BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

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Bank Negara Malaysia Annual Report 2003

Malaysian Economy in 2003

The Malaysian economy expanded by 5.2% in 2003 to exceed earlier forecasts. Economic growth was broad based and balanced across all sectors, driven by strong domestic demand and augmented by a stronger export performance. The dampening impact on growth by the emergence of the severe acute respiratory syndrome (SARS) and geopolitical concerns in the first half of the year was overcome by the mutually reinforcing effects of strong economic fundamentals, supportive monetary and financial policies and an economic stimulus package. Growth accelerated in the second half-year.

GDP by Kind of Economic Activity (% change)

	2002	2003*p*	2004*f*
Real GDP	4.1	5.2	6.0 ~ 6.5
(RM billion)	219.3	230.7	244.6
Agriculture	3.0	5.5	2.6
Mining	3.7	4.8	5.5
Manufacturing	4.0	8.2	10.2
Construction	2.3	1.9	1.5
Services	4.1	4.1	5.2

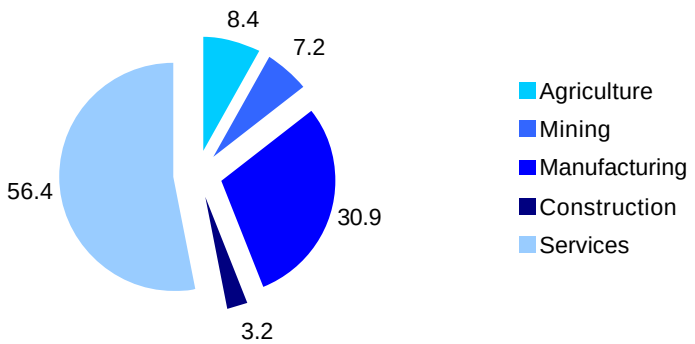
p Preliminary
f Forecast

All sectors of the economy expanded in 2003, in response to the strong domestic and external demand conditions. The manufacturing sector grew at a rapid pace following the broad based recovery in the global economy and strengthening domestic demand. Despite the outbreak of SARS in the first half of the year, the services sector recovered rapidly in the second half due to stronger domestic demand, as concerns receded following the global containment of the outbreak, as well as the timely introduction of the Government Economic Package to assist the affected industries and to boost consumer confidence. Stronger trade-related activities also ensured growth in the services sector remained resilient.

The agriculture sector recorded the strongest growth in 11 years driven mainly by higher production and prices, especially for crude palm oil and rubber. The stronger performance of the agriculture sector in 2003 generated significant spill over effects, particularly on the rural population. Given that the agriculture sector employs about 14% of the total workforce in Malaysia and that a sizable proportion of them are smallholders, the higher incomes helped support the increase in consumption among the rural community.

The mining sector expanded on the back of strong external and domestic demand, as well as increased production capacity from new oil and gas fields. Meanwhile, growth in the construction sector moderated due mainly to a slowdown in the civil engineering sub-sector following the completion of several privatised projects.

GDP by Sector in 2003
(% share)



Note: Adjustments have not been made for imputed bank service charges and import duties.

In 2003, GDP growth was private sector-driven. Private expenditure contributed 2.5 percentage points to the 5.2% growth rate. Both households and the corporate sector benefited from rising disposable incomes, the improving terms of trade for commodities and strengthening external demand. As a result of higher disposable income, especially for households, private consumption increased by 5.1%. In addition, the low interest rate environment, coupled with the high savings rate, provided the impetus for households to increase their borrowings for consumption expenditure. Measures unveiled in the Economic Package in May improved consumer confidence, further supporting consumption expenditure.

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

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

GDP by Expenditure Components (% change)

	2002	2003*p*	2004*f*
Real Aggregate Demand	4.2	4.8	5.0
Private Expenditure[1]	0.7	4.3	8.7
Consumption	4.4	5.1	8.1
Investment	-13.1	1.1	11.5
Public Expenditure[1]	10.8	5.5	-1.3
Consumption	12.2	7.9	4.2
Investment	9.8	3.6	-5.7

[1] Exclude stocks.

