BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Statutory Requirements

In accordance with section 48 of the Central Bank of Malaysia Act 1958, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Annual Accounts for the year ended 31 December 2005, which have been examined and certified by the Auditor-General. The Annual Accounts will also be published in the Gazette.

Zeti Akhtar Aziz
Chairman
Board of Directors

22 March 2006

Board of Directors

Dr. Zeti Akhtar Aziz
D.K. (Johor), P.S.M., S.S.A.P., D.P.M.J.
Governor and Chairman

Dato' Ooi Sang Kuang
D.M.P.N.
Deputy Governor

Datuk Zamani bin Abdul Ghani
D.M.S.M., D.S.M., K.M.N.
Deputy Governor

Dato' Sri Izzuddin bin Dali
S.S.A.P., D.S.P.N., K.M.N.

Datuk Oh Siew Nam
P.J.N.

Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor
P.S.M., D.A., P.N.B.S., J.S.M., J.B.S., A.M.N., P.B.J., P.P.D.(Emas)

Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee (deceased)
P.S.M., D.G.P.N., D.I.M.P., D.M.S.M.

Dato' N. Sadasivan
D.P.M.P., J.S.M., K.M.N.

Tan Sri Dato Sri Mohd Hassan Marican
P.S.M., S.P.M.T., D.S.M.T., P.N.B.S., A.M.K.

Datuk Oh Siew Nam, Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor, the late Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee and Dato' N. Sadasivan were reappointed as members of the Board effective 1 March 2005.

The late Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee passed away on 29 December 2005.

Governor	Dr. Zeti Akhtar Aziz
Deputy Governor	Dato' Ooi Sang Kuang
Deputy Governor	Datuk Zamani bin Abdul Ghani
Assistant Governor	Dato' Mohamad Daud bin Hj. Dol Moin
Assistant Governor	Dato' Mohd Razif bin Abd. Kadir
Assistant Governor	Muhammad bin Ibrahim
Assistant Governor	Nor Shamsiah binti Mohd Yunus
Secretary to the Board	Dato' Mohd Nor bin Mashor
Advisor (Special Projects)	Dr. Aini binti Ibrahim
Director	
Governor's Office	Ng Chow Soon
Corporate Communications	Abu Hassan Alshari bin Yahaya
Internal Audit	Hor Weng Keng
Legal	Gopala Krishnan Sundaram
Special Investigation	Kamari Zaman bin Juhari
Financial Intelligence	Koid Swee Lian
Economics	
Monetary Assessment and Strategy	Dr. Sukhdave Singh
Economics	V. Vijayaledchumy
International	Ismail bin Alowi
Finance	Abdul Aziz bin Abdul Manaf
Regulation	
Bank Regulation	Dato' Mohd Razif bin Abd. Kadir
Insurance Regulation	Donald Joshua Jaganathan
Islamic Banking and Takaful	Bakarudin bin Ishak
Development Finance and Enterprise	Marzunisham bin Omar
Risk Management	Santhini a/p Chandrapal
Supervision	
Banking Supervision I	Che Zakiah binti Che Din
Banking Supervision II	Chung Chee Leong
Insurance Supervision	Mahdi bin Mohd. Ariffin
Information Systems Supervision	Ramli bin Saad
Payment Systems	Ahmad Hizzad bin Baharuddin
Investment and Operations	
Investment Operations and Financial Market	Norzila binti Abdul Aziz
Foreign Exchange Administration	Wan Hanisah binti Wan Ibrahim
Statistical Services	Chan Yan Kit
Organisational Development	
IT Services	Hong Yang Sing
Human Resource Management	Mior Mohd Zain bin Mior Mohd Tahir
Human Resource Development Centre	Lim Lai Hong
Strategic Management	Lim Foo Thai
Corporate Services	Dato' Mohd Nor bin Mashor
Security	Ahmad bin Mansur
Property and Services	Zulkifli bin Abd Rahman
Currency Management and Operation	Tengku Zaib bin Raja Ahmad
Chief Representative	
London Representative Office	Lillian Leong Bee Lian
New York Representative Office	Mahendran a/l Kanagaratnam
Branch Manager	
Pulau Pinang	Raman a/l Krishnan
Johor Bahru	Abdul Aziz bin Ahmad
Kota Kinabalu	Mohd Ramzi bin Mohd Sharif
Kuching	Ishak bin Musa
Kuala Terengganu	Mokhtar bin Mohd Noh
Shah Alam	Mohd. Khir bin Hashim

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Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Economic expansion strengthened in 2005, driven by strong domestic demand and reinforced by the improvement in external demand. For the third successive year, the private sector has continued to be the main driver of growth. The improved growth performance in the second half of 2005 is expected to be sustained in 2006 as the external environment continues to improve and as domestic demand remains robust. The growth for 2006 is expected to be supported by a more broad-based expansion in all sectors of the economy. This will strengthen further the structure of the economy and its potential for sustained growth over the medium term.

A distinctive and important feature of the Malaysian economy is its high degree of flexibility. Malaysia's competitiveness has been derived from this high degree of flexibility. This economic flexibility has been important in mitigating the impact of external shocks and in sustaining Malaysia's growth performance for more than three decades. Going forward, the medium-term growth prospects for the domestic economy will thus hinge on measures to further strengthen this economic flexibility in this more challenging and competitive global economy. Therefore, the renewed emphasis on investments in human capital will be vital in enabling the work force to adjust and support Malaysia's transition toward higher value added activities and to new growth industries. This is vital to meet the increased demand for adequately qualified and highly skilled personnel. This will reinforce the ongoing efforts to identify new sources of growth to diversify the economic base and to enhance competitiveness of the economy. While the public sector is committed to providing the enabling environment for enhancing the flexibility of the economy, the private sector also has an important role in adjusting to the changes that are occurring in both the international and domestic fronts and in capturing the new opportunities that are emerging in this more dynamic environment.

A major challenge confronting the world economy in 2005 has been the sustained high energy prices during the year. While high and volatile energy prices continue to remain a risk, the world economy has, however, been better positioned to manage its economic consequences. Improved energy efficiency and the globalisation of production have contained its impact on the global economy. The pressure on prices has also been modest. For several economies, however, these trends have prompted increases in interest rates, particularly in countries where interest rates have been at exceptionally low levels. In Malaysia, notwithstanding the increase in prices in response to the rise in energy prices, the rate of inflation has remained within a manageable range. The growth in labour productivity and capacity expansion combined with increased competition have moderated the price increases. In 2006, the rate of inflation is expected to rise further before it moderates during the latter part of the year. The macroeconomic conditions, therefore, continue to remain favourable, providing a positive and stable environment conducive for the economy.

Macroeconomic policies will continue to remain supportive of the economy while financial conditions are expected to remain favourable. Policy initiatives will continue to focus on promoting high quality growth in an environment of macroeconomic stability. The Federal Government's overall financial position is expected to strengthen in 2006 as economic growth gains momentum. The Government will also continue its policy of fiscal sustainability with the financing from non-inflationary sources. Later this month, the Government will launch the Ninth Malaysia Plan, which will outline the strategies for strengthening the growth potential of the economy and enhancing national resilience over the Plan period, 2006-2010.

In 2005, monetary policy has continued to remain accommodative. As the risk of slower growth diminished in the second half of the year, the policy rate, which had remained at historical lows since the 1998 currency crisis, was raised twice, on 30 November 2005 and on 22 February 2006. The increase aimed to align the monetary conditions to the current economic environment. Going forward, monetary policy will respond appropriately to ensure sustainable growth in an environment of price stability. With interest rates still below neutral levels, monetary policy continues to remain supportive of the economy. The macroeconomic conditions are also supported by stable conditions in the assets markets. Malaysia's long record of strong growth performance in an environment of low inflation over several decades has provided a basis for anchoring inflationary expectations. In addition, the increased level of Central Bank communications on inflation and on the monetary policy process aims to promote a greater understanding on the conduct of monetary policy and to provide a further basis for anchoring expectations and thereby contributing towards achieving price stability.

Significant progress has been made in strengthening the role of the banking system and the capital market to intermediate funds, thereby enhancing their ability to support and facilitate the economic growth process. Indicators show increased financial strength and further gains in operational efficiency essentially reflect the payoffs from the earlier restructuring, consolidation and rationalisation. Portfolio quality has also improved with the non-performing loans ratio continuing its downward trend. The successful winding up of Pengurusan Danaharta Nasional Berhad in December 2005 marked the completion of the final chapter in the financial sector restructuring exercise undertaken to address the vulnerabilities that surfaced during the Asian currency crisis. As part of this restructuring process, there was also further strengthening in risk management and governance in the financial institutions during the year. This has also been reinforced by the introduction of a more dynamic prudential regulatory framework, supervisory oversight and surveillance.

To further diversify sources of financing in the economy, several initiatives were also taken to enhance further the role of the bond market in the financial system, in particular the private debt securities market. These included measures to enhance the liquidity of the market and to promote a more effective price discovery process and thereby enhance the efficiency of the market. The private debt securities market now accounts for 52% of GDP exceeding the significance of the government debt market, as it becomes an increasingly more important source of financing for the corporate sector.

With the strengthening of the economic and financial resilience, the opportunity was taken to further deregulate and liberalise the domestic environment to promote greater flexibility and efficiency in the economy. A major policy initiative in this direction was the shift in the exchange rate regime to a managed float in July 2005. The adoption of the new regime was to better position Malaysia to respond to the structural changes taking place in the regional and international environment. In the context of this shift, there was no change in the monetary policy framework and the conduct of monetary policy. Under the new regime, the exchange rate will reflect Malaysia's economic fundamentals and developments in the exchange rates of the currencies of Malaysia's trading partners. The regime also accords greater leverage for Malaysia to respond to external shocks. In operating under this regime the Central Bank does not target any particular level of the exchange rate, and intervenes only to smoothen exchange rate volatility, in particular, when large short-term capital flows create excessive movements in the exchange rate. While the developments in the exchange rate are an important consideration in the setting of monetary policy, it is important to emphasise that the Central Bank does not use the exchange rate as an instrument to achieve monetary policy objectives. The orderly transition to the new regime has been positive for the economy.

The financial sector continued to be progressively transformed during the year following the rationalisation among existing institutions, the introduction of new institutions and the strengthening of the international dimension in the financial system. The rationalisation efforts through the phasing out of traditional players such as finance companies and discount houses have resulted in the emergence of new specialised institutions. The consolidation of the retail banking business into a single entity with the merger of finance companies and commercial banks is now complete. The merger of merchant banks, stockbroking companies and discount houses currently being undertaken will see the emergence of investment banking in the financial landscape. These rationalisations aim to increase the capacity of the financial system to meet more effectively and efficiently the new changing and differentiated requirements of the economy. The consumer protection framework was also strengthened with the establishment of the deposit insurance corporation, which is now fully operational.

There has also been greater regional and international integration of the financial system. New licences have been issued to foreign Islamic financial institutions of which one institution has already commenced operations. In addition, the potential for foreign participation in the investment banks and in the Islamic subsidiaries have been raised to 49%. A number of domestic players have also increased their presence in foreign markets. To-date, our banking sector has representations in twenty countries. As part of the process of facilitating increased international integration, the liberalisation of the foreign exchange administration rules in April 2005 has allowed for greater flexibility and efficiency in foreign exchange transactions, as well as higher foreign participation in the issue of ringgit-denominated papers in the domestic bond market. This has contributed to further enhancing our economic and financial inter-linkages with other parts of the world.

During the year, aggregate spending by the household sector has continued to be robust. While this has been supported by increases in income, the banking sector has also provided increased financing to the sector. In order to sustain the contribution to growth by the household sector, new institutional arrangements have been put in place to ensure that the expansion is commensurate with the capacity of the sector to absorb the higher level of indebtedness. As part of these efforts, a Credit Counselling and Debt Management Agency is being established as a pre-emptive measure to address issues relating to household financial commitments, to essentially provide financial counselling and loan restructuring for the household sector.

Other key policy initiatives in 2005 included ensuring that all segments of the economy have access to financing. The development of a more inclusive financial system is an important element that needs to be taken into account in the development of the domestic financial system. The focus on financial inclusion ensures that institutional mechanisms are in place in the formal credit market to facilitate access to credit by micro enterprises, small and medium scale businesses, and the lower income groups. The aim is to bring these target groups into the economic mainstream, reduce poverty and promote a more balanced growth. The strengthening of the institutional arrangements that include specialised development financial institutions, micro financing institutions and cooperatives has been instrumental in promoting financial inclusion.

Important progress was made in 2005 to expedite the development of SMEs in the economy. Efforts have focussed on strengthening the supporting infrastructure for SME development, the introduction of capacity building measures and in enhancing the access to financing. As the Secretariat to the National SME Development Council, the Bank was actively involved in developing the National SME Development Blueprint for 2006. The blueprint outlines the Government's objectives, targets and strategies, including the action plans and programmes for 2006 to accelerate the development of SMEs. An important milestone was the launch of the SMEinfo Portal, a one-stop online information gateway to provide comprehensive information to SMEs on access to financing, Government support facilities and training and development programmes for SMEs. The Portal also serves as a platform for SMEs' networking and marketing activities. During the year, SME access to financing continued to receive priority. In addition to the establishment of the SME Bank, banking institutions have launched two new trade finance products to encourage greater SME participation in the export market. Following increased access to financing from the banking sector, SME loans now account for 43% of business loans.

Significant progress was achieved in both the Islamic banking and takaful sectors in 2005. At the same time, developmental efforts in Islamic finance have also been intensified to position Malaysia as an international Islamic financial hub. These efforts have been directed towards institutional development, enhancing the domestic financial infrastructure, strengthening the Shariah and legal infrastructure, and promoting greater international integration. The year also witnessed the introduction of new foreign players and the transformation of the Islamic windows in conventional banks to Islamic subsidiaries. In addition, the Bank further strengthened the regulation and supervision of takaful intermediaries.

In line with the considerable progress made in the Islamic banking and takaful sectors, the Islamic capital market also recorded impressive developments in terms of higher issuances of Islamic papers and the introduction of innovations, which have contributed to broaden and deepen the domestic Islamic capital market. Moving forward, efforts to enhance Malaysia's position as an international Islamic financial hub will be strengthened with the establishment of the International Centre for Education in Islamic Finance (INCEIF) which will commence operations in March 2006. This represents the investment in human capital which is vital for the development of the Islamic financial services industry. INCEIF will serve as an international centre of educational excellence in Islamic finance, specialising in developing professionals and specialists in Islamic finance. Such talents are much needed to sustain market competitiveness and meet the future challenges of the Islamic financial industry. The Bank has established an endowment fund of RM500 million to support this initiative.

The payment system represents an important pillar of the overall financial system and the Bank continued to accord priority in strengthening the efficiency, reliability and security in the payment system. Continued efforts have been directed at developing and improving the major payment system infrastructure to ensure its robustness and to mitigate any systemic risks to the financial system and the wider economy. Initiatives have also been made to encourage the migration from paper-based payments to electronic payments to increase efficiency and reduce costs. Improvements in the payment systems operated by the Bank included the establishment of a "payment versus payment" mechanism to reduce inter-bank foreign exchange settlement risks and the introduction of a cheque truncation system to reduce the physical handling of cheques and its related costs. To enhance the security of payment cards, banking institutions have also successfully completed the installation of chip-based terminals in 2005, making Malaysia the first in the region to complete a national chip migration exercise. Moving forward, intensive efforts will be made to promote debit cards as an alternative and more cost-effective means of payment. Efforts have also been intensified to increase public awareness on the various payment channels, products and innovations. The agenda is essentially to increase the use of electronic payments through initiating changes in the infrastructure and processes, enhancing accessibility and facilitating the right incentive structure to encourage the active use of electronic payments.

The Bank has always accorded priority to organisational development to ensure that the Central Bank continually enhances its capacity to manage the new challenges emerging in this ever-changing environment. In addition to increased investments in staff development, changes were made in organisational structure, as well as the introduction of ICT enhancements to raise the level of connectivity, enhance access to information and to strengthen networking. Other initiatives include the adoption of a performance-based culture and further efforts toward becoming a Knowledge-Based Organisation. Attention was also given to work and space management to enhance efficiency, security and the effectiveness of the functioning of the Bank. During the year, work commenced on the construction of the Financial Services Resource Centre. Upon completion, it is envisaged that it will become a centre of excellence for knowledge and learning, to support the requirements of the Bank, as well as the South-East Asian Central Banks (SEACEN) Research and Training Centre, and the Islamic Financial Services Board (IFSB). The Centre will also house the Bank's Knowledge Management Centre, Financial Museum and Art Gallery. Given the challenging environment in which the Bank operates, these initiatives aim to ensure that the Bank delivers the expected results with the highest level of competence and professionalism.

Zeti Azis

Zeti Akhtar Aziz
Governor

22 March 2006

The Malaysian Economy in 2005

The Malaysian Economy in 2005

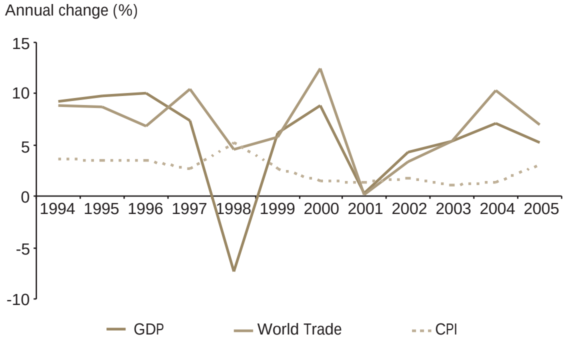
OVERVIEW

Notwithstanding the persistently high oil prices and the downturn in the global electronics cycle, real gross domestic product (GDP) expanded by 5.3%. Growth was private-sector driven and was underpinned by supportive macroeconomic policies and favorable financial conditions. Private consumer demand was sustained at a strong pace while the resilience in private investment further supported economic expansion. The public sector continued to take the opportunity of a favourable environment to consolidate its finances to more sustainable levels.

Real GDP expanded by 5.3% in 2005. Appropriate macroeconomic policies and favourable financial conditions continued to enhance economic resilience and supported balanced economic expansion.

The estimates indicate that the economy was on a balanced growth path in 2005 as potential output growth was sustained at 5.7%. As a result, the output gap, (the difference between actual and potential output expressed as a percentage of the potential output level) was low at +0.7%. The data also showed that the contribution of productivity growth to total growth had improved, suggesting the gradual shift up the productivity ladder and the more efficient utilisation of factor inputs (Details in Box 1).

Graph 1.1
Real GDP, World Trade and Inflation Rate



Growth was balanced and broad based, with most sectors of the economy, (except the construction sector) registering positive growth rates. Value added in the manufacturing sector increased by 4.9%. The developments in the manufacturing sector were influenced by the cyclical turns in the global electronics industry. The first half-year experienced slower production growth, mainly as a result of the mild downturn in the global electronics cycle which was caused by accumulation of excess inventories in the second half of 2004. Domestic manufacturers undertook an inventory adjustment exercise and rationalised production at the beginning of the year. However, the subdued performance of the electronics and electrical (E&E) industry was cushioned by the strong growth in selected resource-based industries, namely the chemical products and off-estate processing industries, as well as strong performance in selected domestic-oriented industries.

The manufacturing sector was stronger in the second half-year as the export-oriented industries regained strength and other major domestic industries continued to expand. During this period, global semiconductor sales began to pick up as global demand from both businesses and consumers worldwide increased. Sales in the Asia Pacific region improved in the second half-year (18.5%; 1H2005: 14.1%) spurred by strong demand for mobile computers due to the increasing popularity of wireless systems as well as the pick-up in global demand for consumer electronic products such as mp3 players, digital cameras, digital televisions and cellular phones. Malaysian producers, who had completed their inventory adjustment in the earlier part of the year, were well-positioned to take advantage of the higher demand and as a result, production and sales expanded. In the domestic-oriented industries, output of the food products and transport equipment industries increased due to resilient domestic demand while output of the construction-related industries contracted due to the slow construction activities.

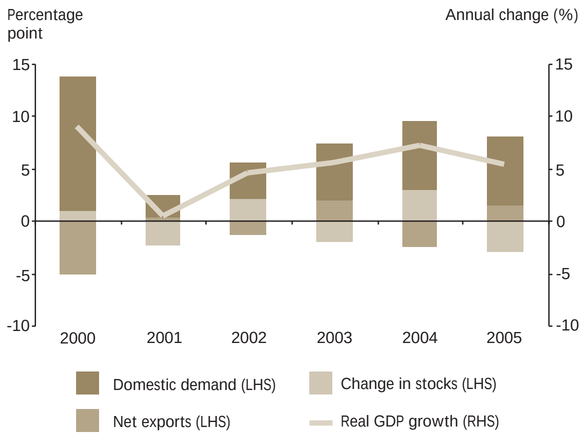
Growth in services sector was sustained at 6.5%, surpassing the overall GDP growth rate. Growth was underpinned by the strong private consumption and increased tourism and increased business activities. The expansion in the wholesale and retail trade, hotels and restaurants sub-sector (8%; 2004: 7.1%) was bolstered by strong consumer spending. Higher spending was particularly evident during certain periods of the year when there were the annual nationwide sales and the year-end festivities. In the intermediate services, the transport, storage and communication sub-sector expanded at a moderate pace of 6.3%, reflecting the lower spending of the new but less affluent mobile phone subscribers. Although world and regional trade performance was strong in 2005, it slowed from the exceptionally strong growth rates registered in 2004. This coupled with the more moderate growth in the domestic manufacturing sector tempered the growth in the transportation industry. The finance, insurance, real estate and business services sub-sector recorded a sustained growth at 5.4% during the year, as demand for funds and other financial and business services increased in tandem with economic activity. Furthermore, the new business services such as shared services and outsourcing activities continued to provide the impetus to growth in the sector.

Value added in the agriculture sector recorded a moderate increase of 2.1% in 2005. Palm oil production was markedly higher, growing by 7%, although higher yields were offset by the weaker performance in the other agriculture activities including rubber, fisheries and paddy. Growth in the mining sector also moderated (0.8%) due to lower production of crude oil, though natural gas output was substantially higher. The decline in crude oil production was a result of shutdowns of several oil installation facilities during the year for maintenance and repair purposes. In contrast, the increase in natural gas output was supported by the strong demand from the domestic power generators, industrial sectors as well as foreign buyers. The higher demand was accommodated by the increased capacity utilization at the MNLG plants.

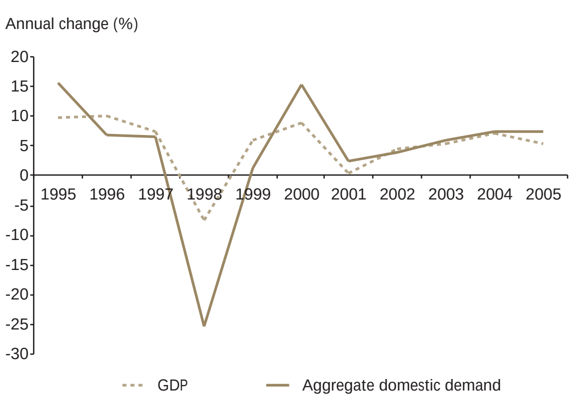
Value added in the construction sector contracted for the second consecutive year (-1.6%; 2004: -1.5%) as civil engineering activities were subdued following the completion of several large infrastructure projects in recent years. However, the residential and non-residential segments continued to expand due to resilient demand for houses and firm interest for office and retail space. Reflecting the increased demand, occupancy rates for office and retail space improved in 2005. In the residential sub-sector, continuing income growth and stable job prospects encouraged demand from households. In addition, the low interest rates and innovative property loans also supported this demand as they helped make purchases of houses affordable.

Aggregate domestic demand remained resilient, growing by 7.3%, as the economy was able to adjust to the impact of the escalating oil prices. The staggered increment of retail petrol prices did not have a disruptive effect on the cost structure of companies who continued to register reasonable profit margins. Producers had partly absorbed some of the price increases and thus moderated the increase in domestic prices. The cost-push increase was mainly seen in the transport and communications category while the core inflation remained at 2% (2004: 1%). As a result,

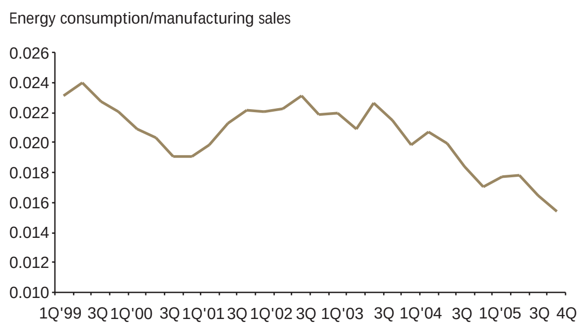
Graph 1.3
Contribution to Real GDP Growth



Graph 1.2
Real GDP and Aggregate Domestic Demand



Graph 1.4
Efficiency of Energy Usage



Source: Department of Statistics, Malaysia and Tenaga Nasional Berhad

Table 1.1: Malaysia – Key Economic Indicators

	2003	2004	2005*p*	2006*f*
Population (million persons)	25.3	26.0	26.7	27.2
Labour force (million persons)	10.4	10.8	11.3	11.5
Employment (million persons)	10.0	10.5	10.9	11.1
Unemployment (as % of labour force)	3.6	3.5	3.5	3.5
Per Capita Income (RM)	14,870	16,616	18,106	19,484
(USD)	3,913	4,373	4,781	5,145
NATIONAL PRODUCT (% change)				
Real GDP	5.4	7.1	5.3	6.0
(RM billion)	232.4	249.0	262.0	277.6
Agriculture, forestry and fishery	5.6	5.0	2.1	2.0
Mining and quarrying	5.8	3.9	0.8	5.0
Manufacturing	8.4	9.8	4.9	7.0
Construction	1.5	-1.5	-1.6	1.0
Services	4.5	6.8	6.5	6.0
Nominal GNP	10.5	14.1	11.3	9.7
(RM billion)	372.5	425.1	473.1	519.1
Real GNP	6.9	7.3	6.4	5.8
(RM billion)	217.2	233.1	248.0	262.5
Real aggregate demand[1]	6.1	7.5	7.3	5.9
Private expenditure[1]	5.5	13.1	9.5	7.4
Consumption	6.6	10.5	9.2	6.8
Investment	0.4	25.8	10.8	10.0
Public expenditure[1]	7.2	-2.1	3.1	3.0
Consumption	11.5	6.0	5.9	3.2
Investment	3.9	-8.7	0.4	2.7
Gross national savings (as % of GNP)	36.5	37.3	37.1	38.1
BALANCE OF PAYMENTS (RM billion)				
Goods balance	97.8	104.5	126.5	138.4
Exports (f.o.b.)	398.0	481.2	536.9	601.9
Imports (f.o.b.)	300.2	376.8	410.5	463.5
Services balance	-15.3	-8.8	-10.2	-10.3
(as % of GNP)	-4.1	-2.1	-2.2	-2.0
Income, net	-22.5	-24.5	-21.5	-23.7
(as % of GNP)	-6.1	-5.8	-4.5	-4.6
Current transfers, net	-9.3	-14.6	-17.0	-15.0
Current account balance	50.6	56.5	77.8	89.4
(as % of GNP)	13.6	13.3	16.4	17.2
Bank Negara Malaysia international reserves, net[2]	44.9	66.7	70.5	-
(in months of retained imports)	6.6	7.9	7.8	-
PRICES (% change)				
CPI (2000=100)	1.2	1.4	3.0	3.5 - 4.0
PPI (1989=100)	5.7	8.9	6.8	-
Real wage per employee in the manufacturing sector	2.9	1.9	0.8	-

Note: Figures may not necessarily add up due to rounding.

[1] Exclude stocks.

[2] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account.

p Preliminary

f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	2003		2004		2005*p*	
FEDERAL GOVERNMENT FINANCE (RM billion)						
Revenue	92.6		99.4		106.3	
Operating expenditure	75.2		91.3		97.7	
Net development expenditure	38.3		27.5		27.3	
Overall balance	-20.9		-19.4		-18.7	
Overall balance (% of GDP)	-5.3		-4.3		-3.8	
Public sector net development expenditure	83.3		56.7		71.0	
Public sector overall balance (% of GDP)	-4.9		4.1		1.4	
EXTERNAL DEBT						
Total debt (RM billion)	186.7		200.6		195.9	
Medium- and long-term debt	153.2		156.8		149.7	
Short-term debt[1]	33.5		43.7		46.2	
Debt service ratio (% of exports of goods and services)						
Total debt	6.4		4.6		4.7	
Medium- and long-term debt	6.3		4.4		4.5	
	Change in 2003		**Change in 2004**		**Change in 2005**	
	RM billion	**%**	**RM billion**	**%**	**RM billion**	**%**
MONEY AND BANKING						
Money supply M1	13.0	14.6	12.2	11.9	9.8	8.5
M2	42.5	11.1	108.1	25.4	82.0	15.4
M3	48.5	9.7	68.0	12.4	49.7	8.0
Banking system deposits	49.5	9.8	70.1	12.7	68.6	11.0
Banking system loans[2]	21.6	4.8	40.1	8.5	44.2	8.6
Manufacturing	-0.2	-0.3	1.9	3.2	-2.4	-3.7
Broad property sector	14.6	8.4	19.7	10.5	20.5	9.9
Finance, insurance and business services	-0.6	-2.1	1.7	5.7	-0.8	-2.6
Loan-deposit ratio (end of year)	80.9%		78.4%		77.5%	
Financing-deposit ratio[3]	91.7%		87.7%		85.8%	
	2003		**2004**		**2005**	
	%		**%**		**%**	
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)						
Overnight Policy Rate (OPR)	-		2.70		3.00	
Interbank rates						
3-month	2.87		2.80		3.20	
Commercial banks						
Fixed deposit 3-month	3.00		3.00		3.02	
12-month	3.70		3.70		3.70	
Savings deposit	1.86		1.58		1.41	
Base lending rate (BLR)	6.00		5.98		6.20	
Treasury bill (3-month)	2.77		1.96		2.96	
Government securities (1-year)	2.93		2.24		3.30	
Government securities (5-year)	4.28		3.64		3.73	
	2003		**2004**		**2005**	
	%		**%**		**%**	
EXCHANGE RATES						
Movement of Ringgit (end-period)						
Change against SDR	-8.5		-4.3		8.9	
Change against USD[4]	0.0		0.0		0.5	

[1] Excludes currency and deposits held by non-residents with resident banking institutions.
[2] Includes loans sold to Cagamas.
[3] Adjusted to include holdings of private debt securities.
[4] Ringgit was pegged at RM3.80=USD1 on 2 September 1998 and shifted to a managed float against a basket of currencies on 21 July 2005.
p Preliminary

Potential Output of the Malaysian Economy

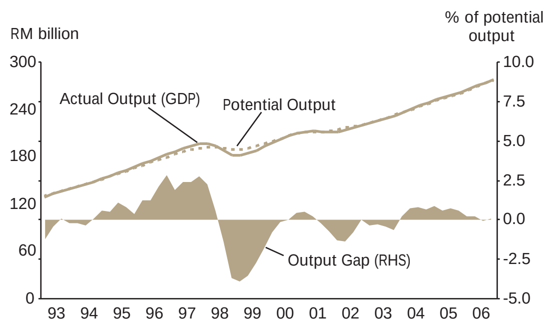
Potential output is the trend level of output that is consistent with the aggregate productive capacity of an economy. It traces the sustainable growth path of the economy. Conceptually, the growth in potential output is primarily determined by the expansion and non-inflationary utilisation of physical capital and the labour force, as well as total factor productivity (TFP) growth. TFP growth captures productivity increase arising from improvements in the utilisation of factor inputs due to technological progress and overall efficiency improvement. Therefore, the sustainability of long-term growth of an economy depends not just on factor accumulation but also crucially on improvements in skills, capital efficiency, the overall economic environment, as well as technological progress.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	(Annual change in %)				(% of potential output)
1994-1998	5.8	7.3	2.7	3.1	0.9
1999	6.1	1.0	-6.5	3.7	-3.1
2000	8.9	6.4	25.7	4.3	-0.1
2001	0.3	3.3	-2.8	1.6	0.0
2002	4.4	2.8	0.3	3.5	-0.8
2003	5.4	4.8	2.7	3.6	-0.4
2004	7.1	5.8	3.1	4.0	0.7
2005*e*	5.3	5.7	4.7	4.1	0.7

e Estimates

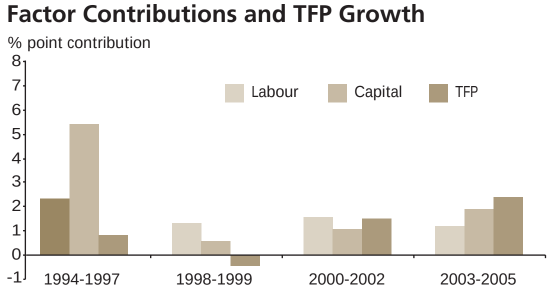
Graph 1
Actual and Potential Output



The latest estimates for Malaysia show that potential output grew at 5.7% in 2005, with the output gap[1] estimated at positive 0.7% of potential output. This indicated that the Malaysian economy was operating slightly above its potential in 2005. Overall, the period corresponding to the 8th Malaysia Plan (2001-2005) was characterised by relatively balanced growth, with the economy expanding close to its potential capacity. Amidst a backdrop of a recovering capital stock, potential output grew at an average annual rate of 4.6% compared with 4.5% for actual output during this period. The output gap, which captures the extent to which the economy is deviating from the non-inflationary trend of output, was on average less than ±1% of potential output. Despite numerous external shocks to the region and the growing global imbalances during this period, the economy did not experience any large deflationary or inflationary cycles, indicating Malaysia's growing economic resilience.

The period of 2001-2005 also witnessed a transition of the Malaysian economy in terms of factor contributions and the general level of economic efficiency. As shown in Graph 2, the growth in potential output was driven mainly by the accumulation of capital in the early 1990s, with moderate contributions from labour and TFP growth. However, beginning 1997, the contribution from capital accumulation began to decline and from 2001, TFP growth started to improve. This shift suggests that Malaysia has been moving from a factor-driven to a productivity-driven economy.

Graph 2
Factor Contributions and TFP Growth



Going forward, potential output of the economy is expected to grow at a pace of 6% in 2006 with the positive output gap closing towards the end of the year due to the continuous improvement in productivity and expansion of both capital stock and labour force. This trend of a balanced expansion of the Malaysian economy is expected to be sustained into the future, given the continued upward trend in productivity and increased resilience.

[1] The output gap is the difference between the levels of actual and potential output and the gap is measured as a percentage of potential output. A positive output gap indicates that actual output is above potential output, while a negative output gap indicates the reverse.

inflation which peaked at 3.7% in August, was lower than the increase in commodity prices. More importantly, higher energy prices also appeared to have increased the pace of transformation towards greater efficiency and drive for higher productivity in order to minimize costs, thereby helping to contain inflation at manageable levels. The data indicates a downward trend in the energy intensity of the manufacturing sector.

Private consumption increased at a strong pace of 9.2% as positive developments in the economy, in particular, the increase in job vacancies, rising disposable incomes and the accommodative financing conditions supported the growth. While consumers were affected by higher fuel prices, there was a willingness to moderate their savings rate in order to maintain their level of consumption, further underscoring their confidence on income growth and positive outlook for the economy. Reflecting this confidence, the Malaysian Institute of Economic Research (MIER)'s Consumer Sentiments Index remained over the 100-point threshold throughout 2005, rising to 116.1 by end-year. In addition, the Government took active measures, following the adjustment in administered prices by reinstating allowances to mitigate the increase in the cost of living and reducing road taxes on smaller vehicles used by the lower-income group.

Private investment registered a strong growth of 10.8% in 2005 as companies expanded their capacity, upgraded and replaced old and obsolete machinery. Although volatile energy prices may have increased the firms' uncertainty regarding the outlook for aggregate demand, this was balanced by positive factors, particularly the strengthening of the electronics cycle in the second half of the year as well sustained strength in domestic demand. Higher capital expenditure was seen in all sectors of the economy with services, mining and manufacturing sectors recording strong increases in capital expenditure. In contrast, the capital spending in the construction sector declined as a result of the end of the construction of several privatized roads.

While external demand expanded at more moderate pace compared to 2004, its contribution to growth turned positive in 2005 (1.5 ppt; 2004:-2.5 ppt). The positive contribution to growth was primarily due to exports growing (11%) at a faster rate than imports (8.5%). The expansion in exports was more subdued than in 2004 as a result of the softening of the IT sector, which was felt at the beginning of the year. Exports of primary commodities however remained strong (16%, 2004: 21.8%) reflecting the higher prices of crude oil and liquefied natural gas (LNG). Malaysian crude oil, which is of the "light sweet", grade commands a premium over the "heavy and sour" crude grade.

Import growth moderated to 8.5% (2004: 26.4%), resulting in a larger trade surplus. The slower growth in imports of intermediate goods reflected the subdued performance of the E&E sector. As a result, the trade surplus widened to RM99.8 billion (2004: RM80.7 billion).

The services account recorded a larger deficit of RM10.2 billion (2004: -RM8.8 billion) as the smaller deficit in the transportation account was offset by higher payments for travel abroad as well as a higher deficit in the other services account. Similarly, the income account also recorded a deficit in 2005, albeit smaller than in 2004 (-RM21.5 billion; 2004: -RM24.5billion). Outflows of profits and dividends accruing to foreign investors was partly offset by higher receipts from earnings accruing to Malaysian investors abroad as well as higher returns on the external reserve holdings. The combined effects of a wider trade surplus with a smaller income account deficit resulted in a higher current account surplus of 16.4% of GNP, the highest level achieved since 1999 (2004: 13.3%).

Given its strong fundamentals and the structural changes taking place in the region, Bank Negara Malaysia adjusted the exchange rate regime on 21 July 2005, moving from a pegged exchange rate against the US dollar to a managed float. The more flexible regime allows Malaysia to respond to changes in the international and domestic environment. The ringgit since appreciated to reach 3.7460 to the US dollar before closing the year at 3.78. Reflecting Malaysia's strong external conditions, the rate has continued to improve further to 3.7055 in 3 March 2006.

Speculative portfolio investment, which flowed in at the beginning of the year in anticipation of an appreciation of the ringgit, was unwound in the second half of the year. The portfolio flows have subsequently returned to normal levels in an orderly price discovery process. Apart from the portfolio funds, the larger repayment of external loans by the public sector and larger extension of trade credits by Malaysian exporters also contributed to the outflows in the financial account during the period. As a result of these outflows, the financial account recorded a net outflow of RM42 billion in 2005 (2004: +RM15.1 billion).

On a gross basis, foreign direct investment (FDI) increased to RM25 billion (2004: RM23.5 billion), or 5.3% of GNP. The FDI inflows were seen mainly in the services, oil and gas and manufacturing sectors. In the services sector, the FDI inflows were broad based, channeled mainly into the finance, insurance and business services as well as restaurants, hotels, wholesale and retail sub-sectors. Reflecting the increased interest by Malaysian companies to diversify abroad, outflows for overseas investment also increased.

The current account surplus remained and more than offset the net outflow in the financial account and foreign exchange revaluation losses arising from the strengthening of ringgit against the major currencies. As such, the international reserves increased further to RM266.3 billion or equivalent to USD70.5 billion at end 2005. By 28 February 2006, the international reserves level rose further to RM272.7 billion or USD72.2 billion, adequate to finance 7.6 months of retained imports and is 6.7 times the short-term external debt.

Malaysia's external debt declined to RM195.9 billion in 2005 (2004; RM200.6 billion), reflecting mainly the higher repayment of external loans by both the Federal Government and the non-financial public enterprises (NFPEs). The repayments by the Federal Government marked the maturity of a Euro bond issued in 2000 and some scheduled principal repayments of syndicated loans while in the case of the NFPEs, the maturity of US dollar-denominated bonds as well as prepayments of several loans. In contrast, the slight increase in short-term debt was due mainly to the increase in short-term debt of the banking sector arising from hedging activities on trade-related transactions and treasury activities. Malaysia's external debt position remains sustainable with the debt service ratio holding steady at 4.7% with its ratio to GNP declining to 41.4% (2004: 47.2%). Further, the short-term debt remained low, accounting for only 23.6% of total external debt.

In an environment of economic expansion and macroeconomic stability, financial sector soundness continued to improve. Capitalisation remained strong, accompanied by continued growth in profits and in the quality of loan portfolios. The capital position of the banking system remained strong with the risk-weighted capital ratio (RWCR) and core capital ratio (CCR) at 13.1% and 10.2% respectively (2004: 14.4% and 11.4% respectively). In addition, the improvements in the asset quality of the banking system were evident, with the 6-month net non-performing loan (NPL) ratio improving to 4.6% (2004: 5.8%) while the 3-month net NPL improved to 5.8% (2004: 7.5%).

Macroeconomic Management

The prudent macroeconomic management by the Government further enhanced fundamentals of the Malaysian economy in 2005. The current account in the balance of payments remained in surplus, savings remained high, reserves increased, inflation remained at manageable levels and the external debt declined. In this context of sustained growth performance and fundamentals, the Government's continued commitment to strengthen its budgetary position was reflected in the narrowing of its budgetary deficit to 3.8% in 2005 from 4.3% of GDP in 2004. The Government's focus was on reallocating resources to smaller projects particularly in agriculture, construction, housing and for infrastructure development in rural areas. This progressive reduction in the deficit would provide the policy flexibility for the Government to mitigate potential adverse effects from uncertainties in the external sector. The Government recognised the need to help mitigate the higher international oil prices while ensuring price signals were transmitted efficiently, thus allowing economic agents to make the necessary adjustments to these developments. In 2005, the Government removed the price subsidies gradually, while in early 2006, a further adjustment was made to fuel prices effective 28 February. In order to improve predictability and allow agents to plan ahead, the Government also announced that no further adjustments would be made in 2006.

Macroeconomic management in 2005 focused on sustaining economic growth while improving the capacity of the economy to generate sustainable growth.

In managing the economy, public policy in 2005 focused on accelerating the shift towards higher value-added activities, strengthening the business environment to develop new sources of growth and enhancing competitiveness. In Budget 2005, the incentive structure was enhanced further to promote investment, particularly in new areas in the agriculture, manufacturing and services sectors, while efforts at improving the delivery system were intensified. In particular, the National Biotechnology Policy (NBP) was launched on 28 April 2005, to be implemented in three phases over 15 years. The objectives of NBP are to promote the establishment of new companies in order to develop the sector. When fully implemented, the biotechnology industry is expected to contribute up to 5% of GDP and provide strong links to upstream activities, most notably agriculture and manufacturing. Another important initiative taken was the setting up of the Tax Review Panel to ensure a more efficient tax system that is business-friendly and provides greater clarity and transparency.

To further enhance and promote the activities by small- and medium enterprises (SMEs), the National SME Development Council, which is chaired by the Prime Minister and with Bank Negara Malaysia acting as the

Secretariat, announced new initiatives to accelerate SME development. New trade financing products were introduced; SME info portal and online training portal were launched; a comprehensive definition for SMEs in various sectors for targeted development was released; and a framework for SME Development Planning and Evaluation was developed. The Council also endorsed the National SME Development Blueprint 2006, which includes a total of 245 programmes in all sectors to accelerate the development of SMEs. An allocation of RM3.9 billion has been committed by the Government to implement these programmes. The SME Bank commenced operations on 3 October 2005 to promote and expand SMEs contribution to the economy. The SME Bank specialises in providing both financial and non-financial assistance, including meeting business advisory needs, and providing education and training to SMEs. To further promote Malaysia's export of goods and services, the functions of Malaysia Export Credit Insurance Bhd (MECIB) has been absorbed by the Export Import Bank of Malaysia, in an effort to further improve the facilities for Malaysian exporters to enhance their competitiveness in the global market.

Development of Small and Medium Enterprises

The development of competitive small and medium enterprises (SMEs) is an important focus of Government policy. The efforts are aimed at:
- strengthening enabling infrastructure for SME development;
- building the capacity and capability of SMEs; and
- enhancing access to financing by SMEs.

The National SME Development Council[1] has provided the strategic direction for the Government policies on SME development so as to ensure coordination and effectiveness of Government programmes for SMEs.

(i) Strengthening Enabling Infrastructure for SME Development

(a) Framework for SME Development Planning and Evaluation

In view of the extensive SME programmes undertaken by a large number of Ministries and Agencies, it is important to ensure that the implementation of these programmes are coordinated and effective in developing the SMEs. A Policy Formulation and Evaluation Framework has been introduced to enhance the formulation and coordination of SME policies and programmes, as well as to monitor the implementation and outcomes of the programmes. The Framework involves the identification of broad strategic priorities, programmes and targets for SME development, as well as the establishment of comprehensive key performance indicators to evaluate effectiveness of the programmes on an annual basis.

(b) National SME Development Blueprint 2006

Following the adoption of the Framework for SME Development Planning and Evaluation, the National SME Development Blueprint for 2006 (Blueprint 2006) was endorsed by the Council in December 2005. The Blueprint 2006 is a one-year action plan of the Government to promote the development of SMEs. It outlines the following:
- Objectives and targets for SME development in 2006;
- Key strategies, programmes and financial commitments; and
- Ministries and Agencies involved in implementing these programmes.

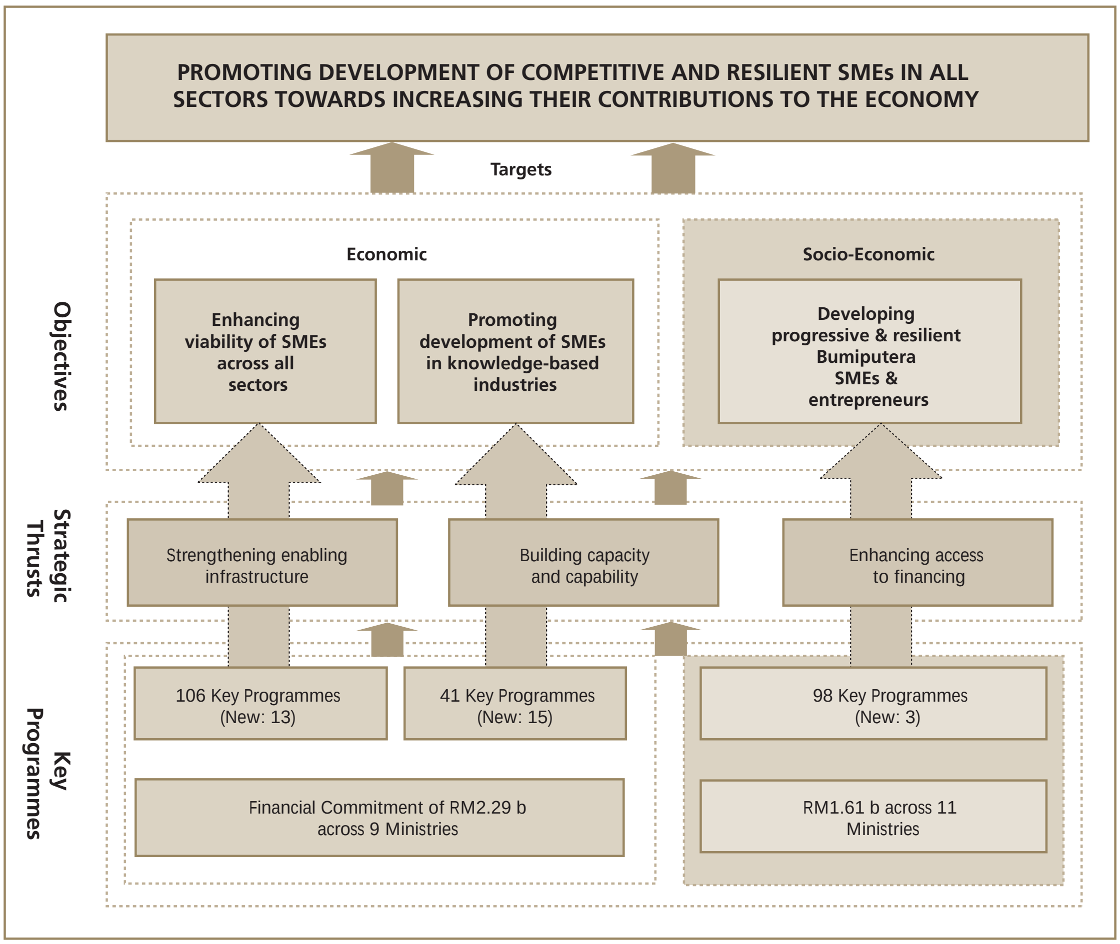
For 2006, a total of 245 programmes involving financial commitment of RM3.9 billion have been identified for implementation to accelerate the development of SMEs. These are aimed at strengthening the enabling infrastructure to support SME development; building the capacity and capability of SMEs; and enhancing SMEs' access to financing. The programmes will cover all sectors, including SMEs in agriculture and agro-based industries, and those involved in knowledge-based industries. Efforts will also be directed to developing progressive and resilient Bumiputera entrepreneurs and SMEs.

[1] The National SME Development Council is chaired by the Prime Minister and comprises of Ministers and Heads of 18 key Ministries and Agencies involved in SME development.

A total of 170 key programmes will be implemented to build capacity and capability of SMEs, mainly in the areas of entrepreneurial and human resource development, as well as marketing and promotion. These include programmes to inculcate entrepreneurship at schools and institutes of higher learning, as well as initiatives to assist SMEs in expanding their market network, through market expansion programmes and developing linkages with large corporations, government-linked companies and hypermarkets.

Forty-two key programmes will be implemented to strengthen the infrastructure to support SME development, which include incentives to encourage SMEs to upgrade their business premises as well as establishment of incubation centres. For greater access to financing, 33 key programmes will be

Overview of SME Development: Objectives, Strategies, Key Programmes and Financial Commitment in 2006



implemented in 2006. These include the establishment of a RM300 million venture capital fund for agriculture, an additional RM300 million allocation for the Fund for Food, pre-seed funding for the ICT sector and the transformation of the Credit Guarantee Corporation Berhad to further strengthen the infrastructure for SME financing.

(c) Adoption of Definitions for SMEs in Malaysia

All Ministries, Agencies and financial institutions involved in the development of SMEs have adopted the new definitions of SMEs in the primary agriculture, manufacturing, manufacturing-related services and services sectors. The definitions are based on the criteria of annual sales turnover or number of full-time employees. The adoption of a common identifier for SMEs in these sectors will facilitate the identification of issues and prospects of the sectors concerned to enable appropriate policy actions to be taken. It will also allow for closer monitoring of SME performance and contribution to the economy.

(d) Profile and Contribution of SMEs to the Economy

The availability of relevant data on the development and performance of SMEs is critical to facilitate the formulation of effective policies to support the creation and growth of SMEs. As a result, the Census of Establishment and Enterprise for the agriculture, manufacturing and services sectors was launched in March 2005, covering about 1.7 million companies and businesses. At end-December 2005, 492,806 completed responses were received. A preliminary assessment of responses from 349,617 companies and businesses (including large enterprises) highlighted the following:

- Of the 349,617 establishments, 99% or 346,211 respondents are SMEs (including microenterprises). Of this, 81% are microenterprises operating with less than 5 full-time employees, while 17% and 2% are small and medium enterprises respectively; and
- The SMEs contributed to 38% of total output and accounted for 55% of total workforce of these 349,617 business establishments.

The preliminary findings reinforced the need for aggressive efforts to be undertaken in a strategic and coordinated manner to support the expansion of SMEs and strengthen their capacity and competitiveness, given the potential for them to contribute more effectively to the nation's economy. A detailed analysis of the profile and performance of SMEs will be provided in the first Annual Report on SME Development 2005, scheduled to be released in June 2006.

(ii) Building Capacity and Capability of SMEs

(a) SMEinfo Portal: A One-Stop Online Information Gateway for SMEs

The SMEinfo Portal (www.smeinfo.com.my), launched in January 2006, is a one-stop online information gateway to provide comprehensive information on all aspects of SME development. The SMEinfo Portal provides SMEs with convenient access to information on Government support and development programmes, financing, advisory services and training programmes. In addition, the Portal also provides links to relevant websites that contain useful information for SMEs, including websites of financial institutions. An important feature of the Portal is the free SME Directory, which offers an opportunity for SMEs to advertise their companies and products to large potential customers.

(b) Online Training Portal for SMEs

To facilitate SMEs to obtain information and register for training, the Human Resource Development Portal (HRD Portal), a web-based training portal developed by Pembangunan Sumber Manusia Berhad, was launched in March 2005. The HRD Portal, www.hrdportal.com.my, will assist employers to search, identify and register for training programmes online, and at the same time, allow training providers to offer their training programmes and activities online. By providing access to a central pool of training information, the HRD Portal will facilitate and encourage employers, particularly SMEs, to retrain and upgrade the skills of their employees in order to enhance productivity and competitiveness.

(c) Publication of Annual Report on SME Development

A report on SME development, that will provide a comprehensive assessment on the status and performance of SMEs in all sectors, as well as details and achievements of the Government's programmes for SMEs, will be published every year. The publication is part of the initiatives to enhance the dissemination of information on SMEs, and therefore, increase the awareness among SMEs and others on the status of SME development and programmes to support SMEs. The Annual Report on SME Development 2005 is scheduled for release in June 2006.

(iii) Enhancing Access to Financing by SMEs

Banking institutions are the largest provider of financing to SMEs. In 2005, the banking system approved RM35.8 billion of new loans to more than 85,000 SME accounts, representing an increase of 13.1% from 2004 (2004: RM31.6 billion; 92,000 SME accounts). Loan disbursements grew by 10.2% to RM110.7 billion (2004: RM100.4 billion), while loans outstanding to SMEs expanded by 8.7% to RM96 billion as at end-2005 (end-2004: RM88.3 billion). Loans to SMEs accounted for 42.6% of business loans outstanding as at end–2005, compared with 40.3% as at end 2004. On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to distributive trade, manufacturing and construction sectors. Gross non-performing loans (NPLs) of SMEs declined marginally to RM10.2 billion and the gross NPL ratio declined to 10.6% (end-2004: RM10.6 billion; 12%).

A number of development financial institutions (DFIs) also provide financing to SMEs. In 2005, the DFIs approved RM2.3 billion of loans to 5,223 SME accounts (2004: RM2.4 billion to 5,397 SME accounts), and disbursed RM1.5 billion (2004: RM1.2 billion). The loans outstanding of DFIs to SMEs increased by 3.3% to RM3.1 billion as at end-2005 (end-2004: RM3 billion). Another source of financing for SMEs is the leasing and factoring companies, which provide an alternative mode of financing to finance equipment and working capital requirements. In 2005, RM819 million of financing was extended by leasing and factoring companies to businesses in services, manufacturing and general commerce sectors (2004: RM996 million). For newly established businesses, especially in the ICT sector, financing could also be obtained from venture capital companies. The total available funds for venture capital investments increased by 14.3% to RM2.6 billion as at end-2005 (end-2004: RM2.3 billion). The funds were invested in 380 companies as compared with 332 companies as at end-2004.

Special Funds for SMEs

Bank Negara Malaysia has five special funds to assist SMEs to have access to financing at reasonable costs (lending rates ranging from 3.75% to 5.00%). The funds are channeled through participating institutions comprising banking institutions, DFIs and ERF Sdn. Bhd.:

- Fund for Small and Medium Industries 2 (fund size: RM4.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.35 billion);
- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

Due to strong demand, allocations for the Fund for Small and Medium Industries 2 and New Entrepreneurs Fund 2 had been increased in 2005 by RM250 million and RM350 million to RM4.75 billion and RM2.35 billion respectively.

Initiatives to Improve Access to Financing by SMEs

The policy on enhancing access to financing by SMEs during the year continued to focus on:

- Strengthening the existing infrastructure to ensure a more effective intermediation of funds to SMEs;
- The provision of advisory support and awareness programmes; and
- Assisting in debt restructuring of financially distressed SMEs with viable business.

Among the new initiatives introduced in 2005 are:

(a) Transformation of Credit Guarantee Corporation Malaysia Berhad

One of the initiatives to strengthen the infrastructure of SME financing is the transformation of Credit Guarantee Corporation Malaysia Berhad (CGC) involving the enhancement of its role and expansion in the range of products and services offered by CGC. In enhancing SMEs' access to financing, CGC will take a holistic approach by providing wider range of credit enhancement products, advisory services on financial and business development, and credit information services. These services are aimed at facilitating greater lending to SMEs while promoting sound financial management practices by SMEs. To meet its new expanded role, the composition of the Board of CGC has been broadened to include members with experience in business and finance, while efforts are being taken to strengthen the resources of CGC.

(b) Venture Capital for Agriculture Sector

To support the Government's objective of realising the potential of the agriculture sector as the third engine of growth, Bank Negara Malaysia is establishing two venture capital funds of RM150 million each for the agriculture sector in 2006. The objective of the funds is to create and develop an integrated agricultural business through the provision of venture capital financing, as well as technical and business support, with its spill over effects that will benefit and enhance the whole value chain of the agriculture sector. The targeted areas for investments are integrated farming and fisheries, as well as biotechnology-related ventures.

(c) Establishment of the SME Bank

The SME Bank commenced operations on 3 October 2005 as a result of integration and rationalisation exercise between Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad, to support the development of the SME sector. The SME Bank will complement the banking institutions through the provision of financial and business support services to the SMEs. These include equity financing, working capital, term loans, industrial hire purchase, leasing, factoring, contract financing as well as bank guarantees. In addition, the SME Bank will also provide business and consultancy support services, such as advisory services and preparation of business plans.

(d) New Trade Finance Products for SMEs

Two new trade finance products for SMEs were introduced in January 2006, namely the Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS), under both conventional and Islamic financing. These products are aimed at encouraging SMEs to export their goods and services, particularly to the non-traditional markets such as members of the Organisation of Islamic Countries. The MCTF provides financing to Malaysian direct exporters in Ringgit and major foreign currencies in the form of pre and post shipment financing. The IEFS provides Ringgit financing to indirect exporters without recourse, whereby the participating banks will discount their trade invoices arising from the supply of goods and services to direct exporters. These products benefit the SMEs by lowering financing costs, without collateral requirements. Under the arrangements, the SMEs can obtain financing from the participating banks, with the credit risks being shared between the bank and Export-Import Bank of Malaysia Berhad.

Financial Advisory Service

Bank Negara Malaysia provides financial advisory services to SMEs in the following areas:

- information on various sources of financing;
- assistance in facilitation of loan application process; and
- advice on financial requirements and problems of SMEs.

In 2005, the number of enquiries and assistance sought by SMEs increased to 4,019 cases (2004: 1,399 cases) reflecting heightened awareness among SMEs as well as a result of the establishment of Laman Informasi, Nasihat dan Khidmat (LINK), in Bank Negara Malaysia, Kuala Lumpur. Of these, 81% were enquiries on special funds provided by the Government and advice on loan matters, and 19% were complaints against financial institutions, mainly for cases of loan rejection and poor response on SMEs' loan applications.

Performance of Small Debt Resolution Scheme

The Small Debt Resolution Scheme was established on 1 November 2003 to facilitate the restructuring of non-performing loans (NPLs) of SMEs with on-going business. Under the mechanism, a Small Debt Resolution Committee undertakes independent assessments on the viability of the businesses, loan restructuring and financing requirements of the SMEs.

As at end-2005, 394 applications with NPLs of RM278 million were received under the scheme (end-2004: 228 applications with NPLs of RM180.2 million). Of these, 286 applications, involving NPLs of RM183 million, have been approved for restructuring and RM16 million new financing was approved under the Rehabilitation Fund for Small Businesses. A total of 83 cases, with total NPLs of RM83 million, were rejected due to non-viability. Another 25 cases involving NPLs of RM12 million are being evaluated as some of the cases could not be processed due to the inability of applicants to provide the necessary information required to facilitate evaluation. The performance of the scheme has shown that the restructuring of NPLs is more important than the provision of new financing in ensuring the viability and sustainability of financially distressed SMEs.

In addition to new initiatives, the Government implemented further new measure to improve delivery system and quality of services. A number of customer service offices and one-stop centres were established, leveraging on ICT to expand public sector's reach and response time to investors, businesses and consumers.

Moving forward, the 2006 Budget put forth various pro-active measures to enhance national resilience and the ability to face external challenges, arising from higher oil prices, higher global interest rates and increasing global competition. Incentives have been given to develop new growth areas such as biotechnology, high technology manufacturing and ICT industries. The National Biofuel Policy was launched at the end of 2005 to encourage private sector involvement in the production of biodiesel. In terms of special development funds, the Government has announced an increase of RM300 million for the Fund for Food; the creation of Malaysian Life Sciences Capital Fund for investment in biotechnology with RM100 million contribution from the Government; and an RM1 billion fund to assist and encourage local entrepreneurs, especially *bumiputeras*, to venture abroad via facilities such as trade financing, overseas projects financing and credit insurance guarantee. In addition, selected companies undertaking ICT and multimedia services will be given Pioneer Status, which allows for tax exemption or tax allowances of up to 50% for five years. The Government increased the pace of developing the Multimedia Super Corridor (MSC) by awarding the status to cybercities of Bayan Lepas, Pulau Pinang and the Kulim High Technology Park in Kedah. The Government also continues to support the development of soft infrastructure by providing a large allocation to the education and training sector, focusing on developing skills in order to increase productivity and value-add from the workforce.

The overall motivation of macroeconomic management of Malaysia is the policy of pursuing balanced growth in an environment of social and political stability. At end-March 2006, the Government will launch the Ninth Malaysia Plan (9MP), 2006-2010, which provides the foundation for further development and strengthening the prospects for the Malaysian economy. The Plan will also focus on the importance of making progress in the new growth areas in order to achieve the successful transformation of Malaysia into a more resilient knowledge-based economy, while re-emphasising the Government's commitment to maintaining macroeconomic stability.

The monetary policy stance in 2005 aimed to promote sustainable growth in an environment of price stability. In formulating the stance of monetary policy, Bank Negara Malaysia undertakes a careful assessment of the risks to inflation and economic growth. In 2005, a particular challenge was to respond appropriately to the higher oil prices, recognising that price increases arose due to a multitude of factors with cost-push factors being dominant. Following the increases in transportation charges and retail prices of petrol and diesel in May, the inflation rate breached the 3% level. Demand-driven inflation, as measured by core inflation, was however well contained and registered a more gradual increase in the first half of the year. Real and monetary indicators did not suggest that demand pressures were a source of inflationary concern. Growth, which had been high at 6.2% in the first quarter, had also slowed to 4.4% in the second quarter.

Consumption and investment activity appeared to hold steady while financing activities and money supply continued to increase at relatively stable rates. In the second half of the year, the growth momentum picked up, with private sector demand growth becoming more entrenched. In the third quarter, real GDP growth accelerated to 5.3%, with the outlook for external demand becoming more optimistic. Growth in the global economy had remained relatively resilient to the higher oil prices while the semiconductor down-cycle had reached its trough by mid-year, with global sales and shipments picking up thereafter. Consequently, the Overnight Policy Rate (OPR) was raised by 30 basis points to 3% on 30 November 2005 to align the rates to the prevailing monetary conditions. At 3%, the OPR continued to remain below its neutral level, and therefore, continued to remain supportive of economic activity. With the release of the fourth quarter GDP data, which showed that the growth momentum was sustained at 5.2% while the underlying pressure on prices remained strong, Bank Negara Malaysia raised the OPR by another 25 basis points on 22 February 2006.

The institutional framework for developing, implementing and communicating monetary policy was further enhanced in 2005. Starting in December 2005, the Monetary Policy Committee (MPC) decided that the Monetary Policy Statement (MPS) would be issued after every MPC Meeting, further enhancing the transparency in communicating monetary policy. The December announcement also included the schedule of MPC meetings for 2006. This would allow market participants to better anticipate and understand Bank Negara Malaysia's policy stance and direction.

On the external front, there was an increase in net portfolio flows in the first half year, following speculation that there would be a revaluation of the Chinese yuan resulting in an appreciation of regional currencies including the ringgit. These inflows were at manageable levels and Bank Negara Malaysia sterilised the additional liquidity. On 21 July, Bank Negara Malaysia announced the change from a fixed exchange rate system to a managed float exchange rate regime. The ringgit's value is now based on a basket of currencies of major trade partners and regional countries. The new arrangement would enhance economic flexibility without sacrificing the stability accorded by the previous arrangement. Following the floating of the ringgit, speculative portfolio positions that had been built-up in the first half of the year were unwound. The unwinding of these flows was orderly, indicating that the price discovery process in the financial markets has been able to function efficiently. The strong reserves level provided an added cushion for these outflows, some of which were large, while the domestic financial system continued to operate in an environment of ample liquidity.

Of significance, the change to the floating rate regime was preceded with the setting up of the necessary risk management infrastructure to ensure a smooth transition. Rules on hedging were liberalised in April 2004 to allow both residents and non-residents to enter into hedging arrangements with licensed onshore banks. The rules allow greater flexibility to residents in managing their investments by facilitating wider options and avenues for risk management. In addition, Bank Negara Malaysia took steps to further liberalise the foreign exchange administration rules in order to improve the delivery system and enhance flexibility in the financial system and the economy. Effective 1 April 2005, further changes were made to give greater flexibility for overseas investment, including changing the thresholds for investment abroad, extension of credit facilities to non-residents and placement of funds by residents. Residents are also now allowed to open foreign currency accounts onshore or offshore, without requiring the approval from the Central Bank. Similarly, limits on foreign currency credit facilities that can be obtained by residents have been increased.

In managing the financial sector, the year saw further progress in implementing the longer-term development plans for the sector. With the Financial Sector Masterplan (FSMP) entering the second of its three phases, the stages was set in 2005 to create investment banks. Investment banks would mainly be involved in capital market activities and would be formed by the rationalisation of merchant banks, stock-broking companies, and discount houses. Similarly, universal brokers would also be allowed to seek partners to form investment banks. This integration will enhance the efficiency and effectiveness of capital market players by minimising duplication of resources and overlapping of activities, leveraging on the common infrastructure and reaping benefits of synergies and economies of scale. The framework is among the key initiatives to strengthen the capacity and capabilities of domestic banking and financial groups to contribute towards economic transformation and developing a more resilient, competitive and dynamic financial system. Another sign of the growing maturity of the financial system was the announcement that the limits to foreign ownership in local investment banks was now raised to 49%, compared with 30% for domestic banking groups.

To further increase competition in the banking industry, operational flexibility has been awarded to the locally incorporated foreign banking institutions (LIFBs) operating in Malaysia. LIFBs are allowed to establish four additional branches in 2006, which represents the first of a phased approach of branching liberalisation. This will allow greater participation of LIFBs in financial intermediation to all segment of the Malaysian society and economy. The wider dispersion of LIFB's branches across the country will further enhance consumers' access to a wider range of banking services and increase competition in providing wider spread of products to less developed areas of the country. The policy of gradually deregulating and liberalising the banking system is complementary with the objectives of bringing increased benefits by lowering the cost of intermediation and increasing the quality of financial services provided.

In the capital market, the launch of RM760 million Wawasan Bond by the International Bank of Reconstruction and Development (IBRD) in April 2005 was a significant development. This issuance further widened and deepened the domestic bond market. The Government has also issued short-term Islamic Treasury Bills and longer-term Islamic bonds to meet investor demand and diversify further Islamic financial instruments. Ensuring tax neutrality between Islamic and conventional capital market products would further facilitate the development of the Islamic bond market. To further enhance market turnover, Bank Negara Malaysia has actively used repurchase agreements (repo) since January as a monetary instrument, introduced the Institutional Custodian Programme to enable borrowing and lending of securities, and provided a securities lending facility for principal dealers. The implementation of these measures are also aimed at improving the price discovery process and increasing liquidity in the financial market and the development of a reflective benchmark yield curve. The ringgit bond market has continued to become an increasingly important source of financing to the economy.

In 2005, Bank Negara Malaysia adopted a multi-pronged approach in empowering consumers. In strengthening the consumer protection and education infrastructure various initiatives were implemented, and these include the establishment of Bank Negara Malaysia LINK *(Laman Informasi Nasihat dan Khidmat)*, the introduction of Basic Banking Services Framework, the establishment of the Financial Mediation Bureau, the introduction of a Deposit Insurance System and the establishment of the Credit Counselling and Debt Management (CCDM) Agency. In particular, the Bank Negara Malaysia LINK aims to enhance the effectiveness of Bank Negara Malaysia's interface with the public and is established as a centralised point of contact with the public on issues that relates to Bank Negara Malaysia's policies and operations, the financial sector and consumer education in the area of finance. Bank Negara Malaysia LINK also assists SMEs on issues that relate to access to financing by providing a centralised point of contact, and thereby contributing towards enhancing their contribution to the economy. These initiatives involve both infrastructure and institutional capacity development that includes financial education, advisory services, distress management, rehabilitation and putting in place avenues for redress. These steps are part of the efforts to ensure stability of the financial system as promoting a sound and progressive financial system is a pre-requisite to achieving sustainable economic growth and development.

SECTORAL REVIEW

Manufacturing Sector

Value added in the manufacturing sector grew at a moderate pace of 4.9% in 2005 (2004: 9.8%), as the domestic electronics and electrical product (E&E) segment experienced a soft patch in the first half of the year following the mild downturn in the global semiconductor industry. However, the slowdown was brief and by the second half of the year, the recovery in the E&E segment led to a stronger performance of the manufacturing sector (2H: 6.4%; 1H: 3.8%). The impact was also cushioned by continued growth in selected resource-based industries, such as the chemical products and off-estate processing industries. In the domestic-oriented industries, food and beverages and paper products industries also strengthened further during the year, while the transport equipment industry was firm supported by the strong domestic consumption. However, industries that are related to the construction sector, namely basic metal, non-metallic mineral products and fabricated metal products remained weak affected by the subdued performance of the construction sector.

The manufacturing sector continued to contribute to growth despite the slowdown in the electronics and electrical (E&E) product segment. The E&E recovery in the second half-year improved the performance in the manufacturing sector.

In 2005, the share of the manufacturing sector to overall GDP was largely unchanged at 31.4% (2004: 31.6%). Given the continued additions in capacity amidst the new investments, the overall capacity utilisation rate of the manufacturing sector was lower at 75% in 2005 (2004: 79%). The export-oriented industries operated at 77%, while the domestic-oriented industries operated at 73% during the year (2004: 81% and 75% respectively).

Based on the latest statistics from the revised Industrial Production Index (2000=100), manufacturing production grew by 5.1% in 2005 (2004: 12.8%). Of significance, output growth of the **electronics and electrical products (E&E)** industry

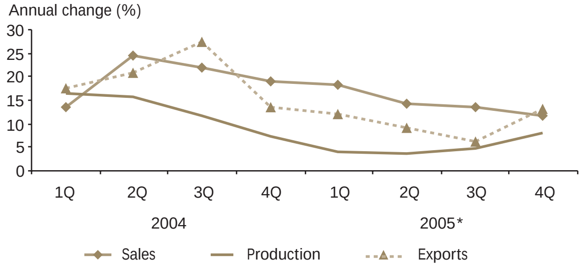
Table 1.3
Manufacturing Sector: Value Added and Production

	2004	2005
	Annual change in (%)	
Value-added (Constant at 1987 prices)	**9.8**	**4.9**
Overall Production	**12.8**	**5.1**
Export-oriented industries	**14.8**	**5.7**
of which:		
Electronics	25.6	5.2
Electrical products	5.5	-0.8
Chemicals and chemical products	15.1	11.0
Petroleum products	9.8	10.8
Textiles, wearing apparel and footwear	-4.8	3.4
Wood and wood products	12.8	1.5
Rubber products	8.1	-0.4
Off-estate processing	2.7	8.1
Domestic-oriented industries	**5.2**	**2.8**
of which:		
Construction-related products	1.3	-0.5
Food products	2.0	7.6
Transport equipment	11.7	8.5
Fabricated metal products	11.4	-4.9

Source: Department of Statistics, Malaysia

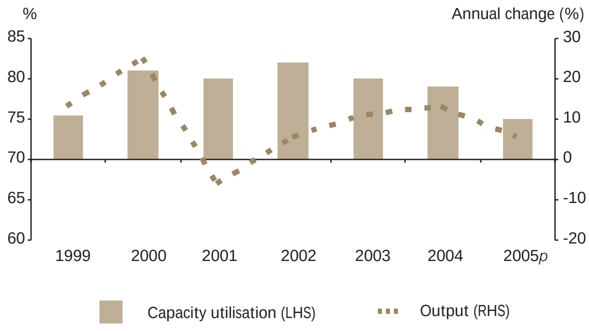
slowed down to 3.5% in 2005 (2004: 19.3%) affected by the global semiconductor down-cycle in the first half of the year. In an environment of an oversupply situation, while world demand continued to remain relatively steady, an early inventory adjustment by industry players across the various segments helped in the speedier recovery process during the second half of the year. Of significance, producers in the computer segment had normalised their inventory levels by the end of first quarter of 2005. Furthermore, global demand for computers was also supported by a structural shift in consumer demand from desktop computers to mobile and

Graph 1.5
Manufacturing Sector: Sales, Production and Exports



* 2005's production data were based on the new IPI figures (2000=100).

Graph 1.6
Capacity Utilisation in the Manufacturing Sector



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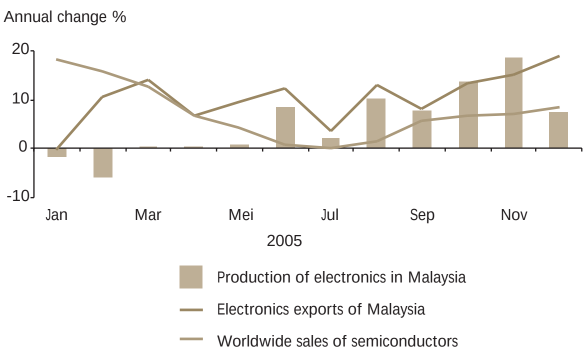
Output data from 2001 onwards is based on the new Industrial Production index (2000=100)
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

portable computers, such as laptops, pocket personal computers (PCs) and handheld PCs with wireless connectivity function. Being a major exporter of computers with renowned multinational companies operating in Malaysia, the country had benefited from the positive developments in the computer segment throughout 2005. Computers and parts accounted for 27.5% of total manufactured exports and 41.8% of the E&E exports.

Despite the slowdown, domestic E&E manufacturers continued to invest and upgrade to higher value-added products. Of significance, major European electronics manufacturers continued to shift some of their production lines of more advanced semiconductors to Malaysia to benefit from the cost-efficient and matured manufacturing base. The move had broadened and deepened the industrial linkages within the sector.

By the second half of 2005, the global semiconductor industry began to show signs of recovery. Global semiconductor sales compiled by the Semiconductor Industry Association (SIA) gradually picked up to record a growth of 8.6% by December 2005 after bottoming out in July 2005. The US book-to-bill ratio of semiconductor equipment also rebounded to 0.93 by-end 2005 from its low of 0.77 recorded in February and the US new and unfilled orders continued to register positive growth. Industry experts expect the recovery to become more entrenched in 2006 and to continue into 2007. Growth would be increasingly broad based, supported by expansion in all categories of semiconductors, particularly consumer electronics which is expected to be the next driver of growth in the E&E industry.

Graph 1.7
Production and Exports of the Electronics Industry



The **chemicals and chemical products** industry continued to register a double-digit growth in 2005 (11%; 2004: 15.1%), led mainly by the strong growth in production of plastic products (21.5%; 2004: 19%) and other chemical products (10%; 2004: 25.5%). Higher domestic and external demand, emanating from the packaging, household and automotive segments supported the stronger expansion in the output of plastic products. Meanwhile, production of other basic industrial chemicals expanded further in 2005 due mainly to higher production of oleochemicals, which is a derivative of crude palm oil.

The **off-estate processing industry** recorded a robust growth in 2005, expanding by 8.1% (2004: 2.7%) benefiting from the higher output of crude palm oil during the year. Production of palm oil expanded at a faster rate of 7% (2004: 4.7%) attributable to increases in mature areas as well as higher yields.

Growth in output of **rubber products** declined marginally by 0.4% in 2005 (2004: 8.1%), due mainly to a decline in production of tyres and tubes, while the rubber gloves industry continued to expand. The production of tyres and tubes during the year was affected by a number of factors, including shortage of raw materials in line with the lower rubber production, temporary disruption in production of a major tyre manufacturer due to upgrading of machineries as well as competition from other regional producers.

Output growth of **wood and wood products** meanwhile moderated in 2005 (1.5%; 2004: 12.8%) due partly to weaker demand for Malaysian products from the major industrial countries such as the US, United Kingdom (UK) and Japan. During the year, the industry also faced shortages in supply of raw materials, particularly rubber wood. Subsequently, the Government took measures to alleviate the supply shortage by banning the export of rubber wood sawn timber as of 8 June 2005.

Output growth of the **textile, wearing apparels and footwear** industry recovered to expand by 3.4% in 2005 (2004: -4.8%) as Malaysia was one of the countries that benefited from the diversion of demand from China following the exhaustion of US import quota on China's textile products. Initially, in the early part of the year, production was soft as the expiry of the Agreement on Textile and Clothing (ATC), which came into effect on 1 January 2005, had an adverse effect on demand as industrial countries shifted their orders for textile and wearing apparels to lower-cost countries, particularly China. However, following the influx of textile import from China, the US authorities responded by imposing a growth limit on imports of Chinese textile goods to the US. As China's import quota for the year was filled up by July 2005, the excess new orders of textile products from the US were diverted to other textile-exporting countries in the region, including Malaysia, hence benefiting the textile output of these countries particularly towards the end of the year.

Production of **petroleum products** was also favourable during the year due mainly to robust oil refining activities amidst the higher domestic demand. Growth was also supported by activities related to liquefaction of natural gas for the export market.

In the **domestic-oriented industries**, production of **transport equipment** continued to expand strongly in 2005 due to the rapid growth in the car assembly activities and the spillover effects on production of parts and accessories for motor vehicles. Assembly of motor vehicles expanded by 7.5% (2004: 12.6%), led by the sustained demand for passenger cars which was supported by increases in household incomes and attractive financing packages offered by financial institutions, together with the introduction of new and affordable car models during the year. Meanwhile, the increasing localisation of the new models introduced during the year had also benefited the local production of car parts and accessories (12.1%; 2004: 1.1%).

On the other hand, output of industries in the **construction-related products** remained subdued (-0.5%; 2004: 1.3%), in line with the performance of the construction sector. In particular, production of **iron and steel** was affected by the slowdown in the domestic civil engineering segment, which is the major user of iron and steel. On the export front, external demand for iron and steel also softened substantially in 2005, due to the excess production in China, thus resulting in an overcapacity situation in the global market. Meanwhile, output growth in the **non-metallic mineral products** recovered during the year aided by the turnaround in the output of glass products. However, production of cement, structural clay and ceramic products continued to decline in line with the subdued performance of the construction sector.

Production of **fabricated metal** contracted for the first time since 2001, declining by 4.9% (2004: 11.4%) in 2005. The weak performance of this industry was caused mainly by the contraction in product segments such as wire products, metal fasteners, pewter and aluminium products. Meanwhile, the performance of other segments remained positive, particularly for structural metal products such as tanks, boilers, pressure vessels and heaters which are used mainly in the petroleum, food and off-estate processing industries.

Output growth in the **paper products** industry strengthened to 7.5% in 2005 (2004: 4.2%), supported by demand for pulp and paper products and continued growth of containers and paperboards, led by the increase in packaging activities emanating from the food and beverages industry.

Output of the **food and beverages industries** was higher in 2005, underpinned by strong private consumption. Of significance, the higher growth in the food industry was led mainly by the improvements in the segments related to dairy products as well as chocolate and sugar confectionary. The **tobacco industry** contracted by 3% (2004: 2.9%) due to lower demand for cigarettes arising from the higher prices following the increase in sales tax on cigarettes.

Services Sector

In 2005, the **services sector** continued to be the major driver of growth, contributing to 3.8 percentage points of the 5.3% GDP growth. Value-added growth of the services sector remained high at 6.5% (2004: 6.8%), surpassing the overall GDP growth during the year. As a result, the share of the sector to overall GDP increased further to 58.1% (2004: 57.4%; 1995: 51.2%).

An important contributing factor for the continued lead performance of the services sector in 2005 was the strong growth in private consumption. Correlation between final services and private consumption is significant (1Q 2000 – 4Q 2005: 0.66). Besides the robust private consumption, the services sector was also driven by higher tourism and business activities and, to a lesser extent by trade-related activities, which picked up towards the latter part of the year in line with the upward momentum in manufacturing production and exports.

The services sector remained the key driver of growth underpinned by strong growth in private consumption.

In addition, efforts by the Government in recent years in promoting new areas of growth in the services sector also began to yield results and contribute towards the services sector's growth. These are high value-added activities such as information technology (IT) services; shared services and outsourcing (SSO); Islamic finance; investment banking; and health and medical tourism.

Given the strong private consumption, the **final services** segment (comprising the utilities; wholesale and retail trade, hotels and restaurants; Government services and other services sub-sectors) registered a higher growth of 7.1% (2004: 6.6%), the highest recorded since 1995. Meanwhile, the **intermediate services** segment (comprising the transport, storage and communication; and finance, insurance, real estate and business services sub-sectors) grew at a moderate pace of 5.7% (2004: 7.1%). The impact of the moderation in manufacturing growth and regional trade was to some extent offset by stronger performance of other business activity.

Graph 1.8
Growth in Private Consumption, Final Services and the Overall Services Sector

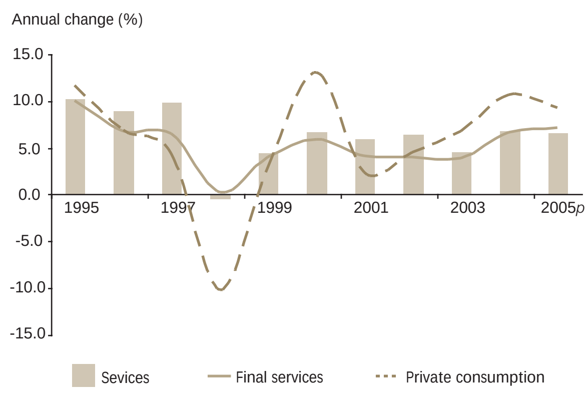


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Table 1.4
Growth in the Services Sector at Constant 1987 Prices

	2004	2005*p*	2004	2005*p*
	Annual change (%)		% share of GDP	
Services	**6.8**	**6.5**	**57.4**	**58.1**
Intermediate services	7.1	5.7	23.8	23.9
Transport, storage and communication	8.5	6.3	8.8	8.8
Finance, insurance, real estate and business services	6.3	5.4	15.1	15.1
Final services	6.6	7.1	33.5	34.1
Electricity, gas and water	8.2	5.5	4.1	4.1
Wholesale and retail trade, hotels and restaurants	7.1	8.0	14.3	14.7
Government services [1]	6.5	8.8	7.3	7.6
Other services [2]	4.9	4.9	7.8	7.8

[1] Include general public services (general public administration, external affairs and public order and safety), defence, health, education and others.
[2] Include imputed rent from owner-occupied dwellings; community, social and personal services; products of private non-profit services to households and domestic services of households.
p Preliminary

Source: Department of Statistics, Malaysia

The **wholesale and retail trade, hotels and restaurants sub-sector**, which accounts for one-fourth of the services sector recorded another year of strong growth of 8% (2004: 7.1%). The strong performance was supported by higher spending by domestic households and foreign tourists. In particular, the distributive trade (wholesale and retail) industry strengthened significantly. The motor vehicles trading and related accessories stores, one of the major components of the distributive trade industry recorded a robust performance supported by the 13% growth in vehicle sales.

Increase in domestic tourism activity following the full adoption of the five-day working week for the civil service since July 2005 was another contributory factor for the robust performance of the wholesale and retail trade, hotels and restaurants sub-sector. In addition, the various promotions and strategies undertaken by the Ministry of Tourism and the private sector, the change in the Mega Sales Carnival from twice previously to once a year (23 July 2005 to 4 September 2005) and the Year-end Sales (new programme: 1 December 2005 to 31 January 2006) resulted in increased shopping activities during the year. The strong consumer sentiment and confidence in the economy also contributed to the higher consumer spending during the year.

Besides higher domestic tourism, the country also saw an increase in foreign tourist arrivals, which contributed to the growth of the wholesale and retail trade, hotels and restaurants sub-sector in terms of increase in revenue from shopping, dining and hotel accommodation. The increased number of high-spending and long-haul tourists from the Oceanic (Jan-Nov 2005: 28.9%), Southern Asian (27%), West Asian (15.6%) and European (13%) countries contributed to the growth in the sector. As a result, the average hotel occupancy rate rose to 63.6% in 2005 (2004: 60.8%).

In addition, there was also an increase in long-term tourists as reflected by the 36.4% growth in the number of 'Malaysia, My Second Home' (MMSH) programme participants (2004: 16.5%). The higher number of new participants was a result of the increased efforts taken by the Government in promoting the programme. Among the key measures taken by the Government to make the programme more attractive to foreigners include extending the social visa from five years to ten years. Under the current MMSH programme (2002 – 2005), close to 7,000 foreign participants have been able to travel and live in Malaysia for an extended period, as well as to bring their families, purchase residential property and send their children to Malaysian schools.

Growth in the **finance, insurance, real estate and business services sub-sector** was sustained at 5.4% in 2005 (2004: 6.3%). Growth emanated from expansion in bank lending activities as well as increased collection of insurance premiums. Despite the narrowing spreads between the lending and deposit rates amidst the competition as well as mergers between commercial banks and finance companies, the increase in total loans outstanding by 8.6% contributed to the higher net interest income during the year. The finance segment has also been increasingly supported by fee-based income arising from the introduction of new banking services and products. Islamic banking gained further prominence during the year with the establishment of three new Islamic banking subsidiaries and one foreign Islamic bank. As a result, growth in total loans (16.5%), deposits (15.1%) as well as assets (17.7%) of the Islamic banking system continued to remain firm.

Insurance activity was also strong amidst the increase in the penetration rate in the life insurance industry (38.7%; 2004: 37.9%), led mainly by strong growth in premiums collected from new businesses from endownment; and medical and health insurance, and stronger growth in general insurance, particularly the motor vehicles industry. The increase in net premiums was also contributed by the higher net contribution from the takaful industry, emanating from both the family and general takaful funds.

The performance of the business services segment that includes the SSO industry and IT services was also encouraging. During the year, an additional 19 operational headquarters, 15 international procurement centres and three regional distribution centres were approved. In addition, 37 new SSO companies were granted Multimedia Super Corridor (MSC) status during the year, thus bringing the total to 57 as at end-2005. These entities undertake various types of shared services activities with their related and unrelated companies within and outside Malaysia.

With regards to IT services, the Government continued to promote MSC as a global ICT hub and to increase the usage and adoption of innovative domestic ICT products and services. As part of the gradual rollout of the MSC to the rest of the country, Penang and Kulim Hi-tech Park in Kedah were declared cybercity status in 2005, thus enabling new MSC-status companies to be based in the northern region. In the second phase of the rollout (2004 - 2010), the focus is on accelerating the MSC flagship applications, increasing adoption and introducing new initiatives to increase its competitiveness. As at end-2005, a total of 1,421 companies have been given MSC-status with total approved investment of RM18.2 billion.

The **transport, storage, and communication** sub-sector continued to expand by 6.3% in 2005 (2004: 8.5%). In the telecommunications industry, growth was mainly contributed by the cellular segment where the number of cellular subscribers and usage of both voice and data services continued to increase strongly during the year. Cellular subscribers rose by 33.8% (2004: 31.3%) to 19.5 million (74.1% penetration rate), while short messaging system (SMS) traffic rose significantly by 130.8%. During the year, SMS was increasingly used as a means of communication and to substitute for telephone voice calls; and in various applications, especially in the entertainment and leisure industry. Demand in the telecommunications industry was also induced by the introduction of 3G cellular phones services during the year. Meanwhile, the number of Internet subscribers rose to 3.7 million at end-2005, representing a growth of 11.5% (2004: 14.3%). As at end-2005, the penetration rate for Internet stood at 13.9% (2004: 12.7%). In the case of broadband, its usage continued to increase with the penetration rate rising to 1.9% as at end-2005 (end-2004: 1%).

Nevertheless, growth in the telecommunications industry was more moderate compared to 2004, following the downward trend in average revenue per user (ARPU) of cellular phones during the year. This was due to the keen competition among telecommunication players, as well as lower spending by new cellular subscribers, consisting mainly students and other lower income groups attracted by the introduction of low-priced starter packs.

Table 1.5
Selected Indicators for the Services Sector

	2004	2005*p*
	Annual change (%)	
Electricity production index	8.2	5.8
Loans outstanding in the banking system	8.5	8.6
Insurance premiums	16.3	7.7
Bursa Malaysia (turnover, volume)	-4.2	-4.7
Bulk cargo throughput at five major ports[1]	9.2	3.4
Container throughput at six major ports[2]	10.7	4.6
Airport passenger traffic	18.9	4.8
Air cargo handled	10.5	4.3
Consumption credit outstanding	16.4	18.7
Imports of consumption goods	24.1	5.9
Tourist arrivals	48.5	4.3[3]
SMS traffic	54.7	130.8
	%	
Hotel occupancy rate	60.8	63.6
Penetration rate:		
- Internet dial-up	12.7	13.9
- Broadband	1.0	1.9
- Mobile phone	56.5	74.1
- Fixed line	17.2	16.6

1 Port Klang, Johor Port, Penang Port, Sabah Ports and Bintulu Port
2 Port Klang, Johor Port, Port of Tanjung Pelepas, Penang Port, Sabah Ports and Bintulu Port
3 Refers to Jan-Nov data
p Preliminary

Source: Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Bursa Malaysia Berhad; Malaysian Communications and Multimedia Commission; Ministry of Finance; Relevant port authorities; Malaysia Tourism Promotion Board and Bank Negara Malaysia.

Meanwhile, the transportation segment grew moderately in line with the slower expansion in trade-related activities and moderate growth in passenger travel. Total container throughput at the five major ports increased by 4.6% in 2005 (2004: 10.7%), while the air cargo volume increased by 4.3% (2004: 10.5%). After a significant increase in tourist arrivals in 2004 in the post-SARs recovery period, air passengers at all airports grew moderately by 4.8% in 2005 (2004: 18.9%). Total passenger traffic at the Kuala Lumpur International Airport recorded a growth of 10.2% (2004: 20.6%) to reach 23.2 million passengers in 2005, supported by new landings and increase in flight frequencies of several international airlines as well as growth in the budget airlines. Passengers carried by the domestic budget airline rose by 30.1% or 1.1 million to a total 4.8 million in 2005. The significant increase was in response to new routes introduced by the budget carrier during the year. The year also saw a higher growth in land and rail passenger traffic as reflected by an increase in toll revenue from major highways as well as higher light rail transit riderships.

In the **Government services** sub-sector, the introduction of new allowances and increase in existing allowances for selected civil servants, yearly increments as well as bonus payments led to higher emoluments, with the sub-sector recording a higher growth of 8.8% (2004: 6.5%).

Growth in the **other services** sub-sector was sustained at 4.9% supported by expansion in other private services, namely entertainment and new areas such as private medical and healthcare services, private higher education services and multimedia broadcasting services. Malaysia is increasingly becoming a choice centre for medical tourism, particularly in niche areas such as cardiology, radiology, general surgery and wellness programme. Revenue from the private healthcare services, including private hospitals, recorded a strong growth as a result of more Malaysians and foreigners seeking medical treatment and health screenings in private hospitals and clinics. As at end-2005, 35 private hospitals are recognised by the Ministry of Health for the promotion of health tourism. In the private higher education services industry, there are more than 550 private higher educational institutions in 2005, including 11 private universities, 12 university colleges, five foreign university branch campuses and 537 private colleges, serving around 312,000 local students and 27,000 foreign students. The majority of the foreign students were from PR China and Indonesia, which accounted for a combined share of about 53.5% of total foreign students.

Meanwhile, the **utilities** sub-sector expanded by 5.5% (2004: 8.2%), supported by continued strong expansion in the economy, which resulted in sustained demand for electricity, particularly from the commercial and household sectors.

Agriculture Sector

Growth in the **agriculture, forestry and fishing (agriculture)** sector expanded at a more moderate pace of 2.1% in 2005 (2004: 5%). The growth was mainly supported by strong performance in the palm oil sector and higher growth in livestock, particularly poultry. Meanwhile, output of other agriculture activities including rubber, fisheries, saw logs, cocoa and paddy, declined during the year affected by factors related to nature. During the year, the Government together with the private sector continued in efforts to revitalise the agriculture sector and to sustain its importance as the third largest economic sector in the country. This was reflected in terms of the share of the sector to overall GDP (8.2%) as well as employment, with 12.9% of the overall labour force or 1.41 million people involved in the activity. On the external front, foreign exchange earnings from agriculture exports grew by 3.4% to account for 7% of total gross exports during the year.

The agriculture sector continued to expand, led mainly by strong performance in the palm oil sector amidst the favourable commodity prices.

While the palm oil sector benefited from high yields and an increase in mature areas, performance of the other agriculture crops were affected during the year by unfavourable weather conditions. In the initial part of the year, the after-effects of the Tsunami as well as the dry weather spell affected fishing and rubber activities. This was subsequently followed by rainy conditions towards the end of the year which disrupted rubber tapping and harvesting activities of many crops. Nevertheless, plantation companies and farmers continued to be encouraged by the favourable commodity prices in the global market. At the same time, yields continued to rise as a result of Good Agriculture Practices, which placed

Table 1.6
Agriculture Sector: Value Added, Production and Exports

	2004		2005*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value Added (RM million at 1987 prices)	**21,137**	**5.0**	**21,585**	**2.1**
Production[1]				
of which:				
Crude palm oil	13,976	4.7	14,961	7.0
Rubber	1,169	18.6	1,124	-3.8
Saw logs	21,509	-0.1	21,334	-0.8
Cocoa beans	33	-7.8	28	-16.3
Fish landings	1,528	3.2	1,424	-6.8
Exports (RM million)	**36,176**	**7.4**	**37,421**	**3.4**
of which:				
Palm oil				
(‘000 tonnes)	11,788	-5.6	13,073	10.9
(RM/tonne)	1,706	5.5	1,456	-14.6
(RM million)	20,107	-0.4	19,036	-5.3
Rubber				
(‘000 tonnes)	1,105	16.7	1,128	2.1
(sen/kilogramme)	470	24.3	513	9.0
(RM million)	5,198	45.1	5,787	11.3
Saw logs				
(‘000 cubic metres)	5,207	-5.9	5,759	10.6
(RM/cubic metre)	398	8.9	428	7.7
(RM million)	2,070	2.5	2,465	19.1
Sawn timber				
(‘000 cubic metres)	3,166	13.5	3,685	16.4
(RM/cubic metre)	1,015	-10.4	1,099	8.3
(RM million)	3,214	1.7	4,051	26.0

[1] All in ‘000 tonnes, except for saw logs in ‘000 cubic metres.
p Preliminary

Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Forestry Departments (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Fisheries Department, Malaysia

emphasis on intensive application of agricultural inputs such as fertilizers and utilisation of labour-saving technologies among estates and smallholders.

During the year, the Government continued to intensify its efforts to deepen and broaden the agriculture base as well as to encourage downstream activities to strengthen the linkages to the other sectors of the economy. Government ministries and agencies have begun implementing plans to transform and modernise the agriculture sector through higher productivity, accelerated private sector involvement (including government-linked companies) and deeper linkages between upstream activities and downstream agro-based industries.

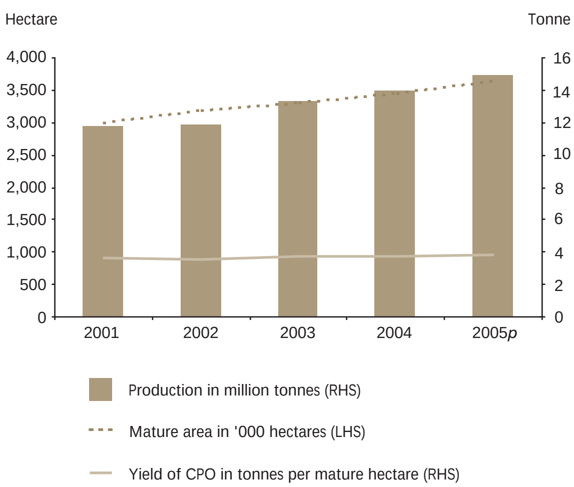
Of significance, the food crops sub-sector, which accounts for about 40% of the value added in the agriculture sector, has vast potential for creation of downstream value-adding activities such as processed and manufactured products for both domestic consumption and exports. These new activities would not only accentuate the growth potential of the economy and increase export earnings, but would also ensure that the rural communities involved in the agriculture sector enjoy higher and more stable income.

Crude palm oil (CPO), which is the most important crop in terms of value added in the agriculture sector (37%), saw another year of strong expansion, growing by 7% to reach a record high of 14.96 million tonnes in 2005. This represented the third consecutive year of strong growth (2004: 13.98 million tonnes, +4.7%; 2003: 13.36 million tonnes, +12.1%). The increase in production was mainly in the first half-year (20.3%) due to a bumper harvest. The substantial increase was attributed to two main factors.

First, during the year, the mature oil palm acreage rose substantially by 5.2% (179,790 hectares) to 3.63 million hectares (2004: +4.5%). The increase was reflected across all regions, with mature acreage in Peninsular Malaysia rising by 5.3% to 2.07 million hectares, Sabah's acreage increasing by 3.9% to 1.12 million hectares, while Sarawak's was higher by 8.3% to 0.44 million hectares. Of significance, production in Sabah (the largest producer by state accounting for 5.33 million tonnes or 35.6% of total production) and Sarawak recorded double-digit increases of 11.9% and 19.7%, respectively, while production in Peninsular Malaysia rose by 2.4%. Overall, Peninsular Malaysia continued to account for a majority share of about 55% to total Malaysian CPO production (2004: 58%).

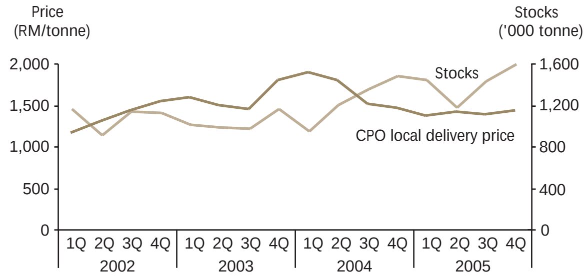
The second factor contributing to the strong production was the continued uptrend in palm oil yield productivity as reflected by the increase in oil extraction rates (OER) and output of fresh fruit bunches (FFB). The Malaysian OER continued to remain above the critical 20% threshold for the second straight year, rising to 20.15% (2004: 20.03%). This is a key performance indicator in the industry as every 1% increment in OER translates to an estimated increase of about 500,000 tonnes in CPO output. FFB yields were also higher by 1.5% to 18.88 tonnes per mature hectare (2004: 18.60 tonnes per mature hectare). In the light of these positive developments, Malaysia continued to maintain its status as the world's largest palm oil producer and exporter, accounting for 45% of world output and 51% of world exports.

Graph 1.9
Oil Palm: Area, Production and Yield



p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

Graph 1.10
Palm Oil Price and Stocks



Source: Malaysian Palm Oil Board (MPOB)

Prices of palm oil remained supportive of the industry in 2005 with the CPO local delivery price averaging RM1,398 per tonne. Nevertheless, compared with the previous year, the price was lower by 16% (2004: RM1,664 per tonne). Palm oil prices began to consolidate since the second half of 2004 due to the increase in the supply of global edible oils as well as the increase in domestic palm oil stocks. The trend continued into 2005 with the price declining in the first half-year by 24.7% to RM1,391 per tonne before stabilising at RM1,405 per tonne in the second half-year. The sharp increase in palm oil harvests (1H 2005: +20.3%; 1H 2004: -2.3%) and the attendant increase in domestic palm oil stocks (May: 1.48 million tonnes) led to softer prices. Nevertheless, prices remained relatively stable in the second half-year supported by other mitigating factors such as the sluggish soybean harvest in the Latin American region as well as expectations of future demand for palm oil-based biodiesel. Overall, CPO remained competitive against other major edible oils, as the price discount of CPO to that of soybean oil and rapeseed oil widened further during the year to USD123 per tonne and USD237 per tonne, respectively.

The People's Republic of China (PR China) remained as the largest importer of Malaysian palm oil in 2005, accounting for 22.1% of the total exports. However, export growth to PR China grew at a more moderate pace (2005: 2%; 2004: 13.1%) despite the fact that PR China's import quota for palm oil was raised from 2.7 million tonnes in 2004 to 3.2 million tonnes in 2005. The moderation in demand was due to Chinese importers reducing their purchasing activities in the second half-year in anticipation of the impending changes in import duties. In line with PR China's commitment under the World Trade Organisation, effective 1 January 2006, the quota for edible oil imports was abolished and a standardised import tariff of 9% was imposed across all edible oils. This would be a positive development for palm oil exports to PR China.

Meanwhile, demand for palm oil from the US increased substantially by 79.4% (534,137 tonnes; 2004: +28.7%), as US food manufacturers began to increase the usage of palm oil as a substitute to other edible oils. Beginning 1 January 2006, the US Food and Drug Administration (FDA) would require food manufacturers to label products that contain *trans* fatty acid as clinical studies have linked *trans* fatty acid to serious diseases. Palm oil, which is *trans* fatty acid free, has benefited from this regulation. During the year, purchases from India declined further (-28.2%; 2004: -44%) as the discriminatory increase in import tariff rates for palm oil compared to soybean oil had resulted in higher import prices and, consequently, lower demand from Indian buyers.

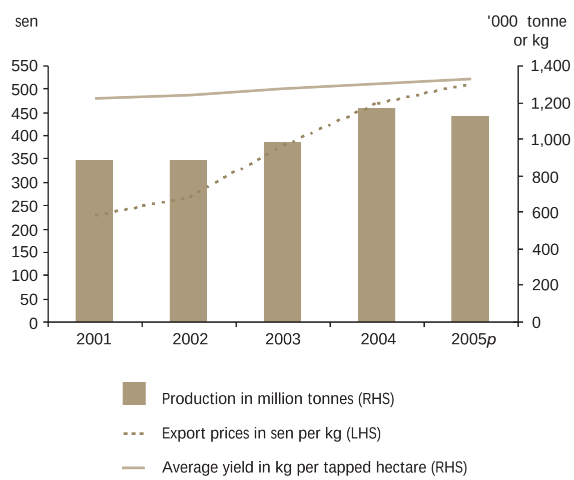
The Malaysian palm oil industry continued to make significant progress in terms of research and development. The Malaysian Palm Oil Board (MPOB) introduced 43 new technologies and products for commercialisation in the industry, and undertook 312 research projects during the year. The new breakthroughs were mainly in developing cost-effective milling and refining techniques, improving yields, minimising wastage, eradicating diseases and creating higher value-added palm-based products, as well as palm-based biomass.

Another important development in the palm oil industry in 2005 has been the commercialisation of palm oil-based biofuel at a global level. Amidst the increase in energy prices, countries began to seek alternative sources of energy, particularly from renewable resources. Among the renewable energy resources, palm oil has distinct advantages over other sources both in terms of price competitiveness as well as ready availability as Malaysian palm oil stocks have consistently been above 1 million tonnes over the last three years. Malaysia has pioneered the development of this technology through sustained research and development efforts which began a few years ago. The current high energy price environment has made it both feasible and necessary for Malaysia to embark on palm oil-based biofuel on a large scale. This would help to meet the higher demands in energy consumption from domestic users, create a new source of export earnings and stabilise the volatility in CPO price movements.

In line with this development, in August 2005, the Government announced the formulation of the National Biofuel Policy, which will be completed in 2006. The policy would provide guidelines on biofuel usage for all related sectors (particularly transportation, petroleum companies and palm oil industries), in addition to standardising the B5 biodiesel mixture for the domestic market (5% from processed palm oil, 95% from petroleum diesel), and ensuring that the palm biodiesel (chemically known as methyl ester) produced for the external markets conform to international standards. As part of the biofuel policy, attractive incentives would also be provided to encourage the growth in the biodiesel industry in Malaysia. To date, the interest in this industry has been tremendous with five palm biodiesel plants in the pipeline to commence operations in late 2006. At the same time, a pilot project to utilize B5 biofuel in transportation vehicles would be implemented by selected Government agencies.

After expanding at a strong pace in the last two years, **natural rubber** production declined in 2005 by 3.8% to 1.12 million tonnes (2004: 1.17 million tonnes). Nevertheless, the output level remained above the key threshold mark of 1 million tonnes. The decline in production during the year was due entirely to adverse weather conditions. Usually rubber trees produce less latex during the wintering months of February to April,

Graph 1.11
Natural Rubber: Production, Prices and Yield



p Preliminary for average yield
Source: Malaysian Rubber Board (MRB) and Department of Statistics.

but in 2005, exceptionally dry weather conditions during this period further aggravated the situation, thus resulting in declines in output on a year-on-year basis. In the last two months of the year, adverse weather, namely excessive rain, reduced tapping activity by smallholders, who account for almost 95% of total Malaysian rubber output. At the same time, the total tapped areas continued to decline, by 4% to 767,340 hectares, as more rubber land holdings were either being replanted with new rubber trees (2005: 23,000 hectares, with 94% replanted by smallholders), or in the process of being converted into other economic activities during the year. Nevertheless, Malaysia retained its position as the third largest producer of natural rubber after Thailand and Indonesia, with a 13% share of world output.

On the price front, Malaysian natural rubber prices continued on a strong upward trend in 2005 in line with developments in the global market. Prices of SMR20, the Malaysian benchmark, showed a double-digit growth for the third consecutive year, rising by 13.4% to average 523 sen per kilogramme in 2005 (2004: 461 sen/kg). In particular, prices rose significantly in the second half of the year to reach the highest daily traded price of 632 sen per kilogramme on 30 December 2005, while the monthly high of 588 sen per kilogramme was recorded in October 2005. The firming of rubber prices was supported by seasonal and fundamental factors. On one hand, global rubber supply was constrained due to adverse weather conditions in the key producing regions. Meanwhile, global demand continued to remain strong, particularly from PR China, driven by the rapid expansion in the automotive industry.

The strong demand coupled with the low production resulted in a significant fall in global stocks to reach a record low level, especially in the latter half of the year, thus exerting upward pressure on prices. In addition, natural rubber's closest substitute, synthetic rubber, which is a petrochemical product continued to record higher prices in line with higher crude oil prices. For the first time in 23 years, natural rubber prices rose above synthetic rubber prices.

Export proceeds from rubber rose markedly by 11.3% to RM5.8 billion in 2005, accounting for 1.1% of total gross exports. Almost one-third of the rubber exports during the year comprised shipments to PR China (2004: 26.1%). For the fourth consecutive year, PR China continued to increase its rubber purchases at a double-digit rate (33.7%; 2004: 39.2%). The higher off-take was fuelled by strong demand from tyre manufacturers arising from the rapid expansion in the domestic automotive industry. Apart from PR China, the other major buyers were the European Union (EU) countries, particularly Germany and France, accounting for 28.3% of total rubber exports.

In recent years, natural rubber has regained its status as one of the key commodities in the Malaysian agriculture sector due to its strong linkages to the overall economy, both to the rural-based smallholders, as well as to key export-oriented downstream rubber industries, such as rubber glove and tyre manufacturing. The strong natural rubber prices have benefited the smallholders in terms of raising their income levels, and this has been a significant factor in reviving interest in the sector. Besides increasing tapping activities, smallholders have also adopted better exploitation technologies such as the low frequency tapping system (LITS) and Good Agricultural Practices by using stimulants to improve yields in order to take advantage of the high prices.

In addition, the Government has also encouraged rubber smallholders to undertake replanting activities to ensure sustainable production in the coming years. As of end-2005, the programme has succeeded in replanting of rubber trees covering 23,000 hectares of land, supported by rising confidence among smallholders and the effects of high rubber prices. Smallholders were also encouraged to replant latex timber clones (LTC) which yield higher latex and also ensure an adequate supply of rubber wood, once the trees become too aged to produce latex. This would help meet the expected increase in domestic demand from the local furniture industry in the coming years.

Performance of **other agriculture commodities**, comprising fisheries, livestock, as well as miscellaneous agriculture (which includes paddy, fruits and vegetables) showed a mixed trend in 2005. Value added in the **livestock** sub-sector increased by 4.7%, led mainly by higher growth in output of poultry (+5.7%), as many large-scale poultry operators, primarily public-listed companies took advantage of the incentives provided by the Government to modernise their operations. Thus, these companies have invested substantially on poultry rearing techniques using the climate-controlled closed house system that not only increased production, but most importantly, maintained internationally-recognised hygiene conditions. The increase in poultry output and the assurance on quality have been the main factors behind the substantial rise seen in external demand, in addition to meeting demand from the domestic food processing industries.

Meanwhile, output in the **fisheries** sub-sector declined by 6.8% in 2005 to 1.42 million tonnes (2004: 1.53 million tonnes), due mainly to lower marine landings (2005: -9.2%; 2004: 3.8%) as a result of the after-effects of the Tsunami, as well as the rise in diesel prices which affected fishing activities. However, this was partially mitigated by the increase in aquaculture harvests, which accounted for about 15% of the total output in the fisheries sector (2005: +9.8% to 215,475 tonnes). Aquaculture products such as seaweed, surimi and ornamental fish are high value-added activities mainly targeted for the export market. Meanwhile, output of **paddy** also declined in 2005 due to adverse weather conditions.

In the **forestry** sector, logging activities declined in 2005 in line with Malaysia's policy on conservation by implementing sustainable forest management practices. Production of saw logs declined slightly by 0.8% to 21,334 million cubic metres (2004: 21,509 million cubic metres). Nevertheless, global demand for Malaysian logs and sawn timber strengthened significantly during the year, particularly from PR China and the EU countries. The strong demand was also due partly to the continued ban on exports of logs and sawn timber by Indonesia since 2004. Consequently, average Malaysian log prices reached a record high of RM428 per cubic metre in 2005. Amidst the increase in export prices (7.7%) and the rise in volume of 10.6%, export receipts from saw logs rose significantly by 19.1% to RM2.5 billion. In terms of sawn timber, export proceeds strengthened by 26% to RM4.1 billion, due to higher volume (16.4%) and prices (8.3%).

With regards to the environment, Malaysia has been at the forefront in driving initiatives on responsible trade in tropical timber products. In the last few years, the Malaysian timber industry has taken vital steps in addressing the issue of illegal logging, unsustainable forest management and trade in endangered tropical species. Malaysia has developed its own timber certification scheme that assures importers and consumers that Malaysian timber products are from legal and sustainable sources. By end-2005, the Malaysian Timber Certification Council (MTCC) has awarded the Certificate for Forest Management to eight states in Peninsular Malaysia and the Upper Ulu Baram region in Sarawak, covering a total of 4.73 million hectares of permanent reserve forests.

In addition, 83 timber companies had been certified for 'chain-of-custody', ensuring that the timber products are sourced from MTCC-certified forests and are legally harvested. The credibility of these certification efforts has been recognised by major buyers of Malaysian timber products, most recently by a number of EU countries (United Kingdom, Germany, France, Belgium and the Netherlands) that have a public procurement policy aimed at eradicating imports of timber from illegal sources. In addition, the Government has also been vigilant in enforcing regulations on trade in endangered timber species (such as *Ramin, Karas* and *Gaharu*) from neighbouring countries, in accordance with the regulations under the Convention for International Trade of Endangered Species of Wild Flora and Fauna (CITES). As part of the strategy on implementing sustainable forest management, the Government also continued its efforts on forest plantation. During the year, it was announced that a RM200 million grant would be given to establish a forest plantation programme to reduce the dependence on tropical timber.

Meanwhile, output of **cocoa** declined further by 16.3% to 27,964 tonnes (2004: 33,423 tonnes). The decline in production was mainly attributable to continued reduction in cultivated area to 33,313 hectares (2004: 41,612 hectares; 1990: 393,000 hectares) mainly reflecting active conversion of cocoa land into other crops. The lower production was also attributable to the lack of application of inputs such as fertilizers and pesticides by cocoa farmers as a result of the rising cost of these inputs. To encourage cocoa planting among smallholders, the Malaysian Cocoa Board implemented the Cocoa Smallholders' Development Programme. Currently, there are 4,860 farmers who are actively involved in the programme, with a total area of 5,368 hectares. The Government has also announced that cocoa smallholders will be given a 100% replanting grant, in addition to the prevailing assistance given in the form of high-yielding clones, disease-resistant planting materials as well as technological assistance.

Mining Sector

The **mining and quarrying (mining)** sector expanded by 0.8% in 2005 due entirely to higher production of natural gas and condensates, while crude oil production was lower. Production of tin-in-concentrates rose slightly by 2% to 2,800 tonnes. During the year, the global energy market was characterised by high prices arising from the continued fine balance between demand and supply of energy sources amidst the lack of spare output capacity in the major oil producing countries. As a net energy-exporting nation, Malaysia benefited from the high prices, leading to a significant increase in export proceeds from minerals for the third consecutive year (+27.1% to RM52.3 billion; 2004: +38.2% to RM41.2 billion). Of significance, the proportion of mineral exports to total gross exports rose further to 9.8% (2004: 8.6%), further underlining the significance of the oil and gas industry to the Malaysian economy.

Value added in the mining sector was sustained, supported by strong performance in natural gas amidst the high energy prices.

Production of **crude oil including condensates** averaged 726,860 barrels per day (bpd), representing a decline of 4.9% from the level recorded in 2004 (762,318 bpd or +3.6%). The lower output was due mainly to the decline in production of crude oil, while condensates rose sharply in line with the upward trend in natural gas production. The lower production of **crude oil** to 571,359 bpd (2004: 623,957 bpd) was caused by shutdown of several oil installation facilities during the year for repair and maintenance purposes. Nevertheless, the production was within the range set for the year under the National Depletion Policy, which has been

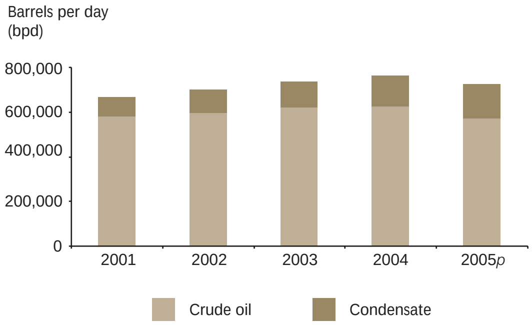
Table 1.7
Mining Sector: Value Added, Production and Exports

	2004		2005*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value added (RM million at 1987 prices)	**17,372**	**3.9**	**17,504**	**0.8**
Production				
Crude oil and condensates (barrels per day)	762,318	3.6	726,860	-4.9
of which:				
Crude oil (barrels per day)	*623,957*	*0.6*	*571,359*	*-8.7*
Condensates (barrels per day)	*138,361*	*19.6*	*155,501*	*12.1*
Natural gas - net (million standard cubic feet per day)	5,196	4.0	5,800	11.3
Tin-in-concentrates (tonnes)	2,745	-18.3	2,800	2.0
Exports (RM million)	**41,177**	**38.2**	**52,321**	**27.1**
of which:				
Crude oil and condensates				
(‘000 tonnes)	18,090	1.0	17,719	-2.0
(USD/barrel)	40.81	34.8	55.93	37.0
(RM million)	21,318	36.1	28,508	33.7
Liquefied natural gas (LNG)				
(‘000 tonnes)	20,729	19.7	21,948	5.9
(RM/tonne)	824	6.8	947	15.0
(RM million)	17,079	27.9	20,790	21.7
Tin				
(tonnes)	29,966	96.6	33,610	12.2
(RM/tonne)	31,585	68.6	27,827	-11.9
(RM million)	947	231.5	935	-1.2

p Preliminary

Source: PETRONAS
Department of Statistics, Malaysia
Department of Minerals and Geoscience, Malaysia

Graph 1.12
Production of Crude Oil and Condensates



p Preliminary
Source: PETRONAS

implemented since 1980 to ensure a sustained and regulated development of the country's oil resources. The depletion policy and discoveries of new oil fields over the years has led to the expansion in Malaysia's oil reserve lifespan to 20 years (2002: 15 years).

Meanwhile, production of **condensates** increased at a double-digit rate (12.1%) for the fourth consecutive year, to a record high of 155,501 bpd (2001: 86,855 bpd). Condensates, which in its natural state is in gaseous form but condenses to liquid upon production, shares the same properties as that of the Malaysian light, sweet crude oil. In recent years, the contribution of condensates to total Malaysian oil production has increased significantly. Condensates now account for 21.4% of the total oil output of 726,860 bpd in 2005 (2001: 13%), thus complementing the country's production of crude oil as the source of liquid fuel for purposes of exports and fulfilling the domestic consumption requirements. In 2005, export proceeds from crude oil and condensates rose further by 33.7% to RM 28.5 billion (2004: +36.1% to RM21.3 billion), thus accounting for an increased share of 5.3% of total exports (2004: 4.4%).

Prices of the Malaysian benchmark crude oil grade, Tapis Blend, continued to strengthen by 39.3% to USD57.26 per barrel in 2005 (2004: USD41.12 per barrel) in line with developments in the global energy markets. In particular, there was a strong demand for "light sweet" crude oil, primarily from the US market. US refineries are mainly catered to process light sweet crude that has low sulphur content which enables uncomplicated and cost-effective refining processing. Tapis Blend, a "light sweet" variety, which has always commanded a premium over other "sour" crude, benefited further during the year, as the premium widened in 2005.

The increase in global crude oil prices during the year was supported by strong fundamentals. The market was influenced by a combination of high global demand and tight supply amidst lack of spare production capacity (2005: 1.5 million bpd; 2001: 4.5 million bpd) as a result of under-investment by major oil producing countries in the last few years. According to the International Energy Agency, global demand for crude oil in 2005 rose to 83.3 million bpd, mainly fuelled by demand from the US and PR China, while global supply was only slightly higher at 84.1 million bpd. Despite the Organisation of Petroleum Exporting Countries (OPEC)'s decision in July 2005 to effectively suspend its output quota system among the member countries by producing at 28 million bpd, the highest level in over 25 years, prices continued to remain high. The high prices were also partly due to the lack of refining capacities in the major consuming nations, particularly in the US, which had resulted in an inability to sufficiently produce refined petroleum products (such as gasoline and distillates) to meet the high demand during the summer and winter seasons. Consequently, the market was sensitive to movements in stock levels, particularly in the US, as it was a reflection of the risk of short supply.

During the year, market sentiment was also highly susceptible to events that could potentially disrupt supply given that the major producing countries were operating at close to full capacity. Thus, when Hurricane Katrina struck the US in late August, which saw the shutdown of about 70% of the supply in the Gulf of Mexico region, oil prices (West Texas Intermediate and Tapis Blend) soared close to the USD70 per barrel threshold. Market participants also remained highly sensitive during the year to geopolitical events occurring

Graph 1.13
Crude Oil Prices (1-Month Futures) in 2005

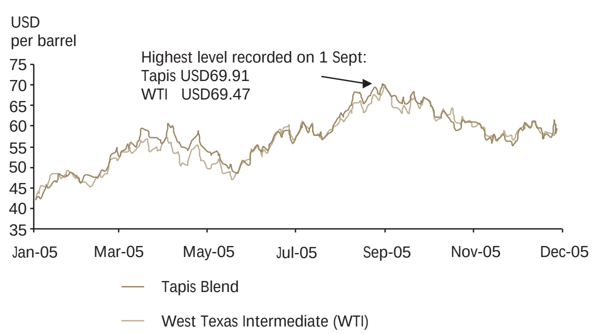


Table 1.8
Malaysia: Crude Oil and Natural Gas Reserves[1]

	As at end	
	2004	2005*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.29	5.38
Reserve/Production (year)	19	20
Natural gas		
Reserves (trillion standard cubic feet)	85.20	84.92
Reserve/Production (year)	33	33

[1] The National Depletion Policy was introduced in 1980 to safeguard the exploitation of the national oil reserves by postponing the development and controlling the production of major oil fields (with reserves of 400 million barrels or more).
p Preliminary

Source: PETRONAS

in major producing countries. The global benchmark oil prices, namely West Texas Intermediate and North Sea Brent, averaged higher at USD56.59 and USD54.86 per barrel, respectively (2004: USD41.40 and USD38.34 per barrel, respectively). The Tapis Blend ended the year at USD62.05 per barrel, which was almost USD20 higher than the price at 1 January 2005 (USD42.11 per barrel).

Natural gas production continued to strengthen in 2005, growing by 11.3% to a record high of 5,800 million standard cubic feet per day (2004: 5,196 mmscfd). The rise in output was driven by increasing demand from traditional buyers, consisting of domestic power generators (accounting for about 70% of total domestic gas users) and industrial users (primarily in the manufacturing sector), as well as major importers of liquefied natural gas (LNG). This has subsequently led to increased utilisation rate at the MLNG plants in Sarawak, as well as the Gas Processing Plants (GPPs) in Peninsular Malaysia.

During the year, LNG prices also rose significantly in line with developments in the global energy markets. In the second-half of 2005, natural gas prices in the global market strengthened sharply following the disruption in supply in the US in the aftermath of Hurricane Katrina. The Malaysian LNG export price rose to breach the RM1,000 per tonne threshold for the first time in September, and peaked at RM1,066 in December. For the year as a whole, the Malaysian LNG export prices averaged RM947 per tonne, an increase of 15% (2004: 6.8%).

Given the higher prices and increase in export volume, LNG export proceeds for the year rose substantially by 21.7% to RM20.8 billion (2004: RM17.1 billion), resulting in its share to total exports rising to 3.9% (2004: 3.6%). The higher export volume (5.9% to 21.9 million tonnes; 2004: 20.7 million tonnes) was mainly due to higher offtake from traditional buyers, particularly Japan and Korea which rose by 9.1% and 3.8% respectively to cater for their power generation industry.

The Malaysian oil and gas industry received further boost in 2005 with new **discoveries of oil and gas resources** following some major discoveries offshore Sabah from 2002 through 2004. During the year, seven new offshore oil fields were discovered, of which four were in Sabah, two in Sarawak and one in Peninsular Malaysia. This brought the total number of oil fields discovered in Malaysia to 153. In addition, 12 new production sharing contracts (PSCs) were signed during the year, thus resulting in the total number of PSCs in Malaysia to increase to 59. In 2005, 54 exploration wells and 78 development and production wells were drilled.

Production of **tin-in-concentrates** rose slightly by 2% to 2,800 tonnes in 2005 (2004: 2,745 tonnes). Average prices of tin, as traded on the Kuala Lumpur Tin Market, remained relatively high at USD7,356 per tonne (2004: USD8,494 per tonne), supported by high demand from the electronics industry. In recent years, arising from the environmental guidelines set by the European Union, lead has been gradually replaced with tin as the main material in soldering activities in the electronics industry.

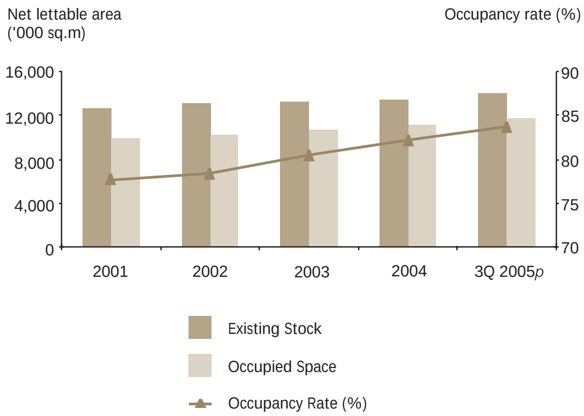
Construction Sector

Value added in the **construction sector** declined by 1.6% in 2005. The contraction was due to weak activity in the civil engineering sub-sector following the completion of many privatised infrastructure projects in recent years. However, the residential and non-residential sub-sectors continued to expand during the year. The residential sub-sector was supported by favourable demand, particularly in choice locations amidst the attractive financing environment. Meanwhile, the non-residential sub-sector benefited from the buoyant business and retail activities.

Activity in the construction sector was supported by the residential and non-residential sub-sectors. Civil engineering meanwhile, continued to contract.

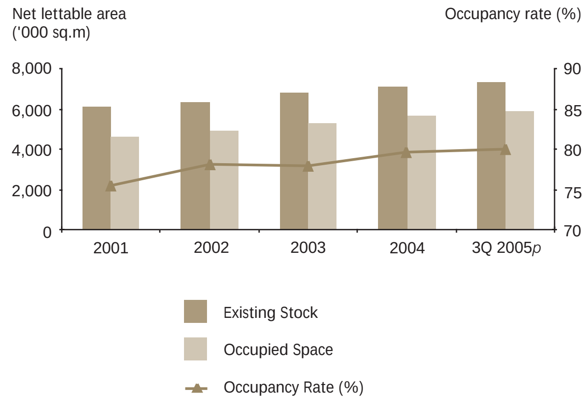
The **civil engineering sub-sector** remained weak, in the absence of new large infrastructure projects. The excess capacity in this sub-sector encouraged many Malaysian construction companies to venture abroad. Among the successfully secured contracts were in road

Graph 1.14
Supply and Occupancy Rate of Purpose-Built Office Space in Malaysia: 2001 - 2005



p Preliminary
Source: NAPIC, Valuation and Property Services Department.

Graph 1.15
Supply and Occupancy Rate of Retail Space in Malaysia: 2001 - 2005



p Preliminary
Source: NAPIC, Valuation and Property Services Department

building, housing, power generation and airport projects in the regional and Middle Eastern nations. In particular, India continued to be the major destination for Malaysian contractors given its current huge spending on infrastructure development. On the domestic scene, ongoing projects related to power generation plants, roads, ports, water and sewerage continued to support the civil engineering activity. Furthermore, construction activity in the oil and gas sector was high, supported by investments in oil rigs, following recent oil discoveries in Malaysia.

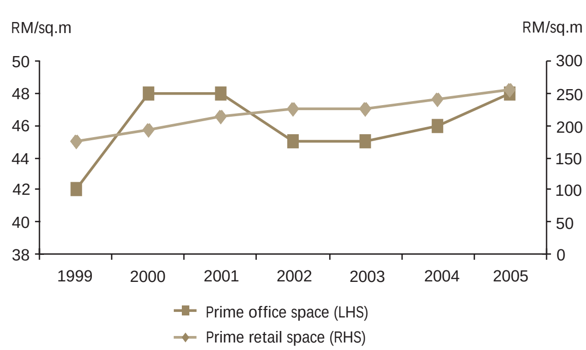
Activity in the **non-residential sub-sector** continued to improve in 2005, underpinned by firm demand for office and retail space amidst the robust business activities. Overall occupancy rates for office and retail space improved to 83.8% and 80% respectively as at end-September 2005, from 82.1% and 79.6% respectively at end-2004. Reflecting the increased demand, average monthly rentals for prime office space in the Klang Valley edged up slightly from RM46 per sq. metre in 2004 to RM48 per sq. metre in 2005, while rentals for retail space in shopping complexes rose from RM242 per sq. metre to RM254 per sq. metre.

In the office segment, 17 new office buildings, mainly Government buildings, with a total space of 605,000 square metres were added on to the market. As a result, total stock of office space as at end-September 2005 was 14.1 million sq. metres (end-2004: 13.5 million sq. metres). Meanwhile, in the retail segment, an additional 209,000 sq. metres were completed, bringing the total stock to 7.3 million sq. metres. Demand for retail space was encouraged by the strong growth in the retail segment, supported by buoyant private consumption activities during the year.

In the case of hotels, 15 new hotels were completed during the year, bringing the total sum to 2,239 hotels in the country, providing 149,106 rooms. Average occupancy rates for hotels improved to 63.6% from 60.8% in 2004, supported by increased tourist arrivals and domestic tourism activity.

The **residential sub-sector** remained important in supporting construction activity during the year. Demand for residential property was sustained by interest in new properties, especially in prime locations. The increase in

Graph 1.16
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley [1]



[1] Refers to Kuala Lumpur and Selangor.
Source: CH Williams Talhar & Wong Sdn. Bhd.

Table 1.9
Residential Property Indicators

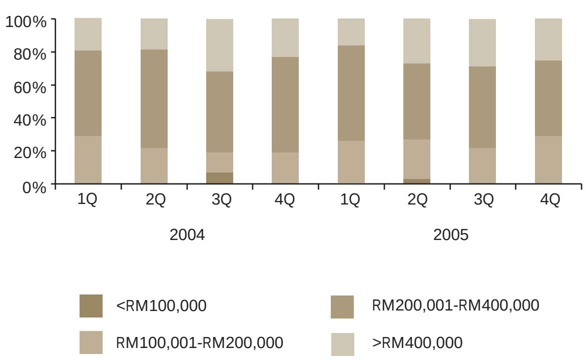
	2004	2005
	Units	
Residential property transactions		
Units	195,241	181,762
Value (RM billion)	29.3	28.4
Approvals[1]	174,671	169,960
Developers' licences		
New	1,071	1,209
Renewals	353	407
Sales and advertising permits		
New	1,038	1,203
Renewals	1,510	1,726
Loans by banking system - Value (RM billion)		
Outstanding	132.9	149.2
Approvals	35.7	36.6

[1] Units approved for construction by private developers.

Source: NAPIC, Valuation and Property Services Department, Ministry of Housing and Local Government and Bank Negara Malaysia

income levels amidst the stable employment market, low interest rates and attractive financing packages offered by financial institutions supported buying interest. Nevertheless, activity was more moderate than the growth seen in 2004, which was induced by the incentives provided under the 2003 Economic Package. This was evidenced by the lower take-up rates in the first half of 2005 of 32.7% compared to 48% in 2004. Purchasers became more discerning in buying properties, due to the intense competition among developers and the wide choice of new concepts and products offered in the market. Among the concepts that were well-received include the gated community concept and focus on green landscaping.

Graph 1.17
New Launches of Residential Property[1] in Klang Valley by Prices



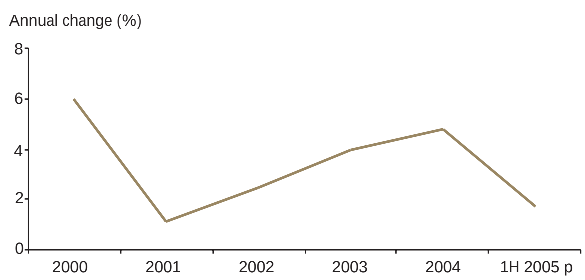
[1] Landed property only
Source: Jones Lang Wooton

On the supply side, 130,000 more new residential units came on stream in the first nine months of 2005, bringing the total stock to 3.59 million units. While approvals of new housing projects continued to decline in 2005, new sales and advertising permits increased markedly by 15.9% (2004: -5.9%). Among the new launches, houses priced above RM400,000 on average accounted for 24% of the total launches in the Klang Valley (average for 2004: 23%), indicating the sustained interest for higher-end properties in the city area. Nevertheless, providing affordable housing remained a priority to the country. In Budget 2006, the Government allocated RM1 billion for low-cost housing programmes, namely *Program Perumahan Rakyat Dimiliki*, *Program Perumahan Rakyat Disewa and Program Perumahan Rakyat Bersepadu.* The Ministry of Housing and Local Government (KPKT) had also taken the initiatives to improve the application procedure for low-cost housing. Among the key changes instituted included liberalising the ceiling of the monthly salary of applicants from RM1,500 to RM2,500, reducing the number of supporting documents for applications and standardising the procedure for all states. In 2005, a total of 55,209 low-cost housing units were constructed.

Given the above developments, the Malaysian House Price Index increased moderately by 1.7% in the first half of 2005 (2004: 4.8%). The slowest increase in prices was recorded in the high-rise and semi-detached categories. Among the states, Selangor, Terengganu, Kelantan, Sabah and Sarawak registered lower prices, while in other areas, prices continued to increase.

