Chapter 3

The Impact of Currency Crisis on Malaysian Economy

3.1 Introduction

During the colonial and post-Independence period, Malaysia's economy has been dominated by export-oriented commercial agriculture as a main contributor to GDP, foreign exchange earning as well as employment opportunity to a large proportion of labor force. After the mid-1980s recession, Malaysian economy underwent a tremendous transition in the structure of economy. In line with government's intention of reducing Malaysia heavy dependence on primary export, government implemented heavy industrialization and financial liberalization. During 1987-1996, the Malaysian economy grew at an average annual rate of 8 per cent, raising per capita income from US$1,850 to US$4,425 and the economy was at virtual full employment with modest inflation (4.5 %).

Despite being one of the best economy in the Southeast Asia, Malaysia is facing difficult time ahead. The deliberate devaluation of the Thai baht has sent panic waves across Asia consequently causing the ringgit to tumble beyond the 3.0 ringgit to a US dollar level. Since mid-1997, the Malaysian ringgit has fallen continuously, reaching RM4.88 to the US dollar in early June 1998. The further depreciation of ringgit was aggravated by the massive outflow of short-term capital.

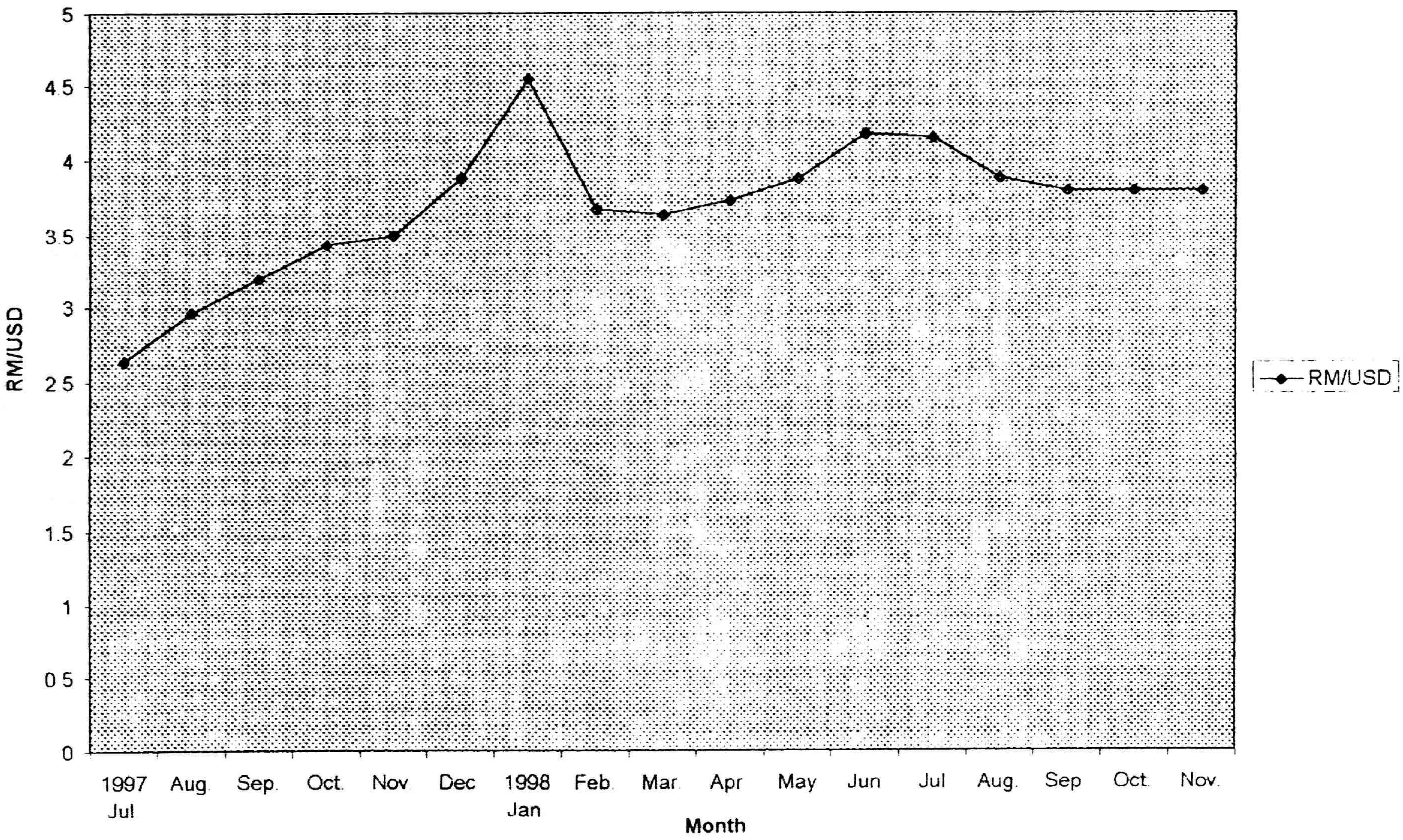
Table 3.1: Malaysia: Currency and Stock Market Movements, July 1997-July1998

