THE MALAYSIAN GOVERNMENT'S RESPONSE TO THE ECONOMIC CRISIS

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)
MALAYSIA OFFICE

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PREFACE

Malaysia has recorded rapid economic development, especially over the last decade until the Asian economic crisis of 1997. The country's annual GDP growth averaged more than 8% from 1990 to 1996, then contracted by 6 7% in 1998.

To deal with the crisis, the Malaysian government initially implemented the International Monetary Fund (IMF) style policies of tight monetary and fiscal policy and market oriented reforms. However, when the crisis did not stop and the country seemed headed for deeper and prolonged recession, Malaysia opted to abandon the IMF style policies The government reversed most of the initial contractionary policies and embarked on an expansionary monetary and fiscal policy to pull the country out of the recession

The policies followed by the Malaysian government were somewhat unorthodox and controversial at times. However, the policies seem to be working and there are now clear signs that the economy is recovering with positive growth expected in 1999.

As a donor agency providing technical cooperation under the Government of Japan, JICA Malaysia Office would like to understand and share the Malaysian experience with other developing countries and donor communities by documenting the Malaysian Government's responses to the crisis and the early results of the measures introduced.

JICA Malaysia Office commissioned this compilation work on Deloitte Touche Tohmatsu Malaysia/ Kassim Chan Management Consultants Sdn Bhd

I would like to acknowledge cooperation of the Malaysian Government including the Economic Planning Unit (EPU) and related institutes for assisting in preparing this report.

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Preface (cont'd)

This report was prepared jointly by JICA Malaysia Office and Deloitte Touche Tohmatsu Malaysia/ Kassim Chan Management Consultants Sdn Bhd (DTT/ KCMC). The findings, interpretation and view expressed in this report are entirely those of the authors and should not be attributed to JICA Malaysia Office or Deloitte Touche Tohmatsu Malaysia/ Kassim Chan Management Consultants Sdn Bhd.

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ABBREVIATIONS

BCI	Business Conditions Index
BIS	Bank Of International Settlement
BLR	Base Lending Rate
BNM	Bank Negara Malaysia (Central Bank of Malaysia)
CDS	Central Depository System
CEO	Chief Executive Officers
CLOB	Control Limit Order Book
CPI	Consumer Price Index
CDRC	Corporate Debt Recovery Committee
CSI	Consumer Sentiments Index
Danaharta	Danaharta Nasional Berhad
Danamodal	Danamodal Nasional Berhad
ECM	Exchange Control Malaysia
EPF	Employees Provident Fund
ES	Explanatory Statement
ESCL	Exchangeable Subordinated Capital Loans
FDI	Foreign Direct Investments
FIA	Futures Industry Act 1993
FMM	The Federation of Malaysian Manufacturers
GDP	Gross Domestic Product
GNP	Gross National Product
HRDC	Human Resource Development Committee
HRDF	Human Resource Development Fund
IMF	International Monetary Fund
INCPS	Irredeemable Non-Cumulative Convertible Preference Shares
IPI	Industrial Production Index
IPO	Initial Public Offerings
JACTIM	Japanese Chamber Of Trade And Industry Of Malaysia
JEXIM	Japan Export Import Bank
KLCI	Kuala Lumpur Composite Index
KLOFFE	Kuala Lumpur Options And Financial Futures Exchange
KLSE	Kuala Lumpur Stock Exchange
LAR	Liquid Asset Requirement
LPG	Liquid Petroleum Gas
MCD	Malaysian Central Depository Sdn Bhd
MDCH	Malaysian Derivatives Clearing House
MESDAQ	Malaysian Exchange Of Securities Dealing And Automated Quotation Bhd
MGS	Malaysian Government Securities

Abbreviations (cont'd)

MME	Monetary Exchange
MSC	Multimedia Super Corridor
MSCI	Morgan Stanley Capital International
MTR	Mid Term Review
NEAC	National Economic Action Council
NERP	National Economic Recovery Plan
NPLs	Non Performing Loans
NLC	National Land Code
NSB	National Savings Bank
NTA	Net Tangible Assets
OECF	Overseas Economic Cooperation Fund
PALs	Provision Allotment Letters
PCS	Preliminary Conceptual Scheme
PLC	Public Listed Companies
PNB	Permodalan Nasional Berhad
PPI	Producer Price Index
RM	Ringgit Malaysia (Malaysian Ringgit)
RO	Restraining Order
RWCR	Risk Weighted Capital Ratio
SBCs	Stock Broking Companies
SC	Securities Commission
SCA	Securities Commission Act 1993
SDN BHD	Sendirian Berhad (Private Limited)
SEA	Special External Account
SIA	Securities Industry Act 1983
SICDA	Securities Industry (Central Depository)Act 1991
SMIs	Small and Medium Sized Industries
SPV	Special Purpose Vehicle
SRR	Statutory Reserves Requirement
SSR	Statutory Service Requirement
TFP	Total Factor Productivity
UNDP	United Nations Development Program
WTO	World Trade Organisation

1. INTRODUCTION

1.1 OBJECTIVE AND SCOPE

The objective and scope of this report are to document until the first quarter of 1999;

- The economic measures introduced by the Malaysian government in response to the economic crisis which inflicted Malaysia and the region from middle of 1997.
- The background and early results of the measures introduced.
- The response of the various stakeholders in the Malaysian economy e.g. private sector, public sector, foreign investors, etc

1.2 METHODOLOGY

This report has been prepared mainly by desk research on the subject matter and supplemented by interviews where appropriate

The figures and statistics quoted in the report are mainly from

- The **National Economic Recovery Plan (NERP)** released in July 1998.
- The Malaysian government's **"White Paper On The Status of the Malaysian Economy"** (White Paper) released in April 1999.
- Statements and documents released by the **National Economic Action Council (NEAC).**
- The mid term review of the 7^{th} **Malaysia Plan** (1996 – 2000) released by the government in April 1999.
- **Bank Negara Malaysia Annual Reports** (several years).
- Other sources as quoted in the report.

1.3 LIMITATIONS

Whilst every effort was made to verify the information obtained from our desk research and interviews, we are unable to provide any warranty as to the accuracy of the information so obtained.

Accordingly, readers of this report are reminded to obtain advice from the relevant competent authority before making any business decision and not make decisions based on information contained in this report.

2. THE ASIAN ECONOMIC CRISIS

2.1 EVENTS LEADING TO THE CRISIS

Asia went into economic crisis in 1997, after more than a decade of strong economic performance. The crisis began in Thailand in mid 1997 and spread rapidly, initially to other countries in the region and subsequently to other continents as well. The speed of the **contagion effect** has been unprecedented and caught almost everyone by surprise.

The crisis resulted in massive and sudden capital flight out of the region, substantial depreciation in the value of the currencies, significant wealth loss and drop in asset prices in most countries in the region. Many corporations in the region went into difficulties, resulting in rising unemployment, cash flow problems, a drop in output and deflation There was a general increase in non-performing loans, which threatened the stability of the financial system and the economies as a whole.

Various reasons have been put forward for the cause and spread of the crisis. The reasons vary from putting the blame entirely on the internal weaknesses of the relevant countries to putting the blame entirely on external factors like the operation of hedge funds and the failure of the international financial architecture.

The steps leading to the crisis are outlined below.

2.1.1 Rapid Economic Growth Of The Region

Most of the affected countries, prior to the crisis exhibited rapid growth, price stability, high savings, high fiscal surplus and foreign exchange reserves.

Malaysia, Indonesia and Thailand all recorded annual growth rates between 7%-12% from the early to mid-1990s. Similarly, Singapore, Taiwan and South Korea also recorded high growth rates.

Please see **Table 1** for some economic data on some of the affected countries.

Though many of these countries had relatively high saving levels, the savings were not enough to fund the rapid growth. As such, rapid growth in many of these Asian countries was financed by funds from abroad

2.1.2 Overheating Of The Economies

The rapid growth of the countries funded by foreign funds, resulted in large current account deficits, inflated stocks and property markets in most of these countries.

According to the International Monetary Fund (IMF), inadequate supervision of the financial sector and poor assessment of risk by banks and corporations in the region led to large amounts of capital and loans from abroad being channelled into the property market and the share market. Apparently a substantial portion of these loans and capital were short term, denominated in foreign currency and unhedged.

TABLE 1
ECONOMIC INDICATORS FOR SELECTED ASIAN COUNTRIES

	1994	1995	1996	1997
1. Malaysia				
• Growth Of Real GDP (%)	9.3	9.4	8.6	7.7
• Consumer Prices (%)	3.7	3.4	3.5	2.7
• Current Account Balances (% of GDP)	-7 8	-9.9	-4.9	-5.1
2. Indonesia				
• Growth Of Real GDP (%)	7 5	8 2	7.8	4.9
• Consumer Prices (%)	8.5	9.0	6 6	10.3
• Current Account Balances (% of GDP)	-1 7	-3.3	-3 4	-2.3
3. Philippines				
• Growth Of Real GDP (%)	4.4	4.7	5 9	5 2
• Consumer Prices (%)	9.0	8.0	9 1	6.0
• Current Account Balances (% of GDP)	-4 6	-4 4	-4.8	-5.3
4. Singapore				
• Growth Of Real GDP (%)	10.5	8.4	7.5	8.0
• Consumer Prices (%)	3.1	1.7	1.4	2.0
• Current Account Balances (% of GDP)	+16.2	+17.3	+15.9	+15.8
5. Thailand				
• Growth Of Real GDP (%)	8.9	8.8	5.5	-0 4
• Consumer Prices (%)	5.1	5.8	5.9	5.6
• Current Account Balances (% of GDP)	-5 6	-7.8	-7.9	-2.0
6. South Korea				
• Growth Of Real GDP (%)	8.6	8.9	7.1	5.5
• Consumer Prices (%)	6.2	4 5	4.9	4.5
• Current Account Balances (% of GDP)	-1 0	-1.9	-4.7	-1.9
7. Hong Kong				
• Growth Of Real GDP (%)	5.4	3.9	4 6	5.3
• Consumer Prices (%)	8.1	8.7	6.0	5 7
• Current Account Balances (% of GDP)	+1.2	-4.3	-1.4	-3.5

Source: Bank Negara Malaysia Annual Report 1998

Please see **Table 2** for the significance of the short-term funds flows in relation to the Gross Domestic Products (GDP) for some selected Asian countries.

Sluggish growth in Europe and Japan, made the fast growing Asian countries attractive to short-term foreign funds resulting in massive and volatile cross-border fund flows These capital flows contributed to the rapid economic growth of the countries and at the same time led to increases in asset prices, especially property and shares prices.

There was a general euphoric feeling about these economies

However, with the outbreak of the crisis in mid 1997, the perception of the region changed rapidly.

2.2 DEVALUATION OF THAI BAHT AND CONTAGION EFFECTS

It is generally accepted that the trigger of the Asian economic crisis was the defacto devaluation of the Thai Baht on **2nd July 1997**.

The devaluation was in response to the "attack" on the Thai currency amidst concerns of slowdown in Thailand's exports, significant overvaluation of the currency, drop in asset prices generally and large amount of short term foreign debts of the Thai economy.

Short-term inflows of Thailand accounted for 7%-10% of the GDP in 1994, 1995 and 1996 while Foreign Direct Investments (FDIs) was only about 1% of GDP.

In the face of sustained speculative attacks on the Thai Baht in June 1997, the Thai government decided not to defend the Baht resulting in a defacto devaluation of the Baht.

The attack on the Thai Baht and the subsequent devaluation of the Thai Baht caused serious concerns among investors in the region who began to fear that similar risks as in Thailand could be present in all countries in the region. Essentially investors perceived all countries in the region as the same, besieged with similar problems. Accordingly, market sentiments and investor confidence in the region deteriorated rapidly, resulting in a massive outflow of short-term capital and massive sell-outs in the stock markets across the region.

The attack on the Thai Baht was followed by similar speculative attacks on other currencies in the region, including the Malaysian Ringgit. The other affected currencies include the Indonesian Rupiah, the Singapore Dollar, the Philippines Peso and the Korean Won.

TABLE 2
CAPITAL FLOWS IN SELECTED ASIAN ECONOMIES [1]
(In percent of GDP)

	1983-88 [2]	1989-95 [2]	1991	1992	1993	1994	1995	1996	1997
Indonesia									
Net private capital flows [3]	1 5	4.2	4 6	2.5	3 1	3 9	6 2	6.3	1.6
Net direct investment	0 4	1.3	1.2	1 2	1.2	1.4	2.3	2.8	2 0
Net portfolio investment	0.1	0.4	-	-	1.1	0 6	0.7	0 8	-0.4
Other net investment	1 0	2.6	3 5	1.4	0.7	1.9	3.1	2 7	0 1
Net official flows	2 4	0.8	1 1	1 1	0.9	0 1	-0.2	-0.7	1.0
Change in reserves [4]	-	-1.4	-2 4	-3 0	-1.3	0 4	-0.7	-2.3	1.8
Korea									
Net private capital flows [3]	-1.1	2 1	2 2	2.4	1.6	3.1	3.9	4.9	2.8
Net direct investment	0 2	-0.1	-0.1	-0.2	-0.2	-0 3	-0.4	-0.4	-0.2
Net portfolio investment	0.3	1.4	1 1	1 9	3 2	1.8	1 9	2.3	-0 3
Other net investment	-1 6	0 8	1.3	0 7	-1 5	1 7	2.5	3.0	3.4
Net official flows	-	-0.3	0.1	-0 2	-0.6	-0.1	-0 1	-0 1	-0 1
Change in reserves [4]	-0 9	-0 8	0.4	-1 1	-0.9	-1 4	-1.5	0 3	-1 1
Malaysia									
Net private capital flows [3]	3.1	8.8	11.2	15.1	17 4	1 5	8 8	9.6	4 7
Net direct investment	2.3	6 5	8 3	8.9	7 8	5 7	4 8	5.1	5.3
Net portfolio investment	-	-	-	-	-	-	-	-	-
Other net investment	0 8	2.3	2 9	6 2	9.7	-4.2	4.1	4 5	-0 6
Net official flows	0 3	-	0 4	-0 1	-0.6	0.2	-0.1	-0.1	-0 1
Change in reserves [4]	-1.8	-4.7	-2.6	-11 3	-14 7	4.3	2.0	-2.5	3.6
Philippines									
Net private capital flows [3]	-2.0	2 7	1.6	2.0	2.6	5 0	4.6	9 8	0.5
Net direct investment	0 7	1.6	1 2	1.3	1 6	2.0	1 8	1.6	1.4
Net portfolio investment	-	0.2	0 3	0 1	-0.1	0.4	0 3	-0.2	-5 3
Other net investment	-2.7	0.9	0 2	0 6	1.1	2.5	12.4	8.5	4.5
Net official flows	2.4	2.0	3.3	1.9	2.3	0.8	1 4	0.2	0.8
Change in reserves [4]	0.5	-1.1	-2.3	-1.5	-1.1	-1.9	-0.9	-4 8	2.1
Singapore									
Net private capital flows [3]	5.0	3 8	1 7	2 7	9.4	2.5	1.3	-10.1	-5 5
Net direct investment	8.7	6 0	8 8	2.1	5.5	4.8	4.9	4.3	5 3
Net portfolio investment	-0.5	0.1	-2.1	3 3	0 5	1 1	0.9	-16.2	-14.4
Other net investment	-3 2	-2.4	-5 1	-8.0	3.4	-3.4	-4.6	1 8	3.6
Net official flows	-	-	-	-	-	-	-	-	-
Change in reserves [4]	0 5	-1 1	-2.3	-1.5	-1 1	-1 9	-0.9	-4.8	2 1
Thailand									
Net private capital flows [3]	3.1	10 2	10.7	8 7	8 4	8 6	12.7	9.3	-10.9
Net direct investment	0.8	1.5	1.5	1.4	1.1	0.7	0.7	0 9	1 3
Net portfolio investment	0 7	1.3	-	0.5	3 2	0.9	1.9	0.6	0.4
Other net investment	1.5	7.4	9.2	6.8	4 1	0.7	10.0	7 7	-12 6
Net official flows	0.7	-	1.1	0 1	0.2	0.1	0.7	0.7	4.9
Change in reserves [4]	-1 4	-4 1	-4 3	-2 8	-3 2	-3.0	-4.4	-1.2	9.7

Source: *The Malaysian governments' White Paper on the Status of the Malaysian Economy*

1 *Net capital flows, comprise net direct investment, net portfolio investment, and other long – and short-term net investment flows, including official and private borrowing*

2 *Annual averages.*

3 *Because of data limitations, other net investment may include some official flows*

4 *A minus sign indicates an increase*

The Asian Economic Crisis

Please see **Table 3** and **Exhibit 2** for the changes and movement of some of the regional currencies during the economic crisis period.

Almost all countries in the region experienced depreciation of their currency and sellouts in the stock market. These in turn adversely affected market sentiments further, resulting in further depreciation of the currency and stock markets.

