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

4.1.1 Tight Fiscal And Monetary Policies

In view of the continuously high levels of monetary growth driven by rapid growth in credit, the government in early 1997 continued with its 1996 tight monetary and fiscal policies in managing the country's economy with the objectives of : moderating demand, containing asset inflation and steering the economy towards a more sustainable growth path (Bank Negara Malaysia, 1997 and Ministry of Finance, 1997)

Some of the more prominent tight monetary and fiscal measures taken were: (Ministry of Finance, Malaysia, Economic Report 1997/98 and Bank Negara Malaysia, 1997):

Monetary policies:

i) Introduction of tight credit measures on 1 April 1997 to curb bank lending to the broad property sector as well as for share financing. Specifically, ceilings of 15% of total outstanding loans for commercial banks and finance companies, and 30% for merchant banks were set for credit facilities granted for the purchase of stocks and shares and units of unit trust funds. However, loans extended for the purchase of Amanah Saham Nasional, Amanah Saham Bumiputra, Amanah Wawasan 2020 and units of unit trust funds established by the state government were exempted from these limits. In regards to the credit facilities extended to financing of property, banking institutions were given a limit of 20% of their total outstanding loans (which excluded houses and apartment costing RM150,000 and below, infrastructure projects and industrial buildings and factories).

ii) Maintaining high interest rates by keeping the 3-month interbank rate between 7.22% and 7.55%

Fiscal policies:

i) Withdrawn some of the tax exemptions provided in the past

ii) Targeting to achieve higher tax revenue, that is RM320 million.

These tight policies seemed to work well in the first half of 1997, whereby GDP had remained high at 8.5% while money supply, M3 had slowed down to 20.8% and external debt had lower to 42.6% of GNP (Table 20)

Table 20: Macroeconomic indicators for the first half of 1997

Indicators	Achievements
GDP	Remained strong at 8.5%
CPI	Increase contained at 2.8%
Growth in M3[9]	The growth in the broad monetary aggregate, M3 decelerated from 22.7% at end of April 1995 to 20.8% at end of July 1997
Reserves Level	At RM70.7 billion at end June, sufficient to cover 4.3 months of retained imports
External Debt	Lower, that is, 42.6% of GNP at end-June in terms of USD
Exchange Rate	Stable, that is, +0.2% against USD
Stock Market	Performance weakened :-13% in first half year
Investment	Strong Sentiment
Loan Growth	30.4%
Banking Sector	RWCR : 10.4% NPL (6 months) : 3.6% Loan loss provision (6 months) : 92% of NPL

Source: Bank Negara Malaysia, Annual Report 1997

[9] This data is obtained from Ministry of Finance Malaysia, Economic Report 1997/98

The optimism on Malaysia economic growth remained even as Malaysia was confronted with the initial contagion effects of speculative pressures on the Thai baht in early May 1997.

However, after July 1997, the economic situation in Malaysia changed dramatically and deteriorated progressively as the regional financial crisis became more intense and wide spread. Ringgit fluctuated greatly due to the speculative attack by the hedge-fund managers in the financial markets. In July 1997, ringgit had depreciated to RM2.64 / US$ from a high of RM2.49/US$ in Jan 1997 (Table 21).

Table 21: Exchange Rates on RM/US$, 1995-1997

End Of Period	Exchange Rates (RM/US$)
1995	2.54
1996	2.53
1997: January	2.49
February	2.48
March	2.48
April	2.51
May	2.51
June	2.52
July	2.64
August	2.96

Source: Ministry of Finance Malaysia, Economic Report, 1997/98

Attempts were made to stabilize the ringgit through government sterilized intervention in the foreign exchanger market. However, when sterilized intervention was implemented, it drained the country's international reserves. By end December 1997, the international reserves in the country had moderated to RM59.1 billion and only sufficient to cover 3.4 months of retained imports compared to the reserves level at RM70.7 billion in June 1997, which capable of covering 4.3 months of retained imports (Table 22)

