To Meet the Challenges of Globalization and IC Technical Advancement:

Malaysia Launched OPP 3 to Build A Resilient and Competitive Nation By Strengthening Her Ability

The Malaysian economy remained resilient in 2001 in the face of a challenging external environment. While the global economic slowdown in 2001 was more severe than earlier expectations, Malaysia avoided economic contraction and growth for the year remained in positive territory. Unemployment was also contained at a low level.

Given the openness of the Malaysian economy, the negative effects of the US economic slowdown and global electronics downturn was felt as early as March 2001. These were manifested in declining manufacturing production and negative export growth. Concerted efforts since the crisis to promote domestic sources of growth and reduce the overdependence on exports resulted in real Gross Domestic Product (GDP) expanding by 0.4% in 2001. Fiscal stimulus measures and monetary policy that had remained accommodative led to higher public spending and positive growth in private consumption.

During the year, public investment expenditure increased by 15.5%, while public consumption expenditure increased by 11.9%. The direct contribution of the public sector (excluding the non-financial public enterprises) was significant, contributing 3.4% points to GDP growth in 2001.

Inflationary pressures remained muted with prices, as measured by the Consumer Price Index (CPI), increasing moderately by 1.4% (2000: 1.6%). The moderation in inflation was due mainly to the prevalence of excess capacity in several sectors of the economy, the moderate appreciation of the ringgit vis-a-vis non-US dollar currencies, as well as lower imported inflation. The lower inflation was also consistent with the widening output gap, estimated at 5.6% of the potential output level.

The external position remained robust in 2001. The global economic slowdown affected export performance, but imports of goods and services for export production also declined. Hence, the current account remained in surplus, estimated at about 8.9% of GNP. In the financial account, the flows have been relatively stable. Long-term flows continued to dominate. Inward direct foreign investment flows were increasingly channeled to the services sector.

The reserves level fluctuated in early 2001 following volatility in foreign exchange markets. Reserves, which declined in early 2001, reversed to a rising trend from end June following stronger fundamentals and lower interest rates abroad. By end-2001, international reserves of Bank Negara Malaysia (BNM)-Central Bank of Malaysia was higher at RM117.2 billion or US$30.8 billion (US$4.9 billion higher than the lowest level in 2001).

Subsequently, reserves increased further to RM119.6 billion or US$31.5 billion as at 28 February 2002. This level is adequate to finance 5.2 months of retained imports and cover 5.1 times the short-term external debt.

While the external debt increased during the year, the outstanding amount remained relatively low, at about 55.4% of GNP (previous peak after the Asian crisis was 64%). The overall debt service ratio continued to remain low at 6.2%, despite the decline in export value. The debt profile also remained healthy with short-term debt accounting for only 13.7% of total debt.

The banking system demonstrated greater resilience despite adverse economic conditions. In 2001, the risk-weighted capital ratio (RWCR) remained above 12% throughout the year, whilst the increase in the levels of non-performing loans (NPLs) during the year was contained within manageable levels. The increase in the level of NPLs of banking institutions during the second half of 2001 was within expectations. As at end-2001, the net NPL ratio on a 6-month basis was 8.1% (11.5% on a 3-month classification basis).

Recent measures to accelerate corporate restructuring have improved the balance sheet of the corporate sector, contributing to greater resilience of the banking system. The resolution of the debt restructuring schemes for companies in the transport sector in the final quarter of 2001 reduced the level of NPLs by 0.7 percentage points.

As at end-2001, the banks' risk-weighted capital ratio stood at 12.8%, well above the Basel Capital Accord requirement of 8%. The capital position will further strengthen following the strong profits of RM7.4 billion recorded in 2001. With improvements in the economy, Danamodal,

The multimedia development corporation -- the one-stop agency responsible for the development of the MSC. To access developed ICP business activities, Malaysia has created the Multimedia Super Corridor (MSC) and put in place the necessary infrastructure, policies and cyber laws to make the MSC an ideal place for ICP activities.

the special purpose vehicle set up in 1998 to recapitalize viable banking institutions, received repayments amounting to RM2.3 billion in 2001 of the RM4.4 billion that was outstanding at the end of 2000.

In 2001, macroeconomic policy was focused on managing the downside risks arising from the slowdown in the major industrial countries. Economic policies were targeted at creating an enabling environment for domestic demand to support growth. Given that there was considerable uncertainty over the severity of the slowdown in 2001, there was greater recognition that economic policies would need to address short-term cyclical risks that emerged during the course of the year, with the objective of minimizing the adverse effects on the Malaysian economy.

The initial assessment was for Malaysia's GDP growth to show a moderating trend in the first two quarters of 2001, with a recovery in the second half-year. However, as the downturn in the global economy became more severe during the course of the year, policies turned more expansionary. The strengthened economic fundamentals provided Malaysia the policy flexibility to implement additional pro-growth policies in response to external shocks, without creating imbalances in the economy.

Given the increased prospects that the stimulus from the external sector would be relatively subdued in 2001, the overall budget deficit for 2001 announced in October 2000, was projected to remain large, at RM16.5 billion or -4.7% of GDP. The assessment was that a premature consolidation of the fiscal position in the face of a more challenging external environment would have a damaging impact on the economy.