From its start in Thailand, the crisis started spreading rapidly to other countries.

The initial reaction of most of the countries in the region was to defend the speculative attacks on their currencies Most of the central banks in the region intervened to shore up their respective currencies This strategy proved to be disastrous as it had a draining effect on the limited foreign currency reserves of these countries. Most of the countries quickly abandoned this strategy and allowed their currencies to depreciate The Philippines Peso was floated on July 11 The Malaysian Ringgit was allowed to depreciate from July 14, while the Indonesian Rupiah was allowed to fall from July 21

The prevailing view internationally at that time was that the crisis was caused by market reaction to policy weakness in the affected countries. This was also the view of the International Monetary Fund (IMF). Accordingly, the affected countries began implementing economic and financial reforms, increased transparency of policies and introduced macro-economic measures to strengthen domestic economic and financial systems.

The conventional wisdom then was that, such measures were required to restore confidence in the economies concerned, which in term was to have brought stability to the currencies and the stock markets.

The initial strategy of defending the currencies and the substantial depreciation in the value of these currencies, resulted in some countries rapidly depleting their foreign currency reserves. This raised serious concerns about these countries' ability to meet their foreign currency denominated loans and other financial obligations when due.

Thailand, Indonesia and South Korea, when it became evident that they would not be able to meet their foreign currency denominated interest and loan repayment obligations, sought financial assistance from the IMF.

The IMF approved "rescue schemes" for these 3 countries totalling loans of **US $118.6 billion** as follows:

Country	**IMF Assistance (US$ Billion)**
Thailand	17.2
Indonesia	43.0
South Korea	58.4

TABLE 3

EXCHANGE RATE MOVEMENT OF SELECTED ASIAN CURRENCIES AGAINST THE US DOLLAR (1 USD)
June 1997 – March 1999

CURRENCY	June 97		Jul 97		Aug 97		Sept 97		Oct 97		Nov 97		Dec 97	
	A	C	A	C	A	C	A	C	A	C	A	C	A	C
Yen (¥)	114	-	114	-	118	+4	115	-3	121	+6	125	+4	131	+6
Hong Kong Dollar	7 74	-	7.74	-	7.74	-	7 74	-	7.74	-	7 73	-0.01	7.75	+0 02
Singapore Dollar (S$)	1.43	-	1 44	+0.01	1 52	+0 08	1 48	-0 04	1.56	+0 08	1 58	+0 02	1 65	+0.07
Malaysian Ringgit (RM)	2.52	-	2.54	+0.02	2.80	+0 26	2.75	-0.05	3 34	+0 59	3 32	-0.02	3.81	+0 49
Philippines Peso	26 38	-	30 00	+3.62	30.20	+0 20	28 59	-1 61	33 86	+5 27	34.05	+0.19	37.50	+3.45
Thai Baht	24.25	-	29 70	+5.45	32.90	+3 20	31.45	-1 45	37.65	+6 20	38 45	+0 8	45.05	+6.60
Indonesia Rupiah	2,248	-	2,451	+23	2,990	+539	2,615	-375	3,660	+1,045	3,465	-195	5,050	+1,585
South Korea Won	888	-	892	+4	899	+7	894	-5	915	+21	987	+72	1,713	+726
Taiwan Dollar	27 89	-	27.93	+0.04	28.73	+0.80	28.74	+0.01	29.88	+1.14	31 10	+1.22	32.55	+1.45

A – Actual

C – Change

Source: Asiaweek Magazine's Vanous Issues.

TABLE 3 (cont'd)
EXCHANGE RATE MOVEMENT OF SELECTED ASIAN CURRENCIES AGAINST THE US DOLLAR (1 USD)
June 1997 – March 1999

Currency	Jan 98		Feb 98		Mar 98		Apr 98		May 98		June 98		Jul 98	
	A	C	A	C	A	C	A	C	A	C	A	C	A	C
Yen (¥)	128	-3	126	-2	130	+4	130	-	135	+5	145	+10	-	-
Hong Kong Dollar	7.74	-0.01	7 74	-	7 75	+0 01	7.75	-	7 75	-	7.75	-	-	-
Singapore Dollar (S$)	1 74	+0 09	1.67	-0.07	1.61	-0 06	1 59	-0 02	1 66	+0 07	1 75	+0 09	-	-
Malaysian Ringgit (RM)	4 18	+0 37	3.88	-0.30	3.80	-0 08	3.65	-0.15	3 84	+0 19	4.08	+0 24	-	-
Philippines Peso	41.50	+4 00	40 50	-1 00	39.45	-1.05	37 85	-1 6	39.60	+1.75	42 45	+2.85	-	-
Thai Baht	51 75	+6 70	46 15	-5.60	40.30	-5 85	39 90	-0 40	39.22	-0 68	43 80	+4.58	-	-
Indonesia Rupiah	8,550	+3,500	9,750	+1,200	10,100	+350	7,650	-2,450	12,500	+4,850	14,700	+2,200	-	-
South Korea Won	1,619	-94	1,622	+3	1,462	-160	1,404	-58	1,443	+39	1,433	-10	-	-
Taiwan Dollar	33 80	+1 25	32 85	-0 95	32 44	-0 41	33.00	+0 56	33.50	+0 50	34 90	+1 40	-	-

A – Actual

C – Change

Source: Asiaweek Magazine's Various Issues

TABLE 3 (cont'd)

EXCHANGE RATE MOVEMENT OF SELECTED ASIAN CURRENCIES AGAINST THE US DOLLAR (1 USD)

June 1997 – March 1999

CURRENCY	Aug 98		Sept 98		Oct 98		Nov 98		Dec 98		Jan 99		Feb 99		March 99	
	A	C	A	C	A	C	A	C	A	C	A	C	A	C	A	C
Yen (¥)	146	+1	131	-15	114	-17	120	+6	117	-3	114	-3	114	-	119	+5
Hong Kong Dollar	7 75	-	7 75	-	7 75	-	7.74	-0.01	7.75	+0.01	7.75	-	7.75	-	7 75	-
Singapore Dollar (S$)	1.77	+0 02	1 72	-0 05	1 62	-0 10	1.63	+0 01	1 65	+0 02	1.68	+0 03	1 69	+0 01	1 73	+0.04
Malaysian Ringgit (RM)	4 24	+0.16	3 80	-0.44	3.80	-	3.80	-	3.80	-	3.80	-	3 80	-	3.80	-
Philippines Peso	43 30	+0 85	43 73	+0.43	42.74	-0.99	40 13	-2.61	38.80	-1 33	38.40	-0.40	38.65	+0 25	39.15	+0.50
Thai Baht	41.80	-2.00	40 78	-1 02	37.99	-2 79	36 50	-1 49	35 75	-0.75	36.45	+0.70	36.85	+0.40	37.35	+0 50
Indonesia Rupiah	13,150	-1,50	11,750	-1,400	7,920	-3,830	7,650	-270	7,475	-175	8,450	+975	8,700	+250	9,000	+300
South Korea Won	1,334	-99	1,368	+34	1,320	-48	1,316	-4	1,208	-108	1,185	-23	1,176	-9	1,234	+58
Taiwan Dollar	34.75	-0.15	34 50	0.25	32.85	-1 65	32 59	-0.26	32 25	-0 34	32.25	-	32.30	+0 05	33 16	+0 86

A – Actual

C – Change

Source: Asiaweek Magazine's Various Issues.

The Asian Economic Crisis

As part of the IMF rescue programme, the 3 countries were required to implement the **"IMF Prescription"** i.e. institute tight monetary and fiscal policies, introduce greater transparency and implement structural reforms to open up the economies to allow market rationalisation and restore investor confidence in these economies.

Essentially, the IMF programmes, which were similar to the IMF response to the "**Mexican crisis**" in 1995, involved.

a) Tight monetary policies to **contain inflation and restore international confidence** in these countries' ability to prudently manage the economy.
b) **Higher interest rates** to support domestic currencies and stop capital flight out of the country.
c) **Tight fiscal policies** to correct macro-economic imbalances.
d) Rapid structural reforms to address **financial sector weaknesses** and **imbalances in corporate finances** such as high gearing levels.
e) Improved governance to **correct market imperfections**.
f) **Trade and financial liberalisation** to attract foreign capital

The IMF programmes as outlined above were implemented by Thailand, Indonesia and South Korea. Non-viable financial institutions were closed. The remaining viable financial institutions were restructured and where necessary re-capitalised, with new domestic and/or foreign capital. Financial and labour market reforms were also instituted. Monopolies were dismantled and subsidies abolished.

These **"belt tightening" measures resulted in social unrest** in some of the countries, especially in Indonesia. All 3 countries under the IMF programme saw a **change in the political leadership** in their country.

The cutbacks in government expenditure and fiscal consolidation coupled with high interest rates which were intended to restore investor confidence and stabilise the currencies had a drastic deflationary impact and worsened the economic downturn which was setting-in in these countries. This situation in turn, undermined investor confidence further and led to domestic currencies continuing to depreciate, translating in rising debts in domestic currency terms, which in turn caused more concern internationally on these countries ability to meet their debt obligations when due. These concerns resulted in further pressure on the currencies.

The **downward spiralling situation** stabilised only after the debtors of these countries agreed for a rollover of short-term credit and subsequently convert some of the debts due into medium term bonds and after IMF credit lines were in place in Thailand, Indonesia and South Korea.

Most other countries in the region including Malaysia which were not under the IMF programme, voluntarily followed a variant of the IMF prescription to stabilise their currencies and their economies and restore international confidence in the domestic economies.

2.3 ECONOMIC CRISIS IN MALAYSIA

2.3.1 Pre-Crisis Economic Conditions[1]

During the 5-year (1991-1995) period before the crisis, Malaysia's real GDP growth averaged **8.7%** per annum.

Inflation during the period was at **3.8%** per annum In fact from January to July 1997, the Consumer Price Index (CPI) averaged at **2.7%.**

The rate of unemployment in 1996 was **2.5%**.

Malaysia's external debt in January 1997 was relatively low at **RM115.1 billion** (approximately USD 45.2 billion[2]), which was approximately **42%** of the Gross National Product (GNP). The debt service ratio was at a manageable **5.5%** of GNP.

The country's external reserves, free from encumbrances or forward commitments, held at the Central Bank as at June 1997 was **USD27.4 billion,** sufficient to finance **4.3 months** of retained imports.

The government had a surplus budget since 1993. In 1997, the public sector surplus amounted to **RM17.3 billion**, equivalent to **6.6%** of the GNP.

The government's external reserves stood at **RM9.1 billion** as at June 1997. The government's external debt service ratio was **0.9%.**

Malaysia's current account deficit declined substantially from **RM21.6 billion** or **10.4%** of GNP in 1995 to **RM14.2 billion** in 1997, equivalent to **5.4%** of GNP in 1997.

Please refer to **Table 4** for some economic performance indicators of the Malaysian economy.

The banking sector was considered to be generally healthy with non-performing loans at **2.2%** of total loans (NPLs) using the 6 months classification rule. NPLs using the 3 months classification rule were only **3.6%** of total loans outstanding. The Risk Weighted Capital Ratio (RWCR) of Malaysian banks as at June 1997 was **12%**, compared to the Bank of International Settlement (BIS) minimum standard of **8%.** Malaysian banks also adopted almost all 25 Core Principles of Effective Banking Supervision recommended by the Bank of International Settlement (BIS).

The Malaysian economy was considered to be generally sound before the outbreak of the crisis. Both the IMF and the World Bank gave a "clean bill of health" to Malaysia just prior to the crisis.

1 *Source : White Paper, NERP, Bank Negara Annual Reports, NEAC*
2 *Based on exchange rate of RM2 55 = 1 USD*

TABLE 4
MALAYSIA ECONOMIC INDICATORS, 1993 – 1998

	1993	1994	1995	1996	1997	1998
Population (million persons)	19.6	20 1	20.7	21.2	21.7	22.2
Labour force (thousand persons)	7,627	7,834	8,257	8,641	9,038	8,881
Employment (thousand persons)	7,498	7,603	8,024	8,417	8,805	8,538
Unemployment (%)	3 0	2 9	2.8	2.6	2 6	3 9
Per capita income (RM at current prices)	8,024	8,996	10,068	11,228	12,051	11,835
Gross national savings (RM million at current prices)	54,534	62,133	73,448	91,572	102,807	108,075
% of GNP	34 7	34 4	35.3	38 5	39 4	41 2
Gross Domestic Product (RM million at current prices)	165,206	190,274	218,671	249,503	275,367	278,724
Gross Domestic Product (RM million at 1978 prices)	100,617	109,976	120,272	130,621	140,684	131,258
Growth Rate (%)						
Gross domestic product	8.3	9 3	9.4	8 6	7 7	-6 7
Agriculture, forestry and fishing	4 3	-1 0	1.1	2.2	1 3	-4 0
Manufacturing	12 9	14 7	14.2	12 3	12.5	-10.2
Mining and quarrying	-0 5	2 5	9.0	4 5	1 0	0 8
Construction	11 2	14 1	17.3	14 2	9 5	-24.5
Services	9 8	9 7	9.4	9 7	8 0	1 5
Gross National Product (RM million at current prices)	156,941	180,862	208,294	237,687	261,094	262,494
Gross National Product (RM million at 1978 prices)	95,291	104,006	113,704	123,166	132,811	124,476
Gross Rate (%)						
Gross National Product	8.7	9 1	9.3	8 3	7 8	-6 3
Public consumption	10 7	9 9	7.3	1 4	5 3	-3 5
Private consumption	4 6	9 9	9.3	6 0	4 7	-12 4
Public investment	8 4	-0 6	8.7	1 1	8.6	-10 0
Private investment	19 1	27 9	25.3	13 4	8.4	-57.8
Exports	17.2	22 5	17.6	7 2	10.8	-0 7
Imports	19.1	27.7	21.4	4.2	10.2	-18.3
Balance of Payments (RM million)						
Merchandise balance	8,231	4,460	97	10,154	11,337	69,322
Services balance	-16,670	-17,005	-19,229	-19,414	-21,792	-23,381
Transfers	513	-2,225	-2,515	-2,936	-3,698	-9,873
Current account	-7,926	-14,770	-21,647	-12,196	-14,153	36,068
% of GNP	-5 1	-8.2	-10.4	-5.1	-5 4	13 7
External Trade (RM million)						
Total exports (f.o b)	121,238	153,921	184,987	197,026	220,890	286,756
Total imports (c.i.f.)	117,405	155,921	194,345	197,280	220,936	228,309
Balance of trade	3,833	-2,000	-9,358	-254	-45	58,446
Consumer Price Index (%)	3 6	3 7	3.4	3 5	2 7	5.3
External Debt (RM million) [1]	69,181	76,062	85,014	98,086	170,757	159,775
Debt service ratio (% of exports)	7.1	5 5	6.6	6 9	5.5	6 7
% of GNP	44.1	42 1	40.8	41 3	65 4	60.9
Net Bank Negara Reserves (RM million)	76,435	68,173	63,770	70,015	59,123	99,424[2]
Months of retained imports	7.8	5 5	4.1	4 4	3 4	5 7

Source: The Malaysian government's "White Paper on the Status of the Malaysian Economy".

1 *Refers to short-, medium- and long-term external loans*
2 *As at 31 December 1998*

2.3.2 Concerns About The Malaysian Economy Before The Crisis

Though the Malaysian economy had many strengths, there were also some emerging concerns about the economy. Some of the main concerns were:

- **"Overheating" Of The Economy**

  The Malaysian economy grew more than its potential output with **investment persistently exceeding savings since 1991**. The gap was partly financed by foreign capital.

  The growth also resulted in increasing demand for labour which led to wage increases exceeding productivity increases.

  There were inflationary pressures building up in the economy, but the government by controlling the prices of essential items largely kept these pressures under control.

- **Declining Productivity Of The Economy**

  There were also emerging concerns whether the economy was operating efficiently. Total Factor Productivity (TFP), which is a measure of a economy's efficiency, declined from **28.2%** during 1991–1995 to **19.5%** during 1996–1997.

  The decline in the TFP was causing concern about the sustainability of the high growth of the economy

- **Fast Loan Growth**

  The expansion of credit, especially to the property sector and to purchase shares was another concern. Loans to these 2 sectors in 1996 grew at an average of **30%** and **38%** per annum respectively.

  Loans to the property sector amounted to **32.2%** of total loans outstanding in 1997, while loans to purchase shares stood at **9.2%** of total loans outstanding in 1997.

To deal with these concerns, **even before the Asian economic crisis developed**, the government began instituting several measures to reduce the current account deficit, improve productivity and control the growth of loans.

For example, to ensure that future downward trends in asset prices does not threaten the stability of the financial system, the government in April 1997 imposed the following limits on financial institutions.

- Lending by commercial banks and financial companies to purchase shares was caped at 15% of the total outstanding loans.