	Currency (against dollar)	Stock Market (local currency)
1997-July	2.636	1012.8
August	2.9620	804.4
September	3.1975	814.5
October	3.4370	664.6
November	3.5010	545.4
December	3.8883	594.4
1998-January	4.5450	569.5
February	3.6750	745.3
March	3.6430	719.5
April	3.7365	625.9
May	3.8785	538.2
June	4.1750	455.6
July	4.1525	402.6

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, 1998

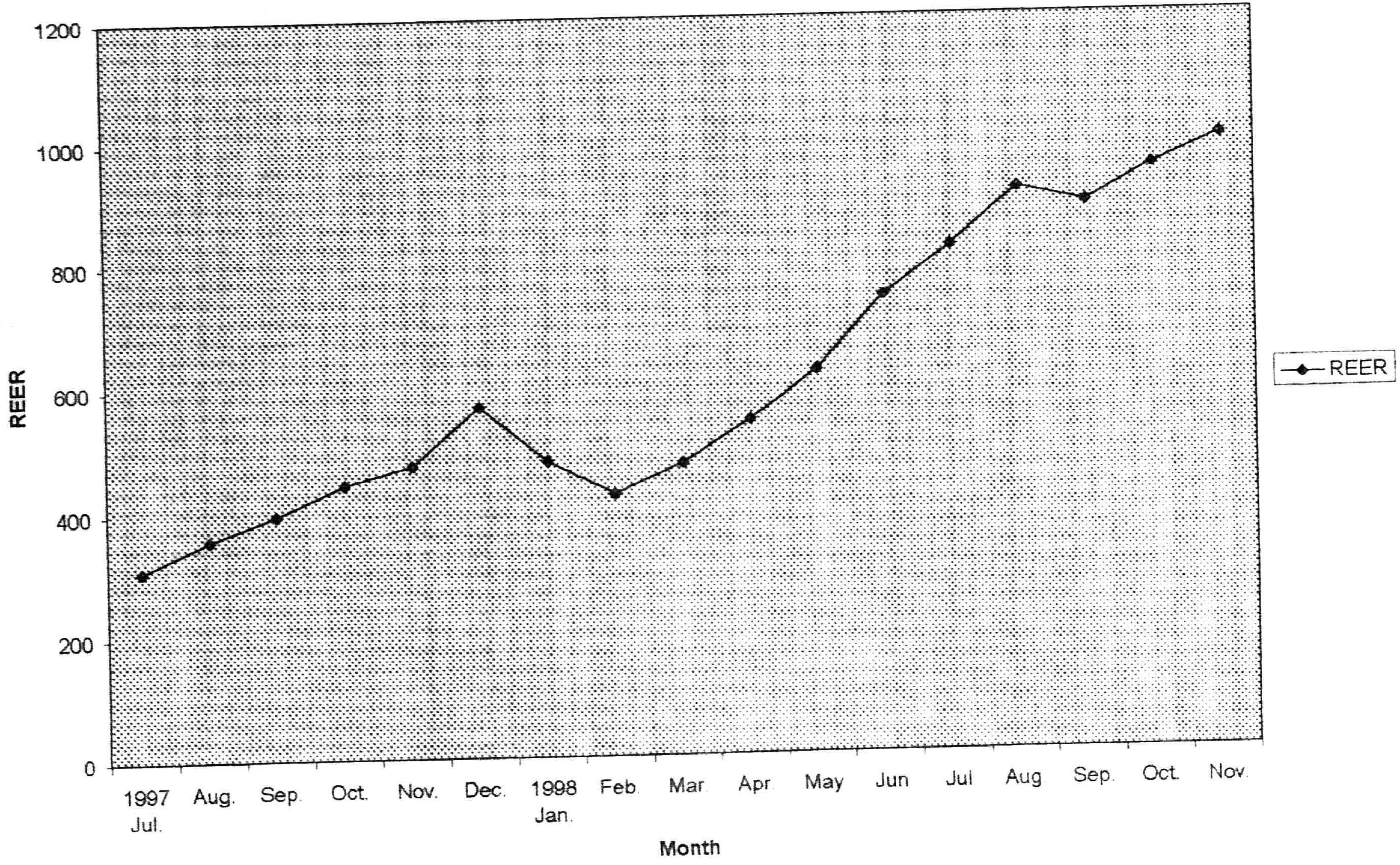
It was noted that in 1997, the outflow of short-term capital amounted for RM11 billion compared to an inflow of short-term capital of RM10 billion in 1996 (Table 3.3). As a result of sharp depreciation, the government implemented capital control in September 1,1998 and the ringgit was fixed at 3.80 ringgit to a US dollar (Figure 1). Following the depreciation of ringgit, the stock market also has fallen more severely, with the main KLSE Composite Index dropping to less than 500 in January 1998 from over 1,300 in the first quarter of 1997 (Table 3.1). Latest indicators showed that the KLCI index has reached 720 point, which indicates that our economy are in the progressive path and will recover soon from current economic downturn (The STAR, May 6,1999).

