Economic Management and Outlook

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ECONOMIC REPORT

Overview

Malaysia's economic resilience mitigates adverse impact of external environment and the economy remains on track towards sustained growth...

After experiencing sluggish growth in 2001, the Malaysian economy rebounded strongly in 2002. Higher growth in 2002 bolstered optimism for a stronger economic performance in 2003 in anticipation of an improved world economic outlook. The prospect for a global economic recovery was, however, affected by recent geopolitical developments, in particular the war in Iraq, sporadic incidences of militancy and outbreak of the Severe Acute Respiratory Syndrome (SARS). During the second quarter, consumer and business sentiments in regional economies were particularly affected by the anxiety of a probable prolonged and widespread SARS epidemic that curtailed transport and tourism-related activities besides trade and investment flows.

Against this adverse global environment and concerns of further weakening of the already sluggish global economy, the Government has put in place a package of broad-based pro-growth measures in May 2003. The Package of New Strategies, apart from providing immediate relief for the SARS-affected sectors, was to address structural and organisational issues towards sustaining economic growth in the medium and longer term. The strategic measures introduced boosted confidence necessary to stimulate domestic consumption and investment. In addition, the short war in Iraq and the quick containment of SARS provided the much-needed relief for the economy to ride over the difficult times and remain on track to a firmer growth trajectory. Malaysia's sound economic fundamentals and expansionary fiscal and accommodative monetary policies, supplemented by the Government's proactive stimulus package, have helped to sustain high growth in the real gross domestic product (GDP). After expanding 4.5% in the first half and with prospects of sustained growth in the second half, the economy is set to achieve its targetted growth of 4.5% this year, higher than the 4.1% achieved in 2002.

The economy is expected to be driven by stronger domestic demand reinforced by a modest pick-up in external demand in the second half of the year. Exports will continue to be buoyed by global economic recovery and the upturn in electronics, especially in information technology-related products and equipment. On the domestic front, consumer spending continues to pick up, on account of favourable export earnings and high commodity prices, positive wealth effect from better stock market performance as well as rising consumer confidence. All sectors registered positive growth with manufacturing and services driving the economy.

With exports expanding faster than imports, trade balance in July 2003 remains in surplus for 69 consecutive months since November 1997. International reserves continued to increase to a record high of USD38.67 billion at end-August, sufficient to finance 6 months of retained imports and 4.3 times the short-term external debt. Malaysia remains a high net saver with gross national savings constituting about one-third of gross national product (GNP), ranking third among the other high savers in the world.

The corporate and financial sectors continued to strengthen further. With the emergence of stronger and larger capitalised banks amidst an improved economic environment, non-performing loans (NPLs) have declined with the risk-weighted capital ratio (RWCR) sustaining way above the Basle requirement. The stock market began its upward trend after the announcement of the Package of New Strategies as investor confidence started to build up in response to the measures laid out by the Government. By 5 September, the Kuala Lumpur Composite Index rose to 756.48 points, its highest level since July 2002 with market capitalisation rising to RM582 billion.

In the absence of price pressures, the general price level remains stable while the labour market was steady at full employment level. There is a general improvement in the standard of living with per capita income and purchasing power parity higher at RM14,343 (USD3,774) and USD9,390, respectively and overall poverty level declining to 4.5% of total households.

Managing the Economy

Expansionary fiscal and accommodative monetary policies help sustain the growth momentum...

Macroeconomic policies adopted in recent years have focussed on mitigating the increasing uncertainties emanating from the external environment as well as in sustaining the growth momentum. This necessitated the conduct of an expansionary fiscal policy and an accommodative monetary policy to enhance domestic economic activities. Whilst engaging in an expansionary budget stance, the Government remains committed towards achieving a balanced budget in the near term.

The Government continues to play a pivotal role in sustaining growth in 2003 and in providing the enabling environment conducive towards enhancing further private sector activities. Sustained domestic demand amidst strengthening consumer and investor confidence helped to keep unemployment low whilst the increasing per capita income continues to improve the standard of living.

Fiscal Policy

Fiscal policy focussed on consumption and private sector demand to drive the economy ...

Since the Asian financial crisis, Malaysia has adopted an expansionary **fiscal** stance to stimulate economic activity to compensate for the lacklustre performance of the private sector in order to sustain the growth momentum. The continuing volatility and uncertainty in world economy in 2003 posed further challenges to the Government in administering its fiscal consolidation process. Nevertheless, the Government was able to strike a balance between sustaining growth and consolidating its fiscal position by financing the bulk of the latest stimulus Package of New Strategies through off-budget sources.

Revenue for the year is expected to increase by 6.8% to RM89,168 million, marginally lower than the RM89,183 million projected in Budget 2003, due to a decline in sales tax collections following the increase in tax exemptions for petroleum products. Revenue outurn is, nevertheless, commendable considering the less favourable external environment and the numerous incentives provided by the Government. Revenue collection was also able to sustain its performance, reaching 23.1% of GDP.

On the **expenditure** side, there was an increase of 6.2% from the previous year. The higher operating expenditure came from salary adjustments following the implementation of the Malaysia Remuneration System as well as the half-month bonus paid to civil servants to stimulate consumption. In addition to emolument, salaries and pensions, a large portion of the operating expenditure, which constitutes 65.9% of the total budget, was spent on supplies and services, including repairs and maintenance in order to upgrade the service standard as part of measures to enhance the delivery system. Development expenditure was mainly for capacity building, particularly for the expansion of transport network and other infrastructure facilities. The construction of schools, training institutions, hospitals and public housing were also given priority as part of the Government's efforts to develop a quality workforce, improve public health services and provide affordable houses. Expenditure that caters especially for the welfare of the poor and the rural sector was increased by more than 30%, in line with the social policy thrust to reduce the burden of the special groups.

The increased expenditure has led to a higher budget deficit. Continuing with its prudent financial management practice, the Government financed the bulk or 91.7% of its financing needs from the liquid domestic market. This helped to contain the external debt, which remains at sustainable and manageable levels.