Table 22: Macroeconomic indicators for the Second Half of 1997

Indicators	Achievements
GDP	Moderated to 7.1%
CPI	Increase moderated to 2.5% but picked up slightly in December 1997 and to 4.4% in February 1998
Reserves Level	Moderated to RM59.1 billion at end –December 1997, sufficient to cover 3.4 months of retained imports
External Debt	Increased to 45.6% of GNP in terms of USD
Exchange Rate	Sharp decline in stock market i.e. –35.1% against USD
Stock Market	Sharp decline in stock market :-44.8%
BOP	Current account deficit stabilized at 5.1% of GDP
Investment	Weak market sentiment and confidence
Loan Growth	Moderated to 26.5% at end December
Banking Sector	RWCR : 10.6% NPL (3 months) : 6.8% Loan loss provision (3 months) : 54.5% of NPL

Source : Bank Negara Malaysia, Annual Report 1997

Worthy to note is, accompanying with the drop in reserves was the tightening of liquidity in the country, which in turn put an upward pressure on the interest rates and led to a significant increase in the interest rate. As illustrated in Table 23, the 3 month interbank interest rate had increased from 7.50% in June 1997 to 8.70% in December 1997.

Table 23: Interest Rates, May- December 1997

	As at end-month in 1997							
	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
	% per annum							
3-Month Interbank	7.51	7.50	8.38	7.50	8.04	8.30	8.50	8.70
Commercial Banks								
Average Fixed Deposits:								
3-month	7.30	7.43	7.73	7.54	7.69	8.56	9.08	9.06
12-month	7.30	7.38	7.52	7.56	7.79	8.77	9.26	9.33
Average Savings Deposits	4.17	4.16	4.14	4.19	4.19	4.24	4.23	4.23
Average Base Lending Rate	9.27	9.50	9.58	9.61	9.61	9.53	10.07	10.33
Finance Companies								
Average Fixed Deposits								
3-months	7.54	7.63	8.01	7.67	7.79	8.97	9.98	10.32
12-months	7.44	7.50	7.64	7.67	7.87	9.08	9.99	10.25
Average Savings Deposits	5.09	5.10	5.12	5.18	5.15	5.33	5.47	5.49
Average Base Lending Rate	10.71	10.85	11.01	11.22	11.28	11.20	11.88	12.22
Bank Negara Bills (91 days)	-	-	6.37	-	-	-	-	-
Treasury Bills (91 days)	6.35	6.48	6.39	6.16	6.00	6.57	7.31	6.76
Govt. Securities (5 years)	6.63	6.62	6.58	6.58	6.61	7.26	8.16	7.75
Govt. Securities (10 years)	6.83	6.78	6.74	6.74	6.76	7.33	7.92	7.84

Source: Bank Negara Malaysia, Annual Report, 1997,

From the above discussion, clearly, tightening monetary instruments, for example, raising interest rates or contracting liquidity to counter price pressures in the asset markets could be counter-productive as it would result in an over-adjustment in the real economy without having a significant effect on speculative activity. This is particularly the case when price and profit expectations remain high in the markets. Speculative activity is driven by expectations of high returns and therefore unlikely to be affected by the increase in borrowing costs (Bank Negara Malaysia, 1999). Instead, high interest rates had adversely affected the business sectors, leaving the banks with a riskier pool of borrowers and increasing the potential for bad loans (Khor, 1998).

4.1.2 Managed Floating Exchange Rate Regime

The managed floating exchange rate system, which had aided Malaysia to achieve economic growth and stability over the past decade, remained in place in the early 1997. However, this exchange rate system began to show sign of incompetency in mid June 1997 in coping with the currency instability caused by the external development, that is, the speculative attack on Thai baht and the contagion effects to the ringgit (Kwan, 1998).

In order to defend the ringgit peg and deter the speculative capital flow, the government had widened the band for its exchange rate in conjunction with sterilizes intervention. Under the managed floating exchange rate system, sterilization appeared to be the only option for the country to restore the monetary disequilibrium. However, according to Kwan (1998), widening the band of the exchange rate would increase the risk of short-term investment by foreign investors compared with a purely fixed exchange rate system. Unless the potential investors are convinced that the exchange rate can be kept within the band, it would always lead to adverse effects. In addition, widening the band for exchange rate fluctuation also weakens the synchronization of domestic and foreign interest rates, thus lowering the effectiveness of monetary policy (Boschee, 1996).

