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Managing The Malaysian Economy in 1999

An Overview

At the time of the presentation of the 1999 Budget on 23 October 1998, there were signs that the economy was responding positively to measures initiated by the Government especially since September 1998 to reinvigorate the economy, strengthen the banking system as well as insulate the economy from the contagion of the international financial crisis that had beset the region since mid-1997. Expectation then was that the economy would recover by 1% in 1999, as exports were expected to improve in anticipation of a recovery in world trade while domestic demand would be supported by fiscal and monetary stimulus. However, apprehension remained, given the uncertainty of the external environment, as there were potential downside risks that could deflate further the economy should the global financial crisis become prolonged or turn for the worse, especially in view of the lack of resolve on the part of the international community to deal with the crisis effectively.

Given the volatile nature of the international environment as well as the need to pull the economy out of recession which, if prolonged, could have severe ramifications on the health of the corporate sector, the systemic stability of the banking system and the socio-economic well-being of the population, the Government continued its efforts to revive the economy by vigorously implementing the National Economic Recovery Plan put forward by the National Economic Action Council. Consequently, the main thrust of the 1999 Budget was aimed at reinvigorating the economy speedily. This was to be achieved largely through domestic demand stimulus, supported by increased budgetary allocation, a supportive tax regime, enhanced efforts by the Government machinery to speed up project implementation and an easier monetary policy. To ensure that these policy initiatives were not undermined by external developments, the economy had to be insulated from any further contagion effects arising from regional and global financial crisis. In this regard, the pegging of the ringgit to the US dollar and the selective capital controls need to be maintained to enable Malaysia to continue to pursue an independent monetary policy to support economic recovery as well as to ensure stability in the financial markets. The selective capital controls were subsequently relaxed through the imposition of a graduated exit levy effective 15 February 1999 to replace the one-year holding period for portfolio funds, given that the nation's external reserves position had strengthened significantly. The graduated exit levy was a two-tier levy system which entailed a 30% levy on profit made and repatriated within a year, and a 10% levy on profit repatriated after one year. This two-tier levy system was aimed at encouraging investors to take a longer term view of their portfolio investment in Malaysia. However, given that the two-tier levy system had created some problems for foreign fund managers in computing prices and determining the amount of levy applicable to their investment, the Government, in response, introduced a flat exit levy of 10% on repatriation of profit on portfolio investment to replace the two-tier levy system with effect from 21 September 1999. The change reduces the rate of the levy and makes the levy more efficient to administer as well as addresses all the administrative problems raised by the foreign fund managers.

While reinvigorating the economy continues to be the main thrust of macroeconomic policies during 1999, the Government recognises that this policy thrust must be accompanied by further strengthening of the nation's resilience to systemic risks as well as improvement in the nation's international competitiveness. In this regard, the Government has accelerated the pace of reforms in the banking system to ensure that the banking sector continues to remain sound and resilient to systemic risks and is well-positioned to support an early economic recovery. Pengurusan Danaharta Nasional Bhd. (Danaharta), Danamodal Nasional Bhd. (Danamodal) and the Corporate Debt Restructuring Committee (CDRC) which were set up in June and August 1998 play a key role in strengthening the banking system and ensuring that it can continue to perform its intermediation function effectively to revive the economy. By end of June 1999, Danaharta had completed its primary task of acquiring the non-performing loans (NPLs) of the banking system, while Danamodal had completed the task of recapitalising the banking institutions. CDRC has also made significant progress in facilitating and expediting corporate debt work-outs to ensure viable business which temporarily faced liquidity problem can continue to have access to financing. These debt-work-outs are in the mutual interest of both creditors and debtors.

The recent financial crisis has highlighted the risks of over reliance on the banking system for the purpose of financing economic activities particularly the broad property sector and large privatisation projects which were in part funded by short-term borrowings. This had led to a rapid growth in bank loans averaging 25% during the period prior to the crisis. When the crisis struck, NPLs rose sharply. Debtors were faced with liquidity problems due to margin calls following deterioration in the quality of collateral caused by falling asset prices, high interest rates prior to September 1998 as well as mismatches between the flow of income and payments of liabilities faced by those who had borrowed short to finance long-term investments. The fundamental reason for the over-reliance on the banking sector as a source of funding has been the slow development of the bond market due to a number of impediments, including multi-layered approval process involving more than one regulator. Thus, as an initial step to rationalise the current regulatory framework, the Government has named the Securities Commission as the sole regulatory authority for the supervision and regulation of the corporate bond market in Malaysia. This was announced on 7 September 1999. A National Bond Market Committee has also been established to take the lead in all corporate bond market development efforts in Malaysia.

