MALAYSIA GLOBAL SUKUK INC.

(Incorporated in Labuan, Malaysia with limited liability)

U.S.$[ ],000,000 Trust Certificates due 2007

Issue Price: 100 per cent.

The U.S.$[ ],000,000 Trust Certificates due 2007 (the "**Certificates**" or the "**Sukuk**") of Malaysia Global Sukuk Inc. (the "**Issuer**") will be constituted by a declaration of trust (the "**Declaration of Trust**") dated on or about [ ] July 2002 (the "**Closing Date**") by the Issuer. Pursuant to the Declaration of Trust, the Issuer will declare that it will hold certain assets, primarily consisting of beneficial title to certain land parcels and rights under the related lease agreements, upon trust absolutely for the holders of the Certificates *pro rata* according to the face amount of Certificates held by each Certificateholder in accordance with the Declaration of Trust and the terms and conditions of the Certificates.

On the [ ] day of each January and July, or if any such day is not a Business Day (as defined herein), the following Business Day, commencing on [ ] January 2003 (each, a "**Periodic Distribution Date**"), Certificateholders (as defined herein) will receive, from proceeds received in respect of the Trust Assets (as defined herein), a periodic distribution calculated based on LIBOR (as defined herein) plus [ ] per cent. per annum (the "**Rate of Return**"), calculated on the outstanding principal amount of the Certificates as at the beginning of the relevant Return Accumulation Period (as defined herein) on an actual/360 basis.

Unless previously redeemed in the circumstances described in Condition 8 of "*Terms and Conditions of the Certificates*", the Certificates will be redeemed on the Periodic Distribution Date falling in July 2007 (the "**Scheduled Dissolution Date**") at the Dissolution Distribution Amount (as defined herein) from proceeds received in respect of the Trust Assets.

Application has been made for the listing of the Certificates on the Luxembourg Stock Exchange and the Labuan International Financial Exchange Inc. (the "**Labuan Financial Exchange**"), but there can be no assurance that either listing will occur on the Closing Date or at all.

Investing in the Certificates involves risks. See "*Investment Considerations*" beginning on page 16.

The Certificates have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**") or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold or delivered within the United States or to U.S. Persons (as defined in Regulation S under the Securities Act ("**Regulation S**")) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Certificates are being offered, sold or delivered: (i) in the United States only to qualified institutional buyers ("**QIBs**") (as defined in Rule 144A under the Securities Act ("**Rule 144A**")) in reliance on, and in compliance with, Rule 144A; and (ii) to non-U.S. Persons (as defined in Regulation S) outside the United States in reliance on Regulation S. Each purchaser of the Certificates will be deemed to have made the representations described in "*Transfer Restrictions*" and is hereby notified that the offer and sale of Certificates to it is being made in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A or Regulation S.

Delivery of the Certificates in book-entry form will be made on the Closing Date. The Certificates will be issued in registered form in minimum denominations of U.S.$10,000 and integral multiples of U.S.$1,000 in excess thereof. Certificates which are offered and sold outside the United States to non-U.S. Persons in reliance on Regulation S (the "**Regulation S Certificates**") will be represented by interests in a global registered certificate without coupons attached (the "**Regulation S Global Certificate**"), deposited on or about the Closing Date with The Hongkong and Shanghai Banking Corporation Limited as common depositary (the "**Common Depositary**") for Euroclear Bank S.A/N.V. as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**"). Certificates which are offered and sold in the United States to QIBs in reliance on Rule 144A (the "**Rule 144A Certificates**") will be represented by interests in a global registered certificate without coupons attached (the "**Rule 144A Global Certificate**" and, together with the Regulation S Global Certificate, the "**Global Certificates**" and each, a "**Global Certificate**"), deposited on or about the Closing Date with the Common Depositary for Euroclear and Clearstream, Luxembourg. Interests in the Global Certificates will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg and will be subject to certain restrictions on transfer. Definitive Certificates evidencing holdings of interests in the Certificates will be issued in exchange for interests in the Global Certificates only in certain limited circumstances described herein.

Lead Manager and Bookrunner

HSBC

Co-Managers

ABC Islamic Bank (E.C)   Abu Dhabi Islamic Bank   Bank Islam   Dubai Islamic Bank

Islamic Development Bank   Maybank International   Standard Chartered Bank

It is a condition of the issuance of the Certificates that they be rated "Baa2" by Moody's Investors Service Inc. ("**Moody's**") and "BBB" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies ("**S&P**"). A rating is not a recommendation to buy, sell or hold securities, does not address the likelihood or timing of prepayment and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. A suspension, reduction or withdrawal of the rating assigned to the Certificates may adversely affect the market price of the Certificates.

Malaysia is responsible for the information included in this Offering Circular under the heading "*Summary of Malaysia*" and "*Malaysia*" (the "**Malaysia Information**"). Malaysia, having made all reasonable inquiries, confirms that the Malaysia Information is true and correct in all respects material in the context of the issue and offering of the Certificates and, in light of the circumstances under which it is provided, is not misleading, that there is no omission of a material fact necessary to make the Malaysia Information, in light of the circumstances under which it is provided, not misleading, and that the opinions and intentions expressed in the Malaysia Information are honestly held. Malaysia accepts responsibility accordingly. Save for the Malaysia Information, Malaysia has not verified any other information contained in this Offering Circular, makes no representation or warranty as to the accuracy, adequacy or completeness of the information contained herein, and nothing herein shall be deemed to constitute such a representation or warranty.

The Issuer accepts responsibility for the information contained in this Offering Circular other than the Malaysia Information (collectively the "**Issuer Information**"). To the best of the knowledge and belief of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information. The Issuer accepts responsibility accordingly. Save for the Issuer Information, the Issuer has not verified any other information contained in this Offering Circular, makes no representation or warranty as to the accuracy, adequacy or completeness of the information contained herein, and nothing herein shall be deemed to constitute such a representation or warranty.

No person has been authorised to give any information or to make any representation other than those contained in this document in connection with the offering of the Certificates and, if given or made, such information or representations must not be relied upon as having been authorised by the Issuer, the Managers, the Agents, the Issuer Administrator, the Payment Administrator (each as defined herein) or any other person. Neither the delivery of this document nor any sale of the Certificates pursuant to this offering shall, under any circumstances, constitute a representation or create any implication that the information contained herein is correct as of any time subsequent to the date hereof or that there has been no change in the affairs of any party mentioned herein since that date.

This document does not constitute an offer, and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such an offer or solicitation is not authorised or is unlawful. Save as mentioned under *"Plan of Distribution"* and *"Transfer Restrictions"*, no action has been or will be taken to permit a public offering of the Certificates in any jurisdiction where action would be required for that purpose. The Certificates may not be offered or sold, directly or indirectly, and this Offering Circular may not be distributed in any jurisdiction except in accordance with the legal requirements applicable in such jurisdiction.

None of the Managers, the Agents, the Issuer Administrator or the Payment Administrator have verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by any thereof as to the accuracy, adequacy, reasonableness or completeness of the information contained in this Offering Circular or any other information provided by the Issuer in connection with the Certificates, their distribution or their future performance.

Neither this Offering Circular nor any other information supplied in connection with the Certificates is intended to provide the basis of any credit or other evaluation or should be considered as a recommendation by the Issuer, Malaysia, the Managers, the Agents, the Issuer Administrator or the Payment Administrator that any recipient of this Offering Circular should purchase any of the Certificates. Each investor contemplating purchasing any Certificates should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and Malaysia.

In connection with the offering of the Certificates, the Lead Manager or any persons acting for the Lead Manager may over-allot or effect transactions with a view to supporting the market price of the Certificates at a level higher than that which might otherwise prevail for a limited period after the issue

date. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period.

The Labuan Financial Exchange takes no responsibility for the contents of this Offering Circular, makes no representations as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon any part of the contents of this Offering Circular. Investors are advised to read and understand the contents of this Offering Circular before investing. If in doubt, investors should consult their advisors.

Neither the United States Securities and Exchange Commission nor any state securities commission in the United States has reviewed, recommended, approved or disapproved of these securities or passed upon or endorsed the merits of the offering of the Certificates or the adequacy or accuracy of the disclosures in this Offering Circular. Any representation to the contrary is a criminal offence in the United States.

This Offering Circular is being distributed in the United States to QIBs only for informational use solely in connection with the consideration of the purchase of the Certificates. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone if such distribution or disclosure would be contrary to applicable securities laws.

NOTICE TO UK RESIDENTS

The Issuer will be a collective investment scheme as defined in the Financial Services and Markets Act 2000 (the "FSMA") of the United Kingdom (the "U.K."). The Issuer will not be authorised or otherwise approved by the U.K. Financial Services Authority nor is it a recognised scheme and it cannot be marketed in the U.K. to the general public. The contents of this document have not been approved by an authorised person in accordance with the rules of the U.K. Financial Services Authority, which approval is required (unless an exemption applies) by Section 21 of the FSMA. This document is for distribution in the U.K. only to (and is directed in the U.K. only at) (i) persons who have professional experience in matters relating to investments and of participating in unregulated collective investment schemes and falling within Article 19 of the FSMA (Financial Promotion) Order 2001 (the "FP Order") and Article 14 of the FSMA (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "CIS Order") (i.e. investment professionals) and (ii) persons falling within Article 49 of the FP Order and Article 22 of the CIS Order (i.e. high net worth companies, unincorporated associations etc.) (all such persons together being referred to as "Relevant Persons"). This document must not be acted on or relied on by persons in the U.K. who are not Relevant Persons. Any investment or investment activity to which this document relates is available in the U.K. only to Relevant Persons and will be engaged in the U.K. only with Relevant Persons.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE UNIFORM SECURITIES ACT WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF THE STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

AVAILABLE INFORMATION

To permit compliance with Rule 144A under the Securities Act in connection with the resales of the Certificates, so long as the Issuer is not subject to and in compliance with Section 13 or 15(d) of the United States Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, the Issuer has undertaken to furnish a holder or beneficial owner of Certificates and to any prospective purchaser of such Certificates, upon the request of such holder, beneficial owner or prospective purchaser, any information required to be delivered under Rule 144A(d)(4) under the Securities Act.

CERTAIN DEFINED TERMS AND CONVENTIONS

Statistical information included in the Malaysia Information of this Offering Circular is official data publicly available as of the date of this Offering Circular, and in most cases the latest official data publicly available. Financial data provided in the Malaysia Information of this Offering Circular may be subsequently revised in accordance with Malaysia's ongoing maintenance of its economic data, and such revised data will not be distributed by the Issuer to any holder of the Certificates.

References to "**Malaysia**" herein are to the Federation of Malaysia.

References to the "**Government**" herein are to the Federal Government of Malaysia.

References to "**BNM**" herein are to Bank Negara Malaysia, the central bank of Malaysia.

The fiscal year of Malaysia ends on 31 December of each year. The fiscal year ended 31 December 2001 is referred to in this Offering Circular as "2001", and other fiscal years are referred to in a similar manner.

References to tonnes herein are to metric tonnes, each of which equals approximately 2,205 pounds or 1.102 short tons. Measures of distance referred to herein are stated in kilometres, each of which equals approximately 0.62 miles.

Totals in certain tables in the Malaysia Information of this Offering Circular may differ from the sum of the individual items in such tables due to rounding. In addition, certain figures contained in the Malaysia Information of this Offering Circular are estimates prepared in accordance with procedures customarily used by Malaysia for the reporting of data. Certain other figures are preliminary in nature. In each case, the actual figures may vary from the estimated or preliminary figures set forth in the Malaysia Information of this Offering Circular.

Unless otherwise specified, percentage increases or decreases stated for periods or dates in 2002 represent increases or decreases as compared with the relevant amount for the corresponding period or date in 2001.

FORWARD LOOKING STATEMENTS

This Offering Circular includes, and any accompanying offering circular supplement may include, forward-looking statements. All statements other than statements of historical facts included in this Offering Circular and any offering circular supplement regarding, among other things, Malaysia's economy, fiscal condition, debt or prospects may constitute forward-looking statements. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "continue" or similar terminology. Although each of Malaysia and the Issuer believes that the expectations reflected in its forward-looking statements are reasonable at this time, there can be no assurance that these expectations will prove to be correct.

DATA DISSEMINATION

Malaysia was among the first group of countries that subscribed to the International Monetary Fund's Special Data Dissemination Standard, which is designed to improve the timeliness and quality of information of subscribing member countries. This standard requires subscribing member countries to provide schedules indicating, in advance, the date on which data will be released or the so-called "Advance Release Calendar". For Malaysia, precise dates or "no-later-than-dates" for the release of data are disseminated three months in advance through the Advance Release Calendar, which is published on the Internet under the International Monetary Fund's Dissemination Standards Bulletin Board. Summary methodologies of all metadata to enhance transparency of statistical compilation are also provided on the Internet under the International Monetary Fund's Dissemination Standards Bulletin Board. The Internet address is "http://dsbb.imf.org/country/myscats.htm".

SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

The Issuer is incorporated in Labuan, Malaysia with limited liability. All of the directors of the Issuer reside in Malaysia and substantially all of the assets of the Issuer and of such directors are located outside the United States. As a result, it may not be possible for investors to effect service of process outside Malaysia upon the Issuer or such persons, or to enforce judgements against them obtained in courts outside Malaysia predicated upon civil liabilities of the Issuer or such directors under laws other than Malaysian law, including any judgement predicated upon United States federal securities laws. The Issuer has been advised by its Malaysian legal counsel that there is doubt as to the enforceability in Malaysia in original actions or in actions for enforcement of judgements of United States courts of civil liabilities predicated solely upon the federal securities laws of the United States.

EXCHANGE RATES

References herein to "U.S.$", "$" or "U.S. dollars" are to United States dollars and references to "RM" or "ringgit" are to Malaysian ringgit. Since 2 September 1998, the ringgit has been pegged to the U.S. dollar at an exchange rate of RM3.80 to U.S.$1.00.

The following table sets forth the exchange rate between the ringgit and the U.S. dollar for the last day during, and the average for, the periods indicated.

Exchange rate of ringgit per U.S. dollar

Year	Period End	Period Average(1)
1997	3.8883	2.8132
1998 (through 1 September)	4.0900	3.9794
1998 (full year)	3.8000	3.9229
1999	3.8000	3.8000
2000	3.8000	3.8000
2001	3.8000	3.8000
2002 (through [ ] June 2002)	3.8000	3.8000

(1) The average of the monthly average exchange rates for each month of the applicable period.
Source: Bank Negara Malaysia.

This Offering Circular contains conversions of certain ringgit amounts into U.S. dollars for the convenience of the reader. No representation is made that the ringgit amounts actually represent the U.S. dollar amounts or could have been or could be converted into U.S. dollars at the rates indicated, at any particular rate, or at all.

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Prospective investors should rely only on the information contained in this document or to which reference is made herein. The Issuer has not authorised anyone to provide prospective investors with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

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SUMMARY OF THE OFFERING

The following summary does not purport to be complete and is qualified in its entirety by reference to, and must be read in conjunction with, the detailed information appearing elsewhere in this Offering Circular and related documents referred to herein.

Reference to a "Condition" is to a numbered condition of the "Terms and Conditions of the Certificates".

Parties

Issuer	Malaysia Global Sukuk Inc., a special purpose company incorporated in Labuan, Malaysia under the Offshore Companies Act, 1990 of Malaysia (the "**Issuer**"), has been incorporated solely for the purpose of participating in the transactions contemplated by the Transaction Documents (as defined below).
Ownership and Administration of the Issuer	The authorised share capital of the Issuer is U.S.$12,000, of which two ordinary shares of par value U.S.$1.00 each have been issued. The Issuer's ordinary shares are owned by The Minister of Finance, a body corporate established under the Minister of Finance (Incorporation) Act 1957 of Malaysia. The affairs of the Issuer will be managed by Ernst & Young Trust Sdn. Bhd. (the "**Issuer Administrator**"), who will also provide certain administrative services for and on behalf of the Issuer pursuant to the Issuer Administration Agreement dated the Closing Date between the Issuer and the Issuer Administrator (the "**Issuer Administration Agreement**").
Seller	The Federal Lands Commissioner, a body corporate established under the Federal Lands Commissioner Act 1957 of Malaysia (the "**Seller**"), will convey to the Issuer the beneficial title to certain Land Parcels (as defined below) pursuant to the Purchase Agreement (as defined below).
Lessee	Malaysia will lease from the Issuer the Land Parcels on the terms set out in the Lease Agreement (as defined below) for a period commencing on the Closing Date and terminating with the acquisition of the Land Parcels from the Issuer on the Scheduled Dissolution Date, unless the Certificates are earlier redeemed and the Trust dissolved as described herein.
Trustee	The Issuer will act as trustee (together with the Co-Trustee (as defined below) and any other trustee appointed under the Declaration of Trust, the "**Trustee**") on behalf of the Certificateholders in respect of the Trust in accordance with the Declaration of Trust. Pursuant to the Declaration of Trust, the Issuer will, as Trustee, hold the Trust Assets for and on behalf of the Certificateholders.
Co-Trustee	Pursuant to the Declaration of Trust, the Issuer as Trustee will appoint Ernst & Young Trust Sdn. Bhd. as co-trustee (the "**Co-Trustee**") to perform and comply with all the duties and obligations expressed to be assumed by a trustee under the Declaration of Trust and the other Transaction Documents. In the event of any conflict or disagreement between the Issuer as Trustee and the Co-Trustee on any matter, the decision of the Co-Trustee will prevail.
Payment Administrator	The Hongkong and Shanghai Banking Corporation Limited ("**HSBC**"), as Payment Administrator (the "**Payment Administrator**") under the Payment Administration Agreement (as defined in the Conditions), will, among other things, operate the Transaction Account, collect and receive payments from Malaysia under the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed and the Service Agency Agreement and make certain payments in respect of the Certificates.

Principal Paying Agent, Transfer Agent, Reference Agent and Registrar	HSBC.
Summary of the Certificates	
Certificates	U.S.$[ ],000,000 Trust Certificates due 2007 (the "**Certificates**" or the "**Sukuk**").
Closing Date	[ ] July 2002, or such other date as may be agreed by the Issuer and the Lead Manager.
Issue Price	100 per cent. of the aggregate principal amount of the Certificates.
Periodic Distribution Dates	The [ ] day of each January and July, or if any such day is not a Business Day, the following Business Day, commencing on [ ] January 2003. "**Business Day**" means a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in Hong Kong, Kuala Lumpur, London and New York.
Periodic Distributions	On each Periodic Distribution Date, each Certificateholder will receive, from moneys received in respect of the Trust Assets, a periodic distribution calculated based on LIBOR plus [ ] per cent. per annum (the "**Rate of Return**") on the principal amount of Certificates held by such holder on the first day of the relevant Return Accumulation Period (as defined below). Each Periodic Distribution Amount (as defined in Condition 6) will be calculated on the outstanding principal amount of the Certificates as at the beginning of the relevant Return Accumulation Period on the basis of the actual number of days elapsed in such Return Accumulation Period and a 360-day year. See *"Condition 6"*.
Return Accumulation Period	With respect to any Periodic Distribution Date, the period from and including the immediately preceding Periodic Distribution Date (or in the case of the initial Periodic Distribution Date, from and including the Closing Date) to but excluding such Periodic Distribution Date is the related "**Return Accumulation Period**".
Redemption of Certificates and Dissolution of the Trust	Unless the Certificates are earlier redeemed (and the Trust is dissolved after such redemption) following (i) the occurrence of a Dissolution Event (as defined in Condition 11); (ii) the imposition of any Taxes (as defined in Condition 9) permitting Malaysia to exercise its right to require the Issuer to sell the Trust Assets to Malaysia pursuant to the Sale Undertaking Deed; or (iii) the occurrence of a Total Loss Event (as defined below), the Certificates will be redeemed on the Scheduled Dissolution Date at the Dissolution Distribution Amount and the Trust will thereafter be dissolved. Malaysia will execute a Purchase Undertaking Deed (the "**Purchase Undertaking Deed**"), pursuant to which Malaysia will undertake irrevocably to purchase from the Issuer the beneficial title to the Land Parcels at the Exercise Price (as defined below): (a) on the date specified by the Trustee to Certificateholders in accordance with Condition 11 for redemption of the Certificates following a Dissolution Event; or (b) on [ ] July 2007, the Scheduled Dissolution Date.

	The Issuer will execute a Sale Undertaking Deed (the "**Sale Undertaking Deed**"), pursuant to which the Issuer will undertake irrevocably to sell to Malaysia the beneficial title to the Land Parcels at the Exercise Price on any Periodic Distribution Date, provided that Malaysia has given not less than five Business Days prior written notice to the Trustee and Certificateholders in accordance with Condition 14, if as a result of a change in law after [ ] June 2002 Malaysia would, on the next Periodic Distribution Date, be required to pay additional amounts as described in Condition 9 and such requirement cannot be avoided by the use of reasonable measures available to Malaysia.
	Upon receipt of the Exercise Price from Malaysia in accordance with the terms of the Purchase Undertaking Deed or Sale Undertaking Deed, such amount, together with Lease Rentals through the date of the termination of the Lease Agreement, will be applied to redeem the Certificates in accordance with Condition 4(2) at the Dissolution Distribution Amount.
	"**Exercise Price**" means an amount equal to U.S.$[ ],000,000 plus Expenses.
	"**Expenses**" means all outstanding expenses incurred by the Service Agent (as defined below) under the Service Agency Agreement dated the Closing Date entered into between the Issuer and the Service Agent (the "**Service Agency Agreement**") (including but not limited to land proprietorship taxes) to be reimbursed by the Issuer to the Service Agent under the Service Agency Agreement.
	"**Dissolution Distribution Amount**" means, as of any date, the aggregate principal amount of the Certificates then outstanding plus accrued and unpaid Periodic Distribution Amounts as of such date.
Redemption Following a Dissolution Event	The "**Dissolution Events**" are set forth in Condition 11. If any Dissolution Event shall occur, the Trustee will give notice of the occurrence of such Dissolution Event to the holders of the Certificates with a request to such holders to indicate if they wish the Trust to be dissolved. If so requested in writing by the holders of at least 25 per cent. in aggregate principal amount of the Certificates then outstanding or if so directed by an Extraordinary Resolution (as defined in the Conditions) of the holders of the Certificates, the Trustee shall (subject in each case to being indemnified to its satisfaction), or, if the Trustee so decides in its discretion, may give notice to all the holders of the Certificates that the Certificates are to be redeemed at the Dissolution Distribution Amount and the Trust is to be dissolved on the dates specified in accordance with Condition 11.
Redemption for Tax Reasons	If as a result of a change in law after [ ] June 2002 Malaysia would, on the next Periodic Distribution Date, be required to pay additional amounts as described in Condition 9, and such requirement cannot be avoided by the use of reasonable measures available to Malaysia, Malaysia may (having given not less than five Business Days written notice prior to such Periodic Distribution Date) exercise its rights under the Sale Undertaking Deed to purchase the beneficial title to the Land Parcels at the Exercise Price and the Trustee will then redeem the Certificates at the Dissolution Distribution Amount on the Periodic Distribution Date following receipt of the Exercise Price and the Trust will thereafter be dissolved.
Redemption Following Total Loss Event	Following a Total Loss Event, the Issuer will have recourse (i) to Malaysia under the Lease Agreement, if such Total Loss Event was due to the negligence or default of Malaysia as lessee or (ii) otherwise to the

	Insurance Provider under the Insurance Agreement, in each case for an amount sufficient to allow redemption of the Certificates at the Dissolution Distribution Amount. Upon receipt of such amount, the Trustee will redeem the Certificates at the Dissolution Distribution Amount and the Trust will thereafter be dissolved.
	"**Insurance Agreement**" means the insurance agreement covering a Total Loss Event, effective as of the Closing Date, to be procured from the Insurance Provider by the Service Agent pursuant to the Service Agency Agreement, which policy (i) specifies the Issuer as the insured party and provides for all claims to be paid directly by the the Insurance Provider to the Issuer; (ii) only excludes a Total Loss Event occurring as a direct result of default or negligence on the part of Malaysia; (iii) in the aggregate provides a sum insured equal to or greater than Expenses plus the Dissolution Distribution Amount as of the date a full claim payment has been received by the Issuer thereunder; and (iv) is unconditional and irrevocable, subject only to its terms.
	"**Insurance Provider**" means Malaysia (in the capacity of insurer).
	A "**Total Loss Event**" means (i) total loss or destruction of, or damage to the whole of the Land Parcels or any event or occurrence that renders the whole of the Land Parcels permanently unfit for any economic use and the repair or remedial work in respect thereof is uneconomical or (ii) compulsory acquisition, confiscation or expropriation of the whole of the Land Parcels.
Form and Delivery of the Certificates	The Certificates will be issued in registered form only, without coupons attached, and will consist of (i) Regulation S Certificates offered and sold outside the United States to non-U.S. persons (as defined in the Securities Act) in reliance on Regulation S under the Securities Act and (ii) Rule 144A Certificates offered and sold in the United States only to QIBs, in reliance on and in compliance with Rule 144A.
	The Regulation S Certificates will be represented by interests in the Regulation S Global Certificate. Until the termination of the distribution compliance period (as defined in Regulation S) with respect to the offering of the Certificates, interests in the Regulation S Global Certificate may only be held by Euroclear or Clearstream, Luxembourg.
	The Rule 144A Certificates will be represented by interests in the Rule 144A Global Certificate.
	Definitive certificates evidencing holdings of Certificates will only be issued in exchange for interests in the Global Certificates in certain limited circumstances.
	See "*The Global Certificates*".
Clearance and Settlement	Interests in the Global Certificates will be held in book-entry form through Euroclear or Clearstream, Luxembourg. Transfers within Clearstream, Luxembourg or Euroclear will be in accordance with the usual rules and operating procedures of the relevant clearance system.
Denominations	The Certificates will be issued in minimum denominations of U.S.$10,000 and integral multiples of U.S.$1,000 in excess thereof.
Status	Each Certificate represents an undivided beneficial ownership in the Trust Assets and will rank *pari passu*, without any preference, with the other Certificates. The Certificates are limited recourse obligations. See *"Conditions 3 and 12"*.

The Trust and the Trust Assets	Pursuant to the Declaration of Trust, the Issuer will declare that it will hold the Trust Assets upon trust absolutely for the holders of the Certificates *pro rata* according to the face amount of Certificates held by each Certificateholder in accordance with the Declaration of Trust and the Conditions. The "**Trust**" is the trust declared by the Issuer under the Declaration of Trust. The "**Trust Assets**" are the Issuer's beneficial title to the Land Parcels, all of the Issuer's rights, title, interest and benefit, present and future, in, to and under the Transaction Documents all monies standing to the credit of the Transaction Account, and all proceeds of the foregoing.
The Purchase Agreement	Pursuant to the Purchase Agreement, the Seller will sell to the Issuer the beneficial title to the Land Parcels (free from all claims and encumbrances and with all attached or accrued rights as of the date of the Purchase Agreement). The gross proceeds received by the Issuer from the issuance and sale of the Certificates will be used to pay the aggregate purchase price payable by the Issuer to the Seller for the beneficial title to the Land Parcels. Under the Purchase Agreement, only beneficial title to the Land Parcels will pass to the Issuer and the Seller will remain the registered proprietor of the Land Parcels. Pursuant to a declaration of trust (the "**Seller's Declaration of Trust**"), the Seller will declare that it is the registered proprietor of the Land Parcels only as trustee for and on behalf of the Issuer.
Land Parcels	The "**Land Parcels**" consist of four parcels of land, including all buildings and all other fixtures forming part thereof, located in and around Kuala Lumpur, Malaysia. See "*The Trust Assets—Land Parcels*".
The Lease Agreement	Under the terms of a master *ijarah* agreement dated the Closing Date between the Issuer as lessor and Malaysia as lessee, the Issuer and Malaysia agree to execute consecutive, semi-annual leases to lease the Land Parcels to Malaysia during the term commencing on the Closing Date and extending to the Scheduled Dissolution Date. The "**Lease Agreement**" means, collectively, such master *ijarah* agreement and all or any of the semi-annual leases executed in accordance therewith. Under the terms of the Lease Agreement, Malaysia will agree that the Issuer shall not under any circumstances be liable to Malaysia or to any third party for any cost, claim, demand, loss, damage or expense of any kind or nature caused directly or indirectly by, or out of, the use of any part or the whole of the Land Parcels. Malaysia will agree to indemnify and keep indemnified and save harmless the Issuer against all and any such costs, claims, demands, losses, damages and expenses. Under the terms of the Lease Agreement, Malaysia shall, at its own cost and expense, be responsible for the performance of all Ordinary Maintenance and Repair required by the Land Parcels. "**Ordinary Maintenance and Repair**" means all repairs, replacements, acts, and maintenance and upkeep works required for the general usage and operation of the Land Parcels and to keep, repair, maintain and preserve the Land Parcels in good order and condition, and in compliance with such maintenance, repair and upkeep standards and procedures generally expected in the ordinary course of business. Under the terms of the Lease Agreement, the Issuer will be responsible for the performance of all Major Maintenance, and will procure that the Service Agent, in accordance with the terms and conditions set out in the Service Agency Agreement, will perform all Major Maintenance on behalf of the Issuer. "**Major Maintenance**" means all repairs, replacements, acts and maintenance required in respect of the Land Parcels other than Ordinary Maintenance and Repair.

The rental payments under the semi-annual leases to be entered into pursuant to the Lease Agreement (the "**Lease Rentals**") will be calculated based on LIBOR plus the Margin (as defined in the Conditions), and will equal the Periodic Distribution Amounts payable on the Periodic Distribution Date coinciding with the Rental Payment Date for such Lease Rental. Lease Rentals will be re-calculated semi-annually based on LIBOR two London Business Days (as defined in the Conditions) before the commencement of each semi-annual lease.

Malaysia will be obligated to pay Lease Rentals on the [ ] day of each January and July or, if any such day is not a Business Day, the following Business Day, commencing in January 2003 and to and including July 2007, or any other date on which the Lease Agreement is earlier terminated by agreement of the parties (each, a "**Rental Payment Date**").

See "*The Trust Assets—The Lease Agreement*".

The Service Agency Agreement — Under the terms of the Service Agency Agreement, Malaysia (in this capacity, the "**Service Agent**") will, *inter alia*, be responsible on behalf of the Issuer for the performance of all Major Maintenance in respect of the Land Parcels and the procuring of an Insurance Agreement.

Transaction Account — The Payment Administrator will maintain and operate the Transaction Account on behalf of the Trust. Monies deriving from the Trust Assets will be paid into the Transaction Account and payments to be made to holders of the Certificates will be made from funds standing to the credit of the Transaction Account.

Priority of Distributions — On each Periodic Distribution Date, or on the date specified in accordance with the conditions for redemption of the Certificates (the "**Redemption Date**"), the Payment Administrator shall apply the monies standing to the credit of the Transaction Account in the following order of priority:

(a) *first*, to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of all Periodic Distribution Amounts due and unpaid;

(b) *second*, only if such payment is made on the Redemption Date (as defined in the Conditions), to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of the Dissolution Distribution Amount; and

(c) *third*, only if such payment is made on the Redemption Date, in or towards payment *pari passu* and rateably of all outstanding Expenses.

Deed of Undertaking — Pursuant to a deed of undertaking (the "**Deed of Undertaking**") executed by Malaysia, Malaysia will pay certain fees and expenses of, and indemnify against certain losses of, among others, the Trustee, Co-Trustee, Payment Administrator, Issuer Administrator and Agents.

Limited Recourse	Each Certificate represents an undivided beneficial ownership in the Trust Assets. The Certificates do not represent an interest in or obligation of any of the Issuer, Malaysia, the Managers, the Agents, the Issuer Administrator or the Payment Administrator or any affiliate of any of the foregoing entities. Accordingly, Certificateholders will have no recourse to any assets of the Issuer, Malaysia (to the extent it fulfils all of its obligations under the Transaction Documents to which it is a party), the Managers, the Agents, the Issuer Administrator or the Payment Administrator or any affiliate of any of the foregoing entities in respect of any shortfall in the expected amounts from the Trust Assets. However, Malaysia is obliged to make the payments under the Transaction Documents to which it is a party directly to the Issuer, and the Issuer, as Trustee for the benefit of the Certificateholders, and any other Trustee, will have direct recourse against Malaysia to recover payments due to the Issuer from Malaysia pursuant to the Transaction Documents to which Malaysia is a party.
Negative Pledge	So long as any of the Certificates remains outstanding, the Issuer has undertaken that it will not secure any of its present or future indebtedness for borrowed money by any lien, pledge, charge or other security interest upon any of its present or future assets, properties or revenues (other than those arising by operation of law).
Enforcement	Following the distribution of the Trust Assets to the Certificateholders in accordance with the Conditions and the Declaration of Trust, the Trustee shall not be liable for any further sums or assets, and accordingly such Certificateholders may not take any action against the Trustee or any other person to recover any such sum or asset in respect of the Certificates or the Trust Assets. Under no circumstances shall the Trustee or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets except pursuant to the Purchase Undertaking Deed or Sale Undertaking Deed, and the sole right of the Trustee and the Certificateholders against Malaysia shall be to enforce the obligation of Malaysia to pay the Exercise Price thereunder. The Trustee shall not in any circumstances be obliged to take any action against Malaysia under the Transaction Documents unless, following the occurrence of a Dissolution Event, directed to do so by the Certificateholders in accordance with the Conditions and then only to the extent indemnified to its satisfaction. No Certificateholder shall be entitled to proceed directly against Malaysia unless (i) the Trustee, having become bound so to proceed, fails to do so within two months of becoming so bound and such failure is continuing and (ii) the relevant Certificateholder (or such Certificateholder together with the other Certificateholders who propose to proceed directly against Malaysia) holds at least 25 per cent. of the aggregate principal amount of the Certificates then outstanding. The foregoing is subject to the following. After enforcing or realising the Trust Assets and distributing the net proceeds in accordance with Condition 4(2), the obligations of the Trustee in respect of the Certificates shall be satisfied and no holder of such Certificates may take any further steps against the Trustee to recover any further sums in respect of such Certificates and the right to receive any such sums unpaid shall be extinguished.

Withholding Tax	All payments in respect of the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement, the Service Agency Agreement and the Certificates shall be made without withholding or deduction for, or on account of, any taxes, levies, imports, duties, fees, assessments or other charges of whatever nature, imposed or levied by or on behalf of any Relevant Jurisdiction (as defined in Condition 9) Labuan or Malaysia or by any department, agency or other political subdivision or taxing authority thereof or therein, and all interest, penalties or similar liabilities with respect thereto ("**Taxes**"), unless the withholding or deduction of the Taxes is required by law. In such event, Malaysia will be required, pursuant to the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement or the Service Agency Agreement, as the case may be, to pay to the Issuer additional amounts (which amounts will be applied towards payments in respect of the Certificates) so that, subject to certain exceptions, the full amount which otherwise would have been due and payable under the Certificates is received by parties entitled thereto. See "*Condition 9*".
Use of Proceeds	The gross proceeds of the issue of the Certificates will be used by the Issuer to purchase the beneficial title to the Land Parcels from the Seller pursuant to the Purchase Agreement.
Listing	Application has been made to list the Certificates on the Luxembourg Stock Exchange and the Labuan Financial Exchange. There can be no assurance that either listing will occur on the Closing Date or at all. See *"General Information"*.
Rating	The Certificates, upon issue, are expected to be rated "BBB" by S&P and "Baa2" by Moody's. See *"Ratings"*.
Certificateholder Meetings	A summary of the provisions for convening meetings of Certificateholders to consider matters relating to their interests as such are set forth under Condition 15.
Tax Considerations	See "*Certain Tax Considerations*" for a description of certain United States, United Kingdom, European Union and Malaysia tax considerations applicable to the Certificates.
ERISA Considerations	See "*ERISA Considerations*" for a description of certain considerations under the United States Employee Retirement Income Security Act applicable to the Certificates.
Transfer Restrictions	The purchase and transfer restrictions applicable to the Certificates are set forth under "*Plan of Distribution*" and "*Transfer Restrictions*".
Transaction Documents	The "**Transaction Documents**" are the Purchase Agreement, the Lease Agreement, the Seller's Declaration of Trust, the Service Agency Agreement, the Insurance Agreement, the Purchase Undertaking Deed, the Sale Undertaking Deed, the Declaration of Trust, the Agency Agreement, the Payment Administration Agreement, the Deed of Undertaking, the Certificate Purchase Agreement, the Issuer Administration Agreement, the Certificates and any other agreements and documents delivered or executed in connection therewith (each as defined in the Conditions).
Governing Law	The Declaration of Trust, the Agency Agreement, the Payment Administration Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Certificate Purchase Agreement and the Certificates will be governed by English law. The Purchase Agreement, the Lease Agreement, the Seller's Declaration of Trust, the Service Agency Agreement, the Insurance Agreement, the Deed of Undertaking and the Issuer Administration Agreement will be governed by Malaysian law.

SUMMARY OF MALAYSIA

The following information is qualified in its entirety by the detailed information contained in this Offering Circular under the heading "Malaysia".

Malaysia

General

Malaysia is located in Southeast Asia, just north of the equator, and consists of two major land masses: Peninsular Malaysia and the states of Sabah and Sarawak, which are located on the island of Borneo. Peninsular Malaysia is separated from the states of Sabah and Sarawak by the South China Sea. The total land area of Malaysia is approximately 330,000 square kilometres. Malaysia has a population of approximately 23.8 million. Kuala Lumpur, the capital and largest city, has an estimated population of 1.4 million.

Government

Malaysia has a federal system of government based on a parliamentary democracy headed by a constitutional monarch called the Yang di-Pertuan Agong. The Yang di-Pertuan Agong is elected for a five-year term by the nine hereditary Rulers who are members of the Conference of Rulers. The Federal Constitution lays the framework for the executive, legislative and judicial system of the country. The Federal executive power is exercised by the Prime Minister and his cabinet. Dato' Seri Dr. Mahathir bin Mohamad has been the Prime Minister since 1981. Prime Minister Mahathir is 76 years old. Since its formation, Malaysia has been governed by the National Front coalition comprising three major component parties, namely: the United Malay National Organisation, known as UMNO, the Malaysian Chinese Association and the Malaysian Indian Congress, and a number of smaller parties which have changed from time to time. In the general elections held in November 1999, members of the National Front coalition were elected to 151 out of 193 seats in the House of Representatives of the Parliament.

Economy

Malaysia has a diversified economy, the principal sectors of which are services, manufacturing, agriculture, mining and construction. Malaysia's industrial base has strengthened as industries have progressed beyond simple assembly to focus on the manufacture of high value-added capital- and technology-intensive products. In view of its strong linkages with other sectors of the economy, the services sector is also being promoted intensively. Malaysia produces and exports a wide range of manufactured goods, including electronic components and equipment, electrical machinery and appliances, chemicals, textiles, wood products and metal products, and also exports petroleum, liquefied natural gas, sawn timber, saw logs and tin. Malaysia is one of the world's largest exporters of semiconductors, air conditioners, rubber gloves, palm oil and rubber.

In 1996, the Government launched the Multimedia Super Corridor to spearhead the development of an information-rich society using state-of-the-art technology. Under the Third National Agriculture Policy, which covers the period from 1998 to 2010, the Government is taking measures to accelerate the transformation of the agriculture sector into a modern, commercialised and technology-driven sector, as well as to diversify the agricultural base by promoting non-traditional activities such as floriculture and horticulture. In April 2001, the Government released both the Third Outline Perspective Plan, which covers a ten-year period from 2001 through 2010, and the Eighth Malaysia Plan, which covers a five-year period from 2001 through 2005. These plans provide the policy framework that outlines the strategies for the next phase of Malaysia's economic development. An important policy objective is to increase the knowledge content of all sectors of the economy to enhance the country's competitive position. To advance this policy, in 2001 a master plan was completed for the transition towards a knowledge-based economy. Within the new framework for the economy, the Capital Market Masterplan and the Financial Sector Masterplan were launched on 22 February 2001 and 1 March 2001, respectively. These plans provide the framework for the development of the capital markets and financial sector for the next 10 years.

Malaysia's economic growth has been supported by a well-developed financial system. The Government has consistently adopted measures to increase the efficiency and soundness of the financial system, including measures to ensure that credit is available for productive activities. These measures have been consistent with the objective of maintaining macroeconomic stability, while reducing excessive banking institution exposure to vulnerable sectors of the economy. Malaysia's developed banking system and high savings rate have provided the monetary resources required for economic growth. Malaysia currently has one of the world's highest savings rates. In 2000, gross national savings accounted for 39.9% of gross national product, or GNP, and total deposits with banking institutions (including Islamic banks) amounted to 138.1% of gross domestic product, or GDP. In 2001, gross national savings accounted for 34.8% of GNP, as consumption spending remained resilient in the context of lower gross national income. Nevertheless, the savings rate in Malaysia remains relatively high by historical standards and in comparison with other countries. The supervisory and regulatory framework of Malaysia's banking system is consistent with international standards and best banking practices.

The macroeconomic and monetary policies of Malaysia over the past four decades have sought to achieve sustainable economic growth while maintaining price stability. As a result, Malaysia achieved annual real GDP growth averaging 9.3% per year over the decade ending in 1997, while inflation remained low, averaging 3.4% over the same period. The onset of the regional economic crisis in mid-1997 caused severe economic problems in a number of East Asian countries. Malaysia was also severely affected by the contagion effects of the regional economic crisis. In 1998, real GDP declined by 7.4% while inflation increased to 5.3%. The policies implemented by the Government in response to the crisis contributed to a strong economic recovery in 1999 and 2000, with real GDP growth of 6.1% in 1999 and 8.3% in 2000. In 2001, real GDP grew at a rate of 0.4%. Real GDP grew at a more moderate rate of 3% and 0.4% in the first and second quarters of 2001, respectively, but contracted at a rate of 0.9% and 0.5% in the third and fourth quarters, respectively, each as compared to the corresponding period in 2000, due primarily to the effects of the economic slowdown in major industrial countries. In March and September 2001, the Government adopted additional fiscal measures aimed at stimulating domestic demand to compensate for lower export growth. At the same time, monetary policy continued to be accommodative to support overall economic activity amid low inflation of 1.4% in 2001 and in the first three months of 2002. In addition, the Government actively promoted special funds for vital sectors and small- and medium-sized enterprises by expanding the size of these funds and lowering their lending rates. Economic growth in the first quarter of 2002 was driven mainly by strong consumption spending and supported by improved external demand following the general recovery in the global economy.

During the period from 1997 to 2001, the United States, Japan and Singapore were consistently the largest export markets and the major suppliers of imported goods to Malaysia. Since 1997, the United States has been Malaysia's largest trading partner. In 2001, the United States accounted for 18.3% of total trade, followed by Japan at 16% and Singapore at 15%. Since the mid-1990s, the Government has intensified efforts to address structural problems in the economy and to contain the current account deficit in the balance of payments. These efforts have included measures designed to enhance Malaysia's export competitiveness, increase the value-added content of exports and develop the services sector. The current account deficit improved from 10.2% of GNP in 1995 to 6.3% of GNP in 1997, in large part as a result of these policy measures. In 1998, with lower imports due to the economic contraction in Malaysia, Malaysia registered a current account surplus of 14% of GNP, its first since 1989. The current account surplus was 10.2% of GNP in 2000 and averaged 13.7% of GNP in 1999-2000 due to a strong increase in exports. In 2001, the current account surplus narrowed to 9% of GNP, reflecting a moderate decline in the trade surplus. From the first quarter of 2001, Malaysia began compiling its balance of payments in conformity with the guidelines set out in the Fifth Edition of the Balance of Payments Manual of the International Monetary Fund and reclassified data for 1999 and 2000 based on these guidelines. Among other changes, line items previously presented as the long-term capital inflows and short-term capital inflows are now combined as one line item under the financial account. The financial account outflows amounted to RM25.2 billion in 1999 and RM23.8 billion in 2000, due primarily to the increase in trade credit extended to foreign importers, outflows of portfolio capital and changes in the external assets and liabilities of commercial banks. In 2001, financial account outflows moderated to RM14.8 billion, due mainly to lower net outflow of short-term capital, and, to a lesser extent, net inflow of external borrowings by the Government and the private sector.

Malaysia has adopted prudential rules that govern external borrowings by both the private and public sectors. External borrowings of the Government are subject to the provisions of the External Loans Act 1963, which sets a ceiling on Government borrowings. The expansionary fiscal policy implemented since the regional economic crisis has increased the debt of the Government. This is a result of borrowings to finance the overall deficit of the Government, which increased to RM9.5 billion in 1999, RM19.7 billion in 2000 and RM18.4 billion in 2001. The external borrowings of the Government accounted for 21% of the Government's total borrowing requirements in 2000 and 23% in 2001. Malaysia's short-term external debt has been relatively low, accounting for an average of 19.2% of total external debt from 1996 to 2000. In 2001, Malaysia's short-term external debt accounted for 14% of total external debt. The Government has also encouraged prepayments of foreign currency loans by public and private sector companies to contain external debt at a manageable level and to reduce the debt servicing burden. Refinancing efforts have helped lengthen the maturity structure of Malaysia's debt profile, smooth the bunching of repayments and lower interest costs. Total external debt, including short-term debt, was equal to 50.3% of GNP for the year 2000. The country's external debt service ratio has remained low at 6.7% in 1998, 6.1% in 1999 and 5.3% in 2000. Total external debt, including short-term debt, amounted to RM170.4 billion (U.S.$44.8 billion) as of 31 December 2001 and RM175.6 billion (U.S.$46.2 billion) as of 31 March 2002.

As of 31 May 2002, net international reserves held by BNM amounted to RM[124.4] billion (U.S.[$32.7] billion), sufficient to finance 5.5 months of retained imports, and five times external short-term debt outstanding (as defined under "*Malaysia—The Economy—External Debt*"). The increase in net international reserves since 31 December 2001 (U.S.$30.8 billion) was due to the build-up in foreign exchange reserves generated mainly from trade and long-term capital inflows. These inflows more than offset payments for services, overseas investment and external debt repayments.

Summary Economic Information

The following tables provide certain information concerning Malaysia.

Economy

	1997	1998	1999	2000E	2001P	First three months of 2002P
Gross domestic product(1)						
Nominal (RM million)	281,795	283,243	300,764	342,157	334,589	83,347
Nominal (U.S.$ million)(2)	100,169	72,202	79,148	90,041	88,050	21,933
Change in GDP in constant prices (%)	7.3	(7.4)	6.1	8.3	0.4	1.1
Per capita GNP (U.S.$)(2)	4,376	3,079	3,243	3,544	3,410	n.a.
Annual inflation rate (%)	2.7	5.3	2.8	1.6	1.4	1.4
Unemployment rate (%) (at year end)	2.5	3.2	3.4	3.1	3.6	n.a.

E Estimate.
P Preliminary.
(1) In the first quarter of 1999, the Department of Statistics began releasing a new series of GDP data based on 1987 prices. Unlike the 1978-based GDP data, which relied more on gross output in the computation of value added, the 1987-based GDP data attempts, whenever data is available, to take into account variations in input in the computation. The new series of data is also more comprehensive in terms of wider coverage of industries and takes into account the change in the industrial structure of the economy between 1978 and 1987.
(2) Converted to U.S. dollars at the average exchange rate for the relevant period.
Sources: Department of Statistics, Malaysia.
Bank Negara Malaysia.

Balance of Payments (net)

	1997	1998
	(U.S. $ million,(1) except percentages and months of retained imports)	
Merchandise balance (f.o.b.)(2)	3,652	17,649
Merchandise export growth (%)	0.7	(7.2)
Balance on services	(8,103)	(5,671)
Unrequited transfers	(1,484)	(2,444)
Balance on current account	(5,935)	9,535
Overall balance of payments	(5,993)	4,460
Current account balance as a percentage of GNP (%)	(6.3)	14.0
Current account balance as a percentage of GDP (%)	(5.9)	13.2
Long-term capital inflows	6,788	2,710
Short-term capital inflows	(4,590)	(5,261)
BNM net international reserves(3)	21,704	26,164
Months of retained imports(4)	3.4	5.7

(1) The balance of payments accounts are recorded in ringgit. The U.S. dollar amounts in the table reflect the ringgit amounts converted to U.S. dollars at the annual average exchange rate for the relevant year.
(2) The merchandise balance differs from the trade balance in the table under "*Malaysia—The Economy—Balance of Payments—External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to an f.o.b. basis under merchandise balance; and (c) merchandise balance data include military goods which are not included in trade data.
(3) Converted to U.S. dollars at the exchange rate at the end of the relevant period.
(4) Represents the number of months of retained imports that could be financed by BNM's net international reserves.
Sources: Department of Statistics, Malaysia.
Bank Negara Malaysia.

Balance of Payments[(1)] (net)

	1999	2000	2001[P]
	(U.S.$ million)[(2)]		
Goods[(3)]	22,644	20,854	18,383
Services	(2,816)	(2,951)	(2,202)
Balance on goods and services	19,828	17,904	16,181
Income	(5,496)	(7,514)	(6,743)
Current transfers	(1,728)	(1,980)	(2,152)
Balance on current account	12,604	8,410	7,286
Current account balance as a percentage of GNP (%)	17.1	10.2	9.0
Current account balance as a percentage of GDP (%)	15.9	9.4	8.3
Capital account	—	—	—
Financial account	(6,619)	(6,276)	(3,892)
Direct investment	2,473	1,762	287
Portfolio investment	(1,156)	(2,472)	(649)
Other investment	(7,936)	(5,565)	(3,531)
Official sector	1,762	1,036	1,872
Private sector	(9,698)	(6,601)	(5,403)
Errors and omissions	(1,296)	(3,109)	(2,430)
Overall balance	4,689	(974)	964

P Preliminary.

(1) From the first quarter of 2001, the balance of payments is compiled in conformity with the guidelines set forth in the Fifth Edition of the Balance of Payments Manual of the International Monetary Fund. The merchandise line item has been reclassified as the goods balance; line items previously presented as the long-term capital inflows and short-term capital inflows are now combined as one line item under the financial account; and the balance on services line item is now broken out to two line items, services and income. Data for 1999 and 2000 have also been reclassified based on the new guidelines. Data for prior periods contained in the previous table have not been so reclassified, and, therefore, are not comparable in several respects to the data in this table.

(2) The balance of payments accounts are recorded in ringgit. The U.S. dollar amounts in the table reflect the ringgit amounts converted to U.S. dollars at the annual average exchange rate for the relevant year.

(3) The goods balance differs from the trade balance in the table under "*Malaysia—The Economy—Balance of Payments—External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to an f.o.b. basis under goods balance; and (c) goods balance data include military goods which are not included in trade data.

Source: Department of Statistics, Malaysia.

External Debt

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001P	2002P
Total external debt (U.S.$ million)(1)	43,840	42,900	42,406	41,530	44,843	46,206
Total external debt/GNP ratio (%)	46.2	62.8	57.6	50.3	55.2	n.a.
Total external debt/GDP ratio (%)	43.8	59.4	53.6	46.1	50.9	n.a.
External debt service ratio (%)(2)	5.5	6.7	6.1	5.3	5.9	n.a.

P Preliminary.
(1) Consists of total external debt of the Government, non-financial public enterprises and the private sector. Converted to U.S. dollars at the exchange rate at the end of the relevant period.
(2) Measures the principal repayment, excluding prepayment, and the interest payment of the external debt as a proportion of gross exports of goods and services.
Sources: Ministry of Finance.
Bank Negara Malaysia.

Government Finance

	1997	1998	1999	2000	2001P	First three months of 2002P
	(RM million, except percentages)					
Current revenue	65,736	56,710	58,675	61,864	79,567	17,143
Current expenditure	(44,665)	(44,584)	(46,699)	(56,547)	(63,757)	(14,716)
Current surplus	21,071	12,126	11,976	5,317	15,810	2,427
Net development expenditure	(14,445)	(17,128)	(21,462)	(25,032)	(34,232)	(3,713)
Overall balance	6,626	(5,002)	(9,486)	(19,715)	(18,422)	(1,286)
Overall balance (% of GNP)	2.5	(1.9)	(3.4)	(6.3)	(6.0)	n.a.
Overall balance (% of GDP)	2.4	(1.8)	(3.2)	(5.8)	(5.5)	n.a.