An examination of the effectiveness of the sterilization policies in managing capital flows carried out by the IMF (1998) suggests that sterilized intervention may not be very effective on a sustained basis and may potentially create new problems in terms of the economy's adjustment to large-scale capital flows. One reason is that despite substantial exchange rate intervention, the authorities have often been unable to eliminate all the pressure in the foreign exchange market. More importantly, short-term interest rates tend to increase when sterilization efforts begin thus inducing more inflows. Conversely, it might encourage capital flight, as sterilization not only drains the country's reserves but it also causes other burdensome fiscal losses which arise from the differential between the interest earned on foreign reserves and that being paid on debt denominated in domestic currency. In addition, earlier literature have shown that the depletion of reserves coupled with the macroeconomic imbalances would pose danger signs and cause the market to loss confidence, thus inducing currency speculation and capital flight, which in turn lead to financial crisis (Camdessus, 1999; Corbett and Vines,1998).

The above phenomenon was exactly what Malaysia had encountered in July 1997 and it showed where the origins of the currency crisis lied in.

In mid July 1997, Bank Negara Malaysia eventually ceased intervention after spending an estimated US$3.58 million in external reserves and it appeared that Bank Negara Malaysia had insufficient reserves to support the ringgit (Kwan,1998). The weakness of the managed floating exchange rate was clearly proven in this case i.e. it is vulnerable to large and potentially volatile capital flows, particularly when the market has lost confidence in the country.

The above discussion clearly indicated that, the conventional tight macroeconomic policies together with the managed floating rate have limited power in closing the inflationary gap and containing the price inflation, particularly when free flow of capital is allowed in the financial market. Under a managed floating exchange rate system with perfect capital mobility, even the smallest deviation of the domestic interest rate from the interest rate parity (with that of international interest rates) is assumed to be pre-empted by a potential flood into or out of domestic money markets (Copeland, 1994). When massive movement of capitals occur in the domestic markets, it would lead to exchange rate disequilibrium and eventually economy instability. As evidenced from the earlier table, that is, Table 22, the overall performance of the country deteriorated in the second half of 1997 under the initial tightening macroeconomic polices and managed floating exchange rate adopted in first half of 1997.

4.2 Initial Policies After The Outbreak Of The Currency Crisis, That Is, Prior To 1 September 1998

4.2.1 Greater Flexibility In Exchange Rate Policy (July 1997 – January 1998)

With the onset of the crisis and the greatly depleted reserves, the managed floating exchange rate system was eventually abandoned. Instead, a flexible exchange rate policy was adopted, where the ringgit was allowed to free float clean in the market for the first time since 1975 and to move in response to market demand and supply forces (Kwan, 1998).

Flexibility in the exchange rate policy appeared to have effectively stopped draining the government reserves, but it had provided even greater opportunity for speculative attack on the currency. Ringgit fluctuated greatly and by the end of December 1997, ringgit to US dollar exchange rate had depreciated by 35.4% (Table 24)

Table 24: 1997 Financial Meltdown in Malaysia

	31 Dec 1996- 2 July 1997	2 July 1997 – 31 Dec 1997	2 July 1997- 9 Jan 1998
Exchange Rate			
Ringgit / US$	-0.2%	-35.4%	-45.2%
Ringgit / Yen	+1.2%	-26.4%	-36.8%
Ringgit / UK	-2.1%	-34.9%	-43.7%
Ringgit / S$	+1.8%	-23.9%	-31.9%
Stock Market			
KLSE Composite Index	-12.4%	-45.2%	-54.7%
Market Capitalization	-9.9%	-49.4%	-57.9%
RM billion	-79.6	-359.6	-421.1
US$ billion	-32.3	-193.0	-220.7

Source : *Coping with Capital Flow in East Asia -Kwan, Vandenbrink and Chia, 1998*

The conventional premise for countries to maintain flexible exchange rates is that: it provides the country some degree of monetary independence since the exchange rate can move to bring into equilibrium disparities between inflows and outflows. Therefore, monetary policy can influence interest rates to achieve the domestic policy objectives of maintaining low rates of inflation (Chrystal and Lipsey, 1998). However, this assertion is based on some premises that do not often hold for an open economy with massive capital flows like Malaysia. When the magnitude of the short-term capital inflows was large, the consequential volatility in exchange rates would exert a disruptive impact on the country's trade and investment, eventually to its economy (BNM, 1999).

Hence, there is no denying that a freely floating exchange rate is a wrong policy in a no- confidence and economic instability situation. More often than not, the exchange rate tends to overshoot especially when confidence is lacking. The ringgit overshot and depreciated to its lowest level to touch US$1=RM4.88 in Jan 1998.

