stock markets, coupled with the decline in domestic and export demand subsequently prompted a shift to more growth promoting policies. As the regional crisis became more entrenched, the orthodox International Monetary Fund (IMF) policy prescription of tight fiscal and monetary policies would only have destabilised the situation further and induced a much sharper contraction in real output.

The tight fiscal and monetary policies that were adopted in an environment of weakening external demand caused aggregate demand to fall more sharply than anticipated. During this period, inefficiencies in the domestic money market and the loan intermediation process that emerged in the early part of the year were further factors

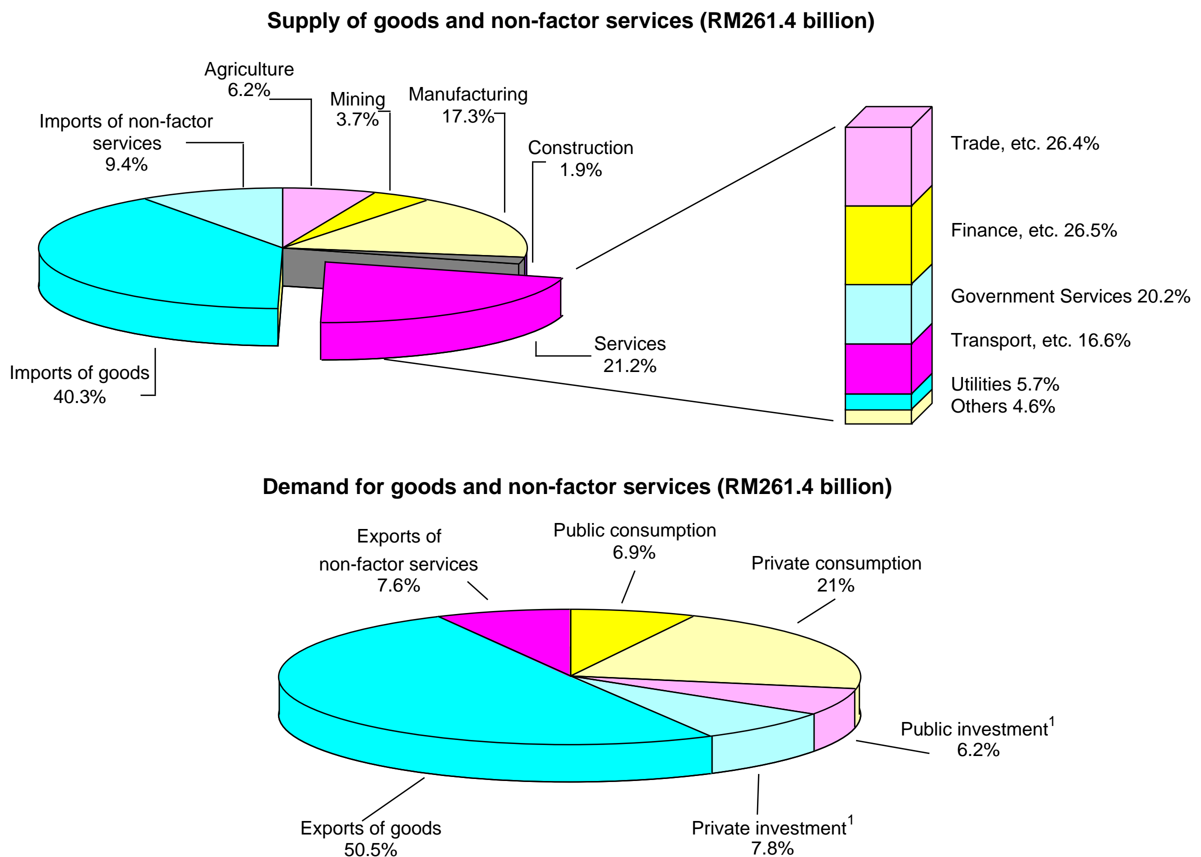


Table 1.1: Malaysia – Key Economic Indicators

	1996	1997	1998*p*	1999*f*
Population (million persons)	21.2	21.7	22.2	22.7
Labour force (million persons)	8.6	9.0	8.9	–
Employment (million persons)	8.4	8.8	8.5	–
Unemployment (as % of labour force)	2.6	2.6	3.9	4.5
Per Capita Income (RM)	11,228	12,051	11,835	11,831
(US$)	4,446	4,284	3,018	3,113
NATIONAL PRODUCT (% change)				
Real GDP	8.6	7.7	–6.7	1.0
(RM billion)	130.6	140.7	131.3	132.6
Agriculture, forestry and fishery	2.2	1.3	–4.0	5.0
Mining and quarrying	4.5	1.0	0.8	–0.4
Manufacturing	12.3	12.5	–10.2	0.8
Construction	14.2	9.5	–24.5	–8.0
Services	9.7	8.0	1.5	2.5
Nominal GNP	14.1	9.8	0.5	2.4
(RM billion)	237.7	261.1	262.5	268.7
Real GNP	8.3	7.8	–6.3	1.5
(RM billion)	123.2	132.8	124.5	126.3
Real aggregate domestic demand [1]	7.0	6.5	–25.9	4.3
Private expenditure [1]	9.0	6.3	–32.2	1.1
Consumption	6.0	4.7	–12.4	1.1
Investment	13.4	8.4	–57.8	0.9
Public expenditure [1]	1.3	6.9	–6.6	11.4
Consumption	1.4	5.3	–3.5	10.1
Investment	1.1	8.6	–10.0	12.8
Gross national savings (as % of GNP)	38.5	39.4	41.2	40.2
BALANCE OF PAYMENTS (RM billion)				
Merchandise balance	10.2	11.3	69.3	57.1
Exports (f.o.b.)	193.1	218.7	282.0	277.6
Imports (f.o.b.)	183.0	207.4	212.7	220.5
Services balance	–19.5	–21.8	–23.4	–21.0
(as % of GNP)	(–8.2)	(–8.3)	(–8.9)	(–7.8)
Transfers, net	–2.9	–3.7	–9.9	–6.6
Current account balance	–12.2	–14.2	36.1	29.5
(as % of GNP)	(–5.1)	(–5.4)	(13.7)	(11.0)
Bank Negara Malaysia reserves, net	70.0	59.1[2]	99.4[3]	–
(as months of retained imports)	(4.4)	(3.4)	(5.7)	–
PRICES (% change)				
CPI (1994=100)	3.5	2.7	5.3	< 4.0
PPI (1989=100)	2.3	2.7	10.7	1.5
Average wages in the manufacturing sector	8.4	7.3	0.3	–

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

1 Exclude stocks.
2 In 1997, the foreign exchange gain on the balance sheet date was not recognised in the Bank's account, in view of the volatility of the exchange rates during that year.
3 Arising from the fixing of ringgit/US dollar exchange rate at RM3.80 in September, 1998, all assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the cumulative gain has been reflected accordingly in the Bank's current year account. The US dollar equivalent of international reserves as at 31 December, 1998 was US$26.2 billion.
p Preliminary
f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	1996	1997	1998*p*
FEDERAL GOVERNMENT FINANCE (RM billion)			
Revenue	58.3	65.7	56.7
Operating expenditure	43.9	44.7	44.6
Development expenditure	12.6	14.4	17.1
Overall balance	1.8	6.6	–5.0
Overall balance (% of GNP)	0.8	2.5	–1.9
Public sector development expenditure	30.8	40.0	47.2
Public sector overall balance (% of GNP)	4.2	6.6	–1.8
EXTERNAL DEBT			
Total debt (RM billion)	97.8	170.8	159.8
Medium & long-term debt	72.7	127.5	131.3
Short-term debt	25.1	43.3	28.5
Debt service ratio (% of exports of goods & services)			
Total debt	6.9	5.5	6.7
Medium & long-term debt	6.2	4.7	6.0

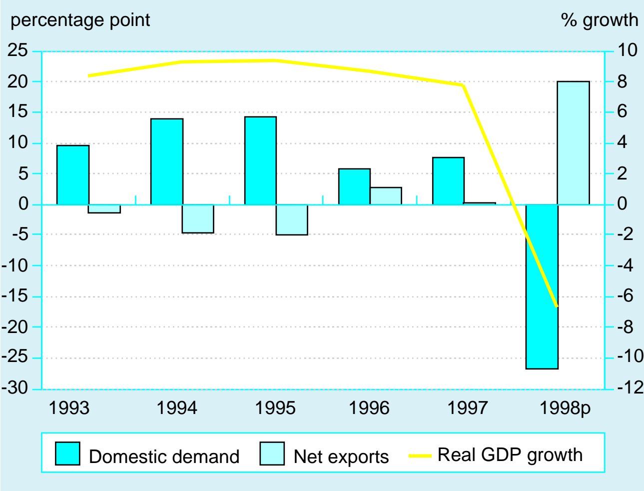
	Change in 1996		Change in 1997		Change in 1998	
	RM billion	%	RM billion	%	RM billion	%
MONEY AND BANKING						
Money supply M1	8.7	16.7	2.8	4.6	–9.2	–14.6
M2	39.3	19.8	54.0	22.7	4.3	1.5
M3	57.8	21.2	61.1	18.5	10.6	2.7
Banking system deposits	74.5	26.3	76.1	21.3	–2.1	–0.5
Banking system loans[1]	72.1	27.6	88.2	26.5	–7.6	–1.8
Manufacturing	4.6	9.5	9.9	18.5	–0.1	–0.2
Property sector	30.8	41.9	35.5	34.0	6.2	4.4
Finance, insurance and business services	0.9	3.0	3.4	10.3	0.9	2.5
Loan-deposit ratio (end of year)	89.3%		92.7%		91.4%	

	1996 %	1997 %	1998 %
Interest rates (average rates at end of year)			
3-month interbank	7.39	8.70	6.46
Commercial banks			
Fixed deposits: 3-month	7.21	9.06	5.83
12-month	7.26	9.33	5.74
Savings deposit	4.10	4.23	3.87
Base lending rate (BLR)	9.18	10.33	8.04
Finance companies			
Fixed deposits: 3-month	7.32	10.32	6.43
12-month	7.36	10.25	6.57
Savings deposit	5.02	5.49	5.01
Base lending rate (BLR)	10.65	12.22	9.50
Treasury bill (3-month)	6.39	6.76	5.31
Government securities (1-year)	6.70	7.01	5.79
Government securities (5-year)	6.55	7.75	6.66

	1996 %	1997 %	1998 %
Movement of Ringgit (end-period)			
Change against composite	2.6	– 31.4	–0.2
Change against SDR	3.9	– 30.8	–1.8
Change against US$	0.5	– 35.0	2.3

[1] Beginning December 1996, loans by sector are classified using a new statistical reporting format.
p Preliminary

Graph 1.2
Contribution to GDP Growth: Domestic Demand and Net Exports



contributing to this process. These inefficiencies resulted in higher lending rates than those reflected by the official intervention rate. These higher lending rates led to debt servicing problems in the corporate sector and threatened the stability of the financial system. It was evident towards mid-year that growth in GDP would contract significantly. Consequently, the strategies were reassessed to break the vicious cycle of destabilising developments in the financial sector and the economy reinforcing each other. As a result of these reassessments, the National Economic Action Council announced a comprehensive National Economic Recovery Plan to expedite recovery.

Policy response since May 1998 focused on counter-cyclical measures to avoid a recession-deflation spiral. Fiscal policy was relaxed in March 1998 and monetary policy was eased in early August 1998 when inflationary pressures became subdued. The volatility in the financial markets, however, persisted arising from several external developments including that in Indonesia in May, the weakening of the yen in June and the events leading to the devaluation of the Russian ruble. By the end of August 1998, the ringgit had depreciated by 40% against the United States dollar from the pre-crisis level, while the stock market declined by 72% during the same period. Given this continued adverse external environment, Malaysia imposed the selective exchange control measures on 1 September to eliminate the internationalisation of ringgit and to stabilise short-term capital flows. On 2 September 1998, the ringgit was also fixed at RM3.80 against the United States dollar. To complement the selective capital controls, further measures were introduced to improve the liquidity flows in the banking system to enhance the intermediation process and generate increased lending to viable businesses. Monetary policy was also eased further. Interest rates were brought down to levels prevailing at end-1995 following the progressive reduction in the intervention rate of Bank Negara Malaysia (BNM) and the statutory reserve requirement (SRR). The banking sector reform programme was also accelerated. Overall, the exchange control measures resulted in greater stability in the currency and stock markets and the financial system, as well as revival in domestic consumer and investor confidence. Although the economy continued to contract in the second half-year, on a year-to-year basis, the fundamentals had begun to strengthen towards end-1998.

Overall, the developments in 1998 clearly indicated that the financial crisis was not only due to the build-up of vulnerabilities in the region but also due to the shortcomings in the international monetary system in dealing with short-term flows. The “herd” behaviour among market participants led to market expectations becoming self-fulfilling. The international rating agencies also contributed to further market volatility with frequent rating reviews to compensate for earlier shortcomings of not having recognised the risks in the region. The positive features of the Malaysian economy that were acknowledged by the market and the international rating agencies included the low inflation, a high level of savings, Malaysia’s openness to international trade and foreign

Graph 1.3
GNP Growth and Nominal GNP per Capita

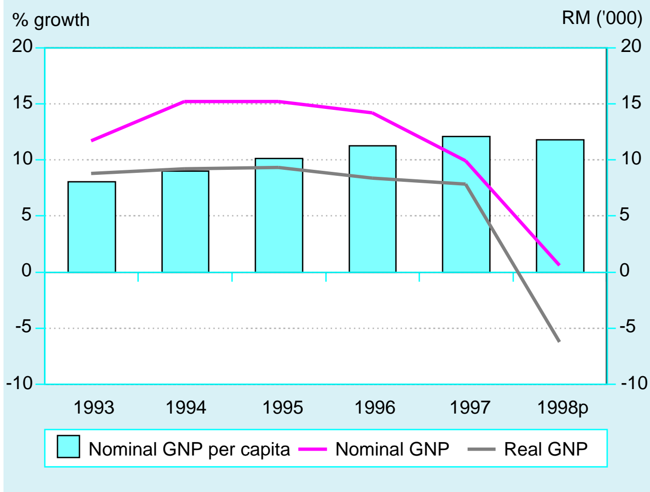


Table 1.3
Malaysia: Savings-Investment Gap,1997-99

	1997	1998*p*	1999*f*
	RM million		
Public gross domestic capital formation	31,564	31,750	36,809
Public savings	50,314	42,330	30,102
Deficit/surplus	18,750	10,580	–6,707
Private gross domestic capital formation	85,394	40,257	41,746
Private savings	52,493	65,745	77,991
Deficit/surplus	–32,901	25,488	36,245
Gross domestic capital formation	116,958	72,007	78,555
(as % of GNP)	44.8	27.4	29.2
Gross national savings	102,807	108,075	108,093
(as % of GNP)	39.4	41.2	40.2
Balance on current account	–14,151	36,068	29,538
(as % of GNP)	–5.4	13.7	11.0

p Preliminary
f Forecast

Source: Department of Statistics and Bank Negara Malaysia

investment, low external debt, strong fiscal position and a well-regulated and supervised banking system. The risks in the Malaysian economy which prompted adverse investor sentiment towards Malaysia were mainly the high loan-GDP ratio, the deficit in the current account of the balance of payments and strong credit growth. Although there was general recognition that Malaysia had relatively stronger fundamentals, investors did not differentiate the risks in countries in the Asian region. As Malaysia was not under an IMF programme, it was also perceived that without an IMF programme, Malaysia would be less committed to structural reform. Investors failed to recognise that Malaysia does not qualify for an IMF programme in view of its relatively strong balance of payments position and its relatively lower external debt exposure. Throughout the crisis period, external reserves of Malaysia were adequate to finance more than three months of retained imports. Since controls were introduced in September 1998, these reserves have increased significantly. The payments system continued to function effectively and did not break down during this crisis period. More importantly, Malaysia did not default on its external payments obligations.

In 1998, real GDP declined by 6.7%, with real aggregate **domestic demand** declining by 25.9%. The decline in private expenditure was significant. Uncertain economic outlook and employment prospects, the deferment of high import content projects, the negative wealth effects from the decline in share prices and the consequential balance sheet adjustments in the financial and corporate sectors led to a significant contraction in private sector spending. The adjustment was reflected in reduced consumption and investment. The decline in consumption and export demand

Table 1.4
Private Consumption Indicators

	1997	1998				
		Q1	Q2	Q3	Q4	Year
Sales of passenger cars, including 4WD ('000 units)	314.4	23.1	29.1	38.9	51.1	142.2
MIER Consumer Sentiments Index (points)	–	88.5	79.1	80.0	80.5	–
Imports of consumption goods (US$ billion)	5.0	0.9	0.8	0.8	0.9	3.4
Total loans approved by banking system (RM million)						
• Personal use	7,414	600	417	499	554	2,070
• Consumer goods	1,520	44	24	21	10	99
Stock market indicators [1]						
• Market capitalisation (RM billion)	375.8	452.9	285.9	249.1	374.5	374.5
• KLSE composite index (points)	594.4	719.5	455.6	373.5	586.1	586.1
DOS Business Expectations Survey (RM billion)		1H		2H		
• Gross revenue	48.1	15.9		17.1		33.0
Wholesale	*41.3*	*13.9*		*14.9*		*28.8*
Retail	*6.8*	*2.0*		*2.2*		*4.2*

[1] End-period

Table 1.5
Private Investment Indicators

	1997	1998				
		Q1	Q2	Q3	Q4	Year
Sales of commercial vehicles, including 4WD ('000 units)	90.4	4.8	4.2	5.0	7.6	21.7
Imports of capital goods (US$ billion)	15.5	2.8	2.2	2.3	2.0	9.3
MIER Business Conditions Index (points)	–	41.0	42.3	41.8	44.7	–
(RM billion)						
Applications to MITI						
• No. of projects	849	191	165	171	202	729
• Total capital investment	34.2	4.7	6.7	3.1	4.5	19.0
Foreign	*14.4*	*2.7*	*4.2*	*2.1*	*3.6*	*12.7*
Local	*19.8*	*2.0*	*2.5*	*0.9*	*0.8*	*6.3*
Approvals by MITI						
• No. of projects	759	261	167	199	217	844
• Total capital investment	25.8	11.2	4.8	7.0	3.4	26.4
Foreign	*11.5*	*4.8*	*2.0*	*5.2*	*1.1*	*13.1*
Local	*14.3*	*6.4*	*2.8*	*1.8*	*2.3*	*13.3*
Total loans approved by the banking system						
• Manufacturing sector	27.6	2.0	2.2	2.6	3.7	10.5
• Construction sector	18.6	1.2	1.2	1.2	2.0	5.6

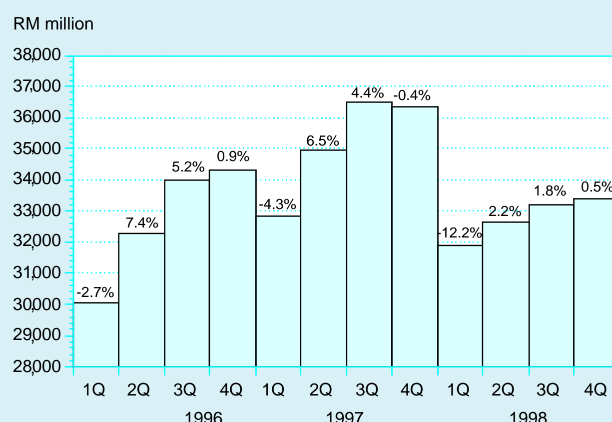
led to a build-up in stocks and excess capacity, depressing further private investment.

Following the imposition of selective exchange controls since September, monetary policy was eased further resulting in improved liquidity conditions and lower cost of funds. There was a revival in investor and consumer sentiment towards end-year. This improved sentiment was reflected in the Business Conditions Index of the Malaysian Institute of Economic Research (MIER), which indicated an increase in the index to 44.7 points in the fourth quarter from 41 points in the first quarter of 1998. In addition, other indicators such as the higher passenger car sales and loan approvals for personal use showed an improvement in domestic consumer sentiment. The Consumer Sentiments Index of MIER improved to 80.5 points in the fourth quarter from 79.1 points recorded in the second quarter of 1998. Reflecting mainly the sharp contraction in the first three quarters of 1998, private sector expenditure declined by 32.2% in real terms in 1998. The counter-cyclical policy adopted by the Government contained the decline in public spending to 6.6% in real terms.

On the **supply side**, the latest estimates showed that the annual decline in real GDP was most pronounced in the third quarter of 1998 (-9%). The decline in GDP moderated to 8.1% in the fourth quarter. However, on a preceding quarter basis, real GDP had begun to increase since the second quarter of 1998.

In 1998, activities in all sectors were affected, with the exception of the mining sector. The adjustment was most severe in the construction sector, followed by the manufacturing and agriculture sectors (decline in output of 24.5%, 10.2% and 4% respectively). The sharp contraction in the construction sector was due to completion of large projects, deferment of selected new infrastructure projects and the slow implementation of existing infrastructure projects as well as postponement of non-residential projects. Activity in the sector was sustained mainly by the less adverse developments in the residential sub-sector which recorded a smaller decline as Government policy continued to encourage the implementation of housing projects, especially low- and medium-cost housing. The lower output in the manufacturing sector was due to both weak domestic and external demand, particularly the decline in exports to the Asia-Pacific region, including Japan. The decline in

Graph 1.4
Quarterly GDP and Growth over Preceding Period



output was broad-based and affected both export- and domestic-oriented industries, with the exception of the rubber products industry. The decline in output of 4% in the agriculture sector reflected an across-the-board decline in the production of all major commodities. Output in this sector was affected by lower external demand that was aggravated by inclement weather, labour shortages, unfavourable prices, reduced cultivated area and lower yields. Reflecting the contraction of activities in the other major sectors, the performance of the services sector was sluggish, as evidenced by the decline in the wholesale and retail trade, hotel and restaurants sub-sector and a deceleration in the growth of the other services sub-sectors. Only output of the mining sector increased, mainly on account of higher crude oil production. Output of tin registered a positive growth in 1998 in response to the favourable price for the commodity, while gas production increased marginally.

On the positive side, the adjustment measures implemented succeeded in restoring the external balance and containing inflation. The current account in the **balance of payments** turned around to record the first surplus since 1989, amounting to RM36.1 billion or US$9.2 billion. In terms of GNP, the surplus amounted to 13.7% of GNP. The significant decline in investment, amidst an increase in savings, contributed to a large resource surplus in the balance of payments. The consolidation in private sector investment activity led to a 40.3% decline in imports of capital goods in United States dollar terms. With weak export demand, imports of intermediate goods also contracted, albeit at a lower rate of 21.3%. The increase in gross national savings (41.2% of GNP) reflected both higher income levels due mainly to gains arising from the weaker ringgit as well as the decline in consumer spending. Reflecting this trend, imports of consumption goods also registered a contraction of 32.7%. Developments on the export front in the fourth quarter were more encouraging. The decline in exports in United States dollar terms stabilised in September and increased thereafter.

The favourable balance of payments position and the stabilisation of short-term capital flows following the implementation of selective exchange controls led to a significant strengthening of the **external reserves** of BNM. The net international reserves increased from US$21.7 billion at the end of 1997 to US$26.2 billion at the end of 1998, adequate to finance 5.7 months of retained imports. External reserves increased further to US$28.7 billion as at the end of February 1999, adequate to finance 6.2 months of retained imports. At the same time, total **external debt** outstanding declined by 6.4% to RM159.8 billion at the end of 1998 (end-1997: RM170.8 billion). In United States dollar terms, external debt was equivalent to US$42 billion. Consequently, the ratio of external debt to GNP declined to 60.9% in 1998 from 65.4% in 1997. The decline in total external debt was due entirely to the decline in short-term external debt. Of significance, the ratios of short-term debt to total external debt and external reserves holdings were relatively low. The share of short-term external debt to total external debt declined from 25% at the end of 1997 to 18% at the end of 1998. This makes Malaysia less vulnerable to credit outflows over the short term. The nation's medium- and long-term external debt outstanding increased moderately by 3% to RM131.3 billion at the end of 1998, due largely to the drawdown of external loans of RM4 billion by the Federal Government. In the pre-crisis period, total external debt of the Federal Government had progressively declined to RM9.1 billion or US$3.6 billion (3.5% of GNP). This favourable position accorded greater flexibility to the Government to raise funds abroad to finance the stimulus package and strengthen the banking system.

Inflation, which trended higher towards the end of 1997 and in the first half of 1998 under the impact of the depreciation of the ringgit, declined progressively after June 1998. The sharper-than-expected contraction in aggregate demand and excess capacity in the economy reduced inflationary pressures arising from the decline in the ringgit. The rate of increase in the Consumer Price Index (CPI) moderated progressively to 5.3% in December 1998, after the year's peak of 6.2% in June. For 1998 as a whole, inflation rose by 5.3%, lower than the earlier expectations of 7–8%. Excluding food, the adjusted CPI rose more moderately by 3.1%. The fixing of the ringgit exchange rate against the United States dollar also reduced inflationary expectations.

On the **employment** front, the contraction in output led to a softening of the domestic labour market. The rate of unemployment is estimated to have increased to 3.9%, below the full employment level of 4%. During the year, 83,865 workers were retrenched. Nevertheless, the demand for labour

remained strong in selected sub-sectors, with 74,610 vacancies reported throughout the country. Reflecting labour market flexibility, wage increases showed a moderating trend in 1998.

Macroeconomic policy management in 1998 focussed on reducing risks in the economy to ensure macroeconomic stability and promote a stronger financial system. The policies evolved at different stages of the economic crisis. Throughout the crisis period, the objectives of policy remained unchanged, namely to maintain price stability while avoiding a further contraction of the economy. However, as circumstances changed, policies had to be adjusted or modified to ensure objectives were realised.

Monetary policy was adjusted during the course of 1998. At the start of the year, the policy of monetary restraint was aimed at containing inflationary pressures arising from the ringgit depreciation as well as to preserve stability in the domestic financial markets. BNM believed that higher interest rates would not be effective in supporting ringgit exchange rates. The basic fundamental principle that was adopted in determining interest rates was to ensure that the expected real rate of return on ringgit deposits is not eroded and to ensure adequate return on ringgit assets to avoid capital outflows. The tight liquidity situation following the ringgit depreciation and the inefficiencies in the domestic financial markets were addressed by placement of RM34 billion by BNM into the banking system to reduce pressures on interest rates, which were kept relatively low in 1997. Interest rates were, however, raised to the highest level of 11% in February 1998 following the marked deterioration of the Indonesian rupiah by 45% and the depreciation of the ringgit to US$1=RM4.88 on 7 January 1998. Although interest rates were adjusted upwards in line with the increase in the expected rate of inflation during this period, consideration was also given to the need to ensure that the productive sectors of the economy had access to financing at reasonable cost and the need to maintain price stability and a stable exchange rate. Hence, interest rates in Malaysia remained significantly lower compared with levels in other countries in the region which were also affetced by the crisis. At the same time, BNM also reduced the SRR to lower funding costs for banks. This contributed to removing market distortions which had emerged during the flight to quality as depositors shifted funds to larger institutions. In order to offset the effects of higher lending rates on the more vulnerable segments of society, special funds were set up to enhance access to financing by selected sectors at concessional rates. In addition, measures to improve liquidity flows were implemented, including further reduction of the SRR and measures to make money market operations more transparent and to ensure efficient liquidity management.

Despite the injection of funds by BNM into the banking system, weaker business expectations and more cautious lending policies of the banking institutions led to a sharper-than-expected slowdown in loan growth. Thus, with banking institutions continuing to be preoccupied with managing their existing asset portfolios, total loans extended by the banking system generally declined since February 1998. The lack of access to credit by borrowers contributed to dampening the Malaysian economy further. Real output contracted by 2.8% in the first quarter and further by 6.8% in the second quarter. In the first half-year, real GDP contracted by 4.8%.

The adverse developments in the real and financial sectors led to the deterioration in the asset quality of the banking institutions. The lower stock prices and higher interest rates made it more difficult for companies to service loans. The non-performing loan ratio rose on the average by 1% a month. As at end-June 1998, the net non-performing loans (NPLs) to total loans ratio for the banking system had increased to 8.9% based on the 3-month classification from 4.7% as at 31 December 1997. The risk-weighted capital ratio (RWCR), however, remained high at 11.2% as at end-June 1998 from 12% as at end-June 1997. While the RWCR of the banking system as a whole remained well above the minimum Bank for International Settlements (BIS) requirement of 8%, some banking institutions required recapitalisation.

Given these adverse developments from the prolonged crisis and the sharper-than-anticipated contraction in the domestic economy, Malaysia adopted a comprehensive approach to avoid a deflation-recession spiral. Recognising the limited capacity of the private sector due to liquidity problems, it was decided in early 1998 that the public sector would bear the major burden of stabilising domestic demand. The successful fiscal consolidation since 1982, which was evident in the

budget surpluses during the period 1993-97, gave greater flexibility to the Government to adopt an expansionary fiscal stance. In late July, the National Economic Action Council announced the National Economic Recovery Plan (NERP) to provide a comprehensive and action-oriented framework to expedite economic recovery. The six objectives of the NERP are interrelated and complementary, that is, stabilising the ringgit; restoring market confidence; maintaining financial stability; strengthening economic fundamentals; continuing the equity and socio-economic agenda; and restoring adversely affected sectors.

Fiscal policy was selectively relaxed beginning March 1998, following changing economic and financial conditions. At the time of the Budget 1998 (October 1997), the Federal Government targeted to maintain a fiscal surplus of 2.7% of GNP. This target was reduced to 0.5% in March 1998 and thereafter to a deficit of 3.7% of GNP. The fiscal deficit remained manageable, funded by non-inflationary finance, mainly domestic savings. The fiscal measures included selective increase in infrastructure spending, setting-up of funds to support small- and medium-sized enterprises, higher allocation on social sector development as well as reducing taxes. Additional expenditures have been carefully programmed to generate high multiplier effects, without rekindling inflationary pressures while preserving the improvement in the current account position of the balance of payments. Special funds were also established or expanded to provide credit to priority sectors at concessional rates.

With the moderation in inflation, monetary policy was eased in August to be consistent with fiscal policy in promoting new activities. The SRR and BNM 3-month intervention rate were reduced in stages. To encourage banking institutions to break from the self-imposed mentality of cutting back loans, banks which had the capacity to lend were encouraged to increase loan growth to at least 8%. Rules on recognition of NPLs were also adjusted to provide breathing room to both financial institutions and the corporate sector, without sacrificing financial prudence and supervision.

At the same time, BNM embarked on a comprehensive restructuring programme for the banking sector. The approach was to provide a mechanism to deal with the rising NPLs, the need for recapitalisation of certain banking institutions and corporate debt restructuring in a market-oriented and transparent manner. The approach was also pre-emptive because the institutional arrangement commenced as early as March 1998 before NPLs reached high levels. The institutional framework to restructure the banking institutions started as early as January 1998 with the **merger programme for finance companies** to consolidate the sector. The final outcome would be a reduction in the number of finance companies from 39 to less than half of this number. Subsequently, in June 1998, the Government set up **Pengurusan Danaharta Nasional Berhad (Danaharta)**, an asset management company, to purchase NPLs from the banking institutions. The objective was to enable the banking institutions to focus on loan intermediation to support economic activities. The banking system remained relatively resilient throughout the crisis. The existence of high prudential and supervisory standards prior to the crisis had placed the system on a strong foundation to cope with the stress from the crisis. However, while the industry as a whole remained resilient, certain banking institutions experienced capital loss. **Danamodal Nasional Berhad (Danamodal)**, a special purpose vehicle was set up as an interim funding vehicle which would meet the required capital injections of affected institutions.

In order to contain the growth in NPLs, it was essential to address financing problems of viable businesses which were affected by the crisis. In August, the **Corporate Debt Restructuring Committee (CDRC)** was set up to complement the restructuring of the financial institutions. The CDRC's main objective was to implement a comprehensive framework for debt restructuring through bringing together creditors and debtors for a voluntary debt workout. To co-ordinate the activities of the three agencies, a Steering Committee, chaired by the Governor of BNM, oversees and monitors the policies, operations, and progress of these agencies to ensure that they operate in a cohesive and structured manner to achieve the objectives. The financial corporate restructuring exercises in Malaysia are based on the following principles:

- Minimise the use of public funds;
- Transparency in the bank restructuring process as well as operating guidelines for the institutions established to undertake the restructuring process;

- Operations of institutions based on commercial and market-oriented principles;
- Recapitalisation of financial institutions must be tied to comprehensive restructuring of each financial institution including, where appropriate, a change in management; and
- Ensure equitable burden-sharing among stakeholders.

Despite the measures taken, uncertainty over international and regional developments remained. Instability in the ringgit exchange rates was further aggravated by outflows of ringgit to offshore ringgit markets. It was felt that ringgit exchange rates could only stabilise with a return of positive sentiment and confidence and economic recovery. The need to stabilise the ringgit exchange rates prompted the imposition of selective exchange controls on 1 September 1998. The controls were targeted at containing potential speculation against the ringgit by reducing the avenues for offshore markets to fund ringgit activities. Convertibility of the current account transactions was maintained, and inflows and outflows of long-term foreign investment remained free. On 2 September 1998, the ringgit exchange rate was also fixed at US$1=RM3.80. The exchange control measures are not intended to disrupt or dislocate genuine trade-related activities or foreign direct investment (FDI). The rules on FDI have not changed. Indeed, Malaysia had further liberalised the foreign equity investment guidelines in selected sectors in order to encourage the inflow of longer-term capital to further boost the foreign direct investment (FDI). The share of foreign equity investment had been raised to 49% in the telecommunications sector (61% for a period of 5 years on a case-by-case basis); 51% in the insurance sector (subject to certain conditions) and 49% in the stock broking industry. In the manufacturing sector, 100% foreign ownership was allowed for applications received between 31 July 1998 and 31 December 2000.

While the exchange control measures did not act as a constraint, long-term investors, however, remained cautious due mainly to the uncertain global environment. While the value of manufacturing investment approved by the Ministry of International Trade and Industry (MITI) increased to RM26.4 billion in 1998 (RM25.8 billion in 1997), the value of applications received by MITI for the establishment of manufacturing projects was lower amounting to RM19 billion (RM34.2 billion in 1997).

Overall, Malaysia ended the year on a positive note, with the underlying economic conditions generally favourable. Price pressures had abated, with CPI stabilising at 5.3% for 1998, lower than the earlier projection of 7–8%. The economy had shown signs of recovery, although real GDP in the second half-year, on a year-on-year basis, continued to contract due to the high base in 1997. Of significance, exports in key sectors, including electronics, had improved in United States dollar terms. The external reserves of BNM had not only remained intact and unencumbered, but had also continued to rise by US$8.5 billion from US$20.2 billion at end-August to US$28.7 billion at end-February 1999, adequate to finance 6.2 months of retained imports. On the employment front, the situation is improving, with the number of employees retrenched declining to 5,556 in December, from a peak of 12,335 in July. The number of registered job seekers is on a declining trend (33,345 as at end-1998; 34,514 as at end-July 1998).

The fixed exchange rate had been positive for economic activity. Lending rates had declined to below pre-crisis levels, and loan approvals have begun to increase. The value of loans approved by the banking system has picked up to a monthly average of RM7.1 billion in September-December, compared with an average of RM4.2 billion in the first eight months of 1998. On an annual basis, loans extended by the commercial banks rose by 3.3% as at end-December 1998. This increase was, however, more than offset by the decline in loans extended by the finance companies (–15%) and the merchant banks (–3.7%). The decline in loans extended by the finance companies was to some extent due to the ongoing merger programme and restructuring exercise that affected their lending operations. With the inclusion of NPLs sold to Danaharta, outstanding loans in the banking system would have increased by 1.3% on an annual basis.

The progress on bank restructuring had been on track. Danaharta had acquired and managed NPLs from the banking institutions amounting to RM15.1 billion, equivalent to about 20% of total NPLs of the banking system. Including NPLs

Box I

The Asian Crisis: A Survey of Views on the Causes and Policy Response

Introduction

The East Asian crisis that began in July 1997 was unprecedented in terms of the speed and severity of the contagion effect which spread to countries spanning three continents. At its initial stage, the crisis was perceived as an isolated problem affecting individual countries. However, as the crisis deepened and widened, an international consensus emerged that external factors also contributed to the crisis. This article summarises the evolving views on the roots of the Asian crisis and the corresponding policy responses. It concludes that both domestic and international factors contributed to the crisis and that the appropriate response would be needed to address weaknesses on both fronts.

Why is the Asian Crisis Different from Previous Crises?

The Asian crisis occurred following a decade of strong economic performance in all crisis-affected countries. To varying degrees across countries, the crisis resulted in a significant wealth loss, declines in asset prices, sudden capital flight and threats to currency and banking system stability. Adverse consequences were reflected in corporate problems, rising non-performing loans in the banking institutions, declining output, rising unemployment and deflation.

Unlike previous crises such as the global debt crisis in the 1980s, which originated mainly from the public sector, the source of instability in the Asian countries emanated mainly from the private sector. Conditions prevailing in the Asian crisis countries prior to June 1997 showed that these countries had strong fundamentals — price stability, high saving and investment ratios, fiscal surplus and high foreign exchange reserves. Capital inflows financed investment rather than consumption. However, there were some similarities between the Asian and Mexican crises in terms of large short-term capital inflows, large current account deficits, and nominal and real exchange rate appreciation. In the case of the Asian countries, the general consensus is that the "trigger" for the crisis was the rapid accumulation of private short-term foreign debt.

Causes of the Asian Crisis

The depth and severity of the contagion of the Asian crisis have created considerable debate on the cause of the crisis and the appropriateness of policy responses. The different views on the causes of the Asian crisis can be broadly categorised into two groups. The first view attributes the crisis primarily to policy weaknesses in the domestic economy, while the second view maintains that external factors were responsible for the crisis.

Among the proponents of the view that the crisis reflected domestic policy weaknesses was the **International Monetary Fund (IMF)**. While accepting that fiscal balances were generally favourable in the crisis-affected economies, the IMF had raised concerns on overheating pressures that became evident in many countries in the region that was manifested by large current account deficits and property and stock market bubbles. The IMF further suggested that the crisis stemmed from weaknesses in domestic financial systems and governance in these countries. According to this view, a combination of inadequate financial sector supervision, poor assessment and management of financial risk, and the maintenance of relatively fixed exchange rates led banks and corporations to borrow large amounts of international capital. Much of the borrowing was short-term, denominated in foreign currency, and unhedged. Sluggish growth in the advanced economies, in particular Europe and Japan, made investments in fast-growing Asian countries relatively attractive and thus led to the

build-up of foreign capital inflows. Over time, it was argued that these inflows tended to be used to finance poorer-quality investments. It was further suggested that this was exacerbated by governance issues, notably government involvement in the private sector and lack of transparency in corporate and fiscal accounting and the provision of financial and economic data. As the crises unfolded, the questions that were raised about the authorities' commitment and ability to implement the necessary adjustment and reforms also exacerbated pressures on currencies and stock markets.

The **World Bank** shared this view that the key problems were in the financial sector, where distorted incentives, weak regulatory standards, poorly managed financial liberalisation, and inadequate disclosure and supervision encouraged excessive risk taking. It was argued that these financial sector weaknesses led to poor investments and a proliferation of non-performing loans. Large capital inflows amplified these problems and fuelled domestic demand which, coupled with the depreciation of the yen against the dollar, caused real exchange rates to appreciate. When the crisis broke out, the currency depreciation increased the local currency value of the external debts owed by banks and businesses, creating solvency problems. As debts mounted, the firms attempted to reduce their foreign exchange liabilities by obtaining dollars to close out open positions. This further increased the demand for foreign exchange, thus leading to even greater depreciation of the domestic currency. The crisis also resulted in immense human suffering due to lack of social safety nets in crisis-affected countries as they had relied on rapid growth and employment to provide social security to their people.

Among the academia, **Professor Paul Krugman** of the Massachusetts Institute of Technology (MIT) attributed the crisis to macroeconomic policy slippages and weaknesses in financial systems in the affected countries. He suggested that the crisis originated from financial intermediaries whose liabilities were perceived as having an implicit government guarantee, but were essentially unregulated and, therefore, subjected to severe moral hazard problem. This resulted in financial excesses, over-investment, unrealistic speculation, particularly in real estate, and inefficient resource allocation to politically connected individuals, all of which inflated asset prices. Imprudent public spending also contributed to the build-up to the crisis, following several years of rapid growth. This view emphasises the reaction of currency and equity markets to payments disequilibrium and weak economic fundamentals, which include large current account deficit and external debt.

According to **Professor Rudi Dornbusch** of MIT, the Asian 'capital market crisis' reflected the varying degrees of exposure of Asian countries to external capital or financial instruments, which rendered the economies vulnerable to various developments. These vulnerabilities arose from a mismatch of maturities and currency denominations of assets and liabilities of financial systems and large corporations in the Asian countries. Another source of vulnerability was market risk where external funds were borrowed to purchase foreign stocks and commodities whose value fluctuated with the movements in the exchange rates. Since the banks and companies had collectively assumed a large risk position, the national credit standing was also at risk. The build-up of these vulnerabilities was the result of fragile financial structures arising from negligent or deliberate lack of regulation, supervision and transparency. External factors did play a role in the run up to the crisis, namely the performance of the Japanese economy which adversely affected the trade environment of the Asian economies. The other factor was the sharp fluctuation of yen/ dollar exchange rate.

In contrast to the earlier views that blamed the crisis mainly on domestic economic conditions and policies in the Asian countries, an alternative view pointed to weaknesses in the international financial system. The main proponent of this view has been **Professor Jeffrey Sachs** of Harvard University, who noted that economic fundamentals in the crisis-affected countries were basically sound. The crisis was seen as a classic case of financial panic with capital flight aggravated by the mismatch of maturities and currencies of many Asian banks and borrowers. This view noted that the financial system in the affected countries was not adequately prepared to deal with the risks of rapid financial liberalisation, which rendered the countries vulnerable to external shocks. The problem was compounded by weaknesses in the

international financial system. Such weaknesses permitted massive and volatile cross-border capital flows that often overwhelmed the relatively small size of financial markets in emerging economies.

Professor Jagdish Bhagwati of Columbia University has written that the Asian crisis was due partly to rapid financial liberalisation in the crisis countries, without the adequate policy and institutional framework. He voiced concern that while the benefits of free capital movements had frequently been propagated, its costs were often underestimated, including that of an outbreak of systemic crisis. The arguments in favour of free trade do not necessarily apply to capital movements. Unlike trade, failures in capital markets can be severe because of lack of information and the problem of mismatch of assets and liabilities.

In a recent speech, **Mr. Joseph Yam**, Chief Executive of the Hong Kong Monetary Authority, maintained that the crisis reflected the flaws in the global financial system. He noted that financial market liberalisation and globalisation, advancements in information technology and the increasing sophistication of investment tools have outpaced improvements in the management of the global financial system, which remained primitive and fragmented and rendered the international financial architecture incapable of coping with the demands of global finance. The essence of the problem was the operations of the highly leveraged institutions, which could move vast amounts of funds around the world rapidly and with little or no regulation. He maintained that, by distorting or manipulating markets in search of profits, the highly leveraged institutions were "capable of throwing many smaller, vulnerable economies into chaos".

Malaysia has been among the first countries to voice the view that the Asian crisis reflected shortfalls in the management of the international financial system. During the Joint Annual Meetings of the IMF and World Bank in September 1997, the Prime Minister, **Dato' Seri Dr. Mahathir Mohamad**, highlighted the dangers of volatile flows of speculative, short-term capital in disrupting trade and real economic activities. Large market players had been able to manipulate the financial markets to their advantage, to the detriment of the economic well-being of many economies. Furthermore, trade in currency, which had become so much bigger than real trade in goods and services, only contributes to huge uncertainties and volatile currency movements so as to cause financial crisis for the country concerned. As such, he had called for an international mechanism to regulate short-term capital flows. Despite the initial differences in views, there is now a growing consensus that the Asian crisis also reflected flaws in the international financial architecture.

Policy Response

At the initial stage of the Asian crisis, the predominant view of the international community was that the crisis was an isolated case of policy weaknesses in individual countries. Hence, the international response focused on efforts to encourage the crisis-afflicted countries to implement economic and financial reforms, increase transparency of government policies and undertake macroeconomic adjustments and measures to strengthen domestic economic and financial systems.

Thailand, Indonesia and Korea initially instituted measures to address their respective economic weaknesses and to stem speculative attacks on their currencies. These countries subsequently sought financial assistance from the **IMF**. In line with IMF programmes, conditionalities of tight monetary and fiscal policies, and structural reforms were imposed, particularly in the financial sector. The rationale was as follows: tight monetary policy was needed to restore confidence and contain inflation. Higher interest rates were viewed as necessary to support domestic currencies. Fiscal tightening was needed to correct macroeconomic imbalances and to make up for the cost of cleaning up the financial sector. Rapid structural reform was needed to address financial sector weaknesses, imbalances in corporate finances, improve governance, and market imperfections. Trade and financial liberalisation were also included in the programmes to attract foreign capital.

In all three countries, fiscal and monetary policies were tightened significantly from the inception of IMF programmes. Financial sector restructuring was initiated. The intensity and

implementation of the reforms varied to reflect the different institutional framework and machinery in each country. Non-viable financial institutions were closed and legal and institutional frameworks were established for the disposal of assets, as well as bankruptcy and foreclosure procedures. The remaining viable financial institutions were recapitalised, either through domestic or foreign capital, or a combination of both. Labour market reform was also carried out. In some countries, structural reforms also included the dismantling of monopolies and abolition of subsidies which were subsequently reinstated, following social unrest.

The IMF programmes instituted in the three Asian countries were fairly similar to the Mexican programme in 1995. In the case of Mexico, apart from tight monetary and fiscal policies, adoption of a floating exchange rate, and advances in structural reform and market liberalisation, the Mexican government also implemented measures to avoid contagion. These measures included provision of liquidity in foreign exchange by the central bank to commercial banks to prevent them from becoming delinquent on their foreign obligations. Also included were the activation of a programme to provide temporary capital to banks and a subsequent programme to increase the incentives for investment in distressed banks, legal reforms to allow greater foreign equity participation in banks and programmes to back certain categories of bank debtors.

The difference though was in the timing of efforts to address the external debt problems. In the case of Mexico, negotiations with foreign creditors for debt restructuring purposes were initiated soon after the inception of the programme. In the case of the three Asian countries, debt restructuring came later in the programmes. In Mexico, there were fiscal imbalances, with very high public sector's short-term external liabilities. This was not the case in Asia. Thus, the cutback in public expenditure and fiscal consolidation, in addition to higher interest rates, exacerbated the economic downturn. As the domestic currencies continued to depreciate, the liquidity problems of the financial systems and corporate sectors worsened, because the depreciated currencies translated into rising debt denominated in domestic currencies. The problem was only resolved when the affected countries started negotiations for a rollover of short-term credit for a period of three months until end-March 1998 and to further convert them into medium-term bonds. In the case of Indonesia, other factors caused delays in assistance and the implementation of IMF programmes.

There has been significant debate on the IMF policy response. The **World Bank** has suggested that the IMF's prescription of high interest rates and fiscal restraint has contributed to the recessionary forces. **Jeffrey Sachs** argued that the rescue package by the IMF should have delivered more financial assistance and less conditionalities. Meanwhile, **Martin Feldstein** from Harvard University suggested that the demands by IMF for far-reaching structural reforms to resolve Asia's liquidity crisis were unnecessary and counter-productive. **Paul Krugman** provided an alternative to the crisis countries by advocating capital control, with certain preconditions. The imposition of exchange controls should complement, not replace economic and financial reforms and that the controls should not be used to defend an over-valued currency. Since it imposed distortions on the economy, it should not be maintained any longer than necessary, with a clear exit policy.

Contagion Dynamics

Contagion during the Mexican crisis was limited to a few countries in Latin America. In contrast, contagion was widespread in the case of the Asian crisis. An attack on one currency spilled over or spread to the currencies of other countries with apparently sound fundamentals. This could be attributed to trade and capital market linkages (through a devaluation in one country which adversely affected the international competitiveness of other countries) or interdependence in the creditors' portfolios (where illiquidity in one market forces financial intermediaries to liquidate assets in other markets).

The Asian crisis, which was initially confined to East Asia, spread to other regions by the end of 1997. This reflected market concern over the emergence of vulnerabilities in these regions similar to those seen earlier in Asia. In contrast to the Mexican crisis, the international setting

prior to the outbreak of the Asian crisis was characterised by declines in non-oil commodity prices in 1996. The Asian crisis, which reduced aggregate demand in Asia, aggravated this downturn and partly led to the decline in oil prices. This weakened the balance of payments and partly, the fiscal position of commodity-exporting countries. On the other hand, currency depreciation in Asia gave rise to market concerns over external competitiveness, particularly in Latin America. In the case of Russia, both the fiscal and external debt positions were unsustainable. The devaluation of the ruble to significant investor pessimism over investments in emerging markets, and this adversely affected market sentiment over Brazil's fiscal position and therefore, its exchange rate arrangement.

Another factor that led to the contagion was the herd behaviour among investors when investors generalised the risks and grouped the Asian countries as having a common set of vulnerabilities despite the fact that these countries had different economic and financial structures. It became self-fulfilling of market expectations due to the impact of massive reversal in capital flows on the affected economies. The forces that allowed for this to occur included the advances in telecommunication and information technology, financial liberalisation, and the development of complex and innovative financial products.

In the Asian crisis, currency speculation by international investors proved more damaging because the amounts involved were very large. Less orthodox responses were implemented to protect the economies and avoid further economic contraction. In August 1998, Hong Kong Special Administrative Region (SAR), The People's Republic of China took action against market manipulation by currency traders by instituting general measures to counter speculative attacks on its currency and stock markets. The Hong Kong government also made substantial purchases in its stock and futures exchanges in an unexpected move to defend its financial system against concerted speculative attacks.

In the case of Malaysia, the authorities had initially focused on conventional macroeconomic measures to address the crisis. However, as conditions in the regional and global financial markets worsened, and speculative pressures against the Malaysian ringgit continued to build up, Malaysia implemented, in September 1998, measures to curb the internationalisation of the Malaysian ringgit and discourage destabilising short-term capital inflows. The measures sought to protect the domestic economy from potentially damaging external shocks in order to provide a stable environment to facilitate ongoing economic and financial adjustments. The measures were subsequently modified in February 1999 (see Box III).

Towards a New International Financial Architecture

As the crisis became more prolonged and severe than anticipated, there was a growing international recognition that remedial actions were needed at the international level as well. It was noted that several external factors, namely, imprudent foreign investor behaviour, herding behaviour and speculative activity, played a major role in aggravating the crisis. These developments highlighted weaknesses in the international financial system, notably the lack of an appropriate framework to ensure orderly global financial markets. One of the elements of the Basle capital-adequacy standard, for example, is that short-term lending requires less provisioning than long-term loans. This has encouraged international banks to indulge in the practice of lending short-term because such loans carried a lower risk-weighting.

Proposals for reforms of the international financial architecture have been discussed at various fora, including the IMF, Bank for International Settlements (BIS), the Willard Group or Group of 22, Association of South-East Asian Nations (ASEAN), the Group of Seven (G-7), Group of Fifteen, Group of 24 and Asia-Pacific Economic Co-operation (APEC). The clearest sign of the international recognition of the global nature of the Asian crisis came in October 1998, when the G-7 endorsed several G-22 proposals on reforms in the international financial system. These included a recognition of the need to examine the implications of the operations of highly leveraged and offshore institutions, with a view to encouraging offshore centres to comply with internationally agreed standards. The G-7 also emphasised the need to review and

strengthen the role of the IMF, the World Bank, and other international financial institutions in crisis prevention and resolution.

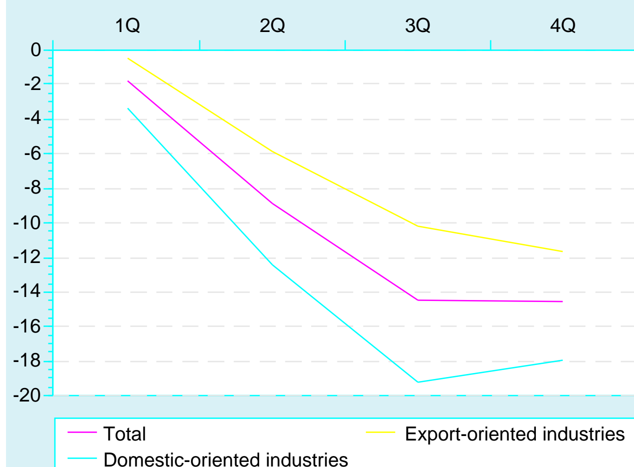
It is recognised that the reform of the international financial system should, at least, include a number of important elements. First, there is a need for a more balanced approach to the issue of transparency and disclosure by not only the public but also the private sector. Second, there needs to be surveillance of capital flows, in particular short-term flows to ensure the orderly functioning of the international financial markets and that the destructive volatility of international capital flows can be prevented. Measures would be necessary to address the issue of cross-border manipulative activities in financial markets and the need for appropriate international prudential standards in financial institutions, especially on exposure of commercial banks to the highly leveraged financial institutions. Third, a mechanism is needed to ensure that international rating agencies are made more accountable for their actions, given the implication of their actions on financial markets. Lastly, a framework for the orderly liberalisation of the capital account with appropriate criteria to serve as guideposts for countries is needed.

Notwithstanding the international recognition of the need for a global solution to the Asian crisis, progress in terms of building a consensus on concrete measures and initiatives to implement the proposed reform in the international financial system remain slow. In this connection, while moves on arrangements to reform the international financial system have been confined to the G-7 and multilateral institutions, developing and emerging market economies have been drawn in to participate at G-7 initiated forums to present their views. To be effective, discussions on the reform of the international financial architecture need to include the advanced and developing countries given the bond arising from the globalisation process.

Conclusion

There is a growing literature on the causes and consequences of the Asian crisis. As the crisis unfolded and its contagion spread, perceptions of the crisis have changed, from being a localised to a regional and international problem. While it is recognised that individual countries must implement economic and financial reforms to put their houses in order, there is also a realisation that such efforts would not be sufficient. As a result, the search for solutions has focused increasingly on reforms to the international financial architecture to ensure that globalisation and financial liberalisation proceed in an orderly manner. In particular, there are growing concerns on the need to manage capital flows and prevent manipulation of currencies. In this regard, appropriate safeguards and mechanisms need to be in place in order to maximise the benefits of globalisation while mitigating the potential destabilising effects of volatile short-term capital flows.

acquired from other financial institutions, the total NPLs acquired and managed amounted to RM21.7 billion. Danamodal had injected RM6.15 billion in the form of Exchange Subordinated Capital loans into ten institutions. CDRC had received 48 applications for assistance with debt restructuring. Total debt of the companies amounted to RM22.7 billion. A total of 26 creditor committees have already been formed and two debt restructuring schemes have been implemented. CDRC had also recently announced the debt restructuring proposal for one of the largest conglomerate, involving RM8.4 billion, without any need for Government financial assistance. This is consistent with the Government's policies where private sector solutions are applied for problems faced by Malaysian companies.



Overall, there are indications that the trough in the growth cycle had been reached in the third quarter of 1998. Greater stability in terms of the foreign exchange and stock markets and the financial system has encouraged a steady revival in consumer and investor confidence. Macroeconomic policies had been geared to ensuring that the non-inflationary expansion of output and employment would be maintained over the medium term.

Sectoral Review

Manufacturing

The manufacturing sector was affected by the slowdown in the Asia-Pacific region as well as in the domestic economy in 1998. Output of the manufacturing sector contracted by 10.2% during the year, the first decline since 1985. The decline was broad-based with almost all industries recording lower production levels although the declines were more pronounced in industries producing construction-related materials and transport equipment. The impact of the regional financial crisis was less severe in the first quarter as the manufacturing sector contracted by only 1.8%. However, the effects of the crisis became evident in the second quarter when production fell by 8.9%. The situation worsened in the third and fourth quarters when the sector contracted sharply by 14.5% and 14.7% respectively. Owing to the severe contraction in domestic demand, output of the domestic-oriented industries declined sharply by 13.4% in 1998. Export-oriented industries also recorded a decline in production, albeit at a less rapid pace of 7.3%, reflecting mainly the economic downturn in the Asia-Pacific region, which accounted for 40% of Malaysia's manufactured exports.

Production of **electrical machinery, apparatus, appliances and supplies** as a group shrank by 7.7% in 1998, attributable to weak demand from the Asia-Pacific region as well as a depressed global market for semiconductors. During the year, the global semiconductor market experienced another year of decline as the excess supply of memory chips continued to persist. The resultant sharp decline in prices prompted some major world producers to halt or cut back their production of DRAM chips, contributing to some price stability, particularly towards the end of the year. Some manufacturers in Malaysia had also taken a similar action as the product was no longer profitable. Consequently, the output performance of the electronics industry deteriorated from an increase of 3.1% in the first quarter to a decline of 11.3% in the third quarter. Nevertheless, the performance of the industry improved in the fourth quarter to record a more moderate decline of 6%, boosted mainly by the revival in the disk-drive sub-sector as well as higher sales of personal computers. Demand for disk-drives started to pick up towards the end of the year in line with the depletion of inventories. The recovery was facilitated by the need to upgrade facilities in preparation for the Y2K problem.

In the face of the regional economic slowdown, the performance of the electrical appliances sub-

sector continued to deteriorate. As external demand started to dwindle, a number of companies resorted to shorter working days or reducing the number of shifts, resulting in a more severe contraction in output from 1.5% in the first quarter to 26.1% in the fourth quarter. The decline reflected mainly sharply lower production of air-conditioners and cables and wires.

Production of textiles declined by 8.8% in 1998 due to sluggish demand from the Asia-Pacific countries. In particular, the natural fibre spinning and weaving activities fell sharply due to cutbacks in production in response to the rising cost of imported cotton. The decline, however, was offset in part by an increase of 1.1% in the wearing apparel sub-sector, supported mainly by higher demand from the United States and Europe. On balance, the **textiles and wearing apparel industry** as a group contracted by 5.3% in 1998.

Table 1.6
Growth in Manufacturing Production (1993=100)

	1996	1997	1998
	Annual change (%)		
Export-oriented Industry	**8.2**	**10.3**	**–7.3**
Electrical machinery, apparatus, appliances and supplies	8.8	13.6	–7.7
Radio and television sets	*6.0*	*–7.2*	*3.9*
Semiconductors	*12.6*	*22.8*	*–4.2*
Cables and wires	*12.6*	*10.4*	*–29.4*
Manuf. of office, computing and accounting machinery	*–2.3*	*9.1*	*–4.5*
Manuf. of refrigerating, exhaust, ventilating and air-conditioning machinery	*–5.0*	*–0.7*	*–48.5*
(Electronics)	(12.6)	(22.8)	(–4.2)
(Electrical)	(3.2)	(–1.7)	(–14.8)
Textiles and wearing apparel	0.0	5.3	–5.3
Wood and wood products	11.4	–1.6	–11.3
Off-estate processing	10.2	9.8	–2.7
Domestic-oriented Industry	**16.9**	**14.6**	**–13.4**
Chemicals and chemical products	19.5	24.5	–1.8
Construction-related products	21.1	11.3	–27.6
Non-metallic mineral products	*24.5*	*10.1*	*–26.5*
Basic iron & steel and non-ferrous metal	*17.1*	*13.1*	*–29.1*
Transport equipment	22.3	14.3	–52.2
Food products	4.4	3.8	–2.1
Beverages	15.6	–0.2	–11.9
Tobacco products	7.4	19.9	–9.1
Rubber products	11.1	3.4	7.8
Petroleum products	12.7	8.9	–11.5
Fabricated metal products	23.1	11.9	–17.2
Paper products	–4.9	13.0	–8.7
Total	**12.3**	**12.4**	**–10.2**

Source: Department of Statistics

Lower demand from Japan and The People's Republic of China, coupled with the downturn in domestic construction activities and weak demand for furniture led to a sharp contraction of 11.3% in the **wood and wood products industry.** The lower output was attributed mainly to a sharp decline in the plywood, hardboard and particle board sub-sector, which mainly catered for the export market. However, the decline was offset partly by higher production in the sawn timber sub-sector.

Production in the **off-estate processing industry** was affected by insufficient supply of raw materials and higher crude palm oil prices. Following an increase of 1.4% in the first quarter, output contracted sharply by 10.4% in the second quarter as production of crude palm oil fell markedly. With a slower decline in crude palm oil production in the second half-year, output of the off-estate processing industry improved to record a marginal decline of 0.8% in the second half of 1998 (–5% in the first half of 1998). For the year as a whole, output declined by 2.7%.

Growth in the domestic-oriented industries was affected by the slowdown in the domestic economy. However, due to the lag effect, the impact was less severe in the first quarter as output of the domestic-oriented industries declined only moderately by 3.4%. As the economic situation deteriorated, output declined further by 12.4% and 19.2% in the second and third quarters respectively. The decline moderated to 17.9% in the fourth quarter as domestic demand improved following the implementation of several measures to stimulate the economy. For the year as a whole, output declined by 13.4%.

Reflecting the sharp downturn in construction activities, output of the **construction-related products industries** contracted sharply by 22.4% in the first half of 1998, followed by a sharper decline of 34.6% in the third quarter and a more moderate decline of 30.6% in the final quarter. For the year as a whole, the output of this group of industries declined by 27.6%. The postponement of several large projects, including the development of higher cost residential houses, caused demand for non-metallic mineral products and iron and steel to fall sharply, particularly in the third quarter. Consequently, these industries were faced with

excess capacity and inventories. The situation was aggravated by the expansion programmes undertaken by companies before the onset of the financial crisis in mid-1997.

The **fabricated metal products industry** was not severely affected by the economic slowdown in the first half of 1998 as its output declined by only 5.1%. However, in the face of the sharp downturn in the construction sector, output contracted sharply by 29.3% in the second half of 1998. For the year as a whole, the industry recorded an output decline of 17.2%. The lower output level reflected mainly the decline in the production of structural metal products attributable to slack demand from the heavy and light engineering sub-sector, especially in the construction sector. Output of other sub-sectors, namely, tin and metal boxes, wire and wire products and brass, copper and aluminium also declined due to poor domestic demand.

Despite the economic slowdown, output of the **chemicals and chemical products industry** continued to record an impressive growth of 8.3% in the first quarter of 1998, supported mainly by the expansion in the plastic products, fertilisers and pesticides and soap and cleaning products sub-sectors. As experienced by other industries, output of this industry also declined in the last three quarters, albeit at a relatively low rate of 4.9%. The decline was attributable mainly to lower production of industrial gases (mainly LNG) arising from lower demand from Japan and Korea. In addition, production in the paints, varnishes and lacquers sub-sector also declined due to the downturn in the construction sector. For the year as a whole, the chemicals and chemical products industry declined marginally by 1.8%.

Table 1.7
Manufacturing Production: Selected Indicators

	1998	1997	1998
	Output	Annual change (%)	
Integrated circuits (million units)	11,652	28.6	–7.3
Semiconductors (million units)	8,950	41.9	20.4
Television sets ('000 units)	8,057	–12.7	3.6
Room air-conditioners ('000 units)	1,284	–28.8	–39.3
Household refrigerators ('000 units)	206	–3.1	–17.3
Vehicles assembled ('000 units)	418	22.0	–52.6
Passenger cars	*149*	*15.7*	*–58.8*
Commercial vehicles	*20*	*20.3*	*–78.9*
Motorcycles & scooters	*249*	*28.5*	*–41.3*
Pneumatic tyres ('000 units)	13,567	12.2	–1.1
Rubber gloves (million pairs)	10,588	4.8	–18.8
Plywood ('000 cu.metre)	3,660	1.5	–18.9
Veneer sheets ('000 cu.metre)	1,156	–4.3	–8.6
Liquefied petroleum gas ('000 tonnes)	1,271	–2.9	–6.1
Kerosene & gasoline ('000 tonnes)	2,184	3.1	–2.6
Diesel and gas oil ('000 tonnes)	5,974	7.4	–12.0
Fuel oil ('000 tonnes)	2,390	12.8	–24.2
Cement ('000 tonnes)	10,495	2.6	–17.2
Iron and steel bars and rods ('000 tonnes)	1,892	11.4	–43.9

Source: Department of Statistics

As output of the manufacturing sector weakened, especially in the electronics and electrical products industry, output of the **paper products industry** also declined by 13.2% in the last three quarters of the year (+6% in the first quarter). The decline was attributed to lower production of containers and boxes of paper and paperboard, which were used for packaging purposes. In addition, output of the paper and pulp products sub-sector also declined due to sluggish domestic demand.

The **transport equipment industry** was severely affected by the economic downturn, with output contracting by 52.2% as the demand for motor vehicles declined sharply. Sales of motor vehicles fell from a high of 41,591 units in October 1997 to a low of 6,872 units in February 1998. The decline was caused mainly by increased cost of financing due to tight liquidity as well as difficulties faced by finance companies in sourcing deposits. Subsequently, with the easing of hire purchase criteria since April 1998, reduction in interest rates and promotion activities conducted by car distributors, sales started to increase gradually to reach 23,058 units in December. Overall, output of the transport equipment industry sub-sectors, namely assembly of motor vehicles, motor vehicle parts and accessories and assembly of motor cycles and scooters contracted by 59.5%, 40.1% and 42.1% respectively.

Spurred by strong external demand from the United States and Europe for rubber gloves, output of the **rubber products industry** recorded a strong growth of 7.8% in 1998, representing the only industry that continued to record a positive growth during the economic downturn. The demand for

latex-based examination and surgical gloves was particularly strong for the high quality Malaysian gloves that met stringent international standards. In addition, sales were boosted further by competitive pricing of Malaysian products due to the depreciation of the ringgit. Nevertheless, the strong increase was offset in part by the decline in the output of the tyres and tube industry caused by the sharp decline in car sales. Despite its encouraging growth, the rubber products industry continued to face competition from Thailand.

With the slowdown in the car industry, the demand for **petroleum products** also declined, particularly in the last three quarters (at an average of –13.3%; –5.5% in the first quarter). For the year as a whole, the industry recorded an output decline of 11.5%. The decline reflected lower production by the crude oil refineries as well as lower output of other petroleum products, such as lubricating oil for motor vehicles and premixed asphalt for road construction purposes.

In tandem with the slowdown in domestic demand, output of the **food, beverages and tobacco products industries** as a group was also affected, particularly in the second half of 1998 when its output fell by 9.8% from a marginal increase of 0.4% in the first half of 1998. The decline was broad-based, affecting almost all sub-sectors.

Construction

In 1998, the construction sector experienced a contraction in output due mainly to lower aggregate demand. Value added of the sector declined by 24.5% in 1998, compared with a growth of 9.5% in 1997. To a large extent, the sharp adjustment reflected the strong growth of the sector in recent years. Following the sharp contraction in demand for high end residential and commercial properties during the course of 1998, the value and volume of property transactions fell by 47.6% and 32.3% respectively by the end of the year. The decline of the sector was generally broad-based, affecting the residential, non-residential and civil engineering sub-sectors. However, sustained demand for medium- and low-cost residential properties mitigated the contraction of the sector. The adjustment was more severe in civil engineering due to the completion of large projects and the deferment of new projects. Construction activity was also affected by a stock overhang, particularly of non-residential and high-end condominium properties as a result of the completion of several large projects in the previous few years. Towards the latter part of 1998, several measures were introduced to stimulate residential construction activity in order to moderate the over-adjustment of this sector to the financial crisis.

Table 1.8
Supply of Office Space and Condominiums in the Klang Valley

	Office space		Condominiums		
	No. of projects	Area in sq. metres	No. of projects	No. of units	Area in sq. metres
1983	11	159,840	5	782	81,698
1984	12	342,899	4	561	60,065
1985	28	747,757	9	1,240	204,638
1986	11	304,780	2	460	70,857
1987	10	244,069	6	1,143	175,975
1988	4	43,255	4	936	95,771
1989	2	45,628	4	682	64,248
1990	0	0	8	1,221	139,386
1991	6	57,470	13	2,576	266,252
1992	7	95,296	21	3,346	380,897
1993	12	232,693	26	5,013	565,439
1994	15	350,951	40	8,507	973,202
1995	20	451,119	52	14,241	1,576,297
1996	16	321,629	35	8,342	1,022,444
1997	21	639,375	25	7,530	864,057
1998	29	909,219	45	14,151	1,645,172
1999*e*	19	639,673	28	9,215	967,751
Total	**223**	**5,585,653**	**327**	**79,946**	**9,154,149**

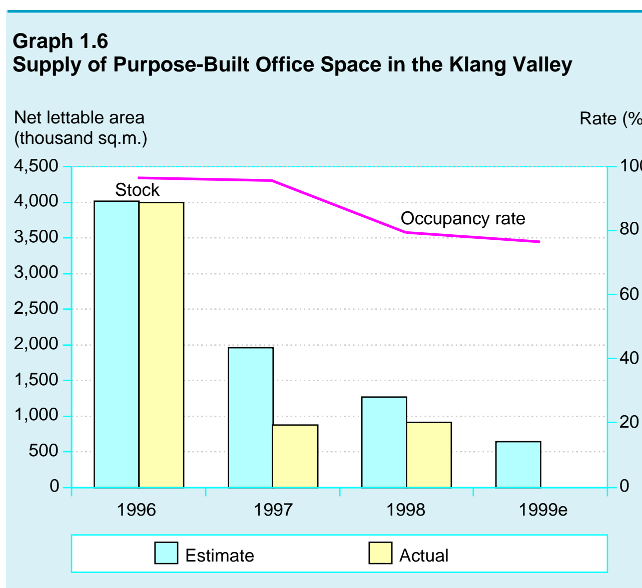
e Estimate

Source: Survey by Bank Negara Malaysia, Valuation and Property Services Department

In the **civil engineering sub-sector**, growth was affected by the deferment of infrastructure projects totalling RM65.6 billion as announced in the 1998 Budget as well as completion of projects associated with the KLIA and the Commonwealth Games Village. The impact became more severe in the second half of 1998 as more projects were deferred, including the Dedicated KL-KLIA Expressway, the People Mover-Rapid Transit System (Phase 1) and the South Klang Valley Expressway. As a result, growth was only supported by other on-going projects related to power plants, airports, roads, rail, water and sewerage and waste disposal. This was confirmed by the findings of the Central Bank's Ad-Hoc Survey of the Civil Engineering Sub-Sector which indicated that 75% of the respondents had deferred or stopped work on at least one project.

Recognising the importance of infrastructure development to facilitate economic recovery, the Government announced in July 1998 an initial fund of RM5 billion for the development of infrastructure. The Fund would assist in reviving selected infrastructure projects which have low import content and high spin-off effects on the economy. The 1999 Budget had also dedicated RM4.04 billion specifically for the building of roads, bridges, rail, ports and civil aviation. Although some of the projects have since been revived, the effect on the economy is expected to be gradual. This was confirmed by Bank Negara Malaysia's survey findings which indicated that of the respondents (64%) who expected their projects to be revived, 86% expressed that activity would only begin in either the first or second half of 1999.

Graph 1.6
Supply of Purpose-Built Office Space in the Klang Valley



The **non-residential sub-sector** contracted sharply by 29% in 1998 (+8.1% in 1997) due mainly to the postponement or delay in the completion of some of the ongoing projects affected by falling demand and financing difficulties that were experienced in the early part of the year. At the same time, growth was constrained by the large increases in capacity which occurred since 1995. The correction was reflected in the decline in the number and value of commercial property transactions by 44.1% and 43.9% respectively in 1998. In particular, industrial property transactions contracted by 48.1% in volume terms and 55.5% in value terms. The hotel sub-sector also slowed down markedly after the completion of several hotels prior to the hosting of the Commonwealth Games in September 1998.

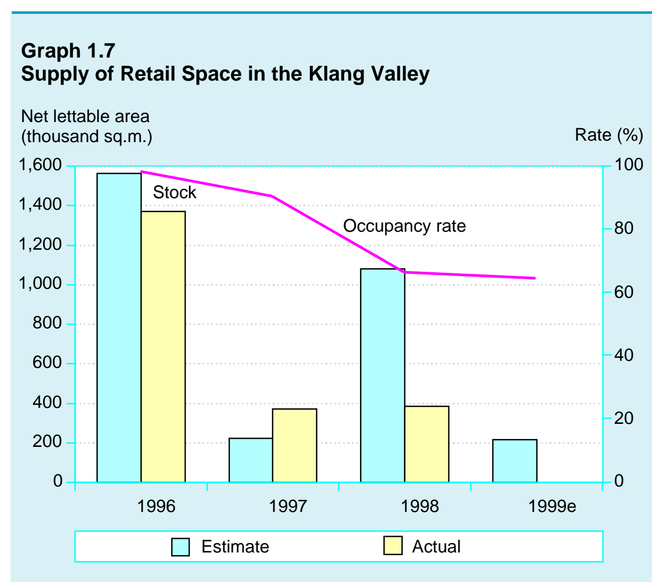
In the **purpose-built office space sub-sector**, growth was mainly supported by ongoing projects, which had started before 1998. Despite the postponement in the completion of some projects, a net lettable area of 0.9 million square metres in the Klang Valley entered the market, bringing the total supply to 5.8 million square metres (+18.7%) at end-1998. Nevertheless, the new supply was substantially lower than the previous estimate of 1.3 million square metres. Most of the office buildings that were completed were located in the central areas of Jalan Sultan Ismail, Jalan Ampang and Jalan Tun Razak. With lower occupancy in the new buildings, especially those in the peripheral areas of the Klang Valley, the average occupancy rate in the office space market continued to decline to around 79% at end-1998 from 95% at end-1997. Nevertheless, office buildings in the Golden Triangle, on average, enjoyed higher occupancy rates compared with secondary areas of Kuala Lumpur and Petaling Jaya. Although the supply of new space will continue to increase due to past commitments, the economic downturn and curbs on financing for high-end properties had prompted developers to postpone further or scale down their projects. As a result, the supply of office space coming on-stream in 1999 and 2000 are expected to moderate significantly. Reflecting the oversupply situation, the average monthly rental declined further to RM41.40 per square metre in 1998 (RM3.85 per square foot) from RM49.75 in 1997. The decline was more pronounced for office buildings in relatively decentralised areas. Rentals in the prime locations in the Golden Triangle also declined, by about 15%.

Similarly, reflecting the completion of projects started earlier, the total stock of **retail space** in commercial complexes in the Klang Valley increased by 0.4 million square metres to 2.1 million square metres at end-1998 (1.7 million square metres at end-1997), lower than an earlier estimate of an additional 1.1 million square metres. Retail space under construction amounted to 1.2 million square metres in 1998 (representing 55.6% of the existing stock), reflecting mainly the continuation of work on delayed projects. The new supply, however, will not come on-stream until 1999 and beyond. With lower demand, occupancy rates in retail centres in the Klang Valley fell to 65.7% at end-1998 (90.5% at end-1997). Nevertheless, commercial complexes in selected areas of Kuala Lumpur that were over two years old continued to have relatively high occupancy rates, averaging 91%.

Construction activity was also lower for the hotel sub-sector, with supply of new hotels moderating to 54 or 9,351 rooms (122 hotels or 27,832 rooms in 1997). The increased supply amidst lower demand from the tourism industry, resulted in a decline in the average occupancy rate to 49.9% in 1998 from 58% in 1997. The decline was across the board with the Klang Valley, Penang and Johor Bahru recording lower occupancy rates of 53.2%, 56% and 48.3% respectively (68.8%, 57% and 56.5% in 1997).

Despite the strong underlying demand, the performance of the **residential sub-sector** was affected by declining income, poor market sentiment and job uncertainties in 1998. Value added of the sub-sector declined by 16.5%. The value of residential property transactions fell by 36% to RM13.9 billion in 1998 (1997: +15.2% to RM21.8 billion). The number of residential transactions declined by 30% to 122,881 units. The contraction in residential construction was also reflected in slow construction starts. New sales and advertising permits for Peninsular Malaysia declined by 28.3% (1997:+18.9%). The number of renewals for sales and their advertising permits, however, increased considerably by 38.8% (1997: –1.2%), reflecting the slowdown in the sale of houses, especially high-cost units costing RM250,000 and above. Similarly, BNM's Ad-hoc Survey of the Residential Sub-sector also showed that construction activity for the period January-August 1998 had contracted by 21-30%, compared with the same period a year ago. Nevertheless, due to past construction activity, the estimated number of completed housing units rose by 7.2% to 154,519 in 1998. A sharp contraction in demand for high end units resulted in an oversupply situation, particularly of condominiums. The situation was aggravated by the supply of high-end condominiums (above RM250,000), coming on-stream in 1998, which increased significantly by 87.9% to 14,151 units, with a total built-up area of 1.6 million square metres.

Graph 1.7
Supply of Retail Space in the Klang Valley



The falling demand and oversupply situation caused a downward correction in house prices for the first time since 1988. The National House Price Index for the first half of 1998 declined by 8.5% compared with an increase of 1.9% for the whole of 1997. The decline was more significant for detached houses (–9%), followed by high-rise units (–5.9%), semi-detached houses (–5.4%) and terraced houses (–4.3%). By region, the decline was more pronounced in Johor Bahru (–21.9%), the Klang Valley (–11.2%) and Pulau Pinang (–11.5%). Among the states, the fall in house prices was most evident in Kuala Lumpur, with prices of semi-detached houses declining by 17.3%, followed by detached houses (–8.8%), high-rise units (–6.8%) and terraced houses (–5.0%). House prices in certain areas, however, declined by up to 30%, especially in areas where prices had recorded higher rates of increase in previous years.

The contraction of the construction sector had severe implications on the economy, affecting especially the low-income group. Several measures were, therefore, introduced during the year to avoid an over-adjustment of the sector and to continue to ensure that construction of medium- and low-cost houses would continue since demand for such houses remained strong. A balanced adjustment among the various sub-sectors in the construction sector was also important as the sector has strong linkages with other economic sectors, especially the manufacturing and services sectors. To meet these objectives, the measures to assist the construction sector focused mainly on reducing the excess stocks built up by several years of investment and ensuring the lower-income group continued to have access to affordable housing. The measures, therefore, supported mainly the construction of low- and medium-cost houses where import content was low and sectoral linkages were high and for which the underlying demand remained strong. In May 1998, a RM2 billion fund for the Special Scheme for Low and Medium Cost Houses was established, of which RM1 billion was made available for bridging finance and another RM1 billion for end-financing. This measure was deemed necessary as the number of houses built for this category had failed to meet

demand. For the period 1996-98, only 24.4% of the low-cost and 20.2% of the medium-cost houses were built out of the respective targets set under the Seventh Malaysia Plan, compared with 80% for the high-cost range. Other measures included the liberalisation of lending for the construction or purchase of residential properties costing RM250,000 and below. Lending for these purposes were exempted from the 20% limit on lending to the broad property sector. The 60% limit on margin of loan financing for the purchase of non-owner occupied properties was also abolished. To help clear the excess stock of residential properties, the Government also assisted in the Home Ownership Campaign (12 December 1998 to 12 January 1999). Financing incentives included exemption of stamp duties and lower financing costs for houses purchased during this period. At the close of the Campaign, total sales amounted to RM3.5 billion for 19,281 units of residential and commercial properties, or about a third of the total number of units offered for sale (56,338) worth RM15.4 billion.

Measures were also introduced to stimulate foreign demand for high-end properties. The RM100,000 levy on foreign purchases was removed with effect from August 1997 and the Real Property Gains Tax was reduced to 5% for disposal of properties after the fifth year as announced in the 1998 Budget. Effective 22 April 1998, foreigners were allowed to purchase all types of residential units, shop houses, commercial and office space costing above RM250,000 per unit, provided financing for such purchase was not obtained in Malaysia and the purchase was only confined to newly completed projects or those which were at least 50% completed. Encouraged by lower prices and the effect of the above measures, foreign purchases of residential property increased considerably by 143% to 1,164 units valued at RM434 million in 1998 (–68.5% to 479 units valued at RM215.6 million in 1997). The bulk of the purchases was mainly for condominiums and terraced houses. Transactions for these properties increased significantly by 141.5% to 891 units valued at RM328.5 million and 564.6% to 165 units valued at RM49 million respectively. In the case of commercial property, however, foreign purchases declined sharply in value by 86.4% to only RM44.3 million (+52% to RM326.2 million in 1997).

The measures to balance the adjustment in the construction sector helped to improve sentiment. The number of housing units approved by the Ministry of Housing and Local Government for construction by private developers rose by 3.4% in Peninsular Malaysia to 194,092 by the end of 1998 (63% to 187,625 units in 1997). These comprised 26.6% low-cost units, 41.1% medium-cost units and 32.3% high-cost units. In line with the Government's effort to promote the construction of low and medium-cost houses, approvals for medium and low-cost units rose significantly by 31.1%, while the number of high-cost units fell by 26.4%. The increase in housing approvals is expected to result in greater construction activity for the residential sub-sector in 1999.

Meanwhile, the downturn in the construction sector had affected the performance of construction-related industries. The production of cement and concrete, iron and steel, and construction-related products declined sharply by 40.8%, 35.6% and 27.6% respectively in 1998. Prices of several major building materials were also adjusted downwards amid a contraction in demand during the year. The average price of glass sheet fell by 12.5% and sand by 17.9%. Nevertheless, the average prices of mosaic floor tiles and glazed wall tiles continued to rise steadily by 15.8% and 42.9% respectively. The price of ordinary portland cement fell by 2.4% to RM10.10, below its ceiling price of RM10.35 per 50 kilogramme bag in Peninsular Malaysia, while the average prices of mild steel round bars and high tensile deformed bars fell marginally by 1.1% and 0.6% respectively.

Demand for construction workers also contracted, although this was moderated by flexible adjustment in the wage rates. The average daily wage for skilled and unskilled foreign workers decreased by 1.5% and 4.5% respectively in 1998 (+15% and –2.6% respectively in 1997). The average daily wage for semi-skilled foreign workers, on the other hand, rose albeit marginally by 0.7% in 1998 (7.7% in 1997). The decline in wages was accounted mainly by the local construction workers. For all three categories i.e. skilled, semi-skilled and unskilled workers, the average daily wage fell by 14.3%, 13.3% and 8.6% respectively. Nevertheless, their wages were still higher by 18.9-24.7% (25–43.3% in 1997) compared to their foreign counterparts.

In 1998, total employment in the construction sector declined by 16.9% to 726,000 (8.5% of total national employment), of which 19.7% (30% in

1997) were foreign workers. The share of foreign workers has become smaller following the repatriation of the surplus foreign workers during the year. Foreign workers in the construction sector constituted 18.3% of total foreign workers in the country.

With the slowdown in construction activities, growth in total loans extended by the banking system to the broad property sector, comprising residential, non-residential, real estate and construction companies moderated to 4.4% (1997: 34%) or RM6.2 billion to RM146.1 billion (including loans sold to Cagamas). However, reflecting the lower volume of total loans extended by the banking system in 1998, the share of loans to the broad property sector increased to 35.3% (1997: 33.2%) as at the end of 1998. Under the broad property sector, loans for the construction sector, purchase of residential property, purchase of non-residential property and real estate accounted for 10.4%, 13.6%, 7.2% and 4% respectively of the total loans extended by the banking system in 1998 (10.1%, 12.1%, 6.8% and 4.3% respectively in 1997). Following the easing of the credit situation in the second half-year, the purchase of housing loans by Cagamas moderated, accounting for 33.9% (1997:38%) of total outstanding housing loans. Reflecting the impact of the measure to limit lending to construction and purchase of high-cost residential properties costing RM150,000 and above (subsequently revised to RM250,000), loan growth for the purchase of high-cost properties (> RM150,000) moderated to 19.4% (1997:72.8%). In contrast, loans extended for the purchase of residential properties costing RM150,000 and below was higher by 17.2% as at end-1998 (end-1997 : -9.0%) to account for 34.5% of total outstanding housing loans. The balance of the total housing loans were for purchases in the RM150,000-RM250,000 and above RM250,000 categories which accounted for 18.6% and 13% of total housing loans, respectively.

In 1998, total loans extended by the banking system and housing credit institutions for purchase of residential houses totalled RM56.8 billion in 1998, an increase of 13.2% compared with 1997. Financing of owner-occupied houses costing RM100,000 or less provided by the banking system amounted to RM11.2 billion. As at end-1998, the commercial banks and finance companies had made firm commitments to finance 46,822 and 14,894 of these units respectively. Major housing credit institutions comprising the Treasury Housing Loans Division, the Malaysian Building Society Berhad, the Borneo Housing Mortgage Finance Berhad, Sabah Credit Corporation, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional, as a group, extended a total value of housing loans worth RM19.6 billion (RM18.7 billion in 1997) as at end-1998, representing an increase of 4.7% (4.8% or RM852.3 million in 1997).

Table 1.9
Agriculture: Production

	1997	1998*p*	1997	1998*p*
	'000 tonnes		Annual change (%)	
Rubber	971	885	–10.3	–8.8
Saw logs[1]	31,163	22,700	3.4	–27.2
Crude palm oil	9,069	8,315	8.1	–8.3
Fish	1,277	1,350	3.2	5.7
Cocoa	106	90	–11.7	–14.9

[1] Expressed in thousand cubic metres
p Preliminary

Source: Department of Statistics
PORLA
Forestry Departments (Peninsular Malaysia, Sabah & Sarawak)
Malaysian Cocoa Board
Department of Fisheries Malaysia

Agriculture, Forestry and Fishery

Value added of the agriculture, forestry and fishery sector declined by 4% in 1998 (1997:+1.3%), reflecting declines in the production of all major commodities. The output performance of the sector was affected mainly by adverse weather, labour shortages, unfavourable prices, reduced cultivated area and lower yields. Production of crude palm oil declined by 8.3% due mainly to the reversal in the biological yield cycle for oil palm trees during the year. Meanwhile, the declining trend in rubber production persisted into 1998 (–8.8%) as the industry continued to face unfavourable prices, labour shortages and a decline in cultivated area. Saw log production also contracted by 27.2% as logging activities remained depressed because of lower demand from the major markets in the region as well as the downturn in the domestic construction sector. In addition, adverse weather conditions arising from the El Nino effect had also affected production. Cocoa production was also markedly lower by 14.9% in 1998, being affected mainly by inclement weather. On the other hand, the production of fish increased by 5.7% during the year. Overall, the agriculture, forestry and fishery sector accounted

for a higher share of GDP, 12.3% in 1998 (1997: 12%), 10.5% of gross exports (1997: 10.5%), and 16.8% of total employment (1997: 17%).

Crude palm oil production recorded a decline of 8.3% to 8.3 million tonnes in 1998. The decline was due mainly to lower yields brought about by the reversal in the biological yield cycle of the oil palm trees, which occurs once every three or four years. To some extent, the lower yields were also attributable to the lagged impact of the haze and dry weather, which occurred during the second half of 1997, while labour shortages resulted in a lower harvest as loose fruits tended to be uncollected. The decline in yields during the year had more than offset the expansion in the mature oil palm cultivated area. With the increasing viability of oil palm cultivation in the wake of attractive prices in recent years, the total area under oil palm cultivation expanded further by 2.6% to 2.9 million hectares in 1998, with the mature area increasing by 2.4% to 2.5 million hectares. Despite the decline in production, Malaysia maintained its position as the world's largest producer of crude palm oil, accounting for about one-half of the world's production, with Indonesia as the next major producer, accounting for 31%.

On a regional basis, production in Peninsular Malaysia declined by 9.8% to 6 million tonnes in 1998, while Sabah recorded a decline of 5.6% to 2 million tonnes and Sarawak by 8.1% to 0.3 million tonnes. Growth in mature area under oil palm cultivation was most marked in Sarawak (an increase of 10.8%), followed by Sabah (6.4%) while

Table 1.10
Oil Palm: Area, Production and Yield

	1997	1998*p*	1997	1998*p*
			Annual change (%)	
Area ('000 hectares)				
Planted	2,819	2,893	4.7	2.6
Mature	2,455	2,513	4.3	2.4
Production ('000 tonnes)				
Crude palm oil	9,069	8,315	8.1	–8.3
Yield (tonnes/mature hectare)				
Crude palm oil	3.69	3.31	3.9	–10.3

p Preliminary

Source: Department of Statistics
PORLA

the mature area in Peninsular Malaysia increased only marginally (0.5%). Expansion of mature area in East Malaysia is expected to continue in the future as immature planted areas in Sabah and Sarawak expanded further by 4.2% to 146,700 hectares and 43.6% to 53,500 hectares respectively. Immature planted areas in Peninsular Malaysia declined by 3.5% to 179,600 hectares. In terms of ownership, private estates accounted for the largest share of 55.2% of the total oil palm cultivated area or 1.6 million hectares. Organised smallholder schemes under the Federal Land Development Authority, Federal Land Consolidated and Rehabilitation Authority and the Rubber Industry Smallholders Development Authority as a group accounted for 28.7% or 0.8 million hectares, while schemes under the states and independent smallholders, accounted for the remaining share of 16.1% or 0.5 million hectares.

In 1998, a total of 19 new palm oil mill licences were issued by the Palm Oil Registration and Licensing Authority (PORLA). With the rapid expansion of land under oil palm cultivation in Sabah, the State was granted 14 licences for new mills bringing the total number of mills approved in Sabah to 91. Two new licences were granted in Sarawak and three in Peninsular Malaysia. By end-1998, there were 242 mills operating in Peninsular Malaysia, 70 in Sabah and 13 in Sarawak. These 325 mills in Malaysia had an aggregate capacity to process 59.1 million tonnes of fresh fruit bunches annually. Following the seasonal trend in crude palm oil production, the average rate of capacity utilisation of the mills was 68.4% in the first half of the year and 81.1% in the second half of the year. For the year as a whole, the average rate of capacity utilisation declined to 74.8% from 88.3% in 1997, in line with the lower production of crude palm oil.

With the lower level of crude palm oil production, domestic processing of the commodity by refineries declined by 2% to 8.8 million tonnes in 1998. During the year, there was no new refinery licence issued by the Ministry of International Trade and Industry. However, approvals were given to the existing refineries to expand their installed production capacity. Hence, the total installed capacity of the 45 refineries in operation was 12.7 million tonnes. In order to increase the oil extraction rate (OER), which declined to 18.91% in 1998 from 19.03% in 1997, the smallholders and small estates were encouraged to harvest only the ripe

Table 1.11
World Elastomer: Production and Consumption

	1998*e*		1997	1998 *e*
	'000 tonnes	% share	Annual change (%)	
Production	16,380	100.0	1.8	–0.6
Natural rubber	6,315	38.6	0.3	–1.6
Thailand	2,100	12.8	3.2	3.3
Indonesia	1,583	9.7	–1.5	5.2
Malaysia	885	5.4	–10.3	–8.8
India	500	3.1	7.4	–13.8
The People's Republic of China	455	2.8	3.3	2.4
Vietnam	212	1.3	6.3	5.5
Sri Lanka	96	0.6	–6.0	–9.1
Nigeria	87	0.5	–5.3	–3.3
Others	397	2.4	8.1	–16.6
Synthetic rubber	10,065	61.4	2.8	0.0
Consumption	16,470	100.0	5.0	–0.4
Natural rubber	6,540	39.7	6.0	0.5
Synthetic rubber	9,930	60.3	4.4	–0.9
Deficit(–)/surplus(+)	–90			

e Estimate

Source: Department of Statistics
International Rubber Study Group

fruits. In this regard, training in the grading of fresh fruit bunches was conducted by PORLA.

Natural rubber production declined by 8.8% to 885,400 tonnes in 1998, representing the fourth consecutive year of decline in production. The decline was due mainly to continuing low prices as well as labour constraints. Slackening external demand amidst ample global supplies resulted in a further decline in prices. The price of SMR20 fell from 274.50 sen per kilogramme at the turn of the year to 217.00 sen per kilogramme at end-year. As rubber was traded in ringgit, it did not benefit from the valuation effects arising from the depreciation of ringgit. Meanwhile, the persistent problem of labour shortages has affected tapping activities, resulting in a significant decline in productivity. The Malaysian Rubber Board initiated measures to address the declining productivity. Measures included the active promotion of labour-saving technologies such as the low intensity tapping systems, particularly among the smallholders.

Imports of natural rubber, mainly latex, rose significantly by 30.7% to 564,100 tonnes in 1998 to meet the demand of domestic rubber products manufacturers. The major source of imports was Thailand. Despite lower production in 1998, Malaysia remained as the world's third largest producer and a net exporter of natural rubber.

On a regional basis, the production of rubber in Peninsular Malaysia, which accounted for 95% of total national output, declined by 10% to 842,220 tonnes, with the production of smallholders and estates declining by a similar magnitude. Lower production was also recorded in Sabah (–10.2%). On the other hand, production in Sarawak remained at the previous year's level. In terms of planted area, Peninsular Malaysia recorded a decline in rubber cultivated area by 4% to 1,244,560 hectares, accounting for about 80% of the total area under rubber, with the mature area declining by 4% to 1,029,250 hectares.

With the declining interest in rubber cultivation aggravated by the prolonged weakness of prices for the commodity, there was a need for a revival of the industry in order to sustain its long-term survival. In this regard, the Association of Natural Rubber Producing Countries (ANRPC) has proposed that the International Natural Rubber Price Stabilisation Scheme under the ANRPC be revived. Meanwhile, Malaysia withdrew from the International Natural Rubber Organisation (INRO) with effect from 15 October 1998. On the home front, in an effort to improve the institutional role of the agencies relevant to the rubber industry, the Malaysian Rubber Board (MRB) was established on 1 January 1998, with the amalgamation of the three previous

Table 1.12
Rubber: Area, Production and Yield

	Estates		Smallholdings	
	1997	1998*p*	1997	1998*p*
	'000 hectares			
Planted area	206	197	1,404	1,365
Replanting	4	4	34	30
Newplanting	6	6	106	108
Production ('000 tonnes)	216	199	755	686
Yield (kg./mature ha.)	1,069	997	661	613

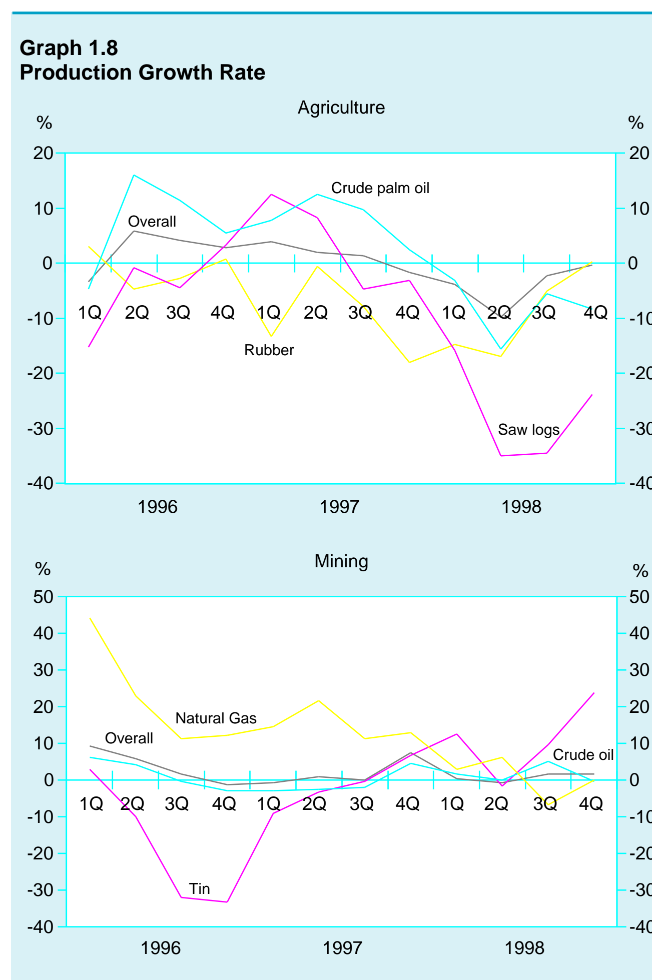
p Preliminary

Source: Department of Statistics
Malaysian Rubber Board
Department of Agriculture, Sarawak
Sabah Rubber Fund Board

rubber agencies, namely, the Malaysian Rubber Research and Development Board, the Malaysian Rubber Exchange and Licensing Board and the Rubber Research Institute. MRB would be responsible for all activities pertaining to the development of the rubber industry to bring about a more co-ordinated and effective approach to the policies on development of the rubber industry. Specifically, the new organisational set-up would have research and development as its core activity. MRB would also consolidate all other related functions and activities from the upstream sector to the mid and downstream sectors in terms of production, processing, value-added manufacturing and market promotion for raw rubber, manufactured rubber and rubberwood products. The MRB has formulated a Revised Rubber Strategy to maximize production from existing rubber trees as well as to promote replanting with Latex Timber Clones to maximize rubber and wood yields.

In 1998, the Rubber Industry Smallholders Development Authority (RISDA) allocated a total of RM157 million to finance replanting projects and an additional RM1.8 million for the rehabilitation programme to assist smallholders with financial difficulties. The replanting projects involved 19,421 hectares of rubber land, while the rehabilitation programme covered 1,272 hectares. These programmes were aimed at ensuring stable production by the smallholders, who accounted for 78% of the nation's rubber production.

Graph 1.8
Production Growth Rate



Production of **saw logs** declined sharply by 27.2% to 22.7 million cubic metres in 1998. The decline was due mainly to weaker demand from the traditional buyers, which were mainly from the Asia-Pacific region. Production in Sarawak and Sabah was also affected by adverse weather conditions. At the same time, logging activities were in line with the Government's conservation policy and commitment to sustainable forest management by the year 2000, in compliance with the requirement of the International Tropical Timber Organisation. Production was lower in all regions. Sarawak's production, which accounted for 49% of the total saw log production, declined by 33.9% to 11.1 million cubic metres, while that for Peninsular Malaysia (28% of total production) was lower by 13.6% to 6.4 million cubic metres. For Sabah (23% of total production), production declined by 25.3% to 5.2 million cubic metres.

The downtrend in the production of **cocoa** continued in 1998 for the eighth consecutive year. Although cocoa prices improved significantly during the year, production of cocoa beans declined by 14.9% to 90,200 tonnes, the lowest since its record production of 247,000 tonnes in 1990. A severe drought, arising from the El Nino weather phenomenon had affected fruit setting and had also delayed the fruit setting for the second season. Besides the weather factor, cocoa output was also affected by rising production cost due to increased labour cost and higher prices of agricultural inputs. During the year, about 6,000 hectares of cocoa areas were converted into oil palm with no conversion of other crop areas into cocoa. Conversion was primarily carried out by the smallholders in Peninsular Malaysia. In Sabah, where production accounted for 68% of the total national output, conversion activity was less active. In the face of lower production of cocoa beans, the domestic cocoa processing industry imported cocoa beans, particularly from Indonesia. Nevertheless, the overall processing of cocoa beans by the local grinders declined by 4.8% to 100,000 tonnes in 1998.

Production of the **fishery** industry increased further by 5.7% to 1.4 million tonnes in 1998. The continued favourable performance in fish production was due to the marked increase in the production of aquaculture (23.2%) and marine fisheries (4.1%), which together accounted for 90.4% of the total fish production. The marine fisheries, which included inshore fisheries, recorded a production of 1,087,380 tonnes while production from aquaculture totalled 133,060 tonnes. Deep sea fishing, on the other hand, contributed 129,420 tonnes to total production. The higher production of fish during the year enabled exports to increase by 1.9% to 238,600 tonnes, mainly to Thailand, Singapore and Japan, while imports declined by 3.4% to 207,840 tonnes, the bulk of which was from Thailand. Meanwhile, Malaysian per capita consumption of fish increased to 42 kilograms in 1998 against 41 kilograms a year ago.

Mining

Value added in the mining sector increased further by 0.8% in 1998 (1997: +1%), reflecting primarily higher crude oil and gas production and a turnaround in tin production. The quarrying sector, on the other hand, contracted sharply by 24.5% in line with the slowdown in construction activities. Overall, the mining sector contributed a slightly higher share of 7.3% of GDP in 1998 (1997: 6.7%), 0.5% to employment (1997: 0.4%) and 5.2% to total exports (1997: 6.9%).

The production of **crude oil including condensates** increased by 1.7% to 726,100 barrels per day (bpd) in 1998. Excluding condensates, crude oil production was higher at 640,600 bpd (1997: 629,200 bpd). Output of condensates (from gas fields) was higher at 85,500 bpd (1997: 84,700 bpd). On a regional basis, the output of crude oil and condensates from Peninsular Malaysia (58% of national production) declined by 1.5% to 422,000 bpd, while that from Sarawak which accounted for 28% of production, declined by 7.7% to 205,000 bpd. In contrast, Sabah's crude oil production increased markedly by 59.6% to 99,100 bpd as one new oilfield commenced operations in December 1997. As at the end of 1998, there were 37 oilfields in production, with two new oilfields in Peninsular Malaysia and one in Sabah. In total, Peninsular Malaysia had 16 oilfields, while Sabah and Sarawak had 13 and eight oilfields respectively. In the upstream sector, five production sharing contracts were signed in 1998,

Table 1.13
Mining: Production

	1997	1998*p*	1997	1998*p*
	'000 tonnes		Annual change (%)	
Crude oil[1]	713,928	726,100	–0.5	1.7
Natural gas[2]	3,846	3,857	12.7	0.3
Tin-in-concentrates[3]	5,065	5,610	–2.1	10.8
Bauxite	279	158	27.4	–43.4
Iron-ore	216	372	–33.5	72.2
Copper	81	63	–6.9	–22.2

[1] Expressed in barrels per day
[2] Expressed in mmscfd
[3] Expressed in tonnes
p Preliminary

Source: Department of Mines
PETRONAS

of which three were in Sarawak and two in Peninsular Malaysia. One oilfield in offshore Terengganu Darul Iman was discovered during the year. By end-1998, a total of 18 exploration wells and 81 development wells were drilled in addition to 68,693 kilometres of seismic data acquired for exploration and development purposes. Most of the development activities in 1998 were concentrated in Peninsular Malaysia and Sabah.

Reflecting weak demand from domestic and international markets, **natural gas** production increased only marginally by 0.3% to 3,857 million standard cubic feet per day in 1998. Domestic demand was sluggish due mainly to lower consumption by the power generation sector. On the external front, exports of LNG to Japan, Korea and Taiwan as a group, declined by 2.6% to 14.7 million tonnes (1997: +18.6%). A total of 10 gas fields were in production in 1998, with five each in Peninsular Malaysia and Sarawak. A gas field located offshore Terengganu Darul Iman was discovered during the year.

Production of **tin-in-concentrates** recorded a positive growth in 1998 after eight consecutive years of decline. Production grew by 10.8% to 5,610 tonnes. The significant increase in tin prices of 43.6% in ringgit terms triggered higher production from the 35 tin mines operating in Malaysia. Meanwhile, domestic consumption of tin metal declined further by 15.4% to 5,575 tonnes, reflecting lower demand from the tin-based industries. Utilisation of tin metal by the solder industry, which accounted for 60% of local consumption, declined

by 6% to 3,350 tonnes as demand from the electronics industry was lower. Similarly, demand by the tin plating industry declined by 32.2% to 595 tonnes, while that by the pewter industry declined by 23.4% to 590 tonnes. As the domestic production was insufficient to meet the demand of local smelters, tin-in-concentrates continued to be imported, mainly from Peru, Australia, Portugal, Bolivia and the United States.

Services

Following the contraction in the economy, the growth of the services sector moderated in 1998 given its strong inter-linkages with the other sectors in the economy. The services sector recorded a growth rate of 1.5% in 1998 compared with 8% in 1997. Growth continued to be led by the intermediate services sub-sector, while the final services sub-sector expanded at a much slower pace. Despite weaker performance of the services sector, it remained as the largest sector in the economy in 1998, contributing to a higher share of GDP of 48.8% and total employment of 47.5%.

Following the contraction in aggregate demand, **intermediate services** comprising transport, storage and communications; and finance, insurance, real estate and business services registered a slower growth of 3.1% in 1998 (1997: 9.1%). A marked slowdown was observed in the **transport, storage and communications** sub-sector, where growth moderated to 1.2% from 8.4% in 1997. Transport activities were affected by the decline in the volume of domestic and international trade, particularly imports. The decline in trade, particularly with regional countries, was reflected in the lower volume of cargo handled at major ports. Estimates for the five major ports in Malaysia showed that cargo handled by these ports declined markedly by 13.8% to 121.1 million freight weight tonnes (f.w.t) in 1998. In terms of container throughput, the growth moderated significantly to 1.2% (1997: 17.1%) to 2.8 million twenty-foot equivalent units (TEUs). Despite the slowdown, several ports embarked on expansion plans to enhance their facilities and services, while new ports were being completed or developed. For example, the new port in Tanjong Pelepas, Johor is under construction and is expected to be operational in early 2000. The Segamat Inland Port began operations in October 1998 and is mainly expected to attract shippers located in southern Melaka and northern Johor. Similarly, the North Port Business Park in Port Klang, upon completion, would provide support to downstream activities in the surrounding area at Port Klang. Several major shipping companies also expanded their capacity by acquiring ships valued at RM3.5 billion. During the year, the Government continued its efforts to enhance port facilities and to promote Port Klang as a load centre and a regional hub. Several measures were undertaken to enhance cargo volume in order to attract main line operators to call at the port, which yielded positive results. In 1998, a total of 67 main line operators called at Port Klang compared with only 10 in 1992. Incentive schemes in the form of rebates, volume discounts, and waiver of certain port charges were made available to encourage main line operators to call at Port Klang. Additional warehousing facilities and inland clearance depot were also established. In an effort to enhance its competitiveness, the Government abolished the inter-terminal transfer fee for cargo at Port Klang, effective 30 November 1998.

For air transport, the decline in cargo handled was partly attributed to some redirection of cargo by domestic traders to Singapore for a brief period after the relocation of the cargo services to the new Kuala Lumpur International Airport (KLIA) in Sepang at the end of June 1998. Domestic and international air travel, on the other hand, were affected by the economic downturn and uncertainties as well as a weaker ringgit. In view of these developments, Malaysia Airlines stepped up efforts to restructure its operations. While the delivery of several new aircraft during the year was partly offset by the sale of old aircraft, flight routes were also rationalised to maximise passenger load. Service to unprofitable destinations was suspended while more aircraft were redeployed to profitable destinations in Europe and Australia.

In the case of rail transportation, revenue from cargo declined during the year, while revenue from passenger services recorded some growth. In particular, the Light Rail Transit extended its service to an increased number of destinations within Kuala Lumpur, thus resulting in greater ridership towards year-end. In the communications sub-sector, the performance of telecommunications services remained buoyant in 1998, weakening only slightly compared with 1997. The number of telephone subscribers grew by 3.8% during the year. The number of residential subscribers increased by 5.7%

Table 1.14
Growth in the Services Sector in 1978 Prices

	1997	1998*p*	1997	1998*p*
	Annual change (%)		% share of GDP	
Services	**8.0**	**1.5**	**44.9**	**48.8**
Intermediate services	9.1	3.1	19.0	21.0
Transport, storage and communications	8.4	1.2	7.5	8.1
Finance, insurance, real estate and business services[1]	9.5	4.4	11.5	12.9
Final services	7.2	0.4	25.8	27.8
Electricity, gas and water	13.0	3.6	2.5	2.8
Wholesale and retail trade, hotels and restaurants	7.0	–2.0	12.3	12.9
Government services[2]	6.1	2.4	9.0	9.9
Other services[3]	7.2	2.5	2.0	2.2

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

to 3.2 million, while that of business subscribers declined by 1.2% to 1.2 million. The Government liberalised the limit on ownership of telecommunication firms by foreigners to 49% from 30% on 25 February 1998.

In the **finance, insurance, real estate and business services** sub-sector, value added increased more moderately by 4.4% in 1998. Total loans extended by the banking system declined in 1998 due in part to the contraction in economic activity. Meanwhile, the sharp decline in prices and volume of shares traded on the Kuala Lumpur Stock Exchange also affected the performance of this sub-sector. At the same time, slower growth was recorded by the insurance industry, as evidenced by the smaller increase of 1.9% in premium income collections in 1998 (1997: 14.4%).

In the **final services** group, comprising utilities; wholesale and retail trade; hotels and restaurants; government services and other services, growth decelerated sharply to 0.4% from 7.2% in 1997. Within this group, the wholesale and retail trade, hotels and restaurants sub-sector, particularly those trading in non-essential and high-end products, were severely affected by the economic downturn and cautious consumer spending. The Malaysian Retail Association's survey findings showed that sales in the retail sector fell by 17% during the period July 1997-June 1998. Amongst the major items which recorded a substantial decline in sales were telecommunication products, fashion and accessories, jewellery, toys and gifts, general merchandise, food and beverages and entertainment. The downward trend was also reflected in the Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index, which fell by 37.5 points to an average of 82.5 points during the first three quarters of 1998. Subsequently, the index recovered slightly indicating an improvement in sentiment in the fourth quarter. The poor consumer sentiment was attributed mainly to the negative wealth effect of the sharp decline in the equity and property markets, uncertainty about employment prospects and business losses. The slowdown in the domestic trade sector was reflected in lower sales tax collection (–38.7%). Value added in hotels and restaurants also showed a significant decline due mainly to lower tourist arrivals (–10.6%). The regional economic downturn affected tourist arrivals in 1998. This, together with a sharp increase in the supply of hotel rooms (+9,351 rooms), led to a decline in the average occupancy rate for hotels to 49.9% in 1998 (1997: 58%). Meetings and conventions, however, showed a sharp increase and provided some boost to the local tourism industry.

During the year, value added in the **utilities** sub-sector slowed down markedly to 3.6% (13% in 1997), mainly attributable to the sharp reduction in electricity supply during the second half of the year in response to lower demand, particularly from the industrial and commercial sectors. On the other hand, growth in water consumption, another component of the utilities sub-sector, remained stable, increasing by an annual rate of 3% to 8,710 million litres per day in 1998, the same rate of growth recorded in 1997. Overall, the production capacity of water in 1998 was 10,428 million litres per day, an increase of 5% compared with a growth of 2% in 1997.

Growth in the **Government services** sub-sector moderated to 2.4% in 1998 (6.1% in 1997). However, its share to GDP increased to 9.9% from 9% a year ago. The moderation was due mainly to the freezing of all vacant posts that are non-critical, salary cuts by senior Government officials and the reduction in allowances for civil servants.

Box II

The 1985 and 1998 Recessions: A Comparison

Malaysia experienced a period of 12 consecutive years of growth, which averaged 7.8% after the economic recession in 1985. In 1998, following the regional financial crisis, Malaysia has entered a period of economic contraction. While the magnitude of the contraction in output in 1998 was larger, the overall impact has been less severe on the population. In particular, unemployment was widespread in 1985. In contrast, in the 1998 recession, structural changes in the economy, the full employment situation and the development of a more flexible labour market have moderated the rise in unemployment. This box article examines the two recession periods, and analyses the causes and the policy responses. Lessons are also drawn from the experience in both the periods.

Economic Structure and Risks

The prevailing structure of the Malaysian economy significantly influenced the depth and magnitude of the recessions. While both recessions emanated from external sources, the impact of the external shocks on the domestic economy were different, given the structural changes in the economy. Policy responses have accordingly differed.

In 1985, the economy was vulnerable to fluctuations in world output and prices of commodities. During this period, the public sector dominated investments, accounting for 30.9% of **total domestic demand**. This was due primarily to the implementation of counter-cyclical policies to ride out the prevailing global recession as well as the Government's entry into heavy industries. While the counter-cyclical policies sustained the growth momentum, it led to the twin deficits in the fiscal and external payment positions, and an increase in the external debt position.

Similar to 1985, the export sector remained vulnerable **in 1997-98**, despite structural changes. The difference was in the product composition of exports. While in 1985 the major export was commodities, in 1998, it was electronics and electrical products. The distribution of markets for export products was also more diversified in 1998, with 40% from East Asia. However, the greater integration of markets meant that the loss of market share in East Asia would also affect demand from other markets. In this regard, diversification of products was less effective in offsetting risks due to the additional vulnerability caused by the integration of global products and financial markets.