Malaysia's economic fundamentals continued to strengthen in 2003 with inflationary pressures remaining subdued amid low unemployment, the external position remaining robust, while international reserves continued to grow. In addition, the external debt position remained manageable and within prudential levels, with a significant proportion in longer-term maturities.

Inflation and Unemployment (%)

	2002	2003*p*
Inflation		
CPI (2000=100)	1.8	1.2
Core CPI[1]	0.5	0.6
Unemployment	3.5	3.5

p Preliminary

[1] Excludes price-controlled and price-volatile items as well as items that are subject to one-off price adjustments.

The overall inflation rate, as measured by the annual change in the Consumer Price Index (CPI), moderated to 1.2% in 2003. Despite strengthening domestic demand, price pressures were contained given the excess capacity in selected sectors and the absence of wage cost pressures, amidst improving labour productivity. Domestic labour market conditions remained stable and healthy in 2003, with the unemployment rate remaining low at 3.5%, and close to the level consistent with full employment.

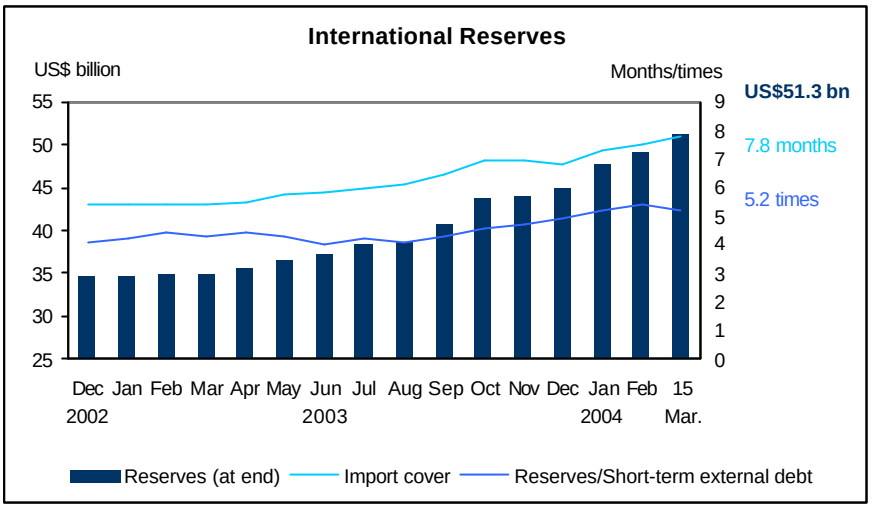
In 2003, the external sector's contribution to growth turned positive (2 percentage points; 2002: –1.3 percentage points), primarily due to the acceleration of exports of goods in the trade account by 11.5% in 2003 (2002: 7%). The trade surplus increased to RM81.1 billion (2002: RM54.6 billion) as a result of the stronger growth in manufacturing exports and the robust expansion in the export of commodities. On the other hand, import growth moderated to 4.8% (2002: 8.1%) as exports of primary commodities have low import content. Furthermore, the changing pattern of investment, especially foreign direct investment (FDI), into the services sector were smaller in scale

but have higher potential to generate value added. As a result, imports of capital goods remained relatively stable (0.7%).

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

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

In line with the stronger external position in 2003, the net international reserves of Bank Negara Malaysia increased by RM39.1 billion, or US$10.3 billion, to a record level of RM170.5 billion or US$44.9 billion as at end-2003. The reserves increased further to RM194.9 billion or US$51.3 billion as at 15 March 2004; sufficient to finance 7.8 months of retained imports and was 5.2 times the short-term external debt. In addition, Malaysia's external debt position in 2003 remained stable and within prudential limits, amounting to RM187.2 billion or 50.7% of GNP (2002: RM185.6 billion or 55.3% of GNP). Malaysia's external debt position is sustainable, with the debt service ratio improving from 6.7% in 2002 to 6.1% in 2003. In addition, the nation's debt profile remains healthy, with short-term debt accounting for only 18.4% of total external debt.