- Lending to the property sector was capped at 20% of total outstanding loans.

2.3.3 Outbreak Of The Economic Crisis In Malaysia

The economic crisis started in Malaysia when the Ringgit came under heavily selling pressure soon after the devaluation of the Thai Baht on July 2nd 1997.

At the outbreak of the crisis in Malaysia, the general view in Malaysia was that the crisis was a **contagion** from the economic crisis in Malaysia's immediate neighbour, Thailand. Accordingly the authorities sought to publicly differentiate the Malaysian economy from the Thai economy, while at the same time intervening in the foreign exchange market to defend the Ringgit at the **pre crisis level of about RM2.50 to 1 USD**.

However, the selling pressure on the Ringgit did not ease up.

The strategy to defend the Ringgit was also not sustainable and costly. It is not known how much the government actually spent to support the Ringgit. However, the international reserves of Bank Negara Malaysia (BNM), the Central Bank of Malaysia dropped by **RM10.9 billion**[1] in 1997, as a result of the outflow of short term capital including funds used for intervention in the foreign exchange market to support the Ringgit.

Accordingly on July 14, BNM ceased defending the Ringgit The Ringgit was allowed to depreciate and the Ringgit dropped to RM2.61 against the US dollar on the same day. The Ringgit continued to depreciate over the next few months, dropping to an intra-day low of **RM4.88 against the US dollar on January 7, 1998**. From 1st July 1997 and 31st December 1997, **the Ringgit depreciated 35%** against the US dollar.

Please refer to **Table 5** below and **Chart 4.1** in **Exhibit 4** for movement of the Ringgit against some major currencies.

TABLE 5
MOVEMENT OF MALAYSIAN RINGGIT AGAINST MAJOR CURRENCIES

	1997												1998
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
RM per unit of US$	2.49	2 48	2 48	2.51	2 51	2.52	2.64	2.96	3.20	3 44	3 50	3 89	4.55
RM per unit of £	4 00	4.01	4.05	4.10	4 12	4 20	4.32	4 79	5 15	5.74	5.87	6.44	7.53
RM per unit of S$	1.77	1.75	1 72	1 74	1 76	1 76	1 79	1.94	2 09	2.16	2.20	2.32	2.59
RM per 100 unit of ¥	2 04	2.07	1.99	1.98	2 16	2.21	2.23	2.48	2 64	2 86	2 74	2.99	3.60
RM per unit of DEM	1.52	1 47	1 48	1 46	1.48	1 45	1 43	1 65	1.81	2.00	1.99	2 17	2 54

Source NERP

Besides the depreciation of the Ringgit, the other very apparent and visible impact of the onset of the crisis in Malaysia was the performance of the Kuala Lumpur Stock Exchange (KLSE). The KLSE Composite Index (KLCI) which is a barometer index of 100 stocks **dropped 44.9% between 1st July 1997 and 31st December 1997**. Similarly, market capitalisation of the KLSE **dropped 35% from RM420 billion in February 1997** to **RM274 billion on August**. (Market capitalisation continued to **drop to a low of 187 billion in November 1997 i.e down 55% from February 1997**).

Please refer to **Table 6** and **Chart 4.2** in **Exhibit 4**, for the movement in the KLCI and market capitalisation.

TABLE 6
KUALA LUMPUR STOCK EXCHANGE: MOVEMENT OF COMPOSITE INDEX (KLSE) AND MARKET CAPITALISATION

	1997											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
KLCI (points)	1216 7	1270 7	1203 1	1080 2	1104 8	1077.30	1012 8	804.40	814 6	664.69	545.4	594 44
Market Cap (RM Billion)	400	420	399	360	369	367	346	274	278	228	187	204

Source· Investors Digest

3. MALAYSIA'S REACTION TO THE ECONOMIC CRISIS

3.1 INITIAL RESPONSE IN 1997 AND EARLY 1988

To address the rapid decline in share prices and market capitalisation of the KLSE, the government announced a series of measures in the later part of 1997 aimed primarily at restricting short selling and panic selling in the stock market.

It is generally agreed that these measures failed to arrest the downward trend of the KLSE. If anything, these measures aggravated the situation as investors, especially foreign investors appeared frightened by the introduction of new rules and sudden changes in rules regarding share trading. Accordingly investors dumped their shares partly as a response to these measures and the market continued to decline.

The government's strategy at that time was to take drastic steps to stop the further decline in share prices by introducing rules to curb short selling and speculative trading.

Some of the initial measures introduced were:

- Declaring all the 100 component stocks of the Kuala Lumpur Composite Index (KLCI) as **"designated securities"** on 28 August 1997. This meant that sale of these stocks were prohibited unless the seller had a free balance of the shares. Dealings in these stocks was also restricted to a **"delivery before sale"** basis and **100% payment** required before any sales transaction could be fully executed.

  The classification of the KLCI stocks as "designated securities" was to disallow contra or netting settlement of a purchase against subsequent sales.

  The authorities later withdraw the "designated securities" classification of the 100 component stock on **5 September 1997**. Nevertheless, the rule disallowing lending of shares and short-selling remained.

- The Companies Act 1965 was amended and a **new Section 67A was introduced** on 1 September 1997 to allow companies to **buy back their own shares.**

  The amendment was done to allow public listed companies with cash reserves to buy, or effectively redeem their shares from the stock market, taking advantage of the low prices. It was also hoped that this action by companies will arrest further decline in the prices of the shares and bring stability to the stock exchange.

  Prior to the introduction of Section 67A, it was an offence for a company to buy its own share.

It is not known how many companies bought back their shares after this amendment to the Companies Act Sources indicated that only a handful of companies actually bought back their shares. The reason for the poor response is thought to be because companies generally wanted to preserve their cash reserves in the light of the setting economic crisis, instead of using their cash to "redeem" their shares.

- The government announced that government controlled funds such as **Employees Provident Fund** (EPF), **Permodalan Nasional Berhad** (PNB), **The Pension Trust Fund**, etc. were allowed to buy shares in the KLSE over and above the limits imposed previously on them for holding such shares. Banks were also allowed to lend money to buy up the shares.

  This was done to provide support to the rapidly falling prices in the KLSE.

- The RM100,000 levy on foreigners buying property in Malaysia costing above RM250,000 introduced earlier was abolished on **28 August 1997**

  The abolishment of the levy on foreigners buying Malaysian properties was aimed partly at reviving the property counters in the KLSE whose share prices had been affected by prospect of excess supply in certain property market segments.

- The government announced that a **RM60 billion** standby facility had been set up to buy shares listed on the KLSE to support the local stock market in the event the need arises

  Apparently the fund was eventually never set up. It is believed that the announcement was made to boost confidence in the KLSE and stop further decline in share prices.

The response of the government to the crisis at that stage was based on the government's assumption that the crisis in Malaysia was essentially a crisis of confidence, spilling-over from the Thailand crisis, aggravated by activities of hedge funds and currency speculation. At the early stages of the crisis, the severity, depth and magnitude of the crisis were not apparent yet.

At the same time, the government especially the Malaysian Prime Minister, Dato' Seri Dr Mahathir Mohammad, embarked on a campaign to expose the detrimental effects of currency speculators and led calls for reforms of the international financial architecture to control the destabilising effects of short term capital.

The Prime Minister, at the Joint Annual Meeting of the IMF and the World Bank in Hong Kong in September 1997, blamed rogue speculators for starting and prolonging the economic crisis in Asia The Prime Minister's views were heavily criticised then, though there are signs of more people now accepting the views put forward by Dato' Seri Dr Mahathir.

Malaysia's Reaction To The Economic Crisis

By October 1997, it became evident that the measures taken till then to stabilise the Ringgit and the KLSE were not sufficient to stop the crisis.

It became clear that the crisis will be more severe and prolonged than previously thought. The need for **structural reforms of the economy and measures to restore investor confidence** in the Malaysian economy became apparent Accordingly, the government introduced various policies to deal with the crisis.

The government essentially took steps to focus economic policy at addressing the following areas which were of concern in late 1997.

(1) Stabilising the volatility in the economy.

(2) Containing excess domestic demand as seen from the rapid growth of credit and widening current account deficit.

(3) Keeping inflation under control.

(4) Maintaining the export competitiveness of the economy (exports accounted for **80%** of the GDP).

(5) Strengthening the financial sector especially the stockbroking and banking systems to avoid a systematic risk and failure of the financial sector.

(6) Maintaining the standard of living.

The policies introduced by the Malaysian government were essentially **"IMF policies"**, using monetary policies, fiscal policies and financial reforms to deal with the crisis.

3.1.1 Monetary Policies

The government introduced various monetary policies aimed at containing the threat of inflation due to the substantial depreciation of the Ringgit and at controlling the rapid credit growth and lending by financial institutions in the past for property, share purchase and consumption/demand.

The government tightened further the tight monetary policies introduced just before the onset of the crisis to deal with the areas of vulnerability in the Malaysian economy. (See **Section 2.3.2**). Essentially, interest rates were pushed upward (See **Table 7** and **Chart 4.4** in **Exhibit 4**) and stringent controls and curbs were imposed on lending by financial institutions. Hire purchase approvals for vehicle financing, share purchases and the property sector were also restricted.

TABLE 7
INTEREST RATES MOVEMENT
(April 1997 Till July 1998)

	1997									1998						
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Base Lending Rate	9 25	9 27	9 50	9 58	9 61	9 61	9 53	10 07	10 33	10 44	11 08	11 96	12 16	12 21	12 27	12 07
Average Lending Rate	10 46	10 43	10 38	10 85	10 70	10 68	10 69	11 09	11 51	11 69	12 35	13 33	13 49	13 54	13 51	13 47
3-mnth Interbank Rate	7 39	7 67	7 71	7 86	7 68	7 65	8 22	8 50	8 60	9 35	10 80	10 91	11 00	11 04	11 07	10 97

The suddenness of the crisis resulted in the corporate sector being unprepared to deal with the crisis. This together with the increase in the interest rates resulted in many companies beginning to default in their loan repayments. This resulted in liquidity becoming tight in the financial system.

Broad money (M3) supply dropped from RM394,150 million in March 1997 to RM372,750 million in September 1997. (See **Table 8** below).

TABLE 8
BROAD MONEY (M3) SUPPLY
(January To September 1997)

	Jan-97	Feb-97	Mar-97	Apr-97	May-97	Jun 97	Jul-97	Aug-97	Sep-97
Broad Money, M3 (RM Million)	393 797	393 980	394 150	392 099	389 316	389 127	387 103	387 372	372 750

To ease the tight liquidity in the financial system, Bank Negara Malaysia (BNM), the Central Bank of Malaysia, lent its funds to the banking system but at the **prevailing market rates** which were quite high then.

3.1.2 Fiscal Policies

The fiscal policies implemented were aimed at cutting government expenditure and deferring implementation of several large infrastructural projects previously approved. The deferment of large infrastructural projects was to "cool down" the economy, control inflationary pressures and reduce imports as many of these large projects had substantial foreign cost elements in them.

The measures were also to curb excessive credit growth and the high leverage of some major private corporations which were at various stage of implementing bank financed large infrastructural projects. At the end of 1997, **private sector debt in the economy was estimated at 167% of the GDP.**

Malaysia's Reaction To The Economic Crisis

Despite the cuts in government expenditure allocations for social development projects like health services, education and social services were generally maintained.

The monetary and fiscal measures introduced in late 1997 were in most cases introduced in an ad-hoc manner to deal quickly with the then rapidly deteriorating economic situation. However there were also some measures which were announced and introduced as a package.

On 17th October 1997, the government unveiled its first major **economic package** to deal with the crisis as part of the Budget for 1998. (See **Exhibit 3.1**).

The economic package contained the following measures:

1. A **2%** cut in government expenditure in the 1998 budget.
2. Deferment of several large infrastructural project e.g. the Bakun Hydro Electric Dam, the proposed link between Indonesia and Malaysia over the Straits of Malacca, the proposed channel in north of the country to link the Straits of Malacca in the west and the South China Sea in the east, the Kuala Lumpur Linear City project, etc.
3. Reclassifying the basis for non-performing loans (NPLs) from **6 months to 3 months** default, to improve the resilience of the banking system to meet future problems.
4. Additional disclosure requirement for banks to improve transparency.
5. Increasing the general provisions of banks for bad debt to **1.5%** of loans from **1.0%** previously.
6. Steps to reduce credit growth to **25%** by end of 1997, **20%** by 1st quarter of 1998 and to **15%** by end of 1998.
7. Loans to non-productive sectors were discouraged.
8. Introduction of additional incentives for companies to export, taking advantage of the weaker Ringgit.

The budget also forecasted a GDP growth of 7% for 1998, indicating that the full extent and severity of the crisis was still not evident in October 1997.

Subsequently, to deal with the economic crisis which proved to be more prolonged than anticipated, several additional economic packages and measures were introduced as follows on:

- 5th December 1997
- February 1998

Malaysia's Reaction To The Economic Crisis

i) Package Of Measures Introduced On 5th December 1997

By December 1997, despite the introduction of various measures and policies in the 1998 Budget in October 1997, there were no signs of the crisis abating. In fact the crisis worsen with the international economic scene looking more bleak. Accordingly, to strengthen the domestic economy in the face of international uncertainly and to install confidence in the domestic financial system, the government introduced an additional package of measures on 5th December 1997.

The policies introduced include.

1 A further cut in government expenditure by **18%** in the 98 budget.

2. Restriction on imports of non-essential items to reduce the current account deficit to **3%** of GNP in 1998.

3. Deferment of all non-strategic, non-essential projects to save government revenue, reduce imports and reduce outflow of Ringgit.

4. Discouraging reverse investment to stop outflow of Ringgit.

5. Emphasis on good governance and enhanced disclosure of information by financial institutions and large corporations to improve transparency and install investors confidence.

6. Restriction on new Initial Public Offerings (IPOs), capital restructuring exercises and schemes in the KLSE as the stock market reaction to IPOs and restructuring scheme introduced then was generally negative leading to further selling pressure in the KLSE.

ii) Package Of Measures Introduced In February 1998

In the face of the prolonging crisis and depreciation of the Ringgit, and signs of decline in growth, the government introduced measures to push interest rates higher, while at the same time trying to stimulate growth.

1. The Central Bank (BNM)'s **3 months intervention rate**[1] was raised from **10%** to **11%** (the rate was 8 7% at end of 1997) resulting in an upward push to interest rates, to ease the pressure on the Ringgit.

2. The **Statutory Reserves Requirement (SRR)** of financial institutions was reduced from **13.5%** to **10%** of eligible liabilities making more funds available for the banks to lend to productive sectors to deal with the decline in growth

[1] *The BNM's 3 months intervention rate is an instrument of monetary policy used by the central bank to determine interest rate in the economy through the Base Lending Rate (BLR).*

3.1.3 Financial Reforms

In addition to tightening monetary and fiscal policies, the government also introduced financial reforms to strengthen the financial systems especially the stockbroking and banking systems with emphasis on greater disclosure, transparency and good governance.

i) Stock Broking Companies (SBCs)

Changes were made to rules relating to the gearing ratio, exposures to single client and single security and margin financing of SBCs. These changes were due to a growing concern among investors as to the financial discipline and financial health of the SBCs amidst the economic crisis. This was because many dealings in securities were done on credit basis i.e. SBCs were willing to obtain loans to purchase shares on behalf of clients pending payment from their clients.

The specific measures introduced were:

1. SBCs were required to maintain a **gearing ratio** of not more than **three times** their capital. Prior to this, there were no rules on SBC's credit exposure.

2. The combined limit on **margin financing exposure** and **trading exposure** to a **single client** of 300% of the SBC's shareholders funds was reduced as follows:

   - 30% of paid up capital for margin financing
   - 100% of paid up capital for total exposure

3. The limit on **margin financing exposure** to a **single security** was reduced to **20%** of the SBC's capital.

   For SBCs with **adjusted capital of less than RM200 million**, the **trading exposure** limit was **100%**, while for SBCs with capital **exceeding RM200 million**, the trading exposure limit was **200%** of its adjusted capital. Prior to the change, the combined limit on margin financing and trading exposure to a single security was 500% of the SBC's shareholder funds.

4. The maximum exposure to a **margin client** was limited to **30%** of the SBC's capital, and the **total exposure** to all margin clients was limited to **100%** of the capital.

5. Effective 4th March 1998, **client funds had to be placed in trust accounts**. This was done to improve protection of investors.

The above rules, including the distinction between the exposure for margin financing clients and trading clients, were aimed to instill a greater sense of financial discipline and to enhance the financial standing of SBCs.

ii) Financial Institutions

The government introduced a package of measures on **24 March 1998** to strengthen the financial system. The measures included:

1. Requirement for **20% provisioning of loan** amounts not backed by security/collateral, to force banks to be more prudent in lending.
2. **Increased the minimum Risk Weighted Capital Ratio (RWCR)** of finance companies from the **8%** to **10%**, requiring finance companies to increase their capital base to become more resilient.
3. Increased the minimum capital funds requirement of finance companies from **RM5 million** to eventually **RM600 million.**
4. Reduction of single customer limit from **30%** to **25%** of capital fund, to improve prudent banking practises.

