Monetary and Fiscal Developments

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Monetary policy remained accommodative, providing a positive environment for private consumption and investment and overall domestic economic activity. The pegged exchange rate regime which was well supported by economic fundamentals continued to benefit the economy.

MONETARY POLICY IN 2001

The overall objective of monetary policy in 2001 was to create a positive environment to promote domestic activity to mitigate the effects of the global economic slowdown. To achieve this objective, interest rates that had been reduced in 1998 and 1999 were kept unchanged in 2000 and during the first eight months of 2001. The stability provided by the pegged exchange rate regime and the absence of inflationary pressures allowed monetary policy to reinforce the counter-cyclical macroeconomic policy measures implemented to promote domestic economic activity. Nonetheless, the September 11 incident had increased the risks of further weaknesses in the global economic outlook and a delay in the prospects for recovery. On September 20, BNM reduced its Intervention Rate by 50 basis points to 5.00%, as a pre-emptive measure to address the potential for weaker economic growth and to enhance business and consumer confidence. During the year, emphasis was also placed on improving access to financing at reasonable cost to the private sector, in particular SMEs and the agricultural sector.

With the Intervention Rate at 5.50% and 3-month interbank rate at 3.22%, the stance of monetary policy at the beginning of the year was finely balanced between the need to promote consumption and investment without discouraging savings, and avoiding macroeconomic imbalances. As the global economic slowdown was relatively moderate, the full effects of the expansionary fiscal and monetary policies were expected to have their impact on domestic aggregate demand given that the inflation situation was expected to remain subdued.

The easing of monetary policy in several steps in 1998 and 1999 led to ample liquidity and a low level of interest rates. The 3-month BNM Intervention Rate, which is the policy rate, was rapidly reduced by a total of 550 basis points during this period. Given that monetary policy works with a lag, a rapid and significant rate adjustment was initiated in the early part of the recovery cycle. This early easing of monetary policy resulted in lending rates in Malaysia falling to amongst the lowest in the region. With ample liquidity and strengthening competition among banking institutions, interest rates for retail loans in particular, were significantly lower than the quoted BLR. The prevailing low level of interest rates led to strong growth in financing activities, which consequently had positive impact on economic growth, particularly on domestic consumption.

Against this background, monetary policy remained neutral during the first three quarters of 2001. The decision to maintain the prevailing monetary policy stance was supported by several considerations. First, the progressively sharper slowdown experienced in the domestic economy was mainly caused by the weaker performance in the export-oriented industries arising from poor external demand. The benefit of a further lowering of interest rates was therefore expected to be marginal, given that the export sector generally relies on internally-generated funds. Demand indicators also showed that the low level of interest rates resulted in significant increases in new loans, especially for purchases of residential property, motor vehicles and consumer durables. Second, consideration was also given to the need to maintain financial and macroeconomic stability. During this period, deposit rates in Malaysia were generally lower than foreign rates, especially US interest rates. Lowering rates beyond a certain threshold could potentially lead to capital outflows.

Third, in a situation of economic slowdown, where employment and demand prospects remained uncertain and excess capacity was prevalent, fiscal policy would play a crucial role in directly stimulating domestic economic activity. As such, fiscal measures were aimed at enhancing disposable income to boost consumption, and implementing projects with high-spillover effects, low import content and short gestation period. In addition to the Budget 2001 allocation, the pre-emptive package of RM3 billion announced in March, was aimed at further stimulating domestic demand.

An important consideration in the conduct of monetary policy was to maintain a positive real rate of return to depositors, especially individuals and organisations whose income stream was highly dependent on the returns from bank deposits. Unlike other countries, households in Malaysia, being mainly net savers, would be more adversely affected by lower interest rates, in contrast to net debtors. Therefore, interest rates that are too low would have an impact on the income of certain sectors with adverse implications on consumption. In January 2002, BNM launched a third series of Bon Simpanan Malaysia worth RM1 billion as an alternative savings instrument for senior citizens and charity organisations.

During the course of the year, an issue that emerged was the market perception that interest rates were used as a means to sustain financial institutions' profitability. However, this does not figure as an issue in the formulation of monetary policy. Indeed, it is not a policy consideration to sustain banks' profitability at the expense of borrowers, depositors and economic growth. In fact, the prevailing ample liquidity situation and competition for new loans during the first eight months had led banks to lower costs and improve efficiency. Banks' interest rate margins had also narrowed during the period, mainly through the reduction in lending rates. This, had in turn, benefited borrowers without having adverse effects on returns for depositors.

On the whole, the accommodative monetary policy together with the expansionary fiscal policy have contributed to alleviating the impact of the sharp contraction in the export-oriented manufacturing sector on the domestic economy. This outcome was evident in several monetary and real sector indicators. In the first eight months, total banking system loans rose by RM14.4 billion compared to RM13 billion in the corresponding period of high growth in 2000. This loan growth occurred despite the moderation in economic growth in 2001. The increase in outstanding loans was also broad-based and most apparent in the case of interest-sensitive loans such as those for housing and consumption including loans for the purchase of passenger cars and credit card facilities. Other sectors that registered higher loans include transport vehicles; transport, storage and communications; finance, insurance and business services; manufacturing; and wholesale trade. The year also saw continued recourse to the PDS market as a major source of funding. Including loans extended by the banking system and the issuance of PDS, total financing in the first eight months grew by 8.2% at end-August, despite the slowdown in economic growth. In addition, indicators for private consumption such as sales of new passenger cars (+12.7% in the first eight months), sales tax collection (+19.6%) and loans approved and disbursed for consumption credit (+20.3% and +24.7% respectively) also registered continued expansion.

The low inflation environment has provided the flexibility to pursue an accommodative monetary policy. As the year progressed, inflation moderated in line with expectations. The headline inflation moderated to 1.4% in 2001 (1.6% in 2000), while core inflation moderated to 1% from 1.5% during the same period. The lower underlying inflation was attributed to demand remaining relatively weak amidst inventory accumulation and excess capacity in several sectors of the economy. These domestic conditions were further supported by the relatively stable exchange rate and lower imported inflation.

However, the subsequent September 11 incident heightened the macroeconomic risks towards further economic weakness and significantly dampened the global growth outlook. Although Malaysia's economic fundamentals have remained strong, with subdued inflationary conditions and a strong external balance, as an open economy, Malaysia is not insulated from external developments. Following these developments, BNM lowered the Intervention Rate by 50 basis points to 5.00% on 20 September. This, together with further fiscal measures was aimed at promoting domestic demand and mitigating the potential risks of adverse external developments. The average BLRs of commercial banks and finance companies declined to 6.39% and 7.45% respectively. In addition, the lending rates of the special funds for SMEs and Bumiputera entrepreneurs were lowered, while the scope and eligibility criteria for selected funds were liberalised in October.

The reduction in lending rates contributed to providing a positive environment for the private sector. Financing activity in the last four months continued to remain resilient. Total financing through loans extended by the banking system and PDS issued by the private sector rose by a further RM9.8 billion in the last four months or 6% as at end-2001. Similarly, both loan approvals (RM39.7 billion for September to December) and loan disbursements (RM124.7 billion) by the banking system were also sustained.

With the reduction in the Intervention Rate, BNM liquidity operations continued to maintain interbank rates at the prevailing levels, moderating the reduction in the deposit rates. Consequently, depositors continued to earn a positive real rate of return on deposits placed with banking institutions.

During the year, the management of monetary policy continued to focus on managing liquidity flows in order to maintain stable interbank rates. Liquidity operations undertaken by BNM were largely expansionary in the first half of 2001. BNM injected RM15.5 billion into the system through the interbank money market to offset the contractionary impact of net outflow of funds from the domestic economy. During this period, amidst the continued inflow of foreign direct investment and trade surpluses, there were higher payments for imports and repayments of external debt as well as higher overseas investment. In addition, there were also sentiment-driven capital outflows, particularly in March and early April when the financial markets were unstable.

However, liquidity operation turned contractionary in the second half of the year following the net inflow of funds during the period. The inflows exerted an expansionary impact on liquidity and exerted downward pressures on interest rates. To maintain stable interbank rates, BNM mopped up RM12 billion of excess funds from the interbank market in the second half of the year. At the end of 2001, total net funds locked in with BNM amounted to RM46.1 billion (RM49.6 billion at end-2000). This essentially reflects the ample liquidity environment in the financial system.

Another important measure included the New Liquidity Framework (NLF), which was implemented in early 1999 and came into full compliance in 2001. The NLF would enable banking institutions to minimise the maturity mismatch in their balance sheets, thereby allowing greater flexibility in managing the investment portfolio. This NLF represents an important step in the ongoing process towards developing a more market-oriented monetary policy framework. A more flexible assets composition will render banks' balance sheets more sensitive to changes in interest rates, making the transmission of monetary policy more effective.

Efforts were also intensified in 2001 to ensure selected sectors, especially the small and medium enterprises and the agriculture sector, continued to have access to financing. These were undertaken in addition to a series of measures implemented including improving the loan approval process in banking institutions, promoting alternative sources of financing including venture capital, setting up of a dedicated unit to monitor loan complaints in each banking institution and to manage problem loans, and the setting up of the Bumiputera Development Unit which provides financial advisory services to Bumiputera entrepreneurs.

In April 2001, the size and scope of selected special funds were expanded, and their lending rates were lowered. In July, the Entrepreneurs Rehabilitation and Development Fund (ERDF) with an allocation of RM500 million was established to assist Bumiputera entrepreneurs to address the problem of NPLs as well as to provide working capital. Following the reduction in the Intervention Rate, the maximum lending rates of selected funds were also reduced in October. Their eligibility criteria and scope were also liberalised (see box on Monetary Measures). As a result of these initiatives, the overall banking system loans extended to the SMEs rose by RM2.2 billion or 3.1% in 2001. The loans were mainly channelled to the broad property, wholesale and retail trade, electricity and transport sectors.

The monetary policy framework in 2001 continued to operate under a pegged exchange rate regime. The ringgit remained fixed at RM3.80=US$1, an arrangement that has been effective since 2 September 1998. Given the volatile environment in the international foreign exchange market in 2001, the fixed exchange rate regime continued to provide positive benefits to the Malaysian economy. The stability accorded by the ringgit peg provided an environment of certainty for decision making, encouraged confidence in the ringgit and discouraged speculation, conferred efficiency gains in the form of lower hedging and transactions costs, while allowing the restructuring of the banking system and the corporate sector to achieve an advanced stage of progress.

Foreign exchange markets, especially regional markets, remained volatile in 2001. Depreciation of yen exchange rate was, from time to time, followed by depreciation of regional currencies. The ringgit in this environment continued to be supported by strong fundamentals of low inflation, strong current account surplus, low external debt, high savings rate, and a

Monetary Measures in 2001

Monetary measures introduced in 2001 were aimed at stimulating domestic demand amid a less favourable external environment. With the global economic slowdown, exacerbated by the September 11 incident in the US, there was further easing of monetary policy, with a reduction in the Intervention Rate, to provide further support for domestic economic activity. Measures were also introduced to improve access to financing, at reasonable cost, to a wider group of small and medium enterprises (SMEs) and the agriculture sector. These measures were as follows:

- In March 2001, together with the unveiling of the fiscal stimulus package, several financial measures were announced and implemented in stages:

(i) The size and scope of existing special funds were expanded while their lending rates were reduced. The allocations for the Fund for Food (3F) and the New Entrepreneur's Fund (NEF) were raised from RM1 billion and RM1.25 billion to RM1.3 billion and RM1.5 billion respectively. The Fund for Small and Medium Industries 2 (FSMI 2) was doubled to RM400 million while its eligibility criteria was expanded to include the non-export sector. With effect from 16 April 2001, the funding and lending rates of the 3F, NEF and FSMI 2 were reduced as follows:

Funds	Maximum Lending Rates[1/] (% p.a.)			Funding Rates[2/] (% p.a.)		
	Previous	New	Change	Previous	New	Change
3F	4.0	3.75	-0.25	1.0	0.25	-0.75
NEF	6.0	5.5	-0.5	4.0	2.0	-2.0
FSMI 2	6.5	5.5	-1.0	4.0	2.0	-2.0

[1/] Charged by lending institutions to borrowers.
[2/] Charged by Government on lending institutions.