P Preliminary.
Source: Ministry of Finance.

Consolidated Public Sector Finance

	1997	1998	1999	2000	2001P
Public sector overall surplus (deficit) (RM million)	17,332	(3,754)	6,835	2,322	(16,215)
Public sector overall surplus (deficit) (% of GNP)	6.5	(1.4)	2.4	0.7	(5.3)
Public sector overall surplus (deficit) (% of GDP)	6.2	(1.3)	2.3	0.7	(4.9)

P Preliminary.
Source: Ministry of Finance.

Direct Government Debt[1]

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001P	2002P
Internal debt (RM million)	76,968	88,197	93,750	106,805	121,396	120,173[2]
External debt (U.S.$ million)	3,325	3,927	4,834	4,953	6,402	5,130
Total direct Government debt (U.S.$ million)	23,086	27,137	29,505	33,059	38,348	36,754
As percentage of GNP (%)	33.7	38.5	40.1	40.2	47.5	n.a.
As percentage of GDP (%)	31.9	36.4	37.3	36.9	43.8	n.a.

P Preliminary.
(1) Excludes debt guaranteed by the Government. Amounts in original currencies were converted to U.S. dollars or ringgit, as applicable, using exchange rates at the end of each period.
(2) Includes RM5.5 billion in borrowings by the Government on behalf of the Housing Loan Department, which loans are repaid by the Housing Loan Department and not by Government funds, and RM4.1 billion in borrowings by the Government from Labuan banks.
Source: Ministry of Finance.

Money and Banking

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001	2002P
Total assets of banking system (RM billion)	676.9	616.4	626.6	645.9	693.2	705.5
Banking system loans[1] (% change)	26.5	(1.8)	(5.0)	4.3	3.8	5.1[2]
Banking system deposits (% change)	21.3	(0.5)	3.4	3.2	1.8	4.5[2]
Money supply (M3) (RM billion)	390.8	401.5	434.6	456.5	469.5	481.2
Three-month interbank rate (%)	8.70	6.46	3.18	3.21	3.27	3.24
Base lending rate of commercial banks (% per annum)	10.33	8.04	6.79	6.78	6.39	6.39
Net NPL ratio of the banking system[3] (%)						
Three-month classification policy[4]	n.a.	13.6	11.0	9.7	11.5	11.5
Six-month classification policy[5]	n.a.	8.1	6.4	6.3	8.1	8.2
Actual net NPL ratio[6]	4.1	9.0	7.4	7.1	9.4	n.a.
Average risk-weighted capital ratio[7] (%)	10.5	11.8	12.5	12.4	12.7	12.5

P Preliminary.
(1) Includes loans sold to Cagamas Berhad, the national mortgage corporation, and excludes loans sold to or managed by Pengurusan Danaharta Nasional Berhad, or Danaharta, the asset management company established by the Government to address the rise in non-performing loans, or NPLs. If loans sold to or managed by Danaharta are included, the percentage change would be an increase of 0.4% as of 31 December 1999, an increase of 5.5% as of 31 December 2000, an increase of 3.6% as of 31 December 2001 and an increase of 4.6% as of 31 March 2002.
(2) Represents the increase from 31 March 2001.
(3) Represents the gross amount of non-performing loans, or NPLs, outstanding, minus interest-in-suspense and specific provisions divided by the gross amount of all loans outstanding minus interest-in-suspense and specific provisions. Beginning 1998, the net NPL ratios of the banking system exclude all NPLs sold to or managed by Danaharta, which as of 31 March 2002 amounted to RM38.1 billion. BNM began compiling data on NPLs according to three-month and six-month classification periods in 1998.
(4) Calculated based on a three-month NPL classification policy applied uniformly across the banking system.
(5) Calculated based on a six-month NPL classification policy applied uniformly across the banking system.
(6) Calculated based on each banking institution's NPL classification policy, which can be based on either a three-month or six-month classification period.
(7) Derived in accordance with the Basle Capital Accord.
Source: Bank Negara Malaysia.

INVESTMENT CONSIDERATIONS

An investment in the Certificates involves certain risks. Prospective investors should carefully consider the following factors, in addition to the matters set forth elsewhere in this Offering Circular, prior to investing in the Certificates.

The Issuer has no operating history and must rely on payments by Malaysia. The Issuer is a newly formed entity and has no significant operating history. The Issuer will have no material assets other than its beneficial title to the Land Parcels (which will be leased to Malaysia pursuant to the Lease Agreement), all of the Issuer's rights, title, interest and benefit, present and future, in, to and under the Transaction Documents, all monies standing to the credit of the Transaction Account, and all proceeds of the foregoing, all of which will be held on trust for the benefit of the Certificateholders. The Issuer will not engage in any business activity other than the issuance of the Certificates and the acquisition and lease of the Land Parcels as described herein and other activities incidental or related to the foregoing. The only source of funds available to make payments of the Periodic Distributions Amounts and the Dissolution Distribution Amount is the payments by Malaysia to the Issuer under the Lease Agreement, Purchase Undertaking Deed, Sale Undertaking Deed and Service Agency Agreement, and payments under the Insurance Agreement. Investors should therefore carefully review the description of Malaysia herein under the heading "*Malaysia*".

There is currently no secondary market for the Certificates and there may be limited liquidity for Certificateholders. There can be no assurances that a secondary market for the Certificates will develop, or if a secondary market does develop, that it will provide the Certificateholders with liquidity of investment or that it will continue for the life of the Certificates. The market value of Certificates may fluctuate. Consequently, any sale of Certificates by Certificateholders in any secondary market which may develop may be at a discount from the original purchase price of such Certificates. In addition, the Certificates are subject to certain transfer restrictions and can only be transferred to certain transferees as described under *"Transfer Restrictions"*and *"Plan of Distribution"*. Such restrictions on the transfer of Certificates may further limit their liquidity. Consequently, an investor in the Certificates must be prepared to hold the Certificates for an indefinite period of time or until their redemption.

There are transfer restrictions on the Certificates. The Certificates have not been registered under the Securities Act, under any U.S. state securities or "Blue Sky" laws or under the securities laws of any other jurisdiction and are being issued and sold in reliance upon exemptions from registration provided by such laws. No Certificate may be sold or transferred unless such sale or transfer is exempt from the registration requirements of the Securities Act (for example, in reliance on exemptions provided by Rule 144A or Regulation S under the Securities Act) and applicable state securities laws.

The Certificates are limited recourse obligations. Recourse in respect of the Certificates is limited to the Trust Assets and proceeds of the Trust Assets are the sole source of payments on the Certificates. Following a Dissolution Event, neither the Trustee nor any Certificateholder will have have any right to cause the sale or other disposition of any of the Trust Assets except pursuant to the Purchase Undertaking Deed or Sale Undertaking Deed, and the sole right of the Trustee and the Certificateholders against Malaysia shall be to enforce the obligation of Malaysia to pay the Exercise Price. Certificateholders will otherwise have no recourse to any assets of Malaysia (to the extent it fulfils all of its obligations under the Transaction Documents to which it is a party), the Managers, the Agents, the Issuer Administrator or the Payment Administrator or any affiliate of any of the foregoing entities in respect of any shortfall in the expected amounts from the Trust Assets. Malaysia is obliged to make its payments under the Transaction Documents to which it is a party directly to the Issuer, and the Issuer, as trustee for the benefit of the Certificateholders, will have direct recourse against Malaysia to recover payments due to the Issuer from Malaysia pursuant to the Transaction Documents to which Malaysia is a party. There can be no assurance that the net proceeds of the realisation of the Trust Assets will be sufficient to make all payments due in respect of the Certificates.

The ratings on the Certificates may be changed at any time and may adversely affect the fair market value of the Certificates. It is a condition to the issuance of the Certificates that the Certificates be rated "BBB" by S&P and "Baa2" by Moody's upon issuance. The ratings address the likelihood of full and timely payment to the Certificateholders of all payments of Periodic Distribution Amounts on the Certificates on each Periodic Distribution Date and the full and timely payment of the Dissolution Distribution Amount by the Scheduled Dissolution Date. The ratings of the Certificates will be based primarily on the credit rating of Malaysia. If Moody's or S&P lower their ratings of Malaysia, the ratings of the Certificates may be lowered by Moody's or S&P. A rating is not a recommendation to purchase, hold or sell the Certificates. There is no assurance that a rating will remain in effect for any given period of time or that a rating will not be lowered or withdrawn entirely by an assigning rating agency. If the ratings initially assigned to the Certificates are subsequently lowered or withdrawn for any reason, no person or entity will be obligated to provide any additional credit enhancement with respect to the Certificates. Any reduction or withdrawal of a rating may have an adverse effect on the liquidity and market price of the Certificates. Any reduction or withdrawal of a rating will not constitute an event of default with respect to the Certificates or an event requiring redemption of the Certificates.

TERMS AND CONDITIONS OF THE CERTIFICATES

The following is the text of the Terms and Conditions of the Certificates which (subject to modification) will be endorsed on each Certificate in definitive form (if issued):

Each of the U.S.$[ ],000,000 Trust Certificates due 2007 (the "**Certificates**") represents an undivided beneficial ownership of the Trust Assets (defined in Condition 4(1)) held on trust (the "**Trust**") for the holders of such Certificates pursuant to a declaration of trust (the "**Declaration of Trust**") dated the Closing Date made by the Issuer (as defined in Condition 4(1)). The Issuer is also acting as trustee for Certificateholders (as defined in the Master Definitions Schedule (as defined below)).

In these Conditions, references to "**Certificates**" shall be references to the Certificates as represented by a global Certificate or definitive Certificates, as described in Condition 1.

Payments relating to the Certificates will be made pursuant to a Payment Administration Agreement dated the Closing Date (the "**Payment Administration Agreement**") made among the Issuer, in its own capacity and as Trustee, and The Hongkong and Shanghai Banking Corporation Limited as payment administrator (the "**Payment Administrator**", which expression shall include any successor Payment Administrator) and pursuant to an Agency Agreement dated the Closing Date (the "**Agency Agreement**") made among the Issuer, the Payment Administrator, The Hongkong and Shanghai Banking Corporation Limited as principal paying agent (in such capacity, the "**Principal Paying Agent**"), as transfer agent (in such capacity, the "**Transfer Agent**"), as reference agent (in such capacity, the "**Reference Agent**") and as registrar (in such capacity, the "**Registrar**"), and Kredietbank S.A. Luxembourgeoise, as paying agent in Luxembourg (in such capacity, the "**Luxembourg Paying Agent**" and, together with the Principal Paying Agent and any further or other paying agents appointed from time to time in respect of the Certificates, the "**Paying Agents**"), as replacement agent (in such capacity, together with the Registrar, the "**Replacement Agents**") and as transfer agent (in such capacity, together with the Registrar, the "**Transfer Agents**").

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of the Declaration of Trust, the Payment Administration Agreement, the Agency Agreement, the Sale Undertaking Deed and the Purchase Undertaking Deed. In these Conditions, words and expressions defined and rules of construction and interpretation set out in the Master Definitions Schedule dated the Closing Date signed by, among others, the Issuer in its own capacity and as the Trustee, the Agents and the Payment Administrator (the "**Master Definitions Schedule**") shall, unless the context otherwise requires, have the same meanings herein. Copies of the Transaction Documents are available for inspection by Certificateholders during normal business hours at the principal office for the time being of the Co-Trustee, being at the date of issue of the Certificates at Level 9F, Main Office Tower, Financial Park Labuan, Jalan Merdeka, 87000 Federal Territory of Labuan, Malaysia and at the specified offices of the Paying Agents. The Certificateholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Declaration of Trust, the Agency Agreement and the Payment Administration Agreement applicable to them.

Each initial Certificateholder, by its acquisition and holding of its interest in a Certificate, shall be deemed to authorise and direct the Trustee to apply the sums paid by it in respect of its Certificates to purchase the Trust Assets, and to enter into each Transaction Document to which it is a party, subject to the terms and conditions of the Declaration of Trust and these Conditions.

*The holders shown in the records of Euroclear Bank S.A./N.V. as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") of book-entry interests in the Certificates are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Declaration of Trust and the other Transaction Documents applicable to them.*

1. Form, Denomination and Title

(1) Form and Denomination

The Certificates are issued in registered form in principal amounts of U.S.$10,000 and integral multiples of U.S.$1,000 in excess thereof. A Certificate will be issued to each Certificateholder in respect of its registered holding of Certificates. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Certificateholders which the Issuer will cause to be kept by the Registrar.

(2) Title

Title to the Certificates passes only by registration in the register of Certificateholders kept by the Registrar. The registered holder of any Certificate will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not any payment thereon is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder of any Certificate. In these Conditions, "**Certificateholder**" and (in relation to a Certificate) "**holder**" have the definitions given thereto in the Master Definitions Schedule.

2. Transfers of Certificates and Issue of Certificates

(1) Transfers

Subject to Conditions 2(4) and 2(5), a Certificate may be transferred by depositing the certificate issued in respect of that Certificate, with the form of transfer on the back duly completed and signed, at the specified office of any of the Transfer Agents. The Issuer will at all times maintain a Transfer Agent having its specified office in Luxembourg so long as the Certificates are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require.

(2) Delivery of New Certificates

Each new Certificate to be issued upon transfer of Certificates will, within five business days of receipt by the relevant Transfer Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Certificate to the address specified in the form of transfer. For the purposes of this Condition, "**business day**" shall mean a day on which banks are open for business in the city in which the specified office of the Transfer Agent with whom a Certificate is deposited in connection with a transfer is located.

Except in the limited circumstances described herein (see "The Global Certificates—Registration of Title"), owners of interests in the Certificates will not be entitled to receive physical delivery of Certificates. Issues of Certificates upon transfer of Certificates are subject to compliance by the transferor and transferee with the procedures described above and in the Declaration of Trust and, in the case of Rule 144A Certificates, compliance with the legend set forth under "Transfer Restrictions".

Where some but not all of the Certificates in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Certificates not so transferred will, within five business days of receipt by the relevant Transfer Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Certificates not so transferred to the address of such holder appearing on the register of Certificateholders or as specified in the form of transfer.

(3) Formalities Free of Charge

Registration of transfer of Certificates will be effected without charge by or on behalf of the Issuer or any Transfer Agent but upon payment (or the giving of such indemnity as the Issuer or any Transfer Agent may reasonably require) by the transferee in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

(4) Closed Periods

No Certificateholder may require the transfer of a Certificate to be registered during the period of seven days ending on the due date for any payment of the Dissolution Distribution Amount or any Periodic Distribution Amount on that Certificate.

(5) Regulations

All transfers of Certificates and entries on the register of Certificateholders will be made subject to the detailed regulations concerning transfer of Certificates scheduled to the Declaration of Trust. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Certificateholder who requests one.

Among other things, such regulations require the following: The Issuer shall ensure that the Registrar maintains a register showing the amount of the outstanding Certificates (with each Certificate bearing an identifying serial number), the issue dates and the names and addresses of the holders of the Certificates. The Trustee and the holders of Certificates may inspect the register. The Certificates are transferable (in whole or in part) and the Certificates to be transferred must be delivered for registration to the specified office of any Transfer Agent (including the Transfer Agent in Luxembourg) with the form of transfer, which may be obtained from any Transfer Agent (including, so long as the Certificates are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, the Transfer Agent in Luxembourg), endorsed and accompanied by such other evidence as the Issuer may require to prove the title of the transferor or his right to transfer the Certificates. The holder of Certificates shall be entitled to receive in accordance with Condition 2(2) only one Certificate in respect of his entire holding of such Certificates. In the case of a transfer of a portion of the principal amount of a Certificate, a new Certificate in respect of the balance of the Certificates not transferred will be issued to the transferor in accordance with Condition 2(2). The holder of a Certificate may (to the fullest extent permitted by applicable laws) be treated at all times as the absolute owner of such Certificate notwithstanding any right, title, interest or claim of any other person. The holder of a Certificate will be recognised by the Issuer as entitled to his Certificate free from any equity, set-off or counterclaim on the part of the Issuer against the original or any intermediate holder of such Certificate.

3. Status; Limited Recourse

(1) Status

Each Certificate evidences an undivided beneficial ownership of the Trust Assets and will rank *pari passu*, without any preference, with the other Certificates.

(2) Limited Recourse

Proceeds of the Trust Assets are the sole source of payments on the Certificates. The Certificates do not represent an interest in or obligation of any of the Issuer, the Trustee, Malaysia or any of their affiliates. Accordingly, Certificateholders will have no recourse to any assets of the Issuer, the Trustee (including, in particular other assets comprised in other trusts), Malaysia (to the extent it fulfils all of its obligations under the Transaction Documents to which it is a party) or any of their affiliates in respect of any shortfall in the expected amounts from the Trust Assets. However, Malaysia is obliged to make the payments under the Transaction Documents to which it is a party directly to the Issuer, and the Issuer, as trustee for the benefit of the Certificateholders, will have direct recourse against Malaysia to recover payments due to the Issuer from Malaysia pursuant to the Transaction Documents to which Malaysia is a party.

The net proceeds of the realisation of, or enforcement with respect to, the Trust Assets may not be sufficient to make all payments due in respect of the Certificates. If, following distribution of such proceeds, there remains a shortfall, subject to Condition 12, no holder of such Certificates will have any claim against the Issuer, the Trustee, Malaysia or any of their affiliates or any of its other assets in respect of such shortfall and any unsatisfied claims of Certificateholders shall be extinguished. In particular, no holder of such Certificates will be able to petition for, or join any other person in instituting proceedings for, the reorganisation, liquidation, winding up or receivership of the Issuer, the Trustee, Malaysia or any of their affiliates as a consequence of such shortfall or otherwise.

(3) Agreement

By purchasing Certificates, each Certificateholder agrees that:

(a) Notwithstanding anything to the contrary contained herein or in any other Transaction Document, no payment of any amount whatsoever shall be made by any of the Issuer, the Trustee or the Trust or any of their respective agents on their behalf except to the extent funds are available therefor from the Trust Assets and further agrees that no recourse shall be had for the payment of any amount owing hereunder or under any other Transaction Document, whether for the payment of any fee or other amount hereunder or any other obligation or claim arising out of or based upon this Agreement or any other Transaction Document, against any of the Issuer, the Trustee or the Trust to the extent the Trust Assets have been exhausted following which all obligations of the Issuer, the Trustee and the Trust shall be extinguished.

(b) Notwithstanding anything to the contrary contained herein or in any other Transaction Document, prior to the date which is one year and one day after the date on which all amounts owing by the Issuer under the Transaction Documents to which it is a party have been paid in full, it will not institute against, or join with any other Person in instituting against the Issuer, the Trustee or the Trust, any bankruptcy, reorganisation, arrangement or liquidation proceedings or other proceedings under any bankruptcy or similar law.

4. Trust

(1) Summary of the Trust

Malaysia Global Sukuk Inc., a special purpose company incorporated in Labuan, Malaysia under the Offshore Companies Act, 1990 of Malaysia (the "**Issuer**"), will enter into a purchase agreement (the "**Purchase Agreement**") with The Federal Lands Commissioner, a body corporate established under the Federal Lands Commissioner Act 1957 of Malaysia (the "**Seller**"). Pursuant to the Purchase Agreement, the Seller will convey its beneficial title to the parcels of land owned by it and identified therein (the "**Land Parcels**") to the Issuer. Pursuant to a declaration of trust (the "**Seller's Declaration of Trust**"), the Seller will declare that it is the registered proprietor of the Land Parcels only as trustee for and on behalf of the Issuer. The Issuer will lease the Land Parcels to Malaysia pursuant to a master *ijarah* agreement (the "**Lease Agreement**") dated the Closing Date between the Issuer and Malaysia.

Pursuant to the Declaration of Trust, the Issuer will declare a trust over its beneficial title to the Land Parcels and all of its rights, title, interest and benefit, present and future, in, to and under the Transaction Documents and all proceeds of the foregoing. Such interests, together with all proceeds therefrom and all monies standing to the credit of the Transaction Account (as defined below) will comprise the "**Trust Assets**". All payments by Malaysia under the Lease Agreement, the Purchase Undertaking Deed and the Sale Undertaking Deed will be deposited into an account of the Trustee maintained for such purpose and operated by the Payment Administrator (the "**Transaction Account**").

The Purchase Agreement, the Lease Agreement, the Seller's Declaration of Trust, the Service Agency Agreement, the Insurance Agreement, the Purchase Undertaking Deed, the Sale Undertaking Deed, the Declaration of Trust, the Agency Agreement, the Payment Administration Agreement, the Deed of Undertaking, the Certificate Purchase Agreement, the Issuer Administration Agreement, the Certificates and any other agreements and documents delivered or executed in connection therewith are collectively referred to as the "**Transaction Documents**".

(2) Application of Proceeds from Trust Assets

Pursuant to the Declaration of Trust, the Trustee holds the Trust Assets for and on behalf of the holders of the Certificates. On each Periodic Distribution Date (as defined in Condition 6(1) below), or on the date specified in accordance with these Conditions for redemption of the Certificates (the "**Redemption Date**"), the Payment Administrator shall apply the monies standing to the credit of the Transaction Account in the following order of priority:

(a) *first*, to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of all Periodic Distribution Amounts due and unpaid;

(b) *second*, only if such payment is made on the Redemption Date, to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of the Dissolution Distribution Amount; and

(c) *third*, only if such payment is made on the Redemption Date, in or towards payment *pari passu* and rateably of all outstanding Expenses.

(3) Late Payment Amounts Received

If the Issuer receives any amounts as late payment amounts under the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement or the Service Agency Agreement, then the Issuer will in each case inform each Certificateholder of the aggregate amount so received and the amount in respect thereof distributed to such Certificateholder, and will further inform each Certificateholder that if *Shariah* principles apply to such Certificateholder then under such principles such Certificateholder should donate such late payment amounts to a charity of the Certificateholder's choice or otherwise in accordance with the Certificateholder's *Shariah* committee instructions.

Subject as set out in Condition 8 and Condition 12, the Certificateholders will not be entitled to request that the Trust be dissolved or to institute proceedings directly against Malaysia. The Certificateholders' sole recourse will be to the Trust Assets and access to these assets is limited as set forth in Condition 8. In certain circumstances, these assets may be insufficient to fund expected distributions to Certificateholders and, taken as a whole, may have a value less than that of the face amount of the Certificates. The Certificateholders will have no recourse to any other assets of the Trustee (including, in particular, other assets constituting other trusts) in respect of any shortfall in the amounts expected from the Trust Assets.

5. Covenants

The Issuer has covenanted in the Declaration of Trust that, among other things, for so long as any Certificate is outstanding, it shall not:

(a) incur any indebtedness in respect of borrowed money whatsoever, or give any guarantee in respect of any obligation of any person or issue any shares (or rights, warrants or options in respect of shares or securities convertible into or exchangeable for shares) other than those in issue as at the Closing Date;

(b) secure any of its present or future indebtedness for borrowed money by any lien, pledge, charge or other security interest upon any of its present or future assets, properties or revenues (other than those arising by operation of law);

(c) sell, transfer, convey or otherwise dispose of (i) its beneficial title to the Land Parcels or any interest therein except pursuant to the Lease Agreement, the Purchase Undertaking Deed or the Sale Undertaking Deed or (ii) its interests in any of the other Trust Assets except pursuant to the Transaction Documents to which it is a party;

(d) exercise its option under the Purchase Undertaking Deed except in its capacity as Trustee; or

(e) enter into any contract, transaction, amendment, obligation or liability other than the Transaction Documents to which it is a party or as expressly permitted or required thereunder or engage in any business or activity (including acting as trustee of any other trust) other than:

  (i) as provided for or permitted in the Transaction Documents to which it is a party;

  (ii) the ownership, management and disposal of the Trust Assets as provided in the Transaction Documents to which it is a party; and

  (iii) such other matters which are incidental thereto.

6. Periodic Distributions

(1) Periodic Distribution Dates

Subject as set out in Condition 4(2) and Condition 8, the Principal Paying Agent shall distribute to holders of the Certificates *pro rata* out of amounts transferred to it by the Payment Administrator from the Transaction Account distributions in relation to such Certificates, equal to [ ] per cent. per annum above the London inter-bank offered rate for six-month U.S. dollar deposits ("**LIBOR**") for the aggregate principal amount of Certificates for each Return Accumulation Period (as defined below).

Distributions on the Certificates will be made on the [ ] day of January and July or if any such day is not a Business Day the following Business Day commencing [ ] January 2003 (each a "**Periodic Distribution Date**"). The period from and including the Closing Date to but excluding the first Periodic Distribution Date and each successive period from and including a Periodic Distribution Date to but excluding the next succeeding Periodic Distribution Date is called a "**Return Accumulation Period**". In these Conditions, except where otherwise defined, "**Business Day**" means a day which is both a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in Hong Kong, Kuala Lumpur, London and New York.

(2) Cessation of Accrual

No further amounts will be payable on any Certificate from and including its due date for redemption unless, upon due presentation, payment in respect of the Certificate is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event such amounts payable on the Certificate shall continue to be due and payable.

(3) Determination of LIBOR

LIBOR will be determined by the Reference Agent on the basis of the following provisions:

(a) On each LIBOR Determination Date (as defined below), the Reference Agent or its duly appointed successor will determine the Screen Rate (as defined below) at approximately 11.00 a.m. (London time) on the LIBOR Determination Date in question and such Screen Rate shall be the value of LIBOR for the forthcoming Return Accumulation Period.

(b) If the Screen Rate is unavailable, the Reference Agent will request the principal London office of each of the Reference Banks (as defined below) to provide the Reference Agent with the rate at which deposits in U.S. dollars are offered by it to prime banks in the London interbank market for six months at approximately 11.00 a.m. (London time) on the LIBOR Determination Date in question and for a Representative Amount (as defined below) and, so long as at least two of the Reference Banks provide such rates, the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) as established by the Reference Agent of such rates shall be the value of LIBOR for the forthcoming Return Accumulation Period.

(c) If fewer than two rates are provided as requested, the value of LIBOR for the forthcoming Return Accumulation Period will be the arithmetic mean of the rates quoted by such major banks in London as selected by the Reference Agent, at approximately 11.00 a.m. (London time), on the first day of such Return Accumulation Period for loans in U.S. dollars to leading European banks for a period of six months commencing on the first day of such Return Accumulation Period and for a Representative Amount.

(d) If LIBOR cannot be determined in accordance with the above provisions, the value of LIBOR for the forthcoming Return Accumulation Period shall be as determined at the preceding LIBOR Determination Date.

(e) In these Conditions (except where otherwise defined), the expression:

(i) "**LIBOR Determination Date**" means the second London Business Day before the commencement of the Return Accumulation Period for which the rate will apply;

(ii) "**London Business Day**" means a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London;

(iii) "**Margin**" means [ ] per cent. per annum;

(iv) "**Reference Banks**" means the principal London office of each of four major banks engaged in the London interbank market selected by the Reference Agent, provided that once a Reference Bank has first been selected by the Reference Agent, that Reference Bank shall not be changed unless and until it ceases to be capable of acting as such;

(v) "**Representative Amount**" means an amount that is representative for a single transaction in the relevant market at the relevant time; and

(vi) "**Screen Rate**" means the rate for six-month deposits in U.S. dollars which appears on Moneyline Telerate page 3750 (or such replacement page on that service which displays the information).

(4) Determination of Periodic Distribution Amount

The Reference Agent shall, as soon as practicable after 11.00 a.m. (London time) on each LIBOR Determination Date, but in no event later than the third Business Day thereafter, determine the U.S. dollar amount payable on each denomination of Certificates (the "**Periodic Distribution Amount**") for the relevant Return Accumulation Period. The Periodic Distribution Amount shall be determined by adding LIBOR for the relevant Return Accumulation Period to the Margin and applying the result to each denomination of the Certificates, multiplying the sum by the actual number of days in the Return Accumulation Period concerned divided by 360 and rounding the resultant figure to the nearest cent (half a cent being rounded upwards).

(5) Publication of Periodic Distribution Amount

The Reference Agent shall cause (i) the sum of the Margin and LIBOR for each Return Accumulation Period after the initial Return Accumulation Period and (ii) the Periodic Distribution Amount for the relative Periodic Distribution Date to be notified to the Trustee and to any stock exchange on which the Certificates are at the relevant time listed and to be published in accordance with Condition 14 as soon as possible after their determination but in no event later than the second Business Day thereafter. The Periodic Distribution Amount and Periodic Distribution Date may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of an extension or shortening of the Return Accumulation Period.

(6) Determination by the Trustee

The Trustee shall, if the Reference Agent defaults at any time in its obligation to determine LIBOR and the Periodic Distribution Amount in accordance with the above provisions, determine LIBOR and the Periodic Distribution Amount, the former at such rate as, in its absolute discretion (having such regard as it shall think fit to the procedure described above), it shall deem fair and reasonable in all the circumstances and the latter in the manner provided in paragraph (4) above and the determinations shall be deemed to be determinations by the Reference Agent.

(7) Notifications, etc. to be Final

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition, whether by the Reference Banks (or any of them) or the Reference Agent, will (in the absence of wilful default, bad faith or manifest error) be binding on the Trustee, the Payment Administrator and all Certificateholders (in the absence as referred to above). No liability to the Trustee, the Payment Administrator or the Certificateholders shall attach to the Reference Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions under this Condition.

(8) Reference Agent

The Trustee will use reasonable efforts to procure that so long as any of the Certificates remains outstanding there shall at all times be a Reference Agent for the purposes of the Certificates and the Trustee may terminate the appointment of the Reference Agent. In the event of the appointed office of any bank being unable or unwilling to continue to act as the Reference Agent or failing duly to determine the value of LIBOR and the Periodic Distribution Amount for any Return Accumulation Period, the Trustee shall appoint another major bank engaged in the London interbank market to act in its place. The Reference Agent may not resign its duties or be removed without a successor having been appointed.

7. Payment

(1) Payments in Respect of Certificates

Payment of the Dissolution Distribution Amount and any Periodic Distribution Amount will be made by the Principal Paying Agent by wire transfer in same day funds to the registered account of each

Certificateholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Certificateholder if it does not have a registered account. Payments of the Dissolution Distribution Amount and any Periodic Distribution Amount due otherwise than on a Periodic Distribution Date will only be made against surrender of the relevant Certificate at the specified office of any of the Paying Agents. The Periodic Distribution Amount on Certificates due on a Periodic Distribution Date will be paid to the holder shown on the register of Certificateholders at the close of business on the date (the "**record date**") being the seventh day before the relevant Periodic Distribution Date.

For the purposes of this Condition, a Certificateholder's registered account means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the register of Certificateholders at the close of business, in the case of the Dissolution Distribution Amount and the Periodic Distribution Amount due otherwise than on a Periodic Distribution Date, on the second Business Day before the due date for payment and, in the case of the Dissolution Distribution Amount and the Periodic Distribution Amount due on a Periodic Distribution Date, on the relevant record date, and a Certificateholder's registered address means its address appearing on the register of Certificateholders at that time.

(2) Payments Subject to Applicable Laws

Payments in respect of Certificates are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 9.

(3) Payment only on a Business Day

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day, for value the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed in each case by the Principal Paying Agent, on the Business Day preceding the due date for payment or, in the case of a payment of the Dissolution Distribution Amount or a payment of Periodic Distribution Amounts due otherwise than on a Periodic Distribution Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of a Paying Agent.

Certificateholders will not be entitled to any Periodic Distribution Amount or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Certificateholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

(4) Initial Payment Administrator

The names of the Principal Paying Agent and the Luxembourg Paying Agent and their initial specified offices are set out at the end of these Conditions. The Trustee reserves the right at any time to vary or terminate the appointment of the Payment Administrator and to appoint additional or other Payment Administrators provided that it will at all times maintain a Payment Administrator. Notice of any termination or appointment and of any changes in specified offices will be given to the Certificateholders promptly by the Trustee in accordance with Condition 14.

(5) Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that (i) it will at all times maintain a Paying Agent having its specified office in Luxembourg for so long as the Certificates are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require and (ii) if any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to such Directive is introduced, the Issuer will ensure that it maintains a Paying Agent in a Member State of the European Union that will not be obliged to withhold or deduct tax pursuant to any such Directive or law. Notice of any termination or appointment and of any changes in specified offices will be given to the Certificateholders promptly by the Issuer in accordance with Condition 14.

8. Dissolution of Trust

(1) Scheduled Dissolution

Unless the Certificates are earlier redeemed (and the Trust is dissolved after such redemption) following (i) the occurrence of a Dissolution Event; (ii) the imposition of any Taxes (as defined in Condition 9) permitting Malaysia to exercise its right to require the Issuer to sell the Trust Assets to Malaysia pursuant to the Sale Undertaking Deed; or (iii) the occurrence of a Total Loss Event (as defined below), the Certificates will be redeemed on the Scheduled Dissolution Date at the Dissolution Distribution Amount and the Trust will thereafter be dissolved.

The "**Scheduled Dissolution Date**" is the Periodic Distribution Date falling in July 2007.

(2) Summary of Dissolution

The Issuer has the option under the Purchase Undertaking Deed for the benefit of the holders of the Certificates, to terminate the Lease Agreement (if still in force) and require Malaysia to purchase the beneficial title to the Land Parcels at the Exercise Price:

(i) on the date specified by the Trustee to Certificateholders in accordance with Condition 11 for redemption of the Certificates following a Dissolution Event; and

(ii) on the Scheduled Dissolution Date.

Upon the occurrence of a Dissolution Event, the Trustee may, or if so requested in writing by the holders of at least 25 per cent. in aggregate principal amount of the Certificates then outstanding or if so directed by an Extraordinary Resolution of the holders of Certificates, the Trustee shall, exercise the Issuer's rights under the Purchase Undertaking Deed by giving notice thereunder to Malaysia.

Prior to the occurrence of the Scheduled Dissolution Date, the Trustee shall exercise the Issuer's rights under the Purchase Undertaking Deed by giving notice to Malaysia in accordance therewith.

Malaysia has the option under the Sale Undertaking Deed to terminate the Lease Agreement (if still in force) and require the Issuer to sell to Malaysia its beneficial title to the Land Parcels at the Exercise Price on any Periodic Distribution Date, provided that Malaysia has given not less than five Business Days prior written notice to the Trustee and the Certificateholders in accordance with Condition 14 if as a result of a change in law after June 2002 Malaysia would, on the next Periodic Distribution Date, be required to pay additional amounts as described in Condition 9, and such requirement cannot be avoided by the use of reasonable measures available to Malaysia.

"**Exercise Price**" means an amount equal to U.S.$[ ],000,000 plus Expenses.

"**Expenses**" means all outstanding expenses incurred by the Service Agent under the Service Agency Agreement (including but not limited to land proprietorship taxes) to be reimbursed by the Issuer to the Service Agent under the Service Agency Agreement.

"**Dissolution Distribution Amount**" means, as of any date, the aggregate principal amount of the Certificates then outstanding plus accrued and unpaid Periodic Distribution Amounts as of such date.

Upon receipt of the Exercise Price from Malaysia in accordance with the terms of the Purchase Undertaking Deed or Sale Undertaking Deed, such amount, together with Lease Rentals through the date of the termination of the Lease Agreement, will be applied to redeem the Certificates in accordance with Condition 4(2) at the Dissolution Distribution Amount.

(3) Dissolution Following a Dissolution Event

Upon the occurrence of a Dissolution Event, in accordance with Condition 11 the Certificates may be redeemed at the Dissolution Distribution Amount and the Trust dissolved by the Trustee on the dates specified in Condition 11.

(4) *Dissolution Following a Total Loss Event*

Following a Total Loss Event, the Issuer will have recourse (i) to Malaysia under the Lease Agreement, if such Total Loss Event was due to the negligence or default of Malaysia as lessee or (ii) otherwise to the Insurance Provider under the Insurance Agreement, in each case for an amount sufficient to allow redemption of the Certificates at the Dissolution Distribution Amount. Upon receipt of such amount, the Trustee will redeem the Certificates at the Dissolution Distribution Amount and the Trust will thereafter be dissolved.

"**Insurance Agreement**" means the insurance agreement covering a Total Loss Event, effective as of the Closing Date, to be procured from the Insurance Provider by the Service Agent pursuant to the Service Agency Agreement, which policy (i) specifies the Issuer as the insured party and provides for all claims to be paid directly by the Insurance Provider to the Issuer; (ii) only excludes a Total Loss Event occurring as a direct result of default or negligence on the part of Malaysia; (iii) in the aggregate provides a sum insured equal to or greater than Expenses plus the Dissolution Distribution Amount as of the date a full claim payment has been received by the Issuer thereunder; and (iv) unconditional and irrevocable, subject only to its terms.

"**Insurance Provider**" means Malaysia (in the capacity of insurer).

"**Total Loss Event**" means (i) total loss or destruction of, or damage to the whole of the Land Parcels or any eventor occurrence that renders the whole of the Land Parcels permanently unfit for any economic use and the repair or remedial work in respect thereof is uneconomical or (ii) compulsory acquisition, confiscation or expropriation of the whole of the Land Parcels.

(5) *Cancellations*

All Certificates which are redeemed will forthwith be cancelled and accordingly may not be held, reissued or resold.

9. Taxation

All payments in respect of the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement, the Service Agency Agreement and the Certificates shall be made without withholding or deduction for, or on account of, any taxes, levies, imports, duties, fees, assessments or other charges of whatever nature, imposed, or levied by or on behalf of any Relevant Jurisdiction, and all interest, penalties or similar liabilities with respect thereto ("**Taxes**"), unless the withholding or deduction of the Taxes is required by law. In such event, Malaysia will be required, pursuant to the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement or the Service Agency Agreement, as the case may be, to pay to the Issuer additional amounts (which amounts will be applied towards payments in respect of the Certificates) so that the full amount which otherwise would have been due and payable under the Certificates is received by parties entitled thereto, except that no such additional amount shall be payable to any Certificateholder (i) who is liable for such Taxes in respect of such Certificate by reason of having some connection with any Relevant Jurisdiction other than the mere holding of such Certificate, (ii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive, or (iii) presented for payment by or on behalf of a Certificateholder who would be able to avoid such withholding or deduction by presenting the relevant Certificate or Coupon to another Paying Agent in a Member State of the European Union.

In these Conditions, "**Relevant Jurisdiction**" means (i) Malaysia or Labuan or any political subdivision or any authority thereof or therein having power to tax or (ii) any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which Malaysia, the Trustee or the Trust, as the case may be, becomes subject in respect of payments made by it under any of the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement, the Service Agency Agreement or the Certificates.

10. Prescription

Certificates will become void unless presented for payment within periods of 10 years (in the case of Dissolution Distribution Amounts) and five years (in the case of Periodic Distribution Amounts) from the Relevant Date in respect of the Certificates, subject to the provisions of Condition 7. In this Condition 10, "**Relevant Date**" means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Payment Administrator or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect shall have been duly given to the Certificateholders by the Trustee in accordance with Condition 14.

11. Dissolution Events

Upon the occurrence and continuation of any of the following events ("**Dissolution Events**"):

(a) default is made in the payment of the Dissolution Distribution Amount or any Periodic Distribution Amount due in respect of any Certificate, and in the case of a Periodic Distribution Amount only, such default continues for a period of seven days; or

(b) Malaysia fails duly to perform or comply with any of the obligations expressed to be assumed by it in the Transaction Documents to which it is a party and such failure, if capable of remedy, is not remedied within 60 days after the Trustee has given notice thereof to Malaysia; or

(c) an event of default occurs under the Lease Agreement; or

(d) Malaysia repudiates any Transaction Document to which it is a party or does or causes to be done any act or thing evidencing an intention to repudiate any Transaction Document to which it is a party; or

(e) at any time it is or will become unlawful for Malaysia to perform or comply with any or all of its obligations under the Transaction Documents to which it is a party or any of the obligations of Malaysia under the Transaction Documents to which it is a party are not or cease to be legal, valid, binding and enforceable; or

(f) the option under the Purchase Undertaking Deed or Sale Undertaking Deed is exercised in respect of the Land Parcels and Malaysia fails to deliver the Exercise Price and complete its purchase of the Land Parcels in accordance with the Purchase Undertaking Deed or the Sale Undertaking Deed, as the case may be; or

(g) at any time it is or will become unlawful for the Issuer to perform or comply with any of its obligations under the Transaction Documents to which it is a party or any of the obligations of the Issuer under the Transaction Documents to which it is a party are not or cease to be legal, valid, binding and enforceable,

the Trustee shall give notice of the occurrence of such Dissolution Event to the holders of Certificates in accordance with Condition 14 with a request to such holders to indicate if they wish the Trust to be dissolved. If so requested in writing by the holders of at least 25 per cent. in aggregate principal amount of such Certificates then outstanding or if so directed by an Extraordinary Resolution of the holders of Certificates, the Trustee shall (subject in each case to being indemnified to its satisfaction), or if the Trustee so decides in its discretion the Trustee may, give notice to all the holders of such Certificates in accordance with Condition 14 that the Certificates are to be redeemed at the Dissolution Distribution Amount on the date specified in such notice and that the Trust is to be dissolved on the day after the last outstanding Certificate has been redeemed, *provided, however*, that in the case of any of the events described in (b) or (c) above, such notice may only be given if the Trustee has certified in writing to the Issuer that such event, in the opinion of the Trustee, is materially prejudicial to the interests of the Certificateholders.

12. Enforcement and Exercise of Rights

(a) Following the distribution of the Trust Assets in respect of the Certificates to the Certificateholders in accordance with these Conditions and the Declaration of Trust, the Trustee shall not be liable for any further sums or assets, and accordingly the Certificateholders may not take any action against the Trustee or any other person to recover any such sum or asset in respect of the Certificates or Trust Assets.

(b) The Trustee shall not be bound in any circumstances to take any action to enforce or to realise the Trust Assets or take any action against Malaysia under any Transaction Document to which Malaysia is a party unless directed or requested to do so (a) by an Extraordinary Resolution or (b) in writing by the holders of at least 25 per cent. in aggregate principal amount of the Certificates then outstanding and in either case then only if it shall be indemnified to its satisfaction against all liabilities to which it may thereby render itself liable or which it may incur by so doing.

(c) No Certificateholders shall be entitled to proceed directly against Malaysia unless (i) the Trustee, having become bound so to proceed, fails to do so within two months of becoming so bound and such failure is continuing and (ii) the relevant Certificateholder (or such Certificateholder together with the other Certificateholders who propose to proceed directly against Malaysia or enforce the Trust Assets) holds at least 25 per cent. of the aggregate principal amount of the Certificates then outstanding. Under no circumstances shall the Trustee or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets except pursuant to the Purchase Undertaking Deed or Sale Undertaking Deed, and the sole right of the Trustee and the Certificateholders against Malaysia shall be to enforce the obligation of Malaysia to pay the Exercise Price thereunder.

(d) Conditions 12(a), 12(b) and 12(c) are subject to this Condition 12(d). After enforcing or realising the Trust Assets and distributing the net proceeds in accordance with Condition 4(2), the obligations of the Trustee in respect of the Certificates shall be satisfied and no holder of the Certificates may take any further steps against the Trustee to recover any further sums in respect of the Certificates and the right to receive any such sums unpaid shall be extinguished. In particular, no holder of the Certificates shall be entitled in respect thereof to petition or to take any other steps for the winding-up of the Issuer or the Trustee nor shall any of them have any claim in respect of the trust assets of any other trust established by the Trustee.

13. Replacement of Certificates

Should any Certificate be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified offices of the Transfer Agents upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Trustee may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

14. Notices

All notices to the Certificateholders will be valid if mailed to them by first class pre-paid registered mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses in the register of Certificateholders maintained by the Registrar and, so long as the Certificates are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, published in a daily newspaper in Luxembourg approved by the Trustee. It is expected that such publication will normally be made in the *Luxemburger Wort* or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange on which the Certificates are for the time being listed. Any notice shall be deemed to have been given on the seventh day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

15. Meetings of Certificateholders, Modification, Waiver, Authorisation and Determination

(a) The Declaration of Trust contains provisions for convening meetings of Certificateholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of these Conditions or the provisions of the Declaration of Trust. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than two-thirds in aggregate principal amount of the Certificates for the time being outstanding, or at any adjourned such meeting one or more persons present whatever the principal amount of the Certificates held or represented by him or them. An Extraordinary Resolution passed at any meeting of the Certificateholders will be binding on all holders of the Certificates, whether or not they are present at the meeting.

(b) The Trustee may agree, without the consent of the Certificateholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Declaration of Trust, or determine, without any such consent as aforesaid, that any

Dissolution Event or Potential Dissolution Event (as defined in the Master Definitions Schedule) shall not be treated as such, which in any such case is not, in the opinion of the Trustee, materially prejudicial to the interests of the Certificateholders or may agree, without any such consent as aforesaid, to any modification which, in its opinion, is of a formal, minor or technical nature or to correct a manifest error.

(c) In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation determination or substitution), the Trustee shall have regard to the general interests of the Certificateholders as a class but shall not have regard to any interests arising from circumstances particular to individual Certificateholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Certificateholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Certificateholder be entitled to claim, from the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Certificateholders.

(d) Any modification, abrogation, waiver, authorisation, determination or substitution shall be binding on the Certificateholders and any modification, abrogation, waiver, authorisation, determination or substitution shall be notified by the Trustee to the Certificateholders as soon as practicable thereafter in accordance with Condition 14.

16. Indemnification and Liability of the Trustee

(a) The Declaration of Trust contains provisions for the indemnification of the Trustee in certain circumstances and for its relief from responsibility, including provisions relieving it from taking action unless indemnified to its satisfaction. In particular, in connection with the exercise of any of its rights in respect of the Trust Assets, the Trustee shall in no circumstances take any action unless directed to do so in accordance with Condition 12(b), and then only if it shall have been indemnified to its satisfaction. Subject thereto, the Trustee waives any right to be indemnified by the Certificateholders in circumstances where the Trust Assets are insufficient therefor.

(b) The Trustee makes no representation and assumes no responsibility for the validity, sufficiency or enforceability of the obligations of Malaysia under the Lease Agreement and shall not under any circumstances have any liability or be obliged to account to the Certificateholders in respect of any Lease Rentals which should have been made by Malaysia, but is not so made, and shall not in any circumstances have any liability arising from the Trust Assets other than as expressly provided in these Conditions or in the Declaration of Trust.

(c) The Trustee is excepted from any liability in respect of any loss or theft of the Trust Assets or any cash from any obligation to insure the Trust Assets or any cash and from any claim arising from the fact that the Trust Assets or any cash are held by or on behalf of the Trustee or on deposit or in an account with any depositary or clearing system or are registered in the name of the Trustee or its nominee, unless such loss or theft arises as a result of default or misconduct of the Trustee.

17. Currency Indemnity

The Issuer agrees to indemnify each Certificateholder against any loss incurred by such holder as a result of any judgement or order being given or made for any amount due under such Certificate and such judgement or order is expressed and paid in a currency (the "**Judgement Currency**") other than U.S. dollars and as a result of any variation as between (a) the rate of exchange at which the U.S. dollar is converted into the Judgement Currency for the purpose of such judgement or order and (b) the spot rate of exchange in The City of New York at which the holder on the date of payment of such judgement or order is able to purchase U.S. dollars with the amount of the Judgement Currency actually received by the holder. This indemnification will constitute a separate and independent obligation of the Issuer and will continue in full force and effect notwithstanding any such judgement or order as aforesaid. The term "**spot rate of exchange**" includes any premiums and costs of exchange payable in connection with the purchase of, or conversion into, U.S. dollars.

18. Contracts (Rights of Third Parties) Act 1999

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of these Conditions, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

19. Governing Law and Submission to Jurisdiction

The Declaration of Trust, the Payment Administration Agreement, the Agency Agreement, the Certificates, the Purchase Undertaking Deed and the Sale Undertaking Deed are governed by, and will be construed in accordance with, English law.

The Issuer has in the Declaration of Trust irrevocably and unconditionally agreed for the benefit of the Trustee and the Certificateholders that the courts of England are to have non-exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Declaration of Trust or the Certificates and that accordingly any suit, action or proceedings arising thereout or in connection therewith (together referred to as "**Proceedings**") may be brought in the courts of England.

The Issuer has in the Declaration of Trust irrevocably and unconditionally waived and agreed not to raise any objection which it may have now or subsequently to the laying of the venue of any Proceedings in the courts of England and any claim that any Proceedings have been brought in an inconvenient forum and has further irrevocably and unconditionally agreed that a judgement in any Proceedings brought in the courts of England shall be conclusive and binding upon the Issuer and may be enforced in the courts of any other jurisdiction. Nothing in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

The Issuer has in the Declaration of Trust irrevocably and unconditionally appointed an agent for service of process in England in respect of any Proceedings and has undertaken that in the event of such agent ceasing so to act it will appoint such other person as the Trustee may approve as its agent for that purpose. In the event that no such replacement agent for service of process in England has been appointed by the Issuer within 14 days, the Trustee shall have the power to appoint, on behalf of and at the expense of the Issuer, a replacement agent for service of process in England.

PAYMENT ADMINISTRATOR, PRINCIPAL PAYING AGENT, REGISTRAR AND TRANSFER AGENT

The Hongkong and Shanghai Banking Corporation Limited
36th Floor Sun Hung Kai Centre
30 Harbour Road
Wanchai
Hong Kong

OTHER PAYING AGENT AND TRANSFER AGENT

Kredietbank S.A. Luxembourgeoise
43 Boulevard Royal
L-2955 Luxembourg

and/or such other or further Payment Administrator, Principal Paying Agent, Paying Agents, Registrar or Transfer Agents and/or specified offices as may from time to time be appointed by the Trustee and notice of which has been given to the Certificateholders.

THE GLOBAL CERTIFICATES

The Global Certificates contain the following provisions which apply to the Certificates in respect of which they are issued whilst they are represented by the Global Certificates, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 7 below.

1. Holders

For so long as all of the Certificates are represented by one or both of the Global Certificates and such Global Certificate(s) is/are held on behalf of a clearing system, each person (other than another clearing system) who is for the time being shown in the records of Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Certificates (each, a "**Holder**") (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Certificates standing to the account of any person shall be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Certificates (and the expression "**Certificateholders**" and references to "**holding of Certificates**" and to "**holder of Certificates**" shall be construed accordingly) for all purposes other than with respect to payments on such Certificates, the right to which shall be vested, as against the Issuer and the Trustee solely in the Common Depositary in accordance with and subject to the terms of the Global Certificates. Each Holder must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Common Depositary.

2. Cancellation

Cancellation of any Certificate following its redemption by the Issuer will be effected by reduction in the aggregate principal amount of the Certificates in the register of Certificateholders and by the annotation of the appropriate schedule to the relevant Global Certificate.

3. Payments

Payments of the Dissolution Distribution Amount and any Periodic Distribution Amount in respect of Certificates represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Certificates, against presentation and surrender of such Global Certificate to or to the order of the Registrar or such other Agent as shall have been notified to the holder of the Global Certificate for such purpose.

Distributions of amounts with respect to book-entry interests in the Certificates held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the Registrar, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant system's rules and procedures.

A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Certificate by or on behalf of the Registrar and shall be *prima facie* evidence that payment has been made.

4. Notices

So long as all the Certificates are represented by one or both of the Global Certificates and such Global Certificate(s) is/are held on behalf of a clearing system, notices to Certificateholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Holders in substitution for notification as required by the Conditions except that, so long as the Certificates are listed on any stock exchange, notices shall also be published in accordance with the rules of such exchange. Any such notice shall be deemed to have been given to the Certificateholders on the third day after the day on which such notice is delivered to the relevant clearing systems.

5. Registration of Title

Registration of title to Certificates in a name other than that of the Common Depositary will not be permitted unless Euroclear or Clearstream, Luxembourg, as appropriate, notifies the Issuer that it is unwilling or unable to continue as a clearing system in connection with a Global Certificate, and in each case a successor clearing system approved by the Trustee is not appointed by the Issuer within 90 days after receiving such notice from Euroclear or Clearstream, Luxembourg. In these circumstances title to a Certificate may be transferred into the names of holders notified by the Common Depositary in accordance with the Conditions, except that Certificates in respect of Certificates so transferred may not be available until 21 days after the request for transfer is duly made.

