Monetary and Fiscal Developments

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MONETARY POLICY IN 2003

In 2003, Bank Negara Malaysia maintained an accommodative monetary policy to support growth. The assessment at the beginning of the year was that the economy was operating below potential. In an environment of the near absence of demand pressures and excess capacity in many sectors, inflation was forecast to remain low in 2003 with the output gap positive. The accommodative monetary policy therefore reinforced fiscal policy and other measures aimed at promoting domestic economic activities. The low inflation and stronger fundamentals provided the flexibility to the Central Bank to maintain this accommodative monetary stance. During the year, efforts were also intensified to improve access to financing to the private sector, in particular to the Small and Medium Enterprises (SMEs).

lending indicators during the first quarter. Stronger expansion was also seen in loans extended to small businesses.

Second, an important consideration to leave the policy rate unchanged in the first quarter was to provide a reasonable return to savers. In an environment of ample liquidity, maintaining a reasonable return to savers continued to remain an important consideration. During this period, consumer and business sentiment was affected by the uncertainties from tensions prior to the Iraq war and subsequently, greater uncertainty following the outbreak of the Severe Acute Respiratory Syndrome (SARS) in April. The stance of monetary policy in early 2003 was therefore aimed at balancing the need to promote consumption and investment while maintaining a reasonable real rate on savings.

With low and stable inflation, monetary policy remained accommodative to support economic growth.

The monetary framework in 2003 continued to operate under a pegged exchange rate regime. The ringgit remained fixed at RM3.80=US$1, an arrangement that has been in place since September 1998. In 2003, the ringgit remained close to its fair value and has been well supported by strengthened economic fundamentals.

During the year, the policy rate of Bank Negara Malaysia, the 3-month intervention rate, was reduced once on 21 May. Interest rate policy in the first quarter was based on two considerations. First, the cumulative reductions in interest rates by 600 basis points since 1998 had resulted in lower interest rates and ample liquidity. Liquidity conditions in the banking system created competitive pressures on banks to price loans at below the quoted base lending rates. The lower lending rates had been effective in raising demand for credit. Amidst stable employment and higher incomes, supported by higher commodity prices and strong performance in selected export sectors, the prevailing accommodative monetary policy reinforced fiscal policy in sustaining domestic demand. Growth in domestic demand was reflected in the further expansion in monetary aggregates and bank

Towards mid-2003, however, developments in the regional and global economies indicated increased risks on the growth prospects. Economic and financial indicators showed that the global economic recovery was slower than expected, with growth in the United States remaining well below trend in the first half-year due to subdued investment. Deflationary concerns and continued financial market volatilities pointed to a more modest recovery for the global economy for 2003. The dampened global outlook and the implication of SARS on a number of sectors threatened to weaken domestic demand and increase the downside risks to economic recovery in Malaysia. Given this, on 21 May, Bank Negara Malaysia reduced the policy rate by 50 basis points to 4.5% as a pre-emptive move to mitigate the effects of a more adverse external environment on the domestic economy.

The impact of SARS on economic recovery was expected to be transitory. Its impact was primarily on the services sub-sectors of tourism, transport and retail services. To ease the burden on the affected industries and workers in these sectors, other measures were implemented, including a Special Relief Guarantee Facility of RM1 billion and special relief for housing loan repayments to workers in these sectors. These specific measures were part of the overall package introduced on 21 May, to address the impact of SARS on the economy as well as to stimulate further structural changes. Implementation of the measures including the reduction in interest rates, as a comprehensive package was designed to give maximum impact to the package.

These coordinated policy measures promoted and reinforced a stronger recovery in the domestic economy in the second half-year when global and regional growth gained momentum. A number of positive developments on the global front lent further support to domestic policies. The reduction in geopolitical uncertainty in the Middle East and the abatement of SARS resulted in markedly strengthened domestic consumer and business sentiment in the third quarter. More favourable trends emerged in the third quarter, with indicators that the global economic growth was strengthening. Growth in the United States in the third quarter, picked up to well above trend following the recovery in investment and a build-up in inventory. On the domestic front, lower interest rates, amidst improving sentiment, led to stronger demand for credit. Demand for financing, which moderated in May on uncertainties of the effects of SARS, recovered strongly since June. Monetary indicators for the second half-year also expanded at a stronger pace, reflecting stronger demand for liquidity. Overall, the accommodative monetary policy reinforced other policies to contribute to stronger growth in output. For the year as a whole, real GDP growth strengthened to 5.2%, with the growth momentum into 2004 sustained. Inflation has continued to remain low at 1.2% while core inflation, that is inflation due to demand pressures, was lower at 0.6%.

Monetary Policy Statement

An important development during the year was the issuance of the Monetary Policy Statement (MPS) by Bank Negara Malaysia at pre-determined intervals. On 27 August 2003, Bank Negara Malaysia issued its first MPS together with the announcement of the second quarter GDP data. The second and third MPS was issued at the release of the third quarter GDP data on 19 November 2003 and the fourth quarter GDP data on 25 February 2004.

The MPS is a forward looking statement, outlining the monetary policy stance in the near term and the rationale for the policy thrust. The objective of issuing this statement is part of the overall strategy to provide greater understanding of the monetary policy objectives and measures in light of a more complex and dynamic environment. In particular, it would help anchor expectations on growth and inflation. Signalling the Bank's policy intent through direct communication is aimed at increasing the understanding and appreciation of money market participants, and thereby, facilitate a more rapid transmission of the policy rate in the pricing of credit and longer-term rates, and thus enhance the overall efficiency of the monetary transmission mechanism. The MPS is released four times a year and would coincide with the release of Malaysia's quarterly GDP performance. Between the fixed scheduled dates, additional press statements would be issued if a policy change is warranted.

The issuance of the MPS is part of the ongoing process to enhance market understanding of the Bank's financial and economic assessments, operations and policy objectives. Since 1998, in a drive to ensure symmetric information to the public, the Bank has disseminated a wider range of information, which included among others, on-line information on its daily liquidity forecasts and money market operations. Over the years, there has also been significant enhancement of the coverage of information available through the Bank's website, and reduction in the time lag of data releases to the public.

MONETARY DEVELOPMENTS IN 2003

In 2003, low interest rates, ample liquidity and a strengthened banking sector supported stronger economic activity. Funds available in the banking system increased during the year as a result of the expansionary fiscal operations and stronger balance of payments position. The underlying ample liquidity continued to result in competitive pricing of loans to selected sectors.

Following the 50 basis point reduction in the policy rate in May, the lending rates of banking institutions declined further. The commercial banks reduced their Base Lending Rate (BLR) by 39 basis points. As the component of lower cost new loans increased relative to the existing loans, the average lending rate (ALR) declined further, and at end-year was 39 basis points lower than the end-2002 level. While the BLR of finance companies declined by 55 basis points, the ALR of finance companies, nevertheless, declined by a larger magnitude of 64 basis points as fixed rates on hire purchase for passenger cars had been on a declining trend. The lower hire purchase rates were due to greater competition for loans in the passenger car market.

Monetary conditions remained supportive of economic expansion. Low interest rates, ample liquidity and a strengthened banking sector contributed to increased financing to the private sector.

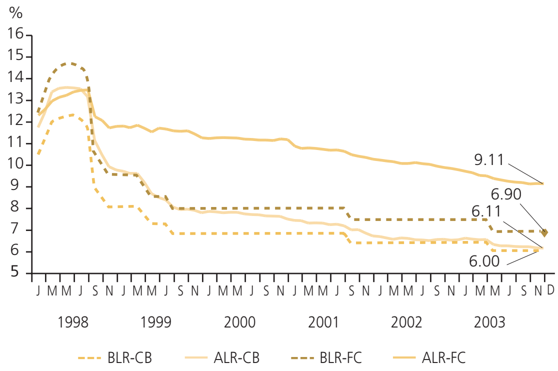
Deposit rates declined by a smaller margin, with the one to 12-month fixed deposit rates of the commercial banks declining by 20-30 basis points. Notwithstanding the reduction in nominal deposit rates, the real rates of return (end year nominal rates of return less inflation rate) on deposits with