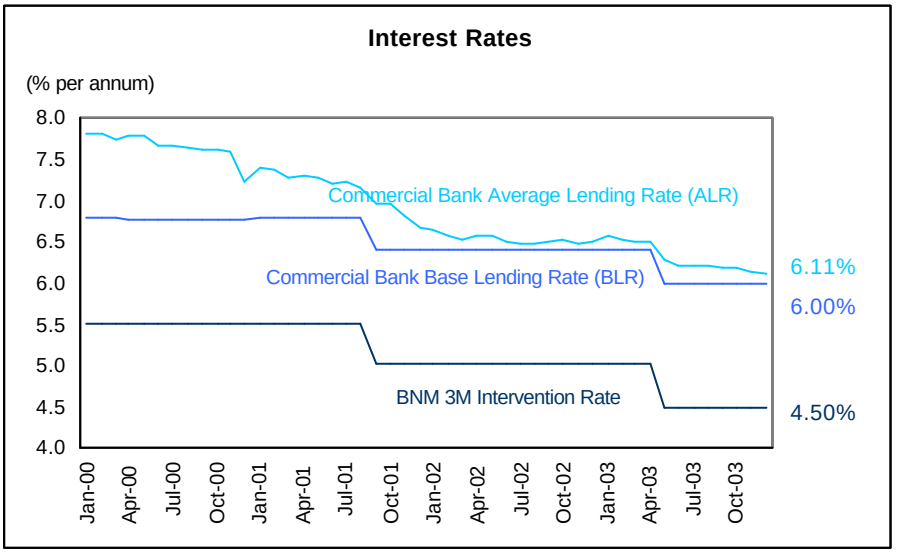


Macroeconomic Management in 2003

Macroeconomic policy in 2003 was focused on attenuating the impact of uncertainties emanating from global political developments and SARS and enhancing the long-term fundamentals of the economy. Pre-emptive monetary and fiscal measures by the Government helped to support and steer the economy through the challenging environment and provided the platform for the private sector to drive the economy forward in generating growth. For the longer term, a comprehensive strategic framework was also formulated to meet new challenges and sustain economic growth.

The Malaysian economy entered 2003 in a strong position. Private sector activity was exhibiting an upward trend. Commodity prices remained high, providing a significant positive multiplier effect on rural incomes. This was reinforced by the monetary and fiscal measures that gave further support to sustaining growth without increasing risks to the economy, given the benign inflation outlook, strong external position and the sustainable Government finances. It was therefore assessed that the economy had the resilience to absorb the impact of uncertainties that could adversely affect growth prospects.

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



With the additional expenditure and the revenue foregone arising from the relief measures implemented, the overall Federal Government deficit was revised from the budgeted 4% of GDP to 5.3% of GDP. The higher deficit did not, however, exert pressure on domestic consumer prices and interest rates as the high savings rate and

excess liquidity in the financial system made it possible for the bulk of the deficit to be financed from non-inflationary domestic sources. While the deficit led to higher Federal Government debt (48.2% of GDP as at end-2003), this level was sustainable. Debt servicing remained low (14% of operating expenditure). Similarly, the Federal Government external debt declined to 9.5% of GDP, thus lowering exposure to external risks.

In the low interest rate environment, the robust loan demand reflected the increased demand from both households and businesses, particularly SMEs. As a result, total financing from the banking system through loans and holdings of private debt securities increased by 5.9%. The demand for credit intensified in the latter part of the year as global economic conditions improved, consequently leading to a strengthening of the growth momentum in Malaysia. In particular, funding to the SMEs increased strongly with a large proportion of new loans directed to this segment. During the year, about 75,000 SMEs obtained new credit facilities totalling RM25.7 billion, accounting for a third of total approvals to the business sector. By end-2003, loans to SMEs had expanded by 10% and accounted for 38.4% of all loans outstanding to business enterprises.

Banking System[1] Loan Indicators

	2002	2003	Annual Growth (%)
	During the year (RM billion)		
Loan Applications	217.2	227.6	4.8
Loan Approvals	137.6	152.7	11.0
Loan Disbursements	411.6	441.7	7.3
Loan Repayments	402.7	430.5	6.9
Change in loans outstanding[2]	19.8	21.8	4.8

[1] Includes Islamic banks.