During the course of the year, the Government had to resort to another round of fiscal stimulus to help mitigate the economy from the negative impact of the Iraq war and the outbreak of SARS. However, recognising the need to contain the budget deficit, the Government launched the RM7.3 billion **Package of New Strategies** in May with the bulk of the financing from the financial system. Only RM1.7 billion or 23% of the value of the Package came from Government budgetary allocation while the balance is from off-budget sources, mainly through Bank Negara Malaysia (BNM) and development financial institutions (DFIs) such as Bank Pertanian Malaysia (BPM), Bank Simpanan Nasional (BSN), Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIMB) and Bank Industri and Teknologi Malaysia Berhad (BITMB). Hence, the Government was able to minimise the impact of the additional budgetary requirements on Government finances.

Unlike previous stimulus packages, which were counter-cyclical and primarily aimed at mitigating the short-term impact of the external environment, this Package has a medium to longer-term objective of enhancing the nation's competitiveness. The Package focusses on four broad strategies encompassing 90 specific tax and non-tax measures aimed at generating economic activities with emphasis on mobilising domestic sources of growth and reducing over-dependence on the external sector. The main strategies are:

* Promoting private sector investment;
* Strengthening the nation's competitiveness;
* Developing new sources of growth;
* Enhancing effectiveness of the delivery system.

In order to promote private sector activity, the Government focussed on providing greater financing accessibility to small and medium enterprises (SMEs), apart from the existing facilities provided by commercial banks. In this regard, the Government mobilised DFIs to act as intermediaries and expanded the scope of micro credit schemes to cover SMEs.

In addition to the emphasis on the development of SMEs, various measures under the Package focussed on generating new sources of growth in manufacturing, agriculture and services in line with the policy to broaden the economic base. Among others, these measures include the establishment of various funds and incentives to enhance value-added activities in the manufacturing and services sectors.

At the same time, recognising that the likelihood of a full-blown SARS on the economy could be even more debilitating than the short war in Iraq, the Package also included immediate measures to provide temporary relief to SARS-affected industries. These include the suspension of income tax installment payments for travel agencies and a 5% discount on monthly electricity bills to hotel operators as well as exemption of Human Resource Development Fund (HRDF) levy for both tourism and hotel operators for a 6-month period beginning 1st June. Road tax for taxis was reduced by 50% while service tax exemptions were also granted for hotels and restaurants. These measures provided the much-needed relief to tourism-related industries. In addition, the Special Relief Guarantee Facility (SRGF) of RM1 billion under BNM, especially for working capital is provided to travel agents, hotel operators, restaurants and shopping centres. As at August, 24 applications valued at RM14.4 million were approved. Banking institutions also provided financial relief plans to borrowers affected by SARS in the form of loan restructuring and rescheduling. As at end-June, 244 loan accounts of SARS-affected borrowers in the banking system were rescheduled.

Monetary policy

Monetary policy complements fiscal policy to support private sector activities...

Monetary policy remains accommodative to support economic activities and complement the fiscal policy in stimulating domestic demand. Concurrent with the implementation of the Package of New Strategies, BNM reduced its intervention rate by 50 basis points, the first revision since September 2001, to stimulate private investment and consumption. Following this, base lending rates declined to 6% for commercial banks and 6.9% for finance companies. The strong macroeconomic fundamentals, low inflation and low unemployment, coupled with a resilient banking system have provided flexibility for monetary easing.

With the merger of 54 commercial banks into 10 anchor banks and the successful recapitalisation exercise undertaken by **Danamodal,** the banking system has become stronger and more resilient. As a result, the RWCR is sustained at a high level of 13%. Pre-tax profit of the banking system, excluding Islamic banks, recovered from a low of RM5,732 million in 1998 during the Asian financial crisis to RM9,311 million in 2002. Pre-tax profit for the first half year of 2003 indicates a stronger trend and is expected to increase with improved economic prospects. Furthermore, bank lending has picked up, registering a growth of 3.9% in the second quarter, higher than the 3.2% recorded in the preceding quarter. With the focus on SME development, bank lending to SMEs also showed significant expansion, growing at 5.4% as at end-July.

Much progress has been made with respect to restoring stability in the financial system following the Asian financial crisis. In particular, the closure of the **Corporate Debt Restructuring Committee** (CDRC) in August 2002 marked an important milestone in Malaysia's restructuring initiatives since the crisis. During its four years of existence from 1998 to 2002, CDRC had successfully resolved 48 cases involving debts of RM52.6 billion, representing some 65% of the cases under its auspices. Of significance, debt restructuring has been accompanied by sales of assets and non-core businesses as well as management changes. The implementation of corporate debt restructuring has contributed to the reduction in the level of NPLs by two percentage points. More importantly, the resilience of the banking system has been strengthened and its efficiency improved to better support economic activities as well as face increased challenges from competition. Also, on account of **Danaharta's** successful dealing of NPLs in the banking system since the Asian financial crisis, NPLs on a 6-month classification declined to 6.7% in July 2003, from 7.5% recorded at end-2002. Along with the improving economy, the broad monetary aggregate M3, expanded by 8.2% in June 2003.

In order to stimulate and strengthen the **capital market**, 10 new measures were introduced in March 2003. These include, among others, the delegation of Foreign Investment Committee (FIC) approvals to the Securities Commission for public listed companies, the introduction of performance incentive schemes and the enhancement of capital market skills as well as the role of intermediaries. As a consequence of these measures and the implementation of the Package, the Kuala Lumpur Stock Exchange (KLSE) became more bullish, breaching the 750 mark in September and is expected to trend higher in the year. Even though there are 83 PN4 companies in the KLSE, they account for less than 10% of the total number of companies listed in the bourse. The assemblage of troubled companies into the PN4 group underscores the commitment of the Government in enforcing good corporate governance and requiring the companies to improve their financial stature and integrity.

The stronger international reserves and higher current account surplus continue to support the pegged exchange rate regime and the ringgit remains consistent with the strong macroeconomic fundamentals of the country. Despite experiencing some softening *vis-a-vis* other currencies in tandem with the weaker US dollar, the peg continues to provide the stability and predictability to facilitate efficient business decisions.

Performance Review

Promoting Investment

Private sector activity gradually picking up with domestic investment increasing...