Meanwhile, the **overhang** situation of new properties showed a mixed trend. Latest data compiled by the National Property Information Centre (NAPIC) of the Valuation and Property Services Department showed that the overhang in residential property, retail shops

Graph 1.18
Malaysian House Price Index



p Preliminary
Source: NAPIC, Valuation and Property Services Department

Table 1.10
Overhang of Residential Property in Malaysia by Price Range

RESIDENTIAL Price Range	Units	Share (%)	Units	Share (%)
	As at end-2004		As at end-Sept 2005*p*	
RM50,000 Or Less	5,245	33.7	3,397	19.8
RM50,001 - RM100,000	3,546	22.8	5,196	30.2
RM100,001 - RM150,000	3,063	19.7	3,523	20.5
RM150,001 - RM200,000	1,774	11.4	2,336	13.6
RM200,001 - RM250,000	651	4.2	974	5.7
More Than RM250,000	1,279	8.2	1,753	10.2
Total	**15,558**	**100**	**17,179**	**100**

p Preliminary

Source : NAPIC, Valuation and Property Services Department

and shopping complexes worsened, while that of purpose-built office improved. In the case of residential property, the overhang increased to 17,179 units, with a total value amounting to RM2.3 billion as at end-September 2005 (end-2004: 15,558 units; RM1.8 billion). These units were mainly concentrated in Johor and Selangor. The bulk of the properties were priced between RM50,001-RM150,000.

Financing remained important in supporting the construction sector. Loans approved by the banking system for the broad property sector rose by 8.2% in 2005 (2004: 18.8%), while loans disbursed increased by 4.3% (2004: 12.6%). Loans outstanding to the broad property sector as at end-2005 was RM229 billion, representing an increase of 9.9% over 2004 (2004: 10.5%). Meanwhile, loans approved for the housing sector by other housing credit institutions as a group increased by 11.6% to RM7.6 billion in 2005 (2004: 15.7%).

In the early part of the year, activity in the construction sector was temporarily affected by the amnesty program for illegal foreign workers that began in late 2004 and ended on 28 February 2005. The slow return of legal foreign workers caused some delays in projects, but the situation improved after prompt measures taken by the Government to alleviate the problem. During the year, the Government also announced the decision to expedite projects worth RM2.4 billion from the Ninth Malaysia Plan to rejuvenate the civil engineering segment.

Another important development that influenced activity in the property sector during the year was the release of the Guidelines on Real Estate Investment Trusts (REITs Guidelines) on 3 January 2005 by the Securities Commission. This marked the rebranding of property trust funds (PTF) that have existed since the late 1980s as REITs, in an effort to accelerate the growth and to establish a competitive REITs industry in Malaysia. In the last three years, the Government had also taken measures to create a more conducive environment for the development of REITs with the granting of special incentives. These measures include the following:

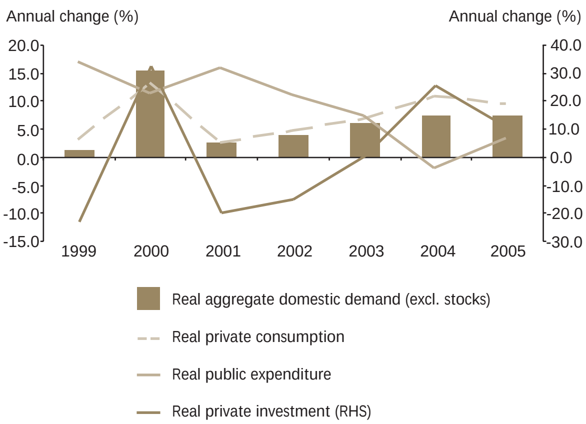
i. Exemptions from Real Property Gains Tax for gains from disposal of real property to REIT or PTF;
ii. Exemptions from stamp duty for instruments of transfer of real property from individuals or companies to REIT or PTF;
iii. Exemptions from income tax on chargeable income distributed to unit holders of REIT or PTF;
iv. Income distributed to unit holders is taxed at their respective tax rates. For non-residents, tax payable is at 28% and is withheld by REIT or PTF;
v. The accumulated income that has been taxed and subsequently distributed is eligible for tax credit in the hands of unit holders; and
vi. Allowing selected fees (consultancy, legal and valuation services) incurred in the establishment of REITs to be tax deductable.

As at end-2005, three REITs funds were listed on Bursa Malaysia. Assets of these REITs consist of office and retail buildings in the Klang Valley.

DOMESTIC DEMAND CONDITIONS

Domestic demand conditions remained favourable in 2005, registering a strong growth of 7.3% during the year (2004: 7.5%). Growth in **aggregate domestic demand** was supported mainly by the buoyant expansion in private sector activities. Despite concerns arising from rising oil prices and the uncertain external outlook in the early part of the year, consumer spending was sustained at a high level throughout the year. Consumers benefited from the

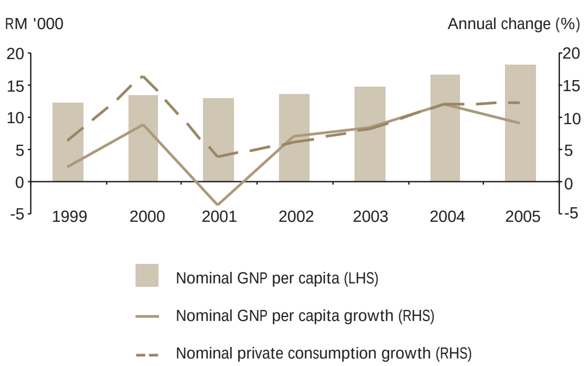
Graph 1.19
Real Domestic Demand Aggregates



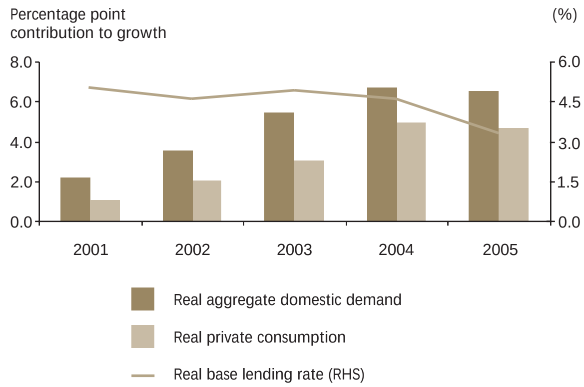
Domestic demand conditions remained favourable in 2005, supported mainly by the buoyant expansion in private sector activities. Public sector expenditure remained supportive of private demand.

continued increase in disposable incomes arising from high export earnings and favourable job market conditions. Measures by the Government to contain inflationary pressures and the competitive credit environment provided further support to household spending. Private investment, which has been on a positive trend since the second half of 2003, strengthened further in 2005, with positive growth in all sectors except construction. Business confidence was

Graph 1.20
GNP per Capita



Graph 1.21
Real Interest Rate and Domestic Demand



sustained throughout the year, while positive cash flows enabled companies to utilise internally-generated funds to finance their capital expenditure. Nevertheless, the surplus narrowed somewhat in 2005 and companies also accessed the financial system for funds, encouraged by the low cost of financing. Meanwhile, the Government continued to focus on developmental efforts while improving essential services and the public delivery system in order to enable the private sector to sustain the growth momentum. As a result, the Government was able to maintain its policy of a gradual consolidation of its fiscal position.

In spite of concerns on high oil prices and some uncertainty on the external outlook in the early part of the year, **private consumption** was sustained at a high level throughout 2005, growing by 9.2% for the year (2004: 10.5%). Consumer confidence remained buoyant as income continued to grow due to high export earnings and

Graph 1.22
Household Debt and Deposit/Loan Ratio

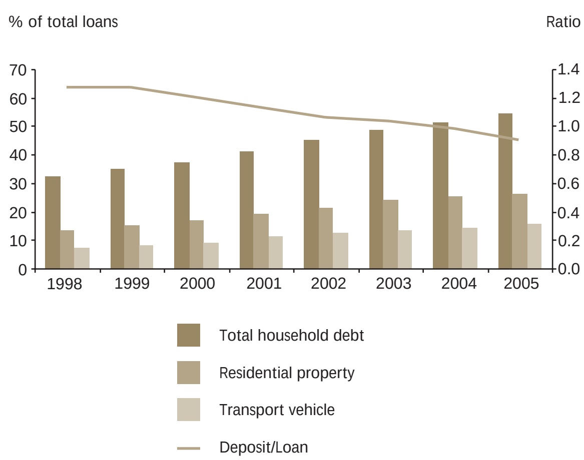


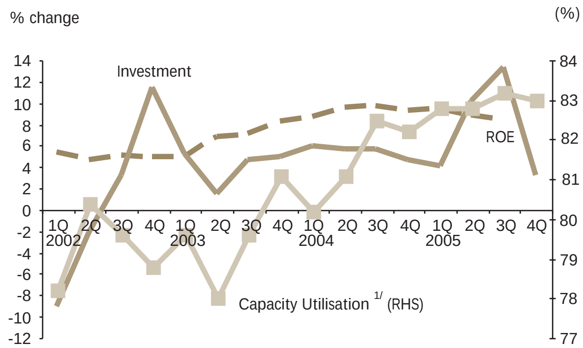
Table 1.11
Private Consumption Indicators

	2004	2005 1Q	2Q	3Q	4Q	Year
Sales of passenger cars (incl. 4WD)						
‘000 units	392.1	101.5	103.1	110.0	111.2	425.8
Annual change (%)	17.0	19.5	3.0	0.8	13.5	8.6
Imports of consumption goods						
RM billion	23.2	5.6	6.0	6.4	6.6	24.6
Annual charge (%)	24.1	10.7	4.3	5.2	4.2	5.9
Tax collection						
Sales tax (RM billion)	6.4	1.2	1.9	1.6	2.3	7.1
Service tax (RM billion)	2.3	0.5	0.7	0.5	0.9	2.6
Narrow money (M1)						
Annual change (%)	11.9	9.4	11.0	9.9	8.5	8.5
Loans disbursed by banking system						
Consumption credit (excl. passenger cars) Annual change (%)	16.8	7.0	12.6	10.4	10.7	10.2
Retail trade, restaurants and hotels Annual change (%)	19.5	21.8	21.1	19.1	6.3	16.5
MRA retail sales						
Annual change (%)	8.0	4.8	10.2	n.a.	n.a.	n.a.
Credit card operation						
Turnover spending (RM billion)	36.8	9.9	9.8	10.8	11.4	41.8
Annual change (%)	19.2	15.7	12.8	12.2	13.0	13.4
MIER Consumer Sentiments Index	-	120.9	109.8	102.5	116.1	-
KL Composite Index	907.4	871.4	888.3	927.5	899.8	899.8
Commodity prices						
CPO (RM/tonne)	1,664	1,363	1,418	1,387	1,423	1,398
Crude oil (USD/barrel)	41	49	54	65	60	57
Rubber (sen/kg)	461	468	467	552	604	523

favourable employment conditions. The MIER Consumer Sentiment Index (CSI), which reflects consumers’ assessments of their personal finances and the economy, peaked at 120.9 in the first quarter of 2005. However, higher oil prices started to impact consumer sentiments, which softened in the second and third quarters of the year. To a large extent, consumers were insulated from large increases in oil prices through the Government’s subsidy for fuel, though a portion of the subsidies was removed. The Government also announced a temporary halt on price increases on fuels and toll rates, and a reduction in road tax.

In the second half-year, improvements in labour market conditions were also accompanied by higher commodity prices, especially prices of rubber, leading to rising disposable income of households in both urban and rural areas. This, together with the bonus payments to civil servants at the end of the year, boosted consumer confidence. The improved sentiment was reflected by the increase in the CSI in the fourth quarter.

Graph 1.23
Investments, Capacity Utilisation and Profitability



1/ Source: Malaysian Institute of Economic Research (MIER)

The increase in the Overnight Policy Rate (OPR) on 30 November 2005 has not hampered households’ ability to borrow, as interest rates remained below neutral levels. Households continued to borrow, mainly for the purchase of residential properties and transport vehicles. Consumers’ willingness to spend by accumulating debt was evidenced by the deposit-to-loan ratio staying below 1 for the second consecutive year. Nevertheless, this increase in household debt remained manageable. The financial position of the household sector remained relatively healthy with the non-performing loan (NPL) ratios for both consumption credit and credit card debt declining further to 7.3% and 4.5% respectively in 2005 (2004: 8.1% and 4.7% respectively).

Following the robust growth in the previous year, the strong momentum of private sector capital spending continued into 2005, despite the tougher business climate due to rising crude oil prices and the mild down-cycle in the electronics sector in the early part of the year. **Private investment** continued to expand strongly during the year, posting a growth of 10.8% (2004: 25.8%), spurred by higher investment in the manufacturing, services and upstream oil and gas sectors. Companies were able to take advantage of their strong financial positions to fund the bulk of the investment through internally generated funds. In addition, the supportive financing environment also promoted investment activities as evidenced by the loans disbursed to businesses, which increased by 7.4% during the year. Investment indicators such as

Table 1.12
Private Investment Indicators

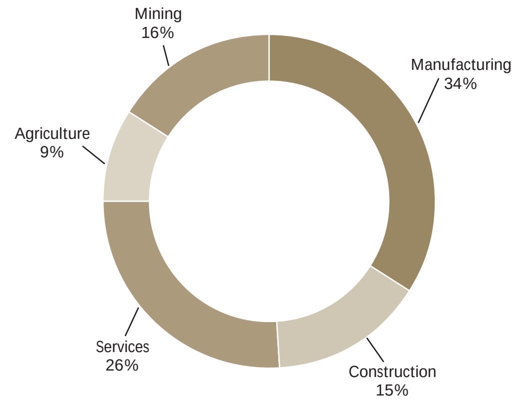
	2004	2005				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles (incl. 4WD)						
'000 units	95.5	30.5	34.8	40.3	34.5	140.2
Annual change (%)	35.1	57.1	47.1	65.6	23.1	46.8
Import of capital goods						
(RM billion)	55.5	12.3	15.5	17.0	15.9	60.7
Annual change (%)	36.0	0.7	16.3	21.0	0.3	9.5
Approvals by MITI (manufacturing sector)						
No. of projects	1,101	181	306	276	263	1,026
Capital investment (RM billion)	28.8	2.4	10.6	6.9	11.0	31.1
Foreign	13.1	0.7	5.9	3.9	7.5	17.9
Local	15.6	1.8	4.8	3.0	3.6	13.2
Loans disbursed by banking system						
Manufacturing sector Annual change (%)	10.2	13.9	4.9	2.5	-2.0	4.5
Construction sector Annual change (%)	10.4	4.5	0.8	5.8	-8.6	0.3
Business services Annual change (%)	19.0	-12.4	1.5	24.2	9.4	5.1
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	28.0	5.3	6.8	9.7	13.8	35.7
New activities	13.0	1.2	3.6	5.6	7.3	17.7
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	4.0	1.9	2.0	0.7	0.8	5.3
MIER Business Conditions Survey						
Business Conditions Index	-	104.1	106.0	102.7	100.5	-
Capacity Utilisation Rate (%)	-	82.8	82.8	83.2	83.0	-
MSC-Status Companies						
No. of companies	190	55	56	80	67	258
Approved investment (RM billion)	2.0	0.2	0.6	0.6	0.3	1.8

import of capital goods and sales of commercial vehicles also indicated that private investment continued to increase in 2005. Throughout the year, the MIER's Business Conditions Index remained above the 100-point threshold level, reflecting the generally positive business sentiment, particularly in the manufacturing sector.

Investment in the **manufacturing sector** remained strong during the year, mainly driven by expenditure on new machineries and equipment. In 2005, MITI approved a total of RM31.1 billion in 1,026 manufacturing projects. Of the total, more than half were joint projects with foreign partners,

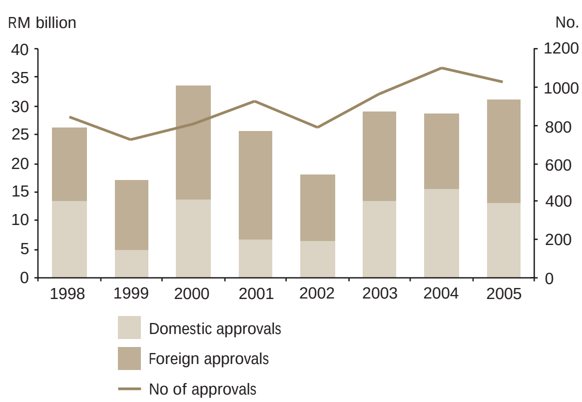
Graph 1.24
Private Investment by Sector (% share)

2005



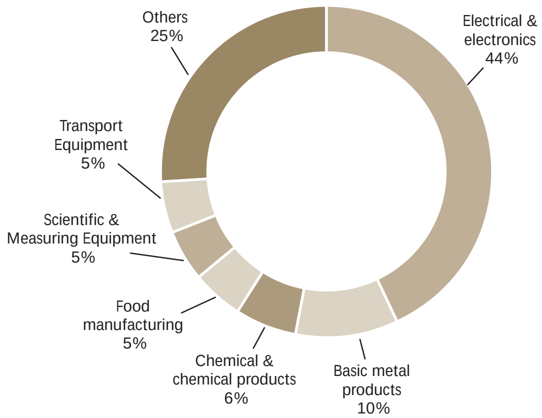
pointing to continued interest from foreign investors in the manufacturing sector. Approved capital spending for expansion or diversification activities are higher than for new projects, signifying that manufacturers were also venturing into high value-added manufacturing activities. The approved projects were mainly concentrated in the electrical and electronic products, basic metal products, and chemical and chemical products industries. Of importance, the approved investments, particularly in the electronics segment, have continued to move towards technology and skill-intensive projects. The emphasis and promotions on high value-added manufacturing-related activities have also attracted R&D projects into the country, where a number of electronics

Graph 1.25
Private Investment in the Manufacturing Sector



Source: Malaysian Industrial Development Authority

Graph 1.26
Approved Manufacturing Investment by Industry, 2005 (% share)

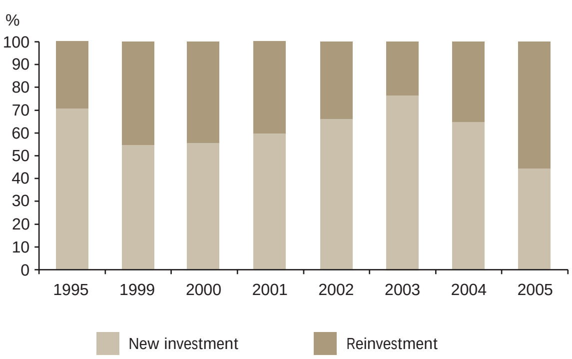


Source: Malaysian Industrial Development Authority

companies were planning to set up R&D centres, and design and test operations in the country.

Investment was substantially stronger in the **services sector** due to notable development of utilities infrastructure and capacity expansion by transportation companies. Higher capital spending for the utilities sub-sector was attributed to the development of power plants and water projects. The independent power plant (IPP) projects include IPP Tanjung Bin, IPP Jimah, IPP Sepangar Bay and IPP Teluk Salut. Meanwhile, the spending on water projects was largely for the Sungai Selangor Project Scheme 3 (SSP3), the Stormwater Management and Road Tunnel (SMART) project as well as the expansion and upgrading of water treatment plants and water distribution in several states. In the transport sub-sector, port operators such as PTP, North Port and West Port continued to invest in improving port facilities and equipment arising from the need to increase port capacity. At the same time, investment on air transport was higher as companies embarked on fleet expansion programmes. Meanwhile, in the telecommunication sub-sector, cellular operators continued to spend on improving the reliability and efficiency of networks, as well as optimising and upgrading existing network equipment to cater for high-speed mobile services. In the retail sub-sector, a number of new outlets were established during the year, particularly buoyed by strong consumer spending activities.

Graph 1.27
Share of Approved New Investments and Reinvestments in the Manufacturing Sector



Source: Malaysian Industrial Development Authority

In the **mining sector**, higher capital expenditure was predominantly in the upstream oil and gas segment. During the year, production-sharing contractors accelerated exploration and production capital spending due to rising oil prices and increasing demand for crude oil. Of importance, intensified exploration during the year was spurred by aggressive exploration campaign in deepwater and ultra-deepwater oil fields. In addition, discoveries of new oil and gas resources since 2002 continued to support capital spending in production facilities and development projects.

In 2005, a large part of investment in the **construction sector** reflected activities from residential construction, arising from the development of new townships and urban centres, with the emphasis on high-end property projects. On the other hand, capital spending on roads was lower due to the completion of two major projects, namely the Butterworth Outer Ring Road and Guthrie Corridor Expressway, as well as the delay in the construction of the Kajang-Seremban Expressway. Nevertheless, ongoing development of several privatised road projects such as the Senai-Desaru Expressway and Jelutong Expressway continued to support investment in the sub-sector.

Capital expenditure in the **agriculture** sector remained largely driven by activities in commercial crop plantation. The expenditure for the development of commercial crop plantations remained at high levels, especially for palm oil, as stronger demand and firm CPO prices have encouraged further capital spending by private plantation companies. The expenditure was mainly to expand and upgrade milling capacity and support replanting activities.

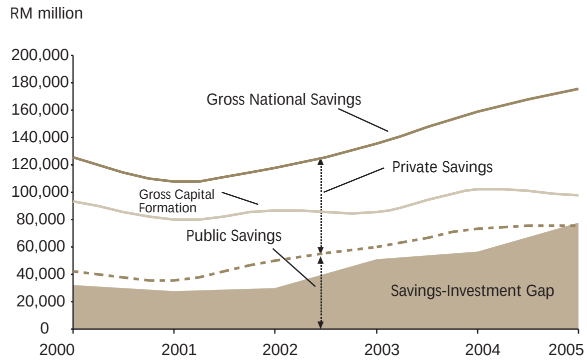
Public consumption increased by 5.9% in 2005, mainly on account of the continued high expenditure on supplies and services, defence as well as emoluments.

The increased expenditure for supplies and services was largely to further improve the administrative machinery and delivery system of the public sector. Reflecting the Government's efforts to continue enhancing human resource development in strengthening the nation's productivity and competitiveness, expenditure on emoluments remained high.

Public investment turned around to register a marginal growth of 0.4% in 2005 (2004: -8.7%). The Federal Government continued to focus on developmental projects that improved economic and social services sectors of the country. Most importantly, these programmes were implemented based on the emphasis of achieving a greater balance between the development of urban and rural areas. In the economic sector, expenditures were mainly focussed on modernising the agriculture sector, improving infrastructure in rural areas, enhancing industrial growth and improving transportation infrastructure. At the same time, capital expenditures for the social services sector were mainly allocated towards enhancing and upgrading of essential services, namely education, training and health and medical services as well as provision of affordable houses to the people. Meanwhile, capital expenditures by the NFPEs were stronger during the year, largely attributed to capacity expansion efforts and commitment to improve efficiency by the NFPEs, such as Petroliam Nasional Berhad (PETRONAS) and Telekom Malaysia Berhad (TM). During the year, investment by PETRONAS increased largely due to intensified exploration activities in the upstream oil and gas sectors as well as expansion of shipping fleet to cater for stronger demand for LNG and petroleum-related products. Capital spending by TM was also higher, mainly for the deployment of new infrastructure for residential and business premises as well as provision of infrastructure in new areas with high demand for broadband services. Meanwhile, Tenaga Nasional Berhad's investment continued to focus on maintenance activities and improvement projects, such as upgrading and replacement programmes of power transmission and distribution systems.

Despite sustained growth in consumption, **gross national savings (GNS)** increased further by 10.9% in 2005, in line with the expansion in nominal gross national income. In the private sector, both households and the corporate sector continued to enjoy better disposable incomes and cash flows, as a result of higher export earnings and better employment growth during the year. This enabled private sector savings to continue to increase by 17.9% in spite of the strength of private consumption. The main source of the increase was due to higher corporate savings. New deposits placed by business enterprises with banking institutions were higher at RM37 billion in 2005, compared with RM31.6 billion in the previous year. Meanwhile, public savings continued to expand by 2.8% in 2005, due mainly to the strong performance of the major NFPEs during the year.

Graph 1.28
Gross National Savings and the Savings-Investment Gap



Overall, the share of GNS to Gross National Product (GNP) remained high at 37.1% (2004: 37.3%). This high rate of savings has enabled Malaysia to continue to finance its growth primarily from domestic sources. Given a lower gross domestic capital formation (including stocks), the savings-investment balance, therefore, recorded a larger surplus of RM77.8 billion or 16.4% of GNP in 2005.

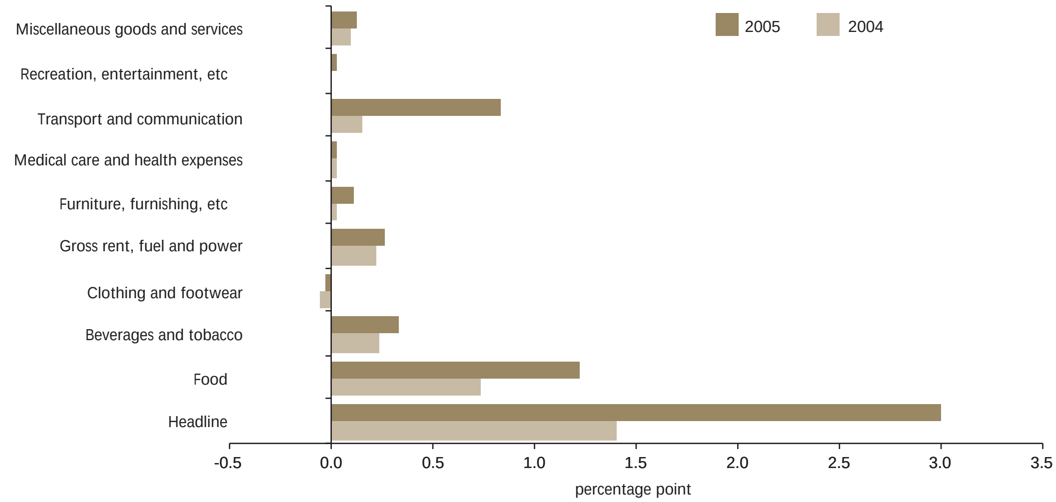
PRICES AND EMPLOYMENT

Consumer Prices

In 2005, inflation emerged as one of the areas of macroeconomic concern in the global economy. A key factor behind this development was the significant increase in international oil prices over the course of the year. Malaysia, as a small open economy, was not insulated from this global phenomenon.

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), increased from 1.4% in 2004 to 3% in 2005. The increase in inflation during the year was primarily due to the supply-related factors following the increase in international oil prices. Core inflation, which is CPI inflation excluding price-volatile items and price-administered items, rose to 2% (1% in 2004) during the period. The rise in core inflation was driven by strong domestic demand, as favourable labour market

Graph 1.29
Contribution to CPI inflation



conditions, a competitive credit environment and high commodity prices supported income and spurred consumer spending.

All categories in the CPI registered higher increase in 2005. The most significant increase in prices during the year was seen in the transport and communication and food categories, both of which are sensitive to the fluctuations in the prices of energy and non-energy commodities. It should be noted that although the uptrend in international oil prices gained momentum in late 2004, the upward pressure on domestic inflation was relatively less. This was partly due to the buffer provided by the subsidy on retail fuel prices and controls on gas prices and power rates. The escalation on the global price of crude oil however has exerted an increasing burden on the Government's operating expenditure, while raising concerns over the misallocation of resources and costs of enforcement. In addressing this issue, the Government has removed part of the oil subsidy, thereby limiting the inflationary impact on consumers. Domestic retail fuel prices were adjusted three times during 2005 (Table 1.13), contributing approximately 0.4 percentage points to the inflation rate for the year.

Although there were concerns that the increase in domestic oil prices would cascade down into the prices of other goods, the subsequent outturn for inflation was rather moderate. This could be attributable to several factors. Firstly, labour productivity, as measured by the real sales per employee in the manufacturing sector increased by 10% in 2005, surpassing the 0.8% growth in the real wages per employee in the manufacturing sector. This, coupled with the intensification of competition amongst producers and from imports have somewhat contained the secondary effects from higher oil prices. In addition, capacity expansion amongst businesses played a role in increasing supply and mitigating possible demand pressures. Active surveillance and enforcement efforts undertaken by the relevant Government agencies also ensured that prices of controlled essential goods and services are transparent and not raised opportunistically.

Table 1.13
Changes in Prices of Administered Goods and Services in 2005

Effective date	CPI items (weight: 12%)	% increase	Contribution to 2005 inflation (in pct. points)
Jan-05	Chicken prices	14.6%*	0.29
Jan-05	Toll charges	10%	0.04
Mar-05	Diesel prices	6%	0.01
May-05	Public transport fares[1]	6.7%*	0.10
May-05	Prices of retail petrol & diesel	7.4%	0.24
Aug-05	Prices of retail petrol products[2]	6.8%	0.15
Sep-05	Prices of alcoholic beverages & tobacco	7.1%**	0.05
Total Contribution to Headline Inflation		**6.50%**	**0.88**

[1] Includes public transport fares such as railway, ship (ferry), airlines, bus and taxi.
[2] Includes retail petrol, diesel and cooking gas (LPG).
* Average increase in 2005.
** Average increase post Budget-2006.

Source: Department of Statistics, Malaysia.

Table 1.14
Price Indicators

Consumer Price Index (2000=100)	Weight	2004	2005
	Annual change (%)		
	100.0	**1.4**	**3.0**
of which:			
Food	33.8	2.2	3.6
Beverages and tobacco	3.1	7.8	10.5
Clothing and footwear	3.4	-1.8	-1.0
Gross rent, fuel and power	22.4	1.0	1.2
Furniture, furnishings and household equipment and operation	5.3	0.4	2.0
Medical care and health expenses	1.8	1.4	1.6
Transport and communication	18.8	0.8	4.4
Recreation, entertaiment, education and cultural services	5.9	-0.1	0.5
Miscellaneous goods and services	5.5	1.8	2.4
Consumer Price Index			
Durable goods	9.4	0.2	0.4
Semi–durable goods	5.4	-0.9	-0.1
Non-durable goods	40.2	2.4	5.0
Services	45.0	1.0	2.1
Producer Price Index (1989=100)	**100.0**	**8.9**	**6.8**
of which:			
Local Production	79.3	10.3	7.9
Imports	20.7	2.0	1.5

Source: Department of Statistics, Malaysia

In the Monetary Policy Statement (MPS) released in August 2005, the Bank stated that the cumulative effect of previous price adjustments was expected to translate into inflation peaking in the third quarter of 2005, and to moderate thereafter. However, it was highlighted that there remained considerable uncertainty on the direction of oil prices. Monetary policy would therefore take into account the need to ensure that the level of monetary accommodation is balanced with the need to ensure price stability. In the third quarter of the year, the economy began to show evidence of stronger economic growth, with indications that the momentum would continue into the fourth quarter and into 2006. As the risk of slower economic growth diminished, the balance tipped towards the increased risks to inflation. Consequently, on the 30 November 2005, BNM raised the Overnight Policy Rate (OPR) by 30 basis points to 3 percent.

Producer Prices

Producer price inflation, as measured by the annual change in the Producer Price Index (PPI), moderated to 6.8% in 2005 (8.9% in 2004). Despite the strong increase in crude oil prices during the year, the commodity-related categories registered a slower annual growth of 10.8% (15.6% in 2004). This was largely due to the consolidation in the prices of crude palm oil and rubber in the first half of the year. Excluding these commodity-related categories, producer prices increased slightly by 2.2% (2% in 2004) due mainly to the higher prices for food and live animals; and machinery and transport equipment. Meanwhile, the annual growth in the PPI for imported goods moderated to 1.5% (2% in 2004), in part due to the increased global competition, increased supply from low cost producing countries and the stronger ringgit against Malaysia's trading partners during the year.

Labour Market Developments

The domestic labour market continued to be healthy and stable in 2005. The **unemployment rate** remained steady at 3.5% as both total employment and labour force increased by 4.1% to 10.9 million and 11.3 million respectively. Total retrenchments declined by 19%,

Labour market conditions remained healthy as vacancies rose and retrenchments declined.

Table 1.15
Labour Market Indicators

	2001	2002	2003	2004	2005*e*
Labour force ('000)	9,724.2	10,064.3	10,426.4	10,846.0	11,290.5
(annual change in %)	1.6	3.5	3.6	4.0	4.1
Employment ('000)	9,378.8	9,709.0	10,047.2	10,463.7	10,894.8
(annual change in %)	1.1	3.5	3.5	4.1	4.1
Unemployment rate (% of labour force)	3.6	3.5	3.6	3.5	3.5
Labour productivity (GDP/Employment) (annual change in %)	-0.8	0.8	1.9	2.9	1.1
Real wage per employee in manufacturing sector (annual change in %)	1.7	3.2	2.9	1.9	0.8

e Estimate

Source: Economic Planning Unit
Department of Statistics, Malaysia
Bank Negara Malaysia

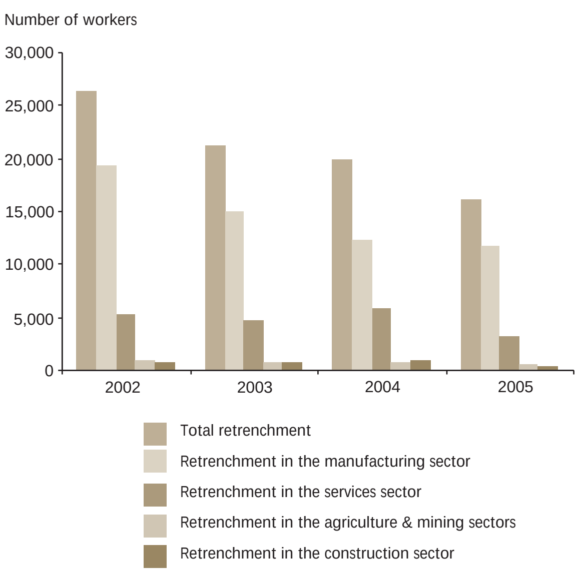
reflecting the recovery in economic activities in the second half-year following slower growth in the second quarter and the flexibility accorded to the employers to take alternative measures such as temporary layoffs and instituting pay cuts. In 2005, the number of job vacancies increased to a record high of 304,500 positions (previous high, 2002: 162,787 positions). Nevertheless, the number of unplaced job seekers was also higher, though the situation improved towards year-end. Meanwhile, job placements were stronger, reflecting increased efficiency in labour-matching process.

In 2005, lower **retrenchments** were recorded following the pick-up in economic activities in the second half-year. Total retrenchments declined by 19% to 16,109 persons (2004: 19,956 persons), with the bulk occurring in the manufacturing and selected services sectors, in particular, the wholesale and retail trade. Most of the retrenched workers were production-related workers (53%) as well as those in the professional and technical positions (17%), and sales and service workers (11%). Among key reasons cited for retrenchments during the year were high costs of production, reduction in demand for products, and sale of companies.

More jobs were available in 2005, especially during the second half-year. Total **job vacancies** reported to the Manpower Department of the Ministry of Human Resources surged to 304,500 positions (2004: 49,975) due in part to a new ruling that makes it compulsory for employers to report job vacancies to the Electronic Labour Exchange before they can apply for foreign workers. Higher job openings were recorded across all key sectors, especially in the agriculture, forestry and fishery, construction and manufacturing sectors. In terms of total positions available, the manufacturing sector continued to generate the highest number of vacancies, accounting for 37% of total job vacancies, followed by the services sector (21%). The bulk of vacancies were for elementary occupations, plant and machine operators and assemblers as well as for clerical, managerial and professional positions.

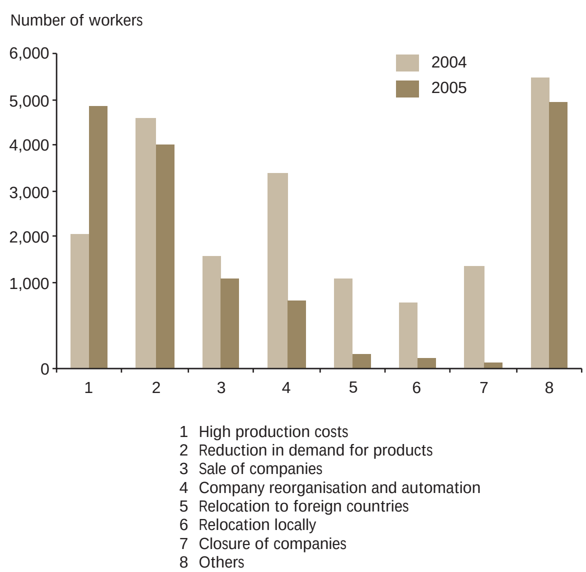
Meanwhile, the number of **unplaced job seekers** registered with the Manpower Department increased to 72,573 persons in 2005. However, the data is not comparable with previous years because from May onwards, the registration period during which job seekers are deemed to be actively seeking jobs was lengthened from three months to six months. Based on the new definition, the number of active job seekers that were still unplaced as at end-year has moderated from May (78,546 persons) and from the peak recorded in August of 104,714 persons. **Job placements** also increased, rising from 6,192 persons in 2004 to 17,459 persons in 2005, reflecting in part an improved labour-matching process, as well as some success in the Government's initiatives to increase the employability and marketability of job seekers via skills

Graph 1.30
Retrenchment according to economic sectors



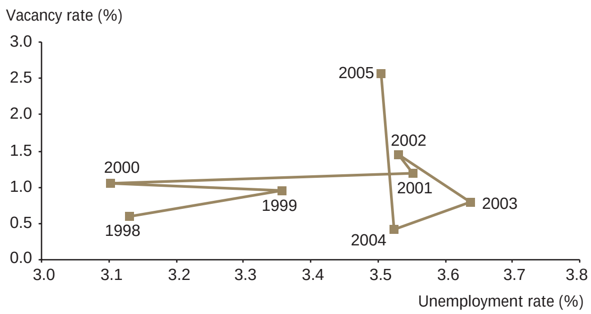
Source: Ministry of Human Resources

Graph 1.31
Reasons for Retrenchment



Source: Ministry of Human Resources

Graph 1.32
Beveridge Curve for Malaysia (1998-2005)



Source: Economic Planning Unit
Ministry of Human Resources
Bank Negara Malaysia

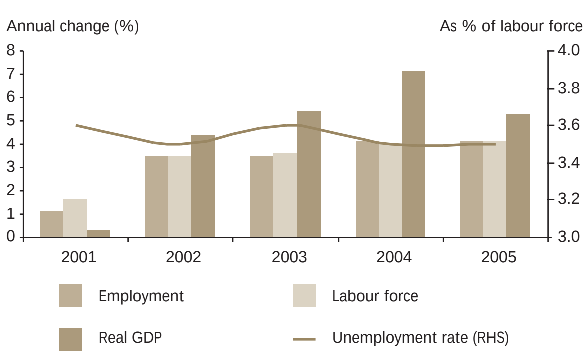
retraining programmes and the nation-wide job fairs to raise awareness regarding job opportunities. A large proportion of successful job placements continued to be recorded in the manufacturing (38%) and the services (30%) sectors.

The Beveridge Curve, which tracks the pattern of unemployment and vacancies in the labour market, moved almost vertically upwards in 2005, reflecting the fact that in spite of higher vacancies, the unemployment rate did not decline. This could mean that further improvements in the labour-matching process were needed. Despite efforts made by the Government to publicise the Electronic Labour Exchange Programme (ELX), which has been in place since 2002, many job seekers (employed and unemployed) were still unaware of the facility. The ELX provides free services to job seekers from school leavers to graduates, and helps them secure jobs. In order to increase the awareness of ELX to the job seekers, the Ministry of Human Resources plans to set up ELX booths in selected shopping malls and two mobile units equipped with computers and Internet access to traverse the country especially in rural areas, to register job seekers and to provide them with career guidance. Meanwhile, the job clearing system within the ELX also helps employers to look for potential workers. In 2005, 17,625 employers utilised the ELX to advertise a total of 304,500 job vacancies (2004: 5,553 employers and 49,975 positions). Although successful matches via the Exchange increased to 308,291 positions in 2005 (2004: 37,295 positions), only 17,459 persons were recruited (2004: 6,192 persons). This could be due to the tendency of employers to be more selective in filling vacancies, as reflected in the Curve's lower elasticity, and also to the fact that that the number of job placements could be under-reported as it is not compulsory for employers and job seekers to report successful job placements.

Overall, most key economic sectors recorded higher employment in 2005, except for the agriculture and construction sectors. The services sector continued to be the largest employer, engaging slightly more than 50% of total workers, particularly the wholesale and retail trade, hotels and restaurants (18%) and government services (10%) sub-sectors, followed by the manufacturing (29%) and agriculture, forestry and fishery (13%) sectors.

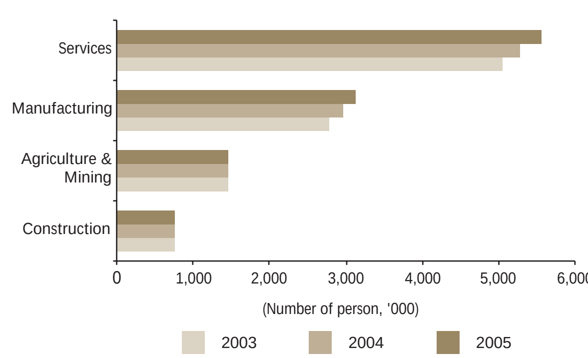
In 2005, nominal **wages** were higher as more employers linked their employees' annual increments and bonuses to performance or productivity. Wages also rose in part due to improved labour market conditions as well as to reflect the higher cost of living.

Graph 1.33
Output and Employment



Source: Economic Planning Unit
Department of Statistics, Malaysia

Graph 1.34
Total Employment by Sector



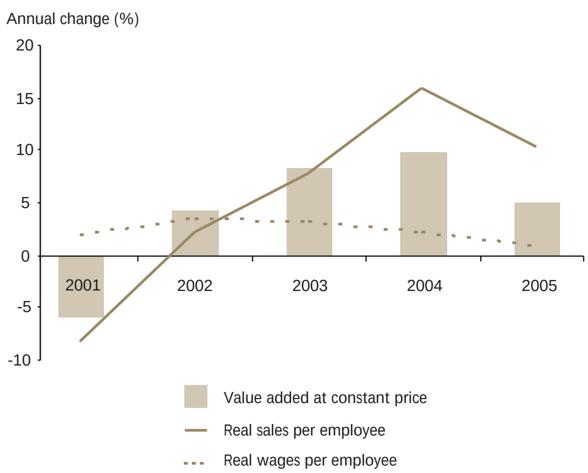
Source: Economic Planning Unit

- The Salary and Fringe Benefits Survey undertaken by the **Malaysian Employers Federation** (MEF) showed a higher increase in the average private sector salary of 5.8% in 2005 (2004: 5.6%), with both categories of employees, executives (5.9%) and non-executives (5.7%), receiving higher salary increases. On a sectoral basis, the average salary increase in the non-manufacturing sector (5.9%) continued to outpace that of the manufacturing sector (5.7%) (2004: 6.1% and 5% respectively). The average minimum monthly salary offered to those with a basic degree without prior working experience was marginally higher at RM1,707 (2004: RM1,666).

- Similarly, findings from the Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the **Federation of Malaysian Manufacturers** also revealed higher salary increments to employees in 2005. The average salary increment given to employees was 6.3% (2004: 5.6%). Meanwhile, the average basic salary offered to a fresh graduate with a degree qualification was RM1, 917 (2004: RM1, 799).

Productivity is a measure of the efficiency with which inputs are transformed into outputs within the production process. **Total factor productivity** growth captures productivity increase arising from improvements in utilisation of factor inputs due to technological process and overall efficiency improvement. Recent estimates by Bank Negara

Graph 1.35
Manufacturing Sector: Output and Productivity



Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Malaysia showed that total factor productivity improved in 2005, registering a growth of 3% (2004: 2.7%), indicating more efficient use of resources and technology. At the same time, data from the Monthly Manufacturing Survey conducted by the Department of Statistics, Malaysia showed that labour productivity, as measured by real sales per employee, rose by 10%, surpassing the 0.8% growth in real wage per employee. Almost all the manufacturing industries such as petroleum and chemicals, basic metal, E&E, textiles, transport and off-estate recorded higher growth in labour productivity vis-à-vis wages. Meanwhile, real labour productivity for the whole economy, as measured by real GDP per worker rose by 1.1% during the year.

In order to enhance flexibility in the labour market to improve competitiveness, the Government has advocated the use of a productivity-linked wage system (PLWS). By implementing PLWS, companies would be able to put in place a flexible and competitive wage system that would enable them to respond quickly and effectively to changing business conditions, leading to higher productivity gains, lower costs and improvement in competitiveness. In addition, a PLWS would also provide a clear incentive to workers to upgrade their performance and productivity. For employees, high performers would reap more benefits. PLWS components include non-contractual bonuses, bonuses based on profits, and salary increments based on merit or performance. Industry data showed that more companies are adopting PLWS. According to the MEF's 2005 Survey, about 80% of its respondent companies linked salaries to performance for the executives, and 74% for non-executives. Similarly, latest available data from the National Productivity Corporation showed that out of 322 collective agreements (CAs) signed in 2004, a total of 201 or 62% contained PLWS components (2003: 45% out of 367 collective agreements). In the agriculture sector, all of the eight CAs contained PLWS components, compared to 83 (77%) in the services sector, and 110 (53%) in the manufacturing sector.

Although the Government has always encouraged employers to hire more local workers and to adopt labour-saving devices such as increased mechanisation and automation to achieve higher efficiency and productivity, **foreign workers** still play a major role in alleviating labour shortages in selected sectors of the economy. As such, in 2005, the Government allowed registered foreign workers whose contracts have expired to change employers within the same economic sector as long as their work permits were still valid. In addition, to ensure a more efficient system of recruiting foreign workers, the Government established a One-Stop Centre to expedite processing of applications for foreign workers, eliminate the use of middlemen or agents and to reduce red tape in the Government sector. The Centre would process applications within 24 hours, thereby speeding up the administrative processes significantly. The Centre commenced operations in August 2005 and was manned by officers from relevant government agencies, including Ministry of Home Affairs, Ministry of International Trade and Industry, Ministry of Agriculture and Agro-based Industry, Ministry of Plantation Industries and Commodities, Construction Industry Development Board and Ministry of Human Resources. The major changes in the process of hiring foreign workers are as follows:

- New levy system for foreign workers, whereby rates differ according to the location (Peninsular Malaysia or East Malaysia) and sector of economic activity. For instance, foreign workers employed in the services sector in Peninsular Malaysia are subjected to a higher levy compared to that in Sabah and Sarawak.
- An increase in the levy for each foreign worker engaged in the plantation and services sector in Peninsular Malaysia to RM540 and RM1,800 per annum respectively (previously: RM360 and RM1,200 respectively). The levy for hiring more than one maid is also increased to RM540 per person (previously: RM360).
- To ensure that employers hire only the required number of workers, employers are required to pay the levy at the Centre based on the number of foreign workers approved.
- Employers are required to register with the Manpower Department before applying for foreign workers. Employers also need to advertise job openings in the Job Clearing System to give local job seekers priority in applying for jobs. If the positions remained unfilled, then companies are allowed to engage foreign workers.
- Employers need to attend an interview at the Centre, thereby eliminating the need for middleman and the potential for fraud.

Meanwhile, beginning 1 February 2006, the Government also requires all non-professional foreign workers (except Indonesians) to attend an induction course on communication skills, Malaysian culture and laws, conducted at centres in the source countries in collaboration with MLVK-approved training centres in Malaysia. Foreign workers who completed the course would be given the Certificate of Eligibility, which is a pre-requisite for a working visa in Malaysia.

In 2005, the Government undertook measures to reduce the number of **illegal foreign workers** and to improve the security of the population. The Amnesty Programme that was launched on 29 October 2004 was extended to end-February 2005. Altogether, about 89,510 illegal workers left Malaysia in the first two months of the year (October - December 2004: 309,248 persons), the majority of whom were Indonesians (84%), followed by Indian nationals (5%) and Bangladeshis (3%). Nevertheless, there were still some illegal migrant workers who chose to remain in Malaysia despite Government efforts to legitimise them. Thus, on 1 March, the Government mounted a full-scale operation called *Ops Tegas* involving stricter enforcement. During the period from 1 March to 31 December, 11,916 more illegal migrants were arrested.

Although the Amnesty Programme was designed to allow the speedy return of the now-legitimised foreign workers to Malaysia, delays emerged due to some administrative bottlenecks in the major source country, Indonesia. In March, the slow return of legal foreign workers created a temporary shortfall in labour in the manufacturing, construction and plantation sectors. Hence, the Government lifted the two-month freeze on hiring of new foreign workers in April, and allowed foreign workers from a number of different countries such as Vietnam, Pakistan, India, Nepal and Myanmar to work in Malaysia.

As at end-year, total **registered foreign workers** in Malaysia numbered 1,815,238 persons, representing an increase of 23.5% from the previous year (2004: 1,470,090 persons). The large increase reflected in part new hires as well as the success of the Government's Amnesty Programme whereby some illegal migrant workers returned to Malaysia as registered foreign workers. In total, foreign workers account for about 16.7% of total employment and are engaged mainly in the manufacturing (32%), plantation (24%) and construction (16%) sectors, as well as domestic helpers (18%). In terms of nationalities, Indonesian workers still constitute the largest group with 67%, followed by Nepalese (11%) and Indian nationals (7%).

In 2005, the Government intensified efforts to address the rising number of **unemployed graduates**. According to a week-long survey conducted by the Economic Planning Unit in September, nearly 60,000 graduates were jobless, with most being unemployed for more than one year. Among key reasons cited for being jobless include no job experience; weak command of the English language and a lack of communication skills; and possessing university degrees that were not relevant to market needs. The large number of unemployed graduates is a concern as it could hamper the country's aim to be a knowledge-based economy. Therefore, in 2005, the Government continued to focus on training and embarked on various programmes to address the issue of mismatch of skills between the unemployed graduates and market requirements. The status of some of the programmes and training schemes are as follows:

- **Graduate Training Scheme III**: Launched in August 2005, the Scheme aims to equip local graduates who have been unemployed since year 2003, with specialised skills such as web publishing and application, tourism (tourist guide) and event management, ICT and English language among others. A total of 11 courses were offered, each running for about two-and-a-half to five months. About RM100 million has been allocated for this Scheme, with plans to train 15,500 unemployed graduates. In 2005, 7,992 unemployed graduates enrolled in the programme, mainly in English language courses, followed by executive development and web-based courses.

- **Graduate Reskilling Scheme**: This Scheme targets engineering and selected technical graduates with no previous employment history. The objective of the Scheme is to upgrade skills and knowledge of graduates in related technical fields, such as manufacturing-plant operation and maintenance in the automotive industry, semiconductor chip design, and supply chain management. Courses are of Certificate level, and conducted in skills development centres and selected participating colleges and universities. As at end-2005, a total of 2,370 graduates have participated in the courses.

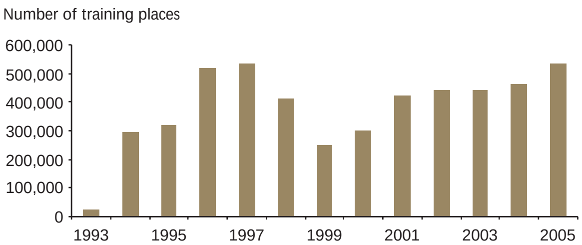
- **Graduate Apprenticeship Programme**: This programme was initiated in 2005 and managed by the Ministry of Higher Education. A total of 79 skills-related courses are offered in various public universities, with apprenticeship in selected private companies. Up till mid-September, a total of 9,225 graduates benefited from this programme.

- **National Dual Training Scheme**: The programme's overarching objective is to produce knowledge workers that match industry needs. The two-year training programme, similar to that implemented in European countries, consists of two components – 20-30% of training being theoretical in nature, conducted in selected National Vocational Training Council (*Majlis Latihan Vokasional Kebangsaan*, MLVK) training institutes; and the balance in the form of practical training in various companies, including Government-linked ones as well as multinational firms. Launched in July 2005, participants would be trained in four specialised areas, namely automotive mechatronic; plant operation in the petrochemical, oil and gas industry; process automation in industrial electronics industry; as well as tool making (mould and dye). The first intake has benefited about 71 school leavers, university graduates and employed workers. Upon completion of the 2-year training programme, participating companies can choose to absorb the trainees into their workforce.

- **Attachment and Training Scheme**: Introduced in 2001, the Scheme seeks to provide unemployed diploma and degree graduates with work experience, thereby improving their chances of getting jobs. Trainees were attached to Government departments and agencies and were exposed to ICT, English language and statistics or research methodologies courses. As at end-2005, seven out of eight programmes under this scheme were completed, benefiting about 38,210 graduates.

The cost of the training programmes is wholly borne by the Government and to attract further participation, trainees were provided with monthly allowances of RM350. In October, in view of the higher cost of living, the allowance was increased to RM500 per month. To further encourage the private sector to provide employment opportunities to unemployed graduates, the 2006 Budget proposed that double deduction be given on the allowances paid by companies listed on Bursa Malaysia to participants of Unemployed Graduate Training programme. This incentive would be available for three years and is expected to benefit at least 1,000 unemployed graduates. The Government also approved additional RM100 million for training of unemployed graduates. Meanwhile, Skills Training Centres at the state levels would increase student intakes and introduce new courses under the Industrial Skills Enhancement Programme. For unemployed graduates who are interested in participating in economic activities, the Government intends to implement 'Young Entrepreneurs' Scheme' that focuses on ICT, tourism, *halal* products, and food processing and packaging. In addition, the PROSPER Graduate Programme seeks to encourage graduates to become entrepreneurs. An initial batch of 200 graduates is expected to benefit from the programme in 2006, each getting RM50,000 in financing aid to assist them in setting up businesses.

Graph 1.36
HRDF: Number of Training Places Approved



Source: Pembangunan Sumber Manusia Berhad

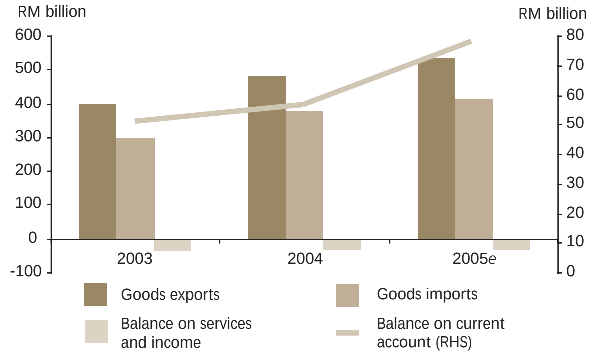
In 1993, the **Human Resource Development Fund** (HRDF) was established with matching grant from the Government to encourage the private sector employers in the manufacturing and services sectors to retrain and upgrade the skills of their employees. The HRDF operates on the basis of levy system, whereby employers who have paid the levy will qualify for training grants from the Fund to defray or subsidise training costs for their Malaysian employees. The rate of financial assistance is 100% of the allowable costs incurred for training in Malaysia and up to 50% for costs incurred overseas, subject to the availability of levy in the employers' accounts with *Pembangunan Sumber Manusia Berhad* (PSMB) which administers the Fund. In 2005, the PSMB approved 535,266 training places, with financial assistance of RM228.7 million. Among others, the PSMB offers training for retrenched and unemployed workers as well as run apprenticeship programme for SPM school leavers. Given the increasing importance of the services sector in terms of its contribution to the economy and its need for knowledge workers, the scope of the PSMB Act 2001 was expanded to include more services industries such as port services; warehousing services; R&D; support services and maintenance engineering; hypermarkets, supermarkets and department stores; security services; private hospitals; and direct sales. With the inclusion, employers in these industries would need to contribute to the development levy for the purpose of training, retraining and upgrading the skills of their employees so as to be in line with business needs and the country's economic strategy.

EXTERNAL SECTOR

Balance of Payments

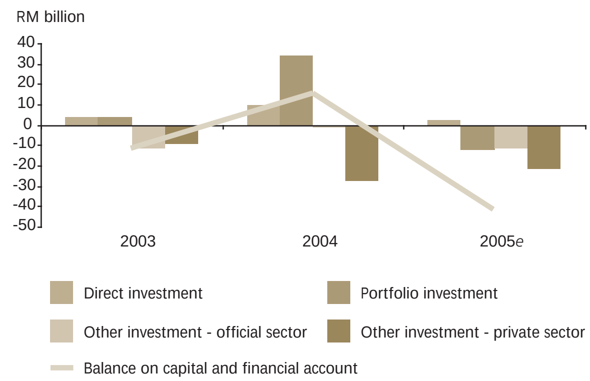
The **overall balance of payments** remained strong and recorded a surplus in 2005. The larger current account surplus was due mainly to a stronger goods surplus, reflecting sustained expansion in commodity

Graph 1.37a
Current Account



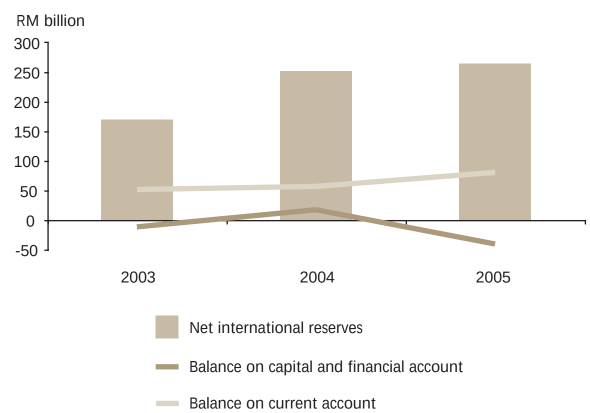
e Estimate

Graph 1.37b
Capital and Financial Account



e Estimate

Graph 1.37c
Net International Reserves



exports and continued growth in manufacturing exports. Meanwhile, the financial account recorded a net outflow attributed mainly to the unwinding of portfolio positions in the fourth quarter and higher external loan repayments by the official sector. Errors and omissions, including exchange loss from revaluation of Bank Negara Malaysia's international reserves due to the strengthening of the ringgit against major currencies, was RM23 billion. Revaluation losses on reserve holdings arising from the appreciation of the ringgit against the major currencies amounted to RM15.5 billion. After adjusting for errors and omissions, the overall balance of payments recorded a surplus of RM12.8 billion. As a result, the net international reserves of Bank Negara Malaysia increased by RM12.8 billion to RM266.3 billion (USD70.5 billion) as at 31 December 2005. The reserves increased further to RM272.7 billion or equivalent to USD72.2 billion as at 28 February 2006. This reserves position is adequate to finance 7.6 months of retained imports and cover 6.7 times the short-term external debt. Malaysia's reserves remained usable and unencumbered.

Current Account

In 2005, the **current account** continued to record a large surplus of RM77.8 billion, equivalent to 16.4% of GNP (2004: RM56.5 billion or 13.3% of GNP), due to a larger surplus in the trade account and, to a lesser extent, an improvement in the income account. The export growth was underpinned by an expansion in manufacturing exports and higher prices for commodity exports. A larger outflow in other services account and higher payments for travel abroad led to a larger deficit in the services account. The income account recorded an

The larger current account surplus was due mainly to a strong trade surplus, driven by the continued expansion in manufactured and commodity exports, and an improvement in the income account.

Table 1.16
Balance of Payments

Item	2004			2005e		
	+	-	Net	+	-	Net
	RM million					
Goods	481,240	376,766	104,474	536,931	410,476	126,455
Trade account	*480,740*	*400,077*	*80,663*	*533,788*	*434,010*	*99,778*
Services	63,717	72,496	-8,780	72,202	82,452	-10,249
Balance on goods and services	**544,958**	**449,264**	**95,694**	**609,133**	**492,928**	**116,205**
Income	16,023	40,572	-24,549	20,469	41,937	-21,470
Current transfers	1,700	16,333	-14,633	1,131	18,094	-16,963
Balance on current account	**562,681**	**506,169**	**56,511**	**630,734**	**552,960**	**77,772**
% of GNP			**13.3**			**16.4**
Capital account			–			–
Financial account			15,083			-41,952
Direct investment			9,739			2,711
Portfolio investment			33,829			-11,881
Other investment			-28,485			-32,782
Balance on capital and financial account			**15,083**			**-41,952**
Errors and omissions			11,467			-23,000
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*7,997*			*-15,496*
Overall balance			**83,061**			**12,820**
Bank Negara Malaysia international reserves, net			**253,513**			**266,334**
USD million equivalent			**66,714**			**70,483**

Note: Numbers may not necessarily add up due to rounding.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

improvement during the year due mainly to higher earnings from larger reserves as well as sustained profits and dividends accruing to Malaysian companies investing abroad. The current transfers account recorded a higher outflow attributable to the one-off remittance by illegal foreign workers under the Amnesty Programme in the first two months of 2005.

Despite the global semiconductor down-cycle in the first half of the year, **gross exports** expanded at a double-digit rate of 11% during the year (2004: 20.8%). The growth was due to the strong performance in the commodities sector, particularly mineral exports (27.1%) underpinned by the higher energy prices. Receipts from manufacturing exports also remained relatively strong during the year, expanding by over 10%, while agriculture exports rose at a moderate rate of 3.4%. The increase in overall exports was reflected both in terms of higher volume (8%) as well as unit value (3.2%).

Receipts from **manufactured goods** grew by 10.1% in 2005 (2004: 19.7%). Arising from the slowdown in the global semiconductor cycle, growth in exports of E&E products grew moderately by 10% (2004: 15.3%). The slowdown in exports of semiconductors and electrical products was cushioned by the continued strength in shipment of computers and parts. Exports of chemical products expanded at a slower pace of 7% in 2005 (2004: 31%) due mainly to the slowdown in exports of organic chemicals, particularly demand for oleochemicals from the People's Republic of China (PR China). However, external demand for plastic products continued to remain strong during the year. The top two export

Table 1.17
Gross Exports

	2005*p*		
	RM million	Annual change (%)	% share
Manufactured goods	**429,873**	**10.1**	**80.5**
of which:			
Electronics, electrical machinery and appliances	282,779	10.0	53.0
Electronics	208,232	10.4	39.0
Semiconductor	*89,967*	*0.7*	*16.9*
Electronic equipment & parts	*118,265*	*19.1*	*22.2*
Electrical machinery & appliances	74,547	8.9	14.0
Consumer electrical products	*22,632*	*2.1*	*4.2*
Industrial & commercial electrical products	*28,608*	*11.0*	*5.4*
Electrical industrial machinery and equipment	*20,476*	*15.1*	*3.8*
Household electrical appliances	*2,831*	*3.9*	*0.5*
Chemicals & chemical products	29,718	7.0	5.6
Manufactures of metal	17,157	6.3	3.2
Optical and scientific equipment	12,318	6.5	2.3
Textiles, clothing and footwear	10,520	1.9	2.0
Wood products	8,860	2.1	1.7
Food	8,488	9.2	1.6
Furniture & parts	7,666	6.1	1.4
Transport equipment	6,993	31.3	1.3
Rubber products	6,777	12.3	1.3
Agricultural commodities	**37,421**	**3.4**	**7.0**
of which:			
Palm oil	19,036	-5.3	3.6
Rubber	5,787	11.3	1.1
Sawn timber	4,051	26.0	0.8
Saw logs	2,465	19.1	0.5
Minerals	**52,321**	**27.1**	**9.8**
of which:			
Crude oil and condensates	28,508	33.7	5.3
LNG	20,790	21.7	3.9
Tin	935	-1.2	0.2
Other exports	**14,173**	**9.5**	**2.7**
Total	**533,788**	**11.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table 1.18
External Trade

	2004	2005*p*
	RM billion	
Gross exports (f.o.b)	**480.7**	**533.8**
Annual change (%)	20.8	11.0
	Annual change (%)	
Volume[1]	25.1	8.0
Prices[1]	0.7	3.2
Gross imports (c.i.f)	**400.1**	**434.0**
Annual change (%)	26.4	8.5
	Annual change (%)	
Volume[1]	27.6	3.5
Prices[1]	2.7	4.9
Trade balance	**80.7**	**99.8**

[1] Volume and prices for 2005 are estimates.
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

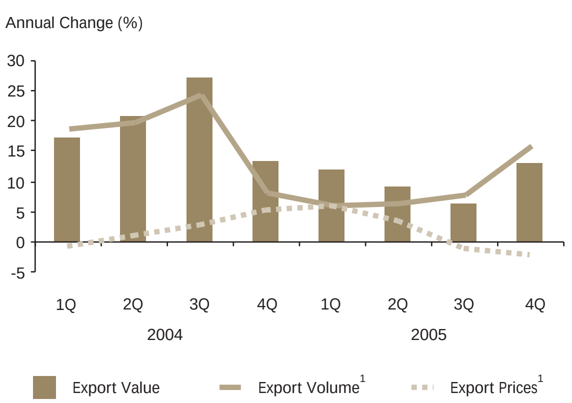
destinations for Malaysian made plastics were Europe and Japan. Among the resource-based industries, exports of rubber products continued to expand by a double-digit rate in 2005, driven largely by the strong global demand for rubber gloves. Meanwhile, exports of other resource-based products such as petroleum products, food, beverages and tobacco continued to expand during the year. In the case of metal products, after experiencing a strong expansion in 2004 (43.6%), growth slowed down to 6.3%, due to global oversupply of steel arising from aggressive capacity expansion by Chinese steel millers which led to lower prices. Overall, both increases in volume (8.8%) and unit value (1.2%) resulted in the higher export proceeds from the manufacturing sector in 2005.

The **primary commodities** sector continued to remain an important source of foreign exchange earnings in the Malaysian trade account with its share to total gross exports rising further during the year to 16.8% (2004: 16.1%). Commodity exports grew by 16% (2004: 21.8%), reflecting the strong growth in exports of energy products, while agriculture exports continued to grow at a moderate rate. The growth in commodity exports was largely driven by higher export prices (13.1%), and further supported by an increase in volume (4.3%).

Mineral exports grew strongly for the third consecutive year, rising by 27.1% to RM52.3 billion (2004: +38.2% to RM41.2 billion). Exports of crude oil and condensates rose significantly by 33.7% to RM28.5 billion, driven entirely by the marked increase in crude oil prices, which rose by 37% to an average of USD55.93 per barrel for 2005 (2004: USD40.81). However, export volume declined by 2% in line with the lower output of crude oil for the year. LNG export performance was also favourable, rising by 21.7% to RM20.8 billion, due to both higher prices (15%) as well as volume (5.9%).

Export receipts from **agriculture** rose at a more moderate pace of 3.4% to RM37.4 billion in 2005. Despite the higher export volume of palm oil (10.9%), earnings from palm oil fell by 5.3% during

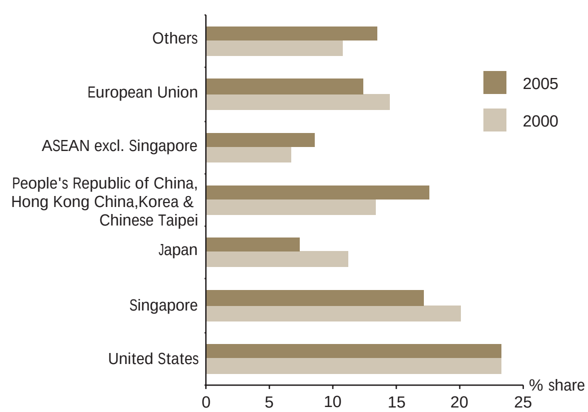
Graph 1.38
Export Performance of the Manufacturing Sector



[1] Volume and prices are estimates based on Bank Negara Malaysia's survey of selected companies.

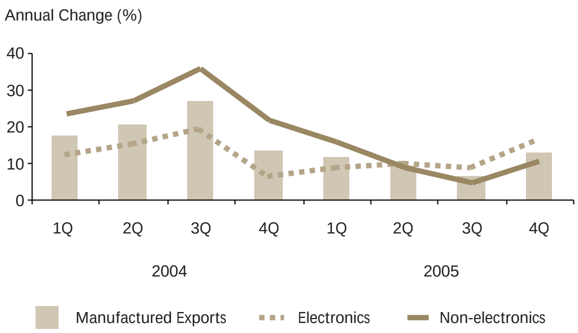
Source : Department of Statistics, Malaysia
Bank Negara Malaysia

Graph 1.39
Exports of Manufactured Goods by Destination



Source : Department of Statistics, Malaysia

Graph 1.40
Export Performance of Electronics and Non-electronics Industries



Source : Department of Statistics, Malaysia

the year to RM19 billion due entirely to lower prices (-14.6% to RM1,456 per tonne from RM1,706 per tonne in 2004). Prices consolidated during the year amidst the increase in global production and stocks of crude palm oil (CPO), coupled with the increase in harvests of soybean, which is palm oil's closest substitute in the global edible oil market. Nevertheless, offtake by major buyers of Malaysian palm oil, namely the European Union (EU), Pakistan and PR China with a combined share of almost 46% of total palm oil exports, increased by 14.7%, 10.8% and 2% respectively. Rubber exports continued to perform favourably, rising by 11.3% to RM5.8 billion (2004: RM5.2 billion) driven by both higher prices (9%) and volume (2.1%). External demand for rubber remained strong, led by PR China, which increased its purchase by 33.7% to 386,058 tonnes (2004: 288,732 tonnes). The sharp upward trend in demand has enabled PR China to become the largest purchaser of Malaysian rubber, surpassing the EU (2005: 319,612 tonnes) for the first time in 2005.

Gross imports increased by 8.5% (2004: 26.4%), reflecting mainly imports of inputs for manufactured exports as well as higher demand for consumer and investment goods. Import prices increased by 4.9%, attributed to higher prices across most goods, particularly, manufactured goods, crude materials, mineral fuels as well as chemicals.

Imports of **intermediate goods**, which accounted for 71% of imports, grew by 7.2%, due mainly to demand for electrical and electronics, and resource-based products, particularly from the US and regional countries. Increased sourcing of intermediate inputs from PR China, Singapore and Thailand was underpinned by the manufacturing supply chain as well as extensive production network and linkages in the region. These imports comprised mainly computer components and machine parts, and industrial supplies such as metals and chemicals. Intermediate imports relating to the manufacture of goods for the domestic market also expanded. Consistent with the strong performance of the motor assembly industry in line with higher demand for passenger cars, imports of parts and accessories of transport equipment recorded a strong growth. In tandem with higher oil prices, imports of fuel and lubricants grew strongly.

Reflecting the further expansion in private investment, imports of **capital goods** increased by 9.5%. Capital imports excluding lumpy items grew by 9.3%. The impetus for growth came from capacity expansion and upgrading for new technologies. Capital imports were channelled mainly into the manufacturing and services sectors. The higher level of business activity and investment to improve the quality and efficiency of the infrastructure in the services industry led to the increase in imports of office equipment and generators, turbines and electric motors for power generation. Imports of industrial machinery and equipment in the manufacturing sector remained strong. Continued capacity expansion in the manufacturing sector occurred in areas such as higher-end electrical and electronics products, metals and plastics. New technologies and products as well as the extension of network infrastructure underpinned the growth in imports of telecommunication equipment. Growing intra-regional trade between ASEAN and North Asia and firm external demand for commodity exports led to higher imports of ships to service these markets.

In line with higher disposable income, imports of **consumption goods** increased by 5.9%. Import growth reflected demand for food and beverages as well as consumer goods particularly durable and non-durable consumer goods, namely, sound and video reproducing equipment, household electrical goods, jewellery and medicine. The share of consumption goods imports to total imports remained low, accounting for 5.7% of total imports.

Consonant with increasing intra-regional trade, imports for **re-exports** expanded by 26.9%. These imports were mainly electrical and electronic products, telecommunication equipment and iron and steel products which were packed, labeled and assembled in the free commercial zones at major ports and airports. These imports were largely re-exported to Singapore, Thailand, US, PR China and Hong Kong China.

Table 1.19
Gross Imports by End Use

	2005p		
	RM million	Annual change (%)	% share
Capital goods	**60,734**	**9.5**	**14.0**
Capital goods (except transport equipment)	53,939	10.0	12.4
Industrial machinery and equipment	*14,419*	*9.1*	*3.3*
Office equipment	*11,291*	*23.5*	*2.6*
Telecommunication equipment	*6,999*	*0.6*	*1.6*
Transport equipment	6,795	5.3	1.6
Intermediate goods	**308,335**	**7.2**	**71.0**
Food and beverages, mainly for industry	8,352	-5.6	1.9
Industrial supplies, n.e.s.	96,599	6.0	22.3
Metals & metal products	*31,870*	*15.6*	*7.3*
Chemicals	*11,667*	*9.6*	*2.7*
Fuels and lubricants	27,492	42.3	6.3
Parts and accessories of capital goods (except transport equipment)	163,660	2.7	37.7
Electronics	*105,710*	*2.7*	*24.4*
Parts and accessories of telecommunication equipment	*7,249*	*-2.5*	*1.7*
Parts and accessories of transport equipment	12,232	34.8	2.8
Consumption goods	**24,600**	**5.9**	**5.7**
Food and beverages, mainly for household consumption	9,280	4.0	2.1
Transport equipment, non-industrial	318	-4.9	0.1
Consumer goods, n.e.s.	15,002	7.4	3.5
Consumer durables	*3,514*	*12.3*	*0.8*
Consumer semi-durables	*4,671*	*0.4*	*1.1*
Consumer non-durables	*6,817*	*10.2*	*1.6*
Dual use goods	**11,308**	**21.5**	**2.6**
Motor spirit	6,424	35.4	1.5
Passenger motor cars	4,884	7.0	1.1
Others	**7,171**	**0.8**	**1.7**
Re-exports	**21,862**	**26.9**	**5.0**
Gross Imports	**434,010**	**8.5**	**100.0**

Note: Numbers may not necessarily add up due to rounding.
n.e.s. Not elsewhere specified.
p Preliminary

Source: Department of Statistics, Malaysia

Malaysia's total external trade expanded by 9.9% to RM967.8 billion in 2005. The share of Malaysia's trade with the major trading partners, namely the US, Singapore, Japan and the EU declined slightly and accounted for 53.8% of total trade. However, trade with regional countries (excluding Japan) grew, and accounted for 44.4% of Malaysia's exports and 49% of imports. Trade links with Australia and India strengthened, driven mainly by higher demand for electrical and electronics and petroleum-related products.

Exports to the **US**, Malaysia's largest trading partner, grew by 16.5% to account for an increased share of 19.7% of total exports. The impetus to the export growth stemmed from higher demand induced by the replacement cycle for wireless computers and computer-related items. Exports of optical and medical instruments and resource-based products, namely wood, rubber and chemical products, strengthened further. The US remained the second largest source of imports for Malaysia. Approximately 80% of imports were intermediate inputs for the electrical and electronics industry. As exports to the US increased while imports declined, the bilateral trade surplus widened to RM49.1 billion (2004: RM32.3 billion).

Singapore remained the second most important trading partner with a share of 13.9% of total trade (2004: 13.2%). Electrical and electronic products continued to be the largest export receipts, accounting for 57.8% of total exports to Singapore. Other export items which recorded strong growth include crude petroleum and

Table 1.20
Direction of External Trade

	2005p				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	RM million
ASEAN countries	**139,208**	**26.1**	**106,976**	**24.6**	**32,232**
Singapore	83,333	15.6	50,828	11.7	32,505
Thailand	28,723	5.4	22,889	5.3	5,834
Indonesia	12,580	2.4	16,566	3.8	-3,986
Philippines	7,476	1.4	12,192	2.8	-4,716
Other ASEAN countries	7,096	1.3	4,501	1.0	2,595
Selected North East Asia countries	**99,184**	**18.6**	**106,254**	**24.5**	**-7,070**
The People's Republic of China	35,221	6.6	49,880	11.5	-14,659
Hong Kong China	31,205	5.8	10,797	2.5	20,409
Chinese Taipei	14,813	2.8	23,974	5.5	-9,160
Korea	17,945	3.4	21,604	5.0	-3,659
European Union (EU)	**62,629**	**11.7**	**50,512**	**11.6**	**12,117**
United Kingdom	9,470	1.8	6,522	1.5	2,948
Germany	11,259	2.1	19,265	4.4	-8,007
Netherlands	17,452	3.3	3,351	0.8	14,101
Other EU countries	24,449	4.6	21,374	4.9	3,075
United States	105,033	19.7	55,918	12.9	49,115
Japan	49,918	9.4	62,982	14.5	-13,064
India	14,972	2.8	4,164	1.0	10,808
Australia	18,042	3.4	8,171	1.9	9,872
Rest of the world	44,801	8.4	39,033	9.0	5,769
Total	**533,788**	**100.0**	**434,010**	**100.0**	**99,778**

Note: Numbers may not necessarily add up due to rounding.
p Preliminary

Source: Department of Statistics, Malaysia

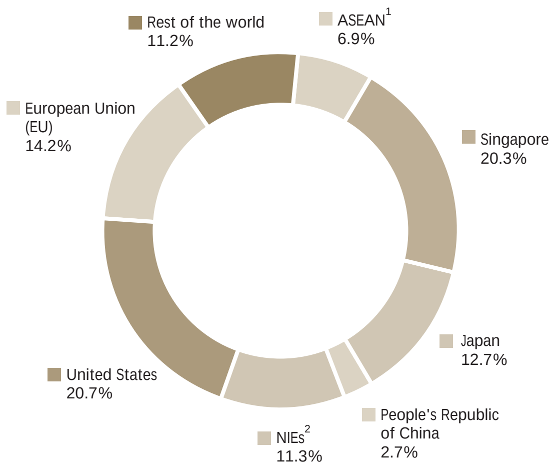
resource-based products, namely petroleum, chemical, iron and steel products. On the imports side, Singapore was the third largest source for Malaysia with imports comprising mainly electrical and office machinery, chemical products as well as refined petroleum products.

Despite a decline in the share of trade to 11.7% (2004: 12.7%), **Japan** continued to be the third largest trading partner of Malaysia. The trade balance with Japan, which has been in Japan's favour, improved to register a smaller deficit of RM13.1 billion as imports declined while exports continued to grow. Export growth of 2.8% was underpinned by increased export receipts from LNG, manufactures of plastics and metals. Imports declined by 1.2%, reflecting lower imports of transport equipment, optical, medical and surgical instruments. Japan remained the principal source of imports for Malaysia, accounting for 14.5% (2004: 15.9%) of total imports, although its share of imports has been declining as Malaysia diversifies its trade and intensifies its trading link with other regional countries.

The growth in trade with countries in the **EU** moderated to 4.4% in 2005, reflecting the slowdown in economic activity in the EU. A trade surplus of RM12.1 billion (2004: RM12.4 billion) was recorded, attributed mainly to trade surplus with the Netherlands (RM14.1 billion), UK (RM2.9 billion), France (RM1.3 billion) and Spain (RM1.2 billion) while trade deficits were recorded in trade with Germany and Italy of RM8 billion and RM2 billion respectively. Within the group, Germany, the Netherlands and the UK remained the leading trading partners. Exports to the EU comprised mainly integrated circuits and furniture while imports were mainly iron and steel products, passenger cars and electrical machinery.

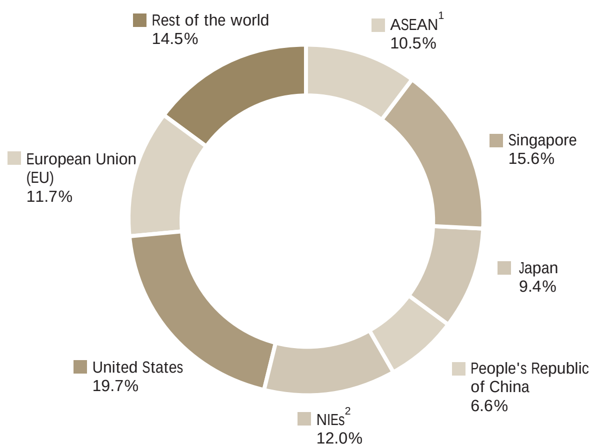
Trade with economies in **North East Asia** (excluding Japan), which accounted for 21.2% of total trade,

Graph 1.41
Direction of Exports (% share): 1995



[1] ASEAN excluding Singapore
[2] Hong Kong China, Korea and Chinese Taipei

Direction of Exports (% share): 2005



[1] ASEAN excluding Singapore
[2] Hong Kong China, Korea and Chinese Taipei

expanded by 11%. Increased sourcing of cheaper inputs caused import growth from these countries to continue to outpace exports. Consequently, the trade balance recorded a deficit of RM7.1 billion in 2005. PR China was Malaysia's fourth major source of imports, with imports comprising mainly intermediate components such as integrated circuits, machinery, appliances and parts, chemical and metal products. Exports to PR China which recorded growth were electronic and electrical products, iron and steel and rubber products. Imports from Korea was underpinned by imports of integrated circuits, office machine parts and passenger cars while exports were largely supported by LNG, computer and components and chemical products.

Increasing intra-regional trade and better economic performance of **ASEAN** countries resulted in Malaysia's trade with ASEAN countries (excluding Singapore) expanding by 12.3% in 2005. Exports to ASEAN were supported mainly by exports of electrical and electronics and resource-based products such as chemicals, iron and steel as well as plastic products. Imports from this region comprised mainly electrical and electronic products, chemical products and manufactures of metal.

The **services account** deficit widened to RM10.2 billion or 2.2% of GNP (2004: -RM8.8 billion or –2.1% of GNP). Higher demand for imported services as the economy moved up the production value chain, led to a higher net payment of RM12.3 billion (2004: -RM9.7 billion) in the **other services account**. The outflows were attributable mainly to higher payments for royalties and license fees, construction services, and other business services. Royalties and license fee payments continued to increase, reflecting acquisition of intellectual property rights for design and development of new products by the manufacturing sector, particularly in the E&E industry, and services sector. More than 70% of payments for royalties and license fees were made to the UK, US and Japan. Net payments for

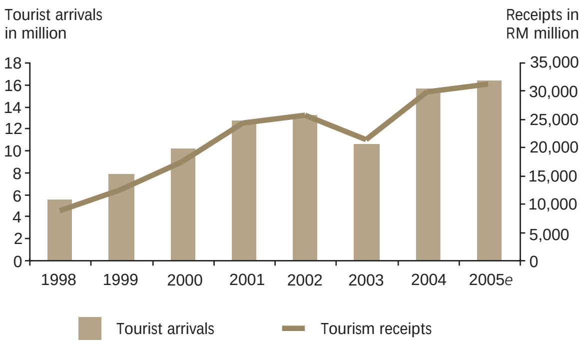
Table 1.21
Services and Income Accounts

	2004	2005*e*		
	RM billion			
	Net	+	–	Net
Services Account	**-8.8**	**72.2**	**82.5**	**-10.2**
% of GNP	*-2.1*			*-2.2*
Transportation	-17.8	16.2	31.9	-15.7
Travel	19.4	32.4	14.2	18.1
Other services	-9.7	23.3	35.6	-12.3
Government transactions n.i.e.	-0.7	0.4	0.8	-0.4
Income Account	**-24.5**	**20.5**	**41.9**	**-21.5**
% of GNP	*-5.8*			*-4.5*
Compensation of employees	-1.1	4.2	4.7	-0.5
Investment income	-23.4	16.2	37.2	-21.0

Note: Numbers may not necessarily add up due to rounding.
n.i.e. Not included elsewhere.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia.

Graph 1.42
Tourist Arrivals and Tourism Receipts



e Estimate
Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia

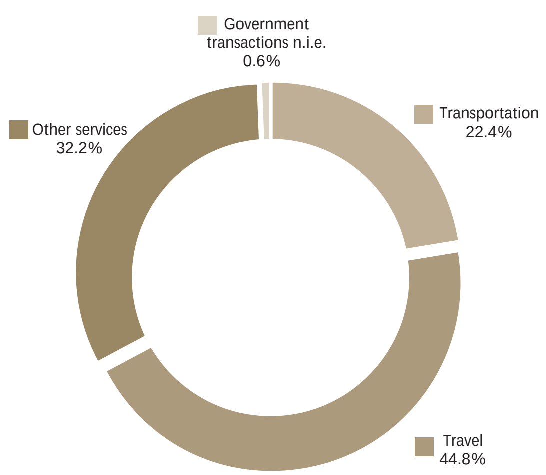
construction services increased, despite higher earnings from construction projects abroad, due mainly to higher imported services for power as well as oil and gas exploration projects. The large outflows for 'other business services' reflected mainly payments for professional services as well as operational leases for ships, tugs and aircrafts. Meanwhile, computer and information services receipts improved, underpinned by the expansion in business process outsourcing and provision of group network support services. About half of these earnings were from Singapore, the UK and US.

Despite a marginally smaller net inflow, the **travel account** remained the largest contributor to services receipts, accounting for 44.8% of gross services receipts in 2005. Tourist arrivals in Malaysia grew by 4.4% to 16.4 million visitors (2004: 15.7 million), with gross foreign exchange earnings amounting to RM31 billion. Visitors from Singapore, Thailand and Indonesia accounted for 76.1% of tourist arrivals. While visitors from PR China and Hong Kong China declined, the growth in tourist arrivals was supported by tourists from West Asia, Korea, India, Australia and New Zealand as well as long-haul tourists from the US and UK. Malaysia has benefited from the expansion in regional travel, particularly from countries such as Vietnam, Thailand and Indonesia, as well as various strategies to promote tourism products including hosting of meetings, international conventions and events (MICE) such as Formula One Petronas Malaysia Grand Prix and Malaysia Mega Sale Carnival.

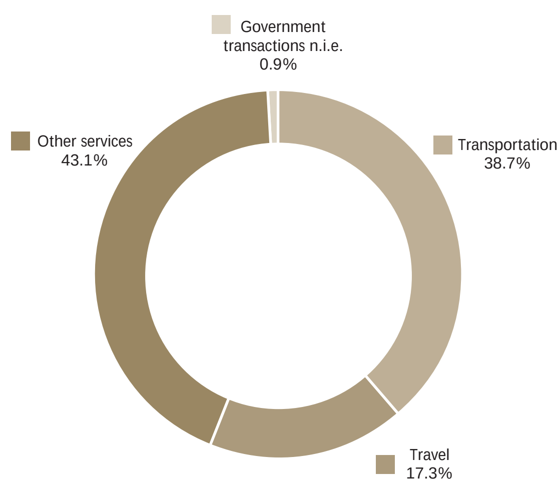
On the payments side, higher income and increased business activities overseas led to travel outflows increasing by 21.1% to RM14.2 billion (2004: RM11.8 billion). These outflows were attributable to the higher number of Malaysians traveling as well as higher payments for education abroad. Payments for travel to border towns increased by 24.2% to RM3 billion. Education outflows increased by 16.5% due mainly to an increase in the number of Malaysian students studying abroad, particularly, in Australia, the US and UK.

The **transportation account** recorded a smaller deficit of RM15.7 billion (2004: -RM17.8 billion), as the increase in receipts by major domestic shipping companies and airlines

Graph 1.43
2005: Components of Gross Receipts in the Services Account (% share)



Graph 1.44
2005: Components of Gross Payments in the Services Account (% share)



Higher returns from larger external reserve holdings together with sustained profits and dividends accrued to Malaysian companies from their investment abroad contributed to an improvement in income account.

outpaced the increase in payments abroad. Gross receipts were supported by earnings from shipments of petroleum, LNG and carriage of cargo following the expansion in intra-regional trade between North Asia and ASEAN, as well as higher freight rates. Gross outflows reflected higher freight charges as well as increased volume of trade.

The **income account** recorded an improvement, with the deficit narrowing to RM21.5 billion or 4.5% of GNP (2004: -RM24.5 billion or –5.8% of GNP). The smaller deficit reflected mainly higher returns from larger external reserve holdings of Bank Negara Malaysia. Meanwhile, the profits and dividends accruing to Malaysian companies from their investment abroad were sustained at RM4.1 billion. The bulk of the receipts were from the oil and gas, utilities and manufacturing sectors.

The profits and dividends accruing to foreign investors in Malaysia remained large, in line with the expansion in exports of electrical and electronics industry and the oil and gas sector. Nevertheless, a substantial portion of these profits and dividends was retained in Malaysia for reinvestment, and credited as inflows of foreign direct investment in the financial account of the balance of payments. A profile of Malaysia's income account from 1999 to September 2005 is published under the Special Feature in the Bank Negara Malaysia's Fourth Quarter 2005 Quarterly Bulletin.

In line with the continued efforts by the Government to reduce illegal foreign workers in Malaysia, a total of 398,758 illegal workers returned to their home countries during the Amnesty Programme from 29 October 2004 to end-February 2005. Reflecting the one-time lump sum repatriation by these workers returning home under this Programme, the **current transfers account** recorded a larger net outflow of RM17 billion (2004: -RM14.6 billion). About 58% of the registered foreign workers in Malaysia were employed in the manufacturing and agriculture sectors.

Financial Account

In 2005, the **financial account** recorded a net outflow of RM42 billion (2004: +RM15.1 billion), attributed mainly to the unwinding of speculative short-term positions in the fourth quarter, larger repayment of external loans by the official sector and higher extension of trade credits by Malaysian exporters. Reflecting the increased interests by Malaysian companies to diversify abroad, outflows for overseas investment also increased. Meanwhile, foreign direct investment was sustained at a high level.

On a gross basis, **foreign direct investment (FDI)** increased to RM25 billion (2004: RM23.5 billion), or 5.3% of GNP, with broad-based inflows across the major sectors such as the oil and gas, services and manufacturing sectors. Of significance, there was a marked increase in FDI from the major investing economies, namely the US, Hong Kong China and Germany. The bulk of FDI continued to be in the form of reinvested earnings, reflecting continued expansion and diversification of operations by existing MNCs, particularly in the manufacturing and oil and gas sectors, amidst favourable investment conditions in Malaysia. After taking into account the adjustments for higher outflows due largely to loan repayments to parent companies abroad, net FDI recorded an inflow of RM15.6 billion (2004: RM17.6 billion) or 3.3% of GNP.

FDI into the oil and gas sector increased significantly, particularly in the upstream activities, encouraged by rising oil prices and greater global demand for crude oil

Table 1.22
Balance of Payments: Financial Account

	2004	2005*e*
	RM billion	
Financial Account	**15.1**	**-42.0**
Direct Investment	**9.7**	**2.7**
In Malaysia	17.6	15.6
Abroad	-7.8	-12.9
Portfolio Investment	**33.8**	**-11.9**
Other Investment	**-28.5**	**-32.8**
Official sector	-1.1	-11.1
of which:		
Federal Government (net)	0.1	-3.5
Gross borrowing	1.1	0.7
Repayment	-1.0	-4.2
NFPEs (net)	-1.3	-7.6
Gross borrowing	11.4	6.3
Repayment	-12.7	-13.9
Private sector	-27.3	-21.7

Note: Numbers may not necessarily add up due to rounding.
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The financial account recorded a net outflow, attributed mainly to the unwinding of speculative portfolio investment, larger repayment of external loans by the official sector and higher extension of trade credits. Overseas investment by Malaysians was also higher, while FDI was sustained at a high level.

during the year. These activities were mostly undertaken by the national oil and gas company in joint venture with its international partners, for deepwater and ultra-deepwater oil explorations, particularly in offshore East Malaysia, as well as for the extraction operations from existing and new oil fields.

In the services sector, foreign investments were received mainly in the finance, insurance, real estate and business services sub-sector, followed by the wholesale and retail trade, hotels and restaurants sub-sector and the transportation and communication sub-sector. Inflows into the finance, insurance, real estate and business services sub-sector reflected mainly investments received by investment holding companies, while one of the three foreign banks which were awarded licenses for Islamic banking in 2004 commenced its operations during the year. Of significance, Malaysia maintained the attraction for MNCs to locate their shared services and outsourcing activities, thus, encouraging higher value-added activity and establishing linkages across the different segments of the services sector. This was reflected in the *A.T. Kearney 2005 Offshore Location Attractiveness Index*, which ranked Malaysia as the third most attractive investment destination for Shared Services & Outsourcing (SSO) for the second consecutive year, citing favourable factors such as world-class infrastructure, attractive fiscal incentive packages and availability of skilled labour. During the year, there was an increase of 169 international and regional facilities, of which 19 were operational headquarters (OHQs), 132 regional and representative offices, 15 international procurement centres (IPCs) and three regional distribution centres (RDCs). Investments in the wholesale and retail trade, hotels and restaurants sub-sector remained firm, supported by strong domestic consumption in trade and tourism-related services. Meanwhile, investments in the transportation and communication sub-sector were mainly for the expansion of activities in the courier as well as air and ocean freight services.

The manufacturing sector continued to be a major recipient of FDI. About one-half of the investments were concentrated in the electrical and electronic industry, primarily for plant expansion as well as upgrading of machinery and equipment, to enlarge capacity as well as for production of higher-end products. Significant investments were also channelled into the downstream petroleum refining and petroleum-related product industry, in line with the higher investment in the upstream oil and gas activities. Meanwhile, investments in the other manufacturing industries were varied, ranging from industrial chemicals and other chemical-related products, plastic-based products to the manufacturing of fabricated metal products and machinery and equipment.

Direct investment abroad by Malaysians increased to RM12.9 billion in 2005 (2004: -RM7.8 billion), reflecting increased interests by Malaysian companies to acquire foreign interests as well as to exploit opportunities to diversify their operations abroad. The top destination for the investment was the ASEAN countries, which accounted for about half of total direct investment abroad. Other major destinations include PR China, US and Hong Kong China although some of Malaysia's investments were channelled through international offshore financial centres before re-directed to its final destination. The scope of investment has become increasingly broad-based, ranging from the oil and gas and manufacturing sectors, to the services sector. On a sectoral basis, a large share of overseas investments was effected by companies in the services sector, in particular, the transport and communication sub-sector as well as the financial services sub-sector. Most of these investments were undertaken through equity acquisitions by several large Malaysian companies, including the takeover of an Indonesian mobile telephone operator, as well as the acquisition of a shipping company in Singapore. In addition to the investments that were carried out by large corporations, many small and medium-sized Malaysian companies also invested in low-cost economies, taking advantage of cheap labour, availability of raw materials and new market base.

In the oil and gas sector, the national oil company continues to forge joint venture partnership with several foreign oil companies for exploration and extraction, lending technical expertise and providing working capital for investment. Meanwhile, overseas investments in the manufacturing sector were led by companies in the semiconductor and other electronic component, and ship building- and repairing-related industries. Apart from the provision of equity capital financed mainly from internal funds, higher overseas investments were also effected through higher loans extension by the parent companies in Malaysia to their subsidiaries abroad. These companies sought to expand production facilities in new markets for entry into the new and often fast-growing markets. Several big companies from furniture and wood-related products, as well as basic metal industries in Malaysia have also invested abroad to achieve cost effective production while at the same time, enhanced the prospects for new export outlet for business expansion. Meanwhile, investments abroad by construction companies continued to be significant following their earlier success in bidding and on-going work of several large infrastructure, roads and highway projects abroad.

Malaysia's investments abroad continued to yield positive results. Reflecting the success of their operations abroad, the net profits and dividends accruing to Malaysian companies investing abroad, particularly from the oil and gas sector and financial services sub-sector, was sustained at RM4.1 billion in 2005 (2004: RM4.3 billion).

In 2005, **portfolio investment** registered a net outflow of RM11.9 billion (2004: +RM33.8 billion). In the first half-year, portfolio investment recorded a net inflow of RM8.1 billion, reflecting mainly foreign interest in short-term money market papers, debt securities as well as equities. The strong interest observed in Malaysia's capital market since last year was partly associated with the periodic anticipation of exchange rate realignments in the region. However, the flows reversed in the second half of the year, recording a net outflow of RM20 billion. The outflows, which commenced in September and continued into October and November, arose mainly from the liquidation of short-term money market papers and debt securities, and to a lesser degree, equity securities. These outflows subsided in December.

The **other investment** recorded a higher net outflow of RM32.8 billion (2004: -RM28.5 billion), reflecting mainly larger repayment of external loans by the official sector while net outflows by the private sector declined. The **official sector** recorded a net repayment position for the third consecutive year, amounting to RM11.1 billion (2004: -RM1.1 billion), in line with Malaysia's prudent external debt management strategy and the Government's commitment towards fiscal consolidation. Meanwhile, other investment by the **private sector**, which comprises mainly borrowing and lending, placements and withdrawals of deposits by the banking sector as well as non-bank private sector transactions with unrelated counterparties, recorded a lower net outflow of RM21.7 billion (2004: -RM27.3 billion). The improvement was due largely to a reversal in the banking sector position registering a net inflow during the year, arising mainly from the withdrawal of deposits placed abroad. These inflows had partially offset the higher outflows by the non-bank private sector, due mainly to higher trade credits extended by Malaysian exporters, as well as larger repayments of external loans by the private sector.

External Debt

Malaysia's external debt management strategy continues to focus on providing a stable foundation for a sustainable debt environment over the longer term. The country's manageable debt situation is achieved through prudent debt management practices supported by a well-functioning debt reporting and monitoring system. The prudential safeguards include efforts to minimise risk exposure against global interest rate shocks, adverse exchange rate movements and shift in investor sentiment. Meanwhile, the debt monitoring system enables the authorities to monitor the overall debt level, the structure of the debt as well as servicing obligations of both the public and private sectors.

External debt position improved, reflecting continued net repayment by the public sector. The share of short-term debt to total debt remained low.

In an effort to improve the compilation of the external debt data for better risk assessment and to be in line with the international standards and practices, the Bank initiated the compilation of external debt data with the offshore financial entities in Labuan International Offshore Financial Centre (Labuan IOFC) being treated as residents. Under this approach, data on debt transactions and exposure of the offshore financial entities in Labuan IOFC vis-à-vis the rest of the world are included as part of Malaysia's external debt. Meanwhile, debt transactions and exposure of residents with offshore financial entities in Labuan IOFC, which were currently included in the nation's external debt, are excluded. The aggregated data of offshore financial entities in Labuan IOFC was obtained

Table 1.23
Outstanding External Debt

	2004	2005*p*	*2004*	*2005p*
	RM million	RM million	USD million	USD million
Total debt	**200,586**	**195,865**	**52,786**	**51,310**
Medium- and long-term	156,849	149,682	41,276	39,212
Short-term[1]	43,737	46,183	11,510	12,098
As % of total debt	*21.8*	*23.6*	*21.8*	*23.6*
As % of net international reserves	*17.3*	*17.3*	*17.3*	*17.3*
As % of GNP				
Total debt	47.2	41.4		
Medium- and long-term debt	36.9	31.6		
As % of exports of goods and services				
Total debt	36.8	32.2		
Medium- and long-term debt	28.8	24.6		
Debt service ratio (%)	**4.6**	**4.7**		

[1] Excludes currency and deposits held by non-residents with resident banking institutions.

p Preliminary

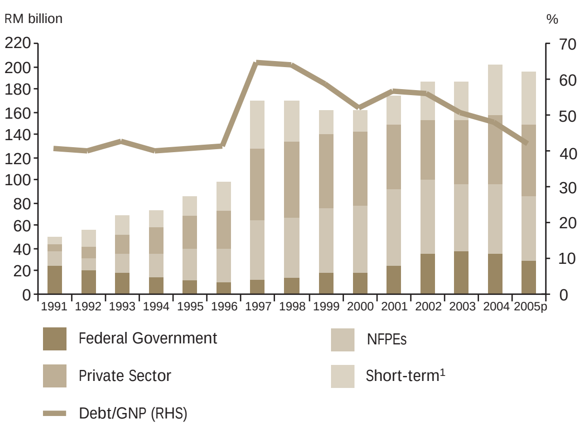
Source: Ministry of Finance and Bank Negara Malaysia

from the Labuan Offshore Financial Services Authority (LOFSA). The external debt position under this new definition is provided in the Box Article titled "Compilation of Malaysia's External Debt: Treatment of Offshore Financial Entities in Labuan IOFC as Residents". In the transition period, the official external debt data published by Bank Negara Malaysia for 2005 and 2006 would continue to follow the existing definition of treating offshore financial entities in Labuan IOFC as non-residents. The Bank would simultaneously compile the external debt position under the new definition i.e. treating offshore financial entities in Labuan IOFC as residents for 2006, with the target of fully adopting and publishing only the external debt position under the new definition starting with reporting period of first quarter of 2007 for release in May 2007. Thus, the development of Malaysia's external debt position in 2005 in this section was analysed and reported based on the data compiled using existing definition i.e. treating offshore financial entities in Labuan IOFC as non-residents.

In 2005, the total external debt outstanding declined by 2.4% to RM195.9 billion (USD51.3 billion), due largely to lower gross borrowings while repayment increased. The improvement in the external debt position was also reflected in the decline in ratios of external debt to GNP and to exports of goods and services to 41.4% and 32.2% respectively (2004: 47.2% and 36.8% respectively). The ratio of short-term debt to international reserves was stable at 17.3% while both the overall debt service ratio (excluding prepayment) and the share of short-term debt to total debt remained low at 4.7% and 23.6% respectively.

The **medium- and long-term external debt** declined by 4.6% to RM149.7 billion (USD39.2 billion) as at end of 2005 (2004: RM156.8 billion), due mainly to a significantly larger net repayment of external loans of RM11.1 billion (2004: -RM1 billion) by the public sector. The decline was also due partly to the exchange revaluation gain of RM3.3 billion following the appreciation of the ringgit against major currencies. Meanwhile, as the increase in gross borrowings outpaced a higher loan repayment during the year, the private sector registered a larger net drawdown of RM4.2 billion (2004: RM2.9 billion).

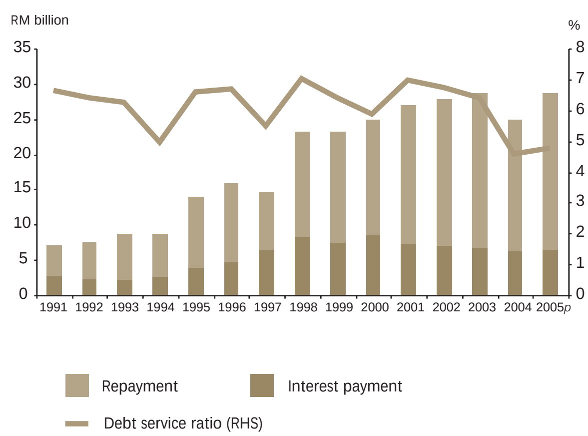
Graph 1.45a
Outstanding External Debt



[1] Excludes currency and deposits held by non-residents with resident banking institutions.

p Preliminary

Graph 1.45b
Debt Servicing



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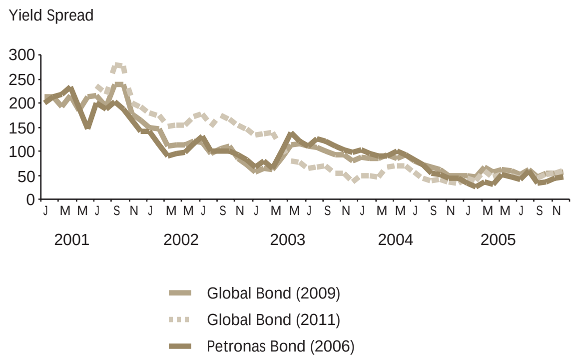
The medium- and long-term debt continued to be largely denominated in the United States dollar, accounting for 80.1% of total medium- and long-term debt outstanding as at end-2005. The share of yen-denominated debt declined marginally to 11.9% (2004: 12.8%) while the euro-denominated debt accounted for only 2.2% (2004: 5.2%) due largely to the settlement of a euro-denominated bond by the Federal Government in the fourth quarter. The remaining 5.8% of the medium- and long-term external debt was denominated in other international currencies, including the pound sterling, Singapore dollar and Hong Kong dollar.

The **public sector** recorded its third consecutive year of net external debt repayment in 2005, reflecting lower gross borrowings by both the Federal Government and NFPEs while the repayment was higher following the maturity of several large borrowings and prepayment of some external loans. Consequently, the outstanding external debt of the public sector declined sharply by 11.1% to RM86.2 billion (USD22.6 billion) as at end-2005 (2004: RM96.9 billion) to account for a lower share of 44% (2004: 48.3%) of total external debt.

In 2005, the **Federal Government** maintained its practice to source its funding requirements mainly from non-inflationary domestic sources. For the second consecutive year, no new market loan was raised from the international capital market. The gross external borrowings by the Government were lower (RM0.7 billion; 2004: RM1.1 billion) while repayments increased significantly to RM4.2 billion (2004: -RM1 billion), reflecting mainly the maturity of a Euro bond of RM2.9 billion in November 2005 and some scheduled principal repayments of syndicated loans. The drawdown of external loan was attributed entirely to project loans committed earlier from the bilateral sources such as under the Miyazawa Initiative, as well as from multilateral sources, such as the World Bank, Islamic Development Bank and Asian Development Bank. Accordingly, the Federal Government external debt declined further to RM30 billion (USD7.9 billion) or 15.3% of total external debt as at end-2005 (2004: RM34.7 billion or 17.3% of total external debt).

Reflecting Malaysia's strong economic fundamentals, the interest spread on Malaysia's benchmark securities remained low in 2005 while Malaysia's sovereign ratings on long-term foreign currency obligations were generally maintained by the international rating agencies. The spread on Malaysia's Global Bond due 2011 over comparable US Treasury Securities stood at

Graph 1.46
Spread of Sovereign Bonds and Selected NFPE Bond Over Comparable US Treasury Securities



56 basis points at the end of 2005 while the spread on the Global Bond due 2009 remained stable at 55 basis points at end-2005. On 25 April 2005, Rating and Investment Information Inc. affirmed Malaysia's foreign currency rating at A- and revised the rating outlook from stable to positive. Moody's Investor Services affirmed Malaysia's long-term foreign currency rating at A3 and maintained a rating outlook of stable on 28 April 2005. In a similar move, on 25 May 2005, Standard & Poor's affirmed Malaysia's long-term foreign currency ratings at A- and maintained a rating outlook of stable. On 18 November 2005, Fitch affirmed Malaysia's long-term foreign currency ratings at A- and maintained a rating outlook of stable.

In 2005, the **NFPEs** registered a markedly higher net repayment of RM7.6 billion (2004: -RM1.1 billion), reflecting mainly a higher gross repayment of external debt of RM13.9 billion (2004: -RM12.6 billion) due partly to the maturity of US dollar-denominated bonds issued by companies in the oil and gas and manufacturing sectors as well as prepayments of several loans. In contrast, gross borrowings was significantly lower at RM6.3 billion (2004: RM11.5 billion). Consequently, the outstanding external debt of NFPEs declined to RM56.2 billion (USD14.7 billion) or 28.7% of total external debt as at end-2005 (2004: RM62.2 billion or 31% of total external debt).

As at end-2005, the **private sector** external debt (including short-term debt) increased to RM109.7 billion or USD28.7 billion (2004: RM103.7 billion), and accounted for 56% of the total external debt. The medium- and long-term external debt recorded a larger net borrowing of RM4.2 billion (2004: RM2.9 billion) as the increase in gross borrowings outpaced a higher repayment of loans during the year. The larger drawdown of external loans was mainly by companies in the services, plantation, manufacturing and oil and gas sectors. Despite a higher borrowing, the overall risk profile of the private sector medium- and long-term debt remained low as the bulk of these loans have a natural hedge. Most of these loans were used to finance export-oriented activities and overseas investment with foreign exchange earnings and income. Furthermore, a large share of these loans was sourced from the offshore shareholders and parent or associate companies with more flexible terms and at concessionary interest rates. Meanwhile, the bulk of the repayments was effected by companies in the plantation, services and manufacturing sectors. Thus, the private sector medium- and long-term external debt outstanding increased to RM63.5 billion (USD16.6 billion) as at end-2005 (2004: RM60 billion).

The outstanding **short-term external debt** (maturity of one year or less) rose by RM2.4 billion to RM46.2 billion (USD12.1 billion) in 2005, due entirely to an increase in the short-term external borrowing by the banking sector, mainly for hedging activities on trade-related transactions and treasury activities. Meanwhile, short-term debt by the non-bank private sector, comprising mainly term loans, revolving credits and overdraft facilities, declined further to RM7.3 billion in 2005 (2004: RM8.4 billion).

Compilation of Malaysia's External Debt: Treatment of Offshore Financial Entities in Labuan IOFC as Residents

The Fifth Edition of the Balance of Payments Manual (BPM 5) of the International Monetary Fund classifies offshore entities in an economy as residents for compilation of external data, including external debt data. Similarly, the External Debt Statistics Guide for Compilers and Users[1] (2003), also states that '***The residence of offshore enterprises*** *— including those engaged in the assembly of components manufactured elsewhere, those engaged in trade and financial operations, and those located in special zones —* ***is attributed to the economies in which they are located****.*' As such, the debt liabilities of offshore entities that are owed to non-residents are to be included as part of an economy's external debt.

In the current definition of external debt in Malaysia, the offshore entities in Labuan International Offshore Financial Centre (Labuan IOFC) are treated as non-residents for foreign exchange administration purposes. Thus, these entities are not subject to the foreign exchange administration rules applicable to residents, including statistical reporting to Bank Negara Malaysia. As a result, while the external debt data compiled and disseminated by Malaysia include debt transactions and exposure of residents with offshore entities in Labuan IOFC, they exclude debt transactions and exposure of the offshore entities vis-à-vis the rest of the world.

As part of our continuous efforts to improve the compilation of external debt data for better risk assessment as well as in conformity with international best practices, Bank Negara Malaysia, with the assistance of the Labuan Offshore Financial Services Authority (LOFSA) has compiled the new external debt data of Malaysia, starting with position as at end-2004. This data includes borrowings by the offshore financial entities in Labuan IOFC from non-residents, while the borrowings by residents from these offshore financial entities are excluded. A comparison of the existing definition of external debt and the new definition is given in Diagram 1.

Implication on Malaysia's External Debt

(i) Comparison of newly defined external debt with existing definition for 2004 position

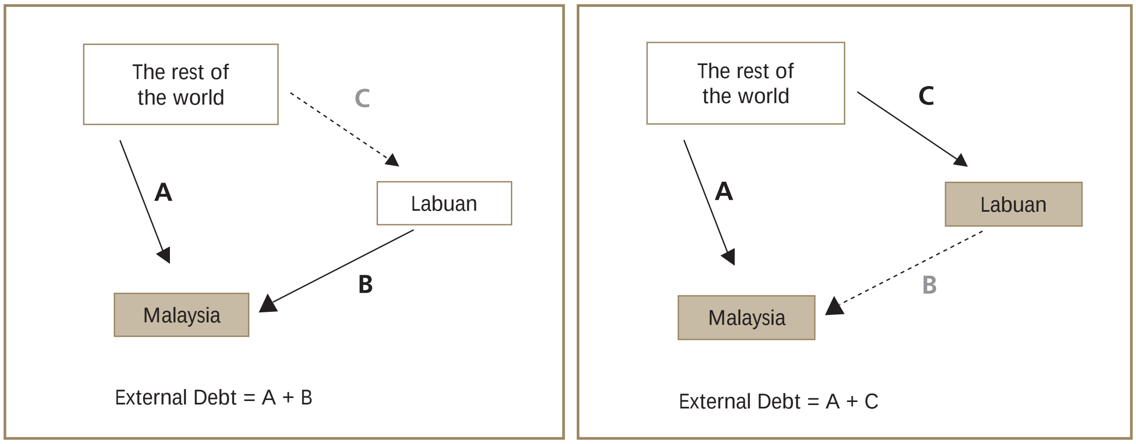
Table 1 provides a comparison of Malaysia's external debt levels with offshore financial entities in Labuan IOFC being treated as non-resident (existing definition) and as resident (new definition)

[1] A guide jointly prepared by the Bank for International Settlements (BIS), Commonwealth Secretariat, Eurostat, International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), Paris Club Secretariat, United Nations Conference on Trade and Development (UNCTAD) and World Bank.

Diagram 1
Malaysia's External Debt Compilation

Existing Definition: Coverage of External Debt with Offshore Financial Entities in Labuan IOFC as Non-resident

New Definition: Coverage of External Debt with Offshore Financial Entities in Labuan IOFC as Resident



respectively. The shift from the existing definition in compilation of external debt to the new definition in accordance with BPM 5 has resulted in some changes in level and profile of external debt as follows:

- Under the new definition, Malaysia's **total external debt** as at end-2004 was higher at RM209.9 billion (USD55.2 billion) or equivalent to 49.4% of GNP compared with the existing level of RM200.6 billion (USD52.8 billion) or 47.2% of GNP.

- **The medium- and long-term external debt** was lower at RM146.4 billion under the new definition (RM156.8 billion under existing definition) due largely to lower external debt of the Federal Government following the reclassification of several market loans sourced from offshore financial entities in Labuan IOFC as part of domestic borrowings. Some of these loans were reflected instead in the medium- and long-term external debt of the banking sector. Consequently, the share of public debt to total external debt was lower at 41.1% compared with 48.3% under existing definition.

- Correspondingly, the share of the private sector debt (medium- and long-term plus short-term debt) to total external debt was larger at 58.9% compared with 51.7% under existing definition. Within this sector, the external debt of the non-bank private sector was lower at RM54.8 billion (RM67.7 billion under existing definition), following the reclassifications of the external loans from the offshore financial entities into domestic borrowings. Some of these loans were reflected in the external debt of the banking sector. As a result, the share of the external debt of the non-bank private sector to total debt declined to 26.1% from 33.7%.

- Meanwhile, the external debt of the banking sector was higher at RM68.7 billion (RM36 billion under existing definition) with its share to total external debt increasing to 32.8% from 18%, reflecting mainly short-term interbank borrowings by offshore financial entities in Labuan IOFC from financial institutions outside Malaysia arising from their investment and treasury operations. As a result, the total **short-term external debt** was higher at RM63.4 billion (RM43.7 billion under existing definition), accounting for a larger share of 30.2% of total external debt (21.8% under existing definition).

Table 1
Outstanding External Debt

	Offshore Financial Entities in Labuan IOFC as		
	Non-Resident	Resident[1]	
	2004	2004	2005
	(RM billion)		
Total external debt (ED)[2]	**200.6**	**209.9**	**220.0**
Medium- and long-term (MLTD)	156.8	146.4	150.6
Federal Government	*34.7*	*23.8*	*22.5*
NFPEs	*62.2*	*62.4*	*60.0*
Private Sector	*60.0*	*60.3*	*68.1*
Bank	*0.7*	*11.0*	*12.4*
Non-Bank	*59.3*	*49.2*	*55.6*
Short-term (STD)	43.7	63.4	69.4
Bank	*35.3*	*57.7*	*64.0*
Non-Bank	*8.4*	*5.7*	*5.4*
Memorandum items:			
Private sector debt (MLTD + STD)	103.7	123.5	136.9
Bank	*36.0*	*68.7*	*76.4*
Non-Bank	*67.7*	*54.8*	*60.5*
	(percent)		
ED/GNP	47.2	49.4	46.5
STD/ED	21.8	30.2	31.6
STD/Reserves	17.3	25.0	26.1
Public debt/ED	48.3	41.1	37.8
Private debt/ED	51.7	58.9	62.2
MLTD	*29.9*	*28.7*	*30.9*
STD	*21.8*	*30.2*	*31.3*
Non-Bank	33.7	26.1	27.5
MLTD	*29.5*	*23.5*	*25.3*
STD	*4.2*	*2.6*	*2.2*
Bank	18.0	32.8	34.7
MLTD	*0.3*	*5.2*	*5.7*
STD	*17.6*	*27.5*	*29.1*

[1] The treatment of offshore financial entities in Labuan IOFC as residents is applicable only to the compilation of the above external debt data by the Bank. Debt transactions and exposure by sector (public, banking and non-bank private sectors) with offshore financial entities in Labuan IOFC will continue to be treated as external debt for other publications until the end of the interim period in mid-2007
[2] Excludes currency and deposits held by non-residents with resident banking institutions

(ii) Developments in 2005 based on new definition

As at the end of 2005, Malaysia's **total external debt** increased by RM10.1 billion to RM220 billion (USD57.6 billion). Nevertheless, the newly defined external debt position accounted for 46.5% of GNP at the end of 2005 compared with 49.4% of GNP at the end of 2004.

The higher external debt level was due to an increase in **short-term debt** to RM69.4 billion (USD18.2 billion), reflecting mainly the higher inter-bank borrowings by offshore banks in Labuan IOFC arising from their investment and treasury operations. Accordingly, the ratio of short-term debt of the banking sector to total debt also increased to 29.1% as at end-2005 compared to 27.5% as at end-2004. Including the short-term debt of the non-bank private sector, the overall ratio of short-term debt to total external debt increased to 31.6%.

Meanwhile, the **medium- and long-term external debt** increased marginally to RM150.6 billion (USD39.4 billion) as at end-2005, reflecting net repayment of loans by the public sector, comprising the Federal Government and NFPEs, being offset by net borrowing by the private sector. Consequently, the share of the public sector debt to total external debt declined to 37.8% while the share of the private sector debt increased to 62.2%.

Risk Assessment of External Debt

Despite a higher total outstanding external debt, Malaysia's external debt position continues to be within the prudent level of 46.5% of GNP in 2005. The higher short-term debt was attributed entirely to borrowings by offshore financial entities in Labuan IOFC, particularly from their head offices and branches abroad, arising from their investment and treasury operations. A large share of these borrowings was on lent to residents in Malaysia. Including the short-term debt of the non-bank private sector, the overall ratio of short-term debt to international reserves and the share of short-term debt to total debt at the end of 2005 remained low at 26.1% and 31.6% respectively.

The increase in medium- and long-term external debt was moderate and reflects the increase in the private sector external debt. The bulk of these loans have a natural hedge as they were used to finance export-oriented activities and overseas investment with foreign exchange earnings and income. Furthermore, a large share of these loans was sourced from the offshore shareholders and parent or associate companies with more flexible terms and at concessionary interest rates.

Conclusion

The compilation of Malaysia's external debt under the new definition, with offshore financial entities in Labuan IOFC being treated as residents, has facilitated a more accurate assessment of the external exposure, including credit, foreign exchange and liquidity risks faced by the Malaysian economy, especially in the light of the increasing trend of residents and non-residents establishing offshore entities in Labuan IOFC to facilitate their financing and investment activities. In addition, the shift towards the new definition underscores Malaysia's commitment to international standard and best practices in external debt compilation and dissemination to facilitate international comparison and assessment.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprises holdings of foreign exchange and gold, the IMF reserve position and holdings of Special Drawing Rights (SDR). For the year 2005 as a whole, net international reserves increased by RM12.8 billion to RM266.3 billion (USD70.5 billion) as at 31 December 2005. The net increase in the reserves in 2005 reflected the fundamentals of the economy with foreign exchange inflows generated mainly from export earnings and foreign direct investment. The reserves level amounted to RM272.7 billion or equivalent to USD72.2 billion as at 28 February 2006. The reserves position is adequate to finance 7.6 months of retained imports and cover 6.7 times the short-term external debt.

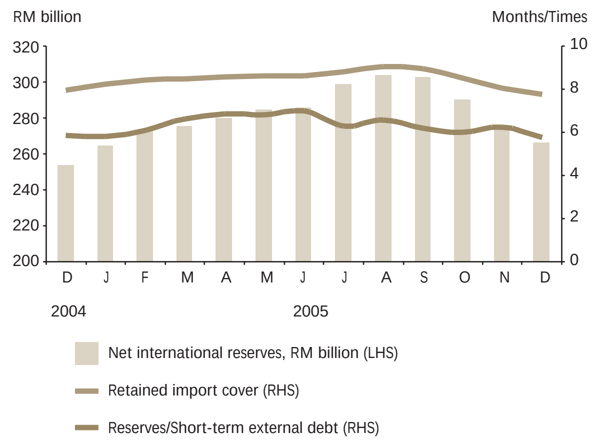
In the first half of 2005, the sustained repatriation of export proceeds and foreign direct investment was reinforced by significant inflows of portfolio investment. The large inflows of short-term funds during the period were partly in anticipation of a change in the exchange rate regime. Following the Bank's announcement of the change in the exchange rate regime to a managed float on 21 July 2005, reserves increased further, driven by significant inflows of short-term funds. The flows normalised subsequently amidst an orderly price discovery process. The decline in reserves, from September to November, reflected mainly the unwinding of the speculative short-term positions. Nevertheless, the outflows of short-term funds subsided by December. The outflows during this period also reflected higher import payments associated with stronger domestic demand, larger repayment of external loans by the official sector as well as higher year-end repatriation of profits and dividends by foreign corporations.

During the year, the cumulative foreign exchange revaluation loss amounted to RM15.5 billion (2004: +RM8 billion), following the strengthening of ringgit against the major currencies.

Net international reserves increased by RM12.8 billion in 2005, reflecting the fundamentals of the economy with foreign exchange inflows generated mainly from export earnings and foreign direct investment.

In managing the reserves, Bank Negara Malaysia continued to adopt a prudent approach to ensure capital preservation and liquidity of reserves whilst optimising returns. The reserves are held in the form of foreign currency deposits and sovereign and quasi-sovereign papers of high investment grade.

Graph 1.47
Net International Reserves (end-month)



Reflecting Malaysia's strong balance of payments position, Malaysia was included in the Financial Transactions Plan of the IMF by making resources available to member countries that are facing short-term balance of payments difficulties. Nevertheless, the **reserve position with the IMF** declined by RM1,882 million in 2005, due to the repurchase of SDR300.3 million (RM1,655.5 million) following repayment to the ringgit account by various member countries under the Financial Transactions Plan, while the exchange revaluation loss amounted to RM226.5 million. Malaysia's holdings of reserves in the form of **SDRs** also declined by RM17 million. Exchange revaluation loss on holdings of SDRs amounting to RM66.8 million was partially offset by net receipt of remuneration worth RM49.8 million arising from Malaysia's net creditor position with the Fund.

The international reserves, held by the Bank remains usable and unencumbered. There are no foreign currency loans with embedded options; and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in options in foreign currencies with regard to the ringgit. Repo and securities lending activities and financial derivative assets are also insignificant.

Table 1.24
Net International Reserves

	As at end-			Change
	2003	2004	2005	2005
	RM million			
SDR holdings	685.0	765.3	748.3	-17.0
IMF reserve position	3,652.0	3,068.4	1,186.3	-1,882.0
Gold and foreign exchange	166,139.3	249,704.1	264,421.6	14,717.5
Gross International Reserves	**170,476.3**	**253,537.8**	**266,356.2**	**12,818.4**
Less Bank Negara Malaysia external liabilities	23.8	24.5	22.5	-2.0
Net International Reserves	**170,452.5**	**253,513.3**	**266,333.7**	**12,820.4**
USD million equivalent	**44,855.9**	**66,714.0**	**70,483.3**	**3,769.3**
Months of retained imports	6.6	7.9	7.8	
Reserves/Short-term external debt (times)	5.1	5.8	5.8	

Table 1.25
International Reserves for Selected Regional Economies

Country	Reserves as at end-2005 (USD billion)	Reserves in months of imports	Reserves as cover of short-term external debt[1]	Reserves as cover of total external debt[1]
Chinese Taipei	253.3	16.7	4.0	3.1
Hong Kong China	124.3	5.0	0.4	0.3
Indonesia	34.1	7.2	3.5	0.2
Korea	210.4	9.7	3.1	1.1
Malaysia	**70.5**	**7.8**	**5.8**	**1.4**
Philippines	18.5	4.9	3.0	0.3
PR China	818.9	14.9	5.7	3.1
Singapore	116.6	7.0	0.6	0.5
Thailand	52.1	5.3	3.1	1.0

[1] External debt data refers to amount outstanding as at end-September 2005, except for Chinese Taipei (end-June 2005) and Malaysia (end-2005).

Source: National authorities; Asian Development Bank; SDDS, International Monetary Fund

Bank Negara Malaysia releases information on the international reserves position and the statement of the Bank's assets and liabilities on a fortnightly basis, with a one-week lag. In addition, the Bank also fulfills the IMF's Special Data Dissemination Standard (SDDS) requirements on detailed disclosure of international reserves and foreign currency liquidity information at the end of each month, with a one-month lag. The reserves data template also provides forward-looking information on the size, composition and usability of reserves and other foreign currency assets, and the future and potential (contingent) inflows and outflows of foreign exchange of the Federal Government and the Bank over the next 12-month period.

FLOW OF FUNDS

The economy registered a higher resource surplus of RM77.8 billion, representing 16.4% of GNP in 2005 (2004: RM56.5 billion or 13.3% of GNP). In terms of the balance of payments, the higher resource surplus reflected the increase in net exports of goods and services to RM116.2 billion (2004: RM95.7 billion). From the perspective of the country's savings-investment balance, the higher resource surplus mainly reflected the higher net savings position of the private sector. The flow of funds between various sectors of the economy in 2004 and 2005 are shown in Tables 1.26 and 1.27.

The resource surplus of the public sector was slightly higher at RM19.9 billion in 2005 (2004: RM18.4 billion). The resource surplus reflected entirely the surpluses from the NFPEs of RM34.1 billion, which helped to offset the resource gap of the general government of RM14.2 billion. The higher resource surplus of the public sector was due to the increase in disposable income, which more than offset the increase in public consumption by the general government and higher investment by the NFPEs. The disposable income of the public sector increased by 6.5% to RM139.6 billion in 2005. This was mainly on account of higher petroleum-related revenue registered in the consolidated public sector. In addition, the Federal Government also recorded higher tax revenue amid sustained economic growth and efforts taken to enhance tax collection. The resource gap of the general government was mainly financed

Table 1.26
Flow of Funds: 2004

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-410.4	131.1	279.3		0	
Consumption	252.1	-59.3	-192.8			0
Investment	91.8	-53.4	-38.4		0	
Change in stocks	10.0		-10.0		0	
Exports of Goods and Non-Factor Services	545.0				-545.0	0
Import of Goods and Non-Factor Services	-449.3				449.3	0
Net Factor Payments Abroad	-24.5				24.5	0
Net Transfers	-14.6				14.6	0
Non-Financial Balance	0.0	18.4	38.2	0.0	-56.5	0
Foreign Financing						
Direct Investment			9.7		-9.7	0
Net Foreign Borrowings		-1.1	20.3		-19.2	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-75.1	75.1	0
Banking System				-6.9	6.9	0
Domestic Financing						
Change in Bank Credit		4.1	31.0	-35.1		0
Change in Deposits[1]		-20.5	-67.9	88.4		0
Net Borrowings from Non-Bank Sector		-0.8	0.8			0
Other items (Net)			-32.1	28.7	3.5	0
Sum		0	0	0	0	

[1] Includes currency in circulation.

Table 1.27
Flow of Funds: 2005

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-456.1	139.6	316.5			0
Consumption	280.5	-64.6	-215.9			0
Investment	98.9	-55.2	-43.8			0
Change in Stocks	-1.1		1.1			0
Exports of Goods and Non-Factor Services	609.1				-609.1	0
Imports of Goods and Non-Factor Services	-492.9				492.9	0
Net Factor Payments Abroad	-21.5				21.5	0
Net Transfers	-17.0				17.0	0
Non-Financial Balance	0.0	19.9	57.9	0.0	-77.8	0
Foreign Financing						
Direct Investment			2.7		-2.7	0
Net Foreign Borrowings		-11.1	-45.3		56.3	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-28.3	28.3	0
Banking System				11.8	-11.8	0
Domestic Financing						
Change in Bank Credit		-1.5	44.6	-43.2		0
Change in Deposits[1]		-7.9	-45.0	52.9		0
Net Borrowings from Non-Bank Sector		0.5	-0.5			0
Other items (Net)			-14.4	6.8	7.6	0
Sum		0	0	0	0	

[1] Includes currency in circulation.

through domestic borrowings. Some of the financing obtained by the general government as well as the resource surplus of the NFPEs were partly utilised for the repayment of foreign debt, while the rest were placed with the banking system.

The resource surplus of the private sector increased to RM57.9 billion or 12.2% of GNP in 2005 compared with RM38.2 billion or 9% of GNP in 2004. The favourable resource surplus position of the private sector was supported by improvement in domestic income and exports growing at a faster rate than imports in the external sector. These factors contributed to the increase in disposable income of the private sector to RM316.5 billion (2004: RM279.3 billion), which in turn, supported the continued growth in private consumption and investment activities. In addition to the resource surplus, net inflows of FDI (RM2.7 billion), and loans from the banking system (RM44.6 billion) also contributed to the pool of funds available to the private sector. Some of the funds were channelled towards the net payment of foreign obligations, including portfolio outflows, and the extension of trade credit; while a portion was also placed as deposits with the banking system.

The current account surplus remained large enough to more than offset private and official sector outflows in the financial account of the balance of payments. As such, Bank Negara Malaysia's international reserves (excluding net foreign exchange revaluation losses) increased further, by RM28.3 billion.

Monetary and Fiscal Developments

Monetary and Fiscal Developments

MONETARY POLICY IN 2005

The conduct of monetary policy in 2005 had the task of balancing the risks to economic growth and price stability. While the Malaysian economy benefited from the sustained expansion in global growth and world trade, the country also faced greater uncertainties arising from developments in the external environment, including higher and more volatile energy prices, volatile short-term capital flows, large payment imbalances, and the gradual removal of monetary accommodation globally. The upward trend in global oil prices led to increases in headline inflation around the world. Globally, monetary authorities increased interest rates in successive steps as high oil prices fed into higher inflation and the build-up of inflationary expectations. Oil importing countries faced deterioration of their current account balances, while the growing burden of oil subsidies in some countries was reflected in their deteriorating fiscal positions. Despite the more challenging global environment, the Malaysian economy showed great resilience amid supportive monetary conditions and the stable financial positions of the corporate, household and banking sectors. Inflation was higher, largely on account of the gradual adjustments to administered prices and the cost-induced adjustments of other prices.

The response of monetary policy to oil price shocks depends largely on the second round inflationary effects in terms of increases in other prices and wages. An exclusive focus on output stabilisation may lead to an inability to anchor inflationary expectations, with wages and prices self-reinforcing. On the other hand, emphasising only on neutralising the impact of oil price shocks on inflation, risks a significant contraction in growth and welfare. Monetary policy, therefore, needs to undertake a careful assessment of both the risks to inflation and economic growth over the medium term. It is the relative balance of these risks that formed the major consideration in the stance of monetary policy for 2005.

At the outset of 2005, a moderate slowdown in external demand was expected in the first half of the year, arising from the continued downcycle of the global semiconductor industry, as well as the global monetary tightening cycle in response to rising inflationary concerns. Domestic GDP growth had moderated to 5.8% in the fourth quarter of 2004. In May, it was evident that the economy had remained resilient in the first quarter of 2005, with GDP expanding by 6.2%. Meanwhile, inflation, as measured by the annual rate of change in the CPI, increased to an average of 2.5% for the first four months of the year, mainly on account of the increases in administered prices and prices of controlled items in late 2004 and early 2005. The inflation rate was expected to edge upwards over the subsequent months, mainly reflecting adjustments in costs, before moderating later in the year.

Following the increases in transportation charges and retail prices of petrol and diesel in May, the inflation rate breached the 3% level and stood at 3.2% at the end of the second quarter. Core inflation, which is indicative of demand-driven inflation, in contrast, registered a more gradual increase in the first half of the year. Real sector and monetary indicators did not suggest that demand pressures were a source of inflationary concern. Consumption and investment activities were holding steady. Bank lending and money supply continued to increase at relatively stable rates. The lack of strong demand pressures allowed monetary policy to continue to remain accommodative to support economic growth.

On the external front, there was an increase in net portfolio flows in the first half of the year, following speculation of a revaluation of the Chinese yuan and ringgit. These inflows, however, were manageable. The Bank sterilised this additional liquidity. There were no signs of excessive credit growth or sharp increases in asset prices.

On 21 July, the Bank adopted a managed float exchange rate regime for the ringgit, with the value of the ringgit being determined by economic fundamentals (See **Exchange Rate Developments**). While the system by which the value of the ringgit is determined was changed, there was no change to the existing monetary policy framework, where the average overnight interbank rate continues to function as the operating target.

At the time of release of the third Monetary Policy Statement in August, the international environment had become more challenging, with increased uncertainty over the likely economic impact of oil prices that had reached new record highs. In the domestic economy, indicators suggested that overt demand pressures had been relatively contained in the second quarter. A more moderate pace of economic expansion of 4.4% was registered during the period. In terms of production capacity, the weighted average of capacity utilisation in

Table 2.1
Monetary Policy Decisions

The Monetary Policy Comittee (MPC) met eight times in 2005. Monetary Policy Statements (MPS) to convey the policy decision were issued following four of those meetings to coincide with the release of the quarterly GDP data. Since its introduction in April 2004, the OPR remained unchanged at 2.70% until the end of November 2005. On 30 November, the OPR was increased by 30 basis points to 3%.