Figure 1:Malaysia: Movements of Nominal Exchange Rate, July 1997-November 1998



Source: Bank Negara Malaysia,Quarterly Economic Bulletin,September 1998

Figure 2:Malaysia: Movements of REER, July 1997-November 1998



On the external front, the depreciation of ringgit is expected to increase Malaysia external trade competitiveness. Real effective exchange rate can be used as measure of external trade competitiveness. Based on Figure 2, it is observed that the real effective exchange rate has been volatile for the month between July 1997 and November 1998. The trend shows that the real effective exchange rate has been increasing for the corresponding period. An increasing real effective exchange rate indicates increasing level of competitiveness while a decreasing real effective exchange rate indicates otherwise[1]. Nevertheless, since the outbreak of currency crisis, the performance of external trade has been very impressive. Due to acceleration in the exports, trade balance has registered surplus since November 1998.

3.2 Events leading to the Turmoil

There are various views and opinion expressed by international economist as well as policy makers and economic journalists on the actual causes of the East Asian financial crisis. Although there were no clear-cut causes of the crisis, there were several factors that led to triggering and prolonged the problem. Basically, many factors played an interrelated role in contributing to the downfall of currencies in the East Asian region.

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[1] Real Effective Exchange Rate calculated by,
$REER = EER.\ P_L/Pm$
where, EER = effective exchange rate, $= e_{ji}\,(ST_{ji}) + \ldots + e_{jn}\,(ST_{jn})\ /n$
where, e = nominal exchange, ringgit Malaysia against major trading partner (United States, Japan and Singapore). Exchange rate denoted in US dollar.
ST_{ji} = share of trade of major trading partner
= Total trade with individual major trade partner/ Total trade of Malaysia
n = number of major trading partner

It is believed that macroeconomic imbalances associated mainly with large current account deficits, due to the slow down in export growth had buildup the risks and vulnerability of Malaysian economy to the external shocks (Jomo, 1998). Moreover, by the first quarter of 1997 the real exchange in Malaysia had appreciated by about 15 per cent. This real appreciation is believed to have been a major factor in setting the scene for the economic crisis (Athukorala, 1998). According to Athukorala, this situation may not permit the authorities to defend the currency successfully in the event of a speculative attack. On the other hand, foreign capital inflows to Malaysia over the past ten years have been dominated by foreign direct investment (FDI), rather than short-term borrowings by private sector and portfolio investment.

