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

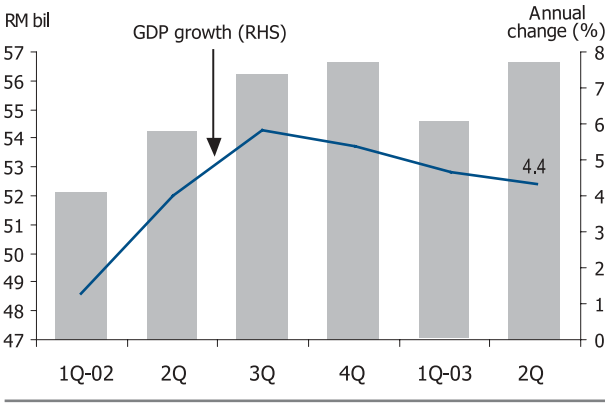
OVERVIEW

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.