Bank Negara Malaysia

Statutory Requirements

In accordance with Section 48 of the Central Bank of Malaysia Act 1958, Bank Negara Malaysia has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Annual Accounts for the year ended 31 December 1997, which have been examined and certified by the Auditor-General and such Accounts will be published in the Gazette.

Ahmad Mohd Don
Chairman
Board of Directors

25 March 1998

Bank Negara Malaysia

Board of Directors

Tan Sri Dato' Ahmad bin Mohd Don, P.S.M., D.P.M.J., D.M.S.M.
Governor and Chairman

Dato' Fong Weng Phak, D.M.P.N., K.M.N.
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.

Datuk Dr. Aris bin Othman was appointed as a member of the Board with effect from 1 January 1998 to replace Tan Sri Datuk Clifford F. Herbert who retired from the Board on 31 December 1997. Tan Sri Kishu Tirathrai was reappointed as a member of the Board effective 1 February 1998.

Senior Staff

Governor	Ahmad bin Mohd Don
Deputy Governor	Fong Weng Phak
Assistant Governor	Abdul Murad bin Khalid
Assistant Governor	Dr. Zeti Akhtar Aziz
Assistant Governor	Mohamad Daud bin Haji Dol Moin
Assistant Governor	Mohamed Yusof bin Ahmad Muhaiyuddin
Adviser, Public Relations	Wan Norhiyati binti Wan Ibrahim
Director/Head of Department	
Economics	Latifah Merican Cheong
Bank Regulation	Mohd Razif Abdul Kadir
Banking	Lillian Leong Bee Lian
Bank Supervision I	Zakaria Ismail
Bank Supervision II	Wong Yew Sen
Insurance Regulation	Tan Yit Seong
Insurance Supervision	Yahaya bin Haji Besah
Strategic Planning	Muhammad bin Ibrahim
Balance of Payments	Md. Radzi bin Haji Kechik
Human Resource Management	Mohamed Yusof bin Ahmad Muhaiyuddin
Property and Services	Maksom bin Kasan Widi
Finance	Azizan bin Abdul Rahman
Information Services	Ramli bin Saad
Internal Audit	Zainul Abidin bin Nazir Ahmad
Staff Training Centre	Tan Wai Kuen
Secretary's Department	Mohd Nor bin Mashor
Currency Management and Operation	Low Koon Seng
Legal	Gopalkrishnan a/l Sundaram
Special Investigation	S. Indralingam
Payment System	Che Sab bin Ahmad
Statistical Services	Chan Yan Kit
Risk Management	Teo Kee Tian
Information Systems Supervision	Norainy binti Mohd Sahid
Mint	Abdul Latif bin Adlin
Security	Che Norudin bin Che Alli
Money Museum and Archives	Fatimah binti Ibrahim
Library	Maimunah binti Mohd Amin
Manager	
London Representative Office	Ab Razak bin Che Yusoff
New York Representative Office	Tan Sook Peng
Branch Manager	
Pulau Pinang	K. Kunchi Raman
Johor Bahru	Shaari bin Mohd Shah
Kota Kinabalu	Hasbullah Abdullah
Kuching	Marlene Margaret Ak John Nichol
Kuala Terengganu	Asmaddin bin Mahmod

Foreword

In early 1997, the fundamentals for Malaysia continued to remain strong as real GDP growth moderated to a more sustainable pace and the external imbalance narrowed. The broad strategy of the Government for the medium term had essentially focused on addressing structural weaknesses, with an investment strategy directed at export orientation and productivity improvement. Against this background, fiscal discipline was reinforced by monetary tightening to ensure overall macroeconomic stability. During this period, the supervisory framework in which the banking sector operated was tightened further to maintain a sound and resilient financial sector.

As the turmoil in the region unfolded, it imposed on economies the need to expedite and reinforce their adjustment policies. During the course of the year, policies in Malaysia were directed at further reducing the current account deficit in the balance of payments, increasing the fiscal surplus through significant cutbacks in public sector expenditure, reducing credit growth and containing inflationary expectations by tightening further monetary policy. To strengthen banking institutions, more stringent prudential standards were imposed on the recognition of non-performing loans (NPL) and provisioning, as well as requiring greater transparency on the financial positions of banking institutions. The authorities were, however, aware that the measures on their own would not lead to a complete restoration of investor confidence. Nevertheless, the measures would contribute to minimising the risks of destabilising contagion effects arising from developments in the regional and global financial markets. Of importance, the measures are aimed at building the foundation on which an early recovery could be achieved.

The economy expanded by 7.8% in 1997. This performance reflected mainly the underlying strength of the real economy where production was broad-based, with a strong export sector. Despite the onset of the regional financial crisis, growth in 1997 remained strong reflecting the structural adjustments that had been undertaken over the years. In particular, the banking sector was relatively resilient with NPL at a historical low. Policy that limited private sector foreign borrowings to those with foreign exchange earnings to service the debt helped to contain external debt at a manageable level. Short-term debt was also low, with the bulk of the debt already hedged. There was adequate domestic liquidity to support productive economic activities. The national savings rate remained high at 40% of GNP, while the country was at full employment.

The intensity of the contagion impact and the severe adjustments undertaken to restore confidence in the domestic financial markets are expected to have their full impact on the economy in 1998. While growth of the economy in 1998 will remain positive, it is expected to slow down to 2-3%. Growth is expected to be sustained by exports as domestic demand is likely to decline due to lower consumption and investment. A positive development will be the dramatic improvement in the balance of payments position in 1998. The current account deficit is expected to narrow significantly to less than 1% of GNP, well below the target of 3% set under the Government's adjustment programme. Taking into account the impact of the depreciation of ringgit, inflation is forecast to double to a range of 7-8%. The inflationary pressure essentially reflects the direct and indirect impact of ringgit depreciation. The lower growth is also expected to result in a softening in the employment situation and unemployment could increase to 3.5%. However, a stronger recovery in exports and a positive response of the services sector to the depreciation could improve the growth prospects. Prospects for recovery will also depend on the restoration of stability in the financial markets.

In an environment of unprecedented depreciation of the ringgit, the commitment to tight monetary policy to contain inflation and to facilitate adjustments in the financial markets cannot be compromised. The objective of interest rate policy is to be pre-emptive in containing inflationary pressures and to help to restore investor confidence. The Bank will continue to exercise a judicious balance in managing monetary growth to contain inflationary expectations, while ensuring that the process of consolidating credit growth would not curtail productive investments. Of importance is that credit expansion is now already slowing down. A further encouraging trend is the higher proportion of credit being channelled to productive sectors. With the prospects for slower economic growth and higher NPL, some banking institutions have become more cautious in their lending operations, even for viable productive activities. While it is important to ensure that loan growth moderates to not more than 15% by end-1998, the Bank will continue to monitor the situation closely to ensure that banking institutions do not over-correct and deny access to bank financing for productive investments and activities. Such a situation could result in an adjustment in the economy that is more than warranted. The banking sector, therefore, has an important role in this adjustment process to ensure efficient intermediation in a difficult economic and financial environment.

Structural adjustments of the past have contributed to economic growth, strengthened the economic base and placed Malaysia in a stronger position to withstand the current financial turbulence. However, the turbulence has brought to the forefront, areas in which Malaysia is vulnerable to external shocks. Over the last decade, the international environment has changed dramatically. The emergence of a broader group of middle-income economies, all striving to expand through an export-oriented strategy, has altered the comparative advantage for Malaysian products. The Malaysian growth strategy, therefore, needs to adjust and adapt to these developments. In the real sector, while manufacturing activities would continue to lead growth, there is a need to develop strategies to enable the sector to meet global competition. The key electronics sub-sector is increasingly becoming more vulnerable to external competition. The linkages in this area to the development of the Multimedia Super Corridor would help to ensure that value added from the latter could be enhanced. There is a need to revitalise the agriculture sector to produce food competitively and to provide the raw materials needed to expand the resource-based industries. New growth areas are also required to promote a broad-based agriculture sector. Previous proposals to develop strong ancillary services to support the industrialisation drive are still relevant. Selected service industries where import content is low and foreign exchange retention is high, such as tourism and education, require co-ordinated national strategies to realise their full growth potential.

In the financial sector, the globalisation of international capital flows amidst the liberalisation of capital accounts has improved the intermediation of funds on a global scale. Malaysia, undoubtedly, has been able to enjoy rapid economic growth partly because of the strong foreign direct investment flows into the country, while the shorter-term foreign capital flows have added liquidity to the capital markets. Depending on their nature and scale, such flows have also been destabilising. However, economic isolation and capital controls are not an option for Malaysia. On the contrary, policies have been directed at increasing the resilience of the economy and the financial system to enhance the ability to adjust to these capital flows. In this regard, the appropriate mix of macroeconomic policies becomes important. Hence, policy has also focused on the promotion of transparency and the disclosure of information by corporations and financial institutions so that investors can make informed decisions. This would help to strengthen economic resilience. The disciplining power of the market would promote good corporate governance. However, this can only be expected to yield positive results under conditions of rational and efficient markets.

The focus of banking policy in recent years has been to consolidate the industry, an important building block in the further development of the financial system. At the same time, the favourable economic performance of recent years has contributed to strong asset quality and facilitated the build-up of capital and reserves to healthy levels. As a result, the capital and reserves of the banking industry have increased by RM35 billion over the last five years to RM47 billion at the end of 1997. The industry, therefore, entered the period of financial turmoil from a position of strength. While the banking sector is likely to experience the strains of a difficult environment, stress tests conducted by the Bank revealed that even under extreme conditions, only four banking institutions would need capital injection amounting to a total of RM2 billion, in order for them to comply with the minimum risk-weighted capital adequacy ratio of 8%. Even in these cases, the banking institutions would remain solvent. The parameters of the stress tests have incorporated a possible deterioration in property and share values, contingent losses of subsidiaries of banking institutions, including their overseas operations, and potential future provisioning for NPL. As part of the policy to consolidate the banking sector, merger initiatives have been intensified. Mergers among several banking institutions are now well underway. These are expected to result in the emergence of a core of large and stronger institutions.

The financial turbulence provided a further impetus to both the Bank and the industry to forge ahead with efforts to further strengthen the banking system in terms of sound banking practices, stronger prudential regulations, supervision and corporate governance, greater transparency, as well as further progress in institutional and market development. The trend will be for a further tightening in the areas of provisioning rules for sub-standard loans and off-balance sheet items. Although these measures may amplify the problems faced by some banking institutions, the adoption of more rigorous requirements will result in stronger balance sheets in the future. These measures will augur well for investor confidence and enhance the capacity of the banking institutions to contribute effectively to economic recovery.

The supervisory framework and standards will continue to be benchmarked against international standards and the best banking practices. Towards this end, supervisory requirements which are no longer relevant will be replaced or modified so that they are more effective and responsive to the changing environment. A new liquidity framework will also be introduced to provide the Bank with more effective means to assess the actual liquidity position of banking institutions. At the same time, the framework will provide the banking institutions with a more efficient mechanism to manage liquidity. The current capital adequacy framework will also be expanded to incorporate market risks. Banking institutions, on their part, would have to continually improve their internal governance, review the effectiveness of their risk management policies and practices and upgrade their skills.

In respect of financial market development, the creation of broad and deep markets with a spectrum of financial instruments and players would improve the management of risks in the financial system. At present, much of the credit extended is intermediated through the banking system. As a result, the risks associated with any cyclical downturn in the economy are concentrated in the banking system. Therefore, the development of alternative sources of funding and secondary markets for financial papers would allow for greater diversification of risks. These changes will enhance the capacity of the economy to assume risk in a more efficient manner in terms of lower cost, greater liquidity and the allocation of risk to those players that are better able to manage them. In this connection, significant progress has been achieved in the development of the private debt securities market in terms of developing the infrastructure and the issue of benchmark Khazanah bonds to assist pricing. Another important aspect of development is the presence of dynamic and progressive market players.

In developing the financial system, due consideration needs to be accorded to the critical success factors as well as their implications on the stability of the financial system. In this regard, a well co-ordinated and concerted effort would contribute to achieving the objective of developing a financial system that is more robust so that monetary and financial stability is preserved. The system would then become more market-oriented to support business activities and complement other sectors in making a greater contribution to GDP growth.

25 March 1998

Ahmad Mohd Don
Governor

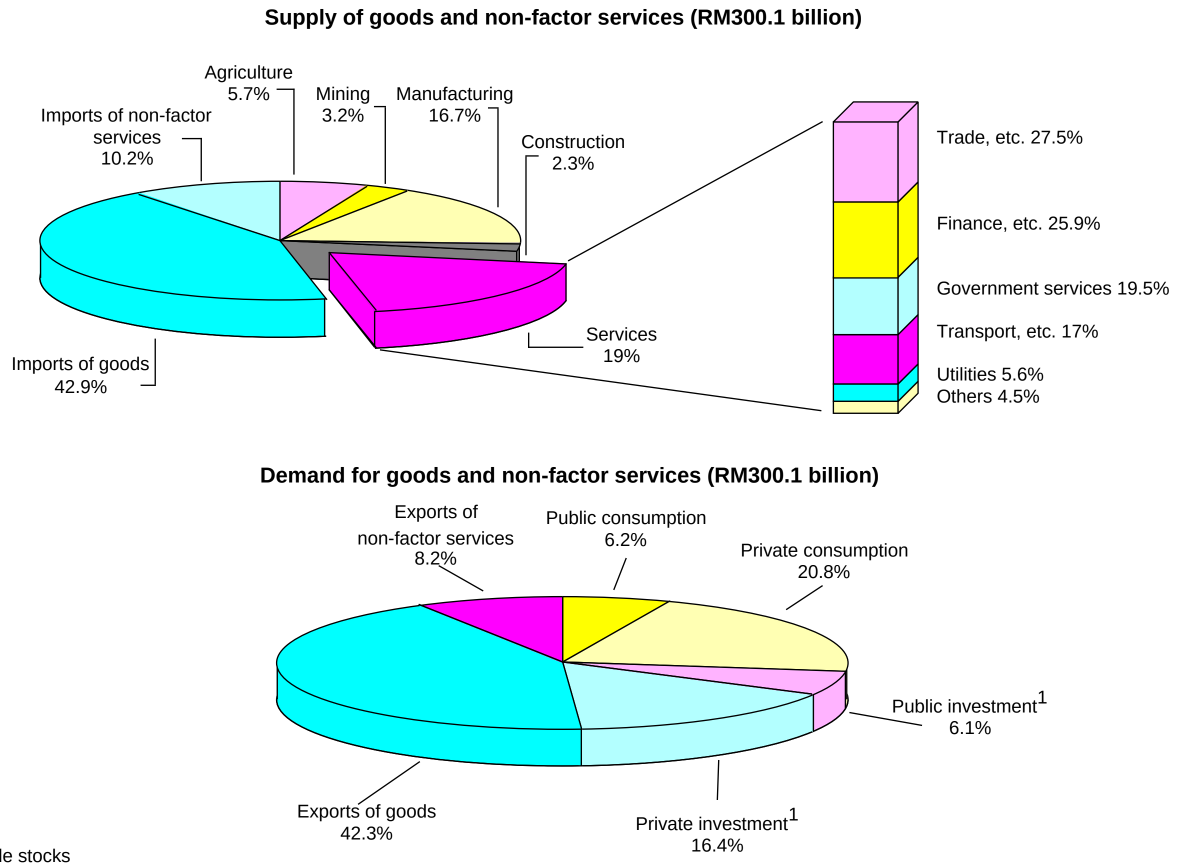
1 The Real Economy

Overview

The year 1997 began on an optimistic note for the Malaysian economy. Indeed, there was a strong sense of optimism that the adjustment measures that had been put in place to address existing economic imbalances would achieve a soft landing in terms of more sustainable growth with stability. In an environment of full employment and capacity constraints, there were a number of concerns over the adverse impact of rapid growth and excess demand pressures on the balance of payments and inflation; the disproportionate expansion in bank credit, particularly to finance the less productive sectors; and the intense competitive pressures on Malaysian exports from lower-cost producers. Remedial measures which had been introduced since 1995 had yielded positive results in terms of the significant improvement in the external balance as well as a moderation in the inflation rate in 1996. The announcement of prudential measures in early 1997 served to enhance market confidence that corrective measures were in place to reduce monetary and credit growth as well as to pre-empt any rise in asset inflation. Reflecting the positive market response to these measures, the ringgit exchange rate appreciated in terms of its composite as well as the United States dollar in the first half-year.

This optimism remained even as Malaysia was confronted with the initial contagion effects of speculative pressures on the Thai baht in early May. However, after July, the economic situation changed dramatically and deteriorated progressively as the

Graph 1.1: The Economy in 1997 (at 1978 Prices)



[1] Include stocks

Table 1.1: Malaysia – Key Economic Indicators

	1995	1996	1997*p*	1998*f*
Population (million persons)	20.7	21.2	21.7	–
Labour force (million persons)	8.1	8.4	8.6	–
Employment (million persons)	7.9	8.2	8.4	–
Unemployment (as % of labour force)	2.8	2.5	2.7	–
NATIONAL PRODUCT (% change)				
Real GDP	9.5	8.6	7.8	2 – 3
(RM billion)	120.3	130.6	140.9	144.4
Agriculture, forestry and fishery	1.1	2.2	3.0	–1.8
Mining and quarrying	9.0	4.5	2.0	2.2
Manufacturing	14.5	12.2	12.5	6.0
Construction	17.3	14.2	10.6	–4.0
Services	9.4	9.7	7.9	2.7
Nominal GNP	15.1	14.3	10.6	6.2
(RM billion)	208.2	237.9	263.1	279.4
Real GNP	9.3	8.4	7.5	1.7
(RM billion)	113.6	123.1	132.3	134.6
Real aggregate domestic demand [1]	13.4	7.0	6.4	–4.7
Private expenditure [1]	15.4	9.0	6.3	–2.4
Consumption	9.4	6.0	4.7	1.0
Investment	25.3	13.4	8.3	–6.8
Public expenditure [1]	8.0	1.3	6.9	–11.6
Consumption	7.3	1.4	4.8	–11.4
Investment	8.7	1.1	9.2	–11.7
Gross national savings (as % of GNP)	35.2	38.5	40.0	40.7
BALANCE OF PAYMENTS (RM billion)				
Merchandise balance	0.1	10.2	11.1	27.6
Exports (f.o.b.)	179.5	193.1	218.7	298.8
Imports (f.o.b.)	179.4	183.0	207.6	271.2
Services balance	–19.4	–19.5	–20.8	–25.3
(as % of GNP)	(–9.3)	(–8.2)	(–7.9)	(–9.0)
Transfers, net	–2.5	–2.9	–3.7	–3.8
Current account balance	–21.8	–12.3	–13.4	–1.4
(as % of GNP)	(–10.5)	(–5.1)	(–5.1)	(–0.5)
Bank Negara Malaysia reserves, net	63.8	70.0	59.1[2]	–
(as months of retained imports)	(4.1)	(4.4)	(3.4)	–
PRICES (% change)				
CPI (1994=100)	3.4	3.5	2.7	7 – 8
PPI (1989=100)	3.9	2.3	2.7	12 – 13
Average wages in the manufacturing sector	6.1	9.6	7.0	–

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

[1] Exclude stocks.
[2] The figure does not include an exchange revaluation gain of RM24.6 billion. Prior to 1997, the holdings in foreign assets were revalued once, at year-end. However, in 1997, the accounting policy of recognising the foreign exchange revaluation gain or loss was changed, whereby, the exchange gain from the revaluation of foreign assets and liabilities was not recognised in the Bank's books. Nevertheless, full provisions will be made for any losses. The US dollar equivalent of international reserves as at 31 December 1997 was US$21.7 billion.
p Preliminary
f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	1995	1996	1997*p*
FEDERAL GOVERNMENT FINANCE (RM billion)			
Revenue	51.0	58.3	65.7
Operating expenditure	36.6	43.9	44.7
Development expenditure	12.5	12.6	14.4
Overall surplus	1.9	1.8	6.6
Overall surplus (% of GNP)	0.9	0.8	2.5
Total public sector development expenditure	29.8	30.8	40.6
Overall public sector surplus (% of GNP)	3.4	4.2	3.4
EXTERNAL DEBT			
Total debt (RM billion)	85.0	98.8	166.2
Medium & long-term debt	68.8	73.2	126.5
Short-term debt	16.2	25.7	39.7
Debt service ratio (% of exports of goods & services)			
Total debt	6.5	6.1	5.7
Medium & long-term debt	6.0	5.7	5.1

	Change in 1995		Change in 1996		Change in 1997	
	RM billion	%	RM billion	%	RM billion	%
MONEY AND BANKING						
Money supply M1	5.5	11.7	8.7	16.7	2.8	4.6
M2	38.5	24.0	39.3	19.8	54.0	22.7
M3	49.6	22.3	57.8	21.2	61.0	18.5
Banking system deposits	50.8	21.9	74.5	26.3	76.0	21.3
Banking system loans[1]	57.6	28.3	72.0	27.6	88.3	26.5
Manufacturing	11.5	30.7	4.6	9.5	9.8	18.3
Property sector	15.2	26.0	31.1	42.3	35.2	33.6
Finance, insurance and business services	9.0	39.4	0.8	2.4	3.4	10.5
Loan-deposit ratio (end of year)	89.0%		89.3%		92.7%	

	1995	1996	1997
	%	%	%
Interest rates (end of year)			
3-month interbank	6.76	7.39	8.70
Commercial banks			
Average fixed deposits: 3-month	6.64	7.21	9.06
12-month	6.89	7.26	9.33
Average savings deposit	3.70	4.10	4.23
Finance companies			
Average fixed deposits: 3-month	6.79	7.32	10.32
12-month	6.98	7.36	10.25
Average savings deposit	4.70	5.02	5.49
Average base lending rate			
Commercial banks	8.03	9.18	10.33
Finance companies	9.38	10.65	12.22
Treasury bill rate (91 days)	5.92	6.39	6.76
20-year Government securities	7.43	7.45	7.70

	1995	1996	1997
	%	%	%
Movement of Ringgit (end-period)			
Change against composite	0.4	2.6	– 31.4
Change against SDR	– 1.1	3.9	– 30.8
Change against US$	0.7	0.5	– 35.0

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

regional financial crisis became more intense and widespread. The crisis dramatically undermined confidence in the region, changing the Malaysian setting from one of relative economic stability to a situation that was characterised by successive depreciation of the ringgit, major corrections in the equity market, generally weaker investor confidence and large outflows of non-resident short-term capital. These developments caused strains to emerge in the financial system. Notwithstanding its relatively strong economic fundamentals, the Malaysian economy has not been spared from the contagion effects of adverse developments in the region. This was manifested mainly through misperceptions of an apparent lack of commitment by the Malaysian authorities to pursue its adjustment policies. Such misperceptions created opportunities for speculators to capitalise on the situation for short-term gains. In the second half of 1997, macroeconomic policy management was further complicated by increased uncertainty in the region. As the financial crisis escalated, 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. By the end of December, the ringgit had depreciated by as much as 35.1% against the United States dollar, while stock market prices fell by 44.8% from the end-June position.

Although the impact of the regional financial crisis on Malaysia in terms of the decline in the value of the ringgit and the stock market were severe, the significant improvement in macroeconomic and financial sector conditions just prior to the crisis has enabled Malaysia to have a greater degree of resilience to withstand the crisis. In addition, an important contributory factor to this resilience was the existence of a strong institutional framework for the financial system. Following the recession in 1985, the financial sector had undergone extensive restructuring with additional regulations based on internationally-accepted prudential standards. More importantly, the ability of the Malaysian economy to adjust to the regional financial crisis was a reflection of its strong economic fundamentals. Indeed, the financial turmoil occurred at a time when the Malaysian economy was at its strongest. Indications were that gross domestic product (GDP) growth, while still remaining strong for the first half-year, had now moderated to a more sustainable path. Inflation had moderated from a peak of 3.3% in December 1996 to as low as 2.1% in July 1997. Asset prices had also stabilised, with the Malaysian House Price Index registering a moderate increase of 6.1% in the first half of 1997, the lowest since 1993. Initial concerns of a prospective oversupply situation in selected property segments had also been alleviated, to some extent, by the deferment of several projects as the private sector adjusted to the situation as well as the limits placed on bank credit to selected property sectors. Deliberate policies to slow down less productive investments over the previous two years had resulted in a significant narrowing of the current account deficit in the balance of payments from 10.5% of gross national product (GNP) in 1995 to 5.1% in 1996. Both the total external debt (including short-term debt) and the debt service ratio remained low. The net international reserves of BNM stood at RM70.7 billion at end-June, sufficient to finance 4.3 months of retained imports. The Government’s fiscal budget remained in surplus at 2.9% of GNP in the first half of 1997, while the national savings rate was maintained at 38.5% at end-1996. In addition to these strong fundamentals, policies were already in place to reduce bank credit and monetary growth through a further tightening of monetary policy. The banking sector also faced the challenges of the crisis from a position of strength. In terms of capital adequacy, the level of capitalisation had improved considerably during the past two years with the risk-weighted capital ratio (RWCR) of the banking institutions improving to 12% at end-June, lower non-performing loans of 3.6% of total loans and general provisions of 2%.

Towards the fourth quarter, however, the pressures of the regional crisis on the domestic economy intensified and its effects became more discernible. The steep depreciation of the exchange rate led to higher production costs, which were passed on to consumers in terms of higher retail prices. The ensuing environment of uncertainty and negative wealth effects dampened domestic demand. There were also large outflows of non-resident short-term capital following the continuous decline in stock prices. Consequently, GDP growth moderated to 6.9% in the fourth quarter from 7.4% in the third quarter and 8.5% in the first half of the year. On the strength of a strong first-half performance, GDP growth for 1997 as a whole expanded at a slower rate of 7.8% (8.6% in 1996). In line with the more moderate pace of growth, nominal GNP expanded by 10.6% compared with 14.3% in 1996.

The slower growth in **domestic demand** (excluding changes in stocks) contributed towards the moderate economic expansion in 1997, with real aggregate domestic demand increasing by 6.4% (7% in 1996). This reflected the effects of tighter macroeconomic

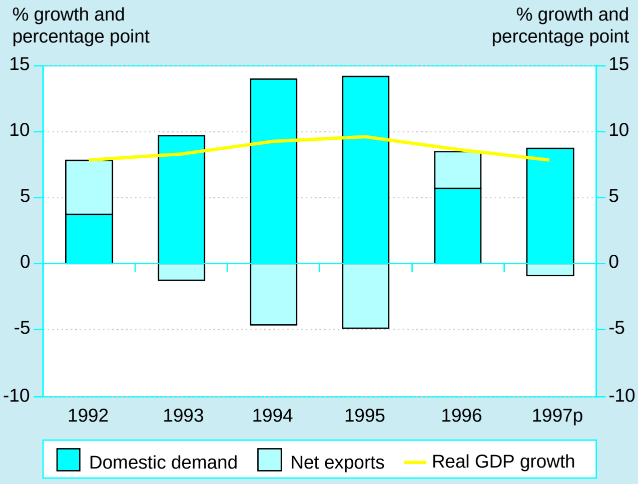
Macroeconomic Indicators for the First and Second Half of 1997

First Half	Second Half
• GDP remained strong at 8.5%.	• GDP moderated to 7.1%.
• CPI increase contained at 2.8%.	• CPI increase moderated to 2.5% but picked up slightly in December 1997 and to 4.4% in February 1998.
• Reserves level of RM70.7 billion at end-June; sufficient to cover 4.3 months of retained imports.	• Reserves moderated to RM59.1 billion at end-December 1997; sufficient to cover 3.4 months of retained imports.
• Low external debt: 42.6% of GNP at end-June in terms of USD.	• External debt increased to 45.6% of GNP in terms of USD.
• Stable exchange rate: +0.2% against USD.	• Sharp decline in exchange rate: -35.1% against USD.
• Stock market performance weakened from second quarter: -13% in first half-year.	• Sharp decline in stock market: -44.8%.
• Indications of improvement in BOP position.	• Current account deficit stabilised at 5.1% of GNP.
• Investment sentiment was strong.	• Weak market sentiment and confidence.
• Loan growth of banking system was 30.4% at end-June.	• Loan growth moderated to 26.5% at end-December.
• Strong banking sector:	• Banking position affected, but remained resilient:
- RWCR : 10.4%	- RWCR : 10.6%
- NPL (6 months) : 3.6%	- NPL (3 months) : 6.8%
- Loan loss provision (6 months) : 92% of NPL	- Loan loss provision (3 months) : 54.5% of NPL

policies to curb excessive growth in aggregate demand in order to reduce the current account deficit. The moderation was largely on account of slower growth in private sector expenditure (6.3%) as public sector spending expanded at a faster pace (6.9%). The slower growth in private sector expenditure was due to more moderate increases in both consumption and investment, reflecting the negative wealth effects of declining share prices. Public sector expenditure, on the other hand, was higher, reflecting higher growth in both investment and consumption. The rise in public investment was due to increased capital outlays by the non-financial public enterprises (NFPEs), particularly in the oil and utility sectors, as well as the accelerated implementation of the Kuala Lumpur International Airport (KLIA) project.

On the **supply side**, the moderation in real GDP growth was attributed mainly to the slower expansion in the mining, services and construction sectors. Activity in the services and construction sectors were more adversely affected by the financial crisis. Growth continued to be supported by the faster pace of expansion in the manufacturing and agriculture sectors which remained resilient despite the financial turbulence. Growth in the manufacturing sector was sustained at 12.5%, reflecting mainly strong external demand for electronic components and parts, chemicals and chemical products, textiles and wearing apparel and off-estate processed products. The recovery in the electronics sector was stronger than expected. However, prices of selected memory chips remained depressed because of intense competition. Output of the electrical products industry declined due to increased competition and excess world-wide production. Meanwhile, output of the domestic-oriented industries continued to register double-digit growth (14.6%), underpinned by higher output of selected products, including chemicals and

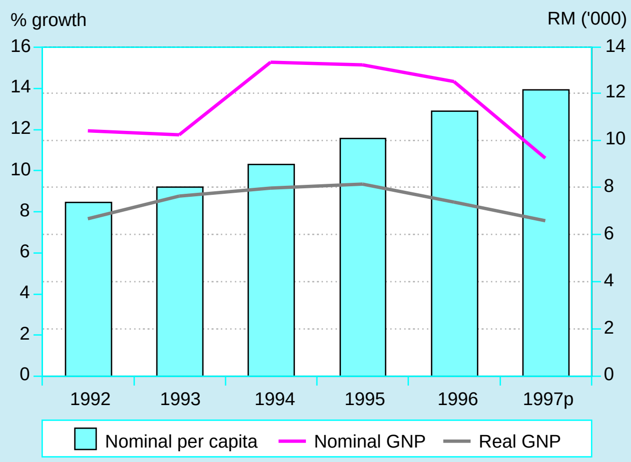
Graph 1.2
Contribution to GDP Growth: Domestic Demand and Net Exports



chemical products. The impact of the regional financial crisis on the export- and domestic-oriented industries was mixed. The export-oriented industries benefited from the improved competitiveness due to the ringgit depreciation but were adversely affected by a slowdown in regional demand towards year-end. However, the fall in the stock market and slower growth in the construction sector affected the domestic-oriented industries. On the whole, the manufacturing sector was less affected by the regional financial crisis for several reasons. Firstly, global demand remained strong, buoyed by sustained growth in the United States and the European markets. Secondly, the sector relied, to a large extent, on internal sources of funds to finance its investment and expansion plans, and was therefore less exposed to external indebtedness. Similarly, the agriculture sector was also less affected by the financial turbulence. A slightly better performance (3%) was recorded during the year, reflecting the continued increase in crude palm oil production and a turnaround in saw log output, which more than offset the lower output of rubber and cocoa. In contrast, activity in the mining sector moderated further, reflecting lower petroleum and tin production, although gas output remained strong during the year. Activity in the construction sector consolidated (10.6%), with all the three sub-sectors, namely, civil engineering, residential and non-residential construction recording strong growth, but at a slower pace than in 1996. Meanwhile, activity in the services sector remained strong (7.9%), with favourable performance in the finance, insurance, real estate and business services; transport, storage and communication; and utilities sub-sectors.

On the **external front**, the current account deficit in the balance of payments increased slightly to RM13.4 billion, about RM1.1 billion higher than the deficit recorded in 1996. As a proportion of GNP, however, the deficit remained at 5.1%. Following the depreciation of the ringgit, export growth increased at a faster rate relative to imports, culminating in a progressive improvement in the trade balance. With merchandise exports and imports growing at about the same level for the year as a whole, at 13.3% and 13.5% respectively, the merchandise surplus was moderately higher than the level recorded in 1996. However, gross exports in United States dollar terms registered only a small increase of 0.7%. The increase in export volume (5.2%) was offset, to a large extent, by a decline in prices. Keen competition in world markets led to a downward adjustment in the United States dollar prices of most manufactured goods. Meanwhile, the services deficit increased slightly to RM20.8 billion, but the ratio in terms of GNP declined to 7.9%, the lowest since 1973. The higher services deficit was mainly attributable to unforeseen developments in the second half of 1997. The most significant was the prolonged haze which severely affected tourist arrivals and related services receipts. In addition, the weaker ringgit led to higher costs of services payments, especially for investment income. In 1997, the deficit in the current account was fully financed by the large net inflow of long-term capital, particularly corporate investment. The surplus in the basic balance increased further to RM5.3 billion (RM1.3 billion in 1996). However, the short-term capital account recorded a large net outflow of RM14.2 billion, resulting in the overall balance of payments reverting to a deficit of RM10.9 billion, from a surplus of RM6.2 billion in 1996. Consequently, the net international reserves of the

Graph 1.3
GNP Growth



Bank declined to RM59.1 billion (US$21.7 billion) as at end-1997, sufficient to finance about 3.4 months of retained imports.

It is significant to note that Malaysia's main strength during the period of financial turbulence to a large extent, is the result of the relatively low level of **external debt**, which gave the country greater flexibility in dealing with the financial crisis. Total external debt (including short-term external debt) in United States dollar terms only increased moderately to 45.6% of GNP as at end-1997 (41.2% of GNP in 1996). The debt service ratio remained low at 5.7% (6.1% in 1996). The bulk of the external debt was in medium- and long-term maturities (76%), while the remaining 24% comprised short-term debt. The latter reflected the low reliance on short-term borrowing by the non-bank private sector, with the bulk of the loans being undertaken by the commercial banks, and was for the most part hedged. Furthermore, a large proportion of the external loans to the private sector was for the export-oriented sector, which had a natural hedge in the form of export receipts to service the external debt.

The increase in **consumer prices** was contained during the period of high growth due to the implementation of prudent macroeconomic policies, a liberal import regime and low inflation in industrial countries. Nevertheless, in early 1997, a combination of strong credit growth, tight labour market and capacity constraints gave rise to concerns over rising inflationary pressures. However, with continued monetary restraint and fiscal prudence complemented by various measures taken over the years to ensure price stability, consumer prices began to moderate after March and reached 2.1% in July, the lowest inflation rate since September 1990. In the second half-year, however, the consumer price index (CPI) rose slightly by 2.5% as the impact of the currency depreciation was translated into higher prices after a time lag of 3–6 months. Hence, for 1997 as a whole, the CPI registered an overall increase of 2.7%. During the first two months of 1998, the impact of the depreciation became more apparent, with the CPI rising at an average rate of 3.9%. The producer price index (PPI), however, was affected by the currency depreciation with a shorter time lag. After moderating significantly in the first half-year, it rose by 4.2% between July and December, resulting in an overall increase of 2.7% in 1997. In January 1998, the PPI increased further by 16% (17.2% for local production and 10.4% for imports).

An area of concern in the first half-year was the potential risk of asset price inflation on both the property and stock markets. The increase in asset prices in recent years had been attributable to the cumulative wealth effect over a prolonged period of rapid growth, accentuated by prospects of capital gains and availability of financing. Although several monetary and fiscal measures that were implemented since late 1995 had moderated price increases in the property sector, property prices in major towns continued to increase.

On the **employment front**, the labour market remained tight, although the unemployment rate increased slightly to 2.7% towards the end of the year. Shortages of workers were reported in the agriculture, manufacturing and services sectors despite the employment of foreign labour. A concern associated with the tight labour market was the increasing pressure on wages and lagging productivity growth. In 1997, average real wages in the manufacturing sector increased by 7%, compared with an increase in labour productivity of 5.7%. In view of the shortage of workers and rising wages, firms reviewed their strategies on the use of labour and stepped up human resource development, increased automation and moved towards high-technology industries. Towards year-end, there were some signs of easing pressures on the labour front, especially in the construction and selected services sectors. However, given the tight labour situation, the workers retrenched in selected industries were easily absorbed by other sectors which continued to experience shortages.

Macroeconomic policy management in 1997 had to address domestic issues as well as the rapid changes in the economic setting following the outbreak of the regional financial crisis. In the first half of 1997, the policy direction was focused on steering the economy towards a more sustainable growth path and on containing asset inflation. However, with the onset of the regional crisis since July, the focus of policy was to restore stability and confidence in the financial markets, while minimising any disruptions on the real economy.

In confronting the regional financial crisis, the Government had to adjust its policy accordingly in response to the uncertainties in the foreign exchange market and the deflation in asset prices. While it was recognised that policy adjustments were necessary to cope with the contagion, the magnitude and duration of the disruption was not immediately clear. Instituting overly harsh measures could precipitate a sharper than desired economic contraction that would, in turn, be very destabilising on the financial markets. Hence, attempts were made to stabilise the currency through intervention in the foreign exchange market. The consequent tightening of liquidity led to a significant increase in interest rates. However, as market pressures intensified with the floatation of the Philippine peso, the focus of policy was directed at the restoration of stability in the domestic financial market and to minimise the impact of external developments on the real sector. Consequently, by mid-August, interest rates were reduced to just above the crisis level. Nevertheless, it was recognised that rates had to remain sufficiently high to contain inflationary pressures. In early August, to limit speculators' access to the ringgit, the Bank introduced limits on outstanding non-commercial related ringgit offer-side swap transactions with foreign customers. This measure enabled interest rate policy to be based more on domestic considerations.

In the ensuing weeks, when both the ringgit and share prices were pushed to successive lows in a progressively volatile external environment, it became clear that there would be long-term repercussions on the economy. It was recognised that stronger macroeconomic adjustments were required. Studies of past currency crises showed that confidence was restored only after comprehensive reforms were implemented. Such programmes generally included economic and financial reforms, monetary and fiscal restraint, and greater flexibility in exchange and interest rate policies. In most cases, the economies of affected countries were found to recover faster than the financial markets. In other words, only when there was an economic recovery did the exchange rate strengthen. Accordingly, a set of austerity measures was announced in early September to further reduce the level of aggregate demand and contain the current account deficit. These measures included a 2% cut across the board in Government spending; rationalisation of the purchase of imported goods by public agencies, including the armed forces; and deferment of several large privatised projects. In addition, the implementation of new privatised projects would be assessed in terms of their macroeconomic impact and contribution to long-term growth. The overall strategy was to curb unnecessary imports and reduce strains on the balance of payments as well as on existing resources. These measures were reinforced with additional measures in the 1998 Budget in October 1997.

The regional instability persisted into the last two months of 1997, with the ringgit depreciating further. The depreciation did not bear any relationship to Malaysia's economic fundamentals. Instead, the movement of the ringgit was dictated increasingly by changes in market sentiment. Such sentiments fluctuated widely, based on perceived concerns that stresses in the economy, together with the apparent lack of transparency and uncertainty in market rules and governance, would adversely affect market players' short-term positions. As the crisis deepened towards year-end, such misperceptions and concerns also included the high leverage of corporations and its potential impact on the banking system, especially in an environment of rising interest rates, economic slowdown and possible asset deflation. During this period, therefore, the over-riding concern of policy was to restore stability to the financial markets and confidence in economic management. Malaysia is currently in a better position to manage a financial crisis, given that the turbulent years of the 1980s had led to continued efforts to strengthen the regulatory and supervisory framework of the banking industry.

When the regional instability continued into December, there was increased concern that the regional financial crisis could be more protracted than earlier anticipated, which would necessitate a stronger policy response. Consequently, on 5 December, the Malaysian Government announced a comprehensive package of policies to address the situation.

The 5 December package of policies was designed to complement the 1998 Budget measures and aimed to strengthen economic stability and instil confidence in the financial system. The measures took into account several underlying concerns on the economy and the financial system. These included the still high deficit in the balance of payments due mainly to the strong private sector investment in the 1990s to expand productive capacity as well as to improve infrastructure facilities. The rapid expansion of private sector activities had also led to the second concern of high credit growth, particularly to the property and stock markets. A related concern was the high private sector debt which accounted for 169% of GDP in 1997. Hence, it was observed that while the Government's finances were being managed prudently, there was a need to curb excesses in the private sector. Nevertheless, such a development needs to be viewed in its proper

Stabilisation Measures

To strengthen balance of payments, fiscal account and improve competitiveness

September

- Defer implementation of privatised large projects.
- Review public agencies' purchases of foreign goods.
- Assess new privatised projects in terms of their macroeconomic impact.
- Cutback in Federal Government expenditure by 2% in 1997.

1998 Budget (announced in October)

- Deferment of projects with total cost amounting to RM65.6 billion.
- Reduce corporate tax and petroleum income tax rate by 2% each.
- Tax exemption for selected exporting companies.
- Increase import duties on construction materials, consumer durables and motor vehicles.
- Promote services sector.
- Establish RM1 billion fund for small- and medium-scale industries.

5 December

- Reduce current account deficit (target 3% of GNP in 1998).
- Defer implementation of non-strategic and non-essential projects.
- Promote exports and tourism.
- Promote utilisation of domestic products.
- Stricter criteria for approvals of new reverse investment.
- Cutback in Federal Government expenditure by 18% in 1998.

To ensure monetary and financial stability

April

- Pre-emptive prudential measures to limit lending to the property sector and for the purchase of stocks and shares.

August

- Limits on non-commercial related ringgit offer-side swap transactions with foreign customers.
- Increase interest rates progressively (from mid-September).

1998 Budget (announced in October)

- Strengthen prudential standards:
  - Classify non-performing loans in arrears, from six to three months.
  - Greater financial disclosure by banking institutions.
  - Increase general provision to 1.5%.
- Introduce credit plan to limit loan growth to 15% by end-1998.
- Tighten rules on hire-purchase financing.

5 December

- Promote good corporate governance:
  - Enhance disclosure of information of corporations.
  - Closer scrutiny for corporate restructuring.
- Ensure funds raised in the equity market are allocated to productive sectors.

February 1998

- BNM's 3-month intervention rate raised from 10% to 11%.
- Statutory reserve requirement (SRR) reduced by 3.5% of eligible liabilities to 10% to enhance efficiency and effectiveness of the intermediation process. SRR amount offset by reducing the Bank's lending to banking institutions by at least the same amount.

perspective. The increase in bank lending to the private sector was associated with the transformation of the economy from one in which the Government played a significant role to one where the private sector was the main engine of growth. This transformation resulted in a significant reduction in Government borrowing, while the share of the private sector in economic activity and in bank credit increased accordingly. Finally, market sentiments were also affected by a number of global and domestic developments, which were perceived to have an adverse impact on Malaysia's competitiveness. These included intense competition from the lower-cost producers in Asia, Latin America and Eastern Europe. The situation was further exacerbated by the sluggish world demand for semiconductors since the end of 1995, although there had been a rebound since May 1997. On the domestic front, there were also concerns that the increase in production costs arising from higher wage increases relative to productivity and increased utility and transportation costs would also undermine competitiveness. Notwithstanding these concerns, it should be noted that many measures had been taken by producers as well as the Government to improve competitiveness (for details, see Box Article VI on Malaysia's International Competitiveness). To address these concerns and reiterate the Government's commitment to adjust, the 5 December policy package was designed to complement the measures in the 1998 Budget. These measures were aimed at strengthening economic fundamentals and rebuilding investor confidence through maintaining fiscal discipline; strengthening the balance of payments position; strengthening the banking system; and enhancing corporate governance.

To strengthen the balance of payments position, efforts were directed toward a more rapid reduction in the current account deficit to 3% of GNP in 1998. Specific steps entailed a sharp cutback in Federal Government expenditure; deferment of selected projects, including privatised projects amounting to RM65.6 billion, as well as reverse investment, except for those that would have significant linkages with the domestic economy and earn foreign exchange. At the same time, efforts were intensified to promote exports, tourism and the usage of locally-produced goods. Meanwhile, continued attention was directed at reducing the cost of doing business in Malaysia. In the 1998 Budget, the corporate tax and the petroleum income tax were reduced by two percentage points each to 28% and 38% respectively.

Measures were instituted to further strengthen prudential standards of the banking system. These measures included the recognition of a loan as non-performing when its servicing had been in arrears for three months instead of six; increasing the minimum general provision from 1% to 1.5%; and greater disclosure in financial statements. Meanwhile, measures to reduce credit growth and exposure to the less productive sectors took the form of voluntary credit plans whereby the financial institutions undertook to reduce overall credit growth to 25% by the end of 1997, 20% by end-March 1998 and 15% by end-1998. Concurrently, banking institutions had to ensure that in allocating credit, priority would be accorded to borrowers engaged in productive and export-oriented activities. Measures were also taken to address the concerns on the high leverage of corporations. To complement credit measures introduced on bank lending, funds to be raised in the capital market were also subject to more stringent requirements.

Measures that were implemented to enhance corporate governance, accountability and high disclosure standards included closer scrutiny on corporate restructuring; and a requirement for companies to disseminate more timely and transparent information to investors. In line with this move, BNM also introduced changes in the format of its regular publications, aimed at providing more detailed and analytical information to the public.

The regional financial crisis has highlighted the importance of sound macroeconomic policies and a strong financial system as the best defence against volatility in capital flows. At the same time, the maintenance of consistent and transparent policies are vital to enhance investor confidence. While these elements would not completely insulate an economy from the contagion effects of external developments, they would increase its resilience in dealing with potential shocks. Recognising these considerations, Malaysia has undertaken appropriate policy adjustments to build upon the strengths while addressing any weaknesses in the economic and financial system. In the process, this would ensure that the Malaysian economy would be able to surmount the present difficulties, and become more resilient and stronger than before.

Sectoral Review

Output growth in the **manufacturing sector** was sustained at 12.5% in 1997. The performance of the manufacturing sector in the **first half** of the year was supported mainly by the better-than-expected recovery in the electronics industry and stronger growth in the chemical, paper products and off-estate processing industries. Hence, growth before the onset of the currency crisis in July was driven mainly by the improved performance of the export-oriented industries (12.2% and 4.7% in the first half of 1997 and 1996 respectively), supported by sustained strong growth in the domestic-oriented industries (15.2%; 17.9% in 1996). However, growth of the manufacturing sector in the **second half** of the year was affected by the financial turbulence in the region as well as structural adjustments in the construction sector. Although the financial turbulence resulted in an improvement in the competitiveness of some industries, on balance, the performance of the export-oriented industries was dampened by the slower growth in demand arising from the economic slowdown in the Asian region, which accounts for about one-third of Malaysia's exports of manufactures. The favourable impact of the depreciation of the ringgit in terms of improved competitiveness of the export-oriented industries as well as the stronger external demand for electronics and textiles were not sufficient to offset the lower growth in external and domestic demand for other products. Compared with 1996, growth in the manufacturing sector in the second half of the year consolidated (11.5%; 13.8% in the corresponding period of 1996), reflecting slower growth in both the export-oriented industries (8.8%; 11.7% in 1996) as well as the domestic-oriented industries (14%; 16% in 1996). Owing to poor external demand for electrical and wood products and the higher cost of inputs for the off-estate processing industries, growth in the export-oriented industries moderated in the second half of the year. On the other hand, growth of the domestic-oriented industries was affected more by the erosion of wealth due to developments in the stock market as well as structural adjustments in the construction sector which had caused growth of construction-related industries to moderate significantly to 7.2% in the second half of 1997 (23.7% in 1996). Despite the unfavourable development, the domestic-oriented industries continued to perform well at double-digit growth, riding on the back of strong growth in selected industries, especially the chemical, paper products and tobacco industries.

In 1997, production of **electrical machinery, apparatus, appliances and supplies**, which accounted for 33% of manufacturing output and two-thirds of total exports of manufactures, expanded strongly to grow by 13.7%. The stronger growth was stimulated mainly by improved global demand for semiconductors, particularly from the United States, Europe and the Asia-Pacific countries (excluding Japan). Arising from the oversupply of memory chips, world demand for semiconductors started to show signs of softening since the end of 1995 and worsened throughout 1996 and early 1997. However, since May 1997, world demand for semiconductors improved. Consequently, growth of the electronics industry surpassed its performance in 1996 to grow by 22.6%. Nevertheless, the recovery in demand was not accompanied by an increase in the price of memory chips. In contrast, the price of the industry benchmark 16MB memory chip plunged to a record low of US$2.50 per chip in December 1997, from a high of US$50 at the end of 1995, as a result of the intense competition among the manufacturers and the rapid process of upgrading to more powerful chips. Growth in this sub-sector was dampened by the moderation in output of disk drives. Increased competition and the consequent lower prices created a glut in the production capacity of disk drives world-wide, thus causing growth in the electronics industry to moderate from 23.8% in the first half of 1997 (6.2% in the corresponding period of 1996) to 20.8% in the last quarter of the year (22.2% in the fourth quarter of 1996). In addition, the economic downturn in the Asia-Pacific region also affected external demand, especially in November and December.

The strong recovery in the electronics industry was, however, offset to a certain extent by the electrical appliances sub-sector. Production declined by 1% due to intense competition and global excess supply of electrical products. In addition, the economic slowdown in the Asia-Pacific region also affected demand, particularly for audio-visual products and air-conditioners. This region accounted for about one-fourth (excluding Singapore) of Malaysian exports of electrical products.

Supported by higher production in the textile sub-sector, particularly the higher value added synthetic textiles, the **textiles and wearing apparel industry** expanded by 7.8% in the first half of 1997 (-0.9% in the corresponding period of 1996). The recovery in this sub-sector was dampened by the continued

Table 1.3
Growth in Manufacturing Production (1993=100)

	1995	1996	1997
	Annual change (%)		
Export-oriented Industry	**15.2**	**8.2**	**10.5**
Electrical machinery, apparatus, appliances and supplies	20.5	8.9	13.7
Radio and television sets	*22.4*	*5.9*	*–6.5*
Semiconductors	*21.7*	*12.6*	*22.6*
Cables and wires	*11.2*	*12.6*	*10.6*
Manuf. of office, computing and accounting machinery	*17.3*	*–2.4*	*9.1*
Manuf. of refrigerating, exhaust, ventilating and air-conditioning machinery	*16.9*	*–5.0*	*0.9*
(Electronics)	(21.7)	(12.6)	(22.6)
(Electrical)	(18.8)	(3.3)	(–1.0)
Textiles and wearing apparel	5.4	0.0	5.1
Wood and wood products	6.1	11.4	–1.7
Off-estate processing	5.1	10.3	10.3
Domestic-oriented Industry	**12.8**	**16.9**	**14.6**
Chemicals and chemical products	11.5	19.6	24.4
Construction-related products	11.7	21.2	11.3
Non-metallic mineral products	*10.9*	*24.5*	*9.9*
Basic iron & steel and non-ferrous metal	*12.8*	*17.1*	*13.2*
Transport equipment	36.2	22.3	14.2
Food products	7.3	4.4	3.8
Beverages	10.7	15.5	0.0
Tobacco products	2.0	7.5	19.9
Rubber products	13.1	11.1	3.4
Petroleum products	13.9	12.7	8.9
Fabricated metal products	9.1	23.1	12.0
Paper products	9.2	–4.8	12.8
Total	**14.2**	**12.3**	**12.5**

Source: Department of Statistics

decline in output of wearing apparel by 1.6% in the first half of 1997 (-3.5% in the same period of 1996) as competition in the international market remained intense. Output of the industry decelerated sharply to 2.5% in the second half of the year. The slowdown was due mainly to cutbacks in natural fibre spinning and weaving activities in response to the rising cost of imported cotton. Reflecting largely the cheaper cost of importing wearing apparel in the second half of the year because of the ringgit depreciation, overseas demand particularly from the United States and Europe (which accounted for about half of the industry's exports), helped to offset the slowdown in the textiles sub-sector. Therefore, for the year as a whole, the textiles and wearing apparel industry recovered to grow by 5.1% in 1997.

The sharp downturn in the property sector in the region resulted in a slowdown in construction activity in Japan, Korea and the People's Republic of China. In turn, this was reflected in lower overseas demand for Malaysian **wood and wood products**. Consequently, output of the industry moderated to 4.4% during the first half of the year (10.6% in the same period of 1996). As the financial crisis in the region spread in the second half of the year, growth in the wood and wood products industry deteriorated further to decline by 6.9%, so that production declined by 1.7% for the year as a whole. The lower output was due mainly to the continued deterioration in the sawn timber sub-sector which was hampered by the limited supply of logs as well as a sharp slowdown in the production of plywood and particle board.

Spurred by strong external demand for palm oil products, production in the **off-estate processing industry** surged strongly by 14.6% in the first half of 1997 (3.3% in the first half of 1996). However, growth moderated significantly to 3.2% in the fourth quarter of 1997 (20.2% in the same period of 1996) mainly because of the higher cost of production due to the increased cost of crude palm oil which was quoted in United States dollars. Indonesia's ban on exports of palm oil in the second half of 1997 also reinforced the upward pressure on the cost of crude palm oil. Although rubber is quoted in ringgit, output from rubber millers declined due to insufficient supply of raw materials. Despite the supply constraint of its raw material inputs, the off-estate processing industry still maintained growth at 10.3%, the same growth rate as recorded in 1996.

Notwithstanding the slowdown in the domestic economy, output of the domestic-oriented industries was sustained at a strong double-digit growth of 14.6%. Growth emanated mainly from the chemicals and chemical products, tobacco, rubber and paper products industries. These industries were less affected by the erosion of wealth in the stock market. The industries that were most affected were the **construction-related products industries** where output moderated sharply to 6% in the last quarter of the year (23% in the fourth quarter of 1996), from a high of 15.9% in the first half of 1997 (18.4% in the first half of 1996). Although growth in this group of industries slowed down significantly from 21.2% in 1996, it remained at a creditable level of 11.3% for 1997 as a whole. In the second half of the year, the industry was significantly affected by lower demand for construction-related materials as large projects were postponed, including development of higher cost residential houses. Reflecting the downturn in construction activity, growth of the non-metallic mineral products and iron and steel industries weakened to 9.9% and 13.2% respectively. The sharp slowdown, particularly in the last quarter of 1997, was due mainly to the scaling back of production in the cement and concrete products, hydraulic cement and primary iron and steel products industries.

After an impressive growth of 23.1% in 1996, growth in the **fabricated metal products industry** slowed down to 12%. This was due to the decline in the output of structural metal products arising from slower demand from the heavy and light engineering sub-sector, especially in the construction sector. Nevertheless, output from other sub-sectors, particularly tin and metal boxes, wire and wire products and brass, copper and aluminium, remained strong due to sustained domestic demand.

Production of **chemicals and chemical products** strengthened further to grow by 24.4%, attributed mainly to a strong increase in output in the industrial chemicals and plastic products sub-sectors. Strong domestic and external demand for industrial gases continued to support growth in the industrial chemicals sub-sector which had expanded its capacity in 1996. Meanwhile, the recovery in the electronics sector helped to boost the output of plastic-related packaging materials.

With the recovery in the electronics sector, there was a corresponding increase in demand for paper-based packaging materials, particularly in the second half of the year. Output of the **paper products industry** increased strongly by 16.5%, from 8.9% in the first half of 1997. Consequently, production for the whole year turned around to grow strongly by 12.8%. Growth was strong for inputs of packaging materials, particularly containers and boxes of paper and paperboard.

Despite the erosion of wealth, demand for new cars continued to remain strong in the first nine months of 1997. Sales of passenger cars and commercial vehicles declined drastically by 9.8% and 34.1% respectively in the last quarter of 1997 (increased by 22% and 26.7% respectively in the first nine months of 1997). Car sales declined towards the end of the year when BNM tightened the hire-purchase guidelines for the purchase of passenger cars by lowering the credit ceiling from 75% to 70% and shortening the repayment period to not more than five years. In addition, demand was affected by the imposition of higher import duties and tight liquidity in the banking system. Despite these developments, the assembly of motor vehicles recorded a higher growth of 21.2% while the production of motor vehicle parts and accessories moderated to 0.3% in the fourth quarter of 1997 (16.7% and 8.7% respectively in the first nine months of 1997). The sharp moderation in production of motor vehicles only occurred in December when its growth slowed down to 13.5%, from 28.6% in November 1997. In addition, the assembly of motorcycles and scooters declined by 15.2% in the fourth quarter (an increase of 26% in the first nine months of 1997). Consequently, growth in the **transport equipment industry** as a group moderated sharply to 10.7% in the fourth quarter (15.5% in the first nine months of 1997), contributing to the sharp moderation in output to 14.2% for the year as a whole.

Boosted by higher external demand for rubber gloves and a weaker ringgit, output of the **rubber products industry** surged from virtual stagnation in the first half of the year to grow by 6.4% in the second half of 1997. Meanwhile, output of the tyre and tube industry remained relatively strong

Table 1.4
Manufacturing Production: Selected Indicators

	1997	1996	1997
	Output	Annual change (%)	
Integrated circuits (million units)	12,552	-4.9	28.4
Semiconductors (million units)	7,432	10.1	41.9
Television sets (‘000 units)	7,775	-5.9	-12.7
Room air-conditioners (‘000 units)	2,114	-3.2	-28.9
Household refrigerators (‘000 units)	250	-12.9	-2.7
Vehicles assembled (‘000 units)	882	15.3	22.2
Passenger cars	*363*	*29.9*	*16.0*
Commercial vehicles	*95*	*41.1*	*20.3*
Motorcycles & scooters	*424*	*0.3*	*28.5*
Pneumatic tyres (‘000 units)	13,754	7.5	12.5
Rubber gloves (million pairs)	8,919	13.1	4.8
Plywood (‘000 cu.metre)	4,508	26.9	1.3
Veneer sheets (‘000 cu.metre)	1,263	-7.0	-4.5
Liquefied petroleum gas (‘000 tonnes)	1,353	5.8	-2.9
Kerosene & gasoline (‘000 tonnes)	2,243	15.9	3.1
Diesel and gas oil (‘000 tonnes)	6,792	6.9	7.4
Fuel oil (‘000 tonnes)	3,153	21.1	12.8
Cement (‘000 tonnes)	12,558	15.3	1.7
Iron and steel bars and rods (‘000 tonnes)	3,377	23.1	11.5

Source: Department of Statistics

despite the softening demand in the car industry. Consequently, production of the industry for the year as a whole moderated to 3.4%. The industry continued to face competition, especially from Thailand and Indonesia, in the wake of the sharp depreciation of the region's currencies. At the same time, expansion of the industry was constrained by the limited supply of natural rubber in the country.

In tandem with the softening of the car market, demand for **petroleum products** also slowed down markedly to 6% in the fourth quarter, from 11.6% in the first half of 1997. For the year as a whole, growth of the industry moderated to 8.9%. Although the production of crude oil refineries remained strong, production of the other petroleum products, such as lubricating oil for motor vehicles and premixed asphalt for road construction purposes, decelerated sharply in tandem with the moderation in the transport equipment industry as well as the deferment of projects in the construction sector towards the end of the year.

Growth in the **food, beverages and tobacco products industries** as a group registered a slightly slower growth of 5.5% due mainly to the decline in output of the soft drinks, chocolate and sugar confectionery, large rice mills and other dairy food sub-sector. In contrast, the production of tobacco increased sharply by 19.9%. To summarise, the sustained strong growth of the manufacturing sector was boosted by higher growth in export-oriented industries (10.5%; 8.2% in 1996) which had supported strong growth in the domestic-oriented industries (14.6%; 16.9% in 1996) through inter-industry linkages.

The **1997 Bank Negara Malaysia Survey of Manufacturing Companies,** which covered 342 companies from a cross-section of all industrial groups, indicated that production in the manufacturing sector increased by 10.1%. Growth emanated mainly from the electronics, textiles, chemicals, transport equipment and basic metal industries. However, the increase was dampened by lower output in the wood and electrical products industries. On the external front, growth in export sales picked up strongly to grow by 11.2% in 1997 (3.5% in 1996), reflecting mainly higher exports of electronics, chemicals, transport equipment and fabricated metal products. The strong growth in export receipts reflected mainly the valuation gain due to the depreciation of the ringgit. In anticipation of higher demand, companies increased their capital investment, particularly in the transport equipment, electronics and off-estate processing industries. With the expansion in production capacity, the slowdown in production, especially towards the end of 1997, caused the average capacity utilisation of the manufacturing sector to decline from 82.2% in 1996 to 79% in 1997. For 1998, a majority of the companies indicated that the capital outlay would be reduced because they were pessimistic about the prospects for the manufacturing sector, particularly for the domestic-oriented industries, as they expected the economic downturn in the region and the volatility of the currency to continue. Growth would be export-led with production projected to slow down to 6.1%, while exports were expected to increase by 17.9% in 1998.

The impact of the depreciation of the ringgit differed among industries. Export-oriented industries in general benefited from the depreciation and increased their export receipts due to the valuation impact, as reported by 58% of the respondents. Another 10% of the respondents indicated a deterioration in export receipts, while 32% were not significantly affected. Export-oriented industries benefited more, as reflected in the improved export receipts for 64% of the companies in these industries compared with 51% of those in the domestic-oriented industries. The gain for exporters was not confined to mere valuation gains; 30% of the respondents reported a higher volume of exports while 57% reported maintaining the previous year’s export level. In the face of intense competition from the region, 33% of the respondents reported a downward adjustment in the United States dollar export price, while another 67% were able to maintain prices in foreign currency. A majority of the respondents, however, expected the export price in foreign currency to slide further in 1998.

The adverse impact of the currency depreciation was more severe on domestic sales as 35% of the respondents reported lower domestic sales turnover, while 44% were not affected. The decline in domestic sales was more significant in industries engaged in the construction-related materials and transport equipment industries which were also affected by the imposition of prudential limits on lending to the less productive sectors. In contrast, domestic sales for 21% of the respondents increased as customers substituted from imported items which had become more expensive. Nevertheless, 90% of the respondents reported a higher cost of production

Table 1.5
Impact of the Ringgit Depreciation on the Manufacturing Sector

	Sales		Export volume			Profit
	Export Sales	Domestic Sales	Export-oriented industries	Domestic-oriented industries	Total	Total
	% of respondents					
Higher	58	21	30	29	**30**	**37**
Lower	10	35	13	16	**14**	**56**
Same/No impact	32	44	57	55	**56**	**7**
Total	100	100	100	100	**100**	**100**

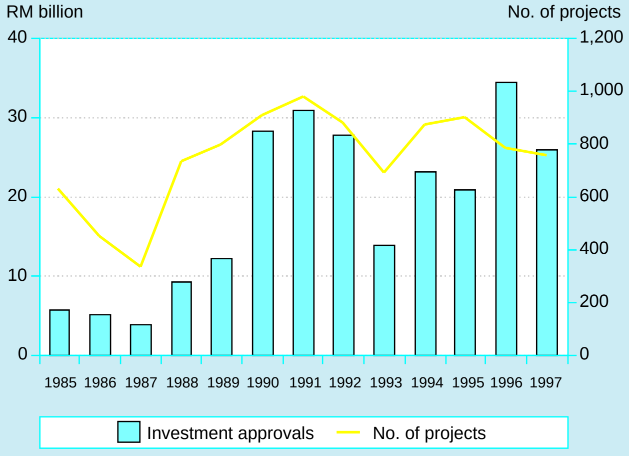
Source: Bank Negara Malaysia Survey of Manufacturing Companies, 1997.

due to the higher cost of imported components. This led to lower profits for 56% of the respondents, compared with 37% which achieved higher profits in 1997. Nevertheless, 91% of the respondents expected to continue to make profits in 1998. In the face of economic uncertainty and higher imported cost of capital items, 49% of the companies indicated that they would either scale down or postpone their investment, but 14% would increase investment plans while another 37% were not affected by exchange rate factors.

The problem of labour shortages persisted for the respondent companies, reflecting six consecutive years of full employment in the country. However, the tight labour market condition was expected to ease in view of the slower growth projected for 1998. In the meantime, the manufacturing firms had undertaken various short- and long-term measures to alleviate the labour problem. While one-third of the respondent companies provided training to improve productivity, 20% resorted to the employment of foreign workers and more than 20% had undertaken strategic adjustment through automation. Nevertheless, a slightly higher proportion of firms (39%) reported an increase in technical or skilled workers in 1997 (38% in 1996) and the share of unskilled workers declined marginally from 54% in 1996 to 53% in 1997.

The value of **investment** approved in the manufacturing sector by the Ministry of International Trade and Industry (MITI) in 1997 was high at RM25.8 billion, although lower than the record level of RM34.3 billion approved in 1996. Applications for investment also showed a similar trend, with the value of applications recording a decline of 20.6% to RM33.4 billion, from a high level of RM42.1 billion in 1996. Of the total investment approved, about 39% was contributed by five large projects, each with proposed capital investment exceeding RM1 billion. This implied a further shift towards higher value added and more capital-intensive investment, reflecting positive response to the provision of special fiscal and other incentives to promote high-technology industries. The level of investment applications and approvals remained high in the second half of 1997, indicating that investors in the real sector were confident of Malaysia's long-term growth prospects, despite the financial crisis. An analysis by industry indicated that the petroleum products (including petrochemicals) industry accounted for the largest share of 25.4% of total value of investment approved. The electrical and electronics industry was the next largest (24.1%), followed by basic metal products (14.6%), non-metallic mineral products (6.2%) and chemicals and chemical products (5.1%) industries. In terms of ownership, the share of domestic investors (56%) exceeded that of the foreign investors (44%). With Malaysia facing keen competition from low-cost producers, the focus in recent years was on the quality of investment, with emphasis on facilitating the manufacturing sector to shift towards higher value added and technology-driven activities with higher export orientation, lower import content and high inter-linkages. In this regard, foreign direct investment continued to play an important role as reflected by the significant foreign involvement in several industries, especially petroleum products (37.2% of foreign direct investment), electrical and electronic products (24.3%), chemicals and chemical products (6.5%), basic metal products (6.2%) and fabricated metal products (5.4%). The top five foreign

Graph 1.4
Malaysia : Investment Approvals



investors in 1997 were the United States (20% of foreign direct investment inflows in 1997), Japan (19%), Germany (16%), Taiwan, Republic of China (ROC) (12%) and Singapore (11%). These countries together accounted for 78% of total foreign direct investment approved.

The 1998 Budget contained several incentives to improve the competitiveness of the manufacturing sector by enhancing Malaysia's business and investment environment. Specifically, these incentives were aimed at further promoting private investment (both domestic and foreign) and increasing productivity, while reducing the cost of doing business. Several of the incentives would reinforce the benefits accruing to the export-oriented industries arising from a weaker ringgit. The major incentive provided was the reduction in the corporate income tax rate to 28% from 30%, with effect from assessment year 1998. At the same time, various other tax exemptions and allowances were provided to boost exports, while customs procedures would be simplified. For the manufacturing sector, companies exporting goods with value added of 30% were given exemption from income tax equivalent to 10% of the increase in export value and exemptions equivalent to 15% for the export of goods with value added of 50%. A special building allowance of 10% was provided on the expenditure incurred for the purchase or construction of warehouses which are used for export purposes.

To enhance the capacity of domestic manufacturing production for import substitution, the initial capital allowance for imported heavy machinery and the annual allowance were reduced to 10%, while the import duty rates were raised for construction materials, heavy machinery and equipment, selected consumer durables, cars and other vehicles. Several incentives were also introduced to support the Second Industrial Master Plan strategy to encourage the manufacturing sector to venture into other upstream and downstream activities along the value chain and to become more technology-oriented and knowledge driven. The reinvestment allowance was reviewed and restricted only to reinvestment that would result in increased productivity through automation and labour saving devices. To promote the use of Malaysian brand names, the expenditure incurred on local advertising was given a double deduction for income tax purposes, while research and development incentives were extended to companies carrying out designing or prototyping as separate activities. In addition, an allocation of RM270 million was also provided in the 1998 Budget to develop local technology and potential research and development that would be capable of assisting the industrialisation process and improving the quality and standard of locally-manufactured goods. In relation to financing, the Government established a RM1 billion fund with the objective of providing financing to the small- and medium-scale industries (SMIs) at lower cost, in order to promote exports and new growth industries (including high-technology industries).

The **construction** sector consolidated in 1997 with growth moderating to 10.6% (14.2% in 1996) following several measures adopted during the course of the year to pre-empt the development of a property bubble. Growth was generally broad-based, driven by continued strong construction activity in the residential and non-residential sub-sectors, as well as the expansion of large infrastructure and civil engineering projects. The civil engineering sub-sector expanded by 12.3% (15.7% in 1996), while growth of the residential and non-residential sub-sectors was more moderate at 10% and 8.1% respectively (13.2% and 12.4% respectively in 1996). Growth was particularly strong in the first three quarters of the year but slowed down to 6.8% in the last quarter of 1997 due to the deferment of some projects as well as tight liquidity conditions, which affected financing to the sector. The Bank also tightened prudential measures to curb excessive lending to specific types of property development. The consolidation of the construction sector was reflected in the moderate increase of 8.4% in the total value of property transactions in 1997 to RM53.1 billion (1996: 22.9% to RM49 billion), while the total number of transactions rose marginally by 1.8% to 275,328 (7.4% to 270,538 transactions in 1996).

Growth in the **civil engineering sub-sector** remained high in 1997 because construction of projects related to infrastructure facilities and capacity expansion peaked during the year. The bulk of the infrastructure projects was in the form of road and rail transport, airport and port facilities as well as power plants. In particular, the construction value of road projects was sharply higher in 1997. This included the on-going construction of the Second Link to Singapore, Shah Alam Expressway (Phase 2), North-South Central Link Expressway, the Middle Ring Road II in Kuala Lumpur, Elevated Highway, New Pantai Highway, Damansara-Puchong Highway and the upgrading of Sungai Besi Road, Cheras-Kajang Road and Kuala Lumpur-Karak Highway. At the same time, construction activity of rail transportation increased significantly due to the Light Rail Transit System, Kuala Lumpur Sentral Station, Express Rail Link and the Kuala Lumpur Monorail System. The construction of the Kuala Lumpur International Airport also gained momentum in order to meet the targeted opening date. Although the Government had announced the deferment of several projects in the 1998 Budget, the impact on the growth performance for the sector in 1997 was minimal as only one on-going project was affected, namely, the Bakun Hydroelectric Dam. In view of these developments, the civil engineering sub-sector continued to account for the largest share (48%) of value added in the construction sector.

The moderation in growth of the **non-residential sub-sector** to 8.1% in 1997 (12.4% in 1996) reflected the slower progress in the construction of several purpose-built office space buildings and shopping complexes, especially towards the last quarter of the year. The slowdown in this sub-sector was, however, offset by the relatively strong demand for commercial space emanating from new business activities and increased consumption as well as expansion in construction activity in the hotel industry. This strong growth was reflected in the total value of transactions for commercial buildings (comprising shop-houses and office buildings) which rose by 23.9%, while those for industrial property declined by 11.2% in 1997. At the same time, the number of transactions increased by 6.4% and 1.7% respectively, reflecting an increase in prices of the commercial property transacted while prices of industrial property declined. In the hotel industry, the number of new hotels increased by 9.5% or 122 new hotels with 27,832 rooms in 1997 (1996: 5.7%; 69 new hotels with 9,141 rooms). The significant increase in hotel capacity was partly in preparation for the XVI Commonwealth Games to be held in Kuala Lumpur in September 1998. Most of the new hotels were located in Kuala Lumpur (32 hotels with 8,229 rooms), followed by Selangor (17 hotels with 4,759 rooms) and Johor (14 hotels with 3,255 rooms). With the increased supply of rooms, the average occupancy rate for the nation as a whole declined to 58% in 1997 from 62% in 1996. However, the average occupancy rate of hotels in the Klang Valley remained high at 69% in 1997.

Bank Negara Malaysia's Survey on Office Space in the Klang Valley showed that a total of 21 purpose-built office buildings with a net lettable area of 639,375 square metres were completed in 1997. A significant portion (34%) of the space completed is in Tower 1 of the KLCC with a net lettable area of 218,000 square metres, and is fully occupied by PETRONAS. The average occupancy rate in the office space market at end-1997 declined only marginally to 95% from 97% in 1996 due to the late completion of several buildings, which were originally scheduled to enter the market in 1997. The void was mainly in the older buildings as tenants relocated to newer buildings that offered more and better facilities. Nevertheless, choice buildings located in the Golden Triangle continued

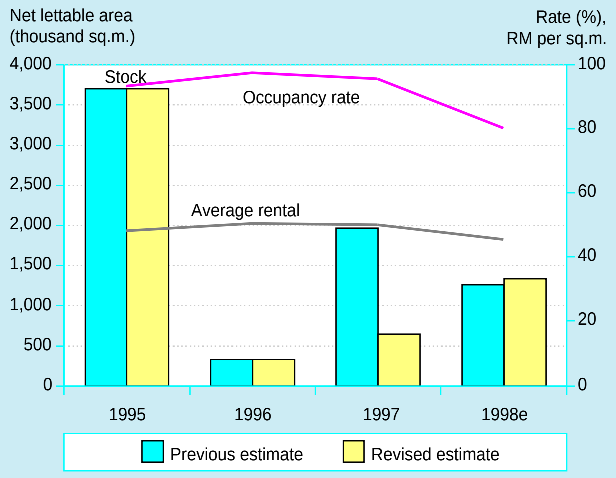
Table 1.6
Supply of Office Space and Condominiums in the Klang Valley

	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*e*	42	1,320,135	47	14,791	1,719,577
Total	**217**	**5,356,896**	**301**	**71,371**	**8,260,803**

e Estimate

Source: Survey by Bank Negara Malaysia

Graph 1.5
Supply of Purpose-Built Office Space in the Klang Valley

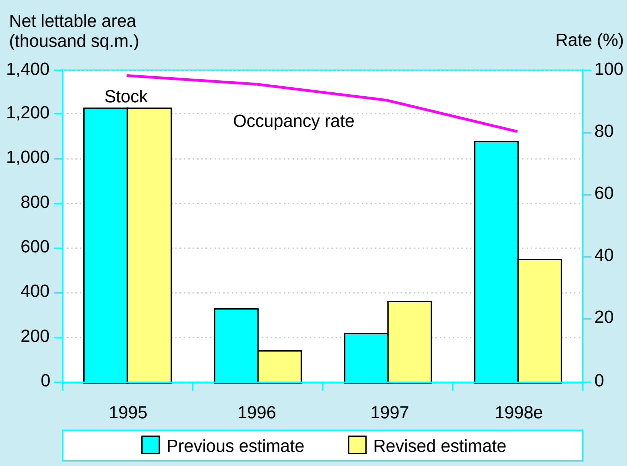


to enjoy full occupancy. The average monthly rental declined marginally by 1.3% from RM50.45 per square metre (RM4.70 per square foot) at the end of 1996 to RM49.75 per square metre (RM4.60 per square foot) at the end of 1997. Certain prime buildings located outside the Golden Triangle were rented out at premium rates similar to buildings in the Golden Triangle due to enhanced accessibility. In addition, prime office buildings located in the Golden Triangle, Central Business District and Damansara in Kuala Lumpur as well as in certain locations of Petaling Jaya were estimated to enjoy full occupancy with stable rentals as the increase in supply in these localities had been rather limited. In view of the new supply, demand for older buildings located in less popular areas in the suburbs of the Klang Valley moderated. However, following curbs on financing for such buildings, the estimates on supply coming on-stream in 1997 and 1998 have been revised substantially downwards.

Based on the 1997 Property Market Report, the stock of retail space in commercial complexes in the Klang Valley increased by 26.6% from 1.4 million square metres in 1996 to 1.7 million square metres in 1997. In addition, a total of 1.4 million square metres (representing 83.4% of the existing stock) of retail space were at various stages of construction in 1997. The Bank's Survey indicates that a total of 549,000 square metres of retail space would enter the market in 1998, instead of an earlier estimate of 1.1 million square metres. Recognising the potential for excess supply, several developers have rescheduled the completion of projects so that the large increase in supply anticipated earlier would probably be moderated.

Value added in the **residential sub-sector** rose by 10% in 1997 in response to the sustained strong demand for housing, particularly landed property. Consequently, the number of houses completed in 1997 increased to 132,562 units, accounting for 16.6% of the 800,000 housing units targeted for completion during the Seventh Malaysia Plan period. In addition, the number of houses approved by the Ministry of Housing and Local Government for construction by private developers in Peninsular Malaysia rose significantly by 63% to 188,400 units (115,540 in 1996). Of the total number of houses approved for construction, 46.9% were high-cost units, 28% medium-cost and 25.1% low-cost units. In the case of flats and condominium units priced above RM100,000, the number approved by the Ministry increased significantly by 82.1% to 29,925 units in 1997 from 16,437 units in 1996. Reflecting strong construction starts, new sales and advertising permits for residential and shop-houses in Peninsular Malaysia issued by the Ministry increased by 18.9% to 867 in 1997. The Bank's Survey on the construction of condominiums in the Klang Valley showed that a total of 25 condominium projects comprising 7,530 apartment units with a total built-up area of 864,000 square metres were completed in 1997 (35 projects comprising 8,342 units with one million square metres in 1996). In response to the sustained strong demand for residential housing, the total value of residential property transactions in 1997 rose by 15.2% to RM21.6 billion (1996: 18.6% to RM18.8 billion), while the total number of transactions increased by 3.3% to 175,682 units (1996: 8.3% to 170,007 units). Transactions were particularly buoyant in the first half of 1997 when expectations of capital gains on property fuelled demand. Towards year-end,

Graph 1.6
Supply of Retail Space in the Klang Valley



financing constraints and the loss of wealth due to the financial crisis caused transaction volume to decelerate markedly.

Although construction activity for residential property remained buoyant, the demand for traditional landed housing consistently exceeded supply, particularly in the major towns. The shortage of housing supply was attributed partly to the scarcity of suitable land for housing in preferred locations, the long time taken for land conversion as well as increased demand from an increasingly affluent population and from migrants who had moved to the major towns in search of better economic opportunities. In view of the strong underlying demand and interest in property investment (partly due to anticipation of speculative gains), **house prices continued to increase in 1997** but at a more moderate rate. The National House Price Index for the first half of 1997 showed an increase of 6.1% compared with an increase of 12.9% for the whole of 1996. Prices for terrace houses increased by 11.2% (10.2% in 1996), followed by detached houses (10.4%; 14.1% in 1996) and semi-detached houses (8.5%; 8.1% in 1996). However, the increase in house prices was most evident in the case of landed residential properties in Kuala Lumpur, Selangor and Pulau Pinang. In Kuala Lumpur, prices for semi-detached and detached houses rose by 22.2% and 16.9% respectively in the first half of 1997. In Selangor, prices for detached houses rose by 17.6% while semi-detached houses in Pulau Pinang increased by 13.6%. In contrast, prices for high-rise units declined by 4.6% due mainly to a 5.9% decline in prices for high-rise units in Kuala Lumpur. The Maybank-Rating Agency Malaysia (RAM) Property Index, which is based on landed residential property prices in the Klang Valley, showed that house prices consolidated during the third quarter of 1997. After registering double-digit growth since 1994, the rise in the Index moderated from 10.6% in the first half of the year to 8.1% in the third quarter (third quarter of 1996: 12.7%). Prices of double storey terrace houses experienced the slowest growth of 6.4% while prices of single storey terrace houses grew by 9.7%. Meanwhile, prices of semi-detached houses continued to record double-digit growth, albeit slower at 12.9% (third quarter of 1996: 15.6%).

The increase in house prices moderated following implementation of several measures during the year to discourage speculative activities and to contain pressure of escalation in property prices. These included the measure by the Bank to limit the credit exposure of the financial institutions to the broad property sector effective April 1997. In addition, expectation of a strong increase in supply following a significant rise in approvals for housing projects also contributed to the slowdown in the rate of price increases. The guidelines by the National Land Council on acquisition of properties by foreigners, which were revised effective 23 June 1995, also had some dampening effect on sentiment in the property sector in 1997. It reduced foreign purchases of residential property, especially condominiums. The total number and value of residential property acquired by foreigners declined further to 479 units and RM215.6 million respectively in 1997 (1,521 units valued at RM488.5 million in 1996). Properties that were adversely affected were condominiums, which declined by 73.1% in terms of number of units and 63.2% in terms of value. The proportion of foreign share of the total transacted value for residential property declined significantly from a peak of about 10% during the 1993–95 period to 2.6% in 1996 and 1% in 1997. However, in the case of non-residential property, foreign purchases of commercial property declined by nine units or 4.6% to 186 units (195 units at RM213.8 million in 1996), but the value continued to increase by RM112.4 million or 52% to RM326.2 million. To promote foreign interest in the property market, the RM100,000 levy on foreign purchases imposed in 1995 was removed effective 28 August 1997. In addition, the 1998 Budget made provisions for the reduction of the Real Property Gains Tax to 5% for disposal of property after the fifth year as well as the relaxation of guidelines on foreign ownership of properties. Foreigners were also allowed to buy two condominium units, with the foreign quota increased from 30% to 50%.

Reflecting the performance of the construction sector in 1997, production of major construction-related materials expanded further. During the year, production of cement and concrete, iron and steel, and construction-related products increased by 21.3%, 7.8% and 11.3% respectively, while sales of cement and concrete products rose by 23%, plywood, hardboard and particle board by 8.1%, and structural clay products by 40%. However, sales of iron and steel declined by 3.4%. Despite the higher output of construction-related materials, prices of several major building materials continued to increase during the year, thus exerting pressure on property prices. The average price of glass sheet increased by 15.9%, paints by 13%, mosaic floor tiles by 11.8%, glazed wall tiles by 10.5% and sand by 7.8%. As cement remained a controlled item, its price was maintained at the ceiling rate of RM10.35 per 50 kilogramme bag of ordinary portland cement in Peninsular Malaysia, while mild steel round bars and high tensile deformed bars were still priced within the ceiling prices of RM1,189 per metric tonne and RM1,229 per metric tonne respectively. However, prices of two items which are mainly used in civil engineering works, namely, fuel oil and bitumen, increased significantly by 33% and 29.7% respectively in the last quarter of 1997 following higher import cost from a weaker ringgit.

Demand for construction workers in 1997 remained high, exerting further pressure on wages. The **average daily wages** for skilled and semi-skilled foreign workers rose further by 15% and 7.7% respectively in 1997, while wages for unskilled foreign workers declined by 2.6% (0%, 5.4% and 6.5% respectively in 1996). However, the average daily wage for local construction workers increased marginally by about 2.9% for all three categories of workers after having increased substantially in 1996 (22.5% for skilled, 13.5% for semi-skilled and 7.4% for unskilled workers). Nevertheless, wages of local workers were higher by 25–43% compared with their foreign counterparts. In 1997, **total employment in the construction sector** continued to expand by 5.4% to 765,000 persons (9.1% of total national employment), of which 30% were foreign workers. In reality, the share of foreign construction workers was higher as the number of illegal workers was not included in the statistics. The Bank's Survey findings indicated that in the case of the civil engineering sub-sector, about 60% of the construction workers (both legal and illegal) were foreigners.

It is estimated that although the gross local content for infrastructure projects is about 64% of the total project value, the net local content is lower at 48%. Imports of building materials and heavy machinery and equipment for the construction sector (such as tower cranes, forklifts, crane lorries and concrete mixer lorries) accounted for 3.8% of total imports, while imports of iron and steel accounted for 3.9% in 1997. In terms of value, imports of intermediate goods for construction amounted to RM5.2 billion, a decrease of 3.5% compared with RM5.4 billion in 1996. To discourage unnecessary imports, the import of heavy machinery for the construction sector was made subject to approval of the Ministry of International Trade and Industry. Approval would be given provided the machinery was not available locally. In addition, the import duty on crane lorries and concrete mixer lorries was increased from 35% to 50%, while the import duty on construction materials such as tiles, marble, iron and steel was increased to between 10% to 30% (from between 5% to 25%).

Despite continued monetary restraint in 1997, demand in the property sector remained high. The total value of loans (excluding loans sold to Cagamas) extended by the banking system to the broad property sector, comprising residential, non-residential, real estate and construction, increased further by 32.5% or RM29.6 billion to RM102.6 billion in 1997. Such loans accounted for 35.8% of total loans extended during the year. However, total loans extended to the broad property sector, including loans sold to Cagamas, accounted for 39.9% of total loans extended in 1997. Of the total housing loans extended in 1997, 52.4% were housing mortgage loans purchased by Cagamas. During the year, new mortgage loans purchased by Cagamas increased further by 41.2% to RM5.6 billion (RM4.7 billion in 1996). The purchase of housing loans by Cagamas accelerated in the fourth quarter as the liquidity situation tightened further. Loan growth for properties covered under the BNM Guidelines effective April 1997 moderated. By the end of December, the exposure of the banking system to the property loans subject to the guideline was 13.1% as against 14% at the end of June.

Loans by housing credit institutions for residential houses amounted to RM48.1 billion, an increase of 9.7% over 1996. The banking system provided RM29.4 billion. This included financing of owner-occupied houses costing RM100,000 or less. As at end-1997, the commercial banks and finance companies had made firm commitments to finance 94,568 and 41,002 of these units respectively. Other than the banking system, the other 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, also extended loans to the housing sector. The total value of housing loans extended by these institutions as a group amounted to RM18.7 billion as at end-1997, representing an increase of 4.8% or RM852.3 million compared with 1996.

Reflecting continued efforts to promote house ownership, especially for the lower income group, a total of 33 projects involving 90,904 units were approved under the **Low-Cost Housing Revolving Development Fund (LCHRDF)** as at end-1997. Of the total units approved, 46% (42,195 units) were for low-cost housing and 34% (31,208 units) for medium-cost housing. During the year, the disbursement of funds under the LCHRDF increased by 33.1% to RM874.1 million (RM656.6 million in 1996). In the case of the **RM600 million Housing Fund for Hardcore Poor**, 31 projects involving the construction of 15,511 low-cost houses, valued at RM644.6 million were approved as at end-1997. In addition, a total of RM52.7 million was withdrawn from the 1997 allocation of RM54 million under the **Public Low-Cost Housing Scheme** for the construction of low-cost houses, while for the **Special Site and Services Scheme**, a total of RM1.9 million was withdrawn from the 1997 allocation of RM2 million for the construction of core houses or the provision of land for those earning less than RM500 per month. Under the **RM500 million Fund to Accelerate the Construction of Low-Cost Housing,** a total of RM379.1 million was approved for the construction of 21,499 units of low-cost houses in 58 projects as at end-1997.

The output growth of the **agriculture, forestry and fishery** sector rose by 3% in 1997 (2.2% in 1996). Output growth expanded in the first three quarters and then moderated significantly in the fourth quarter. Overall, the improved performance was due to the continued increase in the production of crude palm oil by 8.1% and the turnaround in saw log production to 4.3%. In contrast, rubber output declined further by 10.4% in 1997, reflecting mainly the low prices which led to the continued decline in planted area, as well as labour constraints. Cocoa production was also lower, declining further by 10.7%, as the prolonged dry weather, particularly towards the second half of the year, had affected fruit setting. Consequently, the share of the agriculture, forestry and fishery sector in the GDP remained at 12.1% in 1997. In terms of gross exports, its share was 10.5% (11.4% in 1996) and in terms of employment, it accounted for 15.2% (16.8% in 1996).

1997 was an exceptional year for **crude palm oil** production, which reached a new record of 9.1 million tonnes. The sharp increase was attributed to the biological yield cycle, which peaked in September and October 1997. In addition, new mature areas increased further by 3.9% to 2.4 million hectares at the end of 1997. Higher output was also attributable to the improvement in the oil extraction rate (OER) from 18.97% to 19.03%. Despite increasing competition from other producing countries, Malaysia remained the largest producer of palm oil, contributing about 52% of the world supply, followed by Indonesia with a share of 28.6%. Although overseas demand remained strong, the level of stocks of palm oil as at end-1997 increased to 0.96 million tonnes, compared with 0.79 million tonnes as at the end of last year, reflecting higher production relative to exports.

Table 1.7
Agriculture: Production

	1996	1997*p*	1996	1997*p*
	'000 tonnes		Annual change (%)	
Rubber	1,083	970	-0.6	-10.4
Saw logs[1]	30,426	31,731	-3.8	4.3
Crude palm oil	8,386	9,062	7.4	8.1
Fish	1,237	1,261	-0.3	1.9
Cocoa	120	107	-8.7	-10.7

[1] Expressed in thousand cubic metres.
p Preliminary

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

On a regional basis, output of crude palm oil in Sabah and Sarawak continued to record an impressive growth, reflecting a further increase in mature area. In Sabah, production rose by 24.6% to 2.1 million tonnes, accounting for 23.4% of the national production, while in Sarawak, output increased by 20.4% to 331,540 tonnes. Meanwhile, output from Peninsular Malaysia increased by 3.1% to 6.6 million tonnes, with its share of the total national production being reduced further to 72.9%, compared with 76.4% in 1996.

During the year, the total area under oil palm cultivation increased by 3.4% to 2.8 million hectares, of which almost 88% or 2.4 million hectares were mature area. Peninsular Malaysia remained the major contributor to the palm oil sector, contributing 73% of the total mature area. Although the area under oil palm cultivation in Sabah increased significantly by 8.5%, its share of total mature area increased slightly to 22.7%. In Sarawak, planted area rose by 3.6%, with its share remaining relatively small at 4.3%. In terms of ownership, private estates accounted for the largest share of 52.3% of the total oil palm

Table 1.8
Oil Palm: Area, Production and Yield

	1996	1997*p*	1996	1997*p*
			Annual change (%)	
Area ('000 hectares)				
Planted	2,692	2,785	6.0	3.4
Mature	2,353	2,446	4.9	3.9
Production ('000 tonnes)	8,386	9,062	7.4	8.1
Yield (tonnes/mature hectare)	3.55	3.63	1.4	2.3

p Preliminary

Source: Department of Statistics
PORLA

cultivated area or 1.5 million hectares. These were followed by organised smallholder schemes under the Federal Land Development Authority (FELDA), Federal Land Consolidation and Rehabilitation Authority (FELCRA) and the Rubber Industry Smallholders Development Authority (RISDA) which accounted for 30% or 831,619 hectares. The schemes under the States and independent smallholders accounted for the remaining share of 17.7% or 497,292 hectares.

In 1997, an additional 25 new palm oil mill licences were issued by the Palm Oil Registration and Licensing Authority (PORLA). With the opening up of large areas of land for oil palm plantations, Sabah received the largest number of licences for new mills (21) during the year, bringing the total number of mills approved in the State to 96. On the other hand, only three licences were granted for Peninsular Malaysia and one licence for Sarawak. Meanwhile, the number of mills in operation increased further to 306, with an aggregate capacity to process 55.8 million tonnes of fresh fruit bunches annually. By region, there were 239 mills operating in Peninsular Malaysia, 56 in Sabah and 11 in Sarawak. Following the seasonal trend in palm oil production, the average rate of capacity utilisation of the mills increased to 96.3% in the second half of the year, from 80.3% during the first half of the year. For the year as a whole, the average rate of capacity utilisation improved to 88.3%, from 86.2% in 1996, in response to higher production of palm oil during the year.

Consistent with higher production, domestic processing of crude palm oil increased further by 8.4% to 8.9 million tonnes in 1997. During the year, the Malaysian Industrial Development Authority (MIDA) approved three new refineries. At the same time, seven licences were cancelled for refineries that were no longer in operation. As a result, the total number of refineries approved as at end-1997 declined to 67, compared with 71 in 1996. Meanwhile, the total number of refineries in operation increased to 44, with an annual capacity to refine 11.6 million tonnes of crude palm oil and crude palm kernel oil. Although the OER improved slightly to 19.03% in 1997, this was still lower than the record level of 19.87% achieved in 1988. This was due to the indiscriminate collection of ripe and unripe oil palm fruit by harvesters, and labour shortages. The latter was particularly acute in the oil palm estates, thereby resulting in a lower harvest as many loose fruits were left uncollected.

Natural rubber production continued to decline for the third consecutive year, with the production level declining significantly by 10.4% to 970,266 tonnes, a level not seen since 1965 when total production had fallen to 916,940 tonnes. The decline in rubber production during the year was due mainly to a prolonged period of low rubber prices. During the first half of the year, rubber prices fell in response to increased supplies from Indonesia.

Table 1.9
World Elastomer: Production and Consumption

	1997*e*		1996	1997*e*
	'000 tonnes	% share	Annual change (%)	
Production	16,267	100.0	4.6	1.2
Natural rubber	6,240	38.4	7.8	-1.6
Thailand	1,946	12.0	9.6	-1.6
Indonesia	1,552	9.5	5.2	0.6
Malaysia	980	6.0	-0.6	-9.4
India	507	3.1	8.0	-6.2
People's Republic of China	444	2.7	19.4	3.3
Sri Lanka	109	0.7	6.1	-2.8
Nigeria	91	0.6	-2.2	-0.4
Other	611	3.8	22.4	8.4
Synthetic rubber	10,027	61.1	2.6	2.9
Consumption	16,747	100.0	2.6	6.8
Natural rubber	6,573	39.3	2.2	7.2
Synthetic rubber	10,173	60.7	2.8	6.5
Deficit(-)/surplus(+)	-480			

e Estimate

Source: Department of Statistics
International Rubber Study Group

News of a major strike by Goodyear workers in April also affected market sentiment. During the second half of the year, rubber prices remained weak. As rubber was traded in ringgit, it did not benefit from the depreciation of the ringgit. The low prices further dampened tapping activities that were already affected by the continued decline in the total area under rubber cultivation. In Peninsular Malaysia (which accounted for 80% of the total area under rubber), the cultivated area declined further by 1.9% to 1,314,900 hectares, following the continued conversion of rubber land to other more lucrative crops and economic activities. Labour constraints as well as widespread heavy rain and consequent floods contributed further to the decline in tapping and collection activities, resulting in a considerable drop in productivity. Notwithstanding the continued decline in the production of local natural rubber, Malaysia is still a net exporter of the commodity, ranking third after Thailand and Indonesia.

On a regional basis, output from Peninsular Malaysia, which accounted for 96.4% of the total rubber production, declined by 9.6% to 935,804 tonnes. Production by both the smallholders and estates declined further by 10.6% and 9.4% respectively. Similarly, rubber production in Sabah and Sarawak also recorded a significant decline of 16.2% and 55.8% respectively. Lower local production of rubber had, to some extent, caused a shortage of domestic latex, a major raw material in the manufacture of rubber gloves. Presently, Malaysia is the world's largest producer of examination gloves. To meet the demand by domestic manufacturers, imports of rubber, mainly latex (40% of the imported rubber), increased by 59.5% to 431,491 tonnes, two-thirds of which were sourced from Thailand.