An issue of concern which affected investor confidence during the crisis was the integrity of the capital market. To address this concern, issues related to corporate governance and transparency have been given attention. On 25 March 1999, *The Report On Corporate Governance* prepared by the High Level Finance Committee and accepted by Government was made public. The Report, among others, set out a set of principles and best practices for good governance and recommendations to strengthen the overall regulatory framework for public-listed companies. On the issue of transparency of the capital market, the Securities Commission has accelerated the implementation of a three-phased disclosure-based regulatory system which is aimed at increasing the disclosure of information by issuers, improving the quality, timeliness and relevancy of information disclosed and enhancing the accountability of market participants.

In dealing with the issue of New Millennium Bug or Year 2000 (Y2K) problem, the Government has taken concrete steps to ensure that the country's financial system is Y2K compliant. By end of August 1999, all Malaysian banking and insurance industries, capital market institutions as well as intermediaries have implemented Y2K ready systems.

The impact of the policy initiatives taken by the Government has been positive. Economic recovery has strengthened by the second quarter of 1999. Consumer and investor confidence have improved. The external trade balance continued to record large surpluses for 22 consecutive months since November 1997 through August 1999. This has enabled the nation's external reserve position and, consequently, the resilience of the economy to strengthen significantly. The risk-weighted capital adequacy ratio of the banking system has improved while NPLs are at a manageable level.

Fiscal Policy

Policy considerations

The main underlying concern when the 1999 Budget was formulated in October 1998 was the unprecedented contraction of the real economy during the first three quarters of 1998 as a result of the contagion effect of the regional financial crisis. Thus, the priority of the 1999 Budget was to prevent the economy from being entrapped into a vicious circle of prolonged recession and, at the same time, provide the necessary impetus to turn the economy into a virtuous circle of sustainable growth. Thus, an expansionary Budget was announced for 1999 to provide the necessary fiscal stimulus to reinvigorate the economy. Maintaining a tight Budget under the circumstances would have been imprudent as it would have led to a further contraction of the economy. Consequently, the strategy of maintaining fiscal surpluses adopted during the presentation of recent years' Budgets was reversed. As expenditure had to be stepped up during 1999 to revive economic activities, a deficit Budget was planned for the year. In part, the deficit took into cognizance an expected drop in revenue collection, as direct tax collection in 1999 was envisaged to be adversely affected by the severe contraction of the economy in 1998. While the overriding objective of the 1999 Budget was to revive economic activities, the measures introduced were also aimed at strengthening further the resilience and competitiveness of the economy, restructuring the financial sector, improving governance in both the private and public sectors, strengthening further the balance of payments and ensuring the social well-being of the population.

In determining the size of the budget to boost growth, the decision was guided by a number of considerations. Firstly, there was a need to keep the current account of the Federal Government finance at least in balance. This constitutes a basic tenet of prudent fiscal management. Consequently, operating expenditure budgeted for 1999 was only allowed a minimal increase of 1%. Secondly, there was also a need to avoid crowding out the private sector's access to sources of financing. This required restraint in expanding the budget as the circumstances prevailing during the presentation of the 1999 Budget did not allow financing of the deficit from external sources at a reasonable cost. Thirdly, there was a need to keep the overall fiscal deficit at a sustainable level so that the nation's external debt servicing ratio remained within prudential level. Thus, a deficit equivalent to 6% of GNP was planned for 1999, with development expenditure budgeted at RM18 billion. This was to keep the nation's external debt servicing ratio at 6%.

As the economic recovery in 1999 has been stronger than the 1% growth projected earlier, revenue collection has turned out better than anticipated earlier. This favourable variance allowed room for further increases in the size of fiscal stimulus to reinvigorate the economy without exceeding the size of the overall fiscal deficit of 6% of GNP budgeted earlier. As a result, the allocation for 1999 operating expenditure has been increased by 4% to RM48.9 billion from RM47 billion budgeted earlier, while that of development expenditure by 44.1% from RM18 billion budgeted earlier to RM26 billion.