(ii) The tax of RM50 on credit cards introduced in 1997 was abolished to promote greater use of credit cards.

(iii) In July 2001, the Entrepreneur Rehabilitation and Development Fund (ERDF) was established with an allocation of RM500 million to assist viable small and medium Bumiputera entrepreneurs. Of this total allocation, RM120 million was set aside for the resolution of NPLs not exceeding RM1 million and the remainder to assist these businesses to continue their activities through the provision of working capital.

- On 20 September 2001, BNM announced the reduction of the 3-month BNM Intervention Rate by 50 basis points to 5.00%. Accordingly, the ceiling base lending rates of commercial banks and finance companies declined to 6.42% and 7.46% respectively. The reduction in the Intervention Rate was aimed at addressing the increased risks biased towards weaker domestic economic growth in the aftermath of the September 11 incident in the US. In particular, the reduction in the Intervention Rate served to contain the implications of the more adverse external environment on domestic business and consumer activity.

- With the reduction in the 3-month Intervention Rate, BNM announced the further reduction in lending rates and liberalization of eligibility criteria of several special funds:

(i) With effect from 15 October 2001, the lending rates applicable to existing and new borrowers of the Rehabilitation Fund For Small and Medium Industries (RFSMI), FSMI 2 and NEF were reduced by 0.5 percentage points. The funding rates of these funds were also reduced by 0.5 percentage points each. This was the second rate reduction, following the first in April, to further lower the cost of doing business. The changes in the lending and funding rates of RFSMI, FSMI 2 and NEF are as follows:

Funds	Maximum Lending Rates[1/] (% p.a.)			Funding Rates[2/] (% p.a.)		
	Previous	New	Change	Previous	New	Change
RFSMI	5.0	4.5	-0.5	1.0	0.5	-0.5
FSMI 2	5.5	5.0	-0.5	2.0	1.5	-0.5
NEF	5.5	5.0	-0.5	2.0	1.5	-0.5

[1/] Charged by lending institutions to borrowers.
[2/] Charged by Government on lending institutions.

(ii) To further enhance access to the financing schemes, with effect from 15 October 2001, the eligibility criteria and scope of the following special funds were also liberalised:

Fund	Criteria/conditions	Previous	New
Fund for Food (3F)	Maximum financing per customer	90% of total project cost or RM3 million, whichever is lower	90% of total project cost or RM5 million, whichever is lower
	Maximum financing for land cost	20% of the total project cost	30% of the total project cost
	Wages	Not eligible	Eligible
	Financing for food processing and distribution	Not eligible	Eligible, provided the raw materials are from domestic sources
Rehabilitation Fund for Small and Medium Industries (RFSMI)	Maximum limit for loan refinancing/restructuring	30% of the total loan amount approved	40% of the total loan amount approved
Fund for Small and Medium Industries (FSMI 2)	Purpose of financing	Working capital only	Working capital and capacity expansion
	Maximum financing per customer	RM1 million	RM3 million
Bumiputera Entrepreneur Project Fund (BEPF)	Maximum financing	30% of contract amount	60% of contract amount or RM3 million, whichever is lower
	Maximum financing for contract below RM100,000	RM30,000	RM60,000
Entrepreneur Rehabilitation and Development Fund (ERDF)	Borrower’s NPL Limit	RM1 million	Exceed RM1 million, provided the total NPL can be reduced to RM1 million within two months after approval of the facility by ERF Sdn. Bhd.
		Turned NPL from 1 January 1998 to 30 June 2001	Extended to 31 December 2001

- On 27 November 2001, BNM announced the removal of the restriction on the provision of bridging finance for development of residential properties above RM250,000 per unit as well as for development of shop houses exceeding RM250,000 per unit located within residential areas. The upliftment of the financing restriction for this specific sub-sector was in response to the reduction in unsold properties in the residential sub-sector. As the overhang (in value and units of unsold properties) still remains large for the other sub-sectors of the property market, the bridging finance restriction for development of commercial properties and projects involving shop houses priced more than RM250,000 per unit, which are not located within residential areas, remained unchanged.

- On 18 December, BNM announced the Bon Simpanan Malaysia Siri 03 (BSM03) issue. A total of RM1 billion of BSM03 was offered for sale during the period 2 - 31 January 2002, of which RM500 million would be issued based on Islamic principles. The bonds have a maturity period of 2 years and a rate of return of 5% per annum. Only senior citizens that are not employed on a full time basis, and charitable organisations registered with the Registrar of Societies are eligible to purchase the bonds. The BSM03 was issued by BNM to mitigate the impact of the current low interest rate environment on incomes of senior citizens and charitable organizations, primarily dependent on income from deposits placed with the banking institutions, thereby sustaining their spending ability.

more resilient financial sector. Reserves also resumed its rising trend in the second half of the year. Malaysia's external liquidity position remained strong as reserves rose to cover more than 6 times short-term external debt.

Under these circumstances, the strategy was to put in place policies that will facilitate adjustments in the domestic economy to strengthen the nation's competitive position. These policies aimed to ensure that the Malaysian economy has the flexibility to deliver the necessary internal adjustments to support the exchange rate peg. The Malaysian economy has a relatively diversified economic base and a flexible and mobile labour force. The on-going corporate sector restructuring would also result in further flexibility in price adjustments.

Public perception and confidence are also an important factor in exchange rate sustainability. Through the dissemination of more detailed information, regular dialogues with various segments of the private sector including exporters, manufacturers and members of the media, BNM has sought to highlight issues regarding the exchange rate and factors influencing its sustainability. These have contributed to a greater awareness of the exchange rate developments on private sector balance sheet conditions as well as allowing greater appreciation of the macroeconomic rationale of the exchange rate strategy.

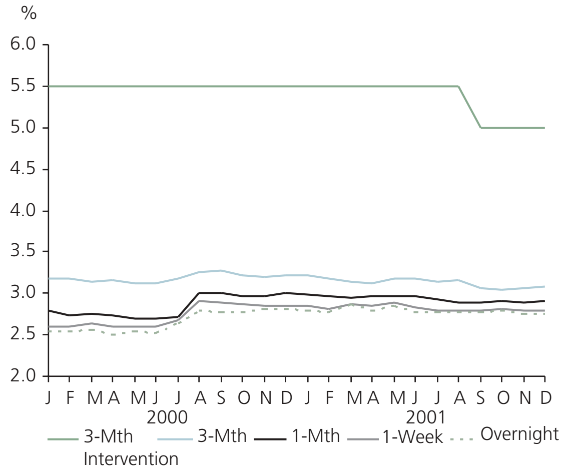
The pegged exchange rate has, for more than three years, effectively and efficiently facilitated international trade and investment without resulting in macro-economic imbalances. As an open economy that is highly dependent on international trade, a stable exchange rate that is consistent with economic fundamentals is of great importance. While it may be tempting to manipulate the exchange rate to gain competitive advantage, it is recognised that such a policy may only provide temporary benefits. Long-term international competitiveness cannot be achieved through exchange rate manipulation. Malaysia has, therefore, chosen to maintain a stable exchange rate, and commit itself to ensuring that policies and domestic economic fundamentals remain consistent with the exchange rate peg. In addition to policies aimed at keeping inflation low, the external balance strong, external debt at low and at prudent levels, reserve levels comfortable and banking sector strong and resilient; efforts are also being directed to continue to build greater flexibility in markets to adjust to external and domestic developments. The stronger macroeconomic fundamentals in a more diversified economy, enhanced mobility of labour and capital, a more resilient banking system and the growing significance of the domestic economy had indeed provided Malaysia with the increased resilience to tolerate and cope with external shocks to the domestic economy.

During the year, the Bank continued to undertake a number of measures that were aimed at enhancing the efficiency and transparency of monetary policy management. A priority of policy was to ensure that adequate information continue to be made available to the public and the market. To achieve this, more frequent statements and dialogues were held with market participants. There were also regular sessions and interviews with both the local and foreign journalists to enable market participants and the media to have a better understanding of monetary policy objectives in Malaysia and its measures. At the same time, there was also a further enhancement of data published through BNM's bulletins. The Bank also hosted a number of international conferences and summits, so that the Malaysian experience and its perspective in managing the economy and financial sector could be better known and appreciated.

MONETARY DEVELOPMENTS

The overall monetary conditions in 2001 were consistent with BNM's monetary policy objectives in promoting domestic economic activity. The low **interest rate** environment together with the ample liquidity situation contributed towards sustained bank lending activity. Higher financing for the private sector coupled with expansionary external operations contributed to the expansion in monetary aggregates during the year. Inflation continued to remain low in this environment.

Graph 2.1
Interbank Rates (average for the month)



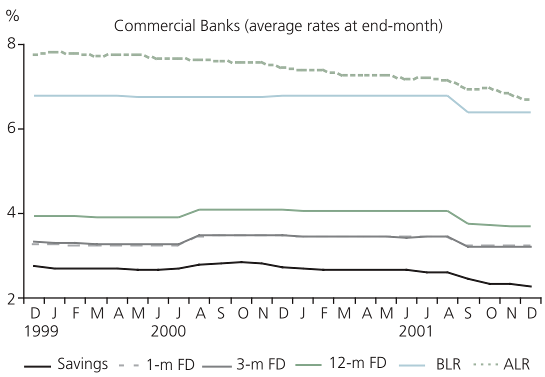
relatively stable throughout the year. The overnight and 3-month interbank rate stood at 2.76% and 3.27% respectively at the end of 2001 (2.77% and 3.25% respectively at end-2000). Consequently, the divergence between the 3-month interbank rate and the Intervention Rate narrowed to 173 basis points from 225 basis points at the end of 2000.

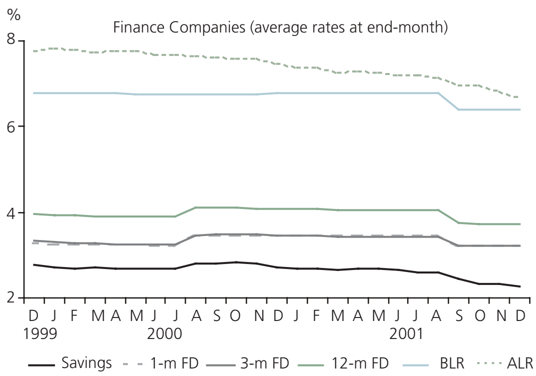
Monetary conditions remained conducive to support domestic economic activity amidst low inflation. The low interest rate environment, ample liquidity conditions and strengthened banking system contributed to higher financing and expansion in monetary aggregates.

