

Overview

A turbulent but positive year...

The world economy turned around earlier than expected as a result of the coordinated approach taken by major economies and posted a strong recovery in the first quarter of 2002, giving rise to optimism for a much improved global economic performance. However, the pace and strength of the recovery faltered on the back of disclosures of a slew of corporate scandals, emerging weak economic data from major economies, widening current account deficit and security problems in the United States (US). Concerns over weak equity markets, political tensions in the Middle East as well as declining consumer spending and investor confidence have further heightened uncertainties of a strong recovery. Nevertheless, the appropriate macroeconomic policy mix pursued by the major economies as well as legislation put in place to clean up corporate fraud is expected to have positive impact on consumer and investor confidence, with world growth anticipated to pick up momentum towards the end of the year.

The need to reinvigorate growth and maintain economic and financial stability was, therefore, given utmost priority at international fora. Discussions centred around the adoption of appropriate policy mix, addressing corporate governance issues and the need to continue with reforms in the financial and banking sectors. Efforts to further strengthen the international financial architecture (IFA) is ongoing, particularly in the area of monitoring and surveillance, peer reviews and monitoring of highly leveraged institutions (HLIs). Issues relating to combating the financing of terrorism and money laundering have gained prominence after 11 September

2001 and are being dealt with in a concerted manner. Progress also continues to be made on the regional front with efforts focussed on further strengthening the self-help and support financial mechanism.

World Economy

World economic performance improves...

Growth in world economy is expected to strengthen modestly in 2002 to 2.8% (2001: 2.5%), with momentum picking up towards the end of the year, as shown in *Table 6.1*. **World output** will still be largely driven by the US, which is anticipated to register a stronger real gross domestic product (GDP) growth of 2.2% (2001: 0.3%).

The US posted a real GDP growth of 3% in the first six months of the year contributed by a rise in production of automobiles, utilities, military and business equipment as well as sustained consumer spending. However, since May, growth has moderated partly due to the slump in the financial markets arising from declining investor confidence in reported corporate earnings and exposures of fraudulent management and accounting practices. Legislation enacted in August to address corporate and accounting malpractices is expected to have some stabilising effect on business and consumer confidence. In Europe, a modest growth is envisaged, aided by generally better external conditions as reflected in the first half of the year. The Japanese economy registered a 0.5% growth in the second quarter (Q1 2002: 0%) supported by a pick-up in exports and industrial production. With the current trend continuing into the year, the economy is expected to record a better performance overall. Similarly,

TABLE 6.1

**Global Economic Indicators
2001-2003**

	Real GDP (%)			Inflation (%)			Unemployment (%)		
	2001	2002 ^e	2003 ^f	2001	2002 ^e	2003 ^f	2001	2002 ^e	2003 ^f
World	2.5	2.8	3.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Advanced countries	1.2	1.7	2.5	2.2	1.3	1.8	6.0	6.4	6.2
Developing countries	4.0	4.2	5.2	5.7	5.8	5.1	n.a.	n.a.	n.a.
Newly Industrialised Asian Economies	0.8	3.6	5.1	1.9	1.3	1.9	4.3	4.1	3.3

^e Estimate.^f Forecast.

n.a. not available.

Source: IMF World Economic Outlook, April 2002 and various sources.

growth prospects for most developing countries, particularly the export-dependent economies, are expected to improve in tandem with the upturn in global economy and rebound in demand for high-tech products as well as improved commodity prices.

World trade in goods and services, which suffered a sharp dent due to the global economic slowdown in 2001, is envisaged to bounce back from -0.2% to record 2.5% this year. Fuelled largely by an upturn in the electronics sector as well as a pick-up in inventory build-up, world trade is set to gain stronger momentum in the second half of the year. However, trade volumes are not expected to regain the levels of the 1990s until the end of 2003.

Despite the challenging external environment, world merchandise trade is forecast to expand among transition economies that depend on foreign direct investment (FDI) inflows, oil exporting countries as well as the People's Republic of China (China) and India. Among Latin American countries, except for Argentina, Brazil and Uruguay whose economies are experiencing difficulties, trade performance is expected to improve in tandem with the US

recovery in investment and inventory cycles. Trade in services is also set for a modest recovery. The travel and transportation sector, which was particularly hard hit by the events of 11 September, is projected to improve as the world economy picks up. In contrast to other countries in Europe and Asia where services trade was affected by the global slowdown, Ireland, China, India and the transition economies have continued to exhibit resilience in the services sector attributed to strong contribution from software development and tourism.

World inflation is generally expected to remain tame despite the turnaround in the global economy. In advanced countries, inflation is projected to fall to an all-time low of 1.3% in 2002 (2001: 2.2%) due to soft labour market conditions, excess capacity in some industries and increasingly competitive international business environment. In Japan, deflation appears to be a nagging problem due to weak consumer sentiment and depressed domestic demand while in developing countries inflation is forecast to increase marginally to 5.8% (2001: 5.7%), reflecting moderate economic recovery. Tensions in the Middle East, however, could raise fuel prices resulting in higher inflation.

As at end of August 2002, the best performing bourses were found in Asia, with that of Bangkok and Jakarta leading the pack, as shown in *Table 6.2*. In contrast, London and New York fared poorly. Overall, **stock markets** which were adversely affected by the burst of the information technology (IT) bubble in 2001 have been trending downwards since early this year. Investor confidence has been affected by corporate scandals and weak corporate earnings, particularly in the US. In contrast, the Asian bourses have been less severely affected by the gyrations in the US and European stock markets. The region has shown greater resilience, strengthened by improvements in macroeconomic fundamentals accruing from macro and sectoral policy adjustments as well as financial and corporate reforms, including corporate governance, since the Asian financial meltdown.

The Dow Jones Industrial Average traded within a moderate range of 9,500-10,500 points from January to May, dampened by weak investor sentiment which reacted towards news of estimated weak corporate earnings for the second quarter and corporate failures as well as the worsening US current account deficit. The Dow plunged to 7,702.34 points on 23 July 2002, the lowest level since October 1998. Market sentiment remains pessimistic as prospects for growth in the US economy point towards weakness. However, positive developments in productivity gains, indications of continued investment in computer equipment and software expenditure as well as recent legislation and other initiatives to improve accountability, corporate governance and pension regulations are expected to boost investor confidence and help arrest any further decline in the equity markets.

