Economic and Financial Developments in the Malaysian Economy in the Second Quarter of 2003

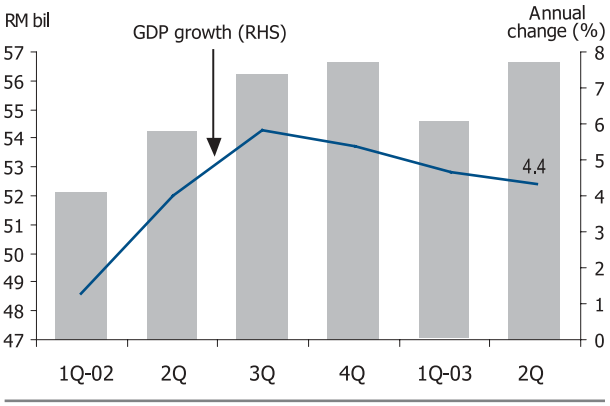
OVERVIEW

Growth momentum was sustained in the second quarter

Real GDP in the Malaysian economy expanded by 4.4% in the second quarter of 2003 (1Q: 4.6%). Proactive policy measures with both fiscal and monetary expansion to stimulate domestic demand, and the diversified and resilient economic base allowed the growth momentum to be sustained despite the Severe Acute Respiratory Syndrome (SARS) outbreak and the uncertain external environment.

Growth was markedly stronger in all sectors except services. Higher growth in the manufacturing sector (6.5%) was driven by strong growth in resource-based industries. In the primary commodities sector, agriculture expanded by 10.4% and mining by 10.5%. The impact of SARS was seen in a more moderate growth in the services sector of 2.8% (4.5% in the 1Q).

Real GDP growth sustained in 2Q 2003



Growth continued to be driven by domestic aggregate demand and reinforced by external demand. Public sector consumption remained strong with higher expenditure on salaries, defence and supplies. The transitory impact of SARS on private sector demand was reversed following the announcement of the economic package on 21 May. Consumer confidence was restored, resulting in a significant increase in private sector demand in June. Lower interest rates and strong commodity prices amidst stable labour market conditions supported consumer confidence towards the end of the quarter.

Stimulative monetary policy to support aggregate demand

Monetary policy, which has been on an expansionary mode since 1998, was eased further during the quarter. The BNM Intervention Rate was reduced by 50 basis points in May. The reduction was a pre-emptive measure to support growth in an environment of a less favourable outlook for the global economy. During the quarter, a Special Relief Guarantee Facility (SRGF) of RM1 billion was also established to alleviate the cash flow problems faced by businesses affected by SARS. The immediate positive development arising from the reduction in interest rates and economic package has been the stronger demand for liquidity.

All loan indicators also increased significantly in June, following the moderation in May. The bulk of the loans were extended to small

borrowers, consumers and SMEs. The large corporations also took advantage of the low interest rate environment to raise longer-term funds in the PDS market at lower cost, while relying on the banking system for short-term working capital requirements.

More robust growth in the second half of 2003

Going forward, more recent developments point towards stronger growth in the second half-year. On the external front, indicators are turning more optimistic for improved growth performance in the United States and Japan. In particular, fixed investment spending in the United States has turned positive, reflecting improved business confidence following reduction in uncertainties. Expansionary monetary policies in the G3 countries and in Asia would also support growth in the second half-year. In regional economies, the recovery in the travel and retail sectors, the continued underlying strength of consumption as well as the improved prospects of the electronics cycle, lend support to higher export demand. Stronger fundamentals also provide regional economies with both monetary and fiscal policy flexibility to address potential shocks.

On the domestic front, conditions favour further increases in aggregate domestic demand. Lending rates, especially for new loans, continue to trend downwards. Fiscal expenditure in education, health and infrastructure will continue to support growth. Stronger corporate balance sheets with improved cash flows amidst rising capacity utilisation augur well for higher investments. Positive sentiment has emerged in the KLSE with seven IPOs attracting oversubscriptions. Other factors include lower energy prices and recovery in household and business confidence.

The underlying fundamentals of the Malaysian economy continue to remain strong with low inflation and stable labour market conditions. The external position remains robust with international reserves increasing to US$38.6 billion as at mid-August 2003, which is adequate to finance 6 months of retained imports and is 4.3 times the short-term external debt. The banking sector continued to record lower NPLs amidst higher capitalisation (RWCR of 13.1% at end-June 2003). Given the resilience of the economy, the expected improvement in the external environment and the positive effects of the Government's economic package, growth is expected to strengthen in the second half of the year.

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, %)

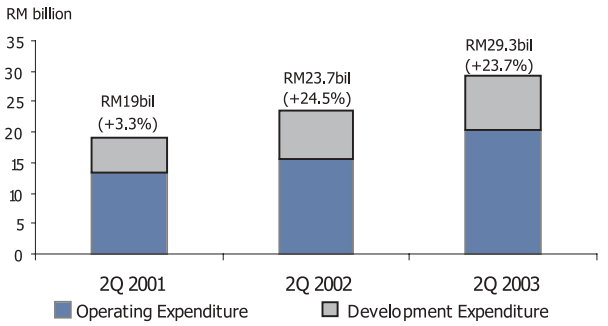
	Yearly	Quarterly		
	2002	1Q'03	2Q '03	Key contributing factors
P. R. China	8.0	9.9	6.7	Adverse SARS impact on retail sales offset strong growth in exports and government spending.
Korea	6.3	3.7	1.9	Slowdown in domestic demand more than offset export growth.
Chinese Taipei	3.6	3.5	-0.1	Adverse SARS impact 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.

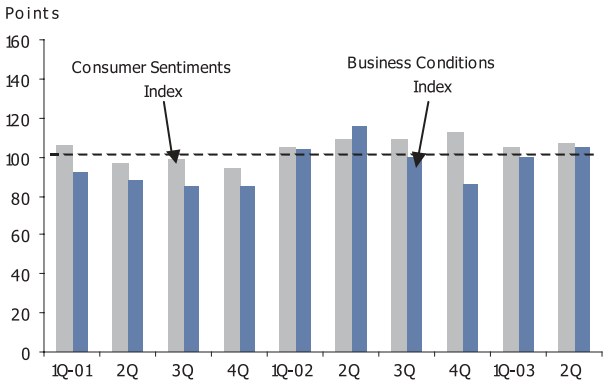
Gross fixed capital formation expanded by 0.4% in the second quarter (1Q 2003: 3.8%). Development expenditure of the Federal Government

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

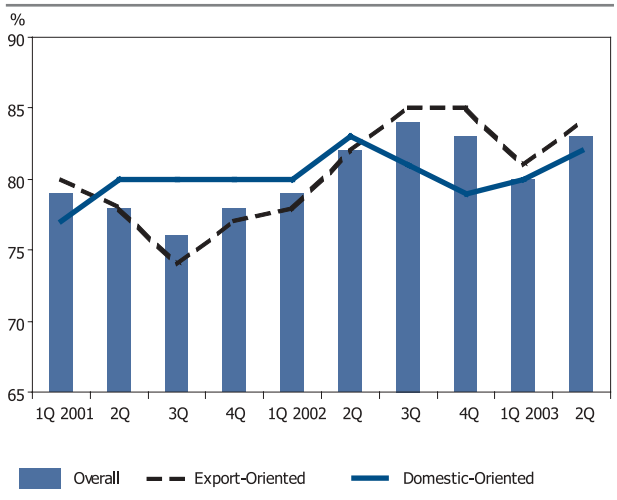
	2002		2003		
	2Q	1H	1Q	2Q	1H
	Annual change in %				
Agriculture	1.4	-1.1	3.4	10.4	7.0
Mining	-1.6	0.0	4.5	10.5	7.4
Manufacturing	5.5	1.6	5.9	6.5	6.2
Construction	3.4	3.1	1.2	1.4	1.3
Services	4.0	4.3	4.5	2.8	3.6
Real GDP (Ann. chg)	4.0	2.6	4.6	4.4	4.5
Real GDP (Preceding chg.)	4.1	-0.5	-3.8	4.0	-1.5

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

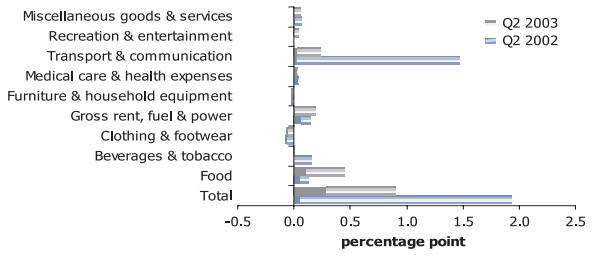
	2002 1Q	2002 1H	2003 1Q	2003 2Q	2003 1H
	Annual change %				
New sales and advertising permits	20.2	29.4	-24.5	-16.7	-20.1
Housing approvals	11.4	9.5	-30.7	0.8	-13.6
Production of construction-related materials	2.6	5.7	13.0	6.9	9.8
Loans approved for construction	-10.2	31.6	19.4	-46.3	-22.3
Imports of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

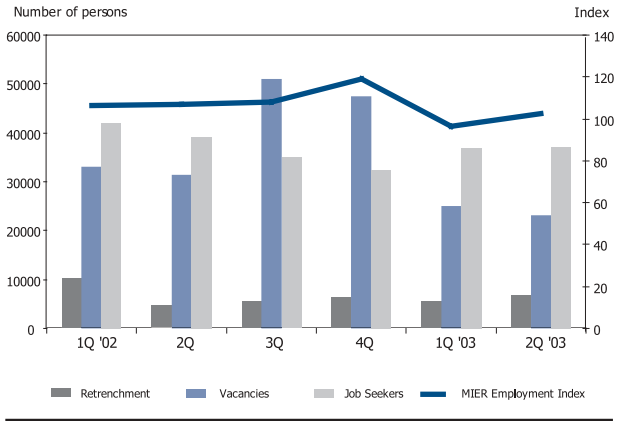
Contribution to Inflation



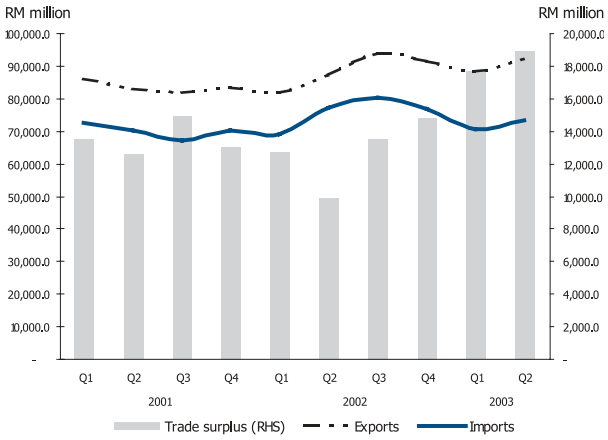
Labour market conditions remained stable

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.

