# Outlook and Policy

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## WORLD ECONOMIC OUTLOOK

### Developments in 2002 and Early 2003

World growth expanded by a modest 3% in 2002 while world trade growth turned positive to grow by 2.9% (2001: -0.1%). The performance of the global economy was lower than expected although growth remained stronger than in 2001 (2.3%). Economic outturn was uneven throughout the course of the year and across regions. Recovery in the United States (US) was lower than earlier expectations and the performances of Japan and the euro area slowed down further, while growth in the East Asian region rebounded. The lower than expected growth in the US was due to the slow pick-up in investment amid continued excess capacity and uncertainties over the strength and sustainability of economic recovery, the threats of terrorist attacks, corporate scandals and declining stock prices.

**Table 3.1**
**World Economy : Key Economic Indicators**

| | Real GDP Growth (%) | | | Inflation (%) | | |
|---|---|---|---|---|---|---|
| | 2001 | 2002*e* | 2003*f* | 2001 | 2002*e* | 2003*f* |
| **World Growth** | **2.3** | **3.0** | **3.1** | - | - | - |
| **World Trade** | **-0.1** | **2.9** | **3.5~4.5** | - | - | - |
| **Major Industrial Countries** | **0.7** | **1.6** | **1.8** | **2.2** | **1.5** | **1.9** |
| United States | 0.3 | 2.4 | 2.4 | 2.8 | 1.6 | 2.5 |
| Japan | 0.4 | 0.3 | 0.6 | -0.7 | -0.9 | -0.9 |
| Euro Area | 1.4 | 0.8 | 0.9 | 2.5 | 2.2 | 2.3 |
| United Kingdom[1] | 2.0 | 1.6 | 1.9 | 2.1 | 2.2 | 2.2 |
| **East Asia** | **4.0** | **6.1** | **5.5~5.7** | **2.1** | **1.0** | **1.6~2.0** |
| **Asian NIEs** | **0.6** | **4.4** | **4.2~4.5** | **1.6** | **0.6** | **1.4~1.5** |
| Korea | 3.0 | 6.2 | 5.5 | 4.3 | 2.7 | 3.4 |
| Chinese Taipei | -2.2 | 3.5 | 3.7 | 0.0 | -0.2 | 0.4 |
| Singapore | -2.1 | 2.2 | 2.0 ~ 5.0 | 1.0 | -0.4 | 0.5 ~ 1.5 |
| Hong Kong China[2] | 0.6 | 2.3 | 3.0 | -1.6 | -3.0 | -1.5 |
| **The People's Republic of China** | **7.3** | **8.0** | **7.0** | **0.7** | **-0.8** | **0.5~1.0** |
| **ASEAN[3]** | **1.5** | **4.0** | **3.5~4.6** | **5.3** | **4.6** | **3.9~4.4** |
| Malaysia | 0.4 | 4.2 | 4.5 | 1.4 | 1.8 | 1.5 |
| Thailand | 1.9 | 5.2 | 3.5~4.5 | 1.6 | 0.7 | 0.5~1.5 |
| Indonesia | 3.3 | 3.7 | 3.5~4.0 | 11.5 | 11.9 | 8.7 |
| Philippines | 3.5 | 4.6 | 4.2~5.2 | 6.1 | 3.1 | 4.5~5.5 |

[1] Refers to retail price excluding mortgage interest.
[2] Refers to composite price.
[3] Includes Singapore.
*e* Estimates
*f* Forecast

Source: International Monetary Fund, Datastream, OECD Economic Outlook, National Sources.

Co-ordinated accommodative monetary and fiscal policies have helped sustain consumer demand, which was the main driver of economic recovery.
In the first-half year, overall growth in the major industrial economies recovered and turned positive (2H 2001: -0.5%) due mainly to stronger US growth, which accounted for about 42% of GDP of the major industrial countries. In the second half of the year, the improvement in the performances of other major industrial economies partially offset the slower growth in the US.

In the **US**, growth expanded by 3.5% in the first half of the year before slowing down to 2.5% in the second half. Activities were supported by the cumulative impact of monetary easing and income tax measures. These policies stimulated refinancing activities, housing demand and auto purchases, thereby sustaining private consumption. In addition, the slower decline in inventory and larger government spending also contributed to GDP growth. However, overall fixed investment and net exports remained weak. Latest data showed **real GDP** slowing down substantially from 4% to 1.4% in the final quarter of 2002. The slowdown was mainly due to lower consumer spending and larger decline in net exports, which more than offset the increase in government spending and an improvement in investment outlay.

In **Japan**, growth was mainly export driven while domestic conditions remained weak throughout the year. In the **euro area**, growth slowed down markedly due to the continued economic weakness in **Germany** where activities were dampened by rising unemployment and the decline in equity markets, even though government spending was higher.

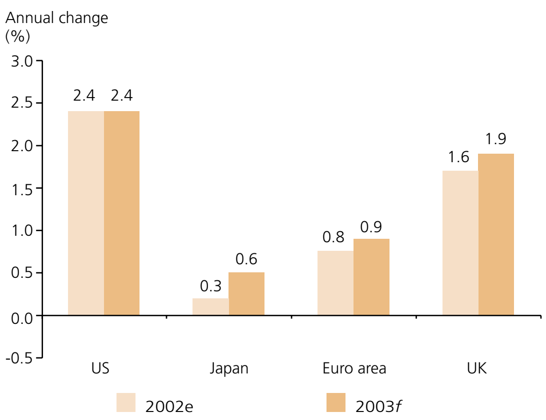
Despite increased external risks, recovery in the **regional economies** remained on track, with growth accelerating to 6.1% or double the global average. Growth was led by the People's Republic of China at a strong pace of 8%, followed by Korea with a 6.2% expansion, while the economies of Singapore and Chinese Taipei turned around to register positive growth rates. Overall, regional growth was broad-based, underpinned by both external and domestic demand. Exports in the region revived, particularly in the electronics sector. At the same time, a rebound in world prices for some non-oil primary commodity exports like rubber, palm oil, sawn timber, rice and coconut products, lifted export revenues significantly. Domestic demand in the regional economies was also sustained at high rates, buoyed by low interest rates and the stimulus provided by expansionary fiscal operations. Of significance was the expansion in intra-regional trade, which gathered momentum in 2002, fuelled by rising domestic demand, especially from the People's Republic of China and Korea.

**Prospects for 2003**

The global economic outlook continues to be affected by the geopolitical and economic uncertainties and the adverse impact of sharply rising oil prices on private sector consumption and investment. Underlying growth, however, remains positive, supported by fundamentals. While growth would likely remain positive, the magnitude of this growth would depend largely on the influences arising from the geopolitical tensions in the Middle East and the impact on consumers and businesses in the major industrial economies. The immediate adverse effect has been the rising oil prices since the second quarter of 2002 to a 12-month high of US$34.99 per barrel (p/b) on 7 March 2003.

## Despite heightened uncertainties, global growth in 2003 would likely remain positive.

**Graph 3.1**
**Major Industrial Countries: Real GDP Growth (2002-2003)**




Given the greater uncertainties, global economic growth is expected to remain modest in 2003. Growth will be supported by a moderate expansion in the US and Asian regional economies as growth prospects for Japan and the euro area remain difficult. Under these circumstances, it is projected that **world growth** will expand modestly by 3.1% (2002: 3%) while **world trade** will increase by 3.5 – 4.5% in 2003. Growth in the **major industrial countries as a group** is estimated at 1.8% (2002: 1.6%).

Activity in the US is expected to be supported by the continued accommodative monetary policy, fiscal expansion, gains in productivity, low inflation, effect of inventory rebuilding and the upturn in the electronics cycle. Growth in the euro area should pick up slightly, due to inventory build-up and the lagged effect of monetary easing. In Japan, growth continues to be hampered by long-standing domestic structural problems, including price deflation and subdued consumer demand, excess capacity and the weak financial sector. In the United Kingdom, growth is expected to be sustained by government spending and private consumer spending, supported by the wealth effect from the property market.

Meanwhile, for the Asian regional economies, policy flexibility, stronger fundamentals, continued growth in domestic consumption, fiscal stimulus, recovery in investment, improvement in exports and strengthening intra-regional trade are expected to sustain growth.

**Industrial Countries**

While the economic and geopolitical uncertainties remain a concern, growth in the **United States** is expected to remain positive. Performance in the first half-year of 2003 will be moderate before improving in the second half-year. For the year as a whole, growth of the US economy is estimated to be modest at 2.4% with higher Government spending providing the main impetus to growth, particularly in the first half-year. The larger federal government expenditure, however, will be partially offset by weaker spending from the state and local governments. This underlying trend remains vulnerable to downside risks arising from geopolitical developments.

Consumer demand, which has in the past been supported by the low interest rate environment and rapid pace of refinancing activity in the housing market, is expected to slow down in 2003. The slowdown in refinancing and new financing activities is projected as interest rates stabilise along with slower growth in house prices. At the same time, households are expected to reduce debt accumulation as further losses in equity value have led to a decline in the stock of wealth (-4% as at end-2002) amidst rising concerns over job losses. Nevertheless, the winding down of debt is expected to occur gradually as reflected in the gradual increase in household saving rates from 2.3% in 2001 to 3.9% in 2002, compared to the historical average of 7.7%.

Despite the adjustments to household balance sheets, consumption is not expected to collapse given the absence of a housing bubble (increase in house prices averaged 6 - 8% during 2001 – 2002). Households are expected to benefit from real income growth amidst continued gains in productivity. The household sector would also receive some benefit from the additional tax stimulus currently under consideration. Meanwhile, low interest rates would continue to keep the debt-servicing burden stable in the range of 13.5 – 14% of disposable income.

Although excess capacity still remains in certain sectors of the economy, the upturn in equipment and software spending, which together account for about 53% of total fixed investment, is projected to support the gradual pick up in investment, mainly during the second half-year. The spending would be mainly for replacement and upgrading of IT equipment amidst lower prices for technology-related hardware. Inventory accumulation, however, is expected to contribute to growth at a slower pace.

The growth performance of the **euro area** is expected to be modest, with real GDP expanding marginally by 0.9% in 2003. Monetary easing, however, would support growth as real interest rates are currently at their lowest levels in two decades. Furthermore, the significant inventory drawdown during the 2001-2002 period (amounted to about 3.8% of GDP) is expected to stabilise and improve growth. In Germany, growth is likely to remain weak. Domestic demand is expected to remain sluggish, attributable to the less favourable labour market conditions and expectations of tax increases amidst weak business confidence.