In cognisance of the importance of the role of **private sector investment** in ensuring sustainable growth in the medium and long term, the Government through Budget 2003 and the Package, instituted measures to enhance domestic investment activity, particularly by SMEs. Since the last few years, the contribution of the domestic sector to GDP, amidst slower external sector performance, has been on an increasing trend although the increase has been gradual, from 82.4% in 1999, rising to 89.6% in 2002, respectively and forecast to improve further to 90% in 2003. The domestic sector was driven largely by both public and private consumption as a result of salary adjustments and bonus payment in the public service as well as sustained consumer and business confidence ensuing from Government measures. Investment by the private sector, which has remained below pre-crisis levels has shown some positive signs, increasing by 2.0% in 2003 from a negative 13.1% in 2002 and is expected to rise further on the back of improved export demand, especially for the information technology (IT) replacement market. Investment was broad-based, encompassing new sectors as well as higher value-added activities of electrical and electronics (E&E), transport, machinery, chemical and chemical products as well as prefabricated metals.

Arising from investors' positive response to the Government's tax and non-tax measures, including liberalisation of FIC rules under the Package as well as reduction in corporate income tax for small and medium industries to 20% and the extension of reinvestment allowance to pioneer status companies announced in Budget 2003, investment activities, particularly in the manufacturing sector, have been encouraging. Compared with a total of 878 investment applications valued at RM18.8 billion received for the year 2002, the January-June 2003 figure of 453 applications with proposed investments totalling RM9.7 billion is commendable given the prevailing weak external environment, suggesting continued investor confidence and enthusiasm to invest in the economy. There has been an improvement in **domestic investment,** which constitutes 59% of total investment compared to less than 40% in the previous year. The higher level of domestic investment reflects renewed domestic investor confidence and points to the positive development arising from the various measures by the Government to assist Malaysian industries, particularly SMEs.

In the six-month period, 487 projects were approved involving investments of RM8.1 billion with domestic and foreign participation quite evenly distributed at 51% and 49%, respectively. Investments were in areas of transport equipment, E&E and chemicals, out of which 65% was for new projects and the remaining for expansion and diversification. These projects have the potential to generate 40,860 job opportunities in the economy. A total of 138 projects benefitted from incentives on investment promotion, where 111 projects were granted Pioneer Status and 27 projects were approved with Investment Tax Allowance. Malaysia remains an attractive investment destination for Japan, Singapore, the United States (US) and Thailand, which together account for 76% of foreign investments.

Stronger domestic and external demand led to a **higher capacity utilisation** of 83% in the manufacturing sector. Indicative of the stronger momentum of growth, the manufacturing production index increased by 8.7% in June 2003. Based on this uptrend, value-added of manufacturing is expected to increase by 6.5% in 2003, contributing a 30.6% share in GDP. Notwithstanding the Government policy of reducing the over-dependence on the E&E sub-sector as a source of growth, its proportion remains high due to the strong external demand for technology products. Sale of computers increased by 8% in June 2003, its strongest growth since 2000. The sustained demand for E&E products in the first half of the year contributed to the higher capacity utilisation of more than 80% within the semiconductors industry. Although E&E products still constitute the largest share, other products such as pharmaceuticals and oleochemicals have begun to feature as emerging products with high export potential.

Presently, there are more than 46,000 **SMEs** contributing 28.5% to manufacturing output but only 20% of manufacturing exports. Traditionally, the concentration of SMEs is in resource-based industries of wood and wood products; food, metal and metal products; as well as chemical and chemical products. There are, however, indications of greater linkages with the larger multinational corporations (MNCs) with increased outsourcing from local SMEs. In 2002, MNCs in the electronics sector procured RM12.6 billion worth of locally produced goods and services and is expected to increase purchases by another 9.5% in 2003, thereby opening greater opportunities for SMEs to invest and tap into the outsourcing business.

Budget 2003 highlighted the reluctance of banks to increase lending activities, particularly to SMEs due to their risk-averse attitude, arising from the large magnitude of NPLs experienced during the crisis period. However, following the establishment of one-stop centres to process investments as well as special SME windows in banks have assisted SMEs in their investment ventures and access to credit. Within the banking system, response to the SME loan programme was equally good. Loans extended to SMEs increased by a record high of RM727.8 million in the month of June 2003 to register a cumulative increase of RM3.4 billion for the first six months of the year. With continued improvement in the economy, further acceleration in lending activity is expected towards year-end with corresponding increases in private sector activity and investments.

The Government introduced the micro credit schemes under the Package to further improve accessibility of SMEs to loans and enable them to become the catalyst in generating domestic investment and economic growth *(see Feature Article: An Update on the Micro Credit Scheme).*

Micro credit facilities amounting to RM1 billion was provided through the various DFIs, namely BPM (RM500 million), BSN (RM300 million) and Amanah Ikhtiar Malaysia (RM200 million). Compared to the conventional terms and conditions imposed by commercial banks, the scheme features a low 4% interest rate, waiver on collaterals, loan approvals based on securitisation of cash flows and repayments based on cash flow projections. The scheme received overwhelming response, whereby within a short span of three months until August, BPM received 28,086 applications valued at more than RM423.61 million. During the period, RM190.46 million was approved by BPM for aquaculture, cash crops, contract farming, agro-product processing, and livestock as well as for working capital and marketing activities. Loan applications received by BSN up to 4 September reached 54,600, totalling RM892 million, out of which RM219 million was approved for various non-agricultural activities in manufacturing, utilities, trade and transport and communications.

In the **capital market,** the introduction of 10 new measures in March has made the KLSE more accessible and attractive to a wider spectrum of investors. The number of listed companies in the KLSE has increased almost four-fold since 1990 to 885 companies in August 2003. The KLSE is currently the largest stock market in the ASEAN region in terms of both market capitalisation and number of companies listed and has regained interests of foreign investors who account for about a third of total trading volume and a collective holding of almost 20% in recent months. Complementing the Package in May, the FIC guidelines were further liberalised to provide greater flexibility in foreign equity participation, acquisitions, mergers and takeovers as well as property and equity ownerships.

AN UPDATE ON THE MICRO CREDIT SCHEME

Introduction

The Government has implemented several measures over the years to address the financing needs of SMEs to develop them as the catalyst of growth in generating domestic investment and economic growth. Of significance, in relation to size and terms, is the establishment of a RM1,000 million micro credit scheme for small businesses and enterprises announced in the Package of New Strategies in May 2003. Of this amount, RM500 million is provided to Bank Pertanian Malaysia (BPM) for small businesses and enterprises in the agriculture sector while RM300 million is allocated to Bank Simpanan Nasional (BSN) to finance non-agricultural projects and an additional RM200 million allocated to the micro-credit scheme of Amanah Ikhtiar Malaysia (AIM).