The 3-month BNM Intervention Rate was reduced by 50 basis points to 5.00% on 20 September to address heightened risks biased towards weakness in the domestic economy following the September 11 incident in the US. Meanwhile, the interbank rates remained

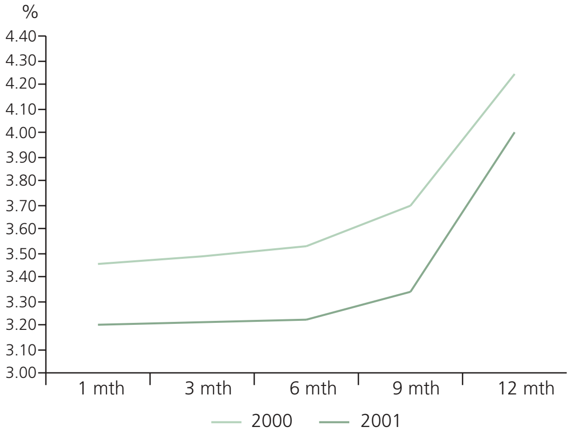
The retail interest rates offered by the banking institutions were generally stable for the first nine months of the year. The average base lending rate (BLR) of the commercial banks (CBs) and finance

Graph 2.2
Interest Rates of Banking Institutions

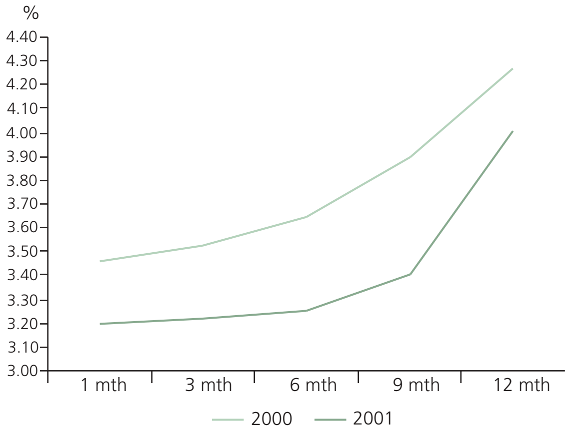




Graph 2.3
Fixed Deposit Term Structure of Commercial Banks (average as at end–period)



Graph 2.4
Fixed Deposit Term Structure of Finance Companies (average as at end–period)



companies (FCs) remained at 6.79% and 7.95% respectively, virtually unchanged since August 1999. Following the 50 basis points reduction in the Intervention Rate on 20 September, the BLRs of both groups of banking institutions adjusted downwards by 39 and 50 basis points respectively to a historical low of 6.39% and 7.45% respectively by the end of September 2001. Thereafter, the rates remained unchanged. Lending rates in Malaysia are the second lowest in the region.

Similarly, the average fixed deposit (FD) rates offered by CBs and FCs, which had remained relatively stable in the first nine months of the year, adjusted downwards following the policy rate reduction by BNM. The average quoted FD rates of CBs and FCs, for the one to 12-month maturities fell to 3.20-4.00% and 3.22-4.03% respectively by the end of September (3.45-4.24% and 3.46-4.27% respectively at end-2000). At the same time, BNM continued to direct its liquidity operations to maintain interbank rates at the prevailing levels, resulting in the smaller reduction in the deposits rates. For the CBs, the quoted FD rates with one to 12-month maturities declined by 24-36 basis points, while the rates for FCs declined by 26-50 basis points. Consequently, the term structure of FD rates became steeper than that at end-2000.

The savings rates of both the CBs and FCs moved in a similar trend as the FD rates. The savings rates were generally unchanged during the first nine months and subsequently declined in October. As at end 2001, the average savings rates of CBs and FCs stood at 2.28% and 2.94% (2.72% and 3.44% respectively at end-2000). Given an inflation rate of only 1.4% in 2001, depositors continued to enjoy a positive real rate of return of 0.88% and 1.54% for deposits with commercial banks and finance companies respectively for savings deposits and 1.81% for 3-month FD for both groups of institutions.

During the year, the gross interest margin of banking institutions narrowed further to 3.86% and 6.31% respectively at the end of 2001. This reflected the larger reduction in the average lending rate (ALR) vis-à-vis the average cost of funds (ACFs). Reflecting the slower declines in FD rates and the relatively stable

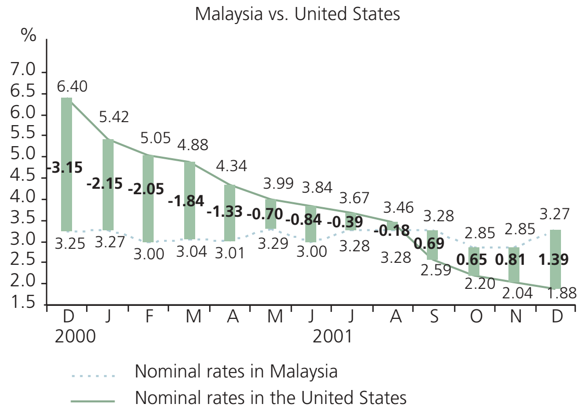
Table 2.1
Interest Rates of Banking Institutions (%)

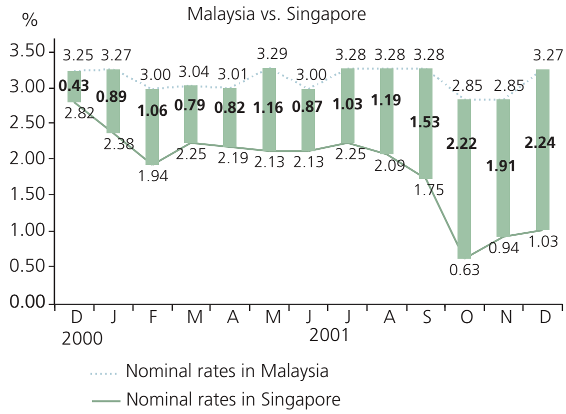
	As at end	2000	2001	Difference
Commercial Banks	3-month FD	3.47	3.21	–0.26
	Savings deposit	2.72	2.28	–0.44
	Base lending rate	6.78	6.39	–0.39
Finance Companies	3-month FD	3.52	3.21	–0.31
	Savings deposit	3.44	2.94	–0.50
	Base lending late	7.95	7.45	–0.50

Table 2.2
Interest Margins of Banking Institutions (%)

	As at end	2000	2001	Difference
Commercial Banks	Avg. lending rate (ALR)	7.46	6.67	–0.79
	Less Avg. cost of funds (ACF)	3.16	2.81	–0.35
	Interest Margin	**4.30**	**3.86**	**–0.44**
Finance Companies	Avg. lending rate (ALR)	11.14	10.24	0.90
	Less Avg. cost of funds (ACF)	4.06	3.93	0.13
	Interest Margin	**7.08**	**6.31**	**0.77**

Graph 2.5
Nominal Interest Rate Differentials





money market rates, the ACFs of CBs and FCs declined at slower rates of 35 and 13 basis points to 2.81% and 3.93% at the end of 2001. The ALR, on the other hand, declined by 79 basis points and 90 basis points to 6.67% and 10.24% for both CBs and FCs respectively at end-2001, underpinned by the more severe competition among banking institutions to attract borrowers amidst an environment of ample liquidity and moderating economic growth. Competitive interest rates were particularly evident for mortgage and hire purchase loans reflecting the relatively strong demand for credit in these sectors.

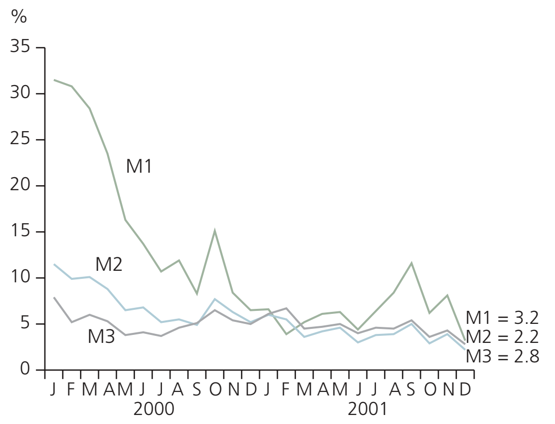
In terms of international comparison of nominal interest rates, the negative differential between Malaysia and the United States (-315 basis points at end-2000) turned positive since September 2001 (+139 basis points at end-2001), following a series of reductions in the US rates throughout the year. The differential widened further in the later part of 2001, following the aggressive cuts in the US rates after the September 11 incident. Comparison with rates in Singapore showed that the interest rates differentials continued to be positive in favour of Malaysia.

Money supply continued to expand in 2001 at a relatively stable pace for the greater part of the year. In the first eleven months, the annual growth in M1, M2 and M3 averaged 6.7%, 4.2% and 4.9% respectively. However, the annual growth rates moderated to 3.2%, 2.2% and 2.8% respectively at end-December due mainly to the high base of December 2000, as well as the build-up in Government deposits in December 2001.

The slower rate of increase in narrow money or M1 (currency in circulation and demand deposits) of 3.2% in 2001 reflected a marginal decline in currency in circulation (-0.5%). Demand deposits also increased at a slower rate of 4.7% (15.0% in 2000). The moderate demand for transaction balances partly reflected the weaker economic activities as well as the optimisation of such balances with the increased utilisation of credit cards. Credit card transactions as a proportion of total private consumption expenditure rose from 8.7% in 2000 to 10.8% in 2001. The slower rate of increase in demand deposits also reflected the performance of the Kuala Lumpur Stock Exchange. As stock market transactions are generally conducted through checking accounts held with banking institutions, the trend in demand deposits tends to be affected by developments on the KLSE.

The continued rise in broad money or M3, albeit at a more moderate pace (2.8%; 5.0% in 2000) generally reflected the overall economic conditions. In terms of components, there were increases in savings deposits, repos and demand deposits. The increase in repos, to

Graph 2.6
Money Supply: Annual Growth



some degree, was indicative of the higher demand for liquidity. Repos provide flexibility for the corporate sector to manage their cash flows. Foreign currency deposits also increased by RM1.3 billion on account of trade-related placements by business enterprises. Despite the large placements by individuals, fixed deposits declined marginally, attributable to the withdrawals by business enterprises and non-bank financial institutions. The latter development partly reflected the shift by these entities to other types of deposits, namely repos and, to a lesser extent, NIDs. While the gap between interest rates on fixed deposits, and NID and repo rates remained relatively stable, the flexibility accorded by NIDs and repos, in terms of tradability and liquidity respectively, were generally more attractive to institutional depositors.

By holder, the higher deposits were almost entirely due to increased deposits by individuals (RM14.3 billion, compared to RM10.7 billion in 2000). This stronger increase in deposits of individuals reflected several factors. The increase in salaries of civil servants, reduction in employees' share of EPF contribution as well as higher tax rebates contributed to higher disposable incomes and, hence, higher deposits. While the propensity to consume was relatively high among those who benefited from tax rebates and higher incomes, there was also some risk aversion amid the weak economic expansion. Consequently, although private sector consumption was sustained, there were some increases in savings and fixed deposits. The higher deposits, to some extent, also reflected the relatively stable and positive real deposit rates amid low inflation.

Meanwhile, the lower deposits by businesses were attributable to a combination of factors. Firstly, it reflected generally lower profitability of some businesses. Secondly, businesses with cash surpluses also repaid their loans amid a situation of excess capacity. Finally, rates on large deposits tended to be lower than quoted rates, which created an incentive among corporations with large deposits to invest their funds in higher yielding papers, such as private debt securities.

While deposits of individuals and businesses accounted for the most significant portion of changes in the components of broad money, deposits by non-bank financial institutions and non-residents contracted during the year (-RM1.5 billion and -RM1.4 billion respectively). The former reflected to some extent, the placement of deposits by a non-bank financial institution with BNM as well as purchases of MGS during the year.

Table 2.3
Broad Money, M3

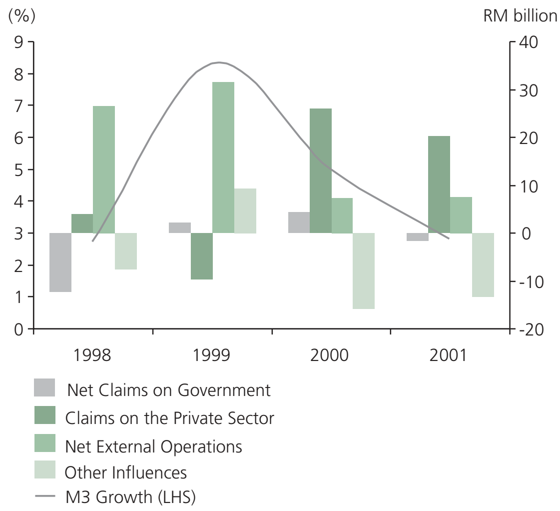
	Change (RM billion)	
	2000	2001
M3	21.9	13.0
Currency[1]	–1.9	–0.1
Demand deposits	7.6	2.9
Broad quasi-money	16.2	10.2
Fixed deposits	8.2	–0.4
Savings deposits	6.4	4.5
NIDs	–0.9	0.6
Repos	–0.3	4.2
Foreign currency deposits	2.9	1.3
Determinants		
Net claims on Government	4.4	–1.5
Claims on private sector	26.0	20.3
Loans	21.6	17.1
Securities	4.4	3.2
Net external operations	7.3	7.6
BNM[2]	1.6	7.7
Banking system	5.7	–0.1
Other influences	–15.8	–13.4

[1] Excludes holdings of banking institutions.
[2] Pre-revaluation.