The **United Kingdom** economy is expected to continue its eleventh consecutive year of economic expansion. Growth is expected to be more broad-based and is estimated at 1.9%. Consumption and government spending are expected to remain relatively robust, sustained respectively by positive wealth effects and the fiscal stimulus estimated at 1% of GDP. Meanwhile, the corporate sector is expected to benefit from a combination of higher public investment spending and some improvement in external demand conditions, particularly in view of the envisaged inventory build-up in the euro area.

In **Japan**, the short- and medium-term outlook remain weak. The fundamental structural problems in the financial and corporate sectors as well as ongoing deflationary pressures continue to weigh down on the economy. Nevertheless, in 2003, real GDP growth is expected to expand by 0.6%. Exports, mainly to the East Asian markets (which accounts for about 40% of its exports), is expected to be the main driver of growth. Meanwhile, weaknesses in the corporate and household balance sheets are expected to dampen further domestic demand.

In 2002, crude oil prices increased steadily, especially in the latter part of the year, to reach a high of US$34.99 on 7 March 2003, an increase of 81.3% from its level at end-2001 (US$19.30 p/b). The increase in oil prices has been due mainly to the war risk premium, stock accumulation in anticipation of lower oil supply following possible disruptions to the oil fields in the Middle East and the temporary reduction in supply due to export disruptions in Venezuela, following a nationwide strike that began in December 2002. Crude oil prices are expected to remain high and volatile for 2003 in an environment of uncertain geopolitical developments in the Middle East. This is despite the commitment by the Organisation of the Petroleum Exporting Countries (OPEC) to increase production quotas by 1.5 million barrels per day and Saudi Arabia's (the world's largest producer) commitment to make up for any shortfall in exports during the year. The assessment is that oil prices are expected to remain relatively high in the first half of 2003 at about US$30 p/b on average and ease in the second half of 2003 to below US$25 p/b.

**Inflation** is not expected to be an issue in the major industrial economies for the year 2003. Although inflation is projected to rise to 1.9%, this is mainly attributed to the impact of high global crude oil prices, particularly during the first-half year. In the euro area, the impact of higher crude oil prices would be mitigated somewhat by the appreciation of the euro as the sales of crude oil is denominated in US dollars. Meanwhile, the Japanese economy is expected to continue to experience deflationary pressures. Consumer prices are estimated to decline for the fifth consecutive year, mainly due to sluggish domestic demand conditions amidst improvements in supply.

Despite current indications that world growth would likely remain positive, the magnitude of this growth would depend largely on the outcome of geopolitical developments and its impact on the major industrial economies. The **main risk would be that the prolonged geopolitical uncertainty in the global economy would lead to a worse-than-expected impact on consumer and business confidence and high oil prices.** Under these circumstances, consumption spending could be curtailed and there could be further postponement of investment spending. High and volatile crude oil prices are likely to negatively impact global growth.

## Sustained regional growth in 2003 is expected to emanate from domestic consumption, some recovery in investment and strengthening intra-regional trade.

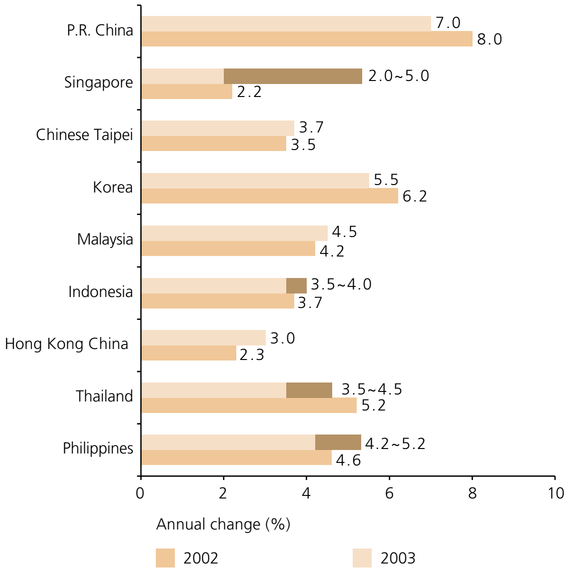
### East Asian Economies

Notwithstanding heightened external uncertainties, prospects are for **growth in the Asian region to be sustained** between 5.5 - 5.7% in 2003. As in the previous year, the People's Republic of China and Korea are expected to lead growth in the region. The impetus to regional growth is expected to emanate from domestic consumption, some recovery in investment and strengthening intra-regional trade. Reinforcing the growth prospects are strategies that have already been implemented to promote domestic sources of growth in new and niche areas as well as adjusting the economic structure to ensure more broad-based development in the services, agriculture and manufacturing sectors. The positive growth prospects are also premised on the strengthened fundamentals, which have increased the resilience of regional economies to external shocks.

Strengthened fundamentals in the region include stronger reserves, a stronger banking system and diversification into new growth activities in the manufacturing and services sectors to enhance productivity and efficiency in capital utilisation. As the region is a net oil importer, high crude oil prices are likely to affect the terms of trade adversely in 2003, with current account balances likely to narrow, but remaining in surplus. Compared with the crisis period, the ratios for short-term debt to total external debt and total external debt to GDP have declined. Whilst total external debt levels vary across countries, high savings rates of between 20 - 45% in the region allow for financing of pro-growth measures from domestic sources. Significant progress has also been made in the restructuring of bank balance sheets, reflecting mainly declining non-performing loan ratios, higher bank capitalisation and improving bank profitability. In view of receding domestic risks, in 2002, international credit rating agencies have improved their assessments for several countries in the region, namely Malaysia, the People's Republic of China, Korea and Thailand.

As strengthened fundamentals accord room for further policy flexibility to stimulate demand-side activity, domestic consumption is expected to remain as the pivotal factor that supports growth during the year. Growth in domestic demand is expected to be underpinned by fiscal expansion in some of the regional countries, low interest rates and further progress in the restructuring of the financial and corporate sectors and supported by increases in exports. With further liberalisation under the ASEAN Free Trade Area (AFTA), the lowering of tariffs to 0 – 5% on an increased number of products by 2003 implies the lowering of production costs in the region and, hence, the potential for domestic consumption to pick up further. Cumulative effects of past expansionary fiscal policies have resulted in increasing incomes to sustain domestic consumption. The household sector is also expected to continue to spearhead domestic demand with further growth in consumer credit and mortgage lending. Except for Korea, household debt levels are relatively low in the region, indicating scope for further expansion during the year. In addition, "Asia's demographic dividend", which reflects the drop in the ratio of

**Graph 3.2**
**Regional Countries:**
**Real GDP Growth (%)**




dependents to the working age population from 80% in 1965 to 55% in the 1990s, implies the potential for consumption to increase further. It has been estimated that for every extra dollar above the US$5,000 per annum income, 60 cents is for discretionary spending.

Whilst there are no major risks on the domestic horizon, external risks suggest that on balance, growth is expected to be modest in the first half of 2003 before the pace of recovery in the industrial countries improves in the second half to result in a more discernible increase in external demand for the Asian region. The magnitude of expansion in external demand is expected to be influenced to a large extent by growth prospects in the major industrial economies and the strength of the global electronics up-cycle. The modest growth in global semiconductor sales in 2002 was below expectations as technological spending was affected by geopolitical risks, recovery prospects of the US economy and sluggish performance in the global stock markets. Latest forecasts for 2003 by the Semiconductor Industry Association (SIA) indicated that the Asia-Pacific market would account for 38% of global semiconductor sales and register growth of 24%, the highest amongst global markets. Amongst regional countries, the People's Republic of China and Korea are expected to account for the bulk of the sales. The robust sales growth is expected to be underpinned by increased corporate IT spending for upgrading purposes, increased demand for consumer electronics, higher spending on capital and R&D by major manufacturers and the continued high capacity utilisation by integrated circuit manufacturers.

The sustained domestic consumption and recovery in the electronics sector are expected to support further increases in intra-regional trade. In 2001, amidst the contraction in demand from the advanced countries and the global electronics downturn, the share of intra-regional exports of total regional exports was sustained at 33%. Consonant with robust private consumer spending in the region, regionally supported trade flows have been on the rise, with the trend being augmented by the People's Republic of China's role as the largest importer in the region. In 2003, given expectations for policy measures to be supportive of domestic demand in most of the regional countries, intra-regional trade is forecast to continue to contribute to growth. In particular, with strong growth prospects, continued large FDI inflows into the People's Republic of China are expected to lead to growth of exports from the region to the People's Republic of China.

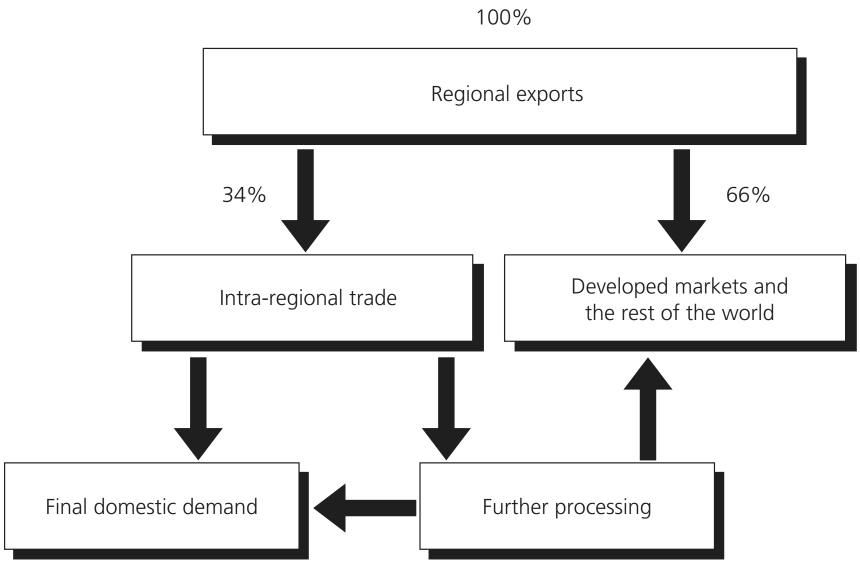
In 2003, growth in the **Asian Newly Industrialised Economies (NIEs)** as a group is expected to be sustained at a rate of 4.2 – 4.5% (2002: 4.4%), reflecting generally stable domestic and external demand conditions. In **Korea**, while government measures in 2002 to contain the rise in consumer loans is expected to contain household consumption growth, the continued strength in exports is expected to be translated into stronger industrial production and economic expansion. While there are external risks and private consumption could moderate, corporate investments are expected to pick up, with investment activity focussing on the automobiles, general machinery and IT-related sectors. Given its strong fiscal position, Korea has the flexibility to use fiscal policy to support domestic demand. In line with the expected developments, the forecast is for real GDP in Korea to expand by 5.5% in 2003.

