BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Statutory Requirements

In accordance with section 48 of the Central Bank of Malaysia Act 1958, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Annual Accounts for the year ended 31 December 2004, which have been examined and certified by the Auditor-General. The Annual Accounts will also be published in the Gazette.

Zeti Akhtar Aziz
Chairman
Board of Directors

23 March 2005

Board of Directors

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

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

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

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

Datuk Oh Siew Nam
P.J.N.

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

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

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

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

Datuk Zamani bin Abdul Ghani was appointed as Deputy Governor with effect from 16 May 2004. Dato' Mohd Salleh bin Hj. Harun retired on 15 May 2004 on completion of his term as Deputy Governor.

Dato' Izzuddin bin Dali was appointed as a member of the Board with effect from 1 August 2004. Tan Sri Dato' Seri Dr. Samsudin bin Hitam resigned from the Board with effect from 31 July 2004 on completion of his term as Secretary General to the Treasury.

Tan Sri Dato Sri Mohd Hassan Marican was appointed as a member of the Board with effect from 1 February 2005.

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

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Governor's Statement

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Robust growth of the Malaysian economy was sustained in 2004. Economic resilience also strengthened as the economic structure became increasingly more diversified and as the macroeconomic fundamentals continued to remain strong. The economy benefited significantly from the stronger domestic demand and high growth in external demand. Of significance was that growth was driven by private sector economic activity for the second consecutive year. Consumer and business confidence strengthened during the year to reinforce this trend.

Monetary policy continued to have a supportive role in the economy throughout 2004. While inflation edged up, it continued to remain within a tolerable range. Price increases have generally reflected one-off price adjustments that occurred during the year. The upward trend in prices has also been contained by the accelerated increase in private investment and the consequent expansion of capacity. In addition, some absorption of the price increases by producers mitigated the price increases. The focus of monetary policy has thus been to support the expansion in business investment activity to enhance the long-term growth potential of the Malaysian economy.

During 2004, Bank Negara Malaysia implemented a new interest rate framework to enhance the operational efficiency of monetary policy. Almost one year after its introduction, the new interest rate framework is operating well, with the overnight policy rate providing the signal to the market on the stance of monetary policy. The deregulation of pricing under the new interest rate framework has also acted as a catalyst for more efficient pricing in the financial system. Combined with the quarterly issue of the Monetary Policy Statement, the market is provided with regular information on the current and expected monetary conditions. The statement reflects the conclusion of the deliberations of the policy options considered by the Monetary Policy Committee in the Bank. Eight monetary policy meetings were held during the year.

Malaysia's inter-linkages with the global economy and the international financial system continued to strengthen in 2004. Trade with the rest of the world, and with the Asian region in particular, continued to be robust. Trade increased by 23.2% during the year, with trade with the Asian region now accounting for 60.2% of total trade. Malaysia has, for seven consecutive years now, recorded a significant current account surplus. This trend has been reinforced by a steady inflow of foreign direct investment. The investment flows have become increasingly more diversified, reflecting the new investment opportunities in the more diversified economy. The stronger position of Malaysian corporates has also resulted in higher Malaysian investments abroad. While portfolio flows were volatile during the year, overall, there was a net inflow. The cumulative inflows from trade, foreign direct investment and portfolio flows have contributed to a significant increase in the nation's international reserves.

To ensure stable financial markets, Bank Negara Malaysia has undertaken sterilisation operations to absorb the inflows to avoid conditions of excessive liquidity in the domestic financial system. The Central Bank continues to have at its disposal, instruments of monetary policy to undertake these sterilisation operations. While these operations entail a cost, the returns from the management of the reserves have exceeded these costs. The Central Bank, therefore, continues to have the capacity to absorb these inflows, and thereby maintain stability in the domestic financial markets and stability of the overall financial system.

Bank Negara Malaysia has taken the opportunity of this strengthened position to liberalise further the foreign exchange administration rules, effective April 2005. This is part of the continuous efforts to enhance the business environment and facilitate efficiency in transactions involving foreign exchange and to allow for better risk management of investments. This liberalisation is part of the on-going initiatives to reduce the cost of doing business and improve the efficiency of the regulatory delivery system. The changes allow for greater flexibility in hedging against currency risks and in the limits on maintaining foreign currency accounts, on domestic credit facilities to non-resident controlled companies and on investments abroad.

The liberalisation in 2004 permitting Multilateral Development Banks, Multilateral Financial Institutions and corporations to raise ringgit-denominated bonds has also increased foreign participation in the domestic capital market. The market has responded positively to these changes. Two multilateral development agencies have taken advantage of this initiative in 2004. The Asian Development Bank became the first foreign entity to issue ringgit-denominated bonds in November, followed by the International Finance Corporation, which became the first foreign entity to raise ringgit-denominated Islamic bonds.

Significant performance and development has also occurred in the financial sector in Malaysia. All segments of the financial sector strengthened in terms of improved capitalisation, quality of portfolios, profitability, soundness of financial positions and exposure to risks. Enhancements have also been made in the areas of corporate governance and risk management standards. Large investments were also made to strengthen internal systems and processes, improve delivery channels and acquire talent. Cumulatively, these enhancements have rendered the financial system to be more competitive. There has also been a narrowing in the gap in performance between domestic and foreign financial institutions.

For the banking system, the opportunity was taken to encourage expansion in activities in the domestic economy, in particular in the new growth areas; and for those institutions with the capacity, to venture beyond domestic borders. In the domestic economy, there has been a significant shift in financing activities to small businesses, which now account for 40% of loans to the business sector. Lending to the household sector also increased. A wider range of products, including those delivered through electronic channels, also came on-stream. Attention continued to be focused on preserving financial stability including strengthening prudential regulation and surveillance over financial conglomerates as well as operations undertaken beyond domestic borders.

The year also saw further progress in streamlining the legal and regulatory infrastructure in Islamic finance. A more structured legal and Shariah governance framework and a more conducive tax environment were introduced, resulting in neutrality of treatment between Islamic and conventional financial products. A further significant development is the transformation of the `Islamic Window' in conventional banks into Islamic subsidiaries. This transition will allow for the Islamic subsidiary to leverage on the group infrastructure, including the branch network and support functions, to maximise cost efficiency and to reap the benefits of group synergies. Several domestic banking groups are in the midst of

strategically participating in this transformation process. The year also saw the liberalisation of the Islamic banking industry with the issue of new Islamic banking licences for three foreign-owned Islamic banks to operate in Malaysia. It is expected that this move will not only spur the development of Islamic finance in Malaysia but would enhance Malaysia's economic and financial linkages with the rest of the world. Cumulatively, these series of developments are also expected to not only enhance the global integration of the domestic Islamic financial system but also increase Malaysia's potential as an International Islamic financial centre.

The Malaysian economy enters the year 2005 from a position of strength. The economic prospects for 2005 will continue to be favourable. The underlying conditions of the domestic economy continue to remain strong, with robust private consumption and investment activity. While there are signs of slower global growth, there is uncertainty relating to the extent to which specific developments may moderate growth. In particular, these include the impact of higher oil prices, the extent to which interest rates will be raised and the depth and duration of the electronic downturn. Despite these emerging trends, domestic economic growth in 2005 is projected to be sustained at 5 – 6%. This growth forecast takes into account the potential uncertainties related to the global developments. The more modest the impact of these developments on global growth, the more supportive will be external demand on the growth prospects of the domestic economy. While these uncertainties prevail in the external environment, the strong domestic demand projected for the year enhances the underlying potential for the favourable growth prospects in 2005.

The favourable global environment in 2004 has, however, masked the risks to world growth arising from the structural imbalances prevailing. The stronger global growth performance in 2004 has not provided a sense of urgency to address directly the risks associated with these imbalances. In a less favourable environment, the risk of disruptions, disorderly adjustments and instability would be heightened. Moreover, such disorderly adjustments could also occur if there is over-dependence on exchange rate adjustments to address these imbalances. Exchange rates may be only part of the solution. The issue of competitiveness, however, requires more than just adjustments in exchange rates. Ultimately these structural imbalances would have to be addressed by the countries where these imbalances exist. The long-term solution is for a rebalancing of demand across the world to eventually reduce the prevailing imbalances. With rising income levels across Asia, there is tremendous potential for this to be part of the adjustment process.

The excessive focus on exchange rates as corrective mechanisms for these imbalances has led to speculative capital inflows, particularly into the Asian economies. Exchange rate flexibility in response to these flows would result in significant exchange rate volatility and would not reflect the prevailing underlying fundamentals. Such adjustments also face the risk of shifts in the opposite direction should a reversal in the flows occur. Malaysia has therefore consistently maintained that, in the present environment, the exchange rate regime in place best serves the nation's interests. Developments in the region and in the international environment will continue to be closely monitored, with assessments made on the implications on the efficient functioning of the mechanism in place. The basis for any change would therefore be made on long-term structural considerations and not short-term movements in capital flows or transient shifts in exchange rate expectations.

With the foundations for strong performance in the financial sector now being firmly achieved in the first phase of the Financial Sector Masterplan, the transition into the second phase of the Masterplan can now be made. In the year 2005, the focus of attention will continue to be to develop and strengthen the framework to enhance access to financing, particularly to meet the new requirements of the economy; to enhance competition and hence efficiency; and to strengthen the infrastructure for consumer protection. While the banking sector is encouraged to provide access to new areas of growth, non-banking institutions, including specialised financial institutions and the cooperative sector, will be developed to have an increasingly more important role.

It has been announced that a bank for small and medium enterprises (SMEs) will be established to complement the role of the banking sector in providing financial services to this segment. The SME bank will also provide non-financial services to SMEs, including nurturing SMEs and creating an entrepreneurial community. Other activities envisaged for the SME bank include providing guarantees to loans granted by banking institutions, facilitating securitisation, providing credit ratings and preparing business reports on SMEs. The role of the cooperative sector in providing financing to micro-enterprises will also be strengthened to enhance access to financing to this sector. A cooperative commission initiated by Bank Negara Malaysia is being established to support this objective. The cooperative commission will have the supervisory oversight of the cooperative sector including taking on a developmental role.

The second phase of the Masterplan will entail the further deregulation and liberalisation of the financial system in general and in the banking system in particular. As part of this process existing foreign banks will be accorded greater operational flexibility so that they can better serve the needs of the growing economy. With this move, foreign banks will, however, need to become more integrated with the domestic economy. A further development in 2005 will be the establishment of a deposit insurance corporation as part of the efforts to strengthen the consumer protection framework and to promote financial stability.

The Malaysian financial landscape will continue to be redefined with the setting up of investment banks. This move essentially transforms merchant banks, stock broking companies and discount houses within the same banking group into investment banks. This rationalisation will contribute towards a more dynamic financial system, with a greater ability to compete effectively in the domestic and international markets. Their integration will not only contribute to enhancing efficiency and effectiveness, but also strengthen the potential to capitalise on expanded business opportunities. These new investment banks will be jointly regulated by Bank Negara Malaysia and the Securities Commission. The permissible foreign equity participation for investment banks is also increased from 30% to 49%, as part of the effort to strengthen global linkages and enhance the transfer of specialised skills and expertise.

A challenge towards increasing efficiency levels in the financial system is in improving the use of electronic payment delivery channels and settlement instruments. Bank Negara Malaysia's policies and initiatives in the payments systems in 2004 have essentially been aimed at creating an enabling environment to promote the migration to electronic payments from a

predominantly paper-based system. There has been a general reduction in the ratio of currency in circulation to GDP from 7.5% to 7.2% and the value of cheques to GDP from 320% to 303% during the year. As part of the measures to enhance the efficiency and safety of the payments systems, the banking industry in Malaysia has taken the lead in the Asia-Pacific region to combat card fraud by investing in a chip-based infrastructure for payment cards. Moving forward, the focus will be on promoting greater efficiency and risk reduction improvements in domestic and cross-border payments, as well as harmonising standards and the functionalities of electronic payment channels across sectors, including the Government agencies. Emphasis will also be given on enhancing the consumer protection framework in payment-related services so as to provide a conducive environment for the large-scale adoption of electronic payment instruments by the general public.

Regional economic and financial co-operation strengthened during the year, with emphasis on promoting greater intra-regional trade and investment. Initiatives were also taken in the area of economic surveillance, the monitoring of cross-border linkages including capital flows, combating money laundering and terrorist financing and the building of stronger financial systems and markets among the countries in the region. Steps have been taken to enhance regional financing and swap arrangements. In addition to the liberalisation of the domestic bond market to allow for the issuance of papers denominated in domestic currency by multilateral institutions, being part of the Asian Bond Market Initiative, a second Asian Bond Fund has also been launched. While the first Fund only invested in US dollar-denominated bonds, the second Fund is for investment in domestic currency bonds issued by sovereign and quasi-sovereign entities in regional markets. This new initiative is also aimed at supporting the overall efforts to develop domestic bond markets in the regional economies.

The world continues to change in economic, financial and geopolitical terms. It continues to present increased uncertainties, greater interdependence, more intense competition, and continues to test our ability to rise to emerging challenges. Indeed, our ability to survive and succeed in this environment very much depends on our level of tolerance, our ability to adjust, the extent to which we are able to effectively and efficiently manage our resources and the flexibility of policy to respond to these changing conditions. All this will also depend on the strength and structure of our economy, the degree of mobility of our resources, and the efficiency and soundness of our financial system. Therefore, our policy initiatives are towards meeting these objectives.

Zeti Akhtar Aziz
Governor

23 March 2005

The Malaysian Economy in 2004

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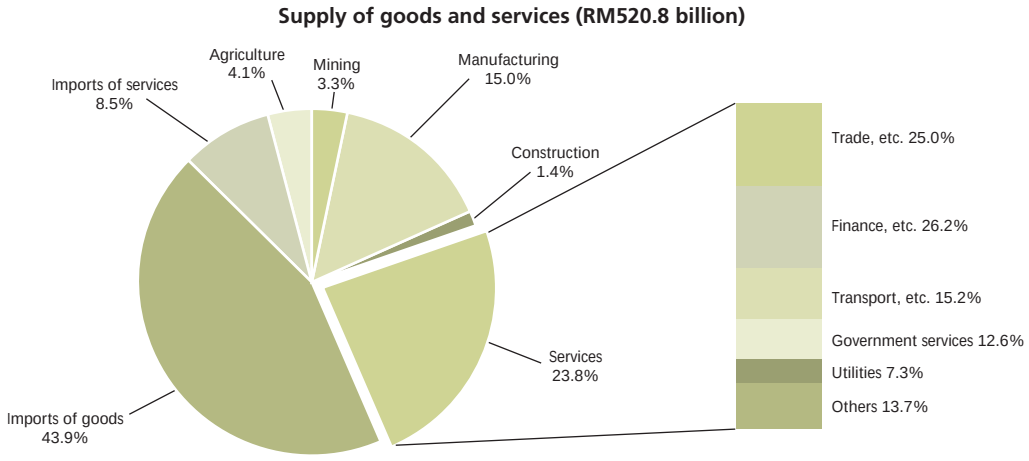
The Malaysian Economy in 2004

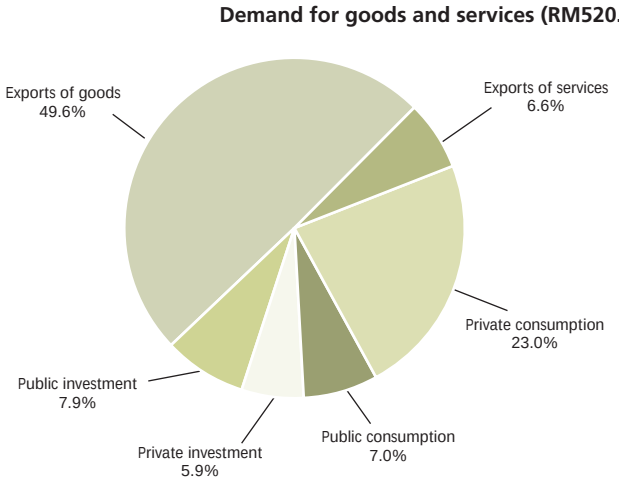
The Malaysian economy experienced its most rapid growth in four years, expanding by 7.1% in 2004 as a result of robust growth in both global trade and domestic demand. Growth was led by the private sector, while the Government made further progress in fiscal consolidation.

OVERVIEW

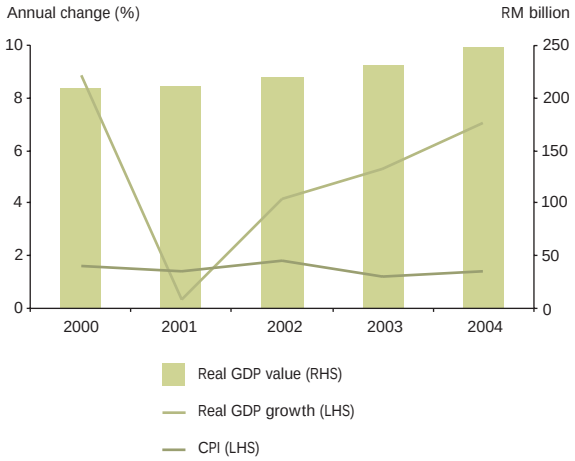
With the more robust growth in global trade and domestic demand, the momentum of economic growth in Malaysia, which began in the second half of 2003, gathered pace in 2004. Real gross domestic product (GDP) increased by 7.1% in 2004 (2003: 5.3%), the fastest growth since 2000. The economy benefited from the rapid growth of global trade in manufactures and higher prices for primary commodities. Although global growth moderated somewhat in the second half of the year, the

Graph 1.1
The Economy in 2004 (at 1987 Prices)

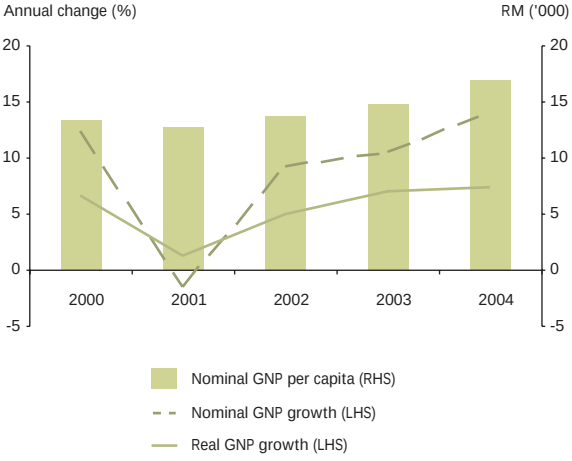




Graph 1.2
Real GDP and Inflation Rate



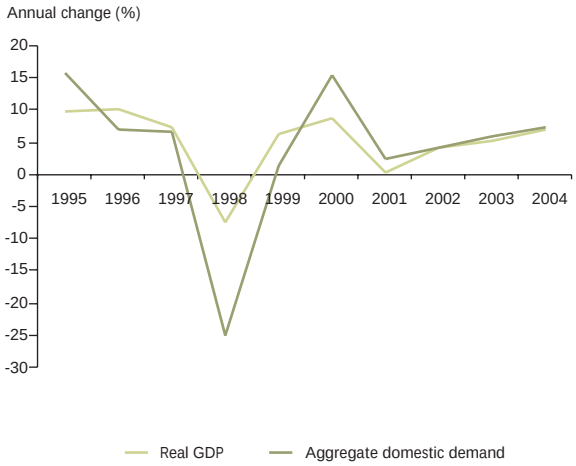
Graph 1.3
GNP Growth and Nominal GNP per Capita



Malaysian economy remained resilient with stronger domestic demand providing the impetus for sustained expansion. The private sector was the main force of economic expansion, while the Government continued with fiscal consolidation.

The improvement in the economy was reflected by positive growth across all sectors except construction. The main drivers of growth were the manufacturing, services and primary commodities sectors. Value added in the manufacturing sector expanded strongly by 9.8%, as output growth in both export- and domestic-oriented industries reflected stronger external and domestic demand for manufactured goods. In the export-oriented industries, the strongest output expansion was seen in the electronics industry, benefiting from the upturn in the global semiconductor cycle. However, the high production during the earlier part of the year led to some inventory accumulation, which led to more moderate expansion in the second half of the year. In addition to strong growth in the electronics industry, growth was reinforced by sustained external demand for resource-based products such as chemical, rubber and wood products. Growth in the domestic-oriented industries was supported by strong demand in the fabricated metal products industry and a turnaround in the transport equipment industry. The favourable performance of the manufacturing sector was also reflected in the stronger expansion in manufactured exports (19.7%) and sustained high capacity utilisation level (79%), in spite of investments in new capacity during the year.

Graph 1.4
Real GDP and Aggregate Domestic Demand



Graph 1.5
Contribution to Real GDP Growth

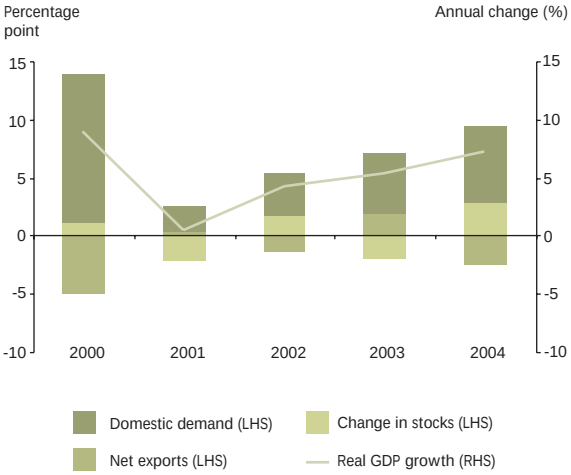


Table 1.1: Malaysia – Key Economic Indicators

	2002	2003	2004*p*	2005*f*
Population (million persons)	24.5	25.0	25.6	26.1
Labour force (million persons)	9.9	10.2	10.6	10.9
Employment (million persons)	9.5	9.9	10.2	10.5
Unemployment (as % of labour force)	3.5	3.6	3.5	3.5
Per Capita Income (RM)	13,722	14,838	16,538	16,987
(US$)	3,611	3,905	4,352	4,470
NATIONAL PRODUCT (% change)				
Real GDP	4.1	5.3	7.1	5.0 ~ 6.0
(RM billion)	220.0	231.7	248.0	260.3
Agriculture, forestry and fishery	2.6	5.7	5.0	3.3
Mining and quarrying	4.0	5.9	4.1	5.0
Manufacturing	4.1	8.3	9.8	4.5
Construction	2.3	1.9	-1.9	-1.0
Services	6.4	4.4	6.7	5.7
Nominal GNP	9.0	10.4	13.8	4.9
(RM billion)	336.6	371.7	423.1	443.9
Real GNP	4.7	6.8	7.2	4.6
(RM billion)	202.7	216.5	232.2	242.8
Real aggregate demand[1]	4.2	5.9	7.3	4.3
Private expenditure[1]	0.3	5.5	11.1	8.7
Consumption	4.4	6.6	10.1	8.5
Investment	-15.1	0.4	15.8	9.6
Public expenditure[1]	11.5	6.6	1.0	-4.0
Consumption	11.9	10.0	6.6	4.5
Investment	11.2	3.9	-3.5	-11.6
Gross national savings (as % of GNP)	34.6	36.3	37.1	34.7
BALANCE OF PAYMENTS (RM billion)				
Goods	72.1	97.7	104.5	114.8
Exports (f.o.b.)	358.5	399.0	481.2	514.9
Imports (f.o.b.)	286.4	301.3	376.8	400.1
Services balance	-6.0	-15.0	-8.8	-8.0
(as % of GNP)	-1.8	-4.0	-2.1	-1.8
Income	-25.1	-22.5	-24.5	-26.4
(as % of GNP)	-7.4	-6.1	-5.8	-5.9
Current transfers, net	-10.6	-9.3	-14.6	-14.1
Current account balance	30.5	50.8	56.6	66.3
(as % of GNP)	9.1	13.7	13.4	14.9
Bank Negara Malaysia international reserves, net[2]	131.4	170.5	253.5	-
(in months of retained imports)	5.4	6.6	8.0	-
PRICES (% change)				
CPI (2000=100)	1.8	1.2	1.4	2.5
PPI (1989=100)	4.4	5.7	8.9	-
Real wage per employee in the manufacturing sector	3.2	2.8	1.8	-

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

[1] Exclude stocks.

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

p Preliminary

f Forecast

Table 1.2: Malaysia – Financial and Monetary Indicators

	2002	2003	2004p
FEDERAL GOVERNMENT FINANCE (RM billion)			
Revenue	83.5	92.6	99.4
Operating expenditure	68.7	75.2	91.3
Net development expenditure	35.1	38.3	27.5
Overall balance	-20.3	-20.9	-19.4
Overall balance (% of GDP)	-5.6	-5.3	-4.3
Public sector net development expenditure	69.1	83.3	67.8
Public sector overall balance (% of GDP)	-0.7	-1.2	-0.3
EXTERNAL DEBT			
Total debt (RM billion)	185.7	186.6	197.3
Medium- and long-term debt	153.2	152.9	154.3
Short-term debt[1]	32.4	33.7	43.0
Debt service ratio (% of exports of goods and services)			
Total debt	6.6	6.2	4.3
Medium- and long-term debt	6.4	6.0	4.2

	Change in 2002		Change in 2003		Change in 2004	
	RM billion	%	RM billion	%	RM billion	%
MONEY AND BANKING						
Money Supply M1	8.3	10.3	13.0	14.6	12.2	11.9
M2	21.0	5.8	42.5	11.1	108.1	25.4
M3	31.6	6.7	48.5	9.7	68.0	12.4
Banking system deposits	25.3	5.3	49.5	9.8	70.1	12.7
Banking system loans[2]	19.8	4.6	21.6	4.8	40.2	8.5
Manufacturing	-1.2	-2.0	-0.2	-0.3	2.0	3.2
Broad property sector	10.8	6.6	14.6	8.4	19.8	10.5
Finance, insurance and business services	-2.5	-7.7	-0.6	-2.1	1.7	5.7
Loan-deposit ratio (end of year)	84.9%		80.9%		78.6%	
Financing-deposit ratio[3]	95.1%		91.7%		87.7%	

	2002	2003	2004
	%	%	%
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)			
3-month interbank	3.13	2.87	2.80
Commercial banks			
Fixed deposit 3-month	3.20	3.00	3.00
12-month	4.00	3.70	3.70
Savings deposit	2.12	1.86	1.58
Base lending rate (BLR)	6.39	6.00	5.98
Finance companies			
Fixed deposit 3-month	3.20	3.00	3.00
12-month	4.00	3.68	3.70
Savings deposit	2.65	2.18	1.98
Base lending rate (BLR)	7.45	6.90	6.90
Treasury bill (3-month)	2.82	2.77	1.96
Government securities (1-year)	2.94	2.93	2.24
Government securities (5-year)	3.15	4.28	3.64

	2002	2003	2004
	%	%	%
EXCHANGE RATES			
Movement of Ringgit (end-period)			
Change against SDR	-7.3	-8.5	-4.3
Change against US$[4]	0.0	0.0	0.0

[1] Excludes currency and deposits held by non-residents with resident banking institutions.
[2] Includes loans sold to Cagamas.
[3] Adjusted to include holdings of private debt securities.
[4] Ringgit was pegged at RM3.80=US$1 on 2 September 1998.
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The services sector recorded a stronger expansion of 6.7% in 2004. The growth was driven mainly by higher consumer spending amidst rising disposable incomes, higher tourist arrivals and increased trade-related activities spurred by the buoyant export performance. Growth in final services, particularly the wholesale and retail trade, hotels and restaurants sub-sector, was due to higher consumer spending and was reinforced by robust tourism activities. In the intermediate services, the transport, storage and communication sub-sector recorded stronger growth, mainly on account of increased trade- and travel-related activities as well as the strong expansion in the telecommunications industry. The growth in the finance, insurance, real estate and business services sub-sector was underpinned by higher bank lending, stronger performance in the insurance industry, greater activity in the real estate market and higher turnover in the capital market. Expansion in new growth areas, such as private education and private healthcare services, Islamic financial services as well as the shared services industry, provided further support to the services sector.

The agriculture sector expanded further by 5%, driven mainly by stronger production of crude palm oil and rubber amidst the favourable commodity prices. Other agriculture commodities, particularly food-related crops, also showed strong growth, in line with the Government's concerted efforts in revitalising the agriculture sector as an important engine of growth. The mining sector grew by 4.1%, mainly on account of increased output of crude oil and natural gas, benefiting from higher domestic and external demand.

On the other hand, the construction sector contracted by 1.9% due to lower activity in the civil engineering sub-sector, which was partly mitigated by expansion in both residential and non-residential sub-sectors. Lower civil engineering activity was mainly attributed to the completion of several large infrastructure projects in recent years and the consequent reduction in public spending on infrastructure projects in 2004. In contrast, the residential sub-sector continued to grow due to sustained demand for residential property, which was supported by higher incomes as well as attractive housing mortgage financing packages. Expansion in the non-residential sub-sector was due mainly to improved business and investment activity, which supported the demand in the office and retail space segments.

With policy orientation supportive of private sector activity and with the improved economic conditions, the private sector contributed 6.2 percentage points to economic expansion. Private consumption expanded strongly by 10.1% in 2004 as consumer confidence was restored following the events of early 2003, including the Severe Acute Respiratory Syndrome (SARS) outbreak. Despite some moderation in activity towards the end of 2004, sentiments remained strong. Both the Consumer Sentiment and Retail Trade Indices, compiled by the Malaysian Institute of Economic Research, remained above the 100-point mark throughout the year. In addition, various tax rebates to sustain consumption announced during the 2004 Budget and the prevailing supportive interest rate and credit environment further supported consumption spending.

The stronger growth of private consumption was driven mainly by higher disposable income in both the household and the corporate sectors on account of higher export earnings and favourable employment conditions in the domestic economy. The findings of the Malaysian Employers Federation's Salary and Fringe Benefits Survey for Executive and Non-Executive 2004 showed that a large majority of companies (86%) continued to pay out bonuses to their employees. The percentage of companies granting salary increases was also higher during the year compared to 2003. Higher commodity prices, particularly prices for rubber and palm oil, provided the impetus for rural income earners to increase their consumption. Meanwhile, sustained high profits and cash flows of the corporate sector continued to emanate from rising productivity and higher export earnings. A sample of 350 listed non-financial companies, which represents almost 75% of the total market capitalisation of Bursa Malaysia, showed that most sectors recorded higher profits in 2004. The annualised return on equity for companies in the sample rose to 9.1% in 2004 (2003: 8.2%).

Growth in private investment, which had turned around in the second half of 2003, accelerated to 15.8% in 2004 as business confidence strengthened further. The stronger growth was due mainly to high capacity utilisation arising from improved external demand and higher domestic consumption. This high level of capacity utilisation, together with improving corporate profitability and favourable financing conditions, has encouraged investment activity. Higher capital expenditure was evident in all sectors

Potential Output in the Malaysian Economy

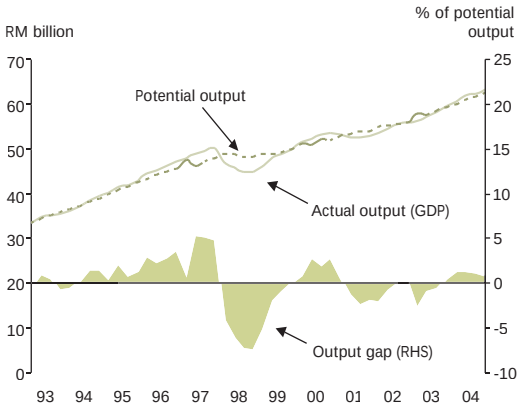
Potential output is defined as the level of output that is consistent with the productive capacity of an economy. Conceptually, the level of potential output is determined by the growth of non-inflationary trend levels of physical capital and the labour force as well as the rate of technological advancement. The output gap – the difference between actual output and the trend level of potential output – is a measure of the cyclical deviation from the non-inflationary trend of output. Knowledge on potential output and the output gap, together with other relevant information would help policymakers in making an assessment on the current position of an economy in the economic cycle, as well as indicating the latent growth path of the economy in the long term.

Potential output and the output gap are however not directly observable concepts. Nonetheless, by using a production function approach and using information regarding the existing physical capital stock and employment levels, estimates of potential output and the output gap for Malaysia can be obtained. It should be emphasised that these estimates alone do not provide an exhaustive perspective of the state of an economy, such as the extent of inflationary pressure. This is especially true for a structurally dynamic economy such as Malaysia.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	(Annual change in %)				(% of potential output)
1994-1998	9.2	8.0	14.1	3.9	2.3
1998	-7.4	3.0	-43.0	-2.1	-6.3
1999	6.1	1.3	-6.5	3.7	-2.0
2000	8.9	4.5	25.7	4.3	2.2
2001	0.3	3.8	-2.8	1.3	-1.2
2002	4.1	3.5	0.3	1.9	-0.7
2003	5.3	5.5	2.7	3.6	-0.9
2004	7.1	5.0	3.1	3.4	1.1

Graph 1
Actual and Potential Output



The latest estimates indicate that the Malaysian economy in 2004 was operating slightly above potential amidst the strong global economic growth, with the output gap estimated at 1.1% of potential output. A similar trend was observed during the previous global upswing in 2000. On the whole however, the deviations of actual from potential output have been modest since 1998, as illustrated in Graph 1, with growth in the Malaysian economy remaining in line with the growth of its potential capacity.

Prior to 1997, potential output of Malaysia grew at a rapid rate, with an average of 8% annually for the period of 1994 to 1997. The pronounced downturn in 1998 and following structural adjustments however altered the productive capacity of the economy. The potential growth path was affected and potential output growth subsequently slowed down during the recovery period as spare capacity within the economy was used up. Since 2000 however, the potential growth path began to improve and by 2004, potential output was growing at a rate of 5% annually, an almost fourfold increase compared to the low of 1999, as shown in Table 1 and Graph 1.

Given that steps have been taken to improve the contribution of productivity to growth, the current momentum in the expansion of productive capacity is expected to persist, resulting in further enhancement in potential output growth. This suggests that the potential growth path of the Malaysia economy is expected to continue to improve in the near future.

of the economy, with the manufacturing, services and mining sectors registering significant levels of spending during the year. The increase in private investment was also supported by foreign direct investment (FDI), particularly in the services, manufacturing and oil and gas sectors.

Public sector expenditure was less expansionary on growth as the Federal Government continued with its policy of fiscal consolidation, lowering the fiscal deficit to 4.3% of GDP in 2004 (2003: -5.3%). Efforts to reduce the fiscal deficit were balanced by the need for the Government to provide for basic support and social services as well as spending to enhance the long-term productivity of the economy. During the year, the Federal Government's expenditure on supplies and services as well as emoluments was higher. As a result, public consumption increased by 6.6% in 2004. On the other hand, public investment declined by 3.5% in 2004 as a result of lower Federal Government development expenditure, which was partially mitigated by the sustained high capital expenditure of the non-financial public enterprises (NFPEs). Notwithstanding the lower development expenditure, spending in 2004 was channelled mainly to smaller scale projects in economic and social sectors that have significant multiplier effects on the economy. The higher capital expenditure of the NFPEs was due mainly to upgrading and capacity expansion programmes.

As a result of the stronger private sector activity, real aggregate domestic demand (excluding change in stocks) expanded further by 7.3%. The stronger growth of domestic demand, however, was achieved within the context of limited price pressures as new capacity was put in place in sectors experiencing strong growth. This expansion in capacity ensured that GDP growth remained broadly in line with the potential capacity of the economy. Stable labour market conditions, high labour productivity and increased competition in the economy also contributed towards containing price pressures. As a result, the consumer price index (CPI) and core inflation were marginally higher at 1.4% and 1% respectively during the year (2003: 1.2% and 0.5% respectively).

In 2004, external demand expanded further and provided an important contribution to the overall growth of the economy. The stronger expansion in exports of manufactured goods, in particular electronics, and sustained growth in commodity earnings contributed to the large trade surplus of RM81.1 billion (2003: RM81.3 billion). The stronger export growth of 20.8% (2003: 11.3%) reflected the buoyant growth in consumer and investment demand in major industrial countries as well as in the region. In tandem with the stronger private sector demand and manufacturing output, imports recorded a higher growth of 26.3% (2003: 4.4%). The sustained large trade surplus, coupled with the significant improvement in the services account deficit due to higher tourism receipts, more than compensated for the larger income account deficit attributed to higher profits accruing to foreign direct investors. As a result, the current account surplus increased further to RM56.6 billion, equivalent to 13.4% of GNP (2003: RM50.8 billion or 13.7% of GNP).

The financial account turned around, recording a net inflow of RM15.4 billion in 2004 (2003: -RM12.1 billion). The higher inflows of FDI and portfolio investment more than offset the higher outflow due to overseas investments by Malaysian companies and other investments by both the public and private sectors. A significant portion of the FDI was channelled to the manufacturing sector, particularly the electronics industry, and the services sector. Meanwhile, inflows into the oil and gas sector were the result of recent discoveries, especially off the coast of East Malaysia. Funds for portfolio investment increased significantly, in tandem with improved investor confidence amidst sovereign ratings upgrades, and speculation that some regional currencies, including the ringgit, had the potential for an upward revaluation during the year.

Arising from the larger current account surplus, higher inflows for investment and foreign exchange revaluation gains, Bank Negara Malaysia's net international reserves increased further to a record level of RM253.5 billion, or equivalent to US$66.7 billion at the end of 2004. By 28 February 2005, the reserves level rose further to RM272.9 billion or US$71.8 billion, adequate to finance 8.6 months of retained imports and is 6.1 times the short-term external debt.

Malaysia's external debt increased moderately to RM197.3 billion in 2004 (2003: RM186.6 billion), reflecting mainly higher short-term debt of the banking sector, which was largely due to hedging activities for trade-related transactions and treasury activities. Nevertheless, the share of short-term debt to total debt remained low, accounting for 21.8% of total external debt. Given the prudent debt management policy in place, Malaysia's external debt position remains sustainable with the share of external debt to GNP and debt-service ratio improving to 46.6% and 4.3% respectively (2003: 50.2% and 6.2% respectively).

Macroeconomic Management

The strong performance of the economy in 2004 reflected the broad-based improvement in the Malaysian economy, amidst the rapid growth of global trade in manufactures and higher prices for oil and most non-oil commodities. The strengthening of domestic demand provided the impetus for sustained growth throughout the year in spite of some moderation in global growth in the second half of the year. There were notable shocks to the global economy in 2004, namely, high oil prices, revival in inflationary pressures, tightening of the global monetary cycle, tightening measures to reduce overheating in the People's Republic of China (PR China), sporadic outbreaks of avian flu and effects of the tsunami in December. Nevertheless, the Malaysian economy remained resilient. With the private sector assuming the lead role in driving growth, Government policies were targeted at maintaining stable economic conditions and ensuring a more efficient, pro-business and investor-friendly public sector delivery system to sustain private investment growth.

Macroeconomic policy in 2004 focused on maintaining stability and improving the risk-bearing capacity of the economy. Looking ahead, improved flexibility, innovativeness and productivity are the key components to sustaining long-term growth.

The monetary policy stance in 2004 remained supportive of domestic economic activities. Domestic inflation was low at 1.4%, with no significant pass-through arising from higher import prices. In addition, external inflows comprised mainly long-term trade and investment flows, with some increase in portfolio flows. Given the ample liquidity in the system arising from sustained trade and investment inflows, money market operations by the Central Bank were focused on stabilizing interest rates at levels that were supportive of economic activity. In addition, sustained competition in the banking sector also contained any upward pressure on interest rates as private sector demand for funds gathered momentum.

The stable macroeconomic conditions allowed the Central Bank to make a significant change in the conduct of monetary policy during the year. On 23 April, the New Interest Rate Framework, designed to strengthen the monetary policy transmission mechanism and promote more efficient pricing by the financial system, was announced. Although the new framework represented a change in the implementation mechanism for monetary policy, it did not reflect any change in the policy stance. The framework was designed to enhance the effectiveness of monetary policy by facilitating the transmission of changes in the policy rate, the Overnight Policy Rate (OPR), to the other market interest rates and ultimately, to key macroeconomic objectives. The OPR serves a dual role – as a signalling device to indicate the monetary policy stance and as a target rate for the Central Bank's day-to-day liquidity operations. The introduction of the OPR complements the changes that began with the issuance of the Monetary Policy Statement in 2003. These changes aimed at improving communications on policy, while also conveying the Bank's assessment of economic and financial conditions to the market. This would also help anchor market expectations, thereby increasing the efficacy of monetary policy.

While the prevailing low interest rates were appropriate and consistent with the overall needs of the economy, it was recognised that there were segments of society who depend on income from deposits, such as senior citizens and charitable groups, could be affected. In view of this, a special instrument, the Merdeka Savings Bond (MSB), was launched to alleviate the effects of lower interest income to these groups. The MSB provides holders with a return of 5%, which is higher than the fixed deposit rates, would be issued at regular intervals in 2004 and 2005.

On the exchange rate front, the pegged exchange rate arrangement continues to provide significant benefits to the Malaysian economy by maintaining predictability and relative stability for trade and investment activities. The weakness of the US dollar and speculation that PR China was considering a more flexible regime during the year underpinned some market expectations that Malaysia's exchange rate policy would be reviewed. The Central Bank has consistently maintained that the exchange rate regime would only be reviewed in the event that the ringgit was headed for a sustained misalignment arising from major structural changes within the international and regional financial system, or if economic fundamentals warranted a change in the system. Any change to the exchange rate regime would thus be on the basis of such longer-term

structural considerations and not short-term movements in capital flows and transient shifts in exchange rate expectations.

Given the stronger economic fundamentals, the Central Bank has taken steps during the year to further liberalise the foreign exchange administration rules. Effective 1 April, several changes are being made, including the simplification of reporting requirements for exporters to reduce administrative costs and business processes; increasing the overnight limit of Foreign Currency Accounts of residents to enhance cash flow management and support value chain expansion in Malaysia; extension of loans in ringgit to non-residents to enhance access to ringgit funds for operations in Malaysia; allowing selected residents to invest abroad to enhance flexibility in fund management; and allowing residents to enter into forward foreign exchange contracts to facilitate efficient risk management of foreign currency exposure. These changes are part of the Bank's continuous efforts to enhance the business environment and increase efficiency of the regulatory delivery system. The relaxation of the rules allows greater flexibility to residents in managing their investments by promoting a wider risk management options.

As part of this package of measures, Bank Negara Malaysia allowed Multilateral Development Banks (MDBs) or Multilateral Financial Institutions (MFIs) and Multinational Corporations to raise ringgit-denominated bonds in the Malaysian capital market. In addition, the Securities Commission allowed interest income derived by non-resident companies from approved Ringgit-denominated Islamic securities and debentures, excluding convertible loan stocks and securities issued by the Government of Malaysia to be tax exempt. The impact of these changes was immediate. In particular, the move to allow multilateral development banks to issue ringgit bonds was followed by two important issues in the domestic bond markets. The Asian Development Bank became the first foreign entity to issue ringgit-denominated bonds in November. This issuance was closely followed by the International Finance Corporation, which also became the first multilateral body to issue ringgit-denominated bonds that conform to Islamic principles.

The monetary developments were complementary to the Government's continued pursuit of a policy of gradual fiscal consolidation. The overall Federal Government deficit declined from 5.3% of GDP in 2003 to 4.3% in 2004. The Government strengthened its financial position by improving spending efficiency and effectiveness and enhancing revenue whilst optimising the utilisation of existing resources and capacity.

In addition to the focus on strengthening the management of public finances, public policy in 2004 aimed at improving the delivery system to enhance competitiveness. Development expenditure was targeted towards expenditure that ensured higher productivity and competitiveness in the economy. The focus of development expenditure was towards rural development and smaller projects in agriculture sector, improving the supply of utilities to rural areas, enhancing roads and other transport links, healthcare and low-cost housing programmes for the general populace. These programmes, while small in value terms, have significant multiplier effects, thus ensuring that the Government's socio-economic goals are met.

The Government will continue to proceed with its measured pace of implementing the fiscal consolidation programme. Prudent financial management remains a key feature of fiscal policy towards improving the overall financial position of the Government. A lower deficit will provide greater policy options for the Government and would permit macroeconomic policy to more effectively mitigate potential adverse shocks in the economy.

The 2004 and 2005 Budgets were formulated with the objective of generating stronger private investment activity and reinstating the private sector as the main engine of economic growth. In particular, public policy continued to emphasise on the need for Malaysian companies to identify and take advantage of the opportunities available in new growth areas. The diversification of the economy would further enhance the resilience of the economy while providing opportunities for companies to move up the value chain. Among the sectors targeted included agriculture, services and high value-added manufacturing activities. In order to further boost some of these activities, the Budgets provided additional funds to further develop the venture capital industry. Other incentives announced included the extension of the MSC status to Kulim High-Technology Park and Bayan Lepas, improving ICT infrastructures including broadband facilities and introducing a centralised Government portal as a single gateway to public services, as well as various tax incentives to specific sectors.

Special attention was given to improve competitiveness and promote investment by small and medium enterprises (SMEs), not only because of their significant contribution to the economy but also due to their strong growth potential. In 2004, Bank Negara Malaysia initiated the establishment of the National SME Development Council, chaired by the Prime Minister. The Council represents the highest policy-making body and will chart the future direction and strategies for SME development. The Council is not only responsible for formulating broad policies and strategies to facilitate SME development but also for ensuing the effective implementation of the policies and action plans. Bank Negara Malaysia has been appointed the Secretariat for the Council. During the year, the Council standardised the definitions for SMEs across all sectors of the economy and took initiatives to improve information on SMEs as first steps towards more effective policy formulation and implementation. The Council also initiated a number of schemes to improve access to financing, training and advisory services for SMEs.

The activities of Government-linked companies (GLCs) were revisited during the year in order to transform them into more efficient and globally competitive corporations. The GLCs have started to undergo a series of reforms to promote a culture of high performance, which includes, among others, shareholders value creation and performance-linked compensation and competitive contracts for senior management of all GLCs. Given the influence and impact of the GLCs on the economy, their reform would also have a beneficial impact on private sector companies that are suppliers and customers of these large corporations. The restructuring of the GLCs, with the greater emphasis accorded to commercially-driven strategies, would thus enhance overall competitiveness.

Short- and longer-term macroeconomic policies in Malaysia have been designed to reinforce one another to achieve sustainable economic development. Short-term policies that destabilise long-term fundamentals are not only less likely to succeed in their own right but would also adversely affect the ability to implement appropriate policies in the future. Therefore, policy design and implementation in Malaysia has been balanced to ensure the interaction between short- and longer-term policies are mutually reinforcing and supportive. Given the encouraging growth performance, strong fundamentals and the supportive macroeconomic and development policy stance, Malaysia is well placed to sustain economic growth. The private sector response to public policy has been encouraging and it is expected that actions and strategies taken would contribute to sustainable long-term growth with balanced socio-economic development.

SECTORAL REVIEW

Manufacturing Sector

The **manufacturing sector** recorded another strong double-digit expansion in 2004, with output growth strengthening to 12.7% (2003: 10.5%). The robust performance was supported by the positive external environment following stronger growth in both the industrial and regional countries, and further reinforced by improved domestic demand. Growth was more pronounced in the first half-year (16.1%; second half-year: 9.6%), fuelled by strong demand for electronics, in line with the upward momentum in the global semiconductor cycle. Growth during the year was also underpinned by strong export demand for resource-based products including

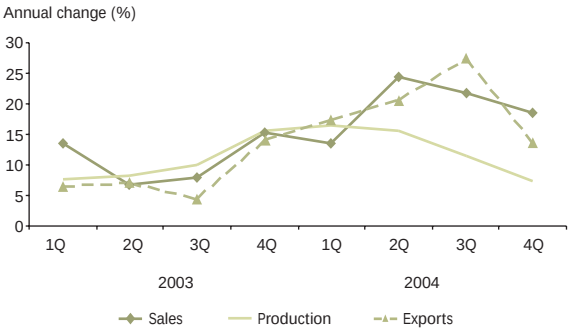
Robust performance in the manufacturing sector supported by positive external environment and improved domestic demand.

Table 1.3
Manufacturing Sector: Value Added and Production

	2003	2004
	Annual change (%)	
Value added (Constant at 1987 prices)	**8.3**	**9.8**
Overall Production	**10.5**	**12.7**
Export-oriented industries	**11.9**	**14.2**
of which:		
Electronics	15.1	25.0
Electrical products	-7.0	-9.4
Chemicals and chemical products	20.8	14.1
Wood and wood products	0.9	12.7
Off-estate processing	11.8	4.0
Textiles and wearing apparel	-2.2	-11.7
Rubber products	18.7	14.8
Domestic-oriented industries	**6.1**	**7.1**
of which:		
Construction-related products	10.2	-0.6
Fabricated metal products	7.4	29.2
Food products	8.8	3.0
Transport equipment	-5.5	8.6
Petroleum products	2.3	1.3

Source: Department of Statistics, Malaysia

Graph 1.6
Manufacturing Sector: Sales, Production and Exports



Source: Department of Statistics, Malaysia

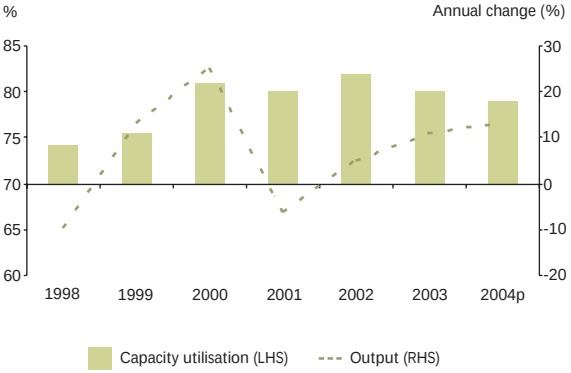
rubber, chemicals and wood. In the domestic-oriented industries, growth was led by a turnaround in the transport equipment industry and robust expansion in the fabricated metal industry, which more than offset the moderation in the construction-related materials industry. Consequently, growth in both the export-oriented and domestic-oriented industries strengthened to 14.2% and 7.1% respectively in 2004 (2003: 11.9% and 6.1% respectively).

In tandem with the significant expansion in production, overall value added growth of the manufacturing sector in 2004 strengthened further to 9.8% (2003: 8.3%). The manufacturing sector remained as the leading driver of economic growth, with its contribution to GDP increasing from 30.8% in 2003 to 31.6% in 2004. Amidst the strong output growth, the overall capacity utilisation rate in the manufacturing sector was marginally lower at 79% in 2004 (2003: 80%), due to additions in capacities in selected industries. The capacity utilisation rate for export-oriented and domestic-oriented industries stood at 81% and 75% respectively (2003: 82% and 76% respectively).

Growth in the electronics and electrical products (E&E) industry doubled to 17.7% in 2004 (2003: 9.6%), spurred by the robust expansion in the electronics segment. The performance of the **electronics industry** was in line with trends in the global semiconductor cycle. In the early part of the year, the electronics sector was buoyed by the strong growth momentum in the global semiconductor industry which started in the second half of 2003. The cycle peaked in mid-year and consolidated thereafter as companies undertook inventory adjustments due to overproduction in the early part of the year.

The semiconductor up-cycle in 2003 – 04 was broad based, characterised by expansion in all categories of chips, from personal computers (PCs) spurred by the replacement cycle, to telecommunications and wireless products to consumer electronics. The strong consumer demand and pick-up in business investment in the industrial countries during the year further contributed to the strength in global semiconductor sales. This positive development was further augmented by the continued trend in wider application of chips and the higher chip content, particularly in the consumer electronics segment. Newly emerging electronic devices such as digital cameras, personal digital assistants, flat panel

Graph 1.7
Capacity Utilisation in the Manufacturing Sector



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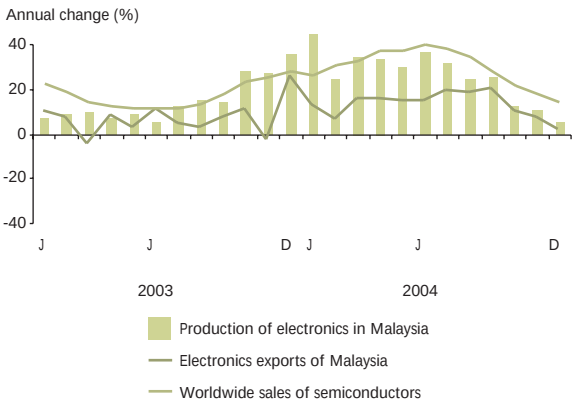
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Graph 1.8
Production and Exports of the Electronics Industry



Source: Department of Statistics, Malaysia
Semiconductor Industry Association (SIA)

televisions and multi-function handsets became the drivers of growth in the consumer electronics segment. Global sales of PCs also continued to expand rapidly in 2004, led mainly by strong demand from the Asia-Pacific region.

Unlike the previous semiconductor cycle (1999 – 2000), which was mainly driven by Y2K-related corporate spending, the latest cycle is differentiated by no significant over-investments in the technology sector. Secondly, the current downturn is caused by an oversupply situation, while the previous cycle was caused by both supply and demand factors. World growth almost halved within a year to 2.4% in 2001 (2000: 4.7%). However, latest indicators show that demand for electronics should continue to hold up as the outlook for world growth remains positive in 2005 (4%). In the US, new orders for electronics continued to register growth throughout 2004 and the US book-to-bill ratio for semiconductor equipment has hovered close to one. Thirdly, inventory accumulation has not been excessive in the current cycle. The inventory-to-shipment ratio of electronic products in the US has remained low at 1.22 at end-December 2004 (September 2004: 1.26; August 2001: 1.93). Lastly, the adjustment to inventories have been relatively quick, as large multinational companies have begun to cut back on production and reduced their inventories since the fourth quarter of 2004. Given these factors, the view is that the current downcycle can be expected to be modest compared with the sharp downturn in 2001.

Since many multinational companies are located in Malaysia, domestic manufacturers are also undertaking the inventory adjustment as reflected in the slowdown in manufacturing production index in the closing months of 2004. During the year, semiconductor manufacturers in Malaysia have also continued to move up the value chain to produce higher value added products and ventured into manufacturing-related activities, including locating their regional hubs in Malaysia.

The **electrical products** industry continued to consolidate further in 2004, with the industry still undergoing structural adjustments in shifting to higher value added products. With the migration to high-value products, the number of units produced was lower while the total export value of electrical products expanded during the year on higher selling prices.

The **chemicals and chemical products** industry expanded at a double-digit rate of 14.1% for the second consecutive year (2003: 20.8%). The strong expansion was led mainly by higher growth in industrial gases, which accounted for about 40% of the overall chemicals and chemical products industry. The robust growth in industrial gases (19.5%; 2003: 15.8%) was in line with the strong increase in natural gas production following the addition in the capacity and the rise in the capacity utilisation of the MLNG plants, especially the new MLNG Tiga Plant. Meanwhile, production of plastic products expanded further, supported by stronger domestic and external demand. Intensification in the usage of fertilisers and pesticides in the agriculture sector due to Good Agriculture Practices amidst the favourable commodity prices spurred the strong growth in the fertilizer and pesticides sub-sector in 2004. Only output of the synthetic resins industry moderated during the year due partly to shortages in chemical inputs as well as the slowdown in the production of PVC pipes due to subdued construction activity. Overall, external demand for chemical products continued to remain strong, with both PR China and Japan remaining as Malaysia's largest export market for chemical products.

Growth in production of **wood products** accelerated to 12.7% (2003: 0.9%), amidst the strong external demand and high prices. The production of plywood and particleboard was stronger in response to rising demand from the US, United Kingdom (UK) and Japan. The move by Indonesia to ban exports of sawn timber has also benefited the timber-producing sector in Malaysia. Meanwhile, the furniture industry was supported by higher demand from the US, UK, Thailand, Chinese Taipei and the Netherlands.

Similarly, output of **rubber products** remained strong, expanding by 14.8% in 2004 (2003: 18.7%). The double-digit expansion was supported mainly by rising external demand for rubber gloves, as more than 90% of the domestic production is for the export market. Stable prices and sufficient supply of latex enabled domestic glove manufacturers to compete successfully in the global market. Manufacturers remained competitive by utilising a higher share of inputs with natural rubber given the higher cost of oil-based synthetic rubber. The US remained as the major export destination of Malaysia's rubber products, followed by Europe, Japan, Korea and Australia.

Production of the **off-estate processing industry** expanded, albeit at a more moderate pace in line with the output of crude palm oil during the year. Palm oil production expanded at a moderate rate during the year after two consecutive years of high growth.

Production of **transport equipment** turned around in 2004 to record a positive growth, following higher volume of cars assembled and sharp increase in production of motorcycle and scooters for the export market. Assembly of motor vehicles rebounded strongly following a contraction in 2003 to record a double-digit growth of 10.6%, spurred by pent-up demand for passenger cars following the revision to the tariff structure in the early part of the year. Rising income levels amidst the availability of attractive financing packages as well as the introduction of many affordable new models during the year further lent support for the motor vehicles industry. In the motorcycle and scooters segment, the year 2004 witnessed the increase in production from new capacity mainly targeted for exports to the regional countries such as Indonesia and Singapore as well as European countries such as Greece and Turkey.

products, were adversely affected. Nevertheless, the iron and steel industry continued to register expansion as steel manufacturers gradually shifted away from long products, mainly for the construction sector to flat products that have a wider usage, ranging from electronic appliances to furniture. Flat products were also not subject to domestic price controls and had benefited from strong export demand during the year.

Production of **fabricated metal** surged during the year (29.2%; 2003: 7.4%), mainly supported by demand from the export market. Of significance, manufacturers, particularly those producing bolts, nuts, gas and water pipes as well as steel structures for buildings and containers, increased their production during the year, responding to the strong external demand and higher prices.

Growth in the **paper products industry** softened to 2.3% in 2004 (2003: 8%), arising from the strong competition from the regional countries in the pulp and paper segment. While the pulp and paper segment contracted, the containers and paperboards segment continued to register expansion during the year following the increased economic activities that

The services sector remained as one of the main drivers of economic growth and was supported by domestic consumption, tourism and trade-related activities.

The **textiles and wearing apparel** industry continued to undergo a structural change. Output declined further due to competition from lower cost producing countries, namely PR China, India and Vietnam. As part of their business strategy, some local textile manufacturers established a presence in other countries in the region to benefit from the lower operating cost and to reap the opportunities arising from the expiry of the Agreement on Textile and Clothing (ATC) in early 2005. Amidst the strong competition, local textile manufacturers also continued to move up the value chain by producing higher value added products for external markets as reflected in the increase in exports of textile and clothing in 2004.

Output of **construction-related products** declined for the first time after five consecutive years of expansion. The sector was affected by the subdued performance of the construction sector during the year. In particular, output of non-metallic minerals products, namely cement and structural clay

supported the packaging industry. Production of **petroleum products** continued to increase, albeit at a more moderate pace given that the oil refineries were operating close to full capacity.

The **food products** industry continued to expand, albeit at a more moderate pace due partly to import substitution, while output in the **beverages and tobacco industries** were negatively affected by the increase in excise duties as well as stricter regulations on cigarette advertisement and packaging requirement.

Services Sector

In 2004, growth in the services sector strengthened to 6.7% supported by strong domestic consumption, tourism, and trade-related activities. In particular, the **final services segment**, comprising the wholesale and retail trade; hotels and restaurants; utilities; Government services; and other services strengthened significantly, with growth picking up from 3.7% in 2003 to 6.3% in 2004, reflecting

Table 1.4
Growth in the Services Sector at Constant 1987 Prices

	2003	2004*p*	2003	2004*p*
	Annual change (%)		% share of GDP	
Services	**4.4**	**6.7**	**57.6**	**57.4**
Intermediate services	5.5	7.2	23.8	23.8
Transport, storage and communication	5.7	8.4	8.6	8.7
Finance, insurance, real estate and business services	5.4	6.5	15.1	15.0
Final services	3.7	6.3	33.9	33.6
Electricity, gas and water	5.7	8.1	4.1	4.2
Wholesale and retail trade, hotels and restaurants	1.5	7.1	14.3	14.3
Government services [1]	7.6	5.1	7.4	7.2
Other services [2]	3.3	5.0	8.0	7.9

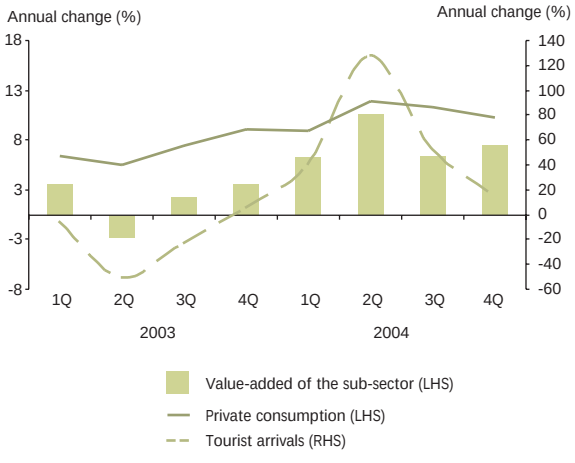
[1] Include general public services (general public administration, external affairs and public order and safety), defence, health, education and others.
[2] Include imputed rent from owner-occupied dwellings; community, social and personal services; products of private non-profit services to households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

Source: Department of Statistics, Malaysia

mainly stronger consumption and the recovery in tourism activities during the year. In line with the higher trade, business and travel activities, growth in **intermediate services segment** was also higher during the year at 7.2% (2003: 5.5%).

Of significance, the **wholesale and retail trade, hotels and restaurants sub-sector** rebounded strongly from the effects of SARS in the previous year to expand by 7.1% (2003: 1.5%). Growth was supported by increased consumer activity arising from higher disposable incomes and increased consumer confidence, and was further reinforced by robust tourism activities. Expenditure on durables, including passenger cars, rose during the year. In particular, sales of passenger cars and imports of consumption goods recorded strong growth rates of 15.3% and 24.1% respectively in 2004.

Graph 1.9
Trends in the Wholesale and Retail Trade, Hotels and Restaurants Sub-sector vis-à-vis Private Consumption and Tourist Arrivals



In the post-SARS period, there was a strong revival in tourist arrivals with the total number of tourists reaching a record level of 15.7 million in 2004 (2003: 10.6 million). The increase in tourists from high-spending markets such as the West Asian and North Asian countries supported activities in the hotels, restaurants and specialty retail stores. The hosting of the Formula One Grand Prix Championship in March and the twice-a-year Mega Sales Carnival (in the first and third quarters of the year) attracted tourist spending. The average occupancy rate of hotels rose to over 60% for the first time since 1996 (2003: 53.3%) with many premier hotels recording close to full occupancy during the peak seasons.

The **transport, storage and communication sub-sector** registered a strong growth of 8.4% in 2004 (2003: 5.7%) in line with the rapid expansion in trade and travel activities. Growth was further augmented by the robust expansion in the telecommunications industry, driven mainly by the cellular segment. Wider subscriber base, increases in international calls and increased popularity in the usage of mobile data supported the growth in this segment. By end-2004, the number of cellular phone subscribers rose to 14.5 million (end-2003: 11.1 million), representing a penetration rate of 55.9%. The intense price competition between operators has helped to increase the usage of short

messaging service (SMS) and other mobile data during the year. Subsequently, revenue from data accounted for an increased share of 16% of total mobile revenue in 2004, up from 12% a year ago, while SMS traffic reached 9.5 billion (2003: 6.2 billion).

Robust trade activities contributed favourably towards the growth in sea and air cargo. Total TEUs handled at major ports expanded by 10.7%, reflecting increases in both indigenous cargo as well as transhipment activity. In terms of operational efficiency, Port of Tanjung Pelepas (PTP) recorded the highest level of productivity among local ports at 32 gross moves per crane per hour. The port received the Container Terminal of the Year Award at the Asia Logistics Award 2004 held in Kuala Lumpur. Air cargo handled in the country also recorded a higher growth of 10.5% in 2004, due mainly to the aggressive promotion by the national airline, including the promotion of the I-port concept, which facilitates seamless movement of cargo between airports and the three major seaports in Malaysia, namely Northport, PTP and the Kuantan Port.

Meanwhile, the passenger segment of the air transportation industry recorded a strong performance of close to 20%. The segment benefited not only from the strong growth of inbound tourists but also from more Malaysians travelling locally and abroad due to greater affordability with the advent of low-cost air travel.

The **finance, insurance, real estate and business services sub-sector** recorded a stronger growth in 2004, driven mainly by banking and insurance activities, which account for the bulk of the sub-sector. In the banking industry, growth emanated from both interest and non-interest income, namely fee-based income. Nevertheless, narrowing interest spreads amidst ample liquidity and intense competition continued to limit the growth in interest income. The increasing Islamic banking activity further contributed to growth during the year. In terms of lending, Islamic financing rose by 19% to account for 11.3% of total bank lending during the year. Total assets in Islamic banking doubled in the last four years to RM94.6 billion as at end-2004. Meanwhile, in the insurance industry, net insurance premiums collected rose significantly underpinned by strong consumer demand for investment-linked life insurance and endowment products.

Activities in the real estate and business services segments also expanded during the year. Real estate activity was supported by a marked increase in the volume of property transactions (20.5%), while the increased turnover at Bursa Malaysia benefited the stock broking industry in the business services segment. Other new growth areas, namely ICT services and shared services, gained momentum to add to the growth in the business services segment. As at end-2004, 910 companies were in operation at the Multimedia Super Corridor (MSC), of which 67 are world-class companies. Activities of these companies include software and content development and providing Internet-based service applications and e-commerce solutions. In the shared services and outsourcing industry, by end-2004 the Malaysian Industrial Development Authority (MIDA) had approved incentives to 87 Operational Headquarters, 162 International Procurement Centres and seven Regional Distribution Centres as companies found Malaysia a suitable country to locate their regional hub for insourcing and outsourcing activities. A.T. Kearney's 2004 Offshore Location Attractiveness Index ranked Malaysia as the third most attractive offshore location for companies to locate their shared services operations abroad.

Table 1.5
Selected Indicators for the Services Sector

	2003	2004*p*
	Annual change (%)	
Electricity production index	5.7	8.3
Loans outstanding in the banking system	4.8	8.5
Insurance premiums	14.0	16.3
Bursa Malaysia (turnover, value)	57.2	18.3
LRT ridership[1]	8.8	5.7
Tourist arrivals	-20.4	48.5
Airport passenger traffic	2.0	18.9
Air cargo handled	7.0	10.5
Bulk cargo throughput at major ports[2]	7.9	9.1
Container throughput at major ports[3]	14.9	10.7
	%	
Hotel occupancy rate	53.3	60.8
Penetration rate of telecommunications services (end-period)		
- Internet dial-up	11.4	12.7
- Broadband	0.45	0.98
- Cellular phone	43.9	55.9
- Fixed line	18.1	17.2

[1] STARline and PUTRAline.
[2] Comprise Port Klang, Johor Port, Penang Port, Sabah ports and Bintulu Port.
[3] Comprise Port Klang, Johor Port, Port of Tanjung Pelepas, Penang Port, Sabah ports and Bintulu Port.
p Preliminary

Source:
Bursa Malaysia Berhad; Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Senai Airport Terminal Services Sdn. Bhd.; Malaysian Communications and Multimedia Commission; Ministry of Finance; relevant port authorities; Syarikat Prasarana Negara Berhad; Malaysia Tourism Promotion Board; and Bank Negara Malaysia

The **other services sub-sector** expanded at a faster pace of 5% (2003: 3.3%) with strong growth in the entertainment segment and supported by the new growth areas such as private education and private healthcare services industries. In the private higher education segment, there were 27 private universities, including six foreign university branch campuses, and 532 private colleges in operation as at end-2004. Total student enrolment in these institutions was around 232,200, of which 8.3% comprised foreign students (2003: 7.9%). In the private healthcare industry, the existing 35 private hospitals treated about 174,300 foreign patients during the year. The majority of patients came to Malaysia for treatment for cardiology, radiology and general surgery. Some tourists also came for diagnostic services and wellness programme, including basic and total health-screening services.

The **Government services sub-sector** continued to expand by 5.1%, due to higher expenditure on emoluments for the civil service, including the higher bonus payment made during the year. Meanwhile, the **utilities sub-sector** expanded strongly in line with the stronger economic performance resulting in increased demand for electricity and water by all categories of consumers, including the industrial, commercial and household sub-sectors.

Agriculture Sector

The **agriculture, forestry and fishing (agriculture)** sector registered another year of strong and broad-based growth, reflecting its revival as an important engine of growth for the economy. The sector contributed to 0.4 percentage points to overall GDP growth in 2004 (2003: 0.5 percentage points; 1993-2002: average of 0.03 percentage

The agriculture sector recorded a strong and broad-based expansion amidst favourable commodity prices.

Table 1.6
Agriculture Sector: Value Added, Production and Exports

	2003		2004*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value Added (RM million at 1987 prices)	**20,123**	**5.7**	**21,135**	**5.0**
Production[1]				
of which:				
Crude palm oil	13,355	12.1	13,976	4.7
Rubber	986	10.8	1,186	20.4
Saw logs	21,532	4.3	21,576	0.2
Cocoa beans	36	-24.0	33	-7.8
Fish landings	1,480	1.1	1,576	6.5
Exports (RM million)	**33,693**	**28.0**	**36,176**	**7.4**
of which:				
Palm oil				
('000 tonnes)	12,487	15.0	11,788	-5.6
(RM/tonne)	1,617	18.3	1,706	5.5
(RM million)	20,192	36.1	20,107	-0.4
Rubber				
('000 tonnes)	946	2.0	1,105	16.7
(sen/kilogramme)	379	41.0	470	24.3
(RM million)	3,583	43.8	5,198	45.1
Saw logs				
('000 cubic metres)	5,532	8.4	5,207	-5.9
(RM/cubic metre)	366	1.8	398	8.9
(RM million)	2,021	10.3	2,070	2.5
Sawn timber				
('000 cubic metres)	2,789	1.3	3,166	13.5
(RM/cubic metre)	1,134	2.9	1,015	-10.4
(RM million)	3,162	4.2	3,214	1.7

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

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

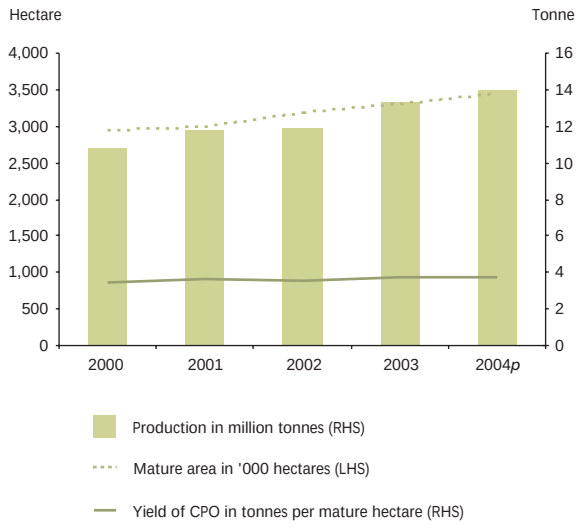
points). Value added growth in the sector expanded by 5% in 2004 reflecting an expansion across a wide range of commodities, namely crude palm oil, rubber, saw logs and food-related activities. On the external front, foreign exchange earnings from agriculture commodities increased by 7.4%, due wholly to the marked increases in export prices of between 5 – 47%. Agriculture exports accounted for 7.5% of gross exports in 2004.

The strong performance of the agriculture sector was due to a confluence of positive developments during the year. Conducive weather conditions, increases in mature areas and strong productivity gains as a result of Good Agriculture Practices (GAP) by farmers encouraged by the high global prices of agriculture commodities were key factors driving growth. In particular, production of crude palm oil and rubber reached record levels during the year. While palm oil production was supported by large expansions in new matured areas and more widespread application of agricultural inputs, especially fertilisers, rubber output was induced by intensive tapping activity, especially among smallholders and higher yields from application of new labour-saving technologies.

The broad-based growth in the agriculture sector was also contributed by higher output of the food crops sub-sector, a major component of Malaysia's agriculture sector (about 40% of the value added in the agriculture sector). The Government's efforts to transform and modernise the agriculture sector in recent years, by encouraging higher productivity and establishing deeper linkages with downstream agro-based industries, has helped to diversify the agriculture base. These contributed to higher and more stable income and increased consumption activity among farmers, fishermen and other smallholders in the rural communities of Malaysia.

Production of **crude palm oil (CPO)** reached a record high of 13.98 million tonnes in 2004, representing an increase of 4.7% over the previous year (2003: 13.35 million tonnes; 12.1%). Growth was driven by two key factors. Firstly, matured oil palm areas rose by 4.5% to 3.45 million hectares in 2004 (2003: 3.6%), reflecting mainly increases in East Malaysia. Sabah and Sarawak registered growth rates of 4.4% and 17.7% respectively, while in Peninsular Malaysia the expansion was more moderate at 2.2%. Nevertheless, Peninsular Malaysia continued to constitute a majority share of about 58% to total CPO production.

Graph 1.10
Oil Palm: Area, Production and Yield

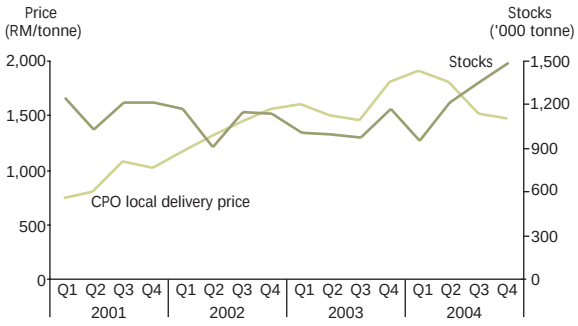


p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

The second factor was the marked improvement in the oil extraction rates (OER), which is one of the critical barometers of palm oil yield productivity. The Malaysian OER breached the critical 20% threshold for the first time in history, to 20.03% (2003: 19.75%). This is an important milestone in the industry, as every 1% increment in OER translates to an estimated increase of about 500,000 tonnes in CPO output. Given these positive developments, Malaysia retained its position as the world's largest palm oil producer and exporter, accounting for 47% of global output, and 54% of world exports.

The Malaysian palm oil commanded a strong price in the global market, with the CPO local delivery prices averaging RM1,664 per tonne in 2004 or 5.5% higher than in 2003 (RM1,577 per tonne). Prices strengthened considerably in the first half of the year (RM1,848 per tonne) amidst the shortage of world supply of oils and fats, which began since the latter half of 2003. The three largest producers of soybean oil (palm oil's closest competitor), namely the US, Brazil and Argentina recorded disappointing harvests in early 2004 due to drought and the onset of the Asian rust disease. Nevertheless, CPO prices consolidated thereafter (second half of 2004: RM1,481 per tonne) following a bumper soybean harvest in the US. Market sentiment was also influenced by the slowdown in external demand for palm oil as well as the gradual build-up in domestic crude palm oil

Graph 1.11
Palm Oil Price and Stocks



Source: Malaysian Palm Oil Board (MPOB)

stocks (end-2004: 1.49 million tonnes; end-2003: 1.16 million tonnes). This caused the already large price discount of CPO against the three other major competing edible oils (soybean, rapeseed and sunflower oils) to widen further during the year.

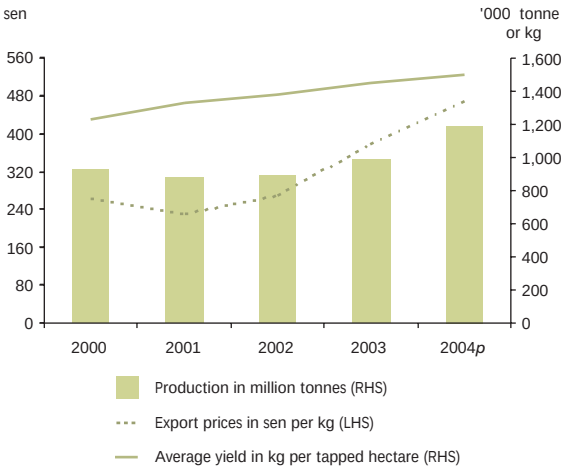
PR China continued to dominate as the major buyer of Malaysian palm oil, accounting for about 24% of the total exports. Exports to PR China rose during the year as its import quota for palm oil increased to 2.7 million tonnes (2002: 2.3 million tonnes) following the republic's accession into the World Trade Organisation (WTO). There was also a discernable increase in offtake by the US (29.2%) to 298,760 tonnes following the announcement by the Food and Drug Administration (FDA) on the changes to the regulations on the labelling of food products that contain *trans* fatty acid. Beginning 2006, US food manufacturers are mandated to label all products that contain *trans* fatty acids, which clinical studies have linked to serious diseases. Palm oil, which is *trans* fatty acid-free has benefited from the regulation as it has been increasingly used by US manufacturers as a substitute for other edible oils. Meanwhile, purchases from other Asian countries, notably India and Pakistan, declined sharply (-44% and -24.2% respectively) following an improvement in the production of their domestic rapeseed oil.

On the development front, the Malaysian palm oil industry continued to make significant progress. Malaysia ventured into four new markets during the year, namely Sao Tome and Principe, Tuvalu, Costa Rica and Guam. In terms of research and development, the Malaysian Palm Oil Board (MPOB) introduced 43 new technologies and products for commercialisation in the industry and undertook 312 research projects during the year. The new breakthroughs were mainly in developing cost-effective milling and refining techniques, improving yields, minimising wastage and creating higher value-added palm-based products (edible and non-edible products) and palm-based biomass. In line with the Government's policy on utilising renewable energy sources, efforts were also intensified in research and development related to biofuel energy prompted by the sharp increase in crude oil prices in 2004.

Natural rubber production continued to expand strongly for the second consecutive year, to breach the 1 million tonne mark for the first time in eight years. Output increased by 20.4% to reach 1.19 million tonnes. The sharp increase emanated entirely from smallholders, who accounted for almost 95% of total Malaysian rubber output. Output by smallholders rose by 22.7% as high prices motivated increased tapping activity and utilisation of improved techniques that raised productivity. While total tapped areas by smallholders expanded by 2.3% to 768,440 hectares, areas tapped by estates declined further by 1.5%, as more rubber land holdings were either replanted with other crops or converted into other economic activities during the year. Malaysia maintained its position as the third largest producer of rubber (16% share of world output) after Thailand and Indonesia.

Malaysian rubber prices, as benchmarked by SMR 20 (RSS 1 was discontinued effective 1 January

Graph 1.12
Natural Rubber: Production, Prices and Yield



p Preliminary for average yield
Source: Malaysian Rubber Board (MRB)

2004), strengthened significantly by 21% to an average of 461 sen per kilogramme in 2004 (2003: 381 sen/kg). Prices rose significantly in the early part of the year to reach the highest daily traded price of 502 sen on 2 March and to record a monthly high of 489 sen in March. The surge in prices was caused by lower world supply as a result of heavy rains and some localised disruptions, while global demand continued to remain strong especially from PR China. As output picked up in the major producing regions in the latter part of the year, prices trended lower to around 425 sen before closing the year slightly higher at 450 sen due to rising price of synthetic rubber following the higher crude oil prices.

Export proceeds from rubber rose significantly by 45.1% to RM5.2 billion in 2004, to account for 1.1% share of total exports. PR China expanded its purchases from Malaysia, registering a strong double-digit growth for the third consecutive year (39.2%; 2003: 60.3%). The strong purchases were fuelled by demand from tyre manufacturers catering to the surge in demand for automobiles. This was further augmented by the Chinese government's decision earlier in the year to abolish the import quota for natural rubber, in accordance with the WTO's trade liberalization measures. As a result, PR China continued to remain as Malaysia's largest importer of rubber with a 26.1% share of total exports (2003: 21.9%). Apart from PR China, the other major export market was the European Union (EU), which accounted for 32% of the total rubber exports, particularly Germany and France.

Rubber remains an important crop for Malaysia, given its strong linkages to the rural community and downstream industries. In recent years, the strong prices have helped to revive the industry, particularly among smallholders. Besides increasing tapping activities, smallholders have also adopted exploitation technologies such as the low frequency tapping system (LITS) and Good Agricultural Practices by using stimulants to improve rubber yield.

The Government has also provided replanting grants since 2002 amounting to RM330 million to encourage smallholders to replant rubber as well as to diversify their activities to supplement their income. They were encouraged to replant latex timber clones (LTC) that yield higher latex. These clones would also ensure adequate supply of rubber wood in future for the local furniture industry. At the same time, the Government has implemented a number of programmes including the G++ Planting System (integrated farming in rubber plantation) and Rubber Technology Village Projects (incorporating technology in rubber cultivation). These initiatives have resulted in higher incomes for smallholders. Rubber smallholders under the Federal Land Development Authority (FELDA) schemes (accounting for 10% of the nation's rubber output) doubled their monthly income from RM980 in 2002 to RM1,800 in 2004.

Other agriculture commodities, comprising fisheries, livestock, as well as miscellaneous agriculture (which includes fruits and vegetables), performed favourably in 2004. The **fisheries** sub-sector grew by 6.5% in 2004 to 1.58 million tonnes (2003: 1.48 million tonnes), driven mainly by more active deep-sea fishing and increased output of high value-added aquaculture and ornamental fish. Similarly, **livestock** production expanded by 4.5%, led by growth in output of cattle and poultry, mainly through better farming techniques such as the integrated cattle farming in oil palm and rubber plantations and poultry rearing via the closed house system. The increase in output was to meet the rising external demand and demand from the domestic food processing industries. Strong growth in **fruits** (7.1%) and **vegetables** (25%) production was due mainly to increases in cultivation areas amidst the strong domestic consumption.

During the year, the Ministry of Agriculture and Agro-based Industry (MoA) and related agencies undertook a Food Trade Balance Action Plan. The aim is to reverse the net deficit in the balance of payments for the food bill to a surplus position by 2010, as stated in the Third National Agriculture Policy (NAP3). In realising this goal, three key objectives have been emphasised. Firstly, to raise the production levels of food crops by increasing planting and catchment areas through schemes such as Permanent Food Production Parks (TKPM), Aquaculture Industrial Zones (AIZ) and private sector-led large scale commercial farming endeavours. Secondly, to strengthen the industry's competitiveness by establishing a deeper linkage with higher value-creating downstream processing activities, such as the agro-based food industries. Thirdly, to establish a sound marketing plan and ensuring the quality and safety of the food products for overseas markets by embarking on a series of accreditation and labelling schemes that is benchmarked to internationally recognised food standards. Some of these schemes that were

launched recently include the Farm Accreditation Scheme of Malaysia (SALM), Malaysian Aquaculture Farm Certification Scheme (SPLAM), Livestock Farm Accreditation Scheme (SALT) and labelling of 'Malaysia's Best' on exported fruits.

In the **forestry** sector, logging activities were moderate during the year in line with the conservation efforts to implement sustainable forest management practises. Production of saw logs increased marginally by 0.2% to 21,576 million cubic metres (2003: 21,532 million cubic metres). However, global demand for logs remained firm during the year, particularly from Japan, PR China, US and the EU countries, which led to higher prices. The average Malaysian log price reached a record high of RM398 per cubic metre following a ban on log exports and sawn timber by Indonesia. Amidst the increase in export prices (8.9%) and the decline in volume of 5.9%, export proceeds from saw logs rose by 2.5% to RM2.1 billion.

Tropical timber continued to come under pressure by environmentalists, particularly from Europe, on concerns regarding illegal logging and trade in endangered tropical species. Malaysia has developed its own timber certification scheme to provide confidence and assurance to importers and consumers that Malaysian timber products are from legal and sustainable sources. By end-2004, the Malaysian Timber Certification Council (MTCC) awarded the Certificate for Forest Management to eight Peninsular Malaysia states, as well as the Upper Ulu Baram region in Sarawak, covering a total of 4.73 million hectares of permanent reserve forests. The credibility of these certification efforts have been recognised by major buyers of Malaysian timber products, most recently by the UK and the Netherlands. In addition, to counter persistent allegations that Malaysia was importing illegal tropical logs from Indonesia, including the endangered Ramin species, the Government has imposed a blanket ban on importing such logs. Malaysia has also been vigilant in enforcing regulations on trade in Ramin in accordance with the regulations under the Convention for International Trade of Endangered Species of Wild Flora and Fauna (CITES).

As a long-term strategy to reduce reliance on natural forest, the Government has embarked on forest plantation as well as considered alternative resources such as oil palm biomass and *Kenaf* to supplement the inadequate supply of raw materials. While biomass has been identified as being suitable for manufacturing of panel products, *Kenaf*, from the hibiscus family, is for production of fibreboard. On forest plantation, as of end-2004, there has been a total of 316,196 hectares in Malaysia, with almost 68% of the planted areas in Sabah. Almost one-third of the total forest plantation is expected to emanate from the rubber species from which rubberwood is produced. In recent years, rubberwood has been increasingly used by the domestic furniture and building component industries due to its suitability. In addition, rubberwood products have also been exported, contributing to about RM5 billion export receipts in 2004. The replanting of rubber trees with LTCs would augment the production of rubberwood in the years to come.

Cocoa production fell further by 7.8% to 33,423 tonnes (2003: 36,236 tonnes) amidst the continued reduction in cultivated area to 44,000 hectares (2003: 44,897 hectares; 1990: 393,000 hectares). The reduction reflected mainly the active conversion into other crops. In addition, average productivity has also declined especially amongst smallholders, who account for two-thirds of total Malaysian cocoa acreage, due to decreased application of inputs. Nevertheless, demand for cocoa from the domestic downstream industries has been increasing, resulting in a significant increase in the import bill. As part of the efforts to encourage cocoa planting among smallholders, the Malaysian Cocoa Board has implemented the Cocoa Smallholders' Development Programme. Currently, there are 4,673 farmers who are actively involved in the programme, with a total area of 4,609 hectares. In addition, the Government has also announced that a 100% replanting grant would be given to cocoa smallholders.

Mining Sector

The **mining and quarrying (mining)** sector expanded further by 4.1% in 2004, on account of higher production of crude oil and natural gas due to strong external and domestic demand. Meanwhile, production of tin-in-concentrates continued to decline amidst the lower number of active tin mines in the country. As a net oil exporting nation, Malaysia largely benefited from the prevailing high crude oil prices during the year. Export receipts from minerals rose significantly for the second consecutive year by 38.2% to RM41.2 billion resulting in its share to total exports increasing to 8.6% (2003: 7.5%).

Malaysian **crude oil** production (including condensates) rose to the highest level of 762,318 barrels per day (bpd) in 2004, an increase of 3.6% (2003: 737,858 barrels per day). Output excluding condensates was within the target range set for the year under the National Depletion Policy. The higher production was supported by increase in demand from Australia, Thailand and Korea, as well as increased domestic demand from downstream industries producing petroleum products. High prices and increased volume resulted in proceeds from crude oil rising by 36.1% to RM21.3 billion, constituting an increased share of 4.4% to total export receipts (2003: 3.9%).

The year saw the Malaysian Tapis Blend, which is of the 'light and sweet' variety due to its low sulphur content, priced at a premium relative to the North Sea Brent. In 2004, the price of Tapis Blend strengthened by 38% to US$41.12 per barrel (2003: US$29.79 per barrel). The price rose steadily during the course of the year to reach a high of US$55.10 per barrel on 21 October. The surge in crude oil prices during the year was driven by both fundamental factors as well as market sentiment. The fine balance between global supply and demand as well as higher risk premiums for crude oil prices due to geopolitical risks, was further exacerbated by active speculative activities in the energy markets.

Based on the estimates by the International Energy Agency (IEA), global oil demand in 2004 experienced the strongest yearly increment in 21 years, rising by 2.7 million bpd to 82.4 million bpd, while global

Crude oil and natural gas production rose to the highest levels. Higher external demand and strong prices contributed to a significant increase in export earnings from minerals.

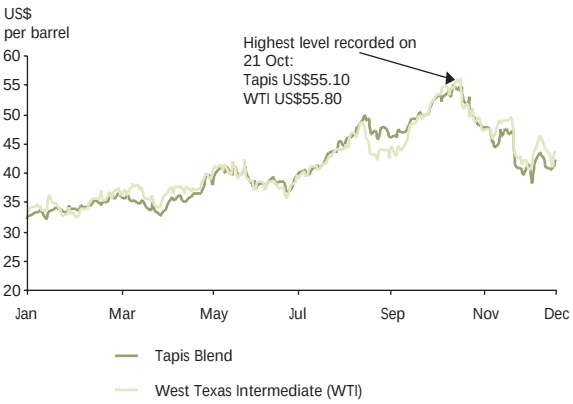
Table 1.7
Mining Sector: Value Added, Production and Exports

	2003		2004*p*	
	Volume and Value	Annual change (%)	Volume and Value	Annual change (%)
Value added (RM million at 1987 prices)	**16,699**	**5.9**	**17,384**	**4.1**
Production				
Crude oil and condensates (barrels per day)	737,858	5.6	762,318	3.6
of which: *Crude oil (barrels per day)*	*621,902*	*4.3*	*623,957*	*0.6*
Natural gas - net (million standard cubic feet per day)	5,013	7.2	5,196	4.0
Tin-in-concentrates (tonnes)	3,358	-20.3	2,800	-16.6
Exports (RM million)	**29,801**	**33.3**	**41,177**	**38.2**
of which:				
Crude oil				
('000 tonnes)	17,913	10.6	18,090	1.0
(US$/barrel)	30.27	22.0	40.81	34.8
(RM million)	15,659	35.0	21,318	36.1
Liquefied natural gas				
('000 tonnes)	17,311	15.4	20,729	19.7
(RM/tonne)	772	17.1	824	6.8
(RM million)	13,358	35.1	17,079	27.9
Tin				
(tonnes)	15,244	-43.7	29,966	96.6
(RM/tonne)	18,730	19.2	31,585	68.6
(RM million)	286	-32.9	947	231.5

p Preliminary

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

Graph 1.13
Crude Oil Prices (1-Month Futures) in 2004



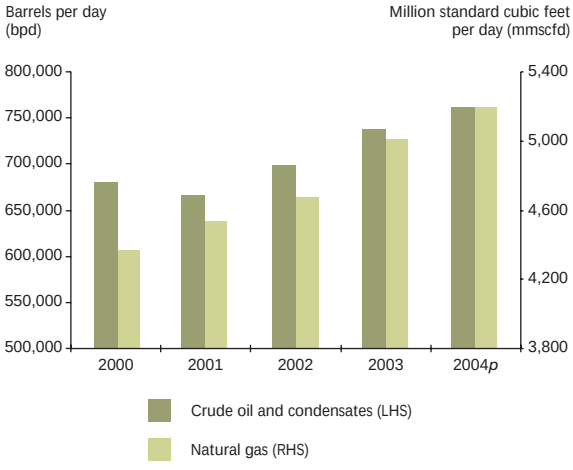
supply picked up slightly to 83 million bpd. The strong global demand emanated mainly from the PR China and the US. PR China contributed to about one-third of the increase in global demand driven by robust economic activities, while strong demand from the US reflected its need to build up its inventory level. Sentiment was further heightened by geopolitical risks in the Middle East and supply disruptions in some producing nations, such as Russia, Venezuela and Nigeria. As such, the risk premium inherent to crude oil prices widened significantly, leading to higher speculative activities. Thus, the global benchmark oil prices, namely West Texas Intermediate and North Sea Brent, averaged higher at US$41.40 and US$38.34 per barrel respectively (2003: US$30.92 and US$28.70 per barrel respectively).

Crude oil prices were also influenced by decisions of the Organisation of Petroleum Exporting Countries (OPEC). For the first time in 23 years, OPEC, which accounts for almost 40% of global oil supply, experienced a sharp reduction in spare production capacity to around 1 million bpd, lower than the average of 4 – 5 million bpd seen previously. This was crucial as non-OPEC producing nations have essentially very little spare capacity. After initially cutting its output quota by 1 million bpd to 23.5 million bpd in March, OPEC subsequently reversed its action due to strong global demand. OPEC raised its quota on three occasions, by 2 million bpd, 0.5 million bpd and 1 million bpd respectively, ending the year with a quota of 27 million bpd. Production increases by OPEC helped to stabilise and moderate oil prices. The Tapis Blend closed the year at US$40.50 per barrel.

Natural gas production also reached historic levels in 2004, with a rise in output by 4% to 5,196 million standard cubic feet per day (mmscfd) (2003: 5,013 mmscfd). The increased capacity utilisation at the MLNG plants and Gas Processing Plants (GPPs) enabled the industry to meet the higher demand from traditional buyers. In addition, domestic demand for natural gas rose during the year due to higher utilisation by the power generation sub-sector and also increased growth from domestic industrial users.

The year 2004 also saw Malaysia remaining as the third largest liquefied natural gas (LNG) exporter in the world after Indonesia and Algeria. Malaysia exported a record high of 20.7 million tonnes or about 16% of the world's total LNG exports. This represented a strong increase in volume of 19.7%. The higher offtake were mainly from traditional buyers, namely Korea and Chinese Taipei whose imports rose sharply by 74.7% and 24.4% respectively. While the majority of Malaysian LNG trade is conducted on a medium- to long-term contractual basis, the country has also benefited from the growing trend in LNG trading on spot and short-term contractual basis (defined as less than five years). In 2004, the US bought about 300,000 tonnes of Malaysian LNG on a spot basis to offset declining imports from Canada, their traditional supplier of natural gas. In line with trends in the energy markets, LNG export price rose by about 6.8% to RM824 per tonne. Accordingly, export receipts from LNG rose by 27.9% to RM17.1 billion.

Graph 1.14
Production of Crude Oil and Natural Gas



p Preliminary
Source: PETRONAS

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

	As at end	
	2003	2004*p*
Crude oil (including condensates)		
Reserves (billion barrels)	4.84	4.81
Reserve/Production (year)	17.5	17.7
Natural gas		
Reserves		
(trillion standard cubic feet)	87.02	87.33
Reserve/Production (year)	36.7	35.1

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

p Preliminary

Source: PETRONAS

Reflecting the vast potential of the Malaysian oil and gas industry, further **discoveries of oil and gas resources** were recorded in 2004. Six new oil fields were discovered offshore Sabah, including deepwater discoveries in Gumusut, Malikai and Senangin. This brings the total number of discoveries since 2002 to 12. In addition, 11 new gas fields were discovered. Of the 507,263 square kilometres of onshore and offshore areas in Malaysia made available for oil and gas exploration, 227,520 square kilometres have been awarded under 52 production sharing contracts (PSCs), four of which were signed during the year. In addition, 125 development wells and 36 exploration wells were drilled. During the year, the national oil corporation, Petroliam Nasional Berhad (PETRONAS) undertook major geological and geophysics studies. 3D seismic data mapping amounting to 546,311 line kilometres were acquired for exploration and development purposes, more than double the acquisition made just two years ago (2002: 246,475 line kilometres). Steps were also taken to enhance oil recovery via utilisation of non-conventional drilling methods.

Production of **tin-in-concentrates** continued to decline by 16.6% in 2004 due mainly to a decrease in the number of active tin mines in the country, as well as a depletion of tin reserves in the existing mines. This development took place despite the strong tin prices during the year. The average tin prices at the Kuala Lumpur Tin Market rose substantially by 73.8% to US$8,494 per tonne. The surge in prices was due to decreasing global tin stocks (particularly in the US), coupled with strong demand from the electronics industry arising from the environmental guidelines set by the EU, to replace lead with tin as the main material in soldering activities.

Construction Sector

In 2004, the **construction sector** contracted by 1.9% due mainly to lower civil engineering activity. The weaker civil engineering performance was a result of fewer infrastructure projects following the completion of many privatised projects in recent years as well as lower Government spending on new large infrastructure. On the other hand, overall activity in the residential and non-residential segments expanded during the year. Demand for residential properties was supported by rising disposable incomes and attractive financing packages, while the non-residential segment recovered in line with the stronger economic and business activities during the year.

The sharp decline in **civil engineering activity** was on account of completion of major privatised projects as well as lower public spending on large infrastructure projects. The slowdown was, however, partially mitigated by higher construction activity in the oil and gas sector following the discovery of several oil fields offshore Sabah. Construction activity centred on building terminals and production facilities, such as installation of oil rigs and pipelines. Ongoing construction in the civil engineering sub-sector was largely for power generation plants, roads, ports, and water and sewerage projects. Malaysian construction companies also secured a number of overseas contracts particularly in India, Middle East and Indochina to help to diversify their earnings base.

Activity in the **residential segment** remained strong, underpinned by firm demand for residential property, especially affordable housing in choice locations with good accessibility. Demand for residential property was encouraged by the low interest rates, attractive housing loan packages as well as incentives provided under the 2003 Economic Package which ended at end-May 2004. Supported by the favourable demand conditions,

In the construction sector, activity in the residential and non-residential segments expanded but overall activity was subdued due mainly to lower civil engineering activity.

Table 1.9
Residential Property Indicators

	2003	2004
	Units	
Residential property transactions		
Units	164,723	195,241
Value (RM billion)	23.0	29.3
Approvals[1]	203,372	174,671
Developers' licences		
New	1,062	1,071
Renewals	436	353
Sales and advertising permits		
New	1,103	1,038
Renewals	1,707	1,510
Loans by banking system - Value (RM billion)		
Outstanding	116.6	132.9
Approvals	30.0	35.7

[1] Units approved for construction by private developers.

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

construction of new houses as indicated by incoming supply and housing starts, continued to expand by 5.5% and 1% respectively in the first nine months of 2004. In recent years, the development of high-end properties has gained growing buyer interest. Reflecting this, the construction of high-end houses, as reflected by the incoming supply of semi-detached and detached houses, rose by 4.7% in the first nine months of 2004. With improving demand, house prices trended upwards in 2004. Latest data for the first half of 2004 showed that the Malaysian House Price Index rose by 5.7%, with increases recorded in all types of houses.

In line with the Government's effort to provide affordable houses to the low-income group, an additional RM1 billion was allocated to implement the *Projek Perumahan Rakyat* (PPR) in 2004. In the 2005 Budget, the Government has allocated RM778 million for the construction of 21,000 low-cost houses under the PPR.

During the year, guidelines on the purchase of properties by foreigners were further liberalised. Bank Negara Malaysia liberalised its lending guidelines to allow all residents (bank and non-bank) to extend ringgit credit facilities up to a maximum of three property loans to a non-resident to finance or re-finance the purchase or construction of properties in Malaysia with no limitation on the credit facilities. As of 1 August 2004, the Foreign Investment Committee (FIC) also relaxed its guideline to allow foreigners to purchase properties valued more than RM150,000 (previously: more than RM250,000). For the year as a whole, FIC approvals for purchase of properties by foreigners rose significantly by 74.6% to 2,824 units or RM1.5 billion (2003: RM770.6 million). Average price of properties purchased by foreigners increased by 10.2% (2003: 0.4%). However, the purchase of commercial properties by foreigners declined during the year.

In 2004, the definition of **property overhang** was reclassified to cover only completed property with certificate of fitness for occupation (CFO) issued, but remaining unsold for more than nine months after it was launched for sale. Previously, all properties that were launched and remained unsold for more than nine months, irrespective of whether the CFO was issued, were defined as overhang. Based on the new classification, data compiled by National Property Information Centre (NAPIC) showed that the overhang of residential properties increased to 15,162 units as at end-September

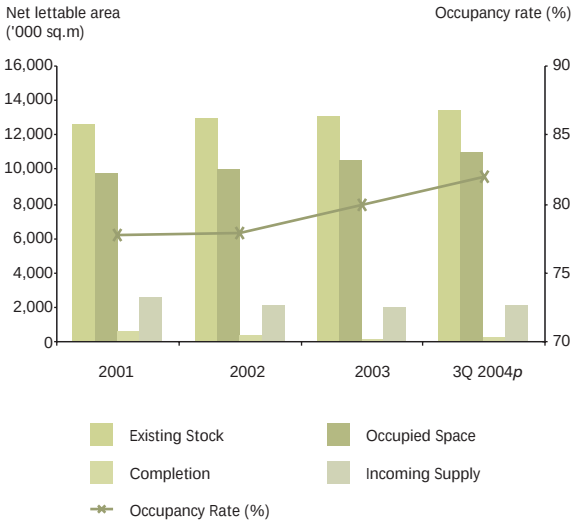
Table 1.10
Incoming Supply and Planned Supply of Property

	Incoming Supply[1]	Planned Supply[2]	Incoming Supply[1]	Planned Supply[2]
	As at end-2003		As at end-Sept 2004*p*	
	Units/'000 sq.m.			
Residential (units)	595,248	539,655	608,140	575,325
Purpose-built office ('000 sq.m.)	2,155	1,903	2,074	1,920
Shopping complexes ('000 sq.m.)	1,707	1,701	1,570	1,723
Retail shops (units)	33,455	35,260	36,123	34,839
Industrial properties (units)	8,443	22,077	8,333	21,658

[1] Consists of properties that are under construction, including those where certificates of fitness/temporary certificates of fitness have not been issued.
[2] Approved but not started.
p Preliminary

Source: NAPIC, Valuation and Property Services Department

Graph 1.15
Supply and Occupancy Rate of Office Space in Malaysia : 2001 - 2004



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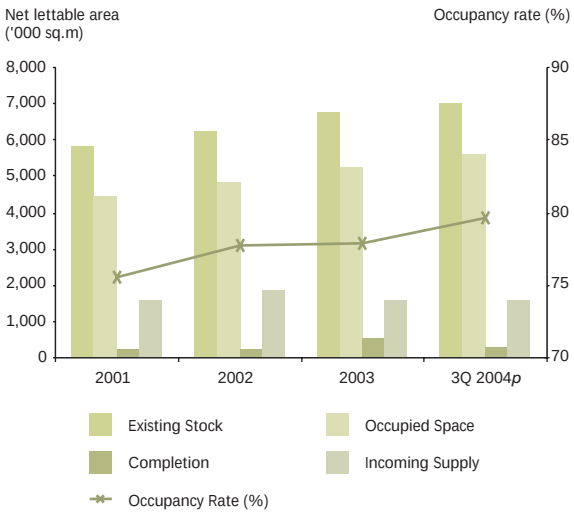
Graph 1.16
Supply and Occupancy Rate of Retail Space in Malaysia : 2001 - 2004



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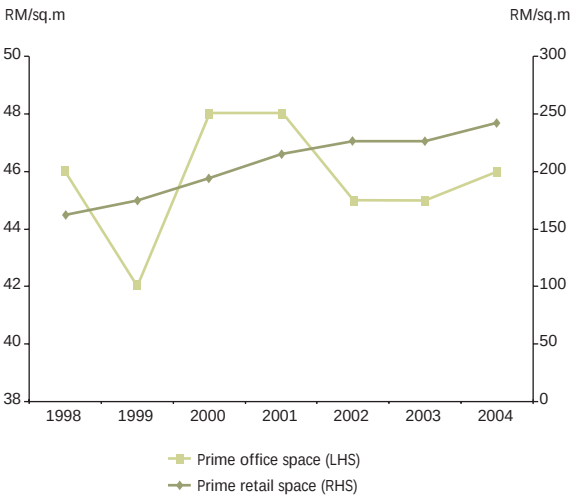
2004 (end-2003: 9,300 units) due to increased supply. Total value of overhang was RM1.8 billion. The overhang units were mainly located in the states of Johor, Selangor and Melaka. Majority of the overhang involved properties priced below RM150,000.

Construction activity in the **non-residential segment** recovered in 2004, driven largely by higher demand for office and retail space following more robust business activities. New office and retail space completed increased by 222,000 sq. metres and 265,000 sq. metres respectively in the first nine months of 2004 (first nine months of 2003: 159,000 sq. metres and 183,000 sq. metres respectively). In the purpose-built office segment, demand was supported by growth of service-related businesses such as finance, insurance, education and health. In the shopping complex segment, demand for retail space was boosted by strong consumer spending. The new shopping complexes were located mainly in the popular residential areas and suburbs to target the growing affluent population in the surrounding neighbourhoods. Notwithstanding the increase in new supply, the overall occupancy rate for office and retail space improved to 81.9% and 79.6% respectively in the first nine months of 2004 (2003: 80.5% and 78% respectively).

Reflecting stronger demand, rentals for prime office and retail space in the Klang Valley firmed during the year. The average monthly rental rates of prime retail space in the shopping complexes rose to RM242 per square metres (2003: RM226 per square metres), while rentals for prime office space rose slightly to RM46 per square metre per month (2003: RM45 per square metre).

In the **hotel segment**, there were 235 new hotels completed during the year, providing an additional

Graph 1.17
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley[1]



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

Table 1.11
Office and Retail Space - Unoccupied Space, Incoming Supply and Planned Supply by State (as at end-September 2004)

	Office Space			Retail Space		
	Unoccupied Space	Incoming Supply[1]	Planned Supply[2]	Unoccupied Space	Incoming Supply[1]	Planned Supply[2]
	('000 sq.m.)					
WP Kuala Lumpur	1,158	1,078	1,061	322	566	653
Selangor	335	58	0	171	304	63
WP Putrajaya	0	419	177	44	0	0
Johor	273	118	495	299	232	809
Pulau Pinang	281	63	41	268	212	47
Negeri Sembilan	18	45	111	36	72	88
Perak	60	52	0	42	0	0
Melaka	34	0	0	66	0	0
Kedah	26	29	1	53	53	14
Pahang	16	23	15	51	4	6
Terengganu	9	0	0	6	7	0
Kelantan	7	4	20	0	63	0
Perlis	0	26	0	0	0	0
Sabah	118	134	0	30	56	44
WP Labuan	40	0	0	15	0	0
Sarawak	49	25	0	28	0	0
Total[3]	**2,423**	**2,074**	**1,920**	**1,431**	**1,570**	**1,723**

[1] Consists of properties that are under construction, including those where certificates of fitness/temporary certificates of fitness have not been issued.
[2] Approved but not started.
[3] Total may not not necessarily add up due to rounding.

Source: NAPIC, Valuation and Property Services Department

6,755 rooms. After being adversely affected by SARS in 2003, the hotels segment recovered strongly with the average occupancy rate rising to above 60% in 2004 (2003: 53%). The improved performance was supported largely by the significant increase in tourist arrivals, which rose by almost 50% to 15.7 million (2003: 10.6 million) as well as robust domestic tourism.

The availability of affordable **financing** contributed significantly to the increase in construction activities. During the year, Bank Negara Malaysia liberalised restrictions on the provision of bridging finance for property development. While the banking sector remained the main provider of financing, the construction sector increased its reliance on the private debt securities (PDS) market as well as Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIMB) to meet part of its financing requirements. During the year, funds raised via PDS issuance for the construction sector rose to RM8.8 billion, representing a significant increase of 46.2% to account for a higher share of 31.5% of total PDS issued (2003: 14.1%). Loans extended by BPIMB also increased strongly by 15.3% to RM9.9 billion (2003: RM8.6 billion). Reflecting the strong demand for houses, end-financing for properties approved by the banking system rose by 18.8% to RM35.7 billion (2003: 2.9% to RM30 billion). Loans approved by other housing credit institutions as a group also increased during the year. Of significance, loans approved by Bank Kerjasama Rakyat Malaysia Berhad, Malaysia Building Society Berhad and Bank Simpanan Nasional as a group rose significantly by 195% to RM3.1 billion (2003: RM1.1 billion).

In early 2004, activity in the construction sector was partly affected by the temporary shortage of steel bars, which led to delays in some projects, particularly in the civil engineering segment. To address the situation, the Government implemented several measures, including a relaxation on imports of steel bars and billets as well as stricter control on exports of steel. The Government also revised upwards the ceiling price of steel bars and billets to reflect the increase in the global prices of these materials. These measures, coupled with the increased stability in global steel prices helped to ease the shortage. Beside steel products, cost of other building materials such as sand and timber products also increased during the year. This was reflected by the Building Materials Cost Index (BMCI), which showed that prices of building materials generally increased during the year.

Report on Small and Medium Enterprise Development Framework

The development of diverse and competitive small and medium enterprises (SMEs) remains central in the national agenda towards creating economic resilience in the face of an increasingly challenging economic and financial landscape. Bank Negara Malaysia has been actively driving inter-Ministry initiatives to strengthen the infrastructure for SME development and promotion through the formation of the SME Steering Committee, which is chaired by the Governor.

Culminating from the recommendations of the SME Steering Committee, the National SME Development Council was established and is chaired by the Prime Minister. The formation of the Council represents the Government's commitment at the highest level to promote the development of SMEs. It is recognised that efforts to promote and strengthen SMEs require a comprehensive approach comprising establishing enabling infrastructure for SME development, strengthening the capacity and capability of SMEs, and enhancing access to financing. A formal structure dedicated to the development of SMEs would allow for greater synergies and the synchronisation of efforts among the various stakeholders involved in SME development. It also ensures that SME development issues across all sectors are adequately addressed.

Bank Negara Malaysia continues its SME developmental role through its SME Unit, which focuses on the promotion of greater access to financing by SMEs. The SME Unit is also the Secretariat to the National SME Development Council.

Towards Focused and Coordinated SME Development

The establishment of the National SME Development Council provides the necessary strategic framework for more focused and coordinated inter-Ministry and Agency efforts on SME development to oversee efficient coordination and ensure effectiveness of policy implementation and outreach. The terms of reference of the Council are as follows:

- Formulate broad policies and strategies to facilitate the overall development of SMEs across all sectors;
- To increase the focus of the roles and responsibilities of Government Ministries and Agencies responsible for SME development;
- Enhance inter-Ministry and Agency cooperation and coordination to ensure effective implementation of SME development policies and action plans;
- Encourage and strengthen the role of the private sector in supporting the overall development of SMEs; and
- To give emphasis to the development of Bumiputera SMEs across all economic sectors

The Ministries and Agencies represented in this Council, based on their role and contribution in SME and entrepreneurial development, are as follows:

1. Y.A.B. Prime Minister (Chairman)
2. Minister of International Trade and Industry
3. Minister of Domestic Trade and Consumer Affairs
4. Minister of Entrepreneurial and Cooperative Development
5. Minister of Agriculture and Agro-Based Industries
6. Minister of Human Resources
7. Minister of Finance II
8. Minister of Energy, Water and Communications
9. Minister of Plantation Industries and Commodities
10. Minister of Science, Technology and Innovations
11. Minister of Tourism

12. Minister of Rural and Regional Development
13. Minister of Education
14. Minister of Higher Education
15. Minister of Housing and Local Government
16. Minister in the Prime Minister's Department, Y.B. Dato' Mustapa Mohamed
17. Governor of Bank Negara Malaysia
18. Director General of the Economic Planning Unit
19. Chief Executive Officer of the Multimedia Development Corporation

The Council convened two meetings in 2004 and have implemented a number of strategic initiatives. The Council approved the following initiatives to strengthen the existing infrastructure for SME development.

Strengthening Infrastructure for SME Development

Definitions for SMEs in Various Sectors for Targeted Development

To assist in the identification of SMEs across sectors and for more effective targeting of SMEs with respect to the design of future development policies, support programmes and the provision of technical and financial assistance, the Council had approved the definitions for SMEs according to the manufacturing, manufacturing-related services, primary agriculture and services sectors. The adoption of a common identifier for SMEs in these sectors will facilitate the identification of issues and prospects of the sectors concerned to enable appropriate policy actions to be taken. It will also allow closer monitoring of SME performance and contribution to the economy.

An enterprise is considered an SME in each of the respective sectors based on the Annual Sales Turnover or Number of Full-Time Employees as shown in the tables below.

Approved SME Definitions in terms of Annual Sales Turnover

Size	Manufacturing (including Agro-Based) & Manufacturing-Related Services	Primary Agriculture	Services Sector (including ICT)
Micro	Less than RM250,000	Less than RM200,000	Less than RM200,000
Small	Between RM250,000 and less than RM10 million	Between RM200,000 and less than RM1 million	Between RM200,000 and less than RM1 million
Medium	Between RM10 million and RM25 million	Between RM1 million and RM5 million	Between RM1 million and RM5 million

Approved SME Definitions in terms of Number of Full-Time Employees

Size	Manufacturing (including Agro-Based) & Manufacturing-Related Services	Primary Agriculture	Services Sector (including ICT)
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 and 50 employees	Between 5 and 19 employees	Between 5 and 19 employees
Medium	Between 51 and 150 employees	Between 20 and 50 employees	Between 20 and 50 employees

Establishment of a Comprehensive National SME Database

The availability of relevant and timely information on SMEs, including their operational conditions, financial status and development requirements, is important to facilitate better policy formulation in promoting SME development. Towards this end, the Department of Statistics has been appointed

to establish and maintain a comprehensive National SME Database. To facilitate the collection of relevant and comparable SME data across the various sectors, the Department of Statistics has launched a nationwide 2005 Baseline Census of all enterprises and businesses, with a focus on establishments in the manufacturing, agriculture and services sectors. This would assist the Council in assessing the current status of SMEs and their requirements, as well as identifying important issues relating to SMEs' performance and development. Information compiled from the census would facilitate the formulation of policies to promote SMEs as an important driver of growth and in the formulation of strategies for the forthcoming 9th Malaysia Plan.

Enhanced Management and Publication of SME Statistics

The role of the Secretariat under Bank Negara Malaysia has been enhanced to include the function of overseeing and coordinating the monitoring, evaluation and publication of SME statistics and reports. Apart from meeting the information requirements of SME policymakers, the Secretariat will also be responsible for developing key performance indicators to monitor and evaluate the progress of SME development, and will oversee the management of the National SME Database. The Secretariat will also publish annual reports on SME development for the benefit of policymakers and the SMEs, thereby improving the availability of SME information in the market.

Building Capacity through Coordinated Training and Human Resource Development for SMEs

Pembangunan Sumber Manusia Berhad (PSMB), an agency under the Ministry of Human Resources, has been appointed as the coordinating authority to oversee and coordinate overall training and human resource development for SMEs. The role of PSMB will therefore be expanded to include: identification of training needs of SMEs across all sectors of the economy, coordination, monitoring and evaluation of SME training and development programmes conducted by Ministries and Agencies, and development of a formal training accreditation system for SMEs.

Enhancing Access to Financing by SMEs

In 2004, the banking system approved RM31.6 billion of new loans to more than 92,000 SME accounts, a significant increase of 21.9% from 2003. Loan disbursements grew strongly by 15.3% to RM100.4 billion, while outstanding loans to SMEs expanded by 7.7% to RM88.3 billion. Loans to SMEs accounted for 40.3% of outstanding business loans as at end-2004, compared with 38% as at end-2003. On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to distributive trade, manufacturing and construction sectors, reflective of the business focus of majority of the SMEs. Gross non-performing loans of SMEs contracted by 11.4% to RM10.6 billion (NPL rate of 12.0%), reflective of the improving financial position of the SMEs.

Policy initiatives by BNM on enhancing access to financing by SMEs during the year focused on:

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

New Initiatives to Improve Access to Financing by SMEs

To further improve access to financing by the SMEs, the National SME Development Council approved the following initiatives in 2004:

- *Establishment of an SME Bank*
  The Council approved the concept of establishing a specialised financial institution to nurture and meet the unique needs of SMEs. The banking system, with large financial

resources and extensive outreach, will continue to be the main provider of funds to SMEs. The set-up of a dedicated SME Bank will complement the banking institutions through provision of financial and non-financial services to SMEs, including ancillary services and credit information. Besides financing, the SME Bank will focus on nurturing the SMEs and creating an entrepreneurial society.

Direct lending activities include start-up and working capital financing, while the SME Bank may also guarantee loans granted by banking institutions to SMEs and facilitate securitisation of SME loans. The SME Bank will also provide ancillary services aimed at nurturing SMEs through the provision of advisory services on financial and business management, marketing and other business aspects. In addition, similar to countries like Japan and Korea, the SME Bank will provide credit information on SMEs to facilitate credit rating and business report on individual SMEs.

- *Interest Subsidy*
  Viable SMEs are currently being assisted through special funds established by the Government to obtain financing at relatively lower costs. As a strategic initiative to further extend accessibility to financing at reasonable costs to more SMEs, while reducing the Government's financial outlay, the Council has approved the introduction of a mechanism to provide interest subsidy on SME loans to selected priority sectors extended by the banking institutions.

- *Securitisation of SME Loans*
  To provide greater flexibility to banking institutions in managing their SME loan portfolio and further enhance their financial capacity to provide lending to SMEs, the Council approved a framework to facilitate the banking institutions to securitise their SME loans. The securitisation framework would also enable SMEs to indirectly tap the capital market for financing, thus broadening the sources of funding for them.

- *New Trade Financing Arrangement for SMEs*
  In an effort to encourage SMEs to participate in the export markets, especially in the non-traditional markets and with members of the Organisation of Islamic Countries, new trade-financing arrangements for SMEs that are more accessible and with lower financing costs will be introduced. Under the arrangements, the SMEs would be able to obtain financing for pre- and post-shipment from banking institutions, with credit risks to be shared between banking institutions and the Malaysian Export Credit Insurance Berhad.

Expanded Role of SME Unit in Bank Negara Malaysia

Bank Negara Malaysia established a dedicated SME Unit in May 2003 to provide information on various sources of financing, facilitate loan application process, assist viable SMEs in accessing financing, and to provide advisory services on financial requirements. For greater effectiveness in planning, implementation and outreach of SME programmes and institutional arrangements for access to financing, the Council approved the enhancement of the SME Unit's role to include:

i Coordination, monitoring and evaluation of overall SME financing across all economic sectors;
ii Coordination of the implementation of all SME financing policies and strategies for greater effectiveness;
iii Review of policies and strategies to enhance SMEs access to financing; and
iv Formulate alternative modes of financing for SMEs.

With this enhancement, the Unit is now responsible for interfacing with the banking institutions, relevant Ministries and Agencies to ensure that a comprehensive financial infrastructure is in place to continuously support the growth and development of SMEs across all sectors.

During the year, the Unit undertook various initiatives to increase awareness among SMEs on financial requirements and procedures, as well as financing sources. These were done through road shows, exhibitions and briefings to SMEs, as well as publication of brochures on special funds. In addition, the Unit also conducted quarterly dialogues with SME-related trade organisations and banking institutions. Also, in 2004, the Unit received 1,401 enquiries, requests for assistance and complaints from the SMEs, of which 90% were enquiries on information and sources of financing and details relating to the special funds. Complaints relating to access to financing constituted only 10% of the enquiries received.

Higher Allocations for Special Funds

To ensure continued access to financing at reasonable costs, Bank Negara Malaysia has established several special funds for SMEs. The funds are channelled through participating institutions comprising banking institutions, development financial institutions and ERF Sdn Bhd with lending rates ranging from 3.75% to 5.00%. Five special funds are currently available to the SMEs, namely:

- Fund for Small and Medium Industries 2 (fund size: RM4.5 billion);
- New Entrepreneurs Fund 2 (fund size: RM2 billion);
- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM800 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM 300 million);

Due to strong demand, allocations for the Fund for Small and Medium Industries 2 and the New Entrepreneurs Fund 2 had been increased in 2004, by RM2.5 billion and RM850 million respectively. As a result, the total allocation of the five special funds amounted to RM8.9 billion at the end of 2004. Of this amount, RM8.1 billion or 91% has been approved to more than 19,000 borrowers. In 2004, RM2.9 billion in financing was approved to 4,570 new borrowers, compared with RM1.9 billion to 3,741 borrowers in 2003.

Performance of Small Debt Resolution Scheme

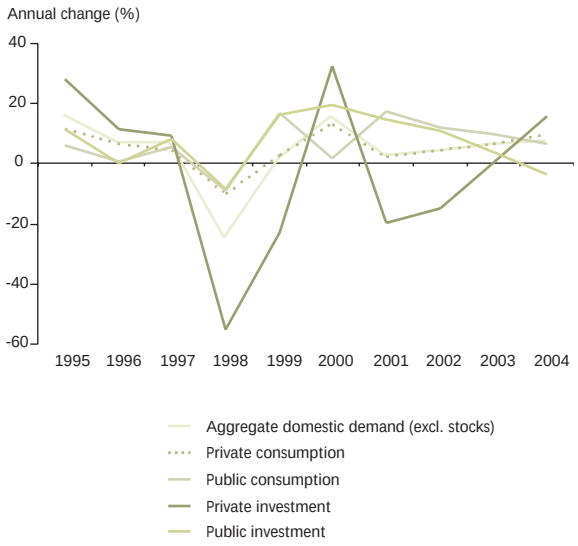
The Small Debt Resolution Scheme was established on 1 November 2003 to facilitate the restructuring of non-performing loans (NPLs) of SMEs with on-going businesses. Under this mechanism, a Small Debt Resolution Committee was established to undertake independent assessments on the viability of the businesses,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

As at end-December 2004, 228 applications with NPLs of RM180.2 million were received under the scheme. Of these, 116 applications (51%) involving NPLs amounting to RM81.8 million have been approved for restructuring, whilst RM10.5 million in new financing was approved to eligible borrowers under the Rehabilitation Fund for Small Businesses. A total of 25 cases, with total NPLs of RM26.5 million, were rejected due to non-viability, while 87 cases involving NPLs of RM72 million were being evaluated. For most of the cases under evaluation, the evaluation by the implementing institutions and the Secretariat have been delayed due to the inability of applicants to provide the necessary information that form an important part of the evaluation process. The performance of the scheme has demonstrated that the restructuring of NPLs is more important than the provision of new financing to ensure the viability and sustainability of financially distressed SMEs.

DOMESTIC DEMAND CONDITIONS

Domestic demand conditions strengthened further, registering a growth of 7.3% in 2004 (2003: 5.9%). Growth in **aggregate domestic demand** was supported mainly by the robust expansion in private sector. Stronger consumer confidence was supported by higher disposable incomes, low inflation and favourable financing conditions. Business spending also accelerated as companies added capacity in response to strong demand and replaced obsolete machinery and equipment. The public sector, while consolidating, remained supportive of growth by providing better infrastructure facilities and improving the delivery of essential services.

Graph 1.18
Real Domestic Demand Aggregates



Public consumption increased steadily by 6.6% in 2004, largely on account of higher expenditure on supplies and services as well as emoluments. The increased expenditure for supplies and services was to improve the administrative machinery and delivery system of the public sector. Reflecting the Government's emphasis on human resource development to enhance the nation's productivity and competitiveness, expenditure on emoluments increased further.

Domestic demand conditions continued to strengthen in 2005, supported mainly by robust expansion in private sector activities. Public sector expenditure, while lower, remained supportive of private demand.

Public investment declined by 3.5% in 2004 (2003: 3.9%) on the back of the notable decline in Federal Government's development expenditure. However, capital expenditure for the Government remained supportive of growth, with a bias towards economic and social sectors, and spread over larger numbers of smaller-scale projects. In the economic sector, expenditures were mainly for modernising the non-plantation agriculture, improving the living standard in rural areas and the transportation system in the country. Meanwhile, capital spending for social projects mainly focused on essential services provided by the Government, such as education, health and housing. Capital expenditure of the NFPEs remained high during the year, due mainly to upgrading and capacity expansion programmes by the three largest NFPEs, namely PETRONAS, Tenaga Nasional Berhad (TNB) and Telekom Malaysia Berhad (TMB). The bulk of PETRONAS' expenditure continued to focus on oil and gas projects in Malaysia and abroad, as well as the shipping business. TNB's capital spending was largely for further improving the power generation and transmission system, while TMB's expenditure was mainly to expand its network infrastructure to meet increasing demand for mobile and data services as well as broadband Internet access.

