UNIVERSITI PUTRA MALAYSIA

AN OVERVIEW OF THE EAST-ASIAN ECONOMIC CRISIS

YONG CHEE LEONG

GSM 1998 1

AN OVERVIEW OF THE EAST-ASIAN ECONOMIC CRISIS

Submitted By :

YONG CHEE LEONG

Matric No : 51396

This paper is submitted as a partial fulfillment for the
Master's Degree in Business Administration
Malaysian Graduate School of Management
Universiti Putra Malaysia

August 1998

I, Yong Chee Leong, Matric No : 51396 hereby confirm that this project paper submitted as a partial fulfillment of the requirements for a Master's Degree in Business Administration is my original work.

....

31 st August 1998.

Specially Dedicated to :

my beloved wife ***Vivien***

& my dearest son ***VinKit***

ACKNOWLEDGEMENT

I would like to take this opportunity to express my deepest sense of gratitude to my project supervisor Associate Professor Dr. Shamsher Mohamed for all his guidance and invaluable advice in this project. Apart from being my supervisor for this project, Dr. Shamsher also taught me in my Financial Management, Investment Analysis and Security Analysis & Portfolio Management. Once again, I wish to thank him for the knowledge I have gained from him particularly in the Malaysian Stock Market.

My heartiest appreciation also goes to all the lecturers who had taught me in this MBA program : Dr. Habrizah, Tuan Hj Yaacob Ibrahim, Dr. Nik Mustapha, Dr. Zain Mohamed, Prof. Dr. Shaik Mohd. Nor Alam, Dr. Mohamed Ali, Prof. Dr. Mohd. Ghazali ,. and Dr. Chris Alcantara.

Last but not least, I wish to thank my wife and my son for their understanding, patience and support.

Yong Chee Leong, Vincent

August 1998

ABSTRACT

The objective of this project is to analyse the possible causes and the effects of the economic crisis in East-asian region with particular emphasis of the impact on Malaysia in respect of the RINGGIT and the KUALA LUMPUR STOCK EXCHANGE; how the crisis affects countries in other regions. The issues of whether the IMF can solve the prevailing problems in this region and how Mexican's crisis is different from the East-asian are also discussed. Lastly, several recommendations are made with a view to strengthen and improve the economic fundamentals of Malaysia.

The possible causes of the crisis incudes : poor financial and banking system resulting in substantial non-performing loans, Investors' loss of confidence, less competitive exports, unproductive investments and over-dependence on the foreign capital.

Malaysia was hit badly by this crisis. The value of Ringgit fell from 2.6450 in July 1997 to 4.1550 against the US Dollar in July 1998 whilst the Composite Index fell from 1,012.84 in July 1997 to 402.65 in July 1998 . The Gross Domestic Product (GDP) growth rate was forecasted to be –1% to -2% compared with the average GDP growth rate of 8.8 % for the period between 1988 to 1997.

It is evident that IMF cannot provide solution to East-asian countries as countries who resorted to IMF's bail-out do not seem to recover from their crisis.

East-asian's crisis is by nature different from that of the Mexican's crisis in 1995. The former is solvency crisis whereas the latter is liquidity crisis.

Malaysian government should strengthen its economic fundamentals by implementing several measures such as making it compulsory to make use of local manufactured parts. Agriculture sector should be revived as it can save the country for RM 9 billion on food. To develop Information Technology, Education and Tourism sectors to generate foreign exchange for the country.

Regulations should be imposed to prevent sudden outflow of foreign portfolio-funds. The Banking sectors has to be strengthen and not to allow politicians to have hands in the Banking industry loans should only be approved based on its merit only.

AN OVERVIEW OF

THE EAST-ASIAN ECONOMIC CRISIS

TABLE OF CONTENTS

LIST OF TABLES

APPENDICES

CHAPTER 1

INTRODUCTION TO
EAST-ASIAN FINANCIAL CRISIS

1.1 Introduction

Over the past 7–8 years, countries in the East-asia which recovered from the 1987 recession, were consistently achieving considerably high growth rates. Many had regarded this achievement as an *' Economic Miracle '*. These countries had moderate inflation, an absence of significant fiscal imbalances and high savings rates. Since the beginning of 1997, some of these have started to experience an economic slowdown again which eventually has turned into currency and economic crisis. As a result of the crisis, stock market crashed, both currency and prices of property depreciated.

