2 Monetary and Fiscal Developments

Monetary Developments

Monetary developments in 1999 reflected the policy measures introduced during the year as well as developments in the domestic real and financial sectors. Monetary policy in 1999 continued to focus on supporting economic recovery while maintaining price stability. Following progressive easing of monetary policy since August 1998 coupled with large trade inflows amid sluggish domestic private investment, liquidity conditions eased in 1999. Consequently, with the absence of inflationary pressures, interbank and lending rates were allowed to ease during the course of the year.

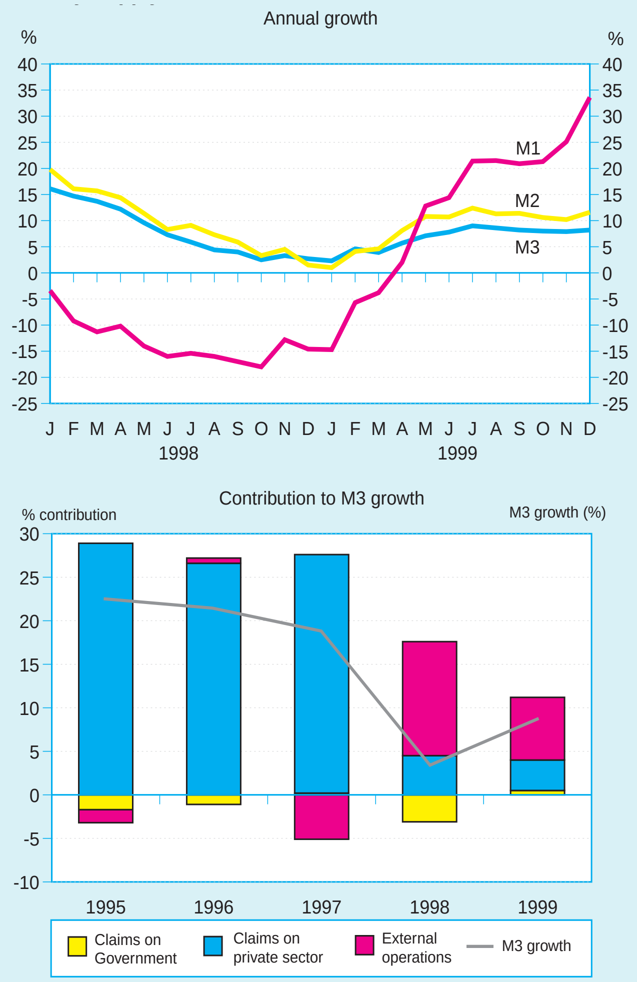
The strong economic performance and large trade surplus as well as the accommodative monetary policy stance resulted in an expansion of all **monetary aggregates** in 1999. Narrow money, M1, which had recorded a sharp decline in the previous year and in the first quarter of 1999, turned around to record a positive growth in April and rose sharply thereafter to 33.6% as at end-December 1999 (end-1998: –14.6%). Similarly, the broader monetary aggregates, M2 and M3, also accelerated, albeit at a slower pace, to record an annual growth rate of 11.6% and 8.2% respectively at the end of 1999 (1998: 1.5% and 2.7% respectively). Overall, the performance of the broad monetary aggregates was consistent with the monetary policy objective of providing adequate liquidity to finance real output expansion while ensuring price stability.

During the year, M3 increased by RM33.1 billion (RM10.6 billion in 1998) to RM434.6 billion at the end of 1999. In terms of components, demand for transaction balances (currency holdings and demand deposits of the private sector) increased significantly by RM18.3 billion during the year (–RM8.9 billion in 1998), reflecting the strengthening momentum in economic and stock market activities. In addition, the private sector also increased their holdings of transaction balances during the year, as the opportunity cost of holding non-interest-bearing deposits became lower with the prevailing low interest rates. To some extent, there was also a shift into higher currency holdings due to Y2K concerns, particularly in December 1999.

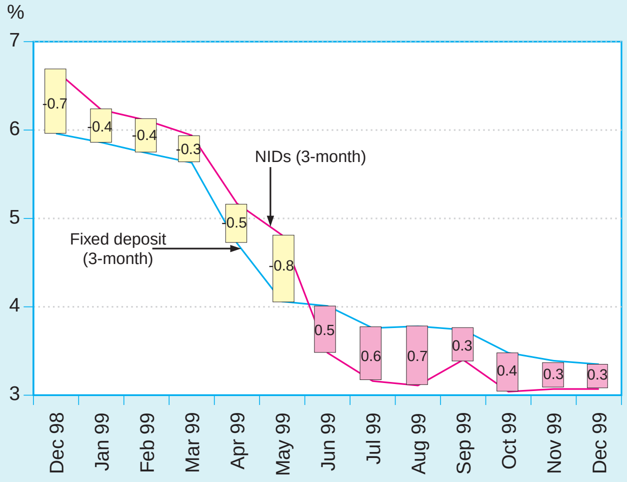
Reflecting the preference for transaction balances, broad quasi-money (private sector holdings of fixed and savings deposits, negotiable instruments of deposits (NIDs) and repurchase agreements (repos) with the banking system) expanded by RM14.7 billion or 4.3% (1998: RM19.6 billion or 6%).

In terms of instruments, fixed deposits, which remained the largest component of broad quasi-money (80.1% of total broad quasi-money as at end-1999) recorded an increase of RM29.9 billion or 11.5% in 1999 (RM14.9 billion or 6.1% in 1998). In contrast, NIDs, which accounted for a share of 1.6% of broad

Graph 2.1
Money Supply



Graph 2.2
Interest Rate Differential: NIDs vs. Fixed Deposits



quasi-money (1998: 7.6%) declined by RM21.9 billion or 79.1%, reflecting to some extent, the shift in private sector holdings from NIDs to fixed deposits to take advantage of the higher fixed deposit rates vis-à-vis NID rates. Amid an environment of excess liquidity, the weighted average rates of NIDs (3-month or lower) declined at a faster rate (–360 basis points) than the weighted average rate of 3-month fixed deposit (–261 basis points) in 1999. Meanwhile, savings deposits also increased by RM7.9 billion or 24.4% (+RM1.3 billion or 4% in 1998) in line with the higher disposable income of the private sector.

In terms of determinants, the primary source of monetary growth emanated mainly from the large increase in the current account surplus of the balance of payments. During the year, net external assets contributed 7.2 percentage points to M3 growth. Net external reserves of BNM increased by RM17.8 billion reflecting mainly the large surplus in the current and capital accounts of the balance of payments.

The other major contributory factor to monetary expansion was the higher claims on the private sector. During the year, it exerted an expansionary impact on monetary growth by RM14.1 billion, contributing about 3.5 percentage points to M3 growth. This reflected higher financing extended to the private sector (RM13.3 billion) and moderate growth in holdings of private securities (RM888 million).

The Government operations also exerted an expansionary impact on money supply in 1999 (RM2.2 billion) due to higher withdrawal of its deposits placed with BNM and the banking system (RM5.1 billion). These withdrawals were mainly to finance Government expenditure and also for domestic loan redemptions. Most of the funds withdrawn were sourced mainly from the surplus funds in 1998 and loan proceeds, including MGS issuance during the year, as well as the Government Global Bond. Nevertheless, holdings of Government securities by banking institutions declined by RM2.9 billion, partially offsetting the expansionary impact from the withdrawal of Government's deposits.

Reflecting the improved economic activity, **total loans outstanding** (including loans sold to Danaharta and Cagamas, write-offs of bad debts and conversion of loans into equity) increased by RM9.1 billion or 2.1% in 1999. Commercial banks and merchant banks

Table 2.1
M3 Determinants

	Outstanding		Change		Annual Growth	
	1998[1]	1999[2]	1998[1]	1999[2]	1998[1]	1999[2]
	RM billion				%	
M3	401.5	434.6	10.6	33.1	2.7	8.2
Of which:						
Net claims on Government	–21.0	–18.8	–12.3	2.2	–140.9	10.3
Claims on private sector[3]	465.3	479.4	17.7	14.1	4.0	3.0
Net external assets	94.6	123.6	51.2	29.0	117.6	30.6
Net other influences	–137.4	–149.6	–45.9	–12.2	–50.2	–8.9

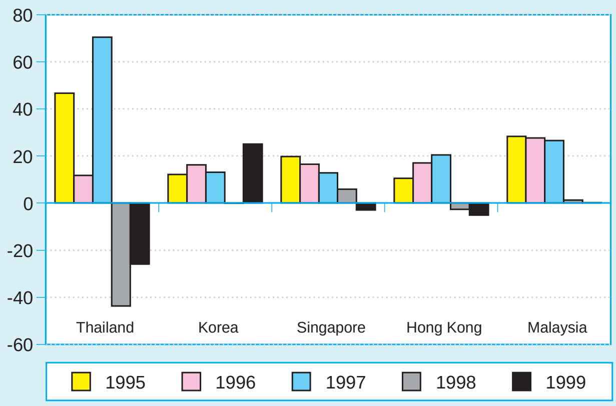
[1] Effective 15 September 1998, following the fixing of the ringgit/United States dollar exchange rate at RM3.80, all foreign currency assets and liabilities have been revalued into ringgit at rates of exchange prevailing on the reporting date. Therefore, part of the increase in the external assets reflected BNM's exchange revaluation gains. The revaluation gains of BNM were also reflected in other influences.
[2] Effective 1 January 1999, all foreign currency assets and liabilities were only revalued at the end of each quarter.
[3] Includes write-offs and loans sold to Danaharta.

recorded an annual increase of 4.8% and 0.3% respectively, while finance companies recorded an annual contraction of 6.4%, partly due to several absorptions of finance companies by the commercial banks that took place in 1999. During the year, the banking institutions increased their holdings of PDS by RM2.9 billion. Including these holdings of PDS, total financing provided by the banking system increased by RM12.1 billion or 2.8% in 1999.

It has been observed that loans have increased with a lag in the initial stage of the economic recovery. Such a phenomenon was apparent in most of the regional economies. Following the crisis and the subsequent restructuring of the banking sector, loan performance in Hong Kong SAR and Singapore declined by 5.1% and 2.9% respectively in 1999 (1998: –2.7% and +5.9% respectively), even though GDP had recovered to increase by 2.9% and 5.4% respectively. In the case of Thailand, the decline was larger at –26% (–43.7% in 1998). In Korea, loans however, increased strongly by 25% in 1999 (–0.1% in 1998) reflecting the strong economic recovery in Korea since the first quarter of 1999.

In Malaysia, total loans outstanding rose moderately in 1999, as the strong loan disbursements were almost matched by the high loan repayments. As such, for 1999, loan disbursements and approvals rather than loans outstanding, provided a better indication of the financing role of the banking system in supporting economic recovery. In this regard, disbursements of loans increased substantially by 28.7% to RM323.2 billion in 1999, with a monthly average of RM26.9 billion compared with RM20.9 billion in 1998. Similarly,

Graph 2.3
Loan Growth: Selected Countries



Source: Datastream.

loans approved rose by 61% to RM104.8 billion or a monthly average of RM8.7 billion (a monthly average of RM5.4 billion in 1998). However, the high disbursements during the year were virtually matched by loan repayments for several reasons:

- In the early part of the year, sluggish economic activity and excess capacity in some industries, as well as uncertainties about the prospects for the economy contributed to slow loan demand. Businesses tended to use their surplus cash to repay their loans and reduce their leverage rather than expand operations.

- During the year, several corporations borrowed to meet short-term working capital needs as opposed to borrowing long-term for new investments in view of the excess capacity. This practice resulted in a high turnover of disbursements and repayments but was not reflected in the level of loans outstanding.