In order to enhance the accessibility to financing for small borrowers, loan conditions under the micro credit scheme have been relaxed through the waiver of collateral requirement with loans based on securitisation of cash flows. In addition, it also features a low interest rate of 4% per annum, loan repayments based on cash flow projections and the introduction of a mentoring system. In particular, the waiver on collateral requirement is deemed an attractive feature of the micro credit scheme as commercial banks typically insist on collaterals for loans, usually in the form of properties or stocks.

Micro Credit Scheme: Some Country Experience

Micro credit schemes of some countries have been proven effective in helping entrepreneurs and small borrowers secure non-collateral and low-interest loans for their business operations. Such facilities have also helped to ease the burden of the poor, raise their income and improve their quality of life and in turn help to stimulate economic growth. The experience of Bank Grameen in Bangladesh is testimony to the success story of the micro credit scheme. Over 10 million poor borrowers have access to micro credit in Bangladesh. Annual total disbursement of micro credit loans is close to USD1,000 million, with Grameen Bank alone accounting for USD319 million or nearly one third in 2002. As at end-July 2003, Grameen Bank has given out USD4,000 million in cumulative loans to borrowers, benefitting in particular women borrowers, which accounted for about 95% of total borrowers, for activities such as small businesses, farming, animal husbandry and handicrafts.

Indonesia’s most successful micro credit scheme has been run by Bank Rakyat Indonesia (BRI) since 1984. BRI through its network of 4,000 branches, has provided micro loans to 2.8 million borrowers as at end-December 2001. Individual loans extended by BRI range from USD3 to USD5,000. Thailand launched the People’s Bank programme in June 2001 to provide low-interest loans without collateral to the poor to help them in their business operations. Loans given out under the programme range from 15,000 baht to 30,000 baht (USD350 to USD700) per borrower with interest rate of 1% a month and repayment period of 13-25 months. During the first six months of its operation, the People’s Bank programme had approved 3,659 million baht (USD88 million) to more than 275,000 borrowers. In addition, Thailand also launched a micro credit scheme known as the Village and Urban Revolving Fund in July 2001 to provide loans to rural villages and urban communities. The scheme provides a revolving fund of one million baht (USD25,000) to each of the 7,125 villages. The revolving fund provides loans to people at the grassroots for activities, such as agricultural product processing and development of skills in handicraft as well as for the provision of public amenities in villages and urban communities.

Micro Credit Scheme in Malaysia

In Malaysia, the micro credit scheme has been implemented since September 1987, through AIM, a non-governmental organisation. AIM was established to help reduce the poverty level of the hardcore poor by providing small loans for any activity or business that could improve their income. AIM has two micro credit schemes, namely the Economic Financing Scheme and the Special/Social Financing Scheme. The former is to finance economic activities while the special scheme provides financing to single mothers and fishermen. The social scheme provides education loans to children of the hardcore poor as well as loans for housing renovations and installation of utilities, such as water and electricity. Loans given out by AIM range from RM100 to RM10,000 for each borrower without collateral or guarantor. Since its inception until June 2003, AIM has provided micro financing totalling RM863 million to some 490,700 borrowers.

The RM500 million micro financing facility under BPM is only for small businesses and enterprises in the agricultural sector, including activities such as farming, processing and marketing. BPM provides non-collateral loans of up to RM20,000 per borrower or business partnership, with annual interest of 4% and repayment period not exceeding 4 years based on securitisation of cash flow. BPM launched its micro credit facility on 3 June 2003. The response has been overwhelming as in just three months, BPM received a total of 28,086 loan applications valued at RM423.61 million for various activities, such as aquaculture, marine fishing, poultry farming, planting of short and long-term crops, food processing as well as working capital and marketing. BPM has approved applications totalling RM190.46 million and disbursed RM148 million. Loan repayment has also been encouraging with a recovery rate of 87.4%.

Under the pro-growth Package, BSN was given the mandate to manage a RM300 million micro credit scheme to finance non-agricultural activities. BSN micro loans are also without collateral or guarantor and range from RM5,000 to RM20,000 per borrower with annual interest of 4% and repayment period from 1-5 years. However, the main difference between the micro credit scheme of BPM and BSN is the mentor system applicable under BSN. Under the mentoring concept, the mentor is appointed by an association to help identify potential borrowers who have the repayment capability as well as assist the borrowers in securing loans. Similarly, the response to BSN's micro credit facility has been overwhelming. Loan applications received during the three-month period up to 4 September 2003 have reached 54,600, totalling RM892 million. During the period, BSN has approved 22,900 loan applications amounting to RM219 million and disbursed RM123 million for various activities in the manufacturing, utilities, trade, broad property, transport and communications and business services sectors.

Conclusion

The experience of several countries, which had implemented micro credit financing, in particular Bangladesh, clearly points to its effectiveness in helping the poor uplift their livelihood from the vicious cycle of poverty and enable them to be self-reliant and contribute to the economy. The Government is, thus, optimistic that the implementation of the RM1,000 million micro credit scheme will further spur the development of SMEs and enhance their contribution to economic growth.

Note: The article is prepared with input from Amanah Ikhtiar Malaysia, Bank Pertanian Malaysia and Bank Simpanan Nasional.

Enhancing Competitiveness

New strategies and incentives increase productivity, lower costs and improve the nation's competitiveness...

Globalisation and liberalisation have intensified competition and resulted in the emergence of new players in the market, particularly lower cost-producing nations. This has prompted the Government to strengthen further the **nation's competitiveness.** Additional measures were designed to build upon the present competitive edge, which hinges on the pillars of political stability, a business-friendly Government, educated and easily trainable workforce, abundant natural resources as well as efficient economic management that have contributed to the present strong macroeconomic fundamentals. The excellent network of infrastructure, including high-speed broadband information and communication technology (ICT) connectivity has further enhanced the nation's competitiveness. Further measures were focussed on reducing the cost of doing business, accelerating the transition to ICT as the enabling tool to enhance productivity as well as developing human resource to meet the demands of the New Economy.

