ECONOMIC AND FINANCIAL DEVELOPMENTS

International Economic Environment

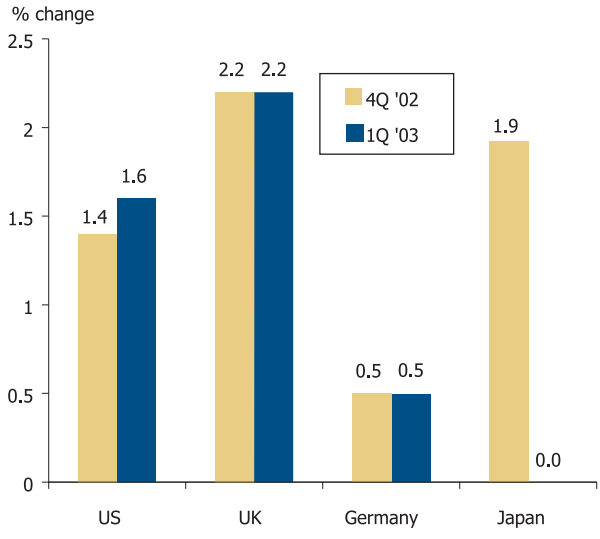
The **global economic environment** in the first quarter of 2003 was marked by significant geopolitical uncertainty. By April, however, this uncertainty abated with the ending of the war in Iraq and the decline in global oil prices. Subsequently, the financial markets in the major industrial countries recovered on optimism of stronger growth in the second half of the year. Notwithstanding these positive developments, global recovery may be weighed down by the uncertainties, including continued geopolitical tensions and the structural imbalances in the major economies. A rapid adjustment to the growing fiscal and current account deficits may impact US growth with global consequences. At the same time, the persistent decline in the US dollar has increased volatility in global foreign exchange markets. Further declines in prices amidst excess capacity in a number of countries raised deflationary concerns and on the effectiveness of current policies to reverse the situation. On balance, however, expectations of positive impact from the current US tax package and other policy actions would result in positive albeit modest growth.

In **Asia**, the outbreak of the Severe Acute Respiratory Syndrome (SARS) largely did not affect growth in the first quarter as it only began in late March. By May, however, it had resulted in significant declines in consumer and business confidence, adversely affecting the travel, tourism, retail and related activities. The economic impact of the SARS outbreak, however, depends on the duration and severity of the health concerns. As of early June, there are indications that the region had probably seen the worst and conditions are now beginning to improve.

Major Industrial Countries: Slower growth in the first quarter. Stronger growth going forward

In the **United States**, the preliminary 1Q GDP data (1.6%) was lower than market expectations (2.3%), due mainly to the lower-than-anticipated government spending and slower consumption growth. Despite the build-up to the Iraq war, government spending was much lower than expected. Moreover, consumption growth in the quarter was the lowest since 1Q 1993, attributable mainly to a slowdown in spending on services following adverse weather conditions. Fixed investment slowed down markedly due to the decline in equipment and software spending, which

Major Industrial Countries: Real GDP Growth



may affect exports from electronics-exporting Asian economies. These developments prompted the IMF to revise downwards its forecast of growth of the US economy to 2.2% in 2003 (February 2003 preliminary: 2.4%; September 2002: 2.7%). By early May, however, some improvements were seen in the latest monthly economic data, including continued consumer confidence, the rise in services sector index, and rising home sales and durable and non-defence capital goods orders. These positive developments more than offset the weakness in the manufacturing sector. Other positive developments include the continued decline in risk spreads in corporate markets and lower energy prices.

While a reduction in geopolitical uncertainty and the decline in energy prices would be positive for growth in the second quarter, concerns over deteriorating labour market conditions and the risk of deflation could threaten growth prospects. The unemployment rate has risen to 6.1% and the weekly jobless claims has remained above the 400,000-level for 16 consecutive weeks, reflecting a weak pace of hiring. Meanwhile, the US Federal Reserve Board (Fed) viewed that, with price inflation already at a low level, substantial further disinflation would be an unwelcome development, especially to the extent that it puts pressure on profit margins and impedes the revival of business spending. Several factors underpin the disinflationary forces. The large excess capacity following the bursting of the equity-investment bubble in 2001 had led to a widening output gap. Weaker labour market and waning effects of tax cut could also have affected consumption in the current period. In addition, investment has remained subdued. However, inflation expectations as measured by surveys and spreads on inflation-indexed bonds have been relatively stable, supported by the continued policy stimulus and expectations of a gradual pick-up in activity following improving business and consumer confidence as well as corporate earnings. More importantly, policy has been used proactively to support growth and prevent the possibility of a deflationary spiral. On balance, the market is expecting stronger recovery in the US economy in the second half-year, although this recovery is expected to be modest.

During the quarter, the real GDP growth in **UK** remained stable at 2.2% (4Q 2002: 2.2%) as the stronger government spending was offset by the slowdown in consumer spending. Latest trends indicate a modest growth prospect as higher business investment and government spending would be mitigated by weaker consumer spending, resulting from higher local and income taxes. Real GDP in **Germany** remained stable at 0.5% during the quarter where the broad-based improvement in domestic demand was weighed down by the decline in net exports. While the rise in domestic orders reported in March prompted optimism for further pick up in activity, continued weakness in consumer and business confidence arising from higher unemployment and declining corporate profitability may dampen growth prospects. The outlook for Germany has been revised downwards to 0.5% for 2003 (from 0.8%) as the strengthening of euro might also affect export growth. In Japan, the economy remained stagnant during the quarter. Increases in investment and consumption during the quarter was not able to offset the decline in export

growth. The outlook in the near term is for further deterioration in labour market conditions and declines in exports.

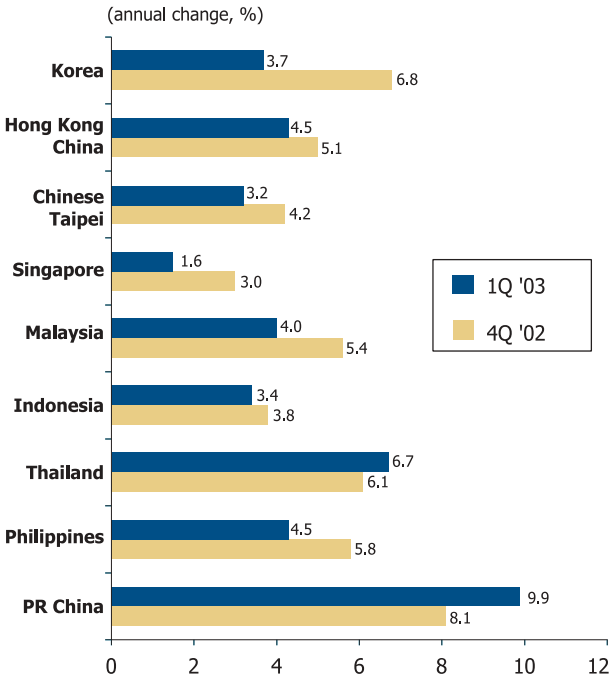
Regional Economies: Sustained growth despite increased uncertainties

In the regional economies, **economic growth** strengthened in the first quarter of 2003. Overall regional growth was sustained notwithstanding the negative impact of continued uncertainty due to geopolitical tensions as well as the impact of the Severe Acute Respiratory Syndrome (SARS) on consumer and business sentiments towards the end of the quarter. Growth continued to be supported by the resilience in exports and domestic demand. All regional countries, except the Philippines, recorded double-digit export growth rates. Amidst geopolitical risks in the Middle East, rising intra-regional trade, particularly for electronics and chemical products provided an impetus to export growth.

Real GDP of the **People's Republic of China** (P.R. China) expanded at a robust pace of 9.9%, the highest rate registered in six years. Growth was attributable mainly to strong export growth, favourable domestic demand conditions, fixed asset investment spending arising from continued government stimulus and expansion in foreign direct investment. In Hong Kong China, the economy grew by 4.5% due mainly to sustained intra-regional trade, particularly with P.R.China and Chinese Taipei. In **Korea**, growth moderated to 3.7%, given a slowdown in domestic demand reflecting mainly the concerns over geopolitical uncertainties. The **Chinese Taipei** economy continued to expand, albeit at a more moderate pace of 3.2%, supported by an expansion in exports which more than offset weak domestic demand conditions.

During the quarter, growth in the **Singapore** economy of 1.6% was attributable to an expansion in the manufacturing, wholesale and retail trade and transport and communications sectors. In **Indonesia**, real GDP rose by 3.4%, supported by robust domestic demand, with government consumption recording the largest increase. The growth was broad-based, with expansion registered across all sectors of the economy. In the Philippines, real GDP growth of 4.5% was due to broad-based expansion, led by the services sector.

Regional Economies: GDP Growth



Following the impact of SARS on the travel, tourism and related sectors, regional governments announced economic relief packages to mitigate its impact on the regional economies.