Table 1.10
Rubber: Area, Production and Yield

	Estates		Smallholdings	
	1996	1997*p*	1996	1997*p*
	'000 hectares			
Planted area	232	226	1,435	1,418
Replanting	7	7	56	46
Newplanting	8	8	103	106
Production ('000 tonnes)	238	215	845	755
Yield (kg./mature ha.)	1,079	984	791	688

p Preliminary

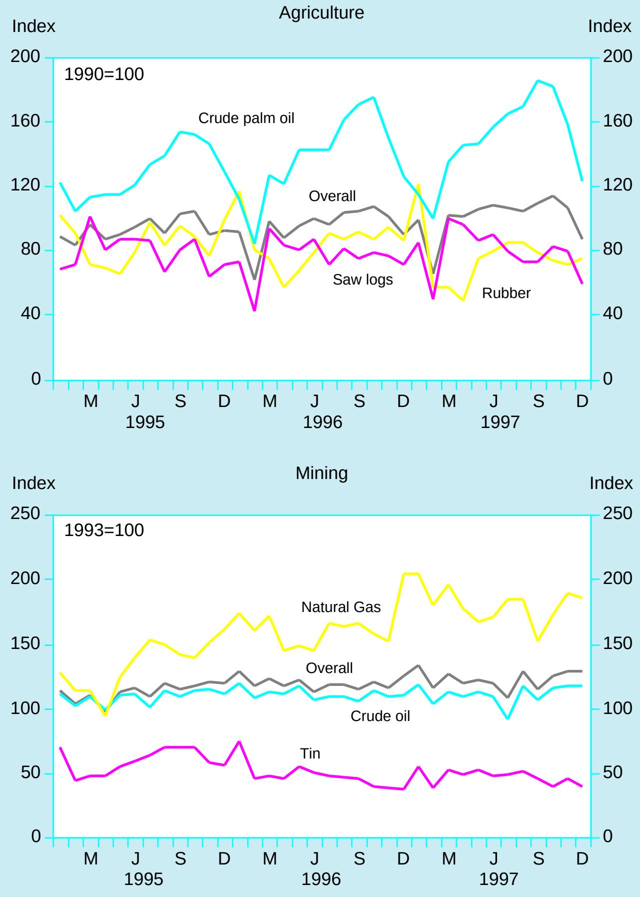
Source: Department of Statistics
Malaysian Rubber Research and Development Board
Department of Agriculture, Sarawak
Sabah Rubber Fund Board

During the year, RISDA allocated a total of RM211 million to finance replanting projects and another RM2.5 million for the rehabilitation programme to assist smallholders with difficulties in their previous replanting projects. The replanting projects involved a total of 21,632 hectares of rubber land, while the rehabilitation programme covered 1,595 hectares. This programme is aimed at ensuring that smallholders who currently contribute 78% of the country's rubber production continue to play a significant role in the rubber sector.

Production of **saw logs** turned around to increase by 4.3% to 31.7 million cubic metres in 1997. The increase in saw log production was mainly due to higher production from Sarawak and Sabah, while Peninsular Malaysia recorded a decline. Output from Sarawak, which accounted for 53% of the total saw log production, increased by 2.8% to 16.8 million cubic metres. The higher production was also due to logging in the agroconversion area as well as in the Bakun Hydroelectric project. However, heavy and thick haze during August and September led to lower production in the second half of the year, as harvesting operations were halted due to poor visibility. Saw log production from Sabah, which accounted for 21.7% of the national saw log production, increased by 21.8% to 6.87 million cubic metres. This was due entirely to the late submission of the previous year's production data, which amounted to 2.9 million cubic metres. Excluding the backlog, saw log production in Sabah declined further by almost 30%. This reflected the depletion of logging areas and the expiry of small logging licences as well as the declining number of active logging licences. Furthermore, in compliance with the Government's target of sustainable forest management by the year 2000, no new logging licences were issued during the year. On the other hand, saw log production in Peninsular Malaysia, which contributed 25.3% of the national production, declined by 4.5% to 8.04 million cubic metres following a reduction in the logging area as well as in compliance with quotas set by the state authorities under the sustainable forest policy.

The production of **cocoa** continued its downtrend in 1997 for the seventh consecutive year. Although

Graph 1.7
Production Indices



cocoa prices in local currency improved strongly during the second half of the year following the ringgit's depreciation, production of cocoa beans declined significantly by 10.7% to 107,176 tonnes, the lowest since its peak production level in 1990. Total production for the year as a whole was affected by the prolonged dry weather in Sabah which affected the fruit setting for the second season, which normally contributed two-thirds of the annual production. At the same time, while there was no conversion of other crop areas into cocoa, about 8,000 hectares of cocoa area were felled and converted to other profitable ventures, especially oil palm. The conversion was actively carried out by the estates in Sabah, which accounted for 84.8% of the total felling, followed by Peninsular Malaysia (13.4%) and the balance in Sarawak. Cocoa output was also affected by rising labour cost which formed a significant portion of the local cost of production, and escalation in the prices of agricultural inputs. With the lower production of cocoa beans, the domestic cocoa processing industry had to import cocoa, particularly from Indonesia. Nevertheless, with favourable weather conditions and as more of the rehabilitated areas reached maturity, productivity in the cocoa sector is expected to improve in the near future.

In 1997, the production of the **fishing** industry turned around to increase by 1.9% to 1,260,088 tonnes. The improved performance in fish production was due mainly to the 2.9% increase in marine fisheries, which accounted for 92% of total fish production. This included inshore fisheries with a total production of 1,023,376 tonnes, while deep sea fishing produced 135,528 tonnes. Total production from aquaculture, however, declined by 7.9% to 101,184 tonnes. Although the total supply of fish increased during the year, it was insufficient for local consumption (per capita consumption of fish is estimated at about 39 kilogrammes in 1997). As a result, the importation of fish increased further by 2.9% to 245,810 tonnes, the bulk of which was from Thailand.

Value added in the **mining** sector moderated further to 2% in 1997, compared with 4.5% in 1996. The slower growth reflected mainly the decline in crude oil production, the first decline since 1993. At the same time, the production of tin decelerated further, attributed mainly to the depletion of tin reserves despite an increase in local tin prices following the ringgit depreciation in the second half of the year. In tandem with the slowdown in construction activities, growth in the quarrying sub-sector moderated to 10.6%. Meanwhile, the production of natural gas remained strong, spurred by continued domestic and international demand. With the slower growth in the mining sector, its share of GDP declined to 6.8% (7.2% in 1996), while its contribution to employment remained stable at 0.5%. Nevertheless, in terms of exports, the share of the mining sector in total export earnings was higher at 7% (6.6% in 1996), reflecting mainly valuation gains from the ringgit depreciation.

In 1997, the production of crude petroleum including condensates, declined marginally by 0.5% to 714,209 barrels per day (bpd). Crude petroleum output was significantly higher in the fourth quarter of the year, following the Government's decision to increase production. However, this was not sufficient to offset the lower production recorded in the earlier quarters. Consequently, for the year as a whole, excluding condensates, crude petroleum production was lower, at 629,297 bpd (645,664 bpd in 1996). Meanwhile, output of condensates increased to 84,912 bpd (70,046 bpd in 1996), in view of higher production of natural gas. On a regional basis, output from Peninsular Malaysia recorded an increase of 3.2% to 429,012 bpd, to account for the largest share of 60.1%. Similarly, output from Sabah increased significantly by 29.2% to 62,474 bpd, with a share of 8.7%. In contrast, Sarawak registered a decline of 12.2% to 222,723 bpd or 31.2% of the total national output mainly due to an unplanned shutdown at Baram Delta Operation (BDO). As at the end of 1997, the total number of oilfields in production increased to 34, with one new oilfield in Peninsular Malaysia. Consequently, Peninsular Malaysia has 14 oilfields, while Sarawak and Sabah have 13 and 7 respectively. In the upstream sector, nine production sharing contracts were signed in 1997, of which two were in Sarawak, four in Sabah, and three in Peninsular Malaysia. In addition, one oilfield located offshore at Terengganu was discovered.

In response to the continued demand from local and international markets, net natural gas production increased strongly by 12.8% to 3,846 million standard cubic feet per day. This reflected the strong external demand for liquefied natural gas (LNG) from traditional buyers. During the year, the volume of LNG exported to Japan, Korea and Taiwan, ROC, increased significantly by 18.6% to 15.3 million tonnes. On the domestic front, demand for natural gas expanded further, emanating mainly from the Peninsular Gas Utilisation (PGU) and MLNG projects as well as other gas-based industries. During the year, the construction of Sectors 2 and 3 of the PGU III project was completed as scheduled. This involved the construction of 265 kilometres of main pipelines from Sitiawan, Perak to Pauh, Perlis to supply gas to PETRONAS Fertiliser (Kedah) Sdn. Bhd. in Gurun, Kulim High Tech Park and the Independent Power Producer (IPP) operated by Teknologi Tenaga Perlis in Kuala Sg. Baru.

Table 1.11
Mining: Production

	1996	1997*p*	1996	1997*p*
	'000 tonnes		Annual change (%)	
Tin-in-concentrates[1]	5,174	5,060	-19.2	-2.2
Crude oil[2]	715,710	714,209	1.8	-0.5
Bauxite	219	279	19.0	27.4
Iron-ore	325	228	60.9	-29.8
Copper	87	81	0.0	-6.9
Natural gas[3]	3,402	3,746	21.4	12.8

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

Source: Department of Mines
PETRONAS

Meanwhile, 10 gas fields were in production in 1997, with five each in Peninsular Malaysia and Sarawak. A gas field located offshore at Terengganu, was discovered.

The production of tin-in-concentrates continued to record a decline for the eighth consecutive year since 1990. Despite a significant increase in local prices, particularly in the second half of the year, the output of tin-in-concentrates declined further by 2.2% to 5,060 tonnes. Although production from dredging, panning and retreatment increased during the year, it was offset by the decline from other modes of mining such as gravel pump, open cast and underground which, as a group, accounted for 61.4% of the total output. Overall, the lower production was due to the reduction of mines in operation to 34 at end-1997, from 35 in 1996. In 1997, Malaysia remained the seventh largest producer of tin in the world.

Despite the decline in production, total domestic consumption of tin metal increased by 9.4% to 6,562 tonnes, reflecting higher demand from domestic tin-based industries. Utilisation of tin metal by the solder industry, which accounted for more than one-half (53.2%) of total domestic consumption, increased marginally by 1% to 3,490 tonnes, supported by strong demand in the electronics industry. Similarly, demand for tin by the tin plate industry also recorded an increase of 4.8% to 903 tonnes, making the industry the second largest consumer with a share of 13.8%. This was followed by the pewter industry, with demand increasing strongly by 18.6% to account for a share of 11.9% of total demand. Reflecting the continued decline in domestic production, the local smelters continued to import foreign tin-in-concentrates for their smelting operations in 1997, mainly from Peru, Australia, Portugal, South Africa and Bolivia. As a result, Malaysia has become a net importer of tin.

Following a strong growth of 8.4% in the first three-quarters of 1997, the performance of the **services** sector showed signs of being adversely affected by the financial market turbulence. In the last quarter of 1997, the value added for the services sector grew by 6.4%, the lowest quarterly growth since 1988. Consequently, growth for the year as a whole moderated to 7.9%, marginally higher than the GDP growth of 7.8%. Following the trend in recent years, growth continued to be led by intermediate services, while the final services sub-sector grew at a more moderate pace. Despite the slower growth, the services sector remained the largest sector in the economy, with a share of 44.8% of GDP. The services sector also accounted for the largest share of employment (47.5%).

During the year, **intermediate services** comprising transport, storage and communications; and finance, insurance, real estate and business services provided the main impetus to growth, expanding by 10.1%. Strong growth was recorded in all sub-sectors, especially in the first three quarters of the year. Growth in the **finance, insurance, real estate and business services** sub-sector remained strong at 10.2%, although marginally lower than the average annual growth of 10.8% during the period 1991-95. This increased the sub-sector's share in real GDP and the services sector to 11.6% and 25.9% respectively. The higher value added in this sub-sector reflected the strong credit expansion by the banking sector, particularly in the first half of 1997 when credit expanded by RM46.5 billion, before moderating to RM36.1 billion in the second half of 1997. The performance of this sub-sector was dampened by the decline in prices and significant moderation in the volume of shares traded on the Kuala Lumpur Stock Exchange, particularly towards the end of 1997. Value added in the finance sub-sector was also affected by the slower growth in the insurance industry as evident by lower estimates in premium income collection of 13.7% in 1997 (20% in 1996).

Notwithstanding the slower growth in the last quarter of 1997, value added in the **transport, storage and communications** sub-sector continued to record a high growth of 10%, to account for 7.6% of GDP in 1997. The stronger growth was attributed mainly to the increase in transport activities to support the increase in the volume of domestic and international trade. Growth was stronger in the first half-year at 11.8%, but slowed down in the second half to 8.3% as the financial crisis adversely affected trade. However, for the year as a whole, three major industries under this sub-sector, namely, rail, air transportation and shipping, recorded higher growth. In the rail transportation services, notable progress was achieved in commuter train services. Passenger revenue of the commuter train services increased significantly in 1997, following the increased frequency of Keretapi Tanah Melayu Berhad commuter trips and the introduction of the Light Rail Transit within the Kuala Lumpur city centre at the end of 1996. In terms of air transport, Malaysia Airlines increased its capacity by expanding its fleet as well as augmenting its flight frequency to more destinations. The transport sub-sector also benefited from the continued buoyancy of the shipping industry. This was reflected in the increase in the acquisition of ships and tankers by the local shipping industry as well as strong performance in local port services. In 1997, at least 25 ships and tankers, valued at RM2.2 billion were purchased by several major shipping companies. Local port facilities and services also expanded further following vigorous efforts by the Government to enhance the role of Malaysian ports in serving its international trade. Currently, approximately 35% of Malaysia's international trade still goes overland via Singapore, while 80% of the total container volume from Penang and 40% from Port Klang are feedered via Singapore. To promote the development of Port Klang as a prime transhipment and regional load centre and to encourage value added transhipment activities, the Government has gazetted the North, South and West Ports as Free Commercial Zones. This complemented an earlier measure in 1993 when the cabotage policy was relaxed to allow foreign ships to provide feeder cargo services from Penang Port

Table 1.12
Growth in the Services Sector in 1978 Prices

	1996	1997*p*	1996	1997*p*
	Annual change (%)		% share of GDP	
Services	**9.7**	**7.9**	**44.8**	**44.8**
Intermediate services	12.6	10.1	18.8	19.2
Transport, storage and communications	9.8	10.0	7.4	7.6
Finance, insurance, real estate and business services[1]	14.6	10.2	11.3	11.6
Final services	7.6	6.3	26.0	25.6
Electricity, gas and water	12.0	13.5	2.4	2.5
Wholesale and retail trade, hotels and restaurants	9.3	7.5	12.4	12.3
Government services[2]	4.2	3.3	9.1	8.7
Other services[3]	8.4	5.1	2.1	2.0

[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.
p Preliminary

Source: Department of Statistics and Bank Negara Malaysia.

Box I

Potential Output in Malaysia

In the 1995 Annual Report, the Bank raised concerns over the sustainability of the strong economic growth over a long period as strains began to emerge in the form of supply bottlenecks that were manifested through labour shortages as well as infrastructure constraints. While macroeconomic management enabled consumer prices to remain under control, the current account deficit widened considerably. These developments in an environment in which the rapid pace of industrialisation and the buoyancy of demand had exceeded the underlying expansion of supply capacity has brought to the forefront, the significance of the concept of **potential output**. The concept of potential output and the implied output gap is defined as that level of output in the economy at which there are no inflationary pressures or external imbalances. Nevertheless, operating at close to potential output or the supply capacity could increase inflationary pressures.

Two possible approaches have been used to measure potential output and thereby ascertain whether the economy is operating at above supply capacity. Firstly, a production function of the economy can be specified and then solved for some equilibrium rates of factor utilisation to estimate potential output. This method, however, assumes that there exists a stable long-run relationship between output and the factors of production. The second approach attempts to create some form of "trend" or "underlying" output based on the assumption that deviations from this equilibrium level of growth will eventually correct themselves. The advantage of the latter approach is the ability to take account of structural developments and changes in relationships over time. The "trend" approach is particularly useful when data is insufficient or unreliable. However, this method is unable to provide more than simple insights.

This Article estimates potential output based on a relatively simple production function approach, utilising a single equation. The following production function was used:

$$Y_t = f(KCU_t, L_t)$$

where KCU represents the utilised level of capital stock (that is, capital stock multiplied by the average level of capital utilisation) and L represents the labour force in employment. From this relationship, the KCU and L were substituted with K and L* to derive the potential output. K represents full utilisation of available capital and L* represents the potential employment, that is, the labour force in employment that is consistent with the "natural" or "long-run" rate of unemployment[1].

In the absence of reliable quarterly estimates of capital stock, annual data were used. Output was defined as real gross domestic product (GDP) at purchasers' value while capital stock estimates were based on estimates made by the World Bank and extended using the perpetual inventory method[2]. Capital utilisation rates were based on capital utilisation in the manufacturing sector as captured in the various Bank Negara Malaysia surveys of that sector. Labour was defined as the number of workers in paid employment.

A number of interesting features emerged from the estimation results. The absolute value of the error-correction factor indicated a stable long-run relationship. However, the estimate of the long-run elasticity of labour appeared to be unusually large while that of capital was small. This seemed to imply increasing returns to scale and poor utilisation of capital although the Wald Co-efficient Restriction Test did not verify this hypothesis.

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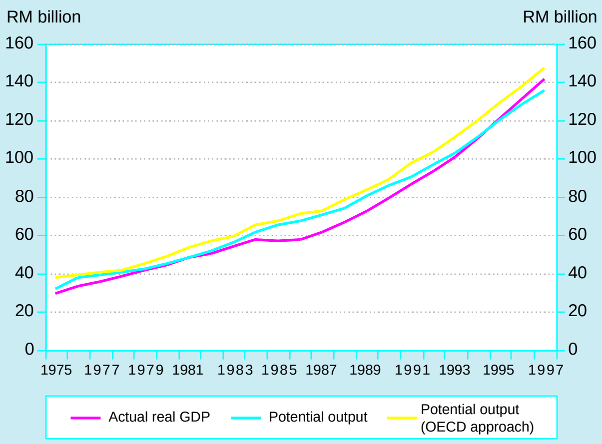
1 In this case, the "natural" or "long-run" unemployment rate is not an explicitly defined Non-Accelerating Inflation Rate of Unemployment (NAIRU) but is a rate of unemployment that has been cyclically adjusted. Assuming that the economy operates at the NAIRU over the course of the cycle, then the cyclical natural rate should be approximately the same as the NAIRU.

2 Explicitly the perpetual inventory method can be written as $K_t=K_{t-1}(1-\delta)+I_t$ where K represents capital stock, I represents investment and δ the depreciation rate. Real gross fixed capital formation was used as the proxy for I and δ was set as 7.2%, the average scrapping rate used by the World Bank.

A possible reason that the estimates differed from theoretically predicted values could be the continuous structural changes in the Malaysian economy over the last 27 years. As the economy has moved towards greater capital intensity, the single equation approach may have underestimated the true level of capital elasticity, especially between 1988 and 1997. Secondly, the estimates of capital stock may have to be refined to take into account investment in "productive" capital, namely, plant and machinery and "less productive" capital, which would encompass most forms of infrastructure. The significant share of investment in infrastructure over the last decade could account for the low impact of some of the capital building on the economy.

The results of this study showed that the growth of potential output for the Malaysian economy during the period 1970–97 averaged 6.9% as compared with the actual output growth of 7.4%. However, it would be too simplistic to conclude from such a simple comparison that the economy was operating above its supply capacity. This simple model merely takes into account two factors of growth and does not incorporate productivity and human capital gains in the 27-year period of the sample. Under these circumstances, the underlying growth of potential output would be underestimated. In the earlier period between 1970 and 1987, the economy expanded at a slower rate of 6.27% compared with an average annual growth in potential output of 6.89%. However, from 1988 to 1996, actual growth was faster at 8.86% compared with potential output growth of 6.94%. In 1997, however, growth in the economy moderated to 7.8%.

Graph I.1
Real GDP: Actual versus Potential



A further measure of potential strains on the economy is the output gap, defined as the difference between actual and potential output. When actual output is above potential – output gap is positive – inflationary pressures would be expected to increase. During the period 1970–97, the gap averaged -5.49% as a proportion of potential GDP, indicating spare capacity in the economy for most of the period. However, this gap had continuously narrowed from -14.18% in 1986 until 1995 when actual growth was in tandem with supply capacity. Between 1988 and 1996, the gap averaged -4.33% of potential output but narrowed to average -2.63% between 1990 and 1996. This indicates that continuous high growth since 1988 had increased the pressure on the country's supply of resources and the average inflation rate had increased from 3.53% to 3.78% over the same two periods. In the period 1990–95, the negative potential output gap had narrowed, suggesting the need for vigilance against possible dangers of inflation. After 1995, the output gap became positive but inflation remained low with the adoption of an anti-inflation package, including monetary restraint, fiscal prudence and stricter enforcement of administrative measures.

To further test the robustness of the estimates, the natural rate of unemployment was re-estimated based on the method employed by the OECD in its estimation of potential output. This yielded the following results. Firstly, the estimate of the natural rate of unemployment using this method tracked the simple trend estimate closely. Secondly, the average growth of potential output was actually lower at 6.50% compared with 6.85% under the production function approach. Thirdly, the trend of the gap for both methods was similar, with the gap narrowing between 1988 and 1995 as well as the requisite widening during the two recessions in the mid-1970s and the mid-1980s. However, the size of the gap was much larger using the OECD approach. On average, the gap was -10.74% of GDP. Taking the period between 1988 and 1996, the gap only narrowed slightly to -9.94%. Between 1990–95, the gap was -8.69%. However, in the later years, the growth in potential GDP was higher at 7.5%, indicating that the economy had moved on to a higher plane.

Earlier studies include the Coe and McDermott study, which estimated the trend in GDP. The authors estimated the underlying GDP growth as 8.6% for Malaysia for the period 1990–94. Although a non-parametric trend approach was used, the underlying growth of potential output would have taken into account structural changes in the economy during that period, thereby allowing for higher growth potential.

The approaches in the above study have used de-trended series with no explicit behavioural assumptions. The results have essentially been similar as far as trends are concerned (that is, the underlying growth of potential output as well as the narrowing output gap) and the difference has been one of magnitude with the OECD approach giving larger values of potential output. The critical issue therefore seems to be the definition of the natural rate. However, shortcomings in the data do not allow for an appropriate behavioural relationship to generate a price (or wage)-consistent NAIRU. Nevertheless, all models seem to provide similar insights.

The above study needs, however, to be refined further to deal with the problem of estimating “natural unemployment” and technical change. Malaysia can be said to have a high rate of technical change (as reflected in the large co-efficient of the slope dummy in the model) as a result of convergence or “catching up”. This implies that the production frontier is not “well behaved” in a mathematical sense, that is, that relationships are liable to change over time and do so often. Finally, additional factors such as human capital, which have not been taken into account, could well push the frontier up, reducing the contribution of the “cyclical” factor. Furthermore, annual data for this period are clearly not sufficient to model these relationships with any degree of confidence and hence, the focus would be on developing credible quarterly estimates of capital stock. Such an effort would not only provide an improved indication of the underlying strength of the economy but it would also provide valuable insights into the efficiency of investment undertaken as well as the actual progress made towards achieving higher value-added growth.

to Port Klang. In addition, the electronic data interchange system was introduced and customs procedures and documentation for re-exports as well as the port tariff structure were reviewed with the aim of improving efficiency. Latest estimates for five major ports in Malaysia showed that cargo handled by these ports increased significantly by about 11.5% to 137.4 million freightweight tonnes (f.w.t.) in 1997 (123.2 million f.w.t. in 1996). Container throughput of these ports also increased significantly by about 16.7% to 2.8 million twenty-foot equivalent units (TEUs). In the communications sub-sector, the performance of telecommunications services was also encouraging in 1997. During the year, applications for new telephone lines grew by 12%, with the number of business subscribers increasing by 13.1% to reach 1.2 million, while residential subscribers increased by 11.5% to 3.1 million.

The financial crisis in the second half of 1997 had a marked impact on the growth of the **final services** group, which moderated to 6.3%. In particular, growth in wholesale and retail trade, other services and government services moderated. This was offset to some extent by the strong increase in the utilities sub-sector. Wholesale and retail trade was affected by the loss of wealth arising from the decline in stock prices. Provision of government services moderated due to deliberate policies to contain expenditure in 1997. With the moderation in income growth during the second half of 1997, value added in the **wholesale and retail trade, hotels and restaurants** sub-sector moderated to 7.5% in 1997. In the first half of the year, this sector recorded a growth of 8% before moderating to 7% in the second half of 1997. The moderation reflected a slowdown in private consumption as indicated by the slower increase in service tax collection and the moderation in revenue of wholesale and retail trade. In 1997, service tax collections moderated to 19.8% compared with 21.2% in 1996. Likewise, the sales value of domestic-oriented industries, one of the indicators for the wholesale and retail trade sub-sector, moderated to increase by 14.4% in 1997, from a growth of 19.6% in 1996. The slowdown in this sub-sector was aggravated further by the slowdown in the hotel and restaurants industry as a result of the decline in tourist arrivals, mainly because of the haze condition during the months of July-October 1997. Consequently, the occupancy rates of hotels dropped from a norm of 60-65% to as low as 30-50% for some hotels in the Kuala Lumpur Golden Triangle area. Nevertheless, the wholesale and retail, hotel and restaurants industry retained its dominance in the services sector to account for the largest share of 12.3% of GDP.

Growth in the **Government services** sub-sector moderated to 3.3% in 1997 (4.2% in 1996) resulting in a decline in its share of GDP to 8.7% from 9.1% in the previous year. The moderation was in line with the Government's efforts to rightsize the civil service and the role of the Government in the economy. Nevertheles, the Government continued to provide improved public services and amenities to facilitate private sector activities.

In tandem with the continued strong demand by the industrial and commercial sectors as well as by households, value added in the **utilities** sub-sector, comprising electricity, gas and water, grew strongly by 13.5%. Higher growth in this sub-sector was due entirely to stronger growth (15%) recorded in the first half of 1997, compared with a growth of 12% in the second half of the year. Supply of electricity as reflected in the Industrial Production Index (1993=100) expanded by 14.2% in 1997, compared with 12.8% in 1996. The electricity consumed by the industrial sector accounted for a major share of electricity consumption with the rest distributed among commercial (27.3%), domestic (16.3%) and public lighting (0.7%). The growth of this sub-sector was also driven by the strong expansion in capacity generation. Approximately 1,400 megawatts of new capacity came onstream in 1997. The biggest project was the Segari Energy Venture plant in Lumut (with a total capacity of 652 megawatts), followed by the Pergau project (600 megawatts), Melaka (110 megawatts) and Sungai Piah (55 megawatts). To date, the Government has issued approvals and licences to a total of 15 Independent Power Producers (IPPs) with a total capacity approaching 10,000 megawatts by the next century, excluding other new entrants and variants such as co-generation plants to serve specific buildings or installations. On the other hand, growth in water consumption, another component of the utilities sub-sector, was moderate, increasing by an annual rate of 3% to 8,000 million litres per day in 1997, the same growth as recorded in 1996. Overall, production capacity of water in 1997 was 9,800 million litres per day, an increase of 1% compared with a growth of 2% in 1996.

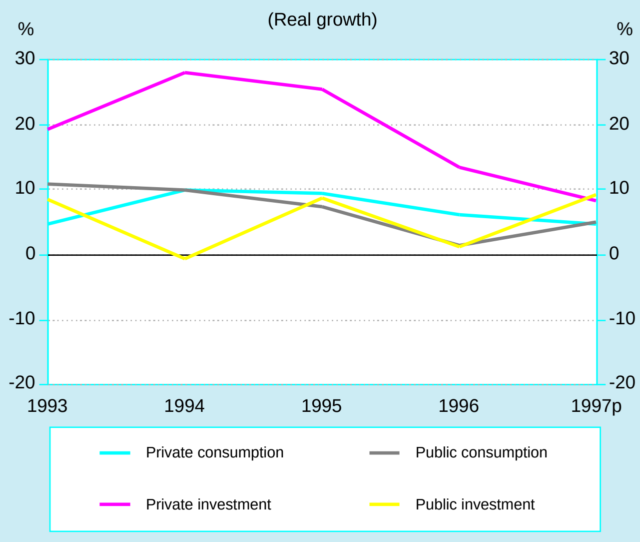
Domestic Demand Conditions

Aggregate domestic demand (excluding changes in stocks) increased at a more moderate pace in 1997. The slower increase reflected the further tightening of macroeconomic policies during the year in order to consolidate the reduction in demand pressures achieved in 1996 and to strengthen economic fundamentals following the emergence of the regional financial difficulties. The slower economic growth and the unprecedented decline in the value of the ringgit and share prices contributed to the softening in domestic demand particularly in the latter part of the year. In current prices, total domestic expenditure increased by 9%, slower than the growth of 9.9% in 1996. In real terms, the increase was 6.4% compared with 7% over the same period. The slower increase in demand was due to a deceleration in the growth in private sector expenditure as a result of a more moderate increase in both private consumption and investment. Public sector expenditure expanded at a faster pace, due mainly to higher investment by the non-financial public enterprises.

Overall, consumption spending which constituted about 57% of total domestic demand, was sustained at an annual growth of 4.8% in real terms (4.9% in 1996). Public consumption increased moderately by 4.8% while private consumption spending grew at a slower rate of 4.7% (1.4% and 6% respectively in 1996). The moderate increase in **public consumption** was due to higher outlays on supplies and services to ensure the smooth running of the Government machinery and to provide improved public services and amenities. The moderation in **private consumption** reflected largely the impact of measures implemented to discourage excessive consumption and promote savings. These measures included the launching of the National Savings Campaign in December 1996 to encourage voluntary savings, and the imposition, in October 1997, of more stringent guidelines on hire-purchase loans for the purchase of non-commercial passenger vehicles and higher import duties on consumer durables and motor vehicles to curb imports. The negative wealth effect resulting from the weak performance of the stock market, slower income growth and lower tourist arrivals as a result of negative reports on the haze situation also dampened overall private consumer spending. At the same time, uncertainty on the short-term growth prospects and employment outlook due to the financial crisis also led to increased caution in consumer spending.

A number of major consumption indicators showed a moderation in the growth of private consumer spending. Although sales of passenger cars increased

Graph 1.8
Domestic Demand Aggregates



in 1997, the 12.3% growth was about one-half the increase recorded in 1996 (22.8%). In particular, sales of passenger cars, especially the luxury and higher capacity cars, were sharply lower in the last two months of the year as a result of higher import duties imposed in the 1998 Budget. The growth in loans extended by the banking institutions for consumption credit moderated to 29% at end-December, while sales tax collection increased slightly to 12.7%. Imports of consumption goods increased by only 1.3% in terms of the United States dollar, although it recorded a stronger growth in ringgit terms (12.4%) due to the depreciation of the currency. Similarly, the Business Expectations Survey of the Department of Statistics showed that revenue from wholesale and retail trade grew by 7.6% in 1997, compared with 9.1% a year ago. The sharp decline in the stock market indicators resulted in a negative wealth effect, contributing significantly to the moderation in private consumption.

Gross investment in nominal terms increased at a marginally slower rate of 11.2% in 1997 compared with 12.1% in 1996, due to a slight moderation in private investment growth. **Private investment** increased by 11% to RM85.5 billion (15.8% in 1996). The continued expansion was underpinned by higher investment in the productive sectors, in particular the manufacturing and the oil and gas sectors, while investment in the services sector increased at a slower rate. The investment sentiment remained strong in 1997 but was dampened somewhat towards the end of the year following increased uncertainties in the regional financial markets. The moderation in the rate of investment towards the latter part of the year reflected a slowdown in the rate of investments in the construction, finance, insurance and business and energy sub-sectors arising from the deferment of projects as well as the scaling down of some on-going projects which were considered less essential.

The positive investor sentiment was reflected in a number of private investment indicators. Loans extended by the banking system to both the manufacturing and broad property sectors registered a strong growth of 18.3% and 32.5% respectively in 1997. Similarly, imports of capital goods recorded a larger increase of 6.9% in terms of the United States dollar (-0.2% in 1996). However, while the value of manufacturing investment approved by the Ministry of International Trade and Industry (MITI) in 1997 was high at RM25.8 billion, it represented a 24.8% decline from the record level of RM34.3 billion approved in 1996. The decline was due largely to lower approvals of big projects (10 big projects worth RM13 billion, compared with 15 projects worth RM19.5 billion in 1996). The investment approvals continue to indicate an increasing shift towards greater automation and capital intensive production processes in the manufacturing sector.

In terms of sectoral composition of private investment, preliminary estimates showed that investment in the services sector expanded at a more moderate pace of 16.2% in 1997 (23.3% in 1996), to account for about one-third (RM29.1 billion) of total private investment. The sustained high investment in this sector reflected higher capital outlay in the transport sub-sector, due mainly to the expansion programmes in the airline and shipping industries and the on-going implementation of several rail projects. However, capital expenditure in the energy sub-sector was lower following the completion of several independent power plant projects as well as the deferment of the Bakun project. The development of the first phase of the Putrajaya and Cyberjaya townships and other strategic projects underpinned investment in the finance, insurance and business sub-sector. Following a reassessment of the supply expected to come on stream, investment in this sector moderated, in particular, in investments for office space and retail outlets in shopping malls. Capital outlay in the manufacturing sector increased further in 1997, by 12.2% to RM22.7 billion, accounting for a share of 27% of total private investment. The sustained strong manufacturing investment reflected the implementation of the large number of investment projects approved by MITI in recent years. Investment was estimated to be highest in the electrical and electronic products industry, representing mainly capital outlay for the production of computer motherboards, hard disk media and silicon wafers. Investments totalling RM12.4 billion were approved by MITI during 1994–97 for the establishment of wafer projects, in response to the provision of special fiscal and other incentives to promote high technology industries, especially those producing wafer fabrication products for the semi-conductor industry. Most of these projects are expected to come into production by 1999–2000. A large part of the investment in the chemical and chemical products industry reflected the on-going implementation of several large petrochemical projects in Kertih, Gebeng and Pasir Gudang. Meanwhile, investment in the basic metal products industry and the non-metallic mineral products industry also remained high. Reflecting continued demand for residential housing and on-going construction of privatised roads and other civil engineering projects, particularly in the Klang Valley, investment in the construction sector remained strong, amounting to RM9.5 billion or a share of 11% of total private investment. Capital investment in the agriculture and mining sectors amounted to RM2.7 billion and RM2.2 billion respectively or a share of 3% each.

Table 1.13
Private Investment by Sector[1]

	1995	1996	1997
	RM billion		
Private investment	66.6	77.1	85.5
Of which:	% share		
Manufacturing	27.2	26.3	26.5
Construction	9.7	10.4	11.1
Services	30.5	32.5	34.1

[1] Estimates

In terms of sources of investment, foreign direct investment remained important. In 1997, net inflows of foreign direct investment were sustained at RM19.2 billion, compared with RM19.4 billion in 1996. The non-oil private sector accounted for 93% of these inflows, particularly for investment in the manufacturing sector.

Public investment increased at a faster pace of 11.9% in 1997 (3.2% in 1996), due to significantly higher capital expenditure by the non-financial public enterprises (NFPEs), especially PETRONAS, Tenaga

Nasional Berhad (TNB), Telekom Malaysia Berhad and the Kuala Lumpur International Airport (KLIA), and a moderate increase in capital outlay by the general government. PETRONAS increased both its upstream and downstream investment during the year, which included the expansion of the gas processing plant, the completion of the Malacca Refinery Centre and expansion of gas transmission lines. Capital investment by TNB was mainly to expand and upgrade its power generation capacity, and its distribution and transmission networks to meet the demand for electricity by the commercial and industrial users. Higher capital spending by Telekom was mainly for the expansion and upgrade of the intemational and local networks, as well as investment in telecommunications infrastructure for the Multimedia Super Corridor projects and cellular infrastructure. The strong increase in investment for the KLIA project during the year reflected an acceleration in implementation to complete the construction of the first phase of the project in 1997. Meanwhile, higher investment by the general government was mainly to improve infrastructure facilities, expand the capacity of existing educational institutions such as polytechnics, technical schools and institutions of higher learning, and on health facilities and rural development.

Growth in **gross national savings (GNS)** rose at a more moderate rate of 15% following very rapid growth in 1996 (24.8%), reflecting the slower growth in nominal income. However, in terms of GNP, the share of GNS increased slightly to 40% from 38.5% in 1996, as a result of the slower growth in consumption. Malaysia's GNS continues to be very high by international standards. Meanwhile, growth in gross domestic capital formation increased further by 14.4% to account for 45.1% of GNP (43.6% of GNP in 1996), which led to a marginal increase in the savings-investment gap to RM13.4 billion (RM12.3 billion in 1996). The current account deficit of the balance of payments, however, stabilised at 5.1% of GNP. The national resource gap was more than adequately financed by the large net inflows of long-term capital, particularly foreign direct investment.

In the public sector, growth in savings increased markedly by 18.8% in 1997, reflecting better revenue performance as well as prudent fiscal discipline. With higher growth in public savings compared with public investment, the overall public sector resource balance improved significantly to a surplus of RM15 billion (RM11.8 billion in 1996). Private sector savings, on the other hand, slowed down to 12.1% in 1997 (27.7% in 1996). Given the more rapid growth of private investment (14.1%) vis-a-vis private savings, the private sector recorded a larger resource gap of RM28.4 billion (RM24 billion in 1996).

In an effort to promote a higher rate of domestic savings to meet the country's rising investment needs, the Government launched a nation-wide savings promotion campaign on 16 December 1996. The main objective of the campaign is to create public awareness on the importance of financial and non-financial savings. In the current economic environment following the sharp depreciation of the ringgit, the promotion of both forms of savings has become even more relevant and urgent. Non-financial savings essentially relates to prudent spending habits, conserving, economising and avoiding wastage, as well as more efficient consumption behaviour leading to surplus income, which could be saved.

In the initial phase of the savings promotion campaign, the strategy was to create public awareness on the importance of financial and non-financial savings and the spectrum of financial savings products offered by the financial institutions. Toward this end, BNM in co-operation with the financial institutions circulated two pamphlets which were made available to the public, namely, "The Importance of Savings" and "Financial Savings Products in Malaysia".

The savings promotion campaign is aimed at three main target groups, namely, students, workers and women. The campaign for school children was launched on 4 March 1997, with the aim of inculcating the savings habit among students and to encourage them to save for their future education. For this purpose, the financial institutions launched several new products under the Education Savings Scheme (ESS), in particular, savings for future education by students as well as long-term savings for education by parents/ guardians. These savings schemes offered several attractive features, including higher interest rates, with a minimum rate of 5%, and an initial minimum deposit of only RM1. At the end of December 1997, 30 commercial banks including Bank Islam, 3 non-bank financial institutions, 35 finance companies and 17 insurance companies participated in these schemes.

In addition, an “Adoption of School Programme” was introduced in April 1997. This programme is aimed at providing an opportunity for closer ties between financial institutions and students and to cultivate a positive savings habit among students. Financial institutions were urged to play a leading role in educating students to deposit their money with the financial system. Under this programme, government-aided primary and secondary schools were adopted by at least one financial institution. At the end of December 1997, 8,473 schools had been adopted by 85 financial institutions. Various activities were organised under this programme, including visits to banks, lectures and talks on the importance of savings, the role and functions of financial institutions and the introduction of financial savings products. The financial institutions were also encouraged to assist students to set up savings clubs in schools. Financial institutions are required to submit quarterly progress reports to BNM on these activities. At the end of December 1997, the financial institutions had mobilised a total of RM95.2 million in deposits from 238,690 student account holders, visited about 4,620 schools and helped establish 370 savings clubs.

Workers represent the largest potential source of voluntary savings. To promote the savings habit among workers, the “Savings Promotion Campaign among Workers” was launched on 3 May 1997, in conjunction with the Labour Day celebrations. After the launch, follow-up savings activities for workers were carried out at the factory level, aimed at encouraging them to save for specific purposes, especially for their children’s education, purchase of houses, fixed assets and consumer durables as well as for emergencies, health care and retirement.

As part of an on-going programme to facilitate the smooth implementation of the savings promotion campaign, representatives from the various committees and financial institutions involved in the campaign were invited to a three-day seminar on the “Japanese Experience in the Promotion of Savings” at BNM on 5–7 May 1997, as well as a one-day seminar at BNM on 26 August 1997. The latter was convened to explain the overall strategy of the national savings campaign to government agencies as well as financial institutions that were involved in the campaign.

The management of household expenses is an important element in the savings campaign. As housewives play an important role in managing household accounts, the savings campaign for the women’s group was focused on enhancing awareness on non-financial savings through conservation and avoidance of excesses as well as via proper budgeting and planning. The women’s savings campaign was launched on 24 October 1997, with the theme of “The Promotion of Non-financial Savings – Economising and Conserving”. A training programme on household financial management was conducted for 30 women leaders from various women’s organisations. After completing the programme, the women leaders returned to their respective home states and conducted similar seminars at the state and district levels.

While the first phase of the savings promotion campaign focused on enhancing awareness on the importance of savings, the second phase of the campaign in 1998 will emphasise activities relating to planning and budgeting for the immediate term as well as for the future. The aim is to encourage people to plan for the future, particularly for children’s education, marriage, housing, purchase of fixed assets and consumer durables, health care and retirement. Efforts will be directed at increasing public awareness about the benefits of planning and the financial commitments that are required to meet one’s plans for the immediate and long term. In this connection, activities will emphasise the importance of proper prioritisation, including the postponement of present consumption, in order to achieve a higher standard of living in the future. The long-term objective is to eventually change the consumption habits of Malaysians in terms of achieving a proper balance between savings and consumption.

To achieve the objective of encouraging life-time planning and budgeting, a guidebook on planning and budgeting will be distributed to the two main target groups, namely, workers and women. These publications provide guidance in identifying one’s goals and the financial requirements of achieving such goals. In addition, a “Household Account Book” will be introduced in 1998 to encourage the maintenance of proper records on household expenditure. The Education Savings Committee intends to introduce a “Pocket Money Account Book” in 1998 to assist students in monitoring their spending habits and to educate them to save the balances from their pocket money.

In the light of the current economic conditions, the need to increase public awareness on the importance of savings, to economise and spend prudently has become even more urgent. The strategy of the savings promotion campaign in 1998 will continue to be directed towards changing spending habits, with a view to economising and conserving resources. As the public learns to restrain and prioritise their spending habits in accordance with the changing economic environment and save their surplus income for the future, this will indirectly assist in containing inflationary pressures and promoting price stability in the country. The increase in savings will also provide additional funds to finance productive investment. The support of all Malaysians is essential for the success of the savings campaign which, in turn, will enhance the nation's economic prospects over the medium and longer term.

External Sector

Overall, the depreciation of the ringgit exerted some positive impact on the outcome of the **balance of payments** for 1997. Although the current account deficit increased moderately by RM1.1 billion to RM13.4 billion, the deficit stabilised at 5.1% of GNP and was lower than the level forecast at the beginning of 1997. The favourable impact from the ringgit depreciation was most evident in the better-than-expected performance of the trade account. The merchandise surplus was RM933 million higher than the level recorded in 1996. There was a significant improvement in the basic balance, comprising the current account and long-term capital account, to RM5.3 billion. This surplus showed that unlike in 1994 and 1995, the long-term capital inflows were more than sufficient to finance the current account deficit. Hence, the decline in international reserves in 1997 was primarily due to a large outflow of short-term capital, including intervention to support the ringgit exchange rate, estimated at RM14.2 billion. Overall, the higher surplus in the basic balance was not adequate to offset the net outflow of capital, resulting in the overall balance of payments reverting to a deficit of RM10.9 billion in 1997, from a surplus of RM6.2 billion in 1996. As at end-1997, net external reserves stood at RM59.1 billion or US$21.7 billion, sufficient to finance 3.4 months of retained imports.

Of significance was that the regional currency crisis did not result in a contraction in long-term capital inflows. The sudden and large depreciation

Table 1.14
Balance of Payments

Item	1997*e* +	1997*e* -	1997*e* Net
	RM million		
Merchandise balance (f.o.b.)	**218,734**	**207,646**	**11,087**
Balance on services	**49,834**	**70,624**	**-20,790**
Freight & insurance	3,216	12,165	-8,949
Other transportation	6,592	4,184	2,408
Travel & education	10,524	6,698	3,826
Investment income	6,767	20,291	-13,524
Government transactions n.i.e.	309	374	-65
Other services	22,426	26,912	-4,486
Balance on goods and services	**268,568**	**278,270**	**-9,703**
Unrequited transfers	2,255	5,952	-3,697
Balance on current account	**270,823**	**284,222**	**-13,400**
Official long-term capital			4,805
Federal Government	462	2,143	-1,681
Market loans	–	697	-697
Project loans	462	1,446	-984
Suppliers' credit	–	–	–
Non-financial public enterprises	9,526	3,046	6,480
Other assets and liabilities			6
Private long-term capital			13,900
Balance on long-term capital			18,705
Basic balance			**5,305**
Private short-term capital (net)			-14,229
Errors and omissions			-1,968
Overall balance (surplus +/ deficit -)			**-10,892**
Allocation of Special Drawing Rights			–
IMF resources			–
Net change in international reserves of Bank Negara Malaysia (increase - / decrease +)			10,892
Special Drawing Rights			-51
IMF reserve position			116
Gold and foreign exchange			10,827
Bank Negara Malaysia international reserves, net [1]			**59,123**

[1] The figure does not include an exchange revaluation gain of RM24.6 billion. Prior to 1997, holdings in foreign assets were revalued once, at year-end. However, in 1997, the accounting policy of recognising the foreign exchange revaluation gain or loss was changed, whereby, the exchange gain from the revaluation of foreign assets and liabilities was not recognised in the Bank's books. Nevertheless, full provisions will be made for any losses. The US dollar equivalent of international reserves as at 31 December 1997 was US$21.7 billion.

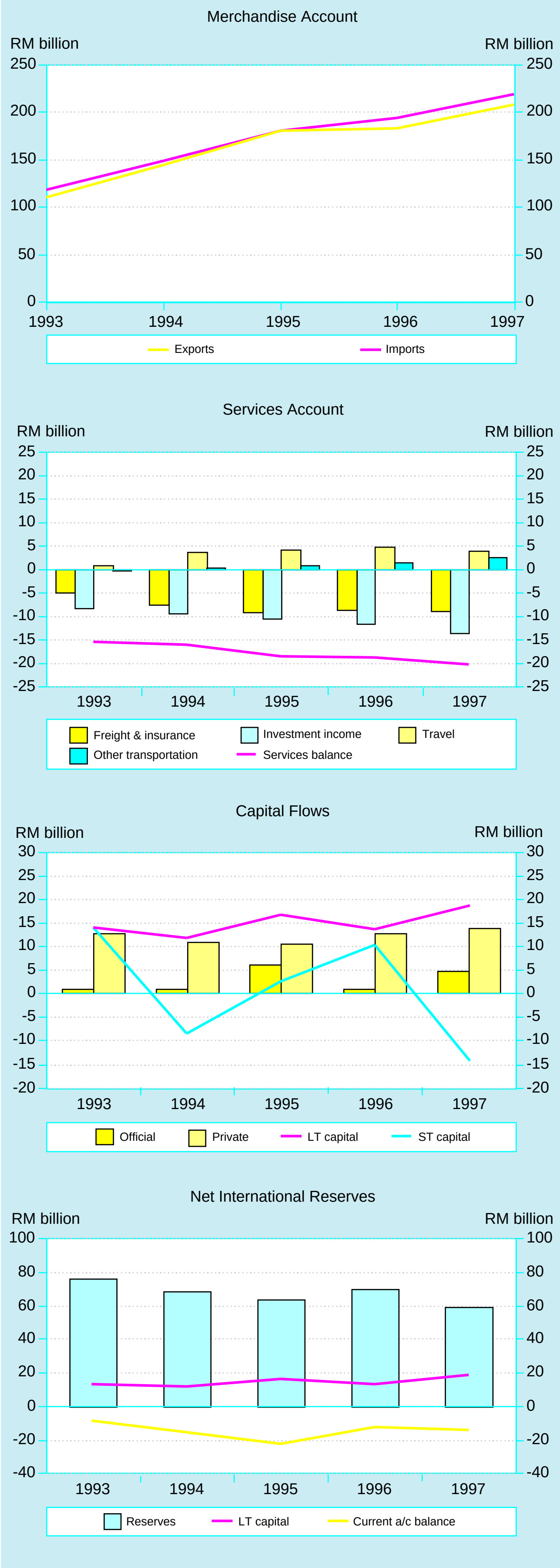
e Estimate

Source : Bank Negara Malaysia and Department of Statistics of the ringgit also did not cause a major disruption to annual servicing of interest and repayments by borrowers. The distinguishing development was that the currency crisis prompted the public and private sectors to postpone planned prepayments and refinancing of external loans scheduled for the second half-year, while some overseas investments were also deferred. Nevertheless, in the face of the depreciation of the ringgit and market concerns over the sustainability of the current account deficit, the strengthening of the balance of payments took on a sense of urgency. Hence, one of the critical elements of the policy packages introduced in the second half of 1997 was to contain excess demand via an appropriate mix of monetary and fiscal policies. The policies were aimed at addressing both short-term cyclical issues as well as accelerating the implementation of structural adjustment programmes already in place.

In 1997, the performance of the **merchandise account** was better than expected. The surplus of RM11.1 billion was RM933 million higher than the level registered in 1996. Reflecting the adjustment measures to reduce imports of lumpy investment goods, exports expanded faster than imports in the second half-year. Reflecting mainly the valuation gains from the depreciation of the ringgit, annual growth in merchandise exports accelerated to 23.3% in the second half-year, from 2.7% in the first half-year. Annual import growth also showed a similar trend, but the pick up in growth was less pronounced. Imports rose by 21% in the second half-year, from 5.7% in the first half-year. For the year as a whole, both exports and imports rose by about the same rate (13.3% and 13.5% respectively) to exceed the RM200 billion level for the first time in 1997. However, exports and imports in United States dollar terms recorded marginal increases of 0.7% and 0.8% respectively, as expansion in volume was offset to a large extent by the decline in the United States dollar prices of Malaysian exports.

The developments in the trade sector indicated clearly that Malaysia is in the transitional stage of moving away from labour intensive industries where Malaysia is losing competitiveness, to industries producing higher-end products. In the transitional stage, the corporations will be experiencing a period of consolidation. The depreciation in the ringgit has given an impetus for these companies in transition to consolidate and to adapt speedily via productivity improvements, to a changing competitive environment. The corporations in the manufacturing

Graph 1.9
Malaysia: Balance of Payments



sector are fully aware that the authorities would not be adopting a weak ringgit policy to maintain competitive strength.

Export earnings in the second half of 1997 improved significantly to increase by 22.5%, compared with only 1.9% in the first half-year. The expansion in export receipts was particularly strong from September to end-year, when growth accelerated from 12.8% in August to exceed 30% in the final quarter. This coincided with the period of sharp depreciation of ringgit exchange rates, from RM3.20 to the United States dollar in September to RM3.89 in December. However, the slower growth in the first half-year caused overall export receipts to expand by only 12.4% for 1997 as a whole (6.5% in 1996). All main categories of exports recorded higher growth during the year. However, in United States dollar terms, export growth was quite marginal, at 0.7% (6.2% in 1996), as the increase in export volume was offset by price declines. Keen competition arising from the larger exchange rate depreciation in countries in the region enabled overseas buyers to demand downward adjustments in United States dollar export prices.

The impact of the depreciation of the ringgit differed among sectors and between industries. In the commodities sector, export performance was constrained by supply bottlenecks so that the sector could not take full advantage of the ringgit depreciation. In the manufacturing sector, exchange rate factors helped to improve the competitive position of some industries. However, the ability of most industries to expand output to take advantage of the weaker currency was fairly limited owing to bottlenecks such as labour constraints and production levels having approached full capacity. Nevertheless, total export volume expanded by 6.6% (compared with 10.6% in 1996) and was more than sufficient to offset the decline in United States dollar export prices of 5.1%.

Exports of **manufactured goods** expanded by 12.9% in 1997 (1996: 7.6%) to RM178.9 billion, due mainly to improved demand for semiconductors and electronic components and parts, chemicals and chemical products, metal products and optical and scientific equipment. While the depreciation of the ringgit helped to enhance competitiveness in most industries, the higher export receipts reflected mainly exchange rate valuation gains. On the demand side, volume growth was constrained by the downturn in the Asia-Pacific region which accounted for about one-third of Malaysia's export market. On the supply side, most industries were already operating at about 80% capacity utilisation so that there was little room for further expansion. The labour market in this sector also remained tight in 1997, inhibiting output. In addition, the increased competition within the region prompted most industries to grant price discounts. Competitive price discounts towards year-end resulted in exports valued in the United States dollar to decline by 2.5% in the final quarter of 1997 (4Q 1996: -2%), although most firms were able to maintain their pace of volume growth. Consequently, exports of manufactures in United States dollar terms rose marginally by 1.1% in 1997 (1996: 7.3%). During the first half of 1997, exports of manufactures valued in United States dollars rose by 1.7% (first half of 1996: 16.1%) and picked up further to grow by 3.5% in the third quarter (third quarter of 1996: 1.8%).

Exports of electronic goods picked up strongly to expand by 25% to RM80.8 billion in 1997 (1996: 13.8%). The growth was due largely to expansion in the export of semiconductors (15.8%; 6.2% in 1996) and electronic equipment and parts (36%; 24.6% in 1996). Although the export of semiconductors had declined marginally in the first half of the year, growth accelerated in the second half of the year in line with the recovery of the global market since May 1997. Demand was particularly strong in the United States, Europe and Asia-Pacific (excluding Japan) markets. Meanwhile, the growth in exports of electronic components and parts was attributable to favourable global developments in the internet, telecommunication and multimedia industry and increased usage of electronic components in higher-end consumer electrical products such as digital television, heavy industries and the transport equipment industry. Total exports of electronic equipment and parts were, however, dampened slightly at the end of the year with emerging signs of oversupply and aggressive pricing in the world market for hard disk drives. Nevertheless, the impact on Malaysian electronic exports was minimal as hard disk drives accounted for less than 5% of total exports of electronics.

Strong external demand for oleochemicals, resins and plastic products from the United States, Japan, Singapore and Hong Kong, Special Administrative Region (SAR), China, led to a marked increase in exports of chemicals and chemical products to 21.6% from only 7.7% in 1996. This industry benefited from the stronger-than-expected recovery in the electronics industry. Growth was particularly strong in the final quarter of the year when export growth in United States dollar terms was almost double its rate in the corresponding period of 1996. With the depreciation of the ringgit, the metal products industry became more competitive with sustained demand from Singapore, Japan and Hong Kong SAR, China. Consequently, export growth of metal products turned around from -11.7% in the first half of the year to increase by 41.5% in the second half of 1997. Meanwhile, stronger external demand from the United States, Hong Kong SAR, China and Europe underpinned the high export growth of optical and scientific equipment, which experienced significantly higher growth in the second half of the year, both in terms of United States dollars as well as in ringgit terms.

Growth in the exports of the remaining industries was more moderate. Exports of rubber products expanded by 11.4% (1996: 9.7%) as stronger orders from the United States and Europe had sustained external demand for surgical and examination gloves which more than compensated for the reduction in tyre exports. The exports of the textile, clothing and footwear industry picked up to 8.8% (1996: 6.8%), reflecting mainly the valuation gains of the currency

Table 1.15
Gross Exports

	1997				
	RM million	Annual change (%)	% share	US$ million	Annual change (%)
Manufacturing sector	**178,858**	**12.9**	**80.8**	**63,717**	**1.1**
Of which:					
Electronics, electrical machinery and appliances	118,958	14.1	53.7	42,368	2.2
Electronics	80,773	25.0	36.5	28,691	11.7
Semiconductor	*40,801*	*15.8*	*18.4*	*14,519*	*3.6*
Electronic equipment & parts	*39,972*	*36.0*	*18.1*	*14,172*	*21.3*
Electrical machinery & appliances	38,185	-3.7	17.2	13,677	-13.3
Consumer electrical products	*17,755*	*-11.0*	*8.0*	*6,364*	*-19.8*
Industrial & commercial electrical products	*11,935*	*13.8*	*5.4*	*4,275*	*2.5*
Electrical industrial machinery and equipment	*7,764*	*-9.4*	*3.5*	*2,780*	*-18.4*
Household electrical appliances	*731*	*11.1*	*0.3*	*257*	-1.7
Textiles, clothing and footwear	7,575	8.8	3.4	2,696	-2.6
Chemicals & chemical products	8,189	21.6	3.7	2,922	9.1
Wood products	6,492	6.6	2.9	2,325	-4.0
Manufactures of metal	5,655	13.0	2.6	2,012	1.2
Transport equipment	4,904	7.9	2.2	1,766	-2.2
Rubber products	3,994	11.4	1.8	1,420	-0.4
Agricultural sector	**23,191**	**3.3**	**10.5**	**8,292**	**-7.1**
Of which:					
Rubber	2,971	-15.4	1.3	1,056	-24.3
Saw logs	2,346	2.8	1.1	834	-8.1
Sawn timber	2,781	-10.9	1.3	989	-20.3
Palm oil	10,810	14.6	4.9	3,843	2.4
Minerals	**15,413**	**18.3**	**7.0**	**5,513**	**6.5**
Of which:					
Tin	479	-10.1	0.2	170	-19.6
Crude oil	7,069	-2.0	3.2	2,513	-12.3
LNG	6,752	42.3	3.0	2,400	27.3
Other	**3,950**	**28.2**	**1.7**	**1,396**	**13.9**
Total	**221,413**	**12.4**	**100.0**	**78,917**	**0.7**

Source: Bank Negara Malaysia and Department of Statistics depreciation and stronger growth in the first half of the year. Improved demand was recorded for high quality textiles, including synthetic textiles and knitting materials from the United States, Japan and Europe. Despite registering a strong growth of 22% in the first quarter arising mainly from strong demand by Japan for plywood and particle board, growth in the exports of wood and wood products slowed down in the following two quarters and moderated to 6.6% for the year as a whole. This was due mainly to stronger competition from South American producers as well as the slowdown in demand from Japan, the People's Republic of China and Korea. Moderate growth was also registered in the exports of several other manufactured goods, including non-metallic mineral products (5.7%), paper and pulp products (7%) as well as petroleum products (2.4%). On the other hand, the depreciation of the ringgit caused a turnaround in exports of transport equipment which expanded by 42.3% in the second half of the year, from a decline of 13.3% in the first half of 1997, resulting in 7.9% growth for the year as a whole (1996: -13.5%).

The only two industries which recorded a contraction in export receipts were electrical goods, and toys and sporting goods. The sluggish external demand for audio-visual products and air conditioners, which had begun in the last quarter of 1996, continued into 1997. Despite the valuation gains in the last quarter of 1997, exports of electrical goods declined by 3.7% as the global oversupply triggered a price war, which was exacerbated by the rapid rate of product innovation common to the industry. In the case of toys and sporting goods, the intense competition from low-cost producers together with the regional turmoil in the second half of the year had depressed the market.

The **commodity** sector experienced favourable export performance in 1997. Export earnings from the sector increased by 8.8% to **RM38.6 billion** (+1.5% to RM35.5 billion a year ago), following the increase in export prices in ringgit terms (6.5%) due to the valuation gains. Export volume, however, recorded a marginal decline of 0.3% during the year. The valuation gains, however, were dampened by the decline in the United States dollar prices for most of the major commodities. Nevertheless, since most of Malaysia's export commodities, except rubber, were traded in United States dollars, the depreciation of the ringgit against the United States dollar resulted in higher prices in local currency terms and hence, higher export earnings.

Exports of **agriculture** commodities turned around to increase by 3.3% to RM23.2 billion in 1997 (-7.2% or RM22.4 billion in 1996). The increase was largely due to significant growth in the exports of palm oil and saw logs, which more than offset the decline in exports of rubber, sawn timber and cocoa. Reflecting the strong external demand in the face of generally tight global supply of vegetable oils and fats, the export volume of palm oil increased by 3.9% in 1997. Despite a marginal decline in the United States dollar price of 1.4%, prices in ringgit terms rose by 10.3% following the ringgit depreciation, particularly during the second half of the year. Consequently, export earnings of palm oil increased strongly by 14.6% in 1997 to RM10.8 billion, representing the single largest export earner for the commodity sector. Although the export volume of saw logs declined by 8.4%, export earnings increased by 2.8% because of price increases. The United States dollar prices for saw logs rose by 0.4% during the year (equivalent to an increase of 12.3% in ringgit terms). Meanwhile, export earnings from sawn timber and cocoa continued to decline by 10.9% and 17.1% respectively, due mainly to the significant decline in export volume. Export earnings from rubber continued with their declining trend, falling further by 15.4% in 1997 to RM3 billion. The lower earnings, despite an increase in export volume of 3.9%, were due mainly to lower prices (-18.5%) arising from poor demand amidst ample supplies in the international markets. As rubber prices were quoted in ringgit, the subsequent lower United States dollar prices prompted an increase in demand from traditional buyers.

Export earnings from the **mining** sector increased markedly by 18.3% to RM15.4 billion in 1997 (+20.8% or RM13 billion in 1996), reflecting a significant increase in the export of liquefied natural gas (LNG), which accounted for almost 44% of total export earnings from minerals. The export volume of LNG increased by 18.6%, in response to strong demand from Japan, Korea and Taiwan, Republic of China (ROC). Likewise, the United States dollar prices of LNG increased further by 7.3% in 1997 to US$156.8 per tonne. Reflecting the valuation gains from the ringgit depreciation, the export unit value of LNG in ringgit terms increased significantly by 20% to RM441 per tonne. Meanwhile, the export unit value of crude petroleum declined by 3.4% to US$20.83 per barrel, in line with the trend in world crude oil prices. Strong global demand following the severe winter season in the northern hemisphere supported high oil prices during the first half-year. Prices started to moderate in the second half, especially towards the end of the year, in response to increased supply following the sale of Iraqi oil under the “oil-for-food” exchange programme. The announcement by OPEC countries in December to increase the quota for crude oil production by 10% exerted further downward pressure on prices. Nevertheless, the exchange rate valuation gains resulted in a marked increase of 8% in the export unit value for Malaysian crude to RM445.3 per tonne. The export volume of crude oil, however, declined by 9.3%, due to increasing demand for domestic consumption as well as lower imports by the traditional buyers. Consequently, gross export earnings from crude oil declined marginally by 2% in 1997 to RM7.1 billion.

The stronger growth in **gross imports** of 12% to RM221 billion in 1997 (1.5% in 1996) reflected mainly an increase in import volume of 10.2%. Import prices also rose, albeit at a slower rate of 3% (-0.5% in 1996). Imports in United States dollar terms, however, recorded only a marginal increase of 0.8% in 1997 (1.1% in 1996). The stronger increase in imports by 5.4% in the first half-year reflected the stronger domestic activities during this period. There was a sharp reversal in the second half-year when imports in United States dollar terms declined by 3.6%, in line with the moderation in aggregate domestic demand. Investment and intermediate goods continued to account for a significant share of 85% of total imports in 1997.

By economic classification, **imports of investment goods** valued in United States dollars recorded the strongest growth (6.9%). The strong growth recorded

Table 1.16
Gross Imports by Economic Function

	1997*p*				
	RM million	Annual change (%)	% share	US$ million	Annual change (%)
Consumption goods	31,584	12.4	14.3	11,314	1.3
Food	6,144	9.5	2.8	2,191	–1.7
Beverages and tobacco	634	15.7	0.3	224	3.0
Consumer durables	5,954	16.7	2.7	2,150	6.0
Other	18,852	12.0	8.5	6,749	0.8
Investment goods	93,864	19.0	42.5	33,527	6.9
Machinery	23,854	10.3	10.8	8,514	–0.9
Transport equipment	13,801	46.2	6.2	4,995	33.3
Metal products	13,669	17.1	6.2	4,855	4.6
Other	42,540	17.6	19.3	15,163	5.5
Intermediate goods	94,180	5.6	42.6	33,697	–4.9
For manufacturing	79,203	5.0	35.8	28,332	–5.5
Of which:					
Electronic parts	45,765	8.1	20.7	16,279	–3.3
CKD parts	4,751	5.9	2.1	1,706	–4.4
Chemicals	6,489	17.1	2.9	2,321	5.3
Textiles	1,581	–12.2	0.7	568	–20.6
For construction	5,215	–3.5	2.4	1,876	–12.7
For agriculture	2,267	13.2	1.0	814	2.2
Crude petroleum	473	1.7	0.2	169	–8.7
Other	7,022	20.2	3.2	2,506	7.9
Imports for re-exports	1,364	21.8	0.6	491	10.1
Tin ore	402	–5.7	0.2	145	–14.4
Natural rubber	962	38.6	0.4	346	25.2
Total	**220,992**	**12.0**	**100.0**	**79,029**	**0.8**

p Preliminary

Source: Bank Negara Malaysia and Department of Statistics reflected mainly the resumption of the capacity expansion programme by the national airline and the increase in the number of ships purchased by domestic shipping companies. Lumpy imports almost doubled in 1997 to US$2.7 billion from US$1.5 billion in 1996. As the bulk of the lumpy items was purchased in the first half-year, imports of investment goods rose at a higher annual rate of 11.1% in the first half-year, compared with 2.9% in the second half-year. Of significance, imports of investment goods for general investment activities moderated in 1997 in line with the slower growth in aggregate investment demand. Imports of machinery declined by 0.9% in terms of the United States dollar, particularly due to a significant decline in imports of generators, following the completion of the capacity expansion programme in the utilities sector.

Imports of intermediate goods declined by 4.9%, valued in United States dollars due to several developments affecting the performances of major sub-sectors within the manufacturing sector, particularly electronic and electrical products, motor vehicles and textile products industries. Imports of electronic components and parts, which accounted for 49% of the total import of intermediate goods, declined in United States dollar terms by 3.3%. This decline was due entirely to lower unit value as growth in import volume remained positive in line with the expansion in production in the electronic and electrical machinery industry. In 1997, prices of electronic components continued to decline in the first half-year due to an excess supply situation globally. The decline in prices, however, moderated since May following the strengthening of demand for semiconductors. Reflecting this trend, imports of electronic components and parts recorded a lower decline of 2.7% in the second half of 1997, compared with 3.8% in the first half-year. Imports of completely-knocked-down parts for the motor vehicle industry was the other major component of intermediate goods to record a decline (-4.4%) in United States dollar terms. Higher interest rates and tighter credit conditions, including the tightening of conditions on hire-purchase for passenger cars, led to a significant slackening in the demand for completely-knocked-down parts for the motor vehicle industry. As a result, imports of completely-knocked-down parts which virtually stagnated in the first half-year declined markedly by 8.5% in the second half-year. Imports of textiles also declined significantly by 20.6%. This decline was due to lower external demand for natural fibre and weaving products. In contrast, imports of chemical inputs for the chemical industry recorded a positive growth of 5.3% as strong external demand for chemical products, particularly oleochemicals, resin and plastic products, provided the main impetus to the growth of this industry. Other imports of intermediate goods which registered negative growth rates were imports for the construction sector (-12.7%), reflecting moderation in activities in the sector towards year-end, and crude petroleum (-8.7%), reflecting mainly a decline in prices.

Growth in **imports of consumption goods** valued in United States dollars stabilised at 1.3% in 1997. Imports of consumer durables and other consumption goods registered positive growth rates of 6% and 0.8% respectively. However, imports of food items declined by 1.7% (+14.6% in 1996). This decline in value reflected the decline in demand for non-essential food items.

The double-digit growth in exports and imports led to a 12.2% expansion in Malaysia’s **total trade** (3.9% in 1996) to RM442 billion or 168.2% of GNP in 1997 from RM394 billion or 165.7% of GNP in 1996. The United States displaced Japan to become Malaysia’s largest trading partner in 1997, accounting for 17.7% of total trade, followed by Japan (17.2%) and Singapore (16.6%). These three countries together accounted for 51.5% of total trade in 1997. In terms of **export destination**, Singapore remained the largest export market. The United States and Japan retained their positions as the second and third largest export markets respectively. In terms of **import origin**, Japan continued to be the largest source of imports (21.9%), followed by the United States (16.8%) and Singapore (13.1%). In terms of **bilateral trade balances**, Malaysia continued to record trade deficits with other major trading partners such as Japan, Korea and Taiwan, ROC. A notable development was that Malaysia's trade balance with Thailand, Indonesia and Germany deteriorated attributable to some import substitution from higher cost suppliers to countries whose currencies either depreciated much more than the ringgit (Thailand and Indonesia) or against which the ringgit recorded a lower depreciation (Germany). Large trade surpluses continued to be recorded with Singapore, Hong Kong SAR, China, the Netherlands, the United States, the United Kingdom and India. Larger trade surpluses recorded with Singapore and the Netherlands reflected higher exports to these transhipment centres.

Table 1.17
Direction of External Trade

	1997*p*				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	
ASEAN countries	60,725	27.4	44,960	20.3	15,765
Singapore	44,356	20.0	29,004	13.1	15,352
Thailand	7,930	3.6	8,683	3.9	–752
Indonesia	3,464	1.6	4,114	1.9	–650
Philippines	3,302	1.5	2,635	1.2	666
Brunei Darussalam	764	0.3	67	…	696
Vietnam	910	0.4	457	0.2	453
European Union	31,944	14.4	31,224	14.1	719
United Kingdom	7,298	3.3	5,797	2.6	1,501
Germany	6,366	2.9	9,697	4.4	–3,331
Netherlands	8,701	3.9	2,167	1.0	6,534
Other	9,579	4.3	13,564	6.1	–3,985
United States	41,122	18.6	37,049	16.8	4,073
Japan	27,798	12.6	48,506	21.9	–20,708
Hong Kong SAR, China	12,179	5.5	5,404	2.4	6,774
Taiwan, ROC	9,633	4.4	10,599	4.8	–967
Korea	7,096	3.2	11,324	5.1	–4,228
People's Republic of China	5,258	2.4	6,254	2.8	–997
Australia	3,797	1.7	5,473	2.5	–1,676
India	3,306	1.5	2,135	1.0	1,171
West Asia	4,216	1.9	1,698	0.8	2,518
Rest of the world	14,340	6.5	16,363	7.4	–2,023
Total	**221,413**	**100.0**	**220,992**	**100.0**	**421**

p Preliminary

Source: Bank Negara Malaysia and Department of Statistics

The improvement in the merchandise surplus in 1997 was offset by the higher deficit in the **services account** and higher outflows on the **transfers account**. In 1997, the transfers account increased by RM761 million to RM3.7 billion, reflecting mainly the increase in remittances by foreign workers. The higher services deficit was attributable to unforeseen developments in the second half of 1997. The most significant was the prolonged haze which severely reduced tourist arrivals, and affected passenger fare receipts. Consequently, growth in services receipts moderated from 21.4% recorded in 1996 to 14.7%. Overall, reduced imports of selected services following the moderation in domestic demand in the second half of the year and the growth in services receipts due to the structural adjustment measures was offset by higher cost due to the depreciation of the ringgit. Hence, the lower growth in output in 1997 was not reflected in a lower deficit for the year. In United States dollar terms, however, the services deficit declined by US$349 million to US$7.4 billion. The improvement was most visible for the freight, other transportation and consultancy services accounts. The services deficit in terms of GNP declined to 7.9%, the lowest ratio recorded since 1973, reflecting the positive results from the structural adjustment policies undertaken to strengthen the services sector of the economy.

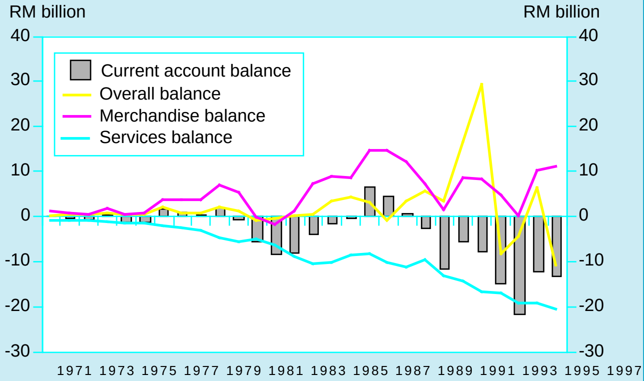
In 1997, the performance of the tourism industry was affected particularly by the prolonged haze in the South-East Asian region. The net surplus in the **travel account** declined by almost RM1 billion to RM3.8 billion, the first decline since 1991. The decline in tourist arrivals by 13% to 6.2 million more than offset the increase in average per capita expenditure of 8.2%. Average per capita expenditure rose during the year as per diem expenditure of tourists increased by 9.6%, while the length of stay of tourists per visit stood at 5.3 days (1996: 5.4 days). The number of excursionist arrivals also declined by 8.1%. Consequently, the combined earnings from various categories of travellers, namely tourists (who stayed more than one day), excursionists (day travellers) and transit passengers,

Box II

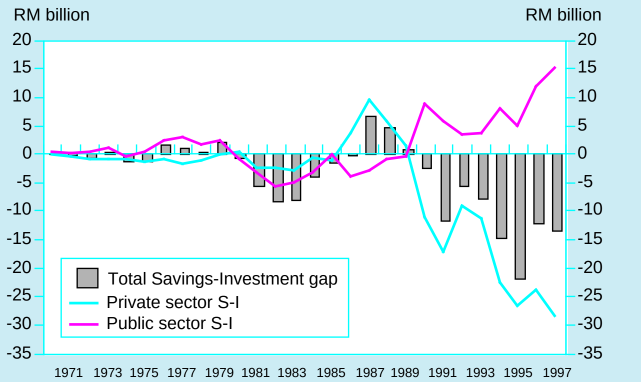
Management of the External Sector in the 1990s

Prior to 1980, Malaysia had not experienced prolonged periods of current account deficit. The first period of sustained current account deficit occurred in 1980–86, when the deficit in terms of GNP averaged 6.5% (Graph II.1). Following voluntary structural adjustment policies undertaken by the Government, the deficit turned around to record surpluses in the period 1987–89. This phase of policy adjustments led to further transformation of the Malaysian economy to one in which the manufacturing sector dominated and in which the private sector played an increasingly significant role. The current account deficit re-emerged during the period 1990–97, averaging 6.2% of GNP. The deficit in 1995 reached 10.5% of GNP. This raised considerable concern that the imbalances were attributable to excessive domestic demand in relation to the productive capacity of the economy and to distortions in the price levels resulting in the shift of resources away from the productive sectors to the less productive sectors. The purpose of this Article is to review the factors contributing to Malaysia's current account deficit in the 1990s and to draw broad implications for the medium–term prospects. In order to assess the situation, it is necessary to identify and distinguish the nature of the current account imbalance, the macroeconomic conditions prevailing and the means by which the current account imbalance has been financed.

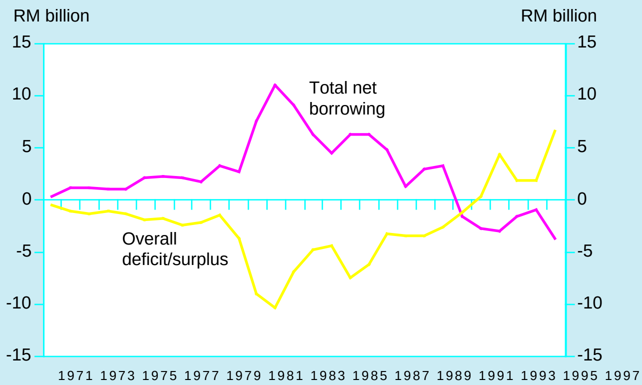
Graph II.1
Balance of Payments



Graph II.2
Savings-Investment Gap



Graph II.3
Federal Government Finance



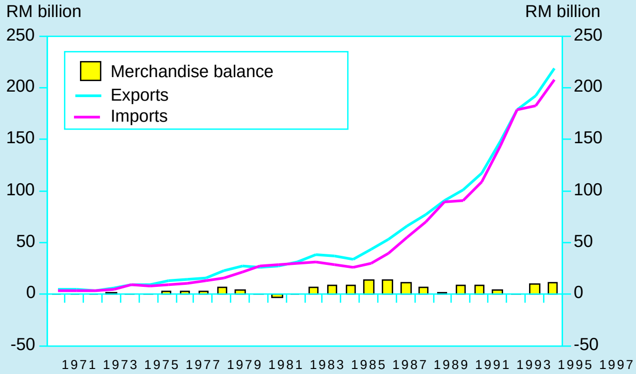
Nature of the Imbalance

Domestic demand was investment driven

The performance of key macroeconomic indicators for the period 1990–96 showed that the developments in the external sector have essentially been associated with strong investment activities. In terms of the savings-investment gap, the current account deficit in the balance of payments reflected the faster growth of investment relative to savings. By international standards, investment and savings in terms of GNP for Malaysia were high during this period, averaging at about 40% and 34% respectively. The shortfall in savings over investment was largely confined to the private sector (Graph II.2). The public sector savings-investment gap has been in surplus since 1990. Of significance, the overall balance of the Federal Government has been in surplus since 1993 (Graph II.3).

The allocation of investment is also important for assessing the nature of the current account deficit. The strong performance in exports in the 1990s (Graph II.4) indicated that the bulk of the resources, particularly foreign savings, were channelled to the more productive sectors of the economy. Guided by the need to increase competitiveness and raise industrial efficiency, greater emphasis was placed in the 1990s on the balanced development of the manufacturing and services sectors. The pressure to enhance competitiveness, which is increasingly determined by the availability of adequate infrastructure facilities, expertise, knowledge and networking, called for efforts to strengthen both the goods and services sectors, particularly in the transport, communication and utilities sub-sectors. Consequently, capital outlays, in both manufacturing and services sectors increased strongly during this period. The high rate of investment and high import requirements of these two leading sectors led to stronger growth in imports of goods and services. In the period 1990–96, imports for the construction sector were also high coinciding with the rapid growth in this sector (14.6%). Investments channelled to the construction sector accounted for 14.3% of total private investment, while loans from the banking system to this sector grew at an average annual rate of 22.4% to account for 8.4% of total loans outstanding as at end–1996. Overall, a double-digit growth rate of 16.5% was recorded for gross exports of goods in the period 1990–96, while gross imports of goods increased at a faster rate of 18.3%. As resources were channelled mainly to the non-resource based manufacturing sector, imports of investment goods and intermediate goods accounted for more than 80% of the total import bill. The share of consumption goods, however, declined from 16.4% in 1990 to 14.2% in 1996. In the services account, the deficit worsened in absolute terms, but policy measures taken to strengthen the services account led to faster growth in receipts (21%) than payments (16%).

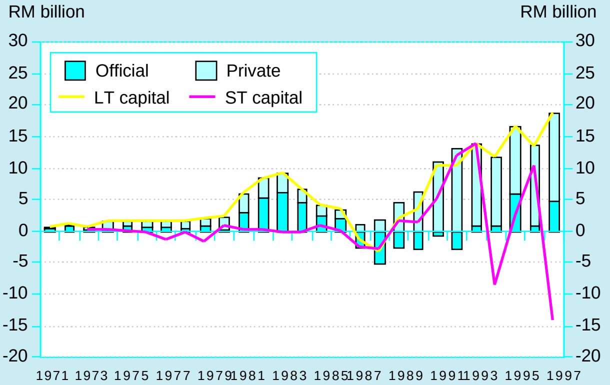
Graph II.4
Merchandise Account



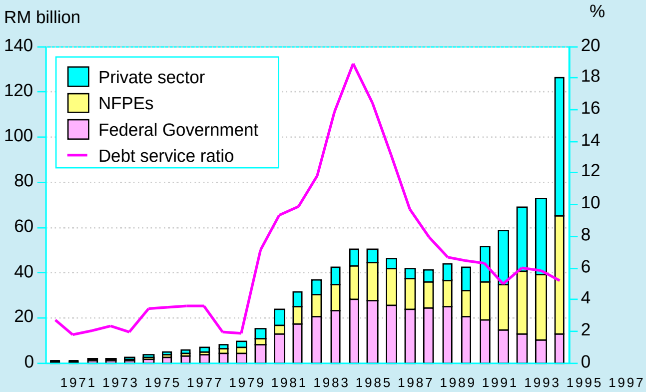
Meanwhile, dependence of non-resource based industries on imported inputs and labour scarcity prompted the Government to move to promote higher value added and high technology-oriented industries. The broad strategy that was put in place was to promote exports of high value added products, expand and diversify overseas markets, improve domestic linkages to reduce the import content of exports and to increase international competitiveness. In this regard, a key strategy of the new Industrial Master Plan (IMP) 1996–2000 is to strengthen the inter-industry linkages through the cluster approach to complement the Vendor Development Programme. The objective is to maximise foreign exchange retention in the country by shifting from assembly-intensive type of manufacturing to higher value added products, encompassing the entire value chain of manufacturing production and other complementary aspects, including research and development, design, distribution and marketing activities. Similarly, in the services sector, policies were also implemented at sub-sector levels to enhance complementary linkages. The IMP has placed priority on the development of the services sector as a major catalyst for growth, as well as a potential source of export growth. Prior to the IMP, selected services sub-sectors, such as education, tourism and consultancy services, were identified for aggressive promotion in an effort to reduce the services deficit. The efforts on this front have now begun to yield positive results. The services deficit in recent years has been contained at less than 10% of GNP (previous peak: 14.6% in 1984). Excluding the net outflow of investment income, the bulk of which are reinvested, the services deficit improved from 7.8% of GNP in 1980 to 3.3% in 1996 and 2.8% in 1997.

The emphasis on providing a stable medium- and long-term macroeconomic environment has enabled Malaysia to attract long-term capital inflows to finance the current account deficit (Graph II.5). Foreign direct investment inflows contributed significantly to the surpluses in the long-term capital account since 1989, the bulk of which was

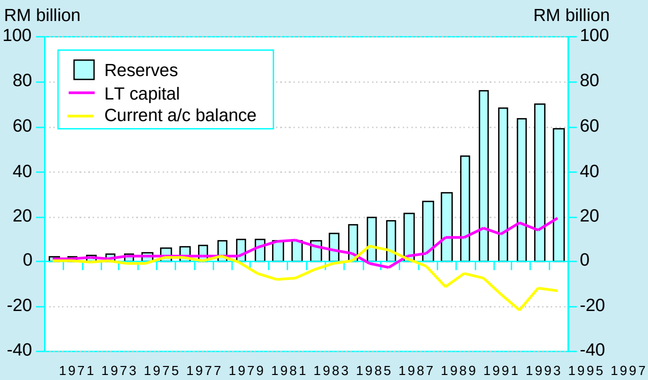
Graph II.5
Capital Flows



Graph II.6
Medium and Long-Term External Debt



Graph II.7
External Reserves



concentrated mainly in the oil and manufacturing sectors. By type of flows, equity flows became important primarily as a result of the relaxation in the foreign ownership requirement in the manufacturing sector. With respect to external borrowings, active debt management by both the public and private sectors in the 1990s has contained the growth of external debt and debt servicing, avoiding bunching of payments as well as reduced Malaysia's exposure to interest and exchange rate fluctuations. The medium- and long-term external debt to GNP ratio fell to 30.5% as at end-June 1997, prior to the financial crisis, from a peak of 75.6% in 1986. As the bulk of the external loans were also channelled to the productive sectors of the economy, the debt service ratio at 5.1% in 1997 has remained low by international standards (previous peak: 18.9% in 1986, Graph II.6). External loans are prohibited for the financing of property development or for the purchase of shares in the country.

Reflecting the dependence on longer-term funds to finance the current account deficit, the basic balance (current account plus long-term capital inflows) has been in surplus for most years. The negative balance in 1994–95 was due to several factors, including the wider current account deficit in 1995 due mainly to the import of several large items during the year, in particular aircraft, in addition to the higher repayments of external debt by the Government as well as the strong outflows in the form of overseas investment by Malaysian-owned companies. Over the period 1990–97, international reserves were sufficient to finance more than three months of retained imports (Graph II.7).

Current Account Deficit, Inflation and Exchange Rate

Inflation pressures remained subdued, ringgit was relatively stable

Inflation, as measured by the consumer price index, was contained below 5% during the period under review due to a combination of factors. In addition to monetary restraint since 1989 and fiscal discipline, the growth in domestic demand had to a significant extent been accommodated by higher imports. Of relevance, growth in imports of investment and intermediate goods was high in the period 1990–96. Imports of investment goods recorded the sharpest annual growth (21%), followed by intermediate goods (18%) and consumption goods (15%). Food imports, which accounted for about 20% of total consumption goods, rose at an average annual rate of 10%.

As the basic balance of the balance of payments remained at near balance position, fluctuations in the exchange rate of the ringgit were associated with movements in short-term capital, which complicated monetary management in Malaysia. Nevertheless, the ringgit in general was not viewed as an overvalued currency. On the contrary, the general perception prior to the currency crisis was that it was undervalued, given the underlying economic fundamentals.

Future Direction

Overall, the authorities envisaged that the current account would remain in deficit during the Seventh Malaysia Plan. The deficit, nevertheless, has improved significantly since 1995, from 10.5% of GNP in 1995 to 5.1% in 1996–97. The recent pressures on exchange rates has increased the urgency for a more rapid adjustment in the current account balance. The expansion and implementation of projects have been critically reviewed. Some projects have been postponed indefinitely, while the strategic projects are being sequenced to prevent bunching of imports. In the immediate term, the deferment of large non-critical projects is expected to yield positive results in reducing the deficit. For 1998, the current account deficit is expected to decline to 0.5% of GNP, well below the 3% target set by the Government. The measures introduced in late 1997 were also aimed at strengthening the competitiveness and resilience of industries to cope with the more challenging environment, the details of which are outlined in the Overview in Chapter 1. All structural adjustment policy measures that have already been in place since the early 1990s would be reinforced to strengthen the balance of payments position. Generally, Malaysia has set specific policy prescriptions to address each of the issues to ensure that the medium term balance of payments position remains viable. Significant progress has also been made to improve data and information in terms of coverage and timeliness of data dissemination to promote greater public understanding of developments in its economic and financial environment to facilitate well informed decision making by the markets.

declined by RM740 million to RM10.5 billion. On the payments front, the economic uncertainty and the higher cost of travelling during the latter part of the year deterred somewhat the number of Malaysians travelling abroad. Expenditure on this item stabilised at RM4.2 billion, about the same level as in 1996. Outflows for pilgrimage rose moderately by 1.3% to RM156 million. Meanwhile, payments for education abroad increased further by 8.7% to RM2.4 billion, due in part to the higher cost of education as a result of the weaker ringgit.

After recording a decline of 5.6% in 1996, net **freight and insurance** payments abroad increased by 5% to RM8.9 billion. Despite the generally lower freight rates, gross outflows on freight and insurance increased by 7.1%, due to the weaker ringgit and the higher import volume. Gross payments were moderated by the increase in freight and insurance earnings by 13.6%, reflecting mainly the expansion in the carrying capacity of the domestic shipping companies. In terms of United States dollars, net payments declined by US$206 million. The share of the freight and insurance account in the services deficit remained virtually unchanged at about 43%.

Net **investment income** payments rose further by RM1.8 billion to RM13.5 billion in 1997. The interest income account reverted to a deficit of RM1.5 billion due to the increase in outstanding external debt, as well as the higher cost of servicing following the weaker ringgit. As a result of higher recourse to foreign loans by the non-financial public enterprises (NFPEs) and the private sector, interest payments by these sectors exceeded the RM4 billion level in 1997. Meanwhile, the profits and dividends accrued to non-residents remained high at RM13.9 billion. Consequently, net investment income outflows remained the largest contributor to the services deficit, with its share rising to 65% in 1997, from 60% in 1996.

The **other transportation** component (consisting of passenger fares; charter fees; and port and airport-related activities, such as stevedoring, bunkers and port and airport disbursements) improved further to record a higher net surplus of RM2.4 billion (RM1.5 billion in 1996). Gross receipts rose by 21.8% to RM6.6 billion, reflecting mainly higher earnings on passenger fares by the national airline and higher receipts for port-related activities. Increased frequencies of flights by the national airline to existing destinations and commencement of services to new destinations were facilitated by the expansion in fleet size and the conclusion of code-sharing arrangements with other airlines. Nevertheless, receipts for passenger fares would have been higher if not for the adverse developments affecting the tourism industry. Port-related activities, particularly port disbursements, stevedoring and sales from bunker fuel also drew higher receipts in 1997 following continued efforts to promote Port Klang as a premier port in Malaysia. The Government's efforts to make Port Klang a hub port also showed encouraging success with transhipment volume increasing by 42.6% in 1997. Meanwhile, gross payments for other transportation rose by 6.8% to RM4.2 billion. Higher outflows in other transportation account were due in part to the weaker ringgit.

Net payments for **other services** declined by RM1 billion to RM4.5 billion (RM5.5 billion in 1996). The improvement in the other services account reflected the completion of some of the big projects, particularly in the civil engineering sector. As a result, the share of the other services deficit to overall deficit declined markedly to 22% in 1997 (28% in 1996).

The long-term **capital account** strengthened in 1997, while the short-term capital account recorded a deficit. This reflected the large reversal of portfolio investment. Net inflow of long-term funds increased during the year to an unprecedented level of RM18.7 billion, with net inflows of official and private long-term capital of RM4.8 billion and RM13.9 billion respectively.

The higher net inflow of RM4.8 billion in the **official long-term capital account** was due mainly to lower net repayment by the Federal Government as well as lower repayments and prepayments by the NFPEs. Gross foreign borrowing by the Federal Government declined by RM287 million to RM462 million. These borrowings were in the form of project loans to finance development expenditure in the public sector. Reflecting the strong financial position of the Federal Government, no new external market loan was raised in 1997. The Government continued its prepayment programme in 1997, amounting to RM911 million which was undertaken entirely in the first half-year. With repayments and prepayments during the year of RM2.1 billion, the Federal Government registered a net outflow of RM1.7 billion for the sixth consecutive year. In the second half-year, the Federal Government postponed the prepayment of three market loans equivalent to RM491 million in ringgit terms.

In 1997, net external borrowings by the NFPEs increased substantially to RM6.5 billion, from RM2.8 billion in 1996. Although gross borrowings declined in the second half-year, they remained high at RM9.5 billion for the year as a whole. This reflected drawdowns mainly by Telekom Malaysia Berhad, Tenaga Nasional Berhad and PETRONAS to finance their domestic capital expenditure, overseas investment as well as prepayments and refinancing of more expensive loans. With the weakening of the ringgit, some prepayments of the more expensive loans scheduled for the second half-year were postponed. Consequently, prepayments of external loans in 1997 declined to RM421 million, from RM1.3 billion in 1996.

In the **private sector**, the net inflow of long-term capital increased by RM1.1 billion to RM13.9 billion due to the combined effects of some valuation gains arising from the weaker ringgit and lower overseas investment by Malaysian-owned companies. **Net inflow of inward investment** continued to remain strong at RM19.2 billion (1996: RM19.4 billion). As in previous years, the bulk of the inflows of foreign direct investment was primarily channelled to the manufacturing (83%) and oil and gas (7%) sectors. Retained earnings by the existing companies accounted for 54% of the net inflow of inward investment, followed by external loans (24%) and equity (22%). External loans, mainly from parent and associated companies, increased in 1997 attributed to the high rate of investment in the first half of 1997 and the valuation effects of the weaker ringgit in the second half-year. The volume of external borrowings in United States dollar terms declined in the second half-year. The slowdown in approval in manufacturing investment in 1997 did not cause a slowdown in actual inflows during the year. New inflows of equity in the manufacturing sector remained strong because of exceptionally large approvals of manufacturing projects in the 1994–96 period. Foreign equity investment approved in 1997 by the Ministry of International Trade and Industry (MITI) was lower (RM3.6 billion) when compared with the exceptionally high approvals in 1996 (RM6.2 billion). A total of 12 large projects (capital investment of RM500 million and above) with foreign equity amounting to RM3.6 billion were approved in 1996. Excluding these large projects in 1996, the amounts approved for 1997 would have exhibited a normal trend. Despite the currency crisis, long-term investors continued to view Malaysia as a favourable investment destination. In the second half of 1997, six big projects with foreign participation were approved by MITI. The proposed foreign equity in these projects amounted to RM1.1 billion or 54% of the total equity. The data on foreign investment approved for manufacturing projects in 1997 showed that the United States was the leading investor, followed by Japan, Germany, Taiwan, ROC, Singapore and Korea. These six countries accounted for 84% of the proposed foreign investment in approved manufacturing projects. Within the oil and gas sector, the United States and the Netherlands continued to remain the major foreign investors, followed by Japan and Taiwan, ROC.

Overseas investment by Malaysian-owned companies, which had risen rapidly since 1991, declined in 1997. The uncertainty in the region prompted investors to defer implementation of some overseas projects. Hence, net overseas investment (including retained earnings overseas) declined to RM8.4 billion in 1997 (1996: RM10.5 billion). Gross outflows of RM5.5 billion which were stronger in the first half-year, moderated to RM4.4 billion in the second half-year. In line with the slackening trend in overseas investment in the second half-year, net external borrowings by Malaysian-owned companies moderated to RM3.1 billion in 1997 (1996: RM3.9 billion). The major recipient countries of overseas investment in 1997 were the United States (24%), Singapore (19%), Hong Kong SAR, China (9%), Indonesia and the United Kingdom (6% each). Investment in the United States was largely concentrated in the high value added sub-sectors in the services and manufacturing sectors. This move by Malaysian companies indicates the corporate strategy towards acquiring technical know-how via participation on a joint venture basis with firms in developed countries.

The short-term capital account recorded a large net outflow of RM14.2 billion in 1997 in the wake of the currency turmoil in the region. The bulk of the net outflow of funds in 1997 was due to liquidation of portfolio investment as well as intervention to support the ringgit exchange rate. While there was some increase in the placement of funds abroad by residents, such outflows were offset by the withdrawals from abroad, as residents took advantage of the weaker ringgit to make foreign exchange gains. During the year, net external liabilities of the commercial banks increased to RM7.7 billion. The tight liquidity conditions in the second half-year and lower interest rates abroad prompted some institutions to source offshore ringgit funds through swap operations with offshore banks. A significant portion of these higher liabilities was fully hedged by forward purchases of foreign currencies from domestic exporters.

The overall debt situation remained manageable in 1997, reflecting prudent **external debt** management strategies adopted since 1987. The adverse impact on debt servicing was not significant as the bulk of Malaysia's external loans had maturity periods of four to twenty years. Short-term debt accounted for only 24% of total debt, of which commercial banks accounted for 80% of total short-term debt. Given that the external loans of the private sector were channelled mainly to export-oriented industries, these companies in general had a natural hedge from export receipts to cover any significant increase in debt servicing. Among the NFPEs which were significant borrowers from overseas markets, PETRONAS had substantial earnings in foreign currencies, while utility companies had strong financial standing in the international markets. As a result, these companies continued to have access to funding, despite the tightening in credit terms in the international capital markets.

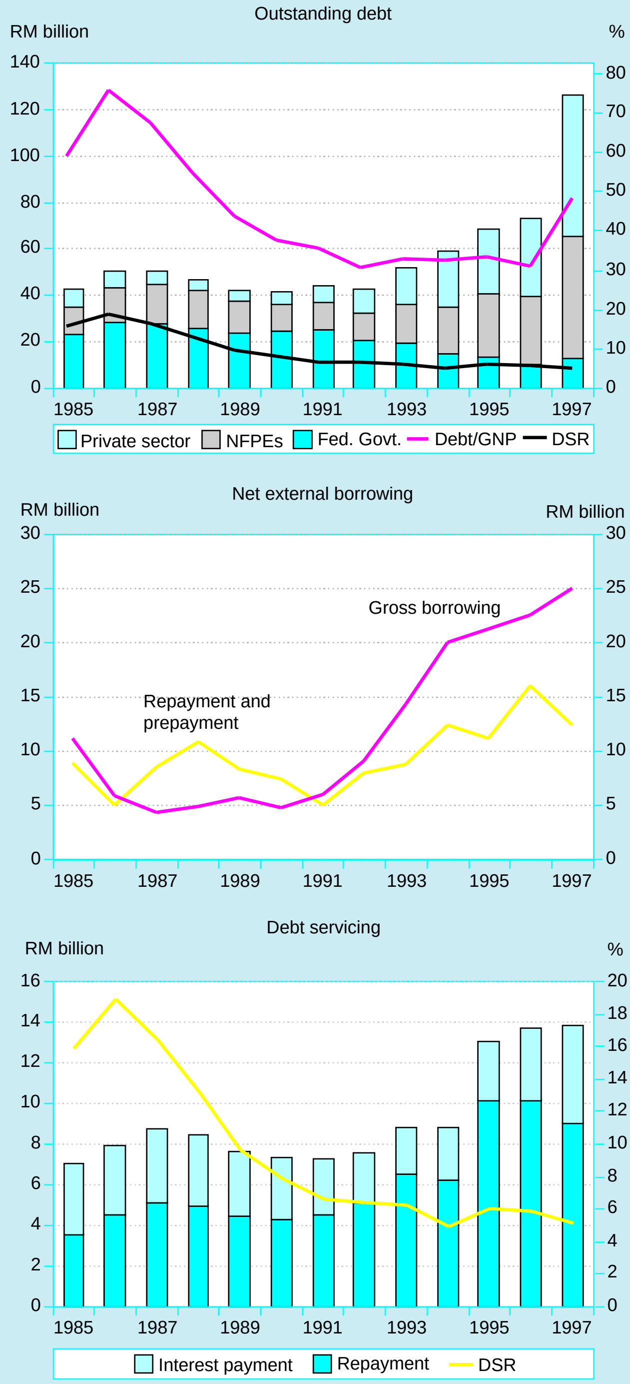
External borrowings of medium- and long-term loans of the NFPEs and the private sector registered a larger net inflow of RM14.3 billion in 1997 compared with RM8.7 billion in 1996. The drawdown

Table 1.18
Outstanding External Debt

	1996		1997*p*	
	RM million	US$ million	RM million	US$ million
Total debt	**98,836**	**38,968**	**166,228**	**42,678**
Medium & long-term debt	*73,181*	*28,863*	*126,508*	*32,480*
Short-term debt[1]	*25,655*	*10,105*	*39,720*	*10,198*
As % of GNP				
Total debt	41.5	41.2	63.2	45.6
Medium & long-term debt	30.8	30.5	48.1	34.7
As % of exports of goods and services				
Total debt	41.8	41.4	61.9	44.7
Medium & long-term debt	30.9	30.7	47.1	34.0
Debt service ratio (%)				
Total debt	6.1	6.1	5.7	5.7
Medium & long-term debt	5.7	5.7	5.1	5.1

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

Graph 1.10
Medium and Long-Term External Debt



of loans by these two categories of borrowers were utilised not only to finance their investment, both at home and abroad, but also to refinance selectively the more expensive loans. Nevertheless, following the outbreak of the currency crisis in mid-1997, there was a noticeable moderation in the drawdown of loans by the NFPEs and the private sector in the second half-year. The Federal Government recorded a net outflow of RM1.7 billion. Reflecting these developments, the medium- and long-term external debt in United States dollar terms increased by 12.5% to US$32.5 billion (1996: US$28.9 billion). Short-term debt, comprising mainly the external borrowings of the commercial banks and short-term debt of the private sector, increased by 54.8% to RM39.7 billion, bringing the total debt outstanding to RM166.2 billion, an increase of 68.2% compared with the level as at end-1996. In United States dollar terms, total external debt increased moderately by 9.5% to US$42.7 billion (US$39 billion in 1996). Consequently, the ratio of total external debt to GNP increased in United States dollar terms to 45.6% from 41.2% in 1996. Likewise, the ratio of medium- and long-term debt to GNP increased to 34.7% in United States dollar terms from 30.5% in 1996. In ringgit terms, the ratio of medium- and long-term debt rose from 30.8% in 1996 to 48.1% in 1997.

