DEVELOPMENTS IN THE ECONOMY

International Economic Environment

Stronger growth in the US economy; growth of Asian region affected by SARS

The global economic environment improved in the second quarter. Growth in the US strengthened to 2.4% during the quarter (1Q: 1.4%), increasing the prospect of a US-led global recovery in the second half of the year. At the same time, the Japanese economy turned around, while the downturn in Europe continued, with Germany and Italy recording negative growth in the second quarter. Financial markets recovered strongly especially the global equity markets, which rose further following the increased optimism on global growth.

Going forward, latest indicators point towards stronger growth in the second half-year. The pace of recovery, nevertheless, will continue to be constrained by the structural imbalances in major industrial countries and rising long-term interest rates. In the foreign exchange market, the US dollar will remain vulnerable to concerns about the growing fiscal and current deficits in the US, as well as developments in the other major industrial economies. On balance, the strength of the global recovery will hinge on a sustained revival in corporate investments.

Industrial Countries: Real GDP Growth Signalled Further Improvement (annual growth, %)

	Yearly	Quarterly		
	2002	1Q '03	2Q '03	Key contributing factors
US	2.4	1.4	2.4	Higher defense outlays, consumption and business fixed investment
UK	1.8	2.1	1.8	Stronger consumer demand and household lending fuelled by lower interest rates
Germany	0.2	0.1	-0.2	Weak exports and unsettled labour markets outweighed improved consumer and business sentiment
Japan	0.2	1.3	2.3	Business investment improved but lower industrial production and weak consumption tempered optimism for economic recovery

Regional Countries: Real GDP Growth Affected by SARS (annual growth, %)

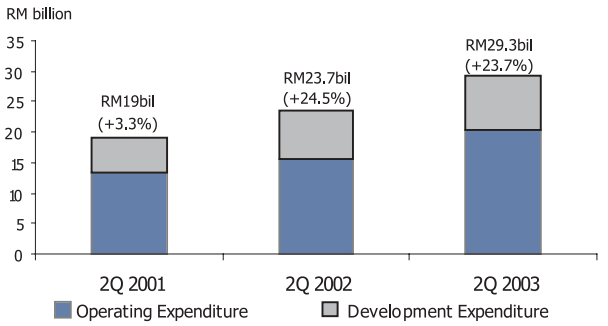
	Yearly	Quarterly		
	2002	1Q'03	2Q '03	Key contributing factors
P. R. China	8.0	9.9	6.7	Adverse SARS impact on retail sales offset strong growth in exports and government spending.
Korea	6.3	3.7	1.9	Slowdown in domestic demand more than offset export growth.
Chinese Taipei	3.6	3.5	-0.1	Adverse SARS impact on private consumption and investment.
Singapore	2.2	1.6	-4.2	All sectors recorded declines, led by the manufacturing and construction sectors.
Indonesia	3.7	3.4	3.8	Supported by government spending and private consumption.

In the Asian region, slower overall regional growth in the second quarter was due mainly to the impact of SARS on economic activity in the People's Republic of China (P. R. China), Singapore, Hong Kong China (H. K. China) and Chinese Taipei. While not affected by SARS, slower domestic demand resulted in Korea entering its first recession since the Asian crisis. Real GDP in Korea contracted for two consecutive quarters on a preceding basis (2Q: - 0.7%; 1Q: - 0.4%). Despite some moderation in intra-regional trade during the quarter, export growth remained positive in all regional countries. Exports continued to be driven mainly by semiconductors and primary commodities.

The inflation environment in the region remained benign. Whist inflation in P. R. China edged up slightly, deflationary pressures in H. K.

China and Chinese Taipei persisted as consumer demand slackened amidst the SARS outbreak. Consonant with low inflation and ample liquidity conditions, short-term interest rates declined in most of the regional countries. During the quarter, regional currencies appreciated against the US dollar following strong inflows of foreign funds. The largest currency increases were recorded by the Indonesian rupiah and Korean won.

Federal Government's spending continued to expand



Developments in the Malaysian Economy

Growth remained driven by aggregate domestic demand

Domestic demand expanded at a moderate pace in the second quarter, underpinned by public sector expenditure. Public consumption increased by 7.2% (1Q 2003: 18.9%) due mainly to the higher expenditure on emoluments, supplies and services and defence as well as the payment of half-month bonus to the civil servants. Meanwhile, private consumption, which was weaker in April and May, showed improvement in June following the containment of the SARS threat and the announcement of the new economic package on 21 May containing selective measures to increase disposable income. Major consumption indicators turned more favourable in June. Higher growth in June was recorded for imports of consumption goods, loans disbursed to households as well as consumer spending on credit cards. Consequently, the Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index rose by 1.7 points to 106.9 points in the second quarter (1Q 2003: 105.2 points). Of significance, consumers were more positive on income and employment outlook in the coming months.