In terms of determinants, the impetus to growth in M3 emanated from higher claims on the private sector (+RM20.3 billion) and expansionary external operations (+RM7.6 billion). Reflecting the significance of domestic-led economic activity, which is more dependent on domestic sources of financing, bank lending remained resilient (+RM16.8 billion), with loans extended primarily to the household sector, amid a particularly supportive environment of competitive lending rates. In addition, holdings of securities by the banking institutions also increased by RM3.2 billion.

Net external operations (pre-revaluation) also contributed further to the expansion in M3, rising by RM7.6 billion. In the first six months of the year, net external operations of the non-bank sector recorded an increase of RM1.6 billion. Although BNM's international reserves recorded a decline of RM10 billion (excluding net revaluation losses) during this period, the net external assets of the banking system rose by RM11.6 billion. Banking institutions sought to hedge the increase in forward purchases undertaken to cover exchange rate risk on import payments, in the wake of volatility in the foreign exchange markets, especially during March and April 2001. In addition, as foreign interest rates were higher during this period, there were some interest rate arbitrage activities. This situation reversed in the second half-year when net external operations of the non-bank sector recorded an increase of RM6 billion.

Graph 2.7
M3 Determinants



The increase in BNM's international reserves of RM17.7 billion (excluding net revaluation gains) was partly offset by the decline in net external assets of the banking system of RM11.7 billion following the unwinding of forward purchases, as well as the non-rollover of balances previously placed abroad as nominal interest rate differentials had turned in Malaysia's favour beginning September 2001.

Government operations were mildly contractionary on money supply (-RM1.5 billion) as the increase in deposits (+RM5.7 billion) offset higher claims on the Government (+RM4.2 billion). There were large withdrawals of Government deposits from BNM at the beginning of the year. Subsequently, significant increments in deposits were registered at the end of every quarter arising mainly from the receipts of three reopenings and one new issue of MGS, totaling RM21.5 billion for the year as a whole. Two new foreign loans, namely the US$1 billion 10-year Notes issued in June and the US$540 million syndicated loan raised in December also contributed to the increase in deposits with BNM. The increase in Government deposits with BNM also reflected the better-than-expected revenue performance.

Other influences were also contractionary on money supply. These included higher provisions for loan losses; higher profits of the banking institutions during the year; as well as the placement of deposits by a non-bank financial institution with BNM amounting to RM1.5 billion.

Financing activities expanded further in 2001 amid an environment of low interest rates and ample liquidity. In aggregate, **financing through loans extended by the banking system (including Islamic banks) and PDS** issued by the private sector increased by RM33.5 billion or 6% in 2001. Loans extended by the banking institutions (including loans sold to Cagamas and Danaharta) increased by 3.6% for the year as a whole. While loan growth was relatively stronger in the first nine months (+3.5%), it moderated in the remaining months of the year (+0.1%). The slower pace of credit growth in November and December was mainly due to the large loan repayments in connection with the restructuring of non-performing loans as well as the refinancing of banking system loans through the issuance of PDS. Excluding these large repayments, credit would have increased by RM20.6 billion or 4.5% in 2001. Including banking institutions' holdings of PDS, total financing by the banking system increased by 5.2% in 2001.

Financing through the PDS market (excluding Cagamas, Danaharta and Danamodal bonds)

Table 2.4
Financing through Banking System Loans[1] and PDS

	Outstanding		Change		Annual growth	
	2000	2001	2000	2001	2000	2001
	RM bilion				%	
Financing by Banking System	**472.1**	**496.6**	**30.0**	**24.6**	**6.8**	**5.2**
Loan outstanding (1)	454.0	470.4	23.5	16.4	5.5	3.6
Holding of PDS	18.1	26.2	6.5	8.2	56.1	45.1
Total PDS outstanding [2] (2)	**100.8**	**118.0**	**22.4**	**17.1**	**28.6**	**17.0**
Total (1) + (2)	**554.9**	**588.4**	**46.0**	**33.5**	**9.0**	**6.0**

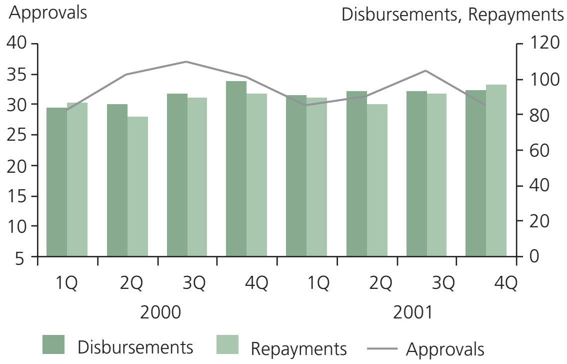
[1] Including Islamic banks
[2/] Refers to total PDS issued by the private sector with original maturity period of more than one year. Exclude debt securities issued by banking institutions, Khazanah, BNM, Cagamas, Danaharta and Danamodal.
Note: Total may not add-up due to rounding

continued to increase strongly, expanding by 17% in 2001. This has been a positive development as it not only reduces the over dependence on the banking system for financing, but also diversifies further the risks associated with long-term financing directly to investors in the PDS market. Of the total gross funds raised from the PDS market, a higher proportion of 41% was to finance new activities, while the remainder was for refinancing (38%) and restructuring (21%). In contrast, in 2000, one-half of the PDS issuance was for restructuring purposes.

During the year, loan approvals were lower, amounting to RM125.6 billion (RM134.8 billion respectively in 2000). Approvals were granted mainly for the purchase of residential properties and passenger cars as well as to the manufacturing sector. Nevertheless, the higher loan disbursements of RM371.8 billion (RM360.7 billion in 2000) were broad-based, channelled mainly to manufacturing; wholesale and retail trade, restaurants and hotels; finance insurance and business services; and construction sectors; as well as for the purchase of residential properties and passenger cars. However, the higher disbursements were almost matched by equally high repayments, amounting to RM364 billion (RM347.1 billion in 2000). As a result, outstanding loans increased by 3.6%.

Overall, credit growth in the banking system reflected the higher loans extended to the household sector for the purchase of residential properties and passenger cars. Loans to business enterprises were lower due mainly to the lower loans for the utilities; transport, storage and communication and construction sectors. However, reflecting the many measures to promote lending to the small and medium enterprises (SMEs), loans to this group expanded further by 3.1% or RM2.2 billion (4.3% in 2000).

Graph 2.8
Loan Approvals, Disbursements and Repayments (RM billion)

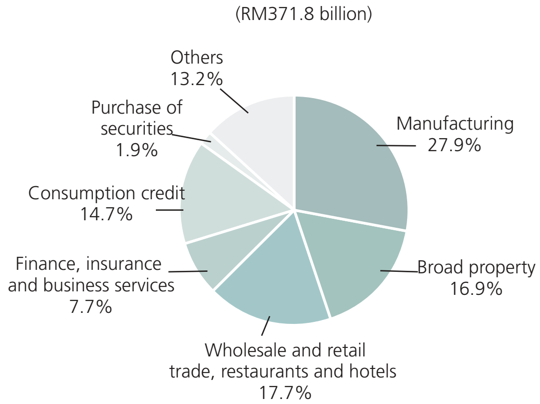


By borrower, loans to the household sector rose markedly by 14% in 2001 (12.4% in 2000). The strong demand for loans by the household sector was attributable to several factors:

- Response to monetary and fiscal measures undertaken to raise domestic demand. The disposable income of households was enhanced through the reduction of the mandatory contribution to the Employees Provident Fund (EPF) and the increase in individual income tax rebates. Other measures also included the reinstatement of incentives offered in the house ownership campaign such as stamp duty exemption and processing fee waivers, as well as the abolition of the RM50 tax on credit cards.

- Amid ample liquidity, banking institutions were more active in promoting consumer loans as reflected by the more competitive interest rates and attractive packages for housing and hire purchase loans as well as credit card facilities. There was also some refinancing of mortgage loans in view of the low interest rate environment.

Graph 2.9
Loan Disbursements in 2001



Loan Approvals in 2001

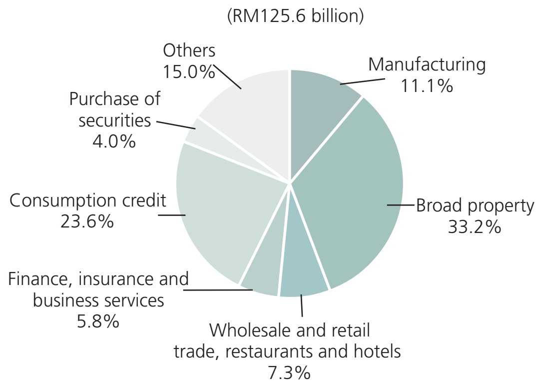


Table 2.5
Banking System[1]: Loans Outstanding by Sector

	As at end		Change 2001	Share of total 2001
	2000	2001		
	RM billion			%
Agriculture, hunting, forestry and fishing	12.0	12.4	0.4	2.6
Mining and quarrying	1.7	1.5	–0.2	0.3
Manufacturing	68.4	68.4	…	14.5
Electricity, gas and water supply	7.8	5.3	–2.5	1.1
Wholesale and retail trade, restaurants and hotels	38.1	38.9	0.8	8.3
Broad property sector	163.2	175.8	12.6	37.4
Construction	*41.1*	*40.1*	*–1.1*	*8.5*
Purchase of residential property	*74.3*	*87.1*	*12.8*	*18.5*
Purchase of non-residential property	*29.4*	*29.7*	*0.3*	*6.3*
Real estate	*18.5*	*19.0*	*0.6*	*4.0*
Transport, storage and communication	13.9	12.5	–1.5	2.7
Finance, insurance and business services	34.5	35.4	0.9	7.5
Consumption credit	59.7	69.4	9.7	14.8
of which:				
Credit cards	*7.4*	*8.9*	*1.5*	*1.9*
Purchase of passenger cars	*37.5*	*45.5*	*8.0*	*9.7*
Purchase of securities	33.6	30.4	–3.2	6.5
Purchase of transport vehicles	1.7	2.4	0.7	0.5
Community, social and personal services	6.3	6.2	–0.1	1.3
Others	13.1	11.8	–1.3	2.5
Total loans outstanding [2]	**454.0**	**470.4**	**16.4**	**100.0**
Plus: Holdings of PDS	18.1	26.2	8.2	
Total Financing	**472.1**	**496.6**	**24.6**	

[1] Including Islamic banks
[2] Including loans sold to Cagamas and NPLs sold to Danaharta
Numbers may not add-up due to rounding

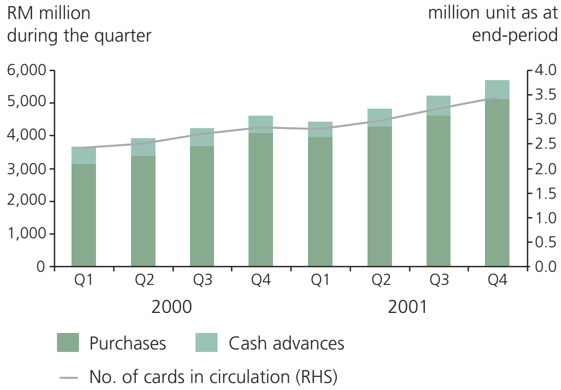
- Banking institutions continued to aggressively promote credit card facilities by selectively offering annual fee waivers and free gifts to widen their customer base. As a result, the number of credit cards in circulation increased by 625,801 or 22.2% to 3.4 million as at end-2001. Correspondingly, the outstanding balance of credit card debt also increased by RM1.5 billion or 21% during the year (+RM1.8 billion or 33.2% in 2000) to RM8.9 billion as at end-2001. The bulk of the credit card transactions was mainly for purchases of goods and services (89.2%) as opposed to cash advances (10.8%).