The measures introduced by the government could be termed as standard IMF prescriptions to stabilise currencies and economies in crisis and are similar to the measures introduced in countries under the IMF programme.

It should be noted that **Malaysia was never under any IMF programme.** As such, Malaysia was not obliged to follow the IMF prescriptions, as was the case with Thailand, Indonesia and South Korea. However, the Malaysian authorities voluntarily implemented these measures to stabilise the crisis situation, in the hope to restore investors' confidence in the economy, the Ringgit and to revive the economy.

3.1.4 Formation Of The National Economic Action Council (NEAC)

In early 1998, once it became clear that the crisis was more serious and deeper than anticipated, the government responded by setting up the **National Economic Action Council (NEAC).**

The NEAC was established on 7th January 1998 as a consultative body to the Cabinet to specifically deal with the crisis and prevent the economy sinking into recession. The NEAC was given the task to formulate measures to deal with the crisis and to chart the economic recovery of the country.

The NEAC consists of 26 members including 13 Ministers with economy related portfolio. The NEAC is chaired by the Prime Minister. The Executive Director of NEAC is Tun Daim Zainuddin, a former finance minister and a prominent and influential businessman in the Malaysian economy. The Prime Minister brought Tun Daim back to the cabinet by appointing Tun Daim as a '**Special Functions Minister**'. Tun Daim Zainuddin has since been appointed First Finance Minister on **9th January 1999.**

The **Executive Committee** of the NEAC headed by the Prime Minister meets almost every working day to discuss and handle the crisis. The Economic Planning Unit (EPU) in the Prime Minister's Department is the secretariat to the NEAC.

The NEAC set to work to draw up a comprehensive recovery plan for the country.

3.2 STATUS OF THE ECONOMY IN MID 1998

The combination of the various measures implemented in late 1997 and early 1998 succeeded in reversing the current deficit in the balance of payment and containing inflationary pressures.

The **current account deficit** of **RM 14.2 billion in 1997** was wiped out and **by the second quarter of 1998, the current account stood at a surplus of RM 8.46 billion.** The consumer price index which peaked at 6 2% in June 1998 also began to ease up.

Please see **Table 9** and **10** and **Chart 4.17** in **Exhibit 4.**

TABLE 9
CURRENT ACCOUNT SURPLUS/(DEFICIT) POSITION
From 3rd Quarter 1997 Till 2nd Quarter 1998

1997		1998			
3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
-1,900	-1,913	6,495	8,456	14,038	11,697

TABLE 10
CONSUMER PRICE INDEX (CPI) MOVEMENT
From September 1997 Till August 1998

Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
2.3	2.7	2.6	2.9	3.4	4.4	5.1	5.6	5.4	6.2	5.8	5.6

However, economic stability was not achieved. In fact, the country was headed for recession, with the GDP in negative growth at the beginning of 1998.

The tight monetary policies followed resulted in a **marked increase in the cost of capital.** The BNM's 3 months intervention rate rose from **8.7%** at end 1997 to **11%** in February 1998 resulting in interest rates rising from about **10%-12%** before the crisis to as high as **20%** per annum in early 1998.

Further, the overall negative sentiments in the economy resulted in the banks becoming reluctant to lend. The tightening of rules on giving credit and in some cases, withdrawal of loans approved earlier resulted in even healthy companies facing cash flow constraints.

The sudden and drastic increase in interest rates and the credit squeeze had a 'choking' effect on businesses already severely affected by the depreciation of the currency, decline in share prices and asset values and weak demand. The contraction of government spending together with the dampened private sector investment contributed to the economy severely shrinking.

Malaysia's Reaction To The Economic Crisis

- Real Gross Domestic Product (GDP) contracted rapidly and resulted in negative growth for the **1st time in 13 years** and the country slipped into recession.

Period	**GDP Growth (Contraction)**
January – March 1997	9.2%
April – June 1997	8.4%
July – September 1997	7 3%
October – December 1997	6.0%
January – March 1998	-2.8%
April – June 1998	-6.8%
July – September 1998	-9.0%
October – December 1998	-8.1%

- Per capital income dropped from **RM12,051** in 1997 to **RM11,835** in 1998 i.e. a drop of **1.8%.**

- The real domestic demand in the economy declined drastically, with overall consumption declining from a **4.9% growth** in 1997 to a **negative 10.3%** in 1998.

- Credit growth declined from **26.5%** at the end of 1997 to **7.5%** at the end of 1998.

- The growth in Broad Money (M3) declined from **18.5%** at the end of 1997 to **4.4%** by the end of August 1998. See **Exhibit 4.3.**

- The base-lending rate (BLR), which represents the cost of funds for banks, went up from **9.3%** in June 1997 to **12.1%** in June 1998.

- The cost to borrowers went up as interest rates are pegged at BLR plus a certain spread. The spread which used to be about **2%** went up to around **4%**, resulting in the borrower's interest cost increasing up to **16%** to **20%**.

- External reserves declined from **RM70,782 million** in June 1997 to **RM58,329 million** in June 1998, registering a fall of **17.59%**. At the same time, external debt rose from **RM115,119 million** in June 1997 to **RM173,738 million** in June 1998, posting an increase of **50.92%.** See **Exhibit 4.5.**

- The **Ringgit continued to depreciate** against the US Dollar and was **64.29%** down in July 1998 compared to the pre crisis level. See **Exhibit 4.1.**

- Firms reported **difficulties in obtaining credits.** A government survey in collaboration with the World Bank found that during the first half of 1998, approximately **25% of the respondents found credits from local banks restrictive,** implying a credit squeeze.

The survey also found that most firms affected by the crisis experienced declining outputs and net profits, with domestic orientated firms more affected than export orientated firms. The net profit to equity ratio of the respondent firms **declined from 67% in 1997 to 47% for the first half of 1998**

- The **KLSE composite index was 62.62% down** in July 1998 compared to the pre crisis level See **Exhibit 4.2**.
- The NPLs in the economy using the 6 month default rule increased from 3 9% in January 1998 to 9.4% in August 1998 of the outstanding loans in July 1998. See **Exhibit 4.7(b)**.
- The **unemployment rate increased** from **2.6%** in 1997 to **3.9%** in 1998.
- **New employment dropped** from a **4.6% growth** in 1997 to a **3% contraction** in 1998.
- **Retrenchment of employees increased** from approximately **19,000** in 1997 to **83,860** in 1998. See **Exhibit 4.33**.
- **The Consumer Price Index (CPI) went up to 6.2%** per annum in June 1998 before beginning to ease. In addition, **the CPI for food rose** from **3.3%** in June 1997 to **11.5%** in June 1998. See **Exhibits 4.10** and **4.11**.
- **The monthly Producer Price Index (PPI) peaked at** about **17%** per annum in July 1998.
- There was also a **decline in the number of new company registrations** and an **increase in liquidation of companies**. According to UNDP Malaysia office, **435** companies were wound up between July 1997 and March 1998. See **Exhibits 4.23** and **4.24**

Please refer to the **Exhibit 4** for a graphic representation of some of the above economic indicators.

By mid 1998, the country was firmly in recession The economic crisis appeared to be worsening, and the outlook uncertain amidst greater regional instability and further erosion of investors' confidence.

There were clear signs that the high interest rates, unavailability of credit, shrinking demand and the onset of recession would result in even well managed corporations facing difficulties and possible closure. This situation threatened to balloon NPLs in the economy, and push banks into closure with drastic economic consequences.

With the situation looking bleak, the Malaysian government decided to change its course of action, instead of continuing the IMF's prescriptions of tight monetary and fiscal policies.

3.3 NATIONAL ECONOMIC RECOVERY PLAN (NERP)

The National Economic Action Council (NEAC) formed in January 1998 formulated the National Economic Recovery Plan (NERP) which was launched in July 1998.

The NERP outlined 6 objectives to deal with the crisis as follows:

1. **Stabilising the Ringgit**

   Stabilising the Ringgit by adopting an appropriate exchange rate regime, increasing external reserves and adopting a balanced interest rate policy.

2. **Restoring market confidence**

   Restoring market confidence through enhanced transparency, establishing rules for assisting ailing industries/companies, consistency of government policies, and improving communication.

3. **Strengthening economic fundamentals**

   Strengthening economic fundamentals by improving the quality of investments, the balance of payments, and price stability, adopting an appropriate monetary policy, and increasing labour competitiveness.

4. **Maintaining financial stability**

   Maintaining financial market stability by establishing agencies to take over non-performing loans and recapitalise banks, improving the capital market and developing the private debt securities market.

5. **Continuing the socio-economic agenda**

6. **Restoring the sectors badly affected by the crisis**

   Revising adversely affected sectors with specific recommendations for each of the 13 sectors affected by the crisis

The NERP outlined **40 lines of action** and **585 detailed recommendations** for implementation by various ministries, agencies and the private sectors.

Please see **Table 11** for details of the **Plan of Action** proposed by the NERP.

The recommendations are at various stages of implementation.

The NEAC closely monitors the implementation of the NERP. The various ministries and government agencies responsible for the implementation of the NERP measures are requested to submit **weekly reports** to the NEAC on the progress. Because of the high powered nature of the NEAC, the implementation of the NEAC recommendations were generally quite fast.

The NEAC also releases monthly progress reports on the status of the implementation of the various measures. As at June 1999, the NEAC has issued **15 progress reports** on the implementation of the recommendations.

The government also appointed the firm of Salomon Smith and Barney, an internationally renown firm of Merchant Bankers as adviser to the government to help in planning the economic recovery of the country.

TABLE 11
NATIONAL ECONOMIC RECOVERY PLAN: PLAN OF ACTION

Objective 1: Stabilising the Ringgit

- Appropriate Choice of Exchange Rate Regime
- Reduce Over-Dependence on the US Dollar
- Increase External Reserves
- Adopt a Balanced Interest Rate Policy

Objective 2: Restoring Market Confidence

- Improve Transparency and Regulatory Environment
- Establish Rules for Assisting Industries and Companies in Trouble
- Increase Consistency of Policies
- Adopt Liberal and market-Based Policies
- Improve Public Relations
- Improve the Dissemination of Economic Information

Objective 3: Maintaining Financial Market Stability

- Preserve the Integrity of the Banking System
- Establish Agencies Along the Lines of FDIC/RTC
- Recapitalise the Banking Sector
- Monitor Closely Overall Credit Expansion
- Improve the Capital Market
- Develop the PDS Market

Objective 4: Strengthening Economic Fundamentals

- Increase the Quality of Investments
- Improve the Balance of Payments
- Maintain a Balanced Public Sector Financial Position
- Maintain an Appropriate Monetary Policy
- Maintain Price Stability
- Increase Labour Competitiveness

Objective 5: Continuing the Equity and Socio-Economic Agenda

- Ameliorate the Hardship from Poverty
- Address the Issues on Bumiputera Equity Ownership
- Expand Employment Opportunities
- Meet the Challenge of Expanding Tertiary Education
- Address the Problem of Graduate Unemployment
- Control the Influx of Foreign Workers
- Gear Up State Corporations to Face the Crisis
- Revamp Cooperatives and Cooperative Banks
- Protect Environment for Sustainable Development

Objective 6: Revitalising Affected Sectors

- Primary Commodities and Resource-Based Industries
- Mining and Petroleum
- Manufacturing
- Information Technology and the Multimedia Super Corridor
- Motor Industry
- Construction
- Property
- Infrastructure
- Transportation
- Freight Forwarding
- Tourism
- Industrial Development Finance Institutions
- Insurance and Reinsurance

3.4 FINANCIAL SECTOR REFORMS

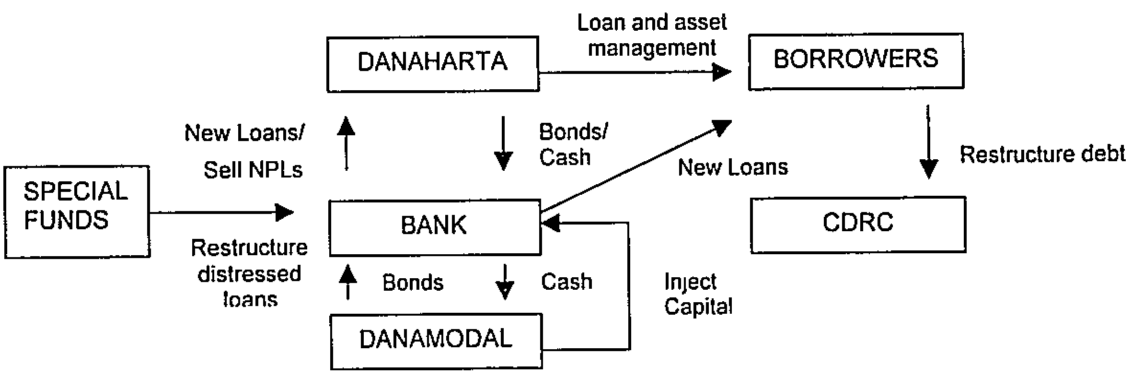
The prolonged crisis caused pressure on the banking and corporate sectors. NPLs were growing, resulting in banking institutions becoming overly cautious in granting loans and in some case, cancelling or recalling unutilised approved credit facilities. The annual loan growth decreased from **30%** in July 1997 to **9.5%** in August 1998.

To address the immediate financial problems faced by financial institutions and large corporations as a result of the crisis, the government decided on a strategy to remove the NPLs from the banking systems and to recapitalise weak banks. At the same time, Bank Negara Malaysia started work on a **banking sector Master Plan** to identify the directions for the next 20 years and chart a comprehensive implementation plan. Apparently, the master plan will contain a comprehensive action plan and sequences of reforms in the short, medium and long terms.

To implement the immediate strategy of removing NPLs from the banking system and recapitalising the weaker banks, the government set up three Special Purpose Vehicle/Institutions (SPV), i e Danaharta Nasional Berhad (Danaharta), Danamodal Nasional Berhad (Danamodal) and Corporate Debt Recovery Committee (CDRC).

The SPVs form a major part of the restructuring of the financial sector.

Operations of Danaharta, Danamodal & CDRC



Source: Bank Negara Annual Report 1998

3.4.1 Removal Of NPLs From The Banking System

Pengurusan Danaharta Nasional Berhad (Danaharta) was set up on 20th June 1998 under the Companies Act 1965 and is owned by the Government through the Ministry of Finance.

Danaharta is an Asset Management Company set up to buy non-performing loans (NPLs) from financial institutions at an **agreed fair market value**. This is to relieve financial institutions from the burden of debts which was preventing the financial institutions from providing badly needed loans to businesses to revitalise the economy. The NERP forecasted that NPLs will amount to **RM74 billion** or **15.7% of loans** by end of 1998 and **RM100 billion** or **19.7%** of outstanding loans by end of 1999 if nothing is done by the government

The setting up of Danaharta was in line with the NERP's recommendations to safeguard the stability of the country's financial system.

Danaharta was formed with the following 2 main objectives:

1. To remove Non-Performing Loans (NPLs) distractions from financial institutions, thereby allowing them to refocus on their core business of lending, and

2. To maximise the recovery value of acquired assets

Danaharta purchases NPLs from financial institutions based on a "**willing buyer and willing seller**" basis.

Special laws have been passed to give Danaharta wider powers with regards to the acquisition, management and disposal of NPLs. 2 such legislation reflecting to Danaharta's operations are the **Pengurusan Danaharta Nasional Berhad Act 1998 (Danaharta Act)** which came into force on 1 September 1998, and the **National Land Code (Amendment) Act 1998** which came into force on 11 September 1998

Danaharta pays for the acquisition of NPLs from the financial institutions through the issuance of Government Guaranteed Bonds and cash. These bonds are zero coupon bonds and are tradable, with an initial tenure of 5 years and a roll-over option of another 5 years at Danaharta's discretion.

As at 15 March 1999, Danaharta has purchased and managed NPLs amounting to **RM21.7 billion** from the financial system, of which **RM15.1 billion** was from the banking system. These NPLs accounted for **20% of NPLs** of the banking system as at end of December 1998. With the removal of NPLs from the banking system, the net NPL ratio of the banking system based on the 6-month classification rule declined from **8.1%** as at end September 1998 to **7.6%** as at end December 1998.

Please refer to **Exhibit 3.2** for more details on Danaharta's operations.

3.4.2 Recapitalisation Of Financial Institutions

Danamodal Nasional Berhad (Danamodal) is a SPV set up on 10th August 1998 to recapitalise and consolidate the financial system by injecting capital into banks facing difficulties, to avoid triggering collapse of the financial system.