Priority in Budgetary Allocations

In line with the 1999 Budget strategy to revive economic activities, 50.9% of the development expenditure has been allocated for the economic sector. To ensure that the development expenditure provides maximum stimulus to economic growth, projects selected for implementation have been those with strong linkages with the economy but with minimal leakage in terms of imports. The identified projects are those with short gestation period as well as those with the capacity to enhance the efficiency of the economy. Consequently, a sizable portion of the development expenditure, that is RM7.9 billion, was provided for infrastructure projects including those in rural areas, such as construction of roads, bridges, rail and ports, utilities and agriculture infrastructure.

Recognising the need to intensify the development of the nation's human resources in order to propel Malaysia to a higher plane of socio-economic development, RM4 billion or 16% of total budget was allocated for investment in human capital particularly for the purpose of expanding and upgrading of educational infrastructure and supporting facilities. This large allocation was also consistent with the Government's policy of making Malaysia a centre of excellence in education, in line with ongoing efforts to encourage more Malaysians to study within the country while attracting foreign students to study in Malaysia, with the view of improving the services account of the balance of payments. In addition, almost RM1 billion was allocated for health and medical services to ensure the population remain healthy and productive.

The 1999 Budget also addressed the needs of the low income group, the needy, small businessmen as well as issues related to housing, the environment, poverty eradication programmes and the nurturing of a caring society. Given that a number of sosio-economic issues remained to be addressed, budgetary allocations have been prioritised judiciously within the resources available.

Speedier Project Implementation

In reinvigorating growth, an area of concern was the pace of implementation of projects that have been provided with budgetary allocations during 1999, as delays in the implementation would deprive the economy the much needed stimulus to generate economic growth. The concern arose when it became apparent that due to expenditure shortfall, the 1998 fiscal deficit turned out to be smaller (1.9% of GNP) than the 3.7% deficit expected when the Government stepped up its expenditure by an additional RM7 billion in July 1998. While the 1998 expenditure shortfall of almost 20% is partly attributed to the additional allocation in July 1998, inadequate coordination and monitoring as well as procedural delays have also contributed to the shortfall. In response, the Government undertook a number of measures to accelerate project implementation in 1999. These measures include intensive monitoring of project implementation at the ministerial level to avoid and overcome undue delays, the submission of monthly reports on the progress of project implementation by the Implementation Coordination Unit of the Prime Minister Department to the Cabinet for perusal as well as procedural changes relating to tenders and procurement to expedite the pace of implementation. Projects that were slow to take off would have allocated funds redirected to other projects that could be implemented expeditiously. As a result of these measures, 61% of the total development expenditure allocated for 1999 has been spent as at end September 1999, against 3.7% at end March the same year.

Tax Measures

On tax policy, the measures introduced during the presentation of the 1999 Budget were aimed at streamlining the tax administration system, reviving the economy, facilitating the restructuring of the financial sector, strengthening the balance of payments position as well as raising revenue. In streamlining the tax administration system, the assessment of income tax based on the income received in the preceding year was changed to that of the current year beginning the year 2000. At the same time, income received in 1999 was waived from income tax and losses incurred in 1999 will be allowed to be carried forward. The present assessment system that is based on the Official Assessment System will also be changed to the Self-Assessment System in stages: 2001 for companies; 2003 for businesses, partnerships and cooperatives; and 2004 for salaried group.

The new assessment system is mutually beneficial to both the taxpayers and the Government. As a result of the contraction of the economy in 1998, many companies faced difficulties in paying their income taxes during the year, as their tax payments were based on 1997 incomes which were higher due to more favourable economic conditions then. Under the new assessment system, income tax payments would be based on the taxpayer's current capacity to pay. This would reduce the financial burden on the taxpayer especially in circumstances where the taxpayer's income is declining. At the same time, with increased capacity on the part of the taxpayers to pay, Government revenue will not be adversely affected by non-compliance.

To support the revival of economic activities, instruments that attract stamp duty for the refinancing of loans for business purposes were now exempted from the duty. This would contribute to lowering the cost of doing business. As a measure to enhance the development of unit trusts, interest income earned by unit trusts is exempted from income tax effective from the year of assessment 1999. For the life insurance industry, income tax would be imposed on actuarial surplus actually transferred to the shareholders' Fund rather than based on an accrual principle. This measure would encourage life insurance companies to retain their actuarial surpluses in the Life Fund that in the long run could be used to further develop the life insurance industry. To enable local manufacturers that produce consumer goods to compete with manufacturers from other ASEAN countries when the ASEAN Free Trade Area (AFTA) is implemented, the Government abolished excise duty on refrigerators, television sets and air-conditioners.