Total **debt servicing** payments, comprising principal repayments and interest payments for medium- and long-term debt in 1997 increased marginally by 1.9% to RM13.8 billion. Nevertheless, the debt service ratio (ratio of debt servicing to export of goods and services) declined to 5.1% in 1997 (1996: 5.7%) due to the stronger expansion in exports of goods and services (13.5%), particularly in the second half-year. Increased recourse to external borrowing by the NFPEs and the private sector in recent years had led to higher interest payments. However, principal repayments declined by 9% during the year.

In terms of currency composition, debts denominated in the United States dollar continued to dominate the currency profile of the nation's medium- and long-term debt. The share of United States dollar-denominated debt rose by four percentage points to 76% of total debt outstanding at the end of 1997. The share of yen denominated debt declined marginally to 15% (1996: 16%) due to the prepayments of yen loans by the public sector. The share of external debt denominated in other international currencies, including the French franc, Singapore dollar, Deutsche Mark and pound sterling declined from 12% to 9%, due to prepayments of several loans as well as maturity of loans denominated in European currencies during the year.

Public sector external debt: The Federal Government continued its active debt management strategy to contain the size of its external debt and its future debt servicing. Prepayment of external loans and restraint on new external borrowing remained an integral part of the Federal Government's debt policy in 1997. In the first half of the year, two Swiss franc market loans amounting to SF225 million or RM424 million were redeemed. The Federal Government also took advantage of the cheaper yen in the early part of the year to prepay four yen loans (two market loans and two project loans) amounting to RM911 million. Apart from the prepayments, about 13 project loans were fully repaid during the year. In aggregate, repayment of external loans by the Federal Government totalled RM2.1 billion in 1997 (1996: RM2.9 billion). Gross external borrowing was limited to drawdown of project loans. The Federal Government did not raise any external market loan in 1997. This was the third time since 1992 that the Government had not raised loans from the international capital market. Despite the large net repayment of loans, the outstanding external debt of the Federal Government increased in ringgit terms. For the first time since 1992, the external debt of the Federal Government rose by 23.7% to RM12.9 billion at the end of 1997 due to an exchange revaluation loss of RM4.2 billion. Nevertheless, the Government's prudent approach to debt management since 1987 helped to minimise exchange rate losses from the adverse movement in ringgit in 1997.

In the first half-year, NFPEs actively sourced funds from abroad to take advantage of the lower international interest rates and the availability of long-term debt at fine margins to finance their investment and expansion programmes, as well as to refinance and prepay some of the more expensive loans. Gross borrowing of the NFPEs increased by 17.2% to RM9.5 billion. The substantial drawdown of loans were made by Tenaga, PETRONAS and Telekom which together accounted for 74% of total external borrowing by the NFPEs. Meanwhile, the repayments of NFPEs declined by 42.4% to RM3 billion (1996: RM5.3 billion) due mainly to the decline in planned prepayment and refinancing of loans to RM1.6 billion against RM3.8 billion in 1996. Coupled with the

Box III

External Debt Management

Recent events in Asia once again demonstrate that high growth rates and strong export performance cannot insulate economies from risks associated with large external debt positions. A high external debt position exposes a country to external shocks, which can not only threaten financial stability but also undermine the economic growth prospects. Malaysia has long recognised the adverse consequences of unsustainable debt levels, with the lessons drawn from the recession in the mid-1980s. Since then, Malaysia has adopted a conservative approach to foreign debt management and kept its external debt at relatively low levels. However, the recent depreciation of exchange rates to unprecedented levels in East Asia has had a cataclysmic impact on external debt obligations and strongly undermined the financial stability of regional economies. In this regard, the lower external debt level of Malaysia has strengthened the country's capacity to face the challenges associated with the regional financial turmoil.

Malaysia's total medium- and long-term external debt of US$32.5 billion at end-1997 (34.7% of GNP in US dollar terms and 48% of GNP in ringgit terms) is low by international standards. In large part, this was due to the low external indebtedness of the Federal Government. Including the short-term external debt of both the banks and non-bank private sector, Malaysia's external debt amounted to US$42.7 billion or 45.6% of GNP (63.2% in ringgit terms), while its debt service ratio was 5.7% in 1997(6.1 % in 1996). Short-term debt accounted for 24% of total external debt, reflecting the low reliance on short-term borrowing by the non-bank private sector. The bulk of the short-term debt was borrowing by the commercial banks, and for the most part was fully hedged against contracts with their exporting clients.

With the weakening of the ringgit as a result of the regional financial turmoil, the debt in ringgit terms has increased significantly. However the policy of limiting private sector external loans to corporations and individuals with foreign exchange earnings has enabled Malaysia to meet its external obligations from export earnings. At the exchange rate of US$1=RM3.895 at end-1997, the total debt in ringgit terms increased to RM166.2 billion from RM114.3 billion at end-June 1997 (US$1=RM2.52). However, the short-term debt remained small, at about 24% of total debt. Total short-term debt of the banks and non-bank private sector amounted to RM39.7 billion, substantially lower than Bank Negara Malaysia's (BNM) reserves of RM83.7 billion (reserves of RM59.1 billion plus exchange rate revaluation gain of RM24.6 billion. In BNM's published accounts, external reserves of RM59 billion at end-1997 are not revalued to reflect the year-end exchange rates). The short-term debts are mainly in the form of revolving credits, inter-company credits through inter-company loans and commercial bank net external liabilities. The net liabilities of banks, which form the bulk of short-term loans, are related to their normal trade financing activities and are fully hedged. More than half of the external borrowing of the banks is covered through forward contracts with exporters.

As at end-December 1997, total external debt that is due in 1998, inclusive of all short-term debt and medium- and long-term debt with remaining maturity of less than one year, would amount to RM57.7 billion or US$14.4 billion. This amount is well below the ringgit equivalent of reserves of RM83.7 billion. While a substantial part of external loans due in 1998 are hedged, some corporations are likely to experience liquidity problems resulting from the magnitude of the currency depreciation. To address these problems, many of these borrowers intend to restructure their debts, including the option to roll over existing loans or to extend the repayment period.

The current exposure of the country reflects a deliberate policy to contain total medium- and long-term external debt in the region of 30–35% of nominal GNP. At end-June 1997, this ratio was 30.5%. The country's policy on active debt management has enabled Malaysia to meet this objective without impinging the ability of the private sector to obtain loans from foreign sources at favourable rates. In addition, the regular prepayment and refinancing exercises have kept debt levels low, while the refinancing programmes have improved the debt maturity profile of the country. The bulk of Malaysia's medium- and long-term debt are loans with remaining maturities of between four and twenty years (55%).

In practice, Malaysia's external debt management strategy is guided by the following objectives:

- To ensure adequate financing for productive investment activities and a level of borrowing consistent with maintaining sustainable growth with low inflation, monetary stability and external stability; and

- To maintain a stream of external debt service payments consistent with the economy's debt servicing capacity over the medium-term.

As a matter of policy, the Government exercises prudence in its recourse to external borrowing and relies mainly on non-inflationary domestic borrowing as well as current budget surpluses to fund its development programmes. In recent years, the Federal Government raised foreign loans mainly to maintain market presence and to refinance loans on more favourable terms. Notwithstanding these considerations, external loans are generally raised only if the funds are to be utilised for productive purposes. In the case of private sector borrowing, the Bank's approval is required for such borrowing to finance productive activities and strategic projects, and for investments that would generate sufficient foreign exchange receipts to service the debt. Companies are not permitted to raise external borrowing to finance the purchase of properties in the country. Foreign investors in the country can borrow funds, especially on a long-term basis from their offshore shareholders or related companies overseas. These loans, however, need to be obtained on reasonable terms. Corporations are also encouraged to raise loans with longer maturities, while short-term borrowing is closely monitored.

These stringent criteria are applied in approving external borrowings in order to achieve the following objectives:

- Contain the size of the national external debt within prudential limits to reduce the vulnerability to adverse movements in global foreign exchange and interest rates;

- Ensure the ability of companies to meet their external debt obligations and to contain the country's total debt servicing within sustainable levels to avoid any potential debt servicing problems; and

- Maintain Malaysia's favourable international credit standing and investment-grade rating of the external debt in order to ensure continued long-term access to financing from the international financial markets and low future borrowing costs.

Over the past decade, the Government had selectively prepaid its more expensive external loans to contain the external debt at a manageable level and to reduce the debt servicing burden. The non-financial public enterprises (NFPEs) and the private enterprises were also encouraged to prepay their external debt. The Federal Government prepaid a total of RM16.5 billion of its debt during the period 1987–97, while the private sector and the NFPEs prepaid RM11.2 billion of their loans. At the same time, the Government closely monitored developments for opportunities to obtain new foreign loans on more favourable terms to refinance existing debt. In total, the public sector refinanced about RM10.9 billion of the debt over the same period. The active refinancing programme helped to lengthen the maturity structure of the debt profile, smoothen the bunching of repayments and lower interest costs.

Malaysia had been successful in maintaining a high credit rating in the international markets through careful management of its "presence" in individual markets and through the judicious use of different market instruments. The public and private sectors were encouraged to diversify their borrowing in terms of currencies, debt instruments and creditors in order to spread risks, achieve a longer maturity profile and gain wider access to capital markets. Traditionally, bank loans and syndicated loans, including Eurodollar loans, were the major instruments in the Government's borrowing programme. Concomitantly, Malaysia also floated fixed rate bonds in Japan and in the various European markets. In the 1980s, the Government shifted to the issuance of Floating Rate Notes (FRN) with longer maturities. Following its successful entry into the Eurobond market, the Government floated its first Yankee bond issue in 1990, establishing its presence in the United States capital market. This paved the way for Malaysian corporations, especially PETRONAS, Tenaga Nasional Berhad (TNB) and Telekom to issue Yankee bonds with long maturities. Indeed, TNB was successful in launching a 100-year bond, while PETRONAS raised a large Global Bond of US$1.9 billion. Several companies undertaking infrastructure projects also issued bonds in the various capital markets. The issue of convertible bonds, including Euro-convertible bonds, increased in the 1990s. It was initiated with the launch of the sovereign Euro-Exchangeable Bond, exchangeable for equity, at the option of the bondholders, in a public enterprise. Commercial bank borrowing and syndicated loans were the major borrowing instruments of private corporations. These were supplemented by loans from parent companies or associated companies and suppliers credit. The Government also received loans from multilateral institutions, such as the World Bank and Asian Development Bank, official development assistance from Japan (loans with long maturities and concessionary interest rates) and bilateral loans.

The rules governing external borrowings by both the private and public sectors are rather stringent. The Federal Constitution provides the legal framework, within which the Government can undertake borrowing from both domestic and external sources. Operations involving Government debt are subject to Parliamentary approval, as it is the Parliament which sets a ceiling on the overall external debt level of the Federal Government. The state governments, local authorities and statutory bodies are not authorised to borrow, except with the approval of the Federal Government. Private sector borrowing is governed by the Exchange Control Regulations administered by BNM. The Bank imposes strict prudential rules, and approval is required for all foreign currency borrowings exceeding the equivalent of RM5 million by Malaysian companies (including non-financial public enterprises). Taken together, the regulations governing foreign borrowing provide an important check on the amount of foreign loans that can be contracted by both the public and private sectors.

There is also a strong institutional framework for monitoring the national external debt level. The debt monitoring system enables the authorities to know the overall debt level, the structure of the debt as well as the servicing obligations of both the public and private sectors. The Ministry of Finance and the Office of the Accountant-General are responsible for maintaining all information necessary to monitor the commitments, disbursements, terms, currencies, principal repayment and interest payment schedules, creditors and end-uses of the loan proceeds of all public sector loans, including NFPE loans guaranteed by the Government. Quarterly reports on the status of the guaranteed loans must be submitted to the Ministry of Finance. BNM is responsible for monitoring and maintaining similar information on private sector and other NFPE loans. Companies are required to submit quarterly reports on their external debt position. Short-term borrowing is also closely monitored by the Bank. Data on external debt and debt servicing, including projections of debt servicing over the medium term, are compiled on a regular basis.

currency revaluation losses of RM17 billion, the external debt of NFPEs increased significantly by 79.4% to RM52.5 billion (1996: RM29.2 billion).

Private sector external debt: As in the case of the NFPEs, the private sector also took advantage of the lower cost of borrowing as well as the easy access to long-term funds from international markets, especially in the first half of the year. Corporations also raised loans through the issuance of bonds, including Euroconvertible bonds, albeit at a lower level compared with 1996. A large number of loans continued to be sourced from the Labuan International Offshore Financial Centre, while non-resident controlled companies continued to receive long-term loans from their offshore shareholders, parent companies and associated companies. External borrowing of the private sector increased by 10.2% to RM15 billion in 1997. The external borrowings during the year were mainly undertaken by export-oriented companies as well as companies undertaking overseas investments. The proceeds were used to finance the purchase of raw materials, machinery, expansion of plants, and factories, overseas investments as well as to refinance some of the expensive loans. The repayments, however, declined by 7% partly due to lower prepayments and refinancing and deferment of repayments by some companies, particularly non-resident controlled companies to their parent companies or associated companies abroad. Together with the large exchange revaluation loss of RM19.8 billion, private sector external debt outstanding increased significantly by 82.5% to RM61 billion at end-1997. Their share of the total medium- and long-term external debt increased from 45.7% to 48.3%, making the private sector the single largest category of borrowers in 1997.

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) declined by RM10.9 billion to RM59,133 million at the end of 1997. After taking into consideration the external liabilities of the Bank of RM10 million, the net international reserves of the Bank stood at RM59,123 million at end-1997.

Prior to 1997, holdings in foreign assets were revalued once, at year-end. However, in 1997, the accounting policy of recognising the foreign exchange revaluation gain or loss was changed, whereby, the exchange gain from the revaluation of foreign assets and liabilities was not recognised in the Bank's books. Nevertheless, full provisions will be made for any losses. In 1997, the gains from revaluation of external reserves amounted to RM24.6 billion. The United States dollar equivalent of gross reserves was US$21.7 billion at end-1997, a level sufficient to finance 3.4 months of retained imports. In SDR terms, the international reserves held by the Bank amounted to SDR16.1 billion.

Table 1.19
Net International Reserves

	As at end		
	1995	1996	1997
	RM million		
SDR holdings	391.0	427.7	478.9
IMF reserves position	1,723.3	1,738.2	1,622.0
Gold and foreign exchange	61,655.2	67,848.7	57,021.9
Net reserves	**63,769.5**	**70,014.6**	**59,122.8**

During the year, net holdings of **gold and foreign exchange** declined by RM10.8 billion to RM57 billion at the end of 1997. The decline in foreign exchange holdings reflected mainly the intervention operations in the second half of 1997 following pressures on regional currencies. For the year as a whole, net outflow of short-term capital was estimated at RM14.2 billion.

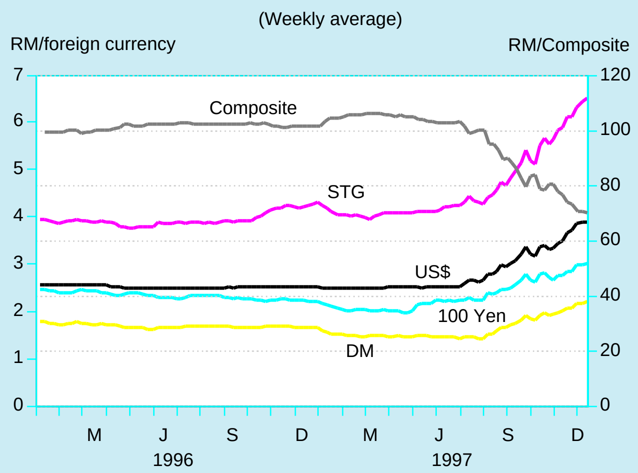
Holdings of reserves in the form of **SDR** increased by RM51 million during the year to RM479 million at the end of 1997. The increase was mainly on account of the receipts of remuneration from the IMF arising from Malaysia's net creditor position with the Fund which more than offset the charges incurred for holding SDRs below the allocated level. Malaysia was not included in the quarterly SDR Designation Plans of the Fund in 1997, 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 1997, this component of external reserves declined by RM116 million to RM1.6 billion or the equivalent of SDR445 million. The decrease reflected mainly the repurchase of

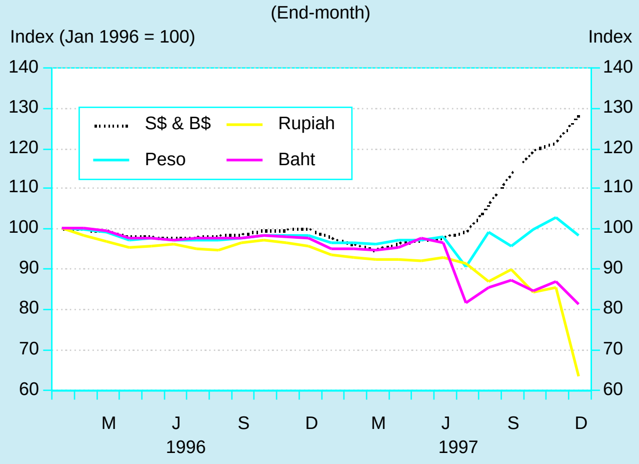
SDR34 million (RM116 million) under the Operational Budget of the IMF. The obligation to purchase the ringgit was intended by the IMF to facilitate the use of the ringgit by the Fund to meet withdrawals of funds by member countries. The obligation to repurchase would arise whenever a country which had drawn ringgit from the IMF subsequently made repayments. Purchases of ringgit from the IMF by a member country would result in an increase in the Bank's reserve position, while repurchase of the ringgit by a member would result in a decrease in the Bank's reserve position. Under the last quarterly Operational Budget for 1996, which covered the period December 1996 to February 1997, Malaysia was obliged to make purchases of SDR7 million and repurchases of SDR17 million. During this quarter, Malaysia repurchased ringgit from the Fund for a total of SDR15 million (RM50 million). Malaysia was included in the quarterly Operational Budget for the periods March to May and June to August 1997, under which Malaysia was obliged to make purchases of SDR24 million and repurchases of SDR41 million. During this period, Malaysia repurchased ringgit from the Fund for a total of SDR19 million (RM66 million) arising from repayments made to the Fund by three other members. Consequently, total repurchases for the year as a whole amounted to SDR34 million or equivalent to RM116 million. No purchases were made in 1997.

The overall objective of foreign reserve management of the Bank is to manage the foreign assets with the aim to optimise returns subject to safety and sufficient liquidity. The foreign assets are held in the form of cash or invested in allowable financial instruments in foreign government and supranational bonds and gold. The concern for safety encompasses the aspect of preservation of value while applying the concept of diversification to reduce portfolio volatility and meeting 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.** Subject to the constraint of minimising risk while maintaining sufficient liquidity, investment strategies are structured so as to optimise returns.

Graph 1.11
Exchange Rate of the Malaysian Ringgit against Major Currencies



Graph 1.12
Exchange Rate of the Malaysian Ringgit against ASEAN Currencies



The movement in the **ringgit** in 1997 was influenced by international, regional and domestic developments. Several distinct phases could be observed during the year. During the first quarter, the ringgit steadily appreciated influenced largely by domestic developments. Against a background of a strengthening United States dollar, the currency experienced bouts of pressure in the second quarter, particularly in May and June, following developments in Thailand. During this period, the ringgit's volatility, as measured by the standard deviation, declined to 0.01 on a monthly basis from 0.02 in 1996. During the second half of the year, the ringgit experienced further increased volatility arising from both domestic and regional developments. In the second half of 1997, the volatility as measured by the standard deviation on a monthly basis increased to 0.09. While the ringgit depreciated significantly during this period, its volatility also increased in comparison to historical levels, although this was not significant when compared with the wider short-term fluctuations experienced by major currencies in recent years.

For 1997 as a whole, the ringgit recorded a depreciation of 31.4% against the composite basket of currencies of Malaysia's major trading partners. The depreciation of the ringgit was pronounced against all major currencies, ranging between 25–35%. Against the United States dollar, the ringgit depreciated by 35%. During the previous bouts of ringgit weakness experienced since the floating of the ringgit in 1975, the annual rate of depreciation of the ringgit against the United States dollar had not exceeded 10%. Against the pound sterling, the ringgit depreciated by 33.7%. The pound sterling was supported by strong output growth in the United Kingdom buoyed by strong private sector spending, aggressive monetary tightening to pre-empt inflation and safe haven buying of the currency during a period of uncertainty over the European Monetary Union. The relatively moderate decline of the ringgit against the Japanese yen by 27.3% reflected mainly the weakening of the yen against the United States dollar in the wake of the weak economic activity and financial sector problems in Japan.

The decline in the ringgit to levels observed in 1997 did not reflect the underlying fundamentals of the economy. With the increasingly greater integration of financial markets, the contagion effects of developments in the region were transmitted quickly to Malaysia. A track record of relative macroeconomic stability and progressive policy tightening was not sufficient to insulate Malaysia from these contagion effects. The market perception of emerging risks in the Malaysian financial system and economic outlook resulted in the contagion effects on Malaysia being much more severe, leading to a significant downward adjustment of the currency. Consequently, speculative activity during the period of uncertainty also increased the extent of the adjustments in the equity markets. For Malaysia, the relatively optimistic views early in the year and market perception that the ringgit was undervalued, were replaced by greater pessimism as the year progressed. As the regional currency crisis escalated, expectations played an increasingly significant role in determining the direction of the exchange rate. The situation was exacerbated by the thin volume of transactions. The decline in ringgit in the final quarter of 1997 reflected weak market sentiment, influenced by regional developments and market perception that the financial system would be adversely affected by the fall in stock value and the potential decline in property prices as well as expectations of higher interest rates.

Throughout the crisis, the exchange rate policy of Malaysia essentially remained unchanged. Since Malaysia adopted a floating exchange rate regime in 1975, no targets were set for the ringgit exchange rate level. The large and unpredictable changes in ringgit exchange rates in 1997 presented a major concern for macroeconomic stability. The significant misalignment of the exchange rates would ultimately, if allowed to remain for an extended period of time, result in economic distortions and a misallocation of resources. Measures adopted during this period were therefore aimed at restoring confidence and stability in the markets. In particular, correction of macroeconomic imbalances would allow the ringgit rate to reflect economic fundamentals. During the final quarter, the Government put in place a package of macroeconomic stabilisation measures. These measures centred on the further tightening of monetary policy, maintaining fiscal prudence, restoring external balance through the deferment of a number of large non-critical projects and the strengthening of the financial system. The measures were aimed at adjusting the economy to the changing economic conditions, including reducing the risks of adverse external developments on the Malaysian economy and the financial system.

With the adoption of the December measures, the basis was firmly in place for the exchange rate to adjust to reflect domestic economic fundamentals. Of importance was also the need to maintain domestic investor confidence. The highly disruptive and destabilising trends in the foreign exchange market, if prolonged, could be highly destabilising to an open economy. In this regard, intervention operations have always remained an option for the Bank.

The ringgit began the year on a bullish note, strengthening to the range of US$1=RM2.47–2.50 in the first quarter of 1997 due to enhanced prospects for Malaysia to achieve a more sustainable pace of growth, amidst price and external sector stability over the medium term. In the first quarter of 1997, the release of real output growth data for 1996 showed a moderation to a more sustainable level at 8.6% in 1996 (9.5% in 1995) and the trade balance improved significantly. In April, however, the ringgit depreciated against the United States dollar in the wake of the outflow of short-term capital following the consolidation of the stock market and increase in interest rates in the United States on 25 March 1997. In mid-May, the ringgit came under pressure, triggered by developments in Thailand. The ringgit, however, recovered to an intra-day high of US$1=RM2.4795 on 16 May and thereafter stabilised within the range of US$1=RM2.4900–2.5250 up to end-June.

In the second half of 1997, the strengthening of the United States dollar and pound sterling in international foreign exchange markets and the escalation of the regional financial crisis set the stage for the depreciation of the ringgit to unprecedented levels. On the international front, the United States dollar and the pound sterling strengthened significantly due to strong growth in their domestic economies, moderate growth of the European economies and stagnation in the Japanese economy. The appreciation of the United States dollar against major currencies was supported by expectations of high returns in the stock markets with the Dow Jones consistently exceeding the 7000 level. This was reinforced by receding expectations of an interest rate hike amidst moderating inflation. These developments resulted in a shift in strategy by international fund managers to increase the proportion of their investments in the United States and the United Kingdom and to reduce their investments to this region, including Malaysia. The outflow of funds from the region to markets in the United States and the United Kingdom contributed to the capital rally in these countries and the strengthening of their currencies. Against these developments, regional currencies, including the ringgit, would have adjusted downwards just based on the performance of the United States dollar alone. This trend, however, was made more pronounced by regional developments triggered by events in Thailand. In the aftermath of the floatation of the Thai baht on 2 July, the contagion effects caused South-East Asian currencies to depreciate significantly.

Amidst the sudden and adverse change in investor sentiment against the regional currencies, speculative activity in ringgit intensified, culminating in a sharp correction in both the equity and currency markets. In August 1997, the ringgit weakened against the United States dollar to breach the previous low of US$1=RM2.7945 recorded on 4 July 1991. The ringgit touched US$1=RM2.7995 on 19 August 1997. Besides the liquidation of securities in the equity market, ringgit funds for speculative activities were raised from the offshore ringgit market and via swap transactions (offer-side) with domestic banks. The increased demand for ringgit for speculative activity was met with sharp increases in domestic interbank interest rates in July. The overnight and three-month rates rose sharply to 40% and 8.6% respectively on 10 July. In an effort to separate the impact of external developments on the domestic markets, the Bank also introduced a limit on non-commercial related offer-side swap transactions with foreign customers on 4 August 1997. Each bank was required to observe a limit of US$2 million outstanding on non-commercial related ringgit offer-side swap transactions with each foreign customer. The measure was to facilitate lower domestic interest rates that were more reflective of domestic conditions without the consequential result of allowing access to low cost ringgit to fund speculation.

Adverse market reaction to a series of events in the last four months of 1997 and early 1998, both at home and abroad, pushed the currency to successive lows until it reached an intra-day low of US$1=RM3.9300 on 15 December 1997 and subsequently US$1=RM4.8800 on 7 January 1998. On the international front, the contagion impact spread in October 1997 to the Hong Kong dollar, Taiwan dollar, and across the globe, causing a sharp fall in stock prices in New York, Hong Kong SAR, China, South-East Asia, Latin America, Europe, Australia and New Zealand. Regional developments, particularly the liquidity crisis in Indonesia and problems of the Korean financial system, exerted a stronger influence. On the domestic front, the weak investor confidence was attributable to United Engineers Malaysia Berhad's purchase of shares of its parent company, Renong Berhad, and the imposition of trading restrictions by the Kuala Lumpur Stock Exchange on five stock broking companies. Consequently, the ringgit traded at

Table 1.20
Movement of the Ringgit

	RM to 1 unit of foreign currency[1]				Annual change (%)	
	1996	1997			1996	1997
	End Dec.	End Dec.	Low	High		
Composite	101.67	69.70	69.58	106.00	+2.6	-31.4
SDR	3.6350	5.2539	3.3939	5.2715	+3.9	-30.8
US$	2.5279	3.8883	2.4717	3.8900	+0.5	-35.0
S$	1.8066	2.3200	1.7121	2.3454	-0.6	-22.1
100 Yen	2.1755	2.9921	1.9737	3.0294	+13.5	-27.3
Pound sterling	4.2747	6.4449	3.9353	6.5276	-8.1	-33.7
Deutsche Mark	1.6256	2.1729	1.3989	2.1958	+8.7	-25.2
Swiss franc	1.8746	2.6742	1.6641	2.7174	+17.5	-29.9

[1] Based on the average of buying and selling rates at noon in the Interbank Foreign Exchange Market in Kuala Lumpur

US$1=RM3.8883 at end-1997, a depreciation of 35% from the end-1996 level. The ringgit touched a record low of US$1=RM4.8800 on 7 January, before recovering to an intra-day high of US$1=RM3.3500 on 11 February 1998. A combination of factors, including Government commitment to accelerate implementation of measures to restore stability as well as favourable developments in the region, particularly the restructuring of short-term Korean debts, the moves to address Indonesia's corporate debt and the abolition of the two-tier exchange rate system in Thailand, contributed to the firmer trend in regional currencies, including the ringgit.

Changes in the exchange rate level have pervasive effects on prices, external trade, external debt servicing, interest rates, output and employment. Although the full impact of the depreciation of ringgit will be more evident in 1998, some favourable developments were seen in the sectors producing "tradeable goods" in the second half of 1997. The manufacturing and plantation sectors showed strong export growth performance. Overall, export growth accelerated since July 1997 and the trade balance improved progressively. Of significance, gross exports grew by 22.5% in the second half of the year compared with gross import growth of 19.6%. While the export performance reflected mainly higher receipts due to the depreciation, there was also an increase in export volume.

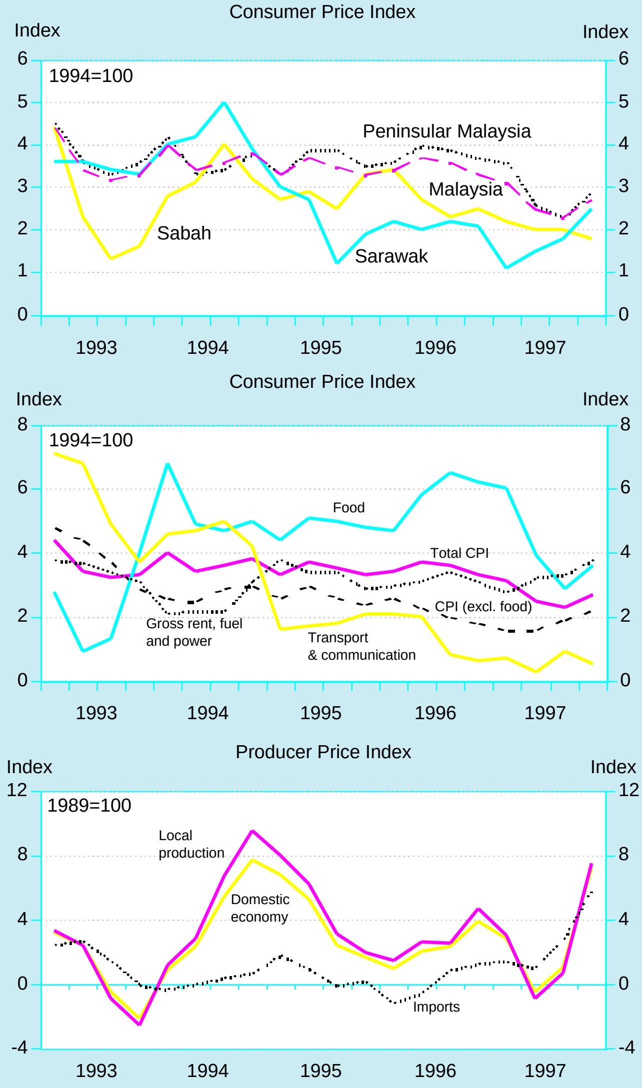
The impact of the depreciation on external debt servicing was not as severe, as Malaysia's external debt, including short-term debt, is relatively low. Arising from the ringgit's depreciation, the external debt in ringgit terms increased from RM114 billion as at end-June 1997 (US$44.9 billion) to RM166 billion as at end-1997 (US$42.5 billion). This included short, medium and long-term debt, with short-term debt accounting for 24% of total debt. The relatively lower debt position was due to deliberate policies maintained over several years. As a result, private sector external borrowings was allowed mainly to fund export-oriented industries. Given that the bulk of the external loans of the private sector was channelled mainly to export-oriented sectors, these companies had a natural hedge from export receipts to cover the significant increase in debt servicing. Hence, recourse to external reserves to meet obligations due in 1998 remains manageable (for details, please refer to Box Article III on External Debt Management).

Of concern is the impact of the depreciation of the ringgit on consumer prices. A 10% depreciation is estimated to result in a 1% increase in consumer prices. Theoretically, therefore, the inflation rate is likely to increase to 7–8% in 1998. In this context, monetary and fiscal policies will remain tight to contain the inflationary pressures. Other mitigating factors to moderate inflationary pressure include lower aggregate demand, traders absorbing higher exchange rate costs in order to maintain market shares and substitution of imports from cheaper sources.

Prices and Employment

While prices moderated in 1997, the rate of **inflation** showed a significant rising trend in early 1998. Similar to experiences in other countries, the

Graph 1.13
Prices Indices : Average Annual Rate of Change



impact of the ringgit depreciation was reflected within a relative short lag on the Producer Price Index (PPI, 1989=100), while its pass-through impact on the Consumer Price Index (CPI, 1994=100) was evident only with a longer time lag. Producer prices rose sharply in the fourth quarter (7.2% in the fourth quarter from 1%, -0.5% and 2.8% in the third, second and first quarters respectively) at the time the depreciation of ringgit against the United States dollar was also most significant for 1997 (35% at end-December compared with 20.9% at end-September and 4.1% at end-July). Consumer prices, however, showed a stronger increase in early 1998, following the depreciation of the ringgit since mid-1997. CPI growth rates remained relatively low at 2.5% in the second half-year, from 2.8% in the first half of 1997. During the first two months of 1998, the CPI rose at an average rate of 3.9%.

This phenomenon reflected two factors. Firstly, the pass-through effect of higher import prices was filtered down to the domestic price level with a time lag. Secondly, the increase in consumer prices had been on a downward trend in 1997. At the start of the financial crisis in July 1997, the CPI rate was 2.1%, the lowest level since September 1990. In addition to the lagged effects, the marginal initial impact of the depreciation on domestic prices was also due to market imperfections, influences of the price-setting mechanisms, and the relatively lower share of imported goods in the CPI basket. Furthermore, the actual impact of the ringgit depreciation on the CPI could also be mitigated by several factors, including the substitution of imports for locally produced goods as well as cheaper alternative sources. As costs increase due to the ringgit depreciation, this would reduce demand and assist in the adjustment process to moderate excesses within the economy, while producers and traders would also absorb part of the price increase in order to maintain market share.

In 1997, inflation, as measured by the CPI, increased at a slower rate of 2.7%, compared with 3.5% in 1996, the lowest rate of inflation since 1990. The moderate increase in the prices of food, and transport and communication, had a particularly strong effect on the CPI. Excluding the food sub-group, the adjusted CPI rose more moderately by 1.8%, compared with 2.3% in 1996. The low rate of consumer price inflation was, in part, due to the slower growth of the economy following monetary policy tightening that contributed to moderate demand pressures.

Table 1.21
Price Indices for Malaysia

	Weights	1996	1997
		Annual change (%)	
Consumer Price Index (1994=100)	100.0	3.5	2.7
Of which:			
Food	34.9	5.7	4.1
Beverages and tobacco	3.6	2.2	1.3
Clothing and footwear	3.6	-0.7	-0.5
Gross rent, fuel and power	21.1	3.2	3.2
Furniture, furnishings and household equipment	5.6	1.1	0.1
Medical care and health expenses	1.9	3.7	3.6
Transport and communication	17.9	1.4	0.6
Recreation, entertainment, education and cultural services	5.8	3.3	0.4
Miscellaneous goods and services	5.6	2.5	4.6
Peninsular Malaysia CPI	100.0	3.8	2.8
Sabah CPI	100.0	2.8	2.0
Sarawak CPI	100.0	2.2	1.7
Producer Price Index (1989=100)	100.0	2.3	2.7
Of which:			
Local production	79.3	2.8	2.5
Imports	20.7	0.1	2.8
House Price Index (1990=100)		12.9	6.1[1]
Of which:			
Klang Valley		15.7	4.6
Johor Bahru		14.3	3.1
Penang Island		4.3	5.2

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

Concomitantly, measures to ease supply constraints and promote savings as well as strict enforcement of administrative measures to curb excessive profiteering also contributed to the moderation in the inflation rate. In addition, stable import prices in the first half-year, reflecting lower world prices of food and beverages and the appreciation of ringgit, as well as the reduction or abolition of import duties on a wide range of goods in recent years, in particular, foodstuff, also contributed to moderate price pressures. On a regional basis, the CPI for Peninsular Malaysia, Sabah and Sarawak also moderated to 2.8%, 2%, and 1.7% respectively in 1997.

The bulk of the 1997 price increases came in the early part of the year, emanating from seasonally high food prices as well as the increase in toll charges; city bus, taxi and airline fares; and electricity tariff rates. In addition, the higher cost of production arising from higher utility charges and transportation costs as well as higher wages was also reflected in the CPI. Price increases eased after March to its lowest level of 2.1% in July. However, the impact of ringgit depreciation was partly reflected in the CPI since October, mainly due to higher import prices in the food; gross rent, fuel and power; and miscellaneous goods and services sub-groups, which together accounted for more than one-half of the imported items in the CPI basket. Consequently, prices edged upwards to 2.9% in December.

The CPI for food (accounting for 34.9% in the overall CPI basket) rose by 4.1% in 1997 (5.7% in 1996), due mainly to slower price increases for food consumed at home (3.7%; 6% in 1996), while prices of food consumed away from home continued to record a large increase of 5.3%. Of significance were the more moderate increases in the prices of fish, meat, fruit and vegetables due to the availability of a larger supply through higher imports and domestic production, as well as the slower price increases for rice, bread and other cereals as a result of lower prices for flour. In March 1997, flour prices which were administered by the Government were reduced by 9.1% to reflect lower world prices. However, to reflect the higher cost of imports arising from the depreciation of the ringgit since July, the Government approved an increase in the ceiling price of two essential items, namely, cooking oil and chicken from mid-December 1997. This was followed by an increase in prices of another three administered items, namely, flour, sugar, and milk effective 1 February 1998. These items account for 4% of the weight in the CPI basket. Among the non-food sub-groups, price increases for gross rent, fuel and power; and medical care and health expenses remained high. Similarly, miscellaneous goods and services also recorded higher prices, largely due to higher import prices of jewellery, watches, and personal goods in the fourth quarter. Slower price increases were registered for all other sub-groups, in particular prices for transport and communication, partly due to slower increases in the prices of petrol and motor oil during the year.

Although the CPI is generally used as a measure of inflation, it may not indicate all the changes that affect the cost of living, as consumers respond to price changes and new choices. The differences between the CPI and the cost of living, often referred to as measurement biases, are mainly caused by substitution bias, quality bias, and “new goods” bias. Substitution bias arises as consumers substitute cheaper products for more expensive ones and as consumers move away from a more expensive retail outlet towards a cheaper outlet. Quality bias arises because the quality of goods and services may change over time but the price index fails to capture this, thereby, overstating or understating changes in the cost of living. Meanwhile, new products are introduced over time while the production of existing products in the basket may be discontinued. Removing an existing product from the basket and replacing it with a new one will result in a measurement bias as the two products are unlikely to be identical. These biases have a cumulative effect on the overall CPI. Inflationary expectations have also begun to build up as producers and suppliers adjust to higher import costs by requesting for price increases, including prices of goods administered by the Government. The Consumer Sentiments Survey conducted by the Malaysian Institute of Economic Research (MIER) in the fourth quarter of 1997, indicated that more than 83% of the households surveyed were expecting prices to increase in the next six months, compared with only 79% of the respondents in the third quarter.

The PPI, which measures prices of both intermediate and final goods charged by domestic producers and paid by importers in the country, rose by 2.7% in 1997, compared with 2.3% in 1996. The deterioration was due to increases in both import prices and domestic production costs in the second half-year. Unlike consumer prices, the impact of the depreciation of ringgit on producer prices is more immediate and direct. The producer prices for imports surged from an annual rate of 1.1% in June to a high of 8.3% in December, reflecting costlier imports of machinery and transport equipment; food and live animals; chemicals and related products; and manufactured goods. Similarly, the PPI for domestic production rose to 9% in December due to an escalation in prices of animal and vegetable oils and fats (44%); and mineral fuel, lubricants, and related materials (11.5%). On the other hand, prices of crude materials continued to decline as a result of lower prices of rubber and timber. Excluding these three major sub-groups, the PPI rose by 1.7%, compared with 2.2% in the previous year.

While the prices of goods as measured by the CPI remained relatively stable, asset prices particularly stock prices continued to increase. Higher prices of properties and excessive overvaluation of stock prices, evident in 1996, spilled over into 1997. The Bank continued with its policy of monetary restraint to contain asset inflation risks. The Bank instituted further prudential pre-emptive measures in April 1997 to limit overall bank exposure to the broad property sector and for share financing. As a result, property prices stabilised with the increase in the National House Price Index moderating to 6.1% in the first half of 1997, the lowest increase since 1993. However, the onset of the regional financial crisis led to a sharp correction in stock prices, which fell by more than 50% from the end-March level. There were also signs that property prices had begun to ease. While residential and industrial property prices had stabilised in 1997, there were signs of an easing in prices in some segments of the property market, particularly office and retail space, and high-end condominiums.

A combination of strong credit growth, buoyant demand, capacity constraints and cost pressures emanating from higher utility and transportation charges and higher wages also gave rise to concern over inflationary risks in early 1997. Hence, macroeconomic policies continued to firmly focus on maintaining price stability in 1997. These were reinforced by continued fiscal prudence and further supported by administrative measures to improve distribution and curb profiteering. With food prices accounting for more than one-half of the increase in the overall CPI, concerted efforts were made to increase food production activities and to improve the marketing and distribution system. The 1997 Budget allocated RM1.7 billion to develop the agriculture, fisheries and livestock sector, while the allocation for the Fund for Food was increased twice during the year to RM700 million. Among the programmes implemented during the year was the launching of the Fishermen's Initiative Fund to help traditional fishermen obtain interest free loans to finance their fishing activities. This Budget also provided an allocation for programmes to combat inflation, including the "Zero Inflation Campaign", price monitoring of 75 essential items for the lower income group and stricter enforcement to curb unethical business practices and profiteering. Import duties and sales tax were reduced or abolished for a number of goods, including foodstuff, paper and printing industry products. The list was extended further to include medication, canned food and selected electrical items in the 1998 Budget. To reduce cost push inflationary pressures, the manufacturers of selected non-taxable goods were allowed to obtain raw materials and components free from sales tax. Meanwhile, several savings promotion campaigns were launched in 1997 to promote voluntary savings amongst the targeted groups, mainly the school children, workers and women, as well as to nurture a more cost-conscious society. These added a further dimension to the overall policy to contain inflation.

In addition, to keep imported inflation in check, more conscious efforts were taken to procure imports from cheaper sources as well as to increase local substitutes. Concomitantly, the Government intensified enforcement of administrative measures to curb profiteering and unjustified price increases that usually occur when the exchange rate depreciates. The Ministry of Domestic Trade and Consumer Affairs conducted a total of 543,626 "Ops Sedar" and took action on 6,709 traders throughout the year. The Ministry plans to launch a special campaign on "Buy Malaysian Products" in 1998. At the same time, to break the expectation-inflation link, the Government announced it will establish benchmark data on prices of both essential and non-essential goods to improve the flow of information on prices of consumer goods. This would be part of an action plan for stabilisation of supply and prices for essential goods, and to curb hoarding and smuggling. Following the rise in the crude palm oil prices, the Government reintroduced the Cooking Oil Stabilisation Scheme in December 1997, whereby the Government agreed to fix the price of palm olein at RM1,700 per metric tonne.

Continued tight labour market conditions and good corporate profits, particularly in the first half of 1997, exerted further upward pressures on **wages**. The real average wage in the manufacturing sector increased by 7% in 1997, albeit at a slower rate than the 9.6% recorded in 1996. The upward pressure on wages was reflected in the three-year collective wage agreements concluded within the private sector during 1997. However, wage increases under collective agreements apply only to 2% of the total workforce in the country. The weighted average wage increased by 13.1% in 1997, compared with 10.3% in 1996. The increase in wage rates was higher in all sectors, except the agriculture and mining sectors. Of significance, wages increased strongly in both the electricity and services sectors, by 18.1% and 14.1% respectively, compared with 6.4% and 7.6% respectively in the previous year. The wage agreements concluded in the manufacturing sector during the year also indicated that the weighted average wage rose at a faster rate of 15%, compared with 13% in 1996. However, this trend was not reflective of wage trends for the manufacturing sector as a whole, as less than 10% of the companies were involved in the collective agreements concluded in 1997. Wages in the transport and commercial sectors also recorded double-digit increases of 10% and 11.8% respectively. In contrast, both the agriculture and mining sectors recorded slower wage increases of 10.2% and 7.7% respectively. As in the previous year, no collective wage agreement was concluded in the construction sector.

During the year, the number of collective wage agreements concluded in the private sector totalled 412, involving 130,035 workers or only 2% of the workforce. A total of 241 agreements involving 63,381 workers were concluded in the manufacturing sector while in the agriculture sector, 18 agreements were concluded involving 35,982 workers. In the services sector, 11,973 workers were involved in the 44 agreements signed in this sector. In tandem with their contribution to the overall GDP and total employment, these three sectors accounted for 86% of the number of workers in the country.

An analysis of wage trends and labour productivity in 1997 provided grounds for concern. Estimates showed that the increase in real labour productivity of 5.7% in 1997 continued to lag behind the growth of real average wages in the manufacturing sector of 7%. The average increase during the previous two-year period, 1995–96, was 7.9% for wages and 6.2% for labour productivity. The overall labour productivity growth for the economy as a whole was also on a downward trend. Growth in labour productivity, as measured by the ratio of GDP to total employment increased at a slower rate of 5.1% in 1997, compared with 5.3% in 1996 and 1995 respectively. The slower rate of growth in labour productivity reflected in part the impact of slower demand, particularly during the second half of 1997, resulting in companies producing below the optimum productive capacity. Although the Government had adopted the guidelines for a productivity-linked wage reform system in August 1996, implementation of the policy by the private sector is still slow. A progressive move to productivity-wage setting arrangements would help the economy avoid being trapped in a cost-push inflation situation as trade unions often use the CPI as a yardstick in negotiations of collective wage agreements.

In 1997, the Government continued to focus on the strategic shift to productivity-driven growth to optimise the utilisation of capital and human resources to achieve sustainable growth, to overcome labour shortages and contain wage-cost inflation in order to maintain the country's export competitiveness. Several fiscal incentives were provided in the 1997 and 1998 Budgets to enhance productivity. These measures included the provision of reinvestment allowance to encourage companies to reinvest in automation and labour-saving devices which would contribute to significant improvements in productivity; fiscal and other incentives to facilitate the shift to high technology, capital intensive and information based industries; incentives for research and development; and incentives to increase the value chain of manufacturing processes to strengthen industrial linkages. Concomitantly, the Government provided an allocation of RM721.4 million for the Technology Development Action Plan and for research programmes under Intensification of Research in Priority Areas (IRPA) and Microelectronic Institute of Malaysia (MIMOS) to encourage more productivity-related and research and development activities to increase the efficiency and effectiveness of industries. At the same time, the NPC three-year *National Productivity Enhancement Campaign* added a further dimension to accelerating the transformation of the economy towards productivity-driven growth.

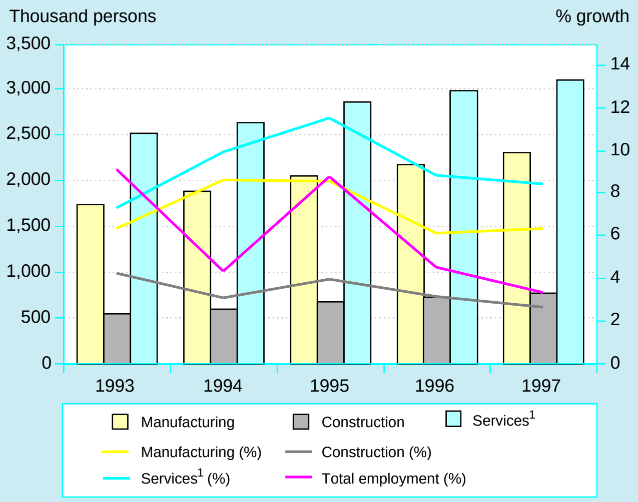
In 1997, the number of strikes declined to five cases involving a total of 812 workers, compared with eight cases involving 935 workers in 1996, an indication of a further improvement in industrial relations in the country. Four sectors, namely, the manufacturing, agriculture, transport and commercial sectors, faced strike actions during the year. In the manufacturing sector, two cases of strike actions involving 598 workers were recorded, compared with three cases involving 572 workers in 1996. The agriculture sector faced only one incident of a strike involving 151 workers compared with five cases involving 363 workers in the previous year. A total of 63 workers were involved in strike actions in the other two sectors. The strike actions were due to refusal to enter into collective bargaining; dispute over terms and conditions of employment; and disputes over other issues. Consequently, the strikes resulted in a loss of 2,396 man-days during the year, compared with 2,423 man-days in 1996.

The number of industrial disputes fell to 463 cases in 1997, compared with 552 cases in 1996. However, the number of workers involved in the disputes more than doubled to 139,187 workers from 66,915 workers in the previous year. The bulk of the cases arose from disputes over terms and conditions of employment (223 cases) and deadlock in the process of collective bargaining (112 cases). On a sectoral basis, the number of industrial disputes in the manufacturing sector declined to 182 cases involving 43,170 workers, from 209 cases involving 46,624 workers in 1996. Most of the other major sectors of the economy also recorded a lower number of industrial disputes. However, the number of industrial disputes in the transport sector rose markedly to 130 cases involving 70,342 workers compared with only 3,759 workers in 1996.

The **employment** situation remained tight in 1997, although it eased somewhat towards the end of the year, especially in the construction and selected services sub-sectors due to the deferment of projects as well as the scaling down of some on-going projects which were considered less essential. The economy operated at full employment for the sixth consecutive year, although the unemployment rate increased slightly to 2.7% compared with 2.5% in 1996. Total employment increased at an estimated rate of 2.6% or 214,000 persons to 8.4 million in 1997, while the labour force grew by 2.8% or 235,000 persons to 8.6 million. The number of registered job-seekers rose to 23,760 persons at the end of the year from 22,420 persons at the beginning of the year, reflecting slightly easier labour market conditions towards the end of the year.

On a sectoral basis, the **services sector** accounted for the major share of new jobs (48%), followed by the manufacturing (28%) and the agriculture (15%) sectors. With the continued expansion of the services sector, the level of employment in the sector grew by 2.6% to four million persons in 1997. The wholesale and retail trade, hotels and restaurants sub-sector remained the major source of employment. Employment in this sub-sector rose by 0.6% during the year, accounting for 16.5% of total employment. In the transport, storage and communications sub-sector, employment rose by 4.6%, while employment in the finance, insurance, real estate and business services sub-sector increased by 4.7%. These two sub-sectors accounted for a combined share of 10.2% of total employment. Reflecting on-going privatisation and continued efforts to rightsize the public sector, growth in employment in the public services sub-sector increased marginally by 0.3% during the year to 880,000 persons or 10.5% of total employment.

Graph 1.14
Employment by Sector



[1]Exclude Government services

Employment in the **manufacturing sector** rose by 6.3% or 138,000 persons to 2.3 million persons, reflecting the sustained expansion in manufacturing activities during the year. Statistics released by the Ministry of International Trade and Industry (MITI) on approved manufacturing investment indicated that the capital investment per employee was slightly lower at RM361,408 in 1997 compared with RM372,800 in 1996. In contrast, total employment in the **agriculture sector** continued to decline by 4.9% to 1.3 million persons during the year. Labour shortages in this sector were further exacerbated by the continuous outflow of labour to other sectors, apparently attracted by better terms and working conditions. Employment in the **construction sector** rose at a slower rate of 5.4% to 765,000 persons in 1997, representing a share of 9.1% of total employment. In the **mining and quarrying sector**, employment stabilised at 43,000 persons, accounting for less than 1% of total employment.

The problem of labour shortages and their adverse implications on efficiency and cost of production continued to persist in 1997. This was exacerbated by the short supply of skilled labour as industries continued to shift into higher value added products and more knowledge-based and technology intensive processes. In the immediate term, the labour-intensive industries have continued to rely on foreign workers. Available data showed that there were 1.14 million registered foreign workers in 1997, while the total number of foreign workers currently employed reached an estimated 1.7 million. The majority of the foreign workers were from Indonesia (65%), Bangladesh (22%), and the Philippines (7%). On a sectoral basis, one-half of the total foreign workers were employed in the productive sectors, namely, the manufacturing (27%) and plantation (23%) sectors, while the balance were in construction (24%), services (13%), and domestic services (12%). The Bank Negara Malaysia Annual Survey of Companies in the Manufacturing Sector for 1997 showed that the recruitment of foreign workers in the manufacturing sector declined by 7.5% in 1997, while employment of local workers declined by only 0.7%. This was due to the tightening of the policy on the employment of unskilled foreign labour in 1997 to expedite efforts to reduce the dependence on labour-intensive production processes and for industries to undertake strategic adjustments in moving towards labour-saving production technology and to high value added and high-technology industries. There were also increasing concerns over the social implications arising from the prolonged reliance on the employment of a large pool of foreign workers and on the need to ensure that employers give priority to hiring local labour, especially in the context of slower economic growth and a weakening of the domestic labour market. Since 10 July 1996, the Government stopped approving new entry permits for foreign workers in the construction, services and plantation sectors. This was extended in August 1997 to include a freeze on recruitment of foreigners in all sectors. In January 1998, the levy on foreign workers (excluding workers in the estate sector and househelpers) was increased to RM1,500 per annum from RM1,200 per annum.

To meet the demand for skilled workers, in particular, manpower with technical skills, the Government further relaxed conditions governing the employment of foreign expatriates and other skilled manpower. Recruitment was allowed based on the needs of companies, especially in sectors actively promoted by the Government, such as companies in the Multimedia Super Corridor (MSC), approved International Procurement Centres and companies producing selected wafer fabrication products. However, the employment of skilled foreign workers was also a temporary measure, with the longer term strategy being to enhance and upgrade skills as well as to increase overall efficiency and productivity. In the 1997 Budget, RM13.2 billion was allocated for human resource development. This was complemented by a package of fiscal incentives to encourage greater automation and more capital-intensive production processes to increase efficiency. These incentives included a tax exemption of 50% on gross income received by foreign lecturers teaching in selected fields (including science, engineering and information technology) in approved educational and training institutions. The tax incentives given to MSC companies were extended to multimedia faculties in institutions of learning in the 1998 Budget.

Greater emphasis continued to be accorded to industrial and skills training in 1997. The Government also proposed to set up a Design Technology Centre and a Flexible Manufacturing Centre to train skilled manpower in the field of design and use of robotic technology which would contribute towards encouraging production at the higher end of the value added chain. The new intake of trainees in the existing nine Industrial Training Institutes increased further by 17.4% to 2,892 participants, while the number of instructors trained by the Centre for Instructors and Advanced Skill Training rose to 3,391 persons. In addition, output from the existing bilateral training centres, namely, the German Malaysia Institute (GMI), Malaysia-French Institute (MFI) and British Malaysia Institute (BMI) which aim to provide skilled workers to selected strategic industries, increased to 559 persons in 1997. During the 7MP period, the Government planned to set up another four bilateral training centres, including the Malaysian Institute of Chemical Engineering Technology, Malaysia Aviation Institute of Technology, Malaysian Automotive Engineering Institute of Technology and Malaysian Institute of Ship Building Technology. It is interesting to note that a World Bank study on *Enterprise Training, Technology and Productivity in Malaysia* on 2,200 manufacturing firms in 1994-95 found that formal training helped to improve productivity at the firm level. Firms that provided training, on average, were about 32% more productive than firms that provided no training. The productivity effects were enhanced when new technologies acquired through licensing were complemented with training.

The Human Resource Development Fund (HRDF), which was established since 1993, has to date assisted companies in retraining and upgrading the skills of a total of 1.7 million employees. As at end-1997, a total levy of RM494 million was collected, of which RM459 million was allocated for training. During 1997, three additional schemes were introduced to further upgrade workers' skills and to retrain workers. These involved the purchase of personal computers to train workers in branch offices; 100%

financial support for employers to retrain and upgrade the skills of workers, particularly among the rural under-employed workers; and an apprenticeship scheme for tools and die machining. As at the end of 1997, a total of 5,883 employers were registered with the Human Resource Development Council (HRDC), of which 80% were from the manufacturing sector and the rest from the services sector. In the 1998 Budget, the HRDF scheme was extended to other sectors, particularly in the energy, education and consultancy fields, to promote sufficiently skilled manpower.

In the face of a slowdown in domestic economic activity, it is expected that the domestic labour market will weaken. During 1997, official estimates indicated that the number of workers retrenched increased to 18,863 workers, compared with 7,773 workers in 1996. The retrenchments were attributed to a drop in demand and increased competition (51%); restructuring of companies (32%); and increased automation and technology (10%). In terms of sectoral distribution, the retrenchments were from the manufacturing sector (82%), particularly the electronics industry (42%), and the transport sector (8%). The balance was from the agriculture, mining, construction and services sectors. In terms of job category, the majority of workers retrenched were production workers (46%), followed by semi-skilled workers (15%), and general workers (10%). The balance were skilled workers, professional and technical workers and clerical staff. The Government monitored the situation closely and implemented various measures to address the problem. In early 1998, the Government established a Tripartite Committee on Retrenchment of Workers and introduced a mandatory requirement for employers to inform the Director-General of Labour Department one month ahead of any retrenchment exercise. The Ministry also set up a mechanism at the local level to register the retrenched workers and to assist them in finding alternative jobs. A programme to improve labour mobility was also introduced to assist in retraining and the redeployment of excess labour to economic sectors which continued to face labour shortages such as the manufacturing, agriculture and services sectors. A Workers' Retraining Programme will be implemented in March 1998 with an initial allocation of RM2.2 million. In order to reduce the financial burden, employers were given a temporary exemption from paying the levy to the HRDF for six months, while RM66 million was recredited to the employers' account, to be utilised to retrain their staff.

2 Monetary and Fiscal Developments

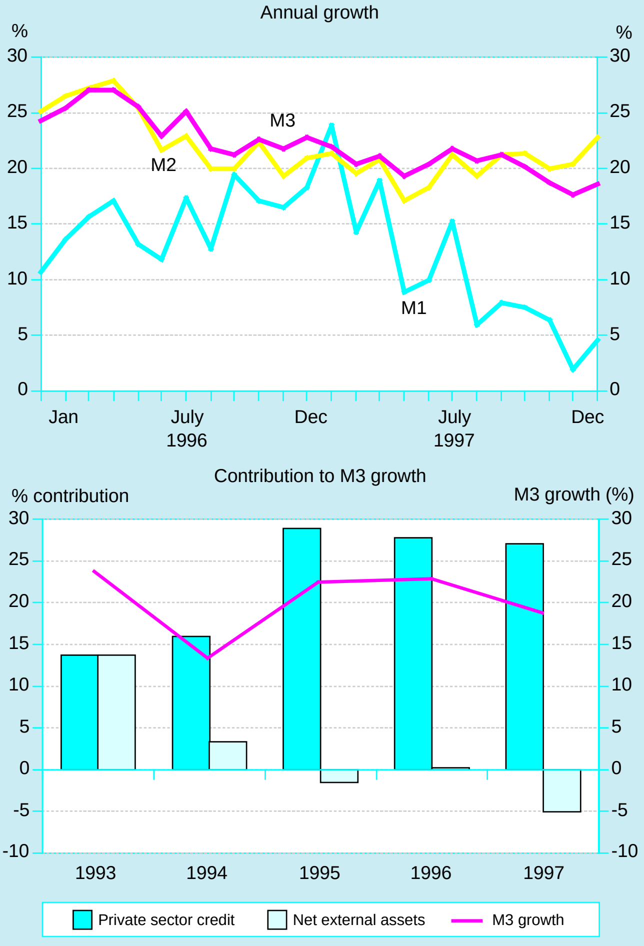
Monetary Developments

The progressive tightening of monetary policy during the course of 1997, complemented by selective prudential measures resulted in a moderation in the growth rates of all monetary aggregates by end-1997. Monetary developments, however, showed distinct trends in the early and latter parts of the year. In the first half-year, monetary aggregates moderated only slightly, in response to measures to address asset inflation. In the second half of 1997, monetary developments were influenced significantly by the policy responses on both the monetary and fiscal fronts to restore macroeconomic stability following turbulence in the financial markets in East Asia. The more pronounced tightening of monetary policy during this period was also to respond to rising inflationary pressures following the depreciation of the ringgit since July 1997. Liquidity conditions tightened considerably towards year-end as uncertainty and public concerns over the banking system resulted in distortions to the intermediation process and the smooth operation of the money market. These developments resulted in the rapid increase in effective lending rates. Several measures, including the reduction in the statutory reserve requirement (SRR) by 3.5% in 1998, alleviated this trend.

The strong growth in **money supply** in the first half of 1997 reflected the high credit growth which became the main focus of monetary policy in early 1997. As the credit growth emanated mainly from loans for the purchase of properties and shares, pre-emptive measures were implemented with effect from 1 April 1997 to facilitate adjustments of the exposure of the banking system to these sectors to more prudent limits. Subsequently, the annual growth rates of all monetary aggregates – M1, M2 and M3 – moderated but remained high, averaging 13.5%, 19% and 19.9% respectively during the first half of the year compared with the average of 15.1%, 23.2% and 23.8% respectively in 1996. The relatively slow response of loan growth to these measures reflected the continued drawdown of earlier loan commitments of the banking system.

The need for a more rapid moderation of monetary and credit growth became more urgent as expectations of inflationary pressures increased following the intensification of the currency crisis in East Asia. The high credit growth was also seen as a potential risk that could have adverse implications on financial stability. Monetary policy was, therefore, tightened further during the latter part of the year, through the firming of interest rates and adoption of further prudential measures. These were complemented by the requirements on banking institutions to draw up credit plans which were announced in October. Banking institutions were required to observe the limits as contained in their estimates for credit growth for the remaining part of 1997 and for 1998. As a result of these

Graph 2.1
Money Supply



measures, the annual growth of M1 and M3 slowed down substantially during the second half-year and ended the year significantly lower, at 4.6% and 18.5% respectively compared with 16.7% and 21.2% respectively at end-1996. Meanwhile, M2 remained high at 22.7% (19.8% at end-1996), reflecting the shift in deposits from finance companies to commercial banks. In absolute terms, M3 increased by RM61 billion during the year (RM57.8 billion during the previous year). The slower annual growth of M3 reflected mainly the moderation in demand for transaction balances, while growth in broad quasi-money was sustained during the year. There was also a notable shift in the preference of the private sector from transaction balances to interest-bearing deposits. Transaction balances accounted for only 4% of the increase in M3 (15% in 1996), following the higher interest rates and weak sentiments on the stock market.

Demand for transaction balances (currency holdings and demand deposits of the private sector) moderated significantly in 1997 to increase by only RM2.4 billion (RM7.7 billion in 1996). Except in January and December when there occurred strong expansion to meet cash requirements for the festive season, demand for transaction balances displayed a declining trend during the rest of the year. The largest decline was recorded in April, mainly as a result of the bearish sentiments in the Kuala Lumpur Stock Exchange (KLSE). The downward trend continued in the second half-year in response to the poor performance of the KLSE and the slowdown in economic activities, particularly in the last quarter of the year. At the same time, the private sector also optimised holdings of transaction balances as the opportunity cost of holding non-interest-bearing deposits became greater with the increases in interest rates.

As interest rates firmed significantly during the year, 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 by RM58.6 billion or 21.8% (RM50 billion or 22.9% in 1996). The higher nominal interest rates amidst lower inflation rates meant higher real rates of return, thereby creating an incentive for the private sector to increase its holdings of interest-bearing deposits. However, the increase in quasi-money was dampened, to some extent, by the negative wealth effect arising from the marked decline in share prices, the consequent outflows of portfolio capital and the overall moderation in growth of disposable incomes.

In terms of instruments, fixed deposits remained the largest component of broad quasi-money. A notable increase was also recorded in NIDs. The tight liquidity situation, particularly in the final quarter of the year, made borrowing in the interbank market relatively more expensive. The banking institutions, therefore, focused on sourcing funds through traditional instruments such as longer maturity fixed deposits and NIDs, in order to lock in funds for longer tenures and at lower cost. In an environment of tight liquidity, competition for funds among banking institutions intensified. Consequently, fixed deposits and NIDs rates were raised significantly, especially in the second half of 1997. Apart from the significantly higher returns from these instruments, the expansion in both instruments also reflected the shift in preference among the institutional and retail investors of the KLSE to less risky portfolios. During this period, savings rates were left virtually unchanged. The consequent higher differential between savings and fixed deposit rates caused savings deposits to decline significantly in 1997. The interest differentials between savings and 1-month fixed deposits of the commercial banks and finance companies widened to 4.6% and 4.8% respectively at the end of 1997 (3.1% and 2.3% respectively at end-1996).

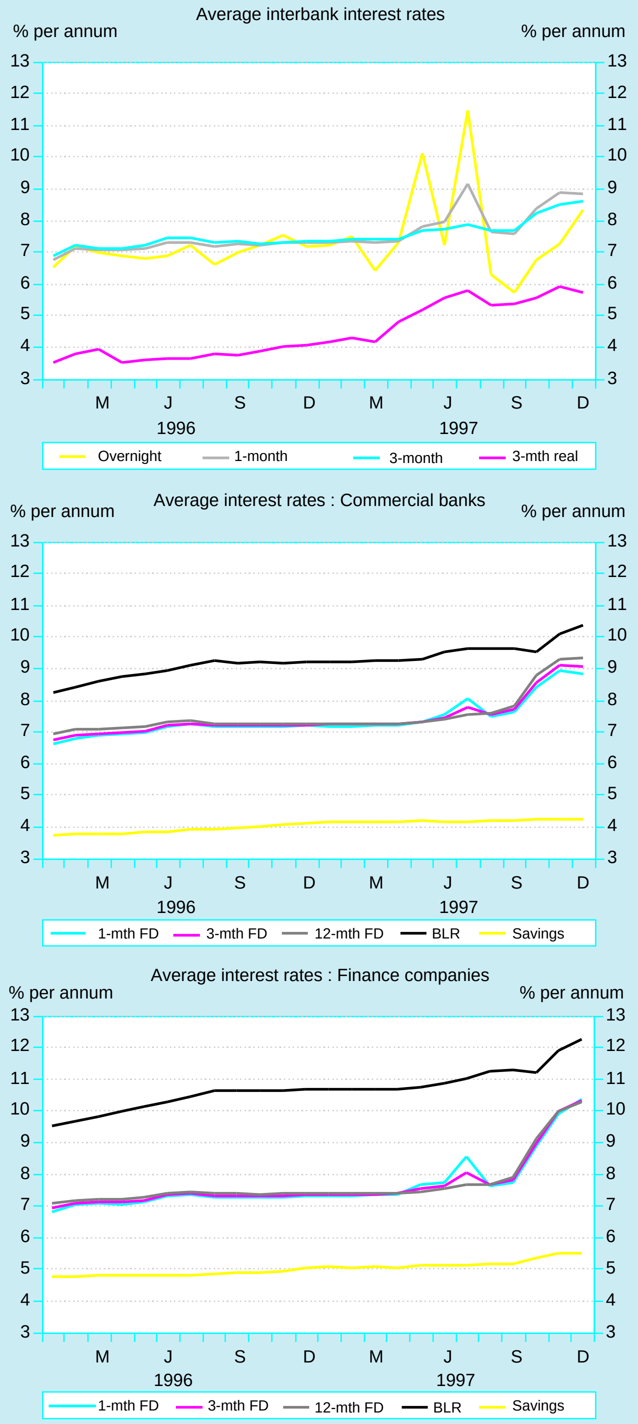
In terms of determinants, claims on the private sector continued to be the main impetus to monetary expansion, contributing about 27.3% of M3 growth. As demand for credit remained strong throughout the year, claims on the private sector increased by RM90 billion or 25.2% (RM72.4 billion or 25.4% in 1996). Of the total increase, 89.7% was in the form of direct loans from the banking system, reflecting corporations' continued reliance on bank credit as a source of financing. Although the increase of RM88.3 billion in total loans and advances extended by the banking system was broad based, the bulk of the credit continued to be channelled to the broad property sector, for consumption purposes, for the purchase of securities and to the finance, insurance and business services sector. At the same time, a significant amount of loans was also channelled to the productive sectors, namely, the manufacturing sector, for general commerce, and transport and storage. While the pre-emptive prudential measures directed at containing credit for financing property and share transactions that were in effect from April did contain further escalation in asset prices, it was noted that lending to the asset markets only slowed down moderately. Further measures were, therefore, required to slow down overall credit growth. The regional crisis since the middle of the year, which saw increased volatility in the stock and foreign exchange markets, increased the potential risks associated with lending to the asset markets. A more rapid slowdown in credit growth was also warranted at a time when inflationary pressures emanating from the weakening of the ringgit became more prevalent. Hence, prudential measures were further tightened with the implementation of voluntary credit plans in October, in order to reduce overall loan growth to a level that would be more consistent with the expansion in the real sector. As a result of the restraint exercised by banking institutions, the annual growth of total loans extended by the banking system moderated to 26.5% at the end of 1997 from a peak of 30.5% at the end of March. The slowdown in loan growth was particularly pronounced in November and December creating fears of a credit crunch. Banking institutions were, therefore, encouraged to allocate the limited resources to lending for productive purposes, and to accord priority to the manufacturing and services sectors, particularly to export-oriented industries. While credit growth moderated, it remained high exceeding the credit plan target of 25%. Loan approvals, however, decelerated towards the final quarter of 1997, auguring well for a further moderation of loan growth in 1998. During this period, the Government sector had a small expansionary impact on money supply of RM451 million.

The expansionary influences of claims on the private sector and Government operations on money supply were partially offset by the contractionary influences of other determinants. External operations exerted a marked contractionary impact due to the significant decline in the country's net foreign assets of RM17.2 billion (RM1.5 billion in 1996). However, the impact of the fall in BNM's net external reserves of RM10.9 billion (RM6.2 billion in 1996) was moderated by an increase of RM6.3 billion in the net external liabilities of the banking system. The latter increased largely as a result of higher foreign interbank borrowings by the banking system. However, a significant amount of the borrowing was fully hedged by forward purchases of foreign currencies from domestic exporters and swap operations. The higher domestic interest rate vis-a-vis rates for the major foreign currencies created an incentive for some banks to source offshore ringgit funds through swaps with offshore banks. The large contractionary impact of RM12.2 billion, recorded in other influences, reflected mainly the higher paid-up capital and undistributed profits of the banking system.

The further tightening of monetary policy in 1997 reinforced the upward trend in **interest rates** that began in 1995. In the first four months of 1997, interbank rates remained firm as the tight stance of monetary policy was maintained to contain inflationary pressures arising from the strong credit growth. This was supported by several prudential measures introduced to contain credit growth to finance purchases of assets. Consequently, the 3-month interbank rate was traded in the range of 7.22–7.55% during the period. However, the relatively stable trend was disrupted by a sharp spike in interest rates in May and again in July, following speculative pressures on the ringgit as a result of the contagion effects of developments in the region. As liquidity contracted in an environment of increased volatility in the financial markets, the overnight and 3-month interbank rates rose sharply to peak at 18.75% and 8.62% respectively in mid-May. As the pressure on the ringgit subsided and liquidity improved, interbank rates subsequently drifted downwards with the 3-month interbank rate recording 7.51% at the end of May and remaining relatively unchanged in June. However, a second round of speculative activity on the ringgit occurred in July that caused an even sharper increase in interbank rates. On 10 July, the overnight and 3-month rates rose to 40% and 8.6% respectively from 7.5% and 7.9% the day before. On both occasions, there were temporary inversions in the term structure of interbank rates whereby the shorter term rates increased significantly to exceed the longer term rates. In contrast, the relative stability of longer term rates throughout the period reflected expectations that the tightness in the money market would be temporary. To maintain stability in the domestic money market and to insulate domestic interest rates from external developments, BNM introduced limits on non-commercial-related ringgit offer-side swap transactions with foreign customers on 4 August. Following this, interbank rates eased further and by mid-August, the 3-month interbank rate returned close to the levels prevailing prior to the emergence of excessive volatility in the currency market.

Interbank rates, however, were adjusted upwards progressively from mid-September until the end of the year as monetary policy was tightened further to pre-empt inflationary pressures arising from the

Graph 2.2
Interest Rates



ringgit depreciation and to maintain positive real rates of return on savings. The firming of interest rates was also due to tighter liquidity conditions in the banking system. The resource gap that emerged from the slower growth of deposits relative to strong demand for credit by the private sector, was reinforced by the net issue of Malaysian Government Securities amounting to RM2 billion in November. Hence, the loan-deposit ratio of the banking system increased from 92.7% in August to 95.8% in November. Liquidity conditions, therefore, tightened in the last quarter. Smaller financial institutions faced higher borrowing cost due to a more selective lending practice in a market that had become segmented. As a result of the overall tighter liquidity and higher rates faced by smaller institutions, the 3-month interbank rate increased from 7.55% in mid-September to 8.3% at end-October, 8.5% at end-November, and eventually to 8.7% at end-December, the highest level recorded since 1986.

A notable development towards year-end were the distortions that emerged in the intermediation process, which affected the smooth functioning of the money market, following the increased uncertainty and tight liquidity conditions. As a result, smaller financial institutions faced considerable difficulty in obtaining interbank funds due to growing segmentation in the money market and the shift of deposits to the larger financial institutions. Subsequently, interest rates in the interbank market were generally higher. Arising from these developments, the term structure of interbank and lending rates was no longer reflective of market conditions. The shorter-end interbank rates reflected the exceptionally tight liquidity situation of a small number of banking institutions. The 1-week rate rose significantly from 6.66% in mid-September to 7.34% at end-October, 7.41% at end-November and to 14.94% at end-December. These developments resulted in a rapid increase in lending rates for loans priced on a cost-plus basis. To address these distortions, a package of monetary measures was introduced in February 1998, including the reduction of the SRR.

As domestic interbank rates rose progressively in Malaysia, the 3-month interbank interest rate differential with the United States widened by 103 basis points to 2.86 percentage points. In contrast, the interest differential with Singapore narrowed significantly by 181 basis points to 2.45 percentage points as the interbank rate in Singapore increased sharply during this period. Although the differential with the United States widened, it was significantly less than the average differential of 4.1 percentage points during the surge of capital inflows in 1992–93. Nevertheless, there was an inflow of funds in 1997, as reflected in the higher net external liabilities of the banking system. These inflows, however, did not have a destabilising impact on the banking system and the economy as a whole since a significant amount of the funds was for trade financing and was fully hedged.

Monetary Measures in 1997

Pre-emptive Prudential Measures in April 1997

With effect from 1 April 1997, Bank Negara Malaysia (BNM) implemented prudential measures to complement the overall policy of continued monetary restraint. Specifically, the objectives of the measures were to ensure that any downward trend in asset prices would not threaten the strength and stability of the financial institutions, and that available resources were channelled for productive activities. In addition, the measures were introduced following concerns over the strong increase in lending by financial institutions to less productive sectors. Lending to the broad property sector (comprising real estate, construction and housing) increased sharply by 29.9% in 1996. At the same time, loans granted for the purchase of stocks and shares and units of unit trust funds, including to holding and investment companies, rose strongly by 30.5%.

- **Credit facilities granted for the purchase of stocks and shares and units of unit trust funds:** With effect from 1 April 1997, ceilings of 15% of total outstanding loans for commercial banks and finance companies, and 30% for merchant banks were set for credit facilities secured by stocks and shares. These limits were defined to cover credit facilities granted for the purchase of stocks and shares and units of unit trust funds, including loans to holding and investment companies. Loans extended for the purchase of Amanah Saham Nasional, Amanah Saham Bumiputera, Amanah Wawasan 2020 and units of unit trust funds established by the state governments were exempted from the limits.

- **Credit facilities extended to financing of specified types of property:** Banking institutions were also required to observe a limit on credit facilities extended to the property sector (excluding houses and apartments costing RM150,000 and below, infrastructure projects and industrial buildings and factories) of 20% of their total outstanding loans. The term "credit facilities" was defined to include all forms of lending, including the issue of guarantees, private debt securities and commercial papers.

Limit on Non-commercial Related Swap Transactions

Banks were required with effect from 4 August 1997, to observe a limit of US$2 million on outstanding non-commercial related ringgit offer-side swap transactions with each foreign customer on a group basis. Banks that exceeded the limit were not allowed to transact in any further non-commercial related ringgit offer-side swaps with such foreign customers until the outstanding amount had been reduced to below the limit. Hedging requirements of foreigners for trade related and genuine portfolio and direct investments in Malaysia were not affected by this measure. The purpose of introducing this measure was to maintain stability in the domestic money market and to allow domestic interest rates to be more reflective of domestic conditions, and hence, promote an environment that was stable and more predictable for genuine investments.

Credit Plan

In the light of prevailing developments in the financial markets, the need to slow down the overall credit growth became more urgent and important, especially in reducing the leverage of the economy and curbing inflationary pressures. In this regard, in October 1997, banking institutions were requested to submit their credit plans for the remaining quarter of 1997 and for the year 1998. The credit plans were drawn up by the banking institutions based on the individual institution's business strategy and their assessment of the opportunities and risks. Based on the projections submitted, the annual loan growth of the banking system as a whole would moderate to 25% by the end of 1997, 20% by the end of the first quarter of 1998, and 15% by the end of 1998.

In the implementation of the credit plans, lending for productive and export-related manufacturing activities, the productive services sector, small- and medium-sized industries as well as low- and medium-cost housing, including end-financing for owner-occupied residential properties, was to be accorded priority.

Guidelines on Hire-Purchase Loans for Non-commercial Passenger Vehicles

Effective 20 October 1997, BNM tightened further the conditions on hire-purchase loans for the purchase of non-commercial passenger vehicles (both new and second-hand). Finance companies were only allowed to provide financing for up to 70% of the purchase price of the vehicles. In addition, the repayment period of these hire-purchase loans was restricted to not more than five years. The same conditions applied to the provision of block discounting for hire-purchase loans granted for the purchase of non-commercial passenger vehicles. This measure was introduced as part of an effort to strengthen existing prudential guidelines.

Guidelines on Lending to the Property Sector

In December 1997, BNM laid down guiding principles for banking institutions in extending loans to the property sector, as follows:

(i) No credit facilities should be granted to property projects where construction had not started, including for the construction of low- and medium-cost residential properties costing RM150,000 and below;

(ii) For property projects where construction had started, banking institutions should assess the viability of such projects under the changed economic conditions. Under strict selectivity, credit could be extended for the construction and purchase of residential properties costing RM150,000 and below. Other projects should preferably be deferred. Where such projects were no longer viable under the changed economic conditions, banking institutions should review the projects and their financing; and

(iii) Notwithstanding the above, banking institutions might continue to extend credit for the construction and extension of factories and industrial buildings which were needed to expand productive capacity.

With a more noticeable slowdown in overall credit growth, the Guidelines on lending to the property sector were modified on 26 January 1998, to exempt bridging loans and end-financing for the construction and purchase of houses and apartments costing RM150,000 and below.

Appointment of Principal Dealers

With effect from 1 January 1997, 16 new principal dealers (PDs) were appointed, comprising nine commercial banks, four merchant banks and three discount houses, for a one-year period. The PDs were required to bid for at least 10% of the instruments specified by BNM, to provide reasonable two-way price quotations, to keep and manage records separately and to provide information as required by BNM.

The PDs were granted several privileges such as eligibility to bid for instruments in the Scripless Securities Trading System (SSTS) at primary auctions, undertake repos of less than one-month maturity from non-interbank customers, and participate in money market auctions, as well as access to the Bank's discount window facility, and ability to net off 15% of the sales and purchases of specified instruments in the secondary market, whichever was lower, from the eligible liabilities (EL) base, up to a maximum of 1% of the EL base. The specified instruments comprised Malaysian Government Securities, Malaysian Treasury Bills, Bank Negara Bills, and any other instrument specified by BNM.

Monetary Measures Announced on 6 February 1998

On 6 February 1998, BNM announced the implementation of a number of monetary measures. The objectives of the measures were to remove distortions in the intermediation process in providing financing to productive economic activities as well as to enhance the efficiency of the operations 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. The measures were as follows:

- **Streamlining the interest rate structure:** The interest rate structure was streamlined to reflect liquidity conditions in the market. Arising from recent developments, the term structures of interbank and lending rates were no longer reflective of prevailing market conditions. The shorter-end interbank rates mainly reflected the exceptionally tight liquidity situation of a small number of banking institutions. However, because of uncertainties, 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 therefore, generate a more orderly 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%.

- **Reduction in the Statutory Reserve Requirement:** With effect from 16 February 1998, 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 and not to provide additional liquidity to the system. BNM in effect neutralised the additional liquidity to the banking system following the reduction in the SRR by reducing its direct interbank lending, thereby slowing down base money growth.

BNM also emphasised that banking institutions should channel their resources to productive activities to support economic recovery, and to be more transparent in their loan pricing mechanisms and not charge excessively high lending rates on a cost-plus formula.

Following the upward movement in interbank rates, commercial banks and finance companies posted significantly higher fixed deposit rates and base lending rates (BLR) during the year. The increase in savings deposit rates was marginal. The stability in interbank rates in the early part of the year was translated into relatively stable fixed deposit rates in the first four months of 1997. However, in line with developments in the interbank market, there was a sustained inversion in the term structure of fixed deposit rates between May and July during which the shorter-term rates were higher than the longer-term rates. In August, as interbank rates reverted to levels more reflective of domestic conditions, the term structure of fixed deposit rates was once again upward sloping. Following further tightening of monetary policy and the firming of interbank rates since mid-September, borrowing from the interbank market became more expensive. As a result, there was intense competition for fixed deposits in the market, as reflected in the rapid increase in both short- and long-term fixed deposit rates since September. The average fixed deposit rates of commercial banks (1-month to 12-month) rose significantly in the last four months of 1997 by 135–177 basis points to 8.81–9.33% (7.18–7.26% at end-1996), while those of finance companies rose even faster, by 257–272 basis points to 10.23–10.32% (7.28–7.36% at end-1996). The average 3-month fixed deposit rates of both commercial banks and finance companies began to exceed the 3-month interbank rate by mid-October. Expectations of continued tight liquidity were also reflected in the banking institutions' greater focus on attracting longer-term deposits. Consequently, the faster increase in longer-term rates caused a steepening of the term structure of fixed deposit rates of commercial banks, with the spread between the average 12-month and 1-month fixed deposit rates increasing from 10 basis points at end-August to 52 basis points at end-December. In spite of fixed deposit rates increasing significantly, the weighted average savings deposit rates remained relatively stable throughout 1997, increasing only marginally by 13 basis points to 4.23% for commercial banks and 47 basis points to 5.49% for finance companies.

Under the existing BLR framework, BLRs quoted by banking institutions are subject to a ceiling rate which is calculated based on the average 3-month interbank rate of the previous month, allowing for SRR cost, a fixed charge and also the reduction in funding cost due to zero-interest current account balances. In line with the higher 3-month interbank rate, for the year as a whole, the average BLR of commercial banks and finance companies edged upwards by 115 and 157 basis points to 10.33% and 12.22% respectively. In view of the volatility in interbank rates in July due to developments in the regional currency markets, the BLR ceiling for August was temporarily capped at the July level. The move to contain fluctuations in the BLR was aimed at limiting the impact of external developments on the stability of domestic interest rates. The cap on BLR was subsequently removed and from September, the computation of the BLR ceiling reverted to the previous basis.

The average cost of deposits (ACD) of both commercial banks and finance companies increased in 1997 by 122 and 120 basis points to 6.52% and 8.28% respectively, consistent with the upward trend in deposit rates. While the BLRs of both institutions also increased in 1997, the subsequent effect on their respective average lending rates (ALR) was not symmetrical, with the ALR of commercial banks increasing more significantly by 139 basis points to 11.51%. In contrast, the ALR of finance companies increased more modestly by 23 basis points to 12.16%, as the bulk of their loans was in the form of fixed rate hire-purchase loans. As a result of these developments, the interest margin of commercial banks was relatively unchanged (increase of 17 basis points to 4.99%) while that of finance companies declined significantly (decline of 97 basis points to 3.88%).

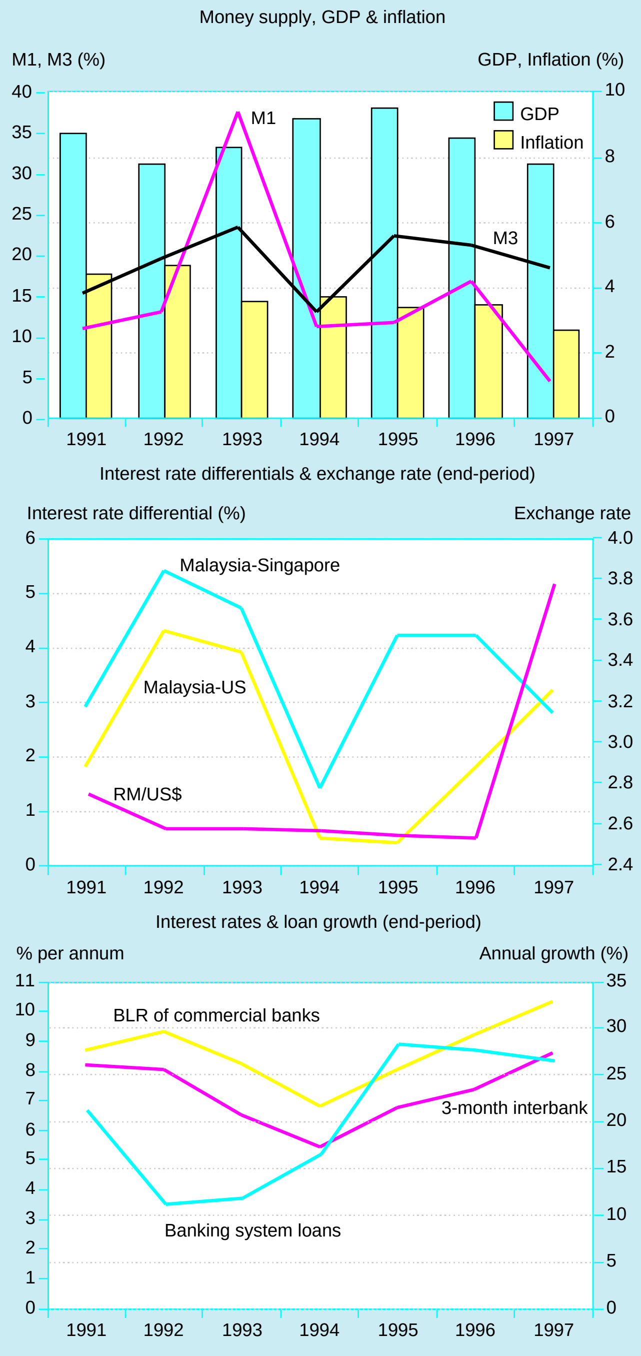
Monetary Policy in 1997

In the conduct of monetary policy in 1997, BNM faced the difficult task of maintaining domestic and external stability in the context of the unprecedented turbulence in the region's financial markets. The contagion impact and prolonged regional uncertainties, which accentuated the depreciation of the ringgit, aggravated inflationary pressures and adversely affected confidence, thereby increasing the complexity of monetary policy implementation.

While the implementation of monetary policy was unusually complex in 1997, its objectives remained unchanged. Price stability remained the primary objective of monetary policy. This became even more critical as the year progressed and the effects of the depreciation of the ringgit began to filter into domestic prices. Of importance, however, was to restore stability in the financial markets, not only enhance the efficient functioning of the intermediation process and thereby facilitate business operations, but also to enhance the effectiveness of monetary policy. Under normal circumstances of stable financial markets amidst a low inflation environment, the ringgit is left to find its level under the flexible exchange rate regime.

Against this background, the implementation of monetary policy in 1997 should be analysed in two separate periods. In the first half of 1997, monetary policy focused mainly on asset inflation. In the period after July, monetary policy responses were

Graph 2.3



directed at restoring stability to overcome the disruptions to economic activities caused by uncertainties in the foreign exchange and stock markets. Towards year-end and in the early part of 1998, monetary policy focused on addressing the tight liquidity situation and inefficiencies in the intermediation process that had emerged in the banking system.

In early 1997, growth in the economy was expected to slow down further to about 8% for the year as a whole, compared with 8.6% in 1996. It was envisaged then that this moderation in economic growth, supported by a continuing firm monetary policy and supply side policies to increase capacity, would contain inflationary expectations and allow the economy to adjust to a more sustainable growth path. The threat of asset inflation was also expected to wane as several pre-emptive measures had been put in place since 1995. The increases in asset prices were driven mainly by the rapid increases in incomes and expectations of speculative windfall gains on the property and stock markets. These were evident in the rising prices of properties and excessive overvaluations of stock prices, particularly in the Second Board counter and during primary offers. Meanwhile, the increase in the Consumer Price Index had been contained by an appropriate mix of contractionary macroeconomic policies. The appreciation in the exchange rate also reinforced this trend. However, the wealth effects from the windfall gains in the asset markets resulted in rising domestic consumption, as reflected in rising imports of consumption goods and strong growth in car sales. If left unchecked, such a rapid growth in domestic spending, financed in part through credit, would increase the vulnerability of the banking system to any downward shift in demand, and if prolonged, could also contribute to inflationary pressures.

The focus of monetary policy was, therefore, to dampen the inflationary impulses emanating from these sources. The main objective of monetary policy was to slow down the overall credit growth to levels that were more reflective of the moderation in GDP growth as well as to encourage available resources into productive uses. The redirection of credit was important because the disproportionate concentration of loans in 1996 and 1997 to finance purchases of property and shares had tended to crowd out lending for more productive purposes, such as for expanding the manufacturing and services industries. Indeed, the annual credit growth for the purchase of properties and shares exceeded 29% and 30% respectively. Bank lending to the broad property sector, and for consumption and for the purchase of stocks and shares accounted for nearly half of the increase in total loans in the first quarter of 1997. The proportion of total outstanding loans allocated to the property and share markets alone amounted to 43%. Even after excluding loans to meet social objectives and loans deemed as productive, namely loans for residential properties costing RM150,000 and below, infrastructure and industrial buildings and factories, the total outstanding loans of the banking system for property and shares exceeded 35%. At the same time, house prices in 1996 rose by 12.9%, while share prices on the Main and Second Boards of the KLSE rose by 24.4% and 93% respectively. While interest rates were raised during this period, lending to these sectors continued to increase as expected gains from asset price increases far exceeded the higher interest cost. The higher interest rates in turn were seen to be dampening investment in the productive sector in which excesses were not evident.

Interest rate increases were therefore reinforced with further prudential measures in the form of credit ceilings. These measures aimed to limit further exposure of the banking system to these sectors in order to minimise its vulnerability to any reversal in price movements in the asset markets. Effective 1 April 1997, banking institutions were not allowed to exceed 20% of their outstanding loans to the broad property sector and not more than 15% (30% in the case of merchant banks) for the purchase of shares. At the end of 1997, outstanding loans for property and shares subject to the guidelines accounted for 13.1% and 8.9% of total loans respectively. There were also indications that price pressures in the asset markets had moderated. The Bank also disseminated the latest available information on estimates of the supply of office and retail space in the market. The information on the potential over-supply situation together with the limits on credit had the effect of scaling down projects and the postponement of others. More importantly, these pre-emptive measures curtailed further increases in lending for financing of purchases of property and shares, thereby providing banking institutions with greater margins to withstand the subsequent declines in stock prices that followed the sharp ringgit depreciation towards the end of the year.

After the outbreak of the region's currency turmoil in July, the focus of monetary policy became much broader and was aimed at restoring stability in the financial markets and addressing inefficiencies that had emerged in the financial markets and in the intermediation process. During this period, the Bank raised interest rates sharply to support the ringgit as it came under several bouts of speculative pressure. The speculative pressure on the ringgit was further exacerbated by the outflow of short-term foreign funds through divestment in the stock market. By the end of 1997, the ringgit had depreciated by more than 34% against the United States dollar. In the initial two weeks of the speculation in July, intervention in the foreign exchange markets absorbed a significant amount of liquidity from the banking system, which caused interest rates in the interbank market to rise to as high as 40% for overnight money. However, following the floatation of the Philippine peso on 11 July, it was recognised that the uncertainty in the currency markets would be prolonged. Given the prevailing circumstances, the Bank placed emphasis on restoring stability in the domestic financial markets in order to minimise the effects of currency speculative activities on the real sector. By mid-August, interest rates were reduced to levels just above the levels prior to the crisis. To insulate domestic interest rates from developments in the foreign exchange markets, effective from 4 August, banking institutions were required to observe a US$2 million limit on outstanding non-commercial related ringgit offer-side swap transactions with each foreign customer. The 3-month interbank rate, which was the indicator rate of the Bank's monetary policy, remained relatively stable during August and September. Towards the end of September, the rate was adjusted upwards as inflationary expectations increased as the ringgit depreciated further to reach US$1=RM3.40.

Although faced with a similar currency crisis, there were significant differences in the policy approach adopted by countries in the region. In Malaysia, it was decided early in the crisis that interest rates would not be raised for the sole purpose of supporting the ringgit. Under normal circumstances of isolated and limited currency pressures, raising interest rates to sharply higher levels and for a short duration would be effective in curtailing speculation against the exchange rate. It was assessed, however, that the speculative activities that engulfed the region in 1997 would persist over an extended period and that an interest rate policy on its own would not contribute to stabilising the currency market. The large foreign share of portfolio investment in the Malaysian stock market provided additional sources of the domestic currency, so that the pressures on the equities and currency markets reinforced each other.

Investor concerns on the economic vulnerability of the region also meant that higher interest rates were unlikely to provide support for the currency. The pressures on ringgit exchange rates essentially reflected negative sentiment on the ringgit exchange rate. The outflows of capital that occurred involved mainly short-term foreign investment with some outflows of funds by Malaysians. Long-term direct foreign investment in Malaysia was for the main part unaffected. There was no evidence of significant outflows of resident funds, and deposits in the domestic banking system continued to increase at high rates. Economic fundamentals during this period remained favourable and activity in the export sector remained generally insulated from the currency turmoil. The loss of confidence occurred mainly among portfolio investors.