4.2.2 Resuming Intervention In The Exchange Rate Policy (January 1998 – August 1998)

Short while after allowing its exchange rate to free float, the government of Malaysia resumed its intervention support for the ringgit in the foreign exchange market in January 1998. This was due mainly to the traumatic effects caused by the flexible exchange rate, where ringigt had depreciated further by 45% against the US dollar and the stock market had shrunk to half its previous worth in January 1998 as showed in the earlier table, that is, Table 24.

When the ringgit value was devalued, it results were:

i) Leading to price pressure, where the consumer price index (CPI) rose by an average rate of 3.8% in the first two months of 1998 and the inflation rate subsequently reached a peak of 6.2% in June 1998 (BNM, 1999).

   This happen because when ringgit was devalued, it indirectly reduced the purchasing power of the people, that is, with the same amount of money or income, lesser goods could be purchased as prices of goods especially imported goods have now become relatively more expensive. With higher prices of goods, inclusive of the input price, it increased the cost of productions. Part of the increment in cost and prices were absorbed by the producers and traders, but the rest were forced to be transferred to the consumers. As a result, it did not only reduce the private consumption and investment, but had also caused an overall decline in the aggregate demand. From Table 25, it is noted that the real aggregate demand has decreased from 7.0% of GDP in 1996 to 6.4% and –25.9% in 1997 and 1998 respectively, while the private consumption has dropped from 9.0% in 1996 to 6.3% and –32.5% in 1997 and 1998 respectively. Private Investment suffered even a sharper decline and reached a low of –57.8% in 1998

Table 25 : Aggregate Demand, Expenditure and Consumption, For 1996 to 1999f (as a percentage of GDP)

	1996	1997	1998p	1999f
Real Aggregate Domestic Demand	7.0	6.5	-25.9	4.3
Private Expenditure	9.0	6.3	-32.2	1.1
Consumption	6.0	4.7	-12.4	1.1
Investment	13.4	8.4	-57.8	0.9
Public Expenditure	1.3	6.9	-6.6	11.4
Consumption	1.4	5.3	-3.5	10.1
Investment	1.1	8.6	-10.0	12.8
P: Preliminary, f: Forecast				

Source: Bank Negara Malaysia, Annual Report, 1998

ii) An increased in the total debt in ringgit terms. At the exchange rate of US$1=RM3.895 at the end of 1997, the external debt in ringgit terms increased by 48.1% to RM170.8 billion or 64% of GNP while the debt service ratio increased to 6.6% of GDP in the second half of 1997. This was due to the higher loan repayment and interest payments in ringgit terms, attributable to revaluation loss arising from the depreciation of the ringgit (Bank Negara Malaysia, 1999).

iii) A raise in interest rate. The interbank rates were adjusted upwards from mid September 1997 until the end of the year to pre-empt the inflationary pressures arising from the ringgit depreciation and to maintain a positive real rate of return on savings for the investors (Bank Negara Malaysia, 1997).

Interest rates could not be lowered to the extent desire due to the fear on the potential outflows of funds that would lead to further exchange rate instability.

However, the problem with a higher interest rate was that, it did not only cause a contraction in the private consumption and investment, but more worrisomely, it dampened the business sectors and thus stifled the economic activities. On one hand, higher interest rates means higher rate of return to the depositors, but on the other hand, it means higher borrowing rates or credit loans for the business sectors.

iv) A reduction in the national income which lower the consumer purchasing power that lead to the chain effects of lower private consumption and investment and aggregate demand.

4.2.3 Continue With Contractionary Macroeconomic Policies (Mid July 1997 – Early 1998)

During the period from mid July 1997 to early 1998, the government persisted on using the conventional instruments to deal with the crisis, where the macroeconomic polices remained tight. The purposes of continue with tight macroeconomic policies were to contain the inflationary pressures arise from the ringgit depreciation, to preserve stability in the domestic financial markets and thereon to regain the market confidence in Malaysia (Bank Negara Malaysia, 1997 and 1998).