With the aggressive promotion of credit cards by banking institutions in recent years, BNM has continued to closely monitor credit card developments. In terms of the quality of credit card debt, the overdue balances as a percentage of total outstanding balances remained low at 13.3% in 2001, compared with 23.5% in 1998. In addition, the share of total outstanding balance of credit card debt to total loans outstanding remained low, at 2.1% in 2001 (1.8% in 2000).

Loans outstanding extended to business enterprises were lower (-1.6%) during the period reflecting the high rate of repayments as a result of refinancing, which to some extent was part of the debt restructuring process, and also the more moderate economic expansion in 2001:

- Although loan disbursements to business enterprises remained high in 2001, they were

Graph 2.10
Number of Credit Cards and Volume of Transaction



matched by equally high repayments. This in part reflected refinancing of loans to take advantage of the historical low interest rates and borrowing for short-term working capital requirements as opposed to borrowing for long-term investment purposes.

- The successful completion of the debt restructuring scheme for the light rail transit companies by the Corporate Debt Restructuring Committee (CDRC), also led to some non-performing loans (RM2.9 billion) being taken off the loan books of the banking institutions.

- There were also some refinancing of loans via the PDS market to reduce the operating costs of companies.

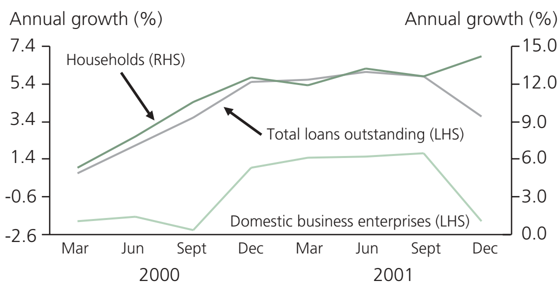
- An increased number of corporations raised funds through the capital market during the year. This was evidenced by the higher gross issuance of private debt securities for financing new activities, amounting to RM13.9 billion or 41% (RM9.2 billion or 32% in 2000) to lock in the low long-term fixed rates.

- There continued to be excess capacity in several industries amid increased uncertainties about the prospects of the global economy and its adverse implications on Malaysia.

Consequently, new loans approved for business enterprises were lower by 12.5% in 2001 and accounted for a smaller share of total new loans approved (50.9%; 54.2% in 2000).

Meanwhile, several measures that were introduced to improve access to credit for the SMEs and the agriculture sector resulted in higher loans to these groups. Loans extended to the SMEs rose further by RM2.2 billion or 3.1% in 2001 (+RM2.9 billion or 4.3% in 2000). The loans to the SMEs were broad based, the bulk of which were channelled to the broad property sector, wholesale and retail trade, as well as the utilities and transport sectors. Loans to the agriculture sector also expanded further by RM435 million or 3.6%. Overall, loans extended to SMEs as a proportion of total loans outstanding remained high at 17.7% at end-2001 (17.8% at end-2000).

Graph 2.11
Loans Extended to Households and Business Enterprises



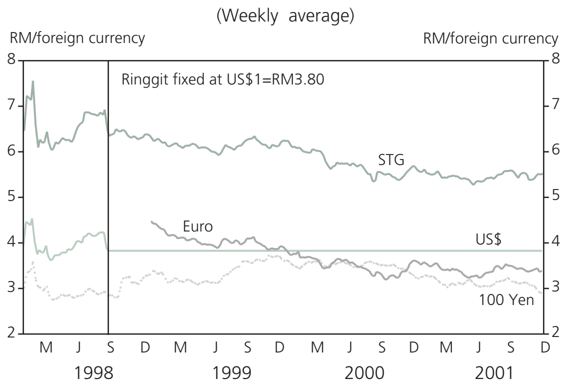
Amongst the many measures implemented to promote SMEs lending were improvement to the loan approval process in banking institutions and promotion of alternative sources of financing including venture capital; establishment of a dedicated unit in BNM to monitor loan complaints and a unit in each banking institution to manage problem loans; and establishment of the Bumiputera Development Unit in BNM which provides financial advisory services to Bumiputera entrepreneurs. The additional measures that were introduced in 2001 included measures on special funds introduced in April, July and October, to expand the scope and size of funds; reduce lending rates, and liberalise the eligibility criteria and conditions of selected special funds (see Box on Monetary Measures in 2001). These measures generated positive results as reflected by the increase in the number of applications approved under the Fund for Food (3F), New Entrepreneur Fund (NEF) and Fund for SMI 2 (FSMI 2) by 26.4%, 23.1% and 291.7% respectively (+5.2% and +13.8% for 3F and NEF respectively in 2000). Disbursements of these funds were also higher, amounting to RM183 million, RM225 million and RM169 million respectively in 2001 (RM81 million, RM132 million and RM43 million respectively in 2000).

EXCHANGE RATE DEVELOPMENTS

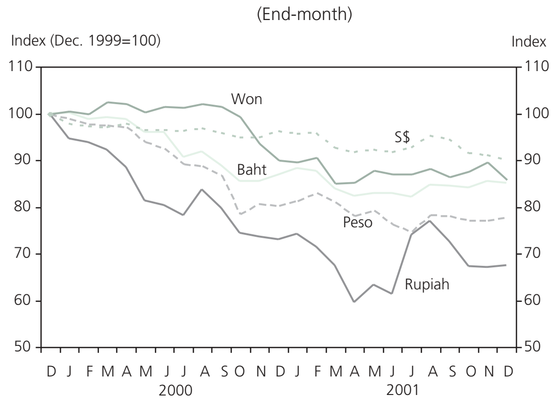
The Malaysian ringgit **exchange rate** remained pegged to the US dollar at the rate of US$1=RM3.80 in 2001. Bilateral exchange rates with other currencies are determined through cross-rates based on the movements of the US dollar against these currencies in the foreign exchange markets.

The international foreign exchange market experienced significant volatility in 2001. The Japanese yen depreciated sharply against the US dollar earlier in the year following increased concerns over growth prospects for the Japanese

Graph 2.12
Exchange Rate of the Malaysian Ringgit against Major Currencies



Graph 2.13
Performance of the Malaysian Ringgit against Selected Regional Currencies



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

economy. Subsequently, the Japanese yen appreciated against the US dollar from mid-July due to market concerns over weakness in the US economy, which were further exacerbated by the September 11 incident. Towards the end of the year, the Japanese yen again experienced a weakening trend. Similarly, the euro exchange rate also exhibited volatility during the year.

The ringgit appreciated against the Japanese yen (14.4%), the euro (5.0%) and pound sterling (2.7%) in tandem with the movements of the US dollar in the foreign exchange markets. However, given the fixed exchange rate to the US dollar, the Malaysian economy was reasonably insulated from the extremes in currency movements. Given that the majority of Malaysia's external transactions are conducted in US dollars, the ringgit peg continued to provide stability to the domestic foreign exchange market in an environment of volatile international and regional foreign exchange markets. The stability accorded reduced the element of uncertainty in the decision making process of domestic manufacturers and service providers.

On the regional front, the ringgit appreciated against all regional currencies in the range of 2.1%-8.2% in 2001. Movements were influenced to some extent by market concerns over the impact of the US economic downturn on the region's economic growth prospects. The depreciation of the Japanese yen also led to depreciation of regional currencies through technical and sentiment-driven factors. In addition, domestic political developments exerted downward pressure on the Indonesian rupiah and the Philippine peso.

The ringgit peg continued to provide stability to the domestic foreign exchange market in an environment of volatile international and regional foreign exchange markets.

In terms of its trade-weighted nominal effective exchange rate (NEER), the ringgit appreciated by 5.5% during the year, in line with the appreciation of the US dollar. The appreciation of the US dollar against other currencies in Malaysia's trade-weighted basket was due mainly to higher expected returns on US dollar denominated assets following the better economic growth prospects for the US relative to the other G-7 economies. However, since September 1998, the ringgit's NEER has appreciated by only 3%. Given the relatively small appreciation, the ringgit has essentially maintained a fair valuation. It has also been well supported by the strengthened macroeconomic fundamentals. The low inflation, low external debt levels, strong external balance, higher reserve levels and strong banking sector have created a favourable environment for Malaysia.

Table 2.6
Movement of the Ringgit

	RM to one unit of foreign currency [1]				Annual Change (%)		Change (%)	
	1997 End-June	1998 Sept.2 [2]	2000 End-Dec.	2001 End-Dec.	2000	2001	End-June '97-Dec. 2001	2 Sept. '98-Dec. 2001
Composite	102.47	72.11	70.86	73.34	3.2	3.5	–28.4	1.7
SDR	3.5030	5.1177	4.9511	4.7714	5.2	3.8	–26.6	7.3
US$	2.5235	3.8000	3.8000	3.8000	0.0	0.0	–33.6	0.0
S$	1.7647	2.1998	2.1946	2.0529	3.9	6.9	–14.0	7.2
100 Yen	2.2088	2.7742	3.3121	2.8955	12.1	14.4	–23.7	–4.2
Pound Sterling	4.1989	6.3708	5.6662	5.5161	8.3	2.7	–23.9	15.5
Deutsche Mark	1.4522	2.1743	1.8064	1.7211	8.5	5.0	–15.6	26.3
Swiss franc	1.7368	2.6450	2.3234	2.2757	2.6	2.1	–23.7	16.2
Euro [3]	–	–	3.5331	3.3662	8.5	5.0	–	–
100 Thai baht	9.7470	9.3713	8.7790	8.6022	15.3	2.1	13.3	8.9
100 Indonesian rupiah	0.1038	0.0354	0.0395	0.0365	37.2	8.2	184.4	–3.0
100 Korean won	0.2842	0.2827	0.3022	0.2883	11.0	4.8	-1.4	–1.9
100 Philippine peso	9.5878	8.8302	7.6053	7.3644	24.7	3.3	30.2	19.9

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

FISCAL POLICY AND OPERATIONS

The 2001 Budget was formulated at a time when the outlook for the global economy, in terms of the magnitude and duration of the slowdown in the major economies was uncertain. Given the openness of the Malaysian economy, the slowdown in global growth would affect Malaysia's growth prospects. In view of the downside risks, the main thrust of the 2001 Budget was directed at stimulating domestic demand, enhancing the nation's competitiveness and achieving the agenda for a caring society.

Given the uncertainties in global economic prospects, weak private sector activities and prevalence of excess capacity in many sectors, counter-cyclical fiscal policy was crucial to directly stimulate domestic economic activities. Therefore, the Government maintained its expansionary budget through higher allocations for both operating and development expenditures. Nevertheless, the fiscal deficit was budgeted at RM16.5 billion or -4.7% of GDP (October 2000), lower than the fiscal deficit of 5.8% of GDP in 2000. At that time, real GDP for 2001 was forecast to grow moderately with economic recovery in the United States expected in the second-half of 2001. Under this scenario, a lower deficit would be consistent with the Government's commitment to fiscal prudence and discipline in its financial management to preserve long-term fiscal sustainability and flexibility.

The focus of the budget allocation was also to ensure maximum impact on growth and keep leakages abroad to a minimum to preserve the strong balance of payments position. Hence, allocations were accorded to projects and programmes which would stimulate domestic demand and strengthen Malaysia's productivity over the longer term. In terms of strategy, the 2001 Budget adopted a two-pronged approach: stimulate domestic growth through allocation for projects which had strong domestic linkages and low import content; and stimulate domestic demand through raising disposable incomes. The latter was effected through tax and non-tax measures including higher individual tax rebates and higher allowances for civil servants in specific categories. In its expenditure allocation to raise economic activity, the Government focused on projects that not only could be implemented quickly for maximum impact on domestic demand, but would also meet the longer-term objective of increasing

Earlier fiscal discipline, accumulation of assets during favourable periods and low Government debt have accorded the Government the flexibility to pursue expansionary fiscal policy to support growth. The actual outturn of the fiscal deficit for 2001 was much lower than estimated due to stronger revenue.

productivity. Hence, a significant share of budget allocation was allocated for projects related to education, infrastructure and industrial development.