During the year, particular emphasis was given to ensure the maintenance of **pro-business and investor-friendly climate,** conforming to the concept of Malaysia Incorporated that encourages greater public-private sector cooperation. The further liberalisation of the FIC rules, indicating the commitment of the Government to enhance investor confidence, was well received. Tax incentives provided under the 2003 Budget were further supplemented by measures introduced in the Package. The Government reinforced efforts in improving the delivery system to reduce the costs of doing business to attract investors.

In consonance with the accommodative monetary policy, the lowering of BNM's intervention rate by half a percent in May this year, aimed at further boosting economic activities and stimulating consumption, led to lower lending rates by commercial banks and financial institutions, which in turn reduced borrowing costs. For SMEs, the micro credit scheme has not only enhanced greater accessibility to financing but also to more favourable interest rates. In addition, tariff rates on public utilities, such as electricity, water and telecommunications have been kept at low levels to ensure that the **cost of doing business** in the country remains competitive.

While both personal and corporate taxes remained at competitive levels, tax and non-tax measures introduced in Budget 2003 helped to further reduce the cost of doing business. Measures introduced include tax waiver on income earned overseas by non-residents, refund of tax paid on service and sales that was actually not collected by companies as well as reduction of sales tax on locally manufactured goods through review of valuation methods.

Pioneer Status with tax exemption and Investment Tax Allowance were provided for manufacturers of selected products in the machinery and equipment industry to further develop the sector. The extension of Pioneer Status from 10 to 15 years and that of the Investment Tax Allowance from 5 to 10 years contributed to the steady increase in investments in the industrial sector from both foreign and domestic investors. In addition, under the pre-package scheme, group relief was also extended to forest plantations and for selected products in biotechnology, nanotechnology, optics and photonics.

Tax incentives were also improved to further encourage **research and development** (R&D) activities, the establishment of operational headquarters, regional distribution centres, international procurement centres and local international trading companies. As for R&D activities in the public sector, RM403 million of its RM621 million under the Eighth Malaysia Plan was released under the Intensification of Research in Priority Areas (IRPA) programme. Research findings with commercialisation potential include stone mix asphalt, biosensor fibre optic in determining pesticide levels as well as optical switches, waveguide devices and fibre amplifiers. A fund of RM100 million was also established to increase the pool of R&D expertise as well as encourage R&D activities. As at May, RM31.9 million was allocated to three pre-package projects involving training, R&D, start-ups and technology transfers.

There has been an all-round improvement in the **productivity** of industries in the country arising from technological improvements, efficient utilisation of inputs as well as higher capacity utilisation. In 2002, the manufacturing sector registered a productivity growth of 3.3% on the back of a 5.2% growth in output. Productivity as measured by value added per employee, in the oil palm industry recorded the highest average annual growth of 7.6%. In the rubber and chemical industries within the manufacturing sector, productivity registered a growth of 6.5% and 4.7%, respectively for the 2001-2003 period. Correspondingly, the unit labour costs in these industries declined by 1.3% and 0.9%, respectively, thereby sustaining their competitiveness in the manufacturing sector.

SMEs, as a group, registered a productivity growth of 2.7% in 2002. The Government has also provided SMEs with technology development grants in the areas of product and process improvement, productivity and quality improvement, certifications as well as the adoption of ICT. As at June 2003, 464 applications were approved with grants amounting to RM28.4 million. Such positive developments in productivity and response towards improvement, thus far, have helped sustain Malaysia's competitiveness.

In the **education sector,** the move towards educational excellence in Malaysia is aimed at improving the quality of workforce. At both primary and secondary levels, the ongoing ICT-driven projects in schools will enable students to tap into the wealth of knowledge arising from the expansion in Internet connectivity. The extension of these projects nationwide will reduce the digital divide between the urban and rural areas. The Government's decision to teach Mathematics and Science in the English language beginning this year, while enhancing proficiency in the language, will also provide students with access to the greater wealth of knowledge in the fields of science and technology. The implementation of single-session schools further ensures that students have effective access to both academic as well as co-curriculum activities and nurture a balanced and all-round development. Such programmes will also equip students with the required knowledge to achieve excellence in education while creating easily trainable and higher quality workforce.

Human resource development, a prerequisite to the enhancement of productivity and efficiency, was given a further boost with an additional allocation of RM500 million to the Skills Development Fund (SDF) for the provision of loans to students pursuing studies in the vocational and technical fields. A Retraining Fund of RM100 million towards re-skilling of new graduates in fields of ICT and accountancy was also established under the Package. Since its inception in 2001, the SDF has trained about 121,000 persons and, with the extra funding, another 76,000 will be trained this year.

The Government continuously improves the National Occupational Skill Standards (NOSS) as a means of maintaining the quality of training in order to meet industrial needs, As at June, there are more than 658 NOSS covering basic, intermediate and advanced training levels. Recognising the need for highly skilled human resource, in line with the transition to higher value-added industries, a total of 2,380 workers is expected to be trained by the end of 2003 in the areas of electrical and electronics, avionics and automotive-related trades. Training schemes for graduates were also provided by corporations such as Tenaga Nasional Berhad, PETRONAS, and Telekom Malaysia Berhad, which apart from improving their skills and marketability, also serve to provide temporary relief in graduate unemployment.

Within the ICT agenda, the penetration rate in Internet usage has surged from 10.6 per 100 population in 2000 to 20.0 per 100 population in 2003 for urban areas as at end-June 2003. As for the rural areas, the progress is also almost two-fold from 1.3 to 2.5 per 100 population for the period under review. Internet connectivity is also being extended to 750 locations for rural schools through the SchoolNet Programme, public libraries as well as clinics throughout the country. As a result of Government programmes, In the Government sector, the establishment of the electronic-government (e-Government) is an initiative towards accelerating information flows and expediting transactions, such as through the e-Procurement and e-Payment.

Malaysia's overall ranking in **world competitiveness,** as reported in the IMD World Competitiveness Yearbook 2003, jumped six notches from the 10th position in 2001 to 4th position out of 30 countries in 2003. It retained the top spot in sovereign competitiveness with respect to Government efficiency, for its pro-business economic policies, fiscal policy on taxes and business legislation that facilitate business activities and foster entreprenuership. Despite the challenges, Malaysia's sovereign rating was maintained at BBB+ with positive outlook for the year.