Tight Monetary instruments adopted were:

i) The 3-month interbank rate was progressively increased from 7.55% in mid September 1997 to 8.3% at the end of October 1997, 8.5% at the end of November 1997 and eventually to

8.7% at the end of December 1997 (Bank Negara Malaysia, 1997).

ii) Effective 20 October 1997, finance companies were only allowed to provide financing for up to 70% of the purchase price of the vehicle and the repayment period of the hire-purchase loans was restricted to not more than five years.

iii) Introduction of a US$2 million limit which each bank in country has to observe on non-commercial related ringgit offer side swap transactions with foreign customers. The objective was to maintain stability in the domestic money market and to allow domestic interest rates to be more reflective of domestic conditions.

iv) With effect from December 1997, no credit facilities should be granted to property projects where construction had not started, including for the construction of low- and medium-cost residential properties costing RM150,000 and below

Tight Fiscal measures undertaken were:

i) Deferring the implementation of several large projects e.g. the Bakun Hydroelectric project, the Northern international Airport Plan, the Kuala Lumpur Linear City and Phrase II of the PutraJaya Projects,

ii) A 2% across the board cutback in government expenditure to achieve a larger overall budgetary surplus

iii) Reviewing the purchase of large foreign goods by government agencies in order to reduce the imports and minimize the capital outflows

However, such measures were found to be insufficient to insulate Malaysia from the contagion effects in the region and prevent the country from further deepening into recession. Various economic indicators have showed that tightening of macroeconomic policies would in fact aggravate the problem rather than helping to heal the crisis.

Of significance, the non-performing loan ratio had rose on the average by 1% a month since late 1997. As at end-June 1998, the net non-performing loans (NPLs) to total loans ratio for the banking system based on the 3-month classification had increased to 8.9% from 4.7% as in December 1997 (Bank Negara Malaysia, 1997 and 1998).

On the other hand, the bank lending capacity had also contracted where the credit loan growth decreased significantly from a high of 28.2% as at the end of June 1997 to 8.9% as at end of July 1998. The concern is that when the lending capacity contracted, it would slow down the business activity and thus affect the economy growth.

4.2.4 Gradually Ease Macroeconomic Policies

The above discussion clearly showed that tight monetary and fiscal policies instead of helping to restore the economy stability and boost economic growth, had worked adversely causing aggregate demand to fall more sharply than anticipated, thus retard the economic growth. The measures were deemed had exacerbated the cash flow problems of businesses, which were already affected by the ringgit deprecation, the fall in share prices and weak external demand.

It is noted that, higher interest rate might help to slow down or prevent the capital outflow, but had indirectly aggravated the effects of the crisis on the financial sector because of the generally higher leverage of Asian corporations.

In view of the deepening of the crisis, the policy response were refocused and redirected to prevent the country from moving into a recession–deflation spiral. Fiscal policy was selectively relaxed in March 1998 while monetary policy was gradually eased in early February 1998.

The major changes noted were:

i) Expansionary Fiscal Policy

Reduction in the federal government intended fiscal surplus of 2.7% of GNP as in Budget 1998 to a deficit of 3.7% of GNP.

ii) Expansionary Monetary Policy

Lowering of interest rates, SRR and the 3-month intervention rates (Table 26). SRR was reduced with the objective to improve the distribution of liquidity in the banking system and to reduce the cost of funds, thereby enhancing the lending capacity of the banks.

The relaxation in the monetary policy was meant to be accommodative to reinforce the expansionary fiscal policy for reviving the economy.

Table 26: Changes to BNM Intervention Rate and SRR

Period		Liquidity	Date	Intervention Rate	SRR (%)
1998			End 97	8.70	13.5
	Jan –Feb	Tightening	9 Jan	9.00	
			20 Jan	10.00	
			6 Feb	11.00	
	Mid Feb-July	Stable	16Feb	-	10
			1 Jul	-	8
	Aug –Dec	Easing	3 Aug	10.50	
			10Aug	10.00	
			27 Aug	9.50	
			1 Sept	-	6
			3 Sept	8.00	
			16 Sept	-	4
			5 Oct	7.50	
			9 Nov	7.00	
1999	Jan-Aug	Continued Easing	5 Apr	6.50	
			3 May	6.00	
			3 Aug	5.50	

Source: Bank Negara Malaysia, 1999

Despite the expansionary macroeconomic measures, the exchange rate remained volatile and susceptible to speculative pressures (Bank Negara Malaysia, 1998). In addition to that, the worsening of the international financial environment had also led to the continued domestic financial instability, contributing to even sharper contraction of economy as indicated by the deteriorating real GDP growth in 1998. From Table 27, it can be seen that the real GDP growth rate had declined throughout the first three quarters of 1998, that is, from –2.8% in the first quarter 1998 to –8.6% in the third quarter of 1998 (Table 27)