MPS Date	Overnight Policy Rate (OPR)
28 February	2.70%
25 May	2.70%
24 August	2.70%
30 November	3.00%

the manufacturing sector remained stable at 76%. Furthermore, labour productivity, as measured by real sales value of products per employee in the manufacturing sector, rose by 9.6% while real wage per employee declined by 0.4%. The risks of slower growth and higher inflation respectively appeared to be in balance. Inflation rose to 3.7% in August, following the second increase in administered prices of retail petrol products. The Bank viewed that the cumulative impact of the price adjustments would cause inflation to peak in the third quarter and to moderate thereafter, barring further price adjustments during the year, as the effect of the previous year's price adjustments lapsed. Therefore, although real returns on savings and short-term fixed deposits had turned negative, this situation was not expected to persist for long.

As growth strengthened and with inflationary pressures remaining strong, the OPR was increased to 3%.

Following the floating of the ringgit, speculative portfolio positions that had been built-up in the first half of the year, started to be unwound in September and continued into October and November. These outflows, however, subsided in December. The unwinding of these flows was orderly. In the debt securities market, local institutional demand was a stabilising force. Price adjustments were orderly in the market for short-term bills and Government securities. The high international reserves level provided sufficient cushion for outflows while the domestic financial system continued to be characterised by a situation of ample liquidity.

Towards the latter part of the year, it became more evident that the growth momentum of the global economy remained intact. The electronics sector showed signs of a pick-up, while domestic demand indicators strengthened. The economy expanded at a higher rate of 5.3% in the third quarter, with the growth momentum expected to continue into the fourth quarter of 2005 and into 2006. Inflation, meanwhile, moderated slightly to 3.3% in October. Core inflation had increased by small increments and was expected to continue to increase at a steady pace going forward. A high level of uncertainty remained with regard to the upside risk to oil prices. With the risk of slower growth diminishing, and inflation risks biased towards the upside, the OPR was raised by 30 basis points to 3% on 30 November 2005. At 3%, the OPR continued to remain below its neutral level, and therefore, remained supportive of economic activity.

MONETARY DEVELOPMENTS IN 2005

In 2005, monetary conditions remained supportive of domestic economic activity. The OPR was maintained at 2.70% in the first 11 months of the year. Towards the end of the year, with the risk of slower economic growth diminishing and inflation risks biased towards the upside, the OPR was increased by 30 basis points to 3.00% on 30 November 2005.

Monetary conditions remained supportive of economic activity.

The daily weighted average overnight interbank rate moved in the range of 2.60% – 2.73% and averaged 2.70% over the period January – November 2005.

Graph 2.1
Lending Rates: Commercial Banks and Finance Companies

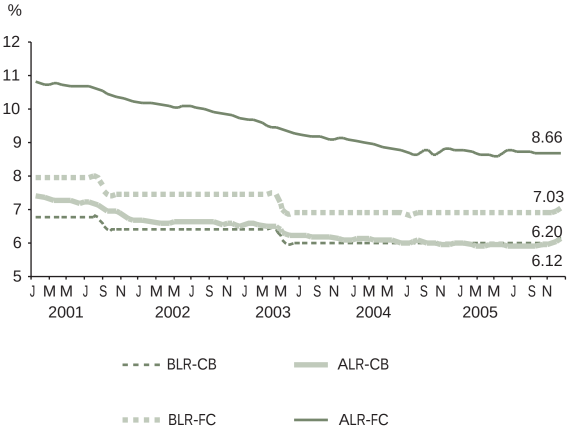


Table 2.2
Interest Rates and Liquidity

	2002	2003	2004	2005
	As at end-period (%)			
3-month Intervention Rate	5.0	4.5	-	-
Overnight policy rate (OPR) [1]	-	-	2.70	3.00
Interbank rates				
Overnight	2.71	2.72	2.69	3.00
1-month	2.99	2.99	2.77	3.12
Base lending rate (BLR)				
Commercial banks	6.39	6.00	5.98	6.20
Finance companies	7.45	6.90	6.90	7.03
Average lending rate (ALR)				
Commercial banks	6.51	6.11	5.98	6.12
Finance companies	9.75	9.11	8.78	8.66
ALR of new loans approved by commercial banks				
Business loans	6.25	5.72	5.64	5.70
of which: SMEs	*6.84*	*6.30*	*6.20*	*6.36*
Household loans[2]	4.66	4.32	4.34	4.09
Fixed deposit rates				
Commercial banks				
3-month	3.20	3.00	3.00	3.02
12-month	4.00	3.70	3.70	3.70
Finance companies				
3-month	3.20	3.00	3.00	3.00
12-month	4.00	3.68	3.70	3.70
Savings deposits rates				
Commercial banks	2.12	1.86	1.58	1.41
Finance companies	2.65	2.18	1.98	1.53
	Average during the period (%)			
Nominal interest rate differential				
Malaysia ñ United States	1.31	1.66	1.16	-0.77
Malaysia ñ Singapore	2.15	2.14	1.79	0.57
	As at end-period (RM billion)			
Resource surplus (+) / gap (-)	76.2	106.0	134.8	155.6
Adjusted resource surplus (+) / gap (-) [3]	24.6	45.9	77.0	98.6
	As at end-period (%)			
Loan-deposit ratio	84.9	80.9	78.4	77.5
Financing-deposit ratio [3]	95.1	91.7	87.7	85.8

[1] OPR replaced 3-month intervention rate as Bank Negara Malaysia's policy rate from 26 April 2004.
[2] Excludes credit cards.
[3] Adjusted to include holdings of Private Debt Securities.

Following the increase in the OPR, the daily weighted average overnight interbank rate rose in December, to move within a tight band of 2.97% – 3.01%, averaging 3.00%. Interbank rates of other tenures, namely the 1-week, 1-month and 3-month maturities, which had shown mild upward trends since April on market expectations of an increase in the OPR, rose by 23 – 32 basis points in December.

With domestic interest rates unchanged for most of the year, interest rate differentials between domestic and US rates turned negative in February and continued to widen as the US Federal Funds rate steadily increased. Notwithstanding this development, domestic liquidity continued to increase amid sustained inflows from the external sector. These inflows mainly reflected the repatriation of export earnings and foreign direct investment, and were also reinforced by significant inflows of portfolio investment in the first half of the year. The large inflows of short-term funds were in part, driven by expectations of a change in the ringgit exchange rate regime. These speculative flows were largely unwound in September through November, and subsided by December. In view of the magnitude and volatility of these flows, Bank Negara Malaysia's money market operation was to ensure that conditions in the domestic financial markets remained orderly.

In terms of retail interest rates, the average base lending rates (BLRs) of commercial banks and finance companies remained unchanged at 5.98% and 6.90% respectively over the period January to November. Following the increase in the OPR, most banking institutions adjusted their BLRs upwards in the range of 25 – 30 basis points. Consequently, the average BLRs of commercial banks rose to 6.20% at end-December. Meanwhile, the average lending rates (ALRs) of commercial banks and finance companies, weighted by outstanding loans, were relatively stable with a modest upward tendency over the period January to November. The merger of two large finance companies with their respective commercial banks resulted in some technical adjustment to the ALRs of the latter, which in turn had a marginal upward impact on the overall ALR for commercial banks. Following the adjustment to BLRs after the policy rate increase, the ALR of commercial banks rose to 6.12%.

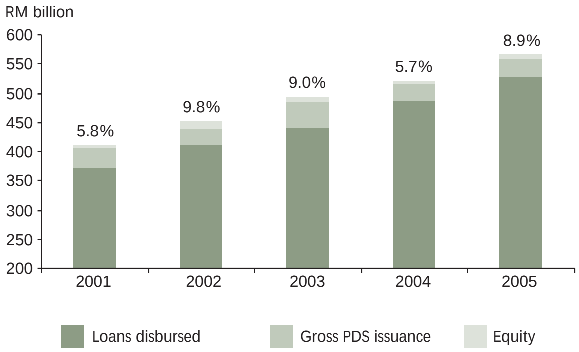
Meanwhile, the ALRs on new loans approved indicated that financing costs in general, were marginally lower for businesses (including SMEs) and households for most of the year compared with 2004. This was notwithstanding the slight upward trend in interest rates on loans approved to the household sector in the second half of the year.

In terms of retail fixed deposit (FD) rates, adjustment to the rates were made by a number of banking institutions. These adjustments were concentrated in the middle tenures, such as the 6-month and 9-month maturities while the rates for the 1-month and 12-month maturities were mostly unchanged at 3.00% and 3.70%. The slower response of deposit rates to the change in the OPR, relative to lending rates, reflected the continued prevalence of ample liquidity in the financial system. This was also reflected by the lower loan-deposit and financing-deposit ratios at 77.5% and 85.8% respectively as at end-2005 (2004: 78.4% and 87.7% respectively).

With accommodative monetary conditions, there was continued growth in financing of the private sector during the year. Gross financing extended through the banking system and capital markets expanded by 8.9% in 2005 (2004: 5.7%), with higher loan disbursements and higher funds raised in the private debt securities (PDS) market. On a net basis, banking system loans and PDS outstanding rose at a combined annual rate of 9.3% at end-2005 (8.6% at end-2004).

Bank lending activity expanded further in 2005. Demand for new credit continued to increase, albeit

Graph 2.2
Private Sector Gross Financing through the Banking System and the Capital Market



more moderately, as reflected in new loan applications, which rose by 11.7% (2004: 20.1%). The ratio of new approvals to applications, meanwhile, remained relatively stable with new loan approvals amounting to RM193.4 billion or an annual increase of 11.4% (2004: 13.6%). Loan disbursements increased by 8.4% (2004: 10.6%), significantly exceeding loan repayments, and providing momentum to the steady increase of 8.6% in loans outstanding at end-2005 (2004: 8.5%).

Trends in the loan indicators were reflective of developments in the real sector; with resilient growth in private consumption and investment, and the services sub-sector being the main growth driver. Growth in demand for new bank loans was observed across most business sub-sectors, with total new loan applications increasing at a more moderate rate of 5.7% in 2005 (2004: 20%). By economic sub-sectors, the slower pace of growth in new business loan applications was mainly attributable to a decline in applications from the construction sector, as well as slower increases in applications from the manufacturing sector; the wholesale and retail trade, restaurants and hotels sector; and for the purchase of non-residential property. Notwithstanding the more moderate increase in applications, growth in new loan approvals was stable at 9.8% while loan disbursements increased by 7.4% (2004:10.5%), with higher or sustained disbursements recorded to most of the business sectors. In particular, the growth in total business loan disbursements was mainly from loans to the wholesale and retail trade, restaurants and hotels sector, which increased by 16.5% on an annual basis.

During the year, corporate financial conditions remained healthy as reflected by indicators such as profitability, leverage and corporate savings. Capital expenditure

Table 2.3
Banking System[1]: Loan Indicators

	During the year (RM billion)					Annual growth (%)				
	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Total										
Loan applications	190.6	217.2	227.6	273.3	305.4	-8.7	14.0	4.8	20.1	11.7
Loan approvals	125.6	137.6	152.8	173.6	193.4	-6.8	9.5	11.1	13.6	11.4
Loan disbursements	373.5	411.6	441.5	488.2	529.3	3.5	10.2	7.3	10.6	8.4
Loan repayments	365.4	402.7	430.4	461.6	489.2	5.3	10.2	6.9	7.3	6.0
Change in loans outstanding[2]	16.1	19.8	21.6	40.1	44.2	3.9	4.6	4.8	8.5	8.6
Businesses										
Loan applications	n.a.	135.3	124.9	149.9	158.5	n.a.	n.a.	-7.7	20.0	5.7
Loan approvals	63.5	68.5	77.3	84.9	93.2	-19.7	7.9	12.8	9.8	9.8
Loan disbursements	270.4	282.0	303.3	335.3	360.1	0.1	4.3	7.6	10.5	7.4
Loan repayments	276.8	275.8	299.5	319.8	343.7	2.8	-0.4	8.6	6.8	7.5
Change in loans outstanding[2]	-5.6	-3.1	-5.2	5.5	6.5	-2.5	-1.4	-2.4	2.6	3.0
SMEs										
Loan applications	n.a.	48.7	44.5	54.2	59.7	n.a.	n.a.	-8.6	21.7	10.3
Loan approvals	n.a.	30.7	25.9	31.6	35.8	n.a.	n.a.	-15.5	22.0	13.1
Loan disbursements	n.a.	49.5	87.1	100.4	110.7	n.a.	n.a.	76.0	15.3	10.2
Change in loans outstanding[2]	4.0	...	7.4	6.3	7.7	5.7	...	10.0	7.7	8.7
Large corporations										
Loan applications	n.a.	86.6	80.4	95.7	98.8	n.a.	n.a.	-7.2	19.1	3.2
Loan approvals	n.a.	37.8	51.4	53.3	57.4	n.a.	n.a.	35.8	3.7	7.8
Loan disbursements	n.a.	232.5	216.2	234.9	249.5	n.a.	n.a.	-7.0	8.6	6.2
Change in loans outstanding[2]	-9.6	-3.1	-12.7	-0.8	-1.2	-6.1	-2.1	-8.8	-0.6	-0.9
Households										
Loan applications	n.a.	81.9	98.4	120.2	141.9	n.a.	n.a.	20.2	22.1	18.0
Loan approvals	59.2	66.9	72.0	86.8	97.2	11.5	13.0	7.6	20.5	12.0
Loan disbursements	87.0	105.1	114.4	130.3	145.2	14.5	20.8	8.9	13.9	11.4
Loan repayments	71.5	83.7	94.1	107.0	115.1	9.9	17.0	12.4	13.7	7.6
Change in loans outstanding[2]	23.1	26.2	26.2	33.3	40.0	14.8	14.7	12.8	14.4	15.1

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

continued to increase, and was supported by internally generated funds as well as financing via bank loans and the PDS market. New loan applications by large corporations increased at a more moderate rate of 3.2% (2004: 19.1%) while loan disbursements rose by 6.2% (2004: 8.6%). Meanwhile, in the PDS market, where borrowing costs remained competitive, funds raised by businesses for new activities increased, and were mainly channeled to the utilities and construction sectors.

Following continued efforts to enhance access to financing by SMEs, loans to this sector continued to expand in 2005, notwithstanding the more challenging environment. SMEs' demand for loans continued to increase as reflected in the increase of 10.3% in new loan applications (2004: 21.7%). Importantly, this growth was closely matched by an increase in loan approvals of 13.1% (2004: 22%). A total of RM110.7 billion loans were disbursed to the sector, representing an expansion of 10.2% on an annual basis, and accounting for a slightly higher proportion of 30.7% of total loan disbursements to businesses.

Notwithstanding some weakening in consumer sentiment during the second and third quarters, household consumption and investment activities generally remained resilient, supported by rising income, stable labour market conditions, and attractive financing options. The year saw a significant rise in passenger car sales, and continued growth in retail sales and imports of consumption goods. The launch of new car models, particularly of national cars, led to a strong increase of 34.4% in loan disbursements for the purchase of passenger cars on an annual basis (2004: 18.8%). Loans disbursed for credit card transactions, meanwhile, increased by 17.6% (2004: 19.1%). At end-2005,

Graph 2.3
Loan Disbursements by Sector: Value and Share

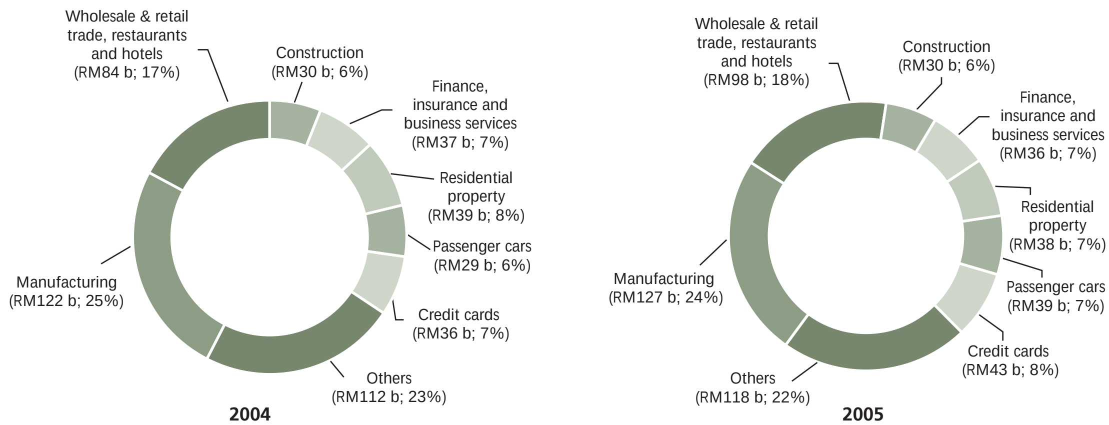


Table 2.4
Banking System[1]: Loans Outstanding

	Annual change 2004	Annual change 2005	% share of total loans at end 2005
	RM billion		
Banking system loans, of which extended to:			
Business enterprises	5.5	6.5	40.4
Individuals	33.3	40.0	54.5
By sector:			
Agriculture, hunting, forestry and fishing	0.4	0.1	2.0
Mining and quarrying	-0.1	-0.2	0.1
Manufacturing	1.9	-2.4	10.9
Electricity, gas and water supply	0.1	-0.5	0.8
Wholesale and retail trade, restaurants and hotels	4.3	3.6	8.4
Broad property sector	19.7	20.5	41.0
Construction	*1.2*	*-0.7*	*5.4*
Purchase of residential property	*16.4*	*16.3*	*26.7*
Purchase of non–residential property	*2.3*	*4.0*	*6.3*
Real estate	*-0.2*	*1.0*	*2.6*
Transport, storage and communication	-0.8	1.4	2.0
Finance, insurance and business services	1.7	-0.8	5.4
Consumption credit	14.6	19.4	22.1
of which:			
Credit cards	*2.0*	*2.5*	*3.0*
Purchase of passenger cars	*10.6*	*14.4*	*15.5*
Purchase of securities	-0.4	1.5	3.7
Purchase of transport vehicles	-0.8	0.4	0.5
Community, social and personal services	0.1	0.6	1.0
Others	-0.7	0.4	1.9
Total loans outstanding[2]	**40.1**	**44.2**	**100.0**

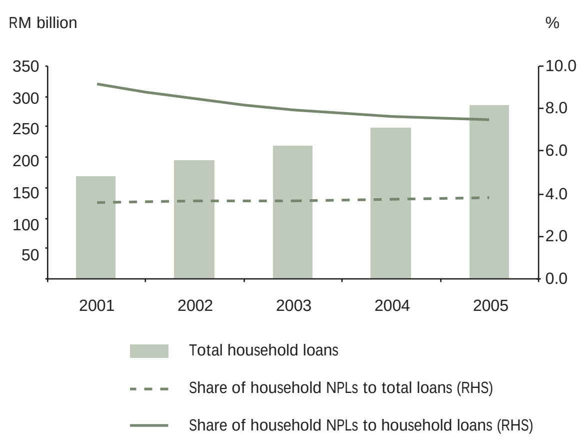
[1] Includes Islamic banks.
[2] Includes loans sold to Cagamas.
Note: Numbers may not add–up due to rounding.

outstanding balances on credit cards amounted to RM16.7 billion, expanding by 17.3% on an annual basis, and accounting for 3% of total banking system loans outstanding.

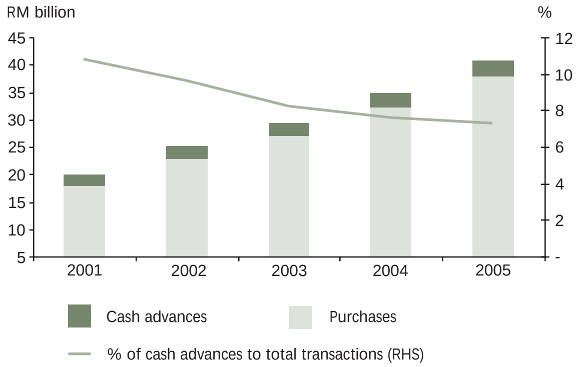
In terms of household investment in residential property, loan disbursements for the purchase of residential property declined marginally by 0.9% (2004: 9.1%), after the strong increase in the previous year, which was driven to some extent, by the home-ownership incentives that was implemented in June 2003 and lapsed in June 2004.

Although lending to households has continued to increase, the debt service burden on an aggregate basis remains manageable for households. Defaults on payments

Graph 2.4
Banking System: Loans to Households (at end-period)



Graph 2.5
Aggregate Value of Credit Card Transactions by Malaysian Cardholders



remained relatively stable. Household NPLs as a percentage of total outstanding loans to the household sector displayed a stable trend and stood at 7.5% at end-December 2005 (end-December 2004: 7.6%). Meanwhile, the number of individual bankruptcies declined by 2.4% on an annual basis. Households' net wealth position also remained strong, with indicators such as deposits and other financial investments suggesting that household financial assets continue to exceed household debt. These factors, along with benign trends in house prices, support the sustainability of household consumption and investment activity. The number of overstretched households whose capacity to service and repay loans could be affected by unexpected developments remains small. Prudent lending practices as well as ready access to comprehensive credit information among banks via the Central Credit Reference Information System (CCRIS) has led to improved risk management in the financial sector, which has been important in balancing credit risk exposures.

Graph 2.6
Monetary Aggregates

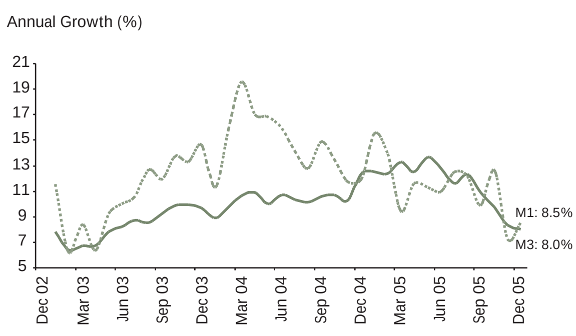


Table 2.5
Broad Money, M3

	Change (RM billion)	
	2004	2005
M3	68.0	49.7
Currency	2.6	1.6
Demand deposits	10.1	8.7
Broad quasi money	55.3	39.4
Fixed deposits	*24.7*	*4.9*
Savings deposits	*6.1*	*1.9*
NIDs	*8.2*	*12.8*
Repos	*13.3*	*17.3*
FX deposits	*3.0*	*2.5*
Determinants of M3		
Net claims on Government	-15.9	-5.5
Claims on private sector	30.6	45.4
Loans	*39.8*	*45.0*
Securities	*-9.2*	*0.4*
Net external operations	82.0	16.5
Bank Negara Malaysia	*75.1*	*28.3*
Banking system	*6.9*	*-11.8*
Other influences	-28.7	-6.7

Nevertheless, as a pre-emptive measure, Bank Negara Malaysia has established the Credit Counseling and Debt Management Agency, which will commence operations in the first quarter of 2006, to address potential credit issues that may be faced by households.

Money supply continued to increase during the year, in tandem with economic and financial developments. Broad money, M3, displayed a relatively stable growth trend in the first half of the year, which subsequently moderated slightly towards end-year. At end-2005, M3 had increased at an annual rate of 8% (end-2004: 12.4%). Higher private sector financing during the year was the main driver of the expansion in M3. In addition, the external sector also contributed to M3 growth, albeit to a lesser extent compared with 2004. In particular, in the last few months of the year, net foreign assets exerted a contractionary impact on M3, reflecting to a large extent, the unwinding of speculative long positions in the ringgit.

Meanwhile, M1, which is a measure of transaction balances, expanded at an annual rate of 8.5% in 2005 (2004: 11.9%), roughly in tandem with the sustained growth of spending activity.

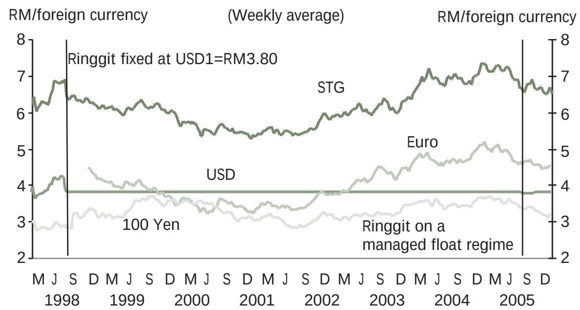
EXCHANGE RATE DEVELOPMENTS

On 21 July 2005, Malaysia shifted from a fixed exchange rate regime of USD1 = RM3.80 to a managed float against a basket of currencies. The policy shift was taken to better position Malaysia to respond to and benefit from the structural changes occurring in the region. With regional countries becoming increasingly important trading partners to Malaysia, their importance is expected to increase further over time in line with regional efforts to promote closer economic and financial inter-linkages.

The overriding objective of the exchange rate policy continues to be the promotion of exchange rate stability against the currencies of Malaysia's major trading partners. Being a small and highly open economy, a stable exchange rate environment against major trading partners is important to achieve sustainable growth and price stability. Under the managed float system, the ringgit exchange rate is largely determined by ringgit demand and supply in the foreign exchange market. The Central Bank does not actively manage or maintain the exchange rate at any particular level – economic fundamentals and market conditions are the primary determinants of the level of the ringgit exchange rate. In this regard, the Central Bank only intervenes to minimise volatility, and to ensure that the exchange rate does not become fundamentally misaligned.

The ringgit exchange rate regime, and therefore movement in the ringgit exchange rate can be distinguished by two periods in the year 2005. The fixed exchange rate regime of USD1 to RM3.80 was maintained from 1 January – 21 July 2005, as it had been maintained since 2 September 1998. During this period, developments in the ringgit were driven entirely by movements in the US dollar and the consequent realignments of major and regional currencies against the

Graph 2.7
Exchange Rate of the Malaysian Ringgit against Major Currencies



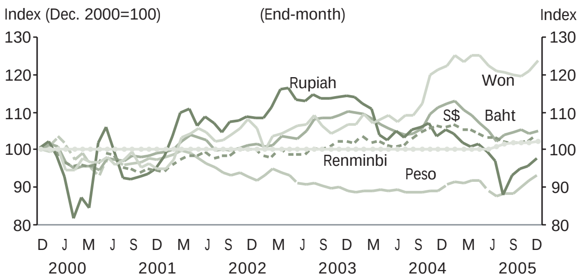
US currency. During 2005, the dollar appreciated against the major currencies amidst expectations of continued increases in the US Federal Funds Rate, which widened yield differentials in favour of the US dollar, as well as on continued expectations that economic growth in the US would outpace that of the euro area and Japan. The US dollar was also supported by sustained demand for US assets by international investors. Regional currencies were, in general, also affected by concerns that higher oil prices would increase import costs and dampen demand for regional exports. Due to the US dollar strength, the ringgit appreciated against the euro (11.9%), pound sterling (10.4%) and Japanese yen (9.7%). Similarly, the ringgit appreciated within the range of 0% - 7.7% against regional currencies, with the exception of the depreciation against the Philippine peso (0.6%).

Table 2.6
Movements of the Ringgit

	RM to one unit of foreign currency[1]					Annual change (%)		Change (%)		
	1997	1998	2004	2005	2006	2004	2005	End-June '97-Dec. 2005	2 Sept.'98 - Dec. 2005	End-Dec '05-28 Feb. '06
	End-June[2]	Sept. 2[3]	End-Dec.		Feb. 28					
SDR	3.5030	5.1177	5.8818	5.4020	5.3234	-4.3	8.9	-35.2	-5.3	1.5
US dollar	2.5235	3.8000	3.8000	3.7800	3.7135	0.0	0.5	-33.2	0.5	1.8
Singapore dollar	1.7647	2.1998	2.3258	2.2714	2.2857	-3.9	2.4	-22.3	-3.2	-0.6
100 Japanese yen	2.2088	2.7742	3.7026	3.2229	3.1907	-4.0	14.9	-31.5	-13.9	1.0
Pound sterling	4.1989	6.3708	7.3169	6.5226	6.4643	-7.5	12.2	-35.6	-2.3	0.9
Swiss franc	1.7368	2.6450	3.3517	2.8825	2.8106	-8.6	16.3	-39.7	-8.2	2.6
Euro[4]	–	–	5.1729	4.4867	4.4055	-7.6	15.3	–	–	1.8
100 Thai baht	9.7470	9.3713	9.7636	9.2049	9.4407	-1.7	6.1	5.9	1.8	-2.5
100 Indonesian rupiah	0.1038	0.0354	0.0408	0.0385	0.0402	9.8	6.2	169.9	-7.9	-4.4
100 Korean won	0.2842	0.2827	0.3671	0.3739	0.3827	-13.4	-1.8	-24.0	-24.4	-2.3
100 Philippine peso	9.5878	8.8302	6.7706	7.1254	7.1793	1.1	-5.0	34.6	23.9	-0.8
Chinese renminbi	0.3045	0.4594	0.4591	0.4686	0.4619	0.0	-2.0	-35.0	-2.0	1.5

[1] US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market.
Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate.
[2] End-June 1997 represents pre-Asian Financial Crisis levels.
[3] Ringgit was fixed at USD1 = RM3.8000 on 2 September 1998.
[4] The euro began to be traded on 4 January 1999 (EUR 1= RM4.5050).

Graph 2.8
Exchange Rate of the Malaysian Ringgit against Selected Regional Currencies



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

With the ringgit strengthening significantly since the beginning of 2005, any undervaluation that existed as a result of the US dollar depreciation in 2003 and 2004 had effectively been reversed. The exchange rate was therefore not expected to change substantially at the time of the change to the new regime. The price discovery process following the unpegging of the ringgit was orderly, resulting in relative stability of the exchange rate. During the period after the move to a managed float regime, between 22 July – 30 December 2005, the ringgit moved not only against the US dollar, but also other major and regional currencies, and reflected the overall strength of the domestic economy. There was, however, a substantial unwinding of the large speculative long positions in the ringgit. During the remaining part of the year, since the introduction of the new regime, the ringgit appreciated against the US dollar (0.5%), Japanese yen (4.7%), euro (3%) and pound sterling (1.6%). Against regional currencies, the ringgit depreciated within the range of 0.6% - 4.4%, the exception being an appreciation of 0.5% against the Indonesian rupiah.

For the year as a whole, the ringgit appreciated against the US dollar (0.5%), euro (15.3%), Japanese yen (14.9%) and pound sterling (12.2%). Against the regional currencies, the ringgit recorded a mixed performance, appreciating against the Indonesian rupiah (6.2%), Thai baht (6.1%) and Singapore dollar (2.4%), but depreciating against the Philippine peso (5%), Chinese renminbi (2%) and Korean won (1.8%).

FISCAL POLICY AND OPERATIONS

Fiscal policy in 2005 remained focused on improving the Federal Government's financial position while supporting capacity building to enhance economic growth. The Government continued to play a supportive role in facilitating the further entrenchment of the private sector as the main engine of growth. The Federal Government's overall macroeconomic strategy continued to concentrate on reinforcing economic growth by stimulating domestic sources of growth, enhancing human capital development, improving capacity of delivery system of the Government and promoting higher productivity. These efforts, together with supportive monetary policy, enabled total private sector consumption and investment to sustain a strong expansion of 9.5% to contribute 5.7 percentage points of economic growth.

While fiscal policy in 2005 continued to focus on capacity building to support economic growth, the Federal Government's fiscal consolidation strategy remained on course with a lower fiscal deficit of 3.8% of GDP.

Notwithstanding higher petroleum-related expenditure, the continued fiscal discipline and prudence in spending, combined with a favourable revenue performance, led to an improvement in the **Federal Government's financial position.** The Federal Government registered a smaller overall deficit of RM18.7 billion or 3.8% of GDP. The reduction of fiscal deficit for the third successive year underscored the Government's strong commitment to a policy of fiscal consolidation. With this manageable deficit, the Government will now have the added

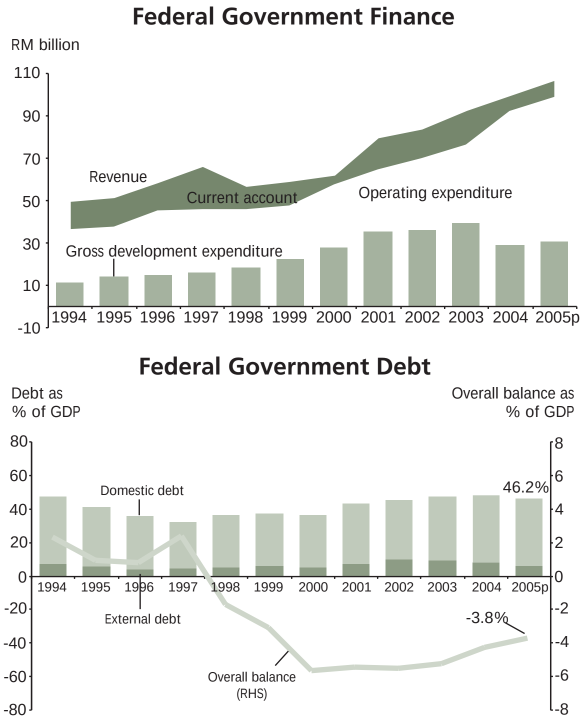
Table 2.7
Federal Government Finance

	2004	2005*p*
	RM million	
Revenue	99,397	106,304
Operating expenditure	91,298	97,744
Current account	**8,099**	**8,560**
% of GDP	**1.8**	**1.7**
Net development expenditure	27,518	27,284
Gross development expenditure	*28,864*	*30,534*
Loan recoveries	*1,346*	*3,250*
Overall balance	**-19,419**	**-18,724**
% of GDP	**-4.3**	**-3.8**

p Preliminary
Note: Numbers may not add up due to rounding.

Source: Ministry of Finance

Graph 2.9



p Preliminary

flexibility to provide more resources for activities that will contribute to further strengthening the economic resilience of the economy.

Federal Government **revenue** continued to rise, increasing by 6.9% to RM106.3 billion in 2005, reflecting sustained growth in the Malaysian economy and higher petroleum-related revenue. Higher tax revenue collection also reflected the concerted efforts made by the Government to broaden the tax base. The proportion of total revenue to GDP remained at a high level of 21.5% (2004: 22.1%). Both categories of tax revenue, direct and indirect taxes, increased in 2005, and resulted in larger shares of 50.4% and 25.4% of total revenue, respectively (2004: 49% and 23.5%, respectively). Receipts from the petroleum income tax registered a significant growth of 26.9% following higher oil prices. Favourable business performance and further improvements in the tax collection machinery contributed to the increased revenue from corporate income tax. Higher revenue was achieved despite the re-computation of current year corporate tax after taking into account treatment for tax refund. In addition, several tax concessions and incentives were introduced in 2005 to promote private investment activity and to reduce the corporate tax burden. During the year, measures

Table 2.8
Federal Government Revenue

	2004	2005*p*	2004	2005*p*
	RM million		Annual change (%)	
Tax revenue	**72,050**	**80,594**	**11.0**	**11.9**
% of GDP	**16.0**	**16.3**		
Direct taxes	48,703	55,543	13.2	9.9
Companies	*24,388*	*26,381*	*1.7*	*8.2*
Petroleum	*11,479*	*14,566*	*35.6*	*26.9*
Individuals	*8,977*	*8,649*	*12.4*	*-3.7*
Stamp duties	*2,381*	*2,460*	*18.6*	*3.3*
Others	*1,479*	*1,487*	*160.1*	*0.6*
Indirect taxes	23,347	27,051	6.7	15.9
Export duties	*1,600*	*2,085*	*38.4*	*30.3*
Import duties	*3,874*	*3,385*	*-1.1*	*-12.6*
Excise duties	*6,427*	*8,641*	*27.7*	*34.5*
Sales tax	*6,816*	*7,709*	*-14.4*	*13.1*
Service tax	*2,350*	*2,582*	*15.3*	*9.9*
Others	*2,280*	*2,648*	*29.1*	*16.2*
Non-tax revenue	**27,347**	**25,710**	**-1.3**	**-6.0**
Total revenue	**99,397**	**106,304**	**7.3**	**6.9**
% of GDP	**22.1**	**21.5**		

p Preliminary
Note: Numbers may not add up due to rounding.

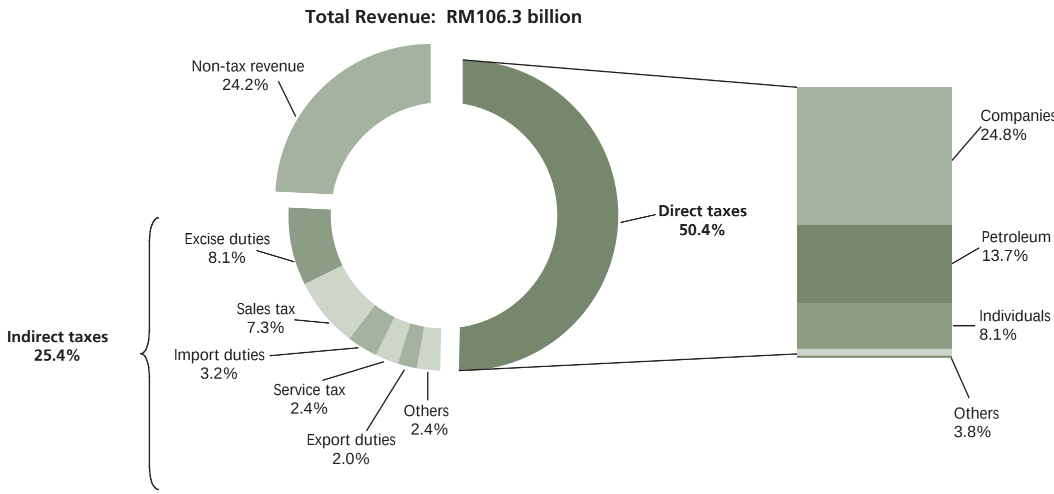
Source: Ministry of Finance

taken by the Inland Revenue Board included enhancing its services and intensifying collection efforts through stricter enforcement. However, individual income tax collections were lower. During the year, higher tax relief was provided to assist disabled taxpayers, for expanding the use of information and communications technology by households, and to inculcate the habit of reading. Commencing in 2005, the Self Assessment System was introduced for individual taxpayers as part of the Government's effort to modernise and streamline the tax administrative system.

The Government continued to emphasise efficiency and effectiveness in its financial management by streamlining tax measures, improving tax administration and intensifying collection efforts. In 2005, the Government established a Taxation System Review Panel comprising representatives from the public and private sectors to review the tax system. Tax administration was enhanced with the setting up of the Fund for Tax Refund to expedite income tax refunds.

Most major sources of indirect taxes recorded double-digit growth, reflecting stronger domestic aggregate demand during the year. Excise duties receipts were significantly higher due to continued high demand for motor vehicles. It also reflected the upward revision of excise duties on locally manufactured cigarettes and

Graph 2.10
Composition of Federal Government Revenue, 2005 (% share)



Summary of Major Tax Measures Implemented in 2005

Individuals Income Tax

- Tax relief on contributions for EPF and insurance premiums increased to RM6,000.
- Additional tax relief for disabled citizens and spouses increased to RM6,000 and RM3,500, respectively.
- Tax rebate for purchases of computers increased to RM500.
- Tax relief for purchases of books increased to RM700.
- Tax exemption on retirement benefits of up to RM6,000 for each year of service.

Companies Income Tax

- Tax deduction for zakat on business income paid by companies.
- Tax exemption on interest income from bonds received by non-resident companies.
- Tax incentives given to encourage the modernisation and commercialisation of the agriculture sector.
- Tax incentives extended for existing companies for relocating manufacturing activities to promoted areas.
- Scope of tax incentives extended for usage of renewable energy to companies which generate such energy for own consumption.
- Double deduction provided for expenses incurred on promoting the export of professional services.

Indirect Tax

- Import duty for selected goods (surgical gloves, carpet, glassware and semi-finished components for the wood-based industry) was abolished.
- Import duty on selected raw materials for apparel industry and herbicides was reduced between 5-30%.
- 5% exemption given for import duty on natural gas vehicles (NGV) conversion kits for vehicles.
- Excise duty on cigarettes increased to RM81 per 1,000 sticks.
- Excise duty on liquor increased between 10 sen to RM28 per litre.

Non-tax revenue

- Road tax for motorcycles with engine capacity between 151-250 cc reduced by 50%.
- Road tax for passenger cars with engine capacity between 1,001-1,600 cc reduced by 50%, while those below 1,000 cc the road tax was charged at RM30 per year.
- Road tax for mono gas and dual-fuel vehicles reduced by 50% and 25%, respectively.
- 10% exemption given for road tax for vehicles with NGV conversion kits.
- Road tax abolished for school and stage buses.

liquor announced in the 2005 Budget to promote a healthy lifestyle and to curb social ills. Meanwhile, the escalating oil prices contributed to the higher export duties receipts. In line with Malaysia's commitment to the Asean Free Trade Agreement (AFTA), the gradual reduction in import tariffs on Complete Built-up (CBU) motor vehicles from ASEAN countries as well as the reduction and abolishment of duties on selected goods introduced in the 2005 Budget, resulted in lower import duties collection during the year.

Collection from non-tax revenue declined by 6% in 2005 due to lower investment income. Nevertheless, its share to total revenue remained favourable at 24% (2004: 27%).

The Federal Government's **gross expenditure** increased by 6.8% to RM128.3 billion in 2005. The overall thrust of the Federal Government's expenditure was to strengthen the fundamentals of the economy and to increase the private sector's resilience. In managing expenditure, emphasis was placed on enhancing efficiency and cost effectiveness. **Operating expenditure** was higher by 7.1% or RM6.4 billion in 2005. The substantially higher subsidies for petroleum products (RM11 billion), which was more than three times the amount recorded in 2004, was the major reason for the increase in operating expenditure. To contain the growth of operating expenditure within a reasonable range, the Government reviewed policies on petroleum subsidies. The prices of retail petroleum products were raised three times during the year in view of escalating oil prices. On 1 March, the Government raised the diesel price by 5 sen. The retail price of petrol was raised by 10 sen and diesel by 20 sen on 2 May and 31 July respectively.

Table 2.9
Federal Government Operating Expenditure by Object

	2004	2005*p*	2004	2005*p*
	RM million		% share	
Emolument	23,779	25,587	26.0	26.2
Supplies and services	16,633	17,984	18.2	18.4
Asset acquisition	1,764	1,603	1.9	1.6
Debt service charges	10,920	11,604	12.0	11.9
Pensions and gratuities	6,060	6,809	6.6	7.0
Subsidies	5,796	12,831	6.3	13.1
Other grants and transfers[1]	21,264	20,982	23.3	21.5
Other expenditure[2]	5,082	344	5.7	0.3
Total	**91,298**	**97,744**	**100.0**	**100.0**
% of GDP	**20.3**	**19.8**		

[1] Includes grants and transfers to state governments as well as public agencies and enterprises.
[2] Includes refunds, grants to international organisations, insurance claims and gratuities and others.
p Preliminary
Note: Numbers may not add up due to rounding.

Source: Ministry of Finance

The total wage bill, which was the largest component of operating expenditure (26.2%), rose by 7.6%. During the year, the Government announced salary increases for Members of Parliament and Cabinet Ministers and higher allowances for various groups of civil servants, including specialists, medical officers and housemen working in Government hospitals. Higher disbursement for supplies and services were largely to improve public sector delivery and promote a culture of maintenance. The bulk of the spending was for procurement of office supplies, repairs and maintenance as well as payments for professional services associated with the Government's initiative to upgrade the quality and efficiency of public services. Payments for grants and transfers to government agencies, statutory bodies and state governments were extended for development and maintenance purposes. Notwithstanding the higher debt level, the debt service charges were contained as new borrowings were raised at lower costs during the year.

Gross development expenditure increased by 5.8% to RM30.5 billion in 2005. The focus of development expenditure was to enhance longer-term productivity and competitiveness, while supporting further economic activity. Spending was reprioritised to focus on smaller-sized projects that have multiplier effects in creating more economic activities in the near term. In particular, such spending was directed to agriculture, construction, housing and infrastructure activities in rural areas. During the year, expenditure efficiency was enhanced by ensuring maximum social and economic benefits. In addition, further emphasis on the usage of the open tender system was undertaken to ensure competitive pricing.

In terms of sectoral distribution, economic services continued to be the largest component of total development expenditure for the second consecutive year with its share of total development expenditure increasing to 49% in 2005 from 35% in 2003. A large part of the increase in spending for this sector was directed to the trade and industry sub-sector to facilitate growth. Spending was focussed on strengthening the small and medium-sized enterprises, industrial research and technological development, and tourism development projects. Expenditure on the transport sub-sector was also higher, reflecting the Government's concerted effort to improve the efficiency of public transportation services and establishing an integrated national transportation network. Funding for agriculture and rural development, as well as public utilities (such as rural roads, water and electricity programmes), were made to further modernise and commercialise the agricultural sector and improve the quality of life in rural areas.

In the social services sector, priority continued to be given to the education sub-sector as focus was placed on human resource development to support the strategy of productivity-driven growth. However, total education expenditure was lower, as most of the education projects in the Eighth Malaysia Plan had been completed by 2003. Expenditure for health services remained high to provide better quality healthcare and medical services. The Government also continued to undertake housing projects for public sector personnel and the lower income groups. Meanwhile, general administration spending was higher to improve further the service delivery system, as well as to enhance the working and service environment. Expenditure was channelled for the purchase of information and communications technology equipment for the implementation of various initiatives under the Electronic Government Application projects.

In an effort to cushion the impact of high oil prices on the domestic economy, the Government, throughout 2005, introduced several measures aimed at encouraging the use of alternative energy sources to reduce the heavy dependence on fossil fuels, lower the cost burden on the general public and to encourage energy conservation, especially by the Government sector. A summary of these measures are listed in the white box.

Table 2.10
Federal Government Development Expenditure by Sector

	2004	2005*p*	2004	2005*p*
	RM million		% share	
Defence and security	4,133	4,803	14.3	15.7
Economic services	11,851	14,957	41.1	49.0
Agriculture and rural development	2,881	2,495	10.0	8.2
Trade and industry	1,201	3,221	4.2	10.6
Transport	6,630	7,660	23.0	25.1
Public utilities	945	1,481	3.3	4.9
Others	193	99	0.6	0.2
Social services	10,260	7,450	35.5	24.4
Education	4,316	3,736	15.0	12.2
Health	2,352	1,220	8.1	4.0
Housing	1,593	1,082	5.5	3.5
Others	1,999	1,412	6.9	4.7
General administration	2,620	3,325	9.1	10.9
Total	**28,864**	**30,534**	**100.0**	**100.0**
% of GDP	**6.4**	**6.2**		

p Preliminary
Note: Numbers may not add up due to rounding.

Source: Ministry of Finance

Measures Taken to Cushion the Impact of Rising Oil Prices

- **Encourage the use of alternative energy sources**
  - Provide more NGV pumps at petrol stations.
  - Promote the use of NGV, especially by long-haul transport vehicles.
  - The use of renewable energy under the small renewable energy programme.
  - Develop Bakun hydroelectric power Project.
  - Introduce the use of "green" fuels, such as biodiesel, using palm oil.
- **Reduce public burden**
  - The price of fuel for NGV was fixed at half of the price of petrol.
  - 50% and 25% road tax reduction for mono gas and dual-fuel vehicles, respectively.
  - 5% exemption on import duty and 10% on road tax on NGV conversion kits for vehicles.
  - Road tax abolished for school and stage buses.
  - Road tax for passenger cars with engine capacity between 1001-1600 cc reduced by 50%, while below 1000 cc the road tax is RM30 per year.
  - Road tax for motorcycles with engine capacity between 151-250 cc reduced by 50%.
  - Diesel subsidy provided to fishermen.
- **Conserve the use of fuel**
  - Energy conservation moves introduced in Government offices, such as switching off lights during lunch time and increasing room temperature slightly.
  - Encourage the use of public transportation and car pooling.
  - Enhance efforts to improve the public transportation system, especially in the Klang Valley.

Table 2.11
Federal Government Sources of Financing

	2004	2005*p*
	RM million	
Net domestic borrowing	25,650	12,700
Gross borrowing	*45,850*	*31,500*
Less: Repayment	*20,200*	*18,800*
Net foreign borrowing	121	-3,503
Gross borrowing	*1,136*	*651*
Less: Repayment	*1,015*	*4,153*
Special receipts	516	454
Realisable assets[1] and adjustments	-6,868	9,073
Total	**19,419**	**18,724**

[1] Includes changes in Government's Trust Fund balances.
A positive (+) sign indicates a drawdown in the accumulated realisable assets.
p Preliminary
Note: Numbers may not add up due to rounding.

Source: Ministry of Finance

As a prudent measure, the Federal Government had always ensured that revenue exceeded operating expenditure. Given the reinforced fiscal prudence to contain spending amidst higher revenue collection, the Government registered a larger current account surplus of RM8.6 billion in 2005. The larger savings enabled the Government to reduce its need to source additional **financing** for development activity. In addition, a large part of the development expenditure was financed from the drawdown of accumulated assets. During the year, the Government drew down RM9.1 billion from its accumulated assets. Financing through issuances of government securities were reduced in 2005.

Total **gross borrowings** of the Federal Government in 2005 amounted to RM32.2 billion (2004: RM47 billion). The bulk of the funding (98% of total) was raised from domestic sources without "crowding out" the private sector, given the ample liquidity situation in the economy. The Government raised a total of RM27.5 billion by issuing Malaysian Government Securities (MGS) and another RM4 billion through Government Investment Issues. In 2005, new issues of government securities were raised at lower costs reflecting lower yields. New issues of government securities with maturities of 3 and 5 years were issued at average yield rates ranging between 3.155–3.756% (2004: 3.135–4.546%). For those with maturities of 10 and 20 years, the average yield rates ranged between 4.391–4.837% (2004: 5.094–5.734% for maturities of 10 and 15 years). In terms of the ownership structure of MGS, the provident and pension funds and insurance companies continued to be the major holders.

Table 2.12
Holdings of Federal Government Domestic Debt

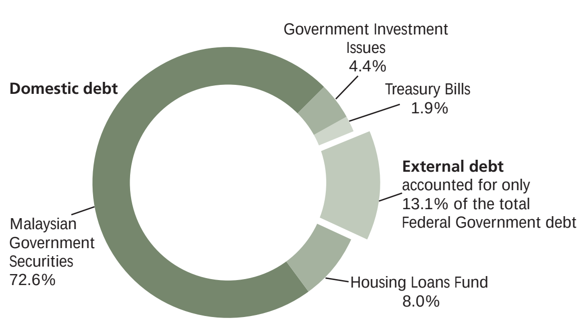
	2004	2005*p*	2004	2005*p*
	Nominal value in RM million		% share	
Treasury Bills	**4,320**	**4,320**	**100.0**	**100.0**
Social security and insurance institutions	17	82	0.4	1.9
Banking institutions	481	1,916	11.1	44.3
Others	3,822	2,323	88.5	53.8
Government Investment Issues	**9,100**	**10,100**	**100.0**	**100.0**
Social security and insurance institutions	973	3,374	10.7	33.4
Banking institutions	6,755	4,146	74.2	41.0
Others	1,372	2,581	15.1	25.6
Malaysian Government Securities	**154,350**	**166,050**	**100.0**	**100.0**
Social security and insurance institutions	109,402	115,109	70.9	69.3
of which:				
Employees Provident Fund	*91,426*	*96,571*	*59.2*	*58.2*
Insurance companies	*14,715*	*14,750*	*9.5*	*8.9*
Banking institutions	23,427	25,123	15.2	15.1
Others	21,520	25,817	13.9	15.5

p Preliminary
Note: Numbers may not add up due to rounding.

External borrowing was limited to the drawdown of existing project loans committed earlier. A total of RM651 million was disbursed from both bilateral and multilateral sources. During the year, there were large redemptions of RM4.2 billion, reflecting mainly the maturity of the 650 million Euro Bond in November.

Overall, the Federal Government recorded a smaller total net borrowing of RM9.2 billion in 2005. As a

Graph 2.11
Federal Government Debt as at end-2005*p* (% share)



Total debt : RM228.7 billion
Domestic : RM198.7 billion
External : RM30.0 billion

p Preliminary

Table 2.13
Federal Government Debt Indicators

	Domestic[1]	External[1]	Total Debt[1]	Debt servicing			External debt service ratio
	(% of GDP)			(% of revenue)	(% of operating expenditure)	(% of GDP)	(% of exports of goods and services)
1985	52.6	29.7	82.4	23.9	26.9	6.5	6.7
1990	58.8	20.8	79.5	23.1	27.3	5.7	3.6
2000	31.1	5.5	36.6	14.6	16.0	2.6	1.2
2001	36.3	7.3	43.6	12.1	15.1	2.9	0.5
2002	35.5	10.0	45.6	11.6	14.1	2.7	1.0
2003	38.3	9.4	47.8	11.4	14.0	2.7	1.2
2004	40.5	7.7	48.2	11.0	12.0	2.4	0.5
2005*p*	40.2	6.1	46.2	10.9	11.9	2.3	1.0

1 Refers to end-period.
p Preliminary

Source: Ministry of Finance

result, the Federal Government **outstanding debt** expanded by a modest rate of 5.6% to RM228.7 billion. Nevertheless, the ratio of outstanding debt to GDP improved to 46.2% of GDP as at end-2005. This level of debt remained manageable with the debt servicing expenditure sustained within prudent levels. Active debt management also reduced bunching of repayments, with about 60% of the debt having remaining maturity of more than three years. The bulk of the loans of about 95% were raised at fixed rates, which reduced exposure to increases in interest rates.

Based on preliminary estimates, the overall financial position of the 30 **non-financial public enterprises** (NFPEs) remained healthy in 2005. The consolidated revenue of the NFPEs rose by 9.6% to RM236.5 billion, as a result of higher earnings of NFPEs involved in oil and gas-related services and utilities sectors. These sectors benefited from the pick-up in economic activities and higher crude oil prices as well as better performance of overseas operations.

Table 2.14
Consolidated NFPEs Finance[1]

	2003	2004	2005*e*
	RM million		
Revenue	155,867	215,858	236,539
Current expenditure[2]	113,900	155,137	171,732
Retained income	**41,967**	**60,720**	**64,807**
% of GDP	**10.6**	**13.5**	**13.1**
Development expenditure	40,160	24,633	39,981
Overall balance	**1,807**	**36,088**	**24,826**
% of GDP	**0.5**	**8.0**	**5.0**

1 Refers to 30 NFPEs in 2004 and 2005; 34 in 2003.
2 Since year 2000, adjusted to include taxes and dividends paid to the Government.
e Estimate
Note: Number may not add up due to rounding.

Source: Ministry of Finance and non-financial public enterprises (NFPEs)

Reflective of measures undertaken by enterprises to enhance operational efficiency and to contain the rising operating costs, the NFPEs, as a group registered a higher retained income of RM64.8 billion. Current expenditure rose by 10.7% reflecting largely higher prices of raw materials and inputs, especially for crude oil, natural gas and coal prices. Cost-cutting initiatives undertaken by NFPEs included reviewing processes, improving efficiency and performance, outsourcing, centralising procurement, tightening credit control as well as refinancing and prepayment of loans.

The higher capital outlay of NFPEs was channelled towards the expansion in capacity, enhancement of productivity to improve efficiency and quality of services rendered to the public as well as higher investments abroad to enhance their revenue-generating capacity. The bulk of the development projects were undertaken by the larger NFPEs, such as Petroliam Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB) and Telekom Malaysia Berhad (TM). During the year, PETRONAS continued to invest in the international arena while reinforcing its established domestic operations of both downstream and upstream activities. Among the major domestic projects undertaken by PETRONAS and its subsidiaries were the construction of new service stations, debottlenecking project of MLNG2 as well as acquisition, upgrading and reconditioning of various vessels by MISC Berhad. Meanwhile, overseas investments included exploration and production projects in Egypt as well as developing a gas processing plant in Ghotki, Pakistan.

TNB's capital expenditure was largely concentrated on the interconnection and upgrading of power generation, transmission and distribution networks. Major expenditure incurred during the year included the construction of Tuanku Jaafar Power Station

Phase 2 in Port Dickson, Paka Power Station rehabilitation, Sabah East – West Coast grid expansion and Supervisory Control and Data Acquisition (SCADA) Phase 2 project. During the year, TM focused on expanding and modernising telecommunications infrastructure and networks domestically. It also expanded its global operations through acquisitions of companies in countries such as Indonesia, Ghana and Pakistan. Major projects undertaken included the Asia Pacific Cable Network 2 and Internet Protocol Digital Subscriber Line Access Multiplexcer (IP DSLAM).

The **consolidated public sector** financial position remained strong in 2005. It recorded an overall surplus of RM7 billion or 1.4% of GDP (2004: 4.1% of GDP). The overall surplus was largely attributable to the larger contribution from NFPEs, particularly PETRONAS as a result of higher crude oil prices.

Table 2.15
Consolidated Public Sector Finance

	2004	2005*e*	2006*f*
	RM billion		
Revenue[1]	116.3	122.6	134.3
Operating expenditure	101.6	108.4	112.5
Current surplus of NFPEs[2]	60.6	63.8	63.8
Current balance	**75.3**	**78.0**	**85.6**
% of GDP	**16.7**	**15.8**	**15.8**
Net development expenditure[3]	56.7	71.0	71.0
General government[4]	*32.1*	*31.0*	*39.4*
NFPEs	*24.6*	*40.0*	*31.5*
Overall balance	**18.5**	**7.0**	**14.7**
% of GDP	**4.1**	**1.4**	**2.7**

[1] Excludes transfers within general government.
[2] Refers to 30 NFPEs in 2004 and 2005; 34 in 2003.
[3] Adjusted for transfers and net lending within public sector.
[4] Comprises Federal Government, state governments, statutory bodies and local governments.
e Estimate
f Forecast
Note: Numbers may not add up due to rounding.

Source: Ministry of Finance and non-financial public enterprises (NFPEs)

Outlook and Policy

Outlook and Policy

THE INTERNATIONAL ECONOMIC ENVIRONMENT

Developments in 2005

In 2005, global economic expansion was sustained at a strong pace of 4.3%. Growth was remarkably resilient against the backdrop of higher oil prices, rising interest rates, large balance of payment imbalances and disruptions from natural disasters. While the economies of the United States (US) and PR China remained major drivers of global growth, the recovery in Japan and the euro area in the second half-year gained momentum, providing additional support to the global economy. Consumer spending was sustained, reinforced to a significant extent by wealth effects, particularly from robust housing markets in several major economies. Reflecting robust demand conditions, stronger corporate financial positions and rising capacity utilization, investment spending expanded further. Meanwhile, growth in the Asian region strengthened in the second half-year as the uptrend in the global electronics cycle became evident. Overall, higher global growth was reflected in the continued expansion in world trade, which rose at a strong pace of 7%.

Strong global demand was also a key factor in driving higher global commodity prices in 2005. While the relatively tight supply conditions and Hurricane Katrina drove oil prices to new peaks in the third quarter, the strong growth performance of the global economy also sustained demand. Overall, global growth exhibited greater resilience to energy shocks, with the effects in large part offset by productivity gains, continued income growth and wealth creation in tandem with improved energy efficiency and technological improvements during the recent two decades. Hence, while higher oil and commodity prices did have some impact on headline inflation, the effect was relatively modest as sustained improvements in productivity, the globalisation of production and the emergence of competitive sources of supply from several regions of

Table 3.1
World Economy: Key Economic Indicators

	Real GDP Growth (%)			Inflation (%)		
	2004	2005*e*	2006*f*	2004	2005*e*	2006*f*
World Growth	**5.1**	**4.3**	**4.3**	–	–	–
World Trade	**10.3**	**7.0**	**7.4**	–	–	–
Major Industrial Countries	**3.3**	**2.6**	**2.6**	**2.0**	**2.2**	**2.0**
United States	4.2	3.5	3.3	2.7	3.4	2.8
Japan	2.3	2.8	2.5	0.0	-0.3	0.0
Euro area	2.1	1.3	1.7	2.1	2.2	1.8
United Kingdom[1]	3.2	1.8	2.0	1.3	2.1	1.9
East Asia	**7.9**	**7.2**	**7.0 ~ 7.2**	**3.4**	**3.1**	**3.3 ~ 3.6**
Asian NIEs	**6.0**	**4.8**	**4.6 ~ 4.9**	**2.3**	**2.2**	**2.3 ~ 2.4**
Korea	4.6	4.0	5.0	3.6	2.7	3.0
Chinese Taipei	6.1	4.1	4.3	1.6	2.3	1.7
Singapore	8.7	6.4	4.0 ~ 6.0	1.7	0.5	0.5 ~ 1.5
Hong Kong China[2]	8.6	7.3	4.0 ~ 5.0	-0.4	1.1	2.3
The People's Republic of China	**10.1**	**9.9**	**9.4**	**3.9**	**1.8**	**3.0**
ASEAN[3]	**6.4**	**5.4**	**5.1 ~ 5.9**	**3.8**	**5.9**	**4.8 ~ 6.0**
Malaysia	7.1	5.3	6.0	1.4	3.0	3.5 ~ 4.0
Thailand	6.2	4.5	4.8 ~ 5.8	2.7	4.6	3.5 ~ 5.0
Indonesia	5.1	5.6	5.0 ~ 5.7	6.1	10.4	7.0 ~ 9.0
Philippines	6.0	5.1	5.7 ~ 6.3	6.0	7.6	8.0 ~ 8.5

[1] Based on Eurostat's harmonized index of consumer prices.
[2] Inflation refers to composite prices.
[3] Includes Singapore.
e Estimate
f Forecast

Source: International Monetary Fund, Datastream, OECD Economic Outlook, National Sources the world helped to mitigate the pass-through effects. The relatively restrained inflationary environment allowed monetary authorities across the world to raise interest rates at a gradual and measured pace. Financial market activity generally benefited from the abundant liquidity conditions and sustained economic growth. Reflecting prospects for ongoing economic recovery and improved corporate performance, equity markets in Japan and Europe recorded strong gains. Meanwhile, rising interest rates in the US supported the US dollar against the other major currencies.

Among the major industrial countries, the **US** continued to lead growth in 2005. Growth was broad based, with strong momentum in domestic demand, owing significantly to the strong contribution from consumption spending, underpinned by the buoyant housing market. In addition, improving labour market conditions provided further stimulus to consumer spending. Strong corporate financial positions, housing-related investment spending and a tax measure to encourage repatriation of funds provided impetus for a further expansion in private investment activity. Despite the impact of the hurricanes in the Gulf Coast and record gasoline prices, US economic performance remained resilient in the second half-year. Consumer confidence, labour markets and business activity rebounded shortly after the impact of Hurricane Katrina. In the government sector, the fiscal deficit improved on higher tax revenue and some expenditure reduction. However, strong domestic demand combined with high oil prices led to a further widening of the current account deficit.

Economic recovery in **Japan** was evident throughout the course of 2005, underpinned by stronger domestic demand and reinforced by external demand in the later part of the year. Domestic demand in Japan was mainly supported by an expansion in investment while recovery in consumption was underpinned by favourable developments in labour market conditions. Meanwhile, export performance picked up in the second-half year, in line with the pick-up in the global electronics cycle.

Economic recovery in the **euro area** was significantly stronger in the second half of 2005, supported largely by stronger exports. This led to a modest increase in investment spending while industrial production gathered momentum. Although business confidence, as reflected by the German Ifo and ZEW indicators, improved markedly towards the end of 2005, consumer sentiments remained weak, reflecting a persistently high level of unemployment. Nonetheless, labour reforms have shown some results in terms of improving labour market flexibility as seen in the rising level of part-time and contract employment.

Meanwhile, growth in the **UK** slowed in 2005 as both consumers and firms held back on consumption and investment spending amidst weaker domestic conditions following the slower housing market.

In the **Asian** region, growth remained strong at 7.2% in 2005 following a milder-than-expected slowdown in the electronics sector. Growth, nevertheless, moderated slightly from the high base of 7.9% in 2004 in the face of surging oil prices, monetary tightening cycle and some slowdown in global IT demand. PR China continued to drive regional expansion with a revised growth estimate of 9.9%. Regional growth was broad based, underpinned by both external and domestic demand.

In 2005, exports grew by 20% (2004: 28.5%). After some slowing down in the first half-year, export performance picked up in the second half-year as the global technology cycle revived. Private consumption continued to grow at a stable pace in the region, with rising incomes offsetting the impact of higher oil prices and tighter monetary policies. In Korea, private consumption increased steadily, following the strengthening of household balance sheets since the burst of the credit bubble in 2002. Fixed investment, on the other hand, grew at a more modest pace in several of the regional economies. However, fixed investment in PR China continued to grow strongly despite measures by the authorities to moderate overheating in selected sectors.

The current account surplus in the region remained strong but showed divergent trends. The surplus was significantly larger in PR China, reflecting continued strong exports but narrowed in a number of regional countries due partly to the impact of high oil prices. This, together with trends in capital flows, led to a moderation in the pace of accumulation in foreign reserves in the second half of the year.

Prospects for 2006

Going forward, the outlook for 2006 is for global expansion to remain positive. World output and world trade are projected to expand at a firm pace of 4.3% and 7.4% respectively in 2006. Global growth is expected to broaden across the major economies, with the economies of Japan and Europe playing a more significant role. Another notable feature is the stronger investment uptrend seen in several major economies. For the Asian region, the global electronics up-cycle is expected to strengthen further following higher ICT-related spending in the industrial economies and stronger intra-regional demand. While monetary stimulus has been reduced due to increased interest rates, monetary conditions continue to remain accommodative to growth.

The global economy is expected to expand at a strong pace of 4.3% in 2006, emanating from a more balanced growth across major industrial countries. Growth will be supported by an uptrend in investment and electronics cycle as well as continued favourable liquidity conditions.

Graph 3.1
Major Industrial Countries: Real GDP Growth (2005-2006)

e Estimate
f Forecast

Industrial Countries

In 2006, the **US** economy is expected to sustain the growth momentum from 2005, with real GDP expanding by 3.3%. Investment is expected to emerge as a stronger driver of growth. Strong corporate positions, rising capacity utilisation and lean inventory levels are expected to further spur capital expenditure, especially for spending related to ICT upgrading and replacement as well as in the energy sector for post-Katrina rebuilding. Meanwhile, despite expectations for a slight moderation due to a cooler housing market, US consumer spending would continue to expand as job creation and income growth are expected to strengthen further in 2006. On the fiscal front, spending on post-hurricane reconstruction is also expected to provide further stimulus to the US economy. The large US current account deficit is, however, expected to widen further, exacerbated by high oil prices, sustained domestic demand and higher interest payment outflows.

In **Japan**, economic recovery is expected to remain intact, with growth sustained above 2% for a third consecutive year in 2006. Domestic demand would remain the driver of growth, led by investment and accompanied by sustained expansion in private consumption. The expansion in private consumption would be supported by stronger improvements in employment, wage and income conditions, despite constraints due to a planned reduction in individual tax allowances and a rise in pension contributions. Recovery in exports to the major markets since the second half of 2005 is expected to continue this year. Meanwhile, the continued recovery in the domestic economy is also reflected in improvements in the health of the banking sector as well as the asset markets.

In the **euro area**, economic recovery in Germany, France, Italy and Spain are expected to pick up pace in 2006. With Italy emerging from its recessionary conditions and growth in Germany and France strengthening further, real GDP as a whole is expected to expand by 1.7%. Nonetheless, recovery – particularly in Germany, which accounts for almost 30% of the euro area's GDP – continues to be supported primarily by external demand as the growth in private domestic consumption remains modest. While business sentiments have improved, weak consumer sentiments coupled with a persistently high unemployment level may constrain prospects for stronger domestic growth in the euro area.

In the **UK**, real GDP growth is expected to remain modest, projected to expand by 2% in 2006. Household consumption is expected to remain subdued as household debts have reached record levels and the wealth effect from rising house prices has tapered off. Government spending, though expected to moderate in 2006, will continue to support economic expansion in the UK as private sector investment remains cautious despite strong corporate profitability. However, as recovery in the euro area picks up, the UK is expected to benefit as exports, which are largely channelled into the euro area, start to recover.

While global growth is expected to be sustained at a steady pace in 2006, several **risks** could adversely affect the outlook. The risk of a sharp and prolonged spike in oil prices remains a concern as the supply-demand balance tightens further and geopolitical uncertainties persist, but high oil prices alone are not expected to destabilize growth. A prolonged and sustained rise in inflation, possibly resulting from a further surge in oil prices, could lead to sharply higher global interest rates. In the financial markets, a disorderly realignment of the major currencies could dampen trade and investment flows. However, thus far, the international financial system and markets have shown an improved capacity for orderly recycling of capital flows. In addition to these concerns, the spread of avian flu could also alter the global and regional prospects. Nevertheless, following the experience with SARS, regional countries are better prepared in coping with the threat.

East Asian Economies

In line with the expected pick-up in world trade and continued favourable global environment, the projection is for growth in the East Asian region to be sustained at a strong pace of 7.0-7.2%. Growth will be supported by the recovery in the electronics sector and continued strength in domestic demand. PR China's growth is expected to remain strong based on the favourable export sector and government measures to rebalance growth by promoting rural development and private consumption. Growth in the other Asian countries is also projected to improve following a more positive outlook of the export sector, strengthening fundamentals and prospects for higher investment.

In the external sector, the global electronics cycle is expected to trend upwards after reaching its trough in mid-2005, sustaining a stronger growth in regional exports. The recovery is expected to be broad based, emanating from stronger demand for major end-products such as consumer electronics, PCs, mobile phones and display devices. Similarly, regional trade is poised to gain from a firmer recovery and increasing openness of the domestic market in Japan.

In the domestic sector, aggregate demand remains stable, underpinned by favourable economic fundamentals amid continued strong growth. The rise of a younger generation with high discretionary spending power and strong taste for consumer electronic gadgets will drive consumption further. Private demand will also benefit from the rise of a modern retail sector characterized by large global retail giants in response to changing spending patterns. Other positive developments include the huge potential in

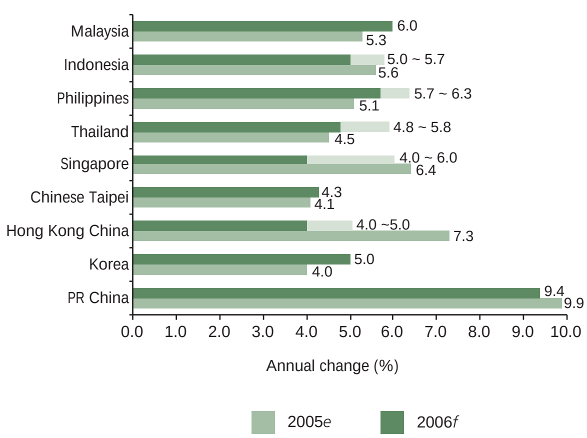
A robust growth of 7.0-7.2% is projected for the East Asian economy, based on a stronger recovery in the global electronics cycle and continued strength in domestic demand.

tourism following rising income, large untapped markets, notably PR China and India as well as the proliferation of budget airlines. For some countries, rising worker remittances have been positive in supporting spending, reducing poverty and facilitating development in home countries. While investment rates in many countries remain low, recent signs suggest a pick-up in investment trends. These include high capacity utilisation, growth in import of capital goods, investment plans to increase infrastructure spending, revival of the property sector and continued FDI inflows.

In 2006, the **Asian Newly Industrialized Economies (NIEs)** as a group is projected to record a real GDP growth of 4.6-4.9%, supported by continued strength in domestic demand and stronger exports. Export growth is expected to strengthen in response to further recovery in the global electronics sector.

The **PR China** will continue to drive growth in the region, with an expected real GDP growth of 9.4% in

Graph 3.2
Regional Countries: Real GDP Growth



e Estimate
f Forecast

2006. While exports will remain a key driver, domestic demand will play an increasing role in the economy. In particular, favourable tax policies such as income tax reform and removal of agriculture tax, and other supportive measures are expected to boost consumption. Furthermore, rural development is projected to accelerate, with the implementation of PR China's 11th Five-Year Programme beginning in 2006. However, concern remains over a rebound in the growth of fixed asset investments and an overcapacity in several sectors, despite policy-cooling measures.

In **Korea**, real GDP is projected to expand at a stronger rate of 5% in 2006. Economic expansion is expected to be propelled by exports and the revival of domestic demand. Recovery in private consumption is expected to continue, benefiting from further progress in restructuring of household balance sheets, positive wealth effects from a rising stock market and strengthening consumer confidence.

Growth is forecast to be at 4 - 5% in **Hong Kong SAR**, led by exports and private consumption. A strong labour market and rising wages as well as an improving housing market are expected to underpin consumer spending, mitigating the negative impact of higher interest rates. Meanwhile, **Chinese Taipei**'s real GDP growth is expected to pick up to 4.3%, reflecting higher exports and steady domestic consumption. Export performance will likely improve in 2006 due to an upturn in the technology sector and the continuing strength of US and Chinese demand.

In **Singapore**, growth is expected to reach 4 - 6%, supported by strong global demand for electronics and an improvement in the labour market, higher asset prices and sustained tourist arrivals. In terms of industrial origin, the manufacturing sector is projected to be boosted by new capacity coming onstream in the pharmaceutical industry. The building of the integrated resorts, new financial centre and the revamp of shopping areas are expected to spur growth in construction activity, its first expansion in seven years.

The **ASEAN-4**[1] economies as a group are expected to grow by 5.3 – 5.9% in 2006. Growth in **Indonesia** is expected to moderate slightly within the range of 5 – 5.7%. Consumer spending will remain supported by stable employment and rising disposable income amid higher inflation and interest rates. Another key growth factor is the pick-up in investment, following measures to support infrastructure spending and continued progress in reforms in the regulatory framework and tax law to improve the investment climate. In **Thailand**, real GDP growth is expected to remain around 4.8 – 5.8%. Economic expansion will be supported by the recovery of the global electronics industry, together with prospects of higher agricultural exports following improved weather conditions and a recovery in tourism. Meanwhile, investment is also expected to pick up with the implementation of mega projects over the next few years. Meanwhile, real GDP growth in the **Philippines** is projected to expand by 5.7 – 6.3%. Agricultural output is expected to recover from the droughts last year, while private consumption is expected to be sustained by strong inflows of remittances from overseas workers. The fiscal gap is projected to narrow further to 2.2% of GDP in 2006 following the introduction of the expanded value-added tax.

While high oil prices remain a concern, its impact thus far on the region has been modest. However, inflationary pressures remain due to the potential pass-through from stronger producer price index (PPI) especially in the ASEAN countries. In addition, despite some recent price increases, the pass-through from higher oil prices remains incomplete in a number of regional countries that offer fuel subsidies.

The growth outlook in 2006 is also subject to the risk of an avian flu pandemic. The overall economic impact is expected to be small if the epidemic is contained, as the poultry sector accounts for a small share of GDP in the affected countries. However, there are concerns that the strain of flu might mutate into a form in which human-to-human transmission occurs and cause human casualties and other economic costs. Its impact on regional growth could be significantly greater than Severe Acute Respiratory Syndrome (SARS) in view of the higher mortality rate and the prevalence across wider geographical areas. In the event of a pandemic, countries with higher degree of trade openness, dependence on tourism as well as population density will be most affected.

Interest Rates and Exchange Rates

In 2005, **monetary policy** in the major industrial countries remained accommodative. In view of sustained economic growth and an upturn in inflation caused primarily by higher energy prices, several central banks initiated consecutive increases in interest rates from low levels towards a more neutral stance.

In the US, against the backdrop of robust growth and concern on inflationary pressures, the **US Federal**

[1] Refers to Indonesia, Thailand, Malaysia and the Philippines.

Reserve Board (Fed) raised interest rates eight times by 25 basis points each time during the year, bringing the Fed funds rate to 4.25% by year-end. In its December statement, the Fed dropped the often repeated phrase 'accommodative' in its policy statement, thus signaling that rates have risen closer to neutral levels from the low of 1% since mid-2004. In the euro area, the **European Central Bank** raised interest rates by 25 basis points to 2.25% in December 2005 amid expansions in the money supply and credit growth to the private sector. In contrast, in the UK, slower consumer spending amid a weaker housing market led the **Bank of England** to lower interest rates in August 2005 by 25 basis points to 4.50%.

Throughout 2005, with official short-term interest rates (uncollateralized overnight call rate) in Japan at around zero percent, the **Bank of Japan (BOJ)** continued to use quantitative easing measures, introduced five years ago, to inject liquidity into the banking system in order to counter deflationary pressures. As at end-2005, the quantitative easing target for current account balances of the commercial banks and financial institutions held at the BOJ stood between 30–35 trillion yen (2001: 6 trillion yen).

During the year, regional countries have raised interest rates broadly in line with global developments. While rate hikes vary across countries, the moves were aimed at containing inflationary pressures and limiting second-round effects in the face of rising oil prices as well as removal of fuel subsidies. Countries that have raised rates include Indonesia, Thailand, India, Philippines and Chinese Taipei while Singapore maintained its policy of a `modest and gradual appreciation' of the Singapore dollar.

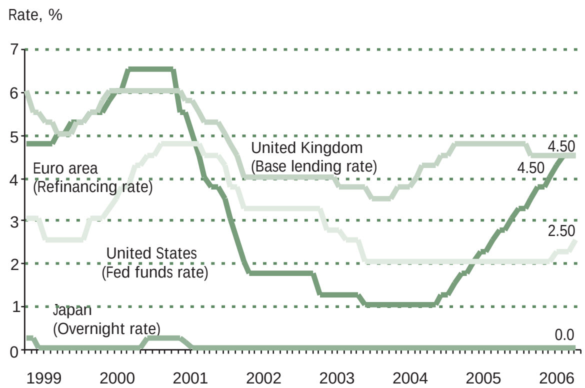
In **2006**, the timing and magnitude of monetary policy actions would depend on country-specific factors, including the strength of economic growth, inflationary expectations, movements in exchange rates and the performance of the financial markets.

In the **foreign exchange** markets, during the course of 2005, the US dollar appreciated strongly against three major currencies, notably the euro, pound sterling and yen, reversing the depreciation recorded in 2004. The main factors that contributed to the US dollar strength were the yield differentials in favour of the US dollar and the relatively stronger economic performance in the US.

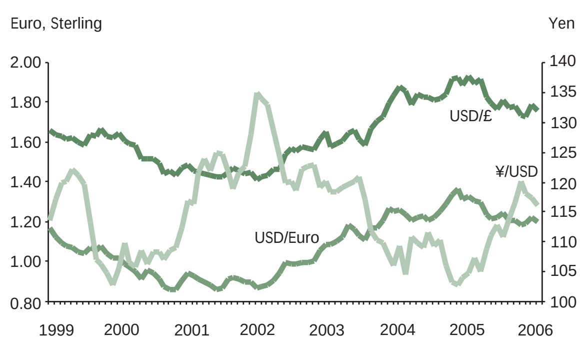
Overall, measured on a trade-weighted basis[2] , the US dollar appreciated by 3.5% in 2005. Specifically, the appreciation was most prominent against the euro (10%), pound sterling (13%) and the yen (13%). The double-digit rate of appreciation recorded by the US dollar against the three major currencies was the strongest since 1999. Against the backdrop of a stronger US dollar, the euro ended the year at E1=USD1.1849 while the yen ended the year at USD1=¥117.75. The depreciation of the yen was also further affected by the strong resident outflows following increased risk appetite for foreign financial assets as investors' confidence rose with continued recovery in the Japanese economy.

In the Asian region, while the exchange rate performance was mixed, regional currencies continued to display increased flexibility against the US dollar. Among regional currencies, the Philippine peso recorded the strongest appreciation of 6% against the US dollar, supported by record inflows of remittances and an improvement in the country's fiscal position. The Korean

Graph 3.3
Major Industrial Countries: Official Interest Rates



Graph 3.4
Movement of the US Dollar against Major Currencies



[2] US Federal Reserve Board's broad nominal index.

won and the RMB appreciated by about 2.6% and 2.5% against the US dollar respectively. For the RMB, after the initial 2.1% appreciation following the change in the exchange rate regime, the RMB gained a further 0.5%. The other regional currencies, however, depreciated against the US dollar, with the Indonesian rupiah recording the largest depreciation of 6%.

In **2006**, the movement of the US dollar against the three major currencies is expected to be driven by a number of factors. These include investors' perception on interest rate differentials and growth performance, the path of adjustment of global imbalances, performance of the equity and bond markets, and global asset reallocation among the major currencies. In addition, country-specific issues that relate to inflationary trends and geo-political risk premiums could also affect sentiments on the major currencies.

MALAYSIAN ECONOMY IN 2006

The Malaysian economy is expected to strengthen further in 2006. Real GDP is projected to grow at a faster rate of 6%, driven by strengthening exports and resilient domestic demand. The global semiconductor upcycle, sustained global growth and higher prices for primary commodities are expected to have positive effects on exports, as well as private consumption and investment.

Growth is expected to strengthen further in 2006. Underpinned by strengthening exports and resilient domestic demand, real GDP is forecast to expand at a faster rate of 6%. The private sector would provide the main impetus to growth for the fourth consecutive year.

Current indicators suggest that the upturn in the global semiconductor industry, which began in the second half of 2005, would gain momentum in 2006. Malaysia is expected to benefit from this favourable development with a stronger growth in manufactured exports, particularly in the computer and semiconductor segments. Domestic demand would be driven by the private sector for the fourth consecutive year as household spending remains an important source of growth. Equally significant, the continued expansion in private investment would ensure the long-term sustainability of growth by expanding the stock of productive capital. In this regard, efforts will be intensified to enhance the contribution of private investment to growth.

The Government will continue to focus on strengthening the fiscal position with the ultimate aim of supporting economic growth without compromising long-term fiscal sustainability. In 2006, prices are expected to increase, driven largely by cost-push factors. Nevertheless, inflation is expected to remain at manageable levels during the year as capacity expansion and productivity improvements in the domestic economy will help contain price pressures. Monetary policy will, therefore, remain supportive of growth. While downside risks remain, the strong macroeconomic fundamentals and diversified economic structure will provide economic resilience.

Domestic Demand

The factors that supported domestic demand in 2005 are expected to continue to provide further stimulus in 2006. Aggregate domestic demand is projected to increase further, by 5.9% in 2006, with private sector expenditure remaining the main driving force. **Private consumption** is expected to increase by 6.8%, exceeding the overall growth rate for the seventh consecutive year. Consumers are expected to benefit from higher income following the expected improvement in the economy and employment conditions, as well as higher primary commodity prices. While interest rates have risen, the ability of households to borrow has not been impaired as rates continue to remain at low levels. Further, although household debt has been on an increasing trend, the ability of the household sector to service its debt remains sustainable amidst continued growth in household disposable income. Malaysia's relatively large young working population with higher propensity to consume will further underpin consumer demand. Therefore, consumption growth is expected to be driven mainly by income growth and demographic factors, with credit conditions playing a supportive role. Notwithstanding the sustained high consumption growth, Malaysia's nominal private consumption-to-GDP ratio (43.7%) continues to be one of the lowest in the world. These indicators point to sustained increases in private consumption.

While private consumption is an important source of growth in domestic demand, **private investment** is playing an increasingly strong supportive role in sustaining economic growth over the longer term. In 2006, favourable external and domestic demand would provide the impetus for private investment to grow by 10%. Given the steady improvement in corporate balance sheets, firms would continue to be able to fund

While private consumption remains an important source of growth in domestic demand, growth in private investment will be broad-based, across most sectors of the economy.

their investment activities by using internally generated funds. In addition, conditions in the financial markets continue to remain conducive for firms to use leverage or tap the capital market to fund their investments. In view of the long-term importance of private investment, efforts have been undertaken to further enhance the contribution of private investment to growth. The Government continues to place emphasis on improving the public sector delivery system and has taken measures to reduce cost of doing business. Investment incentives are customised to attract investment from high technology and knowledge-intensive industries, particularly in the new growth areas within the agriculture, manufacturing and services sectors. Greater emphasis has also been given to human resource development to meet the requirements of these new industries. Recognising the increasingly competitive global environment, the Government has also intensified the promotion of domestic investment, particularly investment by the SMEs.

Private investment growth is expected to be broad-based in 2006, with the bulk of the expenditure expected in the manufacturing and services sectors as well as in the oil and gas industry. Capital spending in the manufacturing sector, which accounts for a third of total private investment, is expected to register a strong growth, supported by the upturn in the semiconductor industry and the high capacity utilisation in the sector. Manufacturing firms, particularly from the E&E and chemical and chemical products industries, are expected to raise investment to improve efficiency and increase productivity to meet the stronger demand. In addition, the Government's emphasis on high technology and higher-skilled projects is expected to increase investment in high value-added projects. The sustained high capital intensity ratio of manufacturing projects approved in these recent three years, which averaged RM324,136 (2000-2002: average of RM315,249), is reflective of this continuous shift towards higher value-added production.

In the services sector, stronger investment is expected from the telecommunications, transportation and utilities sub-sectors. In the telecommunications sub-sector, private cellular operators are expected to continue investing to enhance network capacity and to intensify provision of broadband facilities due to the expected rise in demand for 3G services. Meanwhile, capital expenditure in the transport services industry is also expected to increase, mainly due to the continuation of the airlines' fleet expansion programmes and the development of port facilities. In the utilities sector, capital expenditure is

Table 3.2
Real GDP by Expenditure (1987=100)

	2005*p*	2006*f*	2005*p*	2006*f*
	Annual change (%)		Contribution to real GDP growth (percentage point)	
Domestic demand[1]	**7.3**	**5.9**	**6.6**	**5.5**
Private sector expenditure	9.5	7.4	5.7	4.6
Consumption	*9.2*	*6.8*	*4.5*	*3.4*
Investment	*10.8*	*10.0*	*1.2*	*1.2*
Public sector expenditure	3.1	3.0	0.9	0.9
Consumption	*5.9*	*3.2*	*0.9*	*0.5*
Investment	*0.4*	*2.7*	*0.1*	*0.4*
Change in stocks			**-2.9**	**1.0**
Net exports of goods and services	**19.3**	**-5.4**	**1.5**	**-0.5**
Exports	8.4	8.9	9.8	10.7
Imports	7.6	10.0	8.3	11.2
Real Gross Domestic Product	**5.3**	**6.0**	**5.3**	**6.0**

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

expected to remain high due to the ongoing improvement of water treatment and distribution plants as well as the development of power plants, which will come on stream within the next two years.

Investment in the mining sector is expected to increase strongly, attributable to higher capital spending by the private oil companies operating in Malaysia. While spending on exploration and survey are mainly led by the companies involved in deepwater and ultra deepwater discoveries, companies involved in non-deepwater discoveries are moving from exploration activities to development activities and the setting up of production facilities. Meanwhile, capital expenditure in the construction sector will be supported by the ongoing construction of privatised roads and residential projects.

In 2006, a modest increase in public sector expenditure is expected when the implementation of the Ninth Malaysia Plan commences in April 2006. **Public consumption** is expected to increase moderately by 3.2%, due mainly to higher expenditures on supplies and services to further improve the public sector delivery system to support private sector activities. Prudent expenditure management by the Government has provided the flexibility to focus on developmental efforts in both the rural and urban areas. The largest allocation of development expenditure in 2006 has been for the economic sector, namely the development and improvement of agriculture, industry and infrastructure sectors, to achieve balanced and comprehensive economic development. Meanwhile, the provision of better essential services, such as education, healthcare and housing, remains the main agenda of development in the social sector. The capital outlays by the NFPEs are expected to increase further in 2006, albeit at a slower rate, following the strong expansion a year earlier. The bulk of the capital spending would be undertaken by the three largest NFPEs, namely Petroliam Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB) and Telekom Malaysia Berhad (TM). With new discoveries of oil and gas fields in recent years and new production sharing contracts signed, PETRONAS' capital outlays continue to be dominated by its upstream investment activities. Improvement and expansion of telecommunication infrastructure and power generation and distribution would be the main investment activities for TM and TNB respectively. As a result, **public investment** is projected to increase by 2.7%.

Sectoral Outlook

On the supply side, growth in 2006 is expected to be broad based and balanced, supported by expansion in all sectors of the economy, including construction. About 5.7 percentage points of the 6% GDP growth would emanate from the two key sectors, namely the manufacturing and services sectors, which account for about 90% of the economy. Growth in the manufacturing sector is expected to strengthen in line with the upturn in the global semiconductor cycle, while the services sector is expected to sustain its strong performance supported by higher trade-related activities, and continued increase in consumption and business activities. The commodities sector is expected to see a more broad-based growth, with improvements in the production of rubber, crude oil and the other agriculture segments, while crude palm oil output consolidates after three years of strong performance. The construction sector is expected to register a positive growth in line with the improvement in the civil engineering segment.

Growth in 2006 is expected to be broad-based and balanced, supported by expansion in all economic sectors, including construction.

Value-added growth in the **manufacturing sector** is expected to strengthen to 7% in 2006 (2005: 4.9%). The growth would be led by the electronics and electrical (E&E) segment, and further reinforced by the strong external demand for resource-based products such as chemical, petroleum, and rubber products. In the domestic-oriented industries, the improvement in the construction-related industries would further lend support to the expansion of the sector.

In the E&E sector, the latest assessment is that the recovery in the global semiconductor industry that began since mid-2005 will continue to gain strength into 2006. The view of an up-cycle in the industry is supported by forward-looking

Table 3.3
Real GDP by Sector (1987=100)

	2005*p*	2006*f*
	Annual change (%)	
Agriculture	2.1	2.0
Mining	0.8	5.0
Manufacturing	4.9	7.0
Construction	1.6	1.0
Services	6.5	6.0
Real GDP	**5.3**	**6.0**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

indicators such as the improvement in the book-to-bill ratio of semiconductor equipment since March 2005, and the sustained growth in the US new orders and unfilled orders for electronics. Industry experts also share the view that the recovery would be mild and sustained, with the global semiconductor sales projected to expand by 7.9 ~ 9.5% in 2006 and 7 ~ 10.6% in 2007 (2005: 6.8 ~ 7%). The current cycle would be supported by accelerating demand from the Asia-Pacific region, particularly for consumer electronic gadgets and the stronger ICT-related investment in the industrial countries.

The up-cycle in the global semiconductor sector in 2006 is expected to be broad-based, supported by expansion in all product segments, including computers, consumer electronics, communication and the automotive segments. The wider application of chips, particularly in the automotive segment, as well as the higher chip content in electronic devices will further support the global demand for semiconductors. Given Malaysia's competitive strength in the computer and semiconductor segments, Malaysia is poised to benefit from this broad-based growth in 2006. During the year, continued re-investment in E&E and expansion projects undertaken by existing multinational electronics companies in Malaysia would increase the production capacity and enable Malaysia to leverage on the upturn in the global semiconductor industry.

The **services sector** would continue to remain strong in 2006 recording a sustained growth of 6%. During the year, the services sector growth would be led by the intermediate services segment, while the final services segment will expand at a moderate pace in line with the trends in private consumption.

In the intermediate services segment, the expected higher growth in manufacturing exports and intra-regional trade will further strengthen the growth of the transport, storage and communication sub-sector. Of significance, trade-related activities such as logistics and other services allied to transportation such as ports and haulage activities are forecast to support growth in the transport sector. These are also part of manufacturing-related activities that would be given emphasis under the Third Industrial Masterplan, which will be implemented beginning 2006 until 2020. The telecommunications industry, meanwhile, would continue on a sustained strong expansion driven mainly by the cellular segment amidst the increased subscriber base and expansion in third generation (3G) services by the major telecommunication companies.

Meanwhile, demand for trade financing and other types of credit by businesses, especially from the small- and medium enterprises (SMEs) are expected to increase in line with the more robust manufacturing growth and trade activities. The higher lending activities, in addition to innovative financial products and services offered by the banking sector, would result in increased interest and fee-based income. The expected establishment of more Islamic banks and takaful companies during the year would further enhance the growth in the finance, insurance and real estate and business services sub-sector. Efforts by the Government in promoting new areas of growth, such as IT-related services and shared services and outsourcing (SSO) activities, including business process outsourcing, are also expected to yield positive results and contribute to higher growth in the business services segment.

The final services segment is expected to expand at a moderate pace in line with private consumption activities during the year. Nevertheless, tourism activities are expected to gain further momentum amidst the intensification of promotional activities by both the public and private sectors in preparation for the Visit Malaysia Year (VMY) 2007. The Government plans to achieve a target of 17.5 million tourist arrivals in 2006 and more than 20 million tourists during the VMY 2007 (2005: an estimate of 16.4 million). As a result, higher spending by tourists as well as domestic households would support the wholesale and retail trade, hotels and restaurants sub-sector, which is expected to expand at a sustainable rate of 6% in 2006. Consequently, the services sector will continue to be one of the main engines of growth, besides the manufacturing sector, in supporting the overall growth of the economy.

The **agriculture** sector is expected to record a growth of 2% in 2006. Crude palm oil, which accounts for about one-third of the value-add in the agriculture sector, is expected to increase by 1.6% (2005: 7%). Output would be affected by biological yield down-cycle after three successive years of strong output growth. The moderation in output growth is also due partly to expectations of a slower expansion in matured areas (+0.9%; 2005: 5.3%). Nevertheless, output of rubber and other agriculture produce are expected to recover from the weak performance in 2005, which was affected by the poor weather conditions. Rubber production is expected to increase by 2.3% to 1.15 million tonnes in 2006 as smallholders continue to intensify tapping activities supported by the expected strong rubber prices.

In the **mining** sector, growth is expected to strengthen to 5% in 2005, driven mainly by an expected improvement in crude oil output (including condensates:

3.9%, 2005: -4.9%). Growth would also be supported by the moderate increase in natural gas output during the year (6.9%; 2005: 11.3%) as the utilisation rate at the MLNG plants in Sarawak approach close to its installed capacity.

After two consecutive years of decline, the **construction** sector is expected to turn around and register a positive growth of 1%, led mainly by the improvement in the civil engineering sub-sector. The civil engineering sub-sector would be supported by higher construction activity in the oil and gas industry as well as in public projects with the commencement of new projects under the Ninth Malaysia Plan. Meanwhile, the residential and non-residential sub-sectors are expected to expand further supported by the attractive financing conditions and brisk business activities. The residential sub-sector is expected to expand at a moderate rate following the strong expansion in the last few years, while the non-residential segment would continue to improve, benefiting from the favourable business environment which has resulted in high occupancy rates of retail and office space.

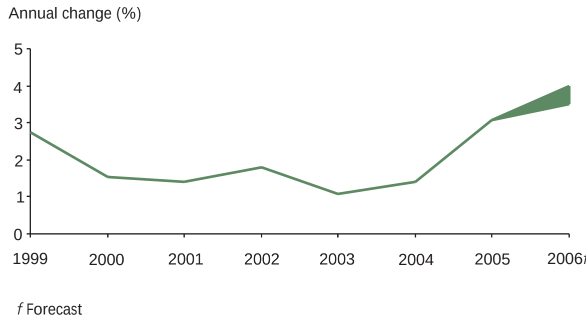
Prices and Employment

The key supply-side factors that have kept inflation up towards the end of 2005, namely the high prices of energy and non-energy commodities are expected to persist in 2006. Cost-push inflation is expected to rise following the increase in the price of petroleum products by the Government on 28 February 2006. Demand pressures could also provide some modest upward impetus to inflation as domestic economic activity is expected to be sustained in 2006. In the absence of further price adjustments, inflation is expected to peak in the first half of 2006. Subsequently, inflation is likely to ease in the third quarter of 2006 following the lapse of the effects of price adjustments that were implemented in 2005. For 2006 as a whole, the average rate of inflation is estimated to be in the range of 3.5% to 4%.

There remains however considerable uncertainty to the inflation outlook with inflation prospects affected by both external influences and domestic cost-push pressures. With no further fuel price increases during the year, the main uncertainty relates to the degree and extent of the secondary effects of the pass-through impact of previous increases in fuel prices that have yet to feed through the supply chain. The sustained high level in international oil prices could put an upward bias on input costs for domestic producers. An upward revision of electricity tariffs would also affect the inflation conditions.

To a certain extent, the upside risks to domestic inflation could be mitigated by the on-going structural

Graph 3.5
Consumer Price Index



improvements in the Malaysian economy. The expansion of capacity by businesses and the continued increase in productivity would augment the output potential of the economy and prevent a tightening in the markets for factor inputs. Sustained competition amongst businesses could also mitigate inflationary pressures.

In tandem with the stronger growth of the domestic economy in 2006, growth in **employment** is expected to increase with more job opportunities in most sectors of the economy. Unemployment is therefore, expected to remain low at 3.5%. In addition to the ongoing efforts to improve the productivity of the labour force, the Government would also continue reviewing its policy on labour, with a view to reducing the shortage of skilled workers and closing the gap between the output of the educational system and the requirements of the job market.

Balance of Payments

The balance of payments position is expected to remain strong in 2006 with a continued large **current account** surplus (17.2% of GNP), supported by a strong trade balance. Strong export growth (12.5%) underpinned by continued expansion in manufactured exports, in particular exports of consumer electronics, will contribute to a larger surplus in the trade account. Growth in commodity exports is also expected to be sustained by high prices. In the financial account, the steady inflow of foreign direct investment (FDI) would also strengthen the overall balance of payments.

The growth in **exports of manufactured goods** is expected to strengthen to 12% in 2006 (2005: 10.1%) as the E&E sector rides on the upturn in the global semiconductor industry. Exports of E&E would be supported by the strong global demand for

The current account surplus is expected to remain large, supported by a strong trade balance. FDI inflows are expected to increase, supported by stronger demand arising from the high capacity utilisation rate as well as investments in new industries. Reflecting a greater interest by companies to diversify abroad, overseas investment by Malaysian companies is also forecast to increase in 2006.

computers, particularly for mobile computers with wireless functions, as well as the expected improvement in global semiconductor demand arising from wider applications of chips in various segments. At the same time, exports of resource-based products such as chemicals, rubber and petroleum products are also expected to perform favourably, expanding at a strong pace underpinned by the firm global demand as well as higher prices in line with the expected increase in commodity prices during the year.

Table 3.4
Balance of Payments

	2005*e*	2006*f*
	RM billion	
Goods	126.5	138.4
Trade account	99.8	108.3
Exports (% annual change)	*11.0*	*12.5*
Imports (% annual change)	*8.5*	*13.4*
Services	-10.2	-10.3
Balance on goods and services	**116.2**	**128.1**
Income	-21.5	-23.7
Current transfers	-17.0	-15.0
Current account balance	**77.8**	**89.4**
% of GNP	**16.4**	**17.2**
Financial account	-42.0	-
Errors and omissions	-23.0	-
of which:		
Foreign exchange revaluation loss	*-15.5*	-
Overall balance	**12.8**	**-**

Note: Numbers may not necessarily add up due to rounding.
e Estimate
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The increase in commodity prices would also be reflected in higher export receipts from **agricultural commodities**, which is expected to record a double-digit growth of 10.5% in 2006 (2005: 3.4%). Receipts from palm oil exports are expected to increase by 6.3% (2005: -5.3%) amidst the higher export price of RM1,550 per tonne in 2006 (2005: RM1,456). The increase in price would be mainly demand-driven, supported by higher global demand, particularly from new users for palm-based biodiesel, as well as from traditional buyers. The expected higher demand from PR China is also encouraged by the abolition of the import quota on palm oil and a standardized import duty structure for all edible oils beginning 1 January 2006. Similarly, growth in exports of rubber is expected to strengthen further by 21.6% (2005: 11.3%) benefiting from a significant increase in rubber prices (620 sen per kilogramme; 2005: 513 sen per kilogramme). The strong outlook for rubber prices in 2006 is a result of expectations of continued strong demand, particularly from PR China; constraints in global natural rubber output; and the impact of strong crude oil prices on the price of synthetic rubber, which is a petrochemical product. For the first two months of 2006, the price of SMR20 increased by 46.2% to average 683 sen per kilogramme.

Mineral exports are expected to expand further by 18.6%, due to higher receipts from crude oil (including condensates) and liquefied natural gas (LNG). The increase would be supported by higher prices as well as an increase in volume, in line with the expected increase in production of these commodities. For the year as a whole, the export price of Malaysian crude oil is projected to average USD62 per barrel (2005: USD55.93 per barrel), or 10.9% higher from the level in 2005. In the first two months of 2006, the price of the Malaysian Tapis Blend had averaged USD65.40. Crude oil prices would continue to be influenced by fundamental factors as the gap between global supply and demand narrows further amidst the improved global outlook. Sentiment on oil prices would also be affected by geopolitical factors that may disrupt global supply. Similarly, in line with expectations of higher energy prices in the global market, LNG export prices are projected to rise further to RM1,120 per tonne (2005: RM947 per tonne). Amidst the higher prices, and an increase in demand from PR China, India and the United States, LNG exports are estimated to increase by 24.6%.

Import growth (13.4%) is expected to emanate from higher imports of intermediate goods, consonant with

Table 3.5
Exports and Imports

	2005*p*	2006*f*
	RM billion	
Gross exports	**533.8**	**600.6**
(% annual change)	***11.0***	***12.5***
Manufactures	**429.9**	**481.4**
(% annual change)	*10.1*	*12.0*
of which:		
Electronics	208.2	235.1
(% annual change)	*10.4*	*12.9*
Electrical products	74.5	84.7
(% annual change)	*8.9*	*13.6*
Chemicals & chemical products	29.7	32.6
(% annual change)	*7.0*	*9.6*
Minerals	**52.3**	**62.0**
(% annual change)	*27.1*	*18.6*
Agriculture	**37.4**	**41.3**
(% annual change)	*3.4*	*10.5*
Gross imports	**434.0**	**492.3**
(% annual change)	***8.5***	***13.4***
Capital goods	**60.7**	**67.7**
(% annual change)	*9.5*	*11.5*
Intermediate goods	**308.3**	**351.8**
(% annual change)	*7.2*	*14.1*
Consumption goods	**24.6**	**26.1**
(% annual change)	*5.9*	*6.0*

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

the forecast of stronger production and exports of the manufacturing sector, in particular, the electrical and electronic segment. Capital imports are expected to strengthen (11.5%) in line with capacity expansion in the manufacturing, services and oil and gas sectors. Higher capital imports in the services industry is expected to be led by enhancement in network capacity by telecommunications companies and the expansion of investment activities by the airlines and shipping companies. Increased exploration and production activity in the oil and gas industry following the discovery of new fields will also result in an increase in capital imports.

The **services account** deficit is expected to be sustained at 2% of GNP. Outflows in the transportation account would be higher, in line with higher volume of trade. Meanwhile, tourism earnings would continue to remain as the largest contributor to services earnings. The improvement in the other services deficit is expected to emanate from exports of communications, business and computer and information services. Higher receipts from computer and information services are consonant with the increasing trend in outsourcing activities, provision of group support and back-office processing services.

The **income account** deficit is projected to be sustained at 4.6% of GNP. The deficit is attributable to higher profits and dividends accruing to multinationals from their investments in Malaysia, in line with the strong export performance of the electrical and electronics industry as well as the oil and gas industry. Profits and dividends accruing to Malaysian companies investing abroad are also expected to be higher. Malaysian companies with investments in the oil and gas, plantation, infrastructure and utilities sectors are expected to provide a higher contribution to income inflows.

The **financial account** is expected to improve, supported by long-term capital inflows, particularly FDI. FDI is expected to increase, with a large portion continuing to be in the form of reinvestment by the existing MNCs in Malaysia. Following the higher level of FDI approved by MITI in 2005 (RM17.9 billion; 2004: RM13.1 billion), particularly from the US, Japan and Singapore, FDI in the manufacturing sector is projected to increase, with the implementation of projects mainly for higher-end electrical and electronic activities. Similarly, investment in the services sector is expected to remain high, supported by further liberalisation and entry of new players in the finance, insurance, real estate and business services sub-sector, as well as the expansion of operations in the wholesale and retail trade, hotels and restaurants sub-sector. Meanwhile, the oil and gas sector will continue to receive sizable inflows, mainly for extraction and production activities, following several discoveries of new oil fields.

Investment abroad by Malaysian companies is expected to increase further in 2006 as companies diversify and position themselves globally to provide greater synergy to their corporate activities. These investments will continue to be broad-based, and channelled into the oil and gas, manufacturing, utilities, construction, and services sectors.

MONETARY POLICY IN 2006

Monetary policy in 2006 would continue to emphasise economic growth in an environment of price stability. The thrust of macroeconomic policy is thus to provide a supportive environment to promote a sustainable level of economic activity in the medium term.

Economic growth prospects for the global and regional economies are expected to remain bright despite high oil and commodity prices. This is expected to be further reinforced by the strengthening of the global electronic up-cycle. The expansionary impact from the external sector on the Malaysian economy is expected to remain strong. Building on the momentum gained in the second half of 2005, GDP growth is expected to improve further in 2006. Stronger export performance is expected to sustain domestic consumption at a strong pace while the favourable external and domestic demand conditions would in turn provide further impetus for increased investment activity.

With the economy poised to register a firm performance, the main challenge for monetary policy in 2006 is to ensure that price expectations are well contained, while financing conditions are supportive of investments. The prospects for inflation would depend on several factors, both foreign and domestic. On the international front, the direction of international oil prices will continue to be a major concern. To date, the subsidies on fuels and energy products have somewhat sheltered the economy from the full impact of global oil price shocks. While there would be no further fuel price increases during the year following the recent adjustment to fuel prices, some uncertainty remains on the degree of the second round impact on the general price level. The sustained high level in international oil prices could put an upward bias on input costs for domestic producers. However, factors such as capacity expansion and continued improvements in productivity by businesses, as well as sustained competition amongst firms are expected to mitigate inflationary pressures somewhat. Taking these factors into account, inflation pressures in Malaysia are expected to remain manageable, with the inflation rate projected to average between 3.5% to 4% in 2006.

To align monetary conditions to the current environment, the OPR was raised by 25 basis points to 3.25 percent on 22 February. The Bank will continue to conduct monetary policy in a manner that will constantly balance the need to rein in inflationary expectations while remaining supportive of growth. Monetary policy would thus respond to new developments, both domestic and international, that would have implications for the medium-term prospects for price stability and sustainable economic growth.

The shift to a managed float exchange rate regime does not entail a change in the monetary policy framework or operations. Monetary policy remains focused on domestic considerations with the OPR as the signaling mechanism to achieve policy objectives. Interest rates, therefore, will not be used as an instrument to influence capital flows or the exchange rate. Notwithstanding the two-way intervention operations to smoothen exchange rate volatility and excessive exchange rate movements induced by large short-term capital flows, the Bank would allow the ringgit exchange rate to be determined by economic fundamentals and market conditions. This is consistent with the stated exchange rate policy objective of ensuring that the ringgit does not become overvalued or undervalued in a sustained manner.

As in 2005, the Monetary Policy Committee (MPC) is scheduled to meet eight times this year, with the option to hold additional meetings when necessary. The calendar for the MPC meetings, together with the associated schedule of releases for the Monetary Policy Statement, was published on the Central Bank website in December 2005. The Bank will continue to undertake additional initiatives in 2006 to enhance communication in promoting greater understanding of the objectives, processes and conduct of monetary policy.

FISCAL POLICY IN 2006

The 2006 Budget is the first annual Budget for the Ninth Malaysia Plan (2006-10). Fiscal policy in 2006 will thus focus on initiatives to generate greater quality growth in the near term to provide a strong foundation for long-term sustainable growth. The 2006 Budget put forth various measures to enhance national resilience and the ability to meet emerging external challenges arising from rising oil prices, higher global interest rates and increasing global competition.

The 2006 Budget projections were broadly in line with the Government's prudent fiscal stance. With the economy regaining its growth momentum, the Federal Government's overall financial position is expected to strengthen further in 2006. The fiscal deficit has been budgeted to reduce further to RM18.4 billion or 3.5% of GDP from 3.8% in 2005. In addition, after taking into account the potential net revenue loss of RM1 billion arising from tax measures announced in the 2006 Budget, the fiscal deficit will be at RM19.4 billion or 3.6% of GDP.

Total Federal Government expenditure (excluding contingent reserves) was budgeted at RM134.7 billion, representing a moderate increase of 5% from the actual 2005 expenditure (2005: +6.8%). In terms of development expenditure, special attention

Table 3.6
Federal Government Finance

	RM billion		% change	
	2005*p*	2006*B*	2005*p*	2006*B*
Revenue	106.3	114.6[1]	6.9	7.8
Operating expenditure	97.7	101.2	7.1	3.6
Current account	**8.6**	**13.3**		
Gross development expenditure	30.5	33.5	5.8	9.7
Loan recoveries	3.3	0.7		
Overall balance	**-18.7**	**-19.4**		
(% of GDP)	**-3.8**	**-3.6**		

[1] Includes net revenue loss of RM1 billion arising from the tax measures announced in the 2006 Budget.
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B Budget
Note: Numbers may not add up due to rounding.

was given to both the economic and the social sectors in an effort to reduce income disparities between the rural and urban areas. In addition to improving the efficiency and effectiveness of the public delivery system, the Government introduced several measures to stimulate private investment, including enhancing the business-friendly environment through wide-ranging tax and non-tax measures to improve business competitiveness; diversify sources of growth into new areas that have high growth potential; augment human capital development; further develop the capital market as well as strengthen the development of small and medium-sized enterprises. Key measures announced in the 2006 Budget are summarised in the white box.

The Government's primary objective for fiscal policy continues to be to ensure a sound and sustainable Federal Government financial position over the medium term. The focus would be on maintaining the fiscal deficit at an appropriate level where a balance between sustaining economic growth and preserving long-term fiscal sustainability is achieved.

Key Measures Announced in the 2006 Budget

Policy area	Measures
First Strategy: Implementing Proactive Government Measures to Accelerate Economic Activity	
Improving further the Government's delivery and procurement systems	• Allow financially autonomous statutory bodies to determine their own schemes of service. • Expedite the issuance of visas, particularly for knowledge workers and professionals in the fields of ICT and financial services. • Expand the use of ICT to facilitate dealings between the public and Government. • Introduction of new modalities of the Government procurement system in efforts to reduce cost, enhance transparency and ensure value for money.
Second Strategy: Providing a Business-Friendly Environment	
Reducing cost of doing business	• Provide group relief to all locally incorporated resident companies. • Allow accumulated losses and unabsorbed capital allowances during the pioneer period be carried forward. • Treat income of investment holding company listed in Bursa Malaysia as business income. • Allow estimated losses on low-cost houses to be offset against estimated profits of other real property development projects.
Strengthening the capital market	• Exempt stamp duty and real property gains tax on mergers and acquisitions of companies listed on Bursa Malaysia. • Allow tax deductions on legal, valuation and consultancy expenses incurred in the establishment of Real Estate Investment Trusts. • Allow tax deductions for discounts on an accrual basis until the maturity of the bonds for corporate issuing bonds.

Modernising the agriculture sector	• Increase Fund for Food by RM300 million. • Establish a new company to develop forest plantations commercially. • Khazanah Nasional to establish the National Agriculture and Food Corporation with a capital of RM500 million.
Developing the ICT and biotechnology sectors	• Set up the Malaysian Life Sciences Capital Fund, with RM100 million from the Government. • Extend tax incentives to qualifying companies operating outside MSC.
Others	• Reduction of 50% for stamp duty charged on loans of up to RM1 million taken by small and medium-sized enterprises (SMEs). • SME Bank to set up a venture capital fund of RM1 billion to finance SMEs. • Establish Bumiputera property trust foundation, Yayasan Amanah Hartanah Bumiputera with an initial capital of RM2 billion.
Third Strategy: Developing Human Capital	
Intensifying human capital development	• Automatic child relief for each child studying in local or recognised institutions of higher learning. • Extend the child relief to disabled child pursuing tertiary education. • Extend the scope of individual tax relief of RM5,000 for further education to professional courses, accountancy and law. • Allow tax deductions on expenses incurred for development and regulatory compliance of new courses by IPTS. • Double deduction to public listed companies on the allowances paid to participants under the Unemployed Graduates Training programme.
Fourth Strategy: Enhancing the Well-Being and Quality of Life of the Rakyat	
Reducing financial burden of Malaysians	• Reduction of road tax by 40% for private diesel vehicles exceeding 1,600 cc, except in Sarawak.
Others	• Allow husband and wife to each claim one property for exemption of Real Property Gains Tax. • Increase tax rates on liquor and cigarettes. • Extend tax incentives to companies providing energy conservation services.

FINANCIAL SECTOR POLICY IN 2006

Against the background of ongoing evolution and developments that are shaping the financial landscape and challenges brought about by economic and financial liberalisation, the thrust of policies for the financial sector in 2006 will focus on further strengthening the role, capacity and contribution of the financial sector in the economic transformation and, hence, the successful realisation of strategies outlined in the Ninth Malaysia Plan. Specifically, policies will be geared towards preserving the stability that has been sustained over the years by further strengthening institutional and systemic resilience and competitiveness, maintaining an efficient and effective financial infrastructure, and promoting a conducive regulatory and supervisory environment that fosters a progressive, dynamic and resilient financial system. These efforts will be complemented by the ongoing consumer education initiatives and protection framework to ensure well-informed and empowered consumers as well as fair and equitable financial dealings amidst a stable socio-economic environment. Of equal importance, particularly in light of the structural changes that are taking place in the domestic economy, emphasis would also continue to be accorded to further improving the efficiency of accessibility of various segments in the economy to financing to be able to contribute effectively to the economic development and transformation.

With the Financial Sector Masterplan already in its second phase, the locally-incorporated foreign banks (LIFBs) are expected to become more integrated within the domestic economy to meet the growing requirements of the banking public. The operational flexibility accorded to the LIFBs through the establishment of additional branches would enhance accessibility of banking services to larger segments of society including those outside the urban areas. The operational flexibility will also allow the LIFBs to better understand the requirements of the different segments of the economy thereby enabling them to play a more direct role in economic development. At the same time, the expanded network of the LIFBs would also provide the public with a broader range of products and services. As the LIFBs begin to operationalise the new branches, the Central Bank will monitor their contribution and effectiveness.

While the progress in the area of capacity and capability building has thus far been commendable, the development of a pool of talented and skilled personnel remains a priority. With the pace of evolution in the financial sector becoming faster and that there is growing demand for differentiated and more complex financial instruments by the economy, the need for the financial sector to have the intellectual and competent human resources becomes even more critical, not only in meeting these demands but in ensuring the ready availability of best talents and high calibre professionals to drive the banking industry forward. Investment in such talents will create value and improve the performance of the institution. While there is a shortage in such talents in Malaysia, in view of the fast pace of developments, the advanced financial systems and markets around the world have nurtured specialists in various aspects of banking operations. To enable the Malaysian banking industry to tap these foreign talents to strengthen the domestic industry and nurture domestic capabilities, especially in newly emerging areas, review is already underway to provide amongst others greater flexibility for banking institutions in the employment of such expertise.

The emergence of investment banks is envisaged to pave the way for further development and maturity of the Malaysian capital market. While the development will create new business opportunities, particularly cross-border activities, new risks and challenges can be expected to emerge. Given the nature of investment banking activities, efforts in 2005 have been focused towards the harmonisation of regulations and the emplacement of a mechanism for regulatory and supervisory coordination and cooperation between Bank Negara Malaysia and the Securities Commission in order to alleviate overlaps in functions and to ensure consistency in policies and regulations for the investment banks. As these have already been completed, policy initiatives in 2006 will focus on the operationalisation of the investment bank framework. Other than the merchant banks, which are existing players, prospective new players will appear arising from the transformation of universal brokers and discount houses into investment banks. Emphasis will be accorded towards assessing the strength and capability of these new players. Given the rigorous requirements which investment banks have to comply, due diligence examination will be conducted on these prospective players aimed at ensuring that the new players have the pre-requisites to assume their new roles. Apart from increasing competition, it is also envisaged that the entry of new players into the industry will increase staff mobility and thus the need for continuing human resource development. Meanwhile, the integration of the banking and capital market activities under a single entity will entail wider risks that need to be appropriately aggregated and managed in order to ensure financial sector resilience, soundness and stability.

Promoting the soundness and stability of the banking system remains high on the agenda of Bank Negara Malaysia not only for the development of the sector, but also to promote sustained growth in economic activity and national prosperity. In 2005, much emphasis had been directed at promoting sound risk management practices and corporate governance standards within the banking industry. While these efforts will continue to be pursued in 2006, greater attention will be directed towards strengthening institutional capacity of market players to withstand any potential financial shocks or macroeconomic imbalances and to have the agility to embrace future challenges. In order to prepare for this, a survey was carried out in 2005 to assess the state of readiness of the banking institutions to cope with emergencies and unexpected disruptions to their operations. The response and information gathered from this exercise has been beneficial and will be used as input in the formulation of the guidelines on business continuity management for the banking sector due for issuance in 2006. The guidelines aim at reinforcing the importance of sound business continuity management and at ensuring that banking institutions are well-equipped with recovery capabilities necessary for the near or instant continuation of their critical business functions in the event of a major disruption.

In an environment where changes are constantly taking place, the responsibility of maintaining financial system stability is no longer the sole responsibility of the Central Bank. The banking industry, together with its customers, shareholder and other stakeholders are also accountable for their actions and share the task of maintaining stability of the overall system. In realising this objective, the Central Bank has finalised the review of the shareholding policy which is expected to be implemented this year. This policy aims at broadening the role of shareholders in overseeing the performance and behaviours of their institutions and the effectiveness of management in conducting the business in a responsible, efficient and professional manner. It is envisaged that the greater participation of institutional investors in the banking sector will contribute towards further developments of these aspects of the banking institutions.

As the implementation date for the new Basel Capital Accord (Basel II) draws near, consultations and collaborative efforts with the banking industry will intensify, to allow both the regulator and banking institutions to identify and deliberate on critical issues and monitor the preparatory process to ensure the smooth implementation of Basel II. Feedback from the consultations will be used as input to the concept papers on Basel II. Given the complexity and extensiveness of Basel II requirements, a series of concept papers will be issued with the first being on the basic approaches for credit and operational risks.

Malaysia remains committed towards aligning its accounting practices to international standards through the adoption of the new and revised Financial Reporting Standards (FRS). Of significance, is the proposed FRS 139 which specifies new accounting rules on recognition, measurement and classification of financial instruments in the financial statements, rules on asset impairment and provisioning, and new requirements for the use of hedge accounting. The adoption of the FRS 139 would in practice involve a considerable degree of judgement and estimation, complex systems and procedures as well as reliance on internal valuation models by banking institutions particularly for the provisioning and measurement of financial instruments. Hence, the ability of banking institutions in implementing the FRS 139 would depend on their internal capabilities and the availability of the necessary infrastructure to ensure not only that their financial statements continue to portray a true and fair view but are sufficiently credible to be used in the context of supervisory assessment. In this regard, Bank Negara Malaysia will be issuing a guideline that outlines the key capabilities and expectations that must be met by banking institutions prior to the adoption of the FRS 139. The scope of the supervisory expectations includes requirements pertaining to credit review and impairment provisions for effective implementation of provisioning requirements in banking institutions, recognition and de-recognition for sell and buy back agreements (SBBA) and financing sold with recourse under Islamic contracts and fair value option on financial instruments.

Continuous and comprehensive surveillance is immensely crucial to ensure the accurate and timely identification and assessment of financial system vulnerability and fragility. Given the close interconnectivity between the banking sector and the economy, the approach to and scope of surveillance by the supervisors has, in recent years, been broadened to encompass macro and micro surveillance and the assessment of key financial soundness indicators. At the macro level, initiatives will be focused on further enhancing the scope and depth of the surveillance framework by employing a broader range of forward-looking tools for monitoring the financial and economic environment. This involves assimilating developments in the various components in the economy and financial markets with the banking sector and assessing the implications. An area that has gained much attention in recent periods is the growing exposure of the banking sector to the household sector and the rapid increase in household indebtedness. While this development has thus far been within prudential levels, the Central Bank will remain vigilant to ensure the sustainability of the household sector and to preserve financial stability. These include measures to further strengthen the risk management of banking institutions in managing their exposure to this sector, as well as to prevent over-leveraging by households. This is critical to ensure the continued capacity of the household sector in contributing towards sustained economic expansion.

With the ongoing introduction of new financial instruments, the task of ensuring effective surveillance by supervisors becomes more complex and demanding. Going forward, more rigorous surveillance will also have to be undertaken at the institution level. In this regard, the stress test framework will be enhanced to ensure its robustness as a tool in assessing the resilience of banking institutions to a broad range of economic and financial shocks. Anecdotal evidence has suggested that knowledge and understanding of events leading up to crises and instabilities in the past provide invaluable information to supervisors. As such, it is envisaged that with the early detection of emerging vulnerabilities and weaknesses within a banking institution, timely and appropriate intervention should be instituted to preserve the stability of the system.

The growing complexity in the group structure of financial institutions has called for a more holistic supervisory approach to facilitate more accurate assessment of a financial conglomerate's risk exposures and the adequacy of the risk management systems at the group level. Taking into consideration the feedback from the industry following the issuance of the first concept paper, a second concept paper on the framework for the consolidated supervision of financial conglomerates will be issued in 2006.

On the supervisory front, focus will also be accorded to further strengthen the capability and capacity of supervisors to better cope with the changing and more challenging environment in the financial markets and economy. This is particularly important in view of the implementation of the Basel II and as the Central Bank moves towards the adoption of principle-based regulatory framework where judgement will be a key element in the supervision and assessment of the resilience of a banking institution. The rigorousness of the analytical process under the Basel II framework is undoubtedly demanding from the supervisory perspective, particularly in developing the appropriate response and assessment framework on these processes. Supervisory attention will need to ensure that the analytical processes are undertaken to support decision making rather than merely meeting regulatory expectations or according excessive emphasis on validating the detailed quantitative and statistical procedures. It is also critical that supervisors undergo early and rigorous training to accelerate their capacity building efforts to enable the identification of the relevant issues when undertaking the supervisory assessment. In this regard, various initiatives have been put in place to accelerate the training and skill development in 2006.

Enhancement to the consumer education framework and the strengthening of the infrastructure for better consumer protection will remain a priority, both to promote a progressive banking sector as well as to foster public confidence in the financial system. With the growth in complexity of financial products and services, and greater expectation on consumers to take on more responsibility in managing their finances, efforts will continue to be directed towards elevating their financial literacy levels to facilitate more meaningful decisions appropriate to their needs and capacity for risk. More confident and financially savvy consumers will be better equipped to exercise a stronger influence on financial service providers and to drive competition and performance. Significant attention continues to be accorded to promote a higher level of disclosure and transparency as well as comparability of information in the financial system. In this regard, the work on the formulation of a more comprehensive product transparency and disclosure framework will be intensified. In principle, the framework aims at providing consumers with adequate and relevant information to make an informed decision relating to financial products and services. In furthering efforts to strengthen the consumer protection framework, issues relating to market conduct will be greatly emphasised to ensure fair and equitable treatment of all consumers. The establishment of the Credit Counselling and Debt Management Agency (CCDMA) in April 2006 will mark a significant milestone in the development of a comprehensive consumer protection infrastructure in Malaysia. As the growth momentum in household spending and household debt is expected to continue into the future, the CCDMA will provide an important avenue for individuals to seek credit counselling, debt restructuring and settlement services, and obtain financial education from expertise and professionals with regard to the management of their finances and debts.

[Please refer to the box article on the Establishment of the Credit Counselling and Debt Management Agency for details.]

Ensuring the safe and efficient operation of the payment systems will remain a key policy objective. Over the years, the banking industry has progressively introduced several electronic-based retail payment systems, completed the migration of the ATM and credit cards to chip-based infrastructure and leveraged on technology such as mobile telecommunication devices to provide more convenient payment services. Given these achievements, the policy focus in 2006 will be geared towards providing an enabling environment for more electronic payment methods to be introduced, promoting the use of formal payment channels and coordinating industry efforts in the migration to electronic payments. The efficiency in cheque processing will be improved by leveraging on the imaging technology to truncate cheques, thereby reducing the physical handling of cheques in the clearing process. At the same time, measures will be taken to improve the current electronic payment services to encourage the greater use of these electronic payment channels. To promote the use of formal payment channels, banking institutions will be allowed to appoint third party ‘collecting agents’ to improve accessibility of their remittance services. Similarly, qualified non-banking institutions will also be allowed to offer remittance services. In leading the industry to adopt more cost effective payment methods, a coordinating body will be established to engage the various stakeholders in promoting the migration to electronic means of payments on a nationwide basis. In addition, efforts will continue to be pursued in enhancing industry security standards and establishing mechanisms to effectively mitigate payment risks. With the growth of e-banking transactions, the Internet banking guidelines will be revised to ensure that the industry adopts best practices and devotes sufficient resources in combating cyber crime and digital attacks. Further, a ‘payment versus payment’ settlement mechanism will be introduced to mitigate the risks associated with inter-bank foreign exchange transactions, particularly for USD and RM trades.

In 2006, the major policy thrust for the Islamic banking sector will concentrate on further strengthening the resilience of the Islamic banking system and expanding the capacity and capability of the Islamic financial institutions. This is in line with the objective of enhancing the integration of the domestic Islamic banking sector with the international Islamic financial landscape, and strengthening Malaysia’s position as a leading Islamic financial centre. The regulatory framework for the Islamic financial institutions (IFIs) will be strengthened following the issuance of the Islamic Financial Services Board’s (IFSB) standards on capital adequacy and risk management. Islamic financial institutions are required to conform to the new requirements with effect from 1 January 2007. In addition, a framework on the governance of the investment account holders and a revised guideline on corporate governance for the IFIs will be introduced by Bank Negara Malaysia to further reinforce the institutional framework. Other areas that will be enhanced include the legal and Shariah framework, product and market development, and human capital development and consumer education.

The legal and regulatory framework is expected to be strengthened with the tabling of the revised Islamic Banking Act 1983 in Parliament in 2006. Efforts will also be directed at meeting the manpower requirements through the establishment of the International Centre for Education in Islamic Finance (INCEIF) in April 2006. Talent building is one of the key factors identified for the development of innovation in Islamic banking products and services and INCEIF is expected to increase the pool of required talent in the global Islamic financial market. New policies and initiatives will also focus on making the Islamic financial services environment in Malaysia to be more conducive and investment-friendly to the international Islamic financial community. Promotion and marketing efforts will target at attracting funds from individuals and multinational corporations, particularly from the Muslim countries, to use Malaysia as the platform for their investment as well as financing needs.

The thrust of policy for the development financial institutions (DFIs) in 2006 is to further strengthen the capacity and capability of the DFIs towards nurturing and developing efficient, effective and robust DFIs in providing financial and non-financial support to the targeted sectors of the economy. With the completion of the rationalisation exercise involving four DFIs in 2005, initiatives going forward will focus on enhancing the functions and scope of activities of the DFIs in meeting their mandates and the financial and developmental needs of their respective targeted sectors. These, among others, include strengthening their financial capacity as well as broadening the range of products and services offered by the DFIs. Towards this end, further efforts will be undertaken to enhance the outreach and effectiveness of the advisory services provided by the DFIs to the SMEs, especially through collaboration with relevant Government agencies.

Another important focus will be the enhancement of the regulatory environment to facilitate the operations of the DFIs through customised prudential requirements and regulatory standards, as well as improving their financial soundness and risk management practices. Emphasis will also be accorded towards enhancing the efficiency of the DFIs. In this regard, initiative will be undertaken to establish a comprehensive performance measurement framework for the DFIs, comprising both financial and non-financial performance indicators.

The Financial System

The Financial System

Sources and Uses of Funds of the Financial System

The continued expansion in economic activity during the year was reflected in the growth of total assets of the financial system, which grew by 8.1% or RM143.6 billion to RM1.9 trillion as at end-2005. As at end-2005, the total assets of the financial system were equivalent to 386% of GDP (2004: 392.5%).

Assets of the banking system and the non-bank financial intermediaries (NBFIs) expanded in 2005, albeit at a slower rate at 7.7% (2004: 13.6%) and 9% (2004: 11.6%) respectively. The Central Bank's assets recorded a more moderate growth in 2005 due to a smaller increase in the holdings of gold and foreign exchange reserves. A moderate growth in assets was also registered by commercial banks and discount houses, while merchant banks and Islamic banks recorded a higher increase in assets.

The contribution of assets by type of institutions changed during the year, reflecting the continued transformation of the Malaysian financial system. Firstly, following the completion of the merger exercises of five finance companies with their respective parent commercial banks, the assets of the commercial banks rose by 14.4% to account for a larger share of 44.1% share of total financial system assets (2004: 41.7%), while the share of finance companies declined to 1.4% (2004: 3.9%). Secondly, with the greater emphasis on developing Islamic financial services, the share of Islamic banks' assets in

Table 4.1
Assets of the Financial System

	Annual change		As at end-2005*p*
	2004	2005*p*	
	RM billion		
Banking system	**142.1**	**91.7**	**1,280.8**
Bank Negara Malaysia	84.0	10.6	295.4
Commercial banks	127.3	106.1	842.4
Finance companies	-73.5	-41.5	26.9
Merchant banks	-1.4	3.9	46.6
Islamic banks	3.9	18.6	43.5
Discount houses	1.7	-5.9	26.0
Non-bank financial intermediaries	**59.7**	**51.9**	**627.7**
Provident, pension and insurance funds	35.6	39.8	423.2
Employees Provident Fund	*20.2*	*23.5*	*263.9*
Other provident & pension funds	*4.8*	*5.6*	*56.8*
Life insurance funds	*10.0*	*9.6*	*83.7*
General insurance funds	*0.6*	*1.0*	*18.8*
Development financial institutions[1]	12.4	8.7	100.1
Other financial intermediaries[2]	11.7	3.5	104.4
Total	**201.8**	**143.6**	**1,908.5**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil dan Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji. Prior to 1 October 2005, data included Bank Industri & Teknologi Malaysia Berhad and Malaysia Export Credit Insurance Berhad and excluded SME Bank.

[2] Refers to unit trusts run by Amanah Saham Nasional Berhad (ASNB) and Amanah Saham Mara Berhad, cooperative societies, leasing and factoring companies, and housing credit institutions (comprising Cagamas Berhad, Borneo Housing Mortgage Finance Berhad and Malaysia Building Society Berhad).

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Graph 4.1
Assets of the Financial System as at end-2005*p* (% share)

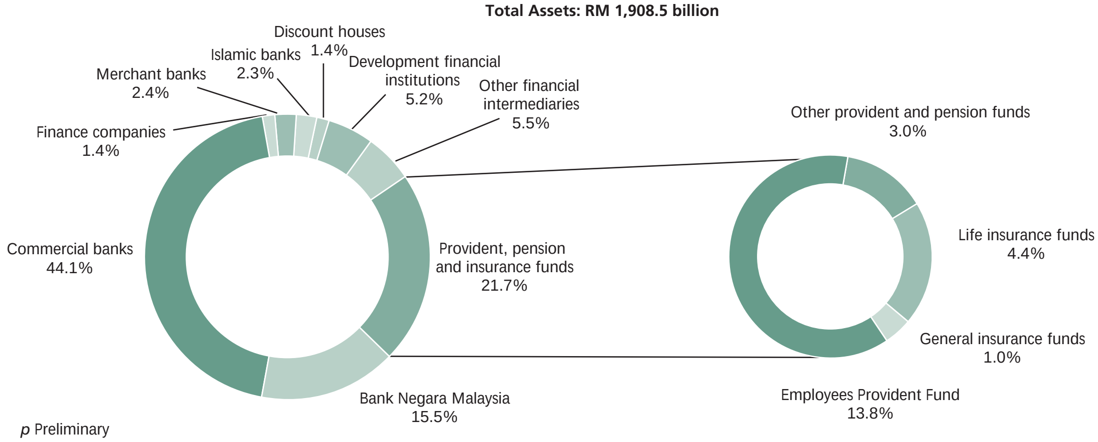

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Table 4.2
Sources and Uses of Funds of the Financial System

	Annual change		As at end-2005*p*
	2004	2005*p*	
	RM billion		
Sources:			
Capital and reserves	18.1	9.3	176.3
Currency	2.9	2.0	34.4
Deposits	126.2	86.6	922.2
Borrowings	3.9	3.7	56.4
Funds from other financial institutions[1]	-15.9	12.5	84.2
Insurance, provident and pension funds	32.3	36.2	374.1
Other liabilities	34.2	-6.7	260.9
Total	**201.8**	**143.6**	**1,908.5**
Uses:			
Currency	-0.5	0.9	6.0
Deposits with other financial institutions	21.6	8.0	256.0
Loans and advances[2]	56.4	66.0	721.7
Securities	23.6	35.0	468.0
Treasury bills	*-3.1*	*1.3*	*1.7*
Commercial bills	*-5.1*	*-1.1*	*7.3*
Malaysian Government (MGS)	*14.3*	*13.7*	*153.2*
Corporate	*17.4*	*19.2*	*290.8*
Private Debt Securities (PDS)	*8.0*	*10.5*	*140.8*
Equities	*9.5*	*8.6*	*150.0*
Foreign	*1.1*	*2.1*	*6.7*
Others	*-1.2*	*-0.1*	*8.4*
Gold and foreign exchange reserves	9.5	8.6	264.4
Other assets	17.1	19.0	192.4

[1] Includes statutory reserves of banking institutions.
[2] Excludes loans sold to Danaharta.
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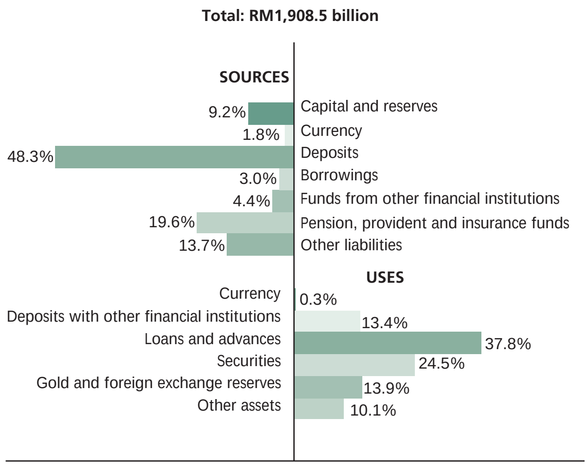
Graph 4.2
Sources and Uses of Funds of the Financial System as at end-2005p (% share)



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the financial system expanded to 2.3% of total financial assets from 1.4% in the previous year. During the course of the year, four additional Islamic banks were established as a result of measures taken to liberalise and accelerate the growth of Islamic banking industry by allowing foreign Islamic banks to operate in Malaysia. Thirdly, as part of the framework for the creation of investment banks, the seven discount houses currently in operation would be rationalised and merged with stockbroking companies and universal brokers to form investment banks. Arising from the rationalisation process, the assets of the discount houses declined by RM5.9 billion to account for a reduced share of 1.4% of total assets of the financial system (2004: 1.8%).