The uncertainties in the external sector made it even more critical for the Bank to ensure that its policies did not create further risks in the domestic economy. In the environment of a depreciated currency, exceptionally high interest rates for an extended period would add to the cost of doing business, dampen investment and constrain growth in the real sector. At the corporate level, this would affect export performance and income levels, and cause a greater contraction of excess demand than required to restore stability.

However, a firm interest rate environment was essential to contain inflationary expectations and to continue to promote a positive real rate of return to encourage savings. Moreover, it was felt that raising interest rates as a policy option could be effective only if implemented with a package of consistent macroeconomic policies to correct the imbalances in the economy. A comprehensive policy package was announced in early December to supplement the measures announced in the 1998 Budget, two months earlier. This policy package was aimed at addressing the imbalances in the economy as reflected in the current account deficit in the balance of payments, risks in the banking system, higher inflation due to the ringgit depreciation and high monetary growth.

With the adoption of a macroeconomic policy package in December, it was felt that higher interest

Box IV

Financial Volatility: The Challenge for Monetary Policy

Volatility refers to the short-term deviations around a long-term trend. Some degree of volatility is expected in financial markets as part of the normal process of “price discovery” that ensures financial resources are allocated in an efficient manner. However, when prices of financial assets become excessively volatile, the signals provided by these prices no longer convey the required information for markets to efficiently allocate financial resources amongst the many competing uses. This article looks at volatility in the two types of financial prices that are most relevant to monetary policy: volatility in the domestic price of money (interest rates) and volatility in the external price of money (exchange rates). It examines the causes of volatility in these prices and the challenges volatility poses for the conduct of monetary policy. Lastly, it looks at the role of monetary policy in mitigating excessive volatility and containing its adverse effects.

Interest Rate and Exchange Rate Volatility

As in the case of the price of any good, the exchange rate of a currency is determined by the conditions of demand and supply for that currency. For an open economy like Malaysia, the level of the exchange rate has important implications for the competitiveness of its exports and for domestic price inflation. Even more important is the need to avoid extreme volatility in the exchange rate, which would distort decision making in international transactions, particularly in trade and foreign investment.

Interest rates are the domestic price of money. They are a crucial element in determining the level of investment and real economic activity in a country. Of importance is the need to focus on real interest rates, i.e., nominal interest rates after excluding the inflation rate. As with the exchange rate, interest rates are determined by the relative magnitude of the demand and supply of liquidity.

What then causes exchange rate and interest rate volatility? In the case of exchange rates, the advent of floating rates in many of the world’s currencies in the 1970s augured in an era of greater volatility. Previously, under the Bretton Woods system, the values of most currencies were stabilised at agreed par values. The choice of an exchange rate regime will affect volatility. However, it is the economic fundamentals of a country that determines the long-run value of a currency. Economic fundamentals such as the inflation rate and the balance of payments, which have become more volatile in the 1980s and early 1990s, by themselves are sources of exchange rate volatility. More recently, increased cross-border flows which have been facilitated by the trend towards liberalisation of the capital account and the advancement in technology have also caused exchange rates to fluctuate.

As with exchange rates, volatility in interest rates can also reflect uncertainty in economic fundamentals. One of the most important of these variables is inflation, or rather, the public’s expectations of the future rate of inflation. The deregulation of interest rates and the removal of controls such as interest ceilings is another important factor leading to increased interest rate volatility. Higher volatility in interest rates could also result when the central bank changes its operating procedures in monetary policy. Targeting interest rates could result in less volatility in interest rates than would targeting money supply. This happened in the United States in the late-1970s and early-1980s. Similarly, unclear signals about the stance of monetary policy can generate uncertainty in the financial markets resulting in greater fluctuations in interest rate levels.

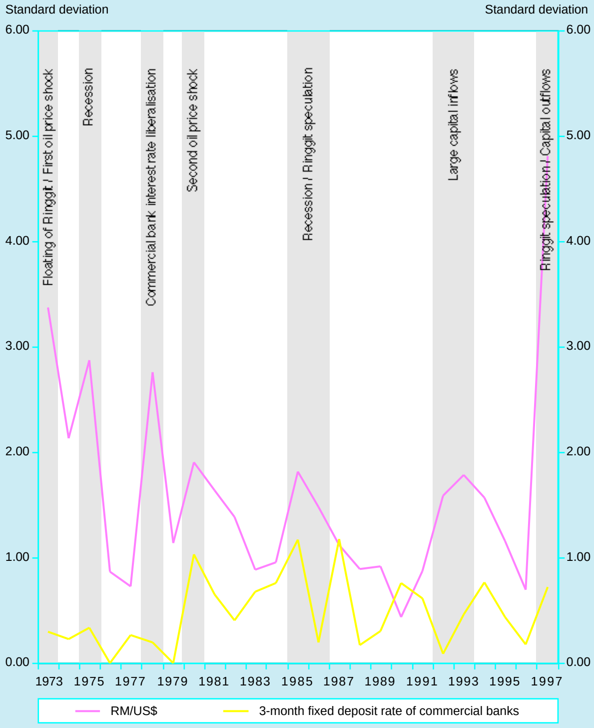
Malaysian Experience

Graph IV.1 presents the volatility of the average 3-month fixed deposit rate of the commercial banks and the RM/US$ exchange rate. Volatility is measured as the standard deviation of monthly percentage changes during each year in the case of exchange rates. Volatility in interest rates is measured as the standard deviation of the end-month interest rate during each year. Also indicated on the same chart are some of the major shocks to the economy that could have affected the volatility of financial prices.

Graph IV.1 shows that the contemporaneous correlation between the volatility of interest rates and the exchange rate is marginal. On average, volatility of interest rates is considerably lower than that for the exchange rate. This suggests that the exchange rate responds faster to shocks in the economy. This observation is evident by the sharp increases in volatility of the exchange rate during each of the periods of external shocks experienced in Malaysia's economic history.

The exchange rate of the ringgit vis-a-vis the United States dollar was very volatile following the floating of the ringgit in June 1973. The commodity price shocks that occurred after the transition to a floating exchange rate regime only served to exaggerate this volatility. Apart from the two oil price shocks, economic recession and currency speculation were the other main shocks

Graph IV.1
Volatility of Interest Rates and Exchange Rate: 1973-1997



Note: For the exchange rate, volatility is measured in terms of the standard deviation of monthly percentage change during each year. For interest rates, it is the standard deviation of the end-month rates during each year.

influencing the volatility in the exchange rate of the ringgit against the United States dollar. In particular, the increase in volatility during the mid-1980s reflected the effects of several factors, the most important being the sharp deterioration in the terms of trade that triggered the recession. Speculative activity on the ringgit also contributed to the increased volatility.

Subsequently, volatility was on a declining trend and was lowest in 1990. Another period of exchange rate volatility occurred during 1992–94, following substantial capital inflows during the period. Attempts by BNM to neutralise the impact of the flows on the exchange rate and domestic liquidity did little to reduce the volatility. However, Graph IV.1 shows a sharp increase in volatility experienced during 1997. Such a level of volatility was unprecedented. As elaborated elsewhere in this Report, the movements in the exchange rate of the ringgit in 1997 were strongly influenced by the contagion effects of developments in the region, which resulted in a loss of investor confidence and large outflows of foreign short-term capital.

The assessment of the historical behaviour of interest rates in Malaysia is based on movements of deposit rates. Volatility of these rates was relatively low during the 1970s. During this period, deposit rates of the commercial banks were administratively set through consultations between the commercial banks and BNM. Consequently, interest rates were changed infrequently. Deposit rates were liberalised in 1978 with commercial banks free to set the deposit rates. Consequently, during most of the 1980s, interest rates were relatively volatile, reflecting the competitive pricing of deposits in response to changing liquidity conditions in the banking system. There was a brief respite in this volatility during 1986–87 when BNM introduced the pegged interest rate system. However, volatility increased again when the system was removed in 1987. The volatility in interest rates has persisted into the 1990s, although at a lower level than in the 1980s. Part of the reason for the lower volatility was the more aggressive management of surplus liquidity by BNM. The persistent excess liquidity situation required the Bank to use all instruments at its disposal to mop up surplus funds from the banking system. It also reflected the effect of the policy to allow banking institutions to move from the daily observation of the statutory reserve requirement and the minimum liquidity requirement to a system whereby the banking institutions fulfil these requirements based on a fortnightly average. This adjustment significantly reduced day-to-day volatility of short-term interest rates in the interbank money market. It is also notable that despite the unprecedented nature of the turbulence in the financial markets in 1997, the volatility of interest rates was not unusually high relative to the rest of the 1990s. This largely reflects BNM's policies designed to ensure that external developments do not destabilise the domestic sector.

Overall, the experience in Malaysia showed that as the country liberalised its interest rates and became more integrated with the international financial system, it also experienced greater volatility of both the exchange rate and interest rates. However, policy changes and improved management of liquidity allowed BNM to offset some of the volatility.

Financial Volatility and the Conduct of Monetary Policy

The volatility in financial prices has significant implications on the conduct of monetary policy. Higher flows and the consequent exchange rate volatility have occurred when investors estimate that such interest rate differentials would adequately compensate for the risks involved in investing in a foreign country, principally the risks of foreign exchange movements. Similarly, interest differentials would also encourage domestic residents, financial institutions and corporations to borrow from abroad. The recent financial crisis indicates the risk associated with such transactions not only for the borrowers but also for the financial system and the economy.

The liberalisation of the capital account and the resulting inflows and outflows of funds greatly complicate the process of monetary policy formulation. When such inflows are large, the natural tendency is for the exchange rate to appreciate. Should the flows reflect sentiments rather than underlying fundamentals, authorities may intervene to reduce the volatility of the exchange rate. In this situation, it would result in a higher growth of money supply and a build-up of excess liquidity within the banking system. Unless the monetary authorities sterilise these injections of liquidity from their foreign exchange operations, by absorbing the excess funds through open market operations, the result will be a decline in interest rates with the subsequent effect of an increase in the growth of credit. The growth of credit can in turn feed demand-driven pressures on prices and work against the authorities' efforts to contain domestic inflation and maintain monetary stability.

When foreign funds flow out of the country, pressure on the exchange rate would occur in the opposite direction. In the absence of central bank intervention, the domestic currency will depreciate. The depreciation can lead to imported inflation. If BNM does intervene to stabilise the exchange rate, it would result in a drain on its foreign exchange reserves. Intervention in the foreign exchange market to support the currency would also result in a contraction of liquidity in the banking system. If not sterilised, this would result in significantly higher interest rates, which over a prolonged period would have adverse implications on economic activity.

Malaysia has for a long time maintained a relatively open capital account with liberal exchange controls. In the early 1990s, high interest rates to control inflation, a booming stock market, and an exchange rate that was expected to appreciate created a one-way bet for foreign investors. Large amounts of foreign funds flowed into the country in 1992 and 1993. The bulk of these short-term funds was invested in the Kuala Lumpur stock market, pushing its capitalisation to 375% of GDP at the end of 1993. Given the short-term nature of the funds, BNM intervention aimed to reduce the potentially destabilising implications of these funds. Exchange rates should appreciate in response to long term economic fundamentals such as large inflows of corporate investments. Inflows in 1992–93 were mainly short-term capital seeking arbitrage profits. Following policies to discourage such inflows, this trend reversed and there was a gradual outflow. In 1997, the reverse problem for monetary policy was experienced – a sudden tightening of liquidity and sharply higher interest rates following the outflow of funds by non-resident portfolio investors.

Therefore, capital account liberalisation and the resulting inflows and outflows of funds can result in greater volatility of the exchange rate.

Since a central bank in an open economy cannot simultaneously determine both the exchange rate and domestic interest rates, attempts to stabilise the exchange rate will transfer the volatility to domestic interest rates. Therein lies the challenge for monetary policy. A balance in judgement is required to limit the volatility in the exchange rate or in domestic interest rates. The initial response of BNM to the contagion pressures on the ringgit arising from the floating of the Thai baht was to intervene in the foreign exchange market to stabilise the exchange rate. However, the result of this intervention was much higher interest rates. The subsequent actions of BNM showed that it decided to accept the volatility in the foreign exchange market in order to maintain the stability of domestic interest rates. This was in contrast to the mid-1980s, when BNM had accepted short-term volatility in interest rates in order to stem speculative activity against the ringgit. In that instance, however, the speculative activities were of a shorter duration, and involved smaller amounts.

Managing Financial Volatility

The growing global integration of both the financial markets, as well as the real economy, results in higher volatility of financial prices as shocks in one market are quickly transmitted across borders. The current financial crisis in Asia demonstrates this phenomenon. It does not imply that volatility of interest and exchange rates due to external shocks should be avoided through economic isolation or capital controls. Rather, there is a general recognition that sound domestic economic management is an important element in reducing the risks associated with this volatility. The impact of policies in one country is even more relevant to other economies when market participants perceive similarities in the characteristics of these economies. Hence, regional co-operation and co-ordination of policies among such economies could reduce volatility in their financial markets. In addition, no one policy instrument can be relied on as a panacea for all financial ills. The Malaysian experience shows that monetary policy instruments can be more effective in moderating the effects of financial volatility on the banking system when complemented by other policies. In particular, such complementary policies include a combination of fiscal, administrative and prudential measures.

Greater transparency in policy-making can also remove much of the uncertainty that is associated with private decision-making. A government that has clear objectives and shows a commitment to achieving those objectives earns credibility. In this context, the Malaysian Government has undertaken measures to increase the flow of information to the private sector. This aims to reduce misinterpretation regarding the priorities and policies of the Government. More transparent data will also ensure correct analysis in interpreting the signals about the direction of monetary policy.

In Malaysia, the intermediate target is the 3-month interbank rate, which is also the Bank's intervention rate. Currently, interest rates are on a rising trend due to tight liquidity and high demand for loans. Despite the exchange rate volatility, interest rates in Malaysia have remained relatively stable. The interest rate instrument is used to contain inflation. In the current circumstances, interest rates have not been used to influence the exchange rate of the ringgit. The authorities are committed to a flexible exchange rate regime that allows the exchange rate to move in response to market forces. However, the exchange rate should reflect the underlying fundamentals of the economy. Currently, the exchange rate is viewed as being undervalued. Therefore, intervention operations to restore stability to the currency remains an option.

To reduce the risks to the banking institutions arising from the volatility, BNM has imposed strict prudential requirements on the banking institutions in Malaysia. The observation of the risk-weighted capital requirement (RWCR) ensures that the banking institutions are adequately insulated against credit risk. Most banking institutions in Malaysia meet or exceed the Bank for International Settlements RWCR of 8%. The smaller less well-capitalised institutions have been actively encouraged by BNM to merge in order to increase their competitiveness as well as their resilience to adverse developments. Recent measures to increase general provisions and shorten the default period for classifying loans as non-performing from six to three months are also aimed at strengthening the balance sheets of the banking institutions. Improved liquidity management and the incorporation into the RWCR of some measure of the vulnerability of different types of assets to interest rate volatility would further boost the resilience of banking institutions.

Volatility tends to be exaggerated in thin markets where even small transactions can cause prices to vary substantially. Therefore, efforts toward developing deeper financial markets should result in greater stability of financial prices. A large and diverse base of financial institutions allows risks to be spread among many players. Institutions that are risk-averse can transfer these risks to those that have the capacity to manage them. The introduction of financial instruments such as futures and options provides the flexibility to hedge and manage the risks associated with the volatility of both the exchange rate and interest rate.

rates would have a greater role in restoring overall economic stability. During this period, the ringgit had depreciated by a greater degree for a more extended period, resulting in an increase in inflationary expectations. In this context, the 3-month interbank rate was raised from about 8.5% in November to 10% by end-January 1998.

The tighter liquidity situation resulted in an increase in the loan-deposit ratio of the banking system, which rose from 92.2% at end-June to 95.8% at end-November. This caused increased competition for funds, with the average fixed deposit rates of the commercial banks for one to 12-month maturities increasing by 127–195 basis points to 8.81–9.33% at end-December compared with their levels at end-June. There was also some shift in deposits from smaller institutions to larger institutions giving rise to higher interest rates as competition for deposits intensified. Following the Bank's assurances on the safety of all deposits in the banking system, this trend was halted. The banking institutions that faced the sudden withdrawal of deposits were provided with temporary funding from the Bank.

The tight liquidity situation and the consequent flight to quality led to distortions in the intermediation process, especially towards year-end. Faced with this scenario, the Bank injected liquidity through direct lending to banking institutions. These institutions were not facing solvency problems but rather a liquidity problem following uncertainty in the financial markets.

In an effort to restore market confidence in an environment of increased volatility in the financial markets, banking institutions were required in October to submit plans for their credit growth for the rest of the year and for 1998. Under the credit plans, overall credit growth for the banking system would moderate to 25% by the end of 1997, 20% by the end of March 1998 and 15% by the end of 1998. As the plans were drawn up in October, loan growth in the final quarter continued to be high following high drawdown of committed loans. By the end of December, total loans extended by the banking system grew at a slightly higher rate of 26.5%.

The policy to slow down loan growth however was not intended to curtail access to financing for productive investments. Viable productive projects are expected to continue to receive financing. To ensure this, banking institutions were encouraged to focus their lending towards financing productive activities. To discourage further concentration of lending in the property sector, the Bank issued new guidelines in December 1997, whereby no new credit facilities were to be granted to property projects where construction had not started. In cases of projects already being implemented, the banking institutions were required to re-examine their viability in the changed economic environment. The guidelines emphasised that the banking institutions should continue to lend for the construction and extension of factories and industrial buildings needed to expand productive capacity. As an additional measure to ensure that credit would be available for productive activities, the Government has set up a special RM1 billion fund to provide financing to the small- and medium-scale industries.

To avoid deterioration of asset quality, a series of prudential measures were also announced in the Budget in October 1997. These measures included disclosure requirements on banks, including providing information to the public on their financial position, lending patterns, the level of non-performing loans, and provisioning against loan losses. To further allay concerns regarding the safety of deposits, a statement was issued by the Bank whereby the principal and interest earned on deposits placed with banking institutions were guaranteed by the Government.

Fiscal Operations and Policy

In the formulation of the 1997 Budget, the Federal Government targeted for an increase in the overall fiscal surplus to 1.6% of GNP in 1997, compared with the surplus of 0.8% of GNP achieved in 1996. The actual outturn of a fiscal surplus of 2.5% of GNP in 1997 exceeded expectations. The achievement of an overall surplus for the fifth consecutive year underscored the Government's commitment to the policy of fiscal prudence and financial discipline. This was part of the overall strategy to contain demand and inflationary pressures, with the broad aim of ensuring sustainable economic growth with price stability and external equilibrium over the long term. Achieving large budget surpluses was aimed at strengthening the foundation for macroeconomic stability and increasing national savings to strengthen the nation's economic resilience to meet future challenges. Following the emergence of the regional financial difficulties, fiscal policy assumed a bigger role to address the economy's underlying vulnerabilities, especially the current account deficit and the national resource gap, and to restore macroeconomic stability and investor confidence.

The Government further tightened budgetary operations to bring about a more rapid downward adjustment in the current account deficit and to reduce inflationary pressures arising from the depreciation of the ringgit. Several fiscal measures were introduced in the third quarter of 1997 to manage the level of aggregate demand and to contain the current account deficit. These measures included an immediate 2% cut across the board in Government spending, the deferment of several large infrastructure projects (Bakun Hydroelectric project, the Kuala Lumpur Linear City, the Northern International Airport, Phase II of the Putrajaya project, the Hill Road project and the Straits of Malacca Malaysia-Indonesia Bridge) and a review of purchases of foreign goods by the public agencies, including the armed forces. The 1998 Budget announced in October 1997 was designed to further consolidate the public sector to further strengthen economic fundamentals and the nation's resilience to overcome external shocks. Additional projects were identified for deferment, including highway projects and the Light Rail Transit projects in Penang and Johor. Overall, the cost of projects deferred involved an estimated RM65.6 billion. In addition, the implementation of the privatisation programme would be more cautious and selective, and only projects that would expand productive capacity and enhance long-term growth prospects would be approved. The Budget also provided additional tax incentives to support the strategy of productivity-driven growth, enhance international competitiveness and further strengthen the balance of payments position. Among the key tax measures were a two percentage reduction in the corporate and petroleum income tax rates to 28% and 38% respectively to reduce the cost of doing business, tax incentives to boost exports and to expedite the pace of industries to shift to knowledge- and technology-intensive processes, as well as imposition of higher import duties on a number of goods to curb imports. In the wake of further regional uncertainties, the Government announced in December the implementation of a comprehensive package of policies, including further fiscal austerity measures involving an 18% reduction in the 1998 Budget allocation, to further strengthen the stabilisation process.

In the management of expenditure, public spending and investment were prioritised to maintain expenditure at a level consistent with the capacity to raise revenue and ensure that the public sector was not a source of inflationary pressures. In particular, the Government continued to exercise prudence and stringent controls on operating expenditure, including stricter accountability of expenditure by departments aimed at avoiding wastage and curtailing less productive spending, while continuing to provide improved public services and amenities to facilitate private sector activities. Further progress was made in streamlining the public sector through the wider use of office automation and information technology, organisational restructuring of Government departments, corporate restructuring of public enterprises, as well as the privatisation of public entities, projects and services. Furthermore, less essential projects were deferred. The Government continued to provide for essential expenditure to address supply constraints, raise productivity and enhance potential output. Higher investments were channelled towards infrastructure, education and training, and research and development, especially in science and technology. Priority was also accorded to socio-economic projects, especially agriculture and health, to eradicate poverty, reduce economic disparity and upgrade the quality of life.

Fiscal policy in 1997 was also aimed at maintaining a tax structure that would provide an environment that was conducive to private sector growth and investment, promote national savings and reduce inflationary pressures. The tax package implemented in 1997 was designed to achieve sustainable growth through enhanced productivity, and a strengthening of the balance of payments position through improving the services sector and increasing domestic production. Improved productivity was also strategic to the nation's effort in addressing a number of other challenges, especially to reduce inflationary pressures, maintain international competitiveness and overcome labour shortages. Several fiscal incentives were provided in the 1997 Budget to foster the strategy of productivity- and quality-driven growth. These measures included provision of the reinvestment allowance to encourage manufacturing and agriculture companies to reinvest in equipment which would significantly improve their productivity, as well as tax incentives to facilitate the shift to high technology, capital-intensive and information-based industries (especially in the Multimedia Super Corridor (MSC)), and enhance the value chain of the manufacturing sector to strengthen industrial linkages. Wide-ranging tax incentives and exemptions were also introduced during the year to promote the services sector. Other fiscal measures included the withdrawal of duty exemptions on inputs used in the manufacturing sector and reimposition of import duties on heavy machinery to encourage domestic production and reduce the dependence on imported capital and intermediate goods. To control inflation and promote savings, the Government eliminated or reduced import duties and sales tax on a number of goods; exempted some inputs used by manufacturers of selected goods from sales tax to reduce production cost; and removed restrictions on relief for life insurance premiums. Incentives were also provided to enhance the effectiveness and efficiency of the financial markets to mobilise long-term savings to support the industrialisation drive.

The Government's commitment to prudent budgetary policies amidst favourable revenue performance arising from sustained economic growth contributed to another overall surplus position in the **consolidated public sector** in 1997. The surplus, however, was lower than in 1996 due largely to the higher development expenditure of the non-financial public enterprises (NFPEs).

The general government's consolidated position, comprising the Federal Government, 13 state governments, statutory bodies and local governments, recorded a much larger current account surplus of RM27.9 billion or 10.6% of GNP in 1997 (8.6% of GNP in 1996). The strong performance was due to both a large increase in revenue collection and a sharp deceleration in operating expenditure. Following a strong growth of 21.9% in 1996, operating expenditure increased only marginally, by 0.4% in 1997. This essentially reflected the tight budgetary control on expenditure, especially on less productive spending, partly in response to the announcement in September of an immediate 2% cut in expenditure. Increased outlays were channelled mainly to improve the quality of public services and amenities. The large surplus was generated mainly by the Federal Government and to a lesser extent, the state governments. As in previous years, the statutory bodies remained in deficit, attributable to their narrow revenue base. With several major public enterprises sustaining good performances during the year, the NFPEs as a group also maintained a large operating surplus of RM21.7 billion or 8.3% of GNP. In aggregate, the consolidated public sector recorded a large surplus of RM49.6 billion or 18.9% of GNP in 1997. This was significantly larger than the surplus of 17.1% of GNP achieved in 1996.

Public sector development spending expanded significantly in 1997, largely due to investments in infrastructure to expand productive capacity to support economic growth as well as to meet the socio-economic objectives of the nation. Both the general government and NFPEs contributed to the expansion in expenditure. In particular, the development outlay of the NFPEs escalated sharply (43%) in 1997, to account for a larger share of 55% of the total public sector development expenditure. Several of the public enterprises, especially Petroliam Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB), Telekom Malaysia Berhad, Keretapi Tanah Melayu Berhad and Malaysian International Shipping Corporation Berhad continued to undertake expansion projects and modernisation programmes during the year. A sizeable share of the expenditure was also for investment overseas, especially by PETRONAS and Telekom, to complement their domestic activities. In the public sector, expenditure was mainly directed at several large infrastructure and related projects under construction, including the Kuala Lumpur International Airport, Putrajaya and the Light Rail Transit Systems. Meanwhile, higher capital expenditure of the general government was also for human resource development and infrastructure projects. In aggregate, public sector development expenditure expanded by 31.7% in 1997, compared with 3.4% a year ago. As a result, the overall surplus of the consolidated public sector was slightly

Table 2.1
Consolidated Public Sector Finance

	1996	1997*p*	1998*r*
	RM million		
General government [1]			
Revenue	70,912	78,549	68,468
Operating expenditure	50,463	50,647	44,204
Current surplus of general government	20,449	27,902	24,264
Current surplus of NFPEs [2]	20,348	21,747	21,732
Public sector current surplus	**40,797**	**49,649**	**45,996**
(% of GNP)	**17.1**	**18.9**	**16.5**
Net development expenditure	30,818	40,588	37,448
General government	*15,306*	*18,407*	*16,490*
NFPEs	*15,512*	*22,181*	*20,958*
Overall surplus	**9,979**	**9,061**	**8,548**
(% of GNP)	**4.2**	**3.4**	**3.1**

[1] Refers to general government, comprising Federal and state governments, statutory authorities and local governments.
[2] Refers to 28 NFPEs in 1996 and 1997 respectively.
p Preliminary
r Revised based on 5 December 1997 announcement.

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

lower at RM9.1 billion or 3.4% of GNP in 1997, compared with 4.2% of GNP in 1996.

The financial position of the **Federal Government** strengthened in 1997. Fiscal discipline and tight controls on expenditure amidst favourable revenue performance resulted in an overall budget surplus for the fifth consecutive year. The current account surplus increased to RM21 billion or 8% of GNP (6.1% of GNP in 1996) and the overall surplus to RM6.6 billion or 2.5% of GNP (0.8% of GNP in 1996).

Federal **revenue** expanded further by 12.8% to reach RM65.7 billion or 25% of GNP. The strong revenue collection in 1997 stemmed from the continued growth of the economy, the improved tax collection machinery coupled with a large positive contribution from petroleum-based revenue. Benefiting from higher petroleum prices and production in 1996 (the tax base for 1997), petroleum-based revenue accounted for nearly one-quarter of the increase in total revenue collection during the year. In addition, several tax measures introduced in the 1997 Budget were estimated to have generated net additional revenue of RM321 million in 1997, compared with revenue foregone of RM437 million in 1996. The currency crisis in the latter part of the year had a marginal impact on revenue in 1997, given that collection of direct taxes, the largest component of Federal revenue, was based on the corporate performance in the previous year. However, indirect tax collections were somewhat affected, especially in the last two months of 1997. While collection from export duties benefited due to gains in export value in ringgit terms, receipts from import and excise duties declined in November-December due to slower aggregate demand arising from measures instituted to curb imports and excessive consumption.

In aggregate, the favourable revenue performance was contributed by all three broad categories of revenue, particularly receipts from direct taxes. **Tax revenue** maintained its strong growth momentum in 1997, due in part to measures to broaden the tax base and the more efficient tax collection machinery. As a result, the Government's tax effort, that is, the ratio of tax receipts to GNP improved to 20.4% (19.9% in 1996). Receipts from **direct taxes** recorded a stronger double-digit growth for the eighth consecutive year to account for a higher share of total revenue (46%), although the increase was moderated to some extent by a number of concessions implemented in the 1997 Budget to enhance productivity and international competitiveness as well as to strengthen the services sector. These fiscal measures included a review of reinvestment allowance, tax incentives (investment tax allowance or pioneer status) for selected tourism projects and information-based industries in the MSC, tax incentives for promoting industrial linkages and acquiring proprietary rights, and a concessionary tax rate for the local fund management industry. While these fiscal measures could result in some immediate revenue loss, it is expected to contribute to additional revenue in the future through expansion of economic activities and growth. Receipts from petroleum income tax recorded an exceptionally large increase (75%) in 1997. Collections from corporate income tax, the single largest contributor of revenue (25%), remained buoyant, while receipts

Table 2.2
Federal Government Finance

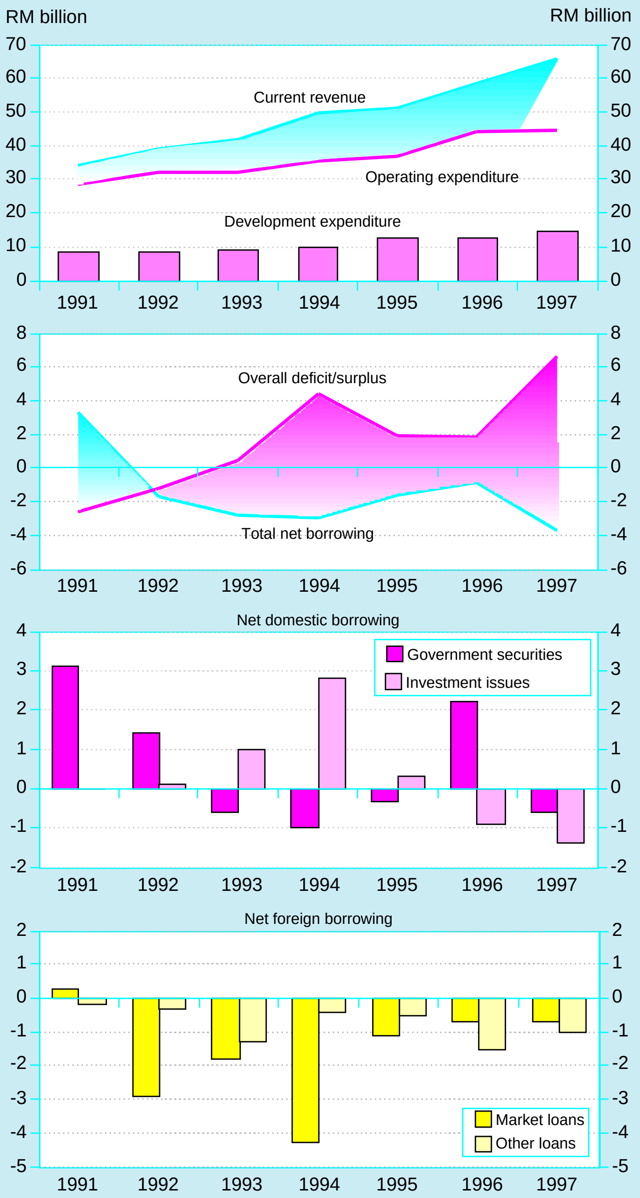
	1996	1997*p*	1998*r*
	RM million		
Revenue	58,280	65,736	55,924
Operating expenditure	43,865	44,665	38,899
Current surplus	**14,415**	**21,071**	**17,025**
(% of GNP)	**6.1**	**8.0**	**6.1**
Development expenditure	12,600	14,445	12,967
Gross development expenditure	*14,628*	*15,750*	*14,267*
Less Repayments	*2,028*	*1,305*	*1,300*
Overall surplus	**1,815**	**6,626**	**4,058**
(% of GNP)	**0.8**	**2.5**	**1.4**
Sources of financing [1]			
Net domestic borrowing	1,291	–2,048	–
Gross borrowing	*6,000*	*3,000*	–
Less Repayments	*4,709*	*5,048*	–
Net foreign borrowing	–2,177	–1,681	–
Gross borrowing	*749*	*462*	–
Less Repayments	*2,926*	*2,143*	–
Special receipts	475	91	–
Realisable assets [2] and adjustments	–1,404	–2,988	–
Total	–1,815	–6,626	–

[1] Data for 1998 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 based on 5 December 1997 announcement.

Source: Ministry of Finance

from personal income tax were also higher. Overall, the improved income tax collection reflected higher profits, business earnings and incomes in 1996, as well as the increasing number of taxpayers included in the tax base. The Inland Revenue Board (IRB) is estimated to register 150,000 new taxpayers in 1997. In addition, concerted efforts were made by IRB to further strengthen the tax collection machinery, expand the tax base and raise the tax compliance rate through stricter enforcement to reduce tax evasion and tax avoidance. These measures were successful in generating an additional RM282 million in back taxes in 1997. Collection from stamp duties stabilised at the previous year's level, with higher values in property transactions being offset by the sharply lower value of shares traded on the Kuala Lumpur Stock Exchange. The contribution from other components of direct taxes, including real property gains tax, increased in 1997.

Graph 2.4
Federal Government Finance



Revenue from **indirect taxes** increased at a more moderate pace in 1997, in tandem with the slightly slower rate of increase in domestic demand. Collections from this source were affected, especially in the last two months of the year, following the measures imposed on import demand, including the higher rates of import duty on construction materials, consumer durables and motor vehicles introduced in the 1998 Budget. Receipts from most major components of indirect taxes moderated during the year. Receipts from export duties were sustained at the previous year's level, with the gains in collection from petroleum export duties (97% of total export duties) arising from the depreciation of the ringgit, largely offset by the decline in petroleum prices and export volume.

Growth in receipts from import duties moderated in 1997 consonant with the deceleration in import volume. The abolition or reduction of import duties on a number of goods in the 1997 and 1998 Budgets to reduce inflationary pressures and reduce excessive protection on domestic industries also contributed to the slower collection. The increase in revenue from indirect taxes was underpinned by the reimposition of duties on heavy machinery and the withdrawal of exemptions on spares, consumables and components used in manufacturing and certain hotel equipment in the 1997 Budget. This was estimated to raise additional revenue of RM326 million. However, the increase in duties on petroleum and, in particular, on motor vehicles slowed down sharply (4.4%; 26.8% in 1996) as a result of a reduction in demand for vehicles towards the end of the year in response to the tightening of financing facilities and the substantial increase in import duty rates on motor vehicles introduced in October 1997. Receipts from excise duties were similarly affected, with sharply lower collections from petroleum and petroleum products, and a smaller increase in duties from motor vehicles. Collection from sales tax remained buoyant despite the exemption of sales tax on inputs of selected domestic manufactured goods to reduce production costs. The increase was largely on account of stronger growth in receipts from sales tax on imported goods, partly due to the ringgit impact. Receipts from service tax benefited from the imposition of a service tax on credit cards. However,

Table 2.3
Federal Government Revenue

	1996	1997*p*	1996	1997*p*
	RM million		Annual change (%)	
Tax revenue	47,272	53,627	13.4	13.4
Direct taxes	25,851	30,432	13.9	17.7
Income tax	22,661	27,121	12.3	19.7
Corporate	*14,166*	*16,688*	*21.0*	*17.8*
Petroleum	*2,203*	*3,861*	*0.8*	*75.3*
Personal	*6,172*	*6,429*	*–0.5*	*4.2*
Co–operative	*120*	*143*	*34.8*	*19.2*
Stamp duties	2,708	2,714	23.5	0.2
Other	482	597	48.8	23.9
Indirect taxes	21,421	23,195	12.9	8.3
Export duties	1,041	1,053	22.2	1.2
Import duties	6,132	6,524	9.1	6.4
Excise duties	5,790	6,054	9.7	4.6
Sales tax	5,473	6,167	12.4	12.7
Service tax	1,231	1,475	21.2	19.8
Other	1,754	1,922	31.7	9.6
Non–tax revenue and receipts	11,008	12,109	18.6	10.0
Total	**58,280**	**65,736**	**14.4**	**12.8**

p Preliminary

Source: Ministry of Finance

receipts were partially offset by service tax exemptions given for the export of professional services and for approved companies undertaking research and development.

Non-tax revenue increased moderately in 1997. Collections from licences and permits remained buoyant with substantially higher receipts from the levy on foreign workers following stricter enforcement by the authorities, as well as higher collections from road tax and petroleum royalty. Service fees also recorded an increase, while investment income receipts stabilised despite the further divestment of Government-owned companies. Non-revenue receipts, which included refunds of expenditure, receipts from Government agencies and revenue from the Federal territories, were marginally higher during the year.

Total **Federal Government expenditure** increased by a modest 4.7% in 1997, as budgetary policy during the year continued to be one of consolidation in order to achieve a larger fiscal surplus. Several measures taken in the third quarter also contributed to containing the increase in expenditure. **Operating expenditure** increased by 1.8% to RM44.6 billion (19.9% in 1996), reflecting continued stringent controls on expenditure to avoid wastage and to curtail less essential spending. Increased efficiency and effectiveness of the government administrative machinery as a result of the wider use of office automation and information technology also assisted in containing the growth in operating costs. The total wage bill, the largest component of operating expenditure (34%), was 7.7% lower than the 1996 expenditure level which included the payment of arrears arising from the salary adjustment for civil servants. In addition, only part of the one month bonus payment to civil servants (up to a maximum of RM500) was made in 1997, with the balance to be paid out in 1998. The reduced wage bill also reflected the policy to rightsize and rationalise the civil service through the privatisation of public services and projects as well as organisational restructuring and consolidation of departments. However, new recruitment continued in the essential services, especially in the health and education sectors. Meanwhile, pension payments increased moderately, reflecting the increased number of pensioners and the annual contribution to the Pensions Trust Fund.

Expenditure on supplies and services was higher, largely for maintenance and enhancing the quality and efficiency of public services. Transfer payments increased moderately, due to larger grants and transfers provided to the state governments and other government agencies for development and maintenance purposes, increased subsidy payments, especially on petroleum products and the paddy fertiliser scheme to assist the lower income consumers, a launching grant to the Higher Education

Table 2.4
Federal Government Operating Expenditure by Object

	1996	1997*p*	1996	1997*p*
	RM million		% share	
Emolument [1]	16,282	15,024	37.1	33.6
Supplies and services	5,673	6,363	12.9	14.2
Asset acquisition	874	905	2.0	2.0
Public debt charges	6,795	6,425	15.5	14.4
Pensions and gratuities	3,509	3,638	8.0	8.1
Other grants and transfers [2]	9,449	10,273	21.5	23.1
Other expenditure	1,283	2,037	3.0	4.6
Total	**43,865**	**44,665**	**100.0**	**100.0**

[1] Includes statutory bodies.
[2] Includes grants and transfers to state governments as well as public agencies and enterprises.
p Preliminary

Source: Ministry of Finance

Fund to assist students facing financial constraints and higher allocation for the Fund for Food. The reduction in the size of the Government domestic debt contributed to the decline in public debt service payments in 1997. Both domestic and foreign interest payments were lower during the year. The impact of the ringgit depreciation on the interest payment burden was insignificant in 1997, largely due to the low external indebtedness of the Federal Government. Debt servicing, however, remained the second largest component of operating expenditure, although its share declined to 14.4%.

Gross **development expenditure** rose moderately by 7.7% to RM15.8 billion, mainly on projects to expand the productive base of the economy and alleviate supply constraints. The increase in expenditure was contained through further privatisation and some deferment of the less essential projects. The emphasis of development expenditure continued to focus on the expansion of infrastructure, upgrading the quality of the workforce through human resource development, and broadening and deepening the research, science and technology base. Priority was also accorded to achieving the socio-economic objectives of the country, especially to eradicate poverty and improve the quality of life of the rural population as well as to provide housing for the low- and medium-income groups.

Table 2.5
Federal Government Development Expenditure by Sector

	1996	1997*p*	1996	1997*p*
	RM million		% share	
Defence and security	2,438	2,314	16.7	14.7
Economic services	7,693	7,800	52.6	49.5
Agriculture and rural development	1,182	1,105	8.1	7.0
Commerce and industry	1,212	1,286	8.3	8.2
Transport	4,530	4,536	31.0	28.8
Public utilities	733	837	5.0	5.3
Other	36	36	0.2	0.2
Social services	3,984	4,919	27.2	31.2
Education	2,091	2,521	14.3	16.0
Health	459	449	3.1	2.9
Housing	501	735	3.4	4.7
Other	933	1,214	6.4	7.6
General administration	513	717	3.5	4.6
Total	**14,628**	**15,750**	**100.0**	**100.0**

p Preliminary

Source: Ministry of Finance

In terms of sectoral distribution, economic services remained the largest component of total development expenditure, although its share declined to 49% due in large part to the on-going programme to privatise new projects, especially the major infrastructure projects. Disbursements on the transport sub-sector was maintained at about the previous year's level, comprising mainly investments on transportation networks to facilitate the flow of goods and passenger traffic to support the industrialisation process and to overcome traffic congestion in the major towns. The major share of the expenditure was for the construction and improvement of Federal roads, and support loans for the development of the rail system, including the light rail transit system projects, and the purchase of rolling stocks for the commuter train system. Priority was also accorded to the development and expansion of ports and airports to strengthen their capacity and efficiency in handling the increasing volume of international and regional trade and passenger traffic. In terms of expenditure on trade and industry, attention continued to focus on industrial development, research and development, promotion of small- and medium-scale industries and tourism projects. A large portion of the expenditure was also channelled to developing technology infrastructure and to programmes to strengthen the technological base of the economy. As part of the continuing effort to reduce the poverty rate to 5.5% by the year 2000 and raise the standard of living of the rural population, expenditure on agriculture and rural development, including land development, and investment to improve rural roads, water supply and electrification programmes remained high.

Capital outlay on the social services sector recorded a large increase of 23.5% in 1997, raising its share to 31% of total development expenditure. Expenditure on education and training increased significantly by 20.6% to absorb the second largest share of development expenditure (16%). The expenditure was mainly for the construction and upgrade of polytechnics, vocational and technical schools and industrial training institutes, the upgrading of educational facilities, including implementation of the computer education programme. The development of institutions of higher learning, including the development of University Malaysia Sabah, also absorbed a larger share of the expenditure. Expenditure on housing was also higher, largely on low- and medium-cost housing projects and housing programmes for the armed forces, police force, customs and immigration officers and teachers in rural areas. The outlay on social and community services included expenditure on projects to conserve the environment and a larger contribution for the development of facilities for the Commonwealth Games in 1998. Investment to provide better quality health care services was mainly on the construction and upgrading of hospitals and health clinics and on the purchase of medical facilities and equipment, including equipping rural health clinics to serve as nerve centres for primary health care services. However, spending on this sector was marginally lower, reflecting the privatisation of support services such as clinical waste management, engineering facilities and biomedical engineering maintenance. Outlays on defence and internal security were mainly for the modernisation of the armed forces and the police force, as well as the construction of training centres. Expenditure for general administration was higher, largely for the construction of office buildings, including the development of the new administrative centre at Putrajaya, and the introduction of electronic government.

The large fiscal surplus recorded in 1997 provided the resources for the Federal Government to further reduce its domestic borrowing while continuing with its external loan prepayment programme. Concomitantly, there was a large build-up in the Government's accumulated financial assets which contributed to increasing national resources to fund development and growth. As a result, **total net borrowing** of the Federal Government remained negative for the sixth consecutive year, with another large net repayment of RM3.7 billion. The total debt position of the Federal Government was, however, marginally higher due to an increase in the foreign debt in ringgit terms following the depreciation of the ringgit. Total debt increased by 0.3% to RM89.9 billion at the end of 1997. In terms of percentage of GNP, it declined further to 34%, from 38% at the end of 1996.

The favourable revenue position permitted the Government to review and subsequently reduce its planned **domestic borrowing** programme during the year. As in the previous year, the Government's domestic borrowing was mainly to accommodate market demand for Malaysian Government Securities (MGS). Gross funds raised through MGS was reduced to RM3 billion, one-half the amount raised in 1996. Hence, for the first time, there

Table 2.6
Public Debt of Federal Government

	Annual change		At end 1997*p*
	1996	1997*p*	
	Nominal value in RM million		
Domestic debt	1,173	–2,243	76,968
Treasury bills	0	0	4,320
Investment issues	–900	–1,400	2,750
Government securities	2,191	–648	66,262
Treasury Housing Loans Fund	–118	–195	3,636
External debt	–2,860	2,480	12,951
Market loans	–1,072	1,312	6,472
Project loans	–1,788	1,168	6,479
Total	**–1,687**	**237**	**89,919**

p Preliminary

Source: Ministry of Finance

was a net repayment of domestic loans as maturing MGS and Government Investment Issues (GII) totalling RM5 billion exceeded new issues. Similarly, no new funds were raised through GII or Treasury bills (TB) during the year, while the Treasury Housing Loans Fund continued to record a small net repayment of loans. Consequently, the total domestic debt of the Federal Government declined by 2.8% to RM77 billion at the end of 1997, thereby accounting for a smaller share of 86% of the total outstanding debt of the Federal Government.

In 1997, the Government floated two issues of MGS worth RM1 billion and RM2 billion respectively by way of tender through the principal dealers. The issues were for maturity of five and ten years. Again, longer-dated MGS were not offered to the long-term institutional investors such as the social security institutions. After adjusting for loan redemptions, total MGS outstanding declined by 1% to RM66.3 billion at the end of 1997 and accounted for 86% of the total domestic debt outstanding. In terms of the ownership structure of **MGS holders**, the social security and insurance institutions maintained their dominant position, although their share of the total outstanding MGS declined to 67%. This reflected mainly the maturity of MGS held by the Employees Provident Fund (EPF), the Social Security Organisation (SOCSO) and insurance companies. This development reflected the recent policy move to liberalise the investment guidelines of these institutions to allow them to further diversify to non-Government securities assets such as private debt securities and equity. Nevertheless, the EPF remained the single largest institutional investor in 1997, holding a slightly lower share of 56% of the total MGS. The new issues of MGS during the year were absorbed mainly by the banking institutions to meet their statutory liquidity requirements following the maturity of Bank Negara Bills of RM6 billion, which is an alternative instrument held to comply with their liquid asset requirement. Consequently, their shareholding in MGS increased further to 20%. The remaining MGS was held mainly by the public enterprises, the non-bank financial institutions and foreign investors.

The balance of the domestic debt was in the form of TB (6%), the Treasury Housing Loans Fund (5%) and GII (3%). There was a significant shift in the profile of **holders of TB** in 1997. The traditional holders, namely, the banking institutions, doubled their holdings to RM3.9 billion, to meet their statutory liquidity requirements. Hence, it regained its position as the major investor to account for 90% of the total TB outstanding. The demand was offset by net liquidations by the insurance companies, which reduced their holdings significantly to only 7% after a large increase of their shareholding to 56% in 1996. The composition of **GII by holder** also indicated an increase in the holdings of the banking institutions participating in the Interest-free Banking Scheme, to account for a larger share of 37% of the total GII outstanding. In contrast, the traditional holders, comprising the Islamic financial institutions, such as Bank Islam, Syarikat Takaful and the Pilgrims Fund Board, further reduced their holdings due to the increased availability of other higher-yielding instruments based on Islamic principles such as Islamic bonds. Meanwhile, BNM's holdings of GII was reduced to 58%, reflecting the large net redemptions 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 prepayment of external loans and restraint on new external borrowing remained an integral part of the Government's debt policy in 1997. Consequently, net **external borrowing** of the Federal Government continued to decline for the sixth consecutive year, recording an outflow of RM1.7 billion in 1997. Gross external borrowing was limited to drawdowns on project loans. During the year, Malaysia signed one project loan agreement with the Asian Development Bank (US$26.3 million) to finance the Klang River Basin Environmental Improvement and Flood Mitigation project. The

Table 2.7
Holdings of Federal Government Domestic Debt

	1996	1997*p*	1996	1997*p*
	Nominal value in RM million		% share	
Treasury bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	2,431	304	56.3	7.0
Banking sector	1,849	3,879	42.8	89.8
Other	40	137	0.9	3.2
Government Investment Issues	**4,150**	**2,750**	**100.0**	**100.0**
Insurance companies	63	119	1.5	4.3
Banking sector	3,878	2,610	93.4	94.9
of which:				
Bank Negara Malaysia	*2,938*	*1,588*	*70.8*	*57.7*
Commercial banks	*611*	*930*	*14.7*	*33.8*
Other	209	21	5.1	0.8
Malaysian Government Securities	**66,910**	**66,262**	**100.0**	**100.0**
Social security and insurance institutions	46,402	44,332	69.4	66.9
of which:				
Employees Provident Fund	*38,743*	*37,055*	*57.9*	*55.9*
Insurance companies	*5,447*	*5,279*	*8.1*	*8.0*
Banking sector	11,541	13,196	17.2	19.9
Other	8,967	8,734	13.4	13.2

p Preliminary

Federal Government also took advantage of the weaker yen in the early part of the year to prepay two market loans and two loans from the Overseas Economic Co-operation Fund of Japan in addition to the maturing of two market loans. However, the recent significant depreciation of the ringgit led to an increase in the external debt in ringgit terms. For the first time in five years, the external debt of the Federal Government rose by 23.7% to RM12.9 billion at the end of 1997.

Based on preliminary estimates, the consolidated financial position of the 13 **state governments** remained in surplus in 1997, for the fifth consecutive year. Reflecting efforts to contain increases in operating expenditure in line with revenue growth, the consolidated current account of the state governments recorded a larger surplus of RM4.6 billion in 1997. Almost all the states achieved surpluses in their current accounts, in line with the objective of raising public sector savings to finance development expenditure. However, with some states recording deficits in their overall balance, the consolidated position showed a smaller overall surplus of RM529 million. The surplus position together with Federal Government loans led to an increase of RM1.2 billion in the accumulated financial assets of the state governments.

The consolidated state **revenue** rose by 1.4% to RM9.6 billion in 1997, on account of higher receipts from both state sources and contributions from Federal grants and transfers. The higher revenue receipts from state sources were mainly from direct taxes, especially forest taxes, which remained the single largest source of state revenue (20%). However, receipts from indirect taxes were lower. Non-tax revenue also declined, largely due to lower receipts from commercial undertakings and the absence of privatisation proceeds. Investment income and payment of petroleum and gas royalty to Sabah, Sarawak and Terengganu Darul Iman were higher during the year. The receipts from Federal sources were aimed at assisting the states in providing infrastructure and other essential amenities to improve the quality of life and to support the industrialisation process.

The total expenditure of the state governments as a group increased at a more moderate rate of 6.3% in 1997, after recording double-digit growth in the preceding two years. Reflecting tighter control on consumption spending, the **operating expenditure** of the state governments increased marginally by 0.7% to RM5 billion (18.9% in 1996). Emoluments, the single largest component of operating expenditure, was lower than the 1996 level which included the payment of salary arrears. The higher expenditure was mainly on maintenance, as well as to provide better facilities and improve the efficiency of state services and administration. **Net development expenditure** increased by 14% to RM4.1 billion (3.8% in 1996), to expand the infrastructure and amenities required to support the high level of industrial development and urbanisation in the states. Most of the states increased their capital expenditure, reflecting their increasing role in the nation's development process. The major share of the outlay was channelled to the economic sector, especially infrastructure (roads, bridges and public amenities), industrial and commercial investments and agriculture and rural development. The balance was for investment in the social services sector, including housing and social and community programmes.

Table 2.8
Consolidated State Government Finance

	1996	1997*p*	1998*f*
	RM million		
Revenue	9,494	9,624	8,739
State sources	*7,974*	*8,023*	*7,283*
Federal grants and transfers	*1,520*	*1,601*	*1,456*
Expenditure	4,955	4,988	4,408
Current surplus	**4,539**	**4,636**	**4,331**
Development expenditure (net)	3,605	4,107	3,612
Gross development expenditure	*4,137*	*4,433*	*3,923*
Less: Loan repayment	*532*	*326*	*311*
Overall surplus	**934**	**529**	**719**
Sources of financing			
Federal loans	544	678	700
Realisable assets [1]	–1,478	–1,207	–1,419
Total	**–934**	**–529**	**–719**

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

Source: State governments

Preliminary estimates of the consolidated position of 28 **non-financial public enterprises** (NFPEs) indicated that the overall financial position of the NFPEs as a group remained in surplus in 1997. However, the surplus was lower than the surplus achieved in 1996 due to the strong increase in capital expenditure by several major public enterprises, mainly to finance capacity expansion. Several NFPEs continued to rationalise their operations during the year, including increasing capacity utilisation by diversifying into upstream and downstream products to improve quality, efficiency and productivity. During the year, TNB completed a corporate restructuring exercise to strengthen performance and consolidate its activities in order to enhance efficiency, as well as optimise utilisation of its assets and human resources. Meanwhile, Telekom Malaysia Berhad also undertook a voluntary redundancy programme to rightsize its workforce. PETRONAS acquired 29.3% shareholding in Malaysian International Shipping Corporation (MISC) to complement and strengthen the operations of both enterprises.

The consolidated revenue of the NFPEs expanded further by 7.2% to reach RM62 billion in 1997, supported by the expansion in business and other activities amidst sustained economic growth. A review of the electricity tariff rates, returns from investments, and gains from overseas operations also contributed to the higher revenue receipts. The depreciation of the ringgit also contributed to higher export earnings of several enterprises during the latter part of the year. Reflecting tight fiscal discipline as well as the restructuring exercises undertaken by some public enterprises to improve productivity and efficiency, operating expenditure rose more moderately by 7.2% to RM39.7 billion. The higher spending reflected the increased cost of business expansion and higher labour and supply costs, including higher import costs due to the weaker ringgit in the latter part of the year. Debt servicing payments, especially the foreign interest servicing burden, increased in 1997 due to the accumulation of a larger debt and the implications of the depreciation of the ringgit.

The operating surplus of the NFPEs as a group was maintained at a high level of RM22.3 billion or 8.5% of GNP in 1997 (8.7% of GNP in 1996). The large surplus was contributed mainly by the major NFPEs, notably PETRONAS, TNB, Telekom and MISC. A small number of enterprises continued to experience losses in 1997.

During the year, several major public enterprises continued to undertake large capacity expansion and modernisation programmes, mainly on infrastructure and utility projects, as well as investment in the oil and gas and manufacturing sectors. The NFPEs also diversified their investment to include acquisition of companies related to their core activities as well as overseas ventures, especially in emerging economies. These developments contributed to a significant increase in the capital spending of the NFPEs, by 43% to RM22.2 billion in 1997 (13.8% in 1996). PETRONAS, TNB, Telekom and MISC accounted for the major share of total capital expenditure during the year. In particular, capital investment by PETRONAS expanded in both upstream and downstream activities. A substantial portion was invested in the gas sector, including the construction of two new gas processing plants (GPP 5 and 6), and the completion of the Peninsular Gas Utilisation project (PGU III); the completion of the Malacca Refinery Centre; and investment in several petrochemical projects as well as PETRONAS Institute of Technology. Overseas investment activities also expanded during the year. Investments by TNB included outlays to expand the power generating capacity and upgrade the transmission and distribution networks to meet the rapid growth in demand for electricity by the commercial and industrial sectors. Major projects underway included the construction of Phases III and IV of the Port Klang Sultan Salahuddin Abdul Aziz Power Station, the construction of two initial phases of the 500kv transmission line network, the construction and installation of gas turbines at the various load centres as well as the rehabilitation and conversion works at several power stations. Other projects included the development of the electricity infrastructure for Putrajaya and the MSC projects and the construction of phase II of the TNB University complex. Other investments included power projects overseas, including those undertaken in Bosnia and Pakistan.

Table 2.9
Consolidated NFPEs Finance[1]

	1995	1996	1997*p*
	RM million		
Revenue	48,682	57,794	61,956
Expenditure	32,343	37,032	39,689
Current surplus	**16,339**	**20,762**	**22,267**
(% of GNP)	**7.9**	**8.7**	**8.5**
Development expenditure	13,630	15,512	22,181
Overall surplus	**2,709**	**5,250**	**86**
(% of GNP)	**1.3**	**2.2**	**–**

[1] Refers to 32 NFPEs in 1995, 28 in 1996 and 1997 respectively.
p Preliminary

Source: Ministry of Finance, Economic Planning Unit and non-financial public enterprises.

A major part of the expenditure of Telekom was for the expansion and upgrading of the international and local networks, as well as investment in telecommunication infrastructure for the MSC projects. Telekom continued to diversify its investments to overseas emerging economies. MISC maintained its long-term fleet expansion programme in 1997 to enhance its capacity to handle the growing volume of international trade. Keretapi Tanah Melayu Berhad continued to enhance the quality and efficiency of rail services as an alternative commuter transport system. The projects included the purchase of 44 additional electric multiple units for the electric commuter train service.

With these large capital investments, the consolidated overall account of the NFPEs as a group recorded a lower surplus of RM86 million or less than 0.1% of GNP in 1997 (2.2% of GNP in 1996). These capital outlays were financed by internally generated funds as well as recourse to domestic and external borrowing. In 1997, the outstanding external debt of the public enterprises increased to RM52.5 billion, to account for 41% of the nation's medium- and long-term external debt.

This increase reflected the increase in borrowing as well as the increase due to the depreciation of the ringgit. However, the external debt position of the NFPEs remained manageable as most of the loans were utilised to fund productive investments, including overseas investments, which were expected to strengthen the performance of the NFPEs as well as generate additional revenue to service the debt. The expenditure, investment activities and borrowings of the NFPEs were closely monitored by the Federal Government to ensure that the activities were consistent with the Government's policy of fiscal prudence and financial discipline.

In 1997, the Government continued with the privatisation programme as part of public policy to consolidate the public sector while increasing private sector participation to meet the country's need for capital investments. During the year, two government agencies, namely, Federal Land Consolidation and Rehabilitation Authority (FELCRA) and the Maritime Academy were corporatised. Another 15 existing and new projects were privatised, mainly involving infrastructure and construction projects. Major privatised projects included several highways such as the Dedicated Kuala Lumpur-Sepang Highway, Western Traffic Dispersal System, Assam Jawa-Taman Rimba Templer Highway and Kajang-Seremban Highway. One state entity, namely, PASDEC was divested through listing in the Kuala Lumpur Stock Exchange. Following the emergence of the regional financial crisis, the Government announced the deferment of a number of large privatised projects, including the Bakun Hydroelectric project, the Kuala Lumpur Linear City, the Northern International Airport, Phase II of the Putrajaya project and Light Rail Transit Systems in Penang and Johor. In addition, the privatisation programme would now be more selective. New privatised projects would be assessed critically in terms of their macroeconomic implications, especially on the balance of payments position. Only projects with low import content, which would contribute to expanding productive capacity and improve the long-term growth prospects would be approved. On-going construction projects which were not strategic were deferred. For large infrastructure projects that have been approved, the implementation would be staggered and the emphasis would be placed on the usage of domestic inputs and on projects that would generate export earnings.

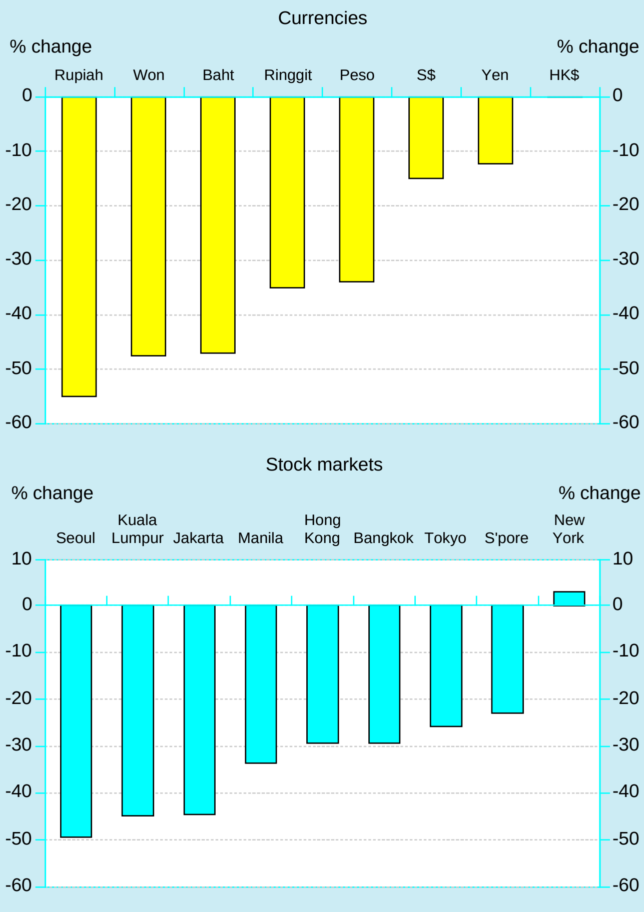
3 Outlook and Policy

International Environment

East Asian Financial Crisis

The East Asian financial crisis is expected to affect growth in world output and trade in 1998. The region's economies would be most affected by the crisis, as the prolonged uncertainty and the implementation of strong measures and structural changes to address existing macroeconomic imbalances take effect. In the short term, fiscal tightening and monetary restraint, and the restructuring of the economy and the corporate and financial sectors, can be expected to exert a dampening influence on growth prospects. However, these measures would pave the way for a more sustainable and broad-based growth over the medium term. Meanwhile, the effect of the crisis on the major industrial economies will vary, depending on their exposure to trade and investment in the region.

Graph 3.1
Performance of Selected Currencies and Stock Markets (30 June 1997 - 31 December 1997)



Prior to the crisis, the East Asian region had enjoyed several decades of strong economic performance, characterised by rapid export-driven growth, relatively low inflation, rising per capita incomes and reduced poverty. The favourable macroeconomic developments in the region attracted large capital inflows. While these inflows supported economic growth, they also contributed to an appreciation in asset prices and general optimism over the region's future prospects. Such flows were made possible by a trend of capital account liberalisation and greater foreign presence in the domestic banking and capital markets. Technological advancements in financial services amidst the globalisation of financial markets also facilitated countries in the region in mobilising foreign savings to finance domestic investments. Benefits of capital inflows accrued in cases where the capital-importing country could maintain sustainable growth with low inflation and a viable current account position. However, imbalances and weaknesses in a number of these countries began to emerge, making the region vulnerable to sudden reversals of these flows, with consequent destabilising effects on the exchange rate and the domestic economy.

Pressures on the regional currencies started with speculative attacks on the Thai baht in mid-May 1997 amidst market concerns over the impact of the export slowdown and the decline in asset prices. These developments heightened investors' perceptions of risks in other economies in the region in terms of the consequences of the export slowdown, asset price deflation and the servicing of high external debt. The consequent deterioration in market sentiment and the loss of investor confidence triggered a series of downward adjustments in regional currencies and sharp declines in the region's equity markets. The Thai baht, which was pegged to the United States dollar prior to the crisis, was floated on 2 July 1997, resulting in its immediate depreciation by about 10–15%. Subsequently, the Philippine peso and the Indonesian rupiah were also allowed to float more freely, while the Malaysian ringgit and Singapore dollar came under selling pressure. The instability in the currency markets was not confined to South-East Asia. The Korean won, the Hong Kong dollar and the Taiwan dollar in turn were subjected to selling pressures. While the Hong Kong dollar peg has remained, the Korean won and the Taiwan dollar depreciated against the United States dollar.

The main feature of the East Asian financial crisis was the severity of the contagion effects and the speed with which the crisis spread across the region. First, significant adjustments in one currency were almost instantly followed by adjustments in the other regional currencies. Second, pressures on the currency and equity markets reinforced each other. The depreciation of the domestic currency resulted in sharp falls in stock prices. The consequent capital outflows exerted further pressure on the exchange rate. Third, despite sharp increases in domestic interest rates, outflows continued, suggesting that investors were more concerned about fundamental weaknesses which existed in the economy. Fourth, the crisis triggered a loss of confidence in the financial system due to high exposure to external borrowing as well as the exposure of domestic financial institutions to properties and stocks and shares. Fifth, the crisis reflected mainly private sector excesses as most countries experienced fiscal surpluses. Finally, there was a spillover of the regional crisis onto the global financial markets, when it generated a global stock market decline in late October, and has since contributed to continued volatility in most equity markets.

Although there were no clear-cut causes of the crisis, there were several factors that triggered and prolonged the problem:

- Movements of the region's currencies against the United States dollar reflected to some extent the global realignments in exchange rates. The United States dollar had strengthened against the major currencies since the second half of 1995. Between the end of September 1995 and the end of 1997, the dollar had appreciated by 26% and 31% against the Deutsche Mark and the Japanese yen respectively.

- Macroeconomic imbalances associated mainly with large current account deficits due to the slowdown in export growth were perceived by the market as defining a build-up of risks and vulnerability to external shocks. Although the magnitude of these imbalances differed among the region's economies, collectively it undermined investor sentiment. Speculators in search of short-term gains aggravated the situation. While the current account deficits had narrowed in several of the East Asian countries, the perception of risks was associated mainly with the financing of these deficits. The East Asian economies relied heavily on foreign capital to finance the current account deficits. During the 1980s, capital inflows were predominantly long-term foreign direct investment. However, the composition changed by the mid-1990s, with a higher proportion in the form of short-term capital inflows, including private sector borrowing and portfolio investment.

- Perceptions of a loss of export competitiveness, after a prolonged period of real exchange rate appreciation, raised concerns on the ability of countries to service the higher external debt.

- Market sentiment was affected by concerns over the sustainability of the exchange rate levels given the regional economic slowdown and outflows of capital. This led to the perception that the region's currencies were generally overvalued.

- Liberalisation led to a large build-up of non-resident investment in the domestic financial markets. This made official reserves more vulnerable to capital outflows.

- As the crisis developed, concerns over vulnerability to external shocks were replaced by concerns over the stability of the region's banking systems. Financial systems in the region were viewed as fragile due to the high credit growth in recent years and the tendency for the allocation of credit to be skewed to non-tradeable and higher-risk sectors, particularly the property and equity markets. As interest rates were raised to contain inflation and discourage capital outflows, banking systems were viewed to have become more vulnerable to a deterioration of their asset quality. Although there were marked differences in the level of non-performing loans of countries in East Asia, the issue of banking sector vulnerability was generalised by the market as a common problem in the region.

The build-up of these vulnerabilities and the global exchange rate realignments against the United States dollar did not entirely explain the sharp correction in the region's currencies and equity prices over a relatively short time period and the speed of the contagion effects. The impact of the changes in market sentiment and investor confidence played a central role in magnifying the extent of currency depreciations and stock market declines. The rapid increase of foreign portfolio investment and international bank lending to East Asia, amidst the euphoria surrounding the region during the period of strong economic growth and booming asset markets, has also been a contributory factor. The excessive optimism and confidence led to an inadequate assessment of risks by international rating agencies, creditors and investors alike in view of the potential high rates of return from loans and investments. The inadequate risk assessment, despite the availability of information, was prompted by views that there were implicit guarantees by governments. The exchange rate stability that prevailed also encouraged capital inflows and the accumulation of private sector external debt, given the narrow spreads on loans. However, as adverse developments unravelled in some of the region's economies, the market began to reappraise the economic and financial situation, leading to the perception that there existed a common set of high risks in the region. The "herd mentality" that prompted the capital inflows into the region became apparent after the outbreak of the crisis, when equally massive reversals of capital flows occurred. According to an estimate by the International Monetary Fund (IMF), net private capital inflows into Asia in 1997 fell sharply to US$34.2 billion from US$101.2 billion in 1996, due mainly to the sharp decline in net portfolio investment and the net outflow of other investment (which included short-term and long-term lending). In addition, the lack of a pro-active role by the international community to facilitate the markets in differentiating the economic and financial conditions and developments among the region's economies accentuated the crisis. The financial market volatility was exacerbated by credit downgrades by international rating agencies, political uncertainties generating concerns over the commitment to undertake drastic policy measures and a reassessment of the region's short- to medium-term economic outlook and stability of the banking system. Confidence was further eroded by the emergence of debt repayment problems in several of the region's economies, which raised the concerns of debt defaults or moratoria.

During the initial stage of the crisis, the monetary and regulatory authorities attempted to stabilise their currencies by intervening in the foreign exchange markets, raising domestic interest rates and introducing selective administrative measures to curb speculation in the currency and equity markets. However, these measures proved insufficient to stem the selling pressures and stabilise the foreign exchange markets. At the same time, intervention in the foreign exchange markets became very costly as it resulted in the depletion of foreign exchange reserves. Similarly, raising domestic interest rates to support the local currencies had the perverse effect of exacerbating the current phase of economic downturn and contributing to the decline in equity prices in the region. Subsequently, since early July, the currencies were allowed to move in response to market forces.

Given the severity of the financial crisis, a more comprehensive solution was sought by policymakers. In this regard, the region's economies shifted their focus to improving the domestic economic fundamentals and enhancing the soundness of the banking system, while at the same time addressing the structural weaknesses in their economies. For several countries in the region, this effort was supported by international financial assistance packages to restore macroeconomic and financial market stability, and undertake reform and restructuring programmes, as well as to replenish their foreign exchange reserves to enable them to fulfil their short-term obligations. In July, the IMF approved the Philippines' request to extend the current Extended Fund Facility until end-year and to augment it by US$435 million. The Philippines had also indicated plans to seek another US$2.7 billion from the IMF as a precautionary stand-by arrangement and additional funds from the World Bank and the Asian Development Bank (ADB).

Thailand put in place a comprehensive adjustment programme in August 1997, in collaboration with the IMF. Financing of the US$17.2 billion programme was from multilateral and bilateral sources, including contributions from the IMF, the World Bank, the ADB and several Asia-Pacific countries, namely, Japan, Australia, Hong Kong, Special Administrative Region (SAR), China, Malaysia, Singapore, Indonesia, the People's Republic of China and Brunei Darussalam. After a brief period of political uncertainty, culminating in the establishment of a new Government and further pressures in the financial markets, the Thai authorities proceeded to introduce measures to achieve the targets as set out in the IMF programme. Fiscal consolidation measures involving cuts in public expenditure and increases in tax revenue were instituted, monetary policy was tightened and a floating exchange rate regime was maintained. Concrete steps were also taken to address weaknesses in the domestic banking sector, beginning with the suspension of 58 domestic finance companies facing bad loan problems. In a further step to rehabilitate the banking sector, a comprehensive financial reform programme was announced in October 1997. The key measures of the programme included the establishment of the Financial Restructuring Agency (FRA) and the Asset Management Corporation (AMC) to administer and facilitate the process of restructuring or closure of the suspended finance companies; establishment of a deposit insurance scheme to protect depositors; provision for majority foreign ownership of up to 100% in local financial institutions for a period of 10 years; recapitalisation of financial institutions and enhancement of the powers of the Bank of Thailand to restructure and replace the management of troubled commercial banks. On 8 December 1997, the FRA announced the closure of 56 of the 58 suspended finance companies in a sweeping reform of the banking sector, and the AMC proceeded to isolate the good assets from the bad assets of the closed finance companies to be transferred to healthy financial institutions. Meanwhile, the other financial institutions which remained in operation were ordered to comply with stricter regulations and disclosure rules. At end-January 1998, the Thai authorities removed the capital and foreign exchange controls that were imposed during the speculative attack on the Thai baht, reflecting increased confidence in the Thai baht.

Meanwhile, Indonesia sought assistance from the IMF on 8 October 1997. The IMF put together a financial support package totalling US$43 billion for Indonesia, comprising first line credits amounting to US$23 billion from the IMF, the World Bank, the ADB and a drawdown from Indonesia's own reserves, and “second line of defence” contributions of about US$20 billion from Singapore, the United States, Japan, Australia, Malaysia and Brunei Darussalam. The financial package was in support of a fiscal consolidation programme to achieve budget and current account surpluses in the medium term via cuts in Government expenditure and deferment of major infrastructure projects, tight monetary policy, and reform programmes to liberalise the domestic markets and external trade. Sixteen commercial banks were closed in a move towards consolidating the banking sector. Domestic conditions, however, hampered progress in meeting the conditions of the IMF package. The announcement of the 1998/99 Budget was perceived by the markets as contradicting the conditions of the package. In addition, mounting concerns over the external debt burden problem caused the rupiah to depreciate to an all-time low of US$1=Rupiah17,100 on 22 January 1998. In response to the worsening financial market conditions, the Government of Indonesia signed a letter of intent to reaffirm Indonesia’s commitment to the conditions of the package. Subsequently, the 1998/99 Budget was revised to conform to the fiscal programme of the financial package, and non-essential infrastructure projects were postponed, while market-oriented reforms and deregulation were announced by the authorities. Further steps to rectify the financial sector problems were also undertaken by the Government, involving the establishment of the Indonesian Bank Restructuring Agency (IBRA) to consolidate and recapitalise weak financial institutions, the imposition of a tighter regulatory and supervisory framework, and guarantees on the banking system’s domestic and external liabilities. Several merger proposals were also announced as part of the overall effort to consolidate the domestic banking sector. Meanwhile, in a move to address the external debt problem, the Government proposed a voluntary framework for a temporary freeze on external debt servicing by Indonesian debtors and the establishment of a committee to work out a new arrangement between lenders and borrowers.

In the case of Korea, the Government announced on 5 December 1997, that it had obtained international assistance amounting to US$58.4 billion to support its economic and financial stabilisation programme. Multilateral agencies, namely the IMF, the World Bank and the ADB, contributed a total of US$35 billion, while the remaining US$23.4 billion of bilateral contributions were pledged by Japan, the United States, the United Kingdom, France, Germany, Italy, Australia, Canada, Belgium, Netherlands, Sweden, Switzerland and New Zealand. The loan package for Korea was the largest ever arranged by the IMF. The measures prescribed by the conditions of the package were broadly similar to those for Thailand and Indonesia. The authorities were required to implement measures to ensure a budget surplus in the medium term, contain current account deficits and inflation as well as implement market-oriented structural reforms and liberalisation in the various sectors of the economy. The authorities were also required to rehabilitate and restructure the ailing banking sector, involving measures such as the closure of insolvent banks, adoption of strict banking regulations and supervision in accordance with international standards and relaxation of rules on foreign operations and ownership in the banking sector. In addition, the Government also took firm steps in dealing with the external debt. The effort began with the negotiation and agreement with international creditors in December 1997 to roll over short-term liabilities maturing at the end of 1997 and January 1998 to March 1998. Subsequent rounds of negotiations ended with a formal agreement on 29 January 1998 between the Government and international creditors to restructure Korea's short-term external debt through the exchange of US$24 billion short-term debt into new Government-guaranteed loans with extended maturities.

In dealing with the regional financial crisis, Malaysia implemented a self-initiated adjustment programme. The 1998 Budget contained policy measures to overcome the external shocks and weaknesses in the system. These involved measures to reduce the current account deficit, maintain fiscal discipline and improve the nation's resource position as well as to contain credit growth and strengthen the banking system. Subsequently, further measures were announced by the Government to reinforce and enhance the Budget measures. Several measures were introduced to strengthen the banking system (for details, refer to the Overview in Chapter 1).

The contagion effects of the regional currency crisis underscored the need for closer regional co-operation in stabilising the financial markets, preventing systemic risks and maintaining investor confidence. In this regard, the momentum towards a new mechanism for regional co-operation was initiated during a meeting of ASEAN Finance and Central Bank Deputies in Manila on 18–19 November, 1997. The meeting endorsed a proposal, subsequently referred to as the Manila Framework, which involved initiatives on four fronts: a mechanism for regional surveillance; technical assistance to enhance domestic financial systems and regulatory capabilities; measures to strengthen the IMF's capacity to respond quickly to a financial crisis; and a co-operative financing arrangement to supplement resources from the IMF and other international financial institutions.

The crisis in East Asia is unprecedented in terms of degree and extent. Given the region's increasing importance and integration with the global economy and international financial markets, the adverse consequences of the turmoil are expected to reach beyond the regional boundaries. Uncertainty remains with regards to the duration and the spread of the crisis, which could eventually alter the world economic and financial environment, and thus the short- to medium-term outlook for the world economy.

World Economic Outlook

In 1997, the overall macroeconomic conditions of the industrial countries improved, as reflected in a higher combined real GDP growth of 2.8%, amidst lower inflation of 2% and significant progress in reducing their fiscal deficits. Nevertheless, there was a marked cyclical divergence in the economic performance among the major industrial countries. Growth in the economies at the mature stage of expansion, namely the United States and the United Kingdom, strengthened in 1997, supported mainly by strong domestic demand. Meanwhile, the cyclical upturn in Europe and the depreciation of the Deutsche Mark resulted in an export-led recovery in Germany. In Japan, economic recovery faltered after the first quarter of 1997 due to the negative impact of the fiscal consolidation measures and the weak financial sector on domestic economic activity, which more than offset the stimulus from strong export growth. In the developing countries, real output growth moderated in 1997, with growth in the South-East Asian region being adversely affected by the sharp exchange rate and interest rate adjustments from the regional financial crisis.

The prospects for the international environment in 1998 continue to remain favourable although growth is expected to moderate. Real GDP of the **industrial countries** as a group is projected to grow more moderately by 2.4%, reflecting slower economic expansion in the United States and the United Kingdom, as well as continued weak growth in Japan. The stronger recovery in Germany would help sustain global economic growth. World trade is projected to expand at a slower pace of 6.2% (1997: 8.6%).

Real GDP growth in the United States is expected to slow down to a more sustainable pace of 2.4% in 1998 (1997: 3.8%). The moderation reflects the slower pace of domestic economic activity and weaker export growth, arising from a slowdown in external demand and the deterioration in export competitiveness following the appreciation of the

United States dollar. Although the economy could slow down on its own impetus and through the effects from the East Asian crisis, the slowdown is expected to be gradual as recent developments, such as continued high consumer and business confidence, the rally in the equity and bond markets and the decline in long-term interest rates, point to a strong growth momentum in the early part of the year. Alternatively, should domestic economic activity exhibit resilience to the dampening factors, inflationary expectations could emerge.

In Japan, growth is expected to remain sluggish at 1.1% in 1998 (1997: 1%). Export growth is expected to be affected by the deceleration in growth in East Asia, which accounts for more than 40% of Japan's total exports. Domestic economic activity is also expected to remain weak, with confidence and business sentiment being adversely affected by the restraint on public spending. In December 1997 and February 1998, the Japanese authorities introduced several measures aimed at reviving domestic economic activity. These measures included the introduction of the fiscal stimulus to boost private sector expenditure through the reduction in corporate tax and reinstatement of the special income tax allowance, provision to address the banking sector problems and the announcement of financial sector reform and liberalisation. Concerns that these measures might not be sufficient to bring about the desired effects of restoring consumer and business confidence and resolving the banking sector problem prompted the international community to call upon Japan to introduce a more substantive economic and financial package.

Germany is expected to sustain its economic recovery, with real output growth of 2.6% in 1998 (1997: 2.3%), boosted mainly by export growth amidst continuing expansion in the European Union (which accounted for more than half of Germany's exports) and a pick-up in business investment. Unemployment, however, remains high and could jeopardise the prospect of a sustained economic recovery by dampening private sector spending. Although the unemployment rate is expected to stabilise, it remains one of the highest in Europe (11.4%). High unemployment in Germany, and in Europe generally, amidst the current phase of economic expansion reflected structural impediments to the process of job creation. Therefore, labour market reform remains an issue. A more flexible and efficient labour market would enable Germany to benefit from the cyclical upturn.

Table 3.1
Industrial Countries: Key Economic Indicators

	Average 1990-94	1995	1996	1997*e*	1998*f*
	Annual change (%)				
Real GDP					
Industrial Countries	**1.8**	**2.2**	**2.5**	**2.8**	**2.4**
United States	1.8	2.0	2.8	3.8	2.4
Japan	2.2	1.5	3.9	1.0	1.1
Germany	2.9	1.8	1.4	2.3	2.6
United Kingdom	0.9	2.7	2.3	3.5	2.4
Consumer Prices					
Industrial Countries	**3.6**	**2.4**	**2.3**	**2.0**	**2.1**
United States	3.6	2.8	2.9	2.4	2.6
Japan	2.0	–0.1	0.1	1.7	0.8
Germany	3.7	1.8	1.5	1.8	2.3
United Kingdom[1]	5.0	2.8	2.9	2.7	2.7
	% of labour force				
Unemployment					
Industrial Countries	**7.4**	**7.7**	**7.7**	**7.5**	**7.4**
United States	6.6	5.6	5.4	5.0	5.2
Japan	2.4	3.1	3.3	3.4	3.3
Germany	7.6	9.4	10.3	11.5	11.4
United Kingdom	8.6	8.2	7.5	5.7	5.1
	US$ billion				
Current account					
Industrial Countries	**–25.2**	**+35.2**	**+21.5**	**+16.9**	**–45.8**
United States	–75.8	–129.1	–148.2	–177.5	–230.2
Japan	+97.4	+111.4	+65.8	+94.9	+98.9
Germany	–4.6	–23.6	–13.1	–8.2	–4.8
United Kingdom	–16.6	–5.8	–0.7	–2.0	–16.8

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

Source: IMF World Economic Outlook, December 1997.

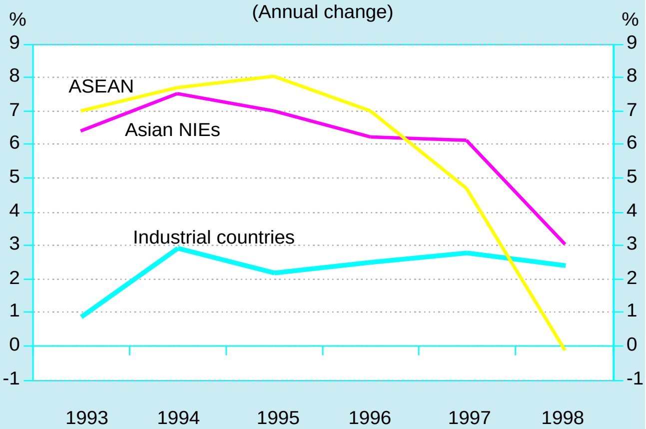
The outlook in the United Kingdom is for a slower growth of 2.4% in 1998 (1997: 3.5%), reflecting the dampening effects of tight monetary conditions. The increases in interest rates and the continuing process of fiscal consolidation would dampen expenditure. On the external front, exports of manufactures would be affected by both the increases in interest rates in 1997 as well as the appreciation of the pound sterling. The key issue is the extent to which the slowdown in domestic demand would ease inflationary pressures in the economy. Consumer spending and a buoyant services sector have been the key contributory factors in fuelling inflationary pressures and mitigating the favourable impact of the strong currency on import costs.

Inflation in the industrial countries as a group is expected to be marginally higher at 2.1% in 1998

(1997: 2%). Although cheaper imports from East Asia and soft commodity prices would contribute to keeping inflation in the industrial countries under control, inflationary pressures would emanate from higher wage increases in countries with tight labour markets and diminishing excess capacity in the economies that are recovering. In the United States, consumer prices are expected to rise by 2.6% (1997: 2.4%), reflecting tight labour market conditions and an increase in services inflation. Similarly, in the United Kingdom, the core inflation rate is expected to remain high at above the official target rate of 2.5% in 1998 (2.7%), despite the expectation of slower growth as wage pressures are anticipated from the continued tight labour market situation. Meanwhile, continued economic recovery and the effects of the weak Deutsche Mark on import costs are expected to raise inflation in Germany to 2.3% in 1998 (1997: 1.8%). In contrast, a lower inflation rate of 0.8% (1997: 1.7%) is projected in Japan, reflecting primarily the weakness in the domestic economy.

The volume of world trade is expected to expand more moderately by 6.2% in 1998 (1997: 8.6%), due primarily to the slowdown in economic growth in East Asia (including Japan), which accounts for about 25% of world trade. The current account balance of the industrial countries as a group is projected to revert to a deficit of US$45.8 billion in 1998. In the United States and the United Kingdom, the current account deficit is expected to widen substantially, following slower export growth relative to import growth. Meanwhile, Japan is likely to register a slightly higher current account surplus, following a large increase in 1997. In contrast, Germany's current account deficit is expected to narrow further to US$4.8 billion due to stronger export growth.

Graph 3.2
Real GDP Growth: Industrial Countries, Asian NIEs and ASEAN



Although some stability has been achieved in **East Asia** following the outbreak of the crisis in mid-1997, the outlook for the region is still uncertain. Nevertheless, the economic and financial disruptions arising from the crisis are projected to dampen the growth prospects of the member countries of the Association of South-East Asian Nations (ASEAN) and the Asian Newly Industrialised Economies (NIEs) in 1998. Domestic demand is likely to be adversely affected by both monetary and fiscal tightening, rising unemployment, structural reforms and negative wealth effects from the sharp declines in property and equity prices. As a result, economic activity in the ASEAN countries as a group is expected to be virtually stagnant (real GDP: -0.4% to 0.1%). Amongst the ASEAN countries, Thailand is expected to experience negative GDP growth of 3–3.5%, Indonesia's economy is projected to stagnate, while growth in the Philippines is expected to slow down to 2.4–3.5%. In all these countries, the main stimulus to growth will be the export sector, which is expected to benefit from the depreciation of their currencies. In the Asian NIEs, the combined output growth is expected to decelerate to 2.7–3.3%. While the Korean economy is projected to be virtually stagnant, a deceleration of growth is expected for Singapore and Hong Kong SAR, China. In contrast, Taiwan, ROC, which experienced minimal contagion from the crisis, is expected to continue to grow strongly, bolstered by strong export growth and higher public investment.

On the inflation front, the depreciation would result in a sharp increase in consumer prices in the ASEAN countries as a group to about 20.7–21% in 1998. Among the ASEAN countries, Indonesia and Thailand are projected to record the highest inflation rates of 40% and 11.6% respectively, due mainly to higher import prices, amidst supply shortages especially of food products and deregulation of the prices of utilities and other price-controlled items. Crop production is expected to be affected by adverse weather conditions. Meanwhile, price pressures are also expected to worsen in the Asian NIEs, where the average inflation rate is expected to double to 6.9%. In Korea, higher prices for imports and the increase in taxes could cause its inflation rate to rise above 10%.

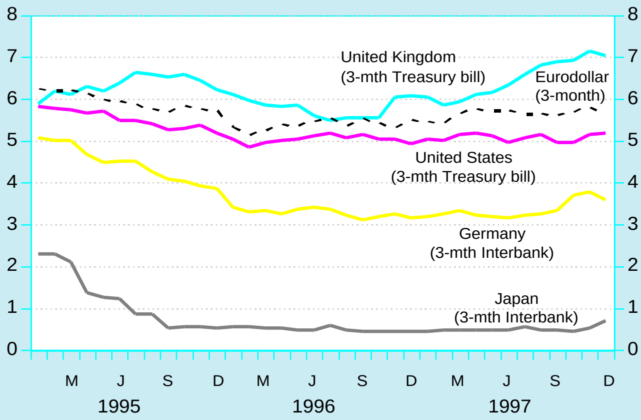
The structural adjustments in East Asia are expected to strengthen the prospects for a major improvement in their current account positions in 1998. Favourable developments include lower imports, particularly of capital goods, due to the cutbacks in spending on infrastructure projects and slower domestic consumption. At the same time, the depreciation in the currencies is expected to improve their overall export competitiveness. Among the Asian NIEs, the current account positions of Korea and Hong Kong SAR, China, are expected to improve further in 1998, due mainly to the improvement in the trade account. In particular, Korea's current account is expected to turn around to record a large surplus of US$10 billion in 1998. Given its service-based economy with a strong regional orientation, Singapore's external sector is expected to be affected by the slowdown in regional trade, mainly arising from lower services receipts from port and air transport-related activities, banking and tourism.

The risks to the growth forecasts are that any unfavourable political, social or economic development could trigger another round of instability in the region. If market sentiment worsens and the crisis is prolonged, the contagion effects would likely be more widespread, and may dampen further the global outlook. Against such developments, the ASEAN economies and the Asian NIEs may experience a sharper slowdown than currently envisaged, while the slowdown in the industrial countries would be more significant. Real output growth in several countries could be slower than projected in the event of a slowdown in export demand. Growth in these countries would be dependent on higher exports to offset the compression in domestic consumption and investment.

In the aftermath of the financial crisis, the main challenge for the economies in the East Asian region is to undertake the necessary adjustments in both the economic and financial sectors, in order to weather the adverse effects and to become more resilient to external shocks in the future. The success of the measures would depend on the speed and timing of the implementation and also on the international environment, particularly the growth performance and the import demand from the industrial countries. Of importance is the restoration of confidence in the financial system. A related issue is the external debt problems, which, if not resolved soon would further erode investor confidence. Meanwhile, for countries which are experiencing asset price deflation, the risk of a sharper decline in asset prices could exacerbate the projected economic slowdown in these economies.

Monetary policy in the major industrial countries remained unchanged during the first two months of 1998. For the remaining part of the year, the conduct of monetary policy is expected to be influenced by both domestic and external developments. In the United States, the issue is whether the East Asian crisis and the strong United States dollar would dampen growth and ease inflationary pressures in the economy, thus obviating the need for monetary tightening. On the other hand, the recent decline in long-term interest rates and its potential positive impact on interest rate-sensitive sectors, the rebound in the equity market and continued high consumer and business confidence could boost domestic demand. In view of the uncertainties about the net impact of these influences on growth and inflation, the Federal Reserve Board of the United States is expected to adopt a neutral stance in the near future. Meanwhile, in the United Kingdom, the February Inflation Report by the Bank of England warned of potential inflationary risks, arising from the tight labour market and the continued rally in the equity market, despite the projected moderation in output growth. Thus, the monetary authorities have not ruled out the possibility of another round of increases in interest rates. Short-term interest rates in Germany are expected to be increased to ensure maintenance of non-inflationary growth in the run-up to the establishment of the European Monetary Union (EMU). However, the high structural unemployment in Germany could dampen private sector expenditure, thereby affecting the economic recovery and hence may delay any monetary tightening in the near term. In Japan, monetary policy is expected to remain accommodative in 1998 to complement the fiscal stimulus measures and various economic and financial reforms to reinvigorate the domestic economy.

Graph 3.3
Industrial Countries : Short-Term Interest Rates



Box V

Implications of Recent Ringgit Depreciation on the Malaysian Economy

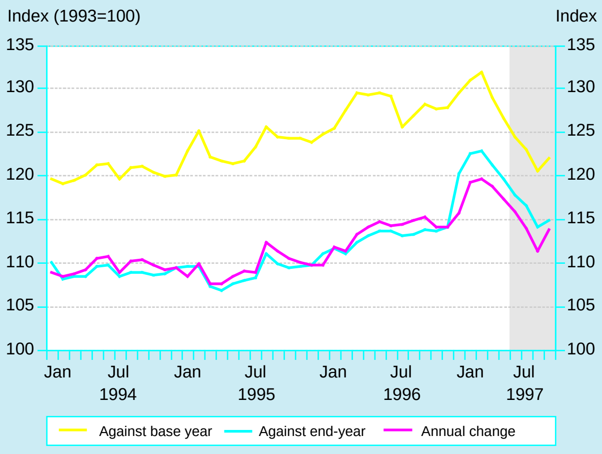
In 1997, the ringgit depreciated by 31.4% against the United States dollar and at mid-March 1998, it traded in the range of RM3.80-RM4.00 to the United States dollar. Since adopting the floating rate regime in 1975, the lowest rate recorded against the United States dollar was RM4.88 on 9 January 1998 and RM7.92 against the pound sterling on 7 January 1998. When the crisis started in July 1997, the ringgit was RM2.52 against the United States dollar and RM4.21 against the pound sterling. Depreciation of the domestic currency in such large magnitudes has serious implications on the economy, in particular, in the medium term. The impact of the depreciation on the economy is covered in this Article.

Signal of Impending Crisis

Prior to July 1997, there was some evidence of imbalances in the Malaysian economy in terms of a current account deficit, some asset inflation and high credit growth. Policies had been put in place to address these weaknesses and results had already emerged. More specifically, these imbalances were already being adjusted and were not so severe that by themselves they could precipitate a crisis. In other words, there were no "fundamental risks" of an impending crisis in terms of devaluation of the currency or a crisis in the financial markets. The "pre-episode" period of the financial crisis in South-East Asia (1994–96) witnessed evidence of favourable economic fundamentals in terms of steady inflows of foreign direct investment into Malaysia, build-up of international reserves and a stable ringgit. Furthermore, this period was not characterised by a sharp appreciation of the ringgit or a loss of international reserves. In addition, the net reserve ratio was high given ample international reserves and a low level of short-term debt. The relevant financial indicators that signal an impending banking stress (Kaminsky and Reinhart, 1996, Goldstein and Turner, 1996 and Demirguc-Kurt and Detragiache, 1997) were favourable for the Malaysian economy during the pre-episode period, notably stable money multiplier, low international interest rates, low inflation rate, stable exchange rate and a moderation in prices in the asset markets. Most noteworthy was an upward trend in the crisis index, that reflected an appreciation of the real effective exchange rate and build-up of international reserves (see Graph V.1). This favourable trend reflected a stable ratio of M2 to international reserves as well as the ringgit. Although there were some economic imbalances, the key variables also indicated the presence of relatively sound economic fundamentals which placed Malaysia in a less vulnerable position. Hence, while it is not unreasonable to expect contagion effects of the crisis, the contagion appeared to be greater and more widespread than expected. The extent of the contagion effect could be attributed to other developments in the country.

Policy measures have focused on reducing domestic absorption to alleviate the vulnerability of the current account as well as instituting both structural and financial reforms to minimise the effects of the "external shocks" to the economy. The medium term issues include measures to counter the erosion of external competitiveness, emphasis on productivity enhancement as a

Graph V.1
Crisis Index, 1994-1997



source of growth to complement expansion of capital formation and identification of new growth areas. With a weak ringgit, inflationary pressures and upward pressure on wages have been contained through consistent macroeconomic policies, including structural, fiscal and monetary measures reinforced by prudential measures to strengthen the banking system. Notwithstanding that the financial system entered the regional crisis from a relatively strong position, strengthening of the financial system has been necessary to limit the high costs of a potential failure of the banking system. More importantly, strengthening the banking system would ensure financial resilience in the wake of additional contagion effects of the regional financial crisis.

The duration and depth of the crisis is expected to have an impact on all aspects of the economy. The most studied issue in international economic theory on the consequence of a devaluation of the domestic currency is the potential contraction of economic growth (Krugman and Taylor, 1978). The contraction of the economy is generally reflected in a decline in aggregate demand for goods and services as well as a deterioration in the trade account. Indeed, exports usually did not increase, while intermediate imports necessary for production would not decline, creating a possibility of slow growth and higher inflation. However, the economy would expand in situations in which exports are responsive to price changes,

Table V.I
Currency Crisis and Key Financial Indicators: 1994-97

Key Indicators	1994	1995	1996	1997
	Annual Change (%)			
Real GDP	9.2	9.5	8.6	7.8
Inflation rate	3.7	3.4	3.5	2.7
Gross exports	27.0	20.2	6.5	12.4
Gross imports	32.8	24.6	1.5	12.0
Total external debt	6.1	15.8	16.3	68.2
Short-term capital flows (RM billion)	–8.5	2.5	10.3	–14.2
Real effective exchange rate [1]	–3.5	–0.1	4.5	–24.5
Domestic credit expansion	16.5	28.3	27.6	26.5
Stock market capitalisation	17.9	11.2	42.6	–53.4
Ratio of private credit to nominal GDP (%)	116.0	130.2	143.0	161.4
Money multiplier (M3)	5.59	6.02	5.53	5.40
Reserves adequacy ratio (M3 to reserves)	3.3	4.3	4.7	6.6
3-month US LIBOR (%)	4.87	6.00	5.46	5.75

[1] Source: J.P. Morgan

and cases in which intermediate imports did not account for a significant share of imports. On the aggregate supply side, the contraction essentially reflects higher domestic cost of production due to costlier imported inputs and services, high nominal wages and financing cost. A higher cost of borrowing leads to an increase in the cost of financing working capital. This so-called “Cavallo effect” will cause a contraction of aggregate supply, which will then result in a “supply shock” to the economy and a “cost shock” for industries.