Developing New Sources of Growth

Progress made in servicies, tourism and ICT ...

The concerted efforts of the Government to broaden the economic base and develop new sources of growth have resulted in a gradual shift from over-dependence on a narrow range of export-earning products. The **manufacturing** sector remains the second largest contributor to GDP growth. E&E still accounts for the major share of about 39% of manufacturing sector, of which about 30% comprises semiconductors. However, exports of chemical & chemical products have become increasingly important with RM11,347 million being exported in the first half of 2003 compared with RM9,135 million in the same period last year. Exports of higher value-add products, such as fashionable apparel, footwear and accessories have also featured more in manufacturing exports, comprising 3.2% of total manufacturing exports. In line with the concerted effort towards a domestic-driven economy, construction-related industries, mainly cement, steel and concrete, rebounded to register 11.5% growth during the period against 0.8% recorded in 2002.

In **agriculture,** while industrial crops and food commodities will remain the mainstay, greater emphasis will be given to exploring new agriculture activities that are still largely untapped but with high growth potential. Among the new activities identified, aquaculture has been successful, registering an estimated output of 197,000 tonnes in 2003 against 117,000 tonnes in 2000. Of late, ornamental fish output has also been on the uptrend following higher demand from Taiwan and Singapore. Efforts were intensified towards establishing Malaysia as a regional hub for the production and distribution of *halal* food products to tap the lucrative global market for *halal* food products potentially worth RM1.63 trillion a year. Following the attractive prospects for such ventures, local industries have embarked on the production of *halal* food and is expected to capitalise on incentives offered by the Government, especially pertaining to product promotion and branding. Government measures continue to support the development of the integrated value chain of related services, such as distribution, marketing, packaging and export.

The **services** sector remains the largest contributor to GDP with a share of 56.8% share in 2003. The **tourism** industry accounts for 4.8% of GDP, while over 30% of retail sales are generated from tourist-related activities. Efforts to promote Malaysia as the preferred tourist destination paid off with total tourist arrivals reaching a record high of 13.3 million, contributing foreign exchange earnings of RM25.8 billion in 2002. However, tourism was affected by the outbreak of SARS and the Iraq war when tourist arrivals plunged to a record low of 457,900 in April, 58.4%, lower than the 1.1 million monthly average for 2002. Arrivals from China, Taiwan, Hong Kong and Singapore were lower due to travel restrictions, as part of measures to contain the spread of SARS. Despite this, with the abatement of SARS, the Government is confident that the tourism industry will pick up during the second half of the year, as shown in the increase in tourist arrivals in July to 753,000. Various measures implemented by the Government, such as the establishment of the Tourism Infrastructure Fund (TIF) to develop more tourism products and the Malaysia My Second Home campaign, are expected to attract more visitors from China, Japan and the Middle-East.

The Government, through Budget 2003 and the Package, has also increased the TIF to RM1 billion as part of its efforts to promote the tourism industry by improving and developing new tourism products to attract more tourists. As at end-July, six applications involving RM150.3 million were approved for projects involving the construction of four integrated tourism centres, a theme park and a marina.

Healthcare is an area with high potential for further expansion since the level of expertise and the standard of equipment and facilities in both public and private hospitals have reached international standards. There has been an increasing number of foreigners seeking health treatment and services in Malaysia, including in areas of cardiology, hematology, dermatology and neurology, from 56,100 patients in 2000 to 84,600 patients in 2002. Foreign exchange earned from foreign patients amounted to RM36 million in 2002. Until March this year, 34,400 foreign patients spent RM13.3 million for treatment in private hospitals in the country. The attractiveness of the healthcare industry in Malaysia, in addition to being well-equipped with adequate, highly trained specialists, state-of-the-art machines and equipment, facilities and comprehensive support services that are comparable to hospitals abroad, also lie in its cost competitiveness. Based on figures by the Association of Private Hospitals of Malaysia, a cardiac bypass at a premier private hospital in Malaysia costs an average of USD6,300, significantly lower than the USD10,400 charged in a neighbouring country. The Government has identified 44 out of 224 private hospitals in the country as part of its health tourism programme and with concerted Government efforts in promoting healthcare as a tourism product, health tourism is set to expand further. With improvements in health infrastructure from continuous investment in capacity building, Malaysia is also poised to become a global health information hub for the region.

Development in the **health** sector, particularly in worldwide sharing of health information, saw the initiation for the establishment of the Global Information Centre spearheaded by the Institute of Medical Research (IMR), in July 2003. With respect to the development of integrated medicine, R&D work will take off in the year with prospects for commercialisation in the fields of traditional and complementary medicine, herbal medicine as well as vaccinology, involving the Herbal Medicine Research Centre and the newly-formed National Institute of Natural Products and Vaccinology. In the area of biotechnology for health, four projects are being undertaken involving the collaboration of research institutes and universities. In relation to this, the BioValley project that has taken off with the first phase due for completion in 2006, would house most of the biotechnology research work in health. In order to further improve health services in the country, the Government has also allowed the recruitment of 1,000 health professionals from foreign countries.

Recent efforts in fostering **education** as a tourism product include the establishment of four new promotion offices in Saudi Arabia, China, Indonesia and Vietnam. There are already 17 public institutions of higher learning in the country with established world standards while in the private sector, 30 institutions have been accredited with high standards at the tertiary level. In 2002, local institutions attracted 28,495 foreign students with China heading the list with 11,058 students, followed by Indonesia (7,503), India (1,409), Thailand (1,369), and Singapore (1,296). The number is expected to reach 30,000 by year-end, facilitated by improved and more liberal immigration procedures as well as allowing private agencies to recruit foreign students.

The objective of promoting **venture capital,** apart from generating new sources of growth and stimulating a domestic-driven economy, is to nurture entrepreneurial development in new ICT investment. As at April 2003, from a total of RM500 million allocated to Malaysian Venture Capital Management Berhad (MAVCAP), a sum of RM132.83 million has been committed for investment. Under the Package, an additional allocation of RM100 million was provided to MAVCAP to spearhead investment in seed ventures through the Cradle Investment Program (CIP), which was launched in July 2003. This ICT-related fund has been utilised to provide bridging finance for venture companies involved in ICT in the form of zero-interest loans for durations of up to 10 years. There were 35 projects in six main categories, namely information technology, network and communications, biotechnology, electronics, medical and health as well as semiconductors. MAVCAP has invested in eight companies for direct ventures and twelve for seed ventures. In order to widen the network for sourcing more quality and capable entrepreneurs, the Government, through MAVCAP has appointed four companies under its outsourcing program. Apart from that, in providing the impetus towards the promotion of innovation and creativity in sectors not entirely related to ICT, the Government established a new fund of

RM1 billion for non-ICT ventures, for which several companies have indicated interests in utilising the fund in the areas of advanced manufacturing and biotechnology.