During the first quarter, the **inflation** environment of the **regional countries** remained

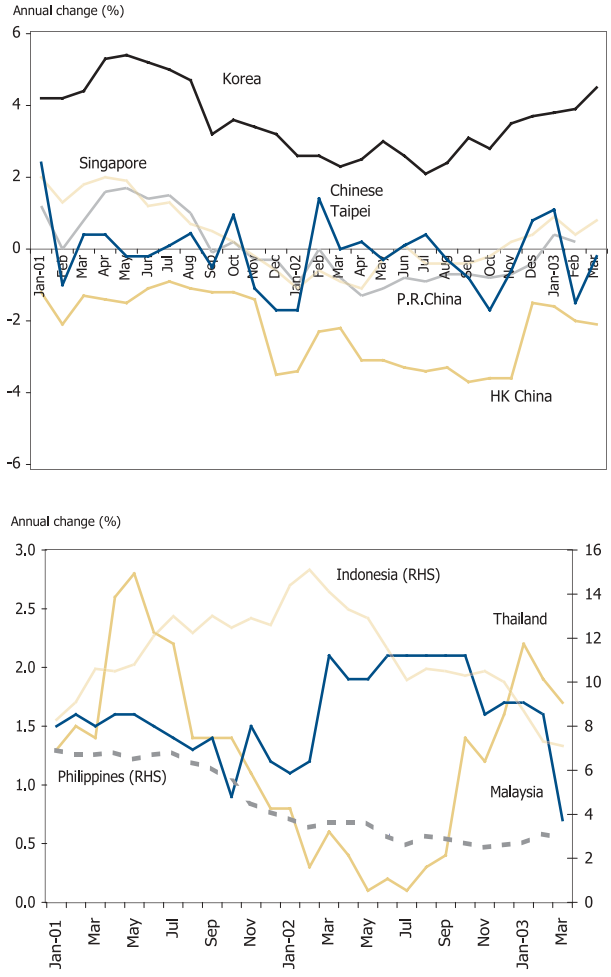
Economic Relief Packages to Mitigate the Impact from SARS outbreak

Singapore	17 April: A S$230 million (US$129.3 million) relief package (0.2% of GDP) focused on providing immediate relief to the most directly and adversely affected sectors, namely, the tourism and transport-related sectors. Allocations/concessions to the tourism and transport-related sectors accounted for 67% and 32% of the economic package. Key measures include tax rebates/reductions, interest rate subsidy, expenditure for training grants and fee rebates/waivers.
P.R. China	20 April - 12 May: Funds amounting to about 6.3 billion yuan (US$763 million) was targeted at improving the public health infrastructure, particularly in SARS-affected regions. Other measures taken by both the central and local governments include waivers/reductions of several tax rates and administrative fees for SARS-affected industries. Tax breaks in Guangdong, amounting to 900 million yuan (US$109 million) is expected to be effective in August 2003.
Hong Kong China	23 April: A HK$11.8 billion (US$1.5 billion) economic package (1% of GDP) will be funded by Hong Kong's fiscal reserves (currently at more than HK$320 billion). Key measures include government guarantee for loans, waivers on utility charges and license fees, reduction in public housing rentals, rebates to taxpayers, creation of temporary jobs and allocations for medical research and publicity campaigns.
ASEAN-China	29 April: ASEAN and China set up a Special SARS Fund at a meeting on SARS in Bangkok. The fund for SARS research and study was launched with Thailand's pledge of 10 million baht (US$0.23 million), 10 million yuan (US$1.2 million) from China and US$0.1 million from Cambodia.
Chinese Taipei	2 May: A T$50 billion (US$1.4 billion) special fund to help industries affected by SARS was approved.
Malaysia	21 May: A RM7.3 billion (US$1.9 billion) economic package (1.9% of GDP) focused on 90 steps to encourage private investment, strengthen competitiveness, generate new sources of growth, enhance the delivery system of both the public and private sectors and mitigate the impact of SARS. The package is expected to enable the economy to grow by more than 4.2%, which was achieved in 2002. Key measures include the reduction in the central bank's intervention rate, reduction in employee's contribution to the Employees' Provident Fund, provision of medical allowances, micro credit scheme, tax exemptions/reductions, relief guarantee facility, discount on bill payments, extension of pioneer status period and tax investment allowance, relaxation in foreign equity ownership, funds for training and subsidy on housing loan interest payment.

benign despite price increases registered in Korea, the Philippines and Thailand, particularly for energy and food products. In contrast, given a stronger rupiah, lower food prices led to the further moderation in consumer prices in Indonesia. Meanwhile, deflationary pressures in the Newly

Industrialised Economies (NIEs) (excluding Korea) and China showed signs of easing. In particular, prices in the People's Republic of China turned around to record the first positive increase since 3Q 2001, attributable mainly to the government's expansionary fiscal and monetary policies.

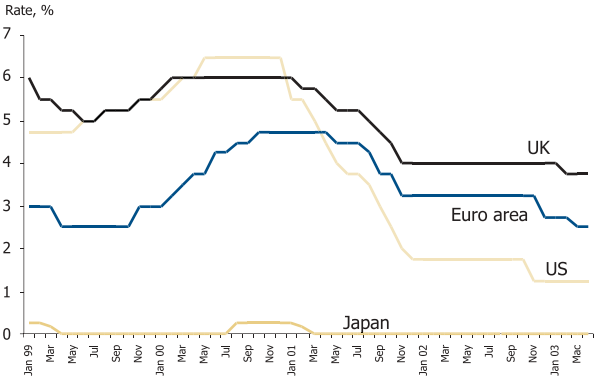
Regional Economies : Inflation rate



Monetary Policy in the Global Economy

Amidst a subdued global growth outlook and declining underlying inflation risks, several central banks in the industrial countries have reduced policy rates in recent months. In February 2003, the Bank of England (BoE) reduced its base lending rate by 25 basis points on concerns that the global outlook would be weak and that underlying domestic demand was weaker than expected. Subsequently, in March 2003, the European Central Bank (ECB) reduced interest rates by 25 basis points to 2.5% following expectations of a less optimistic growth outlook for the euro area. Despite policy rates remaining unchanged in the latest US Federal Reserve Board's policy meeting on 6 May, the concern on increased disinflation may have future implications on monetary policy actions.

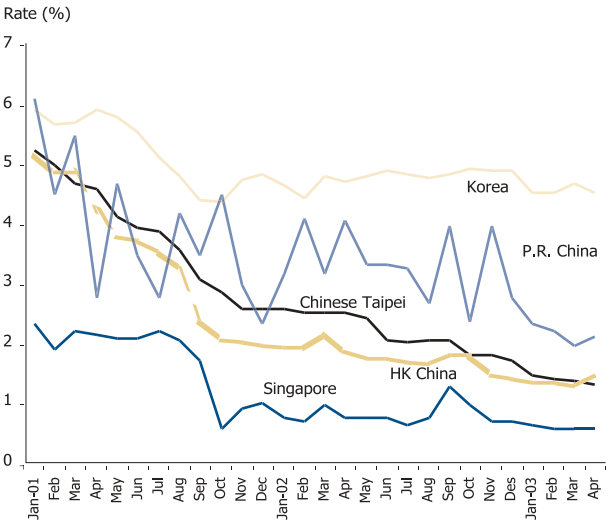
Major Industrial Countries: Interest Rate Movements

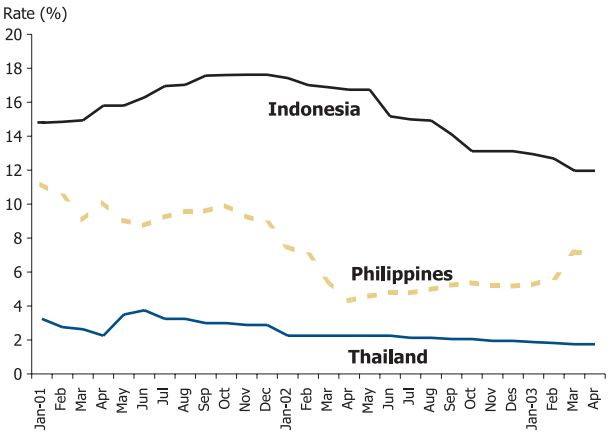


During the quarter, with the exception of Indonesia and the Philippines, **short-term interest rates** in the **regional countries** remained low, reflecting a soft global interest rate environment and excess liquidity conditions in domestic financial markets. However, in Indonesia, the downtrend in the 3-month rate since 1Q 2002 continued into 1Q 2003, prompted by the reduction in the policy rate in November 2002.

In April, the movements of short-term rates were mixed, with lower rates registered in the Philippines, Korea and Chinese Taipei, and stable rates in Indonesia, Thailand and Singapore. In Hong

Regional Countries : Interest Rate Movements





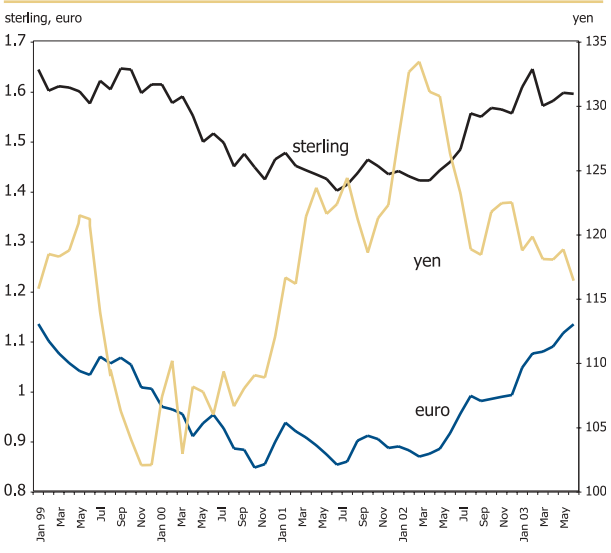
Kong China and P.R. China, the respective rates recorded increases.

Following a 25 basis point reduction in the rupiah overnight intervention rate on 1 and 9 May, respectively, the central bank in Indonesia reduced the rate to 10.5% on 29 May and further by another 25 basis points to 10.25% on 5 June. In line with a progressive easing stance and given subsiding inflationary pressures, rates have been gradually guided lower from the 15.1% peak reached in mid-2002. The interest rate cuts were aimed at stimulating domestic demand, reducing interest rate differentials and easing high debt servicing costs. Indications are that interest rates could fall below 10% during the year, given excess liquidity in the banking system. On 13 May, the central bank in Korea cut its overnight call rate target by 25 basis points to 4%, citing a contraction in production and accumulation in inventories amidst sluggish domestic demand. The emergence of negative sentiments also emanated from concerns over North Korea's nuclear programme and the spread of SARS in the Asian region.