Countries affected by this crisis at varying degree include China, Hong Kong, South Korea, Taiwan, Thailand, Philippines, Indonesia, Singapore and Malaysia. Some of these countries such as China, Hong Kong and Singapore are in the course of recovery whilst others including Malaysia are still struggling to overcome this crisis. Three countries - Thailand, Indonesia and South Korea turned to the International Monetary Fund (IMF) for assistance. The total bailout package for these countries amounted to US $ 118.6 billion, the largest ever bailout arranged under IMF.

The fall in the exchange rate and the value of stocks affect businesses badly, it undermine the financial system, and the foreign debt obligations were accordingly multiplied. As a result, businesses in East-asian countries are badly affected. The crisis has demonstrated how closely the currency and stock markets in the region are inter-linked and how the political and economic circumstances of neighbouring countries affect one another.

Unfortunately, some of the leaders in Asian countries do not acknowledge their own weaknesses in respect of their policies and systems but merely attributed the currency crisis solely to foreign currency speculators who are said to have reprimanded the weaker Southeast-asian countries for the reason that they went against the American's wish to admit Myanmar into the Association of South–east Asia Nation (ASEAN).

This reflects an alarming level of *economic illiteracy* on the part of the leaders in this region. It also indicates their dangerous unwillingness to accept how an *open capitalist economy works.*

1.2 Objective of Study

The **objective** of this study is to analyse the impact of the crisis to the East-asian countries the possible causes and some related issues including that of whether IMF can provide any solution to the crisis and whether the crisis in this region affect countries in other regions. A more in-depth study was made in respect of Malaysia's currency, its stock market and what are the sectors affected most by the crisis. Several recommendations are made with a view to solve the country's economic predicament.

CHAPTER 2

EFFECTS OF THE CRISIS

During the Crisis, these East-asian countries have suffered a loss in *currency depreciation* which ranges averagely from *35 % to 50 %.* Their *stock market* value has declined drastically by at least *60%* in dollar terms since January 1997.

The currency crisis started in *June 1997* with the sharp decline of *Thai Baht* of *47%* against US-dollars over period of the subsequent 8 months. Then the *Philippino Peso* lost *35%* of its value over the same period followed by *Indonesia's Rupiah* which lost *76%* ; the *Malaysian Ringgit* lost *38 %* and the *Singapore Dollar* lost *20%.*

The *Singapore Dollar* had gained an average of *3 %* per annum over 22 years to March, 1996. The cumulative gain of the Singapore dollar over 22 years was effectively cut by half in 8 months! Likewise, The *Ringgit* was holding steadily against the *US-Dollar* over the last *12 years* until 1994, this steady rate was lost within just <u>a few weeks.</u>

The currency crisis and stock-market turmoil have resulted in many companies including financial institutions in East-asian countries *technically bankcrupt.*

However, hardly any have been liquidated due to legal complications relating to the bankcruptcy law and government support. Some governments prefer to rescue the politically well-connected ones from insolvency. Everywhere the volume of *bad debt* is simply too huge. For this reason, foreign investors have lost their confidence in these markets.

As a result of the crisis, many countries in this region have recently revised their GDP growth forecast in 1998 with negative growth rate as shown in *Table 1.*

Table 1 : - Revised growth forecasts of East –asian countries

EAST ASIAN ECONOMIES Lower 1998 Growth Forecasts		
	Previous	**Current (Revised)**
MALAYSIA	**2.0 % to 3.0 %**	**-1.0 % to –2.0 %**
Hong Kong	5.3%	3.0%
China	8.8%	8.0%
Japan	1.1%	-1.5%
Taiwan	6.9%	5.5% to 6.0%
Korea	5.5%	-4.0%
Singapore	4.8%	0.5% to 1.5%
Philippines	3.8%	2.5%
Thailand	0.4%	-4.0% to –5.5%
Indonesia	2.0%	-13%

Source : Ministerial Statement, Dewan Rakyat July 13, 1998.