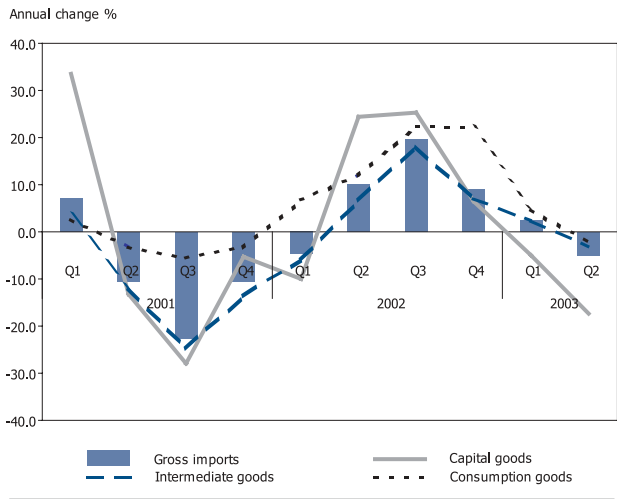
Source: Department of Statistics, Malaysia

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

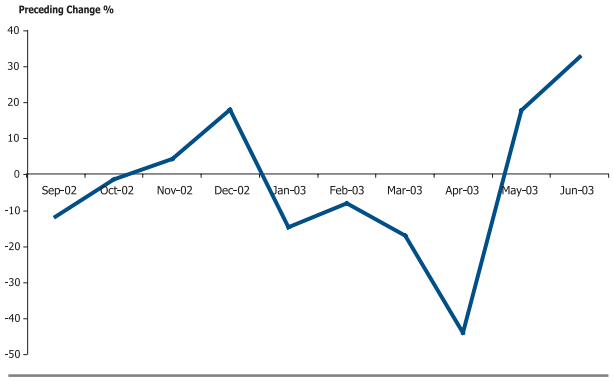
Source: Department of Statistics, Malaysia

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.

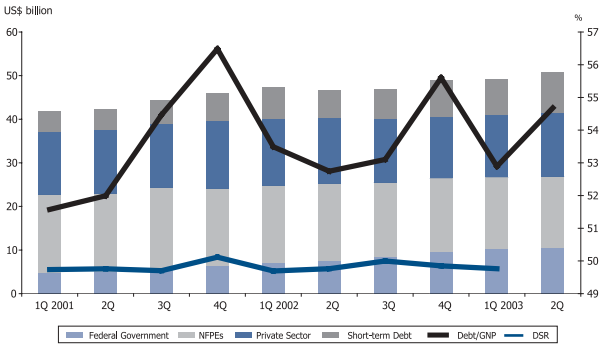
Overseas investment recorded a net outflow of RM2.1 billion (1Q 2003: -RM2 billion). In terms of gross outflows, overseas investment was broadly based. About a third of these investments were in the oil and gas sector, mainly for activities in Egypt and Sudan. This was followed by investments in the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

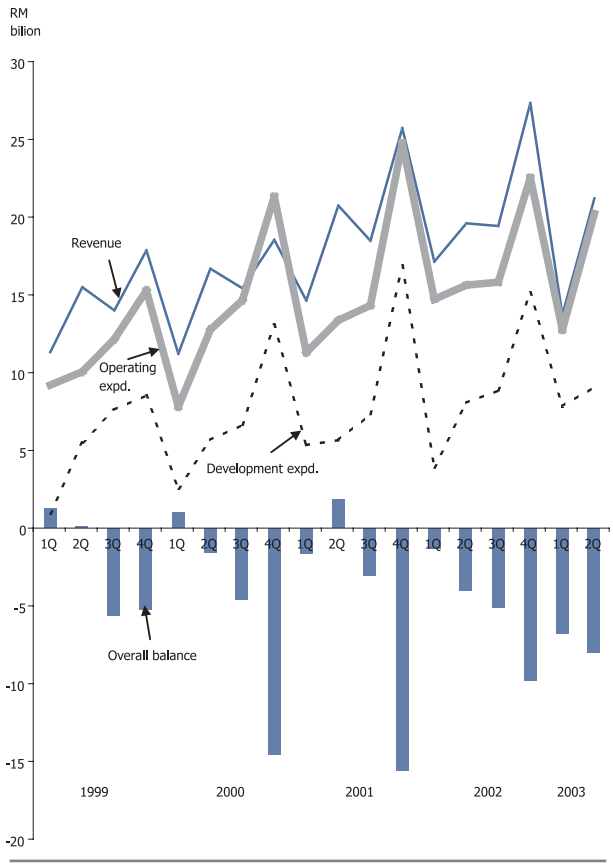
Federal Government Finance [p]

	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



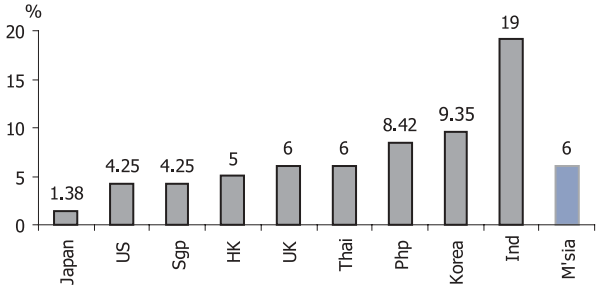
MONETARY AND FINANCIAL DEVELOPMENTS

Lower Interest Rates to Support Economic Activity

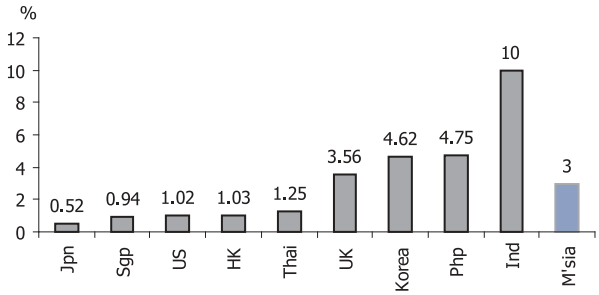
Monetary policy was stimulative during the quarter. While the tensions in the Middle East as well as SARS-related concerns were expected to abate, modest growth in the major economies and continued financial market volatilities had increased uncertainties on the strength of the recovery in the global economy in the second half-year. As a result, on 21 May 2003, Bank Negara Malaysia reduced the 3-month Intervention Rate by 50 basis points to 4.5%. The reduction in the Intervention Rate was a pre-emptive exercise aimed at reinforcing the economic measures introduced by the Government to support the overall growth in the economy. In May, a new special fund, i.e. the Special Relief Guarantee Facility of RM1 billion was made available to assist cash flow management of entrepreneurs in the tourism sector to mitigate the negative impact from the SARS epidemic.

An immediate positive development from the measures has been the stronger demand for liquidity. The reduction in interest rates and the economic package introduced in May 2003 amidst the receding concerns over SARS helped to improve business and consumer sentiment. Demand for financing, which moderated in May on uncertainties of the effects of SARS, recovered strongly in June. All loan indicators for June increased significantly, while monetary aggregates recorded higher growth.

As at end-June 03, Malaysia's nominal lending rate is among the lowest ...



... while the nominal deposit rate is among the highest



Interest Rates

	2002	2003	
	2Q	1Q	2Q
	At end-period (%)		
3-month Intervention rate	5.0	5.0	4.5
Interbank rates (average)			
Overnight	2.73	2.81	2.77
1- month	2.87	2.99	2.99
Base Lending rate (BLR) of CBs	6.39	6.39	6.00
Average Lending rate of CBs	6.50	6.50	6.22
Fixed deposits of CBs			
3-month	3.20	3.20	3.00
12-month	4.00	4.00	3.70

Source: Bank Negara Malaysia

Liquidity operations by Bank Negara Malaysia in the interbank market ensured that interbank rates remained stable. At end-June, the monthly weighted average rates for the overnight, 1-week and 1-month rates were 2.77%, 2.84% and 2.99% respectively (end-March: 2.81%, 2.83% and 2.99% respectively).

Following the reduction in the Intervention Rate by 50 basis points to 4.5% on 21 May, the average base lending rate (BLR) of the commercial banks (CBs) declined by 39 basis points to 6%, while

the BLR of the finance companies (FCs) declined by 55 basis points to 6.9% at end-June. The cumulative decline in the average lending rate for CBs was 28 basis points and 21 basis points for finance companies. Increased competition has also resulted in lower lending rates, especially for new loans. The adjustments in the fixed deposit rates were smaller, by 20-30 basis points for the CBs and 17-28 basis points for the FCs. Given the low inflation rate of 0.8% at end-June, savers continued to earn positive real rates of return on their deposits. The average 3-month and 12-month real fixed deposit rates of CBs stood at 2.2% and 2.9% respectively at end-June (2.5% and 3.3% respectively at end-March). Compared to regional economies, Malaysia has competitive lending rates, while deposit rates are among the higher rates in Malaysia.