Private consumption increased at a faster pace of 10.1% in 2004 (2003: 6.6%), following rising consumer confidence. The MIER Consumer Sentiments Index (CSI), which measures consumers' perception of the economy and personal finances, improved since the second quarter of 2003 and peaked in the first quarter of 2004. Although the CSI softened somewhat towards the second half of the year, consumers' willingness to spend remained unaffected. While the prolonged increase in oil prices had some effect on consumers' optimism, these were largely mitigated by the continued rise in disposable income and continuing favourable employment market. The higher oil prices were not fully translated into higher retail fuel cost as Malaysia, being a net oil exporter, was able to cushion the impact on consumers through graduated subsidies on fuel. In addition, various

Table 1.12
Private Consumption Indicators

	2003	2004				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars (incl. 4WD)						
'000 units	334.4	82.3	98.8	107.2	97.3	385.7
Annual change (%)	-10.9	-3.3	18.8	19.6	27.3	15.3
Imports of consumption goods						
(RM billion)	18.7	5.1	5.8	6.1	6.3	23.2
Annual charge %	-1.2	14.8	28.0	38.8	16.5	24.1
Tax collection						
Sales tax (RM billion)	8.0	1.2	1.8	1.6	2.2	6.8
Service tax (RM billion)	2.0	0.3	0.7	0.5	0.8	2.3
Narrow money (M1)						
Annual change (%)	14.6	19.6	15.9	14.9	11.9	11.9
Loans disbursed by banking system						
Consumption credit (excl. passenger cars) Annual change (%)	10.2	21.4	17.5	16.7	12.5	16.8
Retail trade, restaurants and hotels Annual change (%)	8.4	13.2	14.0	25.5	24.3	19.5
MRA retail sales						
Annual change (%)	8.4	5.9	15.1	8.8	n.a.	n.a.
Credit card operation						
Turnover spending (RM billion)	30.9	8.5	8.7	9.6	10.0	36.8
Annual change (%)	15.5	17.6	22.3	20.0	16.7	19.1
MIER Consumer Sentiments Index	-	117.5	112.4	113.9	109.3	-
KL Composite Index	793.9	901.9	819.9	850.0	907.4	907.4
Commodity prices						
CPO (RM/tonne)	1,577	1,895	1,800	1,505	1,458	1,664
Crude oil (USD/barrel)	30	35	38	46	47	41
Rubber (sen/kg)	381	476	475	435	459	461

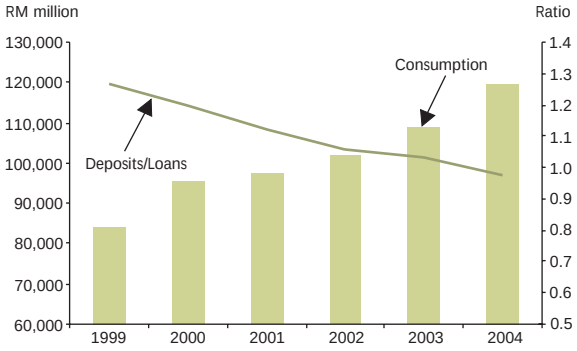
tax rebates to sustain consumption announced during the 2004 Budget and the bonus payments to civil servants reinforced the resilience of household consumption.

The low interest rates provided additional impetus for households to spend on durable goods and houses. Sales of passenger cars rose by 15.3% in 2004, as the car buyers were enticed by the introduction of new car models and attractive financing packages. The willingness to accumulate debt by individuals was reflected in the ratio of deposits to loans dipping below 1.

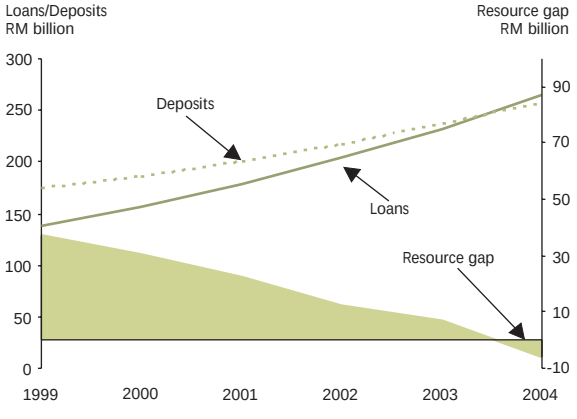
However, the increased willingness to access credit for consumption expenditure did not see an increase in the vulnerability of households. Rather, this new development was primarily driven by income growth and financial innovation, as new lending packages were made available to households by an increasingly competitive banking sector. The implementation of the Central Credit Reference Information System has brought down the cost of assessing the credit-worthiness of potential customers, thereby allowing banks to provide more attractive financing terms to viable borrowers. The non-performing loan (NPL) ratio for consumption credit declined from 9.5% to 8% in 2004 while the NPL ratio for credit card debt remained stable at 4.7%. Importantly, the availability and popularity of other modes of savings, such as unit trusts, insurance funds and pension funds, ensured that while deposit growth slowed, household savings remained high.

Apart from the purchases of passenger cars, purchases of household furnishings and equipment increased in tandem with the relatively strong property sales in recent years. In addition, households that continue to see some modest appreciation in the values of their homes were

Graph 1.19
Individual Deposits/Loans and Consumption



Graph 1.20
Individual Loans and Deposits



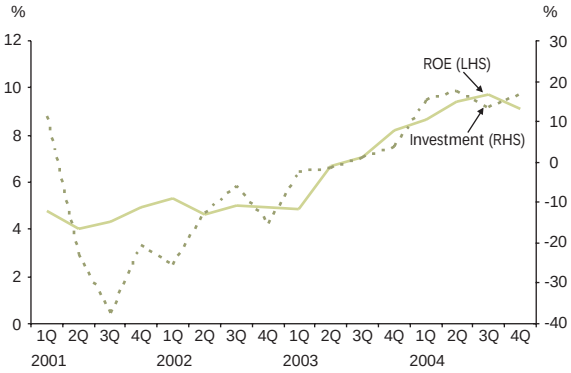
encouraged to spend further. The favourable equity market performance also stimulated household consumption.

Private investment in 2004 was robust (15.8%; 2003: 0.4%) as businesses gained confidence in the strength of economic expansion and in the prospective payoffs of capital investment. Additional production capacities were put in place in response to strong demand, while replacement of obsolete machinery was at a brisk pace as companies were keener to invest in an expanding economy. At the same time, favourable financing conditions were supportive of business investment activities. Loans disbursed to businesses increased further by 10.5% (2003: 7.6%) during the year. The strengthened financial position of companies in terms of profitability and debt-servicing capacity also encouraged companies to expand their productive capacities.

Table 1.13
Private Investment Indicators

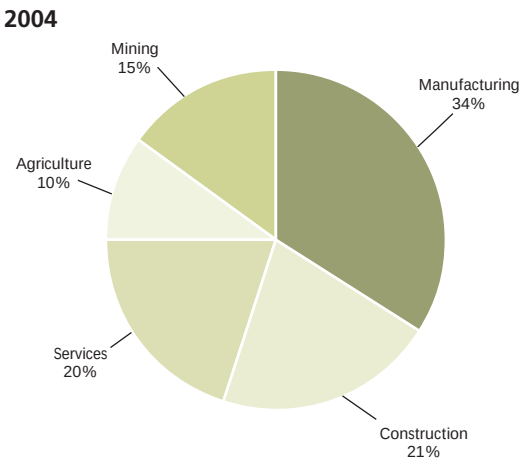
	2003	2004				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles (incl. 4WD)						
'000 units	70.6	19.4	23.7	24.3	28.0	95.5
Annual change (%)	18.5	30.2	46.4	25.3	39.5	35.2
Import of capital goods						
(RM billion)	40.8	12.3	13.3	14.0	16.0	55.5
Annual change (%)	-5.6	30.9	37.0	38.4	37.7	36.1
Applications to MITI						
No. of projects	925	286	285	260	248	1,079
Capital investment (RM billion)	25.6	3.9	5.3	7.0	13.1	29.3
Foreign	11.6	1.6	2.3	1.7	7.4	13.0
Local	14.0	2.3	3.0	5.3	5.7	16.3
Approvals by MITI						
No. of projects	965	299	249	246	307	1,101
Capital investment (RM billion)	29.1	3.7	3.5	5.5	16.1	28.7
Foreign	15.6	1.4	1.7	2.6	7.5	13.1
Local	13.5	2.3	1.8	2.9	8.6	15.6
Loans disbursed by banking system						
Manufacturing sector Annual change (%)	4.8	-0.4	15.1	11.7	14.2	10.2
Construction sector Annual change (%)	-8.6	11.3	10.4	3.0	17.2	10.4
Business services Annual change (%)	6.7	53.6	9.3	13.0	5.8	19.0
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	42.8	2.8	6.5	9.3	9.5	28.1
New activities	2.8	1.1	3.6	4.5	3.8	13.0
Initial Public Offerings (KLSE)						
Total funds raised (RM billion)	4.0	0.4	0.4	1.3	2.0	4.0
MIER Business Conditions Survey						
Business Conditions Index	-	112.0	124.1	110.2	97.3	-
Capacity Utilisation Rate (%)	-	80.2	81.1	82.5	82.2	-
MSC-Status Companies						
No. of companies	161	38	46	56	50	190
Approved investment (RM billion)	1.6	0.2	0.5	0.8	0.5	2.0

Graph 1.21
Investments and Profitability

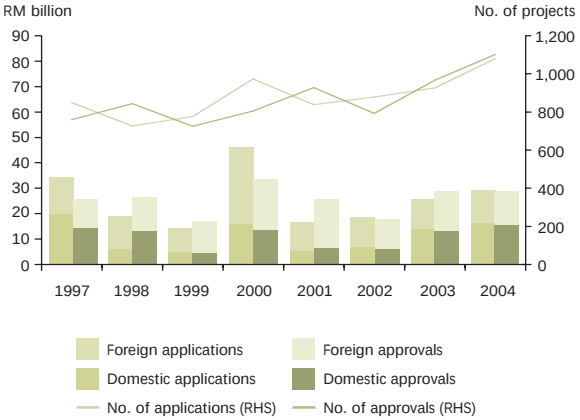


The strong global growth environment, together with steps taken by the Government to improve the business environment, led to indicators of Malaysia's investment climate improving in 2004. For instance, the A.T. Kearney FDI Confidence Index for 2004, which measures the likelihood of investment in specific markets, showed that Malaysia scored well among foreign investors. Malaysia demonstrated among the strongest improvements in investor confidence among all the countries surveyed, rising to 15th place during the year from 23rd in 2003. This significant

Graph 1.22
Private Investment by Sector (% share)

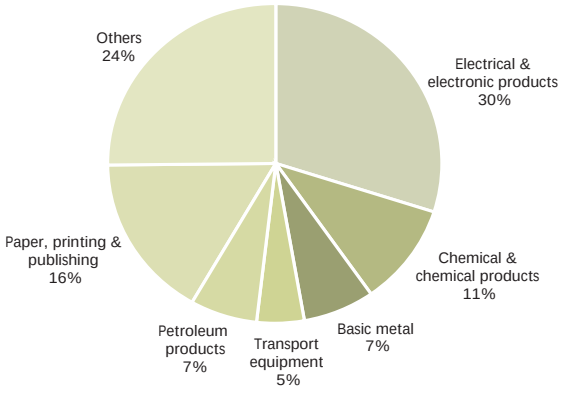


Graph 1.23
Private Investment in the Manufacturing Sector



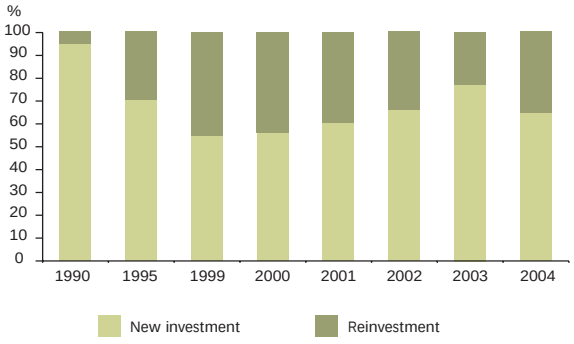
Source: Malaysian Industrial Development Authority

Graph 1.24
Approved Manufacturing Investment by Industry, 2004 (% share)



Source: Malaysian Industrial Development Authority

Graph 1.25
Share of Approved New Investments and Reinvestments in the Manufacturing Sector



Source: Malaysian Industrial Development Authority

improvement underscores the better domestic investment climate and augurs well for the promotion of domestic investment activities.

Higher capital expenditure was evident in all sectors of the economy, with the manufacturing, services and mining sectors registering exceptionally strong outlays during the year. Investment in the **manufacturing sector**, which registered a 32.7% (2003: 4%) growth, was mainly supported by capacity expansion and replacement of old machinery and equipment. Although investment approvals by MITI declined by 1.4% (2003: +63%), the staggered implementation of previously approved projects had contributed to the outlays in 2004. Approvals for new investments continued to exceed reinvestments, suggesting that manufacturers remained keen on venturing into high value-added manufacturing activities. These investments were largely concentrated in the electrical and electronic products, chemicals and chemical products and paper, printing and publishing industries. The positive sentiment that was observed among domestic investors was echoed by foreign investors in the manufacturing sector. In the A.T. Kearney's FDI Confidence Index, both heavy and light manufacturers indicated that Malaysia's attractiveness as an investment destination had improved. Heavy manufacturers now rate Malaysia as the 16th most attractive destination in their industries, up from 18th place in 2003 while light manufacturers placed Malaysia in 9th place, a significant improvement from the 21st position a year ago.

Investment in the **construction sector** increased moderately during the year. Construction activities in the residential sub-sector were the main contributor to the investment in this sector, arising from the strong demand for residential property, which was supported by the prevailing low interest rates and attractive housing mortgage packages offered by the banking institutions. Meanwhile, activity in several ongoing privatised projects, namely, the Guthrie Corridor Expressway, Kajang-Seremban Expressway, Jelutong Highway and Butterworth Outer Ring Road, also provided support to the investment in the construction sector.

Investment was higher in the **services sector** as evidenced by stronger capital spending activities in the utilities and the retail, wholesale and business sub-sectors. Capital expenditure in the utilities sub-sector included the development of the Tanjung Bin power plant and water projects, namely, the Sungai Selangor Project Scheme Phase 3 (SSP3) and Stormwater Management and Road Tunnel (SMART). Following the

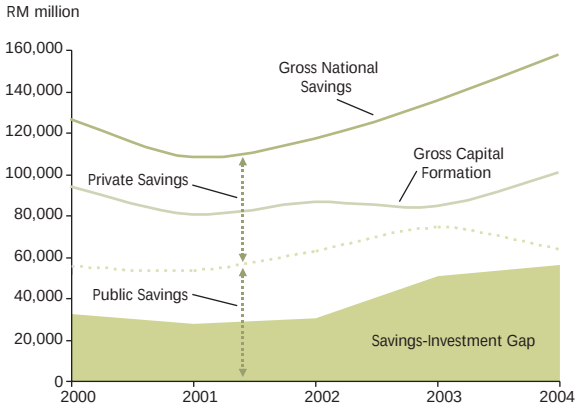
consolidation process in the telecommunication industry in 2003, the industry players began to increase their investment to further improve their services and develop new systems to enhance their competitiveness. Capital spending activities in the transport sub-sector were supported by capacity expansion and development of PTP and West Port. During the year, banking institutions continued to invest in IT projects, mainly to upgrade and optimise their retail banking systems, enhance processing capacity and improve the management of product offerings in order to further improve their customer support services. In the retail sector, capital-spending activities were visible from the establishment of new outlets by major hypermarket operators and retailers in major towns.

Capital outlays in the **mining sector** remained largely driven by the oil and gas segment. The spending was spurred by the increased upstream activities in exploration and production, following the new discoveries of oil fields, stronger demand and higher prices for crude oil. Investment in the **agriculture sector** was mainly for the development of crop plantation. Capital spending for crop plantation activities remained high, particularly for palm oil plantations arising from the increase of crude palm oil production coupled with the favourable CPO prices during the year. The bulk of the capital expenditure was mainly to expand capacity and new planting. In addition, higher imports of agricultural equipment for the year also reflected increased capital spending in the agriculture sector.

The significant expansion in nominal gross national income in 2004 was not only reflected in a robust consumption spending, but also in a further increase in **Gross National Savings (GNS).** Recording a growth of 16.3%, this increase largely reflected the continuing expansion of private sector savings amidst stronger corporate profitability and higher households' disposable incomes due to the concurrent improvement in domestic and external activities. As such, both households and the corporate sector enjoyed stronger cash flows, supported mainly by favourable commodity prices, high export earnings, low levels of inflation and interest rates as well as a stable employment condition. In all, private sector savings increased by 53% in 2004.

In the public sector, however, lower savings were recorded, due mainly to the lower operating surplus of the Federal Government. The decrease in the Federal Government's operating surplus was due mainly to higher subsidies as a result of higher oil prices, higher

Graph 1.26
Gross National Savings and the Savings-Investment Gap



payments for emoluments, increased expenditure on supplies and services to upgrade the quality and efficiency of public services as well as larger refunds and write-offs. However, due to the lower public gross fixed capital formation, the public sector savings-investment balance remained in surplus.

Overall, GNS continued to increase in 2004 to total 37.1% of Gross National Product (GNP) as compared to 36.3% in 2003. This high rate of savings has enabled Malaysia to finance its growth primarily from domestic sources. Excess liquidity and a lower cost of debt contributed to the marked improvement of private gross investment, which despite the decline in public investment expenditure, resulted in a total improvement of 19.3% for overall gross domestic capital formation (including stocks). Given the simultaneous increase in savings, the savings-investment balance, as reflected in the current account of the balance of payments, remained large at 13.4% of GNP in 2004.

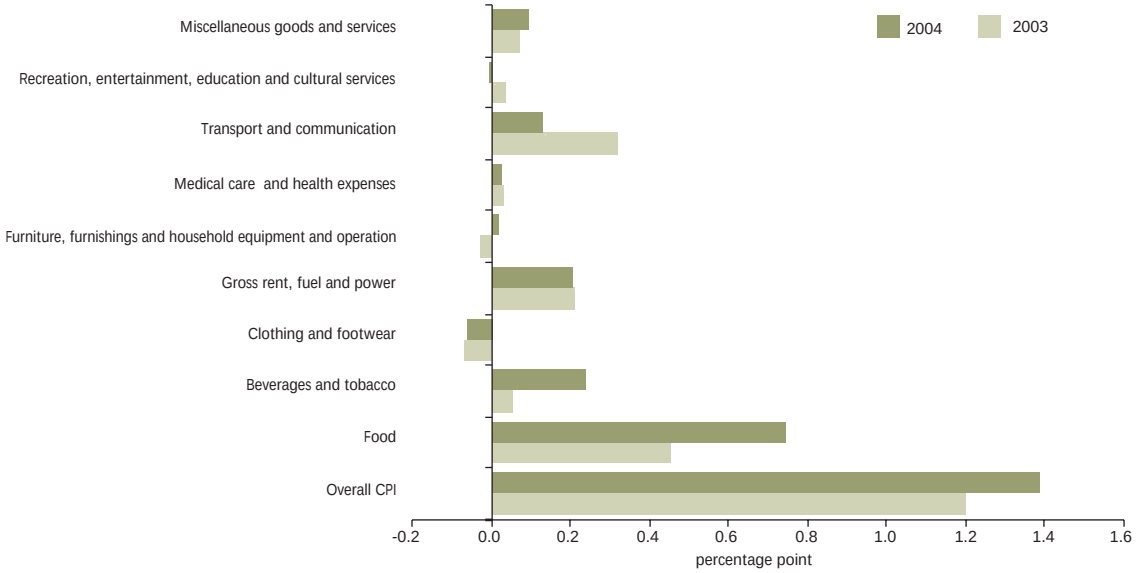
PRICES AND EMPLOYMENT

Consumer Prices

Inflation edged up slightly in 2004. The overall inflation rate, as measured by the annual change in the Consumer Price Index (CPI), was marginally higher at 1.4% (2003: 1.2%). Core inflation, which is inflation excluding price-controlled and price-volatile items as well as items that are subject to one-off price adjustments, also increased to 1% in 2004 (2003: 0.5%).

Despite the stronger expansion in domestic demand during the year, several factors combined to ensure that price pressures were contained. The continued

Graph 1.27
Contribution to Annual Change in the Consumer Price Index



improvements in productivity growth, the absence of wage cost pressures, adequate expansion in capacity and a more competitive environment were factors that contributed to price stability.

The marginal rise in overall prices in 2004 was due mainly to faster increases in the prices of food and beverages and tobacco, moderated by the slower increase in prices in the communications sector. The increase in food prices contributed the most to the increase in prices in 2004, due mainly to the higher prices of food taken away from home, followed by the increase in the prices of beverages and tobacco consequent to the increase in excise duties announced in Budget 2005. The impact however, was offset by the slower increase in telephone and telegraph charges. The increases in the retail prices of petrol in May and October had minimal impact on the rise in personal transportation charges and on the overall inflation rate.

Table 1.14
Price Indicators

Consumer Price Index (2000=100)	Weight	2003	2004
	Annual change (%)		
	100.0	**1.2**	**1.4**
of which:			
Food	33.8	1.3	2.2
Beverages and tobacco	3.1	1.6	7.8
Clothing and footwear	3.4	-2.0	-1.8
Gross rent, fuel and power	22.4	0.9	1.0
Furniture, furnishings and household equipment and operation	5.3	-0.6	0.4
Medical care and health expenses	1.8	1.7	1.4
Transport and communication	18.8	1.6	0.8
Recreation, entertaiment, education and cultural services	5.9	0.6	-0.1
Miscellaneous goods and services	5.5	1.3	1.8
Consumer Price Index			
Durable goods	9.4	-1.1	0.2
Semi–durable goods	5.4	-1.4	-0.9
Non-durable goods	40.2	1.6	2.4
Services	45.0	1.3	1.0
Producer Price Index (1989=100)	**100.0**	**5.7**	**8.9**
of which:			
Local Production	79.3	6.8	10.3
Imports	20.7	0.8	2.0

Source: Department of Statistics, Malaysia

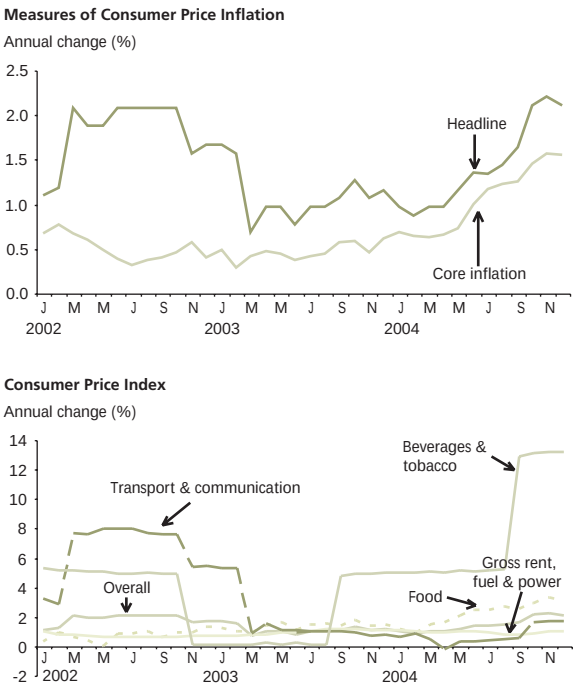
Producer Prices

Producer prices, as measured by the Producer Price Index (PPI), rose at an annual growth rate of 8.9% in 2004 (2003: 5.7%), largely reflecting higher prices for commodity-related products, following higher prices of crude petroleum and crude palm oil. Excluding commodity-related products, the non-commodity related PPI increased at an annual rate of 2% (2003: 0.5%) due mainly to higher prices of food and live animals. Prices paid for imported goods increased by 2% (2003: 0.8%), reflecting mainly higher petroleum prices and the depreciation of the US dollar against the major currencies.

Labour Market Developments

The domestic **labour market conditions** continued to improve in 2004. The underlying growth in labour productivity provided support for competitiveness and the ensuing strong growth environment led to positive job creation. According to latest estimates for 2004,

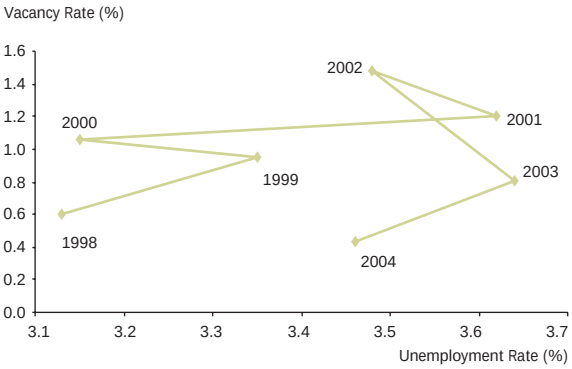
Graph 1.28
Inflation: Annual Rate of Change



employment grew at a faster rate of 3.6% to 10.2 million workers compared with the labour force growth of 3.4% to 10.6 million persons. Consequently, the unemployment rate declined to 3.5% (2003: 3.6%). The labour force participation rate also increased to 66%. Training for workers continued to be promoted to enhance the quality of labour, increase agility and to alleviate skills mismatches to suit the on-going transformation of the economy.

The Beveridge Curve, which tracks the pattern of unemployment and vacancies in the labour market, shifted further downwards and inwards in 2004, indicating lower turnover in the labour market and higher efficiency in the worker-job matching process. Findings from the Salary and Fringe Benefits Survey, conducted by the Malaysian Employers Federation (MEF), confirmed that the overall average monthly turnover rate was lower at 1.51% in 2004 (2003: 1.76%). Similarly, the Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the Federation of Malaysian Manufacturers (FMM) showed that the overall average monthly turnover rate remained low at 1.79% (2003: 1.76%).

Graph 1.29
Beveridge Curve for Malaysia (1998-2004)



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

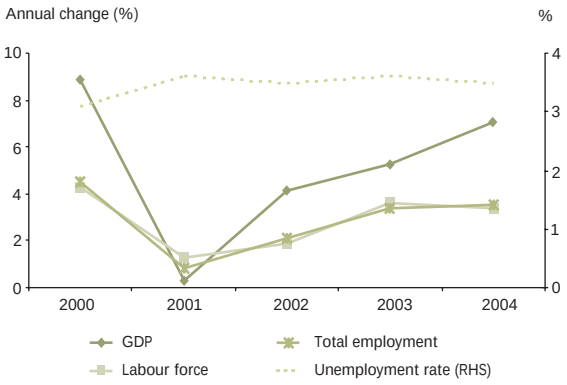
Table 1.15
Labour Market Indicators

	2000	2001	2002	2003	2004*e*
Labour force ('000)	9,572.5	9,699.4	9,886.2	10,239.6	10,587.7
(annual change in %)	4.3	1.3	1.9	3.6	3.4
Employment ('000)	9,271.2	9,348.1	9,542.1	9,866.7	10,221.0
(annual change in %)	4.5	0.8	2.1	3.4	3.6
Unemployment rate (%)	3.1	3.6	3.5	3.6	3.5
Labour productivity (GDP/Employment)					
(annual change in %)	3.9	-0.5	2.3	1.9	3.4
Real wage per employee in manufacturing sector					
(annual change in %)	5.0	1.7	3.2	2.8	1.8

e Estimate

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

Graph 1.30
Output and Employment



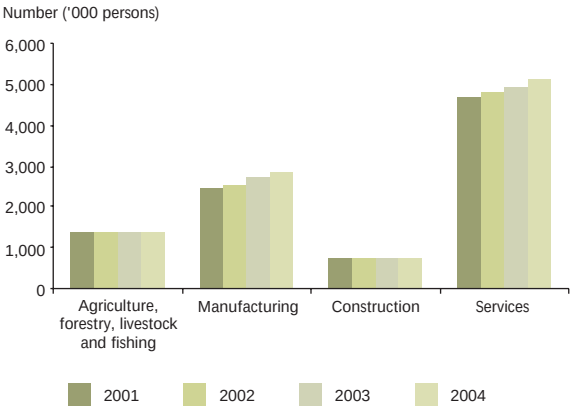
Source: Economic Planning Unit
Department of Statistics, Malaysia

The low turnover in the labour market is also reflected in data on vacancies and retrenchment, while placements and the lower number of unplaced job seekers mirrored the efficiency in the job matching process. Vacancies reported, which were mainly in the services, manufacturing, construction and agriculture sectors, declined to 49,975 positions (2003: 96,918 positions).

Labour market conditions improved, supported by significantly higher growth in labour productivity.

This could be partly attributed to the more open policy on foreign labour. However, vacancies reported for clerical, managerial and professional positions indicated a significant increase (25,495 positions; 2003: 12,611 positions). Retrenchments, which were mainly in the manufacturing and transport-related sectors, dropped by 6% (19,956 persons; 2003: 21,206 persons). The main reasons for retrenchment included reduction in demand for products, company reorganization, high costs of production, completion of projects and outsourcing. Placements in relation to vacancies remained strong (12%; 2003: 17%) while the number of registered unplaced jobseekers stood at 27,227 persons as at end-2004, the lowest in four years, indicating improving matching of workers to jobs available.

Graph 1.31
Total Employment by Sector



Source: Economic Planing Unit

The strong economic growth environment did not exert undue pressure on **wages** in 2004. Available indicators showed that the rate of increase in wages was slightly lower in 2004:

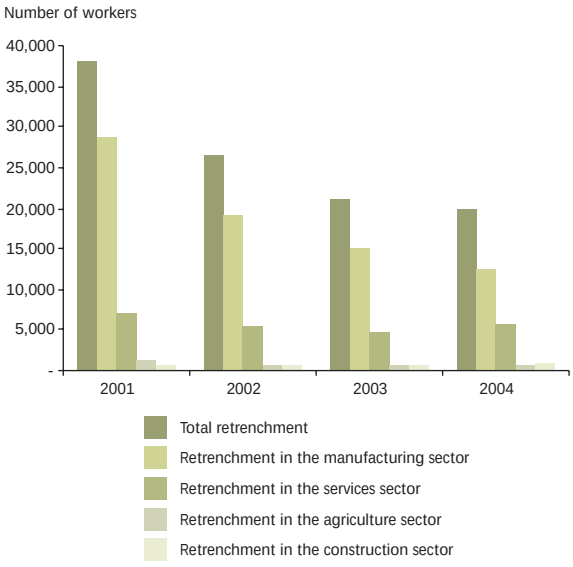
- Data from the Monthly Manufacturing Survey conducted by the Department of Statistics, Malaysia indicated that for 2004, real wage per employee increased by 1.8% (2003: 2.8%).

- The Salary and Fringe Benefits Survey undertaken by the MEF showed that the increase in the average private sector salary was slightly lower at 5.6% in 2004 (2003: 5.8%). On a sectoral basis, the average salary increase in the non-manufacturing sector was higher (6.1%; 2003: 6.1%) than in the manufacturing sector (5%; 2003: 5.5%). The average minimum monthly salary offered to those with a basic degree was unchanged at RM1,666 (2003: RM1,669).

- The Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the FMM showed that the increase in overall average salary paid to employees was also moderate at 5.6% in 2004 (2003: 5.5%). The average basic salary offered to a fresh graduate was lower at RM1,799 (2003: RM1,861).

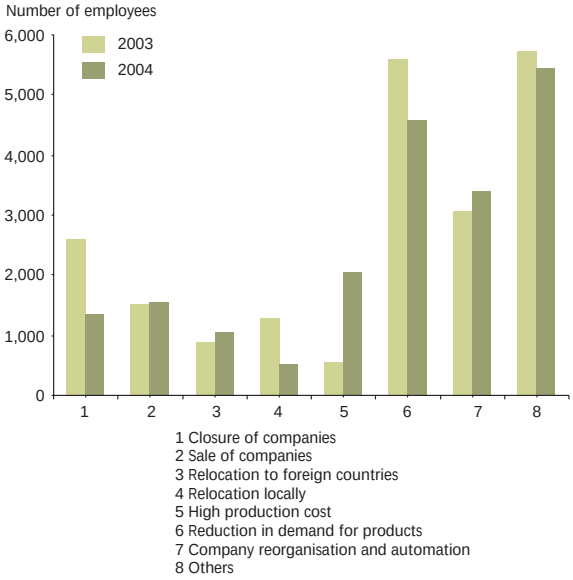
Labour productivity, as measured by the ratio of GDP to total employment, improved significantly, with growth increasing to 3.4% in 2004 (2003: 1.9%). Productivity growth was reflected across most major sectors of the economy. Productivity growth in the manufacturing sector improved significantly to 3.2% (2003: 1.1%) due to increased use of capital and improvements in business processes. Productivity growth in the agriculture and services sectors remained high at 5% and 2.7% respectively. High productivity in the agriculture sector reflected largely higher yields due to good weather

Graph 1.32
Retrenchment in Selected Sectors



Source: Ministry of Human Resources

Graph 1.33
Reasons for Retrenchment



Source: Ministry of Human Resources

conditions, Good Agriculture Practices, mechanisation and automation. The wholesale and retail trade, restaurants and hotels sub-sector also recorded an impressive gain, with productivity growth of 2.3% (2003: 0%) due to higher capital investment.

The Government continues to allow the recruitment of **foreign workers** to alleviate labour and skills shortages and tap synergies that enhance productivity and competitiveness. Currently, there are 34,358 foreign professionals and highly skilled workers employed in the country, mostly in the manufacturing and services sectors. For the semi-skilled and unskilled foreign labour, the number recruited in 2004 declined, despite the strong growth in the economy. This was partly attributed to the subdued performance of the construction sector, where there is a large presence of foreign workers. In addition, employers have increased capital intensity in their businesses, thereby reducing the dependence on foreign labour. The 507,732 foreign nationals recruited during the year (2003: 516,257 foreign nationals) were mostly from Indonesia, Nepal, India, Myanmar and Vietnam and for employment mainly in the manufacturing, agriculture and domestic services sectors.

As at end-2004, the number of foreign workers in the country increased by 18.6% to 1,470,090 (2003: 17.2% to 1,239,406), constituting 14.4% of total employment. They are mostly engaged in the manufacturing sector, followed by the agriculture, services (including domestic services), and construction sectors. About 69.7% are Indonesian nationals, while those from Nepal and India constitute the second and third largest group or 10.2% and 5.4% respectively.

During the year, certain regulations regarding the recruitment of foreign semi-skilled and unskilled workers were amended, mainly to reduce further the dependence on such workers, particularly in the services sector. In addition, with effect from August 2004, foreign workers are only allowed to work in the country for a maximum period of eight years, from ten years previously.

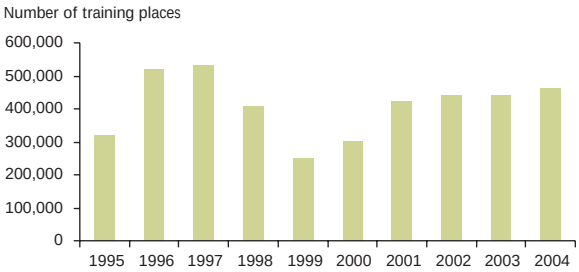
Meanwhile, developmental efforts to enhance the capabilities of the labour force have continued. As at end-2004, a total of 9,213 participants have benefited from the Graduate Training Scheme II. Launched in August 2003, the Scheme helps graduates who are unable to gain employment to acquire additional skills and increase their employability. As funds under the earlier special scheme implemented in 2001 for **unemployed graduates** and retrenched workers were still available, the schemes were continued into 2004. As at end-2004, a total of 40,460 persons have participated in the various attachments and training schemes for unemployed graduates, also known as Graduate Training Scheme I, while another 12,783 participants have benefited from the scheme for retrenched workers and unemployed. To augment the Government's efforts, the various financial institutions associations introduced the Banking Industry Training

Scheme and equivalent insurance training and development programmes for unemployed graduates in early 2004. A total of 148 unemployed graduates, were sponsored by 55 financial institutions to undergo structured training programmes, which were designed and implemented in collaboration with the Institute of Bankers Malaysia (IBBM) and the Malaysian Insurance Institute. The schemes were aimed at improving participants' communication skills, with a focus on English, as well as providing relevant exposure to the graduates in the fields of banking, finance and insurance. Ten other employers have also offered training attachments to unemployed graduates under the double taxation incentive in the 2004 Budget in support of Government efforts to improve the employability of graduates.

The **Human Resource Development Fund (HRDF)** continued to be important in encouraging employers to enroll their staff in initiatives aimed at expanding employees' expertise, knowledge, resourcefulness and ability to adapt to the more liberalised and competitive business landscape. Established in 1993, the HRDF is managed by the corporatised entity known as Pembangunan Sumber Manusia Berhad (PSMB). In 2004, PSMB approved a total of 460,651 training places with financial assistance of more than RM200 million, bringing the total for the period 1993-2004, to 4.4 million training places costing a total of RM1.6 billion. To keep abreast with changes in the business environment, new programmes and training were included under the HRDF during the year. These included strategic management, product branding, English proficiency, adult literacy, particularly for workers in SMEs and an industrial technician apprentice scheme.

The **Skills Development Fund (SDF)** is another initiative for developing and upgrading skills of the workforce. Its aim is to enhance the participation of the private sector as training providers and increase accessibility to technical education and vocational training (TEVT) by providing financial assistance to candidates. School leavers, retrenched workers as well as employees undertaking training in approved public and private training institutes are eligible. After four years in operation, the SDF is being restructured. Legislation for the establishment of a corporatised entity to manage the SDF has been passed and plans are underway to vary the amount of financial assistance such that greater priority in training is accorded to the more crucial skills. In 2004, the SDF provided financial assistance to about 34,000 applicants (2003: 46,421 applicants).

Graph 1.34
HRDF: Number of Training Places Approved



Source: Pembangunan Sumber Manusia Berhad

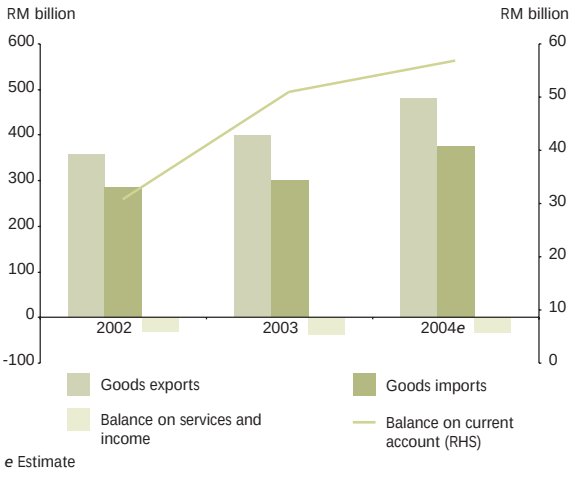
EXTERNAL SECTOR

Balance of Payments

The **overall balance of payments** strengthened in 2004, reflecting the more buoyant external demand underpinned by the stronger global growth and improved foreign investor sentiment on Malaysia. The sustained large current account surplus supplemented by higher foreign direct investment (FDI) and inflows of portfolio capital resulted in a substantial increase in

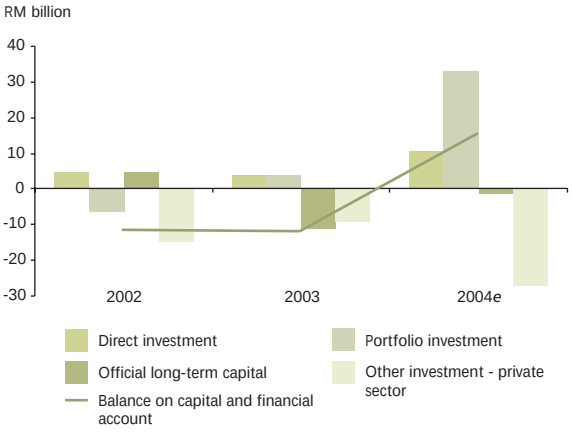
The external position strengthened significantly in 2004, supported by a sustained large current account surplus and higher inflows of foreign direct investment and portfolio investment. External debt remained within prudential limits.

Graph 1.35a
Current Account



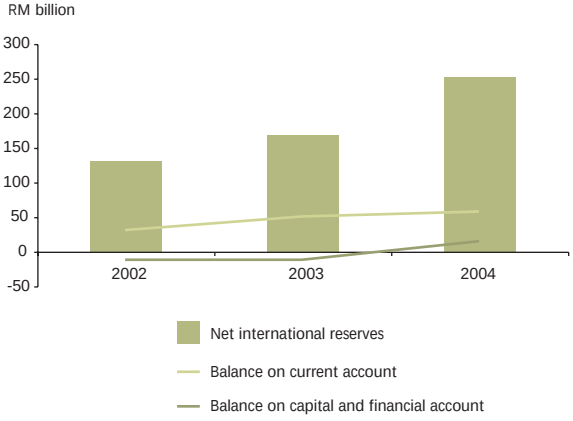
e Estimate

Graph 1.35b
Capital and Financial Account



e Estimate

Graph 1.35c
Net International Reserves



international reserves of Bank Negara Malaysia. Errors and omissions, including exchange gains from the revaluation of international reserves due to the appreciation of major currencies against the US dollar, was RM11.1 billion. After adjusting for the errors and omissions, the overall balance of payments recorded a larger surplus of RM83.1 billion or US$21.9 billion. Consequently, the net international reserves of Bank Negara Malaysia increased to a record level of RM253.5 billion or US$66.7 billion as at end-2004. The reserves increased further to RM272.9 billion (US$71.8 billion) as at 28 February 2005. This level of reserves represented 8.6 months of retained imports and 6.1 times coverage of short-term external debt. Malaysia's reserves remained usable and unencumbered.

Table 1.16
Balance of Payments

Item	2003			2004*e*		
	+	-	Net	+	-	Net
	RM million					
Goods	398,998	301,297	97,701	481,240	376,766	104,474
Trade account	*397,884*	*316,538*	*81,347*	*480,722*	*399,648*	*81,073*
Services	51,595	66,621	-15,026	63,716	72,497	-8,780
Balance on goods and services	**450,594**	**367,918**	**82,675**	**544,957**	**449,263**	**95,694**
Income	13,103	35,630	-22,527	15,307	39,787	-24,480
Current transfers	1,929	11,229	-9,300	1,700	16,333	-14,633
Balance on current account	**465,626**	**414,777**	**50,848**	**561,964**	**505,384**	**56,580**
% of GNP			**13.7**			**13.4**
Capital account			–			–
Financial account			-12,146			15,386
Direct investment			4,194			10,823
Portfolio investment			4,168			33,112
Other investment			-20,508			-28,550
Balance on capital and financial account			**-12,146**			**15,386**
Errors and omissions			358			11,095
of which:						
Exchange revaluation gain (+) or loss (-)			*11,927*			*7,997*
Overall balance			**39,059**			**83,061**
Bank Negara Malaysia international reserves, net			**170,452**			**253,513**
(US$ million)			**44,856**			**66,714**

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Current Account

The **current account** recorded a larger surplus of RM56.6 billion or 13.4% of GNP, reflecting sustained large trade surplus and a significant improvement in the services account deficit. The strong export growth was underpinned by the upswing in global demand for electronics and expansion in most commodity exports. The substantial decline in the services account deficit reflected the significant improvement in the travel receipts following higher tourist arrivals. The income account deficit increased due to higher profits and dividends accruing to foreign direct investors. The current transfers account recorded a higher outflow attributable to the one-off remittance by illegal foreign workers under the Amnesty Programme.

Amidst stronger global growth, **gross exports** expanded significantly by 20.8% in 2004 (2003: 11.3%). Growth was supported by marked expansion in exports of manufactured goods and minerals. Growth in agriculture exports moderated during the year. Higher export receipts during the year reflected both increases in volume (16.1%) and unit value (3.6%). The increase in unit value was due to higher prices for most commodities and resource-based industries.

The large trade surplus was attributed to stronger growth in manufactured exports and sustained high growth in commodity earnings. The strong expansion in imports was reflective of growth in production and exports of manufactured goods as well as strong domestic consumer and investment spending.

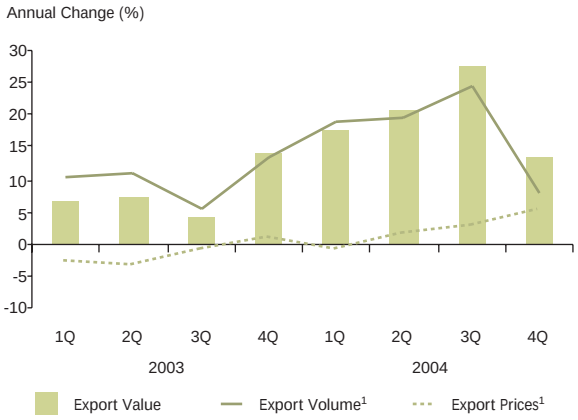
Table 1.17
Gross Exports

	2004*p*		
	RM million	Annual change (%)	% share
Manufactured goods	**390,449**	**19.7**	**81.2**
of which:			
Electronics, electrical machinery and appliances	257,051	15.3	53.5
Electronics	188,605	12.7	39.2
Semiconductor	*89,298*	*4.9*	*18.6*
Electronic equipment & parts	*99,307*	*20.8*	*20.7*
Electrical machinery & appliances	68,446	23.4	14.2
Consumer electrical products	*22,170*	*12.5*	*4.6*
Industrial & commercial electrical products	*25,769*	*27.0*	*5.4*
Electrical industrial machinery and equipment	*17,783*	*30.8*	*3.7*
Household electrical appliances	*2,724*	*45.3*	*0.6*
Chemicals & chemical products	27,767	31.0	5.8
Manufactures of metal	16,140	43.6	3.4
Optical and scientific equipment	11,568	26.3	2.4
Textiles, clothing and footwear	10,328	17.9	2.1
Wood products	8,677	29.5	1.8
Food	7,776	22.7	2.0
Rubber products	6,036	19.3	1.3
Transport equipment	5,324	65.0	1.1
Agricultural commodities	**36,176**	**7.4**	**7.5**
of which:			
Palm oil	20,107	-0.4	4.2
Rubber	5,198	45.1	1.1
Sawn timber	3,214	1.7	0.7
Saw logs	2,070	2.5	0.4
Minerals	**41,177**	**38.2**	**8.6**
of which:			
Crude oil	21,318	36.1	4.4
LNG	17,079	27.9	3.6
Tin	947	231.5	0.2
Other exports	**12,920**	**60.1**	**2.7**
Total	**480,722**	**20.8**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

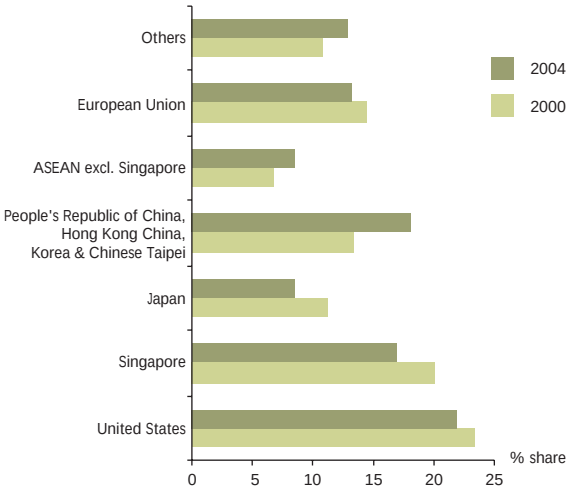
Graph 1.36
Export Performance of the Manufacturing Sector



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

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Graph 1.38
Exports of Manufactured Goods by Destination

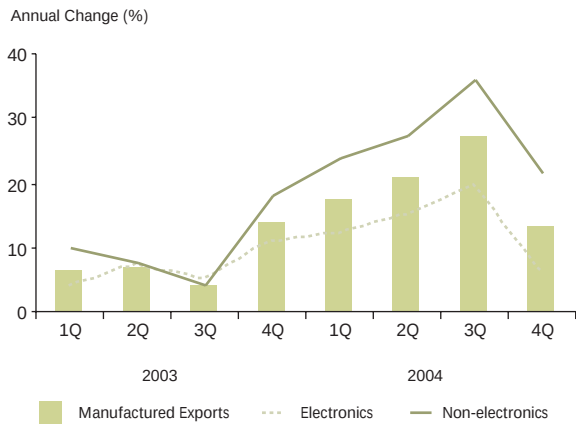


Source: Department of Statistics, Malaysia

Exports of **manufactured goods** recorded a strong growth of 19.7% in 2004 (2003: 8%), contributed by both higher volume (18.3%) and unit value (1.2%). Of significance, exports of electronics and electrical products expanded strongly, particularly in the first half-year benefiting largely from the global semiconductor up-cycle. Resource-based products such as petroleum, chemical, wood and rubber products also benefited from higher prices and volume. The rapid expansion in construction activity in PR China supported the strong demand for metal products from Malaysia. Exports of rubber products, especially for gloves remained strong during the year due to the demand stimulated by the outbreak of the Avian flu in the regional countries. In the transport equipment sub-segment, increased investments in global oil and gas exploration led to the strong demand for floating and submersible drilling platforms for exploration activity. Meanwhile, growth in exports of wood products was supported by sustained demand from Japan and US.

Primary commodities continued to contribute significantly to gross exports during the year, with its share rising to 16.1% (2002: 13.6%). Commodity exports grew by 21.8%, reflecting mainly stronger growth in petroleum exports, while growth in agriculture exports was moderate.

Graph 1.37
Export Performance of Electronics and Non-electronics Industries



Source: Department of Statistics, Malaysia

Table 1.18
External Trade

	2003	2004*p*	2003	2004*p*
	RM billion		US$ billion	
Gross exports (f.o.b)	**397.9**	**480.7**	**104.7**	**126.5**
Annual change (%)	11.3	20.8	11.3	20.8
	Annual change (%)			
Volume[1]	5.9	16.1	5.9	16.1
Prices[1]	1.1	3.6	1.1	3.6
Gross imports (c.i.f)	**316.5**	**399.6**	**83.3**	**105.2**
Annual change (%)	4.4	26.3	4.4	26.3
	Annual change (%)			
Volume[1]	-1.0	23.0	-1.0	23.0
Prices[1]	2.2	3.1	2.2	3.1
Trade balance	**81.3**	**81.1**	**21.4**	**21.3**

[1] Volume and prices for 2004 are estimates.

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Mineral exports recorded another year of strong expansion, increasing by 38.2% to RM41.2 billion. Export revenue from crude oil rose by 36.1% to RM21.3 billion, on the back of significantly higher price which rose by 34.8% to average US$40.81 per barrel for 2004. Exports of LNG also rose strongly by 27.9% to RM17.1 billion, on account of higher volume (19.7%) following the increased offtake by traditional LNG buyers, as well as higher price (6.8%).

Export receipts from **agriculture** totalled RM36.2 billion in 2004, of which palm oil accounted for the largest share of 56% or RM20.1 billion. Despite the higher export price of palm oil, earnings from palm oil fell marginally by 0.4% during the year due to lower export volume (-5.6%). Demand was affected by significant reductions in imports by India (-44%) and Pakistan (-24.2%) as a result of higher production of their domestic oilseeds. Nevertheless, purchases by the other major buyers of Malaysian palm oil, namely PR China and the EU, with a combined share of almost 40% of total palm oil exports, increased by 13% and 12.6% respectively. Rubber exports performed strongly for the second consecutive year, registering a growth of 45.1% (2003: 43.8%) due to both higher prices (24.3%) and volume (16.7%), as imports by PR China and the EU recorded significant increases (39.2% and 15.6% respectively).

Growth in **gross imports** of 26.3% reflected higher production and exports of manufactured goods, as well as stronger domestic consumer and investment spending. Both imports of intermediate and capital goods were higher. Intermediate imports were mainly to support higher manufacturing production, while the surge in imports of capital goods reflected higher investment activity in the services and

Table 1.19
Gross Imports by End Use

	2004*p*		
	RM million	Annual change (%)	% share
Capital goods	**55,545**	**36.1**	**13.9**
Capital goods (except transport equipment)	49,094	28.4	12.3
Industrial machinery and equipment	*13,219*	*36.2*	*3.3*
Office equipment	*9,139*	*78.0*	*2.3*
Telecommunication equipment	*6,957*	*37.8*	*1.7*
Transport equipment	6,451	151.0	1.6
Intermediate goods	**287,223**	**22.0**	**71.9**
Food and beverages, mainly for industry	8,842	52.9	2.2
Industrial supplies, n.e.s.	91,138	38.9	22.8
Metals & metal products	*27,568*	*50.1*	*6.9*
Chemicals	*10,648*	*44.1*	*2.7*
Fuels and lubricants	19,322	41.8	4.8
Parts and accessories of capital goods (except transport equipment)	158,848	10.5	39.7
Electronics	*102,949*	*8.0*	*25.8*
Parts and accessories of telecommunication equipment	*7,434*	*8.2*	*1.9*
Parts and accessories of transport equipment	9,073	35.0	2.3
Consumption goods	**23,234**	**24.1**	**5.8**
Food and beverages, mainly for household consumption	8,926	31.3	2.2
Transport equipment, non-industrial	334	-6.7	0.1
Consumer goods, n.e.s.	13,974	20.8	3.5
Consumer durables	*3,119*	*20.8*	*0.8*
Consumer semi-durables	*4,671*	*18.2*	*1.2*
Consumer non-durables	*6,184*	*22.9*	*1.5*
Dual use goods	**9,310**	**39.8**	**2.3**
Motor spirit	4,743	59.1	1.2
Passenger motor cars	4,567	24.1	1.1
Others	**7,110**	**10.8**	**1.8**
Re-exports	**17,226**	**102.9**	**4.3**
Gross Imports	**399,648**	**26.3**	**100.0**

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

Source: Department of Statistics, Malaysia

manufacturing sectors. Higher disposable income and improved consumer confidence led to the growth in imports of consumption goods.

Imports of **intermediate goods** expanded strongly by 22%. Components, such as parts and accessories for the electronics industry, expanded strongly with a rising trend towards substitution from lower cost suppliers, in particular increased sourcing from Thailand, Indonesia and PR China. In line with higher demand in regional countries for metal and resource-based products, significant increases were recorded in industrial supplies, namely, construction materials, metals, and chemicals. Intermediate imports related to the manufacture of goods for the domestic market also registered growth. Growth of the motor assembly industry, stemming from the robust demand for passenger cars, lifted imports of parts and accessories. In line with sustained consumer spending on food and beverages, imports of primary and processed materials used by the food and beverages industry recorded strong growth.

Imports of **capital goods** increased significantly by 36.1% following the strong pick up in investment. The impetus came from capacity expansion and upgrading of technology in the manufacturing, services, shipping and airline sectors. Investment in machinery and equipment in the manufacturing sector, particularly in new growth areas such as chemicals, metal fabrication and higher-end electrical and electronics, strengthened. The extension of network infrastructure and the introduction of new products and technologies by telecommunication companies also caused imports of telecommunication equipment to record strong growth. Imports of office equipment remained strong as corporations in the services industry improved their service delivery by upgrading infrastructure in information technology. Capacity expansion in the power generation sector led to strong growth of imports of generators, turbines and electric motors. Strong external demand for commodity exports and fleet expansion to service new markets also induced the deliveries of ships and aircraft.

Consonant with higher private consumption, imports of **consumption goods** increased by 24.1%. Import growth was strong for food and beverages, electrical goods, furniture, clothing and footwear, household furnishings, and medicine. Nevertheless, the share of consumption goods imports to total imports remained low, accounting for only 5.8% of total imports.

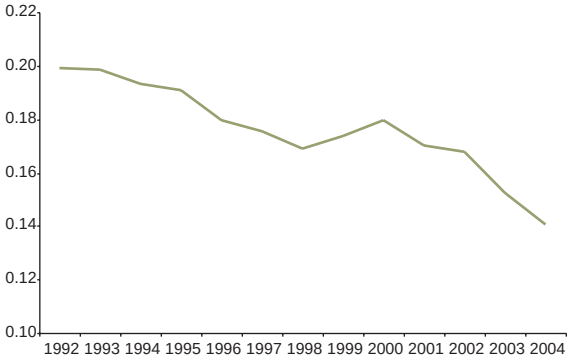
A notable development was the significant growth of 102.9% in imports for **re-exports**, arising from packing and assembling activities in the free commercial zones. These imports, mainly electrical and electronic products, telecommunication equipment and iron and steel products, were largely re-exported to Singapore, Thailand and Hong Kong China.

Malaysia's trade with other countries in East Asia (excluding Japan) has grown over the years and the region now accounts for 45.4% of Malaysia's total trade (1995: 35.9%). Efforts taken to diversify trade with non-traditional markets, such as West Asia, Eastern Europe and South Asia, have made progress. The diversification index, as measured by the normalized Herfindahl-Hirschmann index, improved in 2004. The index for both exports and imports declined from 0.15 in 2003 to 0.14 in 2004, implying increasing diversification.

The **US** remained as Malaysia's largest trading partner with a share of 16.8% (2003: 17.7%) and contributed to a larger trade surplus of RM32.4 billion. The surplus was attributed to higher exports of electrical and electronic products, in particular, integrated circuits, parts for data processing machines and computer components, rubber, optical and scientific instruments, furniture and petroleum products. The US was the second largest source of imports for Malaysia, with imports comprising mainly intermediate inputs, such as semiconductors and office machine parts used in the electrical and electronic industry, optic and medical instruments and aircraft.

Despite the decline in the share of trade to 13.2% (2003: 13.9%), **Singapore** maintained its position as

Graph 1.39
Exports Diversification Index



The exports diversification index is a modified version of Herfindahl-Hirschmann index. It is normalised to obtain a numeric range from 0 to 1. A lower index value signifies a higher degree of diversification.

Table 1.20
Direction of External Trade

	2004*p*				
	Exports		Imports		Trade balance
	RM million	% share	RM million	% share	RM million
ASEAN countries	**120,601**	**25.1**	**95,729**	**24.0**	**24,872**
Singapore	72,176	15.0	44,437	11.1	27,740
Thailand	22,954	4.8	21,992	5.5	962
Indonesia	11,677	2.4	15,936	4.0	-4,259
Philippines	7,362	1.5	10,667	2.7	-3,305
Other ASEAN countries	6,431	1.3	2,697	0.7	3,735
Selected North East Asia countries	**93,430**	**19.4**	**91,603**	**22.9**	**1,828**
The People's Republic of China	32,143	6.7	39,279	9.8	-7,135
Hong Kong China	28,686	6.0	10,850	2.7	17,835
Chinese Taipei	15,763	3.3	21,630	5.4	-5,867
Korea	16,839	3.5	19,843	5.0	-3,005
European Union (EU) [1]	**60,374**	**12.6**	**47,930**	**12.0**	**12,444**
United Kingdom	10,556	2.2	6,640	1.7	3,916
Germany	10,485	2.2	17,798	4.5	-7,313
Netherlands	15,752	3.3	3,434	0.9	12,318
Other EU countries	23,581	4.9	20,058	5.0	3,523
United States	90,181	18.8	57,752	14.5	32,429
Japan	48,552	10.1	63,693	15.9	-15,141
India	11,410	2.4	4,897	1.2	6,513
Australia	15,783	3.3	6,793	1.7	8,990
Rest of the world	40,389	8.4	31,252	7.8	9,137
Total	**480,722**	**100.0**	**399,648**	**100.0**	**81,073**

Note: Numbers may not necessarily add up due to rounding.
[1] Includes the 10 new member states.
p Preliminary

Source: Department of Statistics, Malaysia

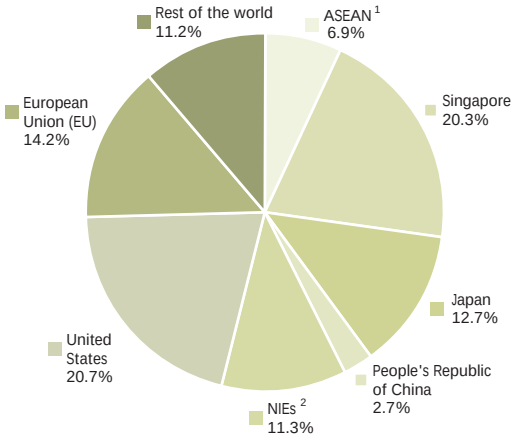
the second largest trading partner of Malaysia. Exports of electrical and electronic products remained the largest export earner with receipts of RM40.9 billion or 56.6% of total exports to Singapore. Other exports that recorded strong growth included refined petroleum products, manufactures of metal, chemicals and transport equipment, particularly floating and submersible drilling platforms for oil and gas exploration activity. On the imports side, Singapore was the third largest source of imports for Malaysia. Imports from Singapore were mainly office machine parts, computers and components, chemicals and optical and scientific equipment.

Japan remained as the third most important trading partner of Malaysia although its share to total trade declined to 12.7%. Export growth of 14.2% was underpinned by exports of electrical machinery, wood products, chemicals, optical and scientific, metal and plastic products. Despite the appreciation of the yen, imports grew by 17.9%, reflecting inelastic demand for machinery, electrical machinery and transport equipment. Consequently, the trade deficit widened to RM15.1 billion (2003: -RM11.5 billion).

Reflecting the improvement in economic performance, total trade with the enlarged **EU** grew by 23.6% to account for a share of 12.3% of Malaysia's total trade. The impetus to the growth came from strong growth in trade with the Netherlands, Spain, Italy, Hungary and Sweden. The trade surplus of RM12.4 billion (2003: RM12.2 billion) recorded with the group arose mainly from trade surplus with Netherlands (RM12.3 billion) and the UK (RM3.9 billion), while trade with Germany and Sweden recorded deficits of RM7.3 billion and RM2.2 billion respectively.

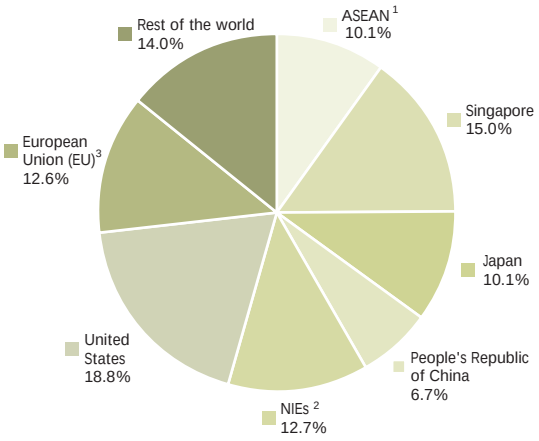
Strong economic growth supported the expansion of intra-regional trade with the East Asia and ASEAN countries. Supporting this growth is the growing extensive production network and the linkages in the region arising from relocation of companies into PR China and ASEAN countries as well as increased outsourcing activity. Trade with the **North East Asia** region (excluding Japan) expanded by 26.3% as increased sourcing of cheaper inputs caused import growth from these countries to outpace export growth. Trade with

Graph 1.40
Direction of Exports (% share): 1995



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

Direction of Exports (% share): 2004



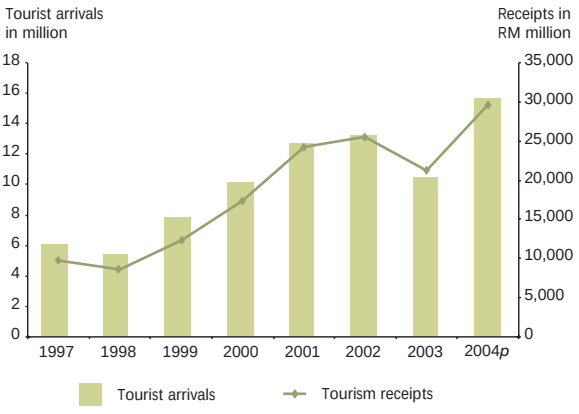
[1] ASEAN excluding Singapore
[2] Hong Kong China, Korea and Chinese Taipei
[3] Includes the 10 new member states

PR China grew by 33.7% and exports consisted mainly of integrated circuits, office machine parts, chemicals and palm oil. Nevertheless, the higher import growth from PR China caused the trade deficit to widen to RM7.1 billion (2003: -RM1.8 billion). Malaysia is PR China's eighth largest trading partner and its largest trading partner in ASEAN. Exports to Korea increased by 45.7% underpinned by demand for resource-based products namely chemicals, petroleum products, rubber products and LNG. The trade pattern was similar for the **ASEAN** (excluding Singapore) countries, with trade expanding by 31.9%. As importers continued to source inputs from low cost suppliers, Malaysia continued to experience trade deficits with Indonesia and Philippines, while the trade surplus with Thailand narrowed. Exports to the ASEAN countries were supported mainly by exports of electrical and electronics and resource-based products. The strong import growth from Thailand and Indonesia were driven by electronic products, chemicals, manufactures of metal and iron and steel products.

In 2004, the **services account** deficit narrowed to RM8.8 billion or -2.1% of GNP (2003: -RM15 billion or -4% of GNP). Policies to promote the export of services and investment in infrastructure in the services industry have enabled new sources of foreign exchange earnings, particularly from tourism and other services, mainly computer and information services, and thereby contributing to significant improvement in the services account deficit.

Travel continued to be the largest contributor to services receipts, accounting for 48.9% of gross services receipts in 2004. Receipts in the **travel account** increased by 38.9% to RM31.2 billion. The strong performance of the travel account reflected the marked increase in the number of tourist arrivals to 15.7 million visitors (2003: 10.6 million). Strong economic performance of regional countries and greater connectivity in air services through an increase in the number of flights, including charter flights and promotional fares provided by low cost carriers, led to a higher number of visitors. Singapore, Thailand, Indonesia and PR China were the main sources of visitors, accounting for 78.8% of total arrivals. Aggressive marketing campaigns targeted, in particular, at summer vacation travel by West Asians induced a

Graph 1.41
Tourist Arrivals and Tourism Receipts



p Preliminary
Source: Malaysia Tourism Promotion Board

Table 1.21
Services and Income Accounts

	2003	2004*e*		
	RM billion			
	Net	+	–	Net
Services Account				
Transportation	-13.3	12.0	29.8	-17.8
Travel	11.6	31.2	11.8	19.4
Other services	-13.0	20.1	29.8	-9.7
Government services n.i.e.	-0.3	0.4	1.1	-0.7
RM billion	**-15.0**	**63.7**	**72.5**	**-8.8**
US$ billion	**-4.0**	**16.8**	**19.1**	**-2.3**
% of GNP	-4.0			-2.1
Income Account				
Compensation of employees	-1.0	2.6	3.8	-1.1
Investment income	-21.6	12.7	36.0	-23.3
RM billion	**-22.5**	**15.3**	**39.8**	**-24.5**
US$ billion	**-5.9**	**4.0**	**10.5**	**-6.4**
% of GNP	-6.1			-5.8

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

travel receipts. Education receipts from foreign students at all levels of education (comprising tertiary, secondary and primary education) increased by 40.5%. Students from PR China accounted for about 40% of the students at private tertiary institutions while the rest were mainly from neighbouring countries, particularly Indonesia and India. Meanwhile, earnings from healthcare services improved further due mainly to the increase in number of foreign patients to 174,289 patients in 2004 (2003: 102,946 patients). The bulk of foreign patients were from the ASEAN countries, accounting for 81.8% of total foreign patients.

On the payments front, higher incomes, increased business activities overseas and improved economic prospects led to higher expenditure on foreign travel which rose by 8.7% to RM11.8 billion. Payments for travel to border towns rose sharply by 108.6% to RM2.4 billion. Education outflows increased by 16.7% due mainly to higher expenditure on tuition

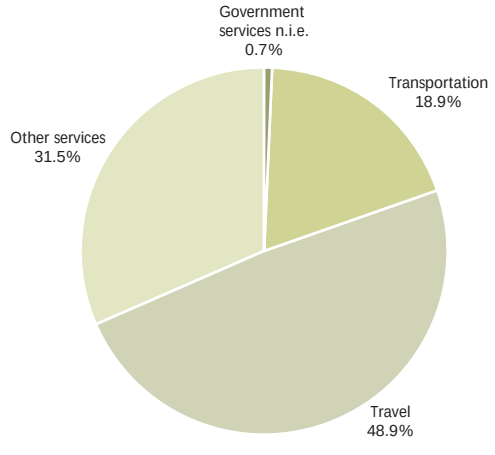
Higher tourism receipts and improvement in earnings from computer and information services contributed to a lower services deficit. Profits and dividends accrued to Malaysian companies abroad also continued to increase.

57.1% increase in number of West Asian tourists. Tourists from emerging markets of Asia such as Korea and Chinese Taipei increased sharply by 97.4% and 38.3% respectively.

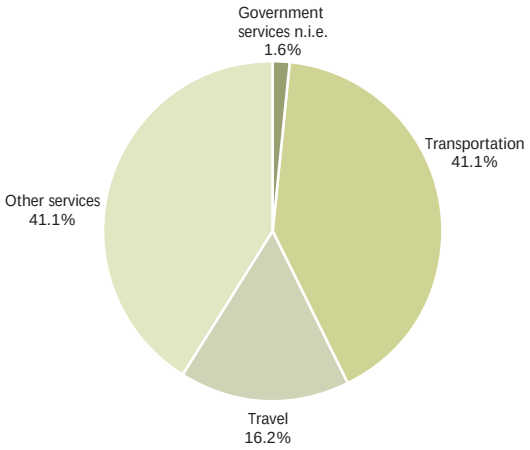
Higher foreign exchange earnings from education and healthcare services also contributed to higher fees and living expenses arising mainly from the appreciation of Australian dollar, pound sterling and Singapore dollar against ringgit.

Another contributory factor to the lower services account deficit was the lower net outflow of RM9.7 billion in the **other services account** stemming mainly

Graph 1.42
2004: Components of Gross Receipts in the Services Account (% share)



Graph 1.43
2004: Components of Gross Payments in the Services Account (% share)



from higher receipts for computer and information services. The setting up of regional hubs for development of ICT products, provision of regional group network support services as well as business process outsourcing and shared services underpinned the growth in exports of computer and information services. On the other hand, payments of royalties and licence fees were larger reflecting usage of intellectual property in areas related to multimedia, communication and retail business. The bulk of these royalties and licence fees payments were made to the US and Japan. Higher payments were also incurred for the import of construction services for power and oil and gas exploration projects. Payments to foreign service providers in areas related to communication and multimedia services also increased in response to strong demand.

The strong expansion in external trade together with higher freight charges by international shipping lines due to tight capacity resulted in the **transportation account** recording a significantly larger net outflow of RM17.8 billion (2003: -RM13.3 billion). The higher gross payments were offset partly by improved earnings from cargo and passenger services provided by major domestic shipping companies and airlines. Capacity expansion by shipping companies and airlines as well as an increase in transhipment cargo contributed to higher earnings.

services sector. For the second consecutive year, income from other investment recorded a net inflow of RM2.6 billion reflecting returns from larger external reserves while the interest payments on external debt continued to decline.

The net outflow in the **current transfers account** increased significantly to RM14.6 billion (2003: -RM9.3 billion). The increase in current transfers payments to RM16.3 billion reflected mainly the one-time lump sum repatriation made by 309,248 illegal workers returning to their home countries under the Amnesty Programme from October 2004 to end of December 2004. Regular remittances by a larger number of registered foreign workers employed, mainly in the manufacturing and agriculture sectors, also contributed towards the larger net outflow.

Financial Account

The **financial account** turned around in 2004, recording a net inflow of RM15.4 billion (2003: -RM12.1 billion). The significant shift was attributed mainly to higher inflows of foreign direct investment and portfolio funds following stronger economic growth and improved corporate earnings. Other investment recorded a larger outflow due to both net repayment of external loans by the official sector for the second consecutive year and higher outflows of other private sector investment.

The financial account turned around to record a net inflow in 2004, attributed mainly to higher inflows of FDI and portfolio funds following stronger economic growth and improved corporate earnings.

The **income account** deficit increased to RM24.5 billion or -5.8% of GNP in 2004, attributable mainly to higher profits and dividends accruing to foreign direct investors. The higher income accruing to foreign direct investors was due mainly to the improved export performance of the electrical and electronics industries as well as the oil and gas sector on the back of the surge in oil prices. Nevertheless, the actual outflows were considerably lower as a large portion of the profits was retained in the country for reinvestment. Meanwhile, income accruing to portfolio investors recorded a larger outflow in line with higher dividend payouts by the Malaysian companies.

Profits and dividends accruing to Malaysian companies from their investment abroad increased further to RM3.6 billion (2003: RM2 billion). These receipts were mainly from the oil and gas sector as well as the

On a gross basis, **foreign direct investment** (FDI) in Malaysia increased to RM24.8 billion (2003: RM19.9 billion) or 5.9% of GNP reflecting broad-based flows to all the major sectors, namely services, manufacturing and oil and gas sectors. The bulk of the FDI continued to be in the form of retained earnings. Nevertheless, inflows of new equity were higher. After taking into account liquidation and loan repayments to parent companies abroad, net FDI increased to RM17.9 billion (2003: RM9.4 billion).

The services sector continued to be a major recipient of new FDI flows particularly in the new growth areas such as the business support and shared services, in line with the Government policies geared towards liberalisation and deregulation. Significant inflows were recorded in the financing, insurance, real estate and business services sub-sector as well as wholesale

Table 1.22
Balance of Payments: Financial Account

	2003	2004*e*	2003	2004*e*
	RM billion		US$ billion	
Financial Account	**-12.1**	**15.4**	**-3.2**	**4.0**
Direct Investment	**4.2**	**10.8**	**1.1**	**2.8**
In Malaysia	9.4	17.9	2.5	4.7
Abroad	-5.2	-7.1	-1.4	-1.9
Portfolio Investment	**4.2**	**33.1**	**1.1**	**8.7**
Other Investment	**-20.5**	**-28.6**	**-5.4**	**-7.5**
Official sector	-11.2	-1.1	-2.9	-0.3
of which:				
Federal Government (net)	-3.7	0.1	-1.0	...
Gross borrowing	3.1	1.1	0.8	0.3
Repayment	-6.9	-1.0	-1.8	-0.3
NFPEs (net)	-7.3	-1.3	-1.9	-0.3
Gross borrowing	5.1	11.4	1.4	3.0
Repayment	-12.4	-12.7	-3.3	-3.3
Private sector	-9.3	-27.4	-2.4	-7.2

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

and retail trade, hotels and restaurants sub-sector. In the financing, insurance, real estate and business services sub-sector, there were new investments in the banking sector upon the approval of Islamic banking licences to three foreign banks. In view of favourable fiscal incentives and good infrastructure, the sub-sector also witnessed the emergence of the shared services and outsourcing activities that accelerated the development of value-add chain to support the MNCs' operations in Malaysia and the Asian region. During the year, several MNCs established or expanded their regional or global operation centres for shared services and outsourcing activities in Malaysia. Meanwhile, the information technology-related back room and call centre operations of some foreign banks continued to expand, establishing linkages across different segments of the services sector. The competitive advantage of Malaysia in shared services activities is reflected in the A.T. Kearney 2004 Offshore Location Attractiveness Index which ranked Malaysia as the third most attractive investment destination for Shared Services & Outsourcing (SSO). Confirming this is the increase in the number of international and regional facilities in Malaysia during the year. In 2004, there was an increase of 6% in the international and regional facilities approved in Malaysia, totalling 233, of which 16 were operational headquarters (OHQs), 193 regional and representative offices, 21 international procurement centres (IPCs) and three regional distribution centres (RDCs). In the wholesale and retail trade, hotels and restaurants sub-sector, foreign investments were largely for the set-up and expansion of hypermarkets and new hotels in response to the growing affluence of Malaysians and the rapid growth of the tourism industry.

In view of the large and long-standing presence of MNCs in the manufacturing sector, investment in this sector continued to be funded mainly by retained earnings, especially in the electrical and electronics, petroleum-related and chemicals and machinery equipment industries. Foreign investments in the manufacturing sector were mainly for upgrading of equipment and technology as well as establishing new product lines and capacity. Meanwhile, in the oil and gas sector, investment in the upstream activities continued to be significant following recent discovery of new oil fields offshore East Malaysia. The national oil company and its foreign partners were also actively engaged in deep-water oil exploration. The investment in this sector was also spurred by higher global demand and prices for oil during the year. In view of the expansion in the services, manufacturing and oil and gas sectors, the broadening and deepening of FDI flows has further enhanced the capacity, technology and skill-base to allow the country to continue to move up the value chain.

Direct investment abroad by Malaysian companies increased to RM7.1 billion in 2004 (2003: -RM5.2 billion). The sizable increase in overseas investment reflected companies' strategy in expanding their operations worldwide to enhance synergistic capabilities to their core operations in Malaysia as well as to tap business opportunities available abroad. Most of these investments were undertaken through acquisitions and joint ventures with some new greenfield investments. The investment was led by several large and established Malaysian corporations in the oil and gas and services sectors, followed by companies in the manufacturing, agriculture and construction sectors. In terms of location, overseas investments by Malaysian companies were well-diversified, with investments directed to diverse parts of the world, including Africa, ASEAN, South Asia, Europe and US.

Overseas investment in the oil and gas sector remained large, especially in the upstream oil exploration and extraction activities following the discovery of new oil fields and the success of the national oil company in forging joint venture partnerships with several foreign national oil companies for oil and gas exploration. The investments were concentrated mainly in large undeveloped oil fields in Africa and ASEAN countries. The investment abroad in the services sector was

broad-based, with the bulk of the investments channelled into the utilities and the financing, insurance, real estate and business services sub-sectors. In the manufacturing sector, local companies continued to venture abroad, emulating global MNCs in establishing subsidiaries or joint ventures with their counterparties in emerging economies so as to relocate their labour-intensive operations abroad, or to be in close proximity to their suppliers and consumers. These investments were largely for the manufacturing of fabricated metal products, machinery and equipments (including electronic and electrical products), palm oil, and wood and wood products including furniture.

Agro-based overseas investments were mainly for oil palm estates in Indonesia and South Africa. Investments abroad by construction companies also continued to increase during the year. Several large and established construction and engineering companies have leveraged on their expertise and experience in civil engineering and property development to secure numerous development contracts in India, PR China, Sri Lanka, Africa and West Asia. Reflecting Malaysian companies' success in overseas ventures, the net profits and dividends accruing to companies investing abroad increased further to RM3.6 billion in 2004 (2003: RM2 billion).

reflecting mainly the Federal Government's fiscal consolidation and sustained net repayments by the Non-Financial Public Enterprises (NFPEs).

The other investment by the **private sector**, comprising mainly borrowing and lending as well as placements and withdrawals of deposits by the banking sector as well as non-bank private sector transactions with unrelated counterparties, recorded a higher net outflow of RM27.4 billion (2003: -RM9.3 billion). This is attributed mainly to the reversal in the banking sector position to register a net outflow during the year arising from higher placement of assets abroad. The net outflows by the non-bank private sector were marginally higher, reflecting the sustained large trade credits extended by Malaysian exporters in line with the significantly stronger trade performance.

External Debt

Malaysia continued to maintain a prudent external debt management strategy. The framework for external debt management has been guided by prudential policies and an efficient debt monitoring system. Permission to allow recourse to external loans by corporations is based on a transparent set of criteria, which requires that external funds be utilised to finance productive investments and for investments that will generate sufficient foreign earnings to service the debt. The prudential safeguards include efforts to minimise risk exposure against global interest rate shocks, adverse exchange rate movements and shifts in investor sentiment. Meanwhile, the debt monitoring system enables the authorities to monitor the overall debt level, the structure of the debt as well as the servicing obligations of both the public and private sectors. These guidelines have been effective in ensuring that the nation's external debt is contained within prudent levels and its debt profile biased towards a longer maturity structure. Overall, the prudential debt management approach has served the nation well in strengthening the underlying economic fundamentals and reducing its vulnerability to external shocks.

External debt remained within prudent level, with the debt profile biased towards a longer maturity structure. The public sector continued to record net repayments. Lower drawdowns amidst higher repayments resulted in a small net borrowing by the private sector.

Portfolio investment recorded a significant increase in net inflow of RM33.1 billion in 2004 (2003: RM4.2 billion) reflecting higher inflows into both the equity and debt markets. The flows of portfolio funds have risen steadily, as international institutional fund managers increased their medium- and long-term strategic exposure in Malaysia in line with upward adjustments in sovereign ratings, positive economic outlook, improving earnings prospects of Malaysian corporations and expectations of realignments of exchange rates in the Asian region.

The **other investment** recorded a higher net outflow of RM28.6 billion (2003: -RM20.5 billion), reflecting the net repayment of external loans by the official sector and larger short-term outflows by the private sector. The **official sector** recorded a net repayment of external loans for the second consecutive year, amounting to RM1.1 billion (2003: -RM11.2 billion),

In 2004, total external debt outstanding increased by 5.7% to RM197.3 billion (US$51.9 billion). Notwithstanding a higher total external debt, the ratios of

Table 1.23
Outstanding External Debt

	2003	2004*p*	*2003*	*2004p*
	RM million	RM million	US$ million	US$ million
Total debt	**186,640**	**197,321**	**49,116**	**51,927**
Medium- and long-term	152,950	154,298	40,250	40,605
Short-term[1]	33,690	43,023	8,866	11,322
As % of total debt	*18.1*	*21.8*	*18.1*	*21.8*
As % of net international reserves	*19.8*	*17.0*	*19.8*	*17.0*
As % of GNP				
Total debt	50.2	46.6	50.2	46.6
Medium- and long-term debt	41.2	36.5	41.2	36.5
As % of exports of goods and services				
Total debt	40.3	35.2	40.3	35.2
Medium- and long-term debt	33.0	27.5	33.0	27.5
Debt service ratio (%)	**6.2**	**4.3**	**6.2**	**4.3**

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

Source: Ministry of Finance and Bank Negara Malaysia

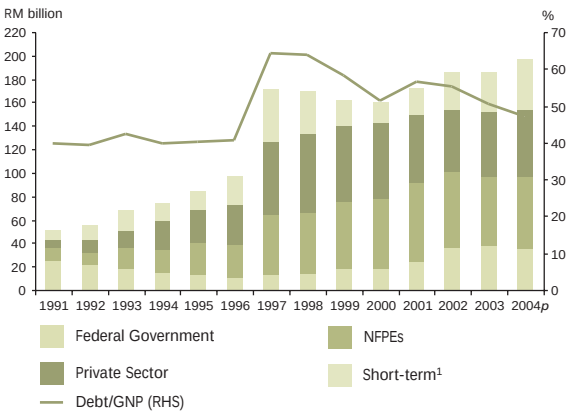
external debt to GNP and exports of goods and services improved further to 46.6% and 35.2% respectively (2003: 50.2% and 40.3% respectively). The increase in external debt reflected mainly an accumulation of short-term debt by the banking sector, resulting from hedging activities for trade-related transactions as well as money market operations involving treasury activities. Nevertheless, the share of short-term debt to total debt remained low, accounting for 21.8% of total external debt. In addition, the ratio of short-term debt to international reserves improved further to account for only 17% of international reserves (2003: 19.8%). The overall debt service ratio (excluding prepayment) declined to 4.3% in 2004 (2003: 6.2%).

The **medium- and long-term external debt** increased by 0.9% to RM154.3 billion (US$40.6 billion) as at the end-2004. The increase was due largely to an exchange revaluation loss of RM1.3 billion following the appreciation of major currencies against the US dollar. During the year, the public sector, comprising the Federal Government and NFPEs, registered a lower net repayment of RM1.2 billion (2003: -RM11 billion). In contrast, gross borrowing by the private sector was lower in 2004, while repayments of external loans increased, resulting in a smaller net borrowing of RM1.6 billion (2003: RM3.9 billion).

The bulk of the medium- and long-term debt continued to be denominated in US dollars, accounting for 77% of the nation's total medium- and long-term external debt as at end-2004. Meanwhile, the share of yen-denominated debt declined marginally to 12.5% (2003:13%) due partly to settlement of a yen-denominated bond by a NFPE. The share of the euro-denominated debt stabilised at 5.2%, while the remaining 5.3% of total external debt was accounted for by other international currencies, including the pound sterling, Swiss franc and Singapore dollar.

The outstanding external debt of the **public sector** declined marginally to RM96.7 billion (US$25.4 billion) as at end-2004 (2003: RM96.8 billion), as the net repayment of external loans more than offset an exchange revaluation loss due to the appreciation of major currencies against the US dollar. Accordingly, the share of public external debt to total external debt declined to 49% (2003: 51.9%). During the year, while the NFPEs increased their borrowings, the Federal Government continued to exercise prudence in its

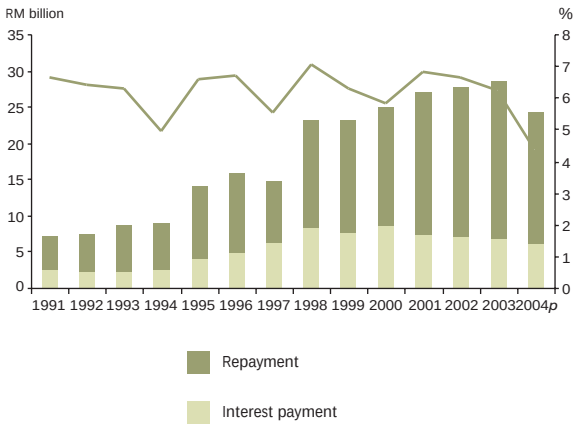
Graph 1.44a
Outstanding External Debt



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

p Preliminary

Graph 1.44b
Debt Servicing



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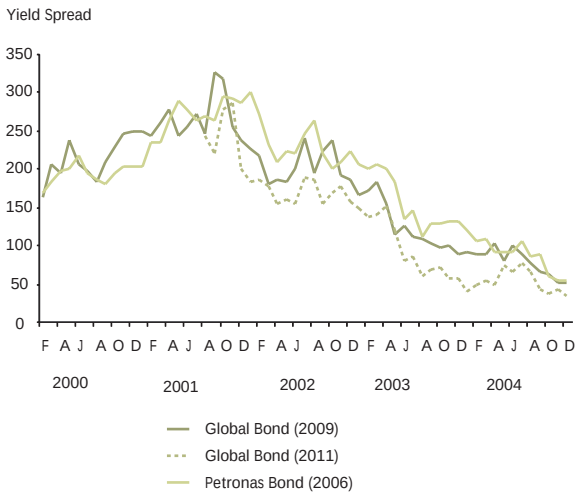
recourse to external borrowing and relied mainly on non-inflationary domestic sources to fund its development programmes.

The **Federal Government** external debt declined to RM34.7 billion (US$9.1 billion) as at end-2004, attributed mainly to the novation of two external loans, previously acquired from public and privatised enterprises, to the NFPEs. Reflective of the Government's prudent external debt management policy, no new market loan was raised. The drawdown of the external loans by the Government was lower at RM1.1 billion (2003: RM3.1 billion), and were mainly from the loans committed earlier under the Miyazawa Initiative as well as project loans from multilateral sources, such as the World Bank, Islamic Development Bank and Asian Development Bank. Meanwhile, repayments of Government external debt were also significantly lower, amounting to RM1 billion (2003: -RM6.9 billion), reflecting mainly scheduled principal repayments of several project loans.

Malaysia's strong and improving economic fundamentals led to several sovereign rating upgrades in 2004 and the interest spread on Malaysia's benchmark securities narrowed further during the year. The spread on Malaysia's Global Bond due 2011 over US Treasuries narrowed steadily to 29 basis points at the end of 2004 (end-2003: 84 basis points). Similarly, the spread on the Global Bond due 2009 narrowed to 48 basis points at end-2004 (end-2003: 76 basis points). During the year, Malaysia's sovereign ratings were further upgraded by several credit rating agencies. On 30 January 2004, Rating and Investment Information Inc. upgraded Malaysia's long-term foreign currency rating to A-, from BBB+, with a stable outlook. On 11 May 2004, Standard & Poor's reaffirmed Malaysia's long-term foreign currency sovereign credit rating at A-. Fitch International assigned a positive outlook to Malaysia's rating on 6 April 2004 and raised its long-term foreign currency rating to A-, from BBB+, with a stable outlook on 8 November 2004. After assigning the outlook for Malaysia's sovereign foreign currency rating to positive from a stable outlook on 6 February 2004, Moody's Investor Services upgraded the rating further to A3, from Baa1 on 16 December 2004.

Graph 1.45
Spread of Sovereign Bonds and Selected NFPE Bond Over US T-bills



In 2004, the **NFPEs** registered a smaller net repayment of RM1.3 billion (2003: -RM7.3 billion), as gross borrowings were significantly higher (RM11.4 billion; 2003: RM5.1 billion). The repayments, including the maturing of several bonds, were mainly by NFPEs in the oil and gas, telecommunication and utilities sectors. The larger recourse to external borrowing was mainly to finance capital investment and repayments and prepayments of offshore loans. Nevertheless, after taking into account the novation of two external loans from the Federal Government and some exchange revaluation losses, the outstanding external debt of NFPEs increased by RM2.5 billion to RM62.1 billion (US$16.3 billion) in 2004 (2003: RM59.5 billion or US$15.7 billion).

The **private sector** external debt (including short-term debt) stood at RM100.6 billion (US$26.5 billion) as at end-2004 (end-2003: RM89.8 billion) and continued to account for about one-half of Malaysia's total external debt. The medium- and long-term external loans recorded a smaller net borrowing of RM1.6 billion (2003: RM3.9 billion), reflecting a lower drawdown (-9.5%) amidst a higher repayment (+9.9%) during the year. The drawdown of external loans was mainly to finance capital expenditure and repayments of offshore loans, particularly by manufacturing companies. Meanwhile, the bulk of the repayments were effected by companies in the manufacturing and plantation sectors. The overall risk profile of the private sector medium- and long-term external debt remained low as the bulk of these loans carried a natural hedge. Most of these loans were used to finance export-oriented activities and overseas investments with foreign exchange revenue and income. In addition, a significant share of these loans was sourced from the offshore shareholders and parent or associate companies with more

flexible terms and at concessionary interest rates. After taking into account some exchange revaluation losses, the private sector medium- and long-term external debt outstanding increased slightly by 2.6% to RM57.6 billion (US$15.2 billion) as at end-2004 (end-2003: RM56.1 billion).

The outstanding **short-term external debt** (maturity of one year or less) rose by RM9.3 billion (US$2.5 billion) to RM43 billion (US$11.3 billion) in 2004, reflecting an increase in the short-term external borrowing by the banking sector, largely for hedging activities on trade-related transactions and treasury activities. Meanwhile, short-term borrowings by the non-bank private sector, comprising mainly revolving credits, overdraft facilities and term loans declined further to RM8.1 billion in 2004 (2003: RM10.4 billion). The decline reflected mainly repayment of these facilities by several large companies, particularly from the manufacturing sector.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprises holdings of foreign exchange and gold, the IMF reserve position and holdings of Special Drawing Rights (SDR). During the course of 2004, net international reserves strengthened by RM83.1 billion or US$21.9 billion to a record level of RM253.5 billion or US$66.7 billion as at 31 December 2004. The reserves level increased further to RM272.9 billion (US$71.8 billion) as at 28 February 2005. The reserves position is adequate to finance 8.6 months of retained imports and cover 6.1 times the short-term external debt. The high level of reserves has increased the country's external resilience against future shocks to the economy.

Table 1.24
Net International Reserves

	As at end-			Change
	2002	2003	2004	2004
	RM million			
SDR holdings	585.0	685.0	765.3	80.3
IMF reserve position	3,315.5	3,652.0	3,068.4	-583.6
Gold and foreign exchange	127,515.1	166,139.3	249,704.1	83,564.8
Gross International Reserves	**131,415.6**	**170,476.3**	**253,537.8**	**83,061.5**
Less Bank Negara Malaysia external liabilities	21.9	23.8	24.5	0.7
Net International Reserves	**131,393.7**	**170,452.5**	**253,513.3**	**83,060.8**
US$ million equivalent	**34,577.3**	**44,855.9**	**66,714.0**	**21,858.1**
Months of retained imports	5.4	6.6	8.0	
Reserves/Short-term external debt (times)	4.1	5.1	5.9	

The net increase in the reserves reflected the overall strong fundamentals of the economy. The increase in **foreign exchange holdings** was due to both the stronger export performance as well as higher inflows of foreign direct investment and portfolio funds. Notably, the increase in reserves occurred amidst higher outflows during the year. The higher payments for imports of goods and services as well as larger repatriation of profits and dividends reflected the strong expansion of domestic economic activity. Overseas investments by Malaysian companies were also higher, reflecting rising interests of Malaysian companies to diversify their activities abroad. Meanwhile, repayments of external loans by the public sector continued to exceed the drawdown of external loans.

Net international reserves strengthened to a record level of US$66.7 billion as at 31 December 2004, reflecting the overall strong fundamentals of the economy, in particular the stronger export performance and higher inflows of foreign direct investment and portfolio funds.

The diversified currency composition of the reserves yielded a net foreign exchange revaluation gain of US$2.1 billion (2003: US$3.1 billion), following the quarterly adjustments of the reserves. The revaluation gains during the third and fourth quarters, arising mainly from the appreciation of the major currencies against the US dollar more than offset the revaluation losses during the first and second quarters when the major currencies depreciated against the US dollar.

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

Reflecting Malaysia's strong balance of payments position, Malaysia was included in the Operational

Graph 1.46
Net International Reserves (end-month)

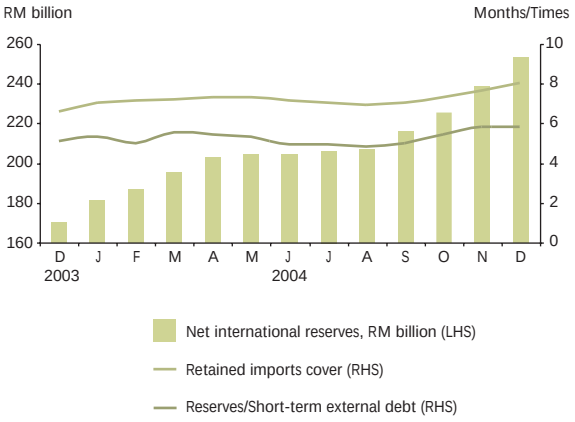


Table 1.25
International Reserves for Selected Regional Economies

Country	Reserves as at end-2004 (US$ billion)	Reserves in months of imports	Reserves as cover of short-term external debt[1]	Reserves as cover of total external debt[1]
Chinese Taipei	241.7	17.3	3.7	2.9
Hong Kong China	123.6	5.5	0.4	0.3
Indonesia	36.3	9.4	5.4	0.3
Korea	199.1	10.6	3.8	1.2
Malaysia	**66.7**	**8.0**	**5.9**	**1.3**
Philippines	16.0	4.6	2.8	0.3
PR China	609.9	13.0	5.8	2.7
Singapore	112.8	8.3	0.8	0.6
Thailand	49.8	6.3	5.2	1.0

[1] External debt data refers to amount outstanding as at end-September 2004, except for Chinese Taipei (end-June 2004), PR China and Malaysia (end-2004).

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

Budget of the IMF by making resources available to member countries that are facing short-term balance of payments difficulties. Nevertheless, the **reserve position with the IMF** decreased by RM583.6 million in 2004, due mainly to the net repurchase of SDR86.4 million (RM485.5 million) following repayments to the ringgit account by various IMF member countries under the Operational Budget arrangements and the maturity of investment with the Enhanced Structural Adjustment Facility Trust (ESAF) amounting to SDR40 million (RM224.1 million). Meanwhile, Malaysia's holdings of reserves in the form of **SDR** increased by RM80.3 million, reflecting the net receipt of remuneration from the IMF arising from Malaysia's net creditor position with the Fund and some exchange revaluation gains on holdings of SDR.

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

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

FLOW OF FUNDS

The economy registered a higher resource surplus of RM56.6 billion, representing 13.4% of GNP in 2004 (2003: RM50.8 billion or 13.7% of GNP). In terms of the balance of payments, the higher resource surplus reflected higher exports of RM545 billion over imports of RM449.3 billion. From the perspective of the country's savings-investment gap, the higher resource surplus reflected the higher net savings position of the private sector. The flow of funds between various sectors of the economy in 2003 and 2004 are shown in Tables 1.26 and 1.27.

The resource surplus of the public sector was lower at RM8 billion in 2004 (2003: RM17.3 billion). The resource surplus reflected entirely the surpluses from the NFPEs of RM25.3 billion, which helped to offset the resource gap of the general government of RM17.3 billion. The lower resource surplus of the public sector was due to the lower disposable income of the public sector as well as higher operating expenditure. The disposable income of the public sector declined by 4.4% to RM123.8 billion in 2004 largely on account of the higher subsidy payments incurred by the Federal Government to keep retail prices of petroleum products relatively stable following the increase in global crude oil prices. While public investment was lower as the Government began to gradually consolidate its fiscal position, public consumption increased, reflecting primarily higher

Table 1.26
Flow of Funds: 2003

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-362.4	129.5	232.9			0
Consumption	227.3	-54.9	-172.4			0
Investment	87.1	-57.2	-29.9			0
Change in Stocks	-2.8		2.8			0
Exports of Goods and Non-Factor Services	450.6				-450.6	0
Imports of Goods and Non-Factor Services	-367.9				367.9	0
Net Factor Payments Abroad	-22.5				22.5	0
Net Transfers	-9.3				9.3	0
Non-Financial Balance	0.0	17.3	33.5	0.0	-50.8	0
Foreign Financing						
Direct Investment			4.2		-4.2	0
Net Foreign Borrowings		-11.2	-11.5		22.7	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-27.1	27.1	0
Banking System				6.4	-6.4	0
Domestic Financing						
Change in Credit		9.6	25.6	-35.2		0
Change in Deposit[1]		9.4	-48.9	39.5		0
Net Borrowings from Non-Bank Sector		-25.2	25.2			0
Other Items (Net)			-28.0	16.5	11.6	0
Sum		0	0	0	0	

[1] Including currency in circulation

Table 1.27
Flow of Funds: 2004

	National Accounts	Domestic Economy			Rest of the World	Sum
		Public Sector	Private Sector	Banking System		
	RM billion					
Disposable Income	-408.4	123.8	284.6			0
Consumption	251.4	-59.4	-192.0			0
Investment	91.8	-56.5	-35.4			0
Change in Stocks	8.7		-8.7			0
Exports of Goods and Non-Factor Services	545.0				-545.0	0
Imports of Goods and Non-Factor Services	-449.3				449.3	0
Net Factor Payments Abroad	-24.5				24.5	0
Net Transfers	-14.6				14.6	0
Non-Financial Balance	0.0	8.0	48.6	0.0	-56.6	0
Foreign Financing						
Direct Investment			10.8		-10.8	0
Net Foreign Borrowings		-1.1	12.9		-11.7	0
Change in Net Foreign Assets						
Bank Negara Malaysia				-75.1	75.1	0
Banking System				-7.2	7.2	0
Domestic Financing						
Change in Credit		9.8	29.1	-38.9		0
Change in Deposit[1]		-25.0	-63.4	88.5		0
Net Borrowings from Non-Bank Sector		8.4	-8.4			0
Other Items (Net)			-29.6	32.7	-3.1	0
Sum		0	0	0	0	

[1] Including currency in circulation

expenditures on supplies and services as well as emoluments. The resource surplus of the public sector together with borrowings from the banking system (RM9.8 billion) and private sector (RM8.4 billion), were placed as deposits (RM25 billion) and utilised for net repayment of foreign borrowings (RM1.1 billion).

The resource surplus of the private sector increased to RM48.6 billion or 11.5% of GNP in 2004 from RM33.5 billion or 9% of GNP in 2003. With continued strengthening in domestic activity and improvements on the external front, disposable income of the private sector increased significantly, to RM284.6 billion (2003: RM232.9 billion). This enabled the private sector to increase consumption expenditure by 11.4%. Private investment was also higher, growing by 18.4% over the previous year. The resource surplus of the private sector, together with net inflows of FDI (RM10.8 billion), net foreign borrowings (RM12.9 billion) and borrowings from the banking system (RM29.1 billion), led to a larger increase of resources available to the private sector amounting to RM101.4 billion in 2004 (2003: RM88.5 billion). The bulk of the resources were placed as deposits with the banking system (RM63.4 billion).

In the external sector, the large current account surplus and capital inflows contributed to the increase of RM75.1 billion (excluding revaluation gain/loss) in Bank Negara Malaysia's net international reserves.

Monetary and Fiscal Developments

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Monetary and Fiscal Developments

MONETARY POLICY IN 2004

Following the reduction in interest rates in May 2003, Bank Negara Malaysia maintained the accommodative monetary policy stance to support the growth momentum in 2004. In particular, monetary policy continued to support private sector activity as the Government began to gradually consolidate its budgetary position. At the same time, the Bank remained vigilant of inflationary pressures. The assessment at several junctures over the course of the year was that the inflation rate, as measured by the CPI, would remain below the average of 1.5% for the year as a whole.

Monetary policy remained accommodative to support the growth momentum amid low underlying inflationary pressures.

The macroeconomic fundamentals, that provided the base for growth in economic activity in 2003, strengthened to support a more rapid pace of expansion in 2004. In particular, the financially sound positions of the corporate, household and banking sectors were instrumental in ensuring the effectiveness of the accommodative monetary policy. On balance, given developments in the domestic economy and on the global economic horizon, the decision was to keep interest rates unchanged during the year with the goal of policy focussed on achieving sustainable long-term growth with price stability.

In early 2004, the outlook for the Malaysian economy improved substantially. The significant recovery in the global economy, which had been underway since the middle of 2003, had a positive impact on the Malaysian economy. In terms of domestic demand, consumption and investment indicators were trending upwards, supported by improving consumer and business sentiment. Businesses had benefited from the measures implemented under the 2003 Economic Package. In addition, the various efforts by the Bank to strengthen the small and medium enterprises' (SMEs) financing infrastructure had created an important conduit for the increase in financing provided to the sector. At the time of the release of the Bank's first Monetary Policy Statement (MPS) for 2004 in February, it was highlighted that maintaining the low interest rate environment was necessary to strengthen the private sector-led expansion, particularly given the early stage of the recovery in the investment cycle and the need for accommodation during the process of fiscal consolidation.

In the subsequent months, developments in the major industrial economies and regional countries confirmed that the global economy had gained firmer traction in the first quarter of 2004. However, possible factors for a moderation in global growth had also emerged. The sustained increase in crude oil prices had the potential to weaken growth in Malaysia's major trading partners. At the same time, there was potential for slower growth in the People's Republic of China (PR China), following measures by the authorities in that country to prevent the economy from overheating. There were also greater expectations, particularly in May, that interest rate increases in the United States (US) were imminent. With the emerging threat of deflation in the US in 2003, the Federal Reserve had reduced interest rates significantly. Meanwhile, domestic interest rates did not move as much, resulting in a substantial positive interest rate differential in favour of Malaysia. This, together with the strong economic fundamentals, provided the flexibility for domestic interest rates to be governed by domestic considerations, while being consistent with the exchange rate policy.

With stable conditions more entrenched and the underlying fundamentals strengthening significantly in the early part of the year, favourable conditions provided a window of opportunity for the Bank to introduce a new interest rate framework in late April. Under the new interest rate framework, the Overnight Policy Rate (OPR) replaced the 3-month intervention rate as the policy rate and the corresponding overnight interbank rate became the operating target of monetary policy. To reflect the unchanged stance of monetary policy, the OPR was set at the prevailing overnight interbank rate of 2.70%. The rationale and operational infrastructure of the new framework are discussed in the white box on **New Interest Rate Framework**.

In May, it was evident that the domestic economy had strengthened substantially. The economy had expanded by 7.8% in the first quarter of 2004, with

New Interest Rate Framework

A significant development in 2004 was the implementation of the new interest rate framework on 26 April 2004. The new framework involved the introduction of a new policy rate and improvements to the conduct of monetary operations, as well as the removal of the ceiling on base lending rates (BLRs) and prescribed lending spreads. Banking institutions now set their BLRs based on their respective cost structures and business strategies. The changes were designed to enhance the effectiveness of monetary policy by facilitating the transmission of movements in the policy rate to other market rates and ultimately to key macroeconomic variables. The new framework also serves as a catalyst for the efficient pricing of financial products and services by banking institutions. The deregulation of pricing is a key initiative under the Financial Sector Masterplan (FSMP) to ensure greater efficiency in the allocation and distribution of resources in the financial system.

The transition to the new interest rate framework was timely given the favourable macroeconomic fundamentals and the more developed financial infrastructure, which is supported by a strong banking system as well as sound regulatory and supervisory frameworks. These factors have been reinforced by on-going enhancements to the consumer protection framework.

Changes in Monetary Policy Implementation and Communication

To signal monetary policy more effectively and enhance the efficiency of the monetary transmission mechanism, Bank Negara Malaysia adopted a policy rate that is closely linked to other interest rates and has introduced enhancements to its monetary operating procedures. Under the new interest rate framework, the Overnight Policy Rate (OPR) replaced the 3-month intervention rate as the indicator of monetary policy stance. The OPR is effectively the target for the average overnight interbank rate (AOIR). In turn, the AOIR serves as the sole operating target for the Bank's daily liquidity operations. The overnight rate was chosen as the policy rate due to its minimal expectations content and high degree of controllability.

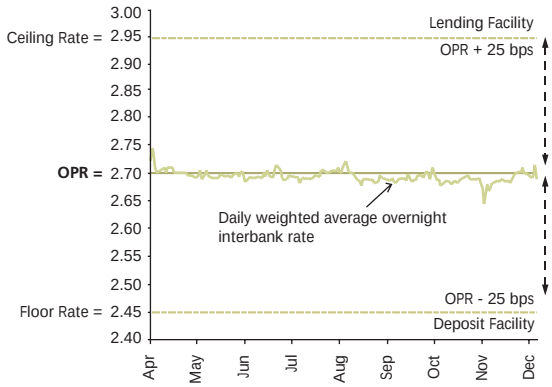
Liquidity operations conducted at maturities other than the overnight tenure are done without targeting any specific interest rate level, thereby allowing interbank rates for these maturities to be market determined. To reflect the unchanged stance of monetary policy at the time of the implementation of the new framework, the OPR was set at the prevailing AOIR of 2.70%. Over the period 26 April – 31 December 2004, the AOIR traded within a narrow range of 2.65 – 2.74% and averaged 2.70%.

In order to prevent excess volatility in the AOIR, the Bank has put in place an interest rate corridor and standing facilities. Essentially, the market rate is allowed to move within a corridor of ± 25 basis points around the OPR. The ceiling and floor rates of the corridor are the rates at which the Bank is willing to lend to or borrow from the market to alleviate residual overnight liquidity shortages or surpluses.

The Bank has begun to complement direct borrowing in the money market with repo-based open market operations in its liquidity management. The use of such open market operations had been previously hindered by the insufficiency of suitable papers. This has been partially addressed with the introduction of the Institutional Securities Custodian Programme (ISCAP) in late 2004. Through ISCAP, the Bank borrows securities, mainly Malaysian Government Securities (MGS), from major institutional investors such as pension funds and insurance companies for its repo operations.

An important aspect of enhancing the monetary transmission mechanism under the new interest rate framework is the communication of monetary policy. The Bank's stance has been made more transparent with explicit policy and operating target rates and the announcement of monetary policy decisions through the Monetary Policy Statement (MPS). The structured and transparent approach to the announcement of monetary policy decisions reduces uncertainty among market participants on the

Graph 1
Daily Weighted Average Overnight Interbank Rate
26 April - 31 December 2004



Bank's stance and policy direction. Any change to the OPR will be announced in the MPS. The MPS is issued at pre-determined quarterly intervals to coincide with the release of Malaysia's quarterly GDP data. Should there be a change in the monetary policy stance, in the period between two scheduled dates, an additional MPS would be issued.

The Impact of the New Interest Rate Framework

The introduction of the new interest rate framework involved changes to the system of implementing monetary policy. The monetary policy stance, however, remained unchanged. The introduction of the new framework did not bring about a change in the cost of funds of banking institutions. As such, no significant variation was expected in the general level of interest rates.

Lending Rates and Financing

Under the new framework, the maximum lending rates charged by banking institutions are no longer subject to the previous BLR formula and the maximum lending spread of 2.5 percentage points above the BLR has also been removed. Instead, the BLR of each banking institution is based on the institution's own cost structure and lending strategy as well as the level of competition in the industry.

At the end of 2004, the average BLR of commercial banks was relatively stable at 5.98% per annum (end-2003: 6.00% per annum), with one banking institution having reduced its BLR. The average BLR of finance companies remained unchanged at 6.90% per annum. Given the unchanged stance of monetary policy, it was expected that most banking institutions would not vary their BLRs in the short- to medium-term.

With the removal of the ceiling on lending rates, loans are increasingly priced according to the risk profile of borrowers or projects. The flexibility accorded to banking institutions in the pricing of spreads allows wider access to financing for borrowers who previously faced difficulty in obtaining funds. Already, several banking institutions have introduced new specialised lending packages for individuals and small businesses.

SMEs have continued to enjoy access to financing under the new interest rate framework, with increased demand for funds as reflected in higher loan applications in the second half-year. Loan approvals and disbursements also rose in the second half-year. At the same time, the lending rates on loans to the SME sector have, on average, remained competitive. In the second half-year, the average lending rate on new loans approved to SMEs by commercial banks was 6.37% per annum compared with 6.42% per annum for the first half-year. In the business sector as a whole, the average lending rate on new loans approved in the second half-year was 5.79% per annum compared with 5.89% per annum in the first half-year.

For the consumer-related sectors, the average lending rates on new loans approved for the purchase of residential property and passenger cars, the latter by finance companies, were 3.27% per annum and 6.74% per annum respectively in the second half-year compared with 3.58% per annum and 6.82% per annum respectively for the first half-year.

The Bank will continue to monitor lending rates charged by banking institutions. To ensure fair and just pricing, the Bank has undertaken several new initiatives to safeguard the interests of consumers. These measures are aimed at ensuring greater product transparency and disclosure, strengthening the infrastructure for consumer redress as well as increasing the financial literacy of the public (See **Management of the Banking System** in Chapter 5 for further details).

The prescribed lending rates have been maintained for financing allocated through the Bank-administered special funds for SMEs and the ceiling still applies on lending rates on housing loans extended to the low- and middle-income groups under the Lending Guidelines to Priority Sectors. In addition, lending rates on hire purchase loans remain subject to the Hire-Purchase Act 1967, while lending rates on credit card loans are subject to the maximum interest rate of 18% per annum as prescribed in the Credit Card Guidelines issued by the Bank.

Deposit Rates

In the sequencing of interest rate liberalisation, a distinction was made between wholesale and retail transactions as well as loan and deposit transactions. The gradual approach adopted aimed at facilitating a smooth transition while at the same time recognising the different levels of financial sophistication among different market participants, namely financial institutions, business enterprises and the general public.

The gradual approach ensures a smooth transition under the new interest rate framework, such that the intermediation process is not disrupted. Another important consideration is the fact that a large section of the population, particularly the middle to lower income groups and retirees, relies on savings in the form of bank deposits. Minimum rates are thus prescribed for deposits of RM1 million and below with tenures between 1 to 12 months. Notwithstanding the current prescribed deposit rates, the Bank has provided an enabling environment for banking institutions to broaden their product range to serve the growing sophistication of the range of savers with different risk-return profiles. In addition, the Bank has channelled efforts towards increasing the financial literacy of the general public.

further expansion in private investment and consumption, as well as buoyant export growth. The external sector had benefited from the global electronics up-cycle, high commodity prices and increased tourist arrivals. However, this faster growth was taking place in an environment of low inflation, with the CPI rising by an average of 1% in the first four months. The increase in crude oil prices was assessed to have minimal impact on inflation given the control of retail prices of petroleum products through the automatic pricing mechanism. In terms of production capacity, the weighted average of capacity utilisation in the manufacturing sector remained relatively stable at 82% in the first quarter and there was evidence of capacity expansion in sectors experiencing strong growth. Further, labour productivity, as measured by real sales value of products per employee in the manufacturing sector, rose by 9%, exceeding the 2.7% increase in real wage per employee. With these considerations, interest rates could continue to remain low to support the growth momentum in an environment of positive output gap still prevailing in the economy. Thus, the OPR remained unchanged at 2.70%.

By the time of the release of the second quarter GDP along with the third MPS in August, global growth for the first half-year had exceeded expectations. During this period, the global monetary cycle entered a tightening phase, engendered by the stronger-than-expected recovery cycle and higher commodity prices. Indicators, however, pointed to some moderation in global growth in the second half-year, but the consensus was that the impact of high crude oil prices and rising interest rates would be modest. In the domestic economy, GDP expanded by 8.2% in the second quarter, with stronger household consumption and private investment activity as the public sector continued to consolidate. Growth for 2004 was now expected to surpass previous forecasts, with the

Table 2.1
Monetary Policy Statements in 2004

The Monetary Policy Statement (MPS) which was introduced in August 2003, was issued four times in 2004 to coincide with the release of the quarterly GDP data in February, May, August and November. The respective MPS issued during the year stated the decision to leave the policy rate unchanged.

Date	Policy Rate	
	3-month Intervention Rate	Overnight Policy Rate (OPR)[1]
25 February	4.50%	
26 May		2.70%
25 August		2.70%
30 November		2.70%

[1] The new interest rate framework was implemented on 26 April 2004. The OPR replaced the 3-month intervention rate as the indicator of monetary policy stance. To reflect the unchanged stance of monetary policy, the OPR was set at the prevailing average interbank overnight rate of 2.70%. See the white box on **New Interest Rate Framework**, for details.

strong first-half performance. CPI inflation remained low at 1.2% in the second quarter of 2004. Importantly, core inflation, reflecting price increases due to demand pressures, averaged less than 1% in the same period. Over the period January to June, approvals for capital investment totalled RM7.2 billion, paving the way for capacity expansion in the electronics and electrical products sector, and in sectors such as chemical and chemical products, and transport equipment, where spare capacity had declined to low levels. Importantly, labour productivity in the manufacturing sector continued to outpace real wage growth. As the outlook for both growth and inflation remained favourable, the monetary policy stance remained unchanged.

Towards the end of the year, indicators showed that global economic activity had remained firm in the third quarter. However, expectations were for a slight tapering off in US economic expansion in the fourth quarter. In addition, the positive outlook for the US economy was dampened slightly by renewed concerns over the US current account deficit and the declining strength of capital inflows into the country. These concerns also led to a sharp depreciation in the US dollar. Among regional countries, a more moderate pace of economic expansion was apparent, as export growth eased, due largely to the gradual slowdown in the global electronics cycle. Inflation trended upwards in most regional countries due mainly to the high crude oil prices, with some countries raising interest rates to contain inflationary pressures.

On the domestic front, a slightly slower but sustained pace of growth was evident in the third quarter. In line with the softening trend in the global electronics cycle, growth in the manufacturing sector moderated somewhat. Despite signs of moderating global growth, the near-term outlook for Malaysia remained favourable. The direct impact of higher crude oil prices was positive for the economy in the short-term, contributing to the trade surplus and to Government revenue.

In the last few months of the year, there were heightened expectations that currencies in the Asian region would be subject to realignments, following speculation of a revaluation of the Chinese yuan and the continuing depreciation in the US dollar. An increase in net portfolio inflows into the domestic economy was registered from September, though these inflows were manageable and had not caused disequilibrating mispricing of asset prices nor distortions in resource allocation in both the financial and real sectors. There continued to be no fundamental pressures that warranted a review of the exchange rate policy (See **Exchange Rate Developments** for a detailed discussion of the ringgit exchange rate). For the year as a whole, the Bank's international reserves increased mainly due to trade proceeds, and to a lesser extent, net capital inflows. The Bank's monetary operations, including the sterilisation of these inflows, were intended to ensure a level of interest rates consistent with domestic conditions. The cost of monetary policy operations continued to remain manageable during the year.

After averaging 1.5% in the third quarter, inflation edged up to 2.1% in October, reflecting mainly higher food prices, higher taxes for cigarette and tobacco as well as higher personal transportation charges after the second increase of retail petrol prices in October, following the first increase in May. Nevertheless, on a historical basis, this inflation rate was still relatively low. Core inflation remained at less than 1.5% in October and averaged less than 1% for the first 10 months of 2004. Additionally, there was no discernible evidence of a pass through from higher crude oil prices.

The fourth MPS for the year was released in late November. The assessment was that there was little evidence of demand-driven inflationary pressures building up in the medium-term, particularly given the moderation in the pace of growth expected in 2005. Inflationary pressures would also be contained given the existence of adequate capacity, which was likely to increase in the year ahead with sustained

private investment activity. The risk of strong inflationary pressures in the property market was also limited as the supply of residential units remained ample, with average prices and rentals having risen slowly. Meanwhile, growth in the broad money measure, M3, had remained relatively stable, at around 10% for most of 2004 and consistent with the growth of nominal income. Preliminary forecasts suggested that the CPI was unlikely to breach 3% in 2005. Monetary policy has the flexibility to respond to continue to support growth in 2005.

MONETARY DEVELOPMENTS IN 2004

Monetary developments in 2004 reflected the policy to support domestic economic activities. While some moderation in economic growth occurred in the second half-year, monetary conditions remained favourable to support private sector activities.

Monetary conditions remained favourable to support private sector activities.

Since the transition to the New Interest Rate Framework, the OPR has been maintained at 2.70%. In the interbank money market, the overnight rate averaged 2.70%, consistent with the OPR, and moved within a tight band of 2.65 – 2.74%.

With domestic interest rates unchanged, the interest rate differentials between domestic and US rates narrowed following the steady increase in US Federal Funds rates during the year. Notwithstanding the narrowing interest rate differentials, the external sector continued to inject liquidity into the system. These inflows reflected mainly long-term flows, including the repatriation of export earnings arising from the strong trade performance. Inflows of portfolio funds were also higher as international fund managers increased their exposure to Malaysia, following the continuous upward adjustments in ratings and improved economic and earnings outlook. Nonetheless, the larger capital inflows did not create any significant destabilising conditions in the domestic financial system. Bank Negara Malaysia continued to manage the excess liquidity to maintain interest rates at the desired level.

The base lending rates (BLR) of banking institutions remained steady given their relatively stable cost of funds structure. The BLR of commercial banks moderated slightly to 5.98% per annum while the BLR of finance companies remained unchanged at 6.90% per annum. Five mergers between commercial banks and their finance companies were effected during the year, resulting in technical adjustments to their average lending rates (ALR). With lower interest rates offered on new loans, the ALR of commercial banks and finance companies moderated to 5.98% per annum and 8.78% per annum respectively at end-2004 from 6.11% per annum and 9.11% per annum at end-2003.

While deposit rates were broadly unchanged from the levels recorded at end-2003, depositors continued to enjoy positive real rates of return from their deposits amidst a low inflation environment. During the year, Bank Negara Malaysia created a new instrument, the Merdeka Savings Bond, to provide retirees with an additional higher-yielding avenue for their savings. The Merdeka Savings Bond, which was based on the Islamic principle of *Bai' Al-Inah*, offered a profit margin of 5% per annum, which was higher than interest rates paid by the commercial banks for 12-month fixed deposits. The bonds would be carried over in 2005 with a total issuance of RM1.31 billion planned for 2005 compared with RM1.94 billion issued in 2004.

The accommodative monetary conditions during the year facilitated financing of private sector activity. Gross financing extended by the banking system and the capital markets increased by 6.2% in 2004 (2003: 9%). On a net basis, banking system loans and PDS outstanding increased at an annual rate of 9% at end-2004 (end-2003: 10.3%).

Bank lending activity was robust in 2004 as reflected by a faster pace of growth in total loans outstanding of 8.5% at end-2004 (end-2003: 4.8%). Stronger demand

Graph 2.1
Lending Rates:
Commercial Banks and Finance Companies

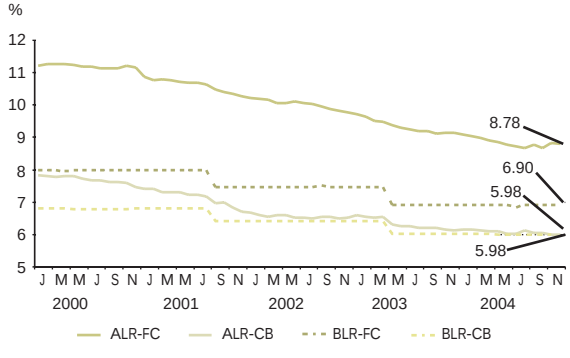


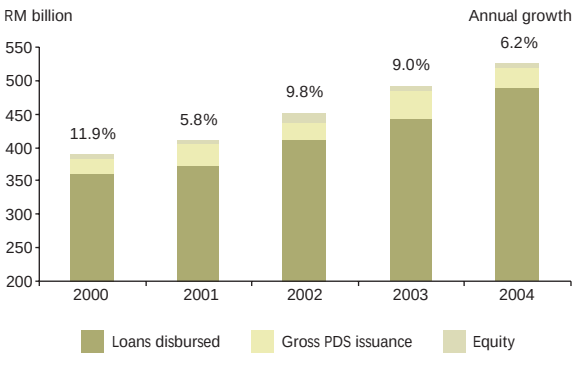
Table 2.2
Interest Rates and Liquidity

	2001	2002	2003	2004
	As at end-period (%)			
3-month Intervention Rate	5.0	5.0	4.5	-
Overnight policy rate (OPR) [1]	-	-	-	2.70
Interbank rates				
Overnight	2.76	2.71	2.72	2.69
1-month	2.97	2.99	2.99	2.77
Base lending rate (BLR)				
Commercial banks	6.39	6.39	6.00	5.98
Finance companies	7.45	7.45	6.90	6.90
Average lending rate (ALR)				
Commercial banks	6.67	6.51	6.11	5.98
Finance companies	10.24	9.75	9.11	8.78
Fixed deposit rates				
Commercial banks				
3-month	3.21	3.20	3.00	3.00
12-month	4.00	4.00	3.70	3.70
Finance companies				
3-month	3.22	3.20	3.00	3.00
12-month	4.01	4.00	3.68	3.70
Savings deposits rates				
Commercial banks	2.28	2.12	1.86	1.58
Finance companies	2.94	2.65	2.18	1.98
	Average during the period (%)			
Nominal interest rate differential				
Malaysia – United States	-0.49	1.31	1.66	1.16
Malaysia – Singapore	1.31	2.23	2.27	1.93
	As at end-period (RM billion)			
Resource surplus (+) / gap (-)	67.4	76.2	106.0	133.4
Adjusted resource surplus (+) / gap (-) [2]	28.6	33.3	57.7	86.9
	As at end-period (%)			
Loan-deposit ratio	85.9	84.9	80.9	78.6
Financing-deposit ratio [2]	95.7	95.1	91.7	87.7

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

for funds was also evident, with loan applications growing significantly by 20.1% compared to 4.8% in 2003. Similarly, loan approvals were higher, amounting to RM173.6 billion, or an increase of 13.6%.

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



In line with the recovery in private investment, bank borrowings by the business sector strengthened after three years of decline in loans outstanding. In 2004, loans outstanding to businesses grew by an annual rate of 2.6% (end-2003: -2.4%). The growth in the demand for bank loans was observed across most business sub-sectors, with total loan applications by businesses increasing at an annual rate of 20% in the year (2003: -7.7%).

The annual growth rate of loan disbursements to businesses also expanded by 10.5%. Sectoral lending data showed that lending to the wholesale, retail, restaurants and hotel sector, predominantly SMEs, accounted for 25% of total business loan disbursements during the year, increasing from 23.1% in 2003.

The confluence of stronger balance sheets, improved profitability and positive business sentiments placed

Table 2.3
Banking System[1]: Loan Indicators

	During the year (RM billion)				Annual growth (%)			
	2001	2002	2003	2004	2001	2002	2003	2004
Total								
Loan applications	190.6	217.2	227.6	273.3	-8.7	14.0	4.8	20.1
Loan approvals	125.6	137.6	152.8	173.6	-6.8	9.5	11.1	13.6
Loan disbursements	373.5	411.6	441.6	488.2	3.5	10.2	7.3	10.6
Loan repayments	365.4	402.7	430.4	461.6	5.3	10.2	6.9	7.2
Change in loans outstanding[2]	16.1	19.8	21.6	40.2	3.9	4.6	4.8	8.5
Businesses								
Loan applications	n.a.	135.3	124.9	149.9	n.a.	n.a.	-7.7	20.0
Loan approvals	63.5	68.5	77.3	84.9	-19.7	7.9	12.8	9.8
Loan disbursements	270.4	282.0	303.4	335.3	0.1	4.3	7.6	10.5
Loan repayments	276.8	275.8	299.5	319.8	2.8	-0.4	8.6	6.8
Change in loans outstanding[2]	-5.6	-3.1	-5.2	5.6	-2.5	-1.4	-2.4	2.6
SMEs								
Loan applications	n.a.	48.7	44.5	54.1	n.a.	n.a.	-8.6	21.6
Loan approvals	n.a.	30.7	25.9	31.6	n.a.	n.a.	-15.5	21.9
Loan disbursements	n.a.	49.5	87.1	100.4	n.a.	n.a.	76.0	15.3
Change in loans outstanding[2]	4.0	...	7.4	6.3	5.7	...	10.0	7.7
Large corporations								
Loan applications	n.a.	86.6	80.4	95.7	n.a.	n.a.	-7.2	19.1
Loan approvals	n.a.	37.8	51.4	53.3	n.a.	n.a.	35.8	3.8
Loan disbursements	n.a.	232.5	216.3	234.9	n.a.	n.a.	-7.0	8.6
Change in loans outstanding[2]	-9.6	-3.1	-12.7	-0.7	-6.1	-2.1	-8.8	-0.5
Households								
Loan applications	n.a.	81.9	98.4	120.2	n.a.	n.a.	20.2	22.1
Loan approvals	59.2	66.9	72.0	86.8	11.5	13.0	7.6	20.5
Loan disbursements	87.0	105.1	114.4	130.3	14.5	20.8	8.9	13.8
Loan repayments	71.5	83.7	94.1	107.0	9.9	17.0	12.4	13.7
Change in loans outstanding[2]	23.1	26.2	26.2	33.3	14.8	14.7	12.8	14.4

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

large corporations in better positions for new investment activity. In this environment, the demand for bank loans by large corporations rose during the year with loan applications growing by 19.1%. The amount of loans disbursed to large corporations also grew at an annual rate of 8.6% during the year.

