

TABLE OF CONTENTS

	Page
Abstract	i
Acknowledgments	iii
Table of Contents	iv
List of Tables	vii
List of Figures	x
CHAPTER 1 : INTRODUCTION	1
1.1 Introduction	1
1.2 Objectives Of The Study	4
1.3 Scope Of The Study	4
1.4 Organization Of The Study	5
1.5 Research Methodology	6
1.5.1 Sources Of Data	6
1.5.2 Data Analysis	6
1.6 Limitations Of The Study	7
1.7 Definition Of Concepts	8
CHAPTER 2 : LITERATURE REVIEW	11
2.1 The Financial Crisis	11
2.2 Surging Capital Flows	14
2.2.1 The Changing Trends In Capital Flows	14
2.2.2 The Behavior Of Foreign Direct Investment (FDI) And Foreign Portfolio Investment (FPI)	16
2.2.3 Pull And Push Factors That Influence The Influx Of Capital Inflows	17
2.3 Significance Of Capital Mobility	20
2.3.1 The Positive Effects Of Capital Inflows	21
2.3.2 The Negative Effects Of Capital Inflows	23
2.4 Capital Flight	25

2.5	Managing Capital Flows	26
2.5.1	An Overview On The Various Instruments For Managing Capital Flows	26
2.5.2	Capital Controls	29
2.6	Exchange Rate Regimes	32
2.6.1	The General Perception	32
2.6.2	The Effects Of Exchange Rates On Capital Flows	37
2.6.3	Exchange Rates Regimes, Interest Rates And Its Effects: Implication For The Management Of Capital Flows	38

CHAPTER 3 : THE ORIGINS OF THE FINANCIAL CRISIS – FROM THE MALAYSIAN PERSPECTIVE

3.1	Currency Speculation And Contagion Effects	40
3.2	Macroeconomic Imbalances	41
3.2.1	Influx Of Capital And Current Account Deficit	41
3.2.2	Mis-management Of Money Supply (In Relation To Capital Inflows) And Exchange Rate System Deficiency.	46
3.2.3	Excessive Credit Expansion And Institutional Deficiencies In The Banking System	49
3.2.4	The Actual Output vs. The Potential Output	54
3.2.5	Investment And Loss of Efficiency	57
3.2.6	Balance Of Trade Imbalance- Deteriorating Export Growth	59

CHAPTER 4 : MALAYSIAN GOVERNMENT MACROECONOMIC POLICIES BEFORE AND DURING THE CRISIS

4.1	Government Policies Prior To The Currency Crisis, That Is, January 1997 to June 1997	63
4.1.1	Tight Fiscal And Monetary Policies	63
4.1.2	Managed Floating Exchange Rate Regime	68
4.2	Initial Policies After The Outbreak Of The Currency Crisis, That Is, Prior To 1 September 1998	70
4.2.1	Greater Flexibility In Exchange Rate (July 1997- January 1998)	70

4.2.2	Resuming Intervention In The Exchange Rate Policy (January 1998 – August 1998)	72
4.2.3	Continue With Contractionary Macroeconomic Policies (Mid July 1997 – Early 1998)	74
4.2.4	Gradually Ease Macroeconomic Policies	76
4.3	New Measures Since September 1, 1998	81
4.3.1	Fixed Exchange Rate And Selective Capital Controls	81
4.3.2	Expansionary Monetary And Fiscal Policies	83
 CHAPTER 5 : THE EFFECTS OF THE SELECTIVE CAPITAL CONTROLS IN RELATION TO THE FIXED EXCHANGE RATE AND EXPANSIONARY MACROECONOMICS POLICIES		 86
5.1	The Short Run Effects	86
5.1.1	Exports And Imports (X-IM) – Balance Of Trade	91
5.1.2	Government Expenditure (G)	92
5.1.3	Consumption (C) And Investment (I)	94
5.2	Sustainability Of The Economy Under The New Measures For The Medium Or Longer Run – An Analysis From The Mundell- Fleming Model	96
5.2.1	Effects Of An Expansionary Monetary Policy	97
5.2.2	Effects Of An Expansionary Fiscal Policy	99
 CHAPTER 6 : CONCLUSIONS		 103
 BIBLIOGRAPHY		 106

LIST OF TABLES

	Page
Table 1: Real GDP and Inflation of Malaysia, Thailand and South Korea, 1997-1999	3
Table 2: Private Capital Flows to Emerging Markets (In billions of US dollar)	15
Table 3: Key economic indicators in selected developing countries	19
Table 4: Annual Capital Inflows by Major Category, 1989-95 (in US\$ billion)	42
Table 5: Government Fiscal Balance (as % of GDP)	43
Table 6: Malaysia's Balance Of Payment, 1988-1997(in RM Million)	44
Table 7: Current Account Deficit As A Percentage of GDP	45
Table 8: Saving-Investment Gap (RM Million)	46
Table 9: Growth Rates in Money Supply, 1992-1997I	47
Table 10: Ratio of M2 to Foreign Reserves	49
Table 11: Bank Lending to Private Sector (as a percentage of GDP)	50
Table 12: Lending Boom for the period between 1990 and 1996	50
Table 13: Percentage of Non-Performing Loans as proportion of total lending in 1996	52

Table 14:	Ratio of Bank Liabilities to Assets	54
Table 15:	Labour and Employment, 1993-1997	56
Table 16:	Investment Rates as a percentage of GDP	58
Table 17:	Incremental Capital Output Ratio (ICOR)	58
Table 18:	Export Growth Rate in East Asia (as a percentage of GDP)	60
Table 19:	Exchange Rates of the Ringgit against the US dollar and the Japanese Yen	62
Table 20:	Macroeconomic indicators for the first half of 1997	64
Table 21:	Exchange Rates on RM/US\$, 1995-1997	65
Table 22:	Macroeconomic indicators for the second half of 1997	66
Table 23:	Interest Rates, May – December 1997	67
Table 24:	1997 Financial meltdown in Malaysia	71
Table 25:	Aggregate Demand, Expenditure and Consumption, For 1996-1999f (as a percentage of GDP)	73
Table 26:	Changes to BNM intervention rate and SRR	78
Table 27:	Real GDP Growth for 1997-1999 (in percentage)	79
Table 28:	Selective Exchange Controls during the Asian Crisis	82
Table 29:	Monetary measures from September 1, 1998	83

Table 30:	Major Economic Indicators (2 nd Quarter 1998-2000f)	89
Table 31:	Balance of Payment, 1995-1999 (RM million)	90
Table 32:	Aggregate Demand, Consumption and Investment	93
Table 33:	Federal Government Development Expenditure by Sector	94
Table 34:	Selected Private Investment Indicators (Annual Change %)	95
Table 35:	Selected Private Consumption Indicators (Annual Change %)	96

LIST OF FIGURES

	Page
Figure 1: Root causes of the East Asian Crisis	13
Figure 2: Growth Rate of Real GDP	20
Figure 3: Real GDP: Actual vs. Potential	56
Figure 4: Total Factor Productivity Growth (%), 1987-1997	59
Figure 5: Non-Performing Loans of Banking System	87
Figure 6: KL Stock Exchange – Composite Index & Market Capitalization	88
Figure 7: Total Export, Total Imports and Trade Balance	92