Meanwhile, the expansion in assets of the NBFIs was contributed largely by a higher increase of the provident, pension and insurance funds' assets. Assets of the provident and pension funds (PPFs) increased by 10% during the year and contributed 16.8% of the total assets of the financial system. This growth was attributed to the increase of investments in debt

Table 4.3
Non-Financial Private Sector Deposits[1] with the Financial System[2]

	Annual change		As at end-2005*p*
	2004	2005*p*	
	RM billion		
Deposits[3] with:			
Commercial banks	87.9	64.1	498.0
Finance companies	-35.4	-22.6	6.0
Merchant banks	0.8	1.3	16.0
Islamic banks	2.1	10.8	22.2
Discount houses	1.8	-2.8	9.7
National Savings Bank	1.8	2.2	12.2
Others[4]	5.5	0.7	37.3
Total	**64.6**	**53.6**	**601.5**
Demand deposits	10.3	9.3	97.2
Saving deposits	5.5	2.4	76.5
Fixed deposits	35.3	19.7	362.9
of which:			
Up to 1 year	*34.2*	*19.4*	*334.7*
More than 1 year	*1.1*	*0.3*	*28.2*
NIDs[5]	5.2	10.7	18.6
Repos[6]	8.3	11.5	46.3

[1] Refers to deposits placed by business enterprises (excluding NFPEs) and individuals.
[2] Excludes provident and pension, insurance and unit trust funds.
[3] Refers to demand, savings and fixed deposits, negotiable instruments of deposits and repos.
[4] Includes development financial institutions, cooperative societies and housing credit institutions.
[5] Refers to negotiable instruments of deposits.
[6] Refers to repurchase agreements.
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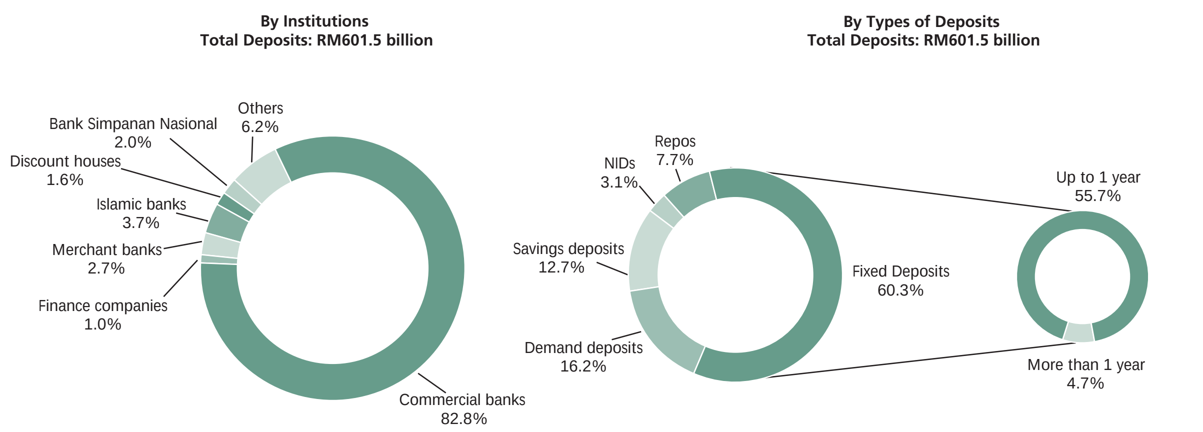
Graph 4.3
Non-Financial Private Sector Deposits with the Financial System as at end-2005*p* (% share)



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securities and equities, as well as from higher lending activity by PPFs in 2005.

Assets of the insurance funds grew at a similar pace, registering 11.6% growth and accounted for 5.4% of the total assets of the financial system as at end-2005. Bulk of the growth in the assets was driven by the life insurance funds (including Takaful family funds) which accounted for 82% of the total insurance funds assets. In terms of growth, the assets of Islamic insurance funds grew at a higher rate of 14.9%, compared to the conventional insurance funds which grew by 11.4%.

The sources of financing for the financial system were contributed mainly by the deposits placed with the financial institutions as well as contributions to the provident, pension and insurance funds. Deposits mobilised by the financial system increased by RM86.6 billion, or 10.4% during the year. The banking institutions remained the largest mobiliser of the deposits, contributing 72.1% of the total increase in deposits during the year and accounted for 77.5% of total outstanding deposits mobilised in the whole financial system.

In terms of deposits by holders, individuals and businesses contributed the bulk of the deposits placed with the banking system and development financial institutions (DFIs). Deposits placed by individuals with the banking system and DFIs increased by 5.4% in 2005 (2004: 9.6%), while deposits placed by businesses grew by 15.3% (2004: 18.8%). In 2005, the growth in deposits was in line with the continued growth in the nation's income as reflected in the strong growth of 11.3% in GNP.

Table 4.4
Direction of Credit[1] to the Non-Financial Private Sector

	Annual change		As at end-2005*p*
	2004	2005*p*	
	RM billion		
Loans and advances	**55.3**	**70.6**	**683.5**
Agriculture	0.7	0.2	14.2
Mining and quarrying	-0.1	-0.2	0.8
Manufacturing	2.5	-0.4	58.1
Construction and real estate	3.9	4.6	84.4
Purchase of residential properties	19.2	18.5	187.8
Retail, wholesale, restaurants and hotels	3.2	1.6	25.7
Transport, storage and communications	0.0	3.4	18.9
Business services	1.6	1.2	23.3
Electricity, gas and water supply	0.7	-0.4	5.7
Consumption credit	15.0	22.2	133.4
Purchase of shares	-0.4	1.6	20.5
Others	8.9	18.2	111.0
Investments in corporate securities	**15.6**	**21.2**	**289.0**
Total	**71.0**	**91.8**	**972.5**

[1] Excludes credit to non-financial public enterprises.
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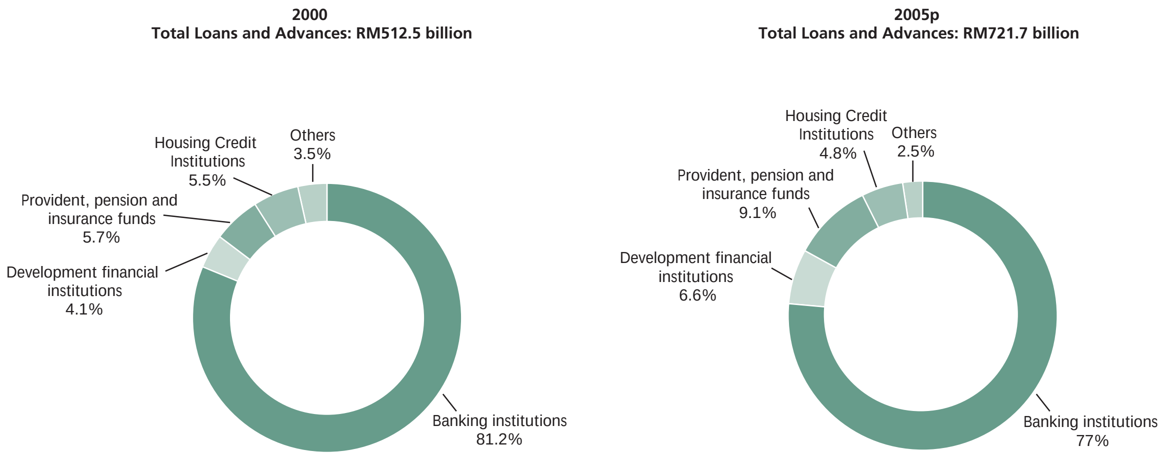
Graph 4.4
Loans and Advances by Institutions (% share)



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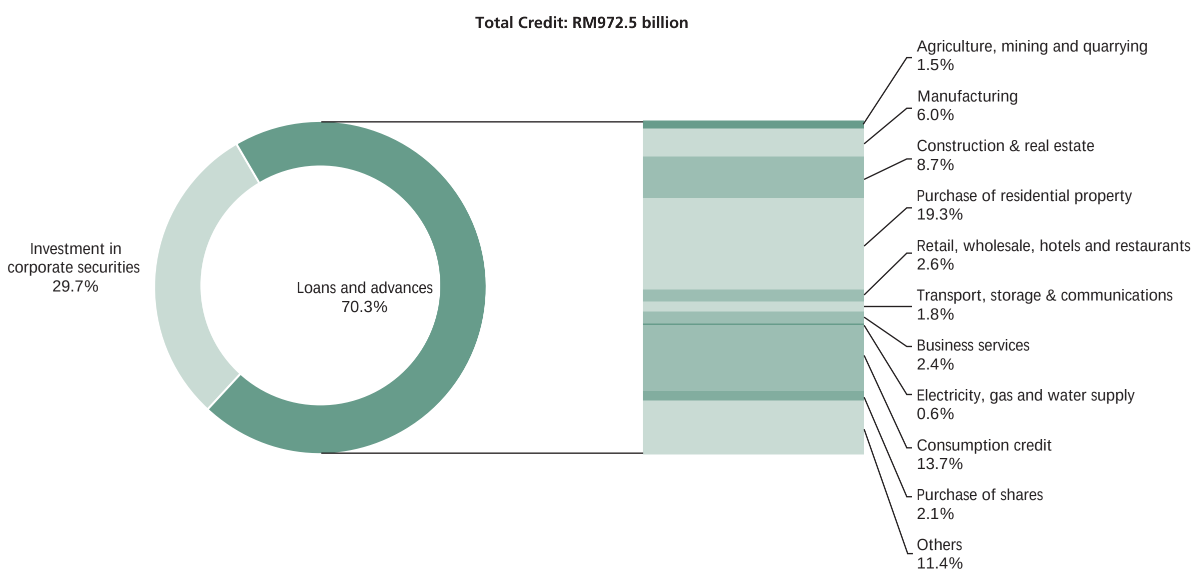
Apart from deposits placed with financial institutions, contributions to the provident, pension and insurance funds remained as the second main source of financing to the financial system, which accounted for 19.6% of the total financing resources. The contributions to the provident and pension funds (PPFs) continued to grow by 10.7% during the year and were largely dominated by contributions to the Employee Provident Fund (91.3% of total contributions to PPFs).

The increase in the total resources of the financial system in 2005 was mainly channeled into loans and advances as well as investment in debt securities and equities.

Graph 4.5
Direction of Credit to the Non-Financial Private Sector as at end-2005*p* (% share)



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Loans and advances extended by the financial system grew by 10.1% during the year and remained the largest type of asset in the financial system (37.8% share of total assets). The banking institutions were the largest provider of the loans and advances with a 77% share, followed by the PPFs and DFIs. The share of loans provided by PPFs and DFIs has expanded since 2000, reflecting the greater role of DFI in financing the economy as well as the diversification of asset allocation of PPFs.

In 2005, the demand for loans and advances were driven mainly by the household sector, particularly for the purchase of residential properties and consumption credit, which together accounted for 57.7% of the increase in total loans and advances during the year. Meanwhile, within the business sector, the loans extended to the small and medium-sized enterprises posted a higher growth of 8.7% in 2005 (2004: 7.7%).

Investment in securities (debt and equities) by the financial system expanded further by 8.1% in 2005 (2004: 5.8%) due mainly to the increase in holdings of securities by PPFs. The PPFs held 50.2% and 47.7% in debt securities and equities investment, respectively. Meanwhile, the holdings of securities by the banking institutions dropped during the year reflecting a shift in portfolio allocation from long-term securities to short-term securities following the anticipation of further interest rate increase in the future.

Progress of Financial Sector Masterplan Implementation

The implementation of the Financial Sector Masterplan (FSMP) is well on track and as at 31 December 2005, i.e. half-way through the 10-year FSMP period, a total of 49 recommendations or more than half of the FSMP recommendations with milestones have been fully implemented. Another 29 recommendations are being implemented on a continuous basis. The list of completed and on-going recommendations is in the Annex.

Throughout the first half of the FSMP period, significant progress was achieved in diversifying the financial structure including further strengthening the position of the domestic financial institutions to operate in a more liberalised environment. Despite a more deregulated and liberalised environment, the domestic banking institutions remained competitive and were able to maintain their market share. As at end-2005, domestic banking institutions maintained 81.7% share of gross loans (end-2004: 81.3%) and 80.5% share of total deposits (end-2004: 80.9%). Profitability levels of domestic banks continued to improve, as exhibited by increases in return on average assets and return on average equity from 1% and 11.5% in 2004 to 1.3% and 15.2% in 2005, respectively. Productivity level also improved further as demonstrated by lower cost to income ratio of 49% in 2005 (2004: 50%). Boosted by stronger profitability level and improving cost to income ratio, the pre-tax profit per RM employee cost of domestic banks also increased from RM1.60 in 2004 to RM1.90 in 2005. Asset quality positions also continued to improve, amidst favourable economic conditions. Net NPL ratio based on the 3-month classification declined by 1.8 percentage points to 6.4% in 2005. Benefiting from the continued capacity building initiatives and efforts taken by domestic banking institutions to further enhance their operational efficiency, several domestic banks have emerged stronger and become performance leaders. These top performers have further narrowed their performance gap as compared with the incumbent foreign banks in all major areas.

Similar to the banking industry, the domestic insurance companies also recorded further performance improvements. Domestic players maintained their dominant position in the general insurance sector with a market share in gross direct premiums of 73.5% in 2005 (2004: 72.6%). Supported by enhanced underwriting capabilities and infrastructure improvements which contributed towards better underwriting results and efficiency gains, the combined return on equity of the larger domestic insurers increased to 29.8% (2004: 20.6%). Significant productivity improvements were also achieved with gross premiums per employee increasing by more than 14% to RM754,301 (2004: RM659,184). In the life sector, the weaker overall growth of life business during the year saw the market share of domestic insurers declining marginally to 34.8% (2004: 35.8%) in 2005. Domestic insurers, nevertheless, maintained their dominant position in the bancassurance market, with a share of 81.9% (2004: 82.4%) of total new premiums generated through banking institutions in 2005. The significant growth of the bancassurance market since 2003 has also seen a number of domestic insurers emerging among the market leaders, with several more positioning themselves to take advantage of the significant growth opportunities to be reaped from their banking alliances.

The Islamic banking industry sustained its expansion in the Malaysian banking system as indicated by the increasing market share of Islamic banking assets to account for 11.3% (2004: 10.5%) of the total assets in the banking system as at end-2005. The market share of deposits and financing also expanded to account for

11.7% (2004: 11.2%) and 12.1% (2004: 11.3%) of the total banking sector deposits and financing respectively.

During the year, various policy initiates were undertaken towards strengthening further the financial system to better support the growing needs of the economy. Measures undertaken in the banking sector, Islamic financial services and the development financial institutions are discussed in detail in chapters *The Banking System, The Islamic Financial System* and *Development Financial Institutions* of the Annual Report 2005. Details on the insurance sector initiatives will be covered in the Insurance Annual Report 2005.

The Malaysian financial landscape will continue to undergo structural changes given the economic transformation and the need for the financial institutions to sustain their competitiveness and resilience. The entrance of new investors and financial players is expected to inject greater dynamism in the financial industry, thus giving more incentives to attain greater performance improvement by domestic financial institutions. The capacity building initiatives will continue to be pursued and intensified during the remaining Phase 2 of the FSMP period to prepare the domestic financial sector for further global integration as we move to the third phase of the FSMP. Gradual liberalisation measures, including the possibility of introducing new foreign competition, will be appropriately sequenced to ensure the achievement of the desired improvement and, new opportunities and benefits to the domestic financial system while preserving overall financial stability.

The Banking System

The Banking System

MANAGEMENT OF THE BANKING SYSTEM

Building on the achievements recorded in the preceding years, further progress continues to be made in enhancing the capacity and capability of domestic banking institutions. The enhanced competitiveness of the domestic banking institutions provided the foundations on which progressive infusion of greater competition could be pursued through further deregulation and liberalisation.

In line with the objective of preserving financial soundness and stability whilst achieving the goals of progressing into a more dynamic financial system, the main thrusts of policy measures in 2005 continued to place emphasis on enhancing the competitiveness of domestic banking institutions and preserving resilience of the financial sector. In this regard, efforts were directed towards improving the structural and operational efficiency of the banking institutions whilst introducing a more dynamic prudential regulatory framework, which is complemented with effective supervisory oversight and enhanced surveillance. Other key policy initiatives in 2005 included ensuring continuous access to financing for all segments of the economy and the further enhancement of infrastructure for consumer protection and education. These are in line with the broad thrust of Phase 2 Financial Sector Masterplan (FSMP) which aims to elevate the overall performance of the financial sector.

Policy measures in 2005 continued to focus on enhancing competitiveness of domestic banking institutions, strengthening the infrastructure for consumer education and protection, and ensuring continuous access to financing.

The banking system sustained its strong performance in 2005, both in terms of financial strength and operational efficiency. The banking sector registered RM12.4 billion in pre-tax profit and maintained the risk-weighted capital ratio (RWCR) above 13%. Non-performing loans (NPLs) ratio continued its downward trend to 4.6%, the lowest level since the advent of the Asian financial crisis. Supported by the strong financial position, the banking system was well-positioned to effectively support economic growth as evident from the expansion in lending activities. New loan approvals and disbursements increased by 11.4% and 8.4% respectively, whilst total outstanding loans expanded by 8.6% during the year.

The winding up of Pengurusan Danaharta Nasional Berhad (Danaharta) in December 2005 marked the successful completion of the final chapter in the financial sector restructuring efforts undertaken to address the vulnerabilities that surfaced in the aftermath of the Asian financial crisis. With financial system stability fully restored and continued strong performance by the banking sector, policies implemented during the year were successful in augmenting the resilience, capacity and efficiency of the banking institutions to effectively meet the needs of an increasingly competitive and dynamic economy.

Enhancing Structural and Operational Efficiency

The year 2005 continued to witness a changing structural landscape in the banking sector. Following the flexibility granted to domestic banking groups to rationalise their commercial banking and finance company businesses, the industry underwent a transformation which saw the consolidation of retail banking businesses into a single entity. All ten domestic banking groups have completed the rationalisation exercise on schedule to benefit from the stamp duty and real property gains tax exemptions granted by the Government which ended on 15 January 2006. The successful completion of the rationalisation exercise allows for more efficient use of the banking groups' capital and resources, which in turn will strengthen the potential of the entities to meet the increasingly more differentiated expectations and sophisticated demands of their customers.

As financial needs grow in complexity and the demarcation of the roles and functions of financial institutions becomes increasingly blurred, further institutional transformation continues to take shape in the continuously evolving Malaysian financial landscape. One of the strategic initiatives aimed to further strengthen the capacity and capability of domestic banking groups to contribute towards economic transformation and to face the challenges of liberalisation is the development of full-fledged investment banks through mergers between merchant banks, stockbroking companies and discount houses. These financial market intermediaries currently undertake and offer similar products and services. The integration will enhance their efficiency and effectiveness by minimising duplication of resources and overlapping of activities, leveraging on common infrastructure as well as reaping the benefits of synergies and economies of scale. It will also further strengthen the potential and capability of domestic financial institutions to capitalise on business opportunities, increase their competitive advantage and widen the range of financial and advisory activities and thereby strengthen their potential to compete effectively with international investment banks.

The emergence of investment banks is aimed at enhancing the dynamism and vibrancy of the capital market to contribute towards economic transformation as well as enable market players to better face challenges of liberalisation and globalisation. Recognising this, the framework for investment banks has been formulated based on three main principles. Firstly, the framework aims to enhance the scope of activities for the merged entity where investment banks will also be allowed to undertake fund management and unit trust businesses in addition to the activities conducted based on the types of licences held prior to the rationalisation. Secondly, the framework seeks to enhance the capacity for growth and business expansion through industry-wide rationalisation. And finally, it aims to minimise the regulatory burden that may arise from dual regulatory regime. To facilitate the establishment of investment banks, incentives via stamp duty and real property gains tax exemptions as well as tax credits for accumulated losses of the financial institutions involved in rationalisation were granted to all entities that are involved in the transformation into investment banks within the given timeframe.

Bank Negara Malaysia announced the framework for creation of investment banks in March 2005. Under the framework, an investment bank can be formed via various merger permutations, namely, via merger of merchant bank and stockbroking company within the same banking group or merger of two stand-alone discount houses with a stockbroking company. To further enable the development of a more resilient, competitive and dynamic financial system, the framework was extended to allow universal brokers to be transformed into an investment bank, via the acquisition of a discount house. All financial groups have been given up to 30 June 2006 to undertake the rationalisation exercise.

Upon completion of the rationalisation process, an investment bank will hold both a merchant banking licence as well as a dealer's licence which are issued pursuant to the Banking and Financial Institutions Act 1989 and the Securities Industry Act 1983 respectively. Hence, investment banks will be co-regulated by Bank Negara Malaysia and the Securities Commission. Towards this end, a clear demarcation of roles between the two regulators has been established. The Central Bank will be responsible for the prudential regulations governing the investment banks to ensure that the safety and soundness of the financial system remains intact, as well as to protect the interest of depositors. The Securities Commission will be responsible for the business and market conduct of investment banks in order to promote market integrity and provide investor protection. To attain these objectives, Bank Negara Malaysia and the Securities Commission are currently finalising the details of a Memorandum of Understanding which outlines all specific aspects of the cooperation and consultation between the two regulators to ensure smooth and efficient coordination of roles and responsibilities with respect to the supervision and regulation of investment banks. Further to this, to ensure that the investment banks are manned by capable and competent workforce, all personnel undertaking functions related to dealing in securities, fund management, investment advice, and futures activities are required to pass the relevant examinations and be licensed as representatives prior to undertaking such activities, as imposed by the Securities Commission.

The framework for investment banks aims to strengthen the capacity of domestic financial institutions to capitalise on business opportunities, increase competitive advantage and widen the range of financial and advisory activities and thereby strengthen their potential to compete effectively with international investment banks.

Bank Negara Malaysia and the Securities Commission had on 1 July 2005, jointly issued the *Guidelines on Investment Banking* which details the requirements and processes to set up investment banks as well as the regulatory framework within which investment banks would operate. Policies were formed taking into consideration the inherent risks of the newly merged entity and the international regulatory framework for investment banks. The Guidelines set a minimum capital funds unimpaired by losses at RM2 billion on a group basis, for investment banks that are part of a domestic banking group and RM500 million for stand-alone investment banks. These stand-alone investment banks have to comply with the minimum capital funds requirement by 31 December 2008, failing which they would be granted a restricted licence which excludes the ability to undertake deposit-taking activities. Investment banks will also be subjected to the *Investment Bank Capital Adequacy Framework* (IBCAF), which is based on the existing capital adequacy framework applicable to banking institutions. All investment banks, except stand-alone investment banks that do not fulfill the minimum capital funds requirement, will be allowed to mobilise deposits with a minimum size of RM500,000. Nevertheless, it is envisaged that in the longer term, the investment banks would increasingly tap the capital market to meet their funding needs. Recognising that the participation of foreign investors can provide an impetus towards enhancing the capacity and efficiency of domestic institutions through the transfer of skills, expertise and technical know-how as well as providing access to international tie-ups, and in line with the gradual liberalisation approach adopted in Malaysia, the limit for foreign equity participation in investment banks has been set at a higher level of 49%.

As outlined in the FSMP, one of the key strategic initiatives towards enhancing the capacity and capability of domestic banking institutions is through the gradual introduction of a more competitive environment to act as a catalyst towards performance improvement. As players in the financial system, the locally-incorporated foreign banking institutions (LIFBs) have contributed significantly to the development and vibrancy of the financial sector through capital investment, creation of employment opportunities, facilitation of economic activities as well as transfer of skills and technology. Supported by extensive research capability and international operations network, the LIFBs have and continue to introduce new business models, using information technology to enhance their risk management and delivery channels, and set the bar for customer service quality. This has had spillover effects on the domestic financial institutions. This, coupled with the diagnosis of their areas of strengths and weaknesses, and areas requiring further performance improvements under the benchmarking exercise, have resulted in an overall improvement of the domestic banking institutions which in turn has contributed towards the enhancement of banking services in the country.

With the strengthened competitiveness of the domestic banking institutions, the LIFBs were granted with greater flexibility through the establishment of up to four additional branches. Given that domestic banking institutions have a large presence in non-urban areas to fulfil the socio-economic objective of ensuring that rural areas have sufficient access to banking services and to further enhance the dispersion of bank branches across the country, the flexibility granted are subjected to a predetermined ratio of the additional branches in the market centres, urban areas and non-urban areas.

In line with efforts to further enhance the ability to provide a comprehensive range of innovative financial products and services to compete more effectively in the marketplace, banking institutions have forged strategic alliances with other types of local and foreign financial institutions. This move has brought about the growth of bancassurance, asset and wealth management activities, as well as provided platforms for trade in foreign equities, fixed income securities and unit trusts. Further to this, many banking institutions have also capitalised on the flexibility accorded to outsource their non-core operational functions as a means towards achieving greater operational efficiency. The outsourcing functions are carried out by third party service providers or by specially established subsidiaries to provide services to entities within banking groups. In tandem with the global trend towards outsourcing, Malaysia has also benefited from the establishment of regional processing and outsourcing centres in the country which serve the region. This stems from the presence of conducive business environment, skilled workforce, strong global exposure and low set up cost in Malaysia. To date, four foreign banking institutions have set up regional processing centres in Malaysia with the total investment amounting to RM343.1 million whilst 5,243 jobs have been created as at end-December 2005. There has also been growing interest by other foreign partners, including non-banking entities to set up business process outsourcing centres in the country to serve their regional and global operations.

To facilitate greater product innovation, banking institutions were accorded greater flexibility with respect to the offering of investment-linked to derivative (ILD) products. The revised *Guidelines on Offering of Investment-Linked to Derivative Products*, which was issued in April 2005, enabled banking institutions to structure ILD products on any asset class, subject to the aggregate notional amount not exceeding 100% of its capital base. Previously, this requirement was accompanied by additional restriction of notional amount not exceeding 30% of capital base on each approved asset class. The revised Guidelines also allowed banking institutions to offer Ringgit-denominated ILD products linked to foreign asset classes. Further to this, the offerings of non-principal protected ILD products to investors are also allowed, as long as the risks of the product are clearly highlighted and investors are informed that their maximum loss potential is limited to the amount of principal invested. Additionally, the approval period for ILD products was reduced from 21 days to 14 days to enable faster time-to-market. In line with ongoing efforts to augment growth and market reach of ILD products in Malaysia, in February 2006, the Bank further liberalised various requirements of the earlier Guidelines. Under the latest revision, the limit on the aggregate notional amount of the ILD products offered by banking institutions was removed, thus enabling banking institutions to engage in ILD products with greater flexibility. In addition, to accord banking institutions with greater operational efficiency, the products offered are deemed to be approved upon submission to Bank Negara Malaysia, subject to meeting all conditions as stipulated in the Guidelines, which covered aspects of risk management, product characteristics, product marketing and classification as well as disclosure requirements and regulatory compliance.

To further enhance consumers' access to a wider array of financial services that are offered by commercial banks, additional flexibility was granted in August 2005 to enable commercial banks to conduct factoring services either within their bank or through a separate entity. The separate legal entity can be in the form of a fully- or partially-owned subsidiary or a joint venture with any other parties, including foreign parties.

Given the increasingly dynamic and competitive operating environment, the banking sector is continuously challenged to improve their operational efficiency and risk management practices. This includes managing their loan portfolio effectively and efficiently. To provide banking institutions with greater flexibility and options in managing their exposures, the Bank had, in December 2005, issued the *Guidelines on the Disposal/Purchase of Non-Performing Loans by Banking Institutions*. With the issuance of the Guidelines, banking institutions are now able to sell outright their NPLs to eligible third parties, namely domestic banking institutions, LIFBs, domestic and foreign investors. Additionally, banking institutions are also allowed to purchase NPLs from other banking institutions. With this flexibility, banking institutions are accorded with an additional option to manage their balance sheets and to reallocate resources towards strengthening their business potential and to generate higher rates of returns. It also enables banking institutions to undertake greater product innovation and releases resources for higher investments in human capital development and technological infrastructure, rather than managing distressed assets. To ensure that the flexibility does not expose undue risk to the participating banking institutions, the banking system and the consumers, the flexibility is subjected to certain general conditions and prudential requirements. One such general condition includes the requirement for the sale and purchase of NPLs to domestic or foreign investors which are not licensed institutions under the Banking and Financial Institutions Act 1989, to be conducted via a locally-incorporated special purpose vehicle (SPV) with foreign equity participation capped at 49%; aimed at nurturing and growing the local asset management industry. To ensure the proper conduct of the sale of NPLs, the Guidelines also set out the broad roles and responsibilities of the board of directors and senior management, as well as the legal requirements and regulatory processes to undertake such activities.

The availability of a highly competent workforce that is customer centric, technology-savvy, flexible and agile in the evolving financial sector will increasingly be the defining factor in determining the success of an institution and ultimately contribute towards building a more resilient and dynamic financial sector. In view of this, continuous enhancement to human capital resources and intellectual capabilities is critical to drive the performance of the financial sector, in particular the banking industry. The International Centre for Leadership in Finance (ICLIF) continued to be committed to providing leadership development programmes for leaders in the financial services sector. In 2005, ICLIF conducted two sessions of its Global Leadership Development Programme under its structured advanced leadership programme as well as various specialised learning programmes on scenario planning and strategic thinking, leading change, leadership innovation and the directors' forum.

In addition, as part of the strategic plan to formulate enhanced training and educational portfolios intended to upgrade skills and sharpen competencies as well as enhance managerial and organisational capabilities of the banking industry workforce to meet future challenges, Institut Bank-Bank Malaysia (IBBM) is currently developing a *Banking and Finance Industry Competency Framework*. The framework will provide the foundation to guide IBBM in the design of relevant technical programmes and assist institutions of higher learning to align their curriculum in order to meet the industry's human resource needs for a pool of highly talented professionals. Further to this, the framework consists of two key output, namely, the core competency, which comprises the key knowledge, skills and attitudinal attributes required for bankers and the technical competency, which outlines the expected technical knowledge, skills and attitudinal attributes required for key tasks in the major banking sectors. In formulating the framework, IBBM had conducted a high-level focus group discussion in December 2005 to deliberate on the Core Competency Framework. The focus group discussion was participated by chief executive officers of major banking institutions and leading academicians. The discussion contributed towards the gathering of holistic and balanced input and insights necessary to refine the Core Competency Framework and form the foundation for further work on the technical competency phase.

Continuing efforts to ensure a steady supply of highly competent graduates in the banking and finance industry led to the signing of a Memorandum of Understanding (MoU) between IBBM and Universiti Malaya on 21 July 2005. The MoU will pave the way towards the development and enhancement of knowledge and skills of undergraduates pursuing specialisation in banking and finance through the enhancement of the banking and finance programme by the University as well as industrial attachments or internship opportunities at banking institutions for the undergraduates. The strategic partnership offers an opportunity for both entities to build on each other's strengths for the common objective of enhancing the quality of the workforce in the banking industry.

Promoting Banking System Soundness and Stability

The presence of a sound and stable financial system is key in achieving sustainable economic growth and prosperity. Under the continuously evolving financial landscape and global integration of financial markets, it is critical for the financial system to remain responsive and capable in managing the multitude of risks that arise. As such, due attention continued to be accorded towards ensuring that the fundamental elements of a safe and sound financial system remain intact. These include having a comprehensive and effective monitoring and surveillance framework, the presence of strong and dynamic prudential regulations and supervisory oversight, as well as having an efficient financial infrastructure and reliable financial safety nets.

During the year, efforts continued to be directed to further strengthen the surveillance of the banking system. The ability to detect and assess emerging vulnerabilities is critical in order to deploy appropriate policy measures to prevent or contain emerging risks in a timely manner. In this regard, initiatives continued to be undertaken towards monitoring and assessing the resilience of the banking system using a combination of relevant financial and macroeconomic indicators, qualitative information as well as on- and off-site surveillance. Throughout the year, domestic macroeconomic and financial market developments and their linkages, the financial system performance and their implications on financial system stability; the performance of specific economic sectors, including the household and corporate sectors and their implications on the banking system, as well as potential impact of regional or global developments on the health of the Malaysian banking system were monitored and assessed. In addition, efforts to develop the capability and tools for a more comprehensive surveillance framework both at the system and institution levels, to identify, measure, assess and predict emerging vulnerabilities are currently underway. These include formulating appropriate methodologies for the models and enhancing the dataset used for modelling. Further to this, the framework on stress testing is currently being reviewed and enhanced to provide guidance to the banking institutions on the implementation of stress testing as a risk management tool within the institutions. The revised guidelines on stress testing will accord banking institutions with the flexibility to develop or adopt stress tests that are most appropriate and effective for their respective business models. Instead of prescribing fixed parameters for conducting the stress tests, banking institutions will identify the risk factors or characteristics which commensurate with the nature of their activities, scale of their risk factors and their risk management infrastructure.

The supervisory activities undertaken in 2005 were also premised on the objective of promoting financial soundness and banking system stability to support the Bank's vision of having in place a dynamic, competitive as well as a stable banking system. The Bank continued with a supervisory approach which focused on continuous surveillance to ensure safety and soundness of the banking institutions and undertaking pre-emptive measures to contain emerging risks in a timely manner.

Attention was accorded towards the identification of significant business activities of the banking institutions, assessing the key risks in each significant business activity and the capability of the banking institutions concerned in managing these risks. A comprehensive approach to supervision of financial groups was carried out to evaluate the capacity and capability of the group's risk management and internal control systems. Bank holding companies and other risk-taking entities within the group were also assessed to facilitate early identification of possible contagion risks to banking institutions within the group. This was further supported by information obtained from other regulators, both domestic and international, to provide a holistic assessment of financial groups.

Recognising the importance of information systems (IS) in the banking business particularly with respect to risk management, product development and delivery of customer service, it is imperative that the integrity and robustness of IS are maintained. In this regard, supervisory initiatives were focused not only on security and control aspects of the IS environment, but also the governance of IS activities by the board of directors and senior management. In cases where most of the IS operations of the banking institution were outsourced to service providers, the scope of examination was also extended to these service providers. This is to ensure that banking institutions have adequate oversight over the services extended by their service providers and that the standards adopted by the service providers were on par, if not better, than the standards applied to the in-house IS environment of banking institutions.

The minimum requirements and standards for planning and managing IS environment and for establishing IS risk management measures were specified in the *Guidelines on Management of IT Environment* which was issued in May 2004. In the course of carrying out on-site examinations in 2005, it was observed that most banking institutions have either complied with these minimum standards, or were making substantial progress in that direction. Some banking institutions had also put in place more stringent controls, consistent with the size and complexity of their respective IS environment. In 2005, the Bank also continued its efforts to strengthen the resilience of the Malaysian financial system in the event of unexpected developments. The requirements for banking institutions to formulate a *Business Resumption and Contingency Plan (BRCP)* and on its testing were also prescribed in the Guidelines.

Effective corporate governance practices that enhance corporate accountability are key elements in the working of market discipline and transparency. In line with the move towards a 'principle-based' regulatory framework, greater responsibility is placed on the shareholders and boards of banking institutions to ensure that their institutions operate in a sound and safe manner, within the parameters set by the Bank. The adoption of sound corporate governance standards and practices ensures that licensed institutions are managed in a safe and sound manner with appropriate balance between risk-taking activities and business prudence so as to maximise returns to shareholders whilst protecting the interests of all stakeholders. To steer the banking sector towards this objective, the Bank had issued the *Guidelines on Corporate Governance for Licensed Institutions (Revised BNM/GP1)* in September 2005 to replace the *Guidelines on Directorship in Banking Institutions (GP1)*. The revised Guidelines were formulated based on the fundamental concepts of responsibility, accountability and transparency. It also contains broad principles relating to board matters, management oversight and audit.

The revised Guidelines place significant emphasis on a board's roles and responsibilities for proper stewardship of its institution as well as to ensure that the policies and procedures adopted by the banking institution are sound and prudent, and are adhered to at all levels of the organisation at all times. This is achieved via rigorous and diligent oversight over the licensed institution's functions and affairs, which include ensuring that the institution establishes comprehensive risk management policies, processes and infrastructure as well as an effective internal audit review process. The board is also charged with the task of establishing corporate values, visions and strategies that will guide the activities of the licensed institution as well as being aware of the types of material financial activities pursued by the institution. The roles of independent directors were also enhanced to provide essential independence and objectivity to the board, ensure effective check and balance as well as mitigate any possible conflicts of interest. The supervisory approach and methodology adopted, which included interviews and assessments of individual directors' performance has contributed towards better corporate governance. There was more active participation among directors and increase in awareness on the expectations on board members in overseeing the operations of a licensed institution.

Other salient features of the revised Guidelines include a clear demarcation of roles between the chairman and the chief executive officer (CEO), as well as a clear separation between shareholders and management of the licensed institution. These are aimed at ensuring an appropriate balance of role, responsibility, authority and

The *Guidelines on Corporate Governance for Licensed Institutions* places significant emphasis on Board oversight, the role of independent directors and the clear separation between management and shareholders of banking institutions.

accountability among the decision makers as well as not to impede the practice of sound corporate governance. Additionally, to ensure effective leadership, fit and proper standards for directors and senior management were further tightened, taking into consideration factors which include competency, character, integrity and probity of the individuals. This is to enhance the level of competence and capability of the board as a whole in order to effectively discharge its duties to oversee and actively contribute to the overall strategic and operational direction of their banking businesses. Given the critical roles of the deputy CEO and chief financial officer in a licensed institution, the revised Guidelines specified that the Bank will complement the Nominating Committee of the licensed institution by conducting limited vetting on the proposed candidates for the respective positions to ensure that only qualified individuals filled those positions.

In an effort to further impart and enhance knowledge of directors of financial institutions on corporate governance issues, IBBM had conducted a *Directors' Programme on the Recent Revised Corporate Governance Guidelines* in November 2005. The objective of the programme was to keep board members well informed of the corporate governance objectives and standards which would add to their effectiveness while discharging duties and responsibilities.

In preparation for the implementation of Basel II, banking institutions conducted detailed gap assessments in 2005 to assess their readiness to adopt the new capital adequacy framework. The results of these assessments that were submitted to the Bank had provided valuable insights on industry's aspirations and key challenges faced in implementing Basel II. While most banking institutions did not foresee major problems adopting the standardised approach beyond system enhancements, many of them highlighted that the low level of penetration of external ratings would limit the potential benefits to be derived from the Standardised Approach.

The gap assessments were followed by a series of bilateral discussions that was also used by the Bank as input in the formulation of the detailed supervisory guidance. These supervisory guidance, to be issued in 2006, would specify the design and areas of customisation under both the Standardised and Internal Ratings Based (IRB) approaches for credit risk. For the Standardised Approach, the detailing and customisation of the framework would involve the review of specific parameters such as the risk-weight mapping and supervisory collateral haircuts to ensure that they reflect local experience, and produce capital requirements that are comparable to those banking institutions under the IRB approach for similar types of risk being undertaken. Similarly, the appropriateness of exercising national discretions needs to be assessed thoroughly such that the discretions would not substantially reduce the risk sensitivity of the framework.

As for the IRB approach, the focus has been on the interpretation of the operational requirements under the approach where sufficient consideration is needed on promoting the adoption of global best practices amongst domestic banking institutions. While the adoption of global best practices would be the desired long-term objective, setting these practices as the minimum benchmark may prove to be unrealistic and hence discourage migration to the IRB approach. A key element in the process of developing the IRB industry guidance is balancing the need for specific technical details and applying a principle-based framework in areas where market practice is still evolving. Guidance that are too prescriptive may result in banking institutions being confined to requirements which may not be appropriate for their business models.

The concept papers to be issued by the Bank in 2006 would also discuss on the implementation of the Basic Indicator Approach and Standardised Approach for operational risk. The results of an operational risk survey conducted by the Bank during the year revealed that many banking institutions have already put in place an operational risk management framework and have initiated operational risk data collection efforts. Guidelines on sound operational risk management practices would be issued in 2006 as a foundation for improving the overall level of operational risk management in the industry.

Data and Systems Challenges in the Implementation of Basel II

The complexity of Basel II continues to pose challenges in the implementation of the new capital adequacy standards among banking institutions and bank supervisors in the global financial system. Implementation issues and challenges have been widely discussed as banking institutions and bank supervisors seek to learn from each others' knowledge and experience. One area that had attracted wide attention is the data and system readiness of banking institutions as they move closer towards the implementation deadline of Basel II in their respective jurisdictions. Indeed, the credibility of the modelling process of the various risk parameters and hence the computation of minimum capital under Pillar 1 of the new accord depends very much on the quality of data and system architecture and infrastructure established by the banking institutions.

Underlying the complex regulatory requirements of Basel II is the expectation for banking institutions to have in place, robust systems and data management infrastructure that would enable sound risk management processes. A fundamental aspect of this is an enhanced data infrastructure that would allow banking institutions to extract information across the various systems in a consistent and timely manner. This would include having the capability to obtain a single and consolidated view of their borrowers or group of borrowers that enables effective monitoring of borrowers and segmentation of exposures into appropriate portfolios according to their risk profile. While most banking institutions have already captured the information on the various credit exposures of their borrowers, this information often resides in database systems which are not fully integrated. Hence, the process of extracting consolidated view of borrowers and obligors would be exposed to errors and inefficiency such as data inconsistencies and duplications. Systems integration that is required involves standardising the customer identifier of each borrower and firmly establishing the linkages between borrowers and all their related parties and the exposures to these parties. To obtain an accurate risk profile of the various credit facilities granted to a borrower or group of borrowers, systems that maintain information on the borrower and the related credit facilities must also be fully integrated with the collateral management system.

The integration of the various systems capturing information related to the borrower would not only provide a strong foundation for an effective credit risk management system but also support a more efficient business decision making process. With enhanced capacity to monitor their respective borrowers, banking institutions would be able to promptly detect any deterioration in the creditworthiness of the borrower or its related parties. The integration with the collateral management systems would also facilitate a more effective monitoring of collateral performance, particularly financial securities. Effective monitoring of such collateral will ensure that any reduction in their value would allow banking institutions to undertake appropriate action to mitigate the resulting increase in risk. At the borrower level, the overall view of the customer would enhance the ability of banking institutions to assess customer profitability, thus facilitating the marketing of new products to these customers. With the enhanced infrastructure, banking institutions will also be in a better position to undertake better product pricing, more accurate customer and portfolio profitability analysis and more effective portfolio risk management. From a strategic perspective, such information could also be used as vital inputs for the development of the banks' future business expansion strategy to the more profitable segments.

Besides systems capability, the acceptability of internal estimates of the various risk drivers such as the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD) for the computation of capital adequacy under the Internal Ratings Based (IRB) approaches would be dependent on the quality and adequacy of input data used by the banking institutions in the modelling process. Lack of data could potentially result in a model that is not adequately robust to provide consistent results for the purpose of capital computation. There would also be difficulties in validating the model if the sample size of defaulted borrowers is either too small or have not been appropriately captured. The requirement for data that covers a full economic cycle that is typically a minimum period of ten years, for purposes of modelling the risk drivers also poses a challenge for banking institutions. In this context, a key consideration for banking institutions and supervisors in Asia would be to deal with the impact of abnormally high default incidences and loss rates during the period following the Asian financial crisis in 1997-1998. While the impact would dissipate naturally as banking institutions populate their database with new data over time, banking institutions would still need to come to agreement with their supervisor on the adjustment methodology to normalise the impact of the crisis data during the initial period of Basel II implementation. The objective is to ensure that the regulatory capital is neither understated relative to the actual risks nor too excessive that it becomes very costly for the banking institutions to conduct their business.

In the context of delivering good model performance, the data collection process is equally important in ensuring data quality. Sound data management processes and procedures are critical to ensure that data is consistently captured and sufficiently accurate. Central to this is the need for banking institutions to establish clear lines of authority and accountability in ensuring that high data quality and integrity standards are observed at all times. This can only be achieved in an environment where the importance of having sound data quality management practices is acknowledged both by the top leadership as well as the various business units within the banking institutions.

Given the intensity of the internal data requirements under the advanced approaches for the computation of capital requirements for credit and operational risk, there has been a tendency to overlook the importance of external data in the implementation of Basel II. In general, external data such as the default studies published by external credit assessment institutions (ECAIs) as well as external credit and operational loss databases may provide useful insights and be used to facilitate the adoption of the advanced approaches. In the context of corporate credit model development in particular, default and credit migration studies from ECAIs may provide valuable input for purposes of benchmarking the output of the models with the experience of ECAIs with local corporates. The default experience of the ECAIs which are usually publicly available may be useful for banks to validate the appropriateness of their model output. The default studies published by the ECAIs can also facilitate the calibration of PD estimates to the internal rating scales. Banks intending to adopt the IRB approaches have been provided the option to map their internal ratings with the rating scales used by ECAIs and subsequently attach the PD estimates attributed with the rating scale to their rating grades. Nevertheless, an important consideration in this process is for banking institutions to ensure the consistency and relevance of these external data to their own internal portfolio, both in terms of rating definition and criteria.

The ECAI ratings also act as an indicator of the relative riskiness of a corporate borrower under the Standardised Approach and are therefore used as the basis for the capital computation. While this may be appropriate in many developed countries with high rating penetration, default information associated with ECAI ratings in emerging markets could be amplified by the smaller sample size of rated borrowers. The result of these structural constraints must therefore be taken into account by both banks and regulators in emerging markets when ECAI ratings are used for purposes of risk management and capital computation. In this context, the pooling of ratings information amongst regional ECAIs should be explored by regional supervisors as a long-term initiative to enhance the credibility of external ratings as the basis for the capital computation under the Standardised Approach.

Given the significance of having robust data and systems infrastructure for the successful implementation of Basel II, Bank Negara Malaysia will be issuing industry guidance on data quality management and management information systems in 2006. Whilst the guidelines will be outlining broad supervisory expectations relating to data integrity and effective management information system within banks, the expectations would be the basis for more specific data requirements to be issued by the Bank for Basel II implementation. In particular, the guidelines will be used by the Bank in its pre-validation assessment on data and systems capabilities for effective Basel II implementation.

In an effort to facilitate industry Basel II implementation efforts on data, the Bank is also exploring other industry-wide initiatives that can be undertaken to accelerate the progress made by banks. In this regard, the possibility of leveraging existing infrastructure like the Central Credit Reference Information System (CCRIS) and the Fraud Information Database System (FIDS) would be explored. The central credit repository system such as the CCRIS could be enhanced with a single borrower group identifier mechanism to facilitate the monitoring of risk concentration on borrowers and their related parties. The information could be shared and used by all banking institutions as benchmarks to ensure that information on borrowers and their related parties captured internally are accurate. The CCRIS could also be further enhanced with the inclusion of ratings on banking institutions' corporate customers, thus facilitating supervisory surveillance and the assessment of the robustness of internal ratings systems among banks.

An industry-wide collection of data on operational risk losses is another initiative where the Bank sees potential benefits for the industry over the long-term. In Malaysia, the existing platform such as FIDS for the capturing of industry data on fraud is only a small portion of operational risk loss data that would be required by banking institutions for the modelling of operational risk. Given the time taken to develop a meaningful operational risk database, the possibility of developing an expanded operational loss database at the national or even at regional level should be explored by banking institutions and supervisors to support further development in operational risk management within the Asia-Pacific region.

From a capacity building perspective, the need to ensure and maintain a high standard of data quality and system capability is not confined to banking institutions. Supervisors will also need to reassess their existing reporting infrastructure from banks given the extensiveness of data required for purposes of more rigorous supervisory monitoring and risk assessment. While there would be a need to enhance the supervisory reporting framework to meet this objective, the challenge for supervisors would be to raise the supervisory reporting standards without putting undue and unnecessary burdens on the banking industry. For Bank Negara Malaysia, investment in data and system capability would complement the continuing efforts and investment to develop specialised skills and expertise for the assessment of banks' internal models and risk estimates. The risk specialist's assessment would be a fundamental basis for making supervisory judgments on the credibility and robustness of the capital calculation process under Basel II environment.

During the year, the Bank also engaged a series of discussions with local external credit assessment agencies (ECAIs) in its process to finalise the criteria for recognition of ECAIs for the implementation of the Standardised Approach. On the international front, Bank Negara Malaysia continued to participate in active dialogues with home supervisors of foreign banking institutions to gain greater clarity on the approaches undertaken by these regulators whilst forging greater cooperation with them for the implementation of Basel II. The Bank has been particularly involved in the work of the Executive Meeting of East Asia Pacific (EMEAP) Working Group on Banking Supervision, focusing on Basel II related issues that are common among member countries, such as the recognition of ECAIs and home-host issues relating to the validation of internal models.

In addition to the initiatives that are being carried out towards preparing for the adoption of Basel II, continued efforts are also being channelled to strengthen the risk management practices of the industry. As banking institutions undertake more investment, trading and hedging activities, it becomes increasingly essential for them to take into account the impact and potential effects of movements in the financial market. In this regard and to complement the Basel II initiatives, the implementation of the *Market Risk Capital Adequacy Framework (MRCAF)* which was issued in September 2004, took effect in April 2005. This represented a significant shift towards explicit provision of regulatory capital for potential losses arising from activities that expose banking institutions to market risk. Further to this, the recent period has witnessed a significant expansion in loans extended by banking institutions for the purchase of residential properties. To ensure that such expansion is undertaken in a prudent manner and that sufficient capital is maintained to support this increased exposure, the risk-weight imposed on housing loans secured by first charge that have turned non-performing was increased from 50% to 100%. In addition to the regulatory changes, the Bank also focused its supervisory resources on assessing the adequacy of risk management systems and market conduct practices in household lending. Despite the incorporation of market risk capital requirements into the existing RWCR framework and the increased risk-weight for housing loan NPLs, banking institutions remained sufficiently capitalised with the RWCR maintained at levels well above the minimum requirement of 8%.

In recent years, banking institutions have begun to engage in more credit derivative transactions to hedge themselves against counterparty risks and to reduce capital requirements without affecting their existing commercial relationship with the counterparty. In tandem with efforts to promote sound risk management practices by banking institutions, Bank Negara Malaysia had issued the *Guidelines on Regulatory Treatment for Credit Derivatives Transactions* in September 2005 which specify prudential rules and regulatory capital treatment for the four most common types of credit derivative products, namely, the credit default swap, first-to-default basket, total rate of return swap and credit-linked notes. The regulatory capital treatment aims to ensure sufficient allocation of capital by banking institutions, either in their position as buyers or sellers of the credit derivative products. In addition, the products offered must be subject to approval by the Bank and be supported by a robust risk management framework.

Enhancing Infrastructure for Consumer Protection and Further Promotion of Consumer Education

In 2005, the thrust of the initiatives on consumer protection and education continued to be directed towards empowering consumers to be better positioned to take responsibility for their own well-being. The strategies adopted were two-pronged. Firstly, strengthening the consumer protection regulatory infrastructure and secondly, enhancing consumer education initiatives.

One of the key elements in building the foundation for an effective consumer protection as outlined in the FSMP is the setting up of an explicit deposit insurance system. Following the completion of the development of a deposit insurance framework which culminated in the passing of the Malaysia Deposit Insurance Corporation Act 2005, the Malaysia Deposit Insurance Corporation (MDIC) commenced its operations in September 2005. This significant milestone marked a change in the approach towards providing protection to depositors and augured well with the continuous objective of enhancing the financial soundness of banking institutions through the promotion of sound financial, business and risk management practices.

Under the deposit insurance system, explicit deposit protection is provided to eligible deposits up to the prescribed limit of RM60,000 per depositor, per member institution. This amount is inclusive of principal and interest. A separate coverage of the same amount is provided for Islamic deposits, accounts held under joint ownership and trust accounts, sole proprietorships and partnerships. It is envisaged that the level of coverage will provide full protection for up to 95% of depositors. In addition to its payout function, the MDIC will also, under certain specific circumstances, undertake the resolution of banking institutions, when the need arises.

Another central objective of consumer protection is to ensure that consumers are not disadvantaged amidst the move towards a more market-driven financial sector. In strengthening consumer protection, efforts were directed towards ensuring that the public continue to have access to basic banking services at reasonable costs. Towards this end,

The Deposit Insurance System in Malaysia

One of the significant milestones achieved during the year was the successful establishment of the Malaysia Deposit Insurance Corporation (MDIC) in August 2005. Malaysia now joins more than 95 countries that have explicit deposit insurance systems. The establishment of the MDIC further strengthens the consumer protection framework in Malaysia and represents a major step forward in the ongoing development of the Malaysian financial system through enhanced discipline and strengthened risk management practices of member institutions, in line with the recommendation outlined in the Financial Sector Masterplan. The deposit insurance system has been carefully designed to meet the needs of Malaysians, and in particular, to provide equitable coverage for conventional and Islamic deposits. As an important component of the safety net, the deposit insurance system complements the role and functions of Bank Negara Malaysia in preserving overall financial stability.

Mandate

The MDIC is an independent statutory body established under the Malaysia Deposit Insurance Corporation Act 2005 (MDIA) with mandates to:

(i) administer a deposit insurance system;
(ii) provide insurance against the loss of part or all deposits of a member institution;
(iii) provide incentives for sound risk management in the financial system; and
(iv) promote or contribute to the stability of the financial system.

In carrying out its mandates of (ii) and (iv), the MDIC is required to minimise cost to the financial system.

Membership

Membership in the deposit insurance system is compulsory for commercial banks (including locally-incorporated subsidiaries of foreign banks operating in Malaysia) licensed under the Banking and Financial Institutions Act (BAFIA) 1989 and Islamic banking institutions licensed under the Islamic Banking Act (IBA) 1983. Banking institutions that focus mainly on wholesale deposits, namely merchant banks, discount houses and investment banks are automatically excluded from membership. The branches of domestic banking institutions operating abroad and other deposit taking institutions namely, development financial institutions, provident and pension funds including the Employees Provident Fund and Lembaga Urusan Tabung Haji (Pilgrimage Fund Management Board) and cooperative societies are also excluded from the deposit insurance system.

Coverage

Deposits which enjoy deposit insurance coverage include savings, demand, fixed, Islamic deposits (general investment and special investment deposits), banker's cheques, bank drafts and other payment instructions. Deposits that are not payable in Malaysia, foreign currency deposits, negotiable instruments of deposit or other bearer deposits, repurchase agreements and money market placements are not insured by the MDIC.

Eligible deposits are insured for up to RM60,000, inclusive of principal and interest. This limit is applied per depositor per member institution. Separate coverage is available for deposits that are held jointly or in trust, and deposits of sole proprietorships, partnerships or professional practices.

Islamic deposits are accorded a separate coverage limit of RM60,000, inclusive of principal and return on deposit. This separate coverage limit ensures equitable treatment and no competitive distortion between conventional and Islamic deposits.

Reimbursement of depositors' claims

Where a member institution is unable to meet its obligations to its depositors, the MDIC is required to reimburse depositors up to the RM60,000 insured limit as soon as possible. Reimbursing depositors on a timely basis is crucial to maintain confidence in the financial system.

Funding

The deposit insurance system is funded by annual premiums assessed against member institutions based on total insured conventional or Islamic deposits held as at 31 December.

The MDIC maintains and administers two separate deposit insurance funds for conventional and Islamic deposits. Investments held in the Islamic Deposit Insurance Fund are made in accordance with Shariah principles.

Governance structure

The MDIC is governed by a seven-member Board of Directors, comprising:

- a Chairman;
- Governor of Bank Negara Malaysia;
- Secretary General of Treasury;
- a representative from the public sector; and
- not more than three representatives with relevant private sector experience and at least one with relevant banking and financial sector experience.

Members of the Board are appointed by the Minister of Finance, with the exception of the Governor and Secretary General. Directors, officers and employees of banking institutions which are members of the deposit insurance system and their related parties are not allowed to be represented on the Board to avoid conflict of interest and unfair access to confidential information. The Board of Directors is responsible for the conduct of the business and affairs of the MDIC and has a statutory duty to act in the best interests of the deposit insurer in accordance with its mandate.

Collaboration and coordination

Bank Negara Malaysia is the primary supervisory and regulatory authority responsible for maintaining overall stability of the Malaysian banking system while the MDIC administers the deposit insurance system in a manner that contributes towards promoting public confidence in the financial system.

As part of its supervisory functions, Bank Negara Malaysia performs examinations on the health of financial institutions and provides the MDIC with reports on their findings. As such the MDIC relies extensively on the information provided by the Bank for assessing its risks. In addition, Bank Negara Malaysia may advise the MDIC that a financial institution is no longer viable. Upon such advice, the MDIC is required to find a least-cost resolution to deal with the troubled member institution. This may involve a wide range of intervention actions, including assumption of control, applying for the appointment of a receiver or presenting a petition for the winding-up of that member institution. This power, however, is only triggered when the Bank makes such a determination.

As a result, close collaboration and coordination between Bank Negara Malaysia and the MDIC is crucial to ensure the effectiveness and efficiency of both organisations in meeting their mandates. The importance of such a relationship dictates that a strategic alliance agreement be executed between the two organisations to clearly set out how they will collaborate and coordinate their activities in fulfilling their respective roles and responsibilities, with the objective of mitigating unproductive overlap and duplication of efforts. Such an agreement will also provide a platform for Bank Negara Malaysia and the MDIC to engage in active and continuous consultations to achieve optimal outcomes.

Conclusion

The establishment of the Malaysian deposit insurance system strengthens the consumer protection framework in Malaysia. Great care was taken in its design to complement the role and function of Bank Negara Malaysia as the primary regulator and supervisor in promoting the safety and soundness of the financial system for the benefit of all Malaysians.

the Bank had in 2004, introduced the basic banking services framework which required the offering of a basic savings account and a basic current account to all Malaysians including permanent residents. Further to this, banking institutions were directed to automatically convert previously designated plain vanilla savings account into basic savings accounts (BSA) in August 2005. The mandatory conversion would facilitate greater banking inclusion of all segments of the community. Concurrent with efforts to ensure financial access was the emphasis on ensuring fair and equitable banking fees and charges. In recent years, in tandem with increasing technological innovation and consumer demand for more innovative products, banking institutions have made substantial investments on hardware and software infrastructure as well as product development to make available financial products and services that are aligned to consumer demands and which are more efficient, reliable and secure. To defray part of the costs of such investments, fees were levied on products and services provided. To ensure that the cost imposed is fair and equitable to both consumers and banking institutions, guidelines outlining the guiding principles for the imposition of fees and charges on banking products and services for individuals and, small- and medium-sized enterprises (SMEs) were issued in mid-2005. Banking institutions were required to ensure that their existing fees and charges framework complies with these guiding principles and prior approval of the Bank was required for new fees or charges to be imposed on customers.

Another important component of the consumer protection framework is to put in place the appropriate institutional arrangements to ensure that consumers have sufficient avenues to seek assistance and redress when they face problems with their financial institutions. In this regard, the Bank is establishing a Credit Counselling and Debt Management Agency (CCDMA) that will provide an avenue for individual borrowers and potential borrowers to seek advice on managing their credit and to equip them with the necessary skills to manage their finances. In addition, the CCDMA will also assist consumers to pro-actively manage their debts via customised debt repayment plans. This service is available for all debts relating to housing loan, personal loan, credit card, charge card and hire purchase that have been obtained by individuals from financial institutions regulated by the Bank.

The Credit Counselling and Debt Management Agency (CCDMA) enhances the avenues for consumers to seek redress and assistance in managing their finances.

Efforts to improve consumer literacy levels continued to be directed at addressing the issue of asymmetry of information through the publication and dissemination of information on retail banking products and services via the consumer education programme, BankingInfo. This program is currently in its fourth year of operation. During the year, two new booklets, *Current Account* and *Investing Your Money* were published. These publications aim at providing basic information

Establishment of the Credit Counselling and Debt Management Agency

An important part of the strategies implemented in the Financial Sector Masterplan has been the development of the consumer protection framework and the enabling infrastructure to protect consumers' interests while at the same time enhancing consumers' financial capability to participate effectively in the financial system. The agenda covers a wide spectrum of initiatives involving infrastructure and institutional development and includes financial education, advisory services, distress management, rehabilitation and putting in place avenues for redress.

In this respect, Bank Negara Malaysia has already put in place a number of institutional arrangements to ensure that consumers have sufficient avenues to seek assistance and redress when they encounter difficulties in their interface with financial institutions. These avenues include dedicated complaint units at banking institutions and an independent dispute resolution mechanism at the Financial Mediation Bureau. In addition, Bank Negara Malaysia Laman Informasi, Nasihat dan Khidmat has been established to act as a centralised point of contact to facilitate a rapid and effective response for members of the public in matters related to the financial sector. These institutional arrangements will be complemented with the establishment of a Credit Counselling and Debt Management Agency (CCDMA) which will provide individuals with money management and credit counselling as well as debt management services. Scheduled to be operational in April 2006, this institutional arrangement aims not only at providing advisory services but also assisting individuals who are encountering difficulties in meeting their financial commitments.

Private consumption in the Malaysian economy has strengthened over the years, supported by positive consumer sentiments and increased access to banks' financing, notably in the area of consumer loans. This trend has been accompanied by an increase in the level of household indebtedness. For a number of consumption-driven economies, household debts have exceeded prudent levels in the range of 80-100% of GDP. Household indebtedness of the banking sector in Malaysia has, however, remained within prudent levels at 61.5% of GDP. Strong debt servicing capacity is also reflected in the levels of non-performing loans of the household sector which remained stable at below 8% of total outstanding household loans as at end-2005, much lower than the peak of 12.2% as at end-1998. This trend is expected to be sustained with household lending continuing to record robust growth. While prudent lending and borrowing practices will continue to be promoted with concerted efforts at educating consumers on wise financial management, there will be cases where consumers are affected by unexpected developments or cases in which they have overstretched themselves financially and are unable to meet their obligations.

The establishment of CCDMA is part of the many efforts by Bank Negara Malaysia to proactively ensure that the household sector continue to be resilient by providing an avenue for existing and potential individual borrowers to seek advice and assistance on managing their credit while at the same time promoting a sound and robust banking system by facilitating debt repayment efforts and minimising incidence of non-payment arising from poor debt management.

The CCDMA will provide free credit counselling, education and debt settlement services to consumers. Credit counselling and education is important as individuals have to be equipped with the necessary skills and tools to manage their finances for long-term financial sustainability and to prevent a recurrence of such a situation. The CCDMA will also assist consumers to proactively manage their debt via out-of-court procedures based on agreed repayment plans between the creditors and the debtors. Eligible individual borrowers will have access to assistance in restructuring debts relating to housing loans, hire purchase, credit card, charge card and personal loans that have been obtained from financial institutions regulated by Bank Negara Malaysia[1]. Cases involving multiple creditors may be referred directly to CCDMA while borrowers with single creditor should refer their cases to CCDMA when they have failed to reach an amicable work-out plan with their creditors. Amongst the services offered by the CCDMA are:

Details of Services Offered by CCDMA

Type of Service	Description
Counselling and Advice on Financial Management	One-to-one counselling and advice that cover financial budget, money management and credit issues. Assistance will be provided to consumers in analysing their financial situation and identifying all options available to help them to get back on track.
Debt Management Programme	A personalised debt repayment programme designed to provide eligible borrowers with solutions for their financial situation. The programme will include review of current financial condition, development of tailored financial solutions in collaboration with borrowers and banking institutions. The programme also provides ongoing counselling and education to consumers throughout the life of the programme and serves as an alternative means of debt settlement through out-of-court procedures based on the agreed repayment plans between banking institutions and the borrowers.
Financial Education	Education programmes for consumers, in particular, on the proper use of consumer credit and basic money management skills such as savings and budgeting as well as tips on how to use credit responsibly and debt management.

The CCDMA will be governed by a Board of Directors of whom the majority are independent directors. The Agency will be staffed by independent and experienced counselors who are experienced in credit counselling and debt restructuring. The CCDMA is located at Level 8, Maju Junction Mall, Kuala Lumpur.

The establishment of CCDMA marks another milestone in the development of a comprehensive consumer protection infrastructure and will contribute positively towards sustainable development of the consumer sector. Much progress has been achieved in developing and strengthening the consumer protection and education framework that aims at promoting a fair, equitable and transparent financial market as well as active consumerism.

[1] The institutions are commercial banks, merchant banks, Islamic banks, selected development financial institutions, insurance companies, takaful operators and credit and charge card issuers.

and tips on current account and investment for individuals. In addition, two information guides, *Looking for Housing Loan* and *Basic Banking Services* were also published during the year to provide quick and easy reference guides for consumers. Simple checklists to enable consumers to do comparison shopping for retail banking products or services are also provided.

To further promote greater access to timely, reliable and accurate information as well as to minimise the cost of information search, comparative information on credit cards and hire purchase products were published in the comparative tables in the BankingInfo website. These tables contain up-to-date and pertinent information and provide a convenient point of reference for consumers. The tables also serve to promote transparency and drive greater competition amongst financial services providers. With the publication of these tables, the total number of tables published thus far stands at five. Currently, efforts are being undertaken to disseminate such tables in hard copy format to enable consumers without internet access to have access to such information.

The publication of consumer education materials was complemented by dedicated outreach programmes targeting groups such as women, college and university students as well as retirees. The outreach programmes seek to educate consumers on financial matters such as banking products and services, budgeting and money management. Women, particularly housewives, have been identified as one of the priority target audience under the programme in view of the important role they play in managing the finances of the household and their relative limited sophistication on financial matters. The outreach programmes targeted at college and varsity students were geared towards proactively equipping them with the requisite knowledge and skills to manage their finances prior to their entry into the work force while outreach programmes for retirees were targeted towards empowering them to take greater responsibility and control for their post retirement financial needs. In 2005, a total of 25 outreach programmes were conducted reaching a total of more than 4,000 participants in these three categories.

To further enhance interface with the public and as part of its corporate social responsibility, Bank Negara Malaysia had established the Laman Informasi Nasihat Khidmat (Bank Negara Malaysia LINK) in February 2005. The Bank Negara Malaysia LINK acts a one-stop reference point for the public to seek information and clarification on issues relating to policies and operations of the Bank and the financial sector as well as acts as one of the platforms for consumer education. It provides face to face interaction to walk-in visitors, including individuals and SMEs, on general enquiries and public complaints, hence enhancing the effectiveness and efficiency of information search. The Bank Negara Malaysia LINK also offers support to the Bank's SME Unit in various matters associated with access to financing by SMEs such as loan applications and restructurings as well as information on various special funds provided by the Bank and other government ministries or agencies. This will greatly increase the outreach capabilities of the Bank in its efforts to promote the development of the SME sector. Further to this, the Bank Negara Malaysia LINK provides another platform for the Bank to educate members of the public on their roles and responsibilities as consumers of financial products and services, with the aim of enhancing the level of financial literacy among the banking public. Information to the public and SMEs is made available via various channels, including exhibitions, interactive information kiosks and booklets. Since its inception, the response has been encouraging, with more than 36,000 visitors received up to end-February 2006. The bulk of the queries relate to banking and insurance, SME financing, credit information, on-line applications for exchange control approvals, returned and dishonoured cheques, and currency.

Bank Negara Malaysia participated in a number of exhibitions and seminars throughout 2005. These participations serve as an important means for understanding and addressing public concerns on financial matters, as well as disseminating the information published thus far. Publicity campaigns via advertisements in major newspapers and radio stations were also undertaken to promote greater consumer awareness of the consumer education programme. In 2005, a total of 1.2 million booklets were taken up by the public while the BankingInfo website recorded 14 million hits, bringing the total number of hits since its launch in 2003 to 31 million (2004: 1.2 million booklets and 17 million hits).

Bank Negara Malaysia also played host to the Third International Forum on Financial Consumer Protection and Education during the year, which was attended by 42 participants from 34 organisations worldwide. The forum, themed *Fostering Greater Consumer Education and Protection*, was aimed to provide a platform for regulators worldwide to share information and insights, discuss challenges and issues as well as work together towards developing best practice standards on consumer protection and education issues.

To complement the policy move towards enhancing consumer protection and in line with rising consumer expectations, the scope of supervisory activities in 2005 was also extended to include assessment of the banking institutions' code of conduct in promoting fair market practices, disclosure standards as well as effective dispute resolution mechanisms to ensure that consumers are treated equitably and have access to adequate and timely information to facilitate effective decision making.

Ensuring Continued Access to Financing

As a primary mobiliser of financial resources that are channelled from savers to the various segments of the economy, the banking sector continues to play an important intermediation role in ensuring continued access to financing for all segments of the economy. The banking system remained the largest provider of funds in the economy, with an increase in loans outstanding of 8.6% to RM558.1 billion in 2005. With the continued growth in consumer spending, the bulk of this increase were channelled to the households and SMEs, which recorded an expansion of 15.1% and 8.7% respectively in 2005. Lending activities throughout the year thus were supportive in meeting the requirements of the various sectors of the economy, with most sectors recording sustained growth in loan approvals.

With the introduction of the new interest rate framework in April 2004, banking institutions have been better able to price interest-based products efficiently, based on their respective cost of funding and business strategy. Since the introduction of the new framework, BLRs quoted by almost all banking institutions in 2005, have been maintained at the same level (prior to the revision of the Overnight Policy Rate). This reinforces the notion that banking institutions are offering competitive rates even before the introduction of the new framework. Additionally, the removal of the maximum lending spread of 2.5 percentage points above BLR facilitated the continued innovation by banking institutions to meet the increasingly complex and sophisticated demands of customers. Indeed, some banking institutions have introduced new innovative interest-based products, which include unsecured personal loans to individuals and SMEs.

Ensuring continued access to financing for priority sectors remains an important priority of the Bank. In line with the objective of providing financing to the priority sectors in the most efficient manner, banking institutions also have an important role to play. Recognising this and the need to balance social responsibility with operational efficiency, banking institutions were given the flexibility to set their own targets for lending to SMEs and lower income group for the purchase of residential properties, based on their respective capacity and business strategy. In 2005, the definitions used for various priority sectors were further refined. The threshold for the purchase of low-cost houses was lowered from RM180,000 to RM60,000, whilst the definition of SMEs was aligned with that of the National SME Development Council. To further promote Bumiputera entrepreneurship, at least 50% of the target set by banking institutions for SME lending must be channelled to Bumiputera SMEs.

Recognising the increasingly significant role of SMEs in the economy, various efforts are underway to enhance the contribution of SMEs to the growth of the economy. In addition to the realignment of functions and institutional structure of DFIs, banking institutions have launched two new trade finance products, namely, Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS), to the SMEs with the aim of encouraging greater SME participation in the export market by lowering the financing cost and removing the requirement for collateral. The credit risk associated with this type of financing will be shared between the participating banking institutions and the EXIM Bank. Further to this, the Bank will be establishing two venture capital funds of RM150 million each to promote the agriculture sector, particularly in the areas of integrated farming and fisheries, as well as biotechnology-related industries.

Completion of Financial Sector Restructuring Exercise

The year 2005 witnessed the conclusion of the institutional arrangements which were established to strengthen the resilience of the banking sector during the Asian financial crisis. The last of the three specialised institutions, Pengurusan Danaharta Nasional Berhad (Danaharta) wound up its operations on 31 December 2005, having successfully fulfilled its mandate of addressing the NPL problems faced by the banking sector in the aftermath of the crisis. Over its lifespan, Danaharta had effectively resolved all of the NPLs acquired and recovered a total of RM30.4 billion, which represent a final lifetime recovery rate of 58%. Of the total amount recovered, RM26.7 billion have been realised in cash whilst the remaining RM3.7 billion are in the form of residual recovery assets which include restructured loans, securities, properties and other non-cash assets. Danaharta has also successfully redeemed all of its zero-coupon bonds which carried a total face value of RM11.1 billion.

The lifetime cost of operating Danaharta is estimated to be RM1 billion. As such, out of the initial seed capital of RM3 billion allocated for the establishment of Danaharta, RM2 billion worth of assets, comprising RM1.5 billion worth of residual recovery assets and RM0.5 billion in cash, were returned to its shareholder, Minister of Finance Incorporated. With the closure of Danaharta's operations and transfer of the control of assets to the Minister of Finance Incorporated, the latter had established a wholly-owned subsidiary, Prokhas Sdn. Bhd., on 1 January 2006 to act as the collection agent for the residual recovery assets and to convert these assets into cash at the best possible value.

All in all, the cost incurred by the Government for the financial sector restructuring efforts through Danaharta and Danamodal Nasional Berhad (recapitalisation agency) amounted to RM12.6 billion or 2.5% of the nation's gross domestic product. This is expected to decline further as a result of prospective returns from the remaining investments. The successful completion of the financial sector restructuring exercise has moulded a strong foundation for future development efforts to ensure that the banking sector remains effective and capable of meeting the changing demands of an evolving economy.

Moving Forward

In responding to the continuously evolving financial landscape as well as changing customer requirements and sophistication, significant efforts will continue to be directed towards the ongoing dynamic transformation of the domestic banking system into one that has the capacity and agility to withstand shocks and survive the increased financial market volatilities. With the second phase of the FSMP well underway, banking institutions will progressively face greater competition, both from within the banking sector and from non-bank financial institutions as well as the capital markets. The challenges of a more liberalised and deregulated environment necessitates the formulation and execution of coherent enterprise-wide strategies by banking institutions, coupled with intensifying efforts to enhance efficiency, productivity and innovation to ensure sustainable performance. In this regard, policy initiatives will continue to be centred on enhancing the dynamism and resilience of the banking system whilst ensuring the preservation of financial stability and protection of consumers, while at the same time ensuring the continued effective intermediation by the financial sector.

Banking Measures Introduced in 2005

In 2005, several initiatives were undertaken to strengthen the resilience of the financial system and to promote efficiency and competitiveness of the banking industry. In addition, measures were also undertaken to enhance consumer protection and public confidence in the banking sector.

Enhancing Safety and Soundness of the Banking System

❏ ***Risk-Weighted Capital Ratio Framework – Amendment to Risk Weight for Housing Loans Secured by First Charge***
To enhance the risk sensitivity of the existing capital adequacy framework, Bank Negara Malaysia revised the risk weight for non-performing housing loans secured by first charge from 50% to 100% in March 2005. The revision would ensure that banking institutions continue to maintain sufficient capital to support the expansion of financing for the purchase of residential properties.

❏ ***Guidelines on Electronic Broking System by Licensed Money Brokers***
The Guidelines were issued in August 2005 to ensure that the electronic broking system offered by money brokers operate in a manner that promotes the overall integrity and stability of the financial market. It also sets out regulatory processes, procedures, conditions, operational as well as regulatory requirements for operating an electronic broking system.

❏ ***Guidelines on Corporate Governance for Licensed Institutions (Revised BNM/GP1)***
As part of the ongoing efforts to enhance corporate governance among licensed institutions, the *Guidelines on Corporate Governance for Licensed Institutions* were issued in September 2005 to replace the *Guidelines on Directorships in the Banking Institutions*. The Guidelines prescribe broad principles and minimum standards as well as specific requirements for sound corporate governance, which licensed institutions and bank/financial holding companies are expected to adopt. The revised Guidelines are based on the fundamental concepts of responsibility, accountability and transparency, with greater emphasis on the role of the board and management. Amongst the key changes of the revised Guidelines are:

- Separation of the roles of Chairman and CEO;
- Separation between shareholders and management;
- Enhanced role and composition of independent directors. At least one-third of the board members must be independent directors and they are expected to display strong elements of independence on the board both in thought and actions;

- Establishment of three new board committees, namely the Nominating Committee, Remuneration Committee and Risk Management Committee; and
- Limitation on the number of Executive Director to not more than one.

❏ ***Guidelines on Regulatory Treatment for Credit Derivatives Transactions***
The *Guidelines on Regulatory Treatment for Credit Derivatives Transactions* were issued in October 2005, to specify the capital adequacy treatment for credit derivatives transacted by banking institutions licensed under the Banking and Financial Institutions Act 1989 (BAFIA). The Guidelines specify regulatory capital treatment for the four most common types of credit derivatives products, namely, the credit default swap, first-to-default basket, total rate of return swap and credit linked notes that are recorded in either the banking book or the trading book. Banking institutions that engage in credit derivatives transactions are required to obtain specific approval from Bank Negara Malaysia under the product approval process as set out under the *Guidelines on New Product Approval Requirements*, with the exception of products that are transacted based on common templates already approved by the Bank.

Promoting Competition and Efficiency within the Banking Sector

❏ ***Guidelines on Base Lending Rate, Lending Rates and Deposit Rates of Banking Institutions***
Effective March 2005, fixed deposits placed by corporations or large business enterprises and non-residents are on a negotiated basis regardless of the amount placed, hence contributing towards a more market oriented pricing environment for depositors. Other categories of depositors including individuals and small medium enterprises (SMEs) however will continue to be eligible for the Board rates for deposits up to RM1 million.

❏ ***Guidelines on Offering of Investments Linked to Derivative (ILD) Products***
In line with the effort to increase choices of ILD products for eligible investors, Bank Negara Malaysia added to its list, yield-enhancing investment products linked to foreign currency, commodities, equity and fixed income derivatives in April 2005. As the list of products expanded, *Guidelines on Offering of Investments Linked to Derivative Products* were issued to replace *Investments Linked to Derivatives Guidelines* issued on 12 May 2003. The Guidelines were further enhanced in February 2006 to incorporate the following changes:

- The cap on aggregate outstanding notional amount of ILD products offered to investors was removed; and
- 'File and Use' approach adopted for submission of applications pertaining to ILD products whereby ILD products are deemed approved upon submission to Bank Negara Malaysia subject to compliance with specified conditions in respect of risk management, disclosure, marketing and type of products offered.

❏ ***Investment in Units of Property Trust Funds and Unit Trust Funds***
Effective 20 May 2005, licensed banking institutions are allowed to invest in both property trust funds and unit trust funds, provided that:

- The investment shall not exceed 5% of the issue size of the fund or 5% of the licensed banking institution's capital funds, whichever is lower;
- The aggregate value of all such investments shall not exceed 10% of the licensed banking institution's capital funds; and
- The aggregate value of the investment in shares and interest-in-shares, unit trust funds, property trust funds and immovable properties does not exceed 50% of the licensed banking institution's capital base.

❏ ***Guidelines on Investment Banks***
Pursuant to Section 126 of BAFIA 1989 and Section 158 of the Securities Commission Act 1993, Bank Negara Malaysia and the Securities Commission (SC) jointly issued the Guidelines on Investment Banks on 1 July 2005 that specify the requirements, processes and regulatory framework for investment banks.

All financial groups involved were given a one-year period, commencing 1 July 2005 to be transformed into investment banks. In facilitating this process, the Government agreed to grant stamp duty and real property gains tax exemptions and tax credits for the accumulated losses of the acquiree financial institutions involved in the rationalisation. Foreign equity participation for investment banks was also increased to 49% to facilitate greater transfer of skills, expertise and technological know-how to the investment banks.

❑ ***Guidelines on Access to Interbank Market by Universal Brokers***

As part of the measures to strengthen the capacity and competitiveness of universal brokers, universal brokers that meet the following eligibility criteria were allowed to access the interbank market to undertake borrowing or lending of RM funds:

- Minimum shareholders' funds unimpaired by losses of RM100 million;
- Strong capital position as measured by capital adequacy ratio (CAR) imposed by Bursa Malaysia (Bursa);
- Satisfactory conduct of current credit facilities obtained from banking institutions; and
- Compliance with prudential and financial regulations imposed by SC and Bursa.

The Guidelines also stipulate the prudential requirements for universal brokers who wish to participate in the interbank market. The main requirements are as follows:

- Limit on aggregate interbank borrowings not exceeding two times its shareholders' funds, unimpaired by losses;
- A robust and effective risk management framework to identify, measure, monitor and manage risks; and
- A sound liquidity management framework that encompasses strategies to manage funds, ability to match near and short-term liquidity requirements and maintenance of sufficient credit lines, liquefiable assets in managing potential shortfall in liquidity.

These universal brokers are also allowed to borrow securities from the Bank via the repo arrangement to enhance their securities broking activity and will be subject to examination by the Bank and SC, where appropriate.

❑ ***Provision of Factoring Services by Commercial Banks***

With effect from 10 August 2005, all commercial banks are allowed to provide factoring services either as part of their commercial banking business or through a separate legal entity. The separate legal entity can be in the form of a fully or partially owned subsidiary or a joint venture with any other parties, including foreign parties. This is to encourage competition and participation of banking institutions in areas currently served by fringe institutions.

❑ ***Guidelines on the Disposal/Purchase of Non-Performing Loans (NPLs) by Banking Institutions***

To allow banking institutions greater flexibility in managing their balance sheets and in reallocating resources to strengthen their business potential and competitiveness, *Guidelines on the Disposal/Purchase of Non-Performing Loans (NPLs) by Banking Institutions* were issued in December 2005. The Guidelines allow banking institutions to undertake outright sale of their NPLs to eligible third parties, as well as to purchase NPLs from other banking institutions. It also specifies general conditions, requirements and processes as well as roles and responsibilities of the Board of Directors and senior management of banking institutions that wish to undertake such sale or purchase. The Guidelines prescribe that NPLs can only be sold to domestic banking institutions or locally incorporated foreign banking institutions in Malaysia, domestic investors or foreign investors through Special Purpose Vehicles (SPVs) with foreign equity participation capped at 49%. All NPLs sold to eligible third parties must be on a non-recourse basis.

❑ ***Establishment of New Branches by Locally-Incorporated Foreign Banks***

In line with the broad strategies outlined in the Financial Sector Masterplan, locally-incorporated foreign banks (LIFBs) are allowed to establish up to four additional branches within a period of one year with effect from 1 January 2006 subject to specified conditions. This operational flexibility represents the first of a phased approach of branch liberalisation. LIFBs are however, required to seek Bank Negara Malaysia's prior approval for the establishment of the new branches.

Enhancing Consumer Protection

- ***Imposition of Fees and Charges on Banking Products and Services***
  As part of the measures to ensure access to banking services and to ensure that fees and charges levied are fair and equitable to both banking institutions and consumers, guiding principles were issued relating to the imposition of fees and charges for banking products and services. Banking institutions are required to ensure that their existing fees and charges comply with these principles and prior approval from Bank Negara Malaysia is required for any upward revision of existing fees and charges or for any introduction of new fees and charges imposed on individuals and/or SMEs.

- ***Access to Financing by Priority Sectors***
  As in previous years, Bank Negara Malaysia continues to place emphasis on lending by banking institutions to the priority sectors, namely SMEs, bumiputera SMEs and low cost houses costing RM60,000[1] and below. Targets on new loans approved were set for the compliance period 1 January 2006 - 31 December 2007 based on various factors taking into account the capacity of the respective institutions. In addition, the interest rate charged by banking institutions for housing loans granted under the Guideline, namely low cost houses costing RM60,000[1] and below has also been capped at BLR + 1.75%.

- ***Basic Banking Services***
  To ensure that all customers have access to banking services, under the Basic Banking Services (BBS) framework, all banking institutions that did not offer automatic conversion for previously designated plain vanilla savings account into Basic Savings Accounts were required to automatically convert all such accounts with effect from 1 September 2005.

- ***Comparative Tables on BankingInfo***
  In December 2005, Bank Negara Malaysia expanded the scope of comparative tables to cover banking retail products on its consumer education website, BankingInfo. These tables allow consumers to perform comparative shopping and is part of the efforts to promote greater access to information and to encourage more informed decisions on managing their finances by consumers.

[1] For Sabah and Sarawak, the purchase price of low cost houses are capped at not more than RM72,000.

PERFORMANCE OF THE BANKING SYSTEM

Overview

Resilience of the banking system strengthened further in 2005 amidst favourable macroeconomic conditions with the key financial soundness indicators exhibiting encouraging trends. The banking system's exposure to the household sector remained within prudent levels and does not represent a threat to the overall systemic stability of the system. Key developments in the financial performance of the banking system are summarised as follows:

- The level of capitalisation remained above 13% amidst strong expansion in asset base and continued strong profit performance;
- The quality of the loan portfolio continued to improve, underpinned by lower incidence of new NPLs, higher reclassification of NPLs to performing status and recoveries. Specifically, the NPL ratio of the business sector declined further whilst the NPL ratio of the household sector remained relatively stable;
- Lending activities remained robust, driven primarily by lending to the retail sector in an environment of greater competition; and
- Exposure to market risks remained manageable.

Profitability

The banking system continued to record a strong profit performance in 2005 underpinned by favourable macroeconomic conditions and financial markets. Preliminary unaudited pre-tax profits for the year amounted to RM12.4 billion, an increase of 7% over the level achieved in the preceding year. Reflecting the continued diversification in business portfolio of banking institutions, growth in profits was driven mainly by higher revenue derived from lending and financing activities, sale of wealth management products, provision of remittance services as well as trading and investment activities. The higher profit was achieved amidst continuing efforts by banking institutions to further strengthen their balance sheets. As a result, return on average equity improved to 16.9%. Meanwhile, return on

Table 5.1
Banking System[1]: Income and Expenditure

	For the calendar year			
	2004	2005*p*	Annual change	
	RM million			%
Interest income[2]	40,755	43,757	3,002	7.4
Less: Interest expense	20,591	22,057	1,466	7.1
Net interest income	20,164	21,701	1,536	7.6
Add: Fee-based income	4,229	4,684	455	10.7
Less: Staff cost	5,662	6,309	647	11.4
Overheads	6,427	7,008	581	9.0
Gross operating profit	12,305	13,068	763	6.2
Less: Loan loss and other provisions	4,587	5,476	889	19.4
Gross operating profit after provisions	7,718	7,592	-125	-1.6
Add: Other income	3,852	4,788	936	24.3
Pre-tax profit	11,569	12,380	811	7.0
Of which:				
Commercial banks[3]	10,679	11,006	328	3.1
Merchant banks	814	1,340	526	64.6
Islamic banks	76	34	-43	-56.1
Return on assets (%)	1.4	1.4		
Return on equity (%)	16.3	16.9		
Cost to income[4] (%)	49.6	50.5		

[1] Includes Islamic banks.
[2] Effective January 2005, banking institutions no longer accrue interests on non-performing loan accounts.
[3] Includes finance companies.
[4] Only taking into account staff cost, overheads, net interest income and fee-based income.
p Preliminary
Note: Total may not add up due to rounding.

average assets remained unchanged at 1.4%, following corresponding increase in total assets during the year.

Gross operating profits for the year rose by 6.2% to RM13.1 billion on account of higher income from interest-related and fee-based activities. Net interest income grew 7.6% driven largely by the growth in interest income from loan and financing activities (+RM1.3 billion or 4%) despite competitive lending conditions, coupled with higher net income from interbank activities. The growth was, however, moderated by an increase in interest expense incurred during the year on deposits (+RM0.9 billion or 6.2%) in tandem with the higher amount of customer deposits accepted. Consistent with the strong expansion in lending activities, driven particularly by the retail segment, interest income as a percentage of interest-related assets increased by 11 basis points to 5.35 percentage points.

Competition in the lending market, particularly in the continuing buoyant retail segment, resulted in further reduction in the average lending rates during the year. The lending rates for new loans to consumers (excluding credit cards) averaged at 4.09% per annum in December 2005 (4.34% per annum in December 2004). The average lending rates on new passenger car loans recorded the most apparent reduction, falling by 219 basis points from 6.53% per annum in December 2004 to 4.34% per annum in December 2005. Consequently, gross interest margin of the banking institutions (measured as the difference between interest income and interest expense, expressed as a percentage of interest-related assets) remained almost unchanged at 2.65 percentage points. This was partly due to the higher base lending rate of banking institutions following the increase in the Bank Negara Malaysia Overnight Policy Rate in November 2005 which saw the 3-month KLIBOR rates trending upwards by 40 basis points to 3.20% per annum as at end-December 2005.

Revenue generated from fee-based activities posted a strong growth of 10.7% during the year, as a result of higher sales of wealth management products such as unit trust and bancassurance, and an increase in remittance services provided by banking institutions. Similarly, there was higher fees received from trade-related activities, such as guarantees and commissions from the issuance of bankers acceptances, following the growth in lending. Meanwhile, the greater usage of cards for purchases and other transactions has also contributed to the higher fee income of banking institutions. For the year as a whole, fee-based income for the commercial banks and finance companies as a group registered an increase of 11.1% to account for 17.3% of gross operating income.

Income derived by the merchant banks from fee-based activities, on the other hand, recorded a marginal decline of 0.4% to RM0.3 billion. Whilst higher income was generated from the extension of loans and financing, this was partially offset by a moderation in income from corporate advisory services. However, fee-based

Table 5.2
Weighted Average Lending Rates for New Loans

	Commercial banks	
	Average for December (% per annum)	
	2004	2005
Business loans	5.64	5.70
of which: SMEs	*6.20*	*6.36*
Household loans[1]	4.34	4.09
of which:		
Purchase of residential properties	*3.08*	*3.15*
Purchase of passenger cars	*6.53*	*4.34*

[1] Excludes credit card.

income remained as the major contributor to operating income of merchant banks, accounting for 44.7% of total income in 2005. With the creation of investment banks, competition in fee-based activities is expected to intensify, thus adding further pressure on revenue sustainability of the merchant banks. Meanwhile, revenue generated from trading and investment activities recorded a marked increase of 116.6%.

Although the banking system continued to incur substantial amounts in staff-related costs and improvements in IT systems and business processes during the year, the ratio of staff cost and overheads to gross operating income rose marginally to 50.5%. Such expenditures were necessary to enhance prospects for further business expansion and to retain existing talents and attract new skills into the industry given the growing mobility of labour. Investments in the acquisition and development of skills have been made to enhance the productivity and profitability of banking institutions. The banking institutions were able to generate RM2.10 in operating profits for every ringgit spent on their personnel. Meanwhile, the increase in overheads reflected the pursuit of aggressive marketing and sales strategies adopted by several banking institutions. Collectively, expenses incurred on marketing, administration and other general expenses accounted for 60.2% of total overhead expenses compared with 57.7% in 2004.

The encouraging business and operating environment and improving financial positions amidst favourable economic outlook have provided the impetus for banking institutions to continue to pursue balance sheet strengthening strategy. During the year, the banking sector set aside loan loss provisions totaling RM11.4 billion comprising specific provisions of RM9.7 billion (+9.8%) and write-offs of RM0.3 billion (+216.4%). Reflecting the higher provisioning amount, net interest margin (difference between interest income and interest expense minus overheads and provisions as a percentage of interest-related assets) showed a small decline of seven basis points to 0.37 percentage point in 2005. With this pro-active move by banking institutions, and the resultant strengthening of the balance sheets, the banking sector is better positioned to continue supporting economic developments and activities in the future.

Lending Activity

Lending activities of the banking system remained strong in 2005, supported by sustained economic growth and the resilient financing demand by both businesses and households. Strengthened resilience amidst favorable financial performance and improved asset quality had enabled the banking system to continue to meet the increased financing requirements by both the business and household sectors, thus contributing towards supporting the growth in business activity and private consumption. Meanwhile, the market lending rates remain competitive with rates on new loans by the commercial banks ranging between 5.62% to 6.23% per annum and 6.23% to 7.39% per annum for finance companies.

Their strengthened position has enabled the banking sector to continuously meet the increased financing requirements of the business and household sectors, thus contributing towards supporting the growth in business activity and private consumption.

The demand for financing continued to register an upward trend, with loan applications received by the banking institutions increasing by 11.7% to RM305.4 billion in 2005. New loan approvals remained relatively stable with

Table 5.3
Banking System[1]: Financing Activities

	For the year		Annual growth (%)
	2004	2005	
	RM billion		
Loan approvals	173.6	193.4	11.4
Loan disbursements	488.2	529.3	8.4
Loan repayments	461.6	489.2	6.0
	As at end-		Annual growth (%)
	2004	2005	
	RM billion		
Outstanding loans	513.9	558.1	8.6
Total banking system financing[2]	547.0	594.0	8.6
Total financing for the economy[3]	671.5	733.6	9.3

[1] Includes Islamic banks.
[2] Outstanding banking system loans plus private debt securities held by the banking system.
[3] Outstanding banking system loans plus outstanding private debt securities.

new loans approved expanding by 11.4% to RM193.4 billion to more than 3 million applications. On average, RM16.1 billion new loans were approved monthly in 2005 compared with RM14.5 billion recorded in the preceding year. With continued expansion in private sector activities, total disbursements rose by 8.4% to RM529.3 billion, mainly attributable to the drawdown by the manufacturing sector, which accounted for 24% (RM127 billion) of total disbursements. Meanwhile, undrawn loans increased by 7.9% to RM170.9 billion, much lower than the preceding year's increase of 16.7%, attributed mainly to unutilised credit card lines. As disbursements surpassed repayments, total outstanding loans rose strongly at an annual rate of 8.6% to RM558.1 billion as at end-2005. Total holdings of private debt securities (PDS) by banking institutions increased by 8.5% in 2005, compared with a decline of 3.1% in 2004. As a result, aggregate financing by the banking sector to support economic activities increased by 8.6%.

Lending to households

Outstanding household loans expanded by 15.1% in 2005 to RM304.4 billion, to account for 54.5% of outstanding loan portfolio of the banking system. Stable labour market conditions, increasing disposable income and attractive financing options contributed towards stronger consumer spending, hence stimulating demand for new financing as reflected by an 18% increase in loan applications received from individuals or 46.5% of total loan applications received by the banking sector. Total loans approved grew by 12% to RM97.2 billion, or 50.3% of total loans approved by the banking system during the year, whilst loan disbursements recorded a corresponding increase of 11.4% to RM145.2 billion, or 27.4% of the total disbursements in the banking system. Unutilised loans within this sector grew by 17.2% to RM79.5 billion, accounting for 46.5% of the total unutilised loans within the banking system. The increase in unutilised loans was mainly due to a higher increase in unutilised credit card lines, attributed to a larger number of credit cards issued and higher approved limits granted by the banking institutions to cardholders.

[A detailed analysis of lending to households is provided under sub-topic "Exposure to the Household Sector" in this chapter.]

Lending to businesses

Lending to businesses remained resilient in 2005, reflecting the stronger private sector investment and business activities during the year. Demand for new financing by businesses grew by a more moderate rate of 5.7% to RM158.5 billion in 2005 (2004:20%). The slower growth in new business loans was mainly attributable to a decline in loan applications from the construction sector, as well as slower increase in applications from the manufacturing sector and the wholesale and retail trade, restaurants and hotels sector. Notwithstanding the more moderate increase in loan applications, growth in new loan approvals was stable. Total loans approved increased by 9.8% to RM93.2 billion, accounting for 48.2% of total approvals within the banking system. Loan approvals to businesses were broad-based with 50.2% or RM46.8 billion of new loans approved were channelled to manufacturing, wholesale and retail trade, restaurants and hotels and construction sectors. Notably, loan approvals to the agriculture sector recorded a significant growth of 80% to RM5.2 billion.

Disbursements to the business sectors increased by 7.4% to RM360.1 billion, accounting for 68% of total loans disbursed by the banking system, of which 72.3% or RM260.2 billion were channelled to the manufacturing, wholesale and retail trade, restaurants and hotels and finance, insurance and business services sectors as the service and manufacturing sectors continue to benefit from strong consumer spending and higher exports of manufactured goods. As disbursements were relatively higher compared with repayments, total outstanding loans to the business sector expanded by 2.9% to RM225.6 billion as at end-2005. Meanwhile, total unutilised loans increased marginally by 0.2% to RM87.4 billion.

Lending to SMEs

The banking sector continued to support the financing needs of the SMEs with lending to SMEs continuing to drive growth of loans to businesses. Total outstanding loans to the SMEs expanded strongly by 8.7% to RM96 billion as at end-2005 to account for 42.6% of loans to businesses or 17.2% of total outstanding loans. Reflecting the increasing financing needs of the SMEs, the banking system received loan applications from more than 100,000 SMEs totaling RM59.7 billion, a 10.3% increase from the previous year. Advancement in credit analysis, assessment tools and methodologies, enhanced access to current customer information and the liberalisation in the pricing framework facilitated the increased provision of financing to the SMEs. During the year, RM35.8 billion new loans were approved to more than 85,000 SMEs, at lending rates which averaged between 5.72% to 6.43% per annum for the commercial banks. The approval rate was higher at 59.9%, whilst rejections remained low, constituting 18.5% of the total applications received from the SMEs. Loan disbursements were also higher. During the year, RM110.7 billion were disbursed to the SMEs, an increase of 10.2% from the preceding year, constituting 30.7% of the total disbursements to the business sectors. On a sectoral basis, lending to SMEs was generally diversified with almost two-thirds being channelled to the wholesale and retail trade, hotels and restaurants, manufacturing and construction sectors, reflective of the business focus of the majority of the SMEs.

With capacity building initiatives for SMEs in the pipeline, measures to enhance access to financing such as the establishment of the SME Bank, securitisation of SME loans, the introduction of new trade financing products for SMEs as well as the establishment of SME Portal will further improve access to financing for SMEs. This would encourage further lending by banking institutions to SMEs. In addition, in response to strong demand on SME special funds allocated by Bank Negara Malaysia, Fund for Small and Medium Industries 2 and New Entrepreneurs Fund 2 were further increased by RM250 million and RM350 million respectively. On aggregate, Bank Negara Malaysia has allocated a total of RM8.9 billion for the special funds for SMEs. Of this, a total of RM11.2 billion has been approved as at end-2005.

Financing through the bond market

The bond market sustained its growth momentum in 2005. A total of RM35.7 billion of PDS was issued, an increase of 27.1% compared to 2004, mainly by the utilities, construction and finance, insurance, real estate and business services sectors which accounted for 74.3% of total issuance. As a result, outstanding PDS in the market rose by 11.4% to RM175.6 billion as at end-2005. Total financing channelled to the economy, which included lending by the banking institutions, expanded by 9.3% to RM733.6 billion.

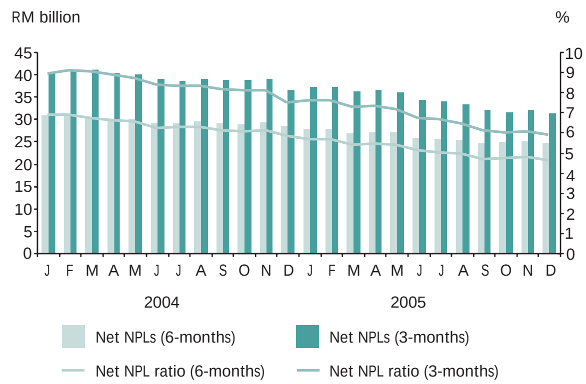
Asset Quality

Amidst sustained economic performance, the loan quality of the banking system improved further in 2005, with non-performing loans (NPLs) declining to record low levels since the Asian financial crisis. The improvement in asset quality during the year was attributed mainly to higher reclassification of NPLs to performing status and write-offs.

The net NPLs of the banking system on the 3-month classification basis declined by 14.6% to RM31.3 billion as at end-2005 (end-2004: RM36.7 billion), whilst net NPLs based on the 6-month classification decreased to RM24.7 billion as at end-2005 (end-2004: RM28.6 billion). Consequently, the net NPL ratio on the 3-month classification improved by 1.7 percentage points to 5.8% (end-2004: 7.5%). Based on the 6-month classification, the net NPL ratio improved by 1.2 percentage points to 4.6% (end-2004: 5.8%). The loan loss coverage of the banking system also strengthened with the declining NPL level as well as the adoption of more prudent provisioning policies by banking institutions. As at end-2005, the loan loss coverage ratio of the banking system improved to 59.2% on the 3-month basis and 65.4% on the 6-month basis (end-2004: 54.9% and 60.1% respectively). During the year, a few more banking institutions adopted the 3-month classification policy. Consequently, banking institutions that control 95.6% market share of total loans in the banking system have adopted the 3-month classification policy.

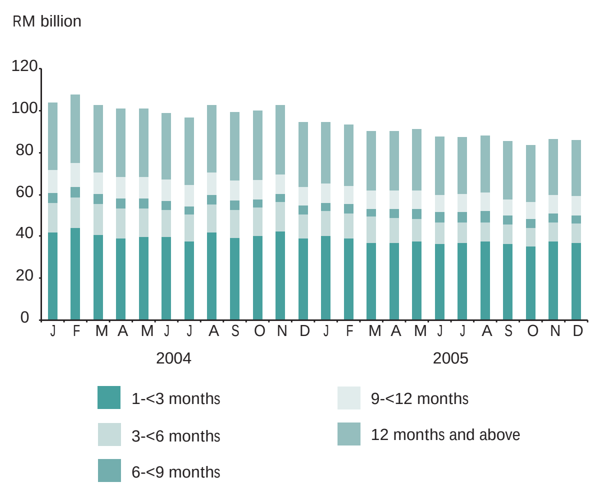
During 2005, the decline in NPLs was also due to the higher rate of reclassification of NPLs to performing status (+30.2%), following the overall improvement in the

Graph 5.1
Banking System[1]: Net Non-performing Loans



[1] Includes Islamic banks.

Graph 5.2
Banking System[1] : Ageing Profile of Loans in Arrears



[1] Includes Islamic banks.

Table 5.4
Banking System: Non-performing Loans and Loan Loss Provisions

	As at end-			
	2004		2005	
	Classification			
	3-month	6-month	3-month	6-month
	RM million			
Banking system				
Non-performing loans	60,379.8	50,711.5	53,558.4	45,196.1
Interest-in-suspense	8,469.4	8,105.6	7,332.6	7,108.8
Specific provisions	15,242.3	14,015.9	14,915.0	13,429.3
General provisions	9,488.7	8,367.5	9,459.4	9,016.2
Net NPL ratio (%)[1]	7.5	5.8	5.8	4.6
Total provisions/NPL (%)	54.9	60.1	59.2	65.4
Commercial banks[2]				
Non-performing loans	55,730.3	46,774.8	48,818.4	41,140.5
Interest-in-suspense	7,880.2	7,537.2	6,696.8	6,488.8
Specific provisions	14,289.8	13,094.8	13,864.0	12,416.6
General provisions	9,089.6	7,968.3	8,913.5	8,470.2
Net NPL ratio (%)[1]	7.1	5.5	5.5	4.4
Total provisions/NPL (%)	56.1	61.1	60.4	66.5
Merchant banks				
Non-performing loans	2,496.8	2,268.0	1,782.8	1,735.1
Interest-in-suspense	373.8	364.4	356.2	355.6
Specific provisions	455.4	457.5	463.5	464.6
General provisions	235.8	235.9	192.9	193.0
Net NPL ratio (%)[1]	19.4	16.8	12.1	11.5
Total provisions/NPL (%)	42.7	46.6	56.8	58.4
Islamic banks				
Non-performing loans	2,152.7	1,668.7	2,957.1	2,320.5
Interest-in-suspense	215.3	204.1	279.6	264.4
Specific provisions	497.2	463.6	587.6	548.1
General provisions	163.4	163.4	353.0	353.0
Net NPL ratio (%)[1]	13.4	9.3	10.5	7.6
Total provisions/NPL (%)	40.7	49.8	41.3	50.2

[1] Net NPL ratio = (NPL less IIS less SP) / (Gross loans less IIS less SP) x 100%.
[2] Includes finance companies.
Note: Total may not add up due to rounding.

repayment capacity of borrowers, and write-offs of loans (+3.1%). New classification of loans as NPLs increased by 5.6% mainly due to the tightening of the NPL classification policy of a number of banking institutions, but the increase was marginal vis-à-vis the improvement in the overall asset quality of the banking system. Loans-in-arrears (net of NPLs) of between one to three months have also declined by 3.5% during the year, accounting for 6.5% of total loans. Hence, risk arising from potential new NPLs in the banking system remained manageable.

The overall decline in NPLs of the banking system primarily reflected improvements in the loan quality of the business sector. Supported by strong external demand and sustained expansion in domestic demand, the repayment capacity of the business sector improved in 2005. NPLs for the business sector showed a marked decline of 15.8% to RM29.4 billion, accounting for 11.2% of total business loans as at end-2005 (end-2004: 13.7%). This was mainly attributed to declines in NPLs for the manufacturing, distributive (wholesale and retail trade and restaurants and hotels) and the construction sectors. The NPLs for the manufacturing sector showed the largest improvement by recording a decline of 24.8% and accounted for 10.8% of loans to the manufacturing sector as at end-2005 (end-2004: 13.8%). The NPL ratios for the distributive and construction sectors improved to 7.7% and 20.4% respectively (end-2004: 10% and 23.7% respectively).

In tandem with the improvement in NPLs for the business sector, the NPLs of SMEs also declined by 3.8% during the year. As at end-2005, NPLs of SMEs declined to

Table 5.5
Banking System[1]: Non-performing Loans by Sector

	As at end-				
	NPL by sector		Change	As percentage of total loans to the sector	
	2004	2005		2004	2005
	RM million		%		
Business enterprises	**34,907.0**	**29,383.3**	**-15.8**	**13.7**	**11.2**
of which SME loans	***10,589.1***	***10,191.9***	***-3.8***	***12.0***	***10.6***
Households	**19,047.6**	**21,468.6**	**12.7**	**7.6**	**7.5**
Others	**1,110.0**	**1,347.1**	**21.4**	**11.0**	**12.8**
Total	***55,064.7***	***52,199.0***	***-5.2***	***10.7***	***9.4***
Agriculture, hunting, forestry and fishing	679.7	601.6	-11.5	6.2	5.5
Mining and quarrying	90.3	123.7	37.0	9.1	15.3
Manufacturing	8,705.4	6,550.1	-24.8	13.8	10.8
Electricity, gas and water supply	1,296.6	1,221.2	-5.8	25.0	26.4
Wholesale and retail trade, restaurants and hotels	4,356.7	3,603.3	-17.3	10.0	7.7
Wholesale trade	*1,635.8*	*1,420.0*	*-13.2*	*6.4*	*5.2*
Retail trade	*1,252.9*	*1,123.8*	*-10.3*	*9.6*	*7.6*
Restaurants and hotels	*1,468.0*	*1,059.6*	*-27.8*	*30.4*	*21.7*
Broad property sector	26,726.6	26,885.6	0.6	12.8	11.7
Construction	*7,286.2*	*6,126.4*	*-15.9*	*23.7*	*20.4*
Purchase of residential property	*11,852.7*	*14,006.8*	*18.2*	*8.9*	*9.4*
Purchase of non-residential property	*4,432.1*	*4,125.1*	*-6.9*	*14.2*	*11.7*
Real estate	*3,155.6*	*2,627.3*	*-16.7*	*23.0*	*17.9*
Transport, storage and communication	778.0	639.6	-17.8	7.8	5.6
Finance, insurance and business services	1,882.9	1,778.3	-5.6	6.1	5.9
Consumption credit	2,579.4	2,698.1	4.6	8.1	7.3
Personal use	*1,878.4*	*1,923.1*	*2.4*	*10.9*	*9.7*
Credit cards	*663.9*	*743.7*	*12.0*	*4.7*	*4.5*
Purchase of consumer durable goods	*37.0*	*31.2*	*-15.6*	*11.8*	*11.4*
Purchase of securities	2,896.6	2,425.6	-16.3	14.9	11.6
Purchase of transport vehicles[2]	3,167.3	3,550.9	12.1	4.3	4.0
Community, social and personal services	795.3	773.8	-2.7	15.6	13.5

[1] Includes Islamic banks.
[2] Includes purchase of passenger cars.
Note: Total may not add up due to rounding.

RM10.2 billion to account for 10.6% of SME loans (end-2004: 12%). Improvements in the asset quality of SME loans were noted in sectors similar to those of the overall business sector, with NPLs of SMEs in the manufacturing sector recording the largest decline. The NPLs of SME in the manufacturing sector improved by 12.7% to account for 11.6% of SME loans to this sector. This was partly attributed to improvements in credit analysis, credit assessment tools and methodologies of banking institutions and enhanced access to current customer information.

[Please refer to the section on "Exposure to the Household Sector" for the analysis on the banking sector's exposure to the household sector].

With sustainable growth in economic performance envisaged in 2006, coupled with the continuous enhancements in the risk management infrastructure and practices of banking institutions, the declining trend in NPLs in the banking system is expected to continue in 2006.

Exposure to the Household Sector

Amidst uncertainties prevailing in the global environment, the level of consumer confidence remained high throughout the year. Private consumption was strong with continued high income levels, stable labour market conditions, improvements in business conditions and productivity gains. Borrowings by households continued to remain strong as reflected by the increase in the ratio of household debts from the banking sector to GDP to 61.5% as at end-2005, as compared to 45.3% in 2000. The debt service ratio of consumers also increased from 29.9% in 2000 to 38.8% in 2005. Nevertheless, the households' level of indebtedness as measured by the average debt-to-disposable income ratio remained at manageable levels that commensurate with the capacity of the sector.

Demand for financing remained strong in 2005, reflected by an 18% increase in loan applications received from the sector. Loans approved grew by 12% to RM97.2 billion,

The households' level of indebtedness as measured by the average debt-to-disposable income ratio remained at manageable levels that commensurate with the capacity of the sector.

whilst loan disbursements recorded an increase of 11.4% to RM145.2 billion. As a result, outstanding household loans expanded by 15.1% to RM304.4 billion, accounting for 54.5% of outstanding loans in the banking system as at end-2005. Lending activities within this sector were concentrated in mortgage financing, purchase of passenger cars and credit cards.

The demand for loans for the purchase of residential properties moderated in 2005, driven mainly by lower demand for the purchase of medium to lower-end properties, with loan approvals for the purchase of residential properties rising by 2.5% to RM36.6 billion. However, reflecting the continued high level of disbursements in 2005, outstanding loans to this sector grew by 12.5% (end-2004: 14.2%). The NPLs in this sector grew by 18.2%, to account for 9.4% of loans to this sector (end-2004: 8.9%). The average lending rates charged by the commercial banks for these loans remained competitive, at between 2.69% to 3.15% per annum.

The aggressive promotional activities by car dealers and manufacturers and the launching of attractive new models at competitive prices continued to boost consumer demand for motor vehicles during the year. Loan applications to finance the purchase of passenger cars increased by 34.4% to RM54.5 billion, while approvals grew by 26.1% to RM38.3 billion during the year. Hence, outstanding loans to this sector recorded a strong increase of 19.9% to RM86.2 billion as at end-2005. In terms of asset quality, vis-à-vis the increase in loans, the growth of NPLs to this sector moderated, to account for 4% of loans to this sector (end-2004: 4.3%).

A total of 2.6 million new credit cards were issued in 2005, bringing the total number of credit cards in circulation to approximately 8 million with approved limits of RM57.1 billion. Promotions to purchase consumer goods using credit cards, coupled with the competitive annual fee promotion contributed towards the stronger growth in credit cards during the year. Credit limits for new credit cards increased by 7.3% to RM12.6 billion, whilst the utilisation of credit card facilities remained strong with total disbursements expanding by 17.6% to RM42.7 billion. Nevertheless, the outstanding balance of credit cards remained a small proportion of outstanding loans of the banking system. While the outstanding loans for credit cards have increased from the previous year, the amount of revolving balance has remained relatively constant vis-à-vis 2004, accounting for about 40% of the outstanding credit card loans, indicating that 60% of card users have been servicing their credit card loans in full. The credit card NPLs accounted for 4.5% of total credit card loans and 1.4% of total NPLs in the banking system as at end-2005.

While enhancements in risk management infrastructure and capabilities of banking institutions have strengthened their capacity to manage risk emanating from their exposure to the household sector, there are emerging concerns on the ability of the household sector in managing their indebtedness. Hence, Bank Negara Malaysia has undertaken a series of pre-emptive measures to ensure sustainability of the household sector as follows:

- Conduct concerted efforts to educate consumers on financial management to enable them to make informed decisions and to manage financial risks in a proactive and constructive manner. This is part of the comprehensive consumer education programme initiated in 2003; and
- Establish a Credit Counseling and Debt Management Agency (CCDMA) to provide assistance in the form of professional advisory and debt management services to individuals facing debt problems that involve multiple financial institutions under the supervision of Bank Negara Malaysia. The CCDMA is expected to commence operations by 1 April 2006.

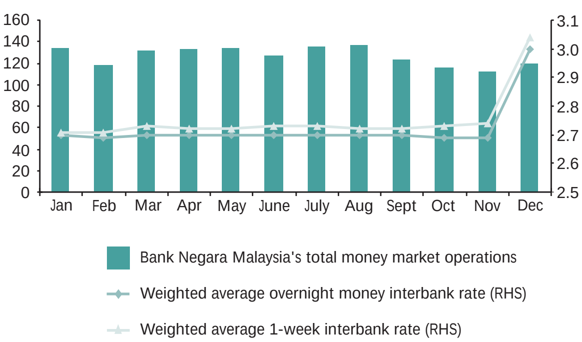
At the supervisory level, Bank Negara Malaysia has also undertaken measures to ensure that the banking institutions' exposure to the household sector does not pose undue risk to the stability of the financial sector, as follows:

- Increase the risk-weightage for mortgage NPLs from 50% to 100% for capital adequacy purposes; and
- Conduct thematic examinations on individual banking institutions, focusing on the adequacy and robustness of their risk management practices on lending to the household sector.

Liquidity Management

The banking system continued to operate within an environment of high liquidity in 2005. This was mainly attributed to the sustained large current account surplus, foreign direct investment throughout the year and portfolio inflows resulting in further increase in the international reserves from RM253.5 billion as at end-2004 to RM266.4 billion as at end-2005. To absorb the excess liquidity, Bank Negara Malaysia continued to undertake active liquidity management through its money market operations in the form of direct borrowings, repos and issuance of Bank Negara Bills and Negotiable Notes. For the first 11 months of 2005, the weighted average overnight interbank rate stabilised at 2.70% while the weighted average one-week interbank rate fluctuated within a tight range from 2.71% to 2.74% per annum. Arising from the increase in the overnight policy rate by 30 basis points to 3.0% at end-November 2005, the weighted average overnight and one-week interbank rates were higher at 3.0% and 3.04% per annum respectively as at end-2005. Total outstanding money market operations by Bank Negara Malaysia in the form of net direct borrowings, repos and issuance of Bank Negara Malaysia papers was RM119.9 billion at the end of 2005, as compared to RM142.6 billion as at end-2004.

Graph 5.3
Liquidity in the Banking System[1] in 2005



[1] Includes Islamic banks.

Table 5.6
Banking System: Liquidity Projection as at 31 December 2005

	Cumulative mismatch (RM billion)		Buffer as % of total deposits	
	1 wk.	1 mth.	1 wk.	1 mth.
Commercial banks[1]	51.7	66.6	10.2	13.1
Merchant banks	8.0	7.3	45.6	41.6
Islamic banks	7.7	6.7	24.1	21.2
Banking system	**67.4**	**80.7**	**12.1**	**14.5**

[1] Includes finance companies.
Note: Total may not add up due to rounding.

Throughout the year 2005, the banking system, as a whole, projected sufficient liquidity to meet any unexpected withdrawals for a period of up to one month. As at end-2005, the cumulative liquidity surplus of the banking system was projected at RM67.4 billion to meet estimated liquidity demands of up to one week and a surplus of RM80.7 billion to meet demands of up to one month. As a group, commercial banks, merchant banks and Islamic banks projected large surpluses in the one-month bucket amounting to 13.1%, 41.6% and 21.2% of their total deposit base respectively. On an individual basis, all banking institutions have projected surpluses, well above the regulatory requirement in the one-week and one-month buckets.

Interest Rate Risk

The banking system's exposure to interest rate risk (inclusive of price risk of Islamic exposures) is assessed using the duration-weighted net position (DWP) approach. The DWP approach estimates the potential impact on economic value of a banking institution for a 100 basis point shift in interest rates. However, the existing DWP approach adopted by Bank Negara Malaysia does not analyse separately the exposures arising from Islamic portfolio whereby the potential economic value impact could be mitigated by the *mudharabah*-based liabilities.

The banking system's DWP increased by 10.57% to RM4.2 billion as at end-December 2005, or 5.1% if expressed as a percentage of capital base of the banking system. During the year, total RM denominated interest sensitive assets grew by 9% from end-2004 with growth concentrated in the one to three months maturity tenure largely as a result of increased interbank lending, and in the seven to 10 years maturity tenure due to the rise in fixed rate hire purchase loans. The increase in RM

Table 5.7
Banking System: Impact of 1% Rise in Interest Rate on Capital Strength

	Duration-weighted net position					
	RM million		As a percentage of capital base (%)		Impact on risk weighted capital ratio (percentage point)	
	As at end-					
	2004	2005	2004	2005	2004	2005
Commercial banks[1]	-3,399	-3,690	-4.8	-4.8	-1.0	-1.1
Merchant banks	-366	-472	-7.3	-9.6	-3.9	-8.3
Banking system[2]	-3,764	-4,162	-5.0	-5.1	-1.1	-1.2

[1] Includes finance companies.
[2] Excludes Islamic banks but includes price risk of Islamic type exposures.
Note: Total may not add up due to rounding.

denominated interest sensitive liabilities was lower at 8%, mainly due to the issuance of debt papers and Cagamas funding that had remaining maturities of one to three months and four to seven years.

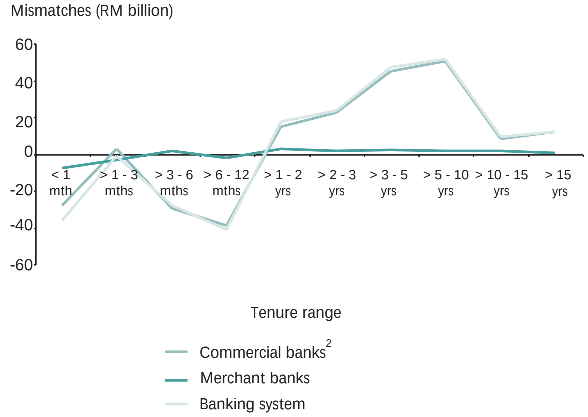
A majority of the banking system's interest rate risk was concentrated in the three to five and five to 10 years maturity buckets, which together accounted for 70% of total net DWP as at end-December 2005. This was primarily attributed to the increase in fixed rate loans with remaining maturities of more than five to 10 years of 24% or RM9.1 billion. The increase was due to the expansion of hire purchase portfolio among banking institutions that have relatively lower credit exposure to the retail segment in 2005. As the variable rate hire purchase financing has only been recently introduced, fixed rate hire purchase continue to be the predominant type of financing registering an increase RM21.5 billion to RM95.5 billion as at end-2005.

Despite the increase in fixed rate loans during 2005, part of the economic value impact arising from Islamic fixed rate loans which rose by RM9.2 billion to RM41 billion during the year, would have been absorbed by the *mudharabah*-based liabilities which amounted to RM20.7 billion as at end-2005, should the loss-absorbing nature of such liabilities be reflected by the DWP approach. Over the long term, the use of Islamic variable rate financing which accounted for 13.5% of total Islamic loans as at end-2005 would also mitigate risk arising from the fixed rate products typical of Islamic financing.

As a group, the DWP of commercial banks recorded an increase of 8.6% to RM3.7 billion as at end-December 2005, due to higher fixed rate loans with remaining maturity of more than five to 10 years mainly in the form of motor vehicle financing. Merchant banks also recorded an increase in their DWP from RM0.4 billion to RM0.5 billion as at end-December 2005 as a result of expansion in their holdings of debt securities with remaining maturities of more than seven years and taking on net long interest rate forwards, forward rate agreements and futures positions in the more than five year maturity tenure.

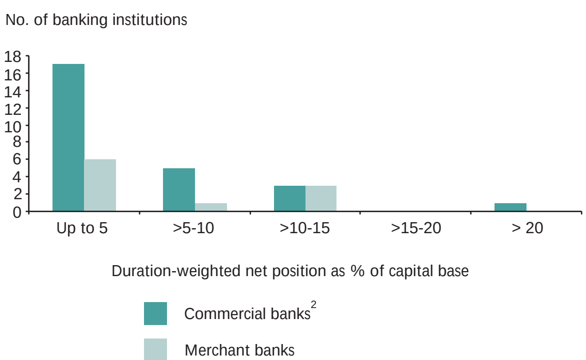
The impact of the higher holdings of private debt securities was also reflected in the increase in the banking system's interest rate risk by 37.4% to RM2 billion or 2.45% of capital base as at end-December 2005, as measured under the Market Risk Capital Adequacy framework which was introduced by Bank Negara Malaysia in September 2004.

Graph 5.5
Banking System[1]: Net Interest Rate Position Mismatches as at 31 December 2005



[1] Excludes Islamic banks but includes price risk of Islamic type exposures.
[2] Includes finance companies.

Graph 5.4
Banking System[1] : Distribution by Duration Weighted Net Position as a Percentage of Capital Base as at 31 December 2005



[1] Excludes Islamic banks but includes price risk of Islamic type exposures.
[2] Includes finance companies.

Table 5.8
Banking System: Impact of Trading Book Interest Rate Risk on Capital Strength as at 31 December 2005

	RM millions		Total interest rate risk/Capital base (%)	
	Interest rate risk			
	2004	2005	2004	2005
Commercial banks[1]	906	1132	1.3	1.5
Merchant banks	522	830	10.9	16.8
Banking system[2]	1,428	1,962	1.9	2.5

[1] Includes finance companies.
[2] Excludes Islamic banks but includes price risk of Islamic type exposures.
Note: Total may not add up due to rounding.

Equity Risk

Equity exposure continues to pose minimal risk to the banking system. Total equity holdings by banking institutions remained relatively unchanged at RM3 billion as at end-2005 as compared to RM3.1 billion as at end-2004. This represented only 0.3% of the banking system's total assets as at end-2005. The lack of movement in total equity holdings reflected fewer restructuring exercises that were completed by banking institutions, as well as the more modest performance of the stock market during the year.

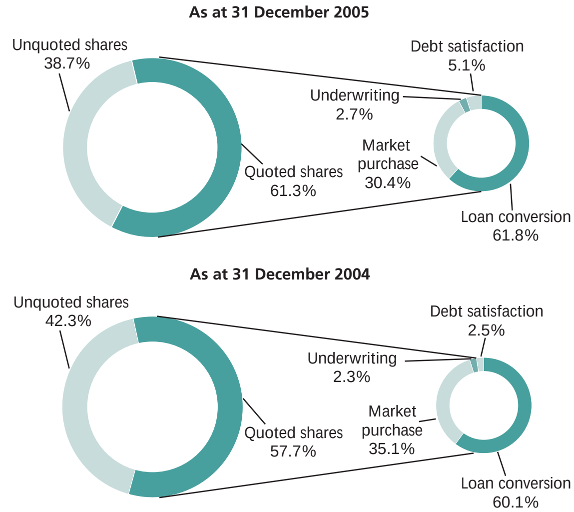
The holdings of quoted shares by the banking system recorded an increase of 3.5% during 2005, despite the declining trend for the major part of the year. Quoted shares held by the banking system registered a decline of 18.2% in the first three quarters of the year, to RM1.4 billion as at end-September 2005, reflecting cautious sentiments in the stock market, influenced by underperformance of major counters in the KLSE and concerns over unfavourable external factors such as rising oil prices, which triggered the selling down of shares. However, the decline in holdings of quoted shares by the banking system was mitigated by several conversions of loans into quoted shares through restructuring activities. Consequently, there was an increase in the holdings of quoted shares in the fourth quarter of 2005 by 26.6% to RM1.8 billion as at end-2005.

Investments in unquoted shares by the banking system recorded an overall decline of 11%, from RM1.3 billion as at end-2004 to RM1.2 billion as at end-2005. This was largely attributed to the decline in the holding of unquoted shares amongst commercial banks, by 12.2%, from RM1.2 billion as at end-2004 to RM1.1 billion as at end-2005, as a result of several share redemption activities by corporate borrowers that had been previously involved in debt restructuring.

Only the merchant banks as a group recorded an increase in equity holding of 9.1%, mainly from quoted shares received from loan equity conversions. As a result, the ratio of quoted shares to capital base rose from 6.4% as at end-2004 to 7.1% as at end-2005. The majority of banking institutions maintained an equity risk exposure of less than 2% of their capital base as at end-2005.

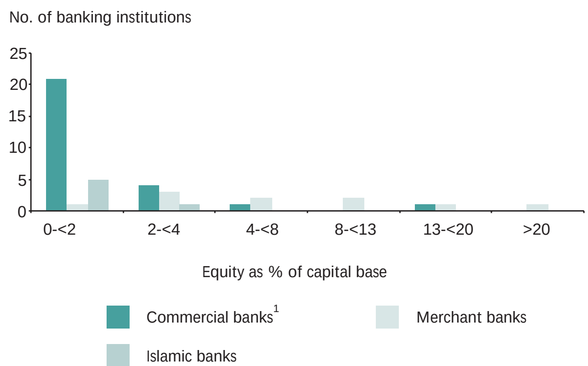
Reflective of the lower volatility of the Kuala Lumpur Composite Index (KLCI) in 2005, the potential maximum loss in equity value for the banking system based on a 10-day volatility of the KLCI as at end-2005 was lower at 4.5% or 0.1% of capital base, compared to 7.7% or 0.2% of capital base as at end-2004.

Graph 5.6
Banking System[1]: Composition of Equity Investments



[1] Includes Islamic banks.

Graph 5.7
Banking System: Distribution by Equity as a Percentage of Capital Base as at 31 December 2005



[1] Includes finance companies.

Table 5.9
Banking System: Equity Exposure

	Equity[1] holdings (RM million)		Equity[1] / Capital base (%)		Potential equity[1] loss/ Capital base (%)	
	As at end-					
	2004	2005	2004	2005	2004	2005
Commercial banks[2]	1,409.3	1,449.5	1.9	1.9	0.1	0.1
Merchant banks	320.8	351.2	6.4	7.1	0.5	0.3
Islamic banks	34.8	26.5	1.8	0.8	0.1	0.0
Banking system	1,764.8	1,827.2	2.2	2.2	0.2	0.1

[1] Amount of investment in quoted shares.
[2] Includes finance companies.

Foreign Exchange Risk

The exposure of the banking system to foreign exchange risk remained manageable in 2005 with the net open foreign currency positions (NOP) trending downwards, particularly in the second half of the year. Foreign currency liabilities, mainly in the form of foreign currency interbank borrowings, increased during the year as banking institutions undertook forward exchange arbitrage activities in the currency swap market. The NOP declined from RM3 billion to RM0.8 billion during the year, with the most substantial reduction of RM2.9 billion recorded in November. As a percentage of the banking system's capital base, the NOP contracted from 3.7% in 2004 to 1% in 2005.

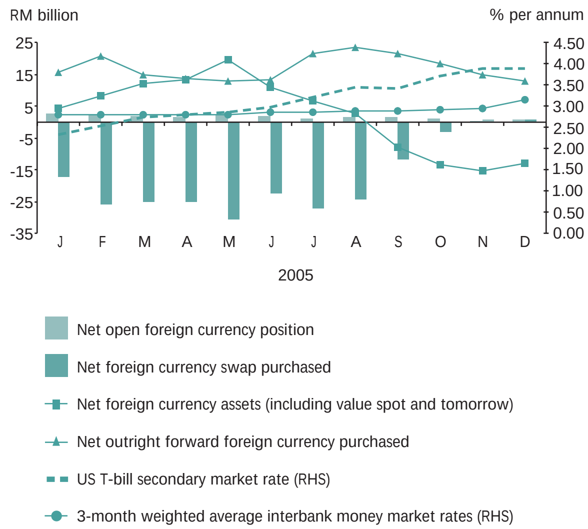
Total foreign currency assets of the banking system, mostly in the form of interbank foreign currency placements, was high in the first half of 2005, with the outstanding amount equivalent to RM61 billion as at 30 June 2005. This was mainly as a result of continuous repatriation of export earnings, sustained foreign direct investment and significant inflows of portfolio investment. The rise in the interbank foreign currency placements that reached the maximum outstanding amount of RM43.1 billion at end-May was also attributed to the increase of RM3.7 billion in foreign currency deposits accepted by the banking institutions as domestic investors took the opportunity of investing in non-ringgit assets following the liberalisation of the foreign exchange rules in April 2005. During the second half of the year, the trend in the inflows of the short-term funds reversed. This reflected the decline in the foreign currency interbank placements by RM2.7 billion and subsequently the fall in total foreign currency assets by RM3 billion.

Total foreign currency liabilities that remained relatively stable in the first half of the year, trended upwards in the second half of 2005 due mainly to the increase in foreign currency interbank borrowings by banking institutions. Although US dollar interest rates rose steadily during the second half of 2005, banking institutions were still borrowing foreign currency in the interbank money market as they entered into swap transactions to hedge their own arbitrage activities in anticipation of the strengthening of ringgit which was reflected in the forward discount. The expansion in foreign currency liabilities of the banking system was also attributed to the increase in foreign currency intra-group placements by selected foreign banking institutions in view of the relatively low exposure of foreign currency risk of the Malaysian subsidiaries. As a result, the net foreign currency asset position that reached its peak of RM19.7 billion in May turned into a net foreign currency liabilities position of RM12.9 billion at the end of 2005.

Table 5.10
Banking System: Foreign Currency Exposure

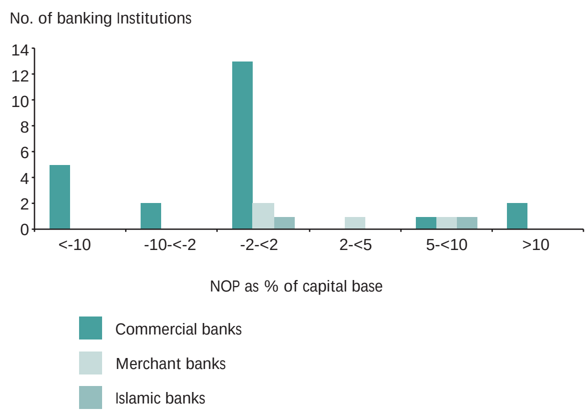
	NOP (RM million)		NOP/Capital base (%)	
	As at end-			
	2004	2005	2004	2005
Commercial banks	2,904	571	4.2	0.8
Merchant banks	48	88	1.0	1.8
Islamic banks	54	125	2.8	2.2
Banking system	3,006	784	3.7	1.0

Graph 5.8
Banking System[1]: Components of Foreign Currency Exposure



[1] Includes Islamic banks.