The Registrar will not register title to the Certificates in a name other than that of the Common Depositary for a period of seven calendar days preceding the due date for any payment of the Dissolution Distribution Amount or Periodic Distribution Amount in respect of the Certificates.

If only one of the Global Certificates (the "**Exchanged Global Certificate**") becomes exchangeable for Certificates in accordance with the above paragraphs, transfers of Certificates may not take place between persons holding Certificates issued in exchange for beneficial interests in the Exchanged Global Certificate and persons wishing to purchase beneficial interests in the other Global Certificate.

6. Transfers

Transfers of book-entry interests in the Certificates will be effected through the records of Euroclear, Clearstream, Luxembourg and their respective participants in accordance with the rules and procedures of Euroclear, Clearstream, Luxembourg and their respective direct and indirect participants.

Any interest in a Regulation S Global Certificate that is transferred to a person taking delivery in the form of an interest in a Rule 144A Global Certificate will, upon transfer, cease to be an interest in such Regulation S Global Certificate and will become an interest in the Rule 144A Global Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to interests in a Rule 144A Global Certificate. No service charge will be made for any registration of transfer or exchange of an interest in a Regulation S Global Certificate, but the Trustee may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

7. Definitive Certificates

Interests in the Regulation S Global Certificate and the Rule 144A Global Certificate will be exchangeable or transferable, as the case may be, for Certificates in definitive form ("**Definitive Certificates**") upon the occurrence of an Exchange Event. For these purposes, "**Exchange Event**" means that (i) a Dissolution Event has occurred and is continuing or (ii) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available. In any such event, the Issuer will issue Definitive Certificates (in exchange for the whole of the relevant Global Certificate) within 45 days of the occurrence of the relevant Exchange Event upon presentation of the relevant Global Certificate by the person in whose name such Global Certificate is registered in the register kept by the Registrar in respect of the Certificates on any day (other than a Saturday or Sunday) on which banks are open for business in the city in which the Registrar has its office. In the case of Definitive Certificates issued in exchange for an interest in the Rule 144A Global Certificates, such Definitive Certificates shall bear the legend set forth under *"Transfer Restrictions"*. Upon the transfer, exchange or replacement of Certificates bearing such legend, or upon specific request for removal of such legend, the Issuer shall deliver only Certificates that bear such legend, or shall refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Trustee a certificate in the form provided in the Declaration of Trust or such satisfactory evidence as may reasonably be required by the Issuer, which may include an opinion of United States counsel, that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

USE OF PROCEEDS

The gross proceeds of the issue of the Certificates will be used by the Issuer to purchase the beneficial title to the Land Parcels from the Seller pursuant to the Purchase Agreement.

RATINGS

It is a condition of the issuance of the Certificates that the Certificates are, upon issue, assigned a rating of "Baa2" by Moody's and "BBB" by S&P.

A rating is not a recommendation to buy, sell or hold securities, does not address the likelihood or timing of prepayment and may be subject to suspension, revision or withdrawal at any time by the assigning rating organisation. A suspension, reduction or withdrawal of the ratings assigned to the Certificates may adversely affect the market price of the Certificates.

THE ISSUER

Malaysia Global Sukuk Inc. was incorporated in Labuan, Malaysia under the Offshore Companies Act, 1990 of Malaysia on 3 June 2002, with its registered office at Level 9F, Main Office Tower, Financial Park Labuan, Jalan Merdeka, 87000 Federal Territory of Labuan, Malaysia. The Issuer is a special purpose company formed solely for the purpose of participating in the transactions contemplated by the Transaction Documents.

The authorised share capital of the Issuer is U.S.$12,000, of which two ordinary shares of par value U.S.$1.00 each have been issued. The Issuer's issued ordinary shares are owned by The Minister of Finance, a body corporate established under the Minister of Finance (Incorporation) Act 1957 of Malaysia.

The directors of the Issuer and their principal occupations are as follows:

Director	Principal Occupation
Ahmad bin Hashim	Secretary of Loan Management and Finance Policy, Ministry of Finance of Malaysia
Raja Azahar bin Raja Abdul Manap	Deputy Secretary of Loan Management and Finance Policy, Ministry of Finance of Malaysia

The business address of each of the directors is Block 9, Government Office Complex, Jalan Duta, 50592 Kuala Lumpur, Malaysia. The Issuer has no employees and will not have any employees.

Certain of the affairs of the Issuer (including the preparation of the necessary books of accounts and records and certain other corporate, secretarial and administrative services) will be managed by Ernst & Young Trust Sdn. Bhd., as administrator under the Issuer Administration Agreement.

The objects of the Issuer as set out in its Memorandum of Association will be to issue the Certificates, enter into the Transaction Documents to which it is a party and other agreements necessary for the performance of its obligations under the transactions contemplated thereby and undertake activities pursuant to or that are not inconsistent with the transactions and documents referred to in this Offering Circular.

The Issuer has not engaged, since its incorporation, in any material activities other than those regarding or incidental to the issue of the Certificates and the matters contemplated in this Offering Circular and the Transaction Documents and the authorisation of its entry into the other transactions and documents referred to in this Offering Circular to which it is or will be a party.

As of the Closing Date, after giving effect to the transactions contemplated by the Transaction Documents, the total equity of the Issuer will be U.S.$2, consisting of two issued and paid shares. Pursuant to the terms of its Memorandum of Association and the Transaction Documents, the Issuer may not issue any securities other than the Certificates or otherwise incur indebtedness.

The fiscal years of the Issuer will end on 31 December of each year, beginning in 2002. The Issuer will prepare audited accounts on an annual basis but will not prepare interim accounts. Deloitte Touche Tohmatsu will serve as auditors to the Issuer.

Other than as described above, there has been no material change in the capitalisation of the Issuer as at the date hereof.

THE TRUST ASSETS

Pursuant to the Declaration of Trust, the Issuer will declare that it will hold the Trust Assets upon trust absolutely for the holders of the Certificates *pro rata* according to the face amount of Certificates held by each Certificateholder in accordance with the Declaration of Trust and the Conditions.

The Trust Assets comprise the following assets of the Issuer held on trust for the benefit of Certificateholders: the Issuer's beneficial title to the Land Parcels, all of the Issuer's rights, title, interest and benefit, present and future, in, to and under the Transaction Documents, all monies standing to the credit of the Transaction Account, and all proceeds of the foregoing.

Land Parcels

The Land Parcels consist of the following four parcels of land located in and around Kuala Lumpur, Malaysia:

- A parcel of land measuring approximately 15.8 hectares (identified as H.S. (D) 30670, Lot No. PT 35622) located in Mukim Batu, Gombak District, Selangor State, on which is situated Selayang Hospital, a Government-owned hospital operated by the Ministry of Health.
- A parcel of land measuring approximately 25.5 hectares (identified as G 39768, Lot No. 9225) located in Mukim Klang, Klang District, Selangor State, on which is situated Tengku Ampuan Rahimah Hospital, a Government-owned hospital operated by the Ministry of Health.
- A parcel of land measuring approximately 80.3 hectares (identified as H.S. (D) 68381, Lot No. PT 11099), located along Jalan Duta in Mukim Batu, Federal Territory of Kuala Lumpur, on which Government living quarters are being constructed.
- A parcel of land measuring approximately 11.2 hectares (identified as H.S. (D) 76173, Lot No. PT 11, Section 0051), located along Jalan Duta in Mukim Bandar, Federal Territory of Kuala Lumpur, on which the Jalan Duta Government Office Complex (including Ministry of Finance, Ministry of International Trade and Industry and Inland Revenue Board offices), the Tunku Abdul Rahman Memorial and living quarters for the Ministry of Works are located.

Purchase Agreement

Pursuant to the Purchase Agreement, the Seller will sell to the Issuer the beneficial title to the Land Parcels (free from all claims and encumbrances and with all attached or accrued rights as of the date of the Purchase Agreement). The gross proceeds received by the Issuer from the issuance and sale of the Certificates will be used to pay the purchase price for the beneficial title to the Land Parcels.

Under the Purchase Agreement, only beneficial title to the Land Parcels will pass to the Issuer and the Seller will remain the registered proprietor of the Land Parcels. Pursuant to a declaration of trust (the "**Seller's Declaration of Trust**"), the Seller will declare that it is the registered proprietor of the Land Parcels only as trustee for and on behalf of the Issuer.

Lease Agreement

Under the terms of a master *ijarah* agreement dated the Closing Date between the Issuer as lessor and Malaysia as lessee, the Issuer and Malaysia agree to execute consecutive, semi-annual leases to lease the Land Parcels to Malaysia during the term commencing on the Closing Date and extending to the Scheduled Dissolution Date. The "**Lease Agreement**" means, collectively, such master *ijarah* agreement and all or any of the semi-annual leases executed in accordance therewith.

Under the terms of the Lease Agreement, Malaysia will agree that the Issuer shall not under any circumstances be liable to Malaysia or to any third party for any cost, claim, demand, loss, damage or expense of any kind or nature caused directly or indirectly by, or out of, the use of any part or the whole of the Land Parcels. Malaysia will agree to indemnify and keep indemnified and save harmless the Issuer against all and any such costs, claims, demands, losses, damages and expenses.

Under the terms of the Lease Agreement, Malaysia shall, at its own cost and expense, be responsible for the performance of all Ordinary Maintenance and Repair required by the Land Parcels. "**Ordinary Maintenance and Repair**" means all repairs, replacements, acts, and maintenance and upkeep works required for the general usage and operation of the Land Parcels and to keep, repair, maintain and preserve the Land Parcels in good order and condition, and in compliance with such maintenance, repair and upkeep standards and procedures generally expected in the ordinary course of business.

Under the terms of the Lease Agreement, the Issuer will be responsible for the performance of all Major Maintenance, and will procure that the Service Agent, in accordance with the terms and conditions set out in the Service Agency Agreement, will perform all Major Maintenance on behalf of the Issuer. "**Major Maintenance**" means all repairs, replacements, acts and maintenance required in respect of the Land Parcels other than Ordinary Maintenance and Repair.

The rental payments under the semi-annual leases to be entered into pursuant to the Lease Agreement (the "**Lease Rentals**") will be calculated based on LIBOR plus the Margin, and will equal the Periodic Distribution Amounts payable on the Periodic Distribution Date coinciding with the Rental Payment Date for such Lease Rental. Lease Rentals will be re-calculated semi-annually based on LIBOR two London Business Days (as defined in the Conditions) before the commencement of each semi-annual lease.

Malaysia will be obligated to pay Lease Rentals on the [ ] day of each January and July, or if any such day is not a Business Day then the following Business Day, commencing in Janaury 2003 and to and including July 2007, or any other date on which the Lease Agreement is earlier terminated by agreement of the parties (each, a "**Rental Payment Date**").

Under the Lease Agreement, if Malaysia fails to pay a Lease Rental or any other sum due under the Lease Agreement to the Issuer when due, then Malaysia will be required to pay to the Issuer, from the date such amount became due until the date of full settlement thereof, a daily late payment amount equal to the then-current Lease Rental amount divided by the number of actual days in the then-current rental period. If the Issuer receives such late payment amounts, it will inform each Certificateholder of the aggregate amount so received and the amount in respect thereof distributed to such Certificateholder, and it shall further inform each Certificateholder that if *Shariah* principles apply to such Certificateholder then under such principles such Certificateholder should donate such late payment amounts to a charity of the Certificateholder's choice or otherwise in accordance with the Certificateholder's *Shariah* committee instructions.

Upon the occurrence of a Total Loss Event, the Lease Agreement will automatically be terminated and the liability of Malaysia to pay Lease Rentals will cease.

Under the Lease Agreement, Malaysia will bear the entire risk of loss of or damage to the Land Parcels or any part thereof arising from the negligent or improper usage or operation thereof by Malaysia, and will indemnify the Issuer against the same.

In the Lease Agreement, Malaysia will covenant that from the Closing Date and for so long as its liabilities under the Lease Agreement have not been discharged, Malaysia will not without the prior written consent of the Issuer create or permit to subsist any encumbrance over all or any of its present or future revenues or assets other than those permitted encumbrances specified therein.

Under the Lease Agreement, if:

(i) Malaysia shall default, for a period of seven days or more, in the payment of any of the sums whatsoever payable under the Lease Agreement or any of the other Related Documents (as defined in the Lease Agreement);

(ii) Any *ijarah* (lease) thereunder is terminated other than in accordance with its terms;

(iii) Malaysia shall fail to observe or perform any of the provisions of the Lease Agreement or any of the Related Documents (other than the payment obligation referred to in paragraph (i) above), whether express or implied, and such failure shall continue for a period of 60 days or more;

(iv) any representation, warranty, covenant or undertaking made or given by Malaysia or the Seller under the Lease Agreement and/or any of the other Related Documents or which is contained in any certificate, document or financial or other statement furnished at any time pursuant to the terms of the Lease Agreement and/or any of the other Related Documents proves to have been incorrect in any material respect on or as of the date made or deemed made;

(v) if any event or condition results in the acceleration of the maturity (other than by optional or mandatory prepayment or redemption) of any External Public Indebtedness of Malaysia having an aggregate principal amount equal to or in excess of U.S.$30,000,000 (or its equivalent in any other currency); or if Malaysia defaults in the payment of principal or interest equal to or in excess of U.S.$30,000,000 (or its equivalent in any other currency) payable (whether upon maturity, acceleration by reason of any default or otherwise) in connection with any External Public Indebtedness of Malaysia beyond any applicable grace or waiver period;

(vi) if Malaysia declares a general moratorium with respect to the payment of principal of or interest on any External Public Indebtedness;

(vii) at any time it becomes unlawful for Malaysia to perform or comply with any or all of its obligations thereunder or any of the obligations of Malaysia thereunder are not or cease to be legal, valid, binding and enforceable; or

(viii) any licence, authorisation, approval, consent, order or exemption of filing with any governmental authority with respect to the Lease Agreement and/or the other Related Documents ceases to remain in full force and effect,

then, in any such event, the Issuer may, without prejudice to any other right or remedy the Issuer may have under the Lease Agreement, the Related Documents or the law by written notice terminate the Lease Agreement and any lease current at such time.

"**External Public Indebtedness**" means any obligation of Malaysia in respect of money borrowed and guarantees given by Malaysia in respect of money borrowed by others payable by its terms or at the option of its holder in any currency other than the currency of Malaysia which is in the form of, or represented by, bonds, notes, debentures or other like instruments or book entries (whether or not initially distributed by means of a private placement, public offering or otherwise) that is, or was intended at the time of issuance to be, or is eligible to be, traded, quoted, listed or ordinarily purchased and sold on any stock exchange, over-the-counter or other established securities market.

Service Agency Agreement

Under the terms of the Service Agency Agreement, Malaysia (in this capacity, the "**Service Agent**") will, *inter alia*, be responsible on behalf of the Issuer for the performance of all Major Maintenance in respect of the Land Parcels, payment of land proprietorship taxes and the procuring of the Insurance Agreement.

"**Insurance Agreement**" means the insurance agreement covering a Total Loss Event, effective as of the Closing Date, to be procured from the Insurance Provider by the Service Agent pursuant to the Service Agency Agreement, which policy (i) specifies the Issuer as the insured party and provides for all claims to be paid directly by the Insurance Provider to the Issuer; (ii) only excludes a Total Loss Event occurring as a direct result of default or negligence on the part of Malaysia; (iii) in the aggregate provides a sum insured equal to or greater than Expenses plus the Dissolution Distribution Amount as of the date a full claim payment has been received by the Issuer thereunder; and (iv) is unconditional and irrevocable, subject only to its terms.

"**Insurance Provider**" means Malaysia (in the capacity of insurer).

A "**Total Loss Event**" means (i) total loss or destruction of, or damage to the whole of the Land Parcels or any event or occurrence that renders the whole of the Land Parcels permanently unfit for any economic use and the repair or remedial work in respect thereof is uneconomical or (ii) compulsory acquisition, confiscation or expropriation of the whole of the Land Parcels.

Tax Gross-up

All payments by Malaysia under the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed, the Insurance Agreement and the Service Agency Agreement are to be made without withholding or deduction for or on account of Taxes, unless the withholding or deduction of the Taxes is required by law. In such event, or in the event that a withholding or deduction for or on account of Taxes becomes applicable to payments to Certificateholders, Malaysia will be required, pursuant to the Lease Agreement, the Sale Undertaking Deed, the Purchase Undertaking Deed or the Service Agency Agreement, as the case may be, to pay to the Issuer such additional amounts so that (i) the Issuer will receive the full amount which otherwise would have been due and payable under the relevant agreement or deed and (ii) the Certificateholders will receive the full amount which otherwise would have been due and payable under the Certificates.

MALAYSIA

The Country

General

Malaysia is located in Southeast Asia, just north of the equator, and consists of two major land masses: Peninsular Malaysia and the states of Sabah and Sarawak, which are located on the island of Borneo. Peninsular Malaysia is separated from the states of Sabah and Sarawak by the South China Sea. The total land area of Malaysia is approximately 330,000 square kilometres.

Malaysia has a population of approximately 23.8 million. Kuala Lumpur, the capital and largest city, has an estimated population of 1.4 million. As of 2001, approximately 62.6% of the population of Malaysia was Malay and other indigenous peoples (together referred to as Bumiputera), approximately 24% was Chinese, approximately 8.1% was Indian and other races, and approximately 5.3% was non-citizens. Malaysia's population growth rate averaged approximately 2.5% per year from 1991 to 2000.

The official language of Malaysia is Bahasa Malaysia, but English is widely spoken.

Government

Peninsular Malaysia attained independence from Britain in 1957 as the Federation of Malaya. In 1963, Malaysia was formed as the successor to the Federation of Malaya, incorporating Sarawak, Sabah and Singapore. In August 1965, Singapore separated from Malaysia. Malaysia now consists of 13 states and three Federal Territories.

Malaysia has a federal system of government based on a parliamentary democracy headed by a constitutional monarch called the Yang di-Pertuan Agong. The Yang di-Pertuan Agong is elected for a five-year term by the nine hereditary Rulers who are members of the Conference of Rulers. The Federal Constitution lays the framework for the executive, legislative and judicial system of the country.

The Federal executive power is exercised by the Prime Minister and his cabinet. Under the Federal Constitution, the Prime Minister is appointed by the Yang di-Pertuan Agong and, in practice, the Yang di-Pertuan Agong appoints the leader of the political organisation that controls a majority of seats in the House of Representatives of the Parliament. The Prime Minister must himself be a member of the House of Representatives. Dato' Seri Dr. Mahathir bin Mohamad has been the Prime Minister since 1981 by virtue of being the Chairman of the National Front coalition that controls a majority of seats in the House of Representatives of Parliament. Prime Minister Mahathir is 76 years old. On 1 June 2001, Prime Minister Mahathir became the Minister of Finance, taking over from Tun Daim Zainuddin who resigned from the position. Datuk Seri Abdullah Ahmad Badawi is the Deputy Prime Minister and also the Minister of Home Affairs.

The Federal legislative authority in Malaysia is vested in the Parliament, which consists of the Yang di-Pertuan Agong and two Houses of Parliament known as the Senate (Dewan Negara) and the House of Representatives (Dewan Rakyat). The members of the House of Representatives are elected by popular vote for five-year terms. The members of the Senate, who serve three-year terms, are elected or appointed in the following manner:

(1) two members for each State are elected in accordance with the Seventh Schedule of the Federal Constitution;

(2) two members for the Federal Territory of Kuala Lumpur and one member for the Federal Territory of Labuan are appointed by the Yang di-Pertuan Agong; and

(3) 40 members are appointed by the Yang di-Pertuan Agong.

Bills become law when passed by both the House of Representatives and the Senate and assented to by the Yang di-Pertuan Agong. Bills passed by the Senate cannot be presented for royal assent until passed by the House of Representatives. The Federal Constitution, however, provides for circumstances under which Bills passed by the House of Representatives but not by the Senate may be presented for royal assent. The Yang di-Pertuan Agong has 30 days to assent to any Bill presented to him by causing the public seal to be affixed to it. However, if the Yang di-Pertuan Agong does not assent within 30 days, the Bill becomes law upon the expiration of the time specified. Federal legislative powers are specified in the Federal Constitution and extend to all matters of national importance such as external affairs, defence, internal security, finance, trade, education, other social services and the administration of justice. The powers of the legislative assemblies of the states are also specified in the Federal Constitution and cover such matters as land, Islamic law, forestry and local government. The states have no independent power to borrow without the approval of the Government. If any state law is inconsistent with federal law, federal law prevails.

Judicial power in Malaysia is vested in the courts. The superior courts are the Federal Court, the Court of Appeal and the High Courts, while the subordinate courts consist of the Sessions Courts and the Magistrate's Courts. The jurisdiction of the respective superior courts are determined by the Federal Constitution and the Court of Judicature Act 1964 while the jurisdiction of the subordinate courts are provided in the Subordinate Courts Act 1948. The Federal Court determines appeals from decisions of the Court of Appeal and the High Courts, and has exclusive jurisdiction to determine matters relating to the validity of any law on the ground that the Parliament or the state legislature has no power to make the law over matters relating to disputes on any other question between the states or between the Federation and any state. The Court of Appeal determines appeals from the High Courts. The High Courts determine appeals from the subordinate courts.

Since its formation, Malaysia has been governed by the National Front coalition comprising three major component parties, namely: UMNO, the Malaysian Chinese Association and the Malaysian Indian Congress, and a number of smaller parties which have changed from time to time. An opposition to the National Front coalition exists but it has never been able to capture sufficient support to win control of the Parliament. In the last general elections held in November 1999, members of the National Front coalition were elected to 151 out of 193 seats in the House of Representatives of the Parliament. In the same elections, the National Front coalition won the majority of seats in the state legislature in 11 of the 13 states and an opposition party won the majority of seats in the state legislature of the states of Kelantan and Terengganu. Under the Federal Constitution, general elections must be held every five years, and the next general elections must be held by late 2004.

UMNO is the dominant party in the National Front coalition, holding 72 of the coalition's 151 seats. Elections for the UMNO Supreme Council, the highest policy making body of UMNO, are held every three years and were last held in May 2000. Prime Minister Mahathir was returned unopposed as President of UMNO and Deputy Prime Minister Datuk Seri Abdullah Ahmad Badawi was elected as Deputy President of UMNO.

In September 1998, Datuk Seri Anwar Ibrahim, the then Deputy Prime Minister and Minister of Finance, was dismissed from office. On 14 April 1999, he was convicted of four charges of corrupt practices and sentenced to four concurrent six-year terms of imprisonment. In August 2000, Datuk Seri Anwar Ibrahim was convicted on additional charges and sentenced to an additional nine-year term of imprisonment. Datuk Seri Anwar Ibrahim has appealed both convictions. From 4 February to 7 February 2002 and in April 2002, the appeal against corrupt practices was heard by the Federal Court and later adjorned for decision on a date to be fixed. The appeal against his conviction on the additional charges has not been set for hearing by the Court of Appeal.

On 2 July 2000 an Islamic extremist group infiltrated a Malaysian army camp in Perak state and stole military weapons. The Malaysian army captured members of the group four days later. In December 2001, 19 of the insurgents were found guilty of treason for "waging war against the government to set up an Islamic state." The ten other insurgents had previously pleaded guilty to a reduced charge of preparing to wage war against the King of Malaysia.

Recent Developments

In early 2001, the Government purchased 29.1% of Malaysian Airline System Berhad, or MAS, from Naluri Berhad for RM1.8 billion. The Government determined that it was in the national interest to acquire MAS, which was financially weakened by the regional economic crisis, high fuel costs and exchange rate movements, in order to ensure that it could continue to remain the national flag carrier. Naluri Berhad is a publicly listed holding company that was controlled by Tan Sri Dato' Tajudin Ramli, a Malaysian businessman. The purchase price per share was RM8.00, which represented a premium over the closing market price of RM3.62 on 20 December 2000 for MAS shares traded on the Kuala Lumpur Stock Exchange. The Government agreed to pay this premium over the market price because it believed that MAS had a net tangible asset value per share higher than its market price and the Government was purchasing a controlling block, for which a control premium was required.

In March 2001, the Pension Trust Fund, a Government-linked pension fund, purchased 10.82% of TimedotCom Berhad for RM903.7 million in connection with that company's initial public offering of shares on the Kuala Lumpur Stock Exchange. In September 2000, prior to the initial public offering, Khazanah Nasional Berhad acquired 30% of TimedotCom. In total, these two entities invested RM3 billion to acquire approximately 40.8% of TimedotCom, which is a Malaysian telecommunications service provider. Khazanah is the investment holding arm of the Government and is responsible for managing assets held by the Government and making new investments in strategic and high technology projects. Khazanah and the Pension Trust Fund acquired these shares for investment purposes. In addition, Danaharta and the Employee Provident Fund acquired approximately 6.3% of TimedotCom in exchange for RM518.7 million in debt of TimedotCom's parent company, Time Engineering. Time Engineering is a subsidiary of Renong Berhad, an investment holding company then controlled by Tan Sri Datuk Wira Halim Saad, a Malaysian businessman.

In the fall of 2001, the Government, through Khazanah Nasional Berhad, paid RM3.8 billion to take control of Renong Berhad by acquiring United Engineers Malaysia Berhad, or UEM, Malaysia's largest construction company. UEM owns a controlling stake in Renong Berhad, Malaysia's largest industrial group. Renong Berhad had been suffering from over-diversification, decline in business and nontransparency of management. At the time of its takeover, Renong Berhad was Malaysia's largest private borrower. The former chairman of Renong Berhad was Tan Sri Datuk Wira Halim Saad. The Renong Berhad group spans the oil, bank, transport, construction and property industries.

In May 2001, the Government signed an agreement with PhileoAllied Berhad, which resulted in a reverse takeover and the privatisation of Pos Malaysia Berhad, or PMB, the Government's postal service. As a result, PMB is now a listed company on the Kuala Lumpur Stock Exchange. Under the initial agreement, PhileoAllied Berhad agreed to pay the Government RM800 million for PMB, RM550 million in cash, and the balance through a five-year 5% convertible loan from the Government. The Government had the option to convert its loan into a 32.9% equity stake in PMB. However, following a decision by the Securities Commission to set an issue price of RM1.92 per share of PMB stock, the Government would have been required to pay an additional cash top-up of RM230 million to acquire the 32.9% equity stake. The Government did not exercise this option. Instead, in a set of alternative transactions, the Government acquired, directly and indirectly, a 31.5% equity stake in PMB, making the Government the largest and controlling shareholder of PMB.

In an effort to avert the negative impact on exports due to the worldwide economic slowdown, the Government announced in September 2001 a further RM4.3 billion fiscal stimulus programme to be allocated for small development projects in rural and selected urban areas, including projects to upgrade Government buildings, to support training programmes and to promote tourism. This programme was in addition to the RM3 billion spending programme announced in March 2001, largely focused on education and training to stimulate economic growth in the short-term and strengthen manpower development in the long-term.

Foreign Relations and International Organisations

Malaysia maintains relations with 188 of the member countries of the United Nations. The United States, Japan and Singapore have historically been Malaysia's most important trading partners, and Malaysia also maintains close trading ties with the European Union and other Asian countries. Malaysia is a member of the United Nations, the Commonwealth, the Organisation of Islamic Countries, the Non-Aligned Movement, the Group of 15 and the D-8 Group of Developing Countries.

Malaysia promotes its economic interests through various bilateral, regional and international fora. Malaysia maintains close ties with its neighbouring countries, particularly through its memberships in:

- the Association of Southeast Asian Nations, known as ASEAN;
- the East Asia Cooperation;
- the ASEAN Free Trade Area;
- the Executive Meeting of East Asia and Pacific Central Banks;
- the South East Asian Central Banks Research and Training Center, known as SEACEN; and
- the South-East Asia, New Zealand, Australia central bank group, known as SEANZA.

Malaysia's inter-regional relations are maintained particularly through its memberships in the Asia-Europe Meeting and the Asia-Pacific Economic Cooperation forum. Malaysia also maintains close economic ties with countries in Latin America, Eastern Europe and Africa. Malaysia participates in various regional and international fora on regional economic surveillance, including the Manila Framework Group. Malaysia is also involved in efforts to reform the international financial architecture, including the Working Group on Capital Flows of the Financial Stability Forum.

Malaysia maintains memberships in a number of supranational organisations, including:

- the International Monetary Fund;
- the World Bank;
- the International Finance Corporation;
- the International Development Association;
- the Bank for International Settlements;
- the Asian Development Bank; and
- the Islamic Development Bank.

In its relations with the International Monetary Fund, Malaysia has ratified its participation in the New Arrangements to Borrow, whereby Malaysia will provide loans to the International Monetary Fund in the event that supplementary resources are required to avoid or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system. Malaysia also provides bilateral contributions to the Poverty Reduction and Growth Facility-Highly Indebted Poor Countries Initiative, the Fund's lending facility for its poorest members. Malaysia was among the first group of countries to subscribe to the Fund's Special Data Dissemination Standard, which is designed to improve the timeliness and quality of information of subscribing member countries. Malaysia has also complied with the new Special Data Dissemination Standard requirement on international reserves and foreign exchange currency liquidity since May 2000. Malaysia is a member of the World Trade Organization, and also participates in international commodity agreements such as the International Tropical Timber Agreement.

Malaysia is a participant in the ASEAN Swap Arrangement. The arrangement was established to provide unconditional and immediate short-term liquidity assistance for emergency foreign exchange financing to members facing temporary international liquidity problems. In its current form, up to U.S.$1 billion is available under the arrangement to ASEAN members until November 2002, subject to renewal upon mutual agreement by the participating members. Financial assistance under the arrangement involves the spot selling of a participant's domestic currency, combined with a forward purchase of that currency against U.S. dollars, Japanese yen or the Euro for an amount of up to twice the requesting member's committed amount under the arrangement for up to six months. It is expected that disbursements under the arrangement can be made within seven business days of the initial request by a participating member.

In 2001, under the Chiang Mai Initiative of the East Asia Cooperation, Japan provided a bilateral swap facility of U.S.$1 billion to Malaysia. This is in addition to the U.S.$2.5 billion available under the New Miyazawa Initiative swap facility, which Japan and Malaysia agreed to renew. These two swap facilities will be in force until October 2004. Malaysia is also engaged in current negotiations to enter into bilateral swap agreements with other ASEAN+3 members.

Affiliation with International Financial Organisations

The following table presents Malaysia's affiliations with major international financial organisations as of 31 December 2001.

Name of Organisation	Date of Affiliation	Malaysia's Subscription (U.S.$ mil)	Malaysia's Subscription (% of Total Subscription)	Amount Paid in by Malaysia (U.S.$ mil)	Malaysia's Approved Borrowing (U.S.$ mil)	Malaysia's Outstanding Borrowing (U.S.$ mil)
International Monetary Fund	March 1958	1,895.1	0.70	1,895.1	—	—
World Bank	March 1958	824.4	0.52	59.5	2,004.1	806.8
International Development Association	September 1960	48.9	0.39	3.7	—	—
Asian Development Bank	August 1966	1,255.4	2.56	87.9	1,439.3	417.4
International Finance Corporation	March 1967	15.2	0.65	15.2	—	—
Islamic Development Bank	August 1974					
Islamic Dinar[(1)]		ID79.6	1.96	ID50.97	ID11.1	ID4.8
U.S. Dollar		—	—	—	98.2	4.6
Multilateral Investment Guarantee Agency	July 1991	6.3	0.58	2.1	—	—

(1) One Islamic Dinar is equivalent to one Special Drawing Right, a unit of account established by the International Monetary Fund.
Sources: Ministry of Finance.
Bank Negara Malaysia.

Economic Developments Since 1997

The following discussion provides an overview of economic developments in Malaysia from 1997 through 2001. You should also read "The Economy" for more detailed information regarding the economic developments described below.

Economic Developments in 1997 and 1998

As a result of the regional economic crisis from mid-1997 through 1998, a number of East Asian countries, including Malaysia, suffered severe economic problems. In 1998, these countries recorded either a contraction in real GDP or experienced very low growth. The value of most regional currencies depreciated relative to the U.S. dollar. The regional economic crisis also contributed to a number of political and social changes in the region.

Prior to the onset of the regional economic crisis, the strength of Malaysia's economy was demonstrated by a number of economic indicators, including:

- strong GDP growth;
- low inflation;
- full employment;
- a high national savings rate;
- an improving balance of payments;
- low external debt;
- a healthy level of international reserves;
- a strong Government fiscal position; and
- a sound banking sector.

These strengths placed Malaysia in a relatively strong position from which to address the economic crisis.

Nevertheless, the regional economic crisis had severe effects in Malaysia. Some of the principal effects of the economic crisis were a decline in GDP, the depreciation of the ringgit, a decrease in short-term and long-term foreign investments, an increase in non-performing loans, or NPLs, a decline in the earnings and overall performance of the corporate and banking sectors, increased inflation, stock market volatility, and a decline in credit ratings. For 1998 as a whole, real GDP declined by 7.4%, inflation increased to 5.3% and the external debt service ratio increased to 6.7%.

Beginning in mid-1997, the Government and the central bank, Bank Negara Malaysia, known as BNM, introduced a series of policy measures to address the effects of the regional economic crisis on the domestic economy. The policy responses can be classified into the initial adjustment and stabilisation phases, beginning with the outbreak of the regional economic crisis through early 1998, and the recovery phase since mid-1998. The policy measures evolved with the changing economic environment during the course of the crisis, but the Government sought throughout to maintain macroeconomic stability and promote economic growth.

During the initial phase of the regional economic crisis, macroeconomic policy focused on addressing key areas of vulnerability, in particular containing inflation and excess domestic demand that were manifested by rapid credit growth and an increase in the current account deficit in the balance of payments. The initial policy measures featured tight monetary policy, fiscal restraint and the adoption of more stringent financial sector regulations. This package of measures helped to contain inflationary pressures and improved the balance of payments. In an environment of weakening external demand, however, these measures caused aggregate demand to fall more sharply than anticipated, dampened private sector activity and contributed to the rapid contraction of the economy.

Accordingly, beginning in mid-1998, the Government's policy focus shifted towards expansionary policies to revive economic growth and to ensure the continuation of socio-economic projects designed to protect living standards. On July 23, 1998, the National Economic Action Council announced the National Economic Recovery Plan, which contained six strategic areas for action to address the impact of the regional economic crisis. The Plan identified socio-economic priorities and sectors affected by the economic crisis and recommended wide-ranging proposals for economic stabilisation and structural reforms.

The Government recognised that addressing the rise in NPLs was a priority to enable effective monetary policy to be achieved. By July 1998, the Government had established Pengurusan Danaharta Nasional Berhad, or Danaharta, an asset management company, to address the increase in non-performing loans; Danamodal Nasional Berhad, a banking system recapitalisation agency; and the Corporate Debt Restructuring Committee, or CDRC, to resolve corporate debt problems. With the restructuring agencies in operation, BNM eased monetary policy beginning in early August 1998, primarily through the reduction of interest rates and the statutory reserve requirement ratio, to make available more funds to borrowers at reasonable rates. Other measures were introduced to improve loan intermediation and liquidity management. The Government eased fiscal policy by selectively increasing its spending on development projects and by establishing specialised funds to ensure that priority sectors continue to have access to credit at reasonable cost. In conjunction with the expansionary monetary and fiscal policies, the Government also introduced measures to strengthen the resilience of the financial sector to avoid systemic risks and ensure the continued efficient functioning of the intermediation role of the banking system.

Despite the measures taken, uncertainty over international and regional developments remained. To contain speculative activity against the ringgit, the Government introduced selective exchange controls to prevent the internationalisation of the ringgit, and pegged the exchange rate of the ringgit to the U.S. dollar in September 1998. The controls were effective in restoring stability in the domestic financial markets. The controls affecting the repatriation of foreign portfolio funds, largely from the sale of stocks listed on the Kuala Lumpur Stock Exchange, or the KlSE, were progressively liberalised in February 1999, September 1999 and February 2001 and were completely removed in May 2001.

Economic Performance in 1999 and 2000

The policies implemented by the Government in response to the economic crisis in 1997 and 1998 contributed to a sustained economic recovery in 1999 and 2000. The strong performance of the export sector and improved domestic demand resulting from expansionary fiscal and monetary policies and structural changes contributed to rising incomes and an improved outlook on employment. Reflecting these developments, real GDP expanded at an annual rate of 6.1% in 1999 and 8.3% in 2000. Growth was broad-based across both aggregate demand and supply and was evidenced by:

- improved macroeconomic fundamentals, such as low inflation, a balance of payments surplus, a sustained high level of international reserves and declining external debt;
- growth in all major sectors of the real economy;
- expansion of aggregate domestic demand, resulting from both higher public sector spending and increased private consumption and investment activities;
- sustained revenue collection; and
- a strengthening banking sector, in terms of capitalisation, asset quality and profitability.

To support the strengthening of the economy and to ensure that recovery was fully entrenched, BNM continued to maintain an accommodative monetary policy in 1999 and 2000, given that inflation remained benign. This accommodative monetary policy was reflected in the three-month intervention rate of 5.50% that was set in August 1999, and the statutory reserve requirement ratio of 4% that has been maintained since September 1998. The intervention rate, which is set by BNM, is a principal component of the base lending rates of Malaysian banks and, accordingly, a relatively low intervention rate effectively keeps interest rates at low levels throughout the Malaysian banking system. In 2000, the average base lending rates of both the commercial banks and finance companies were at lows of 6.78% and 7.95%, respectively.

The favourable economic conditions in Malaysia facilitated the process of banking system restructuring. The institutional arrangements and policy responses to mitigate the impact of the 1997-1998 regional economic crisis on the banking system have succeeded in restoring financial stability and the resumption of economic growth.

These efforts allowed the banking sector to emerge in a much stronger position in 2000. The removal of non-performing loans from the banking system by Danaharta and the strengthening of the banking system's capital position enabled the banking system to contribute effectively to the country's economic recovery. In 2000, new loans approved grew by 26.7% and disbursements increased by 12.6%.

Another area of focus was the consolidation programme for domestic banking institutions to create a stronger and more resilient domestic banking sector. Efforts were directed at ensuring that the mergers were completed in 2000. As of 31 December 2000, 50 out of 54 banking institutions were successfully merged, resulting in 94% of the total assets of the domestic banking sector being rationalised and consolidated.

The favourable economic conditions in Malaysia in 1999 and 2000 facilitated the process of corporate restructuring. Efforts were also directed to achieve industry-wide restructuring, especially in the areas of public transportation, telecommunications and the steel industry. The bankruptcy regulatory framework was considered adequate, but numerous measures were introduced to enhance corporate governance, transparency, minority shareholder protection and accounting and disclosure standards.

Economic Performance in 2001

Real GDP growth moderated to 0.4% in 2001, compared to 8.3% in 2000, largely due to the decline in the manufacturing sector and less favourable external developments. All other sectors continued to record positive growth rates. Real GDP grew at a more moderate rate of 3% and 0.4% in the first and second quarters of 2001, respectively, but contracted at a rate of 0.9% and 0.5% in the third and fourth quarters, respectively, each as compared to the corresponding period in 2000, due primarily to the effects of the economic slowdown in major industrial countries. Due to the worldwide economic slowdown, growth was increasingly supported by domestic demand. Growth was supported by expansion in domestic-oriented industries and strong growth in both the services and agriculture sectors. A diversified economic base helped soften the impact of the contraction in export-oriented industries and higher levels of Government expenditure also supported domestic demand.

As of 31 December 2001, the average risk-weighted capital ratio of the Malaysian banking system was 12.7% and the core capital ratio was 10.8%. Based on a six-month NPL classification, the net NPL ratio increased to 8.1% as of 31 December 2001 compared with 6.3% as of 31 December 2000. During 2001, the net non-performing loans of the banking system increased by RM8.6 billion, representing a net NPL ratio of 11.5% based on a three-month classification policy, compared to 9.7% as of 31 December 2000. The bulk of the increase was due to the expiration of NPL waivers on classification of some loans in the first half of 2001 that were undergoing restructuring efforts under the administration of the Corporate Debt Restructuring Committee, as well as an increase in the gross amount of NPLs.

The equity market was generally bearish in the first half of 2001, but later gains more than offset the early-year losses, causing the Kuala Lumpur Stock Exchange's main index to increase slightly to 696.09 points on 31 December 2001 from 679.6 points as of 31 December 2000. The market's performance was partly attributable to the volatile conditions in global and regional stock markets caused by concerns over the impact of the U.S. economic slowdown and reports of lower corporate earnings. Due to the slower economic growth in 2001 and poor equity market performance, some delays have been experienced in the ongoing corporate restructurings.

Fiscal policy in 2001 continued to emphasise sustaining growth through continuing the Government's fiscal stimulus programmes. In March 2001 and September 2001, the Government adopted a stronger fiscal stimulus programme, including additional spending programmes totalling RM7.3 billion to stimulate domestic demand to compensate for the lower export growth, given the sharper than expected slowdown in the U.S. economy. Priority will be placed on projects that have an immediate impact on the economy, a strong multiplier effect, a short implementation period and low import content. The March 2001 programme, which was largely focused on education and training, was designed not only to stimulate economic growth in the near term but also to advance the long-term objective of manpower development. The September 2001 programme focused on supporting small development projects in rural and selected urban areas, including projects to upgrade Government buildings, to support training programmes and to promote tourism. The overall financial position of the Government recorded a deficit of RM18.4 billion in 2001, compared to RM19.7 billion in 2000, somewhat better than had been projected due to better than expected Government revenue. In addition, the Foreign Investment Committee regulations were liberalised effective 25 April 2001 to facilitate property acquisition by foreigners. To stimulate foreign investment, the Government also liberalised other policies in 2001, including allowing foreign participation through strategic alliances in key sectors of the economy, allowing foreign companies to apply for tailor-made incentive packages and liberalising amounts loaned to foreigners to invest in real estate. To raise disposable income and consumption, the rate of employees' contributions to the Employees Provident Fund was reduced to 9% from 11% on a voluntary basis for a one-year period from April 2001. The rate was reinstated to 11% effective April 2002. These fiscal measures to a certain extent helped sustain domestic economic activities in the context of a worldwide economic slowdown.

In 2001, given that the inflationary outlook remained subdued, monetary policy continued to be accommodative to support economic growth and to mitigate the effects of the worldwide economic slowdown on Malaysia. On 20 September 2001, BNM further reduced the three-month intervention rate to 5%. The ample liquidity in the banking sector coupled with low levels of interest rates continued to ensure that the private sector had access to a ready pool of available funds at reasonable cost. In addition, special funds dedicated to important sectors and small- and medium-sized enterprises were actively promoted by increasing their size, expanding their scope and lowering their lending rates. Overall, the fall in external interest rates, including in the United States, accorded greater flexibility to monetary policy in encouraging investment and domestic demand, while ensuring that a high level of savings continued to be sustained.

Malaysia continues to maintain a pegged exchange rate regime, which remains consistent with economic fundamentals and is supported by its low level of external debt, strong current account surplus, high level of reserves and low rate of inflation, as well as strong and well-capitalised banking sector. The pegged exchange rate regime continues to meet the objective of providing stability and facilitating economic activity. The policy is guided by long-term considerations and is not affected by short-term fluctuations in exchange rates. The Government has stated that it would not use exchange rate depreciation to gain international competitiveness.

BNM's net international reserves as of 31 December 2001 were RM117.2 billion (U.S.$30.8 billion), compared to RM113.5 billion (U.S.$29.9 billion) as of 31 December 2000.

In April 2001, the Government launched the Third Outline Perspective Plan to guide economic development over the next ten years. At the same time, the Government introduced the Eighth Malaysia Plan, which sets out in detail the first phase in the implementation of the Third Outline Perspective Plan.

The primary objective of the Third Outline Perspective Plan is to build a resilient and competitive nation by strengthening Malaysia's ability to meet the challenges arising from the rapid pace of globalisation and advances in information and communications technology. The plan also takes into account the need to strengthen Malaysia's economic, financial and social resilience so that it is able to withstand global volatility and risks similar to the 1997-1998 regional economic crisis. The principal policies reflected in the plan include:

- developing Malaysia into a knowledge-based economy;

- generating growth internally by strengthening domestic investment and developing indigenous capability while continuing to attract foreign direct investment in strategic areas;

- increasing productivity of the agriculture, manufacturing and services sectors through greater infusion of knowledge; and

- reorienting human resource development to support a knowledge-based economy.

The plan contemplates a knowledge-based economy as one in which knowledge, creativity and innovation play an increasing and important role in generating and sustaining economic growth. While traditional factors of production continue to remain important, knowledge will be the key factor driving growth, creating new value and providing a strategy to enhance competitiveness. The nucleus of a knowledge-based economy is human capital with its capacity to create, innovate, generate and commercialise knowledge, while information and communications technology are a key enabling tool to facilitate the transformation to a knowledge-based economy.

The Financial Sector Masterplan, launched on 1 March 2001, provides the blueprint for the development of the financial sector in the next ten years. The recommendations in the Plan are aimed at developing a competitive and dynamic domestic financial system that is resilient to the challenges of the new and more global environment.

Economic Performance in 2002

Real GDP grew by 1.1% in the first quarter of 2002, compared with the first quarter of 2001. Economic growth in this period was driven mainly by strong consumption and supported by improved external demand following the general recovery in the global economy.

As of 31 March 2002, the average risk-weighted capital ratio of the Malaysian banking system remained strong at 12.5% and the core capital ratio was 10.7%. For the first three months of 2002, the net non-performing loans of the banking system increased by only RM0.6 billion, maintaining the net NPL ratio of 11.5% based on a three-month classification policy, and 8.2% based on a six-month classification policy. The net NPL ratios, which increased in 2001, stabilised in the first three months of 2002, indicating an improvement in the asset quality of the banking system.

In the first three months of 2002, the loans extended by the banking system rose further by RM5.7 billion. As of 31 March 2002, loans outstanding grew by 4.6% on an annual basis.

As of 15 May 2002, BNM's net international reserves further increased to RM124.4 billion (U.S.$32.7 billion), which was five times Malaysia's total external short-term debt outstanding (as defined under "*The Economy—External Debt*").

The Kuala Lumpur Stock Exchange Composite Index, or KLCI, rose by 6.6% to 741.76 points as of 31 May 2002, compared to 696.09 points at the close of trading on 31 December 2001. The rise of the KLCI has been attributed to, among others, the positive impact on investors' sentiments due to progress made in domestic corporate restructuring efforts.

On 4 March 2002, S&P revised its outlook on Malaysia's long-term ratings to "positive" from "stable", and affirmed its long- and short-term ratings on Malaysia, including the "BBB" long-term foreign currency sovereign credit rating. S&P stated that the positive outlook reflects the expectation that Malaysia's fiscal position will improve as the global economy recovers and acknowledges that the commitment of the Government to push through difficult corporate restructurings is a positive factor for Malaysia's economy. S&P indicated that a move by the government towards a less interventionist approach would strengthen the credit standing of Malaysia.

On 3 April 2002, Moody's Investors Service upgraded its outlook for Malaysia's "Baa2" foreign currency ceiling for bonds and the "Baa3" foreign currency ceiling for bank deposits to "positive" from "stable", citing the maintenance of the strong balance of payments and external financial position despite the difficult external environment faced by the country during the previous year. Moody's stated that Malaysia's vulnerability to future external shocks has appeared to lessen given the resilience of the external financial position. Moody's also indicated that factors that will influence the future course of Malaysia's rating include the maintenance of Malaysia's strong external financial position, further progress in corporate restructuring, political developments, and trends in both direct and portfolio foreign investments.

On 9 April 2002, Fitch Ratings revised its outlook on Malaysia's long-term foreign and local currency ratings of "BBB" and "A-", respectively, to "positive" from "stable". According to Fitch, the revision reflected the country's accelerated corporate restructuring, a strengthening financial sector, continuing large current account surplus and robust international liquidity but that the ratings remain constrained by diminishing fiscal flexibility, rising yet manageable Government debt and the fixed exchange rate regime, which renders Malaysia more vulnerable to a sharp weakening of the Japanese yen and/or rising global interest rates than other Asian countries. Fitch also expressed concern about Malaysia's political leadership succession process.

On 12 April 2002, Rating & Investment Information, Inc., or R&I, Japan's leading rating agency, revised the rating outlook for Malaysia to "positive" from "stable", while affirming the ratings of "BBB+" and "a-2" for the long-term and short-term foreign currency debt, respectively. R&I attributed this revision to Malaysia's relatively small public as well as external debt, favourable progress in terms of measures taken to enhance corporate governance and economic soundness that allows it to benefit from an anticipated improvement in world economy.

The Economy

Introduction

Malaysia has a diversified economy, the principal sectors of which are services, manufacturing, agriculture, mining and construction. Malaysia produces and exports a wide range of primary commodities and manufactured goods, including electronic components and equipment, electrical machinery and appliances, chemicals, textiles, wood products, metal products, petroleum, liquefied natural gas, sawn timber, saw logs and tin. Malaysia is one of the world's largest exporters of semiconductors, air conditioners, rubber gloves, palm oil and rubber.

Since 1966, the Government has formulated and implemented a series of five-year plans for the development of the Malaysian economy. These plans have been guided by the development policies in the New Economic Policy introduced in 1970, the National Development Policy introduced in 1991, and the National Vision Policy introduced in 2001. The New Economic Policy, the National Development Policy and the National Vision Policy embody the First, Second and Third Outline Perspective Plans. More recent plans have also been guided by a working paper presented by the Prime Minister in February 1991 entitled "Malaysia: The Way Forward", known also as "Vision 2020". The goals of these policies generally have been to eradicate poverty and to redistribute wealth through growth. In particular, they are aimed at promoting social stability through enhancing the participation of Bumiputera in the economy. The pro- business stance of the Government and its commitment to the implementation of these five-year plans and development policies have encouraged foreign direct investment and the private sector to be the main engines of growth in the Malaysian economy. In response to the 1997-1998 regional economic crisis, the Government established the National Economic Action Council to assist in policy formulation and the implementation of short- and medium-term economic recovery strategies.

The Government holds equity interests in a number of major corporations, including non-financial public enterprises, involved in certain strategic sectors, including telecommunications, power, transportation, petroleum, construction and services. The principal non-financial public enterprises are Tenaga Nasional Berhad, Telekom Malaysia Berhad, Petroliam Nasional Berhad, also known as Petronas, Putrajaya Holdings Sdn Bhd and Malaysia Airports Holdings Berhad. In 1983, the Government adopted an active programme of privatisation of projects and state-controlled companies. This programme was intended to increase economic efficiency and to reduce financial and administrative burdens on the Government. A Privatisation Masterplan to guide privatisation efforts was formulated and is being implemented by the Government.

Gross Domestic Product and Gross National Product

The following table sets out the composition of Malaysia's GNP by demand aggregates at current and constant 1987 prices for the periods indicated.

