First quarter of 2003 saw many events that contributed to the world economy downturn. Considering that the past year has already seen a global economic turndown, so far this year there have been no signs to show that the global economic performance will improve drastically. There is doubt from many parties that Malaysia will not achieve the forecasted growth of 4.5% in year 2003 GDP without any stimulus from the government to weather through the bad times. The two major events that have contributed to the economic slowdown in Malaysia are the US-Iraq war and Severe Acute Respiratory Syndrome (SARS) outbreak.

The US-Iraq war officially started on 20th March 2003 and ended on 1st May 2003. What began as retaliation for terrorist activities turned into a pledge to topple the so called "axis of evil" which includes Iraq, North Korea and Iran. Until now there is still no resolution as there is still constant threat from terrorist and from US itself as the President Bush has been threatening to further extend the war to other countries. There is still no world political stability as up to date there is still news of terrorist activities happening worldwide. Lack of stability will affect the world economy as investments will be delayed and reduction in consumption due to uncertainty.

The Severe Acute Respiratory Syndrome (SARS) outbreak which has adversely affected the Malaysian economy has left more than 670 people dead and infected around 8000 in roughly 25 countries since it first appeared in southern China last November. Though Malaysia has only recorded 2 deaths, we were not excluded from its effects as our neighbour Singapore was one of the few countries listen on the WHO travel warning list. Though the outbreak has since subsided the effects can still be felt by the aviation and tourism industry.

Although the Iraq war was generally between US, its allies and Iraq, the Malaysian economy was also affected in certain ways. The main fear that was generated from the war was the fear that oil prices would shoot up. Oil prices doubled to nearly US$40 a barrel on expectations of war in the Middle East and disruptions to oil supplies but went back down shortly as a short war was expected. If oil prices were to have been allowed to climb, it would have led to inflation and with the economy slowing down; this would have caused a dilemma for Bank Negara as it would have to decide to increase interest rates in order to promote growth. Though Malaysia is a member of OPEC we would still not have gained export wise from this price hike. In reality, OPEC has been battling with slowing demand of oil with the weakened global economy. Therefore if prices were to have continued to hiked, Malaysia would not have benefited because regional demand for oil would have weakened.

Another industry that was affected badly by both events was the airline industry. As crude prices soared in the beginning so did diesel-fuel causing a major blow to airlines industries as cost of production also rose. The industry had already heavily impacted by the decrease in passenger traffic due to September 11 incident and uncertainty of war which has caused much doubt in the safety of flying. Fears of contracting SARS aboard did not help to allay consumer fears. Though much was done to improve the safety and hygiene in the aviation industry, there was a significant 15% drop in passenger traffic. This pushed airline industries to increase competition by further cutting prices and capacity, grounding airlines and cancelling flights. Malaysia Airline Systems, the national carrier itself still yet to turn from red to black and furthermore slipped 0.8% to RM2.45 in the KLSE after reporting a huge RM1.3 billion loss for its latest fiscal year.

Further affected would be the tourism industry. The world was shocked by the severity of the SARS epidemic that had spread all over the world and one of the worse affected was our neighbour, Singapore. Malaysia itself has not been spared as people feared going to crowded places like cinemas in the beginning. Domestic tourism and foreign tourist visits to Malaysia has also been greatly affected. One of the sectors in the tourism industry, the hotel industry which was already seeing trying times slipped further down with occupancy rates down 40% and dwindled another 20% to 25% in April. Foreign tourists contribute enormously to our economy. To date, some RM37 billion has been invested in the hotel industry that employs about 67,000 staff nationwide. Tourists, more than half of them foreign, contributed $11.2 billion to Malaysia's GDP in 2002, 19% in total. Even before the SARS outbreak, the hotel and tourism sector was already facing problems, especially after the Sept 11, 2001, attacks and the Iraq war. Western tourists are now more selective in determining their holiday destinations and most, if not all, are trying to avoid Islamic countries. Malaysia has not been spared of this even though our country is one of the most peaceful in the world. Thus, we must make greater efforts to promote Malaysia's fascinating tourist destinations in the western and emerging markets. We must not let foreigners have wrong and negative impressions of our country.