[2] The annual growth is for loans outstanding at end-period.

During a period of increased uncertainty in financial markets, the ringgit peg continued to benefit the economy by providing stability and predictability to facilitate

trade and investment activities. The ringgit continues to remain close to its fair value, with an absence of adverse pressures on the economy.

Performance of the Banking System

The banking sector remained resilient and well capitalised in 2003, with the risk weighted capital ratio (RWCR) sustained consistently above 13% throughout the year while asset quality improved. The capital base of the banking system strengthened due to higher profits and new capital injections while asset quality continued to improve as favourable economic conditions resulted in lower incidence of new NPLs, as well as strong recoveries and reclassifications of NPLs to performing. Including the value of collateral, the loan loss coverage ratio strengthened further to 157.9% on the 3-month basis and 163.8% on the 6-month basis.

Banking System Health[1]

	2002	2003*p*
Capital		
Core-capital ratio (%)	11.1	10.7
RWCR (%)	13.3	13.4
Net NPL ratio (%)		
6 months	7.4	6.8
3 months	10.1	8.7

[1] Excludes Islamic banks.

p Preliminary

Against the backdrop of improving economic conditions, gross operating profits of the banking system increased by 7% to RM11.8 billion in 2003, driven primarily by higher net interest income. Commercial banks and finance companies posted a growth in gross operating profit of 7.7% and 9.7% respectively, while it declined for merchant banks by 18.5%, mainly due to lower net interest income and income generated from fee-based activities.

Total loan loss provisions of the banking system declined by 4% during the year, attributed mainly to higher recoveries, which grew by 10.1% or RM384.8 million. The improved economic conditions and debt restructuring undertaken over the years strengthened the debt servicing capacity of borrowers, thus contributing to the higher recoveries. The decline in loan loss provisions, coupled with the higher gross operating profits, resulted in the preliminary unaudited pre-tax profits increasing by 10.2% to RM10.3 billion in 2003. Consequently, return on equity of the banking system increased to 17.1%, whilst the return on assets was 1.4%.

The structure of banking system loan portfolio has undergone significant changes since the Asian crisis, in terms of greater proportion of smaller-sized loans and more diversified customer base as a result of the greater focus on the retail and SME sectors. This has improved the risk distribution within the banking system in particular and the financial sector in general. On aggregate, outstanding loans of below RM1 million now accounted for 60% of total banking system loans, as compared to 48% during the pre-crisis period of 1996.

The financial sector restructuring that started during the Asian financial crisis is virtually complete. Following the closure of the Corporate Debt Restructuring Committee in August 2002, another important landmark in the financial sector restructuring process was the winding down of the operations of Danamodal Nasional Berhad on 31 December 2003, five years after its establishment in 1998. During its operations, Danamodal injected a total of RM7.1 billion into 10 banking institutions affected by the Asian financial crisis. Danamodal has recovered RM6.1 billion of the capital investment, while the remaining RM1 billion of capital injected in one institution is expected to be fully divested in 2004. Danaharta is also on track to unwind operations in 2005 in view of the significant progress in its recovery operations.

Management of the Banking System

Efforts to enhance the efficiency and competitiveness of domestic banking institutions were further intensified during the year, with particular focus on harnessing human capital in the banking institutions. A development in this area was the establishment of the International Centre for Leadership in Finance (ICLIF) by Bank Negara Malaysia. In collaboration with leading international business schools, the objective of the ICLIF is to provide a focused approach towards the development of world-class leaders in the financial and business sectors in Malaysia and the region.

Measures were also undertaken to safeguard financial stability. To strengthen the regulatory framework, the Central Bank of Malaysia Act 1958, the Banking and Financial Institutions Act 1989, the Islamic Banking Act 1983 and the Takaful Act 1984 were amended in 2003. A new Payment Systems Act 2003 was also enacted to formalise BNM's authority of oversight of the payment systems.