Danamodal operates on market-based principles and methodologies and has 2 objectives as follows:

- **Recapitalisation And Strengthening Of The Banking Industry**

  Danamodal provides interim funding in the form of capital injection for banking institutions to meet their capital adequacy requirements. This was required because with the incerease in NPLs, the capital adequacy ratio of some financial institutions had deteriorated.

- **Consolidation And Rationalisation Of The Banking System**

  Danamodal plays an important role in facilitating the restructuring of banking institutions as a strategic shareholder in the recapitalised banking institutions. Danamodal facilitates the consolidation and rationalisation process of financial institutions and acts as a catalyst to guide changes including mergers.

The terms and conditions for each capitalisation exercise are different, depending on the unique circumstances of each institution that Danamodal invest in. The basic guiding principles for determining the investment instrument are **safety, control, return, capital base, exit potential and monitoring requirement** for each transaction.

Danamodal appointed Salomon Smith Barney and Goldman Sachs as its financial advisor to advice and assist in the financial sector reforms.

As at March 1999, Danamodal has injected capital into **10** financial institutions in the form of **Exchangeable Subordinated Capital Loans (ESCL)** amounting to **RM6,209 million**.

Please refer to **Exhibit 3.3** for more details on Danamodal activities.

Danamodal activities has increased the Risk-Weighted Capital Ratio (RWCR) of the banking system from **11.2%** as at end June 1998 to **11.9%** as at January 1999, increasing the capacity of banking institutions to generate new lending.

Danamodal has also signed Definitive Agreements with 7 banking institutions to convert the ESCL into permanent capital

To strengthen the management of these banking institutions, Danamodal has appointed Chairmen, Deputy Chairmen and Executive Directors to **6** recapitalised banking institutions.

3.4.3 Corporate Debt Restructuring

Malaysia has no specific "Bankruptcy Act" for companies. Further the existing insolvency legislation does not provide much options to preserve value for all the stakeholders in complex, multi-lender situations Often the only solution was liquidation, which may not be in the best interest of the lenders, borrowers and other interested parties

Malaysia has no equivalent to **"Chapter 11 protection"** like in the United States of America. However, corporate borrowers could apply to the courts for temporary protection from creditors, **under Section 176 of the Malaysian Companies Act 1965**. The courts at their discretion could allow a temporary **Restraining Order** on creditors' actions, giving time for the companies to work out a payment scheme for the creditors.

Please refer to **Exhibit 3.9** for more details on section 176 restructuring procedures.

As at June 1999, **40 companies listed** on the KLSE had obtained restraining orders against creditors action under section 176.

However, the issuance of Restraining Orders **without creditors' participation** was apparently causing concern and distress to creditors. Accordingly, the government ammended Section 176 of the Companies Act to address this isuue (See **Exhibit 3.11**) Further, the government decided to form a new body to provide a forum for both creditors and borrowers to work out debt problems in the best interests of all parties concerned.

The Corporate Debt Restructuring Committee (CDRC) was set up in August 1998 by Bank Negara Malaysia to facilitate debt restructuring of viable companies. This was to avoid placing viable companies into receivership or liquidation merely because of cash flow problems caused by the crisis. The objective is to minimise losses to creditors, shareholders and other stakeholders in the company

The CDRC was set up to provide the impetus to informal workouts between financial institutions and borrowers by way of compromise and consensus to expedite the restructuring of corporate debts.

The CDRC's objectives are:

1. To minimise losses to creditors, shareholders and other stakeholders through voluntary co-ordinated workouts of debts;

2. Preserve viable businesses affected by the adverse economic conditions;

3. To introduce and implement a comprehensive framework for debt restructuring.

The CDRC assists in debt restructuring where:

- The company/ business is viable.
- The debtor is not in receivership or liquidation.
- The total aggregate bank borrowings should be **RM50 million** or more.
- The debtor company should have borrowings from **more than one (1)** financial institution.
- Debtors who have already obtained a Restraining Order (RO) pursuant to Section 176 of the Companies Act 1965 may also apply on condition that the RO against the **financial institutions** is withdrawn once **a "standstill" agreement** is reached, and
- Only debts owing to financial institutions will be included in the CDRC workout

The CDRC workouts involves the following:

1. Initial meetings of debtors and creditors to consider the debt restructuring exercise and to obtain a temporary halt to creditors' actions If the parties are agreeable, a **Creditors' Committee** is formed and a **Lead Creditor** is appointed.
2. **Independent consultants** will be appointed to conduct an initial review and to report on viability of business.
3. If a restructuring exercise is feasible and agreeable to the parties, then a formal standstill agreement will executed amongst creditors.
4. The appointed consultants will formulate strategies.
5. Finally, the strategies are implemented.

As at 15 March 1999, **48 applications for debt restructuring** had been made to the CDRC, involving debts of **RM22.7 billion**. **26** creditor committees have been formed to oversee the restructuring efforts and a total of **7 restructuring plans have been implemented**.

Please refer to **Exhibit 3.4** for more details on the CDRC's operations.

3.4.4 Consolidation Of The Financial System

In order to strengthen banks to increase their resilience during the economic crisis and to create bigger and more efficient banks capable of meeting international competition in a liberalised global economy, the central bank promoted the merger and consolidation of banks The number of financial institutions as at end of 1997 is provided below:

• **Commercial Banks** (Financial Institutions handling retail banking eg. checking accounts)	-	Local	22
	-	Foreign	13
• **Finance companies** (Financial institutions providing financial services such as leasing, hire purchases, etc, besides accepting deposits Finance companies do not provide retail banking services)			39
• **Merchant Banks** (Financial Institutions providing trade related banking and consulting services Merchant banks do not provide retail banking services)			12
Total			**86**

As at 31 May 1999, 6 banks followed the central bank's advice and have agreed to be merged as follows:

a) Bank Bumiputra (Malaysia) Berhad and Bank of Commerce Bhd.

b) RHB Bank Berhad and Sime Bank Berhad, and

c) Perwira Affin Bank Berhad and BSN Commercial Bank Berhad.

d) The Southern Bank group is expected to be merged with the Ban Hin Lee bank group soon.

Among other measures introduced by the government to consolidate financial institutions to strengthen the financial sector was the move to encourage Finance Companies to merge or be absorbed by banks

The move was to reduce the large number of finance companies from 39 to a smaller group of 11 large and strong institutions by July 2000.

Malaysia's Reaction To The Economic Crisis

As at July 1999, 12 finance companies had been absorbed by their parent banks while 2 had been merged with larger finance companies as shown below:

a) Absorbed By Parent Companies (Banks)

Finance Company	Absorbed By Parent Company
1. RHB Finance Bhd	1. RHB Bank Bhd
2. Kewangan Industri Bhd	2. Bank Industri Bhd
3. HSBC Finance Bhd	3. HSBC Bank Bhd
4. United Overseas Fınance Bhd	4. OUB Bank Bhd
5. OUB Finance Bhd	5. OUB Bank Bhd
6. Kewangan Utama Bhd	6. Bank Utama Bhd
7. OCBC Fınance Bhd	7. OCBC Bank Bhd
8. Souther Finance Bhd	8. Souther Bank Bhd
9 Multi-Purpose Finance Bhd	9. Multi-Purpose Bank Bhd
10. PhileoALied Finance Bhd	10. PhileoALied Bank Bhd
11. Chew Geok Lin Finance Bhd	11. Wah Tat Bank Bhd
12. Hock Hua Finance Bhd	12. Hock Hua Bank Bhd

b) Merged With Larger Finance Companies

Finance Company	Merger With Larger Finance Company
1. Abrar Finance Bhd	1. Arab Finance Bhd
2. Boon Siew Finance Bhd	2 Public Finance Bhd

3.5 EASING OF MONETARY AND FISCAL POLICIES

By mid 1998, despite all the new policies and measures introduced by the government, Malaysia was in recession for 2 quarters and seem headed for further contraction of the economy. There were fears that continuing some of the policies introduced earlier would see further contraction of the economy and outbreak of social unrest as was seen in Indonesia, Thailand and South Korea

Prevention of further contraction of the economy and reviving economic growth became an urgent priority.

Accordingly, the government began to **ease** the tight monetary and fiscal policies introduced earlier to revive economic growth. Eventually by late 1998, the government **reversed** many of the contractionary policies followed earlier and started following **expansionary** policies to revive the economy.

From mid 1998, the government's macro-economic policy was aimed at·

a) Relaxing the tight fiscal policies followed earlier and providing fiscal stimulus to the economy.

b) Easing monetary policy

c) Continuing reform of the financial and corporate sectors.

3.5.1 Monetary Policy

Due to the importance of the continuous availability of finance to business to revive and continue generating economic activities, the government took steps to ensure that productive activities continue to receive finance. This was to avoid unnecessary business failure due to lack of financing

The major changes in monetary policy included gradually reducing BNM's intervention rate in the money market and reducing the Statutory Reserve Requirement (SRR) as follows:

- The BNM 3 months intervention rate was gradually reduced from a high of **11%** in July 1998 as follows:

Date	**Reduced to**
3rd August 1998	10.5%
10th August 1998	10.0%
27th August 1998	9.5%
3rd September 1998	8.0%
5th October 1998	7.5%
9th November 1998	7.0%
5th April 1999	6.5%

BNM lowered its intervention rate as the intervention rate largely determined the Base Lending Rate[1] (BLR) of financial institution, which in turn determined the interest rates offered by financial institutions. Interest rates to borrowers is usually BLR plus a percentage (usually between 0% to 5%)

- The SRR was also gradually reduced from a high of **13.5%** of eligible liabilities in January 1998 as follows·

Date	**Reduced to**
16th February 1998	10%
1st July 1998	8%
1st September 1998	6%
16th September 1998	4%

This was done to increase liquidity in the system by returning cash back to financial institutions, making available more funds for lending.

The reduction of SRR **released RM32 billion balk** into the system.

- The liquid Asset Requirement of commercial banks was reduced from **17%** to **15%**. (16 September 1998)

The Liquid Asset Requirement (LAR) is the percentage of the total liabilities that financial institutions must hold in the form of liquid asset. Liquid asset is defined as designated assets, which a banking institution may hold in order to meet the LAR.

This was implemented to make more funds in the banking system for lending to productive sectors.

The combination of the reduction in the BNM 3 months intervention rate, SRR and LAR had an impact on the interest rate. Interest rates started dropping from a high of **20%** to settle at about **5%** to **9%.**

- **Viable** banking institutions with **capacity to lend** were directed to achieve an **8% loan growth** for **1998**. (9 September 1998)

Subsequently, for 1999, all financial institutions were directed to achieve an 8% loan growth.

This measure was introduced because, despite the availability of sufficient funds for lending, bank appeared reluctant to lend in the face of the uncertain economic environment.

1 *The Base Lending Rate (BLR) is computed as follows*

(adjusted BNM intervention rate) + fixed administration charge of 2 25%

- Lending restrictions imposed earlier on properties costing **RM250,000 and below** was abolished to ensure that affordable housing will continue to be made available despite the economic slowdown (7 September 1998)

- The limit on loans for the purchase of shares and units of unit trust funds was increased from 15% to 20%.

- The 60% maximum margin for financing the purchase of non-owner occupied residential properties was abolished.

- The margin of financing for hire-purchase loans for passenger cars costing RM40,000 or less was raised to 85%.

- The minimum monthly repayment for credit card holders was **reduced from 15%** to **5%** of outstanding balance. (20 November 1998)

  The interest chargeable on the outstanding balance was reduced from **2.0% per month** to **1.5% per month**.

  This measure was introduced to ease the burden of repayment on cardholders and to revive demand in the economy. (30 December 1998)

- Restrictions imposed earlier on the margin of financing for hire purchase facilities for passenger cars and limit on repayment period were removed allowing financial institutions to determine their own terms and conditions.

  This measure was introduced to address the 60% slump in the sale of new cars, from 404,837 units in 1997 to 163,857 units in 1998. See **Exhibit 4.16**

- The classification of non-performing loans (NPLs) of financial institutions was **changed back to 3 months from 6 months** (23 September 1998)

  This was done to ease the pressure on borrowers and to shift the over emphasis that financial institutions were placing on recovery measures at the expense of granting new loans required to stimulate growth.

These measures generally made available **more funds** in the banking system for borrowers at **low rates.**

BNM also undertook initiatives to ensure the efficient management of financial institution and liquidity. Procedures were also introduced to make money market operations more transparent.

3.5.2 Fiscal Policy

The main fiscal initiatives introduced to revive the economy are outlined below:

- The government **restored back the 18%** cut in government expenditure introduced in December 1997 Reviving government expenditure in the absence of private demand was seen as an important measure to arrest the recession.

- To reactivate economic growth and to ensure continuation of socio-economic projects, the government in July 1998 introduced a stimulus package of an additional **RM7 billion** to develop priority sectors. The allocation of the RM7 billion is given below.

  - ❑ **RM350 million** for **agriculture** to increase food sufficiency and reduce imports (to reduce outflow of currency).

  - ❑ **RM200 million** for **low and medium cost housing** to continue social obligations to the lower income group affected by the crisis.

  - ❑ **RM1.5 billion** for **infrastructure and public utilities** to improve the long-term competitiveness of the economy.

  - ❑ **RM800 million** for **health, rural development** and **poverty eradication** programmes to continue the government's social obligation especially to the lower income group affected by the crisis

  - ❑ **RM1 billion** for **education.**

  - ❑ **RM200 million** for **industrial development**.

  - ❑ **RM654 million** for **the development of the Cyberjaya**, the backbone of Malaysia Multimedia Super Corridor (MSC).

  - ❑ **RM2.25 billion for Dana Pengurusan Harta** to finance Danaharta activities (See **Section 3.4**).

Essentially, the funds were to be utilised for development projects which,

- ❑ Had potential for increasing exports and lead to increased demand for the country's output.
- ❑ Involve import substitution to save outflow of currency and reduce imports.
- ❑ Increases the efficiency and competitiveness of the economy to meet new challenges.
- ❑ Does not cause a drain on the country's reserves or outflow of Ringgit.

The stimulus package selected projects with **strong linkages** and **short gestation period** to ensure maximum impact on the economy.

- To encourage companies to export, the government provide tax exemption of **70%** of the statutory income from the increased value of export sales
- The interest income earned by unit trusts were exempted of income tax to enhance their development.
- The excise duty on refrigerators, television sets and air conditioners were abolished to enable local manufacturers to provide these goods more cheaply.
- The government changed the tax assessment system from being based on the income derived in the preceding year to the current year. To effect this change, the government declared **1999 as a "tax free" year**.
- Tax incentives were introduced to promote domestic tourism. Income tax was exempted on income derived from domestic tourism packages with at least 1,200 local tourists per year.
- The government allowed group relief for companies engaged in food production, where losses incurred by food producing companies were allowed to be set off against profits from other companies in the group (otherwise group relief is not allowed in Malaysia).

Malaysia's Reaction To The Economic Crisis

- The government announced the setting up of a **RM5 billion Infrastructural Development Fund** to fund large infrastructure projects like ports, highways, etc. which would have a multiplier effect to stimulate growth in the economy and increase the long term competitiveness of the country The government restructured the Development Bank of Malaysia (**Bank Pembangunan Malaysia**) to form the Development and Infrastructure Bank (**Bank Pembangunan dan Infrastructure**) within a paid up capital of RM1 billion and expanded the bank role to finance development projects especially infrastructure development projects

- A number of special funds were established and existing funds expanded so that banking institutions could provide credit to priority sectors at reasonable lending rates. The allocation for these funds are provided below:

  - ❑ Fund for Food (RM1 billion)
  - ❑ Petty Traders and Hawkers Fund (Rm500 million)
  - ❑ Fund for Small and Medium Industries (RM1.5 billion)
  - ❑ Export Credit Refinancing Facility (RM3 billion)
  - ❑ Special Scheme for Low and Medium Cost Houses (Rm2 billion)
  - ❑ Suppliers, Buyers and Overseas Investment Credit (RM1 billion)
  - ❑ New Entrepreneurs Fund (Rm1 25 billion)
  - ❑ Rehabilitation Fund for Small and Medium Industires (RM750 million)

  These funds were set up to meet the country's long term economic and social objectives.

  Please refer **Exhibit 3.8** for more details on the disbursement of these funds.

- The government was also concerned that the crisis was having an adverse effect on SMIs. The government viewed the continued survival and development of the SMIs as crucial to the country's long term economic and industrial development. SMIs also contribute in employment generation, increase value add in the industrial sector and earn foreign exchange. Larger companies depend on them to supply components and parts. Hence the SMIs are an important linkage in the economy

  Accordingly, besides increasing the allocation of financial assistance to SMI's, the government also directed financial institutions to speed up the disbursement of government allocated funds for SMI's

  The status of the disbursement of the funds as at 31 January 1999 is given below.