Loan approvals and disbursements strengthened

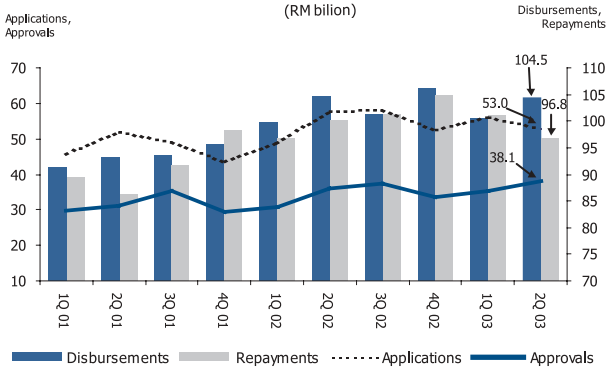
The concerns and uncertainties associated with SARS, led to some moderation in growth of bank lending in May. In June, as SARS impact diminished, lending growth was significantly higher. Overall bank lending activity remained strong in the second quarter, supported by the strength of domestic demand. Loan applications, approvals and disbursements amounted to RM53 billion, RM38.1 billion and RM104.5 billion respectively in the quarter (RM56.1 billion, RM35.3 billion and RM100.4 billion respectively in the first quarter). At end-June, the loan-deposit ratio edged up to 83.7% from 83% at end-March. Including the banking institutions' holdings of private debt securities, the adjusted

Loan Indicators

	During the period					Annual growth				
	2002	2003				2002	2003			
	2Q	1Q	May	June	2Q	2Q	1Q	May	June	2Q
	RM billion					(%)				
Total										
Loan applications	57.8	56.1	16.4	18.3	53.0	n.a.	14.4	-32.6	14.5	-8.2
Loan approvals	35.9	35.3	11.2	13.9	38.1	15.7	14.1	-26.1	24.5	6.1
Loan disbursements	104.8	100.4	31.8	37.7	104.5	12.6	0.5	-12.5	8.5	-0.3
Loan repayments	100.1	100.9	30.7	31.5	96.8	16.2	4.3	-6.9	-3.9	-3.3
Change in outstanding 1/	7.0	1.2	2.2	6.9	10.6	3.8	3.2	2.8	3.9	3.9
Of which:										
Business enterprises										
Loan applications	33.9	33.7	8.6	9.7	28.3	n.a.	-1.6	-40.2	10.2	-16.7
SMEs		12.8	3.0	3.0	9.7					
Others		20.9	5.7	6.7	18.5					
Loan approvals	17.8	18.1	5.3	7.3	19.7	10.2	19.7	-39.5	45.8	10.1
SMEs		6.5	1.4	2.2	5.5					
Others		11.6	3.9	5.2	14.1					
Loan disbursements	73.5	68.1	21.4	26.2	71.5	6.6	0.2	-16.9	6.5	-2.8
of which:										
SMEs		21.1	5.8	6.9	19.1					
Others		47.0	15.6	19.3	52.4					
Loan repayments	69.1	69.4	20.8	21.4	66.3	5.6	5.5	-7.6	-7.0	-4.0
Change in outstanding 1/	1.0	-4.5	0.3	4.0	3.8	-2.8	-2.8	-3.4	-1.7	-1.7
SMEs	-1.1	2.0	0.1	0.7	1.4	-1.7	1.6	3.2	4.9	4.9
Others	2.1	-6.6	0.2	3.3	2.4	-3.8	-5.7	-7.5	-5.4	-5.4
Households										
Loan applications	21.9	21.0	7.5	8.4	24.0	n.a.	19.8	-3.1	14.9	9.5
Loan approvals	17.9	16.0	5.9	6.5	18.2	25.6	7.5	-6.5	6.6	1.7
Loan disbursements	25.7	26.2	8.6	9.6	27.3	26.1	2.4	-0.8	14.3	6.2
Loan repayments	20.3	22.5	7.0	7.2	21.6	17.8	8.5	4.0	12.1	6.5
Change in outstanding 1/	6.7	5.0	1.9	2.1	6.1	16.2	13.5	12.9	12.7	12.7

1/ Annual growth at end-period
Source: Bank Negara Malaysia

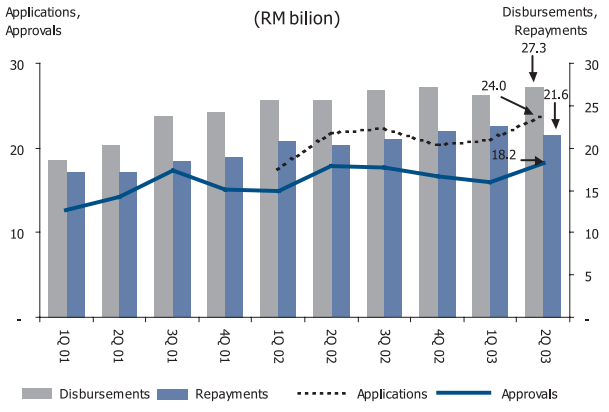
Loan disbursements remained high



loan-deposit ratio stood at 93.8% at end-June (93.7% at end-March).

The strength in loan growth continued to be underpinned by the demand from the household sector and the small and medium enterprises (SMEs). The demand for loans for the purchase of residential property continued to be supported by low interest rates and the stable employment outlook. Amidst increased competition, mortgage loans were priced at below BLR. Demand for loans for the purchase of cars, however, moderated reflecting the plateauing demand for cars after the rapid growth in the past three years. Reflecting

Sustained lending to household sector



mainly the demand for loans for purchases of residential property and consumer credit, loan applications by households expanded at an annual rate of 9.5% during the second quarter.

Demand for business loans, which was temporarily affected by the impact of SARS on business sentiments in April and May, rebounded in June as concerns over SARS and the Iraq war abated. Loan disbursements to businesses remained broad based, notably to the manufacturing, wholesale and retail trade, restaurants and hotels sectors.

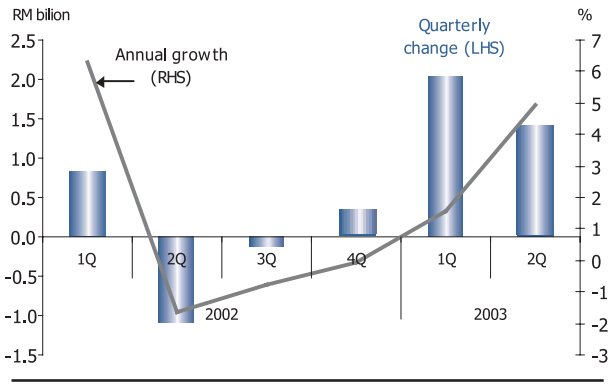
Loans by Sector

	Change during the quarter			Outstanding	% Share of Total
	2002	2003		2003	
	2Q	1Q	2Q	End-June	
	RM billion				%
Banking system loans outstanding of which :					
Business enterprises	1.0	-4.5	3.8	251.4	50.1
Households	6.7	5.0	6.1	217.9	43.4
By sector					
Agriculture, hunting, forestry and fishing	0.0	-0.3	-0.1	11.9	2.4
Mining and quarrying	0.0	0.0	0.0	1.2	0.2
Manufacturing	-1.4	-0.8	0.7	67.1	13.4
Broad property sector	3.7	2.9	3.6	192.9	38.4
Construction	1.0	-0.3	-0.8	37.0	7.4
Purchase of residential property	3.3	3.5	4.0	108.7	21.7
Purchase of non-residential property	0.0	0.0	0.2	29.8	5.9
Real estate	-0.7	-0.2	0.3	17.3	3.5
Electricity, gas and water supply	1.0	-0.6	0.5	6.7	1.3
Wholesale & retail trade, restaurants and hotels	0.8	-0.5	1.1	40.2	8.0
Transport, storage and communication	0.6	-0.8	2.0	12.9	2.6
Financial, insurance and business services	-0.4	-0.7	0.7	32.7	6.5
Consumption credit	3.2	1.3	2.3	85.0	16.9
Of which:					
Credit cards	0.5	0.1	0.4	11.2	2.2
Purchase of passenger cars	2.5	1.3	1.8	58.0	11.6
Purchase of securities	-0.5	-0.9	0.1	29.8	5.9
Purchase of transport vehicles	0.0	0.0	0.0	3.1	0.6
Others	-0.1	1.5	-0.2	18.6	3.7
Total Outstanding loans [1]	7.0	1.2	10.6	502.0	100.0

1 Including loans sold to Cagamas and Danaharta.
Source: Bank Negara Malaysia

Of significance was the sustained expansion in loans to SMEs. Loans outstanding extended to the SMEs increased by RM1.4 billion during the quarter, channeled mainly to the manufacturing as well as the wholesale and retail trade, restaurants and hotels sectors. As a result, SMEs loans accounted

Sustained expansion in bank lending to SMEs



for 15.5% of total loans outstanding and 31% of total business loans as at end-June (15.6% and 30.9% respectively as at end-March).

In aggregate, financing provided by the banking system through direct extension of loans and holdings of private debt securities expanded by RM8.5 billion or 5.2% in the second quarter (RM5.5 billion or 4.5% in the first quarter). Total financing raised by the private sector through the banking system and the bond market rose at an annual rate of 7.8% as at end-June 2003 (3.1% as at end-March).