Table 2.1
Interest Rates and Liquidity

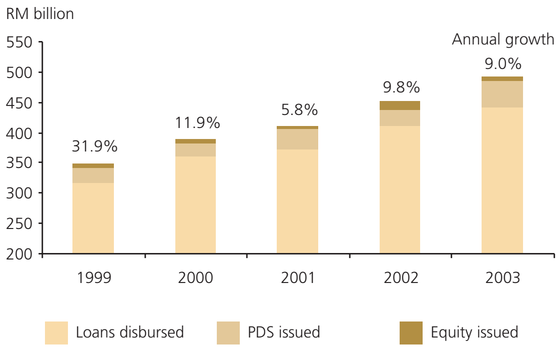
	2000	2001	2002	2003	2003
	At end period (%)				Change (%)
3-month Intervention Rate	5.5	5.0	5.0	4.5	-0.5
Interbank rates					
Overnight	2.77	2.76	2.71	2.72	0.01
1- month	3.05	2.97	2.99	2.99	0.00
Base lending rate (BLR)					
Commercial banks	6.78	6.39	6.39	6.00	-0.39
Finance companies	7.95	7.45	7.45	6.90	-0.55
Average lending rate (ALR)					
Commercial banks	7.46	6.67	6.50	6.11	-0.39
Finance companies	11.14	10.24	9.75	9.11	-0.64
Fixed deposit rates					
Commercial banks					
3-month	3.48	3.21	3.20	3.00	-0.20
12-month	4.24	4.00	4.00	3.70	-0.30
Finance companies					
3-month	3.52	3.22	3.20	3.00	-0.20
12-month	4.27	4.01	4.00	3.68	-0.32
Savings deposit rates					
Commercial banks	2.72	2.28	2.12	1.86	-0.26
Finance companies	3.44	2.94	2.65	2.18	-0.47
	Average during the period (%)				Change (%)
Nominal interest rate differential					
Malaysia - United States	-3.32	-0.49	1.31	1.66	0.35
Malaysia - Singapore	0.73	1.31	2.23	2.27	0.04
	At end period (RM billion)				Change (RM b)
Resource surplus (+)/gap (-)[1]	73.7	67.4	76.2	105.8	29.6
Adjusted resource surplus (+)/gap (-)[2]	36.1	20.8	24.6	45.8	21.2
	At end period (%)				Change (%)
Loan-deposit ratio	84.3	85.9	84.9	80.9	-4.0
Financing-deposit ratio[3]	92.3	95.7	95.1	91.7	-3.4

[1] Deposits less loans.
[2] Deposits less loans and holdings of private debt securities.
[3] Includes holdings of private debt securities.

Graph 2.1
Lending Rates: Commercial Banks and Finance Companies



Graph 2.3
Private Sector Gross Financing through the Banking System and the Capital Market

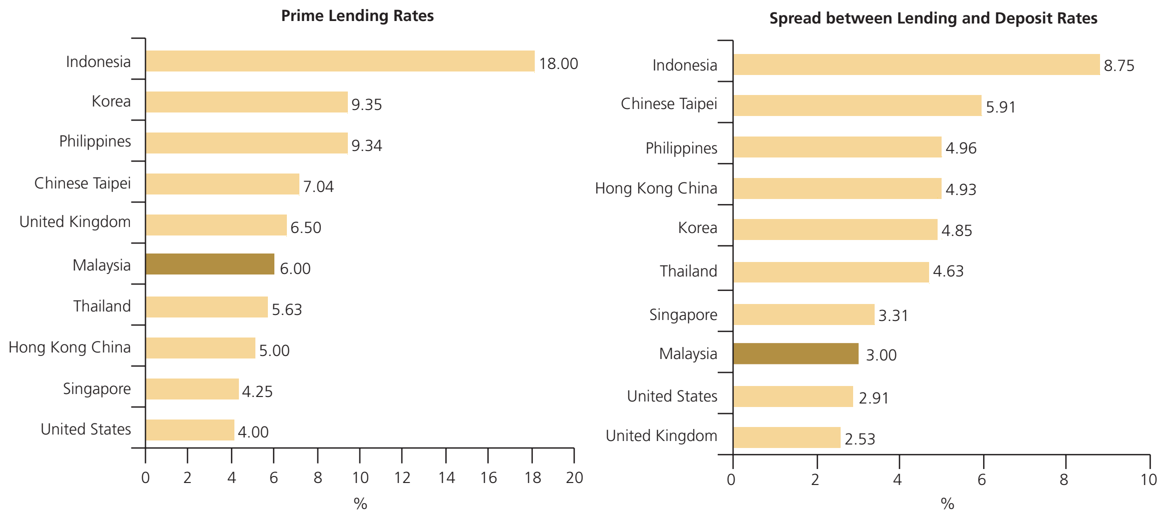


commercial banks were higher at end-2003, at 0.66% for savings deposits (at end-2002: 0.42%) and ranging from 1.8% for the 3-month fixed deposit to 2.5% for the 12-month maturity (1.5% and 2.3% at end-2002). Savings and fixed deposits of individuals increased by 8.8% in 2003 and as a share of GDP, remained stable at 57% at end-2003. Following significantly improving cash flows, total deposits of businesses increased significantly, by 14.9%, and as a share of GDP, rose to 46.9% at end-2003 (at end-2002: 44.4%).

By international standards, lending rates in Malaysia remained competitive, and the spread between lending and deposit rates was among the lowest.

Low interest rates, amidst higher disposable income, particularly in the second half-year, led to stronger demand for financing by the private sector from both the banking sector and the capital market to finance consumption and business expansion. In addition, a larger amount of funds was also raised by businesses in the PDS market to restructure and refinance debts, to strengthen their balance sheets and to prepare for future investment opportunities. Cumulatively, loans disbursed by the banking system for working capital, trade financing and fixed investment, and funds raised in the capital market increased by 9% compared with the previous year. While the banking system remained the main source of finance for the economy, there was further diversification in the sources of financing. Loan disbursements by the banking system which rose by 7.3%, accounted for 89.7% of total gross financing in 2003 while funds raised from the capital market rose at a stronger rate of

Graph 2.2
International Comparison of Interest Rates as at end-2003



26.6% to account for a small share of 10.3% of financing to the private sector.

The success of the measures to promote growth and depth in the PDS market was reflected in the rising ratio of PDS outstanding as a percentage of GDP to 34.7% at end-2003, while the ratio of bank loans to GDP trended down to 120.9%. This is a significant development compared to the 1998 level (PDS at 16.5% and banking system loans at 147.2% of GDP respectively). In 2003, businesses with strong credit profiles took advantage of the low interest rate environment to lock in their funds in long-term PDS. As a result, gross PDS financing increased significantly by 60.5% during the year (-15.4% in 2002).

With the expansion of the PDS market, banking institutions have also increased indirect financing of the business sector through holdings of PDS, accounting for approximately 7% of the loan base. On a net basis, banking system outstanding loans and holdings of PDS increased by 5.9%. The greater diversification in financing sources and the focus on promoting domestic sources of growth has led to a shift in the profile of banking system loans. In particular, with measures undertaken to enhance the contribution of SMEs in the domestic economy and the drive to promote private consumption growth, banking institutions have accorded emphasis on SMEs and the household sector.

Efforts by Bank Negara Malaysia to strengthen the SME financing infrastructure have been important in providing adequate and cost-effective funding to support the growth of SMEs. Reflecting this, outstanding loans to SMEs grew strongly by 10% in 2003 to reach a record high of RM82 billion. This amount represented 38.4% and 17.3% respectively of business and total loans outstanding. Meanwhile, disbursements to SMEs amounted to RM87.1 billion. Financing of SMEs via the special funds has expanded significantly. As at end-2003, RM5.3 billion had been approved to more than 14,000 borrowers, representing an increase of 58.5% for the year as a whole. Meanwhile, disbursements amounted to RM4.1 billion, an increase of 82.9% over the previous year. Excluding both the Special Relief

Table 2.2
Banking System[1]: Loan Indicators

	During the year (RM billion)				Annual growth (%)		
	2000	2001	2002	2003	2001	2002	2003
Total							
Loan applications	208.8	190.6	217.2	227.6	-8.7	14.0	4.8
Loan approvals	134.8	125.6	137.6	152.7	-6.8	9.5	11.0
Loan disbursements	360.7	373.5	411.6	441.7	3.5	10.2	7.3
Loan repayments	347.1	365.4	402.7	430.5	5.3	10.2	6.9
Change in loans outstanding[2]	21.2	16.1	19.8	21.8	3.9	4.6	4.8
Businesses							
Loan applications	n.a.	n.a.	135.3	124.9	n.a.	n.a.	-7.7
Loan approvals	79.1	63.5	68.5	77.2	-19.7	7.9	12.7
Loan disbursements	270.2	270.4	282.0	303.4	0.1	4.3	7.6
Loan repayments	269.4	276.8	275.8	299.6	2.8	-0.4	8.6
Change in loans outstanding[2]	2.0	-5.6	-3.1	-5.1	-2.5	-1.4	-2.3
SMEs							
Loan applications	n.a.	n.a.	n.a.	44.5	n.a.	n.a.	n.a.
Loan approvals	n.a.	n.a.	n.a.	25.7	n.a.	n.a.	n.a.
Loan disbursements	n.a.	n.a.	n.a.	87.1	n.a.	n.a.	n.a.
Change in loans outstanding[2]	2.9	4.0	…	7.4	5.7	…	10.0
Other businesses							
Loan applications	n.a.	n.a.	n.a.	80.4	n.a.	n.a.	n.a.
Loan approvals	n.a.	n.a.	n.a.	51.5	n.a.	n.a.	n.a.
Loan disbursements	n.a.	n.a.	n.a.	216.4	n.a.	n.a.	n.a.
Change in loans outstanding[2]	-0.9	-9.6	-3.1	-12.5	-6.1	-2.1	-8.7
Households							
Loan applications	n.a.	n.a.	81.9	98.5	n.a.	n.a.	20.2
Loan approvals	53.1	59.2	66.9	72.0	11.5	13.0	7.6
Loan disbursements	76.0	87.0	105.1	114.5	14.5	20.8	8.9
Loan repayments	65.1	71.5	83.7	94.1	9.9	17.0	12.4
Change in loans outstanding[2]	17.1	23.1	26.2	26.2	14.8	14.7	12.8

[1] Includes Islamic banks.
[2] The annual growth is for loans outstanding at end-period.
n.a. Not available.