More important was the creation of new risks arising from volatile capital flows as the domestic economy became more integrated with the global economy. The Malaysian economy is very open with imports and exports of goods and non-factor services accounting for about 211% of GDP in 1998 (105% in 1988), while the long-term capital account expanded with gross inflows of RM34.6 billion in 1998 compared with RM11.4 billion in 1985. The globalisation of international capital flows and the relatively open capital account exposed the economy to new areas of vulnerabilities, in particular to the sudden reversal of capital flows and the contagion effect of a crisis emanating in other parts of the world. This risk was heightened when the share of short-term capital flows exceeded foreign direct investments in financing the current account deficit.

The shift from the public sector to the private sector as the engine of growth also created new risks. The slow development of the bond market resulted in loans to the private sector rising to 148.4% of GDP in 1998 from 98.5% in 1990. Loans were collateralised against properties and shares which made the banking system vulnerable to declining asset prices. The mitigating factor to this risk was that loans to the property sector were secured at a

Economic Structure and Risks

1985	1998
• Economy small (nominal GDP of US$31.2 billion) and vulnerable to external shocks.	• Economy much larger (nominal GDP of US$71.1 billion) and fundamentally stronger.
• Economy open with exports at 49.1% of GDP, but concentrated in commodities (66.7% of total exports).	• Economy more open, with exports at 102.9% of GDP, but risks shifted to manufacturing (82.9% of gross exports), especially electronics (39.8% of gross exports).
• Inflation low at 0.4%.	• Inflation much higher at 5.3%.
• Unemployment of 6.9%, no pressure on inflation.	• Full employment, with foreign labour at about 10% of total employment, exerting inflationary pressures.
• Weak fiscal position - large fiscal deficit (peak of 16.6% of GDP in 1982; public sector deficit was 18% in 1982). Revenue base was dependent on export taxes, and expenditure was focused on heavy industries. Deficit was reduced to 0.6% of GDP in 1985.	• Strong fiscal position - fifth year of fiscal surplus in 1997 (2.4% of GDP). Revenue was broad-based, and expenditure has been directed mainly to education, health and infrastructure. Still in surplus in 1997 (2.4% of GDP) but moved to deficit of 1.8% of GDP in 1998 to stimulate recovery.
• Public sector (including NFPEs) engine of growth, accounted for 46.9% of investment (nominal) and 22.7% of consumption (nominal).	• Public sector important in recovery process. Share of public investment amounted to 44.1% (nominal) and consumption to 20.9% (nominal).
• External sector weak with current account deficit high at 2.1% of GDP, attributable to high consumption and high Government expenditure.	• Current account surplus at 12.9% of GDP due mainly to export growth and declining imports.
• High external debt in 1986 (75.6% of GNP), mainly by public sector (64.9% of GNP) and high debt service ratio (DSR) of 18.9%.	• Low external debt of 60.9% of GNP and DSR of 6.7% due to improved debt management and prepayments. Public sector debt low at 26% of GNP.
• Exchange rate stable, fluctuating between US$1=RM2.41–2.60. No change in exchange rate policy, but the rate depreciated following realignment of yen/US$ rate under the Plaza Accord.	• Extreme volatility of exchange rates, breaching intra-day trading levels of RM3.35 to 4.88 between January-August. Fixed exchange rate regime adopted on 2 September 1998, where the ringgit was fixed at US$1=RM3.80.

- Basic thrust of monetary policy generally expansionary to revive economic growth in the face of serious budgetary restraints and declining commodity prices.
- Loans to private sector equivalent to 85.2% of GDP. Growth was fuelled through expansionary fiscal policy.
- Authorised deposit-taking cooperatives that were relatively less regulated, and illegal deposit-takers proliferated. Regulated banking sector in early stage of observing new prudential regulations. Several banking institutions experienced large losses, arising from imprudent lending, poor management and fraud in certain cases.
- Capital adequacy ratio of 7.5% at the end of 1985. NPL of 30.1% at the end of 1988 based on the 12-month classification.
- By the end of 1989, four commercial banks and eight finance companies rehabilitated through capital injection or assumption of control by BNM and placed under receivership prior to absorption by a larger banking institution.

- Tight monetary policy stance in late 1997 to address emerging inflation in early 1998, and to restore stability in the foreign exchange markets. Monetary policy gradually relaxed as inflation eased, to support economic recovery.
- Domestic loans to private sector much higher at 148.4% of GDP.
- Comprehensive regulatory and supervisory framework for licensed banking institutions, with provisions to extend purview of BNM to other financial institutions when required to preserve financial stability. Stronger banking system, and prudential standards largely in line with international standards.
- At end-1998, RWCR of 11.8%; NPLs of 7.6% (net) and 12.6% (gross) under the six-month classification.
- Comprehensive bank restructuring plan implemented. For further details, please refer to Box IV on "Restructuring the Banking Sector".

comfortable margin, at more than 100%, while the proportion of loans extended for the purchase of shares was approximately 8%, well below the prudential limit of 20% for commercial banks and finance companies, and 30% for merchant banks.

The Recessions in 1985 and 1998

Both the 1985 and 1998 recessions were triggered by external developments. **In 1985**, there was a global decline in the prices of major commodities. The slowdown in exports led to a sharp cutback in private sector expenditure. Together with the dampening impact of the fiscal restraint, this led to a severe deflationary effect on the economy. In 1985, real GDP declined by 1.2%. On the business front, the sharp downturn in aggregate demand resulted in excess capacities, a drop in profits and rising number of corporate bankruptcies. The property market which experienced a boom in the period 1983-84 was badly affected, with prices estimated to have declined by between 10-30%. The prevailing unemployment situation deepened with the recession.

Amidst the slowdown in economic activity, the financial system was affected by a crisis of confidence, triggered by the failure of some deposit-taking cooperatives (DTCs) as well as illegal deposit-takers, such as credit and leasing companies. The deterioration in the health of the DTCs and illegal deposit-takers was a result of falling property and share prices as well as weak management, and in some instances, fraudulent and dishonest management. The crisis of confidence in this “unregulated” sector of deposit-taking institutions posed a systemic threat to the banking system. At the same time, the combination of a sharp contraction in cash flows,

deflation in property and share prices, and a rise in debt servicing exposed the financial over-commitments of many entrepreneurs, which consequently resulted in the deterioration in the health of the banking system. Non-performing loans (NPLs) as at end 1988 was approximately 30% and several banking institutions experienced an erosion in capital. By the end of 1989, four ailing commercial banks and eight ailing finance companies had been rehabilitated via capital injection or assumption of control by BNM or placed under receivership prior to absorption by other larger institutions.

While the 1985 recession was triggered by the sharp decline in commodity prices, **the 1998 recession** was, on the other hand, caused by the adverse developments in the regional financial markets following the speculative attacks on the currencies of the East Asian economies. Markets panicked and foreign investor confidence evaporated. Malaysia was not spared from the contagion effect of these developments, despite its relatively strong economic fundamentals. The ringgit and stock market experienced significant downward pressures as a result of weak investor confidence and large outflows of short-term capital. The depreciation of the ringgit and the decline in share prices reinforced each other, creating a vicious circle of exchange rate depreciation and falling stock prices that further undermined confidence.

As the crisis prolonged, the fall in aggregate demand in Asia affected Malaysian exports. Measures to stabilise the domestic economy also caused severe declines in consumption and investment. As the financial crisis permeated to the real economy, the financial system was adversely affected. Banking institutions became preoccupied with managing the deterioration in asset quality and capital and curtailed their lending operations. Total loans outstanding (including NPLs sold to Danaharta) extended by the banking system increased by only 1.3% (26.5% in 1997). This development, combined with the negative wealth effectand the moderation in exports, had a dampening impact on economic activities. Consequently, the economy experienced a contraction of 6.2% in the first nine months of 1998, and an overall contraction of 6.7% in 1998. Furthermore, both the inflation and unemployment rate increased to 5.3% and 3.9% respectively in 1998.

Policy Responses

(a) Monetary Policy

The conduct of monetary policy in addressing the recessions was particularly difficult in an environment of open capital account regimes and significant volatility in exchange rates. BNM was confronted with conflicting objectives of maintaining stability in the foreign exchange market and reducing interest rates to reflect the domestic economic conditions. In the recessionary environment of 1985-86, the basic thrust of monetary policy was generally expansionary to revive economic growth in the face of serious budgetary restraints and declining commodity prices. The easing of monetary policy was achieved principally through the easing of bank liquidity and containing the upward pressure on interest rates. However, attempts to inject liquidity were neutralised to a large degree by outflows of funds, fuelled by speculative pressures on the ringgit in the periods April-May and August-September in 1986. Only when pressures on the ringgit subsided in mid-October 1986 that BNM was able to further ease monetary policy to support economic recovery.

The situation was not dissimilar in 1997-1998. The difference was mainly in the magnitude of the speculative activities. Limits to the effectiveness of monetary measures were greater due to the availability of large amounts of ringgit funds abroad that continually destabilised the ringgit exchange rate. In an environment of unprecedented depreciation of the ringgit in late 1997, BNM monetary policy was tightened to contain inflation and restore stability in the foreign exchange market. While inflation was contained and the current account balance had improved, the ringgit exchange rate continued to be subject to speculative pressure. The tight monetary stance amidst slowing aggregate demand contributed to further weakening of the economy. As the adverse economic conditions became evident by mid-1998, monetary policy was gradually relaxed to support economic recovery. The easing of monetary policy was facilitated by the moderation in inflationary pressures. Several initiatives were also taken to improve the liquidity situation in the banking system, moderate the intermediation cost and generate lending activities. Subsequently, the stability achieved through the imposition of

selective exchange control measures on 1 September 1998 enabled BNM to further ease monetary policy.

Inefficiencies in the intermediation process also emerged during the two periods of recession. There was undue competitive bidding by a small number of banking institutions for deposits that led to increases in the cost of funds for the system as a whole and slow downward adjustment in the base lending rate when the situation improved. As a result, measures were introduced to enhance the efficiency of the intermediation process as well as improve the transmission of monetary policy and the flow of liquidity in the banking system. During the period 1985-87, the authorities suspended the market determination of interest rates, and pegged the deposit rates and the base lending rate. The authorities were pragmatic and recognised that these moves, while not market-oriented, were necessary for the period to ensure that the banking system functioned to support economic recovery.

In 1998, monetary management focused on making liquidity management more transparent as well as ensuring a better distribution of liquidity to improve the efficiency in the loan intermediation process. During both recession periods, the authorities also introduced and expanded various special funds to ensure that viable borrowers and priority sectors continued to have ready access to credit at reasonable rates. These funds also helped to stimulate new fixed investment and to rehabilitate viable borrowers and industries.

(b) Fiscal Policy

A major difference was in the stance of fiscal policy adopted by the Government in dealing with the two recessions. During the **1985-86 period**, the policy response focused mainly on fiscal restraint. Government expenditure was reduced through downsizing its role in the economy. Despite the fiscal restraint, the fiscal deficit increased to 11.2% of GNP in 1986, due mainly to a substantial decline in revenue.

In contrast, **during the 1998 recession**, the healthy fiscal position following five years of fiscal surplus and low government external borrowings provided the Government greater flexibility in the use of fiscal policy in stimulating economic activity. While the Government continued to pursue fiscal discipline and prudence at the beginning of the crisis in late 1997, the severity of the slowdown and the threat of a recession prompted the Government to switch to counter-cyclical fiscal measures in early 1998. However, the expenditure was directed at sectors that had strong economic linkages to maximise the multiplier effect on economic activity, and to protect the vulnerable segments of society. Unlike the situation in 1985-1986, the fiscal deficit in 1998-1999 is not expected to cause strains in the balance of payments position.

(c) Strengthening and Restructuring the Banking Sector

The deterioration in the health of the banking sector during both recessions prompted the authorities to undertake measures to strengthen and restructure the sector. The measures were aimed at preventing the emergence of a systemic crisis and thus, maintain public confidence in the banking system. As a result, the intermediation function continued without disruption during both periods of recession. For the greater part of the early 1980s, banking sector policy was focused on strengthening the prudential regulations through the adoption of capital adequacy standards, single customer limit, prohibition of connected lending and rules on the treatment of NPLs. In addition, a series of amendments and new provisions to the banking legislation were also introduced in January 1986, which, among others, enabled BNM to control abuses by bank management; diversify equity control of banks; and lend to or inject equity into banking institutions whose capital was impaired. These powers allowed BNM to promptly address the problems of ailing institutions that emerged during this period. Consequently, BNM assumed control of four commercial banks and eight finance companies during 1985-89, and rehabilitated them. By 1998, three of these institutions had turned around, following which BNM's investments in these banking institutions were sold to the private sector.

Another important development during this period was the role of BNM in the resolution of the DTC crisis. The promulgation of the Essential (Protection of Depositors) Regulations, 1986,

provided BNM with wide-ranging powers to deal effectively with the DTCs, and allowed BNM to suspend the operations of the 24 ailing DTCs to facilitate investigative operations. The problems were resolved with the formulation and implementation of various rescue schemes, the last of which was finalised in 1988.

The restructuring of the banking system following the 1985 recession enabled the banking system to strengthen during the period of strong economic growth in the next decade. Hence, the banking sector entered the **financial crisis in 1997** from a position of strength. Nevertheless, the severity of the crisis weakened the banking sector. The first steps taken to further strengthen the banking system was to strengthen prudential regulatory and supervisory standards, and promote greater disclosure on the financial condition of banking institutions. Subsequently, mechanisms and the institutional framework were put in place to deal with potential banking sector problems and promote market confidence, in the face of deteriorating economic conditions. These measures were pre-emptive and involved the consolidation of the finance companies which were the most vulnerable segment in the banking system, as well as the establishment of Pengurusan Danaharta Nasional Berhad, Danamodal Nasional Berhad and the Corporate Debt Restructuring Committee, to address the expected rise in NPLs, erosion of capital and deterioration in corporate performance respectively. These measures provided market-oriented mechanisms to deal with potential problems in a systematic manner. In January 1999, BNM assumed control of two finance companies as part of the ongoing measures to strengthen the banking system. These policy initiatives (discussed in detail in chapter 4 of the Annual Report) were different from those measures adopted in 1985. Assets of the banking system had expanded from RM198.4 billion in 1985 to RM616.4 billion in 1998. Capital and reserves were substantially larger, amounting to RM37.4 billion compared with RM4.1 billion in 1985.

(d) Selective Exchange Control Measures

The Government was aware that the uncertainty and instability of international developments could undermine the progress of various measures taken to support the economic recovery process. Hence, selective exchange control measures were introduced on 1 September 1998 and the exchange rate was fixed at US$1=RM3.80 on 2 September. The measures were aimed at insulating the domestic economy from the risks of external developments, containing the speculation on the ringgit and minimising the impact of short-term capital flows, thus enabling the country to regain a greater degree of **monetary independence**. The measures have been successful in limiting the contagion effects of external developments on the domestic economy, while providing an environment of stability so that the authorities could focus on promoting economic recovery with price stability and accelerate the plans to restructure the financial and corporate sector. For details, refer to Box III on "The Exchange Control Measures as a Policy Option".

(e) Other Policies

The centrepiece of the package introduced during the 1985 recession to encourage the private sector to be the main engine of growth was the introduction of the Promotion of Investments Act, 1986, which provided tax and other incentives to generate the expansion in private investment. This included the liberalisation on foreign equity ownership, which acted as a catalyst in reviving private investment. This led to a rapid recovery of the economy. FDI flows, which had declined since 1984, turned around in 1987 to record net inflows of RM1.1 billion and increased further to RM1.9 billion in 1988. Since then, FDI flows had accounted for a significant portion of the financing of economic activities in Malaysia.

The economy in 1998, compared with 1985, was considerably more open. The foreign share in the domestic market was high as reflected in the significant foreign participation in all sectors of the economy. As a result, there was limited scope for the Government to further liberalise the foreign investment guidelines without marginalising domestic entrepreneurs. Nevertheless, the Government has taken bold steps to allow 100% foreign equity irrespective of the level of exports for all applications received until the year 2000 to set up manufacturing projects, with the

exception of specific activities and products including paper packaging and plastic packaging. The foreign equity participation in the telecommunications and insurance sectors has also been relaxed.

During both recessions, the Government took pre-emptive steps to protect vulnerable segments of society. During the 1985 recession, these measures included the Government's three-year programme to build up to 240,000 low cost houses as well as building more roads, especially rural roads. In the current period, the Government also promoted low-cost housing projects, as reflected in the establishment of the Special Scheme for Low and Medium Cost Houses with an allocation of RM2 billion. In addition, funds have also been made available to finance social, health and education projects.

Conclusion

The recovery from the 1985 recession was relatively rapid with GDP expanding by 1.2% in 1986 and 5.4% in 1987, aided by the favourable external environment. The policies implemented during the period helped to set the stage for the economy to record high growth in the subsequent years. In contrast, the recovery from the 1998 recession is expected to be more gradual (growth of 1% in 1999). However, the structural adjustments and financial sector reforms would provide the foundation for sustainable growth and a stronger economy. Nevertheless, uncertainty and the threat of contagion and systemic risk remains, given recent developments on the international front. It is clear that, given the openness of the Malaysian economy, external developments would continue to significantly

Table II.I: Key Macroeconomic and Financial Indicators

	1984	1985	1986	1996	1997	1998*p*
Real GDP growth (%)	7.8	–1.2	1.2	8.6	7.7	–6.7
CPI (% change)	3.6	0.4	0.6	3.5	2.7	5.3
Unemployment rate (%)	8.3	6.9	8.8	2.6	2.6	3.9
Federal Government overall balance (% of GNP)	–6.4	–6.1	–11.2	0.8	2.5	–1.9
Current account balance (% of GNP)	–5.3	–2.1	–0.5	–5.1	–5.4	13.7
External debt (% of GNP)	50.1	59.0	75.6	41.5	65.4	60.9
Debt service ratio (% of exports of goods and services)	11.8	15.8	18.9	6.9	5.5	6.7
Net international reserves (RM bil)	9.6	12.5	16.5	70.0	59.1	99.4
M3 growth (annual change, %)	15.6	9.8	8.8	21.2	18.5	2.7
Banking system deposits (annual change, %)	20.7	10.6	7.5	26.3	21.3	–0.5
Banking system loans (annual change, %)	20.9	14.0	6.0	27.6	26.5	–1.8
3-month interbank rate (average, %)	9.39	7.74	6.41	7.34	8.60	6.48
Average base lending rate (commercial banks, %)	12.25	10.75	10.00	9.18	10.33	8.04
Risk-weighted capital ratio of banking system[1] (%)	6.8*	7.5*	7.0*	10.6	10.6	11.8
Non-performing loans (NPLs)[2] / total outstanding loans (%)	n.a.	n.a.	n.a.	3.7	4.1	7.6
Movement of RM (against composite, %)	+1.8	–8.6	–13.7	+2.6	–31.4	–0.2

[1] Minimum requirement of 8% based on Basle Capital Accord.
* Commercial banks only (Pre-Basle Capital Accord) - minimum requirement of 4% for domestic banks and 6% for foreign banks.
[2] Loans classified as NPLs based on individual banking institution's NPL classification policy, i.e. 3-month or 6-month classification.

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influence the growth cycle of the domestic economy.

The objectives of policy to maintain price stability and achieve sustainable growth remained unchanged during the 1985 recession and in the current situation. The priority of the Government was to put in place policies that would support an early economic recovery. The approach reflected the different circumstances and causes of the economic crisis during these two recessions. In particular, given the more integrated nature of the world economy and the more hostile external environment, the policy responses in the 1998 recession have been more dynamic and unorthodox. The imposition of selective exchange controls has provided an environment of stability which has enabled the Government to continue with implementation of the necessary structural reforms to support economic recovery. Similarly, the Government had to invoke emergency regulations to deal swiftly and decisively with the DTC crisis in the mid-1980s in response to the erosion in depositor confidence.

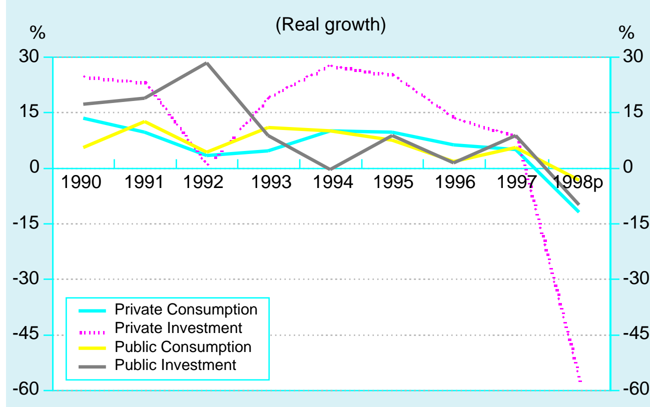
In both periods, the respective measures restored confidence and preserved stability in the banking system and the intermediation process continued to function effectively. The experience during both recessions demonstrates the need for policies to vary according to circumstances. Success depends on the ability to be pragmatic and flexible, while remaining committed to the objective of restoring financial and economic stability and supporting growth with price stability.

Nevertheless, the Government services sub-sector continued to provide improved public services and amenities to facilitate private sector activities during the year.

Domestic Demand Conditions

Aggregate domestic demand declined in 1998 for the first time since 1986. The major correction in the currency and stock markets and the subsequent negative effects of balance sheet adjustments in the financial and corporate sectors amidst weak external demand contributed to a significant contraction in both private sector investment and consumer spending. The reversal of fiscal consolidation and adoption of a stimulative budget in the second half-year helped to avoid a larger contraction in aggregate demand. As inflationary pressures abated, monetary policy also turned expansionary from August to complement the expansionary fiscal measures. Increased liquidity from domestic and external sources, significantly lower cost of funds and greater stability in the currency and equity markets following the implementation of selective exchange control measures contributed to improved investor and consumer sentiment towards year-end. Reflecting mainly the sharp adjustment in the first three quarters of 1998, aggregate domestic demand (excluding stocks) declined by 20.6% in current prices, as against a growth of 9.6% in 1997 and an average annual growth rate of about 13.5% in the period 1987-97. In real terms, the decline in total domestic expenditure was more pronounced (–25.9%, 1997: +6.5%), with the decline in public expenditure exacerbating the sharp contraction in private sector expenditure.

Total consumption spending declined by 6.5% in nominal terms in 1998, following an increase of 8% in 1997. In real terms, total consumption spending, which accounted for about 67% of total demand, declined by 10.3% (1997: +4.9%). The negative wealth effects arising from the decline in share prices, rising inflation rate and uncertain employment prospects led to more cautious consumer sentiment. The major consumption indicators pointed to a significant adjustment as households reduced consumption, increased savings and reduced existing debt levels. Sales of passenger cars in 1998 registered a decline of 54.8%, compared with an increase of 12.3% in 1997. Total loans approved by the banking system for personal use and for purchasing consumer



goods declined markedly by 72.2% and 93.6% respectively. Similarly, the Business Expectations Survey of the Department of Statistics showed that revenue from wholesale and retail trade declined by 31.4% in 1998, compared with an increase of 14.4% in 1997. Imports of consumption goods in terms of United States dollars declined for the second consecutive year by 32.7% (1997: -0.7%). Reflecting the sharp decline in consumer spending, revenue from sales tax by the Federal Government declined by 37.7% (1997: +12.7%). Nevertheless, consumer sentiment picked up towards end-year as evidenced by the upward trend in several major indicators. Sales of passenger cars increased to 20,248 units in December 1998, compared with a low of 5,724 units sold in February 1998. The latest Business Expectations Survey conducted by the Department of Statistics indicated that gross revenue of the wholesale and retail sectors are expected to increase by 7.3% during the second half year of 1998, compared with a decline of 37.4% during the preceding first half-year. This improved sentiment was also reflected in the Consumer Sentiments Index of the MIER, which indicated an increase in the index to 80.5 points in the fourth quarter from a record low of 79.1 points in the second quarter. Under the recent one-month Home Ownership Campaign which ended on 12 January 1999, properties valued at RM3.5 billion were sold. For 1998 as a whole, **private consumption** spending declined by 7.7% in nominal terms and 12.4% in real terms.

Public consumption expenditure which accounts for about 20% of total consumption also declined, albeit at a more moderate rate of 1.5% in nominal terms and 3.5% in real terms. Following the outbreak of the financial crisis in mid-1997, several

measures were announced in the fourth quarter of 1997 to manage the level of aggregate demand as a means to contain the current account deficit in the balance of payments. The economic adjustment measures included an across the board 18% cut in Government spending. However, in the second half of the year, the Government reversed the policy stance and adopted an expansionary fiscal policy with the objective of avoiding further contraction in domestic demand. In practice, the fiscal policy outturn was tighter than planned owing to the implementation gap. Hence, the fiscal deficit is estimated at 1.9% of GNP compared with the Government's 1999 Budget estimate of –3.7% as announced in October 1998. This cutback in non-essential expenditure led to the reduction in public consumption spending on supplies and services and defence expenditure.

The contraction in **total investment** was significantly higher at 39% in nominal terms and 44.9% in real terms. The key investment indicators pointed to the consolidation of investment activities. Imports of capital goods, a leading indicator of investment activity, declined significantly by 40.3% in United States dollar terms (1997: +6.7%). Similarly, sales of commercial vehicles registered a sharp decline of 76.1%, following an increase of 8.4% in 1997. Loans extended by the banking system to the broad property sector (excluding loans sold to Cagamas) increased at a much slower rate of 5.3%, while loans extended to the manufacturing sector declined by 0.2% in 1998 (1997: 32.9% and 18.5% respectively). However, several key indicators have turned positive since September 1998, reflecting some revival in investor sentiment. The performance of the capital market improved with the Kuala Lumpur Composite Index increasing by 123.1% to 586.1 points as at 31 December 1998, from the lowest level of 262.7 points as at 1 September 1998, while the market capitalisation of the Kuala Lumpur Stock Exchange also improved by 106.3% to RM374.5 billion from a low of RM181.5 billion. Sales of commercial vehicles increased to 2,545 units in December 1998 compared with a low of 1,148 units sold in February. The value of proposed investment in the manufacturing sector increased to RM4.5 billion in the fourth quarter, compared with RM3.1 billion in the preceding quarter. The positive sentiment was also reflected in the latest MIER Business Conditions Index, which improved to 44.7 points in the fourth quarter of 1998, from a record low of 41 points in the first quarter.

Table 1.15
Private Investment by Sector[1]

	1996	1997	1998
	RM billion		
Private investment	77.1	86.1	40.2
Of which:	% share		
Manufacturing	26.5	25.7	34.1
Construction	9.7	9.0	12.6
Services	32.9	34.0	31.4

[1] Estimates

The preliminary estimate for 1998 as a whole, indicated that **private investment** declined markedly by 53.3% in nominal terms. The breakdown of private investment by sector showed that activity in the services and construction sectors were more affected by the financial crisis and the adjustment measures implemented to address the economic imbalances in the economy. The decline of 56.9% in capital outlay in the services sector reflected mainly the completion of large infrastructure projects and the slowdown in implementation of existing projects, while selected new projects with high import content were deferred to strengthen the balance of payments position. Large infrastructure projects deferred in 1997 included the Bakun Hydroelectric project, the Kuala Lumpur Linear City project, the Northern Regional International Airport, Putrajaya Administrative Centre Phase II, the Cameron Highlands-Fraser Hill-Genting Highlands Road project and the Malaysia-Indonesia Bridge project over the Straits of Malacca. The slower rate of investment in the transport sub-sector was also attributed to the delay in the implementation of the Express Rail Link project and slow progress of the KL Monorail project. The scaling down of investment in the finance, insurance and business services sub-sector reflected mainly the substantial reduction in investment in office space, hotels and retail outlets in shopping malls in view of the oversupply situation and weak demand following the economic downturn. Following the marked decline in capital outlays in the services sector, the contribution of the services sector to total investment declined from about 34% in 1997 to 31% in 1998.

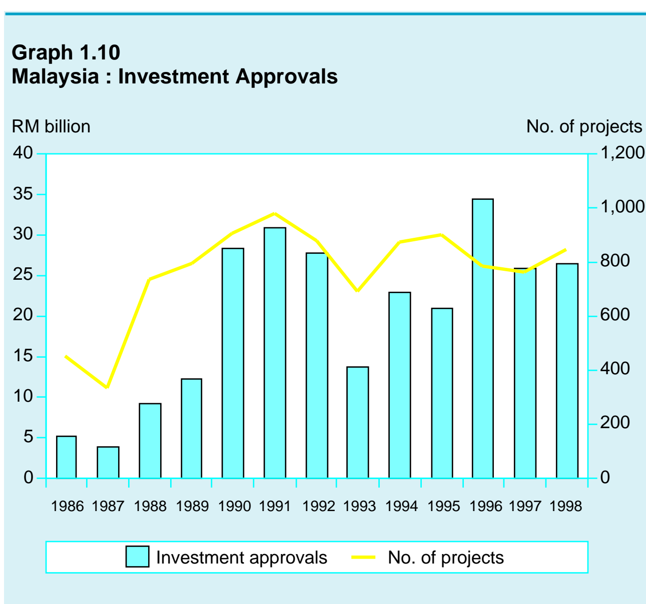
The construction sector also experienced severe adjustment in 1998. Capital outlay in this sector, which accounted for a share of 13% of total private sector investment, declined by 34.1%. With the deferment and delayed implementation of several

privatised road projects, investment activity in the construction sector was supported mainly by the construction of low- and medium-cost houses. The two privatised projects that were deferred in 1998 were the South Klang Valley Expressway and Kuala Lumpur-Kuala Lumpur International Airport Dedicated Highway.

Structural changes in the economy and the uncertain business climate also affected investment activity in the manufacturing sector. Investment in this sector, which accounted for 34% of total private investment, declined by 38% in 1998 (1997: +8.3%). The decline was broad-based, affecting investment in both the domestic and export-oriented industries. Gross inflows of foreign direct investment into the manufacturing sector was estimated to moderate to RM10.5 billion in 1998, compared with RM18 billion a year ago. The uncertainty in the region, in particular weak export demand and less favourable developments in investing countries caused foreign investors to defer several capital-intensive projects, including wafer fabrication plants. New investment activity in the manufacturing sector was supported mainly by the commencement of several joint ventures in petrochemical projects. The total value of investment approved for these projects exceeded RM6 billion in 1998.

The value of investment approved in the manufacturing sector by the Ministry of International Trade and Industry (MITI) in 1998 recorded an increase of 2.3% to RM26.4 billion (RM25.8 billion in 1997). Of the total investment approved, four large projects, each with proposed capital investment exceeding RM1 billion, accounted for an approximate share of 27.2%. The petroleum products (including petrochemicals) industry accounted for the largest share of 24.4% of the total value of investment approved, followed by the chemicals and chemical products industry (22.4%), basic metal products (10.8%), electrical and electronic products (9.1%) and transport equipment (6.3%) industries. In terms of ownership, the share of domestic investors and foreign investors was 51% and 49% respectively, compared with 56% and 44% respectively in 1997. Reflecting mainly the uncertainty caused by the crisis, the value of applications for investment was lower for 1998, registering a decline of 44.5% to RM19 billion from RM34.2 billion in 1997. Nevertheless, there was a discernible reversal in trend in the fourth quarter of 1998, when the value of applications increased to RM4.5 billion from RM3.1 billion in the third quarter.

Graph 1.10
Malaysia : Investment Approvals



The share of foreign investment in approved projects varied among industries. Foreign investment approved in the chemicals and chemical products industry accounted for 31.7% of total approvals. The share of foreign participation was smaller in other industries, in particular, petroleum products (16.4%), electrical and electronic products (14.5%), basic metal products (7.6%) and textiles and textile products (4.8%). The top five foreign investors in 1998 were the United States (49% of the total foreign investment approved in 1998), Japan (14%), Taiwan (8%), Singapore (7%) and the Netherlands (5%). These countries together accounted for 83% of the total foreign investment approved by MITI.

In line with the objective of attracting foreign investment into the country, the Government has further liberalised the foreign equity policy for the manufacturing sector in respect of new investment, expansion or diversification. Under this new guideline, foreign investors can now hold 100% equity irrespective of the level of exports. This relaxation is applicable for all applications received between 31 July 1998 and 31 December 2000 to set up manufacturing projects. All projects approved under this policy will not be required to restructure their equity after the period, provided that the company continues to comply with the original conditions of approval and retains the original features of the project.

In contrast to the developments in the main sectors, capital investment in the agriculture and

mining sectors increased during the year. Investment in the mining sector, which accounted for 6% of total private investment, increased by 18.8% mainly on account of the strong investment in the oil and gas sub-sector. The more favourable export prices for crude palm oil due to the exchange rate factor have also led to some increases in investment in the agriculture sector (7% of total private investment).

Counter-cyclical fiscal policies adopted in early 1998 helped sustain **public investment,** which recorded a marginal decline of 0.3% in nominal terms in 1998 (1997: +11.9%). In line with the implementation of the fiscal stimulus programme, the Federal Government increased the allocation for socio-economic development. Public sector investment was also sustained by capital investment by the non-financial public enterprises (NFPEs). Investments were mainly undertaken for the ongoing capacity expansion and modernisation programmes by the major NFPEs and to meet higher import cost. PETRONAS continued to invest in both upstream and downstream activities, including the construction of two new gas processing plants, central utility facilities in Kertih and Gebeng, several petrochemical projects, development of University Technology PETRONAS and Kuantan-Kertih Railway project. Capital investment by Tenaga Nasional Berhad (TNB) was mainly to expand and upgrade its power generation capacity and its transmission and distribution networks to meet future demand for electricity by commercial and industrial sectors for the industrialisation process. Major projects undertaken by TNB included Phase I of the 500kw transmission network, Phase III of the Port Klang Sultan Salahuddin Abdul Aziz Power Station, the rehabilitation and conversion plants in Melaka, Port Dickson, Prai and Pasir Gudang, development of electricity infrastructure for Putrajaya and Cyberjaya and construction of Phase II of Tenaga Nasional University Complex. Capital outlay by Telekom Malaysia Berhad was largely to upgrade its telecommunication network, including implementation of a host of services and products for the Corporate Information Superhighway, an integral part of the Multimedia Super Corridor and the National Information Infrastructure.

In 1998, **gross national savings** (GNS) continued to increase despite the contraction in the domestic economy. As overall consumption declined significantly, GNS increased further by 5.1% in 1998 (12.3% in 1997 and 24.7% in 1996). The slower growth in 1998 reflected the marginal increase in nominal income. In terms of GNP, the share of GNS increased to 41.2% in 1998, compared with 39.4% recorded in 1997. With gross domestic capital formation declining by 38.4% (1997: +12.7%), the savings-investment gap turned around to register a record surplus of RM36.1 billion or 13.7% of GNP in 1998, from a deficit of RM14.2 billion or 5.4% of GNP in 1997.

In the public sector, public savings declined by 15.9% to RM42.3 billion in 1998 (1997: +26.6%; RM50.3 billion) reflecting lower revenue performance of the public sector arising from the economic downturn and higher expenditure associated with the weakening of the ringgit as well as the counter-cyclical fiscal stance adopted by the Federal Government to address the economic downturn. Nevertheless, the public sector continued to record a surplus, albeit a smaller surplus of RM10.6 billion in 1998, as growth in public investment decelerated to 0.6%.

While the export sector benefited from higher income, due mainly to the depreciation of the ringgit, earnings in other sectors were affected by the erosion of profit margins following the contraction in the economy. Therefore, the increase in private sector savings by 25.2% to RM65.7 billion was mainly on account of the marked decline in private consumption. At the same time, the decline in private investment was significantly higher (–52.9%). Consequently, the private sector resource balance turned around to register a surplus of RM25.5 billion in 1998, from a deficit of RM32.9 billion in 1997.

The high rate of savings has represented one of Malaysia’s strengths and has enabled Malaysia to achieve a decade of high growth that has been financed primarily from domestic sources. This has reduced reliance on external sources of financing and thereby had increased the resilience of the nation to withstand the effects of the depreciation of the currency. In the current environment, it has allowed Malaysia to rely to a greater extent on domestic sources of financing to support the expansionary macroeconomic policy and the restructuring of the financial sector. While savings continue to be important, it is necessary to recognise that consumption is equally important. In particular, during this period of economic contraction,

increased consumption is important to support the economic recovery process. The private sector should, therefore, recognise the need to balance between consumption and savings. Over-cautious spending behaviour and an over increase in savings would result in a slowing down of the recovery process.

Recognising the importance of the need to balance consumption and savings, the efforts of the savings programme in 1998/1999 have emphasised on the efficiency of managing household income and expenditure. Towards this objective, two publications were produced during the year, that is, the Household Accounts Book and a Pocket Money Book for students as part of this programme. The objective of the Household Accounts Book is to encourage households to plan and manage their expenses to be in accordance with their present and future income. It also aims to promote more goal-oriented consumption and savings, in particular, to encourage savings for a specific purpose, that is, for a specific future expenditure, such as education, purchase of cars and houses. Greater planning and efficiency in managing income and expenditure will result in greater benefits from the limited resources and contribution towards better living standards. The student's Pocket Money Book is aimed at introducing financial management of personal accounts at a young age and, therefore, produce a society that has an awareness of the gains that can be obtained from such efficiency. This will contribute towards building the foundation for future growth.

External Sector

Balance of Payments

In 1998, the balance of payments outturn was significantly better than expected. The most significant development was the speed and magnitude of the adjustment in the current account balance. Reflecting both the favourable valuation impact of the weaker ringgit on export earnings as well as the rapid decline in imports, the current account recorded an unprecedented large surplus of RM36.1 billion (US$9.2 billion) in 1998, far exceeding the RM20.1 billion surplus projected in the 1999 Budget announcement in October. This was a significant turnaround from a deficit position of RM14.2 billion (US$5 billion) in 1997 and was the first current account surplus since 1989. In terms of GNP, the surplus increased to 13.7%

Table 1.16
Balance of Payments

Item	1998*e* +	1998*e* –	1998*e* Net
	RM million		
Merchandise balance (f.o.b.)	**282,007**	**212,685**	**69,322**
Balance on services	**49,088**	**72,469**	**–23,381**
Freight & insurance	4,129	12,781	–8,652
Other transportation	6,547	4,278	2,269
Travel & education	9,344	6,273	3,071
Investment income	5,789	21,500	–15,711
Government transactions n.i.e.	331	491	–160
Other services	22,948	27,146	–4,198
Balance on goods and services	**331,095**	**285,154**	**45,941**
Unrequited transfers	2,938	12,811	–9,873
Balance on current account	**334,033**	**297,965**	**36,068**
Official long-term capital			2,138
Federal Government	4,001	2,182	1,819
Market loans	2,435	1,324	1,111
Project loans	1,566	858	708
Suppliers' credit	–	–	–
Non-financial public enterprises	4,705	4,344	361
Other assets and liabilities			–42
Private long-term capital			8,740
Balance on long-term capital			10,878
Basic balance			**46,946**
Private short-term capital (net)			–21,700
Errors and omissions			15,055
Overall balance (surplus +/ deficit –)			**40,301**
Allocation of Special Drawing Rights			–
IMF resources			–
Net change in international reserves of Bank Negara Malaysia (increase – / decrease +)			–40,301
Special Drawing Rights			–315
IMF reserve position			–757
Gold and foreign exchange			–39,229
Bank Negara Malaysia international reserves, net [1]			**99,424**

[1] Arising from the fixing of ringgit/US dollar exchange rate at RM3.80 in September 1998, all assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the cumulative gain has been reflected accordingly in the Bank's current year account. The US dollar equivalent of international reserves as at 31 December was US$26.2 billion.
e Estimate

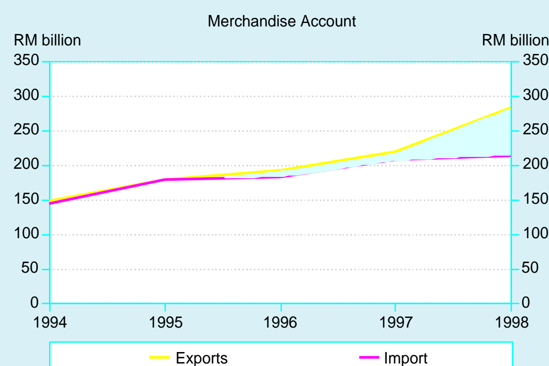
Source : Bank Negara Malaysia and Department of Statistics

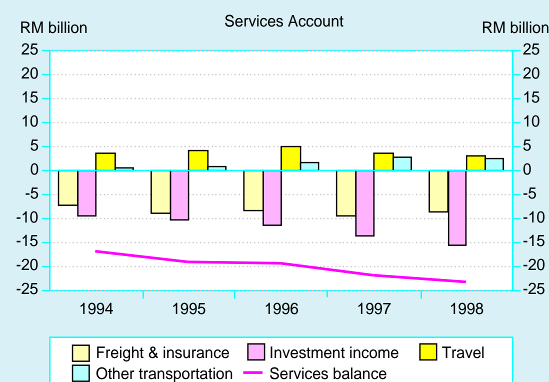
(1997: –5.4%), surpassing the previous high of 8.9% achieved in 1987, after the last recession. The improved current account position reflected an exceptionally large surplus in the merchandise account, which more than offset both the higher services account deficit and the large outflows on the transfers account. The merchandise surplus rose to a record high of RM69.3 billion (US$17.7 billion) in 1998, due mainly to a reduction in import volume, particularly of capital goods, reflecting the impact of the sharp contraction in domestic demand combined with the deliberate policy to defer non-critical infrastructure projects and rationalise the purchase of imported goods by public agencies. At the same time, export earnings increased sharply in ringgit terms, due mainly to valuation gains. More significantly, exports in United States dollar terms recorded positive growth in the last three months of 1998, reflecting a surge in the exports of electronic equipment and parts.

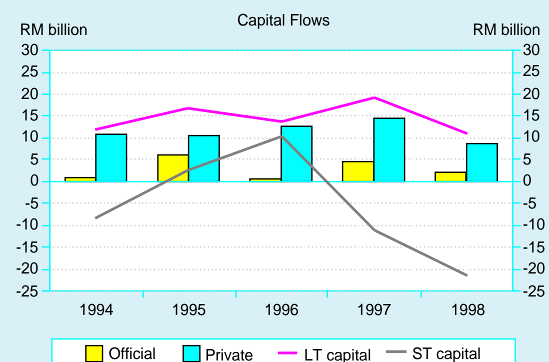
The global financial market turmoil and investors' risk aversion to emerging markets, including Malaysia, resulted in a decline in new capital inflows in 1998. The net inflow of long-term capital declined to RM10.9 billion from RM19 billion in 1997. This was attributable to the lower net inflows of both official and private long-term flows, which were affected by the tightening of lending conditions in international debt markets, continued uncertainty in the region and the cautious approach of new long-term foreign investors following the introduction of selective exchange control regulations in September 1998. Meanwhile, the widening spreads following the downgrading of Malaysia's sovereign debt rating (but still at investment grade) made external borrowing a more costly funding option for Malaysian borrowers. Nevertheless, Malaysia continued to receive official loans from the World Bank and bilateral lenders, especially Japan. Reflecting the above developments, the basic balance, comprising the current account and long-term capital account, recorded a large surplus of RM46.9 billion in 1998 (RM4.8 billion in 1997).

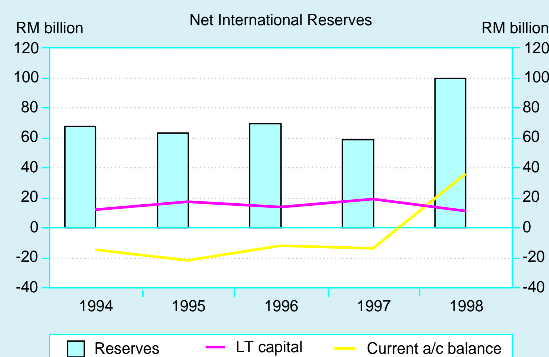
For the second consecutive year, the short-term capital account recorded a substantial outflow of RM21.7 billion (1997: –RM11.3 billion), reflecting the decline in short-term debt of the commercial banks in response to the stagnation in domestic demand, sluggish external trade and liquidation of portfolio investment by foreign investors. After adjusting for errors and omissions of RM15.1 billion,

Graph 1.11
Malaysia: Balance of Payments









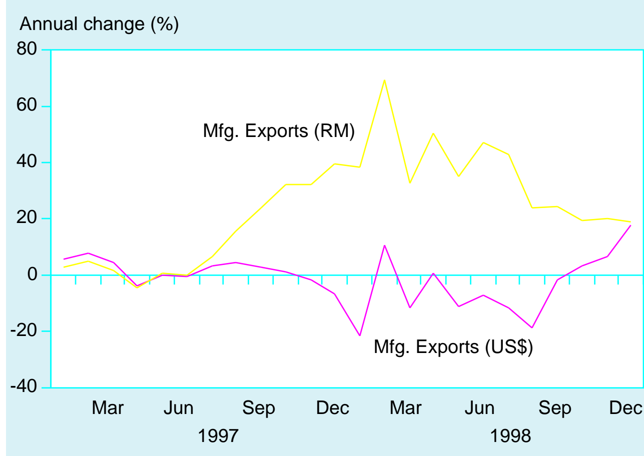
reflecting mainly the exchange rate gain from the revaluation of external reserves, the overall balance of payments reverted to a surplus of RM40.3 billion (US$10.3 billion) from a deficit of RM10.9 billion (US$3.9 billion) in 1997. Net international reserves of Bank Negara Malaysia increased to RM99.4 billion (US$26.2 billion) at the end of 1998 from RM59.1 billion (US$21.7 billion) at end-1997. This level of reserves was sufficient to finance 5.7 months of retained imports (3.4 months in 1997).

The stimulative measures introduced since mid-July did not result in significant leakage abroad in 1998. The additional funds were directed at projects which used, to a large extent, domestic raw materials and services to ensure sustained improvement in the balance of payments to strengthen Malaysia's external reserves position. Maintaining a strong reserves position is important to both the short-term objective of economic recovery as well as the long-term aim to maintain a sustainable external position. A large reserves cushion is indeed a key element in protecting the country against unforeseen destabilising developments. This would help to sustain market confidence and stability, enhance creditworthiness and at the same time, provide the Government with greater flexibility in the conduct of domestic policies.

In 1998, the performance of the **merchandise account** exceeded all targets set during the year to achieve a substantial surplus of RM69.3 billion, far higher than the RM11.3 billion recorded in 1997. The expansion in the surplus was the result of the stronger expansion of merchandise exports (28.9%) compared with merchandise imports (2.6%). In the case of exports, this was primarily due to valuation gains from the depreciation of the ringgit as international prices for most of Malaysia's major exports were lower while export volume remained stable. In the case of imports, both volume and prices declined to offset the higher import costs due to the weaker ringgit.

The **trade account** performed better than expected. The trade surplus rose to an unprecedented level of RM58.4 billion in 1998, far exceeding the previous high of RM13.3 billion recorded in 1987. Export receipts grew by 29.8% in ringgit terms to reach RM286.8 billion, due in large part to the depreciation of the ringgit against most major currencies, especially the United States

Graph 1.12
Manufactured Exports



dollar. Growth in imports decelerated to 3.3% to reach RM228.3 billion. In United States dollar terms, imports recorded a large reduction of 26.2%, reflecting the sharp contraction in domestic demand. The Government also implemented deliberate measures to strengthen the external balance, including rationalisation of the purchases of imported goods by public agencies and the deferment of large projects.

By the end of 1998, the trade account had been in surplus for 14 consecutive months since November 1997. More importantly, the size of the surpluses has also been rising. This has primarily been the result of the sustained strong export growth in ringgit terms. In United States dollar terms, exports registered a decline of 6.9% for 1998 as a whole. However, a positive development was that the value of exports in United States dollars stabilised by September 1998 to levels recorded a year ago and expanded gradually for the remaining months of the year.

Export earnings in ringgit terms rose by 29.8% in 1998, reflecting increases in the exports of manufactured goods (32.8%) and commodities (17.4%). However, export receipts in United States dollar terms contracted by 6.9%, as the marginal increase in the export volume was offset by the relatively sharper slide in United States dollar export prices. Despite recording lower earnings in United States dollar terms, manufactured exports remained the major contributor of foreign exchange earnings to account for 82.9% of total gross exports (1997: 81%). Reflecting mainly the strong export growth of the electronic equipment and parts sub-sector,

gross exports recorded a positive growth of 5.2% in the fourth quarter of the year (1Q: –11.3%; 2Q: –10.1% and 3Q: –10.8%).

Exports of **manufactured goods** in ringgit terms rose by 32.8% to RM237.6 billion in 1998 (1997: 12.9% to RM178.9 billion). All industries recorded higher export receipts except for wood and petroleum products. Higher exports reflected mainly exchange rate valuation effects as well as a marginal increase of 1.4% in export volume (exchange rate of ringgit vis-à-vis United States dollar averaged US$1=RM3.92 in 1998 compared with US$1=RM2.81 in 1997). Exports rose sharply in the first half-year (44.2%) reflecting mainly valuation effects before moderating in the second half of the year (23.8%). The moderation in the second half-year reflected partly the sharper deterioration in the export volume in the third quarter before it recovered strongly in the fourth quarter. In United States dollar terms, manufactured exports contracted by 7.8% in the first half-year and its performance worsened to record a sharper decline of 11.1% in the third quarter. However, during the fourth quarter of the year, a turnaround was recorded when exports rebounded to increase by 8.8%, representing the first quarterly

Table 1.17
Gross Exports

	1998				
	RM million	Annual change (%)	% share	US$ million	Annual change (%)
Manufacturing sector	**237,649**	**32.8**	**82.9**	**60,797**	**–4.6**
Of which:					
Electronics, electrical machinery and appliances	161,733	35.9	56.4	41,375	–2.4
Electronics	114,175	41.3	39.8	29,238	1.9
• *Semiconductor*	*54,483*	*33.3*	*19.0*	*13,931*	*–4.2*
• *Electronic equipment & parts*	*59,692*	*49.6*	*20.8*	*15,307*	*8.2*
Electrical machinery & appliances	47,558	24.3	16.6	12,138	–11.4
• *Consumer electrical products*	*20,648*	*16.1*	*7.2*	*5,267*	*–17.3*
• *Industrial & commercial electrical products*	*15,065*	*25.5*	*5.3*	*3,841*	*–10.5*
• *Electrical industrial machinery and equipment*	*10,974*	*41.8*	*3.8*	*2,807*	*1.2*
• *Household electrical appliances*	*871*	*19.0*	*0.3*	*223*	*–13.5*
Textiles, clothing and footwear	9,442	24.0	3.3	2,408	–11.1
Chemicals & chemical products	10,627	30.6	3.7	2,717	–6.6
Wood products	5,982	–7.8	2.1	1,528	–34.3
Manufactures of metal	8,255	45.8	2.9	2,114	5.0
Transport equipment	8,064	62.6	2.8	2,085	17.1
Rubber products	5,739	45.0	2.0	1,465	3.8
Optical and scientific equipment	4,760	21.7	1.7	1,217	–11.8
Agricultural sector	**30,201**	**30.4**	**10.5**	**7,704**	**–6.4**
Of which:					
Rubber	2,829	–4.8	1.0	723	–32.5
Saw logs	1,866	–20.5	0.7	475	–43.4
Sawn timber	2,526	–9.0	0.9	644	–36.0
Palm oil	17,779	64.4	6.2	4,533	17.8
Minerals	**14,874**	**–2.4**	**5.2**	**3,786**	**–32.7**
Of which:					
Tin	485	1.5	0.2	123	–29.2
Crude oil	7,510	6.2	2.6	1,917	–23.8
LNG	5,981	–4.4	2.1	1,525	–37.1
Other	**4,032**	**16.9**	**1.4**	**1,039**	**22.1**
Total	**286,756**	**29.8**	**100.0**	**73,326**	**–6.9**

Source: Bank Negara Malaysia and Department of Statistics

increase since the third quarter of 1997. As a result, the decline in exports in United States dollar terms moderated to 4.6% in 1998 (+1.1% in 1997). A surge in the exports of electronic equipment and parts and rubber products contributed to the rebound in exports during the fourth quarter.

Although exports in United States dollar terms declined, overall **export volume** of manufactured goods rose by 1.4% during the year. This reflected a 5.9% decline in export prices expressed in United States dollars. Price competition in the major markets had intensified during the year, owing to excess capacity and competition among countries affected by the regional financial crisis. At the same time, external demand was affected by poor orders from the Asia-Pacific region, which accounted for about 40% of total manufactured exports (including exports to Singapore which were mainly re-exported to the Asia-Pacific region, the United States and Europe). Exports to the United States, which was the single largest export market, however, improved to increase by 9.3% in United States dollar terms (1997: 2.7%) and helped to offset in part the declining trend in exports to the East Asian countries. The United States accounted for 25.4% of Malaysia's total manufactured exports in 1998 (22.1% in 1997).

Exports of electronic goods in United States dollar terms rose by 1.9% in 1998, accounting for 48.1% of total manufactured exports, due mainly to the contribution from electronic equipment and parts. The revival of the disk-drive sub-sector, coupled with improved sales of personal computers and intensified efforts to deal with the Year 2000 problem, boosted the demand for electronic equipment and parts, which posted an increase of 8.2% during the year. Exports of semiconductors, however, shrank by 4.2% on account of the persistent oversupply of memory chips and the resultant sharp decline in prices. The severity of the downward adjustment in chip prices only moderated towards year-end following the decision of some major world producers to halt or cut their production levels in an effort to restrain falling prices and rapidly dwindling margins. Meanwhile, according to the latest report of the Semiconductor Industry Association, global semiconductor sales fell by 8.4% in 1998, although the contraction in annual sales moderated towards year-end. In particular, sales in the Asia-Pacific market increased by 2.4% in December 1998 after declining for eight consecutive months.

Poor external demand caused the exports of electrical products in United States dollar terms to decline by 11.4% in 1998. Although exports to the United States were higher, they were not sufficient to offset the lower demand from the Asia-Pacific region. The export performance of this industry was also affected by aggressive price cutting by other producer countries. The decline in exports of electrical products was across-the-board, encompassing consumer electrical products (mainly audio-visual products), industrial and commercial electrical products, electrical industrial machinery and equipment, and household electrical products. The introduction of digital electrical products (such as digital television and digital video disk players) had not stemmed the downward trend of foreign orders, reflecting cautious consumer spending in the face of the economic downturn.

Exports of textile and clothing valued in United States dollars also fell by 11.1%, attributed mainly to sluggish demand from the Asia-Pacific region. Meanwhile, demand for wearing apparel in the United States and the European Union was sustained despite intense price competition. However, this was offset by lower exports of textiles, particularly synthetic textiles to the East Asian countries, including Hong Kong Special Administrative Region (SAR), The People's Republic of China; Japan; The People's Republic of China; and Singapore. In the chemical products industry, Malaysian manufacturers succeeded in expanding their exports to the United States. Nevertheless, the slow pace of industrial activities in Hong Kong SAR, Singapore and Japan resulted in reduced offtake of organic chemicals and chemical materials from these countries. Overall, exports of chemical products contracted by 6.6% during the year.

The wood products industry recorded a sharp decline in exports of 34.3% in 1998, due to both lower prices and external demand. Sluggish construction activities in The People's Republic of China, Japan and Korea dampened demand for plywood, hardboard and particle board. Towards the end of the year, prices of plywood improved moderately due mainly to stock replenishment by major buyers. The market was also boosted by the reconstruction activities in The People's

Republic of China, following the big flood and the ban on logging in some locations.

The downturn in the domestic construction sector prompted manufacturers of metal products to seek export markets. Higher export earnings were recorded for the metal products industry (+5%), particularly from exports to the United States and Hong Kong SAR. Exports of non-metallic mineral products, however, declined further (–13.2%) as construction activities in the Asia-Pacific region, which accounted for about 60% of the industry's exports, remained sluggish. The decline in the United States dollar export price was also more severe in the case of non-metallic mineral products as compared with metal products.

Exports of transport equipment, on the other hand, rose by 17.1% in United States dollar terms, owing to higher re-exports of aircraft upon completion of repairs and servicing. Meanwhile, the export performance of motor vehicles was hampered by poor global sales of automobiles. The sluggish global demand had also affected major world producers as reflected in their move towards consolidation through mergers and acquisitions.

Exports of rubber products rose by 3.8% in United States dollar terms in 1998, bolstered by sustained demand for examination and surgical gloves from the United States, the European Union and Australia. Stringent quality controls set by the Malaysian glove manufacturers to meet the international standard requirement of the major markets helped gain market shares. Meanwhile, intense competition from low-cost producing countries which had abundant supplies of raw materials prompted the Malaysian manufacturers to move towards higher value-added surgical gloves, particularly those which were powder-free. The industry is faced with a major challenge in the immediate term as competing producers in the major export markets are campaigning for greater use of synthetic gloves.

The optical and scientific equipment industry, which has gained prominence in recent years, registered lower exports valued in United States dollars (–11.8%), due to lower demand for measuring, checking and controlling instruments as well as watches and clocks, particularly in Singapore, Hong Kong SAR, Japan and the United States. Similarly, lower consumption in the region had affected the exports of food products. Meanwhile, sluggish industrial demand in the region, coupled with weak prices in the international markets also resulted in lower export earnings from petroleum products.

The export performance of the **commodity** sector remained strong during 1998. Export earnings from this sector increased by 17.4% to RM45.1 billion (1997: +8.2% to RM38.4 billion). Export prices in ringgit terms increased by 29.7%, reflecting mainly the valuation gains while the overall export volume remained stable as the higher volume of crude oil exports was offset by the declines in the export volumes of other major commodities. However, in United States dollar terms, commodity export earnings declined by 17.1% during the year, due to lower export prices for all major commodities, except palm oil and cocoa.

Exports of **agricultural** commodities increased significantly by 30.4% to RM30.2 billion (1997: +3.2% to RM23.2 billion), reflecting mainly a marked increase in palm oil exports, which more than offset lower proceeds from the export of rubber, saw logs, sawn timber and cocoa. Export earnings from palm oil increased strongly by 64.4% to RM17.8 billion in 1998, reflecting mainly a sharp increase in export unit value, thereby maintaining its position as the single largest export earner for the commodity sector. During the year, the export unit value of palm oil rose by 19.1% in United States dollar terms (66.1% in ringgit terms), on account of the decline in the global supply of palm oil. On the other hand, the export volume of palm oil declined by 1%, due mainly to supply constraints. The nation's crude palm oil production fell by 8.3% in 1998 attributable primarily to the reversal in the biological yield cycle for oil palm trees.

Export earnings from rubber continued to decline by 4.8% to RM2.8 billion, largely due to a further decline in prices (–2%) as demand from the major consuming countries remained weak during the year amidst excess global supplies of the commodity. Export proceeds from saw logs also declined sharply by 20.5% to RM1.9 billion due to both lower export volume (–15.3%) and export unit value (–6.1%). Similarly, export earnings from sawn timber and cocoa declined by 9% and 17.3% respectively.

Adverse developments in the market for saw logs and sawn timber were due mainly to lower demand from the Asia-Pacific region. Malaysia exported almost all of its saw logs and 61% of its sawn timber to the region.

Total export earnings from the **mining** sector declined by 2.4% to RM14.9 billion in 1998 (1997: +16.9% to RM15.2 billion). Crude petroleum remained as the top export earner accounting for 50.5% of total export receipts of this sector and 2.6% of total gross exports. The export volume of crude oil increased by 13.5% to 18 million tonnes as demand for Malaysian superior grade crude oils remained favourable. However, arising from lower crude oil prices which reflected weak global demand and excess supplies, the export unit value of Malaysian crude petroleum declined by 32.8% to US$14.00 per barrel. The decline in world crude oil prices accelerated in the second half of the year as global demand weakened in the face of high inventories of crude oil and a mild winter in the Northern Hemisphere. Nevertheless, in ringgit terms, the export unit value of crude oil declined less sharply by 6.4% to RM417 per tonne from RM445 per tonne in 1997. Export earnings from liquefied natural gas (LNG) fell by 4.4% to RM6 billion during the year, contributing to 40.2% of total export proceeds of the mining sector. The export unit value of LNG declined by 1.9% to RM408 per tonne, in line with lower crude oil prices. The volume of LNG exports also declined by 2.6% reflecting lower demand from the major buyers, namely, Japan and Korea as these economies experienced a contraction in output.

The weak growth in **gross imports** of 3.3% reflected both declines in volume and lower international prices for most major import commodities, which largely offset the valuation impact of the depreciation of the ringgit. Import volume was estimated to be lower by about 20.5%, while import prices declined by 7.2%. As a result, gross imports in United States dollar terms were lower by 26.2% (1997: +0.8%). The decline in the import volume reflected weak domestic demand conditions, as well as the reduction in imports of inputs for manufacturing exports in response to the less favourable export environment. The postponement of non-critical infrastructure and other large projects by both the public and private sectors also contributed to the reduction in imports.

Since 1970, Bank Negara Malaysia (BNM) had been the only source of information for data on **gross imports by economic function**, which was compiled based on the methodology suggested by the United Nations Economic Commission for Asia and the Far East (now known as the Economic and Social Commission for Asia-Pacific or ESCAP). However, in February 1998, the Department of Statistics published for the first time in its Monthly External Trade Statistics Bulletin, information on imports by end use classified according to the Broad Economic Categories (BEC) system. The switchover to the BEC methodology is timely for the following reasons:

- The BEC classification ensures compatibility with the national accounts data, which is already being compiled based on the System of National Accounts of the United Nations; and
- Malaysia's adoption of the BEC classification system brings us in line with practices in most countries and allows international comparison of imports by economic functions.

Based on the BEC classification, the shares of capital and consumption goods imports are lower, while the share of intermediate goods is higher compared with the classification based on the ESCAP system.

By economic function, all types of imports, except imports of intermediate goods, declined. When valued in United States dollar terms, all categories of imports recorded substantial reductions. **Imports of capital goods** declined by 15.1% even in ringgit terms (–40.3% in United States dollar terms), a significant decline following the sharp contraction in private investment during the year. The decline also reflected deliberate adjustment measures undertaken by the Government to reduce imports of lumpy capital goods to strengthen external balances. Imports of all categories of capital goods were lower during the year. In United States dollar terms, the decline was most noticeable for construction and mining equipment (–93.9%), reflecting the severe downturn in the construction sector, industrial machinery (–46.4%) and industrial transport equipment (–46.4%) . Imports of telecommunications equipment declined by 45.6% as most operators had either completed their investment in the run-up to equal access or shelved investment plans due to the economic downturn. Imports of generators and power transmission

equipment declined by 20.6% following the completion of the capacity expansion programmes in the utilities sector. Similarly, imports of ships fell by 19.7% with the deferment of investment plans. Imports of ships and aircraft together amounted to US$2.5 billion, lower than the US$2.7 billion incurred in 1997.

Imports of intermediate goods in United States dollar terms, declined by 21.3%. The decline was in line with the decline in manufacturing production in response to weak domestic and export demand, especially from the East Asian countries. The decline in the imports of intermediate goods was mainly the result of lower imports of processed industrial supplies (–35%). Inputs used in domestic market-oriented industries in this category contracted severely. Imports of metals, in particular, were lower by 42.1%, while those of metal products declined by 25.5%. Imports of semi-manufactured gold were lower by 70.9%, reflecting a decline in domestic demand for jewellery as well as a sharp drop in tourist arrivals. Reflecting the severe contraction of activities in the construction sector, imports of mineral products declined by 57.4%. Inputs used in export-oriented industries in this category were relatively less severely affected. Imports of non-electronic parts for electrical apparatus (–44.8%), textiles and fabrics (–24.3%) and chemicals (–20.4%) recorded substantial declines reflecting the poor the performance of these sectors within the manufacturing sector. The decline in imports of non-electrical parts for electrical apparatus reflected, to some extent, lower costs from the significant depreciation of other East

Table 1.18
Gross Imports by Economic Function

	1998				
	RM million	Annual change (%)	% share	US$ million	Annual change (%)
Capital goods	**36,339**	**–15.1**	**15.9**	**9,258**	**–40.3**
Capital goods (except transport equipment)	29,757	–13.4	13.0	7,582	–38.8
Industrial machinery	*10,965*	*–24.9*	*4.8*	*2,789*	*–46.4*
Transport equipment	6,582	–22.1	2.9	1,676	–46.4
Intermediate goods	**159,958**	**9.8**	**70.1**	**40,875**	**–21.3**
Food and beverages, mainly for industry	4,166	27.8	1.8	1,065	–7.4
Industrial supplies, n.e.s.	50,315	–8.5	22.0	12,846	–34.9
Metals	*11,855*	*–19.3*	*5.2*	*3,026*	*–42.1*
Fuels and lubricants	4,627	3.6	2.0	1,183	–44.6
Parts and accessories of capital goods (except transport equipment)	98,752	24.1	43.3	25,251	–10.5
Electronics	*64,201*	*40.2*	*28.1*	*16,415*	*0.8*
Parts and accessories of transport equipment	2,098	–38.4	0.9	531	–57.0
Consumption goods	**13,152**	**–6.1**	**5.8**	**3,361**	**–32.7**
Food and beverages, mainly for household consumption	5,681	1.6	2.5	1,453	–27.0
Transport equipment, non-industrial	37	–79.3	0.0	10	–85.4
Consumer goods, n.e.s.	7,435	–9.8	3.3	1,899	–35.4
Consumer durables	*1,107*	*–23.4*	*0.5*	*282*	*–45.5*
Consumer semi-durables	*2,778*	*–13.2*	*1.2*	*709*	*–37.7*
Consumer non-durables	*3,550*	*–1.3*	*1.6*	*907*	*–29.3*
Dual use goods	**3,826**	**–38.5**	**1.7**	**974**	**–56.1**
Motor spirit	2,286	21.7	1.0	583	–13.5
Passenger motor cars	1,540	–64.5	0.7	391	–74.7
Others	**4,215**	**–12.4**	**1.8**	**1,081**	**–37.9**
Re-exports	**10,819**	**45.7**	**4.7**	**2,799**	**6.1**
Gross Imports	**228,309**	**3.3**	**100.0**	**58,348**	**–26.2**

n.e.s: Not elsewhere specified.

Source: Department of Statistics

Asian currencies. Imports of other accessories for motor vehicles and engines and engine parts for motor vehicles contracted by 63.1% and 55.7% respectively, reflecting the downturn in the motor assembly industry due to higher interest rates and tight credit conditions for the greater part of the year. However, the moderate decline in imports of parts and accessories of capital goods (excluding transport equipment) of 10.5% helped slow the overall decline in imports of intermediate goods. This was mainly the result of a 0.8% increase in the imports of electronic component parts, in part reflecting the pick up in exports towards the end of the year.

Imports of consumption goods declined by 32.7% in United States dollar term, reflecting weak consumer demand amidst uncertainty regarding income and employment prospects as well as the negative wealth effects arising from the decrease in asset values. This decline was mainly the result of lower imports of durable and semi-durable consumer goods. The weaker ringgit also resulted in greater domestic substitution of consumer durables. In particular, imports of sound and video reproducing equipment declined by 48.9%, while those of cameras and optical equipment were lower by 56.8%. Among semi-durable consumer goods, particularly significant declines were evident in imports of tapes and records (–37.6%), toys, games and sports equipment (–39.9%), clothing and footwear (–50.1%) and household furnishings and goods (–39.4%). Imports of processed food declined by 27.1% while those of primary food fell by 26.8%. In United States dollar terms, imports of **dual use goods**, namely motor spirit (gasoline) and passenger motor cars, declined by 56.1%, mainly on account of the 74.7% decline in the import of passenger motor cars. The 1998 Budget had raised import duties on luxury motor vehicles, which further contributed to this decline.

The relatively more moderate decline in imports of intermediate goods resulted in its share of total imports increasing to 70.1% (1997: 65.9%), primarily at the expense of a lower share of imports of capital goods of 15.9% of gross imports (19.4% in 1997). Imports of consumption goods remained relatively stable to account for 5.8% (6.4% in 1997).

The effects of the depreciation of ringgit was seen in the expansion in Malaysia's **total trade** by 16.6% (12.1% in 1997) to RM515 billion or 196% of GNP in 1998 (RM442 billion or 169% of GNP in 1997). In United States dollar terms, however, total trade declined by 16.5%, vis-a\-vis the growth in world trade of 3.4%. During the year, the relative importance of various trade partners shifted, reflecting domestic demand conditions prevailing both in Malaysia as well as in partner countries. The United States continued to remain Malaysia's largest trade partner and its relative importance grew during the year. In terms of total trade, the United States increased its share from 17.7% in 1997 to 20.8% in 1998. Singapore continued to remain a major trade partner with a share of 15.5%, in view of the transhipment of a significant portion of Malaysian trade through the republic. However, Japan's share of total trade fell from 17.2% to 14.6%, reflecting the weak demand conditions in the Japanese economy. As a result, Japan slipped into third place, behind Singapore. Countries of the European Union continued to maintain their share of Malaysia's total trade at 14.3%. Germany, the United Kingdom and the Netherlands remained the largest trading partners in this group. Trade with these four major trading partners (including the European Union) accounted for 65.1% of total trade.

In terms of **export destination**, the United States became Malaysia's largest export market in 1998 while Singapore was relegated to second position. Japan retained its position as the third largest export market. In terms of **import origin**, the United States and Japan were the largest source of imports with a share of 19.6% each, followed by Singapore (13.6%). Reflecting the substitution of imports from cheaper alternative sources, the share of imports from Indonesia, the Philippines, The People's Republic of China and Korea increased mainly at the expense of imports from Japan and Europe.

In 1998, the depreciation of the ringgit yielded significant improvement in Malaysia's favour in terms of **bilateral trade balances**. Malaysia recorded larger trade surpluses with Singapore, the United States, the European Union (mainly the Netherlands, the United Kingdom and Belgium), Hong Kong SAR and India. Of significance, Malaysia's trade surplus with the United States rose to RM17.4 billion, substantially higher than the RM4 billion surplus recorded in 1997. The trade surplus with the Eurupean Union also increased sharply to RM19.4 billion (1997: RM692

million), especially with the Netherlands and the United Kingdom. In the case of several other trading partners, the trade deficits turned into surpluses in 1998, especially the trade balance with The People's Republic of China, Taiwan and Australia. The significant improvement in the trade balance was due in part to higher demand for cheaper Malaysian goods following the currency depreciation as well as the valuation impact on export earnings. Meanwhile, the persistent deficit with Japan remained, albeit much smaller at RM14.6 billion (1997: RM21 billion). The discernible shift by Malaysia to source imports from lower cost suppliers, especially from countries experiencing large currency depreciations led to the widening trade deficits with Indonesia, the Philippines and Korea.

For the first time since 1989, the surplus in the merchandise account was more than sufficient to offset the higher services deficit and higher outflows on the transfers account. In 1998, the net outflow in the **transfers account** increased significantly to RM9.9 billion (RM3.7 billion in 1997). This reflected mainly the one-time lump sum repatriation made by nearly half a million foreign workers returning to their home countries. The deficit in the **services account** widened by RM1.6 billion to RM23.4 billion, reflecting mainly the valuation impact of the depreciation of the ringgit as the services account valued in United States dollars recorded a smaller deficit of US$6 billion (US$7.7 billion in 1997). In terms of ringgit, the deterioration was due mainly to higher gross payments of RM72.5 billion (RM71.3 billion in 1997). Overall, reduced demand for imported services following the slowdown in economic activity was more than offset by the higher cost of transactions on account of the weaker ringgit. Gross receipts were marginally lower at RM49.1 billion (RM49.5 billion in 1997). The poorer performance of the services account essentially reflected larger net outflow of investment income arising from higher cost of debt servicing during the year. At the same time, the net surplus in the travel and other transportation accounts were smaller, with receipts affected by the lower demand for Malaysia's exported services due to the regional economic downturn. Meanwhile, the freight and insurance and other services accounts showed some improvements in 1998.

Table 1.19
Direction of External Trade

	1998				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	
ASEAN countries	68,578	23.9	51,492	22.6	17,086
Singapore	48,689	17.0	30,944	13.6	17,745
Thailand	9,059	3.2	8,832	3.9	227
Indonesia	3,932	1.4	5,778	2.5	–1,846
Philippines	4,521	1.6	5,386	2.4	–864
Brunei Darussalam	907	0.3	15	0.0	892
Vietnam	1,470	0.5	538	0.2	932
European Union	46,432	16.2	27,072	11.9	19,361
United Kingdom	10,328	3.6	5,067	2.2	5,261
Germany	8,655	3.0	9,019	4.0	–364
Netherlands	13,437	4.7	2,001	0.9	11,436
Other	14,012	4.9	10,985	4.8	3,027
United States	62,130	21.7	44,762	19.6	17,367
Japan	30,237	10.5	44,854	19.6	–14,618
The People's Republic of China	7,764	2.7	7,250	3.2	514
Hong Kong SAR	13,300	4.6	5,943	2.6	7,356
Taiwan	11,798	4.1	11,647	5.1	151
South Korea	6,516	2.3	13,126	5.7	–6,610
India	6,744	2.4	1,830	0.8	4,914
Australia	6,617	2.3	4,997	2.2	1,621
Rest of the world	26,640	9.3	15,336	6.7	11,303
Total	**286,756**	**100.0**	**228,309**	**100.0**	**58,446**

Source: Department of Statistics.

Net payments in the **investment income** account increased further by RM1.9 billion to RM15.7 billion in 1998, affected by the deterioration in both the interest income and profits and dividends components. The interest income account remained in deficit (–RM2.1 billion) for the second successive year, reflecting higher cost of debt servicing due to the weaker ringgit and the increase in the medium and long-term external debt. Similarly, the profits and dividends component recorded larger net payments, attributed to substantially lower receipts from Malaysian investment abroad during the year. Profits and dividends accruing to foreign investors from higher ringgit export earnings were largely offset by increased import costs, higher provisions for valuation losses as well as lower oil prices affecting profits of oil campanies. As in previous years, net investment income outflows remained the largest contributor to the services deficit, with its share rising further to 67% (63% in 1997).

In 1998, the regional economic downturn affected the performance of the tourism industry. The net surplus in the **travel account** fell to RM3.1 billion, representing an annual decline of 13.6%. Tourist arrivals fell for the third consecutive year, by a further 10.6% to 5.6 million, below the initial official target of 6.8 million visitors for the whole of 1998. Average per capita expenditure of tourists also declined, albeit at a marginal rate of 1%, due primarily to a 5% reduction in per diem expenditure as the length of stay of tourists per visit increased to 5.5 days (1997: 5.3 days). Similarly, the number of excursionist arrivals also dropped by 16.4%. As a result, the combined earnings from tourists (who stayed for more than one day), excursionists (day travellers) and transit passengers, fell by RM1.2 billion to RM9.3 billion. On the payments front, expenditure on travel and education abroad fell by 8% and 16.4% to RM4.1 billion and RM2 billion respectively. The economic uncertainty, the negative wealth effect from falling asset price and the weaker ringgit resulted in a significant reduction in the number of Malaysians travelling abroad as well as a smaller number of students studying abroad, including Government-sponsored students. The decline in the number of students abroad was also attributable to the Government's policy to increase the intake at local universities and to promote the establishment of twinning programmes between foreign universities and private colleges and the setting up of branch campuses of foreign universities in Malaysia. The promotion of domestic tourism also contributed to the smaller outflow on the travel account. Meanwhile, payments for pilgrimage rose by 33.6% to RM200 million, reflecting mainly the exchange rate effect.

The net surplus in **other transportation** account (consisting of passenger fares; charter fees; and port and airport-related activities, such as stevedoring, bunkers and port and airport disbursements) declined by 11.7% to RM2.3 billion, after registering a record surplus of RM2.6 billion in 1997. Gross receipts were marginally lower at RM6.5 billion, due mainly to lower earnings on passenger fares by the national airline and lower receipts for port-related activities. Passenger traffic and the demand for port services were affected by the regional economic slowdown. Several cost cutting measures were implemented by the national airline during the year, mainly to rationalise capacity on the domestic and Asian routes, while focusing on long haul routes particularly to North America and Europe where traffic growth was largely unaffected. At the same time, concerted efforts to promote Port Klang as a national load centre and transhipment hub yielded positive results. Despite the economic slowdown, the port recorded some 136,000 twenty-foot equivalent units (TEUs) or an 8% improvement in terms of throughput. In particular, transhipment volume increased significantly in terms of tonnage (36.5%) and TEUs (57.3%). Gross payments for other transportation increased by 5.9% to RM4.3 billion, as most payments were settled in United States dollars.

The **freight and insurance** account improved in 1998, with a smaller net payments abroad of RM8.7 billion (RM9.5 billion in 1997). Gross payments abroad recorded a marginal increase of 0.6%, with the gains associated with the contraction in import volume and lower freight rates offset by higher cost of transactions due to the weak ringgit. Total earnings from provision of freight and insurance services increased further by 30.1% to RM4.1 billion, reflecting mainly higher receipts in ringgit terms as overall cargo throughput declined. In terms of United States dollars, net payments abroad declined by US$1.2 billion. Consequently, the share of net freight and insurance payments to total services deficit declined to 37% (1997: 44%).

The deficit in the **other services** account narrowed only marginally to RM4.2 billion from RM4.5 billion a year ago, due to the valuation

loss from the weaker ringgit. The improvement reflected reduced demand for other services, in tandem with the overall contraction in the economy and the completion or deferment of some big projects, particularly in the infrastructure sector. Consequently, the share of other services in the overall services deficit fell to 18% from 21% in 1997.

Less favourable global economic conditions in the wake of the prolonged financial crisis in Asia and investors' continued risk averse attitude towards Asia led to the deterioration of the **capital account** of the balance of payments in 1998. The long-term capital account declined to RM10.9 billion in 1998 (1997: RM19 billion), reflecting the lower net inflows in both the official and private long-term capital accounts. The short-term capital account recorded a substantial net outflow for the second successive year amounting to RM21.7 billion.

The **official long-term capital account** registered a smaller net inflow of RM2.1 billion in 1998 compared with RM4.6 billion in 1997. This was due mainly to the lower gross external borrowings by the non-financial public enterprises (NFPEs) which declined sharply to RM4.7 billion (1997: RM9.4 billion). Following the tightening of lending conditions in international debt markets in the wake of increased aversion to Malaysian credit risk, the NFPEs revised their investment plans. At the same time, the scheduled repayment of loans by the NFPEs increased to RM4.3 billion in 1998 (1997: RM3 billion), reflecting mainly the valuation losses arising from the ringgit depreciation. Hence, on a net basis, the NFPEs recorded a much lower net external borrowing of RM361 million in 1998 (1997: RM6.4 billion). In contrast, gross external borrowings by the Federal Government increased significantly to RM4 billion in 1998 (1997: RM462 million) to finance the recovery package. Repayment of loans, however, was maintained at about the previous year's level of RM2.2 billion. There was no prepayment of loans during the year (1997: RM911 million). Hence, in 1998, the Federal Government registered a net borrowing of RM1.8 billion for the first time in seven years.

The **private long-term capital account** recorded a significantly lower net inflow of RM8.7 billion in 1998 (1997: RM14.4 billion), reflecting mainly the lower net **foreign direct investment** (FDI) of RM11.6 billion, compared with a net inflow of RM19.1 billion in 1997. Domestic problems in the major investing countries, global excess capacity and continued uncertainty in the region contributed to the lower FDI in 1998. Reinvestment by foreign investors in Malaysia also declined as a result of higher repatriation of profits and dividends, mainly by the Japanese firms to meet liquidity needs of their parent companies. In addition, although the imposition of selective exchange control regulations did not affect FDI, foreign investors had adopted a cautious approach towards new investment.

The bulk of the FDI in 1998 was channelled into the manufacturing sector, which accounted for 60%, followed by the oil and gas sector (23%) and the services sector (14%). External loans from parent and associated companies, although lower in 1998 due mainly to the reduced corporate profitability and liquidity problems faced by the parent companies, accounted for 36% of the FDI, followed by retained earnings by the existing companies (34%) and equity (30%). However, new inflows of equity increased in 1998, reflecting mainly funds brought in by foreign investors to acquire stakes in Malaysian companies following the liberalisation of foreign equity participation in the telecommunication and manufacturing sectors.

Despite the economic slowdown in major investing countries, the value of proposed foreign investments received by the Ministry of International Trade and Industry (MITI) continued to remain significant in 1998, amounting to RM12.7 billion (1997: RM14.4 billion). In general, long-term foreign investors, particularly the existing foreign companies in Malaysia, continued to maintain a positive outlook on the long-term prospects for the Malaysian economy. The applications for the expansion and diversification projects by the existing foreign companies amounted to RM6.2 billion in 1998 (49% of the total value of proposed foreign investment). In terms of sources of investment, the bulk of the applications were received from the United States (51.6% of total foreign investment), followed by Japan (9%), Netherlands (8.6%), Singapore (6.4%) and the United Kingdom (4.9%). Within the oil and gas sector, the United States and Netherlands continued to remain the major foreign investors in the country.

Gross **overseas investment** by Malaysian-owned companies declined to RM8.1 billion in 1998 (1997: RM11.5 billion). The slowdown in domestic

economic activity and uncertainty in the region prompted a significant cutback in overseas investments. This declining trend was reinforced by the Government's directive to defer overseas investments that do not have direct linkages with the domestic economy as well as the tightening of exchange control regulations on overseas investment since 1 September 1998. The economic slowdown also resulted in the liquidation of some assets of Malaysian companies abroad to help finance the companies' domestic operations and investments. Hence, the net outflow from overseas investment declined substantially to RM3.1 billion in 1998 (1997: -RM8.2 billion). The major recipient countries of overseas investment in 1998 were Singapore (28% of total overseas investment), the United States (22%), the United Kingdom (11%), Thailand (7%) and Netherlands (4%). Investment in Singapore was largely concentrated in the finance and business services sector (mainly investment holding companies) and in the manufacturing sector. Malaysian companies continued to participate in high value added industries on a joint venture basis with firms in the United States and the United Kingdom as part of the corporate strategy to acquire technical know-how.

The **short-term capital account** recorded a substantial net outflow of RM21.7 billion in 1998 (1997: –RM11.3 billion) due mainly to the decline in net external liabilities of the commercial banks and the liquidation of portfolio investments by foreign investors. The decline in the net external liabilities of commercial banks reflected both the decline in short-term external debt of commercial banks in response to the stagnation in domestic demand, as well as the unwinding of trade-related hedging activities following a decline in forward sales of export proceeds by the exporters. Heightened uncertainty, including increased concerns over the risks in the financial system and economic outlook, led to the large outflows of portfolio investment, especially in the second and third quarters of 1998. However, short-term capital flows stabilised in the last quarter following the implementation of the one-year holding period for portfolio investment in Malaysia effective from 1 September 1998.

External Debt

Malaysia's overall external debt situation remained manageable in 1998, despite the prolonged regional financial crisis. This outturn reflected the Government's prudent external debt management strategy, as a result of which Malaysia did not experience a payment crisis and has been able to meet its higher external obligations in 1998 due to the depreciation of the ringgit. Regular prepayment exercises had contained the nation's external debt at moderate levels while refinancing programmes had improved the debt maturity profile, smoothened the bunching of repayments and lowered interest costs. To a large extent Malaysia's resilience to the regional crisis was due to its relatively low reliance on short-term financing. Short-term borrowings accounted for only 18% of the total external debt and 29% of international reserves, while the bulk (60%) of the medium and long-term debt were with remaining maturity of more than three years. In addition, the external loans were channeled mainly to export-oriented industries and to fund overseas investments. Hence, these companies had a natural hedge from their foreign exchange earnings to cover their increased debt service obligations.

The nation's total external debt outstanding declined by 6.4% to RM159.8 billion at the end of 1998. In United States dollar terms, the total debt was equivalent to US$42 billion (US$43.8 billion in 1997). Consequently, there was an improvement in the debt indicators in 1998. The ratio of external

Table 1.20
Outstanding External Debt

	1997		1998*p*	
	RM million	US$ million	RM million	US$ million
Total debt	**170,757**	**43,840**	**159,775**	**42,046**
Medium & long-term debt	*127,500*	*32,734*	*131,271*	*34,545*
Short-term debt[1]	*43,257*	*11,106*	*28,504*	*7,501*
As % of GNP				
Total debt	65.4	47.2	60.9	62.8
Medium & long-term debt	48.8	35.3	50.0	51.6
As % of exports of goods and services				
Total debt	63.7	46.0	48.3	49.8
Medium & long-term debt	47.5	34.3	39.6	40.9
Debt service ratio (%)				
Total debt	5.5	5.5	6.7	6.7
Medium & long-term debt	4.7	4.7	6.0	6.0

[1] Refers to bank and non-bank private sector short-term debt.
p Preliminary

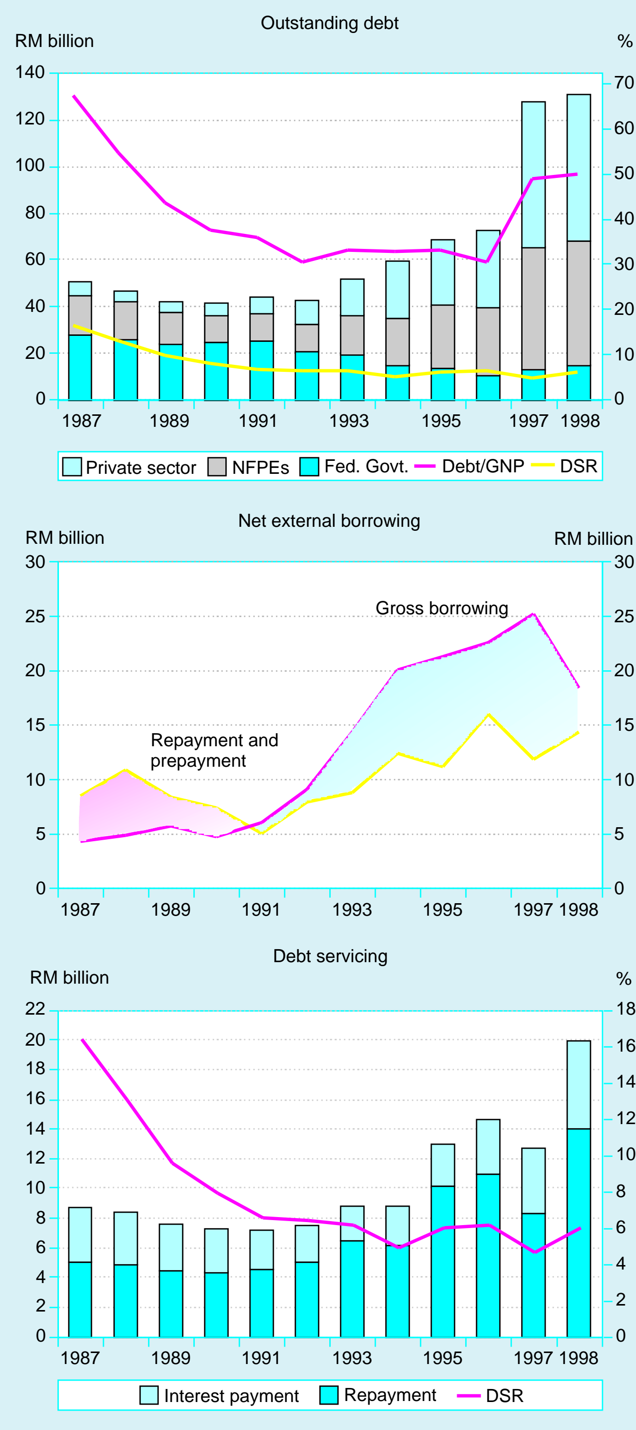
debt to GNP and exports declined to 60.9% and 48.3% respectively (65.4% and 63.7% respectively in 1997).

External borrowing of medium and long-term loans registered a sharply lower net inflow of RM4 billion in 1998 (1997: RM13.4 billion). The drawdown of loans by the non-financial public enterprises (NFPEs) and the private sector fell by 50% and 37% respectively in 1998. The lower borrowings were due to revisions in investment plans amidst the tightening of lending conditions and wider spreads in the wake of investors' increased risk aversion towards lending to Asian countries. The reassessment of lending to the region, including Malaysia, was triggered by increased uncertainty and the flight to quality in offshore markets. The aversion of lenders to market risk also resulted in a shortening of the maturity period for loans. Consequently, both the private sector and the NFPEs recorded smaller net inflows of RM1.8 billion and RM361 million respectively in 1998 (RM8.7 billion and RM6.4 billion respectively in 1997). The Federal Government, in contrast, recorded a net inflow of RM1.8 billion for the first time since 1991, reflecting official borrowing to finance the fiscal deficit. As a result, the **nation's medium and long-term external debt** increased by 3% to RM131.3 billion at the end of 1998. In United States dollar terms, the debt increased by 5.5% to US$34.5 billion (1997: US$32.7 billion).

Short-term debt, comprising mainly the external borrowings of commercial banks and non-bank private sector, declined by 34% to RM28.5 billion at the end of 1998. This reflected lower short-term loans of the banking institutions as trade financing requirements were reduced following the stagnation in domestic demand and reduction in external trade. As a result, the ratio of short-term debt to total external debt declined to 18% from 25% in 1997.

In terms of **currency composition**, debt denominated in United States dollar continued to dominate the medium and long-term debt profile with a share of 74% of total debt outstanding at the end of 1998 (1997: 76%). The share of yen denominated debt increased to 17% (1997: 15%), reflecting the increase in new yen loans during the year as well as the exchange revaluation loss which raised the yen debt in ringgit terms. The share of external debt denominated in other international currencies including the French franc,

Graph 1.13
Medium and Long-Term External Debt



Singapore dollar, Deutsche Mark and pound sterling remained at 9%.

The overall cost of servicing the external debt increased significantly in 1998, due mainly to the valuation losses arising from the ringgit depreciation. Total **debt servicing payments** increased by 50% to RM22.1 billion, due to both higher principal repayment, especially by the NFPEs, and higher

interest payments. In United States dollar terms, total debt servicing increased by 8%. Therefore, the total **debt service ratio** (ratio of debt servicing to export of goods and services) increased to 6.7% from 5.5% in 1997.

Public sector external debt: The **Federal Government's** external debt which accounts for 9.3% of total external debt, increased by 15.2% to RM14.9 billion at the end of 1998. While a large part of its borrowing to fund the increased fiscal deficit was met from non-inflationary domestic sources, the Federal Government also increased its recourse to external borrowing in 1998. Gross borrowings increased significantly to RM4 billion, mainly from official creditors such as the multilateral institutions and bilateral lenders. There has been less incentive to access the international capital markets as interest spreads had widened following several instances of downgrading of Malaysia's sovereign debt rating by the international credit rating agencies. Although the sovereign ratings had remained at investment grade, spreads for Malaysian issues widened significantly in 1998. Recently, following modification to the exchange control rules on portfolio investments, these spreads had narrowed considerably. In June 1998, the World Bank disbursed a US$300 million (RM1.2 billion) loan to mitigate the adverse effects of the economic adjustment on the more vulnerable segments of society. In December, Malaysia signed the ¥74 billion (RM 2.4 billion) five-year term loan agreement/Euroyen bond with Sumitomo Bank Ltd./ Nomura Securities Co. Ltd. The structured financing was through a combination of a term loan and Euroyen bond issue guaranteed by Ministry of International Trade and Industry, Japan. Drawdown of existing project loans totalled another RM381 million during the year. There was no prepayment in 1998. Malaysia made scheduled repayments totalling RM2.2 billion following the maturity of a Samurai bond of ¥30 billion (RM882 million) and a 100 million Swiss franc bond (RM274 million).

Gross borrowing of the **NFPEs** declined to RM4.7 billion (1997: RM9.4 billion). The drawdown of loans were mainly made by Tenaga Nasional Berhad and Telekom Malaysia Berhad to refinance loans due in 1998 and for funding domestic capital expenditure and investment in subsidiaries abroad. The NFPEs recorded a small net inflow of RM361 million (1997: RM6.4 billion) with scheduled repayments increasing by 45% to RM4.3 billion, reflecting mainly the valuation losses arising from the ringgit depreciation. Together with an exchange revaluation loss of RM403 million largely due to the appreciation of Japanese yen, the outstanding debt of the NFPEs increased by 1.5% to RM53.2 billion at the end of 1998.

Private sector external debt: In the face of a slowdown in domestic economic activity and a contraction in private investment, gross borrowing of the private sector declined by 37.4% to RM9.6 billion in 1998 (1997: RM15.4 billion). About 67% of the external borrowings were undertaken by non-resident controlled companies (NRCCs). These loans were mainly long-term from their offshore shareholders and parent and associated companies. Hence, NRCCs were less affected by the diminution of credit in international debt markets. Repayments increased by 16.7% to RM7.8 billion, reflecting mainly the impact of the ringgit depreciation. While a substantial part of external repayments due in 1998 were hedged, the unprecedented magnitude of the currency depreciation created liquidity problems for some corporations. However, these borrowers did not face problems in rescheduling these debts. Many borrowers restructured their debts through refinancing to roll over existing loans or by extending the repayment period. Following these developments, private sector external debt outstanding recorded a modest increase of 1.7% to RM63.1 billion at end-1998, due in part to the exchange revaluation gain of RM777 million, following the fixing of the ringgit exchange rate at RM3.80 to the United States dollar on 2 September 1998. The private sector remained the single largest borrower in 1998, accounting for a large share of 48% of the total medium and long-term debt.

The Government will continue to exercise prudence in its recourse to external borrowing. The aim of policy is to contain the nation's external debt within prudent levels in order to minimise the impact of adverse global financial market developments on the Malaysian economy. With this objective, the debt management strategy will continue to balance the need to ensure that the corporate sector can have access to the most competitive funding sources.

In the immediate term, however, the financing requirements for the economic recovery package and restructuring of the banking institutions will necessitate some increase in the Government's recourse to external borrowing. While the funding

requirements will be primarily met from domestic non-inflationary sources, some external loans will be raised in 1999, from multilateral institutions and bilateral sources. The Japanese Government, for example, has offered bilateral financial assistance to Malaysia under the ODA programme and the Miyazawa Initiative. Such assistance will include loans from the OECF and EXIM Bank of Japan. Such borrowing from official creditors will not adversely affect the overall external debt profile, as they are offered on more favourable terms, including concessionary interest rates or lower risk premiums and longer maturities.

International Reserves

The **gross international reserves** held by the Bank, comprising gold, foreign exchange, reserve position with the International Monetary Fund (IMF) and holdings of Special Drawing Rights (SDRs) rose significantly by RM40,305 million to RM99,438 million at the end of 1998, following a decline in 1997. After taking into consideration the current external liabilities of the Bank of RM13.7 million, the net international reserves of the Bank stood at RM99,424 million at end-1998. The United States dollar equivalent of gross reserves was US$26.2 billion at end-1998, a level sufficient to finance 5.7 months of retained imports. In SDR terms, the international reserves held by the Bank amounted to SDR18.6 billion.

During the year, net holdings of **gold and foreign exchange** rose by RM39.2 billion to RM96.3 billion at the end of 1998. Foreign exchange holdings rose rapidly subsequent to the introduction of selective exchange control measures on 1 September, and the fixing of the exchange rate on the following day. Between end-August and December 1998, reserves rose by US$6 billion. On the whole, the rise in foreign exchange holdings reflected partly Malaysia's large trade surplus in 1998, as well as foreign currency loans from both official and private institutions. The increase in reserves in ringgit terms was also due to the revision in the accounting policy of recognising the foreign exchange revaluation gain or loss in 1998. Since 15 September 1998, the exchange gain from the revaluation of foreign assets and liabilities has been reflected in the Bank's books, with assets and liabilities in foreign currencies being revalued at the exchange rate prevailing on the reporting date. With effect from January 1999, foreign exchange revaluation will be calculated on a quarterly basis.

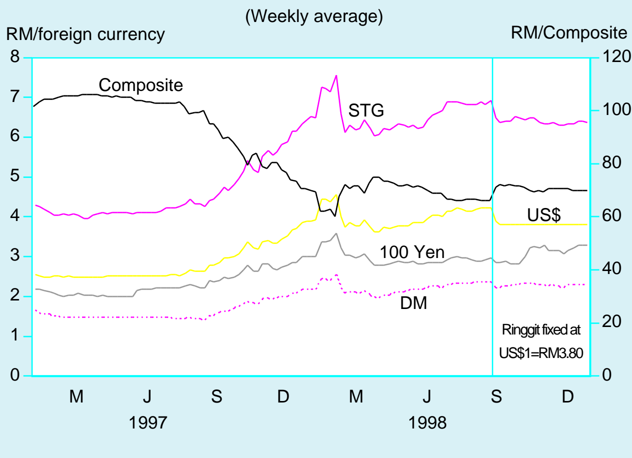
Table 1.21
Net International Reserves

	As at end		
	1996	1997	1998
	RM million		
Net Reserves	**70,014.6**	**59,122.8**	**99,424.4**
SDR holdings	427.7	478.9	793.9
IMF reserves position	1,738.2	1,622.0	2,379.2
Gold and foreign exchange	67,848.7	57,021.9	96,251.3
	US$ billion		
Gross Reserves	**27.7**	**21.7**	**26.2**
Months of retained imports	**4.4**	**3.4**	**5.7**

Holdings of reserves in the form of **SDR** rose by RM315 million during the year to RM793.9 million at the end of 1998. The increase was mainly on account of the receipts of remuneration from the IMF arising from Malaysia's net creditor position with the Fund as well as exchange revaluation gain. During the year, Malaysia was not included in the quarterly SDR Designation Plans of the Fund, under which countries were required to provide convertible foreign currency in exchange for SDRs upon request.

The **reserve position of Malaysia with the IMF** defined in terms of SDR, reflected transactions with the Fund during the year. In 1998, this component of external reserves remained unchanged at SDR444.7 million. However the SDR holdings in ringgit terms increased by RM757.2 million during the year to RM2,379.2 million at the end of 1998 on account of exchange revaluation gains for the year. The reserve position of Malaysia with the IMF remained stable during the year.

The overall objective of the Bank in managing the foreign reserves is to optimise returns without compromising on safety and liquidity. The foreign assets of the Bank comprise major foreign currencies, which are held in the form of cash, investments in allowable fixed income securities issued by foreign governments and multilateral agencies, and gold. The concern for safety encompasses the preservation of value and diversification of assets to reduce portfolio volatility



Graph 1.14
Exchange Rate of the Malaysian Ringgit against Major Currencies

and minimise risk. The foreign reserves are managed against a customised benchmark and within the investment guidelines of the Bank. **The Bank ensures adequate supply of liquidity to meet its obligations and has not entered into any forward transactions in its investment operations.**

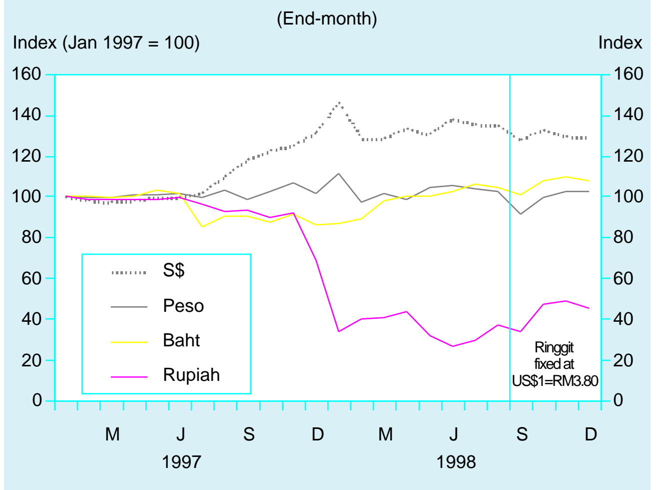
Exchange Rates

During the year, the **ringgit** recorded a mixed performance against the major currencies, depreciating marginally by 0.2% (1997: –31.4%) against the composite basket of currencies of Malaysia's major trading partners. The ringgit appreciated by 2.3% against the United States dollar and by 1.8% against the pound sterling. The ringgit's rise against the pound sterling reflected the dollar's strength, as well as concerns over Britain's weaker export sector, the threat of slower economic growth and the advent of the Euro in 1999. However, the ringgit depreciated by 2.7% against the Swiss franc, 4% against the Deutsche Mark and 9.7% against the Japanese yen largely reflecting the strength of these currencies against the dollar. Against the regional currencies, the ringgit appreciated by 1.4% against the Singapore dollar and 51.5% against the Indonesian rupiah, but depreciated by 1.1% against the Philippine peso, 20.5% against the Thai baht and 27.7% against the Korean won.

The prolonged and severe Asian financial crisis continued to exert downward pressure on the ringgit during the first eight months of the year. However, compared with 1997, the ringgit was relatively stable in 1998. The ringgit's standard deviation against the United States dollar was 0.253 on a daily basis during this period compared with 0.419 in the second half of 1997. Since 2 September when the ringgit rate was fixed at US$1=RM3.8000, there was reduced volatility of ringgit rates against major currencies. Consequently, for 1998 as a whole, the ringgit's standard deviation against the United States dollar moderated to 0.222 on a daily basis (1997: 0.437). Similarly, the ringgit's volatility moderated to 0.123 against the Deutsche Mark (1997: 0.231), 0.198 against the Japanese yen (1997: 0.307) and 0.326 against the pound sterling (1997: 0.749).

The most notable event in exchange rate developments in 1998 was the adoption of a fixed exchange rate regime on 2 September 1998, following the imposition of selective exchange controls on 1 September. This is the first time Malaysia departed from the floating exchange rate regime adopted in June 1973. With this significant development, the performance of the ringgit during 1998 can be distinguished in terms of two distinct phases.

During the earlier phase of **January-August 1998**, the ringgit continued to be affected by the turbulent regional developments as well as the contraction in domestic economic activity. Three distinct periods were observed prior to September 1998. The ringgit experienced extreme volatility in the early months of 1998. Following the sharp depreciation in the Indonesian rupiah on 7 January, the Asian currencies, including the ringgit, weakened



Graph 1.15
Exchange Rate of the Malaysian Ringgit against Selected ASEAN Currencies

during this period. The ringgit breached a historical intra-day low of US$1=RM4.8800 on 7 January, with the ringgit's standard deviation rising significantly to 0.233 in January. Subsequently, the ringgit strengthened significantly and recovered to an intra-day high of US$1=RM3.3500 on 11 February. Positive developments that supported the ringgit included the improvement in Malaysia's trade account for 1997 and announcement of further stabilisation measures by the Government, including a tightening of monetary policy. During the period mid-February to June, the ringgit was relatively more stable, fluctuating within the range of US$1=RM3.5800 to RM4.1750.

Towards end-June until August, the ringgit experienced another phase of downward pressure while the regional instability intensified. The pressure on the ringgit rates was also affected by the significant depreciation of the Japanese yen against the United States dollar. The yen reached an eight-year low of US$1=¥147.2650 on 11 August causing the ringgit to depreciate to US$1=RM4.2430. The other regional currencies were also influenced by the yen's performance in view of the region's substantial trade and investment ties with Japan. In addition, the spill over effects from adverse developments in Indonesia as well as indications that the region had entered a period of slower growth exerted further downward pressure on the Asian currencies, including the ringgit. On the domestic front, the release of the first quarter GDP data at end-May, which showed an economic contraction for the first time since 1985, also fuelled concerns over the adverse impact of the depreciation on the corporate and financial sectors. Although the Government had been proactive in managing the negative impact of the domestic contraction and to stabilise the economy and the ringgit in particular, the efforts were constrained by the vulnerability of the ringgit to sustained speculative activity, especially in offshore markets.

The rapid increase in the internationalisation of the ringgit since April 1998 also contributed to the ringgit's weakness during this period. This development caused outflows of ringgit deposits which were attracted by higher offshore interest rates ranging from 20-40%. Onshore rates were then around 11%. Opportunities to speculate on the ringgit increased with the build-up of offshore ringgit leading to further depreciation of the currency in July and August. The ringgit traded to an intra-day low of US$1=RM4.3260 on 10 July and subsequently recovered to trade within a range of US$1=RM4.0900-4.2650 during the period July to August.

Following the introduction of selective exchange control measures on 1 September, the ringgit appreciated to an intra-day high of US$1=RM3.8200. On 2 September, the ringgit was trading at US$1=RM3.8000 in the foreign exchange market prior to the fixing of the exchange rate at that level at 11 a.m.. This was also the rate at which the ringgit was, on average, traded during February to June 1998. The fixed exchange rate allowed

Table 1.22
Movement of the Ringgit

	RM to one unit of foreign currency[1]					Annual change (%)		
	1997	1998				1997	Sept. 2* 1998	1998
	End-Dec.	Sept. 2	End-Dec.	Low	High			
Composite	69.70	72.11	69.57	58.23	77.38	–31.4	–19.8	–0.2
SDR	5.2539	5.1177	5.3505	4.6701	6.3076	–30.8	–22.3	–1.8
US$	3.8883	3.8000	3.8000	3.4600	4.7250	–35.0	–22.6	+2.3
S$	2.3200	2.1998	2.2879	2.1378	2.6516	–22.1	–12.2	+1.4
100 Yen	2.9921	2.7742	3.3141	2.7439	3.5972	–27.3	–12.5	–9.7
Pound Sterling	6.4449	6.3708	6.3313	5.6250	7.6604	–33.7	–25.7	+1.8
Deutsche Mark	2.1729	2.1743	2.2640	1.9147	2.5754	–25.1	–25.6	–4.0
Swiss franc	2.6742	2.6450	2.7497	2.3691	3.1861	–29.8	–25.5	–2.7
100 Thai baht	8.2337	9.3713	10.3613	7.8031	10.6592	+19.8	–9.5	–20.5
100 Indonesian rupiah	0.0721	0.0354	0.0476	0.0248	0.0671	+48.4	+176.3	+51.5
100 Korean won	0.2305	0.2827	0.3190	0.2159	0.3418	+29.8	+14.8	–27.7
100 Philippine peso	9.6024	8.8302	9.7064	8.5336	10.7031	+0.1	+8.3	–1.1

[1] With the exception for 1996 data, where the Thai baht, Indonesian rupiah, Korean won and Philippine peso are based on customer rates, all other data is based on the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market.
* Compared with 2 September 1997's levels.

Box III

Exchange Control Measures as a Policy Option

Introduction

The exchange control measures introduced by Malaysia on 1 September 1998 were part of a series of pre-emptive measures implemented to reduce several areas of vulnerabilities in the economy. Of significance, Malaysia did not rush to impose exchange control measures to address issues arising from the contagion impact of the currency crisis. The use of exchange controls as a policy option was imposed 14 months after the outbreak of the currency crisis following macroeconomic adjustment policies undertaken to restore internal and external balance. More importantly, the circumstances prevailing in the country in September were favourable to achieve the desired objectives of the exchange control measures. Policy measures implemented in the early part of the crisis had already improved the key areas of vulnerabilities in the economy. In terms of the overall macroeconomic framework, Malaysia had contained inflation and improved its external balance. External reserves were intact, while external debt exposure remained low. The banking sector continued to perform its intermediary function. By end-August 1998, the institutional framework to restructure the financial sector was completed and its operations on track.

Objectives of the Exchange Control Measures

The exchange control measures adopted by Malaysia have been designed and implemented to achieve specific objectives in response to specific circumstances. Malaysia imposed selective measures, directed mainly at reducing the internationalisation of the ringgit. On its part, Malaysia had already undertaken adjustment policies and implemented financial reforms to reduce the risks and vulnerabilities to external developments. The prospects for these initiatives to yield the desired results could only be achieved in a stable environment. However, the worsening of the international financial environment led to continued domestic financial instability, contributing to a sharper-than-expected contraction of the economy of 4.8% in the first half of 1998. Despite macroeconomic adjustment policies in all crisis countries, exchange rates remained volatile and susceptible to speculative pressures. Although it had become clear that there was a need for greater transparency among the large players, and for reforms in the international financial system, a concerted international effort to stem this volatility was not forthcoming. For Malaysia, a major source of concern that was emerging since April 1998 was the increase in the rate of internationalisation of the ringgit, resulting in an outflow of ringgit to offshore markets. This ringgit outflow was attracted by higher interest rates in the region of 20% to 40% offered by offshore centres, while onshore rates were in the region of 11%. The strong demand for offshore ringgit and the consequent build-up of offshore ringgit increased the vulnerability of the ringgit. This trend, if left unchecked, would undermine the prospects for recovery and the ability to conduct monetary policy based on domestic conditions, thereby resulting in fundamental damage to the real economy.

Malaysia, therefore, designed the selective exchange control measures to specifically achieve the objective of reducing the internationalisation of the ringgit. This was achieved by eliminating access to ringgit by speculators, both at home and abroad. This involved the introduction of rules relating to the external account transactions of non-residents and currency of settlement of trade transactions, while general payments, including movements of funds relating to long-term investments and repatriation of profits, interest and dividends remained unaffected. The measures are also aimed at stabilising short-term capital inflows, by requiring inflows of capital to remain in the country for a period of 12 months. The measures are

temporary and would be modified or removed when its objectives have been achieved. In this regard, on 4 February 1999, the rule on the one-year holding of portfolio capital was modified to allow the foreign investors to repatriate the principal capital and profits subject to a graduated levy.

Features of the Exchange Control Measures

The exchange control measures involved the following:

- Selected ringgit-denominated transactions among non-residents effected via non-resident external accounts require approval;
- Short-term capital flows by requiring such inflows to remain in the country for a minimum period of one year. These funds, however, could be actively managed in the form of ringgit assets;
- Import and export of ringgit by travellers, both residents and non-residents, are restricted for amounts exceeding RM1,000;
- Malaysian investments abroad exceeding the equivalent of RM10,000 require prior approval; and
- Malaysians travelling abroad require approval to carry foreign currencies in excess of RM10,000 equivalent.

The changes were directed at containing speculation on the ringgit and at stabilising short-term capital flows. **There are no controls on:**

- Current account transactions (amendment in rules only require trade transactions, both in goods and services, to be settled in foreign currencies and no longer in domestic currency);
- Repatriation of profits, dividends, interest, fees, commissions and rental income from portfolio investment and other forms of ringgit assets; and
- Foreign direct investment inflows and outflows.

The main change in rules, therefore, pertains to **external account transactions of non-residents.** Under the new requirements, transfers of funds between external account holders who are non-resident corporations and non-resident individuals residing outside Malaysia are restricted. Prior approval is required for transfer of funds between external accounts and for uses of funds for other than permitted purposes. The uses of funds from external accounts are freely permitted for the following purposes, other purposes are allowed subject to approval by Bank Negara Malaysia (BNM):

- Purchase of ringgit assets/placements of deposits;
- Payment of administrative and statutory expenses in Malaysia;
- Payment of goods and services in Malaysia; and
- Granting of loans and advances to staff in Malaysia according to the terms and conditions of service.

All external account holders are free to fund these accounts from proceeds from:

- Sale of ringgit instruments, securities registered in Malaysia or other assets in Malaysia;
- Salaries, wages, commissions, interest or dividends; and
- Sale of foreign currencies.

As part of the measures, the ringgit has been fixed against the United States dollar to provide a greater degree of certainty to the market for the conduct of trade and investment activities. Following the introduction of these measures, the ringgit strengthened against the United States dollar by 10.5% from the end-August level of RM4.22 to an intra-day high of US$1=RM3.82 on 1 September 1998. The ringgit appreciated further to US$1=RM3.80 after which the ringgit's rate was fixed at that rate, effective 11 a.m. on 2 September 1998. During the period February to mid-June, the ringgit traded at about this level against the United States dollar.

Preconditions for Controls

The experience of countries in achieving the objectives of capital control measures has been varied. The use of controls has been widely criticised by proponents of the free market system on the grounds that it leads to distortions and inefficiencies. Capital controls have been identified as a major cause for creating distortions in some of the economies, undermining their prospects for growth and development. The potential costs associated with controls on capital flows are lower real interest rates and capital flight, thereby contributing to higher rates of inflation and deterioration in the balance of payments position over the long term. Consequently, there has been general perception that the measures introduced by Malaysia would create distortions in the economy. In judging the use of exchange controls as a policy option, it is important to consider when and under what circumstances such capital controls can be applied, in what form they should take, the preconditions that would ensure it would yield the desired results and how it might be efficiently implemented.