Net Financing through Banking System
Loans and PDS rose significantly by 7.8%

	Change during quarter (RM billion)			Annual growth (at end period, %)	
	2002	2003		2003	
	2Q	1Q	2Q	Mar	Jun
Financing by banking system	5.0	5.5	8.5	4.5	5.1
Loans outstanding (1)	7.0	1.2	10.6	3.2	3.9
Holdings of PDS	-2.1	4.3	-2.1	29.2	31.9
Total PDS outstanding 1/ (2)	-19.4	15.5	3.6	2.8	27.2
Total (1) + (2)	-12.4	16.7	14.2	3.1	7.8

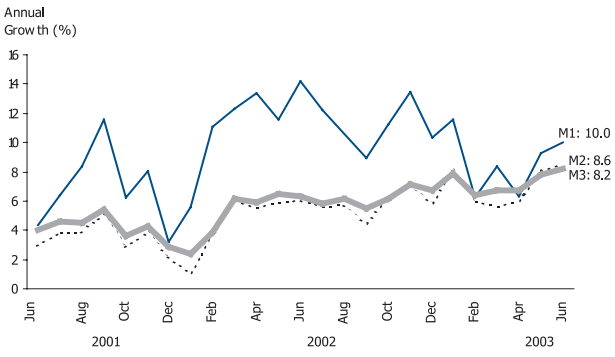
1/ Refers to total PDS issued by the private sector with original maturity of more than one year.
Exclude debt securities issued by banking institutions, Khazanah, Cagamas, Danaharta and Danamodal.

Source: Bank Negara Malaysia

Monetary aggregates recorded higher growth

In tandem with the increased economic activity and sustained consumption spending, growth in monetary aggregates was higher, with M1, M2 and M3 expanding at annual growth rates of 10%, 8.6% and 8.2% respectively at end-June (8.4%, 5.6% and 6.7% respectively at end-March). Of significance, demand for transaction balances remained high, indicating sustained consumer spending by households and businesses continuing to build up demand deposits for near-term expenditure. The primary source of broad money expansion emanated from higher bank financing and the expansionary Government operations.

Monetary aggregates recorded higher growth



Capital Market

The capital market remained an important source of financing

Total gross funds raised in the capital market remained high at RM21.4 billion in the second quarter of 2003. Gross funds were mainly raised through the bond market (RM21 billion). Gross funds raised by the public sector were mainly through a new issuance and one reopening of Malaysian Government Securities (MGS).

The low interest rate environment continued to encourage the private sector to issue long-term debt at competitive costs. Funds

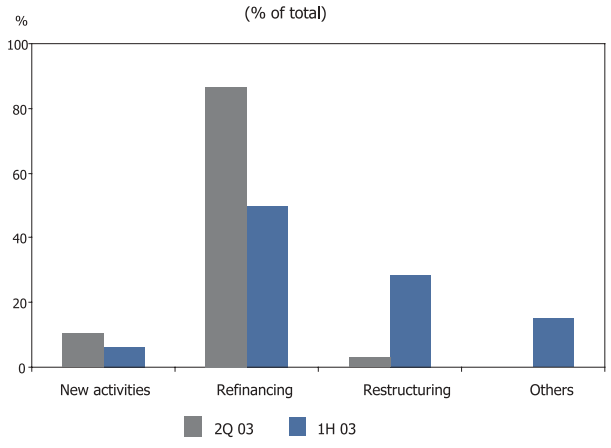
Funds Raised in the Capital Market

	2002		2003 P		
	2Q	2H	1Q	2Q	2H
	RM million				
By Public Sector					
Government Securities, gross	3,181	6,589	17,730	8,132	25,862
Less Redemptions	500	5,900	10,300	1,500	11,800
Less Government holdings	0	0	0	0	0
Equals Net Federal receipts	2,681	689	7,430	6,632	14,062
Khazanah Bonds, net	0	0	878	(138)	740
Govt. Investment Issues, net	0	0	1,729	0	1,729
Malaysia Savings Bond, net	(3)	469	(2)	(2)	(4)
Net Funds Raised	2,678	1,158	10,035	6,492	16,527
By Private Sector					
Shares	7,193	9,244	601	396	997
Debt securities [1]	11,189	16,039	17,406	12,911	30,317
Less Redemptions	16,739	20,408	2,176	9,237	11,413
Equals Net issues	(5,550)	(4,369)	15,230	3,674	18,904
Net Funds Raised	1,643	4,875	15,831	4,070	19,901
Total Net Funds Raised	4,321	6,033	25,866	10,562	36,428
Short-term Papers and Notes, net [2]	(813)	(2,274)	743	85	828
Total	3,508	3,759	26,609	10,647	37,256

[1] Excludes debt securities issued by banking institutions.
[2] Refers to Commercial Papers and Cagamas Notes only.
P Preliminary.

raised were mainly for refinancing purposes which accounted for 86.5% of the total funds raised in the private debt securities (PDS) market. PDS issued for new activities and debt restructuring purposes accounted for 10.4% and 3.1% respectively. During the quarter, higher redemptions were recorded by both the public and private sectors. As at end of June, total bonds

Private Debt Securities Issued by Purpose



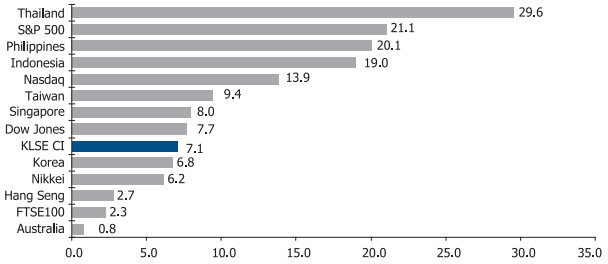
KLSE: Selected Market Indicators

	As at end				
	2002		2003		
	2Q	1H	1Q	2Q	1H
Price Indices					
- Composite	725.44	725.44	635.72	691.96	691.96
- EMAS	176.50	176.50	153.98	170.23	170.23
- Second Board	119.84	119.84	93.00	108.96	108.96
Average daily turnover					
- Volume (million units)	299.3	302.0	213.6	286.7	251.4
- Value (RM million)	643.8	640.1	367.1	457.2	413.7
Market Capitalisation (RM b)	505.89	505.89	478.30	532.45	532.45
No. of Companies Listed	843	843	874	877	877

outstanding stood at RM308 billion, of which private sector bonds accounted for a share of 54.1% of the total outstanding.

Total funds raised in the equity market amounted to RM396 million in the second quarter. There was a total of 7 IPOs issued, of which two were listed on the Main Board, three on the Second Board and two on the MESDAQ Market. The amount raised through the IPOs totalled RM173.4 million and was issued mainly by companies in the infrastructure, industrial products and technology sectors. During the quarter, four companies were delisted.

Performance of Selected Global and Regional Markets in the Second Quarter of 2003



KLSE: Turnover of Corporate Securities

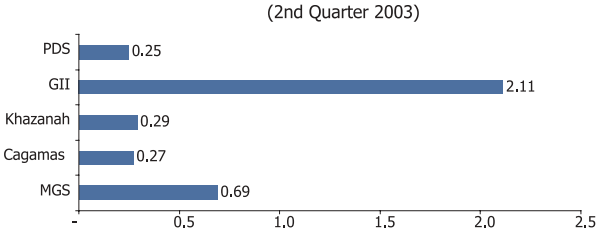
	2002				2003					
	2Q		1H		1Q		2Q		1H	
	million units	RM million	million units	RM million	million units	RM million	million units	RM million	million units	RM million
Turnover	18,555	39,913	36,239	76,808	12,387	21,294	17,775	28,349	30,162	49,642
of which:										
Main Board	16,122	35,720	30,891	66,765	10,609	19,397	14,421	24,648	25,030	44,045
of which:										
- Consumer Products	406	2,473	1,053	5,089	309	1,481	509	1,959	818	3,440
- Industrial Products	1,069	1,939	2,361	3,686	711	1,535	1,429	2,105	2,139	3,640
- Construction	1,458	3,290	2,643	5,950	1,482	1,687	1,181	1,796	2,663	3,483
- Trading/Services	4,384	13,211	7,457	23,384	2,791	7,165	3,329	9,009	6,119	16,173
- Finance	2,000	6,949	4,670	14,366	1,532	3,784	1,908	4,422	3,440	8,205
- Properties	2,173	2,135	3,695	3,514	1,370	966	2,942	2,210	4,312	3,176
- Plantations	415	1,739	756	3,009	296	1,283	307	1,129	602	2,413
- Mining	98	290	160	402	48	91	53	92	101	183
Second Board	2,320	4,117	5,208	9,932	1,591	1,807	2,685	3,377	4,276	5,184

Stronger performance in the equities market

For the second quarter as a whole, the performance of the KLSE CI improved by 8.8% since the end of the first quarter of 2003 and by 7.1% since end-2002. Market capitalisation and trading activities during the quarter were significantly higher than the previous quarter. Market sentiments improved following the announcement of the new economic package by the Government, containment of the SARS impact and the introduction of the standard 100-unit board lots which encouraged retail participation.

Secondary trading in bonds rose to RM153.1 billion (1Q 2003: RM132.3 billion), as investors continued to favour fixed-income investments given concerns over the impact of SARS and anticipation of an interest rate cut. In terms of total turnover, trading activities were concentrated in the Government and quasi-Government securities. Trading activities on the PDS market were also higher and accounted for 24.7% of the total turnover during the quarter (16.8% in the previous quarter). The GII and MGS were the most liquid papers, registering total turnovers of 2.11 times and 0.69 times of its outstanding amount respectively.

Liquidity Ratio



Liquidity in the PDS market improved as the liquidity ratio increased to 0.25 times from 0.15 times registered in the previous quarter.