- As the economy recovered during the course of the year, many borrowers took the opportunity to repay their loans following an improvement in business conditions as well as higher earnings of individuals and business enterprises. Meanwhile, a number of corporations refinanced their bank borrowings by raising funds in the PDS market to take advantage of the more competitive interest rates prevailing in the PDS market as well as the ability to borrow long-term on a fixed rate basis.

Consequently, due to the high repayments of loans (+24% to RM335.6 billion or a monthly average of RM28 billion compared with a monthly average of RM22.5 billion in 1998), total loans outstanding did not reflect the actual strength of credit expansion in 1999. Nevertheless, the increased repayment of loans and increased recourse to the PDS market, are positive developments as it reduces risk of potential loan defaults as well as over dependence on the banking system, particularly for long-term financing.

By sector, loans disbursed generally reflected the performance of the various sectors. Loans disbursed were higher to nearly all sectors. Disbursements were lower in the mining and quarrying sector; finance, insurance and business services; and for the purchase of securities. Loans disbursed to the manufacturing sector, which led the economic upswing, was the highest, amounting to RM85 billion

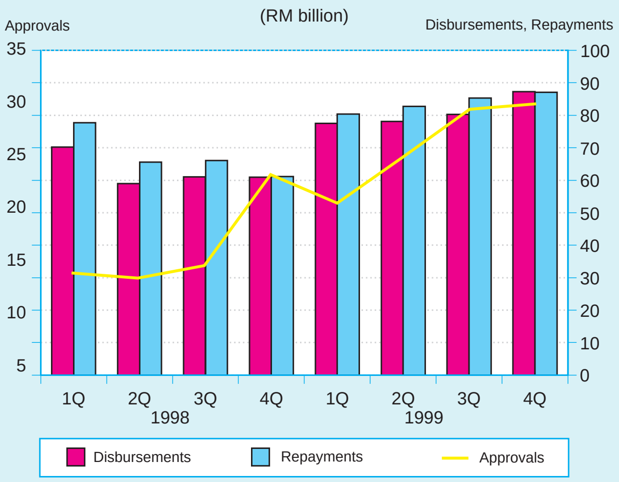
Table 2.2
Banking System: Loans Outstanding by Sector

	As at end		Change	Share of total
	1998	1999	1999	1999
	RM million			%
Agriculture, hunting, forestry and fishing	7,816.2	9,183.8	1,367.5	2.1
Mining and quarrying	1,685.3	1,579.5	–105.9	0.4
Manufacturing	65,133.5	66,074.9	941.4	15.5
Electricity, gas and water	5,854.1	7,087.9	1,233.9	1.7
Wholesale, retail, restaurants and hotels	35,759.9	36,321.7	561.8	8.5
Broad property sector	149,612.7	153,954.0	4,341.3	36.0
Construction	*45,091.7*	*43,108.7*	*–1,983.0*	*10.0*
Purchase of residential property	*56,450.4*	*63,348.5*	*6,898.0*	*14.8*
Purchase of non-residential property	*30,958.5*	*28,978.1*	*–1,980.3*	*6.8*
Real estate	*17,112.1*	*18,518.7*	*1,406.6*	*4.3*
Transport, storage and communication	15,210.9	15,532.0	321.1	3.6
Finance, insurance and business services	38,023.8	33,357.2	–4,666.7	7.8
Consumption credit	49,491.7	50,242.1	750.5	11.8
Purchase of passenger cars	*30,831.7*	*30,029.6*	*–802.0*	*7.0*
Purchase of securities	37,943.5	33,996.2	–3,947.3	8.0
Purchase of transport vehicles	4,504.8	1,966.9	–2,537.9	0.5
Community, social and personal services	6,686.3	7,068.5	382.2	1.7
Others	8,845.0	11,326.6	2,481.6	2.7
Total loans outstanding[1]	**426,567.7**	**427,691.2**	**1,123.5**	**100.0**
Plus: Write-offs and conversions	3,152.4	11,169.9	8,017.5	
Total loans outstanding	**429,720.1**	**438,861.1**	**9,141.0**	
Plus: Holdings of PDS	5,918.3	8,851.2	2,932.8	
Total financing	**435,638.4**	**447,712.3**	**12,073.9**	

[1] Including loans sold to Cagamas and Danaharta.

(1998: RM68.7 billion) accounting for 26.3% of total loans disbursed during the year. A significant share of loans was also disbursed to the wholesale, retail, restaurants and hotels and the broad property sectors with total disbursements of RM57.7 billion and RM57 billion respectively. The bulk of the loans disbursed to the broad property sector were to the construction sector and for the purchase of residential property. The house ownership campaign organised in 1999 contributed to the higher disbursements for residential property, particularly towards the end of the year. Loans disbursed to the agriculture sector were also higher at RM8.2 billion, as the activity in the sector recovered in 1999. Loans disbursed for the purchase of transport vehicles amounted to RM15.6 billion or 4.8% of total loans disbursed. The bulk of these loans were extended for the purchase of passenger cars which increased to RM12.5 billion.

Graph 2.4
Banking System: Loan Approvals, Disbursements and Repayments



In terms of total loans approved, the bulk of the approvals (55.2%) during the year were for the purchase of residential property, for the manufacturing sector, purchase of transport vehicles and for finance, insurance and business services. A total of RM20.6

Table 2.3
Banking System: Total Loans Approved and Disbursed

Sectors	Loans Approved 1998	Loans Approved 1999	Loans Disbursed 1998	Loans Disbursed 1999
	RM million			
Agriculture, hunting, forestry and fishing	2,236.2	3,448.2	6,147.8	8,227.7
Mining and quarrying	225.6	197.0	1,918.3	1,483.1
Manufacturing	10,347.7	14,012.1	68,693.1	84,975.4
Electricity, gas and water	926.5	2,187.5	3,141.2	6,275.7
Wholesale, retail, restaurants and hotels	4,869.4	7,630.6	35,858.9	57,716.4
Broad property sector	16,608.6	34,840.8	45,735.4	56,975.3
Construction	*5,668.2*	*7,893.6*	*21,390.3*	*25,600.8*
Purchase of residential property	*9,269.6*	*20,649.5*	*14,235.2*	*17,039.3*
Purchase of non-residential property	*1,670.8*	*3,289.1*	*5,876.0*	*6,307.9*
Real estate	*n.a.*	*3,008.6*	*4,223.8*	*8,027.9*
Transport, storage and communication	3,001.3	3,150.0	7,199.7	8,885.5
Finance, insurance and business services	8,752.4[1]	10,587.0	42,562.4	38,894.6
Consumption credit	4,066.6	5,714.2	11,659.0	17,111.9
Purchase of securities	3,998.7	5,276.9	9,833.5	9,655.5
Purchase of transport vehicles	5,876.6	12,619.2	6,097.2	15,637.1
of which: Purchase of Passenger Cars	*n.a.*	*11,055.3*	*n.a.*	*12,510.8*
Community, social and personal services	760.5	2,004.3	3,039.3	5,106.6
Others	3,453.8	3,135.8	9,240.8	12,224.2
Total	**65,123.9**	**104,803.7**	**251,126.5**	**323,169.0**

[1] Includes real estate.

billion of new loans had been approved for the purchase of residential property, which accounted for 19.7% of total loans approved in 1999. Loans approved to the manufacturing sector and for the purchase of transport vehicles amounted to RM14 billion and RM12.6 billion respectively, accounting for 13.4% and 12% respectively of total new approvals during the year. Loan approvals for finance, insurance and business services amounted to RM10.6 billion or a share of 10.1% of total loans approved.

During the year, a total of RM21 billion of NPLs were sold to Danaharta. The bulk of the NPLs sold to Danaharta were loans to the broad property sector (35% of total loans sold), in particular, the construction sub-sector; manufacturing sector (17%); and for the purchase of securities (15.6%). As at the end of 1999, Danaharta had acquired and managed a total of RM34 billion worth of NPLs from the banking system or 42% of total NPLs of the banking system.

Several adjustments were made during the year to ensure the effectiveness of the special funds established by the Government. In tandem with the lower interest rate levels, the funding rates and maximum lending rates for funds administered by Bank Negara Malaysia were reduced. With effect from May 1999, funding rates for the Fund for Small and Medium Industries and the Special Scheme for Low and Medium Cost Houses were reduced from 6% to 4% per annum with the maximum lending rate being concurrently reduced from 8.5% to 6.5% per annum. In the case of the New Entrepreneurs Fund, the funding rate was reduced from 6% to 4% per annum, while the maximum lending rate was reduced from 8% to 6% per annum. Due to its weak performance, the Industrial Adjustment Fund (IAF) and the Special Scheme for Low and Medium Cost Houses (SLMCH) were terminated with effect from 4 August 1999. The allocation under the Rehabilitation Fund for Small and Medium Industries (RFSMI) was also reduced to RM500 million from RM750 million previously. To ensure the effective utilisation of the Government financial resources, the unutilised portions of the IAF and the SLMCH, as well as the RM250 million withdrawn from the RFSMI were channelled into the Fund for Small and Medium Industries which had a higher utilisation rate.

Interest rate movements in 1999 exhibited a downward trend reflecting the easing of monetary policy since August 1998 as well as the excess liquidity in the banking system. The outstanding resource surplus of the banking system increased from RM37 billion at end-1998 to RM71.2 billion at end-1999. With the inflation outlook remaining subdued and given the monetary policy objective to support the economic recovery, the BNM 3-month intervention rate was further

Graph 2.5
Interbank Rates (average for the month)

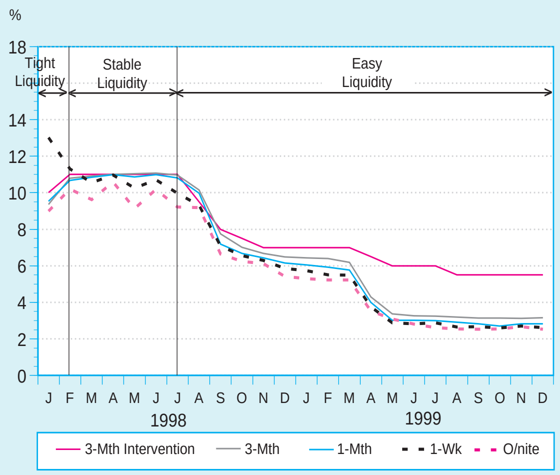


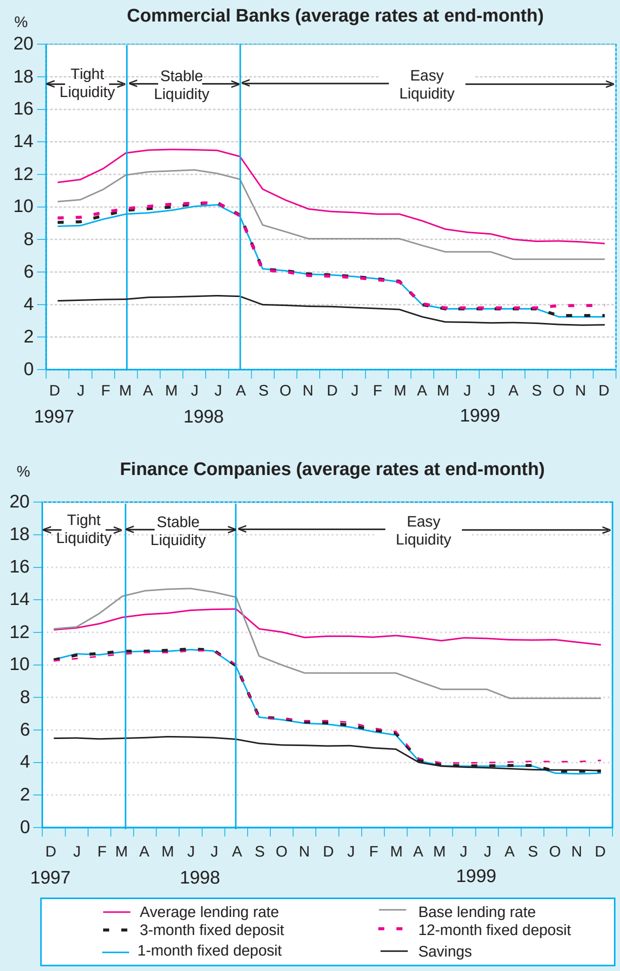
Table 2.4
Changes to BNM Intervention Rate and SRR Ratio