Table 2.3
Special Funds for SMEs administered by Bank Negara Malaysia

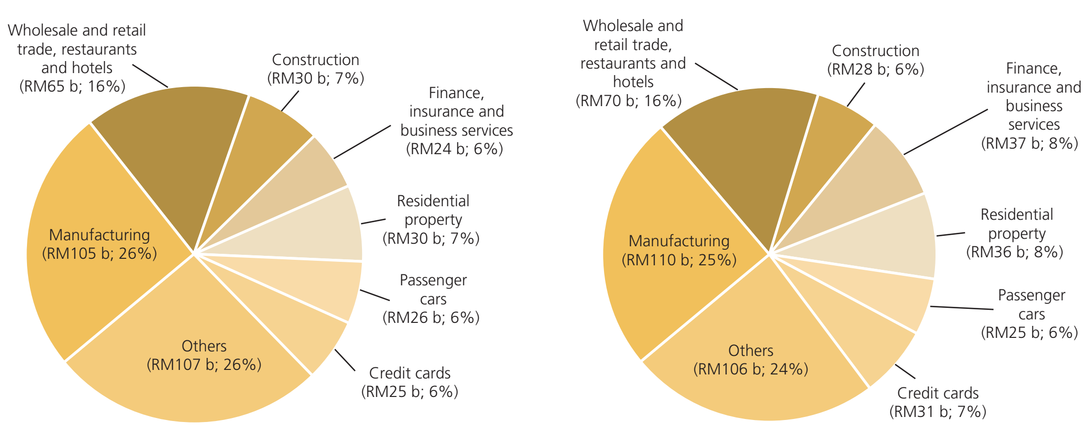
Type of Fund	RM million					%	
	Allocations	Approvals	Disbursements	Repayments	Loans Outstanding	Utilisation Rate[2]	Ratio of undrawn portion to approvals
	As at end-2003						
Fund For Food	1300.0	1410.8	1298.8	600.8	698.0	108.5	7.9
New Entrepreneurs Fund 2	1150.0	1077.2	806.7	36.1	770.6	93.7	25.1
Fund For Small and Medium Industries 2	2000.0	2284.9	1588.4	177.9	1410.4	114.2	30.5
Bumiputera Entrepreneurs Project Fund	300.0	437.7	361.5	269.1	92.4	145.9	17.4
Special Relief Guarantee Facility[1]	1000.0	40.3	0.0	0.0	0.0	4.0	100.0
Rehabilitation Fund for Small Businesses	800.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	**6550.0**	**5250.9**	**4055.4**	**1083.9**	**2971.4**	**80.2**	**22.8**
	Change since end-2002						
Fund For Food	0.0	115.1	174.4	152.8	23.5		
New Entrepreneurs Fund 2	650.0	425.0	480.9	26.6	454.2		
Fund For Small and Medium Industries 2	1350.0	1236.0	1078.2	124.3	953.7		
Bumiputera Entrepreneurs Project Fund	0.0	121.0	104.1	122.7	-18.5		
Special Relief Guarantee Facility[1]	1000.0	40.3	0.0	0.0	0.0		
Rehabilitation Fund for Small Businesses	800.0	0.0	0.0	0.0	0.0		
Total	**3800.0**	**1937.4**	**1837.6**	**426.4**	**1412.9**		

[1] This is only a guarantee fund.
[2] As a percentage of total loans approved to the fund's total allocations.

Guarantee Fund (SRGF) and the Rehabilitation Fund for Small Businesses (RFSB), which were recently introduced in 2003, the allocations for the remaining four funds have been fully utilised, with a utilisation rate of 109.7%. With the Central Credit Reference Information System (CCRIS) in place, banking institutions have been able to accelerate loan processing and assess the viability of SMEs, given the comprehensive and current credit profiles of all borrowers available in the system.

Almost half the loan disbursements were channelled to large businesses in the main sectors of the economy, namely the manufacturing, wholesale and retail trade; agriculture; and finance, insurance and business services sectors. New loan approvals and loan disbursements to large businesses were significantly higher in the second half-year. Nevertheless, there was a decline in outstanding loans of large businesses. Better corporate health and improving cash flow positions led to a greater reliance on internal funds, and less on bank borrowings to fund business activities. In addition, the bulk of loans disbursed were primarily for short-term working capital purposes. As a result, the high level of disbursements was matched by a similar volume of repayments, which resulted in a neutral effect on loans outstanding.

Graph 2.4
Loan Disbursements by Sector: Value and Share



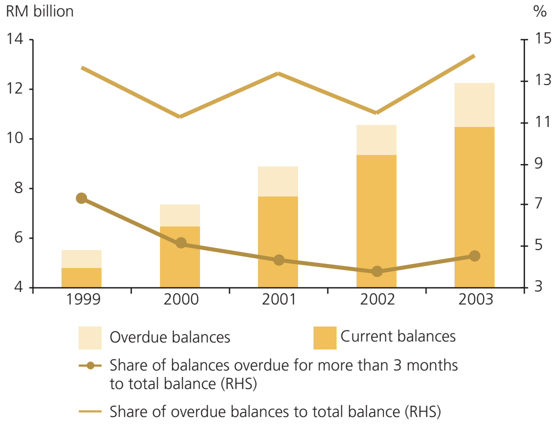
2002 2003

Table 2.4
Banking System[1]: Loans Outstanding

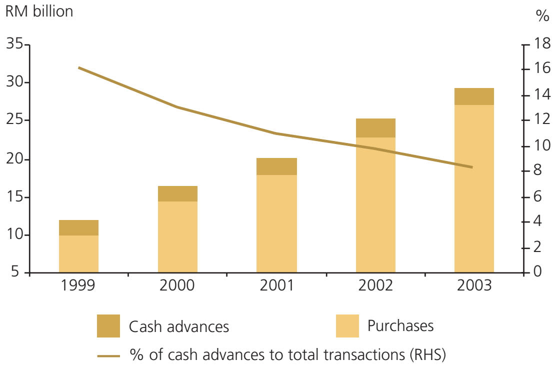
	Annual change 2002	Annual change 2003	% share of total loans at end-2003
	RM billion		
Banking system loans, of which extended to:			
Business enterprises	-3.1	-5.1	45.1
Individuals	26.2	26.2	48.8
By sector:			
Agriculture, hunting, forestry and fishing	-0.1	-1.1	2.2
Mining and quarrying	-0.3	0.1	0.2
Manufacturing	-1.2	-0.2	12.9
Electricity, gas and water supply	1.6	-1.7	1.1
Wholesale and retail trade, restaurants and hotels	1.0	2.1	8.3
Broad property sector	10.8	14.7	39.8
Construction	*-1.7*	*-2.7*	*6.2*
Purchase of residential property	*14.2*	*16.2*	*24.6*
Purchase of non-residential property	…	*1.1*	*6.1*
Real estate	*-1.6*	…	*2.9*
Transport, storage and communication	-0.4	1.0	2.3
Finance, insurance and business services	-2.5	-0.6	6.2
Consumption credit	12.0	8.9	18.8
Of which:			
Credit cards	*1.8*	*1.6*	*2.6*
Purchase of passenger cars	*9.6*	*6.5*	*13.0*
Purchase of securities	0.2	-1.7	4.2
Purchase of transport vehicles	-0.5	0.3	0.7
Community, social and personal services	-0.3	-0.7	1.0
Others	-0.4	0.9	2.3
Total loans outstanding [2]	**19.8**	**21.8**	**100.0**

[1] Includes Islamic banks.
[2] Includes loans sold to Cagamas.
Numbers may not add-up due to rounding.

Graph 2.5
Banking System: Outstanding Credit Card Balances (at end-period)



Graph 2.6
Banking System: Credit Card Transactions



On an outstanding basis, bank lending to the household sector expanded at a high annual rate of 12.8% in 2003. The low interest rates and competitive financing packages offered by banking institutions continued to stimulate demand for loans from households, with the bulk of credit channelled towards the purchase of residential property. In the residential property market, the value of loan applications increased by 24.8% while loan disbursements were higher by 20%.