In line with the pick up in private sector investment, almost half of the total funds raised in the PDS market were to finance new projects. The share of PDS funds raised for new projects rose significantly to 46.5% compared with 6.6% in 2003, mainly for power generation and water supply services in the utilities sector and provision of highway infrastructure in the construction sector. This also reflected the greater recourse of large corporations to the PDS market for long-term financing needs.

For the SMEs, the favourable macroeconomic conditions during the year increased their demand for financing. Banking institutions adopted a more focused approach to SME lending with the establishment of specific SME lending divisions to concentrate on the promotion of loan packages to this sector. The increased demand for funds by the SMEs, as reflected by the annual growth rate of loan applications of 21.6%, was matched by loan approvals, which rose by 21.9%. Outstanding loans of the SMEs grew at an annual rate of 7.7% (2003: 10%), to account for 40.3% of total outstanding loans of the business sector (2003: 38.4%). The demand for funds by SMEs is expected to continue to trend upwards, with the sector emerging as an important driver of growth in the economy.

Households' willingness to spend improved during the year, amidst rising consumer confidence, rising disposable income and the positive monetary environment. Given the positive sentiments and outlook, household sector loans outstanding continued to grow strongly by 14.4% in the year (end-2003: 12.8%). At end-2004, the share of loans

Table 2.4
Banking System[1]: Loans Outstanding

	Annual change		% share of total loans at end-2004
	2003	2004	
	RM billion		
Banking system loans, of which extended to:			
Business enterprises	-5.2	5.6	42.6
Individuals	26.2	33.3	51.4
By sector:			
Agriculture, hunting, forestry and fishing	-1.1	0.4	2.1
Mining and quarrying	0.1	-0.1	0.2
Manufacturing	-0.2	2.0	12.3
Electricity, gas and water supply	-1.7	0.1	1.0
Wholesale and retail trade, restaurants and hotels	2.1	4.3	8.5
Broad property sector	14.6	19.8	40.6
Construction	*-2.7*	*1.3*	*6.0*
Purchase of residential property	*16.2*	*16.4*	*25.9*
Purchase of non–residential property	*1.1*	*2.3*	*6.1*
Real estate	*...*	*-0.2*	*2.7*
Transport, storage and communication	1.0	-0.8	1.9
Finance, insurance and business services	-0.6	1.7	6.0
Consumption credit	8.9	14.6	20.2
of which:			
Credit cards	*1.6*	*2.0*	*2.8*
Purchase of passenger cars	*6.5*	*10.6*	*14.0*
Purchase of securities	-1.8	-0.4	3.8
Purchase of transport vehicles	0.3	-0.8	0.5
Community, social and personal services	-0.7	0.1	1.0
Others	0.9	-0.7	2.0
Total loans outstanding[2]	**21.6**	**40.2**	**100.0**

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

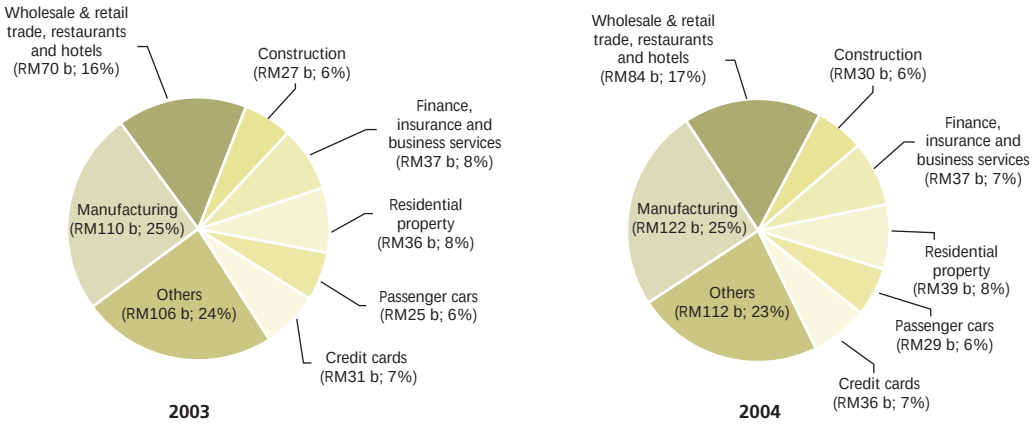
outstanding to the household sector relative to total loans outstanding edged up further to 51.4%, from 48.8% in the previous year. The increase in lending was also driven by supply-side factors, particularly active competition between banking institutions to enlarge their market share in retail lending. Household loan applications and loan approvals also grew during the year.

In terms of household sectoral loan growth, lending for the purchase of residential properties continued to be the main driver of household loans, with loans outstanding accounting for 49.3% of total household loans at end-2004. The high loan growth for the purchase of residential properties was especially evident in the first-half year, buoyed by the sustained buying interest for landed residential properties observed since the second half of 2003, and by the imminent expiry of property-related incentives announced in the Economic Package of May 2003.

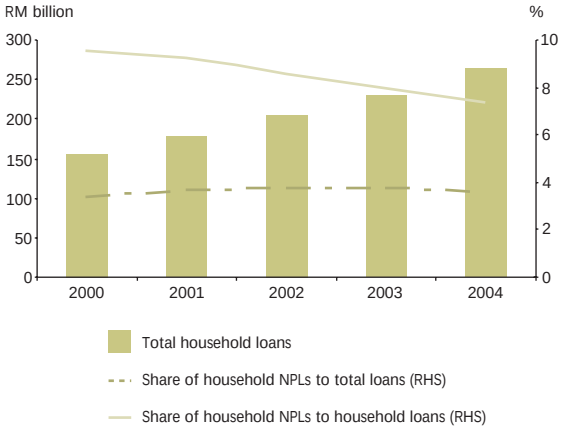
The growth in the demand for loans for the purchase of passenger cars was significant during the year. The announcement by the Ministry of Finance on the framework for the levy of import and excise duties, in line with Malaysia's commitment to the ASEAN Free Trade Agreement (AFTA), removed the uncertainty regarding prices and spurred consumers who had held back on purchases in 2003 and the first quarter of 2004. In addition, the release of new models by both domestic and foreign carmakers also heightened consumer interest. As a result, the demand for loans for passenger cars exhibited a strong uptrend since the second quarter. The annual growth of loan disbursements for the purchase of passenger cars rose by 18.8% in 2004 (2003: -4.9%).

In tandem with the improved economic performance and growth in private consumption, credit card usage

Graph 2.3
Loan Disbursements by Sector: Value and Share



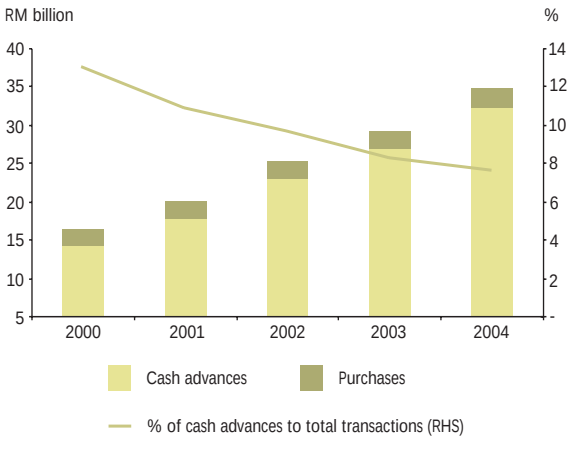
Graph 2.4
Banking System: Loans to Households (at end-period)



increased in 2004. The number and value of credit card transactions by Malaysian cardholders grew by 12.3% and 18.8% respectively in 2004 (2003: 15.5% and 16% respectively). With the bulk of the transactions mainly for the purchases of goods and services, the share of cash advances to total credit card transactions continued to decline to 7.5% (2003: 8.2%). At end-2004, the NPL ratio for credit card loans remained low at 4.7%, while credit card loans outstanding accounted for 2.8% of total banking system loans outstanding.

The financial position of the household sector remained sound. During the year, indicators of household financial conditions showed that households were in a position to manage their debts. The gross NPL ratio for the household sector was lower at 7.2% in 2004 (2003: 7.9%). Similarly, the gross NPL ratio for residential properties was also lower at 8.5% at end-2004 (end-2003: 8.7%). In addition, the number of bad cheque offenders declined by 6.5% from a year ago.

Graph 2.5
Aggregate Value of Credit Card Transactions



Following robust economic activity, money supply expanded during the year. Broad money, M3, grew by an annual rate of 12.4%, driven mainly by higher net inflows of RM82.2 billion, mostly in the form of foreign direct investment, repatriation of export earnings and portfolio inflows. In addition, higher private sector financing activity also contributed RM30.3 billion to the increase in money supply during the year. In contrast, fiscal consolidation by the Government had a restraining effect on money supply (-RM11.8 billion).

M1, an indicator of transaction activity, grew by 11.9% in the year (2003: 14.6%) as the demand for transaction balances by households and businesses,

Graph 2.6
Monetary Aggregates

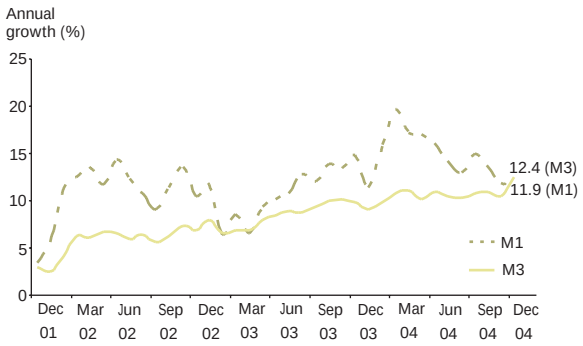


Table 2.5
Broad Money, M3

	Change (RM billion)	
	2003	2004
M3	48.5	68.0
Currency	2.2	2.6
Demand deposits	11.2	10.1
Broad quasi money	35.1	55.3
Fixed deposits	*17.1*	*24.7*
Savings deposits	*5.6*	*6.1*
NIDs	*2.0*	*8.2*
Repos	*8.0*	*13.3*
FX deposits	*2.4*	*3.0*
Determinants of M3		
Net claims on Government	12.9	-11.8
Claims on private sector	31.3	30.3
Loans	*21.5*	*39.8*
Securities	*9.8*	*-9.5*
Net external operations	20.7	82.2
Bank Negara Malaysia	*27.1*	*75.0*
Banking system	*-6.4*	*7.2*
Other influences	-16.5	-32.7

including cash and demand deposits, increased further in line with higher household spending and retail activity. The growth of M1 was notably higher in the first half-year, while exhibiting some moderation in the second half-year, reflecting the trend registered in the real economy.

EXCHANGE RATE DEVELOPMENTS

The fixed exchange rate regime of US$1 to RM3.80 has been maintained since 2 September 1998. The fixed parity of the ringgit continues to provide significant benefits to the Malaysian economy by providing predictability and relative stability for trade and investment activities.

In 2004, developments in the ringgit were driven mainly by the depreciation of the US dollar and the consequent realignments of major and regional currencies against the US currency. Due to the dollar weakness, the euro, pound sterling and yen appreciated by 8.3%, 8.1% and 4.2% respectively. The dollar reached an unprecedented low of $1.3619 against the euro on 30 December 2004, a 14-year low of $1.9455 against the pound sterling on 21 December 2004 and a 5-year low of 102.105 against the yen on 6 December 2004.

For the year as a whole, the dollar depreciated mainly on concerns over the widening current account and budget deficits in the US. Among the major currencies, the primary adjustment was in the euro, as investors acquired more euro assets. Against the British pound, sustained United Kingdom (UK) rate increases over the year widened the yield differentials in favour of the UK and provided strong support for the British currency. Concurrently, the yen strengthened on signs of Japanese economic recovery.

The dollar weakness, however, was interspersed by rallies, noticeably in the second and third quarter of the year. The dollar was aided to some extent by the five Federal Funds Rate increases in the second half of the year, which shifted the yield gaps more favourably to the US, while the weaker performances of Germany and France put some dampener on the euro. Meanwhile, the strength of the yen was tempered by fears of official intervention. From September, the dollar, however, began to depreciate markedly as the foreign exchange market noted that the US was following a policy of a weak US dollar to manage the country's external imbalances.

Graph 2.7
Exchange Rate of the Malaysian Ringgit against Major Currencies

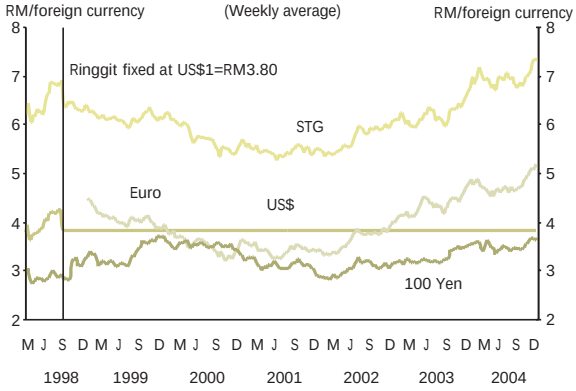
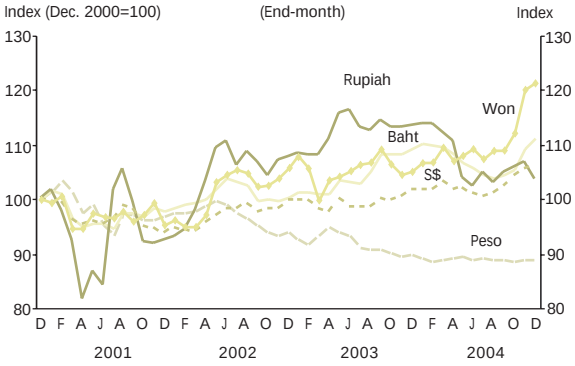


Table 2.6
Movements of the Ringgit

	RM to one unit of foreign currency[1]				Annual change (%)		Change (%)	
	1997	1998	2003	2004	2003	2004	End-June '97- End-Dec. 2004	2 Sep.'98 - End-Dec. 2004
	End-June[2]	Sept. 2[3]	End-Dec.					
SDR	3.5030	5.1177	5.6264	5.8818	-8.5	-4.3	-40.4	-13.0
US dollar	2.5235	3.8000	3.8000	3.8000	0.0	0.0	-33.6	0.0
S$	1.7647	2.1998	2.2342	2.3258	-2.0	-3.9	-24.1	-5.4
100 yen	2.2088	2.7742	3.5546	3.7026	-9.9	-4.0	-40.3	-25.1
Pound sterling	4.1989	6.3708	6.7678	7.3169	-10.0	-7.5	-42.6	-12.9
Swiss franc	1.7368	2.6450	3.0632	3.3517	-10.6	-8.6	-48.2	-21.1
Euro[4]	–	–	4.7783	5.1729	-16.7	-7.6	–	–
100 Thai baht	9.7470	9.3713	9.5947	9.7636	-8.2	-1.7	-0.2	-4.0
100 Indonesian rupiah	0.1038	0.0354	0.0449	0.0408	-5.3	9.8	154.1	-13.3
100 Korean won	0.2842	0.2827	0.3180	0.3671	0.6	-13.4	-22.6	-23.0
100 Philippine peso	9.5878	8.8302	6.8431	6.7706	4.4	1.1	41.6	30.4

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

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



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

Under the pegged exchange rate regime, the ringgit depreciated in lockstep with the US dollar against the euro by 7.6%, against the pound sterling by 7.5% and against the yen by 4%. The ringgit depreciated in the range of 1.7 – 13.4% against most regional currencies, with the notable exceptions being an appreciation against the Philippine peso and Indonesian rupiah, by 1.1% and 9.8% respectively. Regional exchange rate appreciations were mainly influenced by the dollar weakness, strong export growth and foreign equity inflows, which outweighed concerns over higher oil prices and the possibility of PR China's policy tightening impacting the economy more strongly than expected.

The weakness of the US dollar underpinned some market expectations that the ringgit peg policy would be reviewed and in particular in the light of considerable speculation that PR China is considering a more flexible regime. Speculation on the possible timing and nature of adjustments to the ringgit peg had ebbed and flowed along with the intensity of the debate pertaining to the Chinese yuan, and movement of the US dollar against other major currencies notably the yen and the euro. Despite these bouts of speculation, the pegged exchange rate continued to function effectively. Bank Negara Malaysia has consistently maintained that unless the ringgit is expected to become significantly misaligned for a prolonged period, or the current regime is no longer consistent with macroeconomic fundamentals due to major structural changes in the international or regional financial system, there would be no revisions to the peg.

FISCAL POLICY AND OPERATIONS

Fiscal policy in 2004 was aimed at improving the financial position of the Government, as well as facilitating the private sector in enhancing its role as the main engine of growth. This objective was in line with the overall macroeconomic strategy to stimulate and accelerate domestic sources of growth. Recognising the necessity for policy flexibility in times of uncertainty, the strong commitment of the Government to fiscal consolidation policy was evidenced by the narrowing of the fiscal deficit to 4.3% of GDP in 2004, from 5.3% in 2003 and a high of 5.7% of GDP in 2000. The steady and gradual reduction in the fiscal deficit was necessary to minimise any negative impact on economic growth.

Fiscal consolidation remains on track. Budgetary operations continued to focus on providing an enabling environment for private sector activity and enhancing the economy's long-term growth potential.

Fiscal consolidation was achieved through both enhancing revenue and improving spending efficiency and effectiveness. Revenue enhancing measures included intensifying efforts through stricter enforcement, tax audits and anti-smuggling measures to minimise tax leakages and evasions.

In terms of expenditure management, concerted efforts were made to reduce wastage, optimise the use of available resources and enhance the economic value of physical assets through productive use and maintenance. While development expenditure was lower, emphasis was given to expenditure which ensured longer-term productivity and competitiveness of the economy. Special attention was placed on smaller projects involved in agriculture and rural development to spread the benefits of growth and balanced economic development.

In order to ensure that social projects and rural development remain a priority, the Government increased the development expenditure ceiling under the Eighth Malaysia Plan (2001-05) by RM10 billion to RM170 billion. This was necessary as a significant portion of the original development allocation was

utilised during 2001-03, following pro-growth strategies and stabilisation measures taken to mitigate recessionary pressures. During this period, the implementation of social and economic projects, especially in the education and health sectors, were brought forward and accelerated. Consequently, the higher ceiling reduced the impact of a sharp fall in development spending on the economy and thereby ensured that the growth momentum was not disrupted.

At the same time, policies were targeted at ensuring a more efficient public sector. Among the improvements made to the public sector delivery system were the simplification of existing rules and regulations as well as work processes. In addition, a management review and revamp exercise among government-linked companies were undertaken to drive a performance driven culture and creation of shareholders' value. These measures helped promote investor confidence and resulted in a more favourable business environment for the economy.

The Government also offered additional tax breaks, incentives and financing facilities for the private sector to augment its role in spearheading growth. These measures included raising the threshold of 20% corporate tax rate for SMEs to RM500,000 (from RM100,000), establishment of a one-stop agency to promote the services sector, tax incentives for companies providing cold chain facilities and services for perishable agricultural produce, additional incentives for hotels and tourism projects, enhancement of the size of the Micro-Credit Scheme by RM1 billion, allowing deductions on entertainment expenses incurred in sales promotions, reducing or abolishing import duties of selected goods such as computer batteries, wooden and plastic goods, as well as reducing and abolishing export duties on several agricultural produce and commodities. These strategies contributed to creating an environment where private sector activity gained momentum to contribute towards higher economic growth. The private sector's contribution to economic growth rose to 6.2 percentage points in 2004 (2003: 3.1%; 2002: 0.2%).

Given the ample liquidity situation in the economy, the bulk of the financing requirements of the Government were raised from domestic sources without crowding out the private sector. New issues of government securities with maturities of 3, 5 and 7 years were raised at average yield rates ranging between 3.14 – 4.55% and for those with maturities of 10 and 15 years the average yield rates ranging between 5.09 – 5.73%. The Government continued to ensure prudence in its recourse to external borrowing to minimise exposure to external risks. During the year, recourse to external borrowings was limited to the drawdown of project loans committed earlier.

Table 2.7
Consolidated Public Sector Finance

	2003	2004*e*	2005*f*
	RM million		
Revenue[1]	107,055	116,663	115,760
Operating expenditure	84,163	102,727	100,091
Current surplus of NFPEs[2]	55,651	52,295	52,892
Current balance	**78,543**	**66,231**	**68,560**
% of GDP	**19.9**	**14.8**	**14.6**
Net development expenditure[3]	83,315	67,772	63,523
General government[4]	*43,155*	*33,638*	*33,175*
NFPEs	*40,160*	*34,135*	*30,348*
Overall balance	**-4,772**	**-1,541**	**5,037**
% of GDP	**-1.2**	**-0.3**	**1.1**

[1] Excludes transfers within general government.
[2] Refers to 34 NFPEs in 2003 and 2004; 36 NFPEs in 2002.
[3] Adjusted for transfers and net lending within public sector.
[4] Comprises Federal Government, state governments, statutory bodies and local governments.
e Estimate
f Forecast
Note: Numbers may not add up due to rounding.

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

Reflecting the strong commitment to fiscal consolidation policy, the Government was able to contain its debt at a manageable level. As at end-2004, the debt level was 48.4% of GDP, of which external debt accounted for 16% of total debt.

Consolidated Public Sector

The consolidated public sector's financial position improved in 2004. Although revenue remained favourable, higher operating expenditure resulted in a lower public sector current surplus position of 14.8% of GDP. However, lower development expenditure by both the general government and the non-financial public enterprises (NFPEs) led to a smaller overall public sector deficit of RM1.5 billion or 0.3% of GDP.

Federal Government Finance

Reflecting its fiscal consolidation stance, the Federal Government registered a lower fiscal deficit of RM19.4 billion or 4.3% of GDP in 2004 (2003: -5.3% of GDP). The improved fiscal position was due to better revenue collection and lower disbursements of development expenditure.

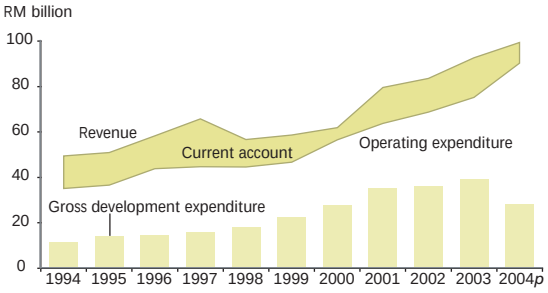
Federal Government **revenue** increased by 7.3% to RM99.4 billion or 22.2% of GDP in 2004. The better

revenue performance was due to higher collections from both direct and indirect taxes. Non-tax revenue receipts remained favourable.

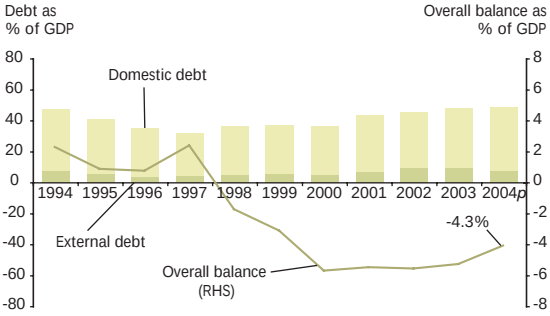
The higher tax revenue collection reflected the improved economic performance as well as the high oil prices in the previous year. The higher collections were also the result of several measures implemented to enhance tax collection and minimise tax leakages and evasions. These measures included rationalising the tax structure, intensifying collection efforts through stricter enforcement, tax audits and anti-smuggling measures. Income tax receipts increased sharply, accounting for a larger share of total revenue (46%). Of significance, receipts from the petroleum income tax registered a significant growth of 35.6% following higher oil prices that averaged at US$30.30 per barrel in 2003 (the tax base for 2004) and an increased production of crude oil. Higher personal income and business earnings contributed to increases in personal and corporate income taxes, despite tax concessions implemented in the 2004 Budget to reduce the tax burden of individuals and SMEs. These tax concessions included an increase in child relief from RM800 to RM1,000 for children below 18 years and RM3,200 to RM4,000 for children above 18 years that are studying at local institutions of higher learning and an increase in the chargeable income threshold from RM100,000 to RM500,000 to be eligible for a lower corporate tax rate of 20% for SMEs.

Graph 2.9

Federal Government Finance



Federal Government Debt



p Preliminary

Table 2.8
Federal Government Finance

	2003	2004*p*	2005 Budget
	RM million		
Revenue	92,608	99,397	99,102[1]
Operating expenditure	75,224	91,298	89,141
Current account	**17,384**	**8,099**	**9,961**
% of GDP	**4.4**	**1.8**	**2.1**
Net development expenditure	38,312	27,518	27,589
Gross development expenditure	*39,353*	*28,864*	*28,304*
Less: Loan recoveries	*1,041*	*1,346*	*715*
Overall balance	**-20,928**	**-19,419**	**-17,628**
% of GDP	**-5.3**	**-4.3**	**-3.8**
Sources of financing:			
Net domestic borrowing	23,250	25,650	–
Gross borrowing	*41,850*	*45,850*	–
Less: Repayment	*18,600*	*20,200*	–
Net foreign borrowing	-3,709	120	–
Gross borrowing	*3,144*	*1,136*	–
Less: Repayment	*6,853*	*1,015*	–
Special receipts	0	516	–
Realisable assets[2] and adjustments	+1,387	-6,867	–
Total	**20,928**	**19,419**	**–**

[1] Includes net revenue gains.
[2] Includes changes in Government's Trust Fund balances. A positive (+) sign indicates a drawdown in the accumulated realisable assets.
p Preliminary

Source: Ministry of Finance

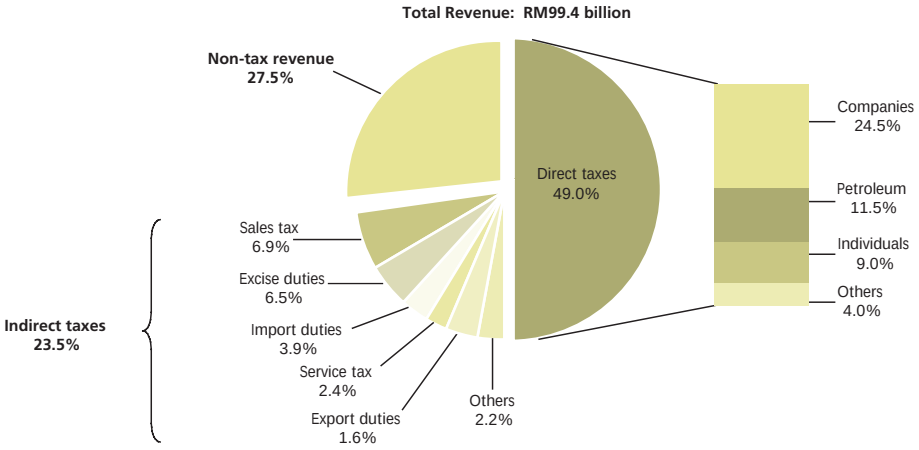
Table 2.9
Federal Government Revenue

	2003	2004*p*	2003	2004*p*
	RM million		Annual change (%)	
Tax revenue	**64,891**	**72,050**	**-2.9**	**11.0**
% of GDP	**16.5**	**16.1**		
Direct taxes	43,016	48,703	-3.0	13.2
Companies	*23,990*	*24,388*	*-2.6*	*1.7*
Petroleum	*8,466*	*11,479*	*10.9*	*35.6*
Individuals	*7,984*	*8,977*	*-19.3*	*12.4*
Stamp duties	*2,008*	*2,381*	*15.9*	*18.6*
Others	*568*	*1,478*	*26.0*	*160.0*
Indirect taxes	21,875	23,348	-2.8	6.7
Export duties	*1,156*	*1,600*	*43.9*	*38.3*
Import duties	*3,919*	*3,874*	*6.9*	*-1.1*
Excise duties	*5,031*	*6,427*	*6.0*	*27.7*
Sales tax	*7,965*	*6,816*	*-13.8*	*-14.4*
Service tax	*2,038*	*2,349*	*-7.9*	*15.3*
Others	*1,766*	*2,281*	*-3.8*	*29.2*
Non-tax revenue	**27,717**	**27,347**	**66.4**	**-1.3**
Total revenue	**92,608**	**99,397**	**10.9**	**7.3**
% of GDP	**23.5**	**22.2**		

p Preliminary

Source: Ministry of Finance

Graph 2.10
Composition of Federal Government Revenue, 2004 (% share)



Stronger domestic demand conditions during the year resulted in higher collections of most major sources of indirect taxes. In particular, the continued high demand for motor vehicles combined with measures announced in the 2004 Budget contributed to higher collections of excise duties. Among the new measures were higher excise duties on cigarettes and tobacco products and measures to curb smuggling activities through the use of special stickers or banderole and security ink. During the year, there was a rationalisation of the tariff structure on motor vehicles in line with Malaysia's commitment to the ASEAN Free Trade Area (AFTA) agreement. With effect from 1 January 2004, under the new tariff structure, import duties for the completely knocked down (CKD) ASEAN passenger cars were reduced to 25% (from 42-80%), while higher excise duties of 60-100% were imposed (from 25-65%). Nevertheless, import duties collection was only slightly affected. Sales tax collections were also lower due to the higher tax exemption given for petroleum products. Under the Automatic Price Mechanism, a higher tax exemption would be provided to oil companies to minimise the impact of higher oil prices on the retail prices of petroleum products.

In line with the Federal Government's fiscal consolidation stance, the growth in total gross expenditure of the Federal Government was lower at 4.9% in 2004 (2003: 9.5%). The overall thrust of Government expenditure was to continue to provide a supportive environment for the private sector and to enhance the productive capacity as well as the quality of life for all Malaysians. The substantially higher subsidy for petroleum products was the major reason for **operating expenditure** increasing by 21.4% in 2004.

The sharp increase in oil prices resulted in significantly higher subsidies, largely for petroleum product. Under the Automatic Pricing Mechanism, the Government is required to pay subsidies to oil companies in the event that the duty exemption provided is not adequate to compensate for the loss of revenue arising from increases in oil prices but maintaining stable retail prices of petroleum products. To mitigate some of the impact of further increases in oil prices on the payment of subsidy, the Government raised the retail prices of petroleum products by two sen with effect from 1 May and by five sen with effect from 1 October 2004. Higher expenditure for supplies and services was mainly for maintenance and repairs, rent and payments for professional services to upgrade the quality and efficiency of Government services.

Table 2.10
Federal Government Operating Expenditure by Object

	2003	2004*p*	2003	2004*p*
	RM million		% share	
Emolument	21,721	23,779	28.9	26.0
Supplies and services	13,968	16,633	18.6	18.2
Asset acquisition	1,409	1,764	1.9	1.9
Debt service charges	10,546	10,920	14.0	12.0
Pensions and gratuities	5,870	6,060	7.8	6.6
Subsidies	2,679	5,796	3.6	6.3
Other grants and transfers[1]	16,323	21,264	21.7	23.3
Other expenditure[2]	2,706	5,083	3.6	5.6
Total	**75,224**	**91,298**	**100.0**	**100.0**
% of GDP	**19.1**	**20.4**		

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

Source: Ministry of Finance

Higher payments were made in the form of grants and transfers to government agencies, statutory bodies and state governments for development and maintenance purposes. There was a sharp increase in the payment of refunds on excess taxes collected prior to 2004. The total wage bill, which was the largest component of operating expenditure (26%), rose by 9.5%. During the year, the Government enhanced incentives for the teaching profession with a 20% pay rise for teachers with excellent performance and also increased salaries for the armed forces. Debt service charges were slightly higher, reflecting the higher level of financing taken to finance the Federal Government deficit. Nevertheless, the share of debt servicing expenditure to operating expenditure declined to 12% (2003: 14%).

Gross **development expenditure** declined substantially by 26.7% to RM28.9 billion during the year (2003: RM39.4 billion). As greater emphasis was placed on agriculture and rural development and public utilities projects, higher outlays were recorded for these sectors.

In terms of sectoral distribution, the economic services sector became the largest component of total development expenditure with its share increasing to 41%. Higher outlays on agriculture and rural development and public utilities, such as rural roads, water and electricity programmes, reflected the Government's efforts to further modernise the agriculture sector and to enhance the standards of living in rural areas. Outlays for the transportation sub-sector remained favourable, in line with the Government's objective of promoting a more efficient and effective integrated transportation network. Funding was channelled mainly towards constructing and upgrading roads and bridges, as well as improving and increasing the capacity of the railroad system, ports and airports. Spending under the trade and industry sub-sector was focussed on industrial research and technological development, promotion of SMEs and tourism development projects.

In the social services sector, priority continued to be given to the education sub-sector. However, expenditure on the education sub-sector was significantly lower, as most projects in this sector under the Eighth Malaysia Plan had already been completed. As part of earlier fiscal stimulus programmes, implementation of single session schools and the construction of computer laboratories, polytechnics and universities were accelerated during 2001-03. Expenditure for health purposes also remained high to provide better quality healthcare and medical services. The bulk of this expenditure was for the construction and upgrading of hospitals and the provision of rural health services. The Government also continued to undertake housing projects for public sector personnel and the lower income groups. Spending for defence and internal security purposes was mainly for the modernisation programme of the armed forces and police. Higher expenditure for general administration was largely for Information and Communications Technology (ICT) development as well as for the acquisition of fixtures and fittings for new Government buildings.

Total **gross borrowings** of the Federal Government in 2004 amounted to RM47 billion (RM45 billion in 2003). Almost the entire financing requirement (98% of total) was sourced domestically as there was excess liquidity in the banking system. The regular issuance of government securities helped to further develop the ringgit bond market by ensuring a more reflective benchmark yield curve.

During the year, fourteen issues of Malaysian Government Securities (MGS) totalling RM41.8 billion were issued through open tenders and private placements. Out of this total, the Government reopened nine MGS issues to increase their respective issue sizes, which served to enhance liquidity in the bond market. The Government also made three new issuances of the Government Investment Issues (GIIs)

Table 2.11
Federal Government Development Expenditure by Sector

	2003	2004*p*	2003	2004*p*
	RM million		% share	
Defence and security	6,029	4,133	15.3	14.3
Economic services	13,793	11,851	35.0	41.1
Agriculture and rural development	1,620	2,881	4.1	10.0
Trade and industry	3,456	1,201	8.8	4.2
Transport	7,354	6,630	18.7	23.0
Public utilities	920	945	2.3	3.3
Others	443	193	1.1	0.6
Social services	17,707	10,260	45.0	35.5
Education	10,193	4,316	25.9	15.0
Health	2,681	2,352	6.8	8.1
Housing	1,928	1,593	4.9	5.5
Others	2,905	1,999	7.4	6.9
General administration	1,824	2,620	4.7	9.1
Total	**39,353**	**28,864**	**100.0**	**100.0**
% of GDP	**10.0**	**6.4**		

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

Source: Ministry of Finance

Table 2.12
Federal Government Debt

	Annual change		As at end-2004*p*
	2003	2004*p*	
	Nominal value in RM million		
Domestic debt	**22,803**	**30,487**	**181,970**
Treasury Bills	0	0	4,320
Government Investment Issues	2,000	2,100	9,100
Malaysian Government Securities	21,250	23,550	154,350
Treasury Housing Loans Fund	2,628	4,837	14,200
Market loans	-3,075	0	0
External debt	**1,001**	**-2,631**	**34,654**
Market loans	-485	-3,259	24,930
Project loans	1,486	629	9,724
Total	**23,804**	**27,856**	**216,624**
% of GDP			**48.4**

p Preliminary

Source: Ministry of Finance

amounting to RM4.1 billion. By holders, the provident and pension funds and insurance companies continued to be the major holders. The banking institutions raised their holdings of MGS to 15% of total outstanding MGS as at end-2004. The holders of GIIs were mainly banking institutions (74% of total amount outstanding).

In line with the Government's prudent debt management policy, the Government limited its access to external borrowing to the drawdown on existing

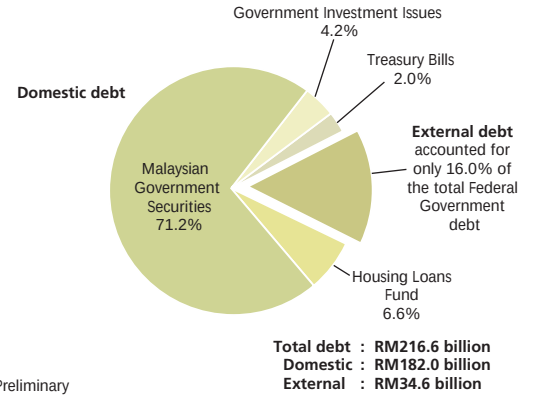
Table 2.13
Holdings of Federal Government Domestic Debt

	2003	2004*p*	2003	2004*p*
	Nominal value in RM million		% share	
Treasury Bills	**4,320**	**4,320**	**100.0**	**100.0**
Insurance companies	67	17	1.6	0.4
Banking institutions	3,266	481	75.6	11.1
Others	986	3,822	22.8	88.5
Government Investment Issues	**7,000**	**9,100**	**100.0**	**100.0**
Insurance companies	390	597	5.6	6.6
Banking institutions	6,611	6,755	94.4	74.2
Others	0	1,748	0.0	19.2
Malaysian Government Securities	**130,800**	**154,350**	**100.0**	**100.0**
Social security and insurance institutions	99,162	109,362	75.8	70.9
of which:				
Employees Provident Fund	*84,678*	*91,402*	*64.7*	*59.2*
Insurance companies	*11,598*	*14,700*	*8.9*	*9.5*
Banking institutions	19,008	23,427	14.5	15.2
Others	12,630	21,560	9.7	14.0

p Preliminary

Note: Numbers may not add up due to rounding.

Graph 2.11
Federal Government Debt as at end-2004*p* (% share)



p Preliminary

project loans. A total of RM1.1 billion were disbursed from both bilateral and multilateral sources. During the year, the Government novated two loans to government agencies. Hence, the external debt level of the Federal Government was lower at 7.7% of GDP at end-2004, compared to 9.5% at end-2003.

Total **outstanding debt** of the Federal Government increased to RM216.6 billion due mainly to higher domestic debt. In terms of the ratio of Federal Government outstanding debt to GDP, it was slightly higher at 48.4% as at end-2004 (end-2003: 47.9%). Despite the higher debt levels, the Government's debt servicing capacity continued to remain within prudent and manageable levels. Debt servicing as a proportion of operating expenditure and revenue remained low at 12% and 11% respectively in 2004. The external debt service ratio of the Federal Government was also low at 0.5% in 2004, given the low external debt exposure of 16% of total outstanding debt in 2004 (2003: 19.8%). Active debt management also minimised bunching of repayments, with about 60% of the external debt at end-2004 having remaining maturity of more than three years. The bulk of the loans (about 95%) were raised at fixed interest rates, which reduced exposure to any interest rates fluctuations.

State Governments

Based on preliminary estimates, the consolidated financial position of the state governments recorded an overall deficit of 0.3% of GDP. The slight deterioration was due to higher operating and development expenditures despite the stronger revenue performance. The overall deficit was financed by the drawdown of accumulated financial assets of the state governments and loans from the Federal Government.

Table 2.14
Consolidated State Government Finance

	2003	2004*e*	2005 Budget
	RM million		
Revenue	8,541	10,085	10,183
State sources	*7,217*	*8,277*	*7,448*
Federal grants and transfers	*1,324*	*1,808*	*2,735*
Operating expenditure	5,307	6,796	6,787
Current surplus	**3,234**	**3,289**	**3,396**
% of GDP	**0.8**	**0.7**	**0.7**
Net development expenditure	3,817	4,739	4,852
Gross development expenditure	*4,362*	*4,856*	*4,969*
Less: Loan recoveries	*545*	*117*	*117*
Overall balance	**-583**	**-1,451**	**-1,456**
% of GDP	**-0.1**	**-0.3**	**-0.3**
Sources of financing:			
Net Federal loans	1,033	440	385
Realisable assets[1]	-450	+1,011	+1,071
Total	**583**	**1,451**	**1,456**

[1] A positive (+) sign indicates a drawdown in the accumulated realisable assets.
e Estimate
Note: Numbers may not add up due to rounding.

Source: State governments

During the year, higher revenue was derived from both state and Federal sources. The states' own sources of revenue were enhanced mainly by higher receipts of royalties on petroleum and gas, as well as better returns from investments. As in previous years, receipts from Federal sources were channelled to assist the states in providing infrastructure and essential amenities to improve the quality of life of the people.

The increase in operating and development expenditures of state governments reflected efforts undertaken in improving public amenities and services. The higher operating expenditure was mainly due to higher emoluments and payments for supplies and services. A major portion of the rise in development expenditure was directed towards agricultural and rural development, expansion and upgrading of public utilities and housing development.

Non-Financial Public Enterprises (NFPEs)

Based on preliminary estimates, the consolidated financial position of the 34 NFPEs continued to record an overall surplus. The consolidated revenue of the NFPEs rose by 4.2% to RM162.3 billion, as a result of higher earnings from the oil and gas-related sector, telecommunications and utilities, manufacturing and services sectors. The better revenue performance was attributable to higher economic activity and higher prices of crude oil and gas. To a lesser extent, extraordinary gains from sales of assets also contributed to an increase in revenue. Nevertheless, a smaller current account surplus of 11.7% of GDP was recorded due to the higher current expenditure. The increase in current expenditure resulted from the higher costs arising from business expansion and higher prices of raw materials and inputs, especially for crude oil.

Development expenditure was sustained at a high level. Capital expenditure was channelled towards the expansion of capacity, both at home and abroad. The bulk of the development projects were undertaken by the larger NFPEs, such as Petroliam Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB) and Telekom Malaysia Berhad (TMB). During the year, PETRONAS continued its domestic and international investments in both upstream and downstream activities. Acquisition of equity shares in the Egyptian Liquefied Natural Gas (LNG) Project and the Dragon LNG terminal in Milford Haven, UK were significant inroads made by PETRONAS to enter into the Atlantic Basin LNG market. The year also saw a formalisation of Pars LNG, a joint venture with the National Iranian Oil Company and TOTAL S.A, in which PETRONAS holds a 20% equity that established PETRONAS' supply position in the Middle East. Other projects undertaken included the on-going enhancement of LNG and petroleum tanker fleet, and construction of the remaining government buildings, quarters, commercial buildings and infrastructure works. Meanwhile, international projects undertaken by PETRONAS included exploration and production projects in Egypt, Vietnam, Sudan, Iran and Indonesia.

Table 2.15
Consolidated NFPEs Finance[1]

	2002	2003	2004*e*
	RM million		
Revenue	126,562	155,867	162,337
Current expenditure	80,951	99,429	109,980
Current balance	**45,611**	**56,438**	**52,358**
% of GDP	**12.6**	**14.3**	**11.7**
Development expenditure[2]	32,297	40,160	34,135
Overall balance	**13,314**	**16,278**	**18,223**
% of GDP	**3.7**	**4.1**	**4.1**

[1] Refers to 34 NFPEs in 2003 and 2004; 36 NFPEs in 2002.
[2] Includes grants from the Federal Government.
e Estimate
Note: Number may not add up due to rounding.

Source: Ministry of Finance and non-financial public enterprises

A large portion of capital expenditure by TNB was concentrated on the expansion and upgrading of power generation, transmission and distribution networks which were needed to ensure adequate and reliable supply of electricity in meeting the increasing demand from commercial, industrial and residential users. Projects undertaken included the Rehabilitation of Tuanku Jaafar Power Station Phase I and II in Port Dickson, Yan Power Station, Gelugor Combined Cycles Power Plant and Power Quality Monitoring System. TMB continued with its upgrading and expanding of telecommunication infrastructure and services, which included the submarine cable network connecting the Asia Pacific region, lease line of Internet protocol and the virtual private network for Government.

Outlook and Policy

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Outlook and Policy

THE INTERNATIONAL ECONOMIC ENVIRONMENT

Developments in 2004

In 2004, the global economy expanded at its strongest pace of 4.8% since 1984, led by the United States (US), reinforced by strong growth in the Asian region and revival of growth in Japan and Europe. Above-trend growth in the first half-year reflected the strong rebound from the lower base of 2003 due to economic uncertainties related to the war in Iraq and the outbreak of Severe Acute Respiratory Syndrome (SARS) in Asia. In the second half-year, despite the dampening effects of sharply higher oil prices and the reversal of interest rate trends, the growth momentum was maintained, reflecting sustained strong consumer spending and the revival in investments. Overall, the global economy exhibited greater resilience to energy shocks.

Robust global growth was reflected in significant improvements in international trade and financial flows. World trade grew by 8.8% in 2004, supported by the global electronics up-cycle, higher commodity prices and rising import demand, notably in the US and People's Republic of China (PR China). In the Asian region, these developments in tandem with stronger domestic demand contributed to further expansion in intra-regional trade. In the financial markets, major equity market indices rose strongly, buoyed by improved investor optimism amidst higher corporate earnings. In the foreign exchange markets, growing concerns on the large and widening US current account imbalances, and the sustainability of capital inflows to finance the deficit led to the depreciation of the US dollar against the other key currencies.

Among the major industrial countries, the **US** registered above-trend growth in 2004. Growth was broad based, with sustained expansion in consumption and strength in investment expenditure supplemented by inventory rebuilding. Household spending remained strong throughout the year. Despite the tapering off in tax cuts, increases in household wealth supported by rising house prices and historically low mortgage rates

Table 3.1
World Economy: Key Economic Indicators

	Real GDP Growth (%)			Inflation (%)		
	2003	2004*e*	2005*f*	2003	2004*e*	2005*f*
World Growth	**3.9**	**4.8**	**4.0**	**–**	**–**	**–**
World Trade	**5.1**	**8.8**	**5.8**	**–**	**–**	**–**
Major Industrial Countries	**2.0**	**3.4**	**2.6**	**1.8**	**2.0**	**2.1**
United States	3.0	4.4	3.5	2.3	2.7	3.0
Japan	1.4	2.6	1.3	-0.3	0.0	-0.1
Euro area	0.5	2.0	1.5	2.1	2.2	1.9
United Kingdom[1]	2.2	3.1	2.1	1.4	1.3	1.9
East Asia	**6.4**	**7.5**	**6.3 ~ 6.5**	**1.8**	**3.4**	**2.9 ~ 3.2**
Asian NIEs	**3.0**	**5.8**	**4.1 ~ 4.2**	**1.2**	**2.3**	**2.3 ~ 2.4**
Korea	3.1	4.7	4.0	3.6	3.6	3.0
Chinese Taipei	3.3	5.7	4.2	-0.3	1.6	1.9
Singapore	1.4	8.4	3.0 ~ 5.0	0.5	1.7	1.0 ~ 2.0
Hong Kong China[2]	3.2	7.5	4.5	-2.6	-0.4	1.5
The People's Republic of China	**9.3**	**9.5**	**8.5**	**1.2**	**3.9**	**3.0**
ASEAN[3]	**4.8**	**6.3**	**5.0 ~ 5.9**	**3.8**	**4.5**	**3.9 ~ 5.1**
Malaysia	5.3	7.1	5.0 ~ 6.0	1.2	1.4	2.5
Thailand	6.9	6.1	5.3 ~ 6.3	1.8	2.8	2.5 ~ 3.5
Indonesia	4.9	5.1	5.0 ~ 6.0	6.6	6.1	5.0 ~ 7.0
Philippines	4.7	6.1	5.3 ~ 6.3	3.1	5.9	5.0 ~ 6.0

[1] Inflation refers to the Retail Price Index excluding mortgage interest.
[2] Refers to composite prices.
[3] Includes Singapore.
e Estimate
f Forecast

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

continued to provide significant stimulus to consumption expenditure. The pick-up in labour markets, particularly evident in the second half-year, led to improved household incomes and consumer confidence. Meanwhile, strong investment expenditure was supported by healthy corporate balance sheets and rising demand, and further reinforced by an investment tax incentive. The stronger-than-expected surge in demand in 2004 after a period of lean inventories in the preceding year led to a significant rebuilding of inventories, contributing to growth. The strong demand amidst higher oil prices, however, led to further deterioration in the current account deficit.

Economic recovery in **Japan** was better-than-expected in the first half-year, underpinned by export growth and mild improvement in private consumption. Growth in the **euro area** improved mainly due to stronger demand for exports but remained below-trend. In the **United Kingdom** (UK), strength in both consumption and investment spending continued to sustain growth.

technology goods, progress in corporate restructuring, improved corporate profitability and ample liquidity in the financial systems.

Stronger external payments positions were supported by sustained current account surpluses and strong private capital inflows, which have resulted in a continued build-up of foreign reserves. The improved macroeconomic fundamentals and stronger banking sectors led to sovereign ratings upgrade in several countries in the region.

Prospects for 2005

Going forward, the outlook for 2005 remains favourable. World output and world trade are projected to expand at a steady pace of 4% and 5.8% respectively in 2005. The pace of slowdown in the US and PR China is expected to be modest, on the basis that adjustments of the imbalances in these economies would be gradual. The scenario assumes that the US dollar weakness would be orderly and that the US fiscal deficit narrows, albeit moderately. In addition, as oil prices recede from its peak in October 2004, inflationary pressures are expected to remain manageable, providing flexibility for gradual increases in interest rates in the US to a neutral level. Monetary conditions are, therefore, expected to remain supportive of growth. Meanwhile, PR China is expected to manage some softening of the economy.

Global growth would be sustained at a steady pace in 2005. The pace of slowdown in the United States and PR China is expected to be modest with gradual adjustment in the current account imbalances. Monetary conditions are expected to remain supportive of growth.

In the **Asian region (excluding Japan)**, growth accelerated to 7.5% in 2004, the strongest since 2001. PR China led the expansion with strong growth in fixed investment, robust consumption and exports. Overall, the strong growth in the region was driven mainly by a combination of rapid increase in exports as well as continued strength in domestic demand. The pick-up in domestic demand emanated from higher private investment activities and rising consumer spending in most parts of the region. Export growth accelerated to 26.2% (2003: 19.7%), despite some easing towards the second half-year. Intra-regional trade, measured by exports to regional countries as a share of total exports of the region, rose further to exceed 40% (2000: 36%).

Growth in consumption was supported by low interest rates, continued growth in consumer finance and higher incomes from stronger employment conditions. In Korea, however, consumer spending continued to contract since the second quarter of 2003, with households consolidating from the unwinding of the credit card boom in 2002. Fixed investment grew at low double-digit rates for most of the regional economies, driven by the revival in demand for

Industrial Countries

In 2005, growth in the **US** economy is expected to be near-potential, with real GDP expanding by 3.5%. While the stimulus arising from wealth effects of higher house prices and mortgage refinancing would taper off, higher incomes through continued job creation and lower unemployment would lend support to consumption spending. On the corporate front, prospects are for continued growth in investment expenditure, albeit at a more moderate pace, stemming from diminishing excess capacity, favourable corporate financial positions and incentives under recent legislation to encourage profit repatriation for domestic investment. Meanwhile, the US fiscal deficit is expected to narrow modestly. Moderate domestic demand is expected to reduce the current account deficit, amidst a weaker US dollar.

In **Japan**, the expected lower growth in 2005 reflects to a large extent the slowdown in external demand. Capital expenditure would be affected by the lower export demand for capital goods, particularly as measures to moderate China's investment boom take effect.

In the **euro area**, the recovery is uneven, with final domestic demand likely to grow more strongly in France and Spain, but weaker in Germany and Italy. In Germany, growth is expected to be dampened by sluggish growth in household income amidst ongoing labour market adjustments and some increase in savings by households in response to social security reforms. The strong appreciation of the euro would also impact the larger exporting countries, such as Germany and France where non-European Union (EU) exports account for about 40% of total exports. However, some improvement in investment spending is expected due to the effects of ongoing corporate balance sheet restructuring, which has lagged behind the US and Japan.

In the **UK**, real GDP growth in 2005 is expected to moderate to 2.1%, as household consumption growth trends to a more sustainable pace in response to previous interest rate increases and less favourable wealth effects from the housing market. The labour market is still close to full employment, sustained by private sector hiring. Investment expenditure would continue at a more modest pace, supported by the declining excess capacity. Although the housing market has been slowing steadily thus far, a sharp correction in house prices would remain a concern.

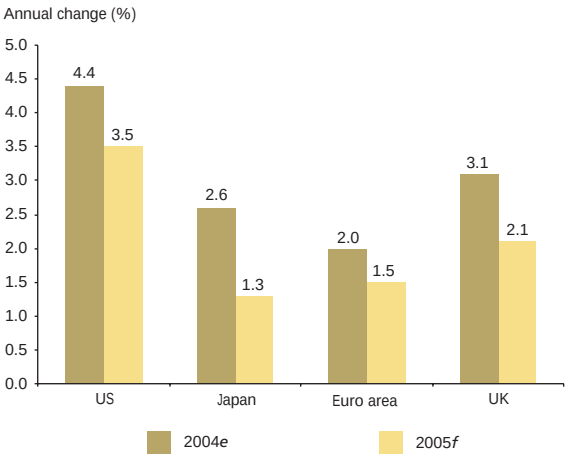
While global growth could be sustained at a steady pace in 2005, several risks could adversely affect the outlook. Inflation could rise more than expected, resulting in higher interest rates globally. In the financial markets, a disorderly realignment of the major currencies could dampen trade and investments. As a supportive engine of global growth, a significantly slower growth in China would lower growth prospects in the rest of Asia.

In 2005, growth in the US economy is expected to be near-potential. Economic expansion would be sustained by improving labour market conditions and the strong financial position of the corporate sector.

East Asian Economies

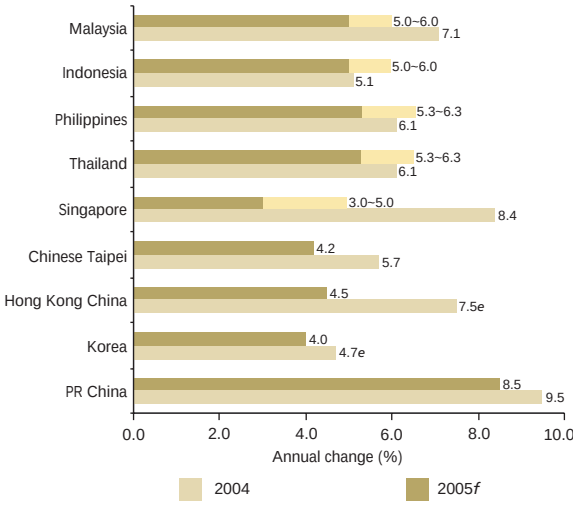
With the external environment and domestic demand projected to remain favourable, growth in the East Asian region is expected to expand at a reasonably high rate of 6.3 – 6.5%. The economic impact of the tsunami disaster is estimated to be minimal, with short-term impact on the tourism and fishery industries in the affected countries. Among the regional countries, China will remain the driver of growth. In the other Asian economies, growth will vary across countries, depending on their exposure to the downturn in the global electronics cycle.

Graph 3.1
Major Industrial Countries: Real GDP Growth (2004-2005)



e Estimate
f Forecast

Graph 3.2
Regional Countries: Real GDP Growth



e Estimate
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In the external sector, the global electronics industry is consolidating from its cyclical peak in mid-2004. Unlike the previous cycles, where both demand and supply contracted simultaneously (in 2001), the current down-cycle is characterised by some inventory accumulation due to overproduction in the first half of 2004. Thus, the current down-cycle is expected to be modest, given that world demand continues to hold up and the inventory levels are still relatively low.

On the domestic front in the East Asian region, favourable fundamentals amid continued strong overall growth and progress in economic restructuring would continue to support growth in domestic spending. Consumption will be sustained by rising disposable income and increases in employment. Another key contributing factor is the rising young age groups in the labour force in an increasingly urbanised environment with higher propensity to consume. Private demand would also benefit from the accommodative monetary stance. While interest rates have been rising in some countries, the rise has been gradual and from historical lows. Domestic demand is also likely to remain resilient, given increasing contribution of intra-regional trade, the bulk of which is for final consumption within the Asian region. Meanwhile, progress in corporate restructuring, improved corporate profitability and ample liquidity are expected to underpin the rise in investment. The fiscal stance of consolidation remains on track, with new measures to increase tax revenues, reform public enterprises and reduce fuel subsidies.

Promotion of new growth areas in various countries has also been effective in diversifying sources of growth and enhancing resilience. The broadening of the economic base to cover the promotion of SMEs, agro-business and services industries has contributed to enhancing growth.

The **Asian Newly Industrialised Economies (NIEs)** as a group is expected to register a growth of 4.1 – 4.2%, sustained by intra-regional trade and domestic demand.

PR China is still expected to lead the region's growth by registering real GDP growth of 8.5% in 2005, above the earlier target of 7%. Continued high growth rates in investment and credit in 2004 raised the concern of overheating and longer-term sustainability of growth. However, policy measures taken to address the concern in 2004 have led to some realignments of growth in fixed investment and credit expansion.

In **Korea**, real GDP is projected to increase by 4% in 2005. Private consumption is expected to turn around after two consecutive years of negative growth with the Government's introduction of a 10 trillion won (US$10 billion) fiscal stimulus package, aimed at supporting growth in 2005 and creating 400,000 jobs. Investment in the construction sector is projected to slow down. Export performance would, however, be affected by the downturn in the global electronics industry.

The East Asian region is expected to expand at a reasonably high rate. The current electronics down-cycle is expected to be modest given that world demand continues to hold up and the inventory levels are still relatively low compared with the 2001 period. In the domestic sector, favourable economic fundamentals and progress in restructuring efforts are expected to support domestic demand.

Supported by the strong economic link with mainland China, **Hong Kong China** is expected to grow by 4.5% in 2005. The close economic relationship between Hong Kong and the mainland as well as the expectation of a Renminbi revaluation has encouraged a continued inflow of funds. The strong inflow and ample liquidity have allowed the commercial lending rates to remain low, notwithstanding the increase in Hong Kong Monetary Authorities (HKMA)'s overnight discount rates which follows US interest rate trends very closely. In **Chinese Taipei**, growth is expected to moderate to 4.2%, following slower exports after a strong expansion in 2004.

Growth is expected to range between 3 – 5% in **Singapore**, depending on the performance of the electronics sector. However, its increasing diversification into biomedical as well as financial and education services would cushion the impact of the electronics cycle. Furthermore, the improvement in the unemployment situation and higher asset prices would provide some support for domestic consumption.

The **ASEAN** economies as a group is expected to grow at 5 – 5.9% in 2005. In **Thailand**, real GDP growth is expected at around 5.3 – 6.3%. Elections and infrastructure spending during the year would provide added support to domestic demand. Real GDP growth in the **Philippines** is projected to range between 5.3 – 6.3%.

The fiscal gap is projected to narrow further in 2005 following the introduction of tax reform measures. Growth in **Indonesia** is expected to be 5 – 6%, the fastest pace in nine years, with private consumption as the primary source of growth. The outlook for investment is also improving, with recovery already apparent in the second half of 2004 and likely to gather strength.

On the **global inflation** front, price increases are forecast to rise gradually, stemming mainly from the pass-through effects of high commodity prices and the narrowing output gap in some countries. The inflation pass-through effects in some economies may accelerate as producer price indices have risen faster than consumer price indices for some time, while declining corporate profit margins have eroded the capacity to absorb higher costs of production. Nonetheless, the rise in inflation is expected to be gradual as labour productivity continues to exceed real wage growth.

In 2005, inflationary pressures are expected to trend upwards in the regional countries except in Korea. In Hong Kong China, deflationary pressures have begun to ease, while in Indonesia, price pressures are expected to increase in view of the Government's plan to remove fuel subsidies. In Korea, however, inflation is projected to moderate, reflecting a stabilisation in oil prices and domestic wage growth as well as continued lacklustre domestic demand and the continued strengthening of the won.

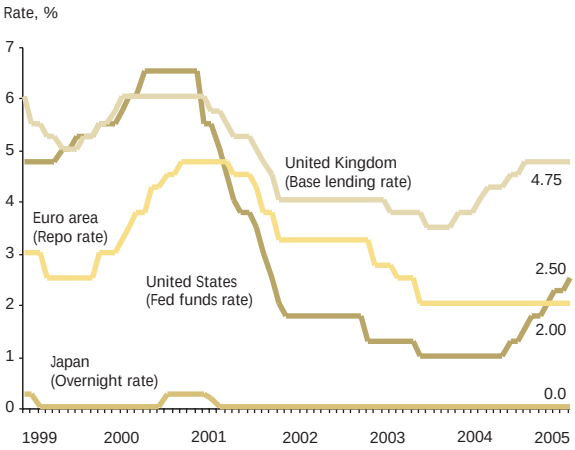
Interest Rates and Exchange Rates

In 2004, **monetary policy** in the major industrial countries remained accommodative. In view of robust economic growth and a mild upturn in inflation, several central banks began raising interest rates from low levels towards a more neutral stance.

In the US, after keeping official interest rates stable in the first half-year, strong domestic demand and some supply side factors (higher energy prices) prompted the **US Federal Reserve Board (Fed)** to start raising interest rates in June 2004, marking the first increase in four years. This move signalled the Fed's intent to return monetary policy to a more neutral stance at a measured pace. Interest rates were increased in six consecutive Fed meetings, by 25 basis points each, bringing the Federal funds rate to 2.50% by early-2005. Meanwhile, in the UK, in view of the continued strength in the housing market and rapid consumer borrowing, the **Bank of England (BOE)** raised its base lending rate twice in 2004, by 25 basis points each in February and August, to 4.75%.

In the euro zone, despite some increase in inflation due mainly to higher oil prices in 2004, the **European Central Bank (ECB)** maintained its benchmark repo rate at 2% throughout the course of the year to support domestic demand and fragile growth outlook in the euro area. Throughout 2004, with official short-term interest rates (uncollateralised overnight call rate) in Japan at around zero percent, the **Bank of Japan (BOJ)** continued to use quantitative easing measures, introduced four years ago, to inject liquidity into the banking system in order to counter deflationary pressures. As at end-2004, the quantitative easing target for current account balances of the commercial banks and financial institutions held at the BOJ stood between 30 – 35 trillion yen.

Graph 3.3
Major Industrial Countries: Official Interest Rates



During the second half-year, to contain rising inflationary pressures emanating from higher global oil prices and rising food prices, several regional economies such as Thailand, Chinese Taipei and PR China raised their interest rates. Korea, on the other hand, reduced interest rates twice to support domestic demand.

In 2005, the timing and magnitude of monetary policy actions would depend on country-specific factors, including the strength of economic growth, inflationary expectations, movements in exchange rates and the performance of the financial markets.

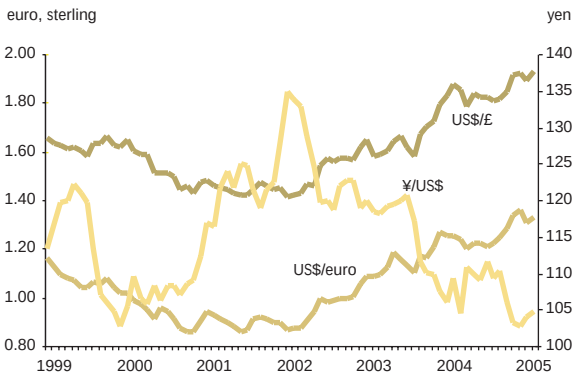
In the **foreign exchange** markets, the US dollar continued to depreciate against all major currencies in **2004**, extending its decline which began in early 2002. Measured on a trade-weighted basis[1], the dollar has declined by about 17% from its peak in March 2002 to end-December 2004. While the

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

cumulative depreciation has been most prominent against major currencies, such as the euro (36%), sterling (24%) and the yen (23%), of significance is that the dollar has recently begun to depreciate against several Asian currencies in the last quarter of 2004. On a cumulative basis since March 2002,the dollar has depreciated by about 21% against the Korean won and about 10% against both the Singapore dollar and Taiwan dollar. Against the backdrop of a weaker dollar, the euro appreciated in 2004 and ended the year at a record high of E1=US$1.3538, while several Asian currencies also appreciated against the US dollar at end-2004.

A combination of factors contributed to the dollar's decline. Underlying the depreciating trend has been the pressure from structural problems in the US, namely a widening and large current account deficit and to a lesser extent, the fiscal deficit. The relatively orderly pattern of dollar depreciation has been related to trends in the financing of the current account deficit. Since 2002, large official flows namely from the Asian region, have become an important source of financing for the current account deficit, in contrast to 2000 when foreign direct investment flows were more significant due to the technology related boom in the US. On balance, conditions exist for a further weakening dollar. The dollar is still, however, expected to receive some longer-term support given its status as a vehicle currency for trade and international financial transactions.

Graph 3.4
Movement of the US Dollar against Major Currencies



In 2005, the movement of the dollar against other major currencies is expected to be influenced by a number of factors. These include global asset reallocation among the major currencies, the path of adjustment in global imbalances, investors' perception on growth and interest rate differentials and the performance of equity and bond markets. In addition, country-specific issues that relate to inflationary trends and geo-political risk premiums could also affect sentiments on the major currencies.

MALAYSIAN ECONOMY IN 2005

The prospects for the Malaysian economy in 2005 remain sound. Real GDP is expected to expand by 5 – 6%. The sustained global growth, the modest downturn in the global semiconductor industry as well as relatively favourable prices for primary commodities are expected to provide support to export growth. While the global electronics industry is consolidating after reaching a peak in mid-2004, the cyclical downturn is forecast to be modest in view of the strong Asian demand, the rapid inventory adjustments and relatively low inventory levels. Current indications point to an expected upturn in the global electronics cycle in the second half-year. In the domestic economy, the private sector would remain as the main driver of growth, as the Government remains committed to optimising expenditure in order to strengthen the fiscal position. With the core inflation projected to remain low in 2005 (1.8%), monetary policy is able to remain supportive of the further expansion in private sector activities.

Real GDP is expected to expand by 5 – 6% in 2005. The catalyst to growth would originate from the private sector, as the Government remains committed to optimising expenditure. Monetary policy remains supportive of the further expansion in private sector activities.

Domestic Demand

All demand components, except public investment, are expected to register positive growth in 2005. In particular, private sector expenditure is projected to sustain a strong expansion of 8.7% (11.1% in 2004). Both household consumption and business outlays are projected to remain resilient, thereby cushioning some of the effects of lower public investment spending arising from the Federal Government's gradual fiscal consolidation programme. Public consumption is expected to increase moderately mainly on account of higher expenditure for supplies and services.

Table 3.2
Real GDP by Expenditure (1987=100)

	2004*p*	2005*f*
	Annual change (%)	
Domestic Demand[1]	**7.3**	**4.3**
Private sector expenditure	11.1	8.7
Consumption	*10.1*	*8.5*
Investment	*15.8*	*9.6*
Public sector expenditure	1.0	-4.0
Consumption	*6.6*	*4.5*
Investment	*-3.5*	*-11.6*
Net exports of goods and services	**-22.3**	**43.1**
Exports	15.6	8.1
Imports	19.8	5.6
Gross Domestic Product	**7.1**	**5.0 ~ 6.0**

[1] Excluding stocks.
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Private consumption is expected to increase by 8.5%. Stable labour market conditions, a supportive credit environment and high commodity prices would continue to provide support to consumption expenditure. Therefore, given the prospects for relatively strong income growth, private consumption expenditure would remain a significant source of stimulus for GDP growth in 2005. In addition to the current favourable economic conditions, long-term factors also are positive for sustained consumption growth. Malaysia presently has one of the lowest private consumption-to-GDP ratios (45.4%) in the world as well as low levels of household indebtedness by international standards. As a result, the scope for sustained growth in private consumption remains high.

Private investment spending is also expected to remain resilient. The projected increase of 9.6% is based on the assessment of higher capital outlays in all sectors except construction. Forward-looking indicators based on demand and growth of new industries suggest a continued upward trend in private investment activities. The Government has provided the enabling environment for the private sector to invest in new areas of growth by putting in place the necessary infrastructure and providing both fiscal and non-fiscal incentives as well as financing facilities. The improvement in the public sector's delivery system and the lower cost of capital will contribute to further enhancing the investment climate, which in turn will promote new FDIs and reinvestment to support domestic investment.

The manufacturing sector, which accounts for about a third of total private sector investment, is projected to record a strong positive growth for the third consecutive year. Capital expenditure for projects already committed to would extend into 2005. In periods of favourable business operating conditions, manufacturers are expected to continue to replace their old or obsolete machinery and equipment to improve their efficiency and enhance flexibility to meet changing demand.

The strongest growth in capital spending is expected in the services sector, particularly in the utilities and telecommunications sub-sectors. Capital expenditure in the utilities sub-sector is expected to be largely concentrated on the ongoing development of a coal fired power plant and water projects. In the telecommunications sub-sector, capital spending is expected to be channelled towards the integration, enhancement and upgrading of the efficiency and capacity of cellular networks. The upgrading of the existing infrastructure would allow the cellular operators to migrate to more advanced technologies, particularly third generation (3G) roaming. Significant efforts are being undertaken not only to develop new applications for these standards but also to ensure the older wireless application protocol (WAP)-based and multimedia messaging services are integrated into the improved technologies. In addition to higher expenditure in the telecommunications sector, IT spending is also expected to increase as a result of efforts by financial institutions and business enterprises to improve their operating efficiency through the adoption of faster and more sophisticated business applications.

Private sector activity would again drive domestic demand in 2005 as the Government continues to pursue a policy of gradual fiscal consolidation. Private consumption would be supported by sustained income growth and an accommodative credit environment, while private investment outlays would provide additional capacities in an environment of strong demand conditions.

Table 3.3
Contribution of Demand Components to Real GDP Growth

	2004*p*	2005*f*
	% point of contribution	
Domestic Demand[1]	**6.6**	**3.9**
Private sector expenditure	6.2	5.1
Consumption	*4.7*	*4.1*
Investment	*1.5*	*1.0*
Public sector expenditure	0.3	-1.3
Consumption	*1.0*	*0.7*
Investment	*-0.6*	*-1.9*
Change in stocks	*2.9*	*-2.3*
Net exports of goods and services	**-2.4**	**3.4**
Exports	17.0	9.6
Imports	19.5	6.1
Gross Domestic Product	**7.1**	**5.0 ~ 6.0**

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

With the discovery of new oil fields in 2003 and 2004, capital outlays in the oil and gas sector are projected to be higher, driven by exploration and development activities.

Meanwhile, ongoing mechanisation and automation of food production methods would continue to support outlays in the agriculture sector. In the construction sector, capital expenditure would be sustained in the residential segment.

In 2005, public sector expenditure is expected to decline by 4% due to the Federal Government's fiscal consolidation programme. **Public investment** is estimated to register a decline of 11.6%. While Federal Government development expenditure will be lower, spending will be reprioritised to focus on smaller-sized projects with lower costs, including projects to revitalise the agriculture sector and higher spending on education and training; health; and housing. This would benefit a larger section of the population, especially the lower income group, thereby ensuring a more balanced distribution of the benefits of development among the different segments of society. **Public consumption** is expected to increase, albeit moderately by 4.5%, largely on account of higher spending on supplies and services.

Sectoral Outlook

On the supply side, growth would be supported by expansion in all sectors, except construction. Following the strong output expansion in 2004, the manufacturing sector is expected to grow at a moderate pace of 4.5% in 2005, in tandem with developments in the global semiconductor industry. The services sector would remain firm supported by consumption and tourism activities as well as strong expansion in the telecommunication, finance and business services activities. The primary commodity sector would continue to benefit from higher production of crude palm oil, rubber, natural gas and crude oil, as well as increasing contribution from other miscellaneous agriculture, mainly food-related activities. Meanwhile, the construction sector is expected to remain weak due to a decline in activities in the civil engineering segment.

In the **manufacturing** sector, strong external demand for chemical and rubber products as well as sustained growth in the output of domestic-oriented industries, led by the transport equipment and fabricated metal industries, would provide support for growth in the sector. The diversified base would moderate the impact of the ongoing consolidation in the electronics industry.

Growth would be supported by expansion in the manufacturing, services and commodity sectors. The diversified base of the manufacturing sector would provide support to moderate the impact of the ongoing consolidation in the electronics industry.

In the electronics industry, the latest assessment is that the global semiconductor down-cycle would be modest, with the impact mainly felt in the first half of

Table 3.4
Real GDP by Sector (1987=100)

	2004*p*	2005*f*
	Annual change (%)	
Agriculture	5.0	3.3
Mining	4.1	5.0
Manufacturing	9.8	4.5
Construction	-1.9	-1.0
Services	6.7	5.7
Real GDP	**7.1**	**5.0 ~ 6.0**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

2005. Forward-looking indicators in the US including new orders, unfilled orders and the inventory-to-shipment ratio for electronics support the view of a modest downturn. Taking cognisance of the increase in inventories of electronics arising from some over-production in the first half of 2004, manufacturers have responded early to rationalise and reduce their inventories. However, the speed in inventory adjustment varies across the segments. The personal computer (PC)-related segment is positioned to resume growth sooner than the other segments as major global PC producers have succeeded in reducing their inventories significantly since the fourth quarter of 2004.

Meanwhile, global demand for electronics is expected to remain favourable in 2005 supported by the relatively strong global growth. The PC segment would also continue to benefit from the strong demand in the Asia-Pacific region. The growth in the electronics sector would be further reinforced by the continued trend towards increased application of chips in consumer appliances due to the increasing convergence in computing, digital media and wireless technology. Malaysia is therefore expected to benefit from these positive factors, given the diversity in the electronics and electrical products manufactured in the country. More importantly, major multinational companies have been migrating production lines for some of the high value-added products to Malaysia to leverage on the cost-efficiencies in production.

Growth in the **services** sector is projected to be sustained at 5.7%, reflecting expansion across all sub-sectors. The increased resilience is a result of the services sector becoming more diversified over the years. The sector has shifted from depending on a narrow range of activities related to trade and manufacturing to a broader range of activites supported by domestic consumption and growth in new services activities related to tourism and business support services.

The wholesale and retail trade, hotels and restaurants sub-sector is expected to remain strong, in line with the relatively strong consumption activities as well as higher tourist arrivals. The higher travel activities and strong growth in the telecommunications industry is expected to drive growth in the transport, storage and communication sub-sector. Growth would be further supported by port-related activities, including transhipment, in line with the moderate increase in trade. In the telecommunications industry, growth will be driven by a further increase in the subscriber base and introduction of new products and services in the cellular segment. The expansion of the cellular services coverage to the entire country by major cellular providers and increasing convergence of technologies between the cellular and other IT and Internet services will also benefit the industry. The finance, insurance, real estate and business services sub-sector is expected to see another year of strong expansion, led mainly by increased bank lending, continued expansion in fee-based income and robust insurance activities. The pick-up in momentum in ICT-related services and shared services such as business process outsourcing and insourcing activities should see an increase in the business services segment.

The **agriculture** sector is projected to expand further by 3.3% in 2005 following two successive years of strong growth. Growth would be supported by higher palm oil and rubber production as well as miscellaneous agriculture. The increase in palm oil production would be driven by both higher yields and expansion in mature areas, particularly in East Malaysia. Farmers are also envisaged to continue with Good Agriculture Practices, reflecting utilisation of agricultural inputs to increase productivity encouraged by the relatively favourable prices. Following the strongest output growth in more than 30 years to 1.19 million tonnes in 2004, natural rubber production is projected to increase marginally to 1.2 million tonnes in 2005, with smallholders continuing to account for the bulk of the production amidst the firm prices. Growth in the agriculture sector is also expected to emanate from newly promoted areas, such as food crops and food-related activities, particularly fisheries, livestock, fruits and vegetables.

Growth in the **mining** sector meanwhile is expected to strengthen to 5% in 2005, supported mainly by higher production of natural gas in view of the anticipated rise in capacity utilisation of the MLNG plants in Sarawak to meet the increasing global demand. Despite already achieving relatively high production levels in 2004, crude oil production (including condensates) would continue to increase by 1.5% to reach 776,250 barrels per day in 2005 (2004: 762,300 bpd) amidst the strong global demand and relatively high crude oil prices forecast for the year.

The **construction** sector is expected to remain weak (-1%) due to lower civil engineering activity following the completion of several privatised projects as well as lower public spending on infrastructure projects. Nevertheless, activities in the residential and non-residential segments are expected to remain firm. Growth in the residential segment is expected to continue to be driven by sustained demand for houses, encouraged mainly by the continued favourable economic conditions. In the non-residential segment, growth is envisaged to be supported by rising demand for office and retail space, amidst the strong expansion in service-related business activities.

Prices and Employment

Headline **inflation** is projected to average 2.5% in 2005. Inflation is expected to edge up in the first half of the year, reflecting the continuing one-off impact of price adjustments to retail petroleum products as well as higher taxes on cigarettes and tobacco that were implemented in 2004. There may also be some pass-through from higher commodity prices and other developments in the external sector. However, the impact of these factors on headline inflation is expected to be transitory and once the effects wear off, inflation is expected to moderate in the second half of 2005. The continued improvements in productivity and the capacity expansion that have been taking place are also likely to mitigate any build-up of inflationary pressures. Given the lack of significant general demand pressures, core inflation is projected to increase to 1.8%.

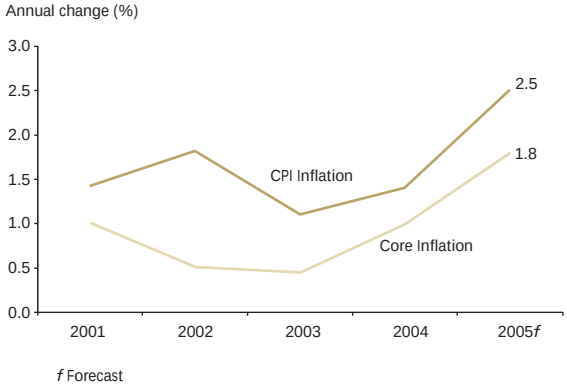
The favourable economic growth environment will provide greater **employment** opportunities across most major sectors of the economy in 2005. Unemployment is, therefore, forecast to remain low at 3.5%. Meanwhile, efforts to develop human capital as a catalyst of productivity growth would continue to be pursued. The training opportunities provided would continue to lay emphasis on developing skills and enhancing the value-added contribution from the labour force.

Balance of Payments

On the external front, the **current account** surplus is projected to remain large at 14.9% of GNP as a result of the sustained large surplus in the trade account and the smaller deficit in the services account. The trade surplus is expected to remain large as the moderation in export growth (7%) would be offset by slower

The surplus in the current account of the balance of payments is expected to remain large due to the large trade surplus and smaller services deficit. FDI inflows would be mainly from reinvested earnings by multinational companies, and channelled to higher value-added activities in Malaysia.

Graph 3.5
Consumer Prices



f Forecast

Table 3.5
Balance of Payments

	2004*e*	2005*f*	2004*e*	2005*f*
	RM billion		US$ billion	
Goods	104.5	114.8	27.5	30.2
Trade account	81.1	89.5	21.3	23.6
Exports				
(% annual change)	*20.8*	*7.0*	*20.8*	*7.0*
Imports				
(% annual change)	*26.3*	*6.3*	*26.3*	6.3
Services	-8.8	-8.0	-2.3	-2.1
Balance on goods and services	**95.7**	**106.8**	**25.2**	**28.1**
Income	-24.5	-26.4	-6.4	-6.9
Current transfers	-14.6	-14.1	-3.9	-3.7
Current account balance	**56.6**	**66.3**	**14.9**	**17.4**
(% of GNP)	***13.4***	***14.9***	***13.4***	***14.9***
Financial account	15.4		4.0	
Errors and omissions	11.1		2.9	
of which:				
Exchange revaluation gain	*8.0*		*2.1*	
Overall balance	**83.1**		**21.9**	

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

growth in imports (6.3%). In the services account, receipts are expected to increase with the continuing growth in tourist arrivals. In the financial account, sustained inflows of long-term capital, particularly foreign direct investment (FDI) would also strengthen the overall balance of payments.

In line with the consolidation in the global semiconductor sector, growth in **manufactured exports** is expected to expand at a more moderate pace of 8.6% (2004: 19.7%). Electronics exports are projected to expand by 4.5% in 2005 (2004: 12.7%), with some segments growing at a faster rate, particularly the PC sector, thus providing support to the overall performance of the sector. Exports of non-electronic goods would continue to register a strong growth (12.5%; 2004: 27%), supported by continued demand from PR China, mainly for resource-based products, particularly for petroleum, chemical and rubber products, as well as metal products.

Mineral exports are projected to register a positive growth of 2.2%, as receipts from liquefied natural gas (LNG) and crude petroleum exports would be higher amidst the higher export volume, offsetting the effects of declining prices. Export prices of Malaysian crude oil are expected to stabilise at around US$40 per barrel (2004: US$40.81). Malaysian crude oil prices would be largely influenced by trends in the global oil markets in 2005, as global supply and demand remain finely balanced amidst bullish sentiment supported by geopolitical concerns. Export volume of LNG is projected to increase as the MLNG Tiga plant continues to expand its capacity utilisation on the back of higher offtake from major buyers in 2005.

Following two successive years of strong performance, **exports of agriculture products** are forecasted to decline by 15.2%, as lower prices more than offset the increase in volume. Export prices of major agriculture commodities are expected to consolidate in line with global developments after two years of strong performance. In particular, the export price of palm oil would be lower at RM1,200 per tonne (2004: RM1,706 per tonne) due to the expected increase in harvests of competing oilseeds, especially soybean oil, as well as higher domestic stocks of palm oil carried over from 2004. While rubber prices are also expected to soften to 440 sen per kilogramme in 2005, this remains a relatively lucrative price level for rubber producers and is in line with expectations of continued demand growth in the international markets. The exports of palm oil and rubber account for the bulk of agricultural exports (63% of total agriculture exports).

Growth in **imports** of 6.3% is expected to be supported by the continued growth in imports of intermediate and capital goods. Intermediate import growth will stem from continued demand for imported components for expansion in manufacturing production, in response to the growth in external demand. Growth in capital imports will be supported by ongoing investment activity and will emanate from upgrading of equipment for new technology and capacity expansion in the manufacturing and services sectors. Higher capital imports in the services industry is expected to be led by capacity expansion in power generation and improvements in network capacity and quality by telecommunication companies. Increased exploration in the oil and gas industry in the wake of discoveries of new fields will also induce growth in capital imports.

The **services account** deficit is envisaged to improve further to 1.8% of GNP. Attractive promotional campaigns targeted at medium- and long-haul tourists are expected to enhance tourism earnings. Capacity expansion by the airlines is expected to contribute to higher export earnings from cargo and

Table 3.6
Exports and Imports

	2004*p*	2005*f*
	RM billion	
Gross exports	**480.7**	**514.4**
(% annual change)	***20.8***	***7.0***
Manufactures	**390.4**	**424.2**
(% annual change)	*19.7*	*8.6*
of which:		
Electronics	188.6	197.2
(% annual change)	*12.7*	*4.5*
Electrical products	68.4	73.3
(% annual change)	*23.4*	*7.1*
Chemical & chemical products	27.8	32.9
(% annual change)	*31.0*	*18.6*
Minerals	**41.2**	**42.1**
(% annual change)	*38.2*	*2.2*
Agriculture	**36.2**	**30.7**
(% annual change)	*7.4*	*-15.2*
Gross imports	**399.6**	**424.9**
(% annual change)	***26.3***	***6.3***
Capital goods	**55.5**	**57.3**
(% annual change)	*36.1*	*3.1*
Intermediate goods	**287.2**	**305.0**
(% annual change)	*22.0*	*6.2*
Consumption goods	**23.2**	**25.4**
(% annual change)	*24.1*	*9.4*

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

passenger services. The expansion in the shared services industry and new products in the ICT sector will continue to underpin the growth in exports of computer and information and financial services. Meanwhile, payments for transportation are expected to be higher, in line with the higher volume of trade and increases in the freight rate. Higher outflows are expected for royalties and licence fees, reflecting the acquisition of new technologies by companies for the production of higher value-added products.

The **income account** deficit is projected at 5.9% of GNP, reflecting larger profits and dividends accruing to multinational companies (MNCs). Profits and dividends accruing to Malaysian companies operating abroad are also expected to be higher. The higher contribution to income is expected mainly from Malaysian companies participating in the oil and gas, plantation and infrastructure sectors.

The **financial account** is expected to remain favourable, supported by long-term capital inflows, in particular FDI. Based on the potential investments announced by MNCs, FDI is anticipated to be channelled to higher value-added activity in the manufacturing sector. The bulk of the FDI will continue to be in the form of reinvestment by the MNCs. Inflows into the services sector, such as the wholesale and retail trade and business and support services are likely to remain high, given Malaysia's advantages in terms of excellent infrastructure, educated and skilled human resources as well as customised fiscal incentives. In the oil and gas sector, recent discoveries of new oil fields are likely to spur greater investment in exploration and extraction activities as well as investment in downstream activities.

Overseas investment by Malaysian companies is expected to remain large, with investment decisions continuing to be driven by companies' desire to gain access to new markets and natural resources, to diversify their earnings and to support domestic activities through vertical integration. In 2005, investments abroad will continue to be broad based, involving both greenfield investments and acquisitions of foreign interests, particularly in the oil and gas, services and manufacturing sectors. Investment abroad by companies in the construction sector is expected to increase following the award of several contracts for large-scale infrastructure projects as well as customised housing and commercial projects to Malaysian companies, particularly in India, Africa and West Asia.

MONETARY POLICY IN 2005

The accommodative monetary policy stance, amidst the low and stable inflation, has positively supported the stronger expansion of domestic economic activity. The stability of the exchange rate, accorded by the pegged exchange rate regime, has also ensured strong external performance and reinforced the expansion in domestic economic activity. Against the prospect of sustained growth in domestic demand and the continued positive external outlook, domestic monetary conditions remain conducive for a sustained expansion in household consumption and provide support for business activity and capacity expansion. On the inflation front, consumer prices are expected to edge up in the early part of the year because of the one-off effect of changes in administered prices, taxes on tobacco and alcoholic products, and possibly some pass-through from the external sector. However, these factors are expected to have a transitory effect and inflation is expected to moderate during the rest of the year. Of importance, the continued sustained growth in productivity, capacity expansions, and the lack of significant general demand pressures would mitigate any inflationary tendencies.

The monetary policy stance in 2005 will continue to take into consideration both global and domestic developments. On the external front, sustained global growth will ensure that the external sector continues to contribute positively to domestic growth. While the pace of global growth is expected to moderate, it will, nonetheless, remain strong. Indicators of economic activity in the major and regional economies continue to remain positive and point towards further expansion in global economic activity. Of importance, the adverse effects from the high crude oil prices on both global growth and inflation have been modest and have not threatened the prospect for continued global growth. While several major and regional countries have pre-emptively tightened their monetary policies, the pace of tightening has been gradual and overall monetary conditions continue to support growth. The inflation outlook in most of these countries has stabilised and any further monetary tightening is likely to be gradual and modest.

On the domestic front, economic fundamentals have strengthened further and there is greater resilience of domestic demand. Consumer spending remains strong amidst the continued increase in household disposable income, stable employment conditions and

low borrowing costs. While this has led to higher household debt levels, the ability of the household sector to service its debt remains strong. There has been a continued downtrend in the non-performing loans ratio of the household sector. Therefore, household spending is expected to continue expanding and contribute towards the sustainability of domestic economic activity.

Meanwhile, the current expansion of productive capacity by businesses is expected to continue. While the capacity expansion and new business activity of the corporate sector have so far been financed largely through internal funds, signs of stronger demand for external financing are also emerging. In particular, demand for long-term bank financing by the small and medium enterprises has continued to increase at strong growth rates in recent months. Similarly, while there are strong indications that large corporations would continue to raise large amount of funds from the private debt securities and equity markets, long-term financing sourced from the banking institutions is also likely to remain important. With the steady improvement in the corporate sector's financial position, banking institutions have actively responded to the financing requirements of the business sector. These positive underlying developments are expected to support further expansion in business investment activity, while providing the flexibility for fiscal consolidation to take place without any adverse effects on the level of economic activity. The continued expansion in productive capacity and improvements in productivity would enable businesses to better meet growing demand, and help mitigate upward pressures on wages and prices.

A key development in the international financial markets has been the gradual and sustained depreciation of the US dollar against major and regional currencies on account of the growing deficits in the current and fiscal accounts of the US. While the ringgit has depreciated along with the US dollar, its overall undervaluation, taking into account the performances of the currencies of Malaysia's major trading partners, has been relatively small. Consequently, the pass-through effect into domestic prices from the depreciation of the ringgit is likely to be modest. In the absence of any substantial misalignment of the ringgit, due to external or domestic changes in fundamentals, the pegged exchange rate regime continues to accord significant benefits to the Malaysian economy by providing a stable environment to support trade and investment.

To ensure price stability and sustainable growth, monetary policy will remain flexible and responsive to emerging trends in macroeconomic conditions. While prevailing circumstances continue to warrant the maintenance of the current accommodative monetary stance, pre-emptive action will be taken if developments indicate a significant shift in growth and inflation prospects. Policies will always aim to ensure that the levels of interest rates and market liquidity remain appropriate and continue to support private sector activity.

FISCAL POLICY IN 2005

With the private sector assuming the role as the main driver of growth, fiscal consolidation is on course to further strengthen the Government's financial position in 2005. The thrust of fiscal policy in 2005 will be to progress forward with a further gradual reduction of the fiscal deficit through prudent financial management, while efforts to support private sector initiatives will focus on providing a strong enabling environment to support increasing productivity and reducing the cost of doing business. As announced in the 2005 Budget, strategies were aimed at developing human capital, increasing productivity, enhancing research and development capabilities, supporting new sources of growth and improving the quality of life for all Malaysians. The Government will emphasise efficiency in its delivery system and effectiveness in its financial management. Fiscal consolidation in 2005 will move forward through revenue enhancement and expenditure reduction.

In terms of revenue enhancement, the focus will be on streamlining tax measures, improving tax administration and enforcement. A new consumption tax will be introduced in 2007, with a shift away from the present narrow based sales and services taxes to a more comprehensive goods and services tax, based on a value-added concept. The new tax is expected to be more efficient, transparent and broad based.

Total Federal Government expenditure (excluding contingency reserves) was budgeted to be lower at RM117.4 billion, declining by 4.2% from the estimated 2004 expenditure, with development expenditure falling by 9.1% to RM28.3 billion. Overall government spending will be reduced in a prudent manner without creating adverse implications for the economy. Efficiency of expenditure will be pursued by means of cost effectiveness and the re-prioritisation

of projects to benefit a larger segment of the population, especially the lower income groups and the rural population. Hence, projects aimed at reducing the rural-urban socio-economic gap and revitalising the agriculture sector will be prioritised. Special attention will also be given to developing the rural infrastructure and promoting the development of small and medium enterprises (SMEs).

Reflecting its fiscal prudence and consolidation stance, the Federal Government is expected to register a lower fiscal deficit of RM17.7 billion or 3.8% of GDP in 2005. In addition, after taking into account the potential net revenue gain of RM72 million arising from the tax measures in the 2005 Budget, the overall fiscal deficit will be marginally lower at RM17.6 billion. The bulk of financing will be raised from the domestic market given the ample liquidity in the financial system.

Key strategies in the 2005 Budget are aimed at supporting private sector activity, raising productive potential and widening the export base to support long-term sustainable growth. Towards this end, various tax and non-tax incentives were directed at accelerating the shift towards higher value-added growth in niche areas, with greater emphasis on agriculture as the third engine of growth, enhancing the services sector (especially Information and Communications Technology, Islamic banking and finance, and tourism) and strengthening the manufacturing sector. In the agriculture and agro-based sectors, tax incentives and measures were introduced to further modernise and commercialise the sector. The measures for the manufacturing sector included incentives for outsourcing manufacturing activities, relocating investments to promoted areas, especially the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak, and the development and promotion of halal products. In addition, incentives were provided to develop the SMEs as a key growth catalyst. Two special funds under the administration of Bank Negara Malaysia were enhanced, while new funds were established to increase technological capability, market penetration and training to enhance the management of SMEs.

Measures also continued to focus on enhancing the country's efficiency and productivity and overall competitiveness to enable Malaysian companies to compete globally. These incentives were directed at reducing the cost of doing business, enhancing human capital development with emphasis on increasing skilled manpower and creating capable and dynamic entrepreneurs. Incentives were also targeted at increasing innovation through greater focus on research and development (R&D) and spearheading the commercialisation of local R&D. Several measures were introduced to further strengthen the capital market.

FINANCIAL SECTOR POLICY IN 2005

In an increasingly competitive and dynamic operating environment, the thrust of financial sector policy for 2005 will continue to be directed at enhancing the competitiveness of the financial sector, as well as promoting a sound and robust financial system that is able to support economic growth and development. Emphasis would also continue to be accorded to further strengthen the consumer education and protection framework. Ensuring continuous access to financing for all segments of the economy will remain as an important endeavour in 2005. There will also be further deregulation and liberalisation with progressive infusion of competition into the financial sector. This is so as to not disrupt the system and the overall policy objectives.

For the banking sector, policy measures will continue to focus on enhancing the capacity and capability of domestic banking institutions, to prepare them for greater liberalisation and competition as outlined in the second phase of the Financial Sector Masterplan. Capacity building measures implemented over the past few years have yielded positive results and these efforts will continue to be pursued in 2005 to ensure continuous improvement in the performance of the domestic banking institutions. This includes the benchmarking initiative, which began in 2000 that has provided banking institutions with the ability to assess their performance against their peers and identify the areas of opportunities to better themselves. With the narrowing of the gap in the performance between the domestic and foreign banking institutions, policy measures will also focus on enhancing competition in the banking system. Greater operational flexibility will be accorded to the locally incorporated foreign banks to enable them to contribute more effectively to the development of the financial sector and economy as a whole.

The year 2005 will see further rationalisation within the financial sector, with more mergers of commercial bank and finance company entities within a domestic banking group taking place. The capital and regulatory, as well as the legal

framework governing investment banks will be finalised. With the advent of investment banks, similar activities carried out by various entities involved in capital market activities will be integrated under one roof. This will result in synergies and economies of scale, and consumers would be able to enjoy a wider range of financial services at a 'one-stop' centre. An investment banking industry that is dynamic and competitive will act as a catalyst to the development of a vibrant and efficient capital market that can contribute towards economic transformation and growth.

Maintaining financial stability remains a priority. During the year, a number of major policies will be implemented to further enhance the prudential framework and to safeguard the soundness of banking institutions. A second concept paper will be issued on the consolidated supervision framework of financial conglomerates, the objective of which is to provide regulators with a holistic approach in assessing the financial health of the conglomerates. It will also facilitate monitoring of the activities of financial conglomerates such that the non-depository institutions within the group will not introduce excessive risk to the depository institutions in particular, and to the financial system in general. Extensive discussions with the industry will take place on the implementation of the new Basel Capital Accord in 2008 as it is critical to ensure that the necessary skills and expertise are harnessed and systems infrastructure is in place to facilitate a smooth transition to the new Basel Capital Accord. Risk management of banking institutions will be further improved with the inclusion of market risk in the Risk Weighted Capital Ratio framework that the banking institutions are required to fully comply with from April 2005.

In response to the changing financial landscape and to provide a more flexible operating environment, policies pertaining to the extension of credit by banking institutions to a single customer and connected parties, as well as guidelines on non-performing loans, are being reviewed. The shareholding policy will be further refined to encourage corporate shareholding and promote shareholder activism. Shareholders are expected to be more proactive and play a more diligent role in monitoring performance of banking institutions and the effectiveness of the board of directors and management. A review of the guidelines on anti-money laundering and 'Know Your Customer' policy will also be carried out to incorporate measures on anti-terrorism financing. It is critical to ensure that the integrity of the banking system, as the mobiliser of funds, remains intact by determining that funds flowing through the system are derived from legitimate sources and are used for legitimate purposes. In addition, effective corporate governance practices are critical to ensure the proper management of an institution. In this regard, Bank Negara Malaysia will be issuing a comprehensive guideline on corporate governance to replace the current Guidelines on Directorship in Banking Institutions (BNM/GP1), covering amongst others, the broad principles of corporate governance and minimum standards and specific requirements on the role and structure of the Board and management, as well as ensuring checks and balances. Efforts would also be focused on developing additional tools to enhance the banking system's surveillance framework. These tools would facilitate the identification of emerging vulnerabilities and state of resilience both in the system and at individual institution level.

Another primary thrust for the year will be to continue enhancing access to financing by all segments of the economy. Banking institutions will continue to be the main provider of funds in the economy through continued expansion in lending activities and remain as an important contributor to economic growth and development. Efforts will continue to encourage banking institutions to channel funds to the small and medium enterprises (SMEs), as well as to increase financing to the agriculture and agro-based industries and to microenterprises, which are potential growth areas.

Measures to enhance and further strengthen the consumer education and awareness framework, as well as the consumer protection infrastructure, will continue to be a priority in our efforts to develop an efficient, dynamic and competitive financial sector. Additional booklets and fact sheets will be issued under the consumer education programme and the programme will adopt a more targeted approach by tailoring information for specific groups. Also, with effect from 1 February 2005, banking institutions will be required to adhere to the framework on basic banking services. Another milestone that took place in January 2005 was the launching of the Financial Mediation Bureau, to serve as a one-stop centre for the resolution of a broad range of retail consumer's complaints against financial institutions regulated by Bank Negara Malaysia. It is also vital that consumers realise their growing role and responsibility in taking

control of their financial decisions. Banking institutions should facilitate this process by providing consumers with accurate information regarding their products and services so that they are able to make informed decisions. In this regard, further guidelines will be issued to require product-specific and institutional transparency and full disclosure. Emphasis will also be given to the development of a structured and comprehensive framework on fair market practices that will foster greater competition and promote equitable market practices amongst banking institutions. In addition, as part of the efforts to strengthen the consumer protection infrastructure, a deposit insurance system is being established. The framework on the system has been finalised and the Deposit Insurance Bill will be tabled in the Parliament this year.

The focus for the payment systems in 2005 is to further improve accessibility to electronic payment systems, enhance efficiency and improve security measures to spur the migration to electronic payments. Arising from the major accomplishments that were achieved by the financial institutions in 2004, efforts will be continued to enhance the accessibility to electronic payment systems by utilising convenient delivery channels such as internet banking and ATMs, and through extensive deployment of card acceptance devices. Bank Negara Malaysia will facilitate an industry-wide collaboration to further improve the security measures in internet banking transactions, enhance cross-border payments mechanisms, promote payment related standards to facilitate payment referencing and improve efficiency and services of the inter-bank giro system to increase its usage. The consumer protection framework in payment related services, such as measures to promote responsible lending in credit cards and to avoid over-indebtedness, will also be enhanced.

As for the Islamic banking sector, the major policy thrust in 2005 will focus on further strengthening the Islamic banking system as an integral component of the Malaysian financial system. The policy thrust will centre on the enhancement of institutional structure, regulatory and prudential structure, legal and Shariah framework, product and market development, and human capital development and consumer education. In terms of the institutional structure, it is envisaged that there will be greater dynamism in the Islamic banking market following the issuance of Islamic banking licences to foreign financial institutions and the establishment of Islamic subsidiaries by the domestic banking groups. The exercise is expected to stimulate more competition and product innovation in the market. To meet the increasing manpower requirements, an initiative is also being taken to enhance the intellectual capital and expertise with the objective of creating a larger pool of experts and high calibre professionals in Islamic banking and finance.

To enhance the effectiveness of the regulatory and prudential structure, efforts will be directed at strengthening the provisioning and liquidity framework to meet the specific requirements of the Islamic banking operations. The development of an Islamic reference rate to act as a benchmark for the pricing of Islamic banking products will be pursued. To promote sound development of the legal infrastructure, the review of the Islamic Banking Act 1983 will be accelerated and undertaken on a comprehensive basis to keep pace with the development of the Islamic banking market. Transparency in banking practices will be an important focus for the year as part of the efforts to increase customer awareness and satisfaction.

Policy thrust for the development financial institution (DFI) sector in 2005 will continue to focus on further enhancing the capacity and capability of DFIs in providing financial and non-financial support to the targeted sectors of the economy. In particular, efforts are being undertaken to implement the merger of the Export-Import Bank of Malaysia Berhad and Malaysia Export Credit Insurance Berhad, and the rationalisation of lending activities of Bank Industri & Teknologi Malaysia Berhad and Bank Pembangunan dan Infrastruktur Malaysia Berhad. The rationalisation exercise aims to enable these institutions to operate in a more focused manner, and facilitate the transformation of these institutions as specialists in rendering financial and advisory support to their respective targeted sectors. The project to enhance the advisory capability of selected DFIs for the SMEs is targeted to be completed in 2005. The expected improved capability of these DFIs to provide quality non-financial services would increase their effectiveness in serving the SMEs. To complement strategies on capacity building, continuous efforts will also be pursued in 2005 to further strengthen the financial and operational soundness, corporate governance and risk management practices, in order to create a group of sound, dynamic and efficient DFIs that supports the Government's development objectives at minimal cost.

Liberalisation of the Foreign Exchange Administration Rules

The foreign exchange administration rules are aimed at providing an appropriate framework that will influence capital flows and facilitate currency risk management to promote financial and economic stability of the country. The rules complement the overall macroeconomic policies and are reviewed regularly in line with the changing environment.

On 1 April 2004, in conjunction with the release of the Bank's Annual Report 2003, several major foreign exchange administration policies were liberalised to promote the efficiency of business operations in Malaysia and better risk management of investments.

With effect from 1 April 2005, the Bank announced further relaxations to the foreign exchange administration rules as part of its ongoing initiatives towards reducing cost of doing business, improving regulatory delivery system and encouraging better risk management activities by residents and non-residents as well as promoting the development of domestic foreign exchange market to promote stability in the financial system and economy of the country. The liberalisations are in the following areas:

(i) Forward Foreign Exchange Contracts by Residents and Non-residents

To allow businesses and individuals to effectively manage their risks, residents and non-residents may enter into forward foreign exchange contracts with licensed onshore commercial and Islamic banks (licensed onshore banks) and approved merchant banks without prior permission of the Controller of Foreign Exchange (the Controller) to buy or sell foreign currency against ringgit or another foreign currency as follows:

- **Residents** are now allowed to enter into forward foreign exchange contracts to hedge the following:
  (a) Foreign currency exposures of permitted overseas investments;
  (b) Payment for permitted overseas investments;
  (c) Repayment of principal and payment of interest for foreign currency credit facilities (onshore or offshore) which are payable within 24 months; and
  (d) Anticipatory receipts from exports and anticipatory payments for import of goods and services, based on the value of export receipts and import payments of the preceding 12 months.

  With the above flexibility, residents may now effectively hedge all committed and anticipatory inflows and outflows of their current account transactions (i.e. payments for export and import of goods, services and income) and committed inflows and outflows for capital account transactions (e.g. payments for overseas investments and extension of credit facilities to non-residents or repayments of credit facility from non-residents) as well as safeguarding the value of their overseas investments.

- In addition, **non-residents** are now allowed to enter into forward foreign exchange contracts for the following committed flows of funds:
  (a) Repatriation of investment proceeds from Malaysia; and
  (b) Purchase of ringgit assets in Malaysia.

(ii) Maintenance of Foreign Currency Accounts (FCA) by Residents and Conversion of Ringgit into Foreign Currency for Credit into FCA

The rules on the maintenance of FCA by residents are also liberalised further to facilitate effective cash flow management and to promote business efficiency.

- Residents are now free to open FCA with licensed offshore banks in Labuan and overseas banks for any purpose, except for the retention of export receipts. With this flexibility, residents may retain their foreign currency receipts (other than export proceeds) in FCA maintained with licensed onshore banks, licensed offshore banks in Labuan and overseas banks with no overnight limits imposed on these accounts.

- Resident companies maintaining FCA with licensed offshore banks in Labuan and overseas banks are required to submit monthly statement, Statement OA, to the Controller.

- Residents may also convert ringgit into foreign currency for credit into these FCA maintained with licensed onshore banks, licensed offshore banks in Labuan and overseas banks as follows:
  (a) Any amount for residents (companies and individuals) without any domestic credit facilities;
  (b) Up to RM10 million per calendar year on a corporate group basis by resident companies with domestic credit facilities; and
  (c) Up to RM100,000 per calendar year by resident individuals with domestic credit facilities.

- Residents are now free to retain any amount of export receipts in FCA maintained with licensed onshore banks. The limits imposed on export FCAs are, accordingly, uplifted.

With the removal of the limits, effectively all FCA maintained with licensed onshore banks (except for FCA for overseas education and employment purposes by residents with domestic credit facilities) are free from any overnight limits.

- The aggregate overnight limits on FCA for overseas education and employment purposes maintained by residents with domestic credit facilities remain as follows:
  (a) US$150,000 for FCA maintained with licensed onshore banks or licensed offshore banks in Labuan respectively; and
  (b) US$50,000 for FCA maintained with overseas banks.

(iii) Domestic Credit Facilities to Non-resident Controlled Companies (NRCCs)

The RM50 million limit on extension of credit facilities to a NRCC by residents as well as the 3:1 gearing ratio requirement imposed on NRCC for its domestic borrowing exceeding RM50 million are abolished. With the abolishment, residents are now free to extend any amount of ringgit credit facilities to NRCCs.

(iv) Investment Abroad

As part of efforts to further enhance management of funds and provide diversification of business opportunities, the rules on investment abroad by residents have also been liberalised.

- Residents with no domestic credit facilities are now free to invest any amount abroad. The investment may be made through the conversion of ringgit or from foreign currency funds retained onshore or offshore. Overseas investment funded by foreign currency borrowing will be limited to only RM10 million equivalent at any one time.

- Residents with domestic credit facilities are also free to invest abroad their foreign currency funds maintained onshore or offshore. In addition, they are allowed to convert ringgit into foreign currency up to the following limits for overseas investments:
  (a) Up to RM10 million per calendar year by companies on a per corporate group basis; and
  (b) Up to RM100,000 per calendar year by individuals.

For companies converting ringgit for overseas investments, they must have a minimum shareholders' funds of RM100,000 and must be operating for at least one year.

In addition, they may finance overseas investment with foreign currency borrowing up to RM10 million equivalent at any one time.

- The limit that can be invested abroad by unit trust management companies is also increased to 30% from 10% of the Net Asset Value (NAV) attributed to residents. Fund/asset managers may now invest abroad any amount of investment of resident clients without any domestic credit facilities and up to 30% of investments by resident clients with domestic credit facilities. The funds may be pooled for investment abroad. Such investments must be in line with the Securities Commission's prudential guidelines.

- Resident insurance companies and takaful operators may also invest abroad up to 30%, increased from 10%, of the NAV of the investment-linked funds that they market. These investments are subject to compliance with prudential insurance and takaful regulations issued by Bank Negara Malaysia.

- The above flexibilities are subject to prior registration of any overseas investments exceeding the equivalent of RM50,000 with the Controller.

(v) Foreign Currency Credit Facilities

To enhance expediency in managing business in Malaysia, the limit for residents to obtain foreign currency credit facilities from non-residents, licensed onshore banks and licensed merchant banks in Malaysia is increased from the current limit of RM5 million equivalent.

- Resident companies on a corporate group basis may now obtain foreign currency credit facility up to an equivalent of RM50 million in aggregate.

- Resident individuals are allowed to obtain foreign currency credit facility up to an equivalent of RM10 million in aggregate.

- The above flexibilities are subject to prior registration of any foreign currency credit facility exceeding RM1 million equivalent with the Controller.

- Residents may prepay their foreign currency credit facilities subject to the registration of such prepayments with the Controller prior to effecting the payments.

- Residents may also utilise up to an aggregate of RM10 million equivalent of their foreign currency credit facilities to finance overseas investment activities.

(vi) Activities by Approved Operational Headquarters (OHQs)

In line with the relaxation on residents for retention of export proceeds and overseas investments as well as freedom to obtain domestic credit facilities by NRCC, OHQs may now:

- Retain any amount of export receipts in their FCA maintained with licensed onshore banks;

- Obtain any amount of ringgit credit facilities from domestic sources; and

- Finance their overseas investment activities, including extension of credit facilities to non-residents, by converting up to RM10 million into foreign currency per calendar year if they have domestic credit facilities.

The Financial System

The Financial System

Sources and Uses of Funds of the Financial System

In line with the overall improvement in economic activity, total assets of the financial system expanded significantly by 12.8% to RM1,762.6 billion in 2004 (2003: 12% to RM1,563.1 billion). As at end-2004, total assets of the financial system were equivalent to 394% of GDP (end-2003: 397%).

Assets of both the banking system and the non-bank financial intermediaries (NBFIs) grew at a higher rate than in 2003. Assets of the banking system increased by 13.6% (2003: 13.2%), while assets of the NBFIs expanded by 11% (2003: 9.7%).

Following the completion of the merger exercise between three commercial banks and three finance companies in the third quarter of 2004, the commercial banks' share of total financial system assets rose to 41.8% (2003: 39%), while the share of finance companies declined to 3.9% (2003: 9.1%). Meanwhile, the Islamic banks' share of total assets of the financial system rose to 1.4% (2003: 1.3%), reflecting the steady expansion of the Islamic banking industry in 2004.

All major segments of the NBFIs continued to expand strongly in 2004. Assets of the provident and pension funds (PPFs), which accounted for 16.5% of

Table 4.1
Assets of the Financial System

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM billion		
Banking system	**122.4**	**142.9**	**1,189.9**
Bank Negara Malaysia	38.6	84.0	284.9
Commercial banks	66.3	128.1	737.1
Finance companies	11.2	-73.5	68.4
Merchant banks	2.8	-1.3	42.8
Islamic banks	0.8	3.9	24.9
Discount houses	2.8	1.7	31.9
Non-bank financial intermediaries	**45.5**	**56.6**	**572.7**
Provident, pension and insurance funds	30.6	35.4	383.2
Employees Provident Fund	*18.0*	*20.0*	*240.2*
Other provident & pension funds	*1.6*	*4.7*	*51.1*
Life insurance funds	*9.8*	*10.1*	*74.1*
General insurance funds	*1.2*	*0.6*	*17.8*
Development financial institutions[1]	6.6	11.2	90.3
Other financial intermediaries[2]	8.3	10.0	99.2
Total	**168.0**	**199.5**	**1,762.6**

[1] Includes Bank Simpanan Nasional (National Savings Bank), Bank Kerjasama Rakyat Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad (MIDF), Borneo Development Corporation, Sabah Development Bank Berhad, Sabah Credit Corporation, Export-Import Bank Malaysia Berhad, Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri dan Teknologi Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Credit Guarantee Corporation Malaysia Berhad (CGC) and Lembaga Tabung Haji (Pilgrims' Funds Board).

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

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Graph 4.1
Assets of the Financial System as at end-2004*p* (% share)

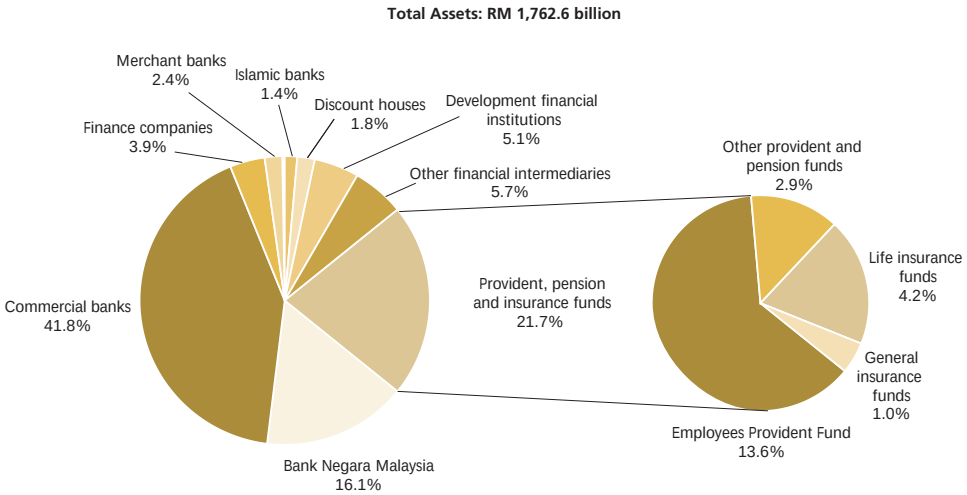

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Table 4.2
Sources and Uses of Funds of the Financial System

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM billion		
Sources:			
Capital and reserves	14.1	15.0	164.0
Currency	2.3	2.9	32.4
Deposits	74.7	126.2	835.6
Borrowings	3.8	2.5	51.2
Funds from other financial institutions[1]	16.7	-15.5	72.0
Insurance, provident and pension funds	31.3	33.6	339.2
Other liabilities	25.0	34.9	268.2
Total	**168.0**	**199.5**	**1,762.6**
Uses:			
Currency	-1.8	0.5	6.1
Deposits with other financial institutions	38.4	21.3	247.6
Loans and advances[2]	38.8	56.3	655.6
Securities	48.4	20.3	429.8
Treasury bills	*-2.1*	*-3.1*	*0.4*
Commercial bills	*0.1*	*-5.1*	*8.4*
Malaysian Government (MGS)	*20.8*	*14.6*	*139.8*
Corporate[3]	*27.5*	*14.0*	*268.2*
Private Debt Securities (PDS)	*n.a.*	*7.0*	*129.2*
Equities	*n.a.*	*7.0*	*139.0*
Foreign	*0.2*	*1.2*	*4.6*
Others	*1.8*	*-1.3*	*8.4*
Gold and foreign exchange reserves	38.6	83.6	249.7
Other assets	5.5	17.6	173.9

[1] Includes statutory reserves of banking institutions.

[2] Excludes loans sold to Danaharta.

[3] Breakdown of Corporate Securities between Private Debt Securities (PDS) and Equities available only from 2003.

n.a. Not available.

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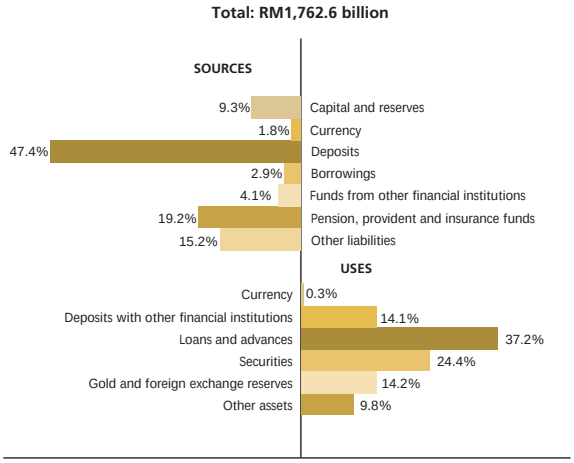
Graph 4.2
Sources and Uses of Funds of the Financial System as at end-2004*p* (% share)



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the total assets of the financial system as at end-2004, rose by 9.3% during the year. Higher returns from investments in private debt securities and equities, as well as from lending activity contributed significantly to the growth in the PPFs' asset portfolio in 2004.

Assets of the insurance sector, which accounted for 5.2% of the total assets of the financial system as at end-2004, rose by 13.1% in 2004 (2003: 15.7%). Growth in the insurance sector was driven mainly by the life insurance segment, which registered a 15.7% growth in 2004 (2003: 18%), while the general insurance segment expanded at a more moderate rate of 3.4% (2003: 7.8%).

In terms of asset composition, loans and advances remained the largest class of asset owned by the

Graph 4.3
Loans and Advances by Institution (% share)

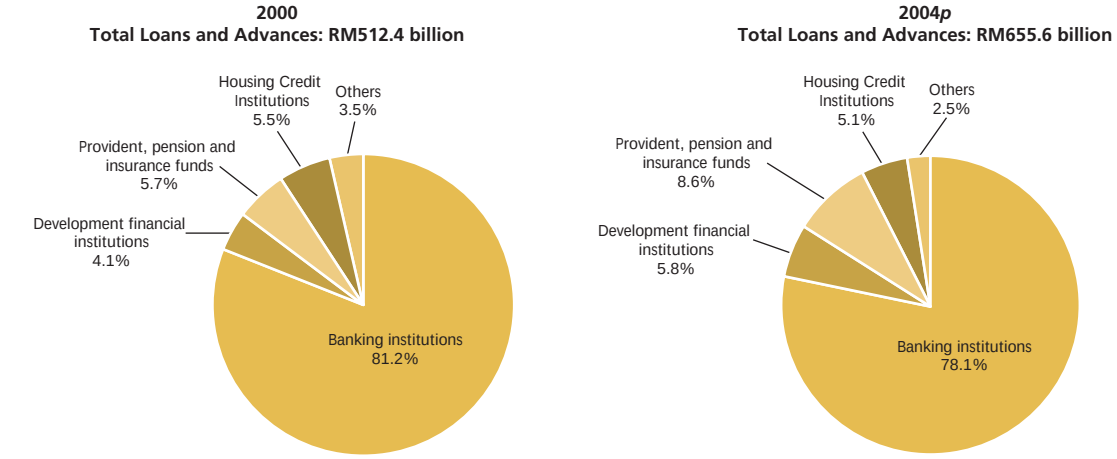

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Table 4.3
Direction of Credit[1] to the Non-Financial Private Sector

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM billion		
Loans and advances	**35.6**	**54.3**	**611.9**
Agriculture	-0.8	0.7	14.0
Mining and quarrying	0.1	-0.1	1.0
Manufacturing	1.2	2.5	58.5
Construction and real estate	-0.6	3.9	79.7
Purchase of residential properties	19.0	19.1	169.2
Retail, wholesale, restaurants and hotels	-0.5	3.2	24.0
Transport, storage and communications	1.3	0.0	15.4
Business services	0.6	1.6	22.1
Electricity, gas and water supply	-1.1	0.7	6.2
Consumption credit	9.9	15.0	111.2
Purchase of shares	-1.8	-0.4	18.8
Others	8.3	8.0	91.8
Investments in corporate securities	**26.0**	**14.2**	**266.4**
Total	**61.6**	**68.5**	**878.3**

[1] Excludes credit to non-financial public enterprises.

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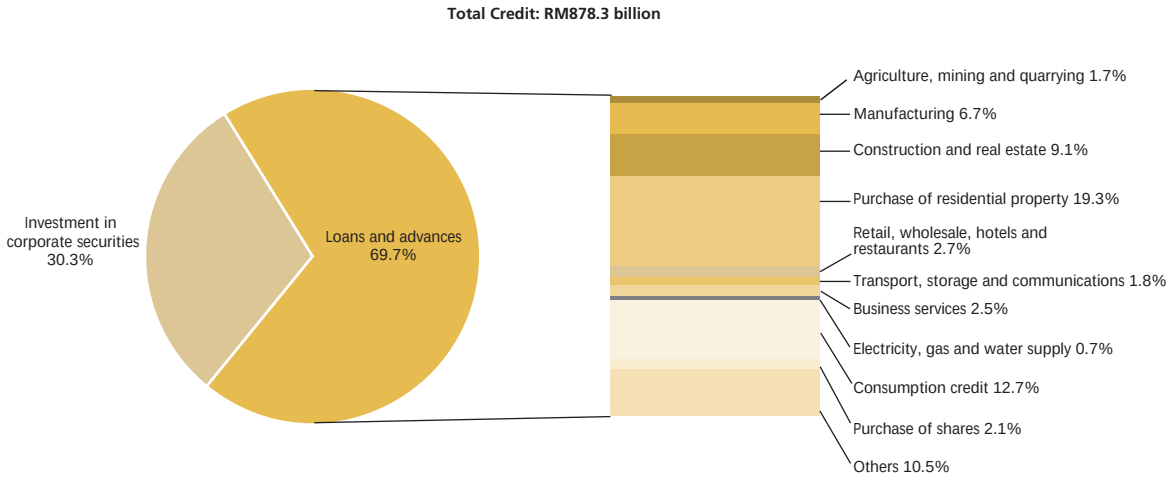
financial system in 2004, with a 37.2% share of total assets (2003: 38.3%). While the banking institutions (comprising commercial banks, finance companies, merchant banks, Islamic banks and discount houses) remained the largest provider of loans and advances, with a 78.1% share in 2004, the development financial institutions (DFIs) and the provident, pension and insurance funds have increased their share of lending activities in recent years.

In 2004, loans and advances grew by RM56.3 billion, or 9.4% (2003: 6.9%). The household sector continued to be the main driver of loan demand, as indicated by the significant share (62.9%) of the increase in total loans and advances that was extended for the purchase of residential properties and consumption credit. Within the business sector, loans extended to the small and medium enterprises continued to grow strongly, registering an increase of 7.7% in 2004 (2003: 10%).

Investment in securities by the financial system expanded by 5% in 2004 (2003: 13.4%). The lower growth was mainly due to the decline in the financial system's holdings of Treasury and commercial bills, as well as the smaller increase in holdings of Malaysian Government Securities and corporate securities (comprising private debt securities and equities). The banking institutions reduced their holdings of securities in 2004 by 11.6% or RM12.2 billion, reflecting the shift of more resources towards direct lending activity. The lower holdings of securities by the banking institutions was, however, offset by the RM23.6 billion, or 9.7% increase in investments in securities by the provident, pension and insurance funds.

Meanwhile, gross holdings of gold and foreign exchange reserves recorded a significant increase of

Graph 4.4
Direction of Credit within the Non-Financial Private Sector as at end-2004*p* (% share)



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RM83.6 billion, or 50.3% in 2004 (2003: RM38.6 billion or 30.3%). The increase reflected the markedly stronger export performance as well as substantial inflows of foreign direct investment and portfolio flows in tandem with improved investor confidence.

Deposits remained as the largest source of funding for the financial system in 2004. Deposits mobilised by the financial system grew by RM126.2 billion, or 17.8%, in 2004 (2003: 11.8%), of which, 59% were contributed by the banking institutions. Deposits placed with the banking institutions accounted for 78% of the total deposits of the financial system as at end-2004 (end-2003: 81.4%).

In terms of holders, the non-financial private sector (comprising individuals and businesses) continued to account for the bulk (71.8%) of the deposits placed with the banking system and development financial institutions (DFIs). Deposits placed by individuals with the banking system and DFIs increased by 9.3% in 2004 (2003: 9%), while deposits placed by businesses grew by 17.2% (2003: 13.8%). The strong growth in deposits is reflective of the higher disposable income and financial wealth of households and business enterprises, in line with the strengthening economy.

Apart from deposits, other major sources of funds for the financial system also increased in 2004. Provident, pension and insurance funds grew by 11% (2003: 11.4%), while capital and reserves rose by 10.1% (2003: 10.5%). The latter reflected the improved financial performance of the banking institutions and DFIs, as well as higher undistributed dividends of the unit trust funds.

Table 4.4
Non-Financial Private Sector Deposits[1] with the Financial System[2]

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM billion		
Deposits[3] with:			
Commercial banks	36.0	87.9	433.9
Finance companies	0.2	-35.4	28.7
Merchant banks	2.4	0.8	14.7
Islamic banks	1.3	2.1	11.4
Discount houses	2.3	1.8	12.6
National Savings Bank	0.2	1.6	9.9
Others[4]	7.8	5.3	36.3
Total	**50.2**	**64.2**	**547.4**
Demand deposits	13.5	10.3	87.9
Saving Deposits	4.5	5.5	74.1
Fixed deposits	25.8	34.8	342.8
of which:			
Up to 1 year	*37.3*	*33.7*	*314.9*
More than 1 year	*-11.5*	*1.1*	*28.0*
NIDs[5]	0.3	5.2	7.9
Repos[6]	6.1	8.3	34.8

1 Refers to deposits placed by business enterprises (excluding NFPEs) and individuals.
2 Excludes provident and pension, insurance and unit trust funds.
3 Refers to demand, savings and fixed deposits, negotiable instruments of deposits and repos.
4 Includes development financial institutions, cooperative societies and housing credit institutions.
5 Refers to negotiable instruments of deposits.
6 Refers to repurchase agreements.
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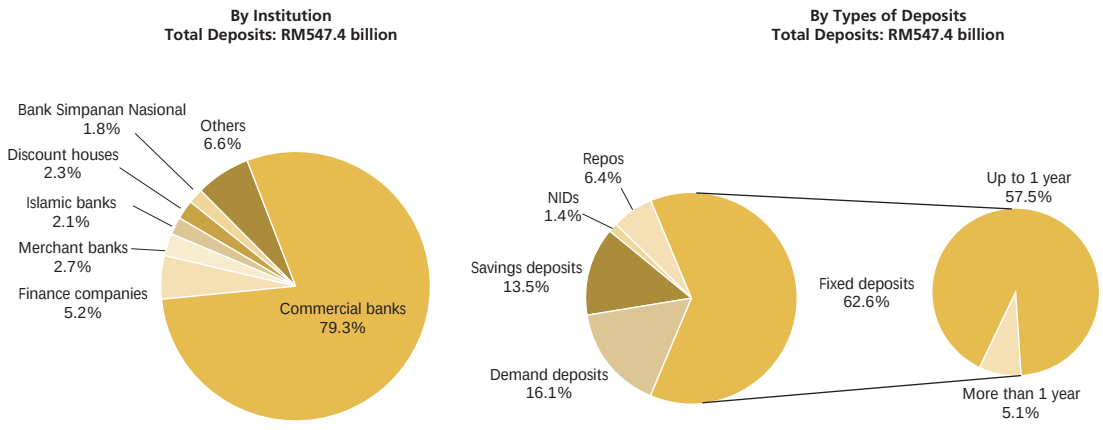
Graph 4.5
Non-Financial Private Sector Deposits with the Financial System as at end-2004*p* (% share)



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108-109 Management of the Banking System
110-111 *White Box: ICLIF Forging Ahead to Realise its Vision*
120-124 *White Box: Banking Measures Introduced in 2004*
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125-133 *White Box: Financial Sector Masterplan*
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The Banking System

The Banking System

MANAGEMENT OF THE BANKING SYSTEM

Significant progress was achieved in strengthening the capacity and capability of domestic banking institutions in 2004. With the financial sector restructuring programme effectively completed and the foundation for an efficient, effective and resilient banking system firmly in place, the domestic banking institutions are well positioned to operate in a more deregulated and liberalised environment, as envisaged in the second phase of the Financial Sector Masterplan (FSMP). In addition to capacity building, policy measures in 2004 also focused on widening access to financing by key economic sectors, strengthening the consumer protection framework and preserving overall system resilience.