Poor market sentiment has been similarly reflected in the performance of IT stocks. NASDAQ, which has been trending downwards since its peak of 5,048.62 points on 10 March 2000, dropped to the lowest level for the year at 1,206.01 points on 5 August 2002. With the corporate reform bill in place to act more decisively against erring

companies, thereby instilling confidence, it is envisaged that the market will stabilise and perform better towards the end of the year.

The FTSE index in the first five months of 2002 averaged 5,200 points. Positive sentiment was supported by the strengthening of the United Kingdom (UK) economy in the first quarter. Prices, however, began to tumble at the end of May, mirroring the slide in the US equity markets. Weak investor sentiment continues to depress the market and on 24 July the FTSE touched a new low since the September 11 incident at 3,777.10 points. The market, however has firmed on account of positive sentiments arising from the prospect of further cuts in interest rates in US.

In Asia, the performance of the Japanese stock market has continued to be volatile. Having hit its lowest for the year at 9,420.85 points on 6 February, the Nikkei rose steeply to almost touch 12,000 points by early March, contributed by inflow of foreign funds. The market fluctuated within a narrow range of 11,000 to 12,000 points from March to May before sliding steeply to 10,100 points at the end of June 2002, depressed by concerns over the strong yen appreciation which affected exports, translating into lower corporate earnings. Since late July, the index has continued to trend downwards trading below 10,000 points over concerns of setback in the US recovery.

The Hang Seng Index has been fluctuating between 9,770 points to 11,900 points since January 2002, compared to a peak of 18,301.69 points on 28 March 2000. The performance of the Hong Kong bourse remains muted, reflecting the weak domestic environment. In addition, the index has also been affected, though less severely, by the vulnerabilities in the US equity markets. However, with the Hong Kong dollar pegged to the depreciating US dollar, the market stands to benefit from higher exports, while China's impressive growth should contribute positively to Hong Kong Special Administrative Region's (SAR) tourism and offshore trade.

In terms of **foreign exchange** movements, up to early 2002, the US dollar strengthened *vis-à-vis* the yen whilst the euro traded within a relatively narrow range against the dollar. The strength of the US dollar was attributed to market perception of the resilience of the economy against the slowdown that began in early 2001. The yen, on the other hand, has been affected by the continued weakness in the Japanese economy. The euro performed relatively better, trailing closely the movements of the US dollar.

The situation, however, changed in April when the value of the dollar fell relative to the euro and yen when the US market reacted negatively to revelations of corporate scandals and, later, of the worsening current account deficit. The dollar continued to slide and, on 15 July fell below parity to the euro for the first time since early 2000, although lasting only a week. At the end of August, the yen had appreciated by 11.3% against the dollar, while the euro gained 11.2% since the beginning of the year, as shown in

TABLE 6.2

Stock Markets

	1 September 1998	End 2001	End August 2002	Change (%) ¹	Change (%) ²
Stock Markets					
Bangkok	211.09	303.85	361.72	71.4	19.0
Hong Kong SAR	7,062.47	11,397.22	10,043.87	42.2	-11.9
Jakarta	325.85	392.04	443.67	36.2	13.2
Kuala Lumpur	262.70	696.09	711.36	170.8	2.2
London	5,118.70	5,217.40	4,227.30	-17.4	-19.0
Manila	1,191.76	1,168.08	1,103.36	-7.4	-5.5
New York	7,827.43	10,021.50	8,663.50	10.7	-13.6
Seoul	309.71	693.70	736.40	137.8	6.2
Singapore	823.33	1,623.60	1,488.50	80.8	-8.3
Taipei	6,335.09	5,551.24	4,764.94	-24.8	-14.2
Tokyo	14,369.63	10,542.62	9,619.30	-33.1	-8.8

¹ Percentage change between 1 September 1998 and end August 2002.

² Percentage change between end 2001 and end August 2002.

Source: Kuala Lumpur Stock Exchange and various sources.

TABLE 6.3

Foreign Exchange

	2 September 1998	End 2001	End August 2002	Change (%)
Currencies (Against USD)				
Euro ¹	-	0.89	0.99	11.2
Indonesian rupiah	10,750.00	10,410.96	8,857.81	17.5
Japanese yen	136.98	131.24	117.96	11.3
Korean won	1,344.50	1,318.07	1,199.87	9.9
Malaysian ringgit	3.80	3.80	3.80	0.0
New Taiwan dollar	34.77	35.01	34.23	2.3
Philippine peso	43.04	51.60	51.81	-0.4
Singapore dollar	1.73	1.85	1.75	5.7
Thailand baht	40.55	44.17	42.19	4.7

¹ USD against euro

Source: Bank Negara Malaysia.

Table 6.3. The depreciation of the dollar has been attributed to corporate governance issues, the slowdown in capital inflows into the US, reluctance to hold US assets as well as concerns over the ability of the US to finance the twin trade and budget deficits. A weak dollar, however, may bode well for the US economy as it would boost exports and improve corporate profitability as was reflected in the second quarter when exports grew by 11.7% compared to the preceding quarter (Q1 2002: 3.5%).

For Japan, however a weak dollar could render her exports less competitive and pose a threat to the nascent recovery that began during the first quarter, contributed by the global demand for electronics. Conversely, a stronger euro is anticipated to boost consumer spending while restraining price pressures as a result of cheaper imports.

Advanced Countries

Signs of recovery amidst mixed signals...

For the first time in more than two decades, the three major engines of global economic growth, that is, the US, Japan and Europe, experienced synchronised downturns in 2001. However, growth in **advanced economies** is expected to pick up from 1.2% in 2001 to 1.7% in 2002, driven by the US. In general, the implementation of accommodative macroeconomic policies across the board, upturn in the global electronics cycle and renewed business and consumer confidence have helped spur growth among the advanced countries.

Growth in advanced countries is expected to be strongest in the **United States**. Real GDP growth moderated to 1.1% in the second quarter after posting a strong first quarter growth of 5%, as reflected in the US Institute for Supply Management (ISM) factory index falling from 56.2 in June to 50.5 in July and August. However, consumer spending continues to remain strong led by purchases of houses and durable goods, with exports as well as business investment in equipment and software increasing in the second quarter.