In **Chinese Taipei**, real GDP is projected to register growth of 3.7% while the economy of **Hong Kong China** is expected to expand by 3% on the strength of expectations that the external sector will continue to benefit from closer economic integration with the People's Republic of China. In Hong Kong China,

**Intra-regional trade*: Increased Importance of the People's Republic of China**

Since the Asian crisis, the share of intra-regional exports of total regional exports has risen from 31.8% in 1998 to 33.8% in the first-half of 2002. In terms of annual growth, intra-regional exports have accelerated from 6% in 1997 to 23% in 2000. The impetus to intra-regional trade stemmed from strong economic growth in regional countries, trade liberalisation measures and higher contribution of domestic demand to overall growth. In particular, the opening up and rapid growth of the People's Republic of China has provided new end-markets for goods in the region. Also, the extensive production network in the region arising from the relocation of multinational companies into the People's Republic of China, increased outsourcing activity and vertical specialisation have continued to support intra-regional trade. Various estimates indicate that about 30-50% of intra-regional trade is for final demand from within the region.

**Graph 1**
**Direction of Regional Exports and Composition of Export Demand**




However, while intra-regional trade will be important in contributing to regional growth, it is not sufficient to provide adequate buffer against demand shocks from the developed markets. Although a growing proportion of intra-regional exports are retained for domestic demand within the region, the size of private consumption is small relative to the developed markets, accounting for about 8.5% of consumption in the developed markets. This explains the larger share of regional exports outside the region (2001: 66%). In addition, the intra-regional export growth cycle generally correlates with the growth cycle of the region's exports to the developed markets; hence, the pro-cyclical pattern of the bulk of regional demand.

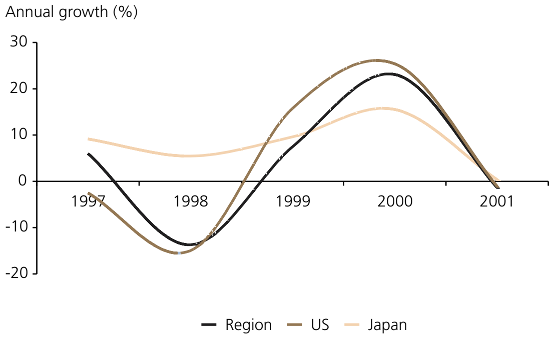
Intra-regional trade gains have, nevertheless, been supported by the People's Republic of China's emergence as a growing source of independent demand within the region. During the period 1991-2001, the People's Republic of China's role in the region reversed from that of net exporter to net importer in 1993. With the share of regional exports to the People's Republic of China of intra-regional trade averaging 28.8% per annum during the period 1991 to the first-half of 2002, the People's Republic of China has become the largest market for intra-regional exports. During the period 1996 to 2001, growth of intra-regional trade (including the People's Republic of China) was faster at 3% per annum, compared with 2% per annum for intra-regional trade (excluding the People's Republic of China).

*Refers to trade between the People's Republic of China, Hong Kong China, Korea, Singapore, Malaysia, Thailand, Philippines and Indonesia.

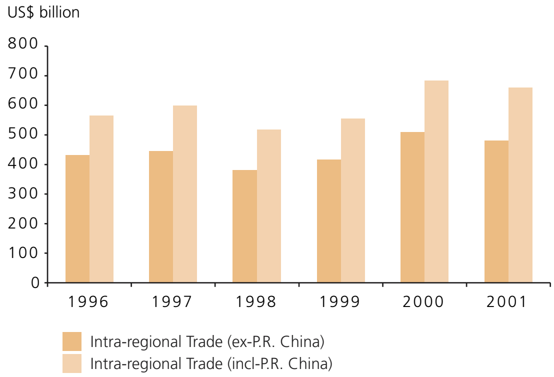
Overall, with its accession to WTO at end-2001, the People's Republic of China's role in world trade has risen, as reflected in its share of global trade rising from 2.7% in 1996 to 4.5% in the first-half of 2002. In consonance, the share of regional exports to the People's Republic of China of total regional exports rose from 12.9% in 1996 to 13.1% in the first-half of 2002.

Estimates from various sources indicate that at least 50% of the People's Republic of China's imports from the region are for domestic demand. In line with growth in demand from the People's Republic of China, regional economies' exports to the People's Republic of China have expanded significantly. Korea's exports to the People's Republic of China as a share of its total regional exports increased most rapidly, by about six times from 7.8% in 1991 to 46.9% in the first-half of 2002. In Singapore, Malaysia and Thailand, export shares almost tripled during the period. It is forecast that with further growth of trade to the People's Republic of China and trade among ASEAN members and the other large Asian economies, there would be a decoupling of intra-regional exports from its current close correlation with regional exports to the advanced countries.

**Graph 2**
**Destination of Regional Exports (1997 - 2001)**




**Graph 3**
**Intra-Regional Trade (1996 - 2001)**




growth prospects also hinge on an improvement in domestic demand as well as investment activity. The focus on higher value added activity in financial services, logistics, tourism and professional services is expected to provide impetus to economic activity. In Chinese Taipei, stimulus packages to boost public construction projects and create new jobs are expected to lead to higher domestic consumption during the year. This is part of the six-year national development plan introduced in early 2002, "Challenge 2008", which focuses on value-added activity as a platform for the creation of employment.

The **Singapore** economy is envisaged to continue its recovery, with growth between 2 – 5%. Amidst structural unemployment, supply-side policy measures are being implemented to promote growth. Strategies are directed to diversify the economy and reduce operating costs. In February 2003, an economic roadmap for the next 15 years was introduced, with emphasis on expanding external ties, maintaining competitiveness, encouraging entrepreneurship, developing human resources and promoting a more service-based and value-added manufacturing economy. Meanwhile, real GDP growth in the **People's Republic of China** is projected to be sustained at a high level of 7%, induced by strong domestic demand, maintenance of supportive monetary and fiscal policies, increase in foreign direct investment and an acceleration in its privatisation policy.

In 2003, the **ASEAN** economies as a whole is expected to register growth of between 3.5 – 4.6% (2002: 4%), given expectations for export growth to remain on track and the contribution from domestic consumption and investment to be largely sustained. Growth in the **Philippines** is projected to increase by 4.2 – 5.2%, with growth in the telecommunications and call-centre businesses expected to complement sustained expenditure on domestic consumption and fixed capital formation amid decade-low interest rates. In **Thailand**, private consumption is expected to maintain its robust momentum in supporting growth, attributable to a favourable employment outlook. Given low inflation, there is the policy flexibility to further promote domestic demand. The indicators point to a real GDP growth of 3.5 – 4.5% during the year. In **Indonesia**, growth is expected to be sustained at between 3.5 – 4%, attributable to expansion in private consumption and private investment. However, despite high oil prices, which are expected to positively impact the terms of trade, the softening of non-oil commodity export prices is expected to lead to a moderation in export growth.

In 2003, **inflation** in the regional countries is forecast to remain benign, although edging upwards to 1.6 - 2%, due mainly to rising oil prices. Deflationary pressures in Hong Kong China are expected to ease, while inflationary conditions have begun to re-emerge, given stronger domestic demand in the People's Republic of China, Singapore and Chinese Taipei. In the People's Republic of China, the continued pursuit of an expansionary monetary policy is expected to curb further price declines. Inflation in the **Asian NIEs** as a group is expected to rise moderately to 1.4 – 1.5%. In Korea, price pressures are likely to emerge from rising wages, higher oil prices and increases in public services charges. Whilst the expected easing of deflationary pressures in Hong Kong China is due to the envisaged improvements in demand conditions and the expiry of government subsidies for utility charges, the deflationary condition in Singapore is likely to end, following the increase in the goods and services tax (GST) rate from 3% to 4% from January 2003.

Inflation in the **ASEAN** countries as a group is expected to moderate slightly to 3.9 – 4.4% due mainly to markedly lower inflation in Indonesia to a single-digit level from the double-digit levels registered in the last two years. Price pressures are expected to subside in Indonesia, with a downward revision in basic utility charges and the anticipated strengthening of the rupiah in 2003. Meanwhile, inflation is expected to rise in Thailand, attributable to strong domestic consumption and a planned value-added tax (VAT) rate increase from 7% to 10%. Similarly, in the Philippines, inflation is forecast to rise in view of higher oil prices and increases in food prices due to uncertainty over weather conditions.

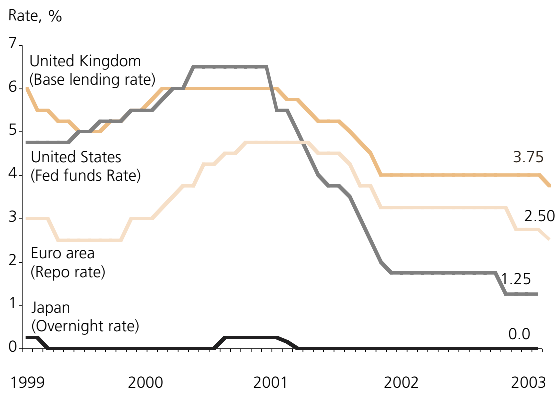
**Interest Rates and Exchange Rates**

In 2002, **monetary policy** in the major industrial countries remained accommodative. After keeping official interest rates stable for most part of the year, new signs of economic weaknesses led both the US Federal Reserve Board (Fed) and the European Central Bank (ECB) to reduce interest rates in late 2002.

In the US, including the 50 basis point reduction on 6 November 2002, the **Fed** has reduced the Federal funds rate by a cumulative 525 basis points in 12 steps since January 2001. This brought the Federal funds rate to 1.25%, its lowest level in more than 40 years. Meanwhile, the **ECB** also reduced rates by 50 basis points in December 2002 and a further 25 basis points on 6 March 2003. Compared to the US, the magnitude and pace of the ECB's reduction could have been constrained by concerns over inflation that remained above the target rate of 2%. Hence, thus far the ECB has brought down the repo rate to 2.5% in six steps by a cumulative 225 basis points since May 2001 to mitigate the slowdown in the euro area.