The pervasive effects of the ringgit’s depreciation and the stock market declines on the domestic economy are expected to be more pronounced in 1998. Following policy measures to consolidate the economy, **real aggregate demand** is envisaged to decline particularly in the first half of 1998. **Private consumption** is envisaged to show a marginal increase in 1998, reflecting the negative wealth effects due to the decline in the capitalisation of the KLSE, measures to curb excessive spending, and promotion of national savings. Consumption would also be affected by the expected slower growth in real disposable income, and higher prices of imported goods. Private consumption is not expected to be affected by a potential redistribution of income from labour to capital. **Public consumption** is projected to decline sharply in 1998 in line with the Government’s austerity drive.

The volatility of the ringgit, however, has made decisions to invest increasingly difficult. Theoretically, the pace of aggregate investment would be influenced by considerations such as the increase in prices for imported capital goods and high nominal wages. Furthermore, investors would also perceive that the market value of investment may be lower than its “replacement costs”, reflecting the so-called Tobin Q theory of investment. This would discourage investment activity. In the wake of the higher nominal interest rates, it is expected that certain inefficient firms would exit from the market, and be replaced by efficient firms that would be able to accept higher costs of financing. An adverse result of this development could be the proliferation of riskier projects that are associated with higher expected returns. A combination of these factors together with the Government's austerity programme, is expected to result in a decline in real **private investment in** 1998.

The production and investment composition would also change in the wake of the ringgit's depreciation. Production activities by domestic-oriented industries could be discouraged, while those of export-oriented industries which receive "windfall" profits from exchange rate valuation gains would be encouraged to expand their activities. For the economy, too rapid a shift of resources over a short period could lead to misallocation and inefficiency of utilisation of resources. The higher nominal domestic value of a weaker ringgit would imply higher remuneration, and hence send out the wrong price signals.

The weak ringgit is envisaged to have a marginal impact on the demand for higher wages. In the labour market, some softening in the labour situation has begun to emerge, especially in the construction and services sectors. According to "Okun's Law" a moderation of real growth to 2–3% could generate potential unemployment in Malaysia of 3.5% in 1998 (1997: 2.7%).

A more important concern is the emergence of greater competition in the region as economies compete for market shares in similar products. Malaysia has some degree of comparative advantage in the export of higher value added and capital intensive goods. However, in the endeavour to increase supplies to the global market, Malaysia would face lower prices as an excess supply of products could emerge (problem of "aggregation" of products). A positive impact of the depreciation of the ringgit by over 30% is that it would provide flexibility for Malaysian exporters to "price to the market" by lowering export prices in United States dollars. This would be an advantage as long as the gains in export prices exceed the rise in import prices of intermediate inputs. The more significant depreciation of the ringgit vis-a-vis other global competitors could contribute to enhance competitiveness of Malaysian exports. For the gains from the weak ringgit to have longer-term benefits to the economy, the supply of exports must be elastic and along with it an enhancement of productivity. The depreciation of a currency to promote international competitiveness is not sustainable. In the long run, enhancement of international competitiveness for exports has to reflect structural and cyclical developments in productivity and demand and the financial market conditions, rather than a weak currency.

Empirical evidence from European economies in the early 1990s showed that a real depreciation that followed a nominal devaluation, led to a stronger external sector. Similarly, for Malaysia, the external sector has responded favourably to the depreciation of the ringgit with a recorded trade surplus of RM1.6 billion in the fourth quarter of 1997. A larger merchandise account is, therefore, envisaged for 1998. Indeed, the response in trade volume was favourable compared with the experience for other economies, whereby, only 50% of the adjustment in trade volume took place in the first three years. Preliminary empirical work on the trade balance response to the ringgit movements reveal that the trade balance is expected to improve for the first two quarters, and deteriorate from the third to the sixth quarters. Since the trade balance has responded favourably to the ringgit depreciation, the so-called J-curve phenomenon of a delayed response of trade to devaluation appeared to be irrelevant during the present crisis. The J-curve phenomenon is relevant to economies where exports are settled in domestic currencies and imports are in foreign currencies. About 70% of Malaysian exports are being settled in the United States dollar vis-a-vis 65% for imports, and hence providing a net valuation gain for the trade balance. Positive policy measures have been in place to reduce the import volume, through switching expenditure to domestic goods and the postponement of projects with high import content. Since the economy is investment driven, the

Table V.II
Implications on Key Macroeconomic Indicators: 1996-98

Key Indicators	1996	1997	1998
	Annual Change (%)		
Real GDP	8.6	7.8	2–3
Real aggregate domestic demand [1]	7.0	6.4	–4.7
Real aggregate consumption	4.9	4.8	–1.9
Real aggregate investment [1]	9.8	8.5	–8.1
Inflation rate	3.5	2.7	7–8
Federal Government Budget			
(% of GNP)	0.8	2.5	0.1
Balance of payments (RM billion)			
Gross export growth (%)	6.5	12.4	36.5
Gross import growth (%)	1.5	12.0	30.9
Merchandise account	10.2	11.1	27.6
Services account	–19.5	–20.8	–25.3
Current account	–12.3	–13.4	–1.4
(% of GNP)	–5.1	–5.1	–0.5
Long-term capital account	13.5	18.7	–
Overall balance of payments	6.2	–10.9	–
Net external reserves	70.0	59.1[2]	–

[1] Exclude stocks.
[2] The above figure does not include an exchange revaluation gain of RM24.6 billion.

postponement of large projects would have an immediate impact on the trade volume, especially in moderating the import growth for investment goods.

The larger surplus in the merchandise account is expected to more than offset the larger deficit of the services account resulting in a narrowing of the current account deficit to 0.5% of GNP in 1998 (1997: -5.1% of GNP). The narrowing of the current account deficit would reflect a depreciated real effective exchange rate, increased production of tradables and import-substitution of goods and services. In the wake of the crisis, inflows of private long-term capital are expected to slow down in 1998, albeit marginally on account of an uncertain outlook for the domestic economy. The basic balance, however, is expected to show a larger surplus, resulting in an improved overall balance of payments in 1998. As a result, the higher net external reserves (post-valuation) is expected to support about four months of retained imports.

The exchange rate valuation is estimated to increase the total external debt in ringgit terms to RM166.2 billion as at end-1997 (63.2% of GNP). The total outstanding external debt is estimated to increase to RM171.8 billion (61.4% of GNP) in 1998. The servicing of external debt is not expected to increase significantly in 1998 on account of the regular prepayment and refinancing exercise as well as productive use of external borrowing by the private sector. The longer debt maturity profile would mitigate the problem of large principal payments in the short term. Hence, prudent debt management and selected measures to influence debt flows have contributed to avert excessive indebtedness of the Malaysian economy. However, there would be incidences of higher foreign exchange obligations of certain corporations, resulting in some liquidity problems.

The present inflationary pressure differs from the experience of inflationary pressures in the 1970s and early 1980s. Inflation in the earlier periods reflected higher imported inflation as the sharp increase in oil prices led to inflation in industrial countries. In 1997 and 1998, the higher prices would reflect higher prices for imports due to the decline in the value of ringgit. Prospects are for an **inflation rate in the region of 7–8% in 1998**, after taking into account the stabilisation of the ringgit, incomplete pass-through of the depreciation and the deflationary trend in the economy. The estimated magnitude of the complete pass-through to domestic price is about 5–10%, based on the preliminary analysis that a 1% rate of depreciation of the ringgit would result in a 0.05% rise in the inflation rate. The incomplete pass-through of the depreciation of the ringgit on domestic prices is due to mitigating factors such as rigidity of contracts and nominal wages, and more importantly the presence of anti-inflation policy measures. Other contributory factors include product substitutability, market structure, and the absorption of prices by traders to maintain market share.

Inflationary pressure as a result of the depreciation of the ringgit is also restrained by the relatively low share of imported items (about 20%) in the Malaysian consumer price index. Imported goods and services are denominated mainly in United States dollars and determined by world prices. The balance is accounted for by non-traded goods (like property and domestic services) that would be determined by domestic supply and demand considerations as well as a secondary impact through higher domestic cost of production as a substantial share of intermediate inputs are imported. It is not expected that the supply of non-traded goods would be inelastic as to exert pressure on domestic prices. Except for the cost of working capital, inflationary pressure are also not expected to be exacerbated by increases in nominal wages and rents. The moderation in economic growth would have an adverse impact on employment and would make job security a more important consideration, thereby alleviating pressures for higher wages.

On the impact on asset markets, the pre-emptive monetary and fiscal measures taken since 1995 had alleviated the exposure of the banking industry to the property sector. Lending for speculative activities have also remained well within prudential limits. Pre-emptive prudential measures and a relatively sound regulatory framework meant that the banking system entered the crisis from a position of strength in terms of capitalisation, quality of portfolio, provisioning and overall profit performance and low ratio of non-performing loans. Nevertheless, the uncertainty in the macroeconomic environment, in particular the large depreciation of ringgit, higher interest rates and declines in equity prices are expected to exert some stress on the banking sector.

IMPLICATIONS OF RINGGIT DEPRECIATION

Economic Growth

Contractionary Effect

- higher prices of imported inputs
- wage increase offset by job security
- increased cost of working capital
- some retrenchment of workers

Expansionary Effect

- improved trade and current account balance
- lower wage pressures

Aggregate Demand

Lower Consumption

- negative wealth effects
- higher external debt
- higher imported inflation
- redistribution of income

Lower Investment

- uncertainty and risks
- costlier imported capital goods
- disparate investment incentives
- perception of low market value: Tobin Q theory
- Government's austerity drive

Aggregate Supply

Rising cost of production: Cost Shocks

- higher price of services inputs
- higher price of intermediate inputs
- higher cost of working capital
- encourage domestic production: import substitution

Increased International Competitiveness

- " hysterisis in exports": adjustment of US$ export prices
- depreciation of real effective exchange rate
- face challenge from collective depreciation of East Asian currencies and higher cost of production at full employment

External Balance

- improved trade and current account
- expected favourable terms of trade
- expansion in export volume
- J-curve not relevant

Capital Flows

- perception of risks
- implications on capital formation
- cheaper RM will encourage FDIs

Higher External Debt in RM terms

- valuation effect
- composition of debt matters
- debt position sustainable
- low share of short-term debt

Domestic Prices

- valuation effect from imports
- partial pass-through with time lag
- industry -wide adjustment
- erosion of competitiveness of exports
- surge in prices upon recovery

Asset Market

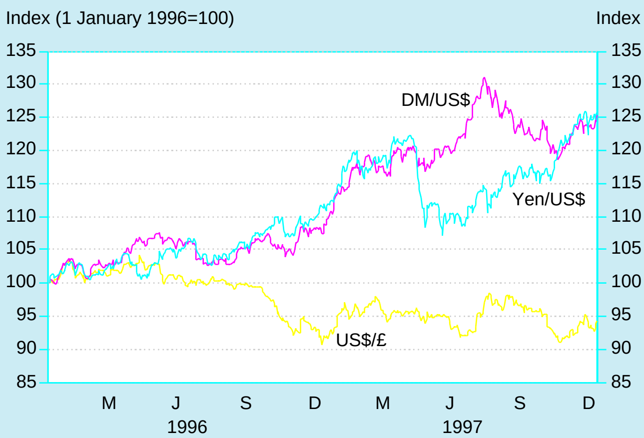
- pre-emptive measures have alleviated an asset bubble
- decline in share prices. Loss in market capitalisation
- moderation in prices of property

Banking System

- higher interest rates
- system remained sound reflecting past structural adjustments
- deterioration in asset quality affected a few institutions but they remained solvent

In the **foreign exchange** markets, the United States dollar continued to strengthen against the major currencies during the most part of January. It appreciated against the Deutsche Mark to a high of US$1=DM1.8438 on 20 January 1998 following concerns over the stability of the EMU and the persistent high unemployment in Germany, which dampened market expectations of interest rate increases in the near term. Against the yen, the dollar appreciated to reach a five and a half year high of US$1=¥134.40 on 7 January 1998 amidst indications of continued strong domestic economic activity in the United States and a pessimistic economic outlook in Japan. The new wave of selling pressures in the East Asian financial markets during the period also contributed to the strengthening of the dollar. The dollar gains were subsequently reversed, particularly against the yen, when it declined to a low of US$1=¥122.45 on 12 February 1998, as sentiments on the yen improved on expectations of a new fiscal stimulus package in Japan. However, the recovery in yen was short-lived as the dollar rebounded to above US$1=¥127.00 level on 20 February 1998, when the measures announced by the Japanese Government fell short of market anticipations of an increase in public spending or tax cuts. Meanwhile, the pound sterling was traded in the range of £1=US$1.61–1.67 during the first two months of 1998, after closing at £1=US$1.6475 on 31 December 1997, amidst uncertainties over the direction of monetary policy. For the remaining part of 1998, movements of the major currencies are expected to be influenced by a number of factors, namely, the relative strength of the major industrial economies amidst the expected slowdown in world output growth, movements in interest rate differentials, developments in East Asia and assessment on the stability of the EMU following the decision on which countries would qualify for the membership of the Union in mid-1998.

Graph 3.4
Movement of the US Dollar against Major Currencies



Malaysian Economy in 1998

The Malaysian economy ended 1997 on a weaker note as the regional financial crisis began to take effect on domestic economic activities. The full impact of the crisis on the domestic economy is expected to be felt in the first half of 1998, before recovering in the second half of the year. This will result in overall growth for the year to slow down and some increase in unemployment. While inflationary pressure, arising mainly from higher import costs due to the depreciation of the ringgit are expected to increase in 1998, indications are that the balance of payments position of the country will improve significantly. The Government is cognisant of these developments and appropriate adjustment measures have been introduced to maintain financial stability and business confidence as well as to minimise the impact of the crisis on the economy. These measures are essential to ensure an early recovery and sustainable growth over the medium term. In the immediate term, however, these adjustment measures, particularly the fiscal cutback, deferment of several large projects and reduction in credit growth to the less productive sectors, would contribute to a contraction in domestic demand in an environment of continued uncertainty in the region. The measures, however, would result in a significant improvement in the balance of payments position as well as greater efficiency in the allocation of resources towards higher value added activities. Overall, based on conservative assumptions, real GDP growth is expected to slow down to about 2–3%, after a decade of rapid growth.

Notwithstanding the slowdown in growth, the latest assessment is that growth will remain positive in the first half of 1998 with stronger growth taking place in the second half of the year. This projection is premised on prospective developments in the international and regional environment, as well as developments in the domestic economy in the context of the Government's macroeconomic adjustment programme. The implementation of the adjustment measures introduced in December 1997 as well as emerging signs of restoration of regional financial stability have had a positive effect in restoring investor confidence. On the domestic front, the measures were aimed at strengthening the balance of payments and the banking system and enhancing corporate governance in order to reduce the nation's vulnerability to external shocks. Other positive developments have been the stronger-than-projected export growth especially of electronics, and some recovery in the equity market. Should this trend strengthen, the prospects for growth could be higher. Despite these favourable developments, a number of risks remain. They include the possibility of a sharper-than-expected moderation in world growth and trade; a more prolonged regional crisis and increased uncertainty in the performance of capital flows; more intense competition; slower growth in regional trade; and the uncertain outlook for exports of electronic and electrical goods. Other risks revolve around a prolonged weakening of investor sentiment as well as a sharper-than-projected softening in consumption demand in the event of weaker consumer confidence. Recognising these risks, the Government announced a comprehensive economic package in March 1998. The package aims to limit the severity of the adjustment, maintain a positive growth for the economy and set the stage for an early recovery. More importantly, the package aims to allay concerns on the health of the banking system by outlining broad-based pre-emptive measures to further strengthen the banking system.

Notwithstanding its potentially adverse implications, the slowdown in economic growth provides an opportunity for consolidation and review. The prospects of a decline in construction activity in 1998 will allow the market time to clear the surplus office and retail space, and high-end apartment buildings after several years of over-investment. Such a correction will contribute to a better balance in demand and supply in the construction sector and more sustainable growth in the medium term. Nevertheless, the manufacturing and services sectors will continue to provide the main impetus to overall growth in 1998, supported by sustained output in the mining sector. Output in the agriculture sector is expected to decline.

Prospects are for output growth in the **manufacturing sector** to expand at a more moderate pace of 6% in 1998. The export-oriented industries would benefit from the ringgit depreciation and recent measures to enhance productivity. They are expected to expand further (5.5%; 10.5% in 1997), with sustained world demand for electronic goods, including semiconductors and electronic equipment and parts. Despite intense competition in selected items, particularly electronic chips, the demand for electronic components and parts is expected to remain favourable because of the increase in new uses for these items in non-personal computer devices, including high-end digital consumer electrical goods, multimedia equipment and automobiles. In the case of disk drives, expectations are for a recovery in demand in the second half of 1998. In contrast, the performance of the electrical products industry is expected to remain weak due to sluggish external demand for audio-visual products and air-conditioners, amidst global oversupply and excess capacity. Meanwhile, output of the domestic-oriented industries is expected to record a slower growth of 6.2% (14.6% in 1997) due to lower output of construction-related products and transport equipment industries. However, strong growth is expected in the chemicals and chemical products industry. On the whole, the manufacturing sector is expected to expand at a more rapid pace than the overall economy, raising further its share of GDP to 36.9% in 1998.

Growth in the **agriculture sector** is expected to decline by 1.8% in 1998 (+3% in 1997), reflecting lower output of palm oil and saw logs which would more than offset the higher production of rubber and cocoa. The output of palm oil is expected to be lower because of tree stress following strong growth in 1997. Similarly, saw log production is expected to decline sharply during the year in line with the sustainable forest management policy as well as weak demand from traditional buyers, including Japan, Taiwan, Republic of China (ROC) and Korea. In contrast, rubber output is expected to recover in 1998, following three years of decline, due to increased domestic demand. Value added in the mining sector is expected to be sustained (2.2%; 2% in 1997) with a turnaround in crude oil production reflecting the Government's policy to increase production and strong gas output. Tin production is envisaged to decline further.

Following the consolidation of the **construction sector** in 1997, activity in the sector is expected to decline by 4% in 1998. This would reflect mainly the projected decline in both the civil engineering and non-residential sub-sectors. Activity in the residential sub-sector, on the other hand, is expected to remain strong (4%), amidst continued strong demand for low- and medium-cost houses, which would more than offset the subdued demand for high-cost properties. The Ministry of Housing and Local Government will give priority to assist developers to convert high-cost housing units to more affordable units priced below RM150,000. In addition, the financial institutions will continue to ensure that financing is available at reasonable cost for housing projects, particularly those priced below RM150,000. However, activity in the civil engineering sub-sector is expected to decline by 10%, with the completion of several projects in 1997, and the deferment of several large and less strategic projects. Similarly, in the non-residential sub-sector, growth is expected to decline by 1.7%, as most projects are near completion and no new projects have been launched. Nevertheless, the development of the Multimedia Super Corridor as well as the on-going activity in the construction of office space, which is expected to be taken up largely by the services sector, could mitigate the decline. The 1997 BNM Survey of Office Space in Kuala Lumpur and Selangor Darul Ehsan showed that a total of 86 office buildings are at various stages of construction and are expected to supply an additional 3.2 million square metres of office space upon completion in the period 1998-2000. It is envisaged that the market for office space will be highly competitive, with wider choices and potentially lower rentals. There would be increased opportunities for foreign participation in the property market in 1998, in the light of the lifting of the RM100,000 levy, and the relaxation of rules to allow foreign participation of up to 50% (from 30%) in a project.

The **services sector** would expand further, albeit at a more moderate pace (2.7%; 7.9% in 1997) because of slower domestic demand. All the sub-sectors are expected to record slower growth, including the utilities; transport, storage and communication; wholesale and retail trade, hotels and restaurants; and finance, insurance, real estate and business services. The moderation in activity in the transport sub-sector is premised on slower growth in trade, especially within the Asia-Pacific region. In line with this trend, major transport operators are expecting more moderate revenue growth for 1998. Meanwhile, the decline in economic activity would imply lower growth in demand for new telephone lines for the telecommunications industry. Lower disposable income, coupled with the negative wealth effect of the stock market, would also moderate growth in the wholesale and retail trade, hotels and restaurants sub-sector, while the consolidation of banking activities would be translated into slower value added growth in the finance sub-sector. The services sector is, however, expected to benefit from the Commonwealth Games to be held in September 1998.

Over the last 10 years, domestic demand had consistently made a strong contribution to overall growth in the Malaysian economy. In 1998, however, the full impact of asset deflation and higher cost of imports and domestic prices as well as the fiscal austerity programme to achieve macroeconomic stability will adversely affect domestic demand in the immediate term. Aggregate domestic demand in real terms is therefore expected to decline. The main impetus to growth will emanate from net exports.

Real aggregate **domestic demand** (excluding changes in stocks) is expected to decline by 4.7% (+6.4% in 1997), reflecting a sharp decline of 11.6% in public sector expenditure and lower private spending (-2.4%). Private consumption is expected to record a deceleration in growth, while private investment is projected to decline. The forecast of a marginal growth of 1% in private consumption in real terms reflects expectations of more cautious consumer sentiment in the wake of lower real incomes and the uncertain employment situation, as well as the adverse wealth effects of the decline in stock prices. In nominal terms, however, private consumption would register a growth of 8.6%, compared with 7.6% in 1997, due to the price effect. Private investment is expected to decline by 6.8% in real terms, but increase by 0.5% in nominal terms. On a sectoral basis, investment in the construction sector is expected to moderate as the sector adjusts to the reprioritisation of bank credit as well as the deferment of several large projects. Investment in the utility sector is expected to decline with the completion of power projects as well as deferment of a hydroelectric project. Investment in the manufacturing sector is expected to increase at a more moderate pace. Indications are that the depreciation of the ringgit is unlikely to result in a major change in the investment plans of existing foreign companies and multinationals, although investment prospects could be dampened if the regional crisis is protracted. Investment in the manufacturing sector will largely be concentrated in the electrical and electronics, chemicals and chemical products and basic metals industries, reflecting the increasing shift towards higher technology and capital-intensive industries. Similarly, investment in the oil and gas and transportation sectors is also expected to be higher, with the latter reflecting additional investments by the airline companies. Overall, the Government remains committed to promote productive investment. In the 1998 Budget, several measures were also introduced to further reduce the cost of doing business and strengthen competitiveness. These included a 2% reduction each in corporate income tax to 28% and in petroleum income tax to 38%, as well as the establishment of a

RM1 billion fund to provide financial support for the small- and medium-scale industries.

Public sector expenditure is expected to decline in 1998 (-11.6%) due to lower public investment and consumption (-11.7% and -11.4% respectively in real terms; and -4.8% and -9.2% respectively in nominal terms). This reflects mainly the fiscal austerity package announced on 5 December 1997, involving a cut in both current and development expenditure. The deferment or scaling down of some projects by the NFPEs as well as the completion of the first phase of the KLIA will also contribute to the decline in public investment.

The fiscal austerity package is aimed at addressing existing economic imbalances as well as ensuring a balanced Federal Government budget in 1998 in the face of an anticipated decline in revenue following the economic slowdown. The current account position of the Federal Government is expected to record a surplus of 5.4% of GNP. This surplus would be sufficient to finance the projected increase in development expenditure to provide for higher outlays on health, education, housing and poverty reduction projects to mitigate the adverse effects of the economic adjustment on the poorer segments of the population. Notwithstanding the projected increase in allocation for such facilities, the Federal Government is expected to achieve a small overall surplus of RM336 million or 0.1% of GNP in 1998. In the event that the outturn in revenue performance is better than anticipated, continued fiscal discipline would enable a larger overall surplus to be realised. Similarly, the consolidated public sector financial position is expected to remain in surplus, as total expenditure will also be reduced in line with total available resources.

The overall **balance of payments** is expected to improve significantly in 1998, with a large surplus in the merchandise account and a reduced current account deficit. Reflecting the positive impact of the weaker ringgit on the export sector, the contraction in import volume arising from the fiscal measures and the postponement of non-critical projects with large import content, the current account deficit is projected to narrow substantially to RM1.4 billion or 0.5% of GNP (-RM13.4 billion or -5.1% of GNP in 1997). This is well below the Government's target of 3% of GNP. The surplus in the merchandise account is anticipated to increase markedly to RM27.6 billion (RM11.1 billion in 1997), due mainly to a more rapid expansion in merchandise exports (36.6%) relative to imports (30.6%). However, the weaker ringgit is expected to lead to higher net payments on freight and insurance as well as investment income. Consequently, the services deficit is expected to deteriorate further to RM25.3 billion. It is important to note that the large net payments of investment income reflect more an accounting entry as part of these profits and dividends earned by foreign investors are retained in Malaysia. Indeed, a large proportion of these funds is reinvested in the country and shown as inflows of long-term capital, so that a large segment of the current account has been generally self-financing. In the capital account, the net inflow of long-term capital is expected to moderate to RM10.7 billion, mainly on account of a lower surplus in the long-term official capital account. Net inflows of private long-term capital in ringgit terms are anticipated to moderate, but remain relatively high at RM10 billion, about the same levels recorded in 1994-95. Meanwhile, net external borrowings of the NFPEs are expected to decline to RM1 billion (RM6.5 billion in 1997). The latter essentially reflects the lower drawdown of external loans by the NFPEs and higher repayments due to the weaker ringgit. As in previous years, the Federal Government is expected to make net repayments (-RM0.3 billion). Given these developments, the basic balance would record a larger surplus of RM9.3 billion in 1998.

The prices of most major **commodities** are projected to be higher in 1998, with the overall commodity export unit value index increasing sharply by 20.8%. To a large extent, the increase is mainly attributable to the exchange rate revaluation gains on major commodities which are traded in United States dollars (except for rubber which is traded in ringgit). Hence, prices of most major commodities are expected to register significant increases in ringgit terms. Palm oil prices are expected to remain strong at US$500 per tonne. In the case of saw logs and sawn timber, prices are expected to be lower in United States dollar terms, as demand for these commodities in the Asia-Pacific region is expected to be adversely affected by the regional crisis. Meanwhile, crude oil prices are expected to moderate to US$16 per barrel (US$20.8 per barrel in 1997), reflecting the oversupply situation following the resumption of Iraqi oil exports under the "oil for food" exchange programme and the announcement by OPEC countries to increase by 10% the quota for crude oil production. At the same time, demand would be weaker in view of the financial crisis in the Asian region. Similarly, rubber prices are also expected to remain weak due to the ample supply in the world market amidst poor demand. In aggregate, total export earnings from primary commodities are projected to decline in United States dollar terms due to the decline in both export price and volume. These mitigated to some extent the revaluation gains, with total export earnings in ringgit terms projected to increase by 20.9% to RM46.7 billion, to account for 15.4% of gross exports.

Meanwhile, **exports of manufactured goods** are projected to increase sharply by 39.6% to RM249.7 billion and are expected to continue to be the leading source of export earnings with a projected share of about 82.6% of total exports. Whilst the depreciation of the ringgit helped to enhance competitiveness in most manufacturing industries, the higher export receipts would mainly reflect exchange rate valuation gains. In volume terms, manufactured exports are expected to increase by 4.4%. The manufacturing export items which are expected to record strong growth in volume terms in 1998 include electronic components and parts, chemical products and rubber products. In the case of the electronics sector, the expected strong performance would reflect the continued higher demand from the United States and Europe arising from the increased usage of electronic components in higher-end consumer products, and heavy and transport equipment industries. It was observed that keen competition arising from the exchange rate depreciation in countries in the Asia-Pacific region had prompted exporters to provide discounts in United States dollar prices in the last quarter of 1997. However, over-reliance on the exchange rate to strengthen export competitiveness would not be sustainable over the long term. Rather, the emphasis has to be on reducing the cost of production and enhancing productivity. In this regard, there is a need to accelerate the implementation of the Second Industrial Master Plan to promote more technology-intensive industries as well as to intensify the strategic shift towards the manufacture of high value added products.

Growth in **gross imports** is expected to increase by 30.9% to RM289.2 billion, mainly reflecting exchange rate revaluation effects. In volume terms, gross imports are envisaged to decline by 5% in 1998. The cutback in Government expenditure and the deferment of a number of projects as part of the policy package to strengthen the balance of payments position would contribute towards reducing import volume during the year. In particular, imports of “large items” in 1998 would be lower (RM6.3 billion; RM7.5 billion in 1997) despite the revaluation effect. The bulk of these lumpy imports would comprise mainly imports of aircraft and ships, and machinery and equipment for the oil and gas industry. Reflecting the sustained growth in the manufacturing sector, the import volume of intermediate goods is expected to increase, albeit marginally, while import volume of investment and consumption goods is expected to decline.

The outstanding medium- and long-term **external debt** of the nation is expected to expand at a moderate rate of 4.4% to RM132.1 billion in 1998 because of lower recourse to external borrowings by both the public and private sectors. In the wake of the weaker ringgit, the private sector is expected to defer new investment projects both at home and abroad, thereby reducing their requirements for funds. Consequently, the debt/GNP ratio is expected to improve to 47.3% (48.1% in 1997). Nevertheless, with the expected higher repayments in ringgit terms, the debt service ratio will increase to 7%, from 5.1% in 1997. Based on the assumption that the short-term external debt remains unchanged at end-1997 level, the outstanding external debt, including short-term debt, is expected to total RM171.8 billion or 61.5% of GNP in 1998.

Malaysia has enjoyed relatively low inflation rates during the last decade of high growth. While the impact of the depreciation on the consumer price index has been moderate until late 1997, it is expected to intensify in 1998. Indeed, the pass-through effects of the depreciation of the ringgit on domestic prices are expected to increase progressively in 1998. Taking into account both the direct and indirect impact of the ringgit depreciation, **inflation** is expected to increase to about 7–8%. This forecast has taken into consideration several factors that would mitigate inflationary pressures in 1998. These include reduced demand pressures with the projected slower pace of growth and the substitution of imports with cheaper alternative sources. Producers and traders have also tended to absorb part of the price increases arising from the depreciation in order to maintain market share in an environment of moderating consumption demand. Another contributory factor is the influence of administrative measures, including price regulation for essential goods for the low-income group. The Government is committed to the achievement of price stability as a matter of high priority. This is to ensure that inflation would not erode real income, wealth and the competitiveness of the country. A combination of tight monetary and fiscal policy is already in place to contain inflationary pressures. At the same time, administrative measures to improve the flow of information on the prices of consumer goods and to curb unfair trade practices would be stepped up during the year to ensure reasonable prices.

In line with the moderation in domestic economic activity, a weaker **employment** situation is likely to emerge in 1998. It is envisaged that retrenchments could arise in the construction-related industries and also in the manufacturing and services sectors as companies undertake restructuring exercises to reduce costs in the face of a decline in market demand or following completion of existing projects. In the context of slower economic growth, these adjustments could lead to an increase in the overall unemployment rate. However, the agriculture sector, especially the plantations, would continue to face shortages of workers. Selected manufacturing firms have also indicated a shortage of production workers. The mixed picture suggests the need for a redeployment of workers across industries and sectors. This would mitigate a further rise in unemployment. It would also help to moderate the pressure for wage increases in 1998.

The regional financial instability and the economic adjustment measures that it has entailed would inevitably lead to some disruptions to the domestic economy. While these will pose challenges that would need to be addressed, they also provide opportunities for a consolidation and review of the future direction of the economy. The crisis has brought into focus the need to re-examine the country's economic development plans and strategies. It provides a timely opportunity to assess the weaknesses and vulnerabilities of the economy, and to implement remedial measures. The regional crisis has also demonstrated the need to expedite on-going efforts to transform the structure of the economy and further develop the financial system to support new growth strategies and to better cope with the changing dynamics of the global economy. Malaysia has been fortunate in that the structural adjustments of the past two decades have contributed to rapid economic growth, strengthened the economic base and placed Malaysia in a stronger position to face the crisis. Nevertheless, the severe contagion effects demonstrate that there are several weaknesses in the domestic economy and the financial system that rendered Malaysia vulnerable to external shocks. These include the relatively large current account deficits in the past few years, the strong credit growth, and excessive demand pressures, in addition to risks in the asset markets. Expectations that economic growth will slow down significantly in 1998 have also raised concerns about the quality of bank assets. In this context, the immediate objective of public policy in 1998 is to preserve economic and financial stability and restore business confidence. The Government is fully committed to a policy of fiscal austerity and monetary restraint to address existing imbalances and ensure a speedy recovery. In particular, efforts to strengthen the financial system have also been expedited, in addition to ensuring that productive sectors continue to have access to bank credit at reasonable cost.

With rising inflationary pressures, **monetary policy** would need to remain tight in 1998 in order to mitigate the effects of the currency depreciation on domestic prices. The implementation of the credit plans of the financial institutions will be monitored closely to curb excessive growth in bank credit, particularly for less productive purposes. Given the prospects of slower economic growth and the need to manage the quality of bank assets, the financial industry would have to accord high priority to efforts to strengthen the evaluation of credit as well as to channel bank credit to productive sectors. This is important to ensure that growth in monetary aggregates is consistent with the underlying developments in the real economy. The Bank is monitoring the situation closely to ensure that productive investments are not denied access to bank financing at reasonable cost.

To enhance the efficiency and effectiveness in the **mobilisation and allocation of the country's scarce resources** towards achieving the over-riding objective of sustaining non-inflationary growth, several measures have been put in place to enhance the intermediary role of the private debt securities market to complement the banking system and the equity market in providing financing support for the economy. At the same time, parallel development in the financial market infrastructure has aimed to enhance the safety and efficiency of financial transactions. A combination of all these efforts would help to preserve financial stability, a prerequisite in maintaining market confidence and the promotion of greater private sector initiatives.

The regional financial crisis has highlighted the urgent need to **strengthen and consolidate the financial sector** in order to minimise its vulnerability to external shocks and avoid the risk of price misalignments. The policy focus would be to create financial institutions which have the commitment, capacity and ability to gear up to a higher level of competitiveness and efficiency as well as to meet the changing needs of the economy in the face of globalisation and pressures for liberalisation. Amidst these developments, the improvement of risk assessment or management is given priority. In this context, due emphasis is placed on prudential conduct and financial transparency as well as integrity to ensure that the interests of investors are safeguarded and confidence in the market place is enhanced. This would require vigilance on the part of both the participants and the relevant regulatory authorities to anticipate and pre-empt potential problems that may emerge.

In the immediate term, the focus of policy is to contain inflationary expectations and address existing economic weaknesses to facilitate economic recovery. The continued volatility in the foreign exchange markets, uncertain and unpredictable regional developments, including the pervasive impact of non-economic events on investor confidence would constrain the prospects for a quick recovery. While the economic adjustment and stabilisation package already in place should be allowed to take their course, additional policies cannot be ruled out, given the prevailing uncertainties. Concomitantly, the implementation of on-going adjustment efforts to correct existing imbalances would need to avoid an over adjustment. Additional measures may therefore be necessary to mitigate the adverse impact of an over adjustment, particularly on the lower-income groups. A budgetary allocation for a social safety net to provide for health and education services would be necessary. The focus of activities in such an eventuality would be to undertake selected projects that will serve as new engines of growth to facilitate a speedy revival in domestic economic activity. Such projects would include those that could be speedily implemented, possess high multiplier effects and strong inter-sectoral linkages, as well as utilise domestic raw materials and services, with minimal import content.

The regional financial crisis is likely to lead to a softening of the domestic labour market. Although any increase in the **unemployment** rate is expected to be small, it will still need to be managed effectively to reduce the burden, particularly on the lower-income groups. Efforts to mitigate the unemployment situation would need to include measures to improve labour market flexibility and mobility, including retraining of retrenched workers. While the Government would continue to accord priority to improve overall human resource development, the role of the private sector is crucial in ensuring that the retraining programmes are relevant to the needs of the respective industries.

While the immediate priority of public policy would be to restore confidence and stability, the longer-term challenges confronting the management of the economy would be to reassess development strategies to attain a **sustainable balance of payments position**, and to foster a productivity-driven growth. Overall, another round of economic restructuring is required for the economy to adjust to the changing international environment. The emergence of a broader group of middle-income economies, all striving to expand through an export-oriented strategy has altered the competitive advantage of many Malaysian products. The Malaysian growth strategy would need to adjust and adapt to these developments. In the real sector, while manufacturing activities would continue to lead the growth process, there is a need to develop new market niches to enable the sector to cope with the challenges of intense global competition. The key electronics sub-sector is increasingly becoming more vulnerable to external competition. The development of effective linkages in this area with the development of the Multimedia Super Corridor would ensure that value added from the latter could be enhanced. There is also a need to revitalise the agriculture sector to regain Malaysia's natural comparative advantage in this area, and provide the raw materials needed to expand the resource-based industries. New growth areas are also required to stimulate a broad-based economy. On-going measures to develop a strong ancillary services industry to support the industrialisation process are still relevant. Selected service industries, where import content is low and foreign exchange retention is high, such as tourism and education, require a well co-ordinated national strategy to realise their full growth potential.

In the wake of the regional financial crisis, considerable attention has been given to reduce the current account deficit in the balance of payments, which reached a high of 10.5% of GNP in 1995. The situation is expected to improve considerably to 0.5% of GNP in 1998, following the implementation of the adjustment measures. This improvement in the current account deficit will be achieved through both improved export performance and a decline in import volume. The completion of expansion programmes and infrastructure facilities as well as the deferment of selected projects would lead to a reduction in imports of capital goods. At the same time, the moderation in domestic demand would result in lower imports of consumption goods. While a decline in import volume is necessary to facilitate a more sustainable balance of payments position in the immediate term, a better balance in policy direction is required in the medium to long term, with the focus on increasing export earnings further to strengthen the external sector. The strategy for further improvement in the balance of payments position will focus on the promotion of exports through strengthening international competitiveness; increasing local content to alleviate the dependence on imports of intermediate goods; and encouraging long-term capital inflows into high value added industries to enhance the future export and growth potential. Amongst the many measures that have already been put in place to increase Malaysia's export competitiveness are initiatives to increase the value chain of the manufacturing process. Moves are also in the pipeline to accelerate the use of technology, including information technology, and to strengthen Malaysia's research and development capabilities. Details of other measures to increase competitiveness are discussed in Box Article VI on Malaysia's International Competitiveness.

Meanwhile, the traditional deficit in the services account indicates that much remains to be done to develop Malaysia's **services sector** to provide more comprehensive and efficient services to meet the increasing needs of the business sector. The services deficit reflects the significant increases in freight and insurance payments as well as higher outflows of profits and dividends from increased profitability of foreign investments. The weaknesses in the services sector are well recognised and there has been an intensification of efforts to enhance the development of the services sector. This sector has the potential to become a new growth area for the economy both in terms of increasing value added and strengthening of the export base. The tourism industry, in particular, is a major source of foreign exchange earnings in Malaysia. The basic infrastructure such as transportation and a wide range of hotels and tourism attractions are already in place. Further intensification of measures to promote tourism could contribute toward the reduction in the services deficit. There is also scope for the development of the private education industry, which will not only reduce education payments abroad, but also generate foreign exchange earnings. Legislative and other changes have been made to facilitate the establishment of private universities and colleges in Malaysia. The current situation offers opportunities to promote Malaysia as a regional centre for education.

As the country moves towards an industrialised nation status, more emphasis needs to be placed on fostering **productivity-driven growth** as opposed to an investment-driven growth. Measures are already in place to develop a more conducive environment that nurtures productivity-driven growth. These include the introduction of various incentives to encourage industries to move towards greater automation and higher technology activities as well as to shift the value chain of the manufacturing processes up to a higher plane. In addition, a SMI Fund of RM1 billion was recently established to assist small- and medium-scale industries to enhance their productivity. These measures are being reinforced with other strategic moves, including efforts to enhance the efficiency and capacity of the services sector to play a more pivotal role in contributing towards higher productivity in the economy. In particular, the development of the financial services sub-sector is being intensified to further enhance its efficiency in the mobilisation of investment in the economy. The development of the Multimedia Super Corridor is another area that is being pursued actively to facilitate the development of information technology and increase productivity. At the same time, it is recognised that the key to productivity and technology-driven growth lies with the development of a highly trained and skilled labour force that can effectively engage in technological innovation, and research and development. Additional measures have been introduced to further upgrade the development of human resources. In the 1998 Budget, additional allocations were provided for education and human resource development, with a view to producing a critical mass of individuals with multiple and diverse skills.

The regional financial crisis has highlighted many implications for Malaysia. On a more positive side, the crisis has provided the nation with the opportunity to consolidate its industries as well as reassess its long-term development strategies. In the process, this will enable Malaysia to place itself in a stronger position to compete in the new global environment.

Monetary Policy in 1998

Growth in the Malaysian economy is forecast to moderate significantly to 2–3% in 1998. This moderation in growth reflects the uncertain regional and international outlook that has continued into 1998 as well as the implications of the adjustment measures on the domestic economy. Although the growth of the Malaysian economy is expected to moderate in 1998, the risks of inflation remain high following the significant depreciation of the ringgit since mid-1997. In this environment, monetary policy will remain tight. Indeed, the maintenance of a tight monetary policy stance is an integral part of the economic stabilisation policy package that was implemented in 1997. This is essential to restore macroeconomic stability and thereby promote stability in the domestic financial markets. The primary focus of monetary policy in 1998 will, therefore, continue to be directed at containing any rise in inflation, in particular, inflationary expectations that may be generated by the increase in import prices following the ringgit depreciation. At the same time, prevailing uncertainties in the external environment require that monetary policy remains flexible to respond to changes in the economic environment during the course of the year. The need for flexibility is particularly important as the conduct of monetary policy in 1998 will be complicated by several elements in the external environment, notably the magnitude and duration of the regional financial crisis and the prospective course of United States monetary policy amidst concerns about the sustainability of the equity markets in the United States as well as the developments in Japan. Under these circumstances, while the focus of monetary policy will be on containing any build-up of price pressures, its implementation will be in co-ordination with other macroeconomic, structural and prudential measures to achieve the desired macroeconomic and financial stability. It will not be the intention of policy to create an over adjustment or correction of the economy.

On the domestic front, the conduct of monetary policy will also be influenced by several factors including the severity of the "pass-through" effect of the depreciation on domestic prices, as well as the need to encourage the allocation of resources to the more productive sectors. Notwithstanding the emerging strength of the current account position in the balance of payments, uncertainties remain on the net flows of short-term capital. While the most important consideration in the conduct of monetary policy in 1998 will be the need to address potential inflationary pressures, of equal importance is the need to ensure the efficiency of the functioning of the money market as well as the intermediation process. The restoration of investor confidence is not only premised on reducing price and demand pressures and re-establishing macroeconomic stability but also on ensuring access to financing by the productive sectors through an efficient intermediation process by the banking sector. To achieve macroeconomic stability, the formulation of policy will need to be based on an appropriate sharing of the burden of macroeconomic adjustment between monetary policy and fiscal policy. The maintenance of confidence in economic management makes it imperative to recognise this balance and the relative roles of monetary policy and fiscal policy as well as to ensure the efficient allocation of resources, based on market principles.

Measures that were implemented in 1997 and in early 1998 to moderate the strong credit and monetary growth have begun to show positive results. At the end of January 1998, credit growth moderated to 23.4% from the high rate of 28.6% in October 1997, while growth in M3 slowed down significantly to 16%. Given the uncertain economic environment and the need for monetary restraint to contain inflationary pressures, the moderation in credit growth will be monitored closely, to ensure that it is consistent with the projected growth of output. Based on the forecast of real GDP growth of 2–3% in 1998 and significantly higher inflation of 7–8%, the moderation in credit growth at the current pace will allow for an expansion of the monetary aggregates that is more consistent with output growth. However, in an environment of slowing economic growth, the credit growth has, in fact, moderated at a much faster pace than expected as a result of an uneven expansion in credit growth among the banking institutions. These developments, if allowed to persist can precipitate a credit crunch. BNM recognises that an effective allocation of resources to productive activities is a crucial element of public policy during a period of a slowdown in economic growth. Consequently, the need to maintain a tight monetary policy to fight inflation needs to be reinforced with appropriate policy adjustments to ensure an efficient functioning of the intermediation process.

On the inflation front, current indicators are that the sharper increases in prices that are emerging in early 1998 are caused entirely by the depreciation in the ringgit exchange rate. The rise in consumer prices reflect mainly the higher cost of imports, as evidence indicates that a significant moderation in consumption demand has already taken place since the last quarter of 1997. During the course of 1998, it is expected that aggregate demand will remain subdued and this will help to moderate the pressures on prices during the year. Furthermore, the economic slowdown, increase in unemployment and consequent concerns about job security will contribute to moderating pressures on wage increases. In 1998, the risk of a re-emergence of asset inflation is also unlikely and the erosion of wealth (following the decline in the equity market) will continue to dampen growth in consumption demand. All these factors will moderate inflationary expectations and the likelihood of demand-driven pressures on prices. However, in the immediate future, monetary policy will remain tight to dampen any rise in inflationary expectations and to facilitate adjustments in the economy when the regional financial crisis comes to pass.

The reduction of the statutory reserve requirement (SRR) from 13.5% to 10%, effective 16 February, does not represent a more accommodative policy. The objective of the measure was to enhance the intermediation process and increase the efficiency of the transmission mechanism of monetary policy through the banking system. The liquidity released to the banking system by the reduction in the SRR was more than offset by the withdrawal of funds of RM15.7 billion from the banking system. At the same time, the Bank's 3-month intervention rate in the interbank market was also raised from 10% to 11%. Given the less flexible nature of the SRR as an instrument of monetary policy, it is not used to address short-term fluctuations in liquidity. Instead, such changes in the SRR are only undertaken when there is a fundamental shift in the liquidity conditions of the banking system. There were some distortions in the intermediation process towards year-end due to the increased uncertainty, tight liquidity conditions and the consequent flight to quality of deposits. Consequently, smaller institutions faced a liquidity problem. The reduction in the SRR in February reflected the need to address this fundamental shift in the liquidity situation by facilitating the flow of liquidity to the banking system.

While monetary policy will continue to focus on reducing inflation, the tightening of fiscal policy complements such efforts by ensuring that the public sector does not aggravate demand pressures. The co-ordination of monetary and fiscal policies underscores the Government's commitment to its adjustment programme to address existing imbalances. At the same time, the appropriate fiscal-monetary policy mix will avoid placing undue pressures on the use of monetary policy to achieve price stability. In the absence of an appropriate balance between fiscal policy and monetary policy in the adjustment process, the burden of adjustment will fall unduly on monetary policy. This could lead to higher-than-optimal interest rates, which could have negative implications on the domestic economy and financial system. Of importance is that the expected real rate of return on savings will remain positive.

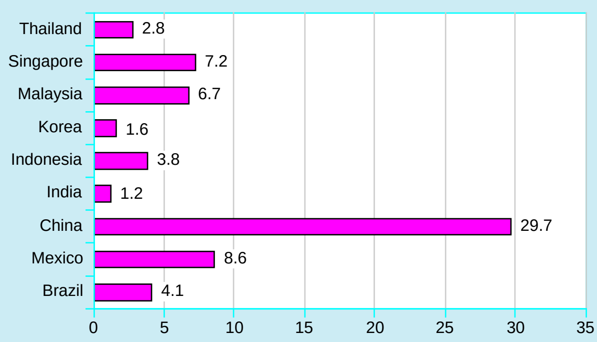
In the current environment where the regional financial crisis has imposed significant pressures on the domestic financial system, the role of monetary policy to maintain as well as to further strengthen the resilience and stability of Malaysian financial institutions assumes critical importance. This is essential to minimise the vulnerability of the financial system to external shocks as well as to further develop the banking system to meet the changing needs of the Malaysian economy as it adapts to a more competitive and integrated global environment. The co-ordination of monetary, prudential and institutional policies assumes renewed significance as the Bank focuses its policies on ensuring that banking institutions remain strong and viable, as well as become more efficient. In its conduct of monetary policy, the Bank will continue to ensure that it optimises the use of available instruments so that financial intermediation can be undertaken more efficiently and at the lowest possible cost. Structural impediments that hindered the effective transmission of monetary policy and the issue of market segmentation will continue to be resolved during the course of 1998. Among the measures that will need to be considered are those aimed at ensuring that the policy signals on the stance of monetary policy are effectively transmitted to the markets. In this regard, the Bank has initiated work to develop and strengthen the financial system through the development of more market-oriented policy instruments. Monetary management will be directed towards a sharper focus on interest rates as the intermediate target, increased flexibility in the use of the various monetary policy instruments, more flexible liquidity management, improved policy signals and the development of additional indicators of monetary conditions. It is recognised that a more market-oriented financial system will require a substantial broadening and deepening of financial markets. This will not only allow for a greater degree of securitisation and reduce the reliance on banking intermediation, but also facilitate the development of

Box VI

Malaysia's International Competitiveness

The ultimate measurement of a nation's competitiveness is its ability to effectively sell goods and services in the international market and at the same time, attract substantial foreign investment. Over the last decade, growth in Malaysia has been largely export driven, supported by large inflows of foreign direct investment. During the last few years, the international competitive position among countries has changed significantly. Competition for foreign savings as well as export markets have become increasingly more intense due to both domestic and external factors. On the domestic front, rapid economic growth over an extended period has exerted pressures on the availability of resources, with strains emerging on several fronts, notably the balance of payments and the labour market. On the external front, liberalisation in many developing countries has resulted in the emergence of new competitors, particularly the lower-cost producing countries. This development has altered Malaysia's relative comparative advantage. Technology and the globalisation of financial markets and production centres have also created new challenges for countries to maintain or gain comparative advantage in international trade. In this environment, Malaysia needs to engineer its growth strategies, and structural adjustments could be necessary to remain competitive.

Graph VI.1
Foreign Direct Investment to Selected Countries, 1991-96



Source: World Investment Report, 1997

Present State of International Competitiveness

Based on several studies undertaken by international organisations, Malaysia has been rated favourably in terms of overall competitiveness

Table VI.1
The Non-OECD Scoreboard

Overall ranking	Competitiveness ranking			
	1990	1993	1996	1997
1	Singapore	Singapore	Singapore	Singapore
2	Taiwan, ROC	Hong Kong SAR, China	Hong Kong SAR, China	Hong Kong SAR, China
3	Hong Kong SAR, China	Taiwan, ROC	Chile	**Malaysia**
4	Korea	**Malaysia**	Taiwan, ROC	Taiwan, ROC
5	**Malaysia**	Chile	**Malaysia**	Chile
6	Thailand	Korea	Israel	Israel
7	Mexico	Thailand	People's Republic of China	People's Republic of China
8	Indonesia	Mexico	Thailand	Argentina
9	Brazil	Venezuela	Philippines	Thailand
10	India	Indonesia	Argentina	Philippines

Source: World Competitiveness Report, various issues

Table VI.2
Malaysia's Ranking: Eight Factors of Competitiveness[1]

Factors		1994	1995	1996	1997
Domestic economy	Macroeconomic evaluation	4	4	7	2
Internationalisation	Extent of participation in international trade and investment flows	18	23	16	17
Government	Conduciveness of government policies to competitiveness	4	4	4	4
Finance	Performance of capital market and quality of financial services	20	21	19	19
Infrastructure	The extent to which resources and systems are adequate to serve businesses	20	21	22	27
Management	Management of enterprises in an innovative, profitable and responsible manner	12	23	15	17
Science & technology	Scientific and technological capacity	26	30	29	25
People	Availability and qualifications of human resources	29	33	34	33

[1] The World Competitiveness Yearbook analyses competitiveness of 46 countries. The country showing the best performance is ranked as first and the worst performance is ranked as last.

Source: World Competitiveness Report, various issues

as well as in attracting foreign investment. The World Competitiveness Report, 1997, published by the International Institute for Management Development (IMD), ranked Malaysia 17 out of 46 developed and developing countries (improving from 23 in 1996) in the world competitiveness ranking. Among the non-OECD countries, Malaysia was ranked as the third most competitive nation after Singapore and Hong Kong, Special Administrative Region (SAR),China.In another study conducted by the World Economic Forum (WEF) in 1997, Malaysia was ranked ninth out of 53 countries, ahead of Japan, Germany and Korea.

The World Competitiveness Report focused on eight major factors to assess competitiveness, namely, domestic economy, internationalisation, Government, finance, infrastructure, management, science and technology, and people. Malaysia's favourable ratings were due to the ability to sustain high economic growth over a protracted period with price stability, reflecting the policies to attract foreign direct investment and provide a conducive environment for business activities. The nation's growth expanded by 8.5% per annum during the period 1991–97, exceeding the average growth of developing countries as a group (6.1% per annum) and the ASEAN region (6.9% per annum excluding Vietnam). An important factor that has enabled Malaysia to achieve high growth is its competitive edge in attracting large inflows of foreign direct investment. Based on investments approved by the Ministry of International Trade and Industry (MITI), foreign direct investment surged to RM78.7 billion during the period 1991–96, compared with RM35.9 billion during the period 1985–90. Malaysia accounted for 28.8% of total foreign direct investment flows to ASEAN countries during the period 1991–96 and 6.7% of flows to developing countries. The nation's competitive position was also relatively favourable in the export sector, particularly for exports of manufactured goods. Indeed, Malaysia accounted for a rising share of 1.5% of the world's total exports at end-1996 from 0.6% at end-1970.

A key element that has underpinned the country's competitive edge has been the track record of

Table VI.3
Comparison on Stability of Currencies[1]

Period	(%)				
	RM	S$	Stg	DM	Yen
1973-92	7	11	18	20	28
1986-92	3	10	8	12	11
1991-96	4	9	8	7	13

[1] Refers to coefficient of variation of the average rate against the US dollar.

consistent macroeconomic policies which had contributed to stable financial conditions. Indeed, consistent monetary and fiscal policies have enabled Malaysia to maintain a low inflation rate and thus, ensure monetary stability. During the period 1980–96, consumer prices increased at an average rate of 3.7% per annum, compared with 9.2% in Indonesia, 7.6% in Korea and 5.5% in Thailand. The exchange rate had also been relatively stable before 1997, which facilitated the smooth conduct and settlement of international trade and investment. Calculations using the coefficient of variation of the average ringgit/US dollar rate indicate that the ringgit was one of the most stable currencies during the period 1973–96. In terms of the Real Effective Exchange Rate (REER), the index showed that Malaysia was less competitive than Indonesia, Thailand and Korea during the period 1992–96. However, this did not lead to a significant loss of competitiveness as actual competitiveness depends more on productivity gains and other factors that are not captured by the REER index. More importantly, overall international competitiveness entails not just pricing considerations but also non-price factors. For example, in the recent period of volatility, the REER does not serve as a good indicator of competitiveness. In such a situation, non-price factors such as confidence, the relative stability of macroeconomic conditions, reliability of services and availability of credit become more important to facilitate trade and investment, rather than the rate of depreciation of the currency.

Table VI.4
Financial and Real Sectors' Performance

	1979-87	1988-97
	(Average growth in %)	
Nominal GDP	8.9	13.3
International trade	11.8	19.3
Total assets of banking system	13.1	50.1
Net funds raised in the capital market (RM billion)	45.6	167.7

Malaysia's competitiveness has also been supported, to some extent, by productivity and quality improvement. Based on productivity measurement (ratio of real gross domestic product (GDP) to total employment), Malaysian workers compare favourably with selected newly industrialised economies (NIEs). This is evident in the productivity growth which rose by an average annual rate of 5.3% during the period 1990–96 (the increase in Korea, Taiwan and Singapore was 4.9%; 4.9%; and 7.4% respectively). Improvements in productivity were more pronounced in the manufacturing sector, with the increase in productivity in this sector exceeding the overall productivity growth. Malaysia has now reached a stage in its economic development where the enhancement of productivity and quality in its goods and services are the major determinants of the nation's future prospects.

Table VI.5
Competitiveness of the Banking Sector: Selected Countries

	Ranking							
	Malaysia	**Singapore**	**Indonesia**	**Thailand**	**Korea**	**Chile**	**Argentina**	**Mexico**
The policy of the Central Bank	6	3	21	22	43	20	18	40
Size of banks ranked by assets (1995)	22	28	17	15	10	38	34	22
Bank savings, 1994 [1] (US$ per capita)	26	4	38	29	28	34	31	30
Banking sector assets (as percent of GDP, 1995)	11	8	34	17	30	26	45	43
Interest rate spread, 1996 (lending rate minus deposit rate)	3	11	38	30	2	18	19	28
Legal regulation of financial institution	19	1	37	32	45	21	27	40

[1] Only include bank savings in the form of fixed-term deposits, savings books and savings deposit accounts.

Source: World Competitiveness Report, 1997

Table VI.6
Inter-Country Comparison: Cost of Doing Business

	Malaysia	Thailand	Indonesia	Singapore	Korea
1992-96			(%)		
Average lending rate [1]	9.5	12.1	19.7	6.0	11.9
Producer Price Index [2]	2.8	3.3	6.7	-1.8	2.8
Consumer Price Index	3.8	4.9	8.6	2.1	5.3
Corporate tax rate [3]	28	30	30	26	16 – 28
Power rate (Sen/KWH) [4]	22.17	21.41	-	22.26	17.64

[1] For Singapore and Korea, it refers to prime lending rate, while for Thailand, it refers to minimum loan rate.
[2] For Indonesia, Singapore and Thailand refer to wholesale price index.
[3] For Korea, corporate tax rate is 16% for income up to 100 million won and 28% for income exceeding this amount.
[4] Based on electricity tariff rates charged by selected power companies in 1997 except for Korea which is based on 1996.

Malaysia's competitive advantage has also been supported by a relatively well-developed financial infrastructure. There appears to be a strong correlation between financial sector expansion, real GDP growth, and increase in international trade. Reflecting the increasing intermediation process as trade activity expands, banking assets expanded at an average annual rate of 50.1% during the period 1988–97, while nominal GDP and international trade (total value of exports and imports) grew by 13.3% per annum and 19.3% per annum respectively. The capital market has increasingly played a more prominent role, particularly during the period 1988–97, with net funds raised from the capital market (both bond and equity markets) rising significantly by RM167.7 billion compared with RM45.6 billion in 1979–87. Based on the World Competitiveness Report, Malaysia is ranked 19 out of 46 countries in terms of performance of the banking system, the capital market and the quality of financial services.

The cost of doing business has also been relatively low in Malaysia as reflected in the low average lending rates and producer price index. Malaysia's corporate tax rate has also been reduced to 28% in 1998 compared with 30% each for Indonesia and Thailand. After taking into account tax incentives, the effective tax rate for the country is even lower. Several other factors supporting Malaysia's competitive edge include adequate physical and financial infrastructure, a pool of well educated workforce and the availability of natural resources.

Issues and Challenges

Maintenance of international competitiveness is a continuous process given the dynamic international environment. In the past, Malaysia's comparative advantage was in terms of abundant natural resources and labour to support a labour-intensive development strategy. However, with the more intense competition from emerging economies, the global scenario of comparative advantage has now changed. New approaches are necessary for Malaysia to strengthen its competitive advantage. Producing distinctive and differentiated products and investing in high value-added and knowledge-based industries may not be sufficient. Seven areas are being identified for improvement in order to increase the nation's resilience and competitiveness.

Macroeconomic, monetary and financial stability:

As a small and open economy, Malaysia is more vulnerable to world economic cycles as evident in the recent regional financial crisis. The regional crisis has exposed some of the risks in the economy, which have far-reaching implications on business decisions, inflation and asset markets, and ultimately, competitiveness. Given the current environment, policies that are firmly directed at attaining overall macroeconomic and monetary stability will help to restore confidence in the financial market and the ringgit. This calls for an appropriate mix of fiscal and monetary policies. At the same time, emphasis will also be directed at maintaining the soundness and stability of the financial system which has underpinned Malaysia's rapid rate of expansion. An important strategy is to build a well-capitalised financial sector comprising banks, insurance companies, stockbroking companies and fund managers. At the same time, strong emphasis on prudential conduct and financial transparency will instil confidence in the system. Further measures have been instituted to enhance disclosure of information and improve accounting standards that are consistent with international standards. The smooth functioning of the capital market also requires that rules and regulations of the marketplace continue to be strengthened and rationalised, with emphasis on corporate governance.

Deepening and broadening of the financial system:

The competitive environment can further be enhanced by a well-developed financial system that supports and facilitates trade and investment. The financial system must be able to respond to the needs of corporations by providing a broad range of instruments that suit the needs of customers as well as ensuring speedier and more efficient financial services at lower cost. Hence, the consolidation of the banking system with strong emphasis on liability and asset management, project evaluation and risk management is given priority. The present financial sector developments have, to some extent, induced the banking institutions to meet these challenges. The institutions have also become more active in the development of a wide range of banking activities, as well as more sophisticated retail banking services, regional banking and Labuan International Offshore Financial Centre (IOFC). The capital market is to be strengthened further in tandem with these developments. The broadening and deepening of financial market will provide an efficient and cost-effective source of funds for corporations. Efforts to further develop the capital market especially the corporate bond market, have been intensified.

Restrategising foreign and domestic investments:

Looking back, foreign direct investment has had an important role in the economic development and diversification of Malaysia. Foreign direct invesment has been beneficial to output and employment growth, and has brought with it both imported capital and new technology. The role of foreign direct invesment continues to remain significant for a small developing economy like Malaysia. More recently, efforts have been directed at attracting capital-intensive and high-technology investment. Amongst the steps that have been taken by the Government are the more selective approvals of projects, and providing a special incentive package for the establishment of wafer fabrication projects. In addition, incentives have been provided to attract companies in information technology (IT) to establish their operations in the Multimedia Super Corridor (MSC). These strategies have been successful as evident by the lower ratio of labour absorption to capital in new investments approved by MITI (three employees per RM1 million of investment in 1997 compared with 16 in 1988) and the larger average size of investments per project (RM12.4 million in 1988; RM34.2 million in 1997). The capital-intensive investments have been more pronounced in the electrical and electronics products industry, such as computer motherboards, hard disk media and silicon wafers. Investments totalling RM12.4 billion were approved by MITI during 1994–97 for the establishment of wafer projects, in response to the provision of special incentives to promote high-technology industries. Nevertheless, competition for such investments from other developing countries has also intensified over the past few years. In such an environment, a review of policies will ensure that they remain relevant and pragmatic in the new environment.

The manufacturing sector remains the key sector in Malaysia in terms of output, exports and competitiveness. Nevertheless, given the changing global environment and the increased competition from newly emerging countries, past strategies have been reassessed. The new strategies emphasise on development of core capabilities to enhance the sector's competitive advantage. These core capabilities would be developed based on a cluster approach that places importance on the strength of the leading and supporting firms and institutions as well as linkages between them. Three broad types of potential industrial clusters have been identified for development in the Second Industrial Master Plan. These are the international-linked clusters; resource-based clusters; and policy-driven clusters. Besides developing the leading firms, the supporting industries (mainly SMIs) involved mainly in the production of machinery, engineering, fabricated metal products, automobile and component parts and foundry will also be developed. This will strengthen intra and inter-sectoral linkages in the manufacturing sector, which is particularly important, as Malaysia makes a strategic shift towards a more integrated approach in manufacturing production.

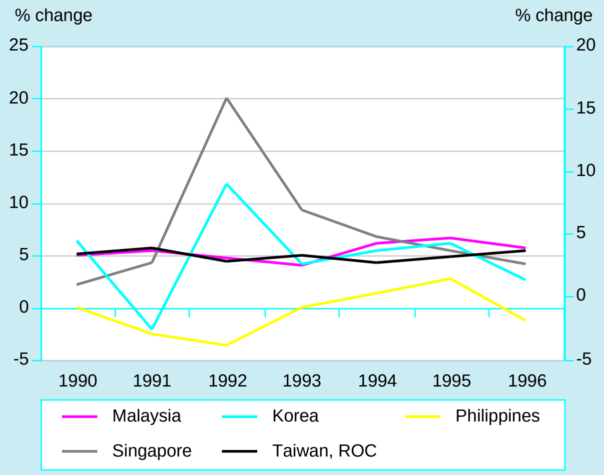
An area which has vast potential to be developed into a new engine of growth is the services sector. An efficient services sector will strengthen the competitive advantage of all sectors of the economy because of its inter-linkages with other activities. There is scope to promote the "tradable" services, with emphasis on developing the finance, education, tourism, insurance and shipping sub-sectors. Besides the potential in generating net foreign exchange earnings, the education sub-sector will also help to develop human resources. The tourism industry also has the potential to become a major foreign exchange earner for the nation.

Productivity enhancement:

An important element that will affect efforts to sustain international competitiveness is productivity. An analysis of total factor productivity (TFP) showed that past growth in value added has been largely input driven, indicative of a less-than-optimal use of scarce resources. In an environment of full employment and resource constraints, enhancing TFP will improve Malaysia's competitive edge. TFP can be enhanced through advancement in education of workers, skills and

Graph VI.2
Overall Productivity Growth

(Percentage change of real GDP per person employed)



Source: Based on information from "Key Indicators of Developing Asian and Pacific Countries", Asian Development Bank, 1997 and National Productivity Corporation

Table VI.7
Growth of Productivity, Labour Cost per Employee and Unit Labour Cost of the Manufacturing Sector

	1991	1992	1993	1994	1995	1996	1997*e*
	(Annual change in %)						
Productivity of labour	6.9	4.9	6.2	6.4	7.3	5.8	5.7
Labour cost per employee	11.9	10.7	5.3	7.3	5.2	9.3	7.0
Unit labour cost	3.2	3.6	-0.1	8.0	-1.6	2.7	1.5

e Estimate
Source: National Productivity Corporation & Bank Negara Malaysia (for 1997)

expertise, acquisition of superior management techniques and know-how, improvements in organisation, gains from specialisation, introduction of new technology and innovation or upgrading of existing technology and enhancement of IT. Indeed, the long-term strategy to sustain international competitiveness is through increased application of IT and to undertake research and development. IT will not only provide firms with access to an expanding array of services, but will also create new business opportunities. The rapid accessibility of information and the ability to process and use the results speedily will enhance the competitive edge of firms by boosting production, reducing costs and ensuring quality products. Recognising the importance of IT, the Government has launched a world-class IT hub, namely, the MSC to accelerate the pace of diffusion of IT in the country. At the firm level, value added can be raised by developing new IT products and services such as software, hardware and computer services through research and development, for use by the local industries and for export.

On the product side, competitiveness can be further enhanced through research and development. However, expenditure on research and development in Malaysia remains low and accounted for only 0.32% of GDP in 1995 (Singapore: 1.13%; Korea: 2.68%; and Taiwan: 1.81%). By international comparison, Malaysia was ranked only 37 out of 43 countries by the World Competitiveness Report in terms of research and development. Plans to enhance research and development in Malaysia would require specific targets in terms of experienced research and development personnel. At the same time, the Government would continue to play a proactive role in creating an environment that will be conducive to the private sector to undertake research and development activities. Provision of appropriate incentives may also be required.

Developing a competitive labour force:

In the past, foreign direct investment inflows into Malaysia were attracted by low wages and quality of the labour force. However, in recent years, Malaysia has begun to be affected by the erosion of its wage competitiveness vis-a-vis emerging countries in Asia, Latin America and Eastern Europe which have relatively lower wages and vast domestic markets. Given the full employment situation in Malaysia, the current focus of industrial development is directed at promoting high-technology industries, emphasising on products with potential for market and technology development and with high value added. This shift in the industrial structure will require a highly trained workforce. In this regard, the education curriculum has been reviewed to produce a larger number of technicians and engineers. Vocational schools have been restructured into technical schools and measures have been taken to expand computer education. To match skill requirements with the rapid change in technology, the private sector has been encouraged to constantly upgrade employees' skills through in-house training as well as training in technical institutions. In this context, a multinational electronic company in Malaysia provides training to local engineers by involving them in product development locally as well as overseas. Other large public corporations such as Tenaga Nasional Berhad, Telekom Malaysia Berhad and PETRONAS also have their own training facilities.

A related issue that requires further attention is the relative growth in wage gains vis-a-vis productivity increases. In recent years, productivity growth in the manufacturing sector which increased strongly in the first half of 1990s moderated in 1996–97, reflecting the increase in labour cost per employee. Cost competitiveness requires that wage increases correspond with productivity growth. While the Government has introduced a set of guidelines on a productivity-linked wage system, its implementation has been limited. The implementation of this system will ensure that Malaysia's export competitiveness will not be eroded.

Cost competitiveness:

Theoretically, a large depreciation in the exchange rate of the domestic currency should result in valuation gains from exports. However, in the present environment, it was observed that keen competition arising from the exchange rate depreciation in countries in the Asia–Pacific region had prompted exporters to provide discounts in United States dollar terms, thus benefitting purchasers and negating, to some extent, valuation gains to exporters. Furthermore, a depreciation will ultimately lead to increased business costs and undermine competitiveness. Domestically, there have also been upward pressures on utility charges. Industries with rising labour and material input costs can shift towards greater automation and mechanisation as well as seek alternative sources of materials including domestic substitutes, in order to offset the increased costs. The existence of an efficient infrastructure as well as the supply of utilities and other support services at competitive costs become vital in the current environment.

Appropriate marketing strategies:

In the face of the changing global trade configuration, Malaysian manufacturers can enlarge their export market shares by promoting distinctive and differentiated products as well as diversifying aggressively into non-traditional markets. The surge in private investment in the manufacturing sector since the second half of the 1980s has provided the sector with a more diversified industrial base, and many firms are now producing products of relatively higher technology and skills content. Nevertheless, in comparison with the more developed countries, Malaysia continues to export goods that require lower advanced technology and skills content. There is also a need to improve marketing strategies. In this aspect, a more active role by the business associations or councils can take the form of dissemination of trade information and establishing contacts with potential buyers overseas for local manufacturers, particularly the small- and medium-scale enterprises which generally have weak marketing networks.

Conclusion

In a globalised world market, efforts to enhance international competitiveness through incentives, lowering of tax rates and other orthodox measures are clearly no longer adequate. In addition, the globalisation process has also opened new avenues through which risks can spread rapidly, posing potential systemic damage to the financial system and the economy. While the recent depreciation of the ringgit, to some extent, will help to strengthen the competitiveness of exports, the nation should not rely solely on the exchange rate to sustain long-term competitiveness. Improving the, competitive position in the longer term is a structural issue to be attained through the development of new approaches, strategies and products.

more sophisticated savings, credit and risk management instruments. The shift towards a more efficient financial system involves further institutional development. In this regard, work is underway to move towards risk-based supervision of banking institutions, which will facilitate a more effective assessment of emerging risks in the financial system. Under this approach to enhance the financial system, there will be much closer interaction in the consideration of monetary policy, prudential standards and institutional development.

During this period of turbulence in the foreign exchange market, the Bank's exchange rate policy has remained unchanged. No targets are set for the ringgit exchange rate level and market forces will continue to determine the value of the ringgit. As a matter of policy, Malaysia has never relied on the exchange rate to promote export competitiveness. Instead, the country has sought to maintain and enhance its competitiveness by lowering costs and via improvements in productivity. Currently, the ringgit is assessed as being grossly undervalued. Consequently, the ringgit exchange rate has been driven more by changes in market sentiments rather than underlying shifts in economic fundamentals in recent months. To address this situation, particularly market concerns about existing imbalances, Malaysia has undertaken a comprehensive package of economic adjustment and stabilisation measures to further strengthen the economy and the financial system against the impact of the regional currency crisis. As these measures take effect and market confidence is restored, it is envisaged that the exchange rate will adjust to reflect the economic fundamentals of the country. As in recent years, the option for BNM to intervene in the foreign exchange market will continue to remain. Such intervention operations, however, are aimed at maintaining a degree of stability and not to support any specific level.

As monetary policy operates in a dynamic environment, it must always be pragmatic and flexible. This approach in the implementation of monetary policy is particularly relevant in 1998, given the uncertainties in regional and domestic economic conditions. Regular monitoring of the monetary aggregates, such as credit and monetary growth and interest rate developments will be complemented by close monitoring of price developments, including asset prices, and indicators of consumption and investment demand, to facilitate timely policy responses to monetary and economic developments. During this period of uncertainty, the dissemination of timely and accurate information to the public becomes more important in order to promote a better understanding of monetary conditions and issues confronting the conduct of monetary policy to facilitate the effectiveness of monetary policy.

4 The Financial Sector

Sources and Uses of Funds of the Financial System

Total assets of the financial system continued to increase strongly by RM198.1 billion or 21.6% to RM1,117.2 billion at the end of 1997 (an increase of RM171.5 billion or 22.9% in 1996). The growth was contributed mainly by a sharp increase in total assets of the banking system, which rose by RM181.4 billion or 28.7%, compared with an increase of RM116.1 billion or 22.5% in 1996. Concomitantly, the banking system remained as the largest financial intermediary, accounting for 72.8% of total assets of the financial system at the end of 1997 (68.7% in 1996). Within the banking system, the commercial banks (including Bank Islam) recorded a significant increase in their total assets, reflecting strong growth of loans and advances as well as placement of deposits with other financial institutions. Consequently, their share of total assets of the financial system increased from 39.6% at the end of 1996 to 43.6% at the end of 1997.

Table 4.1
Assets of the Financial System

	Annual change 1996	Annual change 1997	As at end 1997	As at end 1997
	RM billion			% share
Banking system	**116.1**	**181.4**	**813.2**	**72.8**
Bank Negara Malaysia	8.3	12.2	109.0	9.8
Commercial banks[1]	68.6	122.5	486.6	43.6
Finance companies	27.9	32.6	152.4	13.6
Merchant banks	7.0	10.3	44.3	4.0
Discount houses	4.3	3.8	20.9	1.9
Non-bank financial intermediaries	**55.4**	**16.7**	**304.0**	**27.2**
Provident, pension and insurance funds	27.5	24.0	191.0	17.1
Employees Provident Fund	*18.5*	*15.0*	*132.4*	*11.8*
Other provident & pension funds	*3.3*	*3.5*	*21.9*	*2.0*
Life insurance funds	*3.4*	*3.6*	*24.5*	*2.2*
General insurance funds	*2.3*	*1.9*	*12.2*	*1.1*
Development finance institutions[2]	1.4	2.0	15.3	1.4
Savings institutions[3]	3.0	1.2	19.4	1.7
Other financial intermediaries[4]	23.5	-10.5	78.3	7.0
Total	**171.5**	**198.1**	**1,117.2**	**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 Kerjasama 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.

Total assets of the non-bank financial intermediaries (NBFI) rose at a much slower pace of RM16.7 billion or 5.8% in 1997, compared with a growth of RM55.4 billion or 23.9% in 1996. As a result, their share of total assets of the financial system declined from 31.3% at the end of 1996 to 27.2% at the end of 1997. The slower growth was due mainly to a decline in total assets of unit trust funds by RM22.5 billion (an increase of RM15.1 billion in 1996), following a sharp fall of stock prices since the second quarter of 1997 which adversely affected the value of their investments. At the same time, a slower accumulation of assets by the provident, pension and insurance funds group also contributed to the slower growth in total assets of the NBFI. In particular, the growth in assets of the Employees Provident Fund (EPF) moderated to 12.8% (18.7% in 1996), due partly to the lower net contributions and slower growth in the number of contributors.

During the year, the bulk of funds continued to be sourced from deposits placed with the financial system, which grew by RM94.6 billion or 20.8% (RM90.9 billion or 24.9% in 1996) to account for 47.8% of the total increase in resources of the financial system. As in previous years, the banking institutions (comprising the commercial banks, finance companies, merchant banks and discount houses) accounted for the bulk of the increase in these deposits, mobilising 83% of total deposits of the financial system (82.8% in 1996). In terms of holders, the deposits were held mainly by the non-financial private sector, comprising individuals and business enterprises. Non-financial private sector deposits

Table 4.2
Sources and Uses of Funds of the Financial System

	Annual change		As at end 1997	
	1996	1997		
	RM billion			% share
Sources:				
Capital and reserves	30.8	-6.4	103.1	9.2
Currency	2.1	3.5	24.5	2.2
Deposits	90.9	94.6	550.0	49.2
Borrowings	2.1	22.7	31.1	2.8
Funds from other financial institutions	6.0	42.7	98.7	8.8
Insurance and provident funds	19.8	22.3	169.2	15.1
Other liabilities	19.8	18.7	140.6	12.6
Total	**171.5**	**198.1**	**1,117.2**	**100.0**
Uses:				
Currency	0.9	1.3	4.1	0.4
Deposits with other financial institutions	7.4	69.2	215.8	19.3
Bills	-0.1	5.0	21.3	1.9
Treasury	*-2.0*	*2.0*	*3.9*	*0.3*
Commercial	*1.9*	*3.0*	*17.4*	*1.6*
Loans and advances	78.5	102.4	486.7	43.6
Securities	42.2	10.5	213.0	19.1
Malaysian Government	*6.1*	*-0.8*	*66.8*	*6.0*
Foreign	*0.3*	*0.4*	*0.8*	*0.1*
Corporate	*71.0*	*14.0*	*138.5*	*12.4*
Others	*-35.2*	*-3.1*	*6.9*	*0.6*
Gold and foreign exchange reserves	6.2	-10.8	57.1	5.1
Other assets	36.4	20.5	119.2	10.7

placed with the financial system rose by RM57.9 billion or 22.4% (RM55.3 billion or 27.1% in 1996). The slower growth rate of the deposits reflected the moderation in economic activities in the second half of 1997. Fixed deposits continued to account for the bulk of the deposits placed by the non-financial private sector, accounting for 77.4% of the increase in total deposits. By maturity, fixed deposits continued to be concentrated in shorter-end maturities. On the other hand, savings deposits declined by RM5 billion (+RM7.8 billion in 1996), largely on account of a decline in savings deposits mobilised by the commercial banks and finance companies.

Contractual savings with provident funds and contribution to insurance funds remained a major source of funds for the financial system, expanding by RM22.3 billion or 15.2% (RM19.8 billion or 15.6% in 1996), to account for 15.1% of total funds of the financial system. However, a notable development in 1997 was a significant increase in funds obtained from other financial institutions (RM42.7 billion) and borrowings (RM22.7 billion), which accounted for 21.6% and 11.5% respectively of the increase in total resources of the financial system. This reflected the tight liquidity situation in the banking system as growth in total deposits fell short of loan growth. As a result, the banking system had to rely on the interbank money market as well as placements by Bank Negara Malaysia (BNM) to meet their funding requirements. Meanwhile, capital and reserves of the financial system declined by RM6.4 billion, due mainly to the adverse impact of the sharp fall in the stock market on the level of reserves and profitability of unit trust funds which fell by RM22.3 billion.

The bulk of funds mobilised was utilised to finance loan operations of the financial system, followed by deposits with other financial institutions, in particular in the form of interbank placements, and investment in securities. Despite the moderation in economic growth in the latter part of 1997, total loans and advances extended by the financial system continued

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

	Annual change		As at end 1997	
	1996	1997		
	RM billion			% share
Deposits[3] with:				
Commercial banks	38.8	46.2	221.1	69.7
Finance companies	11.7	9.8	61.7	19.5
Merchant banks	2.2	1.8	12.0	3.8
Discount houses	1.2	–1.9	3.7	1.2
National Savings Bank	0.7	0.1	6.0	1.9
Others	0.7	1.9	12.5	3.9
Total	**55.3**	**57.9**	**317.0**	**100.0**
Demand deposits	6.4	1.1	36.7	11.6
Fixed deposits	36.3	44.9	205.5	64.8
Savings deposits	7.8	–5.0	40.0	12.6
NIDs[4]	1.9	13.7	18.3	5.8
Repos[5]	2.9	3.2	16.5	5.2
Fixed deposits				
Of which:				
Up to 1 year	33.3	39.4	179.5	56.6
More than 1 year	3.0	5.5	26.0	8.2

[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.

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

	Annual change		As at end 1997	
	1996	1997		
	RM billion			% share
Loans and advances	90.6	91.3	456.0	76.7
Agriculture	*1.0*	*1.7*	*9.3*	*1.5*
Mining & quarrying	*-0.2*	*0.7*	*1.6*	*0.3*
Manufacturing	*4.7*	*9.3*	*65.8*	*11.1*
Housing	*8.2*	*14.2*	*62.4*	*10.5*
Construction[2]	*24.7*	*25.6*	*90.8*	*15.3*
Business services	*3.3*	*-0.9*	*9.6*	*1.6*
General commerce	*3.1*	*4.9*	*30.1*	*5.1*
Transport & storage	*2.3*	*6.4*	*13.4*	*2.2*
Purchase of shares	*9.4*	*11.7*	*36.1*	*6.1*
Consumption credit	*12.1*	*10.7*	*53.5*	*9.0*
Others	*22.0*	*7.0*	*83.4*	*14.0*
Investment in corporate securities	71.0	14.0	138.5	23.3
Total	**161.6**	**105.3**	**594.5**	**100.0**

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

to expand strongly by RM102.4 billion or 26.7% (RM78.5 billion or 25.7% in 1996), to account for 51.7% of the increase in total resources of the financial system. The bulk of the increase in loans and advances was channelled to the non-financial private sector, which rose by RM91.3 billion or 25% (RM90.6 billion or 33.1% in 1996). Except for the business services sector, loans and advances extended to all other sectors of the economy registered increases during the year. Of concern was the high proportion of loans and advances channelled to the less productive sectors (broad property, consumption credit and for the purchase of shares), which together accounted for 68.1% of the increase in total loans and advances extended to the non-financial private sector. Meanwhile, loans and advances extended to the manufacturing sector recorded a strong growth of RM9.3 billion or 16.4% (RM4.7 billion or 9.1% in 1996).

In contrast, investment in corporate securities by the financial system, consisting mainly of the holding of stocks and shares, recorded a slower growth of RM14 billion or 11.2% (RM71 billion or 132.5% in 1996). In particular, there was a marked decline of RM19.6 billion in investment in corporate securities by unit trust funds (an increase of RM13.2 billion in 1996). The slowdown in growth was in tandem with the weak stock market performance prevailing for the most part of 1997, which dampened stock prices as well as the overall investment climate. Deposits with other financial institutions increased significantly by RM69.2 billion or 47.2% (RM7.4 billion or 5.3% in 1996). The increase was accounted for by a sharp growth in interbank placements by BNM and the banking system, reflecting the banking system reliance on the interbank money market to meet its funding requirements. Meanwhile, gross holdings of gold and foreign exchange reserves of BNM declined by RM10.8 billion to RM57.1 billion at the end of 1997 (an increase of RM6.2 billion in 1996), reflecting mainly the intervention operations in the second half of 1997 following pressures on regional currencies.

Management of Banking System

Policy Direction

The year 1997 was a challenging year for the banking industry, as it had to cope with the rapid and sharp fall in equity prices and the value of the ringgit, as a result of the contagion effects of the regional financial crisis. Following a period of relative stability and a decade of high growth, the banking system entered this crisis from a position of relative strength. At the end of June, the banking system had a non-performing loan (NPL) ratio of 3.6%, while loan loss reserves (specific provisions, general provisions and interest-in-suspense) amounted to 92% of total NPL. As early as 1995, measures had been introduced to reduce exposure to the more volatile sectors of the economy. These measures were reinforced with further measures to limit the amount of credit facilities granted for the purchase of shares and to finance specified types of property in March 1997, just prior to the crisis (please see Monetary Measures in 1997 in chapter 2, for details). As the currency crisis intensified, the high credit growth had to be moderated more rapidly, given the potential risks and the adverse implications on financial stability. Monetary policy was also tightened further during this period. In addition, more stringent requirements on the prudential standards governing the classification of NPL were imposed. This included the shortening of the period in arrears for classifying loans of RM1 million and below as "sub-standard" and "doubtful" (please see Banking Measures in 1997 in this chapter, for details). These measures were complemented by the requirement for banking institutions to abide by their own estimates on credit growth for the rest of 1997, and for 1998, which should see credit growth slowing down to 25% by end-1997, 20% by March 1998 and 15% by the end of 1998.

Banking Measures in 1997

Institutional and Market Development

Two-Tier Regulatory System: In 1997, a new incentive was offered under the Two-tier Regulatory System (TTRS) that permits the rationalisation of group operations and conduct of cross-institutional business within eligible banking groups. Under this framework, Tier-I banking institutions within a group had been allowed to freely cross-sell, through agency arrangements, banking products and services belonging to one another as well as financial products and services belonging to other financial institutions within the group, such as insurance services, stockbroking services and mutual fund products. In addition, Tier-I banking institutions would also be allowed to freely combine their internal operations among themselves.

The incentives form part of the continuing efforts by BNM to establish a core of strong and competitive banking institutions. The incentives would provide opportunities for the Tier-I banking institutions to maximise synergy from their existing group structure and to achieve economies of scale from the rationalisation of internal operations. Strategically, delivery channels for the group could be significantly enhanced through shared branches and on-line computer networks. Through their cross-selling activities, customers would be able to avail themselves of a broad spectrum of financial products offered by the various institutions within the group from any one of the service outlets of the Tier-I banking institutions. Economically, cost savings and operational synergy would be obtained by integrating common functions and eliminating duplicate activities. The combination of internal operations would also permit a more consolidated view of financial risk and consistency in policy application across the group. In this regard, it was envisaged that this measure would place these banking institutions in a more strategic position to compete in an increasingly competitive and liberalised global environment. To date, two qualified banking groups are in the process of actively implementing such arrangements.

Bond Information and Dissemination System: A Bond Information and Dissemination System (BIDS) was launched on 1 October 1997 to provide comprehensive market information on domestic debt securities to market participants. BIDS is a computerised system which centralises the collection and dissemination of information on Scripless Securities Trading System (SSTS) securities and private debt securities (PDS). The information provided include the terms and conditions of issuance, details of deals done and relevant news on the debt securities market.

The members of BIDS comprise commercial banks, merchant banks, discount houses, Cagamas Berhad and the rating agencies. The ready access and transparency of information provided by BIDS were expected to improve liquidity and widen the type and number of market participants, thereby promoting further development of the primary and secondary markets. At a later stage, the membership of BIDS would be widened to include the finance companies, money brokers as well as other market participants. In recognising the dynamics of the debt securities market and the role of the PDS market as an important source of large-scale and long-term financing for economic development, BIDS would be continually enhanced to improve its efficiency in providing transparency of information and facilitating development of the domestic debt securities market.

Prudential Measures

Classification of Non-Performing Loans and Suspension of Interest on Non-Performing Loans: With effect from financial year beginning 1 January 1998, the period in arrears for classifying a loan as non-performing by banking institutions was reduced from six months to three months. Banking institutions were also required to claw back and suspend the interest accrued-but-not-received to day one of default on any loan which became non-performing. Similarly, the standard yardstick for loans of RM1 million and below to be classified as "sub-standard" had been reduced from a period in arrears of six months to three months; "doubtful" from 12 months to six months; and "bad" from 24 months to 12 months.

The revision to BNM's "Guidelines on the Suspension of Interest on Non-Performing Loans and Provision for Bad and Doubtful Debts" (BNM/GP3), which was made during the 1998 Budget announcement in October 1997, was to enable early identification and monitoring of problem loans as well as to bring the current practice closer to international standards. The anticipated slowdown in credit and economic growth in the months ahead could result in cash flow difficulties for borrowers and consequently, deterioration in their credit quality. Hence, the revised guideline would facilitate early recognition of any deterioration in a bank's loan portfolio and enable prompt remedial action to be taken by the bank's management, if necessary.

Minimum Requirement for General Provision for Bad and Doubtful Debts: With effect from financial year beginning 1 January 1998, BNM has also raised the minimum level of general provisions for bad and doubtful debts to be maintained by banking institutions to 1.5% of total loans (net of specific provision and interest-in-suspense).

Since 1990, the minimum level of general provisions for bad and doubtful debts was set at 1% of total loans (net of specific provision and interest-in-suspense). However, the need for banking institutions to increase their resilience and build up their reserves as additional buffer against possible future loan losses would become more crucial in the years ahead. In anticipation of such a need, BNM raised the minimum level of general provisions required together with the package of economic reforms made in the 1998 Budget.

Risk–Weighted Capital Requirement – Measurement of credit exposure for interest rate and foreign exchange related derivative contracts: With effect from 1 June 1997, all banking institutions were required to value their credit exposure for interest rate and foreign exchange related contracts by using the "current exposure method" instead of the "original exposure method". Credit exposure would be calculated as follows:

> The total replacement costs (obtained by marking-to-market) of all its contracts with positive value
>
> plus
>
> The total amount of potential future exposures calculated by multiplying the notional value of each contract by an "add-on" factor

The above standards were made in line with the changes in international standards set by the Bank for International Settlements (BIS). Under the previous "original exposure method", banking institutions were permitted to use a static valuation method whereby the expected credit exposure value was estimated and fixed at inception of the contract and remained unchanged throughout the life of the contract irrespective of future volatility of the underlying rates. Consequently, such a method might result in a possible understatement of exposure if the underlying rates were subsequently to move more than expected initially; or result in overstatement of exposure if actual exposure values declined significantly during the life of the transaction, resulting in inefficient utilisation of capital to support derivative activities.

The "current exposure method" provided a more updated and continuously revised exposure of a contract as it progressed to maturity. Marking-to-market measured the current credit exposure of a contract, while the "add-on" factor estimated the potential exposure of the contract that might be further incurred over time. The adoption of the above method would ensure that the credit exposure values were constantly updated and in line with current market conditions, especially during times of severe interest rate and currency fluctuations.

However, BNM's revised standards differed slightly from the BIS standards in terms of the quantification of risk. As Malaysian banking institutions operate mainly in the local interest rate and foreign exchange market, the set of "add-on" factors used in estimating the potential future exposure was revised based on risks arising from the local interest rate and foreign exchange rate environment. The "add-on" factors were arrived at after taking into consideration the movements in the ringgit interest rate and exchange rates of the Malaysian market over a considerable period of years. This approach had resulted in higher exposure values compared with the BIS standards, in which the set of "add-on" standards were more attuned towards interest rate and currency volatility of the G-10 countries.

Disclosure Requirements for the Financial Statements of Banking Institutions: With effect from 17 October 1997, the Bank had further increased the level of transparency in the annual financial statements of banking institutions. The additional disclosure requirement would provide improved information to depositors and investors to assess the financial soundness of banking institutions, and assist in the comparison of one institution with another. Details of the additional disclosure requirements are as follows: -

(a) Director's Report on Business Strategy and Outlook

Highlight the business plan and strategy during the financial year and the outlook of the institution for the coming year in the director's report. The report should also comprise a post event evaluation and the institution's direction for the coming year in dealing with the challenges posed by the business and economic environment.

This disclosure requirement was intended to bring to the forefront the role of the directors of banking institutions in planning the institution's business strategy and forecast for the financial year. This would serve as a challenge to the directors to play a more prominent and active role in managing prudently the direction of business of the banking institutions, which will now come under greater public scrutiny.

(b) Sectoral Concentration of Loans

Disclose the sectoral concentrations of credit exposure according to industry or economic sector.

Given that business risks vary greatly among different industry segments, sectoral breakdowns would provide better information value for the users of financial statements to assess the risk profile of the financing given by banking institutions.

(c) Non-Performing Loans

Disclose the amount of non-performing loans, the ratio of non-performing loans to total loans, movements in specific and general provisions for bad and doubtful debts and movements in interest-in-suspense.

This information would enable better analysis and monitoring of the performance of the banking institutions' loan portfolio.

(d) Capital Adequacy

Disclose the components of Tier-1 capital and Tier-2 capital as provided under the Basle Capital Accord to provide a better understanding on the capital strength of the banking institution. Details of the risk-weighted assets according to the various categories of risk-weights would also be disclosed.

Capital had always been given prominent consideration in the assessment of financial soundness of a banking institution by central banks and creditors alike. Capital provides depositors and creditors with a cushion against an institution's losses. To date, capital remains a widely accepted yardstick with which to judge an institution's ability to accommodate risk. Internationally, the Basle Capital Accord had also refined capital adequacy to a sophisticated level based on a risk-adjusted concept. Because of the importance of capital as a basis for a wide range of financial judgements, disclosure on the components of a banking institution's capital and the broad risk profile of an institution's credit exposure serves as a valuable source of information for all interested parties.

(e) Bank Rating

State in the annual report whether they had been rated by external agencies. Any banking institution that had been rated would be required to disclose the rating, name of the rating agency and when the rating was made. The disclosure must also be accompanied by a description of the rating grades used by the rating agency concerned.

Credit rating would strengthen market discipline, as banking institutions would have strong incentive to ensure that their credit rating compared favourably with those of other institutions. The prominent disclosure of a credit rating should serve to strengthen the inducements for banking institutions to adopt prudent practices and maintain high standards of financial health.

The focus of policy was aimed at containing asset inflation in the early part of the year, given that house prices had risen by 12.9% in 1996, while share prices on the Kuala Lumpur Stock Exchange had risen by 24.4% on the Main Board and 93% on the Second Board. As stock prices fell and the ringgit depreciated, in the aftermath of the currency crisis, policy was directed towards maintaining financial stability and restoring confidence in the banking system. In this regard, several prudential measures were introduced to require early recognition of any deterioration in the loan portfolio, so that prompt remedial action would be taken by the management of the banking institutions. While the imposition of more stringent requirements would impact on the profitability of the banking institutions in the immediate term, these measures were necessary in the light of the expected slowdown in economic growth that would affect the cash flows of borrowers. These measures brought the standards in line with international best practices, as well as demonstrated the resolve of policy to deal head-on with potential risks to credit quality. The industry had even been more pro-active, as 47 banking institutions had adopted the more stringent rules in 1997, ahead of the implementation date of 1 January 1998. Prompt pre-emptive action to recapitalise those banking institutions in need of additional capital, arising from deterioration in their loan portfolio, would avoid the destabilising impact of rising NPL on the banking system.

The requirement for greater disclosure, including disclosure of the rating of the institution, can be expected to have the desired effect of imposing greater market discipline on the banking institutions, and encouraging corporate governance. This would also enable investors to assess the financial health of a banking institution. Towards this end, banking institutions are required to publish data on their loan exposures by industry as well as changes in NPL and provisions, in addition to details on their capital strength. To discourage concentration of lending in the property sector, further measures were introduced in December, whereby no new credit facilities were allowed to be granted to property projects where construction had not yet commenced, while the viability of implemented projects had to be re-examined in the light of a changed economic environment.

As the crisis unfolded, concerns emerged among depositors, leading to a shift of funds from the smaller institutions to the larger banking institutions. The smaller banking institutions essentially experienced heavy withdrawals of deposits arising from unfounded rumours on their health. As the affected institutions were solvent, and their liquidity problems were the result of segmentation in the money market and the shift of deposits to the larger institutions, BNM provided short-term collateralised liquidity support to these institutions to preserve confidence in the banking system. In addition, BNM assured the public that deposits, both the principal amount and interest earned, were guaranteed by the Government.

Despite the prevailing environment and the more stringent provisioning and classification requirements for NPL, the performance of the banking system in calender year 1997 was encouraging, with pre-tax profit of RM7.9 billion. For financial year 1996, the industry had recorded a pre-tax profit of RM8.7 billion, which was the highest level on record. The return on assets for the calender year 1997 as a whole amounted to 1.3%, while the return on equity stood at 19%, both of which were reasonably good given the peak of 2% and 27% respectively in financial year 1996. Total NPL amounted to 5.7% at the end of 1997, while the capital adequacy ratio at 10.6% remained well above the minimum requirement of 8%. The loan loss reserves, including collateral, was at a comfortable 173.6% of total NPL. The banking system has been able to absorb the shocks, and has emerged resilient. The banking system as a whole remains sound. At the institutional level, BNM's stringent stress test showed that four banking institutions would have to increase their capitalisation in order to meet the minimum 8% capital requirement in the event that the stringent conditions materialised. Nevertheless, these institutions remained solvent.

The liquidity problems experienced by some small finance companies provided the impetus to these institutions to forge alliances to become bigger and stronger entities. To facilitate this process, five finance companies were identified to be the anchor companies to spearhead mergers. It was envisaged that by 31 March 1998, the respective finance companies would have identified and agreed on the merger partners as well as the terms and conditions of the mergers. Arising from this exercise, the number of finance companies would be significantly reduced. Mergers would not only promote further consolidation of the banking system, but would strengthen the capital base of the banking institutions and provide the cushion against unanticipated risks. Furthermore, adequate capital of a minimum size was necessary in order for a banking institution to remain relevant in a competitive and global world. Three mergers were instituted in 1997, namely, DCB Bank with Kwong Yik Bank, DCB Finance with Kwong Yik Finance, and United Overseas Bank with Chung Khiaw Bank.

While BNM would encourage the push for a core of strong domestic banking institutions under the Two-Tier Regulatory System, the Bank also called on the banking institutions to take stock of their progress and evaluate how successful they had been in achieving the stated objective. Banking institutions have also been requested to re-examine their expansion plans, especially in the light of resource constraints and concerns over their rapidly expanding loan portfolio. The broad objective for strong institutions is not only a matter of size but also to enhance their resilience in adjusting to unanticipated shocks.