For the year, the US is expected to achieve a real GDP growth of 2.2% (2001: 0.3%), sustained by strong fundamentals of low inflation and strong productivity growth. The historically low overnight inter-bank rate of 1.75% is expected to continue boosting mortgage-refinancing activities and interest rate-sensitive purchases, such as durable goods as well as promote business spending as shown in *Chart 6.1*. Likewise, discretionary government expenditure on military and internal security, in addition to tax cuts contained in the USD1.35 trillion ten-year package, will also help to sustain the pace and momentum of growth in the economy. However, concerns remain, particularly with regard to the huge current account deficit now standing at 4.25% of GDP, the volatility of the US dollar, weak capital spending as well as corporate governance and security issues.

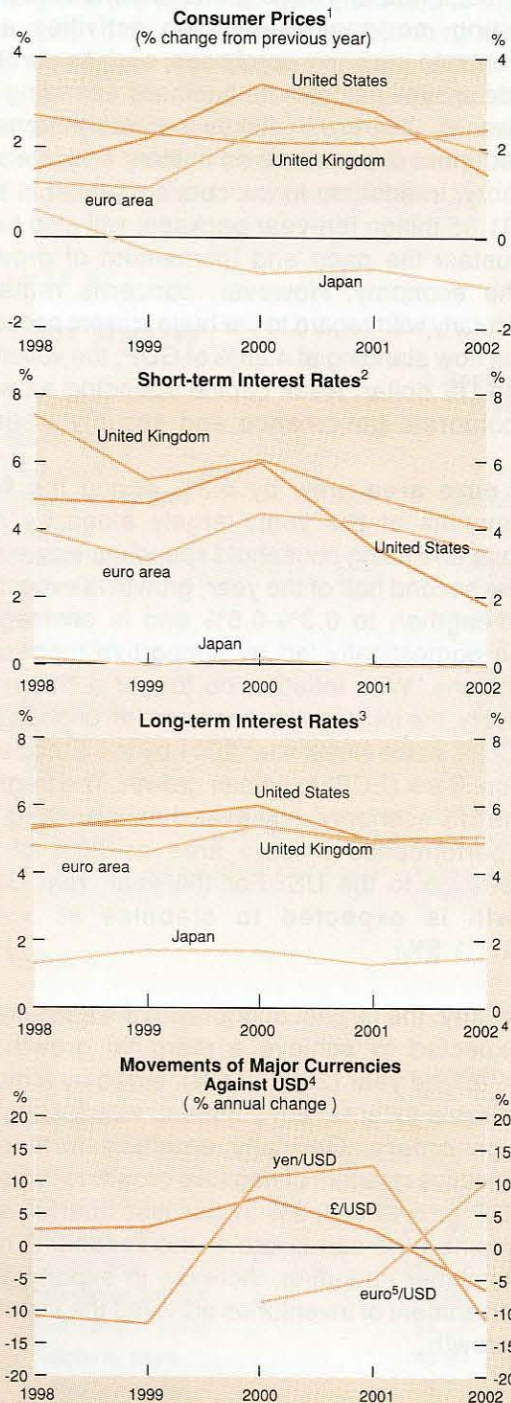
The **euro area** grew by 0.3% during the first six months of the year, largely aided by net exports and rising household spending. However, for the second half of the year, growth is expected to strengthen to 0.3%-0.6% and is envisaged to be domestically-led by supportive monetary conditions. With inflation no longer a threat to recovery, the interest rate has been left unchanged at 3.25% since November 2001 by the European Central Bank (ECB) to bolster growth. The fragility of the US economy, however, has a bearing on the performance in euro area as 20% of its exports go to the US. For the year, real GDP growth is expected to stabilise at 1.4% (2001: 1.5%).

Germany, the largest economy in the euro area, is expected to achieve a marginal growth of 0.7% for the year (2001: 0.6%), aided by a more favourable external environment, which spurred foreign orders. Germany emerged from two consecutive quarters of negative growth to register a GDP growth of 0.3% in the first quarter and maintained the same rate in the second. A rise in consumer spending, increase in exports and replenishment of inventories provided the impetus for growth.

Outside the euro area, real GDP growth in the **United Kingdom** in the second quarter strengthened to an estimated 1.5% (Q1 2002: 1.1%) supported by household spending, higher

CHART 6.1

Current Trends in Key Economic Determinants in Advanced Countries 1998-2002



¹ 2002 figures are estimates.

² Averages of interest rates weighted by the average USD value.

³ Average yield on Government bonds

⁴ Up to April 2002.

⁵ euro was introduced in 1999

Source: IMF, World Economic Outlook, April 2002.

value-added growth in manufacturing and services as well as government spending on schools, transport, housing and defence. However, latest economic data paint a mixed picture on the outlook for the second half of the year. Despite a drop in manufacturing production in June due to weak external demand and a dramatic rise in company insolvencies in the second quarter, consumer spending remains on the uptrend.

Faced with uncertainties in the external environment and doubts regarding the strength of the UK recovery, the Bank of England (BOE) has maintained the benchmark interest rate at a 38-year low of 4% after paring it seven times in 2001 to boost domestic growth. Real GDP growth for the year is forecast to moderate at 2% (2001: 2.2%).

After 19 months of contraction, the **Japanese economy** rebounded to register a real GDP growth of 0.5% in the second quarter (Q1 2002: 0%), aided by rising exports mainly to the US and Asia as well as a pick-up in industrial production. The improved export earnings has, in turn, bolstered corporate profits and business sentiment. Japan's recovery, however, stands at risk from an appreciated yen *vis-a-vis* the US dollar, which will make Japanese exports less competitive.

In addition, concerns remain about high corporate and government debt, rising unemployment, falling prices as well as weak domestic demand. As the US absorbs a third of Japanese exports, the faltering recovery of the US economy may have an impact on Japan's nascent recovery. However, this is envisaged to be mitigated by Japan's rising exports to Asia, which has been on the upward trend for five straight months, registering 19% in July. Exports comprised mainly computer chips and steel to China.

East Asia

The fastest growing region...

East Asia, led by China, the Republic of Korea (ROK) and Taiwan, has been the fastest growing region since the Asian financial crisis. Real GDP growth is expected to accelerate to a robust

5.2% in 2002 (2001: 4.3%) spurred by a rebound in the global electronics cycle. Further, with intra-regional trade now accounting for a larger share of total trade, these economies including the Association of South-East Asian Nations (ASEAN) stand to gain from China's strong economic performance, which is expected to further enhance the growth momentum.

China grew at a blistering pace of 8% in the second quarter, after a strong first quarter growth of 7.6%. Growth was boosted by exports and strong state spending on housing, roads, airports and other infrastructure projects. Exports, which accounted for 20% of GDP, were mainly from foreign manufacturers who had benefitted from China's entry into the World Trade Organisation (WTO). China is expected to continue attracting FDI in search of low labour costs and a huge domestic market. With the yuan, one of the three Asian currencies pegged to the dollar, the weakening of the US dollar since April has provided Chinese exports the competitive edge.