In the UK, after keeping interest rates steady in 2002, the **Bank of England** (BOE) eased its base lending rate (BLR) by 25 basis points on 6 February 2003, in view of the downturn in the manufacturing sector and concerns that demand, both globally and domestically, would be lower than earlier anticipated. Hence, on a cumulative basis, the BOE has lowered interest rates by 225 basis points in eight steps since February 2001. Meanwhile, in Japan, with official short-term interest rates virtually at zero, the **Bank of Japan** (BOJ) engaged in several quantitative easing measures throughout 2002 to inject liquidity into the banking system in order to counter deflation amidst the continued weakness in its economy.

**Graph 3.3**
**Major Industrial Countries: Official Interest Rates**



**For the remaining part of 2003**, economic uncertainty amidst geopolitical risks would keep interest rates low as central banks are not likely to raise rates until economic growth has become entrenched. Should geopolitical uncertainties lead to further economic slowdown, central banks are likely to act to support growth. The timing and magnitude of such action would, however, depend on country-specific factors, including the strength of the economic growth, inflation trends, movement in the major currencies and the performance of the financial markets.

In the **foreign exchange** markets, the US dollar depreciated against all major currencies in **2002**. The US dollar began to decline from its 15-year trade-weighted peak in February 2002 as investor sentiment became more averse to holding US dollar assets. Consequently, by end-2002 the US dollar had declined by about 18% against the euro and about 11% against both the Japanese yen and pound sterling. Its performance was affected by weak corporate profitability, softening economic growth and geopolitical factors following heightened tensions in the Middle East and homeland security issues, which eroded confidence in US dollar denominated assets. The consequent moderation in net capital inflows into the US has led to concerns over the widening current account deficit as well as market uncertainty over the future direction of the US dollar policy. Against the weakening US dollar, the euro appreciated in 2002, breaching the E1=US$0.90 level in late April and ended the year at a two-year high of E1=US$1.0492. This trend has continued into early 2003 as the dollar weakened further against the euro on intensified geopolitical concerns.

**For the rest of 2003**, the movement of the dollar against other major currencies would be influenced by a number of factors. These include global asset reallocation changes among the major currencies, investors' perception on the importance of growth differentials vis-á-vis interest rate differentials, and performance of stock and bond markets. Investor concerns about war and terrorism risk premiums also influence shifts in asset allocation. In addition, country-specific issues that relate to the health of the financial system could also affect sentiment on the major currencies.

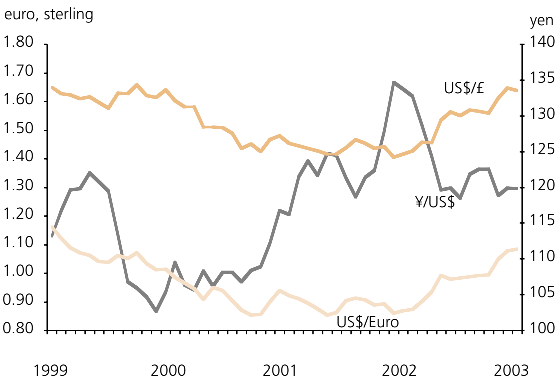
**MALAYSIAN ECONOMY IN 2003**

In an environment of heightened uncertainty in the global economy, growth in the Malaysian economy would be mainly domestic driven, supported by a modest growth in external demand. Real GDP growth has the potential to be sustained in the region of 4.5% in 2003 (4.2% in 2002). However, unlike 2002, when the public sector remained the principal driver of economic growth, private sector demand is expected to assume a more significant role in driving economic expansion in 2003. The improved domestic fundamentals would provide support for the sustained consumption and continued recovery in private investment. The public sector, whilst consolidating, would remain supportive of growth. External demand, however, remains a concern for possible downside risks. Malaysia's increased resilience provides the authorities with the policy flexibility to enhance domestic sources of growth. Hence, policies in 2003 would focus on promoting domestic-led private sector driven growth, with the Government providing a positive enabling environment for private sector activities and initiatives.

The projections for growth in 2003 are based on a modest world economic growth, some pick-up in the global electronics industry, firm commodity prices and further expansion in intra-regional trade. The expectation of a moderate pace of growth takes into

## Growth in 2003 to be predominantly dependent on domestic demand and led by the private sector. Government policies directed at providing an enabling environment for the private sector to resume the lead role in driving growth.

**Graph 3.4**
**Movement of the US Dollar against Major Currencies**



account the increasing strength of domestic sources of growth following the restructuring of the financial and corporate sectors since the crisis. These developments would provide further flexibility for the economy in managing the uncertainties emanating from the spillover of geopolitical tensions. Increased domestic sources of growth in the region and the consequent stronger growth in regional trade would also contribute towards growth in Malaysia.

In this regard, key strategies in the 2003 Budget focused on promoting domestic investment in all sectors with growth potential, in particular to promote activities in new and niche growth areas in the services, agriculture and manufacturing sectors; enhancing human resource development to support a knowledge-based economy; and strengthening Malaysia's competitive position. Towards this end, further tax and non-tax incentives were provided to encourage the development of small- and medium-scale enterprises (SMEs) and penetration of new export markets and to encourage manufacturers to undertake higher value-added activities such as design and research and development. Direct fiscal incentives focused on lowering cost for small businesses through cuts in corporate taxes as well as attracting higher investment in target areas in the agriculture sector (including non-traditional downstream activities), and in higher value-added services related activities. Going forward, the new growth sectors, the information, communication and technology sector and resource-based industries would be important drivers of growth that would add depth and diversity as well as strengthen the resilience of the economy.

Notwithstanding the fiscal consolidation to reduce medium-term risks, fiscal policy would remain moderately expansionary in 2003 (-4% of GDP). In an environment of low inflation, monetary policy would continue to remain accommodative to support economic growth. While keeping interest rates low, monetary policy in 2003 would continue to provide a positive enabling environment for strengthening private consumption and investment. Priority would be accorded to enhancing the financial infrastructure to improve access to financing for a broader segment of the business community, particularly the emerging industrial and service enterprises and to SMEs and small borrowers. Efforts would also continue to focus on enhancing the efficiency and effectiveness of the banking system to meet the financing needs of the economy. At the same time, the revamping of regulations, including liberalising foreign exchange rules to provide a more business-friendly environment, would enable businesses to operate more efficiently and respond speedily to changes in market environment.

There are downside risks to the growth forecast emanating from the external sector, which could affect the momentum of the recovery as well as the outlook for the Malaysian economy. On the external front, a prolonged global uncertainty would result in a "wait-and-see" attitude which would cause delays in the expansion of investment and the expected pick-up in the electronics industry. For Malaysia, should the recovery in private investment seen in the second half of 2002 not gain momentum, real GDP growth could be weaker than expected.

The Government remains cognizant of the factors that could heighten the macroeconomic risks. In the event of significant shocks to the economy, monetary and fiscal policies have the flexibility to support domestic economic activity, given the low inflation, the strong balance of payments position, the low debt situation, the comfortable level of international reserves, and the healthy banking system. Further supply side measures to be implemented will also provide a conducive enabling environment for the private sector.

**Domestic Demand**

On the demand side, real GDP growth in 2003 is expected to emanate mainly from sustained domestic demand. Reflecting the trend towards fiscal consolidation, public expenditure would increase moderately. Private sector expenditure, under a positive enabling environment, would re-emerge as the primary driver of growth, with higher growth in both private consumption and investment. As expectations are for moderate export growth coupled with slower import growth, the contribution of net exports to growth would improve.

Growth in broad-based **private consumption** is expected to improve to 6.9% with consumer confidence remaining steady in tandem with stable employment and income prospects for 2003. Consumption in the rural areas is expected to increase as commodity prices are forecast to remain high. In addition, the direct tax measures introduced in the 2002 Budget as well as civil service salary adjustments would continue to have a sizeable multiplier impact from households with the increase in disposable incomes. At the same time, the high savings rate of about 34% gives further potential for increases in domestic consumption.

**Table 3.2**
**Real GDP by Expenditure (1987=100)**

| | 2002*p* | 2003*f* |
|---|---|---|
| | Annual change (%) | |
| **Domestic Demand**[1] | **4.3** | **5.9** |
| Private sector expenditure | 2.0 | 7.1 |
| *Consumption* | *4.2* | *6.9* |
| *Investment* | *-6.1* | *8.1* |
| Public sector expenditure | 8.6 | 3.6 |
| *Consumption* | *13.8* | *3.1* |
| *Investment* | *4.6* | *4.1* |
| **Net exports of goods and services** | **-18.9** | **-0.7** |
| Exports | 3.6 | 5.2 |
| Imports | 6.2 | 5.7 |
| **Gross Domestic Product** | **4.2** | **4.5** |

[1] Excluding stocks
*p* Preliminary
*f* Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2002. Improved revenue position coupled with the narrowing of excess capacity in many sectors would provide the impetus for private sector investment activities to strengthen in 2003. Private sector capital formation is expected to emanate mainly from new investment in the manufacturing sector, continued investment in on-going privatised infrastructure and utilities projects, residential housing, down-stream agriculture-based industries and the oil and gas sub-sector. Investment in the services sector would be sustained, particularly in utility projects, tourism, information technology and research and development centres. Investment in logistics and support services, and the setting up of regional hubs for multinational operations, including operational headquarters, international procurement centres, and regional data processing, financial and customer service centres is expected to be stepped-up.

Improved revenue positions of companies, narrowing of excess capacity in many sectors and steady inflows of foreign direct investment support prospects for increases in private investment.

After two consecutive years of negative growth, **private investment** recovered in the second half of 2002. Private investment is expected to build on this recovery and increase by 8.1% in 2003, supported by a steady inflow of foreign direct investment. The financing gap is estimated to have narrowed with cash flow positions of corporations continuing to improve as reflected by an increasing number of companies reporting higher revenues in

**Table 3.3**
**Contribution of Demand Components to Real GDP Growth**

| | 2002*p* | 2003*f* |
|---|---|---|
| | % point of contribution | |
| **Domestic Demand**[1] | **3.9** | **5.3** |
| Private sector expenditure | 1.2 | 4.1 |
| *Consumption* | *1.9* | *3.2* |
| *Investment* | *-0.8* | *0.9* |
| Public sector expenditure | 2.7 | 1.2 |
| *Consumption* | *1.9* | *0.5* |
| *Investment* | *0.8* | *0.7* |
| Change in stocks | 2.5 | -0.7 |
| **Net exports of goods and services** | **-2.1** | **-0.1** |
| Exports | 3.9 | 5.6 |
| Imports | 6.0 | 5.7 |
| **Gross Domestic Product** | **4.2** | **4.5** |

Note: Figures may not necessarily add up due to rounding
[1] Excluding stocks
*p* Preliminary
*f* Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The public sector will remain expansionary in 2003. Taking cognizance of lingering uncertainties in the external environment, the consolidation of public sector expenditure would be gradual. Accordingly, the expansion in **public sector investment expenditure** is projected to increase by 4.1% in 2003 (4.6% in 2002). The focus of the Federal Government development expenditure allocation would continue to be in the social and economic services sectors, with special emphasis on education and upgrading manpower skills, research and development, as well as agriculture and rural development programmes. **Public sector consumption expenditure** is projected to increase by 3.1%, largely on account of emoluments as well as higher outlays on supplies and services.