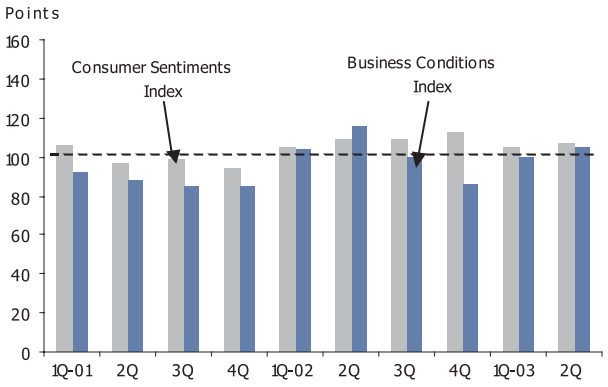
Gross fixed capital formation expanded by 0.4% in the second quarter (1Q 2003: 3.8%). Development expenditure of the Federal Government

GDP by Expenditure Components
(at constant 1987 prices)

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Aggregate Domestic Demand (excluding stocks)	3.9	2.0	5.9	3.0	4.4
Consumption	7.2	5.9	6.9	4.3	5.6
Private sector	*5.6*	*4.4*	*4.3*	*3.4*	*3.9*
Public sector	*12.8*	*12.2*	*18.9*	*7.2*	*12.2*
Gross Fixed Capital Formation	-2.0	-5.1	3.8	0.4	2.0
Exports of Goods and Services	3.1	-1.8	1.9	0.2	1.0
Imports of Goods and Services	6.6	0.8	1.7	-2.9	-0.7
GDP	**4.0**	**2.6**	**4.6**	**4.4**	**4.5**

Source: Department of Statistics, Malaysia

Improved consumer and business confidence



continued to remain high, particularly on infrastructure development. Indicators of private investment such as higher loans disbursed to businesses and higher sales of commercial vehicles pointed to a recovery in private investments in the latter part of the quarter. The business sentiments also improved during the period as reflected in the MIER Business Conditions Index (BCI), which rose above the threshold level for the first time (2Q 2003: 104.9 points) since the third quarter of 2002. The strengthening of the BCI reflected improved performance of most components, especially production, domestic orders, export orders, capacity utilisation, expected production and expected export orders. The announcement of additional measures to promote private investment in the economic package as well as further liberalisation of foreign equity ownership and expatriate employment in the manufacturing sector also had a positive impact on business confidence.

Sectoral Developments

Diversified economic base cushioned impact of SARS

The Malaysian economy was able to weather the impact of the SARS relatively well due partly to the diversified economic structure. The effects of SARS was confined largely to the services sector, especially tourism and tourism-related industries. Other sectors of the economy continued to perform strongly. Of significance, the stronger growth of manufacturing and primary commodities sectors contributed 3.5 percentage points (ppt) to overall growth of 4.4% during the quarter (1Q 2003: 2.4 ppt), thus compensating for the lower growth in the services sector.

Quarterly GDP by Kind of Economic Activity at 1987 Prices

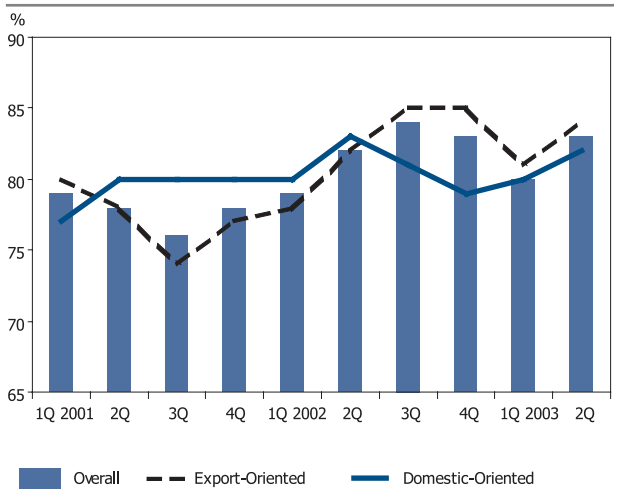
	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Agriculture	1.4	-1.1	3.4	10.4	7.0
Mining	-1.6	0.0	4.5	10.5	7.4
Manufacturing	5.5	1.6	5.9	6.5	6.2
Construction	3.4	3.1	1.2	1.4	1.3
Services	4.0	4.3	4.5	2.8	3.6
Real GDP (Ann. chg)	4.0	2.6	4.6	4.4	4.5
Real GDP (Preceding chg.)	4.1	-0.5	-3.8	4.0	-1.5

Source: Department of Statistics, Malaysia

Manufacturing sector as the main growth driver in the second quarter

The stronger value added growth in the manufacturing sector of 6.5% (1Q: 5.9%), was mainly supported by stronger growth in the export-oriented industries (9.4%; 1Q: 8%). The domestic-oriented industries also expanded by 4.2% (1Q: 6.4%). The overall capacity utilisation rate in the manufacturing sector was higher at 83% (1Q: 80%) with both the export- and domestic-oriented industries operating at 84% and 82% respectively (1Q: 81% and 80% respectively).