To ensure that all sectors of the economy had adequate and continued access to financing, policies were directed at facilitating access to credit by developing the financial infrastructure to meet the financing needs of various sectors of the economy, particularly the SMEs. Among others, measures include the establishment of a SME Special Unit in Bank Negara Malaysia to assist SMEs in loan application process, the establishment of a Small Debt Resolution Committee to facilitate loan restructuring of viable SMEs constrained by NPLs and additional allocations to the two Special Funds for SMEs. To alleviate the financial burden of sectors affected by the outbreak of SARS, Bank Negara Malaysia established the Special Relief Guarantee Facility with an allocation of RM1 billion in the form of a guarantee fund provided through the Credit Guarantee Corporation. Banking institutions were also requested to formulate appropriate rescheduling or restructuring schemes to reduce the financial burden of borrowers whose businesses and cash flows were affected by SARS.

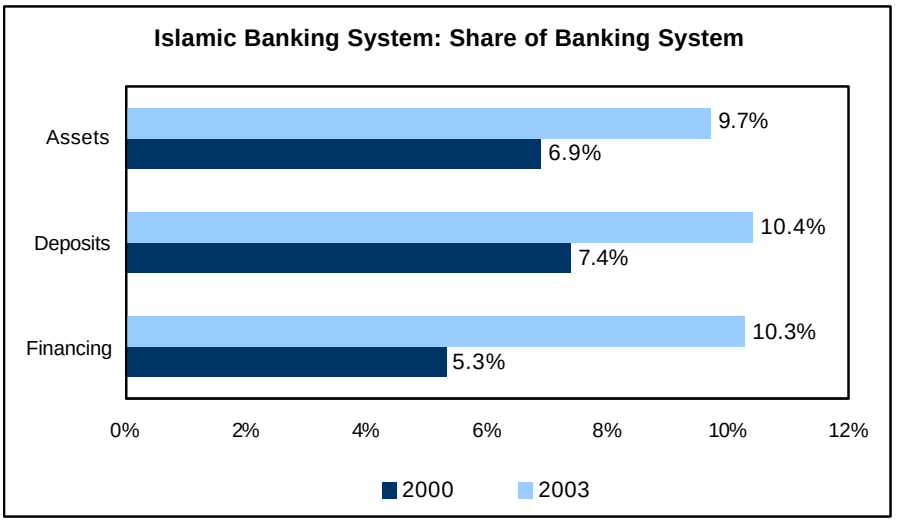
The framework for consumer awareness and protection was further strengthened in 2003. The work on this area is aimed at laying the foundation for a more competitive

operating environment and where banking consumers will be able to make well-informed decisions.

Progress continues to be made in implementing the recommendations of the Financial Sector Masterplan (FSMP). During the first three years of the implementation of the FSMP, a total of 31 out of the 119 recommendations have been fully implemented, with an additional 20 recommendations being implemented on a continuous basis. Efforts undertaken during the initial stages of the implementation were predominantly directed towards enhancing the effectiveness and competitiveness of domestic financial institutions, strengthening the regulatory and supervisory framework, promoting a safe and efficient payments system as well as developing the framework on consumer education and protection.

Islamic Banking System

Against the backdrop of a stronger economy and strong macroeconomic fundamentals, the Islamic banking industry continued to register strong expansion during the year to account for 9.7% of the total assets of the banking system (8.9% in 2002), 10.4% of total deposits (10.2% in 2002) and 10.3% of total financing (8.1% in 2002). The improved performance was characterised by strong capitalisation levels attributable to increase in capital and profits as well as higher financing activities with significant growth in financing for the purchase of transport vehicles and residential property. In addition, asset quality recorded further improvement with a declining trend in net non-performing financing ratio and high financing loss provisions.



The thrust of Islamic financial policy in 2003 continued to be directed at further strengthening the fundamental underpinnings of the Islamic banking system to support the development of a sound and progressive Islamic banking industry. The focus was on strengthening the institutional financial infrastructure, enhancing the regulatory framework, strengthening the Shariah and legal infrastructure as well as enhancing intellectual capital development and consumer education. In 2003, BNM brought forward liberalisation in Islamic banking to allow three full-fledged foreign Islamic banks to be set-up in Malaysia.