Period		Liquidity	Date	Intervention Rate	SRR Ratio
1997			End-Dec	8.70	13.50
1998	Jan-Feb	Tight	9 Jan	9.00	
			20 Jan	10.00	
			6 Feb	11.00	
	Mid-Feb -Jul	Stable	16 Feb		10.00
			1 Jul		8.00
	Aug-Dec	Easy	3 Aug	10.50	
			10 Aug	10.00	
			27 Aug	9.50	
			1 Sep		6.00
			3 Sep	8.00	
			16 Sep		4.00
			5 Oct	7.50	
			9 Nov	7.00	
1999	Jan-Dec		5 Apr	6.50	
			3 May	6.00	
			9 Aug	5.50	

lowered in three steps during the year: from 7% to 6.5% on 5 April, to 6% on 3 May, and to 5.5% on 9 August (see Graph 2.5). These reductions in the policy rate resulted in a reduction of lending rates across the banking industry. However, with the larger amount of excess liquidity in the banking system, the decline in the interbank money market rates was significantly more than the reduction of the intervention rate. On the whole, while the intervention rate fell by 150 basis points in 1999, the 3-month interbank rate fell by 328 basis points from 6.46% at end-1998 to 3.18% at end-1999. To ensure that real interest rates remained positive, BNM conducted operations in the interbank money market to absorb part of the excess liquidity.

Retail interest rates of the banking institutions also trended downward in 1999. During the year, the average base lending rates (BLRs) fell to a historically low level. The average BLR of the commercial banks and finance companies declined in April, May and August in step with the reductions in BNM's intervention rate (see Graph 2.6). For commercial banks, the BLR fell by 40 basis points on each occasion to 7.64% at end-April and to 7.24% at end-May. In August, the commercial banks' BLR fell by another 45 basis points to 6.79% and has since remained unchanged. This level is equivalent to the historical low recorded in November 1994. For the finance companies, their BLR fell by 50 basis points on each occasion to 9% at end-April and 8.50% at end-May. In August, it fell by another 55 basis points to 7.95% and has since remained unchanged, surpassing the historical low of 8.40% recorded in December 1994.

Graph 2.6
Interest Rates of Banking Institutions



Monetary Measures in 1999

Monetary measures implemented in 1999 reflected the continued accomodative monetary policy stance to strengthen economic recovery while maintaining monetary and financial stability. To build upon the earlier measures introduced in 1998, several measures were introduced in 1999 to stimulate domestic spending as well as to ensure that credit continued to be channelled for productive purposes. These measures were as follows:

- To ensure that there were sufficient funds to finance the economic recovery process, banking institutions with the capacity to lend continued to be encouraged to achieve a minimum annual loan growth of 8% by the end of 1999.

- In view of the need to clear the backlog of properties, **effective 6 January,** banking institutions were **not allowed to finance the development of residential properties and shop houses where the individual unit costs more than RM250,000 each**. In addition, banking institutions were not allowed to provide financing to develop hotels, resorts, office buildings, golf courses, clubs and shopping complexes. This prohibition would be applicable under the following circumstances:

  i) Where applications for credit facilities to finance the development of properties costing above RM250,000 had yet to be approved; and

  ii) Where approval had already been given, banking institutions were only permitted to disburse loans to complete the current phase of development subject to project viability. For subsequent phases, banking institutions were only allowed to finance the construction of properties costing RM250,000 and below.

  However, the guideline would not affect end-financing for the purchase of both residential and non-residential properties which had been fully completed as well as those currently under construction. Banking institutions were in fact encouraged to extend end-financing credit. Similarly, financing for the development of projects that had commenced and new applications to complete existing projects where construction had already commenced would not be affected. The guideline would be applicable only in cases where application for bridging finance facility had yet to be approved by the banking institutions and construction had yet to commence.

- BNM reduced the **3-month intervention rate** by 50 basis points to 6.5% effective **5 April.** The rate was further reduced to 6.0% on **3 May** and to 5.5% on **9 August**. The reduction in the policy rate was to reflect the expectations of lower inflation over the medium term and to allow for further easing of lending rates to support economic activity.

- In tandem with the lower interest rates level, the funding rates and maximum lending rates for **selective funds administered by BNM** were also reduced. With effect from **3 May,** the funding rates for the Fund for Small and Medium Industries (FSMI) and the Special Scheme for Low and Medium Cost Houses (SLMCH) were reduced from 6% to 4% per annum, with the maximum lending rate being concurrently reduced from 8.5% to 6.5% per annum. In the case of New Entrepreneurs Fund (NEF), the funding rate was reduced from 6% to 4% per annum, while the maximum lending rate was reduced from 8% to 6% per annum.

- Due to the low demand for loans under the Industrial Adjustment Fund (IAF) and Special Scheme for Low and Medium Cost Houses (SLMCH), these funds were terminated with effect from **4 August 1999**. In addition, the total allocation under the Rehabilitation Fund for Small and Medium Industries (RFSMI) was reduced from RM750 million to RM500 million. To ensure an effective utilisation of the Government's financial resources, the unutilised portion under the IAF and SLMCH as well as the RM250 million from the RFSMI were reallocated to the Fund for Small and Medium Industries (FSMI), which had a higher utilisation rate.

- Effective **28 July**, the minimum annual income eligibility criterion for **credit cards** was reduced to RM18,000 from the existing RM24,000.

- A total of RM2 billion of **Malaysia Savings Bond Series 02 (BSM 02)** was offered for sale to retirees during the period from 1 November 1999 to 10 November 1999, of which RM1 billion was offered under the Islamic principles. The bonds have a maturity of 2 years with a rate of return of 5.75% per annum, to be paid on a quarterly basis.

- To assist small- and medium-scale Bumiputera entrepreneurs and to provide financing at reasonable cost, Tabung Projek Usahawan Bumiputera (TPUB) with an allocation of RM300 million was established on **10 February 2000.**

The fixed deposits rates of all tenures remained higher than the average rate of inflation of 2.8% throughout 1999. This reflected the policy to maintain positive real rates of return to savers. During the year, the movements of fixed deposit (FD) rates of both commercial banks and finance companies also closely tracked the wholesale interbank rates. Overall, the 3-month FD rates for commercial banks and finance companies declined by 250 and 294 basis points respectively from end-December 1998 to end-December 1999. During the first half of the year, both the interbank rates and the retail FD rates were on a declining trend. However, during the second half-year, in line with the stability in the interbank rates, the FD rates also exhibited greater stability. There was, however, a notable change in the term structure of FD rates in the last quarter of 1999. From being relatively flat for most of the year, the term structure steepened as the longer-term rates increased in October. From a difference of only four basis points between the 1-month and 12-month FD rates of commercial banks at end-September, the differential widened to 71 basis points. The 1-12 month FD rates increased to 3.24–3.95% by end-1999. Similarly, the differential for finance companies also widened to 79 basis points with the 1-12 month FD rates increasing to 3.34–4.13%.

The savings deposit rates for both commercial banks and finance companies also trended downward in 1999, but the decline in the savings rates was smaller than that of the FD rates. For commercial banks, the savings rate declined by 111 basis points from end-December 1998 to end-December 1999. For finance companies, it declined by 151 basis points over the same period.

The interest margins of both the commercial banks and finance companies widened by 91 and 246 basis points respectively during the year. The wider margins were due to the faster reduction of the average cost of funds (ACF) as compared with the average lending rates (ALR). The larger interest margin achieved by finance companies was largely an outcome of a more rapid decline in their ACF as higher-cost deposits and

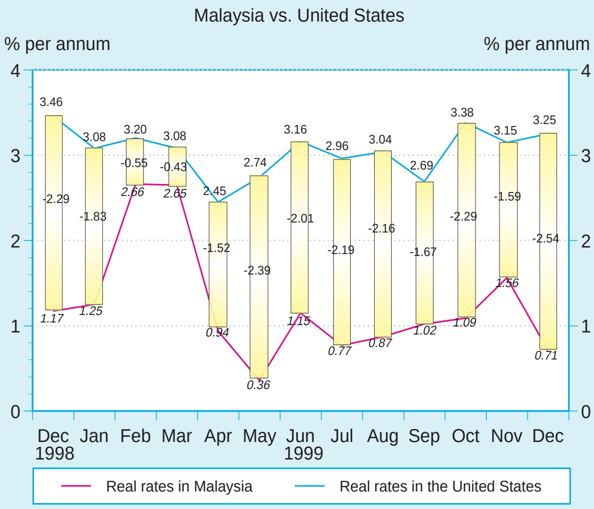
Table 2.5
Interest Rates of Banking Institutions (%)

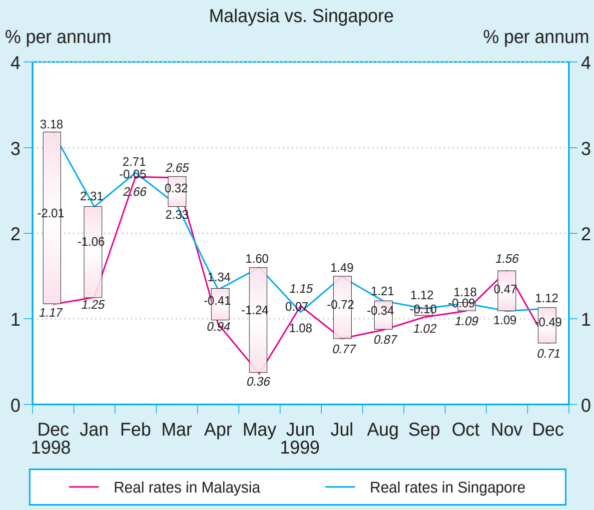
	As at end	1998	1999	Difference
Commercial Banks	3-Month FD	5.83	3.33	–2.50
	Savings Deposit	3.87	2.76	–1.11
	Base Lending Rate	8.04	6.79	–1.25
Finance Companies	3-Month FD	6.43	3.49	–2.94
	Savings Deposit	5.01	3.50	–1.51
	Base Lending Rate	9.50	7.95	–1.55

Table 2.6
Interest Margins of Banking Institutions (%)

	As at end	1998	1999	Difference
Commercial Banks	Avg. Lending Rate (ALR)	9.72	7.75	–1.97
	Less Avg. Cost of Funds (ACF)	6.17	3.29	–2.88
	Interest Margin	**3.55**	**4.46**	**0.91**
Finance Companies	Avg. Lending Rate (ALR)	11.76	11.23	–0.53
	Less Avg. Cost of Funds (ACF)	7.68	4.69	–2.99
	Interest Margin	**4.08**	**6.54**	**2.46**

Graph 2.7
Real Interest Rate Differentials[1]





[1] Based on the 3-month interbank rates

borrowings matured during the year. Additionally, since the bulk of the finance companies' loans are at fixed rates, their lending rates fell at a slower pace than the predominantly floating lending rates of the commercial banks.