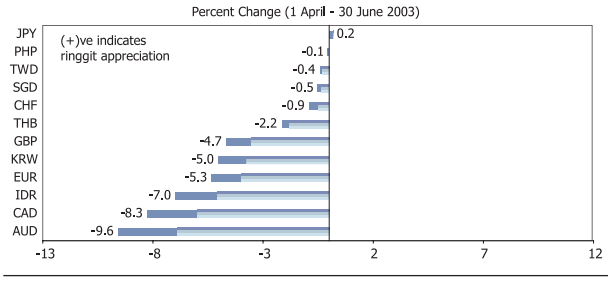
Ringgit exchange rates continues to benefit trade and investments

In line with the weaker US dollar in the international foreign exchange markets, the ringgit depreciated against most major and regional currencies in the second quarter of 2003. The dollar was adversely affected by market concerns over the weakness of the US economy and the perception that the administration was no longer advocating a 'strong dollar' policy. In contrast, the euro resumed its upward trend to reach a four-year high on 29 May, exceeding the level at which it was launched in January 1999. The euro was supported by inflows into higher yielding euro denominated assets and the global realignment of currency portfolios.

Among the regional currencies, the Indonesian rupiah appreciated significantly on improving economic fundamentals and strong capital inflows.

The ringgit exchange rate continues to be well supported by the strong level of foreign exchange reserves, low inflation, continued surpluses in the current account, low external debt as well as a strong and resilient banking system.

Summary of Ringgit Performance Against Selected Currencies

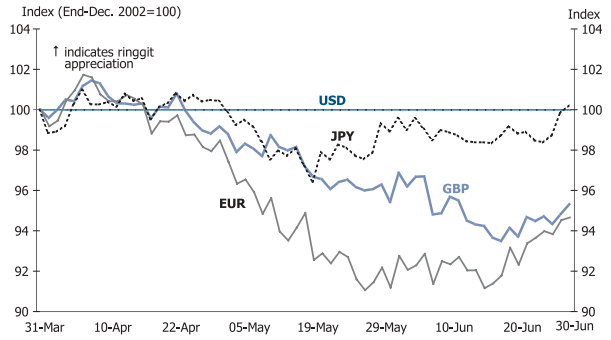


Performance of Ringgit against Selected Currencies

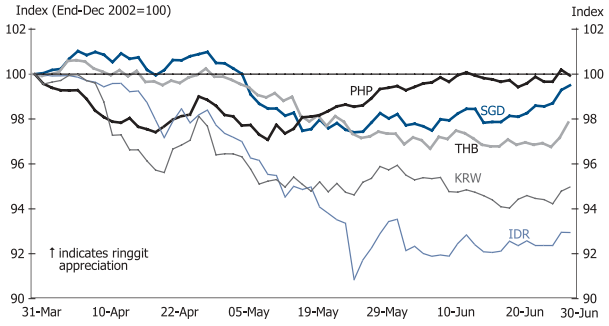
RM per foreign currency	End-June 1997	2 September 1998	End-1Q 2003	End-2Q 2003	% change since [1] End-June 1997	2 September 1998	End-1Q 2003
US dollar	2.5235	3.8000	3.8000	3.8000	-33.6	0.0	0.0
Euro	-	-	4.1145	4.3463	-	-	-5.3
Pound Sterling	4.1989	6.3708	5.9898	6.2835	-33.2	1.4	-4.7
100 Japanese yen	2.2088	2.7742	3.1774	3.1708	-30.3	-12.5	0.2
Singapore dollar	1.7647	2.1998	2.1523	2.1631	-18.4	1.7	-0.5
100 Thai baht	9.7470	9.3713	8.8588	9.0541	7.7	3.5	-2.2
100 Philippine peso	9.5878	8.8302	7.0948	7.0995	35.0	24.4	-0.1
100 Indonesian rupiah	0.1038	0.0354	0.0427	0.0459	126.1	-22.9	-7.0
100 Korean won	0.2842	0.2827	0.3019	0.3178	-10.6	-11.0	-5.0

Note:
[1] (+) indicates appreciation of ringgit against respective currency and (-) indicates depreciation.

Ringgit Performance Against Major Currencies



Ringgit Performance Against Regional Currencies



DEVELOPMENTS IN THE BANKING SYSTEM

The banking system maintained its strength and resilience in the second quarter of 2003, as reflected in the strong financial indicators with no signs of vulnerabilities both at the system and institution levels. Of significance was the continued improvement in the quality of loan portfolio and high levels of capitalisation.

Capitalisation sustained at high levels

The capital position of the banking system remained strong with both the risk-weighted capital ratio (RWCR) and core-capital ratio sustained above 13% and 10%, respectively throughout the second quarter. The RWCR stood at 13.1% at end-June 2003. The strong capital position enhanced the capacity of the banking system to extend new loans. Meanwhile, Tier-1 capital declined by RM1.1 billion or 1.8% resulting from a merger between two commercial banks. Consequently, core capital ratio declined marginally to 10.6% at end-June 2003.

Capitalisation of the Banking System

	2002			2003	
	Jun.	Sep.	Dec.	Mar.	Jun.
Capital					
Core-capital ratio (%)	10.9	11.0	11.1	11.0	10.6
RWCR (%)	13.2	13.3	13.2	13.2	13.1

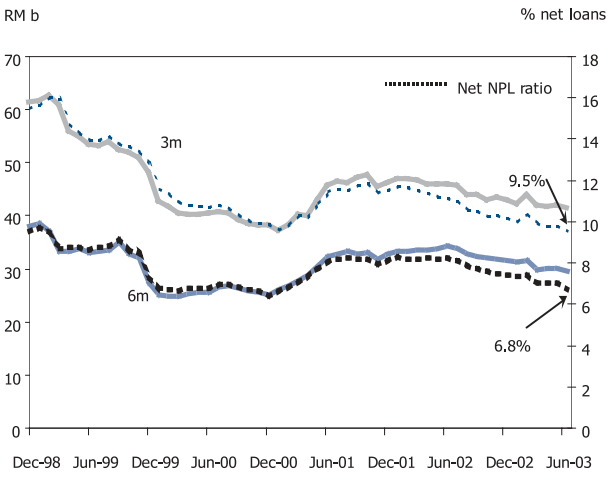
Banking operations remained profitable amidst intense competition

The banking system registered gross operating profits of RM2.9 billion in the second quarter, similar to the level achieved in the preceding quarter. Increased competition in the loan market, particularly in lending to the household sector, resulted in a flat growth in net interest income. In addition, the higher income of RM0.9 billion from fee-based activities (increase of RM0.5 billion) offset the increase in administrative expenses. However, the increased recoveries of RM2.4 billion (increase of RM1.4 billion) and trading and investment income of RM1.5 billion (increase of RM0.5 billion) contributed to increase in the profit before tax of the banking system by 16% to RM2.8 billion.

NPLs trending downwards

The level of non-performing loans (NPLs) of the system in the second quarter of 2003 improved further as a result of higher loan write-offs and implementation of debt restructuring schemes. Net NPLs on a six-month classification declined to RM29.6 billion or 6.8% of net total loans from 7% as at end-March 2003 (three-month classification: declined to 9.5% from 9.9% as at end-March 2003). During the quarter, a total of RM2.5 billion of loans

Banking System: Non-performing Loans



were written off whilst recoveries amounted to RM2.4 billion. Loans classified as NPLs during the quarter amounted to RM5.6 billion, a decline of 9.4% compared with RM6.2 billion in the previous quarter. The loan loss coverage ratio remained comfortable at 61.1%.

In terms of economic sector, the level of NPLs for the business sector declined by RM1.8 billion to account for 16.4% of total business loans primarily due to conversions of manufacturing and construction-related loans into bonds as part of debt restructuring exercises. Meanwhile, NPLs for the household sector increased only moderately by RM0.2 billion to RM17.1 billion with NPLs for the purchase of residential properties grew by RM0.3 billion to RM9.6 billion. The increase in incidence of default in the household sector remained manageable, with NPLs for household sector accounting for 8.5% of total household sector loans.

The Changing Pattern of Financing of the Economy

Introduction

With the strengthening of the banking system, growth in bank lending has become more robust in providing the necessary financing to support economic growth. Since 2000, a significant shift in the pattern of bank lending has also occurred in line with the changing economic structure and sources of economic growth.

Increased bank lending to support domestic economic activity

Amidst ample liquidity conditions and low interest rates, bank lending has resumed since the 1998 crisis to support the higher level of economic activities. In value terms, loan applications and approvals in 2002 recorded the highest level in five years. Loans disbursed in 2002 were higher than the level recorded in 1997. In the first six months of 2003, loan applications and approvals have improved further to record a monthly average of RM18.2 billion and RM12.2 billion respectively (RM18.1 billion and RM11.5 billion respectively in 2002). Notwithstanding the uncertainties arising from the geopolitical tension and SARS outbreak, loan disbursements remained high at a monthly average of RM34.2 billion (RM34.3 billion in 2002). While growth in lending activity is reflected in the higher loan applications, approvals and disbursements, the growth in outstanding loans also reflects the high level of repayments. The significant repayments followed the restructuring and refinancing exercise, which resulted in either loans written off by the banking institutions or refinanced through the bond market or converted into equity.