To complement this strategy, incentives were introduced to further strengthen the foundation for long-term sustainable growth. Towards this end, wide ranging fiscal incentives were provided to develop new sources of growth, strengthen the nation's competitiveness and resilience through development of skilled manpower, technological competence and establishing strategic partnerships with international and global players in the services sector. Measures were also undertaken to enhance the ability of the financial markets to be more dynamic, innovative and efficient in supporting growth, particularly as the economy transforms into a knowledge-based economy.

In the early part of 2001, there were increasing signs that the slowdown in the United States economy was becoming more severe with diminishing prospects of an early recovery. The economic outlook for Malaysia in 2001 was revised downwards to 1-2% from 7% announced in October 2000. The impact on the external sector was expected to be more severe due to a stronger deceleration in global growth. Under a more uncertain outlook, the Government implemented several pre-emptive measures to sustain the growth momentum. On 27 March 2001, the Government announced a package of stimulative measures to strengthen domestic demand. These measures included an additional fiscal stimulus of RM3 billion, reduction in employees' share of contribution to the EPF by two percentage points for one year and the removal of tax on credit cards. Projects identified under this package were those with high spill-over effects, low import content and short gestation period. A higher allocation was given to social services, notably for education and training as well as for low-cost housing. At the same time, the Government also undertook several other measures to encourage private investment. These included measures to reduce the property overhang and additional financing for the small- and medium-sized industries through expanding the size and scope as well as lowering the lending rates of special funds.

Subsequently, when there were increased risks biased towards weaker domestic demand following the September 11 incident, a further fiscal stimulus package of RM4.3 billion was announced on 25 September ahead of the 2002 Budget. Apart from containing and minimising the adverse spill-over effects from the deterioration in global demand, the fiscal stimulus also aimed at cushioning the negative impact on the poor and the less fortunate, increasing income opportunities for small enterprises and assisting retail businesses. The new fiscal stimulus package was mainly allocated for small projects for which funds could be disbursed immediately. The projects identified were small development projects in rural and selected urban areas, upgrading of Government buildings and facilities, training of retrenched workers and unemployed graduates and tourism promotion. The early announcement of this fiscal stimulus before the 2002 Budget was aimed at providing enough lead time for higher expenditure to impact economic activities during the remaining months of 2001.

Following the two fiscal stimulus packages, the fiscal deficit was expected to be higher than the deficit of 5.8% recorded in 2000. Efforts were made to contain the estimated budget deficit at about 6.5% of GDP or RM22.4 billion. This level was deemed prudent and within limits that would not create longer-term risks. The actual outturn of the fiscal deficit was however, much lower. Efficiency in tax collection amidst sustained economic activities resulted in the actual tax revenue collection being much higher than projected. Expenditure was on target with the shortfall contained at less than 5% of total allocation. Following the stronger revenue, lower fiscal deficit of RM18.4 billion or -5.5% of GDP was achieved compared to earlier estimates of -6.5% of GDP.

In implementing the fiscal stimulus programmes, it became necessary to undertake measures to overcome the slow disbursement of funds, especially in the early months of 2001. Existing procedures were adjusted in order to enhance the efficiency of project implementation, speed up payments to contractors and remove bureaucratic delays. Besides the review of procedures, rules and guidelines on the implementation of development projects and procurements as well as payment to contractors, the implementation of projects was also more closely monitored.

Previous fiscal prudence and accumulation of assets during favourable periods ensured that the Government had substantial resources to finance expansionary fiscal policies. Although the budget deficits were recorded as a result of counter-cyclical measures taken since 1998, these deficits had not led to macroeconomic imbalances. On the contrary, the fiscal stimulus programmes had contributed positively in promoting domestic sources of growth, thereby ensuring economic stability and building resilience against adverse external developments. At the same time, the Government maintained prudent practices and refrained from unsustainable expansion in fiscal policy. In this respect, the Government targeted for at least a balanced position in the current account of the Government budget. This was achieved by ensuring that operating expenditure would not exceed revenue estimates.

The counter-cyclical demand impulse was effective and succeeded in sustaining domestic demand to compensate for the rapid decline in export demand. The positive response of consumer spending to the Government measures sustained total consumption spending, which accounted for 59% of GDP. As a result, domestic demand was the main engine of growth in 2001. The contribution of government expenditure to domestic output was higher at 31% in 2001 compared with 27% in 2000. This expenditure supported investment activities so that the decline in capital formation was contained. Public sector expenditure, as a whole contributed 3.8 percentage points to real GDP growth in 2001. At the same time, public sector expenditure did not erode the gains made in strengthening the balance of payments position. In addition, the benefits of the stimulus programmes would also enhance long-term growth prospects for the Malaysian economy.

While fiscal expansion contributed to GDP growth, it did not exert pressure on domestic consumer prices and interest rates. High savings rate and excess liquidity made it possible for the bulk of the fiscal deficit to be financed through non-inflationary domestic sources in the form of Malaysian Government Securities (MGS). The large issuance of MGS was subscribed mainly by provident, pension and insurance funds. Apart from meeting financing requirements, the domestic borrowing programme was also aimed at providing a benchmark yield curve to facilitate the development of the domestic ringgit bond market. An auction calendar on the issue of government securities also continued to be announced to enhance transparency and assist investors in the formulation of their investment strategies. As there was sufficient liquidity in the banking system to meet the private sector financing needs, the Government requirements did not result in any crowding out effects. In essence, this favourable situation resulted in new issues of MGS being raised at lower coupon rates in line with declining interest rates during the course of 2001.

In 2001, taking advantage of the favourable market conditions and improved overall yields, the Government also tapped external borrowings through the international capital and debt markets. During the year, two new market loans were raised to maintain regular market presence and to provide a benchmark for Malaysian corporations. Meanwhile, no new loans were raised from the bilateral and multilateral sources. The Government continued to draw down from loans committed earlier from both bilateral sources, especially under the New Miyazawa Initiative as well as from multilateral sources.

The higher borrowing raised the Federal Government debt to RM145.7 billion or 43.8% of GDP as at end-2001. At this level, the debt remained low and sustainable. Interest cost accounted for only 15% of operating expenditure in 2001. More importantly, 83% of the total government debt was domestic debt and denominated in ringgit. Hence, the domestic debt will not have exposure to exchange rate risks. As part of a prudent debt policy, the Government will continue to ensure prudence in its recourse to external borrowing to maintain its low external debt level.

Consolidated Public Sector

In 2001, the financial position of the consolidated public sector continued to record a large surplus in the current account. This was due to better revenue

Table 2.7
Consolidated Public Sector Finance

	2000	2001*e*	2002*f*
	RM million		
General government[1]			
Revenue	76,002	92,937	87,692
Operating expenditure	64,445	72,295	74,437
Current surplus of general government	11,556	20,642	13,255
Current surplus of NFPEs [2]	41,204	31,303	33,493
Public sector current surplus	**52,760**	**51,945**	**46,748**
% of GDP	**15.5**	**15.6**	**13.3**
Net development expenditure	50,438	68,161	57,766
General government	*27,078*	*33,934*	*30,028*
NFPEs	*23,360*	*34,227*	*27,737*
Overall balance	**2,322**	**–16,215**	**–11,018**
% of GDP	**0.7**	**–4.9**	**–3.1**

[1] Comprises Federal Government, state governments, statutory bodies and local governments.
[2] Refers to 37 NFPEs.
e Estimate
f Forecast

Source: Ministry of Finance, state governments and non-financial public enterprises performance of the general government. Nevertheless, the significantly higher development expenditure of both the Federal Government and the non-financial public enterprises (NFPEs) to stimulate economic activities, led to an overall deficit of 4.9% of GDP.

Federal Government Finance

The continued weakness in the external environment and its adverse impact on the domestic economy prompted the Government to pursue a more aggressive fiscal stimulus programme. Notwithstanding the additional allocations arising largely from the implementation of two fiscal stimulus packages, the Federal Government recorded a lower fiscal deficit of RM18.4 billion or -5.5% of GDP in 2001. This was significantly lower than the earlier estimated deficit of RM22.4 billion or -6.5% of GDP due mainly to higher revenue.

In 2001, Federal Government **revenue** registered a significant increase of 28.6% or RM17.7 billion to RM79.6 billion or 23.9% of GDP. The better-than-expected revenue collection was attributable largely to improved procedures for income tax collection as well as higher dividend payments from public enterprises. In aggregate, the increase in revenue emanated from all three broad categories of revenue, especially direct taxes.

The higher **tax collection** was attributed to the continued increase in economic activities, collection of delayed payments for taxes for the assessment year 2000 as well as high oil prices in the previous year. It also reflected the success of the widening of the tax base and concerted efforts to strengthen efficiency in tax collection. In particular, tax compliance was enhanced further through creating public awareness in paying taxes and duties as well as ensuring stricter enforcement to reduce tax evasion. Consequently, the ratio of tax receipts to GDP increased to 18.5% from 13.8% in 2000. This was close to the pre-crisis level in 1997.

Of significance, collection from income tax increased sharply, thus increasing its share to one-half of total revenue (44% a year ago). This development

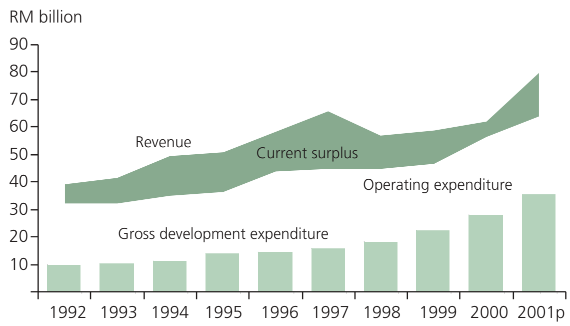
Table 2.8
Federal Government Finance

	2000	2001*p*	2002 Budget
	RM million		
Revenue	61,864	79,567	
Operating expenditure	56,547	63,757	65,342
Current account	**5,317**	**15,810**	**7,825**
% of GDP	**1.6**	**4.8**	**2.1**
Net development expenditure	25,032	34,232	26,689
Gross development expenditure	*27,941*	*35,235*	*28,382*
Less Loan recoveries	*2,909*	*1,003*	*1,700*
Overall balance	**–19,715**	**–18,422**	**–18,857**
% of GDP	**–5.8**	**–5.5**	**–5.1**
Sources of financing			
Net domestic borrowing	12,714	13,381	–
Gross borrowing	*23,182*	*23,500*	–
Less Repayment	*10,468*	*10,119*	–
Net foreign borrowing	864	6,295	–
Gross borrowing	*4,767*	*7,030*	–
Less Repayment	*3,903*	*735*	–
Special receipts	13	6	–
Realisable assets[1] and adjustments	6,123	–1,259	–
Total	**19,715**	**18,422**	**–**

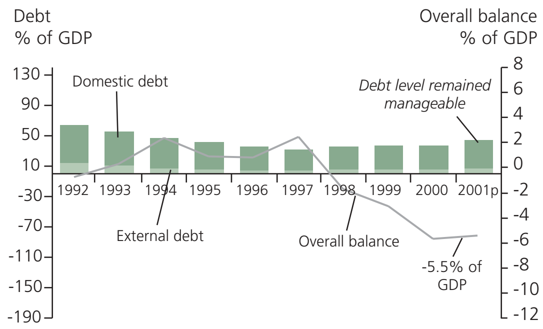
[1] Includes changes in Government's Trust Fund balances. An increase in the accumulated realisable assets is indicated by a negative (–) sign.
[2] Includes a net revenue loss of RM234 million arising from the tax changes for 2002.

p Preliminary
Source: Ministry of Finance

Graph 2.14
Federal Government Finance



Federal Government Debt



reflected the significantly higher petroleum oil prices in 2000 (tax base year for 2001) as well as better performance of the corporate sector, with fewer losses being carried forward from previous year to offset current year profits. In addition, a portion of corporate tax payable in 2000 was collected in 2001 as instalment payment was allowed during the transition period, following the introduction of the current year assessment system in 2000. Collection from individual income tax was also significantly higher, notwithstanding the provision of higher rebates announced in the 2001 Budget to individuals to encourage consumption. The rebate for individuals was increased from RM110 to RM350 and from RM60 to RM350 for wives.