Graph 5.9
Banking System: Distribution of Net Open Foreign Currency Position as at 31 December 2005



In the foreign currency forward market, the forward premiums in the USD/RM rate narrowed considerably and turned into a deep forward discount of 55 basis points reflective of the interest rate differentials increasingly in favour of the US dollar. Nevertheless, there was still strong demand from customers to sell foreign currency forward contracts especially in July and August which eased off subsequently following the shift to a new exchange rate regime. As a result, banking institutions' foreign currency forward contracts purchased mainly from domestic non-bank entities rose from RM36.1 billion as at end-January to RM42.9 billion as at end-August 2005. To manage the foreign currency forward contracts purchased, banking institutions undertook foreign currency swap transactions which resulted in the increase in foreign currency swap payable by 39.8% to RM72.7 billion in July 2005.

Capital Strength

Capitalisation in the banking system was sustained at strong levels throughout the year. This development was underpinned by continued capital management activities by the banking institutions to lower the cost of capital and maximise value to shareholders. This included higher dividend payments and share buybacks as well as issuance of tier-2 capital and hybrid capital instruments. The strong capital position enabled the banking institutions to absorb the effects of capital-related measures introduced during the year which were aimed at further enhancing the risk-sensitivity of the capital framework. Following this, the risk weighted capital ratio (RWCR) remained comfortably above 13% during the year. The RWCR was 13.1% as at end-2005, whilst the core capital ratio stood at 10.2%. At the micro level, the impact of the inclusion of market risk factor in the computation of risk-adjusted capital on merchant banks was relatively substantial, resulting in a 5.4 percentage points decline in the RWCR to 17.5%.

The capital base grew by RM2.3 billion largely on account of higher tier-2 capital which accounted for 83% of the growth in total capital. Nonetheless, tier-1 capital remained as the major component, accounting for 70.6% of total capital. The increase in tier-1 capital during the year mainly emanated from the inclusion of RM2.5 billion of audited profits and the exercise of ESOS totaling RM0.2 billion. In regard to tier-2 capital, there were seven issuances of subordinated debts totaling RM3.9 billion, of which RM2.2 billion was denominated in USD, hence enabling the issuers not only to benefit from the relatively lower US interest rates but also to enhance their presence in the international capital and debt markets.

Table 5.11
Banking System: Constituents of Capital

	As at end-		Annual change	
	2004	2005		
	RM million		RM million	(%)
Tier-1 capital	64,920.4	65,685.0	764.6	1.2
Tier-2 capital	23,611.6	27,338.6	3,727.0	15.8
Total capital	88,532.0	93,023.5	4,491.6	5.1
Less:				
Investment in subsidiaries and holdings of other banking institutions' capital	7,294.7	9,526.6	2,231.9	30.6
Capital base	81,237.3	83,496.9	2,259.6	2.8
Risk assets:				
0%	210,391.3	210,324.5	-66.8	0.0
10%	14,669.8	8,226.9	-6,442.9	-43.9
20%	120,316.9	102,207.7	-18,109.2	-15.1
50%	136,487.1	145,916.2	9,429.2	6.9
100%	471,839.2	503,180.5	31,341.4	6.6
Total risk-weighted assets	565,613.1	635,610.9	69,997.8	12.4
Risk-weighted capital ratio (%)				
Banking system	**14.4**	**13.1**	**-1.3**	
Commercial banks[1]	14.1	12.9	-1.2	
Merchant banks	22.9	17.5	-5.4	
Islamic banks	12.3	14.2	1.9	

Note: Total may not add up due to rounding.
[1] Includes finance companies.

Risk-weighted assets recorded a double-digit growth of 12.4% during the year. This expansion was brought about by a combination of factors, namely expansion in lending activities, particularly in the SME and consumer segments, the inclusion of market risk in the capital adequacy framework and higher capital charge on mortgage NPLs. (*Please refer to the section on Lending Activity for details on the performance of fund-based operations of the banking system*). The increase in risk-weight for mortgage NPLs to 100% since March 2005 only resulted in a marginal decline of 0.1 percentage point in the RWCR. The implementation of a market risk framework beginning April 2005, however, resulted in a larger decline of 0.8 percentage point in the RWCR. With the inclusion of market risk in the risk-adjusted capital framework, the level of capital positions of banking institutions has now become more reflective of the various risks facing the banking institutions instead of merely credit risk.

By asset category, growth in the 50% risk-weight category was consistent with the continued expansion in mortgage financing, whilst the increase in assets in the 100% risk-weight category was attributable to other lending activities of the banking system and the re-categorisation of mortgage non-performing loans. Assets in the 10% and 20% risk-weight categories, however, declined partly due to the maturity of Cagamas debt securities held by the banking institutions, and outstanding claims on OECD and non-OECD banks, respectively.

Malaysia's Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) Programme

Overview

Malaysia's Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) regulatory regime under the Anti-Money Laundering Act 2001 (AMLA) continues to evolve in order to keep pace with new global trends and internationally accepted standards, that is, the Financial Action Task Force on Money Laundering's (FATF) 40+9 Recommendations. As with other jurisdictions, Malaysia's efforts were expanded during the year by extending the AMLA regulatory net to non-financial businesses and professions, strengthening the AML/CFT legislative framework and ensuring proper implementation of measures to counter money laundering and the financing of terrorism.

Malaysia, as the lead shepherd for money laundering in the Association of Southeast Asian Nations (ASEAN), has taken efforts to enhance the skills and knowledge of personnel involved in the fight against money laundering and terrorism financing both at the national and regional level. Various training workshops were organised/co-organised by Bank Negara Malaysia and the Southeast Asia Regional Centre for Counter Terrorism (SEARCCT). These training workshops were participated by regulatory and law enforcement agencies. Besides training workshops, regular dialogues and awareness programmes were conducted for new as well as existing AMLA reporting institutions in Malaysia. The face-to-face interactions have gained the willing commitment, compliance and co-operation of the reporting institutions in playing their critical role in implementing the national AML/CFT measures.

The National Co-ordination Committee to Counter Money Laundering (NCC) that consists of 13 Ministries and Government agencies continues to play its role in mobilising and garnering the co-operative efforts from the relevant domestic agencies. Among others, the NCC established the AMLA Investigation Reference Guide and is now in the process of establishing the Financial Investigators Accreditation Programme. The Ministry of Foreign Affairs, which is a member of the NCC, has forwarded the AMLA Information Booklet to Malaysian missions abroad to apprise these missions of the efforts taken by Malaysia to enhance its AML/CFT regime.

During the year, the first offender under the AMLA, a snatch thief, was successfully convicted after he pleaded guilty to five counts of money laundering charges amounting to RM83,216. He was sentenced to three years imprisonment on each of the five charges. Another six persons are also being prosecuted for money laundering offences involving a total of 193 charges and amounting to RM71.3 million.

As the fight against money laundering and terrorism financing requires global collaborative efforts, Malaysia participates actively in global AML/CFT initiatives. At the international front, Malaysia achieved the distinction of being selected at the 8th Asia/Pacific Group on Money Laundering (APG) Annual Meeting as the representative for the South East Asia region in the APG Steering Group (for a period from July 2005-July 2006). The APG Steering Group was established at the APG Annual Meeting in September 2003. The membership includes a representative from each of the five broad geographical areas within the APG, namely North Asia, Pacific Islands, South Asia, South East Asia and 'Others'. The purpose of the APG Steering Group is to provide the APG Co-chairs and APG members with strategic advice on the structure, functioning and support for the APG. Among the roles played by the members of the Steering Group is to provide advice on issues of strategic importance, obtain feedback from sub-regional members on key issues and influence the APG members to participate in the APG activities.

Enhancing AML/CFT Regime

New AMLA Reporting Institutions

Under the AMLA, a reporting institution is required to file a Suspicious Transaction Report (STR) directly to Bank Negara Malaysia if there are reasons to suspect any transaction involving the proceeds of any unlawful activities that are listed in the Second Schedule to the AMLA. Since the enforcement of the AMLA on 15 January 2002, the AMLA reporting institutions include financial institutions from the conventional, Islamic and offshore sectors and non-financial businesses and professions such as lawyers, accountants, company secretaries as well as the only licensed casino in Malaysia.

During 2005, the AMLA reporting obligations were invoked on licensed gaming outlets, Bank Pertanian Malaysia and notaries public with effect from 31 March 2005 and on offshore trading agents and listing sponsors with effect from 20 October 2005. Notaries public are required to report to Bank Negara Malaysia any suspicious transaction in the course of carrying out the following activities for their clients:

(i) buying and selling of immovable property;
(ii) managing of client's money, securities or other property;
(iii) managing of accounts including savings and securities accounts;
(iv) organising of contributions for the creation, operation or management of companies; or
(v) creating, operating or managing of legal entities or arrangements and buying and selling of business entities.

Increase Reporting Obligations

Bank Negara Malaysia adopts an incremental approach in invoking the AMLA provisions on the reporting institutions. This approach ensures that sufficient time is given to the reporting institutions to put in place an effective and efficient AML/CFT system before the rest of the reporting obligations are invoked on them. In this regard, the statutory requirement to report suspicious transactions was initially invoked on Pos Malaysia Berhad with effect from 15 January 2003 and on stock brokers and futures brokers with effect from 31 March 2004. Subsequently, the remaining reporting obligations under Part IV of the AMLA were invoked on Pos Malaysia Berhad with effect from 31 March 2005 and on the stock brokers and futures brokers with effect from 20 October 2005. These remaining reporting obligations include, among others, retention of records for a minimum period of six years, conducting customer due diligence as well as establishing internal reporting and compliance programme that are designed to safeguard the institutions from being used as conduits by criminals.

Increase Predicate Offences

In 2005, the number of money laundering predicate offences in the Second Schedule to the AMLA was increased from 168 to 185 serious offences from 27 pieces of legislation. The new predicate offences are from the Customs Act 1967, Islamic Banking Act 1983, Payment Systems Act 2003, Takaful Act 1984, Futures Industry Act 1993, Securities Commission Act 1993 and Securities Industry Act 1983.

Compliance Monitoring

Given the diversity in the types of AMLA reporting institutions and the large number of non-financial businesses and professions, Bank Negara Malaysia has established appropriate mechanism to effectively monitor the reporting institutions' compliance with the AMLA reporting obligations and the relevant AML/CFT guidelines. Compliance monitoring may be by way of completing Bank Negara Malaysia's self-assessment questionnaires by the reporting institutions or AML/CFT focused internal audit.

In line with the non-integrated approach, the relevant functional supervisory authority conducts AMLA compliance examinations on the reporting institutions under their purview. The AML/CFT examinations are carried out as part of the functional supervisory authority's overall examination on the financial institutions concerned. For this purpose, a comprehensive AMLA supervisory framework providing the banking supervisors with a documented set of uniform processes was formulated and established to guide them in their examination of financial institutions' AML/CFT measures. The core areas of AML/CFT examination encompass the following:

i) AML/CFT infrastructure;
ii) institution's compliance with internal AML/CFT policies and procedures;
iii) identification of account holders;
iv) monitoring of transactions;

v) record-keeping;
vi) detection and reporting of unusual and suspicious transactions;
vii) training and awareness programmes for employees;
viii) internal audit of the AML/CFT initiatives; and
ix) roles and responsibilities of the AML compliance officer.

The AML/CFT examination reports are forwarded to the Financial Intelligence Unit (FIU) and the findings are uploaded into the FIU's compliance database to ensure continuous monitoring of the reporting institutions' compliance with the AMLA requirements. For reporting institutions that are from unregulated industries and from industries where the regulatory authorities are not empowered to conduct examinations, Bank Negara Malaysia will supervise these institutions for AMLA compliance.

Financial Intelligence

Since May 2004, Bank Negara Malaysia has implemented the Financial Intelligence System (FINS) that enables the reporting institutions to submit STRs through a secure web in an efficient and secure on-line environment. Bank Negara Malaysia is in the process of enhancing the FINS with more powerful and advanced intelligence analytical software. Phase II of the FINS will also incorporate i-2 tools that will assist Bank Negara Malaysia's analysts in establishing financial links among STRs. Based on the analysis of STRs, Bank Negara Malaysia is able to provide financial intelligence to the relevant law enforcement agencies. The financial intelligence provided has enabled the law enforcement agencies to effectively conduct financial investigation on the perpetrators and to establish the underlying predicate offences as well as money laundering offences. Hence, Bank Negara Malaysia will enhance the effectiveness of its financial analysts by leveraging on information technology to better detect criminal activities and to enable timely dissemination of financial intelligence to law enforcement agencies.

Capacity Building

AMLA Awareness Programme

In 2005, Bank Negara Malaysia continued its nationwide awareness programme to ensure that the reporting institutions effectively implement the AML/CFT measures. A series of briefing sessions were held for various categories of the reporting institutions, particularly for the new reporting institutions as well as their respective regulatory and supervisory authorities in order to apprise them of their obligations under the AMLA.

In July 2005, a total of 10 nationwide AMLA briefing sessions were conducted for banking institutions and licensed gaming outlets, namely the number forecast companies. The briefing sessions for banking institutions were organised by the Institute of Bankers Malaysia (IBBM) while for licensed gaming outlets, they were conducted in collaboration with the Betting Control Unit, Ministry of Finance. The main focus of the AMLA briefing sessions for banking institutions is on 'Know Your Customer (KYC) Policy' and on the importance of conducting customer due diligence when establishing business relations while the sessions for gaming outlets were on the submission of STRs.

During the year, Bank Negara Malaysia was also invited by the Malaysian Association of Company Secretaries to conduct briefing sessions on AML/CFT for its members. In total, three sessions were conducted in Sabah and one in Johor Bahru. As the number of company secretaries is large and their trade associations are fragmented, these briefing sessions have proven to be an effective outreach to the industry to ensure that their members fully understand their roles in preventing and detecting criminal activities.

Dialogue Sessions

Bank Negara Malaysia continues to conduct regular dialogue sessions with the reporting institutions. These dialogue sessions were effective in updating the reporting institutions on the latest AML/CFT measures and to gather feedback on the effectiveness of the AML/CFT measures. The dialogue sessions also provide a platform for the reporting institutions to raise their concerns and exchange ideas on the best practices to implement the AML/CFT measures effectively. With better understanding and co-operation from the reporting institutions, Malaysia's AML/CFT regime will be more effective and efficient.

Compliance Officer Networking Group (CONG)

The banking institutions have established the Compliance Officer Networking Group (CONG), which is an informal consultative forum to discuss and share AML/CFT issues and concerns. Since its establishment in 2003, the banking institutions have benefited from the consultative deliberations at the meetings of the compliance officers from the CONG. Members of the CONG participate in creating industry standards, suggest best practices, reinforce the necessity of compliance and co-operation with the authorities and amongst themselves in order to minimise the potential of being exploited by money launderers and terrorist financiers.

The insurance sector also plays an important role in the AML/CFT regime. The inclusion of investment products with the usual portfolio of insurance policies increases the potential for the insurance sector to be exploited as money laundering conduits. As a result, the respective insurance associations are following the example of the banking sector in setting up their own CONG. The General Insurance Association of Malaysia (PIAM), the Life Insurance Association of Malaysia (LIAM), the Insurance Brokers Association of Malaysia and the Malaysian Takaful Association have proposed that separate CONGs be established for the general insurers, life insurers, insurance brokers and takaful operators respectively as issues raised may be different for different types of insurance businesses. PIAM has established a CONG for general insurers in 2005 while LIAM has established a CONG for life insurers in January 2006. The remaining insurance associations will establish their CONGs in due course.

Computer-Based Training Centre

Bank Negara Malaysia has collaborated with the United Nations Office on Drugs and Crime (UNODC) to establish an AML Computer-Based Training Centre (CBTC) for the relevant agencies in Malaysia. The CBTC was launched at the FIU in Bank Negara Malaysia on 30 May 2005. The UNODC's interactive AML computer-based training programme consists of 13 modules on legal, regulatory and law enforcement AML measures. Participants are assessed through a series of quizzes, pre-tests and post-tests to determine their knowledge on AML/CFT measures. This e-learning training initiative helps to enhance the knowledge of personnel from the law enforcement agencies and ensure greater outreach to relevant sectors involved in the fight against money laundering and financing of terrorism. As at 31 December 2005, a total of 48 officials from various NCC agencies have signed up for the AML Computer-Based Training programme and 22 have completed the training, while the rest are at various stages of completion.

World Bank E-Learning AML/CFT Programme

Apart from the UNODC computer-based training programme, the World Bank has also developed an e-learning AML/CFT programme, which is currently accessible to seven countries, namely Malaysia, Thailand, Vietnam, Indonesia, the Philippines, Cambodia and Laos PDR. The e-learning programme consists of seven modules covering the following topics that are related to AML/CFT:

Module 1 - Effects on Economic Development and International Standards;
Module 2 - Legal Requirements to meet International Standards;
Module 3 - (a) Regulatory and Institutional Requirements;
(b) Compliance Requirements for Financial Institutions;
Module 4 - Building an Effective Financial Intelligence Unit;
Module 5 - Domestic (inter-agency) and International Co-operation;
Module 6 - Combating the Financing of Terrorism; and
Module 7 - Investigating Money Laundering and Terrorist Financing.

The World Bank allows countries to customise the e-learning programme to their domestic AML/CFT regime. As such, Bank Negara Malaysia is currently customising the modules by including the Malaysian AML/CFT laws and measures. Upon completion of the customisation, the Bahasa Melayu version will also be developed. The World Bank e-learning programme will be accessible to the government and private sectors in the following format:

i) hardcopy;
ii) CD-ROM; or
iii) on-line learning management system.

The flexibility given by the World Bank also allows the government and private sector's training institutions to modify the modules to suit their training requirements.

Training Initiatives

To stay ahead of money launderers who are increasingly creative in structuring their activities in order to avoid detection by law enforcement officers, Bank Negara Malaysia continues to upgrade the expertise of law enforcement personnel through formal workshops and seminars. The training workshops and seminars were conducted by both internal and external resource persons and experts.

During the year, Bank Negara Malaysia has organised/co-organised and participated in the following training initiatives:

i) The AMLA Advance Net Worth Analysis Workshop, Port Dickson, 20-24 June 2005;
ii) Financial Intelligence Training, Kuala Lumpur, 5-9 September 2005;
iii) Terrorism Financing Typologies Workshop, Kuala Lumpur, 14-17 November 2005; and
iv) AML Seminar and Workshop, Labuan, 23-24 November 2005.

Financial Investigators Accreditation Programme

At the 19th NCC Meeting on 9 November 2004, members agreed to develop the Accreditation of Financial Investigators Programme for AMLA investigators. The objective of the Accreditation Programme is to develop financial investigators with the relevant skills in conducting financial investigations. The proposed accredited training programme consists of the following nine modules:

i) UNODC Anti-Money Laundering Computer-Based Training;
ii) Legal Aspects on Financial Investigation under the AMLA;
iii) AMLA Investigation: Process & Procedure;
iv) Basic Net Worth Analysis Workshop;
v) Advance Net Worth Analysis Workshop;
vi) Forensic Accounting;
vii) Introduction to Computer Forensics;
viii) Attachments with commercial banks & insurance companies; and
ix) Training on Visual Investigative Analysis Software

It is anticipated that the first batch of accredited financial investigators will graduate by the end of 2006.

Challenges Ahead

The year ahead will be very challenging for Malaysia as it is scheduled for a second round of Mutual Evaluation jointly by the APG and the Offshore Group of Banking Supervisors (OGBS) in early 2007. The OGBS will evaluate the AML/CFT regime of the offshore sector in the Labuan International Offshore Financial Centre. The APG evaluation team will assess the effectiveness of Malaysia's AML/CFT system and its compliance with the FATF's 40+9 Recommendations based on the revised 2004 Methodology for Assessment. To carry out this massive and important exercise, various working groups have been established under the NCC to focus on all the 250 assessment criteria. Malaysia's current AML/CFT measures, laws, regulations, guidelines and framework are being reviewed to identify gaps and to formulate rectification measures.

Going forward, Bank Negara Malaysia will continue to be vigilant and respond to evolving AML/CFT threats as well as AML/CFT standards and trends by fine-tuning its legal and regulatory measures, including the invocation of the AMLA reporting obligations on other categories of financial and non-financial businesses and professions as recommended by the FATF.

The Islamic Financial System

The Islamic Financial System

MANAGEMENT OF THE ISLAMIC BANKING SYSTEM

The Islamic financial system in Malaysia showed significant progress in an increasingly liberalised and competitive environment in line with the increased integration of the Malaysian Islamic financial system into the global Islamic financial landscape. The liberalisation of the Islamic banking market saw the opening in August 2005, of the first foreign Islamic bank licensed under the Islamic Banking Act 1983 (IBA). Following the liberalisation of the foreign exchange administration rules in 2004, greater market depth was demonstrated in the Islamic financial market in 2005 as further ringgit-denominated Shariah-compliant financial instruments were raised in the domestic bond market by foreign entities. This not only boosted confidence in the domestic capital market but contributed to strengthening the depth and breath of the market.

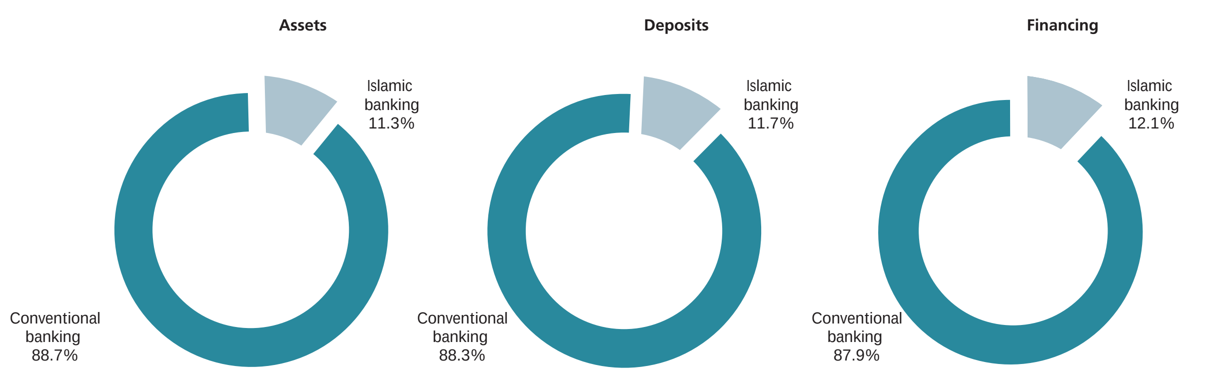
The institutional capacity and capability of the Islamic banking players as well as the financial infrastructure and regulatory framework were further strengthened to achieve the objectives as embodied in the second phase of the Financial Sector Masterplan. Strengthening the corporate governance and risk management system of the Islamic banking institutions remained as the core agenda throughout the year in pursuit of an Islamic financial industry that is robust, stable and with a global outlook in facing the rising challenges in the overall banking and financial environment. Islamic subsidiaries of some domestic banking groups have commenced operations to capitalise on the full extent of operational flexibility accorded by the Islamic banking licence. The International Centre for Education in Islamic Finance (INCEIF) will be in operation in the second quarter of 2006 to offer professional certification and postgraduate programmes as part of the efforts to build the necessary talents and skills in Islamic finance. These developments are among important building blocks in the effort to position Malaysia as a premier international Islamic financial centre.

Strengthening the corporate governance and risk management system of the Islamic banking institutions remained as the core agenda throughout the year.

In conjunction with the 30th Board of Governors Annual General Meeting of the Islamic Development Bank held in Malaysia, a seminar on the 10-Year Master Plan for Islamic Financial Services Industry to chart the roadmap for the Islamic financial services industry worldwide was held on 22 June 2005. It provided a platform to deliberate and provide the foundations for the development of a master plan that would outline the blueprint and strategic direction for a sustained development of the global Islamic financial services industry.

In terms of financial performance, the Islamic banking industry as a whole showed commendable results in 2005, with profitability and assets surpassing for the

Graph 6.1
Market Share of Assets, Deposits and Financing as at end-2005



first time the RM1 billion and RM100 billion thresholds respectively. Assets increased to RM111.8 billion, registering a strong growth of 17.7% and accounting for 11.3% of the total assets of the entire banking system. The market shares of Islamic deposits and outstanding financing also increased to 11.7% and 12.1% of the industry's total respectively. Total outstanding financing grew by 16.5%, attributed by the growth in new financing approved and disbursed of 55.1% and 19.4% respectively, while net non-performing financing ratio declined further to 4.8% at the end of the year. The Islamic banking sector remained well-capitalised with the risk-weighted capital ratio (RWCR) sustained above 12% throughout the year.

Strengthening Financial Infrastructure

Following the issuance of three new Islamic banking licences under the IBA to foreign Islamic financial institutions, the first foreign Islamic bank commenced operations in August 2005 while the other two foreign Islamic banks would commence operations later in 2006. The expertise brought in by the foreign Islamic banks ranging from retail banking to the more sophisticated investment banking, wealth and fund management, real estate development and venture capital business would further enhance the competitiveness of the domestic Islamic banking industry, its global linkages and Malaysia's position as an international Islamic financial centre. On the other hand, it would entail new regulatory and supervisory challenges to Bank Negara Malaysia in view of the different business models adopted by these banks.

In tandem with the progressive liberalisation of the Islamic banking industry, strategic initiatives were undertaken to further strengthen the institutional capacity and financial resilience of the domestic Islamic banking institutions. In this regard, Bank Negara Malaysia has approved to date, the transformation of the "Islamic window" institutional structure of seven domestic banking groups into Islamic subsidiaries (IS) licensed under the IBA within their respective banking groups to carry out Islamic banking business. Three IS commenced operations in 2005 while four others would commence operations in 2006. The IS structure allows the domestic banking groups to maximise the full potential accorded by the universal nature of Islamic banking licence under the IBA which provides wider strategic focus for Islamic banking institutions to strengthen their competitiveness through diverse and innovative product offerings. These range from retail banking products to the higher end corporate finance and investment banking products that include private wealth and fund management as well as private equity and real estate investments.

The IS structure allows the domestic banking groups to maximise the full potential accorded by the universal nature of Islamic banking licence under the IBA.

In contrast to the Islamic window structure, where Islamic banking operations reside within the conventional banking entity, the incorporation of IS also provides the opportunity to potential institutional investors, both domestic and foreign, to participate in the Islamic financial activities through direct equity participation. The liberalised shareholding policy in the IS, whereby the equity of the IS can be owned up to 49% by foreign institutional investors, will increase the potential for building strategic partnerships to acquire new expertise, tap the best international talents from a broad range of fields and develop new value-added activities that would enhance competitiveness and stimulate greater innovation in the Islamic banking industry. In addition, it will support the capital expansion exercise for the IS, increase the potential to tap regional and international business opportunities as well as enhance the global integration of the domestic Islamic banking industry.

While the IS structure allows the leveraging of certain functions of the group, institutions subscribing to the IS structure are encouraged to invest in dedicated internal risk management system as part of the measures to strengthen the financial resilience of these institutions in line with the prudential regulatory and supervisory standards that have and will be issued by the Islamic Financial Services Board (IFSB). In February 2006, the IFSB issued two standards, namely the Capital Adequacy Standard (CAS) and the Guiding Principles of Risk Management (Guiding Principles) for institutions offering Islamic financial services. The CAS provides guidance on the requirements for minimum capital adequacy to cover for credit, market and operational risks of the Islamic banking institutions that is equivalent to the Basel II Capital Framework adopted by the conventional banking institutions. A significant differentiation in the CAS as opposed to Basel II is in the computation of RWCR. In Islamic banking, given that the risks on asset financed by profit-sharing investment account (PSIA) holders do not represent risks to the capital of Islamic banking institutions, the CAS allowed the risk-weighted assets

Calculation of RWCR

$$\text{RWCR} = \frac{\text{ELIGIBLE CAPITAL}}{\text{TOTAL RWA (Credit Risk + Market Risk) + Operational Risk Weighted} \quad \text{LESS} \quad \text{RWA FUNDED BY PSIA (Credit Risk + Market Risk)}}$$

(RWA) that are funded by the PSIA holders to be deducted from the total risk-weighted assets in the calculation of RWCR.

The Guiding Principles provides specific guidance in establishing and implementing effective risk management practices to cater for the specificities of the Islamic financial institutions. The Guiding Principles set out 15 principles in managing six categories of risk associated with the specific features of Islamic contracts, namely, credit, equity investment, market, liquidity, rate of return and operational risks.

The CAS and the Guiding Principles are the first two international standards that govern the prudential regulatory and supervisory framework for Islamic banking institutions issued by the IFSB. Thus, Bank Negara Malaysia will collaborate with the Islamic banking institutions to ensure a smooth and successful implementation of both standards.

In November 2005, Bank Negara Malaysia introduced additional measures to further strengthen the risk management of the conventional banking institutions operating under the "Islamic window" institutional structure. These measures include separate compliance on the single customer limit for financing facilities based on the capital funds of the Islamic banking portfolio; separate compliance on the new liquidity framework and statutory reserve requirement for the Islamic banking portfolio; and apportionment of overhead costs and other expenditure incurred in managing the Islamic banking portfolio. These new measures are in addition to the current requirement to observe a separate compliance with the minimum RWCR framework for the Islamic banking portfolio in the conventional banking institutions.

Improvements were also made to the Guidelines on Financial Reporting for Licensed Islamic Banks (GP8-i) in June 2005 to incorporate new requirements on accounting policy for securities, in particular, the classification and measurement of financial securities under the fair value accounting. The revised GP8-i requires the Islamic banks to classify their securities under the categories of "Held for trading" (HFT), "Available for sale" (AFS) and "Held-to-maturity" (HTM). Islamic banks are required to measure securities classified under the HFT and AFS based on current market price or "mark-to-market" valuation technique following their intention to trade further these financial securities in the secondary market. Securities under the category of HTM are measured based on amortised cost given the intention to hold these securities as long-term investment. The GP8-i also specified the rules on reclassification of securities from one category to another to instil discipline in ensuring that consistent accounting policy is adopted on the classification and measurement of financial securities.

Other improvements made to the GP8-i were the requirements for the submission and publication of annual and interim financial reports and enhancement of disclosure of the profit equalisation reserve and unrealized gains or losses on AFS securities to reflect the apportionment between the depositors and the Islamic banks. The revised GP8-i will further enhance the transparency, comparability and timeliness of information on the financial condition of the Islamic banks to the various stakeholders.

In 2005, several new Islamic financial products were introduced that include residential mortgage-backed securities, commodity-based financing as well as investment and equity-linked products based on *murabahah*, *musyarakah* and *mudharabah*. The commodity-*murabahah*, among others, is a new feature in the Malaysian Islamic banking industry although it has been used extensively in the Middle East. It involves a parallel back-to-back arrangement between a financial institution and its customer to buy and sell certain specified commodities, such as aluminium, steel, copper and nickel which are listed on the major commodity exchanges, on a cost plus profit basis. It is structured such that a commodity is being exchanged on spot basis and the settlement arrangement will be structured in a manner to meet the various requirements. In a deposit taking arrangement, the first sale from bank to customer will be settled with cash (deposit amount) while the second sale from customer to bank will be on deferred terms at a pre-determined maturity date. Similarly, in a financing arrangement, the first sale from customer to bank will be settled with cash (disbursement amount) while the second sale from bank to customer will be on deferred terms at settlement date. The parallel back-to-back transactions involving the commodities takes place simultaneously and therefore, does not expose the parties to the price risk associated with the underlying commodity.

The submission of proposals for the introduction of new Islamic financial products to Bank Negara Malaysia has been successfully automated following the implementation of the Product Approval and Repository System (PARS) in February 2006 to expedite the processing of new products for approval and provide for a repository of Islamic banking products. The new secured online application system will streamline the submission of new product applications from Islamic financial institutions and simplify the process for users by providing them, among others, the ability to submit data on new product application; review the application history; update existing approved products; and interact with external parties in seeking feedback on the submitted products.

In the area of liquidity management, Bank Negara Malaysia has introduced a new Islamic monetary instrument, namely, Bank Negara Malaysia Sukuk Ijarah. The Bank Negara Malaysia Sukuk Ijarah was issued in February 2006 through a special purpose vehicle, BNM Sukuk Berhad with an issue size of RM400 million. The proceeds were used to purchase Bank Negara Malaysia's assets which were then leased back to the Bank for rental payment consideration and to be distributed to investors as returns on a semi-annual basis. Upon the maturity of the sukuk, which would coincide with the end of the lease tenure, BNM Sukuk Berhad will resell the assets to Bank Negara Malaysia at a pre-determined price. The Bank Negara Malaysia Sukuk Ijarah will be issued on a regular basis with subsequent issues ranging from RM100 million to RM200 million. The Bank Negara Malaysia Sukuk Ijarah will add to the diversity of liquidity instruments used by Bank Negara Malaysia in managing liquidity in the Islamic money market as well as to serve as a benchmark for other short to medium-term Islamic bonds.

Strengthening Shariah Framework

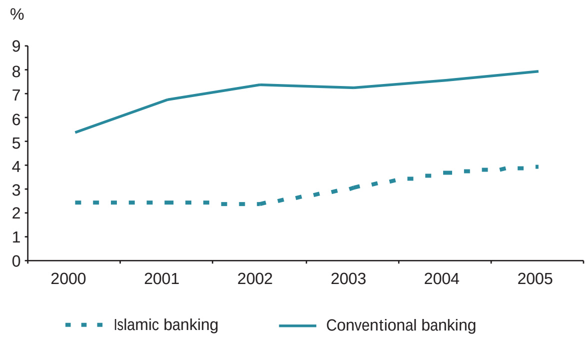
Bank Negara Malaysia continued to monitor the implementation of the Shariah governance framework following the issuance of the Guidelines

Maximising the Potential of Islamic Banking Business

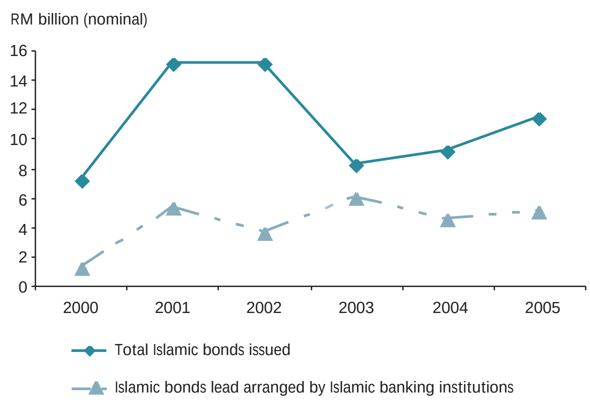
The Islamic Banking Act 1983 (IBA) accords a universal banking stature to the licensed Islamic banks. Under the IBA, the Islamic banks are allowed to conduct the full spectrum of banking business in line with Shariah principles, ranging from the retail-based commercial banking business to the more sophisticated investment banking business that includes, among others, corporate finance, private equity and wealth management activities. Up till the present, the banking business activities conducted by the Islamic banks in Malaysia have largely been based on the traditional banking business model. Similar scenario also exists in the Islamic banking activities conducted by the conventional banking institutions participating in the Islamic Banking Scheme. Approximately 70% of the financing extended by the Islamic Banking Institutions (IBIs) are sales and lease-based modes of financing which are mainly directed to the retail sector to finance the purchase of residential property and passenger cars.

The universal nature of Islamic banking business, particularly in the field of investment banking, has yet to be fully exploited. While the ratio of fee-based income from investment banking-related activities to the total income of IBIs has been increasing over the recent years, fee-based income still constitute a small portion of the total income of the IBIs. In the Islamic capital market, significant potential still remains to be tapped in the origination of Islamic bonds.

Graph 1
Ratio of Fee-based Income to Total Income



Graph 2
Participation by Islamic Banking Institutions in Origination of Islamic Bonds



As competition intensifies in the retail banking market following the progressive liberalisation of the financial sector, IBIs need to take strategic moves towards enhancing their capacity and capabilities to expand the traditional scope of banking business and tap the full potential that a universal Islamic banking licence offers. This includes venturing into new growth areas such as private equity investments, real estate investments, private banking, and fund and wealth management business. Such a move would diversify the sources of earnings for IBIs, enhance returns to shareholders and depositors as well as strengthen the capacity to sustain strong financial performance.

In addition, the Islamic banking licence allows IBIs to diversify the sources of funding from the traditional deposit products to take full advantage of the profit-sharing investment accounts (PSIA). PSIA provides the opportunity to customise the risk and reward profiles of the financing and investment activities on the asset side in accordance with the distinct investment preferences and risk appetite of the PSIA holders on the liabilities side. Under the Capital Adequacy Standard issued by the Islamic Financial Services Board (IFSB), the risk-weighted assets funded by the PSIA would not attract a capital charge, thereby providing an added advantage to the IBIs.

By exploring beyond the traditional sectors, the IBIs would also enrich the diversity of new asset classes for Islamic investment and further enhance the depth of the Islamic financial markets. This would not only increase the efficiency of the financial intermediation process in the Islamic financial system but would also enhance Malaysia's position as an attractive international hub for Islamic finance.

Under the Financial Sector Masterplan, the Islamic financial infrastructure has been progressively developed to build the capacity of IBIs to capitalise on the universal nature of Islamic banking business. These, among others, include the transformation of Islamic windows into dedicated Islamic subsidiaries, the licensing of foreign Islamic banking players with distinct capabilities in Islamic investment banking activities and the divestment of up to 49% equity interest in IBIs to strategic institutional domestic and foreign investors. IBIs are thus able to leverage on this progressive liberalisation policy to forge strategic alliances as well as tap new expertise and growth opportunities within the domestic environment and abroad to maximise the potential of Islamic banking business.

on the Governance of Shariah Committee for the Islamic Financial Institutions (GPS1) which came into effect on 1 April 2005. Following the Guidelines, the number of Shariah advisers in the Shariah committees of Islamic banking institutions and takaful companies has increased significantly, and would serve as a base to enlarge the number of competent Shariah experts in the country. Although a majority of the Shariah advisers are academicians in the field of *Fiqh Muamalat*, the committee also includes former judges, legal practitioners and economists. It is expected that, with a combination of their diverse background and expertise, Shariah deliberations not only be thorough but also add value to the further development of the industry.

In terms of Shariah supervision, the Bank continued to assess the compliance of Islamic financial institutions with the Shariah principles and governance process. The Bank also evaluates the effectiveness of Shariah committees in providing proper advice and validating the Shariah compatibility of the daily operational matters, such as observing the adequacy of firewalls to ensure no co-mingling between the Islamic and conventional funds in the Islamic window operations. Similarly, the internal auditors are also required to consciously play their role in ensuring that Islamic banking institutions comply with the Shariah principles by formulating a comprehensive audit programme for Shariah compliance and equipping themselves with the required knowledge in performing their duty.

In developing and promoting Shariah dynamism and convergence on the international front, Bank Negara Malaysia undertook two important initiatives in 2005. The first initiative is the Shariah Scholars Dialogue held from 22 to 23 June 2005 in Kuala Lumpur. The main objective of the Dialogue is to promote convergence and harmonisation of Shariah interpretations and appreciation among the Shariah scholars in the development of Islamic banking and finance at the global front. The Dialogue gathered more than 40 eminent Shariah scholars from several countries including Saudi Arabia, Tunisia, Iran, Bahrain, Pakistan, Bangladesh, Indonesia and Brunei Darussalam. The Dialogue has provided a good networking platform to bridge the gap amongst Shariah scholars in terms of fostering understanding and appreciation of Shariah implementation in various jurisdictions and to facilitate the integration of the domestic Islamic financial system with the global Islamic financial system.

The second initiative undertaken by Bank Negara Malaysia is the establishment of the RM200 million Fund for Shariah Scholars in Islamic Finance. The Shariah Fund will provide the resources to finance Shariah research activities, scholarships for Shariah studies as well as organising the annual international Shariah scholars' dialogue. The Shariah Fund will facilitate the creation and development of competent Shariah scholars equipped with sound knowledge and expertise in both Islamic laws and *Fiqh Muamalat* to deal with the ever-changing and dynamism of the Islamic financial industry.

During the year, the Shariah Advisory Council (SAC) of Bank Negara Malaysia deliberated on a number of issues pertaining to Islamic finance and among the main decisions made by the SAC are as follows:

a) **Permissibility of Forward Foreign Exchange Mechanism**
The SAC approved a mechanism for forward foreign exchange transaction based on a binding unilateral promise that does not tantamount to a contract before the settlement date. In the event of default of the binding promise, the compensation charge is allowed to be imposed on the defaulter.

b) **Application of Compensation Charges for Late Payment of Judgment Debt**
The Court may grant compensation charges for late payment of judgment debt in Islamic finance cases based on the average Islamic money market rate or 8% per annum, whichever is lower and shall not be compounded.

c) **Review the Application of *Qardh Hasan* in Islamic Banking Transactions**
As banking businesses involve mainly commercial deals with the purpose of earning profit, the principle of *qardh hasan* is not appropriate to be applied as a main contract for financing. *Qardh hasan* is more suitable for charity purposes as it is a benevolent loan contract with the possibility of the principal amount being waived. As an alternative, the principle of *qardh* (interest-free loan) may be used as a secondary or complementary contract wherever necessary.

d) **Application of *Kafalah* Contract for Guarantee Scheme in Islamic Banking**
The SAC approved the Islamic guarantee scheme based on the *kafalah* contract for credit enhancement of the small and medium enterprises (SME). Originally, *kafalah* is regarded as *tabarru'* contract in which the guarantee is provided based on the spirit of brotherhood without any consideration. However, current banking and financial transactions have made guarantee as a commercial contract with the charging of fees. The charging of fee for *kafalah* is allowed based on the necessity (*hajah*) for SME to obtain financing.

Strengthening Legal Framework

In a heightened competitive environment in the Islamic banking and finance industry, it is imperative that specific attention be given towards harmonising laws and regulations to give full effect to Shariah requirements given the differences between the principles of Shariah and the conventional legal system. In December 2005, the Attorney General's Chambers launched the Shariah Community, a smart networking platform with the main objective of addressing the Shariah issues and challenges in the context of Malaysian regulatory framework and legislation. Islamic finance and takaful have been identified as two of the areas being studied in collaboration with Bank Negara Malaysia.

As part of the measures to be continuously consistent with Shariah, to remove impediments on Shariah compliant product innovation and diversification, and to encourage participation in Shariah compliant instruments, the Hire Purchase Act 1967 is being reviewed to cover Islamic hire purchase whilst other relevant legislation including the National Land Code, Companies Act 1965, Civil Law Act 1956 and Contracts Act 1950 are being studied to cater for the ongoing developments of Islamic banking and finance. This is in addition to the ongoing review of the Islamic banking and takaful legislation by Bank Negara Malaysia. To further promote the tax neutrality policy, recent amendments to the Stamp Act 1949, which took effect in October 2005, included a new provision which accords instruments for the purchase of goods within the meaning of the Hire Purchase Act 1967 under the concept of *bai' bithaman ajil*, the same stamp duty as conventional instruments of the same nature.

In response to the continuous rapid expansion of the Islamic financial industry that has correspondingly increased demand for Islamic financial instruments, the Government Investment Act 1983 was amended in June 2005 to allow the Government to issue a wider range of Islamic securities. The amended legislation, renamed as the Government Funding Act 1983, accorded greater flexibility for the Government to source funds from the capital market through the issuance of lease-based and asset-based Islamic financial instruments. Apart from the traditional Government Investment Issues, the Government initiated the issuance of Islamic Treasury Bills, a short-term Islamic securities with a maturity tenor of less than one year based on the sell and buy back of asset transactions.

Enhancing Intellectual Capital Development
A significant milestone that took place during the year has been in the area of promotion human capital development with the establishment of the International Centre for Education in Islamic Finance (INCEIF) that will commence operations in 2006. The establishment of INCEIF serves as a catalyst in creating a large pool of world-class experts and high calibre professionals in Islamic banking and finance, to meet the talent requirements of the industry both domestically and internationally.

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The International Centre for Education in Islamic Finance

Building skills talent is one of the key pre-requisites in supporting the progressive developments of Islamic finance. Human intellectual capital is a critical asset that is much needed to drive innovation and sustain market competitiveness to meet challenges in the Islamic financial industry. With the rapid growth of the Islamic financial system, Bank Negara Malaysia has taken a strategic move to establish an international education centre in Islamic finance to produce the needed pool of professionals and specialists in Islamic finance for the domestic and global markets. The establishment of the International Centre for Education in Islamic Finance (INCEIF) will promote greater linkages between the domestic and international Islamic financial system and make Malaysia as a leading centre of education in Islamic finance.

The establishment of INCEIF was announced by the Prime Minister of Malaysia at the 3rd ASEAN Business and Investment Summit in December 2005. Extensive pre-operating work is underway for INCEIF to commence operations in the second quarter of 2006. Bank Negara Malaysia has set up an endowment fund of RM500 million to support this initiative.

INCEIF is to be a leading international centre for educational excellence in Islamic finance with the objectives of:

- facilitating the coordination, planning and implementation of human capital initiatives for the global Islamic financial industry;
- developing superior talents for the global Islamic financial system;
- offering internationally recognised professional certification and postgraduate programmes; and
- supplying talented researchers and educators in Islamic finance.

Programmes
INCEIF programmes are designed to provide the latest onsite and online teaching techniques with unique value elements. INCEIF will also form strategic alliances with renowned local and international institutions of higher learning to provide joint education programme through visiting professor and scholar-in-residence schemes.

INCEIF programmes are categorised into three main areas:

1. Professional certification programme
   INCEIF will award professional certification, namely, Certified Islamic Finance Professional to qualified Islamic finance practitioners. The certification programme, which will commence in June 2006, consists of three parts:

   - *Part I: Building knowledge*
     Candidates will acquire the necessary knowledge in Islamic finance from theory and ethics to wealth planning and management. Validations are done through examinations, written case studies and project papers before candidates are conferred as Associate Members.

- *Part II: Building skills*
  Candidates will obtain the required skills in handling operational issues and Islamic financial transactions such as structuring corporate financing and issuing Islamic securities. Candidates have the option of specialising in specific areas of Islamic banking and/or takaful. To be conferred as Proficient Members, candidates have to pass examinations, undertake project papers, develop new products and prepare transactional documentations.

- *Part III: Building competency and experience*
  This final part is designed to provide articleship programmes where various activities will be designed to provide candidates with practical experience in the Islamic financial services industry. These include a mentor-mentee programme at pre-approved participating Islamic financial institutions and running a simulation bank via financial laboratory. Candidates will have to go through validation processes such as solving problems, restructuring exercises, simulation and management games, product conversion exercises, Shariah and audit compliance, and interviews in order to be conferred as Practising Members.

2. Postgraduate programmes
   INCEIF will embark on its own Masters and Ph.D. programmes to produce graduates with strong foundation in Islamic finance, coupled with strong research and development capabilities. The Masters programme of INCEIF will be on a highly specialised field of Islamic finance such as Islamic Wealth Management. Candidates will also participate in internship programmes. The programme will commence latest by end 2006.

3. Research and publication programmes
   INCEIF will set up a world-class resource centre and will intensively engage in research and development projects in Islamic finance as well as publication of books, journals and working paper series. The certification and postgraduate programmes will facilitate and enhance this programme by supplying the relevant research materials and publications for academic references. INCEIF Educational Colloquium to be held in April 2006 will also serve as a platform for INCEIF to assess research materials relevant for its research programmes. INCEIF will also develop a comprehensive domestic and international financial database.

Governance
INCEIF will be headed by a Chief Executive Officer who reports to the Board of Directors (BOD). The INCEIF Governing Council, comprising prominent local and international personalities, has been established to advise the BOD on INCEIF strategic directions and provide visionary global insights on the learning needs of the Islamic financial services industry that will enhance the prominence of INCEIF. The Professional Development Panel has also been set up as the highest authority in academic matters that is responsible for reviewing and approving the certification and postgraduate module programmes and to ensure INCEIF offers the highest quality of module content and standards for all its programmes.

The establishment of INCEIF completes the talent development infrastructure in Malaysia's Islamic financial industry. The industry-owned Islamic Banking and Finance Institute of Malaysia (IBFIM) and the Securities Industry Development Centre (SIDC) focus their training programmes to meet the industry needs at the technical level whilst INCEIF will provide intermediate and advanced knowledge and skills in Islamic finance. The International Centre for Leadership in Finance (ICLIF) provides leadership programmes to top management that include top management of Islamic financial institutions. This allows Malaysia to offer a full range of Islamic finance talent development programme for the global needs of the Islamic financial services industry.

INCEIF reflects Malaysia's continuous effort and commitment towards development of a progressive Islamic financial industry by developing and enhancing human intellectual capital in Islamic finance. It is envisaged that the establishment of INCEIF would contribute towards supporting the growth and development of the global Islamic financial system.

Consumer Education

During the year, concerted efforts continued to be accorded to further strengthen the consumer education and awareness in Islamic banking and finance. Bank Negara Malaysia participated actively in the Islamic Banking and Takaful Roadshow 2005 (IBTR) organised by the Association of Islamic Banking Institutions Malaysia (AIBIM). Bank Negara Malaysia participated in six IBTRs, namely, in Shah Alam, Ipoh, Alor Setar, Johor Bahru, Putrajaya and Pulau Pinang, which managed to gather an average of 20,000 visitors per each IBTR. Bank Negara Malaysia also participated in the exhibition on Islamic banking and finance at the OIC Trade Exhibition organised by the Malaysian External Trade Development Corporation (MATRADE) which was held from 20 to 24 June 2005 and an exhibition in conjunction with the Investors Conference from 22 to 23 June 2005. For the second consecutive year, Bank Negara Malaysia participated in the Malaysia International Halal Showcase, organised by the Islamic Da'awah Foundation, which was held from 28 to 31 July 2005.

Moving Forward

With the development of a comprehensive Islamic financial system that is increasingly becoming more liberalised and integrated with the international financial system, Malaysia is well positioned to develop as an international Islamic financial centre. To meet the rising challenges, the focus will be to strengthen the innovativeness and competitiveness of the Islamic financial services industry in Malaysia, underpinned by high calibre human talents, world-class infrastructure and best international standards. Malaysia is set to serve as an important gateway for institutional and high-networth investors to tap investment opportunities in this rapidly growing region.

With the development of a comprehensive Islamic financial system that is increasingly becoming more liberalised and integrated with the international financial system, Malaysia is well positioned to develop as an international Islamic financial centre.

Initiatives are being directed at enhancing Malaysia's strength in the origination, issuance and trading of Islamic capital market and treasury instruments, Islamic fund and wealth management, offshore Islamic financial services market, and takaful and retakaful activities. To complement these initiatives are efforts targeted at making Malaysia a centre of excellence in Islamic banking and finance education, training, consultancy and research. This is in view that talent and product innovation are key factors in sustaining the global development in Islamic finance. In addition, it is envisaged that the domestic Islamic banking institutions will continue to expand overseas to become regional Islamic financial players with the long-term objective of becoming global players. The policy direction will be to enhance the resilience, efficiency and capacity of the domestic Islamic financial institutions and the Islamic financial infrastructure with the aim of intensifying the robustness and stability of the Islamic financial system.

PERFORMANCE OF THE ISLAMIC BANKING SYSTEM

The Islamic banking system continued to show strong performance in 2005, with higher profitability and positive trends in all key financial soundness indicators. At the same time, the level of capitalisation in the Islamic banking system was further strengthened through new capital injections, enabling the industry to expand with vigour and able to withstand unexpected future shocks. The main highlights of the performance of the Islamic banking system were:

- Profitability was higher, contributing to improved returns on assets and equity;
- Financing activities were active with higher demand from households for the purchase of residential properties and passenger cars;
- Non-performing financing ratio continued to trend downwards, improving further the asset quality;
- Liquidity remained ample with financing to deposits ratio at around 80%;
- Rates of return on *mudharabah* general investment deposits was marginally lower; and
- High capital adequacy ratios due to strong capitalisation level.

Profitability

There was further improvement in the profit before tax and zakat recorded by the Islamic banking sector due to higher income and lower provisions for non-performing financing, despite increases in overhead and staff costs. In calendar year 2005, the Islamic banking sector recorded an increase of RM712.5 million or 28.7% in net income (2004: RM307 million or 14.1%), while other income increased by RM47.4 million or 12.9% (2004: RM88 million or 11.8%). At the same time, overheads rose by RM259.3 million or 61.5% (2004: RM37 million or 9.6%),

Table 6.1
Islamic Banking System: Income and Expenditure

	For the calendar year 2004	For the calendar year 2005*p*	Annual change	Annual change
	RM million			%
Income[1] net of income-in-suspense	4,298.6	5,220.2	921.6	21.4
(Income-in-suspense)	*306.2*	*234.5*	*-71.7*	*-23.4*
Less: Expense[1]	1,813.9	2,023.0	209.1	11.5
Net income	2,484.7	3,197.2	712.5	28.7
Add: Other income	368.1	415.5	47.4	12.9
Less: Staff cost	267.0	431.8	164.8	61.7
Overheads	421.5	680.8	259.3	61.5
Profit before provisions	2,164.3	2,500.1	335.8	15.5
Less: Financing loss & other provisions	1,176.2	945.3	-230.9	-19.6
Pre-tax profit	988.1	1,554.8	566.7	57.4
Return on assets (%)	1.1	1.5		
Return on equity (%)	15.7	21.0		

[1] From financing activities and securities
p Preliminary

while staff cost rose by RM164.8 million or 61.7% (2004: RM38 million or 16.6%). After allocating financing loss and other provisions of RM0.9 billion (2004: RM1.2 billion), the Islamic banking sector recorded profit before tax and zakat of RM1.6 billion for the calendar year 2005 (RM988.1 million in 2004). The better profitability has increased the return on assets and return on equity to 1.5% and 21% (2004: 1.1% and 15.7%) respectively, despite the increase in asset size and capital funds.

Table 6.2
Islamic Banking System: Sources and Uses of Funds

	Annual change 2004	Annual change 2005*p*	As at end-2005*p*
	RM million		
Sources			
Capital and reserves	1,137.4	2,615.2	10,051.7
Deposits	16,907.1	11,047.9	83,874.8
Funds from other financial institutions	-2,902.9	429.5	4,459.1
Other liabilities	2,542.4	2,697.0	13,437.9
Total	**17,684.0**	**16,789.6**	**111,823.5**
Uses			
Cash	15.9	58.6	329.2
Reserve with Bank Negara Malaysia	-158.3	567.5	1,925.9
Deposits with other financial institutions	7,239.7	4,314.8	20,374.9
Financing	9,227.5	9,523.2	67,364.6
Securities	-1,776.2	4,600.7	20,800.9
Other assets	3,135.4	-2,275.2	1,028.0

p Preliminary

Assets
During the year, the total assets of the Islamic banking sector increased significantly by RM16.8 billion or 17.7% to RM111.8 billion with more than half of the increase attributable to a 16.5% (RM9.5 billion) growth in total financing. As at end-2005, total outstanding financing amounted to RM67.4 billion (2004: RM57.8 billion) or 60.2% of the total Islamic banking assets. Investment in securities increased by 28.4% (RM4.6 billion) during the year to account for RM20.8 billion or 18.6% of the total assets. At the same time, deposits placed with other institutions also rose by 26.9% (RM4.3 billion), to account for another RM20.4 billion or 18.2% of the total Islamic banking assets. In terms of market share, the largest portion of Islamic banking assets remained with the commercial banks in the Islamic Banking Scheme (IBS) with a share of 53.4%, followed by the Islamic banks (38.8%) and the IBS discount houses (5.3%). In terms of the growth in assets, Islamic banks recorded the highest growth of 74.7% arising from the transformation of three "Islamic windows" into Islamic banks, followed by IBS commercial banks (10.7%) and IBS discount houses (0.5%).

Financing Activities
During the year, there was a higher number and amount of financing applications received by the Islamic banking institutions. In tandem with the increase in financing approvals of 55.1%, financing disbursements increased by 19.4%. Financing repayments also recorded an increase of 25.3% as the overall economic condition improves.

Arising from the active financing activities, total financing expanded by 16.5% or RM9.5 billion in 2005, (19% or RM9.2 billion in 2004). Supported by the strong consumer spending, consumer financing

Table 6.3
Islamic Banking System: Financing Activities

	For the year 2004	For the year 2005*p*	Annual change (%)
	RM million		
Financing approvals	17,273.0	26,789.2	55.1
Financing disbursements	41,088.6	49,058.7	19.4
Financing repayments	33,679.0	42,207.5	25.3
	As at end- 2004	**As at end- 2005*p***	**Annual change (%)**
	RM million		
Outstanding financing	57,841.3	67,364.6	16.5

p Preliminary

continued to account for the largest component (36.2%) of financing extended by the Islamic banking institutions, mainly for the purchase of passenger cars, while the broad property sector recorded the second largest component of financing, comprising 34% of the total financing, extended mainly to the residential property sub-sector. In 2005, financing for the purchase of passenger cars constituted 29.9% of the total financing, while financing for the purchase of residential properties constituted 23.8%. The higher household demand was as the result of attractive and competitive financing packages offered by the Islamic banking institutions. Under the business sector, financing extended to the manufacturing sector accounted for 11.2% of the total financing as at

Table 6.4
Islamic Banking System: Direction of Financing

	Annual change		As at end-2005*p*
	2004	2005*p*	
	RM million		
Agriculture, hunting, forestry and fishing	466.9	40.8	2,369.3
Manufacturing	1,725.8	1,406.9	7,519.5
Mining and quarrying	13.1	28.3	104.9
Electricity, gas and water supply	470.3	-300.2	419.1
Wholesale and retail trade, restaurants and hotels	1,273.9	317.1	3,388.0
Wholesale trade	*1,141.3*	*148.9*	*2,392.2*
Retail trade	*126.5*	*167.1*	*905.0*
Restaurants and hotels	*6.1*	*1.1*	*90.8*
Broad property sector	1,926.2	512.4	22,923.1
Real estate	*94.5*	*66.3*	*972.7*
Construction	*597.4*	*-199.3*	*3,331.6*
Purchase of residential property	*1,047.0*	*581.7*	*15,974.7*
Purchase of non-residential property	*187.3*	*63.6*	*2,644.1*
Transport, storage and communication	152.2	111.0	1,287.5
Finance, insurance and business services	172.0	22.0	1,999.0
Financial services	*-37.8*	*178.7*	*1,376.3*
Insurance	*-0.4*	*-1.7*	*1.4*
Business services	*210.2*	*-154.9*	*621.3*
Consumption credit	3,458.9	7,255.1	24,376.1
Personal uses	*811.3*	*1,289.9*	*3,738.2*
Credit cards	*155.8*	*155.1*	*467.1*
Purchase of consumer durables	*-10.5*	*-5.6*	*38.0*
Purchase of passenger cars	*2,502.3*	*5,815.8*	*20,132.8*
Purchase of securities	-43.0	42.4	920.3
Purchase of transport vehicles	-525.2	25.1	706.6
Community, social and personal services	115.2	216.7	635.2
Others	22.0	-154.4	716.0

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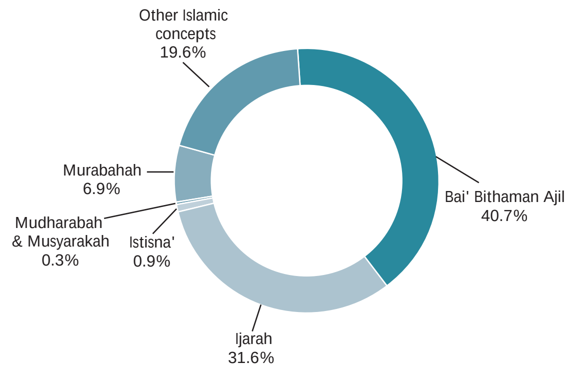
Graph 6.2
Islamic Banking System:
Major Financing Concepts as at end-2005



end-2005 (end-2004: 10.6%). In terms of financing concept, financing based on the *bai' bithaman ajil* concept remained dominant, constituting 40.7% of the total financing, albeit at a lower percentage compared with last year (49.9%). In contrast, financing based on *ijarah* increased to 31.6% of the total financing (2004: 24%) following the increase of RM5.8 billion in passenger car financing.

The Islamic banking sector continued to support the expansion of small and medium enterprises (SME). In 2005, financing approvals and disbursements to SME increased by 32.7% and 19.7% respectively. Total financing to the SME provided by the Islamic banking institutions increased by 7.7% to reach RM8.6 billion as at end-2005 (end-2004: RM8 billion) to account for 33.6% of the total Islamic business financing as at end-2005.

Asset Quality

The asset quality of the Islamic banking sector improved further during the year. The gross and net non-performing financing (NPF) ratios as at end-2005 stood at 7.7% (2004: 8.1%) and 4.8% (2004: 5.2%) respectively based on a 6-month classification. The net NPF ratio of the Islamic banking institutions sustained within the range of 4.7% to 5.3% throughout the year. Financing loss coverage remained high at 58.7% of the total NPF as at end-2005 (2004: 61.6%). In terms of absolute amount, financing loss coverage increased to RM3.5 billion as at end-2005 from RM3.1 billion as at end-2004. The general and specific provisions set aside by the Islamic banking institutions increased by 16.7% and 27% respectively during the year, while income-in-suspense decreased by 11.1%. The general provision for

Table 6.5
Islamic Banking System: Non-performing Financing and Financing Loss Provisions

	As at end-					
	2004			2005*p*		
	Actual[1]	Classification		Actual[1]	Classification	
		3-month	6-month		3-month	6-month
	RM million					
Islamic banking system						
Total financing	57,841.3			67,364.6		
General provisions	1,236.5	1,236.1	858.9	1,443.0	1,443.4	1,053.0
Income-in-suspense	640.5	661.2	633.8	569.5	582.6	554.6
Specific provisions	1,183.2	1,239.4	1,170.6	1,502.5	1,547.2	1,461.6
Non-performing financing	4,968.2	6,313.4	4,710.5	5,991.8	6,653.1	5,167.3
Net NPF ratio (%)[2]	5.6	7.9	5.2	6.0	6.9	4.8
Total provisions/NPF (%)	61.6	49.7	56.5	58.7	53.7	59.4
Islamic banks						
Total financing	11,423.1			20,627.1		
General provisions	163.4	163.4	163.4	353.0	353.0	353.0
Income-in-suspense	204.1	215.3	204.1	278.7	291.8	276.3
Specific provisions	468.1	501.7	468.1	626.8	661.5	621.6
Non-performing financing	1,668.7	2,152.7	1,668.7	2,399.6	2,957.1	2,320.5
Net NPF ratio (%)[2]	9.3	13.4	9.3	7.6	10.2	7.2
Total provisions/NPF (%)	50.1	40.9	50.1	52.4	44.2	53.9
Commercial banks[3]						
Total financing	38,802.1			45,398.5		
General provisions	930.6	930.2	553.0	1,056.8	1,057.2	666.8
Income-in-suspense	328.3	330.4	321.6	260.2	260.2	247.7
Specific provisions	558.0	565.6	545.4	797.0	803.5	761.3
Non-performing financing	2,800.1	3,411.7	2,542.4	3,422.0	3,445.6	2,676.6
Net NPF ratio (%)[2]	5.0	6.6	4.4	5.3	5.4	3.8
Total provisions/NPF (%)	64.9	53.5	55.9	61.8	61.6	62.6
Finance companies[3]						
Total financing	6,823.4			1,070.9		
General provisions	129.6	129.6	129.6	26.8	26.8	26.8
Income-in-suspense	100.5	107.9	100.5	22.7	22.7	22.7
Specific provisions	138.6	153.6	138.6	49.2	52.7	49.2
Non-performing financing	389.6	639.2	389.6	122.9	203.1	122.9
Net NPF ratio (%)[2]	2.3	5.8	2.3	5.1	12.8	5.1
Total provisions/NPF (%)	94.7	61.2	94.7	80.3	50.3	80.3
Merchant banks[3]						
Total financing	792.7			268.1		
General provisions	12.9	12.9	12.9	6.4	6.4	6.4
Income-in-suspense	7.6	7.6	7.6	7.9	7.9	7.9
Specific provisions	18.5	18.5	18.5	29.5	29.5	29.5
Non-performing financing	109.8	109.8	109.8	47.3	47.3	47.3
Net NPF ratio (%)[2]	10.9	10.9	10.9	4.3	4.3	4.3
Total provisions/NPF (%)	35.5	35.5	35.5	92.3	92.3	92.3

[1] Financing classified as NPF based on individual banking institution's NPF classification policy i.e. 3-month or 6-month classification

[2] Net NPF ratio = (NPF less IIS less SP) / (Gross financing less IIS less SP) x 100%

[3] Refers to Islamic banking portfolio of conventional banking institutions participating in Islamic Banking Scheme and represents a subset of the figures reported under the total banking system for commercial banks, merchant banks and finance companies

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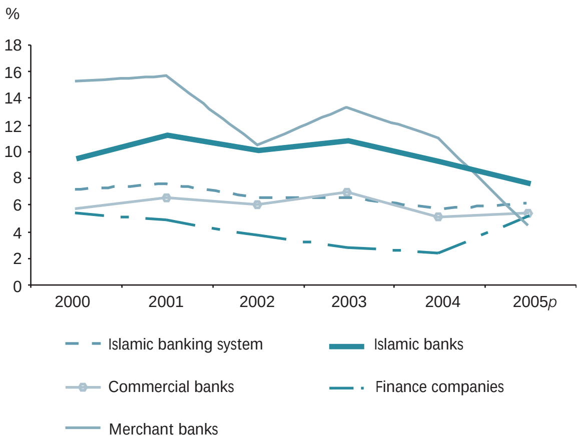
the Islamic banking sector remained at 2.2% of the total net financing, reflecting the prudent stance adopted by the Islamic banking institutions.

The broad property sector continued to account for the largest share of NPF, at 60.6% (2004: 66.7%). The high NPF in the broad property sector was recorded in the residential property, which increased by RM383.9 million (21.4%). The NPF level of the residential property increased from 36% as at end-2004 to 36.3% as at end-2005. Apart from the broad property sector, there was also an increase of RM258.1 million in NPF in financing for the purchase of transport vehicles.

Liquidity

There was ample liquidity in the Islamic banking system throughout 2005. Total deposits recorded a significant growth of 15.1% or RM11 billion to reach

Graph 6.3
Islamic Banking System:
Net Non-Performing Financing Ratio[1]



[1] Based on actual classification

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RM83.9 billion as at end-2005. The IBS commercial banks contributed the major share (51%) of the total deposits in the Islamic banking sector (2004: 54.6%), followed by the Islamic banks of 42.5% (2004: 28.5%). Among the Islamic banking players, the Islamic banks recorded the highest growth rate in deposits of 71.7% mainly due to the transformation of three "Islamic windows" into Islamic banks, followed by the IBS of commercial banks which recorded a growth of 7.5%.

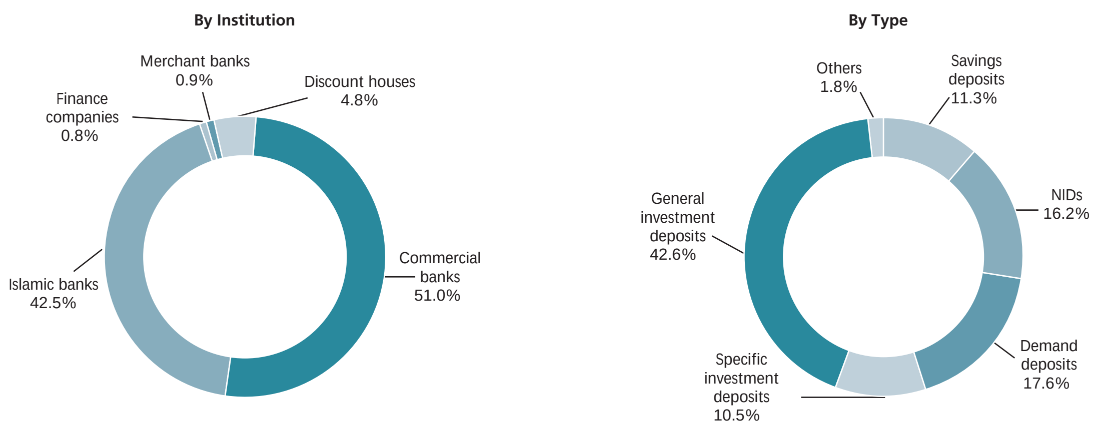
Investment deposits (general and specific) continued to capture a major portion of the Islamic banking deposits, contributing 53.2% (2004: 57.6%) of the Islamic banking deposits. However, investment deposits only grew by 6.2%, while savings and demand deposits grew by 12.7% and 14.5% respectively mainly due to the increase in the retail customer base in Islamic banking. In terms of the maturity profile of general investment deposits, 96.2% continued to be concentrated at the shorter end of the yield curve, mainly in the one to three-month maturity tenure as the incremental return between the shorter and longer placement tenures continued to remain small. The average rates for deposits remained stable in 2005.

Financing to deposits (FD) ratio of the Islamic banking institutions showed a favourable trend. The FD ratio increased from 79.4% as at end-2004 to 80.3% as at end-2005 due to higher percentage increase in the total financing base (16.5%) compared to deposits (15.1%) during the period.

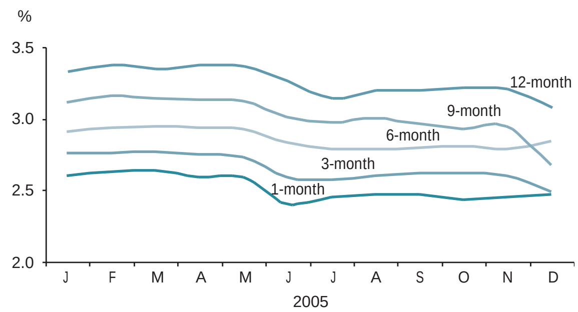
Rates of Return

The rates of return distributed to the various tenures of the *mudharabah* general investment deposits (GID) by the Islamic banking institutions continued to decline in 2005. The average rate of return of 1-month ranged from 2.40% to 2.63% (2004: 2.63% to 2.87%) and 3-month GID ranged from 2.57% to 2.76% (2004: 2.73% to 2.93%) respectively. The declining trend in the rates of return was attributed to the marginal increase in the average monthly net distributable income, which was not proportionate to a higher growth in the average monthly GID. During the year, the average monthly net distributable income grew by RM30 million that contributed to a marginal increase of 0.01 times of profit payable to outstanding GID across all tenures. However, the corresponding outstanding monthly average of GID increased by 13.6% or RM34.5 billion in 2005.

Graph 6.4
Islamic Banking System: Deposits by Institution and Type as at end-2005



Graph 6.5
Islamic Banking System:
Average Rates of Return to General Investment Deposits in 2005



During the year, the Islamic banking institutions allocated an additional RM12.4 million from the gross income to the profit equalisation reserve (PER) account. As at end-2005, the outstanding PER stood at RM481.1 million as compared with RM468.7 million in 2004. The increase in PER provides the additional buffer for Islamic banking institutions to sustain competitive rate of return and smoothen the potential negative impact while operating in an increasing interest rate environment in the dual banking system.

Capital Strength

The Islamic banking sector remained well capitalised thus enabling the sector to sustain the RWCR and core capital ratio above 12% and 10% respectively throughout the year. The total capital base of the Islamic banking institutions increased from RM7.9 billion as at end-2004 to RM10.2 billion as at end-2005, mainly due to new capital brought in with the setting up of three new Islamic subsidiaries and a new foreign Islamic bank, as well as new capital injections and audited profits. Total risk-weighted assets of the Islamic banking system grew by 16.2% or RM10.1 billion in the past 12 months. The growth was apparent in the 0% and 100% risk categories (RM1 billion and RM8.5 billion respectively). As at end-2005, the Islamic banking system recorded a strong RWCR of 14.1% and core capital ratio of 11.3%.

The RWCR of the Islamic banks and IBS commercial banks stood at 14.3% and 14.2% respectively. The RWCR of the IBS merchant banks increased from 14.8% to 22.2% mainly due to the increase in the capital base and decrease in the risk-weighted assets. The RWCR of the IBS finance companies was 10.2% with the capital base declining significantly by 82.1% or RM700.9 million to RM152.9 million as at end-2005 mainly due

Table 6.6
Islamic Banking System: Constituents of Capital

	As at end-		Annual change	
	2004	2005*p*		
	RM million			(%)
Tier-1 capital	6,618.1	8,207.5	1,589.4	24.0
Tier-2 capital	1,324.8	2,012.7	687.9	51.9
Total capital	7,942.9	10,220.2	2,277.3	28.7
Less:				
Investment in subsidiaries	12.8	13.5	0.7	5.5
Capital base	7,930.0	10,196.5	2,266.5	28.6
Risk assets:				
0%	*22,349.5*	*23,396.6*	*1,047.1*	*4.7*
10%	*825.3*	*1,419.9*	*594.6*	*72.1*
20%	*7,422.9*	*6,258.4*	*-1,164.5*	*-15.7*
50%	*14,706.2*	*13,588.0*	*-1,118.2*	*-7.6*
100%	*47,234.5*	*55,707.0*	*8,472.5*	*17.9*
Total risk-weighted assets	62,239.0	72,314.0	10,075.0	16.2
Risk-weighted capital ratio (%)				
Islamic banking system	12.7	14.1		
Islamic banks	*12.4*	*14.3*		
Commercial banks	*13.1*	*14.2*		
Finance companies	*11.1*	*10.2*		
Merchant banks	*14.8*	*22.2*		

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to the rationalisation of capital arising from the merging of operations of four IBS finance companies into their IBS commercial banks within the same group. The risk-weighted assets of IBS finance companies also decreased by 80.5% or RM6.2 billion.

ISLAMIC INTERBANK MARKET

The value of trading in Islamic interbank market declined by 36.6% during the year with the decrease in *mudharabah* interbank investment transactions, which constituted more than 70% of the total turnover volume in the Islamic interbank market. The decline in *mudharabah* transactions was also attributed to the stable liquidity condition coupled with the lower average rate of return offered in the *mudharabah* interbank investment transactions. In addition, the increased issuance of Government Investment Issues (GII), Islamic Treasury Bills (ITB) and Bank Negara Negotiable Notes (BNNN) also influenced the turnover volume of the *mudharabah* interbank investments following the relatively active trading in the Government and Bank Negara Malaysia Islamic securities. The increased supply of the Shariah compliant securities in the Islamic money market has contributed towards strengthening the Islamic interbank market position in meeting the increasing market demand for liquid Islamic financial assets.

Table 6.7
Islamic Interbank Market: Turnover Volume

	2004	2005*p*	Annual change	
	RM billion			%
Total	**562.5**	**356.5**	**-206.0**	**-36.6**
Mudharabah* Interbank Investment	**485.7**	**254.7**	**-231.0**	**-47.6**
Financial Instruments	**76.8**	**101.8**	**25.0**	**32.6**
Islamic Accepted Bills*	10.3	9.4	-0.9	-8.7
Negotiable Islamic Debt Certificate*	8.2	8.6	0.4	4.9
Bank Negara Negotiable Notes	21.2	36.1	14.9	70.3
Islamic Treasury Bills	1.2	4.5	3.3	275.0
Government Investment Issues	35.9	43.2	7.3	20.3

* Volume transacted through brokers
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Table 6.8
Outstanding Islamic Securities

	2004	2005*p*	Annual change	
	RM billion			%
Total	**106.8**	**131.3**	**24.5**	**22.9**
Government Securities	**15.1**	**19.1**	**4.0**	**26.5**
Government Investment Issues	9.1	10.1	1.0	11.0
Islamic Treasury Bills	1.0	2.0	1.0	100.0
Bank Negara Negotiable Notes	5.0	7.0	2.0	40.0
Private Debt Securities	**91.7**	**112.2**	**20.5**	**22.3**
Khazanah bonds	9.0	10.0	1.0	11.1
Corporate bonds	66.0	75.4	9.4	14.2
Commercial papers	3.6	4.4	0.8	22.2
Medium-term notes	10.0	16.7	6.7	67.0
Cagamas bonds	2.5	2.5	0.0	0.0
Asset backed securities	0.6	3.2	2.6	433.3

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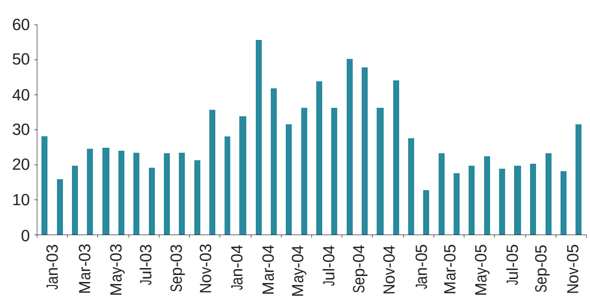
In 2005, the Government of Malaysia issued additional Islamic securities amounting to RM2 billion, consisting of GII and ITB of RM1 billion each. Similarly, Bank Negara Malaysia also increased the issuance of BNNN by RM2 billion during the same period. Overall, the increase in the issuance of Government and Bank Negara Malaysia Islamic securities by RM4 billion or 26.5% during the year has not only stabilised the liquidity condition in the Islamic interbank market but also improved the supply of class one Shariah compliant liquefiable assets in the secondary market. In the case of GII, the new issuance of a 10-year maturity tenure has effectively lengthened the benchmark yield curve of Islamic securities.

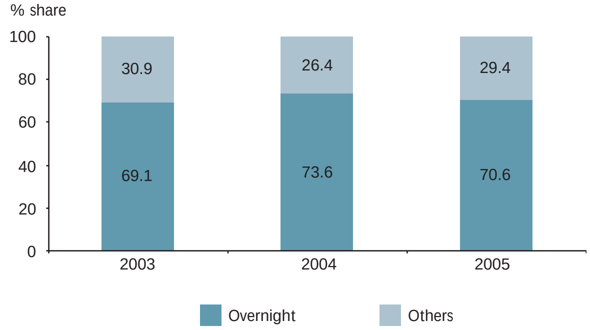
During the year, the total amount of liquidity surplus absorbed through the conduct of *wadiah* interbank acceptance mechanism has reduced as a consequence of the increase in the issuance of Islamic securities. The daily average outstanding amount of liquidity absorbed under this mechanism decreased by 15% from RM3 billion in 2004 to RM2.6 billion in 2005. The stable liquidity position in the Islamic interbank market has led to a steady turnover volume of an average of RM21 billion monthly as well as stabilised the rate of return in the *mudharabah* interbank investment transactions, which registered an average indicative overnight rate of return of 2.6%.

During the year, the trading of Islamic money market papers recorded moderate growth in terms of turnover volume and largely centred on the Islamic securities issued by the Government and Bank Negara Malaysia. The trading of the Islamic Accepted Bills (AB-i) in the secondary market continued to be captive as the issuers prefer to hold the short-term paper until maturity due to the relatively attractive earnings offered by this paper. Similarly, the trading of Negotiable Islamic Debt Certificate (NIDC-i) also recorded moderate growth of 4.9% corresponding with the increase in the creation of this instrument in the

Graph 6.6
***Mudharabah* Interbank Investment - Turnover Volume**



Graph 6.7
***Mudharabah* Interbank Investment - Share of Turnover Volume**



primary market. In 2005, NIDC-i issues increased to RM13.6 billion or 51.1% compared with RM9 billion in 2004. In terms of maturity tenure, more than 45% or RM6.1 billion of NIDC-i is of the maturity of more than one year.

The improvement in the supply of short-term Islamic government securities through BNNN and ITB has contributed to a higher trading volume of these instruments in the secondary market. During the year, the turnover volume of BNNN and ITB grew substantially by RM14.9 billion and RM3.3 billion or an increase of 70.3% and 275% respectively as compared with 2004. In terms of GII, trading in the longer term government securities recorded a growth of 20.3% or RM7.3 billion as compared with 2004. The availability of a continuous and an enlarged supply of these instruments with varying maturity tenure has effectively widened the range of tradable Islamic instruments in the Islamic interbank market.

In terms of total outstanding securities, the Islamic bond market continued to chart a positive growth of 22.9% or RM24.5 billion. The outstanding Islamic private debt securities amounted to RM112.2 billion as at end of 2005 accounted for 40% of the total outstanding private debt securities in the debt market. Corporations have actively sourced funding under the Islamic principles to lock their funding cost through the issuance of longer term Islamic private debt securities with the anticipation of a possible increase in interest rate in the later part of the year. An encouraging development in the Malaysian Islamic bond market, following the liberalisation of the foreign exchange administration rules, was the issuance of a RM700 million ringgit-denominated Islamic debt securities by an international multilateral development financial institution.

In the mortgage securities segment, Cagamas MBS Berhad issued the inaugural Islamic residential mortgage-backed securities (IRMBS) represented by receivables of the Islamic house financing provided by the Government of Malaysia. The RM2.05 billion IRMBS issue is with a maturity tenure ranging from 3 to 15 years and structured based on the concept of *musyarakah*. This landmark issuance, which was oversubscribed by 5.4 times, has attracted wide participation from the domestic as well as the regional investors.

Development Financial Institutions

Development Financial Institutions

OVERVIEW

The year 2005 marked a significant milestone in efforts to further strengthen the development financial institutions (DFIs) which are regulated under the Development Financial Institutions Act (DFIA) 2002. The rationalisation exercise involving four DFIs, was completed during the year, and resulted in the establishment of the Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank) and the merger of the Export-Import Bank of Malaysia Berhad and Malaysia Export Credit Insurance Berhad (MECIB). Meanwhile, Bank Pembangunan dan Infrastruktur Malaysia Berhad was restructured and renamed Bank Pembangunan Malaysia Berhad to reflect its new focus. The rationalisation exercise was an important initiative to realign the activities of the DFIs towards enhancing their strategic and business focus. In addition, progress was also achieved in efforts to strengthen the capacity and capability of the DFIs, as well as to enhance the prudential framework aimed at strengthening the operations of the DFIs. All these initiatives have contributed to the improved performance of the DFIs in carrying out their mandated roles.

During the year, the DFIs continued to record strong financing activities to the identified priority and strategic sectors. Loans outstanding of these DFIs as a group increased by 25.8%, supported by higher deposits (7.3%). Improvements were also recorded in the non-performing loan ratio and profitability indicators. Moving forward, the performance of the DFIs is expected to improve further, as they expand the range of products and enhance the quality and delivery of products and services, coupled with improvements in human resource, processes and systems in the DFIs.

Policy efforts in 2005 for the DFI sector focused on strengthening the DFIs' capacity and capability, as well as enhancing the prudential framework to further strengthen the operations of the DFIs.

POLICIES AND DEVELOPMENTS

Policy efforts in 2005 for the DFI sector focused on two broad areas, namely, strengthening the DFIs' capacity and capability, as well as enhancing the prudential framework to further strengthen the operations of the DFIs. These were complemented by continuous surveillance and supervision of the DFIs to ensure that they remain focused on their mandated roles and that their activities are carried out in a prudent, effective and efficient manner.

Strengthening Capacity and Capability of DFIs

- ***Realignment of roles and functions***
  The rationalisation of Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad (Bank Industri), Export-Import Bank of Malaysia Berhad and MECIB was completed in the fourth quarter of 2005. The rationalisation, which involved changes to the institutional structure and functions of these DFIs, was aimed at enhancing their strategic focus in the respective mandated roles so that these DFIs could efficiently and effectively meet the financial and non-financial needs of the targeted sectors.

  The restructuring of Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri resulted in the establishment of SME Bank, which assumed the entity of Bank Industri, while Bank Pembangunan dan Infrastruktur Malaysia Berhad was renamed Bank Pembangunan Malaysia Berhad (Bank Pembangunan) to reflect its new focus. The exercise involved the transfer of small and medium enterprise (SME) loans of Bank Pembangunan dan Infrastruktur Malaysia Berhad to the SME Bank, while the maritime and technology-related loans of the former Bank Industri were transferred to Bank Pembangunan. Under this new institutional arrangement, the SME Bank becomes a wholly-owned subsidiary of Bank Pembangunan, with a paid-up capital of RM1 billion. Both Bank Pembangunan and the SME Bank commenced operation on 3 October 2005.

  In addition to promoting the development of the infrastructure projects, Bank Pembangunan is also entrusted to promote the development of the maritime sector, as well as the capital-intensive and high technology industries. In financing these sectors, Bank Pembangunan not only provides direct financing, but also arranges for syndicated loans and offer credit enhancement facilities such as bank guarantees and standby revolving credit to facilitate greater access to financing for the targeted sectors.

The SME Bank is a development bank dedicated towards nurturing and promoting the development of SMEs. The SME Bank complements the banking sector in providing financing to the SMEs, especially to those that lack track record and collateral, as well as start-ups. In addition to the normal financial products such as working capital financing and term loans, the SME Bank would be developing new innovative products to meet the requirements of start-ups and SMEs in new growth areas, including those in professional services, export-oriented activities and franchise businesses. Another important focus of the SME Bank is to provide a broad range of advisory services and business development support to SMEs, including financial management, business diagnosis and marketing support. To support the expansion of business activities of the Bank Pembangunan Group, including the SME Bank, a total of RM7 billion would be raised from the capital market.

The other part of the rationalisation exercise involved the merger of the Export-Import Bank of Malaysia Berhad (EXIM Bank) and MECIB. The merged entity, EXIM Bank, is placed directly under the ownership of the Ministry of Finance. The merger led to a creation of a larger entity with bigger financial resources to focus on promoting exports of Malaysian goods and services, as well as in providing overseas projects financing to Malaysian companies venturing abroad. In addition, it promotes greater synergy and economies of scale, while reducing potential duplication of resources, skills and expertise. The placement of the EXIM Bank directly under the Ministry of Finance would enable the bank to capitalise on its near sovereign status in gaining better credit rating recognition, and higher acceptance from the foreign counter parties on guarantees and insurance coverage issued by the bank. This would provide EXIM Bank with more alternative and competitive sources of funding to support its business operations, thus allowing it to better serve its customers and exporters with competitively priced products and services.

In addition to providing an array of financing products, guarantee facilities and insurance products to promote Malaysia's external trade, EXIM Bank will further strengthen its financial support for Malaysian companies to undertake overseas projects. To facilitate this, as announced in the Budget 2006, Bank Negara Malaysia is establishing a RM1 billion fund at EXIM Bank to assist Malaysian companies which have secured or are bidding for contracts to have greater access to financing to undertake their projects abroad. In addition, as part of the Government's efforts to enhance SMEs' access to financing, the EXIM Bank launched two new products, namely, the Multi-Currency Trade Finance and Indirect Exporter Financing Scheme, in January 2006. With these products, SMEs can obtain greater access to financing at attractive costs with no collateral requirement to finance their export activities to the non-traditional markets, especially to the member countries of the Organisation of Islamic Conference.

- ***Strengthening of Bank Pertanian Malaysia***
  Efforts have been initiated to strengthen the role of Bank Pertanian Malaysia (Bank Pertanian) in enhancing access to financing for the agriculture sector and agro-based industries. Towards this end, the financial capacity and institutional structure of Bank Pertanian will be strengthened, while its scope of activities will be widened to include a broader range of financial and non-financial products and services. This initiative is envisaged to increase the effectiveness of Bank Pertanian in meeting the needs of the entire value chain of agriculture activities, while continuing to facilitate the achievement of the socio-economic development objectives of the Government.

- ***Enhancing Advisory Capabilities of DFIs for SMEs***
  The project to enhance the capabilities of DFIs in providing consultancy and advisory services to the SMEs, which involved the Japan International Cooperation Agency, Bank Negara Malaysia and selected DFIs, was completed in November 2005. Following this, a customised action plan was formulated for the SME Bank, Bank Pertanian and EXIM Bank, which identifies the types of advisory services to be provided by each of these DFIs, as well as outline the strategies to improve their operational infrastructure and develop human resource capability to better provide advisory services. Among the consultancy and advisory services identified include customer counselling, basic problem identification and management diagnosis for SMEs, as well as the provision of business matching services for the SMEs. The action plans also include strategies for the DFIs to establish collaborative and strategic alliance with the relevant Government SME agencies to leverage on the expertise and facilities of these agencies, particularly in the provision of technical support. The collaboration and network established between the DFIs and the Government SME agencies would facilitate the SMEs to have better access to advisory services in a more structured and well-coordinated manner.

Enhancing Prudential Framework for DFIs

- ***Guidelines on the Governance of Shariah Committee***
  Bank Negara Malaysia issued the Guidelines on the Governance of Shariah Committee to the DFIs under the purview of DFIA on 31 May 2005, to rationalise and streamline the functions, as well as duties of the Shariah Committees of the DFIs. The guidelines set out the rules, regulations and procedures of establishing a Shariah Committee, define the role and responsibilities of the Committee, as well as ensure that the Committee is competent and effective in performing its duties and responsibilities. Among the duties of the Committee are to advise the Board of Directors of the DFIs on Shariah matters involved in their business operations, as well as other related responsibilities similar to the Shariah Committees in other Islamic financial institutions. The guidelines also define the relationship and working arrangement between the Shariah Committee of the DFIs and the Shariah Advisory Council of Bank Negara Malaysia. The Shariah Committees of DFIs must comprise a minimum of three members, and prior approval of Bank Negara Malaysia needs to be obtained for the appointment and reappointment of a Shariah Committee member.

- ***Circular on Takaful Protection for Islamic Financing***
  This circular, which was issued on 27 May 2005, requires DFIs to provide Takaful protection for their Islamic financing products. This is in line with the Bank's efforts to strengthen the Islamic banking operations and to streamline practices adopted by other financial institutions in the industry. The DFIs which provide Islamic financing are required to offer Takaful plans to their customers in offering protection for Islamic financing that needs coverage. Conventional insurance coverage would only be allowed as an alternative in the event that a Takaful plan is not available in the market, or is rejected by customers. In such incidents, the conventional insurance coverage should be offered separately and not as part of the Islamic financing package.

- ***Issuance of Guidelines and Circulars to Bank Pertanian Malaysia***
  Following the placement of Bank Pertanian under the purview of Bank Negara Malaysia, a number of existing prudential measures issued to the regulated DFIs were also extended for implementation by Bank Pertanian. This is to strengthen its financial and operational soundness, as well as to ensure that it performs the mandate to promote the development of the agriculture sector in an effective and efficient manner.

Monitoring and Supervision of DFIs

In ensuring that the operations of DFIs are carried out in a prudent, effective and efficient manner to meet their mandated roles, supervisory activities by the Bank in 2005 were focused on enhancing the standard of corporate governance, risk management and operational efficiency of the DFIs.

- ***Strengthening Corporate Governance***
  In strengthening corporate governance, the quality and proactiveness of the board's oversight as well as effectiveness of leadership of the DFIs, in terms of providing strategic direction and contribution towards the overall management of the DFIs were assessed. In this context, the roles and functions performed by the board of directors towards enhancing the DFIs' capacity, capabilities and competitiveness were rigorously evaluated.

  In the course of on-site examinations, interviews with members of the board were conducted to better assess the level of participation and contribution of the directors in managing the institutions. The interviews also provided an avenue for supervisors to discuss supervisory concerns and measures, whilst keeping abreast with issues confronting the DFIs. These interactions have translated into more active participation among the board and senior management of the DFIs in driving the performance of the institutions, including managing the stakeholders' expectations, as well as improving their oversight function. The board and senior management were also encouraged to identify and develop clear key performance indicators to gauge the efficiency and effectiveness of the DFIs in performing their mandated roles. These indicators are to enable the DFIs to evaluate their performance and hence, continually strive to better meet the increasing demand and challenges of the targeted sectors.

- ***Enhancing Risk Management and Operational Efficiency***
  Supervisory activities were also directed at ensuring that the risk management practices of DFIs commensurate with the magnitude and complexity of the risks assumed. In this regard, emphasis was placed on assessing the effectiveness of asset management and internal control, as well as the adequacy of infrastructure and management information systems to support their business

operations. During the year, the quality of customer services was also assessed to ensure that the DFIs are able to effectively meet the needs of their identified strategic sectors. It was noted that the DFIs have made improvements in areas such as enhancement of policies and operational procedures; putting in place adequate human resource capabilities; establishing clear lines of responsibilities and management structures, as well as strengthening of the internal audit function. In addition, loan delivery systems and delivery channels had also improved.

PERFORMANCE OF DEVELOPMENT FINANCIAL INSTITUTIONS

The performance of the DFIs remained favourable, with higher growth in deposits and strong increase in the financing activities to support the strategic sectors of the economy. Among the strategic sectors which received financing from the DFIs were the infrastructure, manufacturing, agriculture, maritime and export sectors, as well as capital-intensive and high technology industries, and Bumiputera entrepreneurs.

Financing activities of the DFIs continued to support the strategic sectors of the economy.

Financing Activities

Total loans outstanding of the 13 DFIs expanded by 25.8% to RM47.5 billion as at end-2005 (end-2004: RM37.7 billion) to account for 47.4% of total assets of the DFIs as at end-2005. The strong increase was driven largely by the growth in financing for consumption credit extended by Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat) and loans extended by Bank Pembangunan for infrastructure projects. Lending for consumption credit rose strongly by 42.2% to account for 29.6% of the total loans outstanding of the DFIs. Loans extended to the construction, utilities, and transport and communication sectors as a group increased by 31.1%, representing 27.8% of total loans. Favourable growth was also recorded in financing to the manufacturing and agriculture sectors, with total loans extended to these two sectors as a group accounting for 16.5% of DFIs' total loans outstanding. Meanwhile, the extension of guarantee and credit insurance facilities rose by 12.4% to RM4.8 billion as at end-2005 (end-2004: RM4.3 billion), due largely to higher guarantees provided by the Credit Guarantee Corporation Malaysia Berhad (CGC).

Table 7.1
Development Financial Institutions[1]: Sources and Uses of Funds

	Annual Change		As at end-2005
	2004	2005	
	RM million		
Sources:			
Shareholders' funds	1,119.7	2,072.6	12,616.4
Paid-up capital	*670.0*	*701.1*	*8,563.4*
Reserves	*451.7*	*396.8*	*2,448.1*
Retained earnings	-2.0	974.7	1,604.9
Deposits accepted	7,474.7	3,658.6	53,536.6
Borrowings	2,154.1	2,250.7	20,981.6
Government	*1,319.9*	*1,821.3*	*14,871.4*
Multilateral / International agencies	*885.7*	*602.5*	*4,646.7*
Others	*-51.5*	*-173.1*	*1,463.5*
Others	1,611.0	712.6	13,009.8
Total	**12,359.5**	**8,694.5**	**100,144.4**
Uses:			
Deposits placed	2,663.3	-4,796.9	14,111.1
Investments	4,327.5	4,174.3	29,731.3
of which:			
Government securities	*-321.5*	*2,148.5*	*4,777.8*
Shares	*1,477.9*	*1,535.2*	*9,791.2*
Quoted	*1,168.2*	*1,564.6*	*7,933.7*
Unquoted	*309.7*	*-29.4*	*1,857.5*
Loans and advances	5,392.3	9,731.3	47,478.4
Fixed assets	350.2	169.2	4,226.9
Others	-373.8	-583.4	4,596.7
Total	**12,359.5**	**8,694.5**	**100,144.4**
Contingencies:			
Guarantee	287.4	455.1	4,404.1
Export credit insurance	185.3	71.8	380.4
Total	**472.7**	**526.9**	**4,784.5**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Credit Guarantee Corporation Malaysia Berhad, Lembaga Tabung Haji, Sabah Development Bank Berhad, Sabah Credit Corporation, Borneo Development Corporation (Sabah) Sendirian Berhad and Borneo Development Corporation (Sarawak) Sendirian Berhad.
Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and Malaysia Export Credit Insurance Berhad and exclude SME Bank.

The six DFIs under the purview of Bank Negara Malaysia recorded strong growth in loans outstanding of RM9.9 billion or 29.6% to RM43.4 billion as at end-2005 (end-2004: RM33.5 billion). The increase in financing emanated primarily from retail financing provided by Bank Rakyat which grew by 36% and financing of the infrastructure projects by Bank Pembangunan (+34.1%). Similarly, lending activities of Bank Simpanan Nasional (BSN) and EXIM Bank also recorded strong growth of 30.9% and 25.6% respectively. However,

Table 7.2
Development Financial Institutions[1]: Direction of Lending

	Annual Change 2004	Annual Change 2005	As at end-2005
	RM million		
Agriculture, forestry and fishery	387.4	96.2	3,357.6
Mining and quarrying	-8.4	-10.2	56.6
Manufacturing	174.2	332.4	4,458.6
Electricity, gas and water supply	611.8	1,024.1	2,253.0
Import and export, wholesale and retail trade, restaurants and hotels	448.4	-55.5	643.3
Broad property sector	1,708.1	1,578.2	11,662.9
Construction	*177.2*	*933.9*	*5,120.5*
Purchase of residential property	*1,150.2*	*1,397.0*	*5,475.1*
Purchase of non-residential property	*22.8*	*-34.3*	*429.6*
Real estate	*357.9*	*-718.4*	*637.7*
Transport, storage and communication	*231.5*	*1,179.3*	*5,844.5*
Finance, insurance and business services	-710.5	-173.5	810.7
Consumption credit	1,830.0	4,172.5	14,069.0
Others	719.8	1,587.8	4,322.2
Total	**5,392.3**	**9,731.3**	**47,478.4**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Credit Guarantee Corporation Malaysia Berhad, Lembaga Tabung Haji, Sabah Development Bank Berhad, Sabah Credit Corporation, Borneo Development Corporation (Sabah) Sendirian Berhad and Borneo Development Corporation (Sarawak) Sendirian Berhad.
Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and exclude SME Bank.

Bank Pertanian registered a moderate loan growth of 2.8%, while the SME Bank, which began operation in October 2005, approved RM333.8 million to 202 SMEs between October and December 2005. The underwriting activities of EXIM Bank, including credit insurance and guarantee facilities from the former MECIB, increased by 18.1% (2004: 25.2%). Higher financing activities by the DFIs were reflected in high approvals and disbursements. Total loans approved by the six DFIs amounted to RM16.1 billion (2004: RM19 billion) while total loans disbursed were significantly higher at RM17.8 billion, compared with RM10.9 billion in 2004.

Total gross NPLs of the 13 DFIs as a group declined by RM49.3 million to RM5.2 billion as at end-2005. As a result of the larger loan base, the gross NPL ratio improved to 11.4% as at end-2005 (end-2004: 14.7%). For the six DFIs under the purview of Bank Negara Malaysia, the gross and net NPL ratios improved to 10.3% and 4.4% respectively (end-2004: 13.2% and 5.5% respectively).

Table 7.3
Development Financial Institutions[1]: Non-performing Loans and Loan Loss Provisions

	As at end-2004	As at end-2005
	RM million	
General provisions	735.7	948.6
Interest-in-suspense	1,362.1	1,367.8
Specific provisions	2,095.0	2,085.8
Non-performing loans	5,229.6	5,180.3
	Percent (%)	
Gross NPL ratio[2]	14.7	11.4
Net NPL ratio[3]	5.5	4.1
Total provisions/NPL	80.2	85.0

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad and Sabah Credit Corporation.
Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and exclude SME Bank.
[2] Gross NPL ratio = (NPL / Gross loans*) X 100%.
[3] Net NPL ratio = (NPL less IIS less SP) / (Gross loans* less IIS less SP) X 100%.
* Excluding loans provided by Credit Guarantee Corporation Malaysia Berhad, Lembaga Tabung Haji, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad and loans under ECR scheme.

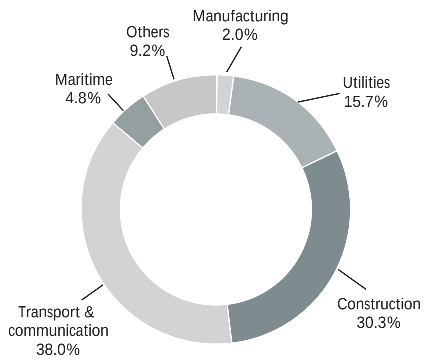
Sources of Funding

Total deposits mobilised by the deposit-taking DFIs increased by 7.3% to RM53.5 billion as at end-2005 (end-2004: RM49.9 billion), to account for 53.5% of the total resources of the DFIs. During the year, savings by individuals increased by 4.1% to RM25.5 billion (end-2004: RM24.5 billion), accounting for 47.6% of total deposits mobilised. Deposits from individuals were mainly mobilised by Lembaga Tabung Haji and BSN. Meanwhile, deposits mobilised from private business enterprises and the Government (including its related agencies), grew strongly by 16.9%, increasing their share to 46.7% of total deposits of the DFIs. In addition to deposits, other sources of funds were shareholders' funds which increased by RM2.1 billion as well as higher borrowings, mainly from the Government (RM1.8 billion).

Bank Pembangunan Malaysia Berhad

In 2005, financing activities of Bank Pembangunan continued to remain strong, especially lending for the infrastructure projects. Formerly known as Bank Pembangunan dan Infrastruktur Malaysia Berhad, the bank evolved following a rationalisation exercise involving a number of DFIs in September 2005. The rationalisation resulted in a structural change in the bank's loan portfolio. In addition to providing financing for infrastructure projects, the bank was entrusted with

Graph 7.1
Bank Pembangunan Malaysia Berhad: Direction of Lending as at 31 December 2005



additional roles of providing medium- to long-term financing to the maritime sector, as well as capital-intensive and high technology-based industries in the manufacturing and other selected sectors. The loan portfolios in maritime and high technology industries of the former Bank Industri were absorbed by Bank Pembangunan. Effective 1 October 2005, the bank's SME loan portfolio was transferred to its newly formed subsidiary, SME Bank.

The bank's total loans outstanding increased strongly by 22.7% to RM14.2 billion as at end-2005 (end-2004: RM11.6 billion), led by the strong growth of 34.1% (2004: 15.3%) or RM3.4 billion in lending to the infrastructure sector. Both Government-identified and private sector projects increased markedly by 29.2% and 47.1% respectively, with the former accounting for 70% of the total loans outstanding for the infrastructure sector. The bulk of the increase in infrastructure loans was channelled to the utilities sector (RM1 billion), transport and communication sector (RM908 million) and construction sector (RM802 million). Loans for infrastructure projects amounting to RM4.7 billion were disbursed (2004: RM1.9 billion). However, total loans approved to the sector declined to RM1.9 billion, compared with RM7.4 billion in 2004.

The bank's lending to its new targeted sectors, namely the high technology and maritime sectors totaled RM868.3 million as at end-2005. Financing to the maritime sector, which comprised shipbuilding, shipyard and marine-related industries, constituted 78.6% of the total loans outstanding to the two sectors. During the period between October to December 2005, the bank approved a total of RM31.9 million loans to the two sectors while total loans disbursed amounted to RM107.4 million.

Bank Pembangunan's gross NPLs declined to RM433.4 million as at end-2005, due mainly to the transfer of the SME loan portfolio to the SME Bank. As a result, the gross NPL ratio improved from 7.9% to 3%, while the net NPL ratio improved to 0.8% (2004: 2.7%).

Following the rationalisation exercise, Bank Pembangunan's total investments increased to RM2.6 billion, accounting for 13.7% of total assets. During the year, the investment portfolio grew markedly by 95.9% (RM1.3 billion) attributed primarily to the acquisition of shares in a subsidiary of the former Bank Industri and investment holdings in the SME Bank. Meanwhile, total deposits placed with financial institutions declined by RM2.1 billion due mainly to the utilisation of funds for loan disbursements as well as a transfer of funds to the SME Bank.

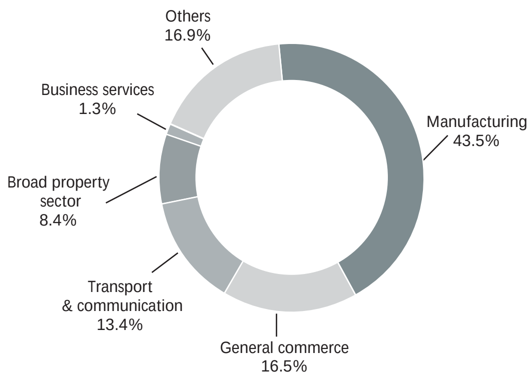
The major source of funding for Bank Pembangunan was borrowings from the Government and multilateral international agencies, which amounted to RM8.8 billion as at end-2005, forming the largest component (57.2%) of its total liabilities. During the year, total borrowings rose by 11% (RM875.9 million) reflecting additional funds received from Government agencies. However, this was partially offset by the transfer of borrowings to the SME Bank. In 2005, total shareholders' funds grew markedly by RM869.2 million to RM3.8 billion as at end-2005 (end-2004: RM2.9 billion), contributed mainly by the share swap with SME Bank (RM328.7 million) as well as capital injection by the Government (RM200 million).

Bank Perusahaan Kecil & Sederhana Malaysia Berhad

SME Bank started operations on 3 October 2005, following the rationalisation of Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri. The bank is a subsidiary of Bank Pembangunan and has 15 branches to serve the entrepreneurial community in the country.

Reflecting the Government's commitment to support SMEs, the SME Bank commenced operations with a paid-up capital of RM1 billion. The loan portfolio of SME Bank comprised of all SME loans transferred from Bank Pembangunan and the former Bank Industri. As at end-2005, total assets of the SME Bank amounted to RM4.9 billion, of which 43.5% were loans and 22% were deposit placements.

Graph 7.2
Bank Perusahaan Kecil & Sederhana Malaysia Berhad: Direction of Lending as at 31 December 2005



During the initial three months of its operations, the bank approved a total of 202 loan accounts amounting to RM333.8 million, of which RM311.2 million (or 93.2% of total loans approved) was extended to Bumiputera SMEs (193 loan accounts). Loan approvals were mainly granted to SMEs in the manufacturing, construction and business services sectors. Meanwhile, RM319.7 million of loans were disbursed to 563 loan accounts over the same period, mainly to SMEs in the manufacturing, general commerce, and transport and communication sectors. In December 2005, the bank launched a new product called SME professional, whereby financing is given to professionals involved in the services industry such as health care, accounting, consultancy and architecture.

The bank's total loans outstanding declined by RM43.8 million to RM2.1 billion as at end-2005, due to loans write-off amounting to RM147.7 million. Excluding the write-off, loans outstanding increased by RM191.5 million, channeled mainly to the manufacturing, general commerce, and transport and communications as well as construction sectors. As at end-2005, loans to the manufacturing sector accounted for 43.5% of total loans outstanding. Meanwhile, loans outstanding to Bumiputera SMEs declined by RM6 million to RM1.7 billion as at end-December 2005, representing 79.4% of total loans.

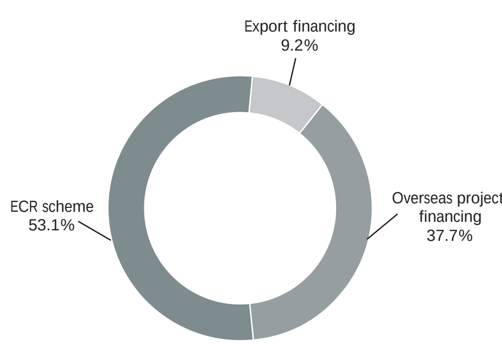
As at end-2005, SME Bank managed 23 Government funds with loans outstanding amounting to RM1.1 billion or 50.3% of total loans outstanding. During the three month period, loan approvals and disbursements under the funds amounted to RM827.4 million and RM1.4 billion respectively, mainly through the New Entrepreneurs Fund 2 and Fund for Small and Medium Industries 2.

Export-Import Bank of Malaysia Berhad
In tandem with the continued expansion of Malaysia's external trade sector, financing activities of the EXIM Bank were higher in 2005. The bank's total loans outstanding expanded strongly by 25.6% to RM2.8 billion as at end-2005 (2004: 15.3%), reflecting mainly increased in loans under the Government-funded Export Credit Refinancing (ECR) scheme.

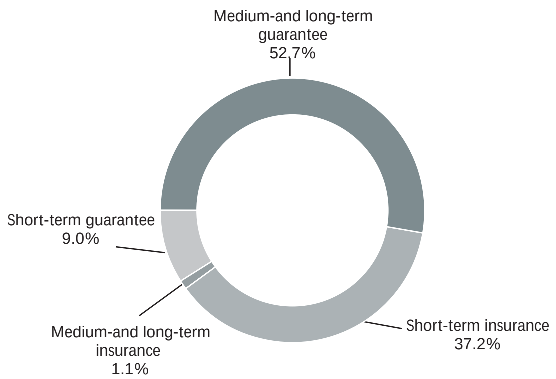
Loans outstanding under the ECR scheme, which was extended mainly to the palm oil, rubber and chemical industries, expanded markedly by 27.7% (2004: 4.7%) to RM1.5 billion as at end-2005. The strong demand for financing under the scheme was due largely to the continuous nationwide promotion by ECR participating banks and EXIM Bank, as well as anticipation of higher interest rates in the market. Concomitantly, loans disbursed under the scheme increased by 7.7% (2004: 2.3%).

Loans outstanding under the export financing and overseas project financing also expanded strongly during the year, by 38.1% and 20.3% respectively. Consistent with the bank's role to facilitate the diversification of Malaysia's export markets, about 58.7% of total overseas project financing and 38% of export financing were channelled to non-traditional markets. Nearly one-half of the total overseas project financing were channelled to projects in South-East Asia, followed by Africa (22.4%) and East Asia (12.7%).

Graph 7.3
Export-Import Bank of Malaysia Berhad: Credit Facilities as at 31 December 2005



Graph 7.4
Export-Import Bank of Malaysia Berhad: Contingent Liabilities as at 31 December 2005



The gross NPL amount, excluding loans provided under the ECR scheme, increased to RM361.6 million in 2005 (2004: RM306.8 million). However, due to larger loan base, the gross NPL ratio improved to 27.2% compared with 28.5% as at end-2004. Overseas project financing accounted for 97.1% of the NPLs.

Following a rationalisation exercise, effective 1 October 2005, EXIM Bank merged with MECIB with the merged entity retaining EXIM Bank's name and all operations of MECIB was absorbed by EXIM Bank. Total exposure of the bank arising from its guarantee and export credit insurance business recorded an increase of 18.1% during the year (2004: 25.2%) to RM993.9 million as at end-2005. Export credit insurance facilities expanded by 23.3% or RM71.8 million during the year to RM380.5 million, while guarantee business increased by 15% or RM80.2 million to RM613.5 million. Medium- and long-term coverage continued to account for the major portion of the total exposure with 53.8% (RM534.5 million) and the balance 46.2% (RM459.4 million) constituted of short-term coverage.

Reflecting the bank's efforts to promote the diversification of Malaysia's export markets, 45.5% of the total exposure were to countries categorised as non-traditional markets. In terms of distribution by region, East Asia was the largest region accounting for 25.7% of total exposure, followed by South-East Asia (22.8%), North America (12.7%), Western Europe (10.8%) and Middle-East (10.5%).

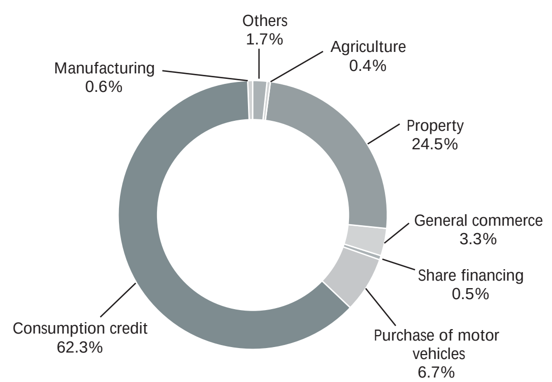
Following the merger, EXIM Bank's shareholders' funds increased to RM481.4 million due largely to the increase in paid-up capital of the merged entity to RM380.5 million. During the year, the bank's outstanding borrowing from the Government which was utilised solely for the ECR scheme, remained unchanged while borrowings from international agencies increased by RM191 million to RM691 million as at end-2005. Deposit placements which accounted for 25.1% of the bank's total assets, however, declined by 19.9% or RM254.7 million during the year to RM1 billion as at end-2005 (end-2004: RM1.3 billion).

Bank Kerjasama Rakyat Malaysia Berhad

The total assets of Bank Rakyat increased by 13.2% to RM25.3 billion as at end-2005 (end-2004: RM22.3 billion), contributed mainly by strong growth in financing. The share of total financing outstanding to total assets increased to 66.6% as at end-2005, from 55.4% as at end-2004. The growth in financing was partially offset by the reduction in both deposit placements and investment in securities. Deposits placed with the financial institutions declined by RM1.2 billion to RM2.8 billion, while holdings in investment securities declined by RM348 million to RM5 billion as at end-2005. As a result, the proportion of these asset components to total assets declined to 31% as at end-2005 from 42% the year before.

Total financing outstanding increased strongly by 36% to RM16.8 billion as at end-2005 (end-2004: RM12.4 billion) with the increase attributed mainly to the strong increase in consumption credit, especially for personal loans, which grew by 36.3% to RM10.5 billion. In addition, financing for the purchase of houses and vehicles was also strong, increasing by 40.7% and 70.7% to RM3.7 billion and RM1.1 billion respectively. Of the total financing outstanding, 62.3% was extended for

Graph 7.5
Bank Kerjasama Rakyat Malaysia Berhad: Direction of Financing as at 31 December 2005



consumption credit, followed by the property sector (24.6%), and purchase of vehicles (6.7%). While Bank Rakyat's lending to its members increased by RM2 billion to RM11.7 billion at the end of the year, its proportion to total financing outstanding declined from 78.2% to 69.3%, following higher lending to non-members which increased markedly by RM2.5 billion (2004: RM0.4 billion) to RM5.2 billion. The bank's strong financing activities in 2005 were reflected in higher financing approvals and disbursements, which amounted to RM8.2 billion and RM9.2 billion respectively. Mainly as the result of its enlarged loan base, the gross non-performing financing (NPF) ratio improved to 6.8% from 8.8%, while the net NPF ratio improved to 2.9% from 4.2%.

Deposits mobilised by Bank Rakyat increased by 14.2% or RM2.4 billion to RM19.5 billion as at-end 2005, due mainly to the relatively attractive returns offered by the bank. The increase in deposits reflected higher placements by business enterprises, which increased by RM1.2 billion to RM12.7 billion, to account for 65% of total deposits as at end-2005. Deposits mobilised from individuals increased by RM0.3 billion to RM2.5 billion.

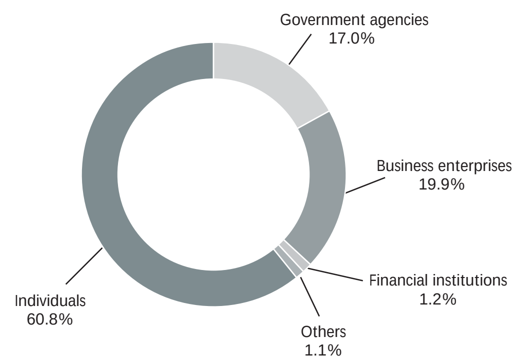
The bank's shareholders' funds increased to RM3.7 billion as at end-2005 (end-2004: RM3.5 billion) mainly from higher profits. The bank recorded profits before tax and zakat of RM535.5 million compared with RM460 million in 2004. During the year, the bank's paid-up capital increased by RM3.7 million to RM1,951.9 million, reflecting subscriptions by new members. The paid-up capital of the bank has reached close to RM2 billion since September 2004 following an upward trend in applications for membership and additional shares. As at end-2005, Bank Rakyat's individual membership stood at 693,963 (end-2004: 714,743) while the membership of cooperatives was 1,207 (end-2004: 1,172).

Bank Simpanan Nasional

BSN, or National Savings Bank, continued to record strong growth in deposits mobilised and retail loans during the year. BSN operations, as at end-2005, were supported by 390 branches and 616 ATMs located in both the urban and rural areas. To further improve its services, BSN joined Malaysian Electronic Payment System (MEPS) in December 2005, which enable its customers to access ATMs that support MEPS service.

Total deposits mobilised by BSN increased by 19.1% to RM13.1 billion at end-2005 (end-2004: RM11 billion), due mainly to placements by the Government. Deposits of private business enterprises increased by RM1 billion during the year, but there were net withdrawals by

Graph 7.6
Bank Simpanan Nasional:
Total Deposits Accepted as at 31 December 2005



Government-controlled companies amounting to RM0.4 billion. As a result, total deposits of business enterprises increased by RM0.6 billion or 28.3% to RM2.6 billion as at end-2005, to account for 20% of total deposits (end-2004: 18.5%). Deposits of individuals increased marginally by 1.2% to RM8 billion as at end-2005 to account for 60.8% of total deposits (end-2004: 71.6%). Fixed deposits accounted for 52.1% of total deposits accepted, while savings deposits comprised 40.1%, and the remaining was general investment deposits.

In terms of uses of funds, 56.6% were invested in securities, which increased by 37.8% to RM8.6 billion as at end-2005. In particular, the holdings of Government papers increased by RM1.6 billion. Loans and financing accounted for 27.5% of total assets.

Financing activities of BSN remained strong in 2005, and initiatives to introduce Islamic products were successful as Islamic financing rose significantly by RM628.1 million to RM782.8 million as at end-2005. Higher loans were approved and disbursed, amounting to RM2.2 billion and RM1.6 billion respectively (2004: RM1.4 billion and RM1.3 billion respectively). Total financing outstanding increased strongly by RM1 billion or 30.9% to RM4.2 billion as at end-2005, due mainly to the significant growth in personal loans (RM0.9 billion) as a result of attractive low interest rate package. In addition, there was also a marked increase in financing for the purchase of residential houses of RM315.7 million to RM1.5 billion as at end-2005. The micro credit scheme, which was launched in June 2003, was suspended in December 2004. A total of RM723.1 million was disbursed to 88,774 applicants. Following the suspension of the scheme, efforts were focused on improving repayment and recovery, and as a result the outstanding micro credit loan outstanding declined to RM517.1 million as at end-2005 (end-2004: RM610.7 million).

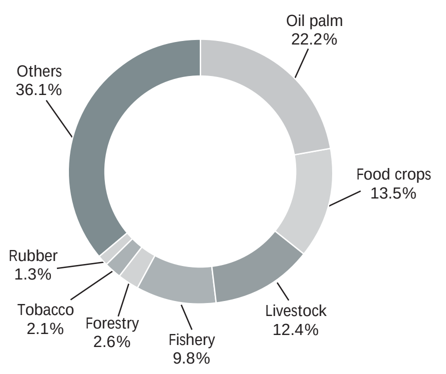
Gross NPLs increased by RM176.1 million to RM626 million as at end-2005, attributed mainly to the increase in the NPL of housing loans, micro credit and credit card loans. As a result, the gross NPL ratio deteriorated from 14.1% at end-2004 to 15% at end-2005. However, on a net basis, the NPL ratio improved to 6.7% from 7.7%, due mainly to higher provisioning for micro credit.

Bank Pertanian Malaysia

Bank Pertanian Malaysia or Agriculture Bank of Malaysia continued to support the agriculture activities by providing financing to the entire value chain of the agriculture sector. In addition to the oil palm industry, Bank Pertanian continued to extend financing to new areas, such as support services and agro-based processing industries. The increase in loans extended to these industries was, however, largely offset by the decline in loans to paddy, forestry and livestock sectors. As a result, total loans outstanding increased at a moderate rate of 2.8% (2004: 14.8%) to RM3.2 billion as at end-2005. During the year, RM716.8 million were disbursed, mainly for agricultural support services (RM296.7 million) and oil palm (RM186.4 million).

Small farmers continued to be the largest group of borrowers, accounting for 98.7% of total number of borrowers, with total loans outstanding of RM1.7 billion. During the year, Bank Pertanian approved loans totalling RM865.5 million to 37,182 loan accounts, mainly to small farmers (99.6% of total number of borrowers).

Graph 7.7
Bank Pertanian Malaysia:
Direction of Lending as at 31 December 2005



Bank Pertanian discontinued the micro credit scheme in December 2004 as the allocation had been fully utilised. Since the launch of the micro credit scheme in June 2003, Bank Pertanian received a total of 32,173 applications and approved 17,603 applications with a value of RM202.1 million. A total of RM200 million had been disbursed under the scheme, with borrowers mainly involved in trading and marketing of agricultural products. As at end-2005, total loans outstanding of micro credit scheme stood at RM75.7 million (end-2004: RM117 million).

Gross NPLs declined by RM86.9 million to RM1.2 billion as at end-December 2005, which resulted in a lower gross NPL ratio of 36.5% (end-2004: 40.3%). Similarly, net NPL ratio improved to 18.7% (end-2004: 22.8%).

In terms of total assets, loans remained the largest component, accounting for 51.5% of total assets, followed by investments which formed 27.2% (RM1.7 billion) of total assets. The investments were mainly in promissory notes/commercial papers (51.6%), private debt securities (37.5%) and unit trusts (28.7%).

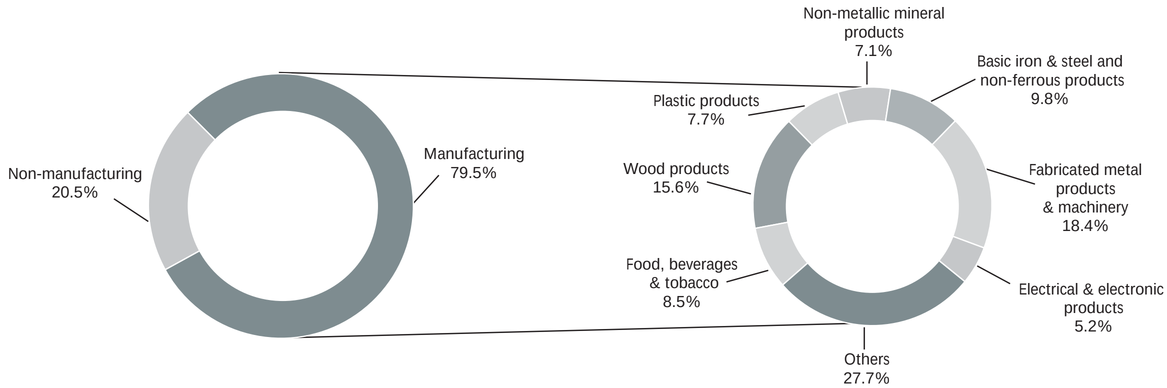
Total deposits outstanding declined by RM521.1 million or 12.7% (2004: 8.8%) to RM3.6 billion as at end-2005, mainly due to net withdrawal by business enterprises. Nevertheless, deposits, which were mobilised through its network of 172 branch offices and 5,634 mobile units nationwide, remained the largest sources of funds for Bank Pertanian, accounting for 58.5% of total resources. To further enhance services offered to its customers, Bank Pertanian became a member of MEPS in July 2005, thus enabling its depositors to access ATMs that support MEPS services.

Borrowings from the Government amounted to RM1.7 billion as at end-December 2005 (27.6% of total resources) mainly to support the various Government financing schemes. Bank Pertanian managed 10 funds with loans outstanding amounting to RM176 million or 5.6% of the total loans outstanding as at end-December 2005.

Malaysian Industrial Development Finance Berhad

The Malaysian Industrial Development Finance Berhad (MIDF) sustained its lending activities in 2005, with total loans approved and disbursed increasing by 14.3% to RM532 million (2004: RM466.1 million) and 1.4% to RM306.3 million (2004: RM302 million) respectively. In order to enhance its services, MIDF planned to introduce two new supplementary products, namely, the Revolving Credit and Contract Financing for working capital purposes in 2006, to better meet its customers' financing requirements.

Graph 7.8
Malaysian Industrial Development Finance Berhad: Direction of Lending as at 31 December 2005



Total loans outstanding declined slightly by 1.3% to RM1.1 billion as at end-2005, as the increase in loans disbursed was offset by repayments. Loans to the manufacturing sector remained the largest share (79.5%) of MIDF's total loan portfolio. Among the manufacturing activities benefiting from loans by MIDF were the fabricated metal products and machinery industry (18.4% of total manufacturing financing), followed by the wood product industry (15.6%), basic iron and steel and non-ferrous product industry (9.8%), and transport equipment industry (8.5%). In terms of borrower, the SMEs remained the main beneficiaries, with its share of total loans outstanding increasing further to 66.4%, compared with 57.8% in 2004.

Meanwhile, as an institution that manages the Government special funds, total outstanding funds managed by MIDF increased by 12.1% to RM442 million as at end-2005 (end-2004: RM394.1 million). SMEs were the major recipients of financing from these funds, which include the Soft Loan for SME Fund, Fund for SMI 2 and the Japan Bank for International Cooperation Fund for SMIs.

Based on a 3-month classification, NPLs improved significantly in 2005. Gross NPLs, which comprised mainly NPLs to the manufacturing sector, declined to RM245.9 million (2004: RM362 million) with gross NPL ratio improving to 21.8% (2004: 31.7%). On a net basis, the NPL ratio declined to 9.3% (2004: 12.4%).

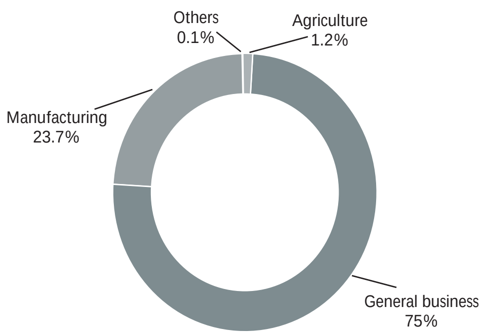
Shareholders' funds and borrowings remained the major sources of funds to support activities of MIDF. During the year, despite a slight decline in the shareholders' funds to RM1.4 billion due to dividend payout, it remained the largest funding source to account for 48.7% of MIDF's total resources. Borrowings contributed to another RM1.2 billion or 40.3% of MIDF's total resources. These included borrowings from the Government of RM561.6 million for lending to support socio-economic development and RM415 million funds raised from the capital market for use in corporate lending activities.

Credit Guarantee Corporation Malaysia Berhad

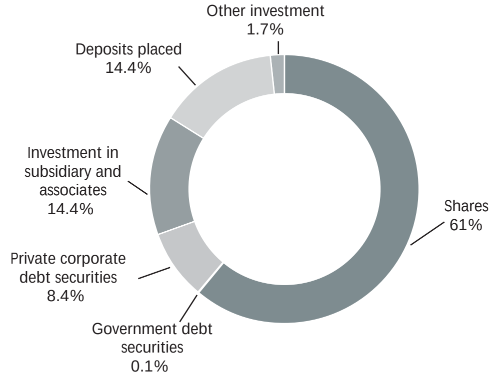
The Credit Guarantee Corporation Malaysia Berhad (CGC) continued to assist and facilitate SMEs in gaining better access to financing through the provision of guarantees and advisory support services. As part of these efforts, CGC launched the Islamic Direct Access Guarantee Scheme (DAGS-*i*) in December 2005, aimed at meeting the needs of SMEs which utilised Islamic financing to fund their activities. During 2005, total guarantees outstanding expanded by 11.8% to RM3.7 billion as at end-2005 (end-2004: RM3.3 billion), mainly attributed to the growth in the major guarantee schemes, namely, the Direct Access Guarantee Scheme (DAGS), the New Principal Guarantee Scheme and the Flexi Guarantee Scheme. During the year, total guarantees provided under these schemes increased by 23.8%, constituting a combined share of 86.1% of total guarantees outstanding.

Reflecting continuous efforts in supporting the smaller SMEs, loans of less than RM250,000 was the largest component of loans to have benefited from the guarantee schemes of the CGC, accounting for 81% of the total number of loans guaranteed as at end-2005 (end-2004: 77.7%). In terms of value guaranteed, loans of between RM500,000 to RM1 million accounted for 29.3% of the total guarantees outstanding, followed by those of above RM1 million (25.7%), and between RM250,000 to

Graph 7.9
Credit Guarantee Corporation Malaysia Berhad: Guarantee by Sector as at 31 December 2005



Graph 7.10
Lembaga Tabung Haji: Investments as at 31 December 2005



RM500,000 (24.4%). During the year, loans extended to SMEs involved in the general business sector received three quarters of CGC's total guarantee coverage, while 23.7% of the guarantee coverage was for loans extended to the manufacturing sector. In 2005, total claims paid by CGC to the banking institutions increased by 19.1% to RM147.3 million (2004: RM123.7 million).

CGC continued to rely on its shareholders' funds (RM2.2 billion) and borrowings from the Government and its shareholder (RM1.9 billion), which together accounted for 88.3% of the total sources of funds to support its guarantee issuance and lending activities. In line with the Government's focus to promote the development of SMEs, Bank Negara Malaysia, as the largest shareholder of CGC, initiated efforts to enhance the capacity and capability of CGC to enable the institution to better serve the needs of SMEs. Towards this end, the scope of activities of CGC has been widened to not only providing credit guaratee facilities, but also to offer a broader range of products and services, including equity financing and other ancillary supports such as business development and financial advisory services, as well as credit information services. To meet its new expanded role, the Board of CGC has been broadened to include members with experience in business and finance, while efforts are being taken to strengthen the resources of CGC.

Lembaga Tabung Haji

The performance of Lembaga Tabung Haji (LTH) or Pilgrims Fund Board remained favourable in 2005, as deposit mobilisation and investment activities continued to expand further. Total deposits mobilised by LTH rose by 10.2% or RM1.2 billion to RM13.3 billion as at end-2005 (end-2004: RM12.1 billion), reflecting to some extent the increase of 174,002 or 3.6% in the number of depositors to five million. LTH has announced a 2005 bonus payout of 4.5% to the depositors (2004: 4.3%).

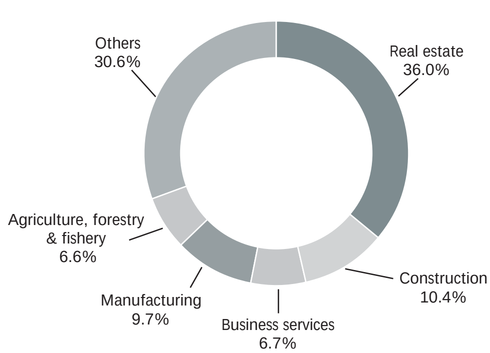
Total investments increased by 9.8% or RM994 million to RM11.1 billion as at end-2005 (end-2004: RM10.2 billion), to remain as the largest asset component of 76.2% of total assets. The increase was due mainly to the sustained growth of 25.2% in share investments, which amounted to RM6.8 billion as at end-2005. As a proportion to total investments, share investments continued to account for the largest share of 61% (2004: 53.5%). The other main investment components were investment in subsidiaries in the form of financing and placement of deposits with financial institutions, each accounted for 14.4% of total investments during the year.

Sabah Development Bank Berhad

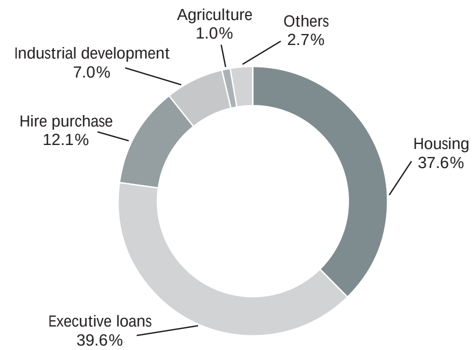
Lending activities of Sabah Development Bank Berhad (SDB) increased further, with loans outstanding growing by 13% to RM1.6 billion as at end-2005 (end-2004: RM1.5 billion) to account for 73.9% of total assets. The increase was mainly attributed to strong growth in loans extended to the construction and manufacturing sectors. In terms of composition, 36% of total loans outstanding was extended for real estate financing, while 10.4% and 9.7% were to the construction and manufacturing sectors, respectively. During the year, total loans approved and disbursed rose further to RM606.9 million and RM496.5 million respectively (2004: RM381.5 million and RM314.3 million respectively).

While gross NPLs increased to RM525.5 million (2004: RM517.5 million), the gross NPL ratio declined to 32.1%

Graph 7.11
Sabah Development Bank Berhad:
Direction of Lending as at 31 December 2005



Graph 7.12
Sabah Credit Corporation:
Direction of Lending as at 31 December 2005



(2004: 35.7%), as a result of a larger loan base. A major share of the NPLs (72.3%) were loans extended to the manufacturing and real estate sectors. On a net basis, the net NPL ratio was at 3.2% (2004:1.5%).

Borrowings from financial institutions as well as deposits from the Government and Government-controlled business enterprises continued to be the main sources of funds for SDB. Together these contributed to RM1.2 billion or 53.4% of the total resources (2004: RM 1.1 billion or 56.2%).

Sabah Credit Corporation

Lending activities of Sabah Credit Corporation (SCC) expanded by 5% in 2005 (2004: 9.1%), with loans outstanding increasing to RM725.1 million as at end-2005 (end-2004: RM690.3 million) to account for 93.2% of total assets. During the year, total loans approved and disbursed increased further, amounting to RM235.8 million and RM235.4 million respectively (2004: RM209.7 million and RM209.2 million respectively).