Table 3.2:Malaysia: Macroeconomic Fundamentals 1992-1996

	1992	1993	1994	1995	1996
GDP Growth Rates (%)	7.8	8.1	9.2	9.5	8.6
Growth Rate of M2	19.1	22.1	14.7	24.0	21.4
CPI Inflation rate (%)	4.7	3.6	3.7	3.4	3.5
Total External Debt (per centage of exports of goods and services)	53.9	57.1	49.4	50.1	49.8
Debt service ratio	6.9	7.1	5.5	6.5	6.6
Short-term debt(RM million)	13,157	17,320	14,244	16,204	25,746

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, various issues.

However, in 1996 there was a significant increase in the net inflow of private short-term capital. The capital inflow was attracted by the boom in the Malaysian stock/share market, which accounted for 49.8 per cent of the total annual capital inflows by the end of 1996 (Table 3.2). Malaysia's high dependence on short-term capital further increased the vulnerability of the ringgit to speculative attacks. This is because short-term capital can turn around very quickly and leave the country. Moreover, the rapid inflow of short-term capital caused excess liquidity in banking system and Malaysia's share market. This excess liquidity is channeled into risky investment in stock market, real estate and other incompetitive business. This resulted in increase in non-performing loans at the local banks and aggravated financial weaknesses in Malaysian economy. On the other hand, rapid inflow of short-term capitals also led to build-up of short-term external debts from RM13,157 million in 1995 to RM 25,746 million in 1996 (Table 3.2). Thus, when Thai baht came under heavy speculative attack in mid-May, the ringgit also experienced heavy selling pressures and led to depreciation of ringgit.

3.3 The Overall Implications of Ringgit Depreciation

The duration and depth of the crisis affected all the sectors in the economy. Theoretically, it is expected that a nominal devaluation will results in expenditure switching, increases the production of tradables, higher export and an improvement of the external position of the country question (Sebastian Edwards, 1983). The contraction of the economy is generally reflected in a decline in aggegrate demand for goods and services as well as deterioration in trade account. On the supply side, the contraction reflects higher domestic cost of production due to expensive imported inputs and services, high nominal wages and financing cost. In Malaysia, ringgit depreciation had adversely affected all the sectors in the economy.

3.3.1 Economic Growth

The most studied issue in international economic theory on the consequence of a devaluation of the domestic currency is the contraction of economic growth. It is well known that, prior to mid-1997 currency crisis, Malaysia has achieved highest economic growth, in which the economy grew at an average annual rate of 8 per cent since 1990 (Table 3.3). However, since the outbreak of currency crisis, economic growth has been declined to its lowest level for the first time in 10 years. In October 1997, the government forecasted a growth rate of 7 per cent for 1998, but subsequently adjusted this downward to 4.5 per cent in December and again to 2-3 per cent in March 1998. Bank Negara reported that for the first and second quarters of 1998, the economy contracted to 2.8 per cent and 6.8 per cent compared to the corresponding quarters in previous years. The economy contracted further to 8.6 per cent in the third quarter of 1998 (Table 3.4). Latest indicators showed that there is gradual improvement in economic conditions and it was reported that the Malaysian economy is expected to recover in 1999 with real Gross Domestic Products (GDP) recording a growth of between one and two per cent. A higher growth is expected to be achieved if the international environment improve or the private sector responded more favourably to the policy measures (New Straits Times, April 1, 1999).