Capacity Utilisation in the Manufacturing Sector



Performance in the Manufacturing Sector

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual Change in %				
Value Added (Constant Price)	5.5	1.6	5.9	6.5	6.2
Overall Production	6.5	1.4	7.6	7.9	7.7
Export-oriented industries	6.0	0.0	8.0	9.4	8.7
of which :					
- Electronics	23.6	10.4	8.6	6.1	7.3
- Electrical	-7.1	-8.2	-4.3	-7.5	-6.0
- Textiles & wearing apparel	-6.5	-10.8	0.8	2.7	1.8
- Chemicals and chemical products	-2.0	-5.6	16.4	23.3	19.8
- Off-estate processing	-2.8	-1.0	4.5	27.3	16.0
- Rubber products	-0.1	-2.3	9.6	11.5	10.5
- Wood and wood products 1/	-6.3	-10.9	4.3	-0.7	1.7
Domestic-oriented industries	8.2	5.9	6.4	4.2	5.3
of which :					
- Transport equipment	13.0	15.4	-6.6	-13.6	-10.2
- Fabricated metal products	11.6	3.4	3.8	13.4	9.0
- Iron & steel and non-ferrous metal	10.1	3.5	16.7	1.7	8.6
- Non-metallic mineral products	7.1	7.5	10.0	11.4	10.7
- Petroleum products	-11.6	-4.3	1.9	17.1	9.1
- Food	8.9	10.6	5.5	4.3	4.9
Total Manufactured Exports	5.5	0.7	1.7	1.1	1.4
- Electronics	16.6	8.4	-6.1	-4.5	-5.3
Semiconductor	15.7	-0.1	27.1	22.5	24.7
Electronic equip. & parts	17.3	15.5	-28.6	-25.5	-27.1
- Electrical products	-12.5	-13.2	-6.5	-5.5	-5.9
Consumer electrical products	-11.5	-11.6	-11.8	-17.0	-14.6
Industrial & commercial electrical products	-21.8	-20.4	-12.5	-0.9	-6.6
Electrical industrial machinery & equipment	0.3	-5.0	4.0	3.5	3.7
Household electrical appliances	11.1	9.2	78.3	33.9	54.0
- Wood and wood products	-7.4	-9.9	13.2	5.5	9.1
- Furniture & parts	9.6	6.4	8.8	5.1	6.9
- Textiles, clothing & footwear	-12.6	-14.7	8.3	1.8	4.8
- Optical & scientific equipment	-1.9	1.5	19.2	15.1	17.1
- Chemical and chemical products	14.5	4.1	33.5	22.5	27.5
- Petroleum products	-15.8	-26.5	67.3	21.2	42.9

1/ Output of furniture and parts are not captured in the wood production data

In the export-oriented industries, resource-based industries such as off-estate processing and chemicals and chemical products benefited from the favourable external demand. In particular, industrial gases expanded strongly (39.6%) due to the commencement of the new MLNG plant. The

semiconductor industry continued to expand by 6.1%, supported by demand from the Asia-Pacific region. Domestic-oriented industries grew at a more moderate pace of 4.2% due to the moderation in the construction-related materials industries as well as the decline in the transport equipment industry. The latter was affected by the moderation in car sales after reaching a peak in the previous year.

...Further reinforced by stronger performance of the primary commodities sector

The strong expansion in agriculture sector by 10.4% and the mining sector by 10.5% during the quarter (Q1: 3.4% and 4.5% respectively) was led by higher output of crude palm oil, rubber, crude oil and natural gas. The high prices of the major commodities (2Q: 6-51%) was also an important factor resulting in higher production levels, especially for rubber.

Performance of the Agriculture Sector

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Value Added (RM million at 1987 prices)	**1.4**	**-1.1**	**3.4**	**10.4**	**7.0**
Production [1/]					
Of which:					
Crude palm oil	-3.5	-5.9	0.4	27.4	14.2
Crude palm kernel oil	-13.3	-9.1	-5.2	28.5	11.0
Rubber	7.5	4.0	16.6	21.0	18.6
Saw logs	-1.1	-0.7	0.1	-3.5	-1.9
Cocoa	-25.6	-31.6	71.5	14.7	41.5
Exports (RM million)	**26.9**	**17.0**	**41.8**	**34.1**	**37.6**
Of which:					
Palm oil					
('000 tonnes)	2.9	-4.4	9.3	15.6	12.7
(RM/tonne)	45.3	43.6	41.4	25.4	32.4
(RM million)	49.5	37.3	54.6	44.9	49.2
Palm kernel oil					
('000 tonnes)	-22.8	6.7	-33.9	15.0	-12.1
(RM/tonne)	34.6	17.5	51.0	21.1	35.5
(RM million)	3.9	25.4	-0.2	39.3	19.1
Rubber					
('000 tonnes)	18.8	3.1	13.4	2.0	7.3
(Sen/kg)	11.1	-0.4	57.6	40.0	47.4
(RM million)	32.0	2.6	78.7	42.8	58.2
Saw logs					
('000 cu.metres)	-6.4	-6.9	19.5	32.9	26.7
(RM/cu.metres)	6.8	-1.5	18.9	5.6	11.4
(RM million)	0.0	-8.3	42.1	40.3	41.1
Cocoa beans					
('000 tonnes)	22.2	21.9	51.7	-38.0	-11.8
(RM/tonne)	36.6	36.7	62.9	37.2	43.3
(RM million)	66.9	66.7	147.2	-14.9	26.4