The strong sales of motor vehicles led to higher receipts of excise duties and sales tax. Sales tax collection was also boosted by the increase in sales tax rates on cigarettes and tobacco products and alcoholic beverages. Receipts of service tax were also higher due largely to higher collection from professional services and widened coverage of service tax to all telecommunication services (except the internet), golfing and golf driving range facilities, public houses selling liquor and forwarding agents. Nevertheless, the increase in service tax revenue was moderated to some extent by the abolishment of the RM50 service tax on each credit card, implemented as part of the fiscal stimulus measures to encourage consumption.

Other major components of **indirect taxes**, however, recorded declines in collection. Lower receipts of import duties were seen in all categories of goods especially motor vehicles, tobacco and cigarettes as well as machinery and spare parts. The decline of the latter reflected the tax exemptions on selected machines and spare parts provided in the 2001 Budget to enhance the efficiency and competitiveness of the economy. Receipts of export duties were also lower, attributable to both the decline in export volume and oil prices during the year.

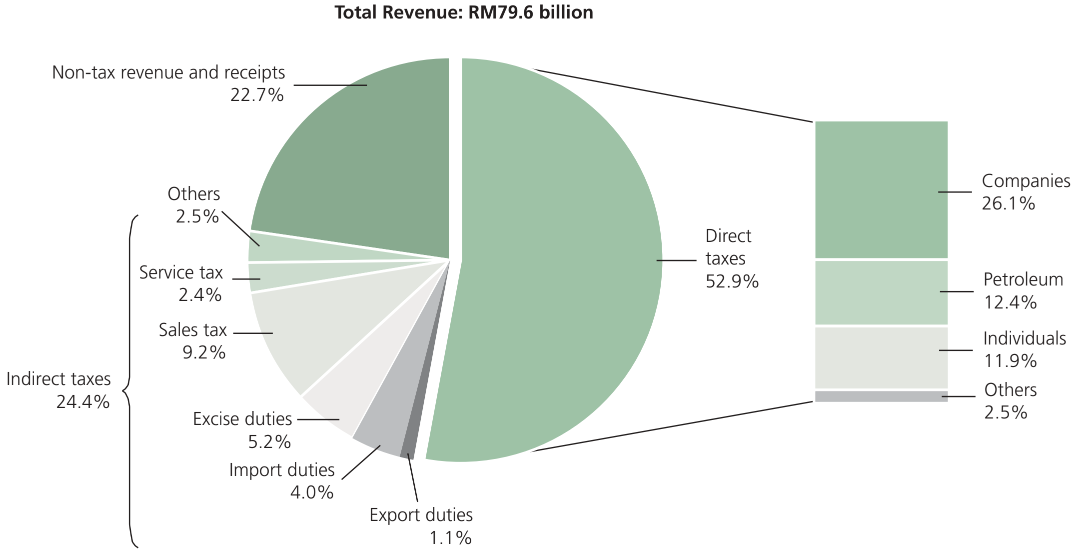
Table 2.9
Federal Government Revenue

	2000	2001*p*	2000	2001*p*
	RM million		Annual Change (%)	
Tax revenue	**47,173**	**61,492**	**4.0**	**30.4**
% of GDP	**13.8**	**18.5**		
Direct taxes	29,156	42,097	7.0	44.4
Income taxes	27,016	40,135	7.4	48.6
Companies	*13,905*	*20,770*	*-11.7*	*49.4*
Petroleum	*6,010*	*9,858*	*110.4*	*64.0*
Individuals	*7,015*	*9,436*	*9.3*	*34.5*
Co-operatives	*87*	*70*	*-39.0*	*-19.2*
Real property gains tax	247	227	-13.9	-8.3
Stamp duties	1,799	1,650	14.9	-8.3
Others	94	85	-59.8	-9.4
Indirect taxes	18,017	19,395	-0.5	7.6
Export duties	1,032	867	53.9	-16.0
Import duties	3,599	3,193	-23.8	-11.3
Excise duties	3,803	4,130	-19.5	8.6
Sales tax	5,968	7,356	33.0	23.3
Service tax	1,701	1,927	16.6	13.3
Others	1,914	1,922	-6.2	0.4
Non-tax revenue and receipts	**14,691**	**18,075**	**10.2**	**23.0**
Total revenue	**61,864**	**79,567**	**5.4**	**28.6**
% of GDP	**18.2**	**23.9**		

p Preliminary

Source: Ministry of Finance

Graph 2.15
Composition of Federal Government Revenue, 2001 (% share)



Overall, tax revenue increased by 30%, leading to a slight increase of its share to 77% of the total revenue. Accordingly, the share of non-tax revenue accounted for 23% with higher receipts from payments of dividend especially from PETRONAS and petroleum royalties.

Total Federal Government expenditure increased by 17.2% to RM99 billion in 2001 due to a stronger expansionary budgetary operation. The additional stimulus packages were effected during the year in March (RM3 billion) and in September (RM4.3 billion). Apart from higher expenditure, the Government stepped up efforts to improve policy implementation, particularly to eliminate bureaucratic delays and accelerate disbursements. The Government also reviewed the procedures, rules and guidelines on the implementation of development projects and payments to contractors (see Box for details). The objective was to ensure that the fiscal stimulus had the intended impact on the economy as well as to improve the delivery of public goods and services. As a result of these measures, the Government's gross expenditure shortfall in 2001 was small, at less than 5%.

In tandem with available resources, **operating expenditure** was raised by 12.8%, mainly to stimulate public and private sector consumption to increase domestic demand. During the year, the total wage bill, the largest component of operating expenditure (27%), increased by 6.6%. The increase in wage bill reflected the increased allowances, particularly for the police and armed forces personnel as well as nurses, doctors and headmasters. The payment for pensions and gratuities was also higher

Measures Undertaken by the Government to Improve Project Implementation

To eliminate bureaucratic delays:

- A task force was established in the Ministry of Finance to monitor the progress as well as identify and address implementation problems to ensure that all measures under the fiscal stimulus programmes are implemented efficiently.
- Established a "Flying Squad" to ensure that the implementation of public and privatised projects proceed as scheduled.
- To ensure that development projects are implemented as scheduled, all implementing agencies are required to submit monthly progress reports to the highest authority.
- For ministries that do not fully utilise their allocations, such allocations would be withdrawn and reallocated to other ministries.

To expedite the implementation of projects:

- Ministries and agencies have been empowered with greater delegated authority in approving tenders.
- To reduce processes, the Government appointed project management consultants (PMCs) to supervise public sector projects and awarded projects based on turnkey and design-and-build basis.
- To facilitate early project start-ups, all contractors implementing government projects were given advance payments of 15%, while for those implementing small projects under the pre-emptive package, advance payments of up to 75% were allowed.

To speed up payments:

- Specific procedures were put in place to expedite payments. In particular, projects undertaken through PMCs were allowed to submit claims for payment directly to the Accountant General's office.

Table 2.10
Federal Government Operating Expenditure by Object

	2000	2001*p*	2000	2001*p*
	RM million		% share	
Emoluments	16,357	17,443	28.9	27.4
Supplies and services	7,360	10,704	13.0	16.8
Asset acquisition	572	1,339	1.0	2.1
Debt service charges	9,055	9,634	16.0	15.1
Pensions and gratuities	4,187	4,711	7.4	7.4
Subsidies	4,824	4,450	8.5	7.0
Other grants and transfers[1]	11,757	13,626	20.8	21.5
Other expenditure[2]	2,435	1,851	4.3	2.9
Total	**56,547**	**63,757**	**100.0**	**100.0**
% of GDP	**16.6**	**19.2**		

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

Source: Ministry of Finance

reflecting the higher annual contribution to the Pensions Trust Fund (RM929 million in 2001; RM637 million in 2000) as well as the special payments of RM200 each to pensioners.

Disbursement on supplies and services was significantly higher, mainly for the procurement of office supplies related to e-government flagship applications, 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. Domestic debt servicing was higher, reflecting the increased debt level to finance the fiscal stimulus programme. Meanwhile, lower global interest rates contained the servicing of external debt. The share of debt servicing was slightly smaller at 15% of operating expenditure. Expenditure for subsidies was also lower. This reflected the reduced quantum of subsidy payments following two recent price increases for petroleum products and lower oil prices.

Implementation of stronger fiscal impulse during the year led to the sharply higher **development expenditure** (26.1%). Significantly higher expenditure was spent on the social services sector, notably for education and training. The social services sector continued to account for the largest component of the total development spending (44%), reflecting the Government's concerted effort to promote skills development in order to develop a knowledge-based economy. The expenditure was mainly for upgrading of educational facilities, curriculum development, construction of single

Table 2.11
Federal Government Development Expenditure by Sector

	2000	2001*p*	2000	2001*p*
	RM million		% share	
Defence and security	2,332	3,287	8.3	9.3
Economic services	11,639	12,724	41.7	36.1
Agriculture and rural development	1,183	1,394	4.2	4.0
Trade and industry	3,667	4,829	13.1	13.7
Transport	4,863	5,042	17.4	14.3
Public utilities	1,517	1,092	5.4	3.1
Others	409	367	1.5	1.0
Social services	11,076	15,385	39.6	43.7
Education	7,099	10,363	25.4	29.4
Health	1,272	1,570	4.6	4.5
Housing	1,194	1,269	4.3	3.6
Others	1,511	2,182	5.4	6.2
General administration	2,894	3,839	10.4	10.9
Total	**27,941**	**35,235**	**100.0**	**100.0**
% of GDP	**8.2**	**10.6**		

p Preliminary

Source: Ministry of Finance

session schools and building of new community colleges and universities. Priority was also placed on the construction of computer laboratories to narrow the digital divide between the urban and rural areas.

Outlays on health were also higher to ensure better health care and support the increasing demand for public health services. This included the construction and upgrading of hospitals and health clinics. Similarly, the large expenditure on housing was mainly for low-cost public housing projects for the poor as well as housing programmes for the armed forces, police personnel, and teachers in rural areas.

In the economic services sector, emphasis continued to be placed on infrastructure, industrial as well as agriculture and rural development. Expenditure on transport absorbed a sizeable share of the development expenditure reflecting the Government's efforts to increase activities as well as to provide a more efficient and integrated national transportation network. The bulk of the expenditure was for the construction and upgrading of roads (including highways) as well as the development of the rail system, including the dual track from Rawang to Ipoh.

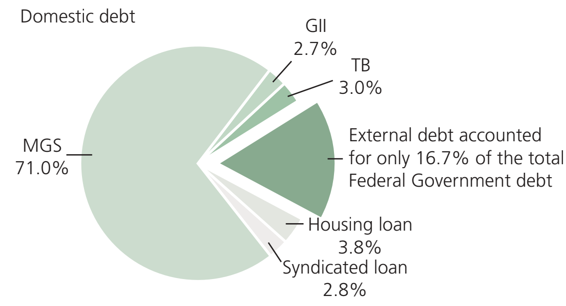
Under the trade and industry sub-sector, the bulk of expenditure was for the development of small- and medium-scale industries, industrial research and development, promotion of tourism and Bumiputera

Commercial and Business Community. Additional expenditure was also incurred in the Government's acquisition of the national airline as part of the corporate restructuring exercise. During the year, the Government also intensified its efforts to increase the income of the poor and enhance rural accessibility to public utilities and amenities. Thus, expenditure for agriculture and rural development (including land development and drainage) as well as investment to improve rural roads, water supply and electrification programmes was higher.