Real GDP growth for the year is expected to remain one of the highest in the world at 7.5% (2001: 7.3%), as shown in *Table 6.4*. However, weak domestic demand remains a concern and China is expected to rely on state spending, exports and FDI to achieve the high growth target.

Aided by low interest rates and a combination of corporate, income and consumption tax cuts as well as a fiscal stimulus package directed at the construction sector, real GDP in the **Republic of Korea** grew by 5.7% in the first quarter. As the economy gathered steam, the Bank of Korea (BOK) on 7 May 2002 raised its overnight call rate, one of the few central banks to do so, from 4% to 4.25% in order to ward off inflationary pressures without constraining economic activity. Though the higher interest rate cooled the home-buying boom, real GDP in the second quarter continued to strengthen to 6.3%, driven by still buoyant consumer spending and rising exports of computer chips, cars and other goods.

With strong fundamentals in place, the Korean economy is anticipated to maintain its high growth momentum. Foreign reserves, which fell to USD 3,900 million at the height of the crisis in 1997,

TABLE 6.4

East Asian Economies: Major Economic Indicators 2001-2003

	2001	2002 ^a	2003 ^f
Gross Domestic Product* (%)			
China	7.3	7.5	7.2
Japan	-0.4	0.0	1.1
Republic of Korea	3.0	6.5	5.8
Taiwan	-1.9	3.1	4.0
Inflation (%)			
China	0.7	0.3	1.5
Japan	-0.7	-1.1	-0.5
Republic of Korea	4.1	2.7	2.6
Taiwan	-0.01	0.4	1.6
Current Account Balance (% of GDP)			
China	1.7	1.1	0.5
Japan	2.1	2.9	3.4
Republic of Korea	2.0	1.5	0.6
Taiwan	6.7	6.6	6.6

* Real GDP.

^a Estimate.

^f Forecast.

Source: IMF World Economic Outlook, April 2002 and various sources.

have risen to USD115,500 million as of end July 2002, a result of strong export performance and higher FDI inflows which responded positively to the liberalisation in the capital account. Total external debt is expected to fall from 33.4% of GDP in 1997 to 24.1% in 2002. For the year, real GDP growth is envisaged to accelerate to 6.5% (2001: 3%).

As the world's fourth largest IT hardware manufacturer, **Taiwan** benefitted from the upturn in the global electronics market. After three consecutive quarters of decline, Taiwan emerged from recession to post a real GDP growth of 0.9% in the first quarter, which subsequently strengthened further to 4% in the second quarter. However, downside risks remain. Domestic demand continues to be subdued owing to high unemployment, which averaged 5.2% in the second quarter as well as stagnant wages. To

revitalise domestic demand, the China Central Bank reduced its discount rate 13 times since December 2000 to 1.87%. In addition, the Government has also set up the Financial Restructuring Fund and instituted legislation to hasten the pace of corporate and financial restructuring. Real GDP growth for the year is expected to rebound to 3.1% (2001: -1.9%) while inflation is forecast to remain at a low of 0.4%.

Developing Countries

Growth strengthening in developing countries...

Among **developing countries**, the extent of rebound from the 2001 downturn varies. For the more open and globally integrated Asian countries, exports have risen since late last year in tandem with improvement in world electronics demand. At the same time, domestic demand, which cushioned the slowdown in 2001, is strengthening in several Asian countries. Coupled with an upturn in global demand, manufacturing output has increased strongly during the first quarter of the year in several countries.

In Latin America generally, Mexico and countries in Central America, growth is anticipated to rebound moderately in the light of improving economic and financial prospects in the US. However, several Latin American countries, namely Argentina, Brazil and Uruguay, are expected to register lower growth as they have to contend with macroeconomic imbalances. Reflecting their varied economic performance, developing countries are expected to register a moderate real GDP growth of 4.2% (2001: 4%).

ASEAN countries were also affected in varying degrees by the global slowdown in 2001, with Singapore being most severely hit. Nevertheless, with the implementation of counter-cyclical measures, financial and corporate reforms well under way, rising intra-ASEAN trade and

improvements in the external environment, the region is poised for stronger growth of between 3.4% and 4% (2001: 2.8%). Inflation is expected to remain subdued across the region except for Indonesia, where it is expected to be higher at about 9%.

Singapore's real GDP growth contracted 2% in 2001. Growth remained in negative territory in the first quarter at 1.5% before rebounding to a positive 3.9% in the second, aided by external demand for manufactured goods and transport related services. Expansion in the manufacturing sector, which saw four quarters of decline, came from pharmaceuticals and electronics. Real GDP growth for 2002 is projected at 3%-4%.

In order to sustain the growth momentum and stay competitive, the Singapore Government introduced various incentives which would effectively narrow its fiscal surplus to 0.6% of GDP in 2002 (2001: 1.6%). Both corporate and personal income tax rates are to be reduced in stages, beginning 2001 from 24.5% and 26.5%, respectively, to 20% in 2004. In addition, enhanced tax incentives are provided for the financial sector while employees are to be given stock options. To offset the loss in tax revenue, the goods and services tax (GST) is to be raised to 5% from 3% effective 1 January 2003. To complement the fiscal policies, the Monetary Authority of Singapore (MAS) on 11 July 2002, announced the continuation of its neutral exchange rate policy stance adopted in mid 2001. This is aimed at maintaining the stability of the Singapore dollar and keeping inflation in check, thereby preventing further erosion in her export competitiveness.

As part of an overall long-term strategy to accelerate growth, the Singapore Government has embarked on a programme to broaden its economic base. This entails developing new growth areas in education, health care, and information, communications and media. Emphasis is being given to higher value-added activities such as biomedical sciences, IT and larger wafer fabrications whilst electronics, chemicals, shipping, engineering as well as financial services are being strengthened.

Led by the services sector, in particular transport and communications, as well as rising electronics exports, real GDP growth in the **Philippines** expanded 4.5% in the second quarter (Q1 2002: 3.7%). Consumer spending has also been robust due to strong earnings from the agriculture sector, falling interest rates, a reasonably stable exchange rate and rising remittances from overseas workers. However, with farm production growth slowing down to 2.5% in the second quarter, as against a targetted growth of 3.7%, agriculture which accounts for 20% of GDP, may affect the real GDP forecast of 4%-4.5% (2001: 3.9%) for the year. The outlook for the sector, which employs 40% of workers, is anticipated to worsen with the *El Nino* dry weather phenomenon expected in the second half of the year.