Several tax measures were also introduced in the 1999 Budget and in August 1999 to facilitate the restructuring and strengthening of the financial sector through mergers as well as to reduce the sector's financial burden due to increases in NPLs following the regional crisis. To encourage mergers in the financial sector, the stamp duty and the real property gains tax incurred in mergers were given tax exemption for mergers concluded during 24 October 1998 through 30 June 1999. However, this tax benefit was subsequently extended to 30 June 2000. Another tax benefit provided to support the merger programme is the recognition of 50% of the accumulated losses of banking institutions that are to be acquired for the purposes of computing the tax payable by the merged entity through tax credit. However, the credit must be utilised within two years from the completion of the merger exercise.

To assist the financial institutions during this difficult period, the Government also decided not to consider 50% of the amount in the interest-in-suspense account as income for purposes of income tax for the year of assessment 1999 and 2000. Such income will only be taxed when it is realised.

The regional financial crisis has highlighted the need to build up sufficient external reserves to enable the nation to withstand financial shocks. In this regard, a number of measures have been introduced since the presentation of the 1999 Budget to further strengthen the balance of payments position. These measures were:

(i) losses incurred in the production of approved food items such as maize and cattle are allowed as deduction from profits of companies in the same group for purpose of income tax. This is to encourage the involvement of the corporate sector in food production on a commercial basis for purpose of substituting imports. This incentive is applicable for applications received before the end of 1999.

(ii) exemption of rental income from 'time charter' and 'voyage charter' from income tax. This is to further develop the shipping industry and also to increase the tonnage of 'Malaysian Ships', in order to address the large net payment on freight services;

(iii) provision of income tax exemption for activity in the leisure boats and yachts repair and maintenance in Langkawi for a period of 5 years. This is to promote Langkawi as a regional centre for the repair and maintenance of leisure boats and yachts;

(iv) income tax exemption on income earned by non-residents from performing in arts and cultural shows, participating in exhibitions, games and competitions;

(v) income tax exemption of 50% on income derived by organisers of sports, cultural shows, art exhibitions and carnivals involving foreign participation;

(vi) exemption from entertainment duty on admission tickets to cultural performance, arts shows, exhibitions, carnivals and sports that are held in National Sports Complex, National Theatre, National Art Gallery and the Petronas Philharmonic Hall; and

(vii) sales tax exemption on goods sold by Malaysian companies during approved sales carnivals held in the National Sports Complex, Bukit Jalil.

Additional tax measures specifically aimed at attracting tourists into this country were also introduced in the 1999 Budget. These include provision of full income tax exemption for income derived by drivers and 50% tax exemption for income derived by organisers of 'Formula One' and other forms of motor racing which are internationally recognised and held in Malaysia. These incentives are aimed at promoting 'Formula One' racing and other cars and motorcycles racing in Malaysia with the view of attracting foreign tourists. Experiences in several European countries indicate these sports attract large number of tourists. To further promote Malaysia as a tourist shopping centre, the Government on 22 May 1999 abolished all import duties on a variety of leather goods such as suit-cases and vanity-cases as well as footwear. As a measure to promote domestic tourism as well as to curb the outflow of funds, tax exemption on benefits in kind in the form of free passages overseas extended to employees has been capped at the maximum of RM3,000 following the presentation of the 1999 Budget. However, the exemption for leave passages within the country up to three times from income tax was maintained.

In view of the envisaged decline in revenue in 1999 as a result of provision of tax exemption and incentives as well as the contraction of the economy in 1998 which affected direct tax collection in 1999, higher taxes were imposed on certain goods and activities to raise revenue. These were alcoholic beverages, gaming, pool betting, the casino, cigarettes and tobacco. The increase in these taxes was in part to promote a healthier lifestyle.

Financing the 1999 Budget

In financing the 1999 fiscal deficit, the consideration is to avoid crowding out the private sector in terms of access to funds while, at the same time, minimising the nation's exposure to external debts. Given that there is excess funds in the country as a result of the large surpluses in the current account of the balance of payments in 1998 and in 1999, the funding of the 1999 fiscal deficit is largely from domestic non-inflationary sources as well as from cash balances brought forward from 1998.