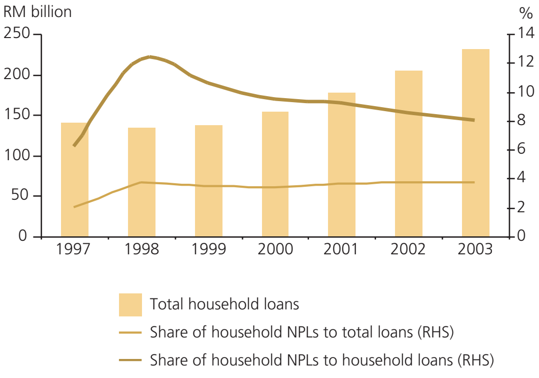
Credit card spending, as reflected by loan disbursements, grew at a rate of 20%. Outstanding balances on credit cards increased by 15.5% (2002: 19.5%) to RM12.2 billion, representing 2.6% of total loans outstanding at end-year (at end-2002: 2.3%). While credit card spending on goods and services continued to increase, households are not over leveraged. Total overdue balances amounted to 14.1% of outstanding credit card balances at end-2003, which was lower than the average over the previous five years of 14.6%. Similarly, balances overdue for more than 3 months were relatively contained at 4.4% compared to the average over the previous five years of 7.2%.

On the whole, as the majority of household loans were relatively long-term in nature, the continued growth in these loans has led to an increase in the share of household loans as a percentage of total loans outstanding to 48.8% at end-2003 (at end-2002: 45%) and as a percentage of GDP, to 58.9%. These percentages are similar to those recorded among regional countries, and lower than those registered in several of the advanced economies. While the household debt exposure has become a cause for concern in some countries, indicators suggest that the Malaysian household balance sheet has remained strong and debt servicing is sustainable with the potential for further expansion in consumption growth. Underpinning the resilience of the household balance sheet, is the high savings rate, increasing disposable income, a stable property market, an improvement in the stock market as well as stable labour market conditions. As a leverage indicator, the ratio of household deposits to loans remained at greater than one, demonstrating that households continued to accumulate wealth. Lower lending rates have also been instrumental in sustaining households' financial net worth and the capacity of the sector to service debt. With falling rates, interest payments incurred on new loans have been lower and refinancing activity has also increased, allowing consumers to pay down earlier higher cost loans.

The non-performing loans (NPLs) of the household sector has also remained manageable. As a proportion of total household loans, the gross NPL ratio for the sector declined to 8% at end-2003 (12.2% at-end 1998 and 8.5% at end-2002). In particular, the gross NPL ratio for the purchase of residential property remained unchanged at 8.7%. The default rate on credit card loans, an emerging concern in some economies, had declined to a level less than one-third the rate registered at the height of the financial crisis in 1998.

Bank Negara Malaysia's efforts to improve the financial infrastructure to facilitate bank lending have also ensured that banking institutions assign appropriate risk evaluation in lending to this sector, thereby maintaining the quality of household debt. In particular, the implementation of risk-based measures included setting up CCRIS and effecting credit card guidelines. To facilitate the assessment of risks across non-bank credit institutions, such as charge card companies, the information in CCRIS is also extended to these institutions, with the necessary "firewalls" to protect customer information. These risk management measures have enhanced the capacity of lenders to extend loans without creating unnecessary vulnerabilities in the real and financial sectors.

Graph 2.7
Banking System: Loans to Households (at end-period)



In tandem with higher financing by the banking system, broad money, M3, expanded at a faster annual rate of 9.7% at end-2003 (at end-2002: 6.7%). The growth in M3 was also due to stronger external operations arising from a higher trade surplus, sustained foreign direct investment and higher portfolio inflows; as well as expansionary Government operations. Growth in M3 was broadly consistent with nominal demand during the year.

In terms of components, transaction balances, consisting of currency in circulation and demand deposits, grew strongly by 14.6% at end-2003 (at end-2002: 10.3%), in line with higher consumption spending, higher turnover of the KLSE CI, and improved business activity. Among broad quasi-money

Graph 2.8
Money Aggregates: Annual Growth

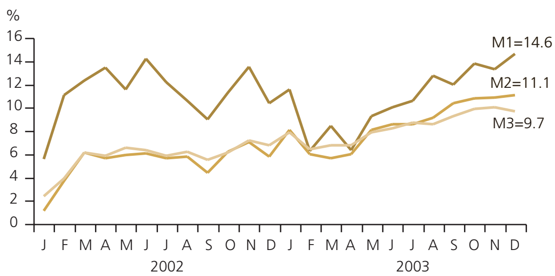


Table 2.5
Broad Money, M3

	Change (RM billion)	
	2002	2003
M3	31.6	48.5
Currency	1.8	2.2
Demand deposits	6.7	11.2
Broad quasi money	23.1	35.1
Fixed deposits	*12.6*	*17.1*
Savings deposits	*5.6*	*5.6*
NIDs	*3.6*	*2.0*
Repos	*2.5*	*8.0*
FX deposits	*-1.2*	*2.4*
Determinants of M3		
Net claims on Government	11.5	12.9
Claims on private sector	27.7	32.4
Loans	*19.3*	*21.7*
Securities	*8.4*	*10.7*
Net external operations	1.2	19.5
Bank Negara Malaysia	*7.6*	*27.1*
Banking system	*-6.3*	*-7.6*
Other influences	-8.9	-16.3

components, the increase was mainly in terms of fixed deposits and to a lesser extent, repos. The increase in fixed deposits was primarily in the 9-12 month maturity and was spread out during the year, reflecting to some extent, the desire of depositors to hold fixed deposits as an asset class.

In contrast to the previous year, business deposits recorded the biggest increase and were mainly short-term fixed deposits. The stronger financial position of corporations was in line with improving profitability and cash flow, higher trade surplus and faster repatriation of export proceeds. Meanwhile, higher personal disposable income and financial wealth of households sustained the growth in deposits of this sector, which grew at a stronger rate in 2003 compared to the previous year.

Developments in the ringgit foreign exchange market were driven mainly by the depreciation of the US dollar and the consequent realignments in the currencies of most major and several regional economies. Throughout the year, the US dollar was mainly affected by concerns over the large US current account deficit and the positive interest rate differentials in favour of other major economies. The corresponding adjustments to the US dollar were seen mainly in major currencies, including the Australian dollar, the Canadian dollar and the euro, which appreciated by 32.7%, 21.7% and 20% in 2003. The yen and pound sterling appreciated to a lesser degree of 11% and 11.1% respectively.

Given the pegged exchange rate regime, the ringgit depreciated against the euro (-16.7%), the pound sterling (-10%) and the yen (-9.9%), along with the US dollar in 2003. The ringgit depreciated to a lesser extent against most regional currencies in the range of 2 – 8%. Against the Korean won and the Philippine peso, the ringgit appreciated. The ringgit remained stable against the Chinese renminbi and the Hong Kong dollar, as these currencies are also pegged to the US dollar.

Amid considerable volatility in international currency markets, the ringgit peg continues to provide a stable and predictable environment to promote trade and investment as well as supporting the structural changes in the Malaysian economy.

EXCHANGE RATE DEVELOPMENTS

In 2003, the system of a fixed exchange rate for ringgit at RM3.80 to US$1 was maintained with strengthening economic fundamentals. The fixed exchange rate regime has been in place for the sixth year since it was introduced in September 1998. Amidst volatility in the foreign exchange markets and debates on effects of the volatility of major currencies on the ringgit peg, the ringgit continues to fulfil its intended objective of supporting the expansion of trade and investments in Malaysia.