### Sectoral Outlook

On the production side, growth is expected to be broad based and reflected in all sectors of the economy. An improved performance is projected for the manufacturing and agriculture sectors, while activity is expected to be sustained in the services and mining sectors. Construction activity is projected to be slower in 2003 due mainly to moderate activity in the civil engineering and residential property sub-sectors.

Value added growth in the **manufacturing sector** is expected to increase by 5% in 2003, on the assumption of a modest global economic outlook and moderate growth in the global electronics sector. The rising trend in intra-regional trade is expected to continue to augment demand for exports of manufactured goods. While Malaysian companies producing computer-related products, higher-end memory chips and chips for the wireless sector are optimistic on the outlook for 2003, others in the sector expect a moderate performance. The general consensus is that growth would improve in the second half of the year.

A number of positive trends that would provide support for the electronics industry are that the personal computer (PC) segment can be expected to benefit from the expected PC replacement cycle; that growth in the Asia-Pacific region would continue to be strong and remain the fastest in the world due to rising domestic demand, the continued outsourcing activity and the relocation exercise by MNCs. Demand in the region is expected to be driven by higher-end memory, flash and digital signal processing chips, as well as wider application of chips in consumer products and in the automotive industry. In addition, although new orders and shipments remain subdued in the US, inventory levels of electronic products have normalised to below US$42 billion (February 2001: US$59.1 billion) after the significant drawdown of stocks in 2001 and the first half of 2002. The inventory-to-shipment ratio of electronic products has also moderated to 1.55 in January 2003 from a peak of 1.98 in August 2001. Malaysia is thus likely to benefit from improved demand from the US as well as continued demand from the Asian region.

## Growth to be broad based. Manufacturing production to increase with the expected increase in global demand for semiconductors. Services sector growth to be supported by domestic demand and exports.

Given the upside potential in the electronics and electrical products industry and the positive spin-off on the chemical products industry, growth of the export-oriented industries as a whole is projected to increase by 6.2% (2002: 5%). At the same time, growth in the domestic-oriented industries is also expected to improve to 4.3% in 2003 (2002: 3.4%), supported by the food, beverages, fabricated metal, paper and petroleum products industries. Nevertheless, growth in the construction-related industries and transport equipment industry is expected to remain modest, reflecting the slower performance of the construction sector and some moderation in demand for passenger cars following the strong growth of the last two years.

In the **services sector**, growth is expected to be sustained at 4.4% in 2003 (2002: 4.5%), reflecting continued expansion across all sub-sectors. Growth is expected to emanate from both the intermediate and final services sub-sectors. In particular, the transport, storage and communications sub-sector is expected to pick up in view of the expected expansion in trade, higher tourist arrivals, and growth in the telecommunications industry. Similarly, the wholesale and retail trade, hotels and restaurants sub-sector is expected to benefit from the increase in tourist spending and sustained domestic demand, while the utilities sub-sector is projected to strengthen in line with the improved performance of the manufacturing sector. Overall, growth in the services sector is expected to emanate from new niche areas as well as enhancement of traditional services such as financial services and transport.

With the labour shortage problem expected to improve in the first half of 2003, growth in the **construction sector** is envisaged to increase by 1.9%, reflecting mainly the slower growth in the civil engineering and residential sub-sectors. This reflects the lower spending on infrastructure projects by both the private sector and the Government following the completion of some of the on-going projects. In the case of the residential sub-sector, there has been an

**Table 3.4**
**Real GDP by Sector (1987=100)**

| | 2002*p* | 2003*f* |
|---|---|---|
| | Annual change in % | |
| Agriculture | 0.3 | 1.5 |
| Mining | 4.5 | 4.5 |
| Manufacturing | 4.1 | 5.0 |
| Construction | 2.3 | 1.9 |
| Services | 4.5 | 4.4 |
| **Real GDP** | **4.2** | **4.5** |

*p* Preliminary
*f* Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia increase in property overhang and the take-up rate for newly-launched projects during the first half of 2002 was low. Meanwhile, activity in the non-residential sub-sector will continue to be affected by the oversupply situation.

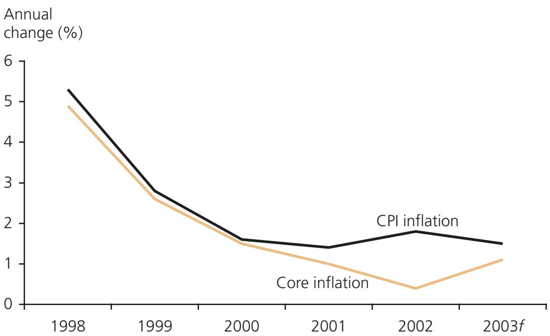
The **agriculture sector** is expected to improve in 2003 to record a growth of 1.5% due primarily to higher production of crude palm oil, rubber and other agriculture products. The change in the biological yield cycle as well as the increase in newly matured oil palm areas coming into production in East Malaysia would contribute to higher output of crude palm oil during the year. Production of natural rubber, which had picked up in 2002 for the first time in eight years, is also expected to increase as sustained high prices would continue to encourage tapping activity, particularly among the smallholders who account for 85% of the total production of natural rubber. Meanwhile, continuous efforts by the Government to improve domestic production of food are expected to result in higher production of livestock, fish, fruits and vegetables.

Amidst the better price outlook for petroleum and natural gas, growth in the **mining sector** is expected to be sustained at 4.5%. Both crude oil and natural gas production are expected to increase during the year. While higher demand is expected to support crude oil production, the increase in natural gas output is expected to emanate from the commencement of the MLNG Tiga plant. For 2003, production of crude oil (excluding condensates) has been targeted at 620,000 barrels per day.

**Prices and Employment**

The overall **inflation** (CPI) rate is expected to moderate to 1.5% in 2003 (1.8% in 2002), due mainly to the lower impact of the one-off price increase for selected services. Supply-related inflation would moderate to 0.8 percentage point from 1.5 percentage points in 2002. This expectation has taken into account the total impact (direct and indirect) of the recent upward price adjustment of 2 sen on retail petrol, diesel and LPG; and the RM3 increase in the monthly telephone rental. Price increases due to demand pressures are only expected to increase moderately from 0.4% in 2002 to 1.1% in 2003, with the expansion in domestic economic activity.

**Graph 3.5**
**Consumer Prices**




*f* Forecast

The potential for sustained economic growth can be expected to continue to generate employment opportunities in the major sectors of the economy, led by the services and manufacturing sectors. The **unemployment** rate is estimated to be about 3.4%. Initiatives undertaken by the Government in recent years have aimed to increase the quality of labour to meet changing demands of employers and to reduce the skills mismatch in the domestic labour market.

**Balance of Payments and External Debt**

The moderate GDP growth is expected to sustain a strong balance of payments position with a continued large **current account surplus** (7.9% of GNP) in 2003. The surplus in the trade account is expected to increase in line with moderate growth in exports (7%), particularly electrical and electronic exports and higher revenue from agricultural and mineral exports. As the contribution of agricultural and mineral exports would be higher in 2003, this is not likely to be matched by a corresponding increase in imports given that these exports have low import content. The increase in gross imports is therefore expected to be more moderate at 7.1%, with imports of intermediate goods increasing by 6.8%. Excluding lumpy imports, capital imports are expected to increase by 19.5% in line with the expected recovery in investment activity. The higher trade surplus is expected to be partially offset by the slightly higher services and income account deficits.

The performance of **manufactured exports** is expected to be sustained into 2003 with a growth of 6.7%, reflecting the improvement in electronics demand, especially from the Asian region. Exports of electronics, which accounts for more than half of total manufactured exports, are expected to expand further by 7.8%, supported by strong demand for computer-related products, higher-end memory chips and chips for the wireless sector. Exports of non-electronics products are projected to turn around to increase by 5.6% (2002: -0.8%), attributable to better performance in the chemical products, wood products, non-metallic mineral products, optical and scientific equipment, toys and sporting goods, furniture and textiles. As in 2002, the increase in manufactured exports is expected to be driven mainly by higher export volume, which is projected to increase by 9.3% (2002: 7.9%). Competition from low-cost producing countries, especially in the electrical products industry, would lead to downward pressure on export prices, resulting in further declines by 2% (2002: -2.5%).

## Sustained strong balance of payments position with continued large current account surplus. Trade surplus to increase with growth in electronics exports and higher revenue from agriculture and mineral exports. FDI inflows to remain sizeable.

Commodity prices are expected to remain strong in 2003. This would raise export proceeds from the **agriculture sector** by 10.9%, after the strong growth of 31.9% in 2002. While export volume is forecast to rise slightly, the higher export receipts would reflect primarily higher average prices of all major agricultural commodities. Given the expectation of tight global supplies of oils and fats, particularly during the first half of 2003, the export price of palm oil is expected to record a higher average of RM1,550 per tonne. Similarly, rubber prices are expected to continue to trend upwards during the year, in view of the sustained demand amidst the tight supplies. Despite the anticipated recovery in external demand for saw logs and sawn timber, prices of these commodities are projected to remain stable due to increased competition from low cost producing countries.

In the **mining sector**, crude oil prices would continue to be largely influenced by international developments, arising from geopolitical factors in the Middle East. With the sharp increase in prices in the early part of the year, Malaysian crude oil price is projected to average US$25 per barrel, while the LNG prices are expected to be in line with crude oil prices. The low inventories in the oil importing countries would lend support to demand for crude oil. For LNG, the commencement of the MLNG Tiga plant is expected to enhance its export volume during the year. Hence, exports of minerals are expected to grow by 7.8% in 2003.