Malaysia imposed the controls under conditions and circumstances that increased the prospects for successfully achieving its objectives. Firstly, capital controls have historically been imposed by countries facing balance of payments constraints. Many of these countries imposed restrictions on almost all transactions with non-residents, including current account transactions, in the face of weak external reserves position. Malaysia, on the other hand, has maintained free movement of all current account transactions. Prior to the controls, Malaysia already had taken corrective measures which led to a significant improvement in the current account from a deficit of 5.4% of GNP in 1997 to a surplus of 13.7% of GNP in 1998, thus resulting in a strong build-up of reserves.

Several of the countries that imposed capital controls also faced capital flight. Malaysia has generally not experienced significant capital outflows of the type and magnitude experienced by countries facing balance of payments and reserves constraints. In Malaysia, capital outflows have been in the form of prepayments of external loans by both the public and private sectors, Malaysian investments in ventures abroad in sectors which yield spin-off benefits for the domestic economy and the liquidation of investments by portfolio investors.

Meanwhile, the external reserves of the country was intact, unencumbered and increasing. Before the implementation of the controls, external reserves stood at US$20.2 billion, sufficient to finance 4 months of retained imports. To date, the build-up of external reserves has been significant. As at end-February 1999, international reserves stood at US$28.7 billion, an increase of US$8.5 billion from end-August 1998 level, adequate to finance 6.2 months of imports. This growth in reserves would provide greater overall confidence and place the Government in a better position to cope with any bunching of short-term capital outflows that could occur on 1 September 1999. In addition, the short-term debt is less than half the size of foreign exchange reserves. Malaysia is therefore, not vulnerable to credit outflows over the short term, and 60% of Malaysia's external debt have remaining maturity that exceeds three years. Furthermore, the bulk of the short-term debt is in the form of trade financing. Experience of countries has shown that countries with strong balance of payments position such as The People's Republic of China and Taiwan have achieved a greater degree of success with capital controls.

Other desired objectives of capital controls are not achieved because they were implemented in an inflationary environment caused by an inappropriate mix of macroeconomic policies. Most of these countries have either had protective trade and payments regimes or public expenditure had been diverted to less productive sectors. This in turn resulted in supply constraints and a general rise in prices of goods and services. In comparison, such risks for Malaysia are low. Inflationary pressures have been subdued due to several factors:

- On the domestic front, weak domestic demand has more than offset the effects of the depreciation of the ringgit against the currencies of major trading partners. Excess capacity in product and labour markets contributed to lower inflation so that consumer prices rose by 5.3% in 1998, as against earlier expectations of 7-8%;

- Generally, the low inflation environment and the strong expansion in income levels in the

last decade have resulted in high savings and is expected to remain high at about 40% of GNP. Consequently, the fiscal stimulus is being funded by non-inflationary domestic sources of financing, primarily through the issuance of bonds and Malaysian Government Securities; and

- Malaysia also ranks favourably in terms of overall competitiveness. Malaysia has pursued an export-oriented industrialisation strategy since the 1970s, which has exposed the economy to international competition. Malaysia's economy is open with high foreign presence in the domestic industries, including financial services. Several policy measures have been put in place to enhance productivity improvements on an ongoing basis to increase the nation's competitiveness. Given the low inflation rate, the ringgit is also not overvalued when measured in terms of the real effective exchange rate.

It is important to recognise that Malaysia is not relying on controls to address macroeconomic imbalances in the economy. In administering the exchange control measures, the approach has been that such measures complement other monetary and fiscal measures to bring about sound and balanced development of the country. Malaysia is not substituting capital controls for sound and transparent domestic economic policies. Malaysia has shown commitments to undertake the necessary structural adjustment policies that are critical for long-term growth with price stability. The facts show that the breathing space provided by the exchange control measures has been used effectively to undertake further macroeconomic policies and accelerate structural reform measures. To date, the restructuring of the financial sector has been comprehensive. The achievements of the programme to restructure the financial sector has exceeded the targets. Furthermore, the target dates for completion of acquisition of non-performing loans and recapitalisation of the financial institutions have been brought forward. Work on corporate debt restructuring to facilitate debt workouts on a voluntary basis has also been accelerated.

In the implementation of the selective exchange control rules, the Government has also adopted a flexible approach. The situation has been closely monitored. Emphasis has been placed on the efficiency of the implementation process as well as the dissemination of information on the changes to the exchange control rules to provide a greater understanding of the measures. Efforts have been directed to ensure that the administrative machinery is in place to provide prompt response to emerging issues to ensure that any disruptions are addressed.

Malaysia has a track record for showing flexibility in the implementation of policies. Similarly, once the policies have achieved the desired results, such policies will be removed. Although Malaysia has adopted over time an increasingly liberal exchange control regime, the country had, under certain circumstances, used selective exchange control regulations to complement the macroeconomic policies to restore stability. Use of such selective exchange control measures occurred in 1993-94 and were removed after six months. These measures were effective and allowed stabilisation to be achieved with reduced cost to the economy. During this period, the distortionary effects were minimised.

The exchange control measures implemented on 1 September 1998, which included the requirement for portfolio capital to remain in Malaysia for at least 12 months, have contributed significantly to the stability of the economy. Accordingly, on 4 February 1999, the Government announced a new rule to replace the one-year holding rule for portfolio capital. Under the new rule, the principal capital and profits will be allowed to be repatriated subject to a graduated levy depending on when the funds were brought into Malaysia and the duration of investment. The details are as follows:

For funds brought in before 15 February 1999

- The principal capital repatriated after one year from 1 September 1998 or one year from the actual date (after 1 September 1998) the funds were brought in will not attract any levy;

- If the principal capital is repatriated within one year, it will be subject to a levy at a decreasing rate, depending on the duration the principal is held (up to 7 months: 30%, exceeding 7 months and up to 9 months:

20%; and exceeding 9 months and up to 12 months: 10%);

- No levy will be imposed on the repatriation of profits on investment made within the 12-month holding period;

- However, all profits on investments made after the 12-month holding period will be subject to a repatriation levy of 10%.

For funds brought in on or after 15 February 1999

- The principal is allowed to be repatriated without any levy;

- However, profits made and repatriated within 12 months after the investment is made are subject to a levy of 30% of the profits;

- Profits realised and repatriated after 12 months from the date of investment are subject to a levy of 10%; and

- Profits realised during the 12-month period of the investment, but repatriated after 12 months from the date of investment are also subject to a levy of 10%.

These measures are aimed at encouraging existing portfolio investors to take a longer-term view of their investments in Malaysia, attract new funds into the country, while at the same time discourage destabilising short-term flows. In addition, the rule was designed to allow a smoother outflow of funds, rather than a sudden and massive outflow upon the expiry of the one-year holding period. With respect to rules on external account transactions, Malaysia would remain cautious and lift the controls only when there are clear indications that the necessary safeguards are in place in the international financial environment to contain excessive speculative activities on currencies.

Conclusion

Initial indicators point to the success of the exchange control measures. The greater stability in the currency, stock markets and the financial system is contributing to some revival in consumer and investor confidence. The controls, although limited in scope, have been sufficient to provide a greater degree of independence for the conduct of monetary policy to support the recovery process. The measures have been positively received by long-term investors. The measures have enabled an intensification of the ongoing reform. Malaysia has taken full advantage of the "breathing space" provided by these controls to further expedite economic and financial reforms. On the international front, there has been an important shift in thinking on the broader issue of policy response to the financial crisis in general, and on the issue of exchange controls in particular. There is now increasing recognition that such controls are appropriate under specific circumstances, particularly when they are targeted at short-term destabilising capital flows and when the controls complement, and are not a substitute for policy adjustments.

External Accounts

Definition

An External Account is defined as a ringgit account maintained with a financial institution in Malaysia where the funds belong to a non-resident individual or corporation.

A resident and a non-resident are defined, for exchange control purposes, in Table III.1.

Sources and Uses of Funds Held in External Accounts

External Accounts are mostly maintained by foreign non-bank entities, which include corporations and individuals. Funds in the External Account represent a claim on Malaysia's reserves. The types of deposits held in External Accounts are as follows:

(i) Ringgit demand deposits from foreign non-bank entities;

(ii) Ringgit savings deposits from foreign non-bank entities;

(iii) Ringgit fixed deposits from foreign non-bank entities;

(iv) Ringgit fixed deposits from foreign banking institutions;

(v) Islamic Banking ringgit deposits from foreign banking institutions;

(vi) Islamic Banking ringgit deposits from foreign non-bank entities; and

(vii) Ringgit vostro accounts of foreign banking institutions.

Prior to the implementation of the selective exchange controls, the sources of funds in these accounts would be either in the form of ringgit receivables, conversion of foreign currency, or

Table III.1
Definition of Non-Resident and Resident

Non-Resident	Resident
• Non-Malaysian citizen	• Malaysian citizen
• Malaysian citizen with permanent resident status abroad and resides abroad	• Malaysian citizen with permanent resident status of another country but resides in Malaysia
• Foreign embassies, high commissions, supranationals, central banks and international organisations	• Non-Malaysian citizen with permanent resident status in Malaysia and resides in Malaysia
• Business entities established abroad	• Business enterprises or any body, whether incorporated or unincorporated, or registered with or approved by any authority in Malaysia.

ringgit earnings in Malaysia. There was no limitation as to the sources and uses of ringgit balances in this account. A non-resident could freely transfer the ringgit balances from one External Account to another for any purpose. Effective 1 September 1998, balances in the External Accounts can continue to be used for settlement of ringgit asset transactions and payment of services and administrative expenses in Malaysia. Other transactions are detailed in Table III.2. In addition, External Account holders may also transfer funds between their own External Accounts. Other than the permissible purposes mentioned above, use of these balances for other purposes, including transfers between External Accounts, require approval of BNM.

An increase in the External Account balance at any particular time does not necessarily reflect or indicate new inflow of foreign funds into the country as it could also reflect the sale of ringgit assets to residents of Malaysia, the proceeds of which are then deposited into the External Account. Similarly, decreases in the External Account balance do not necessarily reflect an outflow of foreign funds from the country since the External Account balance could also be used to purchase ringgit assets from residents. However, the movements in ringgit balances in the External Accounts to a certain extent reflect the activities of non-residents in the country.

External Accounts and Money Supply

All External Account balances, except for the vostro balances, are captured in the components of money supply, as money supply is a measure of the non-bank private sector liquidity. As ringgit vostro balances of foreign banking institutions represent transactions between banking institutions, it is therefore excluded from the compilation of money supply. The various impact of the movements in the External Accounts on money supply are as follows:

(i) When non-residents sell their assets in Malaysia to residents, there should not be an increase in money supply, as the increases in the External Accounts from the proceeds of the sales would be offset by corresponding withdrawals of funds by residents to purchase the assets.

(ii) In the event of non-residents bringing in foreign exchange and converting them into ringgit and placing the ringgit funds in their External Accounts, money supply would increase.

(iii) Ringgit funds held abroad and brought back to Malaysia and deposited into the External Accounts would increase money supply.

(iv) Increases in vostro balances would not have an impact on money supply as these represent transactions among banking institutions. Nevertheless, if the banking institutions use the funds to extend loans to the non-bank private sector, this would increase money supply.

Types of External Accounts

Apart from the External Accounts described above, two other types of External Accounts have been established. The first is the Designated External Account (DEA). This Designated External Account is set up solely for non-residents wishing to trade on the COMMEX and KLOFFE exchanges, and must be funded from the sale of foreign currency. This measure was carried out to encourage participation in the domestic derivatives market. Funds in DEAs can freely be converted to foreign currency and repatriated without any levy.

On 4 February 1999, the Government announced a new rule to replace the one-year holding rule for portfolio capital. Under the new rule, the principal capital and profits will be allowed to be repatriated subject to a graduated levy depending on when the funds were brought into Malaysia and the duration of the investment. To distinguish between the different periods when the funds were brought in, funds brought in on or after 15 February 1999 will be placed in Special External Accounts (SEAs). For the funds under the SEAs, the principal amount brought in is allowed to be repatriated without any levy. However, profits made are subject to a levy upon repatriation depending on the duration of the investment.

Table III.2:
Sources and Uses of Funds in External Accounts

Account Holder	Sources of Funds	Uses of Funds
Non-resident corporations not incorporated in Malaysia	• Sale of ringgit assets in Malaysia • Sale of foreign currency • Interest, dividends and rental from ringgit assets • Fees and commissions for services done in Malaysia	• Purchase of ringgit assets in Malaysia • Administrative and staturory expenses in Malaysia • Payment of goods and services provided in Malaysia • Granting of loans and advances to staff in Malaysia pursuant to the terms and conditions of service • Payment of trade transactions for outstanding contracts entered into prior to 1300 hours on 1 September 1998
Embassies, consulates, central banks and international organisations	• No restrictions	• No restrictions
Non-resident individuals residing outside of Malaysia	• Sale of ringgit assets • Sale of foreign currency	• Purchase of ringgit assets in Malaysia • Statutory expenses in Malaysia • Payment of goods and services provided in Malaysia provided in Malaysia • Payment of import transactions entered into prior to 1300 hours on 1 September 1998.
Non-resident individuals with work permit and residing in Malaysia	• No restrictions	• No restrictions
Offshore entities in Labuan International Offshore Financial Centre	• Sale of foreign currency • Proceeds of permitted credit facilities in ringgit • Fees and commissions from residents	• Administrative and statutory expenses in Malaysia • In the case of Licensed Offshore Insurance entities, also for the purpose of reinsurance of domestic insurance business • Other permitted activities

Offshore Ringgit Market

Definition

The offshore ringgit market encompasses all ringgit-related activities transacted outside the boundaries of Malaysia. These activities include ringgit trading as well as trading in derivatives on the ringgit such as options, forwards, futures and swap contracts. The offshore ringgit market also encompasses all ringgit deposit-taking and lending activities outside of Malaysia. The offshore ringgit market activities take place mostly in Singapore, and to some extent, in other financial centres such as London, New York and Hong Kong Special Administrative Region (SAR), The People's Republic of China.

Development of Offshore Ringgit Market and Sources of Funding

Prior to the introduction of selective exchange controls, there was an active market for trading in ringgit outside Malaysia. The offshore ringgit market developed partly due to Malaysia's liberal exchange control regime prior to 1 September 1998. There were no restrictions on the sources of funds placed in External Accounts as well as on the transfer of funds into or out of the External Accounts. Before the selective exchange control measures were put in place, import and export settlements could be denominated in ringgit. This had relieved resident importers and exporters from the need to hedge their export proceeds and import payments. At the same time, this had given rise to the development of an offshore market in ringgit as the burden of hedging these trade transactions had to be borne by the non-resident counterparties.

Prior to the implementation of the exchange control measures, funding for speculative activity in ringgit was obtained from:

(i) Offer side swaps with a resident bank. This was essentially a ringgit borrowing by non-residents to fund their speculative ringgit activities. Bank Negara Malaysia (BNM) had limited the access of non-residents to ringgit through the implementation of an outstanding limit of US$2 million for each bank group of vostro accounts since August 1997.

(ii) Offer side swaps with another non-resident bank. This was effected through the transfer of ringgit funds from one External Account to another External Account.

(iii) Repo transactions on ringgit instruments. This avenue arose from the borrowing of United States dollars by banks in Malaysia from non-resident banks collateralised by ringgit securities. The offshore banks in turn used the securities to obtain ringgit funding through repo transactions with banks in Malaysia.

(iv) Other sources of funding through the External Accounts are payments for imports by residents in ringgit; outright purchase of ringgit with foreign currency; and dividends, interest, wages, salaries, commission and sale of ringgit assets.

Over the years, the existence and development of offshore ringgit activities, particularly in 1997 and 1998 had reached the extent of affecting domestic monetary policy implementation. In early 1998, the offshore ringgit deposit interest rates started to increase. Offshore banks in Singapore were offering interest rates of over 20% for ringgit deposits. The differential arose due to a large demand for ringgit offshore to meet the ringgit cash flow requirement from the speculative ringgit trading activities. To limit the supply of ringgit offshore, BNM announced on 4 August 1997 a limit of US$2 million on Malaysian banks for non-commercial related ringgit offer side swap transactions with foreign customers. With this regulation, ringgit funding from swap transactions

for speculative activities in ringgit was severely curtailed. This regulation drove a wedge between the demand and supply of ringgit outside of Malaysia, causing the price of ringgit offshore (i.e. the interest rate) to increase. This large interest rate differential made the conduct of domestic monetary policy difficult as interest rates could not be reduced significantly without facing a threat of a large capital outflow by residents.

Size of Offshore Ringgit Market

Although it is very difficult to estimate the size of the offshore ringgit market, the magnitude of the amount is reflected in the External Account balance. Non-residents hold ringgit balances in External Accounts maintained with resident banks. These accounts are held in the form of vostro accounts in the case of non-resident banks, or normal over-the-counter accounts maintained with the banking institutions in Malaysia in the case of non-resident non-banks. As at end-August 1998, the outstanding balance in the External Accounts maintained with the banking system was RM9.1 billion.

The External Account balance essentially represents the amount of ringgit that is under the control of non-residents. Any ringgit that is placed with an offshore bank will ultimately be reflected in a corresponding entry in the bank's vostro account with commercial banks in Malaysia. Transactions in ringgit among offshore players are ultimately settled through credits and debits to the External Accounts concerned.

It should be noted, however, that the External Account balance is an estimate of the stock of ringgit offshore, and not the volume of offshore ringgit transactions. The actual volume of transactions is many multiples of the underlying stock figure. If trading in the secondary market of ringgit-denominated contracts is active, the volume of trade can be a large multiple of the underlying ringgit asset. For example, if a contract on RM100 million was traded three times in a day, the volume of transactions would be RM300 million, even though the underlying asset is only RM100 million.

Effect of Exchange Controls on the Offshore Ringgit Market

To curb the ringgit-related activities outside Malaysia as well as to repatriate ringgit currency notes from abroad, Malaysia decided to impose selective exchange controls beginning 1 September 1998.

Details of the measures, which form part of the selective exchange controls, and other complementary measures are as follows:

Selective Exchange Control Measures

- **Prohibit crediting of External Accounts among External Account holders**: To reduce the volume of offshore market activity in ringgit among non-residents, the transfer of funds among non-residents was disabled by prohibiting the crediting of an External Account by another External Account holder. However, to facilitate business transactions among non-residents who maintained External Accounts, the above prohibition was relaxed for the sale and purchase of ringgit assets among such non-residents. The measure curtailed the availability of ringgit to speculators, brought the ringgit market back to Kuala Lumpur, and trade in ringgit was confined only to trading hours in Kuala Lumpur.

- **Prohibit granting of credit line to non-resident banks and stockbrokers**: Previously, banks in Malaysia were allowed to grant a credit line of RM5 million to non-resident banks and stockbrokers, and permission of BNM was required for any amount in excess of RM5 million. To cut off ringgit funding to non-resident banks and stockbrokers, banks in Malaysia were prohibited from providing any credit line to non-resident banks and stockbrokers. Offshore banks were, therefore, no longer able to overdraw their External Accounts to fund their activities in ringgit.

- **Require imports and exports to be denominated in foreign currency**: As the

non-residents were no longer allowed to pay in ringgit for imports from Malaysia and would receive payment for their exports to Malaysia in foreign currency, they no longer had the need to hedge in ringgit. This would reduce the offshore ringgit market activity related to trade with Malaysia.

- **Restricting the import and export of ringgit currency notes:** The amount of ringgit currency notes that can be taken into or out of Malaysia was limited to RM1,000.

Other Measures

- **Prohibit transactions in offer side swaps by banks in Malaysia with non-resident banks:** To eliminate this source of funding, the outstanding limit of US$2 million per bank group of vostro accounts was replaced by a total prohibition of such transactions with non-resident banks.

- **Prohibit reverse repo transactions with non-resident banks:** Banks in Malaysia were prohibited from engaging in reverse repo transactions collateralised by ringgit instruments with non-resident banks, to eliminate this avenue for non-residents to raise ringgit funds.

The selective exchange controls and other measures have effectively eliminated the offshore ringgit market. The supply of ringgit outside Malaysia has ceased and this has resulted in traders and speculators being unable to trade in ringgit-denominated contracts outside of Malaysia. While ringgit remains fully convertible, conversion of ringgit must be undertaken through banks in Malaysia.

The elimination of the offshore ringgit market will not affect the efficiency of trade. While importers and exporters in Malaysia are required to settle their transactions in foreign currency, they are also allowed to maintain part of their export proceeds in foreign currency accounts with banks in Malaysia.

stability to return to the foreign exchange market and facilitated a greater degree of certainty for traders, investors and consumers.

Subsequent to the adoption of the fixed exchange rate regime, the ringgit's performance against major currencies had been influenced by dollar movement in the international foreign exchange market. During the period 2 September-31 December 1998, the ringgit appreciated by 0.6% against the pound sterling but depreciated by 3.8% against the Swiss franc, 4% against the Deutsche Mark and 16.3% against the Japanese yen. Against the composite index, the ringgit depreciated by 3.5%. The ringgit's depreciation reflected movements of the dollar, which had weakened against the yen and Deutsche Mark in the fourth quarter of 1998. Meanwhile, against selected regional currencies, the ringgit depreciated by 3.9% against the Singapore dollar, 9% against the Philippine peso, 9.6% against the Thai baht, 11.4% against the Korean won and 25.6% against the Indonesian rupiah.

In terms of policy direction, Malaysia adopted a less orthodox approach. It has been suggested that interest rates should be raised sharply to avoid further depreciation. Bank Negara Malaysia's view, however, was that higher interest rates by itself would not strengthen the currency in view of the regional currency instability that was being experienced. Events outside Malaysia's control could take the currency in the opposite direction, even if interest rates were raised. Not only would such a move not provide support for the currency, higher rates would be detrimental to the economy and the banking system, and therefore contribute towards further weakening of the currency. There was also no evidence of outflows of foreign currency by residents, indicating that Malaysia did not experience capital flight.

It was viewed that the ringgit exchange rate could only stabilise with the resumption in confidence, positive sentiment as well as an overall economic recovery. Interest rates were, therefore, only raised in small steps since October 1997 mainly to address the expected increase in inflation due to the ringgit depreciation. (Interest rate policy is discussed in detail under Monetary Policy 1998, in Chapter 2). Developments in the offshore markets further constrained the use of interest rates to

Table 1.23
Movement of the Ringgit

	Foreign currency to one unit of RM[1]					Annual change (%)		
	1997	1998				1997	Sept. 2* 1998	1998
	End-Dec.	Sept. 2	End-Dec.	Low	High			
Composite	69.70	72.11	69.57	58.23	77.38	–31.4	–19.8	–0.2
SDR	0.1903	0.1954	0.1869	0.2141	0.1585	–30.8	–22.3	–1.8
US$	0.2572	0.2632	0.2632	0.2890	0.2116	–35.0	–22.6	+2.3
S$	0.4310	0.4546	0.4371	0.4678	0.3771	–22.1	–12.2	+1.4
Yen	33.4213	36.0464	30.1741	36.4445	27.7994	–27.3	–12.5	–9.7
Pound Sterling	0.1552	0.1570	0.1579	0.1778	0.1305	–33.7	–25.7	+1.8
Deutsche Mark	0.4602	0.4599	0.4417	0.5223	0.3883	–25.1	–25.6	–4.0
Swiss franc	0.3739	0.3781	0.3637	0.4221	0.3139	–29.8	–25.5	–2.7
Thai baht	12.1452	10.6709	9.6513	12.8154	9.3816	+19.8	–9.5	–20.5
Indonesian rupiah	1,386	2,824	2,100	4,032	1,490	+48.4	+176.3	+51.5
Korean won	433	353	313	463	292	+29.8	+14.8	–27.7
Philippine peso	10.4141	11.3248	10.3025	11.7184	9.3431	+0.1	+8.3	–1.1

[1] With the exception for 1996 data, where the Thai baht, Indonesian rupiah, Korean won and Philippine peso are based on customer rates, all other data is based on the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market.
* Compared with 2 September 1997's levels.

support ringgit rates. The need to stabilise the ringgit exchange rate was the main reason for the introduction of selective exchange controls on 1 September 1998 and the fixing of the ringgit rate at US$1=RM3.8000 on 2 September 1998.

Inflation

The inflation rate increased in 1998 but was substantially lower than expected. The effects of higher import prices due to a weaker ringgit was not fully transmitted to domestic prices. Inflation as measured by the **Consumer Price Index** (CPI, 1994=100) rose by 5.3% in 1998, lower than the earlier estimates of 7-8%. This was, however, the highest level recorded since 1982 (5.8%). The 28.3% depreciation in the average exchange rate of ringgit against the United States dollar in 1998 would have raised consumer prices by about five percentage points, based on the findings that a 1% depreciation in ringgit would increase CPI by 0.176 percentage points. However, the full impact of the depreciation was not passed through to the consumers as firms absorbed part of the increase in order to maintain market share in an environment of weak domestic demand and excess capacity in the economy. On the external front, low inflation abroad and lower oil and commodity prices in the world markets also had a moderating effect on domestic prices. During the first two month of 1999, the CPI rose at an average of 4.5%. On a regional basis, the CPI for Peninsular Malaysia, Sabah, and Sarawak rose by 5.5%, 4.3%, and 4.2% respectively in 1998.

Excluding food, the adjusted CPI rose more moderately by 3.1%. In Malaysia, a system of administered prices has been put in place for approximately 11% of the basket, whereby prices are administered to stabilise them at reasonable levels. Hence, there is no price controls as such, contrary to general perceptions. The Government approves price increases for the price administered items based on their production costs as well as agreements arrived at after negotiations with producers. Producers and distributors, however, are free to lower prices below the determined prices. Except for Liquified Petroleum Gas (LPG), there is also no subsidy element in the system. A total of 46 items are currently covered under the Supplies Control Regulation and are classified under two groups. Supplies of 21 items are monitored all year around. Of this total, prices of 11 items are administratively controlled, namely, white sugar, wheat flour, round steel bars, cement, petrol, diesel, sweetened condensed milk, LPG, standard loaf bread, chicken, and cooking oil (100% palm olein). For these 11 items, price adjustments are allowed to reflect changes in economic fundamentals such as higher imported prices. Supplies of another 25 items are monitored during festive seasons. Prices of these items are supervised, but not administered. Meanwhile, only prices of locally-produced rice (which accounted for 2.8% of the CPI basket) are controlled by legislation. In terms of contribution to the basket of goods and services in the CPI, the 10 items (excluding round steel bars) whose prices are administered accounted for 10.8%, while the other items under the Supplies Control Regulation whose

prices are supervised but not administered by the Government accounted for another 4.2%. Of the latter 4.2% share of the CPI basket, only 0.3% are supervised throughout the year, while the balance of 3.9% are supervised during festive seasons.

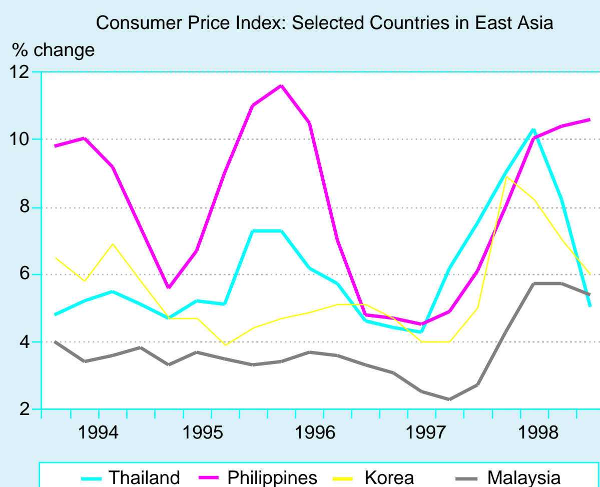
Inflationary expectations started to build up towards the end of 1997 as the ringgit declined to successive lows, buffeted by a volatile external environment. The ringgit traded at US$1=RM3.8883 as at the end of 1997, a depreciation of 35.1% from the level recorded as at the end of June 1997. The Consumer Sentiments Survey conducted by the Malaysian Institute of Economic Research (MIER) in the fourth quarter of 1997 indicated that 83% of the households surveyed were expecting price increases in the first half of 1998 (79% in the third quarter of 1997). However, as the financial crisis became more prolonged, the subsequent deterioration in investor and consumer demand as well as weak export demand led to a sharper-than-expected contraction in domestic economic activities. Consequently, inflationary pressures abated, reflecting mainly the slack in the product and labour markets. The rate of increase in the CPI moderated progressively to 5.3% in December 1998, from the year's peak of 6.2% in June. The introduction of the new exchange control measures on 1 September and the fixing of the ringgit exchange rate against the United States dollar at US$1=RM3.80 on 2 September 1998 further reined in inflationary expectations.

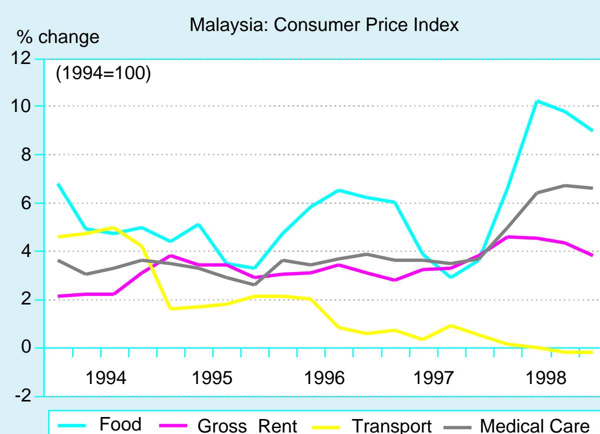
Reflecting mainly rising cost pressures arising from higher import prices and cyclical supply shortage of essential food items, prices of non-durable goods rose at a faster rate of 6.9%. Prices for services which were less affected by exchange rate changes also rose, albeit more moderately by 5.2%, attributable to higher inflationary expectations and the higher cost of business following higher prices in the goods sector. Meanwhile, price increases for semi-durable goods and durable goods such as electrical and electronic goods and cars were more subdued (1.4% and 0.4% respectively), reflecting adjustments to weaker global prices and weak consumer demand. For these categories of goods, producers had reconsidered their pricing strategies and reduced their profit margins to maintain market shares. Consumers had greater flexibility either to reduce consumption of the non-essential goods or to substitute for lower cost products.

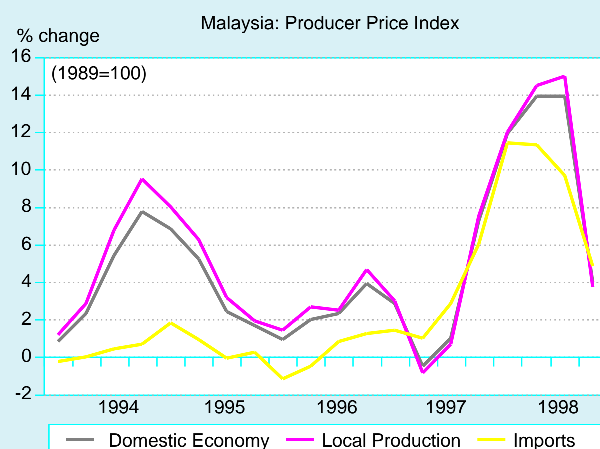
In terms of components, the CPI for food; miscellaneous goods and services; and medical care and health expenses, recorded stronger increases exceeding 5.3%. The CPI for food, which accounted for 34.9% of the weight in the overall CPI basket, rose by 8.9% in 1998. Higher prices for both food consumed at home (9.1%) and food consumed away from home (8.4%) reflected, to some extent, the stronger pass-through effect of higher imported food prices following the depreciation of the ringgit. Prices of most imported essential items, namely, sugar; rice, bread and other cereals; oils and fats; and coffee and tea increased at a faster rate during the year. Following the higher cost of imports, the Government approved increases in the ceiling prices of two essential items, namely, cooking oil (5% increase) and chicken (10%) from mid-December 1997. This was followed by increases in prices of another three administered items, namely, flour (20%), sugar (21%), and milk (6%), effective 1 February 1998. These five items together accounted for about 6% of the weight in the CPI basket. The total impact (direct as well as indirect effects) of higher prices for these items added nearly 1.1 percentage points to the rate of inflation.

Among the non-food sub-groups, above-average price increases were observed in the sub-groups of miscellaneous goods and services; and medical care and health expenses, which together accounted for 7.5% of the weight in the consumer basket. Key imported consumer goods that registered substantial price increases under the sub-group of miscellaneous goods included items such as jewellery; watches; toiletries; goods for personal care; and writing and drawing equipment. Moderate price increases, ranging between 3.3% and 4.4%, were recorded for gross rent, fuel and power, the second largest sub-group accounting for 21.1% of the weight in the CPI basket; as well as recreation, entertainment, education and cultural services; furniture, furnishing and household equipment; and beverages and tobacco. The increase in import and excise duty on cigarettes, tobacco products and alcoholic beverages in the 1999 Budget is estimated to have a direct effect of nearly 0.2 percentage point rise in inflation. Prices of clothing and footwear registered a marginal increase of 0.4%. Of significance, prices of transport and communication, the third largest sub-group

Graph 1.16
Inflation: Average Annual Rate of Change







accounting for 17.9% of the weight in the consumer price basket, declined by 0.1%. Within this category, prices of motor cars, motorcycles and bicycles declined by 2.9% in response to a sharp reduction in demand and excess capacity in the transport-related industries. This decline was partly offset by increases in fares paid for public transportation, particularly rail transportation.

While the pass-through impact of the weaker ringgit on the CPI was evident with a longer time lag, the **Producer Price Index** (PPI, 1989=100), adjusted with a relatively short lag. The PPI, which measures prices of both intermediate and final goods charged by domestic producers and paid by importers in the country, started recording stronger increases since October 1997. In the first eight months of 1998, double-digit increases were recorded, with the largest increase of 17% recorded for the month of July. The increase in producer prices, however, moderated from October, partly reflecting the decline in prices of mineral fuels, lubricants and related materials. The decline in the prices of mineral fuels, lubricants and related products, which accounted for 18% of the weight of the PPI basket, reflected lower world oil prices of US$13.00 per barrel in the fourth quarter of 1998 (US$20.90 per barrel in the fourth quarter of 1997). For 1998 as a whole, the PPI increased by 10.7%. The largest increase in prices was registered in the animal and vegetable oils and fats sub-index (63.8%) due largely to higher prices of palm oil arising mainly from valuation effects from the weaker ringgit. Palm oil accounted for 7% of the weight in the PPI basket. Meanwhile, higher import prices due to the weaker ringgit and higher local production costs contributed to a substantial increase in the prices of machinery and transport equipment; manufactured goods; miscellaneous manufactured articles; and chemical and chemical products, which together accounted for 37% of the weight in the PPI basket. Excluding the prices of animal and vegetable oils and fats, the adjusted PPI showed an increase of 3.8% in 1998.

In 1998, the Government adopted a more integrated approach to address supply constraints in the food sector. In March 1998, the Government widened the activities financed by the Fund for Food (3F) to include rice production, ostrich, rabbit, quail and deer farming. The 1999 Budget also contained a number of supply enhancement measures. To reduce excessive reliance on imports and to promote investment in large-scale food production, the Government would allow losses incurred in the production of approved food items to be deducted from the profits of the companies in the same group for purpose of income tax computations. For a start, food and feed items such as cattle and maize have been identified to qualify for this incentive because they are largely imported. At the same time, import duties and sales tax were abolished or reduced on selected

food items, such as canned anchovies. Local importers have also been urged to import food from cheaper sources. With respect to non-food items, import duties and sales tax were abolished or reduced on paper products and all types of printed paper for the purpose of reducing publishing costs, particularly items used in schools. Meanwhile, under the ongoing programme to curb unjustified increases in prices and ensure an adequate supply of essential goods, the relevant Government agencies stepped up enforcement and price checks. Since mid-October, foreigners were prohibited from carrying across the border four essential items, namely, cooking oil, sugar, sweetened condensed milk and flour. The Ministry of Domestic Trade and Consumer Affairs also conducted weekly price monitoring exercises on 233 daily used items through 34 collection centers to improve the flow of information on prices of essential goods.

The downward movement in **asset prices** which emerged towards the end of 1997 became more pronounced in 1998. In terms of share prices, the Kuala Lumpur Composite Index (KLCI) touched a low of 262.70 points on 1 September 1998, a decline of 55.8% from the end-1997 level. This initially reflected to a large extent the liquidation of portfolio capital by non-residents. However, overall market sentiment weakened further in 1998 due to increasing concerns over the health of the corporate sector as domestic output contracted at a faster pace than anticipated. The KLCI, however, recovered following the implementation of the exchange control measures on 1 September 1998 and other policy measures implemented to support economic recovery. The improved performance of the regional markets also contributed to greater investor confidence. The KLCI ended the year at 586.13 points (end-1997: 594.44 points).

With regard to property prices, the **Malaysian House Price Index** (MHPI) declined by 8.5% in the first half of 1998 (+1.9% in 1997). By the end of 1998, residential property prices were about 10% lower than the peak level recorded in 1997. In view of the linkages of the construction sector to the services and manufacturing sectors and the oversupply of houses, Bank Negara Malaysia selectively relaxed the requirements with respect to lending to the residential property sector. In early September, lending for the construction or purchase of residential properties costing up to RM250,000 were exempted from the 20% limit on lending to the broad property sector. With effect from 5 October 1998, the 60% maximum margin of financing was abolished for the purchase of non-owner occupied residential properties costing RM150,000 and above; the purchase of shophouses costing RM300,000 and above which are not for the conduct of own business; and the purchase of land lots. This relaxation was aimed at facilitating efforts to clear the backlog of properties. It was complemented by the "Home Ownership Campaign" launched in October. (The details on policy measures affecting asset markets are contained in the sections on "Sectoral Review" in Chapter 1 and "Financial Markets" in Chapter 4).

Table 1.24
Inflation Indicators

	Weights	1997	1998
		Annual change (%)	
Consumer Price Index (1994=100)	100.0	2.7	5.3
Of which:			
Food	34.9	4.1	8.9
Beverages and tobacco	3.6	1.3	4.3
Clothing and footwear	3.6	–0.5	0.4
Gross rent, fuel and power	21.1	3.2	4.4
Furniture, furnishings and household equipment	5.6	0.1	3.9
Medical care and health expenses	1.9	3.6	6.2
Transport and communication	17.9	0.6	–0.1
Recreation, entertainment, education and cultural services	5.8	0.4	3.3
Miscellaneous goods and services	5.6	4.6	7.1
Peninsular Malaysia CPI	100.0	2.8	5.5
Sabah CPI	100.0	2.0	4.3
Sarawak CPI	100.0	1.7	4.2
Producer Price Index (1989=100)	100.0	2.7	10.7
Of which:			
Local Production	79.3	2.5	11.2
Imports	20.7	2.8	9.2
House Price Index (1990=100)		1.9	–8.5[1]
Of which:			
Klang Valley		4.4	–11.2
Johor Bahru		0.1	–21.9
Penang Island		4.3	–11.5

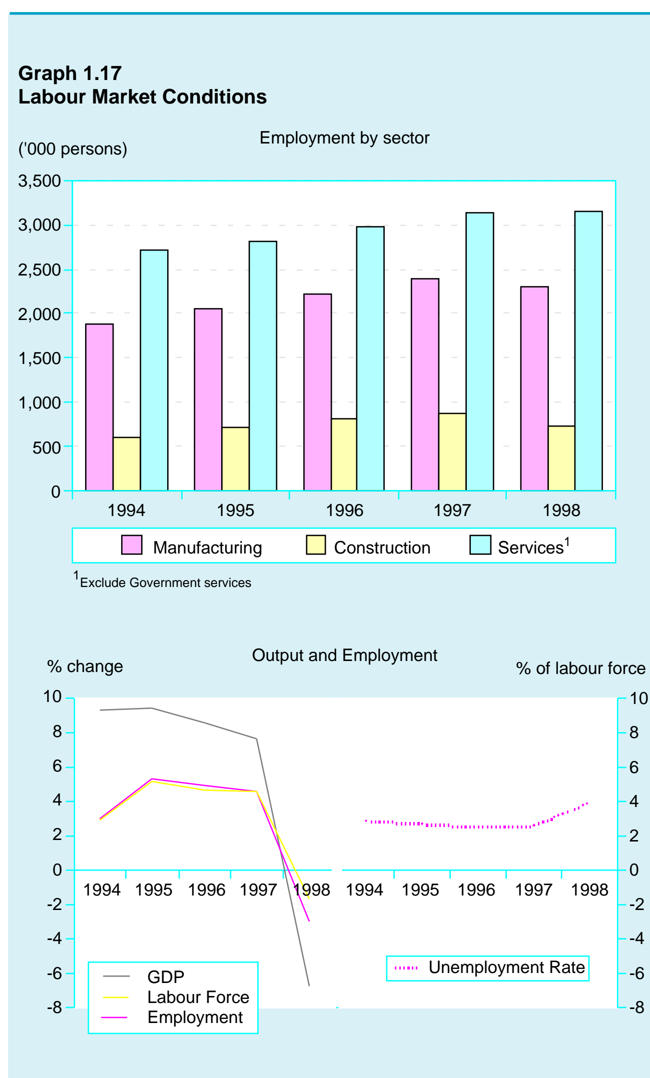
[1] January-June.
Source: Department of Statistics
Department of Valuation and Property Services

Labour Market Developments

In the face of a contraction in domestic economic activity, the **unemployment** rate is estimated to

have increased from 2.6% in 1997 to 3.9%, below the 4% or full employment level. During the year, the number of unemployed increased by 109,000 to 342,000 in 1998. A total of 83,865 workers were officially recorded as being retrenched in 1998. The slack labour market conditions contributed to some moderation in wage increases in 1998.

On a positive note, labour demand for selected categories of workers remained strong in 1998 with a total of 74,610 job vacancies. The quarterly indicators also pointed to more favourable developments in the fourth quarter, following the improvement in the domestic economic and financial conditions in the fourth quarter of 1998. The number of retrenchments declined to 6,039 workers per month during the fourth quarter of 1998, from the year's peak of 12,335 in July 1998. At the same time, the number of job seekers declined to 33,345 persons at the end of 1998, compared with a peak of 34,514 persons at the end of July 1998. After



declining from 126.3 points at the end of 1997 to 80.5 points in the third quarter of 1998, the MIER Employment Index increased to 86.4 points in the fourth quarter.

In 1998, total **employment** declined by 3%. The decline was more pronounced in the construction sector (148,000 persons); followed by manufacturing (86,000); and agriculture (61,000). Fewer job opportunities created by the services and mining sectors also added to the weaker employment conditions. Reflecting mainly the significant slowdown in the construction sector (-24.5%), the job loss in this sector was the largest. Consequently, the share of the *construction sector* in total employment declined from 9.9% to 8.5%. The net job loss in the *manufacturing sector*, which accounted for 27% of total employment, was lower compared with 170,000 new jobs created in this sector in 1997. The decline in jobs was concentrated in industries producing construction-related materials and transport equipment. The *services sector* continued to create new job opportunities, although at a slower pace. In 1998, an additional 27,000 jobs were created in this sector, with the finance, insurance, real estate and business services sub-sector accounting for 40% of the total, followed by transport and communication (11%), Government services (7%), and electricity, gas and water (4%) sub-sectors. However, employment in the wholesale and retail trade, hotels and restaurant sub-sector was more affected by the contraction in the economy. Employment in this sector declined by 0.6% in 1998, following lower demand and closure of businesses.

As earnings contracted, employers reduced their workforce as part of the overall rationalisation process to reduce the cost of production. In 1998, a total of 83,865 workers were officially recorded as being retrenched, with 54% from the manufacturing sector. Of those retrenched in the manufacturing sector, 58% were workers in the transport-related industries and another 18% were in industries producing construction-related materials. The services sector as a whole accounted for 28% of the total number of workers retrenched. Based on data provided by the Ministry of Human Resources, the retrenchments were attributed to the decline in demand following the downturn in activity (60%); financial constraints (13%); closure of companies (8%); and restructuring of companies (6%). In terms of broad job category, the majority of workers retrenched were production workers

(54%), followed by professional and technical staff (14%), clerical staff (12%), managers (7%), and others (12%). In the production workers category, skilled workers accounted for 35%, semi-skilled workers, 33%; and general workers, 32%.

During the year, the Government had monitored closely the employment situation and adopted pre-emptive measures to address the problem arising from rising retrenchment and weak domestic labour market conditions (the measures are summarised in the Box on "Measures Implemented to Stabilise the Labour Market Conditions in 1998"). The measures included the amendment of the labour law which gave more flexibility to companies to adjust wages according to changing economic conditions and productivity levels. Data compiled by the Ministry of Human Resources showed that more employers adopted alternative measures such as pay cuts, temporary layoffs and voluntary layoffs before resorting to permanent layoffs during the period August-December 1998. During this period, 795 employers implemented pay cuts involving 22,514 workers, while another 52 employers implemented temporary layoffs involving 6,342 workers. At the same time, 336 employers implemented voluntary layoffs involving 6,193 workers during the same period.

Table 1.25
Job Vacancies and Retrenchment in 1998

	Job Vacancies[1]		Retrenchment	
		Number	% Share	Number
% Share **Total**	**74,610**	**100.0**	**83,865**	**100.0**
Agriculture, forestry and fishing	5,231	7.0	5,108	6.1
Mining and quarrying	188	0.3	877	1.1
Manufacturing	52,159	69.9	45,151	53.8
Construction	2,156	2.9	9,334	11.1
Services	14,876	19.9	23,395	27.9
Wholesale and retail trade, hotel and restaurant	*5,281*	*7.1*	*10,434*	*12.4*
Finance, insurance, real estate and business services	*3,070*	*4.1*	*6,596*	*7.9*
Transport, storage and communication	*1,066*	*1.4*	*2,007*	*2.4*
Electricity, gas and water	*122*	*0.2*	*1*	*...*
Social and private services	*–*	*–*	*4,242*	*5.1*
Other services	*5,337*	*7.1*	*115*	*0.1*

[1] The number of job vacancies could have been under-reported as it is not compulsory for firms to report vacancies to the Manpower Department.

Source: The Ministry of Human Resources
Manpower Department

Labour demand as reflected by the number of job vacancies remained strong as a total of 74,610 job vacancies were reported throughout the country in 1998. The number of job vacancies could have been under-reported as it is not compulsory for firms to report vacancies to the Manpower Department. Feedback from industry sources indicated that demand existed for certain categories of workers, particularly production workers. According to *The Business Expectation Survey of Limited Companies, Second Half 1998* conducted by the Department of Statistics (DOS), selected manufacturing and non-manufacturing firms continued to demand for workers. At the same time, the Government also approved the intake of 55,463 new foreign workers to meet the demand for production workers in 1998. Of this total, 17% was for manufacturing, 8% each for plantation and construction, and 6% for services. The balance (61%) was for the domestic services sub-sector.

The number of registered **foreign workers** employed in the country declined to 781,548 from 1.2 million in 1997. Foreign workers were mainly employed in the manufacturing sector (35%), followed by plantation (19%), construction (18%), domestic services (17%) and other services sectors (10%). In terms of country of origin, workers from Indonesia and Bangladesh remained the biggest group, accounting for 60% and 31% respectively. During the year, the Government introduced additional measures on foreign workers to ensure that employers gave priority to hiring local labour, amidst the weak domestic labour market. The measures included the imposition of a new levy structure and the freezing of the recruitment of new foreign workers. The levy charges were increased to RM360 from RM300 for domestic helpers and plantation workers, while a levy of RM1,500 was imposed on those in the construction, manufacturing and services sectors. In addition, it

was made mandatory for registered foreign workers to contribute to the Employees Provident Fund (EPF).

With the retrenchment of workers and the reduction in salaries experienced by selected sectors of the economy, **wage pressures** eased. Indicators on wages showed moderating increases in the wage rates. As measured by the Malaysian Employers Federation (MEF) survey, the salary increases in the private sector slowed from 8.9% in 1997 to 6.2% in 1998. The findings of the Monthly Surveys of Manufacturing Industries conducted by DOS also showed a similar trend, with wages increasing at a slower rate of 5.6% in 1998, compared with 10.2% in 1997. At the same time, the weighted average wage of the three-year collective wage agreements, covering 143,000 workers in the private sector or 2% of the total labour force, increased at a slower rate of 9.6% in 1998 (13.1% in 1997). All sectors, except for commerce and mining, registered slower wage increases. Following the wage agreements concluded in the manufacturing sector during the year, wages in the sector rose at a slower rate of 8%, while wage increases in the services and agriculture sectors moderated to 10.1% and 8.9% respectively. Wage increases in the electricity sector also moderated to 10% in 1998 from a strong growth of 18.1% in 1997. In contrast, wage increases in both the commerce and mining sectors increased at a higher rate of 13.8% and 10.6% respectively in 1998, compared with 11.8% and 7.7% respectively in 1997. However, this trend is not reflective of the wage profile for the commerce and mining sectors as a whole, as less than 12% and 1% respectively of the workforce in these sectors were covered by the collective agreements concluded in 1998. The findings of the Monthly Surveys of Manufacturing Industries of DOS also indicated that the labour cost in the manufacturing sector as measured by real average wages increased at a slower rate of 0.3%, reflecting a decline in the nominal wage bill (–1.1%), and an increase in the inflation rate.

Labour productivity, as measured by the ratio of GDP to total employment, declined by 3.8% in 1998. In the manufacturing sector, labour productivity declined by 0.1%. The poor productivity results in 1998 reflected the reduction in output in response to the build-up in inventories due to the sharp contraction in domestic demand as well as weak external demand. Recognising that productivity continued to lag behind wage growth, efforts have been intensified to enhance productivity levels through the implementation of productivity and quality management systems, improvements through benchmarking activities, intensifying the application of information technology, skill upgrading of human resource, and quality products through research and development.

In 1998, the Government implemented further measures to upgrade **industrial skills**. To strengthen the quality of manpower to meet the increasing demand for highly skilled manpower, the Government increased new intakes of trainees in the existing training institutes. The number of trainees in the nine Industrial Training Institutes increased by 35.5% to 2,842 trainees, while 3,147 instructors were trained by the Centre for Instructors and Advanced Skill Training (CIAST). The existing bilateral training centers, namely, the German Malaysia Institute (GMI), Malaysia French Institute (MFI) and British Malaysia Institute (BMI) recruited another 701 trainees (742 trainees in 1997). In addition, the Japan-Malaysia Technical Institute (JMTI) was established under the technical co-operation between the Governments of Malaysia and Japan. The institute started operations in July 1998 with its first intake of 58 trainees to specialise in computer engineering technology and electronics engineering technology. In January 1999, the JMTI absorbed another 31 trainees and has plans to increase its intake to 100 in the July 1999 session. At the same time, two new courses, namely, mechatronics engineering technology and manufacturing engineering technology would be introduced in the July session to widen the scope of industrial training for both the industrial and public sectors.

In the 1999 Budget, the Government also introduced several fiscal incentives to promote human resource development. In line with the objective of promoting Malaysia as the centre of excellence for education, the Government allocated RM13.5 billion to provide and upgrade educational infrastructure as well as for curriculum development. Vocational schools would be upgraded and new technical schools constructed. With the additional expenditure of RM2.85 billion allocated to upgrade existing education facilities, the intake of students into local universities will be increased from 77,600 to 84,000 students in 1999. A sum of RM1.145 billion is allocated for skills training in the 79 vocational and technical schools, 16 Skills Development Training Institutes and 135 Pusat Giat

Measures Implemented to Stabilise the Labour Market Conditions in 1998

Measures	Rationale
With effect from 1 February 1998, it became mandatory for employers to inform the Director General of Labour Department at least one month before retrenchment exercise.	➩ To monitor the retrenchment situation closely, facilitate investigation and provide the necessary advisory services to employers to safeguard the welfare of the retrenched workers.
Task forces were set up to provide employment services to retrenched workers at the state and district levels, improving the mobility of labour through publication of vacancies and regular dialogues with employers' and employees' organisations as well as industry associations.	➩ To help redeploy retrenched workers into alternative jobs via tripartite cooperation involving all parties, the Government, employers and workers' union.
With effect from 1 August 1998, *Employment Act 1955* was amended to promote more flexible working practices and encourage employers to provide incentives for productivity.	➩ To raise productivity.
On 1 August 1998, *Guidelines on Retrenchment* was issued.	➩ To guide employers and workers on alternatives to retrenchment and if unavoidable, the procedures to be followed.
Encourage employers to provide exit services such as counselling service and career guidance to assist those retrenched to find new jobs.	➩ To help and facilitate retrenched workers seeking alternative jobs.
As an alternative to retrenchment, encourage employers to resort to other cost cutting measures, such as pay-cuts or reduced working hours, temporary or voluntary lay-off.	➩ To maintain industrial harmony and labour market stability.
On 2 May 1998, the Ministry of Human Resources established a RM5 million retraining programme for retrenched workers.	➩ To upgrade skills to meet demand for higher skilled workers while assisting retrenched workers seek alternative employment.
Employers in particular sector which were facing difficulties were exempted from paying a levy to the HRDC for 6 months, from 12 February to 11 August 1998. In August, this exemption was extended to some industries for another six months till February 1999. The industries which benefited included manufacturers of plastic products; professional, scientific and controlling instruments and apparatus; rubber;	➩ To ease the financial burden of affected employers and moderate the level of retrenchment.

tobacco; electrical machinery; electronic apparatus and appliances; paper and paper products; telecommunications, postal services and courier; and air transport and shipping. However, industries which registered better performance and were in a stronger financial position were required to re-contribute a levy to the HRDC.

MARA besides the construction of an additional 24 new skills training centres.

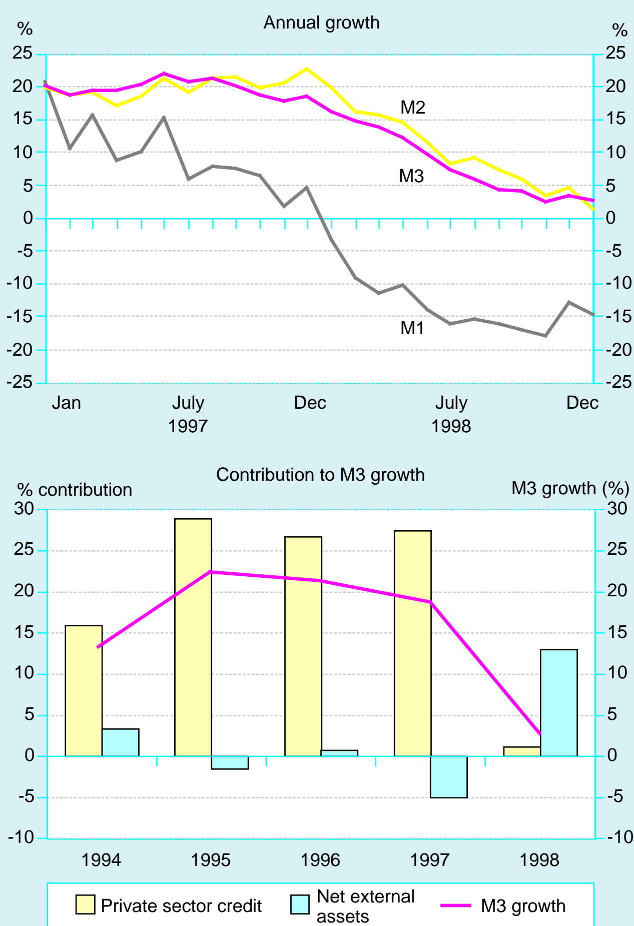
Under the **Human Resource Development Fund (HRDF)**, which was established in 1993, companies conducted courses to retrain and upgrade skills of a total of 2.1 million employees in 1998. Employers who faced financial problems were given exemption from contributing to the HRDF during the period 12 February to 11 August 1998. This exemption was extended for another six months to industries that continued to face financial constraints. As a result, the value of levy collected under HRDF in 1998 was lower at RM62 million, compared with RM144 million in 1997. Of this total, RM340 million was allocated for training. Meanwhile, the Human Resource Development Council (HRDC) implemented 12 training schemes, involving 409,814 trainees and extended financial support for employees participating in retraining and skill upgrading courses of RM141 million. More importantly, the Council established on 2 May 1998 a RM5 million retraining programme for retrenched workers. Under this programme, firms are allowed to seek financial assistance for retraining workers. Of the total of 572 trainees under this scheme in 1998, 36% were trained in computers, 28% in technical/engineering, and 37% in management.

Overall, some adjustment was observed in the domestic labour market. All parties concerned, including the Government, the industry and workers demonstrated greater flexibility to changing circumstances in the domestic labour market. The Government facilitated the adjustment through changes in the labour laws. The workers were more receptive to salary adjustments while the industry accelerated efforts in retraining workers.

2 Monetary and Fiscal Developments

Monetary Developments

Monetary developments in 1998 were influenced by the policy measures implemented during the year as well as developments in the domestic corporate and banking sectors. Monetary growth slowed down significantly in 1998 in a period of severe economic contraction. Growth in money supply decelerated sharply as credit growth slowed down rapidly in an environment of sluggish economic activity; weak business prospects; lower private consumption; as well as more cautious lending policies of banking institutions amidst rising non-performing loans (NPLs). Against this background, monetary policy evolved according to the changing conditions during the course of the year to address emerging risks and challenges, with the aim of maintaining overall macroeconomic stability. In achieving this objective, Bank Negara Malaysia (BNM) relied on a combination of interest rate, and prudential and structural measures. While in the early part of the year the focus of policy was on ensuring stability and efficiency of the financial markets which is an important precondition to achieve the longer term policy objectives, the latter part of the year was focused on supporting economic recovery.



The annual growth rates of broad **monetary aggregates** - M2 and M3 - moderated significantly during the year, while narrow money or M1 declined for the first time in 1998. By end-1998, the annual growth of M2 and M3 decelerated to 1.5% and 2.7% respectively (22.7% and 18.5% respectively at end-1997), while M1 contracted by 14.6% (+4.6% at end-1997). On the whole, the deceleration of monetary growth during the year had been more severe than anticipated, with M2 and M3 expanding by only RM4.2 billion and RM10.6 billion respectively (+RM54 billion and RM61.1 billion respectively in 1997), while M1 contracted by RM9.2 billion (+RM2.8 billion in 1997). M3 had trended downwards since February and contracted during the months of April to July (–RM7 billion or –1.8%). However, since August money supply turned around to record a moderate expansion in response to the easing of monetary policy as well as the improved performance in the external sector. In comparison, the rate of deceleration in the growth of M3 during the previous recession experienced in the mid-1980s was more gradual. During that period, the annual growth of M3 slowed down from a peak of 16.3% at end-March 1985, to 8.8% at end-1986 and further to a trough of 3.9% at end-January 1988. The more rapid slowdown in M3 during the current economic downturn reflected mainly the larger GDP contraction as well as structural changes in the economy in which a more developed equity market exerted a relatively more significant negative wealth effect on the economy.

Reflecting the contraction in economic activity, the demand for transaction balances (currency holdings and demand deposits of the private sector)

declined by RM8.9 billion in 1998. Demand deposits recorded a substantial decline of RM5.7 billion while currency in circulation contracted by RM3.2 billion. Except for January, June, September, November and December, the demand for transaction balances displayed a declining trend during the year. The generally weak business activity and poor business sentiments resulted in lower holdings of demand deposits by the corporate sector (–RM4.8 billion). Meanwhile, lower private sector consumption reduced households' requirements to hold more currency in their daily transactions, leading to a decline in the currency in circulation. In addition, the decline also reflected the return of currency to the banking sector following the announcement of the demonetisation exercise of the RM500 and RM1,000 denominations. It was announced on 12 September 1998 that the RM500 and RM1,000 notes will cease to be legal tender, effective 1 July 1999. In response to the announcement, about RM3.9 billion worth of RM500 and RM1,000 notes were returned to BNM between September and December 1998. The bulk of these currency notes was placed mostly in the form of deposits with banking institutions.

Broad quasi-money (private sector holdings of fixed and savings deposits, negotiable instruments of deposit (NIDs) and repurchase agreements (repos) with the banking system (excluding interbank transactions), expanded moderately by RM19.6 billion or 6% in 1998, compared with RM58.7 billion or 21.8% in 1997. The sharp deceleration in the growth of broad quasi-money reflected mainly lower income with the contraction in GDP. Deposit placement by individuals in savings and fixed deposits expanded by RM17.7 billion, compared with the increase of RM22.8 billion in 1997. For the corporate sector, a combination of weak business activities as well as relatively higher lending rates, particularly in the first half-year adversely affected their liquidity and cash flow position. As a result, total deposits placement by business enterprises in interest-bearing instruments with banking institutions declined, with a net withdrawal in fixed deposits (–RM4.9 billion) and NIDs (–RM425 million).

In terms of instruments, the moderate expansion in the broad quasi-money reflected the increase in fixed deposits (RM14.9 billion); foreign currency deposits (RM1.4 billion); savings deposits (RM1.3 billion); repos (RM1.1 billion) and NIDs (RM974 million). The large differential between savings and fixed deposits interest rates, in particular during the first half of the year, led to the increase in fixed deposits during the year. It also reflected the shift in preference among institutional and retail investors of the Kuala Lumpur Stock Exchange (KLSE) to less risky portfolios following the sluggish stock market performance.

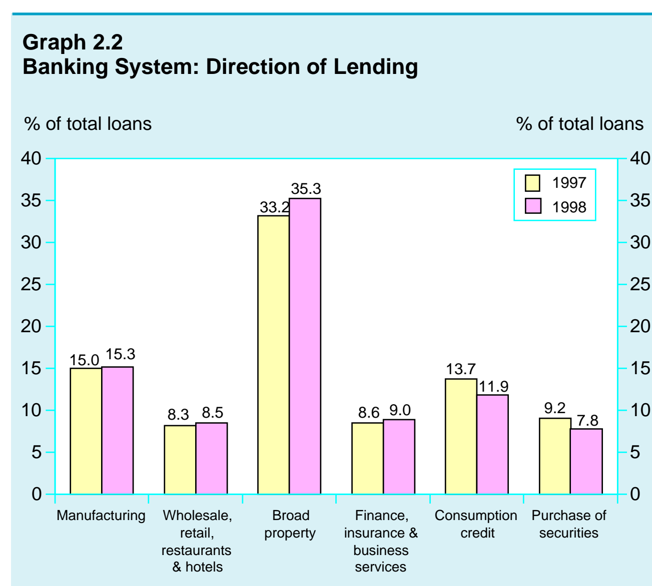
In terms of determinants, the main impetus to the expansion in money supply emanated from external operations. Reflecting the surplus in the current account of the balance of payments of RM36.1 billion, as well as the impact from the introduction of selective exchange control measures in September, net external assets of BNM and the banking system expanded by RM51.2 billion. During the year, external reserves of BNM increased by RM40.3 billion, a turnaround from the decline of RM10.9 billion in 1997. However, it should be noted that effective 15 September 1998, following the fixing of the exchange rate of the ringgit against the United States dollar at US$1=RM3.80, all foreign currency assets and liabilities of BNM have been revalued into ringgit at rates of exchange prevailing on the reporting date. Hence, part of the increase in the external assets during the year reflected the exchange revaluation gains. This, however, had a neutral impact on money supply since the revaluation gains were offset by increases in the item "other influences", which also recorded a decline of RM32.4 billion during the year. In addition to the significant accumulation of reserves by BNM, the higher net external assets position was also due to the marked decline in the external liabilities of the banking system. In 1998, net external liabilities of the banking system declined by RM10.9 billion. This was largely attributed to the repayment of foreign loans by the banking institutions. Following the improved liquidity situation, especially in the second half of 1998, local banking institutions did not roll over the bulk of their maturing loans from abroad. The domestic banking institutions also reduced a large portion of their foreign interbank borrowings, especially those with shorter-term maturity.

Claims on the private sector, which had been the main expansionary factor in previous years, exerted a marginal impact on monetary growth in 1998, contributing about 1.1% to M3 growth compared with 27.3% in 1997. During the year, claims on the private sector expanded by only RM4.2 billion or 0.9%, compared with the significant expansion of RM90.4 billion or 25.3% in the

previous year. The expansion in credit was due wholly to the higher holdings of private debt securities by the banking institutions of RM14.1 billion, partly reflecting subscriptions to Danamodal and Danaharta bonds. In the last quarter of 1998, Danamodal Nasional Berhad (Danamodal) issued zero-coupon bonds with a face value of RM11 billion, while Pengurusan Danaharta Nasional Berhad (Danaharta) issued two series of zero-coupon bonds with a total face value of RM2.6 billion in exchange for the banking institutions' NPLs. In contrast, loans and advances extended by the banking institutions (as defined under M3 determinants) declined by RM9.9 billion or 2.4%, compared with a substantial expansion of RM82.1 billion or 25.3% in 1997.

Total loans of the banking system (comprising commercial banks, finance companies and merchant banks) declined by RM7.6 billion or 1.8% in 1998. However, if the NPLs that were purchased by Danaharta during the year were included, total loans in 1998 would have increased by RM5.5 billion or 1.3%. By institutions, commercial banks continued to record a moderate increase in loans (+3.3%). Loans extended by finance companies and merchant banks, however, declined by 15% and 3.7% respectively. The ongoing merger exercise among the finance companies had affected their loan growth. The poor performance of the affected finance companies also contributed to the decline in loans extended to the private sector. On the whole, the decline in loans extended by the banking system in 1998 was attributed to both demand and supply factors. On the demand side, the relatively higher interest rates, particularly during the first half-year, as well as the contraction in economic activity were the main reasons that led to the lower demand for loans by the private sector. The decline in loans also reflected the higher repayments in response to higher interest rates in the first half-year and the postponement of expansion plans as the crisis became more severe. Furthermore, as inventory levels increased and capacity utilisation was lower, the demand for loans for new investments fell, leading to a decline in the overall financing needs of the economy. On the supply side, the decline in the extension of loans by the banking institutions was attributed to the tight liquidity conditions in early 1998 and more cautious lending policies by banking institutions. With the actual NPL ratio on a net basis increasing from 4.1% of total loans as at end-1997 to 9% of total loans as at the end of 1998, and the ensuing erosion of capital, banking institutions became more cautious in their lending activities during the year as they adjusted to strengthen their balance sheet.

Graph 2.2
Banking System: Direction of Lending



Total loans extended by the banking system were generally on a declining trend during the period February to September before reverting to an increase in October and November. Sales of gross NPLs to Danaharta amounting to RM13 billion in December, caused total loans to decline during the month. For the year as a whole, the decline in total loans was due to lower lending for consumption credit, purchase of securities, purchase of transport vehicles and community, social and personal services and manufacturing sectors, which more than offset the higher loans to the broad property; transport, storage and communication; electricity, gas and water; and finance, insurance and business services sectors. The bulk of the loans continued to be channelled to the broad property sector (+RM6.2 billion or 4.4%). By the end of 1998, total credit extended to the broad property sector represented 35.3% of total loans (33.2% in 1997). Nevertheless, the higher exposure to the broad property sector did not reflect new risks, as the increases in loans were mainly for the purchase of residential property (RM5.5 billion). Given the slowdown in the implementation of existing infrastructure and non-residential projects as well as the deferment of selected new projects, loans extended to the construction sector and for the purchase of non-residential property increased by only RM582 million and RM1.5 billion respectively. At the same time, loans for transport, storage and communication, as well as for finance, insurance and business services sectors continued to receive adequate financing with increases of RM1.9 billion or 14.9% and RM907 million or 2.5% respectively. Meanwhile, in line with the lower economic activity

Table 2.1
Banking System: Loans by Sector

	As at end		Change	Share of total
	1997	1998	1998	1998
	RM million			%
Agriculture, hunting, forestry and fishing	7,637.8	7,717.8	80.0	1.9
Mining and quarrying	1,348.5	1,673.6	325.1	0.4
Manufacturing	63,310.4	63,200.4	–110.0	15.3
Electricity, gas and water	4,461.1	5,879.2	1,418.1	1.4
Wholesale, retail, restaurants and hotels	34,940.7	35,111.4	170.7	8.5
Wholesale trade	*19,926.8*	*18,725.0*	*–1,201.8*	*4.5*
Retail trade	*10,531.4*	*10,240.0*	*–291.4*	*2.5*
Restaurants and hotels	*4,482.5*	*6,146.4*	*1,663.9*	*1.5*
Broad property sector	139,922.4	146,148.4	6,226.0	35.3
Construction	*42,615.9*	*43,198.4*	*582.5*	*10.4*
Purchase of residential property	*50,843.9*	*56,386.7*	*5,542.8*	*13.6*
Purchase of non-residential property	*28,440.2*	*29,967.0*	*1,526.8*	*7.2*
Real estate	*18,022.4*	*16,596.3*	*–1,426.1*	*4.0*
Transport, storage and communication	13,040.6	14,983.1	1,942.5	3.6
Finance, insurance and business services	36,209.4	37,116.8	907.4	9.0
Financial services	*26,617.3*	*28,375.0*	*1,757.7*	*6.9*
Insurance	*131.6*	*249.0*	*117.4*	*0.1*
Business services	*9,460.5*	*8,492.8*	*–967.7*	*2.1*
Consumption credit	57,836.0	49,418.5	–8,417.5	11.9
Personal uses	*14,924.8*	*13,446.9*	*–1,477.9*	*3.3*
Credit cards	*4,586.4*	*4,313.0*	*–273.4*	*1.0*
Purchase of consumer durables	*1,717.0*	*826.9*	*–890.1*	*0.2*
Purchase of passenger cars	*36,607.8*	*30,831.7*	*–5,776.1*	*7.5*
Purchase of securities	38,951.2	32,460.0	–6,491.2	7.9
Purchase of transport vehicles	5,687.3	4,504.8	–1,182.5	1.1
Community, social and personal services	6,872.0	6,671.4	–200.6	1.6
Others	10,985.1	8,752.8	–2,232.3	2.1
Total loans	**421,202.5**	**413,638.2**	**–7,564.3**	**100.0**
Adjusted total loans (Including NPLs sold to Danaharta)	421,202.5	426,677.3	5,474.8	

and contraction in disposable income, loans extended for consumption credit, including for purchase of passenger cars, recorded a net repayment of RM8.4 billion. Consequently, the share of outstanding loans declined to 11.9% at end-1998. Similarly, loans for the purchase of securities declined by RM6.5 billion or 16.7%. Loans to the manufacturing sector recorded a decline of RM110 million or 0.2%, reflecting lower manufacturing activities as well as large loan repayments. Meanwhile, loan approvals improved substantially in the second half of 1998 (RM38.2 billion compared with RM24 billion in the first half-year). For the year as a whole, the bulk of the approvals were for the manufacturing sector, the purchase of residential properties and the finance, insurance and business services sector. A total of RM10.5 billion of new loans had been approved for the manufacturing sector, which accounted for 16.9% of total loans approved. Loans approved for the purchase of residential property and the finance, insurance and business sector amounted to RM9.3 billion and RM8.1 billion respectively, accounting for 14.9% and 13.1% of total new approvals during the year.

In response to the slowdown in loans, several measures were implemented to promote credit expansion and to avoid a credit crunch in order to ensure that the banking sector is better able to support economic recovery. With the improvement in the medium-term inflation prospects, interest rates were lowered in stages during the second half of the year. Consequently, the average BLR of commercial banks declined steadily from a peak of 12.27% at end-June to 8.04% at end-1998. In addition, with effect from 14 September 1998, all banking institutions were also required to reduce the maximum margin over the quoted BLR from 4 percentage points previously, to 2.5 percentage points. These measures effectively reduced the borrowing cost to the borrowers and eased the burden in servicing interest payments. To ensure that there were sufficient funds to finance the

economic recovery process, banking institutions with the capacity to lend were encouraged to expand their loan base and achieve a minimum loan growth of 8%. In addition, the SRR and liquidity ratios were also reduced to improve the liquidity conditions.

These measures have produced encouraging results. Even though the actual loans disbursed in the second half-year remained slow, the amount of loans approved by the banking system increased substantially in the latter half of 1998. Other initiatives that had been taken to improve the financial intermediation process and expand credit included the establishment of Danaharta to purchase NPLs from the banking institutions so that banking institutions can focus more on their core activity of providing credit. Similarly, Danamodal was set up to recapitalise the banking system. This recapitalisation process by Danamodal was also accompanied by a restructuring of the banking institutions. A Corporate Debt Restructuring Committee had also been established to assist borrowers and creditors to discuss solutions for debt restructuring.

During the year, the expansionary impact from the external operations and claims on the private sector were partially offset by the contractionary influences of other determinants. Net lending to the Government contracted by RM12.3 billion primarily due to the higher accumulation of deposits during the year. By end-year, total Government deposits placed with BNM and the banking institutions amounted to RM46.2 billion, an increase of RM17.5 billion from the previous year. The large increase in deposits was mainly attributed to the proceeds from domestic borrowing as well as disbursement of external loans, particularly during the last quarter of the year to finance the fiscal stimulus programme. As such, the accumulation of Government deposits during the period was expected to be temporary and would eventually be drawn down in stages to finance the Government's expenditure. In addition to Government operations, net other influences also exerted a contractionary impact on money supply. During the year, net other influences contracted by RM32.4 billion reflecting the exchange revaluation gains on external reserves holdings of BNM, the higher provisions for bad and doubtful debts as well as the capital injection by Danamodal to selective banking institutions.

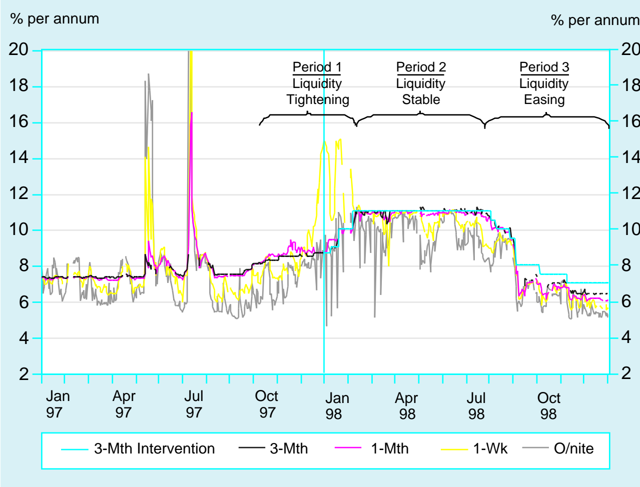
Table 2.2
Changes to BNM Intervention Rate & SRR Ratio

1998	Liquidity	Date	Intervention Rate	SRR Ratio
Jan-Feb	Tightening	End-97	8.70	13.5
		9 Jan	9.00	
		20 Jan	10.00	
		6 Feb	11.00	
Mid-Feb -Jul	Stable	16 Feb		10
		1 Jul		8
Aug-Dec	Easing	3 Aug	10.50	
		10 Aug	10.00	
		27 Aug	9.50	
		1 Sep		6
		3 Sep	8.00	
		16 Sep		4
		5 Oct	7.50	
		9 Nov	7.00	

In 1998, the movement of **interest rates** was primarily influenced by the level of liquidity, which was in turn affected by financial market expectations, as well as the shift in the monetary policy stance. On the whole, interest rates developments can be divided into three periods. Prior to February 1998, interest rates were on an upward trend. Between February and July 1998, interest rates were stable, while thereafter, interest rates were on a downward trend.

In the first two months of the year, interest rates continued its upward trend as a policy of monetary restraint was adopted since September 1997 to contain inflationary pressures arising from the ringgit depreciation as well as to discourage capital outflows. The 3-month interbank rate, which is BNM's policy rate, had been raised in several steps from 7.55% in mid-September 1997 to 8.7% at end-1997. It was raised twice again in January 1998 to 10% and again in February to 11%. Reflecting the tight liquidity situation and the uneven distribution of liquidity among banking institutions during this period, the average 1-month interbank rate rose above the average 3-month rate from October 1997 onwards, while the 1-week and overnight rates began to follow suit since December 1997. As a result, the term structure of interest rates was inverted during this period. The high shorter-term interest rates reflected the tight liquidity conditions faced especially by smaller financial

Graph 2.3
Interbank Rates

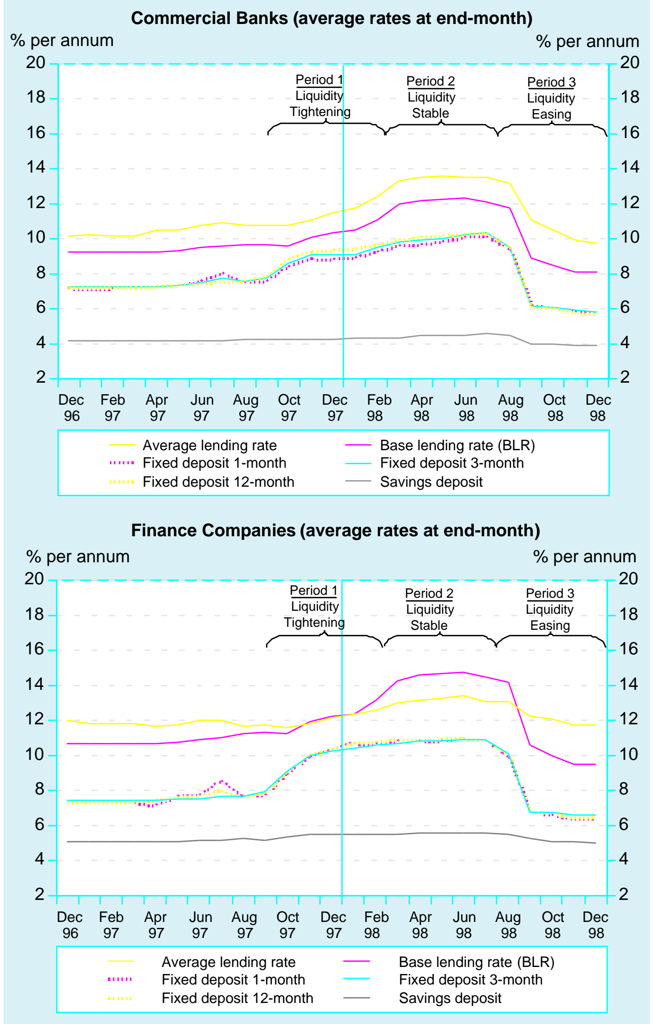


institutions. Furthermore, with increased uncertainties in the financial market, there was a flight to quality of retail deposits placed with these smaller institutions towards the end of 1997 and in early 1998. During this period, these institutions faced considerable difficulties in obtaining interbank funds due to selective lending practices by the larger institutions. The consequent aggressive bidding by the smaller institutions at the short end of the money market led to sharply higher short-end rates, with the 1-week rate peaking at 15.04% in January 1998 (see Graph 2.3: Interbank Rates). The resulting inverted term structure of interest rates, therefore, reflected the exceptionally tight liquidity situation of a few institutions rather than that of the banking system as a whole. The higher cost of funds incurred by these institutions led to a rapid increase in lending rates for loans priced on a cost plus basis.

Faced with this scenario, BNM injected liquidity through direct lending to banking institutions. To rationalise the term structure of interest rates as well as to improve liquidity flows in the system, BNM raised the intervention rate to 11% on 6 February as well as reduced the SRR from 13.5% to 10% on 16 February 1998. Consequently, the term structure of interest rates flattened from its inverted position. The purpose of the SRR reduction was not to add further liquidity but to improve the distribution of liquidity that had already been injected into the banking system as well as to reduce the cost of funds for banking institutions given that banks do not earn interest on SRR. The SRR was again lowered without causing a net injection on 1 July. This time around, the main objective was to reduce the cost of funds to banking institutions so as to enable them to lower the lending rates to their customers. On both occasions of the SRR reduction, the liquidity for the system as a whole was unchanged, resulting in the 3-month interbank rates remaining firm at around 11%.

In the subsequent months, the ringgit rates became more stable following the monetary measures undertaken between February and July 1998. There were also emerging signs that inflationary pressures had moderated. These developments enabled BNM to ease monetary policy to complement fiscal policy to revive the economy. In August, the 3-month intervention rate was adjusted downwards in three steps to 9.50%. Since September when selective exchange controls were introduced, further monetary easing was pursued. The intervention rate was reduced to 7% over three successive reductions, while the SRR was reduced in two steps to 4%. Consequently, the interbank rates fell below the BNM intervention rates as a

Graph 2.4
Interest Rates of Financial Institutions



result of the significant increase in liquidity in an environment of continued weak loan growth.

Reflecting the movements in the interbank money market rates, **interest rates of financial institutions** also increased up to June and subsequently adjusted downwards (*see Table 2.3: Interest Rates of Financial Institutions*). As these rates tend to lag behind interbank rates, the rates peaked in June. In the case of **fixed deposit rates**, the finance companies' fixed deposit (FD) rates adjusted more rapidly in response to the increases in interbank rates, whereas commercial banks' rates had a longer lagged response. As a result, the average spread offered by finance companies over commercial banks' FD rates increased from 0.2% before the crisis in June 1997 to as high as 1.5% in January 1998, before declining to 0.6% by end-1998. The greater responsiveness of finance companies' FD rates reflected the more aggressive competition for funds following their tighter liquidity situation compared with commercial banks. Meanwhile, **savings deposit rates** for both types of institutions were more stable, moving within a narrower range of only 0.6–0.8% during the year (the corresponding range for FD rates was 4.4–4.5%). A similar trend was also evident for the **base lending rates** (BLRs), which was linked to the 3-month interbank rate under the BLR framework. These BLRs are also linked to the SRR and as such, the reductions of the SRR in February, July and twice in September all contributed to a decline in the BLR. With the reduction in both the 3-month interbank rate and the SRR, the BLR for commercial banks adjusted downwards by 4.23 percentage points from a peak of 12.27% at end-June to 8.04% by mid-November. It remained unchanged thereafter until the end of the year.

Meanwhile, the **interest margins** or interest spreads of financial institutions also narrowed during

Table 2.3
Interest Rates of Financial Institutions

		End-97		June 98		End-98
Commercial Banks	3-Month FD	9.06	↗	10.19	↘	5.83
	Savings Deposit	4.23	↗	4.51	↘	3.87
	Base Lending Rate	**10.33**	↗	**12.27**	↘	**8.04**
Finance Companies	3-Month FD	10.32	↗	10.97	↘	6.43
	Savings Deposit	5.49	↗	5.56	↘	5.01
	Base Lending Rate	**12.22**	↗	**14.70**	↘	**9.50**

Table 2.4
Interest Margins of Financial Institutions

		End-97		June 98		End-98
Commercial Banks	Avg. Lending Rate (ALR)	11.51	↗↗	13.51	↘↘	9.72
	Less Avg. Cost of Funds (ACF)	7.62	↗	8.60	↘	6.17
	Interest Margin	**3.89**	↗	**4.91**	↘	**3.55**
Finance Companies	Avg. Lending Rate (ALR)	12.16	↗	13.35	↘	11.76
	Less Avg. Cost of Funds (ACF)	8.47	↗↗	11.67	↘↘	7.68
	Interest Margin	**3.69**	↘	**1.68**	↗	**4.08**

1998. The smaller margin was due to the faster reduction in the average lending rate (ALR) compared with the average cost of funds (ACFs) during the year. The spread, however, widened towards mid-year in the case of commercial banks but narrowed in the case of finance companies, before reversing trends in each case towards year-end. This asymmetry reflected the different relationships of these institutions' ALR and ACF to changes in liquidity and the general level of interest rates (see Table 2.4). Essentially, despite the sharp increase in the BLRs of finance companies at end-1997 and early 1998, their ALRs were relatively stable. The bulk of finance companies' loans was in the form of fixed rate hire purchase loans rather than BLR-plus loans. As a result of the relative stability or "stickiness" of the ALR of the finance companies, the rates were lower than their BLRs for the 10 months between November 1997 and August 1998. In contrast, the ALR of commercial banks moved in tandem with their BLR. On the other hand, the ACFs of finance companies were more sensitive to changes in liquidity and interest rates and had, therefore, increased significantly when there was a flight to quality in late 1997 and early 1998. Meanwhile, the ACFs of commercial banks increased more marginally. As a result of the stickiness of the ALR and the greater responsiveness of cost of funds to monetary developments, the margins of finance companies were squeezed in times of rising interest rates, while in contrast, the margins of commercial banks increased during periods of tight liquidity.

Interest rate differentials with other countries also changed significantly during the year. The real interest rates (nominal interest rates adjusted for inflation) in Malaysia have moderated and are now lower than the real interest rates in the United States and Singapore. The trend reflects the more significant decline in Malaysia's nominal rates and the relatively higher Consumer Price Index vis-a-vis

Monetary Measures in 1998

Adjustment and Stabilisation Measures (January - July 1998)

Monetary measures implemented in the first seven months were aimed at enhancing the efficiency of the money market to allow interest rates to reflect underlying liquidity conditions. The measures were also aimed at reinforcing the fundamental thrust of policy to achieve the objectives of monetary and financial stability while supporting economic recovery. The measures were as follows:

- On **26 January**, banking institutions were allowed to continue to provide bridging finance to housing developers to start new projects for residential properties costing RM150,000 and below as long as the project was deemed viable.

- On **6 February,** Bank Negara Malaysia (BNM) announced the **streamlining of the interest rate structure** to better reflect liquidity conditions in the market. Arising from developments in late 1997 and early 1998, the term structure of the interbank and lending rates was not reflective of the prevailing market conditions. The shorter-end interbank rates mainly reflected the exceptionally tight liquidity situation of a small number of banking institutions. Following uncertainties during the period, there was a tendency for lending rates to be based on these short-term rates on a cost-plus basis. To improve the flow of liquidity in the system, and to streamline the term structure of interest rates that would better reflect the liquidity in the financial system, the 3-month BNM intervention rate was adjusted upwards to 11% from 10%.

- With effect from **16 February, the statutory reserve requirement (SRR)** for all commercial banks, finance companies and merchant banks was reduced from 13.5% to 10% of their eligible liabilities. This was aimed at enhancing the efficiency of the intermediation process rather than to provide additional liquidity to the system. BNM further reduced the SRR to 8% on **1 July** so as to reduce the cost of funds to the banking institutions and improve the liquidity distribution among the banking institutions.

- Effective **1 May**, the band for the permissible daily variation in the average balance that is required to meet the SRR was widened to ±2% of the prescribed SRR rate from the previous band of ±0.5%. The widening of the SRR band would accord banking institutions greater flexibility in managing their daily liquidity operations.

Economic Recovery Plan (from August 1998)

Beginning early August, monetary measures reflected easing of monetary policy to support economic recovery. The measures were also aimed at strengthening the financial system. These measures were as follows:

- In early August, with the improvement in the medium-term inflation prospects, **BNM reduced its 3-month intervention rate** in three steps from 11% to 10.5% on **3 August**, to 10% on **10 August** and further to 9.5% on **27 August**. Following the introduction of the new exchange control measures, the 3-month intervention rate was further reduced to 8% on **3 September**, to 7.5% on **5 October** and to 7% on **9 November**.

- On **1 September**, the Government introduced selective exchange controls to insulate the Malaysian economy from the prospects of further deterioration in the world economic and financial environment and to regain monetary independence. On **2 September**, BNM announced that the exchange rate for the ringgit was fixed at RM3.80 against the United States dollar.

- Meanwhile, to ease liquidity in the banking system and make available more loanable funds to borrowers at a lower rate, the **SRR was reduced from 8% to 6% on 1 September and further to 4% on 16 September.**

- As of **3 September**, commercial banks were no longer required to maintain **vostro balances** of foreign banking institutions with BNM.

- The **base lending rate (BLR) framework was revised** on **1 September** to ensure a more rapid transmission of changes in monetary policy on interest rate levels into the BLR of banking institutions. The calculation of the BLR is now based on the BNM 3-month intervention rate instead of the KLIBOR. In addition, to ensure that borrowers benefit from the higher level of operational efficiency within the banking industry, the flat administrative margin of 2.5 percentage points was reduced by 25 basis points to 2.25 percentage points. The maximum margin over the quoted BLR was also reduced from 4 percentage points to 2.5 percentage points.

- To ensure that there was sufficient funds to finance the economic recovery process, banking institutions with the capacity to lend were encouraged to achieve a **minimum annual loan growth of 8%**.

- In an effort to assist the construction sector that had been severely affected by the economic crisis, some **relaxation to the earlier ceilings on the broad property sector** were implemented on **7 September**. Lending for the construction or purchase of residential properties costing up to RM250,000 were exempted from the 20% limit on lending to the broad property sector. In addition, effective **5 October**, the 60% maximum margin of financing was abolished for the purchase of non-owner occupied residential properties costing RM150,000 and above; the purchase of shophouses costing RM300,000 and above which are not for the conduct of own business; and the purchase of land lots.

- The **ceiling on loans for the purchase of shares and unit trust funds was also raised** from 15% to 20% of total outstanding loans for commercial banks and finance companies on **23 September**. The limit for merchant banks remained at 30%. The increase in the limit was aimed at promoting long-term investments in the stock market.

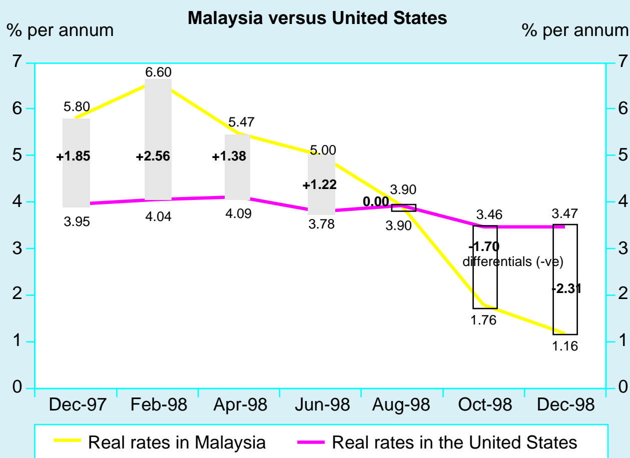
- The **margin of financing for all passenger cars was raised** from 70% to 85% on **23 April** and the restriction on the maximum repayment period was removed on **28 July**. The margin of financing of 85% was abolished on **21 November**, and banks were free to determine the percentage of financing based on their credit assessment of the borrower.

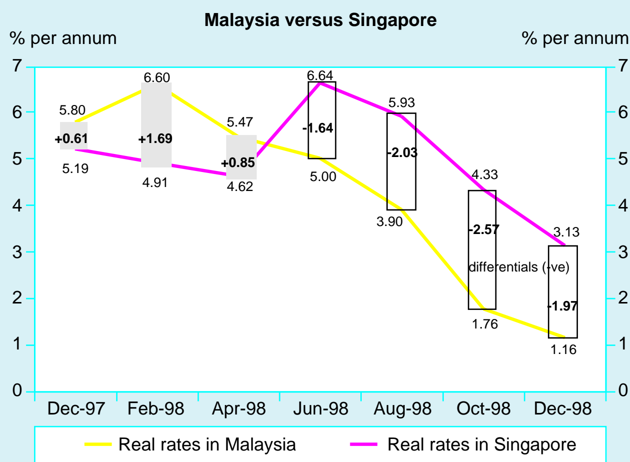
- Effective **5 December, BNM reduced the maximum lending rate under the Fund for Small and Medium Industries and the Special Scheme for Low and Medium Cost Houses** from 10% per annum to 8.5% per annum and the funding rate from 8% per annum to 6% per annum.

- Effective **20 November, the minimum monthly repayment on credit cards was reduced** from 15% to 5% of the outstanding credit card balances in order to ease the cash flow burden of credit card holders. To ensure that the charges imposed on the credit card holders were reasonable, banking institutions that issue credit cards were required from **30 December** to impose a maximum finance charge of not more than 1.5% per month or 18% per annum and that the late payment charges should not be more than 1% of the amount in default. However, banking institutions were allowed to charge a minimum penalty of RM5.

- In view of the need to clear the current backlog of properties, effective **5 January 1999**, banks were not allowed to finance the development of new residential properties and shophouses where the individual unit costs more than RM250,000 each. In addition, banking institutions were not allowed to provide financing to develop hotels, resorts, office buildings, golf courses, clubs and shopping complexes.

Graph 2.5
Real Interest Rate Differentials



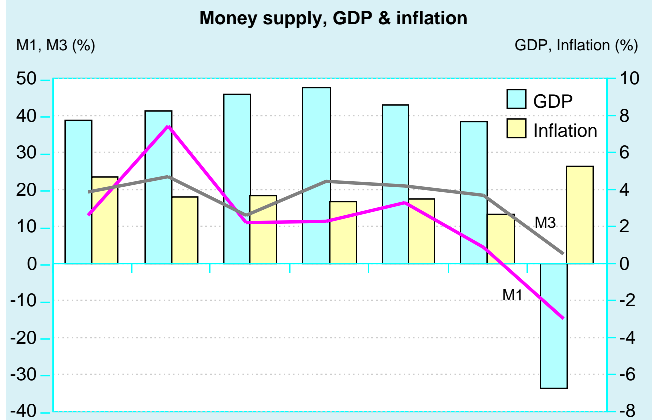


the United States and Singapore. The low real rates in the region of 1% at end-1998 was previously experienced in 1994 in Malaysia, during the period of massive capital inflows, and in 1988, during the recovery years after the recession of the mid-1980s.

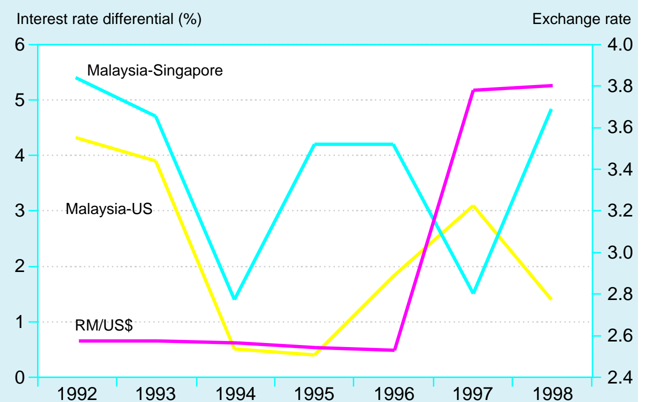
Monetary Policy in 1998

As the Asian financial crisis became more severe in 1998, the formulation of monetary policy was governed by the need to address the increasing volatility in the financial markets, the irrational market behavior, the deterioration in the financial position of the banking and corporate sectors, the existence of imbalances in the economy and the contraction in economic activities. In this context, monetary policy was pursued as part of a comprehensive set of policies to maintain macroeconomic and financial stability with the ultimate objective of stabilising and reviving the economy. While price stability remained the primary objective of monetary policy, it was necessary that monetary policy was also implemented to create a conducive environment to achieve sustainable long-term growth. Given the severe adverse effects of too tight a monetary policy on the economies of countries in the region, Malaysia adopted a different approach. It was recognised that high interest rates would not stabilise the exchange rate due to the strong external factors. It was more important to ensure that monetary policy would promote domestic macroeconomic stability and confidence and contain the severity of external developments on economic growth.

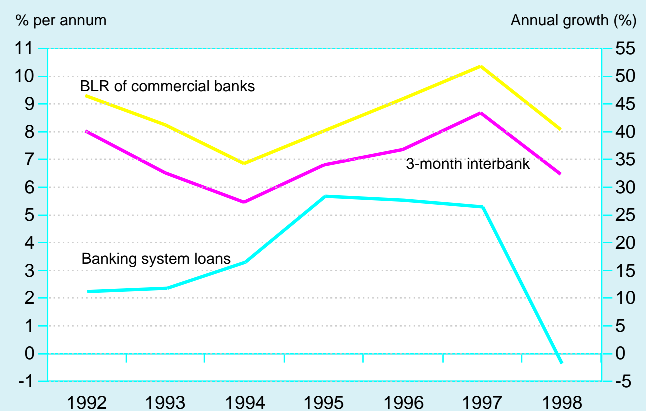
Graph 2.6



Interest rate differentials & exchange rate (end-period)



Interest rates & loan growth (end-period)



In a rapidly changing environment and a global environment of uncertainty, monetary management needs to be appropriately sequenced. The timing of policy is important. While several issues may need to be addressed, it is important to prioritise these policy responses to minimise disruptions in the system. Monetary policy, therefore, evolved at different stages of the economic crisis to adapt to changing domestic and external developments as well as to address new risks and challenges. Nevertheless, throughout the crisis period, the fundamental objective of policy remained unchanged.

At the start of the year, the tight monetary policy that was pursued before the onset of the crisis aimed to address the rising inflationary pressures associated with the depreciation of the ringgit and the consequent outflow of short-term funds. Towards mid-1998, it was evident that inflationary pressures were contained and the external balance turned around from a deficit to a surplus position. However, this contributed to reinforce the effects of a worsening external environment on domestic activity. Consequently, in response to early indicators of a weaker-than-expected growth and lower inflation in July, monetary policy was eased in early August. The policy aimed to complement the fiscal stimulus to create an environment in which the prospects for economic recovery would be enhanced. It was also recognised that growth could only recover and be sustained in an environment of stability and investor confidence. Given the build-up in risks that emerged in the regional and global financial markets during August-September, Malaysia acted decisively to stabilise the economy. On 1 September, selective exchange control measures were introduced and the ringgit was fixed against the United States dollar on the following day. This, together with an easing of monetary policy and an expansionary fiscal policy, had a positive effect on the economy. Key macroeconomic indicators as well as financial aggregates at the end of 1998 and in early 1999 suggested that the economy is emerging from the country's worst economic turbulence.

An integral part of financial policy has been the promotion of a sound financial system that is able to carry out its intermediation function efficiently. As Malaysia had entered the crisis with a relatively strong and well-regulated financial sector, the payments system and loan intermediation process remained relatively intact. However, the behaviour of markets caused distortions. Throughout the crisis period, Bank Negara Malaysia (BNM) had focused on improving the intermediation process and ensuring that sufficient funds were available at reasonable cost for productive activities. This became critical when credit growth slowed down faster than envisaged in the Credit Plan for 1998. During this period, the prolonged contraction led to a deterioration in the asset quality of the banking system. Besides taking pre-emptive steps to address the latter concern, a comprehensive four-pronged strategy was also initiated to strengthen the banking system.

Against this backdrop, monetary policy in 1998 can be classified into three phases, namely the adjustment phase from the outbreak of the crisis to early 1998; followed by the stabilisation phase up to the period in July; and subsequently, the recovery phase.

The start of 1998 witnessed a sharp increase in the volatility in both the foreign exchange and stock markets. Inflation also began to edge upwards as the effects of the depreciation filtered through to the real economy. During this period, the ringgit depreciated further following the depreciation of the Korean won in December 1997 and the near collapse of the Indonesian rupiah in early 1998. Meanwhile, loans which had still been expanding rapidly up to the end of 1997 began to experience a significant slowdown. The outflow of foreign short-term funds during this period contributed to a progressive tightening of liquidity in the banking system. Inefficiencies in the intermediation process also emerged as the sharper depreciation of the ringgit raised concerns on the banking system, particularly on the smaller institutions. This led to a shift of deposits from the smaller to the larger banking institutions. During this period, a small number of banking institutions faced significant liquidity problems due to the flight to quality of deposits. The competition for funds by these institutions contributed to the sharp increases in money market interest rates which resulted in higher interest rates for the industry as a whole. In such an environment, monetary policy focused on addressing this distortion. The most important objective of policy during this period was to improve liquidity distribution and remove distortions in the intermediation process, thereby enabling the banking institutions to reduce their lending rates.

To address these problems, BNM lowered the statutory reserve requirement (SRR) from 13.5% to

10% on 16 February, followed by another reduction to 8% on 1 July. Prior to this, BNM had placed RM34 billion in the banking system to provide liquidity to the system. The funds released by the reduction in the SRR was therefore offset by the non-rollover of funds previously lent by BNM to financial institutions. The purpose of the SRR reduction was aimed at improving the distribution of liquidity that had already been injected into the banking system and to reduce the cost of funds for the banking institutions given that banks earned zero interest on the SRR. As a result of these measures, the money market rates declined, leading to a corresponding reduction in the lending rates, which fell from 21.5% in early February to 16.3% at the end of February.

During this period, there was little leeway to reduce the money market intervention rate. In the initial stages of the crisis in July 1997, interest rates were spiked up briefly for about a week. Interest rates were subsequently reduced to the pre-crisis level from mid-August until September 1997. As the crisis became more prolonged, it was viewed that higher interest rates would have an adverse effect on the real sector, but by itself would not contribute to restore stability in the foreign exchange markets (see article on Monetary Policy in 1997 in the 1997 BNM Annual Report). However, when the Indonesian rupiah experienced a near collapse in January 1998, the ringgit depreciated to its weakest level to touch US$1=RM4.88 on 7 January. Under these conditions, concerns over the potential outflows of funds and rising inflationary pressures prompted increases in interest rates. Interest rates were then allowed to edge up to 11% to ensure that depositors continued to receive positive real rates of interest. This move contained further capital outflows and ringgit rates stabilised in the region of US$1=RM3.84–3.98 in the first and second quarters of 1998. Although interest rates were raised to the level of 11%, it was to a significantly lesser extent than that recommended by the International Monetary Fund (IMF) and expected by the market. The Bank's view was that such high interest rates would dampen economic activity and cause strains on the banking system, resulting in further pressure on the ringgit, thereby making economic recovery more difficult to achieve.

The Bank also undertook a number of other initiatives to ensure the efficient management of liquidity and increase the efficiency of loan intermediation. Procedures were introduced on 30 April to make money market operations more transparent and to promote efficient liquidity management. Under the new procedures, BNM undertook to provide daily forecasts of the cash flows of the financial system, as well as information on the major factors that were expected to influence liquidity, including details of BNM's money market activities. With effect from 1 May 1998, the band for the daily variation in the average balance required to meet the SRR was widened from ±0.5% to ±2%. In addition, a new framework for liquidity management was introduced to enable banking institutions to manage their liquidity positions with greater flexibility without compromising prudential standards. The new framework was set on a six-month trial run starting July 1998. On 3 September 1998, the liquid asset requirement of the commercial banks was reduced from 17% to 15% of total eligible liabilities. The Bank also undertook measures to increase the efficiency of monetary policy. The base lending rate (BLR) framework was revamped. Under the previous BLR computation based on the 3-month average weighted interbank rate of the preceding month, the retail interest rates responded to changes in monetary policy with a lag of several weeks. To rectify this, with effect from 1 September 1998, the calculation of the BLR was based on BNM's 3-month intervention rate rather than the KLIBOR. The banking institutions were required to adjust their BLRs within a week of a change in BNM's intervention rate, leading to a more rapid transmission of changes in monetary policy. The administrative margin included in the BLR was also reduced from 2.50% to 2.25%. These measures resulted in a downward adjustment in lending rates and contributed to increases in the efficiency of the banking institutions given that they provided the banking institutions with greater flexibility in the management of existing liquidity. The measures also resulted in a lower cost of funds. At the end of July, the BLR had declined to 12.07% from 12.27% at end-June 1998.

Apart from efforts to lower the cost of funds to banks, the Government also recognised the adverse implications high interest rates would have on small businesses. A number of funds were established and existing funds expanded so that banking institutions could provide credit to priority sectors at reasonable lending rates. These funds included the Fund for Food (RM1 billion); Petty Traders and Hawkers Fund (RM500 million); Fund for Small and Medium Industries (RM1.5 billion); Export Credit Refinancing Facility (RM3 billion); Special Scheme for Low and Medium Cost

Houses (RM2 billion); Suppliers, Buyers and Overseas Investment Credit (RM1 billion); New Entrepreneurs Fund (RM1.25 billion) and Rehabilitation Fund for Small and Medium Industries (RM750 million).

The worsening of the regional crisis following the IMF intervention in Korea and Indonesia took the region into a phase of severe economic contraction with its consequent effect on the financial sector. Lower aggregate demand in the region amidst the exchange rate instability and uncertainty and the negative wealth effect from declining asset markets contributed to the contraction in domestic activity. By July 1998, it was evident that the economy had undergone a sharper correction than earlier anticipated. Indications were that the economy would contract for the second consecutive quarter, indicating that the country was technically in an economic recession. The annual loan growth had decelerated sharply from 26.5% at the end of 1997 to 8.9% at the end of July 1998. Similarly, the growth rate of the broad monetary aggregate (M3) had also decelerated from 18.5% to 5.9% over the same period. Other macroeconomic indicators showed that there was a sharp contraction in car sales and collections of sales tax, indicating a sharp slowing down of economic activity. To revive the economy, an adjustment in macroeconomic policies was necessary.

The deceleration in the inflation rate and an absence of demand pressures enabled BNM to undertake an easing of monetary policy beginning in early August to complement fiscal policy to contain the contraction and promote recovery of the economy. The 3-month intervention rate of BNM was reduced in three successive steps, from 11% to 9.5% during the month of August. A cautious and gradual easing of monetary policy was necessary given the threat of volatility in the foreign exchange markets and the risk of capital outflows. Of special concern was the high rates being offered to attract ringgit funds in Singapore and the build-up of offshore ringgit balances to fund speculative activity on the ringgit. During this period, external risks in the regional and global markets had also worsened since end-August. The crisis had spread to Russia and Latin America. In this environment, BNM introduced selective exchange controls on 1 September, while the exchange rate was fixed at RM3.80 to the United States dollar on 2 September. The new measures were aimed at ensuring that Malaysia could gain greater independence in the conduct of domestic monetary policy as well as insulate the economy from the potential risks and vulnerabilities of external developments in the international financial markets. Other considerations included preserving the gains that had been made to stabilise the domestic economy; ensuring stability in prices and the ringgit exchange rate; as well as promoting a stable environment for restoring investor and consumer confidence to revive the economy. Hence, the exchange control regulations were carefully designed to contain speculation on the ringgit and minimise the impact of short-term capital flows on the domestic economy. These regulations did not affect trade and investment in economic activity. Full convertibility remained for current account transactions.

The new measures provided the Bank with the ability to further ease monetary policy to support the domestic economic recovery process given the absence of inflationary pressures. Following the introduction of the exchange control measures and the fixed exchange rate, additional monetary measures were introduced to improve the liquidity flows in the banking system to generate lending activities, as well as to ensure that viable businesses continued to receive financing at lower cost. Consequently, the SRR was reduced to 6% on 1 September, and then again to 4% on 16 September. Similarly, the 3-month intervention rate was reduced from 9.5% to 8% on 3 September, to 7.5% on 5 October, and to 7% on 9 November. As a result of the easing of monetary policy, the average BLR of the commercial banks and finance companies declined further from 11.70% and 14.17% respectively in August 1998, to 8.04% and 9.50% by November.

The period of stability that followed was fully utilised to expedite reform of the financial sector through the institutional framework that was already established. Targets set for Danamodal Nasional Berhad (Danamodal) and Pengurusan Danaharta Nasional Berhad (Danaharta) were brought forward. As at 15 March 1999, Danaharta, the asset management company, has acquired and is managing gross non-performing loans (NPLs) from the banking system amounting to RM15.1 billion. Danamodal, the special purpose vehicle to recapitalise the banking system, injected RM6.15 billion in capital into 10 banking institutions and additional injections are in the pipeline. The Corporate Debt Restructuring Committee (CDRC) has received 48 applications involving debt totalling

RM22.7 billion. In the case of the small and medium industries (SMIs), a rehabilitation fund was also set up in 1998, with an initial allocation of RM750 million to provide financial assistance to SMIs which are viable but have temporary cash flow problems and NPLs. Amongst others, banking institutions can utilise 30% of the total loans approved under this Fund to replace and restructure problem loans.

Throughout the crisis period, the Bank recognised the importance of ensuring the efficient functioning of the intermediation role of the banking institutions. However, given the protracted financial crisis and rising NPLs, the banking institutions placed greater emphasis on balance sheet considerations. With rising NPLs and the erosion of capital, banking institutions had become excessively cautious in their lending decisions. A sharp slowdown in credit ensued. A credit crunch, if allowed to develop, would deepen the economic recession, thus compounding the financial difficulties of sound companies and subsequently affecting the health of the financial system. Hence, additional measures were undertaken to encourage banking institutions to continue to lend for productive purposes. With effect from 9 September 1998, banking institutions with capacity were encouraged to achieve a minimum annual loan growth of 8% for 1998. The motivation for the 8% credit floor was to free the banking institutions from the self-imposed credit freeze. The introduction of the credit growth target, however, did not sacrifice prudential consideration. Banking institutions were required to continue exercising financial discipline in providing credit and making their decisions without compromising prudential standards to ensure that the balance sheets of the banking institutions do not deteriorate further. Nevertheless, banking institutions should not unnecessarily complicate the credit process, making it difficult for borrowers to obtain credit.

Other measures adopted to revive economic activities of identified sectors included the relaxation of the earlier ceilings on the broad property sector and the share markets. Earlier rules restricting consumption credit imposed during the period of high credit growth were also relaxed.

On the whole, although there has been a tendency to generalise the problems confronting the East Asian region, there are important differences in these economies that require alternative policy approaches in dealing with the crisis. It is important to recognise that there is no standard prescription. The approach adopted in Malaysia has differed from that of its neighbours in response to differences that exist in its financial and macroeconomic environment. Malaysia went into the crisis from a position of favourable economic and financial fundamentals of a high savings rate, full employment, low external debt, a strong fiscal position, and a strong and well-capitalised banking system. These favourable initial conditions gave Malaysia greater flexibility in its policy response to the crisis and enabled the country to formulate a series of pre-emptive monetary and financial policy initiatives.

Fiscal Operations and Policy

The 1998 Budget was formulated in October 1997 when Malaysia was in the initial phase of the regional crisis and was still experiencing robust growth. Fiscal policy during this period focused on strengthening macroeconomic stability and restoring investor confidence. The policy aimed to address the key areas of vulnerabilities, including containing inflationary pressures arising from the ringgit depreciation and addressing the current account deficit in the balance of payments. The fiscal policy stance was therefore one of prudence and restraint. In line with these objectives, the Government budgeted for a fiscal surplus of 2.7% of GNP in the 1998 Budget. This was effected through restraint on consumption spending, the rightsizing of the public sector and the privatisation of Government activities. Less critical projects were also deferred to narrow the resource gap. The Government, however, continued to provide essential expenditure to address supply constraints, raise productivity and enhance potential output. Priority was also accorded to poverty eradication programmes and upgrading the quality of life.

In the wake of continued regional instability and its adverse impact on Federal revenue, the Government announced in December 1997, further fiscal austerity measures involving a reduction of 10% across the board and 8% on a selective basis, of both operating and development expenditure allocations in the 1998 Budget. The cutback, was however, implemented without affecting essential public services, poverty eradication programmes and key infrastructure development. As the crisis became more prolonged, this tight fiscal policy became

unsustainable. On 24 March 1998, the Government reversed the earlier policy and reduced the targeted budget surplus to 0.5% of GNP as the contraction in the economy became evident in the first quarter. An additional expenditure of RM1 billion was also provided for socio-economic projects to protect the more vulnerable segments of society.

The adjustment measures taken in terms of restrained fiscal and monetary policies in the early part of the crisis contributed towards improving the current account of the balance of payments and containing price pressures. However, the public sector expenditure cutbacks aggravated the decline in investor and consumer demand, causing a severe deflationary impact on the domestic economy. Given the change in economic conditions, the Government adopted counter-cyclical measures to revitalise the domestic economy. The policy change aimed to minimise the severity of the economic downturn. In July 1998, the Government announced a fiscal stimulus package involving an additional allocation of RM7 billion for implementing projects with strong linkages within the domestic economy; minimum leakage in terms of imports; short gestation period; and expenditures to meet socio-economic objectives. In this regard, the projects that were given priority included those related to housing, education, health, and rural and infrastructure development. In addition, an Infrastructure Development Fund, with an initial allocation of RM5 billion was established to assist the financing of infrastructure projects and large public facilities so that their implementation could proceed. The projects identified included the mass-transit transportation system, ports, highways, water supply and waste disposal as well as sewerage projects. The Government also established or expanded special funds to ensure continued access to credit at reasonable costs for priority sectors. With the change in the fiscal policy stance, the fiscal account was estimated to have recorded a deficit of 3.7% of GNP in 1998.