Real interest rate differentials (3-month interbank nominal rates adjusted for inflation) between Malaysia and other countries, notably the United States and Singapore, had generally remained negative during the year. Malaysia's real interest rate differentials with the United States widened towards the end of the year as US nominal interest rates began to edge upwards, while Malaysian nominal interest rates remained largely unchanged. On the other hand, although the interest rate differentials with Singapore remained negative, the gap had narrowed significantly during the year. On a number of occasions, the interest rate differential was in fact positive. The narrowing of the real interest rate differentials with Singapore was primarily reflective of changes in the Consumer Price Index of Singapore, which varied from a deflationary trend in early 1999 to a reversal in the trend in late 1999. The inflation rate in Malaysia, on the other hand, continued to moderate.

Monetary Policy in 1999

In 1999, the basic thrust of monetary policy was to create an environment to support economic recovery and facilitate structural reforms, while preserving price stability. The easing of monetary policy which began in August 1998 was continued into the year. Against an environment of a strengthening financial sector; benign inflationary environment; improving balance of payments position and a more favourable performance of the world economy including the regional economies, monetary policy remained accommodative throughout the year. With the large trade inflows, however, an important task of monetary policy in 1999 was to manage excess liquidity to avoid inflationary pressures. While interest rates were reduced to support economic recovery, Bank Negara Malaysia also ensured a positive real rate of return to depositors.

Following progressive easing of monetary policy since August 1998 through the reduction in the Bank Negara Malaysia policy rate (3-month intervention rate) and the statutory reserve requirement, liquidity conditions eased considerably in early 1999. As the year progressed, the underlying excess liquidity became progressively larger due to large inflows on both the current and capital account of the balance of payments. In managing this excess liquidity, the conduct of monetary policy in 1999 was influenced by several considerations. Firstly, it was important to ensure that the underlying excess liquidity would not reignite inflationary pressures, especially as the economic recovery strengthened and asset prices recovered significantly. In this regard, BNM noted that while consumer spending and asset prices had recovered, they were still below the levels that could potentially trigger inflationary pressures in the near term. Nevertheless, the Bank monitored closely these developments. The second concern was the impact of monetary easing on deposit rates. While a reduction in interest rates was necessary to promote increased consumption and investment activities, it was important to strike an appropriate balance with the need to ensure a positive real rate of return for depositors. Finally, the conduct of monetary policy had to bear in mind that efforts for structural reforms have to be intensified. Too rapid a reduction in interest rates would undermine the positive impact of other measures being implemented to strengthen the banking institutions, thereby impairing the financial restructuring process. Given the overhang of the high-cost deposits incurred by banking institutions during the high interest rate period in 1998, reducing the BNM 3-month intervention rate (the anchor rate for the computation of BLR) too sharply would result in disruptive adjustments in the investment portfolio of the banking institutions.

Taking into account the impact of lower interest rates on the financial system and the economy, BNM opted for a smooth and more gradual easing of interest rates under the pegged exchange rate regime. Interest rates were kept relatively stable in the first quarter of 1999, as BNM assumed a more active role to sterilise the significant trade inflows from abroad. Since April, with prospects of further large trade inflows and improvement in the inflationary outlook, the interbank rates were allowed to ease to reflect the underlying liquidity situation in the system. Consequently, the 3-month interbank rates eased by 29 basis points in the first quarter before declining by 299 basis points for the rest of the year to reach 3.18% at the end of 1999. The intervention rate, on the other hand, was reduced albeit at a slower pace. Amid the improvement in the inflationary outlook and the maturing of some of the high-cost deposits, Bank Negara reduced further the intervention rate in several steps in April, May and August by 50 basis points in each revision to 5.5% to strengthen economic recovery. Thereafter, the intervention rate remained at 5.5% for the rest of the year.

The decision to leave the intervention rate unchanged since August 1999 was based on several factors. Firstly, the effective BLR rate had fallen to the historical low of 6.79%. At that level, the BLR was nearly 550 basis points below its peak in June 1998. Amid the ample liquidity situation, the average lending rate fell to an unprecedented level of 8% by the end of August 1999, before easing further by another 25 basis points to 7.75% at the end of 1999. Secondly, there was ample evidence that the recovery was gaining momentum. Indications were that the rebound in GDP would be stronger than earlier expectations. Concerns on rising non-performing loans (NPLs) had also dissipated, with the NPLs in fact moderating to 7.9% by March (based on six-month classification) and subsequently to 6.6% by the end of 1999 from a peak of 9% at end-November 1998. Thirdly, significant progress had also been made by banks in financing economic recovery. Loan approvals picked up during the period June-December, nearly double the amount recorded in the first five months of 1999, while loans disbursed were one-and-a-half times higher over the same period. Nevertheless, as the high volume of disbursements was mainly for working capital, the amount extended was virtually matched by repayments so that the loans outstanding remained low. To some extent, credit growth was also affected by the conversion of debt into bonds as well as the write-offs of loans by banks. The year also saw increased recourse to financing from the equity and the private debt securities market, as corporations took advantage of the improved market sentiment in the stock market and the underlying low interest rates to refinance their activities on a longer-term basis. On the whole, these favourable developments indicated that monetary easing had adequately supported economic recovery while maintaining price stability. More importantly, it provided an environment in which the cost of bank and corporate restructuring was reduced.

In ensuring stable monetary conditions, BNM absorbed a total of RM28 billion through direct interventions in the money market. During January-August 1999, there was a consistent net inflow of capital. By August, total funds locked in with BNM through direct borrowings reached a peak of RM45 billion. In September, there was a net outflow of portfolio funds (–RM5.2 billion) following the expiration of the 12-month holding period on 1 September. To alleviate the temporary withdrawal of liquidity from the system, funds were released into the system through the maturing of the short-term borrowings by BNM. Reflecting the growing confidence in the market, the outflow of funds moderated significantly in the subsequent months and reverted to a net inflow in January 2000. Since November 1999, BNM resumed its mopping up operations to offset the expansionary operations of the external sector and the Government. Throughout the period of September to December, interbank rates remained relatively steady in the range of 2.52–3.15% for overnight to 3-month money.

On the whole, the extent of the monetary easing, as reflected in the reduction in lending rates, was less pronounced compared with other crisis-affected regional economies. This was due to the recognition by BNM at the onset of the crisis that the pursuance of a very high interest rate regime in a prolonged economic crisis would not only be ineffective in stabilising the foreign exchange market, but would also contribute to undermining the domestic real economy. Consequently, unlike several of the other crisis-affected economies, BNM had not resorted to raising interest rates too sharply during the height of the economic crisis. Furthermore, the Bank was mindful that in complementing the role of fiscal policy to revive the economy, there was a need to avoid overly excessive monetary expansion which could lead to a potential risk of rekindling inflation over the medium term and undermine output growth in the long term.

It is also important to note that the selective exchange controls to some extent allowed interest rates in Malaysia to diverge significantly from the US dollar interest rates. By the end of 1999, interest rate spreads widened against US rates to 2.75 percentage points in favour of the US dollar interest rates from 4 percentage points in favour of Malaysian rates at the end of August 1998 (prior to the imposition of the selective exchange controls).

While the focus of monetary policy was directed at supporting the economic recovery, BNM had also placed high priority on the need to ensure that the low interest rate regime does not unduly affect those who depend on interest from savings as their main source of income. Indeed by April, the fixed deposit rates offered by the commercial banks had fallen to 3.99–4.06% for one- to 12-month maturity (5.82–5.74% at end-1998). In addition to monetary policy ensuring real positive rates of interest to depositors, BNM also introduced other savings instruments to provide alternative investments to deposits, especially for pensioners. In November, BNM launched a second series of Malaysia Savings Bond for subscription by retirees.

Throughout the year, the decisions on monetary policy had also been taken on the basis of what is considered appropriate to preserve financial stability. This was viewed necessary as market confidence and the bank intermediation process hinged critically on the state of the banking system. The conduct of monetary policy was balanced delicately to ensure that monetary easing did not destabilise the financial system and will continue to promote long-term savings. The year saw the imposition of more stringent guidelines aimed at strengthening the banks. These included, among others, guidelines governing the extension of lending to their controlling shareholders and guidelines on future capitalisation of banking institutions by controlling shareholders. This was to avoid a repeat of past practices whereby the capitalisation of banks by the controlling shareholders was made through bank borrowings which consequently exerted pressure on banks to generate large returns to service these loans at the expense of prudent lending. At the same time, complementary measures were also undertaken to reduce the NPLs of banks and facilitate the restructuring of banks and the private sector.

During 1999, there was a change in policy focus from managing the Asian crisis to addressing longer-term issues of strengthening and enhancing the competitiveness of the banking system to support the further transformation of the economy as well as to improve the transmission mechanism of monetary policy. As part of this process, BNM initiated a merger programme for the domestic banking institutions during the year. The Bank also commenced work on the masterplan for the development of the financial sector over the next ten years to enhance the efficiency, effectiveness and stability of the financial system.

Fiscal Operations and Policy

The 1999 Budget formulated in October 1998 during a recession year appropriately focused on the counter-cyclical role of fiscal policy to revitalise economic activities and strengthen the nation's resilience and competitiveness. Various measures were also introduced to further improve the balance of payments; strengthen the financial sector; promote the services and agriculture sectors; and improve governance in the public and private sectors as well as ensure social well-being. Overall, the Budget strategy reinforced the fiscal stimulus adopted in 1998 in line with the plan to revitalise the economy as set out in the National Economic Recovery Plan (NERP). The fiscal stimulus in 1999 via a budget deficit of 6.1% of GNP contributed to the restoration of consumer and investor confidence, particularly in the second half of 1999.

While the Government undertook a stimulative role, fiscal prudence and discipline continued to be maintained to contain the fiscal deficit at a manageable level so as not to jeopardise long-term growth. The level of expenditure, therefore, was managed with the consideration that revenue should be sufficient to finance operating expenditure; fiscal deficit be contained at a sustainable level of about 6% of GNP in 1999; and availability of domestic and external financing without crowding out the private sector. This required restraint in the increase in public sector spending through a tight budgetary control on non-essential and non-productive spending.

Meanwhile, the better-than-expected revenue outturn in 1999, reflecting the strong pick-up in the momentum of economic recovery as the year progressed, provided the Government with increased flexibility in managing its fiscal policy. It enabled the Government to expand its fiscal stimulus to reinvigorate the economy further through increased expenditure during the course of 1999, while containing the budgeted deficit to within 6% of GNP. Consequently, total expenditure (including contingency reserves) was raised from the budgeted RM65.1 billion to RM74.6 billion. The bulk of the increased expenditure was expended on social and economic sectors. The Government also announced the provision of RM600 special payments to each eligible civil servant and pensioners as well as the reinstatement of civil service allowances.

However, in early 1999, implementation of projects was relatively slow, due to the slow disbursement of development expenditure. It was clear that delays in project implementation would impede economic recovery. In response, the Government implemented several measures to accelerate the pace of implementation of projects to ensure that budgetary allocations were utilised to the maximum, with minimal shortfall. The various measures instituted included intensive monitoring of project implementation; submission of monthly reports on the progress of project implementation; as well as changes in procedures relating to tenders and procurement. With these measures, the Government was able to contain its shortfall in development expenditure to 12.5% of total allocation of RM25.8 billion (shortfall of 21.6% in 1998).