Exchange Rate Developments

The **United States dollar** showed mixed trends against the other major currencies in the first quarter of 2003. The dollar depreciated against the euro by 5.6%, but appreciated marginally against the pound sterling and Japanese yen by 0.8% and 0.9% respectively. Gains in the euro were spurred by its favourable yield-differentials relative to dollar and yen assets as well as market expectations for the further strengthening of the euro. The pause in dollar depreciation during the Iraq war proved to be

Movements in the Major Currencies

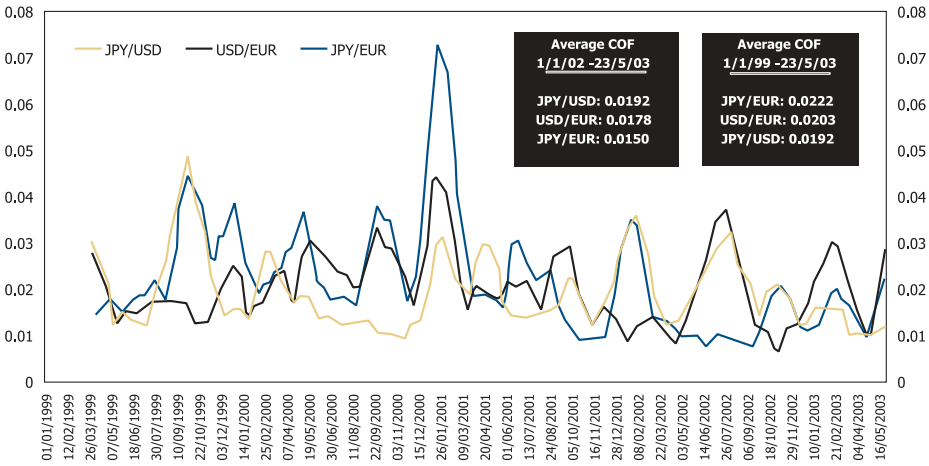


White Box: Volatility of the G-3 currencies

To analyse the relative volatility of the G-3 currencies, a comparison is made between the bilateral exchange rates of the three currencies, i.e. the USD, euro and yen. Using the coefficient of variation for the G-3 exchange rates for the period 1 January 2002 to 23 May 2003 (which roughly corresponds to the recent period of US dollar weakness), it is observed that, on average, currency pairs involving the USD have been more volatile than currency pairs involving the euro. However, expanding the sample to the period since the inception of the euro in January 1999, the currency pairs involving the euro are found to be on average more volatile than currency pairs involving the US dollar.

3-Month Rolling Coefficient of Variation for the G-3 Currencies

(1 Jan. 1999 - 23 May 2003)

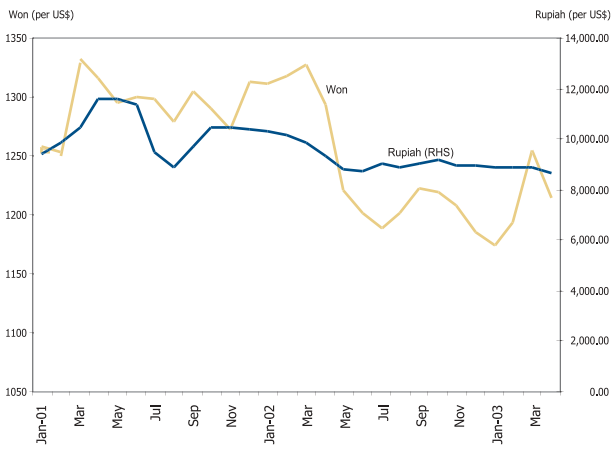


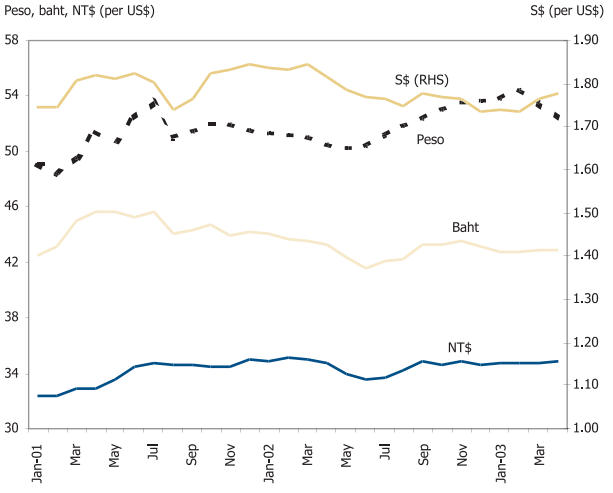
short-lived as the euro resumed its appreciating trend with the cessation of the Iraq conflict in April. The euro breached the E1 =US$1.17 level on 19 May 2003, approaching its launch level in January 1999 of E1 =US$1.1747, representing a gain of about 12% this year to date. Market perceptions that the US authorities have effectively abandoned its strong dollar policy, further fueled the euro's rise. Fund flows thus far were mainly from Japan to the euro-zone, resulting in a corresponding large decline in the euro-yen cross-rate. Against the US dollar, the yen has not shown a corresponding appreciation as market indications and authorities' statements indicate that intervention has been undertaken with the desire to prevent a sharp rise in the currency.

In the first quarter, regional currencies closed mixed against the US dollar. The downward movements in the Korean won, Singapore dollar and New Taiwan dollar were due mainly to weak investor sentiments, given concerns over the war in Iraq as well as the spread of the SARS illness towards the end of the first quarter. On the other hand, the appreciation in the Thai baht, Indonesian rupiah and the Philippine peso was buoyed primarily by positive domestic developments.

In April, the performance of regional currencies remained mixed against the US dollar. Whilst the positive sentiments on the Korean won and the Philippine peso were attributable mainly to falling global oil prices, the Indonesian rupiah appreciated from favourable economic data and the inflow of funds aimed at domestic assets. In contrast, the Thai baht, New Taiwan dollar and Singapore dollar depreciated on concerns over the negative impact of SARS on the economies.

Movements in the Regional Currencies





DEVELOPMENTS IN THE MALAYSIAN ECONOMY

Domestic demand was sustained in the first quarter of 2003

The first quarter GDP growth continued to be mainly supported by the expansion in domestic aggregate demand. Consumption growth was sustained at 6.2% while gross fixed capital formation expanded by 3.8%. Underpinned by

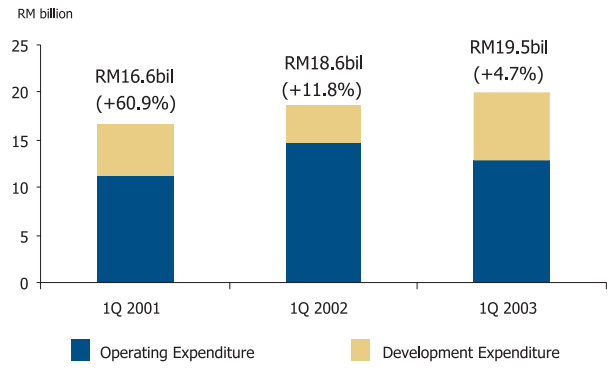
GDP by Expenditure Components (at constant 1987 prices)

	2002			2003
	Q1	Q4	Year	Q1
	Annual change in %			
Aggregate Domestic Demand (excluding stocks)	0.0	6.6	4.2	5.4
Consumption	4.6	5.1	6.2	6.2
Private sector	*3.3*	*4.6*	*4.4*	*4.2*
Public sector	*11.4*	*6.5*	*12.2*	*15.6*
Gross Fixed Capital Formation	-8.5	10.0	0.3	3.8
Exports of Goods and Services	-6.5	7.2	3.6	1.9
Imports of Goods and Services	-4.8	8.1	6.2	1.7
GDP	**1.3**	**5.4**	**4.1**	**4.0**

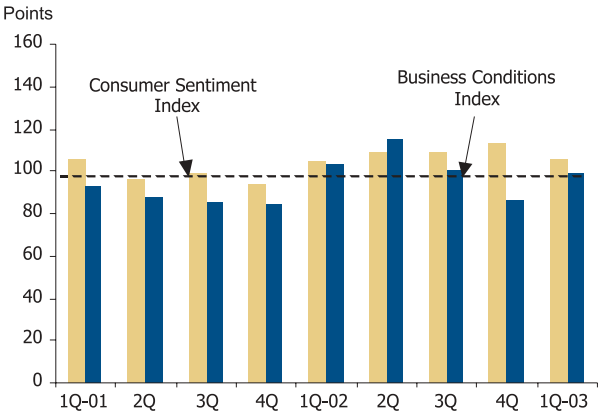
stronger public sector spending, **public consumption** increased by 15.6%, due mainly to higher expenditures on emoluments, and supplies and services. At the same time, **private consumption** continued to be resilient, supported by low inflation, stable job market as well as higher commodity prices. In addition, various promotions by retailers nationwide also promoted consumer spending. This was reflected in major consumption indicators such as imports of consumption goods, loans disbursed for purchases of consumption goods and services and consumer spending via credit cards. For the first quarter, the Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index remained above the threshold level of 100-

points, indicating that consumers were generally positive on the outlook for the domestic economy. Notably, the survey showed that housing demand in the coming months remained favourable as consumers were taking advantage of low interest rates.

Higher Federal Government expenditure



Consumers were generally optimistic while business confidence continued to be resilient



The positive growth in **gross fixed capital formation** continued into the first quarter of 2003 (3.8%, 4Q 2002: 10%), due mainly to higher investment by the public sector. Development expenditure of the Federal Government was increased on education, health and infrastructure development. Meanwhile, the first quarter Business Conditions Index from the MIER was higher by 13.2 points compared to the fourth quarter of 2002 (99.3 points, 4Q 2002: 86.1 points), indicating better results in most components that make up the index, including production, domestic orders, investment in plant and equipment, expected production, export orders and expected export sales. In addition, positive growth in sales of commercial vehicles and loans disbursed for the manufacturing sector also pointed to continued investment activities during the quarter.