The **Multimedia Super Corridor (MSC)** continues to show progress in providing infrastructural support for the development of ICT industries as the country moves towards a knowledge-based economy. By August 2003, 914 companies, comprising 20% foreign companies, were awarded MSC status. Planned investment in the designated areas covering activities of IT services and software development has reached RM13 billion, an increase of 34% against the previous year. The MSC has since created 21,270 jobs, out of which 86% involves knowledge workers. Currently, 59 world-class companies operate in MSC as against 53 the year before. Reflecting improved demand in the technology sector, total sales generated from the MSC amounted to RM5.85 billion, of which 17.5% were from exports.

Improving the Delivery System

Guidelines on processing procedures at state and local levels agreed for the first time...

The success of national development policies and strategies hinges upon efficient and effective **delivery systems** in both the public and private sectors. Improving public sector service both in terms of quality and the speed of delivery is a continuing agenda for the Government. While the remuneration for civil servants has gradually improved over the years both as an incentive as well as to attract higher caliber personnel, the implementation of the Malaysian Remuneration System this year will further provide the impetus for the civil service to achieve excellence in its output. Going by the indicator of allocation expended as a measure of the effectiveness of the delivery system, by year-end it is anticipated that all allocations for 2003 will be fully spent, indicating the swift implementation of planned programmes and projects for the year.

While Budget 2003 acknowledged the need to further improve the delivery system, the Package has also instituted specific measures to facilitate private sector activities as well as public sector performance in general. In ensuring efficiency and timeliness in the delivery system, standard guidelines for processing of applications for licences, land, and building plans were given more clarity and agreed upon by the federal, state and local authority levels. These guidelines addressed matters within the purview of the respective areas of jurisdiction and focussed on the congruence of policies and measures among the various authorities. The various measures aim at reducing red tape and eliminate unnecessary procedures in processing applications for approvals, such as the setting up of one-stop agencies to improve coordination. In the case of the Malaysian Industrial Development Authority (MIDA) for the manufacturing sector, specially appointed project officers will now *hand-hold* and assist investors in obtaining all necessary approvals for projects right up to the operational stage. For SMEs, apart from the more liberalised terms and cheaper cost of borrowing offered through DFIs, commercial banks also provide special windows to facilitate applications, processing and onward approvals for SME loans.

Processing and approvals for building plans and certificates of fitness for occupancy were also streamlined and expedited through the establishment of one-stop centres at the state as well as local government levels. All relevant Government agencies at the federal, state, district and local levels have responded positively to the recommendations encompassed in the Package covering processes pertaining to licences, land matters, billings and payments, including the use of ICT in such undertakings, where appropriate. The validity period of licenses and permits for business and investments will also be extended to reduce the burden of frequent renewals. The duration for approvals of building plans is shortened to 12 weeks and the issuance of certificates of fitness for occupancy reduced to four weeks. As regards land alienation and conversion, a fast track approach has been adopted, whereby approval is decentralised from the state government to the state Director of Land and Mines or the Land Administrators at district levels.

The establishment of e-Government is an initiative towards improving information flows and processes, focussing on effective and efficient delivery of Government services to the people. This is made possible through Internet access to all ministries and departments that have since established their own Internet homepages. The Internet Civil Service Link portal also provides public access to the Government machinery while the Public Complaints Bureau continues to resolve public complaints received through relevant Government agencies. The Project Monitoring System, which has been installed in all 25 ministries and 14 states, aims to monitor the implementation of Government projects. In addition, electronic procurement, which covers services pertaining to central contract and direct purchases, has been extended to include procurement by tender and price quotation. This programme has helped to simplify and facilitate processes in Government procurement while its linkage to the Accountant General's office will further expedite payments to contractors.

The progress made at all levels of Government administration in the delivery system, thus far, has enhanced the nation's competitiveness. Efforts towards continuous improvement in the delivery system will be undertaken to ensure smooth and effective implementation of policies and strategies.

Continuing the Social Agenda

Government policy measures have contributed to balanced growth and improved the quality of life...

Arising from Government efforts in enhancing the economic well-being of the *rakyat,* there has been all-round improvement in the quality of life for Malaysians. Despite the anxiety with respect to SARS and sporadic incidents of terrorist attacks in neighbouring countries, Malaysians continue to enjoy a peaceful, harmonious and stable socio-economic environment. Continued growth in the economy has contributed to the higher **per capita income** of RM14,343 in 2003 against RM13,683 in 2002. The **purchasing power parity** has also improved from USD8,862 to USD9,390 in the same period.

Towards achieving a more balanced growth and equitable sharing of wealth, RM2.56 billion, representing a 36% increase from the previous year, was expended for programmes in **rural** areas. These programmes include agricultural extension services and fertiliser subsidies, rural roads, electricity and water supply, rural health clinics and schools. About 12,400 additional households benefitted from the rural electrification programme while under the rural water supply project, an additional 41,300 households were provided with potable water at the cost of RM99.5 million and RM102.4 million, respectively. Further improvements were made in the provision of land transport network in rural areas to enhance rural economic development through the construction of 7,600 kilometers of rural and *kampung* roads, costing RM582.7 million in 126 districts nationwide. The *Orang Asli* community continues to enjoy better health and educational facilities and higher earning capacity through economic extension programmes in farming and cottage industries, especially handicrafts.