A potential growth area, which has been identified and given prominence by the Government is e-services for which the Philippines has a comparative advantage in its English-speaking labour force. The major e-services identified are medical transcription and call centre services, shared financial services, software development services as well as construction-related engineering and design. These services are expected to contribute USD1,700 million to the economy by 2004.

Driven by domestic demand, real GDP growth in **Thailand** in the first quarter rose by 3.9% (Q4 2001: 2.1%). The low interest rate of 2% has spurred borrowings which, in turn, triggered private investment, consumption and manufacturing activities. In addition, the Government's fiscal stimulus package, which focussed on rural development and public works programme, has boosted investor confidence.

Real GDP grew by 4.9% in the second quarter bolstered by low interest rates and positive consumer sentiment as reflected in higher car sales and growth in credit card issuance. Manufacturing production in a number of industries, including electronics and electrical appliances, iron and steel products, construction

materials and vehicles also rose by almost 8% (Q1 2002: 4.4%). Signs of recovery were also evident in private investment, especially in metal products, machinery and automobiles. Driven by external demand for resource-based products, exports rose by 4.5% while imports grew by 5.5% mainly for durable and capital goods in the second quarter.

Despite the strong growth registered in the first half of the year, Thailand faces a number of challenges to sustain the momentum of growth. The weak external environment coupled with the sluggish growth in Japan and the US, her major trading partners, could adversely affect exports. Increasing competition from China's cheaper exports is also a factor to be considered. Real GDP growth for 2002 is projected at 3%-4% (2001: 1.8%).

Real GDP growth for **Indonesia** accelerated to 3.5% in the second quarter (Q1 2002: 2.2%) driven by strong business and consumer spending amidst a conducive political environment and favourable interest rates. Both exports and imports recorded a strong quarter-on-quarter growth after two consecutive quarters of decline. Amidst a more stable political environment, and with commodity prices improving as well as the pace of net capital outflows slowing down, Indonesia is anticipated to achieve a real GDP growth of 3%-4% (2001: 3.3%).

In contrast to other countries in the region, Indonesia faces inflationary pressures due to higher telecommunication and transportation costs following the removal of subsidies on fuel. In order to achieve its policy objective of attaining single digit inflation by the end of 2002, Bank Indonesia has continued to mop up excess liquidity in the economy. Inflation has, therefore, continued to decline for five consecutive months since March to 10% in July, thereby creating a more favourable business environment.

To regain investor confidence as well as reduce business risks, efforts at strengthening the resilience of the banking system and improving

financial market supervision continue to be undertaken. In addition, the Government continues to promote corporate debt and credit restructuring under the Jakarta Initiative Task Force, Indonesian Bank Restructuring Agency (IBRA) and the Bank Indonesia Credit Restructuring Task Force.

Financial Cooperation and Trade Developments

Initiatives for sustainable growth remain a priority...

Taking into account the uncertain pace at which the global economy has been growing and the existence of security threats, international meetings on financial cooperation and trade developments in 2002 have centred on two major areas of concern: the need for countries to work together towards strengthening growth and combating the financing of terrorism. Financial cooperation is conducted through the Finance Ministers processes and other meetings. Malaysia actively participated in the Fourth WTO Ministerial Conference convened in 2001, the Finance Ministers meetings within ASEAN, ASEAN+3 (China, Japan and the ROK), Asia Pacific Economic Cooperation (APEC), Asia-Europe Meeting (ASEM) as well as the annual meetings of the International Monetary Fund (IMF) and World Bank in 2002.

Significant progress was achieved in a number of initiatives to further enhance regional cooperation, particularly between **ASEAN** and **ASEAN+3**. In relation to the regional financing arrangement, ASEAN+3 has made great strides in the implementation of the regional self-help and support mechanism of the **Chiang Mai initiative (CMI)**, which was launched in May 2000 in Chiang Mai. The aim of the CMI is to provide liquidity support in the event of temporary balance of payments difficulties, through the establishment of a network of bilateral swap arrangement (BSA) between ASEAN and ASEAN+3 member countries.

To date, eight agreements on BSAs between Japan and ROK, Japan and Thailand, Japan and the Philippines, Japan and Malaysia, China and Thailand, China and Japan, China and ROK as well as ROK and Malaysia, with a total value of USD20,000 million, have been concluded and signed. Negotiations on two BSAs between ROK and Thailand and ROK and the Philippines are already at an advanced stage, while negotiations for another four BSAs between Japan and Indonesia, Japan and Singapore, China and Malaysia as well as China and the Philippines have been initiated. In addition to the CMI, the Miyazawa Initiative between Malaysia and Japan and between Japan and ROK were renewed with a combined size of USD7,500 million, of which Malaysia's portion is USD2,500 million.

In moving forward the regional self-help financing arrangement, the ASEAN+3 Finance Ministers mandated the ASEAN+3 Study Group to explore appropriate **mechanisms to enhance economic reviews and policy dialogues** among the ASEAN+3 member countries. Co-chaired by Malaysia and Japan and comprising senior finance and central bank officials, the Study Group has so far met twice, in Kuala Lumpur and Yangon, to work towards a mechanism to encourage regular reporting of member countries' economic situations and the exchange of views on policy issues among member countries. For a start, the finance and central bank deputies met informally in Yangon in early April 2002, that is, on the fringe of the **Sixth ASEAN Finance Ministers Meeting (AFMM)** to discuss regional economic and policy issues. In view of the need to continuously explore and upgrade the dialogue process, a subsequent Study Group and informal meeting is scheduled to be held in Tokyo in November 2002.

ASEAN Finance Ministers also conducted a peer review session and exchanged views on regional economic developments and prospects in line with the **ASEAN Surveillance Process (ASP)**, which was established in 1998 to undertake regional economic surveillance and act as an early warning system to alert member countries

of any impending financial crisis. Another notable achievement is the **Finance Work Programme** under the **Hanoi Plan of Action (HPA)**. This Programme, launched at the ASEAN Leaders Summit in December 1999 comprises a number of activities aimed at expediting economic recovery and promoting integration among ASEAN members. With regard to the reform of the IFA, ASEAN Finance Ministers agreed that a common ASEAN position on the monitoring of hedge fund activities that may be articulated at relevant international fora would help further the cause.