Outstanding loans for consumption credit grew by 15.3% in 2005 (2004: 28.3%), to account for 51.7% of SCC's total loan portfolio. Of this, the bulk was extended as executive loans/personal loans (76.6%), while the remaining was for hire purchase financing. Meanwhile, the outstanding housing loans, which accounted for 37.6% of the total loan portfolio remained unchanged.

Gross NPLs increased to RM116.8 million with a higher ratio of 16.1% in 2005 (2004: RM92.6 million and 13.4%), attributed mainly to the non-performing housing loans. On a net basis, the NPL ratio was at 12.1% (2004: 5.2%). During the year, SCC continued to source its funding through borrowings from the State Government (RM343.8 million) and banking institutions (RM265 million) to support its activities. These fundings accounted for a combined share of 78.2% of its total sources of funds.

Borneo Development Corporation (Sabah) Sendirian Berhad

In 2005, property development activities of Borneo Development Corporation (Sabah) Sendirian Berhad (BDC Sabah) remained slow, as reflected in the decline of property development expenditure and progress billings which amounted to RM15.9 million as at end-2005 (end-2004: RM32.4 million).

Meanwhile, end-financing for the purchase of houses developed by BDC Sabah declined further, as repayment of housing loans continued to offset new lending activity. During the year, the bulk of NPLs consisting of loans to business enterprises for the purchase of non-residential properties was written off. As a result, gross NPLs declined significantly to RM0.5 million and accounted for 8.3% of total loans as at end-2005 (end-2004: RM2.8 million or 31.6%). With loan repayments by individual borrowers and writing-off of non-performing commercial property loans, total loans outstanding declined to RM5.7 million as at end-2005 (end-2004: RM9 million).

As a result, the total assets of BDC Sabah declined by 16.9% to RM96.1 million as at end-2005 (end-2004: RM115.7 million). In terms of sources of funds, BDC Sabah continued to rely on borrowings from financial institutions which amounted to RM37.8 million (2004: RM59 million) or 39.3% of total resources to support its activities.

Borneo Development Corporation (Sarawak) Sendirian Berhad

Property development and construction activities undertaken by Borneo Development Corporation (Sarawak) Sendirian Berhad (BDC Sarawak) expanded further in 2005. Stocks and work-in-progress recorded strong increase of 22.7% (2004: 20.1%) to RM80.9 million as at end-2005, to account for the largest share (69.8%) of BDC Sarawak's total assets.

End-financing activities of BDC Sarawak, however, have been on a declining trend for the past decade, as property buyers increasingly turned to the more competitive financing packages offered by the banking institutions. In 2005, lending by BDC Sarawak declined further with loans outstanding amounting to RM0.7 million as at end-2005 (end-2004: RM0.9 million), which comprised mainly loans extended to its staff (96.7%) for the purchase of residential properties. Meanwhile, total investments in subsidiary and associate companies totalling RM5.9 million, or 5.1% of total assets, recorded a decline of 12.5% in 2005.

Deposits accepted from house buyers (RM61.4 million) have become the main source of funds for BDC Sarawak during the year, accounting for 52.9% of total resources (2004: 36.9%). The institution also continued to rely on shareholders' funds (RM37.2 million) and borrowings from financial institutions (RM6.9 million), which together represented 38.1% of total resources (2004: 51.8%), to support its operations.

Other Financial Institutions

Other Financial Institutions

Discount Houses

As part of the framework for the creation of investment banks, the seven discount houses currently in operation will be rationalised and merged with stockbroking companies and universal brokers to form investment banks. Arising from the rationalisation process, lower sources and uses of funds were recorded in 2005. Total resources mobilised by the discount houses declined by RM5.9 billion or 18.5% (2004: +RM1.7 billion or 5.6%). This was mainly due to lower deposits, which declined for the first time since 1999, by RM6.2 billion or 22% on an annual basis (2004: +RM4.3 billion or 18.3%). Correspondingly, in terms of uses of funds, interbank placements declined significantly by RM5.3 billion to RM6.7 billion (2004: +RM6.2 billion to RM12 billion).

Investments in securities were marginally lower during the year, declining by RM0.5 billion or 2.9% (2004: -RM4.1 billion or -17.8%). There was a notable shift in the types of investment undertaken by discount houses, with a marked reduction in the holdings of bankers' acceptances (BAs) and private debt securities (PDS). The lower holdings of BAs were attributable to the lower yields on these instruments. The lower holdings of PDS were, to some extent, the result of an adjustment in investment portfolios of the discount houses, as part of the rationalisation process. Conversely, the discount houses increased their holdings of Government debt securities, by RM1.1 billion or 63.2% on an annual basis (2004: +RM0.5 billion or 35.7%), particularly in the form of Malaysian Government Securities (MGS), and to a lesser extent, Government Investment Issues (GII) and Treasury Bills (TBs). In addition, investments in BNM bills and Khazanah bonds were higher in 2005. As part of the portfolio reallocation exercise, the discount houses also increased their holdings of Negotiable Instruments of Deposits (NIDs), by RM1 billion to RM1.6 billion (2004: -RM0.3 billion to RM0.6 billion).

During the year, fee-based activities of the discount houses remained relatively stable. The industry arranged, lead-managed and co-managed the issuances of PDS worth RM3.4 billion (2004: RM3.6 billion), while the total amount underwritten moderated to RM0.8 billion (2004: RM1.5 billion) for 31 PDS issues (2004: 32 issuances).

Table 8.1
Discount Houses: Sources and Uses of Funds

	Annual change		At end-2005
	2004	2005	
	RM million		
Sources:			
Approved capital funds	264	-298	2,339
Deposits	4,344	-6,191	21,903
Interbank borrowings	-2,944	526	1,141
Others	38	48	593
Total	**1,702**	**-5,916**	**25,976**
Uses:			
Investment in securities:	-4,146	-555	18,554
Government debt securities	*475*	*1,140*	*2,943*
MGS held	*572*	*686*	*2,093*
Khazanah bonds	*-173*	*251*	*575*
BNM bills	*-365*	*516*	*516*
Private debt securities	*-3,033*	*-1,527*	*9,370*
Bankers acceptances	*822*	*-1,908*	*2,151*
Negotiable instruments of deposit	*-289*	*996*	*1,555*
Cagamas debt securities	*-1,093*	*33*	*1,109*
Others	*-491*	*-56*	*335*
Interbank placements	6,230	-5,316	6,723
Others	-382	-45	699
	2003	**2004**	**2005**
Number of discount houses	7	7	7

Note: Total may not add up due to rounding.

Provident & Pension Funds

Total resources of the provident and pension funds (PPFs) surveyed by Bank Negara Malaysia expanded by 10% to RM320.6 billion in 2005. The Employees Provident Fund (EPF) remained the largest fund, accounting for 82.3% of the total funds of the PPFs. Accumulated contributions, which accounted for 89.9% of the total resources of the PPFs, grew by 10% as at end-2005 (2004: 9%). The increment,

Table 8.2
Provident and Pension Funds: Selected Indicators

	2004	2005*p*
	RM million	
As at end		
Number of contributors ('000)	21,162	21,901
of which: EPF	*10,716*	*11,055*
: SOCSO	*10,239*	*10,627*
Accumulated contributions	262,039	288,203
Assets	291,493	320,645
of which: Investments in MGS	*100,318*	*110,947*
During the year		
Net new contributions	12,423	14,531
Gross contributions	*26,226*	*28,313*
Withdrawals	*13,803*	*13,783*
Dividends credited	10,705	12,993
Investment income	13,458	15,561

p Preliminary

Source: Employees Provident Fund, Pension Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and three other private provident and pension funds.

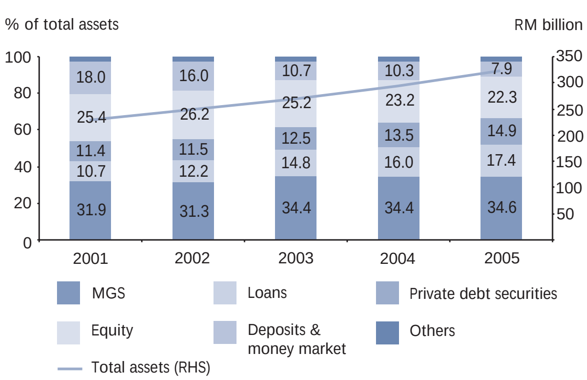
which is the largest since 2000, was mainly due to the significant increase of 17% in net new contributions (2004: 3.4%) and 21.4% in dividends credited (2004: 14.8%). Slightly lower withdrawals were recorded for the year, compared with 2004.

The significant increase of 17% in net new contributions to the PPFs came largely from higher gross contributions. During the year, gross contributions increased by 8% (2004: 8.2%), reflecting sustained growth in wages and the number of contributors to the funds. In addition, total withdrawals from the PPFs declined marginally by 0.1% in 2005 (2004: +12.8%). Nonetheless, withdrawals from the EPF for investment purposes increased by 15.5%, which corresponded with higher sales of unit trust funds during the year.

Given the higher investment income in 2005, the EPF was able to declare a higher dividend rate of 5% to its contributors (2004: 4.75%), which was the highest since 2002. Gross income from investment increased by 11.5% to RM13.1 billion, given the higher returns from investment in private debt securities (PDS) and lending activity. Returns from investment in debt and equity instruments by the EPF contributed 56.1% of its total investment income in 2005. Notwithstanding the lacklustre performance of Bursa Malaysia in 2005, income from equity investment registered a healthy growth of 12.8%.

In terms of asset composition of the PPFs, allocation was skewed towards investments which offered higher returns. Given the relatively low interest rate environment, holdings of cash and near-cash interest-bearing and interest-dependent assets like deposits in banking system and money market instruments, were

Graph 8.1
Provident and Pension Funds: Major Asset Composition



reduced. In addition, the holdings of equity-based investments experienced a marginal decline to 22.3% (2004: 23.2%). Nevertheless, the share of PDS and loans increased further to 14.9% and 17.4% respectively. In 2005, PDS issuance grew significantly and this development led to higher investment in PDS by PPFs.

Venture Capital

In 2005, the venture capital (VC) industry in Malaysia has progressed significantly as an alternative source of financing to the economy, with increased total funds available for disbursement and higher level of participation from industry players. Total investments from both local and foreign sources, number of venture capital fund management companies and number of investee companies also grew throughout the year. Total available funds for VC investments increased by 14.3% to RM2.6 billion. Both investment from domestic sources and investment from foreign sources recorded a significant growth of 32.8% and 54%, respectively. By the end of 2005, the total number of investee companies had increased further to 380 companies, involving a total investment of RM1.4 billion. Funds invested during the year increased by 49.2% to RM431.5 million into 101 investee companies (2004: increased by 27.3% to RM289.3 million into 139 investee companies).

The Cradle Investment Program (CIP), which was administered and managed by the Malaysia Venture Capital Management Berhad (MAVCAP), continued to provide pre-seed funding and entrepreneurial support to aspiring entrepreneurs with the commitment to develop and commercialise their ideas. As at end-2005, the amount of grants approved was RM7.5

Table 8.3
Key Statistics of Venture Capital Industry

	As at end-2004	As at end-2005
Venture capital funds (RM million)	2,266.0	2,589.0
Total investment (RM million)	1,058.0	1,441.5
Local sources (RM million)	887.7	1,179.3
Foreign sources (RM million)	170.3	262.2
No. of venture capital companies / funds	38	48
No. of venture capital fund management companies	34	39
No. of investee companies	332	380
	During 2004	**During 2005**
Total investment (RM million)	289.3	431.5
Local sources (RM million)	248.4	338.2
Foreign sources (RM million)	40.9	93.3
No. of investee companies	139	101

[1]Including divestment activities

Source: Securities Commission

Graph 8.2
Sources of Venture Capital (% share, as at end-2005)

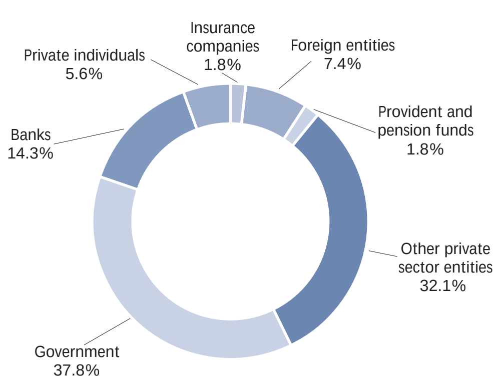


Table 8.4
Investment by Stages during 2005

No. of Investee Companies	101	
Business Stage	RM '000	% share
Seed capital	11,643.1	2.7
Start-up capital	25,116.0	5.8
Early stage	107,276.3	24.9
Expansion, growth	61,569.0	14.3
Bridge, mezzanine, pre-IPO	162,204.8	37.6
Management buy-out	29,664.0	6.9
Management buy-in	14,700.0	3.4
Cashing-out (secondary purchase)	1,642.0	0.4
Other types of investment	17,748.0	4.1
Total	431,563.2	100.0

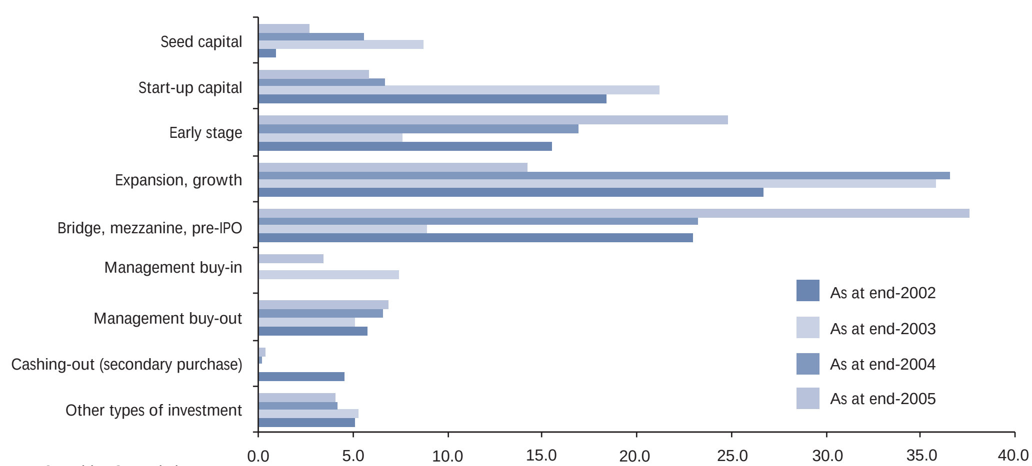
Source: Securities Commission

million and was awarded to more than 150 recipients. As CIP investment was mainly focussed on technology innovations, most of the ideas funded were related to this sector, such as software development, consumer/business products and e-services. CIP's strategy of partnerships with aligned and non-aligned industry partners, which included the various technology and investing community partners, allowed the program to grow as a new source of deal flow for venture capital and private equity firms, as well as other companies. Execution via the Cradle's Ideas Bank has strengthened networking between CIP's grant recipients with the investing community and the media. This was especially important to provide publicity and awareness of success stories which has led to more exposure for CIP's partners.

MAVCAP, as one of the few VC companies to provide seed and early-stage financing, continued to finance companies while maintaining the investment focus on ICT as mandated by the Government. For the year 2005, 17 new investees were provided funding by MAVCAP. Most of the investees funded by MAVCAP were deals related to the life sciences, biotechnology, agriculture and renewable energy.

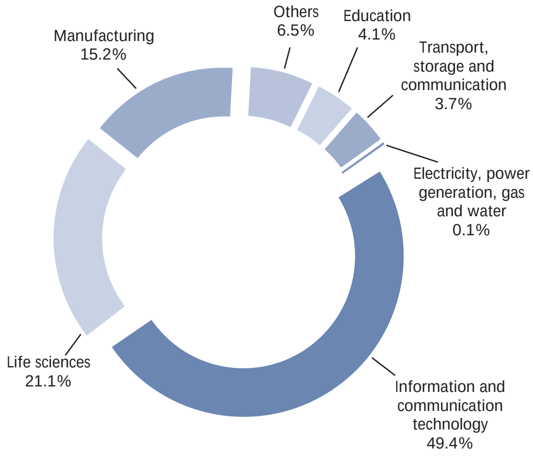
In line with the Government's efforts to allow the private sector to spearhead growth, the contribution of funds for VC investments from domestic private sector entities recorded another significant increase of 20% in 2005 (2004: 35.1%). In 2005, funds from foreign sources recorded the highest growth, followed by funds from banks and other private sector entities. As at end-2005, the Government remained as the largest contributor for VC funds.

Graph 8.3
Outstanding Investment by Stages (% share)



Source: Securities Commission

Graph 8.4
Investment made in 2005 (% share of total)



In terms of stages, VC investments, during the year, continued to focus on the expansion/growth, bridge/ mezzanine/pre-IPO and the early stages. These investments represented more than 75% of all VC investments in 2005. In terms of share, investments in the more risky stages, namely the seed capital and the start-up capital stages, declined from 12.3% in 2004 to 8.5% in 2005. Investments in other stages increased slightly.

In terms of outstanding investments by stages, the expansion/growth, bridge/mezzanine/pre-IPO and start-up capital stages were still the main business stages that received the bulk of VC investments since 2003.

Table 8.5
Outstanding VC Investment by Sectors

	As at end-2005	
	RM '000	% share
Information and communication technology	661,189.2	45.9
Manufacturing	292,906.2	20.3
Life sciences	270,574.1	18.8
Education	59,325.0	4.1
Electricity, power generation, gas and water	4,740.0	0.3
Wholesale, retail trade, restaurant and hotels	12,024.0	0.8
Financing, insurance, real estate and business services	15,963.2	1.1
Construction	100.0	0.0
Transport, storage and communication	15,970.0	1.1
Others	108,748.4	7.5
Total	**1,441,540.2**	**100.0**

Source: Securities Commission

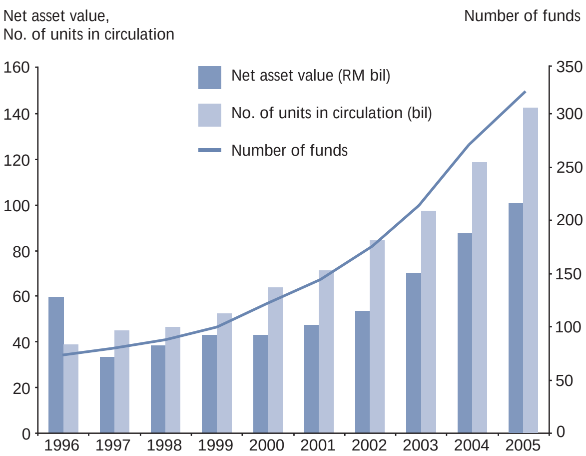
As in the previous year, in terms of investments by sector, the information and communication technology (ICT), life sciences and manufacturing sectors continued to receive the most of the financing. In total, the amount of VC investment in these three sectors constituted 85.7% of total investment made in 2005 (2004: 77.3% of total investment made). In terms of the outstanding size of funding at end-2005, the sectors which received most of the VC investment were the ICT sector (49.4% of total), the life sciences sector (21.1%) and the manufacturing sector (15.2%). The three sectors combined, accounted for RM1.2 billion or 85% of total funds invested. During the year, domestic VC funds were concentrated in the ICT (53.6%), manufacturing (17%) and life sciences (11.1%) sectors, while foreign VC funds mainly invested into the life sciences (57.4%), ICT (34.1%) and manufacturing (8.5%) sectors. The apparent shift in investment preferences as experienced in 2004 continued in 2005. The bulk of the domestically-sourced VC investment was more focussed on the ICT sector, a move away from the previous focus on the manufacturing sector, while foreign VC funds continued to concentrate on the life sciences sector.

Growth of the VC industry has advanced significantly to support sustainable funding for new growth areas as well as to serve as an alternative source of financing to the economy. Nevertheless, while many initiatives were undertaken to develop this form of alternative financing, areas for further improvement are still prevalent. The VC industry development needs to diversify further in meeting financing needs of potential investees in the seed stages.

Unit Trust Industry

The unit trust industry expanded further in 2005, with more new funds launched and further increases in the number of units in circulation. The net asset value (NAV) of the industry continued to expand by 12.7% and accounted for 14.2% of the total equity market capitalisation as at end-2005 (end-2004: 12.1%). During the year, a total of 51 new unit trust funds were launched (62 in 2004), bringing the total number of funds to 332 as at end-2005 (end-2004: 281). The sustained increase in the number of unit trusts launched reflected continued confidence in unit trusts as an investment vehicle to access a well-diversified portfolio. Gross sales of units remained consistently high throughout the year with an increase of 25.3% (33.4% in 2004). Despite the relatively higher repurchases made during the year, the industry recorded resilient annual net sales of RM14.9

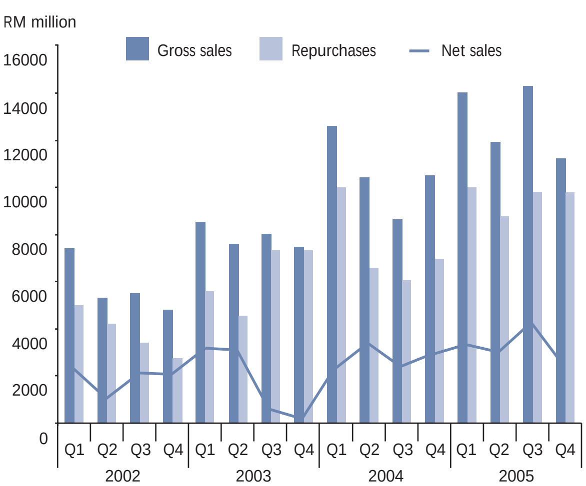
Graph 8.5
Unit Trust Industry - NAV, Units in Circulation and Number of Funds



billion or 18.2% higher than the year before (RM12.6 billion or 81.9% in 2004).

Effective 1 April 2005, the threshold for investing in funds abroad by unit trust companies was increased from 10% to 30% of the total NAV of all resident funds managed by a unit trust company. As a result, more global funds were established in 2005. Out of 51 new unit trust funds launched during the year, 13 of these funds were global funds meant for investment in foreign securities, either directly or via alliances with foreign unit trust funds.

Graph 8.6
Unit Trust Industry - Gross Sales, Repurchases and Net Sales

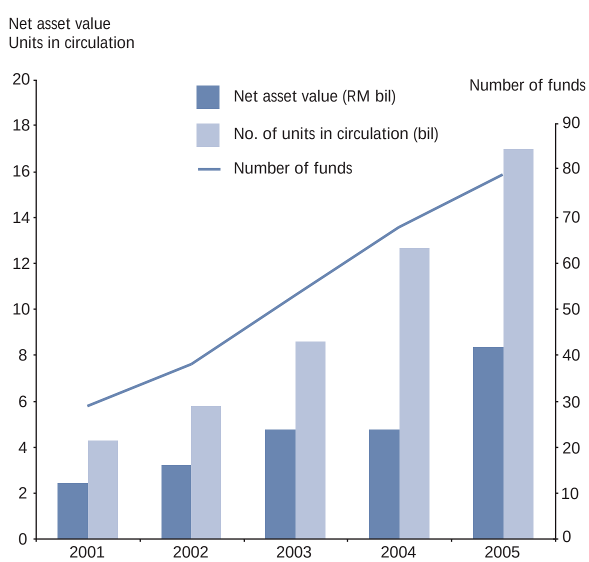


Ongoing efforts to further stimulate the development of the Islamic unit trust industry brought about continued positive growth in terms of NAV for the industry. In 2005, a total of 12 new Islamic funds were launched (15 in 2004), bringing the total number of Islamic funds to 77. The NAV of Islamic funds, which grew by 25.5%, accounted for 8.6% of total NAV of the unit trust industry as at end-2005 (end-2004: 7.7%).

The Government undertook further measures to accelerate the development of a vibrant and competitive Real Estate Investment Trusts (REITs) industry in Malaysia. The Guidelines on REITs were revised by the Securities Commission (SC), with the objective of attracting new players and enhancing awareness amongst local industry players and property owners/developers on the benefits of establishing a REIT. As at end-2005, three REITs were successfully listed on the Main Board of Bursa Malaysia, bringing the total number of listed REITs to six, while one REIT remained unlisted. Acceptance of REITs as an additional instrument for investors has been favourable thus far. Total turnover for REITs listed on Bursa Malaysia increased significantly to RM341.6 million for the year (RM11.8 million in 2004).

To further develop the Malaysian unit trust industry, the Government continued to seek ways to create an enabling environment in the country to maximise the potential for unit trusts. The SC continued to release guidelines for new products and revised rules for

Graph 8.7
Islamic Unit Trusts - NAV, Units in Circulation, and Number of Funds



feeder funds, fund-of-funds and wholesale funds to encourage wider participation by both high net worth individuals retail and institutional investors. Several investment restrictions were lifted to allow greater flexibility for unit trust fund managers to invest in a variety of instruments that would provide investors with a wider spectrum of risk-return mandates.

The penetration level, as measured by the ratio of net asset value of the unit trust industry to equity market capitalisation, improved to 14% from 12% in 2004. While this ratio remained low relative to countries with more mature financial systems, it indicated an opportunity for the unit trust industry to progress as an important investment vehicle for Malaysian investors.

Financial Markets

Financial Markets

Overview

The operating environment in the financial markets was influenced by episodes of larger capital flows, upward pressures on oil prices and inflation against the backdrop of ample liquidity situation and a higher degree of risk appetite. The relatively low yields in the bond market provided a favourable condition for financing activity by the corporate sector. Volatility in the exchange rates of the major currencies, the floating of the ringgit with reference to a basket of currencies and expectations of interest rate hikes led to increased hedging activity in the foreign exchange and financial futures markets.

Favourable conditions in the financial markets contributed to active fund raising exercises by the private sector.

In 2005, net funds raised in the capital market totalled at RM41.7 billion, albeit marginally lower than the amount raised in the previous year (2004: RM42.7 billion). The sustained large volume of funds raised in 2005 reaffirmed the vital role played by the capital market in mobilising and allocating funds on the basis of market-based competitive financing. Of significance, net funds raised by the private sector accounted for a larger share of 62.1% of total funds raised (2004: 37.5%), attributed to the higher financing needs on the back of the strengthening of private sector activity during the year.

The private debt securities (PDS) market experienced active fund raising activity during the year. Corporations stepped up issuances of PDS to capitalise on the flattening yield curves at the longer-end and the low real yields in an environment of excess liquidity amidst demand for long-term securities. Total net PDS issuance amounting to RM19.6 billion was the highest recorded since 2000. As at end-2005, PDS financing accounted for 24% of total debt financing to the private sector, complementing the banking system in providing long-term financing to the corporate sector. Meanwhile, total funds raised in the equity market were only slightly lower despite the less encouraging market performance during the year. A total of 79 companies sought listing in Bursa Malaysia and more than half (46 companies) of these listings were small to medium capitalised companies which were listed on the MESDAQ Market. The MESDAQ Market remained an important alternative avenue for these companies to raise equity financing.

Funds raised by the public sector declined by 40.6% due mainly to the lower issuance of government securities as the Government continued on its fiscal consolidation phase. The Government made an inaugural issuance of a 20-year Malaysian Government

Graph 9.1
Net Funds Raised in the Capital Market by the Public and the Private Sectors

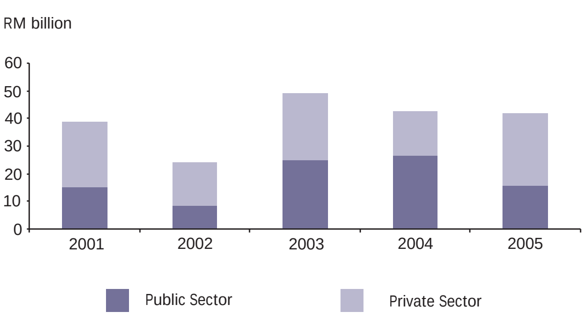


Table 9.1
Funds Raised in the Capital Market

	2004	*2005p*
	RM million	
By Public Sector		
Government Securities (gross)	43,173	28,276
Less Redemptions	18,200	15,800
Less Government holdings	0	0
Equals Net Federal receipts	24,973	12,476
Khazanah Bonds (net)	-1,198	833
Government Investment Issues (net)	1,423	1,000
Malaysia Savings Bond/Merdeka Savings Bond (net)	1,474	1,516
Net Funds Raised by Public Sector	**26,671**	**15,825**
By Private Sector		
Shares	6,475	6,315
Debt securities		
Issuance (gross)	36,340	38,196
Less Redemptions	26,814	18,617
Equals Net Issues	9,526	19,579
Net Funds Raised by Private Sector	**16,001**	**25,894**
Total Net Funds Raised	**42,672**	**41,719**
Short-term papers and notes (net)[1]	-3,208	1,579
Total	**39,465**	**43,297**

[1] Refers to Commercial Papers and Cagamas Notes.
p Preliminary

Securities (MGS) and a 7-year Government Investment Issues, with the purpose of lengthening the benchmark yield curve for the conventional and Islamic debt markets.

The Kuala Lumpur interbank foreign exchange market recorded a significant rise in both spot and swap transactions on the back of increased hedging activity for trade and investment purposes, following the large volatility in the exchange rates of the major currencies. In addition, sizeable movements of short-term speculative flows and the depegging of the ringgit also contributed to higher market activity.

Activity in the money market was marginally lower. The smaller volume of interbank deposits offset the modest growth recorded in the money market papers. Trading in money market papers centred on the MGS, with significant increases in the repo transactions following the introduction of Institutional Securities Custodian Programme (ISCAP) and the introduction of a securities lending facility for principal dealers by the Bank to improve the repo market.

On Bursa Malaysia Derivatives, although trading activity was concentrated on Crude Palm Oil (CPO) futures and KLCI futures (92.3% of total trade), the interest rates-related 3-month KLIBOR Futures and the 3-year MGS Futures recorded higher volume. Open interests of these financial futures rose in the fourth quarter, reflecting the increased participation by financial institutions in taking hedging positions against anticipated interest rate hikes. Meanwhile, trading activity of CPO futures declined due mainly to the reduced volatility in CPO prices.

On the developmental front, the Bank and the relevant authorities took further measures to enhance the infrastructure and the efficiency of the financial markets. Specific measures were also implemented to develop the Islamic financial markets. Measures introduced, among others, were aimed at promoting liquidity in the bond market, liberalising rules on foreign exchange transactions, broadening risk management tools, facilitating the introduction of new products and enhancing the information dissemination system. Details are contained in the box **Key Capital Market Measures in 2005**.

Money Market

Activity in the money market was marginally lower in 2005. The trading volume of interbank deposits was smaller compared to 2004, while the trading volume in money market papers recorded a modest growth.

Table 9.2
Money Market[1]

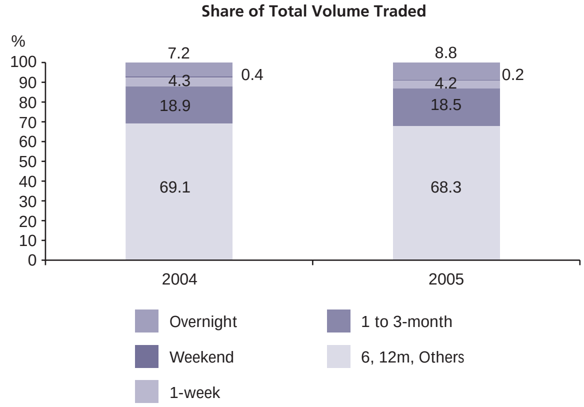
	2004		2005	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total money market transactions	**1,665.9**	**3.0**	**1,622.0**	**-2.6**
Interbank deposits	**1,057.5**	**-2.5**	**887.6**	**-16.1**
Money market papers	**608.4**	**14.3**	**734.5**	**20.7**
Repurchase Agreements	118.6	170.8	264.4	122.9
Malaysian Government Securities (MGS)	193.3	-16.5	179.4	-7.2
Malaysian Treasury Bills	17.1	72.1	12.9	-24.6
Bank Negara Bills	74.1	18.5	72.8	-1.8
Cagamas Bonds	38.6	50.7	16.3	-57.9
Cagamas Notes	4.4	-72.8	0.0	-100.0
Bankers Acceptance (BAs)	48.0	28.6	44.2	-8.0
Negotiable Instrument of Deposits (NIDs)	36.3	-15.8	39.0	7.5
Government Investment Issues	35.9	4.0	43.2	20.5
Khazanah Bonds	17.6	-6.3	20.0	13.6
Malaysian Islamic Treasury Bills	1.2	n.a.	4.5	265.6
Islamic Cagamas Bonds	2.1	2,397.6	1.8	-14.1
Bank Negara Negotiable Notes	21.2	137.6	36.1	70.5

[1] All data are sourced from the Fully Automated System for Issuing/Tendering (FAST), except for BAs and NIDs which are sourced from money market brokers.

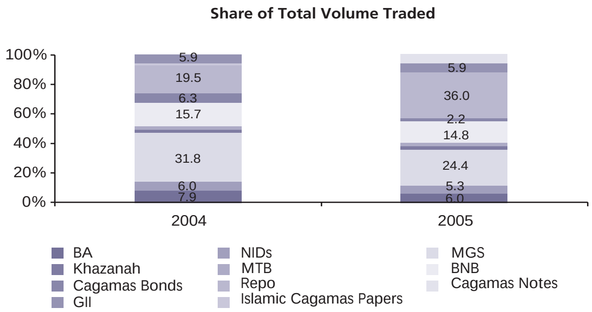
At RM887.6 billion, the volume of interbank deposit transactions was lower in 2005 (2004: RM1,057.5 billion). The bulk of trading continued to be concentrated in the shorter-end of the market with the overnight and weekend tenures continued to be actively used for settlement and liquidity purposes. The lower interbank deposit transactions reflected, to some extent, the slight reduction in liquidity in the interbank deposit market following the outflow of short-term speculative

Graph 9.2
Interbank Deposits

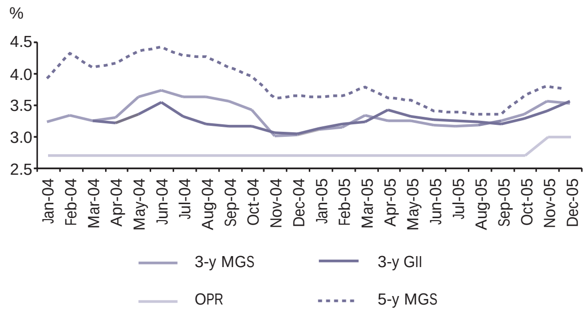
Share of Total Volume Traded



Graph 9.3
Money Market Instruments



Graph 9.5
Yields of Long-term Money Market Instruments



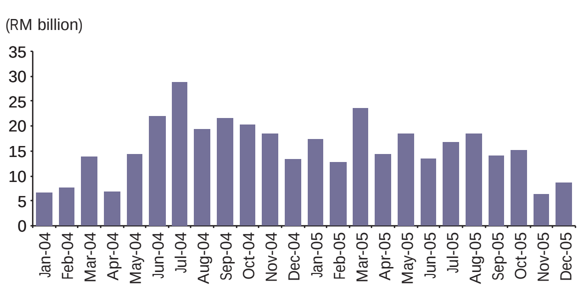
foreign funds and also market preference to trade in money market papers.

In terms of trading in money market papers, the volume of transactions increased to RM734.5 billion in 2005 (2004: RM608.4 billion). There was a significant increase in repo transactions during the year, as reflected by the increased activity in the repo market for Malaysian Government Securities (MGS). The increased utilisation of repos, following the introduction of ISCAP (Institutional Securities Custodian Programme), and the introduction of a securities lending facility for principal dealers in 2005, had a significant impact on the trading volume of MGS in the repo market. The introduction of ISCAP facilitated the release of captive holdings of MGS by institutional investors, while the securities lending facility created more market-making activity, including the use of the repo market to cover short selling positions.

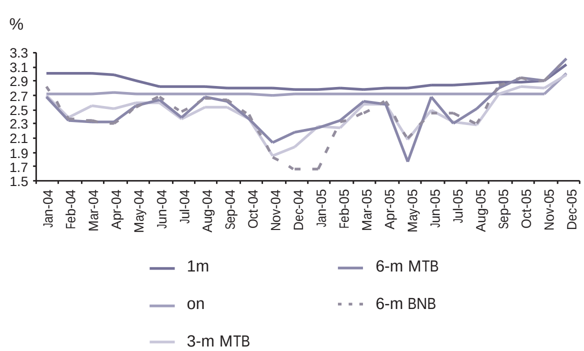
Overall trading volume in the outright purchase and sale of instruments was lower compared to 2004, mainly on account of the lower outright transactions of MGS, amounting to RM179.4 billion in 2005 (2004: RM193.3 billion). This was an outcome of the lower net issuance of MGS by the Government during the year, which at RM12.5 billion, were only half as much as in the previous year (RM25 billion in 2004). In addition, outright transactions in the MGS market were also influenced by expectations on the direction of interest rates. In the final quarter of the year, demand was affected by uncertainty over the supply of MGS. While non-resident activity in the trading of MGS increased during the year, their activity had minimal impact on the volume of transactions and yields of MGS, as demand for MGS by domestic investors remained strong. This was particularly evident in the fourth quarter, when strong demand by domestic investors mitigated MGS prices from correcting sharply following sales by non-resident investors.

During the year, demand for long-term Islamic bonds in the outright market continued to increase. This was clearly evident in the higher trading volume of the Government Investment Issues (GII) and Khazanah Bonds, which increased to RM43.2 billion and RM20.0 billion respectively (2004: RM35.9 billion and RM17.6 billion respectively). In 2005, a new profit-based GII, with a maturity of 10 years, was introduced as an additional instrument to the existing discount-based GII.

Graph 9.4
Volume of Traded MGS



Graph 9.6
Yields on Short-term Money Market Papers & Deposits



The issuance of the profit-based GII was aimed at meeting the growing demand for Shariah-compliant securities.

In terms of Cagamas bonds and notes, including Islamic Cagamas papers, the trading volume was lower at RM18.1 billion (2004: RM45.1 billion) due mainly to the lower issuances of RM2.5 billion during the year (2004: RM9.3 billion).

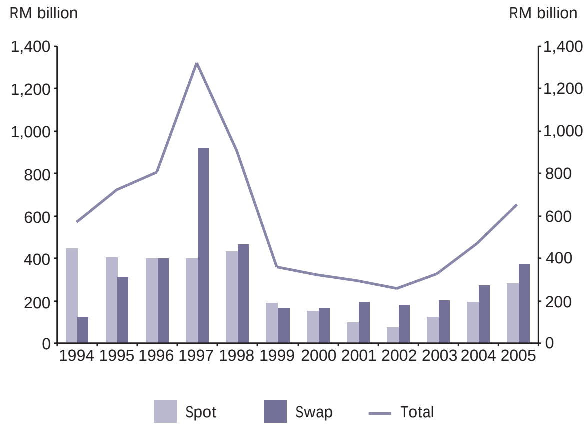
Trading in money market papers with maturities of less than 1-year was mixed. During the year, higher deposits in the banking system spurred the banking institutions to increase the creation and trading of NIDs. On the other hand, the trading volume of the Malaysian Treasury Bills was lower given the smaller total issuance and low yields. The trading volume of Bank Negara Bills was only marginally lower in 2005, amounting to RM72.8 billion (2004: RM74.1 billion), reflecting the stronger demand by non-resident investors.

In contrast, the trading volume of both Bank Negara Negotiable Notes (BNNN) and Malaysian Islamic Treasury Bills (MITB) were higher at RM36.1 billion and RM4.5 billion respectively (2004: RM21.2 billion and RM1.2 billion respectively). This development reflected, to some extent, the increased supply of these instruments amid growing demand from money market players for liquid Shariah-compliant assets, as well as, from the significant amount of non-resident trading activity.

Foreign Exchange Market

In the Kuala Lumpur interbank foreign exchange market, the average daily volume of interbank foreign exchange transactions (spot and swap) increased by 40% in 2005. Spot transactions rose 45%, while swaps registered an increase of 36%. The rise in the volume of transactions was due largely to increased hedging activity for trade and investment purposes, arising from the volatility in the exchange rates of the major currencies during the year. Market participants also sought to actively manage their exposure to currency risk, both prior to, and after the move from a fixed exchange rate to a managed float of the ringgit against a basket of currencies. The Kuala Lumpur foreign exchange market also experienced larger portfolio flows during the year, which contributed to the higher market activity. This increase in volume was more significant in the period after the shift in exchange rate regime on 21 July 2005. Consequently, the volume of transactions was higher in the second half of the year and accounted for 57% of total transactions during the year.

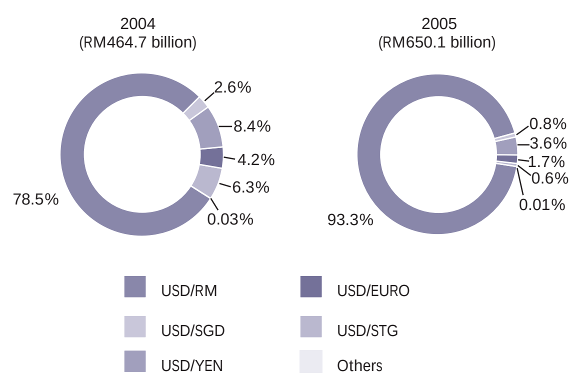
Graph 9.7
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



Note: Data from 2002 onwards is based on the new Ringgit Operations Monitoring System (ROMS), whereas observations for previous years are based on transactions of the eight Authorised Dealers.

By composition, the Kuala Lumpur foreign exchange market comprised mainly of transactions involving the ringgit, yen, euro, Singapore dollar and pound sterling against the US dollar. The US dollar continued to be the currency of choice in the settlement of trade and capital account transactions and thus, the domination of transactions in the US dollar against the ringgit. The share of US dollar - ringgit transactions in total foreign exchange transactions increased further, by 66% in 2005 compared to 2004. As a result, the share of US dollar - ringgit transactions continued to trend upwards, and in 2005 accounted for 93.3% of the total transactions at the Kuala Lumpur foreign exchange market. Following the

Graph 9.8
Transactions in the Kuala Lumpur Foreign Exchange Market by Currency

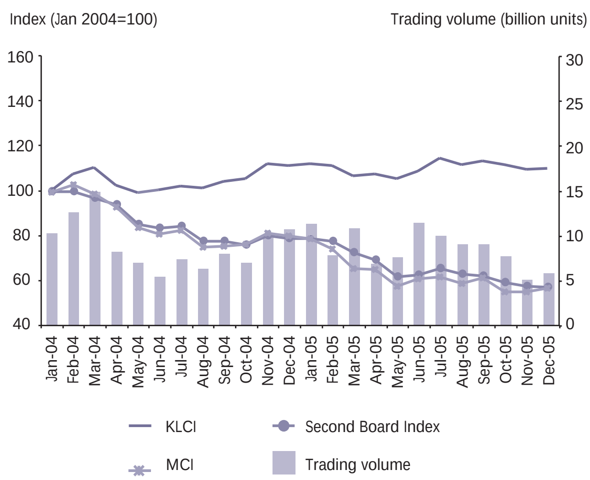


unpegging of the ringgit exchange rate, the share of US dollar - ringgit transactions in total transactions rose, from 91.8% over the 1 January – 21 July 2005 period to 94.8% over the 22 July – 31 December period. Conversely, the share of transactions involving the other currency pairs decreased. The share of transactions involving the yen and euro decreased from 8.4% and 4.2% in 2004 to 3.6% and 1.7%, respectively in 2005. Similarly, there was a decrease in transactions involving the Singapore dollar and pound sterling, from 2.6% and 6.3% of total transactions in 2004 to 0.8% and 0.6% in 2005, respectively.

Equity Market

Throughout 2005, the equity market was affected by concerns over the implications of global developments, primarily high oil prices, on domestic inflation and growth prospects. The year began on an optimistic note with the benchmark Kuala Lumpur Composite Index (KLCI) hitting a four and a half year high of 930.6 points on 11 January. Thereafter, developments such as continued escalation of oil prices, increasing global interest rates, and their consequent impact on the economy, adversely affected market sentiments. In addition, several domestic corporate developments in particular below market expected earnings, contributed negatively to the performance of the KLCI during the year. Nevertheless, Bursa Malaysia remained an important avenue for financing as the number of new companies seeking listing continued to increase.

Graph 9.9
Kuala Lumpur Composite Index (KLCI), Second Board Index, MESDAQ Market Composite Index (MCI) and Bursa Malaysia's Trading Volume



Source: Bursa Malaysia

Table 9.3
Bursa Malaysia: Performance of Sectoral Indices

	2004	2005
	Annual change (%)	
Kuala Lumpur Composite Index	14.3	-0.8
EMAS	9.6	-4.9
Second Board	21.2	-27.4
MESDAQ Composite Index	-19.3	-29.1
Plantation	9.4	15.8
Industrial	10.9	3.8
Trading/Services	14.3	-1.7
Finance	15.3	-3.5
Consumer products	7.3	-5.0
Shariah	8.9	-5.0
Industrial products	4.6	-12.3
Mining	6.7	-12.8
Construction	8.9	-25.9
Properties	4.5	-26.8
Technology	-28.5	-37.8

Source: Bursa Malaysia

The performance of the KLCI in 2005 lagged that of other major global and regional indices. The KLCI ended lower at 899.79 points or weaker by 0.8%, compared to 2004's performance. Market capitalisation declined by 3.7% to

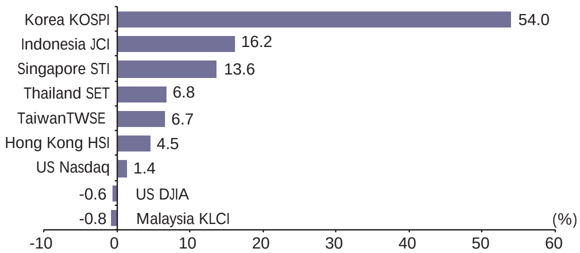
Table 9.4
Bursa Malaysia: Selected Indicators

	2004	2005
Price Indices:		
Composite	907.43	899.79
EMAS	214.26	203.85
Second Board	110.87	80.44
MESDAQ	122.84	87.09
Total Turnover:		
Volume (billion units)	108.0	102.3
Value (RM billion)	216.7	177.1
Average Daily Turnover:		
Volume (million units)	435.5	414.3
Value (RM million)	873.7	716.9
Market Capitalisation (RM billion)	722.0	695.3
Market Capitalisation / GDP (%)	160.6	140.6
Total Number of Listed Companies:	963	1,021
Main Board	622	646
Second Board	278	268
MESDAQ	63	107
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	31.9	25.2
Turnover Volume / Number of Listed Securities (%)	36.4	31.4
Market Concentration:		
*10 Most Highly Capitalised Stocks / Market Capitalisation (%)	34.4	36.1
Average Paid-Up Capital of Stockbroking Firms (RM million)	167.0	152.5

* Based on market transactions only.

Source: Bursa Malaysia

Graph 9.10
Performance of Selected Stock Markets Indices (% change from end-2004 to end-2005)



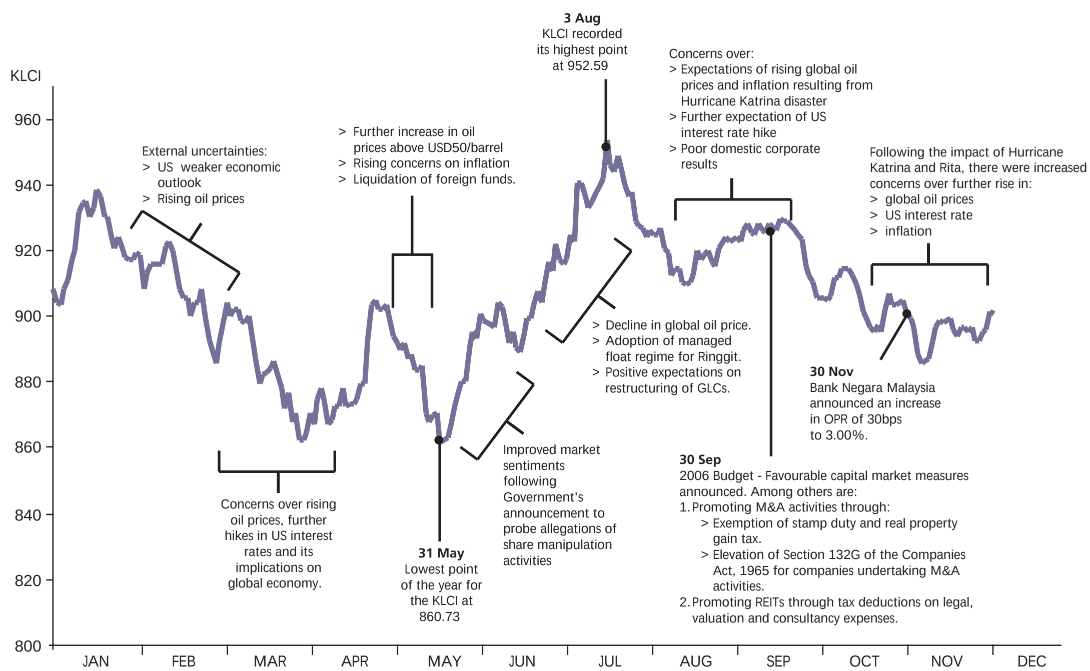
Source: Bursa Malaysia

RM695.27 billion. Market activity was lower, with the annual market turnover at 102.3 billion units, which were valued at RM177.1 billion (2004: 108 billion units; RM216.7 billion). Market liquidity, in terms of average daily turnover, fell to 414 million units (2004: 435 million units).

To a large extent, the weaker financial performance of public listed companies (PLCs) affected market sentiment. Based on a sample of 351 listed non-financial corporations (representing close to 84.4% of Bursa Malaysia's total market capitalisation), the performance of Malaysian PLCs deteriorated in 2005. A drop of 10.5% in cumulative net profit was recorded in the first three quarters of 2005, compared with the same period in 2004. Annualised return-on-equity for the sample also declined to 8.3% in the third quarter of 2005 (3Q 2004: 9.7%) mainly due to a drop in the operating profit margin to 11.8% (3Q 2004: 13.4%). Weaker corporate earnings were particularly evident in the construction, properties, manufacturing and agriculture sectors. Slower global demand for electrical and electronics products, and increased competition contributed significantly to the lower figures reported.

A marginal deterioration in debt servicing capacity was observed. Interest coverage ratio as at third quarter of 2005 was 3.93 times (2004: 4.69 times). Debt-to-equity ratio for the same period dropped slightly to 0.60 times (2004: 0.63 times), mainly reflecting the corporate sector's move to retire old debts and lock-in new rates with new debt financing. Therefore, the indebtedness level of the corporate sector remained sustainable as the debt-to-equity ratio for the third quarter of 2005 was slightly better than the average ratio of 0.61 after the Crisis.

Graph 9.11: Performance of the Kuala Lumpur Composite Index in 2005

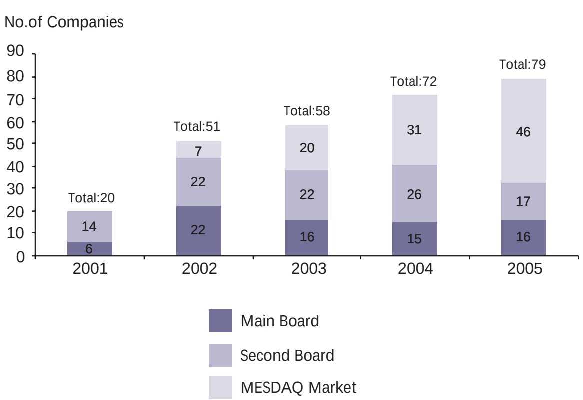


In terms of total number of new listings, Malaysia's equity market remained an important source of capital for Malaysia's corporate sector in 2005. Bursa Malaysia attracted 79 Initial Public Offerings (IPOs), which was the highest number of listings since 1998. New listings on the

Despite its lacklustre performance, Bursa Malaysia remained an important source of equity financing for the Malaysian corporate sector, especially the small and medium-sized companies. 79 companies sought listing in Malaysia's equity market, which was the highest number since 1998.

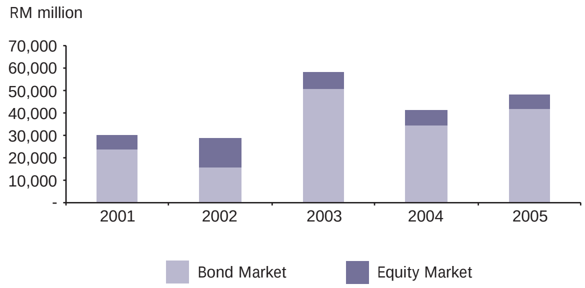
Main Board remained strong with an annual increase of 6.7% (2004: -6.7%), while new listings on the Second Board declined by 34.6% (2004: +18.2%). Over the years, a higher number of small and medium capitalised companies sought financing from Bursa Malaysia. In 2005, slightly more than one-third of the total IPOs was made by companies from the technology sector. The MESDAQ Market remained effective as a platform for high growth potential companies to seek financing and new investors. IPOs in the trading/ services and industrial products sectors accounted for 22.8% and 24.1% of new shares listed in 2005, respectively. While the IPOs comprised mainly small and

Graph 9.12
Bursa Malaysia: Number of New Listings



Source: Bursa Malaysia

Graph 9.13
Funds Raised by the Private Sector in the Capital Market



medium capitalised companies, seven large companies and funds sought listing on Bursa Malaysia. As at end-2005, the total number of listed companies on Bursa Malaysia was 1,021 (2004: 963).

Although the total number of IPOs increased in 2005 on an annual basis, total funds raised through the equity market dropped marginally by 3.1% to RM6.3 billion, compared to RM6.5 billion in 2004. As in past years, the bulk of these funds were raised through IPOs which amounted to RM5.3 billion, while rights issues amounted to RM1 billion (2004: RM4 billion and RM1.5 billion respectively). Most of the IPOs were oversubscribed, indicating continued strong investor interest in new listings. 39.5% of the funds raised through IPOs were by the industrial products sector. The property and finance sectors garnered 24.7% and 20.6% of the funds raised, respectively. Net funds raised in the equity market constituted about 24.4% of the total net funds raised by the private sector in the capital market in 2005 (2004: 40.5%).

In line with the continued efforts to enhance product diversification and innovation in the Malaysian financial system, the year 2005 witnessed a further broadening of the Malaysian equity market in terms of new products. Following the success of Real Estate Investment Trusts (REITs) in other regional countries and the Government's efforts to accelerate the development of such investment vehicles, the Guidelines on REITs were released in January 2005. In 2005, three REITs were listed on Bursa Malaysia. With the release of the Guidelines on Exchange-traded Funds (ETF) in June, the first ETF, the ABF Malaysian Bond Index Fund, was listed on Bursa Malaysia in July 2005.

In 2005, the introduction of new initiatives and measures for the equity market were directed at further enhancing market efficiency, liquidity and integrity. A summary of the measures introduced during the year is contained in the white box on **Key Capital Market Measures in 2005**.

Key Capital Market Measures in 2005

Capital market measures introduced in 2005 focused on further strengthening the capital market by enhancing liquidity, efficiency, risk management, integrity, as well as promoting and accelerating the growth of the Islamic capital market. Key measures introduced in 2005 are summarised, as follows:

Enhancing Liquidity in the Ringgit Bond Market

- On 7 January, the Bank introduced several measures to further enhance the efficiency of the domestic bond market by increasing liquidity in the bond market and improving the price discovery process. The measures were:
  - i. **Repurchase agreements (repo) would be actively used as a monetary instrument** to manage liquidity in the banking system.
  - ii. Through the **Institutional Securities Custodian Programme (ISCAP)**, the Bank would borrow securities, mainly Malaysian Government Securities (MGS) from major institutional investors, for its repo operations.
  - iii. **Securities lending facility for principal dealers (PDs)** was enhanced to facilitate the market-making activities.
- On 31 March, the **ringgit-denominated bonds issued by Multilateral Development Banks (MDBs) and Multilateral Financial Institutions (MFIs)** were **included as eligible securities** to be transacted under repo operations with the Bank.

Enhancement of Risk Management Tools in the Bond Market

- With the liberalisation of foreign exchange administration regulations announced by the Bank on 1 April, **residents and non-residents were allowed to enter into hedging arrangements** with licensed onshore banks for committed inflows and outflows of funds.
- On 7 October, the Bank issued the **Guidelines on Regulated Short-Selling of Securities**. The regulated short-selling framework for MGS in the wholesale market was accorded to PDs, interbank participants and universal brokers.

Removal of Restrictions on the Utilisation of Proceeds from Bond Issuance

- With effect from 28 March, **the National Bond Market Committee's Negative List was repealed**, and restrictions imposed on the utilisation of proceeds derived from bond issues were removed. Nevertheless, the restrictions imposed by the Exchange Control Guidelines on Private Debt Securities for Lead Arrangers remained.

Infrastructure Development and Better Information System for the Bond Market

- On 4 July, the Bank introduced a new version of the **Fully Automated System for Issuing/Tendering (FAST)**. The new version was developed as a web-based application that is available to both FAST members and the public. The new version provided better controls as well as greater flexibility in performing primary market activities.
- Since 25 July, **information on indicative yields to maturity of government securities (conventional and Islamic) was published daily** to provide market participants with information on the market value of government securities.
- On 5 December, the Securities Commission (SC) **allowed a wider group of investors to access the Information Memoranda and Trust Deeds of ringgit-denominated bond issues database**, which would assist investors in making informed investment decisions. Previously, the database was only available to primary subscribers of bonds.

Promoting the Development of Real Estate Investment Trusts (REITs)

- On 3 January, the SC released **Guidelines on REITs** in an effort to accelerate capital market growth and establish a vibrant and competitive REIT industry in Malaysia. Key features included the relaxation of restrictions on REITs for the following transactions:

– Borrowings limits;
– Acquisition of leasehold properties; and
– Acquisitions of real estates that are encumbered by financial charges.

- In order to promote the development of REITs or Property Trust Funds (PTFs), REITs or PTFs approved by the SC were given the following tax treatment:
  – Chargeable income distributed to unit holders was exempted from income tax; and
  – The accumulated income that has been taxed and subsequently distributed was eligible for tax credit by unit holders.

Promote the Growth of the Islamic Capital Market
- On 21 November, the SC issued **Guidelines for Islamic REITs** to further facilitate the development of a new Islamic capital market product and thus, made Malaysia the first jurisdiction in the global Islamic financial sector to issue such guidelines. These guidelines were expected to serve as a global benchmark for the development of Islamic REITs.
- A new **profit-based Government Investment Issues (GII)** was introduced as an additional instrument to the existing discounted-based GII. The profit-based GII would be issued at par via the Islamic concept of *Bai Bithamin Ajil* and would be characterised by the element of profit, payable every half-yearly until its maturity. This instrument was poised to be the new benchmark for the issuance of long-term Islamic bonds and consequently, promote market liquidity.

Enhancing Liquidity in Exchange-traded Products
- On 28 June, the SC released guidelines to facilitate the **introduction of Exchange Traded Funds (ETF)**, which are open-ended investment funds that track specific indices, in an effort to create greater liquidity within the equity market.
- On 28 October, the SC issued **enhanced Guidelines to facilitate issuance of structured warrants** aimed at developing the equity derivatives market, building greater market liquidity and safeguarding market integrity. In addition, the SC also allowed the **introduction of Bull Equity Linked Structures (Bull ELS)**, an investment-yielding instrument linked to designated shares, which provides investors with returns depending on the closing price of the underlying shares on maturity.

Promoting Quality of MESDAQ Companies
- To promote the quality and investibility of MESDAQ companies, **new MESDAQ Market guidelines on entry requirements** were released on 29 November. These guidelines focused on ensuring companies seeking listing are of high quality companies, encouraging efficient and effective price-discovery process, enhancing the method of securities distribution and improving corporate governance.

Liberalisation of Central Depository System (CDS) Accounts Requirements
- Effective 21 October, the SC announced the **liberalisation of CDS accounts requirements** to allow a wider group of individuals to hold securities on behalf of others.

Providing Greater Flexibilities for Merged Stockbrokers
- **Stockbroking companies which completed 1+1 mergers** were permitted to **undertake additional activities of business**, as follows:
  – Allowed to undertake a full range of corporate advisory services, subject to certain criteria, such as shareholders' funds of at least RM100 million;
  – Permitted to operate futures broking activities within the stockbroking entity; and
  – Allowed to do unrestricted branching from 2006 onwards.

Enhancing Investor Protection
- On 15 March, the SC introduced compliance **guidelines for fund managers to further strengthen the level of investor protection**, which required fund managers to adhere to best practices for the following operations:

– Trading and portfolio management;
– Meeting 'know your clients' obligations;
– Proper execution of the roles and responsibilities of the Board of Directors and Compliance Officers;
– Safeguarding of clients' assets; and
– Compliance with the Anti-Money Laundering Act 2001.

Further Liberalisation in the Capital Market

- On 15 September, the SC introduced several measures to facilitate the diversification of investments by domestic investors and further enhance the efficiency of the Malaysian capital market. These measures include:
  i. The framework on investments in foreign securities was revised to **allow investors to invest in foreign securities listed on recognised foreign exchanges**;
  ii. Regulations on secondary market trading of non-ringgit bonds were liberalised to allow 'sophisticated investors' (i.e. commercial banks, merchant banks, Islamic banks, universal brokers or consolidated brokers) to **execute secondary trades of non-ringgit bonds without seeking approval from the SC**;
  iii. The framework for primary offerings of non-ringgit bonds were revised to give **flexibility for the issuance of foreign currency-denominated bonds to 'sophisticated investors'**; and
  iv. The **offering of foreign shares in Malaysia** was permitted subject to the SC's approval.

  The above measures complemented the liberalisation of foreign exchange administration rules by the Bank on 1 April.

Improving Efficiency through Electronic Means

- On 17 February, the SC launched the **Electronic Licensing Application System (ELA)** to facilitate online submission and retrieval of information between SC and market participants. This effort was followed by the rollout of the **Continuing Professional Education (CPE) Tracker System** on 25 February.
- On 28 April, the SC released **guidelines of electronic contract note** in an effort to provide value-added services to investors.

Facilitating Corporate Sector Development

- To further facilitate faster execution of corporate proposals that require SC's approval (such as share buybacks, mergers and executions, etc.), prospectuses received by the SC will be **reviewed on a post-vetting basis** beginning 3 October. Hence, companies would be able to issue a prospectus within two weeks upon lodgement with the SC. In addition, to reduce the time to market, companies involved in takeovers would be required to issue offer documents containing detailed conditions within 21 days from the date of takeover notice, compared to 35 days previously.
- To encourage public listed companies to expand and compete globally, **exemptions were given for stamp duty and real property gains tax on merger and acquisitions (M&As)** undertaken by companies listed on Bursa Malaysia. This exemption was given to M&As approved by the SC from 1 October 2005 to 31 December 2007. Such M&As must be completed not later than 31 December 2008.

Providing a Facilitative Framework for Approval of Negotiable Instruments of Deposit

- The SC issued Practice Note 3 to the Private Debt Securities (PDS) Guidelines and Practice Note 3 to the Islamic Securities (IS) Guidelines on 6 April and 12 December respectively, to provide a more **facilitative framework for the approval of negotiable instruments of deposit (NIDs) and Islamic NIDs** with tenures of more than five years. The PDS Guidelines and IS Guidelines would no longer govern the approval process for NIDs and Islamic NIDs issuances by licensed institutions or Islamic banks. The new framework would facilitate a faster approval process.

Bond Market

The bond market continued to be an important source of funds, mobilising total net funds of RM35.4 billion for the year 2005 (2004: RM36.2 billion). As a result, the size of the ringgit bond market registered a 9.5% growth, with the total bonds outstanding reaching RM397.6 billion (80.4% of GDP) as at end-2005. Of significance, the net private debt securities (PDS) issuance of RM19.6 billion in 2005 was the highest since 2000, and thus contributed to a larger share of 55.3% of total net funds raised (2004: 26.3%).

The fiscal consolidation by the Federal Government resulted in a lower net funds raised, totalling RM13.5 billion (2004: RM26.4 billion). The Federal Government issued and reopened a total of 13 Malaysian Government Securities (MGS) and two Government Investment Issues (GIIs). The auctioning of the Government securities were carefully planned to ensure a smooth functioning of the market as well as to minimise the financing costs to the Government. During the year, the Government made an inaugural issuance of a 20-year MGS, continuing its efforts to lengthen the benchmark yield curve. Similarly, the maturity for GII was also lengthened from 7-year to 10-year for building the Islamic benchmark yield curve, a critical component for the development of the Islamic bond market. In addition, the Government introduced a new profit-based GII, based on the *bai' bithaman ajil* concept, as an additional instrument to the existing discounted-based GII. The new GIIs are poised to be the new benchmark for the issuance of long-term Islamic bonds and consequently, will promote market liquidity for Islamic papers. Meanwhile, the Bank continued to issue Merdeka Savings Bond (MSB) on a quarterly basis, providing additional investment instruments for senior citizens, retired Malaysian Armed Forces personnel and Malaysian citizens who have retired on medical grounds. Inclusive of the issuance of Khazanah bonds, the public sector raised net funds of RM15.8 billion (2004: RM 26.7 billion).

Table 9.5
Funds Raised in the Bond Market

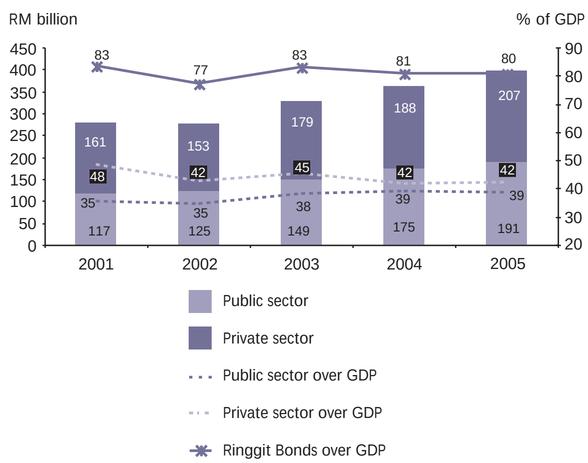
	2004	2005*p*
	RM million	
By Public Sector		
Government Securities (gross)	43,173	28,276
Less Redemptions	18,200	15,800
Equals Net Federal Receipts	24,973	12,476
Government Investment Issues (net)	1,423	1,000
Khazanah Bonds (net)	-1,198	833
Malaysia Savings Bond (net)	1,474	1,516
Net Funds Raised	**26,671**	**15,825**
By Private Sector		
Private Debt Securities (gross)	36,340	38,196
Straight Bonds	4,313	3,869
Bonds with Warrants	60	0
Convertible Bonds	4,301	3,745
Islamic Bonds	9,104	9,537
Asset Backed Securities	2,958	6,210
Medium Term Notes	7,315	12,296
Cagamas Bonds	8,290	2,540
Less Redemptions	26,814	18,617
Private Debt Securities	19,648	13,432
Cagamas Bonds	7,166	5,185
Net Funds Raised	**9,526**	**19,579**
Net Funds Raised in the Bond Market	**36,197**	**35,404**
Private Debt Securities, (excluding Cagamas) gross	*28,050*	*35,656*
Net Funds Raised in the Bond Market, excluding Cagamas	*8,402*	*22,224*
Net Issues Short Term Securities, Commercial Papers[1]	-3,208	1,579
Total	**32,990**	**36,982**

[1] Refers to Cagamas Notes and Commercial Papers.
p Preliminary

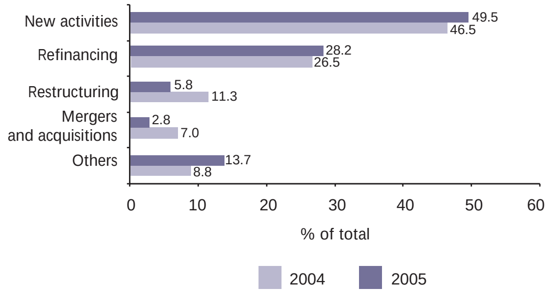
Fund raising activity by the private sector in the bond market increased, encouraged by prevailing low yields.

In the private sector, corporations stepped up issuances of PDS to capitalise on the flattening and declining yield curves at the longer-end in an environment of ample

Graph 9.14
Total Bonds Outstanding



Graph 9.15
Utilisation of Bond Proceeds[1]



[1] Excluding Cagamas

liquidity and strong demand for long-term securities by investors. The strengthening of the private sector-led economic growth contributed to the expansion of the PDS market. As at end-2005, the PDS market accounted for 24% of total debt financing to the private sector, complementing the banking system in providing corporations with opportunity to structure their balance sheet in line with their business requirements.

Issuances of PDS were made by 95 corporations. In total, these companies raised gross funds of RM35.7 billion (2004: RM28 billion), while Cagamas Berhad raised the balance of RM2.5 billion (2004: RM8.3 billion). Consistent with the trend in 2004, the issuances of PDS were mainly to finance new business activity, which accounted for 49.5% of total issuances, followed by refinancing of existing debt. Meanwhile, bonds issued by Cagamas Berhad were reduced significantly due to the ample liquidity in the banking system. After netting out redemptions during the year, net funds raised by the private sector amounted to RM19.6 billion, the highest amount recorded since 2000. Excluding Cagamas bonds, net PDS issuance totalled RM22.2 billion, the highest amount ever recorded by the PDS market.

Corporations in the finance, real estate and business services sector were the main issuers, followed by companies in the utilities and construction sectors, accounting for 36.8%, 19.6% and 17.8% of the total PDS issued respectively. The higher issuance in the finance and business services sector partly reflected the new issuance of asset-backed (ABS) securities originated by financial institutions and residential mortgage-backed securities issued by Cagamas MBS Berhad. In the utility and construction sectors, major issuers were the companies involved in the water projects and independent power producers, which continued to tap the capital market to finance their long-term financing needs.

During the year, the maturity profile of the PDS market lengthened further with the issuance of bonds with a 33-year tenure, by a company involved in infrastructure projects. The tenure of the PDS issuances in 2005 also shifted above 10 years, reflecting the issuers' decision to lock-in the prevailing low yields and hedge possible future interest rates rise. The issuers were mainly companies involved in power production and infrastructure projects, which have long gestation periods and would therefore benefit from long-term financing that matches their projected cashflow. The percentage of short to medium-term securities with tenure between one to five years declined to 34.5%, compared to 45.6% in 2004. Meanwhile, Cagamas MBS extended its Islamic Residential Mortgage Backed Securities (RMBS) to 20 years, thereby lengthening the benchmark curve for the ABS asset class and allowing market participants to price bonds with equivalent tenures.

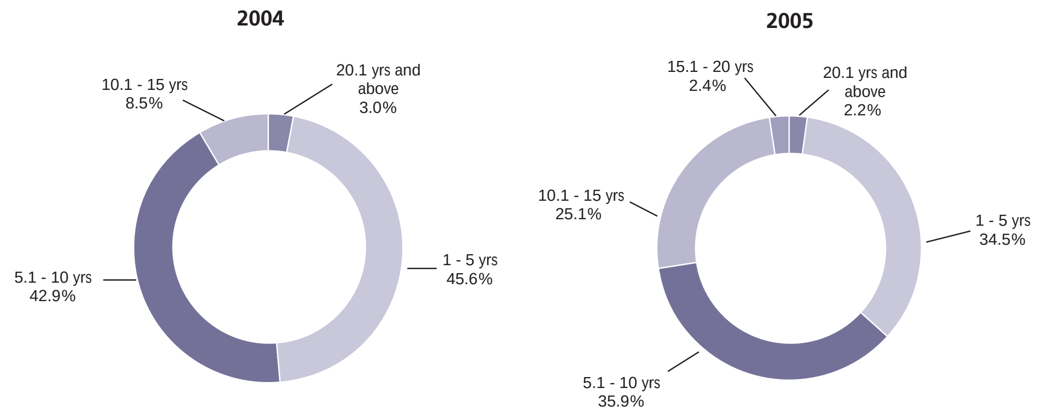
In terms of the types of instruments, Islamic securities (including Islamic Medium Term Notes) remained the most

Table 9.6
New Issues of Private Debt Securities by Sector[1]

Sector	2004		2005p	
	RM million	% share	RM million	% share
Agriculture, forestry and fishing	0.0	0.0	892.8	2.5
Mining and quarrying	0.0	0.0	630.0	1.8
Manufacturing	3,264.5	11.6	2,796.3	7.8
Construction	8,844.9	31.5	6,356.1	17.8
Electricity, gas and water supply	7,840.2	28.0	6,976.2	19.6
Transport, storage and communication	796.0	2.8	2,623.3	7.4
Financing, insurance, real estate and business services	4,767.8	17.0	13,122.7	36.8
Government and others	1,315.4	4.7	1,126.7	3.2
Wholesale and retail trade, restaurants and hotels	1,221.1	4.4	1,132.0	3.2
Total	**28,049.9**	**100.0**	**35,656.1**	**100.0**

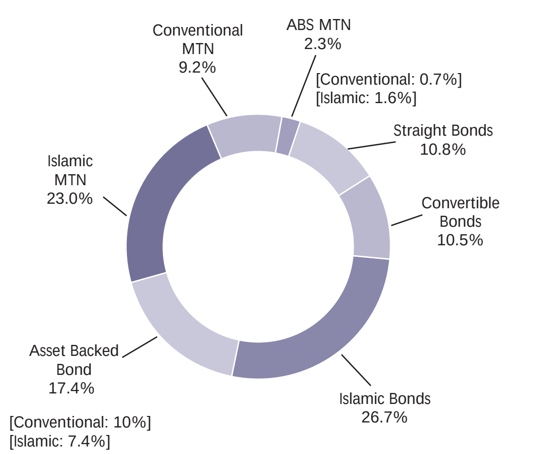
[1] Excluding Cagamas.
p Preliminary

Graph 9.16
PDS Issues by Tenure (excluding Cagamas)



favoured form of debt securities financing, and accounted for slightly more than half of total PDS issued. The implementation of tax incentives for Islamic products as well as measures taken since 2004 to develop a more innovative and sophisticated Islamic capital market resulted in higher issuance of Islamic products during the year. An encouraging development was the issuance of Islamic debt securities backed by future property tax assessment collections by a local authority. The bond was issued based on the *mudharabah* (profit-sharing) concept, which was not widely used previously. The issuance promoted the scope and depth of the Islamic bond market. Meanwhile, Cagamas MBS Berhad issued the inaugural issuance of Islamic RMBS during the year.

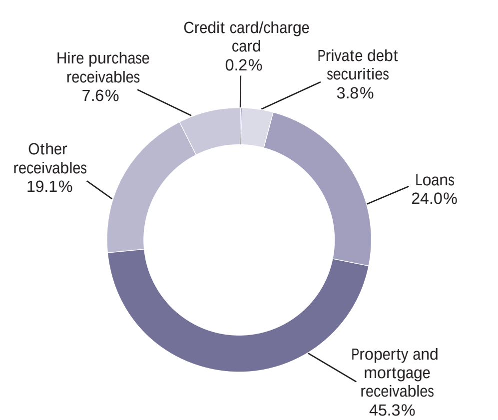
Graph 9.17
PDS Issues by Type of Instrument (excluding Cagamas)



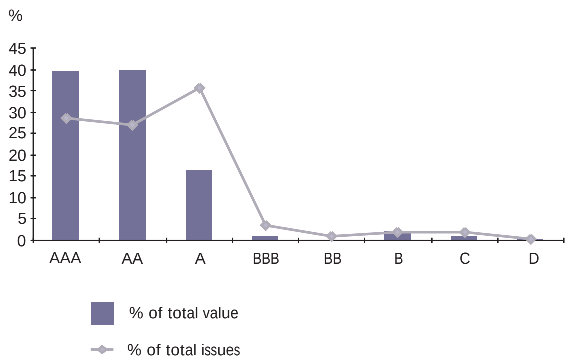
In an environment of continued excess liquidity in the financial system, bonds issued by Cagamas Berhad declined, with 12 issuances of debt securities (including two re-opening exercise) amounting to RM2.5 billion (2004: 18 issues totaling to RM9.3 billion). Out of these 12 issues, seven were issued in the form of fixed rate bonds while the remaining as Islamic securities. The Cagamas Islamic securities, which were previously known as Sanadat Cagamas, are now renamed as Cagamas BAIS (*bai' bithaman ajil* Islamic Securities).

In the securitisation market, Cagamas MBS Berhad issued two issues of RMBS backed by the Government's staff housing loans in August and December. The first issue involved RM2.05 billion of Islamic RMBS based on *musyarakah* principle while the second issue involved

Graph 9.18
ABS Outstanding: Types of Underlying Assets (As at end-December 2005)



Graph 9.19
Rating Distributions of Outstanding PDS
(As at end-December 2005)



Source: RAM and MARC

RM2.06 billion of conventional RMBS. The Islamic *musyarakah* principle bond was the world's first rated Islamic RMBS. In addition, six new ABS (including ABS MTN) were issued during the year backed by underlying assets such as hire-purchase receivables, land and other receivables. In total, the new issues of ABS securities amounted to RM7 billion and accounted for 19.6% of total gross PDS issued in 2005.

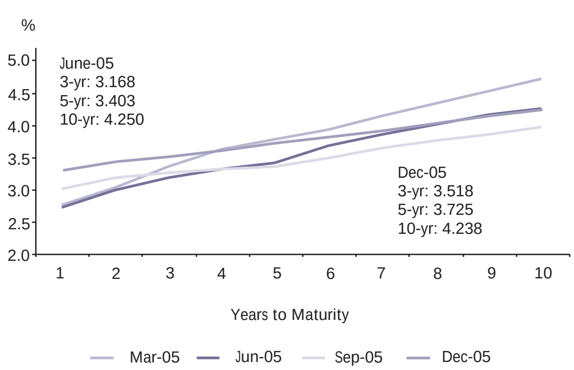
Rating activity during the year remained robust with 156 new long-term PDS issues valued at RM42.3 billion being rated by both the Rating Agency Malaysia (RAM) and Malaysian Rating Corporation Berhad (MARC). The long-term issues accounted for 79% of the total gross value rated. In terms of rating classes, most of the PDS were classified in the AAA, AA and A categories. Throughout the year, 330 rating reviews on existing long-term debt securities were conducted by both agencies, where 276 issues were reaffirmed, 31 upgraded and 23 downgraded. In comparison with the previous year, the proportion of upgrades increased from 7.2% to 9.5% of total reviews, while the percentage of downgrades was also higher at 7% of total reviews, against 3% in the previous year.

The ringgit bond yield curves flattened significantly during the first three quarters of the year, reflecting a similar phenomenon of flattening yield curves experienced globally. During this period, while the short-end of the MGS yield curve held relatively firm, the 10-year MGS yield declined by 78 basis points, driven by the ample liquidity situation coupled with a high demand for bonds amidst lower MGS issuances. The declining yields were also a result of the increasing amount of foreign capital flows into ringgit assets as investors sought higher returns. Conditions in the secondary market were also influenced by concerns over the impact of rising oil prices on the inflation and economic outlook. The yield curves remained stable after the removal of the ringgit peg in July, as demand for long-term bond continued to be high and the market proved resilient to capital outflows.

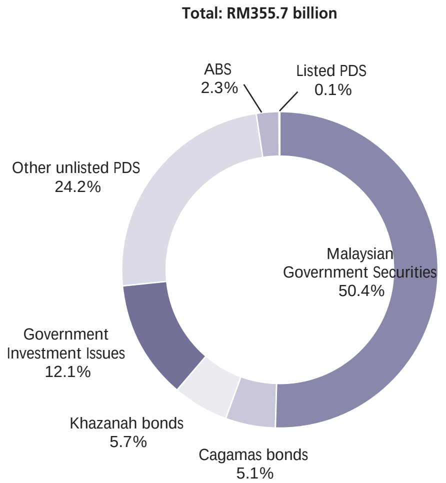
By early September, the short-end of the yield curve rose, indicating that the market had begun to price-in the prospects of possible higher interest rates, following signs of improved economic activity and higher inflation rate. Nevertheless, investors took a cautious stance in trading, after taking into account the possible changes in domestic interest rates, as well as the magnitude of the MGS issuances for the quarter. The MGS yields firmed up across the different tenures by the end of the year, following the 30 basis points rise in the overnight policy rate on 30 November. For the year as a whole, the short-end 1-year MGS yields rose by 106 basis points, while the 10-year MGS yields declined by 50 basis points. These developments resulted in the flattening of the yield curve during the year. Meanwhile, spreads on corporate bonds remained stable, which suggested that there was little change in market participants' perception of corporate credit risks.

Trading in the ringgit bond market averaged RM1.4 billion daily, and amounted to RM355.7 billion for the year (2004: RM355.9 billion), with trading of MGS accounting for 50.4% of total trade. Trading activity in corporate bonds increased to 26.6% of total (2004:18.1%) as investors searched for higher yields from the PDS market. Trading activity in Cagamas papers fell significantly following the lower issuance of Cagamas papers during the year. Liquidity, as measured by the ratio of trading volume to total outstanding bonds, was

Graph 9.20
MGS Benchmark Yields



Graph 9.21
Turnover of Selected Debt Securities (Jan-Dec 2005)



highest for GII and Khazanah bonds, at 4.28 times and 1.84 times, respectively. Liquidity for corporate bonds, however, was the lowest at 0.5 times the outstanding amount.

The introduction of ISCAP (Institutional Securities Custodian Programme), which involved the active use of repo in monetary operations, combined with the MGS lending facility provided by the Bank to the principal dealers since the beginning of the year, helped improved the performance of the repo market significantly. Repo transactions increased by 88.2% to RM347.8 billion (2004: RM184.8 billion), with 76% of the total focused in the MGS market.

On the international front, credit spreads on Malaysia's sovereign bonds narrowed in the first three quarters, following higher demand for Asian dollar credits as economic fundamentals improved and investors seeking better returns. The credit spreads widened in the fourth quarter partly due to the increase in interest rates in major markets, as well as concerns over higher inflationary pressure following the high oil prices.

As part of the initiatives to broaden and deepen the domestic and regional bond markets in East Asia Pacific region, the EMEAP group launched the first regional bond fund or Asian Bond Fund 1 (ABF1) in June 2003. Following from the success of the US dollar ABF1, the EMEAP Central Banks launched the Asian Bond Fund 2 (ABF2) in December 2005, which is mandated to invest in bonds denominated in local currencies of selected member countries namely PR China, Hong Kong China, Indonesia, Korea, Malaysia, Philippines, Singapore and Thailand. The ABF2 was launched with the objective of promoting the domestic currency bond market and introducing bonds of multi currencies in a basket as a new asset class for investors. The launching of the ABF2 also led to the inaugural listing of the ABF Malaysian country sub-fund or ABF Malaysian Bond Index Fund on Bursa Malaysia, which comprised investments in ringgit denominated Government and quasi Government securities. The listing of the ABF Malaysian Bond Index Fund (the first Exchange Traded Fund in Malaysia) would add more diversity to the listings on Bursa Malaysia and eventually greater liquidity in the domestic bond market.

Several measures were introduced in 2005 to further strengthen the bond market. The detailed bond market measures are explained in the box **"Key Capital Market Measures in 2005"**.

Exchange-traded Derivatives Market

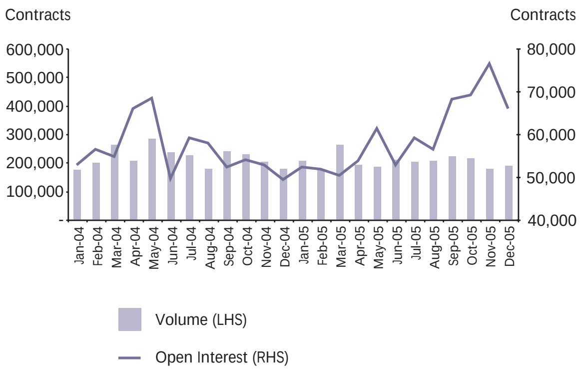
The exchange-traded derivatives market in Malaysia remained active during the year although trading volume declined. Turnover on Bursa Malaysia Derivatives dropped by 6.6% (2004: +32%). While the annual trading volume decreased slightly to 2.5 million

Table 9.7
Sovereign Over US Treasury Benchmark

	Benchmark	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05
MALAYSIA 09	5-yr UST	47	65	58	45	55
MALAYSIA 11	5-yr UST	92	88	68	54	60
CHINA 11	5-yr UST	85	66	75	52	61
INDONESIA 06	2-yr UST	65	108	49	75	52
KOREA 08	2-yr UST	56	68	44	10	3
PHILIPPINES 10	5-yr UST	377	253	236	119	97
THAILAND 07	2-yr UST	54	64	64	40	65
PETRONAS 06	2-yr UST	49	45	44	37	39

Source: Bloomberg.

Graph 9.22
Bursa Malaysia Derivatives : Total Monthly Volume And Month-end Open Interest



Source: Bursa Malaysia Derivatives

contracts (2004: 2.6 million), trading performance remained high for the third consecutive year since 2003. In terms of average daily volume, the financial futures contracts, especially the KLCI Futures and the 3-month KLIBOR Futures, continued to improve compared to the year before. Though relatively small, the modest growth recorded during the year in the financial futures market was largely due to increased interests by financial institutions in taking hedging positions against anticipated interest rate hikes.

The Crude Palm Oil (CPO) Futures market continued to be the most active on the Bursa Malaysia Derivatives market in 2005, accounting for 47% of the total volume transacted during the year. However, the total contracts cleared during the year declined by 15.9% to 1.16 million contracts (2004: 1.38 million contracts), representing a notional value of 28.96 million tonnes of crude palm oil. The decline was attributed to a significantly reduced price range of RM252 (2004: RM621) for the benchmark 3-month CPO contract, implying a reduction in volatility in the market. Meanwhile, no contracts were traded at the Crude Palm Kernel Oil (CPKO) Futures market during the year.

The 3-month CPO Futures commenced the year trading at RM1,378 per tonne, and initially declined to the lowest daily traded price of RM1,252 per tonne on 2 February. The decline in prices was caused by the bumper CPO output recorded in January. However, prices soon recovered to register the highest daily traded price of RM1,504 per tonne on 16 March. Thereafter, prices consolidated to a tight range of between RM1,380 and RM1,430 per tonne for the rest of the year. The upward momentum in prices was

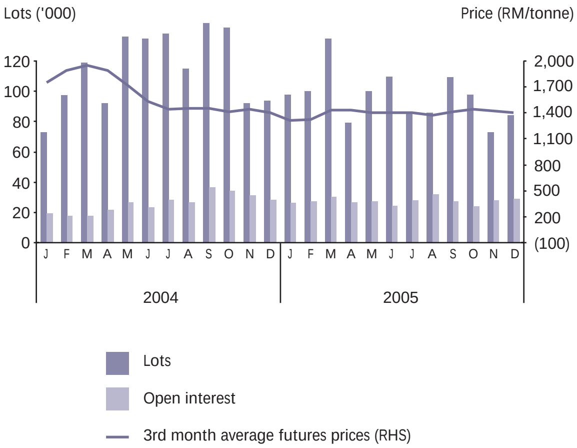
Table 9.8
Performance of Bursa Malaysia Derivatives Products

Products	Turnover						Share of total volume in Bursa Malaysia Derivatives (%)	
	2004			2005				
	Number of lots	Annual change (%)	Average daily volume	Number of lots	Annual change (%)	Average daily volume	2004	2005
CPO Futures	1,378,334	-3.6	5,603	1,158,510	-15.9	4,709	52.3	47.1
Open interest position (as at end-year)	28,314			28,918				
Palm Kernel Oil Futures	449	n.a.	2	-	-100	-	0.02	-
KLCI Futures	1,088,419	228.6	4,424	1,111,575	2.1	4,519	41.3	45.2
Open interest position (as at end-year)	*10,092*			*17,814*				
KLCI Options	-	-	-	-	-	-	-	-
3-month KLIBOR Futures	141,969	18.6	577	162,592	14.5	661	5.4	6.6
Open interest position (as at end-year)	27,418			37,966				
3-year MGS Futures	4,327	454	18	9,753	125.4	40	0.2	0.4
5-year MGS Futures	19,494	-83.6	79	17,215	-11.7	70	0.7	0.7
Open interest position (as at end-year)	-			150				
10-year MGS Futures	-	-100	-	100	100	0.4	-	-

n.a. Not available

Source: Bursa Malaysia Derivatives Berhad

Graph 9.23
Crude Palm Oil Futures



Source: Bursa Malaysia Derivatives

limited by the overall strong increase in CPO production, and rising stocks in Malaysia, coupled with higher harvests of palm oil's closest competitor, soybean, in the US, Brazil and Argentina. On the other hand, robust export volume, as well as market participants' favourable expectations on future demand for palm oil-based bio-diesel, established a floor on CPO prices that contributed to the reduced volatility in the prices of the CPO futures market during the year. The 3-month CPO futures ended the year at RM1,397 per tonne, which was 1.4% higher than the price at the start of the year.

The KLCI Futures market in 2005 recorded a small increase of 2.1% (2004: 229%) in trading activity, with average daily volume still higher than in the previous year. The derivatives liquidity ratio, which represents the ratio between the turnover value of futures against the turnover value of underlying KLCI component stocks, increased to 48.9% in 2005 (2004: 46.9%). In tandem with the lacklustre performance of the KLCI, the growth of KLCI Futures' volume was impinged by poorer than expected market sentiments, following concerns regarding the implications of high oil prices.

Activity in the financial futures market continued to show overwhelming interest. The improvement in market sentiments was mainly influenced by changing expectations on economic growth and expectations about domestic interest rates. Participants of the financial futures market were predominantly domestic institutions, which accounted for more than 95% of total trading activity. The 3-month KLIBOR Futures continued to record a positive growth of 14.5% (2004: 18.6%). Total turnover of MGS futures increased by 13.6% (2004: -80.1%). The 3-year MGS futures contributed significantly to the higher performance and registered an impressive growth of 125.4%, due primarily to the concentration of the underlying market activity in the shorter tenures.

The Payment and Settlement Systems

The Payment and Settlement Systems

MANAGEMENT OF THE PAYMENT SYSTEM

In promoting an efficient, reliable and secure payment system that will contribute to financial stability and the effective functioning of financial markets, the key policy thrust during 2005 remained on enhancing safety and reducing risks in the payment system as well as enhancing the use of electronic payments. In this regard, the Bank continued its efforts in the development and improvement of the country's major payment system infrastructure, ensuring their robustness and the effective mitigation of systemic risks in the payment system.

The key policy thrust during 2005 remained on enhancing safety and reducing risks in the payment system as well as enhancing the use of electronic payments.

During the year, live runs were conducted with the banking industry to ensure the robustness of the payment systems operated by the Bank, as well as its business continuity plans. In pre-empting systemic risk in interbank foreign exchange settlements, the Bank had also commenced work to build a 'payment versus payment' mechanism.

In the area of retail payment systems and instruments, the Bank's focus has been to ensure sustained public confidence in their use to facilitate the effective functioning of commerce. The Bank continued therefore to play its role as a catalyst in the development of the retail payment infrastructure and facilitating industry wide collaborative efforts to strengthen payment security standards. The Bank facilitated the full migration of the country's credit card infrastructure to Europay-MasterCard-Visa (EMV) chip standard with the completion of the conversion to EMV-compliant terminals during the year. Consequently, Malaysia becomes the first country in the Asia Pacific region to fully migrate to the chip environment, boosting the confidence of consumers, tourists and merchants in the use of payment cards in the country.

In ensuring the safety and confidence in Internet banking transactions provided by the banking institutions, additional security measures are being implemented to combat online fraud, including identity theft. To pre-empt the threat of money laundering and terrorism financing activities conducted via the payment system, measures to promote the use of formal remittance channels will be introduced to deter the use of informal payment systems. As such, qualified non-banking institutions would be allowed to offer remittance services while banking institutions may appoint collecting agents to facilitate their remittance transactions.

The second focus area was on enhancing competition and improving payment efficiency. Consistent with the Financial Sector Masterplan to increase competition and efficiency in the payment system, the policies that only allow banks to offer retail payment services were liberalised. The payment landscape continues to evolve with the banking and non-banking institutions introducing new payment services that leverages on modern technology such as the Internet, smart cards and mobile phones. While these developments promote competition and efficiency, they also introduce new risks in the payment system. This poses new challenges to the Bank in the oversight of the payments systems to ensure that the prudential guidelines will effectively address the risks and at the same time, promote innovation while not inhibiting market potential.

The third focus area in 2005 was on promoting the migration to cost efficient electronic payments. With the migration of the automated teller machine (ATM) card to the chip infrastructure, multi-applications such as the debit and electronic purse applications have been incorporated into the ATM card to facilitate point-of-sale transactions at merchant outlets. Debit card transactions has increased at the rate of 24.6% per annum in the recent three years. Its total transaction value of RM240.1 million however, remains insignificant compared with credit card spending of RM40.9 billion in 2005. Nevertheless, there is significant growth for the debit card, particularly with the increase in the number of terminals and merchants that accept the interbank e-Debit transactions and also additional financial institutions participating as acquirers. Significant growth was also seen in the use of Interbank GIRO (IBG) system and Internet banking services. The IBG system recorded a high growth rate of 162.2% per annum while Internet banking transactions increased at a rate of 80.8% per annum over the past three years. Whilst there have been promising growth in electronic payments, the payment system in Malaysia remains predominantly paper-based with cheque payments still accounting for 95.1% of the total value of non-cash payments in 2005.

In managing the transition to a more electronic-based payment system, the Bank continues to work with the banking institutions and the major retail payment system operator, Malaysian Electronic Payment System (1997) Sdn. Bhd. (MEPS), in developing and improving the country's payment system infrastructure to provide more efficient and timely payment services. The IBG Review Team, established by the Bank, has identified a number of focus and improvement areas where MEPS as the system operator, and the banks must address to make the system more efficient. This will enable the banks to deliver a higher quality service level to their customers, with tangible benefits in terms of cost reductions and enhanced revenue and profitability. During the year, the Bank has also taken several measures to facilitate the adoption of electronic payments in the Government sector, resolution of an industry issue on credit cards acceptance at petrol stations and organised the country's first payment system forum and exhibition. These efforts were made to promote a more widespread use of electronic payments to improve payment efficiency and to be able to take advantage of economies of scale.

As significant investments have been made in establishing and enhancing the electronic delivery channels and payment systems in the recent years, the focus is now on increasing accessibility, improving service levels and promoting its active use to reap economies of scale benefits and realise the efficiency gains. Malaysia is still a high user of cheques and cash, and therefore the potential cost savings in moving to electronic technology for making payments is substantial.

REDUCING RISKS IN THE PAYMENT SYSTEM

The promotion of a secure and effective payment system is recognised as one of the main pillars of the Bank, alongside the maintenance of financial and monetary stability. In this regard, the Bank has an important responsibility in minimising systemic risks in the payment system, particularly for the large value interbank payments where the impact of a failed payment transaction can spill over to other banking institutions, leading to a systemic crisis. As part of a continuing effort in promoting effective, safe and efficient payment systems, the Bank is implementing a "payment versus payment" (PvP) infrastructure for settling interbank foreign exchange transactions.

The Bank has an important responsibility in minimising systemic risks in the payment system, particularly for the large value interbank payments.

Foreign Exchange Settlement Risk

The PvP mechanism will be established jointly with the Hong Kong Monetary Authority, to facilitate simultaneous settlement of interbank US dollar and ringgit foreign exchange transactions during the Malaysian business hours. Under this mechanism, the ringgit part of the transaction would be settled through the RENTAS while the US dollar part would be settled simultaneously through the USD CHATS system in Hong Kong China. The PvP mechanism would enable financial institutions to reduce the settlement risks associated with foreign exchange transactions.

MANAGING PAYMENT SYSTEM STABILITY AND CONFIDENCE

During 2005, the Bank as the operator of the RENTAS and SPICK systems, continued to ensure that its Disaster Recovery Planning (DRP) arrangements with its member institutions are operational and effective through regular live runs. In its oversight role, the Bank supervises and monitors major payment operators and designated payment instrument issuers to ensure that they continue to operate in a sound manner. The off-site monitoring is also complemented with on-site examinations to identify gaps that need to be addressed to ensure sustainability of operations. The Bank had also continued its role as a facilitator in coordinating industry efforts to enhance the retail payment infrastructure and also address common security threats on an industry-wide basis. These measures were taken to ensure the continued reliability of the major payment systems and to sustain public confidence and trust in the payment instruments.

Measures were taken to ensure the continued reliability of the major payment systems and to sustain public confidence and trust in the payment instruments.

Disaster Recovery Planning

The Bank manages the risks of the RENTAS system, benchmarked against the Bank for International Settlements' internationally accepted Core Principles for Systemically Important Payment Systems, which provides the minimum standards which covers the legal, financial and operational risks as well as efficiency, access criteria and governance. In this regard, the Bank has continuously enhanced its operations and practices to meet the standards, one of which is ensuring business continuity. In ensuring payment system stability and uninterrupted availability of the payment systems, the Bank operates through contingency procedures at its disaster recovery centre (DRC). Scheduled monthly live runs are conducted from the DRC for both the RENTAS and SPICK systems. The Bank also monitors the contingency systems of its member institutions and encourages them to review and strengthen their arrangements to ensure that their respective off-site DRC for critical systems are readily available and operational. Member institutions are required to conduct quarterly testing of their respective DRCs. In addition, an industry-wide live run between the member institutions' DRCs and the Bank's DRC was successfully conducted in June 2005.

Incident Response Plan and Internet Banking Security Requirement

The establishment of the Internet Banking Task Force (IBTF) by the Bank in October 2004 has led to the successful formulation of an Incident Response Plan (IRP) and the revision of the 'Minimum Guidelines on the Provision of Internet Banking Services by Licensed Banking Institutions'. The members of IBTF are from the Bank, 15 banking institutions, the Malaysian Communications and Multimedia Commission, the National ICT Security and Emergency Response Centre, Polis Diraja Malaysia and TMNet Sdn. Bhd. The establishment of IBTF was in response to the need to pre-empt the threat of Internet banking fraud, particularly on unauthorised fund transfers perpetrated via phishing scams. The IRP which was implemented on 1 September 2005, provides a structured and effective process flow for the banking institutions and relevant authorities to respond to a critical incident promptly. It also facilitates the sharing of information on Internet banking fraud related incidences.

Recognising the significance of preserving consumer confidence in using Internet banking services, which is one of the critical factors in encouraging the use of electronic channels and payments, the Bank will issue a revised 'Minimum Guidelines on the Provision of Internet Banking Services by Licensed Banking Institutions' in 2006. The main feature of the revision is to introduce new authentication requirements, together with greater consumer education and protection measures. This includes the requirement for a two-factor authentication for risky transactions and putting in place an identity theft detection mechanism.

Completion of the Chip Migration Effort

The migration exercise for the ATM and credit card infrastructure led by the Bank together with the banking industry was completed in July 2004 and December 2005, respectively. In implementing a nation-wide migration exercise, cooperation of the relevant stakeholders and industry incentive mechanisms have been important in ensuring a coordinated and timely completion of the exercise.

In the EMV chip migration exercise for credit cards, the banking industry implemented a domestic liability shift policy on 1 January 2005 and disabled the acceptance of domestic magnetic stripe transactions on 3 May 2005. In the liability shift policy, an institution that is not EMV chip compliant would bear the liability of any fraudulent transaction. Following rising credit card fraud incidences at unattended 'self-service petrol pumps', the disablement of the acceptance of magnetic stripe transactions was implemented on 31 December 2004. To avoid fraud attempts using magnetic stripe cards, the banking institutions ceased to accept 'fallback' transactions (using the magnetic stripe data during instances when a chip is defective) for domestic credit card transactions with effect from 31 December 2005. These measures have effectively reduced counterfeit card fraud using information obtained from magnetic stripe credit cards.

To complement the chip migration exercise and promote a safer credit card environment, credit card institutions were also required to ensure that credit card information transmitted over telecommunication lines are encrypted to prevent information theft via 'wire-tapping'. As at end-2005, almost all acquiring financial institutions have implemented the line encryption requirement.

ENHANCING COMPETITION AND INCREASING PAYMENT EFFICIENCY

The Bank continues to collaborate with the banking industry to improve the operational efficiency, functionalities and service standards in the retail and wholesale payment and settlement systems. Infrastructure enhancements in the RENTAS and SPICK systems continued to focus on improving market efficiency and operational cost savings. During the year,

The Bank continues to collaborate with the banking industry to improve the operational efficiency, functionalities and service standards in the retail and wholesale payment and settlement systems.

several new participants joined the RENTAS and the IBG systems, which contribute to wider accessibility and economies of scale benefits. Policy changes have been made to further liberalise the payment industry, leading to the greater participation of non-banking institutions. The Bank continued to facilitate the collaboration of the local ATM network operator with its foreign counterparts in facilitating cross-border ATM and payment services.

Remittance Services and Electronic Money Policies

The Bank is pursuing a two-pronged approach to improve the remittance services in the country, which involves broadening the access to formal remittance channels and encouraging banking institutions to make their remittance services more accessible, convenient and cheaper. Towards achieving this, the Bank has liberalised its policy to allow qualified non-banking institutions to provide remittance services and banking institutions to appoint collecting agents to receive funds from the remitters in facilitating their remittance transactions.

Apart from the liberalised environment for remittance services, the Bank has also permitted more non-bank issuers to enter the electronic money market. This augurs well with the developments in smart card and mobile telecommunication technologies and the rising interest of non-banks in offering electronic money products. These developments would see greater migration to electronic payments and contribute towards reducing the cost of doing business in Malaysia.

Interbank GIRO System

The IBG system, which is operated by MEPS, facilitates bulk credit transfers of up to RM100,000 per transaction. An IBG Review Team was formed in November 2004 by the Bank, with representatives from the Bank, banking institutions and relevant Government agencies tasked to review the IBG services to identify key challenges and issues that should be resolved in order to meet the users' requirements and increase its usage. The team was dissolved in August 2005 after completing its tasks. Measures recommended by the team includes standardising the crediting period and payment references, introducing convenient access points such as ATMs to conduct IBG transactions, improving the account validation procedures and to conduct a concerted awareness and promotion campaign. MEPS, the owner of the system, jointly with the banking institutions, will implement these measures as well as formulate specific strategies and roadmap to further spur the growth in IBG usage.

Regional ATM Link-up

MEPS established a regional link in July 2005 with PT Artajasa Pembayaran Elektronis (Artajasa), its counterpart in Indonesia, to facilitate cross-border ATM cash withdrawals in Malaysia and Indonesia. The facility allows customers of MEPS' member banks to withdraw rupiah using their ATM cards at Artajasa member banks' ATMs in Indonesia. Similarly, customers of Artajasa member banks are able to withdraw cash in ringgit from ATMs in the MEPS' network. As at end-2005, the regional link involved six Indonesian banking institutions with over 300 ATMs in Indonesia and four Malaysian banking institutions with over 2000 ATMs in Malaysia. The remaining banking institutions and development financial institutions in Malaysia are expected to participate in the regional link on a staggered basis in 2006. MEPS will also establish a regional ATM link with the Network for Electronic Transfers (Singapore) Pte. Ltd. in 2006 to facilitate cross-border ATM cash withdrawals between Malaysia and Singapore. The ATM link-up will also pave the way for future services such as cross-border funds transfers via the ATM networks.

Cheque Truncation

The SPICK cheque clearing system remains the largest retail payment system in the country. Infrastructure improvements continued to focus on improving market efficiency and operational cost savings through automation and straight-through processes. Recognising the strong inertia in cheque usage, the Bank will be implementing a cheque truncation system (CTS) aimed at reducing transportation and labour costs associated with the physical handling of cheques in the clearing process. The CTS will leverage on the current imaging infrastructure already in place and will provide opportunities for banking institutions to rationalise their back office operations to reap cost savings in further automating their cheque processing operations.

Scripless Trading of Commercial Papers in RENTAS

RENTAS, the wholesale payment system for real-time funds and scripless securities, continues to function as the backbone of the country's payment system infrastructure.

In enhancing the efficiency of financial market transactions, work has continued to prepare for scripless commercial papers (CPs) to be traded and settled in RENTAS. Inclusion of CPs into RENTAS will enable trading and settlement of scripless CPs to be conducted real-time on a delivery versus payment basis, thereby improving efficiency and eliminating settlement risks.

New Members in RENTAS and Interbank GIRO Systems

In line with the Bank's revised access policy, three more major financial market participants were admitted into the RENTAS in 2005 increasing its membership number to 56. The new members are Bank Simpanan Nasional, Bank Kerjasama Rakyat Malaysia Berhad and Kumpulan Wang Simpanan Pekerja. As for the IBG system, three locally incorporated foreign banks and one development financial institution became IBG members during the year, increasing the number of IBG participants to 16. However, the participation in the IBG system still lags behind the cheque system, which is participated by 30 commercial banks. With a larger number of participating banking institutions and correspondingly a wider coverage of users, economies of scale would be realised much sooner resulting in the lowering of the cost of production of payment services. In this regard, the Bank continues to encourage an open access policy to payment systems to facilitate a more comprehensive participation by banking institutions.

MIGRATION TO ELECTRONIC PAYMENTS

Improvements in technology, automation and straight-through processes have enabled the cost of electronic processing of transactions to decline relative to paper-based processing. Electronic payments which have a lower variable cost component compared to paper-based payments, will experience a declining unit cost as the number of transactions increases. In promoting a country-wide

> Electronic payments which have a lower variable cost component compared to paper based payments, will experience a declining unit cost as the number of transactions increases.

migration to electronic payments, the Bank has continued to play its role as a catalyst in addressing industry issues and facilitating industry forum. This includes identifying and understanding the various hindrances and challenges in adopting electronic payments. Such inputs are relevant for the Bank's formulation of policies and initiatives to promote the wider use of electronic payments.

Government's Adoption of Electronic Payments

The Government's adoption of electronic payments would accelerate the adoption of electronic payments in the country. In recent years, the Government sector had introduced various electronic delivery channels to facilitate convenient access for the public to transact with the Government. In addition, efforts are being made to accept payment cards at most Government payment counters to facilitate consumer convenience and improvement in payment efficiency. These measures would pave the way for the adoption of electronic payments on a national scale, given that most individuals and businesses have payment transactions with the Government. In this regard, the Government has announced its acceptance of payment cards in the 2006 Budget. The Bank had engaged the credit card industry to review the current interchange arrangements to facilitate the acceptance of credit cards in the Government sector.

Financial Process Exchange (FPX)

The FPX Steering Committee has facilitated the adoption of a holistic and pragmatic approach in the long-term strategy for the FPX. MEPS, as the operator of the system, has conducted several merchant seminars in building the awareness on the FPX and its functionalities. Efforts were also made by MEPS and the banking industry to understand and cater for the needs of the merchants, apart from revising the pricing of the FPX services to increase the adoption of the FPX. Initiatives are being made to develop related software solutions that would facilitate smaller merchants to be integrated into the FPX payment solution at lower costs.

Identifying and Understanding Large Issuers of Cheques

In September 2005, the Bank had undertaken a study to gather profiles of cheque users in Malaysia, which includes identifying reasons for the issuance of large value cheques. Discussions with several high issuers of cheque revealed that the main reasons for the issuance of large value cheques were due to its wide acceptance, convenience and a relatively cheaper payment instrument. In ag4ition, several inherent limitations in the electronic payment systems currently offered have hindered the adoption of electronic payment services, such as the absence of payment reference and notification, lack of account validation procedures, higher charges imposed for electronic payments, payment limits imposed on electronic payments via the ATM and Internet banking facilities, limited participation of banking institutions compared to the cheque system and limited infrastructure to facilitate the accessibility of electronic payment services. While electronic payments have been made available in the marketplace, additional measures and initiatives needs to be undertaken to address these issues to make electronic payments more prevalent.

Development of the Domestic Debit Card (e-Debit)
With the adoption of the chip infrastructure in ATM cards, multi-applications on the same card have been made possible. The domestic debit and MEPS Cash electronic purse applications are installed in the chip based ATM card or Bankcard, allowing the cardholders to purchase goods and services at merchant outlets. The debit application or e-Debit allows the cardholders to charge their purchases directly to their savings or current accounts while the electronic purse facilitates micro-payment by deducting the electronic money that has been loaded onto the card. Efforts are being made by the industry to promote the usage of the domestic debit cards. As at end December 2005, about 25,600 card acceptance devices have been deployed by the acquirers to accept interbank e-Debit transactions. More e-Debit terminals are expected to be deployed with the increase in the number of acquiring banks in 2006. In addition, in promoting the usage of the e-Debit application in the Bankcard, a financial institution has offered a 'cash back' facility at its merchant outlets. The 'cash back' facility allows the cardholder to withdraw cash at the merchant, whilst making payment for purchases using the e-Debit application.

National Payment Advisory Council (NPAC)
In December 2005, the Bank held its yearly NPAC meeting. The meeting which was chaired by the Governor, was attended by representatives from financial institution associations, industry associations, related Government agencies, the domestic automated clearing house and two foreign central bank members. The annual forum provides a platform for issues relating to payment systems to be raised and deliberated. The meeting provides the Bank with useful inputs for consideration in its policy making and developmental efforts, which includes the recent initiatives to set up the PvP mechanism to minimise settlement risk of foreign exchange transactions and the review of the regulatory framework for remittance business.

In line with the promotion of migration to electronic payments, the NPAC meeting deliberated on issues relating to the Bank's role in payment system development, measures to reduce large value cheques issued, and strategies to promote the domestic debit cards to be widely used in the country. The NPAC agreed that the Bank's role as an overseer and an operator of payment systems should be clearly segregated within the Bank, and its operational role in cheque clearing and settlement is still necessary at this stage of development of the financial sector. To reduce the number of high value cheques issued, it was agreed that high issuers of large value cheques should be identified and efforts made to encourage them to use electronic payments. The domestic debit card scheme has significant potential to be more widely used. More concerted efforts are being taken by MEPS and its member institutions to increase the deployment of point-of-sale terminals and to promote its use amongst the debit cardholders.

Payment Systems Forum & Exhibition
The Bank organised the country's first Payment Systems Forum & Exhibition in November 2005. The forum provided a platform for the relevant stakeholders including representatives from financial institutions, payment service providers, Government agencies, corporations and industry associations to discuss issues and challenges in migrating the country to electronic payments. In conjunction with the forum, an exhibition was held to increase public awareness of the various payment channels available and to exhibit payment products and innovation.

The inaugural event brought together some 290 participants comprising users and key players in the private and public sectors. Twenty five speakers and payment system experts from a range of countries shared their experiences, perspectives, as well as issues faced in their migration to electronic payments. The migration to cost efficient electronic payments is regarded as a national agenda with 2010 being suggested as a target date for the full implementation of a national electronic payment roadmap. This would require an intensive engagement exercise with the various stakeholders in addressing a broad range of issues such as promoting public awareness and confidence in electronic payments, identifying and resolving current hindrances in electronic payment usage, improving electronic payment services, establishing payment standards, and providing consumers with incentives to adopt the more cost efficient payment methods.

MOVING FORWARD

In shaping the payment landscape, the Bank will continue to play its role as a driver in leading the country toward the adoption of more cost efficient payment systems and instruments. In continuing to provide an enabling environment for the adoption of electronic payments, the Bank's initiatives and policies for 2006 would focus on enhancing the current electronic payment services, promoting competition, transparency and fuller participation in the electronic payment systems, and remaining vigilant on any new payment fraud trends.

Following the more liberalised environment for remittance and electronic money, a comprehensive regulatory and supervisory framework for remittance services and electronic money issuance by non-banking institutions will be introduced to put in place prudential and governance standards for these services. In addition, measures will be introduced to increase the awareness of the readily available remittance products and services with the aim of enhancing the use and accessibility to formal remittance channels and to prevent the potential for any money laundering and other illegal activities. In addition, the Bank will work jointly with regional Central Banks to harmonise payment rules between jurisdictions to facilitate more efficient cross border payments.

To further improve electronic payment services, the Bank will also be reviewing payment rules and governance of the major electronic payment systems to ensure that a minimum service level is uniformly practised. Payment services, such as the provision of payment references that accompany payments, should be offered by all banking institutions to provide the public with a uniform and reliable service. The Bank will also promote transparency in the service levels of the different payment systems, and the pricing of payment services. With increased transparency, users and merchants would be made aware of the cost of the different payment instruments and service level, to help promote greater competition leading to more cost effective and efficient payment services.

The Bank will also continue its effort to encourage the full participation of banking institutions in electronic payment systems similar to the level of participation in the cheque clearing system. To encourage the use of electronic payments on an industry-wide basis, the payment service has to have a wide reach in terms of participating banking institutions and a widespread network of access points for the users to conduct payment transactions conveniently. In line with the developmental efforts taken to improve the electronic payments infrastructure, concerted efforts will also be taken to reduce the use of cheques. The Bank will be working with targeted industries to facilitate their migration to electronic payments.

In addition, the safety of banking and payment services offered over the Internet and mobile channels will be strengthened to ensure that proper security arrangements and consumer education initiatives are implemented to assure the safety of these services. In its effort to continuously enhance the consumers' confidence in using electronic payments, the Bank will monitor the security environment of the various payment channels and issue or enhance its guidelines on fraud management when the need arises to mitigate any developing trend of payment fraud.

Direct Pricing of Payment Services

International studies that have been done have found that paper-based instruments are more costly to operate than electronic payments. Debit cards in particular, are less costly compared to credit card payments and cash withdrawals. It was also found that cash distribution to the public was largely financed through substantial cross subsidies from revenue generated from electronic payment services.

The key driver for consumers in some countries that have successfully migrated to electronic payments has been through the implementation of transparent cost-based pricing of payment transactions. Prices give signals that help consumers choose the more cost efficient payment services. The income from payment services earned by banking institutions in these countries are largely from fees charged rather than from cross-subsidisation of services. By adopting cost-based pricing strategies, banking institutions in these countries were able to reduce their total production cost for payment services and correspondingly increase their overall profitability, by channelling demand towards less costly payment services. The on-going automation of the payment system has resulted in less frequent traditional bank counter transactions, thus allowing banking institutions to focus increasingly on higher value services and relationship management.

In general, the prices of payment transactions in Malaysia does not reflect the cost of production of the respective payment services, and therefore does not provide the right price signals for consumers to utilise the more cost efficient payment services. Payments via cheques, for example, are inefficient as it incurs a large variable cost component contributed by labour costs from the physical handling of cheques, transportation and the costs for paper and printing of cheques. In addition to cost savings, electronic payments also provide benefits to consumers and merchants with shorter crediting period and certainty of payment compared to cheque payments. Merchants receiving electronic payments would be able to improve their operational efficiency by reducing the customers' payment at the cashiers and also their cash holding, thereby minimising the risk of robbery and losses from pilferage. To move towards direct pricing of payment transactions, consumers should first be provided with an alternative electronic payment method that is affordable and comparable in terms of convenience and involvement of participants as in the cheque system. This would encourage consumers to use the relatively low cost electronic payment method when cheques are priced higher to reflect their true processing cost.

PERFORMANCE OF THE PAYMENT SYSTEMS

Overview

Notwithstanding the payment infrastructure developments and enhancements made in the recent years, Malaysia remains a high user of cash and cheques with its currency-in-circulation (CIC) accounting for 6.1% of GDP and cheques accounting for 95.1% of the non-cash payment value in 2005.

In terms of the major electronic payment modes, the usage of IBG and credit cards has been increasing. The share in value of non-cash payment over the past three years has increased at an average rate of 69.16% and 11.58% for IBG and credit cards respectively. Together, they account for 4.7% of total non-cash payment value in 2005. In terms of other payment cards, the use of charge cards is declining with its share of non-cash payment volume falling from 1.85% in 2002 to 0.81% in 2005, while the debit card has yet to make any significant impact with its share of the non-cash payment value and volume at 0.02% and 0.25% respectively. Electronic purse remains a popular micro-payment instrument in the transportation sector with an increase in its non-cash payment volume from 18.57% in 2002 to 47.5% in 2005. As the electronic purse is used mainly for small value payments, it accounted for only 0.07% of the non-cash payment value in 2005.

In terms of the CIC over GDP ratio, which is a proxy to estimate the use of cash, Malaysia's ratio of 6.1% is much higher than the average ratio of 3.2% in 2004

Table 10.1

Non-Cash Retail Payments in Malaysia
Value (%)

	2002	2003	2004	2005
Cheques	97.38	96.97	96.32	95.06
Interbank GIRO (credit transfer)	0.38	0.57	1.00	1.84
Credit cards	2.06	2.26	2.48	2.86
Charge cards	0.15	0.15	0.14	0.15
Debit cards	0.01	0.01	0.01	0.02
E-purse - Toll payments	0.02	0.04	0.05	0.07
E-purse - Retail	0.00*	0.00*	0.00*	0.00*

Note: * negligible

Table 10.2

Non-Cash Retail Payments in Malaysia
Volume (%)

	2002	2003	2004	2005
Cheques	47.74	35.89	30.53	26.05
Interbank GIRO (credit transfer)	0.15	0.24	0.57	1.35
Credit cards	31.44	26.90	25.09	24.04
Charge cards	1.85	1.37	1.00	0.81
Debit cards	0.25	0.22	0.21	0.25
E-purse - Toll payments	18.57	35.38	42.59	47.50
E-purse - Retail	0.00*	0.00*	0.01	0.00*

Note: * negligible

Table 10.3

Benchmarking with Other Countries

Countries (population)	2004 Netherlands (16.3m)	Norway (4.6m)	Sweden (9.0m)	Average	**2005 Malaysia (26.38m)**
Currency-in-circulation/GDP	2.1[1]	2.7	4.7	3.2	**6.1**
Number of cheques transactions per inhabitant (credit transfer)	0.0	0.3	0.2[2]	0.2	**7.6**
Number of Giro transactions per inhabitant (credit transfer)	77.5	95.5	51.4	74.8	**0.4**
Number of point-of-sale terminals per thousand inhabitants	12	21	14	16	**3**
Number of ATMs per million inhabitants	484	473	315	424	**223**

Note: [1] Figure as at 2001
[2] Figure as at 2002

Source: CPSS-Red Book Statistical Update December 2005, Norges Bank Annual Report on Payment Systems 2004 and Bank Negara Malaysia

for the Netherlands, Norway and Sweden, which are high users of electronic payments. The average numbers of Giro and cheque transactions per inhabitant in 2004 in the three selected European countries were 74.8 and 0.2, respectively, while Malaysia recorded an inverse ratio of 0.4 and 7.6 respectively in 2005.

While Malaysia has progressively introduced electronic payment systems to facilitate the migration to electronic payments, further measures need to be implemented to increase the accessibility to these payment services such as a wider deployment point-of-sale terminals for payment cards and enabling its ATMs for interbank funds transfer services. The average number of point-of-sale terminals per thousand inhabitants recorded in the selected European countries in 2004 was 16, compared with only three in Malaysia in 2005. In terms of ATMs, the average number of ATMs in the selected European countries per million inhabitants was 424 in 2004, compared to Malaysia's 223 ATMs in 2005.

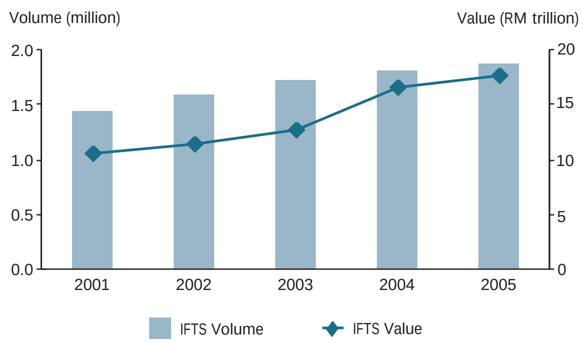
Payment Systems and Instruments, and Delivery Channels

RENTAS

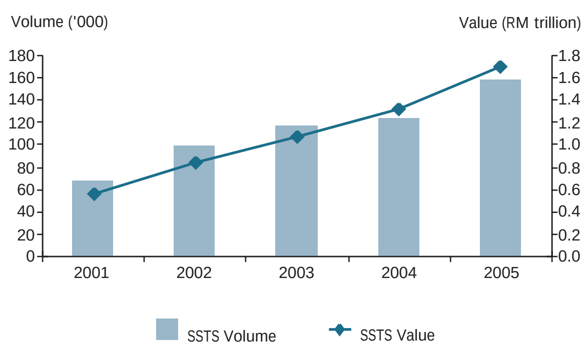
The value and volume of RENTAS transaction has been increasing over the past five years. In 2005, the RENTAS system settled 2.05 million transactions amounting to RM19.3 trillion, an increase of 6.8% and 8.1 % in terms of volume and value of transactions respectively. The Interbank Funds Transfer System (IFTS) recorded an increase of 5.4% and 6.4%, in terms of volume and value respectively, while transactions through the Scripless Securities Trading System (SSTS) increased by 27.6% and 29.5% respectively.

In line with the Bank's revised access policy, major financial market participants admitted into the RENTAS in 2005 were Bank Simpanan Nasional, Bank Kerjasama

Graph 10.1
RENTAS - IFTS Turnover



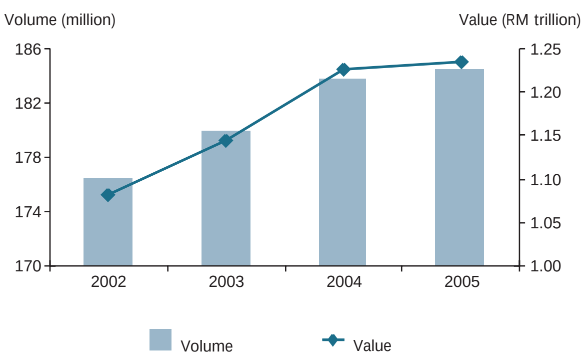
Graph 10.2
RENTAS - SSTS Turnover



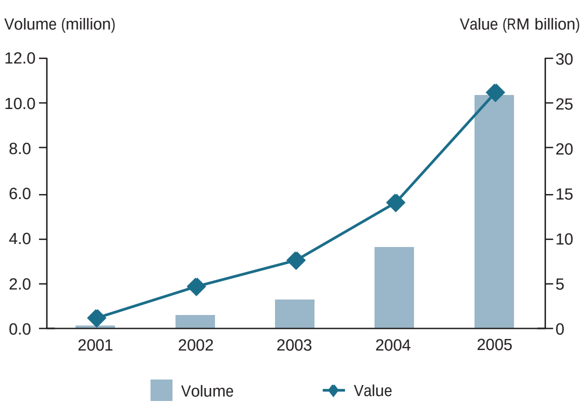
Rakyat Malaysia Berhad and Kumpulan Wang Simpanan Pekerja. As at December 2005, there are 56 RENTAS members, comprising Bank Negara Malaysia, 23 commercial banks, six Islamic banks, ten merchant banks, seven discount houses, two development financial institutions, two finance companies, three universal brokers, Cagamas Berhad and Kumpulan Wang Simpanan Pekerja.

Sistem Penjelasan Imej Cek Kebangsaan (SPICK)
Cheques remain the most widely used non-cash payment instrument accounting for 95.1% of the non-cash payment value in 2005, and has recorded increases in volume and value since 2002. Volume of cheques processed through the SPICK cheque clearing centres increased marginally by 0.4% from 183.8 million cheques valued at RM 1.227 trillion in 2004 to 184.4 million cheques valued at RM1.235 trillion in 2005. This reflects the widespread cheque usage is in the Malaysian economy.

Graph 10.3
Volume and Value of Cheque Transactions



Graph 10.4
Volume and Value of IBG Transactions



Interbank GIRO System (IBG)
Since its implementation, IBG continues to record an increase in transactions from 124,000 transactions valued at RM1.08 billion in 2001 to 10.4 million transactions valued at RM26.3 billion in 2005. Increase in IBG transactions is attributed mainly to the recruitment of corporate users by banking institutions and the increase in the Government's payment via electronic channels. Nevertheless, the IBG transactions which accounts for 1.9% of the cheque payment value in 2005, needs to increase much more significantly to be a major retail payment system.

Financial Process Exchange (FPX)
Since the pilot launch of the FPX in October 2004, more banking institutions and merchants have joined the system, bringing the total number of participants to six and 16, respectively. Two more banking institutions and several merchants are in the final stages of preparation to link to the FPX and are planning to come onboard by the first quarter of 2006. As at the end of 2005, the FPX recorded a total of 686 transactions amounting to RM16.8 million since its debut in 2004. Payment transactions made via the FPX are mainly for businesses, which are termed as B2B transactions, and from consumers to businesses or C2B transactions for online purchases. The introduction of FPX brings about greater convenience and efficiency as it enables both individuals and corporate users to make payments electronically from the banking institution of their choice. To optimise the potential of the system, wider participation is needed to have an enlarged community of online participants.

Payment Cards
Credit cards remain the most popular payment card in Malaysia with transaction value of RM40.9 billion in 2005 and had recorded an average annual growth in transaction volume and value of 13.3% and 17.4% per annum respectively during the recent three years. While the credit card offers a revolving credit line to the cardholders, on average about 60% of the total value of credit card transactions are repaid in full, indicating that a majority of the cardholders are using the cards as a convenient means in making payment. With the growing popularity of credit cards, the number of charge cards in circulation had declined at an average rate of 10.9% and its transaction volume has fallen at a rate of 5.8% over the same period. For debit cards, it has a sizeable card base of 14.3 million, comprising mainly the e-Debit application that has been incorporated into 12 million chip ATM cards and 2.3 million international brand debit cards. Although debit card transactions had increased at an annual rate of 24.6% and 49.8% per annum in terms of volume and

Table 10.4

Payment Card Transactions

	2003			2004			2005		
	Number of cards	Value (RM mil)	Volume (mil)	Number of cards	Value (RM mil)	Volume (mil)	Number of cards	Value (RM mil)	Volume (mil)
Credit cards	5.10	29,359.9	146.3	6.58	34,874.3	164.5	7.84	40,892.5	184.5
Charge cards	0.31	1,895.7	7.5	0.28	2,037.6	6.6	0.24	2,074.8	6.2
Debit cards	3.15	87.4	1.2	7.71	143.1	1.4	14.32[1]	240.1	1.9
Electronic purse - toll	2.98	566.3	192.4	4.23	733.7	279.3	5.66	972.1	364.5
Electronic purse - retail	10.47	0.1	0.02	21.13	0.3	0.09	30.27	0.10	0.02

[1] Figure includes Bank Simpanan Nasional

value, it remains insignificant compared to credit cards. The two main electronic purse schemes are the MEPS Cash scheme, a contact electronic purse which is used in the retail sector and the Touch 'n Go scheme, a contactless electronic purse which is used in the transportation sector. As in most countries' experience, electronic purse usage in the retail sector has been low while it represents a popular payment instrument in the transportation sector.

Mobile Banking and Payment Services

Broader usage of mobile phones has encouraged the acceptance and growth of the mobile banking and mobile payment services in the country. Currently, five banking institutions offer banking services using Short Messaging Services (SMS) via mobile phones, where the range of services include own account funds transfer, bill and loan payments, mobile prepaid airtime reload and balance inquiries. In facilitating mobile payments, banking institutions are partnering with third party service providers to allow subscribers to purchase goods and services or make payments using their mobile phones by either charging the amount to their credit cards, or debiting their savings or current accounts. A total of 391,773 transactions were conducted during the year with an aggregate value of RM4.4 million, mainly for bill payments and own account funds transfer transactions. The number of mobile banking subscribers has more than quadrupled to 127,566 as at the end of 2005 as compared to 25,734 as at the end of 2004. This was contributed by the new mobile banking or payment offerings during the year, apart from the large number of mobile phone users of 19.5 million as at the end of 2005.

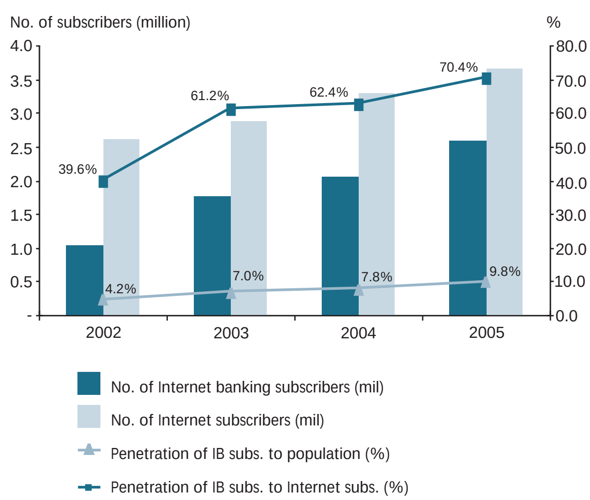
Internet Banking

Internet banking services provided by 14 banking institutions continue to provide convenience and low-cost accessibility to banking services especially in making funds transfer, bill and loan payments, reloading mobile prepaid airtime and account balance and other inquiries. New services available through this channel include online share application service for initial public offering on Bursa Malaysia. The Internet banking channel is becoming increasingly more popular and its subscribers have doubled in the recent two years, with a total of 2.6 million subscribers or 70.4% of the Internet subscribers in the country as at December 2005. In addition, the annual value of online banking transactions has also grown by 69.6% from RM11 billion in 2004 to RM18.6 billion in 2005. The growth is largely contributed by the rise in using the channel for third party and own account funds transfers and payment of credit card balances.

Shared ATM Services

As at end-2005 there were 5,871 ATMs in Malaysia, of which, 5,490 ATMs belonging to 12 domestic banks

Graph 10.5
Internet Banking Growth and Penetration



and three development financial institutions are inter-connected via the MEPS' ATM switch. As at end 2005, approximately 15.1 million chip based ATM cards issued by the participating member banks in the shared ATM network. The network facilitates infrastructure cost savings for individual financial institutions while providing consumers with wider access to ATM services through an expanded pool of ATMs. ATM services provide a number of other functionalities such as balance inquiry, intra-bank funds transfer, bills payment, shares application and reloading of electronic purse applications. However, cash dispensing remains the most popular transaction amounting to RM156.5 billion or 99.8% of the financial transactions conducted at ATMs in 2005. MEPS and the financial institutions are planning to introduce interbank funds transfer and other payment functionalities such as reloading of prepaid mobile phones in the near future. Meanwhile, the regional cross-border link between MEPS and Artajasa in Indonesia recorded a total transaction volume and value of 376 and RM0.13 million respectively in the six months of operations in 2005.

External Relations

External Relations

In 2005, Bank Negara Malaysia continued to strengthen its external relations, both at the international and regional levels to foster closer financial co-operation. At the regional level, while economic surveillance processes remained an integral element of the international agenda, significant steps were taken to enhance economic and financial co-operation. These efforts were focused at strengthening institutional and infrastructure development, and capacity building in Islamic financial services, bond market and financing arrangements. Initiatives were also taken to enhance bilateral relations and combating of money laundering and terrorism financing. Enhancing regional co-operation in these areas form the foundations for realising the potential that greater regional economic and financial integration would bring to the region. At the multilateral front, calls were made for the International Monetary Fund (IMF) and the World Bank (WB) to address the leadership issue and governance structure, and the need for quota review that adequately reflects the economic contribution and voice of the Asian countries in the international financial system.

Economic Surveillance

Bank Negara Malaysia participated actively in the economic surveillance processes of various multilateral and regional fora during the year. At the multilateral fora, surveillance issues were deliberated at the meetings of the IMF, WB and the Bank for International Settlements (BIS). Policy deliberations were focused on the role of respective regions in ensuring orderly resolution of global imbalances and in managing the potential risks of high oil prices. It was recognised that all member countries were collectively responsible to ensure a stable and more balanced global economic growth. The IMF and the WB would play crucial roles in enhancing the coherence and consistency of the international monetary, financial, and trading systems, and in fostering international co-operation to address economic challenges.

At the regional level, the Bank also participated in various initiatives to develop effective regional surveillance capabilities that complemented those undertaken by the international financial institutions. Economic surveillance undertaken at the regional level included those covered by the Executives' Meeting of the East Asia-Pacific Central Banks (EMEAP), South-East Asian Central Banks (SEACEN), the Association of Southeast Asian Nations (ASEAN), ASEAN plus the People's Republic of China (PR China), Japan and Korea (ASEAN+3), and the Asia-Pacific Economic Co-operation (APEC). Among these initiatives included the enhancement and integration of the ASEAN+3 economic surveillance mechanism into the Chiang Mai Initiative (CMI) framework. This would enable early detection of irregularities and swift remedial policy actions, and to facilitate the activation of bilateral swap arrangements (BSAs) under the CMI, while at the same time avoiding the emergence of any moral hazard issues.