GNP by demand aggregates(1)

	1997	1998	1999	2000E	2001P	2001P	First three months of 2002P
			(RM billion)			(% of GNP)	(RM billion)
GNP at Current Prices:							
Consumption	158.1	145.4	158.1	181.0	193.4	62.6	48.2
Private sector	127.8	117.7	125.1	144.7	150.6	48.7	39.4
Public sector	30.3	27.7	33.0	36.2	42.9	13.9	8.9
Investment	121.5	76.0	65.8	87.7	83.3	27.0	19.3
Private sector(2)	89.7	44.0	31.4	44.1	34.1	11.0	n.a.
Public sector(2)	31.8	32.0	34.5	43.6	49.2	15.9	n.a.
Change in stocks	(0.4)	(0.4)	1.5	5.0	(3.7)	(1.2)	n.a.
Exports of goods and non-factor services	262.9	327.8	364.9	427.0	389.3	126.0	96.0
Imports of goods and non-factor services	260.3	265.5	289.5	358.5	327.8	106.1	80.4
GDP	281.8	283.2	300.8	342.2	334.6	108.3	83.3
GDP (U.S.$ billion)(3)	100.2	72.2	79.1	90.0	88.1	108.3	21.9
Net factor payments abroad	(15.1)	(15.3)	(20.9)	(28.9)	(25.6)	(8.3)	n.a.
GNP	266.7	267.9	279.9	313.2	309.0	100.0	n.a.
GNP (U.S.$ billion)(3)	94.8	68.3	73.7	82.4	81.3	100.0	n.a.
Per capita GNP (U.S.$)(3)	4,376	3,079	3,243	3,544	3,410	—	n.a.
GNP at Constant 1987 Prices:							
Consumption	113.4	102.1	107.9	119.1	126.0	65.3	30.9
Private sector	91.4	82.0	84.4	95.0	97.6	50.6	25.3
Public sector	22.0	20.1	23.5	24.2	28.4	14.8	5.7
Investment	96.7	55.2	51.6	64.8	63.1	32.7	14.6
Private sector(2)	71.4	32.0	24.7	32.6	25.8	13.4	n.a.
Public sector(2)	25.3	23.2	26.9	32.2	37.2	19.3	n.a.
Change in stocks	(0.3)	(0.2)	1.3	2.5	(2.4)	(1.2)	0.9
Exports of goods and non-factor services	186.5	187.4	212.1	246.2	227.7	118.1	55.6
Imports of goods and non-factor services	199.7	162.2	179.3	223.1	203.9	105.7	50.0
GDP	196.7	182.2	193.4	209.5	210.5	109.1	52.1
Net factor payments abroad	(14.4)	(9.5)	(13.6)	(19.0)	(17.6)	(9.1)	n.a.
GNP	182.3	172.8	179.8	190.5	192.8	100.0	n.a.

E Estimate.
P Preliminary.
(1) In the first quarter of 1999, the Department of Statistics began releasing a new series of GDP data based on 1987 prices. Unlike the 1978-based GDP data, which relied more on gross output in the computation of value added, the 1987-based GDP data attempts, whenever data is available, to take into account variations in input in the computation. The new series of data is also more comprehensive in terms of wider coverage of industries and takes into account the change in the industrial structure of the economy between 1978 and 1987.
(2) Yearly data are BNM estimates.
(3) Converted to U.S. dollars at the average exchange rate for the relevant period.
Sources: Department of Statistics, Malaysia.
Bank Negara Malaysia.

From 1986 through the first half of 1997, the Malaysian economy grew at a rapid rate. From 1995 to 1997, annual real GDP growth averaged 9%. During this period, the main catalysts of economic growth were investment and exports of goods and non-factor services, which grew at an average annual rate of 13.4% and 11.2%, respectively, in real terms over the period. Gross fixed capital formation was driven by private investment, which increased at an average annual rate of 16.3% in real terms during the same period.

In 1998, real GDP declined by 7.4%, with real aggregate domestic demand declining by 25.2%. The decline in private expenditure was significant. Uncertain economic outlook and employment prospects, the deferment of high import content projects, the negative wealth effects from the decline in share prices and the consequential balance sheet adjustments in the financial and corporate sectors led to a significant contraction in private sector expenditure. The adjustment was reflected in the decline of private sector expenditure in 1998 by 30% compared to 1997. The decline in consumption and export demand led to a build-up in stocks and excess capacity, depressing further private investment.

The counter-cyclical fiscal policy adopted by the Government contained the decline in public spending in 1998 to 8.6% in real terms. The Government increased funding for socio-economic development projects in tandem with the implementation of its fiscal stimulus programme. Public sector investment was sustained by capital investment by the non-financial public enterprises for ongoing capacity expansion and modernisation programmes.

In 1999, the fiscal stimulus programme as well as favourable developments in the external sector contributed to Malaysia's recovery from the recession of 1998. Real GDP registered a positive growth of 6.1% in 1999 as the business sector responded positively to the fiscal stimulus programme and to rising external demand.

In 2000, the economy recorded a strong expansion with real GDP growth of 8.3%. The pace of economic activities accelerated, stimulated by both stronger external demand and an increase in domestic expenditure. The strong growth in exports was due to sustained strong demand for electronic and electrical products. With the strengthening external demand, stronger fiscal stimulus and a low interest rate environment, private sector activities strengthened significantly in 2000. Private consumption rose by 12.5% and private investment increased by 32.1%.

In 2001, real GDP growth moderated to 0.4%, compared to 8.3% in 2000, due to the decline in the manufacturing sector and less favourable external developments. Growth during this period was increasingly supported by domestic demand. Domestic demand was in turn supported by higher Government expenditure during the period. The Government has been able to be flexible in its policies due to strong fundamentals of the economy, and it has been proactive in implementing measures to promote domestic-led growth. The fiscal stimulus programme has been targeted at those activities that have a positive effect on the economy to promote consumption and investment spending. Consequently, growth in total consumption remained positive, increasing by 5.8%, while growth in real gross fixed capital formation declined by 2.8% in 2001.

In the first quarter of 2002, real GDP expanded by 1.1%, driven mainly by strong consumption and supported by improved external demand following the general global economic recovery. Private consumption, which accounts for almost half of GDP, increased by 2.5%, reflecting the cumulative effects of expansionary monetary and fiscal policies and the recovery in exports. Public consumption continued to increase, registering a 13.4% increase, reflecting the fiscal stimulus implemented during the period, including the 10% salary adjustment for civil servants and higher expenditures on supplies and services. Gross fixed capital formation declined by 8.5% as a result of prevailing excess capacity.

Foreign Investment. The following table sets out approved foreign investments in the manufacturing sector by industry for the periods indicated.

Approved foreign investments in the manufacturing sector by industry(1)

	1997	1998	1999	2000	2001P	2001P	First four months of 2002P
			(RM million)			(U.S.$ million)(2)	(RM million)
Food manufacturing	173.8	364.8	276.6	539.5	516.0	135.8	146.7
Beverages and tobacco	209.8	143.6	134.8	107.7	12.0	3.2	0.0
Textiles and textile products	141.4	624.1	60.6	731.9	320.4	84.3	19.2
Leather and leather products	0.0	7.8	13.5	2.8	0.2	0.1	0.0
Wood and wood products	88.9	260.9	56.4	155.6	122.2	32.2	139.3
Furniture and fixtures	47.1	89.4	56.5	106.8	60.0	15.8	5.5
Paper, printing and publishing	474.7	286.7	1,071.5	211.9	3,084.2	811.6	0.0
Chemicals and chemical products	730.4	4,149.9	262.6	586.6	727.8	191.5	235.3
Petroleum and coal(3)	4,201.4	2,184.4	3,147.8	3,208.7	115.5	30.4	1.2
Rubber products	90.3	48.6	32.2	668.3	310.7	81.8	57.5
Plastic products	254.4	297.0	61.1	289.9	216.1	56.9	39.4
Non-metallic mineral products	115.8	464.7	266.9	1,527.6	1,602.4	421.7	52.9
Basic metal products	700.1	992.3	238.4	428.0	421.0	110.8	70.1
Fabricated metal products	605.2	540.5	165.1	163.0	375.1	98.7	95.1
Machinery manufacturing	461.1	152.3	226.3	420.0	346.0	91.0	149.4
Electrical and electronic products	2,875.1	1,905.7	5,946.4	10,209.7	9,493.1	2,498.2	540.2
Transport equipment	281.4	503.1	231.3	273.1	491.2	129.3	50.2
Scientific and measuring equipment	3.6	22.1	25.5	166.5	526.4	138.5	4.9
Miscellaneous	18.6	25.4	0.1	50.7	80.1	21.1	0.0
Total	11,472.9	13,063.5	12,273.9	19,848.5	18,820.6	4,952.8	1,606.9

P Preliminary.
(1) Actual foreign investments in manufacturing projects in any given year typically differ from the amount of investments approved for that year. This is because planned investments are sometimes made over longer periods than originally anticipated or because actual investment amounts proved to be lower or higher than the amounts approved.
(2) Amounts for 2001 were converted from ringgit to U.S. dollars at the exchange rate of RM3.80 = U.S.$1.00.
(3) Includes petrochemicals and natural gas.
Source: Malaysian Industrial Development Authority.

The manufacturing sector continued to attract a significant amount of foreign investment in the period from 1997 to 2001. The average share of foreign investment to total approved manufacturing projects in that period was approximately 59%. Foreign investments in the manufacturing sector were mainly in the capital intensive and technology categories, particularly in electrical and electronic products, petroleum and coal (including petrochemicals), chemical and chemical products and non-metallic mineral products. The United States, Japan, Singapore, Taiwan and the Netherlands were the top sources of foreign investment for the manufacturing sector during this period.

Net foreign direct investment in 1999 was RM[14.8] billion, compared to RM[10.6] billion in 1998. This increase resulted from higher inflows of both new investment and reinvestment. The stability accorded by the selective exchange control measures and fixed exchange rate together with the Government's commitment to maintain pro-business policies contributed to the continued long-term investment of several multinational corporations.

In 2000, net inflows of foreign direct investment in Malaysia were sustained at RM[14.4] billion. This reflected mainly funds brought in for the purpose of expansion and diversification of projects and setting up of new strategic alliances with Malaysian partners following the liberalisation of foreign equity ownership policy in selected services subsectors.

In 2001, the value of foreign investment approved in the manufacturing sector amounted to RM18.8 billion, lower than the RM19.8 billion approved in 2000. The new projects approved were primarily in the electrical and electronic products industry (50.4%); paper, printing and publishing industry (16.4%) and non-metallic mineral products industry (8.5%). The top five foreign investors during the year were from the United States (18.1%), Japan (17.8%), China (15.5%), Germany (13.8%) and Singapore (11.8%). Total value of applications received in 2001 from foreign investors for manufacturing projects amounted to RM11.2 billion compared to RM30.2 billion in 2000. In the first four months of 2002, the total value of foreign investment approved in the manufacturing sector amounted to RM1.6 billion, while the total value of applications received from foreign investors amounted to RM1.5 billion.

The ongoing consolidation by major multinational corporations following the decline in global demand and excess capacity resulted in lower inflows for expansion and new foreign direct investments in 2001. Nevertheless, inflows of equity from foreign strategic alliances, particularly in the telecommunications and financial services sectors, were significant in the first three quarters. These inflows, which were smaller in average dollar size and low in import content, nevertheless brought technology and other expertise that contribute towards raising productivity in Malaysia. In the first nine months of 2001, net inflows of foreign direct investment in Malaysia amounted to RM5.2 billion. The sale of strategic interests in one services company by non-resident investors to Malaysian residents in the fourth quarter, however, largely offset this net inflow. As a result, net inflow of direct investment in Malaysia moderated to RM2.1 billion for 2001 as a whole. The sale of strategic interests by non-resident investors in the fourth quarter of 2001 reflected a decision by a Malaysian company to acquire the stake of its non-resident partners. The move was to enable the Malaysian company to regain control over the subsidiary company, as part of its corporate restructuring exercise. The acquisition was financed by the issuance of long-term debt securities to the non-resident investors as well as by the raising of an offshore loan. Hence, the transaction, which resulted merely in the change of ownership of a subsidiary company, had no impact on international reserves or domestic economic activities.

In an environment of modest global economic recovery and continued excess capacity, gross inflows of foreign direct investment (in the form of equity and inter-company loans only) moderated to RM2.5 billion in the first three months of 2002. On a net basis, foreign direct investment recorded an outflow of RM0.3 billion due to repayment of loans as well as a reduction in the share capital of a foreign-owned bank in Malaysia arising from a merger of the bank in its home country.

During the period from 1991 to 2000, the manufacturing sector accounted for about 40 to 60% of total foreign direct investment. In 2001, the manufacturing sector accounted for a smaller share of about 20% of total foreign direct investment, reflecting ongoing consolidation by major multinational corporations following the decline in global demand and excess capacity. Investment in the oil and gas sector, which accounted for 20 to 30% of foreign direct investment during the period 1991 to 2000, increased to account for about 38% of the total in 2001. There was also significant foreign investment in the services sector (which increased from about 16% of the total in the 1990s, to 41% in the period 2000 – 2001), particularly in the financial and business services sector, ports, telecommunications and investments in the Multimedia Super Corridor. According to the Multimedia Development Corporation, approvals for foreign investment in the Multimedia Super Corridor amounted to RM1.1 billion in 2000, compared with a total of RM1.1 billion during the entire period of 1997 through 1999. In 2001, such approvals amounted to RM0.8 billion.

The Government's efforts have been directed to attracting capital-intensive and high-technology investment. The capital-intensive investments have been more pronounced in the electrical and electronic products industry, including the manufacture of computer motherboards, hard disk media and silicon wafers. During 1997 through 2000 investments made in response to the special incentives offered to high-technology industries amounted to RM3.2 billion for establishment of wafer manufacturing projects. Two approved wafer manufacturing projects commenced commercial production in early 2001.

To promote foreign direct investment, the Government has liberalised the equity ownership policy for the manufacturing sector effective 31 July 1998. Under the current foreign equity ownership policy, foreign equity ownership of up to 100% in manufacturing sector companies is generally permitted irrespective of the level of exports, except for projects involving paper packaging, plastic packaging, plastic injection moulded components, metal stamping, metal fabrication and electroplating, wire harness, printing and steel service centres that remain subject to the previous restrictions. The current foreign equity ownership policy is applicable to all project applications received between 31 July 1998 and 31 December 2003. Projects approved under this policy will not be required to restructure their equity after that period, provided that the companies continue to comply with the original conditions of approval and retain the original features of the projects. Companies licensed before 31 July 1998 must comply with the equity condition stated in their respective licences. If such companies undertake expansion or diversification, however, the current foreign equity ownership policy will apply to those expansion or diversification projects. For other sectors, the Foreign Investment Committee's approval must be obtained for any acquisition of or merger with an existing business in Malaysia.

The Government remains committed to the liberalisation of investment restrictions to increase competition and promote new investments. In March 1998, the Government announced that the maximum level of foreign equity investment would be raised to 49% in locally licensed basic telecommunications companies, 51% in the insurance sector under specific conditions and 49% in the stock brokerage industry. In June 1998, the Government announced that it was prepared to consider applications to raise the 49% ceiling on foreign equity holdings in locally licensed basic telecommunications companies up to a maximum of 61%, provided that the companies concerned reduce their foreign equity holdings to a maximum of 49% within five years. Effective 25 April 2001, the Foreign Investment Committee's guidelines on property acquisition by foreigners were liberalised. On 8 May 2002, the Securities Commission relaxed the requirement for 30% Bumiputera equity participation in foreign-owned companies seeking to list on the KLSE by means of a reverse take-over of, or a back-door listing into, distressed listed companies. Under the new requirements, companies can be 100% foreign-owned under these types of listings.

Given the increasing competition for foreign investment, the Government continues to intensify its efforts to attract high quality investment in order to enhance Malaysia's competitiveness. A high level committee has been established at the Ministry of Finance to formulate special packages of incentives to meet the specific needs of individual investors.

Principal Sectors of the Economy

The following table sets out GDP by economic activity at constant 1987 prices for the periods indicated.

GDP by economic activity (at constant 1987 prices)(1)

	1997	1998	1999	2000	2001P	2001P	First three months of 2002P
		(RM million, except percentages)				(% of GDP)	(RM million)
Services	102,163	101,753	106,293	112,372	118,763	56.4	29,873
Manufacturing	58,788	50,898	56,841	67,717	63,536	30.2	15,753
Agriculture, forestry and fishery	18,010	17,512	17,596	17,943	18,269	8.7	4,179
Mining and quarrying	14,305	14,357	15,344	15,641	15,892	7.6	4,021
Construction	9,522	7,241	6,926	6,996	7,159	3.4	1,703
GDP at purchasers' value	196,714	182,237	193,422	209,538	210,480	—	52,124
GDP growth (decline) (%)	7.3	(7.4)	6.1	8.3	0.4	—	1.1

P Preliminary.
(1) In the first quarter of 1999, the Department of Statistics began releasing a new series of GDP data based on 1987 prices. Unlike the 1978-based GDP data, which relied more on gross output in the computation of value added, the 1987-based GDP data attempts, whenever data is available, to take into account variations in input in the computation. The new series of data is also more comprehensive in terms of wider coverage of industries and takes into account the change in the industrial structure of the economy between 1978 and 1987.
Sources: Department of Statistics, Malaysia.
Bank Negara Malaysia.

During the past three decades, through the implementation of strategic policies, Malaysia made significant progress toward the transformation of its economy from one characterised by agricultural production and mining to one characterised by manufacturing and services. Since the late 1970s, the contribution of the agriculture, forestry and fishery sector has declined from 25.1% of GDP in 1978 to 8.7% in 2001. During the same period, the contribution of the manufacturing sector increased from 19% of GDP to 30.2%. The services sector also developed at a faster pace than the overall expansion of the economy, with its share of GDP rising to 56.4% in 2001 from 38.9% in 1978. Within the sector, intermediate services has gained importance, with its share of GDP rising from 9.4% in 1978 to 22.3% in 2001, benefiting from the rapid pace of industrialisation. At the same time, the contribution of the final services group remained significant at 34.2% compared to 29.5% in 1978. The manufacturing industry, initially characterised by the production of low-end goods such as textiles and clothing, now produces higher value-added products, including indigenous brand names as well as more capital- and technology-intensive goods such as electronic and electrical products. The process of economic transformation in Malaysia involves a strategic shift from labour-intensive to capital-intensive activities utilising more integrated and technology-driven production processes.

In 1998, the 7.4% decrease in real GDP was principally caused by declines in all sectors, except the mining sector, reflecting in part the deferment or cancellation of several infrastructure projects, the consolidation in the property market, lower domestic demand, sluggish external demand, particularly from the Asian markets, and unfavourable weather conditions. In real terms, output in the manufacturing, services, agriculture and construction sectors declined by 13.4%, 0.4%, 2.8% and 24%, respectively, while output in the mining sector grew by 0.4%.

In 1999, real GDP recovered to record an increase of 6.1%. On the supply side, growth was initially driven by strong performance of the export-oriented industries in the manufacturing sector. The recovery became increasingly broad-based during the course of the year. In real terms, output in the manufacturing, agriculture, mining and services sectors increased by 11.7%, 0.5%, 6.9% and 4.9%, respectively, while output in the construction sector declined by 4.4%.

In 2000, economic activity in Malaysia continued to expand due to export growth and rising domestic expenditure. Real GDP expanded by 8.3%, with growth continuing to be broad-based. Growth in output was supported by further expansion in the manufacturing and services sectors, which grew by 19.1% and 5.7%, respectively. The construction and mining sectors increased by 1% and 1.9%, respectively, while the agriculture sector increased by 2%.

In 2001, real GDP increased slightly by 0.4%. Growth continued to be broad-based in general, with all principal sectors of the economy except manufacturing recording positive growth rates. Growth was supported by expansion in domestic-oriented industries and strong growth in the services and agriculture sectors. This diversified economic base helped soften the impact of the marked slowdown in the electronic equipment subsector. During 2001, growth in the agriculture, services, construction and mining sectors was 1.8%, 5.7%, 2.3% and 1.6%, respectively. Value added in the manufacturing sector declined by 6.2% in 2001 due to the general worldwide economic downturn.

In the first quarter of 2002, real GDP expanded by 1.1%. Growth was driven largely by the sustained performance of the services sector and stronger growth in the construction sector. The manufacturing sector recorded a smaller decline of 2.1% in comparison with the 8.4% decline in the fourth quarter of 2001. This improvement followed improved external conditions and sustained domestic consumption.

Services. The following table sets out the growth in the services sector for the periods indicated.

Growth in services sector (at constant 1987 prices)

	1997	1998	1999	2000	2001P	First three months of 2002P
			(Annual change (%))			
Electricity, gas and water	(5.8)	11.1	4.9	16.2	6.9	5.9
Transport, storage and communications	11.8	(0.3)	4.3	11.0	7.5	3.2
Wholesale and retail trade, hotels and restaurants	8.0	(3.4)	3.1	4.8	3.0	2.1
Finance, insurance, real estate and business services	18.9	(1.9)	5.9	4.4	9.5	8.8
Government services(1)	8.6	1.1	6.6	2.4	4.6	3.3
Other services(2)	7.0	1.9	2.7	2.6	2.9	4.2
Total services	9.9	(0.4)	4.5	5.7	5.7	4.6

P Preliminary.
(1) Includes general public services (general public administration, external affairs and public order and safety), defence, health, education and others.
(2) Includes imputed rent from owner-occupied dwellings; community, social and personal services, provision of private non-profit services to households; and domestic services of households.
Sources: Department of Statistics, Malaysia.
Bank Negara Malaysia.

The services sector comprises a wide range of activities which can be broadly classified into electricity, gas and water; transport, storage and communications; wholesale and retail trade, hotels and restaurants; finance, insurance, real estate and business services; government services; and other services. The services sector grew at an average annual rate of 5.7% between 1997 and 2001.

In 1998, the services sector contracted by 0.4%, due to the contraction in the economy. The decline was attributed to a contraction in intermediate services by 1.3%. The intermediate services group comprises transport, storage, communications, finance, insurance, real estate and business services, while the final services group comprises utilities, wholesale and retail trade, hotels and restaurants, government services and other services.

In 1999, the services sector grew by 4.5%, supported by the overall improvement in the economy. During the year, the intermediate services group grew by 5.3%, while the final services group grew by 4%.

In 2000, the services sector grew by 5.7%, supported by strong growth in both the intermediate services and final services groups, at 6.9% and 5%, respectively. The services sector remained the largest sector in the economy in 2000, with a 53.6% share of GDP, and accounted for the largest share of employment at 48.7% of the total labour force.

Growth in the intermediate services group in 2000 was attributable mainly to the 11% expansion in the transport, storage and communications subsector, which was driven by robust trade performance and rapid expansion in the telecommunications industry. In addition, the finance, insurance, real estate and business services subsector grew by 4.4%, reflecting increased profitability of financial institutions following the rapid expansion of the economy and higher demand for insurance products.

The final services group grew by 5% reflecting improved demand conditions in the domestic economy. The improved performance was due mainly to the rapid growth in the wholesale and retail trade, hotels and restaurants subsector as well as the utilities subsector. The utilities subsector expanded by 16.2% due to improved demand for electricity from both industrial and commercial users. The increase of 4.8% in the wholesale and retail trade, hotels and restaurants subsector was attributable to the improvement in consumer spending and higher tourist arrivals. In addition, the government services subsector grew by 2.4%.

In 2001, the services sector grew by 5.7%. The intermediate services group grew by 8.7%. Within this group, the transport, storage and communications subsector grew by 7.5%, due mainly to improved performance of the telecommunications industry. In addition, increased lending activities and increased demand for insurance products supported the growth of the finance, insurance, real estate and business services subsector, which had a growth rate of 9.5% in 2001. The final services group increased by 3.8%, supported by a 6.9% growth in the utilities subsector due to sustained demand from both industrial and commercial users. The wholesale and retail trade, hotels and restaurants subsector grew at a slower rate of 3%.

In the first three months of 2002, the services sector expanded by 4.6%. The intermediate services group grew by 6.6%. Within this group, the finance, insurance, real estate and business services subsector grew by 8.8%, reflecting mainly higher bank lending activity as well as higher insurance premium collections and stronger performance in the stock market. The transport, storage and communications subsector also recorded stronger growth, supported by expansion in the telecommunications industry. The final services group increased by 3.3%, supported by 5.9% growth in the utilities subsector due to higher demand from the manufacturing sector. The wholesale and retail trade, hotels and restaurants subsector grew by 2.1%.

As part of the effort to promote development of the services sector, the Government launched the Multimedia Super Corridor in 1996. The development of the corridor is the centrepiece of a new strategy of the Government designed to accelerate the transformation of Malaysia's economy into a high-tech and high value-added economy. This transformation is considered necessary for Malaysia to enhance its international competitiveness. The Multimedia Super Corridor is a land belt measuring 15 kilometres by 50 kilometres, stretching from Kuala Lumpur City Centre to the Kuala Lumpur International Airport. The corridor's communications network will include digital optical fibre infrastructure. World-class multimedia corporations have been invited to locate their business units and research and development facilities in the corridor. Initially, seven flagship applications were targeted for development, namely electronic government, smart schools, telemedicine (now called telehealth), research and development clusters, borderless marketing centres, world-wide manufacturing web and smart cards. The number of flagship applications has now been reduced to six, with borderless marketing centres and world-wide manufacturing web regrouped as e-business.

As of 30 April 2002, 768 applications had been received from companies applying for approval to operate in the Multimedia Super Corridor. Of this total, 673 applications, representing aggregate planned investments of

RM11.2 billion by the third year of operations, had been approved. Companies that are wholly foreign-owned and joint ventures with majority foreign stakeholders represented 30.6% of the total approved applications. Fifty world-class companies have been granted Multimedia Super Corridor-status, of which 42% have commenced operations. Malaysia's target is to attract a total of 70 world-class companies to the corridor by the end of 2003.

Manufacturing. The following table sets out the change in production indices for the principal industrial products of Malaysia for the periods indicated.

Growth in manufacturing sector (base year 1993 = 100)

	1997	1998	1999	2000	2001	First three months of 2002P(2)
			(Annual change (%))			
Domestic-oriented industries	10.9	(24.1)	11.6	22.1	7.0	2.2
Food products	3.8	(2.1)	5.7	16.2	4.3	11.9
Beverages	(0.2)	(11.8)	(2.5)	6.0	3.2	(2.2)
Tobacco products	19.9	(9.1)	(15.4)	75.3	(6.0)	(23.5)
Paper products	13.0	(8.7)	12.8	15.1	1.9	(2.7)
Petroleum products	8.9	(11.5)	(0.3)	19.9	19.3	3.4
Non-metallic mineral products	10.1	(26.5)	2.6	20.5	9.6	7.8
Iron and steel products	13.1	(29.1)	29.4	16.6	(0.7)	(8.6)
Fabricated metal products	11.9	(17.2)	(1.1)	33.8	3.9	(6.4)
Transport equipment	14.3	(52.1)	53.4	19.1	19.0	17.5
Export-oriented industries	13.0	(5.1)	13.4	25.7	(10.4)	(5.5)
Textiles and wearing apparel	5.3	(5.3)	4.0	8.7	(8.3)	(15.0)
Wood and wood products	(1.6)	(11.3)	(7.3)	4.0	1.2	(15.6)
Rubber products(1)	3.4	7.9	3.6	4.0	3.3	(5.1)
Chemicals and chemical products(1)	24.5	(1.9)	17.1	15.1	(7.7)	(9.3)
Electrical machinery, apparatus, appliances and supplies	13.6	(7.7)	15.7	40.5	(15.9)	(2.5)
Electronics	22.8	(4.2)	21.2	44.8	(20.2)	(0.6)
Electrical	(1.7)	(14.7)	2.7	28.7	(2.8)	(8.2)
Off-estate processing	9.8	(2.7)	24.7	11.7	7.7	0.6
Others	(1.1)	(1.5)	(1.2)	16.7	(17.7)	(11.0)
All industries	12.4	(10.3)	12.9	25.0	(6.6)	(3.7)

P Preliminary.
(1) Reclassified as export-oriented industries rather than domestic-oriented industries in the second quarter of 2001 since about 75% of the total output is related to export demand.
(2) Increase or decrease compared to the first three months of 2001.
Source: Department of Statistics, Malaysia.

The manufacturing sector had been among the most rapidly growing sectors in the Malaysian economy in recent years and a primary contributor to GDP since 1987. During the 1980s, growth in manufacturing came mainly from lower value-added and simple assembly industries related to electrical machinery, semiconductor and electronic assemblies, textiles, petroleum refining and iron and steel products. Since the late 1980s, there has been a shift towards higher technology products including telecommunications equipment and parts, sound recording and reproducing apparatus and equipment, automated office equipment, photographic appliances and equipment and higher value-added production including the development of indigenous brand names.

Production of the manufacturing sector declined by 10.3% in 1998, the first decline since 1985. The decline was due to the slowdown in the region as well as in the domestic economy. The impact of the regional economic crisis was most pronounced in the second half of 1998, with the manufacturing sector contracting by 14.5% in the third quarter and by 14.7% in the fourth quarter. Export-oriented industries, particularly wood and wood products, electrical, electronics, textiles and wearing apparel and off-estate processing, recorded a collective 5.1% decline in production during the year. Production of the domestic-oriented industries declined by 24.1%. The decline was most severe in the construction-related products, transport equipment, fabricated metal products, beverages and petroleum products industries.

In 1999, the overall production of the manufacturing sector recovered strongly by 12.9%. The recovery was aided mainly by a marked improvement in external demand, especially for electronic goods. The manufacturing sector also benefited from the policy measures of the Government that were aimed at stimulating domestic demand and ensuring stability in the financial markets. All industries, except the wood products, beverages and tobacco products, petroleum products and fabricated metal products industries, recorded positive growth in production. The rebound in the construction-related materials industries, which benefited from the turnaround in construction activity in the second half of 1999 also contributed to the manufacturing sector's growth. Amidst improved external and domestic demand conditions, production of both the export- and domestic-oriented industries increased by 13.4% and 11.6%, respectively, contributing to a broad-based recovery in the manufacturing sector. As a proportion of GDP, the share of manufacturing value added rose from 27.9% in 1998 to 29.4% in 1999.

In 2000, manufacturing production expanded by 25%, due to a significant increase in external demand and sustained higher domestic demand. Consequently, the expansion in production remained broad-based with both the export- and domestic-oriented industries increasing strongly by 25.7% and 22.1%, respectively. In particular, growth of the export-oriented industries was driven mainly by favourable demand for electronic goods related to telecommunications, networking infrastructure and wireless applications, as well as higher-end audio-visual products. As one of the major international production centres for multinational electronics companies, Malaysia benefited from these favourable developments in the global information and communications technology sector. Meanwhile, higher demand from both the public and private sectors led to improved performance of firms producing for the domestic market, especially those involved in the production of construction-related products, transport equipment and petroleum products. With expansion in sales and production volumes, there was an increasing number of firms operating at or above 80% of capacity. Of significance, the electronics and electrical products manufacturers operated above the 80% level, despite further capacity expansion in 2000. Reflecting the increasing resilience of the well diversified manufacturing sector, the impact of the U.S. economic slowdown and the downswing in the electronics cycle during the fourth quarter did not significantly affect Malaysia's manufacturing production. As a result, the strong output performance enabled the manufacturing sector to strengthen its position, increasing its share further to 32.3% of total GDP in 2000.

In 2001, production in the manufacturing sector decreased by 6.6% compared to 2000. The decline in production reflected primarily the lower production of the export-oriented sector, particularly the electronics sector. Supported by the positive effects of the fiscal stimulus programme, the production of domestic-oriented industries, however, was strong. This to some extent softened the impact of the severe decline in production of the export-oriented sector.

In the first three months of 2002, the decline in manufacturing production moderated further, following improved external conditions and sustained domestic consumption, decreasing 3.7% compared to the first three months of 2001. Production of the export-oriented industries recorded a smaller decline of 5.5%, compared to the corresponding period in 2001, reflecting mainly an improvement in the output of electronic goods which recorded a marginal decline of 0.6%. At the same time, the production of domestic-oriented industries continued to expand by 2.2%, supported by sustained strong domestic demand, especially for passenger cars and food products.

Agriculture, Forestry and Fishery. The following table summarises production and export volumes of the major agricultural commodities for the periods indicated.

Agricultural production and export volume

	1997	1998	1999	2000	2001	First three months of 2002P(3)
	(Period change (%), except for ringgit amounts)					
Crude palm oil						
Production volume(1)	8.1	(8.3)	26.8	2.7	8.9	(8.4)
Export volume, crude and processed(2)	3.1	(1.0)	19.4	(1.1)	18.1	(11.5)
Gross exports, crude and processed (RM million)	10,817.0	17,779.0	14,475.2	9,948.0	9,876.2	2,740
Saw logs						
Production volume(1)	3.5	(30.5)	0.6	5.9	(15.3)	(15.3)
Export volume(2)	(8.4)	(15.3)	24.4	(3.8)	(25.5)	(7.5)
Gross exports (RM million)	2,345.8	1,865.7	2,662.6	2,489.0	1,522.7	306.6
Rubber						
Production volume(1)	(10.3)	(8.8)	(13.2)	(20.0)	(11.1)	2.0
Export volume(2)	3.9	(2.9)	(0.5)	(0.6)	(16.0)	(10.5)
Gross exports (RM million)	2,970.7	2,828.8	2,343.5	2,571.3	1,866.4	438.9

P Preliminary.
(1) Based upon changes in volume measured in tonnes (except for saw logs, which are measured in cubic meters).
(2) Export volume includes amounts which have been imported and then exported.
(3) Increase or decrease compared to the first three months of 2001.
Sources: Department of Statistics, Malaysia.
Malaysian Palm Oil Board.
Department of Forestry (Peninsular Malaysia, Sabah and Sarawak).

The agriculture sector may be broadly divided into two groups: (1) a resource-based group principally comprising palm oil, rubber, saw logs and cocoa; and (2) an agro-based and food group principally comprising fish, fruits and vegetables and floriculture. Historically, the predominant commodities have been palm oil and rubber. Between 1997 and 2001, value added in the agriculture sector increased by an average annual rate of 0.4%. Notwithstanding the reduced share of agriculture as a percentage of GDP, total exports and employment, the agriculture sector remains an important sector of the economy because of its linkages with other sectors, particularly the resource-based industries. With the launching of Malaysia's second Industrial Master Plan, which emphasises the development of inter-linkages among the various sectors, the role of the agriculture sector, particularly in the development of resource-based industries, is expected to be enhanced. In addition, the Government has accorded greater emphasis to develop further the sector with the implementation of the Third National Agriculture Policy, which aims to ensure the long-term growth of the sector. Under the policy, various initiatives will be taken to accelerate the transformation of the agriculture sector into a modern, commercialised and technology-driven sector. The objective is to promote non-traditional agricultural activities such as floriculture and horticulture, besides the traditional large-scale industrial crops of oil palm, rubber and cocoa.

In 1998, output of the agriculture sector declined by 2.8% due to adverse weather conditions, labour shortages, unfavourable prices, reduced cultivated area and lower yields. The decline in output was broad-based, involving the production of all major commodities. In particular, the production of crude palm oil declined by 8.3% as a result of the downturn in the biological yield cycle for the oil palm trees.

In 1999, agricultural output increased by 0.5% due to favourable weather conditions, higher yields, expansion in mature planted area and strong external demand. In particular, production of crude palm oil increased strongly by 26.8% due to the upturn in the biological yield cycle of the oil palm trees and to a lesser extent, an expansion in mature planted area. Meanwhile, production of saw logs grew by 0.6% in response to the recovery in external demand, while production of fish increased by 4% due to higher output of both marine fish and aquaculture. However, production of natural rubber declined by 13.2% in 1999 as the industry continued to be affected by depressed prices, labour shortage and reduction in cultivated area.

In 2000, output of the agriculture sector increased by 2% due primarily to higher production of crude palm oil, which grew by 2.7%, following an expansion in mature planted area during the year. In addition, higher production of saw logs, livestock and fish also contributed to the growth in the agriculture sector. The production of rubber and cocoa declined further by 20% and 16%, respectively, due to lower prices for these commodities.

Palm oil prices reached a record high in 1998 to average RM2,366 per tonne (U.S.$603 per tonne) due to the decline in the global supply of palm oil. Malaysia's palm oil production, which accounted for almost half of total world production in 1998, declined by 8.3% during the year primarily due to a reversal in the biological yield cycle for oil palm trees. In 1999, palm oil prices fell to RM1,615 per tonne (U.S.$425 per tonne). The major reason for this decline in prices was a large increase in global production. This subsequently led to a sharp build-up in inventories. At the same time, supplies of other major vegetable oils also increased as a result of good harvests, creating a worldwide inventory surplus during the year. In 2000, palm oil prices fell further by 30.5% to an average export price of RM1,122 per tonne (U.S.$295 per tonne) due to this worldwide oversupply of vegetable oils. In 2001, palm oil prices declined sharply by 15.9% to RM944 per tonne (U.S.$248 per tonne) as global oversupply of vegetable oils continued to put downward pressure on prices. Nonetheless, palm oil prices have increased since November 2001, as production of palm oil was affected by lower yields due to periodic fluctuations in the biological yield cycle, while external demand has remained favourable. Palm oil prices were higher on average in the first three months of 2002 at RM1,175 per tonne (U.S.$309 per tonne) due primarily to lower palm oil supply.

In 2001, the agriculture sector grew by 1.8%, primarily due to higher production of crude palm oil (8.9%) and miscellaneous agriculture (including livestock, fruits and vegetables). The latter reflected to some extent the initial results of efforts to increase domestic food production.

In the first three months of 2002, output of the agriculture sector declined by 4.9% as production of crude palm oil and saw logs declined. In the case of crude palm oil, the decline was due primarily to lower yields following periodic fluctuations in the biological yield cycle, whilst the lower output of saw logs was mainly in response to lower demand. In contrast, production of rubber increased due to the improvement in rubber prices.

Mining. The following table summarises changes in production and export volumes of the major mineral products for the periods indicated.

Mining production and export volume

	1997	1998	1999	2000	2001	First three months of 2002P(2)
	(Period change (%)(1), except for ringgit amounts)					
Crude petroleum						
Production volume(1)	(0.2)	1.6	(4.7)	(1.2)	(2.4)	4.0
Export volume	(9.3)	13.5	(1.6)	(5.9)	(9.6)	(2.5)
Gross exports (RM million)	7,068.6	7,509.8	9,305.9	14,240.9	11,117.7	2,367.6
Natural gas						
Production volume(1)	15.4	(5.2)	6.2	10.8	3.7	(10.3)
Liquefied natural gas Export volume	18.0	(3.7)	2.8	2.3	0.4	(1.7)
Gross exports (RM million)	6,485.4	5,981.3	6,348.6	11,422.5	11,342.1	3,030.6
Tin						
Production volume(1)	(2.1)	13.6	27.5	(14.1)	(21.2)	(13.8)(3)
Export volume	(7.8)	(29.3)	7.4	(14.2)	32.3	33.1
Gross exports (RM million)	477.4	484.6	490.7	434.7	460.8	104.8

P Preliminary.
(1) Based upon changes in volume measured in tonnes (except for petroleum production, which is measured in barrels and natural gas production, which is measured in millions standard cubic feet).
(2) Increase or decrease compared to the first three months of 2001.
(3) First two months of 2002 compared to the corresponding period of 2001.
Sources: Department of Statistics, Malaysia.
Petronas.
Department of Minerals and Geoscience, Malaysia.

Malaysia has a wide range of mineral resources. Minerals produced by Malaysia in significant quantities include hydrocarbons (petroleum and natural gas) and tin. Between 1997 and 2001, the mining sector expanded at an average annual rate of 2.5%. The contribution to GDP of the mining sector has increased over the past five years from approximately 7.3% of GDP in 1997 to 7.6% of GDP in 2001.

From 1997 to 2001, approximately 90% of earnings from sales of minerals were attributable to oil and gas sales. Malaysia exploits its oil and gas resources through Petronas Nasional Berhad, or Petronas, the national oil company of Malaysia. Petronas is wholly owned by the Government. Pursuant to the Petroleum Development Act 1974, Petronas has the "entire ownership in and exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore Malaysia". The Act also vests refining, manufacturing and marketing rights in Petronas. Petronas also engages in upstream activities such as the exploration for and production of crude oil and natural gas and engages a number of international oil and gas companies to participate in such activities pursuant to production sharing contracts. Petronas generally sells its liquefied natural gas pursuant to long-term contracts ranging from 15 to 21 years in duration. In addition to Malaysia, Petronas has operations in the following countries:

- Algeria
- Angola
- Argentina
- Australia
- Brunei
- Cambodia
- Cameroon
- Chad
- China
- Gabon
- India
- Indonesia
- Iran
- Libya
- Myanmar
- Pakistan
- The Philippines
- Seychelles
- South Africa
- Sudan
- Switzerland
- Thailand
- Tunisia
- Turkmenistan
- Vietnam

Gas reserves stood at 84.4 trillion and 82.5 trillion standard cubic feet as of January 2000 and January 2001, respectively, or in each case, a useful life of 30 to 40 years based on current production levels. Crude petroleum reserves at January 2000 and January 2001 each amounted to 3.4 billion barrels, or a useful life of 15 years based on current production levels.

In 1999, the mining sector increased by 6.9% due mainly to higher production of natural gas, which grew by 6.2% following increased domestic demand and higher external demand for liquefied natural gas by Japan and South Korea. In addition, production of tin-in-concentrates increased further as tin prices remained favourable. However, production of crude oil declined by 4.7%, consistent with the National Depletion Policy, which aims to extend the period for exploitation of the nation's petroleum resources.

In 2000, the mining sector grew by 1.9% due to higher production of natural gas, which increased by 10.8%, due to an increase in the utilisation of natural gas by the power generation sector as well as higher demand for liquefied natural gas from Japan and Taiwan. In contrast, production of crude oil was 1.2% lower in 2000.

In 2001, the mining sector recorded a marginal increase of 1.6%, attributable to higher natural gas production while production of crude oil declined by 2.4%. The higher natural gas production was primarily in response to increased demand from the domestic power generation subsector.

In the first quarter of 2002, the mining sector declined by 0.8%, as the 4% increase in crude oil production resulting from increased domestic demand was more than offset by the 10.3% decline in natural gas output.

Export proceeds from crude oil increased significantly by 23.9% in 1999 due entirely to higher export prices, while export volume declined by 1.6%. Higher export volume from Australia, New Zealand, the United States, India, Brunei and South Korea was more than offset by lower demand from buyers in Singapore, Taiwan, Thailand, China, Indonesia and Japan. The increase in Malaysia's crude oil prices to an average of U.S.$18.18 per barrel was in line with higher international crude oil prices. Meanwhile, export receipts from liquefied natural gas were also higher by 6.1%, on account of increased export prices as well as higher offtake from Japan and South Korea.

In 2000, export earnings from crude oil rose by 53% due to stronger crude oil prices, which averaged U.S.$29.58 per barrel, while liquefied natural gas exports increased by 79.9%, reflecting higher export prices and volume.

In 2001, export proceeds from crude oil were markedly lower primarily due to weaker oil prices in line with the trend in international oil markets. Oil prices were lower at an average price of U.S.$25.53 per barrel. Similarly, exports of liquefied natural gas also declined as prices fell in tandem with lower oil prices and export volume only increased marginally.

In the first three months of 2002, export earnings from crude oil contracted markedly due mainly to lower crude oil prices. In line with the decline in global oil prices, the average export prices for Malaysian crude oil were lower at U.S.$20.19 per barrel in the first quarter of 2002 compared to the corresponding period in 2001. Liquefied natural gas exports were also lower primarily due to lower prices.

Construction. The construction sector expanded at double digit growth rates in 1996 and 1997. In 1998, the construction sector declined by 24% due mainly to lower aggregate demand. The decline was broad-based, affecting the residential, non-residential and civil engineering subsectors. Following the sharp contraction in demand for high-end residential and commercial properties during the course of 1998, the value and volume of property transactions fell by 47.5% and 32.3%, respectively, for the year as a whole. The adjustment was more severe in the civil engineering subsector due to the completion of large projects and the deferment of new projects. At the end of 1998, the average occupancy rate in the office space and retail space in the Klang Valley had declined to 79.9% and 61.7%, respectively.

To avoid an over-adjustment in the construction sector and to pave the way for new construction activity, measures were introduced since 1998 to reduce excess stocks and to ensure that the lower income group continued to have access to affordable housing. Priority was given to promote residential housing, which has strong underlying demand as well as high sectoral linkages. A RM2 billion fund for the Special Scheme for Low and Medium Cost Houses was established in May 1998 for bridging finance. The Government also assisted in promoting the First Home Ownership Campaign (December 1998 to January 1999) and the Second Home Ownership Campaign (October to December 1999). The home ownership campaigns offered financing incentives, including exemption from stamp duties and lower financing costs for houses purchased during campaign periods. Legal fees were also reduced for the sale and purchase agreements, loan agreements and other charge documents.

Measures were also introduced by the Foreign Investment Committee to stimulate foreign demand for high-end properties. The RM100,000 levy on foreign purchases was removed with effect from August 1997 and the Real Property Gains Tax was reduced to 5% for disposal of properties after the fifth year as announced in the 1998 Budget. Effective 22 April 1998, foreigners are allowed to purchase all types of residential units, shop houses, commercial and office space costing above RM250,000 per unit, provided financing for such purchases is not obtained in Malaysia and the purchase is limited to newly completed projects or those which are at least 50% completed. These guidelines were liberalised effective 25 April 2001.

Recognising the importance of infrastructure development to facilitate economic recovery, the Government restructured the Development and Infrastructure Bank of Malaysia to provide funds for infrastructure projects. In 2000, 20 loans valued at RM7.6 billion were approved to finance projects such as ports, rail transportation, highways and regional development. In 2001, an additional 34 loans valued at RM7.4 billion were approved. From 1998 to 2000, the Development and Infrastructure Bank of Malaysia raised a total of RM3.4 billion to finance infrastructure development. The civil engineering subsector has benefited from the Government's continued efforts in infrastructure development, particularly for construction, upgrading and improvement of roads and highways.

As a result of the measures taken, the construction sector recovered in the second half of 1999 and recorded growth of 4.4% in that period compared to the second half of 1998. Following improved market sentiment, demand for properties also increased. The value and number of properties transacted in 1999 increased by 23.3% and 21.4%, respectively, compared to 1998.

The construction sector grew by 1% in 2000 primarily due to Government spending under the fiscal stimulus programme, privatised infrastructure projects and residential housing development, especially for affordable housing. In contrast, construction activity in the non-residential subsector remained subdued, constrained by excess capacity given the large overhang of office and retail space. The value and number of property transactions continued to increase by 13.9% and 6.2%, respectively, during the year.

The Government's fiscal stimulus programme, privatisation of infrastructure projects and housing development contributed to 2.3% growth of the sector in 2001. Construction activity in the non-residential subsector consolidated further due to the continuing large overhang of office and retail space.

During the first quarter of 2002, the construction sector grew at a rate of 2.9%. This stronger rate of growth was supported by the fiscal stimulus programme and the low interest rate environment.

Gross National Savings

Historically, Malaysia has sustained a high rate of savings by international standards, averaging 39.4% of GNP during the five-year period ending 2001. The high rate of savings has been driven predominantly by high private savings which have been encouraged by Malaysia's generally rising real incomes, low inflation and a well-developed financial system. In addition, the Government has attempted to promote private sector savings through savings programmes such as the Employees Provident Fund. From 1997 to 2001, gross national savings rose from RM104.4 billion to RM107.4 billion, equivalent to an annual average rate of growth of 2.8%. Gross national savings is the difference between gross national disposable income and final consumption. Gross national disposable income is the total income available to individuals for either final consumption or savings.

Notwithstanding Malaysia's high savings rate, the country's gross capital formation exceeded savings in 1997, by an amount equivalent to 6.3% of GNP. This difference, known as the "savings-investment gap", was attributable solely to the private sector, and was reflected in Malaysia's current account deficit. Gross capital formation refers to additions to the physical stock of capital in an economy. This includes both public and private expenditures on buildings, machinery and equipment, and changes in inventories of work in progress and finished goods.

In 1998, gross national savings continued to increase despite the contraction in the domestic economy. Gross national savings recorded a slower growth of 8.2% in 1998 compared to 11% in 1997, reflecting the marginal increase in nominal income in 1998. Public savings decreased due to the counter-cyclical economic policies adopted by the Government to contain the impact of the economic slowdown. This was offset by the increase in private savings resulting from the marked decline in private consumption. In terms of GNP, the share of gross national savings increased to 42.2% in 1998 from 39.1% in 1997. Gross domestic capital formation decreased sharply by 37.6% and accounted for 28.2% of GNP in 1998. As a result, the savings-investment gap had a positive balance of RM37.4 billion.

In 1999, the savings-investment balance remained in surplus for the second consecutive year as gross domestic capital formation moderated further. Private savings declined by 3.1% to RM67.1 billion as private consumption recovered in 1999. Despite higher operating expenditure, public savings increased by 10.2% to RM48.1 billion, reflecting significant improvement in revenue performance of the public sector. Overall, gross national savings increased at a slower rate of 2%. Consequently, the share of gross national savings to GNP declined to 41.2% in 1999.

In 2000, the savings-investment balance amounted to RM32.3 billion, or 10.3% of GNP. Gross national savings increased by 8.5% in 2000 as the strong growth in nominal income led not only to higher consumption spending but also higher savings. Public savings increased by 17.5% to RM56.5 billion due mainly to better revenue performance of the public sector. Private savings increased by 2% in 2000. As gross nominal income increased at a faster rate of 11.9%, gross national savings as a percentage of GNP declined to 39.9%.

In 2001, gross national savings accounted for 34.8% of GNP, as compared to 39.9% in 2000, as consumption spending remained resilient in the context of lower gross national income. Savings of both the public and private sectors were lower. Public savings declined by 15.1% due to higher growth in public consumption and slower growth in public sector revenue. Private savings were lower due to resilient growth in private consumption as consumers reacted positively to the Government's measures to promote consumption and lower interest rates. Nevertheless, the savings rate in Malaysia remains relatively high by historical standards and in comparison with other countries.

Prices, Employment and Wages

Prices. The following table shows annual inflation rates for the periods indicated.

Annual price increases

	1997	1998	1999	2000	2001	First four months of 2002(1)
				(%)		
Consumer Price Index	2.7	5.3	2.8	1.6	1.4	1.5
Producer Price Index	2.7	10.7	(3.3)	3.1	(5.0)	(0.3)

(1) Increase or decrease compared to the first four months of 2001.
Source: Department of Statistics, Malaysia.

Malaysia has historically maintained a low inflation rate. Malaysia measures inflation through the Consumer Price Index, or CPI. The CPI measures prices of final goods and services that are consumed by the average household. The primary final goods and services included in the CPI are food, gross rent, fuel and power, and transportation and communications. In 1998, consumer prices, as measured by the CPI rose by 5.3% as a direct result of the depreciation of the ringgit during the 1997-1998 regional economic crisis. Excluding food, the adjusted CPI rose more moderately by 3.1%. Consequently, during 1998, monetary policy was conducted to maintain price stability. A number of other factors also limited the impact of the ringgit depreciation on domestic consumer prices. Many firms absorbed part of the price increase in order to maintain market share in an environment of weak domestic demand and excess capacity in the economy. Low inflation abroad and lower oil and commodity prices in overseas markets also had a moderating effect on domestic prices. Consequently, inflationary pressures abated.

In 1999, the CPI rose by 2.8%. The relative stability of the ringgit exchange rate, excess capacity in the economy and lower commodity prices led to the low inflation rate. In 2000, higher oil prices led to an upward adjustment in the administered retail prices of petroleum and related products. However, this was offset by lower prices for clothing and footwear and more moderate price increases for some of the other components of the CPI. Consequently, inflation remained low and the CPI increased by only 1.6% in 2000. The inflation rate moderated to 1.4% for 2001 as a whole as compared to 1.6% in 2000. Inflationary pressures were contained primarily by the excess capacity still prevailing in some sectors of the economy, the elimination of supply constraints through capacity expansion in several other sectors, and low inflation abroad combined with a stable ringgit.

In the first four months of 2002, inflation remained stable at 1.5%. Modest recovery in domestic demand amidst the prevalence of excess capacity in several sectors, as well as low inflation abroad, resulted in stable inflation during the period.

In order to protect the welfare of the lower income groups, the Government maintains a system of administered prices for a number of basic products, estimated to constitute 14% of the CPI basket, based on the revised weights of the CPI basket, which weights were revised in 2000. The system is designed to curb unjustified excessive increases in prices of these basic products. Price adjustments are allowed to reflect changes in economic fundamentals such as higher imported prices and increases in production costs. The Government approves the price adjustments based on such changes as well as agreements arrived at after negotiations with producers, distributors and importers. Producers and distributors, however, are free to lower prices at any time they wish to do so.