The banking sector exhibited a strong performance in 2004, with risk-weighted capital ratio (RWCR) sustained at levels above 13% throughout the year, while the net non-performing loan (NPL) ratio reached a record low of 5.9% at the end of the year, the lowest level since the Asian financial crisis. The strengthened balance sheet enabled the banking system to continue to support the economic needs of the nation. Total new loans approved and disbursed grew by 13.6% and 10.6% respectively, resulting in 8.5% growth in total outstanding loans in 2004.

Progress of Danaharta

Of the three agencies established to spearhead the financial sector restructuring in the wake of the Asian financial crisis, only Danaharta remained in operation in 2004. Over its lifespan, Danaharta acquired adjusted loan rights amounting to RM52.4 billion, with an expected recovery rate of 59%. As at 31 December 2004, RM29 billion or 94% of the expected recoveries of RM30.8 billion have been received by Danaharta, of which RM23.6 billion have been realised in cash whilst the balance are held in the form of restructured loans, securities, properties and other non-cash assets. Danaharta has cumulatively distributed RM16.4 billion in cash and 66,472,341 units of securities to the Government and the respective financial institutions, in accordance with the 80:20 surplus recovery sharing agreements it has with these institutions.

Table 5.1
Danaharta: Loan Recovery as at 31 December 2004

	Adjusted loan rights acquired[1] (RM billion)		Expected recovery rate (%)	
	Acquired NPLs	Managed NPLs	Acquired NPLs	Managed NPLs
Plain loan restructuring	1.4	4.1	91	97
Settlement	3.4	8.0	82	75
Schemes of arrangement	2.6	7.5	72	76
Schemes under Special Administrators	2.3	2.7	46	27
Foreclosure	9.8	4.4	28	49
Others	1.9	3.2	49	47
Legal action	0.2	1.0	9	4
Total	**21.6**	**30.8**	**50**	**65**
Overall	**52.4**		**59**	

[1] Comprising total loan rights acquired of RM47.7 billion and accrued interest of RM4.7 billion.
Note: Total may not add-up due to rounding.

Source: Pengurusan Danaharta Nasional Berhad

To date, Danaharta has successfully redeemed 12 tranches of its zero-coupon bonds with aggregate face value of RM10.3 billion. With a cash and cash equivalent balance of RM1 billion as at 31 December 2004, Danaharta is well positioned to redeem the remaining three tranches of bonds with a total face value of RM0.8 billion, maturing in March 2005. Given this progress, Danaharta is on track to unwind its operations in 2005 and close the final chapter of the financial sector restructuring exercise.

Thrust of Policy Measures in 2004

The main thrust of policy measures in 2004 continued to focus on enhancing the performance and competitiveness of the domestic banking institutions and on ensuring that these institutions are ready for a more liberalised operating environment. In particular, efforts were directed at facilitating further improvements in the domestic banking institutions' operational efficiency and flexibility. These initiatives were implemented

Banking policies in 2004 were focused on providing an enabling environment for banking institutions to improve their efficiency and increase access to financing, while preserving overall financial stability.

together with the introduction of strengthened prudential regulations to preserve financial stability and sustain public confidence.

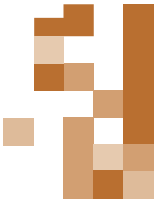
Other key policy thrusts during the year included enhancing access to financing by key economic sectors and continued efforts at strengthening consumer education and protection. As financial products become more complex, the focus was to ensure that consumers have access to the necessary information to make well-informed decisions as well as introducing measures designed to enhance consumer protection and redress mechanism.

Enhancing Domestic Capacity

Building on the momentum of earlier capacity building initiatives, policy direction continued to focus on further enhancing structural and operational efficiencies of the domestic banking institutions. This was to enable the domestic banking institutions to remain competitive and respond to rapidly changing customer requirements in an effective and efficient manner. Consequently, further enhancements to the benchmarking exercise were made in 2004. The spectrum of financial performance and service quality indicators monitored, analysed and shared with the banking institutions was expanded to provide a wider range of information, particularly on the data, ratio and trend analysis pertaining to banking institutions' profitability, productivity and asset quality vis-à-vis their peers.

Bank Negara Malaysia had also completed a study to assess customers' expectations and satisfaction on the quality of products and services offered by banking institutions. The study involved a nationwide survey of more than 3,000 retail, small and medium enterprises (SMEs), and corporate customers of banking institutions. To complement the survey, a business process review was also conducted to gauge banking institutions' level of customer-centricity, their ability to capture information relating to service performance and customer satisfaction levels, as well as the use of these information in quality enhancement initiatives. The detailed results were shared with banking institutions to enable them to measure their performance relative to the industry and formulate measures to improve customer satisfaction and retention.

The survey indicated general satisfaction with the products and services offered, but a high degree of mobility among retail customers accentuates the need for banking institutions to continuously improve customer relationships by identifying and responding to customer needs. Retail customers cited quality interface with bank staff, better complaint management, and efficient delivery channels, loan application and approval processes as their core needs. Emerging needs include higher product innovation and flexibility, as well as improved information and greater transparency on the terms and conditions of financial products and services. The survey also indicated an even higher degree of mobility among SMEs and corporate customers. These customers also highlighted the need for relationship managers to be more proactive in introducing products and services packages to suit their business needs. Complaint management, hotline accessibility, efficient and transparent loan application and approval process and, in particular, reasons for rejection, were cited as important to the SMEs and corporate customers.



The establishment of the legal infrastructure for the Bafin framework allowed banking institutions to streamline retail operations, enhance efficiency and meet customers' demand for comprehensive product packages and integrated delivery channels.

Overall, the results of the study combined with findings from the business process review highlighted the need for banking institutions to identify and respond to customer needs in order to retain customers and remain competitive. The key is to increase investment in staff training and promote customer-centric culture to support the alignment of organisational structure and business models towards meeting customers' needs and expectations. Given the importance of enhancing service quality in ensuring sustainable financial performance of the institution, commitment of management is vital in driving efforts towards building customer-centric institutions.

As domestic banking groups attained critical size and gained economies of scale from consolidation, efforts were directed at further creating the enabling environment for domestic banking groups to streamline their operations, attain operational efficiency and meet increasing customer demand for a comprehensive range of financial products and integrated delivery channels. Policy in this area culminated in the formulation of an integrated commercial bank and finance company (or Bafin) framework. The legal infrastructure for the Bafin

framework, as incorporated in the Banking and Financial Institutions (Amendment) Act 2003, came into force on 15 January 2004. It provides the option for domestic banking groups to conduct commercial banking and finance company business through a single lending entity that holds both licences. To facilitate Bafin mergers, exemptions from stamp duty and real property gains tax were provided by the Minister of Finance for mergers completed before 15 January 2006.

In 2004, five out of ten finance companies, accounting for 55% of the total finance companies assets, successfully merged with their respective commercial bank. The new Bafin entities are Alliance Bank Berhad, EON Bank Berhad, Hong Leong Bank Berhad, Malayan Banking Berhad and Public Bank Berhad. The merged entities have undergone the processes of capital rationalisation, staff redeployment and reorganisation, branch relocation and delivery channel consolidation to gain economies of scale and scope post-mergers. It is envisaged that further cost-savings and operational efficiencies will emerge in the near future as the merged entities complete their adjustment and rationalisation of resources.

Human intellectual capital plays a pivotal role in driving the performance and competitiveness of banking institutions. The International Centre For Leadership In Finance (ICLIF) and Institut Bank-Bank Malaysia (IBBM) provide the avenues for banking institutions to ensure continuous learning and competency building among all levels of their workforce. In 2004, ICLIF conducted two sessions of its flagship Global Leadership Development Programme, a Directors' Forum and a seminar on scenario planning for senior management of banking institutions, while the ICLIF Alumni Association was launched to provide a platform for professional networking.

ICLIF Forging Ahead to Realise Its Vision

Bank Negara Malaysia established the International Centre For Leadership In Finance (ICLIF) with the objective of providing a focused and coordinated approach towards the development of world-class leaders in finance to cater for the needs of the rapidly transforming Asian region. ICLIF, officially launched on 28 October 2003, is entrusted with the role of developing excellent leaders with keen regional and international insights. ICLIF provides leading-edge learning opportunities and experiences through effective leadership development programmes.

Development of ICLIF's Leadership Competency Model (LCM)

One of the key initiatives of ICLIF during the year was to develop LCM. The model supports ICLIF's initiatives by crystallising and articulating the essential skills and behaviours required by leaders to navigate and successfully manage challenges in a fast changing regional and global environment.

The LCM was formulated through a participatory process involving strategic insights from interviews with industry leaders and benchmarked against the best practices adopted by renowned regional and global companies. The preliminary Model was validated by a panel of global experts and subsequently further refined in a Validation Seminar attended by 42 Malaysian Leaders from both the public and private sectors.

Leadership Development Programmes Conducted in 2004

In 2004, ICLIF commenced its Leadership Development Programmes which are broadly divided into three categories:

- ***The Structured Advanced Leadership Programme*** is ICLIF's core programme on Leadership Development which encompasses the Global Leadership Development Programme or GLDP. The programme aims to grow and nurture talent across the financial industry and the corporate sector with strong emphasis on leadership and leadership development.

  The design of the GLDP is based on the High Impact Leadership Model jointly developed by Linkage Incorporated and renowned leadership guru, Professor Warren Bennis of the Marshall School of Business – University of Southern California. It focuses on Leadership Competencies, Skills and

Responsibilities. In addition, broader leadership issues such as globalisation, global marketing issues and macro-economic trends are also covered. The programme also provides an opportunity for the participants to strengthen their networking and participate in shared learning experiences and discussions with leaders of other organisations.

To date ICLIF has successfully conducted a summer and a fall session of the GLDP for 2004. A total of 42 participants comprising 31 from the finance industry from Malaysia, the Asian region and Africa and 11 from the corporate sector attended the two sessions. Resource persons for the programme are drawn from prestigious institutions including Peter F. Drucker Graduate School of Management – Claremont Graduate University, Marshall School of Business – University of Southern California, Harvard Business School and Stanford Graduate School of Business.

- ***The Specialised Learning Programmes*** are designed to provide learning on focused and technical issues confronting leaders in promoting excellence in their organisations. The programmes offered under this category are:

  (i) The Scenario Planning Programme, which aims to provide leaders with the capability to assess the current developments in their business environment, draw the implications of such developments and to act strategically to stay ahead. In particular, participants review current technological changes and explore medium and long-term impact of such changes on the industry, corporations and their own businesses.

  (ii) The Directors Forum, which is conducted in association with INSEAD, is designed to transcend the normal coverage of compliance and legal requirements. Participants are given good insights into best practices to improve Board effectiveness, Board's relationship with management, shareholders and regulators and Board's role in the strategy, performance and values of its organization. The rights and responsibilities of shareholders with particular focus on minority shareholders as well as factors which facilitated or blocked Board effectiveness were also discussed.

- ICLIF's ***Seminars and Workshops***, in particular its 'Saturday Seminar Series' are designed to provide the platform for corporate leaders, regulators and academicians to meet and exchange views on current and emerging issues. It also provides opportunities for participants to exchange views with leading experts and industry leaders. In 2004, the Human Resource Seminar was also conducted to discuss the role of leadership development in nation building with particular focus on ICLIF's Vision and Mission and its linkage to the Financial Sector Masterplan and Vision 2020. A Banking Seminar on 'Deposit Insurance' was also organised in collaboration with Bank Negara Malaysia.

Official Launch of ICLIF Alumni Association (IAA)

With the rapid changes taking place in the financial and corporate landscape in the country and the greater integration in the region and the world, networking among leaders and captains of industries is most valuable in contributing towards greater understanding and in increasing the potential for collaborative efforts that are of mutual interest.

In November 2004, the IAA was officially launched. The establishment of the IAA represents an important part of ICLIF's commitment to provide a platform for members to maintain active networking and productive collaborative alliances. It is also in line with the philosophy that leadership development is a continuous journey.

During the year, efforts to reposition IBBM as an effective training provider and adviser for the industry gained momentum with the formulation of a strategic development plan that identified strategic areas to be progressively implemented to enhance the training infrastructure of IBBM. One key initiative is the enhancement of IBBM's educational and qualification portfolios, which included the development of an industry competency framework and the restructuring of its existing Continuing Professional Development programme. This would place IBBM in a position to design and offer relevant and customised management and technical programmes to meet current and future needs of the banking industry. Forging strategic alliances with related parties has been identified as a possible way of strengthening the capacity and capability of IBBM. In this regard, IBBM has entered into a collaborative arrangement with a local public university to produce a pool of banking and finance graduates equipped with the relevant knowledge and exposure to the industry.

Ensuring Continuous Access to Financing

The strong financial position has enabled the banking system to continue supporting economic growth through lending expansion. During the year, both households and businesses, especially the SMEs, gained increased access to financing. Total outstanding loans grew by 8.5% in 2004, with loans to households and SMEs increasing by 14.4% and 7.7% respectively. Given the important role of the banking system as the main provider of funds in the economy, policy initiatives during the year were focused on ensuring that lending activities were supportive of private sector economic activity and that all sectors of the economy has access to financing. These were complemented by safeguards to maintain financial stability by ensuring observance of prudential lending norms and effective risk management.

Continued focus on lending to the household sector has led to further increase in the share of loans to the sector to 51.4% of total outstanding loans as at end-2004 (end-2003: 48.8%). Strong lending to this sector was accompanied by rising income levels and stable employment conditions which enhanced the capacity of households to continue accumulating net financial assets. The household balance sheet remained healthy, while the exposure of the banking system to the sector was within prudential levels.

A key policy initiative to enhance access to financing was the introduction of the New Interest Rate Framework in April 2004. In addition to enhancing the effectiveness of monetary policy transmission through the introduction of the Overnight Policy Rate as a rate that reflects monetary policy stance, the new framework was also aimed at promoting efficient pricing of interest-based products by banking institutions. Towards this end, the policy of setting a ceiling base lending rate (BLR) by Bank Negara Malaysia was removed and, instead, banking institutions are free to set their own BLR to reflect their funding and other cost structures, as well as business strategies. The maximum lending spread of 2.5 percentage points above BLR was also removed. The removal of these limits provided flexibility for the banking institutions to price their interest-based products, allowing greater use of differentiated pricing strategies to match risk profile of different customers and market segments. In addition, flexibility to price products was key in ensuring continuous innovation by the banking institutions to meet the growing demands for customised and complex financial products. To ensure fair pricing and safeguard consumers' interest, attention is also given to having a comprehensive consumer protection framework in place.

Since its introduction, there has been no change in the BLRs quoted by banking institutions (except one), reflecting that the respective BLRs were already at a competitive level. The average lending rates charged on new loans approved since April 2004 did not exhibit any increasing trend, while average lending rates on new loans for certain customer segments continued to decline. It was also noted that following the introduction of the new interest rate framework, a number of banking institutions have introduced new innovative interest-based products, such as unsecured personal loans for individuals and SMEs.

The New Interest Rate Framework allows greater use of differentiated pricing strategy, promotes efficient risk-price matching and innovation, and enhances access to financing by certain customer segments.

Efforts taken in these recent few years to enhance access to financing by SMEs have yielded positive results. In 2004, RM31.6 billion of loans were approved to more than 92,000 SME accounts, while loan disbursements to SMEs grew by 15.3%. Loans to SMEs accounted for about 40% of total outstanding loans to businesses (27% in 1998). At the same time, the SME Special Unit in Bank Negara Malaysia had received a lower number of enquiries and complaints related to financing and loan restructuring from SMEs in 2004.

During the year, initiatives focused on strengthening the overall infrastructure to promote the development of SMEs and ensure enhanced access to financing by them. A significant milestone was the establishment of the National SME Development Council, in August 2004. This represented an achievement of a two-year effort by Bank Negara Malaysia in collaboration with a number of government agencies to effectively promote the development of SMEs. The roles, structure and achievements of the National SME Development Council are set out in more details in the White Box entitled **Report on Small and Medium Enterprise Development Framework**.

The Small Debt Resolution Committee was established by Bank Negara Malaysia in 2003 to support viable SMEs that are constrained by NPLs. The Small Debt Resolution Scheme has received 228 applications involving NPLs totalling RM180.2 million, of which 116 cases have been successfully resolved. Additional financing of RM10.5 million was approved to eligible borrowers as part of the NPL resolution package to assist these viable SMEs to overcome short-term cashflow problems and ensure continuation of their businesses. As part of the initiatives to enhance access to financing by SMEs, the allocations for the Fund for Small and Medium Industries 2 (FSMI2) and the New Entrepreneurs Fund 2 (NEF2) were increased by RM2.5 billion and RM850 million respectively in 2004 to support the higher demand for loans under these special funds. This brought the total allocations for the FSMI2 and NEF2 to RM4.5 billion and RM2 billion respectively. As at end-2004, a total amount of RM6.1 billion or 93.2% of these two funds has been approved to more than 9,000 SME accounts. As part of the efforts to promote lending to SMEs, banking institutions submitted their lending targets to Bank Negara Malaysia. In cases where the targets were deemed insufficient, the banking institutions were encouraged to review those targets. For the period from July 2003 to December 2004, the banking system as a whole approved RM44.8 billion loans to SMEs, exceeding their collective target of RM26.7 billion by 67.4%.

Bank Negara Malaysia also uplifted the restrictions on the provision of bridging finance for property development in September 2004. These restrictions, which include total ban on provision of bridging finance for development of office buildings, shop houses and shopping complexes, were imposed in 1999 to address oversupply situation and high property sector exposure by the banking system. Considering the stable and positive outlook for the property market, these restrictions were uplifted and under the new Guidelines, the Board of Directors of each banking institution is now responsible for ensuring that any proposed development projects to be financed would not contribute to a worsening of property overhang situation. This is in line with the move to accord greater responsibility and accountability to the Board of Directors in the overall business strategies of the institutions.

During the year, work was initiated to increase access to financing by agriculture and agro-based industries. The agriculture sector has been identified as the third engine of growth, and a comprehensive set of policies have been outlined in the Third National Agriculture Policy (NAP3) to develop and promote the sector. It is estimated that a total of RM32 billion of investment would be required in the sector over the period 2000-2010, of which RM21 billion would involve investment by the private sector. Therefore, financing is vital in ensuring the success of the Government's aspiration to promote the sector. As the banking system is the largest provider of credit to the sector, additional financing to this sector would involve improving the utilisation of funds of the banking system. Government policy initiatives in the pipeline encompass enhancing the viability of the agriculture sector and agro-based industries, including through risk mitigation efforts such as guarantee and insurance schemes. Focus will also be placed on improving access to financing for start-ups and new ventures in new growth areas such as biotechnology and aquaculture.

Promoting Active Consumerism

Bank Negara Malaysia continued to place priority on ensuring that consumers are better able to make informed choices and achieve fair deals in their financial arrangements. In meeting this objective, efforts have been directed at enhancing financial literacy levels of the banking public as well as to strengthen the regulatory infrastructure. Efforts to enhance financial literacy levels continued to be aimed at improving consumers' ability to make financial decisions with confidence and, in particular, empower consumers to make wise savings and investment decisions. The consumer education programme, known as BankingInfo, which has now entered into its third year, continued to provide pertinent information to facilitate informed decision-making. The booklets are being translated into Mandarin and Tamil to enable larger segments of the population to have access to key financial information. BankingInfo has also leveraged on a diverse distribution network via existing branches of banking institutions, complaint and consumer bureaus, official websites as well as via participations in seminars and conferences organised by various organisations throughout the year to enhance the outreach of the programme. The BankingInfo website, to-date, has received an encouraging response of more than 17 million hits and about 3 million booklets were taken up by the public (end-2003: 6.4 million hits and 1.2 million booklets).

The full impact of any financial literacy initiative will only be seen over the medium and long-term period. As such, future generations become an important target for personal finance education so that the benefits of such education can be realised in the future. In this connection, since 1996, Bank Negara Malaysia together with the Education Ministry has embarked on a School Adoption Programme to inculcate smart financial management habits among students by providing simple and practical education about basic money management. Through this programme, about 7,000 schools have been adopted by banking institutions which play a leading role in educating school children on basic financial knowledge through student financial clubs using Students Pocket Money Book as a teaching tool. In October 2004, the online version of the Pocket Money Book was launched to enhance the distribution of the pocket book. The programme to inculcate smart financial management habits has also been extended to cover a wider target audience, including women, teachers and workers through the use of Household Account Books to assist families in the management of household income, savings and investments.

Bank Negara Malaysia has implemented a comprehensive consumer protection framework in the areas of disclosure, access to basic financial services, regulatory oversight and redress mechanism.

Given the wide use of financial services and that consumers do not have access to the same level of information or requisite understanding and bargaining power, it is vital for consumers to be given access to information in a clear and transparent manner and are treated fairly in their dealings with financial institutions. Towards this end, Bank Negara Malaysia has implemented a consumer protection framework, comprising four main areas, namely, providing consumers with adequate information; ensuring consumers have access to basic financial products and services; strong regulatory oversight to ensure fair practices by banking institutions; and establishing an effective redress mechanism.

Access to reliable, relevant and timely information is a critical pre-condition to facilitate informed decisions. Significant attention has, therefore, been given to promote a higher level of disclosure and transparency in the financial system. A concept paper on the proposed 'Guidelines on Product Transparency and Disclosure by the Banking Institutions' was issued to the banking industry in 2004. The proposed Guidelines set out the minimum standards for the banking sector on general and specific disclosure requirements at key stages of financial arrangements, and disclosure requirements in relation to advertisements. Effective 1 February 2005, banking institutions are required to comply with the following:

- Banking institutions shall make available at all their branches and websites, the fees and charges imposed on retail products and services for individuals and SMEs; and
- The conditions and effects of any changes to the terms and conditions of the products and services, including fees and charges, shall be communicated to the relevant customers at least 21 days before the changes occur to allow customers to make any adjustment they deem necessary to their banking arrangements.

To minimise the cost of information search amongst consumers, Bank Negara Malaysia has in 2004, developed comparative tables on key rates, namely BLRs, fixed deposit rates for balances up to RM1 million and exceeding RM1 million, long term fixed deposit rates and negotiable instrument of deposit rates. These comparative tables are published in the BankingInfo website, providing consumers with up-to-date information on the rates offered by different institutions and thus allowing for 'comparative shopping'. Moving forward, comparative tables on commonly offered deposit and credit products would be developed in the immediate term.

Ensuring that Malaysians have access to basic banking services is an issue of fundamental significance in strengthening the consumer protection infrastructure. In December 2004, Bank Negara Malaysia announced the framework on basic banking services which aims at ensuring that the banking public has access to basic banking services at minimal costs. Effective 1 February 2005, commercial banks and finance companies are required to offer a basic savings account (BSA) and a basic current account (BCA), without an overdraft facility, to all Malaysians including permanent residents. The BSA and BCA will allow access to services such as cheque and cash deposits, account enquiries, withdrawals, fund transfer within the same banking institution, bill payment facility, as well as Interbank-GIRO. These accounts entitle accountholders to have access to at least 16 monthly transactions per account of which

14 are free and 2 (namely Interbank-GIRO transactions) will be charged a minimal fee of not more than RM0.50 per transaction. Details of the BSA and BCA are as per the table below. For banking institutions without either ATM and/or GIRO facilities, consumers will be able to perform their transactions over-the-counter (OTC) subject to the overall limit.

In addition, Bank Negara Malaysia has also introduced a framework governing the imposition of fees and charges on retail banking products and services. Under this framework, banking institutions are required to obtain Bank Negara Malaysia's approval prior to any upward revision of existing fees and charges or for any introduction of new fees and charges imposed on individuals and/or SMEs. For existing fees and charges, banking institutions have been required to provide rationale and justification for imposing such charges. In this regard, Bank Negara Malaysia will ensure these charges are appropriate, reasonable and adequately reflect cost and cost savings.

Access to appropriate redress mechanisms is key to preserving consumers' confidence. This is critical to enable consumers to resolve conflicts through an equitable process. In Malaysia, the Banking Mediation Bureau and the Insurance Mediation Bureau have long been in existence to provide consumers with an avenue to resolve disputes without entailing lengthy and expensive legal action. These mechanisms were further

Summarised Features of the BSA and BCA

No.		Parameters	
1	Eligibility	• Must be Malaysian citizens or permanent residents. For BCA, the requirement for an applicant to be at least 18 years old and to have an introducer remain unchanged. • Entitled to 1 BSA and 1 BCA per individual per banking institution.	
2	Features	Basic Savings Account (BSA) • Initial deposit requirement to open a BSA is not more than RM20. • Should earn interest irrespective of account balance. • No service or maintenance charge. • Minimum balance requirement of not more than RM20. • Free mini statement.	Basic Current Account (BCA) • Initial deposit requirement to open a BCA is not more than RM500. • No charges on the issuance of cheque book except for stamp duty incurred. • Service charge of RM10 half yearly for balances less than RM1,000 as per existing ABM rules. • Free monthly statement.
3	Minimum Number of Monthly Transactions	Accountholders are entitled to at least 16 transactions per month per account comprising: a) Six free OTC visits for account enquiries, withdrawals, fund transfers within the same banking institution and bill payments. OTC visit is defined as one visit to the bank's counter irrespective of the number of transactions performed; b) Eight free ATM cash withdrawal transactions. There is no limit on ATM transactions that are not cash withdrawals (e.g. balance enquiry or fund transfer within the same banking institution); and c) Two Interbank-GIRO transactions for which a maximum fee of RM0.50 per transaction may be charged. Note: For banking institutions without ATM and/or GIRO facilities, accountholders will be able to perform these transactions OTC.	
4	Internet Banking Facility	BSA and BCA accountholders of banking institutions which have internet banking services are entitled to unlimited online account enquiries, fund transfers within the same banking institution and payment of bills, at no charge.	
5	Other Fees and Charges	a) Replacement of ATM/bankcard (not more than RM12). b) Closure of BSA and BCA within 3 months of account opening (not more than RM20).	

enhanced with the establishment of a Financial Mediation Bureau (FMB) to expand the scope of arbitration, increase accessibility by consumers and improve efficiency. The FMB, which was launched on 20 January 2005, serves as a one-stop centre for the resolution of a broad range of retail consumer complaints against financial institutions regulated by the Bank. The scope of the FMB has been expanded to cover Islamic banks, takaful operators, development financial institutions, as well as selected payment system operators and non-bank issuers of credit and charge cards. This will provide increased access to the Bureau as an avenue for redress for a wider spectrum of the public. To ensure nationwide accessibility, the FMB plans to progressively establish five regional offices in the near future.

The FMB is governed by a Board of Directors and chaired by an independent Chairperson. Five of the nine directors are independent members representing the public interest with the balance from the banking and insurance industries. The Bureau is staffed by independent mediators who are experienced in judicial matters. The framework and governance structure is aimed at ensuring that consumers have access to a fair and equitable resolution process.

Maintaining Financial Stability

Preserving financial system stability is a key policy objective of the Bank. The resilience of banking institutions and stability of the system is important in safeguarding depositors' interest, and in ensuring uninterrupted intermediation process, a critical element for macroeconomic stability. Bank Negara Malaysia adopts a comprehensive approach in preserving financial stability, which encompasses surveillance at both individual institution and system levels; regulations to ensure prudent practices by banking institutions; and supervisory activities. This is complemented by market discipline, as a tool to act as check and balance to the management of banking institutions. In addition, concerted efforts were also accorded to put in place and develop relevant financial safety nets in reinforcing public confidence in the financial system.

During the year, efforts were directed at further strengthening the effectiveness of the surveillance of the banking system. The aim is to develop a comprehensive and effective banking system surveillance framework that is capable of detecting emerging vulnerabilities and weaknesses that can undermine financial stability as well as assessing the capacity of the banking system to withstand shocks. Initial work has started towards developing additional tools to enhance ongoing surveillance and analyses of banking system resilience. This includes forward-looking surveillance tools both at the system and institution levels to identify, measure, assess and predict emerging vulnerabilities. Additionally, focus was also placed on enhancing existing stress test methodology to ensure its effectiveness and relevance.

In the area of prudential regulations, work in 2004 focused on several aspects, including enhancements to the existing capital framework and the strengthening of corporate governance. These were complemented by the improvement made in the disclosure requirement and the development of a deposit insurance system. The year 2004 saw intensified efforts at the global front as both regulators and the banking institutions prepare to implement the new regulatory capital framework, Basel II. The framework that was finalised by the Bank for International Settlements in June 2004, will be adopted by the Group of Ten (G-10) countries by end-2006, except for the advanced approaches which will be implemented by end-2007. The final framework introduced significant changes from the third Consultative Paper issued in April 2003, with respect to the treatment for expected losses (EL) and unexpected losses (UL), treatment for securitisation exposures, credit risk mitigation and treatment for qualifying revolving retail exposures.

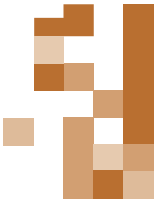
In Malaysia, the earlier assessment conducted by Bank Negara Malaysia on the readiness of banking institutions for Basel II, had provided the basis for the implementation of the new framework. Four key principles are adopted by the Bank to determine Basel II implementation strategies, namely:

- Ensuring that risk management standards amongst all banking institutions are enhanced over time;
- Adoption of a more flexible timeframe that allows for the implementation of capacity building measures. This is based on the recognition that domestic players are at different levels of sophistication, thus more time should be accorded to institutions intending to adopt the more advanced approaches;
- Implementation should not be based on regulatory mandate. The adoption of advanced approaches should be supported by strong business justification; and
- Ensuring a more effective supervisory process for the adoption of more advanced approaches. This will be achieved through the use of an enhanced supervisory methodology to assess internal models and advanced risk management systems.

The adoption of Basel II in Malaysia is in tandem with the overall policy agenda to promote higher standards of risk management amongst Malaysian banking institutions as the banking sector progresses with greater competition

and liberalisation. While the potential capital savings may be one of the main attractions of Basel II, the real benefit to be gained is the integration of risk management practices within the banking institution. Under the new framework, key decision making such as on product pricing, portfolio management and new business development eventually will have to be made based on risk-adjusted returns and capital considerations. The convergence of risk management practices with daily banking operations would also facilitate the nurturing of a strong risk culture within the banking industry overtime. In the longer term, the objective is to promote greater convergence between regulatory capital and economic capital employed by banking institutions.

While both options for credit risk, namely the Standardised and Internal Ratings Based (IRB) approaches would be allowed in Malaysia, banking institutions would need to determine the most appropriate approach based on their cost and benefit analysis and ability to meet all minimum supervisory requirements set by the Bank for



The real benefit to be gained from Basel II is the integration of risk management practices within the banking institution as key decisions will have to be made based on risk-adjusted returns and capital considerations.

International Settlements and Bank Negara Malaysia. Banking institutions that choose to adopt the Standardised Approach for credit risk would be required to comply with the new framework by January 2008. At the same time, these banking institutions are also expected to comply with the Basic Indicator Approach for the operational risk. Subject to prior approval of the Bank, the Standardised Approach for operational risk, under which the capital charge will be determined based on specific risk factors attached to eight pre-determined business lines, may also be adopted by such banking institutions. While most banking institutions may consider adopting the Standardised Approach for credit risk as a more reasonable interim strategy before the adoption of the more advanced approaches, the emphasis would nevertheless be on the development of a sound and well functioning internal rating systems that would ensure a more natural progression towards more advanced approaches in the future.

For banking institutions intending to adopt the IRB approaches, the compliance deadline is January 2010. These banking institutions would be given the flexibility to migrate to the advanced approaches directly from the existing capital accord, provided they can demonstrate to the Bank their ability to meet and comply with all the requirements and regulatory expectations for the implementation of the more advanced approaches. Banking institutions that comply with the IRB approaches for credit risk from January 2010, are also required to provide capital for the operational risks based on any of the three approaches, namely the Basic Indicator Approach, the Standardised Approach or the Advanced Measurement Approach, subject to prior approval of the Bank. All banking institutions would be required to conduct a one-year parallel capital adequacy calculation under the new approaches prior to their respective year of migration to Basel II.

The more flexible time frame for the implementation of the advanced approaches for both credit and operational risks takes into account the need to minimise disruption to the capacity building initiatives that are currently being undertaken by the banking institutions. The progressive approach recognises the greater challenges with respect to meeting the more stringent minimum requirements for the advanced approaches. One of the challenges for the adoption of the Advanced IRB approach would be the requirement for banking institutions to provide robust loss estimates that reflect domestic market experience. The longer time frame will provide sufficient time for banking institutions to enhance their data management infrastructure, collect the necessary data required to estimate the risk parameters and improve their analytical skills. On data collection, the more flexible timeline would also allow banking institutions to accumulate the internal loss data on defaulted loans, for the retail and qualifying SME portfolios, that is required even for the Foundation IRB approach.

Given the wide-ranging impact of Basel II on the business conducted by banking institutions, well-coordinated strategies and a structured approach to implementation would be critical in ensuring a smooth rollout by individual institutions. Therefore, a key success factor for the banking institutions is to have in place a proper governance structure and implementation taskforce to spearhead their Basel II initiatives to ensure projects are not conducted in isolation. It is imperative that all relevant stakeholders and business units within the banking institutions recognise the implications of the new capital framework and are involved in the implementation process. Having a well-defined role for and the proactive

involvement of the Board of Directors and senior management of banking institutions in the overall process is critical. Effective Board oversight, and the commitment and continuous support of senior management, is crucial towards ensuring that Basel II-related initiatives are consistent with the long term risk management agenda of the banking institutions.

To ensure that banking institutions adopt a proactive attitude in addressing the various challenges arising from Basel II, Bank Negara Malaysia has issued a set of fundamental requirements to the banking industry in September 2004 that highlights key regulatory expectations on banking institutions and the requirement for banks to put in place a formal governance framework, conduct gap analysis and engage in discussions with the Bank on their respective Basel II initiatives.

In line with Bank Negara Malaysia's prime objective of continuously enhancing the banking system's financial stability through the promotion of sound risk management practices, the Market Risk Capital Adequacy Framework (MRCAF) was implemented to introduce more risk sensitivity to the existing regulatory capital requirements by explicitly providing for potential losses arising from market risk. The MRCAF is in conformity with international regulatory standards by adopting the Bank for International Settlements' recommendation on 'Amendment to the Capital Accord to Incorporate Market Risk, January 1996'. The implementation of the MRCAF is timely as the banking institutions emerge from the Asian financial crisis and get increasingly involved in treasury and capital market activities, particularly in innovative and financially complex products, that are sensitive to movements in market rates. With the implementation of the MRCAF, all banking institutions and discount houses must incorporate their market risk capital requirements into the existing risk-weighted capital adequacy framework and be subject to the overall minimum risk-weighted capital ratio requirement of 8%.

Following efforts to strengthen corporate governance in banking institutions, coupled with increasing demand for greater public disclosure and enhancement of financial reporting by investors, the 'Guidelines on Financial Reporting for Licensed Institutions' (GP8) was revised in October 2004. In addition to setting out the minimum disclosure requirements, licensed institutions are also encouraged to disclose additional information in their financial statements to ensure that all material activities are reported and well understood by users of the financial statements. Among the major changes in the revised Guidelines are the adoption of fair value accounting, the requirement for interim financial reports to be prepared on a quarterly basis and the extension of the application of the revised Guidelines to discount houses, money brokers and financial holding companies. These enhancements would further improve the transparency, comparability, relevance and timeliness of information relating to licensed institutions' operations and financial condition, which are critical elements for effective application of market discipline. By aligning disclosure requirements to international standards, the revised GP8 would also enhance the comparability of financial statements. This will enable stakeholders to benchmark licensed institutions' performance and financial condition against their international peers, thereby further enhancing market discipline on domestic financial institutions.

As part of concerted efforts outlined in the FSMP to further strengthen the existing depositor protection infrastructure, work on the establishment of a deposit insurance system in Malaysia proceeded during the year. A key objective of the system is to provide a reasonable level of explicit protection to depositors on their deposits held with the commercial banks, Islamic banks and finance companies. The concept paper issued to the industry in November 2004 proposes the establishment of a statutory body responsible for the administration of the deposit insurance system, as well as to undertake the resolution of banking institutions deemed no longer viable by Bank Negara Malaysia. At the same time, the statutory body will also be mandated to strengthen the incentives for sound risk management in the banking system in promoting the stability of the financial system.

The deposit insurance system will provide separate deposit insurance coverage for the conventional and Islamic banking systems. All commercial banks and finance companies currently licensed under the Banking and Financial Institutions Act 1989, as well as all Islamic banks currently licensed under the Islamic Banking Act 1983 are required to become members of the system so as to prevent adverse selection that would undermine the viability of the deposit insurance system. The rationale for separate deposit insurance coverage for the Islamic banking system is to ensure similar treatment with conventional deposits coupled with the required consistency of administration of the deposit insurance system with Shariah tenets in respect of Islamic deposits. Deposit insurance coverage in both systems would be extended to all depositors, whether corporate or individuals, up to a prescribed coverage limit. One of the

underlying principles governing the coverage limit of the deposit insurance system is that it should be sufficient to promote confidence among the large majority of depositors, particularly those who are not in the position to effectively assess and monitor the financial condition of banking institutions. The relationship between the coverage limit and moral hazard is also accorded careful consideration given the need to maintain sufficient incentives for large depositors to effectively exert market discipline over member institutions.

The deposit insurance system will be funded by annual premiums received from member institutions, where a flat rate will be imposed for the initial two years of the implementation of the system. Thereafter, a risk differential premium framework will be implemented, consistent with the mandate of the deposit insurer to strengthen incentives for sound risk management of its member institutions. The framework would be designed to encourage member institutions to improve their risk management systems and business practices in order to qualify for the lower premiums after the initial two-year interim period. The deposit insurance framework is in the final steps of preparation and is expected to be operational in 2005.

In an effort to further improve the level of Information Security (IS) management amongst banking institutions, Bank Negara Malaysia had issued the 'Guidelines on Management of Information Technology Environment' (GPIS 1) in May 2004. The Guidelines outline the minimum responsibilities and requirements for planning and managing the banking institutions' IS environment, as well as for establishing preventive measures to mitigate the risks pertaining to the environment. The Guidelines also include the requirements and best practices in the areas of board and management oversight, system security, system development, operations, communications network and business resumption and contingency plans. The implementation of these minimum requirements and best practices would enable the institutions to minimise the risks associated with service interruption, unauthorised access to customers' information, fraud and loss of customers' confidence.

In July 2004, Bank Negara Malaysia conducted a survey on the disaster recovery capabilities of all commercial and Islamic banks to assess their readiness in ensuring the availability of essential banking services during a disaster situation. The information from the survey shows that all banking institutions have already put in place the necessary business resumption and contingency plans for their critical business functions, although there are areas for improvement in some of these institutions. Subsequently, the banking institutions also benefited from the assessment as they were provided with a benchmark comparing their performance with the rest of the industry. In this regard, banking institutions are expected to make further improvements in disaster recovery readiness thus ensuring the availability of critical banking services with minimal interruptions to the public in the event of a disaster.

Fraud prevention is another critical area in maintaining stability and public confidence in the banking and payment systems. During the year, a number of measures were put in place to enhance fraud prevention mechanisms. In July 2004, Bank Negara Malaysia issued the 'Guidelines on Minimum Security Standards for Cheques' which set out, among others, the minimum standards for security features on cheques, cheque fraud detection facilities and security management in cheque printing. Following the success of the migration to chip-based Automated Teller Machines (ATM) cards in eliminating ATM card forgery, a similar initiative is currently being undertaken by the credit card industry where magnetic strip credit cards are being replaced by the Europay-Mastercard-Visa (EMV) credit cards during the year. Full conversion to EMV environment, which include converting all credit card terminals to be EMV-compliant, is expected to be completed by end-2005.

Moving forward

Greater competition in the banking sector is likely to ensue as the domestic financial landscape evolves over time. This is particularly the case in the second phase of the FSMP, where greater operational flexibility will be accorded to the incumbent foreign banking institutions. In this more liberalised environment, continued enhancements of operational efficiency, and product and services innovation are necessary to ensure the competitiveness of domestic banking institutions. In terms of business focus, it is envisaged that as the economy transforms and consumers grow more affluent, banking institutions would need to strengthen capabilities in the areas of personal financial advisory services, wealth management, consumer banking and SME financing. In addition, the domestic banking groups would increasingly expand their presence in the region to further diversify their earnings and enhance performance. The policy directions in this environment will focus on strengthening the efficiency, effectiveness and resilience of the banking sector with a careful balance made on promoting efficiency and market-driven system, with the objective of maintaining financial stability and consumer protection.

Banking Measures Introduced in 2004

In 2004, further initiatives were undertaken to strengthen the safety and soundness of the financial system and promote competition and efficiency in the banking industry. In addition, measures were implemented to ensure continuous access to financing as well as to enhance consumer protection and confidence in the banking sector.

Measures to Enhance Safety and Soundness

Incorporation of Market Risk into the Risk-Weighted Capital Ratio

The market risk capital adequacy framework was issued for implementation in September 2004. The commercial banks, merchant banks, finance companies and discount houses, collectively known as the licensed institutions, are now required to incorporate their market risk positions into the risk-weighted capital ratio (RWCR) and comply with the minimum RWCR by the second quarter of 2005. Even with the incorporation of market risk, the minimum RWCR requirement remains at 8%.

Under this framework, only interest rate risk and equity risk in the trading book are included, while for foreign exchange risk, both trading and banking book positions are incorporated. Nevertheless, licensed institutions are expected to have in place adequate measures to manage their interest rate and equity risk exposure in the banking book. In line with Bank Negara Malaysia's efforts to enhance corporate governance in licensed institutions, the Board is charged with the responsibility of approving policies and strategies on market risk management and ensuring that adequate measures are in place to monitor and control such risks.

Capital Treatment on Holdings of Other Licensed Institutions' Instruments

The capital framework issued in 1989 required holdings of other licensed institutions' capital instruments to be deducted from the capital base. In tandem with the development of the domestic capital market and international regulatory practices, Bank Negara Malaysia revised the capital treatment to facilitate trading and market making activities of capital instruments issued by licensed institutions. The revised capital treatment, issued in July 2004, specified that the holdings of other licensed institutions' capital instruments would be exempted from capital deduction if it does not exceed 10% of the licensed institution's capital base. However, the capital treatment for the holdings of capital instruments issued by related companies or companies within the same banking group remains unchanged.

Regulatory Treatment for Residential Mortgage-backed Securities

The regulatory treatment, issued on 17 September 2004, accorded a 20% risk weight for the first tranche of residential mortgage-backed securities issued by Cagamas MBS Berhad, a wholly-owned subsidiary of Cagamas Berhad, under the RWCR framework. In addition, holdings of subordinated residential mortgage-backed securities are required to be deducted from capital base. Holdings of residential mortgage-backed securities issued by Cagamas MBS Berhad together with other credit facilities granted to Cagamas MBS Berhad are subjected to the single customer credit limit of licensed institutions.

Regulatory Treatment for Ringgit-denominated Bonds Issued by Multilateral Institutions

Issued in October 2004, ringgit-denominated bonds issued by Multilateral Development Banks and Multilateral Financial Institutions were accorded a 0% risk weight under the RWCR framework and classified as liquefiable assets under the New Liquidity Framework.

Implementation of Basel II

In April 2004, Bank Negara Malaysia announced the implementation approach and timeline of the new Basel Capital Accord (Basel II). Basel II would be implemented in two phases. In particular, as a minimum, banking institutions will be required to implement the Standardised Approach for credit risk and basic

indicator approach for operational risk under Basel II in 2008. However, banking institutions which meet the requirements set by Bank Negara Malaysia will be allowed to adopt the Internal Ratings Based approach in January 2010 without having to comply with the Standardised Approach for credit risk in 2008. The decision whether to migrate directly to the Internal Ratings Based approach in 2010 rests entirely with the Board of Directors based on the banking institution's gap and impact analysis as well as cost-benefit considerations. In September 2004, the minimum requirements on governance structure, gap analysis and development of implementation plans with regard to Basel II were issued to the banking institutions.

Guidelines on Minimum Security Standards for Cheques

As part of Bank Negara Malaysia's continuing efforts to combat rising cheque frauds and to maintain consumers' confidence in using cheques, various measures were undertaken to deter counterfeiting and fraudulent alterations of cheques as well as to facilitate easier detection of such activities. Bank Negara Malaysia issued, in July 2004, the Guidelines on Minimum Security Standards for Cheques which specify the minimum requirements with regard to the role of banking institutions in payment and collection of cheques drawn by or paid in by customers. In addition, the Guidelines set the minimum standards for security features on cheques, cheque fraud detection facilities and security management in cheque printing. Banking institutions are also expected to educate consumers on the risks involved in the use of cheques and the safeguards to be adopted to help prevent cheque fraud.

Guidelines on Management of IT Environment (GPIS 1)

To strengthen and enhance the level of information technology (IT) management in banking institutions, Bank Negara Malaysia issued GPIS 1 in May 2004. The Guidelines place the responsibility on the Board and senior management in implementing good IT governance and risk management practices. The Guidelines set the minimum requirements on system security, system development and operations in an IT environment to ensure appropriate controls are in place to safeguard the institution's systems, data and information. To ensure timely resumption of critical IT operations in the event of a disaster, banking institutions are required to establish an appropriate business resumption and contingency plan. The implementation of the requirements and best practices would enable the institutions to minimise the risks associated with service interruptions, unauthorised access to customers' information, fraud and loss of customers' confidence.

Disaster Recovery Capabilities of Banking Institutions

In July 2004, Bank Negara Malaysia initiated a survey covering 25 institutions to assess the state of readiness of banking institutions' disaster recovery capabilities and to gather information on recovery strategies. The findings of the survey were shared with the industry to further improve their IT disaster resumption arrangements. Bank Negara Malaysia will continue to review the business resumption contingency plans of banking institutions during its on-site IT audit and monitor the testing of disaster recovery plans through reports submitted by banking institutions.

Measures to Enhance Competition and Efficiency in the Banking Industry

New Interest Rate Framework

To enhance the effectiveness of the monetary policy transmission process and the efficiency of financial market operations, Bank Negara Malaysia introduced a new interest rate framework in April 2004. The framework also aims to facilitate more efficient pricing of financial products. Effective 26 April 2004, the ceiling on Base Lending Rate (BLR) and the maximum lending spread of 2.5 percentage points above the BLR or cost of funds were removed. Banking institutions were given the flexibility to determine the BLR based on their own cost structure and lending strategies. This flexibility is expected to facilitate greater product innovation and customisation within the banking industry to meet the differentiated needs of the growing economy.

Revised Regulatory Treatment for New Cagamas Debt Securities

As a measure to further improve the efficient functioning of the domestic bond market, Bank Negara Malaysia revised the regulatory treatment for new Cagamas debt securities issued after 4 September 2004. The risk weight for holdings of new Cagamas debt securities was increased from 10% to 20% under the RWCR framework. In addition, holdings of new Cagamas debt securities together with other credit facilities granted to Cagamas Berhad are subjected to the single customer credit limit of licensed institutions.

Single Customer Credit Limit – Discount Houses

With effect from 1 October 2004, the Single Customer Credit Limit (SCCL) requirement was extended to the discount houses to ensure excessive exposure in holdings of Private Debt Securities (PDS) to a single issuer is avoided. The SCCL imposed on a single issuer is set at 35% of the approved capital funds of the respective discount houses for all new investments in PDS.

Deduction of Ringgit Debt Securities from Eligible Liabilities

In October 2004, commercial banks and merchant banks were allowed to deduct their holdings of the following ringgit-denominated debt securities in the trading book from eligible liabilities in the computation of Statutory Reserve Requirement (SRR):

- Specified RENTAS securities issued through the Principal Dealers network;
- All corporate debt securities including Cagamas securities; and
- Ringgit-denominated securities issued by Multilateral Development Banks and Multilateral Financial Institutions.

The deduction would reduce the holding cost of these papers for the commercial banks and merchant banks. This aims at promoting secondary trading of such securities in the bond market and levelling the playing field for commercial banks and merchant banks with that of the other players in the bond market.

Innovative Tier-1 Capital Instruments

Effective December 2004, licensed institutions are allowed to issue innovative Tier-1 capital instruments for inclusion in Tier-1 capital under the RWCR framework. The issuance of such instruments is, however, subject to the prior approval of Bank Negara Malaysia and the fulfilment of minimum requirements specified in the Guidelines.

Measures to Enhance Consumer Protection

Financial innovation and innovative developments in technology have increased the range and complexity of products and services offered by a myriad of service providers. This in turn, has provided consumers with a wider range of options to manage their personal finances. To ensure that consumers are equipped to make financial decisions that meet their needs and are given a fair deal by financial institutions, Bank Negara Malaysia has put in place a long-term and structured consumer education and protection framework.

Basic Banking Services Framework

To ensure that consumers have access to basic banking services and that these services are provided at minimal costs, Bank Negara Malaysia implemented a basic banking services framework with effect from February 2005. Under this framework, all banking institutions are required to offer at least one basic savings account (BSA) and one basic current account (BCA) to all Malaysians, including permanent residents. The framework provides an account holder with at least 14 free transactions per month, including eight ATM cash withdrawals. In addition, BSA and BCA account holders can perform at least two Interbank GIRO transactions per month at not more than RM0.50 per transaction, while those who subscribe to internet banking services are entitled to unlimited online account enquiries, fund transfers within the same banking institution and payment of bills, at no charge. The basic savings account earns interest irrespective of the account balance.

Imposition of Fees and Charges on Banking Products and Services

In an effort to ensure that consumers and small and medium enterprises (SMEs) have access to financial products and services, apart from the BSA and BCA, at reasonable costs, Bank Negara Malaysia issued Guidelines to govern the imposition of fees and charges by banking institutions in December 2004. Banking institutions are required to obtain the prior approval of Bank Negara Malaysia for any upward revision of existing fees and charges or for any new fees and charges to be imposed on products and services offered to individuals and SMEs. In this regard, banking institutions are required to justify the imposition of or increase in fees and charges as well as the conditions under which the fees may be imposed.

To promote greater market transparency, the Guidelines also require banking institutions to publish all fees and charges imposed on products and services offered to individuals and SMEs at all branches and on their websites. Banking institutions are also required to notify their customers at least 21 days before making any change to the terms and conditions of products and services including fees and charges.

Financial Mediation Bureau

It is important that, in the event of disputes involving products or services offered by financial institutions, consumers have recourse to an inexpensive and effective avenue to seek redress. In this regard, Bank Negara Malaysia spearheaded efforts to enhance the dispute resolution mechanism for consumers to resolve conflicts through an impartial and equitable process.

On 20 January 2005, the Financial Mediation Bureau (FMB) was launched, as a result of the merger between the Banking Mediation Bureau and the Insurance Mediation Bureau and, as such, is an integrated agency for the resolution of disputes against financial institutions under the supervision of Bank Negara Malaysia. The FMB's scope was expanded to cover disputes against Islamic banks, takaful operators, development financial institutions as well as selected payment system operators and non-bank issuers of credit and charge cards to ensure that customers of these financial service providers have access to the dispute resolution mechanism. The scope of the FMB was also expanded with regard to product coverage, type and nature of complaints as well as limits of awards. The FMB provides consumers with a fast and efficient avenue to seek legal redress as an alternative to resolutions through the court process. In addition, consumers benefit from the convenience of a single bureau and consistent processes and procedures applied across the different financial service providers.

Deposit Insurance

In furthering efforts to strengthen the consumer protection framework and enhance the financial safety net of the banking system, Bank Negara Malaysia issued, in November 2004, a concept paper to the banking industry on the introduction of a Deposit Insurance System in Malaysia. The key objective of the deposit insurance system is to provide a reasonable level of protection to depositors on their deposits held with banking institutions. The concept paper detailed some of the features being considered for a deposit insurance system.

Comparative Tables

To facilitate meaningful comparison and minimise the cost of information search amongst consumers, Bank Negara Malaysia has published comparative information on key rates, namely base lending rates, fixed deposit rates and negotiable instrument of deposit rates via BankingInfo website. Moving forward, comparative tables on commonly offered deposit and credit products will be developed.

Concept Paper on Product Transparency and Disclosure

As part of Bank Negara Malaysia's continuous efforts to promote greater market transparency, a concept paper on product transparency and disclosure by the banking institutions was issued in March 2004. Frequently, the risks and costs of financial products and services are not adequately disclosed in the promotional material and that important terms and conditions may not be given due prominence. To

ensure that consumers understand the nature and extent of the risks involved, the concept paper requires that the information be worded and presented in a clear, concise and effective manner. Specific information that must be disclosed includes risk factors, yield, pricing, fees and charges, terms and timeliness of information being disseminated to consumers using standard definitions and terminology. The disclosure requirement also applies to advertisements to ensure that the marketing and promotional material are not misleading.

Complaint Handling

Effective complaint handling is vital to ensure that customer complaints are promptly investigated and resolved in a satisfactory manner. Complaints that are carefully recorded and properly analysed to identify the problems and root causes would enable banking institutions to address the shortcomings in their operations. Starting from June 2004, banking institutions are required to submit a half-yearly report on the number and nature of complaints received. Bank Negara Malaysia will continue to play a role in handling customer complaints against banking institutions to ensure that complaints are dealt with promptly and efficiently to ensure customers are treated fairly by banking institutions.

Revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8)

Following the issuance of two concept papers to the banking industry, the revised guidelines on financial reporting for licensed institutions were issued for implementation in October 2004. The primary objective of the revised Guidelines is to ensure compliance with international accounting standards and consistent disclosure of all material and exceptional items among financial institutions to facilitate evaluation, assessment and comparison of the financial position and performance of the institutions.

The revised Guidelines set out the minimum disclosure requirements and licensed institutions are encouraged to disclose additional information in their financial statements. The major changes to the Guidelines are as follows:

- Licensed institutions are required to prepare interim financial reports on a quarterly basis;
- Interim financial reports prepared on a quarterly and half-yearly basis are not required to be published in the newspapers. Instead, licensed institutions shall make available the interim financial reports in their websites;
- Licensed institutions are required to segregate their securities portfolio into 'held for trading', 'held-to-maturity' and 'available-for-sale' categories;
- Licensed institutions are given two options to account for their derivative transactions; and
- Interest accrued and recognised as income prior to the date the loans are classified as non-performing shall be reversed out of income. Subsequently, interest earned on non-performing loans shall be recognised as income on a cash basis.

The first set of financial statements prepared under the revised BNM/GP8 would be for the financial year ending 31 December 2005.

Measure to Improve Access to Financing

Upliftment of Restrictions on the Provision of Bridging Finance for Property Development

The restrictions on the provision of bridging finance facilities for property development, introduced in 1999 to address the property market overhang, were uplifted in September 2004. To ensure that the upliftment does not lead to oversupply in the property market, banking institutions are required to consider the impact of the project that it proposes to finance on the property market in the surrounding vicinity. This is in addition to the standard viability assessment on the project itself. Banking institutions are also required to provide its board of directors, whose concurrence is required to approve bridging finance facilities, with adequate information to assess such impact.

Financial Sector Masterplan

The implementation of the Financial Sector Masterplan (FSMP) is on track and on schedule. Another 14 recommendations of the FSMP were fully completed during the year, bringing the total number of fully completed recommendations to 45, which accounts for almost half of the recommendations with milestones. Another 28 recommendations are being implemented on a continuous basis, where initiatives are continuously being taken to attain the desired outcomes. Details of the completed recommendations are as listed in the accompanying table.

Completed Recommendations

	Banking Sector
R3.4	Liberalise restrictions on salaries and staff mobility in the banking industry to enable the industry to attract the best talent and reward them accordingly
R3.5	Uplift restriction on employment of expatriates to attract the best international talents to meet the demand for expertise in specific areas of banking
R3.6	Establish board committees, namely Nominating, Remuneration and Risk Management Committees to further enhance corporate governance standards
R3.7	Allow group rationalisation through cross-selling of products and consolidation of back-office processes as well as facilitate the merger of commercial banks and finance companies to further enhance efficiency and competitiveness
R3.9	Streamline the regulation of discount houses and merchant banks to enhance and allow fair competition among players
R3.12	Encourage outsourcing of non-core functions to gain greater strategic focus and efficiency
R3.14	Encourage the development of new delivery channels to increase the range of products and services to further enhance competitiveness
R3.15.1 and R3.15.2	Simplify the product notification process to provide incentive for the development of new and innovative products, and outline a set of guidelines providing criteria for product notification and specific product approval requirements
R3.16a	Introduce the New Interest Rate Framework to provide banking institutions with greater flexibility, thus promoting more efficient pricing of products
R3.18	Encourage participation of banking institutions in areas currently served by fringe institutions to promote a level playing field and preserve consumer protection and investors' interests
R3.21	Implement risk-based supervision with supervisory focus on high risk areas and greater attention on weak institutions
R3.22a	Incorporate market risk into the capital adequacy framework to introduce more risk sensitivity to the existing regulatory capital requirements
R3.23	Develop a formal and informal enforcement action framework to ensure banking institutions take remedial actions on weaknesses highlighted
R3.27	Increase efficiency and competition in the payments system to support the needs of the economy while maintaining its safety and integrity
R3.28	Allow market forces to shape developments in the payments system to promote greater competition and increase innovation in payments system
R3.33	Allow banking institutions to rationalise their branch network to improve the dispersion of their branches in the country
R3.37	Expand the role of the Banking Mediation Bureau with the establishment of the Financial Mediation Bureau to strengthen consumer protection framework and to widen avenues for consumers to seek redress
	Insurance Sector
R4.1	Remove restrictions on outsourcing to enable insurers to further develop core competencies and effective business strategies

R4.2	Allow eligible insurers to use the internet as a distribution channel to enhance competitiveness and efficiency of the insurance industry
R4.3	Promote the growth of bancassurance as a cost-effective alternative distribution channel by implementing a more flexible regulatory framework on remuneration structures governing bancassurance arrangements
R4.6	Relax the restrictions on employment of expatriates to accelerate the development of skills and expertise in the industry
R4.16	Increase the statutory minimum paid-up capital of insurers to enhance their financial resilience and ability to compete effectively in a more deregulated and liberalised market
R4.17	Strengthen 'fit and proper' regulations for board members and senior management of insurance companies, including minimum qualification standards and training requirements for directors, to promote sound corporate governance
R4.18	Establish board committees with specific responsibilities and enhance disclosure standards on compensation to directors and senior management to further strengthen governance structures and processes and promote greater transparency
R4.19	Raise the entry requirements for the agency force to uphold high standards of professionalism and competencies among insurance intermediaries
R4.20	Introduce additional compulsory exams as part of the continuing education programmes for agents to upgrade their knowledge and skills on an on-going basis
R4.21	Further strengthen performance-based supervision to maintain stability under more deregulated and competitive market conditions
R4.22	Develop an enforcement action framework to ensure timely and consistent supervisory intervention processes to address institutional risks
R4.25	Establish the Financial Mediation Bureau to strengthen the consumer protection framework and widen avenues for consumers to seek redress
R4.26	Introduce 'best advice' regulations to enhance consumer protection and professionalism in the sale of life insurance products by insurance intermediaries
R4.27	Strengthen regulations on unfair trade practices to ensure sound business practices and fair treatment of consumers
R4.29	Allow financial and non-financial institutions to acquire interests in direct insurers to create business synergies
	Islamic Banking and Takaful
R5.3	Build strong management through the establishment of board committees, benchmarking and employment of experienced and qualified staff
R5.5	Increase the number of Islamic banks to stimulate greater competition and accelerate international integration by issuing Islamic banking licences to qualified domestic and foreign banking institutions
R5.6	Increase the number of takaful operators to accelerate the expansion of takaful industry
R5.10	Establish a comprehensive legal infrastructure for consumers to seek legal redress arising from Islamic financial transactions
	Development Financial Institutions
R6.4	Introduce a systematic framework for sourcing funds to ensure appropriate and adequate funding for the operations of development financial institutions (DFIs)
R6.7	Establish a legislative framework to regulate and supervise DFIs to ensure that DFIs' policies and objectives are consistent with the national policy objectives
R6.8	Establish a single Regulatory and Supervisory Authority (RSA) to strengthen the supervision of DFIs

Alternative Modes of Financing	
R7.2	Establish a RM500 million venture capital fund to increase the availability of venture capital financing and stimulate new ventures
R7.3	Introduce further tax incentives for the venture capital industry to promote the growth of venture capital
R7.4	Liberalise the MESDAQ listing requirements to facilitate the exit of venture capital companies from their investments
R7.5	Establish two Islamic venture capital funds with a combined initial fund size of RM22.1 million
Labuan International Offshore Financial Centre	
R8.3	Adopt a consultative and market driven approach to create a conducive tax and business environment to enhance the competitiveness and attractiveness of Labuan
R8.6	Strengthen Islamic banking and finance as well as takaful to develop Labuan with a strategic focus on Islamic products and services
R8.7	Enhance Labuan International Financial Exchange (LFX) to be a one-stop financial exchange for residents and global companies

In the initial phase of the implementation of the FSMP, efforts were focused on enhancing the capability and capacity of domestic financial institutions. These efforts were continued in 2004 with further institutional development initiatives as well as measures to strengthen the regulatory and supervisory framework, and enhance the consumer education and protection framework.

Achievements

Measures implemented since the release of the FSMP four years ago, have yielded positive results and strengthened the respective building blocks of the financial sector. It has contributed towards enhancing the capacity and capabilities of domestic financial institutions, promoting a more efficient and stable payment systems infrastructure, providing a robust infrastructure to ensure overall stability of the financial sector as well as putting in place a comprehensive consumer protection infrastructure.

In the banking sector, domestic banking institutions have maintained their market share, despite a more competitive operating environment. As at end-2004, domestic banking institutions commanded 78% share of gross loans and 77% of total deposits (end-2003: 78.3% of gross loans and 77.9% of total deposits). Domestic banking institutions also maintained its position as the main financier for business enterprises with a market share of 78.7% (end-2003: 79%) and further enhanced its position as the main lender to small and medium enterprises (SMEs) with a market share of 84.8% (end-2003: 82.7%), particularly to the manufacturing sector where its market share increased from 76.3% in 2003 to 82% in 2004.

Financial performance of domestic banks continued to be strong. Return on average assets and return on average equity (excluding dividends received from banking subsidiaries) stood at 1.04% and 11.9% respectively (end-2003: 1.02% and 11.3% respectively). Initiatives taken to improve operational efficiency continued to show positive results. The cost to income ratio has declined marginally from 52.6% in 2003 to 51.9% in 2004. Better productivity levels were recorded, as exhibited by an improvement in pre-tax profit per RM employee cost, from RM1.49 in 2003 to RM1.55 in 2004. Customer service efficiency levels have also shown further improvements especially in the turnaround time for loan and credit card processing.

In addition, initiatives previously taken to enhance risk management capabilities have placed domestic banking institutions in a stronger position to compete more effectively with the foreign banks. With better risk management capabilities, domestic banking institutions are better equipped to price their products

and services more competitively whilst ensuring that their risk exposures remained within reasonable levels. Better insight into their exposure levels and management capabilities also enable domestic banking institutions to be more innovative in their product and business development strategies. Furthermore, the mergers between commercial banks and finance companies have enabled domestic banking institutions to capitalise on synergies and economies of scale to further enhance cost-efficiency levels.

For the banking system as a whole, the introduction of the New Interest Rate Framework, which was aimed at promoting a more efficient pricing mechanism for interest-based products, provided banking institutions with greater flexibility in pricing their products and services. This flexibility is also expected to spur greater product innovation by the banking institutions to meet the growing demands of customers who value greater choices and customised financial products.

Similar to the banking industry, the insurance sector has also recorded performance improvements among domestic insurers. Domestic players maintained a strong market position with a market share of 72.7% (end-2003: 73.3%) in the general sector. In the life sector, domestic insurers have successfully leveraged on their comparative advantages to increase their combined market share to 35.8% of life premiums (end-2003: 31.8%) following the comparatively higher new business growth registered by domestic life insurers compared with foreign insurers.

The development of bancassurance as a major distribution channel has contributed significantly to the growth of domestic life insurers. Domestic life insurers controlled 82.9% (end-2003: 79.2%) of total premiums generated through bancassurance in 2004. Leveraging on effective bancassurance strategies, domestic insurers were also able to correspondingly increase their market share of the fast growing investment-linked insurance market which has enjoyed strong demand from consumers in recent years. Domestic insurers accounted for 44.8% of new investment-linked premiums generated in 2004, an increase from 33.6% in 2003.

The implementation of a more flexible policy on remuneration structures governing bancassurance arrangements in December 2004 is expected to provide appropriate incentives for the continued long-term development of bancassurance as a cost-effective distribution channel.

In line with efforts to strengthen Malaysia as an Islamic financial services centre and the growing popularity of Islamic financial services worldwide, Islamic banking has strongly emerged as an efficient and effective financial intermediation channel and has become an integral component of the overall Malaysian financial system. The Islamic banking sector continued to show strong growth, as assets grew to RM94.6 billion as at end-2004 to account for 10.5% of the total assets of the banking system (end-2003: 9.7% or RM82.2 billion). Islamic deposits and financing have increased to RM72.9 billion and RM57.9 billion respectively, to account for 11.2% and 11.3% of the deposits and loans of the banking system (end-2003: 10.4% and 10.3%). The takaful sector has remained stable with assets constituting 5.6% (RM5 billion) of the insurance and takaful industry's total assets, and accounted for 5.1% of total premiums and contributions of the industry.

Significant milestones have been achieved in the regulatory framework of Islamic banking and takaful to strengthen the institutional capacity and resilience of the players. The Revised Rate of Returns Framework is expected to enhance the capacity and efficiency of the Islamic banking institutions in managing their Islamic banking operations. Recognising that good corporate governance reinforces sound regulation and supervision as well as contributes towards maintaining market confidence, the new guidelines on directorship for both Islamic banks and takaful operators are expected to further strengthen transparency and accountability.

Additional measures to strengthen Shariah and legal infrastructure were also undertaken. To further enhance competitiveness, Islamic financial institutions are now exempted from any additional stamp

duty and tax payment arising from instruments and transactions executed in fulfilling Shariah requirements to enable tax neutrality between Islamic and conventional finance. The Regional Centre for Arbitration in Kuala Lumpur was chosen to arbitrate cases for Islamic banking and takaful. This would complement the specialised High Court that is assigned to adjudicate all Islamic banking and finance cases. Following the amendments to the Central Bank of Malaysia Act 1958, the stature of the Shariah Advisory Council (SAC) has been elevated as the sole authority on Shariah matters pertaining to Islamic banking and finance that fall under the purview of Bank Negara Malaysia. The SAC will serve as the reference point by the court or arbitrator in the resolution of disputes that involve Shariah issues on Islamic banking and finance cases. The Guidelines on Governance of the Shariah Committee for the Islamic financial institutions were also issued to specify amongst others, the new structure, roles and functions of the Shariah Committees of the Islamic banks, the conventional banks participating in Islamic Banking Scheme and takaful operators, and the requirements for the appointment of Shariah committee members.

In line with Malaysia's aspirations to become the leading Islamic financial centre, the Labuan Offshore Financial Services Authority (LOFSA) has continued with its efforts to develop the Labuan International Offshore Financial Centre (IOFC). Currently, there are two full-fledged Islamic banks, three Islamic investment banks and one full-fledged takaful/retakaful operator that operate in Labuan IOFC. To further strengthen Islamic financial services in Labuan IOFC, LOFSA has established various working groups comprising market experts to assist in formulating strategies to develop and promote Islamic capital market, international Islamic trust and waqf, Islamic fund management, Islamic insurance or takaful and Islamic trade finance. In addition, there is greater co-operation and collaboration amongst regulatory agencies in the area of financial markets and takaful to meet the requirements of Islamic banking and financial institutions. Labuan IOFC's reputation as an offshore Islamic financial centre was further enhanced following secondary listings of two sukuks from the Middle East, which were listed on the Labuan International Financial Exchange (LFX). To pave the way to further develop Islamic capital market with an enhanced global reach, the LFX signed a Memorandum of Understanding with the Bahrain-based International Islamic Financial Market (IIFM) in 2004 to set a framework for greater cooperation between LFX and IIFM. This is to capitalise on the potential to expand the investor base for the investment of funds mobilised from OIC countries.

To complement the role of the banking and insurance sectors in supporting the national economic development objectives, the DFIs have continued to perform their intermediation role as niche providers of funding and ancillary services to targeted sectors. In line with the recommendations of the FSMP, initiatives remained focused on enhancing the efficiency and effectiveness of the industry, through capacity and capability building efforts, to ensure that DFIs continue to be able to provide financial and advisory support to their respective targeted sectors.

As part of the efforts to ensure that DFIs remain focused in their respective roles, Bank Negara Malaysia had conducted a review on the mandated roles and activities of DFIs. Following the Bank's proposal, the Government has announced the merger of the Export-Import Bank of Malaysia Berhad and Malaysia Export Credit Insurance Berhad, as well as the rationalisation of the roles and functions of Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad. This would enable these DFIs to be more focused, thus more effective in serving the targeted sectors.

Efforts were also undertaken to enhance the capacity and capability of DFIs in providing non-financial services to their targeted clients. A joint project between Bank Negara Malaysia and the Japan International Cooperation Agency to enhance the advisory capabilities of selected major DFIs for SMEs commenced in October 2004. It is envisaged that the provision of advisory services can be used to supplement the financial assistance available to SMEs, thus enhancing the effectiveness of the DFIs in developing and nurturing SMEs. To enable Bank Negara Malaysia to effectively monitor the performance of the DFIs, a computerised online reporting system known as Development Financial Institutions Statistical System (DFISS) has been developed, thus enabling the DFIs to submit statistical data electronically. The system

enables Bank Negara Malaysia to obtain accurate information in a timely manner to facilitate the monitoring of DFIs' performance. In order to address the unique features of each DFI, DFISS captures both generic and specific information relating to their businesses.

The initiatives undertaken thus far have resulted in the creation of a financial sector which is stronger, more resilient and in a better position to face greater competitive pressures. The ability of domestic banking institutions and insurance companies to continue recording strong financial performance despite the increasingly competitive operating environment, is testament to the fact that they have grown in strength and capabilities. In addition, the regulatory framework has been further enhanced to cope with the challenges of the increasingly complex financial market. Financial institutions have adopted better risk management practices in their business operations, which have also provided them with greater ability and flexibility to respond to the increasing demands and expectations from customers. The achievements and the narrowing of the performance gaps between the domestic and foreign-owned institutions provide a platform for further liberalisation and deregulation as envisaged under Phase 2 of the FSMP.

Policy Thrusts in Phase 2

As outlined in the FSMP, the operating environment will be gradually deregulated and liberalised to develop a financial sector that is more efficient, dynamic and capable of supporting the changing needs of the economy effectively and in the most efficient manner. Competitive pressures will be progressively infused into the banking and insurance industries so as to elevate the delivery of service and overall performance of the financial sector.

Nevertheless, efforts to enhance the capacity and capability of the domestic institutions will continue to ensure that they remain competitive in a more liberalised environment. In tandem with efforts to promote greater efficiency and competitiveness, emphasis will also be focused on further enhancing resilience and stability of the financial system that will contribute towards overall economic growth and development. Regulatory frameworks will continue to be revised to ensure that they remain relevant and responsive to the changing financial landscape, and to keep in tandem with the developments in the international markets. Consumer education initiatives will continue to be pursued to promote better informed and active consumers, which will play an increasingly important role towards attaining a world-class financial system in Malaysia.

With the strong interconnectedness between the financial sector and overall economic development, policy initiatives will continue to be focused on improving access to financing in order to support further economic growth. This include specific focus towards strengthening the infrastructure and access to financing for the SMEs and new growth areas such as the agriculture and agro-based sectors.

i) Banking Sector

Phase 2 of the FSMP implementation will see more efforts channelled towards infusing greater competition into the banking sector. This will be gradually undertaken through the levelling of the playing field between domestic and incumbent foreign banking institutions and, in the process, enhance the quality of banking services and provide customers with the opportunity to choose from a wider array of products and services. In order to ensure that a core group of domestic banking institutions continues to remain strong and capable to compete effectively in a more liberalised operating environment, capacity and capability building initiatives will continue to be undertaken. At the same time, initiatives will continue to be taken to further enhance the regulatory framework so as to provide a more conducive platform for the market to function effectively and efficiently while preserving the resilience and stability of the financial sector. Recognising the role that can be played by consumers in instilling greater sense of market discipline, consumer education programmes will continue to be pursued. Under a more market-oriented operating environment, it is important to ensure that the necessary infrastructure for consumer protection is well in place, including the presence of an effective mechanism to monitor and prevent collusive behaviour amongst banking institutions. Therefore, anti-trust regulations

for the banking sector will be developed over the long-term, which will define the guiding approaches to address anti-competitive behaviour and unfair practices of banking institutions, and the remedies for dealing with such behaviours.

As a participant in the global financial system, the Malaysian banking system is expected to operate at international standards. Attestation by an independent third party will add credibility to the institution concerned and, in the process, promote discipline through market forces. However, to achieve this objective, there needs to be an enhanced level of consumer awareness and understanding of financial information. Another prerequisite is the transparency and accountability of rating agencies that undertake the assessment to ensure that the ratings given are based on a comprehensive and consistent methodology.

As the financial market becomes increasingly complex, the need for a more comprehensive and responsive risk management system becomes critical to ensure the soundness of each banking institution and the resilience of the banking sector as a whole. In this regard, a more sophisticated and differentiated treatment of different risk classes will be developed to take into account the risk profile of loan exposures to different sectors of the economy, in addition to the incorporation of market risk into the capital adequacy framework. This measure is aimed at ensuring that the capital of each institution supports the type of risk to which it is exposed. A more detailed and robust capital adequacy framework will enable banking institutions to effectively manage their risk and capital held. All these measures will be undertaken as part of the implementation of Basel II.

The increasingly complex operating environment translates into greater challenges for regulators to effectively perform their oversight functions. With the changing dynamics of risk characteristics, inter-linkages between risk exposures and the development of specialised products, the tools with which regulators conduct the surveillance function are continuously being updated. The use of technology will also be further assimilated into the regulatory function to provide Bank Negara Malaysia with integrated real-time information. Robust surveillance models will promote a better understanding of the impact of specific movements in the market on the stability of the financial sector and the economy. Through an early warning system, Bank Negara Malaysia will be better able to take corrective actions early and thus prevent extensive adverse effect on the financial sector. Such detailed information will also facilitate the analysis and policy formulation process by providing an assessment of the possible impact of any particular change in risk factors on the overall stability of the banking sector.

A key component of the efforts to ensure financial stability is the development of deposit insurance. As part of the financial safety net, a Deposit Insurance Scheme will be introduced to protect depositors in the event of a bank failure. The deposit insurance system will cover both conventional and Islamic banking institutions.

ii) Insurance Sector

The implementation of Phase 2 in the insurance sector will focus on consolidating the capacity building initiatives in order to achieve the desired outcome of a core of strong domestic market leaders that will be well-positioned to compete effectively in a progressively more liberalised environment. This will be undertaken through strategies that provide both the appropriate incentives for performance improvements, as well as a sound supporting framework for financial and market stability.

Following the capacity building measures implemented under Phase 1, a gradual levelling of the playing field between domestic and foreign insurers will be implemented in Phase 2. This will encompass both the gradual removal of remaining operating restrictions applicable to foreign insurers, as well as further deregulation across the board in key areas that will allow insurers greater flexibility to individually pursue innovative business strategies. The deregulatory measures to this end are expected to drive increased competition in the market, thereby accelerating performance improvements among domestic insurers.

More importantly, the development of the necessary supporting infrastructure as well as adjustments to the prudential regulatory and supervisory framework will be simultaneously undertaken to ensure that insurers continue to adopt sound financial and business practices in the more deregulated environment envisaged under Phases 2 and 3 of the implementation of the Masterplan. This will include the strengthening of reserve requirements and the risk management framework governing the significant activities of insurers, establishing an institutional framework to support sound pricing policies following the progressive deregulation of price tariffs for motor and fire business, and enforcing higher standards of disclosure and fair practices in the sale of insurance products.

To achieve a more efficient utilisation of capital, a Risk-Based Capital Framework is being implemented to better align the solvency regime with the risk profiles of individual insurers. Implementation of the framework will provide insurers with substantially greater flexibility to implement appropriate investment strategies that would improve performance and at the same time, achieve better asset-liability matching of insurance funds to support the long term viability of life insurers.

The supporting framework for more effective performance-based supervision will also continue to be strengthened in Phase 2. This includes the implementation of a more rigorous and risk-focused supervisory framework with effect from 2004. The Bank's surveillance capabilities with respect to key risks and trends in the industry will also be further strengthened with enhancements to reporting requirements and the more effective integration of global developments into domestic market analyses and projections to identify trends that may have an impact on the stability of the domestic market.

iii) Islamic Banking & Takaful Sector

The focus for Islamic banking and takaful under Phase 2 will be to enhance performance and upgrade the infrastructure of the Islamic banking and takaful industry. The strengthening of these components will provide the foundations for future sustainable progress in the building of an intermediation system that is robust, resilient, and competitive. Bank Negara Malaysia will continue to focus on a three-pronged strategic initiative where efforts will be focused on positioning Malaysia as a leading centre for educational excellence in Islamic banking and finance, establishing Malaysia as a leading name in Islamic banking and takaful consultancy; and positioning Malaysia's financial institutions as global Islamic financial players.

Given the structure of Islamic banking, the design of the regulatory framework for Islamic banking accords emphasis to full financial disclosure, prudent risk management and adherence to Shariah principles. This will also serve as a firewall to prevent the transmission of risks from investment deposits to demand deposits thus enhancing transparency, depositors' protection and systemic stability.

It has become increasingly evident that, in the long run, dedicated standards need to be promoted for the development of Islamic investment vehicles as well as a robust Islamic capital market. The Islamic Financial Services Board will develop the prudential regulatory and supervisory standards for Islamic banking operations to guide Islamic banking operations, promote disclosure-based principles, enhance transparency, and help nurture the development of the Islamic capital market. In addition, the Malaysian Accounting Standards Board will also set the accounting standards for Islamic financial business.

iv) Development Financial Institutions Sector

DFIs will continue to play an important role in supporting the development strategies of the nation by complementing the banking sector to meet the changing financing requirements of the economy. In this regard, it becomes increasingly important for DFIs to be effective, efficient and dynamic in response to the demands of identified target growth sectors. Efforts that were undertaken in Phase 1 to build the capacity and capability of the DFIs will be continued in Phase 2. Greater emphasis will be placed on strengthening the financial and operating conditions as well as enhancing the corporate governance, risk management

practices and human resource development of the DFIs. This is aimed at ensuring that the financial intermediation process, through the DFIs, will operate effectively and efficiently to support Malaysia's economic transformation.

v) Labuan International Offshore Financial Centre

Labuan IOFC has demonstrated positive and encouraging results in every sector of offshore business covering offshore banking, insurance and insurance-related activities, leasing and capital market activities, and is positioning itself as a leading integrated offshore business centre. Going forward, LOFSA will continue to promote and diversify further the financial players and activities in the IOFC. Business development programmes will be undertaken, aimed at expanding offshore financial services opportunities from other regions. LOFSA will continue to promote and enhance global awareness on Labuan IOFC's position as an attractive and cost-efficient offshore business centre. Most importantly, LOFSA will promote the development of Islamic banking and retakaful business to cater for the growing demand for Islamic finance products. Further development to build a sustainable, progressive and efficient Islamic financial centre will continue to reinforce Malaysia's current potential as a leading Islamic financial centre. In addition, LOFSA will continue to direct efforts to strengthen the capital market, e-commerce and the ancillary activities. Also important is the development of an active secondary market for both conventional and Islamic financial instruments listed on the LFX.

vi) Alternative Mode of Financing - Venture Capital and Credit Enhancements

The development of venture capital financing will continue to be promoted in view of its importance in nurturing new growth areas as well as to serve as an alternative source of financing in the economy. Further efforts will be directed towards greater capacity building in terms of skills upgrade and access to private sector financing. To accelerate the development of the venture capital industry, a network of business angels, diversified sources of funds and a large pool of highly skilled knowledge workers are required. In addition, constraints in the supply of innovations need to be addressed with the improvement of deals flows through the development of a critical mass of high growth-potential investees. In order to assist the cultivation of better entrepreneurship culture, further concerted efforts will aim at providing the necessary business and regulatory environment, ensuring access to financing at earlier stages of innovation and reviewing existing policies relating to commercialisation of ideas.

Another area of focus is the credit enhancement initiatives to facilitate lending, especially in the agriculture sector. Initiatives are being taken to enhance financing activities to include the provision of guarantees on agriculture-related loans granted by the banking institutions to high risk but commercially viable ventures, as well as increasing the range of ancillary services deemed essential for sound development of the agriculture sector. In addition, agriculture insurance could play an important role in transforming the agriculture sector into a modern and dynamic commercial sector. The availability and range of insurance products being developed by the insurance industry aim to provide multiple benefits to the farmers including enhanced access to financing, stability in farm income as well as improved risk management practices and farming technologies.

Moving Forward

The key emphasis of the FSMP is to move towards a more diversified and balanced financial system with strong institutional framework, comprehensive market infrastructure, world-class best practices and conducive regulatory environment. As the financial system transitions into Phase 2 of the FSMP, the thrust of initiatives in 2005 will be two-pronged – to continue the efforts to strengthen the institutional development of domestic financial institutions to be well-positioned in a more liberalised and deregulated environment; and to review the current policies and regulatory framework in order to level the playing field between the various market players. Equally important is for institutions to be able to adapt, adjust and respond to changing economic conditions in particular to support new areas of growth. Having robust financial institutions that are able to withstand any potential shocks and have the agility and adaptability to embrace future challenges are key in ensuring long-term sustainability in a more competitive environment as well as the preservation of financial stability.

Financial Services Liberalisation Measures Since 2000

Year	
	Banking Sector
2000	• The maximum total credit facilities that could be obtained by non-resident controlled companies (NRCCs) from foreign-owned banking institutions in Malaysia was increased from 40% to 50% in December 2000. • Licensed Offshore Banks in the Labuan International Offshore Financial Centre (Labuan Offshore Banks) would be allowed to invest in ringgit assets/instruments in Malaysia for their own accounts, though not on behalf of their clients. • Licensed commercial banks, including the foreign-owned banks, and Bank Islam Malaysia Berhad in Malaysia (licensed banks) were allowed to extend in aggregate an intra-day overdraft facility of not exceeding RM200 million and an overnight facility of not exceeding RM10 million to non-resident stockbroking companies and non-resident global custodian banks to finance funding gaps due to inadvertent delay in relation to settlement for trade on the KLSE. In addition, they can also enter into short-term currency swap and/or outright forward contracts to cover for purchase of shares on the KLSE. **Non-banking financial sector (excluding insurance)** • The maximum foreign equity limits in a stockbroking company and a financial leasing company were increased to 49% from 30% effective 1 July 2000.
	Banking Sector
2001	• Foreign-owned banking institutions were allowed to set up communicative websites from 1 January 2001. • Banking institutions (including the foreign-owned banks) in Malaysia were allowed to extend credit facilities in ringgit to finance the purchase and/or construction of one immovable property for non-residents who participate in the Silver Hair Programme implemented by the Immigration Department of Malaysia. • Financial institutions (including the foreign-owned banks) were allowed to extend up to three credit facilities in ringgit to non-residents to finance the purchase or construction of any property in Malaysia (excluding for the purchase of land), subject to their own internal credit assessment guidelines. • Banking institutions (including the foreign-owned banks) in Malaysia were allowed to effect transfers involving External Accounts and another External Account and/or Resident Account of different account holders by way of: (a) Automated Teller Machine transfer up to RM5,000 per person/company, per day, per bank for any purpose; (b) Internet-bank transfers up to RM5,000 per person/company, per day, per bank for any purpose; and/or (c) Cheques up to RM5,000 per cheque for any purpose. **Insurance sector** • All insurers with the requisite minimum risk management and security systems in place were allowed to offer the full range of life and general insurance products through the internet with effect from April 2001.
	Banking Sector
2002	• Foreign-owned banking institutions were allowed to offer transactional internet banking from 1 January 2002.

	• Internal credit lines used solely to facilitate drawing against uncleared cheques, granted by licensed banks (including the foreign-owned banks) to NRCCs, were excluded from the computation of the NRCC's total domestic credit facilities. Licensed banks were also permitted to allow NRCCs to overdraw their current accounts for amounts of up to RM500,000 per account for a period not exceeding 2 working days. • Banking institutions (including the foreign-owned banks) in Malaysia were allowed to extend additional ringgit credit facilities to any non-resident up to an aggregate of RM5 million per non-resident to finance projects undertaken in Malaysia. Prior to this, credit facilities in ringgit to a non-resident, for purposes other than purchases of three immovable properties or a vehicle, were limited to RM200,000. **Insurance sector** • The areas in which insurers may employ expatriates were expanded to include, in addition to the fields of specialised underwriting, actuarial and information technology previously provided for, other areas involving product research and development, risk management and investment.
	Banking Sector
2003	• Licensed banks (including the foreign-owned banks) in Malaysia were allowed to extend overdraft facilities in ringgit not exceeding RM500,000 in aggregate to a non-resident customer, provided such overdraft facilities are covered by fixed deposits placed by the non-resident customer with the licensed banks in Malaysia. These overdraft facilities were in addition to all ringgit credit facilities allowed to be extended freely by banking institutions since 21 November 2002. • The 50% limit on the maximum total credit facilities that could be obtained by NRCCs from foreign-owned banking institutions in Malaysia was removed on 1 April 2003. • The overnight limit for foreign currency account (FCA) to retain receipts arising from export of goods (export receipts) for Approved Operational Headquarters (OHQ) was increased to US$70 million from US$10 million. The maximum overnight limit on export FCA of other resident exporters was also raised to US$70 million. • Residents may invest in investment products that are linked to foreign currency denominated derivatives that are offered by licensed banks (including the foreign-owned banks) in Malaysia. The foreign currency funds used for the investment that are utilised from the residents' FCA will be earmarked and computed as part of the aggregate overnight balances of the FCA of the residents. • Allow up to three new Islamic banking licences to qualified foreign players. **Insurance sector** • Effective 17 April 2003, foreign-owned insurers with foreign shareholding not exceeding 51% were allowed to open not more than two branch offices in one year.
	Banking Sector
2004	• To enhance cash flow management for supporting value chain expansion in Malaysia, licensed banks (including foreign-owned banks) can retain higher amount of foreign currency funds for residents in FCA: - Up to a maximum of US$100 million (previously US$70 million) of export receipts. - Any amount of non-export receipts for residents with domestic borrowing (previously need approval). - Up to US$150,000 for education/employment purpose (previously US$100,000). • Labuan Offshore Banks are allowed to maintain FCA for residents: - Up to US$0.5 million of non-export receipts for residents without domestic borrowing (previously need approval).

- Up to US$150,000 for education/employment purpose (previously US$100,000).
- Any amount overseas foreign currency funds for resident individuals.

- To enhance access to ringgit funds for business requirements in Malaysia, the various limits for banking institutions lending to non-residents in ringgit have been consolidated to one single aggregate limit of RM10 million for use in Malaysia for any purpose (excluding stockbroking company, custodian bank and correspondent bank).
- The extension of property loans in ringgit by residents, including licensed banks, to non-residents now includes the purchase of land (previously not allowed).
- Licensed banks are allowed to extend an aggregate overnight overdraft facility of RM200 million (increased from RM10 million) to a non-resident stockbroking company or a non-resident custodian bank to facilitate settlement for purchase of shares listed on the KLSE.
- Resident individuals employed or staying abroad with foreign currency funds sourced from abroad are allowed to invest in any foreign currency assets, including those offered by licensed banks, approved licensed merchant banks and Labuan Offshore Banks.
- Multilateral Development Bank and foreign multinational corporation issuers of ringgit-denominated bonds in Malaysia may enter into forward foreign exchange contracts with onshore licensed banks to hedge their currency risks arising from the issuance of the ringgit denominated bonds. Non-resident investors subscribing to these issues can also hedge their foreign exchange risks.

SUPERVISION OF THE BANKING SYSTEM

The supervisory activities throughout 2004 continued to be directed at the promotion of a sound and robust financial system as part of the preservation of financial stability. These objectives were achieved through allocation of on-site supervisory resources to areas of high risk, continuous monitoring of the banking institutions, adoption of pre-emptive measures and enforcement of prudential regulatory standards. The responsibilities of Bank supervisors have also expanded in recent years to include several development financial institutions and payment system operators which have been placed under the supervision of Bank Negara Malaysia. The Bank is also involved in providing technical assistance to other domestic supervisory agencies as well as international bodies.

The supervisory activities, which include on-site examinations and off-site supervision, are based on a rigorous risk based supervisory framework and emphasise vigilant monitoring of the financial condition and operating soundness of banking institutions. The risk-based supervisory framework provides a structured and forward-looking approach to assess a banking institution's risk profile and risk management systems. With this forward-looking methodology, supervisors are able to allocate resources optimally in supervising the institutions, focusing on the risk areas.

The financial and operating conditions of the banking institutions are assessed using the CAMELS rating framework. The respective banking institutions are assigned a composite rating, ranging from strong (best rated) to very unsatisfactory (poorly rated), and supported by a rating for each of the six components of the CAMELS rating framework, namely capital adequacy, asset quality, management capability, earnings performance, liquidity position and sensitivity to market risk. The rating covers both quantitative and qualitative aspects of the financial and operating condition of the banking institution. Implicit in the rating is the adequacy of a banking institution's risk management systems and practices vis-à-vis its risk profile. During 2004, it was observed that the financial performance and risk management capabilities of most banking institutions had improved as evidenced by the improvement in their ratings.

The supervisory objectives were achieved through allocation of resources to areas of high risk, continuous monitoring of the banking institutions, adoption of pre-emptive measures and enforcement of prudential regulatory standards.

The on-site supervision of banking institutions was complemented with rigorous off-site surveillance functions. The off-site surveillance of the financial condition of banking institutions was conducted through a review of regular reports and financial information submitted by the banking institutions. This mechanism enables early detection of emerging problems so that pre-emptive corrective actions can be taken. A fraud surveillance system has also been put in place to monitor incidences of fraud in the banking system. This enabled identification of new modus operandi of frauds that was highlighted to the banking institutions so as to prevent further occurrences and losses in the banking system. The respective banking institutions are also subjected to continuous monitoring of their resilience to economic shocks under stressed conditions. In conjunction with this, banking institutions are required to submit to the Bank the results of their stress tests on a quarterly basis. The stress test incorporates a set of minimum parameters prescribed by the Bank while allowing the banking institution the flexibility to adopt its own assumptions for certain parameters.

As part of the supervisory activities, the Bank evaluates the performance of directors and the various board committees established in the banking institutions, in line with the increasing attention accorded to the assessment of corporate governance practices of the banking institutions. In this respect, it was observed that the board and senior management of banking institutions are becoming increasingly responsive to risk management issues and this has contributed significantly to the creation of a strong risk management culture across the banking industry. There has also been more active involvement of directors and senior management of banking institutions, particularly amongst the independent directors who are more aware of their responsibilities and having a more active role in guiding the institutions. This bodes well for the banking industry as they are able to provide further perspective and direction regarding the level of risk exposures and strategies for the banking institutions. The Bank continues to place emphasis on the importance of embedding strong corporate governance culture in all aspects of a banking institution's operations. In line with the expectations under the Financial Sector Masterplan, the roles and functions performed by the board members either individually or collectively towards enhancing their organisation's capacities, capabilities and competitiveness are continuously assessed and evaluated.

The emphasis on risk management in banking institutions in recent years has also resulted in the development of a more vibrant and dynamic banking sector. With greater risk management capabilities, banking institutions have the capacity to offer new and more complex value-added products and services to a wider market segment, hence enhancing capacity to improve productivity. The growing utilisation of complex and exotic financial instruments either as a risk management or profit-enhancing tool have necessitated greater supervisory attention in the area of risk management, particularly in the identification and measurement of risks. A significant number of banking institutions have invested in sophisticated trading and risk management systems as well as strengthening their middle-office and compliance functions. Correspondingly, the supervisors have also enhanced their capabilities to assess risk measurement models used by banking institutions. In this connection, the supervisors validate the banking institutions' market risk models to ensure that the practices being adopted are in line with best practices. With effect from September 2004, banking institutions are required to implement, on a trial basis, the new Market Risk Capital Adequacy Framework (MRCF). In order to ensure the smooth implementation of the MRCF upon its full compliance from the second quarter of 2005, the Bank has also reviewed the banking institutions' trading book policy statements and MRCF monthly submissions.

As part of the Bank's efforts to ensure that the banking system is not being used as a conduit for money-laundering activities, supervisory resources are also channelled towards reviewing the adequacy of anti-money laundering and anti-terrorist financing measures established by the banking institutions. Over the years, there has been an increasing level of awareness among banking institutions on the importance of establishing a strong institutional framework to combat money laundering and the financing of terrorism. Together, the Bank and the banking industry have instituted the necessary measures to deter and detect undesirable money laundering activities, which can undermine the integrity of the banking system.

In line with the standards stipulated in the Basel Committee's Core Principles of Effective Banking Supervision, the normal on-site examination cycle for each banking institution, including Islamic banks and development financial institutions is once in every 18 months. However, more frequent examinations are carried out if a banking institution warrants closer supervision. These examinations cover local and overseas branches, bank holding companies and related companies of banking institutions. The examinations of bank holding companies and other related companies of banking institutions are an integral part of the

consolidated supervision process undertaken by the Bank. This process enables the Bank supervisors to assess the ability of the bank holding company to act as a source of financial support to the banking institution within the group and to assess whether other risk-taking activities within the banking group may pose a financial and contagion risk to the banking institution. The planning and monitoring of the performance of the Bank's on-site examinations are certified under the MS ISO 9001:2000 Quality Management System.

In line with the importance of the role of the board in the corporate governance of the banking institution, Bank supervisors have more frequent interactions with members of the board and senior management of banking institutions. This assists Bank supervisors to keep abreast with issues confronting the banking institution, its business strategies, risk profile and risk management capabilities and, at the same time, communicating supervisory concerns on the banking institution to the senior management. This two-way communication with senior management is useful for Bank supervisors to have a thorough understanding of the banking institution, identifying emerging risks more efficiently and effectively, hence instituting corrective measures in a prompt manner.

Supervisory issues arising from on-site examinations are communicated to the senior management and board of directors of the banking institutions in addition to the recommended courses of action. Banking institutions are required to respond to the proposed corrective actions and update the supervisors on the status of their implementation. In cases where the supervisory issues are considered significant and require speedy corrective actions, banking institutions are subjected to the Informal Enforcement Action Framework (IEAF). With the implementation of IEAF since September 2002, significant supervisory issues are closely monitored by the Bank supervisors and greater commitment from the board and senior management is being obtained towards their resolution in a prompt and systematic manner.

With the rapid and diversified development of technology in the banking environment in recent years, the banking institutions are required to be more effective in managing the related information systems (IS) risks in order to improve the safety and soundness of the IS environment in these institutions. The Bank has undertaken several measures to enhance the overall IS governance as well as to promote IS best practices. These include on-site examination, off-site monitoring, issuance of guidelines on the management of the IS environment and improving the standards of IS supervision by benchmarking against other proven IS auditing standards.

In addition to on-site IS examination of banking institutions, the Bank also conducted examinations on the payment system operators under the Payment Systems Act 2003. The examination process includes an appraisal of the capability of the institution in managing the IS risks and where applicable, payment systems risks as well as on the overall management of the payment system operator, and subsequently highlighting areas of concerns related to IS initiatives, security and controls, and system performance. Over the years, the overall IS risk management framework in most banking institutions had improved considerably, given the increased awareness and commitment by the management of the institutions.

For better assessment of the banking institutions' IS environment and to ascertain the soundness of their IS operations, the Bank has enhanced the quality of its IS supervision function by implementing a new methodology for on-site examination, PRISM (Information Systems Risk Assessment). This methodology provides a more balanced appraisal of the IS environment in the banking institutions by linking the IS practices and risks to the business requirements and processes. The Bank is also developing a system to enhance the off-site monitoring function by implementing a database of information on the development and usage of technology by the banking institutions. The system would be able to provide an early warning mechanism on potential systemic risks as well as to provide benchmarking of core processes across the banking industry and promote best practices in IS risk management.

An area that has been accorded supervisory importance is the outsourcing arrangements of banking institutions. This is due to the increasing trend in outsourcing of some of the banking institutions' back-office processes, such as payment processing, call centre and IS infrastructure services to third-party service providers. The Bank reviews the outsourcing arrangements between the banking institutions and the third-party service providers as well as conducts examinations on the third-party service providers to ensure that all aspects of the outsourcing are managed effectively. Ultimately, the customers of the banking institutions must be adequately protected while benefiting from the more efficient services provided by the banking institutions.

In order to remain effective in today's fast evolving financial markets, Bank supervisors need to build up expertise quickly in order to be able to provide value add to the banking institutions. For this purpose, several specialised groups of Bank supervisors had been developed to focus on specific areas, which are critical in performing the Bank's supervisory functions.

In meeting the supervisory responsibilities expected of the supervisors specifically under Pillar 2 of the new Basel capital accord, various capacity building initiatives are being undertaken to equip supervisors with the necessary knowledge and skills. In addition to knowledge acquisition, supervisory processes are being reviewed and enhanced to facilitate the assessment of a bank's capital management and processes.

Globalisation and market liberalisation under the Financial Sector Masterplan will see the emergence of new and significant players. The formation of bigger banking entities arising from the merger of the commercial banks and finance companies within each banking group, emergence of new foreign incorporated Islamic banks, increasing complexity of operations arising from the greater regional presence, cross-selling activities within entities in the same banking group and outsourcing of banking institutions operations will necessitate the Bank to continuously set new benchmarks for its supervisory approaches and activities. Efforts will continue to be taken to ensure that the supervisors are equipped with the necessary skills and capacity to manage these challenges.

Malaysia's Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Programme

Overview

Malaysia continued to develop and enhance its national AML/CFT regime by strengthening its AML/CFT legislative framework as well as by improving domestic and international co-operation, and upgrading the capacity of law enforcement personnel in these important areas. Bank Negara Malaysia, as the lead agency for the National Co-ordination Committee to Counter Money Laundering (NCC) that co-coordinates the implementation and enforcement of the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLA) and AML/CFT measures, is committed in ensuring that Malaysia's financial system is sound, robust and free from abuse.

During the year, Bank Negara Malaysia extended the AMLA regulatory net to new reporting institutions and invoked other reporting obligations under Part IV of the AMLA to existing reporting institutions. More importantly, extensive AML/CFT briefings, training and awareness sessions were conducted throughout the country for the law enforcement personnel and the respective regulatory authorities in the public sector as well as various categories of new reporting institutions in the private sector.

Enhancing the Role of the NCC

The NCC continued to ensure that the national AML/CFT regime remained up to date and relevant to the evolving threats of money laundering and terrorism financing. Domestic co-operation was further strengthened by regular meetings of the NCC members during the year to develop, among others, AML/CFT policies, and to coordinate the effective implementation of the AML/CFT measures, based on internationally accepted standards as contained in the Financial Action Task Force on Money Laundering's (FATF) Forty Recommendations on Money Laundering and Nine Special Recommendations on Terrorism Financing. The FATF, which is an inter-governmental body established by the G-7 Summit in Paris in 1989, develops and promotes policies to combat money laundering and terrorism financing. During the year, the NCC continued to ensure that the developments in the national AML/CFT regime are consistent with the FATF's Recommendations.

The NCC's role in the national AML/CFT regime is further strengthened by changes in its composition. The NCC now comprises senior level representation from the various enforcement agencies. The Ministry of Domestic Trade and Consumer Affair's Enforcement Division, which is responsible for enforcing the Optical Discs Act 2000 and Copyright Act 1987, was included as a new member of the NCC. During the year, the National Narcotics Agency ceased to be a member as matters relating to the enforcement of the Dangerous Drugs Act 1952 is under the purview of the Royal Malaysian Police, which is one of the founding members of the NCC.

Enhancing AML/CFT Legislative Framework

Instead of a new anti-terrorism financing statute, Malaysia amended five pieces of legislation namely, the AMLA, the Penal Code, the Subordinate Courts Act 1948, the Courts of Judicature Act 1964 and the Criminal Procedure Code to enable Malaysia to accede to the following two international conventions on terrorism:

- The International Convention for the Suppression of the Financing of Terrorism adopted by the General Assembly of the United Nations on 9 December 1999 and comply with the United Nations Security Council Resolutions on counter-terrorism measures, in particular Security Council Resolution 1373 (2001) of 28 September 2001; and
- The International Convention against the Taking of Hostages adopted by the General Assembly of the United Nations.

The Anti-Money Laundering (Amendment) Act 2003 and the Penal Code (Amendment) Act 2003 were *gazetted* as law on 25 December 2003. The Penal Code (Amendment) Act 2003, among others, extended the application of the Penal Code to extra-territorial offences under the new Chapter VIA, which deals with, among others, the suppression of the financing of terrorist acts, and added on additional grounds for extra-territorial criminal jurisdiction to be sought. The Subordinate Courts (Amendment) Act 2004 and the Courts of Judicature (Amendment) Act 2004 were *gazetted* as law on 23 December 2004. The amendments, among others, extended the extra-territorial criminal jurisdiction of the High Court to offences under the new Chapter VIA of the Penal Code. The consequential amendments to the Criminal Procedure Code on police powers in relation to terrorism offences would be tabled in Parliament after deliberation by the Select Committee of the Lower House of Parliament.

The Anti-Money Laundering (Amendment) Act 2003, among others, extended the reporting of suspicious transactions to Bank Negara Malaysia to cover the reporting of suspected terrorism financing activities. This new law also extended the AMLA mechanism for tracing, freezing, seizing, forfeiting and confiscating assets to include assets used for the financing of terrorist acts. The new Part VIA of the AMLA empowers the Minister of Internal Security to deem any entity as a terrorist, whose property could then be seized and forfeited to the Federal Government.

AMLA Regulatory Net

Extension to New Reporting Institutions

The AMLA requires a reporting institution to report to Bank Negara Malaysia any transaction where the identity of the person involved, the transaction itself or any other circumstances concerning the transaction gives the reporting institution reason to suspect that it involves proceeds of an unlawful activity. The statutory requirement to report suspicious transactions has been invoked incrementally on conventional, Islamic and offshore entities since the commencement of the AMLA on 15 January 2002. During the year, the AMLA regulatory net was extended to the stockbrokers and futures brokers with effect from 31 March 2004 and to the lawyers, accountants and company secretaries with effect from 30 September 2004. Lawyers and accountants are required to report to the Bank any suspicious transaction identified in the course of carrying out the following types of business activities for their clients:

(i) buying and selling of immovable property;
(ii) managing client's money, securities or other property;
(iii) managing of accounts including savings and securities accounts;
(iv) organising of contributions for the creation, operation or management of companies; or
(v) creating, operating or managing of legal entities or arrangements and buying and selling of business entities.

Company secretaries are required to report to Bank Negara Malaysia any suspicious transaction identified in the course of carrying out the following types of business activities for their clients:

(i) acting as a formation agent of legal entities;
(ii) acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal entities;
(iii) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal entities or arrangement;
(iv) acting as (or arranging for another person to act as) a trustee of an expressed trust; or
(v) acting as (or arranging for another person to act as) a nominee shareholder for another person.

The extension of the AMLA regulatory net to cover lawyers, accountants and company secretaries is a significant milestone in the national AML/CFT regime. Money laundering schemes have become more complex as countries endeavour to implement comprehensive AML/CFT measures in the financial sector to detect and deter money laundering, terrorism financing and other transnational crime, thereby forcing criminals to turn to these professionals to assist them in accessing the financial system. The timely invocation of the AMLA reporting obligations on these professionals during the year further denied criminals indirect access to the financial system through the professional 'gatekeepers' who could structure complicated financial transactions with the view to hide tainted proceeds.

Increasing Reporting Obligations

The AMLA reporting obligations are invoked gradually on the reporting institutions to provide sufficient time for them to implement and discharge their AMLA reporting obligations. The statutory requirement to report suspicious transactions to Bank Negara Malaysia was initially invoked on Lembaga Tabung Haji, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional on 15 January 2003. In order to facilitate such reporting to Bank Negara Malaysia, any obligation as to the secrecy or other restriction on the disclosure of information imposed by written law or otherwise on these institutions were overridden and their officers reporting suspicious transactions in good faith to Bank Negara Malaysia were provided immunity from civil, criminal and disciplinary proceedings. During 2004, the remaining reporting obligations under Part IV of the AMLA, where relevant, were invoked on Lembaga Tabung Haji, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional with effect from 31 March 2004. These reporting obligations include retention of records for a period of six years, conducting customer due diligence, as well as establishing internal reporting and compliance programmes that are designed to reduce their vulnerability to misuse by criminals.

Increasing Predicate Offences

In 2004, the number of money laundering predicate offences in the Second Schedule to the AMLA was increased from 150 to 168 serious crimes from 24 pieces of legislation. The inclusion of the new money laundering predicate offences in the AMLA would enable Bank Negara Malaysia to track the financial trail of these offences and share the financial intelligence with the relevant enforcement agencies.

Enhancing AML/CFT Compliance

During the year, Bank Negara Malaysia developed a comprehensive AML/CFT Compliance Handbook as a reference guide to assist reporting institutions in discharging their obligations under the AMLA. The Handbook contains various documents and literature on the national AML/CFT initiatives pertaining to specific industries, including industry specific regulatory and compliance guidelines, international standards and recommendations as well as circulars and core compliance standards. The CD-ROM copy of the Handbook was distributed during the year to the conventional, Islamic and offshore reporting institutions and the various trade associations. Reporting institutions could refer to the Handbook for assistance in establishing, among others, suspicious transactions reporting mechanisms, record-keeping, customer due-diligence, compliance and on-going training of employees.

Domestic Co-operation

Awareness Programme

The AML/CFT awareness programme was conducted nationwide through a series of briefings for the various categories of new reporting institutions as well as the respective regulatory authorities. The objectives of the briefing sessions were to educate the reporting institutions on their obligations and responsibilities under the AMLA and to establish their working relationship with the Financial Intelligence Unit (FIU) in Bank Negara Malaysia. In addition to the AMLA briefings, Bank Negara Malaysia organised training courses and workshops to upgrade the knowledge and skills of the various law enforcement personnel involved in the fight against money laundering and terrorism financing. During the year, the following training sessions were conducted:

- Briefing on the AML/CFT measures to members of the Malaysian Bar Council in January 2004;
- Briefing on the AMLA invocation and reporting obligations to the capital market intermediaries in March 2004;
- Briefing on the AMLA to Heads and Senior Officers of the Enforcement Division of the Ministry of Domestic Trade and Consumer Affairs in April 2004;
- Seminar on the AML/CFT measures to the Sabah Law Association in May 2004;
- Briefing on the AMLA invocation and reporting obligations were conducted at 18 locations for lawyers, accountants and company secretaries from July – September 2004; and
- Briefing on the AMLA to senior officials of the Companies Commission of Malaysia on 5 November 2004 in connection with the invocation of the AMLA reporting obligation on company secretaries.

Combating the crimes of money laundering and terrorism financing is essential to the integrity of the financial systems. The training sessions were effective platforms to raise concerns and exchange ideas on best practices and on the practical implementation of the AML/CFT measures. Arising from these training sessions, which raised the reporting institutions' level of compliance with international standards, the national AML/CFT regime is now better supported by the contribution of the financial and non-financial reporting institutions that hold critical information on transactions that may hide criminal schemes.

AMLA Investigation Reference Guide

As part of the efforts to document the AMLA investigation processes, a Working Group on the AMLA Investigation Reference Guide, comprising members from the relevant agencies in the NCC drafted a set of required tasks to assist investigators in carrying out investigation in relation to money laundering and terrorist financing offences under the AMLA. The successful formulation of the AMLA Investigation Reference Guide is the result of co-operation among experienced domestic law enforcement personnel, who were unstinting in sharing their knowledge and skills in conducting investigations into financial crimes. After the NCC has adopted the AMLA Investigation Reference Guide in the coming year, it would be distributed to the relevant law enforcement agencies to facilitate investigations into any breaches of the AMLA provisions.

Sub-Committee for Information Sharing

The NCC set up a Sub-Committee for Information Sharing during the year for better analysis and sharing of information gathered from suspicious transactions reports (STRs) and for better use of financial intelligence. This Sub-Committee provides a formal mechanism where intelligence developed by Bank Negara Malaysia based on information obtained from the STRs could kick-start investigations into suspected money laundering offences, terrorism financing and other serious crimes.

International Co-operation

As Malaysia is a member of the Asia/Pacific Group on Money Laundering (APG) Technical Assistance Donor and Provider Group, Bank Negara Malaysia provided technical assistance to the National Bank of Cambodia in drafting the relevant AML/CFT Guidelines for banking institutions in Cambodia. In addition, Bank Negara Malaysia will continue to participate in the AML/CFT mutual evaluation exercises undertaken by various jurisdictions that are members of the APG. Collaborative efforts are also enhanced through the signing of Memorandums of Understanding on the sharing of financial information with various jurisdictions.

Capacity Building

Training Initiatives

Capacity building continued to be the focus of Bank Negara Malaysia with emphasis on financial investigation techniques in order to upgrade the expertise of law enforcement personnel. Experts from both domestic and foreign law enforcement agencies shared their knowledge and expertise at various training workshops during the year. The participating agencies included the Inland Revenue Board and the Attorney-General's Chambers of Malaysia, the National Criminal Intelligence Service and the National Terrorist Financial Investigation Unit of the United Kingdom, the Immigration and Customs Enforcement Division of the United States' Department of Homeland Security, and the United Nations Office of Drugs and Crime. During the year, Bank Negara Malaysia organised and participated in the following training programmes:

(i) The Money Laundering and Terrorism Financing Seminar, Kuala Lumpur, March 2004;
(ii) The AMLA Enforcement Workshop, Kuala Lumpur, September 2004;
(iii) The Computer Forensic Introduction Workshop, Kuala Lumpur, November 2004; and
(iv) The AMLA Net Worth Analysis Workshop, Kuala Lumpur, November - December 2004.

Internal Enabling Initiatives

Financial Intelligence System Phase I (FINS)

As the competent authority under the AMLA, Bank Negara Malaysia continued to receive STRs, which have improved in terms of quality and quantity during the year. For the purpose of facilitating the reporting of suspicious transactions by financial institutions, Bank Negara Malaysia developed FINS to assist the financial institutions in their online submission of STRs. FINS went live in May 2004 and enabled the financial institutions to submit STRs from the convenience of the compliance officers' work-stations in a high speed and secured web environment. The basic analysis tool in FINS automatically analyses the STRs received and thereby enables Bank Negara Malaysia's financial analysts to expedite their identification and review of the financial linkages between the dubious transactions.

Increase of Staff in the Financial Intelligence Unit (FIU)

In view of the expanding AMLA regulatory net and the additional responsibility of tracking the financing of terrorism, Bank Negara Malaysia increased the staff strength of the FIU from 18 to 24 with the creation of more high level posts in the department. In order to facilitate the effective implementation and enforcement of the AMLA, two new sections, namely the Compliance Section and the Investigation Support Section, were created during the year. The Compliance Section oversees the financial and non-financial reporting institutions' compliance with the AMLA obligations, while the Investigation Support Section helps the relevant law enforcement agencies with financial intelligence for their AMLA related investigations.

Challenges Ahead

Bank Negara Malaysia will continue to extend the AMLA regulatory net to other classes of reporting institutions such as trust companies, operators of forecast numbers and other gaming outlets, fund and asset management companies, unit trust companies, real estate agents, jewellers, dealers in precious metals and stones and antique dealers. The money laundering trends and typologies as well as international AML/CFT standards will determine the timing of the invocation of the AMLA obligations on any of these non-financial entities. In addition, the AMLA obligations will only be invoked after the requisite briefing sessions to, and consultations with, the respective industries and sufficient time is granted for the target reporting institutions to fully understand and prepare for their statutory obligations.

Another essential mechanism to ensure effective implementation of AMLA is to establish an informal AMLA enforcement framework for swift regulatory action against any reporting institution for its failure to comply with the AMLA reporting obligations. Such an informal enforcement framework would systematically enumerate corrective and pre-emptive actions against any errant reporting institution before its non-compliance deteriorates to a stage where it becomes the weakest link in the national AML/CFT regime and is abused by criminals to launder their tainted funds.

PERFORMANCE OF THE BANKING SYSTEM

Overview

The banking system remained resilient throughout 2004, with positive developments recorded in all key financial soundness indicators. With non-performing loans (NPLs) continuing to trend downwards and profitability improving, capital ratios were sustained at high levels throughout the year, providing the banking system with sufficient buffer to absorb any unexpected shocks. The sound financial position of banking institutions, together with sustained strong economic performance, low interest rate environment, and favourable household and business sentiments, provided the main impetus for strong expansion in the financing activities. The main highlights of the performance of key indicators of the banking system were:

- High capital adequacy ratios despite several capital rationalisation exercises and strong expansion in risk-weighted assets;
- Higher profitability with improved returns on equity and average assets;
- Net interest margin remained narrow as competition continued to exert pressure in the lending market;
- NPLs continued to trend downwards to its lowest level since the Asian financial crisis, driven mainly by sustained recoveries and reclassifications, and lower incidences of new NPLs;
- Lending activities of the banking institutions remained robust, supportive of the increased demand from the households and businesses; and
- Exposure to market risks remained within prudential levels.

Profitability

Supported by favourable economic and financial market conditions, the banking system recorded preliminary unaudited pre-tax profits of RM11.8 billion for the calendar year 2004, 16.1% higher than the preceding year. This was attained on account of improved gross operating profits, higher net gains from securities trading and investment activities, as well as increase in dividend income from non-banking entities. The strong financial performance resulted in higher returns on average assets and equity of 1.4% and 16.6% respectively, whilst pre-tax profits per employee rose to RM127,827 in 2004 from RM110,526 in the previous year.

The banking system posted gross operating profits of RM12.6 billion for the year, an increase of 3.3% over the level recorded in 2003. The improved performance was driven by higher net income from interest- and fee-related activities, which offset the increase in staff cost and overheads. Reflecting strong competition in the loan market, income from loan and financing activities recorded a marginal growth of RM0.3 billion or 1.1%. The boost in net income from interest-related activities was driven by strong increases in interest income from net interbank activities (+RM0.8 billion or 96.6%), bulk of which was due to the liquidity operations of Bank Negara Malaysia to absorb excess liquidity, as well as investment securities (+RM0.6 billion or 23.9%). By type of institutions, net interest income of the commercial banks increased by 13.8%, while that of the finance companies declined by 14.6%, partly reflecting the technical adjustment following the mergers of five finance companies into the commercial banks. Meanwhile, the merchant banks registered a decline in their net interest income of 3.7% during the year given their continued focus on fee-based activities.

As competition kept lending rates low, the commercial banks continued to diversify into a broader range of non-lending fee-related activities to cater to more affluent consumers. Income from fee-based activities for commercial banks and finance companies as a group increased by 18.1% to RM4 billion in 2004. This was contributed mainly by income derived from private banking activities, including cross-selling of unit trust and bancassurance products, and payment-related activities such as remittances. The ratio of fee-based income to operating income of commercial banks and finance companies as a group stood at 17.2% in 2004 compared with 15.6% in the previous year.

Fee-based income of the merchant banks posted a strong growth of 7% to RM350 million, attributed primarily to higher income generated from portfolio management, share placement and loan syndication activities. Fees derived from portfolio management activities recorded a marked increase of 124.7% to amount to RM37.8 million. Although accounting for only 10.8% of total fee-based income of merchant banks, the substantial growth reflected increased awareness and growing acceptance of wealth management products in generating better returns in the prevailing low interest rate environment. The increase in other fee income of 76.3% to RM54 million was driven primarily by several large placements of corporate shares during the year.

The ratio of cost to income rose slightly to 48.8% following increases in both staff cost and overheads. The larger expenses on personnel was reflective of the higher remuneration packages offered to retain

Table 5.2
Banking System[1]: Income and Expenditure

	For the calendar year			
	2003	2004*p*	Annual change	
	RM million			%
Interest income net of interest-in-suspense	38,123	40,612	2,489	6.5
(Interest-in-suspense)	*4,793*	*3,812*	*-981*	*-20.5*
Less: Interest expense	18,943	20,385	1,442	7.6
Net interest income	19,180	20,227	1,047	5.5
Add: Fee-based income	3,741	4,377	636	17.0
Less: Staff cost	5,095	5,683	588	11.5
Overheads	5,625	6,316	691	12.3
Gross operating profit	12,201	12,605	404	3.3
Less: Loan loss and other provisions	4,155	4,493	338	8.1
Gross operating profit after provisions	8,046	8,112	66	0.8
Add: Other income	2,131	3,699	1,568	73.6
Pre-tax profit	10,177	11,811	1,634	16.1
Of which:				
Commercial banks	6,728	8,094	1,366	20.3
Finance companies	2,644	2,739	95	3.6
Merchant banks	685	866	181	26.4
Islamic banks	120	111	-9	-7.5
Return on assets (%)	1.3	1.4		
Return on equity (%)	15.3	16.6		
Cost to income[2] (%)	46.8	48.8		

[1] Includes Islamic banks.
[2] Only taking into account staff cost, overheads, net interest income and fee-based income.
p Preliminary
Note: Total may not add-up due to rounding.

expertise in light of competition in the market and higher number of staff. With greater emphasis accorded to marketing and promotional activities, a total of 17.2% of overheads incurred for the year was for marketing expenditure compared with 14.3% in 2003.

Despite improving asset quality, total loan loss provisions rose by 5.4% as banking institutions set aside higher allocations for general provision, which increased by RM0.4 billion following expansion in the loan base, and specific provision, which was RM0.1 billion higher as several banking institutions adopted stricter provisioning and classification policies for non-performing loans to further strengthen their balance sheets. The higher provisions were partially mitigated by an increase of RM0.2 billion in recoveries.

Interest Margin

Interest margin continued to narrow during the year as competition in the loan market continued to exert downward pressure on lending rates, particularly in the retail and SME lending segments. Consequently, interest margin net of expenses and loan loss provisions for the year declined by 21 basis points to 0.38 percentage points.

Gross interest margin (difference between interest income and interest expense, expressed as a percentage of interest-related assets) of the commercial banks and finance companies as a group, declined by 13 basis points to 2.66 percentage points on account of higher interest expense. Interest income remained almost unchanged at 4.78% despite the generally lower lending rates as the loan base expanded. The reduction in lending rates was most apparent in the housing market, where the average first year lending rates fell by as much as 93 basis points to 3.08% per annum in December 2004, with a smaller quantum of decline in the remaining periods to maturity. In addition, average lending rates on new business loans have also remained competitive at 5.64% per annum, whilst that of the SMEs was at 6.20% per annum. With liquidity remaining ample, deposit rates were maintained at low levels. Nonetheless, interest expense as percentage of interest-related assets increased by 13 basis points to 2.12% as the banking system experienced a strong increase in total deposits of 13%.

The commercial banks and finance companies as a group also incurred higher staff-related and overhead expenses largely attributed to better remuneration packages and higher marketing expenses. Expressed as a percentage of interest-related assets, staff cost and overheads totalled 1.54%. Meanwhile, loan loss provisions as a percentage of interest-related assets for the year rose slightly to 0.74% compared with 0.67% in the previous year reflecting the adoption of more prudent strategies in dealing with irrecoverable NPLs.

Table 5.3
Weighted Average Lending Rates for New Loans Approved During the Month

	Commercial banks		Finance companies	
	Average for December (% per annum)			
	2003	2004	2003	2004
Business loans	5.72	5.64	7.18	8.06
of which: SMEs	*6.30*	*6.20*	*7.17*	*8.04*
Household loans[1]	4.32	4.34	6.49	6.32
of which:				
Purchase of residential properties	*4.01*	*3.08*	*4.09*	*3.13*
Purchase of passenger cars	*n.a.*	*6.53*	*6.59*	*6.37*

[1] Excludes credit card loans.
n.a. Not applicable.

Lending Activity

Lending activities of the banking system remained robust in 2004. The positive sentiments in the household and business sectors, coupled with the conducive interest rate environment, provided an impetus for stronger demand for loans from the private sector during the year. As the main mobiliser of funds in the economy, the banking sector was able to support the increasing lending requirements arising from growth in household consumption and business activities given their strengthened position. The introduction of the New Interest Rate Framework in 2004 also provided greater flexibility for banking institutions to price their financial products more efficiently and effectively, thereby enhancing their ability to structure and customise their banking products to suit the needs of the customers.

expanded by 10.6% to RM488.2 billion during the year, reflecting the higher financing requirements from the private sector to fund their activities. As disbursements surpassed repayments, total outstanding loans rose strongly at an annual rate of 8.5% in 2004. Total holdings of private debt securities (PDS) by the banking institutions declined by 2.7% in 2004. As a result, total financing by the banking sector to support economic activities increased by 7.7% as at end-2004.

Lending to households

Reflecting improved household income and consumer sentiment, the pace of private consumption increased during the year, and the banking system continued to channel a significant portion of their financing to this sector. As at end-2004, loans to the household sector

The banking sector was able to support the increasing lending requirements arising from growth in household consumption and business activities given their strengthened position.

The robust demand for loans was evidenced by the strong growth in loan applications in 2004. During the year, the banking system received loan applications amounting to RM273.3 billion, which was 20.1% higher than the previous year. The average loan approval rate remained strong at 63.5%, with new loans approved growing by 13.6% to RM173.6 billion in 2004. Therefore, the monthly average of new loans approved in 2004 of RM14.5 billion was higher compared to the monthly average of RM12.7 billion recorded in the preceding year. Loan disbursements also

Table 5.4
Banking System[1]: Financing Activities

	For the year		Annual growth (%)
	2003	2004	
	RM billion		
Loan approvals	152.8	173.6	13.6
Loan disbursements	441.6	488.2	10.6
Loan repayments	430.4	461.6	7.2
	As at end-		
	2003	2004	Annual growth (%)
	RM billion		
Outstanding loans	473.8	514.0	8.5
Total banking system financing[2]	508.0	547.2	7.7
Total financing for the economy[3]	618.4	674.0	9.0

[1] Includes Islamic banks.
[2] Outstanding banking system loans plus private debt securities held by the banking system.
[3] Outstanding banking system loans plus outstanding private debt securities.

represented the largest proportion of loans in the banking sector, accounting for 51.4% of total outstanding loans. In total, outstanding loans to the household sector expanded by 14.4% to RM264.4 billion as at end-2004. Loan applications received from households expanded by 22.1% to RM120.2 billion in 2004, of which 72.2% were approved during the year. Total loan approvals to this sector grew by 20.5% to RM86.8 billion, whilst loan disbursements recorded a corresponding increase of 13.8% to RM130.3 billion in 2004. Despite the high disbursements, unutilised loans within this sector grew by 14.7% to RM67.8 billion as at end-2004. As in the previous years, lending activities within this sector were concentrated in mortgage financing, financing for the purchase of passenger cars and credit cards. The strong growth in loans to this sector was supported mainly by the competitive financing packages offered by banking institutions and the promotional campaigns carried out by the private sector to boost demand.