The **liberalisation of financial services in ASEAN countries** has been progressing gradually in accordance with the ASEAN Framework Agreement on Services (AFAS) which was signed by the ASEAN Economic Ministers on 15 December 1995. The aim of AFAS is to develop and enhance the competitiveness of the financial services sector in ASEAN countries through its gradual and progressive liberalisation, taking into account the various levels of financial sector development in each country as well as the need for prudential regulation, effective supervision and capacity building to guide its implementation. Member countries would also be given sufficient flexibility in scheduling the liberalisation of the financial sector in line with their respective development needs.

In this regard, the ASEAN Finance Ministers also agreed that each member country should offer a commitment that is better than the existing commitment under the General Agreement on Trade in Services, that is, a "GATS-plus" commitment. The commitments should be made in at least one common sub-sector, where four or more member countries have made commitments under the GATS or AFAS.

The member countries have since successfully concluded the second round of negotiations on the liberalisation of financial services with the signing of the *Protocol to Implement the Package of Commitments on Financial Services under AFAS* in Yangon at the close of the Sixth AFMM in early April 2002, with commitments for further

liberalisation by all member countries, particularly in banking, insurance and other financial services sectors. The Ministers also agreed to launch a third round of negotiations, which is expected to be concluded in 2004.

Progress has also been made in the development of a **regional early warning system (EWS)**, through technical assistance from the Asian Development Bank (ADB). The EWS prototype has been developed and currently, the ADB is in the process of refining it in preparation for the next EWS seminar in Beijing in October 2002.

The Finance Ministers Process also extends to cooperation at the Asia Pacific Economic Cooperation (APEC) level. In this regard, **APEC Finance Ministers convened their ninth meeting** in Los Cabos, Mexico in early September 2002, to examine the latest international and regional macroeconomic and financial developments, discuss measures to promote confidence, reduce uncertainties and expedite world economic recovery. This year's process was guided by three policy themes, namely, *combating the financing of terrorism and money laundering, advancing pending fiscal and financial reforms as well as improving the allocation of domestic savings for economic development*.

Terrorism financing continued to feature prominently in international fora. A policy dialogue among Ministers evaluated the way enhanced cooperation and measures against terrorism and money laundering have influenced economic recovery and financial stability. The dialogue also considered the policies and measures needed to be strengthened or implemented in order to curb the financing of terrorism and related crimes.

The Fourth Asia-Europe (ASEM) Finance Ministers Meeting, held in Copenhagen in early July 2002, was attended by Finance Ministers or their representatives from ten Asian countries and fifteen European Union (EU) members under the chairmanship of the Danish Presidency of the EU. Various issues of common interest were

COMBATING THE FINANCING OF TERRORISM, MONEY LAUNDERING AND ABUSES OF THE GLOBAL FINANCIAL SYSTEM: AN UPDATE ON MEASURES TAKEN BY MALAYSIA

Malaysia is concerned about the formidable challenge posed by terrorism to international peace and security as well as to economic development. Financing of terrorism and the abuse of the global financial system take many forms—they are multilateral, multi-institutional and multi-jurisdictional. Countering them calls for international cooperation. Recognising this, Malaysia has, at the national level, tightened legislation and strengthened the institutional framework while at the international level, works with other nations through participation in the **Asia/Pacific Group on Money Laundering (APG)** and other fora.

1. Measures taken at the National Level

- **National Co-ordination Committee to Counter Money Laundering**

The National Co-ordination Committee to Counter Money Laundering (NCC), comprising representatives from various law enforcement agencies was established in April 2000, with Bank Negara Malaysia (BNM) as the lead agency. Its objective is to develop and ensure proper implementation of measures to counter money laundering based on internationally accepted standards as contained in the FATF Recommendations.

- **Inter-agency Working Group**

An Inter-agency Working Group led by the Ministry of Foreign Affairs (Wisma Putra) was recently formed to review the United Nations (UN) Convention for the Suppression of the Financing of Terrorism before Malaysia accedes to it.

- **Legal Framework**

The **Anti-Money Laundering Act 2001 (AMLA)** was gazetted on 5 July 2001 and enforced with effect from 15 January 2002. The AMLA covers the offence of money laundering in general, investigation, freeze, seizure and forfeiture of the proceeds of serious crimes, suspicious transaction reporting and record-keeping requirements and the establishment of a financial intelligence unit.

The Act provides for 122 money laundering predicate offences, including offences under Sections 125 and 125A of the Penal Code. The inclusion of these provisions enables the same money laundering tracking mechanism to follow the financial trail of terrorists and their fund providers. Section 125 of the Penal Code provides for an offence of waging war against any power in alliance with His Majesty the King. Section 125A of the Penal Code makes it an offence for harbouring or attempting to harbour any person in Malaysia or person residing in a foreign State at war or in hostility against His Majesty the King. The term 'harbour' is defined in Section 130A to include supplying a person with money, that is financing terrorists.

Prior to the enactment of the AMLA, there were already provisions under various acts to deal with public order and safety. These include articles in the **Federal Constitution** which deal with subversion, organised violence and acts as well as crimes prejudicial to public order and emergency powers; the **Internal Security Act 1960 (ISA)**, which prevents persons acting in any manner prejudicial to Malaysia's national security, maintenance of essential services or the economic life of Malaysia; the **Penal Code**, which addresses offences against the State, public tranquility and offences affecting the public health, safety, convenience, decency and morals; the **Police Act 1967**, which contains provisions to deal with powers to regulate assemblies, meetings and processions; and the **Firearms (Increased Penalties) Act 1971**, which provides increased penalties for the use of firearms in the commission of certain offences and for other offences relating to firearms.

- **Financial Intelligence Unit (FIU)**

The Minister of Finance appointed BNM as the competent authority to carry out the provisions of the AMLA. FIU was therefore established within BNM on 8 August 2001 to facilitate and co-ordinate the implementation and enforcement of the AMLA and cooperate with other countries in the fight against the abuse of the global financial system.

2. International Cooperation

- **Legal Framework**

Section 10 of the AMLA allows the FIU to communicate financial intelligence with its counterpart overseas if an arrangement exists between both parties. Section 29(3) empowers it to cooperate with any law enforcement agency in and outside the country in investigations into any foreign serious offences.

The **Mutual Assistance in Criminal Matters Act 2002** extends the scope of assistance and cooperation to any offence which, upon conviction, is liable to imprisonment for a term of one year and above, or the death penalty.