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

Performance of the Mining Sector

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Value Added (RM million at 1987 prices)	**-1.6**	**0.0**	**4.5**	**10.5**	**7.4**
Production					
Of which:					
Crude oil and condensates ('000 barrels)	-1.1	1.5	2.3	12.7	7.4
Natural gas (net) (million standard cubic feet)	-4.1	-2.8	8.2	9.1	8.6
Exports (RM million)	**-13.9**	**-22.6**	**50.9**	**38.4**	**44.8**
Of which:					
Crude oil					
('000 tonnes)	8.6	3.7	4.2	0.3	2.2
(US$/barrel)	-11.9	-18.9	61.3	15.9	36.6
(RM million)	-4.3	-15.9	68.0	16.2	39.7
Liquefied natural gas					
('000 tonnes)	-21.1	-11.0	6.9	42.8	20.8
(RM/tonne)	-11.6	-18.6	28.8	26.0	28.0
(RM million)	-30.2	-27.6	37.8	80.0	54.6

Crude palm oil production increased by 27.4% due to higher yields and expansion in matured areas. Favourable weather conditions as well as improved agronomic practices resulted in the oil extraction rate edging higher to 19.63% during the quarter (1Q: 19.57%). Rubber output also rebounded as smallholders took advantage of the high prices to intensify their tapping activity following the completion of the wintering season which had affected yields in the first quarter.

In the mining sector, crude oil production (including condensates) rose by 12.7% to 746,060 barrels per day to accommodate higher demand from domestic refineries as well as increased offtake by major buyers in the region. Similarly, the increase in natural gas production was mainly in response to increased demand, particularly from the

power generation sub-sector and the coming onstream of the new MLNG3 plant in late March this year.

The impact of SARS was largely confined to the services sector

The services sector grew at a slower pace of 2.8%, as the SARS outbreak led to lower tourist arrivals and weaker consumer sentiment. However, the impact of SARS was limited to the retail, travel and tourism sectors and was also limited in terms of duration, mainly affecting activity in the months of April-May.

The wholesale and retail trade, hotels and restaurants sub-sector was the most affected, contracting by 2%. Despite the effects of SARS on air travel, especially on the passenger segment, the transport, storage and communication sub-sector was insulated to some extent due to strong growth in the telecommunications sector and robust port activities. By late May, the situation abated as SARS was globally brought under control and as confidence improved following the announcement of the Economic Package. The package was aimed to provide relief to businesses affected by SARS and to strengthen economic activity.

Performance of the Services Sector (Value Added)

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Intermediate Services	5.0	5.5	4.1	4.3	4.2
Transport, storage & communication	2.5	2.2	4.8	4.0	4.4
Finance, insurance, real estate & business services	6.5	7.5	3.8	4.5	4.1
Final Services	3.4	3.5	4.7	1.9	3.2
Electricity, gas & water	5.1	4.6	7.3	7.1	7.2
Wholesale & retail trade, hotel & restaurants	2.3	2.1	3.2	-2.0	0.6
Government services	4.4	5.7	5.9	6.9	6.4
Other services	3.7	3.7	5.0	1.6	3.3
Total Services	4.0	4.3	4.5	2.8	3.6

Source: Department of Statistics, Malaysia

May Economic Package Measures for the Services Industries

Affected industries or beneficiaries	Measures	Effective date
Tourism related industries	- RM1 billion Special Relief Guarantee Facility	21 May 2003
Hotel operators	- 5% discount on electricity bills - Exemption of 5% government tax and Human Resource Development Fund levy - Exemption of import duty and sales tax on tele- and video-conferencing equipments	1 June - 31 Dec 2003
Tours and travel agencies	- Suspension of income tax instalment payments - Exemption of Human Resource Development Fund levy	1 June - 31 Dec 2003
Taxis	- One time reduction in road tax of 50%	Valid for 6 months
Retail, transport and other services	- Reduction of employees' EPF contribution by 2 percentage points - Half-month bonus for civil servants	One year from 1 June 2003
Operators of duty free shops in Malaysian airports	- 50% cut in rental rates for Malaysia Airport Holdings Berhad premises	1 June - 31 Dec 2003

Source: Economic Package, May 2003

Selected Monthly Indicators in the Services Sector

(Annual change, %)

Subsector/ Indicators	2003 March	April	May	June
Wholesale and retail trade, hotels and restaurants				
Tourist arrivals	-35.6	-58.5	-53.1	-44.6
Hotel occupancy rate (%)	50.3	41.7	43.2	55.3
Import of consumption goods	5.9	-2.7	-9.7	6.9
Disbursement of consumption credit	2.1	-0.8	-1.5	8.5
Transport, storage and communication				
MAS passengers	-2.4	-19.4	-31.7	-14.4
MAS passenger load factor (%)	54	54	52	62
Total passenger traffic in all airports in Malaysia	3.5	-17.0	-23.3	-7.4

Source: Various sources

The finance, insurance, real estate and business services sub-sector picked up during the quarter due to the increase in bank lending, the continued growth in the insurance sector and the improvement in the stock market towards the end of the quarter. The growth in the Government services sub-sector was attributed by bonus payments to civil servants, while the utilities sub-sector expanded due to the continued demand for electricity from users.