Adequate domestic resources to finance the deficit in 1999, due to fiscal surpluses from previous years and the large current account surplus in the balance of payments, reduced the reliance on external sources. In line with prudent debt management policy and ample liquidity in the financial system, the Government borrowed mainly from the domestic bond market, thereby minimising the nation's exposure to foreign exchange and interest rate risks. The bulk of the domestic borrowing was raised through the issuance of Malaysian Government Securities and through non-inflationary sources, especially from the Employees Provident Fund and insurance companies, to avoid crowding out the private sector. The Government also drew down its accumulated realisable assets. Funding through external borrowings was small. Borrowings were mainly from the World Bank and bilateral sources, namely under the Japanese New Miyazawa Initiative. In international capital markets, the Government raised only US$1 billion through a global bond issue, the objective being primarily, to set a benchmark for Malaysian corporations accessing the international markets.

The 2000 Budget presented to Parliament on 29 October 1999 was aimed at strengthening recovery and raising economic growth to a level consistent with Malaysia's growth potential. Hence, the budgetary operations of the Federal Government in 2000 continued to be expansionary to strengthen the foundation of economic growth. Nevertheless, in line with fiscal prudence, the Government would ensure that the current account of the Federal Government would be in surplus or at least balanced, while the overall deficit does not exceed 6% of GNP. In managing the deficit, the over-riding objective was to achieve sustainable growth with price stability and, at the same time, avoid crowding out the private sector access to resources. For the year 2000, priority would continue to be accorded to projects, which would expand the productive base, generate strong domestic demand as well as projects for the social sector. A large share of the 2000 Budget allocation was for infrastructure development, education and skills training, health services and industrial development. Emphasis was also given to low-cost housing, and agriculture and rural development.

However, the Budget was retabled in Parliament on 25 February 2000 following the dissolution of Parliament on 11 November 1999. The revised 2000 Budget retained the original Budget strategies as well as all the tax and non-tax proposals. A number of additional new tax and non-tax proposals were tabled. After taking into account the new tax measures as well as increases in the salaries and housing allowances of civil servants announced in the original 2000 Budget, the overall fiscal deficit of the Federal Government for year 2000 is projected at 4.5% of GNP. This deficit is smaller than the original 2000 Budget (–5% of GNP) reflecting the better revenue collection arising from the projected stronger economic activities in year 2000.

The 1999 Budget contained both tax and non-tax fiscal incentives focused at reviving business activities, while strengthening the financial sector and the balance of payments. On tax policy, the Government continued to modernise and streamline the tax system to enhance its efficiency and responsiveness in tax collection; as well as to ensure that the revenue collection will improve flexibility in fiscal operations by ensuring that revenue collection reflects economic development in the current year. Hence, a major policy change in the tax administration system was the revision in the tax assessment, which would be based on income received in the current year instead of the previous year, with effect from year 2000.

Fiscal incentives were also introduced during the year to reduce the cost of doing business and improve competitiveness. These included the exemption of stamp duty on refinancing instruments for businesses and trade activities; and abolition of excise duty on refrigerators, television sets and air conditioners. Wide-ranging tax incentives and exemptions were also provided to promote tourism and to strengthen the balance of payments through the promotion of exports, encouraging import-substitution and enhancing the capacity of the domestic services sector to export and substitute for imported services. Among others, the measures included group relief incentive for food production, tax incentive for the shipping sector and tax exemption on income earned from selected services such as repair and maintenance of luxury boats and yachts in Langkawi; and sports, cultural and arts activities.

Several fiscal incentives were also announced to strengthen the banking institutions to enhance their resilience to meet growing challenges, increase the capacity to grant new loans and, hence, provide a strong impetus for the revival of economic activities. These included the exemption of stamp duty and the real property gains tax on mergers; the 50% tax exemption for interest-in-suspense; and the provision of a tax credit (50%) for the accumulated losses of the merged entity. Incentives were also provided to life insurance companies and unit trust sectors to encourage further development of these sectors. Meanwhile, selective tax increases were imposed to increase the Government revenue as well as to discourage the consumption of selected goods or activities.

Consolidated Public Sector

The financial position of the consolidated public sector recovered to record a surplus in 1999. This was entirely due to the significant improvement in the performance of the non-financial public enterprises (NFPEs). The favourable performance of the NFPEs was due mainly to the substantially higher revenue receipts reflecting largely the recovery in economic activities as well as the sharp pick-up in petroleum prices, especially in the second half of 1999. During the year, the coverage of the NFPEs was reviewed and expanded from 28 public enterprises to 37, retrospective to 1998. On the other hand, the financial position of the general government, in particular the Federal Government recorded a larger deficit attributable to the implementation of the fiscal stimulus package. In aggregate, the overall account of the consolidated public sector recorded a small surplus of RM581 million or 0.2% of GNP (1998: –RM3.5 billion or –1.3% of GNP). This financial position was significantly better than the earlier projection of a deficit (–RM16.4 billion or –5.8% of GNP) in the Treasury Economic Report 1999/2000 attributable largely to the strong pick-up in economic activity as well as the sharply higher petroleum prices in the latter part of the year.

The general government consolidated position, comprising the Federal Government, 13 state governments, statutory bodies and local governments recorded a smaller current account surplus (RM16.9 billion or 6% of GNP). This was mainly due to higher operating expenditure (+7.7%), amidst moderate increase in revenue receipts (+2%). Increased operating expenditure was channelled to improving the quality of the public services and amenities as well as for higher emoluments and debt servicing. The surplus, as in previous years, was generated mainly by the Federal Government and to a lesser extent, the state governments, while the statutory bodies remained in deficit, attributable to their narrow revenue base. In contrast, several major public enterprises recorded improved performance during the year. The operating surplus of the NFPEs, as a group, was higher (RM31 billion or 11.1% of GNP). Consequently, the consolidated

Table 2.7
Consolidated Public Sector Finance

	1998	1999*p*	2000 Forecast
	RM million		
General government[1]			
Revenue	69,595	71,006	74,917
Operating expenditure	50,179	54,061	61,874
Current account of general government	19,416	16,945	13,043
Current account of NFPEs[2]	23,918	31,006	28,804
Public sector current surplus	**43,334**	**47,951**	**41,847**
(% of GNP)	**16.1**	**17.1**	**14.0**
Net development expenditure	46,827	47,370	49,417
General government	*17,168*	*21,823*	*23,061*
NFPEs[2]	*29,659*	*25,547*	*26,356*
Overall balance	–3,493	**581**	**–7,570**
(% of GNP)	–1.3	**0.2**	**–2.5**
General government	*2,248*	*–4,878*	*–10,018*
NFPEs[2]	*–5,741*	*5,459*	*2,448*

[1] Comprises Federal Government, state governments, statutory authorities and local governments.
[2] Refers to 37 NFPEs.
p Preliminary

Source: Ministry of Finance, state governments and non-financial public enterprises public sector recorded a larger current account surplus of RM48 billion or 17.1% of GNP in 1999.

Public sector development expenditure was marginally higher (+1.2%) in 1999 due to the significantly higher development outlays (+27.1%) of the general government to reinvigorate economic growth and meet the socio-economic objectives of the nation, notwithstanding the lower capital outlays of the NFPEs (–13.9%). The bulk of the general government development outlays were channelled to infrastructure projects; human resource development; as well as agriculture and rural development. In contrast, lower capital outlays of the NFPEs reflected largely the deferment of less essential development projects and sharply lower investment overseas. Declines in investments were recorded by several major public enterprises including Tenaga Nasional Berhad, Telekom Malaysia Berhad and Malaysia Airports Berhad.

Federal Government Finance

The Federal Government recorded a larger fiscal deficit in 1999, reflecting the expansionary fiscal programme to promote economic recovery amid the moderate increase in revenue receipts. The current account continued to remain in surplus (RM12 billion or 4.3% of GNP), while the overall balance recorded a further deficit (–RM9.5 billion or –3.4% of GNP) for the second consecutive year. Nevertheless, the deficit was smaller than budgeted in the 1999 Budget (a deficit of RM16.1 billion or –6.1% of GNP), reflecting the better revenue performance than the original estimate, notwithstanding the upward revision of total expenditure.

In 1999, **Federal revenue** registered a moderate increase of 3.5% or RM2 billion to RM58.7 billion or 20.9% of GNP despite the double-digit decline in income taxes. The better-than-expected revenue collection was attributable to the marked improvement in indirect tax collection in tandem with the recovery in aggregate demand as well as higher receipts from investment income. The higher collections also reflected several revenue enhancing measures announced in the 1999 Budget including increases in taxes/duties on selected goods and gaming activities. Meanwhile, for the second consecutive year, contribution from petroleum-based income was lower (–1.2% to RM11.7 billion) due to decline in receipts of petroleum income tax and royalty which were affected by the marked decline in petroleum prices in 1998 and in the first quarter of 1999. In aggregate, the increase in revenue emanating from indirect taxes (+RM2.8 billion) and non-tax revenue and receipts (+RM2 billion) more than offset the decline in direct taxes (–RM2.8 billion).

Revenue from **indirect taxes** expanded by 18.1% following a sharp decline of 33.9% in 1998 to account for a higher share of 31% of total revenue (27% in 1998). Reflecting the moderate recovery in aggregate demand as well as higher petroleum prices, especially in the second half-year, most major sources of indirect taxes registered strong performance. The higher demand, in particular for motor vehicles, as well as machinery and spare parts have contributed to the large increases in excise duties (31.7%), import duties (22%) and sales tax (16.7%). Revenue collections were also boosted by the increases in import and excise duties on liquor, tobacco and cigarettes in the

Table 2.8
Federal Government Finance

	1998	1999*p*	2000 Revised Budget
	RM million		
Revenue	56,710	58,675	61,822
Operating expenditure	44,584	46,699	54,343
Current account	**12,126**	**11,976**	**7,479**
(% of GNP)	**4.5**	**4.3**	**2.5**
Net development expenditure	17,128	21,463	20,881
Gross development expenditure	*18,103*	*22,615*	*21,881*[3]
Less Loan recoveries	*975*	*1,152*	*1,000*
Overall balance	**–5,002**	**–9,487**	**–13,402**
(% of GNP)	**–1.9**	**–3.4**	**–4.5**
Sources of financing[1]			
Net domestic borrowing	11,040	5,423	–
Gross borrowing	*17,990*	*19,281*	–
Less Repayment	*6,950*	*13,858*	–
Net foreign borrowing	1,819	2,923	–
Gross borrowing	*4,001*	*4,763*	–
Less Repayment	*2,182*	*1,840*	–
Special receipts	1	238	–
Realisable assets[2] and adjustments	–7,858	903	–
Total	**5,002**	**9,487**	**–**

[1] Data for 2000 are not given.
[2] Includes changes in Government's Trust Fund balances. A decline in the accumulated realisable assets is indicated by a positive (+) sign.
[3] Includes shortfall in expenditure.
p Preliminary