Within the portfolio of loans to the household sector, the highest proportion of loans was channelled towards the acquisition of residential properties, amounting to RM130.3 billion or 49.3% of total household loans. In line with the Government's effort to promote home ownership, the demand for housing loans continued to remain buoyant to cater for the large supply of mid-range residential properties launched during the year. In 2004, the banking system received RM52.4 billion worth of applications for the purchase of residential properties, 11.7% higher than the preceding year. Loan approvals

for the purchase of residential properties rose by 18.8% to RM35.7 billion in 2004, whilst loan disbursements grew by 9.1% to RM38.8 billion. Borrowers were able to benefit from lower average lending rates for these loans which ranged from 3.08% to 3.73% per annum for the commercial banks and 3.07% to 5.08% per annum for the finance companies. As a result, total outstanding loans for the purchase of residential properties grew at an annual rate of between 14.2% to 16.2% throughout the year. Although the level of exposure of the banking institutions to the residential sector has increased more than twofold since 1998, banking institutions are better able to manage the risk arising from these lending activities given their enhanced risk management standards. Banking institutions have also been able to leverage on the Central Credit Reference Information System to determine the credit profile of borrowers, thereby facilitating their credit assessment process.

Loans for the purchase of passenger cars accounted for the second largest proportion of loans to the household sector. As at end-2004, loans to this sector comprised 27.2% of total household loans, recording an increase of 17.2% from RM61.3 billion as at end-2003 to RM71.9 billion as at end-2004. The strong consumer demand for motor vehicles was attributed mainly to renewed interest in demand following the revision of duties on passenger cars with effect from 1 January 2004, a number of new launches of mid-range passenger cars and the promotional activities undertaken by car companies to expand their sales. Loan applications for the purchase of passenger cars grew by 27.4% to RM40.6 billion from RM31.8 billion in 2003. Loan approvals to this sector increased by 17.2% to RM30.4 billion in 2004, whilst loan disbursements remained high at RM29.1 billion in 2004 compared with RM24.5 billion in 2003.

Reflecting the strong demand for consumption loans, outstanding credit card loans also recorded an increase of 16.3% in 2004. Loan approvals for credit cards soared by 26.6% to RM11.7 billion in 2004, whilst utilisation of credit card lines was high, accounting for 32.4% of the total credit lines extended to cardholders. The increase in utilisation is in tandem with the higher number of cards in circulation, which grew by 28.6% to more than 6.6 million cards as at end-2004. Disbursements to this sector also rose by 19.1% to RM36.3 billion in 2004, compared with RM30.5 billion in 2003. Efforts by banking institutions to promote credit cards as a mode of payment were complemented by sound risk management standards to ensure that the risk arising from more aggressive lending to this sector is manageable.

Lending to businesses

The improvement in corporate profitability, favourable financing conditions and improved external sector performance in 2004 were strong drivers in encouraging larger private investments in new projects and corporate expansion. Reflecting this, demand for new financing by businesses was higher in 2004. Loan applications received from businesses increased by 20% in 2004, a turnaround from the decline of 7.7% in 2003. The increase was driven by higher applications received from the manufacturing, construction and the wholesale and retail trade sectors, amounting to RM76.2 billion in 2004.

In tandem with higher loan applications, new loans approved to businesses increased by 9.8% to RM84.9 billion, accounting for 48.9% of total new loans approved by the banking system. Nearly 51% or RM43.2 billion of new loans approved to businesses were channelled to the construction, manufacturing and the wholesale and retail trade sectors. In terms of disbursements, 68.7% of total disbursements by the banking system were channelled to the business sector. Loan disbursements to businesses grew by 10.5% to RM335.3 billion in 2004, of which 60.8% were channelled to the manufacturing and the wholesale and retail trade sectors. As disbursements were relatively higher compared with repayments of RM319.8 billion, total outstanding loans to the business sector expanded by 2.6% to RM219.2 billion as at end-2004.

Small and medium enterprises (SMEs) continued to receive strong support from the banking sector. Loans to SMEs accounted for 40.3% of outstanding loans to businesses. Loan approvals were high and accounted for 58.4% of total applications received, whilst loan rejections remained low, constituting 19.1% of total applications received. In 2004, new loans approved increased by 21.9% to RM31.6 billion, to more than 92,000 SMEs. On a monthly average basis, the level of loan approvals amounting to RM2.6 billion per month in 2004 was higher compared to the level achieved in 2003 of RM2.2 billion per month. Concurrently, loan disbursements to SMEs also expanded strongly by 15.3% to RM100.4 billion. Consequently, outstanding loans to SMEs expanded by 7.7% in 2004.

In terms of loans to SMEs by sectors, about 59.3% of outstanding loans to SMEs were channelled to the manufacturing, construction and the wholesale and retail trade sectors. In line with the Government's call to promote businesses involved in business process outsourcing and information technology, total outstanding loans to SMEs involved in the business

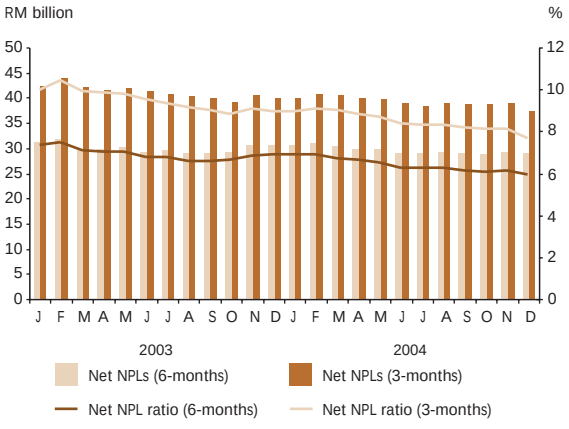
services sector grew by 27.8% on a monthly average basis in 2004. SME loans to the agriculture, forestry and fishing sectors also recorded strong growth of 24.2% to RM4 billion as at end-2004. With the establishment of the National SME Development Council in August 2004 and the initiatives in the pipeline to strengthen the capacities and competitiveness of the SMEs, access to financing for SMEs will be further enhanced.

In view of the positive response to the special funds, Bank Negara Malaysia further increased the allocation of funds to the Fund for Small and Medium Industries 2 and the New Entrepreneurs Fund 2 by RM2.5 billion and RM850 million respectively during the year. With this, a total of RM8.9 billion has been set aside under the five special funds managed by Bank Negara Malaysia to finance priority sectors. As at end-2004, the outstanding loans in these special funds amounted to RM5.1 billion. Meanwhile, the Special Relief Guarantee Facility which was launched in May 2003 to assist businesses affected by the SARS outbreak was eventually closed in July 2004, following the quick containment of the outbreak and the recovery of the businesses that were affected.

Financing through the bond market

The bond market continued to be an important channel for corporations to source funds to meet their financing requirements. In tandem with the buoyant economic performance, the issuance of PDS was sustained at a high level following issuances of debt securities by a few large corporations during the year. In 2004, funds amounting to RM28 billion were raised in the bond market, mainly by the utilities and construction sectors. As a result, outstanding PDS in the market rose by 10.7% to RM160.1 billion as at end-2004. Total financing channelled to the economy, which included lending by banking institutions expanded by 9% to RM674 billion as at end-2004.

Graph 5.1
Banking System[1]: Net Non-performing Loans



[1] Includes Islamic banks.

Asset Quality

Reflecting the strong economic performance underpinned by buoyant business activities and strong consumption, non-performing loans (NPLs) of the banking system declined further in 2004. The net NPL ratio as at end-2004 was at its lowest level since the Asian financial crisis in 1998. Recoveries and reclassifications to performing accounts, supported by lower new NPLs during the year contributed to the large decline in NPLs.

The net NPL ratio as at end-2004 was at its lowest level since the Asian financial crisis in 1998.

Net NPLs based on the 3-month classification declined by 6.3% to RM37.5 billion as at end-2004. Coupled with the high growth in loan base of 8.5%, the net NPL ratio of the banking sector improved by 1.3 percentage points to 7.6% as at end-2004 (end-2003: 8.9%). Similarly, net NPLs based on the 6-month classification declined by 5.8% to RM29 billion, to account for 5.9% of net loans as at end-2004. The loan loss coverage ratios as at end-2004 strengthened to 53.9% and 59% on a 3-month and 6-month basis respectively. Including the value of collateral, the coverage ratios improved further to 165.3% and 171.8% respectively.

The favourable economic environment increased the capacity of borrowers to service their loans. Better loan repayment capabilities translated into lower classification of loans as new NPLs. During the year, new NPLs amounted to RM23.9 billion, representing a decline of 5% or RM1.3 billion. Recoveries and reclassifications of NPLs, albeit lower by 2.2%, remained strong at RM22.4 billion in 2004. A number of banking institutions capitalised on their strong performance to write-off legacy loans that were deemed uncollectible. Total write-offs during the year were high at RM8.7 billion.

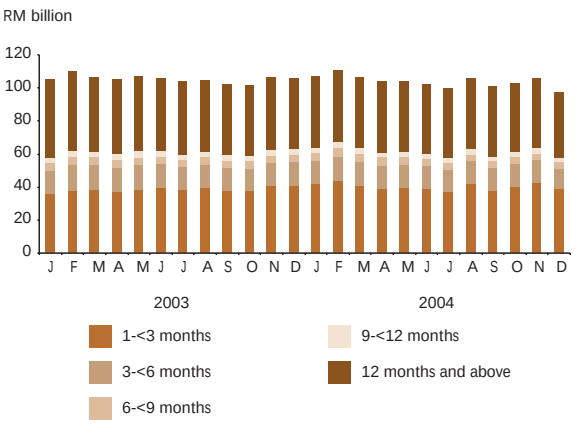
As at end-2004, three CDRC cases had yet to be implemented, with total debts amounting to RM2.4 billion. The other 45 debt restructuring cases with total debts of RM50.1 billion have been successfully implemented in view of the favourable market conditions. The completion of the debt

Table 5.5
Banking System: Non-performing Loans and Loan Loss Provisions

	As at end-			
	2003		2004	
	Classification			
	3-month	6-month	3-month	6-month
	RM million			
Banking system				
Non-performing loans	65,773.8	54,797.5	60,431.2	50,301.7
Interest-in-suspense	9,344.7	8,961.6	8,480.5	8,101.8
Specific provisions	16,416.4	15,070.2	14,473.0	13,222.3
General provisions	9,216.7	8,166.2	9,643.9	8,347.2
Net NPL ratio (%)[1]	8.9	6.8	7.6	5.9
Total provisions/NPL (%)	53.2	58.8	53.9	59.0
Commercial banks				
Non-performing loans	44,541.6	37,562.2	46,214.2	38,869.3
Interest-in-suspense	6,201.2	6,027.5	6,373.1	6,093.9
Specific provisions	11,763.1	10,870.5	11,460.3	10,373.8
General provisions	6,895.7	5,844.6	8,414.7	7,117.9
Net NPL ratio (%)[1]	8.1	6.3	6.8	5.3
Total provisions/NPL (%)	55.8	60.5	56.8	60.7
Finance companies				
Non-performing loans	16,025.5	12,841.2	9,495.5	7,423.7
Interest-in-suspense	2,504.0	2,313.6	1,491.2	1,412.5
Specific provisions	3,616.5	3,205.7	2,058.8	1,927.2
General provisions	1,905.6	1,906.1	829.5	829.5
Net NPL ratio (%)[1]	9.8	7.2	11.3	7.7
Total provisions/NPL (%)	50.1	57.8	46.1	56.2
Merchant banks				
Non-performing loans	3,204.5	2,818.6	2,568.8	2,340.0
Interest-in-suspense	452.6	442.3	400.8	391.3
Specific provisions	603.2	588.5	496.3	497.3
General provisions	240.7	240.9	235.8	235.9
Net NPL ratio (%)[1]	21.5	17.9	19.4	16.8
Total provisions/NPL (%)	40.5	45.1	44.1	48.1
Islamic banks				
Non-performing loans	2,002.3	1,575.6	2,152.7	1,668.7
Interest-in-suspense	186.9	178.2	215.3	204.1
Specific provisions	433.7	405.5	457.7	424.0
General provisions	174.7	174.7	163.9	163.9
Net NPL ratio (%)[1]	15.0	10.8	13.7	9.6
Total provisions/NPL (%)	39.7	48.1	38.9	47.5

[1] Net NPL ratio = (NPL less IIS less SP) / (Gross loans less IIS less SP) x 100%.
Note: Total may not add-up due to rounding.

Graph 5.2
Banking System[1]: Ageing Profile of Loans in Arrears



[1] Includes Islamic banks.

restructuring process has strengthened the corporations and placed them in a better position to drive economic activities.

Total loans that were in arrears by more than one month declined by 6.5% or RM3.2 billion in 2004. As a percentage of total outstanding loans in arrears, the proportion of arrears in buckets of more than one month declined from 61.1% as at end-2003 to 54.7% as at end-2004. Therefore, loans in arrears by more than one month accounted for 8.9% of total loans as at end-2004 (end-2003: 10.3%).

The improvement in NPLs for the business sector has been broad-based during the year. The improved profitability position of the corporate sector, driven mainly by stronger private consumption and external

Table 5.6
Banking System[1]: Non-performing Loans by Sector

	As at end-				
	NPL by sector		Change	As percentage of total loans to the sector	
	2003	2004	2003/2004	2003	2004
	RM million		%		
Business enterprises	**39,699.2**	**34,597.4**	**-12.9**	**16.3**	**13.6**
of which SME loans	***11,923.3***	***10,569.7***	***-11.4***	***14.5***	***12.0***
Households	**17,388.1**	**18,041.5**	**3.8**	**7.9**	**7.2**
Others	**1,184.2**	**1,086.9**	**-8.2**	**11.0**	**10.8**
Total	***58,271.5***	***53,725.7***	***-7.8***	***12.3***	***10.5***
Agriculture, hunting, forestry and fishing	781.2	678.6	-13.1	7.4	6.2
Mining and quarrying	147.9	89.4	-39.5	13.5	9.0
Manufacturing	10,001.4	8,615.8	-13.9	16.4	13.7
Electricity, gas and water supply	1,444.4	1,299.5	-10.0	28.5	25.0
Wholesale and retail trade, restaurants and hotels	4,633.6	4,340.4	-6.3	11.8	10.0
Wholesale trade	*1,758.2*	*1,623.2*	*-7.7*	*8.0*	*6.4*
Retail trade	*1,428.1*	*1,250.5*	*-12.4*	*11.7*	*9.5*
Restaurants and hotels	*1,447.3*	*1,466.6*	*1.3*	*28.9*	*30.4*
Broad property sector	26,641.0	26,029.4	-2.3	14.1	12.5
Construction	*8,178.4*	*7,246.7*	*-11.4*	*27.7*	*23.6*
Purchase of residential property	*10,122.4*	*11,292.5*	*11.6*	*8.7*	*8.5*
Purchase of non-residential property	*4,803.9*	*4,347.4*	*-9.5*	*16.7*	*14.0*
Real estate	*3,536.3*	*3,142.9*	*-11.1*	*25.5*	*22.9*
Transport, storage and communication	1,188.0	722.2	-39.2	11.1	7.2
Finance, insurance and business services	2,356.2	1,876.4	-20.4	8.1	6.1
Consumption credit	2,641.4	2,549.5	-3.5	9.5	8.0
Personal use	*2,014.3*	*1,848.9*	*-8.2*	*13.3*	*10.7*
Credit cards	*578.6*	*663.9*	*14.7*	*4.7*	*4.7*
Purchase of consumer durable goods	*48.5*	*36.8*	*-24.2*	*13.0*	*11.7*
Purchase of securities	3,750.0	2,894.3	-22.8	18.9	14.9
Purchase of transport vehicles[2]	2,749.2	2,752.4	0.1	4.2	3.7
Community, social and personal services	752.7	791.0	5.1	15.2	15.5

[1] Includes Islamic banks.
[2] Includes purchase of passenger cars.
Note: Total may not add-up due to rounding.

sector performance, led to stronger repayments and declining NPLs in the business sector throughout the year. NPLs to the business sector declined by 12.9% or RM5.1 billion, to account for 13.6% of total business loans as at end-2004 (end-2003: 16.3%). The improvement was largest for NPLs of the manufacturing sector, which registered a decline of 13.9% or RM1.4 billion as at end-2004. Although the share of NPLs for this sector remained the largest among all business sectors, accounting for 24.9% of total business NPLs, the NPLs for this sector is expected to decline further with continued growth in the manufacturing sector. NPLs for the construction sector also declined by RM0.9 billion to RM7.2 billion in 2004 due mainly to write-offs of large accounts during the end of the year.

In line with the improvement in NPLs for the business sector, NPLs of the SMEs in almost all economic sectors also declined in 2004. NPLs of SMEs recorded an improvement of 11.4% to RM10.6 billion as at end-2004, to account for 12% of total loans of SMEs. In terms of share of SME NPLs to total business NPLs, they accounted for 30.6% of the total NPLs for the business sector. At the sectoral level, NPLs of SMEs were highest in the manufacturing, construction and the wholesale and retail trade sectors, accounting for 58.7% of total NPLs of SMEs. Reflecting the strong performance in the manufacturing sector, NPLs for this sector registered the largest improvement of RM0.4 billion to RM2.7 billion as at end-2004. NPLs for the transport, storage and communication sector also declined by 43.9% or RM0.2 billion due largely to write-offs. NPLs for the real estate sector improved by 21.2% to RM0.7 billion while NPLs for the construction sector declined by 7.6% to RM1.9 billion as at end-2004.

Gross NPLs for the household sector declined to account for 7.2% of total outstanding household loans as at December 2004 (end-2003: 7.9%). Despite the growth in household NPLs by 3.8% to RM18 billion as at end-2004, the magnitude remained small vis-à-vis the stronger growth in household loans of 14.4% during the year. Within the household sector, NPLs for the purchase of residential properties were the largest contributor to household

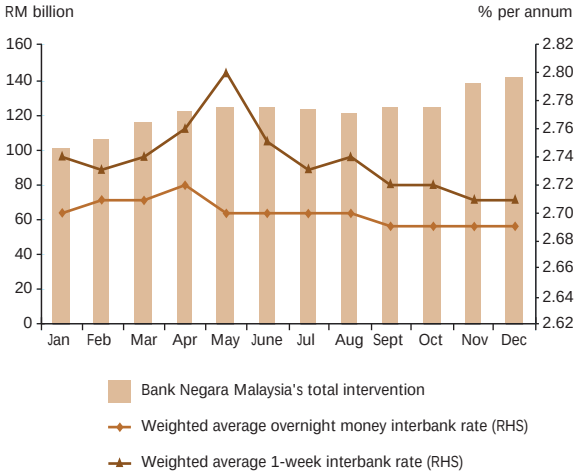
NPLs, accounting for 62.6% of total household NPLs as at end-2004. NPLs for residential properties grew by 11.6% or RM1.2 billion during the year. Nevertheless, its NPL ratio remained manageable at 8.5% as at end-2004, given the higher rate of increase in loans for residential properties of between 14.2% to 16.2% in 2004. NPLs for credit cards remained small at 4.7% of total credit card loans, whilst the NPL ratio for the purchase of transport vehicles declined to 3.7% as at end-2004 (end-2003: 4.2%). Given the improvements in the performance of the stock market, NPLs for the purchase of securities recorded a large decline of 22.8% or RM0.9 billion as at end-2004, to account for 14.9% of total loans to this sector. While there have been concerns about the risk of over-indebtedness of the household sector, such risk is minimised due to the ability of the banking institutions to access comprehensive credit information of borrowers from the Central Credit Reference Information System and the various risk management infrastructure put in place to strengthen credit risk management standards in banking institutions.

As economic performance is expected to remain buoyant in 2005, NPLs in the banking system are expected to improve further. Strong performance of the corporate sector, supported by continued robust private consumption, will strengthen NPL recoveries and reduce the possibility of new NPLs. Against this backdrop, banking institutions are expected to undertake more aggressive measures to deal with their legacy NPLs, especially in cases where recovery prospects are limited even after taking into account the recoverability of the collateral. In tandem with these efforts, banking institutions are also expected to continuously strengthen their risk management infrastructure in preparation for the implementation of Basel II requirements. With a more sound and robust risk management infrastructure in place and a healthier quality of asset portfolios, banking institutions would continue to be in a strong position to support the lending requirements of the growing economy.

Liquidity Management

The sustained large current account surplus of the balance of payments in 2004 led to a further increase in international reserves from RM170.5 billion as at end-2003 to RM253.5 billion as at end-2004. This contributed to high liquidity in the banking system during the year. The resultant excess liquidity in the banking system was mopped up under the liquidity operations conducted by Bank Negara Malaysia to

Graph 5.3
Liquidity in the Banking System[1] in 2004



[1] Includes Islamic banks.

Table 5.7
Banking System: Liquidity Projection as at 31 December 2004

	Cumulative mismatch (RM billion)		Buffer as % of total deposits	
	1 wk.	1 mth.	1 wk.	1 mth.
Commercial banks	64.9	99.9	14.5	22.4
Finance companies	4.2	4.7	10.7	12.0
Merchant banks	6.7	9.4	39.7	56.0
Islamic banks	4.0	5.7	20.4	28.9
Banking system	**79.7**	**119.7**	**15.3**	**22.9**

maintain the overnight interbank rate within the 25 basis points around the overnight policy rate of 2.7% per annum. As a result, market intervention in the form of interbank borrowings and issuance of Bank Negara Bills and Negotiable Notes remained high throughout the year, with additional mopping up of liquidity through repo activities undertaken during the last quarter of 2004. By end-2004, Bank Negara Malaysia had mopped up RM142.6 billion of excess liquidity from the banking system as compared with RM95.4 billion as at end-2003. Liquidity management conducted by Bank Negara Malaysia in 2004 has ensured that interest rates remained stable throughout the year. The weighted average overnight interbank rate ranged from 2.69% to 2.72% per annum while the weighted average one week interbank rate ranged from 2.71% to 2.80% per annum.

In relation to the liquidity management by banking institutions, the banking system as a whole had sufficient liquidity to meet any unexpected withdrawals for a period of up to one month. The projected

cumulative liquidity surplus of the banking system as at end-2004 was RM79.7 billion to meet demands of up to one week and RM119.7 billion to meet demands of up to one month. Commercial banks, finance companies, merchant banks and Islamic banks recorded projected surpluses in the one-month bucket amounting to 22.4%, 12%, 56% and 28.9% of their total deposit base respectively.

Interest Rate Risk

Exposure of the banking system to interest rate risk (inclusive of price risk of Islamic type exposures) is assessed using the duration-weighted net position (DWP) approach. In 2004, the DWP approach was further refined to better reflect the economic value changes of interest rate sensitive positions, taking into account their cash flow payment structures. Applying the refined DWP approach, the level of interest rate risk in the banking system in 2004 remained manageable. Expressed as a percentage of capital base, the banking system's DWP increased marginally to 5% as at end-2004.

A significant portion of the banking system's interest rate risk was concentrated in the more than three years maturity bucket due principally to an increase of 22% in fixed rate loans with remaining maturities of over three years. This increase reflects primarily hire-purchase receivables and Islamic loans that rose by RM5 billion and RM7 billion respectively during the year.

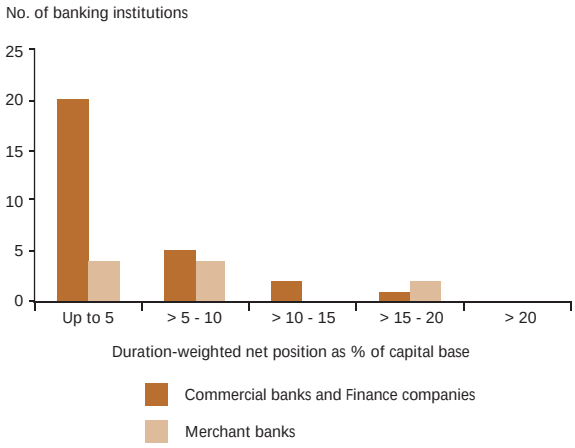
A key measure introduced to address the banking system's interest rate risk associated with fixed rate loans, was the amendment to the Hire-Purchase Act 1967, which was passed by the Parliament in 2004. The amendment allows banking institutions to price their hire-purchase loans based on a variable rate basis. Furthermore, the increased use of Islamic variable rate financing under the concept of *bai' bithaman ajil* (deferred payment sale) which was introduced in 2003, has allowed banking institutions to mitigate their exposures to fixed rate products typical of Islamic financing. Another significant measure allowing the interest rate risk associated with the funding and lending structures of stand-alone finance companies to be better managed was the amendment of the Banking and Financial Institutions Act 1989 to facilitate the merger of the commercial bank and the finance company within a banking

Table 5.8
Banking System[1]: Impact of 1% Rise in Interest Rate on Capital Strength

	Duration-weighted net position					
	RM million		As a percentage of capital base		Impact on risk weighted capital ratio (percentage point)	
	As at end-					
	2003[2]	2004	2003	2004	2003	2004
Commercial banks and Finance companies	-2,898	-3,398	-4.4	-4.7	-1.0	-1.0
Merchant banks	-475	-397	-10.2	-8.2	-3.8	-4.1
Banking system[1]	-3,373	-3,795	-4.8	-5.0	-1.1	-1.1

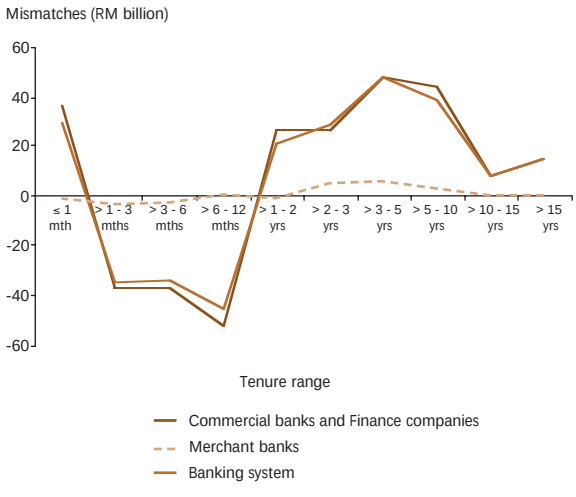
[1] Excludes Islamic banks but includes price risk of Islamic type exposures.
[2] Figures have been adjusted with the application of the refined DWP approach.
Note: Total may not add-up due to rounding.

Graph 5.4
Banking System[1]: Distribution of Duration-weighted Net Position as a Percentage of Capital Base as at 31 December 2004



[1] Excludes Islamic banks but includes price risk of Islamic type exposures.

Graph 5.5
Banking System[1]: Net Interest Rate Position Mismatches as at 31 December 2004



[1] Excludes Islamic banks but includes price risk of Islamic type exposures.

Table 5.9
Banking System[1]: Impact of Trading Book Interest Rate Risk on Capital Strength as at 31 December 2004

	RM million		Total interest rate risk/Capital base (%)	
	Interest rate risk			
	2003	2004	2003	2004
Commercial banks and Finance companies	1,007	994	1.6	1.3
Merchant banks	644	504	14.3	10.5
Banking system[1]	1,651	1,498	2.4	1.9

[1] Excludes Islamic banks but includes price risk of Islamic type exposures.
Note: Total may not add-up due to rounding.

group. However, given that it was only recently implemented, the full benefits of the merger, in terms of the potential reduction in interest rate risk within the banking system is yet to be fully realised.

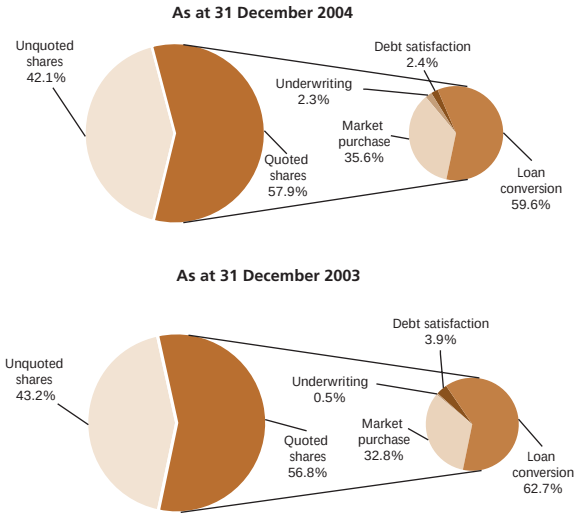
With the mergers, some of which were implemented during 2004, the analysis of interest rate risk of the commercial banks and finance companies was based on their combined statistics. As a group, their DWP recorded an increase of 17% to RM3.4 billion as at end-2004. The rise in DWP of the commercial banks and finance companies as a group, was attributed to a significant increase in fixed rate loans with remaining maturity of more than three years. The merchant banks, however, recorded a decline of 16% in their DWP in 2004, following a contraction in their holding of long-term debt securities with remaining maturities of more than three years.

In September 2004, consistent with the Basel Committee on Banking Supervision (BCBS)'s recommendation, Bank Negara Malaysia issued the Market Risk Capital Adequacy framework for implementation. The framework requires market risk to be incorporated into the capital adequacy framework. For the banking system, the major source of market risk in the trading book is interest rate risk. In 2004, interest rate risk declined by 9% to RM1.5 billion or 1.9% of capital base. The reduction in interest rate risk was due primarily to banking institutions taking advantage of the improved bond market in 2004 by reducing their bond holdings.

Equity Risk

The overall exposure of the banking system to equity risk remained insignificant, with equity investments representing only 0.4% of the banking system's total assets as at end-2004. Equity investments by banking institutions fell by 9.9%, from RM3.4 billion as at

Graph 5.6
Banking System[1]: Composition of Equity Investments



[1] Includes Islamic banks.

end-2003 to RM3.1 billion as at end-2004. Banking institutions took advantage of the improved stock market performance in the first and last quarter of 2004 to sell down the shares acquired from debt restructuring activities in previous years.

During the year, the banking system's investments in quoted shares fell by 8.1% to RM1.8 billion as at end-2004 from RM1.9 billion as at end-2003. Of the overall decline in investment in quoted shares, the holding of quoted shares arising from the conversion of loans into equity declined by RM153.7 million or 12.7% while shares purchased directly from the

Graph 5.7
Banking System: Distribution by Equity as a Percentage of Capital Base as at 31 December 2004

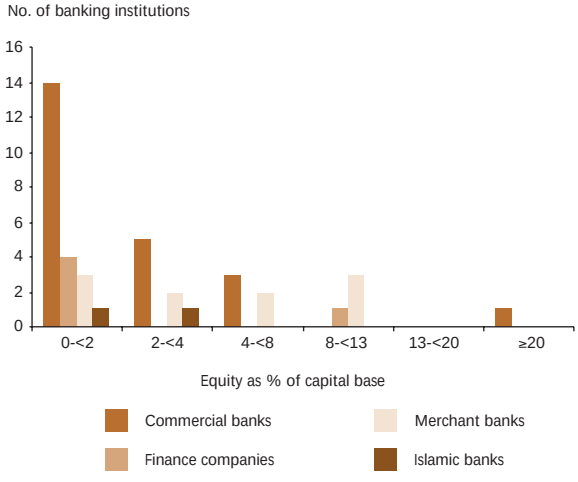


Table 5.10
Banking System: Equity Exposure

	Equity[1] holdings (RM million)		Equity[1]/ Capital base (%)		Potential equity[1] loss/ Capital base (%)	
	As at end-					
	2003	2004	2003	2004	2003	2004
Commercial banks	1,071.6	1,067.0	2.0	1.6	0.1	0.1
Finance companies	427.8	357.2	3.7	6.7	0.3	0.5
Merchant banks	402.3	320.8	8.6	6.7	0.7	0.5
Islamic banks	35.2	34.8	2.2	1.8	0.2	0.1
Banking system	1,936.9	1,779.7	2.7	2.3	0.2	0.2

[1] Amount of investment in quoted shares.

market registered a decrease of RM1.9 million or 0.3% during the year. Similarly, restructuring activities during the year that involved a major conversion of unquoted shares into bonds had resulted in a decrease in total investments in unquoted shares of the banking system by 12.3% to RM1.3 billion as at end-2004 from RM1.5 billion as at end-2003.

Within the banking system, the decline in equity holdings in 2004 was reflected across the different categories of banking institutions. The merchant banks as a group, recorded the highest percentage decline of 17.4% despite an increase in shares held as a result of underwriting. This was followed by the finance companies (-15.4%), commercial banks (-6.5%) and Islamic banks (-4.9%). Despite the relatively significant percentage decline in equity holdings of the merchant banks and finance companies in 2004, as a group, they had a relatively higher ratio of quoted shares to capital base at 6.7%. The commercial banks and the Islamic banks' holdings of quoted shares to capital base were only 1.6% and 1.8% respectively. In terms of individual banking institution, most banking institutions had less than 2% of their capital base exposed to equity risk.

Based on a 10-day volatility of the Kuala Lumpur Composite Index in 2004, the potential maximum loss in equity value for the banking system as a whole was slightly lower at 7.7% as at end-2004 compared to 7.9% as at end-2003. This represented merely 0.2% of the capital base of the banking system.

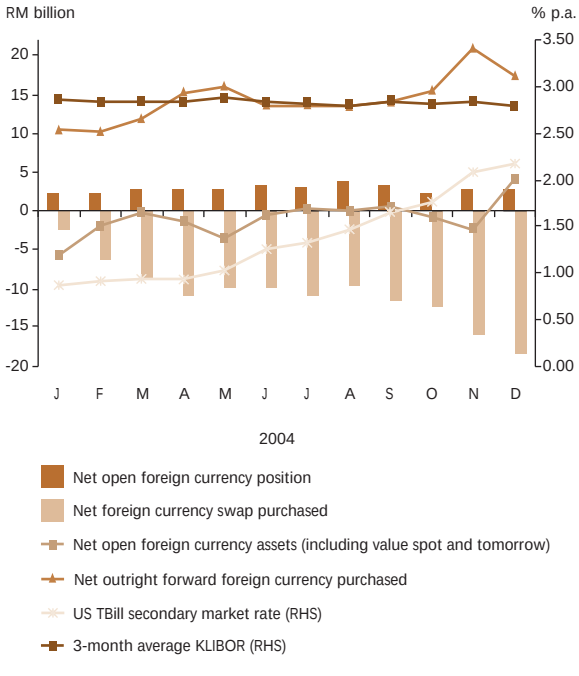
Table 5.11
Banking System: Foreign Currency Exposure

	NOP (RM million)		NOP/Capital base (%)	
	As at end-			
	2003	2004	2003	2004
Commercial banks	2,622	2,928	4.9	4.5
Merchant banks	50	48	1.1	1.0
Islamic banks	35	34	2.1	1.7
Banking system	2,707	3,010	4.5	4.2

Foreign Exchange Risk

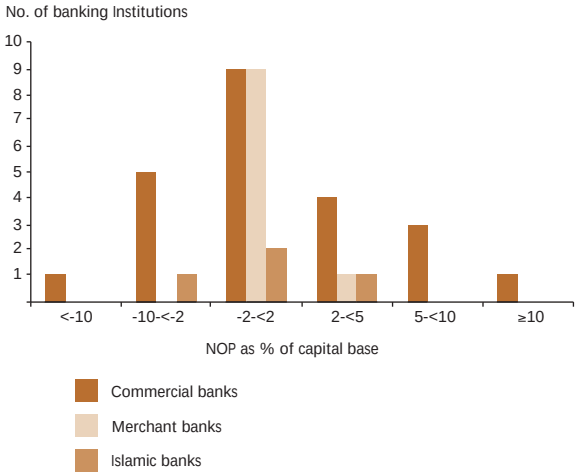
The significant increase in the foreign currency assets of the banking system in 2004 was attributed to the continued repatriation of export earnings and inflows of foreign funds for portfolio and direct investment. However, the foreign currency risk undertaken by the banking institutions remained within prudential levels, as the banking system's net open position (NOP) as a percentage of capital base registered a decline from 4.5% as at end-2003 to 4.2% as at end-2004.

Graph 5.8
Banking System[1]: Components of Foreign Currency Exposure



[1] Includes Islamic banks.

Graph 5.9
Banking System: Distribution of Net Open Foreign Currency Position as at 31 December 2004



To manage their long foreign currency positions, banking institutions placed out the funds in the foreign currency interbank money market, resulting in an increase in interbank foreign currency placements from RM17 billion as at end-2003 to RM34 billion as at end-2004. This was complemented by an increase of RM4.4 billion or 41% in foreign currency loans extended in 2004. Foreign currency liabilities also trended up as banking institutions engaged in currency swaps to hedge their foreign currency forward purchases.

Although the forward premiums in the foreign currency forward market narrowed considerably from 55 basis points to 12 basis points, there was strong demand from exporters to sell foreign currency forward contracts in 2004. As a result, banking institutions' foreign currency forward contracts purchased from domestic non-bank entities rose from RM17 billion as at end-2003 to RM34 billion as at end-2004. The strong demand from exporters to sell foreign currency forward contracts may be attributed to their need to hedge their foreign currency exposures in an environment of increasing exports, which rose by 24% during the year, and heightened speculation by the market that the ringgit would be revalued upwards against the US dollar. This contributed to the overall increase in foreign currency forward contracts purchased by banking institutions from RM21 billion as at end-2003 to RM38 billion as at end-2004. As a result of managing the significant increase in foreign currency forward contracts purchased, foreign currency swaps payable rose by RM27 billion to RM51.8 billion.

The banking system is expected to remain a net foreign exchange forward purchaser in an environment with the interest rate differential between the US dollar and ringgit remaining positive.

Capital Strength

The banking system remained well-capitalised, with risk-weighted capital ratio (RWCR) and core capital ratio sustained above 13% and 10% respectively throughout the year. The capital base increased by RM6.6 billion to RM78.1 billion as at end-2004. The major contributor to the higher capital base was capital raising exercises by several banking institutions that amounted to RM4.2 billion, of which RM3.3 billion was raised through the issuance of US dollar-denominated subordinated debt papers. Audited profits contributed another RM1 billion. Meanwhile, the risk-weighted assets of the banking system grew by RM47.6 billion or 9.2% to RM566.6 billion as at end-2004 due to higher financing activities. Overall, the RWCR of the banking system remained at 13.8% as at end-2004.

Table 5.12
Banking System: Constituents of Capital

	As at end-		Annual change	
	2003	2004		
	RM million		RM million	(%)
Tier-1 capital	62,727.3	61,669.1	-1,058.2	-1.7
Tier-2 capital	19,410.6	23,734.1	4,323.5	22.3
Total capital	82,137.9	85,403.2	3,265.3	4.0
Less:				
Investment in subsidiaries and holdings of other banking institutions' capital	10,604.9	7,296.3	-3,308.6	-31.2
Capital base	71,533.0	78,106.9	6,573.9	9.2
Risk assets:				
0%	177,443.2	210,372.2	32,929.0	18.6
10%	17,256.3	14,669.8	-2,586.5	-15.0
20%	120,995.7	121,059.9	64.2	0.1
50%	120,545.1	136,405.0	15,859.9	13.2
100%	432,769.7	472,700.3	39,930.6	9.2
Total risk-weighted assets	518,967.0	566,581.8	47,614.8	9.2
Risk-weighted capital ratio (%)				
Banking system	**13.8**	**13.8**	**0.0**	
Commercial banks	14.1	13.9	-0.2	
Finance companies	11.6	10.2	-1.4	
Merchant banks	19.2	21.9	2.7	
Islamic banks	11.7	12.5	0.8	

Note: Total may not add-up due to rounding.

Tier-1 capital of the banking system declined marginally due to rationalisation of capital arising from mergers between commercial banks and finance companies (Bafin mergers). This, together with a higher increase in risk-weighted assets, resulted in the core capital ratio declining marginally to 10.8% as at end-2004 (end-2003: 11.1%). Meanwhile, total Tier-2 capital increased significantly due to capital raising exercises by several banking institutions. As a result, total capital increased by 4% and, together with a lower capital deduction for investment in subsidiaries following completion of the Bafin mergers, this caused the capital base to increase by 9.2%.

The RWCR of commercial banks declined marginally to 13.9% as at end-2004, as the increase in risk-weighted assets outpaced the expansion of capital base following lower capital deduction for investment in subsidiaries and issuance of subordinated debt papers. The RWCR of the finance companies declined to 10.2% due to the exclusion of the capital base of the five finance companies that had merged with the commercial banks. The RWCR of the merchant banks increased to 21.9% due mainly to the reduction in risk-weighted assets caused by a decline in the loan base as the merchant banks wind-down their loan activities to focus on investment banking and fee-based activities.

Total risk-weighted assets of the banking system increased by 9.2% to RM566.6 billion as at end-2004, in tandem with higher loan growth during the year. The increase in the 0% category was due mainly to Bank Negara Malaysia's liquidity operations, whilst continued expansion in mortgage financing and lending to the private sector contributed to higher growth in the 50% and 100% categories respectively.

With strong level of capitalisation, the banking system is well positioned to meet the demands for financing to support economic growth and any unexpected shocks in 2005.

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The Islamic Financial System

The Islamic Financial System

OVERVIEW

The year 2004 marked another significant milestone in the progress of Islamic banking and finance in the Malaysian banking system in its two decades of development. The financial liberalisation of the Islamic banking sector was brought forward from 2007 to 2004 with the issuance of three new Islamic bank licences under the Islamic Banking Act 1983 (IBA) to Islamic financial institutions from the Middle East.

The move to bring forward the liberalisation programme emanated from the rapid development and steady performance of the Islamic banking industry over the years. Since 2000, the Islamic banking industry has been growing at an average rate of 19% per annum in terms of assets. At end-2004, total assets of the Islamic banking sector increased to RM94.6 billion, which accounted for 10.5% of the total assets in the banking system. The market share of Islamic deposits and financing also increased to 11.2% and 11.3% of total banking sector deposits and financing respectively.

The move to bring forward the liberalisation programme emanated from the rapid development and steady performance of the Islamic banking industry over the years.

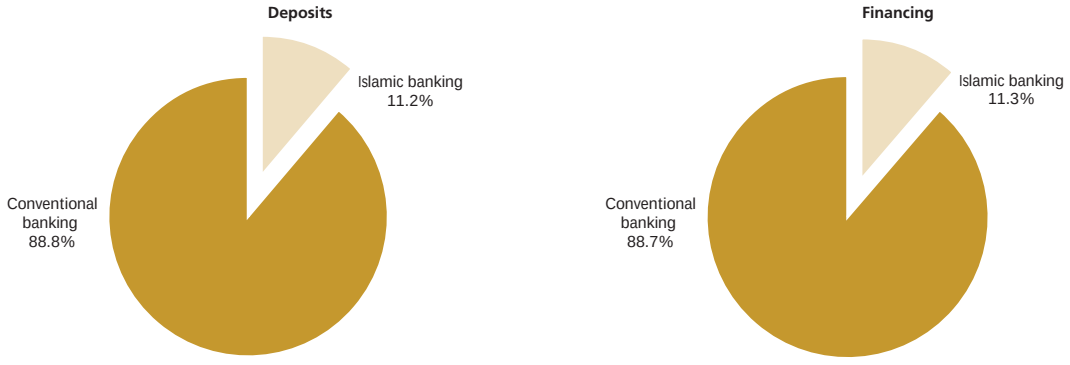
The entry of the new foreign Islamic banking licensees is in line with the recommendations of the Financial Sector Masterplan (FSMP) to position Malaysia as an international Islamic financial hub. The new entrants, each with distinctive capabilities and strengths, will have the opportunity to participate in the growing Islamic banking industry and tap new markets in Malaysia and the region, as well as promote healthy competition which is necessary to elevate the industry to new levels of dynamism.

The presence of the foreign players will also accelerate the global integration of the domestic Islamic banking system. The exchange of knowledge and expertise will promote greater economic and financial linkages between Malaysia and the Middle Eastern region, and foster greater harmonisation in terms of Shariah interpretation and understanding. Greater international trade and investment flows would also be facilitated.

Bank Negara Malaysia also continued in 2004 to further strengthen the overall infrastructure development of the Islamic banking system, including enhancing the institutional structure and human capital development.

- As the Islamic banking industry entered a more advanced stage of development, the 'window-based' institutional structure was reviewed to further strengthen and elevate the development of the domestic Islamic banking industry through a new enabling institutional structure. The domestic banking groups and foreign Islamic Banking Scheme (IBS) banks were encouraged to set up Islamic subsidiaries (IS), which will be licensed as an Islamic

Graph 6.1
Market Share of Deposits and Financing as at end-2004



bank under the IBA. The underlying principle of the incorporation of IS is primarily aimed at further strengthening the institutional structure of Islamic banking business operations for greater strategic focus, while continuing to leverage on the synergies of the conventional banking operating infrastructures, which include the availability of Islamic banking products and services at the existing branches of the conventional commercial banks. Towards this end, Bank Negara Malaysia has approved the application of five domestic banking groups, namely four IBS banking groups and a non-IBS bank, to establish IS under the IBA to carry out Islamic banking business. To date, one of the banking groups has launched its IS.

- In terms of regulatory and prudential structure, efforts were directed at improving the corporate governance of Islamic banks via the issuance of guidelines to enhance the effectiveness of their board of directors. The financial disclosure requirements were also enhanced, in line with international accounting standards, to meet a higher degree of transparency. Additionally, the rate of return framework was further strengthened to provide flexibility to the banks in managing their portfolios to compete and to align their business operations with market trends and outlook.

- In line with the developments in the conventional banking system, the Islamic banking institutions were also required to prepare to embrace the Basel II implementation approach. In adopting either the Standardised Approach for credit risks or the Internal Ratings Based Approach under the new capital accord, sound and robust risk management framework and practices would be continuously upgraded and benchmarked against the best industry practices. This would facilitate the efforts of the Islamic banking institutions to optimally apply their economic and regulatory capital.

- Significant enhancement to the Shariah governance in the Islamic banking system was attained following the enlargement of the role and functions of the Shariah Advisory Council of Bank Negara Malaysia. In addition, the introduction of the new Shariah committee framework, where the functions and duties of the Shariah committees have been clearly outlined and streamlined, has reinforced the central Shariah advisory body at the Central Bank.

- The amendments to the tax legislation that accord neutrality to tax treatment between Islamic and conventional banking products and services will create a more conducive tax regime for the Islamic banking industry.

- Product innovation continued to thrive within the boundaries of the Shariah framework. A more diversified product range that includes variable rate and equity-based mechanisms is being more widely introduced. To mitigate liquidity risk due to market volatility, the Islamic banking institutions are beginning to introduce long-term variable rate financing. Through the usage of periodic rebate mechanism, the effective profit rate on the financing can vary to closely track the benchmark rate currently used in the market, thus alleviating any funding mismatch. To further strengthen the risk management framework, a profit rate swap mechanism that applies Islamic principles will also be introduced, allowing the fixed rate commitment of a financing contract to be exchanged with the variable rate commitment of another contract, and vice versa.

- In terms of human capital development and consumer awareness, continuous efforts were carried out throughout the year through various seminars, workshops, exhibitions and other promotional activities. As the Islamic banking industry progresses, a human capital development programme is being structured collectively by the public and private sectors to create a larger pool of experts and professionals in Islamic banking and finance to meet the increasing manpower requirements arising from the rapid institutional development.

The Islamic financial landscape in Malaysia has been set on a course that is filled with vast potential and prospects for future growth, specifically in positioning Malaysia as a leading Islamic financial hub to the international financial community.

In view of these significant developments, the Islamic financial landscape in Malaysia has been set on a course that is filled with vast potential and prospects for future growth, specifically in positioning Malaysia as a leading Islamic financial hub to the international financial community.

POLICY DIRECTION IN 2004

The key focus of policy in 2004 for the Islamic banking sector continued to be on the efforts to further strengthen the Islamic banking system as an integral component of the Malaysian financial system. The policy thrust centred on enhancing the institutional structure, regulatory and prudential framework, Shariah and legal infrastructure, product and market development, as well as human capital development and consumer education.

exercise will accord licensing of the Islamic banking business of conventional banking groups under Islamic banking law. In this regard, Bank Negara Malaysia has approved the applications of five domestic banking groups to establish an IS under their commercial banking arm to undertake Islamic banking business under the IBA. The incorporation of the IS by the domestic banking groups will involve the detachment and migration of the existing Islamic banking portfolios in the conventional banking institutions to the newly incorporated IS. The IS will be incorporated as a wholly

The policy thrust centred on enhancing the institutional structure, regulatory and prudential framework, Shariah and legal infrastructure, product and market development, as well as human capital development and consumer education.

Strengthening Institutional Financial Infrastructure

Institutional Development

Strengthening the financial infrastructure is a key prerequisite for the development of a dynamic and progressive Islamic banking system. In 2004, significant initiatives were carried out in the development of the institutional financial infrastructure of the Islamic banking system.

- Bank Negara Malaysia approved the issuance of new Islamic banking licences under the Islamic Banking Act 1983 (IBA) to three leading foreign Islamic financial institutions from the Middle East, namely, Kuwait Finance House, Al-Rajhi Banking & Investment Corporation and a consortium of Islamic financial institutions represented by Qatar Islamic Bank, RUSD Investment Bank Inc. and Global Investment House. The issuance of the Islamic banking licences to foreign players is part of the strategy to enhance the diversity and depth of players in the Islamic financial landscape. The presence of full-fledged foreign Islamic banks in Malaysia would increase the potential to tap new growth opportunities as well as raise the performance and development of the overall Islamic financial system.

- An important strategic measure undertaken in 2004 was the move by several conventional banking groups participating in the Islamic Banking Scheme (IBS) to transform the current 'Islamic window' institutional structure into an 'Islamic subsidiary' (IS) within their respective banking groups. This strategic move is in tandem with the recommendations of the Financial Sector Masterplan (FSMP) to further strengthen the institutional structure of the banking institutions participating in the IBS. From the legal perspective, this

owned subsidiary of the commercial bank and any divestment of shares in the IS to either domestic investors or foreign investors is subject to the condition that the IS will remain as a subsidiary of the commercial bank with a minimum equity interest of 51%.

The incorporation of IS will provide an institutional structure that can assimilate future developments in the Islamic financial regulatory infrastructure over the longer term and thus strengthen the overall prudential and supervisory regime of the Islamic banking system. This will preserve the integrity of the Islamic banking system and operations in line with the dictates of the Shariah. Developments include the drafting of a different set of prudential regulatory and supervisory standards for Islamic banking operations to be issued by the Islamic Financial Services Board (IFSB), a different set of accounting standards for Islamic financial business to be issued by the Malaysian Accounting Standards Board (MASB) and the forthcoming introduction of the Deposit Insurance Scheme. Compared to the window arrangement, the incorporation of IS will further strengthen the commitment and provide greater strategic focus by the Islamic banking institutions to promote the development of an efficient Islamic banking system.

The distinctive features of the IS, among others, include:

- o A minimum capital fund of RM50 million or the current amount of Islamic banking capital funds of the conventional banking institution that comply with the minimum risk-weighted capital ratio requirement of 8%, whichever is higher;

- An independent board of directors, a dedicated chief executive officer and management team; and

- Flexibility to leverage on the existing infrastructure of the conventional banking institutions within the banking group, including the branch network and support functions. This would further strengthen the institutional structure for Islamic banking business while retaining the synergies available within the banking group, consistent with the objective of strengthening the competitiveness of the Islamic banking institutions through the maximisation of group synergy and cost efficiency.

Regulatory

- As part of the effort to enhance corporate governance in Islamic banks, the Guidelines on Directorship in the Islamic Banks or GP1-i (the Guidelines) were issued in March 2004. The purpose of the Guidelines is to strengthen the effectiveness of the board of directors, who would assume full responsibility for the overall management of an Islamic bank. The Guidelines set out the requirements on duties and responsibilities of the board, appointment and reappointment of directors and chief executives, directorship in other corporations and composition of the board of directors as well as the requirement for the Islamic banks to establish an Audit Committee and other board committees consisting of Nominating Committee, Remuneration Committee and Risk Management Committee.

The incorporation of IS will provide an institutional structure that can assimilate future developments in the Islamic financial regulatory infrastructure and thus strengthen the overall prudential and supervisory regime of the Islamic banking system.

Risk Management

The Islamic banking institutions also continued to focus on enhancing their risk management framework, an important prerequisite in the development of a sound and robust institutional financial infrastructure.

- In November 2004, a review on the *bai' bithaman ajil* (deferred payment sale) variable rate financing mechanism was conducted to promote efficiency in the pricing of this mode of financing. Under the revised policy, the maximum financing spread of 2.5 percentage points above Base Lending Rate (BLR), which is used to determine the effective profit rate, has now been removed. In addition, the requirement to seek Bank Negara Malaysia's approval for the ceiling profit rate to be more than four percentage points above the benchmarked BLR has been lifted. Accordingly, Islamic banking institutions are now allowed to determine a reasonable ceiling profit rate taking into account the institution's risk management capabilities, business strategies and market outlook. The Islamic banking institutions are also required to include in their financing agreements, and in their letter of offer, the mechanism and benchmark used in deriving the effective profit rate.

Enhancing Regulatory, Prudential and Operational Framework

To ensure effective functioning of the Islamic banking system, various initiatives to enhance the regulatory, prudential and operational framework were taken.

- The Guidelines on Financial Reporting for Licensed Institutions or BNM/GP8 issued in October 2004 to the financial institutions also incorporated several enhancements to the financial reporting requirements for the Islamic banking operations of the IBS institutions. The enhancements, amongst others, included the requirement for the IBS institutions to disclose their cash flow statement and statement of changes in equity, in addition to the balance sheet and income statement. It also specified the requirements for disclosure of the functions and duties of the Shariah advisory committee and responsibility towards *zakat* obligations, policy on profit equalisation reserves disclosure and classification of deposits accepted into *mudharabah* and non-*mudharabah* categories. These requirements were introduced to reflect the nature of and risk associated with Islamic banking operations. The above minimum disclosure requirements are to be adopted for the financial year beginning January 2005.

Prudential

- The revised Framework of Rate of Return was issued to the Islamic banking industry in August 2004 to provide it with greater flexibility in managing its rates of return and to enhance the operational efficiency and capacity among Islamic

banking institutions in managing their business portfolios. Among the revisions made to the framework are the flexibility to offer different profit sharing ratios, requirement to segregate between *mudharabah* and non-*mudharabah* deposits, classification of funds under restricted or unrestricted funds and discretion to assign flexible weightage to each type of deposits. With regard to board rates, the Islamic banking institutions are required to display the profit sharing ratio and rate of return for each type of deposits as well as the effective period of the rate. The revised framework was implemented beginning 1 October 2004.

- In tandem with the implementation of the Market Risk Capital Adequacy Framework for conventional banking institutions, a similar framework for Islamic banks was issued in September 2004. The framework sets out the approach prescribed by Bank Negara Malaysia in determining the level of capital to be held by the Islamic banks against their market risk, which is defined as the risk of losses in on- and off-balance sheet positions arising from movements in market prices. The framework was implemented on a trial basis beginning September 2004 with full compliance from 1 April 2005.

- Following the issuance of the two-phase implementation approach of Basel II for the conventional banks, Bank Negara Malaysia also issued a two-phase implementation approach for the Islamic banks in September 2004. Under this approach, the Islamic banks are given the option to either comply with the Standardised Approach for credit risks in 2008 or to move directly to the Internal Ratings Based Approach in 2010. With regard to the Basel II implementation, the Islamic banks are also required to conduct gap, impact and cost-benefit analyses, develop implementation roadmap, timeline and budget, undertake research and analytical work as well as ensure the roles and responsibilities of the Board and senior management are taken on. These requirements will provide Bank Negara Malaysia with the basis for monitoring the progress made by the Islamic banks in observing the Basel II requirements and, at the same time, serve as a platform for the Islamic banks in complying with the capital adequacy standard for the Islamic banking institutions scheduled to be issued by the IFSB in 2005.

Operational

- With effect from 12 October 2004, acceptance of investment deposits of less than one-month tenure can only be carried out by Islamic banks and discount houses. Following this policy, banking institutions participating in the Islamic Banking Scheme (commercial banks, finance companies and merchant banks) are no longer allowed to accept deposits of this tenure except by way of sell and buy back arrangements.

- In line with the efforts to strengthen Islamic banking operations and streamline industry practices, Bank Negara Malaysia introduced a policy on takaful coverage for financing-i (Islamic financing) in October 2004. Islamic banking institutions are required to offer takaful plans as the first choice to their customers in the offering of protection for Islamic financing that needs coverage. However, if the cost of coverage, i.e. contribution or premium, is to constitute part of the financing package, it is mandatory that the Islamic banking institutions only offer takaful plans.

- To facilitate submission of applications of new products for approval and maintenance of a repository of all Islamic banking products available in Islamic banking institutions, Bank Negara Malaysia is developing an on-line system known as Product Approval & Repository System (PARS). PARS will expedite the processing of applications to introduce new products as it provides on-line application and submission of documents. The system will also facilitate easy monitoring of the flow of processing work on applications, and prompt retrieval of up-to-date product information stored in the system. The project is due for completion in 2005.

Strengthening Shariah and Legal Infrastructure

An effective and conducive Shariah framework combined with a sound legal system is an essential element for a comprehensive Islamic banking system. The Bank has continuously enhanced and fine-tuned the Shariah framework and legal system to keep abreast with developments in the Islamic banking industry.

- Bank Negara Malaysia has issued the Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions in December 2004 to rationalise and streamline the functions and duties of Shariah committees of the financial institutions.

Shariah Governance Framework for Islamic Financial Institutions

The Financial Sector Masterplan on Islamic banking and takaful emphasised the importance of establishing an effective Shariah framework in the development of Islamic banking and takaful. An effective Shariah framework would serve to ensure uniformity and harmonisation of Shariah interpretations that will strengthen the regulatory framework and governance practices for the Islamic financial industry. Bank Negara Malaysia issued the Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions in December 2004, aimed at achieving uniformity of Shariah decisions, in addition to creating and expanding the pool of competent Shariah personnel in Islamic banking and takaful.

Prior to the issuance of the guidelines, various Shariah bodies co-existed and were governed under separate legal framework. An Islamic bank was required under the Islamic Banking Act 1983 to establish a 'Shariah advisory body', while a takaful operator needed to set up a 'Shariah Supervisory Council' as stipulated under the Takaful Act 1984. The Islamic Banking Scheme (IBS) banks under the Banking and Financial Institutions Act 1989 were required to appoint a Shariah consultant, while financial institutions under the Development Financial Institutions Act 2002 appointed Shariah bodies on their own initiatives. These Shariah bodies were not adequately regulated, and were operating independently of one another, and were also independent of the Shariah Advisory Council (SAC) established by Bank Negara Malaysia. Therefore, these Shariah bodies needed to be regulated in order to avoid divergence of Shariah interpretations on similar matters and eliminate confusion among the public. Current practice of allowing similar members in the various Shariah bodies of Islamic financial institutions was also reviewed from the perspective of corporate governance especially in terms of confidentiality and secrecy provisions.

To address these emerging issues, the Bank amended the Central Bank of Malaysia Act 1958 in 2003 to enhance the role and functions of the SAC of Bank Negara Malaysia. The SAC was accorded the sole authoritative body on Shariah matters pertaining to Islamic banking, takaful and Islamic finance. The jurisdiction covers all financial institutions regulated and supervised by the Bank. An important development is that the Judiciary has agreed to refer to the SAC dispute cases involving Shariah issues on Islamic banking and finance. To preserve its independence, members of the SAC of Bank Negara Malaysia are not allowed to participate in any Shariah committee of financial institutions.

Following the establishment of the SAC at the Bank, the guidelines to strengthen the Shariah committees at the Islamic financial institutions were issued in December 2004. The guidelines, which will take effect on 1 April 2005, set out the rules, regulations and procedures in the establishment of a Shariah Committee (the Committee), the role, scope of duties and responsibilities of a Committee as well as the relationship and working arrangement between the Committee and the SAC of Bank Negara Malaysia. The requirement to establish the Committee covers the Islamic banks, banking institutions that participate in the IBS, takaful operators and development financial institutions that provide Islamic banking facilities. IBS banks may establish a Committee for the banking group, while takaful operators must have their own Committee as required by law.

Among the duties and responsibilities of the Committee are to advise the board of directors on Shariah matters on the bank's business operations to ensure that they comply with Shariah principles at all times, to endorse the Shariah Compliance Manuals, and to endorse and validate relevant documentations. To ensure the proper record for easy reference, the Committee is required to provide written Shariah opinions or decisions.

To ensure the smooth running of the Committee, every Islamic financial institution is responsible to provide the necessary assistance to the Committee in all its undertakings. The Islamic financial institution is required to refer all Shariah issues to the Committee for advice for adoption. It is also required to ensure that product documents containing Shariah matters be endorsed and validated by the Committee, provide access to relevant records, transactions, manuals or other relevant information for the Committee members to enable them to perform their duties, and provide sufficient resources, independent expert consultation, reference materials and training.

An individual person is only allowed to be a member of one Committee for each industry. In other words, if the person sits on the Committee of an Islamic banking institution, he cannot sit on another Committee of an institution of the same industry. However, he is allowed to sit on a Committee of a takaful company. A company or an institution is no longer allowed to be a Committee member as the guidelines restrict the members of the Committee to individuals only. The Committee member must be at least qualified in the field of Islamic jurisprudence (*Usul Fiqh*) or Islamic transaction/commercial law (*Fiqh Mu'amalat*) or possess the necessary knowledge, expertise or experience in the related field.

The composition of the Committee shall be a minimum of three members. In addition to the Shariah Committee, an Islamic financial institution is required to designate at least one officer, preferably with knowledge in Shariah, to serve as the secretariat to the Committee. The Committee will report to the board of directors of the financial institution. This reporting structure reflects the status of the Committee as an independent body of the Islamic financial institution.

The guidelines are expected to improve and strengthen the Shariah governance of the financial institutions and contribute towards creating a larger pool of highly qualified, conversant and experienced Shariah advisors.

- Following the establishment of the Shariah Advisory Council (SAC) at Bank Negara Malaysia under the Central Bank of Malaysia Act 1958, the Malaysian Judiciary and the Regional Centre for Arbitration Kuala Lumpur will use the SAC as the reference point in the event of a dispute that involves Shariah issues on Islamic banking and finance. As the reference body and advisor to Bank Negara Malaysia on Shariah matters, the SAC is also responsible for validating all Islamic banking and takaful products to ensure their compatibility with the Shariah principles.

- The SAC has convened six meetings during 2004. Among the main decisions made by the SAC were as follows:-

  - Approval on the mechanism of Islamic bond based on *bai' bithaman ajil* to be used by the national mortgage corporation in purchasing the financing assets from the Islamic financial institutions. The new instrument will be an alternative investment instrument offered to the investors and players that prefer fixed and pre-determined return on their investment. The SAC has also approved the bidding methods for this instrument to be based either on price or rate of return. Methods to determine the rate of return to successful investors can also be based either on bid price or bid profit rate or weighted average of bid profit rates.

  - An Islamic financing that includes cost of coverage as part of its financing package must be covered by takaful. This is to avoid the involvement of Islamic financial institutions in any transaction that is not Shariah compliant. However, the SAC viewed that if the cost of coverage does not form part of the financing package, the Islamic financial institutions should offer takaful as a first choice to the customers.

  - Approval in principle on the profit rate swap transaction based on sell and buy back arrangement was given to an IBS merchant bank. The proposed profit rate swap is an arrangement where one party exchanges the fixed profit rate obligation of its asset with the variable profit rate obligation of the counterparty's asset, or vice versa. One rationale for this mechanism is for the Islamic financial institutions to match their long-term investment or fixed rate financing with their shorter-term variable funding rates in order to mitigate their market risk exposure.

- The Law Review Committee that was formed in June 2003 by Bank Negara Malaysia focused its task in 2004 in reviewing the relevant tax laws governing the Islamic banking and finance transactions, namely the stamp duty and tax law, and has made some recommendations to the Government. Towards this end, the Government has announced the tax neutrality policy for Islamic banking and finance in the 2005 Budget to create an equitable tax treatment of Islamic banking and financial transactions *vis-à-vis* similar conventional banking transactions. Under the tax neutrality framework, the Inland Revenue Board (IRB) will exempt additional instruments and transactions

executed to fulfil Shariah requirement, from additional stamp duty and tax payment. Subsequent amendments were made to the Income Tax Act 1967, Real Property Gains Tax Act 1976 and Stamp Act 1949. To facilitate this arrangement, Bank Negara Malaysia has been empowered under these laws as the authority to recommend to the IRB to exempt such additional instruments and transactions from stamp duty.

Enhancing Human Capital Development and Consumer Education

During the year, efforts continued to focus on developing human capital and expertise to enhance the effectiveness and competitiveness of the Islamic banking business. The purpose was to enhance the intellectual capital development with the objective of creating a larger pool of experts and high calibre professionals in Islamic banking and finance.

- To achieve this objective, the Islamic Banking and Finance Institute Malaysia (IBFIM) organised several courses on Islamic banking and finance, covering the management, operation, Shariah and legal aspects. It undertook joint efforts, local as well as international, with Islamic financial institutions and other institutions in the development of a comprehensive and complete range of Islamic financial products and services. IBFIM also assisted financial institutions in designing training programmes to meet their specific training requirements. In addition, IBFIM provided advisory and consultancy services to domestic and foreign institutions.

- Two workshops on Risk Management and Capital Adequacy, and on Implementing Islamic Money Market for Islamic banking and finance were organised by the Bank on 23 September 2004. The Workshop on Risk Management and Capital Adequacy provided insights on the standard setting process and the challenges faced by the Islamic financial institutions in implementing risk management and in meeting the requirements of the IFSB's capital adequacy standards. The Workshop on Implementing Islamic Money Market focused on the development and importance of an Islamic money market as an integral component of a comprehensive Islamic financial system.

- To boost customer awareness and education, a survey was conducted on the customer requirements and the extent to which these were met by the products and services provided by the Islamic banking industry. The results revealed the need to enhance customer relationship as customers place importance on the quality of interface with banking institutions. Enhancing human capital is therefore vital. Customers are becoming increasingly discerning and demanding greater product differentiation and value added services that meet their financial requirements.

- Bank Negara Malaysia also participated in the 1st Malaysia International Halal Showcase, organised by the Islamic Da'awah Foundation, which was held from 14 to 18 August 2004, and the Islamic Banking and Takaful Expo, organised by the Association of Islamic Banking Institutions Malaysia held from 8 to 10 October 2004.

- Bank Negara Malaysia launched the Islamic money market website in October 2004 as part of the initiative to effectively and efficiently disseminate information on domestic Islamic financial instruments. It provides greater transparency of the Islamic money market operations, thus facilitating investment decisions and enhancing public confidence in their investments. The website also provides an analysis facility to chart historical data, in addition to the rules and regulations in the conduct of Islamic money market transactions. The website at *http://iimm.bnm.gov.my* will be linked to the website of markets in other jurisdictions to serve as a platform for exchanging information and knowledge beyond Malaysian borders.

- In promoting Malaysia as a centre for education excellence and training in Islamic banking and finance, an initiative is underway to establish a structured financial training and education institute. This is to meet the increasing manpower requirements arising from the current institutional development. This will effectively develop a human capital framework where Islamic banking industry requirements for skilled staff and experts would be adequately met by the supply of human resources.

SUPERVISION OF THE ISLAMIC BANKING SYSTEM

An important component in the development of a sound and viable Islamic banking system is the establishment of a strong supervisory framework, which has the capacity to specifically address the unique peculiarities inherent in Islamic banking activities. As Islamic banking and finance has become

an integral component of the banking system, strains experienced in the Islamic banking system would have repercussions on the overall financial system.

Islamic banks are supervised premised on the same risk based supervision framework as in conventional banking. The financial and operating condition of the Islamic banking operations are assessed using the CAMELS-*i* rating framework. This framework assesses capital, asset quality, management quality, earnings performance, liquidity and sensitivity to market risk. However, the rating criteria has been adapted to cater for the specific characteristics inherent in Islamic banking operations. The CAMELS-*i* rating also includes an assessment on the adequacy of the financial institutions' risk management systems. An important facet of the supervision of the Islamic banking operations is the review of the financial institution's compliance with Shariah principles. For this purpose, 'Shariah compliance checklists' have been developed as a tool for bank supervisors to carry out their supervisory functions.

In line with the FSMP, Islamic banking institutions invested more resources in enhancing their risk management systems during 2004, to build resilience while operating successfully in a highly competitive environment. New product development and innovations were also intensified in creating a wide range of Islamic financial products capable of meeting customers' requirements. The Islamic banking institutions also developed and enhanced their operational processes in improving their efficiency and effectiveness to operate in a more dynamic and competitive environment. The stress-test analysis on the Islamic banking institutions showed that there was adequate capital to withstand economic shocks as well as to meet planned business expansion.

In 2004, Bank Negara Malaysia conducted on-site examinations of full-fledged Islamic banks, covering both head offices and branches, as well as the conventional financial institutions (commercial banks, finance companies, merchant banks and discount houses) offering Islamic banking products and services, under the IBS. These examinations were conducted as part of the overall examination of the conventional financial institutions. In reviewing the overall financial and operating conditions of the Islamic banking operations of the conventional financial institutions, particular attention was given to ensure that there were proper internal controls and procedures in place to prevent commingling of conventional and Islamic banking funds. These on-site examinations were complemented with off-site surveillance to ensure that there was continuous monitoring of these financial institutions. The two-pronged approach to supervision enabled the Bank to detect emerging problems and thus take necessary pre-emptive supervisory actions on a timely manner.

The entry of the new foreign Islamic banking players and the establishment of Islamic subsidiaries by domestic banking institutions are expected to foster the development of more innovative Islamic financial products and services into the market. Whilst this development will broaden and deepen the Islamic financial markets, supervisors will need to ensure that financial institutions have in place adequate risk management systems to identify, measure, monitor and control all associated risks and that adequate capital is held against the risks.

An important component in the development of a sound and viable Islamic banking system is the establishment of a strong supervisory framework, which has the capacity to specifically address the unique peculiarities inherent in Islamic banking activities.

The existing supervisory processes and procedures will continue to evolve in line with best international standards. Regulatory and supervisory standards, which can specifically address the unique peculiarities of their operations, are necessary to promote resilience and competitiveness of the Islamic banking sector. In this regard, the work of the IFSB, the body established to issue prudential and supervisory standards for the Islamic banking and finance industry would act as a catalyst to the development of a stronger supervision framework in Malaysia. Concurrently, a group of specialised supervisors has been established to act as a reference point for its peers by keeping abreast with new developments in the area of Islamic banking.

The challenges facing the bank supervisors going forward will be more demanding as the system becomes more complex and liberalised. To meet the increasing supervisory needs in a rapidly changing environment, resources will continue to be invested towards strengthening the Bank's supervisory capacity.

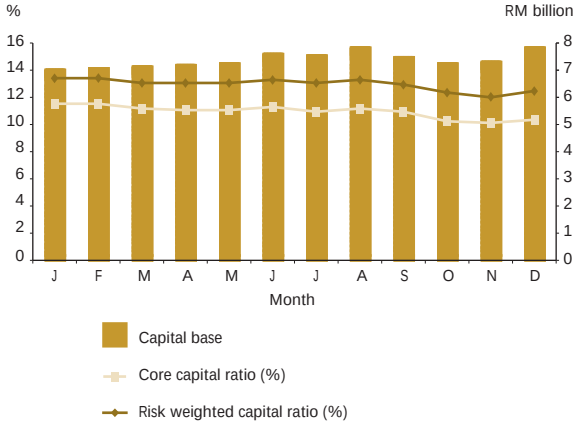
PERFORMANCE OF THE ISLAMIC BANKING SYSTEM

The Islamic banking industry continued to show strong growth in 2004 in tandem with the growth in the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. The industry was able to sustain its performance, and its strong capitalisation levels were attributed to increases in capital and profits as well as higher financing activities. In addition, asset quality recorded further improvement with a declining trend in net non-performing financing ratio and high financing loss provisions.

Capital Strength

The Islamic banking sector remained well capitalised. The risk-weighted capital ratio (RWCR) and core capital ratio were sustained above 12% and 10% respectively throughout the year. The total capital base of the Islamic banking institutions increased from RM6.8 billion as at end-2003 to RM7.8 billion as at end-2004, mainly due to new capital injections and audited profits. Total risk-weighted assets of the Islamic banking system grew by 20.4% or RM10.6 billion to RM62.5 billion in the past 12 months. The growth was apparent in all risk categories except for the 20% category where there was a decline in Islamic Acceptances held and placement with domestic banking institutions. A large increase was recorded in the 100% and 0% risk categories (RM10 billion and RM8 billion respectively) due to hikes in other financing and placement with Bank Negara Malaysia. As at end-2004, the Islamic banking system recorded a strong RWCR of 12.5% and core capital ratio of 10.4%.

Graph 6.2
Islamic Banking System:
Capital Adequacy in 2004



The Islamic banking industry continued to show strong growth in 2004 in tandem with the growth in the economy.

Table 6.1
Islamic Banking System:
Sources and Uses of Funds

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM million		
Sources			
Capital and reserves	2,081	725	7,509
Deposits	6,906	12,647	72,859
Funds from other financial institutions	2,541	-2,958	4,027
Other liabilities	2,598	1,925	10,185
Total	**14,126**	**12,339**	**94,580**
Uses			
Cash	15	16	271
Reserve with Bank Negara Malaysia	321	-159	1,358
Deposits with other financial institutions	1,247	9,670	18,652
Financing	11,897	9,223	57,883
Securities	3,277	-3,510	19,044
Other assets	-2,631	-2,901	-2,628[1]

[1] Denotes the interbranch balances pending settlement.
p Preliminary

The RWCR of Islamic banks and IBS commercial banks stood at 12.5% and 12.7% respectively. The RWCR of IBS merchant banks as a group increased from 13.5% to 14.5% mainly due to the higher increase in the capital base compared with the increase in the risk-weighted assets. The RWCR of IBS finance companies was 10.8% with the capital base declining significantly by 58.4% or RM1,170 million to RM832 million as at end-2004 mainly due to the rationalisation of capital arising from the merging of operations of four IBS finance companies with their IBS commercial banks of the same group. Accordingly, the risk-weighted assets also decreased by 49% or RM7.4 billion.

Assets

As at end-2004, the total assets of Islamic banking sector increased by RM12.3 billion or 15% to RM94.6 billion. A significant portion of the increase in total assets was attributable to the high growth in total financing. As at end-2004, total financing amounted to RM57.9 billion or 61.2% of the total Islamic banking assets. Meanwhile, investment in securities decreased by 15.6% (RM3.5 billion) during the year to account for RM19 billion or 20.1% of total assets. In terms of market share, the largest portion of Islamic banking assets remained with the IBS commercial banks with a share of 57%, followed by Islamic banks (26.3%) and the IBS finance companies (8.2%). In

terms of the growth in assets, IBS merchant banks recorded the highest growth of 47.1%, followed by IBS commercial banks (46.5%) and Islamic banks (18.4%).

Financing Activities

The financing activities of the Islamic banking system grew further in 2004. During the year, there was increased demand for financing, resulting in a higher number of financing applications received by the Islamic banking institutions. Evidently, there were increases in financing approvals and financing disbursements of 0.6% and 14% respectively. In addition, financing repayments increased by 28.6% as many customers repaid and refinanced their financing to take advantage of the environment of low cost of funds.

Table 6.2
Islamic Banking System: Financing Activities

	For the year		Annual change (%)
	2003	2004*p*	
	RM million		
Financing approvals	16,168	16,260	0.6
Financing disbursements	36,049	41,089	14.0
Financing repayments	26,157	33,639	28.6
	As at end-		Annual change (%)
	2003	2004*p*	
	RM million		
Outstanding financing	48,660	57,883	19.0

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Table 6.3
Islamic Banking System: Direction of Financing

	Annual change		As at end-2004*p*
	2003	2004*p*	
	RM million		
Agriculture, hunting, forestry and fishing	267.6	467.0	2,328.6
Mining and quarrying	-11.0	13.1	76.6
Manufacturing	505.6	1,725.8	6,112.6
Electricity, gas and water supply	-284.8	470.3	719.2
Community, social and personal services	89.4	115.2	418.5
Broad property sector	4,747.0	1,923.6	22,451.0
Real estate	*142.6*	*94.5*	*906.4*
Construction	*655.3*	*597.4*	*3,530.9*
Purchase of residential property	*3,581.4*	*1,044.4*	*15,433.3*
Purchase of non-residential property	*367.7*	*187.3*	*2,580.4*
Wholesale and retail trade, restaurants and hotels	410.6	1,273.9	3,070.9
Transport, storage and communication	199.5	152.2	1,176.5
Finance, insurance and business services	661.6	156.8	2,090.1
Purchase of securities	-14.1	-42.7	878.1
Consumption credit	5,584.9	2,931.2	17,803.4
Credit cards	*95.7*	*155.8*	*312.0*
Personal use	*575.5*	*812.2*	*2,449.3*
Purchase of consumer durable goods	*-9.2*	*-10.5*	*43.6*
Purchase of transport vehicles	*4,922.9*	*1,973.7*	*14,998.5*
Others	-258.7	36.1	757.0
Total	**11,897.6**	**9,222.5**	**57,882.5**

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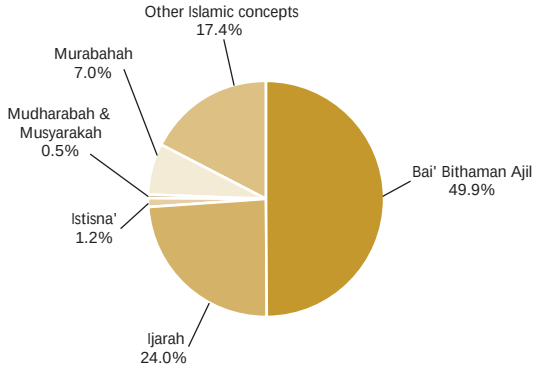
Graph 6.3
Islamic Banking System: Major Financing Concepts



In 2004, total financing expanded by 19% or RM9.2 billion (2003: 32.4% or RM11.9 billion). Consumer financing extended by Islamic banking institutions, which had risen by 19.7%, was supported by strong consumer spending. Similarly, financing for purchase of transport vehicles (primarily for purchase of passenger cars) recorded a growth of 15.2%, while financing for purchase of residential properties expanded by 7.3%. The expansion in consumer demand was further supported by the attractive and competitive financing packages offered by the Islamic banking institutions. Financing extended to the manufacturing sector continued to be significant in 2004, accounting for 10.6% of total financing as at end-2004 (end-2003: 9%). Financing based on *bai' bithaman ajil* (deferred payment sale) concept remained dominant, constituting 49.9% of total financing while *ijarah* (leasing) constituted 24%.

The Islamic banking sector continued to focus on providing financing to small and medium enterprises (SMEs). Total financing provided by the Islamic banking institutions to the SMEs increased by 29.6% from RM6.2 billion as at end-2003 to reach RM8 billion as at end-2004. Islamic financing contributed 13.8% of the total financing extended by the banking system to the SMEs as at end-2004 as compared with 7.5% as at end-2003.

Asset Quality

The asset quality of the Islamic banking industry improved further during the year. As at end-2004, the gross and net non-performing financing (NPF) ratios stood at 8.1% (2003: 8.5%) and 5.3% (2003: 5.5%) respectively, based on a 6-month classification. The net NPF ratio of the Islamic banking institutions was sustained within the range of 4.8% to 5.7% throughout the year. Financing loss coverage remained high at 60.5% of total NPF as at end-2004. In terms of absolute amount, financing loss coverage increased to RM3 billion from RM2.4 billion in 2003.

The income-in-suspense, general provision and specific provision set aside by Islamic banking institutions increased by 16.1%, 36.6% and 15.8% respectively during the year. The general provision of total net financing for the Islamic banking industry increased to 2.1% from 1.8% as at end-2003 reflecting the prudent stance of a number of Islamic banking institutions in setting aside higher provisions for financing.

The broad property sector continued to account for the largest share, at 66.7% of the total NPF (2003: 62.4%). The high NPF in the broad property sector

Table 6.4
Islamic Banking System: Non-performing Financing and Financing Loss Provisions

	As at end-					
	2003			2004*p*		
	Actual[1]	Classification		Actual[1]	Classification	
		3-month	6-month		3-month	6-month
	RM million					
Islamic banks						
Total financing	9,809.2			11,463.3		
General provisions	174.7	174.7	174.7	163.9	163.9	163.9
Income-in-suspense	178.2	186.9	178.2	204.1	215.3	204.1
Specific provisions	405.5	433.7	405.5	424.0	457.7	424.0
Non-performing financing	1,575.6	2,002.3	1,575.6	1,668.7	2,152.7	1,668.7
Net NPF ratio (%)[3]	10.8	15.0	10.8	9.6	13.7	9.6
Total provisions/NPF (%)	48.1	39.7	48.1	47.5	38.9	47.5
Commercial banks[2]						
Total financing	22,323.8			38,803.0		
General provisions	400.9	379.7	300.8	923.2	922.9	545.5
Income-in-suspense	213.3	130.1	207.1	341.5	343.6	334.8
Specific provisions	280.3	284.4	309.3	544.8	552.5	532.3
Non-performing financing	1,991.7	2,274.4	1,653.7	2,798.6	3,411.7	2,542.4
Net NPF ratio (%)[3]	6.9	8.5	5.2	5.0	6.6	4.4
Total provisions/NPF (%)	44.9	34.9	49.4	64.7	53.3	55.6
Finance companies[2]						
Total financing	15,746.0			6,823.5		
General provisions	316.7	316.6	318.7	130.0	130.0	130.0
Income-in-suspense	150.8	155.8	149.8	100.5	107.9	100.5
Specific provisions	274.9	296.7	274.5	136.4	151.4	136.4
Non-performing financing	832.3	1,058.7	805.1	389.5	639.2	389.5
Net NPF ratio (%)[3]	2.7	4.0	2.5	2.3	5.8	2.3
Total provisions/NPF (%)	89.2	72.6	92.3	94.2	60.9	94.2
Merchant banks[2]						
Total financing	781.0			792.7		
General provisions	12.1	12.1	12.1	12.9	12.9	12.9
Income-in-suspense	20.6	20.7	20.6	7.6	7.6	7.6
Specific provisions	5.4	5.4	5.4	14.9	14.9	14.9
Non-performing financing	125.6	128.3	125.6	109.8	109.8	109.8
Net NPF ratio (%)[3]	13.2	13.5	13.2	11.3	11.3	11.3
Total provisions/NPF (%)	30.3	29.8	30.3	32.2	32.2	32.2
Islamic banking system						
Total financing	48,660.0			57,882.5		
General provisions	904.4	883.2	806.2	1,230.0	1,229.7	852.3
Income-in-suspense	562.9	493.5	555.6	653.7	674.4	647.0
Specific provisions	966.0	1,020.2	994.6	1,120.1	1,176.5	1,107.6
Non-performing financing	4,525.2	5,463.7	4,160.0	4,966.7	6,313.4	4,710.5
Net NPF ratio (%)[3]	6.4	8.4	5.5	5.7	8.0	5.3
Total provisions/NPF (%)	53.8	43.9	56.6	60.5	48.8	55.3

[1] Financing classified as NPF based on individual banking institution's NPF classification policy i.e. 3-month or 6-month classification.

[2] Refers to Islamic banking portfolio of conventional banking institutions participating in Islamic Banking Scheme and represents a subset of the figures reported under the total banking system for commercial banks, finance companies and merchant banks.

[3] Net NPF ratio = (NPF less IIS less SP) / (Gross financing less IIS less SP) x 100%.

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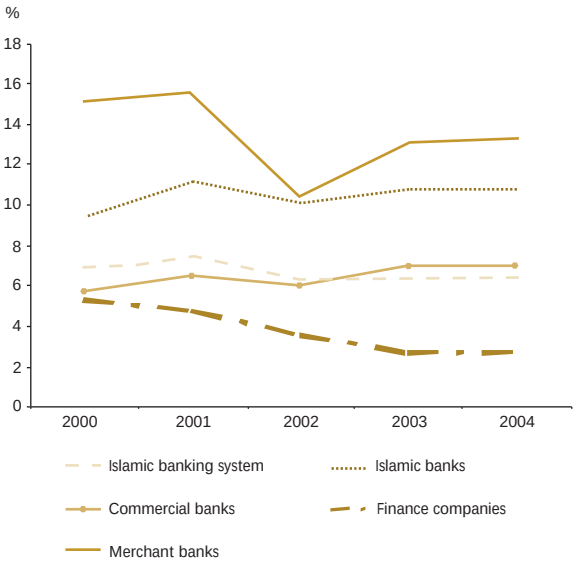
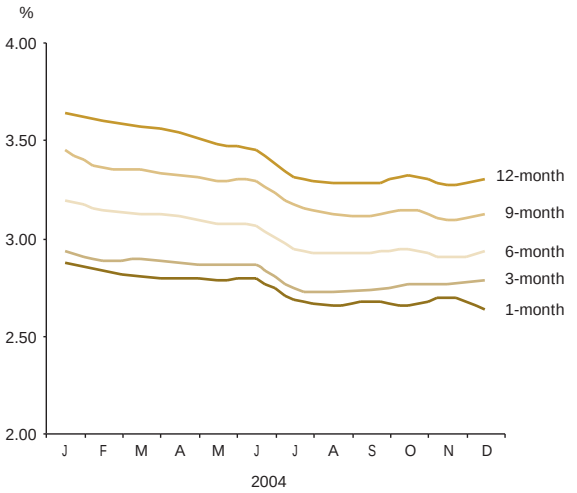
Graph 6.4
Islamic Banking System:
Net Non-Performing Financing Ratio[1]



[1] Based on actual classification.

was recorded in the residential property and construction sub-sectors, which increased by RM345.9 million (24%) and RM176.9 million (29.8%) respectively. The NPF level of the residential property to total financing for this sub-sector increased from 10% as at end-2003 to 11.6% as at end-2004. Apart from the broad property sector, there was also an increase in NPF in the purchase of transport vehicles sub-sector, primarily for purchase of passenger vehicles of RM116.1 million.

Graph 6.5
Islamic Banking System:
Average Rates of Return to General Investment Depositors



Rates of Return

During the year, the rates of return to general investment depositors showed a declining trend across the different tenures. The 1-month and 3-month rates ranged between 2.63% to 2.87% and 2.73% to 2.93% respectively. The declining trend was partly due to the proportionately larger increase in the general investment deposit base than the increase in the net distributable income. The general investment deposits recorded an average monthly growth of 1.5% while the net distributable income registered an average monthly growth of 1.3%.

Profitability

In 2004, the Islamic banking sector recorded an increase of 14.1% in net income (from financing activities and securities) of RM306.6 million at the operating level. Notably, other income of the Islamic banking sector registered an increase of RM87.5 million or 11.8%. The Islamic banking sector posted higher profit before provision of RM2.6 billion (2003: RM2.3 billion). After allocating financing loss provisions, the Islamic banking sector recorded profit before tax of RM986.3 million for the calendar year 2004 (2003: RM960.4 million). Despite the higher provision for financing losses of RM1.6 billion, a higher profit before tax was recorded as the increase in total income was more than offset the increase in provisions. The higher financing loss provisions charged by the Islamic banking institutions were partly due to the increase in NPF and Profit Equalisation Reserve. The return

Table 6.5
Islamic Banking System: Income and Expenditure

	For the calendar year		Annual change	
	2003	2004*p*		
	RM million			%
Income[1] net of income-in-suspense	3,864	4,296	432	11.2
(Income-in-suspense)	*307*	*310*	*3*	*1.0*
Less: Expense[1]	1,689	1,814	125	7.4
Net income	2,175	2,482	307	14.1
Add: Other income	748	836	88	11.8
Less: Staff cost	232	267	35	15.1
Overheads	384	422	38	9.9
Profit before provisions	2,307	2,629	322	14.0
Less: Financing loss & other provisions	1,347	1,643	296	22.0
Pre-tax profit	960	986	26	2.7
Return on assets (%)	1.2	1.0		
Return on equity (%)	14.2	13.1		

[1] From financing activities and securities.
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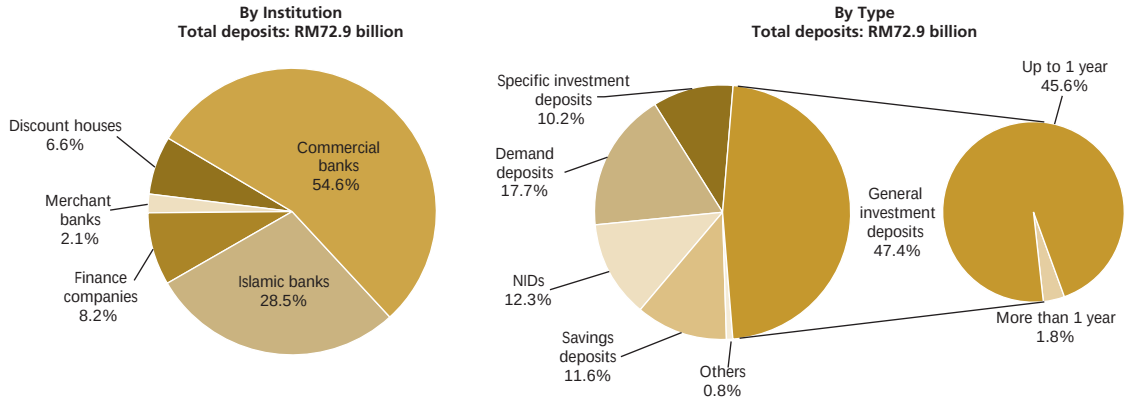
Graph 6.6
Islamic Banking System: Deposits by Institution and Type



on assets and return on equity, however, declined to 1% and 13.1% respectively due to the increase in asset size and capital funds.

Liquidity

There was ample liquidity in the Islamic banking system throughout 2004. Total deposits recorded a moderate growth of 21% or RM12.7 billion to reach RM72.9 billion as at end-2004. The IBS commercial banks and Islamic banks accounted for the major share of 83.1% of the total deposits in the Islamic banking sector (2003: 73.3%). Among the Islamic banking players, the IBS merchant banks recorded the highest growth rate in deposits of 79.2% followed by the IBS commercial banks, which registered a growth of 50%.

Investment deposits (general and specific) continued to capture a major portion of the Islamic banking deposits, amounting to 57.6% of Islamic banking deposits. During the year, savings and demand deposits recorded a growth of 22.8% and 17.6% respectively mainly due to increase in the retail customer base in Islamic banking. In terms of the maturity profile of general investment deposits, 96.2% of the general investment deposits continued to be concentrated at the shorter end of the yield curve, mainly in the one to three-month maturity tenure as the incremental return between the shorter and longer placement tenures continued to remain small. The average rates earned on deposits remained stable in 2004.

In terms of short-term liquidity for the period of up to one month, the two Islamic banks had sufficient liquidity to meet any unexpected withdrawals. There was surplus liquidity above the minimum requirement of 3% for the up to one-week time bucket and 5% for the one-week to one-month time bucket. The financing to deposits ratio decreased from 80.8% as at end-2003 to 79.4% as at end-2004 due to higher percentage increase in total deposit base compared with that in total financing during the period.

Islamic Interbank Market

During the year, the Islamic interbank market registered significant growth of 64.8% in terms of turnover volumes against a backdrop of ample liquidity. The *mudharabah* interbank investment transactions continued to dominate more than 70% market share of the total turnover volumes in the Islamic interbank market. Stable rate of return on the *mudharabah* interbank investment coupled with the enlarged issuance of Government and Central Bank securities had contributed to strengthen the Islamic interbank market position to meet increasing market demand for short-term investments.

Table 6.6
Islamic Interbank Market - Turnover Volume

	2003	2004*p*	Annual change	
	RM billion			%
Total	**341.4**	**562.4**	**221.1**	**64.8**
***Mudharabah* Interbank Investment**[1]	**283.8**	**485.7**	**201.9**	**71.1**
Financial Instruments	**57.6**	**76.8**	**19.2**	**33.3**
Islamic Accepted Bills[1]	10.0	10.3	0.3	3.5
Negotiable Islamic Debt Certificate[1]	4.2	8.2	4.0	94.0
Bank Negara Negotiable Notes	8.9	21.2	12.3	137.6
Islamic Treasury Bills[2]	–	1.2	1.2	–
Government Investment Issues	34.5	35.9	1.4	4.0

[1] Volume transacted through brokers.
[2] Inaugural issuance.
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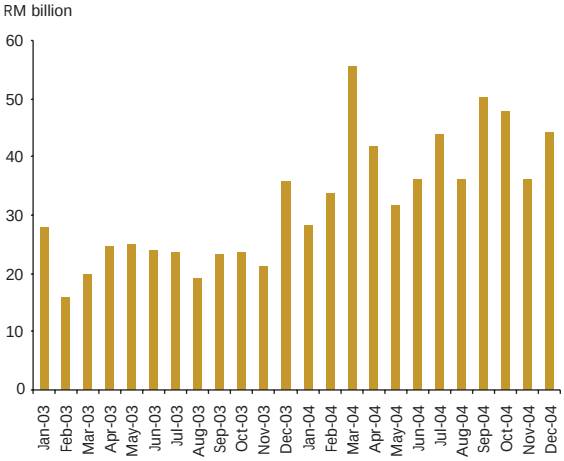
Graph 6.7
***Mudharabah* Interbank Investment - Turnover Volume**



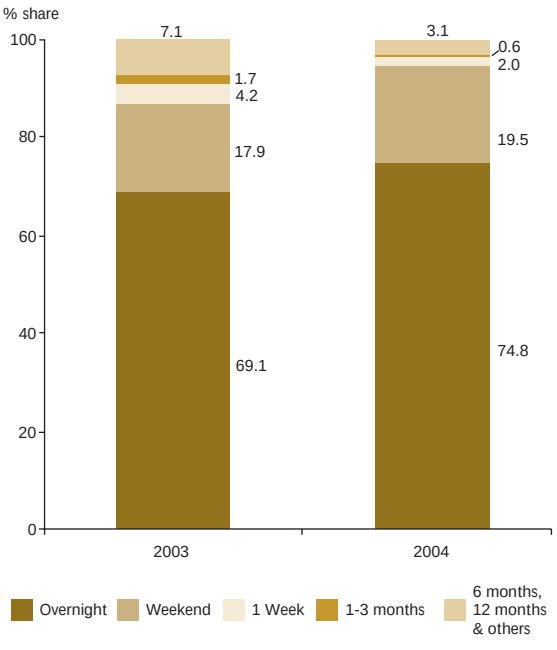
The Islamic interbank market sustained ample liquidity during the year. The excess liquidity condition, however, was effectively maintained at an appropriate level through Bank Negara Malaysia's liquidity operation. Under the liquidity operation, the excess liquidity was absorbed through the issuance of Government and Bank Negara Malaysia Islamic papers as well as through the direct acceptance of *wadiah* interbank deposits. During the year, the Government of Malaysia issued the inaugural Islamic Treasury Bills (ITB) amounting to RM1 billion based on the Shariah concept of sell and buy back arrangement. The one-year Government paper was issued in eight series and attracted broad investor participation, with the issue being over-subscribed by 3.6 times. Apart from the ITB, the Government also issued an additional RM2.1 billion of Government Investment Issues (GII), of which RM1 billion was issued for a seven-year tenor as part of the effort to lengthen the benchmark yield curve for Islamic securities. Bank Negara Malaysia issued an additional RM2 billion of Bank Negara Negotiable Notes (BNNN). Following the issuance of the three Government and Bank Negara Malaysia papers, the net issuance of Islamic securities by the Government increased by 51% or RM5.1 billion.

The continuous liquidity surplus in the Islamic banking system was further absorbed through the *wadiah* interbank deposits transaction whereby the average daily amount absorbed by Bank Negara Malaysia under this mechanism increased from RM2.4 billion in 2003 to RM6.8 billion in 2004. The bulk of the *wadiah* transactions, however, was concentrated on the overnight tenor. Following the liquidity operations carried out by the Bank, the *mudharabah* interbank investment overnight rate that was used as an indicator by Bank Negara Malaysia for the day-to-day liquidity operation in the Islamic interbank market remained stable at an average of 2.70% throughout the year.

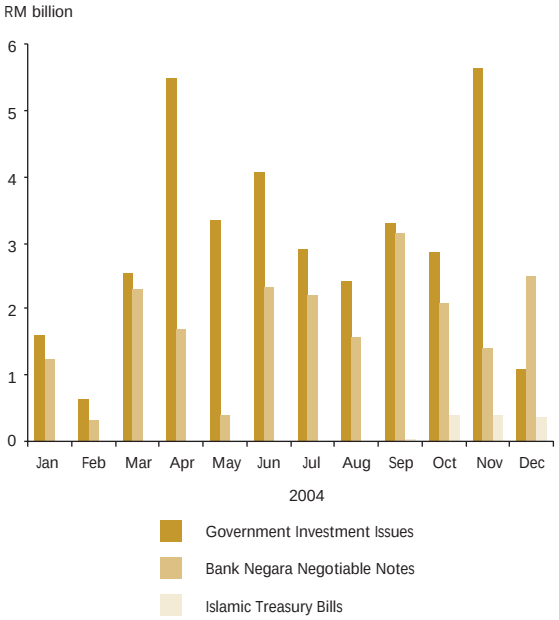
Trading volume in the *mudharabah* interbank investment transactions continued to record favourable growth of 71.1%, at an average monthly turnover of RM40 billion. Similar to the *wadiah* interbank acceptance deposits, more than 70% of the *mudharabah* interbank investment transactions were mainly concentrated on the overnight tenor, primarily due to the limited supply of Shariah compliant short-term papers. The stable rate of return which averaged 2.70% for the overnight investment in *mudharabah* interbank investment was also the contributing factor given that the rate was more favourable to market participants compared to the declining yields in the Government Islamic securities.

With the exception of Islamic Accepted Bills (AB-i), there was continuous demand for short-term liquid assets arising from the surplus liquidity position. Due to the limited supply of instruments in the secondary market, the majority of the AB-i issuers preferred to hold the short-term paper until maturity. In addition, the AB-i provided higher return on investment as it was priced above the *mudharabah* interbank investment rate.

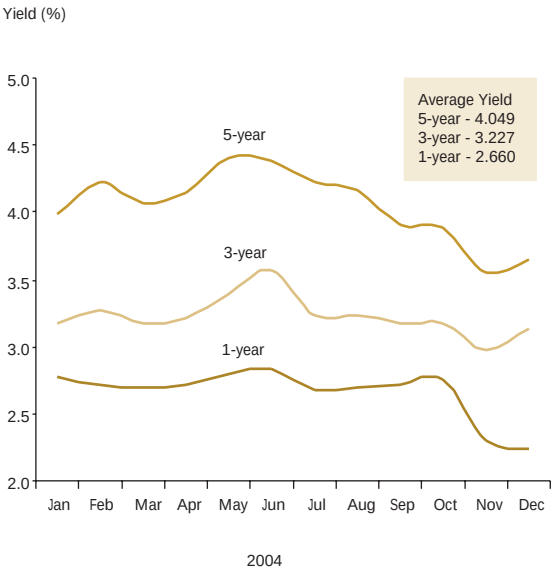
Graph 6.8
***Mudharabah* Interbank Investment - Share of Turnover Volume**



Graph 6.9
Islamic Securities - Turnover Volume



Graph 6.10
Government Investment Issues - Average Yield to Maturity



Notwithstanding the limited supply, the moderate increase in AB-i was offset by a higher increase in the supply of Negotiable Islamic Debt Certificate (NIDC-i). The ample liquidity situation in the banking system provided the environment for the Islamic banking institutions to increase the creation of NIDC-i to mobilise medium and long-term deposits. This exercise has consequently improved the supply of NIDC-i in the secondary market. As at the end of 2004, total outstanding NIDC-i amounted to RM8.8 billion as compared to RM5.7 billion as at end-2003, representing an increase of 54%. In terms of maturity tenor, 62% or RM5.7 billion of the outstanding NIDC-i ranged from nine months to five years.

The increase in supply of BNNN and the new issuance of ITB contributed significantly to higher trading of these instruments in the secondary market. During the year, the turnover volume of BNNN grew by 137.6% or RM12.3 billion. The trading of ITB also showed an encouraging growth where the turnover ratio in the new Government paper recorded 1.2 times in terms of trading volume to the total outstanding securities. Meanwhile, the trading volume of GII recorded a marginal increase of 4% or RM1.4 billion as compared to that of the previous year due to the relatively lower average yield-to-maturity.

The Islamic bond market charted a positive growth of 13.4% or RM11.6 billion in 2004. Total outstanding Islamic securities amounted to RM97.8 billion, accounting for 25.7% of the total outstanding bonds in the capital market. In the private debt securities market, a total of RM82.7 billion Islamic securities remained outstanding as at end-2004, which accounted for 42% of the total outstanding private debt securities in the market or an increase of 8.5% from 2003. The continued low interest rate environment and ample liquidity situation influenced corporations to raise funds in the capital market via the issuance of long-term private debt securities.

A significant development in the domestic Islamic bond market was the inaugural issuance of ringgit-denominated Islamic debt securities based on *bai bithaman ajil* (BBA) by a multilateral financial

Table 6.7
Outstanding Islamic Securities

	2003	2004*p*	Annual change	
	RM billion			%
Total	**86.2**	**97.8**	**11.6**	**13.4**
Government Securities	**10.0**	**15.1**	**5.1**	**51.0**
Government Investment Issues	7.0	9.1	2.1	30.0
Islamic Treasury Bills	0.0	1.0	1.0	-
Bank Negara Negotiable Notes	3.0	5.0	2.0	66.7
Private Debt Securities	**76.2**	**82.7**	**6.5**	**8.5**
Khazanah bonds	10.0	9.0	-1.0	-10.0
Corporate bonds	52.5	57.0	4.5	8.5
Commercial papers	6.2	3.6	-2.6	-41.7
Medium-term notes	5.4	10.0	4.5	83.6
Cagamas bonds	1.1	2.5	1.5	135.6
Asset backed securities	1.0	0.6	-0.4	-39.4

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institution. The issuance was made possible following the liberalisation to the Foreign Exchange Administration Rules to facilitate multilateral development banks, multilateral financial institutions and multinational corporations to raise ringgit-denominated bonds in the Malaysian capital market.

In the mortgage securities segment, Cagamas Berhad (Cagamas) introduced a new Islamic mortgage securities based on the concept of BBA in addition to the existing *mudharabah* Cagamas bond. Under this concept, Cagamas undertakes a sell and buy back arrangement transaction with market participants for the purpose of raising funds from the capital market. Funds raised from these issuances were utilised by Cagamas to purchase the house financing and hire and purchase facilities from the Islamic banking institutions. In 2004, Cagamas issued a total of RM1.6 billion of the new BBA Cagamas with maturities ranging from two to five years. The increase in the supply of the Cagamas bond promoted active secondary market trading activities of this instrument, which registered a growth of 84% or RM2.1 billion in terms of turnover volume.

Development Financial Institutions

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Development Financial Institutions

OVERVIEW

The main policy thrust for the regulation and supervision of development financial institutions (DFIs) in 2004 continued to be directed at enhancing further the capacity and capabilities of the DFIs. As in previous years, while emphasis continued to be accorded on strengthening the foundation on which DFIs could operate efficiently and effectively, the policy efforts took a wider perspective geared towards realigning the activities and institutional structure of the DFIs. These are aimed at ensuring that the DFIs remain focused in providing financial and non-financial support to the identified strategic sectors of the economy. Coupled with these efforts, the supervision and monitoring of DFIs continued to be conducted through off-site surveillance and regular on-site examinations.

While emphasis continued to be accorded on strengthening the foundation on which DFIs could operate efficiently and effectively, the policy efforts in 2004 took a wider perspective geared towards realigning the activities and institutional structure of the DFIs.

In line with the overall growth of the economy, the financing activities of the DFIs increased in 2004 as the DFIs continued to provide financial support to the identified priority and strategic sectors of the economy. Savings mobilised by the deposit-taking DFIs also registered strong growth during the year. The DFIs' efficiency in delivering quality products and services to the targeted sectors is expected to improve as these institutions continuously review their internal operations and benchmark against their counterparts in the markets. This has to be complemented with improvements in staff and management capabilities in supporting the DFIs towards meeting the performance standards expected of these institutions.

POLICIES AND DEVELOPMENTS

The major developments and progress made in actualising the strategy to enhance the capacity and capability as well as to facilitate the development of DFIs were as follows:

- **Realignment of Roles and Functions of DFIs**
  Given that part of the strategy to enhance the effectiveness and efficiency of DFIs is to clearly define the strategic focus and roles of each of the respective DFIs, Bank Negara Malaysia conducted a review on the mandated roles and activities of the DFIs under the Development Financial Institutions Act 2002 (DFIA). The review, aimed at assessing the extent of the strategic focus of the DFIs in performing their roles, identified issues relating to the institutional structure and focus of business activities affecting the performance and effectiveness of the DFIs in developing and promoting the identified strategic sectors. Following the review, the Bank proposed to the Government to rationalise the institutional structure and functions of Bank Pembangunan dan Infrastruktur Malaysia Berhad (Bank Pembangunan), Bank Industri & Teknologi Malaysia Berhad (Bank Industri), Malaysia Export Credit Insurance Berhad (MECIB) and Export-Import Bank of Malaysia Berhad (EXIM Bank). The rationalisation aims to enhance the focus of the business and activities of the DFIs in the respective mandated sectors. The broad policy proposals were announced by the Minister of Finance in the 2005 Budget.

- **Enhancing Advisory Capabilities of DFIs for Small and Medium Enterprises**
  As part of the efforts to support the activities of small and medium enterprises (SMEs), Bank Negara Malaysia embarked on a project in October 2004 to enhance the capabilities of the DFIs in providing advisory services to the SMEs in Malaysia. The advisory services are envisaged to complement the financial services already provided by the DFIs, thus enhancing the effectiveness of these institutions in developing and nurturing SMEs. Five DFIs, namely, Bank Pembangunan, Bank Industri, EXIM Bank, MECIB and Bank Pertanian Malaysia (BPM) participated in the project, given their existing involvement in providing financing to SMEs.

  Taking into consideration the specific mandated functions and the unique features of each of the participating DFIs, a customised action plan

containing strategies to enhance their advisory capabilities will be formulated according to the function of the respective DFIs. The plan would include, among others, identification of the relevant advisory services to meet the demand of SMEs from the different economic sectors, human resource development and training needs, as well as the establishment of an institutional structure for the DFIs.

- **Development of Computerised Statistical Reporting System**
  On 1 December 2004, Bank Negara Malaysia implemented an online reporting system to capture and generate statistical data on DFIs. The reporting system is known as the Development Financial Institutions Statistical System or DFISS. To address the unique business of each DFI, DFISS captures both generic and specific information relating to their businesses. The system enables the Bank to obtain important information in a timely manner, thus facilitating the monitoring of the performance of DFIs and the formulation of effective policies.

- **Monitoring and Supervision of DFIs**
  The Bank's thrust for supervisory activities in 2004 continued to be on strengthening each DFI's institutional capacity and operating infrastructure. Premised on the risk-based supervisory framework, both the off-site and on-site activities were directed at ensuring that the DFIs performed their mandated role effectively and were financially sound. Supervisory attention and resources were directed at identifying areas of high risk and of supervisory concern for improvement and in making recommendations to address the weaknesses in a timely and effective manner. Having completed the first two years of supervision of the DFIs, the Bank continued to ensure that corrective or remedial actions had been taken by the institutions to address weaknesses that have been identified. Consequently, the DFIs have progressed significantly in adopting best practices in the management and achievement of organisational objectives, which include their socio-economic roles. Overall, there were progressive improvements in the operations of the DFIs, especially in the areas of corporate governance, risk management and internal audit.

  During 2004, the on-site examinations continued to emphasise on adequacy, effectiveness and efficiency of the DFIs' operational infrastructure, internal processes as well as staff and managerial capacity in supporting the achievement of mandated roles. The DFIs have focused on putting in place the appropriate infrastructure and human resource capabilities to enable identification of their niche markets and fulfilling the needs of the customers arising from their mandated roles. These included assessing the needs of these markets and ensuring internal operational efficiency and delivery systems that facilitate meeting the financing and business advisory needs of these markets. Some DFIs have also developed their respective key performance indicators to measure and monitor operational efficiency, as well as their achievement in fulfilling their mandated roles. Periodic assessments against the key performance indicators will be undertaken to enforce discipline in addressing the gaps in desired outcomes.

  There were also improvements in the level of corporate governance in the DFIs. Given the significance of the role of the DFIs' Board in overseeing the overall effectiveness and efficiency of the institutions, regular dialogues between the supervisors and members of the Board and senior management were held, enabling the Bank to better assess the quality of the operating infrastructure in terms of Board and management oversight. These sessions have facilitated a better understanding by the members of the Board as to the role that they need to perform, both individually and collectively, in guiding the strategic direction of the institutions. These sessions with the members of the Board also provided the opportunity for the supervisors to share their supervisory concerns on the institutions, thereby facilitating timely and effective corrective measures on the issues of concern impacting the operating and financial conditions of the institutions.

  There were also notable improvements in the risk management initiatives of the DFIs as these institutions have progressively implemented best practices in risk management. The Board and senior management of the DFIs recognised the need to ensure that the risk management infrastructure such as staff, systems and internal processes, including the relevant policies, are in place and effective. Risk management mechanisms are being continuously assessed by the Bank to ensure their effectiveness in supporting the Board and management in

performing their oversight function on the DFIs' operations. The mandated roles of the DFIs in the targeted sectors had resulted in these institutions assuming relatively higher risk portfolios, necessitating the need to have in place adequate and robust risk management systems, consistent with the magnitude and complexity of the risks assumed. The DFIs were also required to strengthen their internal audit function to encompass management audits which would assist the Board and senior management in managing risks and overall efficiency of the organisations, its internal processes and initiatives. The competencies of the audit staff need to be continuously enhanced with relevant training and operational exposure. Overall, audit operations have improved with the adoption of risk-based methodology in addressing the relative riskiness of the DFIs' operations, whose resources were directed at areas that posed higher degree of risks.

The off-site surveillance activities had provided continuous monitoring of the DFIs and enabled early detection of potential problems and implementation of pre-emptive measures. These activities, which included detailed monitoring of financial data and trends on risk areas, had also assisted in monitoring the effective implementation of corrective measures undertaken by the DFIs. The complementary roles played by the off-site surveillance and on-site examination had allowed the Bank to implement risk-based supervision approach that is consistent with the changes in the risk profile and the issues of concern for the institutions.

- **Modifications to the Development Financial Institutions Act 2002**

  The DFIA has enabling provisions which allow modifications to be made to the Act to meet the unique characteristics and specialised roles of each DFI. This flexibility is necessary to cater for the differing circumstances and requirements of new DFIs that may be placed under the purview of DFIA in the future. Such modifications will be put in place by way of an order issued by the Minister of Finance and published in the Gazette. Towards this end, the following modifications have been made to the DFIA so as not to constrain the operations and activities of the DFIs in meeting the financing needs of their respective mandated sectors.

  Modification relating to prohibition of lending to related companies

  Essentially, the DFIA prohibits DFIs from lending to their shareholders, directors or officers and related parties to prevent conflict of interests situation from arising. A provision in DFIA related to this prohibition has been modified to allow two DFIs, namely Bank Pembangunan and Bank Industri to lend to venture capital companies or subsidiary companies, where the formation of such venture capital companies or the activities of such subsidiary companies are in line with the DFIs' mandated roles. The underlying rationale behind this modification is to remove the restrictions which prohibit DFIs from providing wide ranging financing support to the targeted sectors. The modification was given retrospective effect from 15 February 2002.

  Modification to the requirement for the annual accounts to be published after the annual general meeting

  The DFIA requires DFIs to publish their annual accounts within fourteen days following their annual general meetings. As a number of DFIs are statutory bodies and do not hold annual general meetings as in the case of companies, the relevant provision in DFIA was modified and gazetted on 1 May 2004 so as to remove the reference to annual general meetings. The modification provides clarity to those DFIs which are statutory bodies with regard to the requirement for them to publish their annual accounts.

- **Placement of Bank Pertanian Malaysia under DFIA**

  BPM was gazetted as a prescribed institution under the DFIA with effect from 11 June 2004, thus placing BPM under the purview of Bank Negara Malaysia. Similar to other prescribed institutions, BPM was placed under DFIA with the view of strengthening its operational and financial soundness and to ensure that BPM's activities and operations are in line with its mandated objectives. In particular, as a specialised institution for agriculture financing, the continuous improvement and strengthening of BPM's operational and financial conditions through the regulatory and supervisory requirements, are important in ensuring that BPM continues to perform its mandated roles effectively and efficiently. This is important in supporting the Government's strategies for developing the agriculture sector as outlined in the Third National Agricultural Policy.

PERFORMANCE OF DEVELOPMENT FINANCIAL INSTITUTIONS

The financing activities of the DFIs increased in 2004, in tandem with the overall growth of the economy. During the year, the DFIs provided financial support to the identified priority and strategic sectors of the economy namely, agriculture, capital-intensive and high technology industries, shipping, infrastructure, manufacturing, export, Bumiputera entrepreneurs, cooperatives as well as home ownership and property development at the state level, namely in Sabah and Sarawak. Meanwhile, savings mobilised by the deposit-taking DFIs registered strong growth during the year.

Financing Activity

Total loans outstanding of the 14 DFIs identified in the Financial Sector Masterplan as a group recorded a strong growth of 16.5% or RM5.4 billion (2003: 9.9% or RM2.9 billion) to RM37.7 billion as at end-2004. The increase was largely attributable to consumption credit extended by Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat) and infrastructure financing provided by Bank Pembangunan.

In tandem with the overall growth of the economy, financing activities of the DFIs to support the growth of the identified priority and strategic sectors of the economy, increased in 2004.

Consumption credit rose by 18.6%, accounting for 24.5% of total loans outstanding of the DFIs. Similarly, financing to the construction, utilities as well as the transport, storage and communication sectors as a group, which represents 28.3% of total loans

Table 7.1
Development Financial Institutions[1] : Sources and Uses of Funds

	Annual Change		As at end-2004
	2003	2004	
	RM million		
Sources:			
Shareholders' funds	1,519	1,386	10,810
Paid-up capital	*1,180*	*670*	*7,862*
Reserves	*83*	*364*	*1,964*
Retained earnings	*256*	*352*	*984*
Deposits accepted	2,605	7,475	49,878
Borrowings	2,600	993	17,569
Government	*2,855*	*1,260*	*12,990*
Multilateral / International agencies	*-275*	*-1,426*	*1,732*
Others	*20*	*1,159*	*2,847*
Others	-80	1,366	12,053
Total	**6,644**	**11,220**	**90,310**
Uses:			
Deposits placed	3,799	2,662	18,906
Investments	1,961	2,809	24,038
of which:			
Government securities	*999*	*-322*	*2,629*
Shares	*351*	*56*	*6,834*
Quoted	*-124*	*312*	*5,513*
Unquoted	*475*	*-256*	*1,321*
Loans and advances	2,913	5,354	37,709
Fixed assets	100	156	3,864
Others	-2,129	239	5,793
Total	**6,644**	**11,220**	**90,310**
Contingencies:			
Guarantee	502	287	3,949
Export credit insurance	-29	186	309
Total	**473**	**473**	**4,258**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

Table 7.2
Development Financial Institutions[1] : Direction of Lending

	Annual Change		As at end-2004
	2003	2004	
	RM million		
Agriculture, forestry and fishery	-90	387	3,261
Mining and quarrying	-15	-8	67
Manufacturing	595	234	4,186
Electricity, gas and water supply	163	612	1,229
Import and export, wholesale and retail trade, restaurants and hotels	10	180	430
Broad property sector	537	1,645	10,022
Construction	*219*	*126*	*4,136*
Purchase of residential property	*143*	*1,138*	*4,066*
Purchase of non-residential property	*48*	*23*	*464*
Real estate	*127*	*358*	*1,356*
Transport, storage and communication	351	602	5,315
Finance, insurance and business services	-86	-388	1,307
Consumption credit	1,071	1,452	9,239
Others	377	638	2,653
Total	**2,913**	**5,354**	**37,709**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

outstanding, recorded an increase of 14.4%, benefiting primarily from infrastructure financing by Bank Pembangunan. The agriculture and manufacturing sectors also recorded positive growth of 13.5% and 5.9% respectively, together contributing 19.8% to total loans outstanding of the DFIs. Meanwhile, total outstanding insurance cover and guarantees provided by the relevant DFIs increased by 12.5% to RM4.3 billion as at end-2004, attributed mainly to higher guarantee coverage provided by the Credit Guarantee Corporation Malaysia Berhad (CGC).

Financing activities of the seven DFIs that are under the purview of DFIA recorded a growth of 19.1% in total loans outstanding. Retail financing provided by Bank Rakyat to its members rose strongly by 25.3%, while financing to the infrastructure sector and Bumiputera SMEs undertaken by Bank Pembangunan increased by 15.3% and 10.5% respectively. Similarly, Bank Simpanan Nasional (BSN) recorded a strong growth of 30.4% in loans outstanding, on account of personal loans extended whilst BPM registered a growth of 14.8%. Positive growth of 15.7% in lending activities was also recorded by EXIM Bank. Meanwhile, both Bank Industri and MECIB registered a positive growth of 12% and 36.6% respectively, in their lending/ underwriting activities in 2004, as against a reduction in the previous year. Savings mobilised by BSN from individuals increased by 8.5% whilst deposits mobilised by Bank Rakyat grew strongly by 30.6%, partly due to attractive returns offered by the bank.

Table 7.3
Development Financial Institutions[1] : Non-performing Loans and Loan Loss Provisions

	As at end-	
	2003	2004
	RM million	
General provisions	673	747
Interest-in-suspense	1,226	1,363
Specific provisions	1,990	2,074
Non-performing loans	4,732	5,232
	Percent (%)	
Gross NPL ratio[2]	15.6	14.6
Net NPL ratio[3]	5.6	5.5
Total provisions/NPL	82.2	79.9

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad and Sabah Credit Corporation.

[2] Gross NPL ratio = (NPL / Gross loans*) x 100%.
* Excluding loans provided by Credit Guarantee Corporation Malaysia Berhad and loans under ECR scheme.

[3] Net NPL ratio = (NPL less IIS less SP) / (Gross loans* less IIS less SP) x 100%.
* Excluding loans provided by Credit Guarantee Corporation Malaysia Berhad and loans under ECR scheme.

In terms of asset quality, the NPL level of the DFIs as a group increased by RM499.7 million to RM5.2 billion as at end-2004. However, due to a significant expansion in the loan base, the gross NPL ratio improved to 14.6% compared with 15.6% a year ago. Nevertheless, the gross NPL levels of the DFIs remained high, ranging from 7.9% to 40.3% of total loans outstanding. Most of the DFIs classified a loan or financing account in default for six months or more as non-performing. After taking into account the provisions made for potential loan losses, the net NPL amount and ratio of the DFIs stood at RM1.8 billion or 5.5% as at end-2004 (end-2003: RM1.5 billion or 5.6%).

Sources of Funding

Total deposits mobilised by the deposit-taking DFIs increased by 17.6% to RM49.9 billion as at end-2004. Savings mobilised from individuals recorded a growth of 10.2% to RM24.5 billion, accounting for 49.1% of total deposits mobilised. Lembaga Tabung Haji (LTH) and BSN remained dominant in mobilising savings from individuals. Meanwhile, deposit placements by business enterprises and the Government and Government agencies accounted for 28.4% and 13% respectively of total deposits outstanding. Apart from the shareholders' funds totalling RM10.8 billion or 12% of total resources, the DFIs also funded their operations through Government borrowings, which amounted to RM13 billion as at end-2004. This represented 14.4% of total resources and was primarily utilised to enhance access to financing.

Bank Pembangunan dan Infrastruktur Malaysia Berhad

Lending by Bank Pembangunan to its targeted sectors, namely Bumiputera SMEs and the infrastructure sector, recorded a growth of 13.9% in 2004. Total loans outstanding increased to RM11.6 billion as at end-2004 (end-2003: RM10.2 billion), led by financing of infrastructure projects which rose by 15.3% to RM9.9 billion. Both Government-identified and private sector projects registered marked growth of 13.7% and 19.7% respectively, with the former accounting for 72.7% of total loans outstanding for the infrastructure sector. The main beneficiaries of the increase in infrastructure loans were utilities (RM611.8 million), transport and communication (RM238.7 million) and construction (RM125.2 million) sectors.

Total loans outstanding to SMEs meanwhile increased by 6.1% to RM1.7 billion. Financing to Bumiputera SMEs, which accounted for 83.1% of total loans outstanding to SMEs, expanded by 10.5% (2003: 4.6%) to RM1.4 billion. Apart from financing, the bank

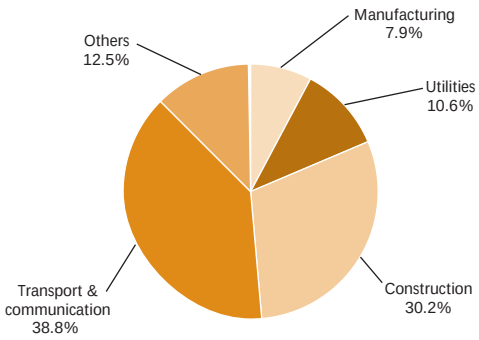
also provides advisory services (inclusive of financial, corporate and technical advice), entrepreneurial training, project consultancy and other services as part of its continuous efforts to promote the development of a viable and resilient Bumiputera Commercial and Industrial Community. In 2004, the bank launched seven new programmes, namely, the Entrepreneur Attachment Programme *(Program Usahawan Sangkut)*, Mentor Mentee Programme (*Program Mentor Mentee*), Vendor Programme (*Program Vendor*), Corporate Technocrat Programme (*Program Teknokrat Korporat*), Women Entrepreneur Programme (*Program Usahawan Wanita*), Batik Entrepreneur Programme (*Program Usahawan Batik*) and Craft Entrepreneur Programme (*Program Usahawan Kraf*).

Loan approvals increased significantly by 54.3% to RM9 billion in 2004 (2003: RM5.8 billion), mainly due to the increase in approval of loans for infrastructure financing. Meanwhile, total loans disbursed rose to RM2.6 billion (2003: RM2.2 billion), also attributed to the increase in disbursement of infrastructure loans.

Bank Pembangunan managed 23 Government funds in 2004. Loan approvals and loan disbursements under these funds rose by 60.7% to RM801.3 million and 34.1% to RM442.6 million respectively. The Tourism Infrastructure Fund and New Entrepreneurs Fund 2 were the main beneficiaries with approvals of RM205 million and RM193.3 million respectively.

Gross NPLs rose by RM5.1 million to RM917.7 million as at end-2004. Due to the enlarged loan base, the gross NPL ratio fell to 7.9% as at end-2004 (end-2003: 9%). Meanwhile, the net NPL ratio stood at 2.8% (2003: 3.4%).

Graph 7.1
Bank Pembangunan dan Infrastruktur Malaysia Berhad:
Direction of Lending as at 31 December 2004



The bank recorded a significant growth of 35.4% in its investment portfolio to RM1.3 billion (7.9% of total assets) as at end-2004. The increase was attributed primarily to the increase in the holdings of private debt securities, which amounted to RM1.1 billion. Placement of deposits with financial institutions totalled RM3.3 billion and accounted for 19.5% of total assets.

Bank Pembangunan sourced most of its funding requirements through borrowings from the Government (RM5.5 billion), deposits accepted from Government agencies and public enterprises (RM4.1 billion), borrowings from multilateral and international agencies (RM1.2 billion), debt securities issued (RM1 billion) and Government grants and subsidies (RM700.5 million). These constituted 73.3% (2003: 73.5%) of the bank's total resources. In 2004, the bank's shareholders' funds rose by RM362.9 million to RM2.9 billion as at end-2004, reflecting an increase in retained earnings and operating profit.