Sectoral Developments

Sustained growth in the manufacturing sector

Value added in the **manufacturing sector** expanded by 5.2% compared with the decline in the first quarter of 2002 (4Q 2002: 5.7%). The expansion was supported by stronger growth in the

Performance in the Manufacturing Sector

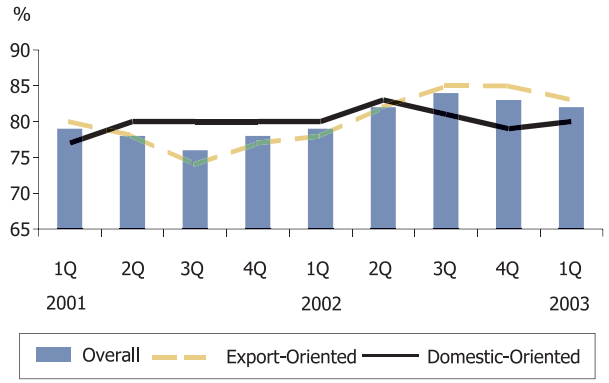
	2002			2003
	1Q	4Q	Year	1Q
	Annual Change in %			
Value Added (Constant Price)	**-2.3**	**5.7**	**4.0**	**5.2**
Overall Production	**-3.4**	**6.7**	**4.5**	**6.3** [2/]
Export-oriented industries	**-5.5**	**8.9**	**5.0**	**7.0**
of which:				
- Electronics	-0.8	12.5	13.4	8.1
- Electrical	-9.3	-4.2	-5.1	-5.5
- Textiles & wearing apparel	-14.9	4.4	-6.2	-0.6
- Chemicals and chemical products	-8.8	13.1	2.7	14.2
- Off-estate processing	1.0	12.0	7.1	4.4
- Rubber products	-4.5	5.5	2.0	9.1
- Wood and wood products [1/]	-15.4	1.0	-6.0	3.5
Domestic-oriented industries	**3.5**	**0.6**	**3.4**	**4.6**
of which:				
- Transport equipment	18.0	-7.9	6.2	-6.3
- Fabricated metal products	-4.9	-1.9	0.8	1.3
- Iron & steel and non-ferrous metal	-3.3	4.7	2.4	12.8
- Non-metallic mineral products	8.0	1.3	5.1	8.1
- Petroleum products	3.4	-6.0	-4.1	1.9
- Food	12.4	10.3	8.7	3.2
Total Manufactured Exports	**-4.0**	**5.2**	**4.8**	**1.7**
- Electronics	1.1	4.6	10.6	-6.1
Semiconductor	-13.2	36.7	19.9	27.1
Electronic equip. & parts	13.8	-18.0	3.5	-28.6
- Electrical products	-13.9	-8.5	-9.8	-6.5
Consumer electrical products	-11.7	-9.5	-10.6	-11.8
Industrial & commercial electrical prod.	-18.8	-20.5	-17.0	-12.5
Electrical industrial machinery & equip.	-10.4	11.9	2.3	4.0
Household electrical appliances	7.0	81.8	26.1	78.3
- Wood and wood products	-12.6	19.2	4.9	13.2
- Furniture & parts	3.2	7.5	7.7	8.8
- Textiles, clothing & footwear	-17.0	5.3	-5.2	8.3
- Optical & scientific equipment	5.6	4.8	4.6	19.2
- Chemicals and chemical products	-6.1	34.6	16.2	33.5
- Petroleum products	-35.6	29.7	-9.0	67.3

[1/] Output of furniture and parts are not captured in the wood production data.
[2/] Manufacturing production index for 1Q 2003 was subsequently revised to 7.6%.

domestic-oriented industries and continued expansion in the export-oriented industries. This resulted in the overall capacity utilisation rate in the manufacturing sector remaining at a high level of 82% (4Q 2002: 83%), with the export- and domestic-oriented industries operating at 83% and 80% respectively (4Q 2002: 85% and 79% respectively). While output growth remained strong, exports of manufactured goods moderated to 1.7% (4Q 2002: 5.2%) due mainly to lower exports of electronic equipment and parts and electrical goods. However, this was offset to some extent by the strong increase in exports of chemicals, petroleum products, textiles, manufactures of metal, optical and scientific equipment and food products. The weaker performance of the manufacturing exports was also due to continued decline in export prices, while export volume grew at a relatively stable rate.

Output growth in the **export-oriented industries** was driven largely by strong expansion in the chemical and semiconductor industries. In particular, both the production and exports of chemicals and chemical products expanded strongly, benefiting from the expansion in the electronics sector and higher external demand for organic chemicals and plastics, particularly from the Asia-Pacific region. Growth was also supported by strong expansion in output of the pharmaceutical products industry, following higher demand from Singapore and from the domestic market. The semiconductor industry also continued to perform well. Output was driven largely by strong global demand, particularly from Asia and Europe. Growth was driven by the wireless sector and, to some extent, the consumer sector (e.g. DVDs, digital cameras and video games). As a result, the semiconductor segment of the overall electronic exports continued to register strong growth, similar with trends in the other regional economies.

Capacity Utilisation in the Manufacturing Sector



Exports of electronics as a group, however, declined as the positive effect from the semiconductor segment was muted by lower exports of computers and peripherals arising from strong competition from lower cost producing countries. Similarly, both production and exports of electrical products such as audio-visual and air-conditioners was affected by increased competition from these countries which led to declines in prices of the electronics and electrical products. Growth in the export-oriented industries was also supported by higher output of rubber products arising from increased demand for rubber gloves from the Middle East, following the outbreak of the war in Iraq.

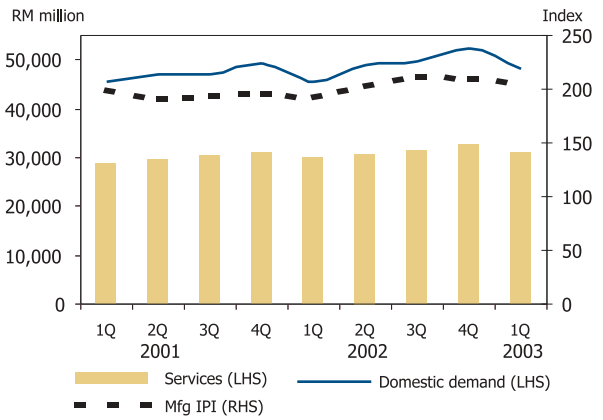
Growth in the **domestic-oriented industries** strengthened due to higher expansion in output of the iron and steel industry arising from higher domestic and external demand. Exports of iron and steel have been strong due to more favourable prices in the export market. Growth in the paper and paper products industry also expanded during the quarter due to increased external demand for paper and paperboard. Meanwhile, production of transport equipment continued to remain subdued in view of the softening in demand for passenger cars as well as

some build-up in inventories from the previous year.

Services sector supported by domestic demand and trade-related activities

The **services sector** continued to expand by 4% in the first quarter of 2003 (4Q 2002: 4.6%). As the outbreak of SARS occurred towards the end of the quarter, its impact was not seen in the first quarter. Domestic demand and strong growth in trade-related activities in line with the expansion in exports continued to support growth in the sector. Tourist arrivals remained high in the first two months of the year despite continued geopolitical tensions. Arrivals only declined in late March into April as travellers became more cautious with the issuance of the World Health Organisation (WHO) travel advisory in mid-March to several countries in the region and Canada. Despite the slowdown in inbound tourists, the wholesale, retail trade, hotels and restaurants sub-sector recorded a stronger growth supported mainly by domestic demand. Similarly, the transport, storage and communication sub-sector strengthened due to robust expansion in the telecommunication industry, in particular the cellular segment, supported by rapid growth in mobile data applications. The growth in the telecommunication industry was further augmented by continued increase in the Internet segment due to rise in subscribers. In the transport sector, strong port activities, including the rapid growth in transhipment cargo in the major ports, had partly offset the effects from weaker air travel.

Services sector supported by domestic demand and trade-related services



Performance in the Services Sector (Value Added)

	2002			2003
	1Q	4Q	Year	1Q
	Annual change in %			
Intermediate Services	**6.0**	**3.8**	**4.3**	**3.7**
Transport, storage & communication	2.0	3.3	2.6	4.2
Finance, insurance, real estate & business services	8.4	4.0	5.3	3.5
Final Services	**3.6**	**5.2**	**4.1**	**4.1**
Electricity, gas & water	4.0	4.3	3.9	6.2
Wholesale & retail trade, hotel & restaurants	1.9	2.6	2.6	3.6
Government services	7.0	9.3	6.7	1.8
Other services	3.6	6.9	4.6	6.2
Total Services	**4.5**	**4.6**	**4.1**	**4.0**

In the finance sector, narrow interest margins amidst the continued strong competition for lending was reflected in more moderate growth in the sub-sector. Overall, the finance, insurance, real estate and business services sector continued to receive support from the insurance industry, which recorded double-digit growth in premium collections. Growth in the utilities sub-sector was higher during the first quarter, reflecting strong demand for electricity from the industrial, commercial and household sectors.

Higher construction activity supported by public projects

The **construction sector** recorded a growth of 1.2% in the first quarter of 2003 (4Q

2002: 0.5%), supported by higher construction activity on public sector projects, including construction of roads, schools, public housing and health facilities. Construction activity in the residential sub-sector was sustained, following the large increase in launches in 2002. Activities in the non-residential sub-sector remained subdued amidst the overhang in office and retail space. Loans disbursed for purchase of residential property increased by 4.6% in the first quarter of 2003 (2002: 4.2%) as purchasers took advantage of the low cost of financing.

While the return of foreign workers helped to support construction activity during the quarter, growth was hampered by delays in some projects following a temporary shortage of steel bars. The shortage arose following the announcement that price control on steel bars and cement would be liberalised. However, domestic production of iron and steel had remained strong during the first quarter, increasing by 12.4%. The shortage situation has improved since as steps have been taken to enhance the efficiency of the distribution channels.

Construction Indicators

Indicator	2002 1Q	2002 4Q	2003 1Q
New sales and advertising permits (number)	274	242	207
(annual change, %)	20.2	-11.4	-24.5
Housing approvals (number)	48,895	45,610	33,899
(annual change, %)	11.4	-32.3	-30.7
Production of construction-related products (annual change, %)	2.6	2.8	10.2 [1/]
Loans approved for construction (annual change, %)	-10.2	69.6	19.4
Imports of construction materials & mineral products (annual change, %)	-5.8	9.9	3.6

[1/] Production of construction related materials for the 1Q 2003 was subsequently revised to 13%.
Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Performance of the Agriculture Sector

	2002 1Q	2002 4Q	2002 Year	2003 1Q
	Annual change in %			
Value Added (RM million at 1987 prices)	**-3.6**	**5.5**	**3.0**	**3.6**
Production [1/]				
Of which:				
Crude palm oil	-8.4	1.6	0.9	0.5
Crude palm kernel oil	-4.8	0.9	-3.9	-5.2
Rubber	1.2	17.8	7.7	16.6
Saw logs	-7.5	18.5	4.2	0.1
Cocoa	-37.2	35.2	-17.4	79.4
Exports (RM million)	**7.0**	**49.3**	**31.9**	**41.8**
Of which:				
Palm oil				
('000 tonnes)	-11.8	12.1	3.8	9.3
(RM/tonne)	41.0	46.9	44.7	41.4
(RM million)	24.4	64.7	50.2	54.6
Palm kernel oil				
('000 tonnes)	54.1	15.1	5.9	-33.9
(RM/tonne)	1.4	38.9	25.6	51.0
(RM million)	56.3	59.8	33.0	-0.2
Rubber				
('000 tonnes)	-10.5	8.2	12.9	13.4
(Sen/kg)	-11.6	55.1	17.0	57.6
(RM million)	-21.0	67.9	32.1	78.7
Saw logs				
('000 cu. metres)	-7.5	12.9	0.8	19.5
(RM/cu. metre)	-10.2	31.8	16.6	18.9
(RM million)	-17.0	48.8	17.5	42.1
Cocoa beans				
('000 tonnes)	21.3	71.2	29.6	51.7
(RM/tonne)	37.0	70.3	49.5	62.9
(RM million)	66.1	191.5	93.7	147.2

[1/] In '000 tonnes, except for saw logs in '000 cubic metres

The agriculture sector continued to perform favourably

The **agriculture sector** expanded by 3.6% (Q4 2002: 5.5%) despite a marginal growth in the output of crude palm oil (0.5%; 1.6% in Q4 2002). Growth was supported mainly by higher production of other major commodities namely rubber and cocoa as well as selected crops within the other agriculture sub-sector. Favourable prices as well as strong external demand encouraged increased production of these commodities. During the

quarter, prices of major commodities, namely crude palm oil, rubber and cocoa, were higher by 37.7%, 51.3% and 55.5% respectively to RM1,585 per tonne, 364 sen per kilogramme and RM6,980 per tonne respectively. Higher prices, together with increased export volume of major commodities, including palm oil, rubber, saw logs and cocoa contributed to higher export proceeds of the agriculture sector by 41.8% during the quarter.