Development Financial Institutions

The financing activities of the development financial institutions (DFI) improved in 2003, in tandem with the overall growth of the economy. The DFIs provided financing to strategic sectors and sub-sectors of the economy. Total loans outstanding of the DFIs increased at an annual rate of 10.5% or RM3.1 billion (2002: 20.2% or RM5.0 billion) to RM32.5 billion as at end-2003, led by lending to the infrastructure sector and retail financing. The total outstanding credit insurance and guarantee coverage provided by DFIs increased by 14.1% to RM3.8 billion as at the end of the year.

Policies during the year remained focused on capacity building and enhancing the regulatory framework. To ensure the DFIs implement their mandated roles in the economy efficiently and effectively, a number of prudential measures were put in place to enhance their financial and operational soundness. To further equip the DFIs for their role as specialised institutions, initiatives on enhancing the advisory capability of DFIs to small and medium enterprises (SMEs) were commenced in 2003, while a policy on minimum capital requirements was initiated to ensure DFIs have the financial capacity to sustain their operations.

With the wide outreach of selected DFIs, the micro credit scheme announced by the Government as part of the Economic Package was launched and implemented by these DFIs. The objective of this programme is to unlock the potential of the large number of small businesses in contributing to domestic economic growth.

Outlook and Prospects for the Malaysian Economy in 2004

The outlook for the global economy has become increasingly optimistic following the strong upturn in the second half of 2003. For 2004, global economic growth is expected to expand at a faster pace of 4.1% (2003: 3.2%), while world trade is expected to expand strongly by 5% - 6% (2003: 3.5% - 4.5%). Growth in the major industrial economies as a group is estimated at 2.9% (2003: 2.2%).

In 2004, the collective real GDP growth of the Asian Newly Industrialised Economies (NIEs) is expected to accelerate at a rate of 5% - 5.2%, underpinned by robust export performance and a pick up in domestic demand. The ASEAN economies as a whole are expected to expand at a faster pace of 4.9% - 6% in 2004, with higher contribution from the domestic and external sectors. In addition, the increased importance of intra-regional East Asian (excluding Japan) trade and the central role of the People's Republic of China in stimulating the growth of exports in the region suggest that the strong growth prospects for the Chinese economy in 2004 will benefit the region as a whole.

The Malaysian economy is expected to strengthen further in 2004, based on the assumption of stronger global economic growth, an upturn in the global electronics cycle, firm prices for crude palm oil and crude oil, as well as continued expansion in intra-regional trade. Real GDP is expected to expand by 6% - 6.5%, underpinned by stronger domestic demand and reinforced by more favourable external demand. Growth will mainly be private sector driven, as the public sector gradually consolidates. The growing consumer and business confidence since the second quarter of 2003, strengthened economic fundamentals and the positive impact of pro-growth fiscal and monetary measures are expected to mutually reinforce robust consumer spending and the upturn in private investment activities.

Growth is expected to be supported by stronger performance in most sectors of the economy. Value added in the manufacturing sector is projected to increase further to 10.2% in 2004 (2003: 8.2%), supported by the pick-up in the global electronics industry and improved domestic demand. The services sector is expected to expand at a faster rate of 5.2%, reflecting higher expansion across most sub-sectors. Growth would be supported by higher trade and tourism activities and improved consumer spending. The services sector will also be supported by the rapid expansion in new growth areas, such as the shared services industry, namely call centres, data centres, operational headquarters, regional distribution centres and international procurement centres, as well as specialised types of ICT services.

The agriculture sector is expected to expand at the more moderate rate of 2.6% in 2004 as growth in the major commodities, particularly palm oil and rubber, are expected to moderate following the double-digit growth in 2003. Growth in the mining sector is expected to strengthen to 5.5% in 2004 led by higher gas output. Growth in the construction sector is envisaged to increase at a moderate rate of 1.5% due to lower activity in the civil engineering sub-sector in both the Government and the private sector. However, activities in the residential sub-sector is expected to remain strong given the increase in new housing starts during the first nine months of 2003, ongoing work on projects under construction, as well as favourable demand for residential

property, encouraged by the incentives granted under the Economic Package which are effective until the first half of 2004.