As part of the effort to promote endogenous sources of growth, efforts were undertaken to enhance SME contribution to growth in the domestic economy. Private domestic consumption was also being promoted to further support domestic growth. The banking system has responded positively to the policy shift with bank lending shifting towards higher lending to the consumers and the small and medium enterprises (SMEs). In terms of maturity structure of

Banking System: Loan Indicators

	Monthly average							Annual growth	
	1997	1998	1999	2000	2001	2002	J-Jun 03	2002	Jun-03
	RM billion							%	
Total									
Loan applications	20.9	7.4	10.7	17.4	15.9	18.1	18.2	14.1	14.5
Loan approvals	17.7	5.5	8.7	11.2	10.5	11.5	12.2	9.7	24.5
Loan disbursements	28.2	20.9	26.5	30.1	31.1	34.3	34.2	10.3	8.5
Loan repayments	22.3	22.5	27.7	28.9	30.4	33.6	32.9	10.3	-3.9
Change in outstanding loans	7.4	0.4	0.1	2.0	1.4	1.7	2.0	4.2	3.9
Of which									
Businesses									
Loan applications	n.a.	n.a.	n.a.	n.a.	n.a.	11.3	10.3	n.a.	10.2
Loan approvals	13.4	3.9	5.1	6.6	5.3	5.7	6.3	7.9	45.8
Loan disbursements	23.2	17.6	21.4	22.5	22.5	23.5	23.3	4.3	6.5
Loan repayments	18.5	19.0	22.4	22.4	23.1	23.0	22.6	-0.3	-7.0
Change in outstanding loans	4.2	0.2	0.5	0.3	-0.5	-0.3	-0.1	-2.1	-1.7
Households									
Loan applications	n.a.	n.a.	n.a.	n.a.	n.a.	6.8	7.5	n.a.	14.9
Loan approvals	3.6	1.4	3.3	4.4	4.9	5.6	5.7	13.5	6.6
Loan disbursements	3.9	2.6	4.1	6.3	7.2	8.8	8.9	21.1	14.3
Loan repayments	3.0	2.8	4.2	5.4	6.0	7.0	7.3	17.3	12.1
Change in outstanding loans	2.7	-0.4	0.3	1.4	1.9	2.2	1.8	14.8	12.7

Loans of the Banking System[1] by Customers, 2001 - June 2003 Outstanding as at end-period, RM billion

	2000	% share	2002	% share	Average Annual Growth rate 2001-2002	June 2003	% share	Annual Growth Rate as at end-Jun 03
Loans extended to:								
Household sector	157.4	34.7	206.8	42.2	14.6	217.9	43.4	12.7
Business sector	260.7	57.4	252.1	51.4	-1.6	251.4	50.1	-1.7
Small and medium enterprises	70.5	15.5	74.6	15.2	2.8	78.0	15.5	4.9
Others	190.1	41.9	177.6	36.2	-3.4	173.4	34.5	-4.4
Others [2]	36.0	7.9	31.3	6.4	-6.7	32.7	6.5	-4.6
TOTAL [3]	454.0	100.0	490.3	100.0	3.9	502.0	100.0	3.9

[1] Include Islamic banks
[2] Others refer to Government, financial institutions, other domestic entities and foreign entities.
[3] Include loans sold to Cagamas and Danaharta

loans, the lending pattern has also changed, becoming more skewed towards shorter-term loans for working capital as large corporations with longer-term financing requirements issue more private debt securities (PDS) to meet their financing needs. Overall, this changing pattern has led to higher share of consumer and SMEs loans to total bank lending.

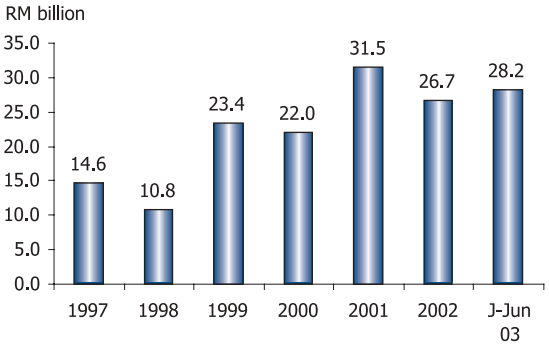
More diversified sources of financing

While the banking sector remains the most important source of financing, large corporations have increasingly raised funds from the bond market for longer-term capital requirements. During the period 1997 to June 2003, the significant debt restructuring has also resulted in refinancing of existing debt by the issue of private debt securities. PDS issued have therefore increased at an average annual growth of 12.8% in the period 1998-2002 with PDS outstanding to GDP increasing from 16.5% in 1997 to 32.2% as at end-June 2003. Amidst the low interest rate environment, large corporations have issued PDS to lock in long-term funds at low cost. Issuance of PDS also ensures that longer gestation projects are being financed by longer-term funds, thus reducing the risks of maturity mismatch for corporations. This has improved the risk management of both corporations and banking system. Total issuance of PDS from January 2001 to June 2003 amounted to RM86.4 billion, 53.7% increase from the issuance of RM56.2 billion recorded during the period 1998-2000. Issuance in the first half of 2003 has exceeded the total issuance for the whole year of 2002.

Banking institutions continue to extend indirect financing to the business sector through significant holding of PDS issued by the private sector. Taking into account this indirect financing,

Large corporations are increasingly raising funds from the bond market. Issuance in the first half of 2003 have exceeded total issuance for the whole of 2002

Gross PDS issuance



Financing through Banking System[1] and PDS, 2001-June 2003 Outstanding as at end-period, RM billion

	2000	2002	Average Annual Growth Rate 2001-2002	Jun-03	Annual Growth Rate as at end-Jun 03
Financing by the banking system	**472.1**	**518.4**	**4.8**	**532.4**	**5.1**
Loans Outstanding[2](A)	454.0	490.3	3.9	502.0	3.9
Holdings of PDS	18.1	28.1	24.8	30.4	31.9
PDS Outstanding[3](B)	**100.5**	**104.0**	**1.7**	**123.1**	**27.2**
Total (A) + (B)	**554.5**	**594.2**	**3.5**	**625.1**	**7.8**

1 Include Islamic banks
2 Include loans sold to Cagamas and Danaharta
3 Refers to total PDS issued by the private sector with original maturity period of more than one year. Exclude debt securities issued by banking institutions, Khazanah, BNM, Cagamas, Danaharta and Danamodal.

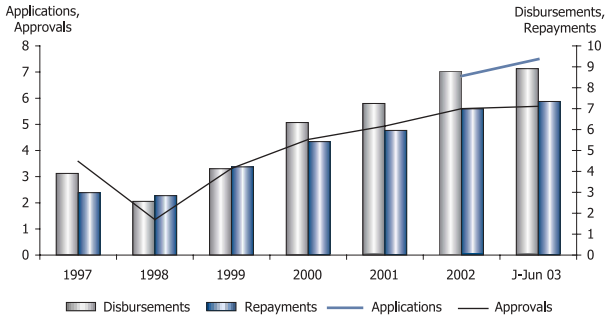
total financing of the private sector by the banking system expanded at an average annual rate of 4.8% during 2001-2002 and 5.2% as at end-June 2003. Consequently, the loan-deposit ratio, including holdings of private debt securities by the banking system, stood at 93.8% as at end-June 2003 (92% as at end-2000). After taking into account redemptions, net financing raised through the banking system and the PDS market rose by 3.5% during 2001-2002 and at a higher rate of 7.8% as at end-June 2003.

Significant growth in bank lending to households reflects policy to promote domestic consumption

The policy to stimulate consumption spending through monetary and fiscal measures has contributed to significant increase in consumption spending. In line with stronger growth in private consumption, financing extended to households by the banking system has increased at a significant average annual rate of 14.6% in the period 2001-2002 and by 12.7% as at end-June 2003. This rapid growth in household loans raised the share of household loans to 43.4% of total loans outstanding as at end-June 2003, from 34.7% as at end-2000. Of the total loans disbursed to the household sector during this period, 31.8% was for purchase of houses, 26.4% for financing of cars and 41.8% for consumption credit. The higher lending to

Lending to households has been on an upward trend, supporting the strong growth in private consumption

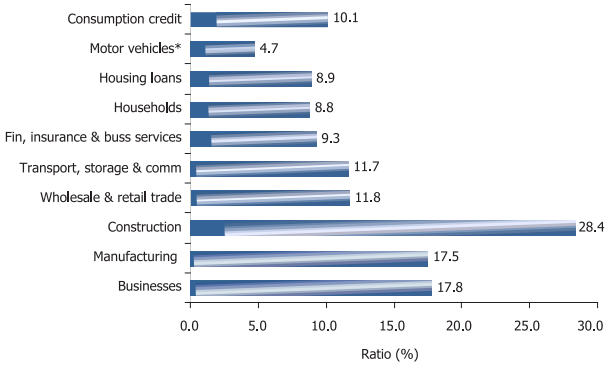
Lending to Household Sector (Monthly averages, RM billion)



household sector has not created increased risks given the high savings rate of the Malaysian households. The risk of household loans turning non-performing has remained at 8.8%, the lowest rate compared with NPLs for other categories. The banking institutions also have the capacity to monitor loan exposure through the Centre for Credit Reference Information System (CCRIS) to ensure that exposure of households remain within prudential limits.

Default rate of household loans has been low at 8.8%

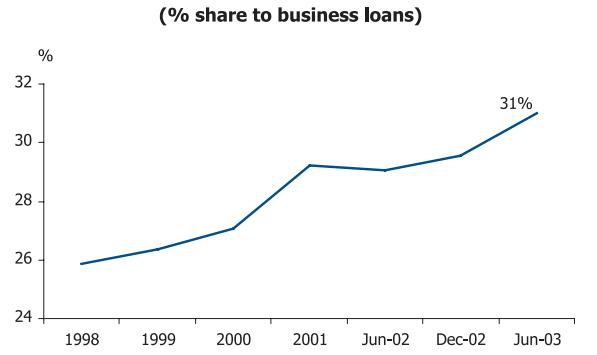
Non-Performing Loans of the Banking System Ratio against outstanding loans as at end-June 2003



* Include passenger cars

Lending to SMEs has increasingly gained importance as evident by the rising share to total business portfolio of the banks

Loans Outstanding to SMEs



Lending by the Banking System[1] to Small and Medium Enterprises (SMEs), 2002-Jun 2003

	2002	Jan-Jun 2003	Total	% share to total loans	% share to business loans
(During the period, RM billion)					
Amount of loans approved	30.7	12.0	42.7	20.2	40.2
Amount of loans disbursed	49.5	40.2	89.7	14.5	21.3
(During the period, Unit)					
No of loans approved	74,233	37,648	111,881	3.5	n.a.