Fund	**Amount allocated (RM million)**	**Number of Cases approved**	**Amount approved (RM million)**
1) SMI Fund	1,500	1,018	1,002
2) SMI Rehabilitation Fund	750	24	8
3) New Entrepreneur Fund	1,250	2,187	1,072
	3,500	**3,299**	**2,082**

  According to the Ministry of Finance, as at end of January 1999, only approximately 60% out of the available funds had been disbursed. The government viewed this situation seriously and directed financial institutions disburse the funds more quickly to SMIs

- The government, after 5 continuous years of **surplus budgets** since 1993, budgeted for a **deficit budget** of 3.72% of GNP in **1998**.

  The 1999 budget continued with the expansionary fiscal policy with a **RM16.1 Billion** deficit or **6%** of the GNP.

  The main thrust of the 1999 budget is summarised below:

  - ❑ Generate growth through fiscal stimulus by increasing expenditures in several sectors such as infrastructure,economic and social sectors.

  - ❑ Implement capital assistance schemes for small scale companies and women entrepreneurs. For example, Samll-Scale Entrepreneur Fund (Tabung Usahawan Kecil) and Economic Business Group Fund (Tabung Ekonomi Kumpulan Usahawan Negara).

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- Abolish excise duty on refrigerators, television and air-conditioners to increase the competitiveness of local manufacturers with other ASEAN countries when the ASEAN Free Trade Area (AFTA) is implemented.
- Improve the efficiency of the puclic sector and co-operation with the private sector
- Provide income tax exemption on 50% of the interest icome in the interest-in-suspense account for the year of assessment 1999 and 2000.
- Increase the levy on crude palm oil with price exceeding RM2,000 per tonne to contribute more revenue to the country.
- Provide tax exemption on stamp duty and real property gains tax incurred in mergers from 24 October 1998 until 30 June 1999 to reduce the financial burden of the financial institutions.
- Increase disclosure requirements fo financial institutions for both public and private sectors.
- Increase exports of the manufacturing sector and reduce imports to strengthen the Balance of Payments.
- Enhance the capacity of the domestic services sector to export and substitute for imported services.
- Increase promotion of Malaysia overseas.
- Eradicate poverty, develop the roles of women and youth in the society.
- Increase the import duty for cigarettes, alcoholic beverages, gaming and casino earnings for more healthy lifestyles.
- Provide subsidies for paddy farmers to reduce their production costs

Please refer to **Exhibit 3.1** for details of the 1998 and 1999 budgets.

3.6 CAPITAL MARKET REFORMS AND CORPORATE GOVERNANCE

3.6.1 Reforms To Foreign Direct Investment (FDI) Condition

With the economy in recession, new investments to stimulate growth became very important With the domestic economic conditions being depressed with less domestic investments, the government undertook measures to promote more investment from abroad, especially **Foreign Direct Investments (FDIs) in the manufacturing sector**

The manufacturing sector which accounted for approximately 36%, the economy was the second largest segment of the economy after the services sector From 1993 to 1997, the manufacturing sector accounted for 47% of FDIs into Malaysia With the advent of the crisis, new investments in the manufacturing sector dropped drastically Applications to set up new manufacturing projects dropped **19.53%** in 1997.

In order to attract more foreign investment generally, the government relaxed its **foreign equity policy** on several sectors in the Malaysian economy, most notably in the manufacturing sector. This was done to make Malaysia more attractive for FDIs.

Some of the major measures introduced were

- **Relaxation Of The Equity Policy In The Manufacturing Sector**

  All applications received to set up new projects for manufacturing, including for expansion and diversification, **between 31 July 1998 until 31 December 2000, will be exempted from both the equity and export conditions**. This meant that 100% foreign equity was allowed in the manufacturing sector for projects submitted before 31st December 2000. Once approved, would be no need to reduce the foreign equity even after end of 2000.

  Prior to this change, a company would have to export directly out of the country at least 80% of its production to be eligible for 100% foreign equity However, the following 7 sectors were excluded from this 100% foreign equity condition

  1 Paper Packaging
  2. Plastic Packaging (Bottles, Films, Sheets & Bags)
  3 Plastic Injection Moulding Components
  4. Metal Stamping, Metal Fabrication & Electroplating
  5. Wire Harness
  6. Printing
  7. Steel Service Centre

The government viewed local participation in projects involving the above 7 segments as important for the long term industrial objectives of the country. Further, these segments were also considered as 'saturated' and no need for further substantial foreign investment. Accordingly, foreign investments in the above 7 industries will still need to comply with the existing conditions.

- **Relaxation Of Restrictions On Domestic Sales**

To assist companies, especially manufacturing companies affected by the crisis, the government temporary deferred the export conditions imposed on them previously. Companies which previously had to export more than 80% of their production were allowed to sell up to 50% of their production to the local market till end of 2000 as follows:

1) Where the products are not **subject to import duty**, an automatic approval would be granted

2) Where the products are liable for import duty, consideration would be given on a case by case basis as follows:

    a) Where the product has no local manufacturer; or

    b) Where the local supplies of the product are insufficient

This move was also to make available to domestic manufacturers and consumers cheaper components and finished products during the crisis period.

- **Relaxation To The Foreign Investment Committee (FIC)'s Guidelines On Foreign Participation**

For non-manufacturing projects, like those in the services sector and trading sector, foreign equity was generally restricted to 30%. The government, in order to encourage more foreign investment and partly as a result of World Trade Organisation (WTO) obligations, relaxed the foreign equity limit for the following sectors:

	Existing	**Revised Foreign Equity Level**
Telecommunications	30%	up to 61%[1]
Shipping Agencies	49%	up to 70%
Forwarding Agencies	30%	up to 49%
Insurance Companies	49%	up to 51%

[1] *To be reduced to 49% after 5 years*

- **Relaxation On Bumiputra Equity Ruling**

  The government also allowed on a case by case basis for non-bumiputra Malaysians to acquire equity previous reserved for bumiputras[2]. This was done on the realisation that immediate survival of these companies with the involvement of new partners was more important than the long term objective of achieve 30% bumiputra equity in the Malaysian corporate sector.

- **Relaxation Of Guideline On Purchase Of Properties By Foreigners**

  To address the surplus of built up high-end properties, the government relaxed the conditions on foreigners buying properties in Malaysia. Essentially all restrictions on purchase of properties costing above RM250,000 by foreigners were removed.

  Please refer to **Exhibit 3.5** for more details on the changes

3.6.2 Capital Market Reforms

The government continued to introduce measures to further improve the capital market operations to be an orderly, fair and transparent stock market **to facilitate raising of the funds from the market**.

On 30 June 1998, the government withdrew most of the restrictions on submission for IPOs and restructuring schemes introduced on 5 December 1999 (see **Section 3.1**) to allow once again, Public Listed Companies the avenue to restructure themselves to deal with the economic crisis.

Further, 5 securities related laws and regulations were amended as follows:

- **The Securities Industry Act 1983 (SIA)**

  - The amendments broadened the definition of insider trading increased the range of sanctions, including civil sanctions, to deter insider trading and market manipulation, required additional disclosure from directors and chief executive officers (CEOs); and increased the power of the Securities Commission (SC) over action of directors and CEOs (**1 April 1998**)

  - The enforcement powers of the KLSE were enhanced to deal with any person failing to comply with the exchange's rules and requirements.

[2] *Bumiputra : Malaysian of indigenous origin e g. Malays, Ibans, Dayaks (from East Malaysia), etc*

- **The Securities Industry (Central Depository) Act 1991 (SICDA)**

  - The definition to securities was extended to include unit trust schemes (**1 April 1998**)

  - It became mandatory for securities of Public Listed Companies (PLCs) to be deposited with the Malaysian Central Depository Sdn Bhd (MCD) within one month of the coming into force of the amendment. The MCD is the custodian of all scrips / shares deposited with **Central Depository System (CDS)** to effect a **scripless trading environment**.

    Failure to deposit the scrips with the MCD would result in the securities being deposited into an account under the name of the Minister of Finance, making it difficult to deal with the security.

  - Every securities account with the MCD was to be in the name of the beneficiaries of the securities or the authorised nominees only. This was to improve transparency in stock trading.

  - Off-market deals that were not transacted through a recognised stock exchange and cleared through a recognised clearing house were prohibited.

  This amendment was aimed at the CLOB market operating in Singapore (see **Section 3.8.1**).

- **The Securities Commission Act 1993 (SCA)**

  - The powers of investigation of the investigating officers of the SC to enforce securities laws were extensively increased.

  - The amendments empowered the SC to conduct an examination without prior notice on the relevant persons.

- **Futures Industry Act 1993 (FIA)**

  - The Amendment to this Act prohibits the setting up of a futures market for the trading in futures contracts unless such futures markets were recognised by the KLSE.

  - The provisions that protect the money and property of a client of a futures fund manger were tightened.

- **Securities Industry (Reporting Of Substantial Shareholding) (Amendment) Regulations 1998**

  These Regulations issued under the Securities Industry Act 1983 (SIA) and came into operation on 1 November 1998.

  These Regulations further tightens the rules on reporting of substantial shareholders in any listed company. The definition of substantial shareholder has been changed from any person holding at least 5% of shares in a company to **2% of shares** in a company. This definition now also applies to bare trustees i.e. any person holding shares on behalf of others.

  Transactions on the shares done by the substantial shareholders, especially bare trustees, should be reported i.e. acquisition, disposal, parties involved (including beneficial owners of bare trustees), and change of shareholding of every party after each transaction.

  The government also amended the Companies Act 1965 and introduced the Companies (Amendment) Act 1988 to streamline the Companies Act to be in line with the amendments to the securities related legislation. Please refer to **Exhibit 3.10.**

  Beside amending the legislation, the authorities also introduced rules to improve corporate governance and transparency in the KLSE.

- **Changes To Rules On Related-Party And Interested-Party Transactions Introduced On 2nd July 1998**

  - Rules previously applicable to directors and substantial shareholders were now extended to include persons connected with them.

  - Details on related-party and interested-party transactions were required to be announced and included in circulars to shareholders.

  - Where such transactions require shareholder approval, interested parties are prevented from voting in the resolution approving the transaction.

  - Appointment of corporate advisors were required to ensure the transactions carried out are on fair and reasonable terms, and

  - The Board of Directors was required to state that any such transaction was in the best interests of the company.

  These changes were made to improve transparency and increase a accountability of shareholders or directors with vested interest.

- **Measures Introduced On 1st September 1998 To Enhance Transparency In The KLSE**

(1) Trading Of Listed Securities

- All dealings of companies listed on the KLSE were to be effected only through the KLSE or through stock exchanges recognised by the KLSE
- Except as otherwise permitted, all dealings in KLSE securities were to be effected only through the KLSE trading system
- Stock Brooking Companies (SBCs) are not to deal in securities on behalf of clients if they have reason to believe that the transaction is being effected in a stock exchange not recognised by the KLSE

These changes were made to give effect to the government's decision not to continue recognisations of the operation of the Control Limit Order Book (CLOB) (see **Section 3.10**).

(2) New Disclosure Requirements

- Any client dealing in securities listed on the KLSE on another person's behalf, would have to disclose the identity of the person to the SBCs.
- The name and other particulars of the beneficiaries would have to be stated in full for all new and existing nominee accounts.
- Each Central Depository System (CDS) account operated by a nominee could have only one beneficiary. For existing accounts with 2 or more beneficiaries, new accounts would have to be opened to comply with this new ruling

(3) Off-Market Business And Its Clearing And Settlement

- SBCs were only allowed to engage in off-market dealing only in the form of direct business.
- All direct businesses must be cleared and settled through the Securities Clearing Automated Network Services Sdn. Bhd.

- No certificates are to be issued by PLCs for new issues of securities as all new issues are now strictly to be credited into the CDS accounts of the securities holders

- Shareholders of companies approved for listing or existing PLCs were required to deposit their share certificates with the Malaysian Central Depository Sdn. Bhd. (MCD).

- All withdrawals of securities would be prohibited, except for circumstances allowed in the notice issued by the KLSE (e.g. to facilitate share buyback, conversion of debt securities, and the process of company restructuring).

One of the objectives of these measures was to protect the local stock market from adverse effects of trading of Malaysian stocks on non-recognised stock markets.

3.6.3 Corporate Governance

To improve corporate governance, in February 1999, the Securities Commission (SC), the Malaysian securities industry "watch dog" published a report on a proposed **"Malaysian Code on Corporate Governance"**.

The proposed code will deal with the following:

- Duties, obligation, rights and liabilities of
    - Company Directors
    - Company Officers
    - Controlling Shareholders
- Adequacy of disclosure by companies
- Conflict of interest
- Enhancing the quality of general meetings
- Shareholder's rights and remedies

The SC is presently seeking feedback on the enforcement of the code.

3.7 LABOUR MARKET REFORMS

Before the crisis in 1997, Malaysia was facing acute labour shortages resulting in rising wages. To cope with the shortage, the government allowed foreign workers especially from Indonesia and Bangladesh to work in Malaysia. The high demand for labour, especially for unskilled labour also resulted in many foreigners mainly from Indonesia entering and working illegally in Malaysia. In late 1996, it was estimated that there was approximately 2 million foreign workers (both legal and illegal working in Malaysia).

With the economic crisis, the demand for labour eased up and some companies began retrenching their employees. The government undertook measures to contain the rise in unemployment due the increase in retrenchment exercises by companies.

- **Measures To Reduce And Handle Retrenchment Of Employees**

  Some companies in an attempt to cut costs retrenched their workers resulting in the level of unemployment increasing. Please refer to **Table 12** below and **Exhibit 4.33** for the unemployment figures during the crisis.

TABLE 12
RETRENCHMENT OF WORKERS
From January 1998 Till March 1999

Jan 98	Feb 98	Mar 98	Apr 98	May 98	Jun 98	Jul 98	Aug 98	Sep 98	Oct 98	Nov 98	Dec 98	Jan 99	Feb 99	Mar 99
1,774	7,395	11,649	6,826	6,366	6,001	12 335	7,125	6,778	7,102	5,458	5,556	3,237	2,855	5,362

The government decided to introduce measures to prevent and control unnecessary retrenchment exercises and make companies accountable for any termination of employees.

The measures introduced to reduce and handle retrenchment of employees include:

- Mandatory requirement for employers to inform the Director General of Labour at least **one month** before any retrenchment exercise (**1 February 1998**).
- Setting up of a task force in the Ministry of Human Resource to provide services for retrenched workers at the state and district levels, improving the mobility of labour through the publication of vacancies and regular dialogues with employers' and employees' organisations as well as industry associations, and
- Issuing the Guidelines on Retrenchment (**1 August 1998**).

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- **Repatriation Of Foreign Workers And Freeze On Employment Of Foreign Worker**

  The government stopped issuing new approvals for foreign workers to enter the country. Companies already employing foreign workers were required to repatriate their workers at the end of their employment passes. These measures were introduced as the government did not want a situation of unemployment among locals while at the same time the country employed many foreign workers.

  The government also tightened the approval of Employment Passes for expatriates. The government wanted retrenched local executives to fill up these positions as far as possible.

- **Exemption From The Human Resource Development Fund (HRDF) Levy**

  The HRDF was a fund set up for companies to make contributions which can later be used to finance approved training of the companies employees. Contribution to the fund is mandatory to all companies in selected industries.

  The rate of contribution to the HRDF Fund is 1% of the monthly wages of the employees [section 3(1) of the Human Resources Development Act 1992].

  In 1998 the corporate sector appealed to the Human Resource Development Committee (HRDC) for an exemption from contributing to the HRDF levy. This is because the companies viewed that the contributions were an additional financial burden for them during the economic downturn.

  Accordingly, to remove additional financial burden for companies already facing financial difficulties, in July 1998, companies in selected industries were **temporary exempted** from contributing to the Human Resource Development Fund (HRDF) training levy. The exemption has been further extended twice until August 1999.

  Industries Exempted From Contributing To The HRDF Fund From 12 February 1999 Until 11 August 1999.

  1. Food manufacturing
  2. Beverage industry
  3. Tobacco manufacturing
  4. Textiles
  5. Leather and leather products
  6. Manufacturing of shoes
  7. Wood products including corks except furniture
  8. Furniture
  9. Paper and paper products
  10. Printing and publishing

11. Industrial chemicals
12 Other chemical products
13. Crude oil refining
14. Petroleum and coal products
15. Rattan and rattan products
16. Glass and glass products
17. Non-metallic mineral products
18. Alloy and primary alloy industries
19 Non-ferric primary metals industry
20. Manufactured metal products except machinery and equipment
21. Machinery except electrical parts
22 Electrical machinery, apparatus, supply parts
23. Transportation equipment
24. Professional and scientific parts, including measuring and security parts
25. Other manufacturing industries
26. Hotels
27. Freight transportation
28. Shipping
29. Air transportation
30. Travel agents
31. Telecommunications
32. Computers and
33. Advertising

- **Other Major Labour Reforms**

  The government decided to introduce other measures in an attempt to assist companies to retain their employees, and helping retrenched workers to find alternative occupation during the economic crisis. This was to maintain industrial harmony and labour market stability during the economic crisis and to upgrade skills to meet demand for higher skilled workers while assisting retrenched workers seek alternative employment

  The major measures introduced include·

  - Amendment to the Employment Act 1955, to encourage employers to institute part-time employment or flexible working hours and introducing guidelines on retrenchment which included pay cuts and reduction or working hours/days and shifts as **alternatives to retrenchment.**

  - Provision of a special fund of **RM5.0 million** under the Human Resource Development Fund (HRDF) to finance the retraining of retrenched workers (**2 May 1998**).