Malaysia's economic fundamentals are expected to remain strong in 2004. Inflation is expected to remain low at 1.5%, while the labour market is expected to improve.

The balance of payments is expected to remain strong in 2004, with a sustained current account surplus, reflecting the continued large surplus in merchandise trade and improvement in the services account. Despite the projected stronger growth in imports, the current account surplus is expected to remain large at 12.7% of GNP due to strong export growth, underpinned by the systemic upswing in global demand. FDI inflows into the manufacturing sector are expected to remain sizeable, mainly in the form of reinvestment by multinational companies for capacity expansion. The services sector is expected to continue to be a major recipient of new FDI inflows, especially in areas such as logistics, distribution and manufacturing-support services in view of the strong linkages between growth of the manufacturing and services sectors. Malaysia's overseas investment is likely to remain significant as companies seek to diversify and provide greater synergy to their operations in Malaysia. Malaysian investments abroad have continued to yield positive results. In 2003, profits and dividends accrued to Malaysian companies from their investments abroad increased to RM2 billion (2002: RM0.7 billion).

Economic, Monetary and Financial Management in 2004

The focus of policies in 2004 is on sustaining the momentum of economic growth and improving the long-term competitiveness and resilience of the Malaysian economy.

Amid improving economic conditions and the return of business and consumer confidence, the 2004 Budget is focused on facilitating the private sector to assume its lead role as the engine of growth, while engineering a gradual reduction in expenditure, in line with the objective of fiscal consolidation. In a recent review of the 2004 Budget,

the fiscal deficit for the year is expected to be 4.5% of GDP, against the fiscal deficit of 5.3% registered in 2003. While the pace of deficit reduction is gradual, the objective of fiscal consolidation remains on track. Given the ample liquidity in the financial system, the bulk of financing would continue to be raised from the domestic market with no risk of crowding out private sector financing.

Notwithstanding rising aggregate domestic and external demand, the existence of excess capacity and ongoing capacity expansion allow for the increase in demand and output to be met without creating pressures on supply and prices. Conditions of continued low inflation provide flexibility for monetary policy in 2004 to remain supportive of economic activities to sustain the growth momentum. With the investment cycle in its early stage, a low interest rate environment remains important to reinforce the private sector-led expansion, while providing flexibility for fiscal consolidation and strengthening growth. Over and above this, monetary policy will aim at improving the efficiency of credit flows to productive sectors of the Malaysian economy.

As part of continuing efforts to provide comprehensive information to the public on the Bank's policies, the Monetary Policy Statement (MPS) will continue to be issued on a quarterly basis together with the announcement of the GDP data. First released in August 2003, the MPS aims to contribute towards stable and efficient conditions in the financial markets by providing a statement of the Bank's policy intent, to enhance the effectiveness of monetary policy actions.

The thrust of financial sector policy in 2004 will continue to focus on building the capacity of domestic financial institutions, enhancing the resilience and stability of the financial sector, and ensuring that all sectors of the economy continue to have adequate access to financing. Attention is also given to strengthening the framework for consumer protection and promoting greater consumer awareness on banking and insurance products and services. The current benchmarking exercise will be further reinforced as a means to further increase performance and the service quality of the banking institutions and insurance companies. A number of domestic commercial banks are

expected to merge with their finance companies following the amendments to the Banking and Financial Institutions Act 1989 allowing for such mergers. The framework for creation of investment banks is also expected to be finalised in 2004.

Initiatives to strengthen the capacity of domestic banking institutions will be complemented by further enhancements to prudential regulations and surveillance infrastructure. As the banking sector remains the main source of financing in the economy, initiatives would be taken to further improve access to financing to all segments of the economy, especially the SMEs. Initiatives to encourage consumer activism and enhancing the consumer protection framework would remain a priority. The Financial Mediation Bureau would be established as a one-stop centre to provide customers with an avenue for legal redress against all financial institutions under Bank Negara Malaysia supervision and payments system operators. A framework to improve the level of transparency and disclosure on all retail financial products offered by the banking institutions to facilitate a more effective and well informed decision making by customers would be introduced during the year. It is expected that the legislation to introduce a deposit insurance system in Malaysia will be tabled before the Parliament in 2004.