Production of **crude palm oil** increased marginally by 0.5% due to the lower yields as well as continued replanting activity. The lagged effects from the dry spell in the earlier months had affected yields with the average oil extraction rate of crude palm oil declining to 19.57% during the quarter (Q4 2002: 20.23%). Meanwhile, a total of 13,840 hectares of old oil palm areas were felled for replanting purposes during the quarter. Crude palm kernel oil production declined by 5.2% during the quarter also due to the lower yields.

In the case of **rubber**, although the first quarter is usually a seasonally low production period due to wintering, production in the first quarter of 2003 exceeded expectations rising by 16.6%. The sharp increase in production was, to a large extent, due to intensive tapping activity among smallholders (who account for 88% of total production) in response to the more attractive rubber prices. Since 2002, rubber prices have trended upwards to reach an annual increase of 81% in March 2003, driven mainly by favourable global demand, including strong demand for rubber gloves following the Iraqi war, while supply remained tight in the other major producing countries of Thailand and Indonesia. Growth in the agriculture sector during the quarter was also contributed by higher production of cocoa. Besides the higher price of cocoa that has motivated better agronomic practices among the smallholders, several yield improvement programmes have led to the expansion in cocoa output. These programmes included the on-going smallholders' rehabilitation scheme.

The developments such as the Iraq war and the outbreak of the SARS disease in the regional countries had a minimal impact on the overall performance of the agricultural sector. Although the war had briefly affected orders and disrupted palm oil shipments to the Middle East, the overall external demand for palm oil remained strong, as reflected by the sharp increase in export receipts of 54.6% during the quarter. Similarly, the impact of SARS on the agriculture sector was negligible, briefly affecting Malaysia's vegetable exports to Singapore.

Continued strong expansion in the mining sector

After the strong performance in the last two quarters of 2002 (7-8% growth), the **mining sector** expanded further by 3.8% in the first quarter of 2003. Growth emanated mainly from higher production of **natural gas** by 5.8%. There was a significant increase in new capacity following the commencement of several new gas fields since 2002 to accommodate increased demand from the newly operational MLNG Tiga plant in March and the power generation plants. The increased production in gas was also supported by higher external demand for LNG during the period, with Japan accounting for the bulk of the exports. Meanwhile, **crude oil** (including condensates) production grew by 2.8% to 726,630 barrels per day in response to increased demand, both domestic and abroad. In particular, demand from domestic petroleum refineries increased by 3.6%, while export volume grew by 4.2%. Higher demand were mainly from buyers in the Asian region.

Performance of the Mining Sector

	2002			2003
	1Q	4Q	Year	1Q
	Annual change in %			
Value Added (RM million at 1987 prices)	**1.4**	**7.1**	**3.7**	**3.8**
Production				
Of which:				
Crude oil and condensates ('000 barrels)	4.0	7.4	4.9	2.8
Natural gas (net) (million standard cubic feet)	-1.6	9.3	3.5	5.8
Exports (RM million)	**-29.4**	**29.3**	**-4.4**	**50.9**
Of which:				
Crude oil				
('000 tonnes)	-0.8	5.5	7.4	4.2
(US$/barrel)	-26.1	37.2	-2.9	61.3
(RM million)	-26.7	44.7	4.3	68.0
Liquefied natural gas				
('000 tonnes)	-3.3	12.9	-2.6	6.9
(RM/tonne)	-23.2	6.6	-8.3	28.8
(RM million)	-25.7	20.4	-10.7	37.8

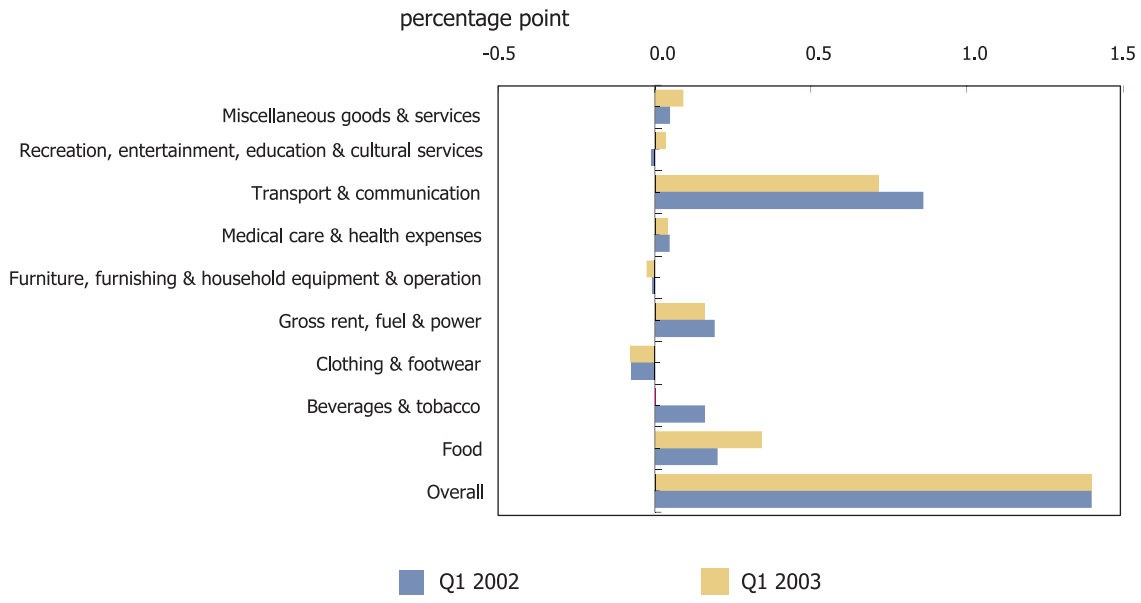
On the price front, the Malaysian crude oil price benefited from developments in the international oil markets during the quarter, with the export unit value for Malaysian crude oil averaging higher at US$32.63 per barrel, or an increase of 61.3% on a year-on-year basis. Reflecting continued strong growth in the external demand for crude oil and LNG and supported further by the sharp increases in prices, aggregate mineral exports rose sharply by 50.9% during the quarter.

Inflation remained low

Inflation, as measured by the annual change in the Consumer Price Index (CPI), remained low at 1.4% during the first quarter of 2003 (1Q 2002: 1.4%; 4Q 2002: 1.8%).

Food prices were higher compared with the first quarter of 2002, driven mainly by higher prices for food items taken at home. Prices for transport and communication as well as beverages and tobacco, on the other hand, registered slower increases, mainly on account of the lapse of the impact of increases in retail petrol prices and sales

Contribution to Inflation



tax on tobacco products. The price increases were implemented in October 2001.

The annual increase in CPI averaged 1.6% in the first two months of 2003 but moderated to 0.7% in March. This was due to the lapse of the impact of the higher tariff on telephone services implemented in March 2002.

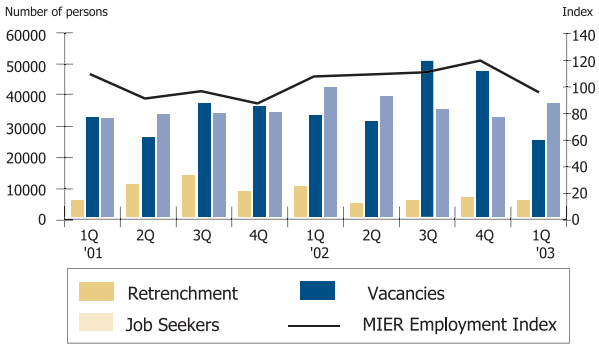
Stable labour market conditions

In the first quarter of 2003, the overall labour market conditions remained stable. During the quarter, workers retrenched were considerably lower than the preceding and corresponding quarters of 2002 by 13% and 46% respectively. At the same time, an additional 16,859 workers were affected by less severe cost-cutting measures adopted by employers that included temporary layoffs, pay cuts and voluntary separation schemes. The workers impacted by these measures were also significantly lower than the preceding and corresponding quarters of 2002 by 39% and 46% respectively as the slowdown in demand for products was viewed as transitory and cyclical in nature.

The impact of the uncertainties surrounding the global economic outlook on the domestic economy was reflected by registered job vacancies (25,052) which was lower than registered job seekers (36,946) causing the ratio of vacancies to job seekers widening to 1:1.5 at the end of March 2003 from 1:1.3 and 1:0.6 at the end of March and December 2002 respectively.

Labour productivity improved during the quarter. Data from the Monthly Survey of Manufacturing Industries undertaken by the Department of Statistics showed that labour productivity as measured by the real sales value of products per employee increased further by 9.4% (4Q 2002: 6.0%). Real wage per employee also increased by 3.1% (4Q 2002: 2.0%).

Labour Market Conditions



External sector characterised by strong trade surplus and rising external reserves

The trade surplus was larger at RM17.6 billion in the first quarter (4Q2002: RM14.8 billion), the largest since the first quarter of 2000.