- Re-crediting unclaimed training funds by the HRDF to companies to encourage them to train and retrain their workers.
- Establishment of **RM40 million** fund to provide initial funding to firms which have exhausted their contributions, to assist them to defray the costs of training, and
- Increasing accessibility to skill training through the setting up of the **Skill Training Loan Fund of RM500 million**.

- **Employee Provident Fund (EPF) Contribution By Foreign Workers**

Similarly, the government also tightened up the approval for Employment Passes for expatriates, the government wanted retrenched local executives to fill these positions instead

The government was worried about the large number of foreign workers in the country who send money back to their countries, contributing to the large outflow of funds from the country Accordingly, the government decided to institute measures to mitigate this problem

Effective from 11 August 1998, the government made **contribution to the Employee Provident Fund (EPF) by foreign workers mandatory**. The EPF is a provident fund for workers. All employers must make mandatory contributions of 12% of the monthly salary while employee contribute 11% to the fund

However, the EPF on 3 October 1998 exempted the following categories of foreign workers from this requirement:

(1) Workers holding Employment Passes or expatriates holding Social Passes (temporary employment) and receiving a monthly salary of not less than RM2,500.00.

(2) Thai national workers who enter into Malaysia using border passes, and

(3) Seamen.

3.8 SELECTIVE CAPITAL CONTROL

3.8.1 Imposition Of Capital Controls

By August 1998, the Asian economic crisis was still not contained In fact, the magnitude of the crisis appeared to be growing and becoming more wide spread with the crisis spreading to Russia and to some Latin American countries.

Malaysia by then had already contained inflationary pressures, improved its external trade balance and managed to keep its low external debt position However, Malaysia still remained vulnerable to external developments and the volatility of the international business environment. Despite the various measures implemented by the Malaysian government, there appeared to be no sign of economic stability and recovery in Malaysia

By August 1998, the Ringgit had decreased by about **40%** since its position in July 1997. The KLSE Composite Index had decreased by **70%** during the same period.

There were also substantial differences between **onshore-offshore interest rates** which were as high as **30%** at times. This substantial difference led to continued flight of Ringgit funds out of the country pursuing higher interest rates abroad, leading to further depreciation of the Ringgit. The continuous outflow of Ringgit and the resultant accumulation of large amount of Ringgit overseas was a serious concern to the government.

The government viewed this situation as unacceptable as it restricted the conduct of monetary policy based on domestic considerations. The government wanted to ease monetary policy and bring down interest rates to avoid the economy severely contracting further. However, it was feared that lowering of interest rates would lead to further flight of Ringgit abroad in search of higher interest and correspondingly result in further depreciation of the Ringgit.

There were also fears that the substantial accumulation of Ringgit abroad could be used by speculators to further attack and depreciate the currency.

Accordingly on September 1, 1999, the government imposed the following capital control measures:

- The Ringgit was made not tradable outside Malaysia.
- Ringgit already outside the country were allowed to be brought back to the country within 1 month.

- A 12 months holding period was imposed on the repatriation of foreign investments brought into the country including foreign investment already in the country.
- Malaysian overseas investment above RM10,000 required prior approval of the Central Bank.

Essentially, the capital controls were:

- **Selective** (not total and across the board).
- **Temporary** (though no time period was announced).

The purpose of the capital controls were to:

- Eliminate access to Ringgit by speculators by making the Ringgit not tradable outside of Malaysia.
- Stabilise short-term capital flow by requiring the funds to remain in the country for at least 12 months.
- To insulate the domestic economy from international economic volatility.
- To facilitate implementation of economic policies based on domestic consideration only.

Trade transactions and Foreign Direct Investments (FDIs) was excluded from the capital control.

Profits, interest, dividends and capital gains would continue to be allowed to be repatriated.

With the introduction of capital controls, the Central Bank introduced a new set of exchange control notices, known as **Exchange Control of Malaysia (ECM) notices** to replace the existing ECM. The sudden imposition of capital controls and the introduction of new ECM notices created some confusion. The Central Bank published a series of explanatory notices to clarify the capital controls and the confusion relating to the ECM notice (please refer to **Exhibit 3.6**). The Central Bank also set up a "hotline" to quickly respond to queries regarding the capital controls.

- **Control Limit Order Book (CLOB)**

  CLOB, an over the counter market was started in Singapore in January 1990 following the split of the KLSE and the Singapore Stock Exchange (SES). CLOB offered an opportunity for investors in Singapore to continue trading in stocks listed on the KLSE.

  However, as CLOB was not under the jurisdiction of the KLSE, controls introduced by the KLSE to curb-short selling of Malaysian stocks in the KLSE were not enforceable on CLOB.

  The CLOB has been an issue of concern to the Malaysian authorities for a long time. With the imposition of the capital controls in Malaysia in September 1998 and the restrictions on the repatriation of foreign capital already in Malaysia, the continued operation of the CLOB was deemed not desirable There was a possibility of foreigners buying stocks in Malaysia and selling in the CLOB in Singapore, effectively taking capital out of Malaysia despite the 12 months moratorium imposed in Malaysia. According to prevent this leakage, the KLSE ceased recognition of CLOB effective 1st September 1999.

3.8.2 Pegging Of The Ringgit Against The US Dollar

Following the imposition of the selective capital controls, the Malaysian government pegged the Ringgit to the US Dollar. The Ringgit, which was trading at RM4.20 to 1 USD appreciated to settle at RM3.80 to 1 USD on the day of imposition of capital controls on 1st September 1998.

On September 2, the government pegged the Ringgit to US Dollar at RM3.80 to 1 USD. Apparently this was also the average level the Ringgit/USD trade between February and June 1998. The pegging was done to end the volatility of the ringgit, which made business planning very difficult for importers and exporters. Further, it was Malaysia's belief that the traded value of ringgit was not reflective of its fundamental strength, but the result of the action of speculators

The pegging of the Ringgit to US Dollar and the stability that it brought to the ringgit has been generally welcomed by investors and businessmen in Malaysia as they could now plan their business activities with more certainty.

Though the government has repeatedly announced that the capital controls are temporary, the government has not announced **when** the peg to the USD will be removed and when the ringgit will again be allowed to float. The appreciation of other regional currencies in relation to the ringgit since the pegging of the ringgit to the USD has meant that the ringgit is relatively undervalued against the USD. The relative competitive edge of the ringgit has assisted Malaysia in its exports and has led to build up of the country's foreign reserves. Accordingly, the government appears to be in no hurry to remove or change the RM3.80 to 1 USD peg. In fact, the government has announced several times recently that the peg will remain for the time being.

3.8.3 Response To Capital Controls

The immediate response to the capital controls introduced by the Malaysian government was generally positive from domestic stakeholders while international agencies reacted negatively

The IMF and the United States of America were of the view that capital controls are incompatible with open trade and will erode international confidence further in Malaysia.

Michel Camdessus, the Managing Director of the IMF in a paper presented at the Asia-Europe Finance Ministers Meeting in Germany on 16 January 1999 stated that while the capital controls in Malaysia have stemmed the capital outflows and reserves have risen, investors' confidence have been damaged by capital controls.

Moody's and Standard & Poor, two of the largest and most influential international rating agency downgraded further their rating on Malaysia.

Moody's downgraded its ratings on Malaysia subsequent to capital controls as follows:

- Malaysian Long Term foreign currency denominated **bonds** was **downgraded from Baa2 to Baa3**.

- Malaysian Long Term foreign currency denominated **bank deposits** was **downgraded from Baa3 to Ba1**, which is below investment grade.

Malaysia was also removed from the **Morgan Stanley Capital International (MSCI)** indices. This meant that most of the large US based pension funds will not be able to invest in Malaysian securities

The response of international investors and the downgrade by the international rating agencies resulted in Malaysia postponing its planned bond issue to raise funds internationally to finance the recovery plans.

Domestically, the capital controls especially the pegging of the ringgit was generally welcomed. The Federation of Malaysian Manufacturers (FMM) reported that its survey indicated that **62.9% of its member welcomed the pegging of the ringgit and wanted the peg to remain**. Only 6.6% of the members wanted the capital controls and the peg to be removed Manufacturers and companies in Malaysia generally, especially importers and exporters welcomed the stability to the currency after the wide fluctuation in the ringgit prior to the capital controls. Businesses could now plan their activities better with the exchange rate fixed.

A survey conducted by the **Malaysian Institute of Economic Research (MIER)** reported that 81% of firms in 17 manufacturing sub-sectors found that despite the capital controls, their production remain competitive. Further, 49% of the respondents to the survey reported that they expected no increase in transaction cost due to the capital controls.

Generally, foreign trade associations in Malaysia like the **Japanese Chamber of Trade and Industry of Malaysia (JACTIM)** also welcomed the stability to the ringgit brought about by the pegging of the ringgit and capital controls.

3.8.4 Relaxation Of Capital Controls

The imposition of the selective exchange control from 1st September 1998 had the desired effect of stabilising the domestic economy from adverse external influences. The insulation of the domestic economy allowed the government to introduce measures to stabilise the economy and stimulate growth based on domestic considerations.

The government maintains that the capital controls are temporary. Malaysia's domestic economy is relatively small. The country is essentially an open trading economy. The country is the 15th largest trading country in the World. Trade is the lifeblood and FDIs is the backbone of the Malaysian economy. In the long run, open economies and free trade are inherently incompatible Concerns were also being raised on a possible large outflow of foreign fund at the end of the 1 year moratorium on 1st September 1999.

Foreign funds were estimated to account for approximately 23% of the KLSE market capitalisation as at 1st September 1998. The complete withdraw of all the foreign funds on 1st September 1999, if it takes place will have serious consequences to the economy. Based on the KLSE composite index of 600 points, the 23% foreign shareholding is estimated to account for RM70 billion.

To address these issues and concerns, on 4th February 1999, the government announced the partial relaxation of the capital controls imposed in September 1988. Essentially, an **exit levy** replaced the 12 months holding period imposed on foreign investment

- **Foreign investment already in the country on 1 September 1998**, the repatriation of which was previously prohibited for 12 months effective 1st September 1998 could be repatriated effective 31st March 1999 (i.e. 7 months since introduction of capital controls) by paying an exit levy of 30% on the amount to be repatriated.

  The 30% exit levy on foreign investment already in the country on 1 September 1998 is reduced progressively to zero as follows:

  - Repatriation done between April 1 and May 30 1999 — 20%
  - Repatriation done between June 1 and August 31 1999 — 10%
  - Repatriation done after 1 September 1999 — 0%

- **Foreign investments brought into the country between 1 September 1998 and 15 February 1999** can be repatriated effective 31 March 1999 by paying a levy as follows:

  - Repatriation within 7 months of the date of investment — 30%
  - Repatriation between 7 to 9 months of the date of investment — 20%
  - Repatriation between 9 to 12 months of the date of investment — 10%
  - Repatriation after 12 months of the date of investment — 0%

- **Capital brought in after 15th February** can be repatriated at any time without paying any levy However, there will be an exit levy **of 30% on the profit**, if the capital is repatriated within 12 months.

  For profit repatriated after 12 months, the levy is reduced to **10%.**

As such, effective 31 March 1999, there is no control on foreign investors taking money out of the country, subject to payment of the exit levy, where appropriate.

The exit levy is intended to encourage investors to take a long-term view of their investment in Malaysia and keep their investments at least 12 months in the country.

On February 18,1999, the government announced that repatriation of sales proceeds and profits from the sale of property was exempted from the exit levy. This was to ensure that the depressed property sector will not be further depressed due to the imposition of the levy.

The imposition of the levy on profits only in February 1999 to replace the one year moratorium on capital and profits imposed on 1st September 1999 have generally being well received, though there are still call internationally to completely remove the capital controls.

The partial removal of the capital control in February 1999 allowing foreign funds to leave the country did not see a net outflow of funds as was feared. The NEAC reported that as of May 12 1999, there was actually a **net inflow of fund** into the country amounting to **RM1,436 million** since the introduction of the levy in February 1999.

3.9 PURSUIT OF SOCIAL OBJECTIVES DURING THE CRISIS

3.9.1 The Impact Of The Crisis On The Social Programme

Besides its impact on the Malaysian economy, the economic crisis also affected the Malaysian society. Many areas of the Malaysian society were not spared from the negative effects of the crisis.

The unemployment rate increased from 2.6% in 1997 to 3.9% in 1998, with total unemployment of about 19,000 in 1997 and 83,865 in 1998.

The new employment rate also dropped to 3% in 1998 from 4.9% in 1996 and 4.6% in 1997 The construction sector registered the biggest drop of 1998 compared with 1997, while the manufacturing sector registered a drop of 3.9% compared with 1997.

The inflation rate was also high as price pressures were mounting. The Consumer Price Index (CPI) "ballooned" to 6.2% in June 1998 from 2.3% in September 1997. However, the CPI has since stabilised to about 3% in March 1999.

The Malaysian government recognised the detrimental impact of the crisis on the various groups of society, especially the lower income groups in the economy. Accordingly, the government undertook various measures to counter the effects of the crisis and restore the nation's social agenda.

3.9.2 Measures Taken By The Malaysian Government

Generally, in the 1998 and 1999 Budgets (see **Exhibit 3.1**), the Malaysian government announced cuts in government expenditure. However, the cutback did not affect essential public services, poverty eradication and key infrastructure development. In fact, the government provided for higher allocations in the 1998 and 1999 Budgets in areas such as healthcare, housing, education and infrastructural development.

Smaller cuts were made in the 1998 Budget for ministries involved in the provision of social programmes, rural development and agriculture programmes for the low and medium income groups were made under the 1999 Budget. However, the government ensured that the Budget for 1999 was sufficient to meet programme objectives.

The other major measures introduced by the government to address the social problems arising from the crisis are outlined in the following paragraphs.

- **Health Care**

  The government announced in the 1998 Budget a one-time tax deduction to companies for contributions made to approved health care facilities. This tax benefit was effective from the year of assessment 1998 onwards.

- **Housing**

  The government estimates that about 112,400 low-cost houses will be needed to eradicate squatter problems in the country In the Klang Valley (the most developed part of Malaysia) alone 65,000 squatters will have to be resettled. Accordingly, besides increasing the budget allocations for housing, the government undertook the following measures

  - The *Syarikat Perumahan Negara* (National Housing Company) was incorporated in 1998 by the government to provide loan facilities to developers of low-cost housing projects.

  - Setting up the Special Housing fund of RM2 billion to support the construction of low and medium-cost houses where import-content was low and sectoral linkages were high and for which demand was strong

- **Rural Development and Poverty Eradication**

  Prior to the economic crisis, there was a general decline in the incidence of poverty in Malaysia. Based on the result from the preliminary findings of the *Household Income and Expenditure Survey* in 1997, **the incidence of poverty had been reduced from 9.6% (417,200 poor households) in 1995 to 6.8% in 1997 (246,000 poor households)**, with the incidence of poverty in urban areas declining from 4.1% in 1995 to 2.4 in 1997. The bulk of the decline in poverty was in the rural areas where the decline was from 16.1% in 1995 to 11.8% in 1997 Hardcore poverty also registered a decline of 2.2% to 1 4% over the same period.

  However, with the economic downturn and the inflation of prices, the incidence of poverty was estimated to have increased to 399,100 households, or **8.0% in 1998**. However, with the exclusion of non-citizens (e.g. migrant workers, illegal immigrants, etc.) the poverty rate was estimated to be 7.1% only

  The rate of hardcore poor was also estimated to have increased in 1998. However, the increase is estimated to be small i e. 1.7% from 1.4% in 1997.

With these figures in mind, the Malaysian government set out the following measures to counter the effects of economic crisis on the poor:

- Retaining the original allocation of the 1998 Budget for the eradication of poverty i.e. RM300 million in the 1999 Budget;

- Allocating an additional RM100 million to the *Amanah Ikhtiar Malaysia* (Malaysian Endeavour Trust) for the provision of interest-free loans to the hardcore poor to assist them to overcome poverty,

- Allocating RM200 million for the new micro-credit scheme to provide assistance to petty traders and hawkers in urban areas;

- Establishing *Tabung Usahawan Kecil* (Small-Scale Entrepreneur Fund) which provides funding facilities up to a maximum of RM20,000 and *Tabung Ekonomi Kumpulan Usaha Niaga* (Economic Business Group Fund) which will be expanded nationwide to provide loans up to a maximum of RM10,000 (These funds are meant to assist small size entrepreneurs expand their business);

- Establishing a RM1 billion fund as financial assistance for Small and Medium Industries (SMIs) entrepreneurs at attractive rates in order to encourage productive investments (Please refer to **Section 3.5.1**).