Another area of priority is the monitoring of cross-border flows. Through the SEACEN Expert Group (SEG) on Capital Flows, the Bank participated in the exchange of information on capital flows among the SEACEN members. During the Fifth Meeting of SEG on Capital Flows that was held in March 2005 in Kuala Lumpur, a discussion was held on the development of a regional early warning system model for capital flow reversals, with the aim of adopting the model as an additional tool for data analysis work by the SEACEN Centre. The establishment of an early warning system in 2006 would further augment the monitoring activities, which would lay a key step forward in better assessment of regional capital flows developments.

Through the EMEAP and the SEACEN fora, the Bank continued its active participation to discuss economic surveillance issues, initiatives for capacity building and training of central bankers. High on the agenda was the framework for financial stability, in light of the volatile and large capital flows, financial liberalisation and increasing integration with global markets. Another priority area was the development of the financial sector, notably the implementation and impact of the new Basel II capital adequacy framework. This needed to be reinforced with the strengthening of the capacities of both the central banks and commercial banks in order to effectively implement Basel II. In light of this, the SEACEN Centre would have an important role in providing training to facilitate the implementation of Basel II.

Multilateral Relations

During the year, Bank Negara Malaysia continued to press forward the need for the IMF and the WB to reflect their representation of all member countries. Among the issues reiterated by Malaysia at the September 2005 IMF/WB Annual Meetings included the need for greater voice and participation of emerging and developing countries at the IMF and the WB, commensurate with their relative strength in the changing global economy. Malaysia highlighted that the emphasis of the IMF and the WB to focus on reforms at the country and regional levels must also be accompanied by reforms on the international front. Consequently, the ability to provide leadership adequately, balancing the interest of the developed and developing countries on the global stage would determine the effectiveness and relevance of the international financial institutions. At the same time, the IMF surveillance efforts should also include initiatives that will enhance the institutional capacity of developing economies in managing risks and vulnerabilities while sustaining their own capacity to support growth and development. The importance for enhancement of development partnership and financing to achieve the Millenium Development Goals (MDGs) was further emphasised.

Toward this end, Malaysia, as a contributor to the IMF's Poverty Reduction and Growth Facility Trust, supported the proposals needed to launch the Multilateral Debt Relief Initiative (MDRI) and the Exogenous Shocks Facility of the IMF. The objective of the MDRI is to assist in debt relief for qualified low-income members of the IMF thereby assisting them in reaching the MDGs, while the Exogenous Shocks Facility would allow the IMF to provide timely financial assistance to low-income members that have been adversely affected by exogenous shocks.

Malaysia continues to maintain its net creditor status in the IMF. During the year, Malaysia continued to be included in the IMF's Financial Transaction Plan (FTP) for the quarterly period up to February 2006. Under the FTP, selected IMF members (47 to date) with strong balance of payments and reserve positions may be called upon to provide foreign exchange resources to support the IMF's financial operations. Malaysia resumed the IMF's FTP status since September 2002, after a period from 1997.

In November, the IMF's Article IV Mission visited Malaysia to discuss and assess Malaysia's macroeconomic performance and policy issues for 2005 and outlook for 2006. Their assessment was that Malaysia's resilience to shocks has continued to improve. Reference was made to the pragmatic approach adopted by the Malaysian authorities in macroeconomic policymaking and the steady progress in the implementation of structural reforms.

During the year, the Bank also participated actively in meetings organised by the BIS. Key issues discussed at the meetings included the design and operation of monetary policy decision-making, central bank co-operation in the Asia-Pacific region, supervision of financial activities, issues relating to the global imbalances and sharp increases in oil prices, and implications of household indebtedness. During the year, the Bank purchased 220 shares out of 35,933 additional shares offered for sale in January 2005 by the BIS to existing shareholders. With the subscription, the Bank's shareholding in the BIS increased to 3,220 shares to account for 0.6% of the increased BIS capital.

Bank Negara Malaysia also progressed forward its collaboration with the Islamic Development Bank (IDB) under the ambit of the Memorandum of Understanding (MoU) signed between Malaysia and IDB in June 2004. Two High-Level Meetings were held during the year to deliberate on areas of co-operation under the MoU. The areas of co-operation included strengthening intra-trade and development of Information Communication Technology (ICT) among the Organisation of Islamic Conference (OIC) member countries. New areas of co-operation continued to be explored by the various working groups and task forces established under the ambit of the MoU. Significant progress have been achieved, with the signing of a Reinsurance Facility Agreement in June 2005 between the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) and Malaysia Export Credit Insurance Berhad (MECIB), aimed at promoting and facilitating more trade and investment among OIC member countries. In addition, the Malaysian Industrial Development Authority (MIDA) signed an MoU with the ICIEC in September 2005 to cooperate in developing programmes for promoting investment opportunities in OIC member countries.

Bank Negara Malaysia is also a member of the IDB 1440H Vision Commission. The role of the Commission is to transform the IDB into a premier and proactive development bank with wide knowledge and competencies in all its core areas, and to be responsive to the diverse needs of people in the member and non-member countries. The Commission has scheduled to launch the IDB 1440H Vision document in Kuala Lumpur on 23 March 2006.

Financial Services Negotiations

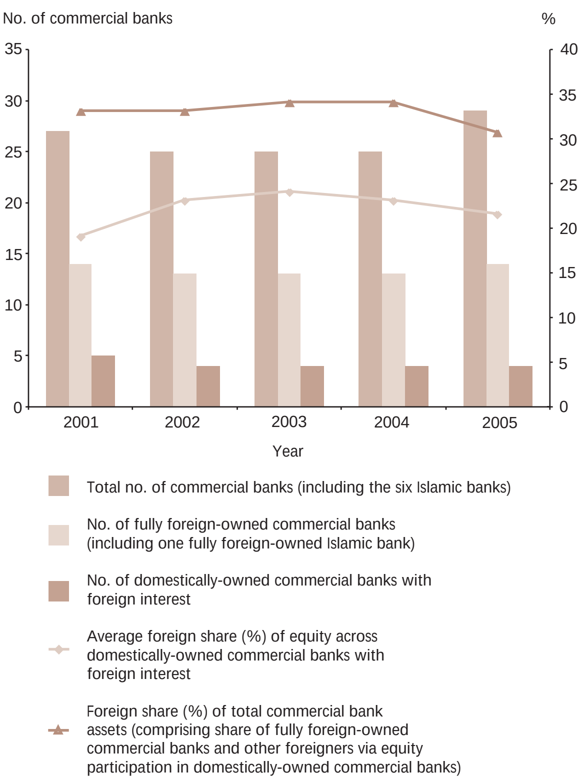
World Trade Organisation

Bank Negara Malaysia played an active role in the services negotiations at the World Trade Organisation (WTO) and is the lead agency undertaking negotiations on trade in financial services. At the Sixth WTO Ministerial Conference (6th MC) held on 13-18 December 2005 in Hong Kong, it declared the establishment of procedures to conclude negotiations under the Doha Development Agenda in 2006. Among others, these procedures covered the details to complete negotiations in agriculture, industrial goods and services. This included securing a final date of 2013 for the elimination of all export subsidies in agriculture, with flexibility for longer timeframe for developing countries, and providing duty- and quota-free access for goods exported by 32 least-developed countries.

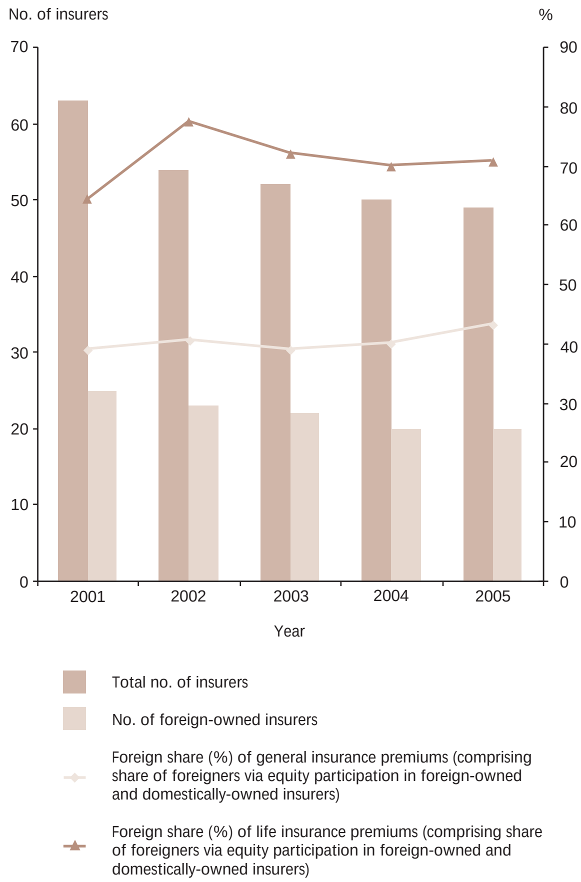
On services negotiations, including financial services, the 6th MC agreed that WTO member countries would submit their final commitments on further market opening by 31 October 2006. It was agreed that member countries would strive to achieve a progressively higher level of liberalisation of trade in services, with appropriate flexibility for developing countries, taking into account factors including the size of their respective economies; level of readiness for liberalisation; and the need to balance it with their domestic considerations.

The procedures and timelines agreed to by the 6th MC were expected to intensify negotiations to further liberalise trade in services at the WTO. This was in keeping with the WTO's objective to ensure that trade flows continued to take place smoothly, predictably and as freely as possible. In line with the commitment to gradually liberalise the financial services sector, Bank Negara Malaysia undertook measures[1] to accord greater flexibility for locally-incorporated foreign banks to establish additional branches, and allow higher foreign shareholdings in takaful operators, investment banks and Islamic banks. These measures are consistent with the overall objective of the Financial Sector Masterplan (FSMP), which is to create an effective, efficient and dynamic financial sector that supports the diversified requirements of the economy.

Graph 11.1
Foreign Participation in the Malaysian Commercial Banking Sector



Graph 11.2
Foreign Participation in the Malaysian Insurance Industry



Regional and Bilateral Free Trade Agreements

The third round of financial services negotiations under the ASEAN Framework Agreement on Services (AFAS) concluded with the signing of the 'Protocol to Implement

[1] Further details on these measures can be referred to in Chapter 5: The Banking System and Chapter 6: The Islamic Financial System.

the Third Package of Commitments on Financial Services Liberalisation' by the ASEAN Finance Ministers at their meeting on 6 April 2005 in Vientiane, Laos. The Protocol put into effect the liberalisation commitments made by ASEAN Member Countries under the third round of negotiations, which started in 2002. The commitments went beyond those made by the Member Countries at the WTO under the General Agreement on Trade in Services (GATS), also known as 'GATS-plus commitments'. Malaysia undertook a GATS-plus commitment in the area of investment advisory services. A fourth round of negotiations on financial services was also launched by the ASEAN Finance Ministers at their meeting on 6 April 2005. The round is expected to be concluded within three years.

Bank Negara Malaysia also participated in ongoing services negotiations, among others, under the ASEAN-China Free Trade Agreement (FTA), the Malaysia-Australia FTA and the Malaysia-New Zealand FTA. Malaysia's first bilateral FTA was signed with Japan on 13 December 2005, officially known as the 'Japan – Malaysia Economic Partnership Agreement'. The FTA was comprehensive in nature, encompassing measures on liberalisation, co-operation and trade facilitation in the areas of goods, services and investment. Malaysia and Japan agreed to establish a 'Working Group on Financial Services' under the FTA. The Working Group will provide a forum for the financial regulatory authorities in both countries to exchange views on issues of mutual interest related to financial services.

Islamic Banking

As a founding member and the host for the Islamic Financial Services Board (IFSB), Bank Negara Malaysia continued to participate actively in the IFSB as a member of the IFSB Council and its Technical Committee. During the year, the IFSB issued two prudential standards for Islamic financial institutions, namely the Guiding Principles of Risk Management and Capital Adequacy Standard. The Guiding Principles of Risk Management complemented the current risk management principles issued by the Basel Committee on Banking Supervision and other international standard setting bodies, by providing a set of guidelines for establishing and implementing effective risk management practices in the Islamic financial institutions. The Capital Adequacy Standard addressed the specific approaches in identifying and measuring risk of Shariah compliant products and services offered by the Islamic financial institutions that were not specifically addressed by Basel II. The two standards are to be implemented with effect from 2007.

In 2005, the Council of the IFSB approved the exposure draft on the Corporate Governance Standard and initiated the preparation of two new standards on transparency and market discipline, and the supervisory review process. In addition, the IFSB launched a project to develop a prudential database of Islamic financial services statistics and a study on financial instruments for monetary management, and facilitating and regulating Islamic money market.

During the year, the IFSB admitted the Monetary Authority of Singapore as a full member and the Banque Du Liban as an associate member. As at end-2005, the total number of IFSB membership increased to 84 members (16 full members, seven associate members and 61 observer members) from 65 members as at end-2004.

Combating Money Laundering and Terrorism Financing

In recent years, the international community has made much progress in establishing mechanisms for an extensive range of international co-operation in combating money laundering and terrorism financing. Countries around the world responded to the United Nations Convention on the Suppression of the Financing of Terrorism and the nine special recommendations on terrorist financing issued by the Financial Action Task Force on Money Laundering (FATF). All countries welcomed the positive incentives for the implementation of FATF's recommendations and AML/CFT[2] systems for the benefit of their societies, businesses and financial sectors.

ASEAN

Malaysia actively participated in the yearly ASEAN Senior Officials Meeting on Transnational Crime (SOMTC). At the 5th ASEAN SOMTC & Consultations with Australia, China, Japan, India, Korea and the United States, ASEAN member countries agreed to prioritise on four areas of transnational crime, namely terrorism, illicit drug trafficking, trafficking in persons and money laundering. As the "lead shepherd" for money laundering, Malaysia offered to host study visits to the Financial Intelligence Unit (FIU) in Bank Negara Malaysia and the Basic and Advanced Net Worth Analysis Workshops for ASEAN members under the ASEAN+3 initiatives.

Asia/Pacific Group on Money Laundering

Malaysia has been a member of the Asia/Pacific Group on Money Laundering (APG) since 2000. At the Eighth APG Annual Meeting in July 2005, Malaysia was nominated as the representative for the South East Asia region in the APG Steering Group for the period of one year from July 2005. As a member of the APG

[2] 'AML/CFT' refers to 'Anti-Money Laundering and Counter Financing of Terrorism'.

Steering Group, Malaysia has participated in the deliberations on the structure, functioning and support for the APG. Malaysia supported Myanmar's membership in the APG as this was in line with the APG's mandate as a platform for practical and technical co-operation that was to be free from political considerations.

Malaysia also participated in the APG programme to review its domestic non-profit organisations (NPO) sector and associated regulations. The NPO review was essential to identify weaknesses that increase the potential for NPOs to be exploited as money laundering conduits. The review would enable risk-based measures to be formulated and established to deter and detect any exploitation of the NPOs as conduits for illegal activities. Bank Negara Malaysia is conducting this review in collaboration with the Registrar of Societies and the Companies Commission of Malaysia.

Malaysia supported the APG's application to the FATF for associate membership as this would enhance the opportunity for practical co-operation with the FATF on areas such as research on money laundering trends, technical assistance, and implementation guidance at the international level.

The Egmont Group of Financial Intelligence Units (Egmont Group)

Bank Negara Malaysia had been a member of the Egmont Group since July 2003. The Egmont Group is an informal organisation established to stimulate international co-operation through information exchange, training and sharing of expertise. The exchange of information to and from the other 100 FIUs worldwide was done through the Egmont Secure Web. Any information provided may not be shared with a third party nor be used in an administrative, investigative, prosecutorial, or judicial purpose without prior consent of the disclosing FIU.

Cross-Border Co-operation on Exchange of Information

Pursuant to Section 10 of the Anti-Money Laundering Act 2001 (AMLA), Bank Negara Malaysia is permitted to communicate any information to a corresponding authority of a foreign State if an arrangement existed between Malaysia and that foreign State. Bank Negara Malaysia signed an MoU for the exchange of financial intelligence with the Anti-Money Laundering Office of Thailand in April 2005. The MoU will facilitate co-operation for both parties to gather and analyse information on financial transactions suspected of being related to money laundering, terrorism financing or other serious crimes to assist in the investigation and prosecution of persons suspected of those crimes. To date, Bank Negara Malaysia has concluded similar MoUs with the FIUs of Australia, Indonesia and the Philippines. Bank Negara Malaysia has finalised the negotiation on a similar MoU with the People's Bank of China and will sign the MoU in 2006. Currently, Bank Negara Malaysia is at various stages of negotiations with other foreign counterparts to execute similar MoUs.

> The Bank continued to enhance the AML/CFT regime by strengthening international collaborative efforts through entering into MoUs with foreign counterparts for information exchange, participating in technical assistance programmes and playing an active role in international fora.

Participation in AML/CFT Mutual Evaluation

As part of our participation in AML/CFT initiatives, Malaysia provided a legal expert for the APG's mutual evaluation on Brunei in January/February 2005 and a financial expert in the joint FATF/APG mutual evaluation on the United States in December 2005/January 2006. Such mutual evaluation assesses the effectiveness of a country's AML/CFT system and its compliance with international AML/CFT standards. Due recognition was given where standards are met and where weaknesses are identified, appropriate recommendations are made with a view to rectification and improvement.

Technical Assistance

Malaysia's approach in implementing the national AML/CFT regime that took into account domestic environment is looked upon as a model for neighbouring countries. Bank Negara Malaysia provided technical assistance to the Lao PDR on the establishment of AML/CFT policy and procedures for two state-owned commercial banks in February 2006 under the sponsorship of the Asian Development Bank. This technical assistance was similar to the assistance provided in 2004 to the National Bank of Cambodia. Bank Negara Malaysia shared its experience in the establishment of an FIU at the International Seminar on Money Laundering in

Islamabad, Pakistan in March 2005 and at the IMF Workshop in Singapore in November 2005. Malaysia also provided technical expertise at the WB's 'Train the Trainers' Workshop in Bangkok in May 2005 and at the AML/CFT Symposium in China in September 2005.

Capacity Building

As domestic financial systems become internationally integrated with more extensive international networks, it requires a more sophisticated approach to conduct surveillance on financial transactions and detecting any potential illicit financier. It is also important to develop the expertise of personnel involved in investigating money laundering and terrorism financing so as to effectively deal with changes occurring in the international environment. In this regard, Malaysia would continue to enhance its AML/CFT regime to ensure that it remains effective in detecting and deterring criminal activities.

Economic and Financial Co-operation

The collaborative efforts on regional financial co-operation in the area of short-term liquidity support in the region and in the further development of regional bond markets gained significant strides in 2005. The Bank participated in various fora to further promote regional economic and financial co-operation, as well as collaborated in the formulation of general agreements on issues of common interest to the region.

The Chiang Mai Initiative (CMI) which comprises two components, namely the ASEAN Swap Arrangement (ASA) among the ASEAN countries and a network of bilateral swap arrangements (BSAs) among the ASEAN+3 countries moved forward in arrangements to enhance the effectiveness of the CMI to address short-term regional liquidity difficulties and to complement the existing international financial facilities. The measures included the doubling of the size of the ASA to USD2 billion at the prevailing proportions of contributions by member countries. The decision reflected the strong motivation of ASEAN countries to further enhance regional self-help arrangements and signaled the move towards greater financing co-operation to address the increased risks of large speculative global capital flows. Consequently, Malaysia's financial commitment doubled to USD300 million (see Table 11.1). The new MoU on the expanded ASA came into force on 17 November 2005.

In May 2005, the ASEAN+3 Finance Ministers agreed on a set of specific measures to raise the level of effectiveness of the BSA network. These comprise initiatives to integrate and enhance the ASEAN+3 economic surveillance into the CMI; clearly-define the swap activation process and adopt a more effective collective decision-making mechanism; increase the size of bilateral swaps significantly; and improve the mechanism for speedy drawdowns. The Bank remained actively engaged in the Working Group on the Review of the CMI whose proposals were endorsed by the Finance Ministers. Malaysia and PR China, were also appointed as the lead countries of the joint study on the possible routes and progressive steps in multilaterising the CMI towards a more effective pooling and utilisation of liquidity support among member countries.

The further strengthening of regional financial cooperation was reflected in the expansion of the ASEAN Swap Arrangement, efforts to enhance the effectiveness of the network of bilateral swap arrangements under the Chiang Mai Initiative, and an acceleration in the development of the Asian Bond Market Initiative and the Asian Bond Fund.

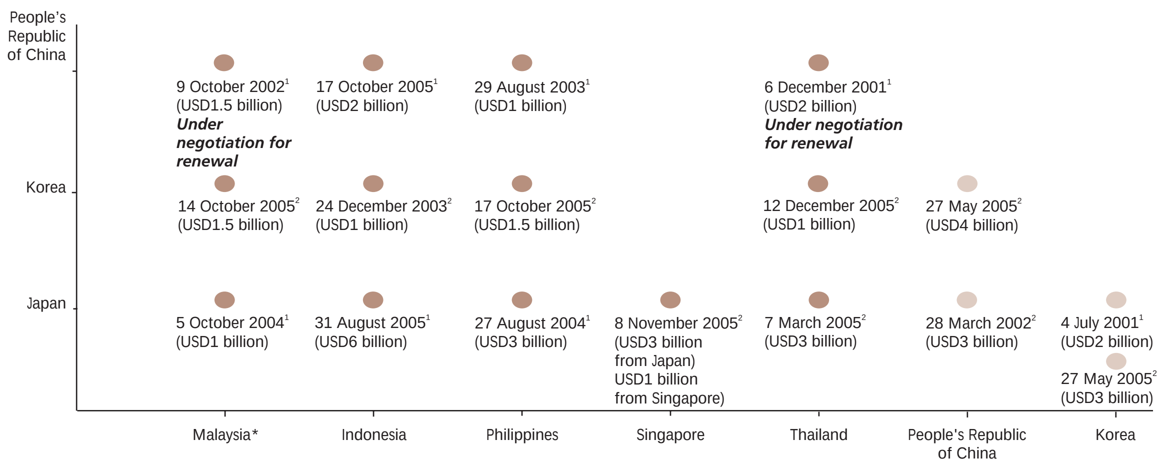
Under the CMI, Malaysia has entered into three BSA agreements, namely with Japan, Korea and PR China. In October 2005, Malaysia's BSA agreement with Korea was renewed for another three years upon its expiry. Consonant with decisions made in

Table 11.1
ASEAN Countries' Commitments under the expanded ASEAN Swap Arrangement (ASA)

Countries	New Commitments with increase of ASA size to USD2 billion (USD million)	% of total size of ASA
Brunei	300	15.0
Indonesia	300	15.0
Malaysia	300	15.0
Philippines	300	15.0
Singapore	300	15.0
Thailand	300	15.0
Cambodia	30	1.5
Lao PDR	10	0.5
Myanmar	40	2.0
Vietnam	120	6.0
Total	**2,000**	**100.0**

May 2005 by the ASEAN+3 Finance Ministers, bilateral negotiations between Malaysia and Korea resulted in agreement on increasing the swap size of the BSA from USD1 billion to USD1.5 billion. In addition, the initial drawdown that could be made without being subject to the IMF conditionality was increased from 10% to 20% of the swap size. In the case of the BSA agreement between Malaysia and PR China, the Bank had entered into negotiations with the People's Bank of China on renewing the agreement. The new agreement is expected to come into effect in 2006. Collectively, as at end-2005, the BSA network which comprised 16 agreements among eight ASEAN+3 countries, totalled USD58.5 billion, an increase from USD36.5 billion at end-2004.

Bilateral Swap Arrangement Agreements under the Chiang Mai Initiative as at end-2005



Dates indicate when the agreements have been signed and the maximum drawing amount for each agreement is indicated in parentheses.

1 A one-way swap arrangement where the requesting country under the agreement can request the swap-providing country to enter into a swap transaction.
2 A two-way swap arrangement where either party could request the other party to enter into a swap transaction under the agreement.
* Malaysia's three BSAs are of a three-year tenure.

Agreements signed between the Plus Three countries (People's Republic of China, Japan and Korea) and ASEAN countries.

Agreements signed among the Plus Three countries.

On the cooperative efforts to further develop the regional bond markets, advancements in promoting greater and more efficient financial intermediation were mirrored in the new initiatives to accelerate capital market development within the Asian Bond Market Initiative (ABMI) under the ASEAN+3 forum and the Asian Bond Fund (ABF) under the EMEAP. Under the Asian Bond Market Initiative (ABMI), the ASEAN+3 member countries continued to make significant advancements in contributing to the development of deeper and more liquid bond markets. At the working group level, to enhance efficiency, the initial six working groups[3] that were established in 2003 were re-organised to four working groups in May 2005, focusing respectively on creating new securitised debt instruments, credit guarantees and investment mechanisms, foreign exchange transactions and settlement issues, and rating systems. At the same time, to facilitate more effective coordination for the Focal Group on ABMI, an Ad-hoc Support Team and a Technical Assistance Coordination Team were established in accordance with the ABMI Roadmap endorsed by the ASEAN+3 Finance Ministers in May 2005.

Achievements of the working groups in 2005 included, amongst others, the completion of studies on the setting up of a credit guarantee and investment mechanism to support issuances of bonds in the region, treatment of withholding tax and possible issuance of regional multi-currency bonds. Under the Working Group on Foreign Exchange Transactions and Settlement Issues, chaired by the Bank, two studies were completed, namely on impediments to cross-border investments and issuance in Asian countries, and on the possibility of setting up a regional settlement linkage to address gaps within the current settlement arrangements for bonds amongst member countries. Following the completion of the former, member

[3] The six working groups formed were on 'New Securitised Debt Instruments', 'Credit Guarantee and Investment Mechanisms', 'Foreign Exchange Transactions and Settlement Issues', 'Issuance of Bonds Denominated in Local Currencies by Multilateral Development Banks, Foreign Government Agencies, and Asian Multinational Corporations', 'Rating Systems and Dissemination of Information on Asian Bond Markets', and 'Technical Assistance Co-ordination'.

countries agreed to provide the minimum relevant information on the rules and regulations involving cross-border bond investments and issuance. Information provided by member countries would be regularly updated on the Asian Bonds Online website[4] . With regards to the latter study, member countries have agreed to undertake the second phase of the study in 2006, focusing on reductions of various risks, in particular foreign exchange settlement risks in cross-border payment and settlement systems.

Meanwhile, concrete achievements by individual ASEAN+3 member countries included local-currency bond issuances by the multilateral development banks in Malaysia, Thailand, China and the Philippines, and the introduction of new instruments such as the securitizing of student loans in Korea.

In complementing the ABMI, the EMEAP Group moved to implement the second phase of the Asian Bond Fund (ABF2) initiative, which encompassed public participation in the fund. The ABF2 consists of nine funds, eight of which are single market local currency funds investing in sovereign and quasi-sovereign bonds issued in China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand respectively, while the Pan-Asian Bond Index Fund (PAIF) is a single bond fund investing in a composite of sovereign and quasi-sovereign bonds issued in the local currencies of all the eight EMEAP economies. The PAIF, which was listed in July 2005 in Hong Kong, has grown by 10.2% since its listing to USD1.1 billion as at end-2005. In 2005, three of the eight single market funds were successfully listed on their respective stock exchanges. These comprised the ABF Hong Kong Bond Index Fund, ABF Malaysia Bond Index Fund, and ABF Singapore Bond Index Fund, which were listed in June, July and August, respectively.

The listing of the ABF Malaysia Bond Index Fund, the first Exchange Traded Fund (ETF) in Malaysia, added to the diversity of listings on the Malaysian Stock Exchange and also paved the way for the increased introduction of other more innovative products. The listing of the ETF also raised awareness and generated interest among domestic and international investors in the Malaysian bond market, thus contributing towards the development of a deeper and broader bond market in Malaysia. Since its launch, the low cost ETF achieved 27% growth as at end-2005.

During the year, Bank Negara Malaysia continued to promote the Bilateral Payments Arrangement (BPA) as part of Malaysia's efforts to enhance its trade co-operation with non-traditional markets. Bank Negara Malaysia, as the implementing agency for the Palm Oil Credit and Payments Arrangement (POCPA) scheme continued to collaborate with the Government to finance Malaysian palm oil exports to markets with potential growth in their demand and usage for oils consumption. Moving forward, Bank Negara Malaysia will continue to enhance the effectiveness of the BPA scheme and also explore the possibilities of expanding the number of countries, particularly to OIC member countries. Currently, Bank Negara Malaysia had signed the BPA with 24 countries, of which nine are OIC member countries, while five out of the 10 countries benefiting from the POCPA scheme are OIC member countries.

Regional members spearheaded new initiatives to transform the SEACEN Centre into an institution of regional excellence and choice of training by central bankers in this region.

Bank Negara Malaysia continued to accord a high priority to regional co-operation in human capital management to strengthen domestic capacities in the financial sector and macroeconomic management. In this regard, Bank Negara Malaysia strongly supported the training activities of the SEACEN Research and Training Centre, focusing on topics relating to core central banking functions, especially in banking supervision, financial sector reform and formulation of monetary policy. During the year, the SEACEN Centre extended its training to 22 non-members while continuing to provide training to its members which expanded to 14, with the admission of the Bank of Papua New Guinea in June 2005. In conducting its training activities, the Centre collaborated with international training institutes, including the Toronto International Leadership Centre, the IMF Institute, the Financial Stability Institute, the WB Institute and the ADB Institute. At the same time, collaboration was also established with central banks from developed countries, such as, the Federal Reserve System of the United States and the Bank of Japan. In 2005, for the first time, the Centre collaborated with the APEC Business Advisory Council, the Asian Bankers' Association and the Pacific Economic Co-operation Council to conduct the public-private Dialogue on 'Cross-Border Implementation of Basel II and Emerging Regulatory Banking Supervisory Issues'.

[4] www.asianbondsonline.adb.org

This collaboration would be enhanced to bring in the business perspective into the training conducted by the Centre.

Given the challenges facing the Centre in performing its functions in the dynamic global environment, regional members spearheaded new initiatives to transform the SEACEN Centre into an institution of regional excellence and choice of training by central bankers in this region. As a result, a broad strategic direction to guide the Centre in conducting its training and research activities was formalised in 2005. The strategic direction on training involved developing training modules and leveraging on technology, establishing strategic partnerships as well as strengthening the existing collaboration with internationally reputable training institutions to design and develop high quality training programmes. As a start, a flagship course would be developed for different levels of central bank staff and with different degrees of depth and complexities. This would enable member central banks to select training activities according to their needs. With regard to the strategic direction on research, the Centre would enhance its research activities, in particular on issues of regional importance to central banks, which were relevant to and supported the training activities.

As part of the Bank's continued efforts to contribute to the region's capacity building for long-term growth, the Bank organised training and attachment programmes, as well as extended assistance in the form of study visits and briefings to share its experience with others. Under the Malaysian Technical Co-operation Programme (MTCP), the Bank offered places to foreign participants in two annual programmes, namely the Central Banking Course (since 1984) and the Banking Supervision Foundation Course (since 2002). To date, the Bank received a total of 253 foreign participants since the inception of the courses. In 2005, a total of 19 officials from 14 countries participated in the training programmes.

Key International Events Hosted by Bank Negara Malaysia in 2005

JUNE 2005

22nd
Seminar on 10-Year Master Plan for Islamic Financial Services Industry

The IDB and the IFSB, in association with Bank Negara Malaysia, jointly organised the Seminar on 10-Year Master Plan for Islamic Financial Services Industry. It was held in conjunction with the 30th Annual Meeting of the IDB Board of Governors. The objective of the seminar was to discuss key issues and considerations in the formulation of a master plan for the progressive and structured development of Islamic banking and finance. The master plan would define the blueprint and provide a common vision and template, as well as the implementation steps for countries in charting the future of the Islamic financial services industry. The seminar attracted more than 700 delegates comprising regulators, supervisors, market players and corporate figures from around the world.

22nd-23rd
Investors Conference on 'Malaysia: An Investment Destination'

The Conference was held in conjunction with the 30th Annual Meeting of the IDB Board of Governors. Highlighting both conventional and Islamic investment opportunities in Malaysia in an environment of rapidly changing financial landscape, financial liberalisation and economic transformation, the Conference received an overwhelming response, with participants from 100 global institutions from 30 countries. At the close of the conference, two indices, namely, the Citigroup Malaysian Government Securities Index and the Dow Jones-RHB Islamic Malaysia Index were launched, marking another milestone in the development of the Malaysian capital market.

22nd-23rd
Shariah Scholars Dialogue

A closed session dialogue was organised by Bank Negara Malaysia to discuss the need to foster the understanding among Shariah scholars on Islamic finance. The dialogue was attended by more than 40 Shariah scholars, including prominent scholars from Saudi Arabia, Tunisia, Iran, Bahrain, Pakistan, Bangladesh, Indonesia, Brunei and Malaysia. Recognising the vital role of the Shariah scholars in the development of a progressive Islamic banking and finance sector and in facilitating its integration with the global market place, a RM200 million endowment fund was established by Bank Negara Malaysia to provide the funding needs for research and development, and human capital development in the areas of Shariah and fiqh muamalat.

24th
Seminar on 'Derivatives in Islamic Finance'

Bank Negara Malaysia and the Financial Market Association of Malaysia co-hosted a Seminar on 'Derivatives in Islamic Finance' as part of on-going efforts to accelerate the growth of Islamic financial markets by strengthening the linkages of their components. This necessitated the development of a wider range of Islamic financial instruments including a tool for hedging or managing risk.

The Seminar was attended by participants from both local and foreign institutions who explored new ideas on managing risks from the Islamic perspective with special focus on the opportunities and challenges faced in implementing Shariah compliance risk-mitigating techniques such as Islamic Profit Rate Swap and Islamic Foreign Exchange Forward Contract. The Seminar would spur the need for greater collaborative efforts among regulators, Shariah scholars, Islamic financial engineers, researchers and practitioners to convert conceptual ideas into risk mitigation techniques and products to pave the way for a more vibrant and dynamic Islamic Financial system.

JULY 2005

13th-15th
The Euro Conference

The Euro Conference was jointly organised by the Bank and the European Commission. The high-level conference, themed 'Expanding ASEAN-EU Economic Links – The Role of the Euro', aimed to explore issues in further strengthening ASEAN-EU economic relations against the backdrop of the increasing role of the euro in the international financial system. The Conference provided a platform for an exchange of views on financial market developments and prospects in ASEAN and the EU, economic and financial integration, and the opportunities for increased trade and investment linkages between the two regional groupings.

Overall, the discussions at the Conference underscored that the bilateral spirit of cooperation between ASEAN and the EU was intact and growing but that there was a need to strengthen cooperation with each other so that both the regional groupings can reinforce the positive partnership to perpetuate continued shared prosperity. It was recognised that the future of ASEAN-EU relations would be dependent on the changing strategic landscape amidst globalisation, ASEAN's and the EU's desire to play a greater role in the global economy and international affairs, the EU's ability in managing its enlargement process, and ASEAN's commitment to forge greater regional integration.

NOVEMBER 2005

21st-23rd
Regional Conference on Investment Climate and Competitiveness in East Asia

The Regional Conference on Investment Climate and Competitiveness in East Asia was jointly organised by the Economic Planning Unit of Malaysia, the WB and Bank Negara Malaysia in Kuala Lumpur. The objective of the Conference was to provide a platform for international experts, private sector representatives, and policy makers from the East Asian region to share experiences in designing and implementing policies to create a good investment climate that would lead to better economic and social outcomes through improvements in productivity and competitiveness, resulting in higher growth and greater wealth creation.

The Conference, which attracted senior officials and private sector participants from 10 countries, namely Brunei, Cambodia, China, Indonesia, Laos PDR, Malaysia, Mongolia, Philippines, Thailand and Vietnam, discussed the following:

- Various forms of investment climate constraints. These included uncertainties in government policies, inadequate infrastructure, poor governance, insufficient human capital, overly restrictive regulatory framework and inadequate access to finance;
- Effects of investment climate constraints on firm performance;
- Programmes and polices to address the constraints to enhance firm productivity; and
- Some lessons from benchmark countries.

The Conference created greater awareness among participating countries on new pressures and challenges from the rapidly changing economic and financial environment and various approaches that could be taken to attract investment and enhance the growth potential.

DECEMBER 2005

14th-16th

Third International Forum on Financial Consumer Protection and Education

The Third International Forum on Financial Consumer Protection and Education hosted by Bank Negara Malaysia was themed ‘Fostering Greater Consumer Protection and Education’. The Forum provided a platform for financial regulators worldwide to discuss emerging issues relating to consumer protection and education as well as to share knowledge and experiences in these areas.

Some 60 participants from 30 countries, comprising senior officials from regulatory authorities attended the Forum. The Forum examined approaches to promoting fair market practices and equitable treatment of consumers as well as effective product disclosure and transparency standards. The Forum also saw an exchange of views on measuring effectiveness of these approaches and on the future or direction of financial consumer protection and education. Significant progress was made in fostering closer working relationships among regulators and laying the groundwork for the development of best practice standards on consumer protection and education issues.

Organisation and Human Resource

Organisation and Human Resource

ORGANISATIONAL DEVELOPMENT

Overview

During the year 2005, the Bank made further progress in its efforts to enhance organisational capabilities and capacity to achieve higher levels of efficiency and effectiveness in performing its roles. Initiatives to transform the Bank into a knowledge-based organisation, which gained momentum in 2004, were continued in 2005, with more deliberate and focussed programmes and interventions in the areas of human capital management, training and learning, information and communications technology, knowledge management, workplace and space management, information security, and corporate governance.

Throughout 2005, the organisational development initiatives in the Bank gave emphasis on two priority areas:

- Developing a more performance driven and strategy-focussed organisation; and
- Supporting the development of knowledge workers and inculcating a performance-differentiated work culture

The first priority highlights the Bank's intent to focus on performance and results. At the strategic level, the Bank's performance matrix defines four important elements, namely desired outcomes, stakeholder orientation, process efficiency, and capability development, all of which are dimensions of performance critical to achieving the Bank's mandate. Like most other central banks of emerging market economies, the Bank's core mandate is to promote and ensure the nation's monetary and financial stability, in order to support growth. This mandate however is performed in the broader context of the Bank's roles as a regulator, supervisor, environmental shaper, driver of change, and as an operator of systems and establishments specially created to meet the needs of the economy.

The Bank's leadership guided the organisation's strategic orientation by conducting a series of programmes during the year, aimed at establishing greater clarity and shared vision among all internal stakeholders about the desired outcomes of the Bank. Efforts were also directed toward translating strategies into operations, aligning the organisation, making strategy everybody's job, and making strategy formulation and execution a continuous process in the Bank.

The second priority reflects the challenges faced by organisations in a knowledge economy, namely how to attract, develop, retain and motivate knowledge workers, to drive organisational performance. In 2005, the Bank intensified its efforts in winning the 'competition for talent' by modernising and enhancing its policies and practices in talent management, encompassing major reviews and reengineering of processes in talent demand, talent supply, and performance management. The Bank's emphasis on a performance-differentiated culture had led to major changes in the practices to link staff performance more directly to organisational performance objectives, and to reward and recognition. During 2005, the management demonstrated its commitment towards higher performance standards through more stringent evaluation and assessment for decisions relating to rewards management, which include promotion, job upgrading, salary increment and bonus payment.

The Bank also continued the implementation and enforcement of the policy of continuous, self-directed learning to further nurture and encourage "engaged learners" who are good at linking their learning objectives to performance objectives. Initiatives on new learning pedagogies and support systems introduced since 2003 to accommodate different preferences and needs of adult learners, helped develop an enabling environment for continuous, life-long learning culture. The Bank's ICT systems continued to be state-of-the-industry, with more investments made during the year to meet knowledge workers' demand for more bandwidth, internet protocol (IP) enabled solutions, wireless technology and mobile telephony. These ICT enhancements gave staff better level of connectivity and greater flexibility in communicating and making quicker decisions, all of which are expected to promote greater collaboration, easier access to information, knowledge sharing, and networking among stakeholders.

Further enhancement in knowledge management practices also supported the needs of knowledge workers in the Bank. The successful completion of the Bank's corporate taxonomy project during the year was followed by a committed work to develop the Bank's knowledge hub, a system that allows easy and fast access to the Bank's strategic knowledge assets repository. The year saw marked increase in the utilisation of knowledge management center facilities and services. Better knowledge management practices could contribute to performance enhancement initiatives by facilitating knowledge acquisition, knowledge reuse, knowledge sharing and knowledge creation, by reducing time-to-competence, by enhancing decision cycle and by facilitating a collaborative work environment.

The new office design which was introduced in 2004, proved popular among the knowledge workers, partly because of some features that met their preferred work environment, thus enhancing their performance. The information security policies and procedures, which were implemented during the year, provided further enablers to create an environment where staff shared knowledge and information with confidence. Corporate governance initiatives during the year gave more emphasis on further refinement to existing performance reporting and monitoring practices, which led to significant changes in the operating departments' orientation towards accountability, ownership of results and outcomes, and greater alignment of departmental performance objectives to Bank's strategic objectives.

Strategic Management Process and Capabilities
The Bank had adopted the discipline of the Balanced Scorecard in 2004 as one of the means to enhance its strategic performance management practices. In 2005 more programmes were implemented to further harness the Bank's strategic management capabilities, by targeting senior management staff particularly department directors and deputy directors. The top leadership had conducted sessions with these target groups, and engaged them in high level strategic conversations to help establish greater clarity, alignment and consensus on the departmental strategic objectives, focus and tasks in the context of the Bank's organisational goals. This had also created greater awareness of interdependencies and opportunities for more cross-functional collaboration.

The programmes implemented in relation to strategic management capabilities and processes include the articulation of more specific strategic results and related strategies and initiatives, development of performance indicators and establishing a more systematic process for reviewing organisational strategies and performance. Information about organisation strategy and performance that takes into account different dimensions of performance provided insights into the type of internal capacities and capabilities needed by the Bank to enhance performance. A dedicated unit – the Strategic Management Office - had been set up to enhance the strategic management capability of the Bank, and assist the Bank in its journey to become a more strategy-focussed organisation.

Human Capital Management
The year 2005 saw focussed reassessments and improvements of key human capital management processes, encompassing major areas including talent demand, talent supply, performance management, staff development, and rewards management. During the year, a new Human Capital Management Committee was established to replace the previous Human Resource Administration Policy Group, consistent with the Bank's commitment to alleviate human capital management issues to the highest level possible, and to promote widespread and effective inclusion and participation of senior line staff in the human capital management processes. The Committee oversaw the process to realign talent needs definition of the Bank to its strategic objectives and core processes, which led to the development and adoption of a new competency model and roles profiling of departmental directors in the Bank.

This was followed by a major exercise to conduct a comprehensive assessment of the current group of departmental directors against their newly designed jobs. A parallel exercise was conducted to identify and measure the development needs of 70 senior managers in the Bank under the Bank's succession management plan, using a comprehensive assessment center approach.

The Human Resource Management Department underwent a major transformation programme during the year, focussing on structural redesign, capacity enhancement and enhancement of selected core talent management processes. New talents were brought in to strengthen the department's performance and effectiveness. Other important milestones achieved during the year included: the adoption of a framework for the creation of technical specialist laddering in the Bank to attract and retain the right talents in the operational areas that impact the Bank's differentiating capabilities, and the adoption of a more reliable set of tools and methodologies to assess and identify the critical talent needs of the Bank. During the year, the Bank sourced high caliber talents for development programmes under its scholarship scheme by going direct to premier learning institutions in the country.

Total staff strength at the end of 2005 remained relatively unchanged at 2,345. During the year 48 staff (2%) resigned while another 15 retired. Over a period of five years (2000 - 2005), the Bank's talent grew by 25% from 1,876 to 2,345 staff - to lend support to the Bank's increasing range of responsibilities. During these five years, there was a marked increase in recruitment at the executive level (graduate degree holders; at 235 or 25.6% increase), and increase in recruitment and promotions at middle management levels (123 or 45% increase). Non-executive staff represented about 32% of total staff population. The staff profile of the Bank had shifted towards higher proportion of middle management staff and reducing percentage of non-executive staff. Staff demographics also changed, with 63% of the staff population now below 40 years old, with a more diverse academic and professional background and experience.

Occupational safety and health continued to be another area of focus during 2005. The Bank gave emphasis in promoting healthy living among staff, by increasing the level of awareness on personal health and well-being, through a series of educational programmes conducted by health and medical professionals. These efforts could encourage more balanced lifestyles for the staff in the long-run, thus contributing to staff performance.

Training and Learning Management

The Bank strengthened its capacity to provide the services of a Corporate University by 2006. Internal learning consultants worked as business partners with line departments to define learning programmes that were more directly linked with the strategic priorities of the Bank as well as learning needs of the individual. Measures had been taken to formalise action learning, project-based learning and coaching, with the Human Resource Development Centre collaborating closely with the Human Resource Management Department.

In response to the Bank's priority of being a more performance driven and knowledge-enabled organisation, internal capabilities in fields such as human performance improvement (HPI), evaluation of learning effectiveness and instructional design were enhanced. The deployment of the Learning Management System (LMS) and online learning solutions for management and financial courses were additional milestones in the transformation towards a Corporate University. Strategic alliances with world-renowned training providers such as Centre for Creative Leadership (CCL) and Toronto Centre for Leadership (TCL) were continuously enhanced to provide high quality learning solutions from thought leaders.

As part of the Bank's effort to develop leaders from within, the first customised Leadership Development Programme (LDP) for senior management, done in collaboration with the Centre for Creative Leadership (CCL), was successfully completed. The programme, which spanned over a period of one and a half years, involved 70 potential leaders who were involved in highly engaging interactions with senior management for purpose of strategic alignment and values inculcation. The 360-degree assessment feedback tool provided greater self-awareness in leadership style and focussed personal development plans. The programme was designed to give opportunities for the participants to have strategic discourse with senior management of the Bank on strategic leadership issues, dialogues with proven industry leaders in the area of leading and managing change, and renowned academics in the areas of leadership. The Bank also conducted a leadership programme on financial supervision for the Bank's supervisors in collaboration with the Toronto Centre for Leadership.

During the year 2005, the Human Resource Development Centre delivered 65 training programmes comprising of 120 sessions, with six training man-days per-staff. Collectively, a total of 65 training programmes were delivered, comprising 20 sessions, with the average training man-days per-staff registered at 6 training days.

More programmes will also be offered under the Malaysia Technical Co-operation Programme (MTCP) in 2006. In addition to the intermediate Central Banking and Basic Banking Supervision courses, programmes such as the Islamic Banking and Finance for Central Bankers, the Basic Central Banking Course, and the Insurance Regulation and Supervision courses will be introduced to enhance the knowledge and expertise of the respective departments. With the introduction of the new courses, work is already underway to develop more structured curricula in central banking, information technology for management, and leadership. The curricula will be developed based on the competency requirements identified by the Bank, thus emphasising the link between learning and performance.

Information and Communications Technology Management

The Bank continues to emphasise on Information & Communication Technology (ICT) as an integral enabling capability in creating a high performance workforce. Specifically, ICT management stresses achieving business efficiency by ensuring timely access to the right information. Towards this end, the role of ICT is being continuously transformed to improve integration with business processes.

In this regard, in line with the Financial Sector Masterplan (FSMP) to improve efficiency of the payments infrastructure, the payment settlement gateway has been modernised. The Bank had also enhanced the cheque clearing system to improve unpaid item processing at commercial banks. A cheque image exchange and truncation system is currently planned for the near future.

The major challenge in 2006 will be the implementation of Enterprise Portal, an evolutionary step of the existing Corporate Portal. This will augment the Bank's ICT infrastructure capability and further enhance the delivery of services to stakeholders. The Enterprise Portal is envisioned to take the Bank to the next phase of knowledge-based organisation (KBO) transformation via a unified and collaborative workplace, which integrates people, process and information.

Within the ambit of promoting collaboration, the Bank had upgraded the extranet infrastructure to allow higher flexibility in data exchange between the Bank and the financial institutions. The deployment of mobile devices with access to e-mail has introduced new opportunities in basic remote information accessibility. This is an initial step to become an extended enterprise by embracing remote collaboration to reduce time-to-decision, ultimately enhancing productivity and efficiency.

In line with rising expectations, the Bank is obligated to sustain the provision of secured, resilient and quality services to its stakeholders. The year marked a persistent approach towards enhancing the Bank's ICT Infrastructure & Services Management. Various internal initiatives, in particular the Data Centre upgrade, have been implemented to enable more prudent ICT governance through continuous optimisation of roles, processes and technology environments. Areas improved include service availability, capacity, security and continuity management. The year ahead presents new challenges with the adoption of Information Technology Infrastructure Library (ITIL) best practices and the development of the new offsite Data Centre, which will be maturing from design to implementation.

Knowledge Management

The strategy of embedding Knowledge Management (KM) practices into the work processes continued in 2005, which contributed towards the creation of better enabling environment for the knowledge workers in the Bank. A key milestone was the successful completion of the Bank's corporate taxonomy project. The taxonomy is the Bank's information classification framework that has been deployed as a foundation to develop a knowledge repository management system referred to as the Bank's Knowledge Hub. Supported by search engines and information security policies, the Knowledge Hub serves to enhance knowledge visibility and accessibility, thus facilitating further the process of knowledge acquisition, reuse, sharing and creation.

Another encouraging trend was the increased utilisation of the knowledge management infrastructure. For instance, the number of walk-in users of the Bank's Knowledge Management Centre (KMC), which was established in 2004, had increased 92% from 8386 to 16,126. The number of subject specific repositories created in 2005 by the KMC increased from 32 to 42 (25%), which is partly a measure of the growth in the Bank's intellectual capital. The other notable trend was the higher utilisation of the KMC's Library portal by 13% from 31,969 to 35,990, as well as increase in user access to online databases of 10%, from 14,010 to 15,440.

The Bank hosted a Knowledge Management Fair during the year to help increase awareness amongst staff about new techniques and practices in knowledge management, as well as about the importance of information security management. Learning games and exhibitions were put in place to showcase the many knowledge management solutions introduced in the Bank. The fair also brought together some of the better-known practices in knowledge management, such as storytelling and social networking through communities of practice.

The re-configuration of space within the Bank has resulted in more open and flexible space, including connectivity to information systems, thus allowing staff from different departments to meet for discussions and work under very efficient and conducive working conditions. This has proven to be valuable for knowledge workers who work in turn as individuals, as departmental teams and in cross-functional projects.

Corporate Governance

During the year, the Board of Directors convened 12 meetings, apart from its quarterly Board Audit Committee Meetings. The Management Committee, being the focal point and highest management decision-making authority in the Bank conducted 38 meetings to discuss high-level cross-functional matters. Additionally, four Reserve Management Committee Meetings, 11 Monetary Policy Committee Meetings, four Risk Management Committee Meetings, 11 Financial Stability Committee Meetings, and three Payment Policy Committee Meetings were held in 2005.

During the year, a briefing was conducted for the Prime Minister and Minister of Finance to present the Bank's assessment of the economy and financial sector, the important financial and economic issues and challenges confronting Malaysia, and the policy recommendations to address these issues and challenges. In response to the needs of its other stakeholders, including the general public, the business community, domestic and international investors and analysts, the Bank conducted road shows and awareness sessions to present the Bank's policies as well as to provide information on banking and insurance matters.

Awards

Heartiest congratulations from the Bank to the following staff on being conferred awards by their respective state rulers.

As part of its internal recognition programme, the Bank had recognised 19 staff for their excellent performance and academic achievement under the Excellent Performance and Academic Achievement awards. In addition to individual awards, three teams were awarded with Quality Service, Innovation and Excellent Team Performance Awards. The awards were presented during the Bank's Annual Dinner held on 3 September 2005.

Retirement

The Board wishes to place on record its appreciation and gratitude to the 15 retirees for their dedication and commitment while in service with the Bank. The staff who retired from service in 2005 are listed in Table 12.1.

Condolence

The Board extends its condolences to the family of the late Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee, on his demise on 29 December 2005. The late Tan Sri Dato' Seri Dr. Mohd. Noordin bin Md. Sopiee who was the Chairman and Chief Executive Officer of the Institute of Strategic and International Studies (ISIS) had served as a member of the Bank Negara Malaysia Board of Directors since 1995 and had contributed significantly to the Board deliberations on the policies of the Bank.

No.	Name	Award	State
1	Puan Azalina binti Omar	Pingat Jasa Kebaktian (PJK)	Penang
2	Encik Saari bin Rajap	Pingat Jasa Kebaktian (PJK)	Pahang
3	Puan Annie Tan	Pingat Khidmat Cemerlang Masyarakat (PMC)	Negeri Sembilan

Table 12.1
List of Retirees

No	Name	Department/Branch
1	Rahim bin Idris	Insurance Supervision
2	Indralingam a/l Subramaniam	Banking Supervision 1
3	Chan Tsoon Hean	Currency Management and Operation
4	Rosli bin Sulong	Currency Management and Operation
5	Hasnah binti Omar	Corporate Services
6	Yaakop bin Yahaya	Payment Systems
7	Samsudin bin Na'Am	Property and Services
8	Hasikin bin Jasman	Property and Services
9	Ismail bin Hashim	IT Services
10	Abdul Latif bin Adlin	Governor's Office
11	Khairani bte Rejab	Banking Supervision II
12	Rohana binti Yusuf	Islamic Banking and Takaful
13	Helen Jeniffer Buma	Bank Regulation
14	Kunchi Raman a/l C V Kluva Chary	Development Finance and Entreprise
15	Mohamed Sapian bin Kamaruddin	PPPM Shah Alam

RISK MANAGEMENT IN BANK NEGARA MALAYSIA

In 2005, the focus of the Risk Management Unit was on the implementation of new methodologies and modified approaches which were conceived in 2004. The implementation was successful and well received by the line departments with minor operational adjustments to ensure smooth implementation during the year. The partnership between the Risk Management Unit and the line departments also continued to improve which augers well in ensuring a risk culture which is consistently embedded in all aspects of operational as well as strategic efforts.

Risk Management Structure

No changes were made to the Risk Management structure of the Bank and the Risk Management Committee, at the apex of the Bank's risk management governance structure, continues to be the leading forum for focussed and regular deliberation on risk issues and the main driver of risk management in the Bank. The requirements for upward reporting by line departments and the Risk Management Unit to the Risk Management Committee remained unchanged so as to enable the Committee to continue to provide direction for addressing and managing potential risk in the organisation.

Risk Management Practices

In providing the risk management oversight, the Risk Management Committee determines the standards and requirements to ensure that appropriate strategic and operational risk management measures are embedded into all programmes, projects and policy making. In 2005, the Committee continued assessing the departments' risks, controls and emerging risk issues in their business plans so as to exercise constant vigilance on the bank's overall risk profiles. The Committee also deliberated with the departments on their policy focus, strategic direction and the optimal approaches to address both existing and potential risks. To support this, the requirement continued to be for departments to make a self-assessment of the risk profiles of their operations and assessment of the adequacy of risk management through an annual declaration to Management. However, the contents of the annual declaration carried increased focus on strategic level risks. The Risk Management Unit provided technical support and performed its coordination and oversight role by assisting the departments in their management reporting. Emphasis was also placed on building greater awareness on risk management in the Bank through workshops to engage staff and familiarise them with the risk management methodology and practices.

In 2005, the Risk Management Unit undertook independent assessments on an on going basis to complement the self-assessment exercise done via the annual declaration. These assessments not only bring a fresh perspective in the identification of major risks in the departments but to also provide assurance to the Risk Management Committee that the process had indeed been rigorous. Further, it covers risks which may not be apparent due to familiarity with the functions or operations, which is a weakness of all self-assessment approaches. In addition, the Risk Management Unit also assessed organisational risk, that is, with emphasis on risks which span across functional lines to address issues arising from interdependencies which could affect the achievement of the strategic aims and objectives of the Bank. These results were also reported to the Risk Management Committee in the course of 2005. The three-pronged approach, that is, self-assessment, independent assessment and organisational risk serves to provide a more holistic view of risks in the Bank. This would serve to enhance organisational alignment for the achievement of the Bank's strategic results.

Policy Risk

The policy-making mechanism in the Bank is designed with the objective of achieving the desired policy outcome. There were no significant changes to the framework to manage policy risk at the Bank. As before, this framework covers the processes for discussion and deliberation of all issues related to policy from the conceptualisation stage through to the development and implementation stages. The high level committees that preside over policy making are the Management Committee, the Monetary Policy Committee and the Financial Stability Committee. Chaired by the Governor, the common objective of these committees is to allow for and provide a platform for high-level cross-functional deliberation and consultation to ensure sound policy decision-making and efficacious implementation. Another component featured in the policy framework are the Policy Working Groups, chaired by Assistant Governors, members comprising directors of all the relevant departments, which represent the working level deliberations on the policy issues.

Financial Risk

The Middle Office is responsible for the management of the Bank's financial risks arising from the management of international reserves. In the course of regular operations, the Middle Office works closely with the Internal Audit Department and the Risk Management Unit to ensure strict compliance with investment guidelines, policies and operational procedures.

Financial risk management continues to develop in line with developments and trends in reserve management activities and the domestic financial market as increased sophistication and achievement in technology in financial markets dictate as such. Throughout the year, initiatives were undertaken to improve methodologies and enhance system infrastructure in order to support a more robust and comprehensive review of financial risks. This is reinforced by increased specialisation, more focus on key risk areas and training programmes for key personnel which are aimed at developing superior understanding of the complexities of various instruments, strategies and methodologies.

Operational Risk

In managing operational risk, the essential elements of ownership of risks, self-assessment, continual review, escalation of key risk issues and accountability for control improvement and issue resolution were retained. At the functional level, the Department Heads continue to have direct responsibility for ensuring that risk management practices are integral to daily operations and that all risks are appropriately addressed. Departments are thus required to conduct process analysis and walkthroughs which are essential to review core processes for operational risks arising from changes in the working environment.

Key measures to address operational risks include the Internal Audit function which plays a crucial role in the monitoring of operational risk. Further reductions in human intervention in processing through the use of computer systems largely reduce human related operational risks. However increased vigilance is now required in monitoring system availability and reliability. Additionally, for increased assurance in major projects, staff of the Risk Management Unit participate in the project teams to ensure the appropriate risks are being managed.

Through all this, the ultimate aim for risk management remains the same, that is, to ensure that regular monitoring takes form to enable pre-emptive and, if necessary, prompt corrective actions in all areas of risk.

Business Continuity Management

The year 2005 witnessed various Business Continuity Management enhancement efforts being carried out at the Bank to ensure that the Bank's ability to prepare, respond to and manage any crisis or unexpected incidences effectively continues to remain sound and robust. A yearly review of the impact of any given disruption to departments in the Bank was conducted to validate the continued effectiveness of existing crisis arrangements that are in place. Along with lessons learnt from other Business Continuity Management exercises, as well as the required maintenance for the Bank's back-up facility, the review contributed to the implementation of an exercise to upgrade this alternate facility. This was done to ensure that the facility is continuously updated with the required technology to guarantee its crisis-time functionality.

Within the Business Continuity framework, there are two high level components, the Crisis Management Committee and the Crisis Management Team. The Crisis Management Committee, which reports to the Governor and is chaired by a designated Deputy Governor, symbolises high level endorsement of the Business Continuity programme in the Bank. The Crisis Management Team has membership comprising directors from all identified critical departments and support teams.

During the year, the Business Continuity Management unit, responsible for overseeing the Business Continuity Management function of the Bank, and which forms part of the Risk Management Unit, drew on the Risk Management Committee as a forum for seeking the ultimate endorsement and direction for Business Continuity Management exercises conducted. This is in view of the parallel membership between the Risk Management Committee and Crisis Management Committee, which sits at the apex of the Bank's Business Continuity Management framework.

During the year, an internal Business Continuity Management website was launched to promote and raise overall staff awareness on the Bank's Business Continuity Management programme as well as to communicate a Business Continuity Management policy endorsed by Management. It is envisaged that added knowledge on the subject matter would help promote and strengthen the involvement of all staff in the Bank's Business Continuity Management programme. This ultimately, would then translate to the ability of all staff to spontaneously deliver prompt and appropriate calculated responses, crucial in any crisis.

Finally, as in previous years, periodic assessments of the Bank's capability to respond to crisis were also done. This was accomplished via the mechanisms of live-run exercises, as well as the twice-yearly Crisis Management Team meeting which met to discuss emerging Business Continuity issues, such as the haze that affected the country in the year. The desired cooperation between the critical departments to produce an integrated and coordinated bank-wide arrangement was tested in a simulation that was part of the same exercise.

BANK NEGARA MALAYSIA
Organisation Structure

- **BOARD OF DIRECTORS**
- **GOVERNOR** — Dr. Zeti Akhtar Aziz
  - Secretary to the Board — Dato' Mohd Nor bin Mashor
  - Governor's Office — Dr. Aini binti Ibrahim; Ng Chow Soon
  - Corporate Communications — Abu Hassan Alshari bin Yahaya
  - **DEPUTY GOVERNOR** — Dato' Ooi Sang Kuang
    - Legal — Gopala Krishnan Sundaram
    - Internal Audit — Hor Weng Keng
    - **ASSISTANT GOVERNOR** — ECONOMICS — Vacant
      - Monetary Assessment and Strategy — Dr. Sukhdave Singh
      - Economics — V. Vijayaledchumy
      - International — Ismail bin Alowi
      - Finance — Abdul Aziz bin Abdul Manaf
    - **ASSISTANT GOVERNOR** — INVESTMENT AND OPERATIONS — Muhammad bin Ibrahim
      - Investment Operations and Financial Market — Norzila binti Abdul Aziz
        - New York Rep. Office
        - London Rep. Office
      - Foreign Exchange Administration — Wan Hanisah binti Wan Ibrahim
      - Statistical Services — Chan Yan Kit
    - **ASSISTANT GOVERNOR** — ORGANISATIONAL DEVELOPMENT — Dato' Mohamad Daud bin Hj. Dol Moin
      - IT Services — Hong Yang Sing
      - Human Resource Management — Mior Mohd Zain bin Mior Mohd Tahir
      - Human Resource Development Centre — Lim Lai Hong
      - Strategic Management — Lim Foo Thai
      - Corporate Services — Dato' Mohd Nor bin Mashor
      - Security — Ahmad bin Mansur
      - Property and Services — Zulkifli bin Abd Rahman
      - Currency Management and Operation — Tengku Zaib bin Raja Ahmad
        - Branches (6)
  - **DEPUTY GOVERNOR** — Datuk Zamani bin Abdul Ghani
    - Special Investigation — Kamari Zaman bin Juhari
    - Financial Intelligence — Koid Swee Lian
    - **ASSISTANT GOVERNOR** — SUPERVISION — Nor Shamsiah binti Mohd Yunus
      - Banking Supervision I — Che Zakiah binti Che Din
      - Banking Supervision II — Chung Chee Leong
      - Insurance Supervision — Mahdi bin Mohd. Ariffin
      - Information Systems Supervision — Ramli bin Saad
      - Payment Systems — Ahmad Hizzad bin Baharuddin
    - **ASSISTANT GOVERNOR** — REGULATION — Dato' Mohd Razif bin Abd. Kadir
      - Bank Regulation — Dato' Mohd Razif bin Abd. Kadir
      - Insurance Regulation — Donald Joshua Jaganathan
      - Islamic Banking and Takaful — Bakarudin bin Ishak
      - Development Finance and Enterprise — Marzunisham bin Omar
      - Risk Management — Santhini a/p Chandrapal

Annual Accounts

Balance Sheet as at 31 December 2005

CERTIFICATE OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2005

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2005. These financial statements are the responsibility of the management. My responsibility is to express an opinion on these financial statements based on my audit.

2. The audit has been conducted in accordance with the Audit Act 1957 and in accordance with approved auditing standards. Those standards require the audit be planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement. This audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Evaluation is also made on the accounting principles used and the overall financial statements presentation.

3. In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2005 and of the results of its operations for the year then ended in accordance with approved accounting standards.

(TAN SRI DR. HADENAN BIN A. JALIL)
AUDITOR GENERAL
MALAYSIA

PUTRAJAYA
15 FEBRUARY 2006

STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Zeti Akhtar Aziz and Oh Siew Nam, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the financial statements are drawn up so as to give a true and fair view of the state of affairs of Bank Negara Malaysia as at 31 December 2005 and of the results of operations for the year ended on that date.

On behalf of the Board,

ZETI AKHTAR AZIZ

CHAIRMAN

15 FEBRUARY 2006
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM

DIRECTOR

15 FEBRUARY 2006
KUALA LUMPUR

DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

I, Abdul Aziz Abdul Manaf, being the officer primarily responsible for the financial management of Bank Negara Malaysia, do solemnly and sincerely declare that the financial statements, are to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 15 February 2006.)

Before me,

PESURUHJAYA SUMPAH
No: W397
Name: KADARIAH BTE ABDUL KARIM
MALAYSIA

Suite 6.08C, 6th Floor, (Box No. 368)
Wisma Central, Jalan Ampang
50450 Kuala Lumpur

Bank Negara Malaysia

Balance Sheet as at 31 December 2005

	Note	2005 RM	2004 RM
ASSETS			
Gold and Foreign Exchange	3	264,421,558,175	249,704,108,859
International Monetary Fund Reserve Position		1,186,337,566	3,068,374,430
Holdings of Special Drawing Rights		748,345,706	765,326,109
Malaysian Government Papers	4	961,013,021	221,100,747
Deposits with Financial Institutions		2,878,873,387	2,887,524,750
Loans and Advances	5	10,295,735,304	10,637,048,634
Other Assets	6	14,940,995,292	17,570,435,602
Total Assets		**295,432,858,451**	**284,853,919,131**
LIABILITIES AND CAPITAL			
Currency in Circulation		34,396,746,453	32,353,945,724
Deposits: Commercial Banks, Finance Companies and Merchant Banks		140,606,624,541	124,709,136,071
Federal Government		27,273,933,343	25,704,665,762
Others	7	4,297,159,874	4,884,385,498
Bank Negara Papers		20,347,587,398	16,877,443,819
Allocation of Special Drawing Rights	8	751,127,007	820,579,258
Other Liabilities	9	29,551,916,821	27,843,305,494
Total Liabilities		257,225,095,437	233,193,461,626
Authorised Capital RM200,000,000			
Paid-up Capital	10	100,000,000	100,000,000
General Reserve Fund	11	8,103,080,465	6,742,117,315
Other Reserves	12	30,004,682,549	44,818,340,190
Total Capital		38,207,763,014	51,660,457,505
Total Liabilities and Capital		**295,432,858,451**	**284,853,919,131**

Notes on the following pages form part of these financial statements.

Profit and Loss Statement for the Year Ended 31 December 2005

	Note	2005 RM	2004 RM
Total Income	13	**4,989,023,000**	**3,427,026,087**
Less:			
Recurring Expenditure	14	809,055,659	504,604,402
Development Expenditure	15	619,004,191	145,180,660
Total Expenditure		**1,428,059,850**	**649,785,062**
Net Profit		**3,560,963,150**	**2,777,241,025**

Profit and Loss Appropriation Statement for the Year Ended 31 December 2005

		2005 RM	2004 RM
Net Profit		**3,560,963,150**	**2,777,241,025**
Transfer to Other Reserves	16	1,000,000,000	700,000,000
Transfer to General Reserve Fund		1,360,963,150	877,241,025
Amount Payable to Federal Government		1,200,000,000	1,200,000,000
		3,560,963,150	**2,777,241,025**

Notes on the following pages form part of these financial statements.

Notes To The Financial Statements - 31 December 2005

1. **Principal Activities of the Bank**

   The Bank's principal roles and responsibilities are as follows:

   (a) to achieve monetary stability;

   (b) to promote a stable financial system;

   (c) to ensure an efficient payment system;

   (d) to issue currency in Malaysia; and

   (e) to act as a banker and a financial adviser to the Federal Government.

2. **Accounting Policies**

   (a) **Gold, Securities and Investments**

   Gold, securities and investments are stated at cost and provisions have been made for diminution in value as at 31 December 2005.

   (b) **Foreign Currency Translation**

   Assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date. Transactions in foreign currencies during the year have been translated into ringgit at rates of exchange ruling on value dates.

   The International Reserves comprising Gold and Foreign Exchange, International Monetary Fund Reserve Position and Holdings of Special Drawing Rights at 31 December 2005 was RM266,356.2 million equivalent to USD70,489.3 million.

   (c) **Repurchase and Reverse-Repurchase Agreements**

   The amount borrowed under repurchase agreements is reported under 'Other Liabilities'. The amount lent under reverse-repurchase agreements is reported under 'Other Assets'. The difference between the amount received and amount paid under repurchase and reverse-repurchase agreements is recognised as interest expense and interest income on a straight line basis, respectively.

3. **Gold and Foreign Exchange**

	2005 **RM**	**2004** **RM**
Foreign Securities	214,223,340,658	172,451,464,614
Foreign Deposits	30,954,385,954	55,869,780,871
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	5,043,988,892	6,307,319,881
Others	14,199,842,671	15,075,543,493
	264,421,558,175	249,704,108,859

4. **Malaysian Government Papers**

	2005 **RM**	**2004** **RM**
Malaysian Government Securities	961,013,021	221,100,747

5. **Loans and Advances**
Loans and advances comprise mainly advances extended by the Bank to the participating institutions under section 30(1) of the Central Bank of Malaysia Act 1958.

6. **Other Assets**
Other assets include investments in shares and bonds of RM14,421,797,503 acquired under section 30(1)(j) and section 30(1)(oo)(i) of the Central Bank of Malaysia Act 1958 and RM200 million for the establishment of Fund for Shariah Scholars in Islamic Finance.

7. **Deposits - Others**
A substantial part of these deposits comprises deposits from Federal Statutory Authorities.

8. **Allocation of Special Drawing Rights**
IMF member countries are allocated Special Drawing Rights (SDR) in proportion to their subscriptions to the IMF. The allocation represents a dormant liability of the Bank to the IMF, against which assets are received in SDR from the IMF. The net cumulative of the allocation was RM751,127,007 equivalent to SDR139,048,000.

9. **Other Liabilities**
Other liabilities include mainly placements by licensed banking institutions under repurchase agreements and accounts payables.

10. **Paid-up Capital**
The entire issued and paid-up capital of RM100 million is owned by the Government of Malaysia.

11. **General Reserve Fund**

	2005 RM	2004 RM
As at 1 January	6,742,117,315	5,864,876,290
Transfer from Net Profit	1,360,963,150	877,241,025
As at 31 December	8,103,080,465	6,742,117,315

12. **Other Reserves**
Other reserves comprise the Exchange Rate Fluctuation Reserve and the Contingency Reserve.

13. **Total Income**
Total income comprises revenue from foreign reserve management which includes interest and dividend, non-treasury income and is stated at net of amortisation/accretion of premiums/discounts and monetary policy cost.

14. **Recurring Expenditure**
Recurring expenditure are expenses incurred in managing and administering the day-to-day operations of the Bank. It includes currency and staff related cost. Currency related cost arising from the larger volume of notes printed and coins minted contributed significantly to the increased recurring expenditure in 2005.

15. **Development Expenditure**

Development expenditure are expenses incurred mainly to finance developmental and long term projects undertaken by the Bank in line with its strategies, principal roles and responsibilities. The higher development expenditure in year 2005 was mainly due to initial contributions of RM250 million for the establishment of BNM Medical Fund and RM200 million for the establishment of INCEIF Trust Fund to support the role of the international centre for education in Islamic finance.

16. **Transfer to Other Reserves**

This transfer is made in accordance with Section 7(2) of Central Bank Act 1958.

17. **Contingent Liabilities**

Total contingent liabilities as at 31 December 2005 amounted to RM7,042,957,192. These comprise:

(a) an amount of RM6,977,728,936 which represents the obligation of the Bank to pay in full, in SDR or other convertible currencies, the amount of Malaysia's quota in the IMF under the Articles of Agreement; and

(b) an amount of RM65,228,256 which represents the uncalled portion of the 3,220 units of shares held by the Bank in BIS. The amount is based on the nominal value (SDR5,000) of the uncalled portion and SDR rate as at the balance sheet date.

18. **Income Tax**

The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989.

Annex

Contents

Key Economic and Financial Statistics

Chapter 1: The Malaysian Economy in 2005

Chapter 2: Monetary and Fiscal Developments

Chapter 3: Outlook and Policy

Chapter 4: The Financial System

Chapter 5: The Banking System

Chapter 6: The Islamic Financial System

Chapter 7: Development Financial Institutions

Chapter 8: Other Financial Institutions

Chapter 9: Financial Markets

Foreign Exchange Administration Policies

Malaysia has always maintained a liberal foreign exchange administration regime. The implementation of foreign exchange administration rules in Malaysia supports the monitoring of capital flows into and out of the country to preserve its financial and economic stability.

As part of Malaysia's continuous effort to increase efficiency and reduce cost of doing business, the foreign exchange administration rules have been progressively liberalised and simplified.

A. RESIDENTS

To encourage better risk management activities, promote cost competitiveness and the use of onshore service providers, residents[i] are given the flexibility to manage own funds onshore and offshore. Residents may enter into risk management arrangements with licensed onshore banks (licensed commercial and Islamic banks) in Malaysia. Details are as listed below:

I Import and Export of Goods and Services

(a) Payment for Goods and Services

A resident may pay a non-resident any amount in foreign currency, other than the currency of the State of Israel, for import of goods and services.

A resident must receive payment for export of goods and services in foreign currency, other than the currency of State of Israel, from a non-resident.

Proceeds arising from export of goods must be received and repatriated by the resident as per the sales contract which should not exceed six months from the date of export. Payments by a resident to another resident for goods and services must be made in ringgit.

(b) Hedging of Payment or Receipt

A resident may hedge foreign exchange exposures arising from:

- Payments due to a non-resident for import of goods and services;
- Receipts due from a non-resident for export of goods and services; or
- Anticipation of payments or receipts for import or export of goods and services provided to a non-resident.

All hedging activities by residents may be undertaken only with licensed onshore banks or approved merchant banks in Malaysia.

(c) Retention of Foreign Currency Proceeds

Upon receiving proceeds from export of goods and services, the resident may sell the foreign currency for ringgit or another foreign currency or retain in foreign currency accounts maintained with licensed onshore banks or approved merchant banks. There are no limits imposed on the foreign currency accounts.

(d) Reporting on Import or Export of Goods

There is no requirement to report to the Controller of Foreign Exchange (the Controller) for any import of goods from non-residents.

Only resident exporters with annual gross export proceeds exceeding the equivalent of RM50 million are required to submit quarterly reports to the Controller.

II Investments in Foreign Currency Assets[ii]

(a) Payment for Investment in Foreign Currency Assets

A resident, individual or company, without domestic ringgit credit facilities[iii] is free to invest in any foreign currency assets. These investments can be financed with:

- Any amount of foreign currency funds converted from resident's own ringgit funds.
- Any amount of resident's own foreign currency funds retained in accounts in Malaysia or overseas.
- Up to an aggregate equivalent to RM10 million from foreign currency credit facilities.

A resident, individual or company, with domestic ringgit credit facility may invest any amount in foreign currency assets using foreign currency funds maintained in Malaysia or offshore. The resident may also convert ringgit funds into foreign currency up to the following limits for this purpose:

- Up to the equivalent of RM10 million in aggregate per calendar year by a company on a corporate group basis.
- Up to the equivalent of RM100,000 in aggregate per calendar year by an individual.

For a resident company intending to invest in foreign currency assets, shareholders' funds of the company must be at least RM100,000 and must be in operation for at least one year. This is irrespective whether the company has or does not have domestic ringgit credit facilities.

A resident individual may also convert ringgit into foreign currency for investment in foreign currency securities under the Employee Share Option/Purchase Scheme offered by overseas parent or related companies of the individual's employer.

In addition, a resident institutional investor may invest in foreign currency assets for resident and non-resident clients as follows:

- Unit trust management company:
  - (i) The full amount of net asset value (NAV) attributed to non-residents.
  - (ii) 30% of NAV attributed to residents.
- Asset/fund management company for:
  - (i) The full amount of funds placed by non-resident clients.
  - (ii) The full amount of funds placed by resident clients with no domestic ringgit credit facilities.
  - (iii) 30% of funds placed by resident clients with domestic ringgit credit facilities.

Funds from different unit trust management companies and fund managers may be pooled to benefit from economies of scale when purchasing foreign currency assets.

A resident insurance company may invest in foreign currency assets up to 5% of the company's margin of solvency and 30% of the NAV of investment-linked funds marketed.

A resident takaful operator may invest in foreign currency assets up to 5% of the operator's total assets.

(b) Hedging of Investments in Foreign Currency Assets

A resident may hedge foreign exchange risks arising from payment for permitted investments and the value of existing foreign currency assets. Such hedging may be undertaken with licensed onshore banks or approved merchant banks in Malaysia.

(c) Registering and Reporting of Overseas Investments in Foreign Currency Assets

All payments for overseas investments exceeding the equivalent of RM50,000 must be registered with the Controller at least seven working days prior to making the payments.

A resident with outstanding overseas investments in excess of the equivalent of RM1 million is required to submit quarterly report on the overseas investments to the Controller.

(d) Registering and Reporting of Onshore Investment in Foreign Currency Assets

There are no requirements for registration or reports by a resident investing in foreign currency assets offered by approved onshore entities.

III Credit Facilities Obtained by Resident

(a) Foreign Currency Credit Facilities

A resident is free to obtain trade financing facilities of any amount in foreign currency from licensed onshore banks.

A resident company may obtain credit facilities in foreign currency up to the equivalent of RM50 million in aggregate on a group basis from licensed onshore banks, licensed merchant banks and non-residents.

A resident individual may also obtain credit facilities in foreign currency up to the equivalent of RM10 million in aggregate from licensed onshore banks, licensed merchant banks and non-residents.

Any amount exceeding the above permitted limits would require prior permission of the Controller. Where the aggregate amount exceeds the equivalent of RM1 million and up to the permitted limit, the resident (company or individual) is required to register the credit facility with the Controller, prior to loan drawdown.

A resident individual or company may finance investments in foreign currency assets up to RM10 million equivalent in aggregate from foreign currency credit facilities.

There is no restriction for a resident to repay or prepay permitted credit facilities. Any prepayment exceeding the equivalent of USD10 million of the facilities should be registered with the Controller prior to effecting the prepayments.

(b) Ringgit Credit Facilities

A resident is required to seek prior permission of the Controller to obtain any amount of credit facility in ringgit from non-residents, including from non-resident shareholders or directors.

IV Forward Foreign Exchange Contracts

(a) Permissible Forward Foreign Exchange Contracts

A resident is free to enter into forward foreign exchange contracts with licensed onshore banks and approved merchant banks for the following purposes:

- Hedging for any payments or receipts for import or export of goods and services as well as income. The contracts may be based on firm commitment or anticipatory basis.
- Hedging for any committed capital inflows or outflows, including:
  - (i) Drawdown of permitted foreign currency credit facilities
  - (ii) Repayment of foreign currency credit facilities up to the amount repayable within 24 months

(iii) Payments for permitted investment in foreign currency assets, including extension of credit facilities to non-residents

- Hedging for existing investments in foreign currency assets

(b) Maturity Date of Contracts

The maturity date of the forward foreign exchange contract should be the expected date of receipt or payment of the underlying transaction. In the event the foreign currency receivables are received earlier, the resident can sell the foreign currency receipts for ringgit on spot basis or temporarily retain the receipts in onshore foreign currency account, pending maturity of the forward foreign exchange contract.

For forward sale of export proceeds, the maturity date of the forward foreign exchange contract should not be later than six months after the intended date of export.

For forward foreign exchange contract involving two foreign currencies, the use or retention of the foreign currency purchased by the resident must be for permitted purposes.

(c) Interest Rate Swaps

A resident with firm underlying commitment may enter into interest rate swaps with licensed onshore banks, approved merchant banks and licensed offshore banks in Labuan.

V Issuance of Ringgit Private Debt Securities

A resident company is free to issue any amount of ringgit Private Debt Securities.

Proceeds from the issuance may be used for any purpose including the purchase of foreign currency assets of not more than RM10 million in a calendar year.

VI Foreign Currency Accounts (FCA)

A resident, individual or company, with or without any domestic credit facilities is free to open FCA to retain any amount of foreign currency receipts, other than receipts arising from export of goods from Malaysia, with:

- licensed onshore banks;
- approved merchant banks;
- licensed offshore banks in Labuan; or
- overseas banks.

A resident exporter may open FCA with licensed onshore banks to retain any amount of foreign currency export receipts.

A resident individual or company may convert ringgit into foreign currency and credit into FCA onshore and offshore. Conversions of ringgit funds must comply with requirement on investments in foreign currency assets.

A resident company maintaining FCA with licensed offshore banks in Labuan or overseas banks is required to submit monthly statement (Statement OA) to the Controller.

B. NON-RESIDENTS

Non-residents are free to invest in Malaysia in any form. There are no restrictions on the repatriation of capital, profits and income earned from Malaysia, including salaries, wages, royalties, commissions, fees, rental, interest profits or dividends. To complement the non-residents' investment strategy, non-residents may obtain financing from licensed onshore banks both in ringgit and foreign currency and enter into foreign exchange contracts with licensed onshore banks to actively manage currency risks arising from investments in ringgit assets. Non-residents are also free to convert foreign currency into ringgit and vice versa. Details are as follows:

I Investment in Malaysia

(a) Foreign Direct Investments

A non-resident may incorporate a company, register a branch, and/or establish sole proprietorship or partnership in Malaysia with the Companies Commission of Malaysia. Please refer to http://www.ssm.com.my/ for details.

Such businesses in Malaysia are resident entities irrespective whether the businesses are controlled by residents or non-residents.

A non-resident is free to purchase any ringgit equity irrespective whether listed or not listed in the Malaysian exchange.

(b) Portfolio Investments

A non-resident is free to make any portfolio investments, including purchasing of any ringgit debt securities issued by non-residents in Malaysia.

(c) Investment in Immovable Properties

A non-resident is free to purchase immovable properties (residential and commercial) in Malaysia. Such purchases should comply with guidelines issued by the Foreign Investment Committee (FIC). Please refer to http://www.epu.jpm.my/ for details.

A non-resident is free to obtain up to three loans from residents to finance the purchase of immovable properties in Malaysia.

A non-resident is required to obtain the prior approval of the Controller for financing the purchase of land only.

Loans by domestic financial institutions are determined by the financial institution's own policies and the Foreign Investment Committee (FIC) guidelines.

(d) Opening of Account in Ringgit (External Account)

External Account is a ringgit account belonging to a non-resident or where the beneficiary of the funds in the account is a non-resident.

A non-resident may open and maintain any number of External Accounts with any onshore financial institutions.

There is no restriction on the amount of ringgit funds that can be retained in the External Account.

Ringgit funds in an External Account can be used for the following purposes:

- Purchase of foreign currency, excluding the currency of the State of Israel.
- Purchase of ringgit assets in Malaysia.
- Payment for goods and services for own use in Malaysia.
- Payment of administrative and statutory expenses incurred in Malaysia.
- Payment under a non-financial guarantee to a resident.
- Extension of ringgit credit facilities to employees in Malaysia in accordance with the terms and conditions of employment.

- Transfers to:
  - (i) Another External Account of the same account holder.
  - (ii) Another External Account of different account holder or Resident Account by way of:
    - – Automated Teller Machine transfer up to RM5,000 per person, per day, per bank for any purpose.
    - – Internet-bank transfers up to RM5,000 per person, per day, per bank for any purpose.
- Payment to residents for any purpose other than the following:
  - (i) Payment for the import of goods and services.
  - (ii) Extension of ringgit credit facilities to residents other than permitted by the Controller.
  - (iii) Settlement under financial guarantees.
  - (iv) Payment on behalf of a third party.

Ringgit funds in the External Account may be derived from:

- Sale of foreign currency, other than the currency of the State of Israel, for ringgit with licensed onshore banks.
- Sale of ringgit assets.
- All income derived in Malaysia including salaries, wages, royalties, commissions, fees, rental, interest, profits or dividends.
- Proceeds from ringgit credit facilities permitted by the Controller.
- Proceeds from repayment of ringgit credit facilities permitted by the Controller.
- Transfers from:
  - (i) Another External Account of the same account holder.
  - (ii) Another External Account of different account holder or Resident Account by way of:
    - – Automated Teller Machine transfer up to RM5,000 per person, per day, per bank for any purpose.
    - – Internet-bank transfers up to RM5,000 per person, per day, per bank for any purpose.
- Deposit of ringgit notes not exceeding RM10,000 per day.
- Deposit of ringgit cheques up to RM5,000 per cheque for any purpose.

There are no restrictions on the operation of External Accounts belonging to:

- Non-residents working or studying in Malaysia (including their spouse, children and/or parents who are currently residing in Malaysia).
- Non-resident participants of the Malaysia My Second Home programme.
- Central banks, Embassies, Consulates, High Commissions, supranational or international organisations recognised by the Government of Malaysia.

Such persons or organisations can use funds in the External Accounts for all purposes, including the permissible purposes referred above.

(e) Opening of Account in Foreign Currency

There are no restrictions on a non-resident to open and maintain any number of foreign currency accounts with licensed onshore banks and licensed merchant banks in Malaysia. There is also no restriction on the amounts that can be retained in these accounts.

There are no restrictions imposed on the use of foreign currency funds in the account. Funds in such accounts may be converted into ringgit with licensed onshore banks or may be repatriated at any time.

(f) Lending to Residents in Ringgit

A non-resident may lend in ringgit to a resident who has obtained prior permission of the Controller.

(g) Lending to Residents in Foreign Currency

A non-resident may lend in foreign currency to a resident as long as the resident's total foreign currency credit facilities are within permitted limits.

II Payment for Investments

A non-resident may pay in foreign currency or in ringgit from own External Account for investments in Malaysia.

III Borrowing from Residents in Ringgit

A non-resident is free to obtain ringgit credit facilities as follows:

- From licensed banking institutions in Malaysia up to an aggregate of RM10 million for use in Malaysia by the non-resident which is not a non-resident correspondent bank or non-resident stockbroking company.
- From licensed onshore banks up to RM200 million on intra-day and overnight basis by a non-resident stockbroking company or a custodian bank. The facilities are strictly for financing funding gaps due to settlement timing mismatches, unforeseen or inadvertent /technical administration errors or delays due to time zone difference in relation to settlement of trades on Bursa Malaysia (stock exchange in Malaysia).
- From resident stockbroking companies in the form of margin financing by the non-resident which is not a non-resident correspondent bank or non-resident stockbroking company.
- From resident insurers up to the value of the cash surrender value of the insurance policies purchased by the non-resident.
- From a non-bank resident up to RM10,000.
- From residents, including financial institutions, up to three loans to finance the purchase of immovable properties in Malaysia.
- From residents and non-residents through issuance of Ringgit Private Debt Securities in Malaysia by Multilateral Development Banks or foreign multinational corporations.

IV Borrowing from Residents in Foreign Currency

A non-resident may obtain any amount of foreign currency credit facilities from licensed onshore banks, approved merchant banks and non-bank residents with no domestic ringgit credit facilities.

V Hedging of Investments

A non-resident is free to enter into a foreign exchange contract on spot or forward basis with a licensed onshore bank for the following:

- To buy ringgit to make payment to a resident.

- To sell ringgit funds arising from a committed transaction in Malaysia.

The maturity date of the foreign exchange contracts should be the expected date of payments or receipts of the underlying committed transactions.

The total amount of the foreign exchange contracts should not exceed the expected sum of payments or receipts of the underlying committed transactions.

VI Sale of Investments

A non-resident may sell any investments in Malaysia, including securities not listed on Bursa Malaysia, to a resident or to a non-resident.

A resident may pay or settle the purchase of the ringgit assets from the non-resident seller in ringgit or in foreign currency.

A non-resident purchaser may also pay or settle the purchase of ringgit assets from the non-resident seller in foreign currency or ringgit from own External Account.

VII Repatriation of Funds

A non-resident is free to repatriate any amount of own funds in Malaysia any time, including capital, divestment proceeds, profits, dividends, rental, fees and interest arising from investments in Malaysia.

C. COMPANIES ACCORDED SPECIAL STATUS

I Offshore Entities in the Labuan International Offshore Financial Centre

An offshore entity incorporated or registered under the Offshore Companies Act 1990 is declared as a non-resident for foreign exchange administration purposes.

As a non-resident, the offshore entity is free to undertake the following:

- Obtain any amount of foreign currency credit facilities.

- Invest any amount in foreign currency assets.

- Enter into foreign exchange contracts involving foreign currencies with licensed onshore banks, approved merchant banks, licensed offshore banks in Labuan and any overseas counterparty.

- Buy or sell foreign currency (other than the currency of the State of Israel) against ringgit with licensed onshore banks for permitted purposes.

- Maintain External Accounts with licensed onshore banks to facilitate the defrayment of statutory and administrative expenses in Malaysia.

- Receive payments in ringgit from residents arising from fees, commissions, dividends or interest from deposit of funds with onshore financial institutions.

- Invest in ringgit assets that are transacted directly with onshore banking institutions or resident brokers for own account.

In addition, an offshore insurance entity in Labuan is allowed to receive reinsurance premiums and pay claims arising from reinsurance of domestic insurance business in ringgit.

II Multimedia Super Corridor Companies

A company with Multimedia Super Corridor (MSC) status is exempted from foreign exchange administration requirements for transactions undertaken on own account.

III Approved Operational Headquarters

An Approved Operational Headquarter (OHQ) is subject to policies applicable to a resident. In addition, an OHQ is allowed to:

- Obtain any amount of foreign currency credit facilities from licensed onshore banks and licensed merchant banks in Malaysia, and from any non-resident, provided the OHQ does not on-lend to, or raise the funds on behalf of, any resident.

- Invest any amount in foreign currency assets to be funded with foreign currency funds or borrowing.

IV Regional Distribution Centres and International Procurement Centres

A Regional Distribution Centre and International Procurement Centre are also subject to policies applicable to residents.

D. STATISTICAL REPORTING

To assist the Controller to compile balance of payments statistics, residents transacting with non-residents or have overseas foreign currency assets or liabilities, are required to submit statistical forms/reports/statements to the Controller, where applicable. Information on the statistical requirements can be obtained from Bank Negara Malaysia's website, http://www.bnm.gov.my/fxadmin.

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[i] Residents:
(a) Citizens of Malaysia (excluding persons who have obtained permanent resident status of a territory outside Malaysia and are residing abroad)
(b) Non-citizens who have obtained permanent resident status in Malaysia and are residing permanently in Malaysia
(c) Persons, whether body corporate or unincorporated, registered or approved by any authority in Malaysia

Non-residents:
(a) Persons other than residents
(b) Overseas branches, overseas subsidiaries, overseas regional offices, sales offices, representatives offices of resident companies
(c) Embassies, Consulates, High Commissions, supranational or international organisations recognised by the Government of Malaysia
(d) Malaysian citizens who have obtained permanent resident status of a territory outside Malaysia and are residing outside Malaysia

[ii] Foreign currency assets include lending to non-residents, placement of deposits with licensed onshore banks, approved merchant banks or offshore banks, and foreign currency products offered by licensed onshore banks, approved merchant banks and other entities approved by the Controller

[iii] Domestic ringgit credit facilities means any ringgit advance, loan, trade financing, hire purchase, factoring, leasing facilities, redeemable preference shares or similar facility in whatever name or form, other than:
(a) Trade credit terms extended by a supplier for all types of goods and services
(b) Forward exchange contracts entered into with authorised dealers
(c) One personal housing loan and one vehicle loan obtained from residents
(d) Credit card and charge card facilities
(e) Inter company borrowing within a corporate group in Malaysia

Funds Administered/Funded by Bank Negara Malaysia: Fund Utilisation

Funds	Date established	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disburse-ments as at end-2005 (RM m)	Outstanding as at end-2005[6] (RM m)
			Total as at end-		Annual change	Total as at end-		Annual change		
			2004	2005		2004	2005			
Ship Financing Facility	30-Oct-92	600	38	38	0	577	577	0	543	0
Fund for Food	04-Jan-93	1,300[3]	8,829	9,611	782	1,528	1,624	96	1,535	706
Bumiputera Entrepreneurs Project Fund	10-Feb-00	300[3]	1,079	1,181	102	499	533	34	448	54
Fund For Small and Medium Industries 2	15-Apr-00	4,750[1,3]	6,239	9,631	3,392	4,172	6,349	2,177	5,403	4,377
New Entrepreneurs Fund 2	15-Jul-01	2,350[2,3]	2,948	4,045	1,097	1,886	2,698	812	2,270	1,967
Rehabilitation Fund for Small Businesses	01-Nov-03	200[8]	23	35	12	11	16	5	9	8

Terminated Funds	Date established	Date terminated	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disburse-ments as at end-2005 (RM m)	Outstanding as at end-2005[6] (RM m)
				Total as at end-		Annual change	Total as at end-		Annual change		
				2004	2005		2004	2005			
Enterprise Rehabilitation Fund	06-Feb-88	01-Jan-91	500[3]	764	764	0	896	896	0	850	89
Abandoned Housing Projects Fund	18-Jun-90	29-Feb-92	600	74	74	0	331	331	0	346	9
Fund to Accelerate the Construction of Low-Cost Houses	29-Oct-93	31-Oct-95	500	54	54	0	297	297	0	297	0
Special Fund for Tourism	10-Mar-90	31-Dec-97	200[3]	194	194	0	203	203	0	203	16
Industrial Adjustment Fund	05-Feb-91	04-Aug-99	100	25	25	0	95	95	0	95	0
Special Scheme for Low and Medium Cost Houses	01-May-98	04-Aug-99	1,000	96	96	0	609	609	0	585	12
Bumiputera Industrial Fund	04-Jan-93	03-Apr-00	100	99	99	0	95	95	0	91	17
Fund for Small and Medium Industries	02-Jan-98	03-Apr-00	1,850[3]	5,420	5,420	0	3,774	3,774	0	3,726	0
New Entrepreneurs Fund	12-Dec-89	15-Jul-01	1,250[3]	3,126	3,126	0	1,420	1,420	0	1,398	291
Rehabilitation Fund for Small and Medium Industries	23-Nov-98	01-Nov-03	330[3,4]	317	313	-4[5]	344	340	-4[5]	328	204
Entrepreneurs Rehabilitation and Development Fund	03-Jul-01	01-Nov-03	10[4]	33	33	0	3	3	0	2	1
Special Relief Guarantee Facility[7]	21-May-01	10-Jul-04	1,000	85	85	0	49	49	0	0	0

1 The allocation was increased from RM4,500 million to RM4,750 million in 2005
2 The allocation was increased from RM2,000 million to RM2,350 million in 2005
3 Revolving funds
4 Unutilised allocations were transferred to Rehabilitation Fund for Small Businesses
5 Approval withdrawn by banks/borrowers and/or amount required were reduced by banks/borrowers
6 Borrowers' outstanding loan balances with the lending institutions
7 A guarantee scheme through Credit Guarantee Corporation Malaysia Berhad funded by Bank Negara Malaysia to assist businesses affected by Severe Acute Respiratory Syndrome (SARS)
8 Reallocation of unutilised RM600 million from Rehabilitation Fund for Small Businesses into Fund for Small and Medium Industries 2 (RM250 million) and New Entrepreneurs Fund 2 (RM350million)

Financial Sector Masterplan

List of Completed and On-going Recommendations

Banking Sector	
Completed recommendations	
R3.4	Liberalised restrictions on salaries and staff mobility in the banking industry to enable the industry to attract the best talent and reward them accordingly.
R3.5	Uplift restrictions on employment of expatriates to attract the best international talents to meet the demand for expertise in specific areas of banking.
R3.6	Established Board committees, namely Nominating, Remuneration and Risk Management committees to further enhance corporate governance standards.
R3.7	Allowed group rationalisation through cross-selling of products and consolidation of back-office processes, as well as facilitate the merger of commercial banks and finance companies to further enhance efficiency and competitiveness.
R3.9	Streamlined the regulation of discount houses and merchant banks to enhance and allow fair competition among players.
R3.10*	Established investment banks through mergers between merchant banks and stockbroking companies or discount houses to reduce duplication, enhance competitiveness and strengthen the potential to capitalise on expanded business opportunity thus contributing towards the economic transformation process.
R3.12	Encouraged outsourcing of non-core functions to gain greater strategic focus and efficiency.
R3.14	Encouraged the development of new delivery channels to increase the range of products and services to further enhance competitiveness.
R3.15.1 and R3.15.2	Simplified the product notification process to provide incentive for the development of new and innovative products, and outline a set of guidelines providing criteria for product notification and specific product approval requirements.
R3.16a	Introduced the New Interest Rate Framework to provide banking institutions with greater flexibility, thus promoting more efficient pricing of products.
R3.18	Encouraged participation of banking institutions in areas currently served by fringe institutions to promote a level playing field and preserve consumer protection and investors' interests.
R3.21	Implemented risk-based supervision with supervisory focus on high risk areas and greater attention on weak institutions.
R3.22a	Incorporated market risk into the capital adequacy framework to introduce more risk sensitivity to the existing regulatory capital requirements.
R3.23	Developed a formal and informal enforcement action framework to ensure banking institutions take remedial actions on weaknesses highlighted.
R3.26f*	Enhanced the level of corporate governance among licensed institutions by prescribing broad principles and minimum standards as well as specific requirements to ensure safety and soundness of licensed institutions.
R3.27	Increased efficiency and competition in the payments system to support the needs of the economy while maintaining its safety and integrity.
R3.28	Allowed market forces to shape developments in the payments system to promote greater competition and increase innovation in payments system.
R3.30*	Allowed money brokers to complements its voice broking sevices by offering electronic broking system to its clients.
R3.33	Allowed banking institutions to rationalise their branch network to improve the dispersion of their branches in the country.
R3.37	Expanded the role of the Banking Mediation Bureau with the establishment of the Financial Mediation Bureau to strengthen consumer protection framework and to widen avenues for consumers to seek redress.

R3.39*	Established a deposit insurance system to provide a reasonable level of protection to depositors while promoting incentive for prudent management by banking institutions.
On-going recommendations	
R3.1	Develop and disseminate industry-wide benchmarks to enable domestic banking institutions to assess their relative performance against market leaders, identify the performance gaps and, accordingly, recognise their comparative strengths and weaknesses to develop appropriate strategies to remain competitive.
R3.2	Increase awareness of best practice by conducting focused training and seminar series for senior management to promote greater understanding on emerging trends and issues facing the banking industry.
R3.3	Enhance credit skills of credit officers and managers with the aim to promote sound lending decisions and credit culture and monitor the requirement for accreditation.
R3.8	Encourage domestic banking institutions to form strategic alliances with other banking institutions and non-banking institutions to provide consumers with greater access to world-class products and services and towards meeting international best practice standards.
R3.13	Require management of banking institutions to accord greater attention to the development of information and communication technology (ICT) to ensure appropriate ICT strategies as a strategic tool towards bringing about holistic improvement within banking institutions.
R3.15	Adopt 'what is not prohibited is allowed' regulatory philosophy and phase out product pre-approval requirement to encourage innovation.
R3.19	Facilitate the development of a conducive tax regime to provide incentives to encourage innovation via greater research and development.
R3.24	Implement a transparent and clearly structured early warning system and set of prompt corrective measures for weak banking institutions to ensure sound and stable banking system.
R3.32	Require provision of advisory services on financial planning and management to small and medium industries and small borrowers to enable these borrowers to make informed decisions and better understand financial planning and management.
R3.34	Development of an active and structured consumer education programme to promote greater financial literacy and promote active consumerism.
R3.36	Encourage consumers to pursue formal administrative and legal redress to protect consumers against unfair practices by banking institutions.
Insurance Sector	
Completed recommendations	
R4.1	Removed restrictions on outsourcing to enable insurers to further develop core competencies and effective business strategies.
R4.2	Allowed eligible insurers to use the internet as a distribution channel to enhance competitiveness and efficiency of the insurance industry.
R4.3	Promoted the growth of bancassurance as a cost-effective alternative distribution channel by implementing a more flexible regulatory framework on remuneration structures governing bancassurance arrangements.
R4.6	Relaxed the restrictions on employment of expatriates to accelerate the development of skills and expertise in the industry.
R4.9*	Introduced a regulatory framework for the licensing of financial advisers to promote higher standards of financial services and enable consumers to obtain professional advice on a wider range of financial products and services.
R4.16	Increased the statutory minimum paid-up capital of insurers to enhance their financial resilience and ability to compete effectively in a more deregulated and liberalised market.

R4.17	Strengthened 'fit and proper' regulations for board members and senior management of insurance companies, including minimum qualification standards and training requirements for directors to promote sound corporate governance.
R4.18	Established board committees with specific responsibilities and enhance disclosure standards on compensation to directors and senior management to further strengthen governance structures and processes and promote greater transparency.
R4.19	Raised the entry requirements for the agency force to uphold high standards of professionalism and competencies among insurance intermediaries.
R4.20	Introduced additional compulsory exams as part of continuing education programmes for agents to upgrade their knowledge and skills on an on-going basis.
R4.21	Further strengthen performance-based supervision to maintain stability under a more deregulated and competitive market conditions.
R4.22	Developed an enforcement action framework to ensure timely and consistent supervisory intervention processes to address institutional risks.
R4.25	Established the Financial Mediation Bureau to strengthen consumer protection framework and widen avenues for consumers to seek redress.
R4.26	Introduced 'best advice' regulations to enhance consumer protection and professionalism in the sale of life insurance products by insurance intermediaries.
R4.27	Strengthened regulations on unfair trade practices to ensure sound business practices and fair treatment of consumers.
R4.29	Allowed financial and non-financial institutions to acquire interests in direct insurers to create business synergies.
On-going recommendations	
R4.5	Promote the management of pension funds by insurers to achieve the most efficient and effective management of the pension funds.
R4.8	Allow insurers to distribute other personal financial service products to enable insurers to make more effective use of the agency force and other distribution channels.
Islamic Banking and Takaful	
Completed recommendations	
R5.3	Build strong management through the establishment of board committees, benchmarking and employment of experienced and qualified staff.
R5.5	Increased the number of Islamic banks to stimulate greater competition and accelerate international integration by issuing Islamic banking licences to qualified domestic and foreign banking institutions.
R5.6	Increased the number of takaful operators to accelerate the expansion of the takaful industry.
R5.10	Established a comprehensive legal infrastructure for consumers to seek legal redress arising from Islamic financial transactions.
On-going recommendations	
R5.1	Develop and disseminate industry wide benchmarks to enable Islamic banking institutions to evaluate their relative efficiency, identify the performance gaps and formulate appropriate strategies to improve and deliver the best results.
R5.2	Enhance the level of knowledge, competency and expertise in order to increase the pool of highly qualified and skilled/trained staff in Islamic banking and finance.
R5.11	Create a favourable tax regime in the implementation of Islamic financial contracts.

Development Financial Institutions	
Completed recommendations	
R6.4	Introduced a systematic framework for sourcing funds to ensure appropriate and adequate funding for the operations of development financial institutions (DFIs).
R6.7	Established a legislative framework to regulate and supervise DFIs to ensure that DFIs' policies and objectives are consistent with the national policy objectives.
R6.8	Established a single Regulatory and Supervisory Authority (RSA) to strengthen the supervision of DFIs.
On-going recommendations	
R6.5	Continued Government's support to the DFIs and enhance coordination among relevant ministries to enable these DFIs to operate in a more focused, efficient and prudent manner in supporting their respective targeted sectors.
Alternative Modes of Financing	
Completed recommendations	
R7.2	Established a RM500 million venture capital fund to increase the availability of venture capital financing and stimulate new ventures.
R7.3	Introduced further tax incentives for the venture capital industry to promote the growth of venture capital.
R7.4	Liberalised the MESDAQ listing requirements to facilitate the exit of venture capital companies from their investments.
R7.5	Established two Islamic venture capital funds with a combined initial fund size of RM22.1 million.
On-going recommendations	
R7.13	Established a one-stop agriculture research and development centre as well as a comprehensive and integrated information database to facilitate banking institutions in their assessment of specialised risks involved in agriculture financing.
R7.14	Develop structured and systematic training programme for borrowers to ensure an orderly development of the players in the agriculture sector.
R7.15	Putting in place an effective risk-distribution mechanism that will reduce risks to the financial institutions and, at the same time, reduce borrowing costs through a guarantee and insurance protection scheme.
R7.15.2	Diversify insurance protection schemes to cater for the unique features of the various sub-sectors within the agriculture sector.
R7.16	Provide subsidies to agriculture industry to help reduce insurance costs, especially for small scale farmers.
R7.17	Grant tax exemptions to provide greater financial assistance to the agriculture sector.
Labuan International Offshore Financial Centre	
Completed recommendations	
R8.3	Adopted a consultative and market driven approach to create a conducive tax and business environment to enhance the competitiveness and attractiveness of Labuan.
R8.6	Strengthened Islamic banking and finance as well as takaful to develop Labuan with a strategic focus on Islamic products and services.
R8.7	Enhanced Labuan International Financial Exchange (LFX) to be a one-stop financial exchange for residents and global companies.
On-going recommendations	
R8.1	Develop an active International Offshore Financial Centre (IOFC) for Malaysia to support the increasing demands of the domestic economy and to play an important complementary role to the Malaysian financial system.

R8.2	Review existing rules and regulations to facilitate expansion in the scope of core business to facilitate new offshore businesses and allow offshore service providers to maximise capabilities and expertise to expand their business.
R8.4	Benchmark against the leading IOFCs in various areas of business to further improve competitiveness, especially in terms of pricing and cost.
R8.5	Establish a well-balanced regulatory policy and supervisory framework which are in line with latest international supervisory regime.
R8.8	Enhance the e-commerce gateway to encourage global e-commerce operators to set up domicile in Labuan.
R8.9	Maximise potentials of Labuan IOFC by developing other complementary economic measures.

* Recommendations completed in 2005.

Licensed Banking Institutions (as at 31 December 2005)

Commercial Banks

1. ABN AMRO Bank Berhad
2. Affin Bank Berhad[1]
3. Alliance Bank Malaysia Berhad
4. AmBank (M) Berhad[2]
5. Bangkok Bank Berhad
6. Bank of America Malaysia Berhad
7. Bank of China (Malaysia) Berhad
8. Bank of Tokyo-Mitsubishi (Malaysia) Berhad[3]
9. Bumiputra-Commerce Bank Berhad
10. Citibank Berhad
11. Deutsche Bank (Malaysia) Berhad
12. EON Bank Berhad
13. Hong Leong Bank Berhad
14. HSBC Bank Malaysia Berhad
15. J.P. Morgan Chase Bank Berhad
16. Malayan Banking Berhad
17. OCBC Bank (Malaysia) Berhad
18. Public Bank Berhad
19. RHB Bank Berhad
20. Southern Bank Berhad
21. Standard Chartered Bank Malaysia Berhad
22. The Bank of Nova Scotia Berhad
23. United Overseas Bank (Malaysia) Berhad

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad
3. RHB ISLAMIC Bank Berhad
4. Commerce TIJARI Bank Berhad
5. Hong Leong Islamic Bank Berhad
6. Kuwait Finance House (Malaysia) Berhad

[1] Merged with AFFIN-ACF Finance Berhad with effect from 1 June 2005
[2] Absorbed by AmFinance Berhad and changed the name to AmBank (M) Berhad with effect from 1 June 2005
[3] Changed the name to Bank of Tokyo-Mitsubishi UFJ (Malaysia) Berhad with effect from 1 January 2006

Finance Companies

1. Bumiputra-Commerce Finance Berhad[4]
2. RHB Delta Finance Berhad[5]
3. Southern Finance Berhad[6]

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Aseambankers Malaysia Berhad
5. Commerce International Merchant Bankers Berhad
6. Malaysian International Merchant Bankers Berhad
7. Public Merchant Bank Berhad
8. RHB Sakura Merchant Bankers Berhad
9. Southern Investment Bank Berhad
10. Utama Merchant Bank Berhad

[4] Absorbed into Bumiputra-Commerce Bank Berhad with effect from 1 January 2006
[5] Absorbed into RHB Bank Berhad with effect from 1 January 2006
[6] Absorbed into Southern Bank Berhad with effect from 1 January 2006

Financial Institutions Offering Islamic Banking Services (as at 31 December 2005)

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad
3. Commerce TIJARI Bank Berhad
4. Hong Leong Islamic Bank Berhad
5. Kuwait Finance House (Malaysia) Berhad
6. RHB ISLAMIC Bank Berhad

Participating Banks in the Islamic Banking Scheme

Commercial Banks

1. Affin Bank Berhad
2. Alliance Bank Malaysia Berhad
3. AmBank (M) Berhad
4. Citibank Berhad
5. EON Bank Berhad
6. HSBC Bank Malaysia Berhad
7. Malayan Banking Berhad
8. OCBC Bank (Malaysia) Berhad
9. Public Bank Berhad
10. Southern Bank Berhad
11. Standard Chartered Bank Malaysia Berhad

Finance Company

1. Southern Finance Berhad

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Commerce International Merchant Bankers Berhad

Discount Houses

1. Abrar Discounts Berhad
2. Affin Discount Berhad
3. Amanah Short Deposits Berhad
4. CIMB Discount House Berhad
5. KAF Discounts Berhad
6. Malaysia Discount Berhad
7. Mayban Discount Berhad

Development Financial Institutions Offering Islamic Banking Services

1. Bank Kerjasama Rakyat Malaysia Berhad
2. Bank Simpanan Nasional
3. Bank Pembangunan Malaysia Berhad
4. Bank Pertanian Malaysia
5. Bank Perusahaan Kecil & Sederhana Malaysia Berhad

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6. Assoc. Prof. Dr. Abdul Halim Muhammad
7. Dr. Mohd Ali Haji Baharum
8. Dr. Mohd Parid Sheikh Ahmad

Table A.1
Gross Domestic Product by Kind of Economic Activity in Constant 1987 Prices

	2001	2002	2003	2004	2005*p*	2006*f*
	RM million					
Agriculture	18,551	19,064	20,134	21,137	21,585	22,010
Mining and quarrying	15,160	15,810	16,720	17,372	17,504	18,378
Manufacturing	63,299	66,019	71,544	78,558	82,394	88,122
Construction	7,108	7,251	7,359	7,248	7,133	7,204
Services	120,194	127,968	133,751	142,849	152,205	161,330
Less: Imputed bank service charges	17,678	21,073	22,431	23,205	23,876	24,525
Plus: Import duties	4,594	5,384	5,282	4,995	5,083	5,107
GDP at purchasers' prices[1]	**211,227**	**220,422**	**232,359**	**248,954**	**262,029**	**277,626**
	Annual change (%)					
Agriculture	-0.6	2.8	5.6	5.0	2.1	2.0
Mining and quarrying	-1.5	4.3	5.8	3.9	0.8	5.0
Manufacturing	-5.9	4.3	8.4	9.8	4.9	7.0
Construction	2.1	2.0	1.5	-1.5	-1.6	1.0
Services	6.0	6.5	4.5	6.8	6.5	6.0
Less: Imputed bank service charges	11.7	19.2	6.4	3.4	2.9	2.7
Plus: Import duties	-2.7	17.2	-1.9	-5.4	1.8	0.5
GDP at purchasers' prices	**0.3**	**4.4**	**5.4**	**7.1**	**5.3**	**6.0**

[1] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2
Growth in Manufacturing Production (2000=100)

	2002	2003	2004	2005	2003	2004	2005
	Index				Annual change (%)		
Export-oriented industries	**95.7**	**107.9**	**123.8**	**130.8**	**12.7**	**14.8**	**5.7**
Electrical machinery, apparatus, appliances and supplies	90.9	104.4	124.5	128.9	14.8	19.3	3.5
Electronics	*88.3*	*108.3*	*136.0*	*143.0*	*22.6*	*25.6*	*5.2*
Electrical products	*96.0*	*96.8*	*102.1*	*101.3*	*0.9*	*5.5*	*-0.8*
Chemicals and chemical products	99.6	117.2	134.9	149.7	17.7	15.1	11.0
Petroleum products[1]	105.9	116.0	127.4	141.2	9.5	9.8	10.8
Textiles, wearing apparel and footwear	86.8	85.5	81.4	84.1	-1.6	-4.8	3.4
Wood and wood products	94.9	95.7	107.9	109.6	0.9	12.8	1.5
Rubber products	105.9	124.2	134.3	133.8	17.4	8.1	-0.4
Off-estate processing	111.7	118.0	121.2	131.0	5.6	2.7	8.1
Others	85.9	90.0	111.4	107.4	4.8	23.9	-3.7
Domestic-oriented industries	**109.0**	**114.0**	**119.9**	**123.2**	**4.6**	**5.2**	**2.8**
Construction-related products	102.8	109.8	111.2	110.7	6.8	1.3	-0.5
Non-metallic mineral products	*106.7*	*114.0*	*111.0*	*113.2*	*6.8*	*-2.6*	*2.0*
Basic iron & steel and non-ferrous metal	*95.5*	*101.8*	*111.7*	*105.8*	*6.6*	*9.7*	*-5.3*
Food products	111.5	118.1	120.5	129.7	5.9	2.0	7.6
Transport equipment	128.3	124.0	138.5	150.2	-3.4	11.7	8.5
Fabricated metal products	109.6	116.6	129.9	123.5	6.3	11.4	-4.9
Paper products	103.5	106.2	110.7	119.0	2.7	4.2	7.5
Beverages	90.6	110.9	112.4	119.3	22.4	1.4	6.1
Tobacco products	84.6	87.9	90.5	87.8	3.9	2.9	-3.0
Total	**98.4**	**109.1**	**123.0**	**129.3**	**10.9**	**12.8**	**5.1**

[1] Under the new Industrial Production Index (2000=100), LNG has been reclassified as petroleum products (previously classified as chemicals and chemical products). Consequently, petroleum products have been reclassified as export-oriented industries

Source: Department of Statistics, Malaysia

Table A.3
Production of Primary Commodities

	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	Volume					Annual change (%)				
Crude palm oil ('000 tonnes)	11,804	11,909	13,355	13,976	14,961	8.9	0.9	12.1	4.7	7.0
Rubber[1] ('000 tonnes)	882	890	986	1,169	1,124	-4.9	0.9	10.8	18.6	-3.8
Saw logs ('000 cu. metres)	18,923	20,649	21,532	21,509	21,334	-18.0	9.1	4.3	-0.1	-0.8
Cocoa ('000 tonnes)	58	48	36	33	28	-17.9	-17.4	-24.0	-7.8	-16.3
Crude oil (including condensates) ('000 bpd)	666	698	738	762	727	-2.4	4.9	5.6	3.6	-4.9
Natural gas (mmscfd)	4,542	4,676	5,013	5,196	5,800	3.7	3.0	7.2	4.0	11.3
Tin-in-concentrates ('000 tonnes)	5.0	4.2	3.4	2.7	2.8	-21.2	-15.2	-20.3	-18.3	2.0

p Preliminary
[1] Revised from 2000 onwards based on new compilation methodology

Source: Malaysian Palm Oil Board
Department of Statistics, Malaysia
Forestry Departments (Peninsular Malaysia, Sabah & Sarawak)
Malaysian Cocoa Board
PETRONAS
Minerals and Geoscience Department, Malaysia

Table A.4
GNP by Demand Aggregates

	2001	2002	2003	2004	2005*p*	2006*f*
	at Current Prices (RM million)					
Consumption	192,909	209,022	227,279	252,088	280,468	306,179
Private consumption	*150,644*	*159,506*	*172,366*	*192,771*	*215,876*	*237,832*
Public consumption	*42,265*	*49,516*	*54,913*	*59,317*	*64,592*	*68,347*
Investment	83,345	83,764	87,089	91,818	98,930	107,106
Private investment	*34,528*	*29,376*	*29,856*	*38,394*	*43,769*	*49,195*
Public investment	*48,817*	*54,388*	*57,233*	*53,424*	*55,161*	*57,911*
Change in stocks[1]	-3,339	3,105	-1,814	10,009	-1,059	1,334
Exports of goods and services	389,255	415,040	447,846	544,956	609,133	682,398
Imports of goods and services	327,767	348,919	365,383	449,262	492,928	554,250
GDP at purchasers' value	334,404	362,012	395,017	449,609	494,544	542,766
Net factor payments abroad	-25,623	-25,061	-22,537	-24,549	-21,470	-23,716
GNP at purchasers' value	308,781	336,951	372,480	425,060	473,074	519,050
	at Constant 1987 Prices (RM million)					
Consumption	125,637	132,872	143,198	156,739	169,993	180,111
Private consumption	*97,630*	*101,946*	*108,722*	*120,181*	*131,266*	*140,132*
Public consumption	*28,007*	*30,926*	*34,476*	*36,558*	*38,727*	*39,979*
Investment	63,050	63,249	64,960	66,996	70,175	74,339
Private investment	*26,120*	*22,181*	*22,270*	*28,015*	*31,047*	*34,145*
Public investment	*36,930*	*41,068*	*42,690*	*38,981*	*39,128*	*40,194*
Change in stocks[1]	-1,279	3,200	-1,267	5,464	-1,708	889
Exports of goods and services	227,685	237,904	251,463	292,476	316,959	345,075
Imports of goods and services	203,866	216,802	225,996	272,721	293,391	322,789
GDP at purchasers' value	211,227	220,422	232,359	248,954	262,029	277,626
Net factor payments abroad	-17,642	-17,253	-15,204	-15,870	-13,999	-15,163
GNP at purchasers' value	193,585	203,169	217,155	233,084	248,030	262,462

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5
Savings-Investment Gap

	2001	2002	2003	2004	2005*p*	2006*f*
	RM million					
Public gross domestic capital formation	48,817	54,388	57,233	53,424	55,161	57,911
Public savings	35,748	49,459	60,093	73,000	75,048	82,899
Deficit/surplus	-13,069	-4,929	2,860	19,576	19,887	24,988
Private gross domestic capital formation	31,189	32,481	28,042	48,403	42,710	50,529
Private savings	71,945	67,904	75,807	85,338	100,595	114,950
Deficit/surplus	40,756	35,423	47,765	36,935	57,885	64,421
Gross domestic capital formation	80,006	86,869	85,275	101,827	97,871	108,440
(as % of GNP)	25.9	25.8	22.9	24.0	20.7	20.9
Gross national savings	107,693	117,363	135,900	158,338	175,643	197,849
(as % of GNP)	34.9	34.8	36.5	37.3	37.1	38.1
Balance on current account	27,687	30,494	50,625	56,511	77,772	89,409
(as % of GNP)	9.0	9.0	13.6	13.3	16.4	17.2

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6
Balance of Payments

Item	2002			2003		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**358,504**	**286,387**	**72,117**	**397,969**	**300,207**	**97,762**
Trade account	*357,430*	*303,090*	*54,340*	*397,884*	*316,538*	*81,347*
Services	**56,536**	**62,532**	**-5,996**	**49,876**	**65,176**	**-15,300**
Transportation	10,847	22,419	-11,572	10,615	24,101	-13,486
Travel	27,049	9,947	17,102	22,411	10,888	11,523
Other services	18,166	29,408	-11,242	16,384	29,395	-13,011
Government transactions n.i.e.[2]	474	758	-284	466	793	-327
Balance on goods and services	**415,040**	**348,919**	**66,121**	**447,847**	**365,383**	**82,462**
Income	**8,129**	**33,190**	**-25,061**	**13,134**	**35,671**	**-22,537**
Compensation of employees	1,653	2,832	-1,179	2,201	3,161	-960
Investment income[3]	6,476	30,358	-23,882	10,933	32,510	-21,577
Current transfers	**2,513**	**13,079**	**-10,566**	**1,929**	**11,229**	**-9,300**
Balance on current account	**425,682**	**395,188**	**30,494**	**462,910**	**412,283**	**50,625**
% of GNP			**9.0**			**13.6**
Capital account			**–**			**–**
Financial account			**-11,941**			**-12,146**
Direct investment			4,935			4,194
Abroad			*-7,238*			*-5,204*
In Malaysia			*12,173*			*9,398*
Portfolio investment			-6,506			4,168
Other investment			-10,370			-20,508
Official sector			*4,720*			*-11,201*
Private sector			*-15,090*			*-9,307*
Balance on capital and financial account			**-11,941**			**-12,146**
Errors and omissions			**-4,362**			**580**
of which:						
Foreign exchange revaluation gain (+) / loss (-)			6,627			11,927
Overall balance (surplus + / deficit -)			**14,191**			**39,059**
Bank Negara Malaysia international reserves, net[4]						
RM million			131,394			170,453
USD million equivalent			34,577			44,856
Reserves as months of retained imports			5.4			6.6

1 Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data
2 Include transactions of foreign military and diplomatic establishments
3 Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account
4 All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
e Estimate
f Forecast
n.i.e. Not included elsewhere
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2004			2005*e*			2006*f*		
+	-	Net	+	-	Net	+	-	Net
RM million								
481,240	**376,766**	**104,474**	**536,931**	**410,476**	**126,455**	**601,903**	**463,502**	**138,401**
480,740	*400,077*	*80,663*	*533,788*	*434,010*	*99,778*	*600,583*	*492,285*	*108,298*
63,717	**72,496**	**-8,780**	**72,202**	**82,452**	**-10,249**	**80,495**	**90,748**	**-10,253**
12,018	29,801	-17,783	16,169	31,876	-15,707	17,281	34,215	-16,934
31,152	11,754	19,398	32,354	14,237	18,117	34,842	16,293	18,549
20,120	29,795	-9,675	23,251	35,562	-12,311	27,945	39,278	-11,333
426	1,147	-721	427	777	-350	427	962	-535
544,958	**449,264**	**95,694**	**609,133**	**492,928**	**116,205**	**682,398**	**554,250**	**128,148**
16,023	**40,572**	**-24,549**	**20,469**	**41,937**	**-21,470**	**21,964**	**45,680**	**-23,716**
2,618	3,760	-1,142	4,229	4,712	-482	5,287	5,654	-367
13,405	36,812	-23,408	16,237	37,225	-20,988	16,677	40,026	-23,349
1,700	**16,333**	**-14,633**	**1,131**	**18,094**	**-16,963**	**1,342**	**16,365**	**-15,024**
562,681	**506,169**	**56,511**	**630,734**	**552,960**	**77,772**	**705,703**	**616,295**	**89,409**
		13.3			**16.4**			**17.2**
		–			**–**			
		15,083			**-41,952**			
		9,739			2,711			
		-7,833			*-12,931*			
		17,572			*15,642*			
		33,829			-11,881			
		-28,485			-32,782			
		-1,145			*-11,064*			
		-27,340			*-21,718*			
		15,083			**-41,952**			
		11,467			**-23,000**			
		7,997			-15,496			
		83,061			**12,820**			
		253,513			266,334			
		66,714			70,483			
		7.9			7.8			

Table A.7
Principal Markets for Manufactured Exports

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
ASEAN	**72,140**	**25.3**	**78,981**	**26.2**	**82,481**	**25.3**	**99,180**	**25.4**	**110,946**	**25.8**
Singapore	*52,483*	*18.4*	*55,917*	*18.5*	*57,367*	*17.6*	*65,800*	*16.9*	*73,872*	*17.2*
Thailand	*9,816*	*3.4*	*12,319*	*4.1*	*13,552*	*4.2*	*17,500*	*4.5*	*21,300*	*5.0*
Indonesia	*4,983*	*1.8*	*5,627*	*1.9*	*6,291*	*1.9*	*8,945*	*2.3*	*9,482*	*2.2*
Philippines	*4,113*	*1.4*	*4,249*	*1.4*	*4,346*	*1.3*	*5,993*	*1.5*	*5,287*	*1.2*
Brunei Darussalam	*745*	*0.3*	*869*	*0.3*	*925*	*0.3*	*942*	*0.2*	*1,005*	*0.2*
United States	65,830	23.1	72,116	23.9	74,918	23.0	85,484	21.9	100,045	23.3
EU[1]	**40,894**	**14.3**	**38,505**	**12.7**	**41,077**	**12.6**	**51,523**	**13.2**	**53,457**	**12.4**
Netherlands	*13,609*	*4.8*	*11,085*	*3.7*	*10,313*	*3.2*	*12,459*	*3.2*	*13,802*	*3.2*
Germany	*7,176*	*2.5*	*7,071*	*2.3*	*8,053*	*2.5*	*9,248*	*2.4*	*9,992*	*2.3*
United Kingdom	*8,355*	*2.9*	*7,836*	*2.6*	*8,131*	*2.5*	*9,678*	*2.5*	*8,652*	*2.0*
Others	*11,754*	*4.1*	*12,513*	*4.1*	*14,580*	*4.4*	*20,138*	*5.1*	*21,011*	*4.9*
Japan	32,413	11.4	28,271	9.4	28,683	8.8	33,341	8.5	31,743	7.4
Hong Kong China	14,327	5.0	19,147	6.3	24,717	7.6	27,482	7.0	30,127	7.0
The People's Republic of China	11,266	3.9	14,041	4.6	17,376	5.3	22,134	5.7	25,728	6.0
Middle East[2]	6,885	2.4	5,992	2.0	7,485	2.3	10,565	2.7	12,901	3.0
Australia	5,862	2.1	5,951	2.0	7,116	2.2	9,531	2.4	10,591	2.5
Chinese Taipei	9,767	3.4	11,216	3.7	11,610	3.6	11,766	3.0	10,247	2.4
Korea	6,692	2.3	7,797	2.6	7,123	2.2	9,178	2.4	9,308	2.2
Latin American Countries	3,436	1.2	3,031	1.0	2,939	0.9	4,154	1.1	4,641	1.1
Canada	1,977	0.7	1,992	0.7	2,132	0.7	2,754	0.7	2,555	0.6
Rest of the World	13,827	4.9	14,981	4.9	18,665	5.5	23,357	6.0	27,584	6.3
Total	**285,316**	**100.0**	**302,021**	**100.0**	**326,322**	**100.0**	**390,449**	**100.0**	**429,873**	**100.0**

[1] Includes the 10 new member states since 2004
[2] Beginning 2004, Cyprus has been excluded from Middle East as it has been included under the EU countries
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.8
Principal Export Markets for Electronics

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	34,793	24.9	41,969	26.7	45,285	27.1	51,912	27.5	64,555	31.0
Singapore	30,335	21.7	33,000	21.0	32,042	19.1	33,466	17.7	35,049	16.8
Hong Kong China	7,470	5.3	12,641	8.0	18,005	10.8	19,606	10.4	21,649	10.4
The People's Republic of China	6,012	4.3	7,838	5.0	9,002	5.4	10,802	5.7	13,183	6.3
Japan	13,502	9.7	11,226	7.1	10,465	6.3	11,213	5.9	10,273	4.9
Netherlands	9,199	6.6	7,746	4.9	7,056	4.2	8,079	4.3	9,846	4.7
Thailand	4,802	3.4	6,921	4.4	7,147	4.3	8,297	4.4	9,343	4.5
Chinese Taipei	6,520	4.7	7,670	4.9	8,056	4.8	6,873	3.6	5,399	2.6
Germany	3,453	2.5	3,804	2.4	4,535	2.7	5,176	2.7	5,153	2.5
Korea	3,862	2.8	4,555	2.9	3,455	2.1	4,436	2.4	4,179	2.0
Others	19,684	14.1	20,031	12.7	22,333	13.2	28,745	15.4	29,603	14.3
Total	**139,632**	**100.0**	**157,401**	**100.0**	**167,381**	**100.0**	**188,605**	**100.0**	**208,232**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.9
Principal Export Markets for Electrical Products

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	17,324	28.6	17,430	31.7	16,354	29.5	18,134	26.5	19,005	25.5
Singapore	8,120	13.4	7,443	13.6	8,340	15.0	10,552	15.4	13,091	17.6
Japan	9,207	15.2	7,584	13.8	6,758	12.2	7,602	11.1	7,542	10.1
The People's Republic of China	1,770	2.9	1,580	2.9	2,094	3.8	2,943	4.3	3,365	4.5
Hong Kong China	2,534	4.2	2,483	4.5	2,398	4.3	2,534	3.7	2,987	4.0
Thailand	1,566	2.6	1,558	2.8	1,643	3.0	2,271	3.3	2,544	3.4
Germany	1,865	3.1	1,410	2.6	1,430	2.6	1,820	2.7	2,188	2.9
Australia	1,128	1.9	1,137	2.1	1,115	2.0	1,420	2.1	1,827	2.5
Others	17,161	28.1	14,272	26.0	15,338	27.6	21,170	30.9	21,998	29.5
Total	**60,675**	**100.0**	**54,897**	**100.0**	**55,470**	**100.0**	**68,446**	**100.0**	**74,547**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.10
Principal Export Markets for Chemicals and Chemical Products

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
The People's Republic of China	1,533	10.3	2,294	13.3	2,930	13.8	4,019	14.5	4,001	13.5
Japan	1,566	10.5	1,750	10.2	2,105	9.9	2,983	10.7	3,005	10.1
Singapore	1,646	11.1	1,736	10.1	2,158	10.2	2,581	9.3	2,834	9.5
Thailand	1,164	7.8	1,387	8.0	1,771	8.4	2,339	8.4	2,715	9.1
Indonesia	999	6.7	1,302	7.6	1,531	7.2	2,232	8.0	2,459	8.3
Hong Kong China	1,176	7.9	1,239	7.2	1,549	7.3	1,847	6.7	2,102	7.1
India	376	2.5	498	2.9	858	4.0	1,089	3.9	1,435	4.8
Korea	511	3.4	546	3.2	766	3.6	1,174	4.2	1,305	4.4
Chinese Taipei	620	4.2	882	5.1	960	4.5	1,337	4.8	1,143	3.8
United States	1,218	8.2	1,042	6.1	1,059	5.0	982	3.5	1,103	3.7
Others	4,070	27.4	4,552	26.3	5,513	26.1	7,184	26.0	7,616	25.7
Total	**14,879**	**100.0**	**17,228**	**100.0**	**21,200**	**100.0**	**27,767**	**100.0**	**29,718**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11
Principal Export Markets for Manufactures of Metal

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	2,020	23.2	2,134	24.3	2,255	20.1	3,057	18.9	3,120	18.2
Thailand	501	5.8	504	5.7	550	4.9	1,340	8.3	2,173	12.7
The People's Republic of China	476	5.5	665	7.6	1,015	9.0	918	5.7	1,213	7.1
United States	644	7.4	486	5.5	706	6.3	1,269	7.9	1,209	7.0
Japan	736	8.5	594	6.8	833	7.4	1,070	6.6	1,045	6.1
Australia	295	3.4	249	2.8	366	3.3	929	5.8	945	5.5
Indonesia	360	4.1	398	4.5	442	3.9	590	3.7	845	4.9
Hong Kong	240	2.8	368	4.2	400	3.6	505	3.1	646	3.8
Others	3,420	39.3	3,398	38.6	4,675	41.5	6,462	40.0	5,961	34.7
Total	**8,692**	**100.0**	**8,796**	**100.0**	**11,242**	**100.0**	**16,140**	**100.0**	**17,157**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.12
Principal Export Markets for Optical and Scientific Equipment

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	2,132	27.3	1,874	23.0	1,983	21.7	2,428	21.0	2,755	22.4
Japan	1,163	14.9	1,186	14.5	1,380	15.1	2,106	18.2	1,832	14.9
Singapore	1,110	14.2	1,573	19.3	1,752	19.1	2,203	19.0	1,673	13.6
The People's Republic of China	232	3.0	199	2.4	451	4.9	567	4.9	982	8.0
Netherlands	415	5.3	511	6.3	642	7.0	877	7.6	852	6.9
Thailand	173	2.2	172	2.1	243	2.7	295	2.5	814	6.6
Germany	437	5.6	408	5.0	404	4.4	397	3.4	508	4.1
Others	2,140	27.5	2,229	27.4	2,301	25.1	2,695	23.4	2,902	23.5
Total	**7,802**	**100.0**	**8,152**	**100.0**	**9,156**	**100.0**	**11,568**	**100.0**	**12,318**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13
Principal Export Markets for Petroleum Products