The **Extradition Act 1992** contains provisions to deny asylum and/or extradite fugitive criminals.

- **Application of the UN Resolutions and Conventions**

Malaysia has signed and/or ratified the following 4 Conventions:

- ✓ Convention on Offences and Certain Other Acts Committed on Board Aircraft;
- ✓ Convention for the Suppression of Unlawful Seizure of Aircraft;
- ✓ Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation; and
- ✓ Protocol on the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation.

The UN Security Council Resolutions No. 1333 (2000) and No. 1267 (1999) and 1373 (2001) which call for amongst others, freezing any funds of entities relating to Osama bin Laden and the Taliban, were implemented through circular letters under the Exchange Control Act 1953. To date, BNM has issued seven circular letters to financial institutions since 1 October 2001. The Labuan Offshore Financial Services Authority (LOFSA) has also issued similar circulars to the offshore industry.

- **Actions through Multilateral Fora**

Malaysia has been a member of the APG, which is a FATF-style regional body, since 31 May 2000. Membership in the APG has allowed the sharing of knowledge and experiences relating to efforts to counter money laundering activities.

- Malaysia, Indonesia and Philippines signed a Trilateral Agreement on Terrorism on 7 May 2002 to strengthen cooperation in addressing cross-border incidents and transnational crimes. Cambodia acceded to this Agreement on 1 August 2002. Through this Agreement, the intelligence agencies of the four countries would be able to work more cohesively in the fight against terrorism.
- A Joint Declaration of Cooperation to Combat International Terrorism was signed with the United States on 14 May 2002, which, among others, allows for the disclosure of intelligence and terrorist financing information, documents and data received.
- Malaysia is a party to the ASEAN-US Joint Declaration for Cooperation to Combat International Terrorism that was signed between ASEAN member countries and the US on 1 August 2002.
- A Memorandum of Understanding on Cooperation to Combat International Terrorism was also signed with Australia on 2 August 2002.

3. Conclusion

Malaysia recognises that the fight against terrorist financing and money laundering goes beyond the sovereign state and is prepared to work with the international community to curb the abuses of the global financial system as well as eradicate all forms of money laundering and terrorist financing.

addressed at the meeting including combating the financing of terrorism, money laundering and the abuses of the global financial system, strengthening the international financial system as well as monetary and financial co-operation. Malaysia was invited to speak on the progress achieved in putting in place the legal and institutional framework to combat the abuse of the financial system, which covers the banking and insurance sectors as well as the money lenders (see *Feature Article*). Germany, the other speaker, highlighted issues with regard to the misuse of correspondent banking, cross border money transfers, automated wire transfers and the non-transparent alternative remittance services. Toward this end, the Ministers welcomed Germany's offer to co-host with Malaysia, a symposium on countering underground banking as well as the need to supervise alternate remittance services in ASEM countries in Berlin in mid July 2003. In a move towards acceptance of common standards in the fight against the abuses of the global financial system, the Ministers encouraged ASEM members to adopt and implement the Financial Action Task Force (FATF) 40 Recommendations on money laundering, the Eight Special Recommendations on Terrorist Financing as well as the United Nations instruments which, amongst others, call for the freezing of terrorists assets.

The Ministers noted that the European Economic and Monetary Union (EMU) is now complete with the physical introduction of the euro notes and coins in January 2002. The single currency is expected to promote stability and foster growth in the EU as well as facilitate cross-border trade and financial transactions between Europe and other regions including Asia.

ASEM members were also updated by the ADB on the initiatives pursued to strengthen regional and financial cooperation in East Asia which could be viewed from three broad areas, namely information exchange and economic surveillance, regional financing arrangements as well as coordination of macroeconomic and exchange

rate policies. The Ministers reviewed the results achieved under ASEM Trust Fund, Kobe Research Project and the Public Debt Management Forum. The discussion at this meeting would constitute input to the ASEM Leaders Summit to be held in Copenhagen in late September 2002. The Ministers agreed that the next ASEM Finance Ministers Meeting, the fifth in the process, will be held in Indonesia in 2003.

At the XI Summit of the Heads of State and Government of the **Group of Fifteen (G-15)** in Jakarta at the end of May 2001, concerns were raised over the lack of progress in the reform of the IFA to address risks and challenges posed by highly volatile capital flows. The members accepted Malaysia's offer to convene a meeting of G-15 experts to assess progress of current efforts on IFA reforms in order to address the concerns, safeguard the interests as well as advance the position of all developing countries.

The Expert Group on the Reform of the IFA, comprising 19 experts from 17 central banks, which met in Kuala Lumpur in late February 2002, focussed on four areas, namely transparency and disclosure, capital flows, HLIs and reform of the international financial institutions (IFIs). Among other recommendations, the Expert Group called for greater efforts to be given towards IFI reforms, in particular transparency and disclosure; voluntary implementation of standards and codes; international efforts to complement measures taken by domestic economies to manage capital flows; greater transparency in reporting of HLIs to lessen the systemic risks from activities of HLIs and a more balanced voting structure at the IMF.

The Expert Group agreed that the proposed recommendations to hasten the pace of reform of the IFA be submitted to the XII Summit of the G-15 which is to be held later in the year. Once endorsed, these recommendations will reflect the stand of developing countries in general and G-15 members in particular, at the various international fora on IFA reforms.

The Fourth WTO Ministerial Conference, which was held in Doha, Qatar in November 2001, agreed to launch a new round of multilateral trade negotiations, scheduled for completion by 1 January 2005. Called the **Development Agenda**, this new round of negotiations includes the continuation of negotiations in the residual and unresolved issues in the agriculture and services sectors as well as possible negotiations on new areas such as transparency in government procurement, competition policy, environment and investment. In view of the contentious nature of the new areas, it was finally agreed that negotiations would only commence after the Fifth Ministerial Conference in Cancun, Mexico, provided that explicit consensus on the modalities of negotiations was attained. To accommodate the views of a number of developing countries, it was also agreed that the educative process would continue.

With regard to the further liberalisation of the financial services sector, the members agreed to submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003, with a view to completing the negotiations by 1 January 2005. Malaysia continued to participate in these negotiations, guided by the principle of progressive liberalisation in accordance with the time schedule laid out in the Financial Sector Masterplan and the Capital Market Masterplan.