After five years of fiscal surpluses, the 1999 Budget, announced in October 1998, maintained a fiscal deficit of 3.7% of GNP for 1998 and targeted for an increase to 6.1% of GNP for 1999. The expansionary fiscal policy was designed to support economic activities to promote economic recovery, to strengthen the nation's resilience and competitiveness, to restructure the financial sector and to ensure social well-being. Although the thrust of budgetary operations was expansionary, fiscal prudence and discipline was being maintained to contain the fiscal deficit at a manageable level so as not to jeopardise long-term growth. These objectives are being achieved through budgetary control on non-essential and non-productive spending, whilst according priority to infrastructure and socio-economic projects that could generate economic activities, promote efficiency, improve competitiveness and long-term productivity, but which are low in import content. Emphasis was also being placed on an adequate programme to protect the lower income group and the poor from the adverse effects of the crisis. Hence, a large share of the 1999 Budget allocation was for public utilities, education and skills training and health and medical services. Emphasis was also being placed on agriculture and rural development and special assistance schemes to assist the low-income group, petty traders and small businesses.

Given the prospect of weak revenue performance in 1999, the comprehensive plan to revitalise and restructure the economy was carefully framed to ensure that sufficient resources are available and that the private sector would not be crowded out. The total financing requirement has been initially estimated at RM62 billion for 1998-99, to finance the recovery package including the fiscal deficit, restructuring of banking institutions and development of infrastructure. In view of the smaller overall fiscal deficit of RM5 billion for 1998 (–RM9.6 billion estimated in the 1999 Budget), the total financing requirement is now estimated to be lower at RM58 billion for 1998-99. The financing requirement would be raised from non-inflationary domestic sources and, to a lesser extent, from selective external financing. In 1998, funding was largely met from domestic sources. For 1999, the bulk of the financing would continue to be met from domestic sources. Besides new funds from the provident, pension and insurance funds, there is sufficient liquidity in the banking system. Additional liquidity would be generated from the large current account surplus in the balance of payments recorded in 1998 and estimated for 1999. In order to avoid crowding out the funding for the private sector, approximately one-third of the funding requirements would be met from external sources. The latter would comprise mainly loans from bilateral and multilateral sources. The Government would continue to ensure prudence in its recourse to external borrowing so as to maintain the external debt at a manageable level and to ensure favourable international credit ratings. The Government would continue to maintain a policy of containing the overall debt service ratio of the nation at a low level.

Throughout the crisis period, the Government has persevered with its programme to reform and simplify the tax system, provide a conducive environment for investment, and enhance competitiveness and productivity. Tax measures that were implemented in 1998 and announced in the 1999 Budget included the two percentage point reduction in both the corporate and petroleum income tax rates to 28% and 38% respectively, aimed at reducing the cost of doing business and providing tax incentives to boost exports. Wide-ranging tax incentives and exemptions were also introduced to expedite the shift to higher value-added and technology-intensive industries, especially for exports. These included tax exemption on the increase in the export value. There was also a review of the reinvestment allowance to encourage industries to move up the industrial ladder and an extension of research and development incentives to accelerate the development of indigenous technology capability. In addition, incentives were also introduced to promote the services sector to address the persistent services deficit in the balance of payments. Comprehensive measures were introduced to strengthen the banking system and improve transparency, while ensuring stability in the financial markets to facilitate trade and commerce. The measures included the introduction of several prudential measures; the change in the tax treatment on actuarial surplus; tax exemption (50%) for interest-in-suspense; as well as the exemption of stamp duty and real property gains tax on mergers of financial institutions. Meanwhile, the 1999 Budget also announced several changes in the tax administration system to enhance its efficiency and responsiveness in the collection of income tax. Most important was the change in the tax assessment, which would now be based on income received in the current year instead of the previous year basis, with effect from year 2000.

Consolidated Public Sector

The financial position of the consolidated public sector weakened in 1998 largely attributable to the deterioration in the revenue performance of the Federal Government and the increase in expenditure, particularly by the non-financial public enterprises (NFPEs). The consolidated public sector account recorded an overall deficit compared with significant surpluses in 1996 and 1997. This largely reflected the significant deterioration in the overall financial performance of the NFPEs as well as the general government, in particular the Federal Government. In aggregate, the overall account of the consolidated public sector recorded a deficit of RM4.7 billion or 1.8% of GNP compared with a large surplus of RM17.3 billion or 6.6% of GNP in 1997. This is the first deficit recorded since 1993. The increase in development expenditure of the general government was mainly to finance the stimulus package as well as for providing facilities and social amenities to the poor. The bulk of the expenditure was mainly for education, health, housing, rural development and infrastructure.

The general government, comprising the Federal Government, 13 state governments, statutory bodies and local governments continued to record a current account surplus, albeit a much lower surplus of RM19.5 billion or 7.4% of GNP (11.4% of GNP in 1997). The lower surplus was mainly attributable to the decline in aggregate revenue collection (–12.4%), as operating expenditure remained virtually unchanged. Increased outlays were recorded mainly for debt servicing, the expansion of several education funds and Fund for Food, as well as reactivating the Sinking Fund. However, these outlays were offset by the decline in other expenditures.

As in previous years, the surplus was mainly generated by the Federal Government and the state

Table 2.5
Consolidated Public Sector Finance

	1997	1998*p*	1999*r*
		RM million	
General government [1]			
Revenue	81,528	71,392	64,581
Operating expenditure	51,884	51,896	54,852
Current surplus of general government	29,644	19,496	9,729
Current surplus of NFPEs [2]	27,680	23,046	23,971
Public sector current surplus	**57,324**	**42,542**	**33,700**
(% of GNP)	**22.0**	**16.2**	**12.5**
Net development expenditure	39,992	47,219	48,559
General government	*18,651*	*21,442*	*23,768*
NFPEs [2]	*21,341*	*25,777*	*24,791*
Overall balance	**17,332**	**–4,677**	**–14,859**
(% of GNP)	**6.6**	**–1.8**	**–5.5**

[1] Comprises Federal Government, state governments, statutory authorities and local governments.
[2] Refers to 28 NFPEs in 1997 and 1998 respectively.
p Preliminary
r Revised

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

governments, while statutory bodies remained in deficit due to their narrow revenue base. Several major public enterprises also experienced less favourable performances due mainly to higher cost of operations and debt servicing arising from ringgit depreciation during the year. As a result, the operating surplus of the NFPEs was also reduced to RM23 billion or 8.8% of GNP (10.6% of GNP in 1997). Consequently, the consolidated public sector current account recorded a reduced surplus of RM42.5 billion or 16.2% of GNP in 1998 (22% of GNP in 1997).

The public sector development expenditure increased by 18.1% to RM47.2 billion in 1998 (29.8% in 1997) due to the substantial increase in capital spending by the NFPEs (20.8%; 37.6% in 1997), while the development outlays of the general government moderated to 15% (21.9% in 1997). Increases in development expenditure were recorded by several major NFPEs, including the Petroliam Nasional Berhad (PETRONAS) and Malaysian International Shipping Corporation Berhad (MISC), mainly on project expansion and modernisation programme. A sizeable proportion of the capital spending was also for the acquisition of companies related to their core business, including investment overseas. However, due to the adverse economic developments, several other NFPEs consolidated their positions and deferred or scaled down development projects during the year.

Federal Government Finance

The financial position of the Federal Government was less favourable in 1998 in the face of a substantial decline in revenue as well as the implementation of the fiscal stimulus package since July. The overall fiscal position reverted to a deficit of RM5 billion or –1.9% of GNP from a surplus of RM6.6 billion or 2.5% of GNP in 1997. This is the first overall deficit since 1992. The current account continued to remain in surplus, albeit smaller, at RM12.1 billion or 4.6% of GNP (RM21 billion or 8.1% of GNP in 1997).

In 1998, **Federal revenue** fell by 13.7% to RM56.7 billion or 21.6% of GNP, reflecting the contraction in economic activity and weak domestic demand. This decline also reflected the reduction in tax rates as well as several tax concessions provided in the 1998 Budget to promote productivity-driven growth and reduce the cost of doing business. Revenue foregone from lower taxes was estimated at about RM1.3 billion in 1998. Meanwhile, the marked decline in petroleum prices coupled with the reduction in the rate of petroleum income tax and export duty also affected receipts from petroleum income tax, exports, imports and excise duties which together with PETRONAS dividends accounted for about one-fifth of total revenue (–5.1% to RM11.8 billion). In aggregate, revenue decline was recorded across the broad categories of direct taxes (–RM417 million), indirect taxes (–RM7.9 billion) and non-tax revenue and receipts (–RM735 million).

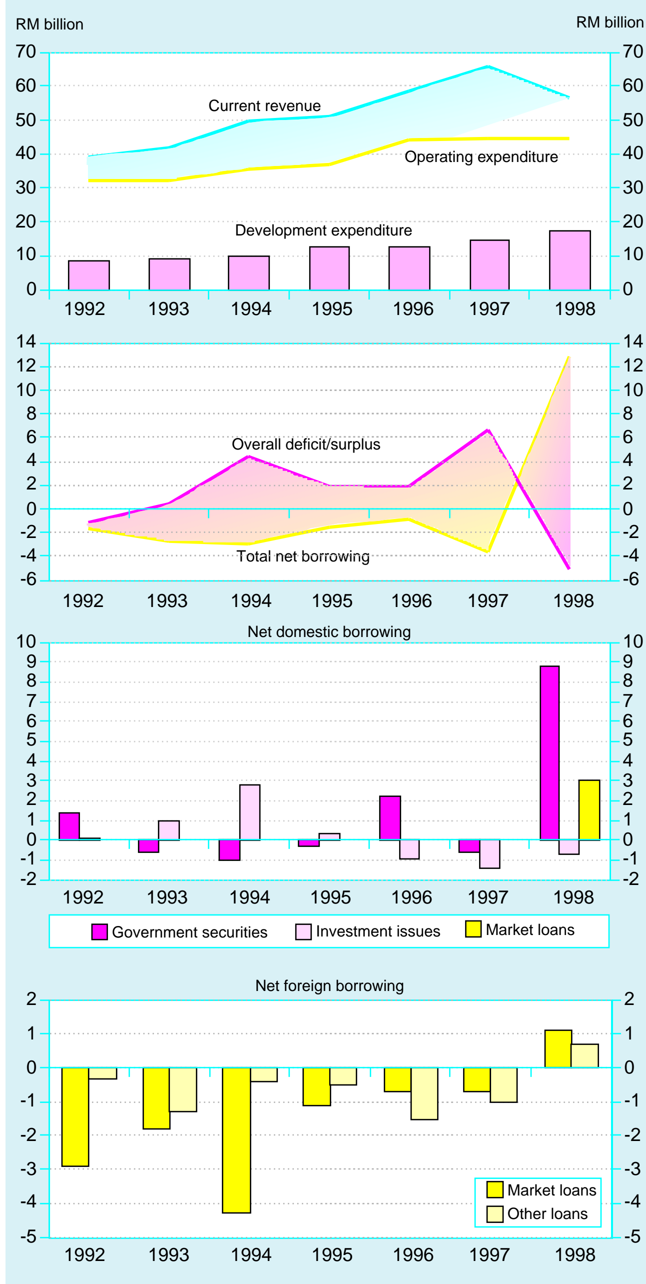
For the first time since 1988, **tax revenue** fell by 15.5% to account for a lower share of 80% of the total Federal revenue. As a result, the ratio of tax receipts to GNP declined to 17.3% (20.5% in 1997). Revenue from **indirect taxes** declined significantly (–33.9%), thereby reducing its share to

Table 2.6
Federal Government Finance

	1997	1998*p*	1999*r*
	RM million		
Revenue	65,736	56,710	50,332
Operating expenditure	44,665	44,584	47,220
Current surplus	**21,071**	**12,126**	**3,112**
(% of GNP)	**8.1**	**4.6**	**1.2**
Development expenditure	14,445	17,128	19,202
Gross development expenditure	*15,750*	*18,103*	*20,202*
Less Loan recoveries	*1,305*	*975*	*1,000*
Overall balance	**6,626**	**–5,002**	**–16,090**
(% of GNP)	**2.5**	**–1.9**	**–6.0**
Sources of financing [1]			
Net domestic borrowing	–2,048	11,040	–
Gross borrowing	*3,000*	*17,990*	–
Less Repayment	*5,048*	*6,950*	–
Net foreign borrowing	–1,681	1,819	–
Gross borrowing	*462*	*4,001*	–
Less Repayment	*2,143*	*2,182*	–
Special receipts	91	1	–
Realisable assets [2] and adjustments	–2,988	–7,858	–
Total	**–6,626**	**5,002**	**–**

[1] Data for 1999 are not given.
[2] Includes changes in Government's Trust Fund balances. An increase in the accumulated realisable assets is indicated by a minus (–) sign.
p Preliminary
r Revised

Source: Ministry of Finance



27% of total revenue. Reflecting the contraction in domestic demand and lower petroleum prices, almost all major categories of indirect taxes recorded double-digit declines. Receipts from import and excise duties registered sizeable declines of 40.7% and 40.8% respectively. Lower collection of these duties were apparent across the whole spectrum of goods, in particular, duties on motor vehicles and spare parts; petrol and petroleum products; electrical appliances and machinery. The poor performance of import duties also reflected the sharp deceleration in import growth. The lower private sector spending affected sales tax collections (–37.7%), with lower receipts in all sub-sectors, especially transport equipment (including passenger, commercial and bus vehicles). Meanwhile, the decline in the collection of service tax was marginal (–1.9%) as widening the scope of the service tax in the 1998 Budget to include services provided by employment agencies, limousine and management services had, to some extent, offset the lower collection particularly from professional services. The reduction in the export duty on petroleum from 20% to 10% as well as the lower crude oil prices also contributed to the lower collection from export duties. However, the decline was moderated somewhat by higher export volume of crude petroleum.

Revenue from **direct taxes** recorded a lower decline (–1.4%) than receipts from indirect taxes and, hence increased its share of total revenue (53%; 46% in 1997). This was largely because income tax collections were mainly based on the previous year's earnings which were still experiencing strong growth in the first-half of 1997. Nevertheless, the rescheduling of some tax payments due to corporate cashflow problems as well as the provision of several tax concessions and incentives in the 1998 Budget to enhance productivity and boost exports had moderated income tax collections. These fiscal measures included the two percentage point reduction in corporate and petroleum income tax, and tax incentives to boost exports, promote research and development, human resource development and tax rebate for the purchase of personal computers. On the whole, the higher receipts from personal (+7.3%), petroleum (+4.8%) and corporate (+3.6%) income taxes were more than offset by lower revenue collection from stamp duties (–56.2%) and real property gains tax (–24.3%). The decline in these two taxes reflected lower prices and volume of transactions in both the stock and property markets.

The sustained high level of income tax collection during the year was partly due to the increased number of taxpayers (+151,930 in 1998). It also reflected to some extent the success of the Inland Revenue Board (IRB) in widening the tax base and its concerted efforts to strengthen the efficiency of the tax collection machinery, improve compliance and ensure enforcement. Further measures were introduced in the 1999 Budget to increase the efficiency and responsiveness in the collection of income tax and to ensure that the cashflow of the Government reflects the current performance. This included the change in the tax assessment based on income received in the current year instead of the previous year basis, beginning from

Table 2.7
Federal Government Revenue

	1997	1998*p*	1997	1998*p*
	RM million		Annual change (%)	
Tax revenue	**53,627**	**45,336**	**13.4**	**–15.5**
Direct taxes	30,432	30,015	17.7	–1.4
Income tax	27,121	28,369	19.7	4.6
Corporate	*16,688*	*17,294*	*17.8*	*3.6*
Petroleum	*3,861*	*4,046*	*75.3*	*4.8*
Personal	*6,429*	*6,900*	*4.2*	*7.3*
Co–operative	*143*	*129*	*19.1*	*–9.7*
Real property gains tax	523	396	21.6	–24.3
Stamp duties	2,714	1,190	0.2	–56.2
Other	74	60	42.3	–18.9
Indirect taxes	23,195	15,321	8.3	–33.9
Export duties	1,053	623	1.2	–40.8
Import duties	6,524	3,868	6.4	–40.7
Excise duties	6,054	3,586	4.6	–40.8
Sales tax	6,167	3,845	12.7	–37.7
Service tax	1,475	1,447	19.8	–1.9
Other	1,922	1,952	9.6	1.6
Non–tax revenue and receipts	**12,109**	**11,374**	**10.0**	**–6.1**
Total	**65,736**	**56,710**	**12.8**	**–13.7**

p Preliminary

Source: Ministry of Finance

year 2000, as well as the implementation of the self-assessment system for companies; businesses, partnerships and co-operatives; and the salaried group, commencing from year 2001, 2003 and 2004 respectively.

Non-tax revenue declined in 1998 (–4.7%; +10.6% in 1997), reflecting lower collections from licences and permits. Substantially lower receipts were recorded on the levy on foreign workers as well as road tax, despite the doubling of fees for international and restricted travel documents and the increase in fees for driving licences in the 1998 Budget. Service fees also recorded a decline. Meanwhile, collections from investment income and petroleum royalty were higher. **Non-revenue receipts**, which included refunds of expenditure, receipts from Government agencies and revenue from the Federal territories, were substantially lower during the year (–28.6%; +1.5% in 1997).

Total Federal Government expenditure increased by a modest 3.8% to RM62.7 billion in 1998. Reflecting the fiscal austerity package announced in the 1998 Budget as well as in December 1997, the Government's total outlays fell sharply by 34.4% in the first half-year compared with the preceding half-year. However, with the shift in fiscal stance since July, total expenditure expanded by 56.6% in the second half-year. In undertaking the fiscal stimulus, the Government is committed to ensuring that the fiscal deficit would be kept within prudent limits. Hence, whilst operating expenditure would be tightly controlled, high priority will be accorded to development projects with strong linkages in the economy and low import content.

Operating expenditure declined marginally by 0.2% in 1998 reflecting continued restraint on expenditure to avoid wastage and to curtail less essential spending. During the year, the total wage bill, the largest component of operating expenditure (31.3%), rose by 3.2%. The higher wage bill reflected largely the payment of the balance of the 1997 bonus and the RM400 financial assistance to civil servants as well as the upgrading of the scheme of service for teachers including time-based promotions. These were partly offset by the reduction in allowances for civil servants and a freeze on all vacant posts that were non-critical. The payment for pensions and gratuities increased by only 0.5% due to the lower annual contribution to the Pensions Trust Fund as well as a review of the policy on the payment of gratuities for optional retirement. Under the revised policy, the Federal Government would only pay 10% of the total gratuities on optional retirement, while the balance would be paid at the age of 55.

In the light of lower revenue receipts, there were increased budgetary controls on transfer items, leading to the decline in payment of grants and transfers. Nevertheless, the Government continued to provide for social programmes. Besides providing the annual grants to the state governments and other government agencies for development and maintenance purposes, increased allocations were made for the Fund for Food and several education funds such as the Education Loan Fund and the National Education Fund, to assist students facing financial constraints. In addition, two new funds were established, namely, the Fund for Car Loans and for Computer Loans for Teachers, while the Sinking Fund was reactivated to meet future debt obligations. Similarly, there was a sharp decline in disbursements on supplies and services and asset acquisition. Meanwhile, expenditure for refunds was higher, reflecting mainly increased tax refunds during the year.

Table 2.8
Federal Government Operating Expenditure by Object

	1997	1998*p*	1997	1998*p*
	RM million		% share	
Emolument [1]	13,195	13,984	29.5	31.3
Supplies and services	6,363	5,212	14.2	11.7
Asset acquisition	905	434	2.0	1.0
Public debt charges	6,426	6,928	14.4	15.5
Pensions and gratuities	3,638	3,658	8.2	8.2
Other grants and transfers [2]	12,101	11,972	27.1	26.9
Other expenditure	2,037	2,396	4.6	5.4
Total	**44,665**	**44,584**[3]	**100.0**	**100.0**

[1] Excludes statutory bodies.
[2] Includes grants and transfers to state governments as well as public agencies and enterprises.
[3] Excludes principal loan repayment of RM2.1 billion.
p Preliminary

Source: Ministry of Finance

In 1998, debt servicing, which is the second largest component in the operating expenditure (15.5%) rose by 7.8%. The higher outlay reflected the increased external indebtedness arising from the depreciation of the ringgit, the charges incurred in raising new loans as well as the higher domestic interest rate during the first half-year.

Gross **development expenditure** rose by 14.9% to RM18.1 billion in 1998. The higher expenditure was mainly attributable to the implementation of the RM7 billion fiscal stimulus package to revitalise the economy as well as the provision of several assistance schemes totaling RM1 billion to mitigate the adverse impact of the economic adjustments on the lower-income group and the vulnerable segments of society. The bulk of the expenditure was channelled to projects with strong domestic economic linkages and low import content. These included agriculture and rural development, infrastructure, housing, health and education projects.

In terms of sectoral distribution, economic services absorbed a larger share or 51% of total expenditure. In particular, disbursements on the trade and industry sub-sector were significantly higher. A large part of the increased expenditure was disbursed to Cyberview Sendirian Berhad (RM654 million), Pengurusan Danaharta Nasional Berhad (RM500 million), Export-Import Bank of Malaysia (RM100 million) and the Multimedia Development Corporation (RM90 million). In addition, part of the allocation was for infrastructure facilities for new and specialised industrial estates as well as for strategic investments including information technology. Priority was also given to the development of the small and medium-scale enterprises, industrial research and development, and the promotion of tourism. In contrast, disbursements on the transport sub-sector were substantially lower in 1998 reflecting largely the ongoing privatisation programme as well as the deferment or scaling down of selective projects that were less critical. The bulk of the expenditure was for the construction and improvement of Federal roads (including highways) and the development and expansion of rail, port and airport projects in tandem with the Government's efforts to provide for an integrated transportation network. This was mainly to strengthen and increase the capacity to facilitate the flow of goods and passenger traffic to support the industrialisation process. The Government also intensified its efforts during the year to meet the socio-economic objectives of the nation. Expenditure on agriculture and rural development (including land development) remained high, while investment to improve rural roads, water supply and electrification programmes was increased.

Development expenditure on the social services sector was also higher, accounting for a larger share of 32% of total development expenditure. Investment in education and training increased during the year, with priority placed on human resource development, especially to develop skilled manpower to support the productivity-driven growth. The expenditure was mainly for the upgrading of education facilities, the construction of primary and secondary schools, polytechnics, vocational and technical schools as well as the development of universities, including the construction of the Universiti Malaysia Sabah and the Universiti Islam Antarabangsa. Outlays on health and family planning were also higher to enhance the quality of health services. The bulk of the expenditure was for the construction and upgrading of hospitals as well as the provision of health facilities. Similarly, the higher expenditure on housing was largely on low-cost public housing projects and housing programmes for the armed forces, customs officers, police personnel and teachers in rural areas, as well as establishing a housing fund for the hardcore poor. Meanwhile, outlays on social and community services included a further contribution to the Commonwealth Games 1998, as well as the establishment of the Amanah Ikhtiar Malaysia and the micro-credit programme to assist the hardcore poor, hawkers, petty traders and small enterprises. Expenditure for general administration was higher,

Table 2.9
Federal Government Development Expenditure by Sector

	1997	1998*p*	1997	1998*p*
	RM million		% share	
Defence and security	2,314	1,379	14.7	7.6
Economic services	7,501	9,231	47.6	51.0
Agriculture and rural development	1,105	960	7.0	5.3
Trade and industry	1,285	3,227	8.2	17.8
Transport	3,578	3,051	22.7	16.9
Public utilities	1,496	1,968	9.5	10.9
Other	37	25	0.2	0.1
Social services	4,919	5,795	31.2	32.0
Education	2,521	2,915	16.0	16.1
Health	449	716	2.8	4.0
Housing	735	1,041	4.7	5.7
Other	1,214	1,123	7.7	6.2
General administration	1,016	1,698	6.5	9.4
Total	**15,750**	**18,103**	**100.0**	**100.0**

p Preliminary

Source: Ministry of Finance

largely for the construction and development of the new administrative centre and the implementation of the electronic Government to enhance efficiency in the provision of services. In contrast, outlays on defence and internal security were lower.

With an expansionary fiscal policy stance in July 1998, the Government reviewed and expanded its planned borrowing for the year. Increased borrowing emanated mainly from domestic sources and, to a lesser extent, from external sources in 1998, to finance the fiscal deficit. As a result, total **net borrowing** (RM12.8 billion) of the Federal Government increased for the first time, following six consecutive years of net repayment of loans. The increased borrowings, particularly from domestic sources, coupled with a marginal net exchange revaluation loss arising from the weakening of the ringgit against the Japanese yen had led to a deterioration in the total debt position of the Federal Government. The total debt outstanding increased by 14.7% to RM103.1 billion at the end of 1998 (end-1997: +0.3% to RM89.9 billion). As a percent of GNP, it increased from 34% to 39% at the end of 1998. Nevertheless, this ratio is still significantly lower, compared with 111% in 1986.

During the year, net **domestic borrowing** amounted to RM11 billion, in contrast to a net repayment of domestic loans of RM2 billion in 1997. This domestic borrowing was mainly from non-inflationary domestic sources to fund its development expenditure. Gross funds raised through Malaysian Government Securities (MGS) amounted to RM15 billion, exceeding the previous high of RM8.6 billion raised in 1987. Part of the new issue was for the refinancing of MGS and Government Investment Issues (GII) which matured in 1998, amounting to RM7 billion. In December 1998, the Government signed a syndicated loan agreement with 12 locally-incorporated foreign banks in Malaysia for a foreign currency loan amounting to US$1.35 billion (equivalent to RM5.1 billion), comprising largely loans denominated in the United States dollar. The loan was drawn down in three tranches, namely in December 1998 (first tranche of US$800 million) and January 1999 (second and third tranches totalling US$550 million). The loan with a maturity period of five years has an interest rate spread of 2.9% over the 6-month USD LIBOR. Meanwhile, there was no net new funds raised through the GII or Treasury bills (TB), while the Treasury Housing Loans Fund recorded a small net borrowing during the year. Consequently, the total domestic debt of the Federal Government increased by 14.6% to RM88.2 billion at the end of 1998 to account for 86% of the total outstanding debt.

In 1998, the Government floated six issues of MGS worth RM15 billion, mainly through private placements and by way of open tender through the principal dealers. The new issues were for a

Table 2.10
Public Debt of Federal Government

	Annual change		At end 1998*p*
	1997	1998*p*	
	Nominal value in RM million		
Domestic debt	–2,243	11,229	88,197
Treasury bills	–	–	4,320
Investment issues	–1,400	–750	2,000
Government securities	–648	8,750	75,012
Treasury Housing Loans Fund	–195	189	3,825
Market loans	–	3,040	3,040
External debt	2,480	1,973	14,924
Market loans	1,312	1,221	7,693
Project loans	1,168	752	7,231
Total	**237**	**13,202**	**103,121**

p Preliminary

Source: Ministry of Finance

wide range of maturities of 3, 5, 7, 10, 15 and 20 years to provide a benchmark yield curve to support the development of the bond market. Longer-dated MGS were mainly offered to institutional investors such as the social security institutions. After adjusting for loan redemptions, total MGS outstanding increased by 13.2% to RM75 billion at the end of 1998 and accounted for 85% of the total domestic debt outstanding. In terms of the ownership structure of MGS holders, the significance of the social security and insurance institutions increased, resulting in a slightly higher share of 70% of the total outstanding MGS. The Employees Provident Fund (EPF) remained the single largest institutional investor in 1998, raising its holdings to 61% of the total MGS, through investment in new issues of MGS as well as absorption of the divested amounts of the Social Security Organisation (SOCSO). The share of MGS held by banking institutions also increased (21%) reflecting the shift to holdings of low-risk financial instruments. The remaining MGS (9%) were held by the public enterprises, the non-bank financial institutions and foreign investors.

The balance of the domestic debt was in the form of TB (5%), the Treasury Housing Loans Fund (4%), the domestic syndicated loan (4%) and GII

Table 2.11
Holdings of Federal Government Domestic Debt

	1997	1998*p*	1997	1998*p*
	Nominal value in RM million		% share	
Treasury bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	304	183	7.0	4.2
Banking sector	3,959	3,678	91.7	85.1
Other	57	459	1.3	10.7
Government Investment Issues	**2,750**	**2,000**	**100.0**	**100.0**
Insurance companies	119	131	4.3	6.5
Banking sector	2,610	1,848	94.9	92.4
of which:				
Bank Negara Malaysia	*1,588*	*940*	*57.7*	*47.0*
Commercial banks	*930*	*757*	*33.8*	*37.9*
Other	21	21	0.8	1.1
Malaysian Government Securities	**66,262**	**75,012**	**100.0**	**100.0**
Social security and insurance institutions	45,329	52,851	68.4	70.4
of which:				
Employees Provident Fund	*38,068*	*45,662*	*57.5*	*60.9*
Insurance companies	*5,256*	*5,307*	*7.9*	*7.1*
Banking sector	12,805	15,419	19.3	20.6
Other	8,128	6,742	12.3	9.0

p Preliminary

(2%). The banking institutions, which remained the major investors of **TB**, continued to hold 85% of the total TB outstanding for liquidity purposes. In terms of the profile of holders of GII, the banking institutions increased its holdings to account for a larger share of 45% of total GII outstanding. All banking institutions, in particular commercial banks including Bank Islam, increased their holdings of GII reflecting the growing Islamic banking businesses as well as attractive returns. Meanwhile, the share of BNM was reduced further to 47%, reflecting the net redemption of loans during the year. The main lenders to the **Treasury Housing Loans Fund** were Cagamas Berhad, the EPF, the National Savings Bank and the commercial banks.

The Government also relied, albeit to a lesser extent, on external borrowing largely from bilateral and multilateral sources, to fund its increased financing needs. Consequently, for the first time since 1991, net **external borrowing** of the Federal Government recorded a net inflow of RM1.8 billion in 1998. Gross external borrowing amounted to RM4 billion, reflecting largely the raising of two loans during the year. In June 1998, Malaysia signed an agreement with the World Bank (US$300 million or RM1.2 billion) under a multilateral arrangement to finance projects to revive the economy as well as to mitigate the adverse effects of the economic adjustment on the more vulnerable segments of society. In December, Malaysia signed the ¥74 billion (RM2.4 billion) five-year term loan agreement/ Euroyen bond with Sumitomo Bank Ltd./Nomura Securities Co. Ltd.. The structured financing was through a combination of a term loan and Euroyen bond issue guaranteed by the Ministry of International Trade and Industry, Japan. Meanwhile, the large scheduled repayments of external loans (RM2.2 billion) in 1998 reflected largely the maturity of a Samurai bond of ¥30 billion (RM882 million) and a 100 million Swiss franc bond (RM274 million). Consequently, the external debt of the Federal Government rose by 15.2% to RM14.9 billion at the end of 1998.

State Governments

Preliminary estimates indicated a smaller current account surplus of RM4.3 billion in the consolidated financial position of the 13 state governments in 1998. The substantial decline in revenue collection was partially offset by a moderate contraction in budgetary operations. In tandem with the policy of fiscal prudence, all states achieved surpluses in

their current accounts. However, with most states recording deficits in their overall balance, the consolidated position reverted to a small deficit of RM169 million. This is the first deficit recorded after five consecutive years of surpluses. As Federal Government loans were more than sufficient to finance the overall deficit, there was a build-up of RM856 million in the accumulated financial assets of the state governments.

The contraction in economic activity and depressed prices of selected commodities affected the **revenue** of the state governments which fell sharply by 15.5% to RM8.4 billion in 1998. The decline in revenue was experienced by most state governments. Receipts from state sources declined, while contributions from Federal grants and transfers increased. The lower revenue collections from state sources was attributable mainly to lower receipts of both tax and non-tax revenue. The decline in revenue from direct taxes reflected lower receipts from forest taxes due to the sharp reduction in both saw log production and prices, following lower demand from both domestic and external markets. Nevertheless, it remained as the largest single source of state revenue, although its share fell to 16%. Similarly, the decline in indirect taxes was due to lower collection from export duties on timber, and import and excise duties on petroleum products. Non-tax revenue also declined, largely due to lower receipts from most major components, particularly from commercial undertakings and investment income. The larger receipts from Federal sources were channelled to assist the states in providing infrastructure and other essential amenities to improve the quality of life and to support the increasing urbanisation in the states.

The total expenditure of the state governments as a group declined by 6.2% attributable largely to the lower operating expenditure. In light of the lower revenue receipts, there was tighter control on non-essential expenditures and transfer payments. Hence, the **operating expenditure** of the state governments fell by 12.5% to RM4.1 billion (–6% in 1997). However, expenditure on emoluments was higher due mainly to the part payment of the 1997 bonus in 1998 as well as the financial assistance of RM400 each to civil servants. Similarly, gross **development expenditure** was marginally lower by 1.4% to RM4.9 billion as the state governments consolidated their position in line with reduced resources. Nevertheless, eight states provided for an increase

Table 2.12
Consolidated State Government Finance

	1997	1998*p*	1999 *Budget*
	RM million		
Revenue	9,968	8,421	7,725
State sources	*8,389*	*6,668*	*6,273*
Federal grants and transfers	*1,579*	*1,753*	*1,452*
Expenditure	4,715	4,123	4,665
Current surplus	**5,253**	**4,298**	**3,060**
Development expenditure	4,442	4,467	3,267
Gross development expenditure	*4,975*	*4,904*	*3,716*
Less Loan recoveries	*533*	*437*	*449*
Overall balance	**811**	**–169**	**–207**
Sources of financing			
Federal loans	816	1,025	666
Realisable assets [1]	–1,627	–856	–459
Total	**–811**	**169**	**207**

[1] An increase in the accumulated realisable assets is indicated by a minus (-) sign.
p Preliminary

Source: State governments

in their capital expenditure. The bulk of the expenditure was channelled to the economic sector, particularly for infrastructure (roads, bridges and public amenities), industrial and commercial investments and agriculture and rural development. The balance was expended on social programmes, including housing and social and community programmes. After taking into account a smaller loan recovery of RM437 million, net development expenditure rose marginally by 0.6% to RM4.5 billion.

Non-Financial Public Enterprises

Preliminary estimates of the consolidated position of the 28 non-financial public enterprises (NFPEs) indicated that the overall financial position of the NFPEs as a group reverted to a deficit of RM1.5 billion or 0.6% of GNP in 1998 after recording a large surplus of RM6.7 billion or 2.6% of GNP in 1997. The poorer outturn was attributed to the strong increase in operating expenditure, including debt servicing arising from the weak ringgit and higher capital spending, amidst more moderate revenue growth. The strong increase in capital expenditure reflected mainly large investments by

several major enterprises including PETRONAS and MISC, mainly in new projects, capacity expansion and modernisation programmes, as well as acquisition of companies related to their core businesses, and overseas investment. Nevertheless, given the economic uncertainties, several other NFPEs either scaled down or deferred projects in the pipeline.

The consolidated **revenue** of the NFPEs continued to expand, albeit at a slower pace of 11.8% to reach RM78.4 billion (1997: 21.3%). While the revenue collection was adversely affected by the contraction of economic activity and poor petroleum prices, it benefited from the sharply higher crude palm oil prices and gains from overseas operations in ringgit terms, as well as higher returns from investments, especially overseas ventures. Meanwhile, **operating expenditure** rose sharply by 28.8% to RM54.1 billion (1997: 13.5%). Higher spending reflected the increased cost of operations and supplies, including higher import costs due to the weak ringgit. Debt servicing was also substantially higher, following higher domestic interest rates, especially in the first half-year. External debt servicing also increased due to a weaker ringgit.

The operating surplus of the NFPEs as a group was maintained at a high level of RM24.3 billion or 9.3% of GNP (10.7% of GNP in 1997). The large operating surplus was contributed mainly by the larger NFPEs, notably PETRONAS, Telekom Malaysia Berhad (Telekom) and Tenaga Nasional Berhad (TNB). A small number of enterprises experienced further losses in 1998.

Table 2.13
Consolidated NFPEs Finance[1]

	1996	1997	1998*p*
	RM million		
Revenue	57,794	70,086	78,378
Expenditure	37,032	42,033	54,129
Current surplus	**20,762**	**28,053**	**24,249**
(% of GNP)	**8.7**	**10.7**	**9.3**
Development expenditure	15,512	21,341	25,777
Overall balance	**5,250**	**6,712**	**–1,528**
(% of GNP)	**2.2**	**2.6**	**–0.6**

[1] Refers to 28 NFPEs in 1996, 1997 and 1998.
p Preliminary

Source: Ministry of Finance and non-financial public enterprises

During the year, the **capital expenditure** of the NFPEs registered a strong growth of 20.8% to RM25.8 billion. Several major public enterprises continued to undertake capital investment, mainly on infrastructure and utility projects (transport, telecommunications and energy), as well as investment in the oil and gas and manufacturing sectors. The increase in expenditure also reflected the investment diversification of some NFPEs through the acquisition of companies related to their core businesses, including overseas ventures. In particular, higher capital spending was incurred by PETRONAS and MISC. However, several other NFPEs consolidated their position and deferred or scaled down development projects in line with available resources.

During the year, PETRONAS continued to invest in both upstream and downstream activities, including the construction of two new gas processing plants (GPP 5 and 6) and the central utility facility projects in Kertih and Gebeng. Other projects undertaken by the company included the development of several petrochemical projects jointly with multinational companies and the construction of the University Technology PETRONAS and the Kuantan-Kertih Railway project. PETRONAS also continued to expand its overseas investment during the year. This included the acquisition of a South African oil company, namely Engen Limited. Meanwhile, the capital investment of TNB was mainly for capacity expansion as well as to expand and upgrade the transmission and distribution networks to meet the increasing demand for electricity by the commercial and industrial sectors as well as residential consumers. Major projects underway included the construction of Phase I of the 500kw transmission network, Phase III of the Port Klang Sultan Salahuddin Abdul Aziz Power Station and the rehabilitation and conversion of power plants including the Melaka, Port Dickson, Prai and Pasir Gudang plants. TNB was also involved in the development of the electrification infrastructure for the XVI Commonwealth Games, 1998, and the development of a world-class electricity infrastructure for Putrajaya and Cyberjaya. Other projects included the construction of Phase II of the Tenaga Nasional University Complex. TNB also continued to invest in power projects abroad including in Pakistan and India. Similarly, Telekom continued with its expansion and modernisation programme to provide the nation with a sophisticated telecommunication infrastructure. A large portion of the expenditure was expended on developing a range of services and products for

the Corporate Information Superhighway (COINS), which would be an integral part of the Multimedia Super Corridor (MSC), and the National Information Infrastructure (NII). Telekom continued to diversify its investments overseas, including projects in South Africa, Malawi and the Republic of Guinea. In line with the policy to encourage the transportation of goods by Malaysian carriers, MISC continued its long-term fleet expansion programme to enhance its capacity to handle the growing volume of international trade. The construction of the new Kuala Lumpur International Airport was completed during the year. Meanwhile, further work was undertaken by Keretapi Tanah Melayu Berhad to modernise and enhance the quality and efficiency of rail services as an alternative commuter transport system.

With these large capital expenditures, the consolidated overall account of the NFPEs as a group reverted to a deficit of RM1.5 billion or 0.6% of GNP (+2.6% of GNP in 1997). This is the first deficit following three consecutive years of sizeable surpluses. The capital outlays were mainly financed by internally generated funds and increased domestic borrowing. Recourse to external borrowing was constrained by the ringgit depreciation. Hence, there was only a marginal increase in the outstanding external debt of the public enterprises to RM53.2 billion (representing 41% of the nation's external debt). The increase reflected a small net inflow of RM361 million as well as an exchange revaluation loss as a result of the appreciation of the Japanese yen against the ringgit. The external debt level of the NFPEs remained manageable as the capital investments currently being undertaken by the public enterprises were expected to generate additional revenue to service the debt, besides strengthening the NFPEs' financial performance. Nevertheless, in view of the large financing needs of the nation to revitalise the economy, investment activities and borrowings of the NFPEs need to be closely monitored.

Following the regional crisis, the privatisation policy was implemented on a more selective basis. New privatised projects were assessed more critically in terms of their macroeconomic impact, especially on the balance of payments, strong economic linkages and domestic multiplier effects. During the year, seven projects were privatised comprising three existing projects and four new projects, mainly involving infrastructure and construction. The projects included several highways such as the Ipoh-Lumut Highway and the East-coast Highway, and the construction of the hostel for Universiti Putra Malaysia. Meanwhile, several approved privatised projects, which were viewed to be less strategic, were deferred.

3 Outlook and Policy

International Environment

The overall performance of the industrial countries was sustained in 1998. Real output growth of the industrial economies as a group, comprising members of the Organisation for Economic Co-operation and Development (OECD) expanded further, albeit at a slower pace of 2.3% (1997: 3.1%) amidst an environment of subdued inflation (1.4%), improved fiscal balance positions and labour market conditions. Nevertheless, there was a distinct cyclical divergence in the economic performance among the major industrial countries. The slower overall growth reflected largely the economic downturn in Japan and moderate growth in the United Kingdom, which offset the higher growth emanating from the United States and continental Europe.

Table 3.1
Industrial Countries: Key Economic Indicators

	Average 1991-95	1996	1997	1998*e*	1999*f*
	Annual change (%)				
Real GDP					
Industrial Countries	**1.7**	**3.0**	**3.1**	**2.3**	**2.0**
United States	2.0	3.4	3.9	3.9	2.8
Japan	1.4	5.0	1.4	–2.9	–1.2
Germany	2.0	1.3	2.2	2.8	1.5
United Kingdom	1.6	2.6	3.5	2.5	0.9
Consumer Prices					
Industrial Countries	**3.1**	**2.3**	**2.0**	**1.4**	**1.4**
United States	3.1	2.9	2.3	1.6	1.8
Japan	1.4	0.1	1.7	0.7	0.0
Germany	3.4	1.5	1.8	1.0	1.0
United Kingdom[1]	3.9	2.9	2.8	2.6	2.5
	% of labour force				
Unemployment					
Industrial Countries	**7.7**	**7.7**	**7.4**	**7.0**	**7.1**
United States	6.6	5.4	4.9	4.5	4.8
Japan	2.6	3.3	3.4	4.2	4.5
Germany	8.2	10.4	11.5	10.9	10.7
United Kingdom	9.1	7.3	5.5	4.7	5.1
	US$ billion				
Current account					
Industrial Countries	**+8**	**–39**	**+66**	**–5**	**–54**
United States	–76	–135	–155	–231	–288
Japan	+111	+66	+94	+128	+139
Germany	–19	–14	–4	+3	+4
United Kingdom	–11	–3	+7	+3	–7

[1] Retail Price Index, excluding mortgage interest
e Estimate
f Forecast

Source: IMF World Economic Outlook, December 1998.
National sources.

In the United States, the economy reached its seventh year of expansion in 1998 with real GDP increasing at above potential. The stronger economic expansion emanated mainly from consumer spending and a strong build-up in inventories, induced by the wealth effects arising from the buoyant stock market. In addition, rising equity prices also sustained the buoyant housing sector and capital spending. In Germany, economic recovery continued to gain momentum in 1998, underpinned by strong domestic demand which took the lead from exports as the main impetus to growth during the year. Meanwhile, real output growth in the United Kingdom slackened after five years of sustained expansion at close to potential output. The slowdown reflected declining manufacturing output arising from deteriorating export growth, which was affected by the strong pound sterling and weak demand from East Asia. Domestic demand also moderated as a result of fiscal and monetary tightening since 1996. In Japan, the economic situation deteriorated significantly with output recording a sharp contraction in 1998. Factors underlying the sluggish performance included increased strains in the financial sector, weak consumer and business confidence and declining demand for exports from the crisis-affected Asian countries.

Real output in the developing countries as a group moderated significantly, reflecting largely the decline in output of the crisis East Asian economies and a marked slowdown in the Latin American region. Weak oil and non-fuel primary commodity prices as well as high interest rates caused growth to moderate significantly (See Box IV on "Developments in the Regional Countries").

Industrial Countries

In 1998, the industrial countries as a group had generally exhibited resilience to the East Asian

financial crisis. However, towards the end of the year it was evident that some major industrial economies were affected by continued financial turbulence following the debt default by Russia in August, the near collapse of a major hedge fund in the United States in September and to a lesser extent, the Brazilian financial crisis which began in the same month. Policy responses included monetary easing in the United States and the United Kingdom to deal with the deteriorating external environment. Prospects for the industrial countries, however, remain uncertain in 1999. Signs of weakening business confidence, slowdown in domestic demand and increased risk aversion among financial institutions have emerged. In 1999, real GDP growth in the industrial countries is, therefore, expected to moderate to 2%, amidst a slowdown in the United Kingdom, continued weakness in the Japanese economy and some loss of momentum in the European economic recovery. Meanwhile, the United States economy will remain strong, although growth is expected to moderate.

In the **United States**, real GDP growth is expected to be sustained at close to the potential level of 2.8% in 1999 (1998: 3.9%). Output growth in the first half-year is expected from continued buoyant consumer spending sustained by strong wealth effects from the stock market. The slower growth reflects an anticipated deterioration in net exports, largely due to lower growth in Latin America, which accounts for 20% of total United States' exports. Investment outlays would likely weaken in response to expectations of lower corporate earnings and declining capacity utilisation. On the downside, there are some concerns over the sustainability of growth in the United States. The economy remains vulnerable to key imbalances, including the low private savings, a possible correction in the stock market and the large external deficit.

Following a year of firm recovery, the **German economy** is expected to record a below trend growth of 1.5% in 1999 (1998: 2.8%), reflecting mainly weak export performance and lower business investment in the face of unfavourable external environment. The expected slower growth in global capital spending is also likely to affect the performance of the manufacturing sector. With weakening external conditions affecting export prospects, the impetus to growth is expected to emanate from domestic consumer demand. Structural unemployment continues to remain a concern that could dampen further consumer confidence. Fiscal policy has, therefore, been relaxed with increased public expenditure mainly targeted at improving labour market conditions.

After six consecutive years of above trend growth, economic activity in the **United Kingdom** is expected to moderate, with growth slowing to 0.9% in 1999 (1998: 2.5%). The slowdown would be felt most in the external sector, which has been affected by the prolonged currency appreciation. On the domestic front, manufacturing output is expected to slow down, while signs of weakness have emerged in the services sector, which accounts for two-thirds of total GDP. Despite the easing of interest rates in the fourth quarter of 1998 and early 1999 to counter the slowdown in domestic economic activity, the effects of the previous tight fiscal and monetary policies are expected to adversely affect consumption and investment in 1999. At the same time, the employment situation is expected to be affected in 1999.

Meanwhile, the **Japanese economy** is expected to remain weak with real output declining further by 1.2% in 1999 (1998: –2.9%). Overcapacity and financial constraints will continue to impinge on business investment, while consumer demand is expected to remain sluggish amidst high unemployment and mounting deflationary pressures. While export performance is expected to improve, the slower growth in the United States and Europe, which together account for close to half of Japan's total exports, could become a constraint on the pace of export growth. However, the impact of the stimulus packages announced by the authorities to boost domestic demand through public sector spending and reductions in corporate and personal income taxes would be felt in the latter part of 1999. At the same time, the programmes to deal with troubled financial institutions via new legislation are also expected to resolve the banking sector problems during the year. The ¥60 trillion (12% of GDP) banking restructuring plan was announced in October 1998, comprising facilities for bank nationalisation, bridge bank operations, rehabilitation of weak banks, public funds to recapitalise banks and depositor protection.

Considerable uncertainty remains about the world economic outlook for 1999. There are several downside risks that could affect both the financial markets and the real economy. A potential risk is that growth in the United States economy could be adversely affected if a major consolidation in the

stock market occurred. In view of the significant reliance of corporations on equity financing and the rising share of household assets in the form of equity, the negative wealth effects of a significant equity price correction would dampen consumption, which has been an important impetus to growth. A significant stock market correction would also have a destabilising impact on other equity markets worldwide. The outlook for the Japanese economy remains uncertain, being dependent on the implementation of the fiscal stimulus and reforms in the banking sector. A slow recovery in the Japanese economy would affect the recovery prospects in the regional economies, in view of their strong trade and investment links.

Although the impact of the Brazilian *real* devaluation on the global financial markets has so far been limited, intensification of the crisis could generate destabilising effects on the financial markets and spillovers to the rest of Latin America and other emerging economies. This could lead to a further loss of investor confidence and a retreat of private capital flows to emerging market economies. Deflationary pressures could intensify in the short-term amidst global overcapacity, weak commodity and oil prices and adjustment in asset prices. At the same time, excess capacity in the global goods markets may heighten the risks of protectionist measures in industrial countries with adverse implications on export growth of emerging market economies. The large external imbalances among the industrial countries stemming from uneven growth could give rise to destabilising movements in exchange rates among the major currencies. If these risks materialise, the slowdown in world growth could continue into the year 2000.

Amidst moderating economic activity, **inflation** in the industrial countries as a group is expected to stabilise at 1.4% in 1999 (1998: 1.4%). Continued weakness in primary commodity prices and intense competition from cheaper imports from Asia would contribute to lower prices. In the United States, inflation is likely to increase at a slightly higher rate of 1.8% (1998: 1.6%), due to wage pressures arising from continued tight labour conditions in the first half of 1999. In the United Kingdom, the core inflation rate is expected to meet the official target of 2.5%, consistent with expectations of lower average earnings and slower economic activity. Inflation in Germany is expected to remain stable at 1% in 1999. Meanwhile, inflation in Japan is expected to register zero growth in 1999 (1998: 0.7%), in the absence of demand pressures and a contraction in the economy.

Growth in the volume of **world trade** is expected to expand at a slightly higher rate of 3.9% in 1999 (1998: 3.4%), in line with the improving economic prospects in the East Asian crisis countries. The external deficit of the major industrial countries as a group is expected to widen to US$54 billion in 1999 (1998: –US$5 billion), reflecting mainly the higher deficit in the United States. The projected increase in the current account deficit of the United States (–US$288 billion; 1998: –US$231 billion) reflects mainly lower exports to Latin America and the sustained demand for imports. In contrast, Japan is expected to register a higher current account surplus of US$139 billion (1998: +US$128 billion), as demand for imports is likely to remain modest amidst weakness in domestic demand. Meanwhile, the current account balance of the United Kingdom is projected to revert to a deficit of US$7 billion (1998: +US$3 billion), on account of slower exports relative to imports, while Germany is expected to register a lower surplus in its current account amounting to US$4 billion (1998: +US$3 billion).

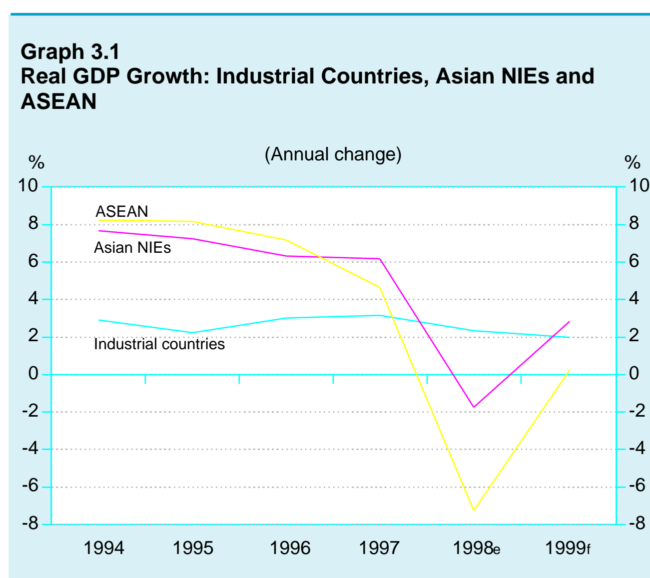
East Asian Economies

Several signs of an economic recovery suggest that the **outlook for East Asia would be more positive in 1999**. Signs of improvement include increasing stability and strength of the regional currencies, improved stock market performance and generally more favourable external positions. Exports are expected to benefit from a resumption in bank lending following the progress achieved in banking sector reforms, steps taken by the authorities to resolve problems in obtaining trade financing for exporters, as well as prospects of improvement in the global electronics industry. Indications are that industrial production has improved, particularly in Korea and Thailand. The international rating agencies have revised upwards the sovereign debt ratings for Korea and the Philippines to investment grade. These developments are likely to be positive on investor confidence leading to a resumption of private capital flows into the regional economies.

For 1999, **real GDP** in the **Asian Newly Industrialised Economies (NIEs)** is expected to revert to a positive growth of 2.8–2.9% (1998: –1.8%), reflecting the recovery in Hong Kong Special Administrative Region (SAR), The People's Republic of China; and Korea; and sustained economic performance in Taiwan, which would more than offset the moderation in output in Singapore. In **Korea**,

output is expected to improve significantly to record a growth of 3.2% in 1999 (1998: –5.4%), underpinned by fiscal expansion and easier monetary conditions including low interest rates. Hence, a revival in domestic demand is expected during the year, induced mainly by higher consumer spending, amidst an environment of improved confidence. Similarly, the **Hong Kong SAR** economy is expected to turn around to record real GDP growth of 0.5% (1998: –5.1%). The improvement is supported by a sustained growth in The People's Republic of China which accounts for 90% of Hong Kong SAR's re-exports, higher government spending, and better performance in the services industry, particularly in tourism.

Meanwhile, real GDP growth in **Taiwan** is expected to remain stable at 4.7% (1998: 4.8%), supported by expansionary fiscal initiatives including higher public sector expenditure on infrastructure and state projects as well as better export performance boosted by the projected recovery in demand for electronics. Nevertheless, consumer demand is expected to remain moderate in the face of weak stock market performance, as households account for a high proportion (90%) of the total stock exchange turnover in Taiwan. The **Singapore** economy is expected to experience the lagged impact of the East Asian financial crisis in 1999 as well as weaker exports as a result of loss of international competitiveness. Real GDP growth is projected to range between –1% and 1% (1998: 1.5%). In order to mitigate the effects of the crisis and to regain the economy's competitiveness, the authorities introduced a S$10.5 billion package in late 1998, aimed at reducing business costs and stimulating private investment.



Graph 3.1
Real GDP Growth: Industrial Countries, Asian NIEs and ASEAN

Real output growth in **The People's Republic of China** is expected to expand at a more moderate pace of 7% (1998: 7.8%), supported mainly by strong government spending on infrastructure projects. The fiscal stimulus is expected to more than offset the dampening effects arising from the accumulation of inventories of industrial and consumer products, rising unemployment and slower foreign direct investment inflows.

Growth prospects for the **Association of South East Asian Nations (ASEAN)** economies are expected to improve slightly, with a combined real GDP growth of between –0.8% and +0.9% (1998: –7.3%). The better outlook reflects mainly the turnaround in growth for Thailand and the Philippines, while the recovery in Indonesia remains hesitant. In **Thailand**, real GDP is expected to turn around to record a modest positive growth of 1% in 1999 (1998: –8%), underpinned by a fiscal deficit, easier monetary policy and better performance in the agriculture and export sectors. Output growth in the **Philippines** is also expected to improve to 2.5–3.2% in 1999 (1998: –0.5%), as the industrial sector regains its growth momentum following a resumption in bank lending activities. Other underlying factors contributing to the higher growth projection for the Philippines include better agriculture sector performance and export growth. For 1999, recovery in the **Indonesian economy** is expected to remain weak, with growth forecast to range between –4 and 0% (1998: –13.7%). The economy is expected to begin its recovery process in the latter part of 1999. Factors supporting the recovery are increased foreign and public investments and resumption of bank lending to the productive sectors.

Inflationary pressures are expected to recede in the regional economies, due mainly to a strengthening in the regional currencies and low commodity and energy prices. Inflation in the **Asian NIEs** as a group is expected to moderate to 1.5–1.6% in 1999 (1998: 4.4%), reflecting mainly lower consumer prices in Korea and Taiwan as well as deflation in both Singapore and Hong Kong SAR. In Korea, inflation is expected to ease to 3% (1998: 7.5%), due to a stronger Korean won, low commodity prices as well as stable rental rates and wages. Inflation in Taiwan is expected to remain subdued at 1.6% (1998: 1.7%), contained mainly by mild imported inflation. Deflationary pressures which emerged during the later part of 1998 in Singapore and Hong Kong SAR, are expected to continue into 1999 (–1.0~0% and –2% respectively; 1998: –0.3%

Box IV

Developments in the Regional Countries

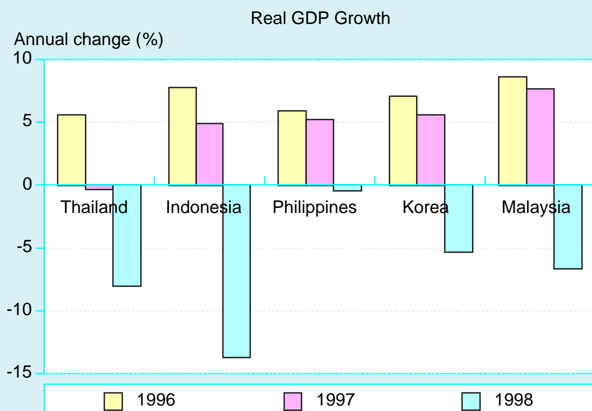
The impact of the East Asian crisis that began in July 1997 was more severe than anticipated and was unprecedented, in terms of depth, spread and duration. This was evident from the several downward revisions in growth forecasts in the regional countries in the course of 1998. The revisions reflected a larger-than-expected compression in domestic demand and the absence of an export-led recovery that was earlier envisaged to lift the economies out of the recession. As the crisis unfolded, the economic performance of the regional countries was severely affected by adjustments in both the real and financial sectors. Private consumption and investment fell sharply, reflecting cautious spending activity amidst deepening recession, rising unemployment, asset price deflation, increased corporate debt burden and narrowing corporate profits and reversals in capital flows. Export growth in the region was affected by the weak economic conditions in Japan, slowdown in the economies of the other major trading partners and trade financing problems in some regional countries. For the South-East Asian countries, namely Indonesia, Malaysia, the Philippines, Singapore and Thailand, Asia represents the largest export market, accounting for 50% of its combined exports.

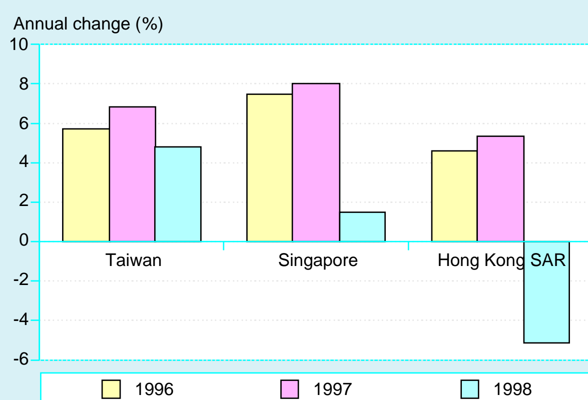
The several waves of instability in the financial markets in early 1998 and again in the wake of the Russian crisis in August-September had heightened investors' risk aversion to emerging markets as a whole. Net private capital outflows from the five countries most affected by the crisis, namely Indonesia, Korea, Malaysia, the Philippines and Thailand rose to US$28.3 billion in 1998 (1997: –US$1.1 billion), reflecting mainly the decline in net bank and non-bank lending. Meanwhile, foreign direct investment (FDI) which had been one of the main sources of growth during the pre-crisis period in these countries remained sluggish in 1998, amounting to US$8.5 billion (1997: US$3.6 billion, 1995-96: averaged US$17.8 billion).

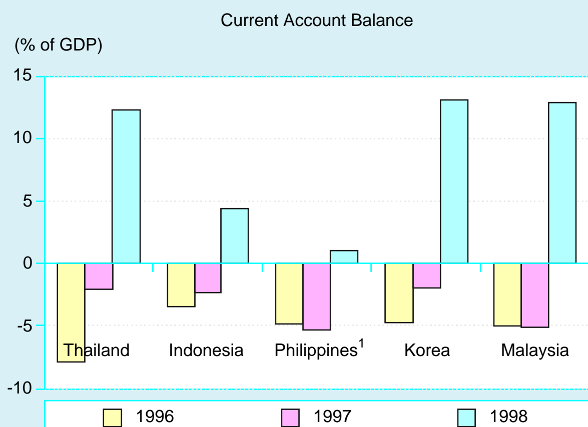
The impact of the crisis on the real sector was felt as early as in 1997, with Thailand posting a decline in **real output growth.** This was followed by a contraction in real GDP in several other economies in the first quarter of 1998, namely Indonesia, Korea and Hong Kong Special Administrative Region (SAR), The People's Republic of China. Growth declined in these countries amidst a contraction in domestic expenditure and increased unemployment arising from the ongoing restructuring in the banking, corporate and real sectors. Meanwhile, the Philippines slipped into a recession in the second quarter of 1998 due also to the weak agriculture performance which was affected by adverse weather conditions. The effects on Singapore were evident in the third quarter as the manufacturing sector was increasingly affected by the global electronics slowdown, as well as the negative impact from the regional downturn on commerce and financial service activities.

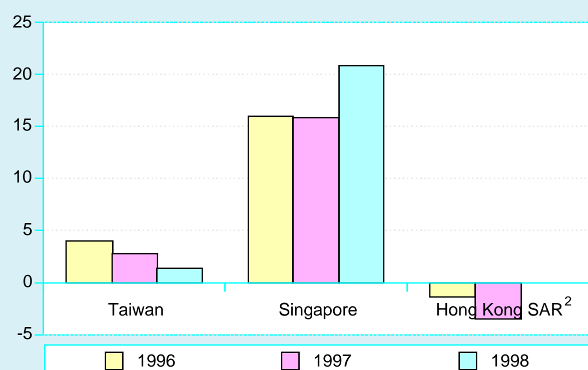
In 1998, the **Association of South-East Asian Nations (ASEAN)** economies as a group, including Singapore, registered a decline of 7.3% in real output (1997: +4.6%). In the ASEAN region, Indonesia recorded the largest output contraction of 13.7%, reflecting an across-the-board decline in economic activities. In Thailand, real GDP was estimated to have declined by 8% in 1998 as domestic demand contracted following economic restructuring and rising unemployment. In the case of the Philippines economy, real output contracted marginally by 0.5% in 1998, due mainly to the poor performance of the agriculture sector brought about by adverse weather conditions, and declines in the construction and manufacturing sectors arising from the high interest rates and volatile currency movement at the height of the currency crisis. Philippines' real GDP was supported by strong export growth in most months of 1998 following the robust demand for electronics and computer peripherals from the United States. Meanwhile, Singapore recorded an expansion in real output of 1.5% in 1998, arising from strong growth performance in the first half of 1998.

Graph IV.1
Regional Countries







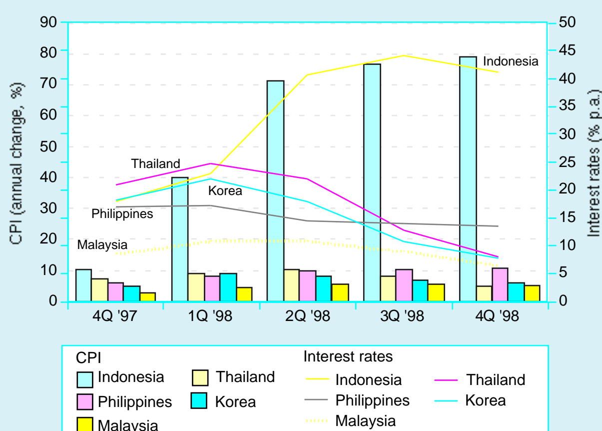


[1] Current account balance for 1998 is as % of GNP
[2] Current account balance refers to balance of goods and services. Figure for 1998 is not available

The **Asian Newly Industrialised Economies** (including Singapore) as a whole recorded a decline in real GDP of 1.8% in 1998 (1997: +6.1%), with contraction in the Hong Kong SAR and Korean economies. In Korea, real output is estimated to have declined by 5.4% due to sluggish consumer spending, significant cutback in investment and slower export growth. Similarly, in Hong Kong SAR, real GDP fell by 5.1% due to a significant downward adjustment in consumer spending in view of rising unemployment and negative wealth effects following a sharp decline in asset prices. In contrast, Taiwan which had initially shown resilience to the crisis registered a slower growth of 4.8% in 1998, weakened by worse-than-expected export performance. In **The People's Republic of China,** real output growth moderated to 7.8% (1997: 8.8%), reflecting a stronger pick-up in economic activity in the second half of 1998, supported mainly by public investment projects.

On the **inflation front,** the regional economies recorded mixed price trends in 1998. Inflationary pressures emerged in countries that had experienced significant currency depreciation arising from the pass-through effect on their domestic economy, with the highest inflation in Indonesia (78%), followed by the Philippines, Thailand and Korea at around 7-10% (1997: 4-6%). The sharp increase in consumer prices in Indonesia reflected higher import costs and supply shocks. In Thailand, inflation was more moderate than was forecast earlier. This was due to the fall in aggregate demand, the appreciation of the baht during the second half of 1998 and declining world commodity prices. Inflation in the Philippines was partly fuelled by food shortages arising from the disruption in crop production, while inflation in Korea was due mainly to the depreciation of the won. Nevertheless, offsetting factors that had helped to restrain price pressures to some extent in both the Philippines and Korea were weak aggregate demand, high interest rates and low prices of imported raw materials and oil products during the year. Meanwhile, there were signs of deflation in The People's Republic of China (1998: –2.6%), Singapore (1998: –0.3%) and in the last quarter of 1998 in Hong Kong SAR (1998: +2.6%). Factors contributing to deflationary trends in the latter two countries included cautious consumer sentiment amidst

Graph IV.2
Inflation and Interest Rates of Crisis Countries



rising unemployment and negative wealth effects from a sharp fall in asset prices. In The People's Republic of China, despite the authorities instituting price support for several basic items and higher food prices due to crop destruction in the floods, retail prices remained negative throughout the year, reflecting an oversupply of inventory. In Taiwan, inflation rose to 1.7% (1997: 0.9%) on account of imported inflation and higher farm prices.

As in any recession, **unemployment** posed a major problem in the crisis countries arising from the financial restructuring process and adjustment in the real sector. During the course of the crisis, an increased number of companies resorted to retrenchments to reduce costs amidst falling profits. The unemployment rate more than doubled in Thailand (4%) and Korea (6.8%), while in Indonesia, unemployment increased to 14.5% of the total labour force in 1998. In Singapore and Hong Kong SAR, unemployment reached record highs of 3-5%. The decline in real wages and reduced job prospects also indicated signs of an easing labour market situation in the regional countries.

On the **external front,** a significant feature was the speed and magnitude of adjustment in the current account balance in most of the crisis countries. Despite the weak export performance, the current accounts of these countries strengthened during the year due mainly to the sharp contraction in imports. Countries that had recorded current account deficits prior to the crisis, namely Indonesia, Korea, the Philippines and Thailand turned around to record surpluses in 1998. In particular, Korea and Thailand registered current account surpluses of more than 10% of GDP. The improvement in the current account positions in Indonesia, Korea, Singapore and Thailand mainly reflected the contraction in imports of 22-36% (in United States dollar terms), which had more than offset the decline in exports of 2-12%. In the case of the Philippines, the improvement in the current account was not only due to the decline in imports of 19%, but also to the sustained growth in exports at 17%, benefiting mainly from the robust external demand for electronics. Despite weaker imports in The People's Republic of China and Taiwan, the current account surplus narrowed slightly in 1998, due to the slowdown in regional demand for their products.

In the **financial sector,** corporate insolvency and rising debt defaults among local corporations as the crisis intensified eventually affected the financial institutions, especially those with large exposure to the property and stock markets. The asset quality of the banking system began to deteriorate following the sharp falls in asset

Table IV.I: Financial Indicators of Crisis Countries in 1997 and 1998

	End-Period	Thailand	Indonesia	Korea	Philippines	Malaysia
Non-performing loans (% of total loans)	1997	19.8	8.2	2.7	5.4	4.7[2]
	1998	45.9	63.3	10.5	11.0	13.2[2]
External debt (US$bn)	1997	93.4	136.1	158.1	45.4	43.8
	1998	86.2	143.0[1]	151.5	46.4	42.0

[1] Figure as at November 1998
[2] Refers to NPL classification of 3 months
Source: National authorities

prices and high interest rates, thus resulting in higher non-performing loans (NPLs) and provisioning requirements. In 1998, the NPLs of the banking system rose in Thailand and Indonesia to 46-63%, and by a lesser extent, in Korea and the Philippines to around 11%. On external debt, Korea and Thailand had succeeded in reducing their total outstanding external liabilities in 1998. Although the total amount of indebtedness only declined slightly in the two countries, the maturity composition of their debt improved significantly. As at end-1998, Korea and Thailand's short-term debt with maturity of less than one year declined to 21.4% and 27.3% of total debt respectively (1997: 40% and 37.3% respectively). In this regard, Korea rescheduled about US$22 billion of its short-term debt to medium and long-term. Meanwhile, the outstanding external debt for Indonesia increased slightly in 1998, but about US$4.2 billion of its external official debt had been restructured.

During the year, there was a discernible shift in macroeconomic policy in the regional countries. The initial response of the countries under the International Monetary Fund (IMF) programme, namely Indonesia, Korea and Thailand was to adopt a tight **monetary stance** by raising interest rates to curb speculative pressure on their currencies, restore investor confidence and contain inflation. Monetary tightening was also evident in other regional countries. Average short-term interest rates increased to 44% in Indonesia (pre-crisis: 11%), above 20% in Thailand and Korea, and 18% in the Philippines. Authorities were faced with a policy dilemma on high interest rates due to the trade-off between growth and stability in exchange rates. The tight monetary stance had, however, not brought about the desired effect of stabilising the currencies. On the contrary, during the course of the year, it became increasingly apparent that high interest rates for an extended period had severe ramifications on the economy with its further destabilising effects on the currency. The higher cost of funds and the consequent uncertainty caused a sharp contraction in aggregate demand. Given the depreciation in the currencies and prevailing high interest rates, corporations had to deal with declining returns and increased debt service and business costs. As an increased number of companies became insolvent, this affected the asset quality of the banking system. The banks responded by curtailing lending and creating a credit crunch situation, which in turn, adversely affected economic activity in these countries. When inflationary pressures subsided and currencies stabilised, monetary policy in the region became more accommodative. Interest rates were adjusted downwards in Thailand and Korea since February-March 1998, followed by Hong Kong SAR, Singapore, Taiwan and the Philippines towards mid-1998. In contrast, in Indonesia, high interest rates were maintained for a large part of the year in view of the high inflation and significant depreciation of the rupiah. The recovery of the yen and interest rate cuts in the industrial countries in the fourth quarter of 1998 allowed room for further cuts in short-term rates in the region, thus paving the way for more growth-oriented policies.

Similarly, **tight fiscal policies** were adopted by the regional countries until mid-1998 in order to restore market confidence, to facilitate non-inflationary financing for restructuring the banking sector and to deal with the weakening in fiscal positions arising from the depreciation of the currencies and lower revenue. In the first half of 1998, however, as the severity of the contraction became apparent and given that the export sector was not as robust as had been expected, fiscal policies were relaxed and more expansionary measures were introduced to revive domestic demand. Fiscal policies in the IMF programme countries and the other regional economies became more expansionary, with provisions for increased spending. Thus, the fiscal deficits in the crisis countries were increased to between 2 and 6% of GDP in 1998. The public expenditure measures included increased infrastructure spending, setting up of funds to support small- and medium-sized enterprises, trade financing and tax rebates for exporters, as well as provision of social expenditures for the more vulnerable segments of the society. On the revenue side, taxes were reduced to stimulate demand. In Singapore and Hong Kong SAR, tax measures were also introduced to support the property market.

During the year, **structural adjustments,** namely banking sector consolidation and recapitalisation; resolution of NPLs, strengthening prudential regulation and supervision; and corporate restructuring and corporate governance

gained momentum in the crisis countries. In **Korea,** priority was given to financial sector reforms. In order to facilitate the financial restructuring, the Financial Supervisory Commission (FSC) was established and fifteen financial reform bills were legislated. During the year, five non-viable commercial banks were taken over by healthy banks. The remaining banks were required to submit voluntary rehabilitation plans with sufficient infusions of new capital to improve their soundness, failing which they had to be either nationalised temporarily, merged or closed. Subsequently, three large commercial banks were temporarily nationalised, of which two were merged into one clean bank, and the other was sold to a foreign consortium at end-1998. As of end-September 1998, 94 financial institutions had been suspended or closed. By end-year, the Korean Government had injected about 41 trillion won (US$30 billion) of public funds for financial restructuring. Meanwhile, the Korea Asset Management Corporation had purchased total NPLs from the financial system worth 44 trillion won (US$32.3 billion), and had sold 748.6 billion won (US$0.5 billion) at the disposal price of 30.3%. Meanwhile, the Korea Deposit Insurance Corporation provided fiscal support of 21 trillion won (US$15.4 billion) for the recapitalisation and depositor protection.

On corporate restructuring, the Korean Government expedited efforts in the fourth quarter of 1998 after the completion of the first phase of the financial restructuring. Corporate restructuring in Korea is significant given the importance of large family-based conglomerates (chaebols) in terms of market share and economic influence. Efforts were directed towards improving the capital structure and corporate governance, with creditor banks having an important role. Meanwhile, legal procedures involving corporate rehabilitation and bankruptcy filing were amended in early 1998 to facilitate the exit of non-viable firms. Creditor banks classified 55 corporations as non-viable and were denied further funding. By October 1998, more than 200 financial institutions had signed the "Corporate Restructuring Agreement" to carry out corporate workouts with the top 6-64 chaebols. Meanwhile, the restructuring of the five largest chaebols included improvement in capital structure as well as business restructuring. A framework for mergers and business swaps, referred to as "big deals" was established to enable these corporations to focus on the core competencies, create management efficiencies and reduce over-capacity and overlapping investments. The top five chaebols agreed to shed unprofitable businesses and concentrate on core industries, thus reducing the number of subsidiaries from 264 to 130 and the debt-equity ratio to less than 200% by end-1999 (1997: 476%). The government also amended labour-related legislation to enable companies to lay off excess workers and introduce flexible working hours.

In **Thailand,** priority was also given to financial sector restructuring. Following the closure of 56 insolvent finance companies in 1997, the assets of the companies worth 860 billion baht (US$21.2 billion) were transferred to the Financial Sector Restructuring Authority (FRA). By end-1998, the FRA had recovered about 105.5 billion baht (US$2.6 billion) or 56% of the nominal value of the assets of the failed finance companies that had already been sold in the auctions. During the year, the Bank of Thailand announced plans to privatise three of the banks it had intervened, merged 18 financial institutions, transferred good assets of one intervened bank to a public bank and bad assets of another intervened bank to a non-bank financial institution called the privately-owned Asset Management Company (AMC). The private AMC was entrusted with the task of managing low quality assets of financial institutions. Meanwhile, the Financial Restructuring Advisory Committee (FRAC) was established to facilitate Tier-1 and Tier-2 capital support schemes and other aspects of financial sector restructuring. About 300 billion baht (US$7.4 billion) of public funds in the form of government bonds were made available to support the recapitalisation of viable financial institutions and to accelerate corporate debt restructuring and encourage new lending. In order to restructure the corporate sector, the Corporate Debt Restructuring Advisory Committee (CDRAC) was formed in August 1998. By December, the CDRAC had accepted about 200 cases of complicated multicreditor-type of debt restructuring, involving 351 companies with debt and overdue obligations amounting to 678 billion baht (US$16.4 billion). As of December 1998, nine cases had been successfully restructured. Concurrently, creditor financial institutions were also negotiating with debtor corporations on

simpler debt cases. By end-December 1998, 9,015 cases of debt restructuring totalling 157 billion baht (US$3.8 billion) were completed by the financial institutions.

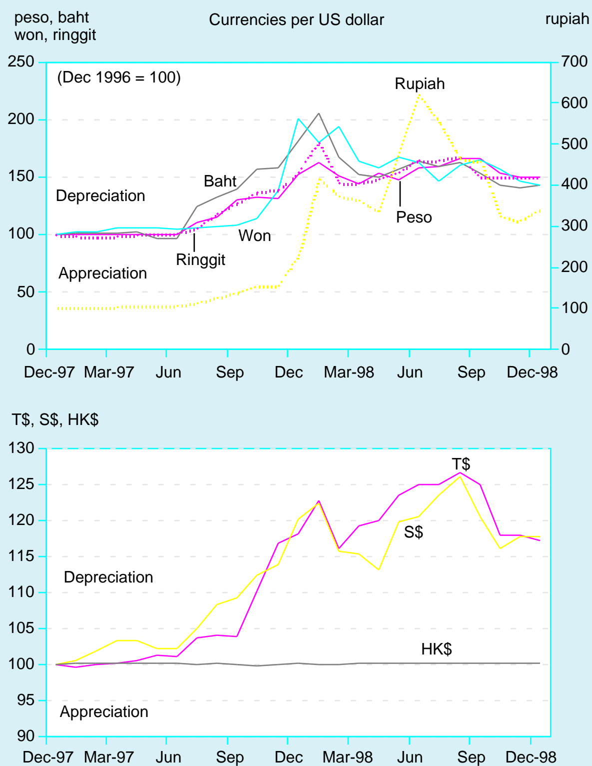
In **Indonesia,** efforts were directed towards reducing structural impediments and market inefficiencies through removal of public subsidies and liberalisation of monopolies and foreign trade. The financial restructuring was undertaken via the establishment of the Indonesia Bank Restructuring Agency (IBRA) to rehabilitate the ailing banks and manage the non-performing assets of intervened banks. After the closure of 16 banks in 1997, Bank Indonesia guaranteed depositors and creditors of all domestic banks to boost confidence in the banking system. In 1998, the government placed seven banks under IBRA's management, froze the operations of ten banks and declared four private banks as insolvent. In December 1998, the authorities conducted due diligence on 150 banks, out of which 40 banks had failed to meet the capital adequacy ratio (CAR) of –25% and were given one month to recapitalise, failing which the bank would be closed or merged, while state banks that had not met the CAR would be recapitalised. In January 1999, a decree was passed allowing the government to provide 80% of the funds needed to raise the capital levels of 56 banks to 4% if these banks could meet certain requirements. On corporate sector restructuring, emphasis was placed on the resolution of private sector debt as it accounted for 58% of Indonesia's total external debt. The first agreement called the Frankfurt Accord created the Indonesian Debt Restructuring Agency (INDRA) to provide an exchange rate guarantee and act as an intermediary between domestic debtors and external creditors in the servicing of renegotiated external debt. The INDRA scheme was later complemented by the Jakarta Initiative, comprising a set of non-binding guidelines for debt workouts with domestic and foreign creditors. As of February 1999, it was reported that more than 128 companies had registered with the Jakarta Initiative, involving foreign debts worth US$18 billion. In early 1999, several conglomerates had also agreed with their main creditors to repay or swap their debt for equity.

Besides the IMF programme countries, the Philippines and Singapore also tightened prudential guidelines in the banking sector. In the **Philippines,** the authorities stepped up the implementation of banking sector reforms during the year to strengthen the banking system. Towards this end, the central bank introduced several prudential measures, including an increase in the minimum capital requirements of banks; the imposition of a 2% general loan loss provisions (to be complied with by all banks by 1 October 1999) in addition to specific loan loss provisions; and the imposition of a 20% ceiling for real estate loans. The central bank also imposed higher disclosure requirements and tighter requirements for granting bank licences, including the approval of new foreign banks.

In **Singapore,** the Monetary Authority of Singapore (MAS) implemented a series of reforms to further develop Singapore as a financial centre. The reforms covered treasury and fund management; equity markets; general debt issuance; corporate finance and venture capital; insurance and re-insurance; and cross-border electronic banking. In April 1998, the MAS created the Financial Sector Promotion Department to promote new financial activities, develop information technology (IT) infrastructure, manpower resources and new incentives for the financial sector. In the banking sector, prudential regulations were strengthened further and greater foreign competition was allowed. In the insurance industry, efforts were made to create niches in captive insurance, reinsurance and marine insurance. Measures to develop Singapore's stock exchange included the deregulation of commission rates, widening of the product range and opening up to more foreign stockbroker participation. Measures were also taken to develop the bond market which included allowing foreign entities to issue Singapore dollar-denominated bonds in Singapore. During the year, Singapore also announced several measures to improve its competitiveness by reducing the overall cost of doing business in Singapore.

In the closing months of 1998, the crisis countries began to show signs of improvement, with the appreciation and increased stability in their currencies and upturn in the stock markets. Most regional currencies appreciated against the United States dollar, above levels recorded at end-1997. The Korean won and the Thai baht in particular had gained around 27-41% of their

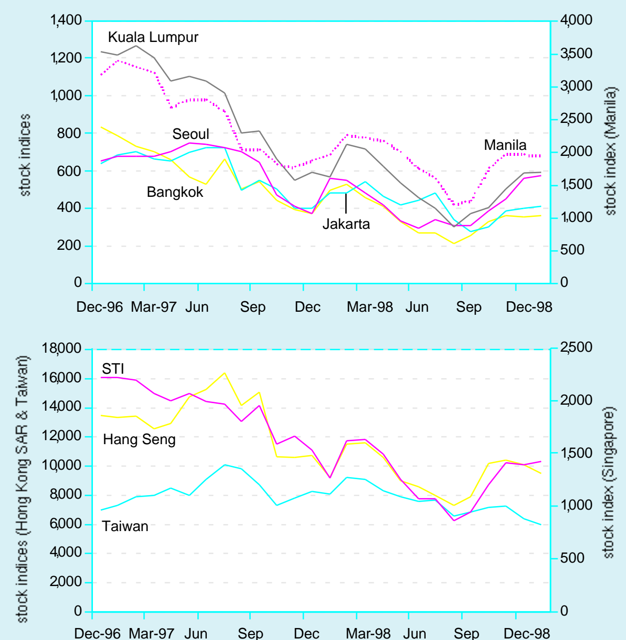
Graph IV.3
Exchange Rate Movements in the Regional Countries



value. At end-1998, the stock indices in the Philippines, Singapore, Thailand and Korea had risen by 63-81% from the lows at the end of August, while in Indonesia, the stock index had recovered by 44% against end-September 1998 level. Among the regional countries, the stock indices in Korea and the Philippines were higher at end-1998 compared with the levels at end-1997. Following the spread of the crisis and the turmoil in the global financial markets to other continents, investors appeared to have reassessed and repriced their risks of the East Asian region as being a relatively more attractive market. Nevertheless, it is too early to conclude that FDI and portfolio flows have returned to the region. Much of the inflows to date reflected essentially foreign loans and multilateral support as well as equity purchases associated with the restructuring of the corporate and banking sectors.

Although investor sentiment remains cautious, other encouraging developments have paved the way for more supportive domestic policies. Interest rates have declined across the region, especially in Hong Kong SAR, Korea, Singapore, Taiwan and Thailand, where rates have declined to pre-crisis levels. Inflationary pressures have also shown signs of receding in the crisis countries and industrial production has improved, notably in Korea, Thailand and the Philippines. The improvements in the real sector appear to indicate early signs of bottoming in several of the regional countries. The renewed optimism in the region was also reflected by the upward revision in the sovereign rating of selected regional countries, namely Korea and the Philippines in January 1999, the first upgrade in the region since the onset of the crisis. In addition, The People's Republic of China and the Philippines have successfully launched sovereign bonds worth US$1 billion and US$1.2 billion respectively in early 1999. At the same time, private and state companies in Korea, Singapore and Thailand have also recently issued bonds in the global market. At this stage, it may be premature to pre-empt a recovery based on these positive advances given that the affected countries are still subject to external uncertainties. Nevertheless, barring any major risks, the recent favourable developments in the real sector and increased financial stability would provide the foundation for a sustainable recovery in the region.

Graph IV.4
Stock Market Performance of the Regional Countries



and 2.6%). Despite the anticipated improved output performance in Hong Kong SAR, the downward price pressure is attributable mainly to continued cautious consumer spending due to weak labour market conditions, wage cuts and a fall in property and asset prices. In Singapore, the introduction of cost-cutting measures, including the reduction in utility, communications and land transport charges, are expected to contain price pressures in the economy. Following a year of deflation, retail prices in The People's Republic of China are expected to increase by 2% (1998: –2.6%), due to higher food prices following reforms in the grain distribution system and adverse weather conditions which are expected to affect crop yields. In addition, higher expenditure on household furnishing items, following reforms initiated by the authorities to abolish welfare housing and encourage residential construction, are also expected to contribute to rising price pressures and to offset the effects of weak consumer demand and inventory overhang. Similarly, the consumer price index, which is a broader measure of inflation in The People's Republic of China, is expected to increase by 4% in 1999 (1998: +0.4%).

In the **ASEAN** countries as a group, inflation is expected to moderate significantly to 7.1–9.3% in 1999 (1998: 34.2%), reflecting a strengthening in the ASEAN currencies and stable food and farm prices following better performance in the agriculture sector, particularly in Thailand, Indonesia and the Philippines. In Thailand and Indonesia, inflation is expected to moderate significantly to the region of 3% and 12–17% respectively in 1999 (1998: 8.1% and 77.6% respectively). The continuation of subsidies on essential products such as gasoline, kerosene and diesel fuel would also mitigate price pressures in Indonesia. In the Philippines, inflation is expected to ease slightly to 8–9% in 1999 (1998: 9.7%).

On the **external front**, except for Taiwan, current account surpluses in the regional economies are expected to narrow, largely due to a pick-up in imports in tandem with the recovery in domestic economic activity. Export performance of Korea, Thailand and the Philippines are expected to improve in 1999 due to higher exports of agriculture and high-technology products such as semiconductors and telecommunications products. Taiwan's current account position is expected to improve further in 1999, due mainly to an improvement in the trade account reflecting a recovery in demand from the Asian economies, which accounts for about 40% of Taiwan's total exports. Taiwan's export growth is expected to increase by 2% (1998: –9.3%), attributable to rising orders for semiconductors as well as information and telecommunications products. In The People's Republic of China, the current account balance is expected to remain in surplus, albeit at a lower level than in 1998, reflecting greater competition from the regional countries.

There are, however, a number of **downside risks** that could affect the recovery prospects of the regional economies. In particular, real output growth in the East Asian countries could be slower than projected in the event of a weak export recovery, arising from slower economic activity in the United States, a loss of momentum in the European recovery and continued weakness in the Japanese economy. Other downside risks include a further deterioration in global financial conditions, the deceleration of equity and other private capital flows to the region and a less-favourable-than-expected outlook for the global electronics industry. Rising unemployment and a deterioration in labour market conditions with the attendant adverse social and economic implications could also dampen the prospects for economic recovery.

Nevertheless, following the encouraging progress on financial sector reforms and corporate restructuring, the restoration of financial stability in the regional countries is expected to support the economic recovery process. The stable and more favourable financial market conditions would continue to allow the authorities to pursue accommodative macroeconomic policies including fiscal expansion and lowering of interest rates to revive domestic demand. The emergence of stronger and healthier banks following the restructuring exercises would enhance the intermediation process of financial institutions in supporting economic activity. At the same time, the stability of the financial markets in the region would encourage the resumption of private capital inflow to the region to complement multilateral and bilateral financing initiatives. Barring any major risks, the recent favourable developments in the real sector and increased financial stability would provide the foundation for a sustainable recovery in the region.

Interest Rates and Exchange Rates

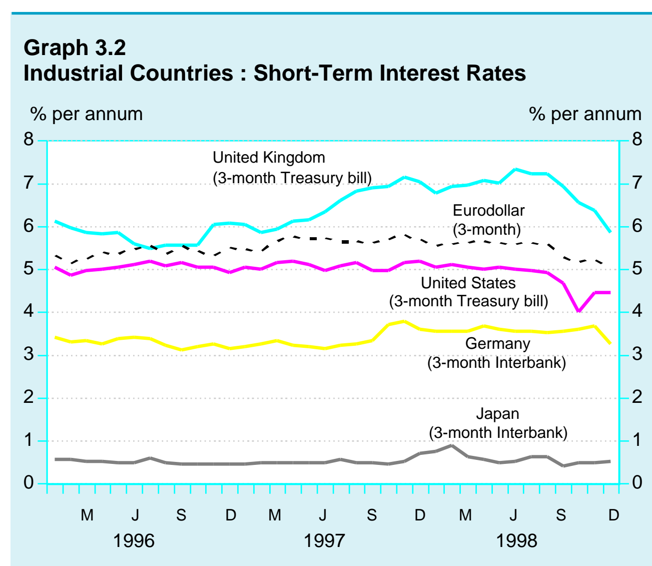
Monetary policy in the major industrial countries was biased towards easing in the second half of 1998 after the Russian debt default and the near-collapse of a major hedge fund in the United States

in September. These moves have contributed to preventing significant dislocations in the global financial markets that could precipitate a slowdown in the growth of the industrial countries. Both the United States' Federal Reserve Board and the Bank of England reduced their key interest rates thrice successively, while the euro-11 central banks jointly reduced their interest rates in early December. In the first two months of 1999, monetary policy remained unchanged in the United States and the euro area, while the Bank of England reduced its base lending rate twice, by a total of 75 basis points to 5.50%. The aggressive monetary easing in the United Kingdom was in response to increasing evidence of slowdown in the economy amidst moderating inflationary pressures. Meanwhile, the Bank of Japan reduced its overnight rate from 0.25% to 0.15% on 12 February 1999 and subsequently, to 0.02% in early March. The move was aimed at preventing the economy from falling into a deflationary spiral.

During the course of 1999, monetary policy in the major industrial countries is expected to be mainly influenced by domestic considerations which include prospects on growth, inflation, as well as performance in the financial markets. In the United States, the Federal Reserve Board is likely to maintain a neutral stance in the conduct of monetary policy in the short term, against a background of subdued inflation and the unexpected strength in the domestic economy.

In Japan, monetary policy is expected to continue to be expansionary to complement the fiscal stimulus to revive the economy. Following the introduction of the euro on 1 January 1999, the European Central Bank (ECB) has assumed the responsibility for the conduct of monetary policy for the euro-11 countries. As the core countries such as Germany, France and Italy show increasing evidence of slowdown, this would increase the possibility of more accommodative policies. Similarly, in the United Kingdom, after the aggressive interest rate cuts of two percentage points since the fourth quarter of 1998, it is expected that the accommodative policy would be maintained to prevent a sharp slowdown in the economy.

Graph 3.2
Industrial Countries : Short-Term Interest Rates



In the **foreign exchange** markets, the United States dollar strengthened against all the major currencies in the first two months of 1999. The dollar appreciated by 4.8% against the Japanese yen and 3.2% against the pound sterling compared with levels at the end of 1998, and 6.1% against the euro compared with the debut rate. However, in early January, the yen appreciated strongly against the dollar by 35% to a 28-month high of US$1=¥108.74 on 11 January 1999 from the low of US$1=¥147.27 on 11 August 1998. Consequently, on 12 January 1999, the Bank of Japan intervened in the foreign exchange market to contain an overadjustment. Thereafter, the yen continued to remain relatively strong, trading in the range of US$1=¥110–116, largely influenced by technical factors, such as unwinding of dollar positions, the repatriation of profits by Japanese corporations for the financial year ending in March 1999 and rising long-term interest rates. However, with the easing in interest rates to near zero on 17 February, the yen weakened to close at US$1=¥121.50 on 24 February. The yen closed at US$1=¥117.70 on 15 March.

Against the euro, the dollar strengthened to EUR1=US$1.1025 on 26 February after its initial debut at EUR1=US$1.1747 on 4 January 1999. The weakness of the euro, which fell to an intra-day low of EUR1=US$1.0969 on 22 February, is likely to be temporary. The euro was affected by the expected interest rate cut by the ECB in the first quarter of 1999 following the release of weak economic data from the core countries, namely Germany, France and Italy. Nevertheless, market expectations are for euro to strengthen against the dollar in the latter part of 1999 due to the expected increase in the demand for euro arising from the gradual portfolio diversification into euro by global financial institutions and central banks. The sentiment on the euro is also expected to be underpinned by the large trade surplus in the euro-11 zone compared with the significant trade deficit in the United States.

Box V

Euro 1999: Implications for the Malaysian Economy

Introduction

The launch of the euro on 1 January 1999 represented an important milestone in the evolution of the international monetary system. At the regional level, the euro marked the culmination of a long process of European economic and financial integration, which began with the Treaty of Rome in 1957. On the global scene, the euro is envisaged to change the manner in which world trade, investment and financial transactions would be conducted in the future. Indeed, the euro heralds the advent of a new tri-polar world currency system, with the United States dollar and Japanese yen constituting the other two major world currencies. The implications of the euro would be far-reaching for the global economy, particularly in the case of small, open, trade-oriented economies such as Malaysia. This article provides a brief overview of aspects of the euro and highlights some of the likely implications for the Malaysian economy.

The Euro

The euro made its debut on 4 January 1999, when it was quoted at Euro 1 = US$1.1747 from the official fixing level of Euro 1 = US$1.16695. In the process, the currencies of 11 European states were irrevocably locked against the euro, signalling the coming into effect of the European Economic and Monetary Union, EMU (Table V.I). Of the 15 members of the European Union (EU) which were signatories to the Maastricht Treaty in 1991, 11 countries fulfilled the “convergence criteria” for participation in the initial phase of the EMU and euro. Britain, Denmark and Sweden had opted to be out of the EMU. The five convergence criteria were:

- Fiscal deficit of not more than 3% of GDP;
- Government debt of not more than 60% of GDP;
- Inflation within 1.5 percentage points of the 12-month average of the three best performing members;
- Long-term interest rates (10-year benchmark bond yields) within 2 percentage points above the 12-month average of the three best performing members in terms of inflation; and
- Exchange rates within the fluctuation margins provided by the European Monetary System’s Exchange Rate Mechanism (ERM) for at least two years.

During the transition period from 1 January 1999 until end-2001, government debt in the 11 countries would be re-denominated into euro. Non-cash transactions such as bank accounts, bank transfers, mortgages, credit card payments, traveller’s cheques and personal cheques can be conducted in euros with immediate effect. In the transition period from 1 January 1999 to

Table V.I
Conversion Rates of the Euro-11 National Currencies

Country	Conversion per euro[1]		Exchange rate per RM[2] (1 Euro=RM4.4639)	
Austria	13.7603	schillings	3.0826	schillings
Belgium	40.3399	francs	9.0370	francs
Finland	5.94573	markkaa	1.3320	markkaa
France	6.55957	francs	1.4695	francs
Germany	1.95583	marks	0.4381	marks
Ireland	0.787564	punt	0.1764	punt
Italy	1,936.27	lire	433.77	lire
Luxembourg	40.3399	francs	9.0370	francs
Netherlands	2.20371	guilders	0.4937	guilders
Portugal	200.482	escudos	44.91	escudos
Spain	166.386	pesetas	37.27	pesetas

[1] On 31 December 1998, the currencies of the 11 euro members were fixed irrevocably against the euro during the transitional period of 1999-2001.
[2] Exchange rates of euro-11 national currencies against the Malaysian ringgit on 4 January 1999.

Source: European Central Bank

31 December 2001, the rule of "no compulsion, no prohibition" applies and national currencies continue to exist while euro will be used in all electronic transactions. By 30 June 2002, euro notes and coins will replace the national notes and coins in the euro-11 zone. The European Central Bank (ECB) was established in June 1998 to assume responsibility for monetary policy in the euro-11 zone. The ECB is the sole issuer of the euro. Its main objective is to maintain price stability. It will, however, not function as a "lender of last resort" and is prohibited from supporting any EMU country through debt purchases.

Impact of Euro on World Economy

As a global currency, the euro will be a viable alternative to the United States dollar as the world's premier financial asset. The euro represents the euro-11 economies, with a combined GDP of US$6.3 trillion of the euro-11 countries (United States GDP: US$8.1 trillion) while euro-11's share of international trade is 19% (United States: 18%). The euro would also be backed by the world's largest pool of external reserves. The combined foreign exchange reserves (excluding gold) of the euro-11 countries amount to US$266 billion, while the reserves of the United States is US$84 billion, Japan (US$203 billion) and The People's Republic of China (US$145 billion). The impact of the euro on the world economy is expected to be significant. The euro would be expected to play an increasingly important role in the international monetary system as a reserve currency as well as a currency of settlement for international trade and investment.

Table V.2
Key Economic and Financial Indicators of Major Industrial Countries

	Euro-11	United States	Japan
Population (in million)	290	268	126
1997			
GDP level (in US$ trillion)	6.3	8.1	4.2
GDP growth (%)	2.5	3.9	1.4
Fiscal balance (as % of GDP)	–2.5*	0.2	–3.5
Current account (in US$ billion)	112	–155	94
1998			
Inflation (%)	1.3	1.6	0.7
Unemployment (%)	11.6	4.5	4.2
Interest rate at end-year (%)	3.0	4.75	0.25
Financial data			
Share in world bond index (%)	33	34	18
Share in world foreign exchange reserves (%)	21	64	8
Share in world exports (%)	34	48	5
Total financial assets (in US$ trillion)	21	23	16
Bank assets (in US$ trillion)	12	5	7

* Refers to General Government Financial Balance.

Source: IMF, World Economic Outlook, December 1998
OECD Economic Outlook, December 1998
Eurostat, European Commission, 1998

Over the medium term, the euro is envisaged to become a strong and attractive reserve currency as well as a viable alternative international currency of settlement for trade and investment transactions. This view is based on the following factors:

- **External positions**. The euro-11 zone is expected to sustain large current account surpluses of about US$103 billion in 1998 and 1999, while the United States could incur larger deficits of US$231 billion in 1998 and US$288 billion in 1999.

- **Shift in reserve composition**. There is likely to be some diversification of reserves from United States dollars to euro by the central banks worldwide.

- **Shift in private investors' portfolio**. Some adjustment in global portfolio holdings of private institutions in favour of the euro is also expected as they are currently relatively underweight in euro. At the same time, the euro countries have deep and liquid bond markets, equivalent to about one-third of the world's market capitalisation.

Notwithstanding the favourable medium-term outlook for the euro, however, its prospects in the immediate term may be confronted by a number of uncertainties. In view of this, financial markets could adopt a cautious approach to the euro in the near term. These uncertainties include:

- **Challenges facing the ECB**. The ECB would need to build its credibility and track

record over time. It needs to address issues such as market perceptions on transparency and accountability, and the absence of a 'lender of last resort' facility.

- **Risk of deflation**. Financial markets are also concerned that the ECB might adopt a highly anti-inflationary stance. This would cause the euro to exert considerable pressure on corporate sector profit margins and performance. In December 1998, the euro-zone inflation was at 0.8%.

- **Differences between policy makers**. Another potential source of market uncertainty was the plausible policy differences between the ECB's monetary policy (on euro and price stability) and the national governments' fiscal and structural policies (on sustaining growth and employment). In the post-EMU period, the euro-11 central banks' excess reserves (estimated at US$50 - 100 billion) have become the centre of political debate as a possible source to finance economic growth and job creation. This move has been resisted by the central bankers in order to maintain stability.

- **Possible asymmetric shocks**. The shocks may arise from a common monetary policy, that will affect the euro-11 countries which have different economic structures and production bases. There is also no fiscal federalism to distribute resources across the euro-11 to stabilise the possible shocks. Empirical studies indicated that the effects of changes in monetary policy would be unevenly distributed across the euro-11 members.

Impact of Euro on Malaysia

Overall, the euro is expected to have a positive effect on emerging economies, including Malaysia, as the single currency and integrated market in Europe would facilitate trade business and financial transactions with the euro-11 countries. The impact of the euro on the Malaysian economy would be felt in both the real economy and the financial sector.

On the **real side**, the impact would be on trade and investment. With respect to **trade**, the euro is likely to have a positive effect. The euro would allow for greater efficiency and reduce the turnaround time for Malaysian exports to the euro-11 countries, as trade would be based on a standardised system. It is envisaged that the use of the euro would simplify and enhance Malaysia's trade relations with the euro-11 countries. The use of the euro for trade settlement with the euro-11 countries would result in cost savings in terms of transparent pricing in euro-11. Malaysian traders would also benefit from lower transaction costs as they would no longer need to hold several currencies. In the medium- and long-run, the euro is expected to be positive for economic growth in the euro-11 zone. The resulting lower transaction and hedging cost is estimated at 0.5% of EU's GDP or US$40 billion a year. The rise in charges for euro settlement is expected to be temporary due to technical problems associated with the new TARGET system in coping with the unexpected high volume of transactions.

The use of the euro would also benefit Malaysia in terms of alleviating the current mismatch between the pattern of trade and the choice of currency used in trade settlement. Although the United States accounts for only 20.8% of Malaysia's total trade in 1998, more than 70% of Malaysia's trade transactions are settled in United States dollars. The launch of the euro offers scope to reduce this imbalance, by providing an alternative to the use of the United States dollar in Malaysia's trade settlement. Currently, Malaysia's trade with the euro-11 countries accounted for 10.6% of total trade in 1998. Asia (excluding Japan) represented 40.3% of Malaysia's total trade. It would, therefore, be in Malaysia's interest to diversify its use of currencies in trade settlement.

At the micro level, the euro would have implications for Malaysian companies in dealing with the euro-11 countries. Malaysian firms would, for example, need to modify their accounting and administrative practices to incorporate the use of the euro. With the standardisation and transparency across the euro-11, Malaysian exporters would no longer be able to depend on a strategy of price

Table V.3
Economic Links Between Malaysia and Euro-11 Countries

	1992	1998
	% share	
Total trade with euro-11	10.0	10.6
Gross FDI to euro-11[1]	2.0	7.2
Gross FDI from euro-11[1]	4.7	8.2
Outstanding external debt with euro-11	5.4	4.3
Settlement of trade with euro-11 currencies	3.9	3.4
Euro-11 banks in Malaysia (number)	2	2

[1] Refers to equity and loans, excluding retained earnings.

Source: Department of Statistics, Bank Negara Malaysia
Accountant General's Office of Malaysia

differentiation. As the euro increases the level of price transparency across the euro-11 countries (where in the past, prices varied by 23% on average), Malaysian companies would find the price differentiation strategy redundant. Malaysian companies can expect greater price competition in the zone.

While it is envisaged that the euro would have a positive effect on trade and generate higher economic activity in Europe, it could expose the disparities between the more competitive and the less competitive countries in euro-11. In the event that this occurs, it would result in a resource transfer from one country to another, leading to structural problems such as higher unemployment in the weaker countries. In such a scenario, protectionist pressures could increase in the euro trading bloc.

With the elimination of uncertainty over exchange rate risks following the launch of the euro, cross-border **investment** within the euro-11 zone is expected to pick up rapidly. Lower foreign exchange risk could encourage investment within the euro countries from higher cost to lower cost members. As the industrial and corporate concentration increases through mergers and acquisitions, opportunities outside the region will encourage the euro-based companies to invest outside the euro-11 zone, including Asian markets. Conversely, Malaysia's investment strategy in the diversified European region will become simpler, less costly and less time-consuming. Malaysia needs to continue to accelerate structural changes to attract European investment.

On the **financial side**, the impact of the euro on Malaysia is mainly in the area of foreign exchange and bond market operations. In terms of central bank **reserve management**, existing holdings of euro member countries' papers are automatically denominated in the euro. It can be expected that some further diversification would take place from existing reserve currencies into the euro, as the euro gains prominence in international finance and trade. Countries with close trade ties to euro-11 would be expected to convert a larger portion of their reserves portfolio to euro. Amongst Asian central banks, Hong Kong Special Administrative Region (SAR), The People's Republic of China; Taiwan; The People's Republic of China; Thailand; and Singapore have indicated plans to increase their reserves denominated in euro. In the case of Malaysia, the automatic conversion of papers issued by the euro-11 countries into euro has resulted in the euro forming part of Malaysia's reserves. However, increased diversification of the reserve portfolio is expected to be gradual, with most countries monitoring market developments closely before undertaking any major shift in the currency composition of their reserves. Larger shifts are only expected in the medium to longer term, as the euro establishes itself as a credible global reserve currency.

On the choice of **exchange rate arrangements**, the proportion of countries which pegged their exchange rate to the United States dollar has declined from 50% in 1975 to 33% in 1996. The debut of the euro could increase the number of countries with an euro peg, in particular, in Eastern Europe, North and West Africa. Generally, the gradual shift from the unipolar system (based on the United States dollar) to a bipolar system (based on the United States dollar and the euro) could ensure greater stability in international foreign exchange markets. Recently, Japan had proposed a tri-polar world exchange rate system based on the United States dollar, the euro and the Japanese yen. Malaysia would give due cognisance to the role of the euro in determining the appropriate

exchange rate arrangement for the country in the future.

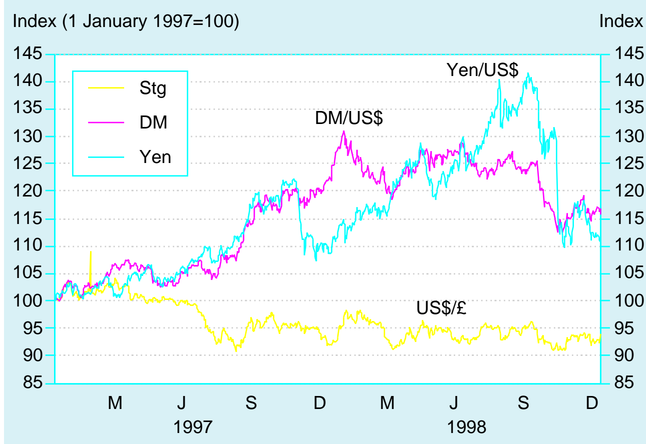
On the outlook for the **currency** and **bond** markets, the euro is expected to create deeper and more liquid markets, offering much broader investment and financing opportunities than the existing domestic markets. The development of the euro-denominated bond market would allow the other governments and corporates to diversify their funding away from over-reliance on the United States dollar or Japanese yen markets. The euro market could become an attractive source of funding for Malaysian corporations.

In the currency markets, a healthy arbitrage between the Eurolibor (based in London) and Euribor (based in Frankfurt) has improved financing opportunities. In considering the option, however, Malaysia would need to weigh all the options and risks before contemplating a similar move to tap the euro markets. Over time, the launch of euro would lead to greater financial innovations and new products in the financial market. Malaysian financial institutions could participate in this process, for example, by offering euro deposits. In the long run, the euro would enhance competition, with positive spillover effects for the rest of the world, including Malaysia.

Conclusion

The euro marks an historic milestone for both European economic and financial integration and the international monetary system. It is envisaged that the shift from a dollar hegemony to a bipolar monetary system will contribute to greater exchange rate stability. However, this will be dependent on the United States and Europe as economic powers exercising their joint responsibility in the smooth functioning of the international financial system. The development of the euro as a credible world reserve currency will allow for greater diversification and thereby reduce the risks associated with over-dependence on the use of any particular currency in international trade and finance. To the extent that the benefits of euro in terms of fostering greater efficiency and growth in the euro-11 countries are realised, there would be positive spillover effects on the global economy, particularly for trade-oriented countries such as Malaysia. The advent of the euro has also spurred discussion on the merits and prerequisites for the creation of a common currency in the ASEAN and Asian region. In this connection, the development of the euro over the next few years will provide important lessons for ASEAN and Asian countries as these economies strive to promote greater regional economic and financial co-operation in the region.

Graph 3.3
Movement of the US Dollar against Major Currencies



Meanwhile, the pound sterling moved in a range of £1=US$1.60-66 during the first two months of 1999 and market expectation is for continued weakness against the dollar in 1999. The sterling fell to a 16-month low, below £1=US$1.60 on 24 February 1999 following the positive indications by the authorities on joining the European Monetary Union. For the remaining part of the year, movements of the major currencies are likely to be affected by the expected slower economic performance in the major industrial economies, movements in interest rate differentials, market adjustments and financial market developments.

Malaysian Economy in 1999

The Malaysian economy is expected to stage a recovery in 1999 with real GDP recording a positive growth of 1%. Export growth has shown a recovery since October 1998 and going into the first quarter of 1999. However, given that its prospects remain uncertain, the main source of growth for the Malaysian economy will emanate mainly from domestic demand, supported by the fiscal stimulus.

Since the fourth quarter of 1998, the outlook for the Malaysian economy has turned positive with indicators showing signs of a revival in consumer and investor sentiment. These signs of economic recovery are likely to continue in line with the improved outlook for the region. Important pre-conditions to ensure sustainability of the economic recovery are already in place. Growth is expected to be mainly domestic-driven despite the recent favourable performance of the Malaysian trade sector. Fiscal policy will lead economic growth through the fiscal stimulus package, while monetary policy will remain accommodative to encourage bank lending to support the growth process. The restructuring of the banking institutions has also progressed at a faster rate than earlier envisaged. This augurs well towards allowing banks to focus on their intermediation function. Meanwhile, the progress in the recapitalisation of banks and corporate debt restructuring will reinforce this process. To date, loan approvals by the banking system have already increased considerably and efforts at addressing the risks in the economy are being accelerated. These include issues relating to improving transparency in policy formulation and issues concerning good governance. The fixing of the ringgit against the United States dollar and the selective exchange controls have provided a stable environment to facilitate sound business decisions. The balance of payments is expected to remain favourable. The large current account surplus provides adequate margins to promote growth without resulting in imbalances in the external sector. On the domestic front, inflation has moderated further in an environment of excess capacity and is likely to remain subdued.

These are important conditions that provide a strong foundation for recovery in 1999. Consistent sound macroeconomic policies during the course of 1999 will ensure that the recovery will be sustained and economic growth will gather momentum in line with potential output, in the medium term. Economic recovery in 1999 is expected to be gradual in view of the high inventory build-up in the first half of 1998, and the increase in capacity in many industries resulting from several years of expansion. Growth will likely be marginal in the first half-year, allowing the economy to consolidate. Restructuring of the financial and corporate sectors will intensify in the second and third quarters of 1999. This would create more favourable conditions for stronger growth in the second half-year.

There is a possibility that GDP growth could be higher than projected in 1999 should the prospects for the international environment improve or the private sector respond more favourably to the policy measures. In addition, the tourism industry has much potential that remains untapped. As the infrastructure in the tourism sector is already in place, the prospects are positive for promoting a significant increase in tourist arrivals, without any significant additional cost. Barring any adverse external developments, the prospect of a higher real GDP

growth, closer to 2%, is possible in 1999 in view of the Government's commitment to accelerate work on a comprehensive restructuring programme for the banking and corporate sectors as well as measures to increase utilisation of excess capacity in the economy.

The forecast hinges on three important factors, namely, the international economic outlook, the timely implementation of the fiscal stimulus package and the private sector response to this package. On the international front, the potential downside risks would be a sharper-than-expected moderation of growth in the industrial countries and a delayed recovery of regional economies, including Japan. These developments could affect the projection for manufactured exports and output in the export-oriented industries for 1999. In particular, a lower growth for the regional and international economies could impact export demand for electronics, rubber and metal products. A deterioration in the external environment could develop in the event of a major correction in the stock market in the United States and further volatility in the financial markets. Secondly, the growth hinges on the recovery of private consumer spending and a moderate increase in private investment activity. A recovery in consumption is expected with the easing of inflationary pressures and improved liquidity as well as lower interest rates in response to the easing of monetary policy. Growth in 1999 also hinges on the expansion in public sector expenditure. The Government would need to press ahead with its planned spending and investment programmes to ensure orderly and timely implementation of projects in the pipeline.

On a sectoral basis, growth in real output in 1999 is expected to reflect positive growth in output in the manufacturing, services and agriculture sectors. The decline in the construction sector is expected to moderate, while production in the mining sector is projected to contract.