Construction activity supported by housing demand and increased public expenditure

The construction sector recorded a growth of 1.4% during the second quarter of 2003 (1Q 2003: 1.2%), supported largely by higher construction activity on public sector projects related to transportation, housing and health facilities. Growth was also supported by the residential sub-sector due to the improvement in sentiment following the announcement of the cut in interest rates and tax incentives in the economic package. The return of foreign labour facilitated higher activity in the sector.

Construction Indicator

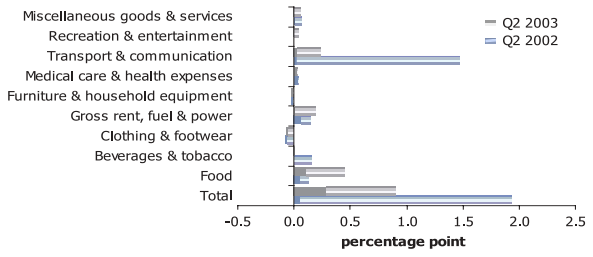
	2002 1Q	2002 1H	2003 1Q	2003 2Q	2003 1H
	Annual change %				
New sales and advertising permits	20.2	29.4	-24.5	-16.7	-20.1
Housing approvals	11.4	9.5	-30.7	0.8	-13.6
Production of construction-related materials	2.6	5.7	13.0	6.9	9.8
Loans approved for construction	-10.2	31.6	19.4	-46.3	-22.3
Imports of construction materials & mineral products	-5.8	6.8	3.6	-15.4*	-4.8**

* April-May '03
** Jan.-May '03
Source: Ministry of Housing and Local Government and Department of Statistics, Malaysia

Lower inflation

Inflation, as measured by the annual change in the Consumer Price Index (CPI), declined to 0.9% during the second quarter of 2003 (2Q 2002: 1.9%; 1Q 2003: 1.4%). This reflected the moderate increase in prices for the transport and communication sector, mainly on account of the elapse of the impact of the higher retail petrol price, which was implemented on 1 May 2002. Food prices were higher compared with the second quarter of 2002, due mainly to higher prices for food taken at home.

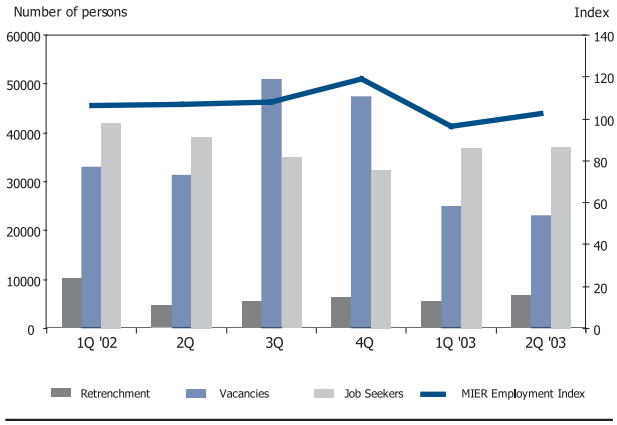
Contribution to Inflation



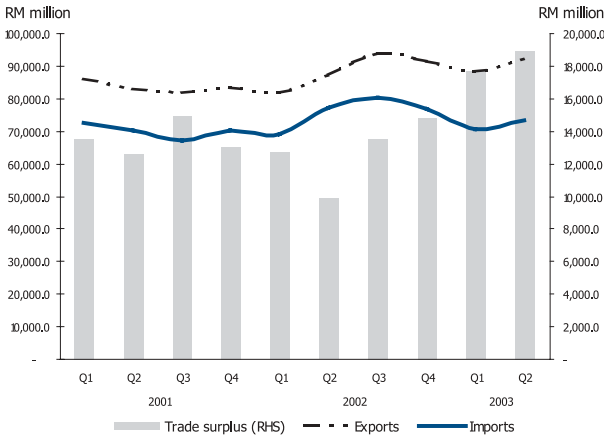
Labour market conditions remained stable

While there was an increase in retrenchment and temporary layoffs during the quarter due to the impact of the SARS outbreak on the economy, overall the labour market remained

Stable Labour Market Conditions



Trade Balance



stable, supported by growth in productivity. In the manufacturing sector, labour productivity, as measured by the real sales value of products per employee rose by 4.9%, exceeding the 2.9% increase in real wage per employee.

Larger trade surplus

Trade was generally less affected by SARS. The trade surplus was larger at RM18.9 billion in the second quarter (1Q2003: RM17.7 billion). The larger surplus was driven mainly by higher commodity prices and lower imports.