Gross exports expanded by 7.8% supported by exports of manufactured goods, agriculture and minerals. The slower rate of growth in manufactured exports of 1.7% was attributed mainly to lower exports of electronic equipment and parts and electrical goods amidst increased competition from lower cost producing countries. This resulted in declines in export volume and prices of electrical goods. Meanwhile, semiconductor exports continued to register robust growth in line with similar trends in the other regional economies. Global demand for semiconductors remained strong, particularly in the Asia-Pacific region. Other major manufactured goods exports, namely chemicals, petroleum products, textiles, manufactures of metal, optical and scientific equipment and food products,

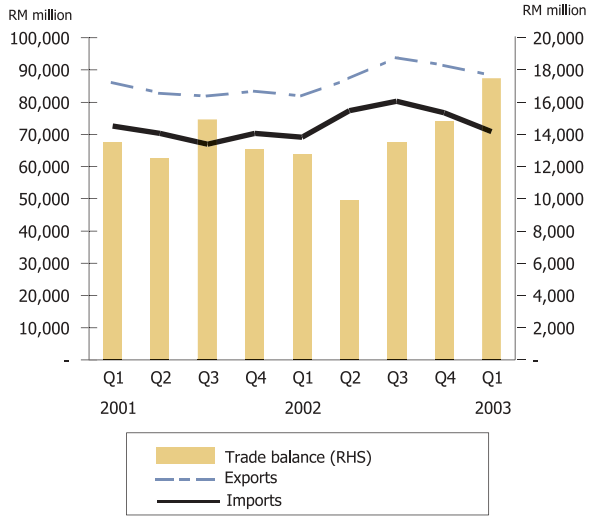
continued to expand strongly. Overall, the volume of manufactured exports grew by 7.5%, while export prices in the sector declined by 3.3% (7.5% and -1.3% respectively in fourth quarter of 2002).

Export earnings from agriculture increased by 41.8%. Exports of palm oil remained strong during the quarter, increasing by 54.6%, attributable to higher export prices and volume. Export prices of palm oil averaged higher at RM1,658 per tonne amidst the tight global supplies of vegetable oils. Overall, export volume of palm oil remained favorable despite a brief disruption in shipments to the Middle East market following the outbreak of the war in late March. Demand, particularly from major buyers, namely, China, European Union and India, grew strongly by 17 - 35%.

Export earnings from minerals rose by 50.9%, attributable to higher proceeds from crude oil and LNG. During the quarter, export prices of Malaysian crude oil strengthened to US$32.63 per barrel (4Q 2002: US$28.03), reflecting primarily developments in the global oil markets. Factors include the price premium related to the war risks, low inventories in the United States and supply disruptions in a few major producing countries. Export prices of LNG were also higher during the quarter in tandem with the trend in oil prices. Overall, the strong performance of mineral exports during the quarter was driven by both increases in volume and prices.

The diversification of export markets has improved since the third quarter of 2002. The diversification of markets is measured by the

Trade Balance

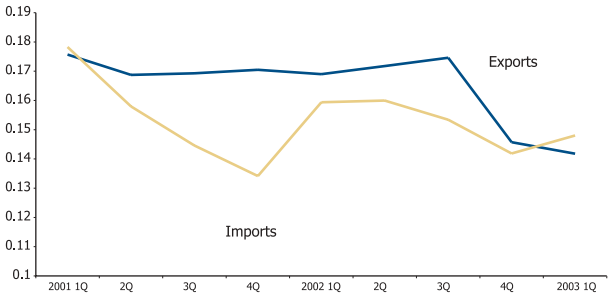


Trade Account

	2002			2003
	1Q	4Q	Year	1Q
	Annual change in %			
Gross Exports	**-4.9**	**9.7**	**6.0**	**7.8**
Manufacturing	-4.0	5.2	4.8	1.7
Agriculture	7.0	49.3	31.9	41.8
Minerals	-29.4	29.3	-4.4	50.9
Gross imports	**-4.8**	**9.0**	**8.3**	**2.3**
Capital goods	-9.9	6.6	10.6	-5.0
Intermediate goods	-5.8	7.0	6.2	2.5
Consumption goods	6.7	22.1	15.9	4.7
Trade balance (RM bn)	**12.8**	**14.8**	**51.0**	**17.6**

Source: Department of Statistics, Malaysia

Diversification Index



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

normalized Herfindahl-Hirschman index where a ratio closer to zero reflects increasing diversification. The index was constructed for 32 of Malaysia's major trading partners which account for 93% of total exports. Reflecting the increasing diversification in export markets, the index declined from 0.17 in the third quarter of 2002 to 0.14 in the first quarter of 2003.

Exports to regional countries (excluding Japan) which accounted for 45.4% of Malaysia's exports, continued to grow by 14% (4Q2002: 18.4%). The impetus to this growth stemmed from the continued strong export growth of 24.3% and 41.3% to the People's Republic of China and Hong Kong China respectively. Exports to Japan and the European Union, which accounted for a share of 11.8% and 13%, continued to grow by 3.2% and 7% respectively. However, exports to the United States recorded a decline of 12.8% reflecting the lower exports of electrical and electronic products, particularly parts and accessories of computers. Nevertheless, exports of optical and scientific instruments, rubber products and chemicals to the United States continued to increase.

Real effective **exchange rate of the ringgit** has depreciated since June 2002. This provided further support to the expansion in exports as reflected in the strong volume growth of commodities and manufactured exports, which grew in the range of 5% to 27% and 9% to 29% respectively. The dip in the volume of commodity exports in November 2002 was due mainly to lower off-take of palm oil by major buyers in the EU, the Middle East and Pakistan, which built up stocks in

Malaysia: Direction of exports to the regional countries

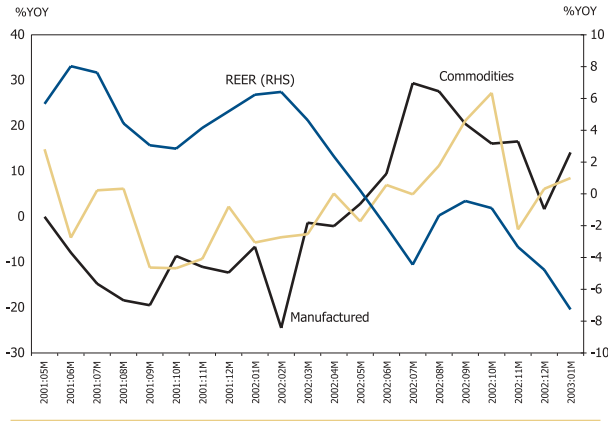
	2002		2003	2002		2003	2002		2003
	1Q	4Q	1Q	1Q	4Q	1Q	1Q	4Q	1Q
	RM million			% share of total exports			% annual change		
Singapore	14,064	15,335	14,766	17.2	16.8	16.7	-4.4	6.3	5.0
Thailand	3,631	3,842	4,066	4.4	4.2	4.6	4.9	35.8	12.0
Indonesia	1,568	1,715	1,836	1.9	1.9	2.1	18.8	5.2	17.1
Philippines	1,241	1,177	1,316	1.5	1.3	1.5	-2.4	-0.1	6.1
Brunei Darussalam	206	238	258	0.3	0.3	0.3	-16.1	-4.9	24.8
Vietnam	492	619	673	0.6	0.7	0.8	9.5	47.0	36.9
Selected ASEAN Countries	21,202	22,926	22,915	25.9	25.1	25.9	-1.2	10.5	8.1
People's Republic of China	4,191	5,633	5,208	5.1	6.2	5.9	24.8	34.4	24.3
Hong Kong China	4,002	6,150	5,657	4.9	6.7	6.4	12.0	56.2	41.3
Chinese Taipei	3,013	3,298	3,251	3.7	3.6	3.7	9.1	-8.4	7.9
South Korea	2,794	3,511	3,105	3.4	3.8	3.5	-12.1	34.8	11.1
Total	**35,202**	**41,518**	**40,136**	**43.0**	**45.4**	**45.4**	**2.5**	**18.4**	**14.0**

Source: Department of Statistics, Malaysia

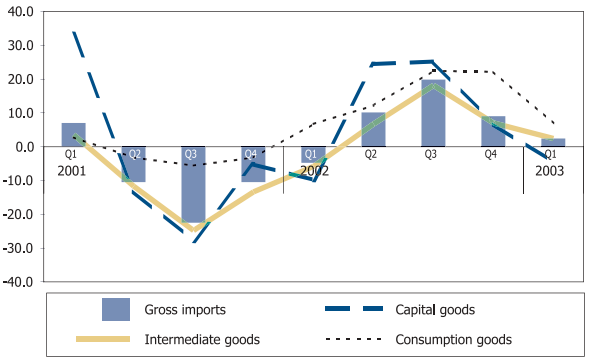
the preceding periods. The slowdown in the volume of manufactured exports in December 2002 was reflected the closure of ports on the west coast of the US. Subsequently, the volume picked up in January 2003.

In the first quarter, imports continued to grow, albeit at a slower rate of 2.3%, reflecting

Real Effective Exchange Rate (REER) & Export Volume



Import growth



mainly the moderate expansion in imports of intermediate goods (2.5%). The moderation in intermediate imports, which accounted for 72.6% of total imports, was due to the decline in imports of parts and accessories of capital goods used as inputs for the export-oriented electronics industry.

Changing structure of imports

The share of imports for domestic use has been increasing since 1998 from 14% to 18.2% of total imports in 2002. Imports for production for the domestic market grew by 9.7% in 2002 supported by the increase in imports of intermediate inputs namely, imports of parts and accessories of transport equipment and food and beverages for industry. Imports of consumer goods, especially durable goods, caused imports of consumption goods to increase by 15.9% in 2002.