Monetary Policy

The stance of monetary policy is to complement fiscal policy in supporting the economic recovery process while maintaining price stability and positive real interest rates for depositors. In fostering economic recovery, a low interest rate regime is needed to stimulate domestic spending as well as to reduce the cost of financing economic activities. Consequently, Bank Negara Malaysia (BNM) lowered its 3-month intervention rate from 7.00% to 6.50% on 5 April 1999 and subsequently to 6.00% on 3 May. In part, the reduction took into consideration the moderation in inflation rate.

The 100 basis point reduction in the BNM 3-month intervention rate led to a significant 240 basis point reduction in the 3-month interbank rate from 5.7% at end March to 3.30% at end June, given the continued increase in liquidity in the banking system following large monthly trade surpluses. In response, commercial banks and finance companies lowered their base lending rates (BLRs) to an average of 7.24% and 8.5% at end June from 8.04% and 9.50% respectively at end March 1999. Consequently, commercial banks lowered fixed deposit rate from 5.39%-5.44% at end March 1999 to 3.75%-3.80% at end June while finance companies from 5.69%-5.90% to 3.78%-3.97% during the same period. The lowering of BLRs and improved economic activities led to a larger amount of loan approvals and disbursements during the second quarter of 1999, that is RM25 billion and RM78.1 billion, against RM20.5 billion and RM77.5 billion in the first quarter during the same year.

To further stimulate domestic demand and to reduce the cost of financing economic activities, BNM further lowered its 3-month intervention rate by another 50 basis points to 5.50% on 9 August. As a result, commercial banks and finance companies reduced their BLRs to an average of 6.79% and 7.95% respectively in August which had remained unchanged till end September. The current levels of BLRs are at a historical low. The average fixed deposit rates of commercial banks remained in the range of between 3.75%-3.79%, while the average fixed deposit rates of finance companies were in a wider range of 3.77%-4.08% as at end of September. The fixed deposit rates remained higher than the average rate of inflation of 3% during the first nine months of 1999 and 2.1% in September. This reflects a policy stance aimed at maintaining positive real rates of interest to minimise the impact of low interest on those who rely mainly on interest income from deposits as a main source of income, particularly the elderly group.

To ensure loans are not directed to the development of property segments with excess supply, effective 5 January 1999 banking institutions were not allowed to finance the development of new residential properties and shop houses exceeding RM250,000 each. However, the end financing for the purchase of completed residential and non-residential properties as well as those under construction were not affected. Banking institutions, instead, have been encouraged to extend end financing to help clear the existing stock of properties to facilitate speedier recovery of the construction sector and related industries.

Strengthening the Banking Sector

In the banking sector, the policy stance focused on strengthening the banking system in terms of its systemic stability and effectiveness in carrying out its intermediation function. In strengthening the banking system, significant progress has been made in addressing the problem of NPLs, the recapitalisation of banking institutions as well as restructuring of large corporate debts that impinge on the health of the banking system. Danaharta, the asset management agency, has completed its primary task of acquiring NPLs of the banking system by end of June 1999. By that date, it had purchased RM17.785 billion worth of NPLs at an average discount of 57% on gross value of acquired NPLs and, at the same time, managed another RM21.541 billion NPLs, thus carving out a total of RM39.326 billion of gross value of NPLs. The amount of NPLs taken over by Danaharta from the banking system was RM30 billion, while from non-BAFIA and offshore institutions the amount was RM7.9 billion, covering 2,272 accounts from 66 financial institutions relating to 1,780 borrowers. By 26 August 1999, RM1.01 billion of the loans were fully settled. Complementing the work of Danaharta is the CDRC which has completed the restructuring schemes of companies with debts totaling RM11.4 billion by end of September 1999.

Similarly, Danamodal has completed its task of recapitalising the banking institutions by early May this year, investing RM6.4 billion in 10 banking institutions. The tasks ahead for Danamodal include restructuring of balance sheets and operations of recapitalised banking institutions and facilitating mergers in efforts to strengthen the banking system.