In the **manufacturing sector**, output is projected to turn around to register an increase of 0.8% in 1999. In view of the gradual recovery in external demand, output in the export-oriented industries is expected to turn around to record a marginal increase of 0.1%. Consequently, the main impetus to growth in the manufacturing sector would emanate from the stronger expansion of 1.3% in output of the domestic-oriented industries. Chemicals, rubber products, food and beverages and transport industries are expected to benefit from the expansion in domestic demand. An increase of 9% is projected for the rubber products industry, supported by strong external demand for rubber gloves. With the strengthening of demand for passenger cars, output in the transport equipment industry, particularly the production of the national cars, is expected to recover to register a positive growth in 1999. In the export-oriented industries, weak demand for electrical products, wood and wood products, and textiles and wearing apparel industries is expected to be more than compensated by the recovery in output of the electronics and off-estate processing sectors. In the electronics sub-sector, the favourable developments include the expected cutback in production of memory chips by Korean manufacturers (production of the top three Korean producers account for about 40% of world DRAM chip production) as well as the postponement of capacity expansion programmes worldwide. The projected recovery of the sector is also supported by signs of strengthening global demand for semiconductors, which was evident in the fourth quarter of 1998. In particular, the problems caused by the millennium bug (Y2K) on older computer systems are expected to boost demand for computer replacements from both the corporate and home markets.

Growth in the **agriculture sector** is expected to turn around to increase by 5% from a decline of 4% in 1998 due mainly to higher output of crude palm oil. After undergoing a downturn in the biological yield cycle, crude palm oil production is expected to increase by 7% to 8.9 million tonnes, due mainly to higher yields. Meanwhile, saw log output is projected to decline by 1% to 22.5 million cubic metres in line with the Government’s conservation policy and commitment to sustainable forest management by the year 2000.

In the **mining sector**, higher production of gas and tin is expected to be more than offset by lower production of crude oil. Given the global oversupply of crude oil and continuing weak demand, the existing plans are for the reduction in crude oil production to 713,000 barrels per day, a decline of 1.8% from the 1998 level. Gas production, on the other hand, is expected to increase by 8% in response to higher domestic demand as well as some pick-up in external demand in the second half of the year. Tin production is also expected to increase further by 24.8% with more mines re-opened in response to favourable tin prices.

The **construction sector** will continue to experience a further consolidation of activities in 1999. Nevertheless, the decline in output is projected to moderate to 8%. The construction of residential units, especially low- and medium-cost units is expected to intensify following an increase in housing approvals as well as public sector expenditure under the fiscal stimulus programme. The civil engineering sub-sector stands to benefit from the Budget allocation for infrastructure projects and the revival of selected deferred projects to be funded by the fund for infrastructure development. A higher level of residential construction activities (4.3%) and the implementation of several civil engineering projects (7.1%) would offset, to some extent, the continued significant decline in the construction of commercial buildings, mainly office and retail space (–54.8%).

Activity in the **services sector** is expected to increase in 1999 in line with the expansion of the leading sectors in the economy. Overall, the services sector is projected to grow by 2.5% (1.5% in 1998). The pick-up in activity in the manufacturing sector is expected to strengthen the demand for intermediate services. Within this category, the finance sector is expected to perform better as banking institutions refocus on lending activity, following the accelerated implementation of the restructuring exercise in the financial sector. Similarly, the performance of the transport and distributive trade sector; and electricity, gas and water sub-sector is estimated to improve in line with the expected pick-up in both domestic and export-oriented industries. After contracting by 2% in 1998, output in the wholesale and retail trade, hotels and restaurants sector is expected to register a positive growth, benefiting from the anticipated recovery in consumer spending as well as the efforts to promote tourism in 1999.

Real aggregate **domestic demand** is projected to turn around to record an increase of 4.3% in 1999, reflecting mainly the positive response to the measures undertaken by the Government to stimulate domestic economic activities. **Public sector expenditure** is expected to turn around to register a growth of 11.4% (–6.6% in 1998) with the pick-up in momentum in the implementation of the Government's fiscal stimulus package. **Public consumption** is estimated to increase by 10.1% mainly on account of higher expenditure on supplies and services and defence expenditure by the Federal Government. **Public investment** is expected to increase at a faster rate of 12.8% attributable to higher allocation for socio-economic projects, including the construction of roads, bridges, upgrading of rural amenities, agriculture, health and education. Investment expenditure by the non-financial public enterprises (NFPEs) is expected to increase in 1999 due to some pick-up in momentum in the implementation of some of the projects that were deferred in 1997-98 due to the economic downturn.

Private sector expenditure is expected to register a small increase of 1.1% in real terms (–32.2% in 1998), with both private investment and consumption recording positive growth rates. The consolidation in the corporate sector will strengthen the foundation for increased private investment activity. Private investment activity is expected to increase by 0.9%, supported by the implementation of infrastructure projects. Although applications received by the Ministry of International Trade and Industry (MITI) for investment in the manufacturing sector in 1998 were lower, quarterly data showed a noticeable increase in the fourth quarter of 1998. With the revival in consumer confidence, **private consumption** is projected to increase by 1.1% in 1999. Consumption spending is expected to increase following the Government's stimulus package, tax exemption for income earned in 1999 and lower cost of borrowings.

The **Federal Government** is projected to record a higher fiscal deficit in 1999, with continued lower revenue performance and fiscal stimulus to spearhead economic recovery. However, the policy of fiscal prudence and discipline will continue to be maintained to ensure that the revenue will be sufficient to meet the operating expenditure. The fiscal deficit is estimated at RM16.1 billion or –6% of GNP, unchanged from the position announced in October 1998. The consolidated public sector financial position is also expected to record a larger overall deficit of RM14.9 billion or –5.5% of GNP.

The recovery projected for 1999 is not expected to cause a significant decline in the **current account surplus of the balance of payments**, for several reasons. Excess capacity would ensure growth is achieved with less need for capital imports. Similarly, the large investments on infrastructure during the past years would facilitate economic activity, so that new growth is supported by higher productivity based on more efficient use of capital. Finally, the fiscal stimulus package is targeted at economic activities where import content is low, inter- and intra-sectoral

linkages are strong and market potential is high. In particular, expenditures targeted at low-cost housing, rural roads, basic infrastructure and education all have very low import intensity.

Within this policy framework, the current account surplus of the **balance of payments** is expected to remain significant at RM29.5 billion or 11% of GNP. The moderate decline in the current account surplus reflects lower surplus projected in the merchandise account (RM57.1 billion), while the services account deficit is forecast to improve to RM21 billion (1998: RM23.4 billion). The surplus in the merchandise account is expected to narrow marginally due mainly to expectations of moderate expansion in imports, in tandem with economic recovery. The improvement in the services account is mainly due to the expected surplus in the travel account, on the basis of an expected recovery in the ASEAN region and aggressive campaigns to increase tourist arrivals. The long-term capital account is forecast to strengthen with a net inflow of RM15.2 billion, reflecting higher inflow of both official and private long-term capital.

Manufactured exports valued in United States dollars are expected to increase by 2.3% in 1999. However, in terms of the ringgit, the value of exports would decline by 0.6% as a result of valuation loss arising from the fixing of the ringgit against the United States dollar. Following the fixing of the ringgit against the United States dollar at US$1=RM3.80 on 2 September 1998, the ringgit would record an appreciation of 3.2% compared with the average exchange rate of RM3.92 for 1998 as a whole. The higher export earnings valued in United States dollars reflect expectations of increased exports of electronic goods, rubber products, metal products, transport equipment, optical and scientific equipment and beverages and tobacco. The projected gradual recovery of demand from the Asia-Pacific region would lend support to the already improved external demand for electronic goods, particularly the disk-drive sub-sector and semiconductors. However, the external demand for electrical goods is not expected to recover significantly given the developments in the region. Nevertheless, the competitiveness of Malaysian exporters could improve due to the more competitive REER for the Malaysian ringgit. Overall, while export volumes are expected to increase, there are concerns of downward pressure on export prices in United States dollar terms (–3.3%).

Commodity prices are expected to remain generally weak in 1999. The overall commodity export unit value is projected to decline by 11.9%. The export unit value for minerals are expected to decline further by 16.2% (–2.7% in 1998), primarily on account of continuing declines in the prices of crude oil and LNG. Malaysia’s crude oil prices are expected to decline to US$12.00 per barrel, in the face of high global inventories of crude oil amidst weak demand. Similarly, prices for the agricultural commodities are expected to decline by 9.7% (1998: +46.3%), but would remain significantly higher than the levels recorded in 1997. Palm oil prices are expected to decline given an expected increase in the supplies of palm oil arising from higher production of crude palm oil during the year. In addition, more intense competition from other vegetable oils particularly soya oil, is expected to add pressure on palm oil prices. In the case of saw logs, prices are expected to decline further as external demand is projected to remain subdued, while the lifting of the ban on log exports from Indonesia would exert some pressure on Malaysian log prices. Prices of sawn timber and rubber are also projected to trend downwards due to gradual recovery in external demand. Total export earnings of the commodity sector is projected to decline by 12.2% to RM39.6 billion arising mainly from the expected decline in prices.

Gross imports are expected to increase in 1999 with a volume growth of 5% (–20.5% in 1998). In United States dollar terms, imports are projected to rise by 6% as imports of intermediate goods are expected to rise by 11.6% with the expected recovery in the manufacturing sector. Imports of capital goods are expected to continue to decline by 17.4% as private investment is forecast to recover gradually. Similarly, public investment is not expected to contribute significantly to import growth, as the projects being earmarked by the Government are those with a low import content. Imports of consumption goods are expected to remain low, expanding by just 6.2% given the exchange rate factor.

The total **external debt** outstanding is expected to increase moderately by 4.2% to RM166.4 billion. This forecast is based on the assumption that the short-term debt level would remain unchanged at end-1998 level. The moderate increase in medium- and long-term debt is due mainly to the net drawdown of loans by the Federal Government from multilateral and bilateral sources to finance the

recovery and financial restructuring programme. Nevertheless, Malaysia would remain a moderately-indebted country, with the ratio of total external debt to GNP stabilising at 62%. Meanwhile, the debt service ratio is expected to decline slightly to 6.5% due to lower principal repayments and interest payments in ringgit terms.

Inflation is projected to be contained below 4% in 1999 (5.3% in 1998). The absence of inflationary pressures from abroad due to a moderate appreciation of the ringgit and low inflation in the industrial countries and lower commodity prices, particularly low oil prices, would help to contain domestic price pressures. Although several measures have been put in place to ensure revival of the economy, the expected recovery in domestic demand and more accommodative monetary policy are not expected to lead to an output gap.

The recovery in the economy in 1999 is expected to generate increased **employment** opportunities in all the major sectors of the economy. However, in view of the higher entrants into the domestic labour market, the unemployment rate is expected to increase above the full employment level. The pressure for wage increases is also expected to remain moderate as adjustments in the labour market continue in 1999.

The year 1999 would be another challenging year to Bank Negara Malaysia and the Malaysian Government in terms of **macroeconomic management**. The impact of the less conventional approach to economic management adopted in 1998 will be felt in 1999. Policy measures will remain dynamic and implemented with flexibility, continuing to evolve to adjust to changing circumstances in domestic and external conditions. However, the basic objective will remain unchanged. Malaysia will aim to target for growth with price stability. While it is crucial to achieve economic recovery in 1999 in order to preserve the standard of living and the quality of life attained during the past decade, such recovery would not be at all costs and at the expense of overall fundamental macroeconomic stability.

The broad thrust of policy in 1999, therefore, will be directed at re-engineering the growth strategies for the immediate and long term, while addressing the vulnerabilities in the economy. This strategy would provide the basis for greater expansion in economic activities that are consistent with the changing environment of world trade and global financial markets. It is also important to ensure that policies to revive growth in the short term do not create new risks. The growth promoting strategy, therefore, contains several "safeguard" elements to ensure that the medium-term prospects remain favourable for the Malaysian economy. In particular, policy measures have been designed to ensure a balanced macroeconomic policy mix to create a conducive environment to stimulate investment and consumption while maintaining stability in the financial markets. Central to the counter-cyclical policy is the need to promote consumption. The average propensity to consume has declined in Malaysia from more than 50% prior to 1996 to 43.6% in 1998, lower than the level recorded during the recession in the mid-1980s. Given the build-up in inventory and excess capacity, promotion of consumption is necessary before investments can pick up. At the same time, Malaysia recognises the need for a large reserves cushion as a key element against unforeseen destabilising developments, to sustain market confidence and enhance credit worthiness. The Asian crisis has shown that high reserves level provide added strength to weather instabilities due to market failure.

The Government has already embarked on a fiscal stimulus programme as early as March 1998 to stimulate domestic demand as the main engine of growth. This strategy of domestic-driven growth would continue in 1999. In this regard, the Federal Government would manage the level of expenditure by taking into consideration the need to revive growth, maintain a balanced position in the current account of the Federal Government, avoid excessive reliance on external financing and avoid crowding out the private sector in terms of access to loanable funds. Therefore, for 1999, only projects and programmes of high priority in terms of revitalising economic growth and improving the efficiency of the economy are given the necessary expenditure allocations. This is to ensure that expenditure is contained at a level in line with available resources and ensure that every ringgit spent will generate the highest increase in value-added activities without the need for excessive recurrent expenditure. The bulk of the development expenditure is allocated for socio-economic projects and for projects that will expedite economic recovery and generate demand for domestic goods.

An important aspect of policy is to ensure positive private sector response to the fiscal stimulus. It is essential to improve performance in the real sector to match, within a reasonable time lag, the improved market sentiment in the stock markets, so that the momentum can be sustained. Sustaining the improved market confidence has, therefore, become a priority objective of policy. In particular, a return of foreign investors would create the watershed to restore confidence to the levels that prevailed during years of strong growth.

While interest rates have declined, the real rate of return to savers has remained positive, given the low inflation environment. It is recognised that in the present environment, the role of monetary policy will remain accommodative to support an expansionary fiscal stance as the risk of inflationary pressures from domestic demand is no longer a source of instability. The excess capacity in the economy and weak domestic demand would contain inflationary pressures. The fixing of the ringgit will lower inflationary expectations. A lower inflation will accord greater flexibility to lower interest rates.

Past prudent fiscal policies have accorded Malaysia greater flexibility in financing the economic recovery and restructuring of financial institutions, while keeping external debt low. In this regard, Malaysia will continue to rely on non-inflationary sources of financing. As the total requirement is not large, the bulk of the requirements can be financed through domestic savings. Malaysia's savings rate is high, at over 40% of GNP. The total financing requirement of the fiscal stimulus, the restructuring of the banking institutions and infrastructure development projects was initially estimated at RM62 billion for 1998-99. In view of the smaller fiscal deficit of RM5 billion for 1998 (–RM9.6 billion in the 1999 Budget), the total financing requirement is now estimated to be lower at RM58 billion for 1998-99. The Government will finance the fiscal deficit through the issuance of Malaysian Government Securities that will be absorbed mainly by provident, pension and insurance funds. Financing of Pengurusan Danaharta Nasional Berhad (Danaharta) is being effected through the issue of government-guaranteed bonds, while financing of bank restructuring is through Danamodal Nasional Berhad (Danamodal) issuing bonds to the banking institutions. Bonds issued by Danamodal are not guaranteed by the Government. In 1999, some increases in external financing is likely to materialise mainly from multilateral and bilateral sources. Given the favourable developments, it would be advantageous for Malaysia to re-enter the capital markets to establish a benchmark borrowing rate for Malaysia. The last market loan was raised in December 1998. Nevertheless, maintaining a low external debt level continues to remain an important policy objective.

It is recognised that the ratio of bank credit, including loans securitised by Cagamas, to GDP in Malaysia was high at 148% of GDP in 1998. However, the ratio of deposits to GDP was also high at 154.8%. The banks, therefore, have financed their lending operations from their own domestic mobilisation of savings, which is non-inflationary, primarily from deposits. If the capital of the banking system is taken into account, the total fund base (deposits and capital)/GDP, was at 172.4%, exceeding the loans/GDP ratio, indicating that banks do have the required resources to lend. As such, the high loan/GDP ratio would not induce instability. Nevertheless, the Government recognises the need to diversify the risks away from the banking system and allow investors to assume a higher share of risks. In recent years, particularly since 1996, efforts have intensified in developing the private debt securities market in an effort to diversify financing away from the banking sector. While emphasis in the immediate term will focus on strengthening the banking system to support recovery, efforts will be stepped up to develop the capital market, particularly the bond market. Currently, the Bank has embarked on a programme to develop the bond market as part of the overall plan to deepen and broaden the financial markets. Hence, the loan/GDP ratio would decline over time.

Addressing structural issues in the economy will be pursued aggressively in 1999. Much of the reform process in the financial system would be completed during the course of the year. More emphasis is being given to corporate debt restructuring and in the process, the restructuring of corporations as well, to improve efficiency. Other long-term issues on which work has begun in 1999 include addressing issues affecting competitiveness. These include strategies to lower the cost of doing business in Malaysia and improve industrial efficiencies. Economic regulation of utility services provided by privatised entities is important to ensure that the cost of operations in Malaysia is maintained at a low level, to be competitive and attract foreign direct investments. Development of human resource continues to be given priority attention, especially to meet the needs of industry for skilled

Table 3.2
Financing of the Economy

	1985	1990 (RM billion)	1998	1985	1990 (% of GDP)	1998
Domestic Debt	106.8	190.3	562.4	137.8	164.5	201.8
Private	66.0	120.3	469.4	85.2	103.9	168.4
Loans by banking system [1]	66.0	114.1	394.5	85.2	98.6	141.6
(Loans by banking system [2])	(66.0)	(116.0)	(413.6)	(85.2)	(100.2)	(148.4)
Private debt securities [3]	-	6.2	74.9	-	5.4	26.9
Public [4]	40.8	70.0	93.0	52.6	60.5	33.4
External Debt	42.5	45.9	159.8	54.8	39.7	57.3
Long-term	42.5	41.5	131.3	54.8	35.9	47.1
Private	7.2	4.9	63.1	9.3	4.3	22.6
Public	35.3	36.6	68.2	45.5	31.6	24.5
Short-term	-	4.4	28.5	-	3.8	10.2
Private	-	-	8.8	-	-	3.1
Bank	-	4.4	19.7	-	3.8	7.1
Total Debt	149.3	236.2	722.2	192.6	204.1	259.3
Total Deposits of the Banking System	73.0	120.8	431.4	94.2	104.4	154.8

[1] Exclude loans sold to Cagamas.
[2] Include loans sold to Cagamas.
[3] Refers to corporate bonds and Cagamas bonds.
[4] Refers to MGS, TB, GII, Khazanah Bond and other loans.

labour. In this regard, the amendment of the Employment Act 1955 in August 1998 to allow greater flexibility in the labour market is a step in the right direction.

Malaysia continues to adopt a pragmatic approach in economic management. The policy response has addressed the vulnerabilities of the economy that emerged through the crisis. To date, these measures have begun to yield positive results. In particular, the measures will strengthen the foundation upon which sustainable growth will be achieved over the medium and longer term.

Monetary Policy in 1999

More than one and a half years since the onset of the regional crisis, the volatility and turmoil, which engulfed the East-Asian countries is slowly receding, giving way to more stable market conditions. The economies in East Asia which were adversely affected by the crisis are expected to recover in 1999 following growth promoting policies undertaken by the authorities, some resumption of capital flows and signs of recovery in the electronics sector. In Malaysia, significant progress has been made towards restoring stability in the economy and the financial markets. The overall economic and financial policy will be directed at supporting economic recovery. The focus of monetary policy in 1999 is, therefore, to create a conducive environment that will support the nascent economic recovery while preserving price stability. In pursuit of this objective, the current stance of monetary policy will be maintained. The policy stance ensures that there are adequate funds at reasonable cost to support private sector activity. At the same time, every effort will be made to ensure that interest rates are kept competitive to promote investments in the real sector and also to provide a positive real rate of return on savings so as not to create disincentives to save. Several measures have also been implemented to ensure stability in the banking system and the smooth functioning of banks' intermediation process. BNM is committed to accelerate the process of restructuring the banking system to strengthen the capital base and structure of banking institutions so that the banking system can effectively meet the needs of the economy in the medium term.

Nevertheless, given the economic uncertainties, especially in the regional and international environment, BNM will continue to monitor the economic and monetary situation closely to respond to the risks and vulnerabilities, so as to ensure that the objective of sustainable growth with stable prices is not jeopardised. The major factors that are

expected to influence monetary policy in 1999 include the outlook for inflation; ensuring attractive returns on ringgit assets; and ensuring adequate access to credit by viable activities. In responding to these factors, monetary policy, during the course of the year, will be managed with flexibility and a close watch on prospective developments in the economic and financial environment. At the same time, achieving growth with financial stability calls for a well co-ordinated and effective implementation of macroeconomic policies as well as structural adjustment measures. Fiscal, monetary, structural and prudential measures have already been put in place to revitalise the economy. Based on past experiences, the impact of monetary policy is only felt with a lag, unlike the immediate impact of fiscal measures. Hence, in the immediate term, the implementation of the wide range of fiscal measures already in place would need to be expedited to promote a revival of domestic demand.

For 1999, the external environment is not expected to provide the major stimulus to the domestic economy. The main impetus to growth will need to be generated from greater domestic activity, including investment and consumption. In the current environment, **inflation** is not expected to be a serious risk given the weak but rising domestic demand and existing excess capacity in the product and labour markets. Inflationary pressures from abroad are expected to remain relatively subdued in the absence of imported cost pressures, as world prices, including oil prices, are expected to remain weak. While the employment rate could increase in 1999, the prospect of wage-push inflation is unlikely. Nevertheless, the close monitoring of the price situation will continue. Monetary expansion in 1999 will be managed consistent with the growth in the real economy, without refuelling inflationary expectations.

In line with this objective, the current level of **interest rates** is likely to be maintained so long as there are no build-up of inflationary pressures. The prevailing level of interest rates is sufficient to support the economic recovery process, as well as to provide for an incentive to save in Malaysia. Meanwhile, the rates of domestic inflation and interest rates in most developed countries are expected to fall in 1999. These developments would provide the Bank with greater room for manoeuvre to support the economic recovery process without endangering price stability as well as stability in the domestic financial markets.

Despite the downward adjustment of lending rates from 12.27% at end-June 1998 to 8% currently, loan growth has been sluggish. The slow loan growth reflects the confidence factor and, to some extent, the high excess capacity and inventories in selected industries. At the same time, banks have continued to be cautious in view of rising NPLs and perceived economic uncertainties. The focus of monetary policy in 1999 would be to create a conducive environment that would support and encourage the growth of domestic economic activity. The challenge to the Bank is to ensure that adequate funds would be readily available to investors at reasonable cost. It is recognised that the ability of banks to lend, within prudent practices, is critical to achieve economic recovery. Hence, efforts to strengthen and restructure the banking sector that have been undertaken in 1998 will be intensified in 1999. BNM will closely monitor lending activities of the banking institutions, to ensure that there is no disruption to the intermediation process.

Efficiency in the implementation of monetary policy is crucial so that policy measures can be transmitted in the quickest manner and at least cost to the economy. In order to achieve this, there must be sound financial intermediaries, which act as an efficient transmission mechanism for monetary policy. BNM has undertaken several measures to ensure an efficient intermediation process. In this regard, a number of policy initiatives were taken to ensure the efficient management of liquidity so as to reduce cost. These included the revision of the permissible daily variation band for the statutory reserve requirement (SRR) in May; the revision in the framework for the computation of the base lending rate (BLR); the announcement of information on BNM daily operations in the money market; and the implementation of the New Liquidity Framework. The new framework has enabled individual banks to better manage their holdings of liquid assets to match the maturity profile of their liabilities. Indirectly, it will also help to promote a more market-oriented pricing of liquid assets which is necessary to develop the secondary market in securities. At the same time, the new BLR framework has allowed the faster transmission of changes in monetary policy and interest rate levels. On the part of BNM, by announcing information on its daily operations in the money market, there is greater transparency in the implementation of monetary policy. Efforts to increase efficiency will continue and be intensified in 1999 as BNM focuses on ensuring that the intermediation process functions effectively to support economic activity and the growth process. Development of

the bond market will also enhance efficiency of monetary policy through increased dependence on market-oriented instruments rather than direct instruments.

Malaysia had adopted a **fixed exchange rate regime** on 2 September 1998 with the objective of creating a stable domestic environment that would be conducive for a revival of investor and consumer confidence. Given that the objective is to provide greater certainty for the conduct of real economic activity, it is not the intent for frequent changes to take place. In view of the many destabilising forces prevailing in the international environment, Malaysia will continue to maintain the fixed exchange rate regime until there is a discernible normalisation in the global financial markets and the global financial system has been strengthened to ensure orderly conditions. The exchange rate would need to reflect long-term fundamentals of the economy. On the whole, the comprehensive measures, including the September measures implemented by the Government had accorded greater stability for producers, traders, investors and consumers. These, however, will be temporary gains unless investors and exporters take advantage of this period of relative stability to sharpen their competitive edge through enhancing productivity; improving quality of products; expanding to non-traditional markets; intensifying market penetration in existing markets; and providing improved services to customers.

4 The Financial Sector

Sources and Uses of Funds of the Financial System

The full effect of the regional financial crisis was felt in the financial system where total assets declined by RM21.4 billion or 1.9% to RM1,093.1 billion at the end of 1998 (an increase of RM195.5 billion or 21.3% in 1997). This decline in the total assets of the financial system resulted mainly from a fall in the assets of the banking system by RM45.3 billion or 5.6% compared with an increase of RM180.2 billion or 28.5% in 1997. The decline in assets of the banking system partly reflected the non-performing loans (NPLs) sold to and managed by Pengurusan Danaharta Nasional Berhad (Danaharta), of RM13 billion. The banking system continued to be the largest financial intermediary, accounting for 70.1% of the total assets of the financial system at the end of 1998 (72.9% at the end of 1997). Within the banking system, the finance companies experienced declines in total assets resulting mainly from a fall in loans and advances, due to the tight liquidity conditions in early 1998, the higher interest rates, particularly during the first half-year, contraction in economic activity as well as more cautious lending policies as their balance sheets deteriorated. The lending activity of finance companies was also constrained by the merger and other restructuring exercises which were undertaken during 1998. The commercial banks (including Bank Islam), in turn, experienced declines in total assets reflecting the fall in deposit placements with other financial institutions. Consequently, their share of total assets in the financial system declined from 13.7% and 43.6% to 11.3% and 42% respectively at the end of 1998. The decline in the share of total assets of the commercial banks, however, was mitigated by the transfer of the assets of five finance companies which were absorbed by the parent commercial banks under the exercise to rationalise the finance companies.

Table 4.1
Assets of the Financial System

	Annual change		As at end 1998*p*	
	1997	1998		
	RM billion			% share
Banking system	**180.2**	**–45.3**	**766.7**	**70.1**
Bank Negara Malaysia	12.2	15.8	124.7	11.4
Commercial banks[1]	121.4	–26.2	459.2	42.0
Finance companies	32.6	–28.8	123.6	11.3
Merchant banks	10.2	–5.1	39.2	3.6
Discount houses	3.8	–1.0	20.0	1.8
Non-bank financial intermediaries	**15.3**	**23.8**	**326.4**	**29.9**
Provident, pension and insurance funds	22.6	22.6	212.2	19.4
Employees Provident Fund	*15.1*	*15.6*	*148.0*	*13.5*
Other provident & pension funds	*3.3*	*3.2*	*24.8*	*2.3*
Life insurance funds	*2.8*	*2.9*	*26.6*	*2.4*
General insurance funds	*1.5*	*1.0*	*12.8*	*1.2*
Development finance institutions[2]	2.0	4.5	19.8	1.8
Savings institutions[3]	1.2	–1.1	18.3	1.7
Other financial intermediaries[4]	–10.5	–2.2	76.1	7.0
Total	**195.5**	**–21.4**	**1,093.1**	**100.0**

[1] Includes Bank Islam Malaysia Berhad.
[2] Includes Malaysian Industrial Development Finance Berhad (MIDF),Bank Pertanian Malaysia, Borneo Development Corporation, Sabah Development Bank Berhad, Sabah Credit Corporation, Export - Import Bank Malaysia Berhad, Bank Pembangunan Malaysia Berhad and Bank Industri Malaysia Berhad.
[3] Includes National Savings Bank, Bank Kerja sama Rakyat and co-operative societies.
[4] Includes unit trusts (ASN, ASB, ASW 2020 and ASM Mara), building societies, Pilgrims Fund Board, Credit Guarantee Corporation, Cagamas Berhad, leasing companies, factoring companies and venture capital companies.

p Preleminary

Total assets of the non-bank financial intermediaries (NBFIs) increased at a faster pace of RM23.8 billion or 7.9% in 1998, compared with a growth of RM15.3 billion or 5.3% in 1997. As a result, their share of total financial system assets increased from 27.1% at the end of 1997 to 29.9% at the end of 1998. The faster growth reflected mainly the sustained high growth of the assets of the provident, pension and insurance funds (RM22.6 billion or 11.9%), the significant increase (231.4%) in the assets of the Export-Import Bank of Malaysia (Exim Bank) due to the increase in loans extended by Exim Bank, following the transfer of the Export Credit Refinancing (ECR) Scheme from Bank

Table 4.2
Sources and Uses of Funds of the Financial System

	Annual change		As at end 1998*p*	
	1997	1998		
	RM billion			% share
Sources:				
Capital and reserves	–3.1	–3.9	102.4	9.4
Currency	3.5	–4.0	20.5	1.9
Deposits[1]	82.5	28.4	523.1	47.9
Borrowings	24.3	–18.3	14.4	1.3
Funds from other financial institutions[1]	55.4	–88.5	66.1	6.0
Insurance and provident funds	21.6	20.2	188.7	17.3
Other liabilities	11.4	44.6	177.9	16.3
Total	**195.5**	**–21.4**	**1,093.1**	**100.0**
Uses:				
Currency	1.2	–0.8	3.2	0.3
Deposits with other financial institutions	72.5	–67.5	151.6	13.9
Bills	5.1	–6.8	14.6	1.3
Treasury	*2.0*	*–0.1*	*3.8*	*0.3*
Commercial	*3.1*	*–6.7*	*10.9*	*1.0*
Loans and advances	101.4	0.1	485.7	44.4
Securities	4.6	18.5	225.6	20.6
Malaysian Government	*–1.5*	*5.5*	*71.6*	*6.5*
Foreign	*0.8*	*0.0*	*1.3*	*0.1*
Corporate	*7.8*	*9.6*	*141.8*	*13.0*
Others	*–2.4*	*3.4*	*10.9*	*1.0*
Gold and foreign exchange reserves	–10.8	39.2	96.3	8.8
Other assets	21.6	–4.1	116.1	10.6

[1] Effective 1998, the statutory reserves of banking institution have been reclassified as "Funds from other financial institutions" rather than "Deposits". In this regard, data from prior years have also been revised accordingly.

p Preleminary

Negara Malaysia (BNM) to Exim Bank, and the significant increase in the assets of Bank Industri Malaysia Berhad (78%) due mainly to the transfer of deposits from Kewangan Industri Berhad following its absorption by Bank Industri. The increase in the assets of the provident, pension and insurance funds accounted for 94.7% of the total increase in the assets of the NBFIs.

During the year, deposits placed with the financial institutions increased by RM28.4 billion or 5.7% (RM82.5 billion or 20% in 1997). Reflecting the contraction in economic output, the banking institutions (comprising commercial banks, finance companies, merchant banks and discount houses) experienced a decline in deposits, mainly on account of the decrease in demand deposits placed with the commercial banks. Nevertheless, deposits maintained its position as the main source of funds, accounting for 47.9% of total sources of funds at the end of 1998 (44.4% in 1997). Similarly, the banking institutions continued to be the largest mobiliser of deposits, accounting for 86.6% of total deposits of the financial system (92.2% in 1997). In terms of holders, the deposits were held mainly by the non-financial private sector (comprising individuals and business enterprises). During the year, their deposits placed with the financial system rose by only RM11.5 billion or 3.6% (RM62.2 billion or 24% in 1997), in tandem with the sharp slowdown in income. As in previous years, fixed deposits continued to account for the bulk of the deposits placed by the non-financial private sector, accounting for 118.7% of the increase in total deposits while demand deposits registered a decline of RM5.2 billion or 13.9%. By maturity, fixed deposits continued to be concentrated in shorter-end maturities.

Contractual savings with provident funds and contributions to insurance funds continued to be a major source of funds for the financial system,

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

	Annual change		As at end 1998*p*	
	1997	1998		
	RM billion			% share
Deposits[3] with:				
Commercial banks	48.7	5.0	228.6	68.7
Finance companies	10.4	4.0	66.3	19.9
Merchant banks	1.6	–0.5	11.3	3.4
Discount houses	–1.9	0.0	3.8	1.1
National Savings Bank	0.6	0.4	6.9	2.1
Others	2.8	2.5	15.8	4.8
Total	**62.2**	**11.5**	**332.7**	**100.0**
Demand deposits	1.8	–5.2	32.2	9.7
Fixed deposits	47.3	13.6	221.5	66.6
Savings deposits	–3.8	2.3	43.5	13.1
NIDs[4]	13.7	0.1	18.5	5.5
Repos[5]	3.2	0.6	17.1	5.1
Fixed deposits				
Of which:				
Up to 1 year	42.3	19.0	201.4	60.5
More than 1 year	5.0	–5.4	20.1	6.0

[1] Refers to deposits of business enterprises (excluding NFPEs) and individuals.
[2] Excludes provident and insurance funds and other financial intermediaries.
[3] Refers to demand, savings and fixed deposits, negotiable instruments of deposit and repos.
[4] Refers to negotiable instruments of deposit.
[5] Refers to repurchase agreements.

p Preleminary

expanding by RM20.2 billion or 12% (RM21.6 billion or 14.7% in 1997), to account for 17.3% of total funds mobilised by the financial system in 1998. Funds obtained from other sources registered strong growth, reflecting mainly gains from foreign exchange revaluation experienced during the year. The increase in these sources of funds were offset by the decline in funding from borrowings, as BNM reduced its lending to the banking institutions following the release of funds to the banking institutions through the reduction in the statutory reserve requirement (SRR). Similarly, the year also saw a significant decline in funds obtained from other financial institutions reflecting mainly the reduction in interbank placements, consonant with the slowdown in lending activity.

As at the end of 1998, the bulk of funds mobilised were utilised to finance the loan operations of the financial system, followed by investment in securities and deposits with other financial institutions. Concomitant with the economic contraction experienced in 1998, total loans and advances extended by the financial system grew marginally by only RM96.7 million. However, including the NPLs of the financial system sold to and managed by Danaharta during the year, total loans and advances extended by the financial system would be higher amounting to RM505.4 billion. Loans and advances to the non-financial private sector declined by RM10.9 billion with significant declines recorded for loans and advances extended for the purchase of shares (–20.5% or RM7.3 billion) and consumption credit (–11.4% or RM6.5 billion). However, loans and advances extended to the broad property sector increased by RM6.5 billion. The bulk of the increase was absorbed by housing loans (RM6.1 billion). As a group, loans and advances extended for these purposes accounted for 52.7% of total loans and advances extended to the non-financial private sector.

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

	Annual change		As at end 1998*p*	
	1997	1998		
	RM billion			% share
Loans and advances	94.6	–10.9	448.3	76.0
Agriculture	*1.3*	*0.2*	*9.2*	*1.6*
Mining & quarrying	*0.3*	*0.3*	*1.5*	*0.3*
Manufacturing	*1.7*	*–0.8*	*57.3*	*9.7*
Housing	*10.9*	*6.1*	*65.3*	*11.1*
Construction[2]	*26.7*	*0.4*	*92.3*	*15.6*
Business services	*–0.8*	*0.0*	*9.6*	*1.6*
General commerce	*7.9*	*–0.4*	*32.6*	*5.5*
Transport & storage	*5.2*	*1.6*	*13.8*	*2.3*
Purchase of shares	*11.3*	*–7.3*	*28.4*	*4.8*
Consumption credit	*13.9*	*–6.5*	*50.3*	*8.5*
Others	*16.3*	*–4.4*	*88.2*	*14.9*
Investment in corporate securities	7.8	9.6	141.8	24.0
Total	**102.3**	**–1.4**	**590.1**	**100.0**

[1] Excludes credit to non-financial public enterprises.
[2] Includes loans for real estate.

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In contrast, investment in corporate securities by the financial system recorded a stronger growth of RM9.6 billion or 7.2% (RM7.8 billion or 6.2% in 1997). In particular, the banking institutions' holdings of corporate securities increased by RM7.5 billion due mainly to investments in Danaharta and Danamodal bonds during the year. Holdings of corporate securities by pension and provident funds also increased in 1998. Deposits placed with other financial institutions, however, declined significantly by RM67.5 billion or 30.8% (increase of RM72.5 billion or 49.4% in 1997). This decline was mainly the result of the reduction in statutory reserves placed by banking institutions with BNM and the decline in the placement of deposits by BNM with banking institutions. In addition, interbank placements also registered a decline reflecting the slowdown in lending activity. Meanwhile, gross holdings of gold and foreign exchange reserves of BNM increased significantly by RM39.2 billion to RM96.3 billion at the end of 1998 (a decline of RM10.8 billion in 1997), reflecting mainly Malaysia's large trade surplus in 1998, foreign currency loans from both official and private financial institutions as well as the revision in the accounting policy effective September 1998, to recognise the foreign exchange revaluation gain/loss.

Management of the Banking System

The year 1998 proved to be one of the most challenging period for the banking system. The financial turmoil which hit the region in mid-1997 following the devaluation of the Thai baht had its full effect on the economy in 1998. The thrust of banking policies in 1998 was, therefore, twofold, aimed at crisis management to stabilise the banking system in the immediate term and building a strengthened and more resilient banking sector over the medium and longer term. Short-term measures were introduced to ensure the continued smooth

and efficient functioning of the intermediation process. At the same time, the consolidation, rationalisation and reform of the banking sector were initiated through mergers, the setting up of an asset management company, a bank recapitalisation agency and a corporate debt restructuring committee. These measures were introduced as part of the strategy to achieve the longer-term objective of a well-developed and strengthened banking sector.

Stabilisation Measures

Stabilisation measures were introduced in March 1998 to address key vulnerabilities in the banking system. Even though the banking system was in a strong position at the onset of the crisis, weaknesses, some structural in nature, began to emerge as the crisis worsened particularly towards the end of 1997. During the early months of 1998, the turmoil in the regional markets resulted in increased volatilities and uncertainties in the domestic financial markets and economy. One year into the crisis and signs of recovery among the Asian countries were not in sight. At the same time, inefficiencies in the distribution of liquidity within the system began to surface that affected the smooth functioning of the loan intermediation process. While the banking system as a whole remained sound and resilient amidst the crisis, some individual banking institutions were faced with severe liquidity constraints which caused them to bid interest rates upwards to a level that would not justify returns on investments for viable businesses. The fragmented finance company industry in particular, became a potential source of vulnerability which could have posed a systemic threat to the health of the overall system if allowed to deteriorate further. Priority was therefore given to rationalise and consolidate the finance company industry into fewer but stronger institutions through mergers. To further strengthen the resilience of the finance companies to withstand shocks in the changing economic and financial environment, a larger capital was prescribed to give additional buffer for the finance companies to absorb higher risks. A stronger capital base would accordingly enhance the risk-bearing capacity of the finance companies. In this regard, the minimum capital funds of the finance companies was increased from the existing RM5 million to RM300 million by mid-1999. The minimum requirement would be further raised to RM600 million by end-2000. In addition, the risk-weighted capital ratio of the finance companies was increased from 8% as prescribed under the Basle Capital Accord to 9% by end-1998 and to 10% by end-1999. Prudential regulations were also tightened and supervisory efforts intensified, with emphasis placed on early identification of problem loans and solvency issues. Efforts were also taken to enhance transparency on the financial position of individual banking institutions as well as the banking system.

As in any economy, the small- and medium-sized industries (SMIs) have an important role in providing the linkages between the various subsectors within the Malaysian economy. Under the prevailing difficult conditions, the SMIs were not spared from the adverse effects of the crisis. Given the importance of their operations, the strains on their cashflows had affected their debt servicing capability leading to deteriorating financial health that had, in some cases, affected their viability. Access to financing also became increasingly limited. Thus, to ensure that viable SMIs continued to have access to credit, a Fund for Small and Medium Industries was set up with an initial allocation of RM1 billion in January 1998 to provide financing to the SMIs at a maximum lending rate of 10% per annum. Reflecting the commitment of the Government to resolve the financial problems facing the SMIs, the allocation under the Fund was increased by RM500 million to RM1.5 billion in May 1998. The list of participating institutions was also expanded to include all commercial banks, 10 identified finance companies, all merchant banks and four development finance institutions, whilst the maximum lending rate under the Fund was reduced to 8.5% per annum in December 1998.

Efforts also continued to be directed to meet the nation’s socio-economic objective of promoting home ownership. Towards the end of the first quarter, the contraction in construction activities had also affected the construction of low- and medium-cost residential properties, while the demand for such residential properties remained high. There was therefore a need to ensure the continuous supply of affordable houses to meet such demand. Towards this end, BNM and Syarikat Perumahan Negara jointly allocated RM2 billion for the Special Scheme for Low and Medium Cost Houses in May 1998 to provide bridging finance to developers for the construction of residential properties costing RM150,000 and below at the maximum lending rate of 10% per annum. The maximum lending rate was further reduced to 8.5% per annum in December 1998.

Economic Recovery Measures

By the end of the first half of the year, the regional financial markets continued to be volatile and uncertain and the effect on the domestic economy became evident as the economic contraction became increasingly severe. While BNM had released liquidity into the system to support the financing needs of the economy, the banking institutions had become reluctant to provide new lending thereby posing a threat to the functioning of the intermediation process. The worsening economic condition coupled with the prolonged crisis had shifted the focus of the banking institutions. Banking institutions became pre-occupied with preserving their balance sheet and managing the deterioration in the quality of their loan portfolio as well as erosion in capital instead of generating new businesses. The rising incidence of non-performing loans (NPLs) had also resulted in banking institutions being overly cautious in their lending activities. As a result, many viable businesses were not able to obtain financing.

Access to financing is a crucial precondition towards economic recovery. Economic recovery measures were needed to create an environment that is conducive for business activities to operate. The need for a comprehensive solution was never more pressing and critical now than before. Measures were introduced to remove the risks and concerns that have emerged in the system. In the second half of the year, Pengurusan Danaharta Nasional Berhad (Danaharta), an asset management company, was set up as a pre-emptive measure to remove the NPL distraction from the banking institutions to enable them to refocus on their lending activities. Danaharta aimed to ensure that the level of NPLs in the banking system remained at manageable proportions. Danamodal Nasional Berhad (Danamodal) was subsequently set up to recapitalise those banking institutions whose shareholders were unable to raise the additional capital. These two agencies were further complemented by the setting up of the Corporate Debt Restructuring Committee (CDRC) to provide a mechanism for the banking institutions and debtors to work out feasible debt workout solutions. Given that the cases dealt with by the CDRC involved those with loans exceeding RM50 million, special loan rehabilitation units were established in individual institutions to manage distressed loans involving smaller amounts. (For a more comprehensive write-up, please refer to Box VI on "Restructuring the Banking Sector")

Weaker business expectations and over-cautious lending attitude of the banking institutions resulted in the outstanding loans of the banking system declining sharper than expected. Meanwhile, activities in the real sectors contracted during the first three quarters of the year. Concomitant with the slowdown in economic activities, it was evident that the initial estimate for loan growth of 15% for 1998 as submitted by the banking institutions in their credit plans had to be reassessed. In responding to the unfavourable developments prevailing in the domestic economy, the loan growth expectations for the year was subsequently revised downwards to 8%. The 8% loan growth for the banking system as a whole, would ensure that sufficient resources would be provided to the real sector to generate new economic activities. Banking institutions with financial constraints, however, were not expected to meet the 8% growth.

Whilst the Fund for Small and Medium Industries became a cheaper source of financing for the SMIs, these funds were extended primarily to fund the working capital requirements of the SMIs. As a large number of the SMIs was facing NPL problems, access to financing for this group of borrowers became limited. In view of this, the Government has set up the Rehabilitation Fund for Small and Medium Industries with a total allocation of RM750 million to provide financing at a maximum lending rate of 5% per annum, where part of the financing could be utilised to restructure the NPLs of SMIs.

Revisions in prudential norms which have direct influence on the credit behaviour of banking institutions and borrowers were announced as temporary measures in response to the prevailing economic condition without compromising on principles of strong supervision and financial prudence. The earlier tightening of the classification period for NPLs was relaxed from three months to six months. While tightening the classification period for NPLs was beneficial in bringing forward the recognition of problem loans, its implementation during periods of economic uncertainties and rising NPLs was not timely. The three-month ruling deterred banking institutions from their prime role of providing financing fearing that such course of action might undermine the quality of their balance sheets. As a result, viable businesses and activities were adversely affected. In addition, as the economic contraction resulted in many businesses experiencing cash flow problems, borrowers stopped

Banking Measures in 1998

Disclosure Requirements for the Banking Institutions: The disclosure requirements in the banking institutions' half-year financial statements were tightened in 1998. Individual banking institutions are required to publish in greater detail the half-yearly income and expenditure statement and provide information on capital adequacy, non-performing loans (NPLs), breakdown of their commitments and contingencies, movements in specific provision, general provision and interest-in-suspense as well as sectoral credit exposure according to economic sectors. In addition, the banking institutions are required to disclose the breakdown of their off-balance sheet items and their respective on-balance sheet credit risk equivalents in their annual financial statements.

This disclosure requirement is intended to promote market discipline by encouraging prudent behaviour by the management of banking institutions so that their financial position would compare positively with others. The information published would also enable more timely monitoring of the performance of the banking institutions by all stakeholders.

Guidelines on the Classification of NPLs: With effect from financial year beginning 1 January 1998, the default period for classifying a loan as non-performing was lengthened from three months to six months. The treatment for rescheduled and restructured credit facilities was also clearly defined. A rescheduled credit facility is one whose repayment terms have been modified but the principal terms and conditions of the contract have not changed significantly. This would include lengthening the repayment tenor of the facility. A restructured credit facility is one in which the terms and conditions have been modified principally, including changing the type or structure of facilities or other facility terms mainly to assist projects or businesses which are still viable. Loans which have been rescheduled can be reclassified as performing when repayments under the rescheduled terms have been complied with for a continuous period of six months, instead of the previous requirement of twelve months. Loans which are restructured for the first time can be reclassified as performing immediately after the completion of the relevant documentation. For subsequent restructuring, the loan will remain classified as non-performing until repayments under the restructured terms have been complied with for a continuous period of six months.

The change in the classification requirement and treatment of rescheduled/restructured facilities is intended to provide some breathing space for borrowers to regularise their accounts before being classified as non-performing, and will encourage borrowers to continue servicing their loans to avoid their loans from being classified as non-performing. Given the close linkages between the health of the banking sector and the performance of the economy, the redefinition of NPL would help strengthen the banking sector as business activities are given the opportunity to recover, thereby improving the debt servicing capacity of the corporate sector and ultimately the asset quality of banking institutions.

Guidelines on Provisions for Substandard Debts: With effect from financial year beginning 1 January 1998, banking institutions were required to provide 20% specific provisions against the uncollateralised portion of sub-standard loans. Banking institutions were also required to set aside provisions for off-balance sheet items where the banking institution faced credit risk from the failure of counter parties to fulfil their contractual obligations.

These requirements are mainly to increase the resilience of the banking institutions and ensure the build-up of their reserves as additional buffer against potential loan losses for accounts which exhibit some risk of loss due to adverse factors whilst, at the same time, streamlining the provisioning policy with international best practices. However, banking institutions with high loan loss reserves as determined by Bank Negara Malaysia (BNM) would not automatically be required to make provisions for their sub-standard loans.

Guidelines on Single Customer Limit: With effect from 25 March 1998, the limit on single customer exposure was reduced from 30% to 25% of total capital. Banking institutions were also required to comply with the single customer limit on a consolidated group basis. The lowering of the limit was to reduce the concentration of risk to a single customer by taking into account the exposure of all institutions in the group to a single customer.

Risk-weighted Capital Ratio - Compliance Requirement: With effect from financial quarter ended 31 March 1998, banking institutions were required to comply with the minimum risk-weighted capital ratio on a consolidated basis every quarter rather than annually.

The prolonged regional financial crisis and weak domestic economy had resulted in strains on the financial position of some of the finance-related subsidiaries of domestic banking institutions. If left unattended, losses experienced by the subsidiaries will eventually erode the capital base of their parent banking institutions.

This new requirement will enable BNM to monitor the capital adequacy position of banking institutions on a consolidated basis in a timely manner. Early recognition of capital erosion would also provide banking institutions ample time to plan and work out recapitalisation solutions.

Reduction of Liquid Asset Ratio: With effect from 3 September 1998, the liquid asset ratio requirement for commercial banks was reduced from 17% to 15% of their total eligible liabilities.

The funds released from the divestment of liquid assets can be used by banking institutions to improve their funding position and increase their loanable funds. The reduction has also enabled the gradual phasing in of the new liquidity framework introduced by BNM.

New Liquidity Framework: In July 1998, BNM introduced a new liquidity framework to replace the present liquid asset ratio requirement for the banking institutions. To ensure a smooth transition, banking institutions are given up to 1 January 2000 to migrate to the new framework. All banking institutions will be required to comply with the new framework by 1 January 2000.

Under the new framework, the liquidity needs of a banking institution is assessed based on its ability to match its short-term liquidity requirement arising from maturing obligations with maturing assets. Banking institutions will be required to make projections on the maturity profile of their assets, liabilities and off-balance sheet commitments in a series of maturity ladder to assess their potential future liquidity surplus and shortfall. To ensure that there is sufficient liquidity to meet their liability obligations in the near term, banking institutions will be required to maintain, as a minimum requirement, adequate liquidity surplus not only to meet expected obligations but also to sustain unexpected heavy withdrawals for at least one month.

The new framework aims to create awareness among banking institutions of their funding structure and their ability to handle short to medium-term liquidity problems. Besides providing BNM with better means of assessing the present and future liquidity position of banking institutions, the framework will encourage a more efficient and proactive management of liquidity among banking institutions. The framework also recognises individual banking institutions' strengths and weaknesses in managing their assets and liabilities portfolio. Banking institutions that manage their liquidity profile prudently and efficiently will no longer be required to hold high amounts of liquid assets. The efficient matching of assets and liabilities will allow better utilisation of funds.

The new liquidity framework will also help reduce the existing price distortion on liquid assets, in particular, Malaysian Government Securities and Cagamas bonds, due to the captive demand created under the present liquid asset ratio requirement. This will promote a more market-oriented pricing of such papers and eventually lead to a more active secondary market development.

Cagamas Securitisation Scheme on Hire-Purchase and Leasing Loans: On 12 December 1998, BNM announced the implementation of a securitisation scheme on hire-purchase and leasing loans with recourse by Cagamas. The

scheme will be subject to the following regulatory requirements:-

- Half of the proceeds from the sale of hire-purchase and leasing receivables will be subject to statutory reserve requirement while the new Cagamas debt securities issued to finance the purchase of hire-purchase and leasing debts will be regarded as Tier-1 Cagamas debt securities and accorded liquid asset status under the present liquidity framework and Class I liquefiable assets under the new liquidity framework.

- The recourse commitment by the selling institutions for loans sold under the new scheme would be treated as an off-balance sheet liability and be accorded a credit conversion factor of 100% while investment by banking institutions in the Cagamas debt securities will carry a risk-weight of 10%.

With more than 50% of the finance companies' loan portfolio comprising of hire-purchase and leasing, the scheme is expected to assist the finance companies in diversifying their funding sources and create additional liquidity to fund their lending activities. As Cagamas normally purchases loans on a 3- to 5- year basis, the scheme would also provide the much needed long-term financing to the financial institutions in order to minimise the liquidity and interest rate mismatch that currently arise from the funding of these assets through short-term deposits.

servicing their loans once their accounts were classified as non-performing. Thus, the lengthening of classification period for NPLs gave borrowers time to regularise their accounts, which ultimately benefited the banking institutions in terms of improved asset quality. While the classification period was lengthened to six months, other prudential rules were retained. A non-performing account would continue to be classified as bad when it had been in arrears for 12 months or more, while accrued interest previously recognised as income would be clawed back to day one of default. In addition, as part of the effort to promote greater transparency, the industry numbers for the NPLs based on both three-month and six-month classifications are published on a monthly basis. The lengthening of the classification period was also balanced with the mandatory requirement for all banking institutions with gross NPL ratios above 10% to sell their NPLs to Danaharta at market determined prices.

As the economy contracted and as activities in the capital market became extremely thin during the first three quarters of the year, the ability of shareholders to raise additional capital was also constrained. In this regard, compliance with the increased minimum capital funds of RM600 million by the finance companies and risk-weighted capital ratio of 10% was deferred until such time when the economy has recovered and the capital market has stabilised.

In an attempt to enhance the degree of transparency, banking institutions were required to publish key financial indicators on a quarterly basis. Nevertheless, as the crisis deepened, more attention was accorded towards managing sources of vulnerabilities arising from the crisis. The quarterly publication posed a heavy administrative burden on the banking institutions. In this regard, the requirement on the quarterly publication of financial indicators was temporarily uplifted so as to reduce the administrative burden of the banking institutions and at the same time, enable banking institutions to shift their focus on their operations. Banking institutions are, however, still required to make public their financial indicators on a semi-annual basis.

Measures were also put in place to contain further accumulation in the supply of high-end properties through the restriction on the provision of bridging finance to developers for the development of properties exceeding RM250,000. The prohibition includes the construction of residential properties, shop houses, hotels, resorts, office buildings, golf courses, clubs and shopping complexes. However, financing to end-buyers for the purchase of properties in both the primary and secondary markets is not affected by the prohibition. The restriction of financing would contain the entry of new properties into the market while at the same time assist in reducing the excess supply in the respective segments in the property market.

Box VI

Restructuring the Banking Sector

Background

Against the background of changing external and domestic conditions in the 1990s, Bank Negara Malaysia (BNM) continued with efforts to develop and reform the banking system in order to ensure that the banking system was well-placed to meet the challenges arising from the changing environment. Policies were, therefore, directed at:

- creating a core of domestic banking institutions which are well managed and highly capitalised, to meet the challenges of liberalisation and to spearhead the development of the financial sector;
- broadening and deepening the financial markets as well as strengthening the financial infrastructure to enable the sector not only to meet the changing needs of the domestic economy, but also to be a sector of economic growth;
- improving the overall level of efficiency and competitiveness of the sector; and
- accelerating the development of the bond market.

Over this decade, the legislative framework for the supervision of the banking institutions was further strengthened, following the review of the various banking legislations in the aftermath of the 1985-86 recession. The Banking and Financial Institutions Act 1989 (BAFIA), which came into effect in October 1989, provided a framework for an integrated supervision of the Malaysian financial system. In addition, the Government has adopted measures designed to increase the efficiency and soundness of the financial system, including measures to achieve credit growth that is in line with the overall macroeconomic growth, while at the same time reducing excessive banking institutions' exposure to the vulnerable sectors of the economy. Other prudential measures introduced include refining the capital adequacy framework, greater information disclosure and improving the risk management of banking institutions. The supervisory and regulatory framework has also constantly been structured to be consistent with international standards and best practices. Compliance with the Basle Committee's "Core Principles for Effective Banking Supervision" was already at an advanced stage before the onset of the crisis.

With the measures in place to achieve the long-term objectives, the banking system was in a position of strength at the onset of the financial crisis. This was reflected in terms of the quality of the asset portfolio and the level of capitalisation of the banking sector. As at end-June 1997, the net non-performing loan (NPL) ratio was at a low of 2.2% and the risk-weighted capital ratio (RWCR) of the banking system was 12%, exceeding the minimum requirement of 8%.

The regional crisis, however, exerted pressures on the currency and stock markets, causing the ringgit to depreciate and the Kuala Lumpur Composite Index to drop by about 35.1% and 44.8% respectively in the second half of 1997. As the financial crisis persisted, the effects on the economy and the financial system began to be felt. While policies had already been put in place to strengthen economic fundamentals as well as to stabilise the financial system, it was recognised that pre-emptive action was necessary to deal with the vulnerabilities of the banking sector. While some banking institutions were facing difficulties, the banking system as a whole remained sound.

Structural weaknesses in the financial system also became more evident. Strong loan growth between 1994-1997, which averaged about 25% per annum, had led to the high loan exposure of the banking system. In addition, the underdeveloped bond market has also resulted in the banking sector providing a significant portion of the private sector financing, thereby increasing the concentration of risk in the

banking sector. Although total financing of the nation amounted to RM722 billion at the end of 1998, this was mainly by the banking system (about 57% of the total financing), mainly because of the privatisation programme. The share of public sector debt declined while external debt was kept low by prudential regulations. As such, financing private sector growth was met mainly by the banking system.

In this environment of prolonged volatility in the financial markets, the finance companies became vulnerable given the highly fragmented nature of the industry (39 companies) and the nature of their business which focused mainly on hire-purchase financing and consumption credit, which was adversely affected by the rising interest rates and slowdown in the economy.

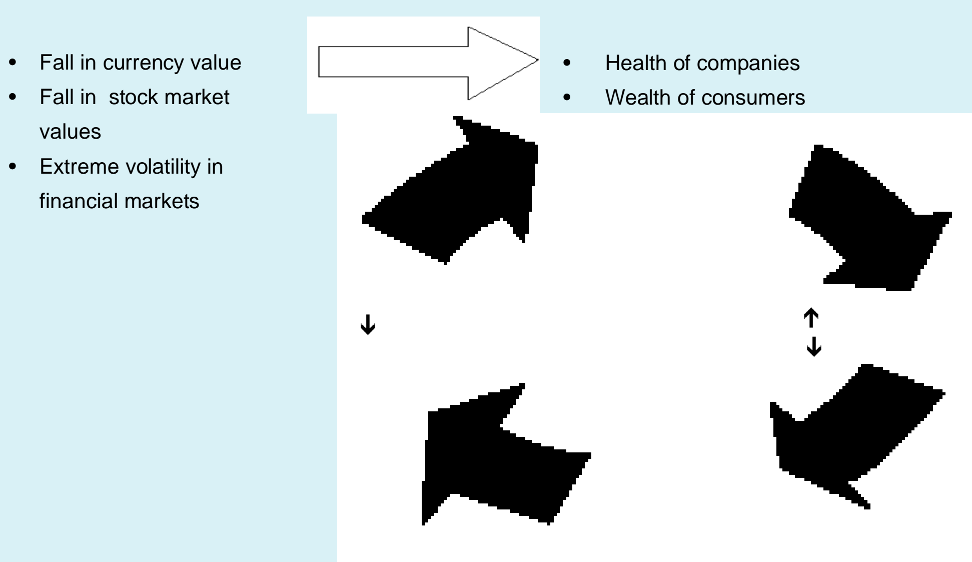
The prolonged financial crisis and subsequent contraction of the economy led to some deterioration in the quality of the asset portfolio of the banking institutions, with the net NPL to total loans ratio increasing to 8.9% as at end-June 1998. Banking institutions became increasingly preoccupied with managing their existing asset portfolio, self-imposing a credit squeeze mentality in their lending activities. The reluctance of the banking institutions to lend combined with higher interest rates caused severe difficulties for individuals and businesses, including viable businesses to obtain financing. This slowed down the prospects of economic recovery. At the same time, the rising level of NPLs also eroded the capital base of a number of banking institutions. While the RWCR for the banking system as a whole remained well above the minimum of 8%, a number of banking institutions required recapitalisation.

If these challenges were not addressed, the economy would be plunged into a vicious cycle, thus hampering economic recovery as illustrated in Chart VI.1 below.

Confidence needed to be restored rapidly in the financial markets in general and the banking sector in particular. If the lack of domestic and/ or external confidence were to persist, economic development would be hampered. The longer this behaviour persists, the more drastic the measures would be needed to restore stability and the higher its costs would be. In view of the worsening economic and financial conditions, the priority of policy since May 1998 was to minimise the contractionary effects of the crisis on the real sector and to further strengthen the financial system, given the critical role of the banking system in supporting the economic recovery.

In order to achieve this, the Government implemented a series of measures to promote

Chart VI.1
The Vicious Cycle of the Current Crisis



economic recovery. These measures included reducing interest rates, injecting greater liquidity into the banking sector and formulating a comprehensive plan to restructure the banking sector. The restructuring plan for the banking sector, which was initiated by the Government well before the NPL ratio reached double-digit levels, was comprehensive and pre-emptive in nature.

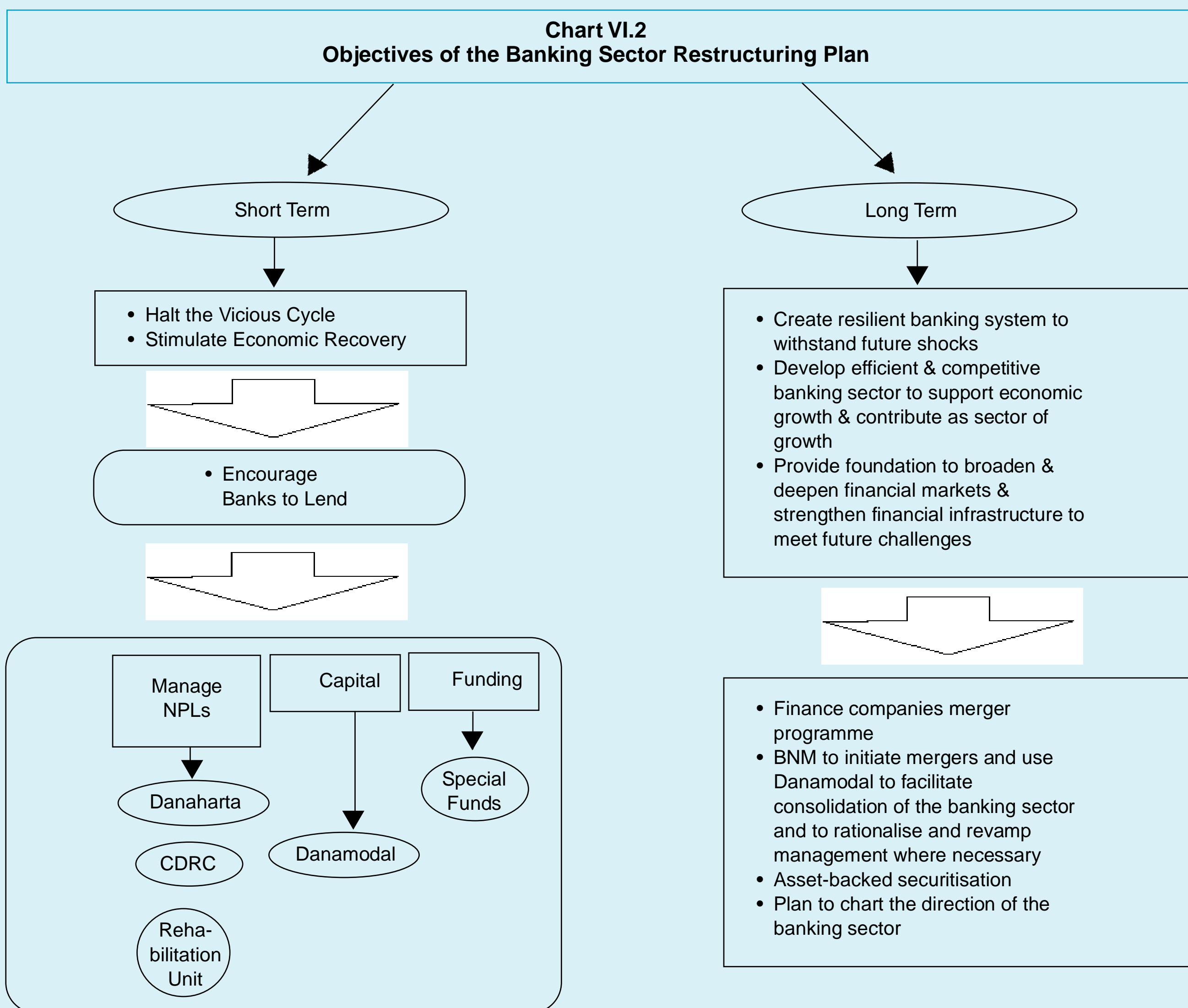
Banking Sector Restructuring

The restructuring plan was aimed at achieving the objectives illustrated in Chart VI.2 below.

The Government adopted a four-pronged approach to strengthen the resilience of the banking sector through a merger programme, the setting up of an asset management company, Pengurusan Danaharta Nasional Berhad (Danaharta); a special purpose vehicle, Danamodal Nasional Berhad (Danamodal); and the Corporate Debt Restructuring Committee (CDRC).

As the crisis had exposed the vulnerability of the finance companies, a merger programme for the finance companies was announced in January 1998 to consolidate and rationalise the industry. While this was consistent with the longer-term objective of creating a core of domestic banking institutions to meet the challenges of increased liberalisation, it also represented part of the overall pre-emptive strategy to increase the resilience of the finance companies to withstand risks arising from the economic slowdown. The merger exercise was however, market-driven, with BNM facilitating the process. On completion of the exercise in 1999, the number of finance companies would be reduced by more than half from the original 39.

Chart VI.2
Objectives of the Banking Sector Restructuring Plan



In view of the NPL problem in the banking sector, the Government established Danaharta, an asset management company, to purchase NPLs from banking institutions and manage these NPLs in order to maximise their recovery value. The speed at which Danaharta was set up and the financial commitment extended by the Government clearly demonstrated the serious intention of the Government to restructure and strengthen the banking sector. Danaharta, like the other asset management companies in the world, operated within the broad concepts of rehabilitation, restructuring and maximising recovery value of the assets.

While Danaharta would not purchase the entire NPL portfolio from the banking system, it would ensure that the residual NPLs in the banking sector remain at manageable levels at all times. To ensure that banking institutions utilise Danaharta to remove their NPLs, banking institutions with gross NPL ratio exceeding 10% are required to sell all their eligible NPLs to Danaharta, otherwise they would have to write down the value of these loans and restructure them. Banking institutions which required recapitalisation from Danamodal are also required to sell their eligible NPLs to Danaharta. The acquisition of NPLs by Danaharta would enable Danaharta to rehabilitate these loans in the most effective and efficient manner.

Danaharta would also assist the restructuring of the corporate sector. Once banking institutions have sold their NPLs to Danaharta, Danaharta would then be able to impose conditions on the borrowers which may include, amongst others, the reconstruction or rehabilitation of the underlying assets and identified cash flows. Danaharta also has the powers to appoint Special Administrators into viable companies that faced temporary cash flow problem. With the assistance from Danaharta and Danamodal, both the banking institutions and corporate sector would then be restructured.

Once the banking institutions are relieved of their burden in managing their NPL portfolio, they would be in a better position to resume their lending activities. However, the sale of NPLs to Danaharta would usually result in banking institutions incurring losses as Danaharta would purchase the NPLs at fair market value. Hence, recapitalisation of certain of these banking institutions became necessary to enable banking institutions to undertake additional businesses and risks and to encourage these banking institutions to resume their lending activities. The recapitalisation, under normal times, would usually be achieved through the effort of the banking institution's own shareholders. Given the current economic environment, the ability of shareholders of banking institutions to raise capital on their own was not expected to be very forthcoming. Hence, to facilitate the recapitalisation exercise of banking institutions, a special purpose vehicle, Danamodal, was established to address the constraints faced by the shareholders to recapitalise the banking institutions to healthy levels.

Danamodal would only inject capital into viable banking institutions on commercially viable terms and market principles. Due diligence reviews would be conducted by international investment bankers to determine the viability of the banking institutions and recapitalisation requirements. In all its capital injection exercises, Danamodal would adhere strictly to the "first-loss" principle where the existing shareholders would be required to bear all losses before the recapitalisation by Danamodal. The "undercapitalised" banking institutions would also have to sell all their eligible NPLs to Danaharta and comply with a comprehensive set of performance indicators.

As a strategic shareholder in these recapitalised banking institutions, Danamodal would then be able to institute micro reforms through its nominees appointed on the respective Boards of these banking institutions. Such reforms would include, amongst others, sound risk management practices and credit culture, good corporate governance and higher operational efficiencies. Danamodal, in its role as a strategic shareholder, may also facilitate mergers in line with BNM's objective to consolidate and rationalise the banking sector.

As the health of the corporate sector and banking sector are intertwined, the establishment of Danaharta and Danamodal would not be sufficiently comprehensive to arrest the problems in the banking sector. In view of the severity of the financial crisis, many corporates were also adversely affected. A

number of the corporate sector debts have either been classified as non-performing or exhibiting signs of potential default. Hence, restructuring these corporate debts to ensure that viable corporates continue to receive financing is crucial in order to generate new economic activities and support the economic recovery process.

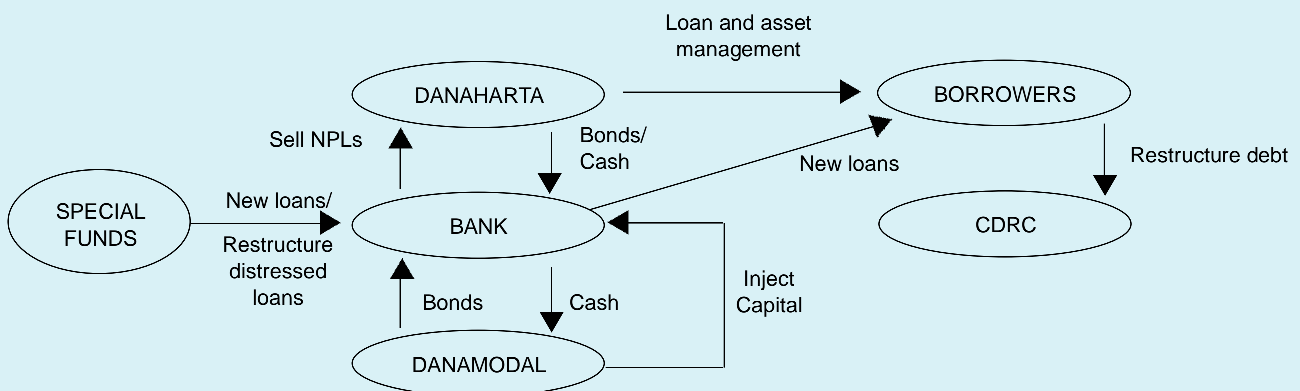
To facilitate the restructuring of corporate debt, a Corporate Debt Restructuring Committee (CDRC) was set up to provide a platform for both the borrowers and the creditors to work out feasible debt restructuring schemes without having to resort to legal proceedings. An increasing number of borrowers in financial difficulties had initially sought legal protection under Section 176 of the Companies Act 1965 rather than negotiating for loan restructuring. With the setting up of CDRC, borrowers would be able to direct their debt restructuring to CDRC. Under the CDRC debt restructuring framework, Creditor Committees comprising banking institutions would be formed to work out the debt restructuring. These restructuring efforts would be conducted based on market-driven principles to ensure that there would be a win-win situation for both the borrowers and the creditor banking institutions. The restructuring of the corporate sector debts would expedite the recovery of the corporate sector which would in turn strengthen the health of the banking institutions. If the process under CDRC could not obtain consensus among the banking institutions, Danaharta would assist by buying over these NPLs from the dissenting banking institutions, thereby facilitating the restructuring process. (Operational details of Danaharta, Danamodal and CDRC are elaborated in the Annex.)

Danaharta, Danamodal and CDRC are interdependent and complementary, representing a comprehensive and coherent plan towards strengthening the banking sector. The complementary nature of these measures is illustrated in Chart VI.3 below.

Given that the measures were interdependent, it was critical that the functions of Danaharta, Danamodal and CDRC were co-ordinated to ensure that these institutions operated in a cohesive and structured manner to achieve the desired objectives. In this regard, a Steering Committee, chaired by the Governor of Bank Negara Malaysia, was established to oversee and monitor the policies, operations and progress of Danaharta, Danamodal and CDRC. The Committee, which meets fortnightly, ensures that the operations of these institutions are well co-ordinated and complement each other, and to keep track of their progress. In addition, mechanisms are also in place to ensure that the activities of Danaharta, Danamodal and CDRC are appropriately sequenced.

In addition to Danaharta, Danamodal and CDRC, the Government has also established several special funds to provide funds at reasonable cost to promote investment in the priority sectors. These special funds include the Fund for Small and Medium Industries (RM1.5 billion), the Special Scheme for Low and Medium Cost Houses (RM2 billion) and Rehabilitation Fund for Small and Medium Industries (RM750 million). The Rehabilitation Fund for Small and Medium Industries was established to provide financial assistance to viable small- and medium-sized industries

Chart VI.3
Overview of Danaharta, Danamodal & CDRC



that are facing NPLs and temporary cash flow problems.

Progress of Restructuring Plan as at 15 March 1999

Danaharta

Danaharta has purchased and managed NPLs amounting to RM21.7 billion from the financial system, of which RM15.1 billion was from the banking system. These NPLs accounted for 20% of NPLs of the banking system as at end of December 1998. With the removal of NPLs from the banking system, the net NPL ratio of the banking system based on the 6-month classification declined from 8.1% as at end-September 1998 to 7.6% as at end-December 1998.

Danamodal

Danamodal has injected capital into 10 banking institutions in the form of Exchangeable Subordinated Capital Loans (ESCL) amounting to RM6.15 billion. This increased the RWCR of the banking system from 11.2% as at end-June 1998 to 11.9% as at end-January 1999, hence, increasing the capacity of banking institutions to generate new lending.

Danamodal has also signed Definitive Agreements with seven banking institutions to convert the ESCL into permanent Tier-1 and/or Tier-2 capital. To strengthen the management of these banking institutions, Danamodal has appointed Chairmen, Deputy Chairmen and Executive Directors into the respective Boards of six recapitalised banking institutions.

CDRC

CDRC has received 48 applications for debt restructuring, involving debt of RM22.7 billion. Two restructuring plans have been implemented thus far and 26 Creditor Committees have been formed to oversee the restructuring efforts.

Mergers

Eight finance companies have been absorbed/ merged, whilst another 14 finance companies will be absorbed/merged this year. Five small finance companies have been allowed to operate on a stand-alone basis for the time being. Nevertheless, the plan to rationalise these small finance companies remains part of BNM's agenda to further strengthen the finance company industry.

Three merger plans among commercial banks have been announced and expected to be completed by end-1999.

Conclusion

Following the implementation of selected exchange control measures and the fixing of the exchange rate at US$1=RM3.80, the stable domestic environment has provided an opportunity for the authorities to continue to undertake economic recovery measures as well as accelerate the necessary restructuring and reform in the financial and corporate sectors.

Signs of economic recovery have already emerged in early December, observed from the greater stability in the exchange rate, stock market, employment and in the financial sector. Borrowers now also have greater access to credit, and are less burdened by the high debt servicing cost. The strains on the banking system are expected to lessen as the economy recovers and the restructuring process continues. The restructuring process would strengthen the banking system and thus, place the banking institutions in a position to perform the intermediation function more efficiently and effectively to support the economic recovery process. A stronger banking system would contribute to a stronger and more developed financial system in the longer term, placing the financial system in a better position to meet the challenges of the future.

Moving Ahead

Globalisation and liberalisation of the financial markets will continue to pose great challenges to the banking sector. As the country graduates to become an industrialised nation, a resilient, dynamic, competitive and efficient domestic banking sector becomes highly critical in order to channel resources efficiently and effectively within the economy. The measures introduced thus far essentially serve as a short-term response to current challenges arising from the crisis and to provide the foundation on which to broaden and strengthen the financial infrastructure to enable the financial sector to meet the growing challenges of the future. The lessons that can be drawn from the crisis will help chart the strategic longer term plan for the banking industry. Efforts to further strengthen regulatory and supervisory framework would also continue. Prudential regulations would be continuously reviewed to ensure that best practices are being put to practice. The initiatives for the banking system will continue to be an evolving process to meet short-term challenges without detracting from achieving the long-term objective of a sound and resilient banking system in order to generate increased value-added in the financial services sector to support and contribute towards the overall growth of the real economy.

Table 4.5
Banking System: Unaudited Income and Expenditure

	For the calendar year			
	1997	1998	Annual change	
	RM million			%
Interest income net of interest-in-suspense	50,125	60,325	10,200	20.3
(Interest-in-suspense)	*520*	*4,899*	*4,380*	*842.5*
Less: Interest expense	33,412	45,570	12,159	36.4
Net interest income	16,713	14,754	–1,959	–11.7
Add: Non-interest income	4,943	6,081	1,138	23.0
Less: Staff Cost	3,993	3,895	–98	–2.5
Overheads	4,383	5,150	767	17.5
Profit before provisions	13,280	11,791	–1,489	–11.2
Less: Loan loss provisions	5,625	14,051	8,426	149.8
Pre-tax profit	7,655	–2,260	–9,914	–129.5
(excluding 3 institutions)[1]	*8,717*	*793*	*–7,925*	*–90.9*
Of which:				
Commercial banks	5,717	531	–5,186	–90.7
Finance companies	1,274	–2,150	–3,424	–268.7
Merchant banks	663	–641	–1,304	–196.7
Return on assets	1.3%	–0.3%		
(excluding 3 institutions)[1]	*1.7%*	*0.1%*		
Return on equity	17.5%	–4.5%		
(excluding 3 institutions)[1]	*22.1%*	*1.7%*		

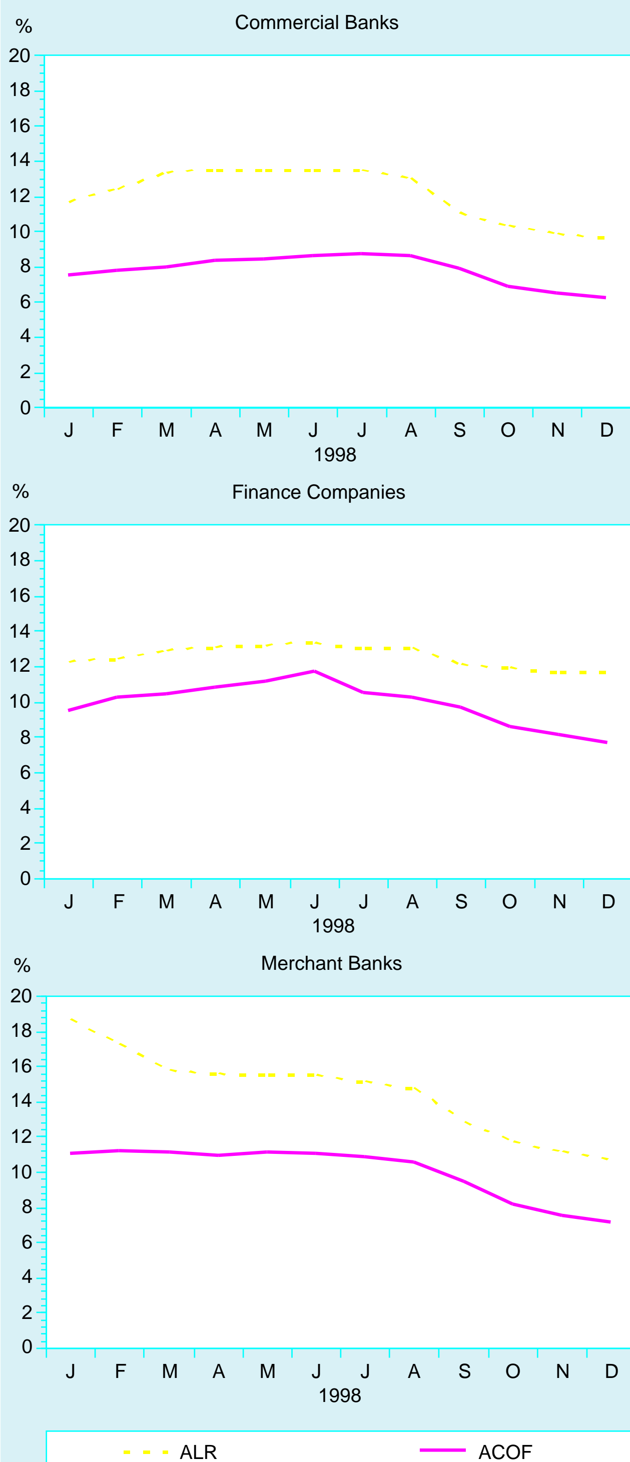
[1] Excluding 3 banking institutions that made exceptional loss.

Performance of Banking System

Profitability

The banking system recorded a pre-tax loss of RM2.3 billion for calendar year 1998 as compared with a pre-tax profit of RM7.7 billion in 1997. This pre-tax loss was due to exceptionally large losses recorded by two commercial banks and one finance company. Excluding the losses registered by these three institutions, the banking system recorded a pre-tax profit of RM793 million which generated a marginal 0.1% return on total assets and 1.7% on total equity. Although the commercial banks as a group (excluding the two commercial banks) recorded a pre-tax profit of RM2.5 billion, this was, however, offset by the pre-tax loss of RM1.1 billion registered by the finance companies (excluding the one finance company) and the loss of RM641 million recorded by the merchant banks.

Losses recorded by the banking system in 1998 were due to the economic contraction which gave rise to negative loan growth, rising NPLs and higher loan loss provisions. Before factoring in the loan loss provisions, the banking system as a whole registered a pre-tax profit of RM11.8 billion, lower than the RM13.3 billion recorded in the previous year. Loan loss provisions and interest-in-suspense charged rose significantly by RM12.8 billion (+208%) to RM19 billion in 1998, mainly as a result of increased net specific provisions charged of RM9.3 billion. Of the total loan loss provisions and interest-in-suspense, RM5.1 billion or 27% was contributed by the three institutions which registered significant losses. The higher loan loss provisions recorded in 1998 was also partly due to the adoption of more stringent provisioning requirements under the revised Guideline on the Suspension of Interest on Non-Performing Loans and Provision for Bad and Doubtful Debts which shortened the period during which banking institutions are required to make loan provisions for doubtful and bad loans.



The reduction in interest rates and the higher incidence of NPLs saw the banking system earning lower net interest income of RM14.8 billion. Although interest rates in the first seven months of 1998 were high, the rapid downward adjustment in interest rates by BNM in the later part of 1998 saw the overall net interest income declining by 11.7% in 1998. The rapid reduction in the 3-month intervention rate by BNM, to which the computed BLR of the commercial banks and finance companies was pegged, from 10.5% per annum in August 1998 to 7% per annum in September 1998, took its toll on interest margins temporarily as banking institutions' average cost of funds normally lags the policy rate by 3-6 months before falling to the new interest rate level.

The finance companies' profitability was also heavily squeezed during the early part of 1998 when a liquidity shortage in the system drove short-term deposit rates up on the back of fixed rate hire-purchase and term loans offered by the finance companies, causing the interest rate margins to narrow considerably to 1.7 percentage points. In addition, lack of sufficient new hire-purchase loans during the year reduced the ability of the finance companies to earn enough positive returns to compensate for the negative spread incurred on their existing fixed rate loan portfolio. Merchant banks, on the other hand, benefited greatly from the liquidity shortage in terms of interest margins as significant increases in interbank rates in the early part of the year were automatically translated into higher lending rates under their KLIBOR-plus loan pricing.

Non-interest income increased by RM1.1 billion in 1998. The favourable comparison to 1997 was due to an exceptional non-recurring provision for diminution in value of regional investment securities by one commercial bank in 1997 of RM0.9 billion and an increase of RM461 million in net trading income in 1998. Staff cost was contained at RM3.9 billion, while overheads rose by RM0.8 billion to RM5.1 billion in 1998.

Loan Growth

Credit extended by the banking system as a whole declined by RM7.6 billion (–1.8%) in 1998. This was due mainly to the removal of loans by Danaharta in 1998 which amounted to RM13 billion (not including loans sold by the Malaysian banks' overseas branches, which amounted to RM1.4 billion). Taking into account the removal of loans by Danaharta, the banking system as a whole registered a marginal growth of RM5.5 billion or 1.3% in 1998. Higher loan repayments, which increased by 5.5%, and lower turnover in loan disbursements by 26.6% also contributed to the slowdown in growth momentum. Only the

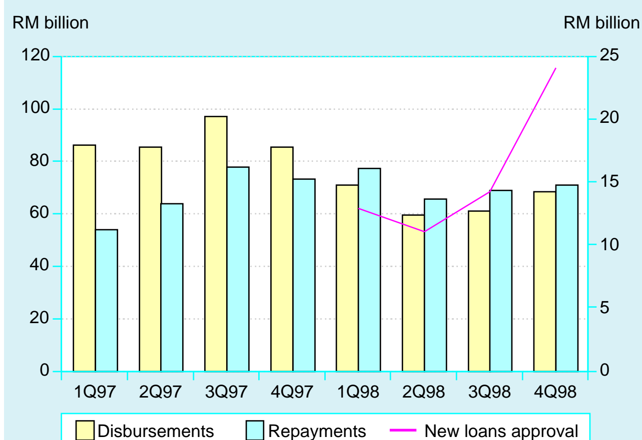
Table 4.6
Banking System: Outstanding Gross Loans

	As at end				
		1998			
	1997	Excluding loans sold to Danaharta		Including loans sold to Danaharta	
	RM million	RM million	Annual change (%)	RM million	Annual change (%)
Commercial banks	289,756.7	299,257.8	3.3	310,405.2	7.1
Finance companies	108,389.2	92,182.1	–15.0	93,072.1	–14.1
Merchant banks	23,056.6	22,198.3	–3.7	23,200.1	0.6
Banking system	**421,202.5**	**413,638.1**	**–1.8**	**426,677.3**	**1.3**

commercial banks as a whole managed to show a positive growth of 3.3% (7.1% if loans removed by Danaharta are taken into account), while both finance companies and merchant banks showed negative growth in 1998. If banks that do not have the capacity to lend due to capital adequacy problems are excluded, the loan growth of the remaining commercial banks was even higher at 8% in 1998. The positive credit growth exhibited by the commercial banks and the negative growth by the finance companies were partly due to the absorption of several finance companies by their respective parent banks.

As the regional financial turmoil became prolonged, banking institutions faced with economic uncertainties became cautious in extending credit during 1998. Tight and uneven distribution of liquidity further heightened the problem.

Graph 4.2
Banking System : Quarterly New Loans Approved, Disbursements and Repayments



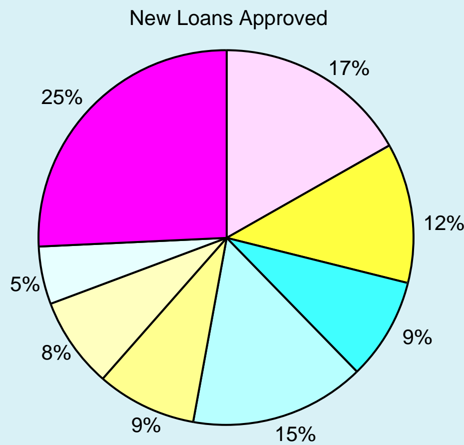
Consequently, only RM38.2 billion of new loans were approved during the first three quarters of 1998, or an average of RM4.2 billion a month. Several measures were introduced to inject greater liquidity, reduce interest rates and remove barriers to the supply of new financing, including the setting up of Danaharta to buy NPLs and the formation of Danamodal to recapitalise banking institutions.

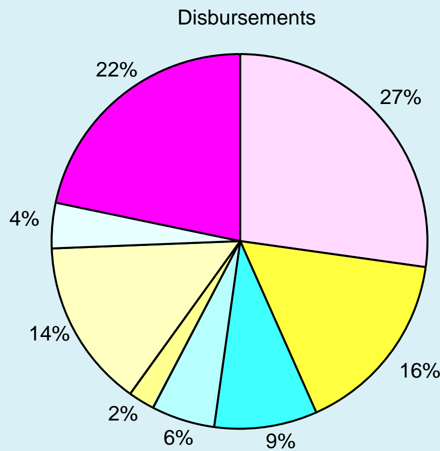
The more conducive business environment brought about by the reduction in interest rates, greater liquidity, the removal of the twin distraction of rising NPLs and erosion of capital as well as rising consumer confidence, resulted in a significant rise in new loans approved during the fourth quarter of 1998. New loans approved amounted to RM24 billion during the last quarter of 1998, or an average of RM8 billion a month, nearly two-fold increase over the preceding nine months. For 1998 as a whole, manufacturing and end-financing for purchase of residential properties were the largest recipients of new loans approved. Loans for the purchase of residential properties costing RM150,000 and below accounted for more than 60% of the new loans approved to the residential property sector.

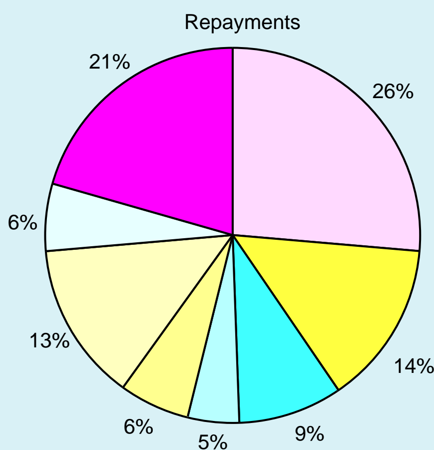
Asset Quality

The asset quality of the banking system was adversely affected during 1998. In an environment where interest rates were high and economic activities had contracted, the ability of borrowers to service their debt was invariably affected. This was evident in the sharp increase in NPLs in the banking system in 1998.

Graph 4.3
Banking System: New Loans Approved, Disbursements & Repayments by Sector in 1998







The actual NPLs of the banking system increased by RM34.2 billion or 8.3% of total loans in 1998, whilst on the 3-month classification basis, NPLs grew by RM48.8 billion. On a net basis, the actual NPL ratio of the banking system increased from 4.1% as at end-December 1997 to 9% as at end-December 1998. As at end-December 1998, 57 banking institutions have reverted to the 6-month classification policy for NPL and they account for 54% of total loans of the banking system. Based on the 3-month classification policy, the net NPL ratio of the banking system increased from 4.7% as at end-December 1997 to 13.2% as at end-December 1998. Excluding the NPLs of three banking institutions that were most affected, the net NPL ratio for the industry as a whole was 12.2% as at end-December 1998. For the commercial bank industry, their net NPL ratio remained below 10% as at end-December 1998.

Although NPLs had increased during the year, the rate of increase has in fact moderated during the fourth quarter of 1998. The average monthly increase in NPLs from October to December 1998 slowed down to 6.2% (after taking into account loans sold to Danaharta), as compared with the average monthly increase of 11.3% in the first nine months of 1998. In December 1998 alone, the monthly rate of growth in NPLs moderated to 2.7%. Loan loss coverage ratio of the banking system declined slightly with total provisions (interest-in-suspense, specific provisions and general provisions) set aside by the banking system amounting to 55.7% of NPLs. Including the value of collateral, the total loan loss coverage of the banking system amounted to 143.3% of NPLs as at end-December 1998.

In terms of NPLs by sector, as at end-December 1998, loans to the broad property sector accounted for 35.3% of total loans and gross NPLs to the broad property sector accounted for 35.1% of total NPLs as at end-December 1998. A major proportion of NPLs to the broad property sector came from the construction and real estate sectors, which accounted for 61.6% of total broad property sector NPLs (52% as at end-1997). NPLs for the purchase of residential properties remained relatively low at 11%.

The sharp decline in the stock market has also adversely affected the quality of loans extended for the purchase of securities. The NPL ratio for the purchase of securities increased from 6.5% as at

end-1997 to 23.2% as at 31 December 1998. However, given the relatively low exposure of the banking system to share financing at 7.9% as at end-1998, the high levels of NPLs for share financing remained manageable.

Table 4.7
Banking System: Non-performing Loans and Loan Loss Provisions

	As at end			
	1997	1998		
	Actual[1]	Actual[1]	3-month Classifi-cation	6-month Classifi-cation
	RM million			
Commercial banks				
General provisions	6,216	6,501	6,555	5,693
Interest-in-suspense	1,805	4,087	4,201	3,643
Specific provisions	3,268	12,602	13,348	11,704
Non-performing loans	14,159	37,279	44,896	32,086
Net NPL ratio (%) [2]	*3.2*	*7.3*	*9.7*	*5.9*
Total provisions / NPL (%)	*79.7*	*62.2*	*53.7*	*65.6*
Finance companies				
General provisions	1,788	1,824	1,824	1,824
Interest-in-suspense	990	2,193	2,640	2,237
Specific provisions	1,923	3,601	3,822	3,551
Non-performing loans	9,798	17,901	25,122	16,320
Net NPL ratio (%) [2]	*6.5*	*14.0*	*21.8*	*12.2*
Total provisions / NPL (%)	*48.0*	*42.6*	*33.0*	*46.6*
Merchant banks				
General provisions	443	446	446	446
Interest-in-suspense	91	463	624	456
Specific provisions	211	1,274	1,416	1,189
Non-performing loans	1,096	4,083	7,197	3,888
Net NPL ratio (%) [2]	*3.5*	*11.5*	*25.6*	*10.9*
Total provisions / NPL (%)	*68.0*	*53.5*	*34.5*	*53.8*
Banking system				
General provisions	8,447	8,771	8,825	7,963
Interest-in-suspense	2,886	6,743	7,465	6,336
Specific provisions	5,402	17,477	18,586	16,444
Non-performing loans	25,053	59,263	77,215	52,294
Exclude 3 banking institutions	16,967	46,203	61,278	39,539
Net NPL ratio (%) [2]	*4.1*	*9.0*	*13.2*	*7.6*
Exclude 3 banking institutions	*3.2*	*8.3*	*12.2*	*6.7*
Total provisions / NPL (%)	*66.8*	*55.7*	*45.2*	*58.8*
Exclude 3 banking institutions	*75.9*	*55.1*	*44.5*	*58.8*

[1] Loans classified as NPLs based on individual banking institution's NPL classification policy i.e. 3-month or 6-month classification.
[2] Net NPL ratio = (NPL less IIS less SP) / (Gross loans less IIS less SP) x 100%.

Table 4.8
Banking System: Non-performing Loans by Sectors

	As at end		
	1997	1998	
	as % of total loans to sector		
		Excluding loans sold to Danaharta	Including loans sold to Danaharta
Agriculture, hunting, forestry & fishing	6.4	10.6	11.7
Mining & quarrying	11.1	15.5	16.1
Manufacturing	5.8	14.3	16.6
Electricity, gas & water	0.6	0.9	1.1
Community, social & personal services	8.3	13.2	13.4
Broad property sector	6.3	16.4	18.4
Real estate	*11.7*	*28.9*	*30.7*
Construction	*5.7*	*18.6*	*21.7*
Purchase of residential property	*8.1*	*11.0*	*11.0*
Purchase of non-residential property	*5.8*	*12.9*	*15.6*
Wholesale & retail, restaurants & hotels	4.4	11.2	12.6
Transport, storage & communication	5.2	18.2	19.4
Finance, insurance & business services	3.8	12.4	13.9
Purchase of securities	6.5	23.2	34.2
Consumption credit	6.9	14.1	14.1
Personal use	*6.0*	*15.4*	*15.6*
Credit card	*10.1*	*17.4*	*17.4*
Purchase of consumer durables	*13.3*	*18.2*	*19.4*
Purchase of transport vehicles [1]	*6.7*	*13.0*	*13.0*
Others	7.5	12.6	13.2
Total	**5.9**	**14.3**	**16.8**

[1] Includes commercial vehicles.

The increase in NPLs was mainly concentrated in the construction, real estate and commercial sectors and for the purchase of shares which together accounted for RM15.5 billion or 45.2% of the total increase in NPLs in 1998. Recognising the vulnerabilities of these sectors, BNM has prohibited banking institutions from extending bridging financing for the development of properties above RM250,000. Although the limit on loans extended for the purchase of shares was increased from 15% to 20% of total loans in September 1998, this was aimed at providing share financing for genuine long-term investment and not for short-term speculative purposes.

Table 4.9
Exposures of Malaysian Banks to East Asian Region

Country	Regional exposures as at 31.12.97	Regional exposures as at 31.12.98	Annual change (%)
	US$ million		
Indonesia	492	490	–0.4
Thailand	276	219	–20.7
Korea	32	32	–
Philippines	735	36	–95.1
Total	**1,535**	**777**	**–49.4**

Exposure to the East Asian Region

The Malaysian banks' exposure to countries in the East Asian region affected by the severe economic crisis was mainly confined to seven banking institutions through their overseas branches and Labuan offshore units. As at 31 December 1998, the loan exposure of the banking institutions to Indonesia, Thailand, Korea and the Philippines was US$777 million, a reduction of US$758 million from December 1997. The significant reduction was due to the sale of some of these loans to Danaharta, particularly those originating from the Philippines. The loan exposure represented only 1.7% of the total assets of the affected Malaysian banks. Nevertheless, banking institutions have been encouraged to recognise potential problems early and to build up provisions for the regional exposures.

Capital Strength

Corresponding with the losses made by the banking system, total Tier-1 capital of the banking system fell by RM4.3 billion (–9.2%) to RM42 billion as at end-1998. The year also saw a reduction in the paid-up capital of finance companies due to the absorption of five finance companies by their parent banks and a merger of two finance companies. Nevertheless, the decline in Tier-1 capital was offset by a RM4.55 billion injection of Tier-2 capital funds by Danamodal in the form of Exchangeable Subordinated Capital Loan into nine banking institutions. This resulted in a marginal increase in the overall capital base of the banking system by 2.2% or RM1.2 billion to RM55.6 billion.

Total risk-weighted assets of the banking system declined by 8.9% or RM46.1 billion to RM470.9 billion as at end-1998, due mainly to the contraction of credit during the first three quarters of the year, and acquisition and management of loans of RM13 billion by Danaharta. The risk-weighted assets in the 0% and 20% risk-weight category also declined significantly by RM34.2 billion and RM23.6 billion respectively. The reduction in the riskless asset class was mainly due to reduction in the banking system's statutory deposit with BNM of RM41.7 billion following the reduction in the statutory reserve requirement from 13.5% to 4%. The bulk of the reduction was channelled towards repaying the banking system's money market borrowings from BNM which amounted to RM23.7 billion. The reduction in assets in the 20% risk category was due to a significant decline in NIDs held (–RM5 billion), other acceptances discounted (–RM5.7 billion), claims on reverse repos (–RM3.2 billion), and claims on OECD and non-OECD banks (–RM7.9 billion).

Reflecting the injection of capital by Danamodal, the removal of NPLs by Danaharta and the decline

Table 4.10
Banking System: Constituents of Capital

	As at end 1997	As at end 1998	Annual change	
	RM million		RM million	(%)
Tier-1 capital	46,203	41,941	–4,262	–9.2
Tier-2 capital	12,584	18,298	5,713	45.4
Total capital	58,788	60,239	1,451	2.5
Less:				
Investment in subsidiaries and holding in other banking institutions' capital	4,431	4,667	236	5.3
Capital base	54,356	55,571	1,215	2.2
Risk assets:				
0%	122,174	87,929	–34,245	–28.0
10%	31,595	26,160	–5,435	–17.2
20%	133,362	109,770	–23,592	–17.7
50%	61,195	62,452	1,257	2.1
100%	456,565	415,057	–41,508	–9.1
Total risk-weighted assets	516,995	470,853	–46,142	–8.9
Risk-weighted capital ratio (%)				
Banking system	**10.5**	**11.8**	**1.3**	
Commercial banks	10.3	11.7	1.3	
Finance companies	10.3	11.1	0.8	
Merchant banks	13.3	15.2	2.0	

in total loans, the risk-weighted capital ratio (RWCR) of the banking system showed an increase of 1.3 percentage points to 11.8% as at end-1998 inspite of the pre-tax loss recorded by the banking system as a whole. By type of institution, the RWCR of commercial banks, finance companies and merchant banks showed an improvement from the 1997 position, to 11.7%, 11.1% and 15.2% respectively.

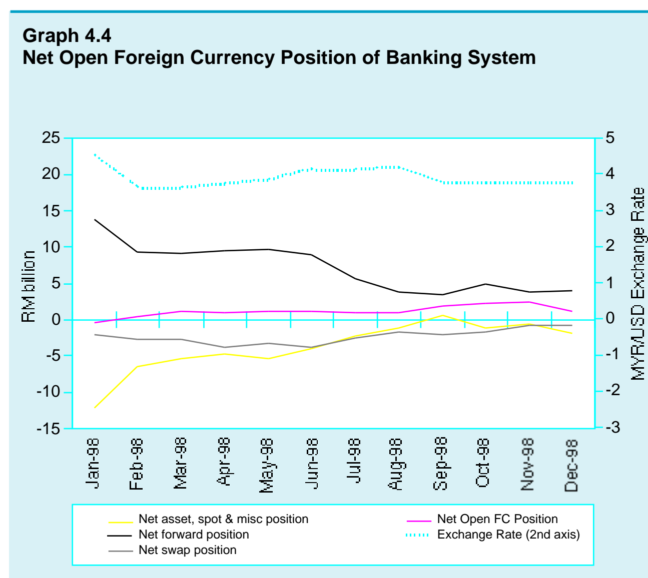
Foreign Currency Exposure

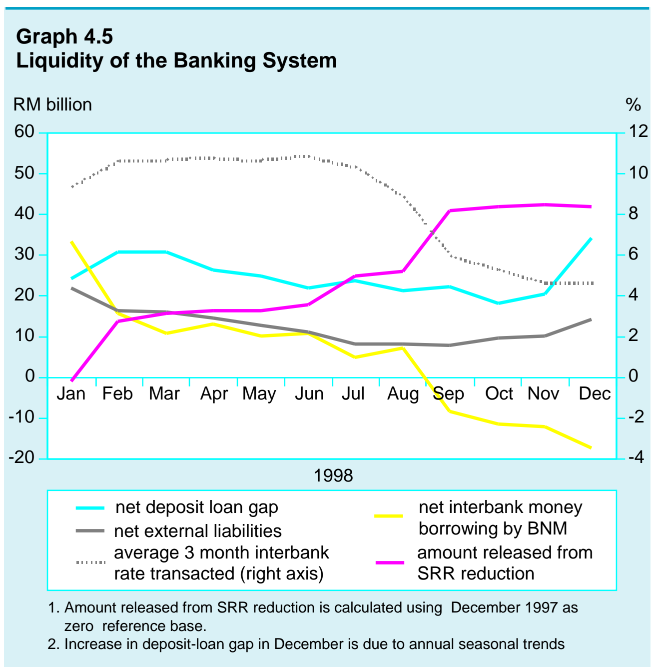
The banking system maintained a relatively small foreign currency position during 1998. Throughout the year, the banking system was net long in forward foreign exchange transactions. This was in line with the net export position recorded during 1998, where overall, there were more parties contracting to sell forward foreign exchange proceeds compared with forward purchases to the banking system. Nevertheless, those positions were essentially matched by the banking system with opposite swap contracts and foreign currency borrowings. There were less forward foreign exchange contracts towards the fourth quarter when capital controls were introduced in September 1998 and concerns over volatile exchange rates diminished.

Liquidity

A large number of banking institutions experienced tight liquidity situation in the first half of the year. Tight liquidity during the period was attributed to the continuous fall in total deposits of RM7.7 billion and the decline in the net external liability position of banking system of RM11 billion, caused by the withdrawal of external funds from the domestic banking system. As a result, banking institutions that had been over-reliant on short-term funding to finance their asset growth, particularly from the interbank money market, encountered funding difficulties. The uneven distribution of liquidity led to a rise in short-term interest rates early in the year. The differences between the highest and the lowest rates transacted among interbank players were as high as 8.8 percentage points for 1-week money and 1.1 percentage points for 1-month money in January. In order to distribute liquidity more evenly among the banking institutions, the statutory reserve requirement of banking institutions was reduced from 13.5% to 10% in February 1998.

Liquidity conditions improved further towards the second half of the year following further reductions in the statutory reserve requirement from 10% to 8% in July and subsequently to 6% and 4% in September. This was accompanied by gradual reductions in the BNM 3-month intervention rate from 10.5% per annum at the beginning of August to 7% per annum in November. These measures contributed to ease the liquidity conditions in the money market as well as to bring down the cost of funds of the banking institutions. As a result, the computed BLR for commercial banks declined from 12.30% per annum in June to 8.08% per annum in December 1998 and for finance companies, from 14.76% per annum to 9.54% per annum. The improvement in the overall liquidity condition was also reflected by the reduction in BNM's money market lending to the banking system.





Box VII

Managing the Y2K Challenges in the Malaysian Banking Industry

Introduction

Given the heavy dependence of the nation on information technology and automation, there is grave concern that business operations would be severely disrupted as we move on to the next millennium if computer systems and automated applications fail to be Year 2000 (Y2K) ready. For the financial sector, the Y2K challenges are especially acute, as it relies heavily on automation in almost all aspects of operations. If automated applications fail to function properly, it will be difficult, if not impossible, to conduct business. In view of this, BNM and the industry has adopted a proactive approach to confront the Y2K challenges.

Impact of the Y2K Challenges

In any economy, the Y2K issue poses significant challenges as businesses and other daily activities are highly dependent on computer technology and integrity of data. Failure to address the problem would result in many automated applications failing to function normally and lead to disruptions in business activities as well as our everyday life. The banking industry faces the greatest challenge, due to its pivotal role in the payment and settlement systems. It is exposed to various risks if it fails to address the Y2K challenges in a proper and timely manner. The payment system may be severely disrupted if the Y2K challenges are not addressed expeditiously. When this happens, the settlement system, both domestically and internationally, will be affected and as a result, customers will not be able to perform their normal banking transactions.

These disruptions could expose banking institutions to a wide array of risks, which include operational risks, credit risks, reputational risks, settlement risks as well as legal risks.

Operational risks are the most obvious. Failure to ensure fully operational automated systems can prevent even simple business functions from being transacted because manual or other alternatives may not be feasible, in view of the sizeable volume of transactions or integrity of data. For example, if the Automated Teller Machine (ATM) network, which is highly dependent on automation, fails to comply with Y2K requirements, cardholders will not be able to perform banking transactions through the ATM.

There are other risks associated with the breakdown in the operations as correspondents and clients would be severely affected by the disruption in the operating environment. In the case where the ATM of a banking institution fails to function, there would be a build-up of negative perception on that institution. This may in turn expose the institution to **reputational risks** and consequently to **legal risks.** Customers would resort to legal action against the institution as it would not be able to conduct transactions, resulting in potential damage to the institution's business.

Business customers of banking institutions may also suffer serious disruptions to their businesses if they fail to meet with the Y2K requirements, thus probably affecting their ability to service their loans. This will in turn increase the **credit risks** for the banking institutions. Furthermore, an operational breakdown resulting from the lack of preparation to deal with the Y2K challenges by any one of the financial market participants may affect the integrity and operation of the entire settlement system, which may even lead to the collapse of the entire payment system. For example, a Y2K-induced operational breakdown that results in delayed fund payments may cause significant liquidity pressures for other market participants. These disruptions and interruptions in the banking system could erode

the public confidence in the integrity of the banking system.

Bank Negara Malaysia's Action Plan

BNM is aware and concerned about the challenges posed by the Y2K problem and the potentially serious implications for the financial market and the public at large arising from the lack of readiness. BNM has adopted a proactive approach to confront the Y2K challenges. Amongst the measures implemented by BNM in managing the Y2K challenges include:-

- Establishing targets and benchmarks for institutions to adhere to in addressing the Y2K challenges;
- Developing and communicating the necessary framework in implementing the Y2K project through the issuance of circulars and guidelines;
- Conducting an industry-wide status assessment through regular reporting by the financial institutions to BNM and the periodic examination of the financial institutions; and
- Placing supervisory pressure on financial institutions to ensure high level of compliance with the Y2K requirements.

A Y2K monitoring system has been implemented to monitor the progress of each banking institution in achieving a fully Y2K-compliant operation. BNM also conducts regular on-site inspections on financial institutions to complement the monitoring process. A special unit, staffed with trained personnel to conduct IT audits, has also been set up to specifically audit the progress of banking institutions in complying with the Y2K requirements.

Y2K Steering Committee for Banking and Insurance Industries

BNM realises that the Y2K issue, which initially started as a technical problem, is a business survival issue for the banking community as a failure by one institution would have ramifications on the whole system. In this regard, an industry-driven approach with supervisory support and oversight from BNM was adopted. Under this approach, the industry undertook collectively planned and co-ordinated steps spearheaded by an Industry Y2K Steering Committee. The Steering Committee, comprising chief executive officers of financial institutions, plays **a proactive role** to ensure that the financial industry in Malaysia can move confidently and smoothly into the next millennium.

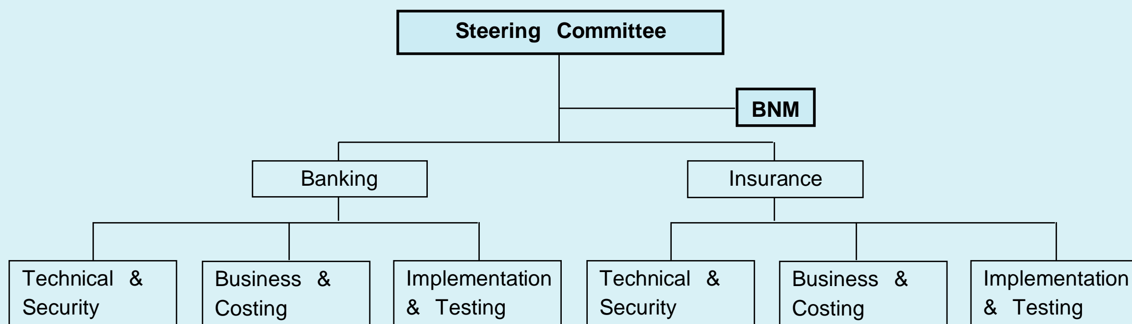
The **terms of reference** of the Y2K Steering Committee are as follows:-

(i) Creating awareness across the industry;

(ii) Creating support from the highest level within an institution;

(iii) Planning and co-ordinating industry-wide action plan;

Banking and Insurance Industry Y2K Steering Committee



(iv) Planning and co-ordinating testing and interfacing of various applications;

(v) Managing cost control;

(vi) Co-ordinating issuance of public statements on the state of readiness of the banking and insurance industries in complying with the Y2K issue; and

(vii) Ensuring security and control issues are appropriately addressed.

Working Committees

The Y2K Steering Committee is supported by two working committees, namely the Banking Sector Working Committee and the Insurance Sector Working Committee. The Banking Sector Working Committee comprises representatives from the commercial banks, merchant banks and finance companies, whilst the members of the Insurance Sector Working Committee are representatives from the insurance companies. Within these two groups, three sub-working committees on each sector were formed to tackle specific issues. The technical and security working committee would address technical and security-related issues, including identifying and listing of inventories to be renovated, while the business and costing working committee would address business and cost-related issues. The responsibility of the business and costing working committee includes co-ordination with vendors to obtain a reasonable cost of renovation as well as ensuring a co-ordinated approach in communicating with the public on Y2K-related issues. The implementation and testing working committee is responsible for co-ordinating testing initiatives within the industry. These sub-committees report to the Y2K Steering Committee on a regular basis in order to keep the Steering Committee abreast with the current progress of the industry's Y2K readiness.