Gross exports expanded by 5.8%, underpinned by improvements in both prices (215%) and volume (15%) of agriculture and mineral exports. In particular, exports of palm oil and saw logs surged during the quarter due to higher demand and prices. Shipment from the new MLNG plant had also contributed to the marked increase in LNG exports during the quarter (80%). The moderate growth in manufacturing exports (1.1%) during the quarter was mainly attributable to the decline in exports of electronic equipment and parts and electrical products, which face increasing

Trade Account

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Gross Exports	**5.4**	**0.1**	**8.0**	**5.8**	**6.9**
Manufacturing	5.5	0.7	1.7	1.1	1.4
Agriculture	26.9	17.0	41.8	34.1	37.6
Minerals	-13.9	-22.6	50.9	38.4	44.8
Gross Imports	**10.1**	**2.5**	**2.3**	**-5.0**	**-1.6**
Capital goods	24.4	6.2	-5.0	-17.4	-11.8
Intermediate goods	6.7	0.4	2.5	-3.1	-0.4
Consumption goods	12.2	9.5	4.7	-2.2	1.1
Trade balance (RM bil)	**9.9**	**22.7**	**17.7**	**18.9**	**36.6**

Source: Department of Statistics, Malaysia

Malaysia Gross Exports: Volume, Unit Value and Value

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Exports Volume	6.7	2.3	7.2	7.9	7.5
Manufactures	7.4	3.0	7.4	6.4	7.0
Agriculture	2.9	-3.1	8.0	13.0	10.4
Minerals	0.7	-1.1	4.9	18.6	10.0
Exports Unit Value	-0.2	-2.0	4.0	0.3	1.7
Manufactures	-2.2	-3.2	-3.5	-3.7	-3.8
Agriculture	32.3	28.7	33.9	20.9	26.7
Minerals	-12.0	-18.8	45.5	19.8	31.7
Exports Value	5.4	0.1	8.0	5.8	6.9
Manufactures	5.5	0.7	1.7	1.1	1.4
Agriculture	26.9	17.0	41.8	34.1	37.6
Minerals	-13.9	-22.6	50.9	38.4	44.8

Source : BNM

Malaysia: Direction of Exports

	2002	2003		2002	2003		2002	2003	
	2Q	1Q	2Q	2Q	1Q	2Q	2Q	1Q	2Q
	RM bil			% share of total exports			% annual change		
United States	18.9	14.5	16.0	21.6	16.4	17.4	12.9	-12.8	-15.0
European Union	10.3	11.4	11.9	11.9	12.9	12.9	-8.6	7.0	15.3
Selected ASEAN countries 1/	23.1	22.9	23.8	26.5	25.9	25.8	12.2	8.1	3.1
North East Asia countries	15.4	17.2	17.7	17.6	19.5	19.2	24.8	23.0	15.6
People's Republic of China	4.7	5.2	6.0	5.3	5.9	6.5	48.4	24.3	29.0
Hong Kong China	4.6	5.7	5.8	5.2	6.4	6.3	15.5	41.3	28.0
Chinese Taipei	3.5	3.3	3.4	4.0	3.7	3.7	29.8	7.9	-2.6
South Korea	2.6	3.1	2.5	3.0	3.5	2.7	4.9	11.1	-5.4
India	1.7	2.2	2.5	2.0	2.5	2.7	8.8	76.3	43.7
Total exports	87.3	88.5	92.4	100.0	100.0	100.0	5.4	8.0	5.8

1/ Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Viet Nam.

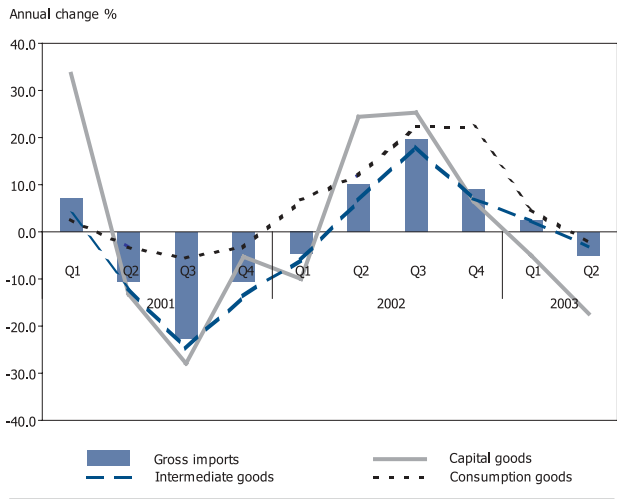
Source: Department of Statistics, Malaysia

competition from lower cost producing countries. Exports of semiconductors remained strong, rising by 22.5%.

The trade pattern continues to shift towards markets in the region. Exports to regional countries (excluding Japan), which accounted for 45% of Malaysia's exports, expanded further by 8.1% (1Q2003: 14%). The impetus to this growth stemmed from the strong expansion of exports to the People's Republic of China (29%) and Hong Kong China (28%). Exports to India expanded strongly by 43.7%, while exports to Japan and the European Union expanded by 12.3% and 15.3% respectively. The expansion in exports to Japan and India was supported by LNG and palm oil products. The trend of declining exports to the United States continued in the second quarter (-15%), reflecting lower exports of electrical and electronic products. The share of Malaysian exports to the US now accounts for 17.4% (16.4% in 1Q 2003 and 20.2% in 2002).