Given the increasing sophistication and challenges faced in combating crimes and ensuring national security, outlays on defence and internal security were higher during the year. Expenditure for general administration was also higher, largely for the construction and maintenance of the new administrative centre at Putrajaya; and the establishment of the ICT infrastructure to support e-government application and computerisation to enhance the efficiency and effectiveness of the Government administrative machinery.

The availability of adequate domestic resources to fund the Federal Government **financing** requirements facilitated fiscal expansion. The bulk of the development expenditure was financed domestically. The issuance of government securities was effected without crowding out private sector's access to financing. In addition, the large issuance continued to facilitate the development of the bond market through regular benchmark issues. Moreover, with the prevailing low domestic interest rate environment, raising funds domestically represented a lower source of financing, and as a result, no unnecessary burden was placed on future Government expenditure. The Government also tapped the international market for continued market presence and established a benchmark for the corporate sector. Recourse to external borrowings, nevertheless, would be prudent in order to maintain the low external debt position.

Graph 2.16
Federal Government Outstanding Debt as at end–2001*p*



Overall, the Federal Government recorded a larger **total net borrowing** of RM19.7 billion in 2001. This led the Federal Government outstanding debt to expand by 16% to RM145.7 billion or 43.8% of GDP as at end-2001. This level of debt remained manageable with low debt service charges (15% of the total operating expenditure) and low external debt service ratio (0.5%). While the domestic debt accounted for 83% of total debt, the external debt of the Federal Government accounted for 14% of the nation's external debt.

Net domestic borrowing totalled RM13.4 billion in 2001. The domestic borrowing was financed largely from non-inflationary domestic sources. During the year, the Federal Government floated four issues of Malaysian Government Securities (MGS) totalling RM21.5 billion mainly by way of open tender through the principal dealers. The Government reopened three existing MGS issues to increase their respective issue size and enhance liquidity in the secondary market to further develop the bond market. Meanwhile, on a net basis, there were no new funds raised through Government Investment Issues (GII) and Treasury bills (TB). The Treasury Housing Loans Fund, however, recorded a higher net borrowing of RM1 billion to meet the increased funding requirements following the relaxation of housing loan eligibility in the Budget 2001. The eligibility for housing loans was increased from

Table 2.12
Federal Government Outstanding Debt

	Annual change		At end
	2000	2001*p*	2001*p*
	Nominal value in RM million		
Domestic debt	**13,055**	**14,592**	**121,396**
Treasury bills	0	0	4,320
Government Investment Issues	2,000	0	4,000
Malaysian Government Securities	10,714	14,400	103,450
Treasury Housing Loans Fund	341	1,259	5,555
Market loans	0	-1,067	4,071
External debt	**451**	**5,508**	**24,328**
Market loans	965	5,642	17,682
Project loans	-514	-134	6,646
Total	**13,506**	**20,100**	**145,724**
% of GDP			**43.8**

p Preliminary

Source: Ministry of Finance

Table 2.13
Holdings of Federal Government Domestic Debt

	2000	2001*p*	2000	2001*p*
	Nominal value in RM million		% share	
Treasury bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	76	160	1.8	3.7
Banking sector	4,166	4,014	96.4	92.9
Other	78	146	1.8	3.4
Government Investment Issues	**4,000**	**4,000**	**100.0**	**100.0**
Insurance companies	194	195	4.8	5.0
Banking sector	3,805	3,805	95.1	95.1
Others	1	0	…	0
Malaysian Government Securities	**89,050**	**103,450**	**100.0**	**100.0**
Social security and insurance institutions	71,232	79,154	80.0	76.5
of which:				
Employees Provident Fund	*61,476*	*67,468*	*69.0*	*65.2*
Insurance companies	*6,652*	*8,566*	*7.5*	*8.3*
Banking sector	12,458	18,594	14.0	18.0
Other	5,360	5,702	6.0	5.5

p Preliminary

Table 2.14
Consolidated State Government Finance

	2000	2001*e*	2002 Budget
	RM million		
Revenue	10,314	9,226	9,566
State sources	*8,118*	*7,127*	*7,470*
Federal grants and transfers	*2,196*	*2,099*	*2,096*
Expenditure	5,254	5,874	5,905
Current surplus	**5,059**	**3,351**	**3,661**
% of GDP	**1.5**	**1.0**	**1.0**
Net Development expenditure	5,082	5,673	5,565
Gross development expenditure	*5,348*	*5,878*	*5,757*
Less: Loan recoveries	*266*	*205*	*192*
Overall balance	**–23**	**–2,322**	**–1,904**
% of GDP	**0.0**	**-0.7**	**-0.5**
Sources of financing			
Federal loans	452	592	501
Realisable assets[1]	-430	1,730	1,403
Total	**23**	**2,322**	**1,904**

[1] A positive (+) sign indicated a draw down in the accumulated realisable assets.
e Estimate

Source: State governments

between RM35,000 and RM200,000 to between RM40,000 and RM300,000.

Following the large net borrowings of MGS, the outstanding debt of the MGS rose to RM103.5 billion as at end-2001. It accounted for 85% of the total domestic debt outstanding. In terms of the ownership structure of MGS, the largest holders were mainly the provident, pension and insurance funds. The banking sector raised its holding in 2001.

Gross external borrowings amounted to RM7 billion, reflecting largely the raising of two new loans during the year. Taking advantage of the favourable market conditions and improved overall yields, in July 2001, the Federal Government raised a US$1 billion (RM3.8 billion) global bond due 2011 at a coupon rate of 7.5%. The bond raised was three times over-subscribed and was priced at 228 basis points above the 10-year US Treasuries which reflected foreign investors' confidence in Malaysia's strong fundamentals and its low external debt position. A syndicated loan was also raised in December amounting to US$540 million (RM2.1 billion). The 7-year loan was raised at an attractive interest rate of US$ LIBOR plus 56 basis points, reflecting the high creditworthiness of the Government and confidence in the Malaysian economy. The Government also drew down on loans from both bilateral sources, especially under the New Miyazawa Initiative, and multilateral sources (World Bank, Islamic Development Bank and Asian Development Bank).

State Governments

Based on preliminary estimates, all 13 state governments registered surpluses in their current accounts. The consolidated state governments financial position, however, recorded a smaller current account surplus due to lower revenue receipts from state sources amidst higher operating expenditure. As development expenditure was also higher, the consolidated financial position of the state governments recorded a small overall deficit of 0.7% of GDP in 2001. The overall deficit was financed largely by Federal Government loans and drawdown of accumulated financial assets of the state governments.

During the year, the lower commodity prices including crude petroleum, crude palm oil and saw log had an adverse impact on the states' own sources of revenue. Meanwhile, receipts from Federal sources were sustained to assist the states in providing infrastructure and essential amenities to improve the quality of life and to support the increasing urbanisation in the states. The increased operating expenditure of the state governments reflected largely higher emoluments. A major share of the increased development expenditure was directed to agriculture and rural sector, public utilities, as well as expansion and upgrading of infrastructure.

Non-Financial Public Enterprises (NFPEs)

Preliminary estimates of the consolidated financial position of the 37 non-financial public enterprises (NFPEs) indicated that the overall financial position of the NFPEs as a group recorded a small surplus of RM1.6 billion or 0.5% of GDP in 2001. The small surplus was due to both lower revenue receipts and higher expenditure. The higher development spending of NFPEs was mainly used for quality improvement, capacity expansion and productivity enhancement to ensure efficiency and adequate supply of goods and services.

The consolidated revenue of NFPEs declined by 6.7% to RM107.7 billion. The lower oil prices during the year contributed to the decline in revenue collection. Excluding receipts from oil and gas-related sector, NFPEs revenue recorded a positive growth of 6.5%. This growth was largely attributable to the higher demand for telecommunications and energy services as well as synergy derived from diversification into new business areas. To a lesser extent, extraordinary gains from sales of assets also contributed to the increase in revenue. Meanwhile, the increase in operating expenditure (0.2%) was marginal reflecting largely the efforts to reduce cost as part of prudent financial management. Several public enterprises also implemented organisational restructuring of their business operations through wholly owned subsidiaries of the core business. The objectives were to increase operational efficiency, transparency, accountability and performance to strengthen business earnings.

Table 2.15
Consolidated NFPEs Finance[1]

	1999	2000	2001*e*
	RM million		
Revenue	100,331	115,419	107,689
Expenditure	61,596	71,725	71,898
Current account	**38,735**	**43,694**	**35,790**
% of GDP	**12.9**	**12.8**	**10.8**
Development expenditure	25,458	23,360	34,227
Overall balance	**13,276**	**20,334**	**1,563**
% of GDP	**4.4**	**6.0**	**0.5**

[1] Refers to 37 NFPEs
e Estimate

Source: Ministry of Finance and non-financial public enterprises

Development expenditure was significantly higher at RM34.2 billion (+46.5%), accounting for slightly more than one-half of total public sector development expenditure. All major public enterprises registered increases in development spending. The higher capital spending was for capacity expansion and modernisation programmes. The NFPEs also invested abroad to strengthen their business earnings. In 2001, Petroleum Nasional Bhd. (PETRONAS) continued its domestic and international investments in both upstream and downstream activities. Major projects included the construction of the Malaysia Liquefied Natural Gas Tiga (MLNG 3) and the integrated petrochemical complexes in Kertih and Gebeng. They also included LNG tanker fleet expansion by the Malaysia International Shipping Corporation to accommodate the increase in future exports of LNG. Meanwhile, international projects undertaken by PETRONAS included the exploration and production projects in Indonesia, Vietnam, Niger, Cameroon, Chad, Egypt, Sudan, Turkmenistan and Iran.

A large portion of the capital expenditure of Tenaga Nasional Bhd. (TNB) was channelled towards the expansion and upgrading of power generation, transmission and distribution networks to ensure adequate, reliable supply of electricity. Major projects included the redevelopment of the Tuanku Jaafar Power Station (Phase I and II), Janamanjung coal-fired power plant, Kenyir Hydroelectric project (Phase II), Pasir Gudang Fast Track Plant-up project and the Gelugor combined cycle conversion project. In the case of Telekom Malaysia Bhd. (TMB), expenditure was largely channelled towards capacity building in communications technology. TMB focused on upgrading and expanding the fixed line and mobile network operations, internet service and multimedia activities. The capital outlays by Putrajaya Holdings Sdn. Bhd. were mainly for the new administrative centre in Putrajaya.

The capital outlays of the NFPEs were mainly financed by internally generated funds and domestic borrowings. In 2001, a total of RM7.4 billion was raised from the private debt securities market mainly by enterprises involved in the power, construction and manufacturing sectors. Net external borrowings by public enterprises amounted to RM0.9 billion in 2001. Public enterprises were active in debt management with repayments of higher cost external loans being made to reduce the debt-servicing burden.

Consequently, total outstanding external debt of the public enterprises remained manageable at RM66.5 billion or 20% of GDP to account for 39% of the nation's external debt. Debt servicing remained low with debt service ratio (ratio of debt servicing to exports of goods and services) at 2.9%. Most of the loans were utilised to fund productive investment, including overseas investments of a strategic nature that would strengthen the future income stream of the NFPEs. Investment activities and borrowings of the NFPEs were closely monitored to ensure they would not create risks to the overall economy.

In 2001, the Government continued to pursue its privatisation policy, while strengthening further the regulatory framework for provision of services to the general public. During the year, 11 new privatised projects were approved, mainly in infrastructure and land development. The privatisation was mostly in the form of build-operate-transfer, leasing of assets, land swap and management contracts. The projects included the construction of hostels in Universiti Malaysia Sabah and Universiti Kebangsaan Malaysia.