Implementation Timeframe

As compliance with the Y2K requirements is crucial, the deadline for complying with the Y2K requirements cannot be compromised. In this regard, the timeframe as recommended by the Bank for International Settlements (BIS) in handling the Y2K challenges has been adopted for the Malaysian banking and insurance industries. Under the timeframe, there are four main stages as follows:-

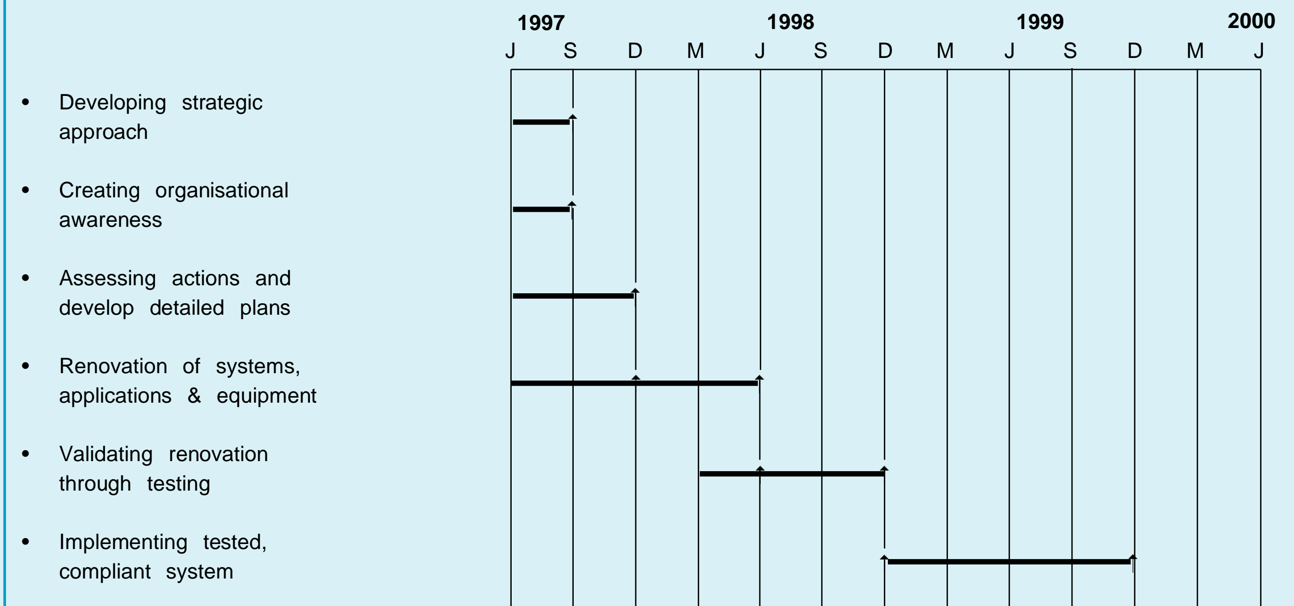
Assessment stage - defined as a phase that moves the project from "concept" to "concrete actions". This stage involves developing detailed inventories of what must be done, the scope of which covers centralised and decentralised hardware, software, and networks, as well as equipment with embedded computer chips and logic. The inventories should include all aspects of business line activities whether internal to the bank or external to it. The risks should be quantified and the priorities should be set based on these risks.

Renovation stage - defined as a phase that is primarily technical in nature. During this phase, the necessary fixing of operating systems, applications, hardware and equipment takes place. The development of contingency plans that identify alternative approaches if renovations lag or fail, is an important part of this phase.

Testing stage - defined as a phase where detailed test schedules must be developed and co-ordinated with correspondents and customers. Data flows, internally and with third parties, must be thoroughly tested, while both the sender and receiver simulates "Year 2000 conditions".

Implementation stage - defined as a phase that requires careful planning to make sure that inter-related applications are co-ordinated when they are put into production. The implementation phase also requires the monitoring of progress by service providers and vendors.

In accordance with the Y2K implementation timeframe, financial institutions should have completed detailing inventories and renovation work on systems, applications and equipment as well as carried out validation and testing by the end of 1998. This is to provide ample



lead time for banking institutions to conduct testing, including external testing to ensure that the system has undergone rigorous testing and validation before it is deemed as Y2K ready.

Financial institutions have to adhere strictly to this implementation timeframe and to submit reports on a monthly basis to BNM on the progress in complying with the Y2K requirements.

Progress Made by the Banking Industry

As at **end-February 1999,** 96.1% or 74 out of 77 banking institutions have completed all the three stages of assessment, renovation and testing. The remaining three banking institutions (one commercial bank and two merchant banks) have completed at least 75% of the testing stage and are expected to complete the entire testing by end-March 1999. BNM monitors closely the progress of these institutions and additional supervisory actions have been taken, including conducting regular on-site examinations and meeting with the management of the institutions, to get their full commitment to resolve problems that could impede remedial efforts.

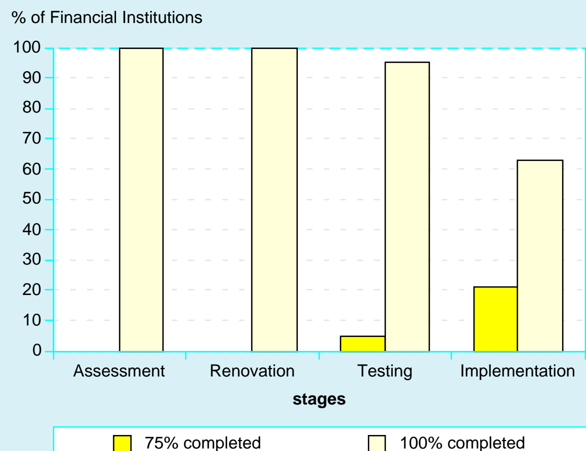
Other Initiatives

BNM has also initiated a series of measures as follows:-

Self-Assessment by Institutions

- Banking institutions have been required to conduct self-assessment exercises on their Y2K compliance process to ensure that they have taken reasonable and prudential steps to address the Y2K challenges and that satisfactory progress is being made to meet the compliance deadline. Banking institutions have been required to report to BNM on the self-assessment.

Graph VII
Financial Institutions: Level of Readiness as at end - February 1999



Formal Statement by Chief Executive Officers

- To ensure the involvement of the highest level of management in handling the Y2K challenges, the chief executive officers of banking institutions have been required to provide formal statements of the Y2K compliance progress on a monthly basis to BNM commencing July 1998. The results so far indicate that the majority of the chief executive officers are satisfied with their institutions' progress.

Public Disclosures

- In order to provide accurate and sufficient information on the progress of the banking industry in achieving the Y2K compliance, banking institutions have been required to disclose their level of compliance with the Y2K requirement in their published accounts from the financial year ending 30 June 1998. As it is crucial to instil public confidence, the Business and Costing Working Committee has also been required to co-ordinate the disclosure of Y2K readiness of the Malaysian financial system.

Business Resumption Plan

- Banking institutions have also been required to develop business resumption plans and submit their plans to BNM by 30 April 1999. The plan would elaborate clearly the process and steps to be taken by each institution in managing the Y2K challenges. It should cover areas of organisational planning, business impact analysis, identification and documentation of the business resumption plans and its implementation modes, as well as evaluation by an independent audit of the viability and soundness of the business resumption plans.

The National Y2K Task Force

To ensure a coherent approach in tackling the Y2K initiatives at the national level, BNM also sits as a member on the National Y2K Task Force, which was set up by the Government to co-ordinate the Y2K preparations nation-wide. The National Y2K Task Force is headed by the Minister of Energy, Communications and Multimedia and it co-ordinates the Y2K initiatives of the critical sectors in the economy. The banking and insurance industries have been identified as among the critical sectors with regard to Y2K compliance.

Progress of the Payment System Y2K Compliance

The payment and settlement system is the key element in facilitating banking transactions. As such, BNM has taken the necessary steps to ensure that all the critical systems will be Y2K compliant by June 1999. The Y2K compliance activities for BNM's internal systems have started since January 1997. As at the end of **February 1999,** about 50% of the critical systems have been tested for Y2K compliance. The other systems are scheduled to be tested in stages until June 1999. The status of the BNM internal critical systems is as follows:-

- The Bond Information Dissemination System (BIDS) and the Fully Automated System for Tendering (FAST) have been tested for Y2K compliance in December 1998.

- The National Imaging Cheque Clearing System (SPICK) was tested for Y2K compliance in February 1999.

- The Real Time Electronic Transfer of Funds and Securities (RENTAS) is now at the advanced stage of development and is scheduled to be implemented as a Y2K ready system in June 1999.

In addition, the Malaysian Electronic Payment System (1997) Sdn. Bhd. (MEPS), the service provider of the largest shared ATM network in Malaysia, has also taken various steps to resolve the Y2K challenges. The focus of MEPS is to ratify the Y2K problem on the existing production system which is the shared ATM network, as well as the development of new application systems such as E-Purse, SET Payment Gateway and Inter Bank Giro. The scope of MEPS Y2K programme covers all critical systems' hardware and software, data centre equipment, network equipment, office equipment and tools, suppliers, service providers, as well as the legal aspect. MEPS has, to

date, completed the assessment and renovation on all critical systems, including replacement of hardware, software and modification of systems. The testing of the main hardware and operating system has been successfully conducted to ensure Y2K compliance. The office equipment and other non-critical systems are at the final stage of testing and implementation. The shared ATM switching module is currently at the final stage of testing with selected financial institutions.

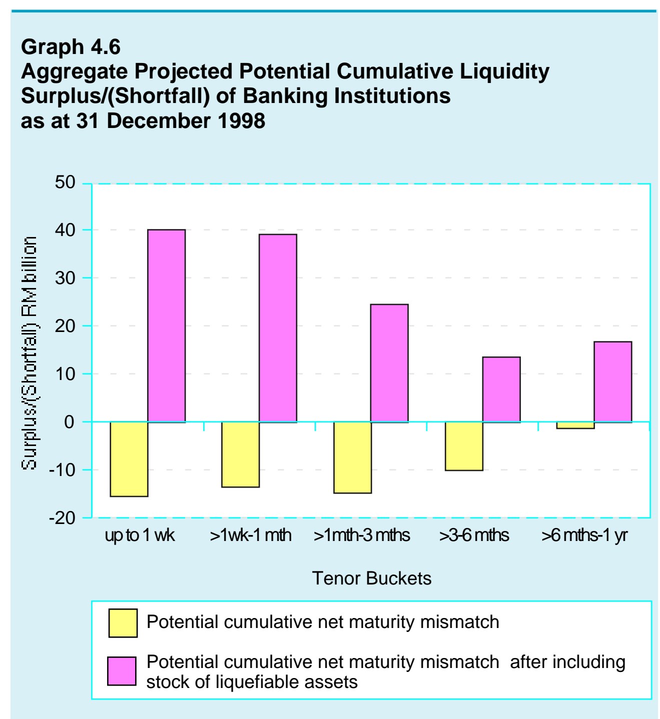
Conclusion

With the year 2000 fast approaching, it is important for everyone to fully realise the challenges and implications of the Y2K issue, and accord the highest priority to ensure compliance with the stipulated timeframe. It is indeed one of the greatest challenges facing mankind today. As a result of a co-ordinated and systematic approach adopted in tackling the Y2K challenges, the banking system is well ahead in preparing for the new millennium. In view of the progress made in complying with the Y2K requirements, we should be able to move on smoothly and confidently into the next millennium. Notwithstanding the measures already in place to ensure readiness, BNM will intensify its supervisory effort and put in place a sound and comprehensive business resumption plan to minimise any potential disruptions.

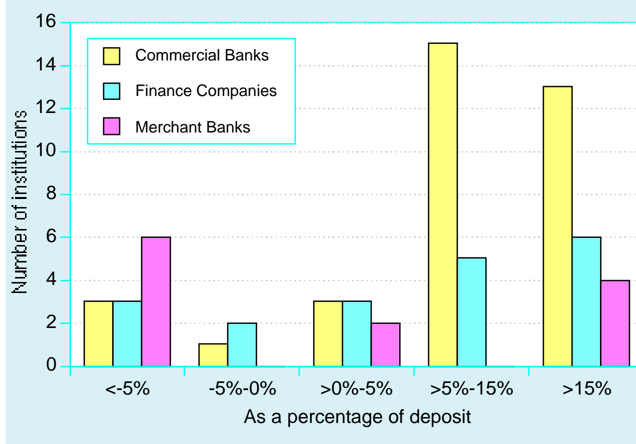
BNM turned from being a net lender during the initial part of the year to a net borrower from the banking system towards the last quarter of the year.

In terms of managing the timing of liquidity to meet obligations, the banking system as a whole maintains sufficient stock of liquefiable assets that can be liquidated to meet any projected potential shortfall that may arise. Taking into account the liquefiable assets as at 31 December 1998, the banking system as a whole had projected a cumulative liquidity surplus of RM20 billion to RM40 billion over the next three months. Approximately 37% of the liquefiable assets held by banking institutions were in the form of Government securities and 22.5% in Danaharta and Danamodal bonds.

The liquidity position by type of institution, however, differs significantly. Finance companies, in general, tend to exhibit higher potential of liquidity shortfall compared with commercial banks, as their deposit base was less stable. Those merchant banks, whose funding structure relied on a small number of large corporate depositors, also faced a higher degree of risk in encountering potential shortfalls. As at 31 December 1998, 77.3% of banking institutions forecasted potential surpluses of liquidity for at least one-month ahead.



Graph 4.6
Aggregate Projected Potential Cumulative Liquidity Surplus/(Shortfall) of Banking Institutions as at 31 December 1998



Graph 4.7
Profile of Individual Institution's Potential Liquidity Surplus/(Shortfall) Up to One Month Ahead as at 31 December 1998

Islamic Banking

Islamic banking continued to record moderate growth in 1998. Total deposits mobilised registered a strong growth of 59.1% to RM16.4 billion during the year. The shareholders' funds of the Islamic bank and the Islamic Banking Fund increased by 23% to RM1.6 billion, while profit before taxation and zakat decreased by 3.3% to RM148 million in 1998. Total assets expanded by 21% to RM21.6 billion due mainly to the increase in holdings of securities (162.4% or RM3.1 billion). Total financing recorded a growth of 1.8% to RM10.9 billion.

Total deposits recorded a strong growth in 1998, particularly in the second half of the year. The increase was partly due to the migration of deposits from conventional banking to Islamic banking in view of the better investment deposit rates. Investment deposits constituted the bulk of deposits (60.5%), which recorded a growth of 108.9% to RM9.9 billion.

The expansion in total financing was small in 1998, due mainly to a decline of 1.4% (RM149 million) in the first half-year, which offset an increase of 3.2% (RM342 million) in the second half of the year. The exposure of Islamic banking to the broad property sector remained significant, at 41.7% of total financing. The high demand for broad property sector financing under Islamic banking was partly attributed to the fixed-rate nature of Islamic financing i.e. Bai' Bithaman Ajil. During the period of rising interest rates in early 1998,

Table 4.11
Islamic Banking: Key Data

	As at end of		Annual change (%)	
	1997	1998	1997	1998
Number of financial institutions	52	49	4.0	–5.8
Commercial banks	24	25	–4.0	4.2
Finance companies	22	18	4.8	–18.2
Merchant banks	5	5	66.7	–
Islamic bank	1	1	–	–
Total assets (RM million)	17,881	21,632	76.5	21.0
Commercial banks	9,078	11,835	148.5	30.4
Finance companies	2,924	3,321	57.8	13.6
Merchant banks	677	778	1.8	14.9
Islamic bank	5,202	5,698	31.3	9.5
Total deposits (RM million)	10,330	16,432	42.2	59.1
Commercial banks	5,558	9,108	108.4	63.9
Finance companies	1,200	2,677	24.2	123.1
Merchant banks	349	607	0.3	73.9
Islamic bank	3,223	4,040	–1.8	25.3
Total financing (RM million)	10,750	10,943	75.0	1.8
Commercial banks	4,706	4,764	121.5	1.2
Finance companies	2,190	2,108	78.8	–3.7
Merchant banks	503	421	28.0	–16.3
Islamic bank	3,351	3,650	39.6	8.9
Financing-deposits ratio (%)	104.1	66.6	24.1	–37.5
Commercial banks	84.7	52.3	11.6	–32.4
Finance companies	182.5	78.7	60.4	–103.8
Merchant banks	144.1	69.4	31.2	–74.8
Islamic bank	104.0	90.3	30.9	–13.6

borrowers took the opportunity to refinance their loans under Bai' Bithaman Ajil to lock in their cost of financing.

The contraction in economic activity in 1998 was also reflected in lower financing activities of the Islamic banking sector. The financing-deposit ratio declined from 104.1% as at end-1997 to 64.9% as at end-1998. The excess deposits were mostly invested in the Islamic money market.

During the year, the Bank introduced the following measures as part of the on-going exercise to strengthen the development of Islamic banking.

- With effect from 1 December 1998, the term "Perbankan Tanpa Faedah (Interest-free Banking)" was replaced by "Perbankan Islam (Islamic Banking)". Banking institutions could use the new term in all their Islamic banking operations, dealings and correspondence.

- With effect from 2 January 1999, banking institutions participating in Skim Perbankan Islam were required to upgrade their Islamic Banking Unit (IBU) into an Islamic Banking Division (IBD). The IBD was required to carry out all

Table 4.12
Islamic Banking: Deposits by Type & Institutions

	Annual change				As at end 1998
	1997		1998		
	RM million	%	RM million	%	RM million
Current deposits	1,808	119.7	–273	–8.2	3,046
Commercial banks	1,474	215.2	–134	–6.2	2,025
Islamic bank	334	40.4	–139	–12.0	1,021
Savings deposits	398	28	225	12.4	2,046
Commercial banks	223	35.4	171	20.0	1,024
Finance companies	43	50	47	36.4	176
Islamic bank	132	18.7	7	0.8	846
Investment deposits	425	9.8	5,180	108.9	9,935
Commercial banks	789	58.4	3,217	150.3	5,358
Finance companies	161	18.3	1,439	138.2	2,480
Merchant banks	1	0.3	258	73.9	607
Islamic bank	–526	–30.1	266	21.7	1,490
Other deposits	435	–	970	223.0	1,405
Commercial banks	405	–	296	73.1	701
Finance companies	30	–	–9	–30.0	21
Merchant banks	0	–	0	0.0	0
Islamic bank	0	–	683	0.0	683

Table 4.13
Islamic Banking: Direction of Lending

	Annual change		As at end 1998
	1997	1998	
	RM million		
Agriculture	41	–22	172
Mining & quarrying	68	–4	69
Manufacturing	358	15	1,298
Electricity	10	–66	33
Real estate & construction	1,177	–431	1,862
Housing	1,039	675	2,699
General commerce	195	104	628
Transport and storage	461	0	720
Finance, insurance & business services	–230	151	457
Purchase of stocks & shares	625	–275	853
Consumption credit	125	314	947
Others	738	–270	1,205
Total	**4,607**	**194**	**10,943**

aspects of Islamic banking such as banking services (formulation of policy, processing of applications and full-fledged Islamic banking branch supervision) and administration (product development, training etc.). The IBD should be headed by a senior management officer of the bank, preferably at the level of the Assistant General Manager (AGM).

- With effect from 2 January 1999, the minimum Islamic Banking Fund (IBF) initially set at RM1 million, was revised upwards as follows:-

  (i) Commercial banks - RM5 million, to be gradually increased to RM20 million by 31 December 2000;

  (ii) Finance companies - RM5 million, to be gradually increased to RM10 million by 31 December 2000;

  (iii) Merchant banks - RM3 million, to be gradually increased to RM6 million by 31 December 2000.

- With effect from 12 November 1998, banking institutions participating in Skim Perbankan Islam were allowed to accept funds of less than one-month maturity from non-interbank customers. However, the funds received through the repos were to be utilised solely for Islamic banking purposes. Previously, only principal dealers were granted the privilege to accept funds from repos of less than one-month maturity from non-interbank customers.

- On 8 December 1998, the Bank introduced the Guidelines on Islamic Negotiable Instruments for two new deposit-taking products based on Islamic principles, namely Negotiable Islamic Debt Certificate (NIDC) based on the concept of Bai' Bithaman Ajil and Islamic Negotiable Instruments of Deposit (INID) based on the concept of Al-Mudharabah. The products provided an additional avenue for the Islamic bank and banking institutions participating in Skim Perbankan Islam to mobilise domestic savings from the public, and at the same time, promote the development of the Islamic money market with marketable and liquid instruments.

- With effect from 4 January 1999, discount houses were allowed to participate in the Skim Perbankan Islam. As at end-February 1999, three discount houses had participated in the scheme.

Other Financial Institutions

Discount Houses

The operations of the discount houses slowed down markedly in 1998. The tight liquidity environment and the high short-term interest rates in late 1997 and the first half of 1998 raised their operational costs and consequently reduced profitability. The situation improved in the second half of 1998 when the liquidity situation eased significantly following the relaxation of monetary policy. Total resources of the industry declined by RM970 million or 4.6% in 1998, compared with an increase of RM3.8 billion or 22% in 1997. The bulk of the decline was due to lower deposits placed by commercial banks with discount houses.

In 1998, total deposits mobilised by discount houses declined by RM1.3 billion or 6.5%. In terms of type of deposits, call money placed with discount houses fell by RM4.8 billion or 63.2% (an increase of RM2 billion or 36.6% in 1997). In the first half of 1998, there was a large withdrawal of call money as financial institutions began to withdraw funds due to the tight liquidity conditions. Meanwhile,

Table 4.14
Discount Houses: Sources and Uses of Funds

	Annual change		At end
	1997	1998	1998
	RM million		
Sources:			
Shareholders' funds	308	–31	859
Deposits	3,551	–1,297	18,631
Others	–85	358	484
Total	**3,774**	**–970**	**19,974**
Uses:			
Investment	2,449	185	18,640
Treasury bills	0	10	10
Government securities	–323	643	954
Bankers acceptances	–10	–168	4,281
Negotiable instruments of deposit	–236	544	909
Cagamas papers	–110	–212	247
Private debt securities	2,725	3	11,875
Others	403	–635	364
Loans to licensed institutions	1,395	–1,354	832
Others	–70	199	502

interbank borrowings by discount houses increased by RM3 billion, most of which was in borrowings from commercial banks. Fixed deposits recorded a smaller increase of RM660 million in 1998 (RM1.2 billion in 1997).

Despite the decrease in total resources, total investments by the discount houses continued to increase, albeit at a very moderate level. Total investment increased by RM185 million (an increase of RM2.4 billion in 1997). The bulk of the investments were in Malaysian Government Securities (MGS) as well as negotiable instruments of deposit. Investments in MGS by discount houses picked up due to the large issuance of MGS in 1998 as well as the shift into the New Liquidity Framework. These developments have reduced the liquid asset premium and increased the effective yield placed on these papers.

During the year, the fee-based activities of the discount houses slowed down significantly. The industry arranged, lead-managed and co-managed RM360 million (RM434 million in 1997) of Private Debt Securities, while the total amount underwritten by the discount houses fell to RM510 million (RM1.5 billion in 1997). As in the previous year, there were only three discount houses appointed as principal dealers in 1998.

National Savings Bank

Total resources of the National Savings Bank (NSB) increased more moderately in 1998 by RM463 million or 6.1% to RM8 billion (RM616 million or 8.9% in 1997). The increase was due mainly to higher deposits, in tandem with the increase in the number of active account holders which rose to 8.7 million at the end of 1998 from 8.5 million at the end of 1997. Fixed deposits rose by 38.1% and deposits in Sistem Perbankan Islam (SPI) products rose significantly by 147.9%, while other types of deposits declined. The higher fixed deposits mobilised during the year was due to extensive savings promotions by NSB for their corporate clients. Although deposits mobilised through the GIRO scheme declined by 3.6%, it continued to be the most popular deposit scheme, accounting for 38.5% of total deposits. The number of Premium Savings Certificates sold during the year declined by 11.9% to 515,003 certificates amounting to RM536 million.

Table 4.15
National Savings Bank

	Annual change		As at end 1998*p*
	1997	1998*p*	
	RM million		
Deposits [1]	489	441	6,380
Savings	–96	–171	1,415
Fixed	588	667	2,419
Save-As-You-Earn	–1	–6	16
GIRO	–10	–93	2,458
Others	8	44	72
Premium Savings Certificate	115	–48	536
Investments (book value)	–300	–132	3,940
Malaysian Government Securities	–572	–209	1,177
Other investments	272	77	2,763
Total loans	535	203	2,225
Total loans (after provision for doubtful debts)	511	173	2,132
Number of NSB branches [2]	–7	–20	448
Number of post offices with NSB facilities	6	3	645
Number of account holders (' 000)	–681	197	8,667

[1] Includes interest credited.
[2] Includes mini-branches and sub-branches.
p Preliminary

During the year, NSB invested about 49.2% of its total resources in various types of investment certificates. As in previous years, in line with the statutory requirement, the bulk of the resources was invested in MGS, which accounted for 29.9% of the total investment as at end-1998. Other investments were in the form of trustee stocks (RM1 billion), unquoted shares (RM487 million), Government guaranteed bonds (RM333 million), non-trustee stocks (RM312 million) and Government promissory notes (RM307 million).

Reflecting the contraction in economic activities, lending operations of NSB slowed down in 1998. Total loans outstanding increased by 10.1% (36% in 1997) to RM2.2 billion as at end-1998. The bulk of the outstanding loans continued to be extended to individuals, accounting for RM1.9 billion or 87.6% of total loans outstanding. Of the total loans outstanding, RM1 billion or 45.4% was granted for the purchase of houses and RM0.7 billion or 33.2% was utilised for hire-purchase financing. While corporate loans declined by RM6.5 million or 6% (+RM0.8 million or 0.8% in 1997), subordinate loans increased by RM125 million. During the year, NSB allocated about 4.2% of its total loans outstanding for doubtful debts. At the end of 1998, non-performing loans accounted for 9.4% of its gross loans.

In 1998, several branches of NSB were merged, reducing the total number of branches and sub-branches to 448 from 468 at the end of 1997. In addition, savings account facilities were also provided in 624 permanent and 21 mobile post offices. During the year, 13 automated teller machines (ATMs) were closed, bringing the total number of ATMs to 583 by the end of 1998.

Provident and Pension Funds

The provident and pension funds (PPFs), the largest source of long-term finance among the non-bank financial intermediaries, continued to expand their activities during the year. Total resources mobilised by the 14 provident and pension funds surveyed by BNM increased by 12.2% to RM172.8 billion at the end of 1998, against a growth of 13.5% to RM154.1 billion at the end of 1997. Most of the resources were derived from accumulated contributions in contributors' accounts (89.7% or RM155 billion), with the balance held in the form of reserves and other liabilities. Contributions placed with the Employees Provident Fund (EPF) have traditionally dominated, representing 94.1% of accumulated contributions. On an annual basis, accumulated contributions of the PPFs grew at a slower pace, at 11.4% (14.4% in 1997), due mainly to lower net contributions as well as the moderation in the growth of the number of members. Total membership rose by 2.4% to 17.2 million persons at the end of 1998 compared with an expansion of 5.4% in 1997.

Table 4.16
Provident and Pension Funds: Selected Indicators

	1996	1997	1998*p*
	RM million		
As at end			
Number of Contributors ('000)	15,931	16,788	17,196
Accumulated Contributions	121,668	139,246	155,067
Assets	135,724	154,080	172,819
Of which: Investments in Malaysian Government Securities	*40,952*	*40,021*	*46,756*
During the year			
Contributions	14,515	16,524	16,707
Withdrawals	4,107	6,392	9,042
Net Contributions	10,408	10,133	7,665
Dividends Credited	8,196	8,163	9,043
Income	9,637	10,233	11,510

p Preliminary

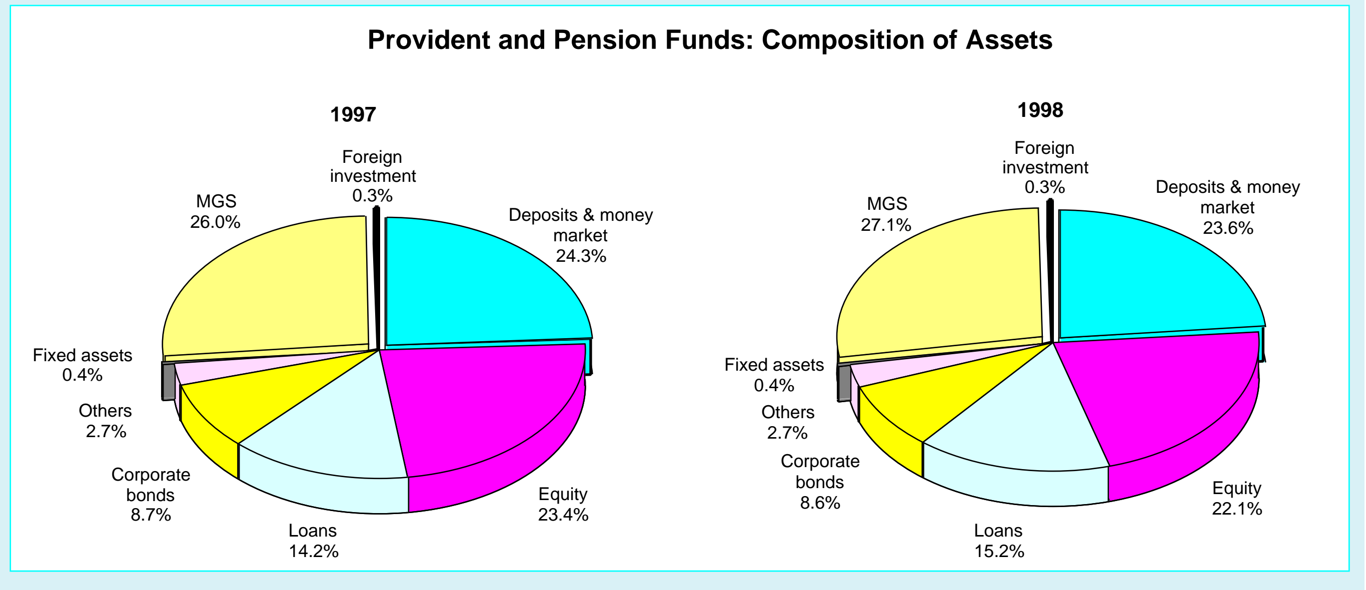
Source: Employees Provident Fund, Pensions Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and eight other private provident and pension funds.

Net contributions of the PPFs were lower in 1998, for the second consecutive year, amounting to RM7.7 billion (RM10.1 billion in 1997). The lower amount of net contributions was due to the marginally higher gross contributions (RM16.7 billion; RM16.5 billion in 1997), while withdrawals were higher, at RM9 billion (RM6.4 billion in 1997). Nine of the PPFs surveyed, in fact, experienced net withdrawals during the year, with the largest net withdrawal registered by the Armed Forces Fund consequent to the lower increase in new recruits compared with the number of retirees. Meanwhile, net contributions were also smaller for the rest of the PPFs except for the Pension Trust Fund. Similarly, net contributions as a percentage of gross national savings was lower at 7.1% (9.9% in 1997).

In the case of the EPF, gross contributions were only slightly higher (RM14.8 billion; RM14.6 billion in 1997). This was attributed to the slower growth in average wages as a result of the reduction in salaries, although the number of active contributors expanded by 2.8% (3% in 1997). In contrast, withdrawals were higher, at RM8.4 billion (RM5.7 billion in 1997), reflecting the cumulative effects of the liberalisation of the EPF's withdrawal schemes. Of the total, RM3.5 billion (or 42.3%) was withdrawn under the Age 55 Withdrawals Scheme, and RM2.4 billion (or 28.1%) for the purchase of houses. Since the introduction of the Member's Savings Investment Scheme in November 1996, which allowed withdrawals to invest in approved fund management institutions, such withdrawals doubled to RM1.2 billion, to account for 14.4% of total withdrawals from the EPF in 1998.

In terms of investments, total new investments by PPFs continued to expand by 12.2% or RM18.7 billion (13.5% or RM18.4 billion in 1997). However, there was a significant shift in the investment strategy of PPFs in 1998. Contrary to the trend which had emerged since 1995, whereby the focus of investment was on private financial instruments, investment in Government papers absorbed the bulk (35.9%) of new investments in 1998. Investments in Government papers expanded by 16.8% or RM6.7 billion (decline of 2.3% or RM931.1 million in 1997) to RM46.8 billion, representing 27.1% of the total assets of PPFs. This was made possible by new issues of Malaysian Government Securities

Graph 4.8



(MGS) in line with the deficit in the Government's fiscal position.

Investments of the PPFs in fixed deposits and money market papers were also higher, encouraged by the high interest rate environment during the first half of the year and hence, higher returns. These investments constituted 18.4% of total new investments. Investments in these instruments rose by RM3.4 billion or 9.2% (–RM722.5 million or –1.9% in 1997), to reach RM40.8 billion or 23.6% of total investments at end-1998.

The economic downturn and the fall in the equity market during most of the year had directly affected the investment of the PPFs in equities. As a result, the growth in the holdings of equities slowed markedly to 6.1% or RM2.2 billion, against an increase of 27.3% or RM7.7 billion in 1997. In addition, investments in equities accounted for a smaller share (11.7%) of the total new investments (42.2% in 1997), although the share of total assets of the PPFs at end-1998 remained relatively unchanged (22.1%).

Similarly, investments in corporate bonds by PPFs were also lower (10.1% or RM1.4 billion; 38.5% or RM3.7 billion in 1997), due to the fewer new issues of private debt securities in the capital market. Of the total new investments of PPFs, 7.2% was invested in corporate bonds, compared with a higher share of 20.4% in the previous year. Loans extended by the PPFs slowed to grow at an annual rate of 19.5% (or RM4.3 billion) from 50.2% (or RM7.3 billion) in 1997.

A similar trend was observed in the asset structure of the EPF given its dominance among the PPFs. Holdings of Government papers by EPF increased by RM6.9 billion or by 18.1% to RM45 billion. Investments in Government papers accounted for 44.2% of total new investments of EPF, with the investment effected through private placement, tender and purchases in the secondary market. In addition, EPF continued to extend Government or bank guaranteed loans to finance Government projects although these loans increased at a slower pace of 20.1% (48.3% in 1997), contributing to 27.1% of total new investments of EPF. Meanwhile, investment in equities increased by RM781.4 million or 3.1% (RM6.4 billion or 33.9% in 1997), while investments in deposits and money market instruments rose by RM1.5 billion or 4.7% (–RM1.9 billion or –5.6% in 1997).

Pilgrims Fund Board

The activities of the Pilgrims Fund Board continued to expand, albeit at a slower pace in 1998. Total resources mobilised by the Board amounted to RM7.3 billion at the end of 1998, representing an increase of RM1.1 billion or 18.7% (RM1.4 billion or 30.4% in 1997). The increase in

resources reflected mainly an expansion of its operations which included the number of depositors increasing by 8.5% to 3,477,562 at the end of 1998 compared with 3,205,885 in the previous year. At the same time, the number of Muslims registered with the Board to perform the pilgrimage was higher at 27,341 (23,886 in 1997).

Total balances held by depositors, including bonuses credited, rose by RM1 billion or 18.3% (RM1.4 billion or 33.4% in 1997), accounting for 92.7% of the total resources mobilised at the end of 1998 (93% at the end of 1997). During the year, deposits placed with the Board increased by 36.7% to RM2.9 billion. With withdrawals of deposits rising by 103.1% to RM2.4 billion in the same period (1997: RM1.2 billion), there was a net increase in deposits of RM580 million. Although the bonus rate was lower at 8% per annum in 1998 (9.5% per annum in 1997), the amount of bonuses credited to depositors' accounts was higher at RM461 million (1997: RM440 million).

The Board invested the bulk of its investible funds in corporate securities. Investments in corporate securities rose by RM518 million or 17.4% (RM1 billion or 54.2% in 1997) to RM3.5 billion, accounting for 48.1% of total assets in 1998. Of these investments, 71.5% was in quoted shares, mainly in the industrial and property sectors, and 28.5% in unquoted shares. Investments in short-term instruments continued to decline by RM193 million or 9.6% (–RM174 million or –8% in 1997) to RM1.8 billion in 1998. Consequently, their share of total assets was also lower at 25.1%. As a result of higher investments in corporate securities, gross dividends received by the Board increased by 37.6% to RM245 million in 1998. Income earned from other investments also increased to RM508 million in 1998 (RM482 million in 1997).

Industrial Finance Institutions

The industrial finance institutions recorded a strong increase in their assets of 43% in 1998 (22.3% in 1997). The increase in assets was attributed mainly to the higher investments in terms of deposits with financial institutions and loans which accounted for 40.9% and 34.5% respectively of the increase. The increase was funded mainly by borrowing.

As the industrial finance institutions are not licensed to conduct deposit-taking activities from the public, they have traditionally relied heavily on borrowing to fund their asset growth. Established primarily to promote development programmes in the agricultural, industrial and international trade and export sectors, they are able to access cheap resources from the Government and international development funds, like the ASEAN-Japan Development Fund and the Overseas Economic Co-operation Fund of Japan.

Borrowings by the industrial finance institutions increased significantly from RM6,655.4 million (25.5%) in 1997 to RM10,463.8 million (57.2%) in 1998, to account for 83.9% of the increase in the total liabilities. The increase in borrowings was mainly by Export-Import Bank of Malaysia Berhad (RM1,782.9 million) and Bank

Table 4.17
Industrial Finance Institutions: Changes in Direction of Lending

Sector	Year					
	1996/95		1997/96		1998/97	
	RM million	%	RM million	%	RM million	%
Manufacturing	115.51	10.48	214.29	19.44	1,334.22	85.29
Transport & storage	0.11	0.01	–25.96	–2.36	125.77	8.04
Real estate & construction	683.47	62.01	568.80	51.61	61.83	3.95
General commerce	104.70	9.50	19.00	1.72	29.06	1.86
Mining & quarrying	–2.91	–0.26	7.73	0.70	3.82	0.24
Agriculture	17.77	1.61	22.75	2.07	–32.33	–2.07
Other	183.55	16.65	295.56	26.82	42.06	2.69
Total	**1,102.20**	**100.00**	**1,102.17**	**100.00**	**1,564.43**	**100.00**

Industri Malaysia Berhad (RM1,577.2 million). The increase in total borrowings of Export-Import Bank of Malaysia Berhad, was to finance the Export Credit Refinancing Scheme, a portfolio which was transferred from Bank Negara Malaysia since January 1998. Bank Industri Malaysia Berhad sourced its funds mainly through deposits placed by the Government agencies following the Government's approval for the bank to accept such deposits to ease its liquidity position.

The other major source of funding for the industrial finance institutions in 1998 was capital funds. However, capital funds declined in 1998 by RM47.6 million due mainly to the losses amounting to RM193.4 million incurred by the industrial finance institutions (in 1997, the capital funds accounted for 28.7% of the total increase in the liabilities of the industrial finance institutions). In 1998, two institutions, namely the Export-Import Bank of Malaysia Berhad and the Malaysian Industrial Estates Berhad (MIEL) had increased their paid-up capital, by RM100 million each.

Loans extended by the industrial finance institutions increased by 25.7% in 1998 (22.1% in 1997). The increase reflected the active participation of these institutions in utilising the various funds established by the Government for lending to priority sectors. Loans to the manufacturing sector accounted for the largest share (85.3%) of the increase in loans, amounting to RM1.3 billion compared with RM214.3 million (19.4%) in the previous year. Loans to the transport and storage sector increased by RM125.8 million, after registering a decrease of RM26 million in 1997. However, loans to the real estate and construction sector declined by RM507 million to RM61.8 million in 1998.

The sharp increase in loans to the manufacturing sector resulted in the exposure to this sector to increase to 44.7% of the total loans outstanding at the end of 1998 (1997: 34.2%). Despite the decline in loans to the real estate and construction sector, the exposure to this sector continued to remain high at 28.9%. Notwithstanding the sharp increase in loans to the transport and storage sector, the industrial finance institutions' exposure to this sector was only 4.5% of the total loans outstanding.

Financial Markets

Reflecting external developments and prevailing domestic economic conditions, activity in the financial markets was generally slower in 1998. A turnaround in the capital and foreign exchange markets was, however, observed consequent to the imposition of the selective exchange controls in September. While the prices and trading volume of stocks improved significantly, offshore trading in the ringgit ceased after September. Market development efforts, nevertheless, continued unhindered.

Recourse to the capital market was influenced by the slowdown in corporate activity, contraction in private sector investment and economic activity, the higher interest rate environment in the first half-year as well as the weak sentiment in the equity market for most of the year. As a result, net funds raised were significantly lower at RM17.3 billion, amounting to half of the peak level of RM33.5 billion in 1997, attributed to the substantially lower amount of net funds sourced by the private sector. The public sector, meanwhile, was more active in tapping funds, for the first time since 1988, as it undertook the lead role in promoting economic recovery.

In the equity market, the benchmark Kuala Lumpur Composite Index (KLCI) ended the year 1.4% lower than the level at the end of 1997, while the total trading volume on the Kuala Lumpur Stock Exchange (KLSE) was lower by 19.9% at 58.3 billion units. After commencing the year on a pessimistic note, the KLCI rose significantly between mid-January and end-February. This was, however, followed by consecutive price declines until the KLCI reached 262.70 points on 1 September, the lowest level in ten years. Improved investor sentiment following the more stable conditions with the introduction of the selective exchange control measures resulted in a turnaround in September, as reflected by the KLCI which increased strongly by 123% to 586.13 points by year-end. Given the lower stock prices for most of the year and the lower trading volume, the value of transactions fell by 71.8% to RM115.2 billion for the year. The market capitalisation of the KLSE which declined marginally to RM374.5 billion at the end of 1998, maintained its seventh rank in the Asia-Pacific region and second rank in the ASEAN region.

As in the equity market, the Kuala Lumpur foreign exchange market also experienced a decline in transactions during the year. In the first eight months of the year, ringgit trading activity was intensive, with the monthly volume averaging RM73.8 billion. The volatility of the market conditions, however, moderated consequent to the introduction of the selective exchange control measures and fixing of the ringgit exchange rate against the United States dollar in September. As a result, the monthly average volume of transactions fell to RM28.4 billion, less than half of that transacted during January-August. For the year as a whole, the average daily volume, therefore, decreased by 32.1% to RM3.7 billion in 1998.

The volume of funds traded in the money market, similarly, declined by 2% to RM1,822.6 billion. Trading in interbank deposits declined, reflecting reduced dependence on the money market as a source of funding and improved liquidity flows in the system. Transactions were focused on the shorter tenures in an environment of uncertainty over the future direction of interest rates. As with interbank deposits, money market papers were traded on a smaller scale. The tight liquidity situation limited the primary issuance and secondary trading of negotiable instruments of deposit and bankers acceptances, while there was no issuance of Bank Negara Bills, although there was a larger volume of trading in Malaysian Government Securities.

Efforts continued to be focused on developing the financial markets. Measures in the money market were intended to enhance the efficiency of liquidity management. Among the measures were the introduction of a new money market operations procedure, widening of the daily variation band for compliance with the statutory reserve requirement, the introduction of a new liquidity framework, and changes to the privileges granted to the principal dealers in the money market. In the capital market, measures were directed towards strengthening the regulatory framework. Towards this end, disclosure and transparency, investor protection and enforcement capabilities of the regulatory authorities were enhanced, corporate governance practices improved, and financial standing of domestic stockbroking companies strengthened. Equally significant was the move towards consolidating the exchanges in the capital market, in line with global trends. Such consolidation would lead to economies of scale by enhancing the efficient utilisation of resources, improving operational efficiency and enhancing the availability of financial products offered. This in turn would contribute to enhance investor confidence in the Malaysian financial markets. Meanwhile, enhancement of the financial infrastructure, product development and education of members, companies and investors were the priorities of the Malaysian Exchange of Securities Dealing and Automated Quotation.

Money Market

Following a robust expansion of 61% in 1997, the volume of funds traded in the money market fell marginally by 2.1% to RM1,822.3 billion in 1998, reflecting a contraction in both the volume of trading in interbank deposits (–1.4%) as well as money market papers (–8.2%). The decline in the volume of interbank deposits reflected the improvement of liquidity flows in the system and reduced reliance on the money market to meet funding requirements given the slowdown in loan growth. Transactions also became more concentrated at the shorter-end of the market. Transactions in tenures of one month and above declined while shorter tenures registered increases. A similar trend was evident in 1997, although the shift in 1998 was less pronounced. The higher number of transactions in the shorter tenure deposits in 1997 and 1998 was associated with the volatility of interest rates. Given the uncertainty about the future direction of interest rates, market

Table 4.18
Money Market

	1997		1998	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total Money Market Transactions	1,860.6	+61.0	1,822.3	–2.1
Interbank Deposits	**1,673.6**	**+71.9**	**1,650.7**	**–1.4**
Money Market Papers	**187.0**	**+2.6**	**171.6**	**–8.2**
Bankers Acceptances (BAs)	85.2	+5.1	79.3	–6.9
Negotiable Instrument of Deposits (NIDs)	56.4	+3.0	43.1	–23.5
Malaysian Government Securities	12.4	–51.3	27.3	+121.0
Treasury Bills	4.3	+52.0	6.7	+54.6
Bank Negara Bills	12.4	–12.1	0.0	–100.0
Cagamas Bonds	3.7	+51.5	2.4	–36.9
Cagamas Notes	12.6	+634.4	12.8	+2.0

Table 4.19
Islamic Interbank Money Market (IIMM)

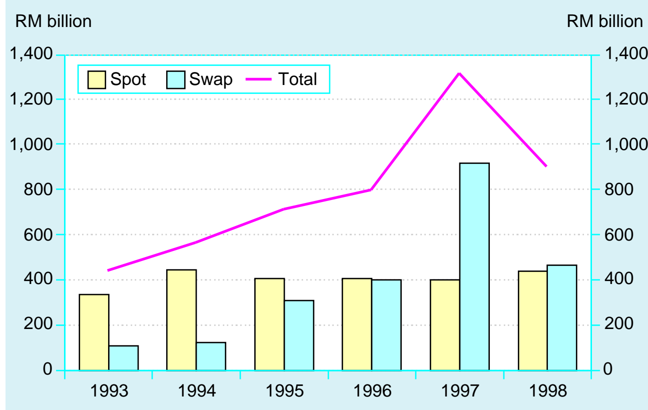
	1997		1998	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total IIMM Transactions	134.1	+175.5	115.4	–13.9
Mudharabah Interbank Investment (MII)	**92.3**	**+221.0**	**77.9**	**–15.5**
Islamic Interbank Cheque Clearing System (IICCS)	**25.5**	**+627.1**	**23.0**	**–9.9**
Islamic Papers	**16.3**	**–0.9**	**14.4**	**–11.3**
Green Bankers Acceptances (Green BAs)	13.7	+5.3	12.7	–7.4
Islamic Acceptance Bills (IABs)	2.6	–24.3	1.8	–31.9

players avoided being locked-in as lenders or borrowers of longer-term funds. The volatility in interest rates since 1997 was primarily associated with the speculative pressure on the ringgit; the outflows of short-term speculative funds and the consequent tightening of domestic liquidity; inefficiencies in the financial intermediation process; as well as shifts in the stance of monetary policy. Meanwhile, the decline in the volume of money market papers traded reflected reduced trading of Negotiable Instruments of Deposit (NIDs), which more than offset the increased trading of Malaysian Government Securities (MGS). The decline in the trading volume of NIDs and Bankers Acceptances (BAs) was due to the tight liquidity situation, especially in the first half of 1998, which limited the primary issuance and secondary trading of these papers. There was also no trading of Bank Negara Bills in 1998, in the absence of new issues by Bank Negara Malaysia (BNM) since October 1997 when the last outstanding Bank Negara Bills matured. Meanwhile, Cagamas Bonds also recorded lower trading volumes due to a net redemption of the paper in 1998 (–RM1.7 billion; net issue of RM3.5 billion in 1997). In contrast, the increase in the trading of MGS was attributed to the larger primary issues of the paper to meet the funding needs of the government in the second half of 1998.

Similarly, the total volume of transactions in the **Islamic interbank money market** (IIMM) declined by RM18.7 billion (-13.9%) to RM115.4 billion, compared with a significant increase of RM85.4 billion in 1997. The contraction in volume reflected declines in all types of transactions, namely Mudharabah interbank investment (MII), the Islamic interbank cheque clearing system (IICCS) and interbank trading of Islamic papers. As a result, the relative size of the IIMM compared to the conventional money market was smaller. The trading volume of the IIMM fell to 6.3% of the conventional money market volume in 1998 (7.2% in 1997).

A number of **measures to improve the efficiency of liquidity management** in the banking system were introduced in 1998. Firstly, a new money market operations procedure was introduced on 30 April. The new system enabled market participants to better assess the liquidity surplus or deficit in the system via BNM's forecasted cash flow of the financial system provided at regular intervals during the day. In addition, transparency was enhanced with all BNM operations being conducted via tender under the new procedure, with the exception of overnight lending/borrowing and the small liquidity support operations for institutions facing exceptionally tight liquidity. A second measure to improve liquidity management was the widening of the daily variation band for the statutory reserve requirement (SRR) compliance. Effective 1 May 1998, this band for the permissible daily variation in the average balances that are required to meet the SRR was widened to ±2% of the prescribed SRR rate from the previous band of ±0.5%. This accorded financial institutions greater flexibility in managing their daily liquidity operations. Thirdly, a new liquidity framework was introduced in July 1998, featuring active monitoring and forecasting of the liquidity position of financial institutions based on the maturity profile of assets and liabilities, as well as diversity of funding sources.

Several measures were also taken during the year to further promote a more active money market. These included increasing the number of principal dealers (PDs) to 16 in 1999, with the appointment of another PD on 1 January 1999. To promote trading in the money market, changes were also introduced to the privileges given to PDs. For the purpose of the calculation of the SRR, PDs were previously allowed to net off from their eligible liabilities (EL) base an amount equivalent to 15% of the higher of either sales or



purchases of specified liquid asset instruments in the secondary market, subject to the amount deducted being less than 1% of EL. Effective 1 January 1999, the amount deductible was raised from 15% to 50% of the volume of liquid assets traded. In addition, the deduction limit (1% of EL) was abolished.

Foreign Exchange Market

The average daily volume of interbank foreign exchange transactions (spot and swap transactions) effected through the eight foreign exchange brokers in the Kuala Lumpur foreign exchange market declined by 32.1% during the year, from RM5.4 billion in 1997 to RM3.7 billion in 1998. The decline was largely attributable to the moderation in the volatility of the currency market conditions, following the imposition of the selective exchange control measures and the fixing of the ringgit exchange rate against the United States dollar in September. The volatility of the ringgit as measured by the standard deviation moderated to 0.22 in 1998 compared with a standard deviation of 0.44 in 1997. The higher volume of transactions in 1997 was on account of the increased number of transactions as well as higher value for each transaction in the wake of the currency turbulence in the region. The activities in the foreign exchange market in 1998 continued to be dominated by the transactions of the United States dollar against the ringgit. These transactions, however, declined to RM703 billion (1997: RM1,215 billion) to account for 77.9% of total transactions (1997: 92.1%). The continued dominance of transactions of the United States dollar against the ringgit was in view of the “safe-haven” status of the currency during the period of economic crisis. Demand for the United States dollar also reflected outflows of foreign funds from the domestic stock market. Transactions in the United States dollar for the Deutsche Mark and Japanese yen accounted for 17.1% and 3.3% respectively.

Activity in the foreign exchange market peaked in January 1998 as speculative activity intensified following adverse market reaction to developments in Indonesia. The monthly volume of total transactions (spot and swap) of the United States dollar against the ringgit averaged RM73.8 billion during the period January-August, which was well above the monthly average of RM58.6 billion for the whole of 1998. However, ringgit trading activity declined significantly in the last four months of 1998 following the imposition of the selective exchange control measures in September. During this period, the monthly average volume of foreign exchange transactions amounted to only RM28.4 billion (RM115.8 billion in the same period in 1997). The exchange control measures effectively restricted the trading activity of ringgit in non-trade transactions. Hence, during this period, the foreign exchange transactions originated mainly from trade-related transactions.

As in the previous year, the offshore financial institutions were the major buyers of the United States dollar for the ringgit, both in the spot and swap markets. Transactions by offshore financial institutions were attributed mainly to speculative activities on expectations of ringgit depreciation as well as outflows of short-term portfolio investments of non-residents. Swap market transactions accounted for 66% of total transactions in the Kuala Lumpur interbank foreign exchange market in 1998 (1997: 75.5%), with a large proportion being transacted during the period January-August. The monthly volume of swap transactions of the United States dollar against the ringgit during this period averaged RM47.8 billion compared with an average of RM38.7 billion for 1998 as a whole. As a consequence of the reduced volatility in the foreign exchange market, the monthly volume of swap transactions declined markedly to an average of RM20.7 billion in the last four months of the year.

Funds Raised in the Capital Market

Funds raised in 1998 were significantly lower, amounting to RM17.8 billion compared with the peak recorded in 1997 (RM33.5 billion). During the year, net funds raised on a monthly basis

were generally moderate, except in October. In the months of January, March, July, August, September and November, there were in fact net redemptions. This situation last occurred in April 1995. Despite the lower net funds raised, the capital market was a more important source of financing in 1998 compared with the banking system. The ratio of net funds raised in the capital market to loans extended by the banking system rose to 3.17 in 1998 (0.41 in 1997). This reflected caution on the part of banks in their lending activities, the slowdown in the demand for loans as well as the increase in the volume of debt securities issued by the Federal Government and Danamodal Nasional Berhad (Danamodal).

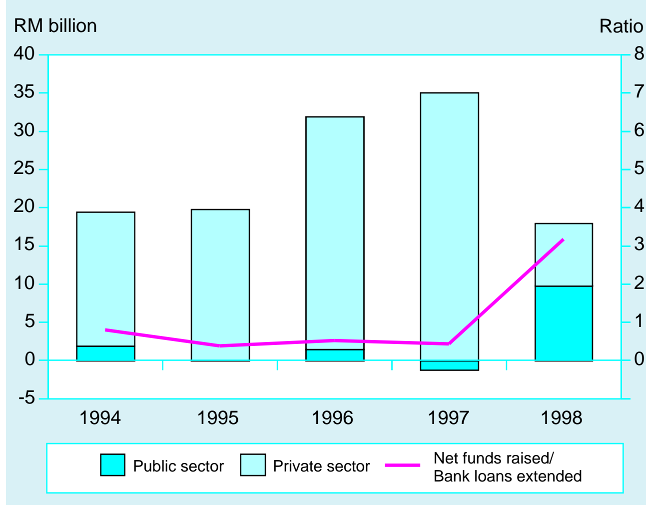
The lower net funds raised during the year was due solely to the significantly smaller amount of net funds raised by the **private sector** of RM8 billion (RM34.9 billion in 1997) from both the equity and debt markets. Danamodal and Syarikat Perumahan Negara accounted for more than half (61.5%) of the new funds tapped through debt issues. However, higher net funds were raised by the **public sector** in 1998. This was a significant development, reflecting the lead role by the Government in reviving economic activities, for the first time since 1988. The public sector raised RM9.8 billion in 1998 (a net redemption of RM1.4 billion in the previous year), accounting for 55% of the net funds raised during the year.

Table 4.20
Funds Raised in the Capital Market

	1997	1998 *p*
	RM million	
By Public Sector		
Government Securities (gross)	3,000	14,950
Less Redemptions	3,648	6,200
Less Government Holdings	–1	0
Equals Net Federal Receipts	–647	8,750
Khazanah Bonds	794	2,732
Govt. Investment Issues (net)	–1,400	–750
Malaysia Savings Bond (net)	–155	–928
Net Funds Raised	**–1,408**	**9,804**
By Private Sector		
Shares	18,359	1,788
Debt Securities[1]	19,597	14,152
Less Redemptions	3,009	7,916
Equals Net Issues	16,588	6,235
Net Funds Raised	**34,947**	**8,023**
Total Net Funds Raised	**33,540**	**17,827**
Short-term Papers and Notes (net)[2]	4,946	–155
Total	38,486	17,672

[1] Excludes debt securities issued by banking institutions.
[2] Refers to commercial papers and Cagamas Notes only.
p Preliminary

Graph 4.10
Net Funds Raised in the Capital Market By the Public and Private Sectors



Recourse to the capital market was affected by investor concerns over the financial health of corporations, the weak sentiment in the stock and bond markets as well as uncertainties over the impact of the global financial market turmoil. Issuers were also affected by the contraction in private sector investment and economic activity, the higher interest rate environment and the freeze on new submissions for capital-raising exercises in the first half-year.

In terms of debt instruments issued by the public sector, **Malaysian Government Securities (MGS)** accounted for the bulk (84.5%) of the gross issuance in 1998. There were six new issues of MGS in 1998 totalling RM14.95 billion (1997: two issues totalling RM3 billion), with yields and maturities ranging between 7.005%-9.03% and 3-20 years respectively. The MGS were issued to offset the redemptions of MGS (RM6.2 billion) and Government Investment Issues (RM750 million) in order to meet market demand as well as to finance the Budget deficit. As a result of the higher number of new issues, total outstanding MGS rose by 13.2% (1997: –1%) to RM75 billion at the end of 1998. Meanwhile, Khazanah Nasional Berhad (KNB), the investment arm of the Ministry of Finance, continued with its programme to issue a series of bonds aimed at providing a benchmark yield curve for the ringgit bond market. KNB made four new issues of

Khazanah *Murabahah* zero-coupon government-guaranteed bonds in 1998, with nominal values of RM3.85 billion (1997: one issue with nominal value of RM1 billion), raising RM2.7 billion (1997: RM794 million). The yields on the bonds ranged between 6.797%-11.23%. The new issues increased the outstanding KNB bonds to RM4.85 billion at the end of 1998. The year also saw the maturity of the discounted 5-year Malaysia Savings Bonds that was issued by BNM in February 1993 as part of the measures to promote savings.

Developments in the equity market reflected the slowdown in corporate activity and private sector investment as well as the weak sentiment on the KLSE in the first three quarters of the year. As a result, funds raised from new equity issues were substantially lower, by 90.3% (1997: +15.3%) and amounted to only RM1.8 billion. The bulk of the funds were raised through rights issues (40.4%) and initial public offers (38.3%). A large portion of the funds raised from the equity market (72.8% of total) was raised in the first half-year, from issues submitted before the general freeze on submissions for capital- raising exercises that was imposed on 5 December 1997 and subsequently lifted on 30 June 1998. The heightened risk aversion of investors and the bearish investor sentiment that prevailed throughout most of 1998 was reflected in the higher percentage of initial public offers (IPOs) that closed at a discount to their offer prices as well as the higher percentage of IPOs that were undersubscribed. Of the 28 IPOs in 1998, 10 IPOs or 35.7% (1997: 17%) closed at a discount to their offer prices on their listing date. In addition, 13 were oversubscribed while the balance of 15 was undersubscribed.

Table 4.21
New Issue of Private Debt Securities by Sector

	1997	1998*p*
	RM million	
Agriculture, hunting, forestry & fishing	214.1	–
Mining & quarrying	–	–
Manufacturing	3,587.1	125.0
Electricity, gas & water supply	2,829.5	529.0
Wholesale & retail trade, restaurants & hotels	–	–
Construction	177.1	–
Purchase of residential property	–	1,000
Purchase of non-residential property	7.8	–
Real estate	302.9	370.0
Transport, storage and communications	3,438.4	1,103.3
Finance, insurance & business services	8,362.5	16,921.4
Purchase of securities	837.5	–
Others	24.0	–
Total	**19,781.4**	**20,048.7**

p Preliminary

In the longer-term corporate debt securities market, the smaller amount of gross funds sourced through the new issuance of bonds, amounting to RM14.2 billion compared with RM19.6 billion in 1997, and increased redemptions of RM7.9 billion compared with RM3 billion caused net funds tapped from the market to be sharply lower, by 62.4% at RM6.2 billion (1997: RM16.6 billion). Syarikat Perumahan Negara Berhad and Danamodal played a key role, accounting for more than half (61.5%) of the new funds raised, while the higher redemptions were due in part to four early redemptions totalling RM745 million. On a monthly basis, there were net repayments every month, except for four months (i.e. February, April, May and October), with no new debt securities being issued in the month of November.

The lower amount of funds raised reflected mainly investors' aversion to investments in corporate bonds and the lower demand for funds by bond issuers. The cautious attitude of the investors can be attributed to several factors, among others, the tight liquidity environment in the first seven months of the year and the high number of rating downgrades that reflected the weakening credit standing of issuers and the increased risk of corporate defaults. Apart from the weak investor sentiment, the low issuing activity in the primary market for private bonds was on account of the relatively higher cost of borrowing and the lower demand for funds for investments by issuers.

In terms of utilisation, 84.4% of the funds raised was channelled to the finance, insurance, and business services sector and 5.5% to the transport, storage and communication sector. By instrument, straight bonds accounted for 72.3% of the gross issuance of debt securities (21.5% in 1997) while the share of asset-backed bonds declined from 26.4% in 1997 to 23.5%. Of the funds raised through the issuance of straight bonds, three-quarters (RM7.7 billion) were in the form of 5-year zero-coupon bonds with a nominal value of RM11 billion, issued by Danamodal for the recapitalisation and strengthening of the banking institutions. In the case of long-term asset-backed bonds issued by Cagamas Berhad, there was a net redemption of

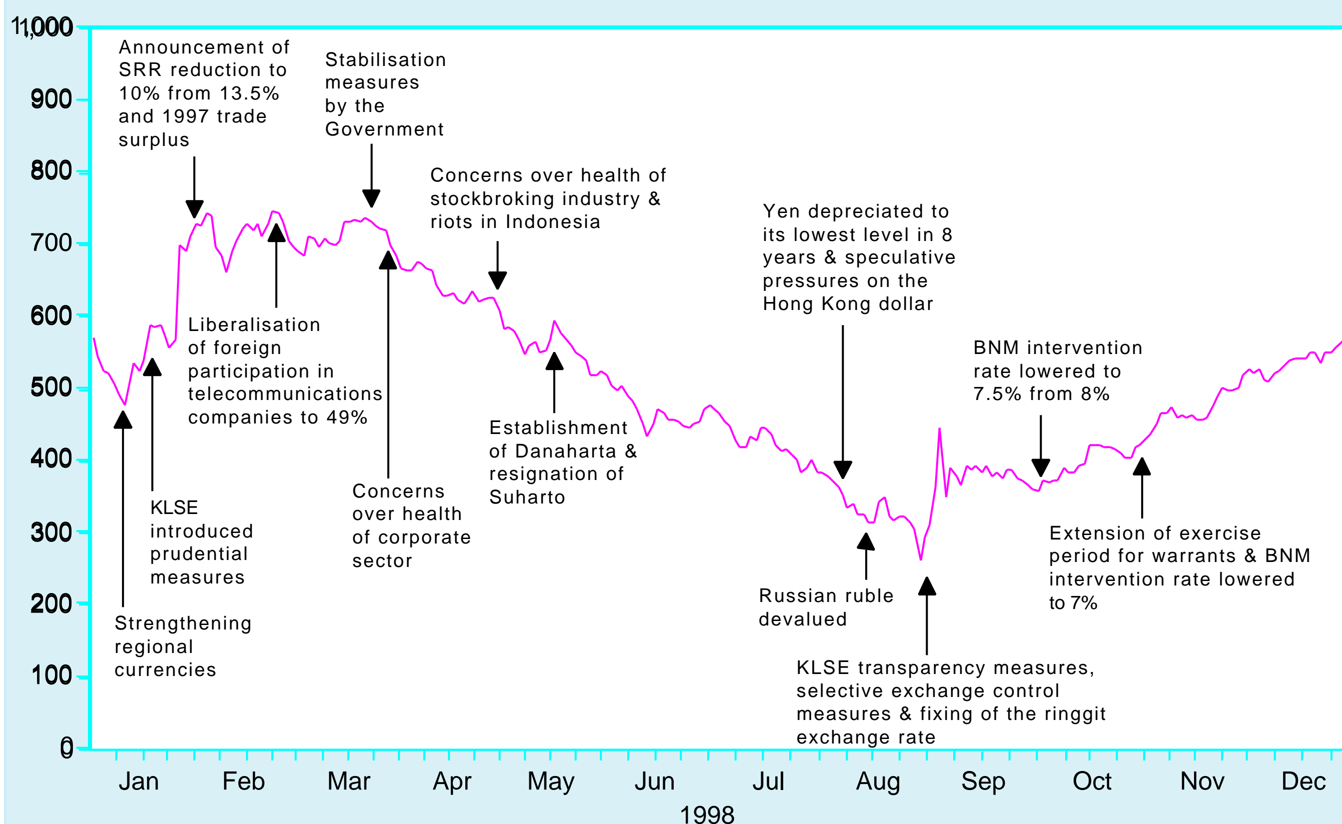
RM1.7 billion (1997: +RM3.5 billion) resulting from the smaller amount of bonds issued (RM3.3 billion) and the higher amount of redemptions (RM5 billion). A significant development in the private bond market in 1998 was the issuance of two Government-guaranteed zero coupon bonds by Pengurusan Danaharta Nasional Berhad (Danaharta), with a total nominal value of RM2.6 billion. These bonds were unique in that they did not raise any funds from the market but were instead issued to the banking institutions as consideration for non-performing loans purchased by Danaharta. This, together with the increase in the net issues of bonds, contributed to the growth of 19.1% in the total outstanding long-term private debt securities (1997: 35.5%) to RM75.5 billion at the end of 1998.

Equity Market

The performance of the **Kuala Lumpur Stock Exchange (KLSE)** during 1998 was mixed, influenced by a combination of domestic and external factors. The benchmark Kuala Lumpur Composite Index (KLCI) experienced three discernible phases, namely the mini-rally phase, downward trend phase and a recovery phase. The year began on a pessimistic note, continuing the downward trend that had prevailed since April 1997. This trend was short-lived as the KLCI increased significantly between mid-January and end-February. During January-February, the KLCI rose by 56% from 477.57 points on 12 January to peak at 745.36 points at the end of February. This was, however, followed by a period of six months of continuous price declines. Between March and early September, the index declined by 64.8% to its lowest level in 10 years of 262.70 points on 1 September. The KLCI subsequently made a significant turnaround, from September to the end of the year, rising strongly by 123% to end the year at 586.13 points. Despite the strong recovery, the KLCI was still 1.4% lower than the level at the end of 1997, reflecting mainly the contraction in corporate activity, private investment and economic activity in general.

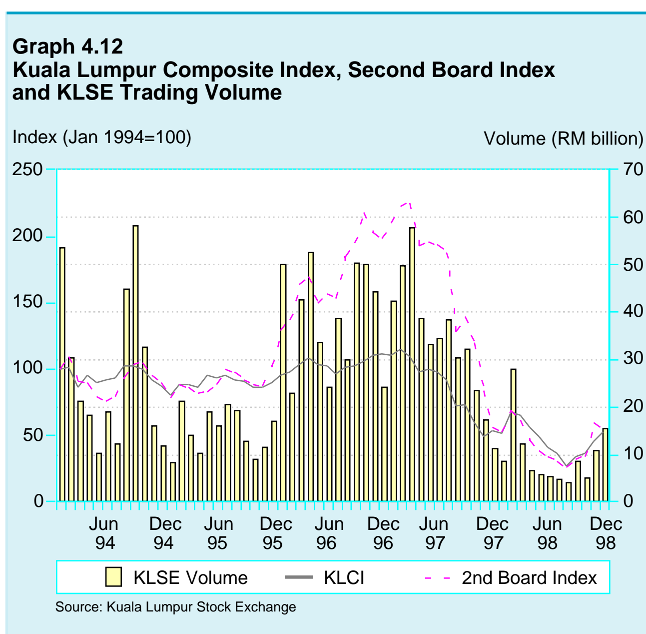
The performance of the other indices on the KLSE generally followed the movements in the KLCI. In the first two months of the year, all the indices were on an uptrend, with the best

Graph 4.11
Performance of the KLCI in 1998



performing indices being the Mining (+68.6%) and Finance (+39.3%) Indices. During the bearish phase from the end of February to end-August, the decline was led by the Mining, Construction, Finance and Second Board Indices, which declined by 70.4%, 69.1%, 62.8% and 61.8% respectively. The significant decrease in the Mining Index reflected a correction following a rise of 68.6% in the index during the mini-rally in the first two months of the year, while the decline in the Construction Index reflected the considerable contraction in construction activities (decline of 24.5% in 1998). Investor concerns over the health of the banking institutions and stockbroking companies contributed to the decline in the Finance Index. The fall in the Second Board Index reflected concerns over the health of Second Board companies, following the move by a number of Second Board companies for court protection under Section 176 of the Companies Act 1965. The index that registered the lowest decline was the Plantation Index, since plantation stocks were viewed by investors to have benefited most from the exchange rate depreciation. The Mining, Finance, Construction and Second Board Indices rebounded strongly by 186.6%, 116.4%, 116.3% and 106.1% respectively, as investor sentiment improved following the introduction of the selective exchange control measures on 1 September, and the more accommodative monetary conditions with ample liquidity and declining interest rates.

The KLSE started off weaker in 1998, as the regional currency crisis continued. Sentiment, however, reversed in mid-January, with the KLCI bolstered by the strengthening ringgit, a preliminary



Graph 4.12
Kuala Lumpur Composite Index, Second Board Index and KLSE Trading Volume

Source: Kuala Lumpur Stock Exchange

announcement of a trade surplus for 1997, the reduction in the statutory reserve requirement (SRR) of the banking institutions from 13.5% to 10% in February and announcements to allow an increase in foreign equity participation in telecommunications companies. These developments were reflected in the 30.9% increase in share prices and 214.4% increase in turnover in February, the highest monthly increase for the entire year, pushing the KLCI to 745.36 points and the turnover to 12 billion units.

The brief rally was abruptly interrupted in early March as concerns over the health of the financial sector emerged for the first time since the early 1990s, amidst rising non-performing loans and financial problems of the corporate sector. Announcements of companies seeking court protection under Section 176 of the Companies Act 1965 and companies being placed under receivership dampened the incentive to invest in equities. In May, news of the cessation of trading of a domestic stockbroking company and the escalation of widespread social unrest in Indonesia as well as the fall in regional stock markets further dampened sentiment. The bearish sentiment, particularly on the financial sector and Second Board companies, were reflected in the decrease in the Finance and Second Board Indices.

The downtrend, however, reversed on 21 May, prompted by the announcement of the establishment of Pengurusan Danaharta Nasional Berhad to acquire and manage the non-performing loans of the financial institutions. The political succession in Indonesia also restored some regional confidence that contributed positively to the KLSE. This optimism was, however, not sustained. From early June, investors became concerned over the performance of the domestic economy following the announcement of a contraction in the first quarter GDP. Market sentiment continued to deteriorate in subsequent months due to the interaction of both domestic and external factors. Domestic factors included uncertainty over the outlook for the economy for 1998, downgrades of Malaysia's credit rating by two international credit rating agencies and poor corporate earnings. The most significant external factors were the weakening Japanese yen and speculative pressures on the Hong Kong dollar and the Chinese renminbi which dampened regional stock markets. By the end of August, the KLCI had declined sharply by 43.7% from the level at

the end of May, while the Mining and Construction Indices fell the most, by 54.8% and 50.2% respectively.

The KLCI staged a turnaround in September on the introduction of selective exchange control measures, although the initial reaction was a 13.3% drop in the KLCI to 262.70 points on 1 September, its lowest level in 1998. This decline also reflected the response to the huge 512-point collapse of the Dow Jones Industrial Average on 31 August. Prices, however, recovered in heavy trading volume as the KLCI surged for four consecutive trading days from 2 September to record a gain of 69% to 445.06 points on 7 September. During this period, on 4 September, the Stock Exchange of Singapore announced the discontinuation of trading in Malaysian shares on CLOB International. Measures to support the economic recovery process such as the fixing of the ringgit exchange rate, easier liquidity conditions and reductions in interest rates contributed to the improved investor sentiment. Within one month, the KLCI had increased by 23.3% to 373.52 points, while turnover was notably higher by 128.6% at six billion units. The best performing index in September was the Construction Index, which rose by 60.1%.

Buying interest continued to be sustained in the fourth quarter of the year, supported by expectations of an expansionary Budget announcement, considerable progress achieved in bank restructuring and recapitalisation, the introduction of a scheme to resolve the problems of troubled stockbroking

Graph 4.13
Performance of Selected Regional & Emerging Stock Market Indices (% change from 1997 to 1998)

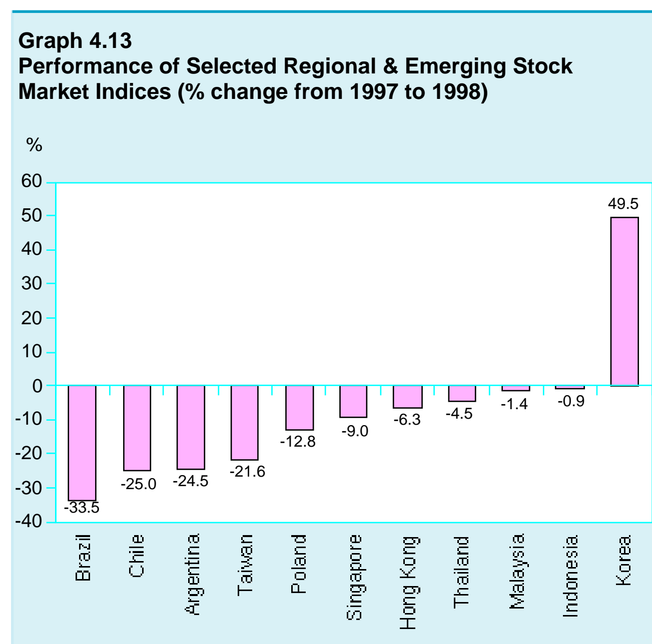


Table 4.22
Kuala Lumpur Stock Exchange: Selected Indicators

	1997	1998
Price Indices		
Composite	594.44	586.13
EMAS	151.21	146.94
Second Board	162.93	158.37
Total Turnover		
Volume (billion units)	72.8	58.3
Value (RM billion)	408.6	115.2
Average Daily Turnover		
Volume (million units)	293.5	236.9
Value (RM million)	1,647.4	468.2
Market Capitalisation (RM billion)	375.8	374.5
Market Capitalisation/GDP (%)	136.5	134.4
Total No. of Companies Listed	708	736
Main Board	444	454
Second Board	264	282
Market Liquidity:		
Turnover Value/Market Capitalisation (%)	108.7	30.8
Turnover Volume/Number of Listed Securities (%)	47.4	37.1
Market Concentration:		
10 Most Highly Capitalised Stocks/ Market Capitalisation (%)	35.9	35.5
Average Paid-Up Capital of Stockbroking Firms (RM million)	72.0	86.1

Source: Kuala Lumpur Stock Exchange

companies and the extension of the exercise period for some listed warrants, in an environment of ample liquidity and lower interest rates. Gains experienced in regional markets further reinforced the positive sentiment. With some stocks continuing to be involved in window-dressing, the KLCI continued to climb to end the year at 586.13 points. This, however, represented a loss of 8.31 points or 1.4% from the level at the end of 1997.

Compared with the performance of the other stock markets in the region, the fall in the KLCI was smaller than the declines in the Taiwan Weighted Index (–21.6%), the Tokyo Nikkei-225 Index (–9.3%), Singapore ST Index (–9%), the Hong Kong Hang Seng Index (–6.3%) and the Thailand SET Index (–4.5%). However, the performance of the KLCI was poorer when compared against the Korea Composite Index, which recorded a 49.5% gain, and the Philippines Composite Index (5.3%).

Reflecting the marginally lower share prices and slower corporate activity, the market valuation of the securities listed on the KLSE decreased marginally by 0.35% to RM374.5 billion at the end of 1998 (end-1997: RM375.8 billion), equivalent to 134.4% of the nation's GDP (1997: 136.5% of GDP). At its highest point, the capitalisation was 323.6% of GDP on 25 February 1997. The KLSE maintained its 1997 ranking of seventh in the Asia-Pacific region and second in the ASEAN region.

Trading volume on the KLSE was lower by 19.9% in 1998, amounting to 58.3 billion units or an average daily volume of 237 million units (72.8 billion and 293.5 million units respectively in 1997). Reflecting the lower stock prices for the greater part of 1998 and the lower trading volume, the total transacted value was markedly lower by 71.8% at RM115.2 billion. The bulk of the trading volume was concentrated in the first and fourth quarters of the year (accounting for 68% of total trading volume) when share prices were generally rising. In terms of sectors, greater interest continued to be centered on the trading/services (23.3%), finance (16.7%) and property (11.5%) sectors on the Main Board, while the share of the Second Board was reduced to 10.6% (1997: 14.4%). Reflecting the lower trading volume, market liquidity (measured by the ratio of trading volume to number of securities listed) fell to 37.1% in 1998 from 47.4% in 1997. Similarly, the ratio of trading value to market capitalisation, declined to 30.8% in 1998 from 108.7% in 1997.

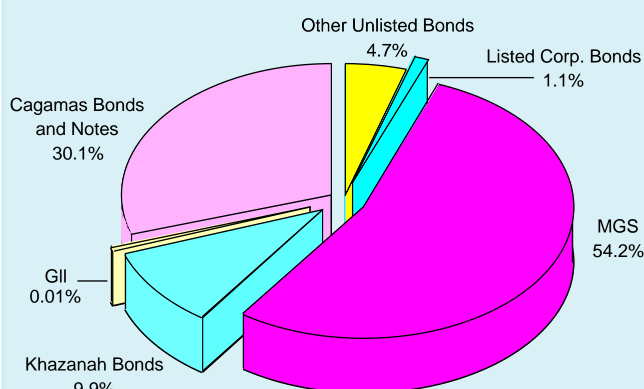
Economic and financial conditions during the year similarly affected developments on the **Malaysian Exchange of Securities Dealing and Automated Quotation** (MESDAQ). In October 1997, the Government set up MESDAQ as an over-the-counter market where high-technology and small companies with good growth potential could raise capital. In 1998, three companies, of which two were in software development and one in the electronics and information technology hardware business, had applied for listing. Another two companies delayed the submission of their applications due to the significant changes in the business environment during the year. As at the end of 1998, the exchange had 18 members, of which eight were market makers. Trading on the exchange is expected to commence in 1999.

In the meantime, MESDAQ focused efforts on enhancing the infrastructure and undertaking product development, as well as educating members, companies and investors. During the year, the MESDAQ Quotation System (MQS) was developed for the trading of MESDAQ stocks. The MQS is an electronic, quote-driven system that supports competitive market-making through the use of Bloomberg software and hardware and represents the first step towards the full deployment of MESDAQ's open architecture. In addition, MESDAQ organised various roadshows and presentations to potential issuers, investors, MESDAQ members, analysts, media and the general public. MESDAQ is also planning to launch the Malaysian Enterprise Network soon. The network represents one of the first electronic networks within the Asian region that utilises the Internet as a medium to showcase companies, thereby enabling them to reach out to investors and strategic partners.

Bond Market

Trading activity on the secondary market for bonds was mixed in 1998. Trading continued to be focused on the unlisted segment of the market (98.9%), particularly on MGS. Trading of MGS was significantly higher at RM27.3 billion, more than double the amount traded in 1997 (RM12.4 billion), while the trading volume of Cagamas bonds and notes was 6.9% lower, at RM15.2 billion (1997: RM16.3 billion). Trading of Khazanah bonds (RM5 billion), Government Investment Issues (RM3 million) and the other unlisted bonds (RM2.4 billion) were on a smaller scale (data for these bonds were

Graph 4.14
Trading of Domestic Debt Securities in 1998



Source: BNM page on Reuters, Bond Information & Dissemination System (BIDS) & Kuala Lumpur Stock Exchange (KLSE)

only available since the launch of the Bond Information and Dissemination System (BIDS) in October 1997). In contrast, trading of listed corporate bonds on the KLSE was considerably lower, amounting to RM536 million or 79.5% lower than the volume traded in 1997. The high trading volume of MGS and the low turnover of corporate bonds can be attributed to increased issues of MGS in 1998. There were six new issues totalling RM14.95 billion in 1998, of which two issues amounting to RM6 billion were privately placed with the EPF. At the same time, due to uncertainties in the economic and financial environment, investors had a preference for the risk-free MGS. Investors were also concerned over the weakening credit risk profiles of corporates, resulting, to some extent, in a “flight to quality”.

In terms of composition, MGS accounted for more than half (54.2%) of the total volume of bonds traded in 1998, while Cagamas bonds and notes and Khazanah bonds accounted for 30.1% and 9.9% respectively. The dominance of MGS emerged in the second half of the year, with trading of other bonds being more active in the first half-year. In January, February, March and May, Cagamas bonds and notes accounted for most of the trades, while trading in June was concentrated on Khazanah bonds.

Trading was more active in the second half of the year, with 81.9% of the total trades being transacted during this period. The increase in bond prices on the back of declining interest rates led investors to accumulate debt securities in anticipation of the continued softening of interest rates. Another contributory factor was the increase in liquidity arising from the three reductions in the SRR (one in July and two in September). The large number of MGS issued also contributed to the higher trading volume during this period. Three out of the four non-privately placed MGS involving RM6.95 billion issued in 1998 were in the second half of the year.

In 1998, the number of new issue ratings (including commercial papers) conducted by Rating Agency Malaysia Berhad (RAM) and Malaysia Rating Corporation Berhad (MARC) was sharply lower. This reflected the reduced issuance of private debt securities in an environment of a slowdown in economic activities and high interest rates during the first half-year. During the year, RAM completed seven rating exercises valued at RM1.4 billion (51 exercises totalling RM13.5 billion in 1997). The bonds issued were by corporations in the financial services, property and consumer products industries. Similarly for MARC, new issue ratings numbered seven compared with 22 issues in the preceding year, while the total value of debt rated was RM2.5 billion (RM11.2 billion in 1997). The bonds rated were from the property, industrial products, transportation, utility and infrastructure sectors. In terms of the maturity profile of the bonds rated, there was a preference for short- and medium-term papers (nine short- and medium-term papers compared with five long-term papers), as the market anticipated an easing in interest rates.

Table 4.23
Unit Trust Industry: Selected Indicators

	As at end					
	1997			1998		
	Government Sponsored Funds	Private Funds	Total	Government Sponsored Funds	Private Funds	Total
No. of Unit Trust Mgt. Cos.	10	21	31	10	22	32
No. of Unit Trust Funds *	27	53	80	28	61	89
Units in Circulation (billion)	35.9	9.3	45.2	35.5	11.0	46.5
No. of Accounts (million)	7.5	0.8	8.3	7.7	0.8	8.6
Net Asset Value (NAV) (RM billion)	28.6	5.0	33.6	32.3	6.4	38.7
% of NAV to KLSE Market Capitalisation	7.6	1.3	8.9	8.6	1.7	10.3

* Refers to funds already launched.

Source: Securities Commission Malaysia

Key Capital Market Measures in 1998

Capital market measures implemented in 1998 were aimed mainly at strengthening the regulatory framework. Among others, the measures were intended to enhance disclosure and transparency, investor protection and the enforcement capabilities of the regulatory authorities as well as improve corporate governance practices, ensure an orderly and fair market in the trading of securities and futures contracts on the Malaysian exchanges and strengthen the financial standing of domestic stockbroking companies. The key measures were as follows:

Rules on Gearing Ratio, Exposures to Single Client and Single Security and Margin Financing

With effect from **19 January 1998**, the Kuala Lumpur Stock Exchange (KLSE) announced new rules on gearing, and improvements to existing rules on margin financing and exposure to single client and single security to instill a greater sense of financial discipline and to enhance the financial standing of stockbroking companies (SBCs).

Gearing ratio on borrowing exposures

- Under this new rule, SBCs were required to maintain a gearing ratio on the approved limit of not more than three times the adjusted capital and on the utilised level of not more than two and a half times the adjusted capital of the SBCs, by 31 December 1998. Prior to this, there were no prudential rules on the SBCs' borrowing exposures.

Exposures to a single client and a single security

- In these new rules, there was a clear distinction between the exposure for margin financing clients and trading clients.

  – ***For exposure to a single client***
  The limits on margin financing exposure were 30% of the SBC's adjusted capital, and for **trading exposure**, 100%. (Previously, the total combined limit on margin financing and trading exposure was 300% of the SBC's last audited shareholders' funds, provided that the exposure for margin financing did not exceed 30%).

  – ***For exposure to a single security***
  The limit on margin-financing exposure was 20% of the SBC's adjusted capital. The limit on trading exposure for SBCs with adjusted capital of less than RM200 million was 100% of the adjusted capital and the limit for SBCs with adjusted capital exceeding RM200 million was 200% of its adjusted capital. (Previously, the total combined limit on margin financing and trading exposure was 500% of the SBC's last audited shareholders' funds).

Margin financing

- The maximum exposure to a margin client was limited to 30% of the SBC's adjusted capital (30% of the SBC's shareholders' funds in the old rule), and the total exposure to all margin clients was 100% (12.5 times the shareholders' funds previously).

Rules on the Placement of Clients' Funds in Trust Accounts

The KLSE announced a new rule provisioning for the placement of clients' funds in trust accounts to enhance investor protection, **effective 4 March 1998**.

Practice Notes to Enhance Disclosure

On **29 May 1998**, the KLSE in its efforts towards **enhancing corporate disclosure and transparency amongst public listed companies**, embarked on the issuance of Practice Notes. With effect from 1 June 1998, two Practice Notes were issued on disclosure of information **on the Year 2000 (Y2K) Compliance and on Default in Payment**. The Practice Notes

served to promote better disclosure by public listed companies regarding their Y2K compliance/readiness and their defaults in payments of interest and/or principal in respect of loan stocks, bonds, debentures or credit facilities.

Removal of Restrictions on Corporate Exercises

On **30 June 1998**, the Securities Commission (SC) announced the lifting of most of the restrictions on submissions for new listings, capital raising exercises and restructuring schemes that were announced on 5 December 1997, to provide companies with the needed avenues to raise funds to support their core businesses. Nonetheless, the SC would continue to exercise close scrutiny over all applications, especially with regard to listing on the Second Board of the KLSE. This was to consolidate and strengthen listed companies in those sectors where there were already a significant number of companies.

Changes to Rules on Related-Party and Interested-Party Transactions

With effect from **2 July 1998**, the rules on related-party and interested-party transactions were revised by the SC to enhance the overall framework for corporate governance in listed companies. The new rules, *inter alia:*

– widened the scope of the application of the rules beyond directors and substantial shareholders to include persons connected with them;

– required details of such transactions to be announced and included in circulars to shareholders;

– required shareholder approval for the transaction while preventing persons interested in the transaction from voting on the resolution approving the transaction;

– required the appointment of corporate advisers to ensure that the transaction was carried out on fair and reasonable terms; and

– required the board of directors to state that the transaction was in the best interests of the company.

Measures to Enhance Transparency in the Stock Market

On **31 August 1998**, the KLSE as part of its efforts to further enhance transparency in the stock market, announced new measures effective 1 September 1998, to ensure an orderly and fair market in the trading of Malaysian securities and to improve overall market transparency in the Malaysian capital market. Among the many benefits that the measures sought to bring about were enhanced transparency in share trading, enhanced investor protection, cost efficiency and overall greater efficiency in the trading system. Key features of the measures were:-

Trading of listed securities

- All dealings in securities listed on the KLSE were to be effected only through the KLSE or through a stock exchange recognised by the KLSE.

- Except as otherwise permitted, all dealings in KLSE securities were to be effected only through the KLSE trading system.

- SBCs should not deal in securities on behalf of a client if they had reason to believe that the transaction was intended to facilitate the dealing in securities on a stock exchange not recognised by the KLSE.

New disclosure requirements

- A client, in dealing in securities listed on the KLSE on another person's behalf, would have to disclose the identity of that person to the SBCs.

- For all new and existing nominee accounts, the name and other particulars of the beneficiary would have to be stated in full.

- Each Central Depository System (CDS) account operated by a nominee could have only one beneficiary. For nominee accounts which were presently shared by more than one beneficiary, new accounts would have to be opened to comply with the new requirements.

Off-market business and its clearing and settlement

- SBCs were permitted to engage in off-market dealing only in the form of direct business (i.e. crossings and married deals).

- All direct business was to be cleared and settled through the Securities Clearing Automated Network Services Sdn. Bhd.

New issues of securities

- Public listed companies were not permitted to issue certificates to the securities holders in respect of any new issues of securities as all new issues were to be made by way of crediting the securities into the CDS accounts of the securities holders.

Mandatory deposit

- Shareholders of companies which had been approved for listing or were currently listed on the KLSE would have to deposit their share certificates with Malaysian Central Depository Sdn. Bhd. (MCD).

Withdrawal

- All withdrawals of securities would be prohibited, except for the circumstances allowed in the notice issued by the KLSE (for example, to facilitate share buyback; conversion of debt securities; the process of company restructuring).

Amendments to Securities Laws

The Securities Industry Act 1983 (SIA) and Securities Industry (Central Depositories) Act 1991 (SICDA) were amended twice. The first set of amendments was passed during the October 1997 session of Parliament and came into force on **1 April 1998**. The second set of amendments was made during an emergency Parliamentary sitting held from 28-30 September 1998 and came into force on **1 November 1998**. At the same time, amendments were also made to the Securities Commission Act 1993 (SCA) and to the Futures Industry Act 1993 (FIA).

April 1998 Amendments

The SIA amendments broadened the definition of insider trading; increased the range of sanctions, including civil sanctions, to deter insider trading and market manipulation; required additional disclosure from directors and chief executive officers (CEOs); and increased the power of the SC over directors and CEOs. Amendments to the SICDA included the amendment to the definition of "securities" to include "unit trust schemes".

November 1998 Amendments

Key amendments to the Acts were as follows:

SICDA

- It was mandatory for securities to be deposited into the CDS within one month of the coming into force of the Amendment Act. Failure to do so would result in the securities being transferred to the account maintained under the name of the Minister of Finance.

- Every securities account with the MCD was to be in the name of the beneficial owner of the deposited securities or in the name of the authorised nominees.

- Off-market deals that were not transacted through a recognised stock exchange and cleared through a recognised clearing house were prohibited.

SIA

- The enforcement powers of the exchange and clearing house in relation to any person failing to comply with their rules or the exchange's listing requirements were enhanced. Among others, the power relating to the compliance with the rules and listing requirements of the exchange and clearing house have been extended to apply to a person to whom the rules or listing requirements are directed and advisers.

SCA

- The powers of investigations of an Investigating Officer (IO) of the SC to enforce securities laws were extensively increased. For example, an IO may arrest without warrant, any person he reasonably

suspects to have committed an offence under the securities laws.

- The Amendment Act empowered the SC to conduct an examination without prior notice on licensed persons.

FIA

- The Amendment Act prohibits the setting up of a futures market for the trading in futures contracts unless such futures markets were recognised.

- The provisions that protect the money and property of a client of a futures fund manager were tightened.

New Capital Adequacy Requirements for the Stockbroking Industry

On **31 December 1998**, the SC approved the Capital Adequacy Requirements for SBCs to refine the prudential benchmark for maintaining market integrity. The new requirements would replace the existing Minimum Liquid Fund rules once they were implemented through the KLSE's business rules in 1999. The new risk-based capital adequacy framework would enable both the KLSE and SBCs to identify more clearly the capital available to cover the risks of running a securities business and would encourage market intermediaries to adopt a more relevant approach to risk management.

Unit Trust Industry

The unit trust industry expanded in 1998, with the launching of nine unit trust funds compared with six in the preceding year and the establishment of one unit trust management company, the same number as in 1997 (see Table 4.23). Units in circulation rose marginally by 1.3 billion units to 46.5 billion units, compared with an increase of 6.2 billion units in 1997. As at the end of 1998, there were 32 management companies and 89 unit trust funds. The increase in the number of funds launched and units in circulation as well as the strong performance of the KLSE in the last four months of the year contributed to a 15.3% growth (1997: –44%) in the net asset value (NAV) of the unit trust industry. The NAV of the industry amounted to RM38.7 billion at the end of 1998 (1997: RM33.6 billion). Consequently, the ratio of the industry's NAV to the total market capitalisation of the KLSE improved from 8.9% in 1997 to 10.3% in 1998.

Futures Market

The **Kuala Lumpur Stock Exchange Composite Index Futures (FKLI)**, remained the only product offered by the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) since it was first launched in December 1995. The FKLI contract performed remarkably well for the larger part of the year, continuing the trend from the previous year. This reflected the increased maturity of the market as well as greater investor awareness of the efficacy of the product, leading to increased utilisation for both income enhancement as well as for hedging investors' portfolio exposure in the underlying stock market. Nevertheless, following the implementation of the selective exchange control measures in September, the lack of depth in the market and the withdrawal of foreign participants caused a substantial drop in activities. Activities, however, stabilised towards the end of the year.

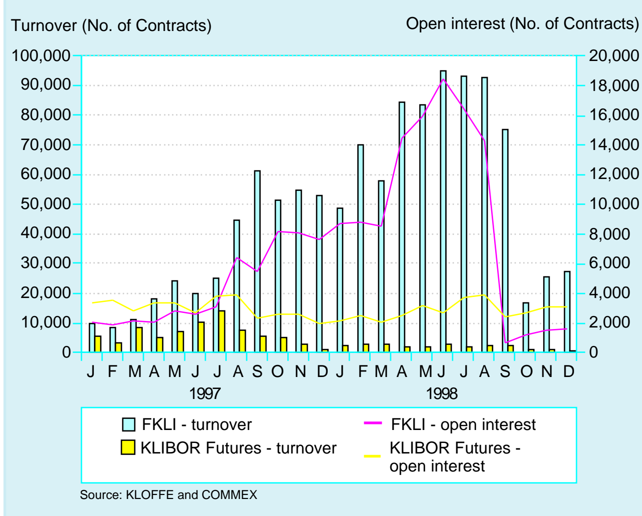
During the first eight months of the year, the FKLI recorded a marked improvement in performance. The average daily turnover climbed progressively, from 2,869 contracts in January 1998 to peak at 4,646 contracts in August 1998. The average daily open interest also rose from 8,787 contracts to reach a record high of 18,442 contracts at the end of June and 14,293 contracts at the end of August. The improvement was equally evident when compared with the same period in 1997. In this regard, the average daily turnover for the first eight months expanded by 289% to 3,888 contracts, while the average daily open interest was significantly higher by 514% to 18,965 contracts. The total turnover during the period increased by 284% to 625,919 contracts. The Derivative Liquidity Ratio (DLR), which measures the value of futures contracts traded against the total value of the 100 underlying component stocks, rose from 55.1% in January to exceed 100% in April and in subsequent months, indicating that investor exposure in the underlying market was fully covered by similar investments in the futures

market. This development indicates signs of growing maturity in the futures market.

The trend, however, reversed subsequently following the imposition of the selective exchange control measures in September. The withdrawal of foreign participation, coupled with the lack of domestic participation, contributed to significantly lower trading activities. As foreign players began to close their open positions, the share of foreign institutions decreased, from 54% of total turnover in August to 28% in September. Consequent to these developments, the average daily volume fell from 4,646 contracts in August to 3,588 contracts in September, accompanied by a more drastic decline in the average daily open interest from 14,293 contracts to only 681 contracts. The DLR also declined from 104% to 48%. To ensure that trading activities were not hindered by the rules restricting the transfer of funds held in external accounts by foreign participants, on 14 September, non-resident clearing members of the Malaysian Derivatives Clearing House (MDCH) were allowed to open designated external accounts for trading purposes in KLOFFE, Malaysia Monetary Exchange and Kuala Lumpur Commodity Exchange. With this, the restrictions on external accounts were relaxed for funds maintained in these accounts for purposes of derivatives trading.

Trading activities stabilised somewhat towards the last two months of the year. Nevertheless, for the period September-December, activities slowed when compared with the corresponding period in 1997, as total turnover declined to 145,325 contracts (1997: 220,082 contracts), while the average daily turnover and average daily open interest also decreased to 1,710 contracts and 4,353 contracts respectively (1997: 2,589 contracts and 9,446 contracts). In comparison with the period January-August, both the average monthly turnover and average daily turnover fell by 56% and 77% respectively. This situation reflected the lack of foreign participation in the market. The dominance of foreign participants declined significantly to account for only 5% to 9% of total turnover in the last three months of 1998. Despite this downturn, for the year as a whole, the considerable improvement over the larger part of the year saw total turnover and average daily open interest improve to 771,244 contracts and 13,916 contracts respectively, from 382,974 contracts and 5,267 contracts respectively in 1997.

Graph 4.15
FKLI & KLIBOR Futures: Turnover and Open Interest

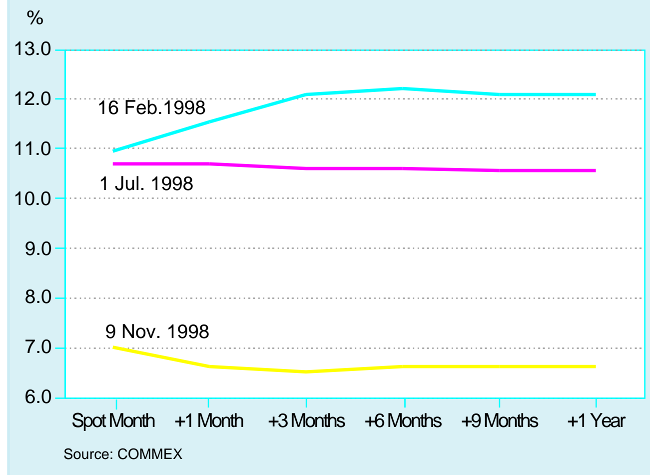


Source: KLOFFE and COMMEX

Recognising the need to ensure greater domestic participation, the Futures Industry Act 1993 was amended during the year to allow the participation of asset managers and unit trusts in the futures industry. Parallel to this, the Securities Commission also issued guidelines for the licensing of futures fund managers and futures fund managers' representatives. In addition, unit trust companies, as provided in the Securities Commission's Guidelines on Unit Trust Funds, have since been exempted from the licensing requirement under the Act to trade in futures contracts.

Another important development that took place in January 1999 was the acquisition of KLOFFE Capital Sdn. Bhd., the holding company of KLOFFE Bhd. by the KLSE. The merger would pave the way for greater consolidation between the two exchanges particularly in the areas of business development and system requirements. Such consolidation, which is in line with global trends, would further enhance investor confidence in Malaysian financial markets. At the end of 1998, KLOFFE had 40 trading members, 49 local members and 563 futures broker representatives.

In 1998, the 3-month **Kuala Lumpur Interbank Offered Rate (KLIBOR)** futures contract continued to be the only product traded in the Malaysia Monetary Exchange (MME), which was later renamed Commodity and Monetary Exchange of Malaysia (COMMEX) after the merger between MME and the Kuala Lumpur Commodity Exchange



Graph 4.16
Selected 3 - Month KLIBOR Futures Implied Yield in 1998

Source: COMMEX

(KLCE). Trading of the product declined significantly in 1998 compared with 1997 as trading activities slowed although the year-end open position added 1,896 contracts to 3,092 contracts.

As the total volume for the year decreased by 67.6% to 24,738 contracts, the average daily volume also fell by 67.3% to 101 contracts. The lower trading volume was attributable to several factors. First, there was a divergence between the 3-month KLIBOR and the rates of related money market instruments, notably the 3-month negotiable instruments of deposit and bankers acceptances. The divergence was particularly noticeable in early 1998 when the shorter-term interbank rates were aggressively bidded up by some smaller banking institutions. To rationalise the term structure of interest rates as well as to improve liquidity flows in the system, in February 1998, BNM officially announced the 3-month intervention rate as its policy rate and reduced the SRR. Second, the preoccupation of the banking institutions with managing their non-performing loans as well as loan recovery reduced their participation in the KLIBOR futures market. This was significant as the domestic banking institutions were major players in the market, accounting for 72.8% of total turnover during July-December 1998. Third, the introduction of selective exchange control measures in September also reduced the activities of the foreign players. During the period August to September, their share of total turnover averaged 23%, but declined to an average of 4.3% in the remaining months of the year.

The low trading volume contributed to reduced trading by market-makers, worsening the lack of liquidity in the market. This was reflected in the wide bid-ask spread averaging 40 ticks (1 tick = 0.01%) in 1998 (average of 3.5 ticks from the period May 1996-June 1997, when the product was first launched to just before the crisis). In fact, the bid-ask spread widened to 200 ticks in the first week of September following the introduction of the selective exchange control measures, indicating the severe lack of liquidity in the market. As the environment remained unconducive, the market-making scheme was terminated on 7 July.

An encouraging development, however, was the relatively stable open-interest position at the end of the year which stood at 3,092 contracts (1,196 contracts in 1997), attributed to the increased use of strip trading among participants. The strip order, introduced in April, essentially involved using three or more consecutive quarterly KLIBOR futures contracts at one single price. The trade was initiated when it was determined that the trader could lock in a higher return or a lower borrowing cost for the spectrum of the 3-year yield curve than was otherwise available in the cash-only money market transaction. In terms of type of trades, outright trades remained most popular, representing 70.3% (93.2% in 1997) of total turnover followed by cross trades (13.8%, 5.3% in 1997), strip trades (12.5%, none in 1997), spread trades (2.4%, 1.2% in 1997) and All-or-None trades (1%, 0.3% in 1997).

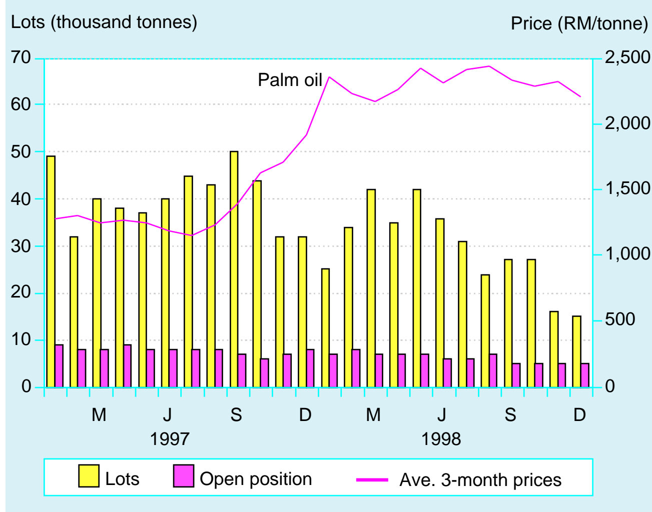
The term structure of the 3-month KLIBOR futures implied yield during the year generally reflected that of the underlying interest rates. Hence, movements in the futures implied yield curve during the year could be divided into three distinct periods, similar to the developments in the cash rates. In January and February 1998, implied yields were high, as indicated by the spot month yield of 10.95% on 16 February, depicting the prevailing high interest rates associated with the progressive tightening of liquidity conditions that had commenced in September 1997. Market expectations during this period were for interest rates to increase further in the near term. Subsequently, the implied yield curve shifted slightly downward on 1 July with the spot month yield of 10.70%, while cash rates were stable amidst the tight liquidity in the system due to continued pressure on the ringgit. The flatness of the implied yield curve indicated that the interest rates were

to remain high in the near future. In the third period from August to December, the implied yield curve shifted significantly downward on 9 November when the spot monthly yield declined further to 7% following successive reductions of the intervention rate and SRR of the banking institutions as part of the measures to support the economic recovery process. However, the implied yield curve became inverted, implying market expectation for further reductions in interest rates in the future.

An important development during the year was the merger between MME and KLCE to establish COMMEX on 7 December. The merger would benefit the industry through economies of scale in enhancing the efficient utilisation of resources as well as improving operational efficiency. In addition, it would enable the exchange to offer multi-financial and commodity derivative products to their clients. At the end of the year, there were 28 companies (18 Broker Members and 10 Non-Broker Members) and 49 individuals (Locals) who had been awarded membership in COMMEX.

In 1998, trading of **crude palm oil (CPO) futures** contracts on the Kuala Lumpur Commodity Exchange (KLCE) declined by 27% to 353,539 lots or equivalent to 8.8 million tonnes of CPO (1997: -2.8% or 484,323 lots or equivalent to 12.3 million tonnes). However, prices have recorded a continuous upward trend since mid-1997. Prices rose above the psychological support level of RM2,000 per tonne at the beginning of 1998 and remained above this level throughout the year. The higher prices reflected primarily the sustained demand for palm oil and its products worldwide as well as lower supplies. Crude palm oil production declined in Malaysia, and supplies were also lower from Indonesia, the world's second largest producer. The Indonesian Government, for most of 1998, had imposed very high export duties (up to 60%) on palm oil exports in its efforts to contain rising prices in Indonesia. During 1998, the price range for CPO futures was, however, slightly narrower at RM500 compared with RM800 in 1997. The highest price

Graph 4.17
Futures Trading on the KLCE



recorded was for the third month contract at RM2,562 per tonne.

The price volatility resulted in several sessions of limit-up and limit-down in the KLCE, thereby impeding market participation. Consequently, the KLCE expanded the daily price limits, effective 9 February 1998, allowing the palm oil industry to continue to undertake hedging activity. Meanwhile, the average daily turnover for the first nine months was 1,615 lots before falling to 928 lots per day in the last quarter. The decline in trading volume during the final quarter reflected mainly subdued foreign interest following the imposition of selective exchange control measures on 1 September 1998 as well as market uncertainties regarding the price prospect for crude palm oil, in view of its high premium over competing oils and expectations of changes to export duties on palm oil in some producing countries. For the year as a whole, the average daily volume was lower at 1,443 lots, compared with the daily average of 1,961 lots in 1997, while the total open positions declined from 6,899 lots in January to 4,597 lots in December. Overall, the decline in activity on the CPO futures market was due primarily to the lower production of crude palm oil in Malaysia and the high price volatility.

5 External Relations

The severity and depth of the Asian crisis and the rapid spread of the contagion effects to other countries within and outside the region, heightened the urgency for efforts to enhance regional and international co-operation during the year. Such efforts were initially focused on measures to promote greater transparency of government policies, to enhance regional surveillance and early warning systems for countries to identify potential risks and to promote the adoption of appropriate policy responses to deal with such risks. This approach was premised on the view that the crisis reflected policy shortcomings in the domestic economic and financial system and regulatory framework in the affected countries. As the crisis became more severe and widespread, the international community conceded that in addition to policy adjustments by individual countries, a global solution was also required to address inherent weaknesses in the international financial system that had contributed to the crisis. In particular, emerging problems associated with hedge fund activities that surfaced in August prompted the international community to acknowledge the need to ensure that the process of globalisation proceeded in a more orderly manner, with an appropriate framework to minimise the destabilising effects of volatile international financial flows.

During the year, Bank Negara Malaysia (BNM) continued to participate actively in various international, regional and bilateral fora, and contributed to discussions on the global response to the financial crisis. In particular, the Bank sought to emphasise Malaysia's call for the international community to expedite efforts to seek a global solution to the crisis and to promote reforms in the international financial system to ensure stable and efficient financial markets so that economies can expand with price stability.

Several initiatives have been initiated at the international and regional levels to bring about a speedy resolution to the crisis as well as to strengthen the architecture of the international financial system to prevent and mitigate the impact of future crises. Such initiatives included measures to augment the capacity of the International Monetary Fund (IMF) to respond to future crises. Another initiative was the special meeting of Finance Ministers and Central Bank Governors of 22 economies (the Group of 22 or Willard Group) to discuss options for crisis resolution and reform of the international financial system. Proposals on long-term reforms to the international financial architecture have been made by the Group of 22, the IMF, the United Nations, Commonwealth, and the Summits of the Group of Seven (G-7), the Group of 15 (G-15), Asia-Pacific Economic Co-operation (APEC) and Association of South-East Asian Nations (ASEAN). Apart from measures to improve transparency and to strengthen domestic economic and financial systems, these fora also called for measures to ensure more equitable burden-sharing in crisis-resolution between debtors and creditors, and between the public and private sectors, promote closer monitoring of short-term capital flows, particularly in relation to highly leveraged operations, greater accountability of international rating agencies, a review of the role of capital controls, an orderly pace of capital account liberalisation, and development of a contingency financing facility to enable countries to avert a crisis. More recent discussions have centred on issues relating to the features of an appropriate exchange rate regime, and mechanisms for ensuring orderly capital flows so that the full benefits of globalisation can be realised. Discussions have also focused on social safety net issues.

The international consensus on the need to strengthen the international financial architecture that had emerged in 1998 is a positive development. The next step would be to build the momentum to translate the proposals into concrete measures. This is a long-term process which would require consultations among the industrial economies as well as the developing countries, to ensure that all views are taken into consideration.

At the regional level, the focus of co-operation in 1998 was on strengthening peer surveillance to complement the IMF's global surveillance role in identifying emerging risks and early policy responses in individual economies and regions. During the year, BNM was directly involved in two regional surveillance efforts, namely, the ASEAN Surveillance Process and the Manila Framework Group of

Finance and Central Bank Deputies. In promoting external relations with developing countries, BNM also continued to provide bilateral technical assistance to a number of central banks.

International Monetary Fund

The 50th meeting of the Interim Committee of the IMF in Washington D.C., on 16 April 1998 endorsed a five-step action plan to help prevent financial crises, and to resolve them when they occur. The action plan included measures to (i) increase transparency of information through the IMF's Special Data Dissemination Standards; (ii) strengthen IMF surveillance over financial sector and capital flows issues; (iii) strengthen international and domestic financial systems, including adoption of international standards on banking, accounting, bankruptcy and corporate governance issues as well as the maintenance of sound and stable macroeconomic policies; (iv) establishment of a Supplemental Reserve Facility (SRF) at the IMF; and (v) measures to ensure that the private sector shared in the burden of debt workouts. On the issue of transparency, the Interim Committee adopted on 16 April 1998 the **Code of Good Practices on Fiscal Transparency - Declaration on Principles**. The Code aims to serve as a guide for members to increase fiscal transparency, and thereby enhance the accountability and credibility of fiscal policy as a key feature of good governance. In addition, the Fund is also expediting work on the code of monetary and financial policies and will be collaborating with relevant international financial institutions and other standard-setting bodies to develop codes and standards on corporate governance, accountancy, and insolvency regimes.

Efforts to strengthen the architecture of the international financial system assumed added urgency at the 51st Interim Committee meeting on 4 October 1998 in Washington, D.C., amidst a scenario of a deteriorating world economic outlook and the spread of the Asian crisis to other regions. Several developments prompted a reassessment of the international community's approach to the crisis. These included the Russian crisis in August 1998, problems in Latin America and the bailout of a large hedge fund, Long-Term Capital Management. These developments threatened the stability of the international financial system and led to a growing recognition that the crisis was not just a problem of domestic economic and financial policy slippages but also reflected weaknesses in the international financial system. In addition to ongoing measures to improve transparency and standards, and strengthen the capacity of the IMF to assist crisis countries, the Interim Committee called for an in-depth analysis of the prudential and supervisory implications arising from the operations of international institutional investors, including highly leveraged operations, with a view to determining whether additional disclosure requirements or regulations would be appropriate to allow better public assessment of the risks involved. The Committee also requested the IMF Executive Board to study further the use of market-based mechanisms to cope with the risk of sudden changes in investor sentiment leading to financial crises. On capital movements, the Committee urged the Executive Board to review the experience on the use of capital controls, and the circumstances under which such measures might be appropriate. The Committee also emphasised that the opening of the capital account must be carried out in an orderly, gradual, and well-sequenced manner, in tandem with the strengthening of domestic financial systems and development of prudential frameworks.

In view of the Fund's tight liquidity position, arising from substantial assistance to crisis-affected countries, the Committee urged all Fund members to accelerate the process leading to the implementation of the **Eleventh General Review of Quotas** and the fourth **Amendment to the Articles of Agreement of the IMF** to provide for a one-time special allocation of Special Drawing Rights (SDRs). Consensus on both the Eleventh General Review of Quotas and the SDR Amendment was reached at the 49th Interim Committee meeting on 21 September 1997 in Hong Kong Special Administrative Region (SAR), The People's Republic of China. Subsequently, members had until January 1999 to consent to the proposed increase in quotas and SDRs. **Malaysia consented to its portion of the increase in quotas in November 1998**. The Eleventh General Review of Quotas came into force on 22 January 1999 when members having an 85% majority of the total IMF votes consented to the increase. The quota increase would raise IMF resources to SDR212 billion (about US$297 billion), while the SDR Amendment would provide for a special allocation of SDRs, totalling SDR21.4 billion, to provide all members with an equitable share of cumulative SDR allocations. Malaysia's quota under this Review was raised from SDR832.7 million to SDR1,486.6 million, thus representing 0.701% of the total voting power.

An important development in 1998 was the coming into force of the **New Arrangements to Borrow (NAB)** on 17 November 1998. The NAB is a set of credit arrangements between the IMF and 25 members and institutions to provide supplementary resources to the IMF to forestall or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system. A total of SDR34 billion (about US$48 billion) will be available to the IMF under the NAB. The first activation of the NAB was in connection with the US$18 billion IMF standby arrangement to Brazil under the US$41.5 billion international financial assistance package. The NAB contribution amounted to SDR9.1 billion (about US$12.7 billion) which will be drawn down by Brazil under the IMF's Supplemental Reserve Facility (SRF). In addition, the World Bank committed to provide up to US$4.5 billion to support the Brazilian programme. An equal amount was also provided by the Inter American Development Bank. Brazil's programme also received bilateral support from a number of industrial countries in North America, Europe and Asia whose governments or central banks would provide through, or in co-ordination with, the Bank for International Settlements (BIS) additional financing totalling approximately US$14.5 billion, to be drawn down in 1999.

