Chapter 1
Introduction

1.1 Overview

Since the 1980s, Malaysia has experienced various reforms to enhance its banks' efficiency by increasing competition and improving management as part of financial liberalisation. Such efforts are to render the Malaysian financial system in a better shape to meet the challenges of globalisation. Since then, Malaysia has received massive capital inflows, partly channelled through financial liberalisation, into its financial system. The result is a rapid expansion in its banking sector.

In July 1997, the currency crises first started in Thailand and spread throughout the region. This resulted in competitive devaluation among the Asian countries, namely Indonesia, Malaysia, the Philippines, South Korea. The currency crises (since renamed the ‘East Asian crisis’) then caused financial and economic problems in these affected countries. Many studies have been conducted by both local and international experts and organisations to identify the causes and policy options to overcome the financial crisis in the affected countries.

In Malaysia, the currency and financial crises became a crisis of the real economy. The Malaysian government undertook many policies to turn around its economy; one of those policies is to restructure its financial system.

1.2 Research Hypothesis and Objectives

This research will mainly focus on the Malaysian banking sector, especially commercial banks, finance companies and merchant banks. The research hypothesis is to identify whether there are causes, consequences, and
implications of the Malaysian banking crisis, with reference to the East Asian financial turmoil. I have developed *three objectives* for this analysis. They are:-

- **First objective** is to investigate potential causes responsible for problems in the Malaysian banking sector.
- **Second objective** is to identify the impacts of the East Asian crisis on the Malaysian banking sector and policies implemented by the central bank.
- **Third objective** is to analyse the implications of the Malaysian banking restructuring.

### 1.3 Scope of Study

The study comprises three main parts: causes, consequences and implications.

To examine causes, I will discuss, in general, the East Asian crisis in terms of the possible common characteristics or weaknesses facing the affected Asian countries, leading to currency and financial crises including its contagion effect. I will also focus upon some important pre-crisis indicators to deduce causes of problems facing the Malaysian banking sector.

I will then investigate the impacts of the East Asian crisis in the Malaysian banking sector. To identify how the central bank responds to the problem, I will also discuss a series of measures, including establishment of special agencies as part of the restructuring process.

The implications of this banking restructuring will be analysed. Although the process is still ongoing, the implications can be seen in many aspects. To support analysis, I will discuss some evidence of improvement in the banking sector as well as concerns and recommendations related to particular aspects. I would complete my study with a conclusion.
1.4 Research Methodology

Information obtained for analysis in this research is mainly secondary data from various sources, for example, local & international newspapers, official publications like Bank's Annual Report, banker's journal, business magazines, periodicals, text books and the up-to-date information gathered via Internet.

To gain reliable information from Internet, I have carefully selected articles written by well-known economists or published in recognised domestic and international organisations' homepages, for example, World Bank, International Monetary Fund (IMF), Asian Development Bank (ADB), the Central Bank Malaysia - Bank Negara Malaysia, Institute for International Economic and so on. I will also examine the banking crises and restructuring experienced by other economies to support the study. I strongly believe that various experiences, studies and researches related to this topic will enhance the significance and completeness of my study.

1.5 Limitation of the Research

Topics discussed in this research have yet to reach a conclusion and information gathered is largely based on current situations happening in the Asian countries, especially in the Malaysian banking sector before the crisis started in July 1997 until October 1998. Thus, the analysis of causes, consequences, and implications of the Malaysian banking restructuring will probably be incomplete at the time of writing. However, I expect that this research will be a useful step for other researchers who wish to study more on a similar topic, but in a different time-frame.