- **Education**

Under the 1998 Budget, one of the steps undertaken by the government to stop the outflow of funds from the country was to try and discourage and reduce the number of local students studying overseas. Initially government funds for students to study overseas were withdrawn. However subsequently, the fundings were reinstated.

The child relief against income tax for children studying abroad was reduced to the amount equivalent to the normal child relief of RM800 only. This reduction was effective from the year of assessment 1998 onwards. However, for children studying abroad before this measure was proposed, their parents can still claim tax relief based on the previous rates applicable until the child's education ends.

An allocation of RM320 million was provided as financial assistance to local students in local institutes of higher learning through the National Higher Education Fund. This fund is expected to benefit at least **24,600 students.**

The government had also forecasted in the 1999 Budget that the intake of students into local universities would increase 8% from **77,600 to 84,000 students in 1999**, as less students will be provided scholarships to study overseas due to the economic crisis and the depreciation of the ringgit.

Malaysia's Reaction To The Economic Crisis

- **Price Controls**

Inflation in 1998 rose by 5.3%, the highest increase in 16 years since 1982 reflecting the rising cost pressures and cyclical supply shortage of essential items. Price of non-durable good rose by 6.9% in 1998. The Consumer Price Index (CPI) for food (which accounted for 34% of the weight in the overall CPI basket) rose by 8.9% in 1998.

Malaysia has in place a system of "administration of prices" to stabilise prices of essential items at reasonable levels.

The government approves price increases for selected essential items based on the production costs as well as negotiations with the producers. Producers and distributors are allowed to lower prices below the administered prices, but not higher. As such, there is no "price controls" in a strict sense. Only the price of locally produced rice is legislatively controlled.

Except for Liquified Petroleum Gas (LPG), there are no **direct** subsidy elements in the system. The government however does **indirectly** subsidies the domestic petrol prices by giving tax exemption for petrol. The total tax exemption for petroleum products in 1998 was estimated at RM1,335 million*.

There are **46 essential items** covered under the **Supplies Control Regulations**, and they are classified under 2 groups

Supplies of **21 items are monitored all year round**, of which **11 items** (white sugar, wheat flour, round steel bars, cement, petrol, diesel, sweetened condensed milk, LPG, standard loaf bread, chicken and cooking oil) are "administered". Prices for these 11 items are adjusted based on economic fundamentals.

25 other items are monitored only during festive seasons. Prices of these items are supervised but not "administered" The authorities persuade the sellers not to increase the price arbitrarily especially during the festive seasons.

** Source. Statement by Minsiter of Domestic Trade and Consumer Affairs (New Straits Times 2nd May 1999).*

To compensate producers for the increased cost of their inputs due to the crisis, the government allowed price increases in the selling price of 5 essential items (out of the 21 items monitored throughout the year) as follows:

Item	Increase
Cooking Oil	5%
Chicken	10%
Flour	20%
Sugar	21%
Milk	6%

To partially buffer consumers, especially those from the lower income groups during the crisis, the price of the other essential items were administratively maintained at the same levels even though the cost of production of these items had risen.

3.10 REVISION OF MIDDLE AND LONG TERM PLANNING

The unexpected economic crisis and drastic measures that the government took to immediately deal with the crisis have implication on the medium and long term plans of the country introduced earlier. The medium and long term plans of the government include the followings:

- Vision 2020
- 2nd Outline Perspective Plan (1991 – 2000)
- 2nd Industrial Master Plan (1996 – 2005)
- 7th Malaysia Plan (1996 – 2000)
- The 3rd National Agricultural Policy

The government has announced that there will be **no change in the basic thrust of medium and the long term plans** of the country though the set target and the target achievement date may have to revised in the light of lower growth projections for the next few years. Most of the medium and long term plans had assumed an average growth rate for the country of 7% - 8% per annum in their projections (The actual growth rate of the country since 1990 till 1995 averaged at 8.5%)

The **Mid Term Review** (MTR) of the Seventh Malaysia Plan was released in April 1999. The MTR revises the growth projection for the period 1995 – 2000 from 8.5% per annum previously forecasted to an **average of 3% per annum** in the light of the economic crisis.

Similarly, the government is studying the Second Industrial Master Plan among other plans and policies to fine tune the medium and long term plans and policies in the light of the economic crisis.

3.11 COST AND FINANCING THE MEASURES FOR ECONOMIC RECOVERY

The government estimates that a sum of **RM62 billion** is required to finance the various proposals for economic recovery as shown below.

3.11.1 Funding Requirements For Economic Recovery (1998 – 2000)

Programme	RM billion
Financing of Danaharta's activities	15
Financing of Danamodal's activities	16
Infrastructure Development Fund	5
Additional 7th Malaysia Plan Allocation (including financing the budgeted deficit in Federal Government expenditure)	26
Total	**62**

Source White Paper - Status of the Malaysian Economy

The government estimates that **RM102 billion can be sourced locally and abroad** in the period 1998-2000, far exceeding the RM62 billion required to finance the recovery of the Malaysian economy, as shown in the table below.

3.11.2 Source Of Funds (1999 – 2000)

Source	RM billion
Local Sources	
Outstanding Cash Balance	
• Provident, Pension & Insurance Funds	42.0
Annual Inflows	
• Provident, Pension & Insurance Funds	30 0
• Oil Revenue	9.0
Total Local Sources	**81.0**
Foreign Sources	
• Bilateral	10.0
• Multilateral	3.0
• Sovereign bonds/loans	8.0
Total Foreign Sources	**21.0**
Grand Total	**102.0**

Source White Paper- Status of the Malaysian Economy

Malaysia's Reaction To The Economic Crisis

The Government intends to rely mainly on domestic sources of funding as there are adequate resources within the country. Further, borrowing from local institutions is advantageous to the economy as it provides non-inflationary funding. In addition, the domestic cost of borrowing is lower compared with the current cost of foreign funds in the open market due to a fall in Malaysia's sovereign risk rating due to the economic crisis.

However, local funds will be complemented by foreign funds whenever necessary

As foreign borrowing through bonds is costly, the Government will.

i) Maximise the procurement of funds from multilateral and bilateral agencies as well as sovereign loans;

ii) Be strategic in market timing on sovereign bonds and make early preparations to issue bonds at the most appropriate time; and

iii) Appoint reputable investment bankers to issue both USD and Euro bonds.

According to the consultants appointed by the government, Saloman Smith Barney, the **sources available** to the government are as follows:

Sources	**RM billion**
Funds in the system from:	
• 2% Statutory Reserve Requirement (SRR) cut	8.00
• Petronas (National Oil Corporation)	8.00
• Employees Provident Fund	13.00
• Insurance and other funds	10.00
• Locally incorporated foreign banks	5.17
• Bilateral sources	22.80
• World Bank	2.66
• Asian Development Bank	0.76
• Industrial Development Bank	0.38
Total	**70.77**

According to the government's White Paper on the Economic Crisis introduced on 6th April 1999, the status of the procurement of foreign funds is as follows:

Source	USD million
Funds Approved/Disbursed:	
• World Bank	700
• Japan Export-Import Bank (JEXIM) IA	300
• JEXIM II	700
• Islamic Development Bank	25
• Sumitomo-Nomura Bank, Japan	665
• Overseas Economic Cooperation Fund (OECF) Phase I	1,100
• Consortium of Foreign Banks in Malaysia	1,300
Total	**4,790**
Funds Being Negotiated:	
• Islamic Development Bank	50
• JEXIM IB	200
• JEXIM III	500
Total	**750**

Source White Paper- Status of the Malaysian Economy

3.11.3 Financial Assistance From The Japanese Government

Apparently the Government is also negotiating another loan package under the OECF Phase II programme. The Government has secured a loan under the OECF Phase I at an interest rate of 0.75% per annum and with a payback period of 40 years, including a 10-year grace period.

Further, the Japanese government under what has been termed as the "**New Miyazawa Initiative**" has agreed to make available to the Malaysian government short term financing totalling **US$2.5 billion**. The facility which is available to the Malaysian government to draw as and when required is aimed at promoting economic activities in Malaysia

3.11.4 Action By Government Owned Investment Arm

The Government decided to use the funds of its investment arms to partly finance the national economic recovery. The major government investment arms involved in this important financing activity includes the Employees Provident Fund (EPF) and the National Savings Bank (NSB). Financing was mainly done through the purchase of **Malaysian Government Securities (MGS)** by these institutions

As at end 1998, the NSB invested about RM1.2 billion in MGS, representing **29.9%** of its total investments in MGS. Besides investing in MGS, NSB also invested in **government guaranteed bonds** (RM333 million) and **government promissory notes** (RM307 million).

Investments in **government papers** by EPF during 1998 increased by RM6.9 billion or **18.1%**, bringing its total investment in government papers as at end-1998 to RM45 billion. Investment in government papers accounted for 44.2% of EPF's new investments for 1998.

Malaysia's Reaction To The Economic Crisis

3.12 EFFORTS AT THE INTERNATIONAL LEVEL

Malaysia has consistently maintained that the Asian financial crisis cannot be solely attributed to domestic weaknesses of the affected countries. Malaysia is of the view that inherent weaknesses in the international financial system contributed very much to the crisis, in particular the unregulated activities of the so called "hedge funds". Accordingly, Malaysia has been advocating a global solution to ensure that global trade operations orderly, within an appropriate framework to minimise destabilising effects of volatile, unregulated international fund flows.

Malaysia participated and in some cases initiated several moves at international and regional levels to strengthen the international financial system, to prevent similar crisis in future.

These included the following forums·

- Group of 22 (Wilfred Group) Meeting
- The International Monetary Fund (IMF) Meeting
- The United Nations
- The Commonwealth heads of government meeting
- Summit of the Group of 7
- APEC Summit
- Asean Summit

There are indications that Malaysia's call for reforms of the international financial architecture is gaining momentum with more countries, especially developing countries joining in the call for the reforms.

Malaysia also joined regional surveillance efforts in identifying risks and formulating early policy responses to future crisis.

These include participation in the following:

- Asean Surveillance Process
- Manila Framework Group

The purpose of these forums are to serve as an early working system to assist Asean countries deal with future economic crisis in a collective and co-ordinated manner.

4. SIGNS OF ECONOMIC RECOVERY

There are now signs that the Malaysian economy has bottomed out in the last quarter of 1998. In 1999, there are clear signs emerging, indicating economic recovery in the country.

- **Gross Domestic Product (GDP)**

For the first time since 1997 Malaysia achieved a positive growth in its real Gross Domestic Product (GDP) in 1999. Though the 1st quarter of 1999 still registered a contraction of 1.3% (compared to a 8 1% contraction in the last quarter of 1998), but the GDP growth for February and March 1999 actually increased by 4.6%.

The quarterly GDP figures for 1997, 1998 and the 1st quarter of 1999 are given below:

Period		GDP Growth (Contraction)
1997	Jan – March	9.2%
	Apr – June	8.4%
	July – Sept	7.3%
	Oct – Dec	6.0%
1998	Jan – March	-2 8%
	Apr – June	-6.8%
	July – Sept	-9.0%
	Oct – Dec	-8.1%
1999	January – March	-1.3%

Growth of real GDP in 1999 is projected between **1% and 2%** compared to a negative 6.3% growth in real GDP in 1998.

International fund managers however have generally been more bullish in their predictions for the GDP growth for the Malaysian economy for 1999 as can be seen below:

Fund Manager	Malaysia's Estimated Growth Rate
Goldman Sachs	2%
Merrill Lynch	2%
Morgan Stanley	2%
Credit Suizze	3%

Signs Of Economic Recovery

- **Industrial Production Index (IPI)**

  The Industrial Production Index (IPI) after declining for 12 months, showed positive growth in February and March 1999 at **4.8 %** and **6%** respectively

  The plastic industry saw the most growth with growth rate as high as **92.8%** in February 1999, followed by the rubber and industrial chemical industries at **20.8%** and **19%** growth respectively as follows:

Industries	**Growth Corresponding Period (%)**		
	Dec 98	**Jan 99**	**Feb 99**
Plastic	- 17.1	- 14.3	92.8
Rubber	5.1	- 0 7	20.8
Industrial Chemicals	-1.4	3.5	19.0

  A positive growth in the industrial production indicates an increased demand for Malaysian industrial products both from the local and foreign markets

- **Foreign Direct Investment**

  Total foreign investment in manufacturing projects in 1998 was approximately RM13.1 billion, an increase of **2.3%** over RM12.7 billion in 1997. Manufacturing investments approved in the 3rd quarter of 1998 was RM6.6 billion compared to RM4 billion in 2nd quarter. Please refer to **Exhibit 4.12**.

  Similarly, data from the Foreign Investment Committee (FIC) indicates that the proposed acquisition of shares and joint ventures by foreign parties in 1998 was higher than those in 1997. The total value of investment approved by the FIC was approximately RM 5.6 billion in 1998, a **3.7 times** increase over 1997.

- **Business Conditions Index (BCI) and Consumer Sentiments Index (CSI)**

  The Business Conditions Index (BCI) for the first quarter of 1999 was at 48.2 point, up to nearly **18%** compared to the BCI a year earlier. See **Exhibit 4.13.**

  The BCI comprises eight (8) components as categorised below:

  1. Sales of manufactured products
  2. Current production volume
  3. Expected production
  4. Domestic orders
  5. Export orders
  6. Investment in new plant and equipment
  7. Capacity utilisation level
  8. Inventory on plant

Signs Of Economic Recovery

The Consumer Sentiments Index (CSI) has also risen since the third quarter of 1998. An increase in the CSI at **84 point** in the beginning of 1999 denotes that there is more purchasing power and spending from the domestic market See **Exhibit 4.14**.

The CSI consists of the followings:

1. Current family's financial income position
2. Expected family's financial income position
3. Expected availability of jobs

The mid term review of the Malaysian government's Seventh Malaysia plan (covering the 1996 – 2000 period) released in 22nd April 1999 predicts, the real GDP growth for the year 2000 at 5%

Providing the major economic elements are unchanged, Malaysia is more likely to emerge with higher growth than Indonesia and Thailand

- **External Trade**

  Malaysia has recorded a dramatic increase in export earnings from **RM17,153 million** in July 1997 to **RM 25,674 million** in March 1999, a growth of about **50%.** See **Exhibit 4.18.**

  This is a sign of economic recovery to the country as there is more demand from abroad for Malaysian goods, causing a higher level of domestic output for export purposes.

  Trade balance between February and March 1999 was up by 32%.

  In the long run, strong growth in the total exports is expected to lead to a healthy balance of payment and thus, generating more income to Malaysia.

- **Kuala Lumpur Stock Exchange (KLSE)**

  Stock prices in the Kuala Lumpur Stock Exchange (KLSE) have rebounded from its lowest position at **262 points** in September 1998 to above **500 points** by March 1999. (See **Chart 4.2** in **Exhibit 4**).

  The increase in the stock prices is also due to the availability of more funds in the financial system to domestic companies for capital refinancing purposes and the relatively low lending rate.

  Low interest rates for savings also makes the stock market more attractive.

Signs Of Economic Recovery

- **External Reserves**

  By March 1999, total value of external reserves has doubled to US$27,707 million, equivalent to **6.3 months** of the retained imports compared to July 1998, when the amount was only USD 20,306 million equivalent to **3.9 months** of retained imports See **Exhibit 4.5**

  Malaysia's liquidity position is therefore stronger than before

- **Consumer Price Index (CPI)**

  Malaysia is expected to contain its inflation rate in terms of Consumer Price Index (CPI) from **5.3% in 1998** to an average of **3.5% in 1999**.

  Exhibit 4.10 shows the country's CPI starting to fall towards the end of the year of 1998. By March 1998, the CPI has contracted to 3%.

  The pegging of the Ringgit against the US dollar in September 1998 aided in stabilising Malaysia's inflation rate. This is due to the fact that prices of the imported goods for domestic consumption can be controlled to of certain extent in a fixed exchange environment

- **Unemployment Rate**

  The unemployment rate in 1998 increased drastically to **3.9%** from **2.6% in 1997**. However, since the beginning of 1999, the unemployment rate started to show a decline.

  Total number of retrenched workers has reduced by more than **76%** between July 1998 and February 1999. Retrenchment has moderated from a high of **12,335** workers in July 1998 to **5,362** workers in March 1999. See **Exhibit 4.33.**

  More jobs are available in the market with total job vacancies increasing from **4,244 in October 1998** to **7,881 in April 1999**, a growth of **86%**

- **Sale Of Motor Vehicle**

  The sale of motor vehicles in March was **160%** higher than a year ago. Please refer to **Exhibit 4.15** and **4.16** for car purchases and sales of commercial vehicles and passenger cars.

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