Country	2001		2002		2003		2004		2005*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	2,906	34.6	3,043	39.9	3,605	38.2	5,392	40.2	9,671	57.8
Japan	991	11.8	1,001	13.1	1,836	19.5	1,905	14.2	1,729	10.3
Australia	276	3.3	188	2.5	407	4.3	459	3.4	635	3.8
The People's Republic of China	201	2.4	188	2.5	275	2.9	977	7.3	563	3.4
Hong Kong China	366	4.4	257	3.4	270	2.9	663	4.9	521	3.1
Indonesia	459	5.5	260	3.4	239	2.5	351	2.6	484	2.9
United States	921	11.0	412	5.4	525	5.6	642	4.8	382	2.3
Others	2,288	27.0	2,271	29.8	2,278	24.1	3,032	22.6	2,744	16.4
Total	**8,408**	**100.0**	**7,620**	**100.0**	**9,435**	**100.0**	**13,421**	**100.0**	**16,729**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.14
Export Prices of Major Commodities

	2001	2002	2003	2004	2005*p*	2002	2003	2004	2005*p*
						Annual change (%)			
Palm oil (RM/tonne)	944	1,367	1,617	1,706	1,456	44.8	18.3	5.5	-14.6
Rubber (sen/kg)	230	269	379	470	513	17.0	41.0	24.3	9.0
Saw logs (RM/cu. metre)	315	359	365	398	428	13.9	1.8	8.9	7.7
Sawn timber (RM/cu. metre)	943	1,102	1,134	1,015	1,099	16.9	2.9	-10.4	8.3
Crude oil (USD/barrel)	26	25	30	41	56	-2.9	22.0	34.8	36.5
Liquefied natural gas (RM/tonne)	721	659	772	824	947	-8.6	17.1	6.8	15.0

p Preliminary

Source: Department of Statistics, Malaysia

Table A.15
Principal Export Markets for Palm Oil

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 tonnes)					% share				
The People's Republic of China	1,364	1,940	2,502	2,829	2,885	13.0	17.9	20.0	24.0	22.1
European Union[1]	1,610	1,478	1,648	1,862	2,135	15.4	13.6	13.2	15.8	16.3
Netherlands	*1,028*	*847*	*975*	*1,135*	*1,364*	*9.8*	*7.8*	*7.8*	*9.6*	*10.4*
Germany	*116*	*225*	*185*	*149*	*180*	*1.1*	*2.1*	*1.5*	*1.3*	*1.4*
Italy	*155*	*127*	*98*	*119*	*155*	*1.5*	*1.2*	*0.8*	*1.0*	*1.2*
Sweden	*100*	*102*	*106*	*114*	*103*	*1.0*	*0.9*	*0.8*	*1.0*	*0.8*
Others	*211*	*177*	*284*	*345*	*333*	*2.0*	*1.6*	*2.3*	*2.9*	*2.5*
Middle East	1,236	1,449	1,749	1,647	1,563	11.8	13.3	14.0	14.0	12.0
Pakistan	1,143	1,059	1,105	838	928	10.9	9.8	8.9	7.1	7.1
India	2,066	1,670	1,650	925	664	19.7	15.4	13.2	7.8	5.1
United States	208	270	231	298	534	2.0	2.5	1.9	2.5	4.1
Bangladesh	178	230	272	353	485	1.7	2.1	2.2	3.0	3.7
Japan	379	434	430	474	438	3.6	4.0	3.4	4.0	3.4
Chinese Taipei	82	80	103	141	246	0.8	0.7	0.8	1.2	1.9
Korea	241	218	211	228	223	2.3	2.0	1.7	1.9	1.7
Australia	101	120	97	96	105	1.0	1.1	0.8	0.8	0.8
Others	1,858	1,909	2,489	2,097	2,867	17.8	17.6	19.9	17.9	21.8
Total	**10,466**	**10,857**	**12,487**	**11,788**	**13,073**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states in 2004
p Preliminary

Source: Department of Statistics, Malaysia

Table A.16
Principal Export Markets for Rubber

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 tonnes)					% share				
The People's Republic of China	85	129	207	289	386	10.4	13.9	21.9	26.1	34.2
European Union[1]	318	309	306	353	320	38.7	33.3	32.3	32.0	28.3
Germany	*119*	*119*	*129*	*147*	*132*	*14.4*	*12.8*	*13.6*	*13.3*	*11.7*
France	*31*	*41*	*40*	*53*	*46*	*3.8*	*4.4*	*4.2*	*4.8*	*4.1*
Netherlands	*12*	*15*	*12*	*20*	*28*	*1.4*	*1.7*	*1.3*	*1.8*	*2.5*
Italy	*30*	*28*	*29*	*29*	*24*	*3.7*	*3.1*	*3.0*	*2.6*	*2.1*
United Kingdom	*25*	*24*	*22*	*24*	*21*	*3.0*	*2.5*	*2.4*	*2.2*	*1.9*
Spain	*14*	*17*	*17*	*24*	*13*	*1.7*	*1.9*	*1.8*	*2.2*	*1.2*
Others	*87*	*65*	*57*	*56*	*56*	*10.7*	*6.9*	*6.0*	*5.1*	*4.8*
Middle East	95	81	84	90	75	11.5	8.7	8.9	8.1	6.6
Iran	*60*	*45*	*48*	*55*	*40*	*7.3*	*4.8*	*5.1*	*4.9*	*3.6*
Turkey	*24*	*24*	*25*	*24*	*24*	*2.9*	*2.6*	*2.6*	*2.2*	*2.2*
Others	*11*	*12*	*11*	*11*	*11*	*1.3*	*1.3*	*1.2*	*1.0*	*0.8*
Korea	58	59	69	64	74	7.0	6.4	7.3	5.8	6.6
United States	66	81	76	74	67	8.0	8.7	8.0	6.7	6.0
Brazil	25	41	29	37	31	3.0	4.4	3.1	3.3	2.7
Canada	16	28	14	19	17	1.9	3.0	1.5	1.7	1.5
Singapore	5	9	9	22	10	0.6	1.0	0.9	2.0	0.9
Others	154	191	152	157	148	18.9	20.6	16.1	14.3	13.2
Total	**822**	**928**	**946**	**1,105**	**1,128**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states in 2004
p Preliminary

Source: Department of Statistics, Malaysia

Table A.17
Principal Export Markets for Saw Logs

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 cubic metres)					% share				
The People's Republic of China	1,071	1,106	1,336	1,146	1,630	22.2	21.7	24.2	22.0	28.3
India	985	998	1,369	1,178	1,448	20.4	19.5	24.7	22.6	25.1
Japan	1,375	1,641	1,356	1,278	1,098	28.4	32.2	24.5	24.6	19.1
Chinese Taipei	669	651	694	736	745	13.8	12.7	12.5	14.1	12.9
Korea	175	159	140	126	117	3.6	3.1	2.5	2.4	2.0
Thailand	29	39	60	86	76	0.6	0.8	1.1	1.6	1.3
Hong Kong China	417	188	103	47	23	8.6	3.7	1.9	0.9	0.4
Others	113	322	474	610	622	2.4	6.3	8.6	11.8	10.9
Total	**4,834**	**5,104**	**5,532**	**5,207**	**5,759**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.18
Principal Export Markets for Sawn Timber

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 cubic metres)					% share				
Thailand	534	589	660	781	851	22.2	21.4	23.7	24.7	23.1
The People's Republic of China	151	159	193	209	614	6.3	5.8	6.9	6.6	16.7
Chinese Taipei	170	187	209	227	225	7.0	6.8	7.5	7.2	6.1
Netherlands	197	186	204	200	187	8.2	6.8	7.3	6.3	5.1
Japan	187	194	167	172	170	7.8	7.1	6.0	5.4	4.6
Singapore	185	155	165	246	160	7.7	5.6	5.9	7.8	4.3
United Arab Emirates	66	64	55	79	88	2.7	2.3	2.0	2.5	2.4
Korea	120	98	85	89	70	5.0	3.6	3.1	2.8	1.9
Republic of Yemen	83	68	78	106	68	3.4	2.5	2.8	3.4	1.8
Hong Kong China	135	149	107	81	67	5.6	5.4	3.8	2.6	1.8
Australia	20	40	40	44	63	0.8	1.5	1.4	1.4	1.7
Belgium	52	64	72	69	58	2.2	2.3	2.6	2.2	1.6
United Kingdom	52	53	51	47	47	2.2	1.9	1.8	1.5	1.3
Italy	25	37	62	40	33	1.0	1.3	2.2	1.3	0.9
Others	434	710	641	776	984	17.9	25.7	23.0	24.3	26.7
Total	**2,411**	**2,753**	**2,789**	**3,166**	**3,685**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.19
Principal Export Markets for Crude Oil

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 tonnes)					% share				
Australia	1,852	1,687	2,248	4,345	3,817	12.3	10.4	12.5	23.3	20.9
India	1,690	2,462	3,396	3,081	3,750	11.2	15.2	19.0	16.5	20.6
Thailand	2,797	2,358	3,097	3,024	3,418	18.6	14.6	17.3	16.2	18.8
Singapore	215	203	468	888	1,638	1.4	1.3	2.6	4.8	9.0
Indonesia	753	956	1,290	1,548	1,431	5.0	5.9	7.2	8.3	7.9
Korea	2,190	1,838	1,271	1,316	1,389	14.5	11.4	7.1	7.0	7.6
Philippines	362	511	610	676	743	2.4	3.2	3.4	3.6	4.1
Japan	1,457	2,131	1,440	1,051	734	9.7	13.2	8.0	5.6	4.0
Sri Lanka	400	485	425	420	358	2.7	3.0	2.4	2.2	2.0
United States	704	412	937	682	314	4.7	2.5	5.2	3.6	1.7
New Zealand	487	604	412	205	299	3.2	3.7	2.3	1.1	1.6
The People's Republic of China	838	1,723	2,013	1,284	240	5.6	10.6	11.2	6.9	1.3
Others	1,332	822	306	166	92	8.7	5.0	1.8	0.9	0.5
Total	**15,077**	**16,192**	**17,913**	**18,686**	**18,223**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.20
Principal Export Markets for LNG

Country	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	('000 tonnes)					% share				
Japan	11,308	10,782	12,491	12,724	13,884	73.3	71.8	72.1	61.4	63.3
Korea	2,256	2,303	2,658	4,643	4,820	14.6	15.4	15.4	22.4	22.0
Chinese Taipei	1,860	1,857	2,108	2,623	3,054	12.1	12.4	12.2	12.7	13.9
United States	–	–	54	299	–	–	–	0.3	1.4	–
Others	–	65	–	440	190	–	0.4	–	2.1	0.8
Total	**15,423**	**15,007**	**17,311**	**20,729**	**21,948**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.21
External Debt and Debt Servicing

	2001	2002	2003	2004	2005*p*
	RM million				
Medium- and long-term debt:					
Gross borrowing	**31,550**	**23,853**	**22,226**	**27,064**	**24,897**
Federal Government	*7,030*	*10,465*	*3,190*	*1,136*	*651*
NFPEs	*11,311*	*3,655*	*5,140*	*11,545*	*6,326*
Private sector	*13,209*	*9,732*	*13,896*	*14,383*	*17,920*
Repayment and prepayment	**22,323**	**23,104**	**29,309**	**25,172**	**31,753**
Federal Government	*735*	*2,445*	*6,854*	*1,015*	*4,154*
NFPEs	*10,447*	*6,942*	*12,437*	*12,645*	*13,911*
Private sector	*11,141*	*13,717*	*10,019*	*11,512*	*13,688*
Net borrowing	**9,227**	**749**	**-7,083**	**1,892**	**-6,856**
Federal Government	*6,295*	*8,020*	*-3,664*	*120*	*-3,503*
NFPEs	*865*	*-3,287*	*-7,297*	*-1,100*	*-7,585*
Private sector	*2,068*	*-3,985*	*3,877*	*2,872*	*4,232*
Outstanding debt	**149,346**	**153,225**	**153,236**	**156,849**	**149,682**
Federal Government	*24,328*	*36,283*	*37,284*	*34,654*	*30,000*
NFPEs	*67,415*	*64,330*	*59,535*	*62,244*	*56,150*
Private sector	*57,604*	*52,612*	*56,417*	*59,951*	*63,532*
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	*78.0*	*77.3*	*76.6*	*76.8*	*80.1*
Japanese yen	*14.5*	*14.3*	*12.9*	*12.8*	*11.9*
Others	*7.5*	*8.4*	*10.5*	*10.4*	*8.0*
Short-term debt:					
Outstanding debt	**24,072**	**32,435**	**33,500**	**43,737**	**46,183**
Banking sector[1]	*11,926*	*21,894*	*23,321*	*35,333*	*38,871*
Non-bank private sector	*12,147*	*10,541*	*10,179*	*8,404*	*7,312*
Total external debt:	**173,419**	**185,660**	**186,736**	**200,586**	**195,865**
Total external debt (USD million)	**45,636**	**48,858**	**49,141**	**52,786**	**51,310**
% GNP	*56.2*	*55.1*	*50.1*	*47.2*	*41.4*
Annual change (%)	*7.7*	*7.1*	*0.6*	*7.4*	*-2.4*
Total servicing (including short-term interest payment)	**26,954**	**27,832**	**28,627**	**24,866**	**28,776**
of which:					
Medium- and long-term debt					
Repayment (excluding prepayment)	**19,612**	**20,780**	**21,854**	**18,675**	**22,269**
Federal Government	*735*	*2,445*	*3,861*	*1,015*	*4,154*
NFPEs	*7,886*	*6,942*	*10,017*	*10,713*	*10,166*
Private sector	*10,991*	*11,393*	*7,976*	*6,947*	*7,950*
Interest payment	**6,346**	**6,297**	**6,150**	**5,442**	**5,445**
Federal Government	*1,150*	*1,692*	*1,883*	*1,758*	*1,729*
NFPEs	*3,574*	*3,430*	*3,287*	*2,684*	*2,683*
Private sector	*1,621*	*1,174*	*979*	*1,000*	*1,032*
Debt service ratio (% of exports of goods and services)					
Total debt	**6.9**	**6.7**	**6.4**	**4.6**	**4.7**
Medium- and long-term debt	*6.7*	*6.5*	*6.3*	*4.4*	*4.5*
Federal Government	*0.5*	*1.0*	*1.3*	*0.5*	*1.0*
NFPEs	*2.9*	*2.5*	*3.0*	*2.5*	*2.1*
Private sector	*3.2*	*3.0*	*2.0*	*1.5*	*1.5*

[1] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance and Bank Negara Malaysia

Table A.22
Consumer Price Index (2000=100) Sub-groups of Food

	Weights (%)	2002	2003	2004	2005
		Annual change (%)			
Food	33.8	0.7	1.3	2.2	3.6
of which:					
Food at Home	24.1	0.2	1.6	2.3	3.9
Rice, bread and other cereals	5.5	0.1	0.4	0.7	1.5
Meat	3.4	-1.3	2.4	4.3	8.6
Fish	4.9	1.0	1.3	3.3	4.5
Milk and eggs	2.1	1.0	2.2	2.6	4.6
Oils and fats	0.8	1.8	4.4	2.3	0.0
Fruits and vegetables	5.0	0.2	2.5	1.5	4.5
Sugar	0.5	-1.9	0.2	0.2	0.3
Coffee and tea	0.8	0.4	1.6	2.1	1.5
Other foods	1.1	0.3	0.5	1.3	0.8
Food away from home	9.7	2.0	0.7	2.1	3.1

Source: Department of Statistics, Malaysia

Table A.23
Producer Price Index (1989=100)

	Weights (%)	2001	2002	2003	2004	2005
		Annual change (%)				
Domestic Economy	100.0	-5.0	4.4	5.7	8.9	6.8
of which:						
Food and live animals chiefly for food	14.9	0.4	0.4	-0.2	3.6	3.8
Beverages and tobacco	2.1	1.8	3.9	0.9	1.6	1.9
Crude materials, inedible except fuels	18.0	-5.9	7.0	7.5	6.6	3.0
Mineral fuels, lubricants and related materials	18.8	-10.6	0.0	11.4	22.3	26.0
Animal and vegetable oils and fats	8.5	-17.6	46.5	15.7	13.2	-14.8
Chemicals and related products	4.4	-1.1	-0.7	1.4	4.3	2.2
Manufactured goods	10.8	-0.5	-0.2	1.8	2.5	2.5
Machinery and transport equipment	18.4	-0.1	-0.3	0.1	0.1	0.6
Miscellaneous manufactured articles	3.6	-0.6	-0.3	0.9	0.6	1.8
Other commodities and transactions	0.6	10.3	2.6	0.5	0.2	0.0
Local Production	79.3	-6.1	5.7	6.8	10.3	7.9
Import	20.7	-0.3	-0.7	0.8	2.0	1.5

Source: Department of Statistics, Malaysia

Table A.24
Labour Market: Selected Indicators

	2001	2002	2003	2004	2005*e*
	(number of positions/persons)				
Vacancies[1]					
By industry:					
Agriculture, hunting, forestry and fishery	36,234	43,805	29,048	1,373	40,438
Mining and quarrying	217	321	121	41	150
Manufacturing	60,471	75,655	34,977	17,769	112,542
Construction	13,834	19,001	13,818	3,505	48,524
Services	20,703	24,005	18,954	18,624	63,441
Electricity, gas and water supply	*171*	*326*	*499*	*198*	*859*
Wholesale and retail trade, hotels and restaurants	*8,022*	*9,472*	*7,359*	*5,221*	*23,921*
Transport, storage and communication	*2,749*	*2,378*	*1,459*	*1,046*	*3,892*
Finance, insurance, real estate and business services	*3,938*	*4,874*	*4,079*	*6,162*	*13,874*
Public administration, defence and compulsory social security	*5,823*	*6,955*	*5,558*	*1,224*	*2,497*
Community, social and personal service activities				*4,773*	*18,398*
Others not elsewhere classified	–	–	–	8,663	39,405
Total vacancies	**131,459**	**162,787**	**96,918**	**49,975**	**304,500**
By occupational groups[2]**:**					
Legislators, senior officials and managers				1,661	1,789
Professionals	5,020	8,575	5,071	5,187	17,285
Technicians and associate professionals				6,848	11,725
Clerical workers	8,914	9,660	7,540	11,799	15,885
Service workers, shop and market sales workers	6,549	7,213	5,747	4,627	26,038
Skilled agricultural and fishery workers	23,084	34,424	18,196	624	14,935
Craft and related trades workers				1,134	18,793
Plant and machine operators and assemblers	87,892	102,915	60,364	9,332	52,740
Elementary occupations				8,763	145,310
Total vacancies	**131,459**	**162,787**	**96,918**	**49,975**	**304,500**
Job placements[3] **by industry:**					
Agriculture, hunting, forestry and fishery	235	246	142	419	131
Mining and quarrying	120	93	36	8	7
Manufacturing	7,461	8,259	6,646	2,812	6,620
Construction	1,560	1,664	1,451	234	590
Services	8,571	9,015	7,992	1,872	5,290
Electricity, gas and water supply	*99*	*99*	*113*	*28*	*51*
Wholesale and retail trade, hotels and restaurants	*3,356*	*3,187*	*3,141*	*722*	*1,809*
Transport, storage and communication	*825*	*693*	*545*	*142*	*379*
Finance, insurance, real estate and business services	*2,017*	*2,086*	*1,911*	*495*	*903*
Public administration, defence and compulsory social security	*2,274*	*2,950*	*2,282*	*141*	*550*
Community, social and personal service activities				*344*	*1,598*
Others not elsewhere classified	–	–	–	837	4,821
Total placements	**17,947**	**19,277**	**16,267**	**6,182**	**17,459**
Unemployment rate (% of labour force)	**3.6**	**3.5**	**3.6**	**3.5**	**3.5**

[1] Refers to new vacancies reported by employers through the Electronic Labour Exchange
[2] Since 2004, classification of vacancies by occupational groups is based on the Malaysia Standard Classification of Occupation (MASCO) 1998. As such, vacancies data prior to 2004 have been adjusted to best match the new classification for ease of comparison
[3] Refers to the placements reported by employers through the Electronic Labour Exchange
e Estimates

Source: Ministry of Human Resources and Economic Planning Unit

Table A.25
New Supply of Purpose-Built Office Space and Retail Space in Malaysia

Year	Office Space		Retail Space	
	Square metres	Occupancy rate[1] (%)	Square metres	Occupancy rate[1] (%)
1996	378,186	93.9	331,747	69.2
1997	1,378,989	92.7	1,658,174	77.7
1998	1,606,986	80.3	499,085	67.4
1999	768,633	82.1	97,960	75.7
2000	763,926	78.6	209,870	73.9
2001	456,352	77.7	115,128	75.4
2002	374,750	78.3	210,657	78.2
2003	169,548	80.5	507,637	78.0
2004	248,328	82.1	319,441	79.6
2005*p* (Jan-Sept)	605,032	83.8	209,277	80.0

[1] Refers to end period
p Preliminary

Source: NAPIC, Valuation and Property Services Department

Table A.26
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley[1]

Year	Prime Office Space		Prime Retail Space	
	RM/sq.m	Annual change (%)	RM/sq.m	Annual change (%)
2000	48	14.3	194	10.9
2001	48	0.9	215	11.0
2002	45	-6.7	226	5.0
2003	45	0.0	226	0.0
2004	46	2.2	242	7.1
2005	48	4.3	254	5.0

[1] Refers to Kuala Lumpur and Selangor

Source: CH Williams Talhar & Wong Sdn. Bhd.

Table A.27
Broad Money (M3)

	Annual change					As at end-2005
	2001	2002	2003	2004	2005	
	RM million					
Broad money (M3)[1]	13,022	31,607	48,524	67,990	49,688	667,327
Currency[2]	-92	1,751	2,233	2,594	1,629	30,166
Demand deposits	2,882	6,718	11,210	10,086	8,650	96,116
Broad quasi-money	10,232	23,138	35,082	55,311	39,409	541,044
Fixed deposits	*-358*	*12,648*	*17,065*	*24,668*	*4,949*	*356,925*
Savings deposits	*4,454*	*5,590*	*5,602*	*6,129*	*1,947*	*70,534*
NIDs	*600*	*3,575*	*1,965*	*8,179*	*12,785*	*31,941*
Repos	*4,186*	*2,507*	*8,016*	*13,337*	*17,260*	*63,773*
Foreign currency deposits	*1,350*	*-1,182*	*2,434*	*2,998*	*2,467*	*17,871*
Factors Affecting M3						
Net claims on Government	-1,542	11,538	12,949	-15,921	-5,474	-12,830
Claims on Government	*4,165*	*-867*	*3,960*	*4,536*	*-2,250*	*35,193*
Less: Government deposits	*5,707*	*-12,405*	*-8,989*	*20,457*	*3,225*	*48,023*
Claims on private sector	20,335	27,737	31,287	30,602	45,422	642,369
Loans	*17,081*	*19,288*	*21,468*	*39,753*	*45,004*	*560,106*
Securities	*3,255*	*8,449*	*9,819*	*-9,151*	*418*	*82,263*
Net external operations	6,741	1,237	20,748	81,970	16,486	236,008
Bank Negara Malaysia[3]	*7,722*	*7,564*	*27,131*	*75,042*	*28,317*	*241,485*
Banking system	*-980*	*-6,327*	*-6,383*	*6,898*	*-11,830*	*-5,477*
Other influences	-12,513	-8,905	-16,460	-28,661	-6,747	-198,221

[1] Excludes interplacements among banking institutions
[2] Excludes holdings by banking system
[3] Includes exchange rate revaluation loss/gain

Table A.28
Money Supply: Annual Change and Growth Rates

	M3[5]													
			M2[3]											
					M1[1]									
	Total		Total		Total		Currency		Demand deposits		Narrow quasi-money[2]		Deposits with other banking institutions[4]	
	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%
2001	13,022	2.9	7,810	2.2	2,512	3.2	-115	-0.5	2,627	4.7	5,298	1.9	5,213	5.1
2002	31,607	6.7	21,030	5.8	8,344	10.3	1,749	7.9	6,595	11.3	12,686	4.5	10,576	9.9
2003	48,524	9.7	42,519	11.1	13,032	14.6	2,205	9.2	10,827	16.6	29,487	10.0	6,005	5.1
2004	67,990	12.4	108,102	25.4	12,164	11.9	2,516	9.7	9,649	12.7	95,937	29.6	-40,112	-32.5
2005	49,688	8.0	82,015	15.4	9,755	8.5	1,561	5.5	8,194	9.6	72,261	17.2	-32,328	-38.7

1 Currency in circulation and demand deposits of the private sector
2 Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks
3 M1 plus narrow quasi-money
4 Comprising fixed deposits and repos of the private sector placed with finance companies, merchant banks and discount houses. Also includes saving deposits with finance companies, negotiable instruments of deposits (NIDs) with finance companies and merchant banks, foreign currency deposits placed with merchant banks and call deposits with discount houses. Excludes interplacement among the banking institutions
5 M2 plus deposits placed with other banking institutions

Table A.29
Interest Rates (%)

	Average rates at end-year					Average rates at end-month in 2005											
	2000	2001	2002	2003	2004	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
3-month interbank	3.25	3.27	3.13	2.87	2.80	2.79	2.79	2.82	2.80	2.80	2.84	2.86	2.89	2.90	2.92	2.95	3.20
Commercial banks																	
Fixed deposit:																	
3-month	3.48	3.21	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.02
12-month	4.24	4.00	4.00	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	2.72	2.28	2.12	1.86	1.58	1.60	1.55	1.51	1.50	1.50	1.45	1.44	1.46	1.42	1.40	1.41	1.41
Base lending rate (BLR)	6.78	6.39	6.39	6.00	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98	6.20
Finance companies																	
Fixed deposit:																	
3-month	3.52	3.22	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
12-month	4.27	4.01	4.00	3.68	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	3.44	2.94	2.65	2.18	1.98	1.94	1.71	1.60	1.61	1.60	1.61	1.61	1.61	1.60	1.52	1.52	1.53
Base lending rate (BLR)	7.95	7.45	7.45	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	7.03
Treasury bills (91 days)	2.98	2.73	2.82	2.77	1.96	2.26	2.22	2.57	2.56	2.07	2.48	2.30	2.27	2.69	2.80	2.79	2.96
Government securities (1 year)	3.36	2.93	2.94	2.93	2.24	2.46	2.50	2.76	2.58	2.64	2.71	2.63	2.75	2.99	3.10	3.24	3.30
Government securities (5 years)	4.80	3.18	3.15	4.28	3.64	3.62	3.64	3.77	3.60	3.57	3.40	3.38	3.34	3.35	3.64	3.79	3.73

Table A.30
Consolidated Public Sector Finance

	2002	2003	2004	2005*e*	2006*f*
	RM billion				
Revenue[1]	96.8	107.1	116.3	122.6	134.3
% growth	*5.6*	*10.6*	*8.7*	*5.4*	*9.6*
Operating expenditure	75.4	84.2	101.6	108.4	112.5
% growth	*4.4*	*11.5*	*20.8*	*6.6*	*3.7*
Current surplus of NFPEs[2]	31.4	41.2	60.6	63.8	63.8
Current balance	**52.7**	**64.1**	**75.3**	**78.0**	**85.6**
% of GDP	***18.5***	***16.2***	***16.7***	***15.8***	***15.8***
Net development expenditure[3]	69.1	83.3	56.7	71.0	71.0
% growth	*15.7*	*20.5*	*-31.9*	*25.1*	*…*
General government[4]	36.8	43.2	32.1	31.0	39.4
NFPEs	32.3	40.2	24.6	40.0	31.5
Overall balance	**-16.4**	**-19.2**	**18.5**	**7.0**	**14.7**
% of GDP	***-4.5***	***-4.9***	***4.1***	***1.4***	***2.7***

[1] Excludes transfers within general government
[2] Refers to 30 NFPEs in 2004 and 2005; 34 in 2003
[3] Adjusted for transfers and net lendings within public sector
[4] Comprises Federal Government, state governments, statutory bodies and local governments
e Estimate
f Forecast
… Negligible
Note: Numbers may not add up due to rounding

Source: Ministry of Finance and non-financial public enterprises (NFPEs)

Key Economic and Financial Statistics

Table A.31
Major Industrial Countries: Key Economic Indicators

	2001	2002	2003	2004	2005*e*	2006*f*
	Annual change (%)					
REAL GDP						
Major Industrial Countries	**1.2**	**1.5**	**1.9**	**3.3**	**2.6**	**2.6**
United States	0.8	1.6	2.7	4.2	3.5	3.3
Japan	0.4	0.1	1.8	2.3	2.8	2.5
Euro Area	1.7	0.9	0.7	2.1	1.3	1.7
Germany	*1.2*	*0.1*	*-0.2*	*1.6*	*0.9*	*1.2*
United Kingdom	2.2	2.0	2.5	3.2	1.8	2.0
INFLATION						
Major Industrial Countries	**2.1**	**1.5**	**1.8**	**2.0**	**2.2**	**2.0**
United States	2.8	1.6	2.3	2.7	3.4	2.8
Japan	-0.7	-0.9	-0.3	0.0	-0.3	0.0
Euro Area	2.3	2.3	2.1	2.1	2.2	1.8
Germany	*1.9*	*1.4*	*1.0*	*1.8*	*2.1*	*1.7*
United Kingdom[1]	1.2	1.3	1.4	1.3	2.0	1.9
	% of labour force					
UNEMPLOYMENT						
Major Industrial Countries						
United States	4.7	5.8	6.0	5.5	5.1	5.2
Japan	5.0	5.4	5.2	4.7	4.4	4.1
Euro Area	7.9	8.3	8.7	8.9	8.6	8.4
Germany	*7.9*	*8.7*	*9.6*	*9.2*	*9.1*	*9.3*
United Kingdom	5.1	5.2	5.0	4.8	4.7	4.8
	% of GDP					
CURRENT ACCOUNT BALANCE						
Major Industrial Countries						
United States	-3.8	-4.5	-4.7	-5.7	-6.4	-6.7
Japan	2.2	2.9	3.2	3.8	3.6	3.0
Euro Area	0.1	0.7	0.3	0.5	0.3	0.2
Germany	*0.2*	*2.2*	*2.1*	*3.8*	*4.3*	*4.4*
United Kingdom	-2.2	-1.6	-1.5	-2.0	-1.9	-1.8
FISCAL BALANCE						
Major Industrial Countries						
United States	0.5	-2.4	-3.4	-3.1	-2.6	-2.9
Japan	-6.3	-6.9	-7.1	-7.0	-6.9	-6.7
Germany	-1.3	-1.7	-1.8	-2.3	-2.1	-2.1
United Kingdom	0.9	-1.6	-3.5	-3.0	-3.2	-3.5

[1] Based on Eurostat's harmonised index of consumer prices
e Estimate
f Forecast

Source: *IMF World Economic Outlook, September 2005; OECD Economic Outlook No.78*

Table A.32
East Asia: Key Economic Indicators

	2001	2002	2003	2004	2005*e*	2006*f*
REAL GDP	Annual change (%)					
Regional Countries	**4.7**	**6.9**	**6.8**	**7.9**	**7.2**	**7.0 ~ 7.2**
The People's Republic of China	8.3	9.1	10.0	10.1	9.9	9.4
Korea	3.8	7.0	3.1	4.6	4.0	5.0
Chinese Taipei	-2.2	4.3	3.4	6.1	4.1	4.3
Singapore	-2.3	4.0	2.9	8.7	6.4	4.0 ~ 6.0
Hong Kong China	0.6	1.8	3.2	8.6	7.3	4.0 ~ 5.0
Malaysia	0.3	4.4	5.4	7.1	5.3	6.0
Thailand	2.2	5.3	7.0	6.2	4.5	4.8 ~ 5.8
Indonesia	3.8	4.4	4.9	5.1	5.6	5.0 ~ 5.7
Philippines	1.8	4.4	4.5	6.0	5.1	5.7 ~ 6.3
CONSUMER PRICES	Annual change (%)					
Regional Countries	**2.4**	**1.3**	**1.8**	**3.4**	**3.1**	**3.3 ~ 3.6**
The People's Republic of China	0.7	-0.8	1.2	3.9	1.8	3.0
Korea	4.1	2.7	3.6	3.6	2.7	3.0
Chinese Taipei	0.0	-0.2	-0.3	1.6	2.3	1.7
Singapore	1.0	-0.4	0.5	1.7	0.5	0.5 ~ 1.5
Hong Kong China[1]	-1.6	-3.0	-2.6	-0.4	1.1	2.3
Malaysia	1.4	1.8	1.2	1.4	3.0	3.5 ~ 4.0
Thailand	1.6	0.7	1.8	2.7	4.6	3.5 ~ 5.0
Indonesia	11.5	11.9	6.8	6.1	10.4	7.0 ~ 9.0
Philippines	6.8	3.0	3.5	6.0	7.6	8.0 ~ 8.5
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	1.5	2.8	3.2	4.2	6.1	5.6
Korea	1.7	1.0	2.0	4.1	2.0	1.5
Chinese Taipei	6.5	9.1	10.2	6.1	4.3	4.6
Singapore	16.8	17.8	29.2	26.1	25.7	22.7
Hong Kong China	6.1	7.9	10.3	9.8	10.3	10.2
Malaysia	8.3	8.4	12.8	12.6	15.7	16.5
Thailand	5.4	5.5	5.6	4.5	-2.5	-2.5
Indonesia	4.2	3.9	3.4	1.2	-0.4	0.7
Philippines	1.9	5.8	1.8	2.7	2.1	1.9
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-3.1	-3.3	-2.8	-1.7	-1.7	-1.5
Korea	1.6	3.9	1.8	0.7	0.1	0.1
Chinese Taipei	-6.6	-3.0	-2.5	-2.0	-1.1	n.a.
Singapore	-1.8	0.1	-1.2	-0.1	0.2	-1.4
Hong Kong China	-5.0	-4.9	-3.3	1.7	0.3	0.4
Malaysia	-5.5	-5.6	-5.3	-4.3	-3.8	-3.5
Thailand	-2.4	-1.4	0.4	-1.5	-2.8	n.a.
Indonesia	-2.3	-1.7	-1.9	-1.4	-0.5	-0.7
Philippines	-4.0	-5.3	-4.6	-3.9	-2.7	-2.2

[1] Inflation refers to composite prices
[2] Refers to central government balance
e Estimates
f Forecast
n.a. Not available

Source: National Sources and Bank Negara Malaysia forecast
IMF World Economic Outlook, September 2005

Table A.33
Sources and Uses of Funds of the Financial System

	2001	2002	2003	2004	2005*p*
	RM million				
Sources of Funds:					
Capital, reserves and profit	123,863.2	134,871.7	148,901.8	167,017.9	176,332.3
Currency	25,385.4	27,137.4	29,445.4	32,353.9	34,396.7
Demand deposits	92,129.0	87,539.5	92,117.8	124,333.4	135,944.1
Other deposits[1] (of which):	*508,836.0*	*547,135.3*	*617,286.6*	*711,307.5*	*786,255.2*
Public sector	*44,971.3*	*44,767.7*	*40,563.0*	*38,809.9*	*43,593.3*
Other financial institutions	*102,161.7*	*122,405.2*	*161,311.5*	*197,022.6*	*219,385.4*
Private sector	*354,996.6*	*372,884.1*	*406,049.3*	*462,149.5*	*508,958.5*
Foreign	*6,706.4*	*7,078.4*	*9,362.8*	*13,325.4*	*14,318.0*
Borrowings	37,380.8	44,948.0	48,715.3	52,607.9	56,357.4
Funds from other financial institutions	68,552.4	70,836.8	87,571.5	71,717.6	84,196.2
Domestic[2]	*53,448.2*	*46,973.0*	*61,837.8*	*33,762.8*	*43,107.8*
Foreign	*15,104.2*	*23,863.8*	*25,733.6*	*37,954.7*	*41,088.4*
Insurance, provident and pension funds	251,409.8	274,384.5	305,657.0	337,937.6	374,114.0
Other liabilities	193,163.0	208,266.6	233,384.8	267,579.3	260,892.9
Total Liabilities	**1,300,719.6**	**1,395,119.8**	**1,563,080.0**	**1,764,855.0**	**1,908,488.8**
Uses of Funds:					
Currency	5,336.7	7,369.8	5,573.8	5,058.3	5,994.0
Deposits with other financial institutions	177,102.0	187,883.0	226,303.7	247,947.3	255,982.9
Domestic	*156,662.9*	*166,670.2*	*211,075.6*	*214,355.2*	*229,084.0*
Foreign	*20,439.1*	*21,212.7*	*15,228.0*	*33,592.0*	*26,898.9*
Loans and advances	528,473.7	560,459.4	599,285.5	655,668.4	721,655.2
Public sector	*5,188.8*	*10,191.1*	*7,799.2*	*7,950.3*	*5,190.2*
Other financial institutions	*26,110.3*	*23,746.4*	*24,295.3*	*24,382.2*	*22,965.9*
Private sector	*494,977.2*	*524,393.4*	*564,850.9*	*620,712.1*	*690,901.8*
Foreign	*2,197.4*	*2,128.5*	*2,340.0*	*2,623.8*	*2,597.3*
Securities	336,379.3	361,113.2	409,488.6	433,071.0	468,040.8
Treasury bills	*4,063.5*	*5,680.0*	*3,539.4*	*445.2*	*1,698.4*
Commercial bills	*12,222.5*	*13,321.8*	*13,468.4*	*8,403.7*	*7,337.9*
Malaysian Government Securities (MGS)	*103,714.8*	*104,354.9*	*125,165.0*	*139,488.3*	*153,157.9*
Corporate[3]	*207,130.1*	*226,671.9*	*254,197.9*	*271,630.7*	*290,781.7*
Private Debt Securities (PDS)	*n.a.*	*n.a.*	*122,237.8*	*130,213.0*	*140,755.3*
Equities	*n.a.*	*n.a.*	*131,960.1*	*141,417.7*	*150,026.4*
Foreign	*2,720.3*	*3,189.7*	*3,429.0*	*4,578.6*	*6,663.9*
Others	*6,528.0*	*7,894.9*	*9,688.7*	*8,524.5*	*8,401.1*
Gold and forex reserves	113,542.3	127,515.1	166,139.3	249,704.1	264,421.5
Other assets	139,885.7	150,779.3	156,289.1	173,406.0	192,394.3
Total Assets	**1,300,719.6**	**1,395,119.8**	**1,563,080.0**	**1,764,855.0**	**1,908,488.8**

1 Equals savings, fixed and other (NIF,LPHT,etc.) deposits + NIDs + repos.
2 Includes statutory reserves of banking institutions
3 Breakdown of Corporate Securities between Private Debt Securities (PDS) and Equities available from 2003
p Preliminary
n.a. Not available

Table A.34
Commercial Banks[1]: Commitments and Contingencies

	As at end-									
	2001		2002		2003		2004		2005	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	21,284.6	5.8	25,519.2	5.7	26,916.9	5.3	26,823.7	4.2	24,265.0	3.2
Credit extension commitments	169,800.2	46.1	177,880.8	39.6	180,149.3	35.8	204,293.3	31.6	228,719.4	30.6
Direct credit substitutes	14,521.8	3.9	13,295.7	3.0	14,795.5	2.9	14,713.9	2.3	16,026.4	2.1
Foreign exchange related contracts	81,902.1	22.3	85,517.3	19.0	101,477.0	20.2	175,504.8	27.2	161,783.3	21.6
Interest rate related contracts	34,056.8	9.3	93,637.5	20.8	124,496.6	24.7	163,101.1	25.2	252,469.9	33.7
Trade-related contingencies	13,932.3	3.8	18,424.3	4.1	20,507.2	4.1	23,851.7	3.7	21,049.1	2.8
Transaction-related contingencies	19,440.1	5.3	21,567.3	4.8	21,621.3	4.3	21,685.4	3.4	23,529.3	3.1
Underwriting obligations	1,768.1	0.5	1,952.0	0.4	1,868.4	0.4	1,522.9	0.2	1,605.7	0.2
Others	11,348.5	3.1	11,869.7	2.6	11,664.3	2.3	14,636.8	2.3	19,211.5	2.6
Total	**368,054.3**	**100.0**	**449,663.8**	**100.0**	**503,496.5**	**100.0**	**646,133.6**	**100.0**	**748,659.7**	**100.0**

[1] Includes finance companies and Islamic banks
Note: Numbers may not necessarily add up due to rounding

Table A.35
Merchant Banks: Commitments and Contingencies

	As at end-									
	2001		2002		2003		2004		2005	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	1,425.5	2.9	1,736.0	2.2	1,595.2	1.3	2,493.7	1.4	2,418.3	1.9
Credit extension commitments	2,639.7	5.4	2,089.1	2.7	2,545.9	2.1	2,387.6	1.3	2,863.0	2.2
Direct credit substitutes	1,325.1	2.7	1,039.3	1.3	1,226.8	1.0	1,126.2	0.6	1,312.4	1.0
Foreign exchange related contracts	1,320.1	2.7	1,506.6	1.9	1,459.9	1.2	2,877.6	1.6	4,976.9	3.9
Interest rate related contracts	39,658.8	81.2	70,701.1	89.7	115,332.1	92.9	169,189.1	94.1	112,409.4	87.6
Trade-related contingencies	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transaction-related contingencies	790.4	1.6	749.0	1.0	818.2	0.7	676.6	0.4	1,794.5	1.4
Underwriting obligations	1,617.5	3.3	937.5	1.2	1,139.0	0.9	1,029.6	0.6	2,094.5	1.6
Others	80.0	0.2	44.1	0.1	55.4	0.0	44.6	0.0	506.2	0.4
Total	**48,857.2**	**100.0**	**78,802.7**	**100.0**	**124,172.6**	**100.0**	**179,825.0**	**100.0**	**128,375.2**	**100.0**

Note: Numbers may not necessarily add up due to rounding

Table A.36
Commercial Banks[1]: Income and Expenditure

	For the financial year			For the calendar year		
	2002	2003	2004	2003	2004	2005*p*
	RM million					
Interest income[2]	34,178.6	17,471.5	19,183.1	38,762.1	41,070.5	43,381.5
Less: Interest expense	17,178.6	17,471.5	19,183.1	20,038.8	21,372.0	22,113.6
Net interest income	17,628.3	18,261.6	19,172.5	18,723.3	19,698.6	21,268.0
Add: Fee-based income	2,951.0	3,211.9	3,925.1	3,355.3	3,878.0	4,334.1
Less: Staff cost	4,501.0	4,718.5	5,332.7	4,826.1	5,364.6	5,958.8
Overheads	5,340.3	5,432.1	6,158.3	5,639.7	6,272.5	6,826.7
Gross operating profit	10,738.0	11,323.0	11,606.6	11,612.8	11,939.5	12,816.5
Less: Loan loss and other provisions	652.6	642.3	629.6	3,850.9	4,485.4	5,402.5
Gross operating profit after provision	10,085.4	10,680.7	10,977.0	7,762.0	7,454.1	7,414.1
Add: Other income	2,631.7	4,135.9	6,850.0	1,930.8	3,300.8	3,625.6
Pre-tax profit	**12,717.1**	**14,816.6**	**17,827.0**	**9,692.8**	**10,754.9**	**11,039.7**

[1] Includes finance companies and Islamic banks
[2] Effective January 2005, banking institutions no longer accrue interests on non-performing loan accounts
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.37
Merchant Banks: Income and Expenditure

	For the financial year			For the calendar year		
	2002	2003	2004	2003	2004	2005*p*
	RM million					
Interest income[1]	1,714.3	1,624.3	1,744.0	1,636.5	1,661.7	1,698.5
Less: Interest expense	1,138.7	1,081.7	1,269.7	1,145.7	1,196.0	1,265.9
Net interest income	575.5	542.6	474.3	490.8	465.8	432.6
Add: Fee-based income	306.2	332.6	375.7	327.6	351.4	349.9
Less: Staff cost	214.8	263.1	295.4	260.6	297.5	350.2
Overheads	117.0	130.8	160.2	133.4	154.6	181.0
Gross operating profit	549.9	481.4	394.5	424.3	365.1	251.3
Less: Loan loss and other provisions	114.3	96.2	111.5	137.4	101.5	73.0
Gross operating profit after provision	435.7	385.2	283.0	287.0	263.6	178.3
Add: Other income	306.3	519.6	412.6	398.2	550.9	1,162.0
Pre-tax profit	**742.0**	**904.8**	**695.6**	**685.2**	**814.4**	**1,340.3**

[1] Effective January 2005, banking institutions no longer accrue interests on non-performing loan accounts
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.38
Commercial Banks[1]: Direction of Lending

	Loans by sector (RM million)					% share				
As at end-	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Business enterprises	**208,607.6**	**206,508.4**	**203,643.5**	**210,800.6**	**217,797.3**	**49.9**	**47.1**	**44.0**	**41.8**	**39.6**
Households	**178,316.8**	**204,552.4**	**230,692.1**	**263,824.2**	**303,791.7**	**42.7**	**46.6**	**49.9**	**52.3**	**55.3**
Others	**30,825.9**	**27,652.5**	**28,398.1**	**29,818.6**	**27,729.0**	**7.4**	**6.3**	**6.1**	**5.9**	**5.0**
Total[2]	**417,750.3**	**438,713.3**	**462,733.6**	**504,443.4**	**549,318.0**					
Agriculture, hunting, forestry and fishing	10,921.9	10,840.9	9,861.8	10,433.3	10,644.4	2.6	2.5	2.1	2.1	1.9
Mining and quarrying	1,221.0	948.1	1,048.4	942.7	761.6	0.3	0.2	0.2	0.2	0.1
Manufacturing	60,316.7	59,264.2	59,415.2	61,725.2	59,613.0	14.4	13.5	12.8	12.2	10.9
Electricity, gas and water supply	4,799.5	6,035.8	4,681.3	4,785.2	4,480.1	1.1	1.4	1.0	0.9	0.8
Wholesale and retail trade, restaurants and hotels	35,223.7	36,358.0	38,506.5	42,725.0	46,350.6	8.4	8.3	8.3	8.5	8.4
Wholesale trade	*19,735.5*	*20,712.8*	*21,896.7*	*25,380.3*	*27,198.6*	*4.7*	*4.7*	*4.7*	*5.0*	*5.0*
Retail trade	*11,008.4*	*11,444.4*	*12,069.5*	*12,990.8*	*14,712.6*	*2.6*	*2.6*	*2.6*	*2.6*	*2.7*
Restaurants and hotels	*4,479.8*	*4,200.8*	*4,540.3*	*4,353.9*	*4,439.4*	*1.1*	*1.0*	*1.0*	*0.9*	*0.8*
Broad property sector	158,892.7	170,226.0	185,854.9	205,628.7	226,381.3	38.0	38.8	40.2	40.8	41.2
Construction	*31,100.8*	*29,694.1*	*27,774.6*	*28,790.3*	*28,165.4*	*7.4*	*6.8*	*6.0*	*5.7*	*5.1*
Purchase of residential property	*86,112.8*	*100,288.6*	*116,474.8*	*132,833.3*	*149,124.5*	*20.6*	*22.9*	*25.2*	*26.3*	*27.1*
Purchase of non-residential property	*27,437.3*	*27,447.1*	*28,648.0*	*31,022.7*	*35,026.6*	*6.6*	*6.3*	*6.2*	*6.1*	*6.4*
Real estate	*14,241.8*	*12,796.2*	*12,957.6*	*12,982.4*	*14,064.8*	*3.4*	*2.9*	*2.8*	*2.6*	*2.6*
Transport, storage and communication	9,547.7	9,393.4	9,882.6	9,595.1	10,959.7	2.3	2.1	2.1	1.9	2.0
Financial, insurance and business services	31,354.0	28,943.2	28,624.2	30,374.9	29,829.2	7.5	6.6	6.2	6.0	5.4
Financial services	*22,006.4*	*20,102.2*	*20,177.9*	*20,762.3*	*20,351.7*	*5.3*	*4.6*	*4.4*	*4.1*	*3.7*
Insurance	*550.3*	*604.9*	*206.6*	*127.7*	*137.2*	*0.1*	*0.1*	*0.0*	*0.0*	*0.0*
Business services	*8,797.3*	*8,236.1*	*8,239.7*	*9,484.9*	*9,340.3*	*2.1*	*1.9*	*1.8*	*1.9*	*1.7*
Consumption credit	22,870.0	25,330.0	27,750.9	31,720.4	36,702.3	5.5	5.8	6.0	6.3	6.7
Personal uses	*13,538.1*	*14,331.2*	*15,141.6*	*17,170.5*	*19,735.6*	*3.2*	*3.3*	*3.3*	*3.4*	*3.6*
Credit cards	*8,812.0*	*10,591.4*	*12,236.5*	*14,235.1*	*16,692.9*	*2.1*	*2.4*	*2.6*	*2.8*	*3.0*
Purchase of consumer durable goods	*519.9*	*407.4*	*372.8*	*314.8*	*273.7*	*0.1*	*0.1*	*0.1*	*0.1*	*0.0*
Purchase of securities	19,219.5	19,658.2	18,097.2	17,919.2	19,101.0	4.6	4.5	3.9	3.6	3.5
Purchase of transport vehicles	48,971.5	58,022.6	64,773.3	74,554.6	89,315.9	11.7	13.2	14.0	14.8	16.3
Purchase of passenger cars	*45,419.1*	*54,987.0*	*61,469.6*	*72,061.3*	*86,460.9*	*10.9*	*12.5*	*13.3*	*14.3*	*15.7*
Community, social and personal services	5,684.6	5,514.3	4,870.2	5,036.7	5,504.3	1.4	1.3	1.1	1.0	1.0
Others	8,727.6	8,178.5	9,367.1	9,002.3	9,674.6	2.1	1.9	2.0	1.8	1.8

[1] Includes finance companies and Islamic banks
[2] Includes loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.39
Merchants Banks: Direction of Lending

	Loans by sector (RM million)					% share				
As at end-	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Business enterprises	**13,304.0**	**12,282.6**	**9,897.8**	**8,266.8**	**7,806.7**	**91.1**	**91.1**	**89.6**	**87.6**	**89.2**
Households	**337.3**	**317.1**	**383.1**	**558.5**	**571.2**	**2.3**	**2.4**	**3.5**	**5.9**	**6.5**
Others	**965.5**	**881.4**	**762.1**	**608.1**	**369.7**	**6.6**	**6.5**	**6.9**	**6.4**	**4.2**
Total[1]	**14,606.8**	**13,481.0**	**11,042.9**	**9,433.4**	**8,747.6**					
Agriculture, hunting, forestry and fishing	864.4	807.4	652.3	445.5	334.5	5.9	6.0	5.9	4.7	3.8
Mining and quarrying	87.5	69.2	47.7	47.4	48.9	0.6	0.5	0.4	0.5	0.6
Manufacturing	2,205.0	2,012.1	1,667.9	1,295.2	1,050.3	15.1	14.9	15.1	13.7	12.0
Electricity, gas and water supply	455.3	779.8	384.7	410.6	168.7	3.1	5.8	3.5	4.4	1.9
Wholesale and retail trade, restaurants and hotels	806.8	705.2	655.3	729.8	702.3	5.5	5.2	5.9	7.7	8.0
Wholesale trade	*172.8*	*156.5*	*97.4*	*129.3*	*133.9*	*1.2*	*1.2*	*0.9*	*1.4*	*1.5*
Retail trade	*190.7*	*148.3*	*92.8*	*125.0*	*129.3*	*1.3*	*1.1*	*0.8*	*1.3*	*1.5*
Restaurants and hotels	*443.3*	*400.4*	*465.1*	*475.6*	*439.0*	*3.0*	*3.0*	*4.2*	*5.0*	*5.0*
Broad property sector	4,383.3	3,859.9	2,858.8	2,832.2	2,616.4	30.0	28.6	25.9	30.0	29.9
Construction	*2,800.4*	*2,495.3*	*1,708.0*	*1,920.8*	*1,826.4*	*19.2*	*18.5*	*15.5*	*20.4*	*20.9*
Purchase of residential property	*73.5*	*77.1*	*78.2*	*80.3*	*74.0*	*0.5*	*0.6*	*0.7*	*0.9*	*0.8*
Purchase of non-residential property	*247.3*	*209.0*	*150.0*	*111.9*	*96.7*	*1.7*	*1.6*	*1.4*	*1.2*	*1.1*
Real estate	*1,262.1*	*1,078.4*	*922.6*	*719.2*	*619.3*	*8.6*	*8.0*	*8.4*	*7.6*	*7.1*
Transport, storage and communication	594.7	363.0	845.3	320.5	395.9	4.1	2.7	7.7	3.4	4.5
Financial, insurance and business services	1,026.7	938.3	633.1	564.5	314.3	7.0	7.0	5.7	6.0	3.6
Financial services	*710.8*	*768.2*	*535.2*	*520.7*	*223.9*	*4.9*	*5.7*	*4.8*	*5.5*	*2.6*
Insurance	*5.5*	*0.0*	*0.0*	*0.0*	*30.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.3*
Business services	*310.4*	*170.2*	*97.9*	*43.8*	*60.4*	*2.1*	*1.3*	*0.9*	*0.5*	*0.7*
Consumption credit	32.6	21.2	35.5	116.6	182.7	0.2	0.2	0.3	1.2	2.1
Personal uses	*32.5*	*21.1*	*35.5*	*116.6*	*182.6*	*0.2*	*0.2*	*0.3*	*1.2*	*2.1*
Credit cards	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of securities	2,199.6	1,981.6	1,709.4	1,468.4	1,803.4	15.1	14.7	15.5	15.6	20.6
Purchase of transport vehicles	12.9	19.4	22.0	21.4	20.7	0.1	0.1	0.2	0.2	0.2
Purchase of passenger cars	*12.1*	*19.1*	*21.5*	*20.9*	*20.3*	*0.1*	*0.1*	*0.2*	*0.2*	*0.2*
Community, social and personal services	367.4	203.9	98.4	69.1	222.5	2.5	1.5	0.9	0.7	2.5
Others	1,570.8	1,720.0	1,432.6	1,112.2	887.0	10.8	12.8	13.0	11.8	10.1

[1] Includes loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.40
Commercial Banks[1]: Non-performing Loans by Sector

	NPL by sector (RM million)					As percentage of total loans to the sector (%)				
As at end-	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Business enterprises	**46,880.8**	**42,282.2**	**37,384.7**	**32,959.8**	**27,931.3**	**19.4**	**17.8**	**15.9**	**13.3**	**10.9**
Households	**15,019.3**	**16,110.4**	**17,104.2**	**18,886.0**	**21,341.2**	**9.2**	**8.5**	**8.0**	**7.7**	**7.5**
Others	**1,543.8**	**1,294.9**	**964.0**	**950.9**	**1,191.4**	**17.7**	**15.8**	**10.3**	**10.6**	**12.3**
Total	**63,443.9**	**62,279.9**	**55,452.9**	**52,796.7**	**50,463.9**					
Agriculture, hunting, forestry and fishing	858.1	920.0	759.2	655.3	581.2	7.9	8.5	7.7	6.3	5.5
Mining and quarrying	248.5	159.5	143.6	85.9	119.1	20.4	16.8	13.7	9.1	15.6
Manufacturing	11,681.1	11,924.8	9,463.3	8,151.1	6,238.1	19.4	20.1	15.9	13.2	10.5
Electricity, gas and water supply	227.6	215.8	1,326.4	1,214.4	1,221.2	4.7	3.6	28.3	25.4	27.4
Wholesale and retail trade, restaurants and hotels	4,853.6	4,223.9	4,416.1	4,182.8	3,426.7	13.8	11.6	11.5	9.8	7.4
Wholesale trade	*2,117.4*	*1,865.2*	*1,748.4*	*1,628.0*	*1,413.1*	*10.7*	*9.0*	*8.0*	*6.4*	*5.2*
Retail trade	*1,358.9*	*1,233.8*	*1,421.6*	*1,251.7*	*1,113.0*	*12.3*	*10.8*	*11.8*	*9.6*	*7.6*
Restaurants and hotels	*1,377.2*	*1,125.0*	*1,246.1*	*1,303.0*	*900.7*	*30.7*	*26.8*	*27.4*	*29.9*	*20.3*
Broad property sector	26,478.8	26,242.2	25,636.4	25,808.4	26,121.1	16.7	15.4	13.8	12.6	11.5
Construction	*9,909.3*	*8,926.7*	*7,647.2*	*6,789.7*	*5,679.2*	*31.9*	*30.1*	*27.5*	*23.6*	*20.2*
Purchase of residential property	*6,947.1*	*8,740.8*	*10,122.3*	*11,852.2*	*14,006.5*	*8.1*	*8.7*	*8.7*	*8.9*	*9.4*
Purchase of non-residential property	*5,025.7*	*4,900.6*	*4,737.9*	*4,382.8*	*4,088.2*	*18.3*	*17.9*	*16.5*	*14.1*	*11.7*
Real estate	*4,596.7*	*3,674.1*	*3,129.0*	*2,783.6*	*2,347.2*	*32.3*	*28.7*	*24.1*	*21.4*	*16.7*
Transport, storage and communication	1,556.1	1,399.6	1,165.1	778.0	639.6	16.3	14.9	11.8	8.1	5.8
Finance, insurance and business services	4,511.3	2,996.6	2,270.6	1,874.5	1,772.6	14.4	10.4	7.9	6.2	5.9
Financial services	*2,784.8*	*1,501.4*	*1,042.0*	*782.4*	*783.7*	*12.7*	*7.5*	*5.2*	*3.8*	*3.9*
Insurance	*42.5*	*33.1*	*18.5*	*4.2*	*1.6*	*7.7*	*0.0*	*0.0*	*0.0*	*1.2*
Business services	*1,684.0*	*1,462.0*	*1,210.2*	*1,087.9*	*987.3*	*19.1*	*17.8*	*14.7*	*11.5*	*10.6*
Consumption credit	2,437.5	2,480.1	2,629.9	2,569.1	2,685.5	10.7	9.8	9.5	8.1	7.4
Personal uses	*1,952.4*	*1,981.8*	*2,002.8*	*1,868.2*	*1,910.5*	*14.4*	*13.8*	*13.2*	*10.9*	*9.7*
Credit cards	*409.4*	*434.3*	*578.6*	*663.9*	*743.7*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*75.7*	*63.9*	*48.5*	*37.0*	*31.2*	*14.6*	*15.7*	*13.0*	*11.8*	*11.4*
Purchase of securities	4,391.4	3,639.7	3,205.7	2,594.7	2,196.7	22.8	18.5	17.7	14.5	11.5
Purchase of transport vehicles[2]	3,439.0	3,069.7	2,749.1	3,167.2	3,550.9	7.6	5.6	4.5	4.3	4.0
Community, social and personal services	1,217.2	1,120.6	723.5	764.4	719.9	21.4	20.3	14.9	15.2	13.1

[1] Includes finance companies and Islamic banks
[2] Includes passenger cars
Note: Numbers may not necessarily add up due to rounding

Table A.41
Merchant Banks: Non-performing Loans by Sector

	NPL by sector (RM million)					As percentage of total loans to the sector (%)				
As at end-	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Business enterprises	**3,597.7**	**3,222.7**	**2,314.5**	**1,947.2**	**1,451.9**	**30.1**	**29.9**	**26.5**	**26.0**	**21.3**
Households	**453.4**	**423.2**	**283.9**	**161.7**	**127.4**	**41.4**	**42.9**	**32.7**	**19.5**	**12.1**
Others	**333.3**	**343.0**	**220.2**	**159.2**	**155.7**	**21.2**	**19.9**	**15.4**	**14.3**	**17.6**
Total	**4,384.4**	**3,988.9**	**2,818.6**	**2,268.0**	**1,735.1**					
Agriculture, hunting, forestry and fishing	86.5	47.3	22.0	24.4	20.5	10.0	5.9	3.4	5.5	6.1
Mining and quarrying	0.5	4.1	4.4	4.5	4.6	0.5	5.9	9.1	9.4	9.4
Manufacturing	891.5	792.5	538.1	554.3	312.0	40.4	39.4	32.3	42.8	29.7
Electricity, gas and water supply	133.4	208.4	118.0	82.3	0.0	29.3	26.7	30.7	20.0	0.0
Wholesale and retail trade, restaurants and hotels	197.4	181.4	217.6	173.9	176.7	24.5	25.7	33.2	23.8	25.2
Wholesale trade	*45.4*	*29.8*	*9.8*	*7.8*	*7.0*	*26.3*	*19.0*	*10.0*	*6.0*	*5.2*
Retail trade	*33.1*	*5.6*	*6.5*	*1.2*	*10.8*	*17.4*	*3.7*	*7.0*	*0.9*	*8.3*
Restaurants and hotels	*118.8*	*146.1*	*201.3*	*165.0*	*158.9*	*26.8*	*36.5*	*43.3*	*34.7*	*36.2*
Broad property sector	1,477.3	1,282.0	1,004.6	918.2	764.5	33.7	33.2	35.1	32.4	29.2
Construction	*807.5*	*756.6*	*531.2*	*496.5*	*447.2*	*28.8*	*30.3*	*31.1*	*25.8*	*24.5*
Purchase of residential property	*0.7*	*0.2*	*0.1*	*0.4*	*0.3*	*0.9*	*0.3*	*0.2*	*0.6*	*0.4*
Purchase of non-residential property	*91.3*	*70.9*	*65.9*	*49.3*	*36.9*	*36.9*	*33.9*	*43.9*	*44.0*	*38.1*
Real estate	*577.8*	*454.3*	*407.3*	*372.0*	*280.1*	*45.8*	*42.1*	*44.1*	*51.7*	*45.2*
Transport, storage and communication	63.6	38.4	22.9	0.0	0.0	10.7	10.6	2.7	0.0	0.0
Finance, insurance and business services	187.2	139.4	85.6	8.3	5.7	18.2	14.9	13.5	1.5	1.8
Financial services	*134.6*	*101.3*	*71.8*	*2.9*	*1.1*	*18.9*	*13.2*	*13.4*	*0.6*	*0.5*
Insurance	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Business services	*52.6*	*38.1*	*13.7*	*5.5*	*4.6*	*16.9*	*22.4*	*14.0*	*12.5*	*7.6*
Consumption credit	13.2	12.2	11.5	10.2	12.6	40.4	57.4	32.4	8.8	6.9
Personal uses	*13.2*	*12.2*	*11.5*	*10.2*	*12.6*	*40.5*	*57.5*	*32.5*	*8.8*	*6.9*
Credit cards	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of securities	878.9	821.5	544.4	301.9	228.9	40.0	41.5	31.8	20.6	12.7
Purchase of transport vehicles[1]	0.1	0.1	0.1	0.0	0.0	1.2	0.6	0.4	0.1	0.1
Community, social and personal services	121.6	118.7	29.2	30.9	53.9	33.1	58.2	29.7	44.6	24.2

[1] Includes passenger cars
Note: Numbers may not necessarily add up due to rounding

Table A.42
Banking System[1]: Selected Indicators

	Commercial banks[2]				
	2001	2002	2003	2004	2005
Pre-tax profit/Average assets (%)	1.0	1.3	1.3	1.4	1.3
Pre-tax profit/Average shareholders' funds (%)	14.7	17.6	18.0	17.9	16.9
Pre-tax profit/Average employee (RM'000)	72.6	98.2	112.4	123.9	124.9
Cost[3] incurred per ringgit of revenue earned[4] (sen)	40.9	42.7	43.2	42.9	43.1
Cost[3] incurred per ringgit of net interest income[4] (sen)	55.0	56.2	55.6	58.7	59.7
Overheads to staff cost ratio (%)	106.3	116.0	116.4	116.7	113.5
Staff cost per employee (RM'000)	50.8	50.9	54.9	60.1	64.3
Loan deposit ratio[5] (%)	93.1	92.9	89.2	85.7	82.7
Loans per office (RM million)	161.8	180.0	187.6	216.6	255.1
Deposits per office[5] (RM million)	173.7	193.8	210.3	252.8	308.3

[1] Based on Malaysian operations only
[2] Includes finance companies
[3] Cost = Staff cost and overheads (excluding loan loss provisions)
[4] Revenue = Net interest income + fee-based income + other income
[5] Including NIDs and repos

Merchant banks					Islamic banks					Banking system				
As at calendar year end-														
2001	2002	2003	2004	2005	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
0.8	1.4	1.6	1.9	3.0	0.4	0.7	0.6	0.3	0.1	1.0	1.3	1.3	1.4	1.4
7.5	13.3	14.0	15.9	25.5	5.4	9.5	8.5	4.8	1.3	13.3	16.0	16.2	16.8	17.5
124.8	244.5	280.8	318.2	504.4	23.9	41.6	37.2	20.8	7.9	72.4	100.2	114.2	125.2	130.3
22.5	31.6	32.4	33.0	27.3	62.5	54.7	58.6	59.3	59.0	40.2	42.5	43.1	42.8	42.7
55.5	65.5	80.3	97.1	122.8	67.9	61.5	66.4	71.9	68.4	55.3	56.6	56.5	60.0	61.4
58.1	53.6	51.2	52.0	51.7	96.7	108.3	132.7	123.9	134.9	104.0	112.9	113.5	113.5	111.1
86.4	93.6	106.8	116.2	131.8	46.1	45.2	46.2	49.6	68.8	51.6	51.8	56.0	61.3	66.4
78.0	69.2	48.5	42.9	35.3	53.4	56.1	55.8	55.2	90.4	91.3	90.7	86.4	83.1	81.3
768.8	793.0	649.6	554.9	460.4	62.9	71.9	74.3	84.3	27.0	151.3	158.3	165.8	179.9	195.3
985.1	1,146.6	1,340.5	1,294.6	1,303.4	117.8	128.1	133.2	152.6	29.9	165.7	174.4	191.9	216.3	240.3

Table A.43
Banking System: Key Data

	As at end-				
	2001	2002	2003	2004	2005
Number of institutions	49	47	46	41	42
- Commercial banks	*25*	*24*	*23*	*23*	*23*
- Finance companies	*12*	*11*	*11*	*6*	*3*[1]
- Merchant banks	*10*	*10*	*10*	*10*	*10*
- Islamic banks	*2*	*2*	*2*	*2*	*6*
Risk-weighted capital ratio (%)	13.0	13.2	13.8	14.4	13.1
- Commercial banks[2]	*12.6*	*13.0*	*13.6*	*14.1*	*12.9*
- Merchant banks	*19.6*	*19.0*	*19.2*	*22.9*	*17.5*
- Islamic banks	*14.4*	*12.6*	*11.7*	*12.3*	*14.2*
Office network	2,675	2,531	2,563	2,429	2,857
- Commercial banks[2]	*2,534*	*2,386*	*2,414*	*2,276*	*2,072*
- Merchant banks	*19*	*17*	*17*	*17*	*19*
- Islamic banks	*122*	*128*	*132*	*136*	*766*
ATM network	4,169	4,213	4,396	4,708	4,892
- Commercial banks[2]	*3,991*	*4,028*	*4,184*	*4,428*	*4,584*
- Islamic banks	*178*	*185*	*212*	*280*	*308*
Number of banks with internet services	8	12	12	13	13
- Commercial banks	*8*	*12*	*12*	*13*	*13*
Persons served per office	8,724	9,757	9,839	10,605	9,295
Number of employees	93,329	90,864	90,844	93,948	96,106
- Commercial banks[2]	*87,886*	*85,296*	*85,092*	*87,222*	*89,047*
- Merchant banks	*2,402*	*2,451*	*2,429*	*2,690*	*2,625*
- Islamic banks	*3,041*	*3,117*	*3,323*	*4,036*	*4,434*

[1] Includes RHB Delta Finance Berhad, Southern Finance Berhad and Bumiputra-Commerce Finance Berhad whose merger with commercial bank were completed on 1 January 2006
[2] Includes finance companies

Table A.44
Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2004	2005	2004	2005
Commercial banks	–		3.1[1]	3.2[1]	1,960	1,963
Finance companies	–		3.1[1]	4.0[1]	316	109
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0	4.0	–	–
Malaysia Building Society Berhad	1950	To be the nation's single largest provider of property finance and to contribute to the continuous growth of the nation	2.0 ~ 10.0	2.0 ~ 10.0	22	22
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	3.0 ~ 8.75	3.0 ~ 8.75	2	2
Sabah Credit Corporation	1955	To improve the social economic development of Sabah through loans mainly to the property, agriculture and business sectors	3.0 ~ 10.5	3.0 ~ 10.0	11	10
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	7.3[1]	7.2[1]	103	106
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	4.8[1]	5.5[1]	393	390

[1] Average

Source: Bank Negara Malaysia and various housing credit institutions

Table A.45
Outstanding Housing Loans

	2004	2005*p*	2004	2005*p*	2004	2005*p*
	RM million		Annual change (%)		% share	
Commercial banks	125,824	148,329	23.6	17.9	77	81
Treasury Housing Loans Division	25,051	25,395	1.2	1.4	15	14
Finance companies	7,009	795	-52.1	-88.7	4	…
Bank Kerjasama Rakyat Malaysia Berhad	2,519	3,592	83.8	42.6	2	2
Malaysia Building Society Berhad	1,874	2,776	55.4	48.2	1	2
Bank Simpanan Nasional	1,059	1,372	0.0	29.6	1	1
Borneo Housing Mortgage Finance Berhad	705	713	3.7	1.0	...	…
Sabah Credit Corporation	239	220	-6.1	-8.3	...	…
Total	**164,280**	**183,192**	**12.7**	**11.5**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.46
Approved Housing Loans

	2004	2005*p*	2004	2005*p*	2004	2005*p*
	RM million		Annual change (%)		% share	
Commercial banks	34,140	36,482	22.2	6.9	80	83
Treasury Housing Loans Division	4,086	4,188	-13.8	2.5	10	9
Finance companies	1,553	97	-25.7	-93.8	4	…
Bank Kerjasama Rakyat Malaysia Berhad	1,040	1,111	75.9	6.8	2	3
Malaysia Building Society Berhad	1,357	1,401	292.7	3.2	3	3
Borneo Housing Mortgage Finance Berhad	89	62	2.4	-30.1	…	…
Bank Simpanan Nasional	249	848	111.1	240.8	1	2
Sabah Credit Corporation	6	8	-69.3	35.5	…	…
Total	**42,520**	**44,197**	**18.3**	**3.9**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.47
Islamic Banking System: Key Data

	As at end-				
	2001	2002	2003	2004	2005*p*
Number of financial institutions	**38**	**37**	**33**	**29**	**29**
Islamic banks	2	2	2	2	6
Commercial banks	14	14	13	13	11
Finance companies	10	9	7	3	1
Merchant banks	5	5	4	4	4
Discount houses	7	7	7	7	7
Number of branches	**132**	**138**	**143**	**153**	**782**
Islamic banks	122	128	132	136	766
Commercial banks	8	8	10	16	15
Finance companies	2	2	1	1	1
Total assets (RM million)	**60,244.5**	**68,967.9**	**83,105.2**	**95,033.9**	**111,823.5**
Islamic banks	17,404.8	20,119.1	20,917.3	24,857.4	43,432.9
Commercial banks	27,026.1	29,074.3	36,837.5	53,912.6	59,697.9
Finance companies	9,821.6	12,501.9	17,879.2	7,767.5	1,254.1
Merchant banks	1,352.9	1,429.6	1,715.8	2,552.4	1,465.6
Discount houses	4,639.1	5,843.0	5,755.4	5,944.0	5,973.0
Total deposits (RM million)	**47,106.5**	**53,162.8**	**60,211.6**	**72,856.9**	**83,874.8**
Islamic banks	14,375.6	16,401.4	17,583.8	20,753.7	35,625.5
Commercial banks	22,031.0	23,353.9	26,518.7	39,775.4	42,775.2
Finance companies	7,663.7	9,092.6	10,965.6	5,951.6	684.1
Merchant banks	673.4	684.3	851.7	1,526.8	796.6
Discount houses	2,362.8	3,630.6	4,291.8	4,849.4	3,993.4
Total financing (RM million)	**28,317.6**	**36,719.8**	**48,613.9**	**57,841.3**	**67,364.6**
Islamic banks	7,671.0	9,159.9	9,764.5	11,423.1	20,627.1
Commercial banks	12,257.6	16,706.4	22,326.1	38,802.2	45,398.5
Finance companies	7,617.4	10,050.0	15,742.5	6,823.3	1,070.9
Merchant banks	771.6	803.5	780.8	792.7	268.1
Discount houses	–	–	–	–	–
Financing-deposits ratio (%)	**60.1**	**69.1**	**80.7**	**79.4**	**80.3**
Islamic banks	53.4	55.8	55.5	55.0	57.9
Commercial banks	55.6	71.5	84.2	97.6	106.1
Finance companies	99.4	110.5	143.6	114.6	156.5
Merchant banks	114.6	117.4	91.7	51.9	33.7
Discount houses	–	–	–	–	–

p Preliminary

Table A.48
Islamic Banking System: Sources and Uses of Funds

	As at end-					
	2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Sources						
Capital and reserves	1,765.0	5,671.5	7,436.5	3,559.2	6,492.5	10,051.7
Deposits	20,753.7	52,073.2	72,826.9	35,625.5	48,249.3	83,874.8
Funds from other financial institutions	438.9	3,590.7	4,029.6	1,578.2	2,880.9	4,459.1
Other liabilities	1,899.8	8,841.1	10,740.9	2,670.0	10,767.9	13,437.9
Total	**24,857.4**	**70,176.5**	**95,033.9**	**43,432.9**	**68,390.6**	**111,823.5**
Uses						
Cash	259.6	11.0	270.6	322.2	7.0	329.2
Reserves with Bank Negara Malaysia	542.0	816.4	1,358.4	972.3	953.6	1,925.9
Deposits with other financial institutions	6,139.2	9,920.9	16,060.1	11,928.4	8,446.5	20,374.9
Financing	11,423.1	46,418.3	57,841.4	20,627.1	46,737.5	67,364.6
Securities	5,221.0	10,979.2	16,200.2	8,436.7	12,364.2	20,800.9
Other assets	1,272.5	2,030.7	3,303.2	1,146.2	-118.2[1]	1,028.0
Total	**24,857.4**	**70,176.5**	**95,033.9**	**43,432.9**	**68,390.6**	**111,823.5**

[1] Denotes the interbranch balances pending settlement
p Preliminary

Table A.49
Islamic Banking System: Commitments and Contingencies

	As at end-							
	2004				2005*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Assets sold with recourse and commitments with drawdown	139.8	3,747.3	3,887.1	14.8	354.5	4,716.9	5,071.4	16.4
Credit extension commitments	1,572.7	9,194.2	10,766.9	40.9	4,298.4	8,829.8	13,128.2	42.4
Direct credit substitutes	429.4	507.0	936.4	3.5	481.6	568.7	1,050.3	3.4
Foreign exchange related contracts	374.0	–	374.0	1.4	1,373.1	65.5	1,438.6	4.6
Trade-related contingencies	1,442.5	5,860.7	7,303.2	27.8	1,540.0	4,548.9	6,088.9	19.6
Transaction-related contingencies	1,421.9	864.2	2,286.1	8.7	1,906.3	990.7	2,897.0	9.3
Underwriting obligations	56.0	467.4	523.4	2.0	143.0	745.0	888.0	2.9
Others	43.8	187.3	231.1	0.9	65.9	359.1	425.0	1.4
Total	**5,480.1**	**20,828.1**	**26,308.2**	**100.0**	**10,162.8**	**20,824.6**	**30,987.4**	**100.0**

p Preliminary

Table A.50
Islamic Banking System: Income and Expenditure

	For the financial year						For the calendar year					
	2003			2004			2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million											
Income[1] net of income-in-suspense	596.9	2,266.8	2,863.7	638.3	2,607.3	3,245.6	953.5	3,345.1	4,298.6	1,588.6	3,631.6	5,220.2
(Income-in-suspense)	*51.6*	*144.1*	*195.7*	*56.1*	*166.1*	*222.2*	*108.2*	*198.0*	*306.2*	*82.0*	*152.5*	*234.5*
Less: Expense[1]	265.4	966.5	1,231.9	289.0	1,100.1	1,389.1	410.2	1,403.7	1,813.9	587.6	1,435.4	2,023.0
Net income	331.5	1,300.3	1,631.8	349.3	1,507.2	1,856.5	543.3	1,941.4	2,484.7	1,001.0	2,196.2	3,197.2
Add: Other income	64.9	102.6	167.5	105.7	178.4	284.1	140.6	227.5	368.1	160.5	255.0	415.5
Less: Financing loss and other provisions	108.0	506.6	614.6	115.7	721.7	837.4	162.5	1,013.7	1,176.2	442.9	502.4	945.3
Staff cost	104.7	73.1	177.8	131.6	69.7	201.3	186.3	80.7	267.0	291.6	140.2	431.8
Overheads	131.2	144.0	275.2	152.8	136.7	289.5	223.7	197.8	421.5	393.5	287.3	680.8
Pre-tax profit	**52.5**	**679.2**	**731.7**	**54.9**	**757.5**	**812.4**	**111.4**	**876.7**	**988.1**	**33.5**	**1,521.3**	**1,554.8**

[1] From financing activities and securities
p Preliminary

Table A.51
Islamic Banking System: Financing Activities

	For the year					
	2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Financing approvals	3,304.5	13,968.5	17,273.0	7,915.9	18,873.3	26,789.2
Financing disbursements	8,771.6	32,317.0	41,088.6	13,014.0	36,044.7	49,058.7
Financing repayments	7,680.0	25,999.0	33,679.0	11,341.6	30,865.9	42,207.5
	As at end-					
	2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Outstanding financing	11,423.1	46,418.2	57,841.3	20,627.1	46,737.5	67,364.6

p Preliminary

Table A.52
Islamic Banking System: Financing to Small and Medium Enterprises

	For the year					
	2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Financing approvals	382.3	2,300.0	2,682.3	751.9	2,807.1	3,559.0
Financing disbursements	1,856.5	4,702.8	6,559.3	1,957.1	5,894.7	7,851.8
	As at end-					
	2004			2005*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Outstanding financing	1,860.9	6,133.1	7,994.0	2,512.4	6,095.3	8,607.7
Total non-performing financing	375.9	307.0	682.9	535.5	576.5	1,112.0

p Preliminary

Table A.53
Islamic Banking System: Direction of Financing

	As at end-							
	2004				2005*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Business enterprises	**5,469.8**	**18,305.7**	**23,775.5**	**41.1**	**8,256.4**	**17,334.7**	**25,591.1**	**38.0**
Households	**5,803.4**	**27,392.0**	**33,195.4**	**57.4**	**12,193.2**	**28,864.2**	**41,057.4**	**60.9**
Others	**149.8**	**720.6**	**870.4**	**1.5**	**177.5**	**538.6**	**716.1**	**1.1**
Total	**11,423.0**	**46,418.3**	**57,841.3**	**100.0**	**20,627.1**	**46,737.5**	**67,364.6**	**100.0**
Agriculture, hunting, forestry and fishing	241.6	2,086.9	2,328.5	4.0	531.4	1,837.9	2,369.3	3.5
Manufacturing	1,687.7	4,424.9	6,112.6	10.6	2,368.5	5,151.0	7,519.5	11.2
Mining and quarrying	15.1	61.5	76.6	0.1	16.4	88.5	104.9	0.2
Electricity, gas and water supply	11.7	707.5	719.2	1.2	275.8	143.3	419.1	0.6
Wholesale and retail trade, restaurants and hotels	447.2	2,623.7	3,070.9	5.3	820.5	2,567.5	3,388.0	5.0
Wholesale trade	*292.3*	*1,951.0*	*2,243.3*	*3.9*	*559.3*	*1,832.9*	*2,392.2*	*3.6*
Retail trade	*135.3*	*602.6*	*737.9*	*1.3*	*231.3*	*673.7*	*905.0*	*1.3*
Restaurants and hotels	*19.6*	*70.1*	*89.7*	*0.2*	*29.9*	*60.9*	*90.8*	*0.1*
Broad property sector	5,985.2	16,425.5	22,410.7	38.7	8,523.5	14,399.6	22,923.1	34.0
Real estate	*86.3*	*820.1*	*906.4*	*1.6*	*294.6*	*678.1*	*972.7*	*1.4*
Construction	*1,452.2*	*2,078.7*	*3,530.9*	*6.1*	*1,440.3*	*1,891.3*	*3,331.6*	*4.9*
Purchase of residential property	*3,596.4*	*11,796.6*	*15,393.0*	*26.6*	*5,796.7*	*10,178.0*	*15,974.7*	*23.8*
Purchase of non-residential property	*850.3*	*1,730.1*	*2,580.4*	*4.5*	*991.9*	*1,652.2*	*2,644.1*	*3.9*
Transport, storage and communication	181.3	995.2	1,176.5	2.0	254.5	1,033.0	1,287.5	1.9
Finance, insurance and business services	146.1	1,830.9	1,977.0	3.4	461.9	1,537.1	1,999.0	3.0
Financial services	*94.3*	*1,103.3*	*1,197.6*	*2.1*	*141.2*	*1,235.1*	*1,376.3*	*2.1*
Insurance	*0.6*	*2.6*	*3.2*	*0.0*	*0.2*	*1.2*	*1.4*	*0.0*
Business services	*51.2*	*725.0*	*776.2*	*1.3*	*320.5*	*300.8*	*621.3*	*0.9*
Consumption credit	2,134.5	14,986.5	17,121.0	29.6	6,232.2	18,143.9	24,376.1	36.2
Personal uses	*810.6*	*1,637.8*	*2,448.4*	*4.2*	*1,236.1*	*2,502.1*	*3,738.2*	*5.5*
Credit cards	*127.1*	*184.9*	*312.0*	*0.5*	*166.1*	*301.0*	*467.1*	*0.7*
Purchase of consumer durables	*33.0*	*10.6*	*43.6*	*0.1*	*31.3*	*6.7*	*38.0*	*0.1*
Purchase of passenger cars	*1,163.8*	*13,153.2*	*14,317.0*	*24.8*	*4,798.7*	*15,334.1*	*20,132.8*	*29.9*
Purchase of securities	256.1	621.8	877.9	1.5	571.6	348.7	920.3	1.4
Purchase of transport vehicles	72.5	609.0	681.5	1.2	164.2	542.4	706.6	1.0
Community, social and personal services	94.2	324.3	418.5	0.7	229.0	406.2	635.2	0.9
Others	149.8	720.6	870.4	1.5	177.6	538.4	716.0	1.1
Total	**11,423.0**	**46,418.3**	**57,841.3**	**100.0**	**20,627.1**	**46,737.5**	**67,364.6**	**100.0**

p Preliminary

Table A.54
Islamic Banking System: Non-performing Financing by Sector

	As at end-							
	2004				2005*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Business enterprises	**1,090.1**	**1,346.7**	**2,436.8**	**49.0**	**1,383.1**	**1,262.8**	**2,645.9**	**44.2**
Households	**572.4**	**1,864.4**	**2,436.8**	**49.0**	**1,005.2**	**2,137.0**	**3,142.2**	**52.4**
Others	**6.2**	**88.4**	**94.6**	**2.0**	**11.3**	**192.5**	**203.8**	**3.4**
Total	**1,668.7**	**3,299.5**	**4,968.2**	**100.0**	**2,399.6**	**3,592.3**	**5,991.9**	**100.0**
Agriculture, hunting, forestry and fishing	38.4	7.4	45.8	0.9	58.1	8.7	66.8	1.1
Manufacturing	195.4	69.7	265.1	5.3	287.3	155.8	443.1	7.4
Mining and quarrying	5.1	1.1	6.2	0.1	5.6	4.3	9.9	0.2
Electricity, gas and water supply	2.1	0.1	2.2	0.0	2.8	0.3	3.1	0.1
Wholesale and retail trade, restaurants and hotels	92.9	138.8	231.7	4.7	104.0	103.5	207.5	3.5
Wholesale trade	*54.7*	*52.7*	*107.4*	*2.2*	*67.1*	*27.5*	*94.6*	*1.6*
Retail trade	*29.1*	*80.6*	*109.7*	*2.2*	*29.8*	*69.4*	*99.2*	*1.7*
Restaurants and hotels	*9.1*	*5.5*	*14.6*	*0.3*	*7.1*	*6.6*	*13.7*	*0.2*
Broad property sector	992.0	2,320.2	3,312.2	66.7	1,446.4	2,183.7	3,630.1	60.6
Real estate	*0.9*	*302.2*	*303.1*	*6.1*	*5.5*	*180.8*	*186.3*	*3.1*
Construction	*407.2*	*364.2*	*771.4*	*15.5*	*439.9*	*352.9*	*792.8*	*13.2*
Purchase of residential property	*373.9*	*1,416.0*	*1,789.9*	*36.0*	*726.5*	*1,447.3*	*2,173.8*	*36.3*
Purchase of non-residential property	*210.0*	*237.8*	*447.8*	*9.0*	*274.5*	*202.7*	*477.2*	*8.0*
Transport, storage and communication	36.4	92.9	129.3	2.6	81.0	72.4	153.4	2.6
Finance, insurance and business services	14.7	7.6	22.3	0.4	32.7	36.0	68.7	1.1
Financial services	*10.8*	*1.1*	*11.9*	*0.2*	*12.0*	*31.0*	*43.0*	*0.7*
Insurance	*0.5*	*0.2*	*0.7*	*0.0*	*0.2*	*–*	*0.2*	*0.0*
Business services	*3.4*	*6.3*	*9.7*	*0.2*	*20.5*	*5.0*	*25.5*	*0.4*
Consumption credit	134.1	86.0	220.1	4.4	166.6	116.9	283.5	4.7
Personal uses	*124.8*	*75.2*	*200.0*	*4.0*	*155.3*	*85.5*	*240.8*	*4.0*
Credit cards	*6.9*	*10.4*	*17.3*	*0.3*	*8.0*	*31.2*	*39.2*	*0.6*
Purchase of consumer durables	*2.4*	*0.4*	*2.8*	*0.1*	*3.3*	*0.2*	*3.5*	*0.1*
Purchase of securities	65.4	93.9	159.3	3.2	65.7	124.5	190.2	3.2
Purchase of transport vehicles[1]	64.4	362.5	426.9	8.6	112.3	572.7	685.0	11.4
Community, social and personal services	21.6	30.9	52.5	1.1	26.0	21.0	47.0	0.8
Others	6.2	88.4	94.6	1.9	11.1	192.5	203.6	3.3
Total	**1,668.7**	**3,299.5**	**4,968.2**	**100.0**	**2,399.6**	**3,592.3**	**5,991.9**	**100.0**

[1] Include purchase of passenger cars
p Preliminary

Table A.55
Islamic Banking System: Deposits by Type and Institution

	As at end-					As percentage of total deposits (%)				
	2001	2002	2003	2004	2005*p*	2001	2002	2003	2004	2005*p*
	RM million					%				
Total deposits	**47,106.5**	**53,162.8**	**60,211.6**	**72,856.9**	**83,874.8**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Islamic banks	14,375.6	16,401.4	17,583.8	20,753.7	35,625.5	30.5	30.9	29.2	28.5	42.5
Commercial banks	22,031.0	23,353.9	26,518.7	39,775.4	42,775.2	46.8	43.9	44.0	54.6	51.0
Finance companies	7,663.7	9,092.6	10,965.6	5,951.6	684.1	16.3	17.1	18.2	8.2	0.8
Merchant banks	673.5	684.2	851.7	1,526.8	796.6	1.4	1.3	1.4	2.1	0.9
Discount Houses	2,362.7	3,630.7	4,291.8	4,849.4	3,993.4	5.0	6.8	7.2	6.6	4.8
Demand deposits	**6,457.4**	**9,191.7**	**10,979.7**	**12,916.8**	**14,785.6**	**13.7**	**17.3**	**18.2**	**17.7**	**17.6**
Islamic banks	2,616.2	3,457.2	4,142.9	4,577.9	6,954.7	5.6	6.5	6.9	6.3	8.3
Commercial banks	3,841.2	5,734.5	6,836.8	8,338.7	7,830.9	8.1	10.8	11.3	11.4	9.3
Savings deposits	**4,149.4**	**5,425.0**	**6,865.7**	**8,432.1**	**9,504.5**	**8.8**	**10.2**	**11.4**	**11.6**	**11.3**
Islamic banks	1,454.0	1,762.3	1,951.9	2,301.6	3,424.8	3.1	3.3	3.2	3.2	4.1
Commercial banks	2,133.4	3,030.5	4,174.8	5,771.3	6,047.1	4.5	5.7	6.9	7.9	7.2
Finance companies	562.0	632.2	739.0	359.1	32.6	1.2	1.2	1.3	0.5	0.0
Investment deposits	**33,504.0**	**35,843.4**	**35,227.5**	**41,993.5**	**44,579.3**	**71.1**	**67.4**	**58.5**	**57.6**	**53.2**
Islamic banks	10,181.1	11,089.6	11,183.0	12,916.9	19,972.6	21.6	20.9	18.5	17.7	23.8
Commercial banks	13,609.6	12,455.5	10,226.5	19,150.2	19,328.9	28.9	23.4	17.0	26.3	23.1
Finance companies	6,985.8	8,403.4	9,019.4	3,859.6	651.6	14.8	15.8	15.0	5.3	0.8
Merchant banks	369.8	377.0	590.3	1,304.0	744.9	0.8	0.7	1.0	1.8	0.9
Discount houses	2,357.7	3,517.9	4,208.3	4,762.8	3,881.3	5.0	6.6	7.0	6.5	4.6
Other deposits	**2,995.7**	**2,702.7**	**7,138.7**	**9,514.6**	**15,005.4**	**6.4**	**5.1**	**11.9**	**13.1**	**17.9**
Islamic banks	124.3	92.4	306.0	957.2	5,273.3	0.3	0.2	0.5	1.3	6.3
Commercial banks	2,446.9	2,133.4	5,280.6	6,515.1	9,568.3	5.2	4.0	8.8	8.9	11.4
Finance companies	115.8	56.9	1,207.1	1,732.8	0.0	0.2	0.1	2.1	2.4	0.0
Merchant banks	303.7	307.3	261.4	222.8	51.6	0.7	0.6	0.4	0.4	0.1
Discount houses	5.0	112.7	83.6	86.7	112.2	0.0	0.2	0.1	0.1	0.1

p Preliminary

Table A.56
Development Financial Institutions[1]: Sources and Uses of Funds

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Sources:					
Shareholders' funds	6,906.7	7,905.4	9,424.1	10,543.8	12,616.4
Paid-up capital	*5,416.9*	*6,012.4*	*7,192.3*	*7,862.3*	*8,563.4*
Reserves	*1,196.2*	*1,517.0*	*1,599.6*	*2,051.3*	*2,448.1*
Retained earnings	*293.6*	*376.0*	*632.2*	*630.2*	*1,604.9*
Deposits accepted	39,305.7	39,797.6	42,403.3	49,878.0	53,536.6
Borrowings	13,024.9	13,977.0	16,576.8	18,730.9	20,981.6
Government	*6,625.8*	*8,875.4*	*11,730.2*	*13,050.1*	*14,871.4*
Multilateral/International agencies	*3,321.7*	*3,434.3*	*3,158.5*	*4,044.2*	*4,646.7*
Others	*3,077.4*	*1,667.3*	*1,688.1*	*1,636.6*	*1,463.5*
Others	8,828.5	10,766.4	10,686.2	12,297.2	13,009.8
Total	**68,065.8**	**72,446.4**	**79,090.4**	**91,449.9**	**100,144.4**
Uses:					
Deposits placed	12,265.2	12,446.2	16,244.7	18,908.0	14,111.1
Investments	21,968.0	19,268.1	21,229.5	25,557.0	29,731.3
of which:					
Government securities	*3,715.0*	*1,952.3*	*2,950.8*	*2,629.3*	*4,777.8*
Shares	*5,099.4*	*6,427.4*	*6,778.1*	*8,256.0*	*9,791.2*
Quoted	*4,478.5*	*5,325.6*	*5,200.9*	*6,369.1*	*7,933.7*
Unquoted	*620.9*	*1,101.8*	*1,577.2*	*1,886.9*	*1,857.5*
Loans and advances	24,486.3	29,442.4	32,354.8	37,747.1	47,478.4
Fixed assets	3,011.6	3,606.7	3,707.5	4,057.7	4,226.9
Others	6,334.7	7,683.0	5,553.9	5,180.1	4,596.7
Total	**68,065.8**	**72,446.4**	**79,090.4**	**91,449.9**	**100,144.4**
Contingencies:					
Guarantee	3,341.5	3,160.1	3,661.6	3,949.0	4,404.1
Export credit insurance	148.0	151.4	123.3	308.6	380.4
Total	**3,489.5**	**3,311.5**	**3,784.9**	**4,257.6**	**4,784.5**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji. Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and Malaysia Export Credit Insurance Berhad and exclude SME Bank

Table A.57
Development Financial Institutions[1] under DFIA[2]: Sources and Uses of Funds

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Sources:					
Shareholders' funds	3,495.0	4,087.6	5,359.4	6,178.1	7,719.3
Paid-up capital	*2,718.0*	*3,288.5*	*4,167.5*	*4,811.1*	*5,503.6*
Reserves	*389.1*	*877.7*	*964.1*	*1,339.4*	*1,736.3*
Retained earnings	*387.9*	*-78.6*	*227.8*	*27.6*	*479.4*
Deposits accepted	28,663.3	29,373.9	30,762.7	37,278.5	40,225.5
Borrowings	9,668.2	9,851.7	12,347.7	14,586.9	16,660.8
Government	*4,659.0*	*6,248.0*	*9,039.8*	*10,438.2*	*12,146.2*
Multilateral/International agencies	*3,037.8*	*3,135.1*	*2,933.9*	*3,846.3*	*4,205.9*
Others	*1,971.4*	*468.6*	*374.0*	*302.4*	*308.7*
Others	6,088.6	8,358.2	8,403.7	9,730.3	10,217.7
Total	**47,915.1**	**51,671.4**	**56,873.5**	**67,773.8**	**74,823.3**
Uses:					
Deposits placed	8,771.4	8,212.5	11,383.5	12,949.5	8,185.6
Investments	12,579.6	11,637.0	12,970.7	15,868.1	18,666.7
of which:					
Government securities	*3,355.0*	*1,952.3*	*2,736.5*	*2,549.8*	*4,730.0*
Shares	*2,364.4*	*6,427.4*	*1,778.5*	*1,705.8*	*1,803.3*
Quoted	*2,205.4*	*5,325.6*	*1,664.7*	*1,616.7*	*1,686.7*
Unquoted	*159.0*	*1,101.8*	*113.8*	*89.1*	*116.6*
Loans and advances	21,135.9	25,191.1	28,072.3	33,472.5	43,381.0
Fixed assets	947.2	1,496.0	1,550.3	1,786.1	1,842.0
Others	4,481.0	5,134.8	2,896.7	3,697.6	2,748.0
Total	**47,915.1**	**51,671.4**	**56,873.5**	**67,773.8**	**74,823.3**
Contingencies:					
Guarantee	672.5	575.4	549.1	533.3	613.5
Export credit insurance	148.0	151.5	123.3	308.6	380.4
Total	**820.5**	**726.9**	**672.4**	**841.9**	**993.9**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia and Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank). Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and Malaysia Export Credit Insurance Berhad and exclude SME Bank
[2] Development Financial Institutions Act 2002

Table A.58
Development Financial Institutions[1]: Direction of Lending

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Agriculture, forestry and fishery	2,750.2	2,964.3	2,874.0	3,261.3	3,357.6
Mining and quarrying	46.1	90.0	75.2	66.8	56.6
Manufacturing	3,147.5	3,356.6	3,952.0	4,126.2	4,458.6
Electricity, gas and water supply	334.9	453.8	617.1	1,228.9	2,253.0
Import and export, wholesale and retail trade, restaurants and hotels	618.1	240.4	250.4	698.8	643.3
Broad property sector	5,700.4	7,840.6	8,376.6	10,084.7	11,662.9
Construction	*2,346.9*	*3,790.6*	*4,009.4*	*4,186.6*	*5,120.5*
Purchase of residential property	*2,593.8*	*2,785.2*	*2,927.9*	*4,078.1*	*5,475.1*
Purchase of non-residential property	*268.8*	*393.4*	*441.1*	*463.9*	*429.6*
Real estate	*490.9*	*871.4*	*998.2*	*1,356.1*	*637.7*
Transport, storage and communication	2,860.5	4,362.1	4,433.7	4,665.2	5,844.5
Maritime	733.1	530.4	473.1	474.4	682.5
Finance, insurance and business services	1,300.7	1,780.5	1,694.7	984.2	810.7
Consumption credit	5,404.2	6,716.1	8,066.5	9,896.5	14,069.0
of which:					
Purchase of motor vehicles	*819.2*	*816.5*	*800.2*	*1,104.8*	*1,508.2*
Credit card	*47.8*	*48.0*	*23.7*	*24.3*	*32.6*
Purchase of securities	356.2	173.2	136.2	103.4	88.2
Others	1,234.4	934.4	1,405.3	2,156.7	3,551.5
Total	**24,486.3**	**29,442.4**	**32,354.8**	**37,747.1**	**47,478.4**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji. Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and exclude SME Bank

Table A.59
Development Financial Institutions[1] under DFIA[2]: Direction of Lending

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Agriculture, forestry and fishery	2,628.3	2,823.1	2,749.1	3,148.3	3,239.5
Mining and quarrying	34.5	80.5	58.8	49.1	35.5
Manufacturing	2,204.2	2,130.2	2,675.3	2,872.2	3,254.5
Electricity, gas and water supply	334.9	453.8	617.1	1,228.9	2,251.6
Import and export, wholesale and retail trade, restaurants and hotels	129.0	125.9	151.5	260.7	356.9
Broad property sector	5,078.2	6,846.9	7,371.4	8,933.1	10,580.9
Construction	*2,192.1*	*3,641.3*	*3,842.0*	*3,973.7*	*4,908.8*
Purchase of residential property	*2,288.0*	*2,480.3*	*2,629.3*	*3,797.0*	*5,195.4*
Purchase of non-residential property	*267.3*	*391.3*	*438.8*	*461.2*	*429.1*
Real estate	*330.8*	*334.0*	*461.3*	*701.2*	*47.6*
Transport, storage and communication	2,746.5	4,321.6	4,390.0	4,615.0	5,794.9
Maritime	733.1	530.4	473.1	474.4	682.5
Finance, insurance and business services	1,198.0	877.6	896.0	827.4	657.0
Consumption credit	5,339.6	6,567.8	7,812.8	9,571.1	13,693.8
of which:					
Purchase of motor vehicles	*754.6*	*741.2*	*800.2*	*1,104.8*	*1,508.2*
Credit card	*47.8*	*48.0*	*23.7*	*24.3*	*32.6*
Purchase of securities	356.2	173.2	136.2	103.4	88.2
Others	353.4	260.1	741.0	1,388.9	2,745.7
Total	**21,135.9**	**25,191.1**	**28,072.3**	**33,472.5**	**43,381.0**

[1] Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia and Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank). Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and exclude SME Bank
[2] Development Financial Institutions Act 2002

Table A.60
Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank)
(formerly known as Bank Industri & Teknologi Malaysia Berhad)

Year of establishment	October 2005
Objectives	To provide financing and advisory services to SMEs involve in manufacturing, services and construction sectors, particularly Bumiputera entrepreneurs.

Sector	Loans Outstanding			Loans Approved			Loans Disbursed		
	As at end-			During the year	During the period		During the year	During the period	
	Dec 04[1]	Sept 05[1]	Dec 05	2004[1]	Jan - Sept 05[1]	Oct - Dec 05	2004[1]	Jan - Sept 05[1]	Oct - Dec 05
	RM million								
SMEs	–	–	2,133.0	–	–	333.8	–	–	319.7
Bumiputera	–	–	*1,694.5*	–	–	*311.2*	–	–	*271.0*
Non-Bumiputera	–	–	*438.5*	–	–	*22.6*	–	–	*48.7*
Maritime	474.4	534.6	–	378.1	214.0	–	171.5	111.8	–
Shipping industry	*309.4*	*355.5*	–	*217.5*	*118.4*	–	*144.6*	*55.3*	–
Shipyard industry	*112.9*	*116.0*	–	*9.2*	*80.6*	–	*10.9*	*24.3*	–
Marine-related services	*52.1*	*63.1*	–	*151.4*	*15.0*	–	*16.0*	*32.2*	–
Manufacturing	407.9	452.7	–	329.8	234.5	–	147.6	122.0	–
of which: *High-technology*	*38.0*	*132.7*	–	*70.0*	*0.0*	–	*1.9*	*17.9*	–
Others	84.4	88.9	–	37.6	0.0	–	39.0	7.6	–
Total	966.7	1,076.2	2,133.0	745.5	448.5	333.8	358.1	241.4	319.7

[1] Refers to data for Bank Industri & Teknologi Malaysia Berhad

Source : Bank Perusahaan Kecil & Sederhana Malaysia Berhad

Table A.61
Export-Import Bank of Malaysia Berhad

Year of establishment	1995			
Objectives[1]	To provide credit facilities to finance and support the exports and imports of goods, services and overseas project financing with concentration to the non-traditional markets, as well as to provide export credit insurance services, export financing insurance, overseas investment insurance and guarantee facilities; as well as other services which are normally offered by the export-import financial institutions and credit insurance financial institutions.			
Loans Facility	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2004	2005	2004	2005
Buyer credit facility	252.7	393.3	24.3	145.3
Overseas investment credit facility	196.4	215.8	212.6	160.6
Supplier credit facility	306.8	496.7	363.8	455.8
Export of services financing facility	0.0	42.3	0.0	0.0
Export credit refinancing	6,762.6	7,286.1	6,762.6	7,286.1
Total	**7,518.5**	**8,434.2**	**7,363.3**	**8,047.8**
Guarantee and Insurance Policy	Contingent Liabilities (RM million)		Business Coverage (RM million)	
	As at end-2004	As at end-2005	2004	2005
Short-term Policies	351.3	459.4	1,540.5	1,715.3
Comprehensive policies	*307.0*	*369.5*	*1,479.3*	*1,577.2*
Bank letter of credit policy	*20.4*	*45.7*	*61.2*	*138.1*
Specific policies	*0.8*	*0.0*	*0.0*	*0.0*
Bond indemnity support	*2.5*	*0.0*	*0.0*	*0.0*
Others	*20.6*	*44.2*	*0.0*	*0.0*
Sub-total[2]	351.3	459.4	1,540.5	1,715.3
Medium- and Long-term Policies	490.6	534.5	22.1	3.8
Specific policies	*1.0*	*0.0*	*9.6*	*0.0*
Buyer credit guarantee	*277.8*	*241.7*	*0.0*	*0.0*
Bond indemnity support	*24.7*	*23.0*	*4.1*	*0.0*
Overseas investment insurance	*7.5*	*10.9*	*8.4*	*3.8*
Others	*179.6*	*258.9*	*0.0*	*0.0*
Sub-total	490.6	534.5	22.1	3.8
Total	**841.9**	**993.9**	**1,562.6**	**1,719.1**

[1] Effective 1 October 2005, the bank has been entrusted with a new and revised mandated role following the merger with Malaysia Export Credit Insurance Berhad (MECIB)
[2] Excluding Banker's export finance insurance policy

Source: Export-Import Bank of Malaysia Berhad

Table A.62
Bank Simpanan Nasional

Year of establishment	1974			
Objectives	Bank Simpanan Nasional is a savings bank, incorporated under the National Savings Bank Act 1974 and focuses on retail banking and personal finance especially for small savers.			

Deposits facility	Deposits Accepted (RM million)		Interest Rate / Rate of Return (%)	
	As at end-2004	As at end-2005	2004	2005
Savings deposits	1,103.7	882.6	1.00~2.00	0.30~1.50
Fixed deposits	4,654.2	6,823.7	3.00~3.70	3.00~3.70
GIRO deposits	4,054.1	4,262.5	1.00~2.00	0.30~1.50
Islamic deposits	252.0	265.0	1.90~5.52	1.00~3.81
Premium savings certificates	922.8	851.4	1.50	–
Total	**10,986.8**	**13,085.2**		

Investments	RM million	
	As at end-2004	As at end-2005
Quoted shares	1,277.7	1,208.8
Malaysian Government Securities	2,267.1	3,626.6
Private debt securities	819.7	1,319.4
Subsidiary companies	437.8	437.8
Associate companies	231.8	231.8
Total	**5,034.1**	**6,824.4**
Number of branches	393	390
Number of account holders (‘000)	11,446	11,537
Number of automatic teller machines (ATM)	599	616

Source: Bank Simpanan Nasional

Table A.63
Bank Kerjasama Rakyat Malaysia Berhad

Year of establishment	1954			
Objectives	Bank Kerjasama Rakyat Malaysia Berhad mobilises savings and provides financing services to its members as well as non-members.			
Sector	Financing Outstanding (RM million)			
	As at end-2004		As at end-2005	
	Members	Non-members	Members	Non-members
Agriculture	48.3	10.2	45.7	14.9
Purchase of property	2,246.8	822.7	2,800.6	1,333.3
General commerce	45.7	399.5	58.3	497.6
Purchase of securities	10.8	78.9	7.8	69.3
Purchase of motor vehicles	649.6	0.6	1,122.9	0.5
Consumption credit	6,656.8	1,032.1	7,623.9	2,859.6
Manufacturing	–	100.8	–	100.8
Others	–	251.1	–	295.1
Total	**9,658.0**	**2,695.9**	**11,659.2**	**5,171.1**

Source: Bank Kerjasama Rakyat Malaysia Berhad

Table A.64
Bank Pembangunan Malaysia Berhad
(formerly known as Bank Pembangunan dan Infrastruktur Malaysia Berhad)

Year of establishment	1973
Objectives[1]	To provide medium- and long-term financing for infrastructure projects, maritime, capital intensive and high technology industries in manufacturing sector and other selected sectors in line with the national development policy.

Sector	Loans Outstanding			Loans Approved			Loans Disbursed		
	As at end-			During the year	During the period		During the year	During the period	
	Dec 04*	Sept 05*	Dec 05	2004*	Jan - Sept 05*	Oct - Dec 05	2004*	Jan - Sept 05*	Oct - Dec 05
	RM million								
Infrastructure	9,929.4	12,776.7	13,313.8	7,428.8	1,643.0	247.4	1,905.5	3,990.9	669.7
Government programmes	*7,218.1*	*9,232.6*	*9,324.2*	*3,412.2*	*276.6*	*70.0*	*863.0*	*2,552.9*	*189.5*
Private programmes	*2,711.3*	*3,544.1*	*3,989.6*	*4,016.6*	*1,366.4*	*177.4*	*1,042.5*	*1,438.0*	*480.2*
SMEs	1,673.9	1,925.6	–	1,583.6	1,317.0	–	648.3	597.7	–
of which: Bumiputera	*1,391.6*	*1,674.7*	–	*1,506.5*	*1,226.0*	–	*601.2*	*577.2*	–
Maritime	–	–	682.5	–	–	8.9	–	–	68.4
Shipping industry	–	–	*396.4*	–	–	*8.9*	–	–	*12.3*
Shipyard industry	–	–	*222.1*	–	–	*0.0*	–	–	*36.7*
Marine-related services	–	–	*64.0*	–	–	*0.0*	–	–	*19.4*
Manufacturing	–	–	185.8	–	–	23.0	–	–	39.0
of which: High technology	–	–	*185.8*	–	–	*23.0*	–	–	*39.0*
Others	–	–	57.4	–	–	0.0	–	–	0.0
Total	**11,603.3**	**14,702.3**	**14,239.5**	**9,012.4**	**2,960.0**	**279.3**	**2,553.8**	**4,588.6**	**777.1**

* Refers to data for Bank Pembangunan dan Infrastruktur Malaysia Berhad
1 Revised following the rationalisation exercise effective 1 October 2005

Source: Bank Pembangunan Malaysia Berhad

Table A.65
Bank Pertanian Malaysia

Year of establishment	1969			
Objectives	Bank Pertanian Malaysia was established to promote sound agricultural development in the country, through the provision of loans and advances. The main function of the bank is to co-ordinate and supervise the granting of credit facilities for agricultural purposes and mobilise savings, particularly from the agriculture sector and community.			
Agriculture, Forestry & Fishery	Loans Approved		Loans Disbursed	
	(RM million)			
	2004	2005	2004	2005
Sub-sector				
Oil palm	*196.8*	*237.0*	*121.2*	*186.4*
Food crops	*74.4*	*110.3*	*82.4*	*85.8*
Livestock	*60.4*	*109.2*	*69.2*	*63.5*
Fishery	*122.7*	*67.4*	*46.8*	*42.6*
Forestry	*21.0*	*16.2*	*1.4*	*7.5*
Tobacco	*0.7*	*1.6*	*19.7*	*14.0*
Rubber	*8.4*	*16.5*	*9.3*	*8.5*
Others	*615.2*	*307.3*	*578.0*	*308.4*
Total	**1,099.6**	**865.5**	**928.0**	**716.7**

Source: Bank Pertanian Malaysia

Table A.66
Other Development Financial Institutions[1]: Core Activities

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Lending Activity					
Agriculture	122.0	141.2	124.9	113.1	118.1
Manufacturing	943.3	1,226.4	1,276.7	1,254.0	1,204.0
Broad property sector	622.2	993.7	1,005.2	1,151.6	1,082.0
Construction	*154.8*	*149.2*	*167.4*	*212.9*	*211.7*
Purchase of residential property	*305.7*	*304.9*	*298.6*	*281.1*	*279.6*
Purchase of non-residential property	*1.5*	*2.1*	*2.3*	*2.7*	*0.5*
Real estate	*160.2*	*537.5*	*536.9*	*654.9*	*590.2*
Consumption credit	64.6	148.4	253.6	325.4	375.3
Others	1,598.3	1,741.7	1,621.9	1,430.5	1,318.0
Total	**3,350.4**	**4,251.4**	**4,282.3**	**4,274.6**	**4,097.4**
Other Activities					
Deposits accepted	10,642.4	10,423.7	11,640.6	12,599.5	13,311.2
of which:					
Savings	*10,565.8*	*10,270.4*	*11,286.6*	*12,085.4*	*12,771.2*
Guarantee issued	2,669.0	2,584.7	3,112.5	3,415.7	3,790.6

[1] Refers to Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.67
Development Financial Institutions: Selected Data

	As at end-					
	2004			2005		
DFIs under DFIA[1]:	Branch	ATM	Staff	Branch	ATM	Staff
Bank Pembangunan Malaysia Berhad[2]	14	–	690	–	–	377
Bank Kerjasama Rakyat Malaysia Berhad	103	119	2,866	106	127	2,860
Bank Simpanan Nasional	393	599	5,220	390	616	5,098
Export-Import Bank of Malaysia Berhad[3]	–	–	72	–	–	160
Bank Pertanian Malaysia	181	142	2,585	172	142	2,628
Bank Perusahaan Kecil & Sederhana Malaysia Berhad[3]	–	–	–	15	–	678
Sub-total	691	860	11,433	683	885	11,801
Other DFIs:						
Malaysian Industrial Development Finance Berhad	7	–	334	8	–	332
Sabah Development Bank Berhad	–	–	82	–	–	81
Borneo Development Corporation (Sabah) Sendirian Berhad	–	–	16	–	–	13
Borneo Development Corporation (Sarawak) Sendirian Berhad	–	–	36	–	–	35
Credit Guarantee Corporation Malaysia Berhad	16	–	325	16	–	374
Sabah Credit Corporation	10	–	212	10	–	210
Lembaga Tabung Haji	119	–	1,581	119	–	1,600
Sub-total	152	–	2,586	153	–	2,645
Total	**843**	**860**	**14,019**	**836**	**885**	**14,446**

[1] Development Financial Institutions Act 2002
[2] Formerly known as Bank Pembangunan dan Infrastruktur Malaysia Berhad
[3] Refer to DFI after rationalisation effective 1 October 2005

Table A.68a
Development Financial Institutions: Government Special Funds

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Export-Import Bank of Malaysia Berhad						
Export Credit Refinancing (ECR) Scheme[1]	6,770.8	7,286.1	6,770.8	7,286.1	1,189.7	1,508.3
Bank Kerjasama Rakyat Malaysia Berhad						
Financing Scheme for Rural Economic Development	9.3	9.3	5.9	11.9	20.2	30.2
Bank Pertanian Malaysia						
Agricultural Mechanisation and Automation Scheme	0.9	10.4	1.7	–	8.8	7.1
Bumiputera Commercial and Industrial Community Scheme	9.0	14.7	6.6	7.5	17.6	20.0
Commercial Agriculture Graduate Entrepreneurs Scheme	1.4	4.5	1.4	1.6	2.2	3.6
Credit Scheme for Paddy	30.4	45.7	30.2	33.8	25.3	26.6
Financial Credit Scheme[2]	–	–	–	–	6.4	5.4
Food Production Credit Scheme	–	1.6	–	1.3	–	1.2
Hardcore Poor Development Programme[2]	–	–	–	–	…	…
Low Intensity Tapping Scheme	0.2	2.9	0.2	0.2	0.1	…
Oil Palm Replanting Scheme	5.7	3.9	12.8	21.1	17.6	63.1
Special Agriculture Financing Scheme[2]	–	–	–	–	40.9	33.7
Special Fund for Fishery	1.6	1.9	1.6	1.4	15.9	15.4
Malaysian Industrial Development Finance Berhad						
Malaysian Industrial Energy Efficiency Improvement Project	4.0	1.3	2.2	1.5	0.3	1.8
Modernisation Automation Scheme[2]	–	–	0.4	…	15.7	10.5
Soft Loan for Factory Relocation Scheme	4.5	8.9	1.1	1.7	1.1	2.8
Soft Loan for Information and Communication Technology Scheme	2.3	2.8	0.3	1.9	0.3	2.1
Soft Loan for Small and Medium Enterprises Scheme	26.1	87.3	42.2	29.7	88.0	96.9
Special Fund for Terengganu-based Small and Medium Industry	0.8	0.4	0.7	0.5	1.4	1.6

[1] Inclusive of funds from Bank Negara Malaysia, which are channelled through 25 participating banks
[2] Funds have been fully utilised
… Negligible

Table A.68b
Development Financial Institutions: Government Special Funds

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Funds prior to rationalisation (data until end-September 2005)						
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
Fiction Film Financing Scheme	–	15.8	–	5.9	–	6.0
Financing Programme for Wholesalers and Distributors (Tanmiah 2)	8.8	0.3	5.0	6.2	4.4	7.5
Financing Scheme for Indian Rural Economic Development	–	–	…	…	0.3	0.3
Financing Scheme for Rural Economic Development	8.8	10.9	5.2	9.1	29.0	34.2
Fund for Film Industry	–	–	–	–	2.6	2.4
Graduate Entrepreneurs Fund	5.9	5.5	5.0	5.1	11.7	13.0
Seed Capital Scheme	52.5	1.5	27.6	22.3	66.8	79.1
Special Fund for Tourism 2	211.0	177.3	100.5	96.8	132.4	226.0
Terengganu Entrepreneurs Fund	4.4	2.1	14.9	3.2	15.0	12.9
Third Window Financing Scheme (Tanmiah 1)	5.0	–	15.2	4.2	8.4	6.8
Tourism Infrastructure Fund	205.0	52.0	66.8	30.7	83.7	79.4
Venture Capital Fund	–	–	0.2	…	8.2	8.8
Batik Entrepreneurs Programme	–	1.4	–	0.8	–	0.8
Handicraft Entrepreneurs Programme	–	0.2	–	0.2	–	0.2
Bank Industri & Teknologi Malaysia Berhad						
Easy Financing Scheme - PAKSI	–	12.1	0.1	13.2	6.7	6.0
High Technology Fund	41.4	78.9	15.6	68.1	38.0	48.4
New Ship Financing Facility	35.0	222.0	29.2	213.2	71.7	197.0
Women Entrepreneurs Fund	–	11.3	1.1	11.4	7.3	5.9
Funds after rationalisation (data for October-December 2005)						
Bank Pembangunan Malaysia Berhad						
High Technology Fund**	–	–	–	10.0	–	56.5
New Ship Financing Facility**	–	3.7	–	29.6	–	223.2
Tourism Infrastructure Fund*	–	20.0	–	4.2	–	91.7
Bank Perusahaan Kecil & Sederhana Malaysia Berhad						
Financing Programme for Wholesalers and Distributors (Tanmiah 2)*	–	…	–	0.6	–	6.7
Financing Scheme for Indian Rural Economic Development*	–	–	–	…	–	0.3
Financing Scheme for Rural Economic Development*	–	4.0	–	2.2	–	35.2
Fund for Film Industry*	–	–	–	–	–	2.3
Graduate Entrepreneurs Fund*	–	1.7	–	1.8	–	14.3
Seed Capital Scheme*	–	–	–	3.0	–	75.1
Special Fund for Tourism 2*	–	32.6	–	33.2	–	257.1
Terengganu Entrepreneurs Fund*	–	0.8	–	1.5	–	12.7
Third Window Financing Scheme (Tanmiah 1)*	–	–	–	–	–	6.4
Venture Capital Fund*	–	–	–	–	–	6.7
Fiction Film Financing Scheme*	–	1.5	–	5.1	–	11.1
Batik Entrepreneurs Programme*	–	0.7	–	0.4	–	1.1
Handicraft Entrepreneurs Programme*	–	0.4	–	0.2	–	0.4
Easy Financing Scheme - PAKSI**	–	–	–	–	–	1.0
Women Entrepreneurs Fund**	–	–	–	–	–	4.9

* Funds originated from Bank Pembangunan dan Infrastruktur Malaysia Berhad
** Funds originated from Bank Industri & Teknologi Malaysia Berhad
… Negligible

Table A.69a
Development Financial Institutions: Bank Negara Malaysia Funds[1]

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Malaysian Industrial Development Finance Berhad						
New Entrepreneurs Fund[2]	–	–	–	–	5.6	4.3
New Entrepreneurs Fund 2	18.5	28.2	11.4	21.5	35.1	53.7
Fund for Small and Medium Industries[2]	–	–	–	–	19.5	–
Fund for Small and Medium Industries 2	79.7	81.1	38.9	74.8	46.9	102.7
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	1.4	0.9
Industrial Adjustment Fund[2]	–	–	–	–	3.7	–
Bumiputera Industrial Fund[2]	–	–	–	–	1.4	–
Bank Pertanian Malaysia						
Fund for Food	117.6	96.0	119.2	116.6	595.8	628.7
Fund for Small and Medium Industries[2]	–	–	–	–	81.3	–
Fund for Small and Medium Industries 2	1.3	–	1.2	0.8	4.3	4.9
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	12.3	10.9
Credit Guarantee Corporation Malaysia Berhad[4]						
New Entrepreneurs Fund 2	–	–	–	–	305.0	262.7
Fund for Small and Medium Industries[2]	–	–	1.2	–	276.7	63.8

[1] Bank Negara Malaysia fund for the ECR scheme administered by EXIM Bank is merged with the Government special funds in Table A.68a
[2] Funds have been fully utilised
[3] Fund was closed on 1 November 2003 and replaced by the Rehabilitation Fund for Small Businesses
[4] Administers and channels the funds through various lending institutions

Table A.69b
Development Financial Institutions: Bank Negara Malaysia Funds[1]

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Funds prior to rationalisation (data until end-September 2005)						
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
Special Fund for Tourism[2]	–	–	–	–	7.7	6.4
New Entrepreneurs Fund[2]	–	–	–	–	96.9	87.5
New Entrepreneurs Fund 2	193.3	92.4	182.5	62.7	328.5	377.0
Bumiputera Industrial Fund[2]	–	–	–	–	11.8	10.7
Fund for Food	–	–	–	–	4.2	4.1
Fund for Small and Medium Industries[2]	–	–	–	–	69.4	54.3
Fund for Small and Medium Industries 2	12.8	15.9	8.4	12.7	14.4	22.5
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	38.6	37.4
Bank Industri & Teknologi Malaysia Berhad						
Ship Financing Facility[2]	–	–	–	–	282.1	274.3
Fund for Small and Medium Industries[2]	–	–	–	–	17.6	13.1
Fund for Small and Medium Industries 2	27.4	15.7	12.9	15.6	16.6	27.8
New Entrepreneurs Fund 2	8.5	13.1	8.3	1.1	8.8	8.9
Industrial Adjustment Fund[2]	–	–	–	–	6.3	–
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	4.0	3.6
Funds after rationalisation (data for October-December 2005)						
Bank Pembangunan Malaysia Berhad						
New Entrepreneurs Fund 2	–	8.2	–	7.9	–	7.4
Fund for Small and Medium Industries[2]	–	5.0	–	5.0	–	–
Fund for Small and Medium Industries 2	–	1.7	–	1.5	–	1.5
Rehabilitation Fund for Small and Medium Industries[3]	–	1.6	–	1.6	–	1.0
Bank Perusahaan Kecil & Sederhana Malaysia Berhad						
Special Fund for Tourism[2]	–	–	–	20.2	–	6.4
New Entrepreneurs Fund[2]	–	–	–	376.1	–	87.5
New Entrepreneurs Fund 2	–	588.9	–	549.3	–	436.5
Bumiputera Industrial Fund[2]	–	–	–	36.0	–	10.7
Fund for Food	–	6.6	–	6.6	–	4.0
Fund for Small and Medium Industries[2]	–	–	–	234.1	–	–
Fund for Small and Medium Industries 2	–	190.2	–	75.9	–	51.5
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	50.3	–	40.0

[1] Bank Negara Malaysia fund for the ECR scheme administered by EXIM Bank is merged with the Government fund in Table A.68a
[2] Funds have been fully utilised
[3] Fund was closed on 1 November 2003 and replaced by the Rehabilitation Fund for Small Businesses

Table A.70a
Development Financial Institutions: Funds from Multilateral and International Agencies

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Malaysian Industrial Development Finance Berhad						
Japan Bank for International Cooperation-Fund for Small and Medium Industries	20.3	38.0	14.0	19.0	93.1	95.2
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	20.4	13.5	22.3	21.1	74.8	86.0
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme	1.2	–	0.1	0.8	14.3	10.9
ASEAN-Japan Development Fund/EXIM[1]	–	–	–	–	0.6	0.2
Bank Pertanian Malaysia						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	–	–	40.4	34.2

[1] Funds have been fully utilised

Table A.70b
Development Financial Institutions: Funds from Multilateral and International Agencies

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2004	2005	2004	2005	2004	2005
Funds prior to rationalisation (data until end-September 2005)						
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	2.0	0.1	57.8	46.1
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme[1]	24.9	–	9.7	8.0	49.5	51.1
Japan Bank for International Cooperation-Fund for Small and Medium Industries	19.9	–	9.3	2.4	96.3	82.4
Japan Bank for International Cooperation 1 - JEXIM[1]	–	120.7	2.0	62.4	1,116.6	1,127.6
Islamic Development Bank	4.0	–	–	–	14.3	10.2
Japan Bank for International Cooperation 2	741.0	–	–	–	–	–
Bank Industri & Teknologi Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	12.6	–	11.5	3.3	2.2
The Export-Import Bank of Japan[1]	–	3.7	–	2.2	1.1	0.9
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme[1]	–	24.8	–	21.7	16.3	15.9
Japan Bank for International Cooperation 300[1]	–	185.2	17.5	172.0	153.5	122.4
Japan Bank for International Cooperation 200[1]	–	72.1	3.3	58.1	30.3	39.6
Japan Bank for International Cooperation-Fund for Small and Medium Industries[1]	18.1	105.8	24.7	92.5	69.6	58.8
Funds after rationalisation (data for October-December 2005)						
Bank Pembangunan Malaysia Berhad						
Japan Bank for International Cooperation-Fund for Small and Medium Industries	–	–	–	–	–	24.5
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme[1]	–	–	–	–	–	3.6
Japan Bank for International Cooperation 1 - JEXIM[1]	–	–	–	–	–	0.9
Japan Bank for International Cooperation	–	–	–	–	–	1.7
Japan Bank for International Cooperation 1	–	–	–	–	–	1.1
Japan Bank for International Cooperation 2	–	–	–	145.7	–	204.7
Japan Bank for International Cooperation 200[1]	–	–	–	–	–	35.0
Japan Bank for International Cooperation 300[1]	–	–	–	–	–	78.1
Bank Perusahaan Kecil & Sederhana Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund*[1]	–	–	–	0.1	–	40.7
Islamic Development Bank	–	–	–	5.6	–	3.8
Japan Bank for International Cooperation-Fund for Small and Medium Industries	–	–	–	8.7	–	97.3
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme*1	–	–	–	8.6	–	38.3
Japan Bank for International Cooperation-Overseas Economic Cooperation Fund/Small and Medium Scale Industry Promotion Programme**1	–	–	–	–	–	6.0
Japan Bank for International Cooperation 200[1]	–	–	–	–	–	3.3
Japan Bank for International Cooperation 300[1]	–	–	–	0.4	–	35.7
Export-Import Bank of Malaysia Berhad[2]						
Japan Bank for International Cooperation 300[1]	–	–	–	–	186.1	144.8
Japan Bank for International Cooperation 200[1]	–	–	–	–	116.3	90.5

[1] Funds have been fully utilised
* Funds originated from Bank Pembangunan dan Infrastruktur Malaysia Berhad
** Funds originated from Bank Industri & Teknologi Malaysia Berhad

As at end-2005, 370 leasing companies and 35 factoring companies had registered with Bank Negara Malaysia. However, only 126 leasing companies and 21 factoring companies submitted statistics pertaining to their operations to Bank Negara Malaysia. Total assets of the 126 leasing companies and 21 factoring companies amounted to RM17.5 billion and RM8.0 billion respectively at end-2005. Nevertheless, of the 126 leasing companies, only 23 were pure leasing companies, while of the 21 factoring companies, only eight were pure factoring companies. The remaining companies only undertook leasing and factoring business as part of their overall business activities.

Table A.71
Leasing Companies[1]: Sources and Uses of Funds

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Sources					
Capital and reserves	839	770	1,554	1,017	1,018
Borrowings from financial institutions	1,923	2,141	1,759	1,816	1,985
Inter-company borrowings	1,343	1,454	1,375	605	1,001
Others	2,400	2,684	2,342	2,095	2,139
Total	**6,505**	**7,049**	**7,030**	**5,533**	**6,143**
Uses					
Cash and bank balances	229	225	198	157	106
Investments	309	323	387	327	309
Receivables	3,014	3,118	2,370	2,180	2,860
Leasing	*1,423*	*1,420*	*1,508*	*1,487*	*1,539*
Factoring	*17*	*209*	*204*	*101*	*93*
Hire purchase	*1,275*	*1,307*	*503*	*453*	*1,077*
Others	*299*	*182*	*155*	*139*	*151*
Others	2,953	3,384	4,074	2,869	2,867

[1] Statistics shown are for pure leasing companies only

Table A.72
Leasing Companies[1]: Income and Expenditure

	During the period				
	2001	2002	2003	2004	2005
	RM million				
Income					
Income from	313	302	326	167	150
Leasing	*217*	*212*	*226*	*107*	*98*
Factoring	*2*	*3*	*6*	*5*	*4*
Hire purchase	*85*	*76*	*75*	*51*	*45*
Others	*9*	*11*	*20*	*3*	*4*
Others	188	306	200	303	221
Total	**501**	**607**	**526**	**469**	**371**
Expenditure					
Interest paid	187	165	141	122	115
Financial institutions	*166*	*155*	*134*	*117*	*111*
Block discounting	*21*	*10*	*7*	*5*	*4*
Bad debts written off and provision	108	35	5	91	67
Others	165	199	183	95	80
Total	**460**	**398**	**329**	**309**	**261**
Pre-tax Profit	**41**	**209**	**197**	**161**	**110**

[1] Statistics shown are for pure leasing companies only

Table A.73
Leasing Companies[1]: Financing by Sector

	During the period				
	2001	2002	2003	2004	2005
	RM million				
Sector					
Agriculture	17	14	25	33	25
Mining and quarrying	3	3	9	4	2
Manufacturing	172	102	123	172	139
Electricity	1	0	0	0	0
General commerce	266	125	106	116	66
Property sector	50	38	207	97	34
Construction	*46*	*36*	*179*	*68*	*33*
Real estate	*4*	*2*	*28*	*28*	*0*
Residential property	*0*	*0*	*0*	*1*	*0*
Transport and storage	805	54	53	55	63
Business, insurance and other services	113	121	116	184	146
Consumption credit	0	0	0	0	0
Others	108	128	53	48	103
Total	**1,535**	**585**	**695**	**709**	**577**

[1] Statistics shown are for pure leasing companies only

Table A.74
Factoring Companies[1]: Sources and Uses of Funds

	As at end-				
	2001	2002	2003	2004	2005
	RM million				
Sources					
Capital and reserves	164	164	81	99	101
Borrowings from financial institutions	445	293	267	77	618
Inter-company borrowings	600	416	267	644	118
Others	658	1,092	425	121	176
Total	**1,867**	**1,964**	**1,040**	**941**	**1,013**
Uses					
Cash and bank balances	202	234	14	20	13
Investments	45	35	24	22	30
Receivables	998	1,170	602	614	612
Leasing	*0*	*0*	*0*	*185*	*149*
Factoring	*872*	*1,111*	*542*	*298*	*303*
Hire purchase	*4*	*4*	*4*	*72*	*84*
Others	*122*	*55*	*57*	*59*	*75*
Others	622	525	401	285	358

[1] Statistics shown are for pure factoring companies only

Table A.75
Factoring Companies[1]: Income and Expenditure

	During the period				
	2001	2002	2003	2004	2005
	RM million				
Income					
Income from	37	38	31	51	57
Leasing	*2*	*0*	*0*	*10*	*12*
Factoring	*29*	*29*	*24*	*20*	*21*
Hire purchase	*0*	*0*	*0*	*9*	*6*
Others	*6*	*8*	*6*	*12*	*17*
Others	129	297	75	38	116
Total	**166**	**335**	**106**	**89**	**173**
Expenditure					
Interest paid	28	17	15	18	24
Financial institutions	*28*	*17*	*15*	*18*	*24*
Block discounting	*0*	*0*	*0*	*0*	*0*
Bad debts written off and provision	28	14	5	11	9
Others	33	45	17	21	56
Total	**89**	**76**	**37**	**50**	**89**
Pre-tax Profit	**77**	**259**	**68**	**39**	**84**

[1] Statistics shown are for pure factoring companies only

Table A.76
Factoring Companies[1]: Financing by Sector

	During the period				
	2001	2002	2003	2004	2005
	RM million				
Sector					
Agriculture	…	0	1	1	4
Mining and quarrying	0	0	0	3	1
Manufacturing	66	57	46	58	49
Electricity	3	2	3	0	1
General commerce	140	179	120	94	88
Property sector	270	103	43	31	25
Construction	*222*	*76*	*36*	*29*	*21*
Real estate	*48*	*27*	*1*	*0*	*0*
Residential property	*0*	*0*	*6*	*2*	*5*
Transport and storage	5	3	1	1	2
Business, insurance and other services	51	50	37	60	51
Consumption credit	20	20	17	0	0
Others	541	513	18	37	21
Total	**1,096**	**927**	**286**	**287**	**242**

[1] Statistics shown are for pure factoring companies only
… Negligible

Table A.77
Capital Market Debt Securities[1]: Amount Outstanding

	As at end-						
	1999	2000	2001	2002	2003	2004	2005*p*
	RM million (nominal value)						
Malaysian Government Securities	78,336	89,050	103,450	109,550	130,800	154,350	166,050
Government Investment Issues	2,000	4,000	4,000	5,000	7,000	9,100	10,100
Khazanah Bonds	8,980	10,000	10,000	10,000	11,000	10,000	11,000
Malaysia Savings Bonds	379	359	–	464	455	–	–
Merdeka Savings Bonds[2]	–	–	–	–	–	1,929	3,444
Danaharta Bonds	10,344	11,140	11,140	11,140	8,539	796	–
Danamodal Bonds	11,000	11,000	11,000	11,000	–	–	–
Cagamas Bonds	13,019	17,312	18,427	22,595	25,628	26,752	24,107
Other Corporate Bonds	79,313	102,220	120,584	108,416	144,595	160,057	182,896
of which: Medium Term Notes	*681*	*1,726*	*2,910*	*4,465*	*8,596*	*14,782*	*24,668*
Total	**203,370**	**245,081**	**278,601**	**278,165**	**328,018**	**362,983**	**397,597**

[1] Refer to debt securities with an original maturity period of more than one year
[2] Merdeka Savings Bonds were introduced in 2004
p Preliminary