Socio-economic issues were also addressed by the Package, especially in respect of providing affordable houses for the low-income group as well as facilitating small businesses. Apart from the micro credit scheme provided to small businesses, including retailers in both urban and rural areas, the Government also introduced the Home Ownership for the People (HOPE) programme. Under this programme, new buyers of houses below RM100,000 will be given subsidy on interests, interest-free loan for deposits, rebates and tax relief on interest payments. By end-August, 85 applications were received and 57 approved involving RM3.4 million and RM2.1 million, respectively. In line with the Government's objective to provide more affordable houses, Syarikat Perumahan Negara Berhad (SPNB) will build 150,000 affordable houses for the low-income group, for which 25,815 units are made available this year. A unique home ownership programme was also introduced, whereby employees of the armed forces, police personnel, widows of civil servants and single mothers who do not own houses, would be eligible to own houses provided by SPNB through a rent-with-option-to-purchase arrangement at a rate of RM50 per month. As at end-July, 40 units of low-cost apartments were in the process of being rented out while another 450 units were in the process of being acquired by SPNB from developers under this programme.

With regards to addressing social problems, particularly in combatting social ills including violence, drug abuse, juvenile delinquency, rape, and a host of other criminal and anti-social activities, the Government launched the **National Social Policy** in August to enhance social development through the forging of noble values at all levels of society throughout the country. In addition, the various programmes under Rakan Muda continued to help foster positive values among youths. Apart from providing the platform for preventive measures under the programme, the Government also continued to provide the social safety net and care for the handicapped, homeless and the poor through various welfare programmes. In this regard, participation of non-governmental organisations (NGOs) has complemented the efforts of the Government, particularly in caring for the handicapped and the elderly, suggesting the strong presence of social voluntarism in the country. In recognition of their role in nation building, RM67.8 million was provided as financial support to NGOs to help raise their effectiveness in rendering services including welfare, caring for the disabled, family development, haemodialysis, as well as drug rehabilitation.

Outlook for 2004

Stronger broad-based growth with higher value-added activities...

World growth and trade are expected to improve with most economic activities returning to normalcy. Business confidence and sentiment will, however, be cautiously optimistic against the backdrop of threats from terrorist attacks. World growth is still hinged on the modest performance of the US economy with the euro area still marked by relative weakness although Japan, the world's second largest economy, is showing signs of a more definitive path of sustained positive growth. Overall, indications point towards an improved outlook and higher optimism for 2004, despite the downside risks. Upbeat stock market activities across major bourses into the second half of 2003 should bolster optimism for a firmer global economic recovery. Thus, world economy is expected to post a higher growth of 4% with the US, euro area and Japan registering growth of 3.6%, 2.3% and 1%, respectively in 2004.

On the **regional** front, with the containment of SARS and the positive impact following the implementation of various economic relief packages introduced by SARS-affected countries, regional growth is envisaged to further accelerate in 2004. China is expected to continue on its strong growth track to register 7.5% GDP growth in the coming year. Together with most of the ASEAN economies gaining strength and with intra-regional trade expanding, the Malaysian economy is forecast to register a faster growth in 2004.

The underlying **strategic thrusts** of macroeconomic management for 2004 are premised on a more dynamic and vibrant private sector supported by the enabling and conducive environment put in place through various measures over the years. The Government will continue to play the facilitative role in enhancing the effectiveness of the delivery system. Complementing each other, the private and public sectors will work in close cooperation and partnership within the spirit of Malaysia Incorporated, thereby enhancing sovereign competitiveness and long term growth and sustainabilitty. To enable the private sector to lead the economy, concerted efforts will be made to encourage private initiatives in new sources of growth, particularly in value-creating activities in services and agriculture.

Measures will be taken to develop and transform the agriculture and rural sector into a more dynamic income-generating economic base. This sector is expected to capitalise on the Government's pro-growth measures to unveil its potential and contribute higher value-add to the economy. In the trade sector, building upon its strength as the 17th trading nation in the world, efforts will be made to intensify the promotion and marketing of Malaysian products and brands. Notwithstanding the emphasis on the creation of economic wealth, the social agenda towards a caring society will continue to be accorded due importance, particularly with respect to elevating the standard of living and the quality of life of the populace, especially of the poor, handicapped, aged and the less fortunate.

In consonance with the commitment to balance the budget in the near term, the Government's **fiscal** stance will be the deliberate tightening of public spending to rein in the deficit that had occurred over the last six years. Total budgetted expenditure will be reduced by 1.1% with a larger decline of 21.1% in the development expenditure. The lower budget expenditure by the public sector signals the clear path towards fiscal consolidation after several years of budget expansion to sustain growth momentum. Hence, the overall financial position of the Federal Government is envisaged to be stronger, with deficit reined in from 5.4% to GDP in 2003 to 3.3% in 2004 while the consolidated public sector will register a surplus position.

Development expenditure will be prioritised towards committed and approved projects under the mid-term review of the Eighth Malaysia Plan, especially those with strong linkages and value creation potential in the economy. Particular attention will be directed towards modernising and nurturing the agriculture and rural sectors to position them as significant growth-generating sectors of the economy. Despite a reduction in the budget, expenditure for rural development is expected to double in 2004 for programmes including roads, education, health, and basic amenities, such as water and electricity. In general, the public sector presence in the economy will focus on sustaining public services and improving the delivery system whilst lending support towards the development of a knowledge-based economy as a means to increase productivity and efficiency and, hence, sovereign competitiveness.

In order to support domestic economic activities, the **monetary** policy is expected to remain accommodative amid ample liquidity in the system and subdued inflation. The accommodative monetary policy will facilitate domestic consumption and business activity while making funds more accessible and at a lower cost to benefit a wider spectrum of society.

Growth is expected to be broad-based with all sectors in the economy registering higher output with services and manufacturing continuing to spearhead growth. Growth is also expected to emanate from the domestic sector as well as pick-up in the external sector, following improved world prospects. Following the introduction and implementation of comprehensive measures to enhance the vibrancy of the economy and the medium and long-term competitiveness of the private sector, the private sector is envisaged to drive economic growth with private expenditure expected to be robust at 7.5% and further acceleration in private investment of 9.9%.

The strengthened macroeconomic fundamentals and a more broadly balanced economic structure with emerging new sources of growth will provide the foundation for sustained higher growth. Alongside pragmatic macroeconomic management and the pro-growth measures in place to support private sector initiatives, Budget 2004 will further enhance competitiveness and reinforce the resilience of the economy against likely destabilising external factors and garner higher economic growth for the country. The Malaysian economy is, therefore, targetted to achieve a stronger GDP growth of 5.5%-6% for 2004.