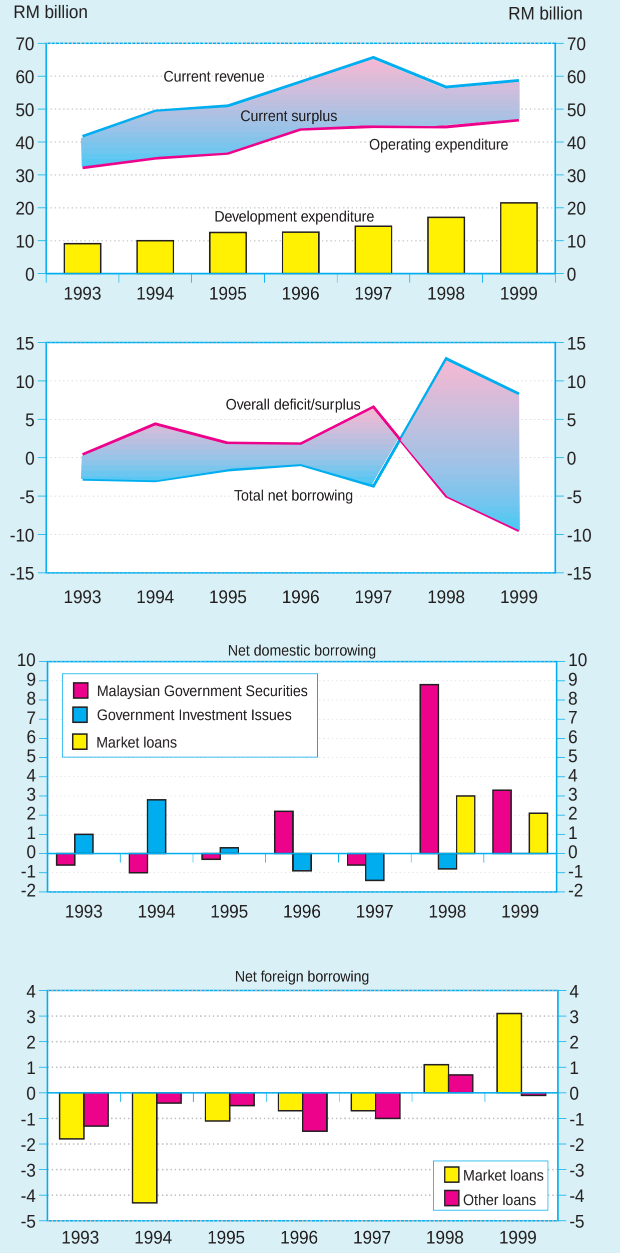
Source: Ministry of Finance

1999 Budget. These measures were expected to result in a revenue gain of RM378 million, which was partially offset by revenue foregone of RM59 million arising from the abolition of excise duties on television sets, air conditioners and refrigerators to enhance competitiveness. Meanwhile, service tax recorded a marginal increase (0.8%) due to increased demand for selected professional services and a miscellany of other services. Reflecting the pick-up in crude petroleum prices during 1999, export duty receipts were higher by 7.6%. Other indirect taxes were also higher (4.5%) attributable to some extent to the increases in the rate of duties or taxes on gaming activities.

Revenue from **direct taxes**, however, declined further by 9.2%, thus reducing its share of total Federal revenue to 46% (53% in 1998). All major categories of direct taxes registered declines except for receipts from stamp duties. The decline was most marked in property gains tax (–27.5%) attributable to both lower property prices and a fall in the number of transactions in 1998 as well as in the first quarter of 1999. Collection from income taxes was also sharply lower due to poor business earnings in 1998 (tax base for 1999) as well as lower crude petroleum prices in 1998. As in the previous year, income tax collections were dampened by the restructuring of tax payments, particularly for companies, due to cash flow problems. It was also affected by the provision of several tax concessions and incentives in the 1999 Budget to stimulate business activities, strengthen the financial sector and the balance of payments, and modernise and increase the efficiency of tax administration system. These measures were estimated to result in revenue foregone of about RM1 billion. These fiscal measures included individual income tax waiver for payees on current year basis; income tax exemption of 50% of the amount in the interest-in-suspense account; tax treatment on actuarial surplus of life insurance companies; income tax exemption on interest income of unit trusts; and tax incentives to promote food production and domestic tourism. In particular, sharp declines were recorded for receipts of petroleum (–29.4%), company (–9%) and individual (–7%) income taxes. Higher receipts, nevertheless, were collected from co-operative income tax (10%). In contrast, collections from stamp duties increased by 31.6% in line with strong recovery in stock market activities in 1999.

Overall, **tax revenue** increased marginally by 0.02%, thereby reducing its share to 77% of the total revenue. Consequently, the ratio of tax receipts to GNP declined to 16.2% (16.8% in 1998), the lowest since 1988.

Graph 2.8
Federal Government Finance



Reflective of the Government's efforts to modernise and streamline the tax administration system, the Inland Revenue Board (IRB) stepped up its efforts to raise productivity and efficiency as well as increase the quality of service to meet new challenges. Measures to increase the compliance rate and expand the tax base included expanding the smart partnership concept with related licensing agencies; increasing education programme and publicity; strengthening enforcement activities; and conducting surveys to minimise tax avoidance or evasion. Meanwhile, skills training was conducted for IRB's officers emphasising on technical competency and customer service orientation. An

Table 2.9
Federal Government Revenue

	1998	1999*p*	1998	1999*p*
	RM million		Annual change (%)	
Tax revenue	**45,336**	**45,346**	**–15.5**	**...**
(% of GNP)	**16.8**	**16.2**		
Direct taxes	30,015	27,246	–1.4	–9.2
Income taxes	28,369	25,159	4.6	–11.3
Companies	*17,294*	*15,742*	*3.6*	*–9.0*
Petroleum	*4,046*	*2,856*	*4.8*	*–29.4*
Individuals	*6,900*	*6,419*	*7.3*	*–7.0*
Co–operative	*129*	*142*	*–9.8*	*10.0*
Real property gains tax	396	287	–24.3	–27.5
Stamp duties	1,190	1,566	–56.2	31.6
Other	60	234	–18.9	289.7
Indirect taxes	15,321	18,100	–33.9	18.1
Export duties	623	670	–40.8	7.6
Import duties	3,868	4,720	–40.7	22.0
Excise duties	3,586	4,723	–40.8	31.7
Sales tax	3,845	4,488	–37.7	16.7
Service tax	1,447	1,459	–1.9	0.8
Other	1,952	2,040	1.6	4.5
Non–tax revenue and receipts	**11,374**	**13,329**	**–6.1**	**17.2**
Total revenue	**56,710**	**58,675**	**–13.7**	**3.5**
(% of GNP)	**21.1**	**20.9**		

p Preliminary

Source: Ministry of Finance

integrated assessment and collection system has been developed to provide for an automated assessment and collection process to facilitate operations of the IRB.

Non-tax revenue increased by 16.5% with higher receipts of investment income mainly from dividends of PETRONAS (RM4.1 billion) and BNM (RM1 billion). However, receipts from licences and permits declined by a further 5.1% with lower collections from levies on foreign workers and petroleum royalties. Similarly, **non-revenue receipts**, which included refunds of expenditure, receipts from Government agencies and revenue from the Federal territories, were substantially higher during the year.

Total Federal Government expenditure increased substantially by 10.6% to RM69.3 billion in 1999 due to the expansionary program to support economic recovery. It also reflected the upward revision in expenditure allocation from RM65.1 billion (including contingency reserves) announced in the 1999 Budget to RM74.6 billion in view of the better-than-expected revenue collection. In the course of the year, the Government undertook several measures to expedite project implementation to ensure that the fiscal stimulus would have maximum impact in generating economic growth. As a result of these measures, the Government's development expenditure shortfall in 1999 was reduced to 12.5%, as against a larger shortfall of 21.6% in 1998.

In line with prudent fiscal management and discipline, the increase in **operating expenditure** was moderate (+4.7%), reflecting continued restraint on less essential spending. During the year, the total wage bill, the largest component of operating expenditure (31%), increased by 3.2%. The higher wage bill reflected the part payment of the one-month bonus announced in the 2000 Budget inclusive of the special payment of RM600 announced in June 1999 to each eligible civil servant. The balance of the bonus payment would be paid in the first three months of 2000. Another contributory factor to the higher wage bill was the reinstatement of the civil service allowances, effective August 1999. The payment for pensions and gratuities was also higher reflecting the special payments to pensioners during the year as well as the higher annual contribution to the Pensions Trust Fund (RM833 million in 1999; RM742 million in 1998). Debt service charges in 1999, which accounted for 17% of operating expenditure were also higher. The higher outlay reflected increased domestic interest payments arising from the higher domestic debt level to finance the economic recovery programme. Foreign interest payments, however, declined reflective of the Government's prudent external debt management policy.

Table 2.10
Federal Government Operating Expenditure by Object

	1998	1999*p*	1998	1999*p*
	RM million		% share	
Emolument[1]	13,984	14,436	31.4	30.9
Supplies and services	5,212	6,074	11.7	13.0
Asset acquisition	434	422	1.0	0.9
Public debt charges	6,928	7,941	15.5	17.0
Pensions and gratuities	3,658	3,792	8.2	8.1
Other grants and transfers[2]	11,972	12,260	26.8	26.3
Other expenditure	2,396	1,774	5.4	3.8
Total	**44,584**	**46,699**	**100.0**	**100.0**

[1] Excludes statutory bodies.
[2] Includes grants and transfers to state governments as well as public agencies and enterprises.
p Preliminary

Source: Ministry of Finance

Table 2.11
Federal Government Development Expenditure by Sector

	1998	1999*p*	1998	1999*p*
	RM million		% share	
Defence and security	1,380	3,122	7.6	13.8
Economic services	9,243	8,970	51.1	39.7
Agriculture and rural development	960	1,089	5.3	4.8
Trade and industry	3,227	2,798	17.8	12.4
Transport	3,062	2,893	16.9	12.8
Public utilities	1,968	1,850	10.9	8.2
Other	26	340	0.2	1.5
Social services	5,783	6,936	31.9	30.6
Education	2,915	3,865	16.1	17.1
Health	716	835	3.9	3.7
Housing	1,030	1,081	5.7	4.7
Other	1,122	1,155	6.2	5.1
General administration	1,697	3,587	9.4	15.9
Total	**18,103**	**22,615**	**100.0**	**100.0**

p Preliminary

Source: Ministry of Finance

Disbursement on supplies and services recorded a sharp increase of 16.5% mainly for repairs and maintenance works as well as professional services to enhance the quality and efficiency of public services. Other transfer items were higher due largely to grants and transfers to other Government agencies for development and maintenance purposes as well as increased allocation to the Higher Education Fund and the National Education Fund. However, grants and transfer payments provided to the state governments and subsidies recorded declines. Meanwhile, disbursements on asset acquisitions and refund of expenditures were lower.

In tandem with the Government's strong commitment to revive economic activities, gross **development expenditure** increased markedly by 24.9% to RM22.6 billion in 1999. Priority was placed on projects that could generate economic activities with minimal leakages in terms of imports. Continued attention was also given to meeting the socio-economic objectives of the nation. The bulk of the expenditure, therefore, was channelled to social and economic programmes to reinvigorate growth as well as to improve the social well-being particularly of the lower income group.

In terms of sectoral distribution, economic services remained the largest component of total development expenditure, although its share declined to 40% (51% in 1998). Reflecting the Government's efforts to complement privatised entities to provide an integrated transportation network, expenditure on transportation remained significant. A large proportion of the expenditure was for infrastructure development, particularly for the construction, upgrading and improvement of roads (including highways) and the development and expansion of rail, port and airport projects. Trade and industry also absorbed a sizeable share of the gross expenditure. This included expenditure for the provision of infrastructure facilities, industrial research and development, development of small- and medium-scale industries and the promotion of tourism. A large proportion of the expenditure was also disbursed to Pengurusan Danaharta Nasional Berhad (RM1 billion), Keretapi Tanah Melayu Berhad (RM132 million), Bank Pembangunan dan Infrastruktur Malaysia Berhad (RM34 million) and Multimedia Development Corporation (RM30 million). Expenditure on public utilities remained high to improve water and electricity supplies. Meanwhile, outlays on agriculture and rural development (including land development) were higher reflecting the Government's commitment to upgrade the standard of living in rural areas.