The **services account** deficit is envisaged to amount to RM6.2 billion, improving marginally to 1.7% of

**Table 3.5**
**Balance of Payments**

| | 2002*e* | 2003*f* | 2002*e* | 2003*f* |
|---|---|---|---|---|
| | RM billion | | US$ billion | |
| Goods | 68.9 | 72.5 | 18.1 | 19.1 |
| Trade account | 51.0 | 54.1 | 13.4 | 14.2 |
| *Exports (% change)* | *6.0* | *7.0* | *6.0* | *7.0* |
| *Imports (% change)* | *8.3* | *7.1* | *8.3* | *7.1* |
| Services | -6.0 | -6.2 | -1.6 | -1.6 |
| **Balance on goods and services** | **62.9** | **66.3** | **16.6** | **17.5** |
| Income | -25.2 | -29.0 | -6.6 | -7.6 |
| Current transfers | -10.4 | -9.5 | -2.7 | -2.5 |
| **Current account balance** | **27.4** | **27.9** | **7.2** | **7.3** |
| ***(% of GNP)*** | ***8.1*** | ***7.9*** | ***8.1*** | ***7.9*** |
| Financial account | -12.0 | | -3.1 | |
| Errors and omissions | -1.2 | | -0.3 | |
| *of which:* | | | | |
| *Exchange revaluation gain* | *6.6* | | *1.7* | |
| **Overall balance** | **14.2** | | **3.7** | |

*e* Estimate
*f* Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

**Table 3.6**
**Exports and Imports**

| | 2002*p* | 2003*f* |
|---|---|---|
| | RM billion | |
| **Gross exports** | **354.5** | **379.2** |
| ***(% change)*** | ***6.0*** | ***7.0*** |
| Manufactures | 298.9 | 319.1 |
| *(% change)* | *4.8* | *6.7* |
| of which: | | |
| Electronics | 154.4 | 166.4 |
| *(% change)* | *10.6* | *7.8* |
| Electrical products | 54.8 | 55.6 |
| *(% change)* | *-9.8* | *1.5* |
| Chemical & chemical products | 17.3 | 18.8 |
| *(% change)* | *16.2* | *8.7* |
| Minerals | 22.4 | 24.2 |
| *(% change)* | *-4.4* | *7.8* |
| Agriculture | 26.3 | 29.2 |
| *(% change)* | *31.9* | *10.9* |
| **Gross imports** | **303.5** | **325.1** |
| ***(% change)*** | ***8.3*** | ***7.1*** |
| Capital goods | 45.7 | 49.8 |
| *(% change)* | *10.6* | *9.0* |
| Intermediate goods | 216.5 | 231.2 |
| *(% change)* | *6.2* | *6.8* |
| Consumption goods | 19.3 | 20.6 |
| *(% change)* | *15.9* | *6.8* |

*p* Preliminary
*f* Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

GNP. Larger payments reflect higher freight and insurance in line with the expected expansion in trade activity. Positive developments include further improvement in tourism receipts as well as higher earnings from port charges and education. In 2003, tourist arrivals are expected to remain high with the introduction of better and broader range of tourist products, easing of visa requirements, aggressive tourist promotion in niche markets and the increase in flight frequencies. Closer collaboration between the Government and the private sector in export promotion and the wider spectrum of fields of study, integrating information technology and research and development in course content, are expected to enhance receipts from education. Port earnings are expected to increase, following efforts to promote the utilisation of domestic ports and with the ports positioning themselves as distribution hubs for transshipment cargo. Innovative approaches such as combined air/sea transshipment, access to information technology, and simplified and standardised customs procedures are expected to enable the ports to provide fast and flexible services.

In addition, gross receipts in the other services account are also expected to increase as expansion of the services sector has seen foreign direct investment being more diversified into services-related activities, including communications and information technology-related services. Similarly, incentives to lower the cost of doing business through double deduction of expenses incurred in export promotion by professional services enterprises are expected to encourage local service providers to venture abroad and thus increase export earnings.

The **income account** deficit is expected to widen to 8.2% of GNP with the increase in profits and dividends accruing to non-residents, following the envisaged increase in exports.

The **financial account** is expected to be supported by continued inflows of funds for investment. A steady inflow of foreign direct investment in Malaysia is expected, mainly in the form of reinvestment of earnings of existing multinational companies, for the upgrading of machinery and equipment as well as some new investment in the manufacturing sector. Investment in the services sector is expected to be sustained. The investment incentives provided in the 2003 Budget, including for the setting up of operational headquarters (OHQ), international procurement centres and regional distribution centres, are expected to attract higher value-added FDI into the services sector. Meanwhile, investment in the oil and gas sector is expected to remain large. Direct investment abroad is also likely to maintain its pace as a number of companies have indicated their interest to position themselves globally to provide greater synergy to their corporate activities.

The official sector is expected to record a net repayment of loans due to higher loan repayments by the NFPEs following the maturing of several bonds and loans during the year. Short-term capital flows are expected to be volatile, responding to short-term sentiments and events.

The **external debt outstanding** is expected to decline to RM184.5 billion (US$48.6 billion) as at end-2003, equivalent to 52.3% of GNP. With short-term debt expected to remain at the 2002 level, the improvement reflects mainly the decline in the debt of the NFPEs in view of the maturing of several bonds and loans raised earlier. The net repayment of external loans by the NFPEs would more than offset the net drawdown of external borrowing by the Federal Government and the private sector. The Federal Government will continue to draw down the loans committed by the multilateral financial institutions and the Miyazawa Initiative. Meanwhile, it is expected that there will be a marginal net inflow of private sector external loans. The debt service ratio is expected to be 7.3%.

**Table 3.7**
**External Debt**

| | 2002*p* | 2003*f* | 2002*p* | 2003*f* |
|---|---|---|---|---|
| | RM billion | | % share | |
| **Medium and long-term** | **153.8** | **153.0** | **83** | **83** |
| Public sector | 100.6 | 99.6 | 54 | 54 |
| *Federal Government* | *36.3* | *38.3* | *20* | *21* |
| *NFPEs* | *64.3* | *61.4* | *35* | *33* |
| Private sector | 53.2 | 53.4 | 29 | 29 |
| **Short-term** | **31.6** | **31.6** | **17** | **17** |
| Banking institutions | 21.9 | 21.9 | 12 | 12 |
| Non-bank private sector | 9.7 | 9.7 | 5 | 5 |
| **Total External Debt** | **185.3** | **184.5** | **100** | **100** |
| ***US$ billion equivalent*** | ***48.8*** | ***48.6*** | | |
| **% of GNP** | | | | |
| Total debt | 55.1 | 52.3 | | |
| Medium and long-term debt | 45.7 | 43.3 | | |
| **Debt service ratio (%)** | | | | |
| Total debt | 6.0 | 7.3 | | |
| Medium and long-term debt | 5.9 | 7.1 | | |

*p* Preliminary
*f* Forecast

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

**Liberalisation of Rules on Foreign Exchange in year 2002 and early 2003**

The rules on foreign exchange are implemented for prudential reasons aimed at maintaining financial stability. These rules complement the overall macroeconomic policies and are implemented in a transparent and pragmatic manner. The rules are under regular review and modifications are made to be consistent with the changing environment.

In 2002 and early 2003, several exchange control regulations were liberalised to create a more conducive business environment as well as to enhance efficiency of businesses operating in Malaysia.
These changes include the following :

| Effective Date | Subject |
|---|---|
| **21 November 2002** | **Financing of Projects Undertaken by Non-residents in Malaysia**<br>Allowing banking institutions in Malaysia to extend additional ringgit credit facilities to any non-resident up to an aggregate of RM5 million per non-resident to finance projects undertaken in Malaysia. Prior to this, credit facilities in ringgit to a non-resident, for purposes other than purchases of three immovable properties or a vehicle, were limited to RM200,000. |
| **3 December 2002** | **Refinancing of Property Loans Obtained by Non-residents**<br>In addition to obtaining property loans to finance new purchases or construction of any property in Malaysia, non-residents may also refinance their domestic ringgit property loans. The above is subject to a maximum of three property loans. |
| **3 December 2002** | **Settlement of Ringgit Assets by Residents and Non-residents**<br>Payments between residents and non-residents as well as between non-residents for ringgit assets are liberalised to allow payments to be made either in ringgit or foreign currency. (Previously, only in ringgit.) |
| **3 December 2002** | **Investment Abroad by Residents in Employee Share Option/Purchase Scheme (ESOS)**<br>The limit of RM10,000 equivalent in foreign currency for investment abroad by residents under the Employee Share Option/Purchase Scheme has been removed.<br>Effective this date, general permission is granted for overseas investment for this purpose. |
| **7 March 2003** | **Ringgit Overdraft Facilities to Non-residents**<br>Commercial banks and Islamic banks in Malaysia are now allowed to extend overdraft facilities in ringgit not exceeding RM500,000 in aggregate to a non-resident customer, provided such overdraft facilities are covered by fixed deposits placed by the non-resident customer with the commercial banks and Islamic banks in Malaysia. These overdraft facilities are in addition to all ringgit credit facilities allowed to be extended freely by banking institutions since 21 November 2002. |

| Effective Date | Subject |
|---|---|
| **1 April 2003** | **Domestic Credit Facilities Extended to Non-Resident Controlled Companies (NRCCs)**<br>Regulations on credit to NRCCs have been liberalised and simplified. The requirement that at least 50% of all credit facilities extended by banking institutions must be extended by Malaysian-owned banking institutions, is abolished. In addition, credit facilities that can be granted by residents to NRCCs have been revised to RM50 million from RM10 million in aggregate. Only domestic credit facilities exceeding RM50 million require the prior approval of the Controller of Foreign Exchange (the Controller).<br><br>The NRCC would have to continue to comply with the 3:1 gearing ratio requirement of domestic debt against eligible capital funds. In computing the 3:1 gearing ratio requirement, NRCCs are now given the option to compute their domestic debt and eligible capital funds either on per corporate group basis or on single entity basis. In addition, the computation of the domestic debt for 3:1 gearing ratio requirement is based only on the amount of domestic borrowing in excess of RM50 million. Prior to this, the computation of the NRCCs' domestic debt and eligible capital funds was on per corporate group basis. In addition, computation of domestic debt includes all domestic credit facilities obtained by the NRCC. |
| **1 April 2003** | **Foreign Currency Accounts of Residents**<br>The export foreign currency account (export FCA) overnight limit for Approved Operational Headquarters has been increased from USD10 million to USD70 million.<br><br>The limits on foreign currency export proceeds retained by resident exporters in export FCA have also been raised. The revised limits, based on the average monthly export proceeds are as follows : |

| Overnight limit (USD million) | Average monthly export proceeds |
|---|---|
| 50 | Exceeding RM100 million |
| 30 | Exceeding RM50 million up to RM100 million |
| 10 | Exceeding RM20 million up to RM50 million |
| 5 | Exceeding RM10 million up to RM20 million |
| 3 | Exceeding RM5 million up to RM10 million |
| 1 | Not exceeding RM5 million or new exporters |