Table 27: Real GDP Growth for 1997-1999 (in percentage)

Years	Real GDP Growth (%)
1997	7.5
1998:	
First Quarter	-2.8
Second Quarter	-6.8
Third Quarter	-8.6
Forecast	-5.2
1999 (Forecast)	0.9

Source : *Bank Negara Malaysia, Quarterly Bulletin, Jul-Sept 1998; and Economics Report 1998/99*

The analysis thus far revealed that in order to move the country out from the recession, the utmost important task for the government would be to restore the economic stability for regaining the market confidence and only thereon it could actually stimulate the aggregate demand and economic growth. In other words, to achieve economic stability, the presence of a stable ringgit would be undoubtedly needed, which in turn suggested the urgency to move towards a fixed exchange rate regime. On the other hand, to prevent the country from moving into deeper recession, the easing of interest rate would deem necessary to reduce the high leverage of the business and financial sectors for stimulating the economic growth. This again hinted on the need of expansionary monetary and fiscal polices.

However, any rapid easing of monetary policy would only be met by further depreciation in the ringgit exchange rate. Whilst, external pressures dictated that interest rates had to remain high to support the exchange rate. A lower interest rate makes it less attractive for people to park their money in the country and some residents may be tempted to send more of their savings abroad in search of higher interest rate, hence it might further induce another local capital flight. This phenomena is similar to what has been explained by Mundell-Fleming model, that is, slight pressures on domestic interest rate will generate massive capital flows, thus induce the exchange rate to adjust.

The dilemma confronting Malaysia appeared to be a trade-off between an expansionary monetary policy that prevent further contraction of the economy, but risk the country with further deterioration in the ringgit exchange rate. It is deemed that either one of the move regardless of tightening or relaxing the monetary policies would do some harm and cause instability in the country if the relationship between the exchange rate, interest rate and capital mobility is not de-link.

From the theoretical point of view, the Mundell-Fleming model suggests that under a fixed exchange rate system with perfect capital mobility, monetary policy will have no impact on domestic interest rates or on output. Uncovered interest rate parity holds and domestic interest rates synchronize with their counterparts overseas (Taylor, 2000 and Kwan, 1998).

However, when capital controls co-exist with fixed exchange rate in the financial system, the assumption of capital mobility where interest rates in the home country must equal to foreign interest rates would be made invalid.

Hence, it seemed that to solve the dilemma and restore the economy, there would be a need to disconnect the relationship between these three elements i.e. exchange rate, interest rate and capital mobility; wherein, a role that can only be played by capital control.

4.3 New Measures Since September 1, 1998

4.3.1 Fixed Exchange Rate And Selective Capital Controls

The selective capital control and fixed exchange rate were introduced on the first and second of September respectively as a last resort for restoring the economy. Such measures were prompted mainly by the need to resolve the dilemma arise from the co-existence of a managed float exchange rate system and expansionary monetary policies as discussed earlier.

Specifically, the capital control was aimed at containing speculation on the ringgit and minimizing the impact of short-term capital flows on the domestic economy, thereby insulating the country from contagion effect caused by the external market development. On the other hand, the main purpose of fixing the exchange rates was to reduce the extreme volatility in currency values and financial markets.

Under these new measures, ringgit was fixed at RM3.80 to one US dollar while the amendments made on the exchange controls were: (Ministry of Finance Malaysia, 1998)

a) <u>External Accounts</u>

Approval is required for transfer of funds between External Accounts. Withdrawals of ringgit from External Accounts other than for permitted purposes, require approval.

b) <u>Authorized Depository</u>

All purchases and sales of ringgit financial assets can only transacted through authorized depositary institutions.

c) Trade Settlement

All settlements of exports and imports must be made in foreign currency.

d) Currency held by Travellers

With effect from 1 October, 1998, travelers are allowed to import or export ringgit currency of not more than RM1,000 per person. There are no limits on the import of foreign currencies by resident and non-resident travelers. The export of foreign currencies by resident travelers is permitted, up to a maximum of RM10,000 equivalent.