The Willard Group or the Group of 22

On 16 April 1998, the United States convened a special meeting of Finance Ministers and Central Bank Governors to explore options to address the crisis and to examine issues related to the stability of the international financial system and effective functioning of global financial markets. Subsequently referred to as the Willard Group or Group of 22 (G-22), the group represented a cross-section of countries from the emerging economies and G-10 countries. Officials from the IMF, World Bank, BIS and Organisation of Economic Co-operation and Development, International Organization of Securities Commissions also attended the meeting. The G-22 members from East Asia included Malaysia, Thailand, Singapore, Hong Kong SAR, Japan, Korea and The People's Republic of China. The G-22 formed three working groups aimed at discussing options to (i) increase transparency and accountability; (ii) strengthen financial systems; and (iii) prevent international financial crises and facilitate the orderly and co-operative resolution of crises that may occur in the future. Malaysia participated in two of the working groups, namely, on transparency and accountability, and on strengthening financial systems. The three working groups have completed their findings and the reports are a basis for future work on the new international financial architecture.

During the G-22 meeting on 5 October 1998, the Finance Ministers and Governors expressed a strong commitment to implement the recommendations of the three working groups. They stressed the need to promote safe and sustainable capital flows by strengthening prudential regulation in major financial centres and by further improvements in transparency and accountability by both the public and private sectors, including highly leveraged financial institutions. The meeting also stressed the importance of strengthening financial systems, including ways to motivate countries to adopt and enforce international standards, and to maintain sustainable exchange rate regimes backed by consistent macroeconomic policies. The meeting endorsed the need to develop new ways to prevent and respond to crises, including the development of better management of risk by the public and private sectors, and effective debtor-creditor regimes to limit financial crises and facilitate their prompt and orderly resolution.

The views of the G-22 were endorsed by the Group of Seven (G-7). On 30 October 1998, the G-7 Leaders adopted a plan which represented both immediate and long-term measures to deal with the problems in the international financial system. The immediate measures included a reduction in interest rates in the industrial countries (Canada, Italy, Japan, the United Kingdom and the United States) and economic and financial reform to promote recovery in Japan, which were seen as vital to promoting recovery in the crisis-affected countries. It also included the establishment of an enhanced IMF facility to provide precautionary credit lines that could be drawn upon if needed by countries pursuing strong IMF approved policies, accompanied by bilateral finance, on a case by case basis, and with appropriate private sector involvement; and the establishment of a new World Bank emergency facility, which would provide in times of crisis, support for the most vulnerable groups and support for critically needed financial sector restructuring and the increased use of financing tools to catalyse private flows.

The G-7 also endorsed several long-term measures to reform the international financial system

to maximise the benefits of globalisation, minimise the risks of disruption and better protect the most vulnerable segments of society. These proposals were mainly based on the recommendations of the G-22, and included the following: (i) the need to examine the implications of operations of highly leveraged and offshore institutions, with a view to encouraging offshore centres to comply with internationally agreed standards; (ii) social safety nets to protect the most vulnerable in times of crises; and (iii) strengthening the role of the IMF, the World Bank, and other international financial institutions. On 20 February 1999, G-7 Finance Ministers and Central Bank Governors endorsed the recommendations by the Basle Committee on Banking Supervision on measures to mitigate risks in dealing with Highly-Leveraged Institutions (HLIs), including hedge funds. The meeting agreed to review the implications arising from the operations of HLIs and of offshore centres on the framework of financial supervision, including the need for additional reporting and disclosure by HLIs. The G-7 also announced the establishment of a Financial Stability Forum to foster closer and more effective co-ordination among national and international authorities and relevant international supervisory bodies and expert groups to promote international financial stability, improve the functioning of the markets and reduce systemic risk.

On 15 December, the United Nations General Assembly adopted several resolutions which requested: (i) the IMF and relevant international regulatory bodies to consider additional regulatory and disclosure measures to ensure greater transparency of financial market participants, including international institutional investors, particularly of highly leveraged operations; (ii) the international community to pursue national and international efforts, at the inter-governmental and inter-agency levels, to contribute to minimising the excessive volatility of global financial flows, and to distribute in a more equitable manner the costs of systemic adjustments between the public and private sectors; and (iii) the IMF to facilitate dialogue among relevant actors to consider the possibility of establishing frameworks for short-term capital flows and trade in currencies. More recent suggestions to strengthen the architecture of the international financial system have included institutional reforms such as proposals to review the roles of the international financial institutions to ensure closer collaboration and to avoid the duplication of functions.

On the whole, progress on the reform of the international financial system was limited in 1998. Nevertheless, a major achievement during the year was the recognition of issues raised by Malaysia at the onset of the crisis during the Joint IMF/ World Bank Annual Meetings in Hong Kong SAR in September 1997. The views of the IMF Interim Committee, G-22, United Nations and the G-7 represent an important recognition of the current problems in the international financial markets. Their policy statements indicate the commitment of the global community to reform the architecture of the international financial system. The task ahead remains substantial, as much work is needed to put in place concrete measures and mechanisms to implement the proposed reforms. Such efforts will take time to arrive at the necessary international consensus. To date, questions of how or which institution or forum should oversee the design and implementation of the proposed reforms remain unclear. The Brazilian crisis, however, highlights the need to accelerate efforts at effecting the reforms.

World Trade Organisation

The World Trade Organisation (WTO) financial services negotiations were concluded on 12 December 1997, with all participating members agreeing to accord most-favoured-nation (MFN) treatment for the market access and national treatment commitments contained in their respective schedules of commitments. The negotiations were concluded among 102 countries, where 70 countries made improved commitments for market access and national treatment. Malaysia participated actively in the negotiations and made substantial improvements, including offering six new licences for life reinsurance and increasing the aggregate foreign shareholding in the insurance sector to 51%, under certain circumstances. (Details provided in BNM 1997 Annual Report). The member countries were required to ratify the agreement by 29 January 1999 and the agreement has come into effect on 1 March 1999. As at 29 January 1999, 54 countries, including Malaysia, had ratified the agreement.

ASEAN Co-operation

ASEAN co-operation was further strengthened in 1998 as member countries sought to address the challenges posed by the Asian crisis. At the **Second Meeting of the ASEAN Finance Ministers** on 28 February 1998 in Jakarta, Indonesia, Ministers

supported the use of regional currencies for intra-ASEAN trade settlement. They endorsed the use of Bilateral Payments Arrangements (BPAs) as proposed by the Special Task Force of the ASEAN Central Banks, which met on 27 February 1998 in Kuala Lumpur. The objectives of the BPA would be to enhance intra-ASEAN trade and strengthen ASEAN economic and financial co-operation. Ministers agreed that the BPA would be implemented on a voluntary basis, with a view to evolving the facility into a multilateral arrangement over the long term. The mechanism would facilitate trade settlement on a net basis. It would be market-oriented, aimed at enhancing efficiency in trade settlements, without involving subsidies or additional costs on existing market trade settlement systems. The BPA would operate in parallel with the existing trade and payment system, and would not impose additional restrictions or controls on international trade and payments. It would also operate within the existing international agreements governing the conduct of international trade and payments (including the WTO and the IMF) and domestic regulations and legislation. Reflecting the ASEAN commitment to this initiative, Bangko Sentral ng Pilipinas signed a BPA with BNM on 11 July 1998. Negotiations are at an advanced stage for a similar agreement between Malaysia and Thailand, while negotiations with Indonesia will commence soon.

During the Second ASEAN Finance Ministers' Meeting, Ministers also agreed to the establishment of an ASEAN Surveillance Process (ASP) in line with their decision at a Special Meeting of ASEAN Finance Ministers in Kuala Lumpur on 1 December 1997. Discussions on options to formalise the ASP dominated the ASEAN Finance Ministers' process in 1998. At the First ASEAN Select Committee Meeting on 7 September 1998 in Kuala Lumpur, Malaysia, ASEAN senior finance and central bank officials agreed on two broad sets of parameters for the ASP. These were (i) general macroeconomic and financial sector performance parameters which would provide the basic information on the status of the economy; and (ii) selected topics on surveillance which would provide important insights into the economic and financial situation and vulnerability of Member Countries. It would also act as an early warning system. The Asian Development Bank (ADB) had agreed to provide technical assistance to facilitate this process.

The **ASEAN Central Bank Forum (ACBF)**, comprising central bank deputies from the ASEAN region, met twice in 1998. The **Second ACBF** was held on 9 May 1998 in Jakarta, Indonesia and the **Third ACBF** was held on 6 September 1998 in Kuala Lumpur, Malaysia. The meetings provided an opportunity for members to exchange views on recent economic developments and policy responses of each ASEAN country. The IMF also made presentations on the outlook for global growth and short-term prospects in the ASEAN region. The meetings considered the areas of surveillance and logistics of the surveillance process. At the Third ACBF, the Central Bank of Myanmar was admitted as a member of the ACBF as provided for under the Accession of New Members in the Terms of Understanding of the ACBF. The **Fourth ACBF** was held in Singapore on 1 March 1999, where Vietnam was admitted as its eighth member. In addition to surveillance issues, the meeting reviewed the ongoing efforts to reform the international financial architecture. The meeting also agreed to initiate a concept paper on the feasibility of a common ASEAN exchange rate arrangement, as a follow-up from the decision of the Hanoi Plan of Action.

The Heads of State of ASEAN gathered in Hanoi for the **Sixth ASEAN Summit on 16 December 1998**. ASEAN Finance Ministers noted in their report to the ASEAN Heads of State that the most urgent task was to restore the conditions for robust economic growth in ASEAN. Restoring sustainable growth throughout the region would include key elements such as reviving domestic demand, enhancing safeguards for the poor, strengthening banking systems, revitalising financial and corporate sectors, strengthening transparency and governance, and mobilising additional resources to finance growth. In the area of strengthening the architecture of the international financial system, ASEAN Finance Ministers agreed to promote closer collaboration and information-sharing among national and international regulatory authorities, play an active role in international fora, and support an orderly and well-sequenced approach to capital account liberalisation. During the Summit, ASEAN Leaders unveiled the Hanoi Plan of Action aimed at strengthening macroeconomic and financial co-operation within the ASEAN region by the year 2004. The Hanoi Plan of Action proposed, among others, a study on the feasibility of developing an ASEAN exchange rate arrangement as a long-term objective of ASEAN economic and financial co-operation. The Plan also called for the development of an ASEAN Bond Market by the year 2000.

In terms of measures to promote regional financing arrangements, ASEAN central bankers signed the Seventh Supplementary Agreement to the Memorandum of Understanding on **ASEAN Swap Arrangement (ASA)** on 14 July 1998 in Tokyo, Japan. The ASA was renewed for another year to 5 August 1999. The ASA represents a long-standing tradition of ASEAN financial co-operation which was first established under a Memorandum of Understanding signed on 5 August 1977 by the central banks of Indonesia, Malaysia, the Philippines and Thailand, and the Monetary Authority of Singapore. The objective of the ASA is to provide short-term liquidity to member countries facing a temporary balance of payments need. The total credit available under the ASA is US$200 million, with each participating central bank or monetary authority being eligible to draw a maximum of US$80 million.

Manila Framework

The Second Meeting of the Manila Framework, comprising Finance and Central Bank Deputies from Australia, Brunei Darussalam, Canada, The People's Republic of China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand and the United States was held in Tokyo, Japan, on 26-27 March 1998 to review progress in addressing the present crisis, and to prepare the ground for sustainable growth in the region. Representatives from the IMF, the World Bank and the ADB also attended the meeting. Discussions focused mainly on progress under IMF-supported economic adjustment programmes in Thailand, Korea and Indonesia, but also reviewed developments across the region. An **ad-hoc joint Manila Framework/G-7 Deputies Meeting** was held in Tokyo on 20 June 1998. The Deputies considered that the restoration of the health of the banking system in Japan was critical to the recovery in Asia. Deputies, therefore, welcomed the Japanese Government's efforts to restructure its financial system as a matter of highest urgency, including the prompt disposal of bad assets, acceleration in the implementation of the fiscal stimulus package, and the reform of both corporate and individual income tax structures. Deputies also stressed the importance of addressing the social consequences of the crisis. The **Third Manila Framework Meeting** was held on 7-8 November 1998 in Kuala Lumpur, Malaysia. Deputies welcomed Japan's financial package (Miyazawa Plan) of US$30 billion to support economic recovery efforts in Asia. The meeting also welcomed the formalisation of the ASEAN Surveillance Process based on peer review which would complement regional surveillance within the Manila Framework Group.

Asia-Europe Co-operation

The **Second Asia-Europe Meeting (ASEM 2)** was held in London on 3-4 April 1998. It was attended by Heads of State and Government from 10 Asian nations (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand, Vietnam, The People's Republic of China, Japan and Korea) and 15 European nations as well as the European Commission. In their discussions on the reform of the international financial system, the Leaders focused on crisis prevention and reducing the vulnerability of domestic financial systems to potential shocks, including speculation-induced instability. In this regard, the Leaders called for strengthening the capacity of the IMF to respond to financial difficulties in a timely and decisive manner. An enhanced and more transparent global IMF surveillance role should be complemented in Asia by the establishment of a new regional surveillance mechanism. The Leaders also called for strengthened co-operation, regulation and supervision in financial sectors, and requested the IMF to examine ways to improve transparency in financial and capital markets, including the monitoring of short-term capital flows.

Co-operation in ASEM was further extended through the creation of an ASEM Trust Fund at the World Bank to help finance technical assistance and advice both on restructuring the financial sector and on finding effective ways to redress poverty, drawing on both the European and Asian expertise. Malaysia has been a recipient of grants and technical assistance under the ASEM Trust Fund. Areas identified for assistance are Financial Sector Strengthening, Enhancing Industrial and Export Competitiveness, Strengthening Institutional Capacity for Implementation of Active Labour Market Policies, Guiding Health Policy Decisions through Demand Analysis and Corporate Crisis Recovery and Upgrading. In addition to existing bilateral arrangements, the Leaders announced the proposal to create a European network, in conjunction with Asian expertise, for increasing the quality and quantity of technical advice in the reform of the financial sector.

ASEM Finance Ministers met on 15-16 January 1999, in Frankfurt, Germany, to discuss the latest developments in the world economy, particularly in relation to ongoing efforts to resolve the Asian crisis. ASEM Ministers agreed that the international community should keep markets open to goods, services and capital. They stressed the need to enhance the role of the IMF in the functioning of the international monetary system and to develop procedures for crisis prevention and the involvement of the private sector in the resolution of financial crises. The Ministers also considered the possibility for strengthening the role of the IMF Interim Committee. In addition, Ministers discussed alternative exchange rate regimes and the need for transparency and disclosure standards for private sector financial institutions involved in international capital flows, including the implications of operations of highly leveraged and off-shore institutions. The Ministers also noted the IMF's ongoing review of the experience with the use of controls on capital movements and the circumstances under which such measures might be appropriate.

Asia-Pacific Economic Co-operation

Finance Ministers of the Asia-Pacific Economic Co-operation (APEC) forum met for the fifth time in Kananaskis, Canada, on 23-24 May 1998 to assess future prospects for growth and development within the APEC region in light of the Asian crisis and to discuss policies and measures to improve such prospects. The discussions focused on two broad themes. The first was an assessment of the current economic situation and policies to restore financial stability and growth, including measures to strengthen social safety nets to help cushion the impact of the crisis on the poor. The second was the development and strengthening of financial markets in the region so as to reduce the likelihood of future financial instability and to facilitate the continued dynamic growth of the APEC region.

On the second theme of development and strengthening of financial markets, Malaysia and the United States were requested by APEC Finance Ministers to undertake further work in the area of assessing the adequacy of banking supervisory regimes in APEC economies; and to co-ordinate an initiative (with the World Bank and the ADB) in the area of strengthening corporate governance in the APEC region. BNM in collaboration with the South-East Asian Central Banks Research and Training Centre (SEACEN) organised the first meeting of APEC bank supervisors on 16-17 December 1998 in Kuala Lumpur. The meeting discussed the preliminary findings of a survey which assessed the adequacy of banking supervisory regimes in APEC economies. A full report will be tabled for the consideration of the APEC Finance Ministers at their forthcoming meeting in May 1999.

Following the APEC Finance Ministers' Meeting in Kananaskis, Canada, Malaysia assumed the chair of the APEC Finance Ministers' process for the period May 1998-May 1999. On 5-6 November 1998, Malaysia hosted the **APEC Finance Deputies Meeting** in Kuala Lumpur to discuss issues and risks facing APEC economies; the social impact of the East Asian crisis; bank and corporate restructuring; and the various ongoing initiatives under the APEC Finance Ministers' process. These included efforts to strengthen financial market supervision; pension fund reform; review the role of credit rating services and strengthen information disclosure standards; develop a voluntary action plan for supporting the freer and stable flow of capital; develop domestic bond markets; and strengthen corporate governance.

At the **APEC Leaders' Summit on 18 November 1998**, APEC Economic Leaders adopted the Kuala Lumpur Declaration which reiterated their commitment and resolve to pursue a co-operative growth strategy to support an early and sustained recovery in the region in order to contain the risks of the contagion and prevent the possibility of a global recession. The Leaders endorsed efforts by the multilateral development banks to use innovative financial instruments to help catalyse and leverage private sector capital flows. Leaders also called for a review of the practices of international rating agencies and noted that ongoing efforts to strengthen the international financial system by the G-22 and other fora should be expedited. The Leaders expressed concern over the prospects for a recovery of capital flows back into the region and noted that there was a need to develop innovative means by which to promote the recovery of such inflows.

EMEAP

Within the Asia-Pacific region, BNM continued to pursue co-operative efforts with central banks and monetary authorities in the region through **the Executives' Meeting of East Asia and Pacific**

Central Banks (EMEAP). Established in 1991, EMEAP is an informal forum for the central banks and monetary authorities of Australia, The People's Republic of China, Hong Kong SAR, Japan, Korea, Indonesia, Malaysia, New Zealand, the Philippines, Singapore and Thailand. The EMEAP forum, which essentially focuses on central banking issues, has thus far contributed to strengthening co-operation among the regional economies and enhancing the stability of the regional financial markets. Three EMEAP meetings (two at the Deputy and one at the Governor level) were held during 1998. The Fifteenth EMEAP Deputies Meeting was held in Singapore on 19 March 1998, while the Third EMEAP Governors' Meeting was held in Tokyo, Japan, on 14 July 1998. The Sixteenth EMEAP Deputies Meeting was held in New Zealand on 23 November 1998.

EMEAP meetings held during the year provided participants with an opportunity to review current economic and financial conditions in respective member countries and to exchange views on current issues. Governors exchanged views on the relationship between investments and financial stability. Governors agreed that, in order to benefit from and minimise the risks of capital account liberalisation, it was important to develop and strengthen domestic financial institutions and market infrastructure, such as efficient and secure payment systems and deep and liquid financial markets, as well as banking supervision. In this regard, Governors endorsed the ongoing work by the EMEAP working/study groups and supported the Deputies' proposal to re-organise the three working/study groups under EMEAP. As such, the Working Group on Financial Market Development which covered the payment system and market development would be re-organised to a new *Working Group on Payment and Settlement Systems,* focusing on payment system issues. The work of the Working Group on Central Banking Operations, which had conducted comparative studies of central bank services against the backdrop of increasing market innovation and interdependence, would be succeeded by a new *Working Group on Financial Markets*. This working group would also assume the work on market development that had been covered by the Working Group on Financial Market Development. Lastly, the Study Group on Banking Supervision would be renamed to the *Working Group on Banking Supervision* and given a more permanent status than the previous Study Group. The change reaffirmed the importance given to improving bank supervision in the region in the wake of the Asian financial crisis. The Working Groups on Banking Supervision, Financial Markets and Payment and Settlement Systems met in Kuala Lumpur on 4-5 March 1999 to discuss recent developments in regional financial markets, supervisory approach for monitoring hedge funds and developments in payment and settlement systems.

New EMEAP initiatives during the year included a new facility for yen liquidity offered by the Bank of Japan, and the launch of the EMEAP web-site on 14 July 1998. Under the yen liquidity facility, the Bank of Japan would purchase Japanese Government bonds and bills from central banks and monetary authorities at their request either outright or under repurchase agreements. The use of this facility would enhance the use of the yen in the region, and thereby contribute to the regional financial stability. The establishment of the EMEAP web-site would facilitate collaboration among EMEAP members.

BNM participated in the **Thirty-Third Conference of Governors of South-East Asian Central Banks, SEACEN** (comprising Bank Indonesia, The Bank of Korea, BNM, Central Bank of Myanmar, Nepal Rastra Bank, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Central Bank of Sri Lanka, the Central Bank of China, Taipei and the Bank of Thailand) held in Denpasar, Indonesia, on 13-15 February 1998. In the Opening Address of the conference, it was noted that in an increasingly integrated international environment, adverse developments in one country could lead to rapid and costly contagion effects, even in countries with sound economic fundamentals. Therefore, while the pursuit of macroeconomic stability was important, it was essential for SEACEN countries to continue to strengthen regional co-operation to maintain monetary and economic stability. In this regard, it was noted that the SEACEN forum could play an important role in facilitating active policy co-operation to promote stability within an environment of free capital markets. It was suggested, however, that capital account liberalisation must be accompanied by stronger prudential measures to strengthen the banking system. The Conference also discussed the world economic outlook and current IMF issues.

As in previous Conferences, the Governors reviewed economic and monetary developments in

the SEACEN economies in 1997 and prospects for 1998. It was noted that growth would likely slow down, inflation could increase but remain at single digit levels in 1998, while the current account of the balance of payments would show surpluses. Financial systems in SEACEN countries were also likely to emerge stronger and more transparent due to compliance to international standards in key areas such as capital adequacy and risk management. Strengthened financial systems in SEACEN countries would support a sustainable rate of economic growth in the medium to long term. The Governors also shared their experiences in addressing the financial crisis, in particular, in the area of financial restructuring, private debt management, institutional and structural reforms and the provision of social safety nets. The Governors also discussed the appropriate mix between interest rate and exchange rate policies. The importance of establishing a new framework for the early resolution of the private sector debt problem was also emphasised. The Governors also reviewed the progress of activities of the SEACEN Research and Training Centre for the operating year 1997/98 and approved the work programme and budget for 1998/99.

The Eighth Summit of the Heads of State and Government of the Group of Fifteen (G-15) was held on 11-13 May 1998 in Cairo, Egypt. At the Summit, the Leaders called for equitable burden-sharing between private lenders, borrowers and governments; the strengthening of social safety nets to protect the more vulnerable segments of the population and to preserve the gains attained in poverty alleviation over many decades; and the urgent need to review the existing international financial arrangements and to ensure their adequacy in the face of the rapidly evolving financial markets. Malaysia presented a paper at the G-15 Summit on “The East Asian Crisis – Causes, Policy Responses, Lessons and Issues”.

Bilateral Co-operation

The annual bilateral meeting between the Bank of Thailand and BNM was held on 20-22 February 1998, in Chiang Mai, Thailand. The bilateral meeting served as a forum for both central banks to exchange views on economic and financial matters, including interest rate policy, experience and policies in the money and foreign exchange markets, financial institutions’ restructuring, experience and policies in supervision of financial institutions, use of ASEAN currencies for intra-ASEAN trade settlement and ASEAN regional surveillance. Although only one bilateral meeting was held during the year, central bankers within the region had the opportunity to meet at various other regional fora held during the year which often included informal bilateral meetings on the fringes of the official meetings.

Technical Assistance and Information Exchange

In response to the interest expressed by foreign central banks and finance ministries to study BNM’s experience in central banking issues, BNM continued to provide technical assistance to foreign financial institutions in 1998. The assistance was in the form of study visits, attachment programmes, official visits, briefings and technical assistance. During the year, 12 foreign delegations visited the Bank to exchange views on matters of mutual interest. The delegations were from the Ministry of Finance of the United Arab Emirates, Australian Securities Commission, Reserve Bank of India, Bank of Uganda, the United Nations, the Ministry of Finance of Bangladesh, National Bank of Cambodia, and the Chung Hua Institute of Economic Research, Taiwan. The areas of interest to the study groups included economics and statistics, the Malaysian capital market, payments system, preparation of budgets, exchange controls, bank supervision and human resource management. During the year, BNM also participated in the Special Joint Malaysian-Kyrgyz Commission that was set up to monitor the implementation of recommendations contained in an earlier joint study on ways to promote co-operation between the two countries and to enhance the development of the Kyrgyz Republic. Malaysia hosted the first meeting of the Commission on 15-16 December 1998.

Attachment programmes in the area of the Bank’s supervisory function was provided to the State Bank of Vietnam and Reserve Bank of Fiji. In addition, briefings were also conducted for delegations from the industrial countries from Europe and Japan. The briefings focused on the latest developments in the Malaysian economic and financial system. The Bank also offered 10 places at the Central Banking Course conducted by the Bank’s Human Resource Development Centre to foreign participants under the Malaysian Technical Co-operation Programme. The participants were from the central banks of Bangladesh, Cambodia, Cuba, Egypt, Indonesia, Kenya, Lao People's Democratic Republic (PDR), Myanmar, Senegal and Turkey.

During the year, BNM continued to conduct bilateral consultations with various international financial institutions, including the IMF, World Bank, ADB and Islamic Development Bank. These consultations reviewed economic policies in Malaysia and prospects for economic growth in the near-term. Bilateral discussions were also conducted with the Institute for International Finance, various international rating agencies and research organisations. The Malaysian Government also engaged an international consultant, Salomon Smith Barney, to provide advice on strengthening the domestic financial sector as well as to facilitate Malaysia's dialogue with international investors and access to the international capital markets.

6 Organisation and Personnel

Staff and Organisation

The Board of Directors recognises the hard work, dedication and commitment of all staff in 1998. The Board also expresses its appreciation to them for enduring a challenging year especially during the implementation of the new exchange control measures in September 1998, whereby there was exceptional teamwork and support within the Bank.

After nearly four years at the helm of the Bank, Tan Sri Ahmad bin Mohd Don and Dato' Fong Weng Phak relinquished their positions as the Governor and Deputy Governor on 1 September 1998. The Board acknowledges Tan Sri Ahmad and Dato' Fong's contributions. Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman succeeded Tan Sri Ahmad as the Governor and Chairman of the Board of Directors and Dr. Zeti Akhtar Aziz was appointed as the Deputy Governor with effect from 7 September 1998. Dato' Nor Mohamed bin Yakcop was appointed as Adviser, also effective from the same date.

Continuation of Reorganisation Process

The Bank continued with the implementation of its change programme, encompassing the review, rationalisation and redesign of its role, structure and function, its processes and procedures as well as its human resource management. One of the strategic projects embarked by the Bank in 1998 was the review of the currency processing and distribution function, which culminated in the establishment of six regional centres to store currency notes and coins, while the distribution and processing function was outsourced to EFT System (M) Sendirian Berhad (EFT), which established its own Cash Centres. Although EFT, as the Bank's agent, performs the distribution and processing, the Bank retains its control over the currency stock at each cash centre. The majority of the 74 EFT staff are from the Bank's currency processing unit who were offered a mandatory separation scheme with benefits and compensation similar to those that were offered under the Voluntary Separation Scheme in 1997.

The year also saw the privatisation of the Mint effective October 1998. This is in line with the Government's effort to privatise productive activities on a more cost-effective basis. The privatisation of the Mint was offered to Boustead Holdings Berhad, a public company owned by Lembaga Tabung Angkatan Tentera. Boustead Mint Sendirian Berhad was established to take over the operations of the Mint. The non-executive staff of the Mint were offered a mandatory separation scheme with benefits and compensation similar to those under the Voluntary Separation Scheme conducted in 1997.

Developments in Human Resource

In the area of human resource development, the Bank continued with the implementation of strategic projects aimed at improving staff performance, productivity and competency. To inculcate a new performance management culture across all levels of the Bank, goal-setting programmes were conducted extensively for the non-executives. A new modular format was also implemented for the Induction Programme for new senior executives aimed at helping them integrate into the work culture of the Bank. In addition, a formal "Mentoring Programme" was introduced to provide a support system for the new senior executives. The line departments were empowered to manage the training and development needs of their staff and were encouraged to jointly share the responsibility with the Human Resource Development Centre. The Human Resource Development Centre, in trying to meet the skill needs of line management, arising from the decentralisation of some of the human resource functions, conducted courses on selection interviewing techniques as well as on domestic inquiry procedures for heads of department. Training in other areas of needs such as computer literacy, occupational safety and health, customer focus and technical programmes in banking, finance and economics continued during the year to equip staff with the necessary skills to perform their work efficiently and professionally. The number of training man-days totalled 538,269 for the year.

The Bank also approved a recognition programme, aimed at complementing its existing reward system. Formal awards such as Teamwork, Leadership, Innovative and Excellent Service were introduced to promote a high level of work excellence.

General

The Board was saddened by the untimely demise of two former Governors, Tun Ismail Ali who passed away on 6 July 1998 and Tan Sri Dato' Jaffar Hussein who passed away on 11 August 1998. Both of them have served the Bank with distinction. The Board wishes to place on record its heartfelt condolences to their families.

Awards

The Board congratulates the Deputy Governor, Dr. Zeti Akhtar Aziz, on being conferred the Darjah Mahkota Johor Yang Amat Mulia Pangkat Kedua (D.P.M.J) on the occasion of the birthday of His Royal Highness, the Sultan of Johor Darul Takzim on 8 April 1998.

The Board would also like to congratulate all 28 staff who received the long service awards upon the completion of 20 and 30 years of dedicated service in the Bank.

Retirement

The Board wishes to place on record its appreciation and gratitude to the 20 retirees who have rendered loyal and dedicated service to the Bank. The staff who retired from the services of the Bank in 1998 were Puan Tan Yit Seong (Insurance Regulation Department), Puan Fatimah binti Ibrahim (Money Museum Unit), Encik Tay Bin Chat (SEACEN), Puan Wong Fong Lin (Exchange Control Department), Encik Zainal bin Mohd Yunus (Payment Systems Department), Encik Lee Ah Kiong (Human Resource Management Department), Encik Ganesan a/l Muniandy (Insurance Supervision Department), Cik Theresa Lai Min Fui (Governor's Office), Puan Gloria Arputhasamy (Insurance Regulation Department), Encik Muhammad bin Hussain, Encik Omar bin Abd. Samad, Encik Abdul Ghani bin Abdul Razak, Encik Othman bin Zakaria (Pulau Pinang Branch), Encik Mohd Sham bin Abdul Rahman, Encik Mohd Sairi bin Hj Abu Bakar, Encik Supaat bin Mohd Yatiman, Encik Mohd Yunus bin Jais (Johor Bahru Branch), Encik Abu Talib bin Abass (Mint), Encik Mesran @ Mahmood bin Haji Siraj (Finance Department) and Tuan Haji Yaakub bin Lebai Titeh (Property and Services Department).

Manpower

As at the end of 1998, the Bank had a total staff complement of 1,560, representing staff in the Head Office, five branches, two representative offices in London and New York, and the Human Resource Development Centre in Petaling Jaya.

BANK NEGARA MALAYSIA
ORGANISATION STRUCTURE

BOARD OF DIRECTORS

GOVERNOR
Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman

- Corporate Services — Mohd Nor bin Mashor
- Special Investigation — S. Indralingam

DEPUTY GOVERNOR
Dr. Zeti Akhtar Aziz

- Internal Audit — Zainul Abidin bin Nazir Ahmad
- Risk Management — Teo Kee Tian

ADVISER
Dato' Nor Mohamed bin Yakcop

ASSISTANT GOVERNOR
ECONOMICS
Latifah Merican Cheong

- Economics I — Ismail bin Alowi
- Economics II — Dr. Phang Hooi Eng
- Statistical Services — Chan Yan Kit

ASSISTANT GOVERNOR
INVESTMENT & OPERATIONS
Huang Sin Cheng

- Investment & Treasury — Lillian Leong Bee Lian
  - New York Rep. Office
  - London Rep. Office
- Information Services — Ramli bin Saad
- Finance — Azizan bin Haji Abd Rahman
- Legal — Gopala Krishnan Sundaram
- Currency Management & Operation — Low Koon Seng
  - Branches (5)

ASSISTANT GOVERNOR
SERVICES
Mohamed Yusof bin Ahmad Muhaiyuddin

- Human Resource Management — Mohamed Yusof bin Ahmad Muhaiyuddin
- Human Resource Development Centre — Essah binti Yusoff
- Property & Services — Maksom bin Kasan Widi
- Security — Che Norudin bin Che Alli

ASSISTANT GOVERNOR
SUPERVISION
Datuk Zamani bin Abdul Ghani

- Bank Supervision I — Zakaria Ismail
- Bank Supervision II — Wong Yew Sen
- Insurance Supervision — Yahaya bin Haji Besah
- IS Supervision — Norainy binti Mohd Sahid
- Payment Systems — Che Sab bin Ahmad

ASSISTANT GOVERNOR
REGULATION
Dr. Awang Adek Hussin

- Bank Regulation — Nor Shamsiah Mohd Yunus
- Insurance Regulation — Muhammad bin Ibrahim
- Exchange Control — Md. Radzi bin Haji Kechik

Annual Accounts

CERTIFICATE OF THE AUDITOR GENERAL ON THE ACCOUNTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 1998

The Balance Sheet and Profit and Loss Appropriation Account together with the Notes thereto have been examined under my direction in accordance with the Audit Act 1957, in conformity with generally accepted auditing standards.

2. In my opinion:

(a) the Balance Sheet and Profit and Loss Appropriation Account together with the Notes thereto give a true and fair view of the state of financial affairs of Bank Negara Malaysia as at 31 December 1998 and of its transactions for the year ended on that date; and

(b) the accounting records and other relevant registers have been maintained satisfactorily.

(DATUK HJ. MOHD. KHALIL BIN DATO' HJ. MOHD. NOOR)
AUDITOR GENERAL

KUALA LUMPUR
11 MARCH 1999

STATEMENT BY DIRECTORS

We, Tan Sri Dato' Seri Ali Abul Hassan bin Sulaiman and Dato' Muhammad Ali bin Hashim, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the accompanying Balance Sheet and Profit and Loss Appropriation Account together with the Notes thereto, 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 1998 and of the results of operations for the year ended on that date.

On behalf of the Board,

TAN SRI DATO' SERI ALI ABUL HASSAN BIN SULAIMAN
CHAIRMAN

8 MARCH 1999
KUALA LUMPUR

On behalf of the Board,

DATO' MUHAMMAD ALI BIN HASHIM

DIRECTOR

8 MARCH 1999
KUALA LUMPUR

DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE ACCOUNTS OF BANK NEGARA MALAYSIA

I, Azizan bin Haji Abd. Rahman, being the officer primarily responsible for the accounts of Bank Negara Malaysia, do solemnly and sincerely declare that the accompanying Balance Sheet and Profit and Loss Appropriation Account together with the Notes thereto, 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 8th day of March 1999.)

Before me,

Bank Negara Malaysia

Balance Sheet as at 31 December 1998

LIABILITIES		Note	1998 RM	1997 RM
Authorised Capital	RM200,000,000			
Paid-up Capital		2	100,000,000	100,000,000
General Reserve Fund		3	3,580,341,905	3,212,432,101
Other Reserves		4	28,342,866,826	42,866,826
Currency in Circulation			20,547,397,698	24,532,291,528
Deposits:				
Commercial Banks, Finance Companies and Merchant Banks			34,650,553,608	65,197,644,636
Federal Government			25,281,306,084	10,545,338,219
Others		5	9,079,320,115	2,319,999,930
Bank Negara Bills/Bonds			3,760,100	909,007,218
Allocation of Special Drawing Rights		6	743,978,271	505,441,566
Other Liabilities			2,380,298,386	1,555,975,153
			124,709,822,993	**108,920,997,177**

Profit and Loss Appropriation Account for the Year Ended 31 December 1998

	1998 RM	1997 RM
Transfer to General Reserve Fund	367,909,804	228,238,857
Amount Payable to Federal Government	1,000,000,000	–
	1,367,909,804	**228,238,857**

Notes on the following pages form part of these accounts.

ASSETS	Note	1998 RM	1997 RM
Gold and Foreign Exchange		96,264,938,326	57,032,062,797
International Monetary Fund Reserve Position		2,379,240,022	1,621,972,139
Holdings of Special Drawing Rights		793,875,612	478,938,730
Malaysian Government Papers	7	1,072,364,460	3,728,653,214
Bills Discounted	8	–	969,314,280
Deposits with Financial Institutions		2,512,101,000	27,798,225,000
Loans and Advances		5,773,389,590	4,694,094,121
Deferred Expenditure	9	2,853,604,578	3,424,325,493
Other Assets	10	13,060,309,405	9,173,411,403
		124,709,822,993	**108,920,997,177**

	1998 RM	1997 RM
Net Operating Profit	1,367,909,804	228,238,857
	1,367,909,804	**228,238,857**

Notes To The Accounts - 31 December 1998

1. **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 1998.

   (b) **Foreign Currency Translation**
   Transactions in foreign currencies during the year have been translated into ringgit at rates of exchange ruling on value dates. Assets and liabilities in foreign currencies have been revalued at rates of exchange ruling on the balance sheet date.

   In 1997, the foreign exchange gain on the balance sheet date was not recognised in the Bank's account, in view of the volatility of the exchange rates during that year. However, arising from the fixing of ringgit/US dollar exchange rate at RM3.80 in September 1998, all assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the cumulative gain has been reflected accordingly in the Bank's current year account.

   The US dollar equivalent of the International Reserves comprising Gold and Foreign Exchange, International Monetary Fund Reserve Position and Holdings of Special Drawing Rights as at 31 December 1998 was US$26,167.9 million.

2. **Paid-up Capital**
   The entire issued and paid-up capital of RM100 million is owned by the Government of Malaysia.

3. **General Reserve Fund**

	1998 RM	1997 RM
As at 1 January	3,212,432,101	2,984,193,244
Net Operating Profit	367,909,804	228,238,857
As at 31 December	3,580,341,905	3,212,432,101

4. **Other Reserves**
   Other reserves comprise the Exchange Rate Fluctuation Reserve, the Investment Fluctuation Reserve, the Insurance Reserve and the Contingency Reserve.

5. **Deposits - Others**
   A substantial part of these deposits comprises deposits from Federal Statutory Authorities.

6. **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 in SDR amounted to SDR139,048,000.

7. **Malaysian Government Papers**

	1998 RM	1997 RM
Malaysian Government Securities	132,549,460	2,107,720,200
Malaysian Treasury Bills	–	33,143,014
Government Investment Certificates	939,815,000	1,587,790,000
	1,072,364,460	3,728,653,214

8. **Bills Discounted**

	1998 RM	1997 RM
Bills rediscounted under export credit refinancing scheme	–	969,314,280

9. **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. The amount outstanding is being amortised over a period of 10 years, beginning from 1994.

10. **Other Assets**

Other assets include investments in shares and bonds of RM12,463,620,502 acquired under section 30(1)(j) and section 30(1)(oo)(i) of the Central Bank of Malaysia Act 1958 (Revised-1994).

11. **Contingent Liabilities**

Total contingent liabilities as at 31 December 1998 amounted to RM1,952,454,553, 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.

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Exchange Control Policy

The exchange control policy of Malaysia is applied uniformly to transactions with all countries except Israel and the Federal Republic of Yugoslavia (Serbia and Montenegro) for which special restrictions apply. The exchange control policy, in general, is aimed at monitoring the settlement of payments and receipts as well as encouraging the use of the country's financial resources for productive purposes in Malaysia. For monitoring and compilation of balance of payments statistics, residents are required to complete statistical forms, Form P and Form R, for each payment or receipt of more than RM10,000 vis-a-vis non-residents. On 1 September 1998, several new exchange control measures were imposed to regulate short-term capital flows as well as to promote financial stability and economic recovery.

The following are the main exchange control requirements:

i. Current Account Transactions

(a) Payment for Import of Goods and Services

- There are no restrictions on payments, irrespective of amount, to non-residents for import of goods and services. All payments for import of goods and services, however, must be made in foreign currency.

(b) Export Proceeds

- All export proceeds are required to be repatriated back to Malaysia in accordance to the payment schedule as specified in the sales contract, which in any case should not exceed six months from the date of export.

- The export proceeds must be received in foreign currency and must either be sold for ringgit or retained in approved foreign currency accounts with onshore commercial banks. For details, please see Item (iv) on Foreign Currency Accounts of Residents.

(c) Import and Export of Currency by Travellers

- All travellers are required to complete Travellers Declaration Forms at the Immigration check-point or carry valid Travellers Declaration Pass upon their exit or arrival at Malaysia.

- Resident and non-resident travellers are allowed to carry ringgit notes up to RM1,000 on person or in their baggage, upon arrival at or departure from Malaysia.

- A resident traveller is freely allowed to take out foreign currency notes, including traveller's cheques, up to the equivalent of RM10,000 per person.

- A non-resident traveller is allowed to take out foreign currency notes, including traveller's cheques, up to the amount brought into Malaysia.

- Resident and non-resident travellers are allowed to bring in any amount of foreign currency notes, including traveller's cheques, upon their arrival in Malaysia.

- Prior permission of the Controller of Foreign Exchange (the Controller) is required for:
  - a traveller to export or import ringgit notes, or to export foreign currency exceeding the permitted limits; and

- any person other than a traveller to export or import foreign currency or ringgit notes irrespective of amount.

ii. Capital Account Transactions

(a) Foreign Direct Investment

- Foreign direct investors are freely allowed to repatriate their investment, including capital, profit and dividends, without being subject to any levy.

(b) Investment Abroad by Residents

- Residents are required to seek prior approval from the Controller to remit funds in excess of RM10,000 for overseas investment purposes.

(c) External Credit Facilities From Non-Residents

Credit Facilities in Foreign Currency

- Residents are freely permitted to obtain credit facilities in foreign currency up to the equivalent of RM5 million. Any amount exceeding the permitted limit would require the prior approval of the Controller.

- There is also no restriction for repayment of credit facilities obtained from non-residents as long as such credit facilities have been obtained in accordance to the relevant exchange control rule.

Credit Facilities in Ringgit

- Residents are not allowed to obtain credit facilities in ringgit from non-residents without the prior approval of the Controller.

(d) Extension of Credit Facilities to Non-Residents

Credit Facilities in Foreign Currency

- Commercial banks are free to extend credit facilities in foreign currency to non-residents for purposes other than financing the acquisition or development of immovable property in Malaysia.

Credit Facilities in Ringgit

- Banking institutions are allowed to extend credit facilities in ringgit up to the aggregate of RM200,000 to a non-resident for purposes other than to finance the acquisition or development of immovable property in Malaysia. Prior approval of the Controller is required for the extension of credit facilities exceeding the limit.

- Banking institutions and other non-bank residents are allowed to extend credit facilities in ringgit to non-residents who are working in Malaysia to finance up to 60% of the purchase price or construction cost of a residential property in Malaysia for their own accommodation.

- The resident stockbroking companies are allowed to extend margin financing facilities to non-resident clients for the purchase of shares listed on the Kuala Lumpur Stock Exchange (KLSE), subject to the compliance with the rules imposed by the KLSE.

(e) Portfolio Capital

- Non-resident portfolio investors are encouraged to hold their investment over a long term in Malaysia. Effective 1 September 1998, the non-residents are required to hold their principal sum for portfolio investment for at least 12 months in Malaysia. This rule was relaxed with effect from 15 February 1999. Since then, capital and profits of the portfolio investments are allowed to be repatriated any time.

A system of levy is imposed on repatriation of portfolio funds, as follows:

For funds brought into Malaysia before 15 February 1999

- The principal capital repatriated after one year from 1 September 1998 or one year from the actual date that the funds came into the country (if it is after 1 September 1998) will not attract any levy.

- If the principal capital is repatriated within the one-year holding period, it will be subject to levy at a decreasing rate, depending on the duration the principal is held, as follows:

Period held	Rate of levy
up to 7 months	30%
exceeding 7 months and up to 9 months	20%
exceeding 9 months and up to 12 months	10%

- All profits realised during the one-year holding period will not attract levy, even if it is repatriated after the one-year holding period.

- If an investment is made during the one-year holding period, but the profit is realised only after the one-year holding period, that profit will still be exempted from levy.

- For investments made after the one-year holding period, a levy of 10% will apply on the profit generated.

For funds brought into Malaysia on or after 15 February 1999

- Repatriation of principal capital will not attract any levy.

- Repatriation of profits will be subject to levy as follows:

Profits	Rate of levy
Realised and repatriated within 12 months from date of investment	30%
Contra profit repatriated within 12 months of realisation	30%
Realised within 12 months of investment, but repatriated after 12 months from the date of investment	10%
Realised and repatriated after 12 months from date of investment	10%
Contra profits repatriated after 12 months of realisation	10%

- No levy will be imposed on the repatriation of proceeds from sale of investments in immovable property (for both principal capital and profits).

iii. Credit Facilities in Ringgit to Non-Resident Controlled Companies

- Non-Resident Controlled Companies (NRCCs) operating in Malaysia are freely permitted to obtain:
  - Credit facilities up to RM10 million per corporate group from domestic sources;
  - Any amount of forward exchange contract, performance guarantees and short-term trade financing facilities; and
  - Any amount of guarantees to secure the repayments of borrowing, subject to the submission of information on the guarantees to the Controller.

- Of the total amount of credit facilities obtained from banking institutions, at least 60% must be from Malaysian-owned banking institutions.

- For borrowing in excess of RM10 million in the aggregate, NRCCs are required to obtain prior approval. The NRCCs are also required to ensure that the ratio between their domestic borrowing and capital funds is less than three times.

iv. Foreign Currency Accounts of Residents

- Resident exporters are permitted to open foreign currency accounts to retain export proceeds in foreign currency up to the following overnight limits, depending on their export receipts:

Aggregate Overnight Limit	Average Monthly Export Receipts
US$10 million	Exceeding RM20 million
US$5 million	Exceeding RM10 million up to RM20 million
US$3 million	Between RM5 million and RM10 million
US$1 million	Less than RM5 million

- Resident companies with domestic credit facilities are permitted to open foreign currency accounts to retain foreign currency receivables, other than export proceeds, up to the following aggregate overnight limits:

  - US$0.5 million with commercial banks in Malaysia; and
  - US$0.5 million with Labuan offshore banks.

- Resident companies with no domestic credit facilities are permitted to open foreign currency accounts with commercial banks in Malaysia to retain foreign currency receivables other than export proceeds with no overnight limit specified by Bank Negara Malaysia.

- Resident individuals are allowed to open foreign currency accounts solely to facilitate education and employment overseas up to the following aggregate overnight limits:

  - US$100,000 with commercial banks in Malaysia;
  - US$100,000 with Labuan offshore banks; and
  - US$50,000 with overseas banks.

v. Foreign Currency Accounts of Non-Residents

- Commercial banks and merchant banks are freely allowed to open foreign currency accounts for non-residents.

- There are no restrictions on the inflow and outflow of funds through the foreign currency accounts of non-residents. No levy is imposed on repatriation of foreign currency funds.

vi. External Accounts of Non-Residents

- Banking institutions are freely allowed to open accounts in ringgit known as External Accounts for non-residents.

- Sources of funds of the External Accounts may be from:
  - Sale of ringgit instruments, securities registered in Malaysia or other assets in Malaysia;
  - Salaries, wages, rental, commissions, interest, profits or dividends; and
  - Sales of foreign currency.

- The uses of funds in the External Accounts are restricted to the following purposes:-
  - Purchase of ringgit assets/placements of deposits;
  - Payment of administrative and statutory expenses in Malaysia;
  - Payment of goods and services for use in Malaysia; and
  - Granting of loans and advances to staff in Malaysia according to the terms and conditions of services.

- Prior approval is required for transfer of funds between External Accounts and for uses of funds other than permitted purposes.

- Nevertheless, there are no restrictions on the operations of External Accounts of non-residents working in Malaysia, embassies, consulates, high commissions, supranational or international organisations in Malaysia.

vii. Designated External Accounts

- Tier 1 commercial banks are allowed to open ringgit accounts known as Designated External Account (DEA) for non-residents, solely for the purpose of facilitating the trading at the Commodity and Monetary Exchange of Malaysia and Kuala Lumpur Options and Financial Futures Exchange. Funds in the DEA are not subject to levy on repatriation.

viii. Special Status Granted to Selected Companies

(a) Offshore Entities in Labuan International Offshore Financial Centre

- Entities set up in Labuan International Offshore Financial Centre (IOFC) are declared as non-residents for exchange control purposes. Offshore entities in Labuan IOFC are freely allowed to deal in foreign currency with non-residents.

- Licensed Offshore Banks in Labuan are permitted to receive payments in ringgit from residents arising from fees, commission, interest from deposit of funds or dividends.

- Offshore Insurance Entities in Labuan are also permitted to use their ringgit accounts for payment of claims and receive insurance premium arising from reinsurance of domestic insurance business.

- All offshore entities are freely allowed to maintain ringgit accounts with onshore banks to facilitate defraying of statutory and administrative expenses in Malaysia.

(b) Multimedia Supercorridor Companies

- Companies operating in Multimedia Super Corridor (MSC) are given exemption from exchange control upon the companies being awarded the MSC status, except for submission of statistics for monitoring purposes.

(c) Approved Operational Headquarters

- Approved Operational Headquarters (OHQs) are allowed to open foreign currency accounts with commercial banks in Malaysia to retain export proceeds up to a maximum aggregate overnight limit of US$10 million, irrespective of the amount of export receipts.

- OHQs are also allowed to open foreign currency accounts with commercial banks in Malaysia, Labuan offshore banks or overseas banks for crediting foreign currency receivables, other than export proceeds, with no restriction on overnight limit.

- OHQs are permitted to obtain any amount of foreign currency credit facilities from commercial banks and merchant banks in Malaysia, and from any non-residents for their own use or on-lend to their related companies overseas.

(d) Approved International Procurement Centres

- Approved International Procurement Centres (IPCs) are allowed to retain any amount of export proceeds in foreign currency accounts maintained with onshore commercial banks.

- IPCs are also allowed to enter into forward exchange contracts with onshore commercial banks to hedge exchange risk based on projected volume of trade.

Funds Administered/Funded by Bank Negara Malaysia: Fund Utilisation

Type of fund	Date Established	Fund Allocation (RM m)	Total as at end 1997		Total as at end 1998		Annual change		Outstanding as at end 1998 (RM m)
			Number of Approval	Amount Approved (RM m)	Number of Approval	Amount Approved (RM m)	Number of Approval	Amount Approved (RM m)	
Enterprise Rehabilitation Fund	06-Feb-88	500	745	841	761	850	16	9	136
New Entrepreneurs Fund	12-Dec-89	1,250[1]	2,069	973	2,186	1,064	117	91	652
Special Fund for Tourism	10-Mar-90	200	212	241	211	239	-1[3]	-2	103
Ship Financing Facility	30-Oct-92	600	32	547	32	547	0	0	390
Fund For Food	04-Jan-93	700[2]	1,025	302	1,689	493	664	191	260
Bumiputera Industrial Fund	04-Jan-93	100	45	58	101	99	56	41	77
Fund to Accelerate the Construction of Low-Cost Houses	29-Oct-93	500	58	379	58	379	0	0	78
Abandoned Housing Projects Fund	10-Aug-94	600	74	331	74	331	0	0	94
Fund For Small and Medium Industries	02-Jan-98	1,500	0	0	873	882	873	882	236
Special Scheme For Low and Medium Cost Houses	01-May-98	2,000	0	0	33	241	33	241	12
Rehabilitation Fund For Small and Medium Industries	23-Nov-98	750	0	0	1	0.1	1	0.1	0

[1] Initial allocation was RM750 million. Additional allocation of RM500 million was approved by the Minister of Finance in 1998.

[2] Initial allocation was RM300 million. Additional allocation of RM400 million was approved by the Minister of Finance in 1997.

[3] Approval withdrawn by bank / applicant.

Bilateral Payments Arrangements (BPA) Between Bank Negara Malaysia and Central Banks of Other Countries

Central Bank of	Model	Date of Agreement	Total Trade Between Partner Countries (RM million)	
			1987	1998
Pakistan	POCPA	6 Aug. 1992	468.5	3,076.5
Myanmar	POCPA	21 Jan. 1994	53.9	1,367.4
Iraq	POCPA	28 Feb. 1993 28 Feb. 1995 28 Feb. 1996	131.9	122.3
Iran	POCPA Iranian	8 Feb. 1994 8 Aug. 1988	46.0	533.7
Bosnia Herzegovina	POCPA	13 Nov. 1996	n.a.	0.6
Algeria	POCPA ALADI	14 June 1992 31 Jan. 1992	3.8	60.7
Albania	ALADI	24 Jan. 1994	0.2	0.9
Argentina	ALADI	3 Dec. 1993	104.9	1,083.1
Chile	ALADI	21 June 1991	120.9	811.6
Lao PDR	ALADI	16 Apr. 1994	0.1	6.8
Mexico	ALADI	24 Sept. 1990	37.6	1,439.8
Peru	ALADI	13 Nov. 1991	5.4	199.3
Romania	ALADI	20 May 1991	14.8	58.7
Seychelles	ALADI	21 Sept. 1992	1.1	14.1
Tunisia	ALADI	25 Nov. 1992	3.5	106.6
Turkmenistan	ALADI	30 May 1994	n.a.	25.7
Uzbekistan	ALADI	28 June 1993	n.a.	8.8
Venezuela	ALADI	3 Aug. 1990	6.5	116.4
Vietnam	ALADI	29 Mar. 1993	43.5	2,008.0
Zimbabwe	ALADI	7 June 1991	15.1	91.9

Central Bank of	Model	Date of Agreement	Total Trade Between Partner Countries (RM million)	
			1987	1998
Sudan	Revolving Credit	4 Jan. 1992 16 Apr. 1992 16 Sept. 1992 18 Dec. 1993 11 Oct. 1996	21.5	65.6
Botswana	Iranian	6 June 1991	n.a.	n.a.
Fiji	Iranian	12 Oct. 1991	67.8	105.4
Mozambique	Iranian	27 Apr. 1991	46.8	28.4
Cuba	POCPA	26 Mar. 1998	8.3	57.1
Philippines	ALADI	11 July 1998	1,185.8	9,906.8

Note:

ALADI Model : Each central bank pays its own exporter in the domestic currency and settles, on a periodic basis (not exceeding 90 days), the net difference with the other central banks in US dollar.

Iranian Model : Each central bank guarantees payments of its own importers.

Palm Oil Credit and Payments Arrangement (POCPA) : Created to promote the export of Malaysian palm oil to other developing countries. The importation is on a deferred payment basis.

Revolving Credit : The importation of goods is limited to the credit limit agreed by both parties on a deferred payment basis.

n.a. not available

Source: Bank Negara Malaysia and Department of Statistics

Licensed Banking Institutions (as at 31 December 1998)

Commercial Banks

1. ABN AMRO Bank Berhad
2. Arab-Malaysian Bank Berhad
3. Ban Hin Lee Bank Berhad
4. Bangkok Bank Berhad
5. Bank Bumiputra Malaysia Berhad
6. Bank of America Malaysia Berhad
7. Bank of Commerce (M) Berhad
8. Bank of Tokyo-Mitsubishi (Malaysia) Berhad
9. Bank Utama (Malaysia) Berhad
10. BSN Commercial Bank (Malaysia) Berhad
11. Citibank Berhad
12. Deutsche Bank (Malaysia) Berhad
13. EON Bank Berhad
14. Hock Hua Bank Berhad
15. Hong Leong Bank Berhad
16. Hongkong Bank Malaysia Berhad*
17. International Bank Malaysia Berhad
18. Malayan Banking Berhad
19. Multi-Purpose Bank Berhad
20. OCBC Bank (Malaysia) Berhad
21. Oriental Bank Berhad
22. Overseas Union Bank (Malaysia) Berhad
23. Perwira Affin Bank Berhad
24. PhileoAllied Bank (Malaysia) Berhad
25. Public Bank Berhad
26. RHB Bank Berhad
27. Sabah Bank Berhad
28. Sime Bank Berhad
29. Southern Bank Berhad
30. Standard Chartered Bank Malaysia Berhad
31. The Bank of Nova Scotia Berhad
32. The Chase Manhattan Bank (M) Berhad
33. The Pacific Bank Berhad
34. United Overseas Bank (Malaysia) Bhd.
35. Wah Tat Bank Berhad
36. Bank Islam Malaysia Berhad

* Change of name to HSBC Bank Malaysia Berhad with effect from 23 February 1999.

Finance Companies

1. Advance Finance Berhad
2. AFFIN Finance Berhad
3. Amanah Finance Malaysia Berhad
4. Arab-Malaysian Finance Berhad
5. Asia Commercial Finance Berhad
6. BBMB Kewangan Berhad
7. Bolton Finance Berhad
8. Boon Siew Finance Berhad
9. BSN Finance Berhad
10. Cempaka Finance Berhad
11. Chew Geok Lin Finance Berhad
12. City Finance Berhad
13. Credit Corporation (Malaysia) Berhad
14. Delta Finance Berhad
15. EON Finance Berhad
16. Hock Hua Finance Berhad
17. Hong Leong Finance Berhad
18. Interfinance Berhad
19. Kewangan Bersatu Berhad
20. Kewangan Utama Berhad*
21. Mayban Finance Berhad
22. MBf Finance Berhad
23. Multi-Purpose Finance Berhad
24. OCBC Finance Berhad*
25. Oriental Finance Berhad
26. Perdana Finance Berhad
27. Perkasa Finance Berhad
28. PhileoAllied Finance (Malaysia) Berhad
29. Public Finance Berhad
30. Sabah Finance Berhad
31. Sime Finance Berhad
32. Southern Finance Company Berhad
33. United Merchant Finance Berhad

* Ceased operation on 1 January 1999.

Merchant Banks

1. Amanah Merchant Bank Berhad
2. Arab-Malaysian Merchant Bank Berhad
3. Aseambankers Malaysia Berhad
4. BSN Merchant Bank Berhad
5. Bumiputra Merchant Bankers Berhad
6. Commerce International Merchant Bankers Berhad
7. Malaysian International Merchant Bankers Berhad
8. Perdana Merchant Bankers Berhad
9. Perwira Affin Merchant Bank Berhad
10. RHB Sakura Merchant Bankers Berhad
11. Sime Merchant Bankers Berhad
12. Utama Merchant Bank Berhad

Credit Guarantee Corporation Malaysia Berhad

The Credit Guarantee Corporation Malaysia Berhad (CGC) was incorporated in July 1972 to provide guarantee cover to the banks for designated loans to small-scale enterprises (SSEs). The various schemes to promote access to institutional credit for SSEs undertaken by CGC includes the Small Entrepreneurs Fund, the New Principal Guarantee Scheme and the Flexible Guarantee Scheme which was introduced on 1 March 1999.

Small Entrepreneurs Fund (SEF)

During the year 1998, CGC, in collaboration with the Ministry of Entrepreneur Development, introduced the SEF which offers small loans ranging from RM2,000 to RM20,000 to the smaller entrepreneurs. The SEF replaced the previous Loan Fund for Hawkers and Petty Traders (launched in 1992) and the Association Special Loan Scheme (also launched in 1992), both managed by CGC, which were wound down in 1998. Each SEF loan is fully funded and guaranteed by the CGC and features bi-weekly repayments which incorporate a service charge to the borrower at the rate of 6% per annum. Loans under the scheme are made available through three types of financing packages, namely the Individual Financing Package for individual borrowers, the Integrated Financing Package for groups of borrowers identified by organisations accredited by the CGC, and the Hawker Centre Financing Package which is promoted jointly with the local authorities. These loans are channelled through 16 participating financial institutions which would carry out the necessary credit assessment although credit decisions ultimately rest with CGC which bears the credit risks. Applications for SEF loans can be made to CGC or the participating financial institutions.

The total allocation for SEF is RM90 million. As at end-1998, a total of 4,304 applications for loans amounting to RM43 million had been approved under the SEF scheme, of which RM32.5 million (75.6%) was extended to Bumiputera borrowers.

Guarantee Schemes

CGC continues to provide guarantee cover for loans to SSEs and small and medium industries (SMIs) granted by the commercial banks and finance companies through its main guarantee scheme, namely, the New Principal Guarantee Scheme (NPGS). In 1998, 2,711 applications for loans amounting to RM515.9 million were guaranteed by CGC. These represented a decrease of 82.8% in terms of number of accounts guaranteed and 86.6% in terms of amount of loans guaranteed over the previous year, mainly due to the slowdown in credit growth during the second half of the year. By sector, 75.3% of the loans extended in 1998 was channelled to general businesses while 22.3% was extended to SMIs in the manufacturing sector. Total guarantee cover issued during 1998 amounted to RM351.6 million, of which 39% (RM137.2 million) was granted to Bumiputera borrowers.

The newly implemented Flexible Guarantee Scheme (FGS) offers guarantee cover for loans extended under the four funds administered by Bank Negara Malaysia, that is, the Fund for SMIs, the Rehabilitation Fund for SMIs, the New Entrepreneurs Fund and the Fund for Food. The maximum guarantee cover for the unsecured portion is capped at RM2.5 million for the manufacturing sector, RM0.75 million for the priority sectors identified by CGC, and RM0.5 million for the other sectors. There is, however, no capping of guarantee cover for the secured portion of the loan. The annual guarantee fee under the scheme, which is to be borne by the lending institution, ranges from 0.5% to 1.5% depending on whether the guarantee cover is for the secured or unsecured portion of the loan. The FGS is made available through the participating financial institutions of the said four funds.

Other than the above guarantee schemes, CGC also manages the SPTF Guarantee Scheme which provides guarantee cover for loans under interest free banking.

Other Schemes

Apart from the SEF, CGC also assists the Ministry of Entrepreneur Development in managing two other schemes, that is, the Small Entrepreneurs Financing Scheme (SEFS) and the Franchise Financing Scheme (FFS). The SEFS provides financing for small borrowers requiring loans ranging from RM10,000 to RM50,000 while the FFS is aimed at assisting franchisees under the Ministry's Franchise Programme. The CGC is also involved in the Youth Economic Development Program which was introduced to encourage Malaysian youths to venture into business and other productive economic activities. The programme is jointly promoted with the Ministry of Youth and Sports and BSN Commercial Bank (Malaysia) Berhad.

Bank Lending under the NPGS

	Amount approved		
	1997	1998	Annual change (%)
	RM million		
General Business of which:	3,052.6	388.5	-87.3
Building and construction	477.4	39.8	-91.7
General commerce and sundry retail trade	1,978.0	236.1	-88.1
Transport and repairs	160.2	38.2	-76.2
Small scale industries of which:	744.9	115.2	-84.5
Food,drinks and tobacco	33.4	4.1	-87.7
Timber products and furniture	100.0	20.4	-79.6
Textiles and clothing	71.7	8.6	-88.0
Building materials	29.9	2.8	-90.6
Printing and publishing	42.0	3.2	-92.4
Agriculture of which:	44.1	11.1	-74.8
Padi cultivation and marketing	0.7	-	-100.0
Livestocks and poultry farming	8.9	1.1	-87.6
Fisheries	7.0	0.5	-92.9
Mining and quarrying of which:	5.8	1.1	-81.0
Other minerals	2.3	0.5	-78.3
Total	**3,847.4**	**515.9**	**-86.6**

Source: The Credit Guarantee Corporation Malaysia Berhad (CGC)

Pengurusan Danaharta Nasional Berhad

Background

Pengurusan Danaharta Nasional Berhad (Danaharta) was established on 20 June 1998 to remove the non-performing loan distraction from financial institutions to enable them to resume their lending activities to viable economic sectors in order to accelerate the overall economic recovery process. Danaharta was incorporated under the Companies Act, 1965 but was given statutory backing to enable it to perform its duties expeditiously. This provides Danaharta with greater flexibility regarding its financing and commercial operations, whilst having special powers to perform its function effectively.

Statutory Powers of Danaharta

To enable Danaharta to perform its duties in an efficient and economical manner, the Pengurusan Danaharta Nasional Berhad Act 1998 was gazetted and came into force on 1 September 1998. This Act encompasses two main principles:-

i. Ability to acquire loans via statutory vesting, whereby Danaharta is allowed to take clear titles to the loans and step into the shoes of the selling institution. Assets can also be transferred without the borrower's consent.
ii. Ability to manage the borrowers through the appointment of Special Administrators (SAs) with the consent of the Oversight Committee. Danaharta also has the powers to impose a 12-month moratorium on all claims to allow the SAs to work out their restructuring proposals.

Transparency and Corporate Governance

Danaharta adopts a market-based approach and incorporates international best practices in its operations. Danaharta upholds the principle of transparency by publishing details of its acquisitions in its accounts, including amount of NPLs acquired from individual financial institutions and average discounts applied, on a half-yearly basis.

The Board of Directors of Danaharta is the focal point of Danaharta's governance structure. The Board consists of a Chairman, the Managing Director of Danaharta, two non-executive directors from the Government, three non-executive directors from the Malaysian community and two non-executive directors from the international community.

Acquisition Approach

Danaharta's acquisition process is divided into three stages - secured loans, unsecured loans and other credit facilities such as foreign currency loans and off-balance sheet facilities. Danaharta accords priority to weaker financial institutions, including those institutions seeking recapitalisation from Danamodal Nasional Berhad before proceeding to acquire non-performing loans from other financial institutions.

Danaharta also manages, on behalf of Bank Negara Malaysia and the Government, loans of selected financial institutions. The management of these loans is to facilitate strategic mergers between identified financial institutions and to preserve the strength of the acquiring institution.

For loans which are secured by properties, Danaharta appoints independent professional valuers to perform detailed valuation of individual properties. For loans which are secured by quoted shares, the fair value of the loans is detemined based on the characteristics of the company whereby premiums are attached to larger stakes that offer influence or control over the company. In the case of loans secured by unquoted shares, acceptable valuation techniques are used. A uniform discount of 90% to the principal outstanding is applied in general to unsecured loans.

Danaharta's profit sharing arrangement stipulates that any excess in recovery value over and above Danaharta's acquisition cost plus direct costs will be shared between the selling financial institution and Danaharta on a 80:20 basis. However, the financial institution's share of the upside will be limited to the shortfall value plus a holding cost of 8% per annum. For larger loans where valuation is either onerous or inconclusive, a risk-sharing arrangement with the selling financial institution is done on a case-by-case basis.

Payments for the Loans Acquired

As consideration for the loans acquired from financial institutions, Danaharta pays cash and/or issues zero-coupon, Government-guaranteed, tradeable bonds with yields approximating those of Malaysian Government Securities with similar tenor. These bonds are issued on a monthly basis with an initial tenor of five years and a rollover option exercisable at Danaharta's discretion for up to an additional five years. For loans acquired from development finance institutions, Islamic loans and unsecured loans, cash payments are made.

Financing Structure

The financing requirement of Danaharta is estimated to be RM15 billion. The paid-up capital of Danaharta is currently RM500 million and will be increased to RM1.5 billion by mid-1999.

Asset Management Approach

Danaharta's asset management approach is divided into two categories, loan management and asset management. The management approach taken by Danaharta will depend on the viability of the loans. For viable loans, Danaharta will undertake the loan management approach whereby Danaharta will rehabilitate or restructure the loans including rescheduling the payments and debt-equity conversion. For non-viable loans, Danaharta will undertake the asset management approach whereby Danaharta will manage the borrower through the appointment of SA or manage the collateral either through the rehabilitation of the collateral or foreclosure if all other options have been exhausted.

Expected Life Span of Danaharta

Danaharta's estimated life span is 7-10 years. Danaharta expects to complete all its acquisition of loans by June 1999, which is 6 months ahead of the original schedule of end-1999.

Danamodal Nasional Berhad

Background

Danamodal Nasional Berhad (Danamodal) was incorporated on 10 August 1998 as a wholly-owned subsidiary of Bank Negara Malaysia to undertake the recapitalisation exercise of the banking institutions so as to ensure that the banking institutions continue to remain well-capitalised at all times. With a strong capital base, the capacity of banking institutions to withstand further shocks in the economy will be further enhanced.

Objectives of Danamodal

- **Recapitalisation and strengthening of the banking industry**
  Danamodal serves as an interim funding vehicle for banking institutions to meet their capital adequacy requirements. The capital injections are in the form of equity or hybrid instruments. Danamodal operates on market-based principles and methodologies.

- **Consolidation and rationalisation of the banking system**
  Danamodal also plays an important role in facilitating the restructuring of banking institutions. Danamodal operates within the existing regulatory and supervisory framework and consistent with national objectives. As a strategic shareholder in the recapitalised banking institutions, Danamodal is in a position to facilitate the consolidation and rationalisation process and act as a catalyst to guide mergers.

Operating Parameters

Danamodal operates within the following parameters:

- Operates within the existing relevant regulatory and supervisory framework.

- Minimises the use of public funds and ensure equitable burden sharing amongst stakeholders. The first loss principle is applied in all its capital injection through the writing down of the value of investments of the existing shareholders to reflect its net tangible assets prior to any capital injection. Danamodal will only inject capital into banking institutions after these institutions have sold their NPLs to Danaharta whereby the existing shareholders would have to bear the losses from the sale.

- Operates based on commercial and market-oriented principles. Danamodal will only recapitalise viable banking institutions (based on the assessment and due diligence review conducted by reputable, international financial advisors).

- As a strategic shareholder, Danamodal will exercise its rights to inject best practices, promote managerial competence, enhance risk management and operating efficiency and improve the banking institutions' profitability.

- Danamodal will formulate a set of comprehensive performance targets and monitor the performance of these institutions closely.

Structure of Investment in Recapitalised Banking Institutions

Danamodal will rely extensively on three principal instruments, namely common shares, Irredeemable Non-Cumulative Convertible Preference Shares (INCPS) or subordinated loans. The choice or combination thereof will depend primarily on the cash flow characteristics of the instruments and the unique circumstances of the banking institutions concerned.

In cases where the capital injection is made in the form of common shares, Danamodal will protect its investments from potential downside risks through the use of a Call Option. In the event that losses arising from the current asset portfolio reduces the net tangible asset per share significantly, the existing shareholders will compensate Danamodal by transferring their shares to Danamodal at nominal value.

Danamodal will appoint at least two nominees to sit on the Board of Directors of the recapitalised banking institutions as Executive Director and as either Deputy Chairman or Chairman. The Board representation will commensurate with the injection of tier-1 capital by Danamodal.

Funding Requirement

Total funding requirement of Danamodal under the worst case scenario has been estimated to be RM16 billion. This amount will ensure that the risk-weighted capital ratio of all banking institutions to be at least 9%. These funds will be raised in the form of equity, hybrid instruments, or debt in both the domestic and international markets.

Transparency

Danamodal will, at all times, maintain transparency and disclosure in management, operations and selection criteria. It will regularly publish its own financial statements in accordance with international accounting standards.

Corporate Debt Restructuring Committee

Background

The Corporate Debt Restructuring Committee (CDRC) was set up in July 1998 to provide a platform for both the borrowers and creditors to amicably and collectively work out debt problems to the mutual interests of both parties. This would ensure that viable businesses continue to have access to financing.

Objectives of CDRC

The objectives of CDRC are as follows:

- To minimise losses to creditors, shareholders and other stakeholders through voluntary co-ordinated workouts;
- Preserve viable businesses that are affected by the current economic conditions; and
- To introduce and implement a comprehensive framework for debt restructuring.

Debt Restructuring Approach and Framework

- CDRC seeks to assist in the restructuring of debts of viable companies with total aggregate debts of at least RM50 million from more than one financial institution.
- The companies should not be in any insolvency administration.
- CDRC does not have any legal powers and provides a flexible and informal framework outside court proceedings.
- As all legal rights of the parties coming to CDRC are preserved, it is critical that all parties must voluntarily agree to abide by the guidelines set.
- The approach cannot and does not guarantee the survival of businesses. The approach to corporate debt restructuring is premised upon co-operation between the stakeholders through which the mutual interests of both debtor and creditors can be addressed in a mutually collaborative environment.
- Companies which have already sought the protection pursuant to Section 176(10) of the Companies Act, 1965 may apply on the condition that the Restraining Orders obtained against the Financial Institutions be withdrawn once the creditors agree to a standstill.
- The CDRC framework calls for the financial institutions to voluntarily give the debtors a reasonable period of time in order for consultants to determine the company's financial health and needs before further decisions are made.
- During the standstill period, the financial institutions should keep credit lines in place and not precipitate insolvency procedures unless either the debtor or the creditor formally terminates the restructuring exercise.
- Consultants are appointed where necessary to review the affairs of the debtor and make the necessary recommendations to the creditors and the debtors.

Steering Committee

A Steering Committee comprising representatives from Bank Negara Malaysia, the Ministry of Finance and the private sector with the experience in the legal, accounting and banking fields has been set up to monitor the progress of the various debt workouts performed by the Creditors' Committee.

Role and Functions of the Creditors' Committee

- A Creditors' Committee (CC) comprising representatives of creditors will be formed. The CC should be of a manageable size and represent the interests of at least 75% of the total debts of all creditors. The quorum to convene the meeting shall be 2/3 of the members.
- A lead institution and a designated individual within the lead institution, must be appointed early in the restructuring process to manage and co-ordinate the entire debt restructuring process of a particular debtor. The lead institution may seek the assistance of a consultant with the consent of the debtor and the creditors.
- Agree and assess the viability of the debtor.
- Decide on the terms for the debtor to continue to receive financial support.
- Negotiate with the debtor to arrive at some agreed options once the business is deemed viable.
- Report to the Steering Committee on the progress of all the debt restructuring exercises on a regular basis, including cases where the Creditors' Committees encounter inter-creditor or debtor-creditor disputes so that the Steering Committee can assist in the process.

Rights of Creditors

- Creditors' existing collateral rights must continue.
- Additional or new credit extended during the restructuring process to enable the debtor to continue operations should receive priority status, subject to the consent of all participating creditors.
- Creditors retain the right to exercise independent commercial judgement and objectives but should consider the impact of any action on the other creditors and the viability of the debtor.
- Debt trading is allowed under certain conditions but the selling creditor has the professional obligation to ensure the buyer does not have a detrimental effect on the restructuring process.

The Stages of CDRC Workout

The five stages in a CDRC workout process are as follows:

- Initial meetings of debtors and creditors to consider debt restructuring exercise and to obtain temporary standstill. Creditors' Committee is formed and a Lead Creditor is identified.
- Consultants are appointed, where necessary.
- Consultants to conduct initial review and report on findings on the viability of the business and their recommendations therein.
- If restructuring exercise proceeds, a formal standstill is to be executed amongst the creditors, and consultants are to formulate strategies for restructuring.
- Implementation of strategies.

The CDRC framework is not new. It has been successfully implemented in various other countries, most notably in the United Kingdom. Although the framework gives an indicative timeframe of completion for each of the stages, the timeframe could be varied depending on the circumstances of the debtor, to be mutually agreed by the parties involved.

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Industrial Origin (in Constant 1978 Prices)

	1994	1995	1996	1997	1998*p*	1994	1995	1996	1997	1998*p*
	RM million					Annual change (%)				
Agriculture, forestry and fishery	16,047	16,231	16,584	16,805	16,133	-1.0	1.1	2.2	1.3	-4.0
Mining and quarrying	8,242	8,679	9,381	9,475	9,553	2.5	8.9	4.5	1.0	0.8
Manufacturing	34,842	39,790	44,684	50,270	45,155	14.9	14.2	12.3	12.5	-10.2
Construction	4,589	5,385	6,150	6,732	5,086	14.1	17.3	14.2	9.5	-24.5
Services	48,709	53,300	58,452	63,135	64,110	9.7	9.4	9.7	8.0	1.5
Gross Domestic Product in purchasers' value	109,976	120,272	130,621	140,684	131,258	9.3	9.4	8.6	7.7	-6.7

p Preliminary

Source: Department of Statistics (1994-97)
Bank Negara Malaysia (1998)

Table A.2
Production: Primary Commodities

	1994	1995	1996	1997	1998*p*
	Annual change (%)				
Crude palm oil	-2.5	8.2	7.4	8.1	-8.3
Rubber	2.5	-1.0	-0.6	-10.3	-8.8
Saw logs	-3.9	-11.3	-4.7	3.4	-27.2
Cocoa	-11.5	-25.7	-8.7	-11.7	-14.9
Crude oil	1.9	6.8	1.8	-0.5	1.7
Natural gas	12.6	19.0	21.4	12.7	0.3

p Preliminary

Source: PORLA
Department of Statistics
Forestry Departments (Peninsular Malaysia, Sabah & Sarawak)
Malaysian Cocoa Board
PETRONAS

Table A.3
Selected Indicators for the Services Sector

	1994	1995	1996	1997	1998*e*
	Annual change (%)				
Insurance premiums	25.0	21.6	20.0	14.4	1.9
KLSE turnover					
Value	-15.3	-45.5	159.3	-11.8	-71.8
Volume	44.2	-43.6	95.8	9.5	-19.9
KL office rentals (RM per sq m)	49.84	48.07	50.45	49.77	41.42
KL office occupancy rates (%)	97	94	95	98	82
Tourist arrivals	10.7	3.8	-4.4	-13.0	-10.6
Hotel occupancy rate (%)	61.4	65.3	65.5	58.0	49.9
Cargo throughput at major ports[1]	8.6	17.4	14.0	12.5	-13.8
Container cargo throughput at major ports[1]	23.6	19.4	19.4	17.1	1.2
Electricity Production Index	13.8	14.1	12.7	14.2	3.4
Water supply	9.8	8.9	2.0	2.0	5.0

[1] Include Port Klang, Penang Port, Johor Port, Bintulu Port and Sabah Port.
e Estimate

Source: Kuala Lumpur Stock Exchange (KLSE)
Department of Statistics
Survey of Office Space in and around Kuala Lumpur 1998, Bank Negara Malaysia and Valution and Property Services Department, Ministry of Finance
Malaysia Tourism Promotion Board (Tourism Malaysia)
Various port operators
Public Works Department

Table A.4
GNP by Demand Aggregates

	1994	1995	1996	1997	1998*p*	1999*f*
	RM million current prices					
Consumption	116,504	132,331	143,179	154,589	144,546	154,074
Private consumption	*92,568*	*104,695*	*114,594*	*123,910*	*114,338*	*120,215*
Public consumption	*23,936*	*27,636*	*28,585*	*30,679*	*30,208*	*33,859*
Investment	76,357	94,120	105,501	117,916	71,921	78,280
Private investment	*51,700*	*66,577*	*77,064*	*86,093*	*40,209*	*41,600*
Public investment	*24,657*	*27,543*	*28,437*	*31,823*	*31,712*	*36,680*
Change in stocks	546	974	-1,732	-958	86	275
Exports of goods and non-factor services	173,771	208,699	229,841	261,227	324,677	321,794
Imports of goods and non-factor services	176,904	217,453	227,286	257,407	262,506	271,148
GDP at purchasers' value	190,274	218,671	249,503	275,367	278,724	283,275
Net factor payments abroad	-9,412	-10,377	-11,816	-14,273	-16,230	-14,568
GNP at purchasers' value	180,862	208,294	237,687	261,094	262,494	268,707
	Annual change (%) constant prices[1]					
Consumption	9.9	8.8	4.9	4.9	-10.3	3.3
Private consumption	*9.9*	*9.3*	*6.0*	*4.7*	*-12.4*	*1.1*
Public consumption	*9.9*	*7.3*	*1.4*	*5.3*	*-3.5*	*10.1*
Investment[2]	17.1	19.9	9.8	8.5	-44.9	6.2
Private investment	*27.9*	*25.3*	*13.4*	*8.4*	*-57.8*	*0.9*
Public investment	*-0.6*	*8.7*	*1.1*	*8.6*	*-10.0*	*12.8*
Exports of goods and non-factor services	22.5	17.6	7.2	10.8	-0.7	3.3
Imports of goods and non-factor services	27.7	21.4	4.2	10.2	-18.3	6.5
GDP at purchasers' value	9.3	9.4	8.6	7.7	-6.7	1.0
Net factor payments abroad	12.1	10.0	13.5	5.6	-13.9	-7.5
GNP at purchasers' value	9.1	9.3	8.3	7.8	-6.3	1.5

1 At constant 1978 prices
2 Excludes stocks
p Preliminary
f Forecast

Source: Department of Statistics and Bank Negara Malaysia

Table A.5
Selected Private Consumption Indicators

	1994	1995	1996	1997	1998
	Annual change (%)				
Import of consumption goods[1]	33.3	9.1	5.7	10.7	-6.1
Sales of passenger cars[2]	25.5	49.5	22.8	12.3	-54.8
Prices of primary commodities					
Rubber	*37.7*	*34.5*	*-11.1*	*-20.7*	*0.7*
Crude palm oil	*44.3*	*44.3*	*-35.7*	*15.9*	*72.3*
Tax collection					
Sales tax	*19.1*	*17.9*	*12.4*	*12.7*	*-37.7*
Services tax	*34.6*	*23.2*	*21.2*	*19.8*	*-1.9*
Gross revenue[3]					
Wholesale and retail	*35.3*	*23.0*	*9.1*	*14.4*	*-31.4*
Consumption credit extended by the banking system[4]	16.3	30.0	35.7	39.3	-14.6
Stock market indicators					
Market capitalisation of KLSE	*-17.9*	*11.2*	*42.6*	*-53.4*	*-0.3*
Kuala Lumpur Composite Index	*-23.8*	*2.5*	*24.4*	*-52.0*	*-1.4*

1 Beginning 1995, the data is compiled based on Broad Economic Categories classification. Prior to 1995, the data was compiled based on Economic and Social Commission for Asia-Pacific (ESCAP) classification.
2 Include four-wheel drive vehicles for passenger use.
3 Business Expectations Survey, Department of Statistics.
4 Beginning December 1996, the data is compiled based on a new statistical reporting format.

Source: Department of Statistics
Royal Customs and Excise Department
Palm Oil Registration and Licensing Authority (PORLA)
Malaysian Rubber Exchange and Licensing Board (MRELB)
Malaysian Motor Traders Association (MMTA)
Kuala Lumpur Stock Exchange (KLSE)

Table A.6
Selected Private Investment Indicators

	1994	1995	1996	1997	1998
	Annual change (%)				
Import of capital goods[1]	32.4	24.7	-6.4	17.0	-15.1
Sales of commercial vehicles[2]	18.8	43.6	48.7	8.4	-76.1
Proposed capital investment in manufacturing					
Applications to MITI	*29.0*	*10.3*	*56.7*	*-18.8*	*-44.5*
Approvals by MITI	*66.9*	*-9.1*	*64.2*	*-24.6*	*2.3*
Loans extended by the banking system[3]					
For manufacturing	*18.7*	*30.7*	*14.0*	*18.5*	*-0.2*
For broad property[4]	*2.3*	*26.8*	*26.8*	*32.9*	*5.3*
Capital expenditure by sector[5]					
Manufacturing	*2.2*	*16.0*	*9.3*	*44.3*	*22.7*
Construction	*26.9*	*72.9*	*-51.2*	*18.5*	*2.1*
Others (Services etc.)	*-9.7*	*39.1*	*-24.3*	*85.7*	*-5.1*

1 Beginning 1995, the data is compiled based on Broad Economic Categories classification. Prior to 1995, the data was compiled based on Economic and Social Commission for Asia-Pacific (ESCAP) classification.
2 Include four-wheel drive vehicles for commercial use.
3 Beginning December 1996, the data is compiled based on a new statistical reporting format.
4 Excluding loans sold to Cagamas.
5 Business Expectations Survey by the Department of Statistics . Beginning second half of 1997, the number of companies surveyed inceased from 220 to 270.

Source: Department of Statistics
Malaysian Motor Traders Association (MMTA)
Ministry of International Trade and Industry (MITI)

Table A.7
Savings-Investment Gap

	1994	1995	1996	1997	1998*p*	1999*f*
	RM million					
Public gross domestic capital formation	24,833	27,828	27,970	31,564	31,750	36,809
Public savings	33,343	32,763	39,729	50,314	42,330	30,102
Deficit/surplus	8,510	4,935	11,759	18,750	10,580	-6,707
Private gross domestic capital formation	52,070	67,266	75,799	85,394	40,257	41,746
Private savings	28,790	40,685	51,843	52,493	65,745	77,991
Deficit/surplus	-23,280	-26,581	-23,956	-32,901	25,488	36,245
Gross domestic capital formation	76,903	95,094	103,769	116,958	72,007	78,555
(as % of GNP)	42.5	45.7	43.7	44.8	27.4	29.2
Gross national savings	62,133	73,448	91,572	102,807	108,075	108,093
(as % of GNP)	34.4	35.3	38.5	39.4	41.2	40.2
Balance on current account	-14,770	-21,646	-12,197	-14,151	36,068	29,538
(as % of GNP)	-8.2	-10.4	-5.1	-5.4	13.7	11.0

p Preliminary

f Forecast

Source: Department of Statistics and Bank Negara Malaysia

Table A.8
Balance of Payments

Item	1994 +	1994 -	1994 Net	1995 +	1995 -	1995 Net
	RM million					
Merchandise balance (f.o.b.)[1]	**148,506**	**144,046**	**4,460**	**179,491**	**179,394**	**97**
Balance on services	**31,323**	**48,328**	**-17,005**	**35,778**	**55,007**	**-19,229**
Freight & insurance	2,054	9,421	-7,367	2,552	11,580	-9,028
Other transportation	3,681	3,240	441	4,434	3,697	737
Travel & education	8,835	5,232	3,603	9,939	5,796	4,143
Investment income[2]	5,745	15,193	-9,448	6,280	16,618	-10,338
Government transactions n.i.e.[3]	316	352	-36	319	342	-23
Other services	10,692	14,890	-4,198	12,254	16,974	-4,720
Balance on goods and services	**179,829**	**192,374**	**-12,545**	**215,269**	**234,401**	**-19,132**
Unrequited transfers	1,867	4,092	-2,225	1,843	4,358	-2,515
Balance on current account	**181,696**	**196,466**	**-14,770**	**217,112**	**238,759**	**-21,647**
Official long-term capital			**861**			**6,147**
Federal Government	1,287	6,051	-4,764	419	2,052	-1,633
Market loans	776	5,104	-4,328	-	1,091	-1,091
Project loans	511	947	-436	419	961	-542
Suppliers' credit	-	-	-	-	-	-
Non-financial public enterprises	8,268	2,507	5,761	9,952	2,184	7,768
Other assets and liabilities[4]			-136			12
Private long-term capital			10,798			10,464
Balance on long-term capital			11,659			16,611
Basic balance			**-3,111**			**-5,036**
Private short-term capital			-8,484			2,529
Errors and omissions			3,333			-1,896
Overall balance (surplus +/ deficit -)			**-8,262**			**-4,403**
Allocation of Special Drawing Rights			-			-
IMF resources			-			-
Net change in international reserves of Bank Negara Malaysia (increase - / decrease +)[5]			8,262			4,403
Special Drawing Rights			-23			-41
IMF Reserve Position			-184			-701
Gold and Foreign Exchange			8,469			5,145
Bank Negara Malaysia international reserves, net			**68,173**			**63,770**
(Reserves as months of retained imports)			5.5			4.1

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 an inflow of direct reinvestment capital under "Private long-term capital".
3 Include transactions of foreign military and diplomatic establishments.
4 Refer to changes in overseas assets of the Government and statutory authorities and subscriptions to international institutions and commodity arrangements.
5 Accumulation of reserves is indicated as a minus (-) sign.
6 In 1997, the foreign exchange gain on the balance sheet date was not recognised in the Bank's account, in view of the volatility of the exchange rate during the year.
7 Arising from the fixing of the ringgit/US dollar exchange rate at RM3.80 in September 1998, all assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the cumulative gain has been reflected accordingly in the Bank's current year account. The US dollar equivalent of international reserves as at 31 December 1998 was US$26.2 billion.
e Estimate

Source : Department of Statistics and Bank Negara Malaysia

1996			1997			1998*e*		
+	-	Net	+	-	Net	+	-	Net
RM million								
193,127	**182,973**	**10,154**	**218,701**	**207,364**	**11,337**	**282,007**	**212,685**	**69,322**
43,443	**62,857**	**-19,414**	**49,531**	**71,323**	**-21,792**	**49,088**	**72,469**	**-23,381**
2,832	11,354	-8,522	3,173	12,699	-9,526	4,129	12,781	-8,652
5,411	3,919	1,492	6,608	4,038	2,570	6,547	4,278	2,269
11,264	6,478	4,786	10,523	6,970	3,553	9,344	6,273	3,071
6,362	17,991	-11,629	6,493	20,320	-13,827	5,789	21,500	-15,711
324	360	-36	308	375	-67	331	491	-160
17,250	22,755	-5,505	22,426	26,921	-4,495	22,948	27,146	-4,198
236,570	**245,830**	**-9,260**	**268,232**	**278,687**	**-10,455**	**331,095**	**285,154**	**45,941**
2,000	4,936	-2,936	2,254	5,952	-3,698	2,938	12,811	-9,873
238,570	**250,766**	**-12,196**	**270,486**	**284,639**	**-14,153**	**334,033**	**297,965**	**36,068**
		748			**4,645**			**2,138**
748	2,927	-2,179	462	2,145	-1,683	4,001	2,182	1,819
342	1,017	-675	-	697	-697	2,435	1,324	1,111
406	1,910	-1,504	462	1,448	-986	1,566	858	708
-	-	-	-	-	-	-	-	-
8,128	5,284	2,844	9,372	3,006	6,366	4,705	4,344	361
		83			-38			-42
		12,777			14,363			8,740
		13,525			19,008			10,878
		1,329			**4,855**			**46,946**
		10,317			-11,337			-21,700
		-5,401			-4,410			15,055
		6,245			**-10,892**			**40,301**
		-			-			-
		-			-			-
		-6,245			10,892			-40,301
		-37			-51			-315
		-15			117			-757
		-6,193			10,826			-39,229
		70,015			**59,123**[6]			**99,424**[7]
		4.4			3.4			5.7

Table A.9
Direction of External Trade[1]

	1994			1995		
	Exports	Imports	Trade balance	Exports	Imports	Trade balance
	RM million					
Singapore	31,842.7	21,991.3	9,851.4	37,584.4	24,079.9	13,504.5
Thailand	5,802.2	3,856.6	1,945.6	7,258.0	5,131.5	2,126.5
Indonesia	1,868.2	2,461.4	-593.2	2,441.2	3,057.3	-616.1
Philippines	1,590.5	841.0	749.5	1,692.2	1,153.5	538.7
Brunei Darussalam	688.7	82.3	606.4	742.8	10.3	732.5
Vietnam[2]	416.7	292.2	124.5	672.8	315.6	357.2
ASEAN countries	41,792.3	29,232.6	12,559.7	50,391.4	33,748.1	16,643.3
Japan	18,550.7	41,627.5	-23,076.8	23,449.0	53,088.8	-29,639.8
The People's Republic of China	5,062.8	3,577.4	1,485.4	4,904.4	4,298.3	606.1
Hong Kong SAR	7,100.9	3,105.9	3,995.0	9,899.3	4,193.7	5,705.6
Taiwan	4,590.3	7,960.3	-3,370.0	5,813.3	9,913.7	-4,100.4
Korea	4,311.1	4,978.4	-667.3	5,162.0	7,965.3	-2,803.3
India	1,279.9	1,078.7	201.2	2,084.1	1,377.9	706.2
Other Far East countries [3]	3,559.0	672.7	2,886.3	3,250.5	449.8	2,800.7
Australia	2,410.1	4,618.9	-2,208.8	2,824.6	5,259.4	-2,434.8
New Zealand	693.8	721.5	-27.7	487.9	800.9	-313.0
United States	32,523.5	26,020.9	6,502.6	38,278.5	31,413.0	6,865.5
Canada	1,421.0	617.4	803.6	1,504.7	1,034.0	470.7
United Kingdom	5,841.1	4,998.3	842.8	7,483.5	5,479.6	2,003.9
Germany	5,087.2	6,542.7	-1,455.5	5,926.6	8,612.6	-2,686.0
Netherlands	3,544.7	1,056.9	2,487.8	4,505.3	1,313.3	3,192.0
France	2,094.0	4,069.0	-1,975.0	1,852.5	5,917.5	-4,065.0
Italy	1,127.1	2,113.5	-986.4	1,418.1	2,462.5	-1,044.4
Belgium	1,962.8	916.4	1,046.4	1,967.6	1,112.8	854.8
Luxembourg	14.8	42.3	-27.5	21.4	43.2	-21.8
Denmark	290.2	251.4	38.8	336.0	275.4	60.6
Ireland	559.4	735.2	-175.8	818.7	1,370.6	-551.9
Greece	107.5	30.3	77.2	137.1	30.3	106.8
Spain	674.5	247.2	427.3	923.0	657.7	265.3
Portugal	111.6	94.1	17.5	140.0	114.5	25.5
Austria [4]	157.4	267.6	-110.2	155.3	288.1	-132.8
Finland [4]	88.3	448.7	-360.4	155.4	646.0	-490.6
Sweden [4]	330.3	1,244.9	-914.6	433.1	1,638.0	-1,204.9
European Union (EU)	21,414.9	21,097.3	317.6	26,273.6	29,962.1	-3,688.5
Other West European countries [5]	1,482.1	5,116.0	-3,633.9	1,581.2	8,385.0	-6,803.8
Russia	138.7	193.0	-54.3	250.0	439.0	-189.0
East European countries [6]	275.6	399.7	-124.1	394.4	496.0	-101.6
Rest of the world	7,314.5	4,902.8	2,411.7	8,437.6	1,519.5	6,918.1
Total	**153,921.2**	**155,921.0**	**-1,999.8**	**184,986.5**	**194,344.5**	**-9,358.0**

1 Exports are valued on a f.o.b. basis and imports on a c.i.f basis. Data have been adjusted to exclude intra-regional trade and military imports.
2 Vietnam became a member of ASEAN on July 28, 1995.
3 Prior to July 1995, include Myanmar, Sri Lanka and Pakistan.
4 Finland and Sweden became members of the European Union on 1 January, 1995 while Austria became one on 1 March, 1995.
5 Include Gibraltar, Greenland, Iceland, Malta, Monaco, Norway, Switzerland and Turkey.
6 Include Bulgaria, the Czech Republic and Slovakia, Poland and Yugoslavia.

Source: Department of Statistics.

1996			1997			1998		
Exports	Imports	Trade balance	Exports	Imports	Trade balance	Exports	Imports	Trade balance
RM million								
40,290.3	26,344.6	13,945.7	44,352.1	28,994.1	15,358.0	48,688.9	30,943.8	17,745.0
8,069.2	6,521.7	1,547.5	7,925.1	8,680.2	-755.1	9,058.9	8,831.7	227.2
3,065.3	3,584.2	-518.9	3,464.1	4,129.3	-665.2	3,932.2	5,777.8	-1,845.6
2,011.1	2,360.2	-349.1	3,301.0	2,632.8	668.2	4,521.2	5,385.6	-864.5
818.0	11.6	806.4	763.5	64.8	698.6	907.0	14.9	892.1
812.8	378.3	434.5	910.7	456.5	454.2	1,469.9	538.1	931.9
55,066.7	39,200.6	15,866.1	60,716.5	44,957.8	15,758.7	68,578.0	51,491.9	17,086.1
26,377.8	48,397.8	-22,020.0	27,483.9	48,497.6	-21,013.7	30,236.9	44,854.5	-14,617.6
4,734.2	4,718.5	15.7	5,256.7	6,274.1	-1,017.4	7,764.0	7,250.1	513.9
11,588.1	4,577.5	7,010.6	12,181.0	5,398.7	6,782.3	13,299.5	5,943.2	7,356.4
8,074.4	9,822.8	-1,748.4	9,484.0	10,574.7	-1,090.7	11,797.9	11,646.5	151.3
5,998.7	10,235.3	-4,236.6	7,049.1	11,352.4	-4,303.3	6,516.5	13,126.4	-6,609.9
3,033.5	1,849.8	1,183.7	3,305.7	2,137.4	1,168.3	6,743.8	1,829.9	4.913.8
3,524.5	310.6	3,213.9	1,345.2	215.8	1,129.5	1,334.3	284.4	1,049.9
3,058.3	5,559.8	-2,501.5	3,797.0	5,490.4	-1,693.4	6,617.4	4,996.5	1,620.9
604.8	918.7	-313.9	564.7	1,079.8	-515.1	820.0	985.2	-165.2
35,821.9	30,495.8	5,326.1	41,124.0	37,102.7	4,021.3	62,129.6	44,762.4	17,367.2
1,367.8	1,191.1	176.7	1,627.0	1,723.6	-96.6	2,144.9	1,466.3	678.6
6,778.0	5,139.3	1,638.7	7,293.5	5,812.1	1,481.4	10,328.4	5,067.0	5,261.4
5,978.9	8,434.7	-2,455.7	6,368.4	9,715.5	-3,347.2	8,654.9	9,018.8	-363.9
5,848.9	1,737.9	4,110.9	8,699.8	2,157.7	6,542.1	13,437.4	2,001.0	11,436.4
1,603.3	3,961.1	-2,357.8	2,101.0	4,257.6	-2,156.6	3,036.4	3,273.5	-237.1
1,535.1	2,740.1	-1,205.0	1,393.4	3,161.3	-1,768.0	2,090.1	2,121.2	-31.2
2,135.6	1,157.4	978.1	2,406.5	1,240.3	1,166.3	3,376.4	1,174.0	2,202.4
17.1	15.4	1.8	23.7	25.3	-1.7	34.9	8.9	26.0
327.7	366.5	-38.8	416.3	373.5	42.8	594.8	440.8	154.0
852.0	1,786.8	-934.8	1,082.5	1,234.2	-151.6	1,740.8	1,435.2	305.7
145.8	48.3	97.5	152.4	22.7	129.7	346.9	21.1	325.8
827.5	575.9	251.6	871.3	564.7	306.6	1,272.3	524.2	748.1
129.0	103.0	26.1	119.7	67.0	52.7	197.4	77.1	120.3
152.3	298.1	-145.8	135.1	244.7	-109.6	214.2	240.6	-26.4
254.2	494.3	-240.1	369.2	810.0	-440.9	448.1	384.2	63.9
412.6	1,559.7	-1,147.2	510.8	1,564.7	-1,053.9	659.2	1,283.8	-624.6
26,998.2	28,418.6	-1,420.4	31,943.7	31,251.5	692.3	46,432.3	27,071.5	19,360.8
1,483.4	6,836.0	-5,352.6	1,222.2	3,587.6	-2,365.4	2,200.8	2,878.6	-677.9
284.6	667.9	-383.3	250.3	1,045.4	-795.1	338.2	500.5	-162.3
458.4	740.1	-281.7	494.4	808.5	-314.1	970.7	459.5	511.2
8,550.8	3,338.9	5,211.9	13,045.0	9,437.6	3,607.4	18,831.0	8,761.9	10,069.1
197,026.1	**197,279.8**	**-253.7**	**220,890.4**	**220,935.5**	**-45.0**	**286,755.7**	**228,309.4**	**58,446.4**

Table A.10
Principal Markets for Manufactured Exports

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
ASEAN	**33,731**	**28.0**	**40,878**	**27.8**	**45,388**	**28.6**	**50,869**	**28.4**	**53,147**	**24.6**
Singapore	*27,583*	*22.9*	*32,818*	*22.3*	*35,686*	*22.5*	*39,340*	*22.0*	*39,980*	*18.5*
Thailand	*3,137*	*2.6*	*4,292*	*2.9*	*4,746*	*3.0*	*5,439*	*3.0*	*6,690*	*3.1*
Indonesia	*1,344*	*1.1*	*1,933*	*1.3*	*2,527*	*1.6*	*2,745*	*1.5*	*2,473*	*1.1*
Philippines	*1,146*	*1.0*	*1,291*	*0.9*	*1,831*	*1.2*	*2,794*	*1.6*	*3,335*	*1.5*
Brunei Darussalam	*520*	*0.4*	*543*	*0.4*	*599*	*0.4*	*551*	*0.3*	*669*	*0.3*
EU	**17,995**	**15.0**	**21,840**	**14.8**	**22,920**	**14.5**	**27,799**	**15.5**	**36,045**	**16.7**
United Kingdom	*5,149*	*4.3*	*6,839*	*4.6*	*6,186*	*3.9*	*6,686*	*3.7*	*8,722*	*4.0*
Germany	*4,625*	*3.8*	*5,277*	*3.6*	*5,430*	*3.4*	*5,826*	*3.3*	*7,244*	*3.4*
Netherlands	*2,132*	*1.8*	*2,953*	*2.0*	*4,446*	*2.8*	*7,363*	*4.1*	*9,538*	*4.4*
Others	*6,089*	*5.1*	*6,771*	*4.6*	*6,858*	*4.3*	*7,925*	*4.4*	*10,540*	*4.9*
United States	31,153	25.9	36,713	24.9	34,410	21.7	39,495	22.1	54,819	25.4
Japan	10,618	8.8	15,202	10.3	17,515	11.0	18,279	10.2	19,490	9.0
Hong Kong SAR	6,564	5.5	9,149	6.2	10,448	6.6	11,176	6.2	11,341	5.3
Taiwan	3,293	2.7	4,439	3.0	6,643	4.2	7,655	4.3	9,069	4.2
Korea	1,880	1.6	2,622	1.8	2,855	1.8	2,950	1.6	2,960	1.4
The People's Republic of China	2,402	2.0	2,348	1.6	2,746	1.7	2,777	1.6	3,791	1.8
Australia	1,750	1.5	1,900	1.3	2,400	1.5	3,058	1.7	5,038	2.3
Canada	1,331	1.1	1,384	0.9	1,280	0.8	1,501	0.8	1,814	0.8
West Asian countries	2,226	1.9	2,767	1.9	2,858	1.8	3,158	1.8	4,320	2.0
Latin American countries	1,613	1.3	1,965	1.3	1,776	1.1	2,431	1.4	2,780	1.3
Rest of the world	5,738	4.8	6,046	4.1	7,299	4.6	7,797	4.4	11,158	5.2
Total	**120,295**	**100.0**	**147,253**	**100.0**	**158,540**	**100.0**	**178,945**	**100.0**	**215,772**	**100.0**

Source: Department of Statistic and Bank Negara Malaysia.

Table A.11
Principal Export Markets for Electronics

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	14,592	34.2	18,159	32.0	16,357	25.3	21,365	26.4	31,964	31.0
Singapore	10,720	25.1	14,578	25.7	17,555	27.2	21,170	26.2	22,325	21.6
Taiwan	1,344	3.2	2,150	3.8	4,056	6.3	4,395	5.4	5,372	5.2
Japan	3,392	8.0	4,670	8.2	5,547	8.6	6,156	7.6	7,383	7.2
Hong Kong SAR	2,139	5.0	2,788	4.9	3,963	6.1	4,490	5.6	3,916	3.8
Other	10,450	24.5	14,435	25.4	17,155	26.5	23,201	28.7	32,195	31.2
Total	**42,637**	**100.0**	**56,780**	**100.0**	**64,633**	**100.0**	**80,776**	**100.0**	**103,155**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.12
Principal Export Markets for Electrical Products

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	8,716	25.8	9,445	23.6	9,145	23.1	8,918	23.3	11,449	25.9
Singapore	8,754	26.0	9,165	22.9	8,323	21.0	7,867	20.6	7,290	16.5
Japan	3,034	9.0	4,894	12.2	5,320	13.4	5,140	13.4	5,908	13.4
Hong Kong SAR	1,894	5.6	2,786	7.0	2,599	6.6	2,223	5.8	2,305	5.2
Germany	1,635	4.8	1,618	4.0	1,757	4.4	1,545	4.0	1,757	4.0
United Kingdom	910	2.7	1,067	2.7	1,053	2.7	1,067	2.8	1,202	2.7
Other	8,788	26.1	10,993	27.5	11,443	28.9	11,490	30.1	14,222	32.3
Total	**33,731**	**100.0**	**39,968**	**100.0**	**39,639**	**100.0**	**38,249**	**100.0**	**44,133**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.13
Principal Export Markets for Textiles, Clothing and Footwear

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	1,829	30.2	1,693	26.0	1,662	23.9	1,885	24.7	2,531	29.7
Hong Kong SAR	409	6.7	801	12.3	1,071	15.4	1,009	13.2	1,037	12.2
Singapore	767	12.7	763	11.7	774	11.1	734	9.6	611	7.2
United Kingdom	538	8.9	498	7.6	494	7.1	527	6.9	553	6.5
Japan	305	5.0	383	5.9	433	6.2	487	6.4	407	4.8
Germany	343	5.7	352	5.4	365	5.2	314	4.1	378	4.4
Taiwan	259	4.3	239	3.7	346	5.0	547	7.2	533	6.3
Other	1,606	26.5	1,790	27.5	1,817	26.1	2,113	27.7	2,472	29.0
Total	**6,056**	**100.0**	**6,519**	**100.0**	**6,963**	**100.0**	**7,616**	**100.0**	**8,522**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.14
Principal Export Markets for Wood Products

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Japan	888	18.6	1,405	28.4	2,105	34.6	2,092	32.2	1,422	26.3
The People's Republic of China	1,486	31.1	1,148	23.2	1,241	20.4	949	14.6	667	12.4
Taiwan	478	10.0	384	7.7	476	7.8	533	8.2	440	8.2
Hong Kong SAR	335	7.0	380	7.7	474	7.8	685	10.6	782	14.5
Singapore	438	9.2	367	7.4	399	6.6	433	6.7	328	6.1
Other	1,149	24.1	1,270	25.6	1,391	22.9	1,798	27.7	1,760	32.6
Total	**4,774**	**100.0**	**4,954**	**100.0**	**6,086**	**100.0**	**6,490**	**100.0**	**5,399**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.15
Principal Export Markets for Chemicals and Chemical Products

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	747	16.4	834	13.3	901	13.4	1,024	12.6	1,151	11.7
Hong Kong SAR	426	9.4	627	10.0	648	9.7	783	9.6	1,015	10.4
Japan	594	13.1	607	9.7	610	9.1	792	9.7	885	9.0
Korea	217	4.8	492	7.9	587	8.7	553	6.8	409	4.2
United States	420	9.2	523	8.4	554	8.3	769	9.5	966	9.9
Taiwan	159	3.5	281	4.5	381	5.7	635	7.8	489	5.0
Thailand	289	6.4	385	6.2	357	5.3	376	4.6	478	4.9
Indonesia	163	3.6	251	4.0	353	5.3	449	5.5	314	3.2
Australia	120	2.6	185	2.9	242	3.6	239	2.9	313	3.2
Other	1,413	31.1	2,072	33.1	2,077	31.0	2,517	30.9	3,776	38.5
Total	**4,548**	**100.0**	**6,257**	**100.0**	**6,710**	**100.0**	**8,137**	**100.0**	**9,796**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.16
Principal Export Markets for Manufacturers of Metal

Country	1994		1995		1996		1997		1998 (Jan.-Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	1,412	38.9	1,513	32.5	1,719	34.4	1,789	31.6	2,118	28.1
United States	310	8.5	357	7.7	414	8.3	418	7.4	621	8.2
Japan	313	8.6	392	8.4	387	7.7	514	9.1	523	6.9
Korea	132	3.6	221	4.7	338	6.8	324	5.7	266	3.5
Thailand	204	5.6	355	7.6	312	6.3	293	5.2	356	4.7
Indonesia	96	2.7	267	5.7	258	5.2	237	4.2	259	3.4
Taiwan	116	3.2	217	4.7	248	5.0	304	5.4	711	9.4
Other	1,051	28.9	1,334	28.7	1,322	26.4	1,782	31.5	2,681	35.6
Total	**3,634**	**100.0**	**4,656**	**100.0**	**4,998**	**100.0**	**5,661**	**100.0**	**7,535**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.17
Export Prices for Major Commodities

	1994	1995	1996	1997	1998
Crude palm oil (RM/tonne)	1,174.0	1,534.0	1,288.4	1,424.9	2,366.4
Rubber (sen/kg)	288.0	398.0	358.0	291.7	286.0
Sawn timber (RM/cu. metre)	911.3	879.0	832.5	904.9	941.4
Saw logs (RM/cu. metre)	302.2	292.0	326.7	366.8	344.4

Source: Department of Statistics

Table A.18
Crude Oil Prices: International Comparison

	1994	1995	1996	1997	1998
	(US$/bbl)				
Tapis Blend	17.14	18.28	22.00	21.11	14.10
North Sea Brent	16.04	17.20	20.76	19.40	13.16
West Texas Intermediate	17.18	18.43	22.12	20.63	14.48

Source: PETRONAS

Table A.19
Principal Export Markets for Palm Oil

	1994		1995		1996		1997		1998	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
The People's Republic of China	1,412.3	20.6	1,102.3	16.2	934.5	12.8	1,102.5	14.5	918.7	12.2
Pakistan	1,194.7	17.4	1,024.8	15.1	1,119.6	15.3	1,097.4	14.5	1,054.0	14.0
India	219.2	3.2	748.8	11.0	991.9	13.5	974.6	12.8	1,329.7	17.7
West Asia	921.0	13.4	865.2	12.7	1,099.0	15.0	937.6	12.4	872.9	11.6
EU	737.4	10.7	640.2	9.4	857.4	11.7	717.2	9.4	1,058.4	14.1
Netherlands	*266.9*	*3.9*	*267.2*	*3.9*	*421.4*	*5.8*	*347.0*	*4.6*	*616.5*	*8.2*
Sweden	*50.1*	*0.7*	*53.9*	*0.8*	*71.8*	*1.0*	*63.2*	*0.8*	*68.3*	*0.9*
Italy	*53.0*	*0.8*	*61.2*	*0.9*	*130.1*	*1.8*	*62.8*	*0.8*	*102.2*	*1.4*
United Kingdom	*143.4*	*2.1*	*79.9*	*1.2*	*67.2*	*0.9*	*60.6*	*0.8*	*56.4*	*0.7*
Other	*224.0*	*3.2*	*178.1*	*2.6*	*166.9*	*2.3*	*183.6*	*2.4*	*215.0*	*2.9*
Singapore	419.2	6.1	441.9	6.5	346.2	4.7	392.1	5.2	399.2	5.3
Japan	341.4	5.0	316.7	4.7	361.8	4.9	344.1	4.5	334.1	4.5
Korea	183.7	2.7	156.7	2.3	190.8	2.6	185.7	2.4	137.8	1.8
Myanmar	178.9	2.6	204.7	3.0	189.0	2.6	179.0	2.4	205.9	2.8
Other	1,255.7	18.3	1,307.8	19.1	1,233.3	16.9	1,661.1	21.9	1,202.2	16.0
Total	**6,863.5**	**100.0**	**6,809.1**	**100.0**	**7,323.5**	**100.0**	**7,591.3**	**100.0**	**7,512.9**	**100.0**

Source: Department of Statistics

Table A.20
Principal Export Markets for Rubber

	1994		1995		1996		1997		1998	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
EU	299	29.4	329	32.5	298	30.4	315	30.9	379	38.3
Germany	*51*	*5.0*	*69*	*6.8*	*73*	*7.5*	*76*	*7.5*	*92*	*9.3*
United Kingdom	*50*	*4.9*	*47*	*4.6*	*46*	*4.7*	*47*	*4.6*	*60*	*6.1*
Belgium	*35*	*3.4*	*41*	*4.0*	*35*	*3.6*	*44*	*4.3*	*57*	*5.8*
Italy	*50*	*4.9*	*48*	*4.7*	*42*	*4.3*	*43*	*4.2*	*39*	*3.9*
Netherlands	*42*	*4.1*	*51*	*5.0*	*30*	*3.0*	*22*	*2.1*	*25*	*2.5*
Other	*71*	*7.1*	*73*	*7.4*	*71*	*7.3*	*83*	*8.2*	*106*	*10.7*
United States	126	12.4	125	12.3	123	12.6	130	12.8	112	11.3
Korea	144	14.2	111	11.0	98	10.0	87	8.5	77	7.8
Japan	52	5.1	52	5.1	44	4.4	52	5.1	32	3.2
The People's Republic of China	84	8.3	40	3.9	80	8.2	52	5.1	41	4.2
Turkey	30	2.9	41	4.0	34	3.4	32	3.1	29	2.9
Other	282	27.7	315	31.2	303	31.0	350	34.5	319	32.3
Total	**1,017**	**100.0**	**1,013**	**100.0**	**980**	**100.0**	**1,018**	**100.0**	**989**	**100.0**

Source: Department of Statistics

Table A.21
Principal Export Markets for Saw Logs

	1994		1995		1996		1997		1998	
	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share
Japan	4,652	55.3	4,060	52.4	3,613	51.7	2,856	44.6	2,222	41.0
Taiwan	1,446	17.2	1,233	15.9	1,172	16.8	1,216	19.0	968	17.9
India	255	3.0	321	4.1	318	4.6	688	10.8	741	13.7
Hong Kong SAR	366	4.4	375	4.8	478	6.8	519	8.1	389	7.2
The People's Republic of China	515	6.1	540	7.0	341	4.9	431	6.7	744	13.7
Korea	627	7.4	678	8.8	496	7.1	370	5.8	234	4.3
Thailand	360	4.3	304	3.9	358	5.1	209	3.3	90	1.7
Other	196	2.3	235	3.0	209	3.0	107	1.7	30	0.5
Total	**8,417**	**100.0**	**7,746**	**100.0**	**6,985**	**100.0**	**6,396**	**100.0**	**5,418**	**100.0**

Source: Department of Statistics

Table A.22
Principal Export Markets for Crude Oil

	1994		1995		1996		1997		1998	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
Thailand	4,201	22.0	4,996	26.1	4,913	28.1	3,735	23.5	3,206	17.8
Japan	4,422	23.2	4,405	23.0	3,929	22.5	2,722	17.2	2,108	11.7
Korea	2,492	13.1	1,837	9.6	2,022	11.6	2,393	15.1	2,328	12.9
Singapore	3,545	18.6	2,949	15.4	2,264	12.9	1,829	11.5	1,094	6.1
India	849	4.5	597	3.1	863	4.9	1,050	6.6	1,958	10.9
Indonesia	744	3.9	810	4.2	683	3.9	882	5.6	2,127	11.8
Philippines	636	3.3	368	1.9	437	2.5	547	3.4	617	3.4
New Zealand	-	0.0	405	2.1	587	3.4	332	2.1	459	2.5
Other	2,172	11.4	2,798	14.6	1,797	10.2	2,382	15.0	4,115	22.9
Total	**19,061**	**100.0**	**19,165**	**100.0**	**17,495**	**100.0**	**15,872**	**100.0**	**18,012**	**100.0**

Source: Department of Statistics

Table A.23
External Debt and Debt Servicing

	1994	1995	1996	1997	1998*p*
	RM million				
Medium and long-term					
Gross borrowing	**20,119**	**21,310**	**22,485**	**25,235**	**18,353**
Federal Government	*1,293*	*442*	*749*	*462*	*4,001*
NFPEs	*8,268*	*9,952*	*8,128*	*9,371*	*4, 705*
Private sector	*10,558*	*10,916*	*13,608*	*15,402*	*9,647*
Repayment and prepayment	**12,357**	**11,155**	**15,958**	**11,862**	**14,361**
Federal Government	*6,050*	*2,077*	*2,926*	*2,143*	*2,182*
NFPEs	*2,507*	*2,184*	*5,284*	*3,006*	*4,344*
Private sector	*3,800*	*6,894*	*7,748*	*6,713*	*7,835*
Net borrowing	**7,762**	**10,155**	**6,527**	**13,373**	**3,992**
Federal Government	*-4,757*	*-1,635*	*-2,177*	*-1,681*	*1,819*
NFPEs	*5,761*	*7,768*	*2,844*	*6,365*	*361*
Private sector	*6,758*	*4,022*	*5,860*	*8,689*	*1,812*
Outstanding debt	**59,391**	**68,811**	**72,682**	**127,500**	**131,271**
Federal Government	*14,818*	*13,331*	*10,470*	*12,952*	*14,924*
NFPEs	*20,370*	*27,400*	*29,239*	*52,467*	*53,231*
Private sector	*24,203*	*28,080*	*32,973*	*62,081*	*63,116*
% GNP	*32.8*	*33.0*	*30.6*	*48.8*	*50.0*
% exports of goods and services	*33.0*	*32.0*	*30.7*	*47.5*	*39.6*
Annual growth (%)	*14.5*	*15.9*	*5.6*	*75.4*	*3.0*
Currency composition (% share)	**100**	**100**	**100**	**100**	**100**
U.S. Dollar	*58*	*65*	*72*	*76*	*74*
Japanese yen	*27*	*22*	*16*	*15*	*17*
Other	*15*	*13*	*12*	*9*	*9*
Short-term					
Outstanding debt	**14,244**	**16,204**	**25,151**	**43,257**	**28,504**
Banking	*9,840*	*11,293*	*17,053*	*32,276*	*19,659*
Non-bank private sector	*4,404*	*4,911*	*8,098*	*10,981*	*8,845*
Total external debt	**73,635**	**85,015**	**97,833**	**170,757**	**159,775**
% GNP	*40.7*	*40.8*	*41.2*	*65.4*	*60.9*
% exports of goods and services	*40.9*	*39.5*	*41.4*	*63.7*	*48.3*
Annual Growth (%)	*6.4*	*15.5*	*15.1*	*74.5*	*-6.4*
Total servicing (including short-term interest payment)	**9,967**	**14,115**	**16,262**	**14,718**	**22,112**
of which:					
Medium and long-term					
Repayment (excluding prepayment)	**6,212**	**10,133**	**11,019**	**8,321**	**13,992**
Federal Government	*1,321*	*2,077*	*1,792*	*1,232*	*2,181*
NFPEs	*1,280*	*1,570*	*2,442*	*1,447*	*4,344*
Private sector	*3,611*	*6,486*	*6,785*	*5,642*	*7,467*
Interest payment	**2,642**	**2,876**	**3,603**	**4,378**	**5,868**
Federal Government	*1,136*	*886*	*751*	*637*	*1,008*
NFPEs	*845*	*1,074*	*1,392*	*1,862*	*2,822*
Private sector	*661*	*916*	*1,460*	*1,879*	*2,038*
Debt service ratio (% exports of goods and services)					
Total debt	5.5	6.6	6.9	5.5	6.7
Medium and long-term debt	4.9	6.0	6.2	4.7	6.0
Federal Government	*1.4*	*1.4*	*1.1*	*0.7*	*1.0*
NFPEs	*1.2*	*1.2*	*1.6*	*1.2*	*2.2*
Private sector	*2.3*	*3.4*	*3.5*	*2.8*	*2.9*

p Preliminary

Source: Ministry of Finance and Bank Negara Malaysia.