Gross imports declined by 5% during the quarter affected mainly by external demand and to a lesser extent by SARS. Lower imports of intermediate goods (-3.1%; 1Q2003: 2.5%), reflected largely the moderation in growth of manufactured exports and to a lesser extent, the changes in export components that drive growth. The growth in exports was supported by the expansion in commodities, namely palm oil, crude oil, and LNG, which by its nature have little import content. Secondly, the impetus to growth in manufactured exports stemmed from resource-based manufactured exports, which grew by 15.8%. These exports consisted of mainly petroleum, chemicals and rubber products. Although non-resource based exports accounted for 66.2% of

Import Growth



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

	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
CAPITAL GOODS	24.4	6.2	-5.0	-17.4	-11.8
Capital goods (except transport equipment)	6.9	-2.9	0.2	0.1	0.1
Transport equipment	232.2	108.1	-49.9	-84.2	-74.2
INTERMEDIATE GOODS	6.7	0.4	2.5	-3.1	-0.4
Food and beverages, mainly for industry	-4.0	12.8	31.4	5.8	19.3
Industrial supplies, n.e.s.	3.6	-2.3	7.5	-2.8	2.0
Fuel and lubricants	-29.9	-19.2	30.9	43.4	37.3
Parts and accessories of capital goods (except transport equipment)	11.4	1.4	-2.9	-4.9	-3.9
Parts and accessories of transport equipment	48.7	49.5	-3.9	-38.9	-23.2
CONSUMPTION GOODS	12.2	9.5	4.7	-2.2	1.1
Food and beverages, mainly for household consumption	2.3	3.0	0.5	-8.5	-4.1
Transport equipment, non-industrial	21.1	22.4	110.7	99.6	104.9
Consumer goods,n.e.s.	19.2	14.1	6.1	0.4	3.0
Durables	12.0	15.3	15.3	15.4	15.3
Semi-durables	34.4	19.2	-10.2	-15.7	-13.2
Non-durables	10.5	9.0	16.2	8.6	12.1
DUAL USE GOODS	-2.0	-6.2	28.8	18.2	23.2
OTHERS	9.7	23.3	3.3	-2.3	0.4
RETAINED IMPORTS	9.5	2.1	2.1	-4.9	-1.6
RE-EXPORTS	37.5	22.9	12.1	-8.9	0.1
GROSS IMPORTS	10.1	2.5	2.3	-5.0	-1.6

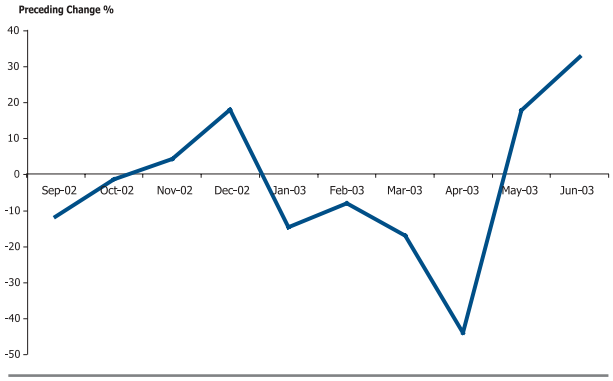
Source: Department of Statistics, Malaysia

gross exports, its growth has declined since the beginning of 2003. The lower growth of these exports was attributable mainly to the decline in exports of electronic equipment and parts and electrical products. Lower imports of capital goods was consonant with the moderate growth in private investment. The sharp decline in consumption goods imports was entirely due to the specific events of health concerns from the SARS effect. The decline in the visitor arrivals and subdued consumer spending affected imports of food and beverages and consumer goods.

Improvements in tourist arrivals in the second quarter

The impact of SARS on tourist arrivals was transitory and recovered rapidly towards the end of the quarter. Overall, tourist arrivals was still lower at 1.7 million arrivals in the second quarter (2Q2002: 3.6 million; 1Q2003: 2.9 million). Month-on- month improvements in arrivals of 17.8% and 32.8% occurred in May and June respectively as the SARS impact diminished. Several promotional campaigns were conducted during the quarter in

Tourist Arrivals



new markets, including Turkey and Iran as well as increased publicity in established markets such as People's Republic of China, Hong Kong China, Chinese Taipei and India. Tourist arrivals from ASEAN countries, which accounted for 63.1% of tourism receipts in 2002, increased by 32.6% in May and 36.9% in June (April: -42.3%). Long haul tourist arrivals from Canada, United States and Europe also recorded improvement in June.

Higher inflow of funds for investments

On a cash basis, inflows of funds for investments were higher during the second quarter. Gross inflows of FDI, in the form of direct equity and inter-company loans, amounted to RM5.5 billion in the second quarter (1Q 2003: RM3.1 billion). The bulk of these inflows were in the form of inter-company loans, channelled mainly into the oil and gas sector as well as an MNC through its centralised treasury operations in Malaysia. New inflows of equity and loans were evident in the manufacturing sector, particularly the petroleum related manufacturing activities and electronic industry. There were also new investments in the services sector, in particular the finance and business services, wholesale and retail trade and air transport industry. After adjusting for outflows due mainly to loan repayment by related companies, FDI recorded a net inflow of RM2.1 billion.