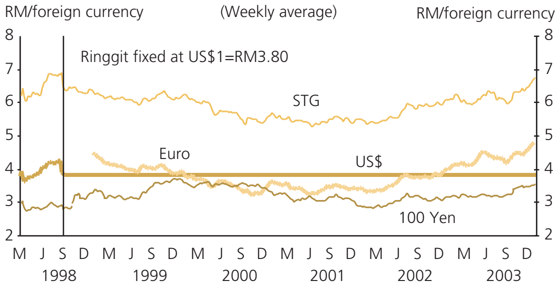
Despite considerable volatility in the foreign exchange market, the pegged exchange rate regime has remained sustainable with the ringgit close to

Table 2.6
Movement of the Ringgit

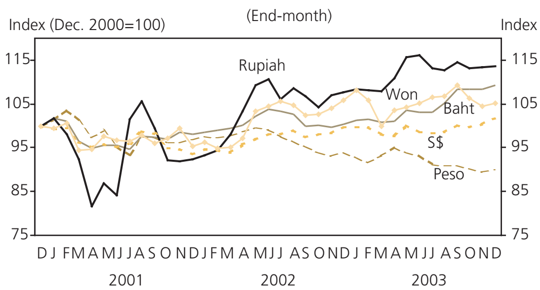
	RM to one unit of foreign currency[1]				Annual change (%)		Change (%)	
	1997	1998	2002	2003	2002	2003	End-June '97- End-Dec. 2003	2 Sep.'98 - End-Dec. 2003
	End-June[2]	Sept. 2[3]	End-Dec.					
SDR	3.5030	5.1177	5.1474	5.6264	-7.3	-8.5	-37.7	-9.0
US$	2.5235	3.8000	3.8000	3.8000	0.0	0.0	-33.6	0.0
S$	1.7647	2.1998	2.1887	2.2342	-6.2	-2.0	-21.0	-1.5
100 yen	2.2088	2.7742	3.2020	3.5546	-9.6	-9.9	-37.9	-22.0
Pound sterling	4.1989	6.3708	6.0924	6.7678	-9.5	-10.0	-38.0	-5.9
Swiss franc	1.7368	2.6450	2.7386	3.0632	-16.9	-10.6	-43.3	-13.7
Euro[4]	–	–	3.9811	4.7783	-15.4	-16.7	–	–
100 Thai Baht	9.7470	9.3713	8.8096	9.5947	-2.4	-8.2	1.6	-2.3
100 Indonesian rupiah	0.1038	0.0354	0.0425	0.0449	-14.1	-5.3	131.4	-21.1
100 Korean won	0.2842	0.2827	0.3197	0.3180	-9.8	0.5	-10.6	-11.1
100 Philippine peso	9.5878	8.8302	7.1462	6.8431	3.1	4.4	40.1	29.0

[1] US$ rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market.
Rates for foreign currencies other than US$ are cross rates derived from rates of these currencies against the US$ and the RM/US$.
[2] End-June 1997 represents pre-Asian Financial Crisis levels.
[3] Ringgit was fixed at US$1 = RM3.8000 on 2 September 1998.
[4] The euro began to be traded on 4 January 1999 (EUR 1= RM4.5050).

Graph 2.9
Exchange Rate of the Malaysian Ringgit against Major Currencies



Graph 2.10
Exchange Rate of the Malaysian Ringgit against Selected Regional Currencies



Note: An increase in the index represents an appreciation of the currency against the ringgit.

its fair value. There are no signs of the ringgit being misaligned. On the domestic front:

- Inflation and unemployment remained low;
- Current account surplus in the balance of payments remained at sustainable levels;
- Continued increase in reserves throughout 2003;
- External debt has been kept at manageable levels with low debt servicing to export ratio; and
- Highly capitalized banking system with further improvements to asset quality ratios.

On the external front, developments were benign on Malaysia's exchange rate regime:

- Depreciating with the US dollar had benefited exports, offsetting the impact on imports;
- Depreciation had a minimum impact on imported inflation since the ringgit did not depreciate against the US dollar and imports denominated in currencies other than the US dollar accounted for only a small share of total imports. In addition, the share of imported components in the CPI basket remained small, at about less than 10%; and
- Impact on overall external debt and debt servicing due to the ringgit depreciation had been manageable, given that only 23% of Malaysia's total external debt is denominated in currencies other than the US dollar.

Under these circumstances, the ringgit peg, on balance, continues to provide significant advantages to the overall economy. The stability of the exchange rate has been effective in improving the longer-term competitiveness of the Malaysian corporate sector by creating incentives for structural adjustments to increase productivity, thereby enhancing the country's future growth prospects.

FISCAL POLICY AND OPERATIONS

The Government presented on 20 September 2002 a moderately expansionary budget for 2003. The fiscal deficit was, therefore, budgeted at 4% of GDP, lower than the fiscal deficit of 5.6% in 2002. The Malaysian economy was expected to strengthen in 2003, benefiting from the recovery in the major industrial countries and stronger growth in the region, with the sustained growth in intra-regional trade. The private sector was envisaged in the Budget to play a larger role in sustaining domestic-driven growth. Private sector investment was projected to return to positive growth due to expected improvement in the financial position of corporations, following the structural adjustments undertaken since the crisis, emerging business opportunities in selected sectors as well as the improved business environment. A major thrust of the 2003 Budget was, therefore, designed to provide the enabling environment and incentives to revitalise the private sector to resume its role as the main engine of growth. Policies in the Budget thus focused on the enhancement of the supportive incentives to promote private sector ventures, especially into new growth areas.

The 2003 Budget contained both expenditure allocation and tax incentives to generate higher growth in the promoted sectors. In terms of budget allocation, emphasis was given towards enhancing the quality of education and upgrading manpower skills. The tax incentives included the reduction in corporate tax for small- and medium-scale enterprises (SMEs) from 28% to 20% for chargeable income of up to RM100,000 and tax incentives for manufacturers of machinery and auto parts makers to promote high value activities in the manufacturing sector. At the same time, an option was introduced for pioneer status holders to qualify for reinvestment allowance if their Pioneer Status were surrendered for cancellation. For the agriculture sector, various incentives were introduced for consolidation of smallholdings, cultivation of rubber wood trees, deep-sea fishing, food processing and modernisation of poultry farming.

The actual outturn of fiscal deficit for 2003 was 5.3% of GDP, due mainly to counter-cyclical expenditure to support growth. Revenue performance was strong in 2003 with higher proceeds from the sale of Government's shares in selected public listed companies. During the year, the Government unlocked some of its assets to optimise returns from its ownership of high-value assets and to achieve greater flexibility in fiscal management. At the same time, such exercise would provide the opportunity towards gradual increases in the "free float" and liquidity of companies with large Government shareholdings and thus benefit trading in the Malaysia Securities Exchange Berhad.

Higher-than-expected expenditure in 2003 was due mainly to the increased expenditure to minimise the spill-over effects from the less favourable global and regional developments in the first half of 2003. An Economic Package amounting to RM7.3 billion was aimed at containing the adverse impact from tensions in the Middle East and the outbreak of Severe Acute Respiratory Syndrome (SARS) in the region.

The positive impact of the Economic Package measures coupled with other factors including low interest rates, high commodity prices and improved cashflow position of companies, strengthened aggregate domestic demand. Together with the recovery in external demand, the private sector's contribution to economic growth rose to 2.5 percentage points in 2003 (0.4% in 2002). Stronger consumption spending and recovery in external demand supported higher investment activities. Private sector investment turned around to register the first positive growth since 2000.

While fiscal expansion contributed to GDP growth, it did not exert pressure on domestic consumer prices and interest rates. Taking advantage of the high savings rate amidst ample liquidity in the banking system, the Government financed its fiscal deficit through non-inflationary domestic sources. Given the low interest rate environment, new issues of MGS with maturities of 5 and 10 years were raised at coupon rates ranging between 3.702-3.917% and between 4.24-4.41% for those with maturity of 15 years. As part of prudent debt management, the Government exercised vigilance on its external indebtedness. Recourse to external borrowings was limited to drawdown of loans committed earlier and refinancing of several loans at lower cost, thereby reducing future debt servicing obligations.

The Federal Government debt amounted to 48.2% of GDP as at end-2003 while the debt servicing remained low at 14% of operating expenditure or 2.7% of GDP. Similarly, external debt of the Federal Government declined in 2003 to 9.5% of GDP (2002: 10.1%), enhancing Malaysia's external position.

Fiscal policy remained supportive of growth in 2003. While budgetary operations remained expansionary, fiscal management focused at ensuring a balance between sustaining the near-term growth and achieving fiscal consolidation.

Consolidated Public Sector

In 2003, the consolidated public sector registered a slightly smaller overall deficit of 0.4% of GDP. The improved position emanated from better revenue performance of the general government and the non-financial public enterprises (NFPEs) as well as lower development expenditure of the NFPEs. Development expenditure of the general government was higher mainly to finance the Economic Package introduced in May 2003 to mitigate the adverse impact of global economic uncertainties and regional health threat on domestic economic activities.