At the same time, the Bank would continue with efforts to review its regulatory and supervisory framework to ensure that they remain relevant and effective in promoting the maintenance of a sound and stable banking system. Development efforts would also continue to promote a more competitive financial system, with broad and deep markets, so that the economy would be able to raise financing in a more efficient manner.

Performance of the Banking System

Following nine consecutive years of robust economic growth and a buoyant economy in early 1997, the banking institutions continued to experience strong performance in the first half of 1997. The NPL had been on a downward trend, and the banking system's profits had increased each year in tandem with the rapidly growing economy. Based on performance in the first half of the year, the banking system was expecting another record year in terms of profitability.

However, the environment changed drastically in the second half of 1997. The sharp fall in the value of the ringgit beginning in July 1997, accompanied by the sharp drop in share prices on the Kuala Lumpur Stock Exchange, strongly affected the earnings and overall performance of the banking sector in the second half of 1997. In the second half of 1997, banking institutions had to accept slower credit growth, rapidly rising interest rates, increasingly tight liquidity conditions, tougher loan provisioning requirements and higher incidence of problematic borrowers. Nevertheless, the banking system managed to turn in encouraging results for calendar year 1997.

Profitability

The preliminary pre-tax profit of the banking system for calendar year 1997 amounted to RM7.9

Table 4.5
Banking System: Performance in 1997

	Net increase	of which:			
	1997/1996	First half 1997		Second half 1997	
	RM million	RM million	% of net increase	RM million	% of net increase
Loans	88,272	48,479	54.9	39,794	45.1
Deposits	76,031	39,432	51.9	36,598	48.1
Non-performing loans	11,565	1,427	12.3	10,138	87.7
(% of total loans)[1]		3.6		5.7	

[1] Refers to position as at end-June and end-December 1997 respectively.

billion, of which 66.8% or RM5.3 billion was earned in the first half of 1997.

The slowdown in profitability during the second half of 1997 was mainly due to the turbulence in financial markets in the region. The impact was seen in rising NPL, higher cost of funds, squeeze on interest margins, and significantly higher loan loss provisions. The higher provisions were largely the result of the sharp increase in net specific provision of RM2.5 billion charged in the second half of the year, as against RM0.3 billion charged in the first half of the year, and adoption of the revised BNM Guideline on the Suspension of Interest on Non-Performing Loans and Provision for Bad and Doubtful Debts. General provisions also increased from RM1 billion during the first half of the year to RM1.4 billion during the second half of the year due to increases in the loan base and the requirement for a higher minimum level of provisioning.

All the three groups of banking institutions registered a significant decline in profitability in the second half of 1997. The decline for commercial banks was the highest, on account of an unusually large pre-tax loss reported by one commercial bank for the six months ended 31 December 1997. For finance companies, the decline in pre-tax profit was largely due to an increase in loan loss provisions and shrinking interest margins on their fixed rate loan portfolio. In addition, the downturn in the motor industry had affected their traditional hire-purchase business. Apart from the substantial increase in loan loss provisions and shrinking interest margins, the decline in the pre-tax profit of the merchant banks in the second half of 1997 was also attributed to the sharp decline in their traditional fee-based activities, resulting in a marked drop in fee-based income. The contribution by the finance companies and merchant banks towards the pre-tax profit of the banking system fell from 17.4% and 11.2% in the first half of 1997 to 14.4% and 7.8% respectively in the second half of 1997.

Although the banking system experienced higher net interest income during the second half of 1997, the increase was offset by the decrease in non-interest income and significant increase in loan loss provisions of RM2.6 billion (+190.5%). During the second half of 1997, the banking system recorded a marginal increase of 1% or RM40 million in

Table 4.6
Banking System: Unaudited Income and Expenditure

	For the calendar year 1997			
	First half	Second half	Change	
	RM million			%
Interest income net of interest-in-suspense	22,310	27,175	4,865	21.8
(Interest-in-suspense)	*249*	*245*	*-4*	*-1.6*
Less: Interest expense	14,248	18,590	4,342	30.5
Net interest income	8,062	8,585	523	6.5
Add: Non-interest income	2,750	2,195	-555	-20.2
Less: Loan loss provision	1,365	3,964	2,599	190.5
Personnel Cost	2,003	1,980	-23	-1.2
Overheads	2,134	2,197	63	3.0
Profit before tax	5,310	2,639	-2,671	-50.3
Of which:				
Commercial banks	*3,794*	*2,051*	*-1,743*	*-45.9*
Finance companies	*923*	*381*	*-542*	*-58.7*
Merchant banks	*593*	*207*	*-386*	*-65.1*

administrative costs. Expenditure on overheads increased by 3% or RM63 million in the second half of the year, mainly due to administrative expenses incurred by the opening of new branches, renovations and relocation of branches.

Reflecting the tight liquidity situation prevailing in the market during the second half of the year, which resulted in the rapid rise in interest rates on deposits, gross interest expense recorded a significant increase of 30.5% in the second half of 1997. Average cost of deposits for the banking system increased from 6.5% per annum as at end-1996 to 6.9% per annum as at end-June 1997 and to 8.1% per annum as at end-1997.

Following deteriorating results in the second half of the year, the key performance indicators of the banking system showed a decline when compared to the first half of the year. Return on assets (ROA) deteriorated from 0.9% in the first half to 0.4% for the second half of the year. Reflective of this, the return on equity (ROE) declined from 10.7% to 5.7% for the second half of 1997. For the calendar year as a whole, the ROA and ROE were 1.3% and 19% respectively, which were reasonable in the context of the prevailing economic environment.

Table 4.7
Banking System: Capital Strength

	As at end			
	Dec. 1996		Dec. 1997	
	RWCR	Tier-1 capital	RWCR	Tier-1 capital
	(%)			
Commercial banks	10.8	9.3	10.3	8.9
Finance companies	9.8	8.1	10.6	8.5
Merchant banks	11.7	10.3	13.3	11.4
Banking system	10.6	9.3	10.6	9.0

Capital

Total shareholders' funds of the banking system increased by RM6.4 billion or 18.1% to RM41.9 billion as at end-June 1997. The increase in shareholders' funds was mainly from the injection of capital totalling RM3.9 billion through rights issues and profits which were ploughed back into reserves. The significant build-up of the capital base during the first half of the year provided adequate cushion for the three groups of banking institutions to absorb provisions arising from deterioration in asset quality.

The capital base of the banking system increased by RM13.7 billion or 33.5% in 1997 to RM54.7 billion. All the three groups of banking institutions registered significant increases in their capital base during the year, with merchant banks registering an increase of 45.2%, followed by finance companies (+36.8%) and commercial banks (+31.2%). The decline in risk-weighted capital ratio (RWCR) of the commercial banks was partly due to the loss made by one commercial bank in the second half of 1997.

The banking system as a whole remained adequately capitalised as indicated by the RWCR which stood at 10.6% as at end-December 1997, against the minimum requirement of 8%. Of this, tier-1 capital ratio amounted to 9%.

Direction of Lending

As a pre-emptive measure to contain asset price inflation, BNM had in March 1997 issued guidelines on lending to the broad property sector and for the purchase of shares and units of unit trust funds. Under these guidelines, loans to the broad property sector were subject to the limit of 20% of a banking institution's total loans outstanding, while loans for the purchase of stocks and shares (including units of unit trust funds) were subject to the limit of 15% of a banking institution's total loans outstanding (30% in the case of a merchant bank). Following the introduction of these guidelines, banking institutions began to channel more of their credit towards the productive sectors of the economy, although growth in lending to the broad property sector remained strong.

Restrictions were also placed on hire-purchase loans for passenger vehicles in that finance companies were not allowed to provide financing in excess of 70% of the purchase price of non-commercial passenger vehicles, while the repayment period of these loans was restricted to not more than five years.

In order to slow down overall credit growth and to ensure that available resources were channelled to productive uses, banking institutions in October were required to submit plans on their credit growth for the rest of 1997 and for 1998. The credit plans were also intended to complement fiscal measures announced by the Government in the 1998 Budget, which were announced in October 1997. In addition, banking institutions were directed to channel more resources to the productive sectors of the economy and to place low priority on the property sector (excluding bridging and end-financing for residential properties costing RM150,000 and below) and for share financing.

In spite of the introduction of the guidelines on lending to the broad property sector in March 1997 and the subsequent currency and stock market turmoil, the net increase in loans to the broad property sector remained significant throughout the year, amounting to RM16.7 billion in the first half and RM18.5 billion in the second half of 1997. This was mainly due to the disbursement of loans already committed prior to the introduction of the guidelines, coupled with exemption given to several types of loans: for the construction of residential properties costing RM150,000 and below; for the development of infrastructure projects, public utilities and amenities; for the purchase and construction of industrial buildings and factories; and for the purchase of owner-occupied residential properties, whether landed or otherwise. As a result, growth in loans to the construction sub-sector was sustained

Table 4.8
Banking System: Loans by Sectors

	As at end		Change	Share of new loans
	Dec. 1996	Dec. 1997		
	RM million			%
Manufacturing	53,447	63,248	9,801	11.1
Broad property sector	104,660	139,874	35,214	39.9
Wholesale, retail, restaurants & hotels	27,501	34,695	7,194	8.1
Financing, insurance & business services	32,640	36,055	3,415	3.9
Purchase of securities	24,584	39,122	14,538	16.5
Consumption credit	41,518	53,568	12,050	13.7

at the same pace throughout the whole of 1997, while growth in loans for the purchase of residential properties picked up in the second half. However, loans for the purchase of non-residential properties slowed down in the second half of 1997, while real estate loans stagnated throughout the whole of 1997 as both were not exempted in the guidelines.

As a percentage of total loans, loans to the broad property sector amounted to 33.2% as at end-1997 (end-1996: 31.4%). Nevertheless, the banking system as a whole complied with the guidelines on lending to the broad property sector issued in March 1997 with an exposure to the non-exempted sector of the broad property sector of 13.1% of total loans outstanding as at end-1997, against the maximum of 20%. The exposure was 13.4% for the commercial banks and 10.5% for the finance companies. Only the merchant banks narrowly exceeded the limit with an exposure of 21.1%.

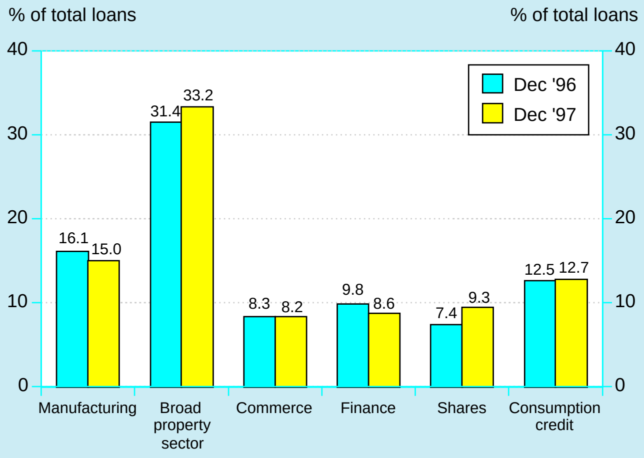
Loans for the purchase of stocks and shares registered a strong growth of RM12.2 billion in the first six months of 1997. However, following the stock market turmoil, loans for the purchase of stocks and shares only increased by RM2.3 billion in the second half of the year. As a percentage of total loans, loans for the purchase of securities (including loans to stockbrokers) amounted to 9.3% as at end-1997 (end-1996: 7.4%), well within the maximum limit of 15% (30% in the case of the merchant banks) stipulated in the guidelines. The exposure was 9.1% for the commercial banks, 5.8% for the finance companies and 20.1% for the merchant banks.

Loans to individuals for the purchase of stocks and shares rose by only RM0.6 billion in the second half of 1997, against the increase of RM2.6 billion in the first half of 1997. Meanwhile, loans to stockbrokers fell by RM1.5 billion in the second half of 1997 as compared with the increase of RM1.8 billion in the preceding half-year period. Total loans to individuals and stockbrokers constituted 4.4% (end-1996: 4.6%) and 0.7% (end-1996: 0.8%) respectively of total loans as at end-1997.

With the cap on lending to the property sector and marked slowdown in lending for the purchase of stocks and shares, banking institutions were encouraged to channel credit to the more productive sectors of the economy, particularly the export-oriented industries. Hence, credit to the manufacturing sector and for general commerce (wholesale, retail, restaurants and hotels) picked up strongly in the second half of the year, with a net increase of RM5.9 billion (first half: RM3.9 billion) and RM5 billion (first half: RM2.2 billion) respectively. As a percentage of total loans, lending to the manufacturing sector fell from 16.1% as at end-1996 to 15% as at end-1997, while the share of general commerce was maintained at 8.2%. Another productive sector experiencing a surge in funding by the banking institutions was transport, storage and communications. Lending to this sector increased by RM4 billion in the second half of 1997 (first half: RM2.5 billion) to account for 3.1% (end-1996: 2%) of total loans outstanding as at end-1997.

Loans for consumption rose by RM7.8 billion in the first half of 1997. In the second half, loans for consumption increased by only RM4.3 billion. The

Graph 4.1
Banking System: Direction of Lending



total increase for 1997 was RM12.1 billion or 29%. The lower increase in the second half was influenced largely by the slowdown in loans for the purchase of passenger cars towards the end of the year, following the tightening of hire-purchase lending for non-commercial passenger vehicles in October 1997. Other contributing factors were the channelling of more loans to the productive sectors of the economy, and the slowing down of credit growth in response to the changing business environment. In addition, consumers were also seen to be restraining their spending in view of the uncertain economic environment. As a percentage of total loans, consumption credit rose marginally from 12.5% as at end-1996 to 12.7% as at end-1997. Of this, loans for the purchase of passenger cars extended by the finance companies amounted to RM32.1 billion or 29.6% of the finance companies' total loans as at end-1997 (end-1996: RM24.5 billion or 28.6%).

To ensure that the loan growth of the banking institutions was in line with the growth in deposits, banking institutions were required to slow down their credit growth. In this regard, they were required to submit their credit plans for 1997 and 1998. Based on these credit plans, credit growth for the banking system as a whole was expected to slow down to 25% by the end of 1997, 20% by end-March 1998 and 15% by the end of 1998. Total loans outstanding as at end-1997 amounted to RM402 billion representing an increase of 25.9% over the amount as at end-1996 (RM319.2 billion). The actual credit growth for 1997 narrowly exceeded the target, largely attributed to drawdown of committed lines. Nevertheless, the slower loan growth and large resource surplus of RM13.8 billion registered for the month of December 1997 compared with a consistent resource gap registered since July 1997, indicated that the call for slower credit growth was beginning to produce the desired results. Consequently, the loan-deposit ratio, which had risen from 89.3% as at end-1996 to peak of 95.8% as at end-November 1997, fell to 92.7% at the end of the year.

Asset Quality

The quality of loans deteriorated towards the end of 1997. Expressed as a percentage of total loans, NPL for the banking system rose from 3.6% as at end-June 1997 to 5.7% as at end-1997. The increase in NPL was partly due to the adoption by 47 banking institutions of the new guidelines on recognition of NPL well ahead of the implementation date. If the new guidelines were applied to the banking system as a whole, the level of NPL would increase to 6.8% as at end-1997. The increase in NPL was most significant in the case of finance companies, where NPL had risen from 4.3% as at end-June 1997 to 7.8% as at end-1997 while that of the merchant banks, at 4.5% at end-1997, was the lowest.

Notwithstanding the deteriorating asset quality, the current NPL level was way below the peak of 30.1% as at end-1988, when the default period for recognising NPL was 12 months. Loan loss provisions and security coverage amounted to 173.6% of NPL as at end-1997 for the banking system as a whole. In view of the relatively low NPL and comfortable level of loan loss provisions, the asset quality problem of the Malaysian banking system as a whole was manageable.

In terms of NPL by sector, the quality of loans to the broad property sector was one of the areas of concern because of the size of the banking system's loan exposure to the sector. Loans to this sector

Table 4.9
Banking System: Non-performing Loans by Sectors

	As at end			
	Jun. 1997		Dec. 1997	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture	320	4.6	511	6.7
Mining & quarrying	48	4.5	143	10.2
Manufacturing	2,733	4.8	3,441	5.4
Electricity	7	0.2	28	0.6
Community, social & personal services	212	3.1	266	3.9
Broad property sector	5,957	4.9	8,656	6.2
Wholesale, retail, restaurant & hotels	990	3.3	1,605	4.6
Transport, storage & communications	290	3.2	517	3.9
Financing, insurance and business services	400	1.1	1,240	3.4
Purchase of securities	323	0.9	2,780	7.1
Consumption credit	2,395	3.9	4,177	6.6
Credit card loans	*384*	*9.9*	*461*	*10.4*
Personal use	*871*	*6.4*	*855*	*5.7*
Purchase of consumer durables	*137*	*5.9*	*258*	*14.5*
Purchase of transport vehicles	*1,003*	*2.4*	*2,603*	*6.2*
Other	230	2.2	680	6.0
Total	13,906	3.6	24,044	5.7

Table 4.10
Banking System: Loan Loss Coverage

	As at 31 December 1997	
	Loan loss provision (% of NPL)	Provision + collaterals (% of NPL)
Commercial banks [1]	73.9	193.7
Finance companies	48.4	126.3
Merchant banks	67.4	235.3
Banking system [1]	64.6	173.6

[1] Includes one commercial bank which incurred heavy losses for the six-month period ended 31 December 1997.

Table 4.11
Banking System: Outstanding Loan Loss Provision

	As at end			
	Jun. 1997		Dec. 1997*p*	
	RM million	% of total loans	RM million	% of total loans
Commercial banks [1]				
Interest-in-suspense	1,825	0.7	1,809	0.6
Specific provision [2]	1,935	0.7	2,826	1.0
General provision [2]	5,138	2.0	6,088	2.1
Total provision	8,898	3.4	10,723	3.7
Non-performing loans	9,233	3.5	14,508	5.0
Finance companies				
Interest-in-suspense	843	0.9	913	0.8
Specific provision [2]	963	1.0	1,426	1.3
General provision [2]	1,530	1.5	1,777	1.6
Total provision	3,336	3.4	4,116	3.8
Non-performing loans	4,240	4.3	8,497	7.8
Merchant banks				
Interest-in-suspense	63	0.3	90	0.4
Specific provision [2]	95	0.4	170	0.7
General provision [2]	397	1.8	440	1.9
Total provision	555	2.5	700	3.0
Non-performing loans	433	2.0	1,039	4.5
Banking system [1]				
Interest-in-suspense	2,731	0.7	2,812	0.7
Specific provision [2]	2,994	0.8	4,422	1.0
General provision [2]	7,065	1.9	8,305	2.0
Total provision	12,789	3.4	15,539	3.7
Non-performing loans	13,906	3.6	24,044	5.7

[1] Includes one commercial bank which incurred heavy losses for the six-month period ended 31 December 1997.
[2] Includes provision under SPTF.
p Preliminary

accounted for 33.2% of total loans as at end-1997. As at end-June 1997, NPL of this sector stood at RM6 billion or 4.9% of total loan exposure to the sector. By end-1997, this had risen to RM8.7 billion or 6.2% of total loans outstanding to this sector. Within the broad property sector, real estate loans accounted for the highest NPL of 11.6%, followed by construction (6.3%), purchase of non-residential properties (5.5%) and purchase of residential properties (4.6%). Although NPL in respect of real estate loans was high, total real estate loans accounted for only 4.3% of the banking system's total loans outstanding as at end-1997.

In the midst of the stock market turbulence, the quality of loans for the purchase of securities was also an area of concern. As at end-June 1997, NPL for loans for the purchase of securities amounted to RM0.3 billion or 0.9% of total loans outstanding to this sector. Following the sharp fall in share prices on the Kuala Lumpur Stock Exchange in the second half of 1997, the NPL of this sector swelled to RM2.8 billion or 7.1% of total loans outstanding to the sector as at end-1997. Nevertheless, loans for purchase of securities remained relatively small, accounting for only 9.3% of total loans outstanding for the banking system as a whole.

Table 4.12
Banking System: Lending to Broad Property Sector (BPS)

	As at end					
	Dec. 1996		Jun. 1997		Dec. 1997	
	Breakdown of BPS	NPL as % of total loans to the sector	Breakdown of BPS	NPL as % of total loans to the sector	Breakdown of BPS	NPL as % of total loans to the sector
	(%)					
Real estate	17.4	5.7	14.6	10.1	12.9	11.6
Construction	26.6	6.6	29.1	4.8	30.4	6.3
Residential	38.7	4.3	36.7	3.6	36.6	4.6
Non-residential	17.3	3.7	19.6	3.6	20.1	5.5

The turbulence in financial markets had also affected the repayment patterns of borrowers pertaining to loans for the purchase of transport vehicles (passenger cars and commercial vehicles). As at end-June 1997, NPL for this sector stood at RM1 billion or 2.4% of total loans to this sector. By end-1997, this had increased to RM2.6 billion or 6.2% of total loans to this sector. Similarly, NPL relating to credit card loans and loans for purchase of durable goods also deteriorated and were among the highest at 10.4% and 14.5% respectively. However, they were insignificant in terms of overall loan exposure of the banking system, accounting for 0.4% and 1.1% respectively of total loans outstanding as at end-1997 respectively. By contrast, the NPL of the manufacturing sector appeared relatively stable in spite of the crisis. Although NPL of this sector deteriorated slightly from 4.8% as at end-June 1997 to 5.4% as at end-1997, this was partly due to the new loan classification policy adopted by a number of banking institutions.

Liquidity

Liquidity in the banking system was ample during the early part of 1997 but was relatively tight towards the end of the first half following the pressure on the ringgit, which was under speculative attack in mid-May. Liquidity continued to tighten in the second half of the year, following the currency and stock market crisis. The situation was further aggravated by strong demand for credit and flight of deposits from smaller banking institutions, particularly the finance companies to larger banking institutions.

The deposit rates of the three groups of banking institutions rose significantly in the second half of the year reflecting the tight liquidity condition in the market. The average three-month deposit rates for commercial banks and merchant banks rose from 7.4% in June 1997 to 9.1% and 11.5% respectively in December 1997, while the three-month deposit rate of the finance companies rose from 7.6% to 10.3%. Similarly, the three-month weighted average Kuala Lumpur Interbank Offered Rate (KLIBOR) increased from 7.8% in June 1997 to 8.5% in December 1997. As a result, the average base lending rate (BLR) of commercial banks increased from 9.5% in June 1997 to 10.3% in December 1997, while the average BLR of finance companies increased from 10.9% to 12.2%.

The higher deposit rates compared with interbank rates had led to a sharp increase in interbank borrowing by banking institutions as it was cheaper to fund their operations from the interbank market. Nevertheless, as banking institutions were constrained from being too dependent on the interbank market as a source of funding, they had to resort to borrowing from non-interbank market sources, especially from the corporates. This had pushed up the cost of funds of banking institutions resulting in a broad divergence between lending based on cost-plus and lending based on BLR. The liquidity flows in the system improved, however, with the reduction in the Statutory Reserve Requirement by 3.5 percentage points in February 1998. This measure did not lead to an increase in the liquidity of the system as BNM deposits with the banking system were not rolled over on maturity.

External Liabilities

Recognising the nature of banking operations and activities, foreign exchange exposures of the commercial banks were limited to a specified net open position. The net open position was set based on the shareholders' funds and dealing capacity of each banking institution. This limit essentially served as a built-in safeguard to ensure that commercial banks maintained a prudent level of exchange rate risk. The foreign exchange exposures of the commercial banks as measured by the net open position stood at only –RM0.7 billion as at end-December 1997. The exposure was certainly not worrisome as it accounted for only 0.14% of the total assets of the commercial banks. Furthermore, net external liabilities of the commercial banks as at end-December 1997 amounted to RM25 billion, representing only 5% of total assets of the commercial banks.

Of the total external liabilities of the commercial banks, the external liabilities of the locally-incorporated foreign banks amounted to RM16.5 billion or 34% of the total external liabilities of the commercial banks. Of these, more than half were in the form of borrowings from their head offices and affiliates abroad.

Regional Exposure

The financial crisis faced by the East Asian region in the second half of 1997 had altered the risk profile of Malaysian banks with credit exposure to countries

Table 4.13
Exposure of Malaysian Banks to East Asian Region as at 31 December 1997

Country	Overseas Branches	Labuan Offshore Units	Total	
	US$ million			%
Indonesia	349	651	1,000	42.4
Thailand	201	224	425	18.1
Korea	36	33	69	2.9
Philippines	57	805	862	36.6
Total	**643**	**1,713**	**2,356**	**100.0**
Non-performing loans	**141**	**343**	**484**	

severely affected by the turbulence. The regional exposure was, nevertheless, confined to seven banking institutions through the operations of their overseas branches and Labuan offshore units. As at 31 December 1997, the exposure of seven banking institutions, including their Labuan offshore units, in the form of loans and investments to Indonesia, Thailand, Korea and the Philippines amounted to US$2.4 billion. Of the US$2.4 billion, 72.7% or US$1.7 billion represented exposure effected through their Labuan offshore units. The total exposure of Labuan offshore units to these four countries represented 19.2% of their total assets. The amount, however, represented only 2.9% of the total assets of the seven Malaysian banks.

Although this regional exposure was insignificant compared with the total assets of the seven banking institutions, the management of these institutions nevertheless had been monitoring closely the status of this exposure. As at 31 December 1997, US$484 million or 20.5% of the total exposure was classified as non-performing. The Bank encouraged these banking institutions to require their Labuan offshore units to recognise any potential problems early and to build up provisions for their regional exposure.

The regional financial crisis has also changed the economic environment for the operations of the banking system. The turbulence has to varying degrees tightened the liquidity and weakened the balance sheets of some banking institutions, thereby affecting their performance. Banking institutions found themselves operating in a more difficult economic and business environment in 1997. Nevertheless, the banking system, as a whole, remained resilient, and the banking institutions, solvent. This, to a large extent, reflects the stringent regulatory framework in which the banking system operates, and the introduction of several appropriate pre-emptive measures to address any potential risks arising from the crisis.

Islamic Banking

Islamic banking continued to record progress in the midst of the financial crisis. Assets expanded by 76.5% to RM17.9 billion while financing recorded a strong growth of 75% to RM10.8 billion. Total deposits mobilised registered a growth of 36.2% to RM9.9 billion during the year. The shareholders' funds of the Islamic bank and the interest-free banking fund amounted to RM1.3 billion, while profit before taxation and zakat amounted to RM153 million in 1997.

Table 4.14
Islamic Banking: Key Data

	As at end of		% change	
	1996	1997	1996	1997
Number of financial institutions	50	52	11.1	4.0
Commercial banks	25	24	8.7	-4.0
Finance companies	21	22	16.7	4.8
Merchant banks	3	5	-	66.7
Islamic bank	1	1	-	-
Total assets (RM million)	10,133	17,881	63.5	76.5
Commercial banks	3,653	9,078	79.2	148.5
Finance companies	1,853	2,924	184.6	57.8
Merchant banks	665	677	156.8	1.8
Islamic bank	3,962	5,202	22.0	31.3
Total deposits (RM million)	7,264	9,895	47.5	36.2
Commercial banks	2,667	5,153	52.8	93.2
Finance companies	966	1,170	154.9	21.1
Merchant banks	348	349	510.5	0.3
Islamic bank	3,283	3,223	19.6	-1.8
Total financing (RM million)	6,143	10,750	75.9	75.0
Commercial banks	2,125	4,706	152.1	121.5
Finance companies	1,225	2,190	170.4	78.8
Merchant banks	393	503	70.9	28.0
Islamic bank	2,400	3,351	22.1	39.6
Financing-deposits ratio (%)	84.6	108.6	12.7	24.1
Commercial banks	79.7	91.3	31.4	11.6
Finance companies	126.8	187.2	7.3	60.4
Merchant banks	112.9	144.1	-290.6	31.2
Islamic bank	73.1	104.0	-0.7	30.9

Although total deposits recorded a growth in 1997, deposits actually registered a decline of 2% (RM200 million) in the second half of 1997, compared with an increase of RM2.8 billion in the first half of 1997. The situation would have been worse if not for the dramatic increase in demand deposits, which recorded a growth of 119.7% as at end-1997. Islamic demand deposits gained popularity given that a number of Islamic banking institutions offered returns on outstanding balances to their depositors. In addition, the increase in demand deposits was also attributed to the shifting of government agencies' accounts previously held with BNM branches to SPTF commercial banks and Islamic bank.

Despite the forecast of a slower loan growth in the banking sector by the end of the year, growth in total Islamic financing rose sharply, particularly in the second half of 1997. During the year, total financing rose from RM6.1 billion at end-1996 to RM10.8 billion at end-1997. It recorded a moderate growth of 29.5% in the first half of 1997 and was much stronger in the second half of 1997, increasing by 36.7%. The exposure of Islamic banking to the broad property sector was significantly large as compared with other sectors and constituted 40.2% of total financing. The high demand for broad property sector financing, particularly in the second half of 1997, was partly due to the increasing trend of the BLR as against the fixed-rate nature of Islamic financing. Under an environment of rising interest rates, borrowers began to seize the opportunity to lock in their cost of long-term financing under Islamic property financing which was cheaper as compared with conventional financing over the long run.

Table 4.15
Islamic Banking: Deposits by Type & Institutions

	Annual change				As at end 1997
	1996		1997		
	RM million	%	RM million	%	RM million
Current deposits	509	50.8	1,808	119.7	3,319
Commercial banks	373	119.6	1,474	215.2	2,159
Islamic bank	136	19.7	334	40.4	1,160
Savings deposits	524	58.3	398	28.0	1,821
Commercial banks	293	86.9	223	35.4	853
Finance companies	58	207.1	43	50.0	129
Islamic bank	173	32.4	132	18.7	839
Investment deposits	1,304	43.1	425	9.8	4,755
Commercial banks	256	23.4	789	58.4	2,141
Finance companies	529	150.7	161	18.3	1,041
Merchant banks	291	510.5	1	0.3	349
Islamic bank	228	15.0	-526	-30.1	1,224

Table 4.16
Islamic Banking: Direction of Lending

	Annual change		As at end 1997
	1996	1997	
	RM million		
Agriculture	113	41	194
Mining and quarrying	2	68	73
Manufacturing	168	358	1,283
Electricity	26	10	99
Real estate and construction	537	1,177	2,293
Housing	532	1,039	2,024
General commerce	150	195	524
Transport and storage	186	461	720
Financial, insurance and business services	247	-230	306
Purchase of stocks and shares	-102	625	1,128
Consumption credit	340	125	633
Others	454	738	1,475
Total	**2,651**	**4,607**	**10,750**

The tight liquidity situation has put pressure on the operations of Islamic banking. The current turmoil revealed a structural weakness in Islamic banking operations particularly under a volatile economic environment. In Malaysia, 90% of Islamic financing are negotiated on fixed-rate terms such as Murabahah, Bai' Bithaman Ajil and Al-Ijarah Thumma Al-Bai'. Conventional banking has the flexibility to adjust upward the interest rates on borrowing accordingly to reflect the higher cost of funds. Comparatively, the return from financing under Islamic banking would decline under this environment and contribute to lower deposit rates to depositors. In essence, Islamic banking could not react swiftly under the current interest rate environment due to the absence of a floating-rate option. Thus, the lagging factor resulted in a mismatch whereby the financing-deposit ratio registered an increase from 84.6% as at end-1996 to 108.6% as at end-1997. To accommodate the shortfall, Islamic banking institutions had to resort to Mudharabah placements from the Islamic money market which amounted to RM2.6 billion as at end-1997.

The National Syariah Advisory Council for Islamic Banking and Takaful (the Council), established on 1 May 1997, held its inaugural meeting on 8 July 1997. The Council comprised

10 members, including a foreign representative from Sudan. During the year, the Council convened three meetings and among opinions issued were on new Islamic financial instruments and the practices of banking and takaful operations.

Other Financial Institutions

Discount Houses

The operations of the discount houses continued to expand, albeit at a slower pace in 1997. Total resources of the industry rose by RM3.8 billion or 22% in 1997, compared with an increase of RM4.3 billion or 33.9% in 1996. As in previous years, the increase was due mainly to higher deposits which accounted for 94% of the increase in total resources.

Reflecting the tight liquidity in the system during the second half of 1997, the increase in total deposits (including repos) mobilised by the discount houses moderated to RM3.6 billion or 21.7% in 1997 (an increase of RM4.2 billion or 34.1% in the previous year). The increase in deposits was mainly placed by commercial banks (RM2.3 billion) and finance companies (RM1.8 billion). In terms of deposits by type, call money increased by RM2 billion or 36.6% in 1997 (an increase of RM2.4 billion or 76% in 1996), accounting for 57.2% of the increase in total deposits during the year. Similarly, fixed deposits recorded a smaller increase of RM1.2 billion or 11.5% in 1997 (RM2.1 billion or 24.5% in 1996).

Table 4.17
Discount Houses: Sources and Uses of Funds

	Annual change 1996	Annual change 1997	At end 1997
	RM million		
Sources:			
Shareholders' funds	199	217	851
Deposits	4,166	3,550	19,927
Others	-21	7	167
Total	**4,344**	**3,774**	**20,945**
Uses:			
Investment	4,746	2,371	18,500
Treasury bills	-54	0	0
Government securities	155	-323	311
Bankers acceptances	-763	-43	4,296
Negotiable instruments of deposit	316	-236	365
Cagamas papers	112	-111	458
Private debt securities	4,781	2,702	11,872
Others	199	382	1,198
Loans to licensed institutions	425	1,395	2,186
Others	-827	8	259

Consonant with the expansion in total resources, total investment of the discount houses increased by RM2.4 billion in 1997, compared with the increase of RM4.7 billion in 1996. The bulk of the increase was invested in private debt securities (PDS), which rose by RM2.7 billion, due to the higher return and the increased availability of PDS in the market. In contrast, investment in Malaysian Government Securities (MGS) and negotiable instruments of deposits declined because of their lower yields compared with yields on PDS and lower primary issues of MGS.

During the year, the discount houses also expanded their fee-based activities. The industry lead-managed, co-managed and arranged the issuance of PDS amounting to RM1.4 billion (RM0.4 billion in 1996), while the total amount underwritten by the discount houses was RM2.7 billion in 1997. The number of discount houses appointed as principal dealers remained unchanged at three in 1997.

National Savings Bank

Total resources of the National Savings Bank (NSB) increased by RM167 million or 2.4% to RM7.1 billion at the end of 1997 (RM861 million or 14.2% in 1996). The moderation in growth in total resources was due to the decline in deposits which accounted for 75.8% of total resources. However, this decline was offset by the increase in the Premium Savings Certificates and other current liabilities. The total amount of deposits mobilised fell by RM71 million or 1.3% in 1997 (an increase of RM634 million or 13.2% in 1996), in tandem with the decline in the number of active account holders which fell to 8.5 million at the end of 1997 from 9.2 million at the end of 1996. In December 1997, NSB closed all inactive GIRO accounts, namely accounts which had outstanding balances of less than RM10 and had been inactive for more than two years. In terms of deposits by type, although the deposits mobilised through the GIRO scheme declined by RM192 million or 7.5% in 1997, it continued to be the most popular deposit scheme, accounting for 44% of total deposits. The growth in fixed deposits increased strongly by 23.5%, while savings deposits declined by 9.6%. The higher fixed deposits mobilised during the year could be due to higher deposit rates offered by NSB which ranged from 9.35% to 9.45% per annum in 1997, compared with a range of 7.20% to 7.25% per annum offered in the previous year. Meanwhile, the Islamic savings scheme introduced in 1994, continued to gain popularity as evident from its increase by RM12.3 million or 57.5% to RM34 million. With the extensive publicity and attractive prizes offered, the number of Premium Savings Certificates sold during the year increased by 7.9% to 583,289 certificates valued at RM604 million.

During the year, NSB invested about 56.9% of its total resources in various types of investment certificates. As in previous years, in accordance with the statutory requirement, the bulk of the resources was invested in MGS, which accounted for 35.8% (RM1.4 billion) of the total investment as at end-1997. Other investments were in the form of trustee stocks (RM904 million), Government promissory notes (RM501 million), unquoted shares (RM485 million) and non-trustee stocks (RM219 million).

Table 4.18
National Savings Bank

	Annual change		At end 1997*p*
	1996	1997*p*	
	RM million		
Deposits [1]	634	-71	5,380
Savings	-52	-162	1,520
Fixed	250	274	1,437
Save-As-You-Earn	….	-3	20
GIRO	427	-192	2,369
Others	9	12	34
Premium Savings Certificate	113	135	604
Investments (book value)	589	-331	4,042
Malaysian Government Securities	-151	-511	1,446
Other investments	740	180	2,596
Total loans	371	458	1,945
Total loans (after provision for doubtful debts)	352	448	1,896
Number of NSB branches [2]	-5	-6	482
Number of post offices with NSB facilities	6	6	642
Number of account holders (' 000)	-165	-680	8,471

[1] Includes interest credited
[2] Includes mini-branches and sub-branches
p Preliminary

Reflecting the expansion in economic activities, lending operations of NSB increased significantly. Total loans outstanding increased by RM448 million or 31% to RM1.9 billion at end-1997 (RM352 million or 32.1% in 1996). The bulk of the outstanding loans continued to be extended to individuals, accounting for RM1.8 billion or 91.9% of total loans outstanding. Of this, RM873 million or 48.9% was utilised for hire-purchase financing and RM738 million or 38.9% was granted for the purchase of houses. Corporate and subordinate loans extended also increased, albeit marginally by RM1.1 million or 0.7% to account for a share of 8.1% of total loans outstanding. As in the previous year, NSB allocated about 2.5% of its total loans outstanding for doubtful debts. This provision was higher than the minimum requirement for general provisions of the banking industry, which was at least 1.5% of total loans outstanding net of specific provisions and interest-in-suspense.

In 1997, several branches of NSB were merged, resulting in the total number of branches and sub-branches being reduced to 469 from 475 at the end of 1996. In addition, savings account facilities were also provided in 621 permanent and 21 mobile post offices. During the year, three new automated teller machines (ATMs) were installed, bringing the total number of ATMs to 595 by the end of 1997.

Provident and Pension Funds

Total resources of the 12 **provident and pension funds (PPF)** surveyed by BNM grew by 13.7% (18.8% in 1996) to RM154.3 billion at the end of 1997. Accumulated contributions in contributors' accounts formed the bulk (90.7%) of the resources, while reserves and other liabilities accounted for the balance. Accumulated contributions in contributors' accounts amounted to RM139.9 billion at the end of 1997 (RM121.7 billion at the end of 1996), with the bulk (94%) placed with the Employees Provident Fund (EPF). Growth on an annual basis moderated to 15% from 16.9%, due largely to lower net contributions as well as lower dividends credited during the year. Another contributory factor was the slower growth in the number of contributors of 3.9% (5.1% in 1996) to 16.9 million at the end of 1997.

Net contributions to the PPF during 1997 declined for the first time since 1987, by 1.3% to RM10.3 billion. Similarly, net contributions as a percentage

Table 4.19
Provident and Pension Funds: Selected Indicators

	1995	1996	1997 *p*
	RM million		
As at end			
Number of Contributors ('000)	15,448	16,231	16,872
Accumulated Contributions	104,103	121,704	139,905
Assets	114,192	135,715	154,254
Of which: Investments in			
Malaysian Government Securities	*41,190*	*40,952*	*40,029*
During the year			
Contributions	11,853	14,535	16,671
Withdrawals	3,677	4,105	6,376
Net Contributions	8,176	10,431	10,296
Dividends Credited	6,833	8,196	8,172
Income	7,498	9,630	10,217

p Preliminary

Source: Employees Provident Fund, Pensions Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and six other private provident and pension funds.

of gross national savings decreased to 9.8% (11.4% in 1996). This reflected the moderation in gross contributions and the sharp rise in withdrawals, particularly for the Investment of Members Saving Scheme. Gross contributions expanded at a slower pace of 14.7% given that the growth of 22.6% in the previous year was exceptionally high following a one percentage point increase in the minimum rate of contribution to the EPF. The 1998 Budget announcement in October 1997 to increase the maximum tax deduction allowed on employers' contributions to the EPF or other approved provident funds from 17% to 19% did not have a significant impact on gross contributions in 1997, with only two months of the year remaining.

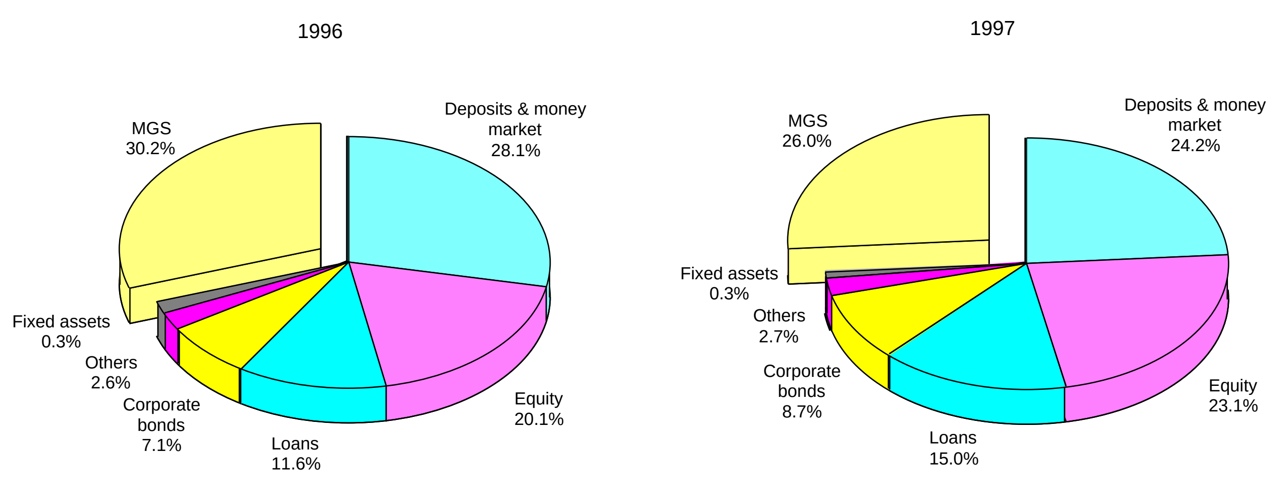
Total withdrawals increased sharply by 55.3% (11.6% in 1996) to reach RM6.4 billion in 1997, reflecting the cumulative effects of the liberalisation of EPF withdrawal schemes. The bulk of the withdrawals from the EPF was effected under the Age 55 Withdrawal Scheme (39.6% or RM2.2 billion) and the Housing Withdrawal Scheme (23.6% or RM1.3 billion). Withdrawals to invest in approved fund management institutions under the Investment of Members Saving Scheme were allowed in November 1996 following amendments to the EPF Act. Such withdrawals grew strongly by nearly 19 times to reach RM627 million, accounting for 11% of total withdrawals from the EPF in 1997.

Another factor that contributed to the moderation in accumulated contributions was the lower amount of dividends credited to contributors' accounts in 1997. Dividends credited decreased marginally by 0.3% in 1997, attributed partly to the lower dividend rate of 6.7% (7.7% in 1996) declared by the EPF, as well as the substantially slower expansion in income of 6.1% (28.4% in 1996).

In terms of the composition of the assets of the PPF, the trend in the shift away from Government papers into private papers continued. Holdings of Malaysian Government

Graph 4.2

Provident and Pension Funds: Composition of Assets



Securities (MGS) declined progressively, accounting for 26% of total assets at the end of 1997 (30.2% at the end of 1996), in view of the lower amount of MGS outstanding as the healthy financial position of the Government reduced its need for new borrowings. However, investments in private papers, namely, loans, corporate bonds and equity, increased in importance, rising by 47.1%, 38.6% and 30.7% respectively to account for higher shares of 15%, 8.7% and 23.1% in their asset portfolio. The higher shares of loans and corporate bonds reflected mainly the increased participation of the EPF in financing privatised infrastructure projects. Similarly, the higher share of equity was primarily a result of the increase in the portion of equity in the asset portfolio of the EPF from 15% to 19% following approval by the Ministry of Finance on 16 August 1997 to allow the EPF to increase its exposure limit to equity investments from 15% to 25%.

In 1997, the EPF continued to play its role in promoting house ownership among the lower-income group, by providing financing for the construction of low- and medium-cost houses through its subsidiary, Malaysia Building Society Berhad (MBSB). As at the end of 1997, MBSB had undertaken housing development projects at four sites (three in Peninsular Malaysia and one in Sarawak) for the construction of 46,854 units.

Pilgrims Fund Board

The activities of the Pilgrims Fund Board continued to expand in 1997. Total resources mobilised by the Board amounted to RM6.1 billion at the end of 1997, representing an increase of 30.2% or RM1.4 billion (37.5% or RM1.3 billion in 1996). The increase in resources reflected the rapid expansion of its operations which included the increase in the number of depositors as well as favourable investment returns during the year. The total number of depositors increased by 8.6% to 3,205,885 at the end of 1997 compared with 2,951,004 in the previous year. Similarly, the number of members registered with the Board to perform the pilgrimage was higher at 25,474 in 1997 (25,326 in 1996).

Total balances held by depositors, including bonuses credited, rose by 33.3% or RM1.4 billion (37.2% or RM1.2 billion in 1996), accounting for 93% of the total resources mobilised at the end of 1997 (91% at the end of 1996). During the year, withdrawals of deposits increased by 24.3% to RM1.2 billion, while deposits increased by 21.4% to RM2.1 billion, resulting in a net increase in deposits of RM982 million. By maintaining the bonus rate at 9.5% per annum, the amount of bonuses credited to depositor's accounts increased by 34.3% to RM440 million.

The Board invested the bulk of its investible funds in corporate securities. Investments in corporate securities rose by 54.2% to RM3 billion (27.6% to RM1.9 billion in 1996), accounting for 48.7% of total assets in 1997. Of these investments, 50.8% was in unquoted shares, mainly in the plantation and industrial sectors, and 49.2% in quoted shares. Although investments in short-term instruments declined by 7.9% to RM2 billion in 1997 (RM2.2 billion in 1996), they accounted for 33% of total assets. Largely due to the higher share of investments in corporate securities, gross dividends received by the Board increased by 48.5% to RM180 million (-24.8% or RM121 million in 1996). During the year, income earned from other investments increased by 44% from RM335 million to RM482 million.

Industrial Finance Institutions

Asset growth of the industrial finance institutions in 1997 was marginally higher than the preceding year. The increase in assets was due mainly to the expansion in loans which accounted for more than half of the increase, and investments. The increase in assets was funded by capital injection and 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.

Borrowing by industrial finance institutions increased significantly by 25.5% in 1997 (12.3% in 1996) to account for 70.3% of the increase in the total liabilities. The increase in borrowings was

Table 4.20
Industrial Finance Institutions: Changes in Direction of Lending

Sector	Year					
	1995/94		1996/95		1997/96	
	RM million	%	RM million	%	RM million	%
Real estate & construction	318	38.1	683	62.0	569	51.6
Manufacturing	187	22.4	115	10.5	214	19.4
Agriculture	-63	-7.5	18	1.6	23	2.1
General commerce	64	7.7	105	9.5	19	1.7
Mining & quarrying	2	0.2	-3	-0.3	8	0.7
Transport & storage	-1	-0.1	…	…	-26	-2.3
Other	327	39.2	184	16.7	295	26.8
Total	834	100.0	1,102	100.0	1,102	100.0

mainly by Export-Import Bank of Malaysia Berhad (RM467.7 million), Malaysian Industrial Development Finance Berhad (RM338.6 million) and Sabah Development Bank Berhad (RM244.2 million). There were no significant changes in the foreign borrowings of industrial finance institutions in 1997, except Export-Import Bank of Malaysia Berhad which recorded an increase of RM155 million.

The other major source of funding in 1997 was capital funds, which accounted for 28.7% of the total increase in the liabilities of the industrial finance institutions. The increase in capital funds was due mainly to the increases in paid-up capital of Export-Import Bank of Malaysia Berhad (RM120 million), Bank Industri Malaysia Berhad (RM120 million) and Sabah Development Bank Berhad (RM100 million).

The loan growth of the industrial finance institutions in 1997 was 22.1% compared with 28.4% in 1996. As in the previous year, loans to the real estate and construction sector took the largest share of the increase in loans. However, the quantum had reduced from two-thirds of the total increase in loans in 1996 to only one-half in 1997. Notwithstanding this, the industrial finance institutions' exposure to the real estate and construction sector continued to remain high at 35.3% of total loans outstanding as at the end of 1997 (1996: 31.7%). Loans extended to the manufacturing sector accounted for one-fifth of the increase in loans in 1997 (10.5% in 1996) to account for 34.3% of total loans outstanding as at end 1997 compared with 37.5% as at end 1996. The balance of the loan increase was channelled to the other sectors of the economy.

Financial Markets

The financial markets in Malaysia experienced turbulence in 1997 following the contagion of the regional financial crisis. Significant adjustment was evident in the capital, money and foreign exchange markets. While stable conditions prevailed in the early months of the year, the domestic financial markets experienced several waves of shocks during the course of the year.

Strong corporate activity and increased private investment outlays led to an increase in net long-term funds raised in the capital market to RM33.4 billion during the year. An equal amount of funds was raised by the private sector in the form of equity and private debt securities. Funds tapped from the stock market were noticeably lower late in the year as investor sentiment weakened. In April, initial concerns were raised over the impact of prudential measures that had been implemented on the banking system, and the direction of international interest rates, on corporate performance. The general sentiment deteriorated during the second half of the year as the effects of the regional crisis worked through the economy and eroded investor confidence. As a result of the bearish sentiment, prices and the value of shares on the Kuala Lumpur Stock Exchange (KLSE) fell by half, an unprecedented development in the history of the Malaysian stock market. Stock prices registered sharp declines on three occasions: in April, August and again in October-November. Total trade transacted was higher than in the previous year although the value decreased, as the overwhelming selling activities vis-a-vis buying activities led to lower transacted prices. By the end of the year, the KLSE was ranked seventh in the Asia-Pacific region and second in ASEAN from fourth and first respectively a year ago.

In the foreign exchange market, trading increased significantly, with activity reaching a peak in July as speculative activity affected a number of currencies in the region and on account of outflows of funds from the domestic equity market. The money market experienced a similar expansion in the volume of trading, reflecting the strong demand for funds in an environment of tight liquidity conditions. Reliance on the interbank market became greater during the latter part of the year when a number of small banking institutions faced large deposit withdrawals.

The greater volatility in the equity market and increased uncertainties in the foreign exchange market contributed towards increased hedging activity on the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE), as reflected in the substantially higher turnover of the KLSE Composite Index futures contracts. In contrast, the trading volume of the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) futures on the Malaysia Monetary Exchange (MME) remained moderate. The low turnover in the last quarter was attributed to the distortion and fragmentation of the KLIBOR futures market and its related cash market, as well as the growing uncertainty in the direction of interest rates.

The Bank continued to accord priority to the development of financial markets as part of the overall development of the financial system, in order that the system would become more strongly market-oriented, with diversity and depth. The objective was for the financial system to have available a variety of instruments and a sufficiently large number of players.

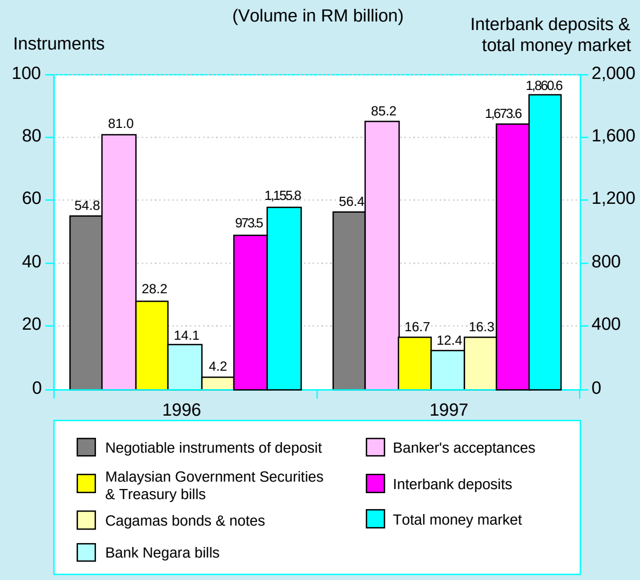
Towards this end, the Bank increased the number of principal dealers as part of the effort to promote an active money market through a principal dealer system that consisted of dynamic and performance-oriented market makers. The privileges of the principal dealers were also reviewed. As the size of operational capacity became increasingly important, and to increase their participation, the Bank raised the minimum capital requirement for finance companies wishing to participate in the money market. The Bank was mindful that the existence of an efficient money market would enhance the effectiveness of the transmission of monetary policy. In the bond market, the launching of the Bond Information and Dissemination System, a comprehensive data collection and dissemination system on the local bond market, reflected the commitment of the Bank towards more efficient dissemination of information and greater efficiency of the market.

Priority was also directed towards improving and strengthening the financial infrastructure, as well as increasing the breadth of other financial markets. The measures included the enhancement of the market infrastructure of the KLSE through sectorisation of the Second Board companies, full prescription of all non-equity counters into the central depository system and shortening of the settlement period from seven days to five days after the transaction date; amendments and revisions to policies and guidelines by the Securities Commission on the issue and offer of securities and release of new guidelines on the offering of securities of foreign-based companies; and introduction of additional products on the MME such as the All-Or-None order and the serial month KLIBOR futures.

Money Market

The volume of funds traded in the **money market** expanded significantly in 1997, reflecting the strong demand for funds to finance credit expansion in an environment of tight liquidity conditions. Total volume of funds traded increased significantly by 61% to RM1,861 billion or an average monthly volume of RM155 billion in 1997 (31% growth in 1996). The increase in total transactions was contributed mainly by the 72% increase in trading in interbank deposits to RM1,674 billion. The higher interbank trading was due to greater reliance on the interbank market to meet funding requirements given the tight liquidity in the banking system as reflected in the resource gap of RM6.6 billion in 1997. Taking into account the compliance with the statutory reserve requirement, the gap would have been higher at RM20.5 billion. The increase in trading volume was also reflective of higher turnover rates as transactions were concentrated at the shorter-end of the market. The greater reliance on the interbank market during the last four months of 1997 was particularly evident among a number of small banking institutions which faced withdrawals of deposits during this period. This development led to the share of overnight transactions increasing to 83% of all deposit transactions in the last four months of the year (79% for 1997 as a whole, 76% for 1996).

Graph 4.3
Money Market



Meanwhile, trading in money market instruments increased more modestly by 2.7% to RM187 billion. This was primarily due to the slower growth in the transactions volume of two of the most heavily transacted instruments, namely, negotiable instruments of deposit (NIDs) and banker's acceptances (BAs), which jointly comprised 75% of the total volume of papers traded in the market. The slower growth in these two instruments was attributed to higher interest rates in 1997. The uptrend in interest rates resulted in declining prices for NIDs and BAs, which discouraged secondary trading. In the case of Malaysian Government Securities (MGS), there was a marked decline in secondary trading following a reduced primary issue of RM3 billion in 1997 (RM6 billion in 1996). The thinner trading in MGS also reflected market players' preference to hold MGS to meet the liquid asset requirement. Availability of assets to meet this requirement was affected by the maturity of RM6 billion of Bank Negara Bills in 1997. The decline in MGS trading was, however, mostly offset by an increase in the trading of Cagamas notes. This, combined with the relative stability in the trading volumes of other instruments, resulted in an overall marginal increase in the total volume of money market instruments traded.

As part of the policy towards promoting an active money market through a principal dealer system that consists of dynamic and performance-oriented market makers, the Bank increased the number of principal dealers (PDs) to 16 in 1997 with the appointment of three more PDs on 1 January 1997. The merging of two of the PD banks in 1997 brought the total number of PDs to 15 at the end of 1997. As the size of operational capacity became an increasingly important competitive factor in the money market, and in efforts to increase participation of PDs in the growth of the financial market as a whole, the Bank raised the minimum capital requirement for finance companies wishing to participate in the money market. With the emphasis on strength of participation and level of activity, finance companies were required to have a minimum shareholders' funds of RM100 million effective 1 January 1997. This minimum was raised further to RM350 million on 1 January 1998 and will be raised again to RM600 million effective 1 January 1999. To further promote trading in the money market, changes were introduced to the privileges given to PDs. Where previously PDs were allowed to net off holdings of excess liquid assets from their eligible liabilities base (subject to a limit of RM50 million), effective 16 May 1997, each PD could deduct from its eligible liabilities base 15% of its sales or purchases of these specified instruments in the secondary market, whichever was lower.

The **Islamic interbank money market** (IIMM) recorded another year of significant improvement in activity. Total volume, encompassing transactions in Mudharabah interbank investment (MII), the Islamic interbank cheque clearing system (IICCS) and interbank trading of Islamic papers, increased significantly by 176% to RM134 billion in 1997. The rise in total volume was attributed to an increase in the volume of MII transacted and greater use of the IICCS to meet funding requirements under the tighter liquidity conditions. Similar to the conventional money market, the volume of trading in papers was also relatively unchanged in the IIMM. Nevertheless, growth of the IIMM as a whole was much faster than the conventional money market. Consequently,

Table 4.21
Islamic Interbank Money Market

	1995	1996	1997
		RM million	
Mudharabah Interbank Investment	1,125	28,742	92,259
Islamic Interbank Cheque Clearing System	2,460	3,513	25,540
Islamic Papers	5,983	16,417	16,274
Total	**9,568**	**48,672**	**134,074**

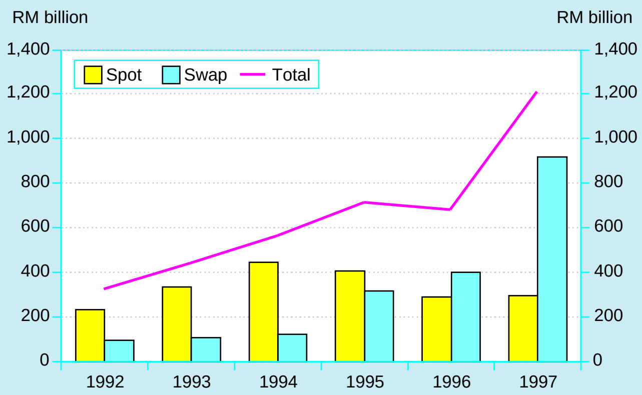
by end-1997, in terms of relative size, the IIMM trading volume equalled 7.2% of the conventional money market volume in 1997 (4.2% in 1996).

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 increased by 65.6% during the year, from RM3.2 billion in 1996 to RM5.3 billion in 1997. The sharp increase reflected the increased number of transactions as well as higher value for each transaction, amidst volatile trading conditions. The activities in the foreign exchange market were dominated by the transactions of the United States dollar against the ringgit. Total transactions in the United States dollar rose to RM1,215 billion from RM686 billion in 1996, accounting for 92.1% of total transactions for the whole year. Transactions in the United States dollar for Deutsche Mark and Japanese yen accounted for 4.3% and 2.4% respectively.

Activity in the foreign exchange market peaked in July in the wake of increased speculative activity on the ringgit in the aftermath of developments in Thailand. The sales of ringgit were also caused by the outflow of funds from the equity markets in Malaysia to markets abroad, particularly the United States. Thereafter, trading activity moderated but picked up again in November and December following increased volatility and commercial demand for the United States dollar for year-end activities. The offshore financial institutions were the major buyers of the United States dollar for the ringgit in the swap market during the year, reflecting speculative activity against the ringgit in the wake of the regional currency crisis.

Graph 4.4
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



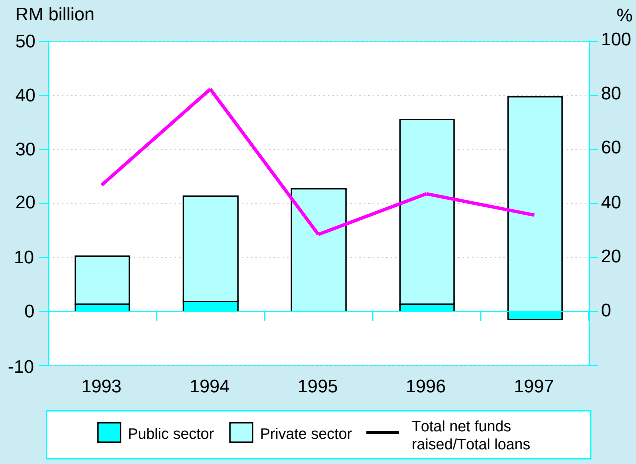
Capital Market

Net long-term **funds raised in the capital market** reached an unprecedented level of RM33.4 billion in 1997 (RM31.8 billion in 1996) representing the fourth consecutive year of growth. While the public sector reduced its recourse to the capital market, the private sector continued to dominate the market, a trend evident since 1989. The predominance of the private sector in the market reflected primarily strong corporate activity and increased private sector investment outlays following an extended period of high economic growth. Stock market sentiment weakened initially at the end of the first quarter as concerns emerged over international interest rates and the introduction of pre-emptive measures to curb credit for less productive activities. Reflecting the contagion effects of the regional financial crisis in the second half-year, economic activity and, hence, corporate activity moderated somewhat, dampening further stock market sentiment. As a result, activities in the primary market showed some signs of moderation. In terms of sources of financing, the ratio of net funds raised in the capital market to total loans extended by the banking system fell to 46% from 53% a year ago. This was attributable to the more stringent approval requirement for new issues of private debt securities (PDS) announced in 1996 as well as the much dampened stock market sentiment, which discouraged the number of prospective issuers seeking new funds.

In tandem with the favourable financial position of the public sector since 1990, the public sector progressively reduced its recourse to the capital market. During the year, the position of the public sector changed to record a net redemption of RM1.4 billion, the last occasion being in 1995 (RM35.2 million). In 1996, net funds raised amounted to RM1.3 billion. Two issues of Malaysian Government Securities (MGS) of RM1 billion and RM2 billion each (RM6 billion in 1996) were raised in part to offset the redemption of the securities during the year, as well as to meet the demand of the banking institutions to fulfil their liquid asset requirements.

A notable development in the Government securities market was the maiden issue of Khazanah Bonds in September, with the objective of developing the benchmark yield curve for the ringgit bond

Graph 4.5
Total Net Funds Raised in the Capital Market
By the Public and Private Sectors



market. The bonds, issued based on the Mudharabah concept, with no coupon or interest payment, had a face value of RM1 billion and tenure of three years. The issue was expected to prelude a series of subsequent and regular issues of benchmark bonds, initially with a tenure of three years to be extended up to 10 years within five years of its introduction.

In contrast to the net repayment by the public sector, net funds raised by the private sector amounted to RM34.8 billion, representing an increase of 14.2% from 1996. In terms of composition, the equity market mobilised a larger amount of RM18.2 billion or 52.4%, while the balance was raised from the PDS market.

In the equity market, about half of the funds was tapped from rights issues (RM8.5 billion or 46.8%). Other forms of corporate securities issued comprised initial public offers (RM4.8 billion or 26.1%), private placements and restricted offers-for-sale (RM3.1 billion or 17.1%) and special issues (RM1.8 billion or 10%). One third of the rights issues was raised by banking institutions to strengthen their capital base as well as to further expand their businesses. Together with the largest rights issue during the year of RM1.5 billion to develop the Bakun Hydroelectric Dam, these issues accounted for approximately half of the total amount sourced from rights issues. In the case of new listings, the number of issues and amount of funds raised were sustained at 88 issues totalling RM4.8 billion (92 issues amounting to RM4.1 billion in 1996). Most of the newly listed companies were also in the Second Board (63), with the remaining 25 companies being listed on the Main Board. Of significance were two developments that occurred late in the year as the regional financial crisis eroded investor confidence and worsened market sentiment. Firstly, the stock market witnessed for the first time, the failure of 15 companies to post a premium over their offer price on the listing date. These companies in fact, closed at a discount to their offer price. More importantly, 13 of these 15 issues occurred in the last two months of 1997, suggesting that investor confidence had reached its lowest. Secondly, related to this, the number of cases of undersubscription of shares was more pronounced, and one company had to abandon its plan to list on the stock exchange after its failure to meet with the minimum subscription level as set out in its prospectus. The weak market sentiment, coupled with these developments, caused several companies to lower their rights issue price and one issuer to abort its rights issue. The dampened market sentiment also discouraged a number of prospective issuers from seeking new funds. As part of the measures to strengthen economic stability and instil confidence in the financial system, a freeze on submissions for new listings, rights issues, and corporate restructuring was imposed on 5 December,

Table 4.22
Funds Raised in the Capital Market

	1996	1997 *p*
	RM million	
By Public Sector		
Government Securities (gross)	6,000	3,000
Less Redemptions	3,809	3,648
Less Government Holdings	-74	-1
Equals Net Federal Receipts	2,265	-647
Khazanah Bonds	-	794
Govt. Investment Issues (net)	-900	-1,400
Malaysia Savings Bond (net)	-34	-155
Net Funds Raised	1,331	-1,407
By Private Sector		
Shares	15,924	18,225
Debt Securities[1]	17,038	19,546
Less Redemptions	2,515	2,998
Equals Net Issues	14,523	16,548
Net Funds Raised	30,448	34,773
Total Net Funds Raised	31,779	33,366
Short-term Papers and Notes (net)[2]	3,811	4,946
Total	35,590	38,312

[1] Excludes debt securities issued by banking institutions.
[2] Refers to commercial papers and Cagamas Notes only.
p Preliminary.

while no new approvals would be given. The only exceptions were strategic investments that generated foreign exchange and savings.

In the PDS market, net funds raised amounted to RM16.5 billion in 1997 (RM14.5 billion in 1996). The higher funds raised were reflective of increased capital investment in line with the sustained economic growth. The bulk of the PDS was raised by the finance, insurance and business services and manufacturing sectors. In terms of purpose, the PDS issued was predominantly for capital investment (69.9% of total), with debt refinancing and mergers and acquisitions accounting for 17.1% and 12.3% respectively of the total issued. In terms of composition, the bulk of the funds was raised through Islamic bonds (26.9% of the total gross funds raised in the PDS market), Cagamas bonds (26.4%), conventional bonds (19.6%) and bonds with warrants (16.9%). As in 1996, the largest issue of Islamic bonds of RM2.2 billion was by Kuala Lumpur International Airport Berhad. On the other hand, Cagamas improved on its previous record of RM4.7 billion raised from 16 issues in 1996 to RM5.2 billion from 13 issues in 1997. The three-year tenure remained most popular, accounting for eight issues. The increased issuance of the bonds reflected mainly the larger amount of housing loans purchased by Cagamas as part of the strategies undertaken by the banking institutions to better manage their liquidity positions as liquidity conditions tightened towards the end of the year.

The year 1997 was a landmark in the history of the Malaysian stock market as the **Kuala Lumpur Stock Exchange (KLSE)** experienced its sharpest correction ever, with both its prices and value reduced by half. In early 1997, expectations were for the buoyant market activity that prevailed at the end of 1996 to continue, supported by foreign investor interest. Reflecting the optimistic outlook, share prices and trading volume on the KLSE rose in tandem, with the volume of turnover reaching a high of 9.2 billion units in February, the highest since January 1996, and the Kuala Lumpur Composite Index (KLCI) culminating in a three-year high of 1,271.57 points on 25 February. The net price/earnings ratio of the KLCI was 27.61 at the end of February. Similarly, the overwhelming interest in the Second Board companies, which was most intense in 1996, persisted into the early part of 1997, so that the Second Board Index (SBI) climbed to a high of 680.25 points on 19 March, and its monthly net price/earnings ratio reached the historical peak of 57.74 in February.

The uptrend was, however, halted in April for several reasons: concerns over the direction of international interest rates; the introduction of

Table 4.23
New Issues of Private Debt Securities (excluding Cagamas Bonds), by Sector and Purpose (RM million)

Sector	Purpose									
	Capital Investment	Debt Refinancing	Mergers & Acquisitions	Others	Total	Capital Investment	Debt Refinancing	Mergers & Acquisitions	Others	Total
	1996					1997				
Agriculture, Forestry and Fishing	-	-	-	-	-	32	181	-	-	214
Mining and Quarrying	-	-	-	-	-	-	-	-	-	-
Manufacturing	1,377	626	1,222	9	3,234	2,879	411	310	5	3,604
Construction	2,116	219	252	11	2,598	1,063	161	824	21	2,069
Electricity, Gas and Water	1,017	-	-	-	1,017	1,691	522	-	-	2,213
Transport, Storage and Communications	2,602	284	-	-	2,886	2,260	-	-	-	2,260
Finance, Insurance, Real Estate and Business Services	219	100	-	-	319	2,044	1,183	600	70	3,897
Government and Other Services	436	-	-	-	436	-	-	-	-	-
Wholesale, Retail Trade, Hotels and Restaurants	369	559	951	4	1,883	84	-	33	3	120
Total	8,136	1,788	2,425	24	12,373	10,053	2,458	1,767	99	14,377

measures to curb excessive lending to the property sector and for the purchase of stocks and shares; and the announcement of plans to shorten the settlement period from seven days after the transaction date to five days. As a result, by end-April, the KLSE experienced a significant fall, with the KLCI declining by 10.2% and the monthly turnover registering a lower amount of RM38.8 billion (average of RM49.9 billion per month in the first three months of 1997).

The bearish sentiment worsened in July, with the market weighed down by concerns over the speculative pressures on the ringgit following the de facto devaluations of both the Thai baht and the Philippine peso. A series of developments further exacerbated the poor sentiment: the revised rating outlook for Malaysia and major Malaysian banks by an international rating agency; the designation of all 100 components of the KLCI; the suspension of short-selling through the prohibition of securities borrowing and lending; and the restriction on non-commercial related offer-side swap transactions. The consequence was the sharpest fall in the KLSE for the year, when the KLCI dipped by 20.6% in August.

The combination of domestic and regional developments continued to influence the performance of the KLSE for the rest of the year. In September, the lifting of the 100 designated KLCI components gave the market some temporary respite. However, the announcement to allow companies to buy back their own shares had limited success in boosting market confidence. Sentiment was depressed again in October, triggered by the contagion effects of the speculative attack on the Hong Kong dollar which precipitated a global stock market plunge, and the Korean won. As a result, the KLCI fell by 18.4% and 17.9% in October and November respectively. The depreciation of the ringgit since July led to higher interest rates and a moderation in domestic economic activity. These developments dampened market sentiment as corporate earnings would be lower.

The depressed sentiment since April pushed all the major price indices significantly lower by the end of 1997. The KLCI, the Exchange Main Board Share (EMAS) Index and the SBI declined by 52%, 56.5% and 71.7% respectively during the year. The largest decline registered by the SBI was not unexpected, given the clear evidence of a significant overvaluation

Graph 4.6
KLCI and Ringgit

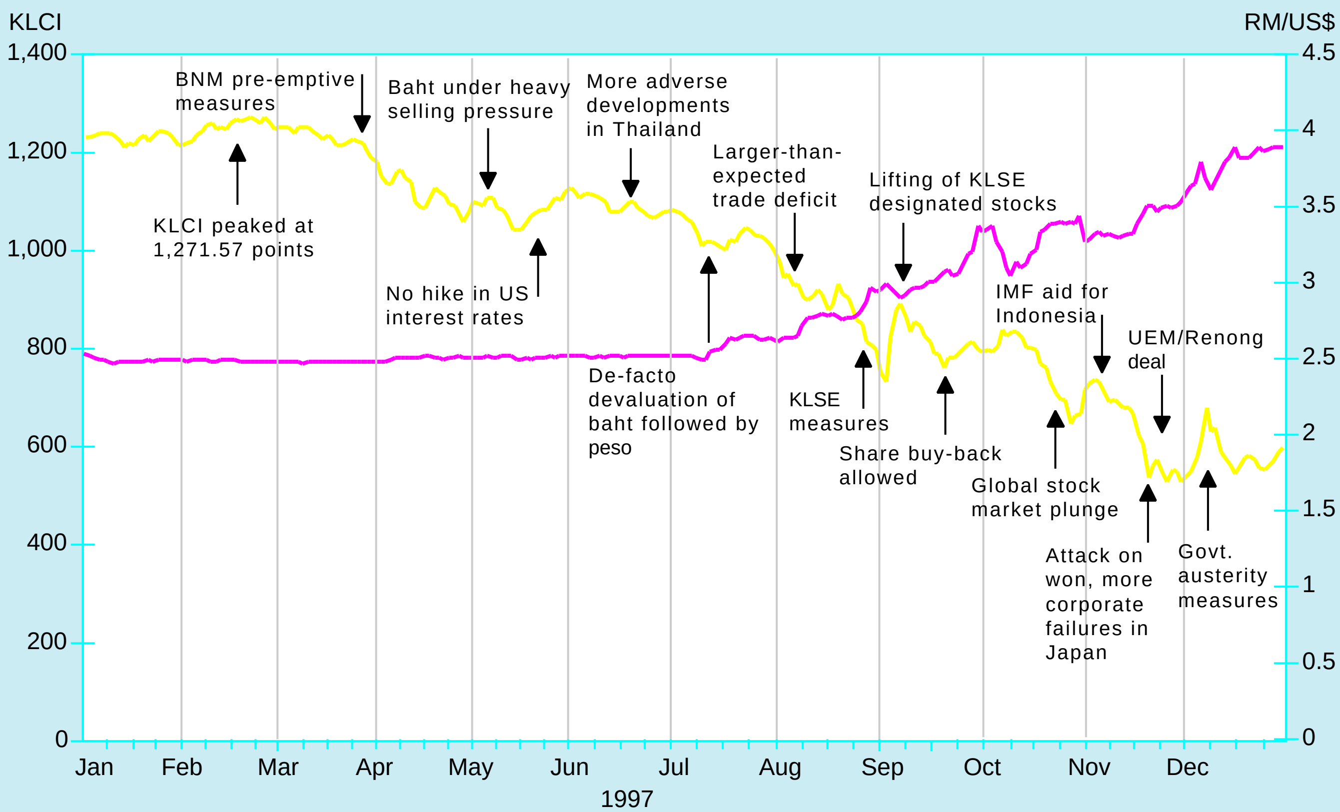


Table 4.24
Kuala Lumpur Stock Exchange: Selected Indicators

	1996	1997
Price Indices		
Composite	1,237.96	594.44
EMAS	347.67	151.21
Second Board	576.31	162.93
Total Turnover		
Volume (billion units)	66.5	72.8
Value (RM billion)	463.3	408.6
Daily Turnover		
Volume (million units)	268.0	294.0
Value (RM million)	1,868.0	1,647.4
Market Capitalisation (RM billion)	806.8	375.8
Market Capitalisation/GDP (%)	322.9	135.6
Total No. of Companies Listed	621	708
Net P/E Ratio	28.6	10.3
Market Liquidity: Turnover Value/Market Capitalisation (%)	57.4	108.7
Market Concentration: 10 Most Highly Capitalised Stocks/ Market Capitalisation (%)	26.8	35.9
Average Paid-Up Capital of Stockbroking Firms (RM million)	67.3	72.0

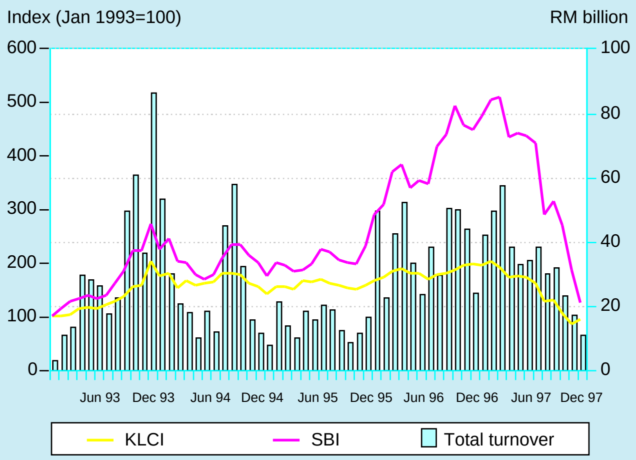
in the Index as early as in the last quarter of 1996. The overvaluation was reflected by the marked deviation of its net price/earnings ratio (49.08) from the historical level then (29.36). The most vulnerable sectors in the economy, namely, the construction, mining, property and finance sectors, recorded price declines in the vicinity of 70%. The restriction on lending for property and the announcements in the 1998 Budget and in December on the postponement of infrastructure projects did not bode well for these sectors. On the other hand, the shares of the finance sector, particularly banking institutions with high exposures to the property and stock markets, were also subject to strong selling activities. Selling pressures intensified as sentiment in the stock market weakened further with mounting concerns over bad loan problems. In addition, the voluntary commitment of the banking institutions in October 1997 to a credit plan implied lower expected earnings for the banking institutions in the near future.

On the turnover front, the volume of turnover transacted increased by 9.5% to 72.8 billion units while the value of turnover declined by 11.8% to RM409 billion. Similarly, on a daily average basis, total trade rose to 294 million units but declined, in value terms, to RM1.6 billion. This anomaly emerged because of the overwhelming selling activities vis-a-vis buying activities which resulted in lower transacted prices. Interest was mainly concentrated in the property (15.7% of the total trade), trading/services (14.9%), Second Board (14.4%) and finance sectors (13.5%). Trading in the construction and finance stocks was higher compared to the previous year, reflecting the weak sentiment in these sectors. On the other hand, the most significant decline in turnover was in the Second Board, from the exceptionally large share of 28.6% of total turnover in 1996 to 14.4%. Market liquidity, as measured by the turnover value to market capitalisation ratio, improved during the year. While the ratio rose from 57.4% in 1996 to 108.7% in 1997, the increase was partly attributed to the significant decline in market capitalisation.

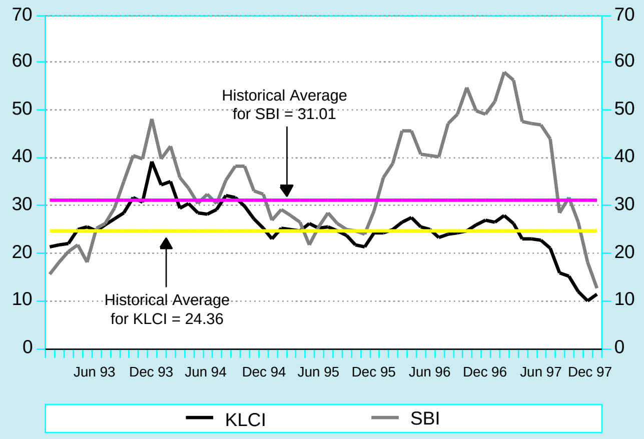
Overall, these developments reduced the market capitalisation of the KLSE by 53% (rise of 42.6% in 1996) to RM376 billion or 135.6% of the nation's gross domestic product (GDP) at the end of the year (RM807 billion or 322.9% of GDP at the end of 1996). In terms of the United States dollar, this decline was the third largest in the Asia-Pacific region after Thailand and Korea. As a result of this, the KLSE was ranked seventh in the region and second in ASEAN after Singapore (fourth in the region and first in ASEAN at the end of 1996). In terms of prices, all regional markets (excluding Australia and New Zealand) closed lower, although the fall in the KLCI was the second after Thailand.

During the third quarter, several measures were implemented by the KLSE to restrain the sharp fall

Graph 4.7
Kuala Lumpur Composite Index, Second Board Index and Total Turnover



Graph 4.8
Net Price Earnings Ratios of Kuala Lumpur Composite Index and Second Board Index



in the market and to restore investor confidence. The most notable was the designation of the 100 components of the KLCI on 28 August 1997 whereby investors were required to deposit their share scrips in the central depository system before selling could take place, and pay cash up front before acquiring shares. In addition, short-selling in the market was effectively suspended by prohibiting the borrowing and lending of securities. Given that the former measure was perceived most adversely by the market, it was rescinded on 5 September. To boost market confidence, listed companies were allowed to buy back their shares following an amendment made to the Companies Act, 1965. As at the end of 1997, four companies had proceeded to buy back their shares.

Other measures included the joint-establishment of a standby fund of RM500 million between the KLSE and the Securities Clearing Automated Network Services (SCANS) in November to provide financial assistance to troubled stockbroking firms. By the end of 1997, the KLSE had placed five stockbroking firms on trading restrictions. The restrictions stipulated that the stockbroking firms were allowed to conduct or execute only selling transactions and make purchases upon the receipt of 100% up-front payment. In addition, they were prohibited from making margin purchases and dealing in direct business transactions and any other activities which would increase their risk or exposure.

The market infrastructure of the KLSE was further enhanced during the year: the sectorisation of the Second Board companies since March resulted in the division of the companies into five sectors, namely, consumer products, industrial products, construction, trading/services and finance; the full prescription of all the non-equity counters into the central depository system at the end of June meant that all settlement and clearing activities in the KLSE had effectively become scripless; the implementation of the T+5 Rolling Settlement System on 18 August shortened the cash and share settlements to five business days after the transaction date instead of seven days, thus bringing the KLSE closer to international standards; and the extension of trading hours in the KLSE by 30 minutes with trading commencing at 9 a.m., effective 5 December.

During the year, the Securities Commision (SC) introduced several measures as a part of the on-going exercise to ensure the growth and orderly development of the capital market:

- The Guidelines for the Public Offering of Securities of Foreign-based Companies with Listing and Quotation on the KLSE were released in April 1997. Among the requirements of the Guidelines were that only primary listings were allowed; the minimum issued and paid-up capital was RM50 million or the equivalent; more than 50% of the capital was to be held by Malaysians or the single largest Malaysian shareholder was to hold 33% of the capital; more than 50% of the total tangible assets was to be situated outside Malaysia; the forecast after-tax profit was to be at least RM6 million; and there was to be a minimum of two Malaysian directors. As at the end of 1997, no application for listing of foreign-based Malaysian companies was received.

- Several amendments were also made to the Policies and Guidelines on the Issue/Offer of Securities (Issues Guidelines):

  – For Main Board companies seeking listing on the KLSE, the minimum issued and paid-up capital was increased to RM50 million from RM40 million while that of Second Board companies, to at least RM10 million but less than RM50 million from at least RM10 million but less than RM40 million.

  – For Main Board companies, the historical profit performance was amended to satisfy either a track record of three years with an after-tax profit of not less than RM4 million per annum and an aggregate after-tax profit of not less than RM25 million over the three years or a track record of five years, with an after-tax profit of not less than RM2 million per annum and an aggregate after-tax profit of not less than RM25 million over the five years. No change was made to the historical performance of Second Board companies.

  – Updates and revisions were made to the dealings by directors; public offerings; listing of property development companies; private placements of securities; reverse take-overs and back-door listings; related party-transactions; information and documents; and submission of proposals.

- The framework on the proposed over-the-counter market or the Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) was announced in February. MESDAQ would be the market where high-technology and small companies with good growth potential could raise their capital for expansion. MESDAQ was also expected to be an important prerequisite for the successful development of the Multimedia Super Corridor. The admission requirements of MESDAQ were generally less stringent than those of the KLSE. Among the important requirements were for eligible companies to be those involved in a single business or a complementary set of businesses, with particular focus on technology-based and technology-related operations such as advanced electronics, biotechnology, environmental technology, advanced materials, information technology, aerospace technology, telecommunications and education/ training; and a minimum paid-up capital of RM2 million. However, a track record on profit was not required. While the operations of MESDAQ were initially planned to begin in the fourth quarter of 1997, they had been postponed given the current depressed sentiment.

In the **PDS market**, the most significant development during the year was the improvement of the infrastructure through the launch of the Bond Information and Dissemination System (BIDS) in October. BIDS is a computerised information system that collects and centralises data on the local bond market, and disseminates the data to market participants. Its establishment was motivated by the need to improve the access to, and transparency of, information on the bond market, thereby further enhancing the development of the secondary market, improving liquidity and facilitating the efficient pricing of new issues, as well as increasing the breadth of the market. Since the launch of the first phase in October, BIDS had been providing information on both primary and secondary activities, including information on all outstanding PDS and MGS, Treasury bills, Bank Negara bills and Cagamas securities. In the next phase to be launched in 1998, the system would be enhanced further, notably, with the inclusion of information on short-term papers. The intention is to continually enhance the infrastructure to keep pace with developments in the debt securities market.

Activities in the **rating industry** moderated in 1997, reflecting the environment of rising interest rates amidst tight monetary policy. In addition, the regional financial crisis and resultant economic slowdown prompted many companies to reduce or defer their corporate exercises and capital expenditure. During the year, Rating Agency Malaysia Berhad completed 51 rating exercises totalling RM13.5 billion, lower than in the preceding year (93 issues totalling RM17.3 billion in 1996). This brought the total number of issues rated since its establishment in November 1990 to 414 totalling RM68.7 billion. The number of ratings was equally divided between the short- and medium-term papers, and long-term bonds. Malaysian Rating Corporation Berhad had its first full year of operations in 1997. It rated 23 corporate debt issues totalling RM11.1 billion in 1997 (six issues totalling RM1.9 billion in the last four months of 1996).

Secondary trading of **MGS** declined from RM25.4 billion in 1996 to RM12.4 billion in 1997, attributed to the smaller amount of MGS issued during the year. Given that redemptions (RM3.6 billion) exceeded the amount issued (RM3 billion), most holders particularly the banking institutions preferred to hold on to existing securities as well as the newly issued securities to meet their statutory liquidity requirements. The first issue of the 10-year RM1 billion MGS in October was oversubscribed by 238% at the weighted average price of the successful bids or coupon rate of 7.284%, while the second issue in November of RM2 billion with a tenure of five years was oversubscribed by 272% at the coupon rate of 8.157%. As in the previous year, there was no issue of Government Investment Issues.

Activities of the **unit trust industry** expanded in 1997 despite the generally depressed market sentiment in the KLSE. During the year, six unit trust funds were launched (10 in the preceding year), while one unit trust management company

Table 4.25
Unit Trust Industry: Selected Indicators

	As at end							
	1996				1997			
	ASN, ASB & ASW 2020	Other Govt./State Backed Funds	Private Funds	Total	ASN, ASB & ASW 2020	Other Govt./State Backed Funds	Private Funds	Total
No. of Unit Trust Funds *	3	24	47	74	3	24	53	80
No. of Unit Trust Mgt. Cos.	1	9	20	30	1	9	21	31
No. of Unitholders (million)	6.6	0.7	0.7	8.0	6.8	0.7	0.8	8.3
Units in Circulation (billion)	27.9	3.7	7.4	39.0	32.0	3.9	9.3	45.2
Net Asset Value (RM billion)	48.9	4.0	7.1	60.0	27.1	1.5	5.0	33.6
NAV/Market Capitalisation of KLSE (%)	6.0	0.5	0.9	7.4	7.2	0.4	1.3	8.9
Net Sales of Units (RM billion)	3.3	…	1.0	4.3	1.6	0.2	1.6	3.4

* Refers to funds already launched.

Source: Securities Commission

(five in 1996) was established. Units in circulation rose by 6.2 billion units to 45.2 billion units, compared with a moderately larger increase of 7.1 billion units in 1996 which was spurred by the launch of Amanah Wawasan 2020. Reflecting the weak sentiment in the KLSE, the net asset value of the unit trust industry fell by 44% to RM33.6 billion. As this decline was smaller than that registered by the KLCI, EMAS Index and SBI, the ratio of the industry's net asset value over the total market capitalisation of the KLSE improved from 7.4% in 1996 to 8.9% in 1997. In addition, an encouraging development was the absence of any significant withdrawals of funds by unit holders, contrary to the general expectation in a depressed market. There was, in fact, a noticeable increase, albeit smaller, in investment in unit trust funds by RM3.4 billion (RM4.3 billion in 1996).

On the regulatory front, the SC announced in May, the first revision to the Guidelines on Unit Trust Funds which were issued in March 1994. The thrust of the revision was to liberalise the Guidelines to allow fund managers to exercise greater product differentiation and innovation. Towards this end, unit trust funds were allowed to invest, within limits, in unlisted securities, other collective investment schemes, and futures and options. The revision also aimed at enhancing the skills and professionalism of the industry, as well as transparency in the industry through the adoption of better disclosure requirements. Another important development was the implementation of a new framework for the marketing and distribution of unit trust products which became effective on 31 January. Under the new requirements, persons who wished to market and distribute unit trust products would have to be registered with the Federation of Malaysian Unit Trust Managers (FMUTM). The implementation and administration of the Guidelines on Marketing and Distribution of Unit Trusts had since been undertaken by FMUTM.

Financial Futures

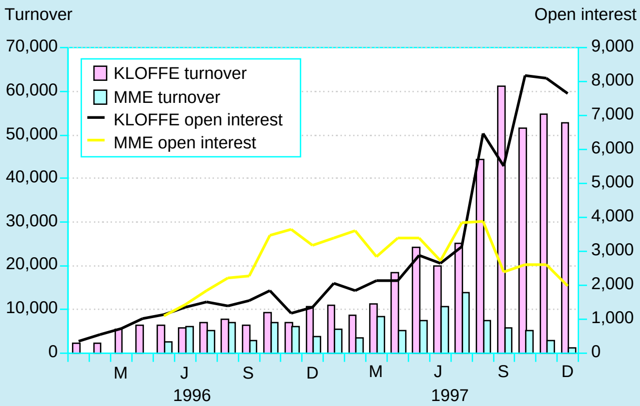
The Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) continued to offer only one product, namely, the **Kuala Lumpur Stock Exchange Composite Index futures (FKLI)** contract in 1997. Trading in the FKLI contract increased significantly, with the total and average daily turnover rising to 382,974 and 1,544 contracts respectively (77,281 and 312 contracts respectively in 1996). The Derivatives Liquidity Ratio, representing the ratio of the turnover value of the futures to the turnover value of the component stocks, also rose from 0.2 in 1996 to 0.5 in 1997.

Turnover expanded progressively from 10,901 contracts in January to reach a record of 61,236 contracts in September. Trading remained buoyant in the last quarter, averaging 52,949 contracts a month. Trading volume was particularly high since August, reflecting the greater volatility in the cash market. The high volume was due mainly to increased hedging activities in response to the uncertainties in the foreign exchange market. This was apparent from the rising share of trade by foreign institutions (mainly hedgers), which accounted for 49% of the trading volume on KLOFFE in the last quarter of 1997 (37% and 43% in the second and third quarters of 1997). The overall improved performance in 1997 could also be attributed to the increased awareness of futures trading, particularly among retail investors, through the various education programmes organised by KLOFFE. The trading volume of the domestic retail sector rose substantially to 30% of the total volume in 1997, from 19% in 1996. Nevertheless, foreign institutions continued to account for the bulk of the trading volume in 1997 (46%).

Reflecting the increased interest in FKLI trading, the size of KLOFFE, measured in terms of "open interest", increased from 1,312 positions at the end of 1996 to a record level of 13,470 positions on 24 December, before declining moderately to 7,614 positions at the end of the year. As part of its future development plans, KLOFFE is working closely with relevant authorities to launch equity index options and individual equity options.

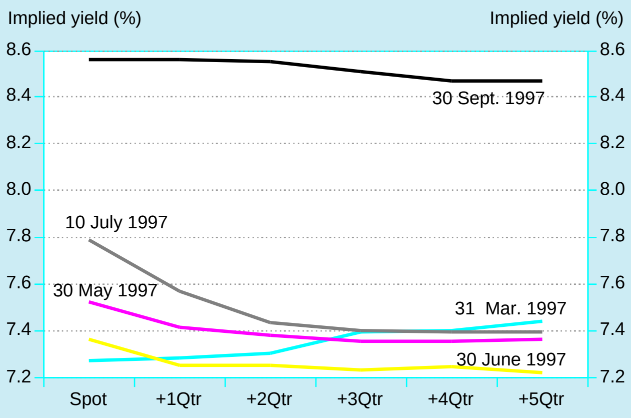
In 1997, only one contract, namely, the **3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) futures** was traded on the Malaysia Monetary Exchange (MME). Trading volume remained moderate, with the total turnover increasing to 76,382 contracts or an average daily turnover of 309 contracts (average daily turnover of 273 contracts in 1996). The monthly turnover reached a peak of 13,893 contracts in July but declined rapidly thereafter to only 1,196 contracts in December, the lowest monthly turnover since its launch in May 1996. The low turnover especially in the last quarter of 1997 could be attributed partly to the distortion and fragmentation in the KLIBOR futures market and its related cash market. This resulted in an increase in the basis risk which made hedging more costly. In addition, the growing uncertainty surrounding

Graph 4.9
KLOFFE & MME: Turnover and Open Interest



Source: Kuala Lumpur Options and Financial Futures Exchange and Malaysia Monetary Exchange

Graph 4.10
Three Month KLIBOR Futures Implied Yield in 1997



Source: Malaysia Monetary Exchange

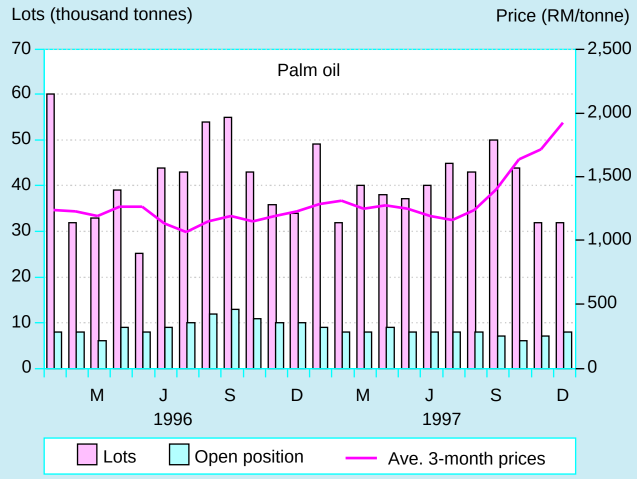
the direction of interest rates forced market makers to quote wider bid-ask spreads (50-90 ticks in December compared with 5-7 ticks in July), thereby contributing to the low turnover. Despite these developments, the market makers continued to play their role of market-making and accounted for the bulk of the trading (49%) in 1997 (46% in 1996).

Against a background of rising interest rate expectations, the implied yields on the KLIBOR futures shifted upwards throughout most of 1997, particularly from September. In the first four months of 1997, the implied yields were relatively steady, with the yields on the spot month contracts trading in the range of 7.16%-7.38%. The stable trend was, however, interrupted by a sharp increase in the underlying KLIBOR fixing rate in May arising from the shortage of ringgit in the foreign exchange market following pressures on the ringgit. Consequently, a slightly inverted implied yield curve developed, as market expectations were for the exceptionally high underlying interest rates to be temporary. As pressure on the ringgit subsided and liquidity improved in the second half of June, the implied yield curve shifted downwards towards the end of the month. However, a second round of speculative activity on the ringgit occurred in July, causing an even sharper increase in the underlying KLIBOR fixing rate. Reflecting this, the implied yield curve again inverted and shifted upwards, with the implied yield on the spot month contract rising to 7.79% on 10 July from 7.36% at the end of June. Thereafter, the implied yield curve moved upwards progressively until the end of the year, reflecting market expectations of higher interest rates as well as tighter liquidity conditions in the money market in the future. The implied yield on the spot month contract rose from 8.56% at the end of September to 10.45% at the end of December.

The size of MME, as measured in terms of "open interest", declined to 1,946 contracts at the end of 1997 from 3,162 contracts a year ago. Notable developments in MME in 1997 included the introduction of the All-Or-None (AON) order in May and the serial month KLIBOR futures in November. The AON order enables users to obtain a single price for large orders when trading in blocks of 50 or more contracts. The two serial month KLIBOR futures contract would be listed at any one time other than the four quarter months available on the standard 3-month KLIBOR futures, and this would enable users to hedge in these additional months. As a result, there would be closer matched hedging, thereby reducing basis risk. As at the end of 1997, 92 serial month contracts had been traded.