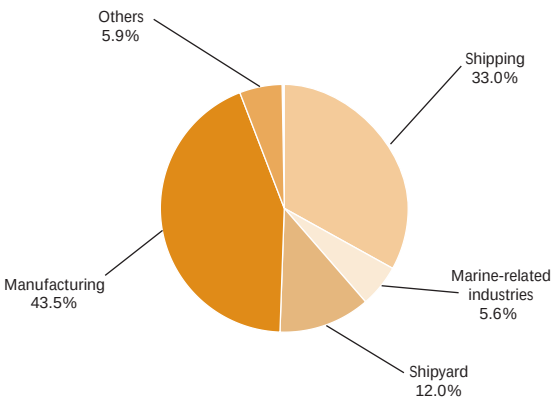
Bank Industri & Teknologi Malaysia Berhad

Bank Industri's lending activities registered a positive growth in 2004 as against a decline in the previous year. Total loans outstanding increased by 12% to RM937.5 million as at end-2004. Lending to the manufacturing sector grew by 12.3% or RM44.6 million, while financing extended to the maritime sector increased marginally by 0.3% or RM1.3 million. The bulk of the loans were extended to two main sectors namely the maritime sector comprising shipbuilding, shipyard and marine-related industries (50.6%) and the manufacturing sector (43.5%), while the balance was to environmental-related sector (5.9%). Total loans outstanding accounted only for 23.1% of the total assets of RM4.1 billion as at end-2004.

Total loans approved in 2004 almost tripled (RM745.5 million) the amount approved in 2003 (RM253.4 million), attributed to a marked increase in approvals for lending to the maritime sector (395.5% or RM301.8 million) mainly involving the purchase and construction of merchant vessels. Loans disbursed also increased significantly to RM358.1 million (2003: RM143.2 million).

Bank Industri managed a total of 13 Government funds during 2004, which accounted for 32% of the total loans outstanding of the bank. Loan approvals and disbursements under the funds increased sharply by 256.1% (RM86.3 million) and 68.6% (RM30.1

Graph 7.2
Bank Industri & Teknologi Malaysia Berhad: Direction of Lending as at 31 December 2004



million) respectively. The increase in loan approvals was contributed primarily by the New Ship Financing Facility (RM30.8 million) and the High Technology Fund (RM24.6 million).

Gross NPLs declined by RM70.2 million to RM253.4 million, representing 27% of total loans outstanding as at end-2004 (end-2003: RM323.6 million or 38.7%), partly due to the conversion of a non-performing shipping loan into equity. Consequently, the net NPL ratio declined significantly to 8.1% (2003: 18.4%).

The bulk of the bank's assets (46.2% as at end-2004) comprised investments in subsidiaries (RM1 billion) and loans and advances extended to subsidiaries (RM846.5 million). The investment and advances were mainly in four subsidiaries, namely, MECIB, EXIM Bank, Global Maritime Ventures Berhad and BI Credit and Leasing Berhad.

The activities of the bank were primarily funded by borrowings, amounting to RM2 billion or almost 50% of total resources as at end-2004, mainly from the Government (RM1.1 billion) and multilateral and international agencies (RM924 million). Deposits placed by the Government and Government agencies of RM741.7 million were another major source of funding for Bank Industri. While borrowings registered a decline of 10.2% during the year, deposits placed by Government and Government agencies increased by 24%. The shareholders' funds of the bank increased by 38.5% (RM101.5 million) to RM365 million as at end-2004 (end-2003: RM263.5 million), mainly attributed to operating profit of RM81.5 million and equity injection of RM20 million by the Government.

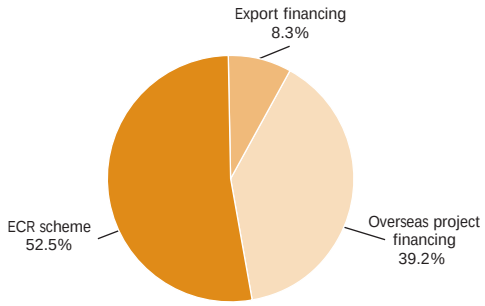
Export-Import Bank of Malaysia Berhad

Financing activities of EXIM Bank grew by 15.7% to RM2.3 billion in 2004. The major activity of EXIM Bank was financing provided under the Export Credit Refinancing (ECR) scheme. The Government-funded ECR scheme managed by EXIM Bank offers competitive rates to banks participating in the scheme for on-lending to exporters. Total loans outstanding under the ECR scheme, which constituted 52.5% of total loans outstanding and which was extended mainly to the palm oil products, rubber products and chemical products industries, increased by 5.4% to RM1.2 billion as at end-2004. Disbursements under the scheme recorded an increase of 2.4% in 2004 to RM6.8 billion (2003: RM6.6 billion), in tandem with the growth of Malaysia's exports.

Export financing (8.3% of total loans outstanding as at end-2004) and the financing of overseas projects (39.2% of total loans outstanding as at end-2004) were the other major activities of EXIM Bank which recorded positive growth of 123.7% and 19.2% respectively during the year. Nearly one-half of total overseas project financing was channelled to projects in South-East Asia and another 30.7% in the African continent. Approximately 64.9% of total overseas project financing and 27% of export financing were channelled to non-traditional markets.

The bank's gross NPLs, excluding loans provided under the ECR scheme, declined to RM306.6 million as at end-2004, representing 28.4% of total loans outstanding (end-2003: 39.2%). Overseas project financing accounted for the largest component (93.3%) of the NPLs. The net NPL ratio was 1.3%.

Graph 7.3
Export-Import Bank of Malaysia Berhad: Credit Facilities as at 31 December 2004



While the loan portfolio represents the main asset of EXIM Bank with a share of 62.9%, deposit placements account for another 35.5% of the bank's assets.

During the year, shareholders' funds increased by 29.8% (RM74.9 million) to RM326.6 million as at end-2004. Borrowings from the Government declined marginally by 0.6% to RM2 billion, whilst borrowings from international agencies increased by 67.7% to RM500.1 million and borrowings from its parent company, Bank Industri, declined by 19.1% to RM302.4 million. Borrowings from the Government were utilised solely for the ECR scheme.

Malaysia Export Credit Insurance Berhad

MECIB, which provides insurance cover and guarantee facilities to facilitate Malaysia's exports and overseas investment, recorded significant growth in its activities in 2004, in tandem with Malaysia's export growth. Total exposures increased by 36.6% to RM675.2 million as at end-2004, largely due to a 150.2% increase in short-term export credit insurance facilities. However, guarantees issued declined marginally by 1.2%. Approximately 45.7% of MECIB's total exposures were export credit insurance covers and the remaining were guarantees. The small size of its shareholders' funds constrained MECIB's ability in providing coverage for large medium-term and long-term businesses.

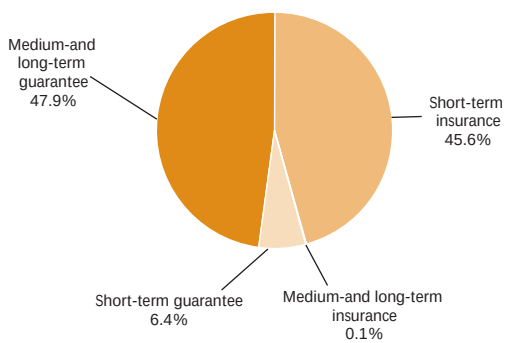
Reflecting MECIB's efforts to promote the diversification of Malaysia's export markets, 67.2% of the total guarantee and insurance coverage were provided to facilitate export to countries categorised under non-traditional markets. In terms of distribution by regions, 42.3% of MECIB's total exposures have been channelled to countries in East Asia, followed by Africa (11%), Western Europe (10.2%) and the Middle East (9.8%).

Deposits placed with financial institutions, which formed its largest asset class (47.1%), increased by 27.4% to RM98.1 million in 2004, while investments in securities, declined by 19% to RM69.9 million. In order to meet its obligations, MECIB continued to rely on its shareholders' funds, which had declined slightly to RM75.2 million as at end-2004. The loss percentage, indicating the ratio of claims paid to premiums received, deteriorated to 38.8% as at end-2004 (end-2003: 29.3%).

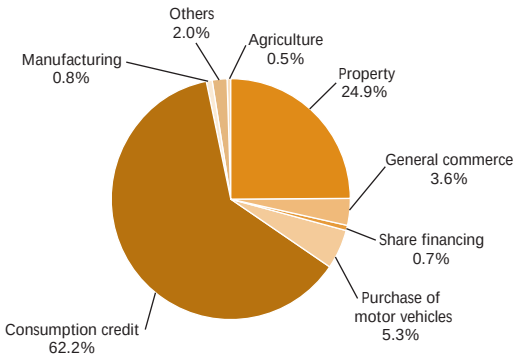
Bank Kerjasama Rakyat Malaysia Berhad

Financing and deposit mobilisation activities of Bank Rakyat, or People's Cooperative Bank of Malaysia, recorded strong growth in 2004. The total assets of Bank Rakyat increased markedly by 29.9% to RM22.3 billion in 2004, in which financing activities, represented 55.3% of total assets. Total financing outstanding grew by 24.1% to RM12.4 billion as at end-2004, mainly attributed to the property sector (61.7% to RM3.1 billion), in line with favourable growth of the housing sector. Similarly, consumption credit registered an increase of 12.2% to RM7.7 billion as consumer spending revived strongly during the year. In terms of sectoral distribution, 62.2% of the financing outstanding was for consumption credit, 24.9% was extended to the property sector, followed by the transport and communication (5.3%) and general commerce (3.6%) sectors. Lending to members accounted for 78.2% of total financing outstanding. During the year, new financing approved and disbursed amounted to

Graph 7.4
Malaysia Export Credit Insurance Berhad: Contingent Liabilities as at 31 December 2004



Graph 7.5
Bank Kerjasama Rakyat Malaysia Berhad: Direction of Financing as at 31 December 2004



RM4,815.2 million and RM4,842.8 million respectively (2003: RM3,727.8 million and RM3,666.4 million respectively).

Gross non-performing financing (NPF) increased marginally to RM1,088.1 million as at end-2004 (end-2003: RM1,066.1 million). However, the gross NPF ratio improved to 8.8% from 10.7%, due to the enlarged loan base. The net NPF ratio has also improved to 4.4% from 5.2%.

Financing activities of the bank were largely funded by deposits which amounted to RM17.1 billion as at end-2004, representing 76.7% of the bank's total funds. Deposits mobilised by the bank registered a strong growth of 30.6% (RM4 billion) in 2004 mainly due to the relatively attractive returns offered by the bank. Deposit placements by business enterprises rose markedly by 31.9% to RM11.5 billion, of which private enterprises accounted for 63.4% while the balance was from public enterprises. Deposits mobilised from individuals also grew strongly in 2004, recording an increase of 34.1% to RM2.2 billion as at end-2004.

The bank's shareholders' funds rose to RM3.5 billion as at end-2004 (end-2003: RM2.5 billion) attributed to the substantial growth in members' shares and subscription funds, which increased by 47.1% (RM623.6 million) to RM1.9 billion as at end-2004. During the year, the individual membership of Bank Rakyat increased by 84,836 to 714,743 whilst cooperative membership increased by 105 to 1,172. The increase in membership was attributed mainly to the ability of the bank to pay relatively attractive rates of dividend and the privilege loan rate offered to members. The bank's improved performance (profit before tax and *zakat* increased from RM401 million in 2003 to RM460 million in 2004) also contributed to the increase in shareholders' funds.

Bank Simpanan Nasional

Deposits mobilised by BSN, or National Savings Bank, as well as retail loans to small borrowers and micro credit extended by BSN recorded strong growth during the year. As at end-2004, BSN operated through 393 branches and 599 ATMs covering both the urban and rural areas.

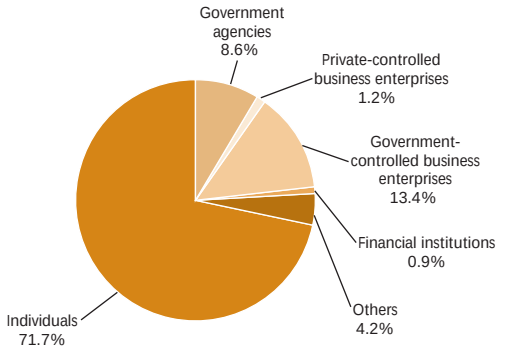
Deposits outstanding increased by 16.4% or RM1.6 billion during the year to RM11 billion. Savings of individuals, which formed the largest component (71.7%) of the deposit base, recorded a growth of 8.5% (RM619.7 million) to RM7.9 billion, partly reflecting the requirement of BSN for micro credit borrowers to maintain an account with the bank.

Deposits from business enterprises meanwhile, rose by 65.6% (RM635.8 million) contributed by an increase in fixed deposits from Government-controlled business enterprises. Saving deposits represented 47.6% of the total deposits, while fixed deposits comprised 42.4% and the remaining was general investment deposits. The number of account holders increased from 10.3 million as at end-2003 to 11.4 million as at end-2004. About one-half of deposits accepted were invested in securities, amounting to RM5.6 billion as at end-2004, of which RM3.3 billion were investments in Government securities. The balance was largely utilised to finance lending operations.

Loans outstanding registered a strong growth of 30.4% during the year from RM2.4 billion to RM3.2 billion as at end-2004, due mainly to the significant growth of personal loans from RM126.5 million to RM738.8 million, benefiting from BSN's vigorous promotion of its repackaged personal loan scheme that attracted more borrowers. Apart from personal loans, the bulk of loans outstanding as at end-2004 was mainly in the form of housing loans (RM1,135.9 million), micro credit (RM610.7 million) and purchase of motor vehicles (RM446.8 million). In 2004, the micro credit scheme recorded an increase of RM195.1 million or 46.9%. Since the launch of the micro credit scheme in June 2003, a total of RM723 million has been disbursed to 82,657 applicants mainly to food stall businesses, retail trading activities and business services.

Gross NPLs increased by RM151.2 million to RM449.9 million as at end-2004, attributed to an increase in NPLs of micro credit and housing loans. The gross NPL ratio deteriorated to 14.1% (end-2003: 12.2%) whilst the net NPL ratio increased to 7.7%, as at end-2004 (end-2003: 6.7%).

Graph 7.6
Bank Simpanan Nasional:
Total Deposits Accepted as at 31 December 2004

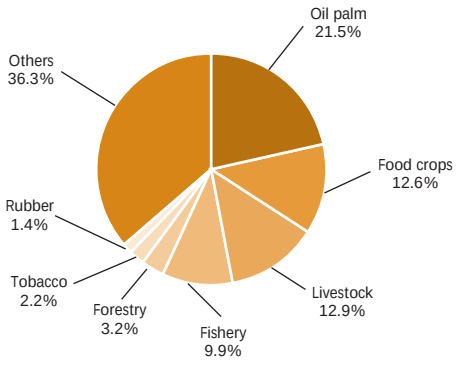


Bank Pertanian Malaysia

BPM, or Agriculture Bank of Malaysia, registered a favourable growth in its financing activities in 2004. Consistent with its role to provide financing to promote sound agricultural development in the country, BPM provided financing for various agricultural activities namely, production, processing and marketing of agriculture products. In 2004, total loans outstanding grew by 14.8% to RM3.1 billion (2003: RM2.7 billion), attributed largely to the strong growth (318.8%) for loans to agro-based processing and support services industries. While BPM continued to provide financing support to the more established agriculture sector, such as oil palm, there was increased focus in 2004 on new areas of financing in the agro-based processing and support industries. During the year, loans outstanding to the oil palm industry declined to RM661.2 million to account for 21.5% of total loans outstanding (2003: RM696.2 million or 26% of total loans outstanding).

Small farmers remained the main beneficiaries of BPM loans, accounting for 98.4% of total number of borrowers. In 2004, BPM approved loans totalling RM1.1 billion involving 46,843 borrowers. Excluding loans for micro credit scheme, loan approvals in 2004 increased by 62.5% to RM1,091.5 million (2003: RM671.6 million), whilst loans disbursed increased by 65.7% to RM918.5 million (2003: RM554.4 million). During the year, BPM managed 12 funds established by the Government to promote the agriculture sector. Since the launch of the micro credit scheme in June 2003, BPM has approved 17,729 applications with a value of RM202 million as at end-2004. A total of RM199.3 million was disbursed to borrowers, mainly involved in agro-based projects, marketing, cash crop cultivation and livestock rearing.

Graph 7.7
Bank Pertanian Malaysia:
Direction of Lending as at 31 December 2004



In 2004, the loans outstanding for the micro credit scheme declined by 31% or RM52.5 million as the RM200 million allocated for the micro credit scheme had been fully utilised.

Gross NPLs increased to RM1.2 billion as at end-2004 representing 40.3% of total loans (end-2003: RM887.6 million or 33.1%). The increased ratio was largely attributed to the change in NPL classification policy, from 12 months to 6 months of default. Net NPL ratio increased to 22.8% as at end-2004 (end-2003: 15.3%).

Loans remained the largest asset component, representing 47.3% of the total assets of RM6.5 billion, followed by investments which formed 26.3% (RM1.7 billion) of total assets. The investments were mainly in private debt securities (38.3%), unit trusts (32.5%) and commercial papers/promissory notes (18.3%).

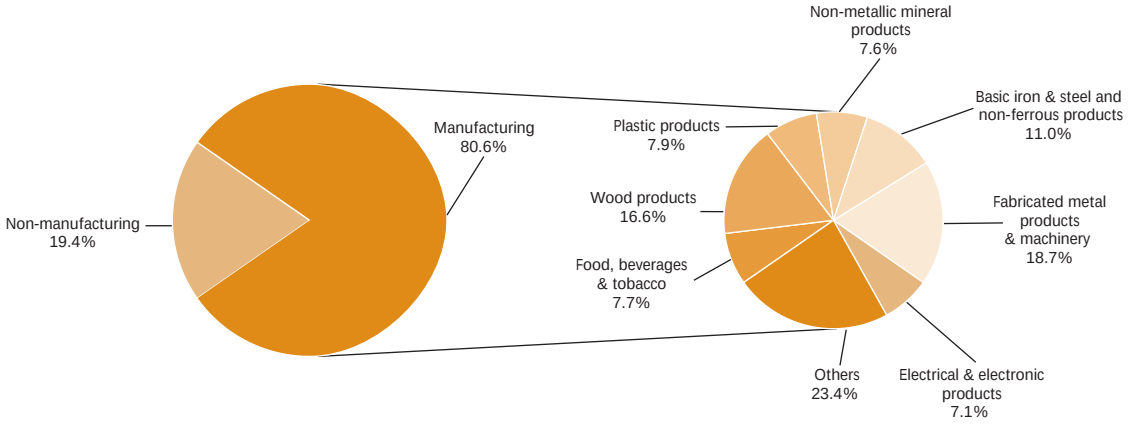
The main sources of funding for BPM were deposits mobilised through its network of 181 branches and 5,135 mobile units nationwide. In 2004, deposits mobilised increased by 8.7% to RM4.1 billion (2003: RM3.8 billion) accounting for 63.3% of total resources. Borrowings from the Government which were mainly for the various Government financing schemes increased by 4.5% to RM1.6 billion as at end-2004 (end-2003: RM1.5 billion).

Malaysian Industrial Development Finance Berhad

Financing activities of Malaysian Industrial Development Finance Berhad (MIDF) aimed at promoting the development of the manufacturing sector, recorded a marginal increase in 2004. As one of the implementing institutions to manage and disburse funds for the Government, MIDF was designated as the disbursing channel for the new Soft Loan Scheme for Information and Communication Technology in 2004. The main emphasis of this scheme is to improve the competitiveness and efficiency of SMEs through the usage of information and communication technology. MIDF also introduced the Fund for Cross Border Investment in Manufacturing in June 2004. The objective of the fund is to assist Malaysian companies to establish or expand their operations offshore to take advantage of lower labour costs, especially in countries within the ASEAN region.

Total loans outstanding increased marginally by 0.9% or RM9.8 million to RM1.1 billion as at year-end due to competitive financing package offered by banking institutions. Loans outstanding of the manufacturing sector shrunk from RM932.7 million to RM918.7 million as at end-2004, accounting for 80.6% of total

Graph 7.8
Malaysian Industrial Development Finance Berhad: Direction of Lending as at 31 December 2004



loans (end-2003: 82.5%). The major beneficiaries in the manufacturing sector were the fabricated metal products and machinery industry (18.7%), wood products industry (16.6%) and basic iron and steel and non-ferrous products industry (11%). Meanwhile, loans outstanding to manufacturing SMEs accounted for 48.8% of total loans.

During the year, total loans approved decreased by 5.6% to RM466.1 million (2003: RM493.7 million). The major decrease in the manufacturing sector was recorded in the transport equipment industry (82.9% or RM41.4 million), basic iron and steel and non-ferrous products industry (49.9% or RM18.9 million) and food, beverages and tobacco industry (26% or RM17.7 million). Consequently, loans disbursed for manufacturing also decreased by 10.3% to RM241.9 million (2003: RM269.7 million).

Based on a 3-month classification policy, gross NPLs increased to RM362 million, accounting for 31.7% of total loans as at end-2004 (end-2003: RM337.9 million or 29.9%). The net NPL ratio increased to 10.4% from 3.3% in 2003.

Shareholders' funds and borrowings remained the main sources of funds for MIDF. Shareholders' funds increased to RM1.4 billion as at end-2004 (end-2003: RM1.3 billion) mainly attributed to the dividend income received from subsidiaries and profit from the sale of its subsidiaries arising from its Group restructuring exercise. Meanwhile, borrowings which totalled RM1.1 billion, registered a decline from RM1.2 billion as at end-2003. The borrowings included RM689.9 million sourced directly or indirectly from the Government to be on-lent for socio-economic purposes. MIDF also relied on funds from the capital market to fund its lending activities. As at end-2004, funds raised from the capital market amounted to RM400.3 million (end-2003: RM528.8 million).

Credit Guarantee Corporation Malaysia Berhad

CGC continued to contribute favourably towards ensuring continuous access to financing by the SMEs, through the provision of a wide range of guarantee schemes and ancillary services to facilitate financing by the banking institutions to the SMEs. To supplement the financial assistance offered through the guarantees provided, CGC launched its Client Service Centre (CSC) in August 2004, particularly to cater for enquiries pertaining to matters such as information on the guarantee schemes offered and application procedures by potential borrowers, as well as enquiries from the banking institutions about the status of applications and claims.

Total guarantees outstanding increased by 9.9% (2003: 18.3%) to RM3.3 billion as at end-2004 with the continued strong growth registered by the major guarantee schemes, namely, the Direct Access Guarantee Scheme (DAGS) as well as the revised New Principal Guarantee Scheme (NPGS) and Islamic Banking Guarantee Scheme (IBGS), which together recorded a growth of 144.1% (2003: 158.3%). The strong growth was partly attributed to the revised NPGS and IBGS that have enabled SMEs from all economic sectors to obtain higher financing to a maximum of RM10 million from the financial institutions (previously: a maximum of RM5 ~ 7.5 million for SMEs from all

other sectors, except the manufacturing sector). Increasing preferences of SMEs for Islamic financing also contributed to the favourable performance of the IBGS.

Reflecting the continuous support provided to the smaller SMEs, loans below RM250,000 continued to form the largest component of loans to have benefited from CGC's guarantee schemes, accounting for 81.7% (2003: 88.2%) of the total number of loans guaranteed. In terms of value guaranteed, loans of between RM500,000 to RM1 million accounted for 32% of total guarantees outstanding, followed by those between RM250,000 to RM500,000 (27%) and loans of below RM250,000 (24.3%). Guarantees provided for loans of above RM1 million remained the lowest at 16.7% of total guarantees outstanding. In terms of guarantee coverage by sector, SMEs involved in the general business sector remained the main beneficiaries of CGC's guarantee schemes. The guarantee coverage extended to this sector accounted for three quarters of total guarantees outstanding, followed by those extended to the manufacturing (24%) and agriculture (1.3%) sectors.

Total provision for claims increased by 8.3% to RM469.6 million as at end-2004 (end-2003: RM433.6 million), reflecting the increase in loans guaranteed that had turned non-performing. Total claims paid to the banking institutions also increased by 33.6% to RM123.7 million in 2004 (2003: RM92.5 million).

Loans outstanding under the various special loan schemes administered by CGC declined by 35.2% to RM593.2 million as at end-2004 (end-2003: RM915.8 million). This was due mainly to the decline in loans outstanding sourced from Bank Negara Malaysia funds following the change in the funding arrangements since November 2002. Bank Negara Malaysia has now channelled the funding for these special loan schemes directly to the banking institutions for lending to SMEs.

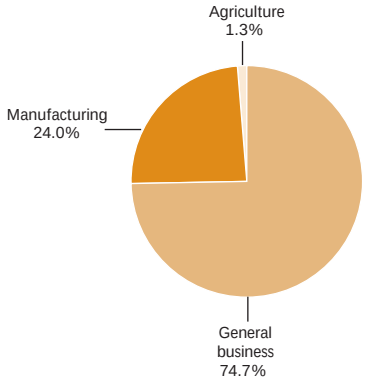
CGC continued to rely on its shareholders' funds (RM2.1 billion) and borrowings from the Government (RM1.8 billion), which together accounted for 85.9% of the total source of funds, to back the guarantees issued and fund its lending operations. The funds were largely placed with banking institutions (RM3.8 billion).

Lembaga Tabung Haji

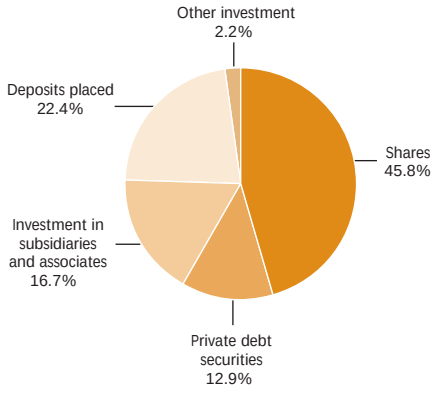
LTH, or Pilgrims Fund Board, recorded a growth in its deposit mobilisation activities in 2004. Total deposits outstanding increased by 7.1% or RM798.8 million to RM12.1 billion while the number of depositors increased from 4.7 million to 4.9 million. As part of the continuous efforts to improve its service to depositors in 2004, LTH has increased its collecting agents to nine from the previous six and opened another branch office to increase the number to 119. In addition, in October 2004, LTH was awarded MS ISO 9001: 2000 Quality Management Systems for its counter services.

Total investments of LTH increased by 8.6% to RM8.7 billion and represented 65.8% of total assets as at end-2004. Deposits placed with financial institutions increased by 34.3% to RM1.9 billion whilst investments in subsidiaries and associates increased by 12.1% to RM1.4 billion. Investment in shares continued to form the largest component, accounting for 45.8% or RM4 billion of total investments

Graph 7.9
Credit Guarantee Corporation Malaysia Berhad: Guarantee by Sector as at 31 December 2004



Graph 7.10
Lembaga Tabung Haji: Investments as at 31 December 2004



(2003: 47.6% or RM3.8 billion), followed by deposits placed with financial institutions which represented 22.4% of total investments. LTH also provided financing to its subsidiaries and other business enterprises, all totalling to RM1.9 billion as at end-2004 (end-2003: RM1.7 billion).

Sabah Development Bank Berhad

Lending activities by Sabah Development Bank Berhad (SDB) turned around in 2004 with total loans outstanding increasing by 17.1% to RM1.5 billion as at end-2004 (end-2003: RM1.2 billion), mainly on account of the strong increase in loans extended to the manufacturing, wholesale and retail trade, real estate, and construction sectors. Loans continued to account for the largest share (75.2%) of the total assets of SDB. As at end-2004, 45.1% of the loans outstanding was for real estate financing, while 10.8% was channelled to the construction sector and 8.7% to the business services sector. During the year, the amount of loans approved and disbursed increased significantly to RM381.5 million and RM314.3 million respectively (2003: RM250.6 million and RM184.3 million respectively).

While gross NPLs increased to RM517.5 million (2003: RM492 million), the gross NPL ratio improved slightly to 35.7% (2003: 39.7%) owing to the larger loan base. A major share (68.7%) of the NPLs were loans to the real estate and business services sectors. Net NPL ratio was lower at 1.4% (2003: 4.6%).

SDB continued to rely on borrowings from financial institutions and deposits from the Government and Government-controlled business enterprises, which collectively contributed to RM1.1 billion or 57.5% of total resources (2003: RM890.6 million or 54%). The bank's shareholders' funds which had increased to RM257.3 million in 2004 (2003: RM228.9 million) also supported SDB's operations.

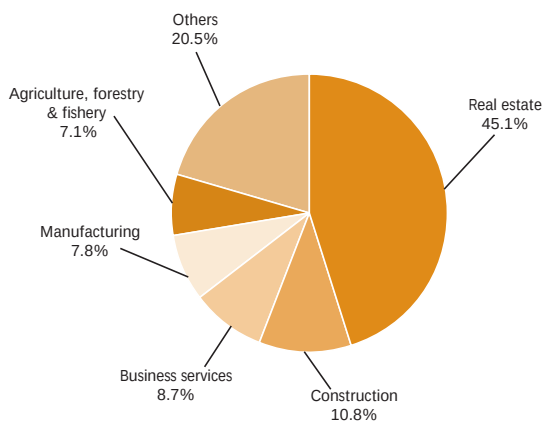
Sabah Credit Corporation

Lending activities of Sabah Credit Corporation (SCC) expanded at a more moderate pace in 2004, with total loans outstanding increasing by 9.1% to RM690.3 million as at end-2004 (end-2003: 18.9% to RM632.8 million). Loans remained the largest asset component, accounting for 93% of total assets of RM742.1 million as at end-2004. The expansion was attributed mainly to consumption credit loans which grew by 28.3%. Riding on the sustained consumer demand, consumption credit loans overtook the declining housing loans financing activity, to account for the largest loan component in 2004. The bulk of the consumption credit loans was for executive loans (72.1%) and the balance for hire purchase financing. Total loans approved and disbursed reduced slightly to RM209.7 million and RM209.2 million respectively (2003: RM236.5 million and RM223.8 million respectively).

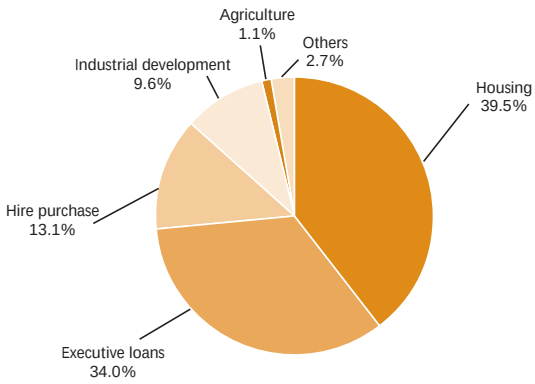
Gross NPLs increased to RM92.6 million (2003: RM86.2 million), attributed mainly to the higher non-performing consumption credit loans. The gross NPL ratio however reduced slightly to 13.4% (2003: 13.6%), relatively due to increase in the loan base. On a net basis, the NPL ratio was at 5.4% (2003: 5%).

Borrowings from the State Government (RM328.8 million) and banking institutions (RM219 million) remained the major sources of funding for SCC, accounting for a combined share of 73.8% of total resources.

Graph 7.11
Sabah Development Bank Berhad:
Direction of Lending as at 31 December 2004



Graph 7.12
Sabah Credit Corporation:
Direction of Lending as at 31 December 2004



Borneo Development Corporation (Sabah) Sendirian Berhad

Property development activities undertaken by Borneo Development Corporation (Sabah) Sendirian Berhad (BDC Sabah) slowed down in 2004. The property development expenditure and progress billings of BDC Sabah, which formed 66.8% of its total assets, declined by 3.1% to RM93.1 million as at end-2004 (end-2003: RM96.1 million).

Due to competitive lending rates offered by banking institutions, total loans outstanding declined further to RM8.9 million as at end-2004 and there was no new lending during the year. Loans to individuals accounted for 69.9% of the amount outstanding, while business enterprises accounted for the balance.

Gross NPLs increased to RM2.7 million, accounting for 30.7% of total loans as at end-2004 (end-2003: RM2.4 million or 25.4%). This was attributed mainly by high NPLs for the purchase of non-residential property, which constituted 94.5% of total gross NPLs.

Borrowings from financial institutions remained the major source of funding for BDC Sabah, which amounted to RM86.7 million or 62.3% of total resources.

Borneo Development Corporation (Sarawak) Sendirian Berhad

Property development and construction activities remained the principal activities of Borneo Development Corporation (Sarawak) Sendirian Berhad (BDC Sarawak) in 2004. The amount of stocks and work-in-progress recorded a further increase of 28% (2003: 63.6%) to RM70.3 million as at end-2004 to account for the largest share (68.1%) of BDC Sarawak's total assets.

Amidst increased competition from the banking institutions, end-financing activities for the purchase of houses remained stagnant for the second consecutive year. As a result, total loans outstanding which comprised largely loans to its staff (97.9%) for the purchase of residential property, declined further to RM0.9 million as at end-2004 (end-2003: RM1 million). Meanwhile, total investments in subsidiary and associate companies totalling RM9.6 million or 9.3% of total assets, recorded a slight decrease (-2.7%) in 2004.

BDC Sarawak sourced its funding mainly from its shareholders' funds (RM37.2 million) and borrowings from financial institutions (RM11 million), which accounted for a combined share of 46.7% of total resources (2003: 62.3%). Deposits by house buyers, totalling RM45.2 million, have also increasingly become an important source of funds for BDC Sarawak, representing 43.8% of total resources (2003: 25.6% or RM24.5 million).

Other Financial Institutions

192 Discount Houses
192-193 Provident and Pension Funds
193-196 Venture Capital
196-197 Unit Trust Industry

Other Financial Institutions

Discount Houses

In 2004, the operations of discount houses continued to expand, albeit at a slower pace. Total resources of discount houses increased by RM1.7 billion or 5.6% (2003: RM2.8 billion or 10.3%). The increase was due mainly to the 18.3% growth of total deposits during the year. Fixed deposits recorded a large increase of RM3.9 billion or 23.4% (2003: RM2.4 billion or 16.5%) with the bulk of the increase being in deposits for maturities of between one to nine months. Meanwhile, call deposits grew at a more moderate pace of 15.2% during the year (2003: 34.2%). Amidst the availability of large supply of funds from deposits, there was less reliance on the interbank market as a source of funds during the year. This was reflected in the RM2.9 billion decline in interbank borrowings.

There was a distinct shift in the uses of funds during the year. Investments in securities declined by RM4.1 billion due mainly to the reduction of holdings of private debt securities and Cagamas debt securities. This shift reflected the discount houses' preference for shorter-term placements in the interbank money market on expectation of higher future interest rates. The decline in PDS holdings also arose out of profit taking activity when yields trended downwards in the second-half year. As a result, the discount houses' interbank placements expanded by more than two-fold to account for 37.8% of the consolidated total assets (2003: 19.2%).

As part of the measures to promote a comprehensive regulatory and supervisory framework for financial institutions, two key prudential requirements were imposed on licensed discount houses in 2004 to safeguard their financial soundness amidst greater competition in the financial sector. Firstly, beginning from September 2004, discount houses' capital adequacy requirements would incorporate their market risk positions and comply with the minimum risk weighted capital ratio (RWCR) requirement of 8% under the revised RWCR framework and the Market Risk Capital Adequacy framework. Upon full compliance in the second quarter of 2005, the revised RWCR framework would align the counterparty risk weights of the existing discount houses' RWCR framework with that of the other licensed banking institutions. This would ensure a level playing field with respect to the provision of capital under the RWCR framework. Secondly, effective from 1 October 2004, discount houses were subjected to the Single Customer Credit Limit (SCCL) requirement under Section 61 of the Banking and Financial Institutions Act 1989 (BAFIA) with respect to all their investments in private debt securities (PDS). This would ensure that discount houses are not overly exposed to a single issuer in their holdings of PDS.

Table 8.1
Discount Houses: Sources and Uses of Funds

	Annual change		At end-2004
	2003	2004	
	RM million		
Sources:			
Approved capital funds	84	238	2,611
Deposits	3,847	4,344	28,094
Interbank borrowings	-1,169	-2,944	615
Others	46	57	564
Total	**2,807**	**1,695**	**31,885**
Uses:			
Investment in securities:	9	-4,146	19,109
Government debt securities	*-571*	*475*	*1,804*
MGS held	*-262*	*572*	*1,407*
Khazanah bonds	*123*	*-173*	*324*
BNM bills	*16*	*-365*	*0*
Private debt securities	*2,397*	*-3,033*	*10,897*
Bankers acceptances	*-2,752*	*822*	*4,059*
Negotiable instruments of deposit	*752*	*-289*	*559*
Cagamas debt securities	*610*	*-1,093*	*1,076*
Others[1]	*-567*	*-491*	*391*
Interbank palcements	1,921	6,230	12,039
Others	877	-389	738
	2002	**2003**	**2004**
Number of discount houses	7	7	7

[1] Includes Danaharta and Danamodal bonds.
Note: Total may not add up due to rounding.

During the year, discount houses' fee-based activity moderated in line with the lower PDS issuance in the capital market. The industry arranged, lead-managed and co-managed the issuance of PDS worth RM5.9 billion (2003: RM9.8 billion). Meanwhile, the total amount underwritten by the discount houses was RM1.4 billion (2003: RM2.6 billion) for 42 PDS issues (2003: 31 issues).

Provident and Pension Funds

Total resources of the provident and pension funds (PPFs) surveyed by Bank Negara Malaysia expanded further by 9.3% to RM291.3 billion in 2004. The Employees Provident Fund (EPF), as the largest fund,

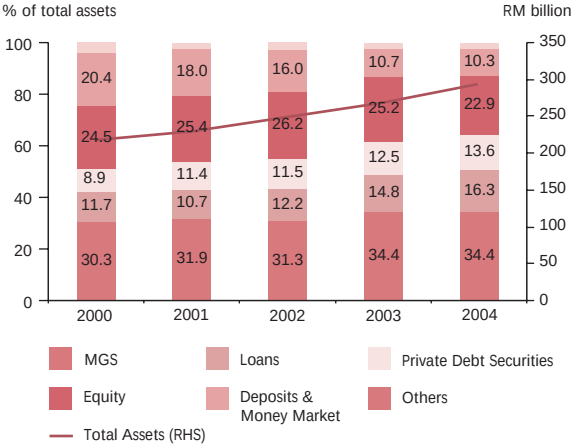
Table 8.2
Provident and Pension Funds: Selected Indicators

	2003	2004*p*
	RM million	
As at end		
Number of contributors ('000)	*20,698*	*21,152*
of which: EPF	*10,490*	*10,706*
: SOCSO	9,997	*10,239*
Accumulated contributions	240,334	262,584
Assets	266,538	291,331
of which: Investments in MGS	*91,596*	*100,317*
During the year		
Net new contributions	12,014	12,400
Gross contributions	*24,247*	*26,238*
Withdrawals	*12,234*	*13,839*
Dividends credited	9,324	11,391
Investment income	12,893	13,447

p Preliminary

Source: Employees Provident Fund, Pension Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and three other private provident and pension funds.

Graph 8.1
Provident and Pension Funds: Major Asset Composition



accounted for 82.5% of the total funds of PPFs. As at end-2004, the accumulated contributions, which accounted for 90.1% of the total resources of the PPF, increased by 9.3% (2003: 9.2%). The strong growth in accumulated contributions was mainly attributed to the significant increase of 22.2% in dividends credited in 2004 (2003: 15.7%). Meanwhile, net new contributions to the PPFs continued to grow, albeit at a slower rate of 3.2% in 2004 (2003: 16.2%). The slower growth was due to higher withdrawals during the year.

During the year, gross contributions of the PPFs surveyed increased by 8.2% (2003: 1%), in line with growth in the number of contributors. Withdrawals increased by 13.1% in 2004 (2003: -10.5%), attributable largely to withdrawals from the EPF for investment purposes, which increased by 47.9% in 2004 (2003: 8.7%). This increase was consistent with the higher sales of unit trust funds during the year. Withdrawals for housing purposes also grew strongly, by 10.9% in 2004 (2003: 2.1%), reflecting the robust demand for residential properties. Meanwhile, growth in EPF withdrawals by pensionable employees, which accounted for the largest share (36.8%) of total EPF withdrawals, moderated to 12.3% in 2004 (2003: 19.1%).

Higher investment income enabled the PPFs to distribute higher dividends to contributors in 2004. The EPF declared a dividend rate of 4.75% in 2004 (2003: 4.5%) as the investment income of the EPF grew by 7.1% to RM11.8 billion on the back of higher returns from investments in private debt securities and from its lending activity. Income from equity investments was also higher due to the stronger performance of the Malaysian stock market. In total, investments in debt and equity instruments contributed 52.2% of the total investment income of the EPF in 2004.

In terms of the asset composition of the PPFs, there was a marginal decline in the holdings of deposits and money market papers, given the low interest rate environment. Higher allocation was given for investments offering higher returns. Thus, the share of private debt securities and loans increased to 13.6% and 16.3% respectively, while the share of deposits and money market papers declined to 10.3% as at end-2004.

As announced in the 2005 Budget, the EPF took steps to allocate RM800 million to external fund managers. Another RM1.75 billion per annum will be channelled over the next three years to local fund management companies. As a result, funds outsourced to local fund managers will increase to RM12 billion. This initiative is expected to enhance investment returns, as well as to promote the development of a larger pool of skilled investment management professionals to foster greater depth in the Malaysian fund management industry, as envisaged under the Capital Market Masterplan.

Venture Capital

The venture capital (VC) industry in Malaysia progressed further as a new source of financing for the economy in 2004. Further expansion was recorded in 2004, in terms of the total size of funds, total investments from both local and foreign sources, number of venture capital fund

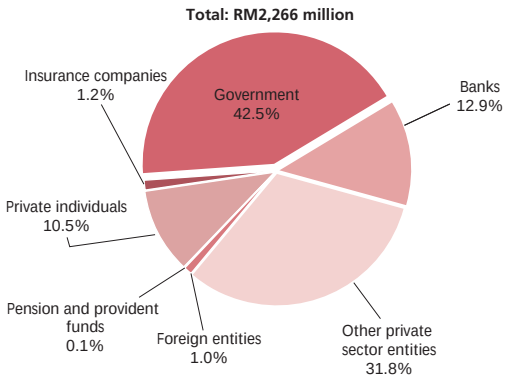
Table 8.3
Key Statistics on the Venture Capital Industry

	As at end-2003	As at end-2004
Venture capital funds (RM million)	2,118.1	2,266.0
Total investment (RM million)[1]	878.7	1,058.0
Local sources (RM million)	769.0	887.7
Foreign sources (RM million)	109.6	170.3
No. of venture capital companies/funds	43[2]	38
No. of venture capital fund management companies	31[2]	34
No. of investee companies	298	332
	During 2003	**During 2004**
Total investment (RM million)	227.2	289.3
Local sources (RM million)	192.5	248.4
Foreign sources (RM million)	34.8	40.9
No. of investee companies	115	139

[1] Including divestment activities
[2] Based on Bank Negara Malaysia's definition

Source: Securities Commission

Graph 8.2
Sources of Venture Capital
(% share, as at end-2004)



Source: Securities Commission

management companies and number of investee companies. Total available funds for VC investments grew by 7% to RM2.3 billion. While investment from domestic sources recorded an increase of 15.4%, investment from foreign sources recorded a significant growth of 55.4%. By the end of 2004, the total number of investee companies had increased to 332 companies, involving a total investment of RM1.1 billion.

The Government gave further support for the development of the VC industry. In the 2005 Budget, the Government announced that foreign VC players would now be allowed to own 100% equity participation in venture capital and venture capital fund management corporations in Malaysia. The move, among others, is expected to encourage higher inflows of funds and skilled workforce, as well as promote technology transfer.

The Cradle Investment Program (CIP), which was administered and managed by the Malaysia Venture Capital Management Berhad (MAVCAP), continued to provide pre-seed funding and entrepreneurial support to aspiring entrepreneurs with the commitment to develop and commercialise their ideas. As at end-February 2005, grants totalling RM7 million were given to 141 recipients. In terms of sectors, CIP investment was mostly concentrated in software (26.95%), consumer/business products (12.77%) and e-services (7.1%). In addition, CIP also collaborated with several key Government bodies to further tap the country's pool of budding entrepreneurs and innovators. CIP currently has 16 'community partners', which include Government Ministries and agencies, and private sector organisations. These 'community partners' are expected to support CIP's objectives through joint initiatives and activities, such as the entrepreneur development programme, and mentoring and commercialisation partnerships.

MAVCAP continued to offer financing to local high-growth information and communications technology companies throughout 2004. As at end-February 2005, MAVCAP had invested RM300 million and nurtured 60 companies.

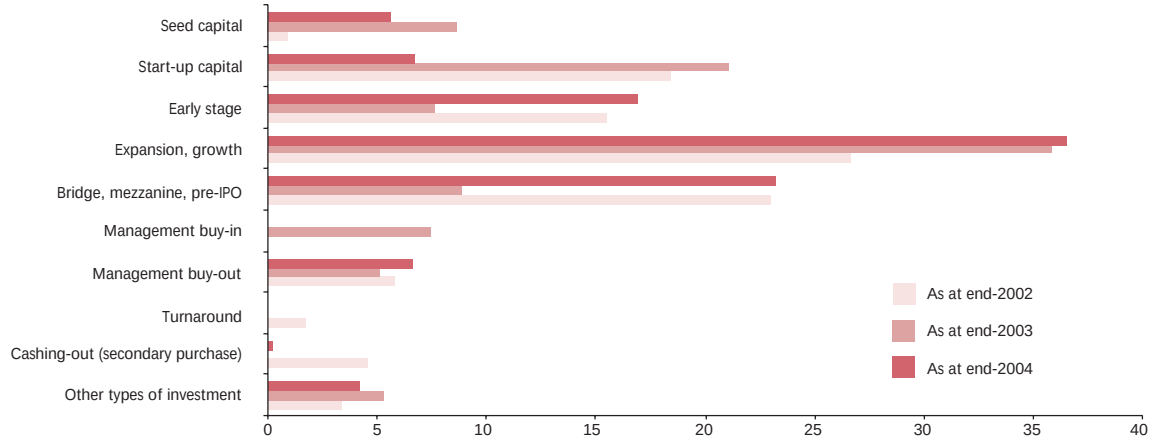
While funds from Government sources remained high, the contribution of funds for VC investments coming from domestic private sector entities recorded a significant increase of 35.1% in 2004. Funds from the insurance companies also increased substantially to RM27 million in 2004, from RM2.4 million in 2003. Funds available from foreign sources increased substantially to RM170.3 million. Funds

Table 8.4
Investment by Stages during 2004

No. of Investee Companies	139	
Business Stage	RM mil	% share
Seed capital	16.1	5.6
Start-up capital	19.3	6.7
Early stage	48.9	16.9
Expansion, Growth	105.8	36.6
Bridge, Mezzanine, Pre-IPO	67.2	23.2
Management buy-out	19.2	6.6
Management buy-in	...	...
Cashing-out (Secondary purchase)	0.6	0.2
Other types of investment	12.1	4.2
Total	**289.4**	**100.0**

Source: Securities Commission

Graph 8.3
Outstanding Investment by Stages (% share)



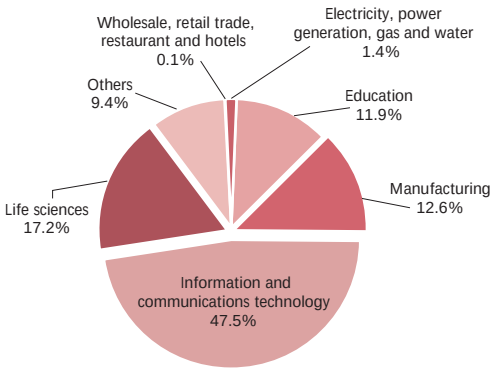
Source: Securities Commission

from Government sources constituted a lower share of 42.5% in 2004 (2003: 54.2%).

In terms of stages, VC investments, during the year, were mainly focussed on the expansion/growth, bridge/mezzanine/pre-IPO and the early stages. These investments represented 76.7% of all VC investments in 2004. Investments in the more risky stages, including the seed capital and the start-up capital stages, declined from 29.8% in 2003 to 12.3% in 2004. Investments in other stages also declined.

In terms of outstanding investments by stages, the expansion/growth, bridge/mezzanine/pre-IPO and start-up capital stages received the bulk of VC investments since 2002.

Graph 8.4
Investment in 2004
(% share of total)



Total Investment: RM289.4 million
Number of Investee Companies: 139

Source: Securities Commission

In terms of investments by sector, the information and communications technology (ICT), life sciences and manufacturing sectors continued to receive most of the financing. In total, the amount of VC investment in these three sectors constituted 77.3% of total investment made in 2004. In terms of the outstanding size of funding at end-2004, the sectors which received most of the VC investment were the ICT sector (42.2% of total), the manufacturing sector (25.4%) and the life sciences sector (18.4%). The three sectors accounted for RM910.1 million or 86.0% of total funds invested. During the year, domestic VC funds were concentrated in ICT (48.7%), education (13.8%), and manufacturing (12.9%) sectors, while foreign VCs mainly invested into life sciences (49.9%), ICT (39.8%) and manufacturing (10.2%) sectors. Compared with 2003, there was an apparent shift in investment preference as the bulk of

Table 8.5
Outstanding Venture Capital Investment by Sectors

	As at end-2004	
	RM mil	% share
Information and communications technology	446.2	42.2
Manufacturing	269.2	25.4
Life sciences	194.7	18.4
Education	38.4	3.6
Electricity, power generation, gas and water	17.4	1.6
Wholesale, retail trade, restaurant and hotels	10.3	1.0
Financing, insurance, real estate and business services	6.8	0.6
Construction	0.1	0.0
Transport, storage and communications	0.0	0.0
Others	74.9	7.1
Total	**1,058.1**	**100.0**

Source: Securities Commission

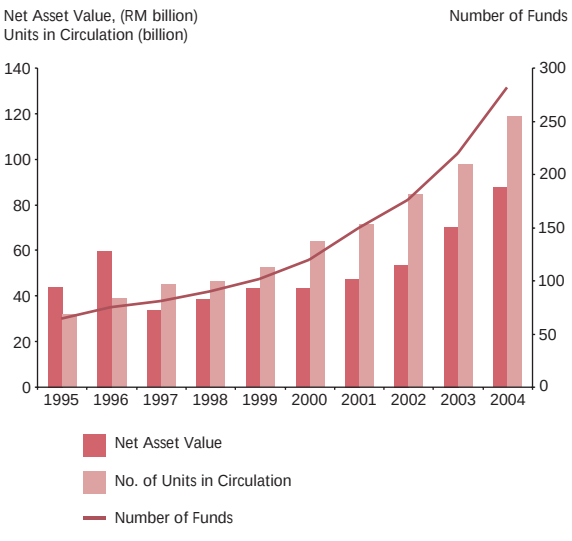
the domestically-sourced VC investments were more focussed on the ICT sector, a move away from the previous focus on the manufacturing sector, while foreign VCs shifted their preference from the ICT sector to the life sciences sector.

The development of VC financing will continue to be keenly promoted in view of its significance in nurturing new growth areas as well as to serve as an alternative source of financing to the economy as a whole. Further efforts will be directed towards greater capacity building in terms of skills upgrading and access to private sector financing. To accelerate the development of the VC industry, a sound network of business angels, diversified sources of funds and a large pool of highly skilled knowledge workers are being developed. Constraints in the supply of innovations would be addressed with the improvement of deal flows through the development of a critical mass of high growth-potential investees. In order to assist the cultivation of better entrepreneurship culture, efforts are being directed at providing the necessary business and regulatory environment, ensuring access to financing at the earlier stages of innovation and reviewing existing policies relating to the commercialisation of ideas.

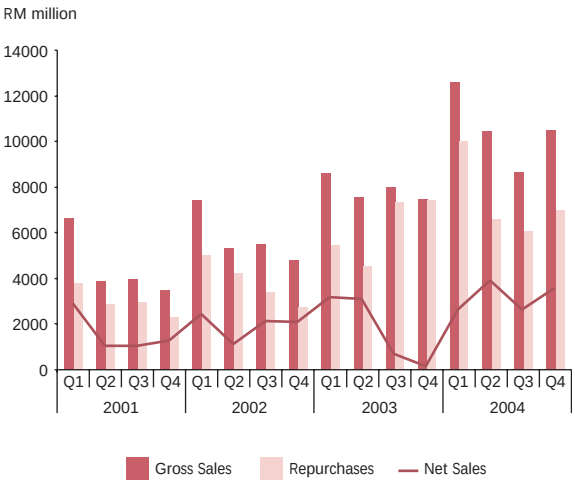
Unit Trust Industry

The unit trust industry experienced significant growth in 2004, reflecting the growing acceptance of unit trusts as an important investment vehicle for the public. During the year, a total of 62 new unit trust funds were launched (2003: 44), bringing the total number of funds to 281 as at end-2004 (end-2003: 219). The level of gross sales was consistently high throughout the year, resulting in total gross sales for the year rising by 33.4% (2003: 37.5%). While repurchases were also generally higher compared with previous years, the industry nevertheless registered its strongest annual net sales of RM12.6 billion (81.9% higher than in 2003).

Graph 8.5
Unit Trust Industry - NAV, Units in Circulation and Number of Funds



Graph 8.6
Unit Trust Industry - Gross Sales, Repurchases and Net Sales

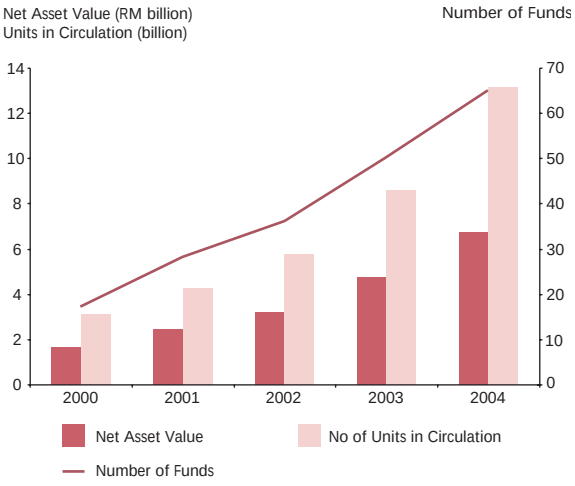


One of the main factors contributing to the growing demand is the availability of a greater variety of unit trust funds, which cater to the diversified risk and return requirements of different investors. The funds approved by the Securities Commission (SC) in 2004 ranged from general equity and bond funds, to funds that invest significantly in more risky securities/ instruments. In addition, there were also funds designed exclusively for institutional investors which carried a higher minimum initial investment amount. Other new unit trust funds introduced included those differentiated by investment strategy, asset allocation, level of risk and distribution policies.

Reflecting stronger investor demand for Islamic financial products, the Islamic unit trusts industry continued to grow at a rapid pace. In 2004, 15 new Islamic funds were launched (2003: 14), bringing the total number of Islamic funds to 65. The net asset value (NAV) of Islamic funds, which grew by 42.3% in 2004, accounted for 7.7% of total NAV of the unit trust industry as at end-2004 (end-2003: 6.8%).

Real estate investment trusts, or REITs (previously known as property trust funds), were first established and launched in Malaysia in 1988. Recognising the

Graph 8.7
Islamic Unit Trusts - NAV, Units in Circulation, and Number of Funds



potential of REITs as an alternative investment vehicle to facilitate financial planning by Malaysian investors, as well as its potential in enhancing liquidity in the local property market, the Government undertook a series of measures in 2004 to spur the development of REITs. These measures included favourable tax treatment as announced in the 2005 Budget, and the introduction of the Guidelines on Real Estate Investment Trust by the SC to attract new players and enhance awareness amongst local industry players and property owners/developers on the benefits of establishing a REIT.

There remains great potential for the Malaysian unit trust industry to expand further despite its significant growth in the last few years. The penetration level, as measured by the ratio of the net asset value of the unit trust industry to equity market capitalisation, remains low in Malaysia relative to countries with more mature financial systems, such as the United States and United Kingdom. Greater investor awareness and knowledge of financial planning and available financial products is essential for more rapid development of the unit trust industry. Towards this end, the authorities, in collaboration with industry players and associations, have undertaken continuous education programmes such as seminars, workshops and road shows on financial planning, and on unit trust investments in particular.

In addition, efforts to widen the distribution channels, such as through the introduction of the Guidelines on Online Transactions and Online Activities in Relation to Unit Trusts to enable the use of the internet and other electronic mediums for promoting, distributing and providing information to investors, would also help to spur further expansion of the Malaysian unit trust industry.

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Financial Markets

Financial Markets

Overview

In 2004, the financial markets continued to function effectively in mobilising and allocating funds to serve the needs of investors and corporates, and to facilitate market-based competitive financing for Malaysian businesses and the public sector. Total funds raised from the capital market in 2004 continued to be significant. After accounting for redemptions, net funds raised from the capital market remained high at RM42.7 billion (2003: RM50.4 billion). The Federal Government continued to tap the domestic market to finance its development activity, given the ample liquidity situation. The public sector raised a higher net amount of RM26.7 billion (2003: RM24.7 billion), accounting for 62.5% of total funds raised from the capital market. Meanwhile, net funds raised by the private sector through the equity and bond markets declined by 37.6% to RM16 billion, due mainly to the lower issuance of private debt securities (PDS). A major reason for this decline was the completion of most corporate restructuring activity, and the bulk of the new funds sourced were to finance new activities. Overall, financing of the economy through PDS issuance remained significant, accounting for 23.7% of total private sector financing obtained through PDS and loans.

In the equity market, fund raising activity was supported by the positive market performance and the improved economic fundamentals. The Kuala Lumpur Composite Index (KLCI) rose by 14.3% to reach 907.43 points as at end-2004, the highest year-end level since the Crisis in 1997. Total funds raised from the equity market amounted to RM6.5 billion, arising mainly from the listing of 72 companies on the Bursa Malaysia, the highest since 1998. The higher number of new listings, especially by small to medium capitalised companies, reflected the improvement in domestic investment activity, especially in the new growth areas of the economy.

The financial markets continued to play an important role as a vital source of financing for the economy. Efforts were undertaken to further develop the financial markets as an efficient allocator and mobiliser of investible funds.

Graph 9.1
Net Funds Raised in the Capital Market by the Public and the Private Sectors

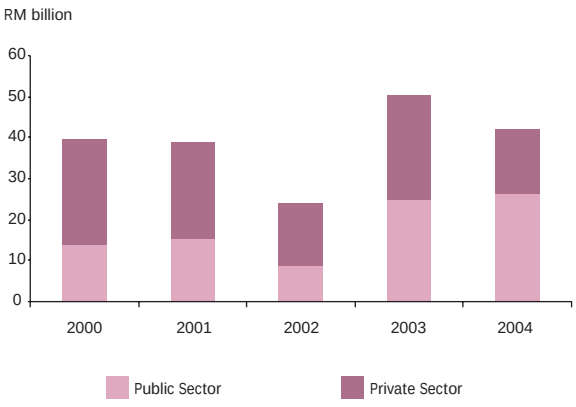


Table 9.1
Funds Raised in the Capital Market

	2003	*2004p*
	RM million	
By Public Sector		
Government Securities (gross)	41,262	43,173
Less Redemptions	18,600	18,200
Less Government holdings	0	0
Equals Net Federal receipts	22,662	24,973
Khazanah Bonds (net)	346	-1,198
Government Investment Issues (net)	1,729	1,423
Malaysia Savings Bond/Merdeka Savings Bond (net)	-9	1,474
Net Funds Raised by Public Sector	**24,729**	**26,671**
By Private Sector		
Shares	7,772	6,475
Debt securities		
Issuance (gross)	50,975	36,340
Less Redemptions	33,123	26,814
Equals Net Issues	17,853	9,526
Net Funds Raised by Private Sector	**25,624**	**16,001**
Total Net Funds Raised	**50,353**	**42,672**
Short-term papers and notes (net)[1]	3,753	-3,208
Total	**54,106**	**39,465**

[1] Refers to Commercial Papers and Cagamas Notes. For 2003, include Medium Term Notes
p Preliminary

In the PDS market, the low inflation and interest rates environment coupled with the strengthening economic fundamentals were the main factors contributing to the continuous supply of new PDS, with a total issuance of RM36.4 billion. The PDS market remained the preferred avenue for financing by companies involved in the utilities and construction sectors, which accounted for 59.5% of the total funds raised by the private sector (excluding Cagamas Berhad). In terms of utilisation of bond proceeds, 46.5% of total issuances were for financing new activity, the highest share recorded since the Crisis. This encouraging development provided further evidence of improvement in private investment activity in the Malaysian economy. A significant development in the domestic bond market was the introduction of new asset classes. Several new instruments including the Residential Mortgage Backed Securities and ringgit bonds by the multilateral development banks were issued during the year.

In terms of market transaction and trading activity, both the Kuala Lumpur interbank foreign exchange market and the exchange-traded derivatives market recorded robust activity with volumes increasing by 44% and 32%, respectively. In the equity, bond and money markets, trading volume declined slightly during the year. Trading of money market papers during the year was influenced largely by changing market expectations on the prospects for economic growth and the direction of interest rate.

The increased transactions in the Kuala Lumpur foreign exchange market can be attributed to increased trade and investment activity, as well as greater volatility in the major currencies. The increased volatility in the foreign exchange markets encouraged currency traders to diversify and to hedge portfolios as well as to trade on opportunities arising from exchange rate movements.

On Bursa Malaysia Derivatives, trading activity was concentrated on CPO futures and KLCI futures, which together accounted for 93.7% of total trade. Of significance was the higher annual growth of 229% recorded in the KLCI futures, due mainly to the better performance in the underlying equity market as well as measures taken by Bursa Malaysia Derivatives to reduce margin requirements and transaction costs in late 2003. To further enhance the risk management tools for palm oil traders, the Palm Kernel Oil Futures was launched, allowing market participants to better manage their exposures to palm oil prices.

On the developmental front, the Government and the relevant authorities continued to support the further growth and strengthening of the domestic financial markets towards achieving higher levels of efficiency, resilience and competitiveness. Of significance, several liberalisation measures were introduced to allow foreign stockbrokers, futures brokers and fund managers to operate in Malaysia. In addition, non-resident companies were exempted from withholding tax on interest income earned on holdings of ringgit-denominated debt securities issued by the Government as well as debt securities approved by the Securities Commission. These developments continued to further widen the investors' profile in the domestic capital market. Details are contained in the white box on **Key Capital Market Measures in 2004**.

Money Market

Activity in the money market was slightly lower in 2004, as reflected by the decline in the trading volume of both interbank deposits and money market papers.

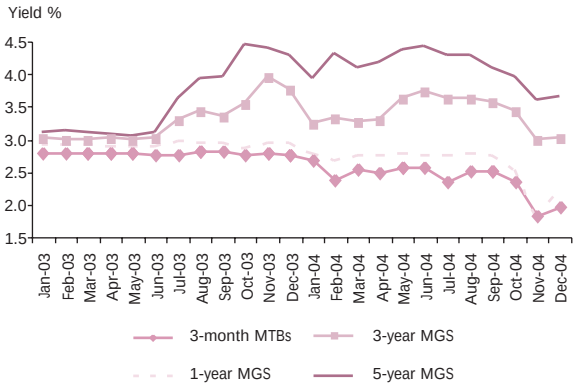
Amidst an environment of stable interbank rates and continued ample liquidity throughout the year, the volume of transactions in the interbank deposit market declined by 2.5% in 2004 as market participants had less incentive to source funds from the interbank market. Compared to 2003, the daily weighted average overnight interbank rate fluctuated within a narrower range of 2.65 – 2.74%, averaging at 2.70%.

Table 9.2
Money Market[1]

	2003		2004	
	Volume (RM billion)	Annual change (%)	Volume (RM billion)	Annual change (%)
Total money market transactions	**1,541.0**	**5.2**	**1,487.0**	**-3.5**
Interbank deposits	**1,084.7**	**7.2**	**1,057.5**	**-2.5**
Money market papers	**456.3**	**0.6**	**429.5**	**-5.9**
Bankers Accecptance (BAs)	37.3	-27.4	48.0	28.7
Negotiable instrument of deposits (NIDs)	43.0	17.3	36.3	-15.7
Malaysian Government Securities (MGS)	231.4	-5.2	193.3	-16.5
Khazanah bonds	18.7	20.7	17.8	-5.1
Treasury bills	9.9	17.7	17.1	73.1
Bank Negara bills	74.5	36.9	74.1	-0.4
Cagamas bonds	25.6	-12.4	38.6	51.0
Cagamas notes	16.0	16.2	4.4	-72.7

[1] All data are sourced from the Bond Information and Dissemination System, except for BAs and NIDs which are sourced from money market brokers.

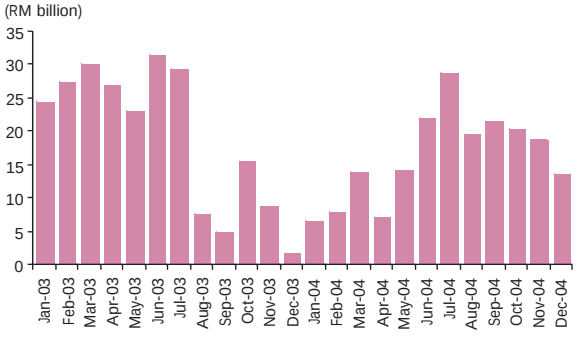
Graph 9.2
Yields of Money Market Instruments



Trading of money market papers during the year were influenced largely by changing market expectations about the prospects for economic growth and interest rate direction. In the first quarter, the low inflation rate and assurances of unchanged domestic monetary policy spurred trading in MGS, as both domestic and foreign investors raised their exposure in fixed income securities. Consequently, the volume of MGS traded rose substantially from RM1.7 billion in December 2003 to RM13.8 billion in March 2004 with a shift in preference towards long-term fixed income instruments. The stronger demand pushed yields down for 3-year and 5-year MGS by 51 basis points (bps) and 20 bps to 3.25% and 4.08% respectively. Trading in treasury bills was also high at an annual rate of 173.7% in the first quarter of 2004, while the yield for the 3-month treasury bills declined by 23 bps compared to the end-December 2003 level.

Subsequently, bond yields began to trend upwards in the second quarter of 2004. The release of the strong first quarter GDP growth and rising US Treasury yields

Graph 9.3
Volume of Traded MGS



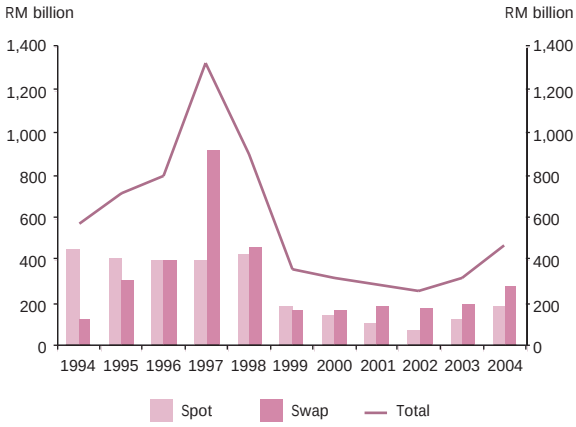
Graph 9.4
Interbank Deposits

amidst expectations that the strong growth in the US would prompt the Federal Reserve to increase interest rates, changed market expectations over the direction of interest rates in Malaysia. This led to selling pressure in the MGS market and caused the 3-year and 5-year MGS yields to increase to 3.72% and 4.41% respectively as at end-June, the highest yields recorded in 2004.

However, in the second half of the year, the trend in bond yields reversed and trended downwards again, mainly influenced by the escalating crude oil prices and their negative impact on prospects for global growth. Demand for ringgit-denominated fixed income securities rose on investor confidence that the inflation outlook in Malaysia remained subdued and on expectations of realignments of currencies in Asia against US dollar. This was further reinforced by the declining US Treasury yields following indications by the Federal Open Market Committee (FOMC) that the increase in the interest rate in the US would be at a moderate pace and the exemption of withholding tax on interest earned on holdings of ringgit-denominated debt securities issued by the Government as well as securities approved by the Securities Commission. The strong interests in ringgit-denominated assets led to a steep decline in the yields, particularly in short-term papers. Between end-October and end-November, yields on 1-year MGS dropped by 76 bps, while yields for 3-month treasury bills declined by 51 bps.

Graph 9.5
Money Market Instruments

Graph 9.6
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



Note: Data from 2002 onwards is based on the new Ringgit Operations Monitoring System (ROMS), whereas observations for previous years are based on transactions of the eight Authorised Dealers.

A notable development during the year was the significant movements in the trading of Cagamas debt securities. The trading in Cagamas notes declined by 73%, due mainly to the lower issuance of only RM1 billion in 2004 compared to almost RM10 billion in 2003. Meanwhile, trading in Cagamas bonds increased significantly following the removal of regulatory incentive of Cagamas debt securities in September 2004, which resulted in marginal increase in yields of Cagamas bonds.

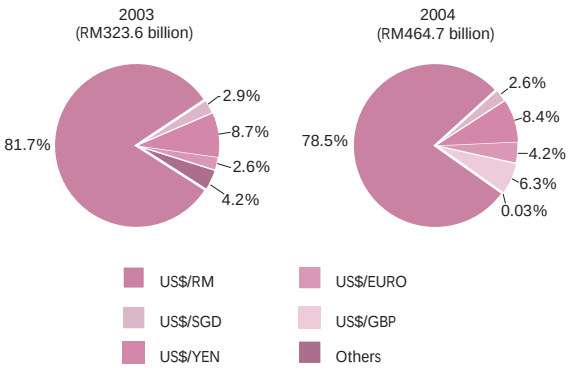
Foreign Exchange Market

In the Kuala Lumpur interbank foreign exchange market, the average daily volume of interbank foreign exchange transactions (spot and swap) increased by 44% compared to 2003. There was a greater increase in spot transactions of 57%, compared to a 36% increase in swap transactions. In general, changes in volume and composition in the foreign exchange market can be attributed to increased trade and investment and greater volatility in the major currencies during the year. Amid the increased volatility among major currencies, currency traders sought to diversify, adjust and hedge their portfolios and trade on profit opportunities created by the movements of exchange rates.

The increased trade and investment activity had a direct positive impact on the volume of both spot and swap transactions. In 2004, Malaysian exports and imports grew by 20.8% and 26.3% respectively, as compared to 11.3% and 4.4% in 2003. The KL foreign exchange market also saw higher activity following a marked increase in portfolio inflows. Higher volatility in the foreign exchange markets amid a depreciating US dollar and the resultant adjustments of world currencies also led to a rise in hedging activity by market participants to manage their exposure to currency risks.

By composition, the Kuala Lumpur foreign exchange market comprised mainly transactions involving the ringgit, yen, euro, Singapore dollar and pound sterling against the US dollar. The US dollar is used widely in the settlement of trade, services and capital account transactions, thus the continued domination of transactions in the US

Graph 9.7
Transactions in the Kuala Lumpur Foreign Exchange Market by Currency



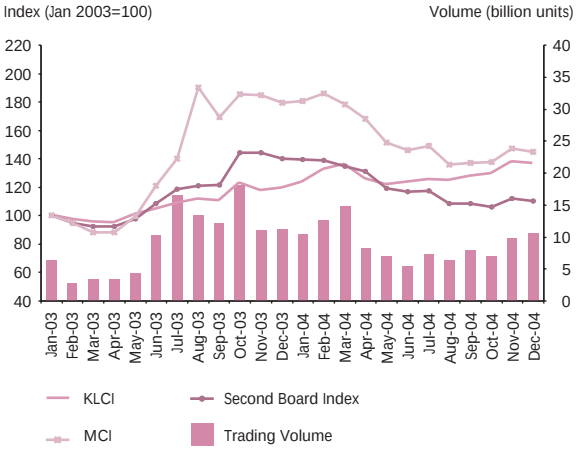
dollar against the ringgit. Nonetheless, the share of such transactions in total foreign exchange transactions decreased from 81.7% in 2003 to 78.5% in 2004. Similarly, the share of transactions involving the yen and Singapore dollar against the US dollar decreased by 3% and 10% respectively. By contrast, there was a significant increase in transactions involving the pound sterling against the US dollar, which became the third largest traded currency pair in 2004. Euro transactions against the US dollar also increased to 4.2% of total transactions in 2004 compared to 2.6% in 2003. To some extent, the shift can be explained by a more active diversification from lower yielding currencies such as the dollar and yen, into higher yielding ones such as the pound sterling and the euro.

Equity Market

In 2004, the Malaysian equity market performed well with most major market indices ending the year higher. The Kuala Lumpur Composite Index (KLCI) ended the year at 907.43 points or 14.3% higher than the end-2003 level. Total market capitalisation increased to RM722.04 billion, an increase of 12.8% compared to the end-2003 level. Market activity remained significant as the annual market turnover amounted to 108 billion units valued at RM216.7 billion. Regionally, the KLCI was one of the outperformers in the Asian region.

Market liquidity declined slightly in 2004 as the average daily turnover decreased to 435.5 million units, from 456 million units in 2003. Market sentiments, on the whole, were negatively influenced by unfavourable external factors, such as the high oil prices and the rising US interest rates. However, stronger overall economic growth and rising corporate earnings buoyed investors' interest in the Malaysian equity market. The reorientation of Government-linked companies (GLCs) towards greater shareholder value creation

Graph 9.8
Kuala Lumpur Composite Index (KLCI), Second Board Index, MESDAQ Market Composite Index (MCI) and Bursa Malaysia's Trading Volume



Source: Bursa Malaysia

Table 9.3
Bursa Malaysia: Selected Indicators

	2003	2004
Price Indices:		
Composite	793.94	907.43
EMAS	195.57	214.26
Second Board	140.64	110.87
MESDAQ	152.25	122.84
Total Turnover:		
Volume (billion units)	112.2	108.0
Value (RM billion)	183.9	216.7
Average Daily Turnover:		
Volume (million units)	456.0	435.5
Value (RM million)	747.5	873.7
Market Capitalisation (RM billion)	640.5	722.0
Market Capitalisation / GDP (%)	162.5	161.3
Total No. of Listed Companies:	906	963
Main Board	598	622
Second Board	276	278
MESDAQ	32	63
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	33.4	31.9
Turnover Volume / Number of Listed Securities (%)	43.2	36.4
Market Concentration:		
*10 Most Highly Capitalised Stocks / Market Capitalisation (%)	31.6	34.4
Average Paid-Up Capital of Stockbroking Firms (RM million)	170.9	167.0

* Based on market transactions only.

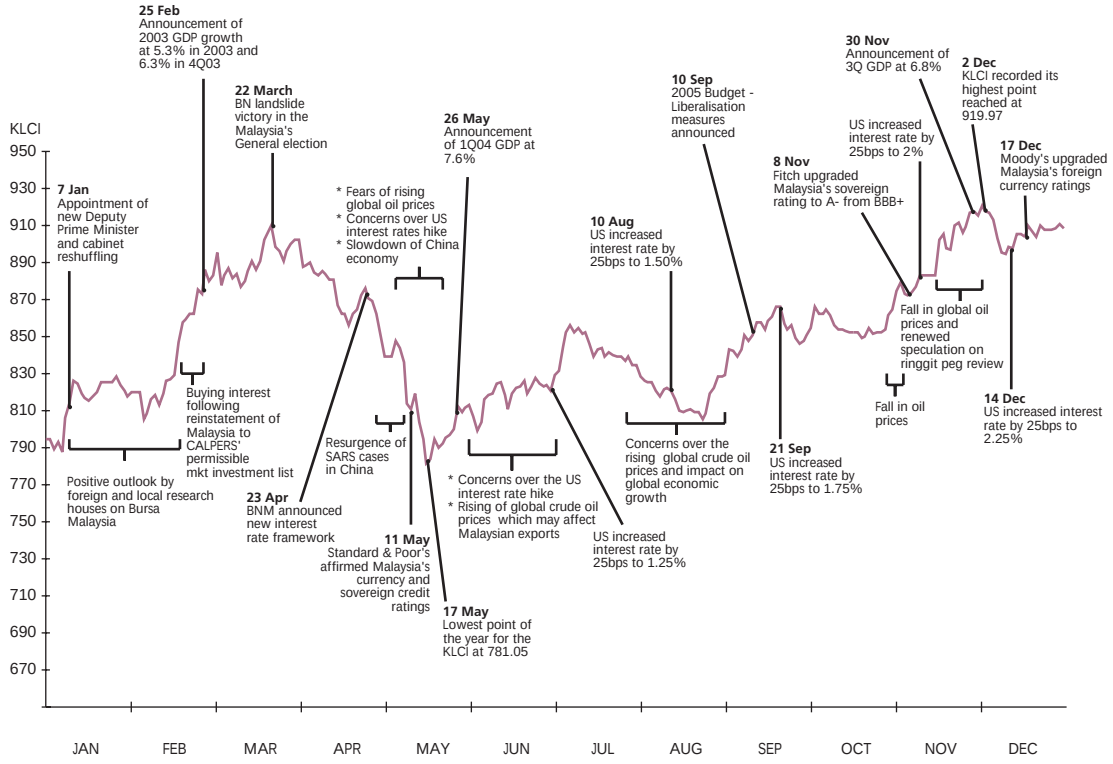
Source: Bursa Malaysia

Table 9.4
Bursa Malaysia: Performance of Sectoral Indices

	2003	2004
	Annual change (%)	
Kuala Lumpur Composite Index	22.8	14.3
EMAS	24.4	9.6
Second Board	43.2	-21.2
MESDAQ Composite Index	82.9	-19.3
Finance	33.2	15.3
Trading / Services	18.3	14.3
Industrial	31.3	10.9
Plantation	19.3	9.4
Syariah	23.2	8.9
Consumer Products	28.8	7.3
Mining	74.8	6.7
Industrial Products	23.4	4.6
Properties	38.8	-4.5
Construction	24.6	-8.9
Technology	33.9	-28.5

Source: Bursa Malaysia

Graph 9.9: Performance of the Kuala Lumpur Composite Index in 2004



Better market performance and broader investor interest resulted in 72 IPOs, the highest since 1998, further evidence of the growing importance of the stock market as a source of equity capital to finance growth in the economy.

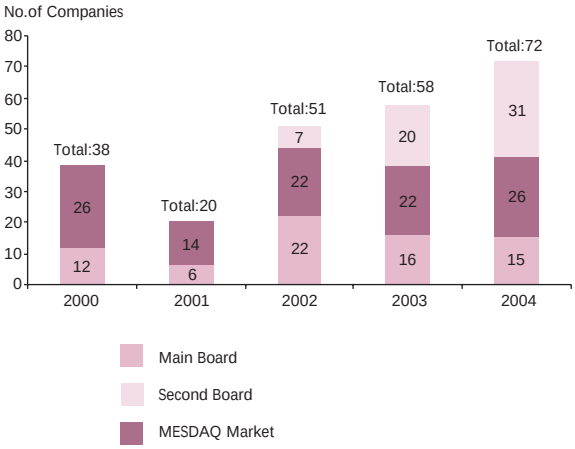
and the initiatives taken by the Government to improve the delivery system of the public sector in order to drive greater efficiency and competitiveness of the economy attracted foreign funds to increase weightings in Malaysia.

Investors were further encouraged by the announcement of new liberalisation measures to allow foreign stockbrokers, fund managers and venture capitalists to operate in Malaysia. These measures are expected to enhance market liquidity, boost competitiveness and strengthen Malaysia's capital market.

The performance of the equity market was supported by strong growth in corporate earnings and strengthened financial position of the corporate sector. From a sample of 351 listed non-financial corporations (representing close to 75% of Bursa Malaysia's total market capitalisation), profits for 2004 grew by 19%. Annualised return-on-equity for the sample rose to 9.1% in the fourth quarter of 2004 (Q4 2003: 8.2%). Earnings growth was particularly strong in the telecommunications, transport and timber sectors, as well as in selected manufacturing sub-sectors (steel products, rubber products, and electronics). The improvement in profitability was also driven by the successful turn-around of a number of companies that had completed their restructuring exercises in the last few years.

In line with the earnings improvement, cash flows from the operations of the corporate sector rose in 2004. Stronger cash flows enabled firms to fund a larger portion of their capital expenditure from internally generated funds. As a result, corporate indebtedness remained stable. Stronger cash flows, together with stable leverage and low interest rates, resulted in stronger debt servicing capacity of the corporate sector. Stronger cash flows also enabled some large corporations to increase their dividend payments to shareholders.

Graph 9.10
Bursa Malaysia: Number of New Listings

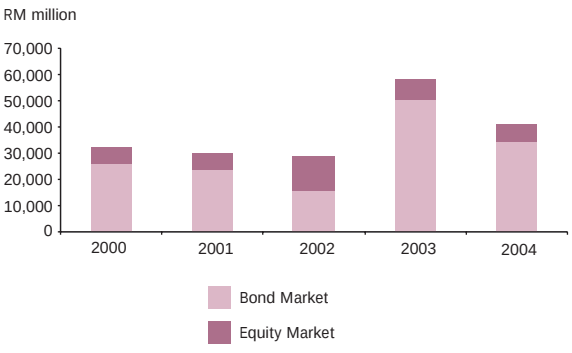


The equity market remained a significant source of financing for the private sector in 2004. Positive market performance coupled with strong economic fundamentals encouraged a larger number of small to medium capitalised companies to raise equity funds in the market. More companies sought listing on the MESDAQ Market and Second Board during the year, with the total number of new listings on the Bursa Malaysia rising by 72, the highest since 1998. Of the total, 31 companies were listed on the MESDAQ Market, 26 on the Second Board and the remaining 15 on the Main Board. Most companies that were listed were from the technology and high growth sectors as well as consumer and industrial products sectors. Two large companies sought listing during the year which enhanced market capitalisation by 0.8%. The higher number of new companies listed on Bursa Malaysia in 2004 provided further evidence of improvement in private investment activity, especially in the new growth areas of the economy. The total number of companies listed in Bursa Malaysia was 963 by the end of 2004. In terms of the number of listed companies, Bursa Malaysia ranks second, after Hong Kong China in the East Asia (excluding Japan) region.

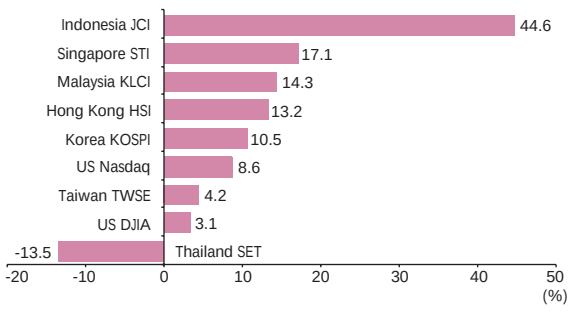
Total funds raised through the equity market, however, were slightly lower at RM6.5 billion, compared with RM7.8 billion in 2003. The bulk of these funds were raised through initial public offerings (IPOs) and rights issues, amounting to RM4 billion and RM1.5 billion, respectively. The funds raised were lower, due to the smaller size of the IPOs. However, most of the IPOs during the year were oversubscribed reflecting strong investor interest in new listings. Funds raised in the equity market constituted about 40% of the total net funds raised by the private sector in the capital market in 2004.

Recognising the significance of equity market as an important source of financing for the economy, the Government and relevant authorities introduced several measures to further strengthen the equity market. The new liberalisation measures were aimed at increasing global competitiveness, promoting innovation and widening market coverage. Other measures introduced in 2004 were targeted at easing the listing process, enhancing disclosure by listed companies, enhancing stockbroking companies' resilience and improving investor protection. Details of the measures introduced during the year are contained in the white box on **Key Capital Market Measures in 2004**.

Graph 9.11
Funds Raised by the Private Sector in the Capital Market



Graph 9.12
Performance of Selected Stock Markets Indices (% change from end-2003 to end-2004)



Source: Bursa Malaysia

Key Capital Market Measures in 2004

Capital market measures introduced in 2004 were aimed at further strengthening the capital market, improving the intermediary process and protecting investors. Key measures introduced in 2004 were as follows:

Strengthening the Bond Market

- Effective 1 April, Bank Negara Malaysia **liberalised the foreign exchange administration rules** to allow Multilateral Development Banks (MDBs) or Multilateral Financial Institutions (MFIs) and Multinational Corporations to raise ringgit-denominated bonds in the Malaysian capital market, in line with Malaysia's on-going efforts to enhance development of the domestic bond market. In facilitating the issuance of the ringgit-denominated bonds issued by MDBs or MFIs, various flexibilities were accorded. Among others, Bank Negara Malaysia classified ringgit-denominated bonds issued by MDBs and MFIs as liquefiable assets under the new liquidity framework for banking institutions, accorded 0% risk weight under the risk-weighted capital ratio framework and allowed deduction from eligible liabilities for the computation of statutory reserves requirements. In addition, for resident insurers, ringgit-denominated bonds issued by MDBs and MFIs are qualified as low risk assets to support their margin of solvency. Similarly, the Securities Commission (SC) also provided various flexibilities, which among others, included accepting international credit ratings and exempting MDBs or MFIs from various requirements of the PDS Guidelines.

- On 26 July, the **Guidelines on the Offering of Islamic Securities (IS Guidelines)** were introduced by the SC to further facilitate the issuance of Islamic securities in Malaysia. With the release of the IS guidelines, the PDS Guidelines were no longer applicable with regards to the issuance of Islamic securities.

- On 3 September, Bank Negara Malaysia **revised the regulatory treatment accorded to new Cagamas debt securities issued after 4 September.** The aim was to promote more market-based pricing and increase investors' interest in the new Cagamas debt securities. The revised regulatory treatment for all new Cagamas debt securities were as follows:
  i. Holdings by banking institutions qualified for a 20% risk weight for capital adequacy purposes and Class-2 liquefiable asset status under the liquidity framework. In line with this, the threshold for Class-2 liquefiable assets recognised under the liquidity framework was increased to 50%;
  ii. Cagamas debt securities would be subjected to the Single Customer Credit limit of 35% of total capital funds of banking institutions;
  iii. Holdings by insurance companies were classified as 'credit facilities' and would continue to be accorded admitted asset status; and
  iv. Primary issuance of Cagamas debt securities would be market driven.

- Effective 11 September, **tax exemption was given on interest income derived by non-resident companies** from ringgit-denominated Islamic securities and debentures, excluding convertible loan stocks, approved by the SC and securities issued by the Government of Malaysia.

Widening Market Coverage for the Equity and Derivatives Markets

- As announced in the Budget 2005 on 10 September, the Government announced several **liberalisation measures to strengthen the equity and derivatives markets** by increasing global market competitiveness, promoting innovation and widening market coverage; as follows:
  i. **allow five major foreign stockbrokers to operate in Malaysia**;
  ii. **allow five leading global fund managers** to participate in the institutional segment of the Malaysian fund management industry;
  iii. **allow 100 percent foreign ownership in futures broking companies**;
  iv. allow local stockbroking companies which have merged with at least one other stockbroking company to **establish four additional branches or Electronic Access Facilities Permitted Activities;** and
  v. **abolish the limit** on the number of foreign dealer representatives.

Easing the Listing Process

- On 9 February, the SC announced some amendments to Schedule 1 of the Securities Commission Act 1993, which **allowed public companies to undertake bonus issues, employee share schemes and employee share option schemes (ESOS) without the need for a prior approval from the SC.**

Enhancing Disclosure by Listed Companies

- From 1 April, **listed companies that delay the submission of their financial statements for a period exceeding three months will be subjected to trading suspensions.**

- On 19 May, the SC released the "Prospectus Guidelines – Guidelines Supplement 1 for listing of Foreign-Incorporated Companies" to **enhance the disclosure requirements for foreign corporations seeking listing** in Bursa Malaysia.

- On 30 November, Bursa Malaysia Securities Berhad **amended the Listing Requirements** in relation to listed companies with unsatisfactory financial conditions and levels of operations. The amendments, among others, required listed companies to submit their regularisation plans within eight months in lieu of trading suspensions and de-listment from the Bursa Malaysia.

Enhancing Stockbroking Companies' Resilience

- On 28 October, the SC announced **revisions to the capital requirements framework for stockbroking companies** to provide the stockbroking industry with greater flexibility in managing their capital requirements as well as to enhance the overall competitiveness. The new capital requirements framework, among others, reduced the minimum paid-up capital for Universal Brokers (UBs) to RM100 million from RM250 million previously and required a minimum level for shareholders' funds unimpaired by losses of RM20 million for non-UBs and RM100 million for UBs.

Improving Investors Protection

- On 25 February, the SC announced several **amendments to the securities laws to better safeguard investors' interests and further enhance corporate governance.** The securities laws included the Securities Industry (Amendment) Act 2003 (SIA), the Securities Commission (Amendment) Act 2003, the Futures Industry (Amendment) Act 2003 and the Securities Industry (Central Depositories) (Amendment) Act 2003. The amendments were aimed at:
  i. enhancing client's asset protection;
  ii. introducing whistle blowing provisions;
  iii. strengthening the framework on investment advice;
  iv. enhancing civil and administrative action powers; and
  v. strengthening clearing and settlement arrangements.

Promoting the Fund Management Industry

- On 28 April, the SC issued a guidance note to the unit trust guidelines that **allowed more Malaysian-incorporated licensed banks and licensed merchant banks to act as guarantors for guaranteed funds.** The guidance note, which aimed at promoting the growth of the unit trust industry in Malaysia, requires the guarantor to have a minimum long-term rating that indicates adequate safety for timely payments of financial obligations and have a credit profile which is regarded as adequate by any global or domestic rating agency.

- On 24 November, the SC released a set of guidelines to **facilitate unit trust management companies (UTMC) to establish online transactions of unit trusts.**

Bond Market

The ringgit bond market remained an important source of financing for the economy in 2004. Total gross financing amounted to RM85.8 billion. After taking into account redemptions during the year, total net funds raised in the bond market amounted to RM36.2 billion. As a result, total outstanding ringgit bonds grew by 10.7% to RM363 billion, equivalent to 81% of GDP. The general market conditions remained favourable for both issuance and trading activities, given the low inflation and interest rates environment and the strengthening of economic fundamentals. A significant development for the bond market was the introduction of new assets classes, which widened the breadth of the market. During the year, two Multilateral Development Banks issued ringgit bonds, while Cagamas MBS Berhad issued the Residential Mortgage Backed Securities (RMBS). The inaugural issuance of the Asian Development Bank (ADB)'s Putra bonds (RM400 million) and the International Finance Corporation (IFC)'s Wawasan Islamic bonds (RM500 million) reflected the confidence of the international institutions in the Malaysian capital market as a reliable source of competitive funds. The ADB and IFC bond issuances were oversubscribed by 6.5 and 4.3 times respectively.

Developments in the bond market were positive and supported the increase in domestic private investment activity in 2004.

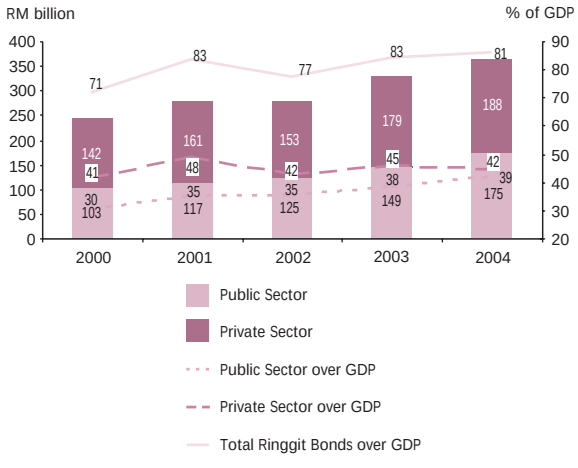
In the primary market, the public sector raised net funds of RM26.7 billion. The Federal Government issued and reopened a total of fourteen Malaysian Government Securities (MGS) and three Government Investment Issues (GIIs). Funds raised by the Government were used to finance development activity. In an effort to further lengthen the benchmark yield curve, the Government issued a 15-year MGS through an open tender to provide the private sector a new benchmark for longer-maturity instruments. As the development of the Islamic bond market runs parallel with the conventional market, the Government had also increased the nominal issuance size of GIIs to RM4.1 billion in 2004 from RM2 billion in 2003. In addition, the GII maturity structure was lengthened from 5-year to 7-year with the objective of developing an Islamic benchmark

Table 9.5
Funds Raised in the Bond Market

	2003	2004*p*
	RM million	
By Public Sector		
Government Securities (gross)	41,262	43,173
Less Redemptions	18,600	18,200
Less Government holdings	0	0
Equals Net Federal Receipts	22,662	24,973
Government Investment Issues (net)	1,729	1,423
Khazanah Bonds (net)	346	-1,198
Malaysia Savings Bond/Merdeka Savings Bond (net)	-9	1,474
Net Funds Raised	**24,729**	**26,671**
By Private Sector		
Private Debt Securities (gross)	50,975	36,340
Straight Bonds	27,983	4,313
Bonds with Warrants	0	60
Convertible Bonds	3,177	4,301
Islamic Bonds	8,143	9,104
Asset Backed Securities	3,487	2,958
Medium Term Notes[1]	0	7,315
Cagamas Bonds	8,185	8,290
Less Redemptions	33,123	26,814
Private Debt Securities	27,971	19,648
Cagamas Bonds	5,152	7,166
Net Funds Raised	**17,853**	**9,526**
Net Funds Raised in the Bond Market	**42,582**	**36,197**
Private Debt Securities, excluding Cagamas (gross)	*42,790*	*28,050*
Net Funds Raised in the Bond Market, excluding Cagamas	*14,820*	*8,402*
Net Issues Short Term Securities, Commercial Papers[2]	3,753	-3,208
Total	**46,335**	**32,990**

[1] Compilation of medium-term notes began in 2004.
[2] Refers to Cagamas Notes and Commercial Papers. For 2003, includes Medium-Term Notes.
p Preliminary

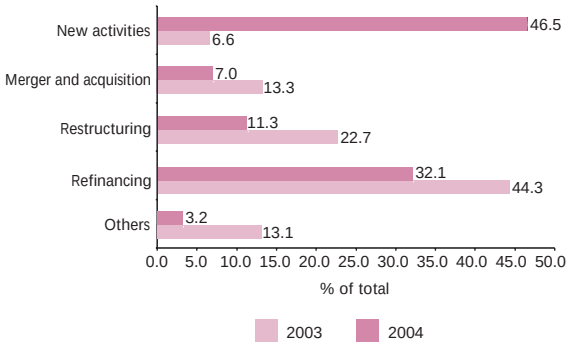
Graph 9.13
Total Bonds Outstanding



yield curve. During the year, BNM launched the Merdeka Savings Bond (MSB), providing a new investment instrument to senior citizens and retired uniformed personnel. Subsequently, the MSB was also made available to Malaysian citizens who have retired on medical grounds. Since its launch, four series of MSBs were issued in 2004 with net funds raised amounting to RM1.9 billion. As at end-2004, total outstanding public sector bonds amounted to RM175.4 billion, equivalent to 39% of GDP.

Favourable market conditions, a low inflation and interest rates environment, coupled with strengthening economic conditions in 2004 were the main factors contributing to the continuous supply of new PDS. Total gross funds raised by the private sector remained significant at RM36.3 billion. A total of 89 companies sourced financing from the PDS market and raised RM28 billion, while Cagamas Berhad raised the balance of RM8.3 billion. Compared to total new issuances of RM51 billion in 2003, there was a decline in new issuances of PDS in 2004. Between 1999 to 2003, the bulk of new issuances of PDS (70% of total, excluding Cagamas bonds) were for restructuring and refinancing purposes. By 2004, the corporate sector had successfully undertaken most of its restructuring exercise and the need to use bond market to finance its restructuring activity declined. The corporate sector continued to register strong earnings and has strengthened its balance sheets since the Crisis. Stronger cash flow positions have enabled firms to embark on new investment activities, as evidenced from the increase in their capital expenditures. Reflecting this development and the continued increase in domestic private investment activity, issuance of PDS to finance new business activity increased significantly in 2004 and accounted for 46.5% of total issuances. Corporations in the infrastructure and utilities sectors were the main issuers for this purpose. Meanwhile, issuances for refinancing purposes accounted for 32.1% of total issuance, of which 20% were issuances of asset-backed securities.

Graph 9.14
Utilisation of Bond Proceeds[1]



[1] Excluding Cagamas

After netting out redemptions during the year, net funds raised by the private sector amounted to RM9.5 billion. As at end-2004, total outstanding private sector bonds had increased to RM187.6 billion, equivalent to 42% of GDP or 51.7% of total outstanding bonds in the market. The share of PDS financing (excluding Cagamas) to the private sector remained significant, at 23.7% of total PDS and loans financing to the private sector.

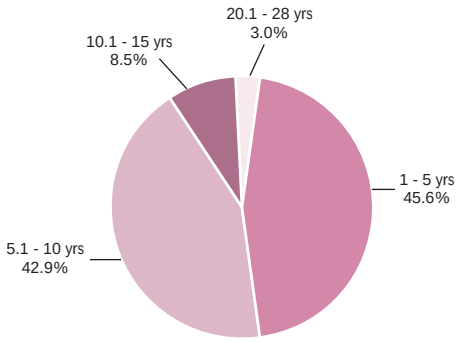
Companies from the construction and utilities sectors were the main issuers of PDS, raising 31.5% and 28% of the total funds respectively. Major issuers within these sectors were the major developers of infrastructure projects, water projects and independent power producers that required long-term and flexible financing.

Table 9.6
New Issues of Private Debt Securities by Sector[1]

Sector	2003		2004[p]	
	RM million	% share	RM million	% share
Agriculture, forestry and fishing	993.1	2.3	0.0	0.0
Mining and quarrying	0.0	0.0	0.0	0.0
Manufacturing	9,072.4	21.2	3,264.5	11.6
Construction	6,049.7	14.1	8,844.9	31.5
Electricity, gas and water supply	3,410.5	8.0	7,480.2	28.0
Transport, storage and communication	8,603.8	20.1	796.0	2.8
Financing, insurance, real estate and business services	8,372.8	19.6	4,767.8	17.0
Government and others	6,288.1	14.7	1,315.4	4.7
Wholesale and retail trade,restaurants and hotels	0.0	0.0	1,221.1	4.4
Total	**42,790.4**	**100.0**	**28,049.9**	**100.0**

p Preliminary
[1] Excluding Cagamas

Graph 9.15
PDS Issues by Tenure[1]



[1] Excluding Cagamas.

During the year, new PDS issues with tenures between one to ten years accounted for 88.5% of total value issued, reflecting investors' preference for short to medium-term securities. A notable development during the year was the lengthening of the PDS maturity profile. PDS issued with tenures between 20 - 28 years represented 3% of total value issued in 2004, compared with 0.9% in the previous year.

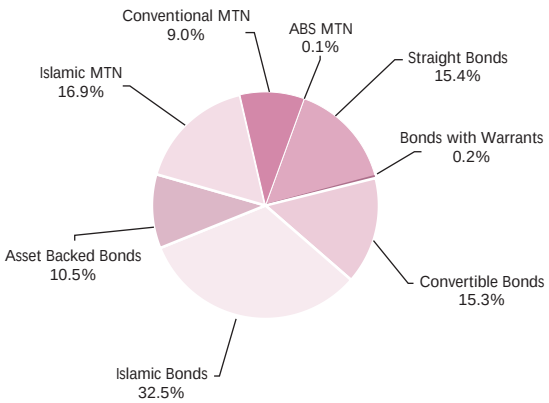
In terms of the types of instruments, Islamic PDS (including Islamic Medium Term Notes) was the most preferred form of funding, accounting for 49.4% of total issuance. Over the years, greater demand from both Islamic and conventional institutional investors for Islamic PDS has led to more competitive bidding for these bonds and resulted in lower costs for the issuers. Another reason for this development was the implementation of tax incentives for Islamic products, as announced in the 2004 Budget, which also resulted in several new structures of Islamic PDS products. The Securities Commission also introduced new guidelines for Islamic securities in 2004, which facilitated the development of a more innovative and sophisticated Islamic capital market.

During the year, Cagamas Berhad maintained its position as an active issuer in the PDS market, accounting for 22.8% of total PDS issuance. Cagamas made 18 issues of debt securities with a total value of RM9.3 billion (including two issues of short-term Cagamas notes totalling RM1 billion). In terms of the types of instruments, fixed rate bonds recorded a higher share of 71.8% of total issuance, while the balance were Sanadat Cagamas and short-term Cagamas discount notes.

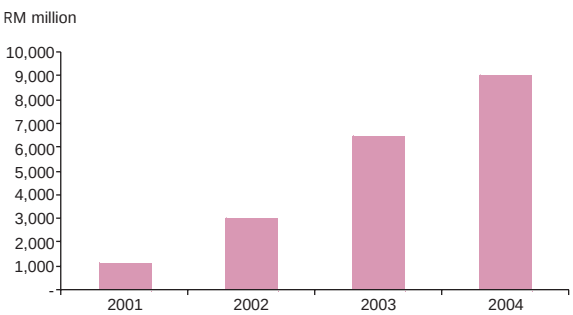
Bank Negara Malaysia revised the regulatory treatment of Cagamas securities to promote a more competitive capital market. Cagamas successfully issued a Sanadat Cagamas for the first time through a book building process in October. The Sanadat Cagamas, an Islamic instrument based on *Bai-Bithaman Ajil* was issued to purchase Islamic housing and hire-purchase debts, totalling RM1.6 billion, the highest volume of Islamic debt ever purchased by Cagamas. Cagamas Berhad through its single purpose and wholly-owned subsidiary, Cagamas MBS Berhad (CMBS) successfully made the first issuance of RMBS backed by the Government's staff housing loans in October. RMBS issuance augured well for the development of the securitisation market in Malaysia. The RMBS is expected to create a yield curve for mortgage-backed securities and serve as a benchmark for other Asset Backed Securities (ABS) issues.

Concurrently, in the securitisation market, four new ABS amounting to RM3 billion, which were backed by

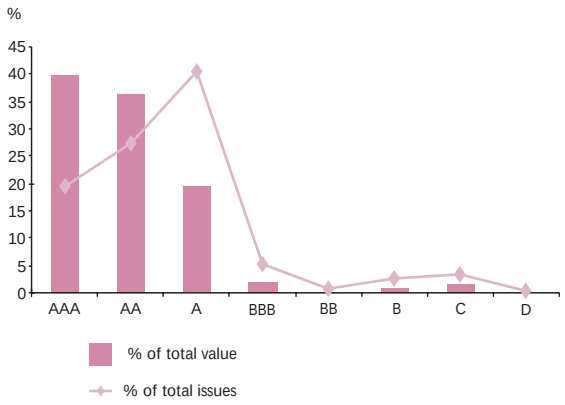
Graph 9.16
PDS Issues by Type of Instrument (excluding Cagamas)



Graph 9.17
ABS Outstanding (2001-2004)

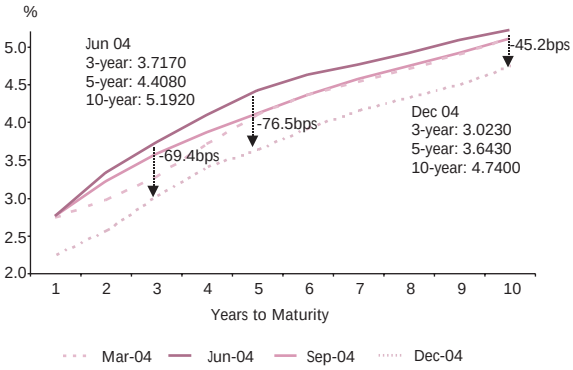


Graph 9.18
Rating Distribution of Outstanding PDS (As at end-2004)



Sources: RAM and MARC

Graph 9.19
MGS Benchmark Yields



credit card receivables, loans, as well as property and mortgage receivables, were issued during the year. In total, there were fifteen ABS (including one commercial paper ABS) outstanding, amounting to RM8.7 billion.

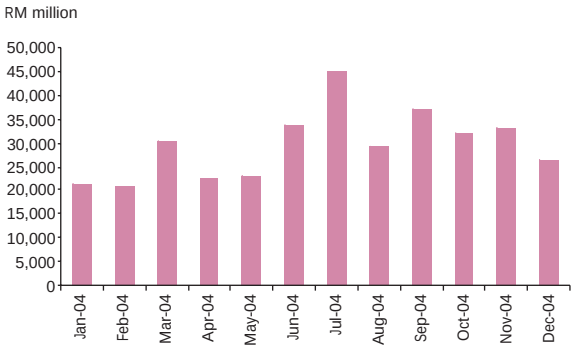
During the year, the Rating Agency Malaysia (RAM) and the Malaysian Rating Corporation Berhad (MARC) rated a total of 139 new PDS issues, valued at RM38.7 billion. The long-term issues represented 68.2% of the total gross value rated. In terms of rating profiles, the issues were distributed throughout the AAA, AA and A categories. Although single A-rated PDS recorded the highest number of issues, the AAA-rated PDS accounted for the largest share in terms of value. Investors' preference for companies with good credit qualities and strong credit profiles had resulted in companies with high ratings tapping the PDS market at competitive pricing. Throughout the year, RAM and MARC conducted 244 rating reviews on the existing long-term debt securities. A total of 213 issues were reaffirmed, 17 were upgraded and seven were downgraded.

In the secondary market, for the first three quarters, the MGS bond yield movements and market sentiments were influenced mainly by investors' expectations on the direction of interest rates. Bond yields shifted downwards in the first quarter, as investors began to rebuild their portfolios, leading to a higher demand for debt securities. In an environment of low inflation, investors were confident that domestic interest rate would remain low. Bond yields, however, reversed direction and trended upwards in the second quarter on improving economic outlook following the release of several positive economic indicators pointing to stronger growth. The rising yields on US Treasury securities arising from expectations of interest rate hikes also influenced domestic bond yields.

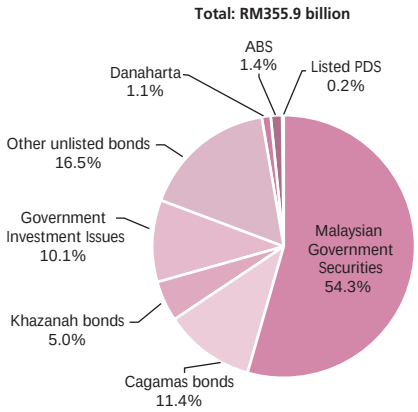
However, in the second half of the year, the bond yields trended downwards again, mainly influenced by the escalating crude oil prices and their negative impact on prospects for global growth. Demand for fixed income securities rose on investor sentiments that the inflation outlook in Malaysia remained subdued and on expectations of realignments of currencies in Asia against the US dollar. This was further reinforced by the declining US Treasury yields following indications by the Federal Open Market Committee (FOMC) that the increase in the interest rate in the US would be at a moderate pace. In addition, the exemption of withholding tax on interest income earned on holdings of ringgit-denominated debt securities issued by the Government as well as securities approved by the Securities Commission generated higher demand for fixed income securities. The strong interest in ringgit-denominated assets led to a steep decline in the yields.

Trading in the ringgit bond market amounted RM355.9 billion (2003: RM436.8 billion) with activities concentrated in the short- to medium-end tenures. The highest trading activity was recorded in July arising from the larger supply of Government papers in June. In September, trading activity rose following the exemption of withholding tax on interest income, which attracted higher foreign investor participation in the bond market. The most actively traded papers were MGS, accounting for 54.3% of total trades. Turnover for corporate bonds accounted for 18.1% of the total trades and were mainly high investment grade papers. Liquidity, as

Graph 9.20
Monthly Trading Volume



Graph 9.21
Turnover of Selected Debt Securities (Jan-Dec 2004)



measured by the ratio of trading volume to total outstanding bonds, was highest for GII and Khazanah bonds, at 3.94 times and 1.78 times, respectively. Liquidity for corporate bonds, however, was the lowest at 0.4 times the outstanding amount.

On the international front, spreads of Malaysia's foreign currency sovereign and corporate bonds tightened during the year. Standard & Poor's affirmed Malaysia's currency and sovereign credit ratings in May, Fitch International upgraded Malaysia's sovereign rating from BBB to A- in November and Moody's Investors Services upgraded Malaysia's foreign currency ratings in December, reflecting strengthening economic fundamentals.

Several measures were introduced in 2004 to further strengthen the bond market. The detailed bond market measures are explained in the white box on **Key Capital Market Measures in 2004**.

Table 9.7
Sovereign Over US Treasury Benchmark

	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04
MALAYSIA 09	80	86	97	62	48
MALAYSIA 11	131	151	156	108	90
CHINA 11	123	123	119	116	98
INDONESIA 06	288	243	312	134	43
KOREA 08	38	54	48	18	1
PHILIPPINES 10	494	556	470	444	377
THAILAND 07	126	110	125	110	53
PETRONAS 06	104	92	100	63	48

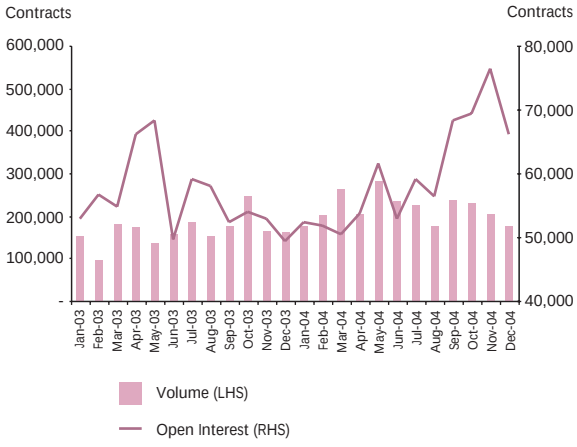
Source: Bloomberg

Exchange-traded Derivatives Market

The Malaysian derivatives market continued to register encouraging growth in 2004. This positive development was attributed to the continued high trading interest in Crude Palm Oil (CPO) Futures, and the significantly stronger interest in KLCI Futures and the 3-year MGS Futures. The total volume of contracts traded on Bursa Malaysia Derivatives increased by 32% from the previous year, as a result of greater awareness and knowledge on the use of derivatives as well as higher activity in the underlying markets. The annual trading volume reached a new record of 2.6 million contracts, from a previous record of 2 million contracts in 2003.

The favourable performance of the commodity futures market, coupled with continued rapid growth of the palm oil industry, induced Bursa Malaysia Derivatives to launch the Palm Kernel Oil Futures (CPKO) on 20 February 2004. The launch of

Graph 9.22
Bursa Malaysia Derivatives: Total Monthly Volume and Month-end Open Interest



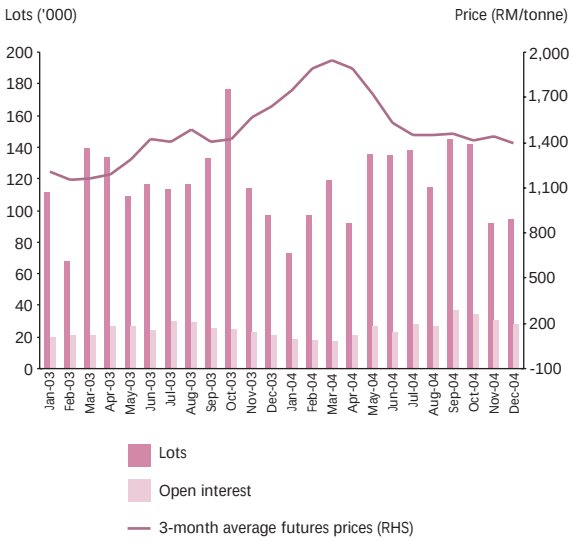
Source: Bursa Malaysia Derivatives

this new product allowed market participants to more effectively monitor, manage and control the pricing of palm oil products. With the launch of this new product, a total of eight products are now being traded on the Bursa Malaysia Derivatives. To further improve the products and services in the capital market, restrictions on foreign equity ownership in futures broking companies were lifted, by allowing 100 percent foreign ownership in these companies.

As in the previous year, the CPO Futures remained the most actively traded product on Bursa Malaysia Derivatives in 2004, accounting for 52.3% of the total volume transacted during the year. The price range for the benchmark 3-month CPO contract was between RM1,372 and RM1,993 per tonne in 2004, a difference of RM621 (2003: RM622). Nevertheless, the performance of the newly-launched CPKO Futures was subdued due to a lack of market participants.

The 3-month CPO Futures prices began the year on a strong note at RM1,766 per tonne, and rallied further in the first quarter to register the highest daily traded price of RM1,993 per tonne on 4 March. Thereafter, prices reversed their earlier trends and declined to RM1,550 on 30 June, on the back of subdued buying interest from overseas investors (that accounted for about 44% of total volume traded) as well as increased CPO production in the major producing countries. In the second half of the year, an increase in Malaysian palm oil stocks and better-than-expected soybean harvests in the US further influenced the downward trend in prices. As

Graph 9.23
Crude Palm Oil Futures



Source : Bursa Malaysia Derivatives

Table 9.8
Performance of Bursa Malaysia Derivatives Products

Products	Turnover						Share of total volume in Bursa Malaysia Derivatives (%)	
	2003			2004				
	Number of lots	Annual change (%)	Average daily volume	Number of lots	Annual change (%)	Average daily volume	2003	2004
CPO Futures	1,429,959	57.3	5,813	1,378,334	-3.6	5,603	71.5	52.4
Open interest position (as at end-year)	21,149			28,314				
Palm Kernel Oil Futures				449	n.a.	2	n.a.	…
KLCI Futures	331,218	41.6	1,346	1,088,419	228.6	4,424	16.6	41.3
Open interest position (as at end-year)	*8,993*			*10,092*				
KLCI Options	-	-	-	-	-	-	-	-
3-month KLIBOR Futures	119,659	86.1	486	141,969	18.6	577	6.0	5.4
Open interest position (as at end-year)	18,977			27,418				
3-year MGS Futures [1/]	781	n.a.	3	4,327	454	18	…	0.2
5-year MGS Futures	118,635	47.5	482	19,494	-83.6	79	5.9	0.7
Open interest position (as at end-year)	127			-				
10-year MGS Futures [1/]	11	n.a.	…	-	-	-	…	…

[1/] Introduced in September 2003
n.a. Not available
… Negligible

Source: Bursa Malaysia Derivatives

a result, prices consolidated to a range of RM1,400 – 1,500 per tonne in the third quarter, before declining further in the fourth quarter to register the lowest daily traded price of RM1,372 per tonne on 18 October. The 3-month CPO Futures ended the year at RM1,387 per tonne, 21.5% lower than the price at the start of the year.

The KLCI Futures was the best performing derivatives product on Bursa Malaysia Derivatives in 2004. Trading activity in KLCI Futures registered a significantly higher annual growth of 229%. The derivatives liquidity ratio (DLR), which represents the ratio between the turnover value of futures against the turnover value of the underlying KLCI component stocks, increased to 46.9% in 2004 (2003: 40.3%). The higher volume was attributed to the better performance of the underlying equity market during the year. In addition, the modification of the contract size and the increase in tick sizes since September 2003, encouraged more participation by both domestic and foreign investors. These measures effectively reduced the margin requirements and the cost of trade. In terms of market participant, domestic retail investors and foreign institutions accounted for 80% of the total trading volume.

Activity in the financial futures market in 2004 was mixed and continued to mirror developments in the underlying markets, which were influenced by changing expectations on economic growth prospects and the direction of interest rates. Participation in the financial futures market continued to be dominated by domestic institutions, which accounted for more than 93% of total trading. The 3-month KLIBOR Futures continued to record a positive growth of 18.6%, in terms of volume traded for the year. The total turnover of MGS Futures, however, registered a decline of 80%, following slightly lower total trading activity in the underlying market. As trading activity in the underlying market was concentrated mainly in the shorter-end tenures, the total turnover of 3-year MGS futures improved significantly.

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The Payment and Settlement Systems

The Payment and Settlement Systems

INTRODUCTION

An efficient, reliable and smooth functioning payment system contributes to the growth of the economy, soundness of the financial system and smooth functioning of financial markets. Given its importance, there is strong public interest in ensuring that the Malaysian payment systems operate in an effective, safe and efficient manner.

Bank Negara Malaysia performs three roles in the area of payment systems in Malaysia, namely, as the operator and overseer of the payment systems, and facilitator to the payment system services. In this regard, the thrust of Bank Negara Malaysia policies and initiatives in payment systems are aimed at **improving the efficiency and enhancing the safety** of payment systems. These include promoting the **migration from a predominantly paper-based system to electronic payments,** improving the efficiency of the payment systems, and promoting the awareness of payment system issues and the protection of consumer interests.

Bank Negara Malaysia's policies and initiatives in payment systems are aimed at improving the efficiency and enhancing the safety of payment systems, as well as promoting the migration to electronic payments.

ENHANCING EFFICIENCY

The efficiency of payment systems is characterised by the competitive price of services, availability of the various different payment modes to the consumers, and expediency of settlement undertaken within a particular system or between systems. The efficiency of a payment system is influenced by the **accessibility** of the payment system to service providers, market players and users. With wider reach to service providers, market players and users, the payment system would provide more value to the participants of the system as a whole. In 2004, the efficiency of payments system in Malaysia was further improved through wider access and enhancements made to the systems.

To achieve greater efficiency in payment systems, access to the electronic payments were addressed in several ways in 2004. The thrust in policy was to promote a fair and open access to the main payment systems in the country and minimise the industry's risk exposure. Notable developments in this area were the revision of the access policy for the RENTAS system, the real-time gross settlement system for Malaysia, and participation of the additional members in the Interbank Giro (IBG) and the shared automated teller machines (ATM) network operated by the Malaysian Electronic Payment System (1997) Sdn. Bhd. (MEPS). Access points for businesses and consumers to make Internet-based payments were also enhanced with the introduction of the Financial Process Exchange (FPX).

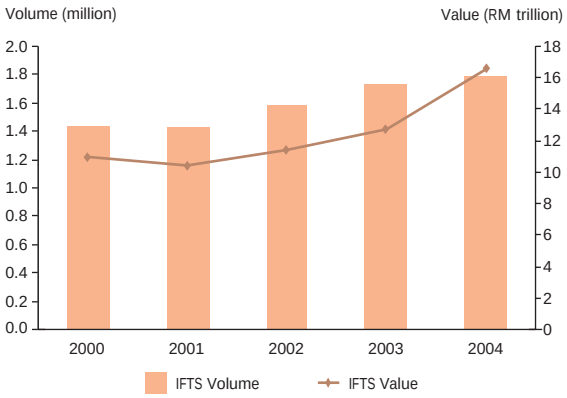
(i) RENTAS

RENTAS is the major wholesale payment system in the country, settling funds and scripless securities between participating institutions on a real-time basis. As at end-2004, there were 51 participants in RENTAS, comprising Bank Negara Malaysia, commercial banks, Islamic banks, merchant banks, discount houses, finance companies, universal brokers and Cagamas Berhad, the national mortgage corporation.

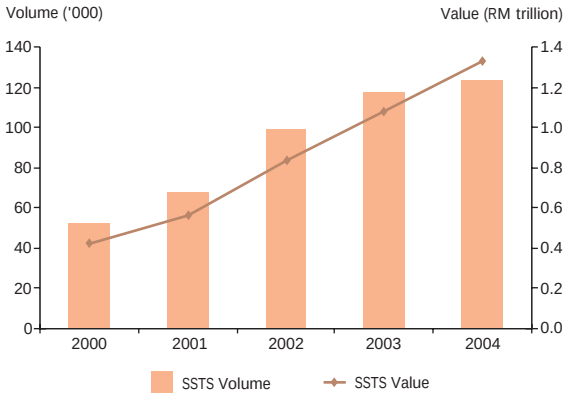
In 2004, Bank Negara Malaysia revised the access policy to the RENTAS system. The objectives of the revision was to improve operational efficiencies and to reduce settlement risk in the financial system with the major financial market participants having direct access to the central real-time payment system operated by Bank Negara Malaysia. New participants would have the same ability of settling financial obligations and receiving funds through the use of the central money, that is, the settlement account held at Bank Negara Malaysia. The revised eligibility criteria to participate in the RENTAS system are as follows:

i. Financial institutions regulated by Bank Negara Malaysia and universal brokers regulated by the Securities Commission;
ii. Major clearing houses that facilitate settlement in the money market and capital market; and
iii. Institutions that are active players in the money market or capital market, and whose average share of settlement consistently exceeds 0.1% of the value of RENTAS transactions.

Graph 10.1
RENTAS - IFTS Turnover



Graph 10.2
RENTAS - SSTS Turnover



The RENTAS system settled 1.9 million transactions amounting to RM17.9 trillion in 2004, an increase of 4.1% in volume and 29.8% in value of transactions from 2003, indicating its continued significance as the main payment system for financial settlement. The Interbank Funds Transfer System (IFTS) saw an increase of 4% and 30.4%, in terms of volume and value respectively, while transactions through the Scripless Securities Trading System (SSTS) increased by 5.8% and 23.1% respectively.

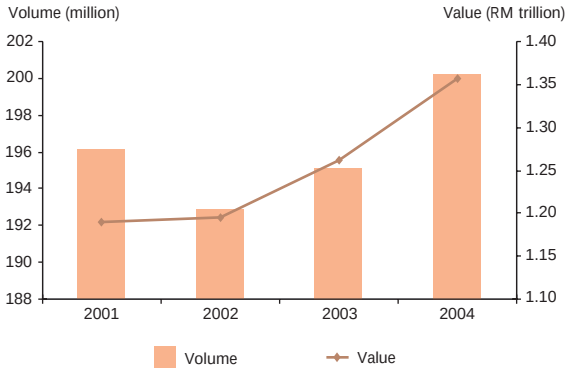
To improve the efficiency and resilience of the RENTAS system, the system's hardware was upgraded with the latest Tandem S Series, which offers 2.3 times additional capacity. As a result, the processing time improved by about 20% and the end-of-day batch processing cycle has been shortened by two hours.

(ii) ***Sistem Penjelasan Imej Cek Kebangsaan*** **(SPICK)**

Besides facilitating greater flexibility in access to the RENTAS system, Bank Negara Malaysia had also in 2004, improved the efficiency of the SPICK system. A web-based reporting system was implemented to improve processing of unpaid items (UPI) in December 2004. The new UPI system allows all participating banking institutions to quickly process the reversals of UPI.

The system was implemented at SPICK centres in Kuala Lumpur and Pulau Pinang, and will be extended to Bank Negara Malaysia's SPICK centre in Johor Bahru by March 2005. At SPICK Pulau Pinang and Johor Bahru, submission of diskettes for the UPI file will be replaced with an online submission, improving the delivery time and process cycle for cheque clearing.

Graph 10.3
Volume and Value of Cheques Processed in Malaysia

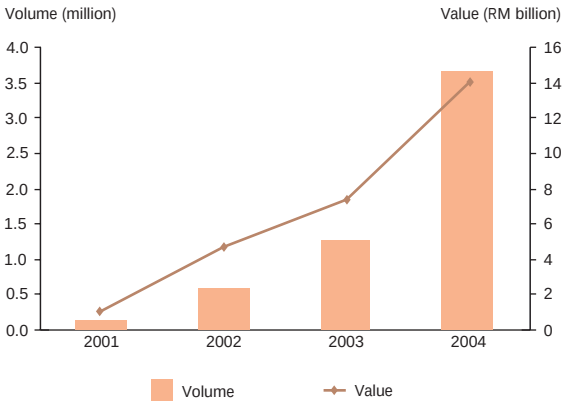


Volume of cheques processed in the country, excluding in-house cheques rose by 2.6% to 202.2 million in 2004 while the value of cheques processed rose by 7.5% to RM1.4 trillion. While concerted efforts are being undertaken in promoting the usage of electronic payment channels, Bank Negara Malaysia recognises that cheques would remain important. As such, Bank Negara Malaysia will embark on a number of initiatives in 2005 to improve the efficiency of cheques as a payment instrument, so as to reduce further the processing time.

(iii) Interbank Giro System (IBG)

In the retail payments arena, the IBG system operated by MEPS facilitates bulk credit transfers to be made between banks electronically on either a T+0 or T+1 basis. The IBG system, which is largely accessible through the commercial banks, has the potential to become a major retail payment system that would reduce the use of cheques given its increasing popularity with businesses and consumers.

Graph 10.4
Interbank Giro Transactions



Recognising that a widely accessible IBG is beneficial, Bank Negara Malaysia promoted an open access policy to IBG by encouraging the removal of barriers of entry to include institutions other than the domestic banking institutions. In December 2004, a locally incorporated foreign bank (LIFB) announced its participation in the IBG. This brings the number of participants in the IBG system to 13. In 2004, the IBG system recorded a significant growth in terms of volume and value of 187.6% and 88.8% respectively, compared to the previous year.

To further spur the growth of IBG usage in the country, an IBG Review Team comprising of representatives from Bank Negara Malaysia, MEPS, the banking industry and relevant Government agencies had been formed in November 2004. The IBG Review Team will formulate a five-year road map to address key issues and formulate specific strategies to encourage users of cheques to migrate to using this electronic channel.