CHAPTER 3

IMPACT OF CRISIS ON MALAYSIA

3.1 Introduction

Prior to the crisis in 1997, there were many favourable features in the Malaysian economy. During the period between 1988 to 1996, Malaysia's Gross Domestic Product (GDP) growth was in average *8.8 %* per annum as shown in *table 2*, inflation rate was low of around *3.8 %,* and the unemployment rate for 1996 was only *2.5 %*. Unlike other East-asian countries, Malaysia has a relatively low amount of external debts of US 45.2 billion dollar or 42 % of the GDP as at June 1997. The debt ratio was only 6.1 % of the exports as at end-1996. The banking sector was healthy, with non-performing loan (NPL) accounted for only 3.6 % of the total loans as at June 1997. Malaysia's saving rate at 38.5 % in 1996 was one of the highest in the world.

3.2 Impact of The Crisis

In consequence of the regional crisis, the Ringgit depreciated against US dollars since July 1997. The month-end closing price against the US Dollar is shown in *Table 3*.

Table 2 : Malaysia's Real gross domestic product growth (1988 - 1998)

YEAR	REAL GDP (RM BILLION)	GDP GROWTH (%)
1988	66.3	8.9
1989	72.4	9.2
1990	79.5	9.7
1991	86.3	8.7
1992	93.1	7.8
1993	100..6	8.3
1994	109.9	9.2
1995	120.3	9.5
1996	130.6	8.6
1997	141.1	8.0
1998 *	*Not Available Yet*	-1.0 to -2.0

Base Year : 1987 (Market Prices)

Source : Past Bank Negara Reports
& Investors Digest, September 1997

The exchange rate against the US Dollar has been very steady between 2.49 (or US $ 0.4011 for every Ringgit) and 2.5760 (or US$ 0.3882 for every Ringgit) . Starting in July 1997, the exchange rate declined drastically with July month closed at 2.6450 (or US $ 0.3781 for every Ringgit). August 1997 closed at 2.9750 and surpassing 3.0000 Ringgit mark thereafter. The month end closing in January 1998, June 1998 and July 1998 even surpassed the 4.0000 Ringgit mark.

In an effort to prevent currency speculation, the Malaysian government has undertaken the following measures : -

- In early August 1997, Bank Negara Malaysia imposed a US $ 2 million limit on outstanding non-commercial –related ringgit offer-side swap transaction with any single foreign customer.
- Subsequently, KLSE declared the 100 component stocks of the Composite Index as designated securities.
- Short –selling in the stock market was suspended.
- Local funds such as the Employees Provident Fund (EPF) and Permodalan Nasional Berhad (PNB) were invited to support the market at the time when the foreign funds were retreating.

Table 3 : Ringgit vs Against US $ and Effect On The Composite Index

	EXCHANGE RATES		
MONTHS	US DOLLAR 1 US $	RINGGIT RM 1	COMPOSITE INDEX
Jan-96	2.5760	0.3882	1,055.42
Feb-96	2.5600	0.3906	1,084.41
Mar-96	2.5480	0.3925	1,149.08
Apr-96	2.5030	0.3995	1,189.54
May-96	2.5100	0.3984	1,141.07
Jun-96	2.5050	0.3992	1,136.31
Jul-96	2.5050	0.3992	1,068.23
Aug-96	2.5050	0.3992	1,118.57
Sep-96	2.5180	0.3971	1,135.27
Oct-96	2.5430	0.3932	1,168.31
Nov-96	2.5370	0.3942	1,226.52
Dec-96	2.5390	0.3939	1,237.96
Jan-97	2.4960	0.4006	1,216.72
Feb-97	2.4930	0.4011	1,270.67
Mar-97	2.4915	0.4014	1,217.64
Apr-97	2.5230	0.3964	1,080.17
May-97	2.5230	0.3964	1,104.83
Jun-97	2.5345	0.3946	1,077.30
Jul-97	**2.6450**	**0.3781**	**1,012.84**
Aug-97	2.9750	0.3361	804.40
Sep-97	3.1250	0.3200	814.57
Oct-97	3.4580	0.2892	664.69
Nov-97	3.5330	0.2830	545.44
Dec-97	3.9250	0.2548	594.44
Jan-98	4.1300	0.2421	701.80
Feb-98	3.7180	0.2690	745.12
Mar-98	3.7080	0.2697	719.52
Apr-98	3.7750	0.2649	625.97
May-98	3.9380	0.2539	538.24
Jun-98	4.2080	0.2376	455.64
Jul-98	**4.1550**	**0.2407**	**402.65**