Activity in the Kuala Lumpur Commodity Exchange (KLCE) in 1997 remained confined to the trading of **crude palm oil (CPO) futures** contracts. The trading volume was lower even though CPO production was at the peak of its cycle and prices had increased significantly arising from the valuation gains, following the depreciation of the ringgit since July 1997. The trading volume declined by 2.8% to 484,323 lots or equivalent to 12.1 million tonnes of CPO in 1997 (1996: -5.3% or 498,118 lots or equivalent to 12.3 million tonnes), while the ratio of total CPO futures volume traded to actual production declined by 14% (134% compared to 148% in 1996). Following the depreciation of the ringgit, the CPO prices had increased steadily and this was later reinforced by

Graph 4.11
Futures Trading on the KLCE



the Indonesian Government's decision to restrict and subsequently ban exports of palm oil in the first quarter of 1998. As CPO futures prices had trended upwards during the year from RM1,067 in January to RM1,910 in December, the price range for CPO futures also widened substantially to RM843 compared with RM340 in 1996. The increase in CPO futures prices was also more pronounced towards the end of the year. Consequently, there were numerous occasions of limit-up and limit-down in the traded CPO futures prices, as a result of which the volume of CPO futures trade moderated in the last two months of 1997. While the daily turnover at the KLCE averaged above 2,000 lots in the first ten months of 1997, it moderated to 1,961 lots at the end of 1997. Total open positions declined to 7,785 lots at the end of 1997 as compared with 9,897 lots at the end of 1996.

5 External Relations

International and regional co-operation assumed increased importance in 1997 as efforts intensified during the year to identify the means by which the current financial crisis could be resolved. The need to evolve a new mechanism in the international financial system has now become more urgent in the light of the increasing integration of the global financial system and the accompanying challenges posed by such integration, in particular, the need to deal with the regional financial turmoil. In this connection, Bank Negara Malaysia (BNM) continued to participate actively in various international, regional and bilateral fora. The Bank was also directly involved in several multilateral and bilateral financial arrangements that were aimed at promoting stability in the international financial system. In the area of external relations with developing economies, the Bank continued to provide bilateral technical assistance to a number of central banks.

International Relations

During the year, several new initiatives were introduced in the area of international and regional co-operation to enhance the stability of the international monetary system. These included measures to increase the financial resources and capacity of the International Monetary Fund (IMF) to respond effectively to members' financing needs, as well as closer co-operation among regional economies. The latter included efforts to promote mutual surveillance in the Association of South-East Asian Nations (ASEAN) and the Asia-Pacific region as well as a new co-operative financing arrangement to supplement IMF resources in times of need.

International Monetary Fund

During the 48th meeting of the Interim Committee of the IMF in Washington, D.C., on 25 April 1997, the Committee urged the Executive Board of the IMF to expedite its work on the Eleventh General Review of Quotas, an allocation of Special Drawing Rights (SDRs), and the proposal to extend the jurisdiction of the IMF to the capital account of the balance of payments of its member countries. Currently, such jurisdiction covers the current account of the balance of payments. At the 49th Interim Committee meeting on 21 September 1997 in Hong Kong, Special Administrative Region (SAR), China, consensus was reached on a 45% increase in overall IMF quotas (members' capital subscriptions to the IMF) under the **Eleventh General Review of Quotas**. This increase, when fully subscribed, would increase IMF resources to SDR212 billion (about US$288 billion). The Articles of Agreement of the IMF provide for a general review of quotas every five years. The last (tenth) quota review, originally scheduled for end-March 1993, was completed in early 1995 without any increase in quotas. Under the Eleventh General Review of Quotas, 75% of the overall increase would be distributed in proportion to members' present IMF quotas while 15% would be distributed in proportion to members' shares in calculated quotas. This distribution was aimed at reflecting better the members' relative economic positions. As in previous reviews, the calculated quota for each member took into account its Gross Domestic Product, reserves position, variability in exports, and payments and receipts for the period 1990-94. The remaining 10% of the overall increase in quotas would be distributed among those IMF members whose existing quotas were out of line with their positions in the world economy (as measured by the excess of calculated over actual quota shares), of which 1% would be distributed among five member countries (namely, Luxembourg, Malaysia, Singapore, Korea and Thailand) whose quotas were significantly out of line, and which were in a position to contribute to the IMF's liquidity over the medium term. In responding to the Interim Committee's request, in December 1997, the IMF Executive Board submitted a draft resolution on the quota increase for the approval of the Board of Governors to effect the agreed increase in quotas. The Resolution was adopted by the Board of Governors in February 1998. The adoption of the Resolution, which required an 85% majority of the total voting power of the IMF's membership, completes the Eleventh General Review of Quotas. A member country that does not have overdue obligations to the General Resources Account of the IMF will be able to consent to the increase in its quota any time before 29 January 1999.

Under the Eleventh General Review of Quotas, Malaysia's quota would increase to SDR1,486.6 million (0.701% of total IMF quotas) from SDR832.7 million

(0.569%). The total proposed quota size of the South-East Asia (SEA) Voting Group (the constituency in the IMF to which Malaysia belongs together with Indonesia, Thailand, Singapore, Vietnam, Union of Myanmar, Brunei Darussalam, Cambodia, Nepal, Fiji, Lao People's Democratic Republic (PDR) and Tonga) would increase from SDR4,050.5 million or 2.77% of total IMF quotas to SDR6,601.9 million or 3.114%, surpassing the proposed quota size of the African (Anglo-fone) Group (SDR6,359.8 million or 3%). In line with the proposed quota increase, the voting power of the SEA Group would also increase from the present 2.91% to 3.19% of total votes. As a result, the SEA Group's ranking in the 24-member IMF Executive Board, in terms of voting share, would improve by one place to 15th position. Within the SEA Group, Malaysia's relative position would remain unchanged, with the second largest quota share. Indonesia would continue to hold the largest share, while Thailand and Singapore would remain at third and fourth position respectively. The relative ranking of the other members of the Group would also remain unchanged under the proposed Eleventh General Review of Quotas. Countries in the SEA Group with the three largest quota sizes have the opportunity to represent the SEA Group members at the Interim Committee meetings of the IMF. In 1997, Malaysia represented the SEA Group at these meetings.

The 49th meeting of the Interim Committee also reached a consensus on the issue of a **special allocation of SDRs**. It was agreed that the Articles of Agreement of the IMF would be amended to provide for a special one-time SDR allocation totalling SDR21.4 billion, to provide all members with an equitable share of cumulative SDR allocations. Under this arrangement, IMF members which faced balance of payments difficulties could draw down their SDR allocations to obtain an equivalent amount of foreign exchange from the IMF. The use of the SDRs would result in a decline in the member's holdings of SDRs below its cumulative allocations and would be subject to IMF interest charges. In contrast, members which held SDRs in excess of their allocations would receive a return on such holdings from the IMF. As Malaysia's holdings exceeded its allocations of SDRs, the country received a return on these balances from the IMF. The share for Malaysia in the special SDR allocation amounts to SDR105.06 million, resulting in a cumulative SDR allocation of SDR244.11 million. This new allocation, when implemented, would result in a net increase in BNM's reserves in the form of SDRs by SDR105.06 million (about US$143 million).

The 49th meeting of the Interim Committee also reached a consensus on the proposed extension of the **IMF's jurisdiction over the capital account** of its members. While there was broad support for the proposal, several countries including Malaysia, urged for a more cautious approach. This was considered important to ensure that the liberalisation of the capital account of the balance of payments would proceed in an orderly manner, commensurate with the appropriate sequencing of macroeconomic and financial reforms. In particular, such liberalisation needed to be accompanied by the development of stronger institutions and an adequate prudential and regulatory framework. The decisions of the Interim Committee were subsequently endorsed by the IMF Board of Governors at the 1997 Joint IMF/World Bank Annual Meetings in Hong Kong SAR, China, on 23-25 September 1997.

In response to the call for a rapid-response facility to address financial crises, the IMF Executive Board agreed on the establishment of a special facility, the **Supplemental Reserve Facility (SRF)** on 17 December 1997. The SRF would provide members with exceptional access to IMF resources where a crisis of confidence had developed with the risk of significant outflows of capital. The purpose of the SRF would be to contain further outflows and rebuild reserves, with the implementation of an adjustment programme and the implementation of a financial package that would bring about a return of confidence. Thus, the SRF is aimed at limiting the potential costs associated with an excessive exchange rate depreciation, undue correction in the current account, and unnecessary insolvency that might otherwise occur.

During the 1997 Joint IMF/World Bank Annual Meetings in Hong Kong SAR, China, BNM also participated in an informal meeting of potential participants of the **New Arrangements to Borrow (NAB)** on 23 September 1997. The meeting reviewed the status of the process of adherence to the NAB Decision and members also exchanged views on issues relevant to the NAB and its future operation. Under the NAB, 25 participating countries, including Malaysia, agreed to extend loans that would amount to a total of SDR34 billion (about US$46 billion) to the IMF in the event that supplementary resources were required to forestall or cope with an impairment of the international monetary system, or deal with exceptional situations that posed a threat to the stability of the financial system. The NAB would come into force when it had been adhered to by potential participants with credit arrangements amounting to no less than SDR28.9 billion (about US$39 billion), including the five members with the largest credit arrangements. Participants of the informal meeting were informed that as of September 1997, 15 countries, with credit commitments amounting to SDR15 billion had already adhered to the NAB Decision. On its part, Malaysia ratified the NAB Decision on 4 March 1997, whereby Malaysia agreed to provide credit arrangements amounting to SDR340 million to the IMF when needed. Countries that had not done so were urged to undertake the necessary steps to adhere to the Decision.

The informal meeting of the potential NAB participating countries also discussed the South-East Asian crisis, its causes and related policy issues in dealing with such situations. Participants noted that the maturity mismatch with long-term lending being financed by short-term liabilities was a major contributory factor to the crisis. In some cases, the mismatch also involved foreign (or foreign currency) transactions. The meeting welcomed an IMF proposal to provide a paper on the lessons of the South-East Asian crisis. Potential participants of the NAB Decision would discuss this paper at the time of the 1998 Spring IMF meetings. The meeting underscored the importance for countries to consistently pursue strong macroeconomic policies, to be better prepared to respond to crises with appropriate policy adjustments, and to attach high priority to efforts to strengthen their financial systems. In this regard, the meeting welcomed the growing collaboration between the Basle Committee, the IMF and the Group of Ten (G-10) in the area of banking supervision. The meeting also suggested that the IMF should explore options to ensure that private creditors bore an appropriate share of the burden in resolving the crisis.

Notwithstanding the lack of progress on the NAB, 1997 was an important year for international and regional financial co-operation. In response to the South-East and East Asian financial crises, several bilateral contributors and international financial institutions acted in concert to provide supplementary financial support to the IMF adjustment programmes for Thailand, Indonesia and Korea. In August 1997, BNM participated in a programme whereby eight countries and the World Bank, the Asian Development Bank (ADB) and the Export-Import Bank of Japan agreed to provide supplementary financing to support an IMF adjustment programme to restore financial stability in Thailand. A total of US$17.2 billion was raised, of which US$4 billion would be provided by the IMF, US$1.5 billion by the World Bank, US$1.2 billion by the ADB and US$4 billion by the Export-Import Bank of Japan. Bilateral financial assistance amounted to US$6.5 billion, including US$1 billion from BNM. The supplementary financing was in the form of a bilateral loan consisting of a currency swap agreement between the Bank of Thailand and the contributing central banks. The tenure of the financing was between three and a half to five years, in line with the IMF facility, while the rate of interest was set at the six-month London Interbank Offer Rate (LIBOR) for the United States dollar. The bilateral drawings would be made in parallel with and proportional to drawings under the IMF stand-by arrangement. In October 1997, Malaysia and other countries in the Asia-Pacific region also made available supplemental financing in support of an IMF adjustment programme for Indonesia. Such financing was in the form of stand-by credit, as a second line of defence in the event that IMF resources were insufficient to meet Indonesia's requirements. Malaysia contributed US$1 billion to this supplemental financing package totalling US$20 billion. Under this arrangement, the first line of defence would be provided by the IMF (US$10 billion), the World Bank (US$4.5 billion) and the ADB (US$3.5 billion). Indonesia would also draw upon its own reserves (US$5 billion) before approaching bilateral contributors for additional financing. In the case of the IMF programme for Korea in December 1997, resources from the IMF amounted to US$21 billion, while the World Bank provided US$10 billion, the ADB, US$4 billion and 13 other bilateral contributors provided US$23.35 billion of supplemental financing in support of the IMF adjustment programme.

World Trade Organisation

1997 marked an important year for the World Trade Organisation (WTO). Following three attempts over a protracted period of six and a half years, the **WTO financial services negotiations** were concluded on 12 December 1997 with all participating members agreeing to accord most-favoured-nation (MFN) treatment in financial services trade. The acceptance of MFN by all countries, including the United States, meant that any concession or favourable treatment would automatically be made available to **all** WTO members. The negotiations were concluded among 102 countries, where 70 countries offered improved commitments for market access and national treatment. The agreement was significant as it represented a multilateral acceptance of a rule-based and transparent system for the conduct of trade in financial services. It was estimated that the agreement covered 95% of financial services trade, involving US$18 trillion in global securities assets, US$38 trillion in international bank lending and about US$2.5 trillion in worldwide insurance premiums. The agreement would be ratified on 29 January 1999 and come into effect on 1 March 1999. In the meantime, members undertook a political commitment to resist any measure that would be inconsistent with their commitments.

The 1997 agreement was the third attempt in seeking a successful conclusion on a MFN basis. When the Uruguay Round was concluded on 15 December 1993, the financial services negotiations concluded without achieving a full MFN-based agreement as a result of the United States' decision to deny MFN treatment and instead allow access only on a reciprocal basis. Many countries responded by scaling down their offers, including filing MFN exemptions. Consequently, the Ministerial Meeting in Marrakesh in April 1994 agreed that the financial services negotiations be resumed in January 1995 for an extended period of six months with the objective of seeking a full MFN-based agreement. As the United States viewed the level of market openings committed by many of its important trading partners to be below expectations, it again could not agree to a full MFN-based agreement. In the light of the United States' position, countries agreed to the European Union's proposal that countries accept an interim agreement, which was subject to review in 1996. Altogether, 43 countries (except the United States) signed this interim agreement and agreed to accord MFN treatment to all WTO members. In December 1996, countries agreed to resume negotiations in April 1997 for conclusion by 12 December 1997.

In the latest negotiations, Malaysia made substantial improvements: six new licences for life reinsurance; 100% equity was offered to foreign fund management companies; and liberalisation in offshore investment banking, offshore insurance, offshore financial leasing, offshore money and foreign exchange broking services and underwriting by offshore banks and offshore investment banks. Expatriate posts in selected areas (for example, treasury operations, actuarial functions) were also committed for banking (five posts) and insurance (three posts). The most significant concession by Malaysia was in the area of foreign presence in the insurance industry. Malaysia agreed to relax the aggregate foreign shareholding in the insurance sector to 51% from 30% in 1993 and 49% in 1995. The concession, however, could be availed only in the following instances – foreign direct insurers operating in Malaysia as a branch which incorporates locally; the existing foreign owner of a locally-incorporated insurer which has yet to restructure and provided aggregate foreign shareholding does not exceed 51%; and the present foreign shareholders of locally-incorporated insurance companies which were the original owners of these insurance companies and which had supported Malaysia's development policy, provided aggregate foreign shareholding does not exceed 51%. Equity participation in locally-incorporated insurance companies by new foreign shareholders would continue to be limited to 30%.

The Malaysian commitments in respect of foreign equity participation in the insurance sector reflected the national development policy which had been in place since the 1970s. Malaysia could not fully meet the requests of developed countries to allow 100% foreign equity in existing insurance companies because this would place at a disadvantage those foreign-owned companies which had already restructured. The concession to grant foreigners controlling interests of 51% foreign equity in the insurance sector was unprecedented and represented a significant political commitment to the importance of preserving the multilateral trading system. Despite this, the United States filed a narrow MFN exemption in the insurance sector which would deny a member country the benefit of expanding existing operations, establishing new commercial presence or the conduct of new activities in the event that the member country were to require an insurance service supplier from the United States to reduce its share ownership in an insurance services provider in the member country to a level below that prevailing on 12 December 1997.

ASEAN Co-operation

The **inauguration of the ASEAN Finance Ministers' Meeting (AFMM)** in Phuket, Thailand, on 1 March 1997 represented an important milestone in ASEAN financial co-operation. The establishment of the AFMM represented a pivotal point for ASEAN co-operation in financial matters, as it provided a more formal and structured mechanism for ASEAN co-operation in the area of macroeconomic management and finance. An important outcome of the AFMM was the decision to strengthen regional surveillance and provide financial assistance to members in times of need. While such co-operation had long been in existence in ASEAN, they had tended to be on an informal and bilateral basis in the past. Recent developments in the global and regional financial markets, however, indicated the need for a more structured and multilateral policy dialogue among the ASEAN finance ministries and central banks to discuss common policy issues and concerns, highlight risks and policy options to promote policies that ensure price stability, sound financial systems and sustainable long-term growth in the region.

Efforts to further enhance financial co-operation gathered momentum at a **Special ASEAN Finance Ministers' Meeting** in Kuala Lumpur, Malaysia, on 1 December 1997. The meeting also witnessed the accession of two new members, Union of Myanmar and Lao PDR to the ASEAN fraternity. Issues discussed at the meeting included the regional financial crisis and member countries' policy responses to address the crisis. The meeting also discussed matters relating to the need for greater transparency of currency markets, a regional surveillance mechanism, regional financing arrangements, a market-based approach to the intermediation problem in Asia and financial and prudential regulation. On the issue of transparency of currency markets, the Finance Ministers of ASEAN recognised the importance of sound and transparent policies and governance to cope with the challenges of globalisation. The Ministers also noted the need to improve understanding and transparency of the operations of key players in financial markets to ensure the efficient functioning of economies and financial markets. The Ministers agreed that such efforts should be implemented on a global basis and welcomed the preliminary results of the IMF study on hedge funds. The Ministers urged the IMF to expand the scope of the study to examine the structure of global financial markets and short-term capital flows, including the operations of hedge funds and their impact on financial and banking sectors, as well as the impact of technology on capital flows.

The ASEAN Finance Ministers also endorsed the proposal for a new framework for regional co-operation arising from a meeting of Asian Finance and Central Bank Deputies in Manila on 18-19 November 1997. In terms of a regional surveillance mechanism at the ASEAN level, Ministers indicated a preference for a mechanism similar to the G-10 format but with a distinct ASEAN character. The Finance Ministers agreed that a permanent ASEAN secretariat be set up to facilitate the surveillance process. Regular informal meetings of central bank and finance officials at the Ministerial and Deputies' level would be held. In this connection, ASEAN Finance Ministers endorsed the establishment of the ASEAN Central Bank Forum and the Select Committee of ASEAN Central Bank and Finance Officials, which would highlight key issues and policy concerns for the attention of the Ministers. The **inaugural meeting of the ASEAN Central Bank Forum** was held in Kuala Lumpur on 4-5 November 1997. Members of the Forum agreed to meet regularly to discuss regional economic and financial developments within the global context. The IMF would provide technical support to the Forum, in particular to assess developments in the region and to identify emerging risks. Through the Forum, members would have an opportunity to share experiences which will help anticipate economic and financial risks and exchange technical assistance and policy advice, where appropriate, on possible solutions to economic and financial issues. The Forum also agreed to discuss various options to foster a common ASEAN position in its relations with other international and regional institutions.

In terms of measures to promote regional financing arrangements, in addition to the proposed Manila Framework, ASEAN Finance Ministers agreed that the **ASEAN Swap Arrangement (ASA)** should be renewed when its current term expired on 5 August 1998. The ASA represented a long-standing tradition of ASEAN financial co-operation. 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 ASA has been renewed on six occasions, the latest being on 25 July 1997 when the Sixth Supplementary Agreement was signed to extend the ASA for another year to 5 August 1998. 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. The renewal of the ASA for only one year was to allow members to re-examine the role of the ASA, in line with the decision of the ASEAN Finance Ministers at their inaugural meeting in Phuket, Thailand on 1 March 1997 to conduct a review of the ASA, taking into consideration existing bilateral and multilateral arrangements. The ASEAN Ministers of Finance also agreed on the importance of a rapid-response mechanism to assist member countries facing financial crises and agreed that ASEAN countries in a position to provide financial assistance should give special consideration to any member country requiring such assistance. ASEAN countries also agreed to provide, in consultation with the IMF and on a case-by-case basis, supplemental financial resources for IMF-supported programmes.

In conjunction with their special meeting, the ASEAN Finance Ministers met with the Finance Ministers of Australia, the People's Republic of China, Hong Kong SAR, China, Japan, Korea and the United States **(ASEAN Plus Six Meeting)** on 2 December 1997 in Kuala Lumpur. The Meeting of the ASEAN Plus Six Finance Ministers discussed the regional financial situation and shared the views of the ASEAN Finance Ministers. The meeting also agreed that there was an urgent need to develop a deep, liquid and mature debt market to address the intermediation problem in Asia. In this connection, the Meeting endorsed a proposal to develop a market-based approach to mobilise private sector resources, with the intermediation of the ADB, IMF, World Bank and other international financial institutions (IFIs) to assist the adjustment efforts in the Asian region. Subsequently, the Hong Kong Monetary Authority hosted a technical meeting on 17 December 1997 to explore options to move this proposal forward.

New Framework for Asian Regional Co-operation (Manila Framework)

In order to pursue a proposal for a regional financing facility to deal with currency speculation, a Meeting of Asian Finance and Central Bank Deputies was convened in Manila, Philippines, on 18-19 November 1997. The meeting endorsed a proposal for a new framework for enhanced Asian regional co-operation to promote financial stability. The proposal, subsequently referred to as the **Manila Framework,** involved initiatives on four fronts: a mechanism for regional surveillance to complement the IMF's global surveillance; technical co-operation to enhance domestic financial systems and regulatory capacities; measures to strengthen the IMF's capacity to respond quickly to financial crises and a co-operative financing arrangement to supplement resources from the IMF and other IFIs. The mechanism for regional surveillance would involve the assistance of the IMF, World Bank and ADB in highlighting policy concerns and issues for discussion. On technical co-operation, the IFIs were urged to assist national authorities to upgrade their financial systems, enhance co-operation among market regulators to respond to contagion and explore other measures to improve the integrity and functioning of the financial markets. In terms of the proposed co-operative financing arrangement, the Manila Framework provided for member countries to contribute supplemental financing for an IMF-supported programme for a country on a case-by-case basis. In exceptional cases, where IMF resources were insufficient to meet a member country's need, other member countries might consider lending in parallel with the IMF. However, it was noted that this initiative should be carefully designed to mitigate the moral hazard issue and ensure that private creditors adequately assess risks and bear an appropriate share of the burden of adjustment and financing in times of crisis. Japan agreed to host another meeting in Tokyo on 26-27 March 1998 to further develop the initiatives of the Manila Framework, with the assistance of the IMF. In this context, the setting up of the Regional Office for Asia and the Pacific by the IMF in Tokyo, Japan, in February 1997 was most timely.

Asia-Europe Co-operation

The First Asia–Europe Finance Ministers' Meeting was held in Bangkok on 19 September 1997. Finance Ministers from 10 Asian nations (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam, the People's Republic of China, Japan and Korea) and 15 Member States of the European Union (EU) attended the meeting. The meeting was a follow-up to the First Asia-Europe Meeting (ASEM) between Leaders of Asia and Europe on 1-2 March 1996 in Bangkok. The Leaders identified several areas of co-operation, including economic co-operation, cultural and development co-operation, and co-operation in education and environment. The Finance Ministers discussed the macroeconomic outlook in their respective countries and exchanged views on developments in the foreign exchange markets and the European Monetary Union (EMU). The Ministers also considered options to promote closer co-operation in the financial sector and in customs matters. In order to enhance co-operation between Asia and Europe, the Ministers agreed to the following initiatives:

- **ASEM Discussion on the Euro and its Implications on Global and Asian Financial Markets** – The Meeting agreed that the opportunity would be offered within the framework of the international financial institutions, bilateral contacts and inter-regional discussions to keep Asian participants fully informed about the implications for the financial markets of the forthcoming introduction of the euro. Subsequently, a seminar on "European Monetary Union" covering, amongst others, the external implications of the euro, was held in London on 4 February 1998. The seminar was attended by the ASEM Finance Deputies.

- **Strengthening ASEM Co-operation in Fighting Money Laundering** – The Meeting agreed to take concrete steps to strengthen the co-operation between the EU and Asia in the fight against money laundering.

- **Computerised Communication Network among ASEM Finance Ministries** – The Meeting agreed to study the development of a framework for establishing a computerised communication network among the ASEM Finance Ministries to facilitate improved information sharing about macroeconomic and financial developments and policies.

- **Strengthening Co-operation in Financial Supervision and Regulation** – In view of the increasing financial integration between Asia and Europe, the Meeting requested the European Commission to develop a programme for more effective implementation of existing supervisory principles and regulations to ensure financial stability in the region.

- **Enhancing Macroeconomic Policy Consultation** – The Meeting agreed that it would be useful to schedule meetings of ASEM Finance Deputies to discuss international financial issues raised in other international monetary and financial fora.

- **Strengthening ASEM Customs Co-operation** – The Meeting agreed to support the future work programme of ASEM Customs' Director Generals and Commissioners to develop closer co-operation between customs authorities in Asia and Europe in the areas of customs procedures and enforcement.

Asia-Pacific Economic Co-operation

The Manila Framework was also welcomed and endorsed by Leaders and Economic Ministers of **Asia-Pacific Economic Co-operation (APEC**) economies. At the APEC Economic Leaders' meeting in Vancouver, Canada, on 24-25 November 1997, Leaders supported the Manila Framework as a constructive step to enhance co-operation to promote financial stability. In this regard, they welcomed enhanced regional surveillance, intensified economic and technical co-operation to improve domestic financial systems and regulatory capacities, adoption of new IMF mechanisms on appropriate terms in support of strong adjustment programmes and a co-operative financing arrangement to supplement, when necessary, IMF resources. The Leaders also called for the acceleration of work launched at the Fourth APEC Finance Ministers' Meeting in Cebu, Philippines, on 5-6 April 1997. This included collaborative initiatives to promote the development of APEC financial and capital markets, and to support freer and stable capital flows in the region.

In 1998, Malaysia will assume the chairmanship of APEC from Canada, the host in 1997. As chair, Malaysia has designated the issues of developing human resources and the expanding use of new technologies as key issues for its APEC agenda. The APEC Ministerial Meeting has been scheduled for 14-15 November 1998 while the APEC Leaders' Summit will be held on 16-17 November 1998.

Other Forms of Regional Co-operation

During the year, BNM continued to actively pursue close co-operation with central banks and monetary authorities in the Asia-Pacific 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, China, Japan, Korea, Indonesia, Malaysia, New Zealand, the Philippines, Singapore and Thailand. The EMEAP forum has thus far contributed greatly to strengthening the co-operation among the countries in the region and enhancing the stability of the regional financial markets. In this context, BNM participated in all four meetings of the EMEAP forum held in 1997. These included the Second EMEAP Governors' Meeting held in Shanghai, the People's Republic of China on 25 July 1997, the Thirteenth and Fourteenth Deputies' level Meetings of EMEAP held in Hong Kong SAR, China, on 21 March and Manila, Philippines, on 21-22 November 1997 respectively, and the informal meeting of EMEAP officials held in Bangkok, Thailand, on 24 May 1997.

As in previous years, EMEAP meetings held during 1997 provided participants with an opportunity to review current economic and financial conditions in the respective member countries and to exchange views on topical issues. In 1997, the Governors of EMEAP countries discussed the phenomenon of asset price inflation and its impact on monetary policy. Other topics included the new monetary arrangements in Hong Kong SAR, China, after 1997 and the new Bank of Japan Law. In line with efforts to foster closer co-operation, the meetings also reviewed the progress of the two working groups and the study group of EMEAP. These groups also examined issues on bank supervision, development of financial markets and central banking operations. During the year, the Working Group on Financial Market Development completed its Red Book on Financial Markets and Payment Systems in EMEAP Economies. The book examined five markets in each member economy, namely, the money market, bond market, stock market, foreign exchange market and offshore market. The book also reviewed the relationship between financial markets and payment systems, and the conduct of monetary policy. The Deputies' Meeting in Manila endorsed the proposal to publish the Red Book. Similarly, the Working Group on Central Banking Operations completed its Gold Book on reserve management policies and practices among EMEAP members, while the Study Group on Banking Supervision was finalising its work on the Green Book on Prudential Banking Supervision in EMEAP Economies.

An important achievement in terms of EMEAP co-operation was the establishment of its Virtual Secretariat in 1997. The Secretariat provided a link for resources devoted to EMEAP matters in various member central banks and monetary authorities and would facilitate easier access, closer contact and better co-ordination among EMEAP working and study groups. In the process, this would further enhance the effectiveness of EMEAP activities and projects. In line with the aim to further enhance communication among EMEAP members, the first and second stages of an EMEAP Internet were also completed in 1997. In the first stage, members acquired an EMEAP Internet address to facilitate the exchange of regular documents and papers by electronic mail. The second stage involved an encryption process to enable the exchange of confidential information. Further refinements that were examined included the possibility of installing software that would perform three functions, namely, an electronic meeting system, an electronic library for EMEAP documents and an electronic bulletin board.

In addition to the regular agenda, the EMEAP Deputies also participated in a dialogue with representatives from the United States Federal Reserve Board and the Federal Reserve Bank of New York in Manila on 21 November 1997. The meeting discussed developments in asset prices and the implication for central bank policies and noted that asset price inflation often arose from easy access to financing through the banking system and capital inflows. In this regard, the policy response in EMEAP economies included a combination of prudential guidelines, moral suasion and more stringent limits on bank exposure to the equity and property markets. Participants also exchanged views and experiences on the effects of foreign exchange market intervention. The meeting noted that the effectiveness of foreign exchange intervention was limited as the combined resources of market players far outweighed the resources of individual central banks. Hence, it was important to pursue sound macroeconomic and financial policies and allay any negative market perceptions or expectations.

The Bank 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 13-14 February 1998. The keynote address on "Financial Stability and International Capital Flows" noted that even countries with strong fundamentals could be affected by a sudden loss of confidence and sound policies also required adjustments in a crisis situation. It was also noted that an exchange rate peg was not a panacea in the current globalised financial market. It was suggested that capital account liberalisation must be accompanied by stronger prudential measures to strengthen the banking system. In this connection, sound banking standards were vital and countries were urged to adopt the Core Principles for Effective Banking Supervision of the Basle Committee. 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 is expected to slow down, while inflation could increase but remain at single digit levels in 1998. The current account positions of several member countries were beginning to improve and the restructuring of the financial sector would ensure a stronger and more transparent financial system, in compliance with international standards. This would help support a return to sustainable growth over the medium term. The Governors later 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 by the Governors.

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.

Bilateral Co-operation

Given the importance of closer central bank co-operation in the region, particularly in the wake of the Asian financial crisis, BNM maintained its **Bilateral Repurchase Agreements** with several central banks and monetary authorities in the Asian region. The agreements were in the form of memoranda of understanding, which enabled the signatories to obtain immediate liquidity from each other on the sale of mutually-agreed securities and currencies as and when needed. During the year, eight such agreements were in force with the Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, The Bank of Korea, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore and the Bank of Thailand. In order to ensure that the agreements could be activated smoothly when called upon, BNM carried out three test runs with the corresponding counter parties, namely, the Reserve Bank of Australia, Bank Indonesia and the Hong Kong Monetary Authority during the year. The test runs proceeded smoothly as planned.

The Bank continued to participate in **annual bilateral meetings** with a number of central banks and monetary authorities in 1997, as such meetings provided an opportunity to discuss issues of common interest and to share experiences on economic and financial matters. During the year, BNM participated in bilateral meetings with Bank Indonesia in Kota Kinabalu on 8-10 August, the Monetary Authority of Singapore in Singapore on 8-10 October and the Hong Kong Monetary Authority in Kuala Lumpur on 17-19 October. Among the issues discussed at these meetings were recent economic and monetary developments in the respective countries; bilateral trade and investment relations; and a review of each country's strategies and policies to address the regional financial turmoil. The consensus that emerged from these meetings was that while sound policies were important, they could not guarantee that a country would be insulated from the contagion effects of market excesses. Hence, there was a need to review the operations of the international monetary system to ensure a more orderly financial environment for global trade and investment. The meetings also emphasised the importance of closer co-operation among central banks in addressing the challenges of a globalised financial system.

Technical Assistance and Information Exchange

The Bank provided technical assistance on various aspects of central banking to foreign financial institutions during 1997. This was mainly in response to the interest expressed by foreign central banks and finance ministries to study BNM's experience in central banking issues. The assistance was in the form of internships, attachment programmes and study visits.

An 8-week internship programme was arranged for the Central Bank of Kazakhstan under a Japan-IMF scholarship programme for Asia. In addition, attachment programmes for four study teams from the central banks of Tanzania, Namibia, Ghana and Vietnam were arranged.

The Bank also received several foreign delegations in 1997. Among them were delegations from the External Aid Co-ordination Department of the Republic of Kazakhstan, Prime Minister's Department of Mauritius, Islamic Development Bank, British Foreign Ministry, Central Bank of Kenya, Bank Indonesia, the Ministry of Finance of Bangladesh, Central Bank of Kuwait, Nepal Rastra Bank, Central Bank of Nigeria, Bangko Sentral ng Pilipinas, Reserve Bank of India, Reserve Bank of South Africa, Central Bank of Mauritania, National Bank of Slovakia, Central Bank of Colombia and an Insurance Trade Mission from the United States. The areas of interest to the visits included economic developments and statistics; insurance regulation; payment, settlement and clearing systems; human resource management; information technology; Islamic banking; foreign reserve management; currency operations and bank regulation and supervision.

In addition to the internships, attachment programmes and study visits by foreign delegations, the Bank also participated in a study on the Kyrgyz Republic conducted jointly by the Malaysian and Kyrgyz Governments. The Bank's role in the study focussed on the monetary sector, identifying the issues faced by the sector and putting forward recommendations to address those issues. The Bank also participated in a commission, jointly chaired by the Director-General of the Economic Planning Unit, Malaysia and First Deputy Prime Minister of the Kyrgyz Republic, to monitor the implementation of the recommendations in the study.

During the year, the Bank offered 10 places at the Central Banking Course conducted by the Bank's Staff Training Centre to foreign participants from eligible countries under the Malaysian Technical Co-operation Programme. The participants were from the central banks of Botswana, Fiji, Malawi, Maldives, Mongolia, Union of Myanmar, Peru, Solomon Islands and Uganda.

6 Organisation and Personnel

Staff and Organisation

The Board of Directors expresses its appreciation to all staff of the Bank for their dedication and hard work in 1997. The Board also expresses its appreciation to them for enduring a challenging and trying year, following the full implementation of the voluntary separation programme, the on-going departmental reviews and the increased responsibility of line departments as a result of the devolvement of certain human resource, financial and staff development functions. The Bank continued to focus on the implementation of the strategic change programme, emphasising on strengthening its structure and streamlining its functions in order to further enhance organisational efficiency. Concurrently, equal emphasis was placed on staff training and development, customer service orientation, and the assimilation of its shared values. An infrastructure to implement and monitor safety and health measures at the workplace was instituted in the Bank, in line with the provisions of the Occupational Safety and Health Act, 1994. With these developments, the Board is confident that a solid base is now in place for the Bank to boldly face the challenges in the years ahead.

After 38% of the non-executive staff voluntarily left the Bank last year, there was a need to redistribute their workload among the remaining staff. Since most jobs including those at the executive level were redesigned and enriched following departmental reviews, there was a consequential need for an accompanying review of the retention strategies, particularly the Bank's salary policy in relation to the external market and the career path of all the staff. The Board agreed to a review of the Bank's salary structure and all staff received their new salaries in July 1997.

During the year, a review of the job-content and profiles of the technical and non-technical support staff was conducted and a new career path for staff in this category was approved. The Bank also implemented the specialist career path for the executives. The Bank is confident that these developments will contribute towards the building of a pool of motivated and multi-skilled staff.

To ensure that staff at all levels acquire and enhance the competencies required to perform effectively in a rapidly changing and challenging work environment, steps were taken to strengthen the management of the training process and the quality of the training programme. Management of staff training was made a shared responsibility of the Staff Training Centre, the line departments and the individual. Through this collaboration, there is greater assurance that the right person is attending the right course at the right time. Training in computer, management and leadership skills were intensified so that together, staff can build up high-performing teams.

Awards

The Board congratulates the Governor, Tan Sri Dato' Ahmad bin Mohd Don, on being conferred the Panglima Setia Mahkota (P.S.M.) and Dr. Awang Adek Hussin on being conferred the Johan Setia Mahkota (J.S.M.) on the occasion of the birthday of His Majesty, the Yang Di-Pertuan Agong on 7 June 1997.

The Board also extends its congratulations to Datuk Zamani bin Abdul Ghani on being conferred the Darjah Mulia Setia Mahkota (D.M.S.M.) on the occasion of the birthday of His Excellency, the Yang Di-Pertua Negeri Melaka on 11 November 1997.

The Board would also like to congratulate all 60 staff who received the long service awards upon the completion of 20 and 30 years of dedicated service in the Bank.

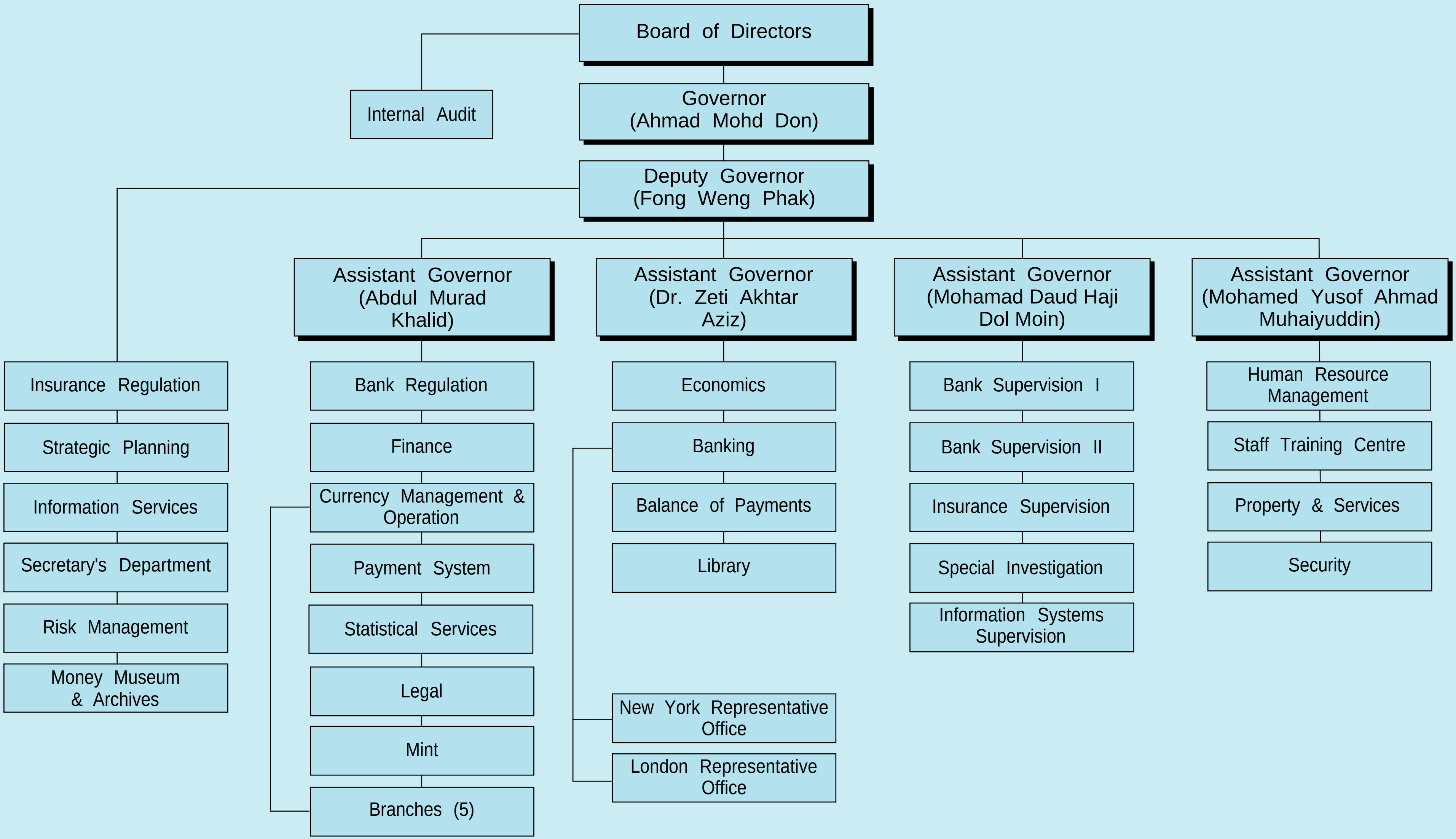
Retirement

The Board wishes to place on record its appreciation and gratitude to the 17 retirees who have rendered loyal and dedicated service to the Bank. The staff who retired from the services of the Bank in 1997 were Tuan Haji Ahmad Fadzli Tajuddin (Assistant Governor), Encik Lee Khee Joo @ Lee Ying Chong (Internal Audit Department), Encik Mohd Arif bin Jaafar, Encik Yap Sze Keong, Encik Samad bin Hussin (Payment System Department), Puan Vivien Yang (Economics Department), Puan Noor Aini bt. Othman (Staff Training Centre), Encik Patt Lok Kong (Currency Department), Puan Halimah bt. Abdullah (Insurance Regulation Department), Encik Ibrahim bin Jap @ Rejab, Encik Malek Ibrahim bin Mohd. Wazir (Mint), Encik Freddie Chen Tham Tai (Kuala Terengganu Branch), Encik Mohd. Rathy @ Radzi bin Hassan (Alor Setar Branch), Encik Munir bin Yusof, Encik Mohamad bin Ibrahim, Encik Abu Bakar bin Muhammad (Kota Bharu Branch) and Encik Sabar bin Moslan (Penang Branch).

Manpower

As at the end of 1997, the Bank had a total staff complement of 1,595 representing staff in the Head Office, five branches, two representative offices in London and New York, the Staff Training Centre in Petaling Jaya and the Mint in Shah Alam.

BANK NEGARA MALAYSIA
ORGANISATION STRUCTURE



Bank Negara Malaysia

Annual Accounts

CERTIFICATE OF THE AUDITOR GENERAL
ON THE ACCOUNTS OF BANK NEGARA MALAYSIA
FOR THE YEAR ENDED 31 DECEMBER 1997

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 1997 and of its transactions for the year ended on that date; and

(b) the accounting records and other relevant records have been maintained satisfactorily.

(DATUK HJ. MOHD. KHALIL BIN DATO' HJ. MOHD. NOOR)
AUDITOR GENERAL

KUALA LUMPUR
10 MARCH 1998

STATEMENT BY DIRECTORS

We, Ahmad Mohd Don and Oh Siew Nam, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the 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 1997 and of the result of operations for the year ended on that date.

On behalf of the Board,

AHMAD MOHD DON
CHAIRMAN

9 MARCH 1998
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM
DIRECTOR

9 MARCH 1998
KUALA LUMPUR

DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE ACCOUNTS OF BANK NEGARA MALAYSIA

I, Azizan 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 9th day of March 1998.)

Before me,

Bank Negara Malaysia

Balance Sheet as at 31 December 1997

LIABILITIES		Note	1997 RM	1996 RM
Authorised Capital	RM200,000,000			
Paid-up Capital		2	100,000,000	100,000,000
General Reserve Fund		3	3,212,432,101	2,984,193,244
Other Reserves		4	42,866,826	42,866,826
Currency in Circulation			24,532,291,528	21,065,609,098
Deposits:				
Commercial Banks, Finance Companies and Merchant Banks			65,197,644,636	49,427,350,423
Federal Government			10,545,338,219	11,107,635,451
Others		5	2,319,999,930	6,184,129,732
Bank Negara Bills/Bonds			909,007,218	4,967,861,569
Allocation of Special Drawing Rights		6	505,441,566	505,441,566
Other Liabilities			1,555,975,153	353,430,804
			108,920,997,177	**96,738,518,713**

Profit and Loss Appropriation Account for the Year Ended 31 December 1997

	1997 RM	1996 RM
Transfer to General Reserve Fund	228,238,857	45,588,588
Amount Payable to Federal Government	–	–
	228,238,857	**45,588,588**

Notes on the following pages form part of these accounts.

ASSETS	Note	1997 RM	1996 RM
Gold and Foreign Exchange		57,032,062,797	67,864,580,815
International Monetary Fund Reserve Position		1,621,972,139	1,738,246,212
Holdings of Special Drawing Rights		478,938,730	427,701,859
Malaysian Government Papers	7	3,728,653,214	3,117,631,832
Bills Discounted	8	969,314,280	1,348,188,330
Deposits with Financial Institutions		27,798,225,000	3,940,565,600
Loans and Advances		4,694,094,121	4,659,794,797
Deferred Expenditure	9	3,424,325,493	3,995,046,408
Other Assets	10	9,173,411,403	9,646,762,860
		108,920,997,177	**96,738,518,713**

	1997 RM	1996 RM
Net Operating Profit	228,238,857	45,588,588
	228,238,857	**45,588,588**

Notes To The Accounts - 31 December 1997

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 1997.

   (b) **Foreign Currency Translation**
   Transactions in foreign currencies during the year have been translated into ringgit at rates of exchange ruling on value dates. However, assets and liabilities in foreign currencies which were transacted before 1997 were valued at exchange rates at end-1996, in view of the volatility of the exchange rates in 1997. If the Bank were to translate its foreign currencies into ringgit at rates of exchange ruling on the balance sheet date, there will be a currency translation gain of RM24,613.2 million. The USD 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 1997 was USD21,706.3 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**

	1997 RM	1996 RM
As at 1 January	2,984,193,244	2,938,604,656
Net Operating Profit	228,238,857	45,588,588
As at 31 December	3,212,432,101	2,984,193,244

4. **Other Reserves**
   Other reserves comprise the Exchange Rate Fluctuation Reserve, the Investment Fluctuation Reserve, the Insurance Reserve and the Contingency Reserve.

5. **Other Deposits**
   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 (SDRs) 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**

	1997 RM	1996 RM
Malaysian Government Securities	2,107,720,200	179,201,832
Malaysian Treasury Bills	33,143,014	–
Government Investment Certificates	1,587,790,000	2,938,430,000
	3,728,653,214	3,117,631,832

8. **Bills Discounted**

	1997 RM	1996 RM
Bills rediscounted under export credit refinancing scheme	969,314,280	1,348,188,330

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 of RM5,770,437,500 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 1997 amounted to RM1,333,082,514. These comprise:-

(a) an amount of RM1,331,402,333 which represents the obligation of the Bank to pay in full, in SDR or other convertible currencies, the amount of Malaysia's quota in the IMF under the Articles of Agreement; and

(b) an amount of RM1,680,181 being liability arising from various transactions on bilateral payments arrangements.

Annex

Contents

Funds Administered/Funded by Bank Negara Malaysia: Fund Utilisation

Type of fund	Date Established	Fund Allocation (RM m)	Total as at end 1996		Total as at end 1997		Annual change		Outstanding as at end 1997 (RM m)
			Number of Approval	Amount Approved (RM m)	Number of Approval	Amount Approved (RM m)	Number of Approval	Amount Approved (RM m)	
Fund For Food[1]	04-Jan-93	700	1,033	294	1,025	302	(8)[3]	8	211
Special Fund for Tourism[2]	10-Mar-90	200	195	219	212	241	17	22	113
New Entrepreneurs Fund[2]	12-Dec-89	750	1,987	930	2,069	973	82	43	637
Bumiputera Industrial Fund	04-Jan-93	100	30	31	45	58	15	27	46
Fund to Accelerate the Construction of Low-Cost Houses	29-Oct-93	500	56	376	58	379	2	3	151
Enterprise Rehabilitation Fund	06-Feb-88	500	762	859	745	841	(17)[4]	(18)	213
Abandoned Housing Projects Fund	10-Aug-94	600	78	377	74	331	(4)[5]	(46)	113
Ship Financing Facility	30-Oct-92	600	30	508	32	547	2	39	437

[1] Initial allocation was RM300 million. Additional allocation of RM400 million was approved by the Minister of Finance in 1997.
[2] Revolving Funds.
[3] Due to withdrawal of approvals.
[4] Approval withdrawn by ERF/applicants.
[5] Approval withdrawn by TPPT/applicants.

Incentives Accorded To Tier-1 Banking Institutions

Commercial Banks

- Issuance of negotiable instruments of deposit up to five times of their capital funds;
- Participation in equity derivatives subject to compliance with the Guideline on “Minimum Standards on Risk Management Practices for Derivatives”;
- Participation in the share borrowing and lending activities subject to the approval of the Securities Commission; and
- For tier-1 domestic commercial banks, regional expansion of operations through the establishment of branch offices, representative offices, subsidiary companies or on joint-venture basis.

Finance Companies

- Provision of factoring services;
- Provision of remittance service within Malaysia, including bankers cheques, demand drafts, payment order and telegraphic transfer. However, a finance company should only use the cheques of the commercial bank belonging to the same Group, or otherwise, the cheques of tier-1 commercial banks;
- Participation in special funds established by Bank Negara Malaysia (such as Fund for Food, Special Fund for Tourism, New Entrepreneurs Fund and Bumiputera Industrial Fund);
- Granting of unsecured business loans up to a maximum of RM500,000;
- Participation in venture capital financing; and
- Issuance of negotiable instruments of deposit up to five times the capital funds.

Merchant Banks

- Participation in the following foreign exchange business with the prior approval from the Controller of Foreign Exchange:

  i. Trade on its own account in the foreign exchange market;

  ii. Undertake foreign exchange transactions with any customer;

  iii. Lend in foreign currency to resident and non-resident customers other than for the purpose of trade financing, subject to the approval of other relevant authorities;

  iv. Borrow any amount in foreign currency from any licensed bank, licensed merchant bank or non resident; and

v. Underwrite foreign securities and hold the securities in the event of under-subscription;

- Participation in domestic and global derivatives markets, subject to compliance with the guideline on “Minimum Standards on Risk Management Practices for Derivatives”;
- Participation in share borrowing and lending activities subject to the approval of the Securities Commission;
- Investment in shares listed in the stock exchanges of ASEAN countries subject to prudential limits;
- Issuance of negotiable instruments of deposit up to five times the capital funds;
- Acceptance of deposits from individuals subject to minimum amount of RM1 million; and
- Expansion of operations regionally through the establishment of branch offices, subsidiary companies or on joint-venture basis.

Licensed Banking Institutions
(as at 31 December 1997)

Tier-1 Commercial Banks

1. Bank Bumiputra Malaysia Berhad
2. Bank of Commerce (M) Berhad
3. Citibank Berhad
4. Hongkong Bank Malaysia Berhad
5. Malayan Banking Berhad
6. OCBC Bank (Malaysia) Berhad
7. Public Bank Berhad
8. RHB Bank Berhad
9. Standard Chartered Bank Malaysia Berhad
10. The Pacific Bank Berhad

Tier-2 Commercial Banks

1. ABN AMRO Bank Berhad
2. Arab-Malaysian Bank Berhad
3. Ban Hin Lee Bank Berhad
4. Bangkok Bank Berhad
5. Bank of Tokyo-Mitsubishi (Malaysia) Berhad
6. Bank of America Malaysia Berhad
7. Bank Utama (Malaysia) Berhad
8. BSN Commercial Bank (Malaysia) Berhad
9. Deutsche Bank (Malaysia) Berhad
10. EON Bank Berhad
11. Hock Hua Bank Berhad
12. Hong Leong Bank Berhad
13. International Bank Malaysia Berhad
14. Multi-Purpose Bank Berhad
15. Oriental Bank Berhad
16. Overseas Union Bank (Malaysia) Berhad
17. Perwira Affin Bank Berhad
18. PhileoAllied Bank (Malaysia) Berhad
19. Sabah Bank Berhad
20. Sime Bank Berhad
21. Southern Bank Berhad
22. The Bank of Nova Scotia Berhad
23. The Chase Manhattan Bank (M) Berhad
24. United Overseas Bank (Malaysia) Bhd.
25. Wah Tat Bank Berhad
26. Bank Islam Malaysia Berhad

Tier-1 Finance Companies

1. Arab-Malaysian Finance Berhad
2. Hong Leong Finance Berhad
3. Mayban Finance Berhad
4. Public Finance Berhad

Tier-2 Finance Companies

1. Abrar Finance Berhad
2. Advance Finance Berhad
3. AFFIN Finance Berhad
4. Amanah Finance Malaysia 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. HSBC Finance (Malaysia) Berhad
18. Interfinance Berhad
19. Kewangan Bersatu Berhad
20. Kewangan Industri Berhad
21. Kewangan Utama Berhad
22. MBf Finance Berhad
23. Multi-Purpose Finance Berhad
24. OCBC Finance Berhad
25. Oriental Finance Berhad
26. OUB Finance (Malaysia) Berhad
27. Perdana Finance Berhad
28. Perkasa Finance Berhad
29. PhileoAllied Finance (Malaysia) Berhad
30. RHB Finance Berhad
31. Sabah Finance Berhad
32. SimeFinance Berhad
33. Southern Finance Company Berhad
34, United Merchant Finance Berhad
35. United Overseas Finance (Malaysia) Berhad

Tier-1 Merchant Banks

1. Arab-Malaysian Merchant Bank Berhad
2. Aseambankers Malaysia Berhad
3. Commerce International Merchant Bankers Berhad
4. Malaysian International Merchant Bankers Berhad
5. Perwira Affin Merchant Bank Berhad
6. RHB Sakura Merchant Bankers Berhad

Tier-2 Merchant Banks

1. Amanah Merchant Bank Berhad
2. BSN Merchant Bank Berhad
3. Bumiputra Merchant Bankers Berhad
4. Perdana Merchant Bankers Berhad
5. Sime Merchant Bankers Berhad
6. Utama Merchant Bank Berhad

Exchange Control Policy

Malaysia maintains a liberal system of exchange control which 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 existing exchange control measures are aimed at monitoring the settlement of payments and receipts, and encouraging the use of the country's financial resources for productive purposes in Malaysia.

All payments to non-residents in foreign currency are permitted through authorised dealers in foreign exchange, which comprise all commercial banks in the country and Bank Islam Malaysia Berhad. The following are the main exchange control requirements:-

- Corporate residents with domestic borrowing are required to seek prior approval from the Controller of Foreign Exchange (the Controller) to remit funds in excess of RM10 million per corporate group in a calendar year for overseas investment purposes, including extension of loans to non-residents.

- Non-residents are freely allowed to open foreign currency and ringgit accounts in Malaysia.

- Resident exporters are also permitted to open foreign currency accounts to retain between US$1 million to US$10 million export proceeds in foreign currency, depending on their export receipts.

- Approved Operational Headquarters are allowed to retain export proceeds up to a maximum limit of US$10 million, irrespective of the amount of export receipts.

- Approved International Procurement Centres are allowed to open foreign currency accounts to retain any amount of export proceeds.

- All export proceeds are required to be repatriated 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 repatriated must either be sold for ringgit or retained in an approved foreign currency account.

- Residents are freely permitted to obtain credit facilities in foreign currency up to RM5 million equivalent. Any amount exceeding the permitted limit would require the prior approval of the Controller. Residents, however, are allowed to borrow in ringgit only for an amount of less than RM100,000 from non-resident individuals.

- 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. They are also permitted to obtain any amount of forward exchange contract, guarantee and short-term trade financing facilities. Nevertheless, of the total amount of credit facilities obtained from banking institutions, they are required to source at least 60% of the short-term trade financing and other credit facilities from Malaysian-owned banking institutions. NRCCs borrowing in excess of RM10 million are also required to ensure that the ratio between their domestic borrowing and capital funds is less than three.

- Banking institutions are permitted to grant ringgit credit facilities to foreign stockbroking companies and foreign correspondent banks up to an aggregate amount of RM5 million to fund the mismatch of receipts and payments through their External Accounts.

- Banking institutions are also allowed to extend credit facilities in ringgit up to RM200,000 to other non-residents External Account holders for any purpose, other than to finance the acquisition or development of immovable property in Malaysia. Non-residents with valid work permit are, nevertheless, permitted to obtain domestic borrowing to finance up to 60% of the purchase price or construction cost of one residential property in Malaysia for their own accommodation.

- General permission has been given to a traveller to hold any amount of ringgit notes or any foreign currency notes in person or in his baggage, upon his arrival in or departure from Malaysia. Prior permission of the Controller is required for any person, other than a traveller, to export or import foreign currency or ringgit notes.

- Licensed Offshore Banks in Labuan are permitted to use the ringgit in their External Accounts to trade (buy or sell) ringgit instruments in the secondary market subject to conditions stipulated by Labuan Offshore Financial Services Authority.

Credit Guarantee Corporation Malaysia Berhad

The main role of the Credit Guarantee Corporation Malaysia Berhad (CGC) is to promote access to institutional credit for small-scale enterprises (SSEs), including small and medium-scale industries (SMIs), through the provision of guarantee cover for loans extended by commercial banks and finance companies. The loans are extended to the SSEs through its main guarantee scheme, namely, the New Principal Guarantee Scheme (NPGS). Besides the NPGS, CGC also provides guarantee cover for loans extended to Bumiputera entrepreneurs by 11 participating commercial banks under the New Entrepreneurs Fund, and loans to SMIs under the Integrated Lending Scheme (ILS) with the participation of eight commercial banks together with Bank Industri Berhad and Perbadanan Usahawan Nasional Berhad. In addition, to improve the access of small borrowers requiring loans ranging between RM10,000 to RM50,000, CGC assists the Ministry of Entrepreneur Development in managing the Small Entrepreneurs Financing Fund which was launched in 1996.

Recognising the growing importance of Islamic banking, CGC introduced in 1997, guarantee cover for loans under interest-free banking tailored after the NPGS but minus the interest element. Further, during 1997, under another co-operative effort between the Ministry and CGC, the Franchise Financing Scheme was launched, aimed at assisting franchisees under the Ministry's Franchise Programme. To address the credit needs of micro-businesses, CGC also manages two loan schemes which were launched in 1992, namely, the Loan Fund for Hawkers and Petty Traders and the Association Special Loan Scheme. Loans under the previous General Guarantee Scheme (launched in 1973), Special Loans Scheme (launched in 1981) and the Hawkers and Petty Traders Loan Scheme (launched in 1986) were completely wound down in 1997. As such, there are no longer any loans guaranteed under these schemes.

New Principal Guarantee Scheme (NPGS)

The NPGS provides guarantee cover for credit facilities granted by the commercial banks and finance companies to SSEs and SMIs which have net assets within the stipulated maximum amounts. In 1997, 15,784 loan applications valued at RM3,847.4 million were guaranteed by CGC. These represented an increase of 5.5% in terms of number of accounts guaranteed and 7.5% in terms of value of loans guaranteed over the previous year. In terms of sectoral analysis, 79.3% of the value of loans extended in 1997 was channelled to general businesses, and 19.4% was to the manufacturing sector. Total guarantee cover issued during 1997 amounted to RM3,144.4 million, of which 25.4% (RM799 million) was granted to Bumiputera borrowers.

Amanah Ikhtiar Malaysia Revolving Fund

As part of its efforts to assist small businesses to obtain financial assistance, CGC entered into an arrangement with Amanah Ikhtiar Malaysia (AIM) in 1992 to establish the Amanah Ikhtiar Malaysia Revolving Fund. AIM is a private trust established in 1987 with the principal objective of eradicating poverty among the hard core poor by providing small interest-free loans to this group of borrowers to finance their economic activities. Funding for the trust was provided by 13 commercial banks and two finance companies in the form of interest-free loans amounting to RM13 million which is managed by CGC to support the activities of AIM.

Loan Scheme for Hawkers and Petty Traders

CGC currently manages two loan schemes specifically for hawkers and petty traders, namely, the Loan Fund for Hawkers and Petty Traders 1992 (LFHPT) and the Association Special Loan Scheme 1992 (ASLS) which superseded earlier schemes introduced in 1986 and 1990. The schemes are intended to ensure that hawkers and petty traders have access to institutional credit at reasonable cost. Applications for the interest free loans (service fees are charged) under the LFHPT may be made from all commercial banks and finance companies, while applications for loans under the ASLS may be made through the approved hawkers and petty traders' associations.

The total allocations for LFHPT and ASLS are RM140 million and RM20 million respectively. As at end 1997, a total of 48,942 loan applications amounting to RM218 million had been approved under the loan schemes for hawkers and petty traders, of which RM138.4 million (63.5%) was extended to Bumiputera borrowers.

Bank Lending under the CGC Scheme

	Amount approved for NPGS		
	1996	1997	Annual change %
	RM million		
General business	2,765.7	3,052.6	10.4
Of which:			
Building and construction	389.1	477.4	22.7
General commerce and sundry retail trade	1,687.4	1,978.0	17.2
Transport and repairs	194.2	160.2	–17.5
Small scale industries	765.3	744.9	–2.7
Of which:			
Food, drinks and tobacco	73.3	33.4	–54.4
Timber products and furniture	87.1	100.0	14.8
Textiles and clothing	49.8	71.7	44.0
Building materials	43.8	29.9	–31.7
Printing and publishing	46.5	42.0	–9.7
Agriculture	38.9	44.1	13.4
Of which:			
Padi cultivation and marketing	0.3	0.7	133.3
Livestocks and poultry farming	13.1	8.9	–32.1
Fisheries	10.5	7.0	–-33.3
Mining and quarrying	8.9	5.8	–34.8
Of which:			
Other minerals	8.1	2.3	–71.6
Total	**3,578.8**	**3,847.4**	**7.5**

Source: The Credit Guarantee Corporation Malaysia Berhad (CGC)

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	1997
Pakistan	POCPA	6 Aug. 1992	468.5	1897.1
Myanmar	POCPA	21 Jan. 1994	53.9	1200.5
Iraq	POCPA	28 Feb.1993 28 Feb.1995 28 Feb.1996	131.9	55
Iran	POCPA Iranian	8 Feb. 1994 8 Aug. 1988	46	389.1
Bosnia Herzegovina	POCPA	13 Nov. 1996	n.a.	0.9
Algeria	POCPA ALADI	14 June 1992 31 Jan. 1992	3.8	53.7
Albania	ALADI	24 Jan. 1994	0.2	1.7
Argentina	ALADI	3 Dec. 1993	104.9	1050
Chile	ALADI	21 June 1991	120.9	883.5
Lao PDR	ALADI	16 Apr. 1994	0.1	6.5
Mexico	ALADI	24 Sept. 1990	37.6	1054.2
Peru	ALADI	13 Nov. 1991	5.4	281.7
Romania	ALADI	20 May 1991	14.8	101
Seychelles	ALADI	21 Sept. 1992	1.1	6.8
Tunisia	ALADI	25 Nov. 1992	3.5	68.2
Turkmenistan	ALADI	30 May 1994	n.a.	1
Uzbekistan	ALADI	28 June 1993	n.a.	33.5
Venezuela	ALADI	3 Aug. 1990	6.5	143
Vietnam	ALADI	29 Mar. 1993	43.5	1367.7
Zimbabwe	ALADI	7 June 1991	15.1	44.3

Central Bank of	Model	Date of Agreement	Total Trade Between Partner Countries (RM million)	
			1987	1997
Sudan	Revolving Credit	4 Jan. 1992 16 Apr. 1992 16 Sept. 1992 18 Dec. 1993 11 Oct. 1996	21.5	47.1
Botswana	Iranian	6 June 1991	n.a.	n.a.
Fiji	Iranian	12 Oct. 1991	67.8	83.3
Mozambique	Iranian	27 Apr. 1991	46.8	6.7

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

Sourse: Bank Negara Malaysia and Department of Statistics

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Industrial Origin (in Constant 1978 Prices)

	1993	1994	1995	1996	1997*p*	1993	1994	1995	1996	1997*p*
	RM million					Annual change (%)				
Agriculture, forestry and fishery	16,205	16,047	16,230	16,580	17,077	4.3	–1.0	1.1	2.2	3.0
Mining and quarrying	8,039	8,241	8,979	9,381	9,569	–0.4	2.5	9.0	4.5	2.0
Manufacturing	30,324	34,782	39,825	44,684	50,247	12.9	14.7	14.5	12.2	12.5
Construction	4,023	4,589	5,385	6,150	6,799	11.2	14.1	17.3	14.2	10.6
Services	44,394	48,711	53,303	58,463	63,084	9.8	9.7	9.4	9.7	7.9
Gross Domestic Product in purchasers' value	100,617	109,915	120,309	130,628	140,863	8.3	9.2	9.5	8.6	7.8

p Preliminary

Source: Department of Statistics (1993–96)
Bank Negara Malaysia (1997)

Table A.2
Production: Primary Commodities

	1993	1994	1995	1996	1997*p*
	Annual change (%)				
Crude palm oil	16.2	–2.5	8.2	7.4	8.1
Rubber	–8.4	2.5	–1.0	–0.6	–10.4
Saw logs	–14.7	–3.9	–11.3	–3.8	4.3
Cocoa	–9.1	–11.5	–25.7	–8.7	–10.7
Crude oil	–1.7	1.9	6.8	1.8	–0.5
Natural gas	19.1	12.6	19.0	21.4	12.8

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

	1993	1994	1995	1996	1997*e*
	Annual change (%)				
Insurance premiums	16.3	25.0	21.6	20.0	13.7
KLSE turnover					
Value	652.3	–15.3	–45.5	159.0	–11.8
Volume	459.3	44.2	–43.5	95.6	9.5
KL office rentals (RM per sq m)	48.74	49.84	48.07	50.45	49.77
KL office occupancy rates (%)	95	97	93	97	95
Tourist arrivals	8.1	10.7	3.8	–4.4	–13.0
Hotel occupancy rate (%)	61.4	65.3	65.5	62.3	58.0
Cargo throughput at major ports[1]	5.9	8.6	17.4	14.0	11.5
Container cargo throughput at major ports[1]	14.2	23.6	19.4	19.4	16.7
Electricity Production Index	12.3	13.8	14.1	12.8	14.2
Water supply	8.5	9.8	8.9	2.0	1.0

[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 1997, BNM
Malaysia Tourism Promotion Board (Tourism Malaysia)
Various port operators
Public Works Department

Table A.4
GNP by Demand Aggregates

	1993	1994	1995	1996	1997*p*
			RM million current prices		
Consumption	102,919	116,504	132,331	143,460	154,083
Private consumption	*81,313*	*92,568*	*104,695*	*114,875*	*123,569*
Public consumption	*21,606*	*23,936*	*27,636*	*28,585*	*30,514*
Investment	63,356	76,357	94,120	105,501	117,354
Private investment	*39,255*	*51,700*	*66,577*	*77,064*	*85,531*
Public investment	*24,101*	*24,657*	*27,543*	*28,437*	*31,823*
Change in stocks	–896	546	1,029	–1,732	1,328
Exports of goods and non-factor services	135,525	173,771	208,699	229,841	261,290
Imports of goods and non-factor services	135,698	176,904	217,453	227,286	257,022
GDP at purchasers' value	165,206	190,274	218,726	249,784	277,033
Net factor payments abroad	–8,265	–9,412	–10,555	–11,872	–13,971
GNP at purchasers' value	156,941	180,862	208,171	237,912	263,062
			Annual change (%) constant prices [1]		
Consumption	6.0	9.8	8.9	4.9	4.8
Private consumption	*4.6*	*9.8*	*9.4*	*6.0*	*4.7*
Public consumption	*10.7*	*9.9*	*7.3*	*1.4*	*4.8*
Investment [2]	14.8	17.1	19.9	9.8	8.5
Private investment	*19.1*	*27.9*	*25.3*	*13.4*	*8.3*
Public investment	*8.5*	*–0.6*	*8.7*	*1.1*	*9.2*
Exports of goods and non-factor services	17.2	22.5	17.6	7.2	9.8
Imports of goods and non-factor services	19.1	27.7	21.4	4.2	10.1
GDP at purchasers' value	8.3	9.2	9.5	8.6	7.8
Net factor payments abroad	2.4	12.1	11.9	12.1	13.7
GNP at purchasers' value	8.7	9.1	9.3	8.4	7.5

[1] At constant 1978 prices
[2] Exclude stocks
p Preliminary

Source: Department of Statistics and Bank Negara Malaysia

Table A.5
Selected Private Consumption Indicators

	1993	1994	1995	1996	1997
	Annual change (%)				
Import of consumption goods	9.9	33.3	9.1	1.7	12.4
Sales of passenger cars[1]	10.2	25.5	49.5	22.8	12.3
Prices of primary commodities					
Rubber	*–2.4*	*37.7*	*32.7*	*–9.8*	*–20.7*
Crude palm oil	*–2.9*	*44.3*	*14.7*	*–19.1*	*15.9*
Tax collection					
Sales tax	*12.5*	*19.1*	*17.9*	*12.4*	*12.7*
Services tax	*90.4*	*34.6*	*23.2*	*21.2*	*19.8*
Gross revenue[2]					
Wholesale and retail	*3.6*	*35.3*	*23.0*	*9.1*	*7.6*
Consumption credit extended by the banking system[3]	14.2	16.3	30.0	35.7	29.0
Stock market indicators					
Market capitalisation of KLSE	*152.1*	*–17.9*	*11.2*	*42.6*	*–53.4*
Kuala Lumpur Composite Index	*98.0*	*–23.8*	*2.5*	*24.4*	*–52.0*

[1] Include four-wheel drive vehicles for passenger usage.
[2] Business Expectations Survey, Department of Statistics.
[3] 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

	1993	1994	1995	1996	1997
	Annual change (%)				
Import of capital goods	13.0	32.4	24.7	0.2	19.0
Import of building and construction materials	13.6	29.3	0.1	22.1	–3.5
Sales of commercial vehicles [1]	–5.5	18.8	43.6	48.7	8.4
Proposed capital investment in manufacturing					
Applications to MITI	*–16.5*	*29.0*	*10.3*	*56.7*	*–20.6*
Approvals by MITI	*–50.5*	*66.9*	*–9.1*	*64.2*	*–24.8*
Loans extended by the banking system[2]					
For manufacturing	*7.2*	*18.7*	*30.7*	*14.0*	*18.3*
For broad property [3]	*11.6*	*2.3*	*26.3*	*26.8*	*32.5*
Capital expenditure by sector [4]	33.0	–3.7	27.3	–8.6	58.5
Manufacturing	*37.2*	*2.2*	*16.0*	*9.3*	*39.2*
Construction	*–34.0*	*26.9*	*72.9*	*–51.2*	*–9.5*
Others (Services etc.)	*30.4*	*–9.7*	*39.1*	*–24.3*	*77.0*
BNM Annual Survey of Manufacturing Companies	9.3	63.3	–15.7	14.3	7.1

[1] Include four-wheel drive vehicles for commercial use.
[2] Beginning December 1996, the data is compiled based on a new statistical reporting format.
[3] Excluding loans sold to Cagamas.
[4] Business Expectations Survey, Department of Statistics.

Source: Department of Statistics
Malaysian Motor Traders Association (MMTA)
Ministry of International Trade and Industry (MITI)

Table A.7
Savings-Investment Gap

	1993	1994	1995	1996	1997*p*
	RM million				
Public gross domestic capital formation	23,760	24,833	27,844	27,970	32,183
Public savings	27,339	32,733	32,763	39,729	47,204
Deficit/surplus	3,579	7,900	4,919	11,759	15,021
Private gross domestic capital formation	38,700	52,070	67,305	75,799	86,499
Private savings	27,195	29,400	40,561	51,788	58,078
Deficit/surplus	–11,505	–22,670	–26,744	–24,011	–28,421
Gross domestic capital formation	62,460	76,903	95,149	103,769	118,682
(as % of GNP)	39.8	42.5	45.7	43.6	45.1
Gross national savings	54,534	62,133	73,324	91,517	105,282
(as % of GNP)	34.7	34.4	35.2	38.5	40.0
Balance on current account	–7,926	–14,770	–21,825	–12,252	–13,400
(as % of GNP)	–5.0	–8.2	–10.5	–5.1	–5.1

p Preliminary

Source: Department of Statistics and Bank Negara Malaysia

Table A.8
Balance of Payments

Item	1993 +	1993 –	1993 Net	1994 +	1994 –	1994 Net
	RM million					
Merchandise balance (f.o.b.) [1]	**118,383**	**110,152**	**8,231**	**148,506**	**144,046**	**4,460**
Balance on services	**22,308**	**38,978**	**–16,670**	**31,323**	**48,328**	**–17,005**
Freight & insurance	1,927	6,817	–4,890	2,054	9,421	–7,367
Other transportation	2,876	3,072	–196	3,681	3,240	441
Travel & education	5,638	4,732	906	8,835	5,232	3,603
Investment income [2]	4,714	12,888	–8,174	5,745	15,193	–9,448
Government transactions n.i.e. [3]	302	374	–72	316	352	–36
Other services	6,851	11,095	–4,244	10,692	14,890	–4,198
Balance on goods and services	**140,691**	**149,130**	**–8,439**	**179,829**	**192,374**	**–12,545**
Unrequited transfers	1,207	694	513	1,867	4,092	–2,225
Balance on current account	**141,898**	**149,824**	**–7,926**	**181,696**	**196,466**	**–14,770**
Official long-term capital			**979**			**861**
Federal Government	1,220	4,354	–3,134	1,287	6,051	–4,764
Market loans	708	2,532	–1,824	776	5,104	–4,328
Project loans	512	1,710	–1,198	511	947	–436
Suppliers' credit	0	112	–112	0	0	0
Non-financial public enterprises	6,682	2,405	4,277	8,268	2,507	5,761
Other assets and liabilities [4]			–164			–136
Private long-term capital			12,885			10,798
Balance on long-term capital			13,864			11,659
Basic balance			**5,938**			**–3,111**
Private short-term capital			13,931			–8,484
Errors and omissions			9,370			3,333
Overall balance (surplus +/ deficit –)			**29,239**			**–8,262**
Allocation of Special Drawing Rights			0			0
IMF resources			0			0
Net change in international reserves of Bank Negara Malaysia (increase – / decrease +) [5]			–29,239			8,262
Special Drawing Rights			–31			–23
IMF Reserve Position			9			–184
Gold and Foreign Exchange			–29,217			8,469
Bank Negara Malaysia international reserves, net			**76,435**			**68,173**
(Reserves as months of retained imports)			7.8			5.5

[1] Adjusted for valuation and coverage to the balance of payments basis.Imports include military goods which is 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] The figure does not include an exchange revaluation gain of RM24.6 billion. Prior to 1997, holdings in foreign assets were revalued once, at year-end. However, in 1997, the accounting policy of recognising the foreign exchange revaluation gain or loss was changed, whereby, the exchange gain from the revaluation of foreign assets and liabilities was not recognised in the Bank's books. Nevertheless, full provisions will be made for any losses.The US dollar equivalent of international reserves as at 31 December 1997 was US$21.7 billion.
e Estimate

Source : Department of Statistics and Bank Negara Malaysia

1995			1996			1997*e*		
+	–	Net	+	–	Net	+	–	Net
RM million								
179,491	**179,394**	**97**	**193,127**	**182,973**	**10,154**	**218,734**	**207,646**	**11,087**
35,778	**55,185**	**–19,407**	**43,443**	**62,913**	**–19,470**	**49,834**	**70,624**	**–20,790**
2,552	11,580	–9,028	2,832	11,354	–8,522	3,216	12,165	–8,949
4,434	3,697	737	5,411	3,919	1,492	6,592	4,184	2,408
9,939	5,796	4,143	11,264	6,478	4,786	10,524	6,698	3,826
6,280	16,796	–10,516	6,362	18,047	–11,685	6,767	20,291	–13,524
319	342	–23	324	360	–36	309	374	–65
12,254	16,974	–4,720	17,250	22,755	–5,505	22,426	26,912	–4,486
215,269	**234,579**	**–19,310**	**236,570**	**245,886**	**–9,316**	**268,568**	**278,270**	**–9,703**
1,843	4,358	–2,515	2,000	4,936	–2,936	2,255	5,952	–3,697
217,112	**238,937**	**–21,825**	**238,570**	**250,822**	**–12,252**	**270,823**	**284,222**	**–13,400**
		6,146			**750**			**4,805**
442	2,076	–1,634	749	2,926	–2,177	462	2,143	–1,681
0	1,101	–1,101	342	1,016	–674	0	697	–697
442	975	–533	407	1,910	–1,503	462	1,446	–984
0	0	0	0	0	0	0	0	0
9,952	2,184	7,768	8,128	5,284	2,844	9,526	3,046	6,480
		12			83			6
		10,464			12,777			13,900
		16,610			13,527			18,705
		–5,215			**1,275**			**5,305**
		2,529			10,317			–14,229
		–1,717			–5,347			–1,968
		–4,403			**6,245**			**–10,892**
		0			0			0
		0			0			0
		4,403			–6,245			10,892
		–41			–37			–51
		–701			–15			116
		5,145			–6,193			10,827
		63,770			**70,015**			**59,123** [6]
		4.1			4.4			3.4

Table A.9
Direction of External Trade [1]

	1993			1994		
	Exports	Imports	Trade balance	Exports	Imports	Trade balance
	RM million					
Singapore	26,259.3	17,872.7	8,386.6	31,842.7	21,991.3	9,851.4
Thailand	4,360.1	2,916.0	1,444.1	5,802.2	3,856.6	1,945.6
Indonesia	1,397.8	1,843.9	–446.1	1,868.2	2,461.4	–593.2
Philippines	1,234.0	563.6	670.4	1,590.5	841.0	749.5
Brunei Darussalam	483.5	7.3	476.2	688.7	82.3	606.4
Vietnam [2]	354.0	238.8	115.2	416.7	292.2	124.5
ASEAN countries	33,734.7	23,203.5	10,531.2	41,792.3	29,232.6	12,559.7
Japan	15,741.1	32,255.4	–16,514.3	18,550.7	41,627.5	–23,076.8
People's Republic of China	3,094.7	2,821.1	273.6	5,062.8	3,577.4	1,485.4
Hong Kong SAR, China	5,001.7	2,371.2	2,630.5	7,100.9	3,105.9	3,995.0
Taiwan,ROC	3,888.1	6,297.0	–2,408.9	4,590.3	7,960.3	–3,370.0
Korea	4,189.3	3,601.9	587.4	4,311.1	4,978.4	–667.3
India	539.4	1,023.1	–483.7	1,279.9	1,078.7	201.2
Other Far East countries [3]	2,390.8	541.2	1,849.6	3,559.0	672.7	2,886.3
Australia	1,616.9	3,323.7	–1,706.8	2,410.1	4,618.9	–2,208.8
New Zealand	515.9	623.6	–107.7	693.8	721.5	–27.7
United States	24,641.2	19,856.6	4,784.6	32,523.5	26,020.9	6,502.6
Canada	1,172.2	600.3	571.9	1,421.0	617.4	803.6
United Kingdom	5,120.9	3,673.0	1,447.9	5,841.1	4,998.3	842.8
Germany	4,432.2	4,504.6	–72.4	5,087.2	6,542.7	–1,455.5
Netherlands	2,952.3	921.0	2,031.3	3,544.7	1,056.9	2,487.8
France	1,713.1	1,675.1	38.0	2,094.0	4,069.0	–1,975.0
Italy	877.2	1,506.0	–628.8	1,127.1	2,113.5	–986.4
Belgium	195.2	274.5	–79.3	1,962.8	916.4	1,046.4
Luxembourg	9.1	23.1	–14.0	14.8	42.3	–27.5
Denmark	195.2	274.5	–79.3	290.2	251.4	38.8
Ireland	216.7	131.7	85.0	559.4	735.2	–175.8
Greece	102.3	13.5	88.8	107.5	30.3	77.2
Spain	401.8	195.8	206.0	674.5	247.2	427.3
Portugal	102.8	77.0	25.8	111.6	94.1	17.5
Austria [4]	146.9	223.4	–76.5	157.4	267.6	–110.2
Finland [4]	84.5	350.5	–266.0	88.3	448.7	–360.4
Sweden [4]	244.9	758.0	–513.1	330.3	1,244.9	–914.6
European Union (EU)	17,573.7	13,636.8	3,936.9	21,990.9	23,043.9	–1,053.0
Other Western Europe countries [5]	1,279.4	3,110.7	–1,831.3	906.1	3,154.8	–2,248.7
Russia	97.7	155.5	–57.8	138.7	193.0	–54.3
East European countries [6]	101.5	300.9	–199.4	275.6	399.7	–124.1
Rest of the world	5,659.2	3,682.2	1,977.0	7,214.5	4,917.4	2,297.1
Total	**121,237.5**	**117,404.7**	**3,832.8**	**153,921.2**	**155,921.0**	**–1,999.8**

1 Exports are valued on a f.o.b. basis and imports on 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 European Union on January 1, 1995 while Austria on March 1, 1995.
5 Include Gibraltar, Greenland, Iceland, Malta, Monaco, Norway, Switzerland and Turkey.
6 Include Bulgaria, Republic Czech and Slovak, Poland and Yugoslavia.

1995			1996			1997		
Exports	Imports	Trade balance	Exports	Imports	Trade balance	Exports	Imports	Trade balance
RM million								
37,584.4	24,079.9	13,504.5	40,286.6	26,348.0	13,938.6	44,355.9	29,004.1	15,351.8
7,258.0	5,131.5	2,126.5	8,057.3	6,524.9	1,532.4	7,930.2	8,682.5	–752.3
2,441.2	3,057.3	–616.1	3,063.7	3,585.1	–521.4	3,463.5	4,113.7	–650.2
1,692.2	1,153.5	538.7	2,358.5	2,011.3	347.2	3,301.6	2,635.3	666.3
742.8	10.3	732.5	815.4	11.2	804.2	763.6	67.2	696.4
672.8	315.6	357.2	812.8	378.5	434.3	910.3	457.4	452.9
50,391.4	33,748.1	16,643.3	55,394.3	38,859.0	16,535.3	60,725.1	44,960.2	15,764.9
23,449.0	53,088.8	–29,639.8	26,584.3	48,372.1	–21,787.8	27,798.1	48,506.4	–20,708.3
4,904.4	4,298.3	606.1	4,801.8	4,720.1	81.7	5,257.9	6,254.4	–996.5
9,899.3	4,193.7	5,705.6	11,586.7	4,576.1	7,010.6	12,178.6	5,404.4	6,774.2
5,813.3	9,913.7	–4,100.4	8,081.5	9,818.2	–1,736.7	9,632.8	10,599.4	–966.6
5,162.0	7,965.3	–2,803.3	6,056.5	10,243.0	–4,186.5	7,095.8	11,323.7	–4,227.9
2,084.1	1,377.9	706.2	3,033.3	1,849.6	1,183.7	3,305.8	2,135.1	1,170.7
3,250.5	449.8	2,800.7	3,174.9	350.9	2,824.0	4,208.1	433.0	3,775.1
2,824.6	5,259.4	–2,434.8	3,058.3	5,560.9	–2,502.6	3,797.1	5,473.4	–1,676.3
487.9	800.9	–313.0	605.1	920.3	–315.2	564.6	1,085.9	–521.3
38,278.5	31,413.0	6,865.5	35,834.4	30,520.9	5,313.5	41,122.0	37,049.0	4,073.0
1,504.7	1,034.0	470.7	1,376.6	1,190.9	185.7	1,626.9	1,734.8	–107.9
7,483.5	5,479.6	2,003.9	6,778.0	5,139.2	1,638.8	7,297.8	5,796.5	1,501.3
5,926.6	8,612.6	–2,686.0	5,978.9	8,432.5	–2,453.6	6,366.1	9,696.7	–3,330.6
4,505.3	1,313.3	3,192.0	5,848.9	1,737.9	4,111.0	8,700.6	2,167.0	6,533.6
1,852.5	5,917.5	–4,065.0	1,603.2	3,960.8	–2,357.6	2,097.2	4,253.1	–2,155.9
1,418.1	2,462.5	–1,044.4	1,535.1	2,740.1	–1,205.0	1,393.3	3,160.1	–1,766.8
1,967.6	1,110.3	857.3	2,135.5	1,155.7	979.8	2,407.6	1,238.1	1,169.5
21.4	43.3	–21.9	17.1	15.4	1.7	23.7	25.2	–1.5
336.0	275.4	60.6	327.7	366.5	–38.8	415.8	370.8	45.0
818.7	1,372.5	–553.8	852.0	1,786.8	–934.8	1,082.5	1,232.0	–149.5
137.1	28.9	108.2	145.8	48.3	97.5	152.4	36.5	115.9
923.0	657.7	265.3	827.5	575.9	251.6	871.3	563.8	307.5
140.0	114.5	25.5	129.0	103.0	26.0	119.7	67.2	52.5
155.3	288.1	–132.8	152.3	298.1	–145.8	135.6	244.5	–108.9
155.4	646.0	–490.6	254.2	494.3	–240.1	369.2	809.9	–440.7
433.1	1,638.0	–1,204.9	412.6	1,559.7	–1,147.1	510.7	1,562.7	–1,052.0
26,273.6	29,960.2	–3,686.6	26,997.8	28,414.2	–1,416.4	31,943.5	31,224.2	719.3
923.7	4,012.8	–3,089.1	969.4	3,571.9	–2,602.5	1,222.9	3,590.8	–2,367.9
250.0	439.0	–189.0	284.6	667.5	–382.9	250.0	1,045.0	–795.0
394.4	496.0	–101.6	458.0	738.2	–280.2	495.5	809.9	–314.4
9,095.1	5,893.6	3,201.5	8,728.6	6,906.0	1,822.6	10,188.2	9,361.9	826.2
184,986.5	**194,344.5**	**-9,358.0**	**197,026.1**	**197,279.8**	**–253.7**	**221,412.9**	**220,991.5**	**421.3**

Table A.10
Principal Markets for Manufactured Exports

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
ASEAN	25,367	28.3	33,731	28.0	40,878	27.8	45,408	28.7	45,844	28.6
Singapore	*21,402*	*23.9*	*27,583*	*22.9*	*32,818*	*22.3*	*35,701*	*22.5*	*35,496*	*22.1*
Thailand	*2,068*	*2.3*	*3,137*	*2.6*	*4,292*	*2.9*	*4,748*	*3.0*	*4,942*	*3.1*
Indonesia	*868*	*1.0*	*1,344*	*1.1*	*1,933*	*1.3*	*2,529*	*1.6*	*2,401*	*1.5*
Philippines	*677*	*0.8*	*1,146*	*1.0*	*1,291*	*0.9*	*1,831*	*1.2*	*2,511*	*1.6*
Brunei Darussalam	*352*	*0.4*	*520*	*0.4*	*544*	*0.4*	*598*	*0.4*	*494*	*0.3*
EU	14,541	16.2	17,995	15.0	21,840	14.8	22,900	14.5	24,888	15.5
United Kingdom	*4,515*	*5.0*	*5,149*	*4.3*	*6,839*	*4.6*	*6,187*	*3.9*	*5,985*	*3.7*
Germany	*4,032*	*4.5*	*4,625*	*3.8*	*5,277*	*3.6*	*5,432*	*3.4*	*5,251*	*3.3*
Netherlands	*1,593*	*1.8*	*2,132*	*1.8*	*2,953*	*2.0*	*4,447*	*2.8*	*6,595*	*4.1*
Others	*4,401*	*4.9*	*6,089*	*5.1*	*6,771*	*4.6*	*6,834*	*4.3*	*7,057*	*4.4*
United States	23,453	26.1	31,153	25.9	36,713	24.9	34,395	21.7	35,035	21.8
Japan	7,638	8.5	10,618	8.8	15,202	10.3	17,520	11.1	16,545	10.3
Hong Kong SAR, China	4,615	5.1	6,564	5.5	9,149	6.2	10,541	6.7	10,048	6.3
Taiwan, ROC	2,556	2.9	3,293	2.7	4,439	3.0	6,645	4.2	6,746	4.2
Korea	1,088	1.2	1,880	1.6	2,622	1.8	2,857	1.8	2,629	1.6
People's Republic of China	1,432	1.6	2,402	2.0	2,348	1.6	2,677	1.7	2,245	1.4
Australia	1,072	1.2	1,750	1.5	1,900	1.3	2,400	1.5	2,645	1.6
Canada	1,105	1.2	1,331	1.1	1,384	0.9	1,281	0.8	1,360	0.8
West Asia countries	1,804	2.0	2,226	1.9	2,767	1.9	2,854	1.8	2,802	1.7
Latin American countries	976	1.1	1,613	1.3	1,965	1.3	1,777	1.1	2,059	1.3
Rest of the world	4,407	4.5	5,739	4.8	6,046	4.1	7,222	4.6	7,614	4.7
Total	**89,694**	**100.0**	**120,295**	**100.0**	**147,253**	**100.0**	**158,477**	**100.0**	**160,460**	**100.0**

Source: Department of Statistics and Bank Negara Malaysia

Table A.11
Principal Export Markets for Electronics

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	10,267	33.3	14,592	34.2	18,159	32.0	16,362	25.3	18,811	26.1
Singapore	7,790	25.3	10,720	25.1	14,578	25.7	17,552	27.2	19,083	26.4
Taiwan, ROC	987	3.2	1,344	3.2	2,150	3.8	4,038	6.2	4,068	5.6
Japan	2,757	8.9	3,392	8.0	4,670	8.2	5,547	8.6	5,538	7.7
Hong Kong SAR, China	1,836	6.0	2,139	5.0	2,788	4.9	3,963	6.1	4,063	5.6
Other	7,205	23.4	10,450	24.5	14,435	25.4	17,167	26.6	20,620	28.6
Total	**30,842**	**100.0**	**42,637**	**100.0**	**56,780**	**100.0**	**64,629**	**100.0**	**72,183**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.12
Principal Export Markets for Electrical Products

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	6,745	27.8	8,716	25.8	9,445	23.6	9,146	23.1	8,159	23.6
Singapore	6,184	25.5	8,754	26.0	9,165	22.9	8,324	21.0	7,137	20.6
Japan	1,829	7.5	3,034	9.0	4,894	12.2	5,321	13.4	4,606	13.3
Hong Kong SAR, China	1,000	4.1	1,894	5.6	2,786	7.0	2,599	6.6	1,986	5.7
Germany	1,446	6.0	1,635	4.8	1,618	4.0	1,758	4.4	1,397	4.0
United Kingdom	737	3.0	910	2.7	1,067	2.7	1,053	2.7	981	2.8
Other	6,346	26.1	8,788	26.1	10,993	27.5	11,448	28.9	10,368	30.0
Total	**24,287**	**100.0**	**33,731**	**100.0**	**39,968**	**100.0**	**39,649**	**100.0**	**34,634**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.13
Principal Export Markets for Textiles, Clothing and Footwear

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	1,676	31.1	1,829	30.2	1,693	26.0	1,662	23.9	1,610	24.0
Hong Kong SAR, China	366	6.8	409	6.7	801	12.3	1,071	15.4	905	13.5
Singapore	683	12.7	767	12.7	763	11.7	774	11.1	659	9.8
United Kingdom	510	9.5	538	8.9	498	7.6	494	7.1	465	6.9
Japan	200	3.7	305	5.0	383	5.9	433	6.2	446	6.6
Germany	365	6.8	343	5.7	352	5.4	366	5.3	269	4.0
Taiwan, ROC	171	3.2	259	4.3	239	3.7	346	5.0	509	7.6
Other	1,412	26.2	1,606	26.5	1,790	27.5	1,817	26.1	1,851	27.6
Total	**5,383**	**100.0**	**6,056**	**100.0**	**6,519**	**100.0**	**6,963**	**100.0**	**6,714**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.14
Principal Export Markets for Wood Products

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Japan	847	21.0	888	18.6	1,405	28.4	2,108	34.6	1,929	33.1
People's Republic of China	1,040	25.8	1,486	31.1	1,148	23.2	1,241	20.4	836	14.3
Taiwan, ROC	409	10.1	478	10.0	384	7.7	477	7.8	471	8.1
Hong Kong SAR, China	250	6.2	335	7.0	380	7.7	474	7.8	620	10.6
Singapore	452	11.2	438	9.2	367	7.4	399	6.6	389	6.7
Other	1,038	25.7	1,149	24.1	1,270	25.6	1,390	22.8	1,585	27.2
Total	**4,036**	**100.0**	**4,774**	**100.0**	**4,954**	**100.0**	**6,089**	**100.0**	**5,830**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.15
Principal Export Markets for Chemicals and Chemical Products

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	614	21.7	747	16.4	834	13.3	906	13.4	920	12.5
Hong Kong SAR, China	274	9.7	426	9.4	627	10.0	648	9.6	702	9.6
Japan	320	11.3	594	13.1	607	9.7	611	9.1	702	9.6
Korea	65	2.3	217	4.8	492	7.9	587	8.7	494	6.7
United States	176	6.2	420	9.2	523	8.4	554	8.2	662	9.0
Taiwan, ROC	80	2.8	159	3.5	281	4.5	399	5.9	569	7.8
Thailand	212	7.5	289	6.4	385	6.2	357	5.3	347	4.7
Indonesia	104	3.7	163	3.6	251	4.0	353	5.2	412	5.6
Australia	97	3.4	120	2.6	185	2.9	242	3.6	227	3.1
Other	886	31.3	1,413	31.1	2,072	33.1	2,080	30.9	2,300	31.4
Total	**2,828**	**100.0**	**4,548**	**100.0**	**6,257**	**100.0**	**6,737**	**100.0**	**7,335**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.16
Principal Export Markets for Manufactures of Metal

Country	1993		1994		1995		1996		1997 (Jan.–Nov.)	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	1,128	36.9	1,412	38.9	1,513	32.5	1,721	34.4	1,596	31.3
United States	207	6.8	310	8.5	357	7.7	414	8.3	373	7.3
Japan	180	5.9	313	8.6	392	8.4	387	7.7	466	9.1
Korea	128	4.2	132	3.6	221	4.7	339	6.8	287	5.6
Thailand	402	13.2	204	5.6	355	7.6	313	6.3	266	5.2
Indonesia	54	1.8	96	2.7	267	5.7	259	5.2	220	4.3
Taiwan, ROC	146	4.8	116	3.2	217	4.7	248	5.0	24	0.5
Other	812	26.6	1,051	28.9	1,334	28.7	1,322	26.4	1,875	36.7
Total	**3,057**	**100.0**	**3,634**	**100.0**	**4,656**	**100.0**	**5,003**	**100.0**	**5,107**	**100.0**

Source : Department of Statistics and Bank Negara Malaysia

Table A.17
Export Prices for Major Commodities

	1993	1994	1995	1996	1997
Crude palm oil (RM/tonne)	985.8	1,174.0	1,534.0	1,288.4	1,420.6
Rubber (sen/kg)	227.5	288.0	398.0	358.0	291.7
Sawn timber (RM/cu. metre)	829.8	911.3	879.0	832.5	904.3
Saw logs (RM/cu. metre)	313.8	302.2	292.0	326.7	366.7

Source: Department of Statistics

Table A.18
Crude Oil Prices: International Comparison

	1993	1994	1995	1996	1997
	(US$/bbl)				
Tapis Blend	18.91	17.14	18.28	22.00	21.11
North Sea Brent	17.14	16.04	17.20	20.76	19.40
West Texas Intermediate	18.46	17.18	18.43	22.12	20.63

Source: PETRONAS

Table A.19
Principal Export Markets for Palm Oil

	1993		1994		1995		1996		1997	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
People's Republic of China	757.2	12.9	1,412.3	20.6	1,102.3	16.2	934.5	12.8	1,102.5	14.5
Pakistan	972.0	16.5	1,194.7	17.4	1,024.8	15.1	1,119.6	15.3	1,091.7	14.3
India	63.6	1.1	219.2	3.2	748.8	11.0	991.9	13.5	974.6	12.8
West Asia	987.9	16.8	921.0	13.4	865.2	12.7	1,099.0	15.0	962.0	12.6
EU	429.9	7.3	737.4	10.7	640.2	9.4	857.4	11.7	717.2	9.4
Netherlands	*206.4*	*3.5*	*266.9*	*3.9*	*267.2*	*3.9*	*421.4*	*5.8*	*347.0*	*4.6*
Sweden	*–*	*0.0*	*50.1*	*0.7*	*53.9*	*0.8*	*71.8*	*1.0*	*63.2*	*0.8*
Italy	*34.3*	*0.6*	*53.0*	*0.8*	*61.2*	*0.9*	*130.1*	*1.8*	*62.8*	*0.8*
United Kingdom	*54.3*	*0.9*	*143.4*	*2.1*	*79.9*	*1.2*	*67.2*	*0.9*	*60.6*	*0.8*
Other	*134.9*	*2.3*	*224.0*	*3.2*	*178.1*	*2.6*	*166.9*	*2.3*	*183.6*	*2.4*
Singapore	521.6	8.9	419.2	6.1	441.9	6.5	346.2	4.7	415.2	5.5
Japan	335.9	5.7	341.4	5.0	316.7	4.7	361.8	4.9	344.1	4.5
Korea	191.8	3.3	183.7	2.7	156.7	2.3	190.8	2.6	185.7	2.4
Myanmar	165.0	2.8	178.9	2.6	204.7	3.0	189.0	2.6	179.0	2.4
Other	1,458.1	24.7	1,255.5	18.3	1,307.8	19.1	1,233.4	16.8	1,637.2	21.5
Total	**5,883.0**	**100.0**	**6,863.5**	**100.0**	**6,809.1**	**100.0**	**7,323.5**	**100.0**	**7,609.2**	**100.0**

Source: Department of Statistics

Table A.20
Principal Export Markets for Rubber

	1993		1994		1995		1996		1997	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
EU	282	30.1	299	29.4	329	32.5	298	30.4	315	30.9
Germany	*55*	*5.9*	*51*	*5.0*	*69*	*6.8*	*73*	*7.5*	*76*	*7.5*
United Kingdom	*56*	*6.0*	*50*	*4.9*	*47*	*4.6*	*46*	*4.7*	*47*	*4.6*
Belgium	*33*	*3.5*	*35*	*3.4*	*41*	*4.0*	*35*	*3.6*	*44*	*4.3*
Italy	*54*	*5.8*	*50*	*4.9*	*48*	*4.7*	*42*	*4.3*	*43*	*4.2*
Netherlands	*27*	*2.9*	*42*	*4.1*	*51*	*5.0*	*30*	*3.0*	*22*	*2.1*
Other	*57*	*6.0*	*71*	*7.1*	*73*	*7.4*	*71*	*7.3*	*84*	*8.2*
United States	124	13.2	126	12.4	125	12.3	123	12.6	130	12.8
Korea	135	14.4	144	14.2	111	11.0	98	10.0	87	8.5
Japan	60	6.4	52	5.1	52	5.1	44	4.4	52	5.1
People's Republic of China	18	1.9	84	8.3	40	3.9	80	8.2	52	5.1
Turkey	41	4.4	30	2.9	41	4.0	34	3.4	32	3.1
Other	277	29.6	282	27.7	315	31.2	304	31.0	350	34.4
Total	**937**	**100.0**	**1,017**	**100.0**	**1,013**	**100.0**	**980**	**100.0**	**1,018**	**100.0**

Source: Department of Statistics

Table A.21
Principal Export Markets for Saw Logs

	1993		1994		1995		1996		1997	
	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share	'000 cubic metres	% share
Japan	5,343	57.5	4,652	55.3	4,060	52.4	3,613	51.7	2,856	44.7
Taiwan, ROC	1,254	13.5	1,446	17.2	1,233	15.9	1,172	16.8	1,216	19.0
India	222	2.4	255	3.0	321	4.1	318	4.6	688	10.8
Hong Kong SAR, China	381	4.1	366	4.4	375	4.8	478	6.8	519	8.1
People's Republic of China	757	8.2	515	6.1	540	7.0	341	4.9	429	6.7
Korea	957	10.3	627	7.4	678	8.8	496	7.1	370	5.8
Thailand	214	2.3	360	4.3	304	3.9	358	5.1	209	3.3
Other	160	1.7	196	2.3	235	3.0	209	3.0	109	1.7
Total	**9,288**	**100.0**	**8,417**	**100.0**	**7,746**	**100.0**	**6,985**	**100.0**	**6,396**	**100.0**

Source: Department of Statistics

Table A.22
Principal Export Markets for Crude Oil

	1993		1994		1995		1996		1997	
	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share	'000 tonnes	% share
Thailand	4,109	19.5	4,201	22.0	4,996	26.1	4,913	28.1	3,736	23.5
Japan	3,949	18.8	4,422	23.2	4,405	23.0	3,929	22.5	2,722	17.2
Korea	3,427	16.3	2,492	13.1	1,837	9.6	2,022	11.6	2,394	15.1
Singapore	5,158	24.5	3,545	18.6	2,949	15.4	2,264	12.9	1,829	11.5
India	496	2.4	849	4.5	597	3.1	863	4.9	1,050	6.6
Indonesia	859	4.1	744	3.9	810	4.2	683	3.9	882	5.6
Philippines	913	4.3	636	3.3	368	1.9	437	2.5	547	3.4
New Zealand	92	0.4	–	0.0	405	2.1	587	3.4	332	2.1
Other	2,029	9.7	2,172	11.4	2,798	14.6	1,798	10.2	2,381	15.0
Total	**21,032**	**100.0**	**19,061**	**100.0**	**19,165**	**100.0**	**17,495**	**100.0**	**15,872**	**100.0**

Source: Department of Statistics

Table A.23
External Debt and Debt Servicing

	1993	1994	1995	1996	1997*p*
	RM million				
Medium and long-term					
Gross borrowing	**14,368**	**20,119**	**21,310**	**22,485**	**24,981**
Federal Government	*1,220*	*1,293*	*442*	*749*	*462*
NFPEs	*6,682*	*8,268*	*9,952*	*8,128*	*9,526*
Private sector	*6,466*	*10,558*	*10,916*	*13,608*	*14,993*
Repayment and prepayment	**8,814**	**12,357**	**11,155**	**15,958**	**12,396**
Federal Government	*4,354*	*6,050*	*2,077*	*2,926*	*2,143*
NFPEs	*2,405*	*2,507*	*2,184*	*5,284*	*3,046*
Private sector	*2,055*	*3,800*	*6,894*	*7,748*	*7,207*
Net borrowing	**5,554**	**7,762**	**10,155**	**6,527**	**12,585**
Federal Government	*–3,134*	*–4757*	*–1635*	*–2177*	*–1681*
NFPEs	*4,277*	*5,761*	*7,768*	*2,844*	*6,480*
Private sector	*4,411*	*6,758*	*4,022*	*5,860*	*7,786*
Outstanding debt	**51,861**	**59,147**	**68,810**	**73,181**	**126,508**
Federal Government	*19,362*	*14,818*	*13,331*	*10,470*	*12,952*
NFPEs	*17,001*	*20,126*	*27,399*	*29,238*	*52,467*
Private sector	*15,498*	*24,203*	*28,080*	*33,474*	*61,089*
% GNP	*33.0*	*32.7*	*33.1*	*30.8*	*48.1*
% exports of goods and services	*36.9*	*32.9*	*32.0*	*30.9*	*47.1*
Annual growth (%)	*21.2*	*14.0*	*16.3*	*6.4*	*72.9*
Currency composition (% share)	**100**	**100**	**100**	**100**	**100**
U.S . Dollar	*52*	*57*	*65*	*72*	*76*
Japanese yen	*32*	*27*	*22*	*16*	*15*
Other	*16*	*16*	*13*	*12*	*9*
Short-term					
Outstanding debt	**17,320**	**14,244**	**16,204**	**25,655**	**39,720**
Banking	*17,320*	*9,840*	*11,293*	*18,399*	*31,541*
Non-bank private sector	*n.a*	*4,404*	*4,911*	*7,256*	*8,179*
Total external debt	**69,181**	**73,391**	**85,014**	**98,836**	**166,228**
% GNP	*44.1*	*40.6*	*40.9*	*41.5*	*63.2*
% exports of goods and services	*49.2*	*40.8*	*39.5*	*41.8*	*61.9*
Annual Growth (%)	*23.6*	*6.1*	*15.8*	*16.3*	*68.2*
Total servicing (including short-term interest payment)	**9,987**	**9,967**	**13,940**	**14,406**	**15,412**
of which:					
Medium and long-term					
Repayment (excluding prepayment)	**6,501**	**6,212**	**10,133**	**9,922**	**9,015**
Federal Government	*2,483*	*1,321*	*2,077*	*1,792*	*1,232*
NFPEs	*1,991*	*1,280*	*1,570*	*1,503*	*1,488*
Private sector	*2,027*	*3,611*	*6,486*	*6,627*	*6,295*
Interest payment	**2,283**	**2,642**	**2,876**	**3,603**	**4,769**
Federal Government	*1,339*	*1136*	*886*	*751*	*634*
NFPEs	*621*	*845*	*1,074*	*1,392*	*1,995*
Private sector	*323*	*661*	*916*	*1,460*	*2,140*
Debt service ratio (% exports of goods and services)					
Total debt	7.1	5.5	6.5	6.1	5.7
Medium and long-term debt	6.2	4.9	6.0	5.7	5.1
Federal Government	*2.7*	*1.4*	*1.4*	*1.1*	*0.7*
NFPEs	*1.8*	*1.2*	*1.2*	*1.2*	*1.3*
Private sector	*1.7*	*2.3*	*3.4*	*3.4*	*3.1*

p Preliminary

Table A.24
Gross Malaysian Investment Overseas[1]

Countries	1993*r*	1994*r*	1995*r*	1996*r*	1997
	RM million				
United States	806	627	566	1,434	2,337
Singapore	748	2,256	2,422	2,122	1,849
Hong Kong SAR, China	830	2,074	1,263	823	851
Indonesia	11	100	328	414	619
United Kingdom	417	506	756	1,355	561
Australia	186	642	603	541	492
France	15	11	17	101	442
People's Republic Of China	113	217	331	513	316
Philippines	53	223	646	378	289
Sudan	–	–	–	16	214
Netherlands	30	281	144	21	179
Taiwan, ROC	59	122	65	202	151
South Africa	–	45	68	1,183	143
Switzerland	11	166	114	67	134
Vietnam	7	73	102	129	127
Japan	192	240	179	709	115
Germany	139	80	12	38	109
Thailand	33	70	154	130	105
Canada	64	191	97	44	63
New Zealand	10	81	46	40	46
India	5	28	14	17	42
Cambodia	8	3	16	67	40
Bahrain	–	–	–	–	29
Mauritius	10	45	72	15	18
Lebanon	–	–	–	–	15
Sri Lanka	10	30	23	70	15
Korea	2	1	36	154	15
Luxembourg	–	–	10	11	14
Denmark	4	–	1	–	11
Saudi Arabia	–	–	1	17	11
Other	258	396	574	833	506
Total[2]	**4,021**	**8,508**	**8,660**	**11,444**	**9,858**

[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.
r Revised based on a more comprehensive coverage i.e. transactions effected through the domestic banking system as well as through inter-company and overseas accounts.