As a whole, the US-Iraq war and Severe Acute Respiratory Syndrome (SARS) has caused much trepidation which has upset consumer confidence causing the Consumer Sentiments Index (CSI) to drop 6.7% quarter to quarter to 105.2 points in the first quarter of 2003. Though business confidence remains resilient, there is still an impact from the war and SARS outbreak on investments. As the SARS outbreak is slowly contained, investor confidence returning in Asian economy especially Malaysia which only caught the brush of the outbreak. But investors can still be seen putting off certain investments in Malaysia due to the uncertainty of the global economy.

Malaysia's new economic stimulus package was unveiled on May 21, 2003 comprising four main strategies and 90 measures aimed at generating economic activities by increasing domestic sources of growth, boosting consumption and encouraging investments. The stimulus package is also aimed at lessening the impact of the Severe Acute Respiratory Syndrome (SARS) outbreak, the Iraqi war and lethargic world economic conditions. The package comprises an allocation of RM7.3 billion ($1.9 billion), of which RM1.7 billion ($0.4 billion) will come from the Government budget, RM2.0 billion ($0.5 billion) from the central bank, Bank Negara Malaysia, while development financial institutions will provide RM3.6 billion ($0.9 billion). The value of the RM7.3 billion ($1.9 billion) package amounts to 2% of gross domestic product (GDP). [Figures from The Star, 2003, 22 May, Front Page]

"*The strategies and new measures were formulated with the aim of boosting economic activities and to further strengthen the fundamentals of our economy. The package also includes specific measures for the people to raise their standard of living*," said Dr Mahathir, who is also the Finance Minister. [from theedgedaily.com, 22 May, 2003]

According to Prime Minister Datuk Seri Dr Mahathir Mohamad., Malaysia's economic growth will have to depend on stronger domestic activities, especially in an environment of continued uncertainty in the external sector. "*The time has now come for us to reengineer our growth strategies towards reducing this high dependence and embark on initiatives to vigorously explore and promote our domestic sources of growth*," he said. [from theedgedaily.com, 2003, 23 May, page 1]

Since November 2000, Malaysia had recoded its highest monthly export in March 2003 with exports amounting to RM32.0 billion ($8.4 billion) and a trade surplus of RM6.3 billion ($1.7 billion), a 27.5% month-on month increase [figures from PriceWaterHouseCoopers, 2003]. Among the top export market was the United States at RM5.5 billion. The US slowdown amounting from the already decelerating economy caused by the expenditure in the recent wars and terrorist activities is expected to create an impact on Malaysia's exports and growth prospects. Among the major highlights from the stimulus package were few measures aimed at generating domestic growth in order to balance growth especially between foreign and domestic growth. Those highlights include providing RM1 billion in loans to be made available as micro credit for small traders and industries. Of that RM1 billion, RM500 million will be placed under Bank Pertanian Malaysia. This amount will be made available to the agricultural sector. RM300 million will be under Bank Simpanan Nasional for non-agricultural projects. An additional RM200 million will be allocated to Amanah Ikhtiar Malaysia fund (AIM) and is to be placed under Bank Pertanian Malaysia. Another additional RM200 million was made available for Tekun (Entrepreneurial Group Economic Fund) to further increase its effectiveness and strengthen its loan infrastructure facilities. RM600 million will also be allocated to Small Medium Industries Fund and RM400 million (USD105.2 million) to New Entrepreneurial Fund. The New Entrepreneurial Fund is important as it would boost entrepreneurship and prove to be a source of financing. These strategies are meant to bolster domestic growth and investment in new and niche areas and make agriculture the country's third engine of growth.