Table 3.3:Malaysia: Macroeconomic Indicators

Indicator	1975	1980	1985	1990	1995	1996	1997	1998
Economic Growth Rate (%)	0.8	7.4	-1.1	9.7	8.8	8.6	7.7	-6.7
Unemployment Rate (%)	7.0	5.3	7.6	5.1	2.8	2.6	2.6	3.9
Inflation Rate (%)	4.5	5.6	0.4	2.0	3.5	3.5	2.7	5.3
Base Lending Rate (%)	8.65	8.50	10.75	7.49	8.03	9.18	10.33	8.04
Capital Formation (RM'm)	5703	14512	21367	36155	94571	103769	116958	72007
Gross Saving (RM'm)	4516	14244	19845	33672	75882	91572	102807	108075
Fiscal Deficits (% of GDP)	-12.4	-8.3	-7.7	-4.3	1.5	1.4	4.7	-3.8
External debt (% of GNP)	11.2	5.3	32.0	41.5	40.8	41.2	65.4	60.9
Money Supply M2 (RM'm)	9981	27991	50412	83902	198873	238208	292217	296471
Trade Balance (RM'm)	701	4721	7579	528	-9358	-253	-45	58442
Current Account Balance (RM'm)	-757	-620	-1522	-2483	-18690	-12197	-14151	36068
Capital Account Balance (RM'm)	928	1622	4731	7848	14287	13525	19008	13905
Short-term Private Capital (RM'm)	83	902	870	1356	2412	10317	-11337	-21700
Net External Reserve (RM'm)	3383	9458	9692	25274	53525	70014	59122	99424
Nominal Exchange Rate (RM/USD)	2.59	2.22	2.41	2.70	2.54	2.53	3.88	3.80

Source: Ministry of Finance, Economic Report, various years
Bank Negara Malaysia, Quarterly Economic Bulletin, various years.

Table 3.4: Malaysia: Quarterly Growth Rate (GDP at 1978 prices),1996-1998

Year	Growth Rate (%)
1996: 1st qtr	6.8
2nd qtr	7.6
3rd qtr	8.8
4th qtr	11.0
1997: 1st qtr	9.2
2nd qtr	8.4
3rd qtr	7.5
4th qtr	6.0
1998:1st qtr	-2.8
2nd qtr	-6.8
3rd qtr	-8.6

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, 1998.

3.3.2 Consumption

Depreciation of ringgit also affected the level of private as well as public consumption. This is in line with government's austerity measure of reducing excessive expenditure and promotion of national savings. The contraction in private consumption is also attributed by the expected slower growth in real disposable income and higher prices of imported goods. It was reported that, aggregate domestic demand declined by 20.6 per cent in current prices in 1998 for the first time since 1986 (Bank Negara Malaysia, 1998). Total consumption spending declined by 6.5 per cent in nominal terms in 1998, following an increase of 8 per cent in 1997. On the other hand, public consumption, which accounts for 20 per cent of the total consumption, declined by 1.5 per cent in nominal terms and 3.5 per cent in real terms in 1998 due to postponement of few major projects (Bank Negara Malaysia, 1998).

3.3.3 Savings and Investment

Table 3.5:Malaysia: Savings-Investment Gap, 1975-1998

	1975	1980	1985	1990	1995	1996	1997	1998
Gross Saving (as % of GNP)	20.8	28.8	27.5	30.4	36.4	38.5	39.4	41.1
Capital Formation (as % of GNP)	26.3	29.4	29.6	32.6	45.4	43.6	44.7	27.4
BOP Current Account	-5.5	-0.6	-2.1	-2.2	-9.0	-5.1	-5.3	13.7

Source: Ministry of Finance, Economic Report, various years
Bank Negara Malaysia, Quarterly Economic Bulletin, various issue

High level of savings is very important for capital formation and national development. Generally, Malaysia had managed to sustain a high level of saving. In 1975, the country saved 120.8 per cent of GNP. There after the ratio kept increasing and achieved a high level of 38.5 per cent of GNP in 1996. Even after the outbreak of currency crisis in mid-1997, the saving ratio increased to 41.4 per cent of GNP in 1998 (Table 3.3 and Table 3.5). Although the nation's savings rate was high by international standard, the corresponding investment rate was also high. It is noted that, since 1980, the investment rate was higher than savings rate. This led to saving investment gap. The gap has been low for the period of 1970 to 1990. However, since 1995 the saving investment gaps was high that is almost 5.4 per cent of GNP in 1997. Due to savings promoting measures, the level of the nation's savings exceeded the level of investment by RM36 billion in 1998 (Table 3.3).