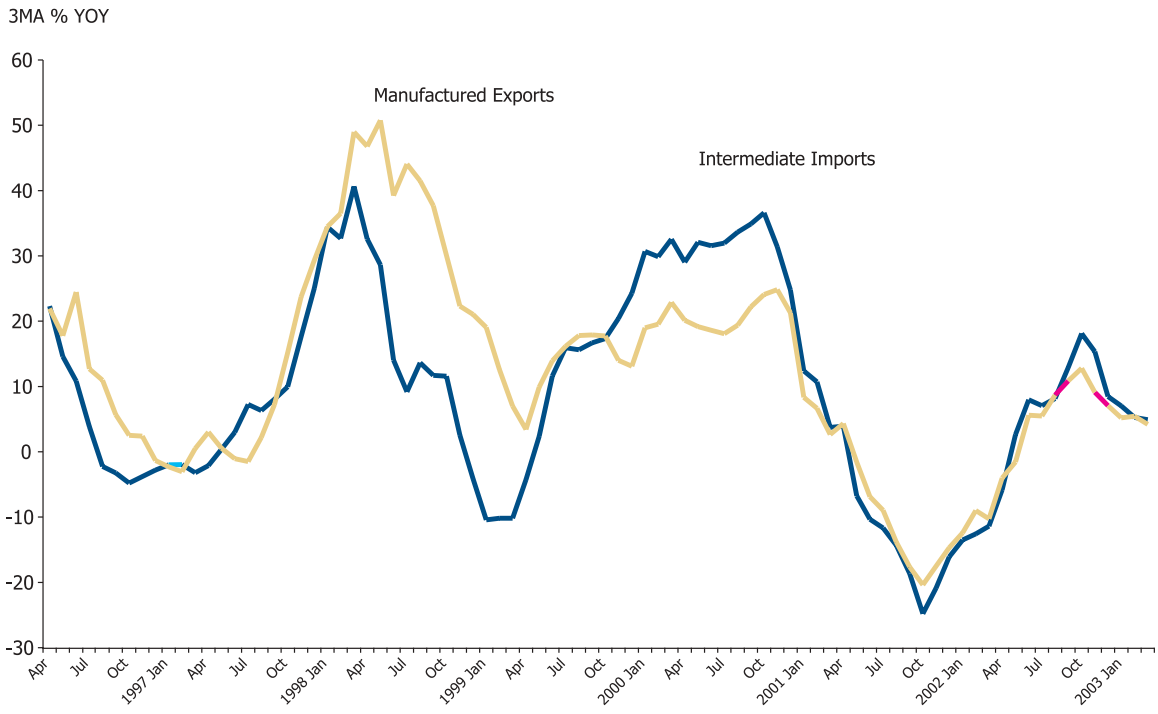
Malaysia: Imports For Domestic Use

	1995	1996	1997	1998	1999	2000	2001	2002
	% share of total imports							
1 Capital goods	**3.9**	**7.7**	**3.7**	**2.0**	**1.8**	**2.0**	**2.2**	**2.2**
Capital goods (except transport equipment)	3.2	6.1	2.8	1.9	1.6	1.7	1.8	1.8
Metal tools	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Metal containers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Agricultural equipment (incl tractors)	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Construction and mining equipment	1.2	2.5	0.9	0.1	0.1	0.2	0.2	0.2
Generators, turbines and electric motors (incl transformers)	1.6	3.0	1.4	1.5	1.3	1.3	1.3	1.3
Refrigerators	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Air-conditioners	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Transport equipment, industrial	0.7	1.6	1.0	0.2	0.2	0.3	0.4	0.4
Commercial vehicles and buses	0.7	1.6	1.0	0.1	0.2	0.3	0.4	0.4
Trailers and containers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2 Intermediate goods	**4.8**	**5.2**	**5.0**	**4.7**	**5.0**	**6.4**	**7.8**	**7.7**
Food and beverages, primary, mainly, for industry	0.7	0.7	0.7	0.8	0.8	0.6	0.7	0.8
Food and beverages, processed, mainly for industry	0.8	0.8	0.8	1.0	0.8	0.6	0.9	0.9
Fuel and lubricants, primary	0.3	0.4	0.4	0.5	0.7	1.7	2.3	1.8
Fuel and lubricants, processed	1.3	1.5	1.6	1.6	1.6	2.2	1.8	1.9
Parts and accessories of transport equipment	1.7	1.8	1.5	0.9	1.1	1.3	2.0	2.4
3 Consumption goods	**6.2**	**6.4**	**6.3**	**5.6**	**6.0**	**5.5**	**5.9**	**6.3**
Food and beverages, primary, mainly, for household consumption	0.8	0.8	0.8	0.8	0.8	0.7	0.9	0.8
Food and beverages, processed, mainly for household consumption	1.4	1.7	1.7	1.7	1.6	1.4	1.7	1.6
Transport equipment, non-industrial	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.1
Consumer goods, n.e.s.	3.8	3.8	3.7	3.1	3.5	3.4	3.3	3.9
Durable	0.9	0.8	0.7	0.4	0.6	0.6	0.6	0.9
Semi-durables	1.4	1.4	1.4	1.2	1.3	1.4	1.2	1.4
Non-durables	1.6	1.5	1.6	1.4	1.6	1.3	1.5	1.6
4 Dual use goods	**2.8**	**2.9**	**2.8**	**1.7**	**2.0**	**2.1**	**2.1**	**2.0**
Fuel and lubricants, processed, motor spirit	0.6	0.7	0.9	1.0	0.7	0.8	0.9	0.8
Transport equipment, passenger motor cars	2.2	2.2	2.0	0.7	1.3	1.3	1.2	1.2
Total	**17.7**	**22.2**	**17.9**	**14.0**	**14.8**	**16.0**	**18.0**	**18.2**

Source: Department of Statistics, Malaysia

The growth in imports of intermediate inputs correlates closely with the growth in manufacturing production index and manufactured exports. Monthly data for the period 1996 to 2001 indicate that intermediate imports is a leading indicator for manufacturing exports. While growth in manufacturing exports used to lag by several months the growth in intermediate imports, growth in manufactured exports and imports of intermediate goods have moved in tandem since the first quarter of 2002, reflecting lower holding of inventories and wider implementation of just-in-time production.

Manufactured Exports and Intermediate Imports



Reflecting the sustained growth in private consumption, imports of primary and processed materials used for the food and beverages industry registered an increase of 31.4% during the quarter. Consonant with sustained private spending, imports of consumption goods increased by 4.7%. Imports of capital goods, excluding lumpy imports, increased by 0.3%, reflecting continued growth in investment.

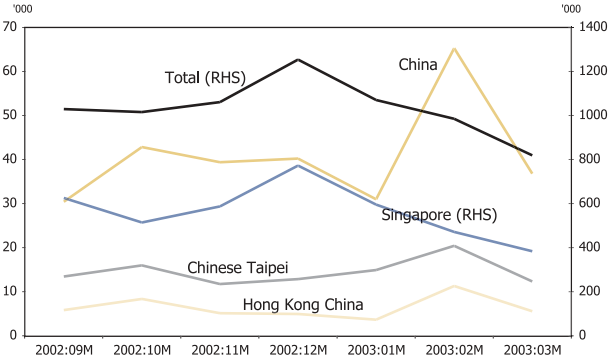
Malaysia: Imports by Economic Function: Broad Economic Categories (BEC) Classification

	2002		2003	
	1Q	4Q	1Q	
	Annual change in %			RM mil
CAPITAL GOODS	**-9.9**	**6.6**	**-5.0**	**9,678**
Capital goods (except transport equipment)	-11.7	7.5	0.2	9,148
Transport equipment	9.1	-11.7	-49.9	530
INTERMEDIATE GOODS	**-5.8**	**7.0**	**2.5**	**51,354**
Food and beverages, mainly for industry	33.8	0.9	31.4	1,550
Industrial supplies, n.e.s.	-8.3	10.7	7.5	15,686
Fuel and lubricants	-4.1	17.4	30.9	3,180
Parts and accessories of capital goods (except transport equipment)	-7.6	5.3	-2.9	29,399
Parts and accessories of transport equipment	50.5	-6.8	-3.9	1,540
CONSUMPTION GOODS	**6.7**	**22.1**	**4.7**	**4,499**
Food and beverages, mainly for household consumption	3.7	-8.0	0.5	1,762
Transport equipment, non-industrial	23.9	28.7	110.2	74
Consumer goods,n.e.s.	8.7	49.1	6.1	2,663
Durables	19.0	154.6	15.3	630
Semi-durables	4.8	28.0	-10.2	842
Non-durables	7.4	23.8	16.2	1,190
DUAL USE GOODS	**-10.3**	**16.2**	**28.8**	**1,784**
OTHERS	**43.2**	**14.4**	**3.4**	**1,582**
RETAINED IMPORTS	**-5.1**	**8.2**	**2.1**	**68,897**
RE-EXPORTS	**7.8**	**40.5**	**12.1**	**1,875**
GROSS IMPORTS	**-4.8**	**9.0**	**2.3**	**70,772**

Sustained Tourist Arrivals

Tourist arrivals remained steady at 2.9 million for the quarter despite the heightened geopolitical risk. Tourist arrivals were sustained at a monthly average of one million arrivals but declined to 0.8 million in March due mainly to the onset of SARS. The SARS impact, with the issue of the WHO travel advisory beginning mid-March, was more concentrated among tourist arrivals from Singapore and Hong Kong China. The decline in arrivals from Singapore and Hong Kong China was mitigated by higher number of visitors from the other countries, including double-digit growth in tourists from Brunei (53.2%), Africa (45.8%), Thailand (28.9%), West Asia (23.5%) and US (10.3%). Going forward, measures announced in the economic stimulus package on 21 May provides further support to the tourism industry to offer attractive packages to encourage the return of tourists.

Monthly Tourist Arrivals



Source: Malaysian Tourism Promotion Board

The Cash BOP Reporting System of Bank Negara Malaysia showed that gross inflow of FDI in the form of direct equity and inter-company loans (excluding retained earnings) amounted to RM3.1 billion in the first quarter, compared to the gross FDI inflow of RM2.9 billion in the first quarter of 2002.

In terms of composition, gross inflows of FDI during the first quarter were mainly through inter-company loans. About 60% of the loans were received from a related company by an MNC, through its centralised treasury operations in Malaysia. Direct equity inflows continued to be channelled into the manufacturing sector and the oil and gas sector. Outflows of FDI during the first quarter reflected largely the higher repayment of short-term inter-company loans, and payment for acquisition of foreign interests in the gas sector by a Malaysian company. The latter was attributed to the

expiry of a joint venture agreement in the production of liquefied natural gas. After taking into account the gross outflows, FDI recorded a net outflow of RM3.3 billion. The outflows were mainly to fund the change in ownership of business interests from non-resident to residents, and thus did not have an impact on economic activity in the country.