Recent economic data is pointing towards a slowdown in economic growth. Most recently, the Consumer Price Index (CPI) in March, it was revealed, grew marginally by 0.7 per cent year-on-year and 0.2 per cent from February. The figures indicate that consumption is declining and the economy could be moving towards disinflation at a time when domestic spending is integral in supporting the economy. SARS has also dampened demand and people are withholding spending until clearer signs emerge. There is no doubt that the average consumer will be reluctant to spend as there is no guarantee of employment. No doubt, the employees of the tourism sector will be greatly affected as there are wage cuts and lay offs in order for the company to survive. To encourage more domestic spending, the government has resorted to putting more money into consumers' pockets. By providing half month bonus for government servants and lowering the EPF contribution from 11% to 9% for a year, this will eventually lead to an increase in the disposable income of consumers and therefore lead to an increase in consumption.

Other measures included in the stimulus package include boosting investments. Highlights to mitigate the effects of a US slowdown include stimulating foreign investments by cutting red tape by liberalizing the Foreign Investment Committee (FIC) Guidelines which will help create a more conducive and investor-friendly environment. Over time, this should help spur the continued participation of foreign investment in the domestic capital market. Foreign equity shareholding would also be relaxed to encourage more foreign equity in listed companies, in line with the Capital Market Master Plan. To promote foreign investment in the housing sector, the ceiling price for foreigners to purchase properties was reduced to RM150,000 per unit and for purchases in excess of

RM100 million. These moves will undoubtedly encourage the inflow of funds and foreign investments. Other moves to boost both foreign and local investments include, extending pioneer status and Investment Tax Allowance to companies under a pre-package scheme. To further stimulate the establishment of R&D companies in Malaysia, pioneer status and Investment Tax Allowance will be provided twice to R&D companies. The pioneer status offered consist of 70% tax exemption for five years or 60% investment tax allowance for capital expenditure made in 5 years. Income Tax exemption will also be offered to operational headquarters. From a competitive standpoint, this will look particularly attractive to companies looking to set up Operational Headquarters here.

The ability for the country to attract Foreign Direct Investments (FDI) in the service sector will also depend on the quality of the country's workforce. Therefore, attention has been paid to improving R&D and training and RM500 million was added to the Skills Development Fund and an additional RM100 million for the retraining fund. This will increase the employability of fresh graduates and school leavers and further reduce the unemployment rate. In order to enhance Information, Communication and Technology (ICT), RM100 million was made available to Malaysian Venture Capital (MAVCAP) to develop seed venture capital. This will ensure that companies and workers alike will have access to the latest technology.

As stated earlier, among the most badly affected industries were the aviation and tourism industry. For the aviation industry, passenger traffic had dropped 15 % and for the tourism sector has also been badly affected mainly due to the SARS outbreak. Visitors of SARS-affected countries make up the bulk of visitors to Malaysia. In 2002, tourists from China, Hong Kong, Singapore, Thailand, Indonesia, Japan, Taiwan and

Vietnam accounted for 80% of total inbound tourist arrivals to Malaysia. According to the Culture, Arts and Tourism Ministry, tourist arrivals from China, Hong Kong and Taiwan dropped 80% following the outbreak of SARS. [figures from PriceWaterHouseCoopers, 2003]. Certain measures were set up to offset the damage done to the travel and tourism industry. Among them was a 5% discount in monthly electricity bill for hotel operators. Service tax on complimentary rooms in hotels is also to be abolished. Service tax for hotels and restaurants will also be exempted. This discount would mean more funds for hotels to concentrate on marketing activities and to promote further domestic bookings. According to Six Happiness Group of Restaurants executive chairman Tan Tong Heng although the group's restaurant business has not been directly hit by the Severe Acute Respiratory Syndrome, walk-ins has dropped by 50%. [From Starbiz, May 22, 2003. Page 5]. The service tax exemption would mean a greater increase in business as it will generally project low-priced food. Other measures include a 50% reduction in six-month road tax for taxis. This will allow relief for taxi drivers who were also affected by the drop in tourist business. A RM1 billion Special Relief Guarantee Facility will be established to help tourism sector operators. The burden of workers under the tourism industry will also be decreased as finance institutions are to restructure and reschedule loans of workers subjected to pay cuts under the tourism industry. Although there is no direct relief granted to the airline industry, which has been directly hit by the SARS outbreak, the positive impact of the RM1bil package would naturally filter through to the airlines, as people are encouraged to travel again - be it for business or leisure.