Prior to this date, resident exporters were allowed to retain export proceeds in export FCA up to the following limits, based on the average monthly export proceeds :

| Overnight limit (USD million) | Average monthly export proceeds |
|---|---|
| 10 | Exceeding RM20 million |
| 5 | Exceeding RM10 million up to RM20 million |
| 3 | Exceeding RM5 million up to RM10 million |
| 1 | Not exceeding RM5 million or new exporters |

| Effective Date | Subject |
|---|---|
| | In addition, upon attaining the maximum limit of permitted overnight limit of the export FCA, resident exporters may retain 10% of subsequent export proceeds repatriated to Malaysia in the export FCA, provided the aggregate overnight limit does not exceed the overnight limit of the next higher threshold. For resident exporters who are eligible to retain export proceeds up to the general permissible USD50 million limit, the maximum additional amount they are able to retain is USD20 million. The balance 90% must be sold to authorised dealers for ringgit.<br><br>Prior to this date, resident exporters were not allowed to retain in export FCA export proceeds exceeding the then permitted overnight limits. All excess funds must be sold for ringgit to an authorised dealer. |
| **1 April 2003** | **Foreign Exchange Forward Contract**<br>The regulation allowing residents to enter into foreign exchange forward contract is liberalised. In addition to selling forward foreign exchange from export proceeds and services receivables, residents are now also allowed to sell forward of up to 12 months foreign currency receivables for ringgit with an authorised dealer for any purpose provided that the transaction is supported by firm underlying commitment to receive such currency. |
| **1 April 2003** | **Threshold for Reporting Payments and Receipts**<br>The threshold for completing a Form P for payment to a non-resident is increased to RM50,001 in ringgit or its equivalent in foreign currency from RM10,001, irrespective of purpose of payment.<br><br>Accordingly, the threshold for reporting payments and receipts under Cash Balance of Payments System is increased to RM50,001 respectively.<br><br>Payment for overseas investment, including extension of loan to a non-resident, continues to require prior approval of the Controller if the amount of payment exceeds RM10,000 equivalent. |
| **1 April 2003** | **Reporting on Export by Residents**<br>The requirement to complete Form KPW X for exports in excess of RM100,000 f.o.b. is abolished. Resident exporters only need to continue to submit quarterly and annual reports on their export related transactions. |

## MONETARY POLICY IN 2003

The prospects for 2003 are for moderate expansion of real output. Under the baseline scenario, the stimulus from external sector will be supportive of growth. In the context of a modestly expansionary fiscal policy, private sector is expected to assume the role as the main engine of growth. The economy will continue to operate at below potential and prevailing excess capacity in some sectors amidst moderate growth will keep inflation low at 1.5%. The current account surplus and the overall balance of payments are expected to remain strong. Against this environment, monetary policy will remain accommodative to support private sector activity. On the exchange rate front, the focus of policy is to ensure that economic fundamentals continue to support the pegged exchange rate.

Monetary policy stance in 2003 will continue to be influenced by global and domestic developments. On the domestic front, economic fundamentals have strengthened significantly and there is stronger resilience to external shocks. On the external front, however, the downside risks from potential shocks have increased significantly. Heightened uncertainty due to geopolitical risks, the impact of higher energy prices on global growth, volatility in financial markets and the concomitant aversion to risk among investors and consumers could lead to a widespread slowdown in the global economy. These developments could cause the balance of risks to be biased towards a possible slowdown in the domestic economic activities. Under this environment, monetary policy will remain flexible to appropriately influence emerging changes in macroeconomic conditions. While current circumstances support the maintenance of an accommodative monetary stance, pre-emptive action will be taken when developments indicate a significant change in circumstances that will increase the risks towards significantly lower economic growth. Policies will aim at ensuring that the level of interest rates and market liquidity remain relevant and continue to support private sector activity.

Within this context, an important consideration with regard to changes in the policy rate is the need to take into account whether the current low interest rates have been effective in stimulating domestic demand. In 2002, demand from the household sector strengthened significantly, a positive development that is expected to continue through 2003. A recovery in demand for loans from the business sector has also taken place. The current interest rate levels are considered appropriate based on the underlying developments and the increased pace of economic activities.

While macroeconomic stimulus to deal with cyclical changes and changes of a fundamental nature has been effective, other supply-side measures are equally important to promote higher and sustainable private sector activity. In this respect, a co-ordinated and comprehensive approach will be taken to promote a competitive environment that would facilitate businesses to operate in a productive manner and with greater flexibility to respond to market forces during a period of uncertain global economic prospects. The conduct of monetary policy would focus primarily on ensuring favourable conditions on cost, market liquidity and accessibility. In this regard, policy measures will continue to leverage on those gains that emerged from the cumulative monetary easing initiated since 1998. Similarly, the capacity of the banking system to support loan growth has been enhanced. Concurrent measures to improve the competitive environment have resulted in declining lending rates. Borrowers have thus benefited from the more competitive credit market. The strategy is, therefore, to enhance the competitive environment further for banks to support the new growth industries, while enabling loans to be priced competitively. In this context, monetary policy will continue to provide a stable and predictable environment to facilitate the fundamental shift from public sector-led growth to the private sector-led growth. The approach is to maintain a broader growth strategy that will increasingly rely on the private sector as the engine of domestic demand and on greater regional trade as the foundations for growth. Overall, monetary policy would be implemented in a pragmatic and supportive manner, within a framework of low interest rates, and improved access to finance to facilitate sustainable economic growth.

## FISCAL POLICY IN 2003

In line with the policy of fiscal consolidation, the Government presented on 20 September 2002 a moderately expansionary budget for 2003. The expectations are for the Malaysian economy to strengthen in 2003, benefiting from the expected recovery in the major industrial countries and sustained growth in intra-regional trade, with the stronger growth prospects in the region. The private sector was envisaged in the Budget to play a larger role in sustaining domestic driven growth. Private sector consumption demand was projected to remain at a high level supported by cumulative stimulus provided by pro-growth macroeconomic policies. Private sector investment was projected to return to positive growth due to expected improvement in the financial position of corporations following the structural adjustments undertaken since the crisis, emerging business opportunities in selected sectors as well as improved business environment. A major thrust of the 2003 Budget was, therefore, designed to provide the enabling environment and incentives to revitalise the private sector to resume its role as the main engine of growth. Policies in the Budget thus focused on enhancement of the supportive incentives to promote private sector ventures, especially into new growth areas.

At the same time, recognising the need for the public sector to consolidate its finances in the medium term, the Budget also targeted to strengthen the finances of the public sector. With total expenditure of the Federal Government budgeted to grow at a moderate rate in 2003 amidst sustained growth in revenue, the fiscal deficit in 2003 was forecast to improve to 4% of GDP, after factoring in potential net revenue loss arising from the tax changes introduced in the 2003 Budget. Total operating and development expenditures (excluding contingency reserves) were budgeted at RM106.7 billion, moderately higher by 4.6% than the estimated expenditure of RM102 billion in 2002. The current account was expected to continue to record a large surplus, while the development expenditure of the Federal Government was budgeted to decline given the policy of fiscal restraint.

In terms of budget allocation, emphasis was given towards enhancing the quality of education and upgrading manpower skills. Priority was also given to rural development programmes with added focus on the poor and the disabled to further uplift the quality of life for all segments of society.

In 2003, the Government would continue to rely on domestic sources to finance the fiscal deficit. Regular issues of government securities will be made to tap private savings and also to provide a reflective benchmark yield curve for the bond market. Fostering the development of an active and growing private debt securities market remains an objective of Government policy. Given the high domestic savings rate and ample liquidity situation, recourse to external borrowing will be determined mainly by the need to establish international market presence and benchmarking for private sector issues.

In addition to the strengthening of public finances, an important thrust of the 2003 Budget included the increasing emphasis placed on efficiency in the delivery of public services and effectiveness in implementation of national development policies and strategies. In this regard, the Government remained committed to review all regulations and procedures, to minimise and eliminate bureaucratic delays. The 2003 Budget included steps to simplify and standardise prevailing custom procedures and regulations to facilitate a faster movement of goods.

For more effective planning and budgeting, the 2002 Budget announced the implementation of a two-year Budget preparation to provide implementing agencies more lead time to plan and implement the projects. Hence, a special allocation of RM1 billion was provided to various ministries to commence preliminary plans and works in 2003 so that physical implementation can be effected in 2004. All Government agencies involved in the implementation of public sector projects are required to intensify efforts towards accelerating the implementation process. To complement efforts at the Federal level, state governments and the local authorities are also encouraged to play their role in simplifying and expediting the acquisition process of project sites as well as expediting the approval of design plans and licences.

The tax measures and the expenditure programmes of the 2003 Budget also placed great emphasis on supporting business and industrial activities to generate higher growth. The incentives for the manufacturing sector included the reduction in corporate tax for small and medium-scale enterprises from 28% to 20% for chargeable income of up to RM100,000 and tax incentives for manufacturers of machinery and auto parts makers to promote high value activities in the manufacturing sector. At the same time, an option has been introduced for pioneer status holders to qualify for reinvestment allowance if their Pioneer Status are surrendered for cancellation. For the agriculture sector, various incentives were introduced for consolidation of smallholdings, cultivation of rubber wood trees, deep-sea fishing, food processing and modernisation of poultry farming.

The 2003 Budget also contained various tax measures to reduce the cost of doing business for exporters of goods and professional services. Besides streamlining custom procedures for speedier movement of goods, other related measures included lowering withholding tax for services provided by non-residents, abolishing import and sales tax on quality paper and exempting service tax for exports of courier service and professional services provided to companies within the same group. To position Malaysia to move up the value chain as well as to attract FDI in higher value added and knowledge–based activities, tax incentives were granted for the setting up of operational headquarters, regional distribution centres and international procurement centres.

Although the external environment facing Malaysia has turned less favourable since the announcement of the 2003 Budget, global recovery is expected to continue, but at a more moderate pace than projected previously. The expansionary 2003 Budget remains relevant and the incentives and expenditure allocation would support recovery of the private sector. The progress made in restructuring and reforms, the accommodative monetary policy with a low and stable interest rate environment and the new fiscal incentives would continue to provide the positive environment for private sector initiatives to thrive and businesses to expand.

**BANKING SECTOR POLICY IN 2003**

In an environment of global economic uncertainties and increased competitive pressures, the policy focus in 2003 is to preserve the resilience and stability of the banking sector as well as enhance the efficiency and effectiveness of banking institutions in performing their intermediation function and contribute positively to economic growth. Emphasis would also continue to be accorded towards ensuring that the objectives set out in the first phase of the Financial Sector Masterplan are achieved, including putting in place the necessary financial infrastructure. Efforts that were initiated in 2002 to improve the existing consumer protection framework will continue to be pursued in 2003.