The heightened uncertainty in the external environment led to lower investment abroad by Malaysian companies. Investment was mainly by the oil and gas sector and the manufacturing of composite component parts for the aerospace industry. There were also some inflows in the form of repayment of inter-company loans extended to subsidiaries or associates abroad. On a net basis, overseas investment recorded a reduced net outflow of RM1.1 billion (4Q 2002: -RM2.1 billion). Outflow of portfolio investment was also much lower at RM1.6 billion in the first quarter (4Q 2002: -RM3.7 billion).

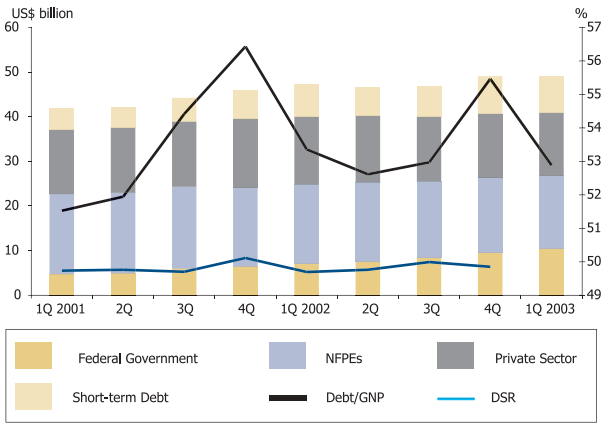
External debt remains manageable

Malaysia's total external debt stabilised at RM186.8 billion (US$49.1 billion) as at end-March 2003, equivalent to 52.9% of GNP. The **medium and long-term external debt**, increased marginally to RM155.9 billion or US$41 billion (4Q2002: RM154.4 billion) during the quarter, attributed mainly to the reclassification of a domestic foreign currency loan raised from Labuan banks into external loan. The external debt of the non-financial public enterprises (NFPEs), which had been on the downward trend since the third quarter of 2002, continued to record a smaller drawdown of RM413 million. Another positive development in the quarter was the full settlement of some large loans by the NFPEs, resulting in a large repayment of RM2.5 billion (4Q2002: RM1.7 billion). The drawdown of external loans of RM2 billion by the private sector, was mainly in the utilities and oil and gas sectors, while the bulk of the repayments were effected by companies operating in the electrical, telecommunication and chemicals industries.

External Debt Outstanding

	2002		2003
	1Q	4Q	1Q
	RM billion		
Medium & Long-term debt	152.2	154.4	155.9
Public sector	94.4	100.6	101.6
Private sector	57.8	53.8	54.3
Short-term debt	27.3	32.2	30.9
Total external debt	179.5	186.6	186.8
- US$ billion equivalent	47.2	49.1	49.1

External Debt



The total **short-term external debt** was lower at RM30.9 billion (US$8.1 billion), reflecting a decline in the revolving credits facilities of the non-bank private sector, arising mainly from the

repayment of these facilities by several major companies, particularly from the oil and gas sector. As at end-March, the short-term debt accounted for only 16.5% of total external debt, one of the lowest in the region and is about 23.3% of the net international reserves.

Reserves increased further

The rising trend in the international reserves of Bank Negara Malaysia continued during the first quarter. As at 31 March 2003, the net international reserves amounted to RM132.6 billion or US$34.9 billion, an increase of RM1.2 billion or US$0.3 billion since end-2002. The increase in reserves was attributed mainly to the sustained repatriation of export earnings and to a lesser extent, steady inflow of investment income. The reserves level had also taken into account the unrealised foreign exchange revaluation gain arising from the quarterly adjustment of reserves amounting to US$211 million, mainly as a result of the appreciation of euro against the US dollar during the first quarter. The international reserves increased further by RM7.1 billion or US$1.9 billion during April to the first half of June to RM139.7 billion or US$36.8 billion as at 13 June 2003. The reserves position is adequate to finance 5.7 months of retained imports and is 4.6 times the short-term external debt.

Federal Government Finance

Fiscal stance remained expansionary

In the first quarter, the fiscal stance remained expansionary. Development expenditure increased substantially to support domestic economic activities. Together with traditionally lower revenue collection during the quarter, the Federal Government's financial position recorded a higher deficit.

Federal Government Finance [p]

	2002		2003
	1st. qtr.	4th. qtr.	1st. qtr.
	RM million		
Revenue	17,143	27,341	14,748
Operating expenditure	14,716	22,538	11,650
Current account	**2,427**	**4,803**	**3,098**
(% of GDP)	***2.9***	***5.0***	***3.3***
Net development expenditure	3,713	14,616	7,775
Gross expenditure	*3,892*	*15,162*	*7,840*
Less: Loan recoveries	*179*	*546*	*65*
Overall balance	**-1,286**	**-9,813**	**-4,677**
(% of GDP)	***-1.5***	***-10.1***	***-5.0***
Sources of financing:			
Net domestic borrowing	-2,400	3,976	8,800
Net foreign borrowing	2,929	2,611	-26
Realisable assets[1]	757	3,164	-4,100
Total	**1,286**	**9,813**	**4,677**

[p] Preliminary.

[1] Include changes in Government Trust Fund balances. A decrease in accumulated realisable assets is indicated by a positive (+) sign.

Source: Accountant General of Malaysia

The more moderate Federal Government revenue during the quarter reflected lower collection of both corporate income tax (-31%) and individual income tax (-2%). Lower corporate income tax was due largely to the high base in 2002. Collections were also affected by the tax incentives given in the 2003 Budget to increase domestic investment in niche areas in the services, agriculture and manufacturing sectors. Tax incentives were also given to businesses to reduce their cost of operations. Other direct taxes collection, particularly stamp duties were also lower due to subdued performances of both the stock and residential property markets.

Federal Government Revenue [p]

	2002		2003	
	1st. qtr.	4th. qtr.	1st. qtr.	
	RM million			% share
Tax revenue	14,384	19,542	12,445	84.4
Direct taxes	9,766	12,705	8,361	56.7
of which:				
Income tax	9,381	12,124	7,973	54.1
Corporate	*5,108*	*8,907*	*3,551*	*24.1*
Petroleum	*500*	*2,324*	*707*	*4.8*
Personal	*3,772*	*853*	*3,686*	*25.0*
Co-operative	*1*	*41*	*29*	*0.2*
Stamp duties	346	463	326	2.2
Real property gains tax	26	104	51	0.3
Indirect taxes	4,618	6,836	4,084	27.7
of which:				
Export duties	149	285	223	1.5
Import duties	709	1,037	670	4.5
Excise duties	1,057	1,299	989	6.7
Sales tax	1,896	2,903	1,474	10.0
Service tax	390	752	378	2.6
Non-tax revenue & non-revenue receipts	2,758	7,800	2,303	15.6
Total	**17,143**	**27,341**	**14,748**	**100.0**

[p] Preliminary.

Source: Accountant General of Malaysia

In the indirect taxes category, receipts from export duties were higher (+50%) due to higher prices of petroleum (US$32.64 per barrel in the first quarter of 2003 against US$20.23 per barrel in the corresponding quarter). Collection of sales tax was lower (-22%) due to larger revenue foregone arising from the subsidy transferred to maintain stable prices for retail petrol pump as well as lower sales of cars. The lower car sales also resulted in lower collection of excise duties (-6.5%). New tax measures also affected collection of service taxes (-2.9%). Measures included service tax exemption for courier service provided from a point within Malaysia to a destination outside Malaysia, and

selected professional services provided to companies within the same group. Meanwhile, collection of import duties was lower (-5.5%) in almost all sub-sectors.

At the same time, total expenditure increased by 4.7% to RM19.5 billion due entirely to higher development expenditure. Higher development expenditure was expended mainly for social and economic programmes. In terms of allocation, expenditure was mainly channelled for education (37.5%), infrastructure (13.5%) and industrial development (12.8%).

Higher Federal Government debt - but within sustainable level

The outstanding debt of the Federal Government was higher at RM175.3 billion as at end-March 2003. In terms of GDP, the level of debt was contained at 45.9% of GDP (45.7% of GDP as at end-2002). This level of debt remained manageable, with domestic debt accounting for 78% of the total debt.

The net increase in outstanding debt reflected mainly the increase in net domestic borrowings. The issuance of government securities in the domestic market during the quarter under review amounted to RM19.1 billion. The Federal Government floated five issues of Malaysian Government Securities (MGS) totalling RM17.1 billion by way of open tender through principal dealers, as well as via private placements. A sole issue of the Government Investment Issues (GII) amounting to RM2 billion was also raised. Given the ample liquidity situation, the issuance of these securities did not 'crowd out' the private sector's financing requirements. After adjusting the reclassification of a foreign-denominated syndicated loan as external debt, the total outstanding domestic debt of the Federal Government stood at RM135.9 billion as at end-March 2003.

As part of prudent debt management to reduce the cost of debt servicing, the Federal Government refinanced its dual-currency syndicated loan raised in 1999. Outstanding external debt of the Federal Government increased from RM36.3 billion as at end-December 2002 to RM39.4 billion as at end of March 2002, due mainly to the reclassification of a foreign-denominated syndicated loan. The loan, which was raised in Labuan, was previously classified as a domestic loan. The Federal Government external debt remains low accounting for 21% of the nation's outstanding debt.

Federal Government Debt

	Change over preceding period			As at end of March 2003	
	2002		2003		
	1Q	4Q	1Q		
	RM million				% share
Domestic debt	-2,424	4,118	7,211	135,891	77.5
Government securities	-2,400	4,000	6,800	116,350	66.4
Other loans[1]	-24	118	411	19,541	11.1
External debt	2,665	4,160	3,114	39,397	22.5
Market loans	2,770	3,612	3,137	31,811	18.1
Project loans	-105	548	-23	7,586	4.3
Total	242	8,278	10,326	175,289	100.0

[1] Include Treasury bills, Investment Issues, loans to the Treasury Housing Loans Division and foreign-denominated syndicated loan. In 2003, foreign-denominated syndicated loan was reclassified as external debt.

Numbers may not add up due to rounding.

Monetary and Financial Developments

Monetary policy remained accommodative in the first quarter of 2003 to support domestic economic activity. Interbank and retail rates continued to remain low and stable. Liquidity remained ample. Reflecting the low borrowing costs and continued access to financing, financing activity of the private sector was sustained during the quarter. Total gross financing through the banking