(iv) Shared ATM Network

As at end-2004, there were 5,565 ATMs in Malaysia. Domestic banking institutions own 4,098 ATMs, Islamic banks own 280 while 327 ATMs are owned by LIFBs. The development financial institutions (DFIs) collectively own 860 ATMs. The MEPS shared ATM network allows member institutions to leverage on each other's ATMs, resulting in cost savings in infrastructure deployment while allowing customers wider accessibility through a larger pool of ATMs. In an effort to enhance efficiency in the financial system and increase connectivity between different types of financial players, a DFI joined the MEPS shared ATM network in June 2004, facilitating customers of the participating banks to have access to an expanded MEPS shared ATM network of 4,416 ATMs.

(v) Financial Process Exchange (FPX)

The FPX was introduced by MEPS in October 2004 as an Internet-based payment system that allows participants such as corporations to make payments electronically. The FPX leverages on the banking institutions' Internet banking services to provide online payments and accompanying payment references for reconciliation purposes.

Bank Negara Malaysia has supported the development of the system, as part of the effort to elevate Malaysia's e-commerce facilities in tandem with the various private sector and Government e-commerce initiatives. The use of an industry-wide payment platform as in the FPX has a comprehensive reach of users. All banking institutions are encouraged to participate in the FPX to be able to provide efficient payment services to their corporate and retail customers, while at the same time forging alliances in a common infrastructure building effort for the benefit of the nation. Currently, there are four banking institutions and five merchants participating in the FPX. As at end-2004, the FPX processed a total of 87 transactions amounting to RM2.6 million.

ENHANCING PAYMENT SYSTEMS SAFETY

The safety and efficiency of the payment systems are important to ensure consumers' confidence in payment systems. Bank Negara Malaysia, in safeguarding the

Table 10.1
Automated Teller Machines

	2000	2001	2002	2003	2004
Number of ATMs[1]	3,944	4,161	4,213	5,241	5,565
Volume of cash withdrawals (million)[2]	146.1	174.9	193.5	215.6	264.3
Value of cash withdrawals (RM billion)[2]	62.0	71.8	77.6	86.3	110.8

[1] Figures in 2000-2002 comprise domestic commercial banks, LIFBs, Islamic banks and finance companies. Figures in 2003-2004 include the DFIs.

[2] Figures in 2000-2003 represent transactions involving the domestic commercial banks, LIFBs and finance companies. Figures in 2004 include Islamic banks transactions.

public interest, exercises its regulatory powers and oversight function through the Payment Systems Act 2003. Payment system operators are required to obtain a notification from Bank Negara Malaysia before operating a payment system while issuers of a designated payment instrument (DPI) are required to obtain the necessary approval from Bank Negara Malaysia prior to the issuance of the DPI. Bank Negara Malaysia supervises the activities of the operators of payment systems and issuers of DPI through on-site examinations, as well as off-site reviews of their financial status. In 2004, a total of 14 payment systems operators were given notification for operating payment systems and approvals were given to three issuers of DPI. Bank Negara Malaysia also conducted on-site examinations on two major payment system operators.

To enhance the safety of payment systems, measures were taken to mitigate the risk of fraud and reduce the system's vulnerabilities to operational risk. In this regard, Bank Negara Malaysia and relevant payments industry players have collaborated in a number of areas to ensure that the large value and retail payment facilities are safe and secure. Notable developments in 2004 include the continued migration to a chip-based environment for **ATM cards** and **credit cards**, aimed at reducing counterfeiting of cards by way of skimming and cloning. Measures to address **Internet banking** fraud by way of 'phishing', **security guideline on cheques** and **business continuity planning** mechanisms were also introduced in 2004.

(i) ATM Cards

All LIFBs and two DFIs had completed the full migration of their ATMs and ATM cards to a chip-based environment in July 2004. This followed the successful adoption of the chip infrastructure by the Government for the national identity card, MyKad, which carries an ATM capability, issuance of Bankcard by domestic banking institutions and completion of the ATM upgrade in 2003. To date, the migration to a chip-based ATM infrastructure has resulted in the elimination of ATM fraud due to counterfeiting. As at end-2004, approximately 11.7 million chip-based ATM cards had been issued while 4,966 ATMs had been upgraded to a chip-based platform.

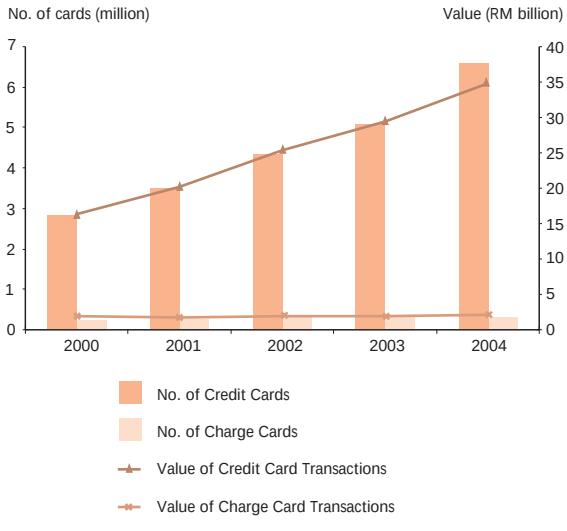
(ii) Credit Cards

Credit card issuers and acquirers in the banking industry, under the stewardship of Bank Negara Malaysia and the Association of Banks in Malaysia, had adopted the Europay-MasterCard-Visa (EMV) standard for credit card issuance by end-2004 and the conversion of card acceptance devices (CADs) by end-2005. The conversion of 6.2 million credit cards to the EMV chip-based cards by end-2004 has sent a strong signal that Malaysia is committed in combating credit card fraud. Banking institutions have accorded high priority in upgrading the CADs at high-risk merchant locations well ahead of the end-2005 deadline. As at end-2004, 80% of the 60,000 CADs at retail outlets were EMV-compliant.

Malaysia is one of the few countries in the region that has adopted the EMV standard in order to improve the confidence of consumers, foreign visitors and retailers in the usage and acceptance of credit cards at retail outlets. This is necessary as the number of credit cards issued in Malaysia was 6.6 million with total transactions amounting to RM34.9 billion in 2004. In contrast, charge card operations are relatively small in Malaysia, with 0.3 million charge cards in circulation and total transactions amounting to RM2 billion in 2004.

To address the high level of credit card fraud taking place at petrol stations, which constituted almost 22% of the value of credit card fraud in 2004, petrol companies had taken a positive step to convert terminals located at petrol pumps to be EMV-compliant and disabled the acceptance of magnetic stripe credit cards at self-service pumps on 31 December 2004.

Graph 10.5
Credit Card and Charge Card Operations in Malaysia



Besides skimming card information from the magnetic stripe, wire-tapping can also be used to steal cardholder's information. In this respect, Bank Negara Malaysia required the banking industry to take several preventive measures, including the implementation of a line encryption system to combat wire-tapping fraud. The Malaysian banking industry is one of the few in the Asia Pacific region to take a firm stand by investing in the necessary infrastructure to combat credit card fraud.

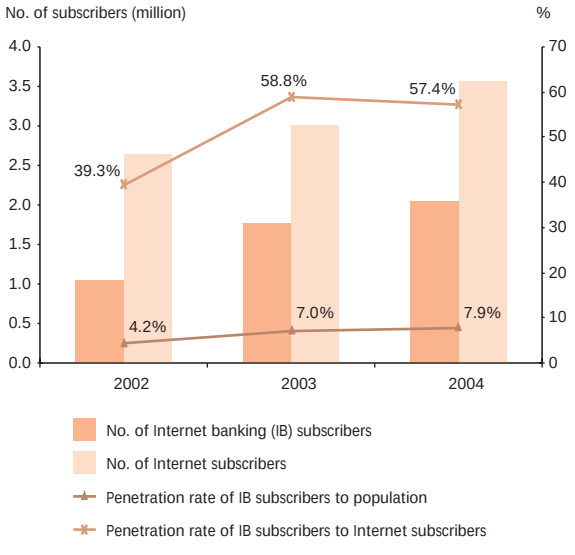
(iii) Internet Banking

In line with the growing prominence of Internet banking in Malaysia, efforts were made to preserve consumers' confidence in using the Internet to access banking services. In 2004, an industry-based Internet Banking Task Force was established by Bank Negara Malaysia to develop industry-wide best practices and collaborate with relevant agencies to handle security infringement incidences. Special emphasis was given to thwarting 'phishing' and other forms of identity theft fraud, that is, illegally obtaining personal information of account holders for financial gain. During the year, one bank introduced an additional password protection for their Internet banking customers through a time-limited one-time use password. This measure has been proven to be successful in countering Internet banking fraud.

Currently, there are 14 banking institutions providing Internet banking services to 2 million subscribers. The number of subscribers increased by 15.4% from the previous year, reflecting the growing acceptance of Internet banking as a convenient and safe delivery channel for accessing banking services.

The use of the Internet as a delivery channel should become more pervasive in the future, as more Internet-based systems and payment gateways are introduced. Besides the MEPS payment gateway, one bank had implemented its own payment gateway in 2004 and three others are making similar arrangements in order to enhance their services to customers. The number of transactions processed by the MEPS payment gateway increased by 650% from 0.2 million in 2003 to 1.5 million in 2004 while the value of transactions processed rose by 1,219% to RM663.3 million. The surge in the use of the MEPS payment gateway was due to the participation of several major merchants active in online offerings.

Graph 10.6
Internet Banking: Growth and Penetration



Source: Bank Negara Malaysia and the Malaysian Communications and Multimedia Commission

(iv) Minimum Security Standards for Cheques

In July 2004, Bank Negara Malaysia issued the 'Guideline on Minimum Security Standards for Cheques' to reduce incidences of counterfeiting and fraudulent alteration on cheques, and to facilitate detection of such cheques. The Guideline specifies minimum requirements for banks in their roles as paying or collecting banks. The Guideline provides specific requirements on governance arrangements, physical security features on cheques, cheque fraud detection facilities, security management in cheque printing and consumer protection.

(v) Business Continuity Planning

Bank Negara Malaysia places high priority on Business Continuity Planning (BCP) to provide uninterrupted availability of the payment systems through contingency procedures at its recovery centre for the RENTAS and SPICK systems. Apart from conducting monthly live runs for the two payment systems, a review of the financial institutions' BCP arrangements was also conducted in 2004 to identify the strengths and weaknesses of the arrangements in the event of a crisis. Financial institutions have been advised to regularly test their BCPs and several procedural requirements had been put in place to strengthen recovery strategies and minimise disruptions.

MIGRATION TO E-PAYMENTS

The migration to electronic payments, while requiring investments in infrastructure development, will facilitate cost savings by being able to leverage on new cost effective infrastructure and to continuously meet consumers' payment needs through innovative facilities and products. The relatively faster settlement cycle of electronic payment systems as compared to paper-based systems improves the efficiency of the financial system and the economy.

The overall increase in the usage of non-paper based payment facilities was encouraging in 2004. As a percentage of the total payment instruments volume (excluding cash), the usage of the credit transfers such as IBG, and e-purse for toll payments expanded in 2004 compared to 2003. Payment cards, particularly credit cards, are becoming a convenient alternative to cash and cheques, since auto-debit facilities for paying basic utility bills and Internet payments are commonly offered through credit cards. Cheque as a mode of payment saw a decline in its share of value and volume as other payment instruments became more widely used. However, due to its wide reach, cheque issuance remains popular and its value constitutes 95.7% of total non-cash payments in 2004.

Financial institutions are therefore, encouraged to support the migration efforts by intensifying development and adoption of various electronic payment mechanisms and addressing specific impediments that hinder the adoption of electronic payments. These include promoting their delivery channels in **mobile banking**, and payment instruments such as the **debit card** and **electronic purse**.

(i) Mobile banking

Mobile banking services provide an innovative and convenient way to access banking facilities. The current range of services offered include balance inquiry, funds transfer, bill and financing payments, mobile prepaid airtime reload, and requests for statements and cheque books. The range of mobile banking services can be further expanded to take advantage of the increasing number of mobile phone users in recent years. As at end-2004, the mobile phone subscriber penetration rate in Malaysia was 55.9% of the total population. However, mobile banking is still in its infancy with only six banks currently offering the services with a subscriber base of approximately 25,000. Nevertheless, the banking industry is confident that mobile phone subscribers will be attracted to mobile banking as more services are added to the current suite of facilities.

(ii) Debit cards

While there is a potential for debit cards to be a viable alternative to cash, its adoption in Malaysia is still low. Debit cards offer benefits particularly to consumers who are not comfortable with paying by credit or are not eligible for credit card facilities such as students. With debit cards, the cardholder's account will be directly deducted when making purchases, benefiting the cardholder who needs to carry less cash and able to enjoy the efficiency and security offered by debit card payments. Retailers would benefit from lower fees compared to the fee that is being charged through credit card payments. With 10.8 million Bankcards in circulation, there is a potential for debit payments to grow once the benefit of using this electronic payment mode is fully appreciated by consumers.

Table 10.2

Non-Cash Payments in Malaysia

	2003		2004	
	Value (%)	Volume (%)	Value (%)	Volume (%)
Cheques	96.67	34.04	95.65	28.75
Credit cards	2.48	27.68	3.03	25.74
Credit transfers (IBG)	0.63	0.24	1.10	0.57
Charge cards	0.16	1.42	0.16	1.03
E-purse - Toll payments	0.05	36.40	0.06	43.69
E-purse - Retail	...	...	...	0.01
Debit cards	0.01	0.22	...	0.21

... Negligible.

(iii) Electronic Purse

The MEPS Cash electronic purse, which is incorporated in the Bankcard and MyKad, is an alternative electronic payment mode to using cash for making retail payments. As at end-2004, banking institutions and third party acquirers had deployed more than 16,000 CADs at various merchants to accept MEPS Cash. The volume of MEPS Cash transactions increased from 0.02 million in 2003 to 0.09 million in 2004, while the value of transactions increased from RM0.1 million to RM0.3 million during the same period. While the usage of MEPS Cash is still low compared to other electronic payments, continuous efforts are being made to promote MEPS Cash usage. Since early 2004, payments using MEPS Cash are accepted at various closed communities such as Bank Negara Malaysia, Universiti Utara Malaysia, Cyberjaya and Putrajaya.

The use of another electronic purse, the Touch 'n Go card in the transportation sector will facilitate the reduced use of cash and coins in the sector. Following the Government's decision to designate Touch 'n Go cards as the only electronic payment method at toll plazas, the volume and value of Touch 'n Go transactions increased by 45.2% and 29.6% respectively in 2004 compared to the previous year.

National Payments Advisory Council (NPAC)

As part of the efforts to promote a vibrant financial system and robust payment systems architecture, Bank Negara Malaysia held two NPAC meetings in 2004, to facilitate discussions on major payment systems issues. The first NPAC meeting was held on 20 July 2004 where issues relating to the migration to electronic payments and the proposed steps to build an effective e-payment infrastructure were discussed. Following the deliberations, the Interbank Giro Review Team was formed to provide direction in promoting the use of IBG in the country. The meeting also deliberated on measures to promote responsible lending and borrowing in credit card usage and measures to enhance consumer confidence in the use of credit cards as a non-cash payment instrument.

The second meeting was held on 8 December 2004, in which the NPAC deliberated on the appropriate regulatory approaches to address alternative remittance systems and measures to promote the use of formal channels for remittances. The NPAC agreed that the banks should make their remittance services more accessible, convenient and cheaper to migrant workers to encourage migration to the formal remittance channels. The NPAC also discussed the measures in managing and reducing foreign exchange settlement risk in Malaysia and to improve the access for international investors to settle their trading of Malaysian papers.

Moving forward, Bank Negara Malaysia will work together with financial institutions to offer efficient and secure payment transactions at lower cost so as to enable more extensive utilisation of electronic payments channels. Bank Negara Malaysia, together with the banking industry and support from the Government sector, will continue to promote efficient and effective delivery channels and electronic payments, in line with enabling the payment systems to facilitate economic activity and contribute to financial stability.

External Relations

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External Relations

Malaysia continued to participate actively at major international and regional fora during the year. Discussions at the international level focused on the global economic imbalances, rising fuel prices and the monetary policies adopted among the major economies. On the regional front, the favourable economic and financial environment provided the catalyst for strengthening economic and financial co-operation, with emphasis on promoting stronger financial systems and markets among countries in the region.

Economic Surveillance

Economic surveillance remained integral to discussions at the regional groupings, including Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), South-East Asian Central Banks (SEACEN), the Association of Southeast Asian Nations (ASEAN), and ASEAN plus People's Republic of China (PR China), Japan and Korea (ASEAN+3). The focus of discussions at these meetings was on global imbalances, with emphasis on the changes in the interest rate trends, the effect of high commodity prices and possible oil price shocks, and the progress on regional integration and financial liberalisation. Surveillance issues were also deliberated at the meetings of the International Monetary Fund (IMF)/World Bank (WB) during the year.

Economic surveillance remained integral to discussions at the regional groupings, with the focus on global imbalances, exchange rate stability, capacity building, and developments in regional integration and financial liberalisation.

Financial market trends and views on the implications of global interest rates on the regional financial markets were discussed at the 9th EMEAP Governors' meeting (comprising 11 central banks and monetary authorities in the East Asia and Pacific region). While there was consensus that the impact of a transition to a higher interest rate environment on the global and Asian financial markets would be minimal, increased efforts would be directed at macro-surveillance issues in EMEAP's regional surveillance initiatives. Toward this end, the EMEAP Working Group on Banking Supervision is developing a template for financial stability map to monitor significant cross-border linkages and possible sources of vulnerability in the financial system.

Given the importance of a sustained economic recovery in the region in particular, and the global economy in general, economic surveillance remained the focus of the 39th Conference of Governors of SEACEN as well as the ASEAN Central Bank Deputies' Meeting and the ASEAN and ASEAN+3 Finance Ministers' Meetings. The meetings emphasised the need for concerted efforts by the major industrial countries to resolve the global imbalances that largely stemmed from the structural weaknesses prevailing in their economies. Concurrently, due emphasis should be given by the emerging market economies to policies that would create a conducive environment for domestic demand-led growth, notwithstanding that some had already contributed to the adjustment process by adopting expansionary policies to promote domestic demand. A supportive macroeconomic environment that included stability in exchange rates and efficient financial intermediation should be complemented with an efficient delivery system in the economy. Equally important was capacity building in the domestic enterprises and financial institutions to enhance their effectiveness in an environment of deregulation and liberalisation.

International Financial Architecture

The momentum for reform of the international financial architecture (IFA) has slowed down in recent years although there was some progress in the areas of crisis prevention and resolution during the year. However, progress remains limited on the more fundamental issue of governance of the international financial institutions (IFIs). In this regard, Malaysia continued to reiterate the need to improve the governance of the IFIs notably that of the Bretton Woods Institutions (BWIs). Malaysia expressed its disappointment on the lack of progress on the institutional and structural issues of governance including quotas, voting power and under-representation of developing countries in the BWIs. The Bank also voiced its concerns on the governance issue and called for a review of the role and structure, policies and operations of the BWIs

to meet changing global challenges and for the BWIs' decisions to be more inclusive, representative and accountable to their members.

A related development on governance and representation at the IFIs was the signing of the Memorandum of Understanding (MoU) during the year by Governors of the South-East Asia (SEA) Voting Group at the IMF. The MoU outlined the new rotation scheme for the SEA Group Office for a period commencing from November 2004 to April 2017, and redefined the roles and responsibilities of each position in that office. The framework included guidelines to improve the efficiency and effectiveness of the SEA Group Office to better serve its members. Similarly, the SEA Group Office at the World Bank also undertook a review of their rotation scheme and signed a MoU during the IMF/WB Annual Meetings in October 2004.

In the area of transparency, the Bank continued to support the IMF's Special Data Dissemination Standards (SDDS) initiative as part of Malaysia's efforts to support greater transparency in the global financial system. The SDDS was created by the IMF to guide members that have, or might seek access to international capital markets, in the dissemination of their economic and financial data to the public. Malaysia was among the first group of 42 countries that subscribed to this initiative established in 1996. In June 2004, the Bank jointly organised with the IMF a seminar on SDDS for current and potential subscribers in the Asia and Pacific region. The seminar discussed the latest developments on SDDS operational and observance issues and provided opportunity for an open discussion among fellow SDDS coordinators as well as the IMF on SDDS-related issues.

Further, and reflecting Malaysia's support toward efforts by the IFIs to strengthen the financial sector, the Bank participated in the IMF's Financial Soundness Indicators compilation exercise which commenced in August 2004. These indicators can be used together with other economic and financial indicators to assess the financial strength and vulnerabilities of a country's financial sector.

Meanwhile, there have been encouraging developments in the area of crisis resolution, with progress made toward the use of collective action clauses (CACs) in international sovereign bonds. The use of CACs gained significant momentum in 2004, with nearly all the sovereign bonds issued in New York in the first nine months containing CACs compared with 47% in 2003. As the largest market for sovereign bonds is in the United States, the increased adoption of CACs in the New York market signifies growing convergence toward a market standard. Overall, the progress recorded will provide greater predictability in the resolution of sovereign debt problems. Malaysia had, since 2000, issued bonds that included CACs.

The SEACEN Expert Group (SEG) on Capital Flows continued to monitor developments in capital flows in the Asian region through the exchange of data on capital flows via a standard set of templates and also held a teleconference to discuss developments of capital flows and their outlook. As part of capacity building efforts among SEACEN member countries, the Bank hosted the SEACEN Workshop on Vulnerability Assessments of the External Sector in Kuala Lumpur in December 2004. The workshop focused on the concepts, framework and methodology in assessing vulnerabilities of the external sector. The workshop also aimed to enhance the use of data on capital flows exchanged among SEG members, including using the data in suitable frameworks to detect emerging risks.

Some progress in IFA issues on crisis prevention and resolution… but still slack on the issue of governance of the IFIs.

External Relations with the IMF

Malaysia actively engaged in the annual IMF Article IV consultations. The IMF's assessment of the Malaysian economy was favourable, highlighting that Malaysia's economic recovery was firmly established with comfortable external positions. The IMF further commended the Bank's approach in managing domestic credit that was prudent and consistent with maintaining the peg, and sustaining progress in enhancing the soundness and efficiency of the financial system.

The Bank co-hosted with the IMF a high-level conference on financial sector issues in emerging markets in Asia. The main focus was the role of the IMF in supporting financial system development and stability in the region. Discussions centred on issues related to financial sector surveillance, the IMF's Article IV consultations, Financial Sector Assessment Programme and Report on Observance of Standards and Codes. The Bank shared its experiences on these issues with other Asian participants and proposed several measures to improve IMF's effectiveness in this region, and in particular, the areas of surveillance and capacity building.

Malaysia continued to assist the low-income and heavily indebted poor countries via its contribution under the Poverty Reduction and Growth Facility (PRGF) and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. During the 2004 IMF/WB Annual Meetings, Malaysia called for the BWI to continue its support for a debt sustainability framework for the low-income countries and to assist them in dealing with exogenous shocks.

Malaysia maintained its net creditor status in the IMF during the year. It was called upon to transfer SDR12 million for the period March-November 2004. The transfer was executed under the IMF's Financial Transaction Plan (FTP), a mechanism through which the IMF finances its lending and repayment operations. Under the FTP, selected IMF members with strong balance of payments and international reserve positions may be called upon to provide foreign exchange resources to support the IMF's financial operations.

Islamic Banking

Bank Negara Malaysia continued to play an active role in the International Financial Services Board (IFSB), through its Council and Technical Committee. In May 2004, IFSB initiated the preparation of a third standard, on corporate governance for the Islamic financial institutions, in addition to the standards on capital adequacy and risk management currently being finalised. The exposure drafts of the capital adequacy standard and risk management standard are expected to be circulated for comments by the first quarter of 2005. In December 2004, the Islamic Development Bank (IDB) and Asian Development Bank (ADB) signed a Technical Assistance (TA) Agreement with the IFSB to facilitate the development of Islamic prudential standards in three areas, namely, transparency and market discipline, establishment of a financial database relating to regulatory and prudential issues in the Islamic financial industry and the preparation of a draft model trust law for Islamic sukuk markets.

During 2004, IFSB admitted the Central Bank of the United Arab Emirates and Bangladesh Bank as full members; and the People's Bank of China and Dubai International Financial Centre Financial Services Authority as associate members. As at end-2004, the total number of IFSB members increased to 65 members (15 full members, six associate members and 44 observer members) from 36 members as at end-2003.

Combating Money Laundering and Terrorism Financing

Money laundering and the financing of terrorism continued to be a challenge addressed by the international community. While much has been done to combat money laundering and the financing of terrorism, these continued to attract international attention and co-operation. During the year, Malaysia participated actively in and enhanced co-operation with the global anti-money laundering network, primarily the Financial Action Task Force (FATF), the Asia/Pacific Group on Money Laundering (APG) and the Egmont Group of Financial Intelligence Units (Egmont Group). Malaysia continued to support regional and international initiatives to combat money laundering activities and the financing of terrorism (AML/CFT) including initiatives such as mutual evaluations and technical assistance.

Mutual evaluation exercises are conducted to assess each country's compliance with the global standards against money laundering and the financing of terrorism. The process of evaluation is designed to give due recognition where the standard benchmarks are met and to identify weaknesses in the national AML/CFT programme of the country being assessed. Where weaknesses are identified in the AML/CFT programme, appropriate recommendations are made with a view to rectification and improvement. The Bank participated in the mutual evaluation exercises of the APG for the Philippines, Pakistan and Brunei Darussalam. The findings of the year's compliance assessments would be reported at the next APG Annual Meeting scheduled for July 2005.

Malaysia also joined the APG's Technical Assistance Donor and Provider Group (DAP) to provide AML/CFT technical assistance and training to Cambodia, Lao PDR, Myanmar and Vietnam to expedite their implementation of the global AML/CFT standards. The assistance provided under the DAP programme mainly relates to establishing financial intelligence units (FIUs) as well as formulating and implementing comprehensive national AML/CFT programmes.

During the year, Malaysia successfully established bilateral and multilateral arrangements for cross-border exchange of financial intelligence and mutual assistance in criminal matters in order to effectively combat money laundering, terrorism financing, and other transnational crime. In addition to the MoU on the sharing of financial intelligence that were signed with the Australian and the Indonesian FIUs earlier, the Bank signed an MoU with the Anti-Money Laundering Council of the Philippines on 4 August 2004. The Bank is at various stages of negotiations with other foreign counterparts

to execute similar MoUs. Another milestone in international co-operation is the signing of a Treaty on Mutual Legal Assistance in Criminal Matters by eight countries in this region, namely, Malaysia, Brunei Darussalam, Cambodia, Indonesia, Lao PDR, the Philippines, Singapore and Vietnam on 29 November 2004. Among others, the Treaty will facilitate cross-border co-operation in criminal investigations and the gathering of evidence for court proceedings.

The Bank has benefited from its membership in the Egmont Group, which is an informal organisation (named after the location of the first meeting held in Egmont-Arenberg Palace in Brussels) for FIUs to improve support to their respective national AML/CFT programmes. This support includes expanding and systematising the exchange of financial intelligence between its 94 members, improving expertise and capabilities of intelligence personnel. The Egmont Group's secure web fosters better communication among FIUs through the application of new technologies, and the rapid exchange of information among the participating FIUs. This forum provides for the Bank and other FIUs to rapidly exchange critical information on evidences of criminal activities abroad. This has facilitated access to information on transnational crime to our domestic investigators and prosecutors in a timely and useful manner.

With respect to capacity building through exchange of knowledge and experience, the Bank participated actively in a number of regional and international fora. Malaysia attended the annual meetings of the Egmont Group and the APG, and participated in the FATF Seminar on Terrorism Financing, the APG Money Laundering Methods and Typologies Workshop and the APG Implementation Workshop on Alternative Remittance System. The Bank also participated in the 4th Annual ASEAN Senior Officials Meeting on Transnational Crime (SOMTC) held in Brunei Darussalam where Malaysia was assigned the task of lead shepherd in combating money laundering and sea piracy. The meeting committed SOMTC to ongoing strengthening of resources, internal procedures and legislative provisions to improve effectiveness of law enforcement in combating transnational crime. Extra-regional co-operation with PR China, Japan and Korea (SOMTC/ASEAN+3) and other countries in the exchange of information and expertise in combating transnational crime helped consolidate efforts in ensuring security and safety in the region.

Malaysia also participated in training activities initiated under the second phase of the Asia-Europe Meeting (ASEM) Anti-Money Laundering Project. The ASEM Anti-Money Laundering Project will also deliver training seminars for prosecutors, judicial officers and officers providing mutual legal assistance to foreign countries. Malaysia continued to support the ASEM Anti-Money Laundering Project by contributing sanitised cases for the Joint Asia Europe Money Laundering Data Exchange (JAEME) project that was established at the Anti-Money Laundering Office in Thailand. JAEME will collect and compile data on sanitised money laundering cases and identify money laundering trends that exist in Asia and Europe.

During the year, the Bank assisted the United Nations Office on Drugs and Crime in adapting its e-learning AML/CFT CD-ROM training software to the domestic legislative framework and in developing the Bahasa Malaysia version for implementation in early 2005. The e-learning AML/CFT CD-ROM training software would be made available for training law enforcement officers as well as AML/CFT reporting officers from the private sector. In addition, the Bank hosted a number of participants on study visits or attachments from Hong Kong China, Indonesia, Japan, the Republic of Fiji and Nepal to gain understanding on the operations of the FIU in the Bank and to understudy Malaysia's AML/CFT programme.

The Bank is committed to co-operate with other jurisdictions and international bodies in the fight against money laundering and terrorism financing through sharing of financial intelligence, active participation in AML/CFT initiatives, including technical assistance.

The Bank is committed to assist other jurisdictions in the fight against money laundering and terrorism financing as provided under the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 and will continue to participate actively in regional and international AML/CFT initiatives.

Financial Services Negotiations

In 2004, Bank Negara Malaysia participated in negotiations on trade in financial services at the multilateral forum of the World Trade Organisation (WTO), the regional forum of ASEAN and bilaterally through ongoing free trade agreements (FTAs). These

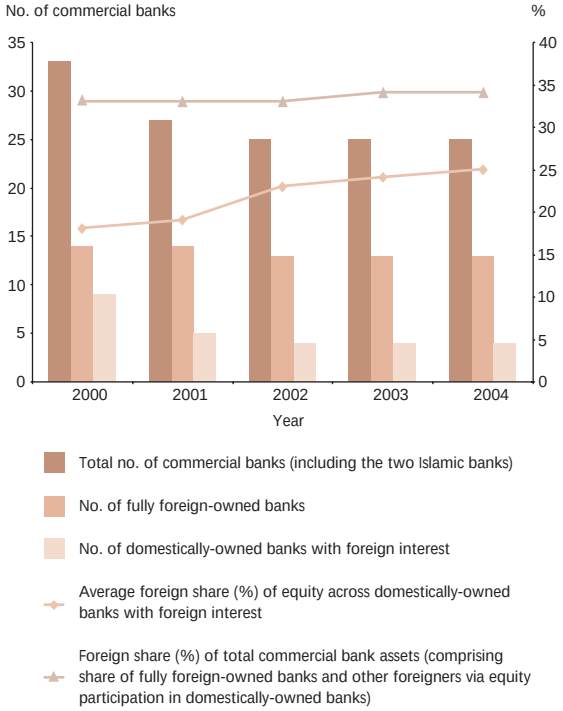
negotiations form part of the overall negotiations on trade in services in the various fora. The objective of the negotiations is for participating countries to progressively liberalise their services regime toward promoting greater trade in services and investment flows in services among the countries.

World Trade Organisation (WTO)

Services negotiations at the WTO, including on financial services, continued to focus on the 'request and offer' phase in 2004. The process generally entailed bilateral discussions between member countries of the WTO based on requests for market opening. The Bank was actively involved in the services negotiations, particularly in discussions relating to the further liberalisation of the financial services sector.

The Bank remains committed to the gradual liberalisation of the financial services sector as part of the steps to further develop the domestic financial sector. In managing the liberalisation process, the Bank would continue to be guided by the phases of development as set out in the Financial Sector Masterplan and the Capital Market Masterplan, consistent with the commitment in moving toward greater market orientation and international

Graph 11.1
Foreign Participation in the Malaysian Commercial Banking Sector



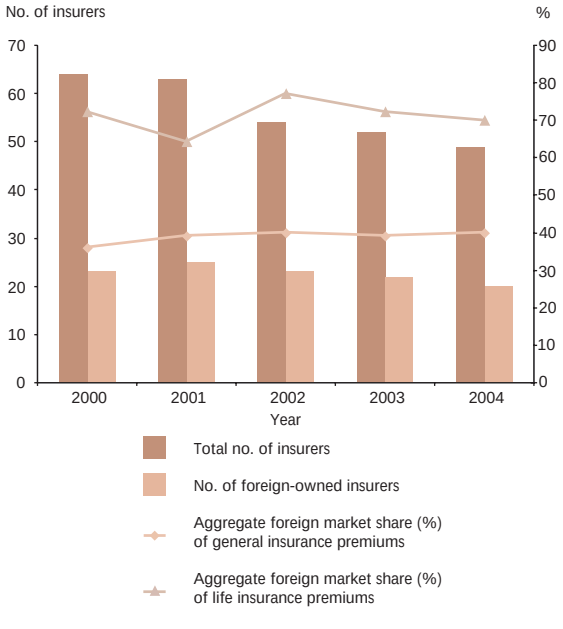
Framework package adopted at the WTO… established steps toward the successful conclusion of negotiations under the Doha Development Agenda.

integration. In this regard, Malaysia has always had a significant foreign presence in the domestic financial sector, both in terms of equity and market share.

The most significant development at the WTO in 2004 was the adoption of the framework package by member countries to move forward on the Doha Development Agenda (DDA) in a range of issues, among others, on agriculture, goods, services (including financial services), implementation issues and the 'new issue' of trade facilitation. With the adoption of the framework package, the timeframe for all negotiations under DDA was also extended for another year to lead toward the next WTO Ministerial Conference in December 2005 in Hong Kong China.

The framework package had established the steps to be taken toward the successful conclusion of negotiations under the DDA. Malaysia's overall stance is to achieve a balanced outcome across all sectors that would also reflect the interests of developing countries. Toward this end, on negotiations to further liberalise

Graph 11.2
Foreign Participation in the Malaysian Insurance Industry



trade in services, Malaysia supports the call by the framework package for offers of market opening to be made particularly in services sectors and modes of supply of export interest to developing countries.

ASEAN Framework Agreement on Services and Free Trade Agreements

The third round of financial services negotiations under the ASEAN Framework Agreement on Services (AFAS) continued to proceed in 2004, with member countries, including Malaysia, negotiating for higher levels of commitments than those made at the WTO. Other than AFAS, financial services also fall under the scope of overall services negotiations in ongoing discussions of the Malaysia-Japan FTA and the ASEAN-PR China FTA in 2004.

Asian Bond Market Initiative (ABMI) under the ASEAN+3 forum and expansion of the Asian Bond Fund (ABF) under the EMEAP process. These positive developments bode well towards the broadening and deepening of regional bond markets to facilitate productive investment and efficient channelling of capital in the region.

In May 2004, the ASEAN+3 Finance Ministers launched a Working Group to explore ways to enhance the effectiveness of the CMI. In this regard, three meetings were conducted by the Working Group and key issues under the review related to the co-ordination, conditions and modality for activation under the CMI. To this end, the Bank is an active member in leading Malaysia's participation in the Working Group in further developing the CMI as an important element in financial co-operation in the region.

In October 2004, the Bank renewed, for another three years, the US$1 billion bilateral swap arrangement (BSA) agreement under the CMI and the US$2.5 billion BSA agreement under the New Miyazawa Initiative between Malaysia and Japan.

Regional co-operation intensified… efforts being taken to enhance the effectiveness of regional financing arrangements under the Chiang Mai Initiative, significant strides were made under the Asian Bond Market Initiative and the Asian Bond Fund was expanded to further develop the regional bond markets.

Regional Co-operation

Significant progress in strengthening regional financial co-operation was achieved through the collective effort of countries in furthering the objectives of major initiatives under various regional fora in 2004. These included efforts taken to enhance the effectiveness of regional financing arrangements under the Chiang Mai Initiative (CMI), advancements in the development of the

Bilateral Swap Arrangement Agreements under the Chiang Mai Initiative

Dates indicate when the agreements have been signed and the maximum drawing amount for each agreement is indicated in parentheses.

[1] A one-way swap arrangement where the requesting country under the agreement can request the swap-providing country to enter into a swap transaction.
[2] A two-way swap arrangement where either party could request the other party to enter into a swap transaction under the agreement.

● Agreements signed between the Plus Three countries (People's Republic of China, Japan and Korea) and ASEAN countries

● Agreements signed among the Plus Three countries

Collectively, the combined size of the current 15 bilateral swap arrangement (BSA) agreements under the CMI is US$33.5 billion.[1]

Since its inception in December 2002 and its official endorsement by the ASEAN+3 Finance Ministers in August 2003, the ABMI has made significant strides in creating an enabling environment to encourage intra-regional investment as well as capacity-building programmes for development of regional bond markets. Keen collaboration among ASEAN+3 countries continued with regular meetings of the six working groups[2], and dialogues and discussions with private sector participation. The Working Group on Foreign Exchange Transactions and Settlement Issues chaired by the Bank continued to examine and explore matters involving the clearing and settlement systems of ASEAN+3 member countries in facilitating cross-border transactions and impediments on cross-border investment and issuance. Discussions in these areas have assisted policymakers in designing strategies for further market development.

In May 2004, the Asian Bonds Online Website[3] was launched as an initiative under the ABMI. The Website is a one-stop information clearing-house on the rapidly growing sovereign and corporate bond markets in the region, which also facilitates information dissemination among issuers and investors. The objective of the Website is to provide the market with information on the bond markets in the region as well as updates on the progress made by each of the working groups under the ABMI.

Achievements by individual ASEAN+3 member countries in 2004, which contributed toward furthering the objectives of the ABMI, included the issuance of the ringgit-denominated bond amounting to RM400 million by the ADB and of the Islamic ringgit-denominated bond amounting to RM500 million by the International Finance Corporation in Malaysia. Other achievements included the permission given to multilateral development banks to issue local currency denominated bonds in Thailand; creation of a new scheme of cross-country primary collateralised bond obligations (CBO) by Japan and Korea; and provision of credit guarantees by the Japan Bank for International Co-operation and the Nippon Export and Investment Insurance for bonds issued by Asian multinational companies.

In complementing the ABMI, the EMEAP Group had successfully launched the Asian Bond Fund 2 (ABF2) in December 2004. The newly launched ABF2 will invest in domestic currency bonds issued by sovereign and quasi-sovereign issuers in the EMEAP markets (other than Japan, Australia and New Zealand, which were deemed to be sufficiently developed markets). The ABF2 built further on the first stage of the ABF, which only invested in US dollar denominated bonds. Members of the EMEAP Group, including the Bank, will participate in the ABF2, and are confident that it will play a catalytic role in contributing to more efficient financial intermediation in Asia in the longer term as well as supporting overall efforts by regional countries to develop their domestic capital markets.

The Bank continued to give its support to the SEACEN Research and Training Centre to conduct central banking training programmes. During the year, the SEACEN Centre focused on topics relating to core central banking functions especially in banking supervision, financial reforms and monetary policy. Besides extending training to its members, which had expanded to 13 with the admission of the Reserves Bank of Fiji in April, the Centre also extended its training to 16 non-members. In conducting training activities, the Centre collaborated with central banks from developed countries, such as the Federal Reserve System of the United States, the Reserve Bank of Australia and the Bank of Japan. At the same time, collaboration with various multilateral organisations and regional institutions, including the IMF, the World Bank, Bank for International Settlements (BIS), the Basel Committee on Banking Supervision, the Financial Stability Institute, the ADB and the Toronto Centre, was established. The collaboration helped to enhance the quality of the training programmes and their effectiveness in enhancing the skills of participants from regional central banks as advisors and regulators in a dynamic global environment.

Bilateral Co-operation

On 30 June 2004, Malaysia entered into an MoU with IDB to develop a framework of co-operation among the Organisation of Islamic Conference (OIC) Member Countries in key economic activities as part of her initiative as the Chair of the OIC. The Governor signed the MoU on behalf of the Government of Malaysia.

[1] Based on the overall availability under the BSAs, where the maximum drawing amount under two-way swap arrangements is counted twice to reflect the swap amount available to both parties under the agreement.

[2] The six working groups are, namely, on 'New Securitised Debt Instruments', 'Credit Guarantee and Investment Mechanisms', 'Foreign Exchange Transactions and Settlement Issues', 'Issuance of Bonds Denominated in Local Currencies by Multilateral Development Banks, Foreign Government Agencies, and Asian Multinational Corporations', 'Rating Systems and Dissemination of Information on Asian Bond Markets', and 'Technical Assistance Co-ordination'.

[3] *www.asianbondsonline.adb.org*

This MoU, which aims to enhance opportunities for growth among the OIC Member Countries, seeks to strengthen financing arrangements to promote trade, provide a new focus on financing services in trade and investment, as well as facilitate the use of Information and Communication Technology (ICT) to expand intra-OIC economic activities. The MoU also promotes the development of Islamic financial markets focusing on promoting business linkages and mobilisation of funds for cross-border investments between the financial centres in the OIC Member Countries. In the area of Islamic finance, the MoU aims to further expand takaful and retakaful businesses among the OIC Member Countries. The MoU also contains provisions to promote the use of insurance instruments for the expansion of trade and investment and encourages the OIC Member Countries to adopt FTAs.

Malaysia entered into an MOU with the IDB to develop a framework of co-operation with the aim of enhancing the opportunities for growth among the OIC Member Countries.

In realising the areas of co-operation embodied in this MoU, two High Level Meetings between Malaysia and the IDB have been held to date. The First High Level Meeting was held in Kuala Lumpur on 30 September - 1 October 2004, while the Second High Level Meeting was held in Jeddah on 20-21 February 2005. Both these High Level Meetings, which concluded with the signing of the Agreed Minutes, deliberated at great length on the areas of co-operation in the MoU to determine and strategise the plan of action and target deliverables. Discussions and negotiations on the implementation of the MoU will be intensified in 2005 to achieve the objectives outlined in the MoU.

In 2004, the Bank also made further progress in the promotion of the Bilateral Payments Arrangement (BPA) and the Gold-based Trade Payments Arrangement (GTPA). On 18 June 2004, the Bank signed a BPA agreement with Bank Mandiri, Indonesia and had throughout the year initiated several bilateral negotiations on the GTPA with interested countries. Moving forward, as part of the Bank's effort to continuously promote trade with non-traditional markets, the Bank is also looking into operationalising commercially-driven trade financing arrangements, which would target non-traditional markets, in general, and OIC markets, in particular.

Technical Assistance and Information Exchange

The Bank continued to provide capacity building programmes to interested parties. Under the Malaysia Technical Co-operation Programme (MTCP), the Bank offered places to foreign participants in two annual programmes, namely, the Central Banking Course (since 1984) and the Banking Supervision Foundational Course (since 2002). In 2004, the Bank received a total of 22 officials from 13 central banks to participate in its programmes. The Bank has received a total of 234 foreign participants since the inception of the courses.

Under the D-8 fora, the Bank continued to promote the development of Islamic banking and takaful through its involvement to enhance the supervisory and regulatory frameworks of the insurance and takaful industries. In addition, at the inaugural Asian Islamic Banking and Finance Summit, the Bank organised two workshops that covered issues on Islamic finances, particularly risk management and capital adequacy in meeting the requirements of the IFSB and development of an Islamic money market. During the year, Bank Negara Malaysia also briefed interested central banks and banking institutions from Bahrain, Bangladesh, Sudan, Lebanon, Singapore and Indonesia on Islamic banking and takaful. In addition, Malaysia organised a dialogue to share experiences on Deposit Insurance and Financial Disclosure among Asia-Pacific Economic Cooperation (APEC) economies in February 2004.

Organisation and Human Resource

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Organisation and Human Resource

ORGANISATION DEVELOPMENT

Overview

The change management programmes in 2004 endeavoured to break new grounds in providing the Bank with enhanced capacities and capabilities to deal with the challenges brought about by a dynamic and uncertain external environment. In particular, the Knowledge-Based Organisation (KBO) initiatives that commenced in 2001 continued during the year to improve the Bank's ability to acquire, create, use and retain knowledge. The Bank continued to promote organisation-wide practices of knowledge sharing and collaborative work within a secured and trusted environment, with the adoption and implementation of newly formulated information security policies and procedures. For performance improvement, the initiatives during the year focused on programmes to modernise talent management practices, enhance learning and training, improve processes, upgrade technological infrastructure, and improve the physical working environment.

One of the tools the Bank adopted in 2004 for the purpose of enhancing the process of performance management is the Balanced Scorecard[1]. The Balanced Scorecard approach emphasises the need to view organisational performance from multiple dimensions, with emphasis on inter-linkages between strategy planners, decision-makers and strategy implementers. The breadth and depth of a central bank's functions in our emerging market economy poses unique challenges to remain focused on strategic long-term objectives, while giving effective attention to tactical issues. The alignment of internal capacity and capability development efforts for strategic and operational goals within the Bank has become more imperative, thus demanding greater levels of flexibility and innovation in how the Bank manages its human, knowledge and technology capital.

Since the launch of the KBO programme in 2001, the Bank put in place programmes and initiatives to enrich its internal knowledge resources through a wide range of human resource, knowledge and technology initiatives. The Bank's corporate intranet now provides extensive online connectivity throughout the organisation, enabling higher levels of organisational and process integration, personal productivity improvement, and collaborative work. A significant new achievement in 2004 is the transformation of the Bank's library into a Knowledge Management Centre (KMC). This centre greatly enhances existing knowledge management processes and promotes a more reliable and effective means for the Bank to manage its knowledge assets. Any individual who needs to obtain new knowledge can use the services of the KMC to expedite knowledge identification, acquisition and use. Furthermore, existing knowledge can easily be converted into reusable knowledge assets, all of which are being managed centrally by KMC staff. The Bank's corporate memory, therefore, will be more accessible to all staff.

The adoption of a strategy-focused organisation as a principal theme for organisational capacity and capability development in 2004 has successfully paved the way for a more deliberate management of intellectual capital in 2005, focusing on areas relevant to the core objectives of the Bank. The combined theme of strategy focused organisation and knowledge management would be at the centre of the organisational development programmes of the Bank for 2005.

Human Capital Management

During 2004, the Bank established a Leadership Development Centre programme to identify, develop and sustain leadership talent in the Bank. In an effort to improve the alignment of human capital development with the Bank's business strategies, changes were introduced to the Bank's competency management framework, as well as, the career management system.

Staff strength as at end-2004 was 2,335, representing an increase of 1.6% from end-2003. Staff turnover rate remained below 2% for 2004. The majority of new hires were graduates, reflecting the Bank's focus on bringing in knowledge workers and new talents to enhance productivity and performance. Between 1998 and 2003, the number of graduates increased from 798 to 1,233, that is, from 42% to 54% of staff population.

[1] The Balanced Scorecard methodology was developed by Professor Robert S. Kaplan of Harvard Business School and David P. Norton of Balanced Scorecard Collaborative Inc.

Occupational safety and health was another area of focus during the year. The Bank has given greater visibility to personal health and well-being by conducting health and environmental assessments with the assistance of the National Institute of Occupational Safety and Health. Staff involved in departmental Safety, Health and Environment (SHE) committees conducted a series of First-Aid certification programmes as well as organised internal seminars on safety and health. The Bank introduced a lactation room for mothers with newly born babies, and is exploring options for providing child care services for staff. These initiatives contribute to an environment where human capital can be more productive without excessive stress.

Training and Learning Management

Greater effort was put into integrating training and learning management with staff performance management. Relevant training and learning programmes for staff to acquire new knowledge and skills were executed in line with efforts in human resource management to align human capital with the Bank's strategic needs. In particular, efforts toward enhancement of self-directed learning with customised content and delivery at the individual and departmental levels serve to increase the overall ability of the Bank in aligning human capital and knowledge assets to meet new challenges faced by the Bank.

In the Bank's effort to develop leaders from within, the Bank successfully organised the first customised Leadership Development Programme. The Bank also engaged external expertise from the Toronto Leadership Centre in the area pertaining to leadership in supervision. The Bank has continued to leverage on internal resources for many of its training programmes, with 290 of the Bank's staff being recognised for their contributions towards the creation and sharing of knowledge.

The Bank invested RM8.9 million in training for knowledge and skill enhancement during the year 2004, an increase of 11% compared to 2003. These training programmes include highly customised solutions designed to meet learning needs of line departments. The average training man-day per staff registered in 2004 was 12 training days and on average, training investment per staff amounted to RM3,800, an increase of 9% from 2003.

Information and Communications Technology Management

The thrust of the Information and Communication Technology (ICT) management in 2004 was on initiatives that promoted the use of ICT in facilitating analysis and decision-making, enhancing efficiency and making information more accessible and visible. The Bank has embarked on an enterprise-wide initiative to create a more unified and collaborative workplace environment through the use of technology.

A special ICT executive programme is also being put in place to promote a more versatile adoption of technological solutions in driving the transformation of business processes. The Bank recognises that the implementation of new technology solutions must be matched with enhanced capacity on the part of users and decision-makers to adopt and work with the technology.

The Corporate Portal introduced in 2003 has proven to be an effective communication channel for the Bank, acting as a central gateway for staff to gain access to the Bank's corporate information and application systems. In 2004, the portal has been extended to all the Bank's branches, representative offices and mobile users. The Bank has also implemented a wireless network infrastructure within the Bank's vicinity to support staff mobility.

The Bank continues to strengthen the security, reliability and resiliency of the ICT infrastructure. The design of the new state-of-the-art Data Centre, offsite from the Bank's Head Office, is currently being developed, with the ultimate aim of providing secure and resilient facilities to support the Bank's operations.

Information Security Management

The Bank achieved yet another milestone in its Information Security Management during 2004 when it successfully translated the Information Security Policies and Standards into procedures that operationalise the classification and access control of information in the Bank.

Where the task of classification is deemed important in identifying the sensitivity and criticality of information, the procedures are expected to institute a form of discipline in encouraging knowledge exchange and sharing amongst staff in the Bank. This endeavour is seen as crucial, especially amidst other strategic knowledge management initiatives undertaken by the Bank.

The deliverables of the Information Security project include the development of revised procedures for proper handling of corporate information, as well as granting access to information based on

the principle of 'need-to-know'. The guidelines also stipulate best practice on aspects of security at various stages of a typical information management cycle.

Knowledge Management

The focus of the Bank's knowledge management initiatives during 2004 shifted from infrastructure development to the more challenging task of embedding knowledge processes within the Bank's routine operations. Several initiatives were launched in order to make knowledge management a natural part of all staff's daily activities. The first initiative was to use the Bank's corporate taxonomy standards and practices to improve governance of the Bank's knowledge assets. The taxonomy makes it easier to discover knowledge that already exists in the Bank by developing an appropriate classification for a more effective search. This also improves the capacity to identify expertise within the Bank since authorship of papers and presentations in the Bank becomes more visible.

The second initiative was the design of the Enterprise Portal Strategy that would be more effective in pulling together all the different information sources and channels within the Bank under a common information delivery platform. The Enterprise Portal would make it easier for staff to collaborate across departments, projects and even with other organisations. It would also enhance the Bank's capacity to reach out to specific stakeholders in providing information services. The Portal would also make it easier to transform business processes using information technology, and thus improving efficiency within the Bank.

The third initiative was the establishment of the KMC which gives more focus and specialised resources towards the management of the Bank's knowledge assets and processes. The core processes within the KMC focus on effective access to knowledge, maximizing reusability of knowledge, continuous learning, creation of new business knowledge and sustaining a collaborative work environment based on knowledge systems.

The KMC essentially creates processes and a comprehensive structure to systematically manage explicit knowledge within the Bank. The Bank as a whole can leverage on the information management skills which have been extensively developed within the KMC, thus making processes such as knowledge creation, identification, acquisition, re-use and re-packaging far more efficient and effective.

Office Space Management

Since 2003, the Bank has studied space management to increase efficiency and effectiveness of work, as well as provide an enhanced working environment for the staff. Space is increasingly managed to enable staff to share tacit knowledge, be more mobile and use technology within the Bank. In 2004, the Bank fully implemented the new office layout that more effectively addresses the needs of the Bank and staff in terms of functioning as a knowledge-based organisation.

During 2004, the Bank's cafeteria was refurbished and staff are now encouraged to use the cafeteria for informal discussions and meetings thus creating more

The Knowledge Management Centre

Effective Access to Knowledge	Maximise Reusability of Knowledge	Facilities for Continuous Learning	Knowledge Creation to Business Needs	Collaborative Work Environment
⬆	⬆	⬆	⬆	⬆

Knowledge Management	Identify/Create	Acquire/Capture	Analyse, Repackage, Organise	Disseminate, Use, Reuse
• Framework • Policy • Knowledge Space • Process Enhancement • KM Systems and Tools • Measurement	• Knowledge Audit • Stakeholders Profiling and Need Analysis • Information Sources Profiling and Analysis • Expertise Profiling • Developing Strategic Contents • Managing Communities of Practice	• Environmental Scanning • Information Acquisition and Processing • Subject in-depth Research • Information and Knowledge Capturing from Events • Archives Management	• Content Management • Information Repositories • Reference Services • Industry Issues and Players Profiling • Information and Knowledge Relationship • Information Analysis and Repackaging	• Corporate Taxonomy Maintenance and Development • Information and Content Dissemination • Current Awareness Service • Knowledge Sharing Techniques and Tools

space for sharing of information and exchanging of ideas. A new Multipurpose Training Complex equipped with complete training facilities such as lecture halls, discussion rooms, secretariat room and amenities for catering services has also been constructed in Pulau Langkawi to expand the space for learning and training. Recreational space has also been provided to support the Bank's work-life balance initiatives.

The Bank has also initiated the construction of the Regional Financial Services Resource Centre (FSRC) to cater for the professional training needs of the Bank and the region, particularly in the areas of Central Banking, Islamic Banking and Finance. Space has been defined to support adult learning and pedagogy that recognises teamwork, action learning and a wide variety of interaction modes.

Corporate Governance

The functions and powers of the Bank are set out in the Central Bank of Malaysia Act 1958. Several other pieces of legislation confer the Bank with additional, specific functions. Collectively, these laws establish the basic structures, arrangements and procedures for the governance of the Bank and the conduct of its business. The Bank's mission, aspirations and shared values also serve as guiding principles in the governance of the Bank.

Based on this governance framework, 12 Board Meetings were held during the year. In addition, the following senior management meetings were held – four Board Audit Committee Meetings, 48 Management Committee Meetings, four Reserve Management Committee Meetings, four Risk Management Committee Meetings, eight Monetary Policy Committee Meetings, four Financial Stability Policy Committee Meetings and two Payment System Policy Working Group Meetings. During the year, two briefings to the Prime Minister and the Minister of Finance were conducted to present the Bank's assessment of the economy and the financial sector, important financial and economic issues as well as challenges confronting Malaysia, and the policy recommendations that could be adopted.

Awards

Heartiest congratulations from the Board to Dr. Phang Hooi Eng, Ismail bin Alowi and Cheong Kwok Yew on being conferred the Johan Setia Mahkota (J.S.M) on the occasion of the birthday of His Majesty, the Yang di-Pertuan Agong on 5 June 2004.

The Board extends its congratulations to Dato' Latifah Merican Cheong on being conferred the Darjah Setia Pangkuan Negeri (D.S.P.N.) on the occasion of the birthday of His Excellency, Yang di-Pertua Negeri Pulau Pinang on 10 July 2004.

The Board also congratulates Wong Puay Chen and Rosli bin Sulong on their conferment of the Darjah Sri Melaka and Pingat Khidmat Lama respectively, on the occasion of the birthday of His Excellency, Yang di-Pertuan Negeri Melaka on 9 October 2004.

The Board also extends its heartiest congratulations to Dato' Mohd Nor Mashor for being conferred the Darjah Indera Mahkota Pahang (D.I.M.P) on the occasion of the birthday of His Royal Highness, the Sultan of Pahang Darul Makmur on 24 October 2004.

As part of its recognition program, the Bank has awarded 22 staff for their excellent performance and contribution under seven types of award categories as follows: Excellent Performance; Sports; Quality Service; Social; Professional Development and Academic Achievement. In addition to individual awards, two teams were awarded with Excellent Team Performance Awards. The awards were presented during the Bank's Annual Dinner held on 4 September 2004.

Retirement

The Board wishes to place on record its appreciation and gratitude to the 35 retirees for their dedication and commitment while in service with the Bank. The staff who retired from service in 2004 are listed in Table 12.1.

The Board would also like to take this opportunity to congratulate Datuk Zamani bin Abdul Ghani for his re-appointment as Assistant Governor upon his retirement on 19 January 2004 and his appointment as Deputy Governor on 16 May 2004.

RISK MANAGEMENT IN BANK NEGARA MALAYSIA

In 2004, in line with the evolution of risk management practices, attention turned to the need for a review and the consolidation of the risk management framework. The review built on the initiatives that had been taken to leverage on a framework that provides for independent oversight at the supervisory and operational levels and the establishment of policies and processes for good practices. A number of improvements were introduced in 2004 for implementation in 2005. Overall, the Risk Management Unit and the line departments also continued to strengthen their

Table 12.1
List of Retirees

No	Name	Department/Branch
1	Datuk Zamani Bin Abdul Ghani	Governor's Office
2	Dato' Latifah Merican Cheong	Governor's Office
3	Cheong Kwok Yew	SEACEN Research and Training Centre
4	Chong Lily Teh	Corporate Communication
5	Christopher Fernandez	Payment Systems
6	John Thomas a/l S Ebenezar	Financial Mediation Bureau
7	Looi Woon Leng	Economics
8	Teo Kee Tian	Risk Management
9	Woo Seok Hooi	Insurance Regulation
10	A. Rahman Bin Abdul Samad	Strategic Management
11	Chan Hon Wai	IT Services
12	Philip Aloysious Baptist	IT Services
13	Lim Pek Sim	International
14	Rohana Binti Yusoff	International Center for Leadership in Finance
15	Sia Geok Hee	Property and Services
16	Yip Lai Yok	Human Resource Development Centre
17	Hasnah Binti Aziz	Foreign Exchange Administration
18	Zainal Bin Kasa	ERF Sdn. Bhd.
19	Tan Chwee Hock	Information Systems Supervision
20	Abdul Ghani Bin Mohd Yusoff	Currency Management and Operation
21	Henry Arunkumar a/l Ponniah	Insurance Regulation
22	Hu Faik Seng	Bank Supervision II
23	Rosna Binti Osman	Bank Negara Malaysia Kuala Terengganu
24	Abot Bin Abong	Bank Negara Malaysia Kuching
25	Arbaiah Binti Ahmad	Governor's Office
26	Ismail Bin Muhd. Nor	Corporate Services
27	Lim Chwee Neo	IT Services
28	Ismail Bin Che Teh	Security
29	Aziah Binti Maulud	Bank Regulation
30	Abdul Kadir Bin Aziz	Security
31	Hassan Bin Serah	Bank Negara Malaysia Kuching
32	Juanis Bin Edong	Bank Negara Malaysia Kota Kinabalu
33	Mohd Hilmey Mohd Said @ Jangkim Bin Tawayon	Bank Negara Malaysia Kota Kinabalu
34	Goh Hooi Choo	Bank Negara Malaysia Pulau Pinang
35	Khor Ah Eng	Bank Negara Malaysia Pulau Pinang

partnership with the aim of ensuring that a risk culture is consistently embedded in all aspects of operational as well as strategic efforts.

Risk Management Structure

The Risk Management Committee, which is at the apex of the Bank's risk management governance structure, is the leading forum for focused and regular deliberation on risk issues and is the main driver of risk management in the Bank. The requirements for upward reporting by line departments and the Risk Management Unit to the Risk Management Committee remained unchanged so as to enable the Committee to continue to provide direction for addressing and managing potential risk in the organisation.

Risk Management Practices

In providing the oversight on risk management, the Risk Management Committee determines and shapes

the standards and requirements to ensure that appropriate strategic and operational risk management measures are embedded into all programmes, projects and policy making. In 2004, the Committee continued assessing the departments' risks, controls and risk issues so as to exercise constant vigilance on the bank's overall risk profile and emerging risk issues. The Committee also deliberated with the departments on their policy and strategic focus and the optimal approaches to address existing and potential risks. At the functional level, the Department Directors have the direct responsibility for ensuring that risk management practices are integral to daily operations. The departments continued to make an annual declaration to Management on their review of the risk profiles of their operations and assessment of the adequacy of risk management. The Risk Management Unit also continued providing technical support and performed its coordination and oversight role by assisting the departments in their management reporting.

With the increased maturity of the risk management function in the Bank, the role of the Risk Management Unit was reviewed and expanded in 2004 to include two additional functions. The Risk Management Unit now performs an independent assessment of risks of the line departments to complement the existing self-assessment approach performed by departments. Secondly, the Risk Management Unit also assesses the organisational risk which could affect the achievement of the strategic aims and objectives of the Bank as outlined in the Corporate Strategy Map. Through assessment of the Bank's execution of its critical functions and responsibilities, and consultation with the relevant departments in the Bank, organisational risk issues are identified and assessed for tabling to the Risk Management Committee. The combination of all three assessments mentioned is expected to result in a holistic view of risk in the Bank. This approach is expected to enhance organisational alignment and strengthen inter-linkages throughout the Bank.

Policy Risk

The policy-making mechanism in the Bank is designed with the objective of achieving the desired policy outcome. To this end, a structured framework is in place to manage policy risk at the Bank. This framework covers the processes for discussion and deliberation of all issues related to policy from the conceptualisation stage through to the development and implementation stages. The high level committees that preside over policy making are the Monetary Policy Committee, the Financial Stability Committee and Management Committee. Chaired by the Governor, the common objective of these committees is to allow for and provide a platform for high-level cross-functional deliberation and consultation to ensure sound and efficacious policies. Another component featured in the policy framework is the Policy Working Groups, membership of which comprise Assistant Governors and directors of all the relevant departments, which represent the working level deliberations on the policy issues.

The rules governing the operation of the Policy Working Groups were tightened in 2004 with focus given to additional resources for stakeholder impact analysis, alternative perspectives and public communications. This is expected to improve oversight of the policy making process, thus allowing the Bank to ensure a more exhaustive process which considers all implications and consequences to stakeholders related to the implementation of policies.

Financial Risk

The Middle Office is directly responsible for managing the Bank's financial risks arising from the management of international reserves. To ensure a consistent management and assessment of risks across the Bank, the Middle Office works closely with the Internal Audit Department and the Risk Management Unit to monitor compliance with investment guidelines, credit and operational procedures. The risk management framework for treasury activities continues to evolve and grow in line with developments in reserve management activities. With the continued growth of reserves, expansion of investment horizons and progress in investment practices, strengthening of overall risk management necessarily becomes a continuous process. Increased specialisation, improved methodologies and the upgrading of risk assessments, monitoring processes and system infrastructure are among the key areas of focus. Exposure and training on the complexities of various products and instruments remains a constant feature for the staff of the front, middle and back offices. Thus, prudent management of the financial risks of reserve management will continue while investment opportunities are optimised.

Enterprise Operational Risk

Traditionally, the operational risk management approach of the Bank requires ownership of risks, self-assessment, continual review, escalation of key risk issues and accountability for control improvement and issue resolution. In 2004, this framework was further enhanced. In recognising the need to step up efforts in value added initiatives, the move was made to increase involvement of the Risk

Management Unit in risk management in the respective departments. While the main focus of the Unit was previously on providing the coordination and oversight role, the Unit would now play a more proactive role and work in a collaborative manner with line departments. This realignment of effort aims to ensure that there is no over-concentration of the risk management effort in operational risk with more attention paid to long-term, high level strategic risks. The closer partnership forged by this arrangement is expected to lead to a more accurate, efficient risk identification and assessment and hence better management and it is expected to cover risks which may not be apparent due to familiarity with the operations.

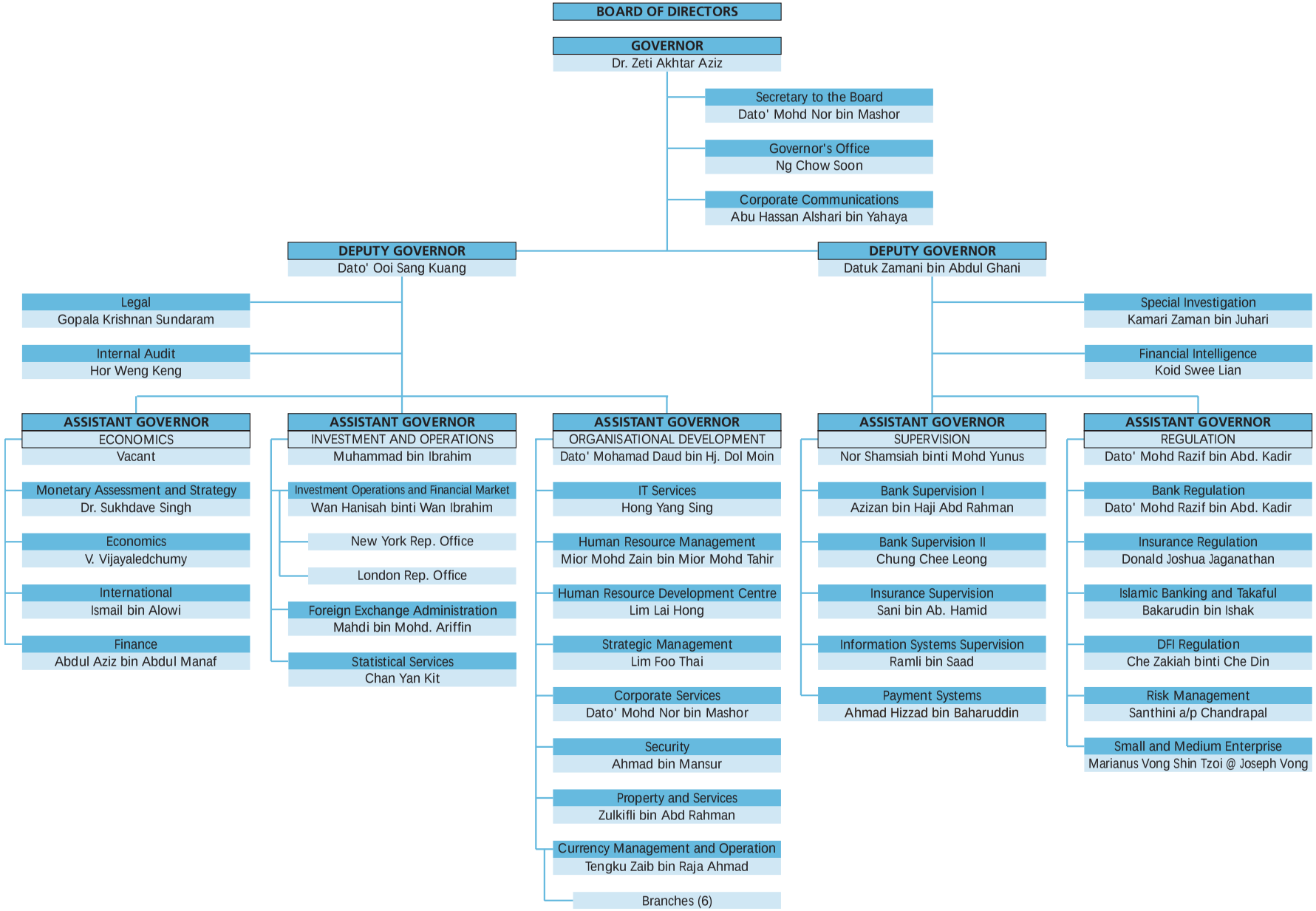
To this end, efforts are currently underway to fine-tune the risk toolkit to help widen the current focus and elevate risk management practices to a new level. Although the overall coverage will expand, the ultimate aim for risk management remains the same, that is, to ensure that regular monitoring takes form to enable prescription of prompt corrective and pre-emptive actions in all areas of risk.

Business Continuity Management

The Business Continuity Management (BCM) framework at the Bank, designed for planning, preparing, responding to and managing a crisis, is aimed at containing any threats of disruptions to monetary and financial system stability whether physical (system breakdowns) or non-physical (financial crisis) in nature. The two high level components of this framework are the Crisis Management Committee and the Crisis Management Team which are responsible for ensuring BCM practices are observed and performed in the Bank. The Crisis Management Committee, which reports to the Governor, is chaired by a designated Deputy Governor and symbolises high level endorsement of the Business Continuity programme in the Bank. The Crisis Management Team has membership comprising directors from all identified critical departments and support teams who meet twice a year to enable members to be updated on developments in the Bank's Business Continuity arrangements, practices, and to discuss all emerging Business Continuity issues. This forum helps to streamline recovery plans and allows premeditated cooperation between the critical departments to produce an integrated and coordinated bank-wide arrangement.

In 2004, in addition to its practice of conducting standard live-run exercises, the Bank conducted live-run exercises over an extended period of time to both prepare the Bank and to enable periodic assessment of the Bank's state of readiness to ensure the Bank's ability to respond to crisis situations.

BANK NEGARA MALAYSIA
Organisation Structure



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Foreign Exchange Administration Policies

The objective of foreign exchange administration is to provide an appropriate framework that will influence capital flows and facilitate currency risk management to promote financial and economic stability of the country. In line with the objective, the foreign exchange administration rules are being further liberalised and simplified with effect from 1 April 2005 (refer to the White Box: 'Liberalisation of the Foreign Exchange Administration Rules' in Chapter 3). All rules continue to be applied uniformly to transactions with all countries, except the State of Israel for which special restrictions apply. With these relaxations, the following are the rules affecting foreign exchange transactions:

I Current Account Transactions

(a) Payments for Import of Goods and Services

- There is no restriction on payments to non-residents for import of goods and services. Such payments must be made in foreign currency with the exception of the currency of the State of Israel (Restricted Currency).

- There is no restriction for residents to enter into a forward foreign exchange contract with licensed onshore commercial and Islamic banks (licensed onshore banks) or approved merchant banks to buy foreign currency against ringgit or another foreign currency to make payment for import from a non-resident.

(b) Proceeds Arising from Export of Goods (Export Proceeds)

- All export proceeds are required to be repatriated to Malaysia in accordance with the payment schedule as specified in the sales contract, which should not exceed six months from the date of export.

- Export proceeds must be received in foreign currency and must be sold for ringgit or retained in export foreign currency accounts (FCA) with licensed onshore banks. There is no limit on the amount of funds retained in the export FCA.

- Residents may enter into a forward foreign exchange contract with a licensed onshore bank to sell export proceeds for ringgit or another foreign currency, provided the maturity of the forward contract is not later than six months after the intended date of export.

- Only resident exporters with annual gross exports exceeding the equivalent of RM50 million are required to submit quarterly reports to the Controller of Foreign Exchange (the Controller).

(c) Import and Export of Currency by Travellers

- Resident travellers are allowed to import or export ringgit notes up to RM1,000, including demonetised RM1,000 and RM500 notes, and to export foreign currency notes, including traveller's cheques, up to an equivalent of RM10,000. Resident travellers are required to obtain permission from the Controller and declare in the Traveller's Declaration Form (TDF) when they:

  - Carry into or out of Malaysia, ringgit notes exceeding RM1,000.

  - Carry out foreign currency notes, including traveller's cheques, exceeding the equivalent of RM10,000.

  Permission is given within one day of application.

- There is no restriction for residents to bring into Malaysia any amount of foreign currency notes.

- There is also no restriction for non-residents to bring in any amount of foreign currency notes and/or traveller's cheques. Declaration in the Arrival/Departure Card (IMM.26) issued by the Immigration Department is only required for amounts in excess of the equivalent of US$2,500.

- Non-residents would need to seek permission from the Controller if the amount of foreign currency notes to be carried out of Malaysia exceeds the amount brought into Malaysia, provided the amount to be taken out is more than the equivalent of US$2,500.

- Non-residents must obtain permission from the Controller and declare ringgit notes exceeding RM1,000 being brought into or out of Malaysia.

II Capital Account Transactions

(a) Investment in Malaysia by Non-residents

- There is no restriction on repatriation of capital, profits, dividends, interest, fees or rental by foreign direct investors or portfolio investors.

- Ringgit assets purchased by residents from non-residents may be settled in ringgit or foreign currency, other than Restricted Currency. However, all remittances abroad must be made in foreign currency other than Restricted Currency.

(b) Investment Abroad by Residents

- Licensed onshore banks and approved merchant banks may invest abroad as long as they comply with the Banking and Financial Institutions Act 1989 or Islamic Banking Act 1983 and their approved foreign currency net open position limit. Remittances for investment abroad must be made in foreign currency, other than Restricted Currency.

- Residents, companies and individuals, with no domestic borrowing are free to invest abroad. The investment may be made through the conversion of ringgit or from foreign currency funds retained onshore or offshore.

- Residents with domestic borrowing are also free to invest abroad their foreign currency funds maintained onshore or offshore. In addition, they are allowed to convert ringgit into foreign currency up to the following limits for overseas investments, including extension of foreign currency credit facilities to non-residents:

  (i) Up to RM10 million per calendar year by companies on a per corporate group basis; and

  (ii) Up to RM100,000 per calendar year by individuals.

  For companies converting ringgit for overseas investments, they must have a minimum shareholders' funds of RM100,000 and must be in operation for at least one year.

  For individuals, they may convert ringgit into foreign currency up to the amount required for investment in foreign currency securities under the Employee Share Option/Purchase Scheme offered by their employers' overseas parent or related companies.

- Residents, with or without any domestic credit facilities, may also finance in aggregate up to RM10 million equivalent their overseas investments with foreign currency borrowing.

- Resident unit trust management companies may invest abroad up to the full amount of the Net Asset Value (NAV) attributed to non-residents and up to 30% of the NAV attributed to residents. Different funds of a unit trust management company or funds of different companies may be pooled to benefit from economies of scale when investing abroad. Such investments are required to be in line with the Securities Commission's prudential guidelines.

- Resident fund/asset managers may invest abroad up to the full amount of investments by their non-resident clients as well as resident clients without any domestic credit facilities and up to 30% of investments by resident clients with domestic credit facilities. These funds by different clients or companies may be pooled to benefit from economies of scale when investing abroad. Such investments should be based on the mandate of their clients and in compliance with the Securities Commission's prudential guidelines.

- Resident insurance companies and takaful operators may invest abroad up to 5% of their margin of solvency and up to 5% of their total assets respectively.

- Resident insurance companies and takaful operators may also invest abroad up to 30% of the NAV of the investment-linked funds that they market. These investments are subject to compliance with prudential insurance and takaful regulations issued by Bank Negara Malaysia.

(c) Credit Facilities Obtained by Residents

Foreign Currency Credit Facilities

- Residents may obtain trade financing facility of any amount in foreign currency from licensed onshore banks and licensed merchant banks.
- In addition, resident companies may obtain credit facilities in foreign currency up to the equivalent of RM50 million in aggregate on a corporate group basis from licensed onshore banks, licensed merchant banks and non-residents.
- Resident individuals may also obtain credit facilities in foreign currency up to the equivalent of RM10 million in aggregate from licensed onshore banks, licensed merchant banks and non-residents.
- Any amount of credit facility exceeding the above permitted limits would require the prior permission of the Controller. Where the aggregate amount exceeds the equivalent of RM1 million and up to the permitted limit, the resident (company or individual) is required to register the credit facility with the Controller, prior to drawing down on the facility.
- Residents may only utilise up to an aggregate of RM10 million equivalent of the foreign currency credit facilities to finance overseas investment activities.
- There is no restriction for the repayment or prepayment of credit facilities as long as such credit facilities have been obtained in accordance with the relevant foreign exchange administration rules. Resident borrowers, however, are required to register with the Controller any proposal to prepay the credit facilities prior to effecting the prepayments.

Ringgit Credit Facilities

- Residents are required to seek prior permission of the Controller to obtain any amount of credit facility in ringgit from non-residents, including from non-resident shareholders or directors.

(d) Extension of Credit Facilities to Non-residents

Foreign Currency Credit Facilities

- Licensed onshore banks and approved merchant banks may extend credit facilities in foreign currency to non-residents for any purpose. However, credit facilities extended for the purchase or construction of immovable property in Malaysia would be subject to similar requirements as for ringgit credit facilities outlined below.
- Residents, companies and individuals, with no domestic borrowing are free to extend credit facilities in foreign currency to non-residents. The extension of credit facility may be made through the conversion of ringgit or from foreign currency funds retained in Malaysia or abroad.
- Residents with domestic credit facilities may also extend credit facility in foreign currency to non-residents subject to the permitted limits for investment abroad by residents.

Ringgit Credit Facilities

- Non-bank residents may extend credit facilities in ringgit not exceeding an aggregate of RM10,000 to a non-resident.
- Resident stockbroking companies may extend margin financing facilities to non-resident clients for the purchase of shares listed on Bursa Malaysia, provided they comply with all the relevant regulations imposed by Bursa Malaysia.
- Licensed onshore banks may extend ringgit intra-day and overnight overdraft facilities in aggregate not exceeding RM200 million to a non-resident stockbroking company or a non-resident custodian bank. The facilities are strictly for financing funding timing gaps due to unforeseen or inadvertent/ technical administration errors or delays due to time zone difference in relation to settlement of trades on Bursa Malaysia.

- Resident insurance companies may extend policy loans in ringgit to their non-resident policy holders for amount up to the attained cash surrender value of their policies and not exceeding the duration of the policies.

- Residents, bank or non-bank, may extend up to a maximum of three immovable property loans in ringgit to a non-resident to finance/refinance the purchase or construction of any immovable property in Malaysia, excluding for the purchase of land only, subject to their own internal credit assessment guideline. All purchases of immovable properties are subject to the guidelines issued by the Foreign Investment Committee. Details of the guidelines can be found at http://www.epu.jpm.my/.

- In addition, banking institutions may extend credit facilities in ringgit up to an aggregate limit of RM10 million to a non-resident (excluding a non-resident stockbroking company, custodian bank or correspondent bank) for any use in Malaysia, other than to finance the purchase or construction of immovable property.

- Prior permission of the Controller is required for the extension of credit facilities exceeding any permissible aggregate limits.

(e) Forward Foreign Exchange Contracts

Forward Foreign Exchange Contracts with Residents

- Licensed onshore banks and approved merchant banks may enter into forward foreign exchange contracts with residents to purchase or sell any foreign currency against ringgit or another foreign currency as follows:

  (i) Any payments or receipts for import or export of goods and services as well as income, based on firm commitment or anticipatory basis;

  (ii) Hedging the foreign currency exposures of permitted overseas investment, including extension of credit facilities to non-residents;

  (iii) Any committed capital inflows or outflows, including drawdown of permitted foreign currency credit facilities, and repayment of foreign currency credit facilities up to the amount repayable within 24 months as well as payments for permitted overseas investment.

- The maturity date of the forward foreign exchange contract should be the expected date of receipt or payment of the underlying transaction.

- For forward purchase of export proceeds, the maturity date of the forward foreign exchange contract should not be later than six months after the intended date of export.

- For forward foreign exchange contract involving two foreign currencies, the use or retention of the foreign currency being purchased by the residents must comply with the current foreign exchange administration rules.

- Licensed onshore banks, approved merchant banks and licensed offshore banks in Labuan are allowed to enter into interest rate swaps with residents, provided the transaction is supported by firm underlying commitment.

- Resident companies that have sold forward foreign currency receivables for ringgit, may temporarily retain up to the amount of foreign currency receipts received earlier than the maturity date of the forward foreign exchange contract in their FCA with licensed onshore banks, pending maturity of the forward foreign exchange contract.

Forward Foreign Exchange Contracts with Non-residents

- Licensed onshore banks are allowed to enter into short-term currency swap arrangements with non-resident stockbrokers and non-resident custodian banks to cover payment for shares purchased on Bursa Malaysia. The permission is subject to the condition that such contracts are based on firm commitment and not on anticipated purchases, and for maturity period of up to three working days with no rollover option.

- In addition, licensed onshore banks are allowed to enter into forward purchase or sales contract against ringgit with non-residents that have purchased or sold ringgit assets to facilitate settlement in ringgit. The permission is subject to the condition that such contracts are based on firm commitment and not on anticipated purchases or sales, and the maturity date is the expected or due date of payment or receipt of the underlying transaction.

- Multilateral Development Banks (MDBs)/Multilateral Financial Institutions (MFIs) and foreign multinational corporations (MNCs) that are allowed to issue ringgit-denominated bonds in Malaysia may also enter into forward foreign exchange contracts with licensed onshore banks to hedge their foreign exchange and interest rate risks arising from the issuance of ringgit-denominated bonds.

- Licensed onshore banks may also enter into forward foreign exchange contracts with non-residents who invest in ringgit-denominated bonds issued by MDBs/MFIs and MNCs to hedge their foreign exchange and interest rate risk arising from the investment in the ringgit-denominated bonds.

III Ringgit Credit Facilities to Non-resident Controlled Companies (NRCCs)

- There is no restriction on residents to extend any amount of ringgit credit facilities to NRCCs.

IV Issuance of Ringgit Private Debt Securities

- There is no restriction for resident companies to raise domestic credit facility through the issuance of ringgit Private Debt Securities regardless of amount, provided the proceeds are not used for refinancing of offshore borrowing and/or for financing of investment abroad exceeding RM10 million in aggregate in a calendar year. The issuance of Private Debt Securities must also be in accordance with the Exchange Control Guideline on Private Debt Securities.

- Applications for issuance of ringgit bonds in Malaysia by MDBs/MFIs and MNCs would be considered based on the merits of each case. The information notes relating to such applications may be found at http://www.bnm.gov.my/fxadmin.

V Foreign Currency Accounts of Residents

- Residents, with or without any domestic credit facilities, are free to open foreign currency accounts (FCA) with any licensed onshore banks, licensed offshore banks in Labuan or overseas banks to retain any amount of their foreign currency receipts, other than receipts arising from export of goods from Malaysia.

- Resident exporters may open FCA with licensed onshore banks to retain any amount of foreign currency export receipts. They are also free to merge their export and non-export FCA maintained with licensed onshore banks without any restriction on the amount of foreign currency receipts retained in such accounts.

- In addition, residents may convert ringgit into foreign currency for credit into their FCA maintained with licensed onshore banks, licensed offshore banks in Labuan and overseas banks subject to the permitted limits for investment abroad by residents.

- Resident companies may also temporarily retain in their onshore FCA, proceeds that have been sold forward for ringgit and received earlier than maturity date of the forward contract.

- Resident individuals with domestic credit facilities may also convert ringgit into foreign currency for credit into FCA opened solely to facilitate education and employment overseas up to an aggregate limit of:

  (i) US$150,000 with licensed onshore banks;
  (ii) US$150,000 with licensed offshore banks in Labuan; and
  (iii) US$ 50,000 with overseas banks.

- Resident companies maintaining FCA with licensed offshore banks in Labuan or overseas banks are required to submit monthly statement, Statement OA, on the accounts to the Controller.

VI Foreign Currency Accounts of Non-residents

- Licensed onshore banks and licensed merchant banks may open FCA for non-residents.
- There are no limits on the FCA of non-residents and no restrictions on the inflow and outflow of funds through the FCA of non-residents.

VII External Accounts of Non-residents

- Resident financial institutions may open accounts in ringgit known as External Accounts for non-residents. There is no overnight limit on External Accounts. Non-residents may make ringgit cash withdrawal of any amount from the External Accounts.
- There is also no restriction on the amount that can be converted from ringgit into foreign currency and vice versa by the non-resident account holders with licensed onshore banks.
- Non-residents may use ringgit funds in the External Account for the following purposes:
  - Purchase of foreign currency, excluding Restricted Currency;
  - Purchase of ringgit assets in Malaysia;
  - Payment for goods and services for own use in Malaysia;
  - Payment of administrative and statutory expenses incurred in Malaysia;
  - Payment under a non-financial guarantee to a resident (where the External Account holder is making payment arising from the guarantee being called upon);
  - Extension of ringgit credit facilities to staff in Malaysia in accordance with the terms and conditions of employment;
  - Repayment of ringgit credit facilities permitted by the Controller or in accordance with terms and conditions of employment; and
  - Payments to resident beneficiary for any purpose other than the following:
    * Payment for the import of goods and services;
    * Extension of ringgit credit facilities to residents other than as permitted by the Controller;
    * Settlement under financial guarantees; and
    * Payment on behalf of a third party.
- The sources of funds for credit into External Accounts may be from:
  - Sale of foreign currency for ringgit with licensed onshore banks, excluding Restricted Currency;
  - Sale of ringgit assets;
  - All income derived in Malaysia including salaries, wages, royalties, commissions, fees, rental, interest, profits or dividends;
  - Proceeds from ringgit credit facilities permitted by the Controller or in accordance with the terms and conditions of employment;
  - Proceeds from repayment of ringgit credit facilities permitted by the Controller or in accordance with the terms and conditions of employment;

- Transfers from:
  - ∗ Another External Account of the same account holder;
  - ∗ Another External Account and/or Resident Account of different account holders by way of:
    - o Automated Teller Machine transfer up to RM5,000 per person/company, per day, per bank for any purpose;
    - o Internet-bank transfers up to RM5,000 per person/company, per day, per bank for any purpose.
- Deposit of ringgit notes not exceeding RM10,000 per day; and
- Deposit of cheques up to RM5,000 per cheque for any purpose.

• Ringgit funds in the External Accounts may be converted into foreign currency and repatriated abroad or used in Malaysia for permitted purposes.

• There is no restriction on the operation of the External Accounts of non-residents working or studying in Malaysia (including their spouse, children and/or parents who are currently residing in Malaysia), central banks, embassies, consulates, high commissions, supranational or international organisations recognised by the Government of Malaysia. Such persons or organisations can use funds in the External Accounts for all purposes, including the permissible purposes referred above.

VIII Special Status Granted to Selected Companies

(a) Offshore Entities in the Labuan International Offshore Financial Centre

• Entities incorporated or registered under the Offshore Companies Act 1990 in the Labuan International Offshore Financial Centre are declared as non-residents for foreign exchange administration purposes.

• Offshore entities in Labuan may buy or sell foreign currency (other than Restricted Currency) against another foreign currency spot or forward with licensed onshore banks, licensed offshore banks (excluding licensed offshore investment banks) in Labuan as well as non-residents outside Malaysia. They may also buy or sell foreign currency (other than Restricted Currency) against ringgit with licensed onshore banks for permitted purposes.

• All offshore entities may maintain External Accounts with resident banks to facilitate the defrayment of statutory and administrative expenses in Malaysia.

• Offshore insurance entities in Labuan may also use their External Accounts to facilitate the receipt of reinsurance premiums and for payment of claims arising from reinsurance of domestic insurance business.

• Licensed offshore banks in Labuan may receive payments in ringgit from residents arising from fees, commissions, dividends or interest from deposit of funds with onshore financial institutions.

• Licensed offshore banks in Labuan may invest in assets/instruments in Malaysia for their own account provided investments are transacted directly with resident banking institutions or resident brokers. The investments must not be financed by ringgit borrowings.

(b) Multimedia Super Corridor Companies

• Companies operating in Multimedia Super Corridor (MSC) that are incorporated as separate legal entities, are given exemption from foreign exchange administration rules upon the companies being awarded the MSC status by the Multimedia Development Corporation. The exemption granted to the MSC companies is solely for transactions undertaken on their own account.

• However, prior permission should be obtained to deal with Specified Persons and in Restricted Currency.

• The MSC companies are required to submit the necessary statistical forms/reports/statements for monitoring purposes. These reports can be obtained from Bank Negara Malaysia's website, http://www.bnm.gov.my/fxadmin.

(c) Approved Operational Headquarters

- Approved Operational Headquarters (OHQs) are allowed to:

  (i) Open FCA with licensed onshore banks to retain any amount of export proceeds in foreign currency.

  (ii) Open FCA with licensed onshore banks, licensed offshore banks in Labuan or overseas banks for crediting foreign currency receivables, other than export proceeds, with no limit imposed on the overnight balances.

  (iii) Obtain any amount of domestic credit facilities in ringgit.

  (iv) Obtain any amount of foreign currency credit facilities from licensed onshore banks and licensed merchant banks in Malaysia, and from any non-resident, provided the OHQ does not on-lend to, or raise the funds on behalf of, any resident.

  (v) Invest abroad any amount, including extension of credit facilities to their related overseas companies, to be funded with foreign currency funds or foreign currency borrowing. They may also convert any amount of ringgit if they have no domestic credit facilities or up to RM10 million into foreign currency per calendar year if they have domestic credit facilities for investment abroad.

Funds Administered/Funded by Bank Negara Malaysia: Fund Utilisation

Funds	Date established	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disbursements as at end-2004 (RM m)	Outstanding as at end-2004[7] (RM m)
			Total as at end-		Annual change	Total as at end-		Annual change		
			2003	2004		2003	2004			
Ship Financing Facility	30-Oct-92	600	38	38	0	577	577	0	543	282
Fund for Food	04-Jan-93	1,300[3]	8,176	8,829	653	1,411	1,528	117	1,418	702
Bumiputera Entrepreneurs Project Fund	10-Feb-00	300[3]	893	1,079	186	438	499	61	412	68
Fund For Small and Medium Industries 2	15-Apr-00	4,500[1,3]	3,527	6,239	2,712	2,285	4,172	1,887	3,312	2,860
New Entrepreneurs Fund 2	15-Jul-01	2,000[2,3]	1,952	2,948	996	1,077	1,886	809	1,542	1,422
Rehabilitation Fund for Small Businesses	01-Nov-03	800	0	23	23	0	11	11	5	5

Terminated Funds	Date established	Date terminated	Fund allocation (RM m)	Number of applications approved			Amount approved (RM m)			Total disbursements as at end-2004 (RM m)	Outstanding as at end-2004[7] (RM m)
				Total as at end-		Annual change	Total as at end-		Annual change		
				2003	2004		2003	2004			
Enterprise Rehabilitation Fund	06-Feb-88	01-Jan-91	500[3]	764	764	0	896	896	0	850	100
Abandoned Housing Projects Fund	18-Jun-90	29-Feb-92	600	74	74	0	331	331	0	346	12
Fund to Accelerate the Construction of Low-Cost Houses	29-Oct-93	31-Oct-95	500	54	54	0	297	297	0	297	0
Special Fund for Tourism	10-Mar-90	31-Dec-97	200[3]	194	194	0	203	203	0	203	35
Industrial Adjustment Fund	05-Feb-91	04-Aug-99	100	25	25	0	95	95	0	95	10
Special Scheme for Low and Medium Cost Houses	01-May-98	04-Aug-99	1,000	96	96	0	604	609	5[5,6]	583	12
Bumiputera Industrial Fund	04-Jan-93	03-Apr-00	100	99	99	0	95	95	0	91	35
Fund for Small and Medium Industries	02-Jan-98	03-Apr-00	1,850[3]	5,420	5,420	0	3,776	3,774	-2[5]	3,726	1,746
New Entrepreneurs Fund	12-Dec-89	15-Jul-01	1,250[3]	3,126	3,126	0	1,421	1,420	-1[5]	1,398	350
Rehabilitation Fund for Small and Medium Industries	23-Nov-98	01-Nov-03	330[3,4]	322	317	-5[5]	352	344	-8[5]	328	227
Entrepreneurs Rehabilitation and Development Fund	03-Jul-01	01-Nov-03	10[4]	33	33	0	3	3	0	2	0.9
Special Relief Guarantee Facility[8]	21-May-03	10-Jul-04	1,000	73	85	12	40	49	9	0	0

[1] The allocation was increased from RM2,000 million to RM4,500 million in 2004
[2] The allocation was increased from RM1,150 million to RM2,000 million in 2004
[3] Revolving funds
[4] Unutilised allocations were transferred to Rehabilitation Fund for Small Businesses
[5] Approval withdrawn by banks/borrowers and/or amount required were reduced by banks/borrowers
[6] Additional funding requirements
[7] Borrowers' outstanding loan balances with the lending institutions
[8] A guarantee scheme through Credit Guarantee Corporation Malaysia Berhad funded by Bank Negara Malaysia to assist businesses affected by the Severe Acute Respiratory Syndrome (SARS)

Licensed Banking Institutions (as at 31 December 2004)

Commercial Banks

1. ABN AMRO Bank Berhad
2. Affin Bank Berhad
3. Alliance Bank Malaysia Berhad[1]
4. AmBank Berhad
5. Bangkok Bank Berhad
6. Bank of America Malaysia Berhad
7. Bank of China (Malaysia) Berhad
8. Bank of Tokyo-Mitsubishi (Malaysia) Berhad
9. Bumiputra-Commerce Bank Berhad
10. Citibank Berhad
11. Deutsche Bank (Malaysia) Berhad
12. EON Bank Berhad[2]
13. Hong Leong Bank Berhad[3]
14. HSBC Bank Malaysia Berhad
15. J.P. Morgan Chase Bank Berhad
16. Malayan Banking Berhad[4]
17. OCBC Bank (Malaysia) Berhad
18. Public Bank Berhad[5]
19. RHB Bank Berhad
20. Southern Bank Berhad
21. Standard Chartered Bank Malaysia Berhad
22. The Bank of Nova Scotia Berhad
23. United Overseas Bank (Malaysia) Berhad

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad

[1] Merged with Alliance Finance Berhad with effect from 1 August 2004
[2] Merged with EON Finance Berhad with effect from 1 November 2004
[3] Merged with Hong Leong Finance Berhad with effect from 1 August 2004
[4] Merged with Mayban Finance Berhad with effect from 1 October 2004
[5] Merged with Public Finance Berhad with effect from 4 September 2004

Finance Companies

1. AFFIN-ACF Finance Berhad
2. AmFinance Berhad
3. Bumiputra-Commerce Finance Berhad
4. Kewangan Bersatu Berhad
5. RHB Delta Finance Berhad
6. Southern Finance Berhad

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Aseambankers Malaysia Berhad
5. Commerce International Merchant Bankers Berhad
6. Malaysian International Merchant Bankers Berhad
7. Public Merchant Bank Berhad
8. RHB Sakura Merchant Bankers Berhad
9. Southern Investment Bank Berhad
10. Utama Merchant Bank Berhad

Financial Institutions Offering Islamic Banking Services

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad
3. RHB Islamic Bank Berhad[1]

Participating Banks in the Islamic Banking Scheme

Commercial Banks

1. Affin Bank Berhad
2. Alliance Bank Malaysia Berhad
3. AmBank Berhad
4. Citibank Berhad
5. EON Bank Berhad
6. Hong Leong Bank Berhad
7. HSBC Bank Malaysia Berhad
8. Malayan Banking Berhad
9. OCBC Bank (Malaysia) Berhad
10. Public Bank Berhad
11. Southern Bank Berhad
12. Standard Chartered Bank Malaysia Berhad

Finance Companies

1. Affin-ACF Finance Berhad
2. AmFinance Berhad
3. Southern Finance Berhad

Merchant Banks

1. Affin Merchant Bank Berhad
2. Alliance Merchant Bank Berhad
3. AmMerchant Bank Berhad
4. Commerce International Merchant Bankers Berhad

[1] Launched on 1 March 2005

Discount Houses

1. Abrar Discounts Berhad
2. Affin Discount Berhad
3. Amanah Short Deposits Berhad
4. CIMB Discount House Berhad
5. KAF Discounts Berhad
6. Malaysia Discount Berhad
7. Mayban Discount Berhad

Development Financial Institutions Offering Islamic Banking Facilities

1. Bank Kerjasama Rakyat Malaysia Berhad
2. Bank Simpanan Nasional
3. Bank Pembangunan dan Infrastruktur Malaysia Berhad
4. Bank Industri & Teknologi Malaysia Berhad
5. Bank Pertanian Malaysia

Shariah Advisory Council Members for Islamic Banking and Takaful Session 2004-2006

Chairman:
Y.A.A. Datuk Sheikh Ghazali Abdul Rahman

Deputy Chairman:
Dr. Mohd Daud Bakar

Members:
1. Datuk Dr. Abdul Monir Yaacob
2. S.S. Dato' Haji Hassan Haji Ahmad
3. Datuk Haji Md. Hashim Haji Yahaya
4. Dato' Dr. Abdul Halim Haji Ismail
5. Y.A. Dato' Abdul Hamid Haji Mohamad
6. Dr. Mohd Ali Haji Baharum
7. Assoc. Prof. Dr. Abdul Halim Muhammad
8. Dr. Mohd Parid Sheikh Ahmad

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Kind of Economic Activity in Constant 1987 Prices

	2000	2001	2002	2003	2004*p*	2005*f*
	RM million					
Agriculture	18,662	18,551	19,036	20,123	21,135	21,836
Mining and quarrying	15,385	15,160	15,774	16,699	17,384	18,250
Manufacturing	67,250	63,299	65,872	71,312	78,323	81,882
Construction	6,964	7,108	7,275	7,417	7,276	7,205
Services	113,408	120,194	127,872	133,531	142,433	150,593
Less: Imputed bank service charges	15,832	17,678	21,225	22,593	23,331	24,402
Plus: Import duties	4,721	4,594	5,384	5,184	4,820	4,958
GDP at purchasers' prices[1]	**210,557**	**211,227**	**219,988**	**231,674**	**248,040**	**260,323**
	Annual change (%)					
Agriculture	6.1	-0.6	2.6	5.7	5.0	3.3
Mining and quarrying	0.3	-1.5	4.0	5.9	4.1	5.0
Manufacturing	18.3	-5.9	4.1	8.3	9.8	4.5
Construction	0.6	2.1	2.3	1.9	-1.9	-1.0
Services	6.7	6.0	6.4	4.4	6.7	5.7
Less: Imputed bank service charges	6.3	11.7	20.1	6.4	3.3	4.6
Plus: Import duties	-11.2	-2.7	17.2	-3.7	-7.0	2.9
GDP at purchasers' prices	**8.9**	**0.3**	**4.1**	**5.3**	**7.1**	**5.0 ~ 6.0**

[1] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2
Growth in Manufacturing Production (1993=100)

	2001	2002	2003	2004	2002	2003	2004
	Index				Annual change (%)		
Export-oriented industries	**200.1**	**210.2**	**235.3**	**268.7**	**5.0**	**11.9**	**14.2**
Electrical machinery, apparatus appliances and supplies	229.2	247.8	271.7	319.8	8.1	9.6	17.7
Electronics	269.1	305.2	351.3	439.0	13.4	15.1	25.0
Electrical products	166.6	158.2	147.1	133.3	-5.1	-7.0	-9.4
Radio and television sets	*170.6*	*157.4*	*134.4*	*114.5*	*-7.8*	*-14.6*	*-14.8*
Manuf. of refrigerating, exhaust, ventilating and air-conditioning machinery	*132.3*	*161.8*	*180.6*	*177.3*	*22.2*	*11.6*	*-1.8*
Cables and wires	*180.6*	*145.8*	*128.8*	*117.1*	*-19.2*	*-11.7*	*-9.1*
Manuf. of office, computing and accounting machinery	*227.1*	*176.1*	*156.6*	*144.5*	*-22.5*	*-11.1*	*-7.7*
Chemicals and chemical products	228.7	235.0	283.8	323.8	2.7	20.8	14.1
Wood and wood products	104.9	98.6	99.5	112.2	-6.0	0.9	12.7
Off-estate processing	200.9	215.1	240.5	250.2	7.1	11.8	4.0
Textiles and wearing apparel	118.8	111.4	109.0	96.2	-6.2	-2.2	-11.7
Rubber products	180.0	183.5	217.9	250.1	2.0	18.7	14.8
Others	106.2	115.1	120.9	142.8	8.3	5.1	18.1
Domestic-oriented industries	**184.1**	**190.4**	**202.0**	**216.4**	**3.4**	**6.1**	**7.1**
Construction-related products	176.1	182.9	201.6	200.3	3.8	10.2	-0.6
Non-metallic mineral products	*171.3*	*180.0*	*197.5*	*187.8*	*5.1*	*9.7*	*-4.9*
Basic iron and steel and non-ferrous metal	*182.3*	*186.6*	*206.7*	*215.9*	*2.4*	*10.8*	*4.4*
Fabricated metal products	200.0	201.7	216.5	279.8	0.8	7.4	29.2
Food products	154.7	168.2	183.0	188.5	8.7	8.8	3.0
Transport equipment	237.1	251.9	238.0	258.5	6.2	-5.5	8.6
Petroleum products	198.3	190.2	194.7	197.3	-4.1	2.3	1.3
Paper products	165.0	186.2	201.2	205.8	12.8	8.0	2.3
Tobacco products	164.4	148.0	153.8	157.7	-10.0	3.9	2.6
Beverages	138.5	121.9	147.3	144.5	-11.9	20.8	-1.9
Total	**195.8**	**204.7**	**226.1**	**254.7**	**4.5**	**10.5**	**12.7**

Source: Department of Statistics, Malaysia

Table A.3
Production of Primary Commodities

	2000	2001	2002	2003	2004*p*	2001	2002	2003	2004*p*
	Volume					Annual change (%)			
Crude palm oil ('000 tonnes)	10,842	11,804	11,909	13,355	13,976	8.9	0.9	12.1	4.7
Rubber[1] ('000 tonnes)	928	882	890	986	1,186	-4.9	0.9	10.8	20.4
Saw logs ('000 cu. metres)	23,074	18,923	20,649	21,532	21,576	-18.0	9.1	4.3	0.2
Cocoa ('000 tonnes)	70	58	48	36	33	-17.9	-17.4	-24.0	-7.8
Crude oil (including condensates) ('000 bpd)	681	666	698	738	762	-2.4	4.9	5.6	3.6
Natural gas (mmscfd)	4,367	4,542	4,676	5,013	5,196	3.7	3.0	7.2	4.0
Tin-in-concentrates ('000 tonnes)	6.3	5.0	4.2	3.4	2.8	-21.2	-15.2	-20.3	-16.6

[1] Revised from 2000 onwards based on new compilation methodology
p Preliminary

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

Table A.4
GNP by Demand Aggregates

	2000	2001	2002	2003	2004*p*	2005*f*
	at Current Prices (RM million)					
Consumption	181,031	192,909	209,521	227,279	251,373	275,869
Private consumption	*145,355*	*150,644*	*159,506*	*172,366*	*191,970*	*213,495*
Public consumption	*35,676*	*42,265*	*50,015*	*54,913*	*59,403*	*62,374*
Investment	87,729	83,345	83,764	87,089	91,818	89,162
Private investment	*44,102*	*34,528*	*29,376*	*29,856*	*35,354*	*38,969*
Public investment	*43,627*	*48,817*	*54,388*	*57,233*	*56,464*	*50,193*
Change in stocks[1]	5,982	-3,339	2,217	-2,842	8,664	-1,580
Exports of goods and services	427,004	389,255	415,040	450,593	544,956	583,654
Imports of goods and services	358,530	327,767	348,919	367,918	449,262	476,850
GDP at purchasers' value	343,215	334,404	361,624	394,200	447,548	470,255
Net factor payments abroad	-28,909	-25,623	-25,061	-22,527	-24,480	-26,387
GNP at purchasers' value	314,306	308,781	336,563	371,673	423,068	443,868
	at Constant 1987 Prices (RM million)					
Consumption	119,238	125,637	133,282	143,198	156,427	168,246
Private consumption	*95,370*	*97,630*	*101,946*	*108,722*	*119,681*	*129,854*
Public consumption	*23,868*	*28,007*	*31,336*	*34,476*	*36,746*	*38,392*
Investment	64,840	63,050	63,249	64,960	66,996	64,675
Private investment	*32,596*	*26,120*	*22,181*	*22,270*	*25,790*	*28,265*
Public investment	*32,244*	*36,930*	*41,068*	*42,690*	*41,206*	*36,411*
Change in stocks[1]	3,384	-1,279	2,356	-1,913	4,863	-874
Exports of goods and services	246,158	227,685	237,904	253,006	292,475	316,216
Imports of goods and services	223,062	203,866	216,802	227,578	272,720	287,941
GDP at purchasers' value	210,557	211,227	219,988	231,674	248,040	260,323
Net factor payments abroad	-19,271	-17,642	-17,251	-15,196	-15,888	-17,524
GNP at purchasers' value	191,287	193,585	202,737	216,477	232,152	242,799

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5
Savings-Investment Gap

	2000	2001	2002	2003	2004*p*	2005*f*
	RM million					
Public gross domestic capital formation	43,627	48,817	54,388	57,233	56,464	50,193
Public savings	55,391	53,534	63,347	74,564	64,429	66,191
Deficit/surplus	11,764	4,717	8,959	17,331	7,964	15,998
Private gross domestic capital formation[1]	50,084	31,189	31,593	27,014	44,018	37,389
Private savings	70,573	54,159	53,129	60,530	92,633	87,683
Deficit/surplus	20,489	22,970	21,538	33,516	48,616	50,294
Gross domestic capital formation	93,711	80,006	85,981	84,247	100,482	87,582
(as % of GNP)	29.8	25.9	25.5	22.7	23.8	19.7
Gross national savings	125,964	107,693	116,476	135,094	157,062	153,874
(as % of GNP)	40.1	34.9	34.6	36.3	37.1	34.7
Balance on current account	32,253	27,687	30,495	50,847	56,580	66,292
(as % of GNP)	10.3	9.0	9.1	13.7	13.4	14.9

[1] Includes the change in stocks. Previously, the change in stocks was distributed between the public and private sector gross domestic capital formation

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6
Balance of Payments

Item	2001			2002		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**334,326**	**264,472**	**69,854**	**358,504**	**286,387**	**72,117**
Trade account	*334,284*	*280,229*	*54,055*	*357,430*	*303,090*	*54,340*
Services	**54,929**	**63,295**	**-8,366**	**56,536**	**62,532**	**-5,996**
Transportation	10,443	21,795	-11,352	10,847	22,419	-11,572
Travel	26,081	9,933	16,148	27,049	9,947	17,102
Other services	17,932	31,119	-13,187	18,166	29,408	-11,242
Government services n.i.e.[3]	473	448	25	474	758	-284
Balance on goods and services	**389,255**	**327,767**	**61,488**	**415,040**	**348,919**	**66,121**
Income	**7,018**	**32,641**	**-25,623**	**8,129**	**33,190**	**-25,061**
Compensation of employees	1,395	2,409	-1,014	1,653	2,832	-1,179
Investment income[2]	5,623	30,232	-24,609	6,476	30,358	-23,882
Current transfers	**2,040**	**10,218**	**-8,178**	**2,513**	**13,079**	**-10,566**
Balance on current account	**398,313**	**370,626**	**27,687**	**425,682**	**395,188**	**30,494**
% of GNP			**9.0**			**9.1**
Capital account			**–**			**–**
Financial account			**-14,791**			**-11,941**
Direct investment			1,091			4,935
Abroad			*-1,014*			*-7,238*
In Malaysia			*2,105*			*12,173*
Portfolio investment			-2,466			-6,506
Other investment			-13,416			-10,370
Official sector			*7,114*			*4,720*
Private sector			*-20,530*			*-15,090*
Balance on capital and financial account			**-14,791**			**-11,941**
Errors and omissions			**-9,234**			**-4,362**
of which:						
Exchange revaluation gain (+) / loss (-)			-4,060			6,627
Overall balance (surplus + / deficit -)			**3,662**			**14,191**
Bank Negara Malaysia international reserves, net[4]						
RM million			117,203			131,394
US$ million			30,843			34,577
Reserves as months of retained imports			5.1			5.4

[1] Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data
[2] Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account
[3] Include transactions of foreign military and diplomatic establishments
[4] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
e Estimate
f Forecast
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2003			2004*e*			2005*f*		
+	-	Net	+	-	Net	+	-	Net
				RM million				
398,998	**301,297**	**97,701**	**481,240**	**376,766**	**104,474**	**514,880**	**400,060**	**114,820**
397,884	*316,538*	*81,347*	*480,722*	*399,648*	*81,073*	*514,366*	*424,872*	*89,494*
51,595	**66,621**	**-15,026**	**63,716**	**72,497**	**-8,780**	**68,774**	**76,790**	**-8,016**
10,514	23,787	-13,274	12,018	29,801	-17,783	12,639	31,953	-19,314
22,423	10,816	11,607	31,152	11,754	19,398	35,120	13,645	21,475
18,206	31,225	-13,019	20,120	29,794	-9,674	20,613	29,975	-9,362
452	793	-341	426	1,147	-721	402	1,217	-815
450,594	**367,918**	**82,675**	**544,957**	**449,263**	**95,694**	**583,654**	**476,850**	**106,804**
13,103	**35,630**	**-22,527**	**15,307**	**39,787**	**-24,480**	**18,099**	**44,486**	**-26,387**
2,170	3,120	-950	2,618	3,760	-1,142	3,179	4,588	-1,409
10,933	32,510	-21,577	12,689	36,027	-23,339	14,920	39,898	-24,978
1,929	**11,229**	**-9,300**	**1,700**	**16,333**	**-14,633**	**1,607**	**15,732**	**-14,125**
465,626	**414,777**	**50,848**	**561,964**	**505,384**	**56,580**	**603,360**	**537,068**	**66,292**
		13.7			**13.4**			**14.9**
		–			–			
		-12,146			**15,386**			
		4,194			10,823			
		-5,204			*-7,111*			
		9,398			*17,934*			
		4,168			33,112			
		-20,508			-28,550			
		-11,201			*-1,140*			
		-9,307			*-27,410*			
		-12,146			**15,386**			
		358			**11,095**			
		11,927			7,997			
		39,059			**83,061**			
		170,452			253,513			
		44,856			66,714			
		6.6			8.0			

Table A.7
Principal Markets for Manufactured Exports

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
ASEAN	**85,210**	**26.8**	**72,140**	**25.3**	**78,981**	**26.2**	**82,481**	**25.3**	**99,180**	**25.4**
Singapore	*63,768*	*20.1*	*52,483*	*18.4*	*55,917*	*18.5*	*57,367*	*17.6*	*65,800*	*16.9*
Thailand	*10,166*	*3.2*	*9,816*	*3.4*	*12,319*	*4.1*	*13,553*	*4.2*	*17,500*	*4.5*
Indonesia	*5,064*	*1.6*	*4,983*	*1.8*	*5,627*	*1.9*	*6,291*	*1.9*	*8,944*	*2.3*
Philippines	*5,537*	*1.7*	*4,113*	*1.4*	*4,249*	*1.4*	*4,346*	*1.3*	*5,994*	*1.5*
Brunei Darussalam	*675*	*0.2*	*745*	*0.3*	*869*	*0.3*	*925*	*0.3*	*942*	*0.2*
United States	74,165	23.3	65,830	23.1	72,116	23.9	74,918	23.0	85,484	21.9
EU[1]	**46,057**	**14.5**	**40,894**	**14.3**	**38,505**	**12.7**	**41,077**	**12.6**	**51,523**	**13.2**
Netherlands	*13,843*	*4.4*	*13,609*	*4.8*	*11,085*	*3.7*	*10,313*	*3.2*	*12,459*	*3.2*
United Kingdom	*11,067*	*3.5*	*8,355*	*2.9*	*7,836*	*2.6*	*8,131*	*2.5*	*9,678*	*2.5*
Germany	*8,682*	*2.7*	*7,176*	*2.5*	*7,071*	*2.3*	*8,053*	*2.5*	*9,248*	*2.4*
Others	*12,465*	*3.9*	*11,754*	*4.1*	*12,513*	*4.1*	*14,580*	*4.4*	*20,138*	*5.1*
Japan	35,763	11.2	32,413	11.4	28,271	9.4	28,683	8.8	33,341	8.5
Hong Kong China	15,795	5.0	14,327	5.0	19,147	6.3	24,717	7.6	27,482	7.0
The People's Republic of China	7,979	2.5	11,266	3.9	14,041	4.6	17,376	5.3	22,134	5.7
Chinese Taipei	11,421	3.6	9,767	3.4	11,216	3.7	11,610	3.6	11,766	3.0
Middle East[2]	5,717	1.8	6,885	2.4	5,992	2.0	7,485	2.3	10,461	2.7
Australia	7,054	2.2	5,862	2.1	5,951	2.0	7,116	2.2	9,531	2.4
Korea	7,363	2.3	6,692	2.3	7,797	2.6	7,123	2.2	9,178	2.4
Latin American Countries	4,169	1.3	3,436	1.2	3,031	1.0	2,939	0.9	4,154	1.1
Canada	2,900	0.9	1,977	0.7	1,992	0.7	2,132	0.7	2,754	0.7
Rest of the World	14,315	4.6	13,827	4.9	14,981	4.9	18,665	5.5	23,461	6.0
Total	**317,908**	**100.0**	**285,316**	**100.0**	**302,021**	**100.0**	**326,322**	**100.0**	**390,449**	**100.0**

[1] Includes the 10 new member states in 2004
[2] Beginning 2004, Cyprus has been excluded from Middle East as it has been included under the EU countries
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.8
Principal Export Markets for Electronics

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	42,378	25.4	34,793	24.9	41,969	26.7	45,285	27.1	51,912	27.5
Singapore	41,048	24.6	30,335	21.7	33,000	21.0	32,042	19.1	33,466	17.7
Hong Kong China	8,017	4.8	7,470	5.3	12,641	8.0	18,005	10.8	19,606	10.4
Japan	15,970	9.6	13,502	9.7	11,226	7.1	10,465	6.3	11,213	5.9
The People's Republic of China	3,494	2.1	6,012	4.3	7,838	5.0	9,002	5.4	10,802	5.7
Thailand	5,641	3.4	4,802	3.4	6,921	4.4	7,147	4.3	8,297	4.4
Netherlands	10,490	6.3	9,199	6.6	7,746	4.9	7,056	4.2	8,079	4.3
Chinese Taipei	7,289	4.4	6,520	4.7	7,670	4.9	8,056	4.8	6,873	3.6
Germany	4,767	2.9	3,453	2.5	3,804	2.4	4,535	2.7	5,176	2.7
United Kingdom	6,268	3.8	3,810	2.7	3,315	2.1	3,393	2.0	4,477	2.4
Others	21,429	12.7	19,736	14.2	21,271	13.5	22,395	13.3	28,704	15.4
Total	**166,791**	**100.0**	**139,632**	**100.0**	**157,401**	**100.0**	**167,381**	**100.0**	**188,605**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.9
Principal Export Markets for Electrical Products

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	17,358	27.3	17,324	28.6	17,430	31.7	16,354	29.5	18,134	26.5
Singapore	8,665	13.6	8,120	13.4	7,443	13.6	8,340	15.0	10,552	15.4
Japan	9,337	14.7	9,207	15.2	7,584	13.8	6,758	12.2	7,602	11.1
The People's Republic of China	1,428	2.2	1,770	2.9	1,580	2.9	2,094	3.8	2,943	4.3
Hong Kong China	2,992	4.7	2,534	4.2	2,483	4.5	2,398	4.3	2,534	3.7
Thailand	1,480	2.3	1,566	2.6	1,558	2.8	1,643	3.0	2,271	3.3
Germany	1,794	2.8	1,865	3.1	1,410	2.6	1,430	2.6	1,820	2.7
Indonesia	1,032	1.6	1,113	1.8	1,201	2.2	1,242	2.2	1,634	2.4
Others	19,552	30.8	17,176	28.2	14,208	25.9	15,211	27.4	20,956	30.6
Total	**63,638**	**100.0**	**60,675**	**100.0**	**54,897**	**100.0**	**55,470**	**100.0**	**68,446**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.10
Principal Export Markets for Chemicals and Chemical Products

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
The People's Republic of China	1,054	7.0	1,533	10.3	2,294	13.3	2,930	13.8	4,019	14.5
Japan	1,586	10.6	1,566	10.5	1,750	10.2	2,105	9.9	2,983	10.7
Singapore	1,900	12.7	1,646	11.1	1,736	10.1	2,158	10.2	2,581	9.3
Thailand	976	6.5	1,164	7.8	1,387	8.0	1,771	8.4	2,339	8.4
Indonesia	1,153	7.7	999	6.7	1,302	7.6	1,531	7.2	2,232	8.0
Hong Kong China	1,373	9.1	1,176	7.9	1,239	7.2	1,549	7.3	1,847	6.7
Chinese Taipei	671	4.5	620	4.2	882	5.1	960	4.5	1,337	4.8
Korea	469	3.1	511	3.4	546	3.2	766	3.6	1,174	4.2
India	222	1.5	376	2.5	498	2.9	858	4.0	1,089	3.9
United States	1,426	9.5	1,218	8.2	1,042	6.1	1,059	5.0	982	3.5
Others	4,181	27.8	4,070	27.4	4,552	26.3	5,533	26.1	7,184	26.0
Total	**15,011**	**100.0**	**14,879**	**100.0**	**17,228**	**100.0**	**21,220**	**100.0**	**27,767**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11
Principal Export Markets for Manufactures of Metal

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	2,270	26.3	2,020	23.2	2,134	24.3	2,255	20.1	3,057	18.9
Thailand	495	5.7	501	5.8	504	5.7	550	4.9	1,340	8.3
United States	687	8.0	644	7.4	486	5.5	706	6.3	1,269	7.9
Japan	755	8.8	736	8.5	594	6.8	833	7.4	1,070	6.6
Australia	242	2.8	295	3.4	249	2.8	366	3.3	929	5.8
The People's Republic of China	445	5.2	476	5.5	665	7.6	1,015	9.0	918	5.7
Indonesia	374	4.3	360	4.1	398	4.5	442	3.9	590	3.7
Korea	288	3.3	240	2.8	217	2.5	430	3.8	581	3.6
Others	3,062	35.6	3,420	39.3	3,549	40.3	4,645	41.3	6,386	39.5
Total	**8,618**	**100.0**	**8,692**	**100.0**	**8,796**	**100.0**	**11,242**	**100.0**	**16,140**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.12
Principal Export Markets for Optical and Scientific Equipment

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
United States	1,999	29.3	2,132	27.3	1,874	23.0	1,983	21.7	2,428	21.0
Singapore	859	12.6	1,110	14.2	1,573	19.3	1,752	19.1	2,203	19.0
Japan	1,004	14.7	1,163	14.9	1,186	14.5	1,380	15.1	2,106	18.2
Netherlands	291	4.3	415	5.3	511	6.3	642	7.0	877	7.6
The People's Republic of China	173	2.5	232	3.0	199	2.4	451	4.9	567	4.9
Hong Kong China	342	5.0	408	5.2	430	5.3	438	4.8	452	3.9
Germany	584	8.6	437	5.6	408	5.0	404	4.4	397	3.4
Others	1,573	23.0	1,905	24.5	1,971	24.2	2,106	23.0	2,538	22.0
Total	**6,825**	**100.0**	**7,802**	**100.0**	**8,152**	**100.0**	**9,156**	**100.0**	**11,568**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13
Principal Export Markets for Petroleum Products

Country	2000		2001		2002		2003		2004*p*	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Singapore	2,457	30.2	2,906	34.6	3,043	39.9	3,605	38.2	5,392	40.2
Japan	1,371	16.9	991	11.8	1,001	13.1	1,836	19.5	1,905	14.2
The People's Republic of China	119	1.5	201	2.4	188	2.5	275	2.9	977	7.3
Hong Kong China	41	0.5	366	4.4	257	3.4	270	2.9	663	4.9
United States	746	9.2	921	11.0	412	5.4	525	5.6	642	4.8
Korea	231	2.8	110	1.3	257	3.4	274	2.9	551	4.1
Australia	239	2.9	276	3.3	188	2.5	407	4.3	459	3.4
Others	2,927	36.0	2,637	31.2	2,274	29.8	2,243	23.7	2,832	21.1
Total	**8,131**	**100.0**	**8,408**	**100.0**	**7,620**	**100.0**	**9,435**	**100.0**	**13,421**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.14
Export Prices of Major Commodities

	2000	2001	2002	2003	2004*p*	2001	2002	2003	2004*p*
						Annual change (%)			
Palm oil (RM/tonne)	1,122	944	1,367	1,617	1,706	-15.9	44.8	18.3	5.5
Rubber (sen/kg)	263	230	269	379	470	-12.7	17.0	41.0	24.3
Saw logs (RM/cu. metre)	384	315	359	366	398	-17.9	13.9	1.8	8.9
Sawn timber (RM/cu. metre)	1,050	943	1,102	1,134	1,015	-10.2	16.9	2.9	-10.4
Crude oil (US$/barrel)	29.58	25.53	24.81	30.27	40.81	-13.7	-2.9	22.0	34.8
Liquefied natural gas (RM/tonne)	740	721	659	772	824	-2.6	-8.6	17.1	6.8

p Preliminary

Source: Department of Statistics, Malaysia

Table A.15
Principal Export Markets for Palm Oil

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 tonnes)					% share				
The People's Republic of China	1,023	1,364	1,940	2,502	2,827	11.5	13.0	17.9	20.0	24.0
European Union[1]	984	1,610	1,478	1,648	1,855	11.1	15.4	13.6	13.2	15.7
Netherlands	*528*	*1,028*	*847*	*975*	*1,130*	*6.0*	*9.8*	*7.8*	*7.8*	*9.6*
Germany	*87*	*116*	*225*	*185*	*149*	*1.0*	*1.1*	*2.1*	*1.5*	*1.3*
Italy	*119*	*155*	*127*	*98*	*119*	*1.3*	*1.5*	*1.2*	*0.8*	*1.0*
Sweden	*76*	*100*	*102*	*106*	*114*	*0.9*	*1.0*	*0.9*	*0.8*	*1.0*
Others	*174*	*211*	*177*	*284*	*343*	*1.9*	*2.0*	*1.6*	*2.3*	*2.8*
Middle East	1,168	1,236	1,449	1,749	1,716	13.2	11.8	13.3	14.0	14.6
India	2,029	2,066	1,670	1,650	925	22.9	19.7	15.4	13.2	7.8
Pakistan	1,075	1,143	1,059	1,105	838	12.1	10.9	9.8	8.9	7.1
Japan	353	379	434	430	458	4.0	3.6	4.0	3.4	3.9
Bangladesh	98	178	230	272	353	1.1	1.7	2.1	2.2	3.0
United States	178	208	270	231	299	2.0	2.0	2.5	1.9	2.5
Korea	198	241	218	211	228	2.2	2.3	2.0	1.7	1.9
Chinese Taipei	76	82	80	103	120	0.9	0.8	0.7	0.8	1.0
Australia	105	101	120	97	96	1.2	1.0	1.1	0.8	0.8
Others	1,576	1,858	1,909	2,489	2,073	17.8	17.8	17.6	19.9	17.7
Total	**8,863**	**10,466**	**10,857**	**12,487**	**11,788**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states in 2004
p Preliminary

Source: Department of Statistics, Malaysia

Table A.16
Principal Export Markets for Rubber

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 tonnes)					% share				
European Union[1]	350	318	309	306	354	35.8	38.7	33.3	32.3	32.0
Germany	*107*	*119*	*119*	*129*	*147*	*10.9*	*14.4*	*12.8*	*13.6*	*13.3*
France	*40*	*31*	*41*	*40*	*53*	*4.1*	*3.8*	*4.4*	*4.2*	*4.8*
Italy	*33*	*30*	*28*	*29*	*29*	*3.3*	*3.7*	*3.1*	*3.0*	*2.6*
United Kingdom	*35*	*25*	*24*	*22*	*24*	*3.5*	*3.0*	*2.5*	*2.4*	*2.2*
Spain	*17*	*14*	*17*	*17*	*24*	*1.7*	*1.7*	*1.9*	*1.8*	*2.2*
Netherlands	*17*	*12*	*15*	*12*	*20*	*1.7*	*1.4*	*1.7*	*1.3*	*1.8*
Others	*101*	*87*	*65*	*57*	*57*	*10.6*	*10.7*	*6.9*	*6.0*	*5.1*
The People's Republic of China	94	85	129	207	289	9.6	10.4	13.9	21.9	26.1
Middle East	88	95	81	84	90	9.0	11.5	8.7	8.9	8.1
Iran	*43*	*60*	*45*	*48*	*55*	*4.4*	*7.3*	*4.8*	*5.1*	*4.9*
Turkey	*30*	*24*	*24*	*25*	*24*	*3.1*	*2.9*	*2.6*	*2.6*	*2.2*
Others	*15*	*11*	*12*	*11*	*11*	*1.5*	*1.3*	*1.3*	*1.2*	*1.0*
United States	101	66	81	76	74	10.3	8.0	8.7	8.0	6.7
Korea	73	58	59	69	64	7.5	7.0	6.4	7.3	5.8
Brazil	34	25	41	29	37	3.5	3.0	4.4	3.1	3.3
Singapore	14	5	9	9	22	1.4	0.6	1.0	0.9	2.0
Canada	27	16	28	14	19	2.8	1.9	3.0	1.5	1.7
Others	197	154	191	152	156	20.1	18.9	20.6	16.1	14.3
Total	**978**	**822**	**928**	**946**	**1,105**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states in 2004
p Preliminary

Source: Department of Statistics, Malaysia

Table A.17
Principal Export Markets for Saw Logs

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 cubic metres)					% share				
Japan	2,184	1,375	1,641	1,356	1,268	33.7	28.4	32.2	24.5	24.4
India	873	985	998	1,369	1,230	13.5	20.4	19.5	24.7	23.6
The People's Republic of China	1,405	1,071	1,106	1,336	1,185	21.7	22.2	21.7	24.2	22.8
Chinese Taipei	898	669	651	694	754	13.8	13.8	12.7	12.5	14.5
Korea	301	175	159	140	131	4.6	3.6	3.1	2.5	2.5
Thailand	102	29	39	60	84	1.6	0.6	0.8	1.1	1.6
Hong Kong China	541	417	188	103	43	8.3	8.6	3.7	1.9	0.8
Others	180	113	322	474	512	2.8	2.4	6.3	8.6	9.8
Total	**6,484**	**4,834**	**5,104**	**5,532**	**5,207**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.18
Principal Export Markets for Sawn Timber

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 cubic metres)					% share				
Thailand	565	534	589	660	608	19.7	22.2	21.4	23.7	19.2
Chinese Taipei	226	170	187	209	227	7.9	7.0	6.8	7.5	7.2
Netherlands	270	197	186	204	220	9.4	8.2	6.8	7.3	6.9
The People's Republic of China	137	151	159	193	213	4.8	6.3	5.8	6.9	6.7
Japan	239	187	194	167	184	8.3	7.8	7.1	6.0	5.8
Singapore	220	185	155	165	179	7.6	7.7	5.6	5.9	5.7
Republic of Yemen	114	83	68	78	105	3.9	3.4	2.5	2.8	3.3
Korea	129	120	98	85	86	4.5	5.0	3.6	3.1	2.7
Hong Kong China	132	135	149	107	81	4.6	5.6	5.4	3.8	2.6
United Arab Emirates	82	66	64	55	74	2.9	2.7	2.3	2.0	2.3
Belgium	69	52	64	72	69	2.4	2.2	2.3	2.6	2.2
Australia	33	20	40	40	63	1.1	0.8	1.5	1.4	2.0
Italy	23	25	37	62	56	0.8	1.0	1.3	2.2	1.8
United Kingdom	56	52	53	51	47	1.9	2.2	1.9	1.8	1.5
Others	581	434	710	641	954	20.2	17.9	25.7	23.0	30.1
Total	**2,876**	**2,411**	**2,753**	**2,789**	**3,166**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.19
Principal Export Markets for Crude Oil

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 tonnes)					% share				
Australia	1,761	1,852	1,687	2,248	4,145	10.6	12.3	10.4	12.5	22.9
Thailand	2,890	2,797	2,358	3,097	2,863	17.3	18.6	14.6	17.3	15.8
India	2,162	1,690	2,462	3,396	2,581	13.0	11.2	15.2	19.0	14.3
Indonesia	1,061	753	956	1,290	1,548	6.4	5.0	5.9	7.2	8.6
Korea	2,295	2,190	1,838	1,271	1,316	13.8	14.5	11.4	7.1	7.3
The People's Republic of China	705	838	1,723	2,013	1,284	4.2	5.6	10.6	11.2	7.1
Japan	1,298	1,457	2,131	1,440	1,016	7.8	9.7	13.2	8.0	5.6
Singapore	626	215	203	468	875	3.8	1.4	1.3	2.6	4.8
United States	1,056	704	412	937	682	6.3	4.7	2.5	5.2	3.8
Philippines	527	362	511	610	676	3.2	2.4	3.2	3.4	3.7
Sri Lanka	415	400	485	425	420	2.5	2.7	3.0	2.4	2.3
New Zealand	565	487	604	412	205	3.4	3.2	3.7	2.3	1.1
Others	1,311	1,332	822	306	479	7.7	8.7	5.0	1.8	2.7
Total	**16,672**	**15,077**	**16,192**	**17,913**	**18,090**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.20
Principal Export Markets for LNG

Country	2000	2001	2002	2003	2004*p*	2000	2001	2002	2003	2004*p*
	('000 tonnes)					% share				
Japan	11,076	11,308	10,782	12,491	12,724	71.8	73.3	71.8	72.1	61.4
Korea	2,497	2,256	2,303	2,658	4,643	16.2	14.6	15.4	15.4	22.4
Chinese Taipei	1,803	1,860	1,857	2,108	2,623	11.7	12.1	12.4	12.2	12.7
United States	–	–	–	54	299	–	–	–	0.3	1.4
Others	54	–	65	_	440	0.3	–	0.4	–	2.1
Total	**15,430**	**15,423**	**15,007**	**17,311**	**20,729**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.21
External Debt and Debt Servicing[1]

	2000	2001	2002	2003	2004*p*
	RM million				
Medium- and long-term debt:					
Gross borrowing	**23,390**	**31,550**	**23,853**	**22,180**	**25,101**
Federal Government	*4,767*	*7,030*	*10,465*	*3,144*	*1,136*
NFPEs	*7,719*	*11,311*	*3,655*	*5,140*	*11,388*
Private sector	*10,903*	*13,209*	*9,732*	*13,896*	*12,578*
Repayment and prepayment	**17,941**	**22,323**	**23,104**	**29,309**	**24,701**
Federal Government	*3,903*	*735*	*2,445*	*6,854*	*1,015*
NFPEs	*3,836*	*10,447*	*6,942*	*12,437*	*12,673*
Private sector	*10,203*	*11,141*	*13,717*	*10,019*	*11,013*
Net borrowing	**5,448**	**9,227**	**749**	**-7,129**	**400**
Federal Government	*864*	*6,295*	*8,020*	*-3,710*	*120*
NFPEs	*3,883*	*865*	*-3,287*	*-7,297*	*-1,286*
Private sector	*701*	*2,068*	*-3,985*	*3,877*	*1,565*
Outstanding debt	**143,465**	**149,346**	**153,225**	**152,950**	**154,298**
Federal Government	*18,821*	*24,328*	*36,283*	*37,284*	*34,654*
NFPEs	*59,566*	*67,415*	*64,330*	*59,540*	*62,054*
Private sector	*65,077*	*57,604*	*52,612*	*56,125*	*57,590*
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	*75.1*	*78.0*	*77.3*	*76.6*	*77.0*
Japanese yen	*17.6*	*14.5*	*14.3*	*13.0*	*12.5*
Others	*7.3*	*7.5*	*8.4*	*10.4*	*10.5*
Short-term debt:					
Outstanding debt	**17,600**	**24,072**	**32,435**	**33,690**	**43,023**
Banking sector[2]	*9,271*	*11,926*	*21,894*	*23,321*	*34,972*
Non-bank private sector	*8,329*	*12,147*	*10,541*	*10,369*	*8,051*
Total external debt:	**161,065**	**173,419**	**185,660**	**186,640**	**197,321**
Total external debt (US$ million)	**42,385**	**45,636**	**48,858**	**49,116**	**51,927**
% GNP	*51.2*	*56.2*	*55.2*	*50.2*	*46.6*
Annual change (%)	*-0.7*	*7.7*	*7.1*	*0.5*	*5.7*
Total servicing (including short-term interest payment)	**25,043**	**26,954**	**27,832**	**28,627**	**24,368**
of which:					
Medium- and long-term debt					
Repayment (excluding prepayment)	**16,370**	**19,612**	**20,780**	**21,854**	**18,227**
Federal Government	*3,903*	*735*	*2,445*	*3,861*	*1,015*
NFPEs	*2,506*	*7,886*	*6,942*	*10,017*	*10,742*
Private sector	*9,962*	*10,991*	*11,393*	*7,976*	*6,469*
Interest payment	**7,117**	**6,346**	**6,297**	**6,150**	**5,413**
Federal Government	*1,187*	*1,150*	*1,692*	*1,883*	*1,758*
NFPEs	*3,408*	*3,574*	*3,430*	*3,287*	*2,664*
Private sector	*2,522*	*1,621*	*1,174*	*979*	*991*
Debt service ratio (% of exports of goods and services)					
Total debt	**5.8**	**6.8**	**6.6**	**6.2**	**4.3**
Medium- and long-term debt	5.4	6.6	6.4	6.0	4.2
Federal Government	*1.2*	*0.5*	*1.0*	*1.2*	*0.5*
NFPEs	*1.4*	*2.9*	*2.5*	*2.9*	*2.4*
Private sector	*2.9*	*3.2*	*3.0*	*1.9*	*1.3*

[1] Data on MAS was included under private sector up to 2000 and under NFPEs from 2001
[2] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance and Bank Negara Malaysia

Table A.22
Gross Overseas Investment by Country[1]

Country	2000	2001	2002	2003	2004
	RM million				
Singapore	2,920	2,082	1,074	845	2,529
Hong Kong China	158	100	410	520	1,126
Chad	0	0	1,099	138	956
United States	3,924	4,007	5,708	994	772
Thailand	292	134	45	226	686
The People's Republic of China	153	313	310	243	407
Indonesia	536	1,683	901	356	389
Netherlands	2	531	934	87	249
Sudan	…	15	125	600	249
Vietnam	50	88	78	86	170
United Kingdom	532	270	822	493	145
Canada	28	34	181	30	89
Australia	73	304	172	167	87
India	22	43	76	57	85
Egypt	…	…	28	215	73
South Africa	29	90	25	3	68
Belgium	…	…	4	…	59
Germany	28	21	30	54	46
Bahrain	…	0	46	120	44
Japan	83	58	142	137	39
Bangladesh	2	2	1	0	38
Finland	16	9	6	10	37
Qatar	…	0	0	6	30
Others	4,958	3,317	4,656	5,254	19,929
of which:					
Labuan[2]	*2,972*	*1,130*	*1,600*	*933*	*19,105*
Mauritius	*59*	*82*	*420*	*386*	*220*
British Virgin Islands	*79*	*53*	*4*	*10*	*102*
Cayman Islands	*349*	*37*	*906*	*1,664*	*87*
Isle of Man	*0*	0	…	*175*	*41*
Total	**13,805**	**13,102**	**16,872**	**10,642**	**28,302**

[1] Refers to direct equity investment, purchase of real estate and extension of loans to non-residents abroad. Includes capital invested or loans extended by the foreign-owned companies in/to their parent companies abroad. For the purpose of compiling balance of payments statistics, capital invested in or loans extended to parent companies abroad must be offset against the capital invested in or loans extended to Malaysia by the parent companies abroad. At present, the Cash BOP Reporting System is not able to segregate this type of transaction

[2] Labuan IOFC is treated as a non-resident for foreign exchange administration purposes

… Negligible

Note: Numbers may not necessarily add up due to rounding

Source: Cash BOP Reporting System, Bank Negara Malaysia

Table A.23
Consumer Price Index (2000=100) Sub-groups of Food

	Weights (%)	2002	2003	2004
		Annual change (%)		
Food	33.8	0.7	1.3	2.2
of which:				
Food at Home	24.1	0.2	1.6	2.3
Rice, bread and other cereals	5.5	0.1	0.4	0.7
Meat	3.4	-1.3	2.4	4.3
Fish	4.9	1.0	1.3	3.3
Milk and eggs	2.1	1.0	2.2	2.6
Oils and fats	0.8	1.8	4.4	2.3
Fruits and vegetables	5.0	0.2	2.5	1.5
Sugar	0.5	-1.9	0.2	0.2
Coffee and tea	0.8	0.4	1.6	2.1
Other foods	1.1	0.3	0.5	1.3
Food away from home	9.7	2.0	0.7	2.1

Source: Department of Statistics, Malaysia

Table A.24
Producer Price Index (1989=100)

	Weights (%)	2000	2001	2002	2003	2004
		Annual change (%)				
Domestic Economy	100.0	3.1	-5.0	4.4	5.7	8.9
of which:						
Food and live animals chiefly for food	14.9	0.4	0.4	0.4	-0.2	3.6
Beverages and tobacco	2.1	0.4	1.8	3.9	0.9	1.6
Crude materials, inedible except fuels	18.0	1.3	-5.9	7.0	7.5	6.6
Mineral fuels, lubricants and related materials	18.8	33.9	-10.6	0.0	11.4	22.3
Animal and vegetable oils and fats	8.5	-31.9	-17.6	46.5	15.7	13.2
Chemicals and related products N.E.C	4.4	1.0	-1.1	-0.7	1.4	4.3
Manufactured goods	10.8	0.9	-0.5	-0.2	1.8	2.5
Machinery and transport equipment	18.4	-0.1	-0.1	-0.3	0.1	0.1
Miscellaneous manufactured articles	3.6	0.9	-0.6	-0.3	0.9	0.6
Other commodities and transactions	0.6	0.4	10.3	2.6	0.5	0.2
Local Production	79.3	3.6	-6.1	5.7	6.8	10.3
Imports	20.7	1.1	-0.3	-0.7	0.8	2.0

Source: Department of Statistics, Malaysia

Table A.25
New Supply of Purpose-Built Office Space and Retail Space in Malaysia

Year	Office Space		Retail Space	
	Square metres	Occupancy rate[1] (%)	Square metres	Occupancy rate[1] (%)
1995	460,618	94.7	395,006	74.6
1996	378,186	93.9	331,747	69.2
1997	1,378,989	92.7	1,658,174	77.7
1998	1,606,986	82.0	499,085	67.4
1999	768,633	82.1	97,960	75.7
2000	2,921,324	78.3	737,828	73.9
2001	547,864	77.8	257,743	75.6
2002	374,750	77.9	210,657	77.7
2003	169,548	80.0	507,637	77.9
2004*p* (Jan-Sept)	221,532	81.9	265,324	79.6

[1] Refers to end period
p Preliminary

Source: NAPIC, Valuation and Property Services Department

Table A.26
Average Monthly Rentals for Prime Office and Retail Space in the Klang Valley[1]

Year	Prime Office Space		Prime Retail Space	
	RM/sq.m	Annual change (%)	RM/sq.m	Annual change (%)
1999	42	-8.7	175	8.0
2000	48	14.3	194	10.9
2001	48	0.9	215	11.0
2002	45	-6.7	226	5.0
2003	45	0.0	226	0.0
2004	46	2.2	242	7.1

[1] Refers to Kuala Lumpur and Selangor

Source: CH Williams Talhar & Wong Sdn. Bhd.