As a result of the economic slowdown, the Malaysian government, like what other neighbouring countries did, revised downward the forecast of economic performance in 1998 which is shown in *Table 4* to reflect the more realistic figures : -

Table 4 : Malaysia's Revised Performance Forecast For 1998

• **Growth of real Growth Domestic Product for 1998 revised to –1% to – 2%.**
• **Inflation rate for 1998 is expected at 7 % to 8 %.**
• **Current account in the balance payments expected to register a surplus of RM 2 billion or 1 % of the Gross National Product (GNP).**
• **Federal Government Budget deficit for 1998 to increase to RM 10 billion or 3.7 % of GNP.**

The *Crisis* will indeed slow-down Malaysia's economy over a period of the next 3 – 5 years before it can be fully recover back to the present economy scenario, provided that the Malaysian government can implement effective policies with full commitment.

Malaysia is very much less dependent on foreign debt, and so has managed to avoid resorting to the IMF's bail-out programs. Nevertheless, the ' curbs on bank lending ' regulation imposed in December 1997 by the BNM have left companies desperate for money. This would threaten to bring about the collapse of the property market and an ensuing cycle of banking distress. Having for years failed to persuade banks to merge voluntarily, the BNM finally resorted to get the banks to merge by mandatory requirement.

As a result of the depreciated Ringgit, for Malaysian, transactions in *US currency* has become very expensive indeed. On the other hand, to the American, transactions in *Ringgit* have become very cheap. In fact, Malaysia's Ringgit has been effectively devalued by some 40 % over a period of 7 months since July 1997. This means the per capita GDP of Malaysian has reduced from somewhere in the region of US$5,000 to just about US$ 3,000 which is a dramatic loss of value. For Malaysian companies which have borrowed foreign loans are now having to service higher interest as well as paying back higher amount of capital sum. They will also incur higher costs of foreign imports. *For example*, Malaysians import US 1 billion worth of foreign food, have to pay RM 4 billion now instead of RM 2.5 billion what they used to pay.

Further, despite the effort of encouraging trade amongst ASEAN countries, the *intra-ASEAN* trades are still undertaken in US dollars, which means that : *for example* the lower cost of buying products from Indonesia or Thailand has not benefited Malaysian citizens because the transactions are billed in US Dollars thus Traders are the ONLY ones who have benefited.

CHAPTER 4

EFFECTS OF THE DEPRECIATED RINGGIT

4.1 Introduction

Currency movements have varying implications on competitiveness and external trade, debt and investment. Because of Ringgit depreciation, Malaysia's competitiveness has been enhanced after taking into account the combination of the currencies of Malaysia's trading partners and correcting for inflation among the countries. The depreciation of the Ringgit against the US Dollar started from July 1997 and is shown in *Table 3*. As a result, the Malaysian goods are relatively cheaper and more competitive than its trading partners. Therefore, we expect some increase in exports and with the reduction in imports, should lead to a better balance of trade.

4.1 Trade Balance

The currency depreciation will generally help to improve the balance in the current account. With cheaper Ringgit, exports grow faster than imports, which help to reduce the size of the current account deficit. For import, an exchange rate of RM4.00 to US$ 1 means that they now have to pay about *37.5 %* more compared to pre-July 1997 when the exchange rate was at RM 2.50.

On the part of exporters, the depreciation of the Ringgit has given an export boost to Malaysian products. When compared with the previous year, the *value of exports* in 1997 grew by *12.4 %* in Ringgit terms, but only *0.5 %* in US Dollar terms. Compared with the corresponding period in 1997, export growth for April 1998 grew by *44.5 %* in Ringgit terms. However, if the exchange rate of RM 3.732 to US $1 is used, the export growth for April 1998 *fell* by *3.1 %*. About 60 – 80 % of the inputs for these industries is imported. In 1997, imports grew by 12.0 % in Ringgit terms and 0.2% in US Dollar terms.

4.3 Manufacturing Exports

The exports from the manufacturing sector are largely from non-resource industries and contribute *80 %* of the total exports. There are limits to the beneficial effect of a devalued currency on manufactured exports. Many firms are already operating at full capacity and cannot increase exports quickly to take advantage of the depreciating Ringgit. In addition, overseas importers are pressing Malaysian exporters for discounts, as such, the value of exports is reduced. Furthermore, the cost of imports, which go into manufactured exports, has also increased substantially and nullifies the benefits of depreciated currency.