In 1996, the Department of Statistics revised the relative weights of the components of the producer price index, or PPI, to reflect more accurately the current prices of intermediate and final goods charged by domestic producers and paid by importers in Malaysia. The revised PPI uses 1989 rather than 1978 as the base year and incorporates significant changes in the composition of items used by the producers in Malaysia to be in line with the structural changes in the domestic economy. The main components of the PPI include inedible raw material, mineral fuels, lubricants and related materials, animal and vegetable oils and fats, and food and live animals. Although the CPI and the PPI both measure the prices of goods, these indices can diverge for a particular period due to differences in the composition of the indices.

In 1999, the PPI declined by 3.3% compared with an increase of 10.7% in 1998. The decline in the PPI was largely due to decreases in the prices of animal and vegetable oils and fats, following a sharp decline in the price of palm oil in the commodity markets. These products are mainly produced for export rather than domestic consumption. As a result, fluctuations in their prices are reflected mostly in the PPI and not in the CPI. On a monthly basis, the decline in the PPI was evident in all months of 1999 except December, when the PPI rose marginally by 1.9%. Significantly higher increases in prices of mineral fuels, lubricants and related materials, a trend observed since July 1999 due mainly to increases in world oil prices, more than offset the decline in the prices of animal and vegetable oils and fats.

The trend toward higher world crude oil prices and the decline in the price of animal and vegetable oils and fats, including palm oil, continued in 2000. The low base effect of 1999 and the significant increase in domestic crude oil prices resulted in the PPI increasing by 3.1% in 2000. However, the PPI declined by 5% in 2001. This was mainly due to continued declines in the prices of crude oil and rubber, which resulted in declines in the prices of mineral fuels and lubricants as well as inedible raw material. The adjusted PPI, which excludes crude oil, palm oil and other related commodities, recorded only a marginal increase of 0.1% in the same period. The PPI showed a slower annual rate of decline of 0.3% during the first four months of 2002. This was largely on account of strong recovery in crude palm oil prices.

Employment. The following table sets out certain information regarding employment in Malaysia in various sectors of the economy for the periods indicated.

Selected employment information

	1997	1998	1999	2000	2001
Labour force (in thousands)	8,784	8,884	9,152	9,616	9,892
Unemployment rate (%)	2.5	3.2	3.4	3.1	3.6
Employment share by sector (%)					
Agriculture, forestry and fishing	17.3	18.8	18.4	17.5	17.0
Mining	0.4	0.4	0.4	0.4	0.4
Manufacturing	24.4	23.2	24.5	25.1	24.1
Construction	9.3	8.7	8.1	8.2	8.6
Services					
Electricity, gas and water	0.6	0.7	0.7	0.7	0.7
Transport, storage and communications	4.9	4.9	4.9	4.9	5.0
Wholesale and retail trade, hotels and restaurants	16.9	17.6	17.3	17.3	17.4
Finance, insurance, real estate and business services	5.2	4.9	4.9	4.9	5.1
Government services	10.5	11.0	10.8	10.6	10.5
Other services	10.5	9.8	10.0	10.4	11.2
Sub-total	48.6	48.9	48.6	48.8	49.9
Total employed	100.0	100.0	100.0	100.0	100.0

Sources: Department of Statistics, Malaysia.
Economic Planning Unit.

In 1998, total employment declined by 2.9%, led by declines in the construction, manufacturing and services sectors. As a result, the unemployment rate for the year increased to 3.2%.

In 1999, the labour market situation improved, underpinned by the recovery in domestic economic activities. Demand for labour increased, with growth in total employment turning around to increase by 3.5% at the end of 1999. The unemployment rate increased marginally from 3.2% in 1998 to 3.4% in 1999 as the labour force increased more rapidly than the growth in employment.

In order to alleviate shortages of semi-skilled and unskilled labour faced by some employers, the Government approved the recruitment of 230,608 new foreign workers in 2000, as compared to 84,150 workers in 1999. In total, the number of registered foreign workers increased by 5.1% to 732,588 workers from 697,219 workers in 1999. The majority of foreign workers were engaged in the manufacturing, agricultural and domestic services sectors.

Labour market conditions strengthened further in 2000, with increased employment prospects and a lower level of retrenchments. While total employment increased by 4.6% to 9.3 million workers, the labour force expanded by 4.3% to 9.6 million persons. Given the higher demand for labour, the unemployment rate declined to 3.1% in 2000.

Official estimates indicated that the number of workers retrenched increased by 51% to 38,116 persons in 2001, compared with 25,236 persons in 2000. Retrenchment in 2001 was due primarily to a decline in demand for products. As some employers viewed the economic slowdown as transitory, less severe measures were adopted to contain the impact on their earnings. These measures included pay cuts and temporary layoffs, involving 36,294 and 91,915 workers, respectively.

Amidst slower growth, the Government continued to monitor closely the employment situation and adopt preemptive measures to address emerging problems. For example, job fairs were held nationwide to provide a platform for job seekers to obtain information on vacancies available from potential employers. In order to further enhance labour mobility, an Electronic Labour Exchange Project was launched in September 2001 to ensure more effective matching of job seekers with vacancies, beyond geographical boundaries. Of significance, in order to upgrade the skills of unemployed graduates and school leavers as well as retrenched workers, the RM4.3 billion fiscal stimulus programme that was introduced in September 2001 included an allocation of RM300 million for the establishment of nine skills training and higher education schemes.

During the first three months of 2002, although the number of workers retrenched rose to 10,083 persons from 8,279 persons in the last quarter of 2001, the total number of job vacancies reported was almost three times the number of layoffs. The bulk of vacancies was concentrated in the manufacturing sector. Reflecting consumer expectations of better job market conditions, the Employment Index compiled by the Malaysian Institute of Economic Research rose by 20.2 points to 106.3 points in the first quarter of 2002 from 86.1 points in the preceding quarter.

Wages. Data from the Department of Statistics, Malaysia, show that on an annual basis, real wage per employee in the manufacturing sector increased by 3% in 1999 and 4.9% in 2000. In 2001, however, consistent with slower economic growth, real wage per employee in the manufacturing sector increased at a more moderate pace of 1.5%.

Monetary Developments

The following tables illustrate the growth of monetary aggregates from 1 January 1997 to 31 March 2002 on a year-on-year basis, and the development of total banking system deposits and loans and the three-month interbank rates over that period.

Monetary aggregates

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001	2002
	(Change in %)					
Currency	12.4	(15.0)	33.5	(8.1)	(0.4)	9.7
M1[(1)]	4.6	(14.6)	35.7	6.5	3.2	12.3
M2[(2)]	22.7	1.5	13.7	5.2	2.2	6.1
M3[(3)]	18.5	2.7	8.3	5.0	2.9	6.1
Deposits[(4)]	21.3	(0.5)	3.4	3.2	1.8	4.5
Loans[(5)]	26.5	(1.8)	(5.0)	4.3	3.8	5.1

(1) Comprises currency in circulation and demand deposits of the private sector.
(2) Comprises M1 plus savings, fixed and foreign currency deposits, negotiable instruments of deposit and repos with commercial banks and Islamic banks.
(3) Comprises M2 plus deposits (including negotiable instruments of deposit and repos) with other banking institutions.
(4) Comprises fixed deposits, demand deposits, savings deposits, repos, foreign currency deposits, Islamic banking deposits and other deposits of commercial banks, finance companies and merchant banks.
(5) Comprises loans of commercial banks, finance companies and merchant banks (including loans sold to Cagamas and excluding loans sold to Danaharta).

Source: Bank Negara Malaysia.

Interbank rates
[BNMS Please Confirm Whether These Are KLIBC Or 3-month Interbank Rates]

	1997	1998	1999	2000	2001[P]	First four months of 2002[P]
	(%)					
Three-month interbank rates (at end of period)	8.70	6.46	3.18	3.21	3.27	3.24
Average three-month interbank rates (for the relevant period)	7.78	9.44	4.08	3.19	3.13	2.96

P Preliminary.
Source: Bank Negara Malaysia.

In 1998, monetary growth slowed significantly in a period of severe economic contraction, weak business prospects, lower private consumption and a cautious lending environment amid rising NPLs. The deceleration of monetary growth during the year was more severe than anticipated. By the end of 1998, the annual growth of M2, by RM4.3 billion, and M3, by RM10.6 billion, decelerated to 1.5% and 2.7%, respectively, while M1 declined by RM9.2 billion, or 14.6%. Generally weak business activity and poor business confidence led to a substantial decline in demand deposits of RM5.7 billion, and lower private sector consumption caused a contraction in the currency in circulation of RM3.2 billion as households reduced their currency requirements for daily transactions. The expansion in M3 was attributable to the easing of monetary policy since August 1998 as well as the improved performance in the external sector. Including loans sold to Danaharta, total loans of the banking system increased marginally by 1.3%, reflecting higher interest rates during the first half of 1998, the banks' concern over the deterioration of asset quality and the slowdown in economic activity. This contributed to the slowdown in money supply growth.

The strong economic performance and large trade surplus registered in 1999, as well as the accommodative monetary policy stance adopted by BNM, resulted in an expansion of all monetary aggregates in 1999. M1, M2 and M3 accelerated to record annual growth rates of 35.7%, 13.7% and 8.3%, respectively. Overall, the performance of the broad monetary aggregates was consistent with the monetary policy objective of providing adequate liquidity to finance real output expansion while ensuring price stability. Demand for transaction balances increased significantly by RM18.4 billion during the year, reflecting the strengthening momentum in economic and stock market activities; the lower opportunity cost of holding non-interest-bearing deposits; and to some extent, Y2K concerns.

In 1999, the primary source of monetary growth was the large increase in the current account surplus of the balance of payments. During the year, net external reserves of BNM increased by RM17.8 billion, reflecting mainly the large surplus in the current and financial accounts of the balance of payments. The Government's operations also exerted an expansionary impact on money supply in 1999, increasing it by RM2.2 billion, due to higher withdrawal of its deposits placed with BNM and the banking system to finance Government expenditure and also for domestic loan redemptions. Most of the funds withdrawn were sourced from surplus funds in 1998 and loan proceeds, including the issuance of Government Securities during the year, as well as the global bonds issued in June 1999.

In 2000, money supply continued to expand broadly in line with the economic recovery. Nevertheless, the monetary aggregates expanded at a slower pace compared with 1999. In the case of M1, which expanded by RM4.8 billion, or 6.5%, the slower growth following the rapid increase in 1999 was mainly attributable to the re-deposit of currency by individuals and businesses in early 2000 following the successful rollover to the year 2000. The increase in M3 of RM21.9 billion, or 5%, reflected mainly the expansion in claims on the private sector as lending by banking institutions recovered strongly to increase by RM20 billion. In addition, with fiscal policy remaining expansionary, Government operations contributed an increase of RM4.4 billion to the money supply.

In 2001, money supply continued to expand at a relatively stable pace for the greater part of the year. In the first eleven months of 2001, the growth in M1, M2 and M3 averaged 6.7%, 4.2% and 4.9%, respectively. However, the annual growth rates moderated for 2001 as a whole to 3.2%, 2.2% and 2.9%, respectively, due mainly to the high base effect of 2000, as well as the build up in Government deposits with BNM in December 2001. The low and stable interest rate environment and ample market liquidity contributed to sustained bank lending. Higher financing for the private sector coupled with expansionary external operations supported the growth in monetary aggregates during the year. On the whole, the overall performance of the monetary aggregates was consistent with the policy of ensuring sufficient liquidity to finance real output expansion while ensuring price stability.

In tandem with signs of economic recovery, money supply continued to increase in the first three months of 2002. M1 and M3 increased by RM0.8 billion and RM11.7 billion, respectively. On an annual basis, the growth rates of M1 and M3 had edged up to 12.3% and 6.1%, respectively, as of 31 March 2002. The impetus for broad money growth during the first quarter of 2002 emanated from bank lending, and expansionary external and Government operations.

Monetary Policy

BNM is responsible for formulating and implementing monetary policy. The principal instruments it has used to implement policy include open market operations, direct borrowing and lending, variations in reserve requirements and recycling of government deposits. In addition, interest on loans in Malaysia is determined by reference to the base lending rate, which is subject to a maximum ceiling based on movements in the BNM three-month intervention rate and a maximum administrative spread of 2.25%. [Deposit rates are freely determined by banking institutions. What kind of deposit rates?]

During 1996 and the first half of 1997, monetary policy was formulated against a background of high economic growth with a tightening employment situation and strong capital inflows. The primary objective of monetary policy during this period was to maintain price stability and contain inflationary pressures emanating from increases in asset prices and the consequent wealth effects on rising domestic consumption. Monetary policy measures were then directed at slowing credit growth to levels more reflective of the moderation in GDP growth as well as to encourage available resources to be directed to more productive uses.

During the early period of the 1997-1998 regional economic crisis, the focus of monetary policy was aimed at stabilising and reviving the economy and addressing inefficiencies that had emerged in the domestic financial markets and in the intermediation process. In the initial two weeks of ringgit volatility in July 1997, intervention in the foreign exchange markets absorbed a significant amount of liquidity from the banking system, which caused interest rates in the interbank market to rise as high as 40% for overnight money. However, following the flotation of the Philippine peso on 11 July 1997, it was recognised that the uncertainty in the currency markets would be prolonged. Interest rates were then reduced to pre-crisis levels to reflect domestic conditions.

Given the then prevailing circumstances, BNM placed emphasis on restoring stability in the domestic financial markets to minimise the effects of speculative activities on the ringgit on the real sector. To insulate domestic interest rates from developments in the foreign exchange markets, banking institutions were required to observe a U.S.$2 million limit on outstanding non-commercial-related ringgit offer-side swap transactions with each foreign customer. The three-month interbank rate remained stable during August and September 1997. Towards the end of September, the rate was adjusted upwards as inflationary concerns increased and the ringgit depreciated further.

The following table sets out the changes made by BNM to the three-month intervention rate and the statutory reserve requirement ratio since 31 December 1997.

Changes to the intervention rate and statutory reserve requirement ratio(1)

	Liquidity	Date	Three-month Intervention Rate (%)	Statutory reserve requirement ratio (%)
1997	Tightening	31 December	8.7	13.5
1998				
January to early February	Tightening	9 January	9.0	13.5
		20 January	10.0	13.5
		6 February	11.0	13.5
Mid-February to July	Stable	16 February	11.0	10.0
		1 July	11.0	8.0
August to December	Easing	3 August	10.5	8.0
		10 August	10.0	8.0
		27 August	9.5	8.0
		1 September	9.5	6.0
		3 September	8.0	6.0
		16 September	8.0	4.0
		5 October	7.5	4.0
		9 November	7.0	4.0
1999	Easing	5 April	6.5	4.0
		3 May	6.0	4.0
		9 August	5.5	4.0
2001	Easing	20 September	5.0	4.0

(1) There have been no changes to the intervention rate since 20 September 2001 and no changes to the statutory reserve requirement ratio since 16 September 1998.

Source: Bank Negara Malaysia.

In early 1998, with a slowdown in loan growth and a shift of deposits from the smaller to the larger banking institutions, a small number of banking institutions faced significant liquidity problems due to the flight to quality of deposits. The competition for funds by these institutions contributed to the sharp increases in money market interest rates, which resulted in higher interest rates for the industry as a whole. As a result, monetary policy in early 1998 focused on addressing this distortion to improve the liquidity distribution and permit banking institutions to reduce their lending rates. In addition, to enhance the signalling mechanism, BNM announced the three-month intervention rate as the policy rate.

In February 1998, BNM lowered the statutory reserve requirement ratio and raised the BNM intervention rate to ensure that depositors continued to receive positive real rates of interest. The statutory reserve requirement ratio reduction was aimed at improving the distribution of liquidity that BNM had already injected into the banking system and reduce the cost of funds for banking institutions. As a result of these measures, money market rates and lending rates fell.

During the stabilisation phase, monetary measures were directed at improving liquidity conditions and ensuring efficiency in loan intermediation. BNM introduced procedures to make money market operations more transparent and to promote efficient liquidity management. In addition, the band for the daily variation in the average balance required to meet the statutory reserve requirement ratio was widened, and a new framework for liquidity management was introduced to enable banking institutions to manage their liquidity positions with greater flexibility without compromising prudential standards.

The deceleration in the inflation rate and an absence of demand pressures enabled BNM to undertake an easing of monetary policy beginning in early August 1998 to complement fiscal policy and to contain the contraction and promote recovery of the economy. The three-month intervention rate of BNM was reduced in three successive steps during the month of August 1998, from 11% to 9.5%. A cautious and gradual easing of monetary policy was necessary given the threat of volatility in the foreign exchange markets and the risk of capital outflows.

In September 1998, there was increased speculation against the ringgit in overseas markets. This led the Government to introduce policies that limited the scope for speculative activity against the ringgit and restored stability in the domestic financial markets. A set of comprehensive measures was introduced by BNM, including the introduction of selective exchange controls on 1 September, followed by the fixing of the exchange rate at RM3.80 to the U.S. dollar on 2 September. The new measures were aimed at ensuring that Malaysia could gain greater independence in the conduct of domestic monetary policy and protect the economy from the potential risks and vulnerabilities of external developments in the international financial markets. Other considerations included preserving the gains that had been made to stabilise the domestic economy, ensuring stability in prices and the ringgit exchange rate, and promoting a stable environment for restoring investor and consumer confidence to revive the economy. The measures were selective to meet specific objectives. The measures did not affect the flow of long-term foreign direct investment and payments for goods and services. Full convertibility remained for current account transactions.

Additional monetary measures were introduced to improve the liquidity flows in the banking system to generate lending activities, and to ensure that viable businesses continued to receive financing at reasonable cost. These measures included reductions in the statutory reserve requirement ratio, the three-month intervention rate and the liquid asset requirement of the commercial banks. BNM also undertook measures to increase the efficiency of monetary policy. The base lending rate framework was revised, requiring banking institutions to link their base lending rates to BNM's intervention rate. The administrative margin included in the base lending rate was also reduced. As a result of the easing of monetary policy, the average base lending rate of the commercial banks and finance companies declined further from 11.70% and 14.17%, respectively, as of 31 August 1998, to 8.04% and 9.50% as of 30 November 1998, respectively.

The period of stability that followed was fully utilised to expedite reform of the financial sector through Danaharta, Danamodal and the Corporate Debt Restructuring Committee. See "*—Financial System—Danaharta*", "*—Danamodal*" and "*—Corporate Debt Restructuring Committee*".

In 1999, the basic thrust of monetary policy was to create an environment to support economic recovery and facilitate structural reforms while preserving price stability. The easing of monetary policy which began in August 1998 was continued into the year. As a result, liquidity conditions improved considerably, and the interbank rates were allowed to ease to reflect the underlying liquidity in the system. As a result, the base lending rate had fallen to a historical low of 6.79% while the average lending rate fell to an unprecedented level of 8% by the end of August 1999 before easing further by another 25 basis points to 7.75% at the end of 1999. Against an environment of a strengthening financial sector, benign inflationary pressure, an improving balance of payments position and a more favourable performance of the world economy, including regional economies, monetary policy remained accommodative throughout the year.

Monetary policy in 2000 continued to focus on strengthening economic growth. Given that inflation remained benign and that the inflation outlook was expected to remain moderate, the accommodative stance of monetary policy continued to be pursued. This accommodative monetary policy was reflected in the three-month intervention rate of 5.5% that had been maintained since August 1999 and the statutory reserve requirement ratio of 4% that had been maintained since September 1998. The intervention rate, which is set by BNM, is a principal component of the base lending rates of Malaysian banks and, accordingly, a relatively low intervention rate effectively keeps interest rates at low levels throughout the Malaysian banking system. The pegged exchange rate arrangement provided for a stable financial market environment. In particular, it avoided the necessity for domestic monetary policy to follow the tightening cycle of the United States monetary policy. Thus, the accommodative monetary policy provided the foundation for the strengthening of economic fundamentals. The interbank interest rates remained stable at low levels amid the continued ample liquidity situation. The three-month interbank rates registered a record low of 3.13% in June 2000 before edging up slightly to close at 3.25% by the end of 2000. The average base lending rates of commercial banks declined to an all time low of 6.75% in May 2000 and stabilised at 6.78% in December 2000. The base lending rate of finance companies also reached a historical low of 7.95%.

In 2000, monetary and financial conditions continued to support the strengthening of domestic demand. Lending activities intensified in an environment of low interest rates, ample liquidity and the strengthened banking system. Outstanding loans increased steadily beginning in February, while loan approvals and disbursements were stronger during the year. Capital flows during the year did not create destabilising conditions in the domestic financial markets. Capital outflows reflected mainly trade-related transactions and transfers by residents for overseas investments, payments of services, including education and travel, repatriation of wages and debt repayment. The reserves position remained strong as inflows financed outflows. Prevailing conditions, therefore, accorded flexibility to monetary policy to be based mainly on domestic considerations.

The principal objective of monetary policy for 2001 was to sustain domestic demand at levels that supported overall domestic economic activities to mitigate the effects of the worldwide economic slowdown on Malaysia. Amid the benign inflation situation, there was greater flexibility for monetary policy to support growth. In this regard, monetary policy continued to ensure that sufficient liquidity was available at reasonable cost to facilitate economic activities. To ensure that there was adequate financing at reasonable rates, particularly for the small and medium enterprises, the size and scope of existing special funds (Fund For Food, New Entrepreneurs Fund, Fund for Small and Medium Industries 2) were expanded in March 2001. In addition, lending rates from these funds were reduced. As a pre-emptive measure to address expected ongoing weaker domestic economic growth and to enhance business and consumer confidence, BNM reduced its three-month intervention rate in September 2001 by 0.5% to 5%. This was followed by a reduction of 0.4% and 0.5%, respectively, in the base lending rate of the commercial banks and finance companies to 6.39% and 7.45%, respectively. Subsequently, the lending rates of selected special funds were reduced further and their eligibility criteria were liberalised.

The stable monetary and financial conditions during 2001 remained conducive for continued expansion in domestic economic activities. Interest rates continued to remain stable at low levels amidst ample liquidity in the banking system. In this environment, loans and money supply continued to expand.

In the first three months of 2002, monetary policy remained accommodative with stable and low interests rates directed towards creating a positive environment to support economic recovery. Amidst ample liquidity and continued improvement in economic outlook, lending activity was higher.

Financial System

The Malaysian financial system consists of BNM, banking institutions and non-bank financial institutions.

The Central Bank. BNM is a statutory body established in 1959 pursuant to the Central Bank of Malaysia Act 1958. The principal objectives of BNM are:

- issuing currency in Malaysia and keeping reserves to safeguard the value of the currency;
- acting as a banker and financial adviser to the Government;
- promoting monetary stability and a sound financial structure; and
- influencing the credit situation in the national interest.

On 1 October 1989, the Banking and Financial Institutions Act 1989 was introduced to provide for integrated supervision of the Malaysian financial system and to modernise and streamline the laws relating to all financial institutions in Malaysia. The Act superseded the Banking Act 1973 and the Finance Companies Act 1969, extended BNM's supervisory role to a broader range of financial institutions and provided BNM with a wider range of powers, including the power to take action against banking institutions acting to the detriment of depositors. Under the Banking and Financial Institutions Act, BNM was also empowered, effective from 1 January 1990, to monitor specified institutions including credit token companies (primarily comprising credit card companies), building credit institutions, development finance institutions and leasing and factoring companies. In addition, BNM is directly responsible for all exchange control matters, supervises and regulates the insurance industry and acts as lender of last resort to financial institutions. As of 31 December 2001, BNM's total assets amounted to RM149.7 billion, of which gross international reserves comprised RM117.2 billion (U.S.$30.8 billion).

BNM maintains a close relationship with the Ministry of Finance at all levels and the Secretary General to the Treasury is also a member of the Board of Directors of BNM. BNM's Board of Directors must keep the Minister of Finance informed about monetary and banking policy and other matters, and the Minister has the authority to direct the Board in relation to actual or proposed policies. Disagreements with such directives must be explained to the Minister in writing, who must present the proposed directive and the Board's objections to the House of Representatives. The Board of Directors of BNM consists of the Governor of BNM, two Deputy Governors and eight other directors. The Governor and the directors, other than the two Deputy Governors, are appointed by the Yang di-Pertuan Agong, while the Deputy Governors are appointed by the Minister of Finance.

The Central Bank of Malaysia Act 1958 empowers BNM to provide temporary advances, known as "ways and means" advances, to the Government to cover any temporary deficit in the budget revenue. There are, however, legal limitations on the amount and the duration of loans that BNM can make available to the Government. Section 33 of the Act stipulates that the advances should not exceed 12.5% of the estimated receipts of the Government for the relevant financial year and must be repaid as soon as possible and not later than three months after the end of the Government's financial year in which it is granted. The Act also explicitly forbids additional funds to be made available to the Government unless the previous advances have been repaid.

Banking System. The banking system comprises commercial banks, finance companies and merchant banks. The Government is also committed to promoting and developing the Islamic banking sector. An international offshore financial centre was also established in 1990 in the Federal Territory of Labuan. The table below presents information on commercial banks as at the end of the relevant period.

Commercial banks

	As of 31 December		As of 31 March	As of 31 December						As of 31 March	
	2000	2001	2002	1999		2000		2001		2002	
	Number of Institutions			Loans	Deposits	Loans	Deposits	Loans	Deposits	Loans	Deposits
				(%)		(%)		(%)		(%)	
Domestic	17	11	11	75.5	77.2	76.2	77.0	75.2	76.8	75.1	77.2
Foreign	14	14	13	24.5	22.8	23.8	23.0	24.8	23.2	24.9	22.8
Total	31	25	24	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank Negara Malaysia.

As of 31 March 2002, the 24 commercial banks licensed to operate in Malaysia had a total of 1,641 banking offices and total deposits of RM375.6 billion. As of 31 March 2002, total loans outstanding of the commercial banks amounted to RM360.4 billion, compared to RM356.4 billion at the end of 2001. As of 31 March 2002, loans extended to the manufacturing sector accounted for 18% of total commercial bank loans, while 40% was extended to finance construction, real estate and residential and non-residential properties.

As of 31 March 2002, there were 12 finance companies in Malaysia with a total of 823 branches. All of the finance companies were domestic institutions. The principal source of funds of the finance companies is fixed deposits, and their assets consist primarily of consumer, equipment, lease financing and housing loans. As of 31 March 2002, total deposits amounted to RM88.9 billion and total loans outstanding amounted to RM98.4 billion. As of such date, loans extended for consumption credit amounted to 51% of total finance company loans, while loans to the construction, real estate and residential and non-residential property sectors amounted to 29% of total loans.

As of 31 March 2002, there were ten merchant banks in Malaysia, all of which were domestic institutions. Merchant banks provide fee-based services, such as underwriting equity issues, providing corporate advice on restructuring and mergers and acquisitions, promoting joint ventures, providing portfolio management and arranging loan syndications.

Islamic Banking. The Government is committed to promoting and developing the Islamic banking sector as an important component of the Malaysian banking system. The first Islamic bank was established in 1983. The Government's long-term objective is to create a comprehensive Islamic banking system which operates alongside the conventional banking system.

In 1993, the Government introduced the "Interest-Free Banking Scheme" to complement the activities of the Bank Islam Malaysia Berhad (the first licensed Islamic bank in Malaysia). This scheme allows conventional banks to offer to customers Islamic banking products, subject to specific guidelines issued by BNM. Effective 1 December 1998, the term "Interest-Free Banking Scheme" was replaced by the term "Islamic Banking". The Government established the National Syariah Advisory Council on 1 May 1997, which has sole authority to issue Syariah opinions and decisions on Islamic banking and *takaful* (Islamic insurance). On 1 October 1999 a second Islamic bank, Bank Muamalat Malaysia Berhad, was established. As of 31 December 2001, 37 banking institutions (including two Islamic banks) were participating in the Islamic banking scheme. A number of these banks have also set up full-fledged Islamic banking branches, particularly in Muslim-dominated areas. The Islamic Interbank money market was introduced in 1994 to enable participants to match their short-term funding requirements based on Islamic principles. As of 31 December 2001, the total Islamic banking assets were RM58.9 billion, deposits were RM47.6 billion and total Islamic financing was RM28.2 billion. As of 31 December 2001, there were two *takaful* operators offering insurance products that conform to Syariah, and the total amount of *takaful* assets was RM3 billion.

BNM has also outlined a ten-year plan for Islamic banking and *takaful* in the Financial Sector Masterplan. The overall objective is to create an efficient, progressive and comprehensive Islamic financial system that contributes significantly to the effectiveness and efficiency of the Malaysian financial sector while meeting the economic needs of the nation. Under the plan, BNM formulated specific recommendations in three main areas: institutional capacity enhancement, financial infrastructure development and regulatory framework development.

The Government has participated actively and internationally in the development of the International Islamic Financial Market, or IIFM, and the forthcoming establishment of the Islamic Financial Services Board, or IFSB. The IIFM, spearheaded by the Labuan Offshore Financial Services Authority, serves as a platform to promote Labuan as one of the active international financial centres for Islamic money and capital markets. In addition, the Government will be hosting the Secretariat of the IFSB, an international standard-setting entity entrusted to promote the soundness of the Islamic financial system through effective supervision and regulation of Islamic financial institutions based on the recognition of the unique risks of Islamic financial products and practices.

Banking System Regulation. The regulatory and supervisory framework for Malaysian banking institutions is well-developed and structured to be consistent with international standards and best banking practices. Compliance with the Basle Committee's "Core Principles for Effective Banking Supervision" was already in its advanced stages before the onset of the regional economic crisis. Steps included refining the capital adequacy framework, requiring greater information disclosure and improving the risk management of banking institutions.

Regulation of banking institutions includes requirements as to licensing, capital requirements, liquidity requirements, reserve requirements, lending limits and restrictions on loans to directors. Banking institutions licensed under the Banking and Financial Institutions Act, their subsidiaries and their holding companies are subject to regular on-site examinations by BNM. BNM also sets guidelines for lending by commercial banks and finance companies, requiring 30% of the total loans of these financial institutions to be made to the Bumiputera community and a pre-determined amount of loans to be made to small- and medium-sized enterprises and for the purchase of a pre-determined number of houses valued at RM100,000 or less. Ceiling interest rates only apply to loans granted to small- and medium-scale enterprises and housing loans for owner-occupied houses where the value of the property is RM100,000 or less.

BNM has adopted the following measures to promote market discipline and enhance corporate governance:

- banking institutions are prohibited from lending to their related parties, including directors, officers and their interested companies, as well as significant or controlling shareholders, to prevent potential abuse of powers by their shareholders, directors and officers;

- banking institutions are prohibited from granting credit facilities to a single person (including related parties) in excess of 25% of the banking institution's capital funds to avoid the over-concentration of credit to a single customer;

- "Guidelines on Duties and Responsibilities of Directors and Appointment of Chief Executives", which incorporate rules relating to the appointment of directors and chief executives and structure of boards of directors, were issued in 1985 and were revised in 1994;
- disclosure requirements in published financial statements of banking institutions were revised in 1994 to conform with the requirements of the International Accounting Standards on Disclosure in the Financial Statements of Banks and Similar Financial Institutions;
- in 1997, greater disclosure requirements were introduced: a director's report on business strategy and outlook, sectoral concentration of loans, amount of NPLs, movements in specific and general provisions, capital adequacy ratios and bank ratings by external agencies;
- "Guidelines on Minimum Audit Standards for Internal Auditors of Financial Institutions" were issued in 1997;
- effective 31 March 1998, banking institutions are required to publish data on key indicators of financial soundness, including capital adequacy, NPL and provisioning levels;
- the Code of Conduct for Directors, Officers and Employees in Banking Industry, which is designed to promote and maintain a uniform ethical standard in order to safeguard the integrity and credibility of the staff of banking institutions;
- a regulation limiting the number of directorships that can be held by the chief executive officer of a banking institution to not more than five subsidiary companies to ensure that chief executive officers give their fullest attention to managing the banking institution; and
- effective January 2000, the appointment of directors and the chief executive officer of banking institutions is valid for two years and approval from BNM has to be sought for reappointment.

For more timely and accurate monitoring and control of credit exposure, BNM requires compliance with the Bank for International Settlements-prescribed 8% minimum risk-weighted capital ratio based on the banking institutions' daily risk-weighted assets. In addition, banking institutions are required to comply with the daily risk-weighted capital ratio on a global basis, covering both Malaysian and overseas operations.

Loan Loss Provision Policy. BNM requires that banking institutions keep a general provision equal to at least 1.5% of gross loans less interest-in-suspense and specific provisions. BNM's guidelines generally classify NPLs into three categories, with a specific provision of 20% of the "reservable amount" (the total amount of the loan less the estimated value of any collateral and interest in suspense) when delinquent for six to nine months ("substandard"), 50% of the reservable amount when delinquent for nine to 12 months ("doubtful") and 100% of the reservable amount when delinquent for more than 12 months ("bad"). Nonetheless, for loans with quarterly repayment periods or longer, such loans are classified as NPLs when they remain unpaid for three months from the date of default. However, banking institutions with high loan loss reserves as determined by BNM in its discretion are not automatically required to make specific provision for their substandard loans.

As of 31 March 2002, loan loss coverage, representing the sum of general provisions and collateral values, divided by net NPLs outstanding amounted to 175% of NPLs based on a three-month classification policy. The loan loss coverage ratio would amount to 192.8% if a six-month NPL classification policy had been adopted uniformly across the banking system.

Banking institutions in Malaysia value all collateral pursuant to guidelines established by BNM and such collateral is revalued periodically at intervals depending on the type of asset. For example, collateral comprising real property is revalued at least every two years, shares are revalued at their current market prices and no value is allocated to guarantees.

The following table shows the valuation guidelines adopted for different types of collateral:

Valuation guidelines

Types of Collateral	Basis of Valuation
Real property	The forced sale value of the property, as determined by an independent professional valuer once every two years. For properties pending auction, their reserve price with a further 10% discount if the auction is unsuccessful.
Debentures	No value is assigned, unless the value is certified by a receiver, liquidator or professional valuer.
Pledged accounts receivable	No value is assigned, unless the debtor's net worth is proven.
Shares	Listed shares are valued based on the latest market price. Unlisted shares are assigned no value, unless the shares are marketable.
Plant, machinery and equipment	Net book value based on 20% depreciation on a straight line basis, unless otherwise determined by a professional valuer.
Vehicles and equipment underhire purchase financing	No value, unless repossessed. Repossessed vehicles and equipment are valued at market value.
Guarantees	No value is attributed to personal guarantees. Full value is attributed to guarantees issued by a banking institution or the Government or state governments.

Source: Bank Negara Malaysia.

Non-Bank Financial Institutions. Other than the banking institutions, the Malaysian financial system also includes provident, pension and insurance funds, development finance institutions, savings institutions and other financial intermediaries. The largest provident and pension fund in Malaysia is the Employees Provident Fund, which was established in 1951 under the Employees Provident Fund Ordinance. The Employees Provident Fund is funded through mandatory employer and employee contributions. The Employees Provident Fund primarily provides social security benefits. The Employees Provident Fund at the end of 2001 represented approximately 82.6% of the RM231.5 billion of total assets of provident and pension funds in Malaysia. Under the Employees Provident Fund Act 1991, the Employees Provident Fund is required to invest or reinvest a minimum of 50% of its annual investible funds in Government securities. In addition, a minimum of 70% of Employees Provident Fund's total investments must be in the form of Government securities. On an annual basis, the Government has granted the Employees Provident Fund exemptions from the 50% and 70% requirements to take account of the limited amount of Government securities in the market. At year-end 2001, 35.8% of the Employees Provident Fund's assets were in the form of Malaysian Government securities. The Employees Provident Fund also invests in quasi-Government and non-Government securities, including domestic bond offerings by the non-financial public enterprises.

Aside from providing a source of medium- and long-term credit, development finance institutions provide other forms of financial assistance. The principal development finance institutions are: the Agricultural Bank of Malaysia, which mobilises resources for agricultural development; Industrial and Technology Bank of Malaysia, which provides long-term credit to finance the expansion of production in capital-intensive and high-technology industries; and the Development and Infrastructure Bank of Malaysia, which was established to encourage Bumiputera participation in industry and commerce.

Savings institutions in Malaysia include the National Savings Bank and other cooperative societies. Assets of the National Savings Bank consist primarily of Government securities and specified classes of securities. The cooperative societies pool small savings and extend loans to their members.

Among the other financial intermediaries, Cagamas Berhad, the national mortgage corporation, was established in December 1986 to promote home ownership in Malaysia by purchasing housing loans from the loan originators and to develop a secondary mortgage market. Cagamas performs the function of an intermediary between the primary lenders of housing loans and investors of long-term funds by issuing mortgage-backed securities. Cagamas commenced its operations in October 1987 by issuing fixed-rate mortgage-backed bonds, and subsequently introduced floating rate bonds in 1992. In 2001, there were 44 issues of Cagamas debt securities with a total value of RM17.4 billion, and an aggregate redemption of matured Cagamas debt securities of RM17.3 billion. In the first four months of 2002 there were 14 issues of Cagamas debt securities with nominal value of RM9.9 billion and an aggregate redemption of matured Cagamas debt securities with nominal value of RM6.6 billion.

On 15 February 2002, the Development Financial Institutions Act 2002, or the DFI Act, became effective and BNM has been empowered to administer the DFI Act. Six development financial institutions were placed under the purview of the DFI Act. Development financial institutions, or DFIs, were established primarily to promote the development of the strategic sectors, of the economy, particularly the agriculture, manufacturing and infrastructure sectors as well as to promote exports, especially capital goods. DFIs and other participating financial institutions also provide financing under several specialised assistance schemes, which are aimed primarily at assisting new high technology and knowledge-based activities and idea-based start-ups, including small- to medium-scale enterprises and venture capital companies.

Assets of the Financial System. The following table presents information on the composition of assets of the financial system at the end of 2001.

Composition of the assets of the financial system

	As of 31 December 2001	
	(RM billion)	(% share)
BNM	149.7	11.6
Commercial banks	512.2	39.6
Islamic banks	17.3	1.3
Finance companies	121.7	9.4
Merchant banks	41.1	3.2
Discount houses	23.8	1.8
Sub-total	865.9	66.9
Provident, pension and insurance funds	294.3	22.7
Employees Provident Fund	191.1	14.8
Other provident and pension funds	40.3	3.1
Life insurance funds	47.6	3.7
General insurance funds	15.3	1.2
Development finance institutions	27.9	2.2
Savings institutions	30.7	2.4
Other financial intermediaries	76.3	5.9
Total non-bank financial intermediaries	429.3	33.1
Total assets of the financial system	1,295.2	100.0

Source: Bank Negara Malaysia.

Total assets of the financial system increased by RM70.1 billion or 5.9% to RM1,250.8 billion at the end of 2000, compared to an increase of RM73.1 billion or 6.6% in 1999. This increase was attributable to the increase in the assets of both the non-bank financial intermediaries (RM42.6 billion or 11.8%) and the banking system (RM27.5 billion or 3.4%).

The bulk of funds mobilised in 2000 was utilised to finance loan operations of the financial system, followed by investment in securities and deposits with other financial institutions. Excluding the NPLs of the financial system sold to and managed by Danaharta, total loans and advances extended by the financial system increased by RM24.6 billion. Loans and advances to the non-financial private sector increased by RM22.9 billion, with large increases recorded for loans and advances extended for housing (15.5% or RM13.2 billion) and consumption credit (14.5% or RM7.4 billion). Loans and advances extended to the agriculture sector increased by RM2.7 billion.

Investment in corporate securities increased by RM16 billion, or 10.2%, in 2000, compared with RM12.3 billion or 8.5% in 1999, primarily because of increased investment by the provident and pension funds.

Deposits placed with other financial institutions increased by RM5.3 billion or 2.9%, compared to an increase of RM27.2 billion or 17.9% in 1999.

Total assets of the financial system increased by RM44.4 billion or 3.5% to RM1,295.2 billion at the end of 2001, compared to an increase of RM70.1 billion or 5.9% in 2000. The increase in 2001 was attributable to the increase in the assets of both the non-bank financial intermediaries and the banking system. Growth in banking system assets was moderate, rising by 2.1%. Given the higher growth of the assets of the non-bank financial intermediaries, which increased by 6.7%, the share of the total assets of the Malaysian financial system represented by the assets of the banking system declined slightly from 67.8% at the end of 2000 to 66.9% at the end of 2001. Within the banking system, the bulk of the increase in assets was due to the increase in the assets of the commercial banks (including Islamic banks), finance companies and merchant banks, reflecting mainly the increase in loans and advances, investment in securities and deposit placements with other financial institutions.

For the non-bank financial intermediaries, total assets rose by 6.7%, compared with 11.8% in 2000. Their share of total financial system assets increased from 32.2% at the end of 2000 to 33.1% at the end of 2001. The higher growth was driven principally by an expansion in the assets of the provident, pension and insurance funds, which increased by RM25 billion and accounted for 92.7% of the increase in the assets of the non-bank financial intermediaries.

The increase in total resources of the financial system was mainly invested in securities and loans and advances. Total loans and advances increased by RM20.5 billion or 4% in 2001. The bulk of the increase was due to increased demand from the household sector. This was reflected in the higher loans extended for the purchase of residential property and passenger cars. Meanwhile, investment in securities by the financial system recorded an increase of 13.6% in 2001, compared to 15.1% in 2000. In particular, there were marked increases in investments in corporate securities (RM22.3 billion) and government securities (RM14.1 billion). Provident and pension funds continued to be the main investors in securities, accounting for 41% of the increase in investments in securities. Deposits mobilised by the financial institutions grew by 2.9% compared to 4.3% in 2000. Deposits continued to account for the largest share (45.8%) of the total sources of funds at the end of 2001 compared to 46% in 2000.

Banking System Lending. The following table sets out the banking system's loans by sector at the end of the relevant period.

Banking system loans by sector

	As of 31 December					As of 31 March
	1997	**1998**	**1999**	**2000**	**2001**	**2002**
			(% of total loans)			
Agriculture, hunting, forestry and fishing	1.8	1.9	2.3	2.7	2.7	2.6
Mining and quarrying	0.3	0.4	0.4	0.3	0.3	0.2
Manufacturing	15.0	15.3	15.3	15.0	14.5	14.5
Electricity, gas and water supply	1.1	1.4	1.9	1.9	1.2	1.1
Wholesale, retail, restaurants and hotels	8.3	8.5	8.9	8.6	8.4	8.3
Construction	10.1	10.4	9.5	8.4	7.9	7.7
Purchase of residential property	12.1	13.6	15.6	17.5	19.9	20.4
Purchase of non-residential property	6.8	7.2	7.0	6.5	6.4	6.3
Real estate	4.3	4.0	3.8	3.6	3.6	3.5
Transport, storage and communications	3.1	3.6	3.5	2.9	2.4	2.4
Financing, insurance and business services	8.6	9.0	8.0	7.7	7.5	7.5
Consumption credit[1]	13.7	11.9	12.9	14.2	15.8	16.3
Purchase of securities	9.3	7.9	6.4	6.0	5.0	4.9
Purchase of transport vehicles	1.4	1.1	0.5	0.4	0.6	0.5
Others	4.1	3.8	4.0	4.3	3.8	3.8
	100.0	100.0	100.0	100.0	100.0	100.0

(1) Includes loans to acquire passenger cars.
Source: Bank Negara Malaysia.

Outstanding loans of the banking system as a whole declined by RM7.7 billion in 1998. This decline was mainly attributable to the removal of RM13 billion in loans from the banking system by Danaharta and the contraction in economic activity. Higher loan repayments, which increased by 5.5%, and a 26.6% lower turnover in loan disbursements, also contributed to the slowdown in growth. As the regional economic crisis continued, banking institutions tended to apply stricter credit risk assessment in granting new loans to avoid possible deterioration of their balance sheets. Tight and uneven distribution of credit exacerbated the problem. Consequently, only RM66.6 billion of new loans were approved in 1998, or an average of RM5.6 billion a month.

Amidst the improving economic environment and greater economic activities in 1999 and 2000, the banking system continued to play its intermediation function by providing financing to support the increased demand in the economy. New loans approved rose by 26.7% and disbursements of approved credit facilities rose by 12.6% during 2000. As economic growth gained greater momentum and excess capacity in some industries diminished, financing for capacity enhancement began to pick up during the year. As a result, repayments registered a marginal increase of 4%. Consequently, total loans outstanding for the banking system increased by 4.3% to RM416.3 billion as of 31 December 2000. Funds raised through the capital markets rose markedly in 2000 as issuers took advantage of the then prevailing low interest rates to raise long term funds. New local private debt securities issued in 2000 totalled RM26.9 billion. Taken together, total outstanding loans and outstanding local private debt securities grew by 10.2% in 2000.

The lending activities of the banking system moderated in 2001 following modest economic growth during the year. The slowdown, which was primarily a consequence of the global economic downturn, affected the domestic economy through lower exports, unfavourable business sentiment and short-term prospects. Against these developments, the demand for loans and financing declined, resulting in a lower number and amount of loan applications received by banking institutions in 2001. In view of the lower number of loan applications received, loan approvals declined by 6.5% during the year. Loan repayments increased marginally by 3.8%, however, as many borrowers repaid and refinanced their loans to take advantage of the low interest rate environment. Loan disbursements also recorded a marginal increase of 2.3%. As a result, total loans outstanding (including loans sold to Cagamas and Danaharta) registered an annual growth of 3.6% in 2001, compared to 5.5% in 2000.

As interest rates continued their downward trend in 2001, new private debt securities issued increased sharply by 23.8%, raising a total of RM33.3 billion from the market. Total loans outstanding, adjusted for loans written off and loan conversion, as well as the repayment of loans of two light rail transit companies and taking into account outstanding private debt securities in 2001, amounted to RM586.6 billion. This translated into an annual growth of 6.4%, relatively lower than the 9.6% achieved in 2000.

The strong performance in lending activities persisted in the first three months of 2002. This was demonstrated by a 4% growth in new loans approved and a 1.4% growth in loan disbursements over the corresponding period in 2001. The encouraging performance resulted in new loans approved averaging RM10.3 billion per month compared to RM9.9 billion for the corresponding period in 2001. Likewise, loan disbursements for the first quarter of 2002 averaged RM30.8 billion per month compared to RM30.4 billion in the corresponding period of 2001. Total loans outstanding for the banking system grew by 4.6% to RM476.5 billion as of 31 March 2002 as compared to 31 March 2001. Funds raised through the capital market continued an upward trend in the first three months of 2002 given the low interest rate environment. Total outstanding local currency corporate bonds increased by 17.1% on an annual basis. Total financing, being the aggregate of outstanding bank loans and local currency corporate bonds, expanded by 6.9% as compared to 31 March 2001.

During the first three months of 2002, total loans outstanding (including loans sold to Cagamas and Danaharta) for commercial banks and finance companies increased by 1.1% to RM360.4 billion and by 2.2% to RM98.4 billion, respectively, while loans and advances for merchant banks contracted by 0.3% to RM 17.7 billion. By sector, the bulk of the increase in loans for commercial banks was channelled to the broad property sector (RM3.1 billion) and the manufacturing sector (RM1.3 billion). The loans made to the broad property sector comprising loans to purchase residential and non-residential properties, construction financing and loans to real estate companies were mainly for the purchase of residential properties (RM77 billion). As of 31 March 2002, loans to finance investment in the broad property sector accounted for 40.1% and 37.5% of all loans made by commercial banks and the banking system as a whole, respectively. Loans to finance the purchase of securities accounted for 6.2% and 6.4% of all loans made by commercial banks and the banking system as a whole, respectively. The stock market and broad property sectors are two of the economic sectors most vulnerable to economic cycles. Accordingly, a high level of lending to these sectors may fuel asset inflation during periods of economic growth and thereby exacerbate the decline in the asset value and stability of certain banking institutions during periods of economic contraction. Recognising the risks associated with excessive exposure to these sectors, BNM has, since April 1997, imposed maximum lending limits for share financing (20% of total loans for commercial banks and finance companies, 30% of total loans for merchant banks) and for loans to the property sector (20% of total loans after excluding loans which are granted for the purchase of owner-occupied properties).

Net external assets of the banking system accounted for 1.7% and 0.3% of total assets of the banking system as of 31 March 2001 and 2002, respectively.

As a whole, exposure to the East Asian region was confined to the Labuan offshore units of six Malaysian banking institutions and overseas branches of five Malaysian banking institutions. As of 31 March 2002, the exposure of these banking institutions, in the form of loans to and investments in Indonesia, Thailand, South Korea and the Philippines, amounted to U.S.$775.6 million, an increase of U.S.$1.9 million from 31 March 2001. The total exposure of offshore units to the East Asian region represented 7.8% of their total assets as of 31 March 2002.

Asset Quality. In 1998, the decline in domestic demand and slowdown in economic activity adversely affected the debt-servicing ability of debtors and, as a result, banking institutions experienced a deterioration of their asset quality. This deterioration was most severe for finance companies and merchant banks. In 1999, the asset quality of the banking system improved and the net NPL ratio (calculated on the basis that the interest-in-suspense and specific provisions are deducted from NPLs) based on a three-month classification policy declined from 13.6% to 11% of total loans. The net NPL ratio based on a three-month classification policy peaked in November 1998 and commenced a downward trend in March 1999 to reach 9.7% as of 31 December 2000. During 2001, the banking system's net NPL ratio based on a three-month classification policy increased by RM8.6 billion to 11.5% of total loans. The bulk of the increase was due to the expiration of NPL waivers granted on some loans in the first half of 2001 which were undergoing restructuring efforts under the administration of the Corporate Debt Restructuring Committee. An NPL waiver allows a non-performing loan to continue to be classified as performing. However, interest on such loans is only allowed to be recognised as income on a cash basis, similar to an NPL account. As a result, NPL waivers do not result in an overstatement of profitability.

Actual net NPLs as classified based on individual banking institutions' NPL classification policies were 9% in 1998, 7.4% in 1999, 7.2% in 2000 and 9.3% in 2001 for the banking system as a whole. Actual NPLs for commercial banks were 7.3% in 1998, 6.5% in 1999, 6.4% in 2000 and 8.8% in 2001. Actual net NPLs for finance companies were 14% in 1998, 9.7% in 1999, 9.2% in 2000 and 9% in 2001. Actual net NPLs for merchant banks were 11.5% in 1998, 12.7% in 1999, 10.9% in 2000 and 21.7% in 2001.

The level of net NPLs of commercial banks, finance companies, merchant banks and the banking system as a whole at the end of the relevant period based on three- and six-month classifications is as follows.

Banking system net NPL ratio(1)

	As of 31 December				As of 31 March	As of 31 December				As of 31 March
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
	three-month classification policy					six-month classification policy				
	(%)					(%)				
Commercial banks	10.3	8.8	8.3	10.5	10.6	6.7	5.5	5.4	7.5	7.6
Finance companies	21.6	16.3	13.2	12.8	12.7	11.9	8.6	8.5	8.4	8.5
Merchant banks	25.4	23.4	18.7	26.2	26.8	10.8	12.3	11.7	21.6	21.2
Banking system	13.6	11.0	9.7	11.5	11.5	8.1	6.4	6.3	8.1	8.2

(1) Excludes loans sold to or managed by Danaharta.
Source: Bank Negara Malaysia.

The net NPL level of the banking system which increased in 2001 subsequently stabilised in the first three months of 2002 indicating an improvement in the asset quality in the banking system. The combination of higher repayments, successful debt restructuring by banking institutions and higher specific provisions contributed to the improvement.

During the initial stages of the economic crisis, the Government shortened the NPL classification period from six months to three months. By mid-1998 the worsening regional and domestic economic conditions caused increasing numbers of NPLs, and banking institutions became preoccupied with preserving the quality of their loan portfolios rather than generating new business. Despite measures taken by BNM to ease both monetary and fiscal policies to support the financing needs of the economy, banking institutions remained reluctant to provide new lending, thereby posing a threat to the functioning of the intermediation process. Accordingly, in September 1998 the Government responded by lengthening the NPL classification period from three months to six months to ensure that the real sector of the economy continues to receive financing and to provide borrowers with additional time to regularise their accounts. The change in the classification of NPLs to six months does not preclude banking institutions from adopting shorter NPL classification periods based on their individual internal policies. Currently, 20 out of 46 banking institutions have adopted the three-month classification period.