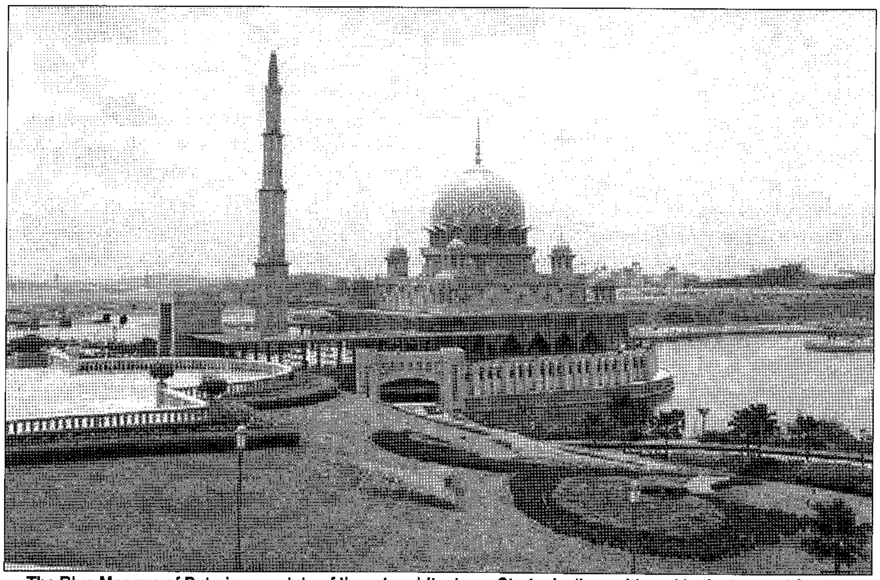
One of the Malaysia's 14 free industrial zones. In Malaysia, the capital investment in the manufacturing sector is expected to increase following a more strengthened global recovery in the second half of 2002. Foreign direct investment (FDI) is expected to show stronger growth in the year.

Consequently, as the downside risks facing the world economy increased in early 2001, the Government announced on March 27, a fiscal stimulus package of RM3 billion. Following the heightened uncertainty after September 11, an additional stimulus package of RM4.3 billion was announced on Sept. 25.

In the Budget for 2002 announced in October 2001, the overall deficit of the Federal Government for 2001 increased to RM22.4 billion or -6.5% of GDP, an increase of RM5.9 billion from the original allocation announced a year earlier. This additional stimulus was equivalent to 2.2% of GDP.

In pursuing the more expansionary demand management policies in 2001, care was taken that fiscal and monetary measures would not unduly increase risks of creating imbalances thereby jeopardizing the long-term growth potential, price stability as well as the gains made in achieving a robust balance of payments.

In particular, strengthening foreign direct investment inflows remained a priority. Incentives addressed the need for foreign direct investment inflows to be more diversified, in terms of location as well as sector. While attracting new investments, it was essential to create a more favorable environment to existing investors to expand operations in Malaysia. The policy to allow 100% foreign equity ownership in promoted manufacturing industries, irrespective of export levels, was extended to 2003.



The Blue Mosque of Putrajaya, a state of the art architecture. Strategically positioned in the heart of Southeast Asia, Malaysia is an example of a successful multi-ethnic and multi-religious polity.

The thrust of policies introduced in 2001 to address longer-term structural issues focused on increasing domestic capacity, institution building and skills upgrading. The Government launched the Third Outline Perspective Plan (OPP 3) in April 2001, which documented the framework and strategies for economic development over the next 10 years (2001-2010).

At the same time, the Government launched the Eighth Malaysia Plan (2001-2005), which set out the first phase of implementation of OPP 3. Within the new framework for the economy, BNM and the Securities Commission took steps to develop longer-term strategies for the development of the financial sector and the capital market respectively.

The primary objective of the OPP 3 is to build a resilient and competitive nation by strengthening Malaysia's ability to meet the challenges arising from the rapid pace of globalization and advances in information and communications technology. The Plan also takes into account the need to strengthen Malaysia's economic, financial and social resilience to withstand external shocks. Specifically, the OPP 3 aims to:

- Develop Malaysia into a knowledge-based economy where knowledge, creativity and innovation would increase productivity growth in all sectors;
- Generate domestic sources of growth by

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strengthening domestic investment in new areas of growth, while continuing to attract foreign direct investment in strategic areas;

- Re-orientate the strategies for human resource development to support a knowledge-based economy.

To advance the policy to increase the knowledge content of the economy, a master-plan for the transition towards a knowledge-based economy was completed in 2001. Accordingly, the 2001 Budget as well as the 2002 Budget accorded priority to human resource development. Expenditure for education, training and skills development accounted for 23% of the Budget and 6.1% of GDP.

Specifically, capital investment in the manufacturing sector is expected to increase following a more strengthened global recovery in the second half of 2002. Foreign direct investment (FDI) is expected to show stronger growth in the year.

In 2002, the current account surplus is forecast to remain large at 7.9% of GNP. The financial account is expected to be supported by sustained inflows of long-term capital, including higher inflows of FDI. In view of the improved global economic conditions, FDI inflows are expected to be higher due to the projected inflows of equity from strategic alliances as well as inflows for expansion and new investment, in the manufacturing, services and oil and gas sectors.

In recent years, FDI has become more broad-based with higher investment in the services sector. There is a distinct shift in the nature of investments towards higher value added investments both in manufacturing and services sectors, which bring new technology and expertise that contribute towards raising productivity. ★