Other main measures include offering various incentives to improve the housing sector. Measures under the package are meant to promote home ownership and improve quality of life. For example, hoses between RM100,000 and RM180,000, tax exemptions of RM5000 will be given on loan interests for assessment year 2003. Stamp duty for the purchase of houses below RM100,000 will also be exempted. Real property gains tax is to be exempted as well. This will allow potential buyers to take advantage of the stimulus package to buy houses of their choice and at the same time reduce property overhang.

It is estimated that sales of houses will generate a multiplier effect of 1 to 8. This means that any RM1 generated from the sale of a house will allow the GDP to increase RM8. We have to keep in mind that the economy works in a circular flow. Any income generated from a party will be another sectors consumption and this flow goes on. This is called a multiplier effect. With this in mind, the stimulus package includes a measure by the government of launching Home Ownership for People (HOPE) programme which encourages home ownership with subsidised housing loans. Syarikat Perumahan Negara Bhd is also to build an additional 150,000 low and medium-cost houses. This offers opportunities for contractors with track records. As mentioned earlier, this will not only perk up the economy but also improve welfare of the poor. Another measure to encourage home ownership among to poor is also to offer loans from Bank Simpanan Nasional with 3% interest in the first year or zero interest for 10% deposit in the first year for houses below RM100,000.

One important feature from the stimulus package is the reduction of Bank Negara intervention rate by 50 basis points to 4.5%. Subsequently, the ceiling base lending rate (BLR) for the commercial banks will accordingly fall to 6% from 6.42%, while BLR for finance companies will decline to 6.94% from 7.46%. This will lower cost of borrowings and further fuel greater credit growth. Through reduction of lending rates, it will induce more people to take up consumption loans, which were said to be coming down lately.

When spending improves, so would businesses; and, in turn, the profitability of companies. In that way, government revenue through taxation would also go up. The lower cost of taking up loans will also lead an increase in private investments thus further boosting domestic growth.

On the subject of SARS, hygiene and health, the stimulus package includes an allowance of RM400 to doctors and RM200 will be paid to other medical staff which is backdated from April 1 2003 until the epidemic is wiped out. Though early and decisive steps were taken by the government to control the outbreak, there is still risk that another epidemic might arise. Therefore steps should be taken to prevent any further outbreaks and to ensure that hygiene and cleanliness is well taken care off so the government has allotted RM200 million to local authorities to improve on sanitation work. A Center for Disease Control (CDC) will also be set up in order to stave off any further widespread outbreak of an infectious disease.

CONCLUSION.

All things taken into consideration, the US-Iraq war and SARS outbreak did much to slowdown the recovery of the Malaysian economy that has since been on the turnabout from the 1997 recession. We too have to take into account the slowdown of the US economy which will affect us as it is one of our major importers. The stimulus package came as a much need relief to the industries badly affected for example the aviation, tourism, and hotel industry.

Businesses generally benefited from the disbursements of funds in the form of loans or incentives. In order to maximize the effects of the package, it depends on the effectiveness of the delivery package. The relaxation of the FIC guidelines is an effective method to bring in foreign investment. Other measures were also important to stimulate investment in order to boost domestic growth. The decision of the government to focus on domestic growth instead of relying on exports was a wise decision as the ability of the world economy to recover any time soon is still obscure. The measures to stir consumption were also vital to the recovery of the economy as domestic consumption is currently integral in supporting the economy.

While these incentives are expected to achieve its target of mitigating the effects of the US-Iraq war and the SARS outbreak, the determinant factor in its success lies in the ability of the government to effectively implement the measures. While these measures were also crucial to address the needs of the people, the challenge before Malaysians is the ability to proactively market ourselves, seek out investments in an environment where funds are limited and attract the right investors to take serious notice of Malaysia in order to achieve the targeted growth of 4.5% in the GDP for year 2003.

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