Source: Cash BOP Reporting System, Bank Negara Malaysia.

Table A.25
Consumer Price Index

	Weights	1993	1994	1995	1996	1997
		Annual change (%)				
Consumer Price Index (1994=100)	100.0	3.6	3.7	3.4	3.5	2.7
Of which:						
Food	34.9	2.2	5.3	4.9	5.7	4.1
Beverages and tobacco	3.6	14.8	5.0	2.3	2.2	1.3
Clothing and footwear	3.6	0.5	–0.7	0.0	–0.7	–0.5
Gross rent, fuel and power	21.1	3.5	2.4	3.4	3.2	3.2
Furniture, furnishings and household equipment and operation	5.6	1.3	1.4	2.8	1.1	0.1
Medical care and health expenses	1.9	5.1	3.3	3.1	3.7	3.6
Transport and communication	17.9	5.6	4.6	1.8	1.4	0.6
Recreation, entertainment, education and cultural services	5.8	0.5	0.7	2.5	3.3	0.4
Miscellaneous goods and services	5.6	2.6	2.4	4.2	2.5	4.6
Peninsular Malaysia	100.0	3.7	3.7	3.7	3.8	2.8
Sabah	100.0	2.4	3.3	2.8	2.8	2.0
Sarawak	100.0	3.4	4.3	2.2	2.2	1.7
Durable goods	10.0	5.3	6.5	1.9	1.4	–0.7
Semi-durable goods	5.5	0.5	–0.5	0.2	1.2	–0.3
Non-durable goods	41.2	3.2	4.3	4.1	4.0	2.6
Services	43.3	4.0	2.7	3.6	3.7	3.8

Source: Department of Statistics

Table A.26
Consumer Price Index for Food

	Weights	1993	1994	1995	1996	1997
		Annual change (%)				
Food	34.9	2.2	5.3	4.9	5.7	4.1
Of which:						
Food at home	25.1	2.3	5.9	5.3	6.0	3.7
Rice,bread and other cereals	5.5	2.4	0.4	1.4	7.4	3.6
Meat	3.8	1.5	8.0	0.8	4.7	3.4
Fish	4.9	3.4	13.2	12.1	11.7	7.2
Milk and eggs	2.3	2.8	1.0	–0.4	4.0	1.6
Oils and fats	0.7	2.6	2.5	11.2	0.2	–0.7
Fruits and vegetables	5.4	3.0	7.4	8.7	3.0	2.6
Sugar	0.6	–0.1	0.1	0.7	0.8	0.3
Coffee and tea	0.8	0.0	2.0	4.6	0.5	0.8
Other foods	1.1	–1.1	–2.2	2.7	4.4	0.7
Food away from home	9.8	2.0	2.8	3.7	5.2	5.3

Source: Department of Statistics

Table A.27
House Price Indicators (MHPI, 1990=100)

	1993	1994	1995	1996	1997 1st half
	Annual change (%)				
	4.8	8.0	18.3	12.9	6.1
Type					
Terraced	4.4	8.7	13.1	10.2	11.2
Semi-Detached	3.3	6.5	9.8	8.1	8.5
Detached	7.5	10.0	15.7	14.1	10.4
High-Rise Unit	–1.4	6.1	4.2	–1.0	–4.6
Region					
Klang Valley	4.8	10.4	15.9	15.7	4.6
Johor Bahru	6.7	15.6	16.6	14.3	3.1
Penang Island	4.5	8.8	11.2	4.3	5.2
Seremban-Sepang	0.6	3.1	11.4	18.6	13.6
Ipoh-Kinta	3.3	3.8	6.7	6.8	7.6

Source: Department of Valuation and Property Services

Table A.28
Producer Price Index

	Weights	1993	1994	1995	1996	1997
		Annual change (%)				
Producer Price Index (1989=100)	100.0	0.7	4.0	4.0	2.3	2.7
Of which:						
Food and live animal	14.9	1.5	5.6	2.4	5.5	2.3
Beverages and tobacco	2.1	7.6	1.9	2.4	0.5	0.1
Crude materials	18.0	0.1	10.0	7.0	–1.5	–4.9
Mineral fuels, lubricants and related materials	18.8	0.7	4.4	–0.4	12.5	7.0
Animal and vegetable oils and fats	8.5	3.1	20.0	26.0	–5.8	12.9
Chemicals and related products	4.4	0.7	0.5	1.9	1.0	1.2
Manufactured goods	10.8	1.0	3.4	–0.1	0.8	0.1
Machinery and transport equipment	18.4	2.4	0.4	–1.8	0.5	3.4
Miscellaneous manufactured articles	3.6	0.4	5.3	2.3	3.4	–1.2
Commodities and other transactions	0.6	4.3	1.7	–0.4	0.3	–0.5
Local Production	79.3	–4.7	5.0	4.8	2.8	2.5
Imports	20.7	–0.2	0.2	0.7	0.1	2.8

Source: Department of Statistics

Table A.29
Wages in Private Sector [1]

Sector	No. of wage agreement		No. of workers involved		Average wages (Weighted increase in %)	
	1996	1997	1996	1997	1996	1997
Manufacturing	210	241	47,686	63,381	13.0	15.0
Transport	55	31	9,966	7,708	6.0	10.0
Commerce	42	62	4,659	6,836	11.6	11.8
Services	38	44	6,374	11,973	7.6	14.1
Agriculture	32	18	12,990	35,982	11.5	10.2
Electricity	9	2	29,713	2,307	6.4	18.1
Mining	6	7	1,342	364	10.1	7.7
Construction	–	–	–	–	–	–
Other	6	7	466	1,484	6.7	9.6
Total	**398**	**412**	**113,196**	**130,035**	**10.3**	**13.1**

[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, Ministry of Human Resources

Table A.30
Labour and Employment

	1993	1994	1995	1996	1997
Labour force ('000)	7,627	7,834	8,140	8,372	8,607
(annual change in %)	3.5	2.7	3.9	2.9	2.8
Employment (annual change in %)	4.2	3.0	3.9	3.1	2.6
Unemployment rate (% of labour force)	3.0	2.9	2.8	2.5	2.7
Labour productivity growth (GDP/Employment)	4.0	6.1	5.3	5.3	5.1
Average wages in manufacturing sector (annual change in %)	2.4	4.2	6.1	9.6	7.0
Employment by sector ('000)					
Agriculture, forestry and fishing	1,680	1,585	1,413	1,339	1,274
Mining	36	36	41	43	43
Manufacturing	1,742	1,892	2,052	2,178	2,316
Construction	544	598	667	726	765
Electricity, gas and water	48	61	71	74	76
Wholesale and retail trade, hotels and restaurants	1,292	1,318	1,337	1,375	1,383
Finance, insurance, real estate and business services	332	352	379	403	422
Transport, storage and communication	344	366	395	414	433
Government services	864	868	872	877	880
Other services	514	542	688	732	783
Total	**7,396**	**7,618**	**7,915**	**8,161**	**8,375**
Services	3,393	3,507	3,742	3,875	3,977

Source: Economic Planning Unit
Department of Statistics

Table A.31
Interest Rates

	As at end				As at end-month in 1997											
	1993	1994	1995	1996	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
	% per annum															
3-month interbank	6.50	5.45	6.76	7.39	7.32	7.35	7.34	7.33	7.51	7.50	8.38	7.50	8.04	8.30	8.50	8.70
Commercial banks																
Average fixed deposits:																
3-month	6.37	5.27	6.64	7.21	7.22	7.22	7.24	7.25	7.30	7.43	7.73	7.54	7.69	8.56	9.08	9.06
12-month	6.29	6.15	6.89	7.26	7.26	7.25	7.25	7.26	7.30	7.38	7.52	7.56	7.79	8.77	9.26	9.33
Average savings deposits	3.99	3.54	3.70	4.10	4.12	4.14	4.16	4.15	4.17	4.16	4.14	4.19	4.19	4.24	4.23	4.23
Average base lending rate (BLR)	8.22	6.83	8.03	9.18	9.19	9.20	9.24	9.25	9.27	9.50	9.58	9.61	9.61	9.53	10.07	10.33
Finance companies																
Average fixed deposits:																
3-month	6.51	5.48	6.79	7.32	7.33	7.34	7.34	7.36	7.54	7.63	8.01	7.67	7.79	8.97	9.98	10.32
12-month	6.48	6.36	6.98	7.36	7.37	7.37	7.38	7.38	7.44	7.50	7.64	7.67	7.87	9.08	9.99	10.25
Average savings deposits	5.27	4.57	4.70	5.02	5.06	5.03	5.06	5.04	5.09	5.10	5.12	5.18	5.15	5.33	5.47	5.49
Average base lending rate (BLR)	9.97	8.40	9.38	10.65	10.66	10.66	10.67	10.67	10.71	10.85	11.01	11.22	11.28	11.20	11.88	12.22
Bank Negara Bills (91 days)	5.20	4.11	6.21	6.63	6.55	6.34	6.35	6.46	–	–	6.37	–	–	–	–	–
Treasury bills (91 days)	4.99	4.56	5.92	6.39	6.31	6.27	6.31	6.48	6.35	6.48	6.39	6.16	6.00	6.57	7.31	6.76
Government securities (5 years)	5.25	6.30	6.50	6.55	6.57	6.57	6.56	6.63	6.63	6.62	6.58	6.58	6.61	7.26	8.16	7.75
Government securities (10 years)	5.75	6.25	6.90	6.78	6.76	6.74	6.81	6.83	6.83	6.78	6.74	6.74	6.76	7.33	7.92	7.84

Table A.32
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	%
1993	37,433	23.5	25,319	22.1	11,397	37.5	1,392	11.5	10,005	54.8	13,922	16.6	12,114	27.1
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	61,018	18.5	53,988	22.7	2,780	4.6	2,402	12.6	378	0.9	51,208	28.8	7,030	7.7

[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.33
Broad Money (M3)

	Annual change				
	1993	1994	1995	1996	1997
	RM million				
Broad money (M3) [1]	37,433	25,719	49,619	57,759	61,018
(Annual growth in %)	(23.5)	(13.1)	(22.3)	(21.2)	(18.5)
Currency [2]	1,380	2,357	1,529	1,525	2,350
Demand deposits	9,996	3,346	4,548	6,209	80
Broad quasi money	26,057	20,016	43,541	50,025	58,588
Fixed deposits	*23,223*	*7,260*	*31,172*	*41,586*	*46,073*
Savings deposits	*4,995*	*5,001*	*1,294*	*6,061*	*–3,712*
NIDs	*–3,770*	*5,829*	*9,408*	*–2,046*	*10,117*
Repos	*1,609*	*1,926*	*1,667*	*2,571*	*3,835*
Foreign currency deposits	*n.a.*	*n.a.*	*n.a.*	*1,853*	*2,275*
Factors Affecting M3					
Net lending to Government	581	–5,945	–3,852	–2,858	451
Lending to Government	–1,248	331	229	2,521	1,798
Less: Government deposits	–1,829	6,276	4,081	5,379	1,347
Private sector credit	21,582	31,267	64,154	72,383	90,047
Net external assets [3]	21,830	6,299	–3,256	1,520	–17,237
Other influences	–6,560	–5,902	–7,427	–13,286	–12,243

[1] Excludes interplacements among banking institutions.
[2] Excludes holdings by banking system.
[3] BNM net of banking system.
n.a. not available

Monthly change											
1997											
Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
RM million											
9,383	4,307	3,185	2,945	5,609	7,471	3,102	5,342	1,699	6,514	506	10,955
(20.1)	(18.8)	(19.3)	(19.3)	(20.3)	(21.8)	(20.7)	(21.2)	(20.1)	(18.7)	(17.6)	(18.5)
2,254	–1,055	–761	–239	211	–321	–66	1,136	–139	203	394	732
4,708	–2,406	–753	–2,550	–470	2,787	–2,227	–916	2,984	–1,213	–2,638	2,773
2,421	7,768	4,698	5,734	5,868	5,005	5,396	5,123	–1,147	7,524	2,750	7,450
235	*4,265*	*5,009*	*5,003*	*2,658*	*7,547*	*2,957*	*5,935*	*–1,490*	*3,934*	*2,979*	*7,040*
563	*–130*	*425*	*–1,189*	*–546*	*–612*	*–478*	*1,531*	*–1,062*	*–651*	*–1,664*	*101*
1,966	*2,647*	*–235*	*–1,874*	*3,280*	*–16*	*210*	*–114*	*123*	*1,843*	*1,832*	*456*
–262	*1,009*	*–440*	*1,919*	*1,714*	*–2,071*	*2,886*	*–2,195*	*906*	*1,896*	*–592*	*–934*
–81	*–23*	*–61*	*1,874*	*–1,237*	*157*	*–180*	*–34*	*376*	*502*	*195*	*787*
2,591	–501	–843	1,338	–1,926	221	–777	–1,619	–481	1,107	–1,216	2,558
–920	–140	–41	32	–20	288	325	294	87	1,061	1,005	–173
–3,511	362	803	–1,306	1,907	66	1,101	1,913	568	–46	2,221	–2,731
12,514	6,357	8,598	6,781	8,328	9,714	7,630	6,311	9,485	9,793	5,001	–465
–3,039	702	–252	–5,228	476	–33	–2,425	162	–5,636	–3,529	–1,490	3,054
–2,682	–2,251	–4,318	54	–1,269	–2,431	–1,326	489	–1,670	–857	–1,789	5,808

Table A.34
Consolidated Public Sector Finance

	1993	1994	1995	1996	1997*p*
	RM million				
General government					
Revenue	52,612	61,136	62,271	70,912	78,549
% growth	*6.8*	*16.2*	*1.9*	*13.9*	*10.8*
Operating expenditure	37,659	40,542	41,395	50,463	50,647
% growth	*–0.3*	*7.7*	*2.1*	*21.9*	*0.4*
Current surplus	14,953	20,594	20,876	20,449	27,902
NFPEs					
Revenue	43,679	43,323	48,335	57,380	61,436
% growth	*2.7*	*–0.8*	*11.6*	*18.7*	*7.1*
Operating expenditure	30,036	28,520	32,342	37,032	39,689
% growth	*3.6*	*–5.0*	*13.4*	*14.5*	*7.2*
Current surplus	13,643	14,803	15,993	20,348	21,747
Public sector current surplus	**28,596**	**35,397**	**36,869**	**40,797**	**49,649**
% of GNP	*18.2*	*19.6*	*17.7*	*17.1*	*18.9*
Net development expenditure	32,307	28,753	29,801	30,818	40,588
% growth	*11.9*	*–11.0*	*3.6*	*3.4*	*31.7*
General government	12,849	12,557	16,171	15,306	18,407
% growth	*1.0*	*–2.3*	*28.8*	*–5.3*	*20.3*
NFPEs	19,458	16,196	13,630	15,512	22,181
% growth	*20.5*	*–16.8*	*–15.8*	*13.8*	*43.0*
Overall budget surplus/deficit	**–3,711**	**6,644**	**7,068**	**9,979**	**9,061**
% of GNP	*–2.4*	*3.7*	*3.4*	*4.2*	*3.4*
General government	2,104	8,037	4,705	5,143	9,495
NFPEs	–5,815	–1,393	2,363	4,836	–434

p Preliminary

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

Table A.35
Industrial Countries: Key Economic Indicators

	1993	1994	1995	1996	1997*e*
	Annual change (%)				
Real GDP					
Industrial Countries	0.9	2.9	2.2	2.5	2.8
United States	2.3	3.5	2.0	2.8	3.8
Japan	0.3	0.6	1.5	3.9	1.0
Germany	–1.2	2.7	1.8	1.4	2.3
United Kingdom	2.1	4.3	2.7	2.3	3.5
Consumer Prices					
Industrial Countries	2.9	2.3	2.4	2.3	2.0
United States	3.0	2.6	2.8	2.9	2.4
Japan	1.2	0.7	–0.1	0.1	1.7
Germany	4.5	2.7	1.8	1.5	1.8
United Kingdom[1]	3.0	2.4	2.8	2.9	2.7
	% of labour force				
Unemployment					
Industrial Countries	8.2	8.1	7.7	7.7	7.5
United States	6.9	6.1	5.6	5.4	5.0
Japan	2.5	2.9	3.1	3.3	3.4
Germany	8.8	9.6	9.4	10.3	11.5
United Kingdom	10.3	9.3	8.2	7.5	5.7
	% of GDP				
Current account balance					
Industrial Countries	+0.2	0.0	+0.2	+0.1	+0.1
United States	–1.4	–1.9	–1.8	–1.9	–2.2
Japan	+3.1	+2.8	+2.2	+1.4	+2.2
Germany	–0.7	–1.0	–1.0	–0.6	–0.4
United Kingdom	–1.6	–0.2	–0.5	–0.1	–0.2
Fiscal balance					
United States	–3.6	–2.3	–1.9	–1.1	–0.3
Japan	–1.6	–2.3	–3.7	–4.1	–2.9
Germany	–3.5	–2.6	–3.5	–3.4	–3.1
United Kingdom	–7.9	–6.9	–5.6	–4.7	–2.0

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

Source: IMF World Economic Outlook, December 1997

Table A.36
East Asia: Key Economic Indicators

	1993	1994	1995	1996	1997*e*
	Annual change (%)				
Real GDP					
Asian NIEs	**6.4**	**7.5**	**7.0**	**6.2**	**6.1**
Korea	5.8	8.6	8.9	7.1	5.6
Taiwan, ROC	6.3	6.5	6.0	5.7	6.8
Singapore	10.4	10.5	8.7	6.9	7.8
Hong Kong SAR, China	6.1	5.4	3.9	5.0	5.2
ASEAN [1]	**7.0**	**7.7**	**8.0**	**7.0**	**4.7**
Malaysia	8.3	9.2	9.5	8.6	7.8
Thailand	8.5	8.9	8.7	5.5	–0.4
Indonesia	7.3	7.5	8.2	8.0	7.5
Philippines	2.1	4.4	4.8	5.7	5.1
Vietnam	8.1	8.8	9.5	9.5	n.a.
People's Republic of China	13.5	12.6	10.5	9.6	8.8
Consumer prices					
Asian NIEs	**4.6**	**5.7**	**4.7**	**4.3**	**3.4**
Korea	4.8	6.2	4.5	4.9	4.5
Taiwan, ROC	2.9	4.1	3.7	3.1	0.9
Singapore	2.3	3.1	1.7	1.4	2.0
Hong Kong SAR, China	8.5	8.1	8.7	6.0	5.7
ASEAN [1]	**6.5**	**7.2**	**7.4**	**6.3**	**5.5**
Malaysia	3.6	3.7	3.4	3.5	2.7
Thailand	3.4	5.1	5.8	5.9	5.6
Indonesia	9.7	8.5	9.4	6.5	6.6
Philippines	7.6	9.0	8.1	8.4	5.1
Vietnam	5.2	14.5	12.8	6.0	n.a.
People's Republic of China	13.0	21.7	14.8	6.1	2.8
Current account balance	US$ bilion				
Asian NIEs	**+19.8**	**+15.0**	**+4.8**	**–0.7**	**+6.4**
Korea	+0.4	–4.5	–8.9	–23.7	–9.3
Taiwan, ROC	+7.0	+6.5	+5.5	+11.0	+7.7
Singapore	+4.2	+11.4	+14.3	+14.6	+14.6
Hong Kong SAR, China [2]	+8.2	+1.6	–6.1	–2.6	–6.6
ASEAN [1]	**–15.6**	**–20.7**	**–34.5**	**–33.8**	**–**
Malaysia	–3.1	–5.6	–8.7	–4.9	–4.8
Thailand	–6.4	–8.1	–13.5	–14.4	–3.3
Indonesia	–2.1	–2.8	–7.0	–7.7	–5.8
Philippines	–3.0	–2.9	–3.3	–3.9	n.a.
Vietnam	–1.0	–1.3	–2.0	–2.9	n.a.
People's Republic of China	–11.6	+6.9	+1.6	+7.2	+23.4

Table A.36
East Asia: Key Economic Indicators (continued)

	1993	1994	1995	1996	1997*e*
	% of GDP				
Current account balance					
Korea	+0.1	–1.2	–2.0	–4.9	n.a.
Taiwan, ROC	+3.1	+2.7	+2.1	+4.0	+2.7
Singapore	+7.2	+16.0	+16.8	+15.7	+15.2
Hong Kong SAR, China[2]	+7.0	+1.2	–4.3	–1.7	–3.8
Malaysia	–4.8	–7.8	–10.0	–4.9	–4.8
Thailand	–5.0	–5.6	–8.0	–7.9	–2.2
Indonesia	–1.5	–1.7	–3.3	–3.3	–2.7
Philippines	–5.5	–4.6	–4.4	–4.7	n.a.
Vietnam[3]	–7.8	–8.5	–10.2	–12.2	n.a.
People's Republic of China	–2.7	+1.4	+0.2	+0.9	+2.6
Fiscal balance [4]					
Korea	0.1	0.6	0.5	0.0	n.a.
Taiwan, ROC	–3.5	–2.0	–0.9	–1.2	–1.5
Singapore	5.9	7.5	6.1	6.0	1.1
Hong Kong SAR, China	2.1	1.1	–0.3	2.2	5.8
Malaysia	0.2	2.3	0.9	0.7	2.4
Thailand	1.9	2.7	3.0	0.9	n.a.
Indonesia	–0.4	0.2	–0.2	0.7	1.4
Philippines	–1.5	1.0	0.6	0.3	0.1
Vietnam	–6.9	–3.1	–1.5	–0.9	n.a.
People's Republic of China	–0.8	–1.2	–1.0	–0.8	–0.6
	% of GNP				
Gross national savings					
Korea	35.2	35.4	36.2	34.6	n.a.
Taiwan, ROC	27.8	26.1	25.3	24.9	24.6
Singapore	45.5	48.5	50.0	50.1	51.2
Hong Kong SAR, China	34.6	33.1	31.0	31.0	n.a.
Malaysia	34.7	34.4	35.2	38.5	40.0
Thailand	34.2	35.2	35.0	35.3	n.a.
Indonesia	32.8	31.9	31.4	33.7	28.0
Philippines	17.5	18.8	18.4	19.5	19.5
Vietnam	11.2	16.6	17.4	18.0	n.a.
People's Republic of China	41.4	42.6	43.3	41.9	41.0

1 Excludes Singapore, Brunei Darussalam, Lao PDR and Myanmar
2 Refers to balance of goods and services
3 As % of GNP
4 Central government balance
e Estimate
n.a. not available

Sources: ADB, Asian Development Outlook, 1997/98
IMF, International Financial Statistics
IMF, World Economic Outlook, October and December 1997
National sources

Table A.37
World Trade [1]

	1993	1994	1995	1996	1997 [2]
	Annual change (%)				
World trade	4.2	10.3	10.1	5.9	8.9
	% share of world trade				
United States	14.2	14.0	13.3	13.5	14.1
Japan	8.1	7.8	7.6	7.1	7.0
European Union	37.8	37.8	38.4	37.5	35.3
Germany	9.3	9.3	9.3	9.0	8.3
United Kingdom	5.1	5.0	4.9	5.1	4.9
Asia [3]	17.7	18.3	18.8	18.9	18.6
People's Republic of China	2.6	2.8	2.8	2.7	3.6
India	0.6	0.6	0.6	0.7	0.8
Asian NIEs	10.1	10.4	10.7	10.6	–
Hong Kong SAR, China	3.6	3.7	3.6	3.6	2.9
Korea	2.2	2.3	2.6	2.6	2.3
Singapore	2.1	2.3	2.4	2.4	1.9
Taiwan, ROC	2.2	2.1	2.1	2.0	n.a.
ASEAN	3.7	3.9	4.1	4.3	4.3
Indonesia	0.9	0.8	0.8	0.9	0.8
Malaysia	1.2	1.4	1.5	1.5	1.5
Philippines	0.4	0.4	0.4	0.5	0.6
Thailand	1.1	1.2	1.2	1.2	1.2
Vietnam	0.1	0.1	0.2	0.2	0.2
Latin America	4.7	4.8	4.8	5.3	5.1
Argentina	0.4	0.5	0.4	0.4	0.4
Brazil	0.9	0.9	0.9	1.0	0.9
Chile	0.3	0.3	0.3	0.3	0.3
Mexico	1.6	1.7	1.6	1.8	1.7
Emerging Markets					
South Africa	0.6	0.6	0.6	0.6	0.5
Russia	0.9	1.2	1.2	1.2	1.5

1 Refers to trade in goods.
2 Refers to January-April, except for world trade data, which is a forecast.
3 Excludes Japan.
n.a. not available

Sources: IMF World Economic Outlook, December 1997
IMF Direction of Trade Statistics

Table A.38
Sources and Uses of Funds of the Financial System

	1993	1994	1995	1996	1997
	Outstanding in RM million				
Sources of Funds:					
Capital, reserves & profit	41,936.2	55,886.5	78,696.4	109,462.5	103,072.3
Currency	14,649.0	17,170.3	18,913.2	21,065.6	24,532.3
Demand deposits	33,449.7	40,051.8	46,155.8	56,231.9	59,078.3
Other deposits[1]	254,653.1	269,219.8	318,307.7	399,163.2	490,954.5
of which:					
Public sector	*28,351.3*	*27,544.1*	*41,420.7*	*35,937.0*	*38,590.6*
Other financial inst.	*95,506.1*	*90,081.0*	*99,506.0*	*124,716.7*	*160,807.6*
Private sector	*127,237.3*	*147,233.9*	*171,804.3*	*233,142.4*	*283,901.6*
Foreign	*3,558.4*	*4,360.8*	*5,576.7*	*5,367.1*	*7,654.7*
Borrowings	5,767.8	6,811.0	6,322.4	8,376.6	31,108.1
Funds from other financial institutions	43,713.7	39,901.3	50,039.1	55,994.6	98,713.6
Domestic	*14,324.7*	*24,245.5*	*33,611.8*	*34,043.4*	*57,702.2*
Foreign	*29,389.0*	*15,655.8*	*16,427.3*	*21,951.2*	*41,011.4*
Insurance, provident & pension funds	93,625.1	108,961.4	127,055.4	146,888.5	169,214.8
Other liabilities	84,361.9	87,417.6	102,074.0	121,917.8	140,550.9
Total Liabilities	**572,156.5**	**625,419.7**	**747,564.0**	**919,100.7**	**1,117,224.8**
Uses of Funds:					
Currency	1,597.2	1,383.4	1,929.3	2,812.3	4,112.3
Deposits with other financial institutions	117,597.2	121,286.4	139,216. 6	146,615.6	215,803.3
Domestic	*110,537.3*	*113,453.2*	*130,830.7*	*139,231.8*	*197,682.5*
Foreign	*7,059.9*	*7,833.2*	*8,385.9*	*7,383.8*	*18,120.8*
Bills	7,824.8	12,081.1	16,391.6	16,312.6	*21,327.6*
Treasury	*2,737.0*	*4,061.2*	*3,887.4*	*1,916.8*	*3,912.2*
Commercial	*5,087.8*	*8,019.9*	*12,504.2*	*14,395.8*	*17,415.4*
Loans & advances	209,801.6	242,498.2	305,751.1	384,269.2	486,698.8
Public sector	*2,757.9*	*4,446.4*	*4,582.0*	*3,966.3*	*7,024.1*
Other financial inst.	*21,535.3*	*19,467.7*	*26,069.8*	*13,615.5*	*20,615.3*
Private sector	*184,198.4*	*217,677.4*	*274,075.1*	*364,705.3*	*455,986.5*
Foreign	*1,310.0*	*906.7*	*1,024.2*	*1,982.1*	*3,072.9*
Securities	105,245.3	124,731.8	160,280.7	202,523.0	213,036.9
Malaysian Government	*61,046.5*	*61,056.1*	*61,532.8*	*67,626.9*	*66,818.9*
Foreign	*68.8*	*91.6*	*92.8*	*385.9*	*790.6*
Corporate	*41,703.1*	*56,061.0*	*53,575.6*	*124,565.9*	*138,543.2*
Others	*2,426.9*	*7,523.1*	*45,079.5*	*9,944.3*	*6,884.2*
Gold and forex reserves	75,309.4	66,830.8	61,681.9	67,864.6	57,068.2
Other assets	54,781.0	56,608.0	62,312.8	98,703.4	119,177.7
Total Assets	**572,156.5**	**625,419.7**	**747,564.0**	**919,100.7**	**1,117,224.8**

[1] Equal savings, fixed and other (NIF,LPHT,etc.) deposits + NIDs + repos.

Table A.39
Commercial Banks: Sources and Uses of Funds

	As at end									
	Dec. 93		Dec. 94		Dec. 95		Dec. 96		Dec. 97	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	9,119.3	4.1	15,996.0	6.7	19,387.7	6.6	25,867.4	7.2	34,953.2	7.3
Debentures and notes	712.2	0.3	1,103.4	0.5	1,949.0	0.7	3,576.3	1.0	1,877.8	0.4
Deposits [1]	140,473.7	63.2	160,272.1	67.0	196,851.0	67.4	243,968.7	68.1	300,535.2	62.4
(of which:										
NIDs issued	*12,820.0*	*5.8*	*19,389.8*	*8.1*	*24,541.3*	*8.4*	*27,467.1*	*7.7*	*39,660.6*	*8.2*
Repos)	*8,263.0*	*3.7*	*9,201.6*	*3.8*	*9,612.0*	*3.3*	*11,818.1*	*3.3*	*15,060.9*	*3.1*
Amount due to financial institutions	34,962.8	15.7	24,614.3	10.3	28,349.9	9.7	34,532.1	9.6	79,984.0	16.6
Domestic	*6,709.0*	*3.0*	*10,052.9*	*4.2*	*13,249.4*	*4.5*	*13,060.8*	*3.6*	*43,890.4*	*9.1*
Foreign	*28,253.8*	*12.7*	*14,561.4*	*6.1*	*15,100.5*	*5.2*	*21,471.3*	*6.0*	*36,093.6*	*7.5*
Bankers acceptances	6,216.6	2.8	9,170.3	3.8	15,781.1	5.4	19,580.5	5.5	23,356.4	4.9
Other	30,752.7	13.8	28,080.6	11.7	29,893.2	10.2	30,562.8	8.5	40,684.6	8.4
Total	**222,237.3**	**100.0**	**239,236.7**	**100.0**	**292,211.9**	**100.0**	**358,087.8**	**100.0**	**481,391.2**	**100.0**
Uses										
Cash [2]	1,105.8	0.5	1,361.4	0.6	1,589.7	0.5	2,363.2	0.7	4,547.9	0.9
Reserve with BNM	7,932.3	3.6	14,074.6	5.9	18,518.8	6.3	27,972.9	7.8	37,130.6	7.7
Amount due from financial institutions	56,291.1	25.3	44,727.7	18.7	45,257.3	15.5	37,949.9	10.6	63,626.5	13.2
Domestic	*49,236.9*	*22.1*	*36,908.6*	*15.4*	*36,908.9*	*12.6*	*30,104.5*	*8.4*	*48,686.4*	*10.1*
Foreign	*7,054.2*	*3.2*	*7,819.1*	*3.3*	*8,348.4*	*2.9*	*7,845.4*	*2.2*	*14,940.1*	*3.1*
Investments	6,353.4	2.9	7,787.0	3.3	7,633.5	2.6	8,773.0	2.4	14,915.1	3.1
(of which:										
Stocks and shares	*2,554.4*	*1.1*	*2,845.7*	*1.2*	*3,251.1*	*1.1*	*4,276.2*	*1.2*	*4,587.3*	*1.0*
Debentures	*198.1*	*0.1*	*666.7*	*0.3*	*864.6*	*0.3*	*821.0*	*0.2*	*2,979.2*	*0.6*
Fixed assets	*1,980.7*	*0.9*	*2,651.2*	*1.1*	*2,989.6*	*1.0*	*3,505.8*	*1.0*	*6,504.2*	*1.4*
Foreign investments)	*1,620.2*	*0.7*	*1,623.4*	*0.7*	*528.2*	*0.2*	*170.0*	*...*	*844.4*	*0.2*
Placement with discount houses	443.9	0.2	2,111.9	0.9	1,829.2	0.6	3,849.4	1.1	6,037.0	1.3
Marketable securities	26,790.7	12.1	29,579.6	12.4	36,962.6	12.6	50,960.1	14.2	61,796.2	12.9
(of which:										
Treasury bills	*1,261.9*	*0.6*	*2,099.3*	*0.9*	*2,301.4*	*0.8*	*1,789.4*	*0.5*	*3,775.2*	*0.8*
MGS	*8,122.2*	*3.7*	*6,242.2*	*2.6*	*6,462.3*	*2.2*	*7,726.1*	*2.2*	*10,082.8*	*2.1*
NIDs held	*11,077.8*	*5.0*	*11,374.7*	*4.8*	*12,528.2*	*4.3*	*20,776.6*	*5.8*	*24,406.0*	*5.1*
Cagamas bonds)	*2,604.2*	*1.2*	*3,835.0*	*1.6*	*4,898.5*	*1.7*	*8,301.7*	*2.3*	*12,471.5*	*2.6*
Loans [3] (incl. trade bills)	117,235.5	52.8	134,151.0	56.1	175,007.4	59.9	217,820.6	60.8	276,366.3	57.4
Other	6,084.6	2.7	5,443.5	2.3	5,413.4	1.9	8,398.7	2.3	16,971.6	3.5
Total	**222,237.3**	**100.0**	**239,236.7**	**100.0**	**292,211.9**	**100.0**	**358,087.8**	**100.0**	**481,391.2**	**100.0**

[1] Includes NIDs issued and repos.
[2] Includes balances with BNM.
[3] Excludes housing loans sold to Cagamas Berhad.

Table A.40
Finance Companies: Sources and Uses of Funds

	As at end									
	Dec. 93		Dec. 94		Dec. 95		Dec. 96		Dec. 97	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	3,172.4	5.0	3,713.0	5.1	4,516.7	4.9	6,844.1	5.7	9,356.4	6.1
Debentures and notes	63.0	0.1	267.6	0.4	332.4	0.4	531.0	0.4	872.2	0.6
Deposits [1]	51,157.5	80.9	57,276.4	78.0	69,963.1	76.1	90,842.0	75.9	106,511.8	69.9
(of which:										
NIDs issued	*3,643.1*	*5.8*	*5,491.6*	*7.5*	*8,711.0*	*9.5*	*14,973.8*	*12.5*	*18,751.9*	*12.3*
Repos)	*563.8*	*0.9*	*1,090.4*	*1.5*	*1,869.8*	*2.0*	*3,001.0*	*2.5*	*7,877.3*	*5.2*
Amount due to financial institutions	2,571.5	4.1	4,989.9	6.8	8,908.1	9.7	12,868.8	10.8	25,479.1	16.7
Domestic	*2,571.5*	*4.1*	*4,989.9*	*6.8*	*8,908.1*	*9.7*	*12,868.8*	*10.8*	*25,479.1*	*16.7*
Foreign	–	–	–	–	–	–	–	–	–	–
Other	6,300.0	10.0	7,225.0	9.8	8,172.1	8.9	8,524.2	7.1	10,184.3	6.7
Total	**63,264.4**	**100.0**	**73,471.9**	**100.0**	**91,892.4**	**100.0**	**119,610.1**	**100.0**	**152,403.8**	**100.0**
Uses										
Cash [2]	104.1	0.2	120.9	0.2	159.6	0.2	164.3	0.1	198.6	0.1
Reserve with BNM	3,718.8	5.9	5,945.7	8.1	7,640.2	8.3	12,050.4	10.1	16,043.1	10.5
Amount due from financial institutions	7,471.2	11.8	6,600.8	9.0	7,548.9	8.2	6,445.4	5.4	5,676.9	3.7
Domestic	*7,470.9*	*11.8*	*6,600.8*	*9.0*	*7,548.9*	*8.2*	*6,445.4*	*5.4*	*5,676.9*	*3.7*
Foreign	*0.3*	…	–	–	–	–	–	–	–	–
Investments	705.3	1.1	807.5	1.1	968.2	1.1	1,241.3	1.0	3,193.7	2.1
(of which:										
Stocks and shares	*231.7*	*0.4*	*293.6*	*0.4*	*282.0*	*0.3*	*281.7*	*0.2*	*437.6*	*0.3*
Debentures	*1.6*	…	*1.9*	…	*70.3*	*0.1*	*767.9*	*0.6*	*1,227.2*	*0.8*
Fixed assets	*472.0*	*0.7*	*511.9*	*0.7*	*615.9*	*0.7*	*827.9*	*0.7*	*1,528.9*	*1.0*
Foreign investments)	–	–	*0.1*	…	–	–	–	–	–	–
Placement with discount houses	391.7	0.6	700.0	1.0	735.1	0.8	1,152.4	1.0	2,051.8	1.3
Marketable securities	5,729.4	9.1	7,913.4	10.8	10,650.8	11.6	14,888.6	12.4	18,315.1	12.0
(of which:										
Treasury bills	*30.9*	…	*241.5*	*0.3*	*119.3*	*0.1*	*22.2*	…	*46.4*	…
MGS	*1,931.8*	*3.1*	*1,586.3*	*2.2*	*1,768.2*	*1.9*	*2,806.5*	*2.3*	*3,243.6*	*2.1*
NIDs held	*539.0*	*0.9*	*1,896.0*	*2.6*	*2,686.6*	*2.9*	*4,451.1*	*3.7*	*7,665.3*	*5.0*
Cagamas bonds)	*979.4*	*1.5*	*1,410.8*	*1.9*	*2,704.6*	*2.9*	*2,959.6*	*2.5*	*2,797.8*	*1.8*
Loans [3] (incl. trade bills)	43,776.0	69.2	50,086.7	68.2	62,752.0	68.3	82,496.7	69.0	102,545.8	67.3
Other	1,367.9	2.2	1,296.9	1.8	1,437.6	1.6	1,171.0	1.0	4,378.8	2.9
Total	**63,264.4**	**100.0**	**73,471.9**	**100.0**	**91,892.4**	**100.0**	**119,610.1**	**100.0**	**152,403.8**	**100.0**

[1] Includes NIDs issued and repos.
[2] Includes balances with BNM.
[3] Excludes housing loans sold to Cagamas Berhad.

Table A.41
Merchant Banks: Sources and Uses of Funds

	As at end									
	Dec. 93		Dec. 94		Dec. 95		Dec. 96		Dec. 97	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Sources										
Capital and reserves	978.9	5.2	1,159.0	4.9	1,615.6	6.0	2,783.4	8.2	3,848.7	8.7
Debentures and notes	17.0	0.1	17.0	0.1	113.8	0.4	183.8	0.5	150.0	0.3
Deposits [1]	13,516.6	71.9	14,574.0	61.8	16,093.3	59.5	23,530.7	69.2	26,389.7	59.5
(of which:										
NIDs issued	*1,716.9*	*9.1*	*2,730.0*	*11.6*	*3,380.7*	*12.5*	*6,000.8*	*17.6*	*6,553.0*	*14.8*
Repos)	*1,293.0*	*6.9*	*2,040.7*	*8.7*	*2,664.0*	*9.8*	*2,373.9*	*7.0*	*3,933.8*	*8.9*
Amount due to financial institutions	2,546.9	13.6	5,680.9	24.1	5,841.3	21.6	5,198.3	15.3	10,771.7	24.3
Domestic	*2,546.9*	*13.6*	*5,680.9*	*24.1*	*5,811.3*	*21.5*	*5,157.3*	*15.2*	*9,650.7*	*21.8*
Foreign	–	–	–	–	*30.0*	*0.1*	*41.0*	*0.1*	*1,121.0*	*2.5*
Bankers acceptances	497.4	2.6	431.6	1.8	676.2	2.5	566.6	1.7	612.4	1.4
Other	1,234.9	6.6	1,722.1	7.3	2,721.6	10.1	1,742.1	5.1	2,556.9	5.8
Total	**18,791.7**	**100.0**	**23,584.6**	**100.0**	**27,061.8**	**100.0**	**34,004.9**	**100.0**	**44,329.4**	**100.0**
Uses										
Cash [2]	25.2	0.1	3.2	…	4.3	…	6.5	…	–	–
Reserve with BNM	886.4	4.7	1,408.0	6.0	1,546.2	5.7	2,643.3	7.8	3,466.4	7.8
Amount due from financial institutions	3,744.3	19.9	4,395.9	18.6	4,968.7	18.4	4,452.8	13.1	6,163.5	13.9
Domestic	*3,743.9*	*19.9*	*4,395.3*	*18.6*	*4,968.4*	*18.4*	*4,413.1*	*13.0*	*5,761.0*	*13.0*
Foreign	*0.4*	…	*0.6*	…	*0.3*	…	*39.7*	*0.1*	*402.5*	*0.9*
Investments	420.2	2.2	468.1	2.0	579.9	2.1	741.7	2.2	974.8	2.2
(of which:										
Stocks and shares	*203.3*	*1.1*	*246.4*	*1.0*	*319.6*	*1.2*	*310.9*	*0.9*	*450.0*	*1.0*
Debentures	*159.7*	*0.8*	*152.9*	*0.6*	*188.3*	*0.7*	*337.4*	*1.0*	*323.9*	*0.7*
Fixed assets	*57.3*	*0.3*	*68.8*	*0.3*	*71.9*	*0.3*	*93.3*	*0.3*	*166.7*	*0.4*
Foreign investments)	–	–	–	–	*0.1*	…	*0.1*	…	*34.3*	*0.1*
Placement with discount houses	51.2	0.3	63.1	0.3	117.0	0.4	296.0	0.9	38.0	0.1
Marketable securities	3,459.1	18.4	5,120.5	21.7	5,132.9	19.0	6,500.1	19.1	9,477.5	21.4
(of which:										
Treasury bills	*42.7*	*0.2*	*119.3*	*0.5*	*78.2*	*0.3*	*40.7*	*0.1*	*57.4*	*0.1*
MGS	*1,034.7*	*5.5*	*362.7*	*1.5*	*316.6*	*1.2*	*633.3*	*1.9*	*592.9*	*1.3*
NIDs held	*1,608.2*	*8.6*	*3,101.9*	*13.2*	*2,894.8*	*10.7*	*3,502.5*	*10.3*	*5,078.4*	*11.5*
Cagamas bonds)	*531.5*	*2.8*	*1,109.5*	*4.7*	*1,211.8*	*4.5*	*1,834.8*	*5.4*	*1,520.3*	*3.4*
Loans [3] (incl. trade bills)	9,764.5	52.0	11,591.3	49.1	14,141.2	52.3	18,888.2	55.5	23,051.1	52.0
Other	440.8	2.3	534.5	2.3	571.6	2.1	476.3	1.4	1,158.1	2.6
Total	**18,791.7**	**100.0**	**23,584.6**	**100.0**	**27,061.8**	**100.0**	**34,004.9**	**100.0**	**44,329.4**	**100.0**

[1] Includes NIDs issued and repos.
[2] Includes balances with BNM.
[3] Excludes housing loans sold to Cagamas Berhad.

Table A.42
Commercial Banks: Commitments and Contingencies

	As at end			
	1996		1997	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	10,582	3.8	14,193	4.0
Credit extension commitments	127,368	46.0	139,622	39.6
Direct credit substitutes	18,618	6.7	22,567	6.4
Foreign exchange related contracts	83,468	30.1	125,472	35.6
Interest rate related contracts	1,827	0.7	3,674	1.0
Trade-related contingencies	10,511	3.8	12,195	3.5
Transaction-related contingencies	17,725	6.4	21,403	6.1
Underwriting obligations	883	0.3	1,301	0.4
Other	6,161	2.2	12,194	3.5
Total	**277,143**	**100.0**	**352,621**	**100.0**

Table A.43
Finance Companies: Commitments and Contingencies

	As at end			
	1996		1997	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	3,262	13.5	6,430	24.7
Credit extension commitments	19,049	78.5	16,793	64.5
Direct credit substitutes	1,786	7.4	2,150	8.2
Foreign exchange related contracts	0	0.0	0	0.0
Interest rate related contracts	0	0.0	300	1.1
Trade-related contingencies	3	…	1	…
Transaction-related contingencies	15	0.1	16	0.1
Underwriting obligations	15	0.1	25	0.1
Other	123	0.5	333	1.3
Total	**24,253**	**100.0**	**26,048**	**100.0**

Table A.44
Merchant Banks: Commitments and Contingencies

	As at end			
	1996		1997	
	RM million	% share	RM million	% share
Assets sold with recourse and commitment with drawdown	445	2.2	214	0.6
Credit extension commitments	10,398	50.5	16,866	43.7
Direct credit substitutes	3,932	19.1	9,711	25.2
Foreign exchange related contracts	908	4.4	3,813	9.9
Interest rate related contracts	1,332	6.5	4,966	12.9
Trade-related contingencies	0	0.0	2	…
Transaction-related contingencies	1,053	5.1	1,326	3.4
Underwriting obligations	2,025	9.8	1,219	3.2
Other	504	2.4	475	1.2
Total	**20,597**	**100.0**	**38,592**	**100.0**

Table A.45
Commercial Banks: Income and Expenditure

	For the financial year				
	1993	1994	1995	1996	1997*p*
	RM million				
Interest income net of interest-in-suspense	14,656.5	15,242.3	17,161.7	23,503.0	32,203.3
(Interest-in-suspense)	*1,265.6*	*594.2*	*334.1*	*495.9*	*651.4*
Less: Interest expense	9,557.3	8,981.8	10,113.3	14,057.4	20,246.3
Net interest income	5,099.2	6,260.5	7,048.4	9,445.6	11,957.0
Add: Non-interest income	2,047.5	2,788.0	2,991.8	3,230.8	4,695.8
Less: Bad debt provisions	885.0	1,137.6	874.7	1,269.1	2,795.7
Staff cost	1,662.1	2,010.3	2,260.4	2,579.7	3,203.5
Overheads	1,684.5	1,997.9	2,064.1	2,658.0	2,962.7
Pre-tax profit	2,915.1	3,902.7	4,841.0	6,169.6	7,690.9

p Preliminary

Table A.46
Finance Companies: Income and Expenditure

	For the financial year				
	1993	1994	1995	1996	1997*p*
	RM million				
Interest income net of interest-in-suspense	5,213.2	5,664.7	6,748.9	9,377.1	12,197.4
(Interest-in-suspense)	*367.3*	*318.2*	*177.8*	*123.7*	*413.5*
Less: Interest expense	3,567.3	3,330.7	3,741.2	5,774.2	8,139.3
Net interest income	1,645.9	2,334.0	3,007.7	3,602.9	4,058.1
Add: Non-interest income	192.0	250.2	308.4	390.5	515.7
Less: Bad debt provisions	344.3	548.6	554.3	645.8	1,000.9
Staff cost	370.5	461.3	572.1	667.2	796.1
Overheads	507.5	611.2	741.9	843.0	1,140.0
Pre-tax profit	615.6	963.1	1,447.8	1,837.4	1,636.8

p Preliminary

Table A.47
Merchant Banks: Income and Expenditure

	For the financial year				
	1993	1994	1995	1996	1997*p*
	RM million				
Interest income net of interest-in-suspense	1,201.8	1,238.0	1,361.4	1,967.8	3,065.6
(Interest-in-suspense)	*41.6*	*61.7*	*11.0*	*45.8*	*38.1*
Less: Interest expense	973.8	964.6	1,025.9	1,488.9	2,335.7
Net interest income	228.0	273.4	335.5	478.9	729.9
Add: Non-interest income	268.5	422.1	502.0	552.7	555.7
Less: Bad debt provisions	97.3	162.0	54.7	97.4	177.6
Staff cost	75.4	94.4	109.9	128.2	162.2
Overheads	66.9	100.3	92.9	99.4	154.9
Pre-tax profit	256.9	338.8	580.0	706.6	790.9

p Preliminary

Table A.48
Banking System: Selected Indicators

	Commercial banks		Finance companies		Merchant banks		Banking system	
	For the financial year							
	1996	1997*p*	1996	1997*p*	1996	1997*p*	1996	1997*p*
Pre-tax profit/ Average assets (%)	1.9	1.9	1.9	1.3	2.7	2.3	2.0	1.8
Pre-tax profit/ Average shareholders' funds (%)	26.2	25.1	29.1	19.9	29.8	24.1	27.0	24.0
Pre-tax profit per employee (RM'000)	90.4	104.3	70.6	59.3	289.4	288.8	90.1	97.2
Cost [1] incurred per ringgit of revenue earned [2] (sen)	41.3	37.0	37.8	42.3	22.1	24.7	39.4	37.4
Cost [1] incurred per ringgit of net interest income [2] (sen)	55.5	51.6	41.9	47.7	47.5	43.4	51.6	50.3
Overheads to staff cost ratio (%)	103.0	92.5	126.3	143.2	77.5	95.5	106.7	102.3
Staff cost per employee (RM'000)	37.8	43.5	25.6	28.8	52.5	59.2	34.9	40.0
	As at calendar year end							
	Dec. 1996	Dec. 1997	Dec. 1996	Dec. 1997	Dec. 1996	Dec. 1997	Dec. 1996	Dec. 1997
Loan [3] deposit [4] ratio (%)	89.1	92.0	91.1	95.6	81.9	87.3	89.2	92.6
Loan [3] per branch (RM million)	138.9	165.4	75.3	89.6	787.2	960.5	118.7	141.6
Deposit per branch (RM million)	127.1	140.5	64.6	68.6	591.4	636.3	105.7	115.7

1 Excluding bad debt provisions.
2 Including interest-in-suspense.
3 Excluding housing loans sold to Cagamas Berhad.
4 Including NIDs and repos.
p Preliminary

Table A.49
Lending Guidelines

	Lending Guidelines 1994 (compliance date 31 March 1996)		Lending Guidelines 1996 (as at end 1997)	
	Target	Achieved	Target (31.3.1998)	Achieved
Loans to Bumiputera Community				
Total outstanding loans (RM billion)				
Commercial banks	21.3	52.6	53.0	76.9
Finance companies	7.8	22.3	19.4	37.0
Total outstanding loans (%)				
Commercial banks	20.0	49.5	30.0 [1]	43.5
Finance companies	20.0	57.2	30.0 [1]	57.2
Non-compliance (no. of institutions)				
Commercial banks		1		9
Finance companies		–		6
Housing Loan Commitments				
Total houses (units)				
Commercial banks	75,000	84,197	100,000 [1]	94,568
Finance companies	25,000	42,771	40,000 [1]	41,002
Non-compliance (no. of institutions)				
Commercial banks		10		12
Finance companies		5		13
New Principal Guarantee Scheme				
Total guarantee cover (RM million)				
Commercial banks	350	859.7	1,000.0	2,286.0
Finance companies	60	161.8	240.0	1,210.0
Non-compliance (no. of institutions)				
Commercial banks		5		7
Finance companies		15		6
New Principal Guarantee Scheme (for Bumiputera community)				
Total guarantee cover (RM million)				
Commercial banks	175.0	217.5	500.0	570.0
Finance companies	30.0	70.8	120.0	274.9
Non-compliance (no. of institutions)				
Commercial banks		5		16
Finance companies		18		9

[1] Under Lending Guidelines 1996, target for loans to Bumiputera community has been increased from 20% to 30%, while targets for housing loan commitments has been increased from 75,000 units and 25,000 units to 100,000 units and 40,000 units respectively.

Table A.50
Commercial Banks: Direction of Lending

Loans by Sectors	As at end			
	Dec. 1996		Dec. 1997	
	RM million	% share	RM million	% share
Agriculture	4,064.6	1.8	5,917.6	2.0
Mining & quarrying	608.9	0.3	786.8	0.3
Manufacturing	47,099.1	20.6	54,931.7	19.0
Electricity	4,146.0	1.8	3,888.8	1.3
Broad property sector	76,701.7	33.6	101,443.7	35.0
Real estate	*13,423.7*	*5.9*	*12,378.7*	*4.3*
Construction	*19,664.0*	*8.6*	*29,180.5*	*10.1*
Residential property	*29,617.0*	*13.0*	*38,087.2*	*13.1*
Non-residential property	*13,997.0*	*6.1*	*21,797.3*	*7.5*
Wholesale, retail, restaurants and hotels	24,009.2	10.5	29,224.0	10.1
Transport, storage & communication	4,411.8	1.9	8,616.8	3.0
Financing, insurance & business services	24,564.4	10.8	28,349.4	9.8
Other services	5,297.4	2.3	4,533.1	1.5
Miscellaneous	37,353.2	16.4	52,054.4	18.0
Purchase of securities	*13,369.4*	*5.9*	*24,397.7*	*8.4*
Individual	*8,488.1*	*3.7*	*10,788.4*	*3.7*
Non-individual	*4,881.3*	*2.1*	*13,609.3*	*4.7*
Consumption credit	*13,453.0*	*5.9*	*17,909.6*	*6.2*
Other	*10,530.8*	*4.6*	*9,747.1*	*3.4*
Total Loans	**228,256.3**	**100.0**	**289,746.3**	**100.0**
Of which housing loans sold to Cagamas	10,379.5	4.5	13,380.0	4.6

Table A.51
Finance Companies: Direction of Lending

Loans by Sectors	As at end			
	Dec. 1996		Dec. 1997	
	RM million	% share	RM million	% share
Agriculture	1,026.8	1.2	1,312.6	1.2
Mining & quarrying	285.6	0.3	516.8	0.5
Manufacturing	3,840.2	4.5	5,534.8	5.1
Electricity	88.4	0.1	96.6	0.1
Broad property sector	23,085.7	26.9	30,898.0	28.5
Real estate	*3,351.9*	*3.9*	*3,675.0*	*3.4*
Construction	*5,261.0*	*6.1*	*8,287.1*	*7.6*
Residential property	*10,826.6*	*12.6*	*13,074.8*	*12.1*
Non-residential property	*3,646.2*	*4.3*	*5,861.1*	*5.4*
Wholesale, retail, restaurants and hotels	2,488.1	2.9	4,029.4	3.7
Transport, storage & communication	1,788.7	2.1	3,470.4	3.2
Financing, insurance & business services	3,820.6	4.5	3,837.0	3.5
Other services	1,984.1	2.3	1,789.7	1.7
Miscellaneous	47,373.5	55.2	56,917.3	52.5
Purchase of securities	*7,736.7*	*9.0*	*10,377.2*	*9.6*
Individual	*6,111.6*	*7.1*	*7,045.4*	*6.5*
Non-individual	*1,625.1*	*1.9*	*3,331.8*	*3.1*
Consumption credit	*27,830.8*	*32.4*	*35,522.5*	*32.8*
Other	*11,806.0*	*13.8*	*11,017.6*	*10.2*
Total Loans	**85,781.7**	**100.0**	**108,402.6**	**100.0**
Of which housing loans sold to Cagamas	3,244.4	3.8	5,856.8	5.4

Table A.52
Merchant Banks: Direction of Lending

Loans by Sectors	As at end			
	Dec. 1996		Dec. 1997	
	RM million	% share	RM million	% share
Agriculture	433.3	2.3	404.4	1.8
Mining & quarrying	80.5	0.4	100.2	0.4
Manufacturing	2,508.0	13.3	2,781.5	12.1
Electricity	285.0	1.5	421.7	1.8
Broad property sector	4,872.7	25.8	7,532.0	32.7
Real estate	*1,472.7*	*7.8*	*1,922.3*	*8.3*
Construction	*2,862.2*	*15.1*	*5,010.8*	*21.7*
Residential property	*63.5*	*0.3*	*69.3*	*0.3*
Non-residential property	*474.3*	*2.5*	*529.6*	*2.3*
Wholesale, retail, restaurants and hotels	1,004.1	5.3	1,441.8	6.2
Transport, storage & communication	509.6	2.7	1,046.7	4.5
Financing, insurance & business services	4,255.1	22.5	3,868.3	16.8
Other services	380.0	2.0	501.1	2.2
Miscellaneous	4,566.4	24.2	4,958.0	21.5
Purchase of securities	*3,477.9*	*18.4*	*4,346.8*	*18.9*
Individual	*625.3*	*3.3*	*601.2*	*2.6*
Non-individual	*2,852.6*	*15.1*	*3,745.6*	*16.2*
Consumption credit	*234.0*	*1.2*	*136.3*	*0.6*
Other	*854.5*	*4.5*	*474.9*	*2.1*
Total Loans	**18,894.7**	**100.0**	**23,055.7**	**100.0**
Of which housing loans sold to Cagamas	2.8	0.0	4.5	0.0

Table A.53
Commercial Banks: Non-performing Loans by Sector

	As at end			
	Dec.1996		Dec.1997	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture	286	7.0	267	4.5
Mining & quarrying	50	8.3	81	10.3
Manufacturing	1,737	3.7	2,763	5.0
Electricity	19	0.5	24	0.6
Community, social & personal services	173	3.3	153	3.4
Broad property sector	3,066	4.0	5,052	5.0
Real estate	*627*	*4.7*	*932*	*7.5*
Construction	*979*	*5.0*	*1,544*	*5.3*
Residential property	*1,157*	*3.9*	*1,628*	*4.3*
Non-residential property	*303*	*2.2*	*948*	*4.4*
Wholesale, retail, restaurants and hotels	896	3.7	1,384	4.7
Transport, storage & communication	132	3.0	242	2.8
Financing, insurance & business services	315	1.3	804	2.8
Purchase of securities	155	1.2	2,005	8.2
Consumption credit	872	6.4	1,158	6.4
Credit card loans	*137*	*5.6*	*345*	*10.2*
Personal use	*656*	*7.4*	*673*	*5.1*
Purchase of consumer durables	*66*	*3.3*	*125*	*12.2*
Purchase of transport vehicles [1]	*13*	*4.4*	*15*	*5.1*
Other	462	4.5	575	5.9
Total	**8,163**	**3.6**	**14,508**	**5.0**

[1] Includes commercial vehicles.

Table A.54
Finance Companies: Non-performing Loans by Sector

	As at end			
	Dec.1996		Dec.1997	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture	62	6.0	133	10.1
Mining & quarrying	21	7.3	32	6.2
Manufacturing	241	6.3	517	9.3
Electricity	2	1.9	4	4.3
Community, social & personal services	54	2.7	96	5.3
Broad property sector	2,172	9.4	3,347	10.8
Real estate	*395*	*11.8*	*1,097*	*29.9*
Construction	*815*	*15.5*	*934*	*11.3*
Residential property	*588*	*5.4*	*721*	*5.5*
Non-residential property	*374*	*10.3*	*595*	*10.2*
Wholesale, retail, restaurants and hotels	97	3.9	160	4.0
Transport, storage & communication	71	4.0	253	7.3
Financing, insurance & business services	90	2.4	362	9.4
Purchase of securities	73	0.9	524	5.0
Consumption credit	1,010	2.6	3,010	6.6
Credit card loans	*74*	*8.4*	*117*	*11.0*
Personal use	*171*	*11.6*	*182*	*11.7*
Purchase of consumer durables	*68*	*7.1*	*133*	*17.6*
Purchase of transport vehicles [1]	*697*	*2.0*	*2,578*	*6.1*
Other	109	11.6	59	5.1
Total	**4,002**	**4.7**	**8,497**	**7.8**

[1] Includes commercial vehicles

Table A.55
Merchant Banks: Non-performing Loans by Sector

	As at end			
	Dec.1996		Dec.1997	
	RM million	% of total loans to the sector	RM million	% of total loans to the sector
Agriculture	17	4.0	111	27.5
Mining & quarrying	0	0.0	30	30.2
Manufacturing	115	4.6	161	5.8
Electricity	0	0.0	0	0.0
Community, social & personal services	1	0.4	17	3.4
Broad property sector	50	1.0	256	3.4
Real estate	*17*	*1.1*	*47*	*2.4*
Construction	*30*	*1.1*	*208*	*4.2*
Residential property	*1*	*1.5*	*1*	*1.1*
Non-residential property	*2*	*0.4*	...	...
Wholesale, retail, restaurants and hotels	36	3.7	61	4.2
Transport, storage & communication	18	3.5	22	2.1
Financing, insurance & business services	7	0.2	74	1.9
Purchase of securities	60	1.7	251	5.8
Consumption credit	9	3.5	10	6.2
Credit card loans	*0*	*0.0*	*0*	*0.0*
Personal use	*0*	*0.0*	...	...
Purchase of consumer durables	*0*	*0.0*	...	...
Purchase of transport vehicles [1]	*9*	*24.5*	*10*	*39.2*
Other	2	0.2	46	10.1
Total	**315**	**1.7**	**1,039**	**4.5**

[1] Includes commercial vehicles.

Table A.56
Banking System: Key Data

	As at end				
	1993	1994	1995	1996	1997
Number of					
- Commercial banks	37	37	37	37	35
- Finance companies	40	40	40	40	39
- Merchant banks	12	12	12	12	12
Risk-weighted capital ratio (%)					
- Commercial banks	12.4	11.3	11.1	10.8	10.3
- Finance companies	8.8	10.1	9.7	9.8	10.6
- Merchant banks	10.0	8.2	11.9	11.7	13.3
Branch network					
- Commercial banks	1,220	1,283	1,433	1,569	1,671
- Finance companies	789	860	988	1,096	1,144
- Merchant banks	17	17	18	24	24
ATM network					
- Commercial banks	1,558	1,975	2,230	2,326	2,573
- Finance companies	299	345	402	525	627
Persons served per office					
- Commercial banks	15,614	15,191	14,024	13,492	12,986
- Finance companies	24,100	22,849	20,341	19,314	18,969
Number of employees					
- Commercial banks	54,569	59,674	64,461	68,068	73,530
- Finance companies	20,500	22,488	24,593	26,322	27,937
- Merchant banks	1,900	2,179	2,334	2,592	2,802

Table A.57
Industrial Finance Institutions[1]: Sources and Uses of Funds

	1993	1994	1995	1996	1997
	RM million				
Sources:					
Shareholders' equity	1,253.98	1,328.34	1,598.38	2,252.10	2,804.64
Issued & paid-up capital	*747.69*	*747.91*	*803.89*	*1,272.99*	*1,613.55*
Reserves	*465.13*	*507.86*	*694.51*	*882.80*	*990.59*
Current profits	*41.16*	*72.57*	*99.98*	*96.31*	*200.50*
Borrowings	3,087.16	3,972.43	4,719.42	5,302.40	6,655.41
Government	*1,526.50*	*1,554.72*	*1,799.13*	*2,078.20*	*2,567.40*
Other	*1,560.66*	*2,417.71*	*2,920.29*	*3,224.20*	*4,088.01*
Other	705.93	765.62	859.45	1,067.18	1,084.90
Total	**5,047.07**	**6,066.39**	**7,177.25**	**8,621.68**	**10,544.95**
Uses :					
Deposits	1,143.32	1,408.13	1,459.73	1,210.61	1,117.10
Investments	561.02	689.35	1,033.18	1,435.74	1,755.18
Quoted	*17.96*	*67.09*	*70.90*	*59.30*	*67.67*
Unquoted	*543.06*	*622.26*	*962.28*	*1,376.44*	*1,687.51*
Loans	2,720.25	3,053.86	3,887.45	4,989.65	6,091.82
Fixed assets	170.47	202.10	213.16	269.67	417.20
Other	452.01	712.95	583.73	716.01	1,163.65
Total	**5,047.07**	**6,066.39**	**7,177.25**	**8,621.68**	**10,544.95**

[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.58
Industrial Finance Institutions[1]: Direction of Lending

	1993	1994	1995	1996	1997
	RM million				
Manufacturing	1,425.55	1,569.07	1,756.57	1,872.08	2,086.37
Agriculture	215.71	157.18	94.50	112.27	135.02
Property	441.08	577.99	895.75	1,579.22	2,148.02
Real estate	*286.45*	*326.52*	*491.05*	*755.16*	*1,060.92*
Construction	*111.69*	*208.73*	*362.49*	*783.41*	*1,046.85*
Housing	*42.94*	*42.74*	*42.21*	*40.65*	*40.25*
General commerce	139.19	97.51	161.04	265.74	284.73
Transport and storage	271.03	242.78	241.41	241.52	215.57
Other	227.69	409.33	738.18	918.82	1,222.11
Total	**2,720.25**	**3,053.86**	**3,887.45**	**4,989.65**	**6,091.82**

[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.59
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.					
	1995	1996	1997	1995	1996	1997
	Business Coverage (RM million)			**Income (RM ’000)**		
I. Export Coverage						
Short-term Policies						
Comprehensive policies (export declared)	699.0	372.0	383.0	1,483.5	1,495.2	1,879.1
Banker’s comprehensive policies (export declared)	–	2.2	4.7	–	57.9	96.9
Bankers’ Export Finance Insurance Policy (guaranteed value)	47.6	44.1	50.4	570.9	508.1	647.4
Confirming bank policy (letter of credit value)	29.6	57.0	19.2	2,035.6	4,031.0	548.1
Sub-total	776.2	475.3	457.3	4,090.0	6,092.2	3,171.5
Medium and Long-term Policies						
Buyer credit guarantee (amount guaranteed)	49.1	161.1	87.4	818.1	3,280.4	3,476.3
Supplier credit guarantee (amount guaranteed)	25.8	56.6	47.5	188.3	244.5	163.5
Bond indemnity support (face value insured)	–	–	2.9	–	–	47.9
Sub-total	74.9	217.7	137.8	1,006.4	3,524.9	3,687.7
Total Export Insurance Coverage	**851.1**	**693.0**	**595.1**	**5,096.4**	**9,617.1**	**6,859.2**
II. Domestic Sales Coverage						
Domestic credit insurance (sales declared)	–	12.0	53.0	–	73.3	268.0
Specific policies (amount covered)	–	15.0	27.0	–	151.9	50.4
Domestic bonds (face value insured)	–	–	1.4	–	–	20.1
Total Domestic Insurance Coverage	**–**	**27.0**	**81.4**	**–**	**225.2**	**338.5**
Total Insurance Coverage	**851.1**	**720.0**	**676.5**	**5,096.4**	**9,842.3**	**7,197.7**
Total Income	**–**	**–**	**–**	**13,785.4**	**20,600.0**	**19,052.0**

Source: MECIB

Table A. 60
Housing Credit Institutions

	Year of establishment	Objective	Average lending rate for housing loans (%)		No. of branches	
			1996	1997	1996	1997
Commercial banks	–		9.0~13.25	9.0~14.35	1,586	1,671
Finance companies	–		9.0~14.95	9.0~16.30	1,096	1,144
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	9.6	9.4	20	20
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	10.0~10.75	10.0~10.75	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	9.0~10.5	10	11
Bank Rakyat	1954	A co-operative society which collects deposits and provides conventional banking facilities as well as according to Syariah principles	10.25~10.75	9.75~10.15	67	70
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from the small savers and to inculcate the habit of thrift and savings	9.5	10.0	475	469

Table A.61
Sources of Housing Credit

	As at end of		Annual change		Share	
	1996	1997 *p*	1996	1997 *p*	1996	1997 *p*
	RM million		%		%	
Commercial banks	18,538.8	22,848.0	10.7	23.2	42	47
Finance companies	7,421.5	6,522.0	1.4	–12.1	17	14
Treasury Housing Loans Division	14,619.4	15,157.7	2.3	3.7	33	31
Malaysia Building Society Berhad	1,675.5	1,589.6	–4.3	–5.1	4	3
Borneo Housing Mortgage Finance Berhad	472.0	480.3	–1.0	1.8	1	1
Sabah Credit Corporation	240.7	265.4	4.6	10.3	1	1
Bank Rakyat	345.2	485.7	7.2	40.7	1	1
Bank Simpanan Nasional	511.2	737.6	–1.5	44.3	1	2
Total	**43,824.3**	**48,086.3**	**5.2**	**9.7**	**100**	**100**

p Preliminary

Table A.62
Approved Housing Loans

	1996	1997 *p*	1996	1997 *p*	1996	1997 *p*
	RM million		Annual change (%)		% share	
Commercial banks	12,485.3	16,953.6	13.3	35.8	72	80
Finance companies	3,016.7	3,014.2	10.6	–0.1	18	14
Treasury Housing Loans Division	990.1	423.1	–10.3	–57.3	6	2
Malaysia Building Society Berhad	224.4	159.9	28.3	–28.7	1	1
Borneo Housing Mortgage Finance Berhad	43.5	48.1	–9.6	10.6	…	…
Sabah Credit Corporation	33.7	43.2	35.3	28.2	…	…
Bank Rakyat	143.4	154.7	126.9	7.9	1	1
Bank Simpanan Nasional	343.7	402.5	2,543.8	17.1	2	2
Total	**17,280.8**	**21,199.3**	**13.9**	**22.7**	**100**	**100**

p Preliminary
… Negligible

Table A.63
Agriculture Credit Institutions

	Annual change				As at end 1997	
	1996		1997			
	RM million	%	RM million	%	RM million	% share
Credit for Agriculture						
Banking System	807.3	15.4	1,583.5	26.2	7,634.6	58.2
Commercial Banks	*690.1*	*17.9*	*1,367.8*	*30.1*	*5,917.6*	*45.1*
Finance Companies	*213.0*	*22.3*	*146.3*	*12.5*	*1,312.6*	*10.0*
Merchant Banks	*–95.8*	*–22.2*	*69.4*	*20.7*	*404.4*	*3.1*
Development Agencies	–227.7	–6.2	–71.0	–2.0	3,394.7	25.9
FELDA	*–240.2*	*–6.7*	*–96.5*	*–2.9*	*3,265.6*	*24.9*
Sabah Development Bank	*12.6*	*13.8*	*25.4*	*24.5*	*129.2*	*1.0*
Rural Credit Institutions	276.2	15.1	–12.3	–0.6	2,092.7	15.9
Bank Pertanian Malaysia	*282.1*	*16.5*	*3.6*	*0.2*	*1,998.1*	*15.2*
Bank Rakyat	*–13.8*	*–23.6*	*–3.5*	*–7.7*	*41.2*	*0.3*
Farmers' organisations, farmers' co-operatives and agro-based co-operative societies and others	*7.9*	*13.7*	*–12.4*	*–18.9*	*53.4*	*0.4*
Total	**855.9**	**7.9**	**1,500.2**	**12.9**	**13,122.0**	**100.0**
Total resources of the Rural Credit Institutions						
Bank Pertanian Malaysia	61.4	1.3	244.7	5.2	4,916.1	42.1
Bank Rakyat	1,250.1	32.2	598.9	11.7	5,733.8	49.1
Farmers' organisations, farmers' co-operatives and agro-based co-operative societies and others	242.4	44.5	248.6	31.6	1,036.1	8.9
Total	**1,553.9**	**17.2**	**1,092.2**	**10.3**	**11,686.0**	**100.0**

Interest Rates	1996	1997
Bank Pertanian Malaysia		
Commercial loans for agricultural purposes	1% to 4% + prevailing BLR (8.5% at end-December)	0% to 4% + prevailing BLR (10.8 % at end-December)
Fixed deposits	7.15% - 7.40%	10.00% - 10.50%
Savings deposits	4.25% - 5.00%	4.25% - 5.00%
Bank Rakyat		
Commercial loans for agricultural purposes	13.00% minimum	13.00% minimum
Fixed deposits	7.15% - 7.35%	10.00% - 10.09%
Savings deposits	4.00%	4.00%
Branches and Membership		
Bank Pertanian Malaysia	142 branches	142 branches
Bank Rakyat	67 branches with 83,157 members	70 branches with 115,559 members
Farmers' organisations	281 with 621,645 members	282 with 638,487 members
Agro-based co-operatives societies	649 with 104,402 members	609 with 98,582 members

Source: Various agencies

Table A.64
Urban Credit Co-operative Societies[1]

	Annual change 1996	Annual change 1997	As at end 1997	Annual change (%)	% share
	Number				
Total co-operative societies	10	30	892	3.5	100.0
Deposit-taking co-operatives	*0*	*1*	*17*	*6.3*	*1.9*
Other credit co-operatives	*10*	*29*	*875*	*3.4*	*98.1*
	('000)				
Total members	2.7	78.9	1,783	4.6	100.0
Deposit-taking co-operatives	*5.2*	*7.0*	*151*	*4.9*	*8.5*
Other credit co-operatives	*–2.5*	*71.9*	*1,632*	*4.6*	*91.5*
	RM million			Annual change (%)	% share
Sources of funds					
Share subscriptions	129.0	104.7	2,159.1	5.1	38.3
Reserves	385.4	141.5	1,831.0	8.4	32.4
Borrowings	491.4	–34.2	759.5	–4.3	13.5
Sundry creditors	–341.2	26.3	552.9	5.0	9.8
Savings and deposits	46.1	24.9	232.6	12.0	4.1
Surplus	–100.7	5.0	105.8	5.0	1.9
Total	**610.0**	**268.2**	**5,640.9**	**5.0**	**100.0**
Uses of funds					
Investments	615.2	117.9	2,565.4	4.8	45.5
Shares	*478.5*	*66.4*	*1,797.0*	*3.8*	*31.8*
Fixed and savings deposits	*4.0*	*33.4*	*403.9*	*9.0*	*7.2*
Real estates	*129.8*	*14.1*	*296.3*	*5.0*	*5.3*
Other	*2.9*	*4.0*	*68.2*	*6.2*	*1.2*
Loans to members	249.3	87.2	1,805.4[2]	5.1	32.0
Fixed assets	–42.3	50.5	589.2	9.4	10.4
Other assets	–178.1	12.5	455.1	2.8	8.1
Cash and bank balances	5.9	–3.2	178.7	–1.8	3.2
Other	–40.0	3.3	47.1	7.5	0.8

[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] Refers to total loans outstanding.

Source: Department of Co-operative Development Malaysia

As at the end of 1997, 271 leasing companies and 19 factoring companies had registered with Bank Negara Malaysia. However, only 157 leasing companies and 18 factoring companies submitted statistics pertaining to their operations to the Bank. Total assets of the 157 leasing companies and 18 factoring companies amounted to RM19.3 billion and RM1.7 billion respectively at the end of 1997. Nevertheless, of the 157 leasing companies, only 53 were pure leasing companies, while of the 18 factoring companies, only 15 were pure factoring companies. The remaining companies only undertook leasing and factoring business as part of their overall business activities.

Table A.65
Leasing Companies: Sources and Uses of Funds

	As at end				
	1993	1994	1995	1996	1997 [1]
	RM million				
Sources					
Capital and reserves	380	439	430	569	802
Borrowings from financial institutions	1,942	2,034	2,779	3,449	4,061
Inter-company borrowings	286	621	841	2,102	1,739
Other	1,523	1,586	2,039	2,294	2,767
Total	**4,131**	**4,680**	**6,089**	**8,414**	**9,369**
Uses					
Cash and bank balances	32	18	20	48	144
Investments	88	126	161	351	484
Receivables	3,471	3,876	4,851	5,544	5,261
Leasing	*2,700*	*2,743*	*3,013*	*3,150*	*3,067*
Factoring	*95*	*133*	*187*	*171*	*90*
Hire purchase	*587*	*965*	*1,536*	*2,016*	*1,843*
Other	*89*	*35*	*115*	*207*	*261*
Other	540	660	1,057	2,471	3,480

[1] Statistics shown are for 53 pure leasing companies only.

Table A.66
Leasing Companies: Income and Expenditure

	During the period				
	1993	1994	1995	1996	1997 [1]
	RM million				
Income					
Income from	335	327	477	611	615
Leasing	*247*	*240*	*323*	*380*	*393*
Factoring	*9*	*9*	*16*	*20*	*12*
Hire purchase	*75*	*77*	*136*	*208*	*200*
Other	*4*	*1*	*2*	*3*	*10*
Other	82	82	120	233	470
Total	**417**	**409**	**597**	**844**	**1,085**
Expenditure					
Interest paid	233	189	273	434	586
Financial institutions	*202*	*159*	*240*	*388*	*529*
Block discounting	*31*	*30*	*33*	*46*	*57*
Bad debts written off & provision	20	35	29	35	100
Other	77	79	145	192	218
Total	**330**	**303**	**447**	**661**	**904**
Pre-tax Profit	**87**	**106**	**150**	**183**	**181**

[1] Statistics shown are for 53 pure leasing companies only.

Table A.67
Leasing Companies: Financing by Sector

	1993	1994	1995	1996	1997 [1]
	During the period				
	RM million				
Sector					
Agriculture	40	61	66	48	50
Mining and quarrying	27	28	37	69	54
Manufacturing	452	549	457	449	406
Electricity	1	2	3	2	3
General commerce	123	152	155	181	164
Property sector	130	197	214	206	195
Construction	*118*	*172*	*191*	*190*	*184*
Real estate	*11*	*22*	*22*	*15*	*9*
Housing	*1*	*3*	*1*	*1*	*2*
Transport	106	131	184	215	167
Business, insurance and other services	196	214	211	274	216
Consumption credit	…	3	0	…	1
Other	57	91	183	114	128
Total	**1,132**	**1,428**	**1,510**	**1,558**	**1,384**

[1] Statistics shown are for 53 pure leasing companies only.

Table A.68
Factoring Companies: Sources and Uses of Funds

	1993	1994	1995	1996	1997 [1]
	As at end				
	RM million				
Sources					
Capital and reserves	78	94	70	92	101
Borrowings from financial institutions	395	403	384	437	596
Inter-company borrowings	163	211	227	354	349
Other	282	315	445	528	675
Total	**918**	**1,023**	**1,126**	**1,411**	**1,721**
Uses					
Cash and bank balances	13	14	12	30	19
Investments	19	19	4	7	10
Receivables	747	925	1,066	1,275	1,664
Leasing	*2*	*1*	*1*	…	…
Factoring	*679*	*714*	*1,006*	*1,186*	*1,459*
Hire purchase	*53*	*178*	*1*	*7*	*19*
Other	*13*	*32*	*58*	*82*	*186*
Other	139	65	44	99	28

[1] Statistics shown are for 15 pure factoring companies only.

Table A.69
Factoring Companies: Income and Expenditure

	During the period				
	1993	1994	1995	1996	1997 [1]
	RM million				
Income					
Income from	57	70	82	110	150
Leasing	…	…	*0*	*0*	*0*
Factoring	*53*	*63*	*73*	*98*	*129*
Hire purchase	*2*	…	…	…	*1*
Other	*2*	*7*	*9*	*12*	*20*
Other	19	14	16	30	39
Total	**76**	**84**	**98**	**140**	**189**
Expenditure					
Interest paid	36	29	34	58	74
Financial institutions	*36*	*29*	*34*	*58*	*74*
Block discounting creditors	…	…	*0*	*0*	*0*
Bad debts written off & provision	8	6	8	11	15
Other	19	21	24	30	34
Total	**63**	**56**	**66**	**99**	**123**
Pre-tax Profit	**13**	**28**	**32**	**41**	**66**

[1] Statistics shown are for 15 pure factoring companies only.

Table A.70
Factoring Companies: Financing by Sector

	During the period				
	1993	1994	1995	1996	1997 [1]
	RM million				
Sector					
Agriculture	1	2	1	1	1
Mining and quarrying	4	5	3	2	3
Manufacturing	148	116	139	183	171
Electricity	1	…	1	5	6
General commerce	232	170	216	198	259
Property sector	143	162	259	308	374
Construction	*141*	*152*	*251*	*298*	*363*
Real estate	*0*	*7*	*0*	*10*	*11*
Housing	*2*	*3*	*8*	*0*	*0*
Transport	6	9	14	14	16
Business, insurance and other services	41	34	86	60	161
Consumption credit	41	28	31	32	33
Other	48	21	132	57	67
Total	**665**	**547**	**882**	**860**	**1,091**

[1] Statistics shown are for 15 pure factoring companies only.

Table A.71
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	
	1996	1997
No. of venture capital companies	17	22
No. of investee companies	231	238
	RM million	
Total funds mobilised	954.4	959.8
Cumulative investments made	579.7	844.6
Sources		
Shareholders' fund	600.3	604.6
Liabilities	442.4	713.3
Total	**1,042.7**	**1,317.9**
Uses		
Investment in venture companies [1]	558.9	815.4
Other assets	483.8	502.5
Total	**1,042.7**	**1,317.9**
	During the year	
	1996	1997
No. of investee companies	70	79
	RM million	
Profit before tax	17.3	41.9
Investment during the year	**233.6**	**180.4**
By sector		
Manufacturing	*198.3*	*115.4*
Other	*35.3*	*65.0*
By type		
Seed capital [2]	*0.1*	–
Start-ups [3]	*32.3*	*42.8*
Second-stage [4]	*56.1*	*58.8*
Acquisition/buy-out [5]	*110.0*	*61.8*
Bridge financing [6]	*26.2*	*7.7*
Other	*8.9*	*9.3*

[1] After revaluation, liquidation and other.
[2] Stage where relatively small amounts of capital are required; rarely involves marketing.
[3] For 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 company requires assistance in the actual making and distribution of the product while the company's account receivables and inventories are growing.
[5] For companies seeking money for plant expansion, marketing and increasing working capital.
[6] Involves venture capital when synergistic partners are sought for the company.

Table A.71
Venture Capital Companies (continued)

	List of venture capital companies	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.	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 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.	1997	Closed

Table A.72
Export-Import Bank of Malaysia Berhad (Exim Bank)

Year of Establishment	Incorporated in August 1995
Objectives	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. Effective January 1998, the Export Credit Refinancing facility was transferred from Bank Negara Malaysia to Exim Bank.

Facility	**Loans / Guarantee Approved**		**Operating Income**	
	1996	1997	1996	1997
	RM million		RM million	
Buyer Credit Facility	488.3	439.9	5.8	10.5
Overseas Investment Credit Facility	238.0	288.0	1.2	6.6
Supplier Credit Facility	14.6	107.8	1.0	1.2
Buyer & Supplier Credit Guarantee	200.0	264.0	0.1	0.7
Export of Services Financing Facility & Other [1]	0.0	53.0	0.0	0.0
Total	**940.9**	**1,152.7**	**8.1**	**19.0**

[1] No operating income was reported in 1997 as approved facility for Exports of Services Financing and Other has not been utilised.

Source: Exim Bank

Table A.73
Funds Raised in the Capital Market

Sector	1993	1994	1995	1996	1997*p*
	RM million				
By Public Sector					
Government Securities					
Malaysian Government Securities (MGS)	1,600.0	2,229.1	2,000.0	6,000.0	3,000.0
MGS Advanced Subscriptions	–	270.9	–	–	–
Khazanah Bonds (KB)	–	–	–	–	794.4
Government Investment Issues (GII)	1,200.0	3,000.0	750.0	–	–
Malaysia Savings Bonds (MSB)	948.0	–	–	–	–
New Issue of Government Securities	3,748.0	5,500.0	2,750.0	6,000.0	3,794.4
Less: Redemptions					
MGS	2,224.5	3,549.0	2,250.0	3,809.0	3,648.0
KB	–	–	–	–	–
GII	200.0	200.0	500.0	900.0	1,400.0
MSB	93.0	69.8	37.8	34.0	154.8
Less: Government Holdings	50.0	–97.0	–2.6	–74.1	–1.2
Net Funds Raised from Public Sector	1,180.5	1,778.2	–35.2	1,331.1	–1,407.2
By Private Sector					
Shares					
Ordinary Shares [1]					
Initial Public Offers	912.7	2,972.9	4,175.0	4,099.2	4,755.7
Rights Issues	1,176.9	3,436.7	5,240.2	5,268.5	8,524.9
Private Placement/Restricted Offer-for-Sale	658.8	798.9	1,146.9	4,554.4	3,125.3
Special Issues	684.2	1,249.4	875.5	2,002.3	1,818.8
Preference Shares	–	–	–	–	–
New Issue of Shares	3,432.6	8,457.9	11,437.6	15,924.4	18,224.7
Debt Securities [2]					
Straight Bonds	2,109.8	1,021.7	3,929.9	2,675.4	3,832.0
Bonds with Warrants	1,089.6	2,861.4	3,607.7	5,563.7	3,300.3
Convertible Bonds	164.6	1,323.1	863.1	1,784.1	1,994.9
Islamic Bonds	–	300.0	800.0	2,350.0	5,249.7
Cagamas Bonds	1,650.0	4,760.0	3,022.0	4,665.0	5,169.0
New Issue of Debt Securities	5,014.0	10,266.1	12,222.7	17,038.2	19,545.8
Less: Redemptions					
Private Debt Securities [3]	474.2	383.5	1,249.1	1,765.0	1,358.0
Cagamas Bonds	900.0	850.0	2,635.0	750.0	1,640.0
Net Issue of Debt Securities	3,639.8	9,032.6	8,338.6	14,523.2	16,547.8
Net Funds Raised from Private Sector	7,072.4	17,490.5	19,776.2	30,447.6	34,772.5
Net Funds Raised from the Capital Market	8,252.9	19,268.7	19,741.0	31,778.7	33,365.3
Short-Term Securities					
Commercial Papers	1,715.0	16,601.9	20,216.5	34,320.5	55,994.2
Cagamas Notes	2,685.0	2,490.0	3,395.0	5,790.0	13,890.0
New Issue of Short-Term Securities	4,400.0	19,091.9	23,611.5	40,110.5	69,884.2
Less : Redemptions					
Commercial Papers	100.0	14,228.2	18,842.7	31,009.2	53,238.0
Cagamas Notes	2,382.0	2,855.0	1,945.0	5,290.0	11,700.0
Net Issue of Short-Term Securities	1,918.0	2,008.7	2,823.8	3,811.3	4,946.2
Total	**10,170.9**	**21,277.4**	**22,564.8**	**35,590.0**	**38,311.5**

[1] Exclude funds raised by the exercise of Employee Share Options Scheme, 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 and Islamic bonds.
p Preliminary

Table A.74
Capital Market Debt Instruments,[1] Amount Outstanding

As at end	Malaysian Government Securities	Government Investment Issues	Malaysia Savings Bond	Private Debt Securities[2]	Cagamas Bonds
	RM million (nominal value)				
1993	66,018.1	2,000.0	1,273.0	10,081.0	5,015.0
1994	64,969.1	4,800.0	1,177.3	15,131.2	8,925.0
1995	64,719.1	5,050.0	1,130.6	22,700.9	9,312.0
1996	66,910.1	4,150.0	1,092.0	33,517.0	13,227.0
1997*p*	66,261.7	2,750.0	918.4	46,543.4	16,756.0

[1] Refer to instruments with a maturity period of more than one year.
[2] Exclude debt securities issued by the banking institutions. PDS are assumed to be redeemed or converted at maturity.
p Preliminary