While the NPL classification period was lengthened to six months, other prudential rules were retained. A non-performing account would continue to be classified as bad when it had been in arrears for 12 months or more, while the entire accrued interest previously recognised as income would be reversed. The lengthening of the classification period was also balanced with the mandatory requirement for all banking institutions with gross NPL ratios above 10% to sell their NPLs to Danaharta at market determined prices. In addition to establishing Danaharta, the Government established Danamodal to recapitalise and facilitate the restructuring of banking institutions, and the Corporate Debt Restructuring Committee to provide an alternative to the Malaysian legal system for the amicable restructuring of corporate debt.

Profitability. In 1998, the banking system suffered the effects of the regional economic crisis and recorded a pre-tax loss of RM5.7 billion as compared to a pre-tax profit of RM7.7 billion in 1997. The pre-tax loss was largely due to exceptionally large losses recorded by three banking institutions. In 1999, the banking system turned around and recorded a pre-tax profit of RM4.7 billion. Reflecting the strong economic recovery, pre-tax profits improved further to RM9.3 billion in 2000, surpassing the pre-tax profit of RM7.7 billion recorded in 1997. With the marked improvements in profitability, the banking system recorded a positive return on assets of 1.5% and a return on equity of 19.5% for 2000. Pre-tax profits for 2001 were lower at RM7.5 billion due to higher loan loss provisioning by commercial banks although mitigated by higher profits of finance companies. The increase in the loan loss provisioning expenses of the commercial banks partly was due to some of them having to realign the policies on loan loss provision of loan portfolios acquired in mergers, to be in line with their more stringent standards. The strong loan growth of finance companies, especially for the purchase of passenger cars, contributed to their higher profitability.

Government Deposit Guarantee. The Government announced in January 1998 that it would guarantee all conventional and Islamic banking deposits (savings, demand and fixed), including interbank lines, negotiable instruments of deposit and repos of all banking institutions licensed in Malaysia, including overseas branches and Labuan subsidiaries. As of 31 March 2002, the total amount of deposits of the banking system and the Islamic banks, including overseas branches and Labuan subsidiaries, guaranteed by the Government equalled RM521.9 billion.

Stabilisation Measures in the Financial Sector. In March 1998, BNM introduced regional stabilisation measures to address key vulnerabilities in the banking system that had become apparent as the financial crisis deepened. Prudential regulations were also tightened and supervisory efforts intensified, with emphasis placed on the early identification of problem loans and solvency issues.

Banking System Restructuring. The prolonged regional economic crisis and subsequent contraction of the economy led to deterioration in the quality of the asset portfolios of banking institutions. Banking institutions became increasingly preoccupied with managing their existing asset portfolio, and increasingly conservative in their lending activities. The reluctance of the banking institutions to lend combined with higher interest rates caused severe difficulties for individuals and businesses to obtain financing. This slowed down the prospects of economic recovery. At the same time, the rising level of NPLs also eroded the capital base of a number of banking institutions and, although the risk-weighted capital ratio for the banking system as a whole remained above the Bank for International Settlements-prescribed minimum of 8%, a number of banking institutions required recapitalisation.

Confidence needed to be restored rapidly in the financial markets in general and the banking sector in particular. Recognising the central role of the banking system in supporting the economic recovery process, the Government adopted a four-pronged approach to strengthen the resilience of the banking sector through a merger programme, and the establishment of Danaharta, Danamodal and the Corporate Debt Restructuring Committee.

Bank Merger Programme. In line with the Government's objective of creating a core of resilient, efficient and competitive domestic banking institutions and recognising the importance for consolidation in the domestic banking sector, the merger programme for the finance company industry initiated in 1998 was extended to the domestic banking sector as a whole in 1999. Under the merger programme, domestic banking institutions were given the flexibility to form their own merger groups and to select the lead banks to spearhead the merger process. On 14 February 2000, BNM approved the formation of ten domestic banking groups with the anchor banks being Malayan Banking Berhad, Bumiputra-Commerce Bank Berhad, RHB Bank Berhad, Public Bank Berhad, Arab-Malaysian Bank Berhad, Affin Bank Berhad, Hong Leong Bank Berhad, Alliance Bank Malaysia Berhad, Southern Bank Berhad and EON Bank Berhad, each with shareholders' funds of at least RM2 billion and an asset base of at least RM25 billion.

The merger programme for domestic banking institutions was successfully concluded with 52 domestic banking institutions, representing 98% of the total assets of the domestic banking sectors, consolidated as of 31 March 2002. The remaining two banking institutions are in the process of completing their merger.

With the completion of the merger programme, the larger domestic banking groups can better provide a comprehensive range of banking services because each of them has a commercial banking, finance company and merchant banking arm. With a bigger and stronger capital position, the merged entities should also be able to invest more in technology and staff training.

In addition, all of the post-merger groups have fully implemented their systems integration process. Several functions within these post-merger groups, such as treasury operations, have also been streamlined to eliminate duplication and reduce operating costs.

Some rationalisation of bank branches and staff is expected as a result of the merger programme to minimise the duplication of resources and to maximise consolidation benefits. Two domestic banking groups have confirmed that they would not be conducting any staff rationalisation exercises over the next few years, while the number of staff involved in staff rationalisation initiatives in the remaining eight banking groups is expected to be not more than 10,000 staff. Staff rationalisation initiatives conducted would be implemented through the offering of voluntary separation schemes where fair compensation would be given to those who accept the offer from the banks to leave their employment. Accordingly, there is not expected to be any forced retrenchment. By the end of 2001, five banking groups had conducted voluntary separation schemes, involving the termination of employment of approximately 4,240 banking personnel.

A comprehensive re-training programme was developed in consultation with major banking groups and the Institut Bank-bank Malaysia, the banking industry training institute, in March 2001 to assist the affected workers and facilitate their transition into other industries. The programme includes professional development and technical training in other areas in the financial services sector and other sectors of the economy.

Danaharta. The Government established Danaharta in June 1998 to strengthen the Malaysian financial system by acquiring NPLs from financial institutions in order to limit their negative impact on the Malaysian financial system. All financial institutions with gross NPL ratios above 10% were required by BNM to sell their NPLs to Danaharta at market-determined prices. Danaharta's objectives are to remove NPLs from balance sheets of financial institutions, thereby allowing financial institutions to focus on lending activities and reallocate funds to other uses, and subsequently to maximise the recovery value of the acquired loans.

The Government chose to create a transparent organisation that operates on market principles. Accordingly, Danaharta was established as a corporate entity with statutory backing under the Pengurusan Danaharta Nasional Berhad Act 1998, or the Danaharta Act. The Danaharta Act is intended to enable Danaharta to carry on business as an asset management company and to acquire, manage and resolve NPLs. Under the Danaharta Act, Danaharta is able to acquire NPLs from financial institutions by way of statutory vesting, which expedites the transfer process. Where a borrower fails to restructure its loan, the Danaharta Act allows Danaharta to foreclose on collateral and sell the property by way of "private treaty", which is defined by the Danaharta Act as a sale of property through open tender, private contract or auction.

The Danaharta Act also confers on Danaharta the ability to manage corporate borrowers through appointment of special administrators over companies. Upon appointment of the special administrators, a moratorium takes place during which no party may enforce its claims or take legal action against the corporate borrower. The special administrators prepare and implement a workout proposal to resolve the corporate borrower's NPL, subject to the review of an independent advisor and approval from Danaharta, a majority in value of secured creditors present and voting and regulatory authorities. The appointment of special administrators and independent advisors must first be approved by an independent oversight committee.

As of 31 March 2002, Danaharta's portfolio comprised NPLs with total loan rights acquired, or LRA, of RM47.75 billion (RM38.1 billion from the banking system, comprising commercial banks, merchant banks, finance companies and Islamic banks). The RM47.75 billion includes RM19.82 billion acquired from financial institutions and RM27.93 billion acquired from Bank Bumiputra Malaysia Berhad Group, or BBMB Group, and Sime Bank Berhad Group, being managed by Danaharta on behalf of the Government and BNM, respectively. In return for the acquired NPLs of RM19.82 billion, Danaharta issued bonds with a face value of RM10.87 billion (having a present value as of 31 December 2001 of RM8.02 billion) and paid RM1.02 billion in cash.

As consideration for the loans acquired from financial institutions, Danaharta paid cash and/or issued zero-coupon, Government-guaranteed, tradable bonds with yields approximating those of Government securities with similar tenor. For loans acquired from development finance institutions, Islamic loans and unsecured loans, cash payments were made.

As of 31 March 2002, Danaharta had dealt with NPLs with a gross value of RM51.18 billion (LRA value of RM47.72 and accrued interest) relating to 2,585 borrowers. Danaharta expects to recover RM28.27 billion, or an average expected recovery rate of 55%. Danaharta is currently focusing on the implementation of all approved recovery strategies until its targeted closure date in 2005.

Danaharta completed its acquisition programme in March 2000. Since then, Danaharta has concentrated on its loan and asset management. Danaharta seeks to recover NPLs by way of loan restructuring or asset restructuring. In the case of viable loans, borrowers are given the chance to restructure and rehabilitate their loans in accordance with Danaharta's loan restructuring principles and guidelines.

Non-viable loans and loans in respect of which the borrowers fail to comply with the loan restructuring principles and guidelines are subject to asset restructuring such as the foreclosure and sale of assets. Asset restructuring results in lower expected recovery rates than loan restructuring, and therefore is a last resort.

As of 19 February 2002, Danaharta had appointed special administrators for 61 groups of companies, and of this total, special administrators for companies from 19 different groups have been discharged following successful restructuring of the debts. The remaining companies are in various stages of special administration.

As of 28 February 2002, Danaharta had offered a total of 644 properties to the market. Of these, 533 properties, or approximately 83%, were sold for a total consideration of RM899.48 million.

Recoveries are collected in the form of cash and non-cash assets, such as restructured loans, securities and properties. Ultimately, all assets are expected to be converted into cash.

Utilising a portion of its portfolio of successfully restructured loans, Danaharta launched its inaugural issue of asset-backed securities on 20 November 2001. The securities comprise RM310 million principal amount of AAA-rated senior notes and RM285.4 million principal amount of subordinated notes, issued through a special purpose vehicle, Securita ABS One Berhad. The securities are backed by performing loans sold and cash transferred by Danaharta to Securita ABS One Berhad. The performing loans sold and cash transferred amounted to an aggregate amount of RM595 million. Funds raised from these offerings and future offerings will help to enhance Danaharta's cash collection from loan recovery efforts, especially in meeting bond redemption and operational requirements.

As of 31 March 2002, Danaharta's loan recovery efforts have resulted in the agency receiving assets with a total value of RM15.66 billion, of which RM10.98 billion has been realised in cash (including adjustments). These assets are those that are owned by Danaharta and do not include shares and properties held as collateral. Danaharta has distributed, on a cumulative basis, recovery proceeds of RM8.52 billion in cash and 55,899,542 units of securities at par value to financial institutions of which recovery proceeds from the BBMB Group and Sime Bank Berhad Group NPLs under management alone amounted to RM8.2 billion. Meanwhile, 24 financial institutions that had sold NPLs to Danaharta have received surplus recovery of RM324 million in cash and 55,899,542 units of securities. This is pursuant to surplus sharing arrangements between Danaharta and the selling institutions whereby any surplus recovery after deduction of initial purchase price and holding costs would be shared between the selling institution, which receives 80%, and Danaharta, which keeps 20%.

Danamodal. Danamodal was established in August 1998 to spearhead the recapitalisation of viable banking institutions. Since its inception, Danamodal has injected a total of RM7.1 billion into ten banking institutions. Following the improved economic environment and in tandem with the merger programme, seven banking institutions have fully repaid their loans to Danamodal while the remaining three banking institutions have made partial repayment, reducing the amount outstanding to RM2.1 billion as of 31 March 2002. Danamodal has seven representatives on the board of directors of the remaining recapitalised banking institutions. Danamodal was financed through RM3 billion of seed capital provided by the Government and by the issuance of bonds. To date, Danamodal has issued RM11 billion in bonds which mature in October 2003.

Corporate Debt Restructuring Committee. In July 1998, the Government established the Corporate Debt Restructuring Committee, or CDRC, to provide an informal platform outside court proceedings for certain borrowers and creditors to amicably and collectively work out debt problems to the mutual satisfaction of both parties. The CDRC's procedures are available to both private and public sector companies. The CDRC does not have any legal powers, and all legal rights of the parties which use the CDRC are preserved. The CDRC seeks to assist in the restructuring of debts of viable companies with aggregate debts of at least RM50 million from more than one financial institution. The CDRC provides for the formation of both a creditors' committee, comprising representatives of the borrower's creditors, and a steering committee, comprising representatives from BNM, the Ministry of Finance and members of the private sector. The creditors' committee assesses the viability of the borrower and, if positive, negotiates with the borrower the terms of the restructuring. After the restructuring plan is negotiated, the steering committee is responsible for monitoring its progress.

In August 2001, the CDRC announced three new initiatives aimed at accelerating the pace of corporate debt restructuring in Malaysia. The initiatives include expanding membership of the Steering Committee to include representatives from Danaharta and the Federation of Public Listed Companies, developing a framework in which operational restructuring is undertaken together with financial restructuring to ensure the viability of the debt restructuring scheme and subjecting both borrowers and creditors to more stringent and definitive timelines in the debt restructuring process to ensure that they complete the resolution process within the shortest timeframe possible. The criteria for acceptance by the Corporate Debt Restructuring Committee has also been made more stringent by increasing the minimum aggregate borrowings of the borrower to RM100 million, compared to RM50 million previously, and requiring the borrower to have exposure to at least five creditor banks, compared to two creditor banks previously. Significant progress has been achieved since the launch of these initiatives, with the resolution of various debt restructuring cases. As of 16 April 2002, the Corporate Debt Restructuring Committee had succeeded in resolving the debts of 43 companies amounting to RM37.7 billion. The Corporate Debt Restructuring Committee has another eight outstanding restructuring schemes with total debts of RM16.8 billion to be resolved. CDRC is expected to meet its target to complete the restructuring of all its remaining cases by July 2002.

Measures to Strengthen the Banking System. Since 1999, BNM has continued to implement various measures to further strengthen the banking system.

Increased Supervision of Banking Institutions. BNM is continuously upgrading its supervisory techniques to gear itself proactively to deal with the challenges ahead and promote banking system stability. The focus is on risk-based supervision, preemptive measures and closer cooperation with international and regional supervisory and regulatory agencies to promote sharing of experience, knowledge and best practices. The risk-based supervisory approach encompasses an active off-site surveillance for early detection of problems in banking institutions, effective planning to customise on-site examinations and concentration of supervisory resources on areas of high risk. On-site examinations of banking institutions are carried out at least once a year on a consolidated basis. Legal provisions are in place to enable BNM to take necessary remedial action against institutions operating in a manner that may impair their solvency. BNM has also formulated strict guidelines for its lender of last resort facility. BNM also plans to implement a system of prompt corrective measures to make intervention by banking supervisors more timely, transparent and less discretionary.

Tightening Prudential Regulations. Currently, BNM imposes a uniform minimum capital adequacy requirement for all banking institutions at 8% of their risk-weighted assets. In the future, BNM plans to impose different minimum risk-weighed capital ratios tailored to each banking institution's overall risk profile, taking into account loan concentration, sectoral exposure and internal controls. In addition, BNM has tightened the restrictions on lending to significant or controlling shareholders to avoid the exercise of undue influence over credit decisions.

Improving Credit Risk Management. BNM has issued standards on credit risk management for banking institutions. The main principles are to ensure appropriate overview by the board of directors and management, adequate infrastructure for effective credit risk management and comprehensive internal controls. Given the importance of developing competent personnel to manage and control credit risk within banking institutions, personnel involved in credit appraisal, approvals and credit review are required to undergo a common training programme conducted by the Institut Bank-bank Malaysia, the banking industry training institute, pass a common test and receive certification before becoming eligible to sign off or approve a credit proposal.

Minimising Systemic Risk. BNM has embarked on a policy to disassociate institutions supervised by it and by the Securities Commission from other non-supervised entities to ensure that the Government's obligation to assure the safety of deposits in the banking system is not extended to other non-supervised institutions of a financial group. The scope of supervision by BNM is to be expanded to cover bank holding companies, and these holding companies will be required to comply with a set of regulations determined by BNM.

Raising the Minimum Capital Requirement. Effective 31 December 2001, the minimum capital requirement was raised to RM2 billion on an aggregated basis for commercial banks, finance companies and merchant banks that belong to the same domestic banking group and RM300 million for locally incorporated subsidiaries of foreign banks.

Minimising Double-Leveraging of Capital. To avoid undue shareholder pressure to generate returns, future bank capitalisation by shareholders must be funded from less obligatory sources such as retained profits, equity issues or long-term bonds.

Improving Credit Availability to Small- and Medium-Sized Enterprises. To meet the demands for financing by small- and medium-sized enterprises, the Government granted an additional RM750 million in April 2001 to increase the allocations for three existing special funds to a total of RM3.2 billion: Fund for Food; New Entrepreneurs Funds; and Fund for Small and Medium Industries 2. The lending rates charged for financing granted under these special funds and the Rehabilitation Fund for Small and Medium Industries were also reduced by 25 basis points to 150 basis points in 2001. At the same time, funding rates to the banking institutions were also lowered by 50 basis points to 250 basis points. As of 30 April 2002, loans outstanding under these funds amounted to RM1.7 billion.

In July 2001, BNM allocated RM500 million under the Entrepreneur Rehabilitation and Development Fund to provide financial assistance to small- and medium-sized Bumiputera enterprises, or Bumiputera SMEs. The objective of the fund was to provide financing to assist Bumiputera SMEs to resolve their NPLs by providing working capital to enable them to continue their businesses. Although the funds were provided by the Government, banking institutions were required to assess the viability and repayment capacity of the Bumiputera SMEs. As of 31 May 2002, loan applications approved under this fund amounted to RM0.9 million.

In view of the strategic importance of small and medium industries in promoting linkages in the economy, the Credit Guarantee Corporation is expected to play an expanded role in providing guarantees. Towards this end, it has taken a number of steps to improve its operations, including the opening of new branches. In addition, to expedite the application and approval process, a portal has been set up where small and medium-sized enterprises can apply online for guaranteed loans.

Further Measures to Enhance Efficiency and Promote Competition. A number of measures were introduced in 2000 to enhance the efficiency levels and competitiveness of the banking sector, including the following:

Outsourcing of Operational Functions. Beginning in April 2000, banking institutions have been allowed to outsource non-core operational functions to third party service providers, in order to relieve banking institutions from having to invest substantial amount of time and funds to undertake such functions, thereby allowing them to maximise returns by concentrating their resources on developing competencies in their core areas of businesses.

Cross-Selling Activities and Rationalisation of Internal Operations. Banking institutions are now allowed to freely cross-sell financial products and services of entities within the same group, including those belonging to their related non-bank financial institutions, provided the interests of the minority shareholders are not compromised. This enables banking institutions to tap a larger pool of customers via wider marketing channels, enjoy greater cost savings and tap the expertise of their larger related banking institutions. The centralisation of internal operations, on the other hand, would enable banking institutions to carry out their operations more efficiently and effectively and avoid duplication of similar operational functions.

Abolishment of Wage Moratorium. Recognising the importance of manpower abilities, expertise and degree of innovation in determining competitive advantage, banking institutions are now accorded greater autonomy in determining the salaries, allowances and bonuses of their employees based on productivity and efficiency levels. This enables banking institutions not only to retain experienced and high quality pool of bankers, but also to attract a substantial pool of highly skilled and innovative manpower to contribute towards the development of an efficient and effective banking sector.

Provision of Internet Banking Services. Advances in information technology are rapidly changing the way business is being conducted. Information technology is also an important enabler in improving internal efficiency and effectiveness in reaching out to customers through alternative delivery channels. Domestic banking institutions have been given a headstart to offer a full range of banking products and services over the internet effective 1 June 2000. Locally-incorporated subsidiaries of foreign banks have been allowed to offer communicative internet banking services effective 1 January 2001 and transactional internet banking services effective 1 January 2002. The lead time is aimed to allow more time for domestic banking institutions to build up their capacity and capability in this new area of business, thereby ensuring fair competition between domestic and foreign banking institutions. To ensure that banking institutions are aware of the risks involved and the controls that should be put in place, BNM has issued a set of guidelines for the provision of internet banking services, stipulating the minimum requirements that banking institutions should observe in providing internet banking. As of 31 December 2001, eight domestic banking institutions had launched transactional internet banking services.

Labuan International Offshore Financial Centre. On 1 October 1990, an international offshore financial centre was established in the Federal Territory of Labuan to promote international business activities in banking, insurance, corporate funding, investment and trust management, and to enhance the attractiveness of Malaysia as an investment centre. As an international offshore financial centre, Labuan offers low or no taxes on income, profit, dividend and interest earned from offshore business activities or transactions carried out by offshore multinational corporations in or from the territory. In February 2001, 51 banks were operating in Labuan. As of 31 December 2001, these banks had deposits of U.S.$3.6 billion and total loans outstanding of U.S.$11.2 billion. Loans made by banks operating in Labuan are not included as part of loans outstanding of the Malaysian financial system. Loans made to residents of Malaysia by banks operating in Labuan are accounted for as external debt of Malaysia. The financial centre is supervised by the Labuan Offshore Financial Services Authority, which administers several major laws relating to offshore activities in areas such as banking, insurance, trusts and fund management, limited partnerships and incorporation/registration of companies.

Anti-Money Laundering Act 2001. The Anti-Money Laundering Act 2001 became effective on 15 January 2002. The Act complies with nearly all of the Forty Recommendations of the Financial Action Task Force on Money Laundering, which are the internationally recognised anti-money laundering standards in the legal, financial and law enforcement areas. The major provisions in the Act include criminalising money laundering, imposing obligations of customer identification, prohibiting anonymous accounts or accounts in false names, requiring records to be kept for a minimum of six years and requiring reporting of suspicious transactions and transactions above a threshold by reporting institutions. The reporting institutions are those institutions that deal with cash and other instruments that could be used by money launderers (*i.e.*, commercial banks, merchant banks, finance companies and discount houses).

The Act also allows for the seizing, freezing and forfeiture of properties that are proceeds of money laundering activities. Executing transactions with proceeds from any of the 122 serious offences constitutes money laundering and is an offence under the Act. The Act provides for anti-money laundering measures alongside existing law enforcement systems and supports the efforts of multiple law enforcement agencies in investigating money laundering activities relating to the 122 serious offences as identified in the Act.

The Minister of Finance has appointed BNM as the competent authority under the Act mandated to receive, analyse and disseminate financial intelligence relating to money laundering activities. The competent authority also implements and enforces the provisions in the Act relating to customer identification, record keeping and reporting of suspicious and significant transactions. For the purpose of carrying out its functions under the Act, BNM has established a new department called the Financial Intelligence Unit to implement measures for the prevention and detection of money laundering. Under the Act, commercial banks, merchant banks, finance companies and Islamic banks are required to report suspicious transactions to BNM and BNM is empowered to forward information gathered to the relevant law enforcement agency when it has reason to suspect any funds to be proceeds of an unlawful activity or that a serious offence is about to be committed. The Act also provides for protection of any person who discloses information on suspicious transactions from civil, criminal and disciplinary proceedings.

BNM has set up teams of designated specialised banking supervisors responsible for the supervision of banking institutions in relation to money laundering. While its current practice is to assess the adequacy of anti-money laundering systems of banking institutions in the course of on-site examination, the designated specialised banking supervisors will allow for more emphasis to be placed on detecting money laundering.

Financial Sector Masterplan. BNM announced the Financial Sector Masterplan on 1 March 2001. The Financial Sector Masterplan provides a long-term vision for the development of a resilient, efficient and competitive financial sector that is able to operate effectively in an environment of new technological advances and more sophisticated consumer demand. The emphasis is to enhance the capacity for the financial sector to support the transition and growth of the domestic economy. The first phase of the Masterplan will take up to three years and focuses on measures to enhance the capacity and capability of domestic financial institutions. This phase will be followed with a four-year period of managed deregulation of the domestic market where incumbent foreign financial institutions would operate in a more liberalised environment. After seven years of implementation, the final phase will see the possibility of introducing new competition in the market place, including the introduction of new types of domestic and foreign banks. The Masterplan, which emphasises the need for a more diversified financial sector, also sets out the strategic direction of the insurance sector, the Islamic banking and insurance (*takaful*), the development financial institutions, alternative forms of financing such as venture capitals, as well as the development of the offshore financial sector in the Labuan International Offshore Financial Centre.

Capital Markets. Reflecting the increasing role of the private sector in driving domestic growth and the continued developmental efforts undertaken by the Government, the Malaysian capital market has undergone significant changes in the last ten years. Significant developments include the incorporation of the first credit rating agency in 1990, the promulgation of the Securities Industry Act in 1983 and the Futures Industry Act in 1993, and the establishment of the Securities Commission in 1993. The establishment of the Securities Commission marked a significant milestone in the Government's commitment to have a central authority in the regulation and development of the securities and futures industries in Malaysia.

The Kuala Lumpur Stock Exchange, or the KLSE, is the primary exchange for the trading of equity securities in Malaysia. In addition to the Main Board, the Second Board was launched in 1988 to provide smaller firms with good growth prospects with access to the capital markets. As of 31 March 2002, there were 840 companies listed on the KLSE. The KLSE Composite Index, or the KLCI, rose by 6.6% to 741.76 points as of 31 May 2002, compared to 696.09 points at the close of trading on 31 December 2001. The rise of the KLCI has been attributed to, among others, the positive impact on investors' sentiment due to progress made in domestic corporate restructuring efforts, especially within the banking and telecommunications sectors. The market capitalisation of the KLSE, including MESDAQ, was RM518.41 billion at the close of trading on 31 May 2002.

In October 1997, the Government established the Malaysian Exchange of Securities Dealing and Automated Quotation, known as MESDAQ, as an over-the-counter market where high technology and small companies with good growth potential can raise capital. Trading on the MESDAQ commenced in April 1999. As of 15 February 2002, the MESDAQ had 16 members.

Within the domestic derivatives market, the main products that are traded are the KLCI futures, Kuala Lumpur Interbank Offered Rate, or KLIBOR, futures and the crude palm oil, or CPO futures. These products are traded on the Malaysian Derivatives Exchange Berhad, or MDEX. The turnover from trading in KLCI futures contracts averaged 2,476 contracts daily in 2001 compared to 1,275 contracts in 2000. On a year-to-date basis, an average turnover of 979 contracts was recorded daily. The average daily trading volume of KLIBOR futures was 231 contracts in 2001 and 191 contracts in 2000. On a year-to-date basis, the average daily trading volume was 287 contracts. In the case of CPO futures, average monthly trading volume rose by 55.5% to 39,983 lots in 2001 from 25,719 lots in 2000.

In January 1998, the KLSE introduced a new rule on the maximum gearing ratio for stock brokerage firms and reduced the permitted exposure to a single security, to a single client and in relation to margin financing. In order to increase confidence and raise the level of transparency in the markets, since 1999, companies have been required to provide greater and more accurate disclosure on their shareholders and on borrowing positions on a quarterly basis. The Government also established a separate high-level committee to effect a framework for corporate governance standards and set best practices for the industry and, in March 1999, this committee released a report containing recommendations regarding a Malaysian code on corporate governance, legal reforms and training.

In August 1998, the KLSE, as part of its own efforts to increase transparency in the Malaysian capital markets, announced new measures which included the mandatory deposit of the share certificates of listed securities with the central depository, additional shareholder disclosure requirements and new restrictions on the mode of holding and issuing securities of publicly-listed companies. In November 1998, the securities and futures laws were amended to ensure an orderly and fair market in the trading of securities and futures contracts and to improve market transparency. A new code on takeovers and mergers was introduced in January 1999 to enhance transparency and add protections for minority shareholders. In December 1999, a new risk-based capital adequacy framework for stock brokerage companies was approved by the Securities Commission.

The Securities Commission (Amendment) Act 2000 was introduced in July 2000 to streamline the responsibilities of the Securities Commission and the Registrar of Companies with regard to prospectuses for greater legal and regulatory certainty in public offerings of securities. These amendments are seen as a significant part of the move towards a disclosure-based regulatory regime as they require issuers to ensure the accuracy of disclosures made to investors and imposes liability for false or misleading statements in these documents. The amendments introduce a new civil remedy enabling investors to recover losses or damages arising from the provision of false or misleading information contained in a prospectus.

In 2001, the KLSE identified listed companies that failed to meet the financial conditions for continued trading and listing on the KLSE. On 15 February 2001, the KLSE issued Practice Note 4, or PN4, to ensure that these affected listed companies take steps to regularise their financial condition expeditiously within a stipulated time frame. PN4 also aims to protect the interests of investors by ensuring that sufficient information disclosures are made on affected listed companies' restructuring plans, and by imposing penalties on affected listed companies that do not meet the requisite deadlines. In April 2002, the Securities Commission held further dialogue with PN4 companies and the KLSE to solicit feedback on the PN4 procedures, in order to speed up the restructuring of PN4 companies. PN4 companies face the consequences of possible trading restrictions, suspension, or ultimately, delisting, if they fail to regularise their financial positions expeditiously. As of 23 May 2002, 100 listed companies were subject to PN4 requirements.

In 2000, the Government launched the Labuan International Financial Exchange to promote Labuan as one of the active international financial centres for Islamic money and capital markets and to provide for the listing and trading of a wide range of financial products. In 2001, the International Islamic Financial Market was established.

Capital Market Masterplan. The Capital Market Masterplan, or CMP, was approved by the Government and launched in February 2001, setting out a vision for the Malaysian capital market which is to be internationally competitive, efficient and supported by a strong regulatory framework. The vision of the CMP is translated into six key objectives, 24 strategic initiatives and 152 recommendations in the areas of market institutions, equity market, bond market, derivatives market, Islamic capital market, stock brokerage industry, investment management, corporate governance, regulatory framework, technology and e-commerce, and training and education. As of 31 March 2002, 15 recommendations were fully implemented. Implementation had been partially completed for 25 recommendations and were ongoing for 47 recommendations. Research or consultation work had commenced for some of the other recommendations.

A major initiative of the CMP is to ensure that the Malaysian capital market remains the preferred capital-raising centre for Malaysian companies. In this regard, some of the measures articulated within the CMP are aimed at enhancing the efficiency of the capital-raising process and providing sufficient diversity of capital-raising instruments commensurate with financing requirements. Consistent with this purpose, the Securities Commission has further streamlined the capital-raising process by embarking on the second phase of the disclosure-based regulation regime for securities issuances and preparing to move to the third phase in 2002. With regard to developing the corporate bond market, various efforts have been undertaken by the Securities Commission and the National Bond Market Committee such as introducing guidelines to allow for shelf-registration schemes as well as guidelines to facilitate the offering of asset-backed securities.

In order to ensure that capital market institutions in Malaysia remain internationally competitive in a more aggressive and dynamic business environment, an initiative of the CMP is to enhance the competitive position and efficiency of market institutions through the creation of a single Malaysian exchange. Work in this area has progressed significantly with the completion of a merger between the country's two remaining derivative exchanges into the MDEX under the KLSE group, and the signing of a merger agreement between MESDAQ and KLSE. Work is also continuing in the area of exchange demutualisation.

Several recommendations to further strengthen and enhance trading, clearing and settlement processes and make them consistent with international best practices and standards had already been implemented before the launch of the CMP, including a reduction of the stock exchange's settlement cycle from five trading days (T+5) to three trading days (T+3). To achieve cost-efficient market intermediation services, transaction costs have been progressively reduced for trading and clearing activities. Also in 2001, MDEX migrated from open outcry floor trading to electronic trading to increase efficiency and transparency of trading processes.

In order to develop a more transparent, accountable and performance-oriented corporate sector that is premised on sound and consistent corporate governance, steps have been undertaken to enhance corporate governance standards amongst Malaysian companies. In 2001, the Malaysian Code on Corporate Governance became effective in KLSE's revised Listing Requirements. Based on the revised requirements, listed companies with financial years ending after 30 June 2001 are now required to inform their shareholders of the extent of their compliance with the best practices described in the code and to provide reasons for any departure. Prior to that, the establishment of Badan Pengawas Pemegang Saham Minoriti (Minority Shareholders Watchdog Group) signified the start of a collective approach in pursuing institutional shareholder activism.

Capital market intermediaries are also encouraged to develop sufficient capacity and offer a range of high-quality cost-effective services and products within the growing and maturing marketplace. As such, the Securities Commission's measures that have been implemented include, among others, progressive domestic deregulation of products and services; developing a core group of well-capitalised full-service domestic intermediaries known as Universal Brokers; and promoting consolidation efforts by the stock brokerage industry to achieve greater efficiencies. As of the end of 2001, each of seven brokerage companies had announced plans to merge with at least three merger partners; one brokerage company had proposed to merge with two partners; and each of eight brokerage companies had plans to merge with one other merger partner. As of the end of 2001, five brokerage companies had been granted Universal Broker status.

Given the importance of developing a sufficiently large pool of highly skilled professionals, the Securities Commission is committed to fostering a culture of continuous learning and skill enhancement. To achieve this, for instance, the Securities Commission introduced mandatory training programmes for licensed representatives. The Securities Commission has also collaborated with various parties to develop knowledge sharing initiatives.

Public Finances

Fiscal Policy. The Government's fiscal policy resulted in budget surpluses from 1993 to 1997. During this time, the Government's fiscal policy formed part of its overall strategy of containing demand and inflationary pressures with the broad aim of ensuring sustainable economic growth with price stability and external equilibrium.

The 1998 Budget and an austerity plan adopted by the Government on 5 December 1997 contained a number of policy measures designed to strengthen the country's economic fundamentals and stabilise the financial markets. Government expenditures included in the 1998 Budget were to be reduced by 10% across the board and by another 8% on a selective basis. Companies in the manufacturing sector and companies involved in selected areas of the agriculture and service sectors were to be granted tax incentives based on the increase in exports generated. Corporate and petroleum income taxes were also reduced to 28% and 38%, respectively, to reduce the cost of doing business. Conversely, imports were to be curbed through the deferment of large projects and the imposition of higher import duties.

As the regional economic crisis continued into 1998, public sector cutbacks aggravated the decline in investor and consumer demand, causing severe deflationary pressure on the domestic economy. The contraction in GDP in the first quarter and the continued weakening in domestic and external demand caused the Government to ease its tight fiscal policy and take immediate action to avoid a deeper recession in the Malaysian economy.

The principal counter-cyclical measures were as follows:

- In March 1998, the Government announced measures designed to stabilise and strengthen the national economy. In 1998, RM1 billion was provided for socio-economic projects including educational facilities, small business loans, credit for the poor, health facilities and rural infrastructure facilities. With the additional expenditure, the Government proposed to reduce the fiscal surplus to 0.5% of GNP in 1998.

- In July 1998, the Government announced additional measures involving expenditures totalling RM7 billion designed to promote exports and counteract a decline in domestic demand. These measures combined with a decline in Government revenue resulted in a budget deficit in 1998. The Government also announced the establishment of a RM5 billion fund for infrastructure projects and projects involving large public facilities.

- During 1998, the Government established or increased the size of a number of special funds to support certain sectors of the economy, including funds for the export sector (RM4 billion); small-and medium-sized enterprises (RM1.5 billion); low- and medium-cost housing development (RM2 billion); food producing and processing (RM1 billion); New Entrepreneurs Fund (RM1.25 billion); and the rehabilitation of small and medium industries (RM750 million).

The 1999 and 2000 Budgets announced by the Government maintained an expansionary fiscal policy designed to support economic activities that promote efficiency, improve competitiveness and long-term productivity, facilitate the restructuring of the financial sector and ensure social well-being. Although the thrust of budgetary operations was expansionary, the Government sought to maintain fiscal prudence and discipline to contain the fiscal deficit at a manageable level so as not to jeopardise long-term growth. Emphasis was placed on agriculture and rural development and on an adequate programme to protect lower income groups from the adverse effects of the financial crisis. Accordingly, a large share of the budget allocation was for public utilities, housing, education and skills training, and health and medical services. The higher expenditure led to a larger deficit of RM9.5 billion or 3.4% of GNP in 1999, and a further deficit of RM19.7 billion or 6.3% of GNP in 2000.

From 1998 to 2001, the financing requirement of RM52.6 billion was funded largely from domestic sources. The funding was sourced primarily from non-inflationary sources, including the Employees Provident Fund and various other provident, pension and insurance funds and the banking system, and from the liquidity generated from the large current account surplus in the balance of payments recorded in 1998, 1999, 2000 and 2001.

In the 2001 Budget, which was announced in October 2000, the Government recognised the possibility of a slowdown in the U.S. economy. Accordingly, the Government maintained its expansionary fiscal policy for 2001 to strengthen domestic demand and long-term productivity for sustainable economic growth.

In early 2001, the Government adopted a stronger fiscal stimulus programme to address the sharper than expected slowdown in the U.S. economy. The package of pre-emptive measures announced by the Government in March and September 2001 included an additional fiscal stimulus of RM7.3 billion. In spite of the additional economic stimuli, the fiscal deficit of the Government was only slightly higher at RM18.4 billion compared to the 2001 Budget estimate of RM16.5 billion. The fiscal deficit will continue to be largely financed from non-inflationary domestic sources.

In the 2002 Budget, which was announced in October 2001, the Government reaffirmed its objective to maintain expansionary fiscal policies to strengthen domestic demand and long-term productivity for sustainable economic growth. To this end, the Government expects to continue to focus on the public sector for continued fiscal growth stimulus by providing various incentives to further stimulate the private sector and encouraging public consumption by measures such as additional reductions in income tax. The main assumption used in preparing the 2002 Budget was real GDP growth of 4 to 5%. In 2002, revenue of the Government is budgeted at RM73.2 billion. The 2002 Budget contemplates a fiscal deficit of RM18.9 billion, or 5.1% of projected GDP, as compared to RM18.4 billion, or 5.5% of GDP for 2001, reflecting the need to ensure sustained economic recovery as the world economy is not expected to recover until the beginning of the second half of 2002. The deficit, as in the past, is expected to be largely financed from non-inflationary domestic sources. Total Government expenditure is estimated to be RM93.7 billion. Of this amount, RM65.34 billion is for current expenditure and RM28.38 billion is for development expenditure.

Consolidated Public Sector Finance. The following table sets out the consolidated public sector finance position for the periods indicated.

Consolidated public sector finance

	Consolidated public sector finance				
	1997	1998	1999	2000	2001
	(RM million)				
General government					
Revenue	79,783	69,369	70,887	76,002	92,937
Operating expenditure	50,139	50,250	54,274	64,445	72,294
Current surplus	29,644	19,119	16,612	11,556	20,643
Non-financial public enterprises					
Revenue	69,713	73,447	98,242	112,929	103,202
Operating expenditure	42,033	49,529	61,596	71,725	71,898
Current surplus	27,680	23,918	36,646	41,204	31,304
Public sector current surplus	57,324	43,037	53,258	52,760	51,946
Net development expenditure	39,992	46,791	46,422	50,438	68,161
General government	18,651	17,132	20,964	27,078	33,934
Non-financial public enterprises	21,341	29,659	25,458	23,360	34,227
Overall budget surplus (deficit)	17,332	(3,754)	6,835	2,322	(16,215)
(% of GNP)	6.5	(1.4)	2.4	0.7	(5.3)
(% of GDP)	6.2	(1.3)	2.3	0.7	(4.9)

Source: Ministry of Finance.
State governments.
Non-financial public enterprises.

The consolidated public sector is made up of the general government and the non-financial public enterprises, with the general government comprising the Government, 13 state governments, statutory bodies and local governments. Non-financial public enterprises are publicly owned or controlled corporations and enterprises engaged in the production, marketing and distribution of goods and services on a commercial basis, excluding those engaged directly in finance. For reporting and monitoring purposes, only large non-financial public enterprises with annual sales turnover of at least RM100 million, large borrowing requirements and high capital expenditure or which have a large economic impact are included. Currently, 37 non-financial public enterprises are monitored. Of these, the major non-financial public enterprises are as follows:

Non-Financial Public Enterprises	Principal Activity
Petroliam Nasional Berhad (Petronas)	Oil and Gas
Tenaga Nasional Berhad	Power
Telekom Malaysia Berhad	Telecommunications
Golden Hope Berhad	Plantations
Kumpulan Guthrie Bhd	Plantations
Putrajaya Holdings Sdn Bhd	Construction
Malaysia Airports Holdings Berhad	Services

In early 2001, the Government acquired a 29.1% shareholding of Malaysian Airline System Berhad. See “*Malaysia—The Country—Government—Recent Developments*”.

In 1998, the general government’s consolidated position recorded a current surplus of RM19.1 billion or 7.1% of GNP compared to 11.1% of GNP in 1997. The lower surplus was mainly attributable to the decline in revenue collection. As in previous years, the surplus was mainly generated by the Government and state governments, while statutory bodies continued to run deficits due to their narrow revenue base. The non-financial public enterprises recorded an operating surplus of RM23.9 billion or 8.9% of GNP compared to 10.4% of GNP in 1997, due to the weak performance of several major public enterprises caused by the depreciation of the ringgit. Consequently, the consolidated public sector current account recorded a reduced surplus of RM43 billion or 16.1% of GNP in 1998 compared to 21.5% of GNP in 1997.

Public sector development spending increased by 17% to RM46.8 billion in 1998 due to an increase of 39% in capital spending by the non-financial public enterprises, while the development outlays of the general government declined by 8.1%. Several major public enterprises, including Petronas, continued to undertake expansion projects and modernisation programmes during the year. A sizeable proportion of capital spending was for the acquisition of companies related to major public enterprises’ core businesses, including investment overseas. However, due to the adverse economic developments, several non-financial public enterprises consolidated their positions and deferred or scaled down development projects during 1998. As a result of the significant deterioration in the overall financial performance of the non-financial public enterprises, the consolidated public sector overall account recorded a deficit of RM3.8 billion or 1.4% of GNP in 1998. This was the first deficit recorded since 1993.

In 1999, the consolidated public sector overall amount recovered to record a surplus. This was entirely due to the significant improvement in the performance of the non-financial public enterprises. The favourable performance of the non-financial public enterprises was due mainly to the substantially higher revenue receipts reflecting largely the recovery in economic activities as well as the significant increase in petroleum prices, especially in the second half of 1999. On the other hand, the financial position of the general government, in particular the Government, recorded a larger deficit attributable to the continued implementation of the fiscal stimulus package first initiated in 1998 in response to the Asian financial crisis. In aggregate, the overall account of the consolidated public sector recorded a surplus of RM6.8 billion, or 2.4% of GNP.

In 2000, the financial position of the consolidated public sector recorded a smaller surplus of RM52.8 billion in the current account, as compared to RM53.3 billion in 1999. This was due to a stable revenue performance of the non-financial public enterprises as a result of continued expansion of economic activities and significantly higher petroleum prices. However, the financial position of the general government recorded a smaller surplus due to higher operating expenditure of the Government because of salary adjustment for civil servants, higher fuel subsidies, and increased expenditure for supplies and services. Higher development expenditure by the Government to stimulate economic activities and by the non-financial public enterprises led to an overall deficit of RM2.3 billion, or 0.7% of GNP, in the consolidated public sector account.

In 2001, the financial position of the consolidated public sector was estimated to record a surplus of RM51.9 billion in the current account. This was attributable mainly to an improved revenue performance of the general government, especially of the Government. However, the higher development expenditure by the Government to stimulate economic activities led to an overall deficit of RM16.2 billion in the consolidated public sector account, mainly due to a decline in the performance of certain non-financial public enterprises, or NFPEs. Major NFPEs such as Petronas and Tenaga Nasional Berhad recorded a lower overall balance in 2001 compared to 2000 as a result of a decline in petroleum prices and increases in capital expenditures for capacity expansion and modernisation programmes.

Government Financial Position. The following table sets out the Government financial position for the periods indicated.

Government finance

	1997	1998	1999	2000	2001P	Budget 2002	First three months of 2002P
				(RM million)			
Current revenue	65,736	56,710	58,675	61,864	79,567	73,167	17,143
Less: Current expenditure	44,665	44,584	46,699	56,547	63,757	65,342	14,716
Current surplus	21,071	12,126	11,976	5,317	15,810	7,825	2,427
Less: Net development expenditure	14,445	17,128	21,462	25,032	34,232	26,682	3,713
Overall balance	6,626	(5,002)	(9,486)	(19,715)	(18,422)	(18,857)	(1,286)
Sources of finance:(1)							
Gross domestic borrowings	3,000	17,990	19,281	18,000	23,500	24,950	1,800
Less: Domestic repayment	5,048	6,950	13,858	5,286	10,119	11,931	3,000
Net domestic borrowings	(2,048)	11,040	5,423	12,714	13,381	13,019	(1,200)
Gross external borrowings	462	4,001	4,763	4,767	7,029	4,563	2,967
Less: External repayment	2,143	2,182	1,840	3,903	735	937	(198)
Net external borrowings	(1,681)	1,819	2,923	864	6,294	3,626	2,769
Special receipts(2)	91	1	238	13	6	–	–
Use of assets(3)	(2,988)	(7,858)	902	6,123	(1,259)	2,212	(283)
Total financing transactions	(6,626)	5,002	9,486	19,715	18,422	18,857	1,286
Overall balance (% of GNP)	2.5	(1.9)	(3.4)	(6.3)	n.a.	(5.5)	n.a.
Overall balance (% of GDP)	2.4	(1.8)	(3.2)	(5.8)	(5.5)	(5.1)	n.a.
Accumulated Government bank balance at period end	14,280	26,013	19,131	17,406	26,189	n.a.	17,890

P Preliminary. Includes additional fiscal stimulus of RM7.3 billion announced in March and September 2001.
(1) See *"- Fiscal Policy"* for a discussion of certain of the Government's financing plans for 2001.
(2) Includes proceeds from the sale of assets and grants from foreign governments and organisations.
(3) A negative amount indicates the accumulation of assets.
Source: Ministry of Finance.
Bank Negara Malaysia.

The financial position of the Government was less favourable in 1998 in the face of a substantial decline in revenue and the implementation of the fiscal stimulus package beginning in July 1998. The overall fiscal position reverted to a deficit of RM5 billion or 1.9% of GNP from a surplus of RM6.6 billion, or 2.5% of GNP in 1997. This was the first overall deficit since 1992. The current account remained in surplus, albeit smaller, at RM12.1 billion, or 4.5% of GNP, compared to RM21.1 billion, or 7.9% of GNP, in 1997.

In 1999, the overall financial position of the Government recorded a larger fiscal deficit, reflecting the expansionary fiscal programme to promote economic recovery amid the moderate increase in revenue receipts. The current account continued to remain in surplus (RM12 billion, or 4.3% of GNP), while the overall balance recorded a further deficit of RM9.5 billion, or 3.4% of GNP, for the second consecutive year.

In 2000, the current account of the Government remained in surplus of RM5.3 billion (1.7% of GNP). However, the overall financial position of the Government recorded a larger fiscal deficit of RM19.7 billion (6.3% of GNP) in 2000 due largely to an expanded fiscal stimulus programme.

The expansionary fiscal policy implemented since the regional economic crisis has increased the debt of the Government. This is a result of borrowings to finance the overall deficit of the Government, which increased to RM9.5 billion in 1999 and RM19.7 billion in 2000. The external borrowings of the Government accounted for 21% of the Government's total financing requirements in 2000.

In 2001, the overall financial position of the Government registered a deficit of RM18.4 billion, or 5.5% of GDP. In spite of higher expenditures, the deficit was significantly lower than the RM18.4 billion, or 6.3% of GDP deficit recorded in 2000 on account of significantly better revenues in 2001.

For the first three months of 2002, the overall financial position of the Government registered a deficit of RM1.3 billion, reflecting expansionary budgetary operations adopted to strengthen the process of economic recovery. Total expenditures in this period rose at a rate of 13.3% to RM18.4 billion, compared to RM16.3 billion in the first three months of 2001, reflecting continued efforts by the Government to provide stimulus to the economy. In additional, revenue for this period recorded growth, which was attributable to the rise in economic activity.

Government Revenue. The following table sets out Government revenue for the periods indicated.

Government revenue

	1997	1998	1999	2000	2001P	Budget 2002	First three months of 2002P
				(RM million)			
Direct taxes	30,432	30,015	27,246	29,156	42,098	35,926	9,766
Corporate income tax	16,688	17,294	15,742	13,905	20,771	18,818	5,108
Petroleum income tax	3,861	4,046	2,856	6,010	9,859	7,926	500
Personal income tax	6,429	6,900	6,419	7,015	9,436	7,171	5,272
Stamp duties	2,714	1,190	1,566	1,799	1,649	1,607	346
Other	740	585	663	428	383	405	40
Indirect taxes	23,195	15,321	18,100	18,017	19,393	20,228	4,618
Export duties	1,053	623	670	1,032	867	1,016	149
Import duties	6,524	3,868	4,720	3,599	3,193	3,203	709
Excise duties	6,054	3,586	4,723	3,803	4,129	4,224	1,057
Sales tax	6,167	3,845	4,488	5,968	7,356	7,577	1,896
Service tax	1,475	1,447	1,459	1,701	1,926	2,055	390
Other	1,922	1,952	2,040	1,914	1,922	2,153	417
Non-tax revenue and receipts(1)	12,109	11,374	13,329	14,692	18,076	17,013	2,759
Total	65,736	56,710	58,675	61,864	79,567	73,167	17,143

P Preliminary.
(1) Includes investment income, licences and permits, services fees, dividend payments and other items.
Source: Ministry of Finance.

In 1998, Government revenue fell by 13.7% to RM56.7 billion, or 21.2% of GNP, reflecting the contraction in economic activity and weak domestic demand. This decline also reflected the reduction in tax rates and several tax concessions provided in the 1998 Budget to promote productivity-driven growth and reduce the cost of doing business. Revenue foregone from lower taxes was estimated at approximately RM1.3 billion in 1998. Meanwhile, the marked decline in petroleum prices coupled with the reduction in the rate of petroleum income tax and export duty also affected receipts from petroleum income tax, exports, imports and excise duties. These receipts and dividends from Petronas together account for 20% of total Government revenue.

Tax revenue, accounting for 80% of total Government revenue, fell by 15.5% for the first time since 1988. The ratio of tax receipts to GNP also declined to 16.9% compared to 20.1% in 1997. Revenue from indirect taxes declined by 34%, reducing its share of total revenue to 27%, as a result of the contraction in domestic demand and lower petroleum prices. Revenue from direct taxes declined by 1.4%, with an increased share of total revenue of 53% compared to 46% in 1997, largely because income tax collections, which were predominantly based on the previous year’s earnings, experienced strong growth during the first half of 1997. Non-tax revenue and receipts declined by 6.1%, primarily because of lower collections from licenses and permits due largely to substantially lower receipts on the levy on foreign workers.

In 1999, Government revenue registered a moderate increase of 3.5%, or RM2 billion, to RM58.7 billion, or 21% of GNP, despite the double-digit decline in income taxes. The better-than-expected revenue collection was attributable to improved indirect tax collection in tandem with the recovery in aggregate demand, as well as to higher receipts from investment income. The higher collection also reflected several revenue enhancing measures announced in the 1999 Budget, including increases in taxes and duties on selective goods and gaming activities.

Tax revenue increased marginally by 0.02%, reducing its share to 77% of the total revenue. The ratio of tax receipts to GNP declined to 16.2% compared to 16.9% in 1998, the lowest since 1988. Revenue from indirect taxes expanded by 18.1% following a sharp decline of 34% in 1998 to account for a higher share of 31% of total revenue compared to 27% in 1998. This reflected largely the moderate recovery in aggregate demand as well as higher petroleum prices, especially in the second half of 1999. Revenue from direct taxes, however, declined further by 9.2%, thus reducing its share of total Government revenue to 46% compared to 53% in 1998, largely because of poor income tax collection. Non-tax revenue increased by 16.5% with higher receipts of investment income mainly from dividends of Petronas (RM4.1 billion) and BNM (RM1 billion).