Development of the Ringgit Corporate Bond Market

Over-dependence on the banking sector to meet the funding needs of the corporate sector was identified in the National Economic Recovery Plan as a contributory factor to the 1997 crisis. To reduce the over-reliance of the corporate sector on the banking system for financing, there is an urgent need to develop the ringgit corporate bond market. A well-functioning domestic bond market will not only provide borrowers with an alternative source of funding, but will also spread some of the credit risks associated with debt financing from the banking sector to the investing public. In addition, the financing for infrastructure projects, which are essential for economic growth, is better served through the equity and bond markets rather than exclusively through bank borrowings.

Several initiatives were taken during 1999 to further develop the Malaysian bond market. These include the implementation of the Real Time Electronic Transfer of Funds and Securities in July 1999 to provide an efficient mechanism for the clearing and settlement of debt securities. Also in the pipeline is the proposed establishment of a financial guarantee insurer to help provide issuers of private debt securities an alternative to enhance their proposed debt issue's stand-alone rating.

An important determinant of the success of corporate bond market development is the policy and regulatory framework within which the market operates. The development of the corporate bond market has been slow due to impediments, including the multi-layered approval process of the primary market, as well as the inefficiency and illiquid secondary markets. The multi-layered approval process arose as there was no single regulatory authority to regulate, supervise and promote bond market development on an integrated basis. Therefore, as a first step to rationalise the current regulatory framework, the Government has announced that the Securities Commission would be the single regulatory authority for the supervision and regulation of the corporate bond market.

At the same time, the Government also established the National Bond Market Committee (NBMC) which would take the lead in all corporate bond market development efforts in Malaysia. The NBMC will seek to:

- Provide overall policy direction as well as rationalise the regulatory framework for the orderly development of the corporate bond market;
- Conduct detailed studies on issues relating to corporate bond market development; and
- Based on the recommendations from the studies, identify appropriate implementation strategies.

The NBMC is chaired by the Secretary-General of the Treasury, with representatives from BNM, Economic Planning Unit, Registrar of Companies, Securities Commission and the Kuala Lumpur Stock Exchange. Relevant market participants would be co-opted by the NBMC as and when the need arises. The NBMC has established three

Working Groups, that is the Legal and Regulatory Reform Committee chaired by the Securities Commission; Product and Institutional Development Committee co-chaired by BNM and Securities Commission; and Infrastructure and Operations Working Group chaired by the Kuala Lumpur Stock Exchange to assist the NBMC. The Government through the Ministry of Finance has committed itself to the full rationalisation of the regulatory framework for the corporate bond market on an urgent basis.

Enhancing the Standard of Corporate Governance

Boosting confidence in the capital market remains part of the overall strategy to revive the economy. In this regard, issues related to integrity of the capital market such as corporate governance and transparency were further addressed. In February 1999, the Government accepted *The Report On Corporate Governance* which proposed the development of the Malaysian Code on Corporate Governance. This code sets out a set of principles and best practices for good governance; recommendations to strengthen the overall regulatory framework for public-listed companies as well as to enhance self regulatory mechanisms that promote good governance; and provision of training and education especially of company directors to undertake responsibilities expected of them. With regard to the promotion of transparency in the capital market, the Securities Commission has accelerated the implementation of its three-phased disclosure-based regulatory (DSR) system aimed at increasing the disclosure of information by issuers and at improving the quality, timeliness and relevancy of information disclosed as well as enhancing the accountability of market participants. Amendments to shareholding spread requirements and dispensations of profit forecast and projections in public documents, originally scheduled for later implementation in the third phase of DSR, was brought into effect in April 1999. This accelerated effort to enhance the integrity of the capital market was to strengthen confidence in the capital market. This, in turn, should facilitate economic recovery, as improvement in the performance of the stockmarket would boost domestic demand through positive wealth effect.

Ensuring Y2K Compliance

On the global issue of New Millennium Bug, the Government has adopted a proactive approach to address the Y2K problem. By end of August 1999, all Malaysian banking and insurance industries have collectively achieved a Y2K Ready Status. The Government has adopted internationally recognised standards for managing Y2K risks in the financial sector. These standards were provided by the Bank for International Settlement as well as organisations such as Federal Financial Institutions Examination Council of the United States of America and Global 2000, a confederation of private financial institutions that has made available the results of its colloborative efforts. BNM has coordinated a rigorous Y2K testing process to ensure the banking system is Y2K ready. Notwithstanding the measures taken to ensure readiness, a comprehensive business resumption plan has also been put in place to minimise any potential disruptions arising from Y2K event. A “Y2K Command Centre” has been set by BNM to monitor and manage issues related to the millennium bug within the banking and financial sector.