Federal Government Finance

The Federal Government registered an overall deficit of 5.3% of GDP in 2003 (2002: -5.6%), higher than the 4% targeted in the 2003 Budget. The larger-than-planned deficit was due to higher counter-cyclical expenditure as well as proactive response to the risk of a private sector pull-back due to global political uncertainties and SARS. The threat of global slowdown in the first half of the year prompted the Government to implement stronger expansionary measures to sustain the growth momentum. Despite the higher fiscal deficit, the total debt of the Federal Government remained manageable at 48.2% of GDP as at

Table 2.7
Consolidated Public Sector Finance

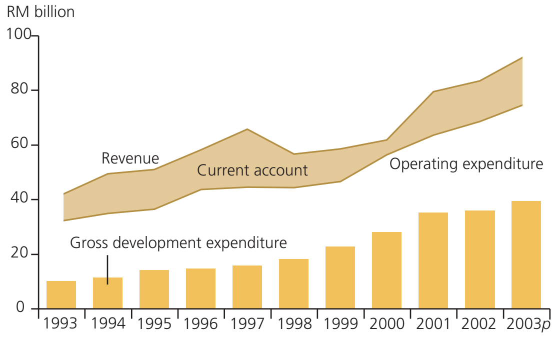
	2002	2003*e*	2004*f*
	RM million		
General government[1]			
Revenue	96,763	110,408	109,389
Operating expenditure	75,450	84,809	88,538
Current surplus of general government	21,312	25,600	20,850
Current surplus of NFPEs[2]	45,324	44,627	41,890
Public sector current surplus	**66,637**	**70,227**	**62,741**
% of GDP	**18.5**	**17.9**	**15.0**
Net development expenditure	69,125	71,951	66,687
General government	*36,828*	*43,727*	*37,563*
NFPEs	*32,297*	*28,225*	*29,124*
Overall balance	**-2,488**	**-1,725**	**-3,946**
% of GDP	**-0.7**	**-0.4**	**-0.9**

[1] Comprises Federal Government, state governments, statutory bodies and local governments.
[2] Refers to 35 NFPEs in 2003 and 2004.
e Estimate
f Forecast

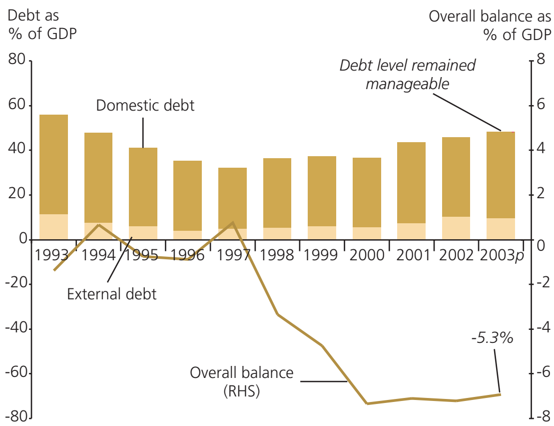
Source: Ministry of Finance, state governments and non-financial public enterprises

Graph 2.11

Federal Government Finance



Federal Government Debt



p Preliminary

end-2003. Debt servicing expenditure also remained low in terms of operating expenditure and GDP. External debt to GDP ratio declined in 2003 as the bulk of financing was raised from non-inflationary domestic sources.

In 2003, Federal Government **revenue** increased by 11.1% to RM92.8 billion, accounting for 23.7% of GDP. The better revenue performance was due to significantly higher non-tax revenue, which accounted for a larger share of total revenue (30%). Higher receipts were registered in almost all components; investment income, licence and permits, petroleum royalties and service fees . In particular, investment income was higher due to proceeds from the sale of the Government's shares in selected public listed companies. The Government disposed of some of its assets to optimise returns from the ownership of high-value assets and achieve a greater flexibility in fiscal management.

Collection from taxes declined slightly by 2.9% (-RM2 billion), mainly attributable to lower receipts

Table 2.8
Federal Government Finance

	2002	2003*p*	2004*r*
	RM million		
Revenue	83,515	92,804	89,966
Operating expenditure	68,699	75,224	79,642
Current account	**14,816**	**17,580**	**10,324**
% of GDP	**4.1**	**4.5**	**2.5**
Net development expenditure	35,069	38,508	29,084
Gross development expenditure	*35,977*	*39,353*	*29,960*
Less: Loan recoveries	*908*	*845*	*876*
Overall balance	**-20,253**	**-20,928**	**-18,760**
% of GDP	**-5.6**	**-5.3**	**-4.5**
Sources of financing:			
Net domestic borrowing	6,076	23,250	–
Gross borrowing	*18,000*	*41,850*	–
Less: Repayment	*11,924*	*18,600*	–
Net foreign borrowing	8,019	-3,709	–
Gross borrowing	*10,465*	*3,144*	–
Less: Repayment	*2,446*	*6,853*	–
Special receipts	62	0	–
Realisable assets[1] and adjustments	6,096	1,387	–
Total	**20,253**	**20,928**	**–**

[1] Includes changes in Government's Trust Fund balances. A positive (+) sign indicates a drawdown in the accumulated realisable assets.
p Preliminary
r Revised

Source: Ministry of Finance

from income taxes and sales tax on petroleum products. The collection of tax revenue was affected by the negative impact of geopolitical developments and the outbreak of SARS on business activities. Other contributory factors included tax incentives and exemptions introduced in the 2003 Budget and measures introduced in the May Economic Package. These tax initiatives included the reduction of the tax rate from 28% to 20% on chargeable income of up to RM100,000 for small and medium-scale companies and the suspension of income tax instalment payments for travel agencies beginning 1 June to 31 December 2003. Additionally, the lower company income tax collection was due to the implementation of the current year tax assessment system in 2000 and self-assessment system in 2001. As companies overpaid income taxes during the transition period, these were set off against tax expenses in 2003. Meanwhile, petroleum income tax rose by 10.9% due mainly to higher crude oil prices.

Import and excise duties collected were higher reflecting the stronger aggregate domestic demand. Other indirect taxes collected, namely sales and service tax, were lower. In particular, the lower sales tax was due to the higher tax exemption for petroleum products. In 2003, a higher tax exemption was provided to oil companies to stabilise the retail prices of petroleum products. The weighted average price of Malaysian crude oil was higher at US$30.30 per barrel in 2003, compared with US$25.24 per barrel in 2002. The decline in service tax collected (-7.9%) was mainly the result of tax exemption. In the restaurants and hotels sub-sector, the exemption on service tax was granted for the period June-December 2003. In the 2003 Budget, courier services and selected professional services provided to companies within the same group were given tax exemption.

The expansionary budgetary operations and the Government's Economic Package implemented in May to support growth and strengthen further the long-term productive capacity of the economy

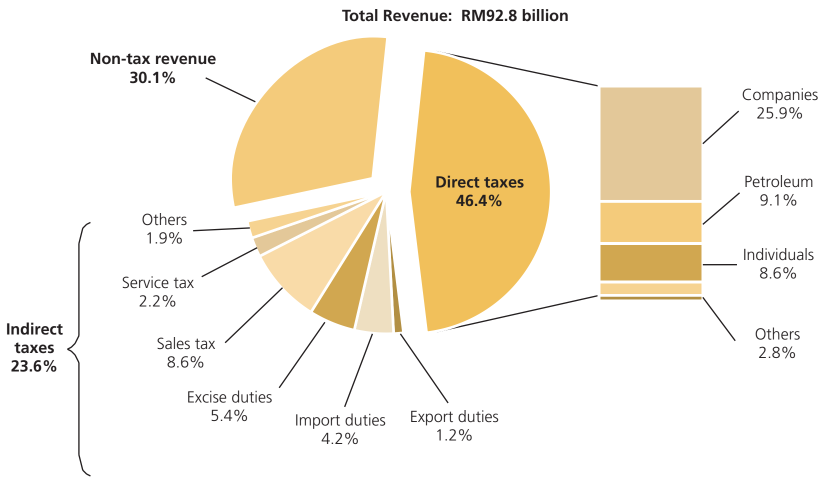
Table 2.9
Federal Government Revenue

	2002	2003*p*	2002	2003*p*
	RM million		Annual change (%)	
Tax revenue	**66,860**	**64,891**	**8.7**	**-2.9**
% of GDP	**18.5**	**16.6**		
Direct taxes	44,351	43,016	5.4	-3.0
Income taxes	42,237	40,690	5.2	-3.7
Companies	*24,642*	*23,990*	*18.6*	*-2.6*
Petroleum	*7,636*	*8,466*	*-22.5*	*10.9*
Individuals	*9,889*	*7,984*	*4.8*	*-19.3*
Others	*69*	*251*	*-1.4*	*263.5*
Real property gains tax	319	264	40.7	-17.1
Stamp duties	1,732	2,008	5.0	15.9
Others	63	53	-26.2	-15.9
Indirect taxes	22,509	21,875	16.1	-2.8
Export duties	803	1,157	-7.3	43.9
Import duties	3,668	3,919	14.9	6.9
Excise duties	4,745	5,031	14.9	6.0
Sales tax	9,243	7,965	25.7	-13.8
Service tax	2,214	2,038	14.9	-7.9
Others	1,836	1,765	-4.5	-3.8
Non-tax revenue	**16,655**	**27,913**	**-7.9**	**67.6**
Total revenue	**83,515**	**92,804**	**5.0**	**11.1**
% of GDP	**23.2**	**23.7**		

p Preliminary

Source: Ministry of Finance

Graph 2.12
Composition of Federal Government Revenue, 2003 (% share)



resulted in **gross expenditure** rising by 9.5% to RM114.6 billion.