[1] Include Islamic banks

Strong growth in lending to SMEs

Another significant development is the increased bank lending to SMEs. Outstanding loans to SMEs increased at an average annual rate of 2.8% in 2001-2002 and at a higher annual rate of 4.9% as at end-June 2003. Data available for 2002 and the first half of 2003 showed that a total of RM42.7 billion of loans were approved to 111,881 SMEs. Total loans disbursed were higher, amounting to RM89.7 billion, reflecting the higher turnover of loans. For the first half of 2003 alone, RM12 billion was approved to more than 37,000 SMEs whilst disbursements amounted to RM40.2 billion compared RM49.5 billion for the whole of 2002. As at end-June 2003, SMEs loans to total business loans outstanding accounted for 31% compared with 26.4% as at end-1999.

The higher lending to SMEs has followed the concerted efforts to enhance access to financing to this group (details in the next article). Measures have focused on building the infrastructure to support increased access to financing by SMEs. Banking institutions have now established special units for SME financing, Loan Rehabilitation Units and Bumiputera Development Units. The Credit Guarantee Corporation and ERF Sdn Bhd have also been enhanced. At Bank Negara Malaysia, an SME Special Unit has been established. Other measures include the strengthening of the effectiveness of

Status of Special Fund under the Administration of Bank Negara Malaysia, 2000 - Jun 2003

	Total allocation at end Jun-03	Loan approvals				Utilisation Rate at end Jun-03	Loan disbursements			
		Total as end		Change (2001-June 2003)			Total as end-		Change (2001-June 2003)	
		2000	June 2003				2000	June 2003		
	RM million				%	%	RM million			%
Fund for Food	1,300	854	1,386	532	62.3	106.6	740 0	1,216	476	64.4
New Entreprenuer Fund 2	900	0	802	802	-	89.1		591	591	-
Fund for SMIs 2	1,250	99	1,506	1,406	1,416.7	120.5	43	1,077	1,035	2,424.9
Bumiputra Entreprenuer Projecy Fund	300	0	407	407	-	135.8	0	324	324	-
Rehabilitation Fund for SMIs	500	288	326	38	13.2	65.2	235	297	62	26.5
Entreprenuer Rehabilitation & Development Fund	500	0	3	3	-	0.6	0	1	1	-
Total	**4,750**	**1,241**	**4,430**	**3,189**	**256.9**	**93.3**	**1,017**	**3,506**	**2,489**	**244.7**

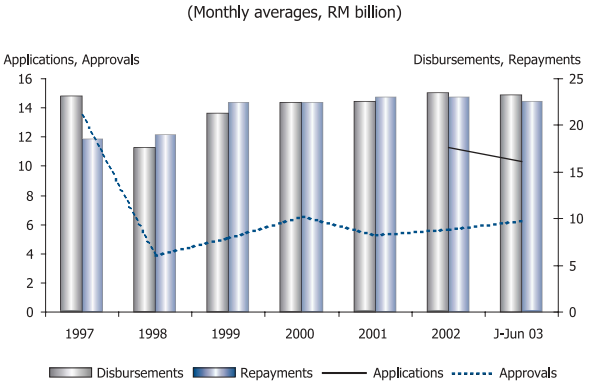
special funds by expanding the scope and size of special funds, liberalising the eligibility criteria of selected special funds, establishing new funds as well as lowering the cost of borrowing. To date, a total of RM4.8 billion has been allocated for special funds. The utilisation rates of these funds were high. A total of RM4.4 billion has been approved and a total of RM3.5 billion has been disbursed as at end-June 2003.

Lending by banks to businesses is now more skewed towards shorter-term financing

The pattern of maturity structure of loans has also changed reflecting the shift in the sources of economic growth to a more domestic driven growth and from an investment-led to increased consumption and the increased reliance of larger corporations on PDS market for longer-term funds. This has resulted in increased demand for shorter-term borrowing. Large corporations seek revolving credit and overdrafts facilities from the banking system to finance short-term working capital. As a result, long-term loans with the maturity of more than one-year extended to the business sector accounted for only 26.3% of total loans as at end-June 2003, down from 30% as at end-1997. For the households, consumption credit is mainly with short-term maturity while housing and car loans have maturity of more than one year. With the rapid growth in consumer loans, the share of housing and car loans have increased from 20.6% of total loans as at end-1997 to 35.7% as at end-June 2003.

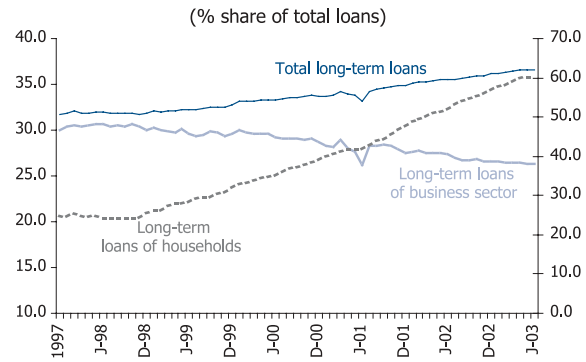
Large corporations continued to raise short-term financing from the banks. This was reflected in the high disbursements and high repayments of loans

Lending to Business Sector



Increase in long-term loans due mainly to long-term loans of households

Long-term Loans of the Banking System



The recourse for more shorter-term funds by the business sector has resulted in higher disbursements, which were being matched by equally high repayments. Consequently, while loans disbursed to the large corporations accounted for 48.5% of the total loans disbursed, the share of this group declined to 34.5% of total loans outstanding as at end-June 2003, from 41.9% as at end-2000. Thus, while this more robust financing activity is not reflected in the outstanding loans, the higher rate of disbursements and its multiplier effects on the economy have been important in supporting the economic growth.

Comprehensive Strategy to Enhance Access to Financing for SMEs

To date, several measures have been undertaken to improve access to credit by the small and medium enterprises (SMEs), in recognition of their emerging role as an important source of dynamism and future driving force for a broad-based and resilient economy.

i. Establishment of SME units at banking institutions

- Apart from normal lending, the roles and functions of these units include providing other ancillary services such as:
  - Identify and structure appropriate financial requirements based on the SMEs' needs;
  - Conduct training courses, workshops and other educational programmes individually or in conjunction with Government agencies or other bodies;
  - Provide cash management services; and
  - Provide other ancillary services such as financial management and insurance protection.

ii. Establishment of SME Special Unit in Bank Negara Malaysia

- The SME Special Unit assists the SMEs in the following areas:
  - Provide information on the various sources of financing available to SMEs;
  - Assists SMEs in their loan applications;
  - Addresses difficulties faced by viable SMEs in securing financing; and
  - Provide advisory services on SMEs' financial requirements.

- As at 18 August 2003, the Unit has received 1,214 enquiries from the public, of which 84% were enquiries on financing, in particular, on available sources of financing.

- SMEs that require assistance can contact the Special Unit during the hours of 0900-1700 at the following numbers:

  Telephone numbers:
  03-2693 2330, 03-2691 4570, 03-2691 6539, 03-2691 3764, 03-2691 6971, 03- 2691 3486, 03-2698 0157

  Fax numbers:
  03-2691 6954, 03-2698 6705, 03-2691 7052

iii. Special funds administered by Bank Negara Malaysia

- Since 1988, Bank Negara Malaysia has provided 12 different funds for SMEs, with a total allocation of RM8.75 billion. These funds are aimed at providing financing at reasonable interest rates for SMEs in various sectors of the economy. Currently, there are six funds that are still open for applications with a combined allocation of RM4.75 billion.

- To further enhance SMEs' access to the funds, the following measures have been undertaken:

- the lending rates on the existing and new borrowers from the special funds were reduced by 0.5 percentage points in 2001; and
- the allocations for Fund for SMIs 2 and New Entrepreneur Fund 2 was increased in October 2002 by RM250 million each. The fund size was expanded again in March 2003 by RM600 million and RM400 million respectively, bringing the total allocation to RM1,250 million and RM900 million respectively.

- As at end-July 2003, RM4.6 billion have been approved from these six funds to more than 13,000 borrowers, with disbursements amounting to RM3.7 billion.

iv. Enhanced the role of Credit Guarantee Corporation (CGC)

- In 2000, BNM injected RM1 billion into CGC to strengthen its capital position, thus enabling CGC to provide more guarantees. In addition, CGC has taken the following measures to enhance its role as a guarantee provider:
  - Introduced Direct Access Guarantee Scheme (DAGS) in 2000 under which all loan applications which need guarantee cover would be processed by CGC and successful applications would be forwarded to the BIs (the usual practice is for banks to process the loans and seek CGC guarantee);
  - Increased its branch network to 12 branches; and
  - Launched 'i-Guarantee' in 2001 to enable SMEs to submit loan applications directly via the website.

- As at end-July 2003, the total outstanding loans guaranteed by CGC under its six schemes amounted to RM8.38 billion.

v. Establishment of Bumiputera Development Unit

- All commercial banks ahave set up a Bumiputera Development Unit to address the financing needs and development of Bumiputera entrepreneurs.

vi. Establishment of Special Loan Rehabilitation Unit

- To address the management of problem loans, all banking institutions have established a Special Loan Rehabilitation Unit to serve the following broad objectives:
  - To segregate the management of problem loans from normal day-to-day credit management and administration; and
  - To commit dedicated resources in terms of personnel and expertise to undertake management of problem loans on a full time basis.

vii. Lending Guidelines

- To ensure continued access to financing to the SMEs, Bank Negara Malaysia will continue to determine lending targets for individual banks based on their individual capacity.

viii. Establishment of the Special Relief Guarantee Facility of RM1 billion to alleviate the cash flow problems faced by businesses affected by the SARS outbreak (tourism-related activities)

- This facility will provide 80% guarantee for new working capital financing raised by these businesses from the commercial banks, Islamic banks, finance companies, Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri dan Teknologi Malaysia Berhad.
  - The maximum amount of financing is an aggregate of RM2.5 million per group of companies;
  - Financing rate charged is 3.75% p.a. for the first year and not more than the 3-month KLIBOR+1 percentage point for the second year; and
  - The loan tenure is up to two years, with a repayment grace period of six months.