Similarly, the Securities Commission has intensified the efforts which began in 1997 to ensure the capital market and intermediaries as well as public listed companies take all the necessary measures to prepare themselves for the roll-over to the year 2000. The market institutions, that is the exchanges, clearing houses, central depository and issuing houses, have implemented Y2K ready systems, having completed rigorous internal and external testing, and are now concentrating on additional testing and contingency planning. Market intermediaries, that is the brokering firms, unit trust management companies and asset management companies, have made good progress in their Y2K compliance work in recent months. Most of these companies have already completed their Year 2000 programme and are ready to face the new year, while a few are still finishing up on testing and implementation and awaiting confirmation of readiness from external parties on which they depend on. The integral part of coping with Y2K problem will be for market participants to have well-developed and well-tested contingency plans that would provide a method for responding to the loss or degradation of essential services in an automated system, and maintaining essential functions for the operation of the market and, thereby, maintaining the confidence of investors and market participants. A Capital Market Y2K Contingency Plan has been put in place to address possible situations that could lead to a market-wide disruption and to identify contingency measures to be undertaken by the respective institutions.

Impact of Policy Initiatives

The policy initiatives under taken by the Government aimed at, among others, reinvigorating the economy, enhancing its resilience to systemic risks as well as strengthening the financial system have borne positive results.

Real GDP has turned around from an unprecedented contraction of 10.9% in the third quarter of 1998 to record a positive growth of 4.1% in the second quarter 1999. This is largely driven by robust growth of the manufacturing sector which recorded a double digit rate of growth during the months of June through August 1999. In part, this was attributed to fiscal stimulus as well as improved consumer confidence as evidenced by the moderate to strong increases in the sales of consumer durables such as passenger cars and motorcycles as well as the import of consumption goods during the second and third quarters of the year.

External demand has also strengthened significantly. Growth in the value of exports in US$ term accelerated to an average of 26% in July and August 1999, reflecting the competitiveness of the external sector which has benefited from a stable ringgit. Imports have picked up since April 1999, indicating a return to positive growth in aggregate demand. As exports continued to outpace imports, Malaysia recorded large trade surpluses for 22 consecutive months since November 1997 through August 1999. The external trade surplus during the first eight months of 1999 amounted to RM46.2 billion, against a surplus of RM32.5 billion during the corresponding period of 1998.

The large surplus in the external trade balance has contributed to a sharp increase in Malaysia's net external reserves to RM119.3 billion or US$31.4 billion (equivalent to 6.5 months of retained imports) by end September 1999 from RM81.5 billion or US$21.5 billion (equivalent to 4 months of retained imports) a year earlier. With Malaysia's short-term external debt declining to about US$7.5 billion, the external reserves position prevailing at end September 1999 was more than four times larger than the short-term external debt. This reflects a significant strengthening of the resilience of the economy to potential outflows of short-term capital. Prudent external borrowing as well as strengthening of export earning has enabled Malaysia's external debt servicing ratio to remain low, at 6.2%.

In the banking sector, the efforts of Danaharta, Danamodal and CDRC as well as the recovery of the economy have helped to strengthen the banking system. The risk-weighted capital adequacy ratio of the banking system has strengthened to 12.8% by end August 1999 from 11.8% at end 1998 and 10.5% at end 1997. This level of capital is significantly higher than the Basle standard of 8%. NPL ratio based on 6 month classification has stabilised at 7.9% since March this year through July, while NPL ratio based on 3 month classification has improved to 12.4% at end July from 13.4% at end of 1998. The restructuring of the banking sector has strengthened banks' intermediation function, enabling them to increase their loan approvals and disbursements.

With economic recovery, the strengthening of the nation's resilience to external shocks and the significant progress that has been made in restructuring the banking system, confidence in the financial market has improved markedly since early September 1998 through 15 October 1999.

The economic recovery has been accompanied by a low rate of inflation and improved employment opportunities. Inflation averaged 3.0% during the first nine months of 1999 while the number of new jobs created per month that was reported to the Manpower Department increased by an annual rate of 114.4% in August 1999 to 12,876 vacancies.

In short, the policy initiatives introduced by the Government have brought about the desired impact. Nevertheless, vigorous efforts will continue to be made to support the recovery process to ensure it is more broadbased and to further strengthen the resilience of the economy.

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