More specifically, the selected capital control applied to the conditions as illustrated in Table 28

Table 28: Selective Exchange Controls during the Asian Crisis

What was Controlled	And Not Controlled........
• Ringgit denominated onshore-offshore transactions • Outflows of short-term capital (one year holding period) • Import and Export of Ringgit (carriage on person) • Residents' exports of foreign currency (carriage on person) • Limit outflows of Malaysian investments abroad	• Current Account transactions-trade transactions denominated in foreign currency • Repatriation of profits, interest, dividends, capital gains and rental income from FDI, portfolio investment and other forms of ringgit assets • FDI inflows and outflows • General payments by residents including for education abroad.

Source: Bank Negara Malaysia, 1999

With the fixing of exchange rate and imposition of capital control, it provided BNM with a greater degree of monetary autonomy in influencing domestic interest rates to support the economic recovery and without worrying the possibility of currency attack by speculator that cause instability in the ringgit exchange rate. This could be achieved, as the move towards capital controls would make the use of offshore ringgit invalid therefore negating the fund managers' ability to interfere in the foreign exchange and stock market (Bank Negara Malaysia, 1999).

On the other hand, the shift to a fixed currency regime would not only enable the country to lower the interest rate, but more importantly it also aided in: (i) encourage investments as investors can anticipate the risk better and know exactly how much money to bring in, (ii) expand short-term credit to exporters and thereon, revitalize industrial production and stimulate growth.

4.3.2 Expansionary Monetary and Fiscal Policies

Following the adoption of fixed exchange rate and selective capital control, both monetary and fiscal policies were further eased.

The objectives of easing the monetary measures were basically to improve the liquidity flows in the banking system which in turn will aid in generating lending activities and ensuring that businesses have access to financing at reasonable rates. The changes made in the monetary policies were as illustrated in Table 29

Table 29: Monetary measures from September 1, 1998

Measures	Date Introduced
1. Stepwise decrease in SRR:	
10% → 8%	July 1,1998
→ 6%	Sept 1,1998
→ 4%	Sept 16,1998
2. 3-months intervention interest rate	

10% → 9.5% → 8% → 7.5% → 7%	Aug 27,1998 Sept 3, 1998 Oct 5, 1998 Nov 9, 1998
3. Prohibition of vostro accounts of foreign banks Maintained with local commercial banks	Sept 3, 1998
4. Stepwise cuts in 3-months intervention rate: 9.5% → 8% → 7.5% → 7%	 Sept 3, 1998 Oct 5, 1998 Nov 9, 1998
5. Relaxed lending rules: i) Residential properties costing RM250,000 and below were exempted from 20% property sector lending ceiling ii) Abolished the 60% margin of financing for purchase of non-owner occupied residential properties costing RM150,000 and above, shop lots costing RM300,000 and above, and land lots iii) Raised ceiling on loans for the purchase of shares and unit trusts from 15% to 20% iv) The earlier measure to tighten hire purchase loans for passenger cars was repealed and relaxed, with no restriction begin imposed on repayment period for such loans, while the margin of financing was increased from 70% to 85% of the purchase price of passenger cars. v) Reduced minimum monthly repayment on credit cards from 15% to 5%	
6. Set a minimum 8% growth rate for domestic Financial institutions in 1998	Sept 9,1998
7. A cut in the liquid asset ratio requirement to 15% from 17% of total eligible liabilities base of banking Institutions to ease the credit	Sept 16,1998

8. Banking institutions are required to reduce the Maximum margin over the quoted base lending rate (BLR) to 2.5 percentage points from 4 percentage points.	1 Oct, 1998

Source : BNM, Quarterly Bulletin, Jul-Sept, 1998

On the other hand, the fiscal policies were relaxed to support economic activities, boost the demand and thereon, revitalise the country economy. More specifically, the relaxing of fiscal policies were noted in the following areas, that is,

i) Maintain a fiscal deficit of 3.7% of GNP for 1998 and targeted for an increase to 6.1% of GNP for 1999

ii) A 2% tax reduction in both the corporate and petroleum income tax rates, that is, to 28% and 38% respectively.

iii) Introduction of wide-ranging tax incentives and exemptions especially for higher value-added and technology-intensive industries in order to expedite their exports

iv) Tax exemption of 50% for interest-in-suspense for banking and financial sectors

v) Exemption of stamp duty and real property gains tax on mergers of financial institutions.