In line with the thrust of policy measures in 2002, the initiatives during the year would continue to enhance the capacity of banking institutions. The present benchmarking exercise would be extended to incorporate benchmarks on the quality of customer service and building the foundation for the development of a service quality index for banking institutions. An enabling environment would also be created to promote mergers of commercial banks and finance companies. Amendments to the Banking and Financial Institutions Act (BAFIA) 1989 would be made during the year to rationalise the different requirements imposed on commercial banks and finance companies and to facilitate the mergers. In addition, the regulatory and supervisory framework for investment banks would be finalised during the year. Investment banks which would be created from the mergers of merchant banks, stockbroking companies and discount houses, would be jointly regulated by Bank Negara Malaysia and the Securities Commission. The first stage of a formal regulatory and supervisory framework for financial conglomerates would also be formulated stipulating prudential requirements to safeguard their financial soundness. Such efforts would be complemented by progressive deregulation of certain policies to allow greater flexibility for banking institutions to introduce new products by replacing the existing product pre-approval requirements.

Initiatives would continue to be taken to improve access to financing by all segments of the economy. These include, amongst others, strengthening the existing infrastructure and putting in place new institutional arrangements to improve the access to financing by both SMEs and microenterprises. In particular, existing microfinancing arrangements will be strengthened and new institutional arrangements will be introduced. Given the objective to encourage consumer activism to drive efficiency in the banking sector, development efforts to put in place an efficient and market-driven consumer protection framework would continue to be pursued in 2003. The launch of the consumer education programme (CEP) earlier this year would be supplemented by a set of comprehensive strategies to achieve an adequate and effective consumer protection framework. This would involve enhancing product transparency by financial institutions, expanding the role of the Banking Mediation Bureau, developing Anti-Trust regulations and establishing a deposit insurance fund.

## Report on SME Development Framework

To achieve the country's national economic agenda of building a resilient and competitive nation, efforts are now concentrated on promoting endogenous growth through the strengthening of domestic industries and developing indigenous capability. The private sector, and more specifically, the small and medium enterprises (SMEs), represents an important segment in the country's economic growth process. In the case of Japan, Chinese Taipei, Germany and Korea, the SME industry forms the backbone of their economies, with SMEs constituting over 98% of total establishments, and contributes significantly to GDP and employment, as shown in the table below.

Recognising the importance of SMEs as a potential driving force in generating higher economic growth, Bank Negara Malaysia initiated a survey on SMEs, through the financial institutions and Chambers of Commerce in November 2001 to assess the level of development of domestic SMEs and to identify pertinent issues and problems affecting their development. The findings from 7,705 respondents and the study of the experience of Japan, Thailand, Chinese Taipei and Germany in supporting the development of SME industries, served as the basis for the report that presents the formulation of "A Comprehensive Framework for the Development of Small and Medium Enterprises in Malaysia".

### SME Survey Findings

The survey findings showed that in general, the potential ability of SMEs in Malaysia to compete and contribute effectively to the economy was affected by their relatively small scale, low efficiency levels and insufficient comparative advantage. Other pertinent issues affecting the viability of the SMEs including access to advisory services and access to financing were also highlighted in the report. The main findings of the survey are: -

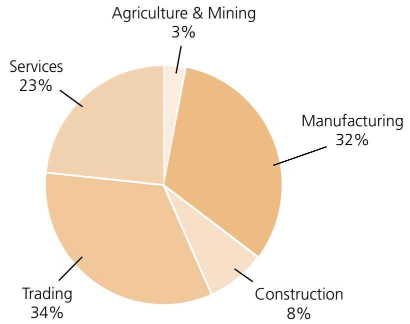
- SMEs are largely involved in the trading, manufacturing and services sector.
- 88% of SMEs are family-owned businesses with 72% operating as private limited companies. Foreign ownership in SMEs is small with participation in less than 15% of SMEs, while 26% of SMEs surveyed are Bumiputera-owned enterprises.
- The SMEs are generally very small with 77% having total assets of less than RM5 million and 74% having less than 50 employees.
- The SMEs were generally affected by the 2001 economic slowdown. 29% of SMEs surveyed were insolvent while 33% were breaking-even or making losses. 70% of the respondents generated sales of less than RM10 million with 50% reporting sales of less than RM6 million, while only 8% of SMEs export their products.
- 62% of the respondents indicated that they did not have difficulty in obtaining financing. 47% financed their business operations through borrowings from banking institutions, 32% through self-financing while 11% were financed through borrowings from other sources.
- Generally, the survey showed that SMEs had low investment in technology and computer utilisation. 45% of the SMEs are still labour-intensive and 48% have low computer usage.

**Table 1**
**Selected Statistics on SME Industry**

| SMEs as a % of | Japan | Chinese Taipei | Germany | Korea | Malaysia |
|---|---|---|---|---|---|
| | | | % | | |
| Total establishments | 99.7 | 98.1 | 99.0 | 99.2 | 92.0[1] |
| Total employment | 69.5 | 78.1 | 69.7 | 75.3 | 33.3[2] |
| GDP (GNP for Germany) | 55.3 | n.a. | 57.0 | 16.0[1] | 6.0[1] |

[1] Based on SMEs in manufacturing sector only (Source for Malaysia's figures: SMIDEC as at 31 December 2001)
[2] Based on SMEs in manufacturing sector only (Source: National Productivity Report 2001).
n.a. Not available.

**Graph 1**
**Distribution of SMEs by Economic Sector**



- Only 57% of SMEs provide training to their employees, which mainly consisted of basic technical training. Of those providing training, only 47% train in the areas of business and management.
- The SMEs surveyed indicated among the areas in which assistance could be useful were advisory services in marketing, business administration and management, information technology, and accounting and finance to improve their position. 52% indicated that they did not have access to advisory services while only 14% had relied on advisory services from Government agencies.
- In the marketing of their products, 60% of SMEs relied on their own efforts while 21% drew on trade fairs, with 7% going through trading companies.

The proposed Framework for the development of SMEs includes a comprehensive set of strategies aimed at strengthening the necessary infrastructure for SME development, building the capacity of the domestic SMEs and enhancing their access to financing. More specifically, the recommendations aim to put in place the infrastructure needed for institutional and capacity building of SMEs, followed by the development of SMEs by enhancing their ability to compete through the production of higher quality products and services, whilst equipping the SMEs with good management, financial skills and sound marketing strategies. Given the number of SMEs involved in the overall development process, there needs to be coordinated efforts by the relevant parties involved in SME development. The ultimate goal is to augment the ability of SMEs to participate and contribute more effectively to the country's economic development and growth process.

**Strengthening the Infrastructure for SME Development**

Towards enhancing the existing infrastructure for SME development, several initiatives have been undertaken.

- Review of the roles and responsibilities of Government ministries and agencies involved in SME development to ensure efficient and effective use of government resources and to enhance coordination of all the efforts.
- Enactment of an SME Law to coordinate efforts for SME development. It is envisaged that it would provide a comprehensive and cohesive foundation for the development of SMEs.
- Establishment of a high level SME Council as the highest policy-making body to chart the future direction and strategies for SME development.
- Establishment of a central SME Agency as the coordinating body for SME development. The SME Agency will function to ensure that high level policy decisions are translated into action plans for implementation. The Agency will also coordinate the development of SMEs across all economic sectors and monitor the performance of the SME industry as a whole. The Agency will also be a central source of information and will facilitate the provision of advisory and consultative services to SMEs.

**Building the Capacity of Domestic SMEs**

Efforts with regard to developing the ability and capacity of the domestic SMEs include: -

- Establishment of a central training institute that provides coordinated, comprehensive and forward-looking training programmes for SMEs. This initiative is aimed at enabling SMEs from all sectors to have access to comprehensive training programmes and to promote awareness among SMEs on the importance of continuous training.
- Establishment of an advisory and information centre within the SME Agency to collate information on SMEs and business diagnostics. SMEs will have access to relevant business information and advisory services through the centre.
- Promotion of an education system that inculcates the spirit of entrepreneurship as well as foster the entrepreneurial spirit among the younger generation. This has been successfully demonstrated by the education system in Germany where the dual system has equipped school leavers with the necessary technical and entrepreneurial skills to start-up their own businesses.
- Encouragement of quality accreditation of products in order to enhance the ability of SMEs to market their products, compete with larger players and export their products to overseas markets. Developmental efforts would be geared towards brand development, patenting of products and intellectual property protection.

**Enhancing Access to Financing**

Efforts to enhance access to financing by SMEs include: -

- Strengthen the existing mechanisms to further promote the participation of banking institutions in the provision of financing and advisory services to SMEs. Towards this end, Bank Negara Malaysia and the banking institutions have taken several measures and initiatives to address the development and financing needs of the SMEs. These include the establishment of ERF Sdn. Bhd., setting up of special funds, guidelines on lending to SMEs, establishment of the Loan Complaint and Monitoring Unit at Bank Negara Malaysia and injecting RM1 billion capital into the Credit Guarantee Corporation. To complement these initiatives, banking institutions have also taken several measures to assist the SMEs, such as establishment of Bumiputera Development Units and SME Units which focus on meeting the financing needs as well as providing additional services to the SMEs and Bumiputera entrepreneurs.
- The development financial institutions would complement the banking institutions by providing mezzanine financing and ancillary services to the SMEs.
- Accelerate development of the venture capital industry as alternative sources of funds for start-ups and equity-type financing.
- Rationalise and consolidate the various Government funds for financing of SMEs activities.
- Enhance of credit guarantee schemes by the Credit Guarantee Corporation.

An SME Steering Committee was formed in October 2002 to take these initiatives forward. The Steering Committee will facilitate the process of creating an enabling environment for the cohesive and comprehensive development of SMEs across all sectors of the economy. The Governor of Bank Negara Malaysia is Chairperson and the appointed members of the Steering Committee include the Director-General of the Economic Planning Unit, Secretary-Generals from the Ministries of International Trade and Industry, Domestic Trade and Consumer Affairs, Entrepreneur Development, Agriculture, Human Resource, and Energy, Communications and Multimedia, and Chief Executive Officers of the Small and Medium Industry Development Corporation and Multimedia Development Corporation Sdn. Bhd.. Continued collaboration and cooperation among the Ministries and agencies would bring about greater synergy in the infrastructure for SME development.