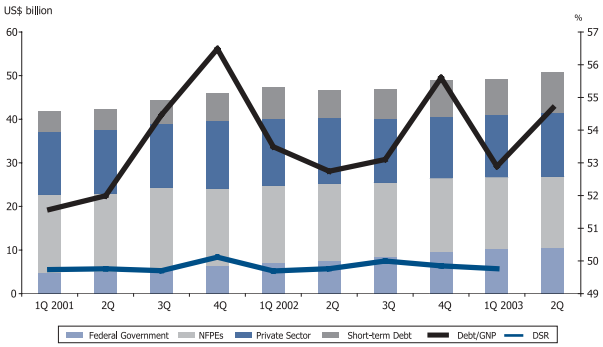
Overseas investment recorded a net outflow of RM2.1 billion (1Q 2003: -RM2 billion). In terms of gross outflows, overseas investment was broadly based. About a third of these investments were in the oil and gas sector, mainly for activities in Egypt and Sudan. This was followed by investments in the utility and manufacturing sectors, particularly in the apparel and electrical and electronic industries.

Portfolio investment recorded a net inflow of RM0.6 billion. Investor sentiments improved as reflected in the better performance of the KLSE.

External debt remains within prudential limits

Malaysia's external debt rose marginally at end-June 2003, but remains within prudential limits. The total external debt outstanding stood at RM193.1 billion (US$50.8 billion) as at end-June 2003, equivalent to 54.7% of GNP. The medium and long-term external debt recorded a net repayment of RM0.6 billion, attributed to net repayment of external loans by the NFPEs. Nevertheless, after taking into account the exchange revaluation loss due largely to appreciation of euro, the medium and

External Debt



long term extenal debt increased marginally to RM157.6 billion or US$41.5 billion (1Q 2003: RM156.9 billion).

The total short-term external debt was higher at RM35.5 billion or US$9.3 billion (1Q 2003: RM30.6 billion) due mainly to increase in short-term debt of the banking sector arising from the hedging activities of banks in relation to trade-related transactions. These short-term transactions are transitional and will be reversed upon maturity. As at end-June, the short-term debt accounted for 18.4% of total external debt, and is about 25.2% of the net international reserves.

External Debt Outstanding

	2002	2003	
	2Q	1Q	2Q
	RM bilion		
Medium & Long-term debt	152.2	156.9	157.6
Public sector	96.2	102.3	102.2
Private sector	56.0	54.6	55.4
Short-term debt	23.8	30.6	35.5
Total external debt	175.9	187.5	193.1
- US$ billion equivalent	46.3	49.4	50.8

International reserves increased further

International reserves of Bank Negara Malaysia remained on an upward trend during the second quarter. As at 30 June 2003, the net international reserves amounted to RM140.9 billion or US$37.1 billion, reflecting an increase of RM8.3 billion or US$2.2 billion since end-March 2003. The increase in reserves was attributed mainly to larger inflows from export earnings and steady inflow of investment income and foreign direct investment. The reserves level at the end of June has also taken into account the quarterly adjustment of the unrealised foreign exchange revaluation gain amounting to US$573 million, mainly as a result of the appreciation of euro and pound sterling against the US dollar during the quarter.

The international reserves increased further to RM146.6 billion or US$38.6 billion as at 15 August 2003, attributed largely to sustained repatriation of export earnings, inflow of portfolio investment and foreign direct investment. The reserves position is adequate to finance 6 months of retained imports and is 4.3 times the short-term external debt.

Fiscal stance remains expansionary

The budgetary operations of the Federal Government were more expansionary to support domestic economic activities in the second quarter. Total expenditure increased by 23.7% to RM29.3 billion, stemming from measures announced in the May economic package to stimulate economic growth. This included the payment of half-month bonus to civil servants, expenditure for rural infrastructure development and local authorities' cleanliness programme, establishment and enhancement of several funds and recapitalisation of selected development financial institutions. Revenue performance recovered to increase at an annual growth of 8.1% in the second quarter. Nevertheless, the Federal Government's financial position recorded a larger deficit due entirely to higher development expenditure.

Federal Government Finance [p]

	2002		2003		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	19.6	36.7	13.7	21.2	34.9
Operating expenditure	15.6	30.3	12.8	20.2	33.0
Current account	4.0	6.4	1.0	1.0	1.9
% of GDP	4.5	3.7	1.0	1.0	1.0
Gross development expenditure	8.1	12.0	7.8	9.1	16.9
Loan recoveries	0.1	0.3	0.1	0.1	0.2
Overall balance	-4.0	-5.3	-6.8	-8.0	-14.8
% of GDP	-4.5	-3.1	-7.3	-8.4	-7.8
Memo item:					
Total Federal Government debt (as at end period)	149.6	149.6	175.3	182.1	182.1
% of GDP	41.5	41.5	45.7	47.5	47.5
Domestic	121.1	121.1	135.9	142.3	142.3
External	28.5	28.5	39.4	39.9	39.9
	Annual Change (%)				
Revenue	-5.5	3.9	-20.0	8.1	-5.0
Operating expenditure	16.9	23.0	-13.3	29.4	8.7
Gross development expenditure	42.5	8.7	101.4	12.7	41.6

p Preliminary

The fiscal deficit was largely financed through domestic borrowings. The level of debt remained sustainable at 47.5% of GDP as at end-June (45.7% as at end-March). External debt was contained, accounting for 21.9% of Federal Government debt.

Federal Government Finance