To prepare for the future WTO work programme, Malaysia has established a National Committee on Multilateral Trade Negotiations with 11 working groups to look into the various areas, among others, agriculture, services, investment, trade and environment, competition policy, government procurement and e-commerce. Each of these working groups, chaired by the relevant ministry, comprises membership from all concerned parties, including the private sector. The task of the working groups is to examine and assess the implications of implementing the Doha Development Agenda, develop Malaysia's strategies and position to be taken at upcoming negotiations as well as to update themselves on

the latest developments in Geneva, the headquarters of the WTO. In addition, the Services Sector Working Group has received requests from local industries for the liberalisation of certain overseas markets. These requests have been forwarded to the countries concerned for consideration. Similarly, requests have also been received from abroad for further liberalisation of Malaysia's services sector and these are presently being studied. In addition to the public sector, industry players have also been the target group for education on the benefits, obligations and implications of WTO and the Doha Development Agenda. Towards this end, the National Economic Action Council (NEAC) has organised several seminars and lectures to disseminate information on globalisation, the WTO and related matters.

Outlook for 2003

Towards a more promising year ahead...

A more promising global outlook is expected in 2003, with projections for growth in most regions to be more certain and stronger while unemployment, lower. World trade is envisaged to expand by 6.6% (2002: 2.5%), driving world growth to achieve 3.7% (2002: 2.8%). Even though inflation will be subjected to some upward pressure with the growth momentum gathering speed, it is expected to remain low.

Downside risks to the generally optimistic outlook for 2003 will emanate mainly from the Middle East tensions. Oil prices, which have been on the increase in recent months, may further escalate should the US begin war with Iraq, putting the brake on global growth.

Notwithstanding the downside risks, world growth is envisaged to be on track, with the major economies, US, Japan and the euro area expected to perform better, and global electronics demand rebounding. In the US, higher growth is likely in response to a better trading and investment environment. The threat of trade war when the US imposed tariffs on foreign steel, has receded

TABLE 6.5

**Advanced Countries:
Major Economic Indicators
2001-2003**

	2001	2002 ^a	2003 ^f
Gross Domestic Product* (%)			
Advanced countries	1.2	1.7	2.5
France	2.0	1.3	2.4
Germany	0.6	0.7	2.1
Italy	1.8	1.0	2.3
Japan	-0.4	0.0	1.1
United Kingdom	2.2	2.0	2.8
United States	0.3	2.2	2.6
Euro area	1.5	1.4	2.9
Inflation (%)			
Advanced countries	2.2	1.3	1.8
France	1.8	1.5	1.4
Germany	2.4	1.5	1.2
Italy	2.7	2.2	1.6
Japan	-0.7	-1.1	-0.5
United Kingdom	2.1	2.4	2.5
United States	2.8	1.4	2.4
Euro area	2.6	1.9	1.6
Unemployment (%)			
Advanced countries	6.0	6.4	6.2
France	9.0	9.2	8.7
Germany	7.9	8.2	8.1
Italy	9.5	9.3	8.9
Japan	5.0	5.8	5.7
United Kingdom	5.1	5.4	5.4
United States	4.8	5.5	5.3
Euro area	8.3	8.5	8.2
Current Account Balance (USD billion)			
Advanced countries	-186.4	-192.6	-191.5
France	32.3	32.7	30.7
Germany	10.0	9.4	12.2
Italy	4.0	8.3	11.7
Japan	87.6	110.2	127.0
United Kingdom	-25.1	-31.1	-36.1
United States	-417.4	-435.3	-451.8
Euro area	41.9	50.1	53.8

* Real GDP.

^a Estimate.^f Forecast.

Source: IMF World Economic Outlook, April 2002 and various sources.

TABLE 6.6

**Selected ASEAN Countries:
Major Economic Indicators
2001-2003**

	2001	2002 ^a	2003 ^f
Gross Domestic Product* (%)			
Brunei Darussalam	2.7	<i>n.a.</i>	<i>n.a.</i>
Indonesia	3.3	3.0-4.0	4.0
Malaysia	0.4	4.0-5.0	6.0-6.5
Philippines	3.9	4.0-4.5	3.8
Singapore	-2.0	3.0-4.0	4.2
Thailand	1.8	3.0-4.0	3.5
Vietnam	4.7	5.3	7.0
Inflation (%)			
Brunei Darussalam	-3.1	<i>n.a.</i>	<i>n.a.</i>
Indonesia	12.5	9.0	8.2
Malaysia	1.4	1.9	-
Philippines	4.1	3.5-3.8	4.0-5.0
Singapore	1.0	-0.5-0.5	1.6
Thailand	0.8	0.0-1.0	1.0-2.0
Vietnam	0.5	4.9	3.7
Current Account Balance (% of GDP)			
Brunei Darussalam	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
Indonesia	4.5	1.8	1.4
Malaysia	8.3	6.5	5.8
Philippines	5.6	3.6	3.5
Singapore	23.3	21.4	21.4
Thailand	5.4	4.0	3.1
Vietnam	1.7	-1.6	-2.9

* Real GDP.

^a Estimate.^f Forecast.*n.a.* not available.

Source: IMF World Economic Outlook, April 2002 and various sources.

after the US announced new exemptions on around half of the seriously affected European steel products while legislation has been put in place to address the issue of corporate and accounting scandals. The euro region likewise is expected to show enhanced performance, with real GDP growth doubling to 2.9% (2002: 1.4%), featuring stronger current account balance as well as lower inflation and unemployment in most countries as shown in *Table 6.5*. The most notable progress, however, is seen in Japan, which is expected to emerge from its third recession in a decade. Together with the euro area, Japan will complement growth in the US to provide a more stable global growth.

With regard to the East Asian economies, China's strong economic performance in recent years is expected to continue, given the underlying attraction of China's domestic market and the

positive impact of her accession to the WTO. The anticipated pick-up in the IT and electronics sector and improving external environment are envisaged to drive growth in Taiwan and the ROK. Stronger growth is also envisaged in the export-oriented ASEAN economies dependent on electronics, supported by subdued inflation and strengthened current account positions as shown in *Table 6.6*. China's strong growth performance is expected to be a catalyst for higher growth in the East Asian region, where intra-regional trade is becoming increasingly important. Given the strong macroeconomic fundamentals and policies in place, coupled with strengthened financial and corporate sectors, East Asia is expected to record high growth and emerge a vibrant and dynamic region with vast potentials. Elsewhere, moderate growth is expected in Africa, Middle East, Central and Eastern Europe as well as Latin America.