Capital outlays on the social services sector recorded a further double-digit growth of 19.9% in 1999 to account for 31% of total development expenditure. In particular, investment in education and training was substantially higher to account for the largest share of development expenditure (17%). This reflected the Government's policy of making Malaysia a centre of excellence in education as well as promoting a highly skilled labour force to support the strategy of productivity-driven growth. The expenditure was mainly for the upgrading of educational infrastructure and support facilities as well as curriculum development. This included the construction and upgrading of primary, secondary, vocational and polytechnic schools as well as the development of universities including the Medical Faculty of the International Islamic University in Pahang and University Malaysia Sabah. The higher expenditure on housing was for low-cost public housing projects and housing programmes for the armed forces, police personnel, customs and excise officers and teachers in rural areas, as well as additional allocation to the housing fund for the hardcore poor. Outlays on health and family planning were also higher to provide better quality health care services.

The higher outlays on defence and internal security during the year reflected largely the modernisation

Table 2.12
Public Debt of Federal Government

	Annual change 1998	Annual change 1999*p*	At end 1999*p*
	Nominal value in RM million		
Domestic debt	11,229	5,553	93,750
Treasury bills	0	0	4,320
Government Investment Issues	–750	0	2,000
Malaysian Government Securities	8,750	3,324	78,336
Treasury Housing Loans Fund	189	130	3,955
Market loans	3,040	2,099	5,139
External debt	1,972	3,445	18,369
Market loans	1,220	3,382	11,075
Project loans	752	63	7,294
Total	**13,201**	**8,998**	**112,119**

p Preliminary

Source: Ministry of Finance

programme of the armed forces and police force. This included the purchase of military and operational equipment as well as construction of infrastructure.

Expenditure for general administration was also substantially higher, largely for the construction and maintenance of the new administrative centre at Putrajaya; the computerisation of the Government administration; expenses pertaining to Y2K compliance in the public sector; as well as enhancing the efficiency and effectiveness of the Government administrative machinery.

The financing requirement of the Federal Government remained high in 1999 to finance its fiscal deficit. Nevertheless, the better-than-expected outturn in revenue collection provided the cushion for the Government to revise downward its borrowing programme during the year. The fiscal deficit in 1999 was largely financed by domestic borrowing given the ample domestic liquidity. External borrowing was relatively small. The Government also drew down some of its cumulative realisable assets. Overall, the Federal Government recorded a **total net borrowing** of RM8.3 billion, which was smaller when compared with 1998 (RM12.9 billion), when the Government's borrowing was larger than its financing needs due to the shortfall in expenditure. Nevertheless, the increased borrowings, coupled with a net exchange revaluation loss arising largely from the weakening of ringgit against the Japanese yen led to a moderate increase in the total debt of the Federal Government. The total outstanding debt rose by 8.7% to RM112.1 billion as at end-1999 or 40% of GNP (end-1998: RM103.1 billion or 38% of GNP). Nevertheless, the ratio was much lower when compared with 1986 (111% of GNP), 1990 (83% of GNP) and 1995 (43% of GNP) reflecting the prudent debt management policy.

During the year, net domestic borrowing totalled RM5.4 billion. The domestic borrowing was financed largely from non-inflationary domestic sources as well as the remaining second and third tranches of the US$1.35 billion syndicated loan signed at the end of 1998 with 12 locally-incorporated foreign banks. Gross funds raised through the issuance of Malaysian Government Securities (MGS) amounted to RM10 billion. Part of the new issue was to refinance MGS which matured in 1999 amounting to RM6.7 billion. The Government also drew down the balance of RM2.1 billion from the syndicated loan of US$1.35 billion. However, the Government took advantage of the narrowing of spreads following Malaysia's improved credit ratings, to refinance the syndicated loan to reduce the debt-servicing burden. In November 1999, the Government signed a syndicated loan agreement with 26 banks (including 10 foreign locally-incorporated banks) for a loan of US$1.25 billion and ¥11.6 billion (equivalent to RM5.2 billion) to refinance the syndicated loan.

A Government Investment Issue (GII) worth RM2 billion was raised to refinance the maturing GII during the year. Meanwhile, no net new funds was raised through Treasury bills (TB), while the Treasury Housing Loans Fund recorded a small net borrowing in 1999. As a result, the total domestic debt of the Federal Government increased by 6.3% to RM93.8 billion or 33.4% of GNP at the end of 1999 to account for 84% of the total outstanding debt.

In 1999, the Government floated five issues of MGS worth RM2 billion each, mainly by way of open tender through principal dealers and through private placements. The new issues were for a wide range of maturities of 3, 5, 7, 10 and 15 years so as to provide a benchmark yield curve for the development of the bond market. As in previous years, the longer-dated MGS were mainly offered to institutional investors such as the social security institutions. After adjusting for loan redemptions, total MGS outstanding increased by 4.4% to RM78.3 billion at the end of 1999 to account for a share of 83% of the total domestic debt outstanding. In terms of the ownership structure of MGS holders, the social security and insurance institutions held a higher

Table 2.13
Holdings of Federal Government Domestic Debt

	1998	1999*p*	1998	1999*p*
	Nominal value in RM million		% share	
Treasury bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	183	41	4.2	1.0
Banking sector	3,678	3,720	85.1	86.1
Other	459	559	10.7	12.9
Government Investment Issues	**2,000**	**2,000**	**100.0**	**100.0**
Insurance companies	132	139	6.6	7.0
Banking sector	1,848	1,858	92.4	92.9
of which:				
Bank Negara Malaysia	*940*	*3*	*47.0*	*0.2*
Other	20	3	1.0	0.1
Malaysian Government Securities	**75,012**	**78,336**	**100.0**	**100.0**
Social security and insurance institutions	52,921	59,929	70.6	76.5
of which:				
Employees Provident Fund	*45,670*	*51,757*	*60.9*	*66.1*
Insurance companies	*5,307*	*6,030*	*7.1*	*7.7*
Banking sector	15,420	12,403	20.6	15.8
Other	6,671	6,004	8.8	7.7

p Preliminary

share of 77% of total outstanding MGS. This reflected the critical role of these institutions in funding economic development as well as implementing the fiscal stimulus package to revive the economy. In particular, the Employees Provident Fund (EPF) while remaining the single largest institutional investor in 1999, increased its holding by five percentage points to 66% through new investment in MGS as well as absorbing the liquidation of MGS, especially by banking institutions. Hence, the share of MGS held by the banking sector declined to 16%. The remaining MGS was held mainly by public enterprises, the non-bank financial institutions and foreign investors.

The balance of the domestic debt was in the form of the domestic foreign currency syndicated loan (6%), TB (5%), the Treasury Housing Loans Fund (4%) and GII (2%). The banking institutions held the bulk of TB (86%) mainly for liquidity purposes and GII (93%), reflecting the growing Islamic banking activities. The insurance companies also held GII (7%) and TB (1%) largely to comply with the statutory requirement to invest in approved Government papers. The main lenders to the Treasury Housing Loans Fund were Cagamas Berhad, the EPF, the National Savings Bank and the commercial banks.

External borrowings were also used by the Government to finance its operations. Net external borrowing of the Federal Government for 1999 recorded a net inflow of RM2.9 billion. Gross external borrowing amounted to RM4.8 billion, reflecting largely the issuance of the US$1 billion Malaysian Global Bond (or RM3.8 billion) and the drawdown of a number of loans secured from multilateral (such as the World Bank and Islamic Development Bank) and bilateral sources especially from Japan under the New Miyazawa Initiative. The issuance of the global bond was mainly aimed at providing a benchmark for Malaysian corporations in international capital markets.

During the year, the Government signed several loan agreements under the New Miyazawa Initiative amounting to an equivalent of RM4.8 billion. In March and April 1999, the Government signed several loan agreements with the Overseas Economic Cooperation Fund (which has merged with Japan Export-Import Bank and is currently known as Japan Bank for International Cooperation or JBIC) totalling ¥65 billion (or equivalent to RM2.1 billion) which was for financing utilities, educational projects and small- and medium-scale industries; and secured a syndicated loan of US$250 million and ¥54 billion (or equivalent to an aggregate of RM2.7 billion) arranged by Citibank North America and guaranteed by the Japan Export-Import Bank (currently known as JBIC) to finance transportation projects. Loan agreements were also signed with the World Bank and Islamic Development Bank (IDB). The Government signed an agreement with the World Bank totalling US$404 million (RM1.5 billion) to finance various projects including education, Y2K compliance and social programmes, while four agreements were signed with the IDB totalling US$99 million (RM376 million) to finance the purchase of health, education and fire equipment.

Meanwhile, one market loan, the Yen Bond 9th series of ¥30 billion raised in 1989, matured during the year. Together with a net exchange revaluation adjustment, the outstanding external debt of Federal Government increased to RM18.4 billion or 6.6% of GNP at the end of 1999 from RM14.9 billion or 5.5% of GNP at the end of 1998.

State Governments

Based on preliminary estimates, the consolidated financial position of the 13 state governments recorded a further overall deficit in 1999, the second consecutive year of deficit. The lower revenue receipts coupled with higher operating expenditure of the state governments led to a smaller consolidated current account surplus (+RM4 billion). Reflecting financial prudence, all states achieved surpluses in their current accounts. However, with most states recording deficits in their overall balance, the consolidated position showed a larger deficit of RM372 million. As total resources including Federal Government loans were more than sufficient to finance the overall deficit, there was a build-up of RM455 million in the accumulated financial assets of the state governments.

During the year, the consolidated state **revenue** fell marginally by 1.9% to RM8.7 billion with most state governments experiencing declines in revenue. The slightly lower revenue collection was attributable to lower Federal grants and transfers on account of the absence of revenue growth grants. As in previous years, the receipts from Federal sources were channelled to assist the states in providing infrastructure and other essential amenities to improve the quality of life and to support the increasing urbanisation in the states. Meanwhile, receipts from state sources were sustained at the previous year's level. This reflected the pick-up in economic activities; the recovery in prices of selected commodities especially crude petroleum; as well as the implementation of several revenue enhancing measures by the state governments to diversify their sources of income. These measures included the 50% increase in the export royalty on high quality logs and the introduction of sales tax on crude palm oil and lottery tickets. Consequently, higher revenue was collected from both direct and indirect taxes, while non-tax revenue recorded a decline. The increased direct tax receipts reflected higher receipts from taxes on lands and mines which emerged as the largest source of state revenue (13.7%). Receipts from forest taxes also remained high and maintained its share of total revenue (13.6%). Meanwhile, the increase in indirect taxes was attributable to higher duties collected from excise and import duties of petroleum products. In contrast, non-tax revenue recorded lower collection mainly on account of declines in receipts from investment income, petroleum royalty, commercial undertakings and government services.