In 2000, Government revenue expanded further to RM61.9 billion (19.8% of GNP). The favourable revenue receipts stemmed largely from the expansion of economic activities; the implementation of the current year tax assessment; and a larger contribution from petroleum-based revenue. As a result, revenue from direct taxes recovered to record an increase of 7% following two consecutive years of decline to account for a slightly higher share of total revenue (47%). On the other hand, collection of indirect taxes was affected by the introduction of several tax concessions to enhance efficiency and competitiveness. These tax concessions (including extension of sales tax and import duties exemptions on spares and consumables as well as abolishment or reduction of import duties on selected consumer goods and food products) were estimated to result in a revenue loss of RM259 million. In the aggregate, the share of tax revenue was slightly lower at 76% of total revenue. The share of non-tax and non-revenue receipts accounted for 24% of total revenue, with higher receipts from petroleum royalty and service fees.

In 2001, Government revenue collection was higher, growing by 28.6%, from 2000, to RM79.6 billion. The higher collection is largely due to higher revenue from direct and indirect taxes as well as from investment income. Out of the RM79.6 billion, tax revenue amounted to RM61.5 million, an increase of 30.4% from 2000. The contribution of tax revenue to Government revenue in 2001 was 77.3% compared to 76.3% in 2000. Direct taxes amounted to RM42.1 million, which was 44.4% higher than in 2000. The increase in direct tax revenue was attributed to higher income tax collection, namely company, individual and petroleum income tax. The extension of instalments under the Current Year Assessment for 2000 to the end of 2001, the increase in the collection of tax arrears due to action taken by the Inland Revenue Board, the high degree of compliance under the Self-Assessment System as well as the increase in world oil prices, also significantly contributed to the increase of direct tax collection for 2001. Indirect taxes increased from RM18 million in 2000 to RM19.4 million in 2001 as a result of increased economic activities during the year. The contribution of direct taxes and indirect taxes to the Government's revenue in 2001 was 52.9% and 24.4%, respectively.

For the first three months of 2002, Government revenue collection was higher, growing by 17.1% to RM17.1 billion, compared with RM14.6 billion in the corresponding period of 2001. This increase reflected continued economic growth and improvements in the tax collection system.

Government Expenditure. Total Government expenditure increased by 4.7% in 1997. Several fiscal tightening measures adopted in the third quarter of 1997 contributed to containing the increase in expenditure. This trend continued into the first half of 1998 as the Government implemented the fiscal austerity packages proposed in the 1998 Budget and on 5 December 1997. Total Government outlays fell sharply by 34.4% during the first half of 1998 compared with the preceding half year. However, with the Government's shift in fiscal policy beginning in July 1998, total net expenditure for the year increased by 4.4% to RM61.7 billion.

Reflecting the continued expansionary fiscal stance to support and strengthen economic recovery, total Government expenditure increased substantially by 10.6% to RM69.3 billion in 1999 and by 21.9% to RM84.5 billion in 2000. In 2001, the total expenditure increased further by 17.2% to RM98.9 billion due to additional stimulus packages implemented in the course of the year.

Government Current Expenditure. The following table sets out Government current expenditure for the periods indicated.

Government current expenditure

	1997	1998	1999	2000	2001P	Budget 2002	First three months of 2002P
				(RM million)			
Emoluments	13,195	13,984	14,436	16,357	17,443	17,581	4,416
Supplies and services	6,363	5,212	6,074	7,360	10,703	11,763	917
Asset acquisition	905	434	422	572	1,339	1,495	11
Public debt charges	6,426	6,928	7,941	9,055	9,634	9,429	2,701
Pensions and gratuities	3,638	3,658	3,793	4,187	4,711	4,556	1,620
Other grants and transfers(1)	12,101	11,972	12,260	16,582	18,045	18,045	4,931
Other expenditure	2,037	2,396	1,774	2,435	1,851	2,473	120
Total	44,665	44,584	46,699	56,547	63,757	65,342	14,716

P Preliminary.
(1) Includes grants and transfers to state governments as well as public agencies and enterprises.
Source: Ministry of Finance.

Current expenditure declined by 0.2% in 1998, reflecting continued controls on expenditure to avoid waste and to curtail non-essential spending. Increased administrative efficiency as a result of the wider use of office automation and information technology also assisted in containing the growth in operating costs. The total wage bill, the largest component of current expenditure at 31.4%, was 6% higher than the 1997 expenditure level, reflecting primarily the payment of the balance of a one-month bonus to civil servants declared in 1997, the financial assistance of RM400 million to civil servants and the upgrading of the scheme of service for teachers including time-based promotions. This wage bill increase was partly offset by the reduction in allowances for civil servants and a freeze on filling non-essential vacant positions.

In 1999, there was a moderate 4.7% increase in current expenditure. The total wage bill increased by 3.2% as a result of the part payment of a one-month bonus payable to eligible civil servants announced in the 2000 Budget. The balance was payable during the first three months of 2000. The reinstatement of the civil service allowances, effective August 1999, also contributed to a higher 1999 wage bill.

In tandem with available resources, current expenditure increased by 21.1% in 2000 to stimulate public and private sector consumption and was aimed at sustaining and strengthening economic growth momentum. A large part of the increase in current expenditure also reflected the one-time salary and pension adjustment for civil servants as well as increased subsidy payment.

In 2001, current expenditure increased by 12.8% compared to 2000. Higher outlays were recorded for almost all categories of expenditures, especially transfer payments to agencies. Pension payments were larger due to the annual contribution to the Pensions Trust Fund, while higher debt servicing, particularly of domestic interest payments, reflected the higher level of domestic debt. During the course of the year, the government implemented additional stimulus packages of RM3 billion and RM4.3 billion in March and September 2001, respectively, to contain and minimise the negative impacts of the worldwide economic slowdown.

In the first three months of 2002, Government current expenditures increased by 30.2% to RM14.7 billion, compared with RM11.3 billion in the corresponding period of 2001. Higher outlays were recorded for almost all categories of expenditure.

Government Development Expenditure. The following table sets out Government development expenditure for the periods indicated.

Government development expenditure

	1997	1998	1999	2000	2001P	Budget 2002	First three months of 2002 P
				(RM million)			
Defence and security	2,314	1,380	3,122	2,332	3,287	2,980	289
Economic services	7,501	9,243	8,969	10,411	12,725	11,798	1,210
Social services	4,919	5,783	6,936	11,077	15,384	10,992	2,298
General administration	1,016	1,697	3,587	4,122	3,839	2,612	95
Total	15,750	18,103	22,614	27,942	35,235	28,382	3,892

P Preliminary.
Source: Ministry of Finance.

Gross development expenditure in 1998 rose by 14.[9][6]% to RM18.1 billion, mainly attributable to the implementation of the fiscal stimulus package and the provision of several assistance programmes to mitigate the adverse impact of economic adjustments on vulnerable segments of society. This trend continued during 1999 and 2000, with gross development expenditure recording annual increases of 24.9% and 23.[6][5]%, respectively. The bulk of the expenditure during the 1998-2000 period was channelled to projects with strong domestic economic multiplier effects and low import content, including projects involving agriculture, rural development, infrastructure, housing, health and education.

In 2001, gross development spending increased by 26.[1][2]% to RM35.2 billion. A significantly higher amount was spent on education, skills training and industrial development.

For first quarter of 2002, Government development expenditure decreased by [27.1][26.4]% to RM3.9 billion, compared to RM5.3 billion in the first three months of 2001. This decline was the result of most progress payments in respect of developmental projects being disbursed in 2001 as part of the Government's implementation of its fiscal stimulus policy and a comparatively smaller amount being disbursed in the first quarter of 2002.

Government Debt

Government Net Borrowing. The following table sets out Government net borrowing for the periods indicated.

Government net borrowing

	1997	1998	1999	2000	2001P	First three months of 2002P
			(RM million)			
Net domestic borrowing	(2,048)	11,040	5,423	12,714	13,381	(1,200)
Government securities	(648)	8,750	3,324	10,714	14,400	(1,200)
Investment issues	(1,400)	(750)	—	2,000	—	—
Market loans	—	3,040	2,099	—	(1,019)	—
Net external borrowing(1)	(1,681)	1,819	2,923	864	6,294	2,770
Project loans	(984)	708	(134)	(250)	117	(74)
Market loans	(697)	1,111	3,057	1,114	6,177	2,844
Total	(3,729)	12,859	8,346	13,578	19,675	1,570
Interest payments	6,426	6,928	7,941	9,055	9,634	614
Domestic	5,789	5,897	7,057	7,868	8,484	545
External(1)	637	1,031	884	1,187	1,150	69

P Preliminary.
(1) Amounts in original currencies were converted to ringgit using the applicable exchange rate on the relevant transaction date.
Source: Ministry of Finance.

With the shift to an expansionary fiscal policy position in July 1998, total net borrowing of the Government increased in 1998. The increased borrowings, particularly from domestic sources, coupled with a marginal net exchange revaluation loss arising from the weakening of the ringgit against the Japanese yen, led to a deterioration in the total debt position of the Government. At the end of 1998, the Government's total debt outstanding increased by 14.7% to RM[103.1] billion compared to a 0.3% increase to RM[89.9] billion in 1997.

The fiscal deficit in 1999 was largely financed by domestic borrowing given the ample domestic liquidity. External borrowing was relatively small. The Government also drew down some of its cash reserves. Overall, the Government recorded a total net borrowing of RM8.3 billion.

The increased borrowings, coupled with a net exchange revaluation loss arising largely from the weakening of ringgit against the Japanese yen, led to a moderate increase in the total debt of the Government. In 1999 total outstanding debt rose by 8.7% to RM[112.1] billion, or 40.1% of GNP, compared to RM[103.1] billion, or 38.5% of GNP, in 1998.

During 1999, net domestic borrowing totalled RM5.4 billion, financed largely from non-inflationary domestic sources as well as from remaining proceeds of a U.S.$1.35 billion domestic syndicated loan signed at the end of 1998. As a result, the total domestic debt of the Government increased by 6.3% to RM93.8 billion, or 33.5% of GNP, at the end of 1999 to account for 84% of the total outstanding debt.

Net external borrowing of the Government for 1999 recorded a net inflow of RM2.9 billion. Gross external borrowing amounted to RM4.8 billion, comprised of a U.S.$1 billion (RM3.8 billion) principal amount of 8.75% global notes due 2009 and the drawdown of several loans secured from multilateral (such as the World Bank and Islamic Development Bank) and bilateral sources, especially from Japan under the New Miyazawa Initiative.

Given the ample liquidity in the banking system and high domestic savings, the Government financed its fiscal deficit largely from domestic sources in 2000. The Government also relied, to a lesser extent, on external borrowing. During the year, the Government issued an additional U.S.$500 million (RM1.9 billion) principal amount of its 8.75% global notes due 2009 and a Euro 650 million (RM2.1 billion) principal amount of its 6.375% global notes due 2005, and drew down several loans secured under bilateral sources, especially from Japan under the New Miyazawa Initiative, and multilateral sources. The Government also drew down some of its cash reserves. Overall, the Government recorded a total net borrowing of RM13.6 billion in 2000. The total outstanding debt of the Government rose to RM125.6 billion, or 40.2% of GNP, at the end of 2000. Domestic debt accounted for 85% of the total outstanding debt.

During 2001, the Government recorded net borrowing of RM19.7 billion. In July 2001, the Government issued U.S.$1 billion (RM 3.8 billion) principal amount of 7.50% global notes due 2011. In December 2001, the Government raised a syndicated loan of U.S.$540 million from offshore banks in Labuan and in February 2002, these banks began seeking to syndicate the facility in the broader bank market. The outstanding debt of the Government increased by RM20.1 billion to RM145.7 billion at the end of December 2001. The external debt of the Government accounted for only 14.7% of the nation's outstanding debt at such time.

In March 2002, the Government issued an additional U.S.$750 million principal amount of 7.50% global notes due 2011.

The following table sets out the direct funded and floating debt of the Government on the dates indicated. For purposes of all debt tables below, "Funded Debt" refers to debt having an original maturity of one year or more and "Floating Debt" refers to debt having an original maturity of less than one year.

Direct Government debt

	As of 31 December					As of 31 March
	1997	**1998**	**1999**	**2000**	**2001P**	**2002P**
Internal (RM million)						
Funded	72,648	83,877	89,430	102,485	117,076	115,853
Floating	4,320	4,320	4,320	4,320	4,320	4,3230
Total internal	76,968	88,197	93,750	106,805	121,396	120,173[1]
External (U.S.$ million)	3,325	3,927	4,834	4,953	6,402	5,130
Total direct indebtedness(U.S.$ million)[2]						36,754

P Preliminary.
(1) Includes RM5.5 billion in borrowings by the government on behalf of the Housing Loan Department, which loans are repaid by the Housing Loan Department and not by Government funds, and RM4.1 billion in borrowings by the Government from Labuan banks.
(2) Amounts in ringgit were converted to U.S. dollars using the exchange rate of RM3.80 = U.S.$1.00.
Source: Ministry of Finance.

The following table shows estimated payments of principal to be made on the direct debt of the Government outstanding as of 31 March 2002.

Summary of direct Government debt payments

	2002	**2003**	**2004**	**2005-2008**
		(RM million)		
Repayable:				
In Malaysian ringgit	11,925	22,764	35,062	38,350
Repayable:[1]				
In U.S. Dollars	740	813	792	5,122
In Euros	1	1	1	2,175
In Japanese Yen	231	2,477	447	1,652
Other	63	63	65	105
Total foreign currency	1,035	3,354	1,304	9,054
Total	12,960	26,118	36,366	47,404

(1) Converted into ringgit at rates of exchange prevailing as of 31 March 2002.
Sources: Bank Negara Malaysia.

The following table sets out the amount of debt guaranteed by the Government on the dates indicated.

Guaranteed Government debt

	As of 31 December					As of 31 March
	1997	1998	1999	2000P	2001P	2002P
Internal (RM million)	14,204	22,733	37,184	38,935	37,123	44,590
External (U.S.$ million)	2,341	2,508	2,868	2,941	2,790	2,751
Total (U.S.$ million)(1)						14,485

P Preliminary.
(1) Amounts in ringgit were converted to U.S. dollars using the exchange rate of RM3.80 = U.S.$1.00.
Source: Ministry of Finance.

Privatisation

Malaysia's privatisation policy was first implemented by the Government in 1983, at the time when the Government was looking for an effective policy instrument to stimulate further economic growth. The privatisation policy was adopted with the following objectives:

- facilitate economic growth through higher investment from the private sector;
- relieve the financial and administrative burden of Government;
- improve efficiency and productivity of Government enterprises;
- reduce the size and presence of the public sector in the economy; and
- help meet the restructuring objective of the National Development Policy.

To facilitate and accelerate the implementation of the privatisation programme, the Government introduced the Privatisation Master Plan in 1991. In connection with the Master Plan, the Government prepared the Privatisation Action Plan to ensure that privatisation plans were undertaken in a systematic and organised manner. Since 1983, a total of 472 projects have been privatised. Of this number, 347 projects represent the privatisation of existing entities and activities while the remaining 125 represent new projects. The Government has received proceeds of RM24.1 billion from sales of equity and assets of privatised projects and entities. Major projects privatised include the North-South Highway, the Express Rail Link from Kuala Lumpur to the Kuala Lumpur International Airport, the Light Rail Transit Systems in Kuala Lumpur, the Second Link from Johor to Singapore and the National Sports Complex.

Government entities have primarily been privatised through divestment of shares either by way of private placements or through listings on the KLSE. Through December 2000, a total of 40 privatised companies have been listed on the KLSE. Among major companies which have been fully or partially privatised are Telekom Malaysia Berhad, Tenaga Nasional Berhad, Heavy Industries Corporation of Malaysia Berhad and Malaysia Airports Holdings Berhad. Other modes of privatisation have included sales of assets, build-operate-transfer, build-operate-own and build-transfer arrangements, asset leases, management contracts and management buy-outs. On 24 May 2001, the Government signed an agreement with PhileoAllied Berhad, which resulted in a reverse takeover of Pos Malaysia Berhad, the Government's postal service. As a result, Pos Malaysia is now a listed company on the KLSE under PhileoAllied Berhad, in which the Government is, directly and indirectly, the largest and controlling shareholder. See "*Malaysia—The Country—Government—Recent Developments*".

Privatisation has played an important role in accelerating economic growth through increased private sector participation, which has led to corporate expansion, and through the generation of multiplier effects in the economy. Since inception of the programme in 1983 through year-end 2000, the Government has saved approximately RM123.6 billion and RM7.6 billion in capital expenditures and operating expenditures, respectively, although the programme is intended to relieve the financial and administrative burden of the Government in providing and maintaining services and not to generate revenue for the Government. The implementation of the privatisation programme has also reduced the administrative burden of the Government in terms of recruitment, promotion and training of personnel. From 1983 through 2001, a total of 110,394 public sector employees were transferred to the private sector.

In line with the objectives of the New Economic Policy and the National Development Policy, the privatisation programme enabled the Government to increase participation of Bumiputeras in the corporate sector through equity participation in privatised companies. The privatisation policy provides that Bumiputeras should hold a minimum of 30% equity in all privatised entities. Bumiputera ownership in privatised entities has also increased through the participation of trust agencies such as the National Equity Corporation (Permodalan Nasional Berhad) and management buy-outs of existing Government entities.

The Eighth Malaysia Plan, which covers the five-year period from 2001 through 2005, continues the privatisation programme as it has contributed to increased efficiency and productivity of the privatised entities. Emphasis will be given to viable projects that have a high multiplier effect and which meet the Government's social objectives. The Government intends to streamline the implementation process and the regulatory framework to further ensure the effectiveness of the privatisation programme.

Balance of Payments

The following tables set out the balance of payments (net) in ringgit and in U.S. dollars for the periods indicated.

Balance of Payments (net) (RM)

	1997	1998
	(RM million)	
Merchandise balance (f.o.b.)[1]	10,273	69,216
Balance on services	(22,795)	(22,239)
Balance on goods and services	(12,521)	46,977
Unrequited transfers	(4,176)	(9,583)
Balance on current account	(16,697)	37,394
Long-term capital inflows	19,095	10,627
Official	4,645	2,137
Private	14,450	8,490
Basic balance	2,398	48,021
Short-term capital inflows	(12,913)	(20,633)
Errors and omissions[2]	(377)	12,913
Overall balance of payments	(10,892)	40,301

(1) The merchandise balance differs from the trade balance in the table under "*- External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to an f.o.b. basis under merchandise balance; and (c) merchandise balance data include military goods which are not included in trade data.

(2) Includes gains or losses, except for 1997, on the revaluation of all assets and liabilities in foreign currencies into ringgit at rates of exchange prevailing on BNM's balance sheet date of year-end in connection with the depreciation/appreciation of the ringgit. The exchange gain of RM24.6 billion in 1997 from the revaluation of foreign assets and liabilities was only recognised in BNM's balance sheet in 1998.

Source: Department of Statistics, Malaysia.

Balance of Payments[1] (net) (RM)

	1999	2000	2001[P]
		(RM million)	
Goods[2]	86,049	79,247	69,854
Services	(10,701)	(11,212)	(8,366)
Balance on goods and services	75,348	68,035	61,488
Income	(20,886)	(28,554)	(25,623)
Current transfers	(6,567)	(7,523)	(8,178)
Balance on current account	47,895	31,958	27,687
Capital account	—	—	—
Financial account	(25,152)	(23,848)	(14,791)
Direct investment	9,397	6,694	1,091
Portfolio investment	(4,392)	(9,395)	(2,466)
Other investment	(30,157)	(21,147)	(13,416)
Official sector	6,697	3,936	7,114
Private sector	(36,854)	(25,083)	(20,530)
Errors and omissions	(4,924)	(11,813)	(9,234)
Overall balance	17,819	(3,703)	3,662

P Preliminary.
(1) From the first quarter of 2001, the balance of payments is compiled in conformity with the guidelines set forth in the Fifth Edition of the Balance of Payments Manual of the International Monetary Fund. The merchandise line item has been reclassified as the goods balance; line items previously presented as the long-term capital inflows and short-term capital inflows are now combined as one line item under the financial account; and the balance on services line item is now broken out to two line items, services and income. Data for 1999 and 2000 have also been reclassified based on these guidelines. Data for prior periods contained in the previous table have not been so reclassified, and, therefore, are not comparable in several respects to the data in this table.
(2) The goods balance differs from the trade balance in the table under "- *External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to an f.o.b. basis under goods balance; and (c) goods balance data include military goods which are not included in trade data.
Source: Department of Statistics, Malaysia.

Balance of Payments (net) (U.S.$)

	1997	1998
	(U.S.$ million)[1]	
Merchandise balance (f.o.b.)[2]	3,652	17,649
Balance on services	(8,103)	(5,671)
Balance on goods and services	(4,451)	11,979
Unrequited transfers	(1,484)	(2,444)
Balance on current account	(5,935)	9,535
Long-term capital inflows	6,788	2,710
Official	1,651	545
Private	5,136	2,165
Basic balance	852	12,245
Short-term capital inflows	(4,590)	(5,261)
Errors and omissions	(2,255)	(2,524)
Overall balance of payments	(5,993)	4,460
RM/U.S.$1.00 (Average customer rate)	2.8132	3.9217

(1) Malaysia's balance of payments accounts are recorded in ringgit. The U.S. dollar amounts in the table reflect the ringgit amounts converted to U.S. dollars at the annual average exchange rate for the relevant year.
(2) The merchandise balance differs from the trade balance in the table under "- *External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to a f.o.b. basis under merchandise balance; and (c) merchandise balance data include military goods which are not included in trade data.
Source: Department of Statistics, Malaysia.

Balance of Payments[1] (net) (U.S.$)

	1999	2000	2001[P]
	(U.S.$ million)[2]		
Goods[3]	22,644	20,854	18,383
Services	(2,816)	(2,951)	(2,202)
Balance on goods and services	19,828	17,904	16,181
Income	(5,496)	(7,514)	(6,743)
Current transfers	(1,728)	(1,980)	(2,152)
Balance on current account	12,604	8,410	7,286
Capital account	—	—	—
Financial account	(6,619)	(6,276)	(3,892)
Direct investment	2,473	1,762	287
Portfolio investment	(1,156)	(2,472)	(649)
Other investment	(7,936)	(5,565)	(3,531)
Official sector	1,762	1,036	1,872
Private sector	(9,698)	(6,601)	(5,403)
Errors and omissions	(1,296)	(3,109)	(2,430)
Overall balance	4,689	(974)	964

P Preliminary.
(1) From the first quarter of 2001, the balance of payments is compiled in conformity with the guidelines set forth in the Fifth Edition of the Balance of Payments Manual of the International Monetary Fund. The merchandise line item has been reclassified as the goods balance; line items previously presented as the long-term capital inflows and short-term capital inflows are now combined as one line item under the financial account; and the balance on services line item is now broken out to two line items, services and income. Data for 1999 and 2000 have also been reclassified based on these guidelines. Data for prior periods contained in the previous table have not been reclassified, and, therefore, are not comparable in several respects to the data in this table.
(2) The balance of payments accounts are recorded in ringgit. The U.S. dollar amounts in the table reflect the ringgit amounts converted to U.S. dollars at the annual average exchange rate for the relevant year.
(3) The goods balance differs from the trade balance in the table under "- *External Trade*" in the following ways: (a) the gross exports data under trade balance are adjusted to exclude cross-border transactions between residents; (b) gross imports data are presented on a c.i.f. basis under trade balance and are adjusted to an f.o.b. basis under goods balance; and (c) goods balance data include military goods which are not included in trade data.
Source: Department of Statistics, Malaysia.

In 1998, the current account turned around to record the first surplus since 1989, amounting to RM37.4 billion or U.S.$9.5 billion (compared to a deficit in 1997 of RM16.7 billion or U.S.$5.9 billion). The current account surplus amounted to 14% of GNP in 1998 compared to a deficit of 6.3% of GNP in 1997. The surplus reflected the rapid decline in imports and the increase in exports of electronic equipment and parts in the fourth quarter of 1998. The resulting large surplus in the merchandise account more than offset both the services account deficit and the large outflows on the transfers account. In 1998, the deficit in the transfers account increased to RM9.6

billion compared to RM4.2 billion in 1997, reflecting mainly the one-time lump-sum repatriation made by the higher number of foreign workers returning to their home country. Weakening investor sentiment towards emerging markets, including Malaysia, resulted in a decline in long-term capital inflows in 1998. Nevertheless, Malaysia continued to receive loans from the World Bank and bilateral lenders, especially Japan. Reflecting the above developments, the basic balance recorded a surplus of RM48 billion in 1998 compared to RM2.4 billion in 1997. The short-term capital account recorded a significant outflow of RM20.6 billion reflecting the decline in short-term debt of the commercial banks and portfolio outflows. After adjusting for errors and omissions of RM12.9 billion, reflecting mainly the exchange rate gain for 1997 and 1998 from the revaluation of international reserves, the overall balance of payments reverted to a surplus of RM40.3 billion in 1998, compared to a deficit of RM10.9 billion in 1997.

In 1999, the current account recorded a surplus of RM47.9 billion (U.S.$12.6 billion) or 17.1% of GNP compared to a surplus of RM37.4 billion (U.S.$9.5 billion) or 14% of GNP in 1998. The larger current account surplus in 1999 reflected an increase in the trade balance. Higher export receipts in 1999 were mainly due to an increase in volume, as export prices in U.S. dollar terms continued to decline, albeit more moderately. The recovery of export growth was broad-based, covering both the resource based and non-resource based industries. The exports of electronics products recorded strong growth of 26.9%. Meanwhile, gross imports increased by 8.9% in 1999 in line with the output expansion connected to the recovery in exports and domestic demand. The resulting surplus in the merchandise account more than offset both the services and income accounts deficit and the continued net outflow on the transfer account.

Beginning from the first quarter of 2001, Malaysia began compiling its balance of payments in conformity with the guidelines set forth in the Fifth Edition of the Balance of Payments Manual of the International Monetary Fund and reclassified data for 1999 and 2000 based on these guidelines. Among other changes, line items previously presented as the long-term capital inflows and short-term capital inflows are now combined as one line item under the financial account.

The financial account recorded a larger net outflow of RM25.2 billion in 1999 due mainly to the significant net outflow of portfolio investment (RM4.4 billion) following the expiry of the 12-month holding period of portfolio investment, and other investment of the private sector (RM36.9 billion). Higher outflow in other investment reflected mainly the decline in net external liabilities of the commercial banks, significant repayment of short-term debt by the non-bank private sector and increase in trade credits due to higher interest rates abroad. Reflecting the improvement in access to long-term funds from the international markets, the official sector recorded a net inflow of RM6.7 billion in 1999. Direct investment also increased significantly to RM9.4 billion, reflecting a higher inflow of direct investment in Malaysia of RM14.8 billion.

Taking into account the above and after adjusting for errors and omissions of RM4.9 billion, the overall balance of payments recorded an overall surplus of RM17.8 billion, in 1999, compared to a surplus of RM40.3 billion in 1998.

In 2000, the current account recorded a surplus of RM32 billion (U.S.$8.4 billion) or 10.2% of GNP, compared to a surplus of RM47.9 billion (U.S.$12.6 billion) or 17.1% of GNP in 1999. The surplus reflected the goods account surplus of RM79.2 billion which more than offset the services and income accounts deficit of RM11.2 billion and RM28.6 billion, respectively, and net outflow on the transfer account of RM7.5 billion.

The financial account continued to record a net outflow amounting to RM23.8 billion, reflecting mainly an increase in the external assets of commercial banks, outflows of portfolio capital, repayment of short-term external debt, increase in trade credit extended to foreign importers as well as maintenance of export proceeds abroad up to the maximum six-month period from the date of exports. The official sector recorded a lower net inflow of RM3.9 billion due to higher repayment of external borrowings, while direct investment recorded a lower net inflow of RM6.7 billion due mainly to higher direct investment abroad by Malaysian companies.

Errors and omissions amounted to RM11.8 billion in 2000, reflecting a revaluation book loss of RM5.3 billion due to the appreciation of the U.S. dollar against the major currencies. Excluding the book loss, the errors and omissions of RM6.5 billion reflects the normal errors and inconsistencies that occur in the course of compilation of the balance of payments statistics. After adjusting for errors and omissions, the overall balance of payments recorded a deficit of RM3.7 billion, compared to a surplus of RM17.8 billion in 1999.

The current account of the balance of payments continued to record a surplus of RM27.7 billion or 9% of GNP in 2001, as compared to RM32 billion or 10.2% of GNP in 2000. The surplus reflected a goods account surplus of

RM69.9 billion, which more than offset the services and income accounts deficit of RM8.4 billion and RM25.6 billion, respectively, and net outflow on the current transfers account of RM8.2 billion.

The financial account recorded a substantially lower net outflow of RM14.8 billion in 2001, as compared to a net outflow of RM23.8 billion in 2000. The improvement in the financial account was mainly due to lower outflows of portfolio investment. The reduction in interest rates abroad and favourable interest rate differentials after September 2001 also resulted in lower trade credits and decline in net external assets of the banking institutions in the second half of the year. Direct investment in Malaysia declined to RM2.1 billion in 2001, due to the worldwide economic slowdown and global excess capacity as well as the sale of strategic interests by non-resident investors in one services company to Malaysian residents in the fourth quarter (see "*The Economy – Foreign Investment*"). Direct investment abroad also declined to RM1 billion. Errors and omissions amounted to RM9.2 billion, reflecting a revaluation book loss of RM4.1 billion due to the appreciation of the U.S. dollar against the major currencies. After adjusting for errors and omissions, the overall balance of payments recorded a surplus of RM3.7 billion, compared to a deficit of RM3.7 billion in the corresponding period of 2000.

External Trade. The following table sets out selected information with respect to external trade for the periods indicated.

External trade

	1997	1998	1999	2000	2001[P]	First four months of 2002[P]
			(RM million)			
Gross exports (f.o.b.)	220,890	286,563	321,560	373,270	334,420	111,587
% change	12.1	29.7	12.2	16.1	(10.4)	(1.7)[1]
Gross imports (c.i.f.)	220,936	228,125	248,477	311,459	280,691	96,173
% change	12.0	3.3	8.9	25.3	(9.9)	0.5[1]
Trade balance	(45)	58,439	73,083	61,811	53,729	15,414
			(U.S.$ million)[2]			
Gross exports (f.o.b.)	78,745	73,278	84,621	98,229	88,005	29,365
% change	0.5	(6.9)	15.5	16.1	(10.4)	(1.7)[1]
Gross imports (c.i.f.)	79,036	58,293	65,389	81,963	73,866	25,309
% change	0.8	(26.2)	12.2	25.3	(9.9)	0.5[1]
Trade balance	(291)	14,985	19,232	16,266	14,139	4,056

P Preliminary.
(1) Percentage change represents change compared to the first four months of 2001.
(2) 1997-1998 amounts were converted to U.S. dollars at the monthly average exchange rate (the total amount in U.S. dollars for the year represents the sum of the monthly totals). Amounts for 1999-2001 are converted at an exchange rate of RM3.80 = U.S.$1.00.
Source: Department of Statistics, Malaysia.

The trade balance (exports f.o.b. less imports c.i.f.) registered a marginal deficit of RM45 million in 1997, which was a marked improvement over the deficit of RM254 million in the preceding year. By the end of 1998, the trade balance yielded a surplus of RM58.4 billion, exceeding the previous high of RM13.3 billion recorded in 1987. For 1999, the surplus reached a new high of RM73.1 billion. In 1998, export receipts grew by 29.7% in ringgit terms to reach RM286.6 billion, due in large part to the depreciation of the ringgit against most major currencies, especially the U.S. dollar. In 1999, export receipts recorded a more moderate 12.2% growth in ringgit terms, mainly attributable to the expansion in manufacturing and mineral exports and a decline in agricultural exports. In U.S. dollar terms, gross exports increased by 15.5%. In U.S. dollar terms, gross imports in 1998 declined by 26.2%, reflecting the sharp contraction in domestic demand. However, in 1999 gross imports increased by 12.2% in tandem with the recovery in export and domestic demand.

The trade account remained favourable in 2000, recording a surplus for the third consecutive year due to strong external demand for electronics and electrical products and other manufactured products. The trade surplus was RM61.8 billion in 2000.

In 2001, the trade account recorded a surplus of RM53.7 billion. Exports declined by 10.4% in 2001, attributable to the contraction in manufactured exports as well as lower primary commodities exports. Imports also declined by 9.9% due primarily to lower imports of intermediate goods in response to weak external demand for manufactured exports.

In the first four months of 2002, the trade account recorded a surplus of RM15.4 billion compared to the surplus of RM17.8 billion recorded in the corresponding period in 2001. Exports declined by 1.7%, due mainly to a decline in manufactured exports while imports increased by 0.5%.

Gross Exports. The following table sets out selected information with respect to gross exports for the manufacturing, agriculture and minerals sectors for the periods indicated.

Gross exports

	1997	1998	1999	2000	2001	2001	First four months of 2002[P]
			(RM million)			(% share)	(RM million)
Manufacturing sector	178,945.1	237,648.9	271,730.2	317,908.3	285,316.2	85.3	95,153.3
Electronics and electricals	119,025.0	161,732.6	195,047.2	230,429.3	200,307.2	59.9	67,922.2
Semiconductors	40,887.2	54,482.6	65,485.4	71,110.8	60,530.0	18.1	20,550.2
Electronic equipment and parts	39,888.6	59,692.0	79,400.0	95,680.1	79,101.8	23.7	29,862.0
Consumer electrical products	17,777.0	20,647.8	21,728.2	26,490.3	23,591.2	7.1	6,568.3
Industrial and commercial electrical	12,001.4	15,065.0	16,497.6	23,660.7	23,518.4	7.0	6,388.6
Electrical industrial machinery	7,738.6	10,973.8	11,106.6	12.584.6	12,461.6	3.7	4,194.0
Household electrical appliances	732.2	871.4	829.4	902.8	1,104.2	0.3	359.1
Transport equipment	4,959.2	8,063.6	5,113.8	2,902.8	2,426.6	0.7	1,212.1
Textiles, clothing and footwear	7,616.2	9,441.6	9,466.9	10,433.4	9,054.2	2.7	2,496.4
Wood products	6,489.7	5,981.7	6,984.3	6,801.3	6,016.8	1.8	1,827.0
Rubber products	3,959.0	5,739.0	5,060.5	4,695.0	4,466.4	1.3	1,473.6
Chemicals and chemical products	8,137.3	10,627.0	11,105.1	15,011.3	14,879.2	4.4	5,104.6
Manufactures of metal	5,661.4	8,255.4	7,861.6	8,617.8	8,691.9	2.6	2,664.3
Optical and scientific equipment	3,912.4	4,760.3	4,833.5	6,824.7	7,801.5	2.3	2,452.9
Agriculture sector	23,139.7	30,201.2	27,672.5	23,013.9	19,966.2	6.0	6,942.1
Rubber	2,970.7	2,828.8	2,343.5	2,571.3	1,886.4	0.6	637.5
Saw logs	2,345.8	1,865.7	2,662.6	2,489.0	1,522.7	0.5	437.4
Sawn timber	2,775.5	2,525.7	2,806.6	3,020.4	2,273.4	0.7	686.9
Palm oil, crude and processed	10,817.0	17,779.0	14,475.2	9,948.0	9,876.2	3.0	3,721.3
Minerals	15,442.0	14,873.5	17,198.0	26,811.2	23,445.0	7.0	7,380.6
Tin	477.4	484.6	490.7	434.7	460.8	0.1	155.3
Crude petroleum	7,068.6	7,509.8	9,305.9	14,240.9	11,117.7	3.3	3,348.5
Liquefied natural gas	6,485.4	5,981.3	6,348.6	11,422.5	11,342.1	3.4	3,674.4
Other exports	3,363.6	3,839.5	4,959.0	5,537.0	5,692.9	1.7	2,110.9
Total	220,890.4	286,563.1	321,559.6	373,270.4	334,420.2	100.0	111,586.9

P Preliminary.
Source: Department of Statistics, Malaysia.

In 1997, the impact of the depreciation of the ringgit differed among sectors. In the commodities sector, export performance in 1997 was constrained by supply bottlenecks as a result of which the sector could not take full advantage of the depreciation of the ringgit in the second half of the year. In the manufacturing sector, exchange rate factors helped to improve the competitive position of some industries. Total export volume of manufactured goods in 1997 expanded by 10.4% and was more than sufficient to offset the decline in U.S. dollar export prices of 8.4%.

Export earnings in ringgit terms rose by 29.7% in 1998, reflecting increases in the exports of manufactured goods (32.8%) and commodities (16.8%) mainly as a result of valuation gains from the ringgit depreciation. However, export receipts in U.S. dollar terms contracted by 6.9%, as the marginal increase in the export volume was offset by the relatively sharper slide in U.S. dollar export prices. Despite recording lower earnings in U.S. dollar terms, manufactured exports remained the major contributor of foreign exchange earnings, accounting for 82.9% of total gross exports compared to 81% in 1997. Reflecting mainly the strong export growth of the electronic equipment and parts subsector, gross exports increased by 5.2% in the fourth quarter of 1998, reversing the declines experienced during the first three quarters of 11.4%, 10.1% and 10.9%.

In 1999, manufactured exports in U.S. dollar terms increased by 17.6%, reflecting mainly higher exports of electronic goods, electrical products, wood products, non-metallic mineral products, furniture products, petroleum products and chemical products. Exports of commodities in U.S. dollar terms increased by 2.7%. The strong expansion in exports of minerals was moderated by lower export proceeds from the agricultural sector.

Exports of manufactured goods remained strong, rising by 17% in 2000. Growth was supported by sustained demand from the major industrial countries and economies in the region. Growth was broad-based, emanating from increased exports of electronic goods, electrical products, furniture, chemical products and petroleum products. Export proceeds from the commodities sector also rose by 11% in 2000 on account of higher mineral exports, benefiting largely from higher crude oil prices. Agricultural exports fell during this period due mainly to lower palm oil prices caused by abundant global supplies of vegetable oils.

The slowdown in global demand, especially in the United States, combined with the more severe downturn in the global electronics sector, affected the performance of manufactured exports in 2001. As a result, exports of manufactured goods declined by 10.3%, with both the electronics and non-electronic subsectors experiencing negative export growth of 16.3% and 3.6%, respectively. Despite the decline in export sales, manufactured exports continued to remain the largest foreign exchange earner, accounting for 85.3% of total gross exports.

Exports of primary commodities declined by 12.9% in 2001 compared to an increase of 11% in 2000 due to both lower agriculture (13.2%) and mineral (12.6%) exports. The decline in agriculture exports was due to lower exports of all major commodities, namely, palm oil, rubber, sawn timber and saw logs. In particular, the decline in palm oil exports was due entirely to lower export prices caused by global oversupply of vegetable oils. In the case of mineral exports, the decline was due to lower exports of crude oil and liquefied natural gas.

In the first four months of 2002, exports of manufactured goods recorded a smaller contraction of 1.5%, compared to a decline of 12.4% in the fourth quarter of 2001, amidst improving external demand conditions. This improvement was due mainly to an upturn in exports in the electronics industry, which benefited from a diversified export base.

In the first four months of 2002, exports of primary commodities fell by 8% due to the decline in mineral exports by 19.1% compared to the corresponding period in 2001, following the decline in crude oil prices. In contrast, exports of agriculture commodities increased by 7.6%, mainly as a result of higher palm oil exports.

The following table sets out gross imports by end use for the periods indicated.

Gross imports by end use

	1997	1998	1999	2000	2001P	2001P	First three months of 2002P
			(RM million)			(% share)	(RM million)
Capital goods	42,823	35,392	31,874	44,171	43,708	15.7	10,233
Capital goods (except transport equipment)	34,375	28,826	28,385	41,899	41,033	14.7	9,175
Industrial machinery and equipment	14,607	10,965	10,170	15,141	12,253	4.4	1,463(1)
Others	19,768	17,861	18,215	26,758	28,780	10.3	7,712
Transport equipment	8,448	6,566	3,490	2,272	2,675	1.0	1,058
Intermediate goods	145,642	161,066	183,619	232,687	201,812	71.9	50,038
Food and beverages, mainly for industry	3,260	4,167	4,001	3,836	4,236	1.5	1,176
Industrial supplies, not elsewhere specified	54,967	50,451	58,836	68,403	62,970	22.4	14,626
Metals	14,694	11,855	14,282	15,121	14,183	5.1	2,424(1)
Others	40,273	38,596	44,554	53,282	48,787	17.4	12,201
Fuels and lubricants	4,465	4,627	5,629	12,089	11,659	4.2	2,428
Parts and accessories of capital goods (except transport equipment)	79,543	99,856	112,320	144,232	117,484	41.9	30,206
Electronics	45,784	64,202	74,287	94,406	76,341	27.2	12,950.1(1)
Others	33,759	35,655	38,033	49,826	41,143	14.7	17,256
Parts and accessories of transport equipment	3,407	1,967	2,833	4,127	5,643	1.9	1,602
Consumption goods	14,011	12,683	14,828	17,040	17,466	6.2	4,299
Food and beverages, mainly for household consumption	5,590	5,674	6,057	6,459	7,177	2.6	1,753
Transport equipment, non-industrial	179	36	90	97	123	—	35
Consumer goods, not elsewhere specified	8,242	6,972	8,682	10,484	10,167	3.6	2,511
Consumer durables	1,446	1,023	1,571	2,022	2,150	0.8	549
Consumer semi-durables	3,202	2,688	3,212	4,366	3,589	1.3	938
Consumer non-durables	3,595	3,262	3,899	4,096	4,428	1.6	1,024
Dual use goods	6,220	3,828	4,934	6,393	5,841	2.0	1,385
Motor spirit	1,878	2,288	1,630	2,469	2,462	0.8	547
Passenger motor cars	4,342	1,540	3,304	3,924	3,379	1.2	838
Others	4,813	4,247	4,415	4,650	5,073	1.8	1,532
Retained imports	213,509	217,216	239,671	304,941	273,900	97.6	67,486
Re-exports	7,426	10,909	8,806	6,518	6,791	2.4	1,673
Gross Imports	220,936	228,125	248,477	311,459	280,691	100.0	69,160

P Preliminary.
(1) First two months of 2002.
Source: Department of Statistics, Malaysia.

In 1998, the weak growth in gross imports of 3.3% reflected both declines in volume and lower international prices for most major import commodities, which largely offset the valuation impact of the depreciation of the ringgit. Import volume was estimated to be lower by about 19.9%, while import prices in U.S. dollar terms declined by 7.9%. As a result, gross imports during 1998 in U.S. dollar terms were lower by 26.2% compared to an increase of 0.8% during 1997. The decline in the import volume reflected weak domestic demand conditions, as well as the reduction in imports of inputs for manufacturing exports in response to the less favourable export environment. The postponement of non-critical infrastructure and other large projects by both the public and private sectors also contributed to the reduction in imports.

In 1999, gross imports in U.S. dollar terms grew at a stronger rate of 12.2% due to higher imports of intermediate goods. Imports of consumption goods and dual-use goods also grew strongly, reflecting the recovery in private consumption expenditure. The more gradual recovery of private investment and the low import content of public investment led imports of capital goods to continue to decline by 9.2% in 1999.

In 2000, gross imports increased by 25.3% due to strong demand for intermediate goods and capital goods, mainly for the export sector.

In 2001, imports declined by 9.9%, reflecting mainly lower imports of intermediate goods in response to weaker external demand. Imports of capital goods declined marginally following the decline in private investment.

In the first three months of 2002, imports declined by 5%, reflecting lower imports of intermediate goods related to the manufacture of goods for the export market. Imports of capital goods declined following the decline in private investment.

Direction of Trade. The following table sets out information on the direction of external trade for the periods indicated.

Direction of external trade[(1)]

	2000		2001P		2001P		First three months of 2002P	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
	(RM million)		(RM million)		(% share)		(RM million)	
Selected Southeast Asian trading partners countries total	97,872	74,612	83,107	63,168	24.9	22.5	21,203	15,429
Singapore	68,574	44,696	56,669	35,313	16.9	12.6	14,064	8,101
Thailand	13,485	11,987	12,768	11,121	3.8	4.0	3,631	2,781
Indonesia	6,484	8,623	5,940	8,517	1.8	3.0	1,568	2,055
Philippines	6,558	7,562	4,892	6,989	1.5	2.5	1,241	2,171
Brunei Darussalam	965	13	1,037	19	0.3	–	206	3
Vietnam	1,806	1,731	1,801	1,208	0.5	0.4	492	318
Japan	48,770	65,513	44,503	54,001	13.3	19.2	10,318	12,638
People's Republic of China	11,507	12,321	14,520	14,457	4.3	5.2	4,191	5,029
Hong Kong SAR	16,854	8,557	15,299	7,191	4.6	2.6	4,002	1,681
Taiwan	14,189	17,511	12,117	15,932	3.6	5.7	3,103	3,793
South Korea	12,464	13,926	11,157	11,240	3.3	4.0	2,917	3,441
India	7,312	2,748	5,993	2,935	1.8	1.0	1,232	643
Other Far East countries	1,181	332	1,034	379	0.3	0.1	312	87
Australia	9,210	6,052	7,798	5,944	2.3	2.1	1,711	1,258
New Zealand	1,353	1,140	1,128	1,300	0.3	0.5	300	273
United States	76,579	51,744	67,672	44,841	20.2	16.0	16,660	12,015
Canada	3,043	1,445	2,079	1,134	0.6	0.4	410	270
European Union total	51,019	33,527	45,502	36,075	13.6	12.9	10,688	7,929
United Kingdom	11,566	6,080	8,779	6,872	2.6	2.4	1,966	1,494
Germany	9,336	9,282	7,767	10,415	2.3	3.7	1,710	2,455
Netherlands	15,616	2,197	15,439	2,466	4.6	0.9	3,728	488
Others	14,501	15,968	13,517	16,322	4.1	5.9	3,284	3,492
Other Western European countries[(2)]	1,702	4,196	2,606	4,037	0.8	1.4	521	810
Russia	282	728	496	517	0.1	0.2	163	76
East European countries[(3)]	1,207	721	1,729	601	0.5	0.2	409	183
Rest of the world	18,725	16,387	17,721	16,939	5.3	6.0	4,350	3,605
Total	373,270	311,459	334,420	280,691	100.0	100.0	82,488	69,160

P Preliminary.
(1) Exports are valued on an f.o.b. basis and imports on a c.i.f. basis.
(2) Including Gibraltar, Greenland, Iceland, Malta, Monaco, Norway, Switzerland and Turkey.
(3) Including Bulgaria, the Czech Republic and Slovakia, Poland and Yugoslavia.
Sources: Department of Statistics, Malaysia.

During the period 1997 to 2000, Japan, the United States and Singapore have consistently been the largest export markets and the major suppliers of imported goods to Malaysia. The double-digit growth in exports and the recovery of imports in 2000 led to a 20.3% expansion in Malaysia's total trade to RM686 billion or 220% of GNP in 2000. Since 1997, the United States has displaced Japan to become Malaysia's largest trading partner and, in 2000, it accounted for 18.7% of total trade, followed by Japan (16.7%) and Singapore (16.5%). These three countries accounted for 51.9% of total trade in 2000. In terms of import origin, Japan and the United States continued to be the largest sources of imports (21.1% and 16.6%, respectively), followed by Singapore (14.3%).

In 2000, the bilateral trade surplus remained in Malaysia's favour. Malaysia continued to record large trade surpluses with the United States, Singapore, the European Union (mainly the Netherlands, the United Kingdom and Germany), Hong Kong SAR and Australia. Meanwhile, the persistent trade deficit with Japan remained. As importers continued to source inputs from lower cost suppliers, Malaysia experienced a trade deficit with the People's Republic of China, the Philippines and Indonesia.

In 2001, Malaysia continued to record large trade surpluses with the United States, Singapore, the European Union (mainly the Netherlands, the United Kingdom and Belgium), Hong Kong SAR and India. The trade deficit with Japan remained, while the trade deficit with China turned into a small surplus. Malaysia continued to experience a trade deficit with the Philippines and Indonesia.

In the first three months of 2002, Malaysia recorded large trade surpluses with the United States, Singapore, the European Union (mainly the Netherlands and the United Kingdom), Hong Kong SAR, India and Australia. During this period, Malaysia experienced a trade deficit with Japan, China, the Philippines and Indonesia.

International Reserves

The following tables set out the net international reserves of BNM, in ringgit and U.S. dollars, as of the dates indicated.

Net international reserves of BNM (RM)

	As of 31 December					As of [15] [31] May
	1997	1998	1999	2000	2001	2002
	(RM million)(1)					
Special Drawing Rights	478.9	793.9	330.3	418.7	487.8	[499.5
International Monetary Fund reserve position	1,622.0	2,379.2	3,168.2	3,310.9	3,193.5	3,168.6
Gold and foreign exchange	57,032.1	96,265.0	113,766.0	109,835.4	113,542.3	120,801.2
Gross international reserves	59,133.0	99,438.1	117,264.5	113,565.0	117,223.6	124,469.2
External liabilities	(10.2)	(13.7)	(21.0)	(23.7)	(20.7)	(21.5)
Net international reserves	59,122.8	99,424.4	117,243.5	113,541.3	117,202.9	124,447.7]

(1) In each year except 1997, external assets and liabilities were revalued at rates of exchange prevailing on the relevant BNM balance sheet date. In 1997, the foreign exchange gain on the BNM balance sheet date was not recognised in BNM's accounts in view of the volatility of the exchange rates during the year but was reflected in 1998. Since 1999, international reserves are revalued on a quarterly basis.
Source: Bank Negara Malaysia.

Net international reserves of BNM (U.S.$)

	As of 31 December					As of [15][31] May
	1997	1998	1999	2000	2001	2002
	(U.S.$ million)(1)					
Special Drawing Rights	175.8	208.9	86.9	110.2	128.4	[131.4
International Monetary Fund reserve position	595.4	626.1	833.7	871.3	840.4	833.8
Gold and foreign exchange	20,935.1	25,332.9	29,938.5	28,904.1	29,879.5	31,789.8
Gross international reserves	21,706.3	26,167.9	30,859.1	29,885.5	30,848.3	32,755.1
External liabilities	(2.6)	(3.6)	(5.5)	(6.2)	(5.4)	(5.7)
Net international reserves	21,703.7	26,164.3	30,853.6	29,879.3	30,842.9	32,749.4]

(1) Converted to U.S. dollars at the exchange rate at the end of the relevant period.
Source: Bank Negara Malaysia.

Gross international reserves of BNM, comprising gold, foreign exchange, reserve position with the IMF and holdings of Special Drawing Rights, or SDRs, declined by RM10.9 billion to RM59.1 billion at the end of 1997. The decline was primarily due to a large outflow of short-term capital estimated at RM14.1 billion, including intervention to support the ringgit exchange rate. After taking into consideration BNM's external liabilities of RM10.2 million, its net international reserves stood at RM59.1 billion at the end of 1997.

In each year between 1996 and 2001, except in 1997, external assets and liabilities were revalued at rates of exchange prevailing on the relevant BNM balance sheet date. In 1997, the foreign exchange gain on BNM's balance sheet date was not recognised in BNM's accounts in view of the volatility of the exchange rates during the year but was recognised in 1998. The gains from revaluation of international reserves amounted to RM24.6 billion in 1997. The U.S. dollar equivalent of gross reserves was U.S.$21.7 billion at end 1997, a level sufficient to finance 3.4 months of retained imports. In Special Drawing Rights terms, the international reserves held by BNM amounted to SDR16.1 billion. However, effective from 15 September 1998, following the fixing of the ringgit/U.S. dollar exchange rate at RM3.80 on 2 September 1998, all assets and liabilities in foreign currencies were revalued into ringgit at rates of exchange prevailing on the reporting date and the exchange revaluation gain has been reflected in BNM's records. Since 1999, international reserves have been revalued on a quarterly basis.