- To date, banking institutions have received 77 applications (RM68.2 million) of which 37 have been approved (RM21.1 million). Eight applications (RM9.8 million) have been rejected because the applicants do not meet the eligibility criteria.

ix. Display of Client Charter

- To enhance the efficiency of the loan approval process, banking institutions are required to display a Client Charter on processing of loans to SMEs disclosing the following:
  - The necessary documents and information which should be submitted to the banking institution to support any loan application;
  - The eligibility criteria for obtaining loans and definition of project viability; and
  - Duration taken by banking institution to process a loan application.

- The banking institutions' compliance with their Client Charters are monitored through on-site inspection of the institutions.

x. Establishment of Complaint Unit

- In order to provide a proper channel for customers to raise complaints, all commercial banks and finance companies have set up a dedicated Complaints Unit.

xi. Enhanced the role of ERF Sdn. Bhd.

- To further strengthen the process of managing issues relating to financing and advisory services for Bumiputera entrepreneurs, the Bumiputera Development Unit in BNM was transferred to the ERF in June 2002. With this expanded role, ERF acts as a one-stop centre by providing financing, training and advisory services to the Bumiputera entrepreneurs.

- Currently, ERF is managing two funds namely Tabung Projek Usahawan Bumiputera and Tabung Pemulihan dan Pembangunan Usahawan with total

allocation of RM800 million. As at end-July 2003, RM418.1 million worth of applications has been approved and RM336.4 million was disbursed under these two funds. In addition, between June 2002 to June 2003, ERF has conducted 8 training courses to more than 200 entrepreneurs.

xii. Efforts to Increase Awareness

- To ensure that SMEs are well informed on the various initiatives in place to support their financing needs, efforts were made to disseminate the information through the publication of brochures and booklets on the special funds, schemes and various products and services available for SMEs.

- In addition, Bank Negara Malaysia also participated in a number of exhibitions and trade fairs organized by the trade associations. Currently, Bank Negara Malaysia is participating in activities organised by the Chambers of Commerce nationwide.

- As part of the consumer education programme, Bank Negara Malaysia is finalising two booklets to assist SMEs on their loan application process and providing information on various products offered by banking institutions.

Enhancing the Malaysian Payments System

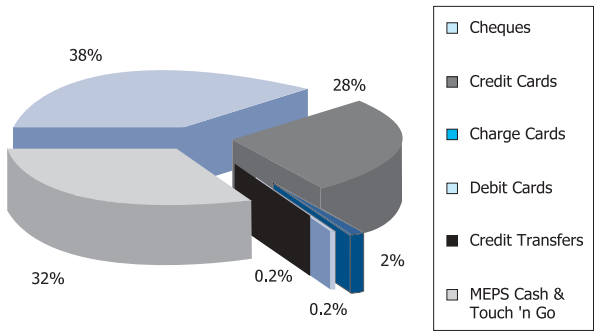
Importance of a smooth functioning payments system

The smooth and efficient operation of the payments system is a critical factor in a country's economic growth process. It is also important to have a safe and efficient payments system to maintain financial stability. In addition, a safe and efficient functioning payments system enables the Central Bank to implement its monetary policy effectively. In modernising the payments system in line with new technology and current needs of the users of payment systems, efforts have been directed at facilitating more efficient means of making online payments. This includes the development of the Financial Process Exchange that provides a multi-bank Internet payment platform to businesses and consumers. The Bank has therefore, given priority to ensuring the safety and efficiency of the payments system. In the recent period, efforts have been focused on reviewing the legal framework on payments system, and monitoring the industry's efforts in enhancing the safety and efficiency of payment instruments as well as collaborating with the police in combating payments fraud.

Greater use of electronic payment methods can create cost savings to the economy

There is a broad choice in payment methods in the country, the common ones being cash, cheques, debit cards, credit cards, charge cards, electronic purse and credit transfers. While the use of most electronic payment methods using payment cards, and interbank payment system has been on an increasing trend, the use of cash and cheques continue to remain high in Malaysia. The use of cash is indicated by the value of notes and coins in circulation, which had doubled as at end-December 2002, as compared to end-December 1992, and the notes and coins in circulation per capita had increased from RM652 to RM974 during the same period. The cheque is also an important mode of payment compared with other cashless payment instruments as shown in the chart below.

Composition of Number of Cashless Payments in 2Q 2003



While cash payments and withdrawal are generally free (unless withdrawal is made at another bank's automatic teller machines or exceeding a specific number of transactions), and the issuance of cheque cost very low to the issuer, the related costs on cash and cheques are highly significant. The Bank incurs high cost on printing, minting, distribution, control and destruction of notes and coins, while the banking industry and retail sector, in handling cash and cheques, incur costs related to transportation, security, insurance, fraud and robberies apart from staff and administration costs.

"By increasing the efficiency and velocity of payments in electronic payment networks, there is a potential to create cost savings of at least 1 percent of GDP annually over paper-based systems in any given economy"

Source: A white paper by Global Insight, which was presented at the ministerial-level session of the United Nations Economic and Social Council in Geneva in June 2003

While the provision of electronic payment systems involves substantial investment by the banking industry, the cost incurred by a bank to process an electronic payment transaction is less than the cost of processing a paper-based payment if a critical mass for the electronic payment method is achieved. A sufficiently high number of transactions will enable the positive network externalities and economies of scale for the electronic payment method to be reaped. The bank's transaction cost in processing electronic payments reduces as the number of transaction increases. In countries that have migrated to electronic payments, the electronic payment systems generally cost in the range of one-half of a paper-based system.

Maximising the benefits from electronic payment systems and instruments require wider public acceptance and further infrastructure building

Creating wider public acceptance of electronic payment systems and instruments requires the public confidence that the systems and instruments are secure and convenient. This includes the strengthening of the legal and regulatory framework governing the payments system, inculcating sound credit risk management practices in credit card operations and enhancing safety of automatic teller machines (ATM) transactions. In addition, efforts are underway to promote MEPS Cash as the national electronic purse scheme with the extensive deployment of the supporting infrastructure including ATM and the card acceptance devices. The increase in the payment card acceptance terminals will enable the consumers to use the electronic payment instruments conveniently. MEPS Cash, created in line with the Multipurpose Smart Card flagship application under the Multimedia Super Corridor project, is the national electronic purse scheme that is to be accepted as a means of payment by all merchants. The supporting infrastructure is also being further improved. The Government's plans over the next few years in meeting the targeted number of personal computers, Internet and broadband users in Malaysia augurs well for this migration to happen. The wider use and acceptance of payment channels and instruments is also encouraged through extensive consumer education and promotional programmes.

Summary

Electronic payments in Malaysia is at a critical threshold of growth. Malaysia has the opportunity to bring the development of its

payments system to an advanced level. In this regard, the strategy going forward to enhance the payments system would be to:

- make available more cost effective and efficient payment methods;

- expedite the development of the necessary payments and supporting infrastructure;

- encourage wider use and acceptance of payment channels and instruments through consumer education and promotional programmes; and

- ensure the regulatory framework is effective and proactive in fostering financial innovation while ensuring the safety of the payments system.

The development of more efficient payment instruments and systems would benefit the country as a whole and enable Malaysia to maximise efficiency and financial gains from its payments system.

Calendar of Events
April – June 2003

7 April 2003

The Bank launched the Coin in Education (CIE) Programme to promote coin appreciation and to inculcate coin collection among young Malaysians. For the first year, twelve different coins depicting the endangered animal species in Malaysia will be issued.

28 April 2003

The Bank released the 2002 Insurance and Takaful Annual Reports, which provide an analysis of the insurance and takaful industries' performance and developments in 2002.

8 May 2003

The Governor launched the Association of Banks in Malaysia (ABM) Electronic Banking and Payments Promotion Programme. The programme was aimed at raising awareness on the new, and more efficient modes for consumers to conduct banking and payment transactions.

19 May 2003

The Bank announced the establishment of the SME Special Unit as part of the on-going efforts to ensure continued access to financing for viable small and medium enterprises (SMEs) and entrepreneurs across all sectors.

21 May 2003

The Government announced a RM7.3 billion economic package, aimed at generating economic activities by mobilising domestic sources of growth, while reducing the country's dependence on the external sector. The announcement came during a period of uncertainty due to geopolitical developments, as well as the SARS outbreak. Among the 90 measures are:

- RM1 billion in micro-credit for small businesses;
- RM1 billion in additional provision to the Fund for Food;
- RM1 billion for a Special Relief Guarantee Facility to alleviate the cash flow problems of businesses affected by SARS;
- A 2% reduction in employees EPF contribution for one year; and
- A temporary exemption of service tax for hotels and restaurants until the end of the year.

To reinforce the new measures, Bank Negara Malaysia announced a 50 basis points reduction in the 3-month intervention rate to 4.5%.

28 May 2003

The Bank announced that the Malaysian economy grew by 4% in the first quarter of 2003, while maintaining a growth forecast of 4.5% for the whole year.

2 June 2003

The eleven central banks and monetary authorities in the EMEAP (Executive Meeting of East Asia and Pacific Central Banks) Group jointly announced the launch of a US$1 billion Asian Bond Fund (ABF). The Fund is an important step in regional co-operation aiming at promoting bond markets in the region, and will facilitate, among others, the channelling of a small portion of official reserves of Asian economies back into the region.