Table 2.14
Consolidated State Government Finance

	1998	1999*p*	2000 *Budget*
	RM million		
Revenue	8,817	8,650	9,475
State sources	*7,064*	*7,067*	*7,544*
Federal grants and transfers	*1,753*	*1,583*	*1,931*
Expenditure	4,546	4,670	4,765
Current account	**4,271**	**3,980**	**4,710**
Net development expenditure	4,357	4,352	4,763
Gross development expenditure	*4,856*	*4,534*	*4,947*
Less Loan recoveries	*499*	*182*	*184*
Overall balance	**–86**	**–372**	**–53**
Sources of financing			
Federal loans	610	827	619
Realisable assets[1]	–524	–455	–566
Total	**86**	**372**	**53**

[1] An increase in the accumulated realisable assets is indicated by a minus (-) sign.
p Preliminary

Source: State governments

Total gross expenditure of the state governments as a group declined by 10% attributable to the lower development expenditure. Reflecting efforts of the state governments to contain spending in line with lower revenue receipts, **operating expenditure** of the state governments rose by 2.7% to RM4.7 billion. The increased expenditure reflected higher emoluments (+4.7%) mainly due to part payment of the one-month bonus including the special payments of RM600 to eligible civil servants announced in the 2000 Federal Budget. Meanwhile, other expenditure was lower following lower revenue receipts. During the year, gross **development expenditure** fell by 6.6% to RM4.5 billion as the state governments consolidated their position in line with reduced resources. Nevertheless, seven states provided for an increase in their capital expenditure. The bulk of the expenditure was channelled to the economic sector, especially infrastructure (road, bridges and public amenities), industrial and commercial investments and agriculture and rural development. The balance was for social programmes, including housing and social and community programmes. After taking into account a smaller loan recovery of RM182 million, net development expenditure declined marginally by 0.1% to RM4.4 billion.

Non-Financial Public Enterprises

During the year, the number of **non-financial public enterprises** (NFPEs) for monitoring and reporting purposes was reviewed and expanded. The objective of the revision was for a more representative coverage of NFPEs to further strengthen the analysis on public sector. In this review exercise, the criteria for determining an enterprise as a NFPE included higher annual sales turnover of at least RM100 million (previously RM50 million) as well as at least 51% equity share by the Government including public sector agencies. Other criteria included enterprises with large borrowing requirements and high capital expenditure or which have large economic impact. Based on these criteria, a total of 19 new enterprises were identified. In addition, the review excluded 10 enterprises from the existing list due to the consolidation of selective enterprises with other NFPEs and some that did not meet the criteria. Hence, as a result of the review, the coverage of NFPEs for monitoring and reporting purposes increased from 28 enterprises to 37 (see table on List of NFPEs), retrospective to 1998.

Based on the revised list, preliminary estimates of the consolidated **financial position** of the 37 NFPEs indicated that the overall financial position of the NFPEs as a group improved significantly to record a surplus of RM7.5 billion or 2.7% of GNP in 1999 after recording a deficit of RM4.5 billion or 1.7% of GNP in 1998. However, if based on the previous coverage of 28 enterprises, the consolidated overall financial position would have shown a larger surplus of RM10 billion or 3.6% of GNP in 1999 (1998: –RM1.9 billion or –0.7% of GNP). This development reflected mainly the large capital outlays of some of the new enterprises.

The better financial outturn in 1999 reflected the strong increase in revenue, while total expenditure was slightly higher with higher operating expenditure, offsetting lower capital spending. It also reflected measures taken by NFPEs in 1998 and 1999 to address the impact of the economic contraction, through measures to improve productivity as well as sales of assets to consolidate financial positions. In particular, Tenaga Nasional Berhad (TNB) completed its internal restructuring with new subsidiary companies established for the generation, transmission and distribution activities to improve operational efficiency and to consolidate its strength. To enhance the competitiveness of the generation sector, TNB has embarked on a programme to divest its thermal generation assets. In 1999, TNB disposed the combined cycle plant in Melaka to a private power generation company. Similarly, PETRONAS continued to diversify its investments related to its core businesses including investment overseas to strengthen its earnings.

The consolidated **revenue** of the NFPEs rose sharply by 18.4% to reach RM88.4 billion (1998: +6.6%). The

Table 2.15 List of NFPEs

(a)	**Existing Enterprises**	
1	Cement Industries (Sabah) Sdn. Bhd.	
2	Keretapi Tanah Melayu Bhd.	
3	Kuching Port Authority	
4	Malaysian Rubber Development Corporation Bhd.	
5	Penang Port Sdn. Bhd.	
6	Perwaja Terengganu Sdn. Bhd.	
7	Petroliam Nasional Bhd.	
8	Sabah Electricity Board	
9	Sabah Energy Corporation	
10	Sabah Port Authority	
11	Sarawak Electricity Supply Corporation	
12	Telekom Malaysia Bhd.	
13	Tenaga Nasional Bhd.	
14	UDA Holdings Sdn. Bhd.	
15	Kumpulan Guthrie Bhd.	
16	Golden Hope Plantation Bhd.	
17	Kontena Nasional Sdn. Bhd.	
18	SEBOR (Sabah) Sdn. Bhd.	
(b)	**New Enterprises**	
1	Klang Port Management Sdn. Bhd.	
2	Rakyat Berjaya Sdn. Bhd.	
3	Central Spectrum (M) Sdn.Bhd.	
4	Antara Steel Mills Sdn. Bhd.	
5	Marconi (Malaysia) Sdn. Bhd.	
6	Pos Malaysia Bhd.	
7	Bintulu Port Sdn. Bhd.	
8	Sergam Bhd.	
9	Kulim (Malaysia) Bhd.	
10	Felda Agricultural Services Sdn. Bhd.	
11	Tabung Haji Plantations Sdn. Bhd.	
12	Perbadanan Pembangunan Ekonomi Sarawak Sdn. Bhd.	
13	Pacific Hardwoods Sdn. Bhd.	
14	Sinora Sdn. Bhd.	
15	Malaysia Airports Bhd.	
16	Gas Malaysia Sdn. Bhd.	
17	Multimedia Development Corporation Sdn. Bhd.	
18	Putrajaya Holdings Sdn. Bhd.	
19	Kelang Container Terminal Sdn. Bhd.	
(c)	**Removed**	
1	Felda Oil Products Sdn. Bhd.	
2	Felda Palm Industries Sdn. Bhd.	
3	Felda Trading Sdn. Bhd.	
4	PERNEC Corporation Sdn. Bhd.	
5	Petronas Carigali Sdn. Bhd.	consolidated into PETRONAS group
6	Petronas Dagangan Bhd.	
7	Petronas Penapisan (Terengganu) Sdn. Bhd.	
8	Malaysia LNG Sdn. Bhd.	
9	Malaysian International Shipping Corporation Bhd.	
10	Tabung Haji Travel Industries Sdn. Bhd.	

Source: Economic Planning Unit

revenue collection was boosted significantly by the higher petroleum prices, which rose from an average of US$14 per barrel in 1998 to average US$18.18 per barrel in 1999. The recovery in economic activities also contributed to the higher revenue collection. Reflecting the tight financial discipline and the restructuring exercises undertaken by selective public enterprises, operating expenditure of the NFPEs increased at a slower pace of 11.8% to RM55.4 billion (1998: +17.8%). The larger outlays reflected the higher cost of supporting increased business activities, while the debt service payment was contained following a smaller accumulation of external debt a year ago and low domestic interest rates.

With the increase in revenue outpacing the growth in operating expenditure, the operating surplus of the NFPEs as a group was substantially higher at RM33 billion or 11.8% of GNP (1998: +9.4% of GNP). The sizeable operating surplus was contributed mainly by the major NFPEs involved in commodities, utilities and commercial services, notably PETRONAS, TNB and Telekom Malaysia Berhad (Telekom). Meanwhile, a small number of small enterprises continued to record losses in 1999.

During the year, the **capital expenditure** of the NFPEs declined by 13.9% to RM25.5 billion (1998: RM29.7 billion). The lower capital expenditure was largely attributable to the sharply lower investment overseas as well as the scaling down or deferring of less essential projects. Most of the enterprises recorded lower investments. Nevertheless, several enterprises including PETRONAS, Putrajaya Holdings Sdn. Bhd. and Sarawak Electricity Supply Corporation (SECSO) increased capital spending for capacity expansion.

Table 2.16
Consolidated NFPEs Finance[1]

	1997	1998	1999*p*
	RM million		
Revenue	70,086	74,715	88,433
Expenditure	42,033	49,529	55,389
Current account	**28,053**	**25,186**	**33,045**
(% of GNP)	**10.5**	**9.4**	**11.8**
Development expenditure	21,341	29,659	25,547
Overall balance	**6,712**	**–4,473**	**7,498**
(% of GNP)	**2.5**	**–1.7**	**2.7**

[1] Refers to 28 NFPEs in 1997 and 37 NFPEs in 1998 and 1999.
p Preliminary

Source: Ministry of Finance and non-financial public enterprises

In 1999, PETRONAS continued to invest in both upstream and downstream activities, including the construction of new gas processing plants and the Centralised Utility Facility projects in Kertih and Gebeng. Other projects undertaken by the company included several petrochemical projects; expansion and upgrading of the University of Technology PETRONAS; construction of the railway link from Kuantan Port to Kertih; as well as continued fleet expansion programme by Malaysian International Shipping Corporation to enhance its capacity to handle the growing volume of international trade. PETRONAS also continued to expand its overseas investments, namely, the acquisition of the 25% stake in the UK-based Premier Oil.

Meanwhile, capital investment of TNB was mainly channelled towards capacity expansion, systems improvement for security purposes as well as to improve reliability and quality of supply to meet the increasing demand for electricity by the commercial and industrial sectors and residential consumers. Major on-going projects included the construction of Phase I and I(A) of the 500kw transmission network, Phase III of the Port Klang Sultan Salahuddin Abdul Aziz Power Station in Kapar and the conversion of power plants including the Melaka, Chenderoh, Paka and Pasir Gudang plants. Other projects included the construction of Phase II of the Tenaga Nasional University Complex and ongoing construction of the RM2 billion TNB Janamanjung coal-fired plant in Perak Darul Ridzuan. Similarly, Telekom also continued to expand and modernise telecommunication infrastructure as well as upgrading the international and local networks. The bulk of the expenditure was expended on developing a range of services and products for the Corporate Information Superhighway (COINS), which is an integral part of the Multimedia Super Corridor (MSC), and the National Information Infrastructure (NII). Telekom continued to diversify its investments overseas, including projects in Ghana, but on a more moderate scale. Capital outlays of Putrajaya Holdings Sdn. Bhd. was mainly for the new administrative centre in Putrajaya, while Malaysia Airports Bhd. and Keretapi Tanah Melayu Bhd. continued to modernise and enhance the quality and efficiency of their services.

The capital outlays of the NFPEs as a group were mainly financed by internally-generated funds and recourse to domestic and external borrowings. In 1999, the outstanding external debt of the public enterprises increased to RM58.6 billion to account for a larger share of 43% of the nation's medium- and long-term external debts. The increase reflected the higher borrowing and, to a smaller extent, a net exchange revaluation loss as a result of the appreciation of the Japanese yen against the ringgit. During the year, PETRONAS issued two bonds, namely the ¥51 billion and US$650 million bonds. The external debt of the NFPEs remained manageable, with debt service ratio (ratio of debt servicing to exports of goods and services) of 1.3% in 1999. Furthermore, most of the loans have been utilised to fund productive investments, including overseas investments, that generate foreign exchange revenue to service the debt. Nevertheless, investment activities and borrowings of the NFPEs would be closely monitored to ensure that their borrowings would not create risks to the economy.

During the year, the Government continued to pursue its privatisation policy. However, projects to be privatised are assessed more critically in terms of the potential impact on the economy, balance of payments, strong domestic linkages and multiplier effects. In 1999, three government agencies were corporatised, namely, the Penang Water Authority, Terengganu Water Department and the Human Resource Department Council. Another 12 existing projects and enterprises were also privatised mainly in the area of land development, while one enterprise was divested.