Operating expenditure, which accounted for two-thirds of total Federal Government expenditure, increased by 9.5% to RM75.2 billion. The total wage bill, which was the largest component of operating expenditure (29%), was higher, due to the implementation of the Malaysian Remuneration System as well as the payment of monthly critical allowances for doctors and medical staff arising from the outbreak of SARS. While debt-service charges increased, their share to operating expenditure was contained at 14% (2002: 14.1%).

Outlays on supplies and services were higher due to measures introduced to enhance productivity and efficiency (increased expenditure for professional services and small repairs and maintenance). Other transfer payments were higher due mainly to grants and transfers to Government agencies for development and maintenance purposes. Payment for subsidies in 2003 was lower. As part of the Government's policy to reduce the subsidy on petroleum products, the retail prices of petrol, diesel and liquefied petroleum gas (LPG) were raised by two sen with effect from 1 March.

During the year, gross **development expenditure** rose by 9.4% to RM39.4 billion. The bulk of the outlays were extended to the social and economic services sectors (80%).

As in the past, the thrust of expenditure was on human resource development. In 2003, education

Table 2.10
Federal Government Operating Expenditure by Object

	2002	2003*p*	2002	2003*p*
	RM million		% share	
Emoluments	20,242	21,721	29.5	28.9
Supplies and services	11,269	13,968	16.4	18.6
Asset acquisition	968	1,409	1.4	1.9
Debt service charges	9,669	10,546	14.1	14.0
Pensions and gratuities	5,134	5,870	7.5	7.8
Subsidies	3,677	2,679	5.4	3.6
Other grants and transfers[1]	15,949	16,324	23.2	21.7
Other expenditure[2]	1,791	2,706	2.6	3.6
Total	**68,699**	**75,224**	**100.0**	**100.0**
% of GDP	**19.0**	**19.2**		

[1] Includes grants and transfers to state governments as well as public agencies and enterprises.
[2] Includes grants to international organisations, insurance claims and gratuities and others.
p Preliminary

Source: Ministry of Finance

and training expenses continued to be the largest component of development expenditure (26% of total). Expenses were channelled mainly towards constructing and upgrading schools, matriculation centres, polytechnics and other institutions of higher learning as well as for computerisation programmes and the acquisition of teaching aids. Meanwhile, the construction of new hospitals as well as upgrading existing hospitals and rural and health clinics were the main factors accounting for the increase in spending for health. Expenditure on housing was also higher as the Government continued to implement housing programmes for public sector personnel and the lower income group. The Government also increased spending on social and community services, mainly for youth programmes, small projects in new local housing estates, development work carried out in Putrajaya and Cyberjaya and acquisition of vehicles for community work.

In the economic services sector, a higher amount was spent on transportation, mainly in constructing new roads and bridges, upgrading existing roads and improving and increasing the capacity of the railroad system, ports and airports. Spending under the trade and industry sub-sector was focussed on the provision of infrastructure facilities, promotion of small and medium-sized industries (SMIs), industrial research and technological development and promotion of tourism. Under the Economic Package announced in May, a total of RM500 million was allocated to development financial institutions (DFIs) as equity to support their efforts in financing small businesses. Outlays on agriculture and rural development remained high, reflecting flood- mitigation projects and the continuous modernisation programme involving the building and upgrading of infrastructure facilities such as rural roads, the water supply network and electrification.

The increase in expenditure for general administration was largely to cater for ICT development in various Government agencies to further improve the quality and delivery of services. Spending for defence and internal security was mainly under the modernisation programme for the armed forces and police.

Federal Government total **debt** outstanding increased by 14.4% to RM188.8 billion or 48.2% of GDP as at end-2003. Higher borrowings from the domestic market resulted in domestic debt outstanding rising to RM151.5 billion as at end-2003

Table 2.11
Federal Government Development Expenditure by Sector

	2002	2003*p*	2002	2003*p*
	RM million		% share	
Defence and security	4,333	6,026	12.0	15.3
Economic services	12,433	13,799	34.6	35.1
Agriculture and rural development	1,364	1,621	3.8	4.1
Trade and industry	3,474	3,463	9.7	8.8
Transport	5,401	7,354	15.0	18.7
Public utilities	1,808	920	5.0	2.3
Others	387	442	1.1	1.1
Social services	18,043	17,704	50.2	45.0
Education	12,436	10,194	34.6	25.9
Health	1,503	2,684	4.2	6.8
Housing	1,808	1,928	5.0	4.9
Others	2,296	2,897	6.4	7.4
General administration	1,168	1,824	3.2	4.6
Total	**35,977**	**39,353**	**100.0**	**100.0**
% of GDP	**10.0**	**10.0**		

Numbers may not add up due to rounding.
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Source: Ministry of Finance

or 38.6% of GDP (35.7% of GDP). The bulk of Government's financing requirements (93%) was financed from domestic sources. Recourse to external borrowings was limited to the drawdown of loans while several external loans were refinanced to take advantage of tighter spreads arising from Malaysia's improved ratings. Overall, the prevailing low interest rate environment enabled the Government to raise funds at low cost and hence, minimised future debt servicing. The regular issue of Government securities in the domestic market also facilitated the development of a more reflective benchmark yield curve while deepening the domestic bond market.

In 2003, total gross borrowings of the Federal Government amounted to RM45 billion, compared with RM28.5 billion in 2002. The higher gross funds raised was to finance both the fiscal deficit as well as to roll-over maturing debt. **Net borrowings** of the Federal Government rose to RM19.5 billion, from RM14.1 billion in 2002. As revenue was more than adequate to finance operating expenditure, the net funds raised were used only to finance development expenditure. During the year, the Treasury Housing Loans Fund recorded a net borrowing to meet the higher demand for housing loans by civil servants.

The high domestic savings rate, coupled with ample liquidity in the banking system, allowed the Federal Government to raise funds required from the **domestic market**, without crowding out private

Table 2.12
Federal Government Debt Outstanding

	Annual change		At end-2003*p*
	2002	2003*p*	
	Nominal value in RM million		
Domestic debt	**7,284**	**22,803**	**151,483**
Treasury Bills	0	0	4,320
Government Investment Issues	1,000	2,000	7,000
Malaysian Government Securities	6,100	21,250	130,800
Treasury Housing Loans Fund	1,180	2,628	9,363
Market loans	-996	-3,075	0
External debt	**11,955**	**1,001**	**37,284**
Market loans	10,992	-485	28,189
Project loans	963	1,486	9,095
Total	**19,239**	**23,804**	**188,767**
% of GDP			**48.2**

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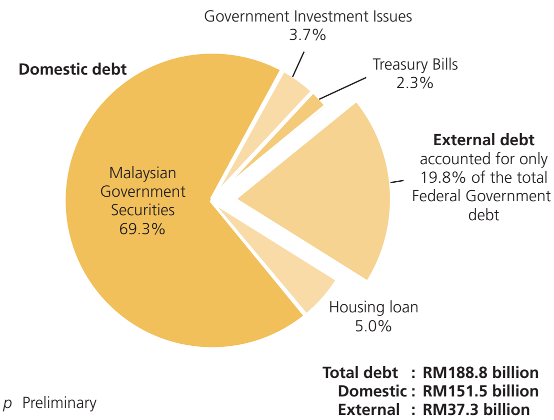
Source: Ministry of Finance

sector. Malaysian Government Securities (MGS) with maturities of 5 and 10 years were issued at coupon rates ranging between 3.702-3.917% (3.15-4.053% for funds raised in 2002) and between 4.24-4.41% for those with a maturity of 15 years. There were no issues of 15-year MGS in 2002.

During the year, the Federal Government floated twelve issues of MGS totalling RM39.9 billion by open tender through principal dealers and private placements and raised a single issue of the Government Investment Issues (GIIs) amounting to RM2 billion. The Government reopened eight of its existing conventional issues to increase their respective issue sizes and enhance liquidity in order to develop the secondary market. The

Graph 2.13
Federal Government Outstanding Debt as at end-2003*p* (% share)



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issuance of Treasury Bills (TBs) facilitated the roll-over of maturing bills. MGS issued continued to be absorbed mainly by provident, pension and insurance funds (76% of the outstanding MGS), while the ownership of GIIs and TBs was mainly dominated by the banking sector (94% and 76% of the respective amounts outstanding). After taking into account repayments, the net domestic borrowing of the Federal Government as at end-2003 amounted to RM23.3 billion.