On the other hand, the private investment is also adversely affected due to currency crisis. The volatility of ringgit has made investors become more cautious. Theoretically, the level of aggegrate investment would be influenced by consideration such as the increase in prices for imported capital goods and high nominal wages. Furthermore, investors would also perceive that the market value of investment might be lower than its replacement costs, in which this would discourage investment activity. It was reported that activity in services and construction sector were more affected by the financial crisis. This followed by investment in manufacturing sector, which declined by 38 per cent in 1998 compared to an increase of 8.3 per cent in 1997 (Bank Negara Malaysia, 1998). With the onset of currency crisis, many investors took out their investment from the East Asian region as uncertainty mounted on the stability of currencies of those countries in the region.

3.3.4 Competitiveness

A positive impact of ringgit depreciation is the increase in its external trade competitiveness. An increase in external trade competitiveness would be advantage as long as the gains in export prices exceed the rise in import prices of intermediate inputs. However, the emergence of greater competition in the region because all currencies in the East Asia experienced a sharp downfall, Malaysia's exports will be adversely affected. Thus, to gain the long-term gains to the economy, the supply of exports must be elastic and an enhancement of productivity.

Many empirical evidence showed that a real depreciation led to a stronger external sector. Similarly for Malaysia, the external sector has responded favorably to the depreciation with a recorded trade surplus of RM 1.6 billion in the fourth quarter of 1997 (Bank Negara Malaysia, 1998). The larger surplus in the merchandise account is expected to more than offset the larger deficits of the service account due to narrowing of the current account deficit.

3.3.5 Money Supply and Net International Reserves

Table 3.6: Malaysia: Growth of Money Supply

	Change in 1996		Change in 1997		Change in 1998	
	RM Billion	%	RM Billion	%	RM Billion	%
M1	8.7	16.7	2.8	4.6	-9.2	-14.6
M2	39.3	19.8	54.0	22.7	4.3	1.5
M3	57.8	21.2	61.1	18.5	10.6	2.7

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, 1998

Since 1970, the money supply (M2) has been increasing tremendously from RM41billion to RM238 billion in 1996 (Table 3.3). However after the outbreak of currency crisis, the growth of money supply was affected significantly. According to recently published Bank Negara Annual Report (1998), the annual growth rates of broad monetary aggregates (M2 and M3) moderated significantly during 1998 while narrow money (M1) declined for the first time in 1998. It was reported that, by end-1998, the annual growth of M2 and M3 decelerated to 1.5 per cent and 2.7 per cent respectively compared to 22.7 per cent and 18.5 per cent in the end-1997 (Table 3.6). On the whole, the decline of the monetary growth during 1998 had been more severe than anticipated, with M2 and M3 expanding by only RM4.2 billion and

RM10.6 billion, while M1 contracted by RM9.2 billion. The slowdown in the growth of M2 and M3 since currency crisis in mid-1997 reflected mainly the larger contraction in GDP.

Prior to financial crisis in mid-1997, the net international reserves were RM 70,014 million in 1996. However, when the crisis erupted, the international reserves had declined to RM 59,122.8 million in 1997, as the government uses more reserves at the initial stage of currency crisis to ward of speculation and for the payment of short-term external debts. There was an increase in the reserves after April 1998 and reached RM99424.4 million in 1998 (Table 3.3). The increase in reserves reflected the rising surplus in the trade account, which more than offset the net payments for services transactions and short-term capital inflows. This level of reserves was sufficient to finance 5.7 months of retained imports compared to 3.4 months in 1997 (Bank Negara Malaysia, 1998).

3.3.6 Fiscal Deficits and External Debt

With the weakening of the ringgit as a result of the regional financial turmoil, the debt in ringgit term has increased significantly. Based on the Bank Negara Malaysia report (1998), the level of external debt has rise from RM98836 million in 1996 to RM166228 million in 1997. However, the appreciation of ringgit against the major currencies in the third quarter of 1998 and the consolidation of economic activities has led to an