In 2003, Bank Negara Malaysia made several enhancements to improve the RENTAS system (the major payment system for the financial system in Malaysia) and promoting the use of electronic payment systems and instruments. In line with the changing landscape, financial institutions began migration to chip based Cards and embarked on several other initiatives ranging from the setting up of the Financial Process Exchange, a multi-bank Internet payment platform, and further enhancements to Internet banking facilities. Going forward, Bank Negara Malaysia will continue to ensure the safety and efficiency of the payment systems and instruments in the country and that there is continued public confidence in the use of payment instruments. Bank Negara Malaysia also encourages the consumers, through the consumer education programmes, to avail themselves of the wide range of electronic payment facilities and products in line with the move towards the greater use of electronic means of payments.

In the Islamic banking sector, policies in 2004 will continue to focus on strengthening the financial infrastructure, enhancing the regulatory framework, strengthening the Shariah and legal infrastructure as well as enhancing intellectual capital development and consumer awareness. In line with developing the financial infrastructure, the window institutional structure of banking institutions participating in the Islamic Banking Scheme would be strengthened to provide for the effective regulation of Islamic banking operations based on its unique characteristics. The Islamic banking landscape will also be transformed with the issuance of up to three new Islamic banking licences to foreign financial institutions in 2004.

Measures to strengthen the Shariah and legal infrastructure includes the introduction of Guidelines on the Shariah Committee for Islamic banks, the development of an arbitration mechanism for Islamic banking and finance cases, the review of the Islamic Banking Act 1983 (IBA) to strengthen the legal framework for Islamic banking operations and the finalization of tax issues on Islamic banking and finance under the Law Review Committee to accord a neutral tax treatment between Islamic and conventional financial products. In addition, prudential regulatory standards will by refined to incorporate specific features of Islamic banking, while the depth of the market will be enhanced through the introduction of a variable rate financing mechanism, implementation of the Mudharabah and Musyarakah framework, as well as the development of an Islamic reference rate.

For DFIs, the thrust of policy will be guided by the strategic direction outlined in the FSMP. In 2004, emphasis will be accorded towards ensuring DFIs remain committed and focused on their mandated roles, as well as increasing the responsiveness of DFIs to the developmental requirements of identified priority sectors, including SMEs. Current initiatives to enhance the capability and capacity of DFIs in providing advisory services to their targeted clients would continue in 2004, complemented by initiatives to strengthen the risk management practices of the DFIs.

As part of the efforts to enhance efficiency in the operations in the financial system in the area of cross-border capital flows, foreign exchange administration rules will be relaxed further in 2004 with a view to improving the delivery system to ensure greater efficiency in the financial system. In addition, to deepen domestic capital markets, selected foreign entities would be allowed to issue ringgit bonds in Malaysia and to hedge the consequent exchange rate risk with onshore banks. The reporting requirements of exporters will also be simplified to promote efficiency, while in the interest of risk management; residents will have greater recourse to hedging instruments. At the same time, overnight limits on foreign currency accounts would also be revised. To facilitate the management of funds and risk diversification, resident institutions and individuals will be allowed greater latitude to invest abroad.

Bank Negara Malaysia's Audited Annual Accounts for 2003

Bank Negara Malaysia's financial position in 2003 has been examined and certified by the Auditor General. Total assets of the Central Bank rose to RM200.8 billion as at end-2003 (RM162.2 billion at end-2002). The major increase in assets was attributed to an increase in international reserves. Bank Negara Malaysia's international reserves increased to RM170.5 billion (US$44.9 billion) as at end-2003. The Central Bank registered a net profit of RM1.5 billion for the financial year ended 31 December 2003 and declared a dividend of RM1 billion to the Government for the year 2003.

Bank Negara Malaysia
26 March 2004