To contain the cost of debt servicing and minimise exposure to external risks, the Government kept its **external debt** level low in 2003 by prepaying and refinancing some of its existing loans. In this regard, new external borrowings were limited to project loans committed earlier. A total of RM1.7 billion was drawn down from bilateral sources, especially from Japan under the New Miyazawa Initiative, as well as multilateral sources. In line with its prudent debt management philosophy, the Government refinanced a number of its existing term and syndicated loans to take advantage of the tighter spreads. In January, a ¥1.4 billion Term Loan due 2006 was raised at Libor + 57.5 basis points to refinance the 3.17% ¥4.1 billion Term Loan due 2006. In March, the Government refinanced a US$250 million and ¥54 billion dual currency syndicated loan at a lower margin of Libor + 38 basis points (previously, Libor + 125 basis points). Another dual currency syndicated loan amounting to US$1.25 billion and ¥11.6 billion was rolled over in December with a tighter spread of 33 basis points (from 52 basis points). The Government also prepaid two of its external loans during the year, namely a Floating Rate Note due 2005 and a syndicated loan due 2005/07 totalling US$433 million. Overall, the Federal Government registered a net repayment of RM3.7 billion in 2003. During the year, the reclassification of a domestic syndicated foreign-currency loan raised in the Labuan International Financial Centre as external debt and exchange revaluation loss, led to a slightly higher external debt. However, with the Government's restraint on recourse to external borrowings and the prepayment exercise, the share of external debt outstanding to GDP declined to 9.5% of GDP (10.1% of GDP in 2002).

Table 2.13
Holdings of Federal Government Domestic Debt

	2002	2003*p*	2002	2003*p*
	Nominal value in RM million		% share	
Treasury Bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	65	67	1.5	1.6
Banking sector	3,744	3,266	86.7	75.6
Others	512	986	11.8	22.8
Government Investment Issues	**5,000**	**7,000**	**100.0**	**100.0**
Insurance companies	320	390	6.4	5.6
Banking sector	4,680	6,611	93.6	94.4
Malaysian Government Securities	**109,550**	**130,800**	**100.0**	**100.0**
Social security and insurance institutions	85,325	99,260	77.9	75.9
of which:				
Employees Provident Fund	*72,980*	*84,678*	*66.6*	*64.7*
Insurance companies	*9,313*	*11,597*	*8.5*	*8.9*
Banking sector	14,629	19,008	13.4	14.5
Others	9,597	12,532	8.8	9.6

Numbers may not add up due to rounding.
p Preliminary

The debt servicing expenditure remained within prudent levels. Debt charges as percentage of operating expenditure, revenue and GDP were kept low at 14%, 11.4% and 2.7% respectively in 2003 (2002: 14.1%, 11.6% and 2.7% respectively). The external debt service ratio of the Federal Government also remained low at 1.3% in 2003 (2002: 1%) while foreign exposure declined to account for 20% of the total debt outstanding (2002: 22%). Proactive and sound debt management enabled the Government to avoid a bunching of repayments. As at end-2003, about 60% of loans outstanding had a remaining maturity exceeding three years and most were at fixed interest rates, reducing exposure to fluctuations in interest rates.

State Governments

Based on preliminary estimates, the consolidated financial position of state governments recorded a small overall deficit of 0.6% of GDP in 2003. While the revenue performance remained strong, operating and development expenditures increased during the year. The overall deficit was financed by Federal Government loans and the drawdown of accumulated financial assets of the state governments.

During the year, the higher consolidated state revenue was derived from state sources. The higher commodity prices, particularly for crude oil and crude palm oil, had a positive impact on the states' own sources of revenue through petroleum royalty and sales tax on crude palm oil. Meanwhile, receipts from the Federal Government were sustained to assist the states in providing infrastructure, utilities and other essential amenities. The increase in operating expenditure reflected mainly higher payments for emoluments following the implementation of the Malaysian Remuneration System for public sector employees, as well as the acquisition of assets to facilitate higher efficiency in the delivery of services. A major portion of the higher development expenditure was on expanding and upgrading public utilities, housing, agriculture and on rural development as well as for industrial development.

Non-Financial Public Enterprises

Preliminary estimates of the consolidated financial position of the 35 NFPEs indicated a higher overall surplus position (4.4% of GDP). The improvement was due to higher revenue and lower development expenditure with the completion of several big projects and the reprioritisation of planned projects.

The higher consolidated revenue of the NFPEs reflected increased earnings from oil and gas-related services, utilities and agriculture-based sectors. These sectors benefited from stronger economic activities and higher commodity prices, especially for crude oil. Significant earnings were also recorded from overseas operations. Higher operating expenditure was due to increased raw material costs, especially crude oil and fuel, and measures taken to improve services, including the upgrading of technology.

The capital outlay of the NFPEs was channelled towards expanding capacities, both at home and abroad. Petroliam Nasional Berhad continued to invest in exploration and production projects in Malaysia and overseas, namely in Egypt, Sudan and Vietnam. The bulk of expenditure was also for Production Sharing Contracts within Malaysia. Other projects included the final stage construction of MLNG Tiga Plant and on-going building of liquefied natural gas and petroleum tankers. In the case of Tenaga Nasional Berhad, expenditure was mainly for generation capacity and transmission

Table 2.14
Consolidated State Government Finance

	2002	2003*e*	2004 Budget
	RM million		
Revenue	8,341	8,787	9,676
State sources	*6,239*	*6,729*	*7,120*
Federal grants and transfers	*2,102*	*2,058*	*2,556*
Expenditure	5,090	6,009	6,397
Current surplus	**3,251**	**2,778**	**3,278**
% of GDP	**0.9**	**0.7**	**0.8**
Net development expenditure	3,772	4,973	4,595
Gross development expenditure	*4,161*	*5,503*	*4,756*
Less: Loan recoveries	*389*	*530*	*161*
Overall balance	**-520**	**-2,196**	**-1,316**
% of GDP	**-0.1**	**-0.6**	**-0.3**
Sources of financing:			
Federal loans	752	773	496
Realisable assets[1]	-231	1,423	821
Total	**520**	**2,196**	**1,316**

[1] A positive (+) sign indicates a drawdown in the accumulated realisable assets.
e Estimate

Source: State governments

Table 2.15
List of NFPES, 2003[1]

1 1st Silicon (Malaysia) Sdn. Bhd.
2 Bintulu Port Sdn. Bhd.
3 Cement Industries (Sabah) Sdn. Bhd.
4 Central Spectrum (M) Sdn. Bhd.
5 Felda Agricultural Services Sdn. Bhd.
6 Golden Hope Plantations Bhd.
7 Indah Water Konsortium Sdn. Bhd.
8 Keretapi Tanah Melayu Bhd.
9 Kontena Nasional Bhd.
10 Kuching Port Authority
11 Kulim (Malaysia) Bhd.
12 Kumpulan Guthrie Bhd.
13 MA (Sepang) Sdn. Bhd.
14 Malaysia Airline System Bhd.
15 Malaysia Airports Sdn. Bhd.
16 Marconi (Malaysia) Sdn. Bhd.
17 Multimedia Development Corporation Sdn. Bhd.
18 Northport (Malaysia) Bhd.
19 Penang Port Sdn. Bhd.
20 Penerbangan Malaysia Bhd.
21 Petroliam Nasional Bhd.
22 PPES Works (Sarawak) Sdn. Bhd.
23 Rakyat Berjaya Sdn. Bhd.
24 Sabah Energy Corporation Sdn. Bhd.
25 Sabah Ports Sdn. Bhd.
26 Sarawak Electricity Supply Corporation
27 Sebor (Sabah) Sdn. Bhd.
28 Sergam Bhd.
29 Silterra Malaysia Sdn. Bhd.
30 Sinora Sdn. Bhd.
31 Syarikat Prasarana Negara Bhd.
32 Telekom Malaysia Bhd.
33 Tenaga Nasional Bhd.
34 TH Plantations Sdn. Bhd.
35 UDA Holdings Bhd.

[1] List of NFPEs for monitoring and reporting purposes was revised in 2003. NFPEs are defined as companies in which the Government has an equity of at least 51 per cent and sales turnover of at least RM100 million or having a significant impact on the economy, including large borrowing needs and capital expenditure.

Table 2.16
Consolidated NFPEs Finance[1]

	2001	2002	2003*e*
	RM million		
Revenue	105,075	126,562	149,970
Current expenditure	65,392	80,951	104,556
Current account	**39,683**	**45,611**	**45,414**
% of GDP	**11.9**	**12.6**	**11.6**
Development expenditure[2]	24,033	32,297	28,225
Overall balance	**15,651**	**13,313**	**17,188**
% of GDP	**4.7**	**3.7**	**4.4**

[1] Refers to 35 NFPEs in 2003.
[2] Includes grants from the Federal Government.
e Estimate

Source: Ministry of Finance and non-financial public enterprises

network. Major expenditure included the construction of the Port Dickson Phase 1 Combined Cycles Power Plant and the East-West Grid Interconnection in Sabah. A large share of the development expenditure of Telekom Malaysia Berhad was focussed on upgrading and expanding capacity to improve the telecommunication infrastructure and services. Projects undertaken included the underwater cable network connecting the Asia Pacific region, Phase VI of the Digitaline II project to facilitate data transmission for businesses and the Government Corporate Information Network Superhighway to support various information technology-related applications for businesses.