Table A.24
Gross Malaysian Investment Overseas[1]

Countries	1994	1995	1996	1997	1998
	RM million				
Singapore	995	2,185	1,806	1,783	2,081
United States	624	544	1,416	1,334	1,650
United Kingdom	444	793	1,308	1,716	812
Thailand	70	89	129	133	537
Netherlands	266	143	21	109	266
Virgin Islands (British)	159	8	183	17	227
Mauritius	44	-	15	18	211
France	11	17	99	90	206
Indonesia	100	328	414	648	192
Hong Kong SAR	1,892	816	769	936	162
Australia	624	592	471	505	115
Philippines	223	646	375	299	103
Bermuda	1	21	23	-	99
Cambodia	3	16	67	40	88
Myanmar	3	-	17	8	83
The People's Republic of China	217	331	514	327	75
Taiwan	40	40	112	100	74
Japan	220	93	641	149	64
Vietnam	73	102	129	142	61
South Africa	45	68	1,183	147	42
India	28	14	17	35	30
Canada	172	96	40	61	28
Italy	7	12	6	6	27
Brunei Darussalam	...	2	...	8	26
Namibia	5	23	20	4	25
Belgium	...	7	18	2	21
New Zealand	79	42	41	50	18
Turkmenistan	-	-	-	-	16
Egypt	-	-	-	2	14
Switzerland	165	89	62	186	13
Germany	60	12	18	110	13
Argentina	-	1	4	-	13
Other	229	612	479	669	146
Total[2]	**6,799**	**7,742**	**10,397**	**9,634**	**7,538**

[1] Refers to equity investment, purchase of real estate abroad and extension of loans to non-residents. Does not include retained earnings overseas.
[2] Does not include investment in Labuan IOFC.

Source: Cash BOP Reporting System, Bank Negara Malaysia.

Table A.25
Consumer Price Index (1994=100)

	Weights	1994	1995	1996	1997	1998
		Annual change (%)				
Total	100.0	3.7	3.4	3.5	2.7	5.3
Of which:						
Food	34.9	5.3	4.9	5.7	4.1	8.9
Beverages and tobacco	3.6	4.9	2.3	2.2	1.3	4.3
Clothing and footwear	3.6	-0.8	0.0	-0.7	-0.5	0.4
Gross rent, fuel and power	21.1	2.4	3.4	3.2	3.2	4.4
Furniture, furnishings and household equipment and operation	5.6	1.6	2.8	1.1	0.1	3.9
Medical care and health expenses	1.9	3.4	3.1	3.7	3.6	6.2
Transport and communication	17.9	4.6	1.8	1.4	0.6	-0.1
Recreation, entertainment, education and cultural services	5.8	0.7	2.5	3.3	0.4	3.3
Miscellaneous goods and services	5.6	2.4	4.2	2.5	4.6	7.1
Peninsular Malaysia	100.0	3.7	3.7	3.8	2.8	5.5
Sabah	100.0	3.3	2.8	2.8	2.0	4.3
Sarawak	100.0	4.3	2.2	2.2	1.7	4.2
Durable goods	10.0	6.5	1.9	1.4	-0.7	0.4
Semi-durable goods	5.5	-0.5	0.2	1.2	-0.3	1.4
Non-durable goods	41.2	4.3	4.1	4.0	2.6	6.9
Services	43.3	2.7	3.6	3.7	3.8	5.2

Source: Department of Statistics

Table A.26
Consumer Price Index for Food

	Weights	1994	1995	1996	1997	1998
		Annual change (%)				
Food	34.9	5.3	4.9	5.7	4.1	8.9
Of which:						
Food at home	25.1	5.9	5.3	6.0	3.7	9.1
Rice, bread and other cereals	5.5	0.4	1.4	7.4	3.6	6.9
Meat	3.8	8.0	0.8	4.7	3.4	8.1
Fish	4.9	13.2	12.1	11.7	7.2	9.1
Milk and eggs	2.3	1.0	-0.4	4.0	1.6	4.7
Oils and fats	0.7	2.5	11.2	0.2	-0.7	5.2
Fruits and vegetables	5.4	7.4	8.7	3.0	2.6	14.1
Sugar	0.6	0.1	0.7	0.8	0.3	19.3
Coffee and tea	0.8	2.0	4.6	0.5	0.8	10.1
Other foods	1.1	-2.2	2.7	4.4	0.7	4.2
Food away from home	9.8	2.8	3.7	5.2	5.3	8.4

Source: Department of Statistics

Table A.27
House Price Indicators (MHPI, 1990=100)

	1994	1995	1996	1997	1998 1st half
	Annual change (%)				
	8.0	18.4	12.9	1.9	-8.5
Type					
Terraced	8.7	13.1	10.2	10.0	-4.3
Semi-Detached	6.5	9.8	8.1	2.9	-5.4
Detached	10.0	15.7	14.1	4.3	-9.0
High-Rise Unit	6.1	4.2	-1.0	-4.8	-5.9
Region					
Klang Valley	10.4	15.9	15.7	4.4	-11.2
Johor Bahru	15.6	16.6	14.3	0.1	-21.9
Penang Island	8.8	11.2	4.3	4.3	-11.5
Seremban-Sepang	3.1	11.4	18.6	7.8	-3.6
Ipoh-Kinta	3.8	6.7	6.8	5.0	-2.0

Source: Valuation and Property Services Department

Table A.28
Producer Price Index (1989=100)

	Weights	1994	1995	1996	1997	1998
		Annual change (%)				
Domestic Economy	100.0	4.0	3.9	2.3	2.7	10.7
Of which:						
Food and live animals	14.9	5.7	2.4	5.5	2.3	8.5
Beverages and tobacco	2.1	2.1	2.3	0.5	0.1	1.5
Crude materials	18.0	10.0	7.0	-1.5	-4.9	3.0
Mineral fuels, lubricants and related materials	18.8	-4.5	-0.3	12.5	7.0	-2.6
Animal and vegetable oils and fats	8.5	19.1	26.0	-5.8	12.9	63.8
Chemicals and related products	4.4	0.3	2.2	1.0	1.2	4.7
Manufactured goods	10.8	3.1	-0.1	0.8	0.1	6.8
Machinery and transport equipment	18.4	0.4	-1.8	0.5	3.4	5.9
Miscellaneous manufactured articles	3.6	5.3	2.3	3.4	-1.2	5.4
Commodities and other transactions	0.6	1.7	-0.4	0.3	-0.5	2.1
Local Production	79.3	5.0	4.8	2.8	2.5	11.2
Imports	20.7	0.2	0.7	0.1	2.8	9.2

Source: Department of Statistics

Table A.29
Wages in Private Sector[1]

Sector	No. of wage agreements		No. of workers involved		Average wage (Weighted increase in %)	
	1997	1998	1997	1998	1997	1998
Manufacturing	241	146	63,381	37,283	15.0	8.0
Transport	31	37	7,708	42,385	10.0	6.1
Commerce	62	52	6,836	50,444	11.8	13.8
Services	44	23	11,973	4,260	14.1	10.1
Agriculture	18	11	35,982	6,665	10.2	8.9
Electricity	2	1	2,307	152	18.1	10.0
Mining	7	4	364	160	7.7	10.6
Construction	-	-	-	-	-	-
Other	7	10	1,484	1,173	9.6	6.0
Total	**412**	**284**	**130,035**	**142,522**	**13.1**	**9.6**

[1] Based on collective wage agreements in the private sector which are of 3-year duration.
– No collective wage agreements were concluded.

Source: Industrial Courts
Bank Negara Malaysia

Table A.30
Labour Market Indicators

	1994	1995	1996	1997	1998
Labour force ('000)	7,846	8,257	8,641	9,038	8,881
(annual change in %)	2.9	5.2	4.7	4.6	-1.7
Employment (annual change in %)	3.0	5.3	4.9	4.6	-3.0
Unemployment rate (% of labour force)	2.9	2.8	2.6	2.6	3.9
Labour productivity growth (GDP/Employment)	6.1	6.6	5.7	5.6	-3.8
Average wages in manufacturing sector (annual change in %)	4.4	6.6	8.4	7.3	0.3
Employment by sector ('000)					
Agriculture, forestry and fishing	1,518	1,524	1,505	1,495	1,434
Mining	38	38	39	39	39
Manufacturing	1,877	2,061	2,221	2,390	2,305
Construction	594	711	802	874	726
Electricity, gas and water	61	66	70	76	77
Wholesale and retail trade, hotels and restaurants	1,318	1,314	1,382	1,447	1,439
Finance, insurance, real estate and business services	346	374	391	406	417
Transport, storage and communication	362	399	419	436	439
Government services	868	870	871	873	875
Other services	636	667	717	769	788
Total	**7,618**	**8,024**	**8,417**	**8,805**	**8,539**
Services	3,591	3,690	3,850	4,007	4,034

Source: Economic Planning Unit
Department of Statistics
National Productivity Corporation

Table A.31
Consolidated Public Sector Finance

	1994	1995	1996	1997	1998*p*
	RM million				
General government					
Revenue	61,136	62,271	70,912	81,528	71,392
% growth	*16.2*	*1.9*	*13.9*	*15.0*	*-12.4*
Operating expenditure	40,542	41,394	50,463	51,884	51,896
% growth	*7.7*	*2.1*	*21.9*	*2.8*	*...*
Current surplus	20,594	20,877	20,449	29,644	19,496
NFPEs					
Revenue	43,323	48,335	57,380	69,713	77,175
% growth	*-0.8*	*11.6*	*18.7*	*21.5*	*10.7*
Operating expenditure	28,520	32,342	37,032	42,033	54,129
% growth	*-5.0*	*13.4*	*14.5*	*13.5*	*28.8*
Current surplus	14,803	15,993	20,348	27,680	23,046
Public sector current surplus	**35,397**	**36,870**	**40,797**	**57,324**	**42,542**
(% of GNP)	**19.6**	**17.7**	**17.2**	**22.0**	**16.3**
Net development expenditure	28,753	29,801	30,818	39,992	47,219
% growth	*-11.0*	*3.6*	*3.4*	*29.9*	*18.1*
General government	12,557	16,171	15,306	18,651	21,442
% growth	*-2.3*	*28.8*	*-5.3*	*22.2*	*15.0*
NFPEs	16,196	13,630	15,512	21,341	25,777
% growth	*-16.8*	*-15.8*	*13.8*	*37.6*	*20.8*
Overall balance	**6,644**	**7,069**	**9,979**	**17,332**	**-4,677**
(% of GNP)	**3.7**	**3.4**	**4.2**	**6.6**	**-1.8**
General government	8,037	4,706	5,143	10,993	-1,946
NFPEs	-1,393	2,363	4,836	6,339	-2,731

p Preliminary

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

Table A.32
World Trade[1]

	1994	1995	1996	1997	1998[2]
	Annual change (%)				
World trade	9.2	9.5	7.0	10.0	3.4
	% share of world trade				
United States	14.0	13.7	14.0	14.6	14.4
Japan	7.8	7.6	7.1	6.9	6.9
European Union	36.6	37.2	36.5	35.2	36.4
Germany	9.0	9.2	8.8	8.3	8.4
United Kingdom	4.9	4.9	4.9	5.0	5.0
Asia[3]	17.4	18.1	18.2	18.4	17.7
The People's Republic of China	3.6	3.7	3.6	4.1	4.0
India	0.7	0.7	0.7	0.7	0.8
Asian NIEs	8.3	8.5	8.4	8.3	7.9
Hong Kong SAR	2.3	2.2	2.1	2.2	2.0
Korea	2.1	2.3	2.3	2.2	2.1
Singapore	1.9	2.0	2.0	1.8	1.9
Taiwan	2.0	2.0	2.0	2.1	1.9
ASEAN	4.0	4.2	4.3	4.5	4.1
Indonesia	0.8	0.8	0.9	0.9	0.9
Malaysia	1.5	1.6	1.6	1.7	1.5
Philippines	0.5	0.5	0.6	0.6	0.6
Thailand	1.1	1.2	1.2	1.1	0.9
Vietnam	0.1	0.2	0.2	0.2	0.2
Latin America	5.0	4.8	5.1	5.5	5.5
Argentina	0.4	0.4	0.4	0.5	0.4
Brazil	0.9	1.0	1.0	1.1	1.0
Chile	0.3	0.3	0.3	0.3	0.3
Mexico	1.6	1.4	1.6	1.8	1.9
Emerging Markets					
South Africa	0.4	0.5	0.5	0.5	0.5
Russia	1.2	1.3	1.3	1.3	1.1

1 Refers to trade in goods.
2 Refers to first quarter, except for world trade data, which is a forecast.
3 Excludes Japan.

Source: IMF World Economic Outlook, December 1998
IMF Direction of Trade Statistics

Table A.33
Industrial Countries: Key Economic Indicators

	1994	1995	1996	1997	1998*e*	1999*f*
	Annual change (%)					
Real GDP						
Industrial Countries	2.9	2.2	3.0	3.1	2.3	2.0
United States	3.5	2.3	3.4	3.9	3.9	2.8
Japan	0.6	1.5	5.0	1.4	-2.9	-1.2
Germany	2.7	1.2	1.3	2.2	2.8	1.5
United Kingdom	4.4	2.8	2.6	3.5	2.5	0.9
Consumer Prices						
Industrial Countries	2.2	2.3	2.3	2.0	1.4	1.4
United States	2.6	2.8	2.9	2.3	1.6	1.8
Japan	0.7	-0.1	0.1	1.7	0.7	0.0
Germany	2.7	1.8	1.5	1.8	1.0	1.0
United Kingdom[1]	2.4	2.8	2.9	2.8	2.6	2.5
	% of labour force					
Unemployment						
Industrial Countries	8.0	7.7	7.7	7.4	7.0	7.1
United States	6.1	5.6	5.4	4.9	4.5	4.8
Japan	2.9	3.1	3.3	3.4	4.2	4.5
Germany	9.6	9.4	10.4	11.5	10.9	10.7
United Kingdom	9.3	8.0	7.3	5.5	4.7	5.1
	% of GDP					
Current account balance						
United States	-1.9	-1.6	-1.8	-1.9	-2.7	-3.3
Japan	+2.8	+2.2	+1.4	+2.2	+3.4	+3.3
Germany	-1.0	-0.9	-0.6	-0.2	+0.1	+0.2
United Kingdom	-0.2	-0.5	-0.2	+0.6	+0.2	-0.5
Fiscal balance						
United States	-2.3	-1.9	-0.9	+0.2	+1.1	+1.1
Japan	-2.3	-3.6	-4.2	-3.5	-6.2	-8.5
Germany	-2.4	-3.3	-3.4	-2.7	-2.4	-2.3
United Kingdom	-6.8	-5.5	-4.5	-1.9	+0.1	-0.7

1 Retail Price Index, excluding mortgage interest
e Estimate
f Forecast

Source: IMF World Economic Outlook, December 1998
National sources

Table A.34
East Asia: Key Economic Indicators

	1994	1995	1996	1997	1998*e*	1999*f*
	Annual change (%)					
Real GDP						
Asian NIEs	**7.6**	**7.2**	**6.3**	**6.1**	**-1.8**	**2.8-2.9**
Korea	8.6	8.9	7.1	5.5	-5.4	3.2
Taiwan	6.5	6.0	5.7	6.8	4.8	4.7
Singapore	10.5	8.4	7.5	8.0	1.5	-1.0~+1.0
Hong Kong SAR	5.4	3.9	4.6	5.3	-5.1	0.5
ASEAN[1]	**8.2**	**8.1**	**7.1**	**4.6**	**-7.3**	**-0.8~+0.9**
Malaysia	9.3	9.4	8.6	7.7	-6.7	1.0
Thailand	8.9	8.8	5.5	-0.4	-8.0	1.0
Indonesia	7.5	8.2	7.8	4.9	-13.7	-4.0-0
Philippines	4.4	4.7	5.9	5.2	-0.5	2.5~3.2
Vietnam	8.8	9.5	9.3	9.0	5.8	5.0-6.0
The People's Republic of China[2]	12.6	10.5	9.6	8.8	7.8	7.0
Consumer prices						
Asian NIEs	**5.7**	**4.7**	**4.3**	**3.4**	**4.4**	**1.5-1.6**
Korea	6.2	4.5	4.9	4.5	7.5	3.0
Taiwan	4.1	3.7	3.1	0.9	1.7	1.6
Singapore	3.1	1.7	1.4	2.0	-0.3	-1.0~0
Hong Kong SAR	8.1	8.7	6.0	5.7	2.6	-2.0
ASEAN[1]	**6.8**	**6.7**	**6.0**	**6.8**	**34.2**	**7.1~9.3**
Malaysia	3.7	3.4	3.5	2.7	5.3	< 4.0
Thailand	5.1	5.8	5.9	5.6	8.1	3.0
Indonesia	8.5	9.0	6.6	10.3	77.6	12.0~17.0
Philippines	9.0	8.0	9.1	6.0	9.7	8.0~9.0
Vietnam	14.5	12.7	4.5	3.6	9.2	10.0
The People's Republic of China[2]	21.7	14.8	6.1	0.8	-2.6	2.0
Current account balance	US$ billion					
Asian NIEs	**+15.6**	**+5.3**	**+0.3**	**+8.5**	**-**	**-**
Korea	-3.9	-8.5	-23.0	-8.2	+40.0	+20.0
Taiwan	+6.5	+5.5	+11.0	+7.7	+3.5	n.a.
Singapore	+11.4	+14.4	+14.5	+15.0	+17.6	n.a.
Hong Kong SAR[3]	+1.6	-6.1	-2.2	-6.0	n.a.	n.a.
ASEAN[1]	**-20.4**	**-33.9**	**-33.2**	**-18.9**	**+27.8**	**+21.7**
Malaysia	-5.6	-8.6	-4.8	-5.0	+9.2	+7.8
Thailand	-7.8	-13.2	-14.4	-3.0	+14.3	+11.0
Indonesia	-2.8	-6.8	-7.7	-5.0	+4.5	+3.7
Philippines	-2.9	-3.3	-4.0	-4.4	+0.8	+0.4
Vietnam	-1.3	-2.0	-2.3	-1.5	-1.0	-1.2
The People's Republic of China	+6.9	+1.6	+7.2	+29.7	n.a.	n.a.
Current account balance	% of GDP					
Korea	-1.0	-1.9	-4.7	-1.9	+13.2	+7.0
Taiwan	+2.7	+2.1	+4.0	+2.7	+1.3	+2.2
Singapore	+16.2	+17.3	+15.9	+15.8	+20.9	+18.4
Hong Kong SAR[3]	+1.2	-4.3	-1.4	-3.5	n.a.	+1.2
Malaysia	-7.8	-9.9	-4.9	-5.1	+12.9	+10.4
Thailand	-5.6	-7.8	-7.9	-2.0	+12.3	+8.5
Indonesia	-1.7	-3.3	-3.4	-2.3	+4.4	+2.5
Philippines	-4.6	-4.4	-4.8	-5.3	+1.1[4]	+0.6[4]
Vietnam	-8.5	-10.0	-10.0	-6.0	-3.7	-5.5
The People's Republic of China	+1.3	+0.2	+0.9	+3.3	+2.4	+1.8

Table A.34
East Asia: Key Economic Indicators (continued)

	1994	1995	1996	1997	1998*e*	1999*f*
	% of GDP					
Fiscal balance[5]						
Korea	0.6	0.5	...	...	n.a.	n.a.
Taiwan	-2.0	-0.4	-0.1	-0.3	1.9	0.5
Singapore	7.5	6.2	6.1	1.1	2.4	-3.5[6]
Hong Kong SAR	1.1	-0.3	2.2	6.0	n.a.	-2.8[6]
Malaysia	2.3	0.9	0.7	2.4	-1.8	-5.7
Thailand	2.7	2.7	2.2	-0.7	-2.4	-3.0
Indonesia	0.2	1.5	0.7	1.3	-5.6	-6.4
Philippines	1.0	0.6	0.3	0.1	-1.9	-2.3
Vietnam	-3.1	-1.6	-1.5	-1.5	-0.9	n.a.
The People's Republic of China	-1.2	-1.0	-0.8	-0.6	n.a.	-1.7
	% of labour force					
Unemployment						
Korea	2.4	2.0	2.0	2.6	6.8	7.5
Taiwan	1.6	1.8	2.6	2.7	2.7	2.6
Singapore	2.0	2.0	2.0	1.8	3.2	n.a.
Hong Kong SAR	1.9	3.2	2.8	2.2	4.7	n.a.
Malaysia	2.9	2.8	2.6	2.6	3.9	4.5
Thailand	2.6	1.7	1.5	1.9	4.0	4.1
Indonesia	4.4	7.2	4.9	7.5	14.5	16.0~18.0
Philippines	9.5	9.5	8.6	8.7	10.1	9.6~9.9
Vietnam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
The People's Republic of China[7]	n.a.	n.a.	n.a.	n.a.	3.1	3.5
	% of GNP					
Gross national savings						
Korea[8]	36.5	36.8	35.2	34.5	34.9	33.9
Taiwan	26.1	25.3	25.0	24.6	24.2	23.9
Singapore	48.5	50.4	51.2	52.3	52.1	n.a.
Hong Kong SAR[8]	33.1	30.5	30.7	30.6	30.0	32.0
Malaysia	34.4	35.3	38.5	39.4	41.2	40.2
Thailand[8]	36.0	33.6	33.7	31.0	31.4	32.0
Indonesia	31.9	25.9	26.9	26.9	24.2	18.1
Philippines	18.8	17.5	18.5	18.7	20.4	n.a.
Vietnam[8]	16.9	17.0	16.7	17.7	16.0	18.0
The People's Republic of China[8]	42.2	41.9	41.4	42.6	39.0	39.0

1 Includes Singapore and Vietnam, but excludes Brunei Darussalam, Lao PDR, Myanmar and Cambodia.
2 Refers to retail prices.
3 Refers to balance of goods and services.
4 As % of GNP.
5 Central government balance.
6 Refers to fiscal year.
7 Refers to urban unemployment.
8 Refers to gross domestic savings (as % of GDP).
e Estimates
f Forecasts
n.a. not available
... Negligible

Sources: ADB, Asian Development Outlook, 1997/98
IMF, International Financial Statistics
IMF, World Economic Outlook, October and December 1998
National sources

Table A.35
Broad Money (M3)

	Annual change				
	1994	1995	1996	1997	1998
	RM million				
Broad money (M3)[1]	25,719	49,619	57,759	61,102	10,650
(Annual growth in %)	(13.1)	(22.3)	(21.2)	(18.5)	(2.7)
Currency[2]	2,357	1,529	1,525	2,339	-3,177
Demand deposits	3,346	4,549	6,209	80	-5,743
Broad quasi money	20,016	43,541	50,025	58,683	19,570
Fixed deposits	*7,260*	*31,172*	*41,586*	*46,138*	*14,909*
Savings deposits	*5,001*	*1,294*	*6,061*	*-3,711*	*1,259*
NIDs	*5,829*	*9,408*	*-2,047*	*10,117*	*974*
Repos	*1,926*	*1,667*	*2,572*	*3,837*	*1,052*
Foreign currency deposits[3]	*n.a.*	*n.a.*	*1,853*	*2,302*	*1,376*
Factors Affecting M3					
Net lending to Government	-5,945	-3,852	-2,858	510	-12,291
Lending to Government	331	229	2,521	1,856	5,194
Less: Government deposits	6,276	4,081	5,379	1,346	17,485
Private sector credit	31,267	64,154	72,383	90,360	4,161
Net external assets[4]	6,299	-3,256	1,520	-16,788	51,154
Other influences	-5,902	-7,427	-13,286	-12,980	-32,374

[1] Excludes interplacements among banking institutions.
[2] Excludes holdings by banking system.
[3] Prior to December 1996, foreign currency deposits were subsumed under its respective category of deposits.
[4] BNM net of banking system.
n.a. Not available

Monthly change 1998												As at end 1998
Jan.	Feb.	Mar	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	
RM million												
2,987	184	169	-2,050	-2,783	-190	-2,023	268	371	1,050	3,429	9,237	401,459
(16.1)	(14.7)	(13.7)	(12.2)	(9.6)	(7.3)	(5.9)	(4.4)	(4.0)	(2.5)	(3.3)	(2.7)	(2.7)
5,179	-5,032	-1,004	-93	-240	-456	-19	428	-2,084	-196	-120	459	17,982
-3,520	-1,972	-1,689	-1,569	-1,996	1,477	-1,565	-755	3,407	-827	1,802	1,464	36,544
1,328	7,188	2,862	-388	-547	-1,211	-439	595	-952	2,073	1,747	7,314	346,933
1,184	*5,890*	*5,343*	*165*	*1,028*	*-29*	*-726*	*3,439*	*128*	*660*	*-2,881*	*709*	*260,001*
-319	*481*	*-1,303*	*-348*	*-938*	*236*	*-730*	*-271*	*1,401*	*508*	*925*	*1,617*	*32,524*
-910	*1,477*	*690*	*-205*	*-1,203*	*-512*	*-169*	*-2,415*	*-1,844*	*-974*	*4,165*	*2,873*	*27,633*
802	*-465*	*-1,854*	*-279*	*-38*	*-746*	*345*	*-347*	*135*	*1,790*	*-233*	*1,941*	*21,244*
571	*-195*	*-14*	*279*	*604*	*-160*	*841*	*189*	*-772*	*89*	*-229*	*174*	*5,531*
3,541	-3,311	300	898	-1,839	-1,786	-2,544	-1,405	843	-6,686	473	-776	-21,016
-223	-77	79	1,743	-70	-37	-611	-575	647	-440	316	4,441	25,229
-3,764	3,234	-221	845	1,769	1,749	1,933	830	-196	6,246	-157	5,217	46,245
7,723	-4,548	-238	-701	-1,269	163	-198	2,894	-1,834	7,138	1,357	-6,325	451,748
157	6,550	2,648	347	917	1,953	2,777	110	24,024	5,999	795	4,877	94,638
-8,434	1,493	-2,541	-2,594	-592	-520	-2,058	-1,331	-22,662	-5,401	804	11,461	-123,911

Table A.36
Money Supply: Annual Change and Growth Rates

	M3[5]													
			M2[3]											
					M1[1]									
	Total		Total		Total		Currency		Demand deposits		Narrow quasi money[2]		Deposits (incl. NIDs and repos) with other banking inst.[4]	
	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%
1994	25,719	13.1	20,566	14.7	4,679	11.2	2,388	17.6	2,291	8.1	15,887	16.2	5,153	9.1
1995	49,619	22.3	38,508	24.0	5,453	11.7	1,557	9.8	3,896	12.8	33,055	29.0	11,111	17.9
1996	57,759	21.2	39,335	19.8	8,661	16.7	1,552	8.9	7,109	20.6	30,674	20.9	18,424	25.2
1997	61,102	18.5	54,009	22.7	2,780	4.6	2,402	12.6	377	0.9	51,229	28.8	7,093	7.8
1998	10,650	2.7	4,255	1.5	-9,231	-14.6	-3,188	-14.9	-6,043	-14.4	13,485	5.9	6,395	6.5

1 Currency in circulation and demand deposits of the private sector.
2 Comprising savings and fixed deposits of the private sector placed with Bank Negara and commercial banks, net NIDs and repos by commercial banks.
3 M1 plus narrow quasi money.
4 Comprising savings and fixed deposits of the private sector placed with the finance companies, merchant banks, discount houses and Bank Islam, net NIDs issued by the relevant banking institutions and repos; excludes interplacements among these financial institutions and with commercial banks.
5 M2 plus deposits (including NIDs and repos) with other banking institutions.

Table A.37
Interest Rates

	Average rates at end-year				Average rates at end-month in 1998											
	1994	1995	1996	1997	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
	% per annum															
3-month interbank	5.45	6.76	7.39	8.70	10.00	11.00	11.00	11.07	11.04	11.20	10.75	9.50	7.48	6.96	6.51	6.46
Commercial banks																
Fixed deposit:																
3-month	5.27	6.64	7.21	9.06	9.09	9.46	9.79	9.89	10.00	10.19	10.27	9.50	6.17	6.09	5.88	5.83
12-month	6.15	6.89	7.26	9.33	9.36	9.67	9.90	10.03	10.18	10.24	10.28	9.46	6.13	6.02	5.79	5.74
Savings deposit	3.54	3.70	4.10	4.23	4.27	4.32	4.34	4.44	4.46	4.51	4.54	4.51	4.00	3.96	3.89	3.87
Base lending rate (BLR)	6.83	8.03	9.18	10.33	10.44	11.08	11.96	12.16	12.21	12.27	12.07	11.70	8.89	8.49	8.04	8.04
Finance companies																
Fixed deposit:																
3-month	5.48	6.79	7.32	10.32	10.61	10.71	10.85	10.85	10.91	10.97	10.92	9.96	6.79	6.71	6.50	6.43
12-month	6.36	6.98	7.36	10.25	10.38	10.53	10.67	10.77	10.77	10.86	10.88	10.02	6.75	6.72	6.57	6.57
Savings deposit	4.57	4.70	5.02	5.49	5.51	5.45	5.50	5.54	5.59	5.56	5.54	5.44	5.18	5.08	5.06	5.01
Base lending rate (BLR)	8.40	9.38	10.65	12.22	12.33	13.16	14.23	14.56	14.65	14.70	14.49	14.17	10.54	10.00	9.50	9.50
Treasury bills (91 days)	4.56	5.92	6.39	6.76	5.87	5.87	6.18	8.18	9.50	9.98	7.80	6.39	6.26	5.82	5.57	5.31
Government securities (1 year)	5.77	6.70	6.70	7.01	7.16	6.95	7.40	8.50	10.00	10.13	9.00	6.84	7.13	6.89	5.82	5.79
Government securities (5 years)	6.30	6.50	6.55	7.75	7.97	7.61	7.61	8.02	8.31	8.47	8.95	6.93	7.38	7.29	6.67	6.66

Table A.38
Sources and Uses of Funds of the Financial System

	1994	1995	1996	1997	1998
	Outstanding in RM million				
Sources of Funds:					
Capital, reserves & profit	55,886.5	78,696.4	109,427.6	106,323.6	102,445.1
Currency	17,170.3	18,913.2	21,065.6	24,532.3	20,547.4
Demand deposits	40,051.8	46,155.8	56,231.9	57,672.4	65,110.6
Other deposits[1]	247,336.4	290,224.5	355,979.8	436,995.6	457,954.1
of which:					
Public sector	*27,544.1*	*41,420.7*	*35,937.0*	*37,444.1*	*40,392.6*
Other financial institutions[2]	*68,197.6*	*71,422.8*	*81,541.6*	*103,823.9*	*103,870.4*
Private sector	*147,233.9*	*171,804.3*	*233,134.1*	*287,729.2*	*305,698.6*
Foreign	*4,360.8*	*5,576.7*	*5,367.1*	*7,998.4*	*7,992.5*
Borrowings	6,811.0	6,322.4	8,365.8	32,683.5	14,400.0
Funds from other financial institutions	61,784.7	78,122.3	99,169.7	154,602.0	66,074.4
Domestic[2]	*46,128.9*	*61,695.0*	*77,218.5*	*113,986.0*	*39,600.2*
Foreign	*15,655.8*	*16,427.3*	*21,951.2*	*40,616.0*	*26,474.2*
Insurance, provident & pension funds	108,961.4	127,055.4	146,888.5	168,451.1	188,687.8
Other liabilities	87,417.6	102,074.0	121,913.9	133,277.0	177,898.2
Total Liabilities	**625,419.7**	**747,564.0**	**919,042.8**	**1,114,537.4**	**1,093,117.6**
Uses of Funds:					
Currency	1,383.4	1,929.3	2,804.6	4,046.0	3,224.1
Deposits with other financial institutions	121,286.4	139,216.6	146,612.2	219,083.8	151,577.9
Domestic	*113,453.2*	*130,830.7*	*139,228.4*	*200,922.3*	*136,138.0*
Foreign	*7,833.2*	*8,385.9*	*7,383.8*	*18,161.5*	*15,439.9*
Bills	12,081.1	16,391.6	16,312.6	21,433.2	14,648.5
Treasury	*4,061.2*	*3,887.4*	*1,916.8*	*3,912.3*	*3,796.0*
Commercial	*8,019.9*	*12,504.2*	*14,395.8*	*17,521.0*	*10,852.5*
Loans & advances	242,498.2	305,751.1	384,261.1	485,615.7	485,712.4
Public sector	*4,446.4*	*4,582.0*	*3,966.3*	*2,661.9*	*5,566.6*
Other financial institutions	*19,467.7*	*26,069.8*	*13,615.5*	*20,615.6*	*28,995.5*
Private sector	*217,677.4*	*274,075.1*	*364,697.2*	*459,250.0*	*448,318.3*
Foreign	*906.7*	*1,024.2*	*1,982.1*	*3,088.2*	*2,832.1*
Securities	124,731.8	160,280.7	202,520.6	207,091.7	225,568.9
Malaysian Government	*61,056.1*	*61,532.8*	*67,626.9*	*66,090.7*	*71,574.8*
Foreign	*91.6*	*92.8*	*491.4*	*1,289.6*	*1,268.8*
Corporate	*56,061.0*	*53,575.6*	*124,458.0*	*132,211.6*	*141,781.5*
Others	*7,523.1*	*45,079.5*	*9,944.3*	*7,499.8*	*10,943.9*
Gold and forex reserves	66,830.8	61,681.9	67,864.6	57,032.1	96,264.9
Other assets	56,608.0	62,312.8	98,667.2	120,234.9	116,121.0
Total Assets	**625,419.7**	**747,564.0**	**919,042.8**	**1,114,537.4**	**1,093,117.6**

[1] Equal 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 "rather than "Other deposits from other financial institutions ". In this regard, data for prior years have also been revised accordingly.

Table A.39
Commercial Banks: Sources and Uses of Funds

	As at end									
	Dec. 1994		Dec. 1995		Dec. 1996		Dec. 1997		Dec. 1998	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	15,996.0	6.7	19,387.7	6.6	25,867.4	7.2	38,390.2*	8.0	37,418.1 *	8.3
Debentures and notes	1,103.4	0.5	1,949.0	0.7	3,576.3	1.0	1,877.8	0.4	1,267.3	0.3
Deposits[1]	160,272.1	67.0	196,851.0	67.4	243,968.7	68.1	300,558.1	62.6	307,439.4	67.8
(of which:										
NIDs issued	*19,389.8*	*8.1*	*24,541.3*	*8.4*	*27,467.1*	*7.7*	*39,660.6*	*8.3*	*36,858.4*	*8.1*
Repos)	*9,201.6*	*3.8*	*9,612.0*	*3.3*	*11,818.1*	*3.3*	*15,060.9*	*3.1*	*15,633.5*	*3.4*
Amount due to financial institutions	24,614.3	10.3	28,349.9	9.7	34,532.1	9.6	79,586.2	16.6	40,635.5	9.0
Domestic	*10,052.9*	*4.2*	*13,249.4*	*4.5*	*13,060.8*	*3.6*	*43,490.0*	*9.1*	*18,193.3*	*4.0*
Foreign	*14,561.4*	*6.1*	*15,100.5*	*5.2*	*21,471.3*	*6.0*	*36,096.1*	*7.5*	*22,442.3*	*4.9*
Bankers acceptances	9,170.3	3.8	15,781.1	5.4	19,580.5	5.5	23,115.4	4.8	18,497.5	4.1
Other	28,080.6	11.7	29,893.2	10.2	30,562.8	8.5	36,720.4	7.6	48,270.0	10.6
Total	**239,236.7**	**100.0**	**292,211.9**	**100.0**	**358,087.8**	**100.0**	**480,248.1**	**100.0**	**453,527.8**	**100.0**
Uses										
Cash[2]	1,361.4	0.6	1,589.7	0.5	2,363.2	0.7	4,547.7	0.9	2,802.2	0.6
Reserve with BNM	14,074.6	5.9	18,518.8	6.3	27,972.9	7.8	37,131.0	7.7	10,624.4	2.3
Amount due from financial institutions	44,727.7	18.7	45,257.3	15.5	37,949.9	10.6	63,744.5	13.3	57,972.3	12.8
Domestic	*36,908.6*	*15.4*	*36,908.9*	*12.6*	*30,104.5*	*8.4*	*48,804.3*	*10.2*	*45,212.3*	*10.0*
Foreign	*7,819.1*	*3.3*	*8,348.4*	*2.9*	*7,845.4*	*2.2*	*14,940.1*	*3.1*	*12,759.9*	*2.8*
Investments	7,787.0	3.3	7,633.5	2.6	8,773.0	2.4	14,073.0	2.9	20,308.3	4.5
(of which:										
Stocks and shares	*2,845.7*	*1.2*	*3,251.1*	*1.1*	*4,276.2*	*1.2*	*3,714.8*	*0.8*	*4,547.8*	*1.0*
Debentures	*666.7*	*0.3*	*864.6*	*0.3*	*821.0*	*0.2*	*2,992.4*	*0.6*	*7,416.4*	*1.6*
Fixed assets	*2,651.2*	*1.1*	*2,989.6*	*1.0*	*3,505.8*	*1.0*	*6,521.4*	*1.4*	*7,266.2*	*1.6*
Foreign investments)	*1,623.4*	*0.7*	*528.2*	*0.2*	*170.0*	*...*	*844.4*	*0.2*	*1,077.9*	*0.2*
Placement with discount houses	2,111.9	0.9	1,829.2.	0.6	3,849.4	1.1	6,037.0	1.3	1,342.0	0.3
Marketable securities	29,579.6	12.4	39,962.6	12.6	50,960.1	14.2	61,871.1	12.9	60,104.0	13.3
(of which:										
Treasury bills	*2,099.3*	*0.9*	*2,301.4*	*0.8*	*1,789.4*	*0.5*	*3,775.2*	*0.8*	*3,611.9*	*0.8*
MGS	*6,242.2*	*2.6*	*6,462.3*	*2.2*	*7,726.1*	*2.2*	*8,900.4*	*1.9*	*9,978.5*	*2.2*
NIDs held	*11,374.7*	*4.8*	*12,528.2*	*4.3*	*20,776.6*	*5.8*	*24,394.7*	*5.1*	*21,059.0*	*4.6*
Cagamas bonds)	*3,835.0*	*1.6*	*4,898.5*	*1.7*	*8,301.7*	*2.3*	*12,487.6*	*2.6*	*12,878.0*	*2.8*
Loans[3] (incl. trade bills)	134,151.0	56.1	175,007.4	59.9	217,820.6	60.8	276,285.3	57.5	285,766.4	63.0
Other	5,443.5	2.3	5,413.4	1.9	8,398.7	2.3	16,558.6	3.4	14,608.3	3.2
Total	**239,236.7**	**100.0**	**292,211.9**	**100.0**	**358,087.8**	**100.0**	**480,248.1**	**100.0**	**453,527.8**	**100.0**

[1] Includes NIDs issued and repos.
[2] Includes balances with BNM.
[3] Excludes housing loans sold to Cagamas Berhad.
* Includes current unaudited unadjusted profit (If excludes, the figure would be for the year 1997: RM33,714.5 million; 1998: RM 35,331.3 million)

Table A.40
Commercial Banks: Commitments and Contingencies

	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	14,360	4.1	15,299	6.0
Credit extension commitments	138,423	39.4	118,004	46.0
Direct credit substitutes	22,567	6.4	18,992	7.4
Foreign exchange related contracts	124,656	35.5	59,029	23.0
Interest rate related contracts	4,202	1.2	5,930	2.3
Trade-related contingencies	12,237	3.5	7,580	3.0
Transaction- related contingencies	21,403	6.1	17,644	6.9
Underwriting obligations	1,301	0.4	1,174	0.5
Other	11,889	3.4	12,627	4.9
Total	**351,037**	**100.0**	**256,278**	**100.0**

Table A.41
Finance Companies: Sources and Uses of Funds

	As at end									
	Dec. 1994		Dec. 1995		Dec. 1996		Dec. 1997		Dec. 1998	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	3,713.0	5.1	4,516.7	4.9	6,844.1	5.7	9,431.2*	6.2	7,726.4*	6.3
Debentures and notes	267.6	0.4	332.4	0.4	531.0	0.4	872.2	0.6	742.2	0.6
Deposits[1]	57,276.4	78.0	69,963.1	76.1	90,842.0	75.9	107,350.8	70.4	98,627.2	79.8
(of which:										
NIDs issued	*5,491.6*	*7.5*	*8,711.0*	*9.5*	*14,973.8*	*12.5*	*18,751.9*	*12.3*	*12,843.8*	*10.4*
Repos)	*1,090.4*	*1.5*	*1,869.8*	*2.0*	*3,001.0*	*2.5*	*7,877.3*	*5.2*	*2,891.2*	*2.3*
Amount due to financial institutions	4,989.9	6.8	8,908.1	9.7	12,868.8	10.8	25,479.1	16.7	5,243.0	4.2
Domestic	*4,989.9*	*6.8*	*8,908.1*	*9.7*	*12,868.8*	*10.8*	*25,479.1*	*16.7*	*5,243.0*	*4.2*
Foreign	-	-	-	-	-	-	-	-	-	-
Other	7,225.0	9.8	8,172.1	8.9	8,524.2	7.1	9,253.5	6.1	11,258.1	9.1
Total	**73,471.9**	**100.0**	**91,892.4**	**100.0**	**119,610.1**	**100.0**	**152,386.8**	**100.0**	**123,596.9**	**100.0**
Uses										
Cash[2]	120.9	0.2	159.6	0.2	164.3	0.1	208.7	0.1	181.7	0.1
Reserve with BNM	5,945.7	8.1	7,640.2	8.3	12,050.4	10.1	16,043.1	10.5	3,475.2	2.8
Amount due from financial institutions	6,600.8	9.0	7,548.9	8.2	6,445.4	5.4	5,676.9	3.7	7,529.4	6.1
Domestic	*6,600.8*	*9.0*	*7,548.9*	*8.2*	*6,445.4*	*5.4*	*5,676.9*	*3.7*	*7,529.4*	*6.1*
Foreign			-	-	-	-	-	-	-	-
Investments	807.5	1.1	968.2	1.1	1,241.3	1.0	3,191.7	2.1	5,129.0	4.1
(of which:										
Stocks and shares	*293.6*	*0.4*	*282.0*	*0.3*	*281.7*	*0.2*	*436.4*	*0.3*	*315.4*	*0.3*
Debentures	*1.9*	*...*	*70.3*	*0.1*	*767.9*	*0.6*	*1,227.2*	*0.8*	*3,134.9*	*2.5*
Fixed assets	*511.9*	*0.7*	*615.9*	*0.7*	*827.9*	*0.7*	*1,528.1*	*1.0*	*1,678.7*	*1.4*
Foreign investments)	*0.1*	*...*	-	-	-	-	-	-	-	-
Placement with discount houses	700.0	1.0	735.1	0.8	1,152.4	1.0	2,051.8	1.3	1,006.1	0.8
Marketable securities	7,913.4	10.8	10,650.8	11.6	14,888.6	12.4	18,312.6	12.0	13,990.6	11.3
(of which:										
Treasury bills	*241.5*	*0.3*	*119.3*	*0.1*	*22.2*	*...*	*46.4*	*...*	*42.8*	*...*
MGS	*1,586.3*	*2.2*	*1,768.2*	*1.9*	*2,806.5*	*2.3*	*3,250.9*	*2.1*	*3,602.9*	*2.9*
NIDs held	*1,896.0*	*2.6*	*2,686.6*	*2.9*	*4,451.1*	*3.7*	*7,665.3*	*5.0*	*5,473.1*	*4.4*
Cagamas bonds)	*1,410.8*	*1.9*	*2,704.6*	*2.9*	*2,959.6*	*2.5*	*2,795.8*	*1.8*	*1,778.5*	*1.4*
Loans[3] (incl. trade bills)	50,086.7	68.2	62,752.0	68.3	82,496.7	69.0	102,528.1	67.3	86,553.9	70.0
Other	1,296.9	1.8	1,437.6	1.6	1,171.0	1.0	4,373.9	2.9	5,731.1	4.6
Total	**73,471.9**	**100.0**	**91,892.4**	**100.0**	**119,610.1**	**100.0**	**152,386.8**	**100.0**	**123,596.9**	**100.0**

[1] Includes NIDs issued and repos.
[2] Includes balances with BNM.
[3] Excludes housing loans sold to Cagamas Berhad.
* Includes current unaudited unadjusted profit (If excludes, the figure would be for the year 1997: RM 8,813.3 million; 1998: RM 7,609.6 million)

Table A.42
Finance Companies: Commitments and Contingencies

	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	6,435	24.8	6,498	35.8
Credit extension commitments	16,798	64.9	9,580	52.8
Direct credit substitutes	2,160	8.3	1,213	6.7
Foreign exchange related contracts	-	-	-	-
Interest rate related contracts	300	1.2	510	2.8
Trade-related contingencies	1	. . .	-	-
Transaction-related contingencies	16	0.1	12	0.1
Underwriting obligations	25	0.1	10	0.1
Other	164	0.6	325	1.8
Total	**25,899**	**100.0**	**18,147**	**100.0**

Table A.43
Merchant Banks: Sources and Uses of Funds

	As at end									
	Dec. 1994		Dec. 1995		Dec. 1996		Dec. 1997		Dec. 1998	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	1,159.0	4.9	1,615.6	6.0	2,783.4	8.2	4,233.1*	9.6	3,977.8*	10.1
Debentures and notes	17.0	0.1	113.8	0.4	183.8	0.5	150.0	0.3	150.0	0.4
Deposits[1]	14,574.0	61.8	16,093.3	59.5	23,530.7	69.2	26,389.7	59.6	26,337.0	67.1
(of which:										
NIDs issued	*2,730.0*	*11.6*	*3,380.7*	*12.5*	*6,000.8*	*17.6*	*6,553.0*	*14.8*	*6,242.2*	*15.9*
Repos)	*2,040.7*	*8.7*	*2,664.0*	*9.8*	*2,373.9*	*7.0*	*3,933.8*	*8.9*	*3,283.9*	*8.4*
Amount due to financial institutions	5,680.9	24.1	5,841.3	21.6	5,198.3	15.3	10,771.7	24.3	4,853.7	12.4
Domestic	*5,680.9*	*24.1*	*5,811.3*	*21.5*	*5,157.3*	*15.2*	*9,650.7*	*21.8*	*4,288.4*	*10.9*
Foreign	-	-	*30.0*	*0.1*	*41.0*	*0.1*	*1,121.0*	*2.5*	*565.3*	*1.4*
Bankers acceptances	431.6	1.8	676.2	2.5	566.6	1.7	612.4	1.4	275.9	0.7
Other	1,722.1	7.3	2,721.6	10.1	1,742.1	5.1	2,143.1	4.8	3,641.4	9.3
Total	**23,584.6**	**100.0**	**27,061.8**	**100.0**	**34,004.9**	**100.0**	**44,300.0**	**100.0**	**39,235.8**	**100.0**
Uses										
Cash[2]	3.2	...	4.3	...	6.5	...	2.3	...	5.6	...
Reserve with BNM	1,408.0	6.0	1,546.2	5.7	2,643.3	7.8	3,466.4	7.8	852.8	2.2
Amount due from financial institutions	4,395.9	18.6	4,968.7	18.4	4,452.8	13.1	6,163.5	13.9	3,191.8	8.1
Domestic	*4, 395.3*	*18.6*	*4, 968.4*	*18.4*	*4, 413.1*	*13.0*	*5, 761.0*	*13.0*	*2, 807.7*	*7.2*
Foreign	*0.6*	...	*0.3*	...	*39.7*	*0.1*	*402.5*	*0.9*	*384.0*	*1.0*
Investments	468.1	2.0	579.9	2.1	741.7	2.2	970.6	2.2	2,861.5	7.3
(of which:										
Stocks and shares	*246.4*	*1.0*	*319.6*	*1.2*	*310.9*	*0.9*	*450.0*	*1.0*	*387.6*	*1.0*
Debentures	*152.9*	*0.6*	*188.3*	*0.7*	*337.4*	*1.0*	*319.7*	*0.7*	*2,244.6*	*5.7*
Fixed assets	*68.8*	*0.3*	*71.9*	*0.3*	*93.3*	*0.3*	*166.6*	*0.4*	*186.8*	*0.5*
Foreign investments)	-	-	*0.1*	...	*0.1*	...	*34.3*	*0.1*	*42.4*	*0.1*
Placement with discount houses	63.1	0.3	117.0	0.4	296.0	0.9	38.0	0.1	-	-
Marketable securities	5,120.5	21.7	5,132.9	19.0	6,500.1	19.1	9,467.5	21.4	8,673.4	22.1
(of which:										
Treasury bills	*119.3*	*0.5*	*78.2*	*0.3*	*40.7*	*0.1*	*57.4*	*0.1*	*131.4*	*0.3*
MGS	*362.7*	*1.5*	*316.6*	*1.2*	*633.3*	*1.9*	*592.9*	*1.3*	*907.4*	*2.3*
NIDs held	*3,101.9*	*13.2*	*2,894.8*	*10.7*	*3,502.5*	*10.3*	*5,078.4*	*11.5*	*4,844.4*	*12.3*
Cagamas bonds)	*1,109.5*	*4.7*	*1,211.8*	*4.5*	*1,834.8*	*5.4*	*1,520.3*	*3.4*	*1,260.2*	*3.2*
Loans[3] (incl. trade bills)	11,591.3	49.1	14,141.2	52.3	18,888.2	55.5	23,052.0	52.0	22,191.5	56.6
Other	534.5	2.3	571.6	2.1	476.3	1.4	1,139.7	2.6	1,459.2	3.7
Total	**23,584.6**	**100.0**	**27,061.8**	**100.0**	**34,004.9**	**100.0**	**44,300.0**	**100.0**	**39,235.8**	**100.0**

1 Includes NIDs issued and repos.
2 Includes balances with BNM.
3 Excludes housing loans sold to Cagamas Berhad.
* Includes current unaudited unadjusted profit (If excludes, the figure would be for the year 1997: RM 3,852.1 million; 1998: RM 3,910.6 million)

Table A.44
Merchant Banks: Commitments and Contingencies

	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	215	0.5	167	0.9
Credit extension commitments	19,869	47.8	7,089	36.6
Direct credit substitutes	9,711	23.3	3,157	16.3
Foreign exchange related contracts	3,813	9.2	1,673	8.6
Interest rate related contracts	4,966	11.9	4,957	25.6
Trade-related contingencies	2	...	2	...
Transaction-related contingencies	1,326	3.2	1,215	6.3
Underwriting obligations	1,219	2.9	635	3.3
Other	475	1.1	476	2.5
Total	**41,595**	**100.0**	**19,372**	**100.0**

Table A.45
Commercial Banks: Income and Expenditure

	For the financial year				For the calendar year	
	1994	1995	1996	1997	1997	1998
	RM million					
Interest income net of interest-in-suspense	15,242.3	17,161.7	23,503.0	29,154.1	33,555.2	43,290.9
(Interest-in-suspense)	*594.2*	*334.1*	*495.9*	*66.8*	*141.8*	*3,009.4*
Less: Interest expense	8,981.8	10,113.3	14,057.4	18,272.8	21,749.9	31,098.1
Net interest income	6,260.5	7,048.4	9,445.6	10,881.4	11,805.3	12,192.8
Add: Non-interest income	2,788.0	2,991.8	3,230.8	4,149.1	3,899.1	5,112.3
Less: Bad debt provisions	1,137.6	874.7	1,269.1	3,231.0	4,022.2	10,091.4
Staff cost	2,010.3	2,260.4	2,579.7	2,889.7	3,007.8	3,040.4
Overheads	1,997.9	2,064.1	2,658.0	2,730.9	2,957.1	3,642.4
Pre-tax profit	3,902.7	4,841.0	6,169.6	6,178.8	5,717.2	530.9

Table A.46
Finance Companies: Income and Expenditure

	For the financial year				For the calendar year	
	1994	1995	1996	1997	1997	1998
	RM million					
Interest income net of interest-in-suspense	5,664.7	6,748.9	9,377.1	12,006.5	13,158.8	13,142.8
(Interest-in-suspense)	*318.2*	*177.8*	*123.7*	*353.0*	*335.9*	*1,411.7*
Less: Interest expense	3,330.7	3,741.2	5,774.2	8,056.5	9,050.6	11,321.2
Net interest income	2,334.0	3,007.7	3,602.9	3,950.0	4,108.2	1,821.6
Add: Non-interest income	250.2	308.4	390.5	386.7	511.6	667.8
Less: Bad debt provisions	548.6	554.3	645.8	1,543.8	1,295.4	2,697.8
Staff cost	461.3	572.1	667.2	785.6	821.7	720.2
Overheads	611.2	741.9	843.0	1,380.6	1,228.5	1,221.0
Pre-tax profit	963.1	1,447.8	1,837.4	626.7	1,274.3	-2,149.6

Table A.47
Merchant Banks: Income and Expenditure

	For the financial year				For the calendar year	
	1994	1995	1996	1997	1997	1998
	RM million					
Interest income net of interest-in-suspense	1,238.0	1,361.4	1,967.8	2,566.3	3,410.8	3,891.1
(Interest-in-suspense)	*61.7*	*11.0*	*45.8*	*25.3*	*42.1*	*478.3*
Less: Interest expense	964.6	1,025.9	1,488.9	1,936.3	2,611.3	3,151.0
Net interest income	273.4	335.5	478.9	630.0	799.5	740.1
Add: Non-interest income	422.1	502.0	552.7	540.1	532.1	301.2
Less: Bad debt provisions	162.0	54.7	97.4	206.6	307.5	1,261.7
Staff cost	94.4	109.9	128.2	143.7	163.4	134.1
Overheads	100.3	92.9	99.4	205.0	197.5	286.7
Pre-tax profit	338.8	580.0	706.6	614.8	663.2	-641.2

Table A.48
Lending Guidelines

	1996 Lending Guidelines (compliance date 31 March 1998)		1998 Lending Guidelines[1] (as at end 1998)	
	Target (31.3.1998)	Achieved	Target[2] (31.3.2000)	Achieved
Loans to Bumiputera Community				
Total outstanding loans (RM billion)				
Commercial banks	53.0	76.6	71.1	82.6
Finance companies	19.4	36.1	24.5	32.2
Total outstanding loans (%)				
Commercial banks	30.0	43.4	30.0	35.3
Finance companies	30.0	55.8	30.0	39.6
Non-compliance (no. of institutions)				
Commercial banks		9		21
Finance companies		9		11
Housing Loan Commitments				
Total houses (units)				
Commercial banks	100,000	107,747	105,233	46,822
Finance companies	40,000	43,431	39,028	14,894
Non-compliance (no. of institutions)				
Commercial banks		4		35
Finance companies		5		32
New Principal Guarantee Scheme				
Total guarantee cover (RM million)				
Commercial banks	1,000.0	2,341.1	-	-
Finance companies	240.0	1,216.1		
Non-compliance (no. of institutions)				
Commercial banks		9		
Finance companies		8		
New Principal Guarantee Scheme (for Bumiputera community)				
Total guarantee cover (RM million)				
Commercial banks	500.0	585.6		
Finance companies	120.0	278.7		
Non-compliance (no. of institutions)				
Commercial banks		16	-	-
Finance companies		8		
Loans of RM500,000 and below to SMEs				
Total loans approved (RM million)				
Commercial banks			1,048.2	748.3
Finance companies	-	-	228.3	104.6
Non-compliance (no. of institutions)				
Commercial banks				27
Finance companies				30
Loans of RM500,000 and below to SMEs (for Bumiputera community)				
Total loans approved (RM million)				
Commercial banks			562.4	147.4
Finance companies	-	-	123.3	25.8
Non-compliance (no. of institutions)				
Commercial banks				36
Finance companies				32

[1] Under the 1998 Lending Guidelines
- Loans under.the New Principal Gurarantee Scheme was replaced by Loans of RM500,000 and below to the Small and Medium-Sized Enterprises (SMEs)
- Bank Islam Malaysia Berhad was included for the first time.

[2] The compliance date for Loans of RM500,000 and below to SMEs is 31 March 1999.

Table A.49
Commercial Banks: Direction of Lending

Loans by Sectors	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	5,917.6	2.0	6,178.4	2.1
Mining and quarrying	786.8	0.3	1,200.2	0.4
Manufacturing	54,952.0	19.0	56,531.5	18.9
Electricity,gas and water	3,943.8	1.4	5,082.6	1.7
Wholesale, retail, restaurants and hotels	29,478.0	10.2	30,262.8	10.1
Wholesale trade	*17,594.8*	*6.1*	*17,005.5*	*5.7*
Retail trade	*8,553.3*	*3.0*	*8,500.0*	*2.8*
Restaurants and hotels	*3,329.9*	*1.1*	*4,757.3*	*1.6*
Broad property sector	101,220.9	34.9	108,829.9	36.4
Construction	*29,156.8*	*10.1*	*30,662.6*	*10.2*
Purchase of residential property	*37,894.7*	*13.1*	*43,373.1*	*14.5*
Purchase of non-residential property	*21,789.0*	*7.5*	*23,054.5*	*7.7*
Real estate	*12,380.4*	*4.3*	*11,739.7*	*3.9*
Transport, storage and communication	8,616.8	3.0	11,419.8	3.8
Finance, insurance and business services	28,432.4	9.8	30,269.7	10.1
Financial services	*21,626.8*	*7.5*	*23,787.8*	*7.9*
Insurance	*58.4*	*...*	*172.3*	*0.1*
Business services	*6,747.2*	*2.3*	*6,309.6*	*2.1*
Consumption credit	18,039.4	6.2	17,144.4	5.7
Personal uses	*13,254.6*	*4.6*	*12,141.4*	*4.1*
Credit cards	*3,521.2*	*1.2*	*3,310.7*	*1.1*
Purchase of consumer durables	*1,016.6*	*0.4*	*528.4*	*0.2*
Purchase of passenger cars	*247.0*	*0.1*	*1,163.9*	*0.4*
Purchase of securities	24,186.1	8.3	19,431.7	6.5
Individual	*10,788.5*	*3.7*	*8,439.1*	*2.8*
Non-individual	*13,397.6*	*4.6*	*10,992.6*	*3.7*
Purchase of transport vehicles	45.8	...	206.7	0.1
Community, social and personal services	4,533.1	1.6	4,821.2	1.6
Others	9,604.0	3.3	7,878.9	2.6
Total Loans	**289,756.7**	**100.0**	**299,257.8**	**100.0**
Of which housing loans sold to Cagamas	13,471.4	4.6	13,491.4	4.5

Table A.50
Finance Companies: Direction of Lending

Loans by Sectors	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	1,315.7	1.2	927.7	1.0
Mining and quarrying	461.5	0.4	327.0	0.4
Manufacturing	5,557.0	5.1	4,026.7	4.4
Electricity,gas and water	95.5	0.1	71.4	0.1
Wholesale, retail, restaurants and hotels	4,020.9	3.7	3,603.6	3.9
Wholesale trade	*1,665.5*	*1.5*	*1,272.7*	*1.4*
Retail trade	*1,753.7*	*1.6*	*1,498.9*	*1.6*
Restaurants and hotels	*601.7*	*0.6*	*832.0*	*0.9*
Broad property sector	31,169.3	28.8	30,191.8	32.8
Construction	*8,448.3*	*7.8*	*7,622.0*	*8.3*
Purchase of residential property	*12,879.8*	*11.9*	*12,908.1*	*14.0*
Purchase of non-residential property	*6,121.5*	*5.6*	*6,423.6*	*7.0*
Real estate	*3,719.7*	*3.4*	*3,238.1*	*3.5*
Transport, storage and communication	3,377.0	3.1	2,480.2	2.7
Finance, insurance and business services	3,907.8	3.6	3,034.6	3.3
Financial services	*1,864.1*	*1.7*	*1,496.3*	*1.6*
Insurance	*27.4*	*...*	*16.8*	*...*
Business services	*2,016.3*	*1.9*	*1,521.5*	*1.7*
Consumption credit	39,660.2	36.6	32,149.7	34.9
Personal uses	*1,542.9*	*1.4*	*1,188.6*	*1.3*
Credit cards	*1,065.2*	*1.0*	*1,002.3*	*1.1*
Purchase of consumer durables	*700.1*	*0.6*	*298.3*	*0.3*
Purchase of passenger cars	*36,352.0*	*33.5*	*29,660.5*	*32.2*
Purchase of securities	10,418.4	9.6	9,071.9	9.8
Individual	*7, 044.7*	*6.5*	*6, 034.3*	*6.5*
Non-individual	*3, 373.7*	*3.1*	*3, 037.6*	*3.3*
Purchase of transport vehicles	5,626.5	5.2	4,282.0	4.6
Community, social and personal services	1,837.7	1.7	1,356.7	1.5
Others	921.7	0.9	658.8	0.7
Total Loans	**108,389.2**	**100.0**	**92,182.1**	**100.0**
Of which housing loans sold to Cagamas	5,861.1	5.4	5,628.2	6.1

Table A.51
Merchant Banks: Direction of Lending

Loans by Sectors	As at end			
	1997		1998	
	RM million	% share	RM million	% share
Agriculture, hunting, forestry and fishing	404.4	1.8	611.7	2.8
Mining and quarrying	100.2	0.4	146.3	0.7
Manufacturing	2,781.5	12.1	2,642.2	11.9
Electricity, gas and water	421.7	1.8	725.2	3.3
Wholesale, retail, restaurants and hotels	1,441.7	6.3	1,244.9	5.6
Wholesale trade	*666.5*	*2.9*	*446.7*	*2.0*
Retail trade	*224.3*	*1.0*	*241.1*	*1.1*
Restaurants and hotels	*550.9*	*2.4*	*557.1*	*2.5*
Broad property sector	7,532.0	32.7	7,126.6	32.1
Construction	*5,010.8*	*21.7*	*4,913.7*	*22.1*
Purchase of residential property	*69.3*	*0.3*	*105.5*	*0.5*
Purchase of non-residential property	*529.6*	*2.3*	*488.9*	*2.2*
Real estate	*1,922.3*	*8.3*	*1,618.5*	*7.3*
Transport, storage and communication	1,046.7	4.5	1,083.2	4.9
Finance, insurance and business services	3,869.2	16.8	3,812.4	17.2
Financial services	*3,126.3*	*13.6*	*3,090.9*	*13.9*
Insurance	*45.8*	*0.2*	*59.9*	*0.3*
Business services	*697.1*	*3.0*	*661.6*	*3.0*
Consumption credit	136.3	0.6	124.3	0.6
Personal uses	*127.3*	*0.6*	*116.9*	*0.5*
Purchase of consumer durables	*0.2*	*...*	*0.2*	*...*
Purchase of passenger cars	*8.8*	*...*	*7.2*	*...*
Purchase of securities	4,346.8	18.9	3,956.3	17.8
Individual	*601.2*	*2.6*	*429.7*	*1.9*
Non-individual	*3,745.6*	*16.2*	*3,526.6*	*15.9*
Purchase of transport vehicles	15.0	0.1	16.1	0.1
Community, social and personal services	501.1	2.2	493.5	2.2
Others	460.0	2.0	215.6	1.0
Total Loans	**23,056.6**	**100.0**	**22,198.3**	**100.0**
Of which housing loans sold to Cagamas	4.5	...	6.8	...

Table A.52
Commercial Banks: Non-performing Loans by Sector

	As at end			
	1997		1998	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture, hunting, forestry and fishing	247	4.2	568	9.2
Mining and quarrying	81	10.3	166	13.8
Manufacturing	2,734	5.0	7,223	12.8
Electricity, gas and water supply	24	0.6	39	0.8
Community, social and personal services	461	10.2	543	11.3
Broad property sector	4,823	4.8	13,212	12.1
Real estate	*934*	*7.5*	*2,593*	*22.1*
Construction	*1,350*	*4.6*	*5,221*	*17.0*
Purchase of residential property	*1,632*	*6.7*	*3,000*	*10.0*
Purchase of non-residential property	*907*	*4.2*	*2,398*	*10.4*
Wholesale and retail, restaurants and hotels	1,339	4.5	3,145	10.4
Transport, storage and communication	242	2.8	1,521	13.3
Finance, insurance and business services	887	3.1	3,132	10.3
Purchase of securities	1,411	5.8	4,130	21.3
Consumption credit	1,160	6.4	2,580	14.9
Credit card	*345*	*9.8*	*554*	*16.7*
Personal use	*715*	*5.4*	*1,765*	*14.5*
Purchase of consumer durables	*85*	*8.3*	*72*	*13.6*
Purchase of transport vehicles[1]	*15*	*5.1*	*189*	*13.8*
Others	750	7.8	1,020	12.9
Total	**14,159**	**4.9**	**37,279**	**12.5**

[1] Includes commercial vehicles.

Table A.53
Finance Companies: Non-performing Loans by Sector

	As at end			
	1997		1998	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture, hunting, forestry and fishing	129	9.8	172	18.5
Mining and quarrying	38	8.3	57	17.5
Manufacturing	773	13.9	1,242	30.8
Electricity, gas and water supply	4	4.5	13	18.0
Community, social and personal services	90	4.9	233	17.2
Broad property sector	3,676	11.8	6,161	20.4
Real estate	*1,128*	*30.3*	*1,904*	*58.8*
Construction	*881*	*10.4*	*1,722*	*22.6*
Purchase of residential property	*914*	*13.0*	*1,099*	*15.1*
Purchase of non-residential property	*754*	*12.3*	*1,435*	*22.3*
Wholesale and retail, restaurants and hotels	152	3.8	621	17.2
Transport, storage and communication	375	11.1	996	40.2
Finance, insurance and business services	400	10.2	989	32.6
Purchase of securities	865	8.3	2,419	26.7
Consumption credit	3,244	7.2	4,927	13.5
Credit card	*117*	*11.0*	*196*	*19.6*
Personal use	*187*	*12.1*	*237*	*19.9*
Purchase of consumer durables	*144*	*20.6*	*78*	*26.2*
Purchase of transport vehicles[1]	*2,796*	*6.7*	*4,416*	*13.0*
Others	51	5.6	71	10.7
Total	**9,797**	**9.0**	**17,901**	**19.4**

[1] Includes commercial vehicles.

Table A.54
Merchant Banks: Non-performing Loans by Sector

	As at end			
	1997		1998	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture, hunting, forestry and fishing	111	27.5	77	12.7
Mining and quarrying	30	30.2	36	24.5
Manufacturing	161	5.8	555	21.0
Electricity, gas and water supply	0	0.0	0	0.0
Community, social and personal services	17	3.4	106	21.5
Broad property sector	268	3.6	1,415	19.8
Real estate	*47*	*2.4*	*297*	*18.4*
Construction	*220*	*4.4*	*1,071*	*21.8*
Purchase of residential property	*1*	*1.2*	*0*	*0.5*
Purchase of non-residential property	-	...	*46*	*9.4*
Wholesale and retail, restaurants and hotels	61	4.2	153	12.3
Transport, storage and communication	58	5.5	204	18.8
Finance, insurance and business services	94	2.4	471	12.3
Purchase of securities	260	6.0	974	24.6
Consumption credit	9	6.2	78	55.2
Credit card	-	...	-	...
Personal use	-	...	*73*	*62.4*
Purchase of consumer durables	-	...	-	...
Purchase of transport vehicles[1]	*9*	*39.1*	*5*	*19.6*
Others	27	5.6	14	6.5
Total	**1,096**	**4.8**	**4,083**	**18.4**

[1] Includes commercial vehicles.

Table A.55
Commercial Banks: Loans Sold to Danaharta

	As at end 1998		
	Non-Performing Loans	Performing Loans	Total Loans
	RM million		
Agriculture, hunting, forestry and fishing	8.9	-	8.9
Mining and quarrying	11.7	-	11.7
Manufacturing	1,720.3	115.1	1,835.4
Electricity, gas and water supply	14.0	-	14.0
Wholesale, retail, restaurants and hotels	517.5	56.1	573.6
Wholesale trade	*321.5*	*28.1*	*349.6*
Retail trade	*132.8*	*28.0*	*160.8*
Restaurants and hotels	*63.2*	-	*63.2*
Broad property sector	2,126.8	158.9	2,285.7
Construction	*1,355.2*	*77.4*	*1,432.6*
Purchase of residential property	*11.7*	*57.8*	*69.5*
Purchase of non-residential property	*585.8*	*10.4*	*596.2*
Real estate	*174.1*	*13.3*	*187.4*
Transport, storage and communication	225.7	2.0	227.7
Finance, insurance and business services	608.4	198.0	806.4
Financial services	*213.4*	-	*213.4*
Insurance	-	-	-
Business services	*395.0*	*198.0*	*593.0*
Consumption credit	33.8	28.5	62.3
Personal uses	*20.7*	*28.5*	*49.2*
Credit cards	-	-	-
Purchase of consumer durables	*13.1*	-	*13.1*
Purchase of passenger cars	-	-	-
Purchase of securities	5,236.3	6.0	5,242.3
Purchase of transport vehicles	-	-	-
Community, social and personal services	10.3	4.6	14.9
Others	60.0	4.5	64.5
Total	**10,573.7**	**573.7**	**11,147.4**

Table A.56
Finance Companies: Loans Sold to Danaharta

	As at end 1998		
	Non-Performing Loans	Performing Loans	Total Loans
	RM million		
Agriculture, hunting, forestry and fishing	-	-	-
Mining and quarrying	-	-	-
Manufacturing	13.0	13.0	26.0
Electricity, gas and water supply	-	-	-
Wholesale, retail, restaurants and hotels	6.0	-	6.0
Wholesale trade	-	-	-
Retail trade	-	-	-
Restaurants and hotels	*6.0*	-	*6.0*
Broad property sector	609.7	113.9	723.6
Construction	*330.6*	*95.4*	*426.0*
Purchase of residential property	-	-	-
Purchase of non-residential property	*104.9*	*18.5*	*123.4*
Real estate	*174.2*	-	*174.2*
Transport, storage and communication	-	-	-
Finance, insurance and business services	19.2	-	19.2
Financial services	-	-	-
Insurance	-	-	-
Business services	*19.2*	-	*19.2*
Consumption credit	10.8	-	10.8
Personal uses	*10.8*	-	*10.8*
Credit cards	-	-	-
Purchase of consumer durables	-	-	-
Purchase of passenger cars	-	-	-
Purchase of securities	104.4	-	104.4
Purchase of transport vehicles	-	-	-
Community, social and personal services	-	-	-
Others	-	-	-
Total	**763.1**	**126.9**	**890.0**

Table A.57
Merchant Banks: Loans Sold to Danaharta

	As at end 1998		
	Non-Performing Loans	Performing Loans	Total Loans
	RM million		
Agriculture, hunting, forestry and fishing	89.5	-	89.5
Mining and quarrying	-	-	-
Manufacturing	30.4	37.1	67.5
Electricity, gas and water supply	-	-	-
Wholesale, retail, restaurants and hotels	69.0	-	69.0
Wholesale trade	-	-	-
Retail trade	*32.1*	-	*32.1*
Restaurants and hotels	*36.9*	-	*36.9*
Broad property sector	473.9	78.8	552.7
Construction	*107.4*	*17.1*	*124.5*
Purchase of residential property	-	-	-
Purchase of non-residential property	*259.9*	*11.9*	*271.8*
Real estate	*106.6*	*49.8*	*156.4*
Transport, storage and communication	-	-	-
Finance, insurance and business services	81.5	-	81.5
Financial services	*81.5*	-	*81.5*
Insurance	-	-	-
Business services	-	-	-
Consumption credit	-	-	-
Personal uses	-	-	-
Credit cards	-	-	-
Purchase of consumer durables	-	-	-
Purchase of passenger cars	-	-	-
Purchase of securities	129.0	12.6	141.6
Purchase of transport vehicles	-	-	-
Community, social and personal services	-	-	-
Others	-	-	-
Total	**873.3**	**128.5**	**1,001.8**

Table A.58
Banking System: Selected Indicators

	Commercial banks		Finance companies		Merchant banks		Banking system	
	As at calendar year end							
	Dec. 1997	Dec. 1998	Dec. 1997	Dec. 1998	Dec. 1997	Dec. 1998	Dec. 1997	Dec. 1998
Pre-tax profit/Average assets (%)	1.4	0.1	0.9	-1.6	1.7	-1.5	1.3	-0.3
Pre-tax profit/Average shareholders' funds (%)	17.8	1.4	15.7	-25.1	18.9	-15.6	17.5	-4.5
Pre-tax profit per employee (RM'000)	77.6	7.5	45.6	-92.8	236.7	-253.9	73.3	-23.3
Cost[1] incurred per ringgit of revenue earned[2] (sen)	38.0	38.6	44.4	78.0	27.1	40.4	38.7	43.4
Cost[1] incurred per ringgit of net interest income[2] (sen)	50.5	54.8	49.9	106.6	45.1	56.9	50.1	61.3
Overheads to staff cost ratio (%)	98.3	119.8	149.5	169.5	120.9	213.8	109.8	132.2
Staff cost per employee (RM'000)	40.8	42.7	29.4	31.1	58.3	53.1	38.2	40.2
Loan[3] deposit[4] ratio (%)	91.9	93.0	95.5	87.8	87.4	84.3	92.5	91.2
Loan[3] per branch (RM million)	165.3	169.1	89.6	78.8	960.5	1,008.7	141.6	140.3
Deposit per branch (RM million)	147.1	150.9	70.6	75.4	662.6	764.1	120.6	126.2

[1] Excluding bad debt provisions.
[2] Including interest-in-suspense.
[3] Excluding housing loans sold to Cagamas Berhad.
[4] Including NIDs and repos.

Table A.59
Banking System: Key Data

	As at end				
	1994	1995	1996	1997	1998
Number of					
- Commercial banks	37	37	37	35	35
- Finance companies	40	40	40	39	33
- Merchant banks	12	12	12	12	12
Risk-weighted capital ratio (%)					
- Commercial banks	11.3	11.1	10.8	10.3	11.7
- Finance companies	10.1	9.7	9.8	10.3	11.1
- Merchant banks	8.2	11.9	11.7	13.3	15.2
Branch network					
- Commercial banks	1,283	1,433	1,569	1,671	1,690
- Finance companies	860	988	1,096	1,144	1,099
- Merchant banks	17	17	24	24	22
ATM network					
- Commercial banks	1,975	2,230	2,326	2,528	2,647
- Finance companies	345	402	525	622	662
Persons served per office					
- Commercial banks	15,191	14,024	13,492	12,966	13,124
- Finance companies	22,849	20,341	19,314	18,939	20,182
Number of employees					
- Commercial banks	59,674	64,461	68,068	73,709	71,124
- Finance companies	22,488	24,593	26,322	27,937	23,153
- Merchant banks	2,179	2,334	2,592	2,802	2,525

Table A.60
Industrial Finance Institutions[1]: Sources and Uses of Funds

	1994	1995	1996	1997	1998
	RM million				
Sources:					
Shareholders' equity	1,328.34	1,598.38	2,252.10	2,804.64	2,757.01
Issued & paid-up capital	*747.91*	*803.89*	*1,272.99*	*1,613.55*	*1,813.54*
Reserves	*507.86*	*694.51*	*882.80*	*990.59*	*1,136.82*
Current profits	*72.57*	*99.98*	*96.31*	*200.50*	*-193.35*
Borrowings	3,972.43	4,719.42	5,302.40	6,655.41	10,463.79
Government	*1,554.72*	*1,799.13*	*2,078.20*	*2,567.40*	*3,579.83*
Other	*2,417.71*	*2,920.29*	*3,224.20*	*4,088.01*	*6,883.96*
Other	765.62	859.45	1,067.18	1,084.90	1,862.22
Total	**6,066.39**	**7,177.25**	**8,621.68**	**10,544.95**	**15,083.02**
Uses :					
Deposits	1,408.13	1,459.73	1,210.61	1,117.10	2,974.47
Investments	689.35	1,033.18	1,435.74	1,755.18	2,167.55
Quoted	*67.09*	*70.90*	*59.30*	*67.67*	*52.56*
Unquoted	*622.26*	*962.28*	*1,376.44*	*1,687.51*	*2,114.99*
Loans	3,053.86	3,887.45	4,989.65	6,091.82	7,656.24
Fixed assets	202.10	213.16	269.67	417.20	429.98
Other	712.95	583.73	716.01	1,163.65	1,854.78
Total	**6,066.39**	**7,177.25**	**8,621.68**	**10,544.95**	**15,083.02**

[1] Consist of Sabah Development Bank Berhad, Malaysian Industrial Development Finance Berhad, Malaysian Industrial Estates Berhad, Bank Pembangunan Malaysia Berhad, Bank Industri Malaysia Berhad, Export-Import Bank of Malaysia Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad and Borneo Development Corporation (Sarawak) Sendirian Berhad.

Table A.61
Industrial Finance Institutions[1]: Direction of Lending

	1994	1995	1996	1997	1998
	RM million				
Manufacturing	1,569.07	1,756.57	1,872.08	2,086.37	3,420.59
Agriculture	157.18	94.50	112.27	135.02	102.69
Property	577.99	895.75	1,579.22	2,148.02	2,209.84
Real estate	*326.52*	*491.05*	*755.16*	*1,060.92*	*1,080.83*
Construction	*208.73*	*362.49*	*783.41*	*1,046.85*	*1,090.79*
Housing	*42.74*	*42.21*	*40.65*	*40.25*	*38.22*
General commerce	97.51	161.04	265.74	284.73	313.80
Transport and storage	242.78	241.41	241.52	215.57	341.33
Other	409.33	738.18	918.82	1,222.11	1,267.99
Total	**3,053.86**	**3,887.45**	**4,989.65**	**6,091.82**	**7,656.24**

[1] Consist of Sabah Development Bank Berhad, Malaysian Industrial Development Finance Berhad, Malaysian Industrial Estates Berhad, Bank Pembangunan Malaysia Berhad, Bank Industri Malaysia Berhad, Export-Import Bank of Malaysia Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad and Borneo Development Corporation (Sarawak) Sendirian Berhad.

Table A.62
Malaysia Export Credit Insurance Berhad (MECIB)

Year of Establishment	1978					
Objectives	Promoting 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. Since the end of 1995, MECIB has also diversified into domestic credit insurance business to provide cover to local SMIs for their domestic sales.					
	1996	1997	1998	1996	1997	1998
	Business Coverage (RM million)			**Income (RM '000)**		
I. Export Coverage						
Short-term Policies						
Comprehensive policies (export declared)	372.0	383.0	484.0	1,495.2	1,879.1	2,299.4
Banker's comprehensive policies (export declared)	2.2	4.7	0.2	57.9	96.9	4.8
Bankers' Export Finance Insurance Policy (guaranteed value)	44.1	50.4	106.8	508.1	647.4	1,022.3
Confirming bank policy (letter of credit value)	57.0	19.2	83.6	4,031.0	548.1	101.5
Sub-total	475.3	457.3	674.6	6,092.2	3,171.5	3,428.0
Medium and Long-term Policies						
Buyer credit guarantee (amount guaranteed)	161.1	368.7	375.5	3,280.4	11,306.9	1,603.3
Supplier credit guarantee (amount guaranteed)	56.6	47.5	38.3	244.5	-	171.8
Bond indemnity support (face value insured)	-	2.9	2.4	-	47.9	10.8
Sub-total	217.7	419.1	416.2	3,524.9	11,354.8	1,785.9
Total Export Insurance Coverage	**693.0**	**876.4**	**1,090.8**	**9,617.1**	**14,526.3**	**5,213.9**
II. Domestic Sales Coverage						
Domestic credit insurance (sales declared)	12.0	53.0	118.4	73.3	268.0	621.0
Specific policies (amount covered)	15.0	27.0	-	151.9	84.9	41.4
Domestic bonds (face value insured)	-	1.4	-	-	20.1	-
Specific bonds (face value insured)	-	-	0.5	-	-	6.8
Comprehensive services rendered policies (amount covered)	-	-	10.0	-	-	2.9
Total Domestic Insurance Coverage	**27.0**	**81.4**	**128.9**	**225.2**	**373.0**	**672.1**
Total Insurance Coverage	**720.0**	**957.8**	**1,219.7**	**9,842.3**	**14,899.3**	**5,886.0**
Total Income	**-**	**-**	**-**	**20,600.0**	**25,546.0**	**16,031.0**

Source: MECIB

Table A.63
Housing Credit Institutions

	Year of establishment	Objective	Average lending for housing loans (%)		No. of branches	
			1997	1998	1997	1998
Commercial banks	-		9.0~14.35	9.0~14.77	1,671	1,690
Finance companies	-		9.0~16.30	9.0~17.2	1,151	1,099
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	9.3	10.4	20	20
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	10.0~10.75	11.0~13.0	2	2
Sabah Credit Corporation	1955	To improve the social economic development of Sabah through loans mainly to the property, agriculture and business sectors	9.0~10.5	8.0~11.0	10	11
Bank Rakyat	1954	A co-operative society which collects deposits and provides conventional banking facilities as well as according to Syariah principles	9.75~10.15	10.75~11.00	70	74
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from the small savers and to inculcate the habit of thrift and savings	10.0	9.56	468	448*p*

p Preliminary

Table A.64
Sources of Housing Credit

	As at end of		Annual change		Share	
	1997	1998*p*	1997	1998*p*	1997	1998*p*
	RM million		%		%	
Commercial banks	24,423.3	29,881.7	27.0	22.4	49	53
Finance companies	7,018.7	7,279.9	-7.4	3.7	14	13
Treasury Housing Loans Division	15,157.7	15,794.2	3.7	4.2	30	28
Malaysia Building Society Berhad	1,586.3	1,436.2	-5.3	-9.5	3	2
Borneo Housing Mortgage Finance Berhad	480.3	532.7	1.8	10.9	1	1
Sabah Credit Corporation	265.4	273.2	10.3	2.9	...	...
Bank Rakyat	464.8	556.2	34.6	19.7	1	1
Bank Simpanan Nasional	759.7	1,010.5	48.6	33.0	2	2
Total	**50,156.2**	**56,764.6**	**14.4**	**13.2**	**100**	**100**

p Preliminary
... Negligible

Table A.65
Approved Housing Loans

	1997	1998*p*	1997	1998*p*	1997	1998*p*
	RM million		Annual change (%)		% share	
Commercial banks	17,338.8	8,007.1	38.9	-53.8	77	70
Finance companies	3,054.1	1,274.2	1.2	-58.3	14	11
Treasury Housing Loans Division	1,189.8	1,673.5	20.2	40.7	5	15
Malaysia Building Society Berhad	159.9	70.6	28.7	-55.8	1	1
Borneo Housing Mortgage Finance Berhad	48.1	121.2	10.6	152.0	...	1
Sabah Credit Corporation	43.2	16.6	28.2	-61.6	...	...
Bank Rakyat	169.7	48.4	18.3	-71.5	1	...
Bank Simpanan Nasional	402.5	176.9	17.1	56.0	2	2
Total	**22,406.1**	**11,388.5**	**29.7**	**-49.2**	**100**	**100**

p Preliminary
... Negligible

Table A.66
Agriculture Credit Institutions

	Annual change				As at end 1998	
	1997		1998			
	RM million	%	RM million	%	RM million	% share
Credit for Agriculture						
Banking System	1,753.0	29.8	80.1	1.0	7,717.8	60.6
Commercial Banks	*1,493.0*	*33.7*	*260.8*	*4.4*	*6,178.4*	*48.5*
Finance Companies	*288.9*	*28.1*	*-388.0*	*-29.5*	*927.7*	*7.3*
Merchant Banks	*-28.9*	*-6.7*	*207.3*	*51.3*	*611.7*	*4.8*
Development Agencies	-726.6	-18.3	-285.6	-8.8	2,968.3	23.3
FELDA	*-752.4*	*-19.4*	*-236.0*	*-7.6*	*2,888.4*	*22.7*
Sabah Development Bank	*25.8*	*24.8*	*-49.6*	*-38.3*	*79.9*	*0.6*
Rural Credit Institutions	6.0	0.3	-82.0	-3.8	2,048.3	16.1
Bank Pertanian Malaysia	*12.1*	*0.6*	*-97.3*	*-4.8*	*1,909.3*	*15.0*
Bank Rakyat	*-3.5*	*-7.7*	*4.4*	*10.8*	*45.6*	*0.4*
Farmers' organisations, farmers' co-operatives and agro-based co-operative societies and others	*-2.6*	*-3.1*	*10.9*	*13.2*	*93.4*	*0.7*
Total	**1,032.4**	**8.6**	**-287.5**	**-2.2**	**12,734.4**	**100.0**
Total resources of the Rural Credit Institutions						
Bank Pertanian Malaysia	167.8	3.6	76.0	1.6	4,915.2	42.4
Bank Rakyat	480.0	9.3	460.9	8.2	6,075.8	52.4
Farmers' organisations, farmers' co-operatives and agro-based co-operative societies and others	-145.3	-19.9	23.8	4.1	608.1	5.2
Total	**502.5**	**4.8**	**560.7**	**5.1**	**11,599.1**	**100.0**

Interest Rates	1997	1998
Bank Pertanian Malaysia		
Commercial loans for agricultural purposes	0% to 4% + prevailing BLR (10.8% at end-December)	0% to 4% + prevailing BLR (10.0 % at end-December)
Fixed deposits	9.55% - 9.85%	6.50%
Savings deposits	4.50%	4.50%
Bank Rakyat		
Commercial loans for agricultural purposes	13.00% minimum	12.50% minimum
Fixed deposits	10.00% - 10.09%	6.84% - 7.03%
Savings deposits	4.00%	4.00%
Branches and Membership		
Bank Pertanian Malaysia	142 branches	143 branches
Bank Rakyat	70 branches with 114,734 members	74 branches with 167,238 members
Farmers' organisations	282 with 638,487 members	282 with 650,170 members
Agro-based co-operatives societies	636 with 100,071 members	630 with 67,930 members

Source: Various agencies

Table A.67
Urban Credit Co-operative Societies[1]

	Annual change 1997	Annual change 1998	As at end 1998	Annual change (%)	% share
	Number				
Total co-operative societies	30	21	913	2.4	100.0
Deposit-taking co-operatives	*1*	*-6* [2]	*11*	*-35.3*	*1.2*
Other credit co-operatives	*29*	*27*	*902*	*3.1*	*98.8*
	('000)				
Total members	78.9	-563	1,220	-31.6	100.0
Deposit-taking co-operatives	*7.0*	*-28*	*123*	*-18.6*	*10.1*
Other credit co-operatives	*71.9*	*-535*	*1,097*	*-32.8*	*89.9*
	RM million			Annual change (%)	% share
Sources of funds					
Share subscriptions	104.6	-513.9	1,645.2	-23.8	44.9
Reserves	141.5	-1,124.8	706.2	-61.4	19.3
Borrowings	-34.2	61.6	821.0	8.1	22.4
Sundry creditors	26.4	-397.6	155.4	-71.9	4.2
Savings and deposits	24.9	79.7	312.4	34.3	8.5
Surplus	5.0	-81.9	23.9	-77.4	0.7
Total	**268.2**	**-1,976.9**	**3,664.1**	**-35.0**	**100.0**
Uses of funds					
Investments	118.0	-1,149.8	1,415.7	-44.8	38.6
Shares	*66.4*	*-728.6*	*1,068.4*	*-40.5*	*29.1*
Fixed and savings deposits	*33.4*	*-136.5*	*267.5*	*-33.8*	*7.3*
Real estates	*14.1*	*-296.3*	-	-	-
Other	*4.1*	*11.6*	*79.8*	*17.0*	*2.2*
Loans to members	87.2	-476.9	1,328.5[3]	-26.4	36.2
Fixed assets	50.5	-173.3	415.9	-29.4	11.4
Other assets	12.5	-310.2	144.9	-68.2	4.0
Cash and bank balances	-3.2	-75.8	102.9	-42.4	2.8
Other	3.2	209.1	256.2	444.0	7.0

[1] Urban credit co-operative societies which comprise 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] There were six deposit-taking co-operatives dissolved in 1998.
[3] Refers to total loans outstanding.

Source: Department of Co-operative Development Malaysia

As at the end of 1998, 282 leasing companies and 34 factoring companies had registered with Bank Negara Malaysia. However, only 136 leasing companies and 23 factoring companies submitted statistics pertaining to their operations to the Bank. Total assets of the 136 leasing companies and 23 factoring companies amounted to RM18.5 billion and RM2 billion respectively at the end of 1998. Nevertheless, of the 136 leasing companies, only 45 were pure leasing companies, while of the 23 factoring companies, only 13 were pure factoring companies. The remaining companies only undertook leasing and factoring business as part of their overall business activities.

Table A.68
Leasing Companies[1]: Sources and Uses of Funds

	As at end				
	1994	1995	1996	1997	1998
	RM million				
Sources					
Capital and reserves	439	430	569	802	677
Borrowings from financial institutions	2,034	2,779	3,449	4,061	3,071
Inter-company borrowings	621	841	2,102	1,739	1,416
Other	1,586	2,039	2,294	2,767	2,364
Total	**4,680**	**6,089**	**8,414**	**9,369**	**7,528**
Uses					
Cash and bank balances	18	20	48	144	266
Investments	126	161	351	484	341
Receivables	3,876	4,851	5,544	5,261	3,820
Leasing	*2,743*	*3,013*	*3,150*	*3,067*	*2,101*
Factoring	*133*	*187*	*171*	*90*	*11*
Hire purchase	*965*	*1,536*	*2,016*	*1,843*	*1,431*
Other	*35*	*115*	*207*	*261*	*277*
Other	660	1,057	2,471	3,480	3,101

[1] Statistics shown are for pure leasing companies only.

Table A.69
Leasing Companies[1]: Income and Expenditure

	During the period				
	1994	1995	1996	1997	1998
	RM million				
Income					
Income from	327	477	611	615	491
Leasing	*240*	*323*	*380*	*393*	*316*
Factoring	*9*	*16*	*20*	*12*	*5*
Hire purchase	*77*	*136*	*208*	*200*	*169*
Other	*1*	*2*	*3*	*10*	*1*
Other	82	120	233	470	418
Total	**409**	**597**	**844**	**1,085**	**909**
Expenditure					
Interest paid	189	273	434	586	620
Financial institutions	*159*	*240*	*388*	*529*	*566*
Block discounting	*30*	*33*	*46*	*57*	*54*
Bad debts written off and provision	35	29	35	100	705
Other	79	145	192	218	283
Total	**303**	**447**	**661**	**904**	**1,608**
Pre-tax Profit	**106**	**150**	**183**	**181**	**-699**

[1] Statistics shown are for pure leasing companies only.

Table A.70
Leasing Companies[1]: Financing by Sector

	During the period				
	1994	1995	1996	1997	1998
	RM million				
Sector					
Agriculture	61	66	48	50	12
Mining and quarrying	28	37	69	54	4
Manufacturing	549	457	449	406	96
Electricity	2	3	2	3	2
General commerce	152	155	181	164	43
Property sector	197	214	206	195	17
Construction	*172*	*191*	*190*	*184*	*15*
Real estate	*22*	*22*	*15*	*9*	*2*
Residential property	*3*	*1*	*1*	*2*	*...*
Transport	131	184	215	167	74
Business, insurance and other services	214	211	274	216	62
Consumption credit	3	-	...	1	1
Other	91	183	114	128	36
Total	**1,428**	**1,510**	**1,558**	**1,384**	**347**

[1] Statistics shown are for pure leasing companies only.

Table A.71
Factoring Companies[1]: Sources and Uses of Funds

	As at end				
	1994	1995	1996	1997	1998
	RM million				
Sources					
Capital and reserves	94	70	92	101	85
Borrowings from financial institutions	403	384	437	596	345
Inter-company borrowings	211	227	354	349	245
Other	315	445	528	675	470
Total	**1,023**	**1,126**	**1,411**	**1,721**	**1,145**
Uses					
Cash and bank balances	14	12	30	19	31
Investments	19	4	7	10	8
Receivables	925	1,066	1,275	1,664	1,053
Leasing	*1*	*1*	*...*	*...*	*...*
Factoring	*714*	*1,006*	*1,186*	*1,459*	*824*
Hire purchase	*178*	*1*	*7*	*19*	*28*
Other	*32*	*58*	*82*	*186*	*201*
Other	65	44	99	28	53

[1] Statistics shown are for pure factoring companies only.

Table A.72
Factoring Companies[1]: Income and Expenditure

	During the period				
	1994	1995	1996	1997	1998
	RM million				
Income					
Income from	70	82	110	150	105
Leasing	*...*	*-*	*-*	*-*	*-*
Factoring	*63*	*73*	*98*	*129*	*76*
Hire purchase	*...*	*...*	*...*	*1*	*4*
Other	*7*	*9*	*12*	*20*	*25*
Other	14	16	30	39	37
Total	**84**	**98**	**140**	**189**	**142**
Expenditure					
Interest paid	29	34	58	74	88
Financial institutions	*29*	*34*	*58*	*74*	*88*
Block discounting creditors	*...*	*-*	*-*	*-*	*-*
Bad debts written off and provision	6	8	11	15	86
Other	21	24	30	34	26
Total	**56**	**66**	**99**	**123**	**200**
Pre-tax Profit	**28**	**32**	**41**	**66**	**-58**

[1] Statistics shown are for pure factoring companies only.

Table A.73
Factoring Companies[1]: Financing by Sector

	During the period				
	1994	1995	1996	1997	1998
	RM million				
Sector					
Agriculture	2	1	1	1	1
Mining and quarrying	5	3	2	3	-
Manufacturing	116	139	183	171	69
Electricity	...	1	5	6	2
General commerce	170	216	198	259	149
Property sector	162	259	308	374	231
Construction	*152*	*251*	*298*	*363*	*218*
Real estate	*7*	*-*	*10*	*11*	*13*
Residential property	*3*	*8*	*-*	*-*	*-*
Transport	9	14	14	16	10
Business, insurance and other services	34	86	60	161	62
Consumption credit	28	31	32	33	30
Other	21	132	57	67	27
Total	**547**	**882**	**860**	**1,091**	**581**

' Statistics shown are for pure factoring companies only.

Table A.74
Venture Capital Companies

Objective	To provide risk capital for new ventures, either for totally new enterprises or expansion by existing enterprises into new investment areas.

	As at end	
	1997	1998
No. of venture capital companies	22	23
No. of investee companies	259	246
	RM million	
Total funds mobilised	1,124.4	1,000.3
Cumulative investments made	904.9	952.1
Sources		
Shareholders' funds	481.3	557.2
Liabilities	756.6	773.4
Total	**1,237.9**	**1,330.6**
Uses		
Investment in investee companies [1]	754.5	853.4
Other assets	483.4	477.2
Total	**1,237.9**	**1,330.6**
	During the year	
No. of investee companies	92	65
	RM million	
Profit before tax of venture capital companies	-59.8	-39.0
Investment during the year by venture capital companies	**200.8**	**152.5**
By sector		
Manufacturing	*139.4*	*99.3*
Other	*61.4*	*53.2*
By type		
Seed capital [2]	-	-
Start-ups [3]	*81.2*	*32.2*
Second-stage [4]	*4.0*	*21.4*
Acquisitionlbuy-out [5]	*67.7*	*43.4*
Bridge financing [6]	*17.5*	*5.3*
Other	*30.4*	*50.2*

[1] After revaluation, liquidation and other.
[2] Stage where relatively small amounts of capital are required; rarely involves marketing.
[3] For investee companies with complete business plans seeking funds to launch both product development and marketing.
[4] Refers to the period during the expansion stage when the investee company requires assistance in the actual making and distribution of the product while the investee company's account receivables and inventories are growing.
[5] For investee companies seeking money for plant expansion, marketing and increasing working capital.
[6] Involves venture capital when synergistic partners are sought for the investee company.

Table A.74
Venture Capital Companies (continued)

	List of venture capital companies surveyed	Year of establishment	Type of fund
1.	Citicorp Capital Sdn. Bhd.	1985	Open
2.	S.B. Venture Capital Corporation Sdn. Bhd.	1989	Open
3.	Mezzanine Capital (M) Sdn. Bhd.	1990	Open
4.	BI Walden Ventures Sdn. Bhd.	1990	Closed
5.	PNB NJI Holdings Sdn. Bhd.	1991	Closed
6.	Perbadanan Usahawan Nasional Bhd.[1]	1991	Open
7.	Public Bank Venture Capital Sdn. Bhd.	1991	Open
8.	MBf Equity Partners Sdn. Bhd.	1991	Closed
9.	Malaysian Ventures (II) Sdn. Bhd.	1991	Closed
10.	Mayban Ventures Sdn. Bhd.	1992	Open
11.	Malaysian Technology Development Corporation Sdn. Bhd.	1992	Open
12.	BI Walden Ventures Kedua Sdn. Bhd.	1992	Closed
13.	Malaysian Technology Venture One Sdn. Bhd.	1993	Open
14.	Malaysian Technology Development (Johor) Sdn. Bhd. (Regional)	1994	Open
15.	Ekuiti Teroka Malaysia Sdn. Bhd.	1994	Closed
16.	Malaysian Technology Venture Two Sdn. Bhd.	1994	Closed
17.	Malaysian Technology Development (Penang) Sdn. Bhd. (Regional)	1994	Open
18.	Sumber Modal Satu Sdn. Bhd.	1995	Closed
19.	PNB NJI Holdings (II) Sdn. Bhd.	1995	Closed
20.	Amanah Venture Capital Co.	1995	Open
21.	East Malaysia Growth Corporation Sdn. Bhd.	1995	Closed
22.	Malaysian Technology Venture II (Agr.) Sdn. Bhd.	1995	Closed
23.	Malaysian Technology Venture III Sdn. Bhd.	1997	Closed

[1] Perbadanan Usahawan Nasional Bhd. is included as it uses venture capital investment instruments.

Table A.75
Export-Import Bank of Malaysia Berhad (Exim Bank)

Year of Establishment	Incorporated in August 1995			
Objective	Establishing an institutional support mechanism to facilitate the exports of manufactured goods and diversification of exports by providing medium-and long-term credit to Malaysian exporters and investors, as well as foreign buyers of Malaysian goods.			
Facility	**Loans / Guarantee Approved**		**Operating Income**	
	1997	1998	1997	1998
	RM million		RM million	
Buyer Credit Facility	417.9	7.1	10.5	19.9
Overseas Investment Credit Facility	220.0	27.5	6.6	13.2
Supplier Credit Facility	83.8	260.0	1.2	3.1
Guarantee	298.3	7.6	0.7	2.3
Export of Services Financing Facility	5.0	5.0	0.0	0.1
Export Credit Refinancing	0.0	929.0	0.0	94.4
Other	45.6	0.0	0.0	4.3
Total	**1,070.6**	**1,236.2**	**19.0**	**137.3**

Source: Exim Bank

Table A.76
Fund Raised in the Capital Market

Sector	1994	1995	1996	1997	1998*p*
	RM million				
By Public Sector					
Malaysian Government Securities (MGS)	2,229.1	2,000.0	6,000.0	3,000.0	14,950.0
MGS Advanced Subscriptions	270.9	-	-	-	-
Khazanah Bonds (KB)	-	-	-	794.4	2,731.9
Government Investment Issues (Gil)	3,000.0	750.0	-	-	-
Malaysia Savings Bonds (MSB)	-	-	-	-	-
New Issue of Public Sector Securities	5,500.0	2,750.0	6,000.0	3,794.4	17,681.9
Less: Redemptions					
MGS	3,549.0	2,250.0	3,809.0	3,648.0	6,200.0
KB	-	-	-	-	-
GII	200.0	500.0	900.0	1,400.0	750.0
MSB	69.8	37.8	34.0	154.8	928.2
Less: Government Holdings	-97.0	-2.6	-74.1	-1.2	-
Net Funds Raised by the Public Sector	**1,778.2**	**-35.2**	**1,331.1**	**-1,407.2**	**9,803.7**
By Private Sector					
Shares					
Ordinary Shares [1]					
Initial Public Offers	2,972.9	4,175.0	4,099.2	4,781.0	684.7
Rights Issues	3,436.7	5,240.2	5,268.5	8,524.9	722.0
Private Placements/Restricted Offers-for-Sale	798.9	1,146.9	4,554.4	3,233.6	320.1
Special Issues	1,249.4	875.5	2,002.3	1,818.8	61.0
Preference Shares	-	-	-	-	-
New Issue of Shares	8,457.9	11,437.6	15,924.4	18,358.3	1,787.6
Debt Securities [2]					
Straight Bonds	1,021.7	3,929.9	2,675.4	4,209.0	10,238.0
Bonds with Warrants	2,861.4	3,607.7	5,563.7	2,950.3	150.0
Convertible Bonds	1,323.1	863.1	1,794.6	2,018.9	98.8
Islamic Bonds	300.0	800.0	2,350.0	5,249.7	345.0
Cagamas Bonds	4,760.0	3,022.0	4,665.0	5,169.0	3,320.0
New Issue of Debt Securities	10,266.1	12,222.7	17,048.7	19,596.9	14,151.8
Less: Redemptions					
Private Debt Securities [3]	383.5	1,249.1	1,765.0	1,368.5	2,904.4
Cagamas Bonds	850.0	2,635.0	750.0	1,640.0	5,012.0
Net Issue of Debt Securities	9,032.6	8,338.6	14,533.7	16,588.4	6,235.4
Net Funds Raised by the Private Sector	**17,490.5**	**19,776.2**	**30,458.1**	**34,946.7**	**8,023.0**
Net Funds Raised in the Capital Market	**19,268.7**	**19,741.0**	**31,789.2**	**33,539.5**	**17,826.7**
Short-Term Securities					
Commercial Papers	16,601.9	20,216.5	34,320.5	55,994.2	70,045.3
Cagamas Notes	2,490.0	3,395.0	5,790.0	13,890.0	16,845.0
New Issue of Short-Term Securities	19,091.9	23,611.5	40,110.5	69,884.2	86,890.3
Less : Redemptions					
Commercial Papers	14,228.2	18,842.7	31,009.2	53,238.0	71,710.3
Cagamas Notes	2,855.0	1,945.0	5,290.0	11,700.0	15,335.0
Net Issue of Short-Term Securities	2,008.7	2,823.8	3,811.3	4,946.2	-155.0
Total	**21,277.4**	**22,564.8**	**35,600.5**	**38,485.7**	**17,671.7**

[1] Exclude funds raised by the exercise of Employee Share Options Schemes, Transferable Subscription Rights, Warrants and Irredeemable Convertible Unsecured Loan Stocks.
[2] Exclude bonds issued by the banking institutions.
[3] Include all straight bonds, bonds with warrants, convertible bonds and Islamic bonds.
p Preliminary

Table A.77
Kuala Lumpur Stock Exchange: Selected Indicators

	1994	1995	1996	1997	1998
Indices					
Composite	*971.2*	*995.2*	*1,238.0*	*594.4*	*586.1*
EMAS	*283.7*	*279.5*	*347.7*	*151.2*	*146.9*
2nd Board	*260.7*	*298.7*	*576.3*	*162.9*	*158.4*
Trading Volume (mil. units)	60,143.0	33,979.0	66,461.0	72,798.7	58,287.1
Main Board	*58,747.0*	*30,862.0*	*47,351.0*	*62,278.3*	*52,061.1*
2nd Board	*1,396.0*	*3,078.0*	*19,039.0*	*10,497.3*	*6,226.0*
Average Daily	*242.5*	*139.8*	*268.0*	*293.5*	*236.9*
Trading Volume (RM mil)	328,057.0	178,859.0	463,265.0	408,558.0	115,180.7
Main Board	*318,251.0*	*157,908.0*	*278,138.0*	*299,595.6*	*100,610.4*
2nd Board	*9,806.0*	*20,877.0*	*185,061.0*	*108,958.4*	*14,570.3*
Average Daily	*1,322.5*	*736.0*	*1,868.0*	*1,647.4*	*468.2*
No. of Listed Companies	478	529	621	708	736
Main Board	*347*	*369*	*413*	*444*	*454*
2nd Board	*131*	*160*	*208*	*264*	*282*
Market Capitalisation (RM bil)	508.9	565.6	806.8	375.8	374.5
Main Board	*493.0*	*542.8*	*746.0*	*354.2*	*353.4*
2nd Board	*15.9*	*22.7*	*60.8*	*21.6*	*21.1*
Market Capitalisation / GDP (%)	267.4	258.7	323.4	136.5	134.4

Source: Kuala Lumpur Stock Exchange

Table A.78
Capital Market Debt Securities[1]: Amount Outstanding

As at end	Malaysian Government Securities	Government Investment Issues	Khazanah Bonds	Malaysia Savings Bonds	Danaharta Bonds	Danamodal Bonds	Cagamas Bonds	Other Private Debt Securities[2]
	RM million (nominal value)							
1994	64,969.1	4,800.0	-	1,177.3	-	-	8,925.0	15,131.2
1995	64,719.1	5,050.0	-	1,130.6	-	-	9,312.0	22,700.9
1996	66,910.1	4,150.0	-	1,092.0	-	-	13,227.0	33,527.5
1997	66,261.7	2,750.0	1,000.0	918.4	-	-	16,756.0	46,594.4
1998*p*	75,011.7	2,000.0	4,850.0	3.8	2,601.4	11,000.0	15,064.0	46,797.3

1 Refer to securities with a maturity period of more than one year.
2 Exclude debt securities issued by the banking institutions. Private debt securities are assumed to be redeemed or converted at maturity.
p Preliminary