Gross international reserves declined by RM3.7 billion during 2000 to RM113.6 billion at the end of the year. After taking into consideration BNM's external liabilities of RM23.7 million, BNM's net international reserves were RM113.5 billion at the end of 2000. The U.S. dollar equivalent of gross reserves was U.S.$29.9 billion at the end of 2000. In SDR terms, the international reserves held by BNM amounted to SDR22.9 billion.

Gross international reserves increased by RM3.7 billion during 2001 to RM117.2 billion at the end of 2001, reflecting the build-up in foreign exchange holdings from trade and long-term capital inflows. After taking into consideration BNM's external liabilities of RM20.7 million, BNM's net international reserves were RM117.2 billion at the end of 2001. The U.S. dollar equivalent of gross reserves was U.S.$30.8 billion at the end of 2001. In SDR terms, the international reserves held by BNM amounted to SDR24.5 billion.

As of 31 May 2002, BNM's net international reserves had increased to RM[124.4] billion (U.S.[$32.7] billion), sufficient to finance 5.5 months of retained imports and five times Malaysia's total external short-term debt outstanding (as defined in "*The Economy—External Debt*").

Exchange Rates

Exchange Rate Policy. From September 1975 to September 1998 the exchange rate of the ringgit was monitored by BNM in terms of a representative "composite basket" of currencies based on Malaysia's major trading partners and major currencies used in international settlements. The ringgit exchange rate was determined by demand and supply factors in the Kuala Lumpur foreign exchange market. Interventions had been aimed at smoothing excessive volatility in the market and not at supporting any specific exchange rate. BNM did not enter into any forward transactions in its intervention operations.

In conjunction with the implementation of selective exchange controls, BNM departed from the prior floating exchange rate regime and, on 2 September 1998, adopted a pegged exchange rate for the ringgit of RM3.80 to U.S.$1.00. The introduction of selective exchange controls and a pegged exchange rate for the ringgit is designed to provide Malaysia with greater independence in the conduct of its domestic monetary policy as well as to protect the Malaysian economy from the potential risks and vulnerabilities of external developments in the international markets. These regulations do not affect trade or foreign direct investment, and full convertibility remains for current account transactions.

Exchange Rate Movements. For 1997 as a whole, the ringgit depreciated 31.4% against the composite basket of currencies of Malaysia's major trading partners. The depreciation of the ringgit was pronounced against all major currencies, ranging from 25% to 35%. The ringgit depreciated by 35% against the U.S. dollar, 33.7% against the pound sterling and 27.3% against the Japanese yen.

Although the continuing regional economic crisis continued to exert downward pressure on the ringgit throughout the first eight months of 1998, the introduction of the selective exchange controls and the fixed exchange rate in September 1998 largely stabilised the currency. During 1998 as a whole, the ringgit recorded a mixed performance against the major currencies, depreciating by 0.2% against the composite basket of currencies of Malaysia's major trading partners. The ringgit appreciated by 2.3% against the U.S. dollar and by 1.8% against the pound sterling. The ringgit's rise against the pound sterling reflected the dollar's strength and concerns over Britain's weaker export sector, the threat of slower economic growth and the advent of the Euro in 1999. However, the ringgit depreciated by 2.7% against the Swiss franc, 4% against the Deutsche mark and 9.7% against the Japanese yen, largely reflecting the strength of these currencies against the dollar. Against the regional currencies, the ringgit appreciated by 1.4% against the Singapore dollar and 51.5% against the Indonesian rupiah, but depreciated by 1.1% against the Philippine peso, 20.5% against the Thai baht and 27.7% against the Korean won.

In 1999, the ringgit appreciated against most major currencies, reflecting the strong performance of the U.S. dollar. The ringgit appreciated against the pound sterling (3.1%) and the Euro (17.5%). However, the ringgit depreciated by 10.7% against the Japanese yen during the year. Meanwhile, the performance of the ringgit against regional currencies in 1999 was mixed. The ringgit appreciated against the Singapore dollar, the Thai baht and the Philippine peso in the range of 0.3% to 2.4%, while depreciating against the Indonesian rupiah, Korean won and the Taiwanese dollar in the range of 2.7% to 12.2%.

In 2000, the ringgit appreciated against most major currencies as well as regional currencies in tandem with the movements of the U.S. dollar during the period. The ringgit appreciated against the pound sterling (8.3%), the Japanese yen (12.1%) and the Euro (8.5%). Domestic developments in the regional countries led the ringgit to appreciate against all regional currencies. The ringgit appreciated against the Indonesian rupiah, the Philippine peso, the Thai baht, the Singapore dollar and the Korean won in the range of 3.9% to 37.2%. In 2001, the ringgit appreciated against both the major and regional currencies. In line with the strength of the U.S. dollar, the ringgit appreciated against the Japanese yen (14.4%), the Euro (5%) and the pound sterling (2.7%). Regionally, the ringgit appreciated against regional currencies in the range of 2.1% to 8.2%, influenced mainly by domestic developments in several regional countries, as well as contagion from the weakening of the Japanese yen in the early part and towards the end of the year. For the period from 1 January 2002 to 24 May 2002, the ringgit reversed its trend and depreciated against both major and regional currencies. Reflecting the weakness of the U.S. dollar, the ringgit depreciated against the Japanese yen (4.6%), the Euro (3.7%) and the pound sterling (0.1%). The U.S. dollar was adversely affected by escalating tensions in the Middle East and by concerns over the pace of U.S. economic recovery. The ringgit also depreciated against regional currencies in the range of 1.7% to 13.9%, reflecting market optimism over growth prospects for regional economies, as well as domestic developments in these countries.

The following table shows exchange rate developments of the ringgit vis-a-vis the U.S. dollar, the Singapore dollar and the Japanese yen for the periods indicated.

Exchange rates(1)

	Ringgit Per U.S.$	Ringgit Per Singapore $	Ringgit Per 100 Yen
End of Period			
December 1997	3.8883	2.3200	2.9921
September 1998	3.8000	2.2546	2.8092
December 1998	3.8000	2.2879	3.3141
December 1999	3.8000	2.2809	3.7115
March 2000	3.8000	2.2107	3.5990
June 2000	3.8000	2.1976	3.5998
September 2000	3.8000	2.1824	3.5197
December 2000	3.8000	2.1946	3.3121
March 2001	3.8000	2.1105	3.0544
December 2001	3.8000	2.0529	2.8955
24 May 2002	3.8000	2.1117	3.0351

(1) U.S.$ rates are the average of buying and selling interbank rates at noon. Rates for the Singapore $ and Japanese yen are cross rates derived from the rates of such currencies against the U.S.$ and the RM/U.S.$ exchange rate.
Source: Bank Negara Malaysia.

Exchange Control Policy

Malaysia has historically maintained a liberal system of exchange controls. Prior to September 1998, the few exchange control rules in place were aimed at monitoring the settlement of payments and receipts for compilation of balance of payments statistics and to ensure that funds raised abroad were channelled to finance productive investments in Malaysia that either directly or indirectly generate foreign exchange. Malaysia has from time to time reviewed its exchange control rules and gradually revised the threshold amounts requiring approvals or reporting. The last major review was made in December 1994, when the key exchange control rules were further liberalised. The objectives of the liberalisation were to reduce operational costs for businesses, allow non-resident controlled companies greater access to domestic credit facilities, increase the efficiency of cross-border transactions and encourage multinational corporations to establish their operational headquarters in Malaysia.

As part of the package of policy responses to the 1997-1998 regional economic crisis, on September 1, 1998, the Government introduced selective exchange control measures. These measures were designed to eliminate the internationalisation of the ringgit to contain speculation and stabilise short-term capital flows. The internationalisation of the ringgit refers specifically to the offshore ringgit market. The offshore ringgit market encompasses all ringgit-related activities transacted outside the boundaries of Malaysia. These activities include ringgit trading and trading in derivatives on the ringgit such as options, forwards, futures and swap contracts. The offshore ringgit market also encompasses all ringgit-deposit taking and lending activities outside Malaysia. Offshore ringgit market activities take place primarily in Singapore and, to some extent, in other financial centres such as London, New York and Hong Kong. Over the years, the existence and development of offshore ringgit activities, particularly in 1998, had increasingly affected Malaysia's implementation of domestic monetary policy. In August 1997, BNM placed a U.S.$2 million limit on non-trade related ringgit offer side swap transactions that Malaysian banks could undertake with foreign customers. This measure essentially closed off this avenue as a source of funding for speculative ringgit positions. In early 1998, ringgit deposit rates in Singapore increased above 20% as speculators sought to fund their ringgit positions through the retail deposit market. The large differential between offshore and onshore ringgit deposit rates constrained BNM's ability to lower domestic interest rates, despite the fact that the Malaysian economy was in a recession.

Under the requirements announced in September 1998, external account holders who are non-resident corporations and non-resident individuals must obtain prior approval from the Controller of Foreign Exchange for transfers of funds between external accounts for uses of funds other than for permitted purposes. The requirements also stipulate that inflows of portfolio capital remain in Malaysia for a minimum period of one year before they may be repatriated, restrict the import and export of ringgit by travellers, and limit the amount of investment abroad or foreign currency that may be carried abroad by travellers. These regulations do not affect trade or foreign direct investment, and full convertibility remains for current account transactions.

The Government initiated the liberalisation of the selective exchange control measures in 1999. Effective 15 February 1999, the one-year minimum holding period was modified to allow foreign investors to repatriate principal capital and profits, subject to a graduated exit levy depending on whether the funds were brought into Malaysia before or after 15 February 1999 and the duration of the investment. This two-tier levy system provided flexibility to investors and was directed at encouraging existing portfolio investors to have a longer-term perspective of their investment in Malaysia. On 21 September 1999, a further relaxation was made when the exit levy on principal and the two-tier exit levy system were replaced by a flat levy of 10% on profits repatriated. On 1 February 2001, the levy was revised to apply only to profits made from portfolio investments retained in Malaysia for less than one year; profits retained in Malaysia for more than one year were exempt from the levy. On 2 May 2001, the Government lifted all controls affecting the repatriation of foreign portfolio funds, which stem largely from the sale of stocks listed on the KLSE.

Domestic Debt

The following table sets out information on Malaysia's outstanding domestic debt by sector and maturity length as of the dates indicated.

Domestic debt outstanding

	As of 31 December					As of 31 March
	1997	1998	1999	2000P	2001P	2002P
			(RM billion)			
Private	468.5	473.3	491.9	536.5	569.7	574.1
Loans by banking system(1)	405.1	397.9	378.9	396.7	411.8	415.9
Term loans	214.6	209.4	210.6	225.3	243.6	247.9
Medium and long-term	193.0	190.2	190.4	206.9	225.8	231.8
Short-term	21.6	19.2	20.2	18.4	17.5	16.1
Other(2)	190.5	188.5	168.3	171.4	168.5	168.0
Local currency corporate bonds(3)	63.4	75.4	113.0	139.8	158.1	158.2
Public(4)	78.9	93.1	103.1	117.2	131.4	129.5
Government						
Medium and long-term	72.7	83.9	89.4	102.5	117.1	114.7
Short-term (Treasury bills)	4.3	4.3	4.3	4.3	4.3	4.3
Khazanah bonds	1.0	4.9	9.0	10.0	10.0	10.0
Malaysia savings bonds	0.9	—	0.4	0.4	—	0.5
Total domestic debt	547.4	566.4	595.0	653.7	701.1	703.6
% of GDP	194.3	200.0	198.1	191.9	210.7	n.a.
Annual growth (%)	22.0	3.5	5.0	9.9	7.3	n.a.

P Preliminary.
(1) Excludes loans sold to Cagamas and Danaharta. Includes Islamic banks. Loans by Islamic banks have been classified under "Other" for years prior to 1999.
(2) Comprises mainly trade bills, trust receipts, overdrafts and revolving credit and foreign currency loans.
(3) Consists of corporate (including non-financial public enterprises), Cagamas, Danamodal and Danaharta bonds with an original maturity period of more than one year.
(4) Consists of Government securities, Treasury bills, Government Investment Issues, housing loans, a syndicated loan, Khazanah bonds and Malaysia savings bonds.
Sources: Ministry of Finance.
Bank Negara Malaysia.
Cagamas.
Danaharta.
Danamodal.

Total domestic debt amounted to RM701.1 billion as of 31 December 2001. The domestic debt consisted of loans extended by the banking system (RM411.6 billion excluding loans sold to Cagamas and Danaharta), private debt securities (RM158.1 billion), and public sector debt (RM131.4 billion). See "*—Financial System—Banking System Lending*" for more information on banking system loans, and see "*—Public Debt*" for more information on public sector debt. As of 31 December 2001, corporate bonds accounted for 74.4% of outstanding local currency corporate bonds, while Cagamas, Danamodal and Danaharta bonds accounted for 11.6%, 7% and 7%, respectively.

Outstanding loans of the banking system increased to RM411.6 billion as of 31 December 2001, compared with RM405.1 billion as of 31 December 1997. By type, term loans accounted for 59.1% of outstanding loans of the banking system as of 31 December 2001, while the other loans comprised mainly trade bills, trust receipts, overdrafts and revolving credit and foreign currency loans. Approximately 93% of the term loans had medium- and long-term maturities of more than one year. Local currency corporate bonds increased at an average annual rate of 31.2% since 1997 from RM63.4 billion as of 31 December 1997 to RM158.1 billion as of 31 December 2001. Meanwhile, the public sector's portion of outstanding domestic debt increased at an average annual rate of approximately 8.8% during the same period largely due to increased borrowings by the Government and the issuance of benchmark bonds by Khazanah Nasional Berhad.

The total outstanding Government debt, including external debt, remained manageable at RM147.2 billion as of 31 March 2002 compared to RM145.7 billion as of 31 December 2001 and RM125.6 billion as of 31 December 2000. Debt servicing of the Government was also low at 15.1% of operating expenditure in 2001.

External Debt

The following tables set out information on the external debt of Malaysia outstanding by sector and maturity length for the periods indicated.

External debt outstanding (RM)

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001P	2002P
	(RM million, except percentages)					
Medium and long-term debt(1)	127,500	130,872	138,750	140,345	146,491	148,649
Government	12,952	14,924	18,369	18,821	24,328	26,994
Non-financial public enterprises	52,467	53,232	56,566	58,720	66,369	66,166
Private sector	62,081	62,717	63,815	62,804	55,794	55,488
Short-term debt(2)(3)	43,257	32,149	22,393	17,470	23,911	26,935
Banking sector	32,276	20,339	12,661	9,271	11,926	15,129
Non-bank private sector	10,981	11,810	9,731	8,199	11,986	11,806
Total external debt	170,757	163,022	161,143	157,815	170,402	175,584
% GNP	64.0	60.8	57.6	50.3	55.2	n.a
% GDP	60.6	57.6	53.6	46.1	50.9	n.a
% exports of goods and services	63.4	48.9	43.3	36.4	43.0	n.a
Annual growth (%)	74.5	(4.5)	(1.2)	(2.1)	8.0	12.4
Debt service ratio (as % of exports of goods and services(4))	5.5	6.7	6.1	5.3	5.9	n.a.

External debt outstanding (U.S.$)

	As of 31 December					As of 31 March
	1997	1998	1999	2000	2001P	2002P
	(U.S.$ million, except percentages)(5)					
Medium and long-term debt(1)	32,734	34,440	36,513	36,933	38,550	39,118
Government	3,325	3,927	4,834	4,953	6,402	7,104
Non-financial public enterprises	13,470	14,008	14,886	15,453	17,466	17,412
Private sector	15,939	16,504	16,793	16,527	14,683	14,602
Short-term debt(2)(3)	11,106	8,460	5,893	4,597	6,292	7,088
Banking sector	8,287	5,352	3,332	2,440	3,183	3,981
Non-bank private sector	2,819	3,108	2,561	2,158	3,154	3,107
Total external debt	43,840	42,900	42,406	41,530	44,843	46,206
% GNP	46.2	62.8	57.6	50.3	55.2	n.a.
% GDP	43.8	59.4	53.6	46.1	50.9	n.a.
% exports of goods and services	45.8	50.5	43.3	36.4	43.0	n.a.
% Annual growth	13.5	(2.1)	(1.2)	(2.1)	8.0	12.4
Debt service ratio (as % of exports of goods and services)(4)	5.5	6.7	6.1	5.3	5.9	n.a.
RM/U.S.$ (customer rate as at end-year)	3.8950	3.8000	3.8000	3.8000	3.8000	3.8000
RM/U.S.$ (yearly average customer rate)	2.8132	3.9217	3.8000	3.8000	3.8000	3.8000

P Preliminary.
(1) Medium and long-term debt refers to debt with original maturity of more than one year.
(2) The Government has not incurred any short-term external debt.
(3) Short-term debt refers to debt with original maturity of one year or less.
(4) Measures the principal repayment, excluding prepayment, and the interest payment of the external debt as a proportion of gross exports of goods and services.
(5) Converted to U.S. dollars at the exchange rate at the end of the relevant period.
Sources Ministry of Finance.
Bank Negara Malaysia.

Malaysia's medium and long-term external debt at the end of 2000 amounted to U.S.$36.9 billion (RM140.3 billion) or 44.8% of GNP. Total external debt, including short-term external debt, of both the banks and non-bank private sector amounted to U.S.$41.5 billion (RM157.8 billion) or 50.3% of GNP. Short-term debt decreased by 22% in U.S. dollar terms and accounted for 11% of total external debt. The bulk of the short-term debt was borrowings by commercial banks related to their trade financing activities. The total debt service ratio (ratio of debt servicing to exports of goods and services) declined to 5.3% from 6.1% in 1999. On 15 September 2000 and 17 November 2000, Malaysia issued an additional U.S.$500 million (RM1.9 billion) of its 8.75% global notes due 2009 and U.S.$650 million (RM2.1 billion) of its 6.375% global notes due 2005, respectively.

Malaysia's medium- and long-term external debt at the end of 2001 was RM146.5 billion (U.S.$38.6 billion). Total external debt including short-term external debt, was RM170.4 billion (U.S.$44.8 billion). Short-term debt remained low, accounting for 14% of total external debt. The total debt service ratio (ratio of debt servicing to exports of goods and services) increased to 5.9% from 5.3% in 2000. On 9 July 2001 Malaysia issued U.S.$1 billion of 7.50% global notes due 2011, and in December 2001, it raised a syndicated loan of U.S.$540 million from offshore banks in Labuan. On 12 March 2002 Malaysia reopened the U.S.$1 billion 7.50% global notes due 2011 by an additional U.S.$750 million. Malaysia's medium- and long-term debt at the end of March 2002 was RM148.6 billion (U.S.$39.1 billion). Total external debt including short-term external debt was RM175.6 billion (U.S.$46.2 billion) at the end of March 2002.

The rules governing external borrowings by both the private and public sectors are fairly stringent. External borrowings by the Government are subject to the provisions of the External Loans Act 1963, which sets a ceiling on Government borrowings. Private sector external borrowing is governed by the Exchange Control Act 1953 and subsidiary legislation administered by BNM. BNM imposes strict prudential rules and approval is required for all foreign currency borrowings exceeding the equivalent of RM5 million by Malaysian companies (including non-financial public enterprises).

Over the past decade, the Government had selectively prepaid its more expensive external loans to contain the external debt at a manageable level and to reduce the debt servicing burden. The active refinancing programme has helped to lengthen the maturity structure of the debt profile, smooth the bunching of repayments and lower interest costs. The non-financial public enterprises and private sector were also encouraged to prepay their external debt. The Government prepaid a total of RM16.5 billion of its debt during the period 1987 to 2000, while the private sector and the non-financial public enterprises prepaid RM14.3 billion of their loans during the same period. The onset of the regional economic crisis prompted the public and private sectors to postpone certain planned prepayments and refinancing of external loans. In July 2000, several holders of U.S.$650 million (RM2,470 million) in floating rate notes issued by the Government in 1985 exercised their put option to redeem U.S.$617.2 million (RM2,345.2 million) of such notes, which the Government paid in October 2000.

Debt Record

The Government has always paid when due the full amount of principal of, interest on and amortisation or sinking fund requirements of its direct or indirect indebtedness in accordance with the terms of such indebtedness.

Litigation

In April 2001, the State Government of Terengganu, one of the states of Malaysia, filed a suit against Malaysia and Petroliam Nasional Berhad, known as Petronas, for non-payment of oil royalties since September 2000. Petronas and the Government have since applied to the High Court for certain issues of law to be determined as preliminary issues prior to a full hearing on the case. If the court decides the preliminary issues in their favour, the Government and Petronas intend to seek a consequential order to strike the suit. The application for a preliminary determination of the issues was heard by the High Court on 18 February 2002, and counsel for Petronas argued at the hearing that no witness needed to be called to testify since the suit involved only the interpretation of several documents and treaties signed in the course of the unification of all the states of Malaysia. The State Government of Terengganu, on the other hand, argued for a full trial on the grounds that the issues pertaining to the case can only be advanced in a full trial. The parties submitted written arguments on the application to the High Court in March 2002. No date for a decision on the application has yet been fixed.

Malaysia is from time to time involved in other litigation or international arbitration, none of which it considers to be material.

CERTAIN TAX CONSIDERATIONS

United States Federal Income Taxation

General

The following is a summary of certain United States ("**U.S.**") federal income tax considerations that may be relevant to a holder of a Certificate that is a citizen or resident of the U.S. or a domestic corporation or that otherwise is subject to U.S. federal income taxation on a net income basis in respect of a Certificate (a "**United States holder**"). This summary does not describe any tax consequences arising under the laws of any taxing jurisdiction other than the income tax laws of the U.S. federal government. This summary is based on laws, regulations, rulings and decisions in effect as of the date hereof, all of which are subject to change, which change could apply retroactively and could affect the tax consequences described below. This summary deals only with United States holders that acquire the Certificates at original issuance and that will hold Certificates as capital assets and does not address tax considerations applicable to investors that may be subject to special tax rules, such as banks, financial institutions, regulated investment companies, tax-exempt entities, insurance companies, dealers or traders in securities or currencies, U.S. branch operations of foreign corporations, holders that are subject to the mark to market rules, persons that will hold Certificates as a position in a hedging, "straddle" or conversion transaction, or as part of a "synthetic security" or other integrated financial transaction, persons that have a "functional currency" other than the U.S. dollar or persons who hold Certificates through a partnership or other pass-through entity. Furthermore, this summary does not address alternative minimum tax consequences or the indirect effects on the holders of equity interests in a holder of the Certificates.

Investors should consult their own tax advisors in determining the tax consequences to them of holding Certificates, including the application to their particular situation of the U.S. federal income tax considerations discussed below, as well as the application of state, local, foreign or other tax laws.

Overview

The Certificates will be analysed for U.S. tax purposes under the rules applicable to debt instruments. In turn, United States holders will not be required to take account of income and expenses incurred at the level of the Trust.

Periodic Distributions

Periodic Distributions will be subject to taxation under the U.S. tax rules applicable to debt instruments. Accordingly, a United States holder will be required to include Periodic Distributions in its income as ordinary income at the time that such distributions are accrued or are received (in accordance with the holder's method of tax accounting). Such income will be treated as foreign source income for purposes of calculating that United States holder's foreign tax credit limitation. The limitation on foreign taxes eligible for foreign tax credit is calculated separately with respect to specific classes of income. For this purpose, such income should generally constitute "passive income" (or, in the case of certain United States holders, "financial services income"). Any foreign income taxes withheld from payments of Periodic Distributions will be includible in the income of United States holders as ordinary income and will likewise be deductible to United States holders, or, alternatively, United States holders may be eligible for a U.S. foreign tax credit subject to various limitations. **United States holders should consult their own tax advisers regarding the availability of a foreign tax credit and the application of the foreign tax credit rules.**

Purchase, Sale and Retirement of Certificates

A United States holder's tax basis in a Certificate generally will equal the cost of such Certificate to such holder. Upon the sale, exchange or retirement of a Certificate, a United States holder generally will recognise gain or loss equal to the difference between the amount realised on the sale, exchange or retirement (less any amounts in respect of accrued Periodic Distributions, which will be taxable as ordinary income) and the holder's tax basis in such Certificate. Gain or loss recognised by a United States holder generally will be U.S. source capital gain or loss. For United States holders who are individuals, trusts or estates that hold the Certificates for more than one year, capital gains may be taxed at lower rates than ordinary income. The deductibility of capital losses is subject to certain limitations.

Information Reporting and Backup Withholding

Information returns may be required to be filed with the U.S. Internal Revenue Service with respect to payments made to certain United States holders of Certificates. In addition, a United States holder may be subject to backup withholding tax in respect of such payments if such holder fails to provide its taxpayer identification number, to certify that such United States holder is not subject to backup withholding, or otherwise to comply with the applicable requirements of the backup withholding rules. Persons holding Certificates who are not United States holders may be required to comply with applicable certification procedures to establish that they are not United States holders in order to avoid the application of such information reporting requirements and backup withholding tax in respect of payments made in the U.S. or through a U.S.-related financial intermediary. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a holder of Certificates generally may be claimed as a credit against such holder's U.S. federal income tax liability provided that the required information is furnished to the Internal Revenue Service. Holders of Certificates should consult their own tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

United Kingdom Taxation

The following applies to persons who are the beneficial owners of the Certificates and is a summary of the Issuer's understanding of current law and practice in the United Kingdom relating to certain aspects of Untied Kingdom taxation. Some aspects do not apply to certain classes of person (such as dealers and persons connected with the Issuer) to whom special rules may apply. Prospective Certificateholders who may be subject to tax in a jurisdiction other than the United Kingdom or who may be unsure as to their tax position should seek their own professional advice.

Payment of the Periodic Distribution Amounts on the Certificates

Periodic Distribution Amounts will be payable without withholding or deduction on account of United Kingdom tax.

United Kingdom Corporation Tax Payers

1. *Income*

In general, Certificateholders which are subject to United Kingdom corporation tax will be charged to tax as income on the proportion of the Lease Rental received by the Trustee and accruing for the Certificateholders' benefit under the Trust.

2. *Chargeable gains*

A disposal of a Certificates by holders which are subject to United Kingdom corporation tax may give rise to a chargeable gain or an allowable loss for the purposes of United Kingdom corporation tax on chargeable gains, subject to the usual reliefs and allowances (including indexation allowance) which may then be available.

A disposal of the Trust Assets by the Trustee may give rise to a chargeable gain or an allowable loss for Certificateholders within the charge to United Kingdom corporation tax, subject to the usual reliefs and allowances (including indexation allowance) which may then be available.

Other United Kingdom Tax Payers

1. *Income tax*

In general, Certificateholders who are individuals resident or ordinarily resident in the United Kingdom or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Certificates are attributable, will be charged to income tax on the proportion of the Lease Rental received by the Trustee and accruing for the Certificateholders' benefit under the trust.

2. *Capital gains tax*

A disposal of a Certificates by individuals resident or ordinarily resident in the United Kingdom or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Certificates are attributable may give rise to a chargeable gain or an allowable loss for the purposes of United Kingdom capital gains tax, subject to the usual reliefs (including taper relief) which may then be available.

A disposal of the Trust Assets by the Trustee may give rise to a chargeable gain or an allowable loss for the purposes of United Kingdom capital gains tax for individual Certificateholders resident or ordinarily resident in the United Kingdom or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Certificates are attributable, subject to the usual reliefs (including taper relief) which may then be available.

3. Inheritance tax

Individuals domiciled, or deemed to be domiciled, in the United Kingdom for inheritance tax purposes are liable to United Kingdom inheritance tax on their assets, regardless of where they are situated. A non-United Kingdom domiciliary is liable only on assets situated in the United Kingdom and, therefore, any asset with a non-United Kingdom situs will be outside the scope of an inheritance tax charge for such persons.

The interests in the Certificates (or the definitive certificates if exchanged), representing the interests in the Trust Assets, do not constitute United Kingdom situs assets. For Certificateholders within the charge to United Kingdom inheritance tax, a gift of the Certificates by, or the death of, a Certificateholder may (subject to certain exemptions and reliefs) give rise to a liability to inheritance tax. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and special rules apply to gifts where the donor reserves some benefit.

Stamp Duty and Stamp Duty Reserve Tax ("SDRT")

No United Kingdom stamp duty is payable on the issue or redemption of a Certificates or on the transfer of a Certificates executed outside of the United Kingdom. No United Kingdom SDRT is payable on the issue, redemption or transfer of Certificates.

European Union Taxation

On 13 December 2001 the Council of the European Union published a revised draft directive regarding the taxation of savings income. It is proposed that, subject to a number of important conditions being met, Member States will be required to provide to the tax authorities of another Member State details of payments of interest (or other similar income) paid by a person within its jurisdiction to an individual resident in that other Member State, except that Belgium, Luxembourg and Austria will instead operate a withholding system for a transitional period in relation to such payments. The proposed directive is not yet final, and may be subject to further amendment.

Malaysia Taxation

The description below is of a general nature and are only a summary of the law and practice currently applicable in Labuan and Malaysia. Prospective investors should consult their own professional advisers on the relevant taxation considerations applicable to the acquisition, holding and disposal of the Certificates and the receipt of distributions.

Exchange Control

Pursuant to a notice known as ECM 15 issued by the Controller of Foreign Exchange in Malaysia, the Governor of BNM, a Labuan offshore company shall be declared as non-resident for exchange control purposes upon submission of specified documents to the Controller of Foreign Exchange in Malaysia.

Bank Negara Malaysia has declared the Issuer a non-resident for exchange control purposes, subject to the condition that the Issuer shall not undertake any transaction with the residents of, or deal in the currencies of, Israel and the Federal Republic of Yugoslavia (Serbia and Montenegro) without the prior permission of the Controller of Foreign Exchange in Malaysia.

Withholding Tax and other Taxes

Payments to any holder of the Certificates by the Trustee will not be subject to Malaysian withholding tax pursuant to Income Tax (Exemption) (No. 16) Order 1991. This Exemption Order also provides an income tax exemption for persons other than those, resident or non-resident, licensed to carry on business under the Banking and Financial institutions Act 1989 of Malaysia, the Islamic Banking Act 1983 of Malaysia, the Insurance Act 1963 of Malaysia or the Takaful Act 1984 of Malaysia. In addition, application has been made pursuant to Section 127(3) of the Income Tax Act 1967 of Malaysia for payments under the Certificates to be expressly exempt from all taxes of any nature imposed under such Act. Although such application is expected to be approved, there can be no assurance of such approval.

Capital Gains

Capital gains are not subject to Malaysian tax unless the gains relate to the disposal of any land situated in Malaysia and any interest, option or other right in or over such land. As this is only the second time that a issue of this nature is being undertaken in Malaysia out of Labuan, consideration should be given to the fact that specific legislation covering the entire scope of transactions of this nature has yet to be developed. However, the Government is actively promoting the development of the Islamic banking and financial markets as well as Labuan and has, in recent developments, indicated that Islamic financing transactions should not be worse off as compared to conventional banking transactions or bond issues. As the law regarding the capital gains liability in respect of the transactions contemplated by the Transaction Documents is not settled, application has been made pursuant to Section 9(3) of the Real Property Gains Tax Act 1976 of Malaysia for the transactions contemplated by the Transaction Documents to be exempt from tax. Although such application is expected to be approved, there can be no assurance of such approval.

Gift or Inheritance Tax

There is neither gift nor inheritance tax in Malaysia.

Stamp Duties, Registrations or other Duties

Application has been made pursuant to Section 80(1) of the Stamp Act 1949 of Malaysia for payment of stamp duties in relation to the transactions contemplated by the Transaction Documents to be exempted. Although such application is expected to be approved, there can be no assurance of such approval. There are no issue, registration or other duties payable under Malaysian law by the holders of the Certificates in connection with the issue or transfer of the ownership of the Certificates outside Malaysia.

ERISA CONSIDERATIONS

The U.S. Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"), and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the "**Code**"), impose certain restrictions on (a) employee benefit plans (as defined in Section 3(3) of ERISA) that are subject to Title I of ERISA, (b) plans (as defined in Section 4975(e)(1) of the Code) that are subject to Section 4975 of the Code, including individual retirement accounts or Keogh plans, (c) any entities whose underlying assets could be deemed to include plan assets by reason of a plan's investment in such entities (each of the foregoing, a "**Plan**") and (d) persons who have certain specified relationships to a Plan or its plan assets ("parties in interest" under ERISA and "Disqualified Persons" under the Code collectively, "**Parties in Interest**"). ERISA also imposes certain duties on persons who are fiduciaries of Plans subject to ERISA, and ERISA and Section 4975 of the Code prohibit certain transactions between a Plan and Parties in Interest or Disqualified Persons with respect to such Plan. Violations of these rules may result in the imposition of excise taxes and other penalties and liabilities under ERISA and the Code.

ERISA and Section 4975 of the Code prohibit a broad range of transactions involving plan assets and Parties in Interest, who have certain specified relationships to a Plan or its plan assets, unless a statutory or administrative exemption is available. Parties in Interest that participate in a prohibited transaction may be subject to a penalty imposed under ERISA and/or an excise tax imposed pursuant to Section 4975 of the Code, unless a statutory or administrative exemption is available. These prohibited transactions generally are set forth in Section 406 of ERISA and Section 4975 of the Code.

The term "plan assets" is not specifically defined in ERISA or the Code, nor has it been definitively defined by the courts in litigation. The U.S. Department of Labor, the governmental agency primarily responsible for the administration of ERISA, has issued a final regulation (29 C.F.R. Section 2510.3-101) setting out the standards it will apply for determining what constitutes the assets of a Plan (the "**Plan Asset Regulation**"). Under the Plan Asset Regulation, the purchase with plan assets of equity interests in the Issuer would cause the assets of the Issuer to be deemed plan assets of the investing Plan which, in turn, would subject the Issuer and its assets to the fiduciary responsibility provisions of ERISA and the prohibited transaction provisions of ERISA and Section 4975 of the Code if 25% or more of the value of any class of equity interests in the Issuer were held by Plans, other employee benefit plans not subject to ERISA or section 4975 of the Code (such as governmental, church and foreign plans), or other entities whose underlying assets could be deemed to include "plan assets".

Accordingly,each initial purchaser of the Certificates and each subsequent transferee will be deemed to have represented and agreed, by its purchase or holding of Certificates, that (A) it is not and for so long as it holds Certificates will not be a Plan or a governmental plan that is subject to any federal, state or local law which is substantially similar to the provisions of Title I of ERISA or Section 4975 of the Code (also, a "**Plan**"), and (B) it and any person causing it to acquire any of the Certificates agrees to indemnify and hold harmless the Issuer, the Trust, the Trustee and the Lead Manager and their respective affiliates from any cost, damage or loss incurred by them as a result of it being or being deemed to be a Plan.

PLAN OF DISTRIBUTION

Under the terms and conditions contained in a certificate purchase agreement dated [ ] June 2002, among the managers listed below (the "**Managers**"), Malaysia and the Issuer (the "**Certificate Purchase Agreement**"), the Issuer has agreed to issue and sell to the Managers U.S.$[ ],000,000 principal amount of the Certificates. Subject to certain conditions, each Manager has severally agreed to purchase the principal amount of Certificates indicated in the following table:

Managers	Principal Amount of Certificates
HSBC, Offshore Banking Unit Labuan	U.S.$ [ ],000,000
ABC Islamic Bank	U.S.$ [ ],000.000
Abu Dhabi Islamic Bank	U.S.$ [ ],000,000
Bank Islamic (L) Ltd	U.S.$ [ ],000,000
Dhabi Islamic Bank	U.S.$ [ ],000,000
Islamic Development Bank	U.S.$ [ ],000,000
Maybank International (L) Ltd	U.S.$ [ ],000,000
Standard Chartered Bank, Offshore Labuan Branch	U.S.$ [ ],000,000
Total	U.S.$ [ ],000,000

The Certificate Purchase Agreement provides that the obligations of the Managers to pay for and accept delivery of the Certificates are subject to the approval of certain legal matters by their counsel and certain other conditions.

The Managers propose to offer the Certificates initially at the offering price on the cover page of this Offering Circular. After the initial offering, the offering price may be changed.

United States of America

Each Manager has acknowledged that the Certificates have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except in accordance with Regulation S under, or pursuant to an exemption from the registration requirements of, the Securities Act. Each Manager has represented and agreed that it has not offered or sold, and will not offer or sell, any Certificates constituting part of its allotment within the United States except in accordance with Rule 903 of Regulation S or Rule 144A under the Securities Act. Each Manager has further represented and agreed that it has offered and sold the Certificates, and will offer and sell the Certificates (a) as part of their distribution at any time and (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date (the "**distribution compliance period**"), only in accordance with Rule 903 of Regulation S or Rule 144A under the Securities Act. Each Manager has agreed that, at or prior to confirmation of sale of Certificates (other than a sale pursuant to Rule 144A under the Securities Act), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases Certificates from it during the distribution compliance period a confirmation or notice detailing the restrictions on offers and sales of the Certificates within the United States or to, or for the account or benefit of, U.S. Persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

United Kingdom

Each Manager has represented and agreed that:

(a) it has not offered or sold and, prior to the expiry of a period of six months from the Closing Date, will not offer or sell any Certificates to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;

(b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to subscribe for the Certificates to (i) investment professionals falling within both Article 14(5) of the Financial Services and Markets Act 2000 (Financial Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "**CIS Promotion Order**") and Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the "**General Promotion Order**") or (ii) high net worth companies and other persons falling within both Article 22(2)(a) to (d) of the CIS Promotion Order and Article 49(2)(a) to (d) of the General Promotion Order or (iii) other persons to whom both an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "**FSMA**")) and an invitation or inducement to participate in a collective investment scheme (within the meaning of section 238 of the FSMA) can lawfully be communicated or caused to be communicated; and

(c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Certificates in, from or otherwise involving the United Kingdom.

Malaysia

Each Manager has represented and agreed that the Certificates may not be offered or sold, directly or indirectly, nor may any document or other material in connection therewith be distributed in Malaysia. Each Manager has acknowledged that:

(a) residents of Malaysia are not permitted to purchase the Certificates without first having had and obtained all the necessary approvals from all relevant regulatory authorities, including but not limited to all the necessary approvals from Bank Negara Malaysia;

(b) the onus of obtaining such approvals is on the residents concerned and none of the Trustee, the Managers or the Issuer accepts any responsibility for the purchase of any Certificate by the residents as aforesaid without the necessary approvals being in place; and

(c) the Certificates may be sold to banks licensed under the Offshore Banking Act 1990 of Malaysia and other non-residents of Malaysia.

Malaysian residents are advised to seek independent professional advice as may be necessary before making any purchase.

Japan

Each Manager has acknowledged that none of the Certificates have been nor will be registered under the Securities and Exchange Law of Japan (the "**Securities and Exchange Law**"). Each Manager has represented and agreed that it will not offer or sell any Certificates, directly or indirectly, in Japan to, or for the benefit of, any resident of Japan (which term as used herein means any persons resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

Hong Kong

Each Manager has represented and agreed that:

(a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, the Certificates other than to persons whose ordinary business it is to buy or sell shares or debentures (whether as principal or agent) or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap.32) of Hong Kong (the "**Companies Ordinance**"); and

(b) unless it is a person permitted to do so under the securities laws of Hong Kong, it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, in Hong Kong, any advertisement, invitation or document relating to the Certificates, other than with respect to Certificates intended to be disposed of to persons outside Hong Kong or to be disposed of in Hong Kong only to persons whose business involves the acquisition, disposal, or holdings of securities, whether as principal or agent.

Singapore

Each Manager has acknowledged that this Offering Circular has not been and will not be registered as a prospectus with the Registrar of Companies and Businesses in Singapore and the Certificates will be offered in Singapore pursuant to exemptions invoked under Section 106C and 106D of the Companies Act, Chapter 50 of Singapore (the "**Singapore Companies Act**"). Accordingly, each Manager has represented and agreed that this Offering Circular and any other document or materials relating to the Certificates will not be issued, circulated or distributed in Singapore nor may any of the Certificates be offered for subscription or sold, directly or indirectly, nor may an invitation or offer to subscribe for any Certificates be made, directly or indirectly, to the public or any member of the public in Singapore other than (a) to an institutional investor or other person specified in Section 106C of the Singapore Companies Act; (b) to a sophisticated investor, and in accordance with the conditions specified in Section 106D of the Singapore Companies Act; or (c) otherwise pursuant to, and in accordance with the conditions of, any other applicable provisions of the Singapore Companies Act.

General

Each Manager has acknowledged that no action has been taken by the Issuer or any Manager that would, or is intended to, permit a public offer of the Certificates in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Manager has represented and agreed that it will not, directly or indirectly, offer or sell any Certificates or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Certificates by it will be made on the same terms.

Purchasers of the Certificates sold outside the United States may be required to pay stamp taxes and other charges in compliance with the laws and practices of the country of purchase in addition to the price to investors on the cover page of this Offering Circular.

The Issuer has agreed to indemnify the Managers against liabilities or to contribute to payments which they may be required to make in that respect.

The Certificates are a new issue of securities for which there currently is no market. The Lead Manager has advised the Issuer that it intends to make a market in the Certificates as permitted by applicable law. It is not obligated, however, to make a market in the Certificates and any market-making may be discontinued at any time at their sole discretion. Accordingly, no assurance can be given as to the development or liquidity of any market for he Certificates.

The Lead Manager or its agent may engage in over-allotment, stabilising transactions, covering transactions and penalty bids in accordance with Regulation M under the Exchange Act.

- Over-allotment involves sales in excess of the offering size, which creates a short position for the Lead Manager.
- Stabilising transactions involve bids to purchase the Certificates so long as the stabilising bids do not exceed a specified maximum.
- Covering transactions involve purchases of the Certificates in the open market after the distribution has been completed in order to cover short positions.
- Penalty bids permit the Lead Manager to reclaim a selling concession from a broker/dealer when the Certificates originally sold by such broker/dealer are purchased in a stabilising or covering transaction to cover short positions.

These stabilising transactions, covering transactions and penalty bids may cause the price of the Certificates to be higher than it would otherwise be in the absence of these transactions. These transactions, if commenced, may be discontinued at any time.

TRANSFER RESTRICTIONS

The Certificates have not been registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. Persons (as defined in Regulation S) except to (a) QIBs in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A and (b) certain persons in offshore transactions in reliance on Regulation S.

Each purchaser of Certificates will be deemed to have represented and agreed as follows (terms used in this paragraph that are defined in the United States Investment Company Act of 1940, as amended, Rule 144A or Regulation S are used herein as defined therein):

(1) The purchaser is not an affiliate (as defined in Rule 144 under the Securities Act) of the Issuer or acting on behalf of the Issuer and (A)(i) is a QIB, (ii) is aware that the sale to it is being made in reliance on Rule 144A and (iii) is acquiring the Certificates for its own account or for the account of a QIB or (B) is not a U.S. Person and is purchasing the Certificates in an offshore transaction pursuant to Regulation S.

(2) The purchaser understands and agrees that the Certificates are being offered in a transaction not involving any public offering in the United States within the meaning of the Securities Act, that the Certificates have not been and will not be registered under the Securities Act and that (A) if in the future it decides to offer, resell, pledge or otherwise transfer any of the Certificates or any beneficial ownership in any of the Certificates, such Certificates may be offered, resold, pledged or otherwise transferred only (i) in the United States to a QIB or to a person whom the seller reasonably believes is a QIB purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A or (ii) outside the United States in a transaction complying with the provisions of Rule 904 of Regulation S, in each of cases (i) and (ii) in accordance with any applicable securities laws of any state of the United States and in a minimum principal amount of U.S.$10,000, and that (B) the purchaser will, and each subsequent holder is required to, notify any subsequent purchaser of the Certificates from it of the resale restrictions referred to in (A) above.

(3) The purchaser acknowledges and agrees that the Issuer and the Trustee reserve the right prior to any sale, pledge or other transfer pursuant to clause 2(A) above to require the delivery of such certifications, legal opinions and other information as the Issuer and the Trustee may reasonably require to confirm that the proposed sale, pledge or other transfer complies with the foregoing restrictions and understands and agrees that the Certificates will bear a legend substantially to the following effect:

THIS CERTIFICATE (OR ITS PREDECESSOR) WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM THE REGISTRATION REQUIREMENTS UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND THIS CERTIFICATE MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. EACH PURCHASER OF THIS CERTIFICATE IS HEREBY NOTIFIED THAT THE SELLER OF THIS CERTIFICATE MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER.

THE HOLDER OF THIS CERTIFICATE AGREES FOR THE BENEFIT OF THE ISSUER AND THE LEAD MANAGER THAT (A) THIS CERTIFICATE MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (I) IN THE UNITED STATES TO A QUALIFIED INSTITUTIONAL BUYER ("QIB") (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QIB PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QIB IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT OR (II) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, IN EACH OF CASES (I) AND (II) IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES AND IN A MINIMUM PRINCIPAL AMOUNT OF U.S.$10,000, AND (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS CERTIFICATE FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE.

ANY TRANSFER IN VIOLATION OF THE FOREGOING WILL BE OF NO FORCE AND EFFECT, WILL BE VOID AB INITIO, AND WILL NOT OPERATE TO TRANSFER ANY RIGHTS TO THE TRANSFEREE, NOTWITHSTANDING ANY INSTRUCTIONS TO THE CONTRARY TO THE ISSUER, THE TRUSTEE OR ANY INTERMEDIARY, IF AT ANY TIME, THE ISSUER DETERMINES OR IS NOTIFIED THAT THE HOLDER OF THIS CERTIFICATE OR A BENEFICIAL OWNERSHIP HEREIN IS IN BREACH, AT THE TIME GIVEN, OF ANY OF THE REPRESENTATIONS SET FORTH IN THE DECLARATION OF TRUST OR THE AGENCY AGREEMENT, THE ISSUER OR THE TRUSTEE MAY CONSIDER THE ACQUISITION OF THIS CERTIFICATE OR SUCH INTEREST IN THIS CERTIFICATE VOID AND REQUIRE THAT THIS CERTIFICATE OR SUCH INTEREST THEREIN BE TRANSFERRED TO A PERSON DESIGNATED BY THE ISSUER; PROVIDED THAT THE FOREGOING RIGHT OF THE ISSUER OR THE TRUSTEE TO VOID SUCH TRANSFER OR REQUIRE ANY FURTHER TRANSFER SHALL NOT APPLY TO ANY TRANSFER EFFECTED ON THE LUXEMBOURG STOCK EXCHANGE.

THE CERTIFICATES MAY NOT BE SOLD OR TRANSFERRED TO ANY (A) "EMPLOYEE BENEFIT PLANS" (AS DEFINED IN SECTION 3(3) OF THE U.S. EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED ("ERISA")) THAT ARE SUBJECT TO TITLE I OF ERISA, (B) "PLANS" (AS DEFINED IN SECTION 4975(E)(1) OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE")) THAT ARE SUBJECT TO SECTION 4975 OF THE CODE, (C) GOVERNMENTAL PLANS THAT ARE SUBJECT TO ANY FEDERAL, STATE OR LOCAL LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF TITLE I OF ERISA OR SECTION 4975 OF THE CODE, OR (D) ENTITIES WHOSE UNDERLYING ASSETS COULD BE DEEMED TO INCLUDE ASSETS OF ANY SUCH EMPLOYEE BENEFIT PLAN, PLAN OR GOVERNMENTAL PLAN BY REASON OF 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE.

THE HOLDER ACKNOWLEDGES AND AGREES THAT THE ISSUER AND THE TRUSTEE RESERVE THE RIGHT PRIOR TO ANY SALE, PLEDGE OR OTHER TRANSFER PURSUANT TO CLAUSES (I) OR (II) ABOVE TO REQUIRE THE DELIVERY OF SUCH CERTIFICATIONS, LEGAL OPINIONS AND OTHER INFORMATION AS THE ISSUER OR THE TRUSTEE MAY REQUIRE TO CONFIRM THAT THE PROPOSED SALE OR OTHER TRANSFER COMPLIES WITH THE FOREGOING RESTRICTIONS.

(4) Until 40 days after the later of the commencement date of the offering and the Closing Date, interests in the Regulation S Global Certificates representing the Certificates sold in reliance on Regulation S may be held only by non-U.S. Persons and through Euroclear and Clearstream, Luxembourg.

(5) The purchaser or holder of the Certificates is, by such purchase or holding, deemed to have represented, warranted and agreed that (A) it is not and, for so long as it holds the Certificates, will not be a Plan, and (B) it and any person causing it to acquire any of the Certificates agrees to indemnify and hold harmless the Issuer, the Trust, the Trustee and the Lead Manager and their respective affiliates from any cost, damage or loss incurred by them as a result of it being or being deemed to be a Plan.

GENERAL INFORMATION

Authorisation

1. The issue of the Certificates has been duly authorised by a resolution of the board of directors of the Issuer on [ ] June 2002. The Issuer has obtained all necessary consents, approvals and authorisations in connection with the issuance of the Certificates.

Listing

2. Application has been made to list the Certificates on the Luxembourg Stock Exchange and the Labuan Financial Exchange. A legal notice relating to the issue of the Certificates and the constitutional documents of the Issuer are being lodged with the Registrar of the District Court in Luxembourg *(Greffier en Chef du Tribunal d'Arrondissement de et à Luxembourg)* where such documents may be examined and copies obtained. There can be no assurance that either listing will occur on the Closing Date or at all.

Clearing Systems

3. The Rule 144A Certificates and the Regulation S Certificates have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN for the Rule 144A Certificates is XSO149973850 and for the Regulation S Certificates is XSO149949470. The Common Code for the Rule 144A Certificates is 014997385 and for the Regulation S Certificates is 014994947. Application will be made for acceptance of the Certificates into the book-entry settlement systems of Euroclear and Clearstream, Luxembourg.

No Significant Change and No Litigation

4. There has been no significant change in the financial or trading position or results of operations of the Issuer since its date of incorporation.

The Issuer is not, and has not been, involved in any litigation, arbitration or administrative proceedings which may have, or has had since the date of its incorporation, a significant effect on its financial position nor is the Issuer aware that any such proceedings are pending or threatened.

Accounts

5. The auditors of the Issuer are Deloitte Touche Tohmatsu, certified public accountants, who are expected to audit the Issuer's accounts in accordance with generally accepted auditing standards in Malaysia. The first financial year of the Issuer will end on 31 December 2002. The Issuer will not publish interim financial statements. The Issuer has no subsidiaries.

Documents

6. So long as any of the Certificates remains outstanding, copies of the following documents will be available for inspection and obtainable free of charge, during normal business hours on any weekday (excluding public holidays) from the registered office of the Issuer and from the specified offices of the Trustee and the Paying Agent for the time being in Luxembourg:

(a) the constitutional documents of the Issuer;

(b) the most recently prepared annual audited financial statements of the Issuer; and

(c) the Transaction Documents.

LEGAL MATTERS

Certain matters relating to Malaysian law will be passed upon for the Lead Manager by Mohamed Ismail & Co. and certain matters relating to United Kingdom and United States federal law will be passed upon for the Lead Manager by Allen & Overy, Shook Lin & Bok, Joint Law Venture. Certain matters relating to Malaysian law will be passed upon for the Issuer by Zul Rafique & Partners. Certain matters relating to Malaysian law will be passed upon for Malaysia by the Treasury Solicitor of Malaysia and certain matters relating to United States federal law will be passed upon for the Issuer and Malaysia by Cleary, Gottlieb, Steen & Hamilton.

PUBLIC OFFICIAL STATEMENTS AND DOCUMENTS

Information included herein which is designated as being taken from a publication of Malaysia or an agency or instrumentality of Malaysia is included on the authority of the Government of Malaysia or such agency or instrumentality.

The information set forth herein relating to Malaysia is provided by the Secretary General to the Treasury, Malaysia, acting in his official capacity and is included on his authority.

THE ISSUER

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MALAYSIA

Ministry of Finance
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50592 Kuala Lumpur
Malaysia

PAYMENT ADMINISTRATOR, PRINCIPAL PAYING AGENT, TRANSFER AGENT, REFERENCE AGENT AND REGISTRAR

The Hongkong and Shanghai Banking Corporation Limited
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30 Harbour Road
Wanchai
Hong Kong

LUXEMBOURG PAYING AGENT, REPLACEMENT AGENT, TRANSFER AGENT AND LISTING AGENT

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