Table A.27
Broad Money (M3)

	Annual change					As at end-2004
	2000	2001	2002	2003	2004	
	RM million					
Broad money (M3)[1]	21,906	13,022	31,607	48,524	68,004	617,654
Currency[2]	-1,949	-92	1,751	2,233	2,608	28,552
Demand deposits	7,623	2,882	6,718	11,210	10,086	87,466
Broad quasi-money	16,232	10,232	23,138	35,082	55,311	501,636
Fixed deposits	*8,207*	*-358*	*12,648*	*17,065*	*24,668*	*351,976*
Savings deposits	*6,380*	*4,454*	*5,590*	*5,602*	*6,129*	*68,587*
NIDs	*-932*	*600*	*3,575*	*1,965*	*8,179*	*19,156*
Repos	*-314*	*4,186*	*2,507*	*8,016*	*13,337*	*46,513*
Foreign currency deposits	*2,890*	*1,350*	*-1,182*	*2,434*	*2,998*	*15,403*
Factors Affecting M3						
Net claims on Government	4,388	-1,542	11,538	12,949	-11,807	-3,242
Claims on Government	*3,326*	*4,165*	*-867*	*3,960*	*8,649*	*41,556*
Less: Government deposits	*-1,062*	*5,707*	*-12,405*	*-8,989*	*20,457*	*44,798*
Claims on private sector	25,968	20,335	27,737	31,287	30,261	596,606
Loans	*21,566*	*17,081*	*19,288*	*21,468*	*39,815*	*515,165*
Securities	*4,402*	*3,255*	*8,449*	*9,819*	*-9,554*	*81,441*
Net external operations	7,336	6,741	1,237	20,748	82,233	219,786
Bank Negara Malaysia[3]	*1,633*	*7,722*	*7,564*	*27,131*	*75,072*	*213,169*
Banking system	*5,703*	*-980*	*-6,327*	*-6,383*	*7,161*	*6,617*
Other influences	-15,786	-12,513	-8,905	-16,460	-32,683	-195,496

[1] Excludes interplacements among banking institutions
[2] Excludes holdings by banking system
[3] Includes exchange rate revaluation loss/gain

Table A.28
Money Supply: Annual Change and Growth Rates

	M3[5]													
			M2[3]											
					M1[1]									
	Total		Total		Total		Currency		Demand deposits		Narrow quasi-money[2]		Deposits with other banking institutions[4]	
	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%	RM m	%
2000	21,906	5.0	17,564	5.2	4,769	6.5	-2,517	-10.2	7,287	15.0	12,795	4.9	4,342	4.5
2001	13,022	2.9	7,810	2.2	2,512	3.2	-115	-0.5	2,627	4.7	5,298	1.9	5,213	5.1
2002	31,607	6.7	21,030	5.8	8,344	10.3	1,749	7.9	6,595	11.3	12,686	4.5	10,576	9.9
2003	48,524	9.7	42,519	11.1	13,032	14.6	2,205	9.2	10,827	16.6	29,487	10.0	6,005	5.1
2004	68,004	12.4	108,116	25.4	12,179	11.9	2,530	9.7	9,649	12.7	95,937	29.6	-40,112	-32.5

[1] Currency in circulation and demand deposits of the private sector
[2] Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks
[3] M1 plus narrow quasi-money
[4] Comprising fixed deposits and repos of the private sector placed with finance companies, merchant banks and discount houses. Also includes saving deposits with finance companies, negotiable instruments of deposits (NIDs) with finance companies and merchant banks, foreign currency deposits placed with merchant banks and call deposits with discount houses. Excludes interplacement among the banking institutions
[5] M2 plus deposits placed with other banking institutions

Table A.29
Interest Rates (%)

	Average rates at end-year				Average rates at end-month in 2004											
	2000	2001	2002	2003	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
3-month interbank	3.25	3.27	3.13	2.87	2.89	2.85	2.85	2.85	2.91	2.83	2.83	2.80	2.83	2.82	2.80	2.80
Commercial banks																
Fixed deposit:																
3-month	3.48	3.21	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
12-month	4.24	4.00	4.00	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	2.72	2.28	2.12	1.86	1.83	1.83	1.77	1.77	1.74	1.73	1.72	1.69	1.65	1.64	1.59	1.58
Base lending rate (BLR)	6.78	6.39	6.39	6.00	6.00	6.00	6.00	6.00	5.98	5.98	5.98	5.98	5.98	5.98	5.98	5.98
Finance companies																
Fixed deposit:																
3-month	3.52	3.22	3.20	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
12-month	4.27	4.01	4.00	3.68	3.66	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	3.44	2.94	2.65	2.18	2.20	2.19	2.14	2.14	2.11	1.99	1.93	1.79	1.93	1.99	2.04	1.98
Base lending rate (BLR)	7.95	7.45	7.45	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90	6.90
Treasury bills (91 days)	2.98	2.73	2.82	2.77	2.68	2.38	2.54	2.49	2.58	2.57	2.34	2.51	2.52	2.35	1.84	1.96
Government securities (1 year)	3.36	2.93	2.94	2.93	2.76	2.67	2.73	2.74	2.78	2.75	2.74	2.76	2.74	2.53	1.77	2.24
Government securities (5 years)	4.80	3.18	3.15	4.28	3.92	4.30	4.08	4.16	4.35	4.41	4.28	4.27	4.09	3.95	3.60	3.64

Table A.30
Consolidated Public Sector Finance

	2000	2001	2002	2003	2004*e*
	RM million				
Revenue[1]	76,002	91,633	96,763	107,055	116,663
% growth	*7.2*	*20.6*	*5.6*	*10.6*	*9.0*
Operating expenditure	64,445	72,299	75,450	84,163	102,727
% growth	*18.7*	*12.2*	*4.4*	*11.5*	*22.1*
Current surplus of NFPEs[2]	41,204	39,484	45,324	55,651	52,295
Current balance	**52,761**	**58,818**	**66,637**	**78,543**	**66,231**
% of GDP	***15.4***	***17.6***	***18.5***	***19.9***	***14.8***
Net development expenditure[3]	50,439	59,724	69,125	83,315	67,772
% growth	*8.7*	*18.4*	*15.7*	*20.5*	*-18.7*
General government[4]	27,079	35,692	36,828	43,155	33,638
NFPEs	23,360	24,032	32,297	40,160	34,135
Overall balance	**2,322**	**-906**	**-2,488**	**-4,772**	**-1,541**
% of GDP	***0.7***	***-0.3***	***-0.7***	***-1.2***	***-0.3***

1 Excludes transfers within general government
2 Refers to 34 NFPEs in 2003 and 2004; 36 NFPEs in 2002
3 Adjusted for transfers and net lending within public sector
4 Comprises Federal Government, state governments, statutory bodies and local governments
e Estimate
Note: Numbers may not add up due to rounding

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

Table A.31
Major Industrial Countries: Key Economic Indicators

	2000	2001	2002	2003	2004*e*	2005*f*
	Annual change (%)					
REAL GDP						
Major Industrial Countries	**3.8**	**1.2**	**1.6**	**2.0**	**3.4**	**2.6**
United States	3.7	0.8	1.9	3.0	4.4	3.5
Japan	2.4	0.2	-0.3	1.4	2.6	1.3
Euro area	3.5	1.6	0.9	0.5	2.0	1.5
Germany	*2.9*	*0.8*	*0.1*	*-0.1*	*1.6*	*1.0*
United Kingdom	3.9	2.3	1.8	2.2	3.1	2.1
INFLATION						
Major Industrial Countries	**2.2**	**2.1**	**1.5**	**1.8**	**2.0**	**2.1**
United States	3.4	2.8	1.6	2.3	2.7	3.0
Japan	-0.7	-0.7	-0.9	-0.3	0.0	-0.1
Euro area	2.1	2.4	2.3	2.1	2.2	1.9
Germany	*1.4*	*1.9*	*1.3*	*1.0*	*1.8*	*1.3*
United Kingdom[1]	0.8	1.2	1.3	1.4	1.3	1.9
	% of labour force					
UNEMPLOYMENT						
Major Industrial Countries						
United States	4.0	4.8	5.8	6.0	5.5	5.4
Japan	4.7	5.0	5.4	5.3	4.7	4.5
Euro area	8.5	8.0	8.5	8.9	8.9	8.7
Germany	*7.8*	*7.9*	*8.7*	*9.6*	*9.8*	*9.5*
United Kingdom	5.5	5.1	5.2	5.0	4.8	4.8
	% of GDP					
CURRENT ACCOUNT BALANCE						
Major Industrial Countries						
United States	-4.2	-3.8	-4.5	-4.8	-5.5	-5.1
Japan	2.5	2.1	2.8	3.2	3.7	3.2
Euro area	-0.5	0.2	0.8	0.3	0.5	0.9
Germany	*-1.4*	*0.1*	*2.2*	*2.2*	*3.7*	*4.8*
United Kingdom	-2.5	-2.3	-1.7	-1.7	-2.4	-1.9
FISCAL BALANCE						
Major Industrial Countries						
United States	2.0	0.5	-2.4	-3.3	-3.3	-3.3
Japan	-6.9	-6.3	-6.9	-6.6	-6.8	-6.3
Germany	1.4	-1.4	-1.7	-1.9	-1.7	-1.7
United Kingdom	3.9	0.8	-1.7	-3.6	-3.2	-3.0

[1] Refers to Retail Price Index excluding mortgage interest
e Estimate
f Forecast

Source: IMF World Economic Outlook, September 2004
OECD Economic Outlook, December 2004

Table A.32
East Asia: Key Economic Indicators

	2000	2001	2002	2003	2004*e*	2005*f*
REAL GDP	Annual change (%)					
Regional Countries	**7.7**	**4.3**	**6.4**	**6.4**	**7.5**	**6.3 ~ 6.5**
The People's Republic of China	8.0	7.5	8.3	9.3	9.5	8.5
Korea	8.5	3.8	7.0	3.1	4.7	4.0
Chinese Taipei	5.8	-2.2	3.9	3.3	5.7	4.2
Singapore	9.7	-1.9	2.2	1.4	8.4	3.0 ~5.0
Hong Kong China	10.2	0.5	1.9	3.2	7.5	4.5
Malaysia	8.9	0.3	4.1	5.3	7.1	5.0 ~6.0
Thailand	4.8	2.2	5.3	6.9	6.1	5.3 ~ 6.3
Indonesia	4.9	3.8	4.3	4.9	5.1	5.0 ~ 6.0
Philippines	6.0	1.8	4.3	4.7	6.1	5.3 ~ 6.3
CONSUMER PRICES	Annual change (%)					
Regional Countries	**1.2**	**2.4**	**1.3**	**1.8**	**3.4**	**2.9 ~ 3.2**
The People's Republic of China	0.4	0.7	-0.8	1.2	3.9	3.0
Korea	2.2	4.1	2.7	3.6	3.6	3.0
Chinese Taipei	1.3	0.0	-0.2	-0.3	1.6	1.9
Singapore	1.3	1.0	-0.4	0.5	1.7	1.0 ~ 2.0
Hong Kong China[1]	-3.8	-1.6	-3.0	-2.6	-0.4	1.5
Malaysia	1.6	1.4	1.8	1.2	1.4	2.5
Thailand	1.6	1.6	0.7	1.8	2.8	2.5 ~ 3.5
Indonesia	3.8	11.5	11.9	6.6	6.1	5.0 ~ 7.0
Philippines	4.4	6.1	3.1	3.1	5.9	5.0 ~ 6.0
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	1.9	1.5	2.8	3.2	2.4	2.8
Korea	2.4	1.7	1.0	2.0	3.1	3.3
Chinese Taipei	2.9	6.5	9.1	10.2	6.9	6.0
Singapore	14.3	18.7	21.4	30.9	25.7	23.9
Hong Kong China	4.3	6.1	7.9	10.7	10.0	9.6
Malaysia	9.4	8.3	8.4	12.9	12.6	14.1
Thailand	7.6	5.4	5.5	5.6	3.8	2.0
Indonesia	5.3	4.8	4.5	3.5	2.9	1.9
Philippines	8.4	1.9	5.8	4.9	2.8	1.8
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-3.6	-3.1	-3.3	-2.8	-2.2	-2.0
Korea	1.1	1.6	3.9	1.8	n.a.	n.a.
Chinese Taipei	-3.2	-6.6	-3.0	-2.5	n.a.	n.a.
Singapore	2.5	-1.8	0.1	-1.2	-0.8	n.a.
Hong Kong China	-0.6	-5.0	-4.9	-3.3	n.a.	n.a.
Malaysia	-5.7	-5.5	-5.6	-5.3	-4.3	n.a.
Thailand	-2.2	-2.4	-1.4	0.4	n.a.	n.a.
Indonesia	-5.1	-2.3	-1.7	-1.9	-1.2	n.a.
Philippines	-4.0	-4.0	-5.3	-4.6	-3.8	-3.4

[1] Refers to composite prices
[2] Refers to central government balance
e Estimate
f Forecast
n.a. Not available

Source: National Sources
IMF World Economic Outlook, September 2004

Table A.33
Sources and Uses of Funds of the Financial System

	2000	2001	2002	2003	2004*p*
	RM million				
Sources of Funds:					
Capital, reserves and profit	120,990.7	123,863.2	134,871.7	148,997.5	164,006.2
Currency	26,708.9	25,385.4	27,137.4	29,445.4	32,353.9
Demand deposits	83,205.3	92,129.0	87,539.5	92,117.8	124,333.4
Other deposits[1] (of which):	503,079.1	508,836.0	547,135.3	617,286.6	711,241.9
Public sector	*45,385.0*	*44,971.3*	*44,767.7*	*40,563.0*	*39,175.5*
Other financial institutions	*110,791.5*	*102,161.7*	*122,405.2*	*161,311.5*	*197,022.6*
Private sector	*339,770.3*	*354,996.6*	*372,884.1*	*406,049.3*	*461,718.4*
Foreign	*7,132.3*	*6,706.4*	*7,078.4*	*9,362.8*	*13,325.4*
Borrowings	34,820.5	37,380.8	44,948.0	48,715.3	51,231.4
Funds from other financial institutions	67,603.3	68,552.4	70,836.8	87,571.5	72,028.7
Domestic[2]	*51,355.6*	*53,448.2*	*46,973.0*	*61,837.8*	*34,434.9*
Foreign	*16,247.7*	*15,104.2*	*23,863.8*	*25,733.6*	*37,593.7*
Insurance, provident and pension funds	236,640.1	251,409.8	274,384.5	305,657.0	339,216.1
Other liabilities	190,138.3	193,163.0	208,266.6	233,289.0	268,177.1
Total Liabilities	**1,263,186.3**	**1,300,719.6**	**1,395,119.8**	**1,563,080.0**	**1,762,588.8**
Uses of Funds:					
Currency	8,834.4	5,336.7	7,369.8	5,573.8	6,066.8
Deposits with other financial institutions	183,470.2	177,102.0	187,883.0	226,303.7	247,594.0
Domestic	*162,274.1*	*156,662.9*	*166,670.3*	*211,075.6*	*214,010.0*
Foreign	*21,196.1*	*20,439.1*	*21,212.7*	*15,228.0*	*33,584.0*
Loans and advances	512,428.5	528,348.3	560,459.4	599,285.5	655,557.8
Public sector	*5,529.4*	*5,188.8*	*10,191.0*	*4,670.1*	*5,007.7*
Other financial institutions	*26,450.3*	*25,984.9*	*23,746.4*	*24,295.3*	*24,385.1*
Private sector	*477,954.0*	*494,977.2*	*524,393.4*	*567,980.1*	*623,497.6*
Foreign	*2,494.8*	*2,197.4*	*2,128.5*	*2,340.0*	*2,667.4*
Securities	298,033.1	336,379.3	361,113.3	409,488.6	429,771.6
Treasury bills	*4,260.4*	*4,063.5*	*5,680.0*	*3,539.4*	*440.4*
Commercial bills	*12,312.0*	*12,222.5*	*13,321.8*	*13,468.4*	*8,403.7*
Malaysian Government Securities (MGS)	*88,197.3*	*103,714.8*	*104,354.9*	*125,165.0*	*139,757.6*
Corporate[3]	*186,728.5*	*207,130.1*	*226,671.9*	*254,197.9*	*268,163.7*
Private Debt Securities (PDS)	*n.a.*	*n.a.*	*n.a.*	*122,237.8*	*129,210.1*
Equities	*n.a.*	*n.a.*	*n.a.*	*131,960.1*	*138,953.6*
Foreign	*1,233.9*	*2,720.3*	*3,189.7*	*3,429.0*	*4,584.3*
Others	*5,301.1*	*6,528.0*	*7,894.9*	*9,688.7*	*8,421.9*
Gold and forex reserves	109,835.5	113,542.3	127,515.1	166,139.3	249,704.1
Other assets	150,584.5	140,011.1	150,779.3	156,289.1	173,894.4
Total Assets	**1,263,186.3**	**1,300,719.6**	**1,395,119.8**	**1,563,080.0**	**1,762,588.8**

[1] Equals savings, fixed and other (NIF, LPHT, etc.) deposits + NIDs + repos
[2] Includes statutory reserves of banking institutions
[3] Breakdown of Corporate Securities between Private Debt Securities (PDS) and Equities available from 2003
p Preliminary
n.a. Not available

Table A.34
Commercial Banks[1]: Commitments and Contingencies

	As at end-									
	2000		2001		2002		2003		2004	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	12,249.3	4.0	11,282.3	3.3	11,440.7	2.7	13,817.4	2.9	17,352.4	2.8
Credit extension commitments	137,597.3	44.4	159,824.0	46.4	167,530.0	39.9	169,490.0	35.8	198,002.5	31.7
Direct credit substitutes	14,999.8	4.8	13,894.6	4.0	12,705.8	3.0	14,156.4	3.0	14,232.5	2.3
Foreign exchange related contracts	84,506.6	27.3	81,445.1	23.6	85,361.0	20.4	101,288.1	21.4	176,020.7	28.2
Interest rate related contracts	15,987.1	5.2	32,667.8	9.5	90,528.5	21.6	121,567.6	25.7	159,931.1	25.6
Trade-related contingencies	14,785.5	4.8	13,465.3	3.9	17,438.5	4.2	19,404.3	4.1	22,409.2	3.6
Transaction-related contingencies	18,485.7	6.0	19,025.6	5.5	20,639.0	4.9	20,448.1	4.3	20,250.6	3.2
Underwriting obligations	1,664.4	0.5	1,768.1	0.5	1,952.0	0.5	1,808.4	0.4	1,466.9	0.2
Others	9,518.3	3.1	11,293.9	3.3	11,838.6	2.8	11,600.3	2.4	14,593.0	2.3
Total	**309,794.0**	**100.0**	**344,666.6**	**100.0**	**419,434.0**	**100.0**	**473,580.6**	**100.0**	**624,259.0**	**100.0**

[1] Excludes Islamic banks
Note: Numbers may not necessarily add up due to rounding

Table A.35
Finance Companies: Commitments and Contingencies

	As at end-									
	2000		2001		2002		2003		2004	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	8,186.1	41.8	9,990.7	48.9	13,983.8	53.0	13,010.2	51.4	7,963.5	50.1
Credit extension commitments	9,640.4	49.2	8,779.9	43.0	9,136.1	34.6	9,241.1	36.5	4,718.1	29.7
Direct credit substitutes	611.0	3.1	198.3	1.0	141.6	0.5	136.3	0.5	52.0	0.3
Foreign exchange related contracts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest rate related contracts	1,007.0	5.1	1,389.0	6.8	3,109.0	11.8	2,929.0	11.6	3,160.0	19.9
Trade-related contingencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transaction-related contingencies	41.6	0.2	40.7	0.2	29.1	0.1	15.9	0.1	12.9	0.1
Underwriting obligations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	105.4	0.5	32.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total	**19,591.7**	**100.0**	**20,431.3**	**100.0**	**26,399.5**	**100.0**	**25,332.6**	**100.0**	**15,906.5**	**100.0**

Note: Numbers may not necessarily add up due to rounding

Table A.36
Merchant Banks: Commitments and Contingencies

	As at end-									
	2000		2001		2002		2003		2004	
	RM million	% share	RM million	% share	RM million	% share	RM million	% share	RM million	% share
Assets sold with recourse and commitments with drawdown	161.0	0.6	1,425.5	2.9	1,736.0	2.2	1,595.2	1.3	2,493.7	1.4
Credit extension commitments	4,114.8	16.0	2,639.7	5.4	2,089.1	2.7	2,545.9	2.1	2,337.6	1.3
Direct credit substitutes	2,111.4	8.2	1,325.1	2.7	1,039.3	1.3	1,226.8	1.0	1,126.2	0.6
Foreign exchange related contracts	964.7	3.8	1,320.1	2.7	1,506.6	1.9	1,459.9	1.2	2,877.6	1.6
Interest rate related contracts	15,686.3	61.0	39,658.8	81.2	70,701.1	89.7	115,332.1	92.9	169,300.3	94.1
Trade-related contingencies	1.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transaction-related contingencies	886.0	3.4	790.4	1.6	749.0	1.0	818.2	0.7	676.6	0.4
Underwriting obligations	1,653.5	6.4	1,617.5	3.3	937.5	1.2	1,139.0	0.9	1,029.6	0.6
Others	118.3	0.5	80.0	0.2	44.1	0.1	55.4	0.0	44.6	0.0
Total	**25,697.1**	**100.0**	**48,857.2**	**100.0**	**78,802.7**	**100.0**	**124,172.6**	**100.0**	**179,886.2**	**100.0**

Note: Numbers may not necessarily add up due to rounding

Table A.37
Commercial Banks[1]: Income and Expenditure

	For the financial year			For the calendar year		
	2001	2002	2003	2002	2003	2004*p*
	RM million					
Interest income net of interest-in-suspense	24,969.7	25,157.7	25,832.4	25,055.5	26,383.7	30,120.2
(Interest-in-suspense)	*3,488.2*	*3,959.0*	*3,296.1*	*3,759.7*	*3,149.6*	*2,562.2*
Less: Interest expense	12,961.4	12,876.2	13,105.7	12,808.6	13,400.2	15,346.6
Net interest income	12,008.4	12,281.5	12,726.7	12,247.0	12,983.5	14,773.6
Add: Fee-based income	2,429.6	2,827.1	3,083.7	2,871.8	3,267.3	3,889.2
Less: Staff cost	3,624.3	3,635.1	3,776.1	3,688.1	3,879.3	4,512.1
Overheads	3,641.8	4,116.4	4,314.9	4,175.3	4,328.2	5,042.4
Gross operating profit	7,171.9	7,357.1	7,719.4	7,255.3	8,043.4	9,108.3
Less: Loan loss and other provisions	6,003.2	3,984.2	2,646.6	3,807.4	2,869.3	3,905.7
Gross operating profit after provision	1,168.7	3,372.8	5,072.8	3,447.9	5,174.1	5,202.5
Add: Other income	3,475.6	2,986.8	1,699.5	2,909.4	1,553.8	2,891.8
Pre-tax profit	**4,644.3**	**6,359.7**	**6,772.3**	**6,357.3**	**6,727.9**	**8,094.3**

[1] Excludes Islamic banks
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Table A.38
Finance Companies: Income and Expenditure

	For the financial year			For the calendar year		
	2001	2002	2003	2002	2003	2004*p*
	RM million					
Interest income net of interest-in-suspense	7,637.4	9,299.7	8,956.8	8,824.1	9,202.4	7,892.9
(Interest-in-suspense)	*1,161.5*	*1,452.4*	*1,339.4*	*1,521.6*	*1,327.7*	*968.5*
Less: Interest expense	3,375.8	4,094.5	3,955.1	3,884.2	4,005.6	3,455.1
Net interest income	4,261.6	5,205.1	5,001.8	4,939.8	5,196.8	4,437.8
Add: Fee-based income	224.8	103.0	88.1	104.2	100.9	88.1
Less: Staff cost	663.0	802.1	785.2	783.0	812.7	687.3
Overheads	786.8	1,093.9	934.0	1,018.5	959.4	895.1
Gross operating profit	3,036.6	3,412.2	3,370.6	3,242.6	3,525.6	2,943.4
Less: Loan loss and other provisions	1,371.6	1,524.4	971.8	1,370.9	1,022.7	368.6
Gross operating profit after provision	1,664.9	1,887.8	2,398.7	1,871.7	2,502.9	2,574.9
Add: Other income	369.2	524.2	176.8	507.7	140.8	164.5
Pre-tax profit	**2,034.1**	**2,412.0**	**2,575.5**	**2,379.4**	**2,643.7**	**2,739.4**

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

Table A.39
Merchant Banks: Income and Expenditure

	For the financial year			For the calendar year		
	2001	2002	2003	2002	2003	2004*p*
	RM million					
Interest income net of interest-in-suspense	1,783.7	1,714.3	1,624.3	1,601.0	1,636.5	1,645.8
(Interest-in-suspense)	*313.8*	*328.1*	*258.1*	*296.8*	*220.9*	*173.0*
Less: Interest expense	1,176.9	1,138.7	1,081.7	1,070.1	1,145.7	1,173.4
Net interest income	606.8	575.5	542.6	530.9	490.8	472.5
Add: Fee-based income	296.3	306.2	332.6	338.2	327.6	350.4
Less: Staff cost	204.9	214.8	263.1	226.5	260.6	297.2
Overheads	118.1	117.0	130.8	121.3	133.4	154.6
Gross operating profit	580.1	549.9	481.4	521.2	424.3	371.1
Less: Loan loss and other provisions	894.7	371.6	306.0	318.2	137.4	56.3
Gross operating profit after provision	-314.6	178.3	175.3	203.1	287.0	314.9
Add: Other income	624.6	488.3	519.6	388.3	398.2	550.7
Pre-tax profit	**310.0**	**666.6**	**695.0**	**591.3**	**685.2**	**865.5**

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

Table A.40
Commercial Banks[1] and Finance Companies: Lending Guidelines to the Priority Sectors

	Compliance Date of 31 December 2004	
	2003/2004 Lending Guidelines	
	Target	Achieved
Housing Loan Commitments		
Total number of houses (units)	100,000	160,272
Non-compliance (no. of institutions)	–	8
Loans to Small and Medium Enterprises		
Total loans approved (RM billion)	28.1	44.7
Non-compliance (no. of institutions)	–	6

[1] Including performance of Islamic banks

Table A.41
Commercial Banks[1]: Direction of Lending

	Loans by Sectors (RM million)					% share				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**183,337.0**	**180,310.0**	**179,580.1**	**177,547.5**	**194,323.8**	**59.5**	**56.8**	**54.6**	**51.3**	**44.5**
Households	**94,459.7**	**107,402.9**	**122,806.1**	**140,998.2**	**213,386.9**	**30.6**	**33.8**	**37.3**	**40.7**	**48.8**
Others	**30,559.8**	**29,687.8**	**26,648.1**	**27,484.4**	**29,194.4**	**9.9**	**9.4**	**8.1**	**7.9**	**6.7**
Total[2]	**308,356.6**	**317,400.7**	**329,034.3**	**346,030.0**	**436,905.1**					
Agriculture, hunting, forestry and fishing	9,277.9	9,935.6	10,010.8	9,090.2	9,708.6	3.0	3.1	3.0	2.6	2.2
Mining and quarrying	1,151.5	996.6	805.7	927.1	868.2	0.4	0.3	0.2	0.3	0.2
Manufacturing	56,489.0	55,949.5	55,090.8	55,122.2	58,133.3	18.3	17.6	16.7	15.9	13.3
Electricity, gas and water supply	6,838.2	4,383.2	5,595.1	4,587.6	4,744.8	2.2	1.4	1.7	1.3	1.1
Wholesale and retail trade, restaurants and hotels	31,218.9	31,565.9	32,500.5	34,465.4	40,710.2	10.1	9.9	9.9	10.0	9.3
Wholesale trade	*17,771.9*	*18,183.7*	*19,047.5*	*20,183.3*	*24,553.2*	*5.8*	*5.7*	*5.8*	*5.8*	5.6
Retail trade	*9,169.1*	*9,424.6*	*9,788.0*	*10,343.6*	*12,170.6*	*3.0*	*3.0*	*3.0*	*3.0*	*2.8*
Restaurants and hotels	*4,277.8*	*3,957.7*	*3,664.9*	*3,938.4*	*3,986.4*	*1.4*	*1.2*	*1.1*	*1.1*	*0.9*
Broad property sector	117,502.7	129,269.9	139,615.3	154,985.5	187,382.6	38.1	40.7	42.4	44.8	42.9
Construction	*25,342.7*	*24,286.3*	*22,871.8*	*21,113.8*	*24,629.9*	*8.2*	*7.7*	*7.0*	*6.1*	*5.6*
Purchase of residential property	*59,094.7*	*71,052.3*	*83,747.2*	*98,762.4*	*122,189.1*	*19.2*	*22.4*	*25.5*	28.5	*28.0*
Purchase of non-residential property	*21,172.1*	*21,285.0*	*21,691.3*	*23,376.2*	*28,350.7*	*6.9*	*6.7*	*6.6*	*6.8*	*6.5*
Real estate	*11,893.2*	*12,646.3*	*11,305.0*	*11,733.1*	*12,212.8*	*3.9*	*4.0*	*3.4*	*3.4*	*2.8*
Transport, storage and communication	8,712.1	7,546.6	7,508.1	8,080.3	8,167.9	2.8	2.4	2.3	2.3	1.9
Financial, insurance and business services	28,331.1	29,628.1	27,256.4	26,982.4	29,460.7	9.2	9.3	8.3	7.8	6.7
Financial services	*21,139.8*	*21,545.4*	*19,715.1*	*19,824.2*	*20,514.6*	*6.9*	*6.8*	*6.0*	*5.7*	*4.7*
Insurance	*256.7*	*533.5*	*587.9*	*191.6*	*124.3*	*0.1*	*0.2*	*0.2*	*0.1*	*0.0*
Business services	*6,934.6*	*7,549.2*	*6,953.4*	*6,966.6*	*8,821.8*	*2.2*	*2.4*	*2.1*	*2.0*	*2.0*
Consumption credit	19,679.6	21,078.9	22,942.4	24,868.0	66,686.8	6.4	6.6	7.0	7.2	*15.3*
Personal uses	*12,035.0*	*12,277.2*	*13,131.9*	*13,626.3*	*15,555.2*	*3.9*	*3.9*	*4.0*	*3.9*	*3.6*
Credit cards	*5,987.6*	*7,290.2*	*8,962.4*	*10,487.3*	*12,711.2*	*1.9*	*2.3*	*2.7*	*3.0*	*2.9*
Purchase of consumer durable goods	*691.5*	*433.4*	*323.8*	*311.2*	*271.1*	*0.2*	*0.1*	*0.1*	*0.1*	*0.1*
Purchase of passenger cars	*965.5*	*1,078.1*	*524.3*	*443.2*	*38,149.3*	*0.3*	*0.3*	*0.2*	*0.1*	*8.7*
Purchase of securities	15,235.8	14,166.5	15,460.0	14,248.9	16,939.7	4.9	4.5	4.7	4.1	3.9
Purchase of transport vehicles	131.7	121.9	58.9	54.4	890.1	0.0	0.0	0.0	0.0	0.2
Community, social and personal services	4,689.6	4,584.2	4,511.1	3,744.1	4,427.2	1.5	1.4	1.4	1.1	1.0
Others	9,098.4	8,173.7	7,679.3	8,874.0	8,785.0	3.0	2.6	2.3	2.6	2.0

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

Table A.42
Finance Companies: Direction of Lending

	Loans by Sectors (RM million)					% share				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**25,106.7**	**24,185.4**	**21,951.0**	**21,568.3**	**11,644.9**	**29.8**	**26.1**	**21.8**	**20.2**	**20.8**
Households	**57,981.4**	**67,777.0**	**77,908.9**	**84,704.9**	**44,138.4**	**68.9**	**73.1**	**77.5**	**79.2**	**78.7**
Others	**1,048.2**	**716.2**	**611.9**	**621.2**	**307.0**	**1.2**	**0.8**	**0.6**	**0.6**	**0.5**
Total[1]	**84,136.3**	**92,678.6**	**100,471.7**	**106,894.4**	**56,090.3**					
Agriculture, hunting, forestry and fishing	732.5	641.0	562.9	569.4	483.2	0.9	0.7	0.6	0.5	0.9
Mining and quarrying	187.0	175.9	113.0	106.3	59.3	0.2	0.2	0.1	0.1	0.1
Manufacturing	2,891.0	3,004.3	2,513.9	2,763.2	1,904.5	3.4	3.2	2.5	2.6	3.4
Electricity, gas and water supply	59.1	46.9	50.1	50.8	28.6	0.1	0.1	0.0	0.0	0.1
Wholesale and retail trade, restaurants and hotels	3,283.4	3,350.7	3,466.0	3,635.2	1,593.9	3.9	3.6	3.4	3.4	2.8
Wholesale trade	*1,122.5*	*1,340.8*	*1,361.7*	*1,428.4*	*561.1*	*1.3*	*1.4*	*1.4*	*1.3*	*1.0*
Retail trade	*1,618.9*	*1,504.6*	*1,576.1*	*1,623.5*	*684.9*	*1.9*	*1.6*	*1.6*	*1.5*	*1.2*
Restaurants and hotels	*542.0*	*505.3*	*528.1*	*583.3*	*348.0*	*0.6*	*0.5*	*0.5*	*0.5*	*0.6*
Broad property sector	25,400.2	26,021.8	25,880.9	25,519.5	12,226.5	30.2	28.1	25.8	23.9	21.8
Construction	*6,137.6*	*6,015.7*	*5,504.1*	*5,332.2*	*2,708.1*	*7.3*	*6.5*	*5.5*	*5.0*	*4.8*
Purchase of residential property	*12,417.2*	*13,035.6*	*14,042.2*	*14,645.5*	*7,009.2*	*14.8*	*14.1*	*14.0*	*13.7*	*12.5*
Purchase of non-residential property	*5,318.6*	*5,427.5*	*4,895.8*	*4,408.0*	*1,825.9*	*6.3*	*5.9*	*4.9*	*4.1*	*3.3*
Real estate	*1,526.8*	*1,543.0*	*1,438.7*	*1,133.8*	*683.3*	*1.8*	*1.7*	*1.4*	*1.1*	*1.2*
Transport, storage and communication	2,077.4	1,863.8	1,785.2	1,649.5	1,295.9	2.5	2.0	1.8	1.5	2.3
Financial, insurance and business services	1,968.1	1,458.2	1,419.2	1,380.3	688.6	2.3	1.6	1.4	1.3	1.2
Financial services	*616.4*	*373.9*	*271.5*	*237.2*	*153.3*	*0.7*	*0.4*	*0.3*	*0.2*	*0.3*
Insurance	*20.0*	*16.3*	*16.5*	*14.4*	*2.9*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Business services	*1,331.7*	*1,068.0*	*1,131.2*	*1,128.6*	*532.4*	*1.6*	*1.2*	*1.1*	*1.1*	*0.9*
Consumption credit	38,743.4	46,794.0	56,880.5	63,592.9	34,960.4	46.0	50.5	56.6	59.5	62.3
Personal uses	*802.1*	*904.6*	*789.5*	*953.3*	*804.7*	*1.0*	*1.0*	*0.8*	*0.9*	*1.4*
Credit cards	*1,372.0*	*1,521.9*	*1,601.2*	*1,658.8*	*1,396.8*	*1.6*	*1.6*	*1.6*	*1.6*	*2.5*
Purchase of consumer durable goods	*104.7*	*39.5*	*38.9*	*21.3*	*10.7*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of passenger cars	*36,464.6*	*44,328.0*	*54,450.9*	*60,959.5*	*32,748.3*	*43.3*	*47.8*	*54.2*	*57.0*	*58.4*
Purchase of securities	5,895.7	4,788.1	3,950.5	3,621.6	723.5	7.0	5.2	3.9	3.4	1.3
Purchase of transport vehicles	1,509.1	3,190.7	2,570.1	2,577.4	1,530.7	1.8	3.4	2.6	2.4	2.7
Community, social and personal services	919.7	952.0	962.0	1,062.4	515.4	1.1	1.0	1.0	1.0	0.9
Others	469.7	391.2	317.6	366.0	79.7	0.6	0.4	0.3	0.3	0.1

[1] Includes loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.43
Merchant Banks: Direction of Lending

	Loans by Sectors (RM million)					% share				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**15,733.0**	**13,304.0**	**12,282.6**	**9,897.8**	**8,355.7**	**90.6**	**91.1**	**91.1**	**89.6**	**87.7**
Households	**464.7**	**337.3**	**317.1**	**383.1**	**560.1**	**2.7**	**2.3**	**2.4**	**3.5**	**5.9**
Others	**1,165.4**	**965.5**	**881.4**	**762.1**	**610.6**	**6.7**	**6.6**	**6.5**	**6.9**	**6.4**
Total[1]	**17,363.1**	**14,606.8**	**13,481.0**	**11,042.9**	**9,526.4**					
Agriculture, hunting, forestry and fishing	1,019.7	864.4	807.4	652.3	445.5	5.9	5.9	6.0	5.9	4.7
Mining and quarrying	88.4	87.5	69.2	47.7	47.4	0.5	0.6	0.5	0.4	0.5
Manufacturing	2,222.6	2,205.0	2,012.1	1,667.9	1,330.1	12.8	15.1	14.9	15.1	14.0
Electricity, gas and water supply	704.7	455.3	779.8	384.7	413.7	4.1	3.1	5.8	3.5	4.3
Wholesale and retail trade, restaurants and hotels	945.4	806.8	705.2	655.3	735.3	5.4	5.5	5.2	5.9	7.7
Wholesale trade	278.1	172.8	156.5	97.4	129.3	1.6	1.2	1.2	0.9	1.4
Retail trade	*213.5*	*190.7*	*148.3*	*92.8*	*130.4*	*1.2*	*1.3*	*1.1*	*0.8*	*1.4*
Restaurants and hotels	*453.8*	*443.3*	*400.4*	*465.1*	*475.6*	*2.6*	*3.0*	*3.0*	*4.2*	*5.0*
Broad property sector	4,798.2	4,383.3	3,859.9	2,858.8	2,874.5	27.6	30.0	28.6	25.9	30.2
Construction	*3,084.5*	*2,800.4*	*2,495.3*	*1,708.0*	*1,949.5*	*17.8*	*19.2*	*18.5*	*15.5*	*20.5*
Purchase of residential property	*75.0*	*73.5*	*77.1*	*78.2*	*80.3*	*0.4*	*0.5*	*0.6*	*0.7*	*0.8*
Purchase of non-residential property	*225.8*	*247.3*	*209.0*	*150.0*	*111.9*	*1.3*	*1.7*	*1.6*	*1.4*	*1.2*
Real estate	*1,412.9*	*1,262.1*	*1,078.4*	*922.6*	*732.7*	*8.1*	*8.6*	*8.0*	*8.4*	*7.7*
Transport, storage and communication	971.6	594.7	363.0	845.3	320.5	5.6	4.1	2.7	7.7	3.4
Financial, insurance and business services	1,230.7	1,026.7	938.3	633.1	564.5	7.1	7.0	7.0	5.7	5.9
Financial services	*860.5*	*710.8*	*768.2*	*535.2*	*520.7*	*5.0*	*4.9*	*5.7*	*4.8*	*5.5*
Insurance	*21.3*	*5.5*	*0.0*	*0.0*	*0.0*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*
Business services	*348.8*	*310.4*	*170.2*	*97.9*	*43.8*	*2.0*	*2.1*	*1.3*	*0.9*	*0.5*
Consumption credit	45.3	44.7	40.3	57.0	139.1	0.3	0.3	0.3	0.5	1.5
Personal uses	*36.5*	*32.5*	*21.1*	*35.5*	*118.1*	*0.2*	*0.2*	*0.2*	*0.3*	*1.2*
Credit cards	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*0.1*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of passenger cars	*8.8*	*12.1*	*19.1*	*21.5*	*20.9*	*0.1*	*0.1*	*0.1*	*0.2*	*0.2*
Purchase of securities	3,278.2	2,199.6	1,981.6	1,709.4	1,468.4	18.9	15.1	14.7	15.5	15.4
Purchase of transport vehicles	0.2	0.8	0.3	0.5	0.5	0.0	0.0	0.0	0.0	0.0
Community, social and personal services	381.3	367.4	203.9	98.4	69.1	2.2	2.5	1.5	0.9	0.7
Others	1,676.8	1,570.8	1,720.0	1,432.6	1,117.9	9.7	10.8	12.8	13.0	11.7

[1] Includes loans sold to Cagamas
Note: Numbers may not necessarily add up due to rounding

Table A.44
Commercial Banks[1]: Non-performing Loans by Sector

	NPL by sector (RM million)					As percentage of total loans to the sector (%)				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**28,164.7**	**37,022.8**	**32,900.4**	**28,921.0**	**27,374.9**	**13.2**	**17.6**	**15.9**	**14.0**	**11.9**
Households	**6,865.3**	**8,616.2**	**9,882.3**	**10,982.2**	**14,026.6**	**7.9**	**8.7**	**8.6**	**8.4**	**7.1**
Others	**630.6**	**1,273.1**	**1,150.0**	**866.9**	**891.8**	**6.9**	**15.6**	**15.0**	**9.8**	**10.2**
Total	**35,660.6**	**46,912.1**	**43,932.7**	**40,770.1**	**42,293.3**					
Agriculture, hunting, forestry and fishing	556.3	737.6	825.7	672.1	580.8	6.0	7.4	8.2	7.4	6.0
Mining and quarrying	150.4	173.8	109.2	101.3	56.6	13.1	17.4	13.6	10.9	6.5
Manufacturing	7,714.6	10,662.9	10,857.5	8,620.1	7,491.4	13.7	19.1	19.7	15.6	12.9
Electricity, gas and water supply	179.5	208.7	196.3	1,316.8	1,210.4	2.6	4.8	3.5	28.7	25.5
Wholesale and retail trade, restaurants and hotels	4,021.8	4,219.0	3,524.6	3,816.5	3,770.8	12.9	13.4	10.8	11.1	9.3
Wholesale trade	*1,869.6*	*1,924.1*	*1,630.5*	*1,565.9*	*1,497.8*	*10.5*	*10.6*	*8.6*	7.8	6.1
Retail trade	*1,057.6*	*1,127.9*	*1,007.9*	*1,245.4*	*1,115.3*	*11.5*	*12.0*	*10.3*	*12.0*	*9.2*
Restaurants and *hotels*	*1,094.6*	*1,166.9*	*886.2*	*1,005.2*	*1,157.7*	*25.6*	*29.5*	*24.2*	*25.5*	*29.0*
Broad property sector	13,818.5	18,951.2	18,635.3	17,701.7	20,029.8	11.8	14.7	13.3	11.4	10.7
Construction	*5,395.4*	*7,366.9*	*6,508.3*	*5,054.4*	*5,072.3*	*21.3*	*30.3*	*28.5*	*23.9*	*20.6*
Purchase of residential property	*3,342.8*	*4,939.3*	*6,425.2*	*7,523.5*	*9,613.6*	*5.7*	*7.0*	7.7	*7.6*	*7.9*
Purchase of non-residential property	*2,540.4*	*2,839.0*	*2,785.1*	*2,584.9*	*3,044.0*	*12.0*	*13.3*	*12.8*	*11.1*	*10.7*
Real estate	*2,539.9*	*3,806.0*	*2,916.7*	*2,538.9*	*2,299.9*	*21.4*	*30.1*	*25.8*	*21.6*	*18.8*
Transport, storage and communication	1,090.8	796.1	751.5	776.7	519.7	12.5	10.5	10.0	9.6	6.4
Finance, insurance and business services	2,387.7	3,856.6	2,361.8	1,805.9	1,605.2	8.4	13.0	8.7	6.7	5.4
Financial services	*1,276.6*	*2,439.7*	*1,239.1*	*811.5*	*625.1*	*6.0*	*11.3*	*6.3*	*4.1*	*3.0*
Insurance	*164.5*	*41.1*	*31.8*	*17.0*	*3.3*	*64.1*	*7.7*	*5.4*	*8.9*	*2.7*
Business services	*946.6*	*1,375.8*	*1,090.9*	*977.4*	*976.8*	*13.7*	*18.2*	*15.7*	*14.0*	*11.1*
Consumption credit	2,016.7	1,986.3	2,082.7	2,198.4	2,214.9	10.8	9.9	9.3	9.0	7.8
Personal uses	*1,661.6*	*1,621.2*	*1,675.4*	*1,681.5*	*1,631.2*	*13.8*	*13.2*	*12.8*	*12.3*	*10.5*
Credit cards	*290.6*	*312.6*	*364.1*	*477.7*	*552.4*	*4.9*	*4.3*	*4.1*	*4.6*	*4.3*
Purchase of consumer durable goods	*64.5*	*52.5*	*43.1*	*39.2*	*31.3*	*9.3*	*12.1*	*13.3*	*12.6*	*11.6*
Purchase of securities	2,192.1	2,927.7	2,389.6	2,250.4	2,130.1	14.4	20.7	15.5	15.8	12.6
Purchase of transport vehicles[2]	409.8	226.7	179.7	135.1	1,133.0	37.4	18.9	30.8	27.1	2.9
Community, social and personal services	491.7	892.3	868.8	508.4	658.9	10.5	19.5	19.3	13.6	14.9

[1] Excludes Islamic banks
[2] Includes purchase of passenger cars
Note: Numbers may not necessarily add up due to rounding

Table A.45
Finance Companies: Non-performing Loans by Sector

	NPL by sector (RM million)					As percentage of total loans to the sector (%)				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**7,904.3**	**9,026.6**	**8,474.9**	**7,466.2**	**4,147.3**	**28.2**	**33.6**	**34.3**	**31.2**	**34.1**
Households	**6,205.9**	**6,046.7**	**5,747.9**	**5,547.8**	**3,246.6**	**11.2**	**9.2**	**7.6**	**6.7**	**7.4**
Others	**145.2**	**220.7**	**135.6**	**93.2**	**29.9**	**30.9**	**56.4**	**42.7**	**25.5**	**37.7**
Total	**14,255.4**	**15,294.0**	**14,358.4**	**13,107.2**	**7,423.8**					
Agriculture, hunting, forestry and fishing	120.3	100.0	59.9	55.2	35.0	16.4	15.6	10.6	9.7	7.2
Mining and quarrying	59.4	70.3	45.6	37.5	23.3	31.8	40.0	40.4	35.3	39.3
Manufacturing	768.1	870.8	859.1	641.0	358.3	26.6	29.0	34.2	23.2	18.8
Electricity, gas and water supply	15.9	16.7	17.8	5.6	1.6	26.9	35.5	35.6	11.0	5.7
Wholesale and retail trade, restaurants and hotels	511.8	568.2	610.7	533.2	297.3	15.6	17.0	17.6	14.7	18.7
Wholesale trade	*153.9*	*158.0*	*191.5*	*148.1*	*63.0*	*13.7*	*11.8*	*14.1*	*10.4*	*11.2*
Retail trade	*210.0*	*203.4*	*189.1*	*149.8*	*99.4*	*13.0*	*13.5*	*12.0*	*9.2*	*14.5*
Restaurants and *hotels*	*147.9*	*206.7*	*230.1*	*235.3*	*134.9*	*27.3*	*40.9*	*43.6*	*40.3*	*38.8*
Broad property sector	5,910.6	6,919.0	6,900.2	7,069.4	4,046.7	23.3	26.6	26.7	27.7	33.1
Construction	*2,060.3*	*2,328.8*	*2,139.7*	*2,233.0*	*1,242.0*	*33.6*	*38.7*	*38.9*	*41.9*	*45.9*
Purchase of residential property	*1,712.2*	*1,801.9*	*2,058.7*	*2,281.2*	*1,304.5*	*13.8*	*13.8*	*14.7*	*15.6*	*18.6*
Purchase of non-residential property	*1,551.1*	*1,998.5*	*1,945.2*	*1,965.2*	*1,044.1*	*29.2*	*36.8*	*39.7*	*44.6*	*57.2*
Real estate	*587.0*	*789.8*	*756.6*	*590.0*	*456.1*	*38.4*	*51.2*	*52.6*	*52.0*	*66.7*
Transport, storage and communication	750.2	735.3	616.7	337.1	166.1	36.1	39.5	34.5	20.4	12.8
Finance, insurance and business services	554.7	637.0	604.0	433.2	245.3	28.2	43.7	42.6	31.4	35.6
Financial services	*257.4*	*344.3*	*243.2*	*210.7*	*146.5*	*41.7*	*92.1*	*89.6*	*88.8*	*95.5*
Insurance	*4.2*	*1.2*	*1.0*	*1.0*	*0.3*	*21.0*	*7.3*	*5.9*	*6.8*	*12.0*
Business services	*293.1*	*291.6*	*359.9*	*221.4*	*98.5*	*22.0*	*27.3*	*31.8*	*19.6*	*18.5*
Consumption credit	313.7	354.7	264.6	281.4	188.7	13.8	14.4	10.9	10.7	8.5
Personal uses	*210.8*	*239.4*	*180.0*	*180.4*	*81.1*	*26.3*	*26.5*	*22.8*	*18.9*	*10.1*
Credit cards	*87.2*	*96.8*	*70.1*	*96.1*	*104.6*	*6.4*	*6.4*	*4.4*	*5.8*	*7.5*
Purchase of consumer durable goods	*15.8*	*18.5*	*14.5*	*5.0*	*3.0*	*15.1*	*46.8*	*37.2*	*23.3*	*28.1*
Purchase of securities	1,344.7	1,374.2	1,161.7	895.8	396.8	22.8	28.7	29.4	24.7	54.9
Purchase of transport vehicles[1]	3,507.6	3,203.0	2,843.7	2,537.2	1,554.9	9.2	6.7	5.0	4.0	4.5
Community, social and personal services	253.2	224.2	238.8	187.4	79.7	27.5	23.5	24.8	17.6	15.5

[1] Includes purchase of passengers cars
Note: Numbers may not necessarily add-up due to rounding

Table A.46
Merchant Banks: Non-performing Loans by Sector

	NPL by sector (RM million)					As percentage of total loans to the sector (%)				
As at end-	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Business enterprises	**2,464.6**	**3,597.7**	**3,222.7**	**2,314.5**	**2,014.9**	**17.7**	**30.4**	**30.3**	**26.8**	**27.0**
Households	**464.1**	**453.4**	**423.2**	**283.9**	**163.2**	**26.4**	**37.2**	**38.2**	**28.7**	**17.1**
Others	**155.5**	**333.3**	**343.0**	**220.2**	**161.9**	**9.3**	**21.2**	**19.9**	**15.4**	**14.5**
Total	**3,084.2**	**4,384.4**	**3,989.0**	**2,818.6**	**2,340.0**					
Agriculture, hunting, forestry and fishing	25.9	86.5	47.3	22.0	24.4	2.5	10.0	5.9	3.4	5.5
Mining and quarrying	0.4	0.5	4.1	4.4	4.5	0.5	0.5	5.9	9.1	9.4
Manufacturing	383.1	891.5	792.5	538.1	570.6	17.2	40.4	39.4	32.3	42.9
Electricity, gas and water supply	57.5	133.4	208.4	118.0	85.4	8.2	29.3	26.7	30.7	20.6
Wholesale and retail trade, restaurants and hotels	195.9	197.4	181.4	217.6	179.4	20.7	24.5	25.7	33.2	24.4
Wholesale trade	*35.2*	*45.4*	*29.8*	*9.8*	*7.8*	*12.6*	*26.3*	*19.0*	*10.0*	*6.0*
Retail trade	*32.8*	*33.1*	*5.6*	*6.5*	*6.6*	*15.4*	*17.4*	*3.7*	*7.0*	*5.1*
Restaurants and *hotels*	*127.9*	*118.8*	*146.1*	*201.3*	*165.0*	*28.2*	*26.8*	*36.5*	*43.3*	*34.7*
Broad property sector	1,144.9	1,477.3	1,282.0	1,004.6	960.9	23.9	33.7	33.2	35.1	33.4
Construction	*565.5*	*807.5*	*756.6*	*531.2*	*525.2*	*18.3*	*28.8*	*30.3*	*31.1*	*26.9*
Purchase of residential property	*0.4*	*0.7*	*0.2*	*0.1*	*0.4*	*0.5*	*0.9*	*0.3*	*0.2*	*0.6*
Purchase of non-residential property	*68.2*	*91.3*	*70.9*	*65.9*	*49.3*	*30.2*	*36.9*	*33.9*	*43.9*	*44.0*
Real estate	*510.8*	*577.8*	*454.3*	*407.3*	*386.0*	*36.1*	*45.8*	*42.1*	*44.1*	*52.7*
Transport, storage and communication	79.6	63.6	38.4	22.9	0.0	8.2	10.7	10.6	2.7	0.0
Finance, insurance and business services	87.9	187.2	139.4	85.6	8.3	7.1	18.2	14.9	13.5	1.5
Financial services	*45.7*	*134.6*	*101.3*	*71.8*	*2.9*	*5.3*	*18.9*	*13.2*	*13.4*	*0.6*
Insurance	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Business services	*42.2*	*52.6*	*38.1*	*13.7*	*5.5*	*12.1*	*16.9*	*22.4*	*14.0*	*12.5*
Consumption credit	12.9	13.2	12.2	11.5	11.8	35.2	40.4	57.4	32.4	10.0
Personal uses	*12.9*	*13.2*	*12.2*	*11.5*	*11.8*	*35.3*	*40.5*	*57.5*	*32.5*	*10.0*
Credit cards	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of consumer durable goods	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Purchase of securities	901.8	878.9	821.5	544.4	301.9	27.5	40.0	41.5	31.8	20.6
Purchase of transport vehicles[1]	0.0	0.1	0.1	0.1	0.0	0.3	1.2	0.6	0.4	0.1
Community, social and personal services	38.9	121.6	118.7	29.2	30.9	10.2	33.1	58.2	29.7	44.6

[1] Includes purchase of passenger cars
Note: Numbers may not necessarily add-up due to rounding

Table A.47
Banking System[1,2]: Selected Indicators

	Commercial banks					Finance companies				
	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
Pre-tax profit / Average assets (%)	1.4	0.9	1.2	1.2	1.2	1.7	1.8	1.9	1.9	2.6
Pre-tax profit / Average shareholders' funds (%)	18.2	10.5	13.9	13.5	14.4	42.4	27.4	26.9	26.0	34.7
Pre-tax profit / Average employee (RM'000)	94.5	65.5	95.4	101.7	112.0	91.6	102.9	119.2	138.9	196.9
Cost[3] incurred per ringgit of revenue earned[4] (sen)	39.0	41.7	43.6	46.1	44.3	31.2	32.1	32.4	32.6	33.7
Cost[3] incurred per ringgit of net interest income[4] (sen)	54.7	63.1	64.2	63.2	64.7	35.7	36.4	36.5	34.1	35.7
Overheads to staff cost ratio (%)	98.4	103.0	113.2	111.6	111.8	123.5	131.7	130.1	118.0	130.2
Staff cost per employee (RM'000)	49.8	54.8	55.4	58.6	62.5	36.7	37.5	39.2	42.7	49.4
Loan to deposit ratio[5] (%)	87.7	89.6	88.4	83.3	82.4	100.4	108.0	111.1	115.8	124.3
Loans per branch (RM million)	175.4	190.7	201.7	205.4	222.9	90.2	106.0	133.1	146.6	177.5
Deposits per branch[5] (RM million)	200.1	213.0	228.1	246.5	270.5	89.8	98.2	119.8	126.6	142.8

[1] Includes Islamic banks
[2] Based on Malaysian operations only
[3] Cost = Staff cost and overheads (excluding loan loss provisions)
[4] Revenue = Net interest income + fee-based income + other income
[5] Including NIDs and repos

Merchant banks					Islamic banks					Banking system[1]				
As at calendar year end-														
2000	2001	2002	2003	2004	2000	2001	2002	2003	2004	2000	2001	2002	2003	2004
1.5	0.8	1.4	1.6	2.0	0.5	0.4	0.7	0.6	0.5	1.4	1.0	1.3	1.3	1.4
17.3	7.1	12.9	13.7	16.4	5.0	5.3	9.3	8.4	6.8	19.5	12.2	15.3	15.3	16.6
248.6	124.8	244.5	280.8	338.2	22.6	23.9	41.6	37.4	30.3	92.7	72.4	100.2	112.0	127.8
19.6	20.7	27.7	32.4	32.9	58.2	62.5	54.7	58.5	59.9	38.4	40.2	42.5	42.8	42.4
43.6	55.5	65.5	80.3	95.6	64.8	67.9	61.5	68.0	75.5	50.7	55.3	56.6	55.9	59.3
70.0	58.1	53.6	51.2	52.0	84.9	96.7	108.3	142.7	120.1	101.6	104.0	112.9	110.4	111.1
70.0	86.4	93.6	106.8	116.1	38.7	46.1	45.2	44.3	50.6	46.9	51.6	51.8	56.1	61.5
70.1	57.6	51.3	37.6	33.1	57.0	53.4	56.1	55.8	55.2	89.0	91.2	90.6	85.4	82.3
789.1	768.8	729.9	649.6	560.4	52.8	62.9	71.9	74.3	84.3	151.1	166.1	184.3	184.9	211.6
1,125.5	1,334.6	1,547.1	1,725.4	1,691.1	92.6	117.8	128.1	133.2	152.6	169.7	182.1	203.4	216.4	257.2

Table A.48
Banking System: Key Data

	As at end-				
	2000	2001	2002	2003	2004
Number of institutions	64	49	47	46	41
- Commercial banks	*31*	*25*	*24*	*23*	*23*
- Finance companies	*19*	*12*	*11*	*11*	*6*
- Merchant banks	*12*	*10*	*10*	*10*	*10*
- Islamic banks	*2*	*2*	*2*	*2*	*2*
Risk-weighted capital ratio (%)	12.5	13.0	13.2	13.8	13.8
- Commercial banks	*12.2*	*12.8*	*13.2*	*14.1*	*13.9*
- Finance companies	*11.5*	*12.1*	*12.0*	*11.6*	*10.2*
- Merchant banks	*17.1*	*19.6*	*19.0*	*19.2*	*21.9*
- Islamic banks	*17.1*	*14.4*	*12.6*	*11.7*	*12.5*
Office network	2,835	2,675	2,531	2,563	2,429
- Commercial banks	*1,758*	*1,660*	*1,631*	*1,685*	*1,960*
- Finance companies	*933*	*874*	*755*	*729*	*316*
- Merchant banks	*22*	*19*	*17*	*17*	*17*
- Islamic banks	*122*	*122*	*128*	*132*	*136*
ATM network	3,694	4,169	4,213	4,396	4,651
- Commercial banks	*3,004*	*3,386*	*3,477*	*3,707*	*4,098*
- Finance companies	*560*	*605*	*551*	*477*	*273*
- Islamic banks	*130*	*178*	*185*	*212*	*280*
Number of banks with internet services	3	8	12	12	13
- Commercial banks	*3*	*8*	*12*	*12*	*13*
Persons served per office					
- Commercial banks	*13,256*	*13,959*	*15,040*	*14,866*	*13,051*
- Finance companies	*24,920*	*26,474*	*32,490*	*34,362*	*80,949*
- Islamic banks	*–*	*–*	*191,641*	*189,773*	*188,088*
Number of employees	96,159	93,329	90,864	90,844	93,948
- Commercial banks	*70,226*	*67,398*	*65,866*	*66,458*	*78,032*
- Finance companies	*20,725*	*20,488*	*19,430*	*18,634*	*9,190*
- Merchant banks	*2,339*	*2,402*	*2,451*	*2,429*	*2,690*
- Islamic banks	*2,869*	*3,041*	*3,117*	*3,323*	*4,036*

Table A.49
Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2003	2004	2003	2004
Commercial banks	–		4.0[1]	3.1[1]	1,700	1,960
Finance companies	–		4.1[1]	3.1[1]	672	316
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0	4.0	–	–
Malaysia Building Society Berhad	1950	To be the nation's single largest provider of property finance and to contribute to the continuous growth of the nation	2.0 ~ 8.5	2.0 ~ 8.5	22	22
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	3.0 ~ 8.5	3.0 ~ 8.5	2	2
Sabah Credit Corporation	1955	To improve the social economic development of Sabah through loans mainly to the property, agriculture and business sectors	3.0 ~ 10.5	3.0 ~ 10.5	11	11
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	7.4[1]	7.3[1]	100	103
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	6.5[1]	4.8[1]	398	393

[1] Average

Source: Bank Negara Malaysia and various housing credit institutions

Table A.50
Outstanding Housing Loans

	2003	2004*p*	2003	2004*p*	2003	2004*p*
	RM million		Annual change (%)		% share	
Commercial banks	101,829	125,825	18.1	23.6	70	76
Treasury Housing Loans Division	24,754	25,930	11.6	4.8	17	16
Finance companies	14,645	7,009	4.3	-52.1	10	4
Bank Kerjasama Rakyat Malaysia Berhad	1,371	2,508	23.7	83.0	1	2
Malaysia Building Society Berhad	1,206	1,753	-2.4	45.4	1	1
Bank Simpanan Nasional	1,058	1,059	-6.6	…	1	1
Borneo Housing Mortgage Finance Berhad	680	705	4.7	3.7	...	...
Sabah Credit Corporation	252	238	-14.2	-5.5	...	...
Total	**145,795**	**165,027**	**14.9**	**13.2**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.51
Approved Housing Loans

	2003	2004*p*	2003	2004*p*	2003	2004*p*
	RM million		Annual change (%)		% share	
Commercial banks	27,942	34,140	4.3	22.2	78	79
Treasury Housing Loans Division	4,738	4,086	-6.2	-13.8	13	10
Finance companies	2,090	1,553	-12.3	-25.7	6	4
Bank Kerjasama Rakyat Malaysia Berhad	591	1,040	46.8	75.9	2	2
Malaysia Building Society Berhad	345	1,820	205.8	426.8	1	4
Borneo Housing Mortgage Finance Berhad	87	89	3.4	1.8	...	…
Bank Simpanan Nasional	118	249	51.1	111.1	…	1
Sabah Credit Corporation	20	6	-34.5	-70.3	…	…
Total	**35,931**	**42,983**	**2.8**	**19.6**	**100**	**100**

p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.52
Islamic Financial Institutions: Branches/Counters

	As at end-	
	2003	2004
Number of financial institutions[1]	**33**	**29**
Islamic banks	2	2
Commercial banks	13	13
Finance companies	7	3
Merchant banks	4	4
Discount houses	7	7
Number of branches[2]	**143**	**153**
Islamic banks	132	136
Commercial banks	10	16
Finance companies	1	1
Number of counters[3]	**2,024**	**1,886**
Commercial banks	1,410	1,661
Finance companies	605	216
Merchant banks	9	9

[1] Excluding new licences/approvals to foreign banks and Islamic subsidiaries
[2] Full-fledged Islamic branches
[3] Branches that offer both Islamic and conventional banking products

Table A.53
Islamic Banking System: Sources and Uses of Funds

	As at end-					
	2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million			RM million		
Sources						
Capital and reserves	1,523	5,261	6,784	1,795	5,714	7,509
Deposits	17,584	42,628	60,212	20,756	52,103	72,859
Funds from other financial institutions	113	6,872	6,985	436	3,591	4,027
Other liabilities	1,779	6,481	8,260	1,882	8,303	10,185
Total	**20,999**	**61,242**	**82,241**	**24,869**	**69,711**	**94,580**
Uses						
Cash	231	24	255	260	11	271
Reserves with Bank Negara Malaysia	587	930	1,517	542	816	1,358
Deposits with other financial institutions	3,239	5,743	8,982	6,119	12,533	18,652
Financing	9,809	38,851	48,660	11,463	46,419	57,883
Securities	5,764	16,790	22,554	5,216	13,828	19,044
Other assets	1,369	-1,096[1]	273	1,269	-3,896[1]	-2,628[1]
Total	**20,999**	**61,242**	**82,241**	**24,869**	**69,711**	**94,580**

[1] Denotes the interbranch balances pending settlement
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Table A.54
Islamic Banking System: Commitments and Contingencies

	As at end-							
	2003				2004*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Assets sold with recourse and commitments with drawdown	45	1,950	1,995	8.6	140	3,747	3,887	14.7
Credit extension commitments	1,418	8,287	9,705	42.0	1,573	9,144	10,717	40.6
Direct credit substitutes	503	357	860	3.7	429	478	907	3.4
Foreign exchange related contracts	189	–	189	0.8	374	–	374	1.4
Trade-related contingencies	1,103	6,429	7,532	32.6	1,442	5,861	7,303	27.7
Transaction-related contingencies	1,157	634	1,791	7.8	1,422	864	2,286	8.7
Underwriting obligations	60	510	570	2.5	56	621	677	2.6
Others	64	392	456	2.0	44	187	231	0.9
Total	**4,539**	**18,559**	**23,098**	**100.0**	**5,480**	**20,902**	**26,382**	**100.0**

p Preliminary

Table A.55
Islamic Banking System: Income and Expenditure

	For the financial year						For the calendar year					
	2003			2004*p*			2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million											
Income[1] net of income-in-suspense	596.9	2,266.5	2,863.4	638.3	2,604.7	3,243.0	924.5	2,939.2	3,863.7	953.5	3,342.4	4,295.9
(Income-in-suspense)	*51.6*	*141.9*	*193.5*	*56.1*	*169.5*	*225.6*	*95.0*	*211.6*	*306.6*	*108.2*	*201.3*	*309.5*
Less: Expense[1]	265.4	966.5	1,231.9	289.0	1,100.2	1,389.2	403.4	1,285.5	1,688.9	410.2	1,403.7	1,813.9
Net income	331.5	1,300.0	1,631.5	349.3	1,504.5	1,853.8	521.1	1,653.7	2,174.8	543.3	1,938.7	2,482.0
Add: Other income	82.5	356.9	439.4	131.7	450.6	582.3	124.0	624.5	748.5	246.8	589.2	836.0
Less: Financing loss and other provisions	125.6	759.2	884.8	141.6	993.2	1,134.8	179.2	1,167.7	1,346.9	268.7	1,374.6	1,643.3
Staff cost	104.7	73.5	178.2	131.6	69.5	201.1	148.8	82.9	231.7	186.3	80.6	266.9
Overheads	131.3	144.0	275.3	152.9	136.6	289.5	197.4	186.9	384.3	223.7	197.8	421.5
Pre-tax profit	**52.4**	**680.2**	**732.6**	**54.9**	**755.8**	**810.7**	**119.7**	**840.7**	**960.4**	**111.4**	**874.9**	**986.3**

[1] From financing activities and securities
p Preliminary

Table A.56
Islamic Banking System: Financing Activities

	For the year					
	2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Financing approvals	1,428.1	14,740.0	16,168.1	2,291.9	13,968.5	16,260.4
Financing disbursements	8,001.9	28,046.6	36,048.5	8,771.6	32,317.0	41,088.6
Financing repayments	7,596.5	18,560.6	26,157.1	7,679.2	25,960.2	33,639.4
	As at end-					
	2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Outstanding financing	9,809.2	38,850.8	48,660.0	11,463.3	46,419.2	57,882.5

p Preliminary

Table A.57
Islamic Banking System: Financing to Small and Medium Enterprises

	For the year					
	2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Financing approvals	404.8	2,064.0	2,468.8	363.1	2,319.2	2,682.3
Financing disbursements	933.0	2,436.8	3,369.8	1,856.5	4,702.8	6,559.3
	As at end-					
	2003			2004*p*		
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total
	RM million					
Outstanding financing	1,759.0	4,407.2	6,166.2	1,860.9	6,133.1	7,994.0
Total non-performing financing	323.0	289.1	612.1	375.9	211.6	587.5

p Preliminary

Table A.58
Islamic Banking System: Direction of Financing

	As at end-							
	2003				2004*p*			
	Islamic Banks	IBS Banks	Total	% share	Islamic Banks	IBS Banks	Total	% share
	RM million				RM million			
Agriculture, hunting, forestry and fishing	202.2	1,659.4	1,861.6	3.9	241.6	2,087.0	2,328.6	4.0
Mining and quarrying	15.0	48.5	63.5	0.1	15.1	61.5	76.6	0.1
Manufacturing	1,529.7	2,857.1	4,386.8	9.0	1,687.7	4,424.9	6,112.6	10.6
Electricity, gas and water supply	43.0	205.9	248.9	0.5	11.8	707.4	719.2	1.3
Community, social and personal services	63.7	239.6	303.3	0.6	94.2	324.3	418.5	0.7
Broad property sector	5,349.9	15,177.5	20,527.4	42.1	6,024.8	16,426.2	22,451.0	38.8
Real estate	*90.6*	*721.3*	*811.9*	*1.7*	*86.3*	*820.1*	*906.4*	*1.6*
Construction	*1,328.5*	*1,605.0*	*2,933.5*	*6.0*	*1,452.3*	*2,078.6*	*3,530.9*	*6.1*
Purchase of residential property	*3,066.9*	*11,322.0*	*14,388.9*	*29.5*	*3,635.9*	*11,797.4*	*15,433.3*	*26.7*
Purchase of non-residential property	*863.9*	*1,529.2*	*2,393.1*	*4.9*	*850.3*	*1,730.1*	*2,580.4*	*4.4*
Wholesale and retail trade, restaurants and hotels	405.9	1,391.1	1,797.0	3.7	447.2	2,623.7	3,070.9	5.3
Transport, storage and communication	152.8	871.5	1,024.3	2.1	181.3	995.2	1,176.5	2.0
Finance, insurance and business services	261.6	1,671.7	1,933.3	4.0	225.6	1,864.5	2,090.1	3.6
Purchase of securities	226.6	694.2	920.8	1.9	256.2	621.9	878.1	1.5
Consumption credit	1,431.5	13,440.7	14,872.2	30.6	2,207.8	15,595.6	17,803.4	30.8
Credit cards	*90.3*	*65.9*	*156.2*	*0.3*	*127.1*	*184.9*	*312.0*	*0.6*
Personal use	*562.0*	*1,075.1*	*1,637.1*	*3.4*	*811.4*	*1,637.9*	*2,449.3*	*4.2*
Purchase of consumer durable goods	*40.3*	*13.8*	*54.1*	*0.1*	*33.0*	*10.6*	*43.6*	*0.1*
Purchase of transport vehicles	*738.9*	*12,285.9*	*13,024.8*	*26.8*	*1,236.3*	*13,762.2*	*14,998.5*	*25.9*
Others	127.3	593.6	720.9	1.5	70.0	687.0	757.0	1.3
Total	**9,809.2**	**38,850.8**	**48,660.0**	**100.0**	**11,463.3**	**46,419.2**	**57,882.5**	**100.0**

p Preliminary

Table A.59
Islamic Banking System: Non-performing Financing by Sector[1]

	As at end-								
	NPF by sector						Change	As percentage of total financing to the sector	
	2003			2004*p*				2003	2004*p*
	Islamic Banks	IBS Banks	Total	Islamic Banks	IBS Banks	Total			
	RM million						%		
Agriculture, hunting, forestry and fishing	32.0	44.4	76.4	38.4	7.4	45.8	-40.1	4.1	2.0
Mining and quarrying	4.8	0.2	5.0	5.1	1.1	6.2	24.0	7.9	8.1
Manufacturing	202.2	163.9	366.1	195.4	68.3	263.7	-28.0	8.4	4.3
Electricity, gas and water supply	4.1	...	4.1	2.1	0.1	2.2	-46.3	1.6	0.3
Community, social and personal services	27.8	17.2	45.0	21.6	30.8	52.4	16.4	14.8	12.5
Broad property sector	865.3	1,951.4	2,816.7	992.0	2,320.0	3,312.0	17.6	13.7	14.8
Real estate	*0.1*	*285.4*	*285.5*	*0.9*	*302.2*	*303.1*	*6.2*	*35.2*	*33.4*
Construction	*359.8*	*234.6*	*594.4*	*407.2*	*364.1*	*771.3*	*29.8*	*20.3*	*21.8*
Purchase of residential property	*317.6*	*1,126.3*	*1,443.9*	*373.9*	*1,415.9*	*1,789.8*	*24.0*	*10.0*	*11.6*
Purchase of non-residential property	*187.8*	*305.1*	*492.9*	*210.0*	*237.8*	*447.8*	*-9.1*	*20.6*	*17.4*
Wholesale and retail trade, restaurants and hotels	66.3	140.0	206.3	92.9	138.8	231.7	12.3	11.5	7.5
Transport, storage and communication	51.3	167.4	218.7	36.4	92.9	129.3	-40.9	21.4	11.0
Finance, insurance and business services	31.6	9.4	41.0	17.6	8.6	26.2	-36.1	2.1	1.3
Purchase of securities	59.5	81.4	140.9	65.4	94.1	159.5	13.2	15.3	18.2
Consumption credit	226.8	291.0	517.8	198.5	448.5	647.0	25.0	3.5	3.6
Credit cards	*4.8*	*3.1*	*7.9*	*6.9*	*10.4*	*17.3*	*119.0*	*5.1*	*5.5*
Personal use	*140.9*	*53.7*	*194.6*	*124.8*	*75.2*	*200.0*	*2.8*	*11.9*	*8.2*
Purchase of consumer durable goods	*4.3*	*0.2*	*4.5*	*2.4*	*0.4*	*2.8*	*-37.8*	*8.3*	*6.4*
Purchase of transport vehicles	*76.8*	*234.0*	*310.8*	*64.4*	*362.5*	*426.9*	*37.4*	*2.4*	*2.8*
Others	3.9	83.3	87.2	3.3	87.4	90.7	4.0	12.1	12.0
Total	**1,575.6**	**2,949.6**	**4,525.2**	**1,668.7**	**3,298.0**	**4,966.7**	**9.8**		

[1] Based on actual classification
p Preliminary

Table A.60
Islamic Banking System: Deposits by Type and Institution

	Annual change				As at end 2004*p*
	2003		2004*p*		
	RM million	%	RM million	%	RM million
Demand deposits	**1,796**	**19.6**	**1,937**	**17.6**	**12,917**
Islamic banks	693	20.1	435	10.5	4,578
Commercial banks	1,103	19.2	1,502	22.0	8,339
Savings deposits	**1,442**	**26.6**	**1,566**	**22.8**	**8,432**
Islamic banks	190	10.8	350	17.9	2,302
Commercial banks	1,145	37.8	1,596	38.2	5,771
Finance companies	107	16.9	-380[1]	-51.4[1]	359
Investment deposits	**-741**	**-2.1**	**6,769**	**19.2**	**41,996**
Islamic banks	93	0.8	1,736	15.5	12,919
Commercial banks	-2,351	-18.7	8,923	87.2	19,150
Finance companies	614	7.3	-5,159[1]	-57.2[1]	3,860
Merchant banks	213	56.5	714	121.0	1,304
Discount houses	690	19.6	555	13.2	4,763
Other deposits	**4,410**	**161.6**	**2,375**	**33.3**	**9,514**
Islamic banks	187	157.1	651	212.7	957
Commercial banks	3,148	147.6	1,234	23.4	6,515
Finance companies	1,150	2,017.5	526	43.6	1,733
Merchant banks	-46	-15.0	-38	-14.6	223
Discount houses	-29	-25.7	2	2.4	86
Total deposits	**6,906**	**13.0**	**12,647**	**21.0**	**72,859**
Islamic banks	1,163	7.1	3,172	18.0	20,756
Commercial banks	3,043	13.0	13,255	50.0	39,775
Finance companies	1,871	20.6	-5,013[1]	-45.7[1]	5,952
Merchant banks	168	24.6	676	79.3	1,527
Discount houses	661	18.2	557	13.0	4,849

[1] Due to merger of finance companies with commercial banks
p Preliminary

Table A.61
Development Financial Institutions[1]: Sources and Uses of Funds

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Sources:					
Shareholders' funds	6,314.3	6,906.7	7,905.4	9,424.1	10,809.8
Paid-up capital	*5,258.5*	*5,416.9*	*6,012.4*	*7,192.3*	*7,862.3*
Reserves	*1,216.6*	*1,196.2*	*1,517.0*	*1,599.6*	*1,963.8*
Retained earnings	*-160.8*	*293.6*	*376.0*	*632.2*	*983.7*
Deposits accepted	34,752.2	39,305.7	39,797.6	42,403.3	49,878.0
Borrowings	11,825.5	13,024.9	13,977.0	16,576.8	17,569.3
Government	*6,238.3*	*6,625.8*	*8,875.4*	*11,730.2*	*12,990.5*
Multilateral/International agencies	*3,034.8*	*3,321.7*	*3,434.3*	*3,158.5*	*1,731.7*
Others	*2,552.4*	*3,077.4*	*1,667.3*	*1,688.1*	*2,847.1*
Others	8,470.2	8,828.5	10,766.4	10,686.2	12,052.7
Total	**61,362.2**	**68,065.8**	**72,446.4**	**79,090.4**	**90,309.8**
Uses:					
Deposits placed	11,493.2	12,265.2	12,446.2	16,244.7	18,906.2
Investments	17,506.6	21,968.0	19,268.1	21,229.5	24,038.4
of which:					
Government securities	*2,497.1*	*3,715.0*	*1,952.3*	*2,950.8*	*2,629.3*
Shares	*4,759.8*	*5,099.4*	*6,427.4*	*6,778.1*	*6,833.9*
Quoted	*4,203.5*	*4,478.5*	*5,325.6*	*5,200.9*	*5,513.3*
Unquoted	*556.3*	*620.9*	*1,101.8*	*1,577.2*	*1,320.6*
Loans and advances	21,998.0	24,486.3	29,442.4	32,354.8	37,709.2
Fixed assets	2,090.2	3,011.6	3,606.7	3,707.5	3,863.6
Others	8,274.2	6,334.7	7,683.0	5,553.9	5,792.4
Total	**61,362.2**	**68,065.8**	**72,446.4**	**79,090.4**	**90,309.8**
Contingencies:					
Guarantee	4,211.5	3,341.5	3,160.1	3,661.6	3,949.0
Export credit insurance	205.0	148.0	151.4	123.3	308.6
Total	**4,416.5**	**3,489.5**	**3,311.5**	**3,784.9**	**4,257.6**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.62
Development Financial Institutions[1] under DFIA[2]: Sources and Uses of Funds

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Sources:					
Shareholders' funds	2,963.4	3,495.0	4,087.6	5,359.4	6,541.8
Paid-up capital	*2,594.5*	*2,718.0*	*3,288.5*	*4,167.5*	*4,811.1*
Reserves	*360.9*	*389.1*	*877.7*	*964.1*	*1,288.4*
Retained earnings	*8.0*	*387.9*	*-78.6*	*227.8*	*442.3*
Deposits accepted	25,140.9	28,663.3	29,373.9	30,762.7	37,278.5
Borrowings	9,086.6	9,668.2	9,851.7	12,347.7	13,397.7
Government	*4,416.7*	*4,659.0*	*6,248.0*	*9,039.8*	*10,328.6*
Multilateral/International agencies	*2,721.2*	*3,037.8*	*3,135.1*	*2,933.9*	*1,533.7*
Others	*1,948.7*	*1,971.4*	*468.6*	*374.0*	*1,535.4*
Others	5,361.7	6,088.6	8,358.2	8,403.7	9,449.3
Total	**42,552.6**	**47,915.1**	**51,671.4**	**56,873.5**	**66,667.3**
Uses:					
Deposits placed	8,139.7	8,771.4	8,212.5	11,383.5	12,949.5
Investments	8,931.4	12,579.6	11,637.0	12,970.7	15,866.7
of which:					
Government securities	*1,935.1*	*3,355.0*	*1,952.3*	*2,736.5*	*2,549.8*
Shares	*1,592.9*	*2,364.4*	*6,427.4*	*1,778.5*	*1,730.4*
Quoted	*1,435.6*	*2,205.4*	*5,325.6*	*1,664.7*	*1,618.9*
Unquoted	*157.3*	*159.0*	*1,101.8*	*113.8*	*111.5*
Loans and advances	18,929.5	21,135.9	25,191.1	28,072.3	33,431.9
Fixed assets	974.7	947.2	1,496.0	1,550.3	1,623.1
Others	5,577.3	4,481.0	5,134.8	2,896.7	2,796.1
Total	**42,552.6**	**47,915.1**	**51,671.4**	**56,873.5**	**66,667.3**
Contingencies:					
Guarantee	806.5	672.5	575.4	549.1	533.3
Export credit insurance	205.0	148.0	151.5	123.3	308.6
Total	**1,011.5**	**820.5**	**726.9**	**672.4**	**841.9**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Malaysia Export Credit Insurance Berhad and Bank Pertanian Malaysia

[2] Development Financial Institutions Act 2002

Table A.63
Development Financial Institutions[1]: Direction of Lending

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Agriculture, forestry and fishery	2,584.9	2,750.2	2,964.3	2,874.0	3,261.3
Mining and quarrying	47.4	46.1	90.0	75.2	66.8
Manufacturing	3,086.1	3,147.5	3,356.6	3,952.0	4,186.3
Electricity, gas and water supply	265.0	334.9	453.8	617.1	1,228.9
Import and export, wholesale and retail trade, restaurants and hotels	522.1	618.1	240.4	250.4	429.6
Broad property sector	4,687.0	5,700.4	7,840.6	8,376.6	10,022.5
Construction	*1,613.7*	*2,346.9*	*3,790.6*	*4,009.4*	*4,136.1*
Purchase of residential property	*2,090.6*	*2,593.8*	*2,785.2*	*2,927.9*	*4,066.4*
Purchase of non-residential property	*163.1*	*268.8*	*393.4*	*441.1*	*463.9*
Real estate	*819.6*	*490.9*	*871.4*	*998.2*	*1,356.1*
Transport, storage and communication	2,028.9	2,860.5	4,362.1	4,712.7	5,315.4
Maritime	801.5	733.1	530.4	473.1	474.4
Finance, insurance and business services	1,213.0	1,300.7	1,780.5	1,694.7	1,306.7
Consumption credit	5,084.5	5,404.2	6,716.1	7,787.5	9,238.5
of which:					
Purchase of motor vehicles	*997.6*	*819.2*	*816.5*	*521.2*	*446.8*
Credit card	*42.9*	*47.8*	*48.0*	*23.7*	*24.3*
Purchase of securities	330.0	356.2	173.2	136.2	103.4
Others	1,347.6	1,234.4	934.4	1,405.3	2,075.4
Total	**21,998.0**	**24,486.3**	**29,442.4**	**32,354.8**	**37,709.2**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.64
Development Financial Institutions[1] under DFIA[2]: Direction of Lending

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Agriculture, forestry and fishery	2,460.2	2,628.3	2,823.1	2,749.1	3,148.3
Mining and quarrying	33.5	34.5	80.5	58.8	49.1
Manufacturing	2,154.2	2,204.2	2,130.2	2,675.3	2,880.4
Electricity, gas and water supply	265.0	334.9	453.8	617.1	1,228.9
Import and export, wholesale and retail trade, restaurants and hotels	135.2	129.0	125.9	151.5	260.7
Broad property sector	4,054.6	5,078.2	6,846.9	7,371.4	8,921.4
Construction	*1,427.6*	*2,192.1*	*3,641.3*	*3,842.0*	*3,973.7*
Purchase of residential property	*1,779.8*	*2,288.0*	*2,480.3*	*2,629.3*	*3,785.3*
Purchase of non-residential property	*160.9*	*267.3*	*391.3*	*438.8*	*461.2*
Real estate	*686.3*	*330.8*	*334.0*	*461.3*	*701.2*
Transport, storage and communication	1,871.1	2,746.5	4,321.6	4,668.9	5,265.1
Maritime	801.5	733.1	530.4	473.1	474.4
Finance, insurance and business services	1,096.8	1,198.0	877.6	896.0	827.4
Consumption credit	5,037.5	5,339.6	6,567.8	7,533.8	8,913.1
of which:					
Purchase of motor vehicles	*950.6*	*754.6*	*741.2*	*521.2*	*446.8*
Credit card	*42.9*	*47.8*	*48.0*	*23.7*	*24.3*
Purchase of securities	330.0	356.2	173.2	136.2	103.4
Others	689.9	353.4	260.1	741.1	1,359.7
Total	**18,929.5**	**21,135.9**	**25,191.1**	**28,072.3**	**33,431.9**

[1] Refers to Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad and Bank Pertanian Malaysia
[2] Development Financial Institutions Act 2002

Table A.65
Bank Industri & Teknologi Malaysia Berhad

Year of establishment	1979			
Objectives	The principal activity of Bank Industri & Teknologi Malaysia Berhad is to finance capital intensive and high technology industries in priority sectors such as shipping industry and manufacturing.			
Sector	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2003	2004	2003	2004
Maritime	76.3	378.1	83.7	171.5
Shipping industry	*57.4*	*217.5*	*54.7*	*144.6*
Shipyard industry	*1.2*	*9.2*	*16.6*	*10.9*
Marine-related industries	*17.7*	*151.4*	*12.4*	*16.0*
Manufacturing	177.1	329.8	59.5	147.6
of which:				
High technology	*16.8*	*70.0*	*7.8*	*1.9*
Others	–	37.6	–	39.0
Total	**253.4**	**745.5**	**143.2**	**358.1**

Source: Bank Industri & Teknologi Malaysia Berhad

Table A.66
Export-Import Bank of Malaysia Berhad

Year of establishment	1995			
Objectives	Establishing an institutional support mechanism to facilitate the exports of goods and services by providing medium and long-term credit to Malaysian exporters and investors, as well as foreign buyers of Malaysian goods. Effective January 1998, the Export Credit Refinancing facility was transferred from Bank Negara Malaysia to Export-Import Bank of Malaysia Berhad.			
Facility	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2003	2004	2003	2004
Buyer credit facility	22.8	252.7	10.7	24.3
Overseas investment credit facility	239.4	196.4	40.7	212.6
Supplier credit facility	209.1	306.8	109.4	363.8
Export of services financing facility	–	–	–	–
Export credit refinancing	6,611.2	6,770.8	6,611.2	6,770.8
Others	–	–	–	0.4
Total	**7,082.5**	**7,526.7**	**6,772.0**	**7,371.9**

Source: Export-Import Bank of Malaysia Berhad

Table A.67
Malaysia Export Credit Insurance Berhad

Year of establishment	1977			
Objectives	Support and strengthen Malaysian exports through the provision of export credit insurance facilities to exporters to cover against commercial and non-commercial risks and issuing guarantees for banks and financial institutions to facilitate access to export finance, and encouraging reverse investment by Malaysian investors through the provision of political risk insurance for investment.			
	Contingent Liabilities (RM million)		Business Coverage (RM million)	
	As at end-2003	As at end-2004	2003	2004
Short-term Policies				
Comprehensive policies	121.4	307.1	1,077.0	1,479.3
Bank letter of credit policy	9.0	41.0	24.2	61.2
Specific policies	–	0.8	–	0.8
Bond indemnity support	–	2.5	–	2.5
Others	–	–	–	–
Sub-total[1]	130.4	351.4	1,101.2	1,543.8
Medium and Long-term Policies				
Specific policies	1.9	0.8	2.0	0.8
Buyer credit guarantee	331.4	290.7	276.5	240.3
Bond indemnity support	23.1	24.7	23.1	24.7
Overseas investment insurance	7.5	7.5	8.4	8.4
Others	0.1	0.1	–	–
Sub-total	364.0	323.8	310.0	274.2
Total	**494.4**	**675.2**	**1,411.2**	**1,818.0**

[1] Excluding Banker's export finance insurance policy

Source: Malaysia Export Credit Insurance Berhad

Table A.68
Bank Simpanan Nasional

Year of establishment	1974			
Objectives	Bank Simpanan Nasional is a savings bank, incorporated under the National Savings Bank Act 1974 and focuses on retail banking and personal finance especially for small savers.			
Deposits facility	Deposits Accepted (RM million)		Interest Rate / Rate of Return (%)	
	As at end-2003	As at end-2004	2003	2004
Savings deposits	1,230.7	1,103.7	1.30 ~ 4.51	1.00 ~ 2.00
Fixed deposits	3,422.0	4,654.2	3.00 ~ 3.70	3.00 ~ 3.70
GIRO deposits	3,595.9	4,054.1	1.30 ~ 2.30	1.00 ~ 2.00
Islamic deposits	281.9	252.0	1.96 ~ 3.40	1.90 ~ 5.52
Premium savings certificates	904.7	922.8	1.50	1.50
Total	**9,435.2**	**10,986.8**		

Investments	RM million	
	As at end-2003	As at end-2004
Quoted shares	1,389.0	1,277.7
Malaysian Government Securities	1,923.7	2,267.1
Private debt securities	1,084.7	819.7
Subsidiary companies	437.8	437.8
Associate companies	231.8	231.8
Total	**5,067.0**	**5,034.1**
Number of branches	398	393
Number of account holders ('000)	10,252	11,446
Number of automatic teller machines (ATM)	591	599

Source: Bank Simpanan Nasional

Table A.69
Bank Kerjasama Rakyat Malaysia Berhad

Year of establishment	1954			
Objectives	Bank Kerjasama Rakyat Malaysia Berhad mobilises savings and provides financing services to its members as well as non-members.			
Sector	Financing Outstanding (RM million)			
	As at end-2003		As at end-2004	
	Members	Non-members	Members	Non-members
Agriculture	45.2	11.7	48.3	10.2
Purchase of property	1,201.9	696.5	2,246.8	822.7
General commerce	46.4	424.7	45.7	399.5
Purchase of securities	15.8	101.5	10.8	78.9
Purchase of motor vehicles	278.3	0.7	649.6	0.6
Consumption credit	6,120.0	735.3	6,656.8	1,032.1
Manufacturing	–	100.3	–	100.8
Others	–	178.4	–	251.1
Total	**7,707.6**	**2,249.1**	**9,658.0**	**2,695.9**

Source: Bank Kerjasama Rakyat Malaysia Berhad

Table A.70
Bank Pembangunan dan Infrastruktur Malaysia Berhad

Year of establishment	1973			
Objectives	To increase the participation and involvement of the Bumiputera community in business and industry through financing and equity participation and to provide financing for infrastructure projects, in particular Government-identified projects.			
Sector	Loans Approved (RM million)		Loans Disbursed (RM million)	
	2003	2004	2003	2004
Infrastructure	4,753.8	7,428.8	1,589.8	1,905.5
Government programmes	*2,883.0*	*3,412.2*	*853.9*	*863.0*
Private programmes	*1,870.8*	*4,016.6*	*735.9*	*1,042.5*
SME	1,086.8	1,583.6	649.7	648.3
of which:				
Bumiputera	*1,059.6*	*1,506.5*	*526.4*	*601.2*
Total	**5,840.6**	**9,012.4**	**2,239.5**	**2,553.8**

Source: Bank Pembangunan dan Infrastruktur Malaysia Berhad

Table A.71
Bank Pertanian Malaysia

Year of establishment	1969	
Objectives	Bank Pertanian Malaysia was established to promote sound agricultural development in the country, through the provision of loans and advances. The main function of the bank is to co-ordinate and supervise the granting of credit facilities for agricultural purposes and mobilise savings, particularly from the agriculture sector and community.	
Agriculture, Forestry & Fishery	Loans Approved (RM million)	Loans Disbursed (RM million)
	2004	2004
Sub-sector		
Oil palm	*196.8*	*121.2*
Food crops	*85.3*	*81.4*
Livestock	*60.4*	*69.2*
Fishery	*122.7*	*46.8*
Forestry	*21.0*	*1.4*
Tobacco	*0.7*	*19.7*
Rubber	*8.4*	*9.3*
Others	*600.3*	*574.9*
Total	**1,095.5**	**923.9**

Source: Bank Pertanian Malaysia

Table A.72
Other Development Financial Institutions[1]: Core Activities

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Lending Activity					
Agriculture	124.7	122.0	141.2	124.9	113.1
Manufacturing	931.8	943.3	1,226.4	1,276.7	1,305.9
Broad property sector	632.3	622.2	993.7	1,005.2	1,101.2
Construction	*186.1*	*154.8*	*149.2*	*167.4*	*162.4*
Purchase of residential property	*310.7*	*305.7*	*304.9*	*298.6*	*281.2*
Purchase of non-residential property	*2.2*	*1.5*	*2.1*	*2.3*	*2.7*
Real estate	*133.3*	*160.2*	*537.5*	*536.9*	*654.9*
Consumption credit	47.0	64.6	148.4	253.6	325.4
Others	1,332.6	1,598.3	1,741.7	1,621.9	1,431.7
Total	**3,068.4**	**3,350.4**	**4,251.4**	**4,282.3**	**4,277.3**
Other Activities					
Deposits accepted	9,611.3	10,642.4	10,423.7	11,640.6	12,599.5
of which:					
Savings	*9,534.0*	*10,565.8*	*10,270.4*	*11,286.6*	*12,085.4*
Guarantee issued	3,405.0	2,669.0	2,584.7	3,112.5	3,415.7

[1] Refers to Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji

Table A.73
Development Financial Institutions : Selected Data

DFIs under DFIA[1]:	As at end-					
	2003			2004		
	Branch	ATM	Staff	Branch	ATM	Staff
Bank Pembangunan dan Infrastruktur Malaysia Berhad	13	–	640	14	–	690
Bank Kerjasama Rakyat Malaysia Berhad	100	112	2,804	103	119	2,866
Bank Simpanan Nasional	398	591	5,041	393	599	5,258
Bank Industri & Teknologi Malaysia Berhad	–	–	303	–	–	327
Export-Import Bank of Malaysia Berhad	–	–	73	–	–	73
Malaysia Export Credit Insurance Berhad	–	–	59	–	–	63
Bank Pertanian Malaysia	181	142	2,345	181	142	2,590
Sub-total	692	845	11,265	691	860	11,867
Other DFIs:						
Malaysian Industrial Development Finance Berhad	7	–	228	7	–	178
Sabah Development Bank Berhad	–	–	82	–	–	83
Borneo Development Corporation (Sabah) Sendirian Berhad	–	–	18	–	–	16
Borneo Development Corporation (Sarawak) Sendirian Berhad	–	–	37	–	–	36
Credit Guarantee Corporation Malaysia Berhad	17	–	272	17	–	325
Sabah Credit Corporation	11	–	206	10	–	206
Lembaga Tabung Haji	118	–	1,543	119	–	1,581
Sub-total	153	–	2,386	153	–	2,425
Total	**845**	**845**	**13,651**	**844**	**–**	**14,292**

[1] Development Financial Institutions Act 2002

Table A.74
Development Financial Institutions: Government Special Funds

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2003	2004	2003	2004	2003	2004
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
Financing Programme for Wholesalers and Distributors (Tanmiah 2)	3.5	8.8	–	5.0	–	4.4
Financing Scheme for Indian Rural Economic Development	–	–	0.2	…	0.3	0.3
Financing Scheme for Rural Economic Development	5.6	8.8	5.3	5.2	29.5	29.0
Food and Furniture Scheme	2.4	7.6	1.6	1.9	19.9	19.2
Fund for Film Industry	–	–	1.5	–	4.0	2.6
Fund for Publication	–	–	–	–	0.2	0.2
Graduate Entrepreneurs Fund	5.4	5.9	2.8	5.0	8.0	11.7
Seed Capital Scheme	27.1	52.5	13.8	27.6	56.1	66.8
Small Scale Enterprises[1]	–	–	–	–	4.9	5.6
Special Fund for Tourism 2	187.2	211.0	33.4	100.5	33.2	132.4
Terengganu Entrepreneurs Fund	11.0	4.4	17.3	14.9	10.6	15.0
Third Window Financing Scheme (Tanmiah1)	14.5	5.0	–	15.2	–	8.4
Tourism Infrastructure Fund	132.5	205.0	9.2	66.8	16.3	83.7
Venture Capital Fund	–	–	0.6	0.2	7.6	8.2
Bank Industri & Teknologi Malaysia Berhad						
Easy Financing Scheme - PAKSI	–	–	0.8	0.1	7.8	6.7
High Technology Fund	16.8	41.4	7.6	15.6	34.3	38.0
New Ship Financing Facility	4.2	35.0	21.4	29.2	49.9	71.7
Women Entrepreneurs Fund	–	–	3.2	1.1	8.3	7.3
Export-Import Bank of Malaysia Berhad						
Export Credit Refinancing (ECR) Scheme[2]	6,611.2	6,770.8	6,611.2	6,770.8	1,128.7	1,189.7
Bank Kerjasama Rakyat Malaysia Berhad						
Financing Scheme for Rural Economic Development	11.0	9.3	9.0	5.9	15.6	20.2
Bank Pertanian Malaysia						
Agricultural Mechanisation and Automation Scheme	3.2	0.9	4.0	1.7	9.0	8.8
Bumiputera Commercial and Industrial Community Scheme	19.6	17.0	9.1	6.6	16.2	17.6
Commercial Agriculture Graduate Entrepreneurs Scheme	0.7	1.4	0.6	1.4	0.9	2.2
Credit Scheme for Paddy	31.2	30.4	31.5	30.2	27.6	25.3
Financial Credit Scheme[1]	–	–	–	–	6.4	6.4
Hardcore Poor Development Programme[1]	–	–	–	–	0.2	…
Low Intensity Tapping System	0.4	0.2	0.2	0.2	0.2	0.1
Oil Palm Replanting Scheme	43.6	5.7	10.9	12.8	30.0	42.2
Special Agriculture Financing Scheme[1]	–	–	–	–	51.3	40.9
Special Fund for Fishery	0.5	1.6	1.1	1.6	16.2	15.9
Malaysian Industrial Development Finance Berhad						
Malaysian Industrial Energy Efficiency Improvement Project	2.0	4.0	–	2.2	–	0.3
Modernisation Automation Scheme[1]	–	–	0.2	0.4	19.3	15.7
Soft Loan for Factory Relocation	–	4.5	–	1.1	–	1.1
Soft Loan for Information and Communication Technology	–	2.3	–	0.3	–	0.3
Soft Loan for Small and Medium Enterprises	46.8	26.1	37.7	42.2	63.3	88.0
Special Fund for Terengganu-based Small and Medium Enterprises	1.2	0.8	0.8	0.7	0.8	1.4

[1] Fund has been fully utilised
[2] Inclusive of funds from Bank Negara Malaysia and these funds are channelled through 24 participating banks
… Negligible

Table A.75
Development Financial Institutions: Bank Negara Malaysia Funds[1]

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2003	2004	2003	2004	2003	2004
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
New Entrepreneurs Fund[2]	–	–	0.3	–	128.9	96.9
New Entrepreneurs Fund 2	106.5	193.3	115.1	182.5	167.6	328.5
Fund for Small and Medium Industries[2]	–	–	0.9	–	108.2	69.4
Fund for Small and Medium Industries 2	–	12.8	4.2	8.4	13.8	14.4
Bumiputera Industrial Fund[2]	–	–	–	–	19.9	11.8
Industrial Adjustment Fund[2]	–	–	–	–	0.3	–
Rehabilitation Fund for Small and Medium Industries[3]	3.1	–	5.1	–	39.9	38.6
Fund for Food	–	–	–	–	5.1	4.2
Special Fund for Tourism[2]	–	–	–	–	8.1	7.7
Bank Industri & Teknologi Malaysia Berhad						
New Entrepreneurs Fund[2]	–	–	–	–	2.2	–
New Entrepreneurs Fund 2	1.8	8.5	0.5	8.3	0.5	8.8
Fund for Small and Medium Industries[2]	–	–	0.3	–	22.9	17.6
Fund for Small and Medium Industries 2	4.1	27.4	4.4	12.9	6.5	16.6
Industrial Adjustment Fund[2]	–	–	–	–	9.9	6.3
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	4.6	4.0
Ship Financing Facility	–	–	0.9	–	341.1	282.1
Malaysian Industrial Development Finance Berhad						
New Entrepreneurs Fund[2]	–	–	–	–	7.9	5.6
New Entrepreneurs Fund 2	17.9	18.5	20.2	11.4	25.5	35.1
Fund for Small and Medium Industries[2]	–	–	1.2	–	31.4	19.5
Fund for Small and Medium Industries 2	22.1	79.7	15.9	38.9	19.4	46.9
Bumiputera Industrial Fund[2]	–	–	–	–	1.7	1.4
Industrial Adjustment Fund[2]	–	–	–	–	3.7	3.7
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	2.9	1.4
Bank Pertanian Malaysia						
Fund for Small and Medium Industries[2]	–	–	0.5	0.1	84.9	81.3
Fund for Small and Medium Industries 2	6.8	1.3	3.1	1.2	3.0	4.3
Rehabilitation Fund for Small and Medium Industries[3]	–	–	–	–	14.1	12.3
Fund for Food	121.0	117.6	171.0	119.2	551.1	595.8
Credit Guarantee Corporation Malaysia Berhad[4]						
New Entrepreneurs Fund 2	–	–	71.4	–	350.4	305.0
Fund for Small and Medium Industries 2	–	–	99.9	1.2	450.0	276.7

[1] Bank Negara Malaysia fund for the ECR scheme administered by EXIM Bank of Malaysia Berhad is merged with the Government fund in Table A.76
[2] Funds have been fully utilised
[3] Fund was closed on 1 November 2003 and replaced by the Rehabilitation Fund for Small Businesses
[4] Administers and channels the funds through various lending institutions

Table A.76
Development Financial Institutions: Funds from Multilateral and International Agencies

	Loans (RM million)					
	Approved		Disbursed		Outstanding as at end-	
	2003	2004	2003	2004	2003	2004
Bank Pembangunan dan Infrastruktur Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	6.0	–	25.1	2.0	78.5	57.8
Japan Bank for International Cooperation-Fund for Small and Medium Scale Industry Promotion Programme[1]	16.9	24.9	17.8	9.7	50.5	49.5
Japan Bank for International Cooperation-Fund for Small and Medium Industries	48.8	19.9	33.2	9.3	110.5	96.3
Japan Bank for International Cooperation 1- JEXIM[1]	–	–	44.1	2.0	1,191.5	1,116.6
Islamic Development Bank	–	4.0	15.7	–	49.0	14.3
Japan Bank for International Cooperation 2	–	741.0	–	–	–	–
Bank Industri & Teknologi Malaysia Berhad						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	–	–	5.8	3.3
The Export-Import Bank of Japan[1]	–	–	–	–	29.3	1.1
Overseas Economic Cooperation Fund-Fund for Small and Medium Scale Industry Promotion Programme[1]	–	–	–	–	21.6	16.3
Japan Bank for International Cooperation 300[1]	52.3	–	39.7	17.5	161.8	153.5
Japan Bank for International Cooperation 200[1]	–	–	6.4	3.3	43.9	30.3
Japan Bank for International Cooperation-Fund for Small and Medium Industries[1]	45.9	18.1	26.0	24.7	64.3	69.6
Export-Import Bank of Malaysia Berhad						
Japan Bank for International Cooperation 300[1]	–	–	–	–	227.5	186.1
Japan Bank for International Cooperation 200[1]	–	–	–	–	142.2	116.3
Malaysian Industrial Development Finance Berhad						
Japan Bank for International Cooperation-Fund for Small and Medium Industries	22.2	20.3	47.2	14.0	95.0	93.1
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund	30.8	20.4	24.2	22.3	57.9	74.8
Japan Bank for International Cooperation-Fund for Small and Medium Scale Industry Promotion Programme	–	1.2	–	0.1	17.5	14.3
ASEAN-Japan Development Fund/EXIM	–	–	–	–	1.3	0.6
Bank Pertanian Malaysia						
ASEAN-Japan Development Fund-Overseas Economic Cooperation Fund[1]	–	–	–	–	121.8	109.6

[1] Funds have been fully utilised

As at end-2004, 317 leasing companies and 29 factoring companies had registered with Bank Negara Malaysia. However, only 137 leasing companies and 17 factoring companies submitted statistics pertaining to their operations to the Bank Negara Malaysia. Total assets of the 137 leasing companies and 17 factoring companies amounted to RM13.1 billion and RM2.3 billion respectively at end-2004. Nevertheless, of the 137 leasing companies, only 24 were pure leasing companies, while of the 17 factoring companies, only eight were pure factoring companies. The remaining companies only undertook leasing and factoring business as part of their overall business activities.

Table A.77
Leasing Companies[1]: Sources and Uses of Funds

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Sources					
Capital and reserves	839	839	770	1,554	1,017
Borrowings from financial institutions	1,711	1,923	2,141	1,759	1,816
Inter-company borrowings	1,316	1,343	1,454	1,375	605
Others	2,447	2,400	2,684	2,342	2,095
Total	**6,313**	**6,505**	**7,049**	**7,030**	**5,533**
Uses					
Cash and bank balances	191	229	225	198	157
Investments	279	309	323	387	327
Receivables	3,107	3,014	3,118	2,370	2,180
Leasing	*1,495*	*1,423*	*1,420*	*1,508*	*1,487*
Factoring	*8*	*17*	*209*	*204*	*101*
Hire purchase	*1,331*	*1,275*	*1,307*	*503*	*453*
Others	*273*	*299*	*182*	*155*	*139*
Others	2,736	2,953	3,384	4,074	2,869

[1] Statistics shown are for pure leasing companies only

Table A.78
Leasing Companies[1]: Income and Expenditure

	During the period				
	2000	2001	2002	2003	2004
	RM million				
Income					
Income from	315	313	302	326	167
Leasing	*223*	*217*	*212*	*226*	*107*
Factoring	*0*	*2*	*3*	*6*	*5*
Hire purchase	*90*	*85*	*76*	*75*	*51*
Others	*2*	*9*	*11*	*20*	*3*
Others	224	188	306	200	303
Total	**539**	**501**	**607**	**526**	**469**
Expenditure					
Interest paid	180	187	165	141	122
Financial institutions	*156*	*166*	*155*	*134*	*117*
Block discounting	*24*	*21*	*10*	*7*	*5*
Bad debts written off and provision	33	108	35	5	91
Others	168	165	199	183	95
Total	**381**	**460**	**398**	**329**	**309**
Pre-tax Profit	**158**	**41**	**209**	**197**	**161**

[1] Statistics shown are for pure leasing companies only

Table A.79
Leasing Companies[1]: Financing by Sector

	During the period				
	2000	2001	2002	2003	2004
	RM million				
Sector					
Agriculture	25	17	14	25	33
Mining and quarrying	17	3	3	9	4
Manufacturing	317	172	102	126	172
Electricity	3	1	0	0	0
General commerce	89	266	125	106	116
Property sector	61	50	38	207	97
Construction	*57*	*46*	*36*	*179*	*68*
Real estate	*4*	*4*	*2*	*28*	*28*
Residential property	*0*	*0*	*0*	*0*	*1*
Transport and storage	83	805	54	53	55
Business, insurance and other services	147	113	121	116	184
Consumption credit	3	0	0	0	0
Others	26	108	128	53	48
Total	**771**	**1,535**	**585**	**695**	**709**

[1] Statistics shown are for pure leasing companies only

Table A.80
Factoring Companies[1]: Sources and Uses of Funds

	As at end-				
	2000	2001	2002	2003	2004
	RM million				
Sources					
Capital and reserves	116	164	164	81	99
Borrowings from financial institutions	324	445	293	267	77
Inter-company borrowings	697	600	416	267	644
Others	896	658	1,092	425	121
Total	**2,033**	**1,867**	**1,964**	**1,040**	**941**
Uses					
Cash and bank balances	255	202	234	14	20
Investments	25	45	35	24	22
Receivables	1,458	998	1,170	602	614
Leasing	*0*	*0*	*0*	*0*	*185*
Factoring	*1,312*	*872*	*1,111*	*542*	*298*
Hire purchase	*4*	*4*	*4*	*4*	*72*
Others	*142*	*122*	*55*	*57*	*59*
Others	295	622	525	401	285

[1] Statistics shown are for pure factoring companies only

Table A.81
Factoring Companies[1]: Income and Expenditure

	During the period				
	2000	2001	2002	2003	2004
	RM million				
Income					
Income from	47	37	38	31	51
Leasing	*0*	*2*	*0*	*0*	*10*
Factoring	*38*	*29*	*29*	*24*	*20*
Hire purchase	*0*	*0*	*0*	*0*	*9*
Others	*9*	*6*	*8*	*6*	*12*
Others	99	129	297	75	38
Total	**146**	**166**	**335**	**106**	**89**
Expenditure					
Interest paid	*28*	28	17	15	18
Financial institutions	*28*	*28*	*17*	*15*	*18*
Block discounting	*0*	*0*	*0*	*0*	*0*
Bad debts written off and provision	14	28	14	5	11
Others	49	33	45	17	21
Total	**91**	**89**	**76**	**37**	**50**
Pre-tax Profit	**55**	**77**	**259**	**68**	**39**

[1] Statistics shown are for pure factoring companies only

Table A.82
Factoring Companies[1]: Financing by Sector

	During the period				
	2000	2001	2002	2003	2004
	RM million				
Sector					
Agriculture	0	…	0	1	1
Mining and quarrying	0	0	0	0	3
Manufacturing	76	66	57	46	58
Electricity	4	3	2	3	0
General commerce	127	140	179	120	94
Property sector	245	270	103	43	28
Construction	*195*	*222*	*76*	*36*	*26*
Real estate	*50*	*48*	*27*	*1*	*0*
Residential property	*0*	*0*	*0*	*6*	*2*
Transport and storage	8	5	3	1	1
Business, insurance and other services	77	51	50	37	41
Consumption credit	22	20	20	17	0
Others	25	541	513	18	37
Total	**584**	**1,096**	**927**	**286**	**264**

[1] Statistics shown are for pure factoring companies only
… Negligible

Table A.83
Capital Market Debt Securities[1]: Amount Outstanding

	As at end-				
	2000	2001	2002	2003	2004*p*
	RM million (nominal value)				
Malaysian Government Securities	89,050	103,450	109,550	130,800	154,350
Government Investment Issues	4,000	4,000	5,000	7,000	9,100
Khazanah Bonds	10,000	10,000	10,000	11,000	10,000
Malaysia Savings Bonds	359	–	464	455	–
Merdeka Savings Bonds[2]	–	–	–	–	1,929
Danaharta Bonds	11,140	11,140	11,140	8,539	796
Danamodal Bonds	11,000	11,000	11,000	–	–
Cagamas Bonds	17,312	18,427	22,595	25,628	26,752
Other Corporate Bonds	102,220	120,584	108,416	144,595	160,057
Total	**245,081**	**278,601**	**278,165**	**328,018**	**362,983**

[1] Refer to debt securities with an original maturity period of more than one year
[2] Merdeka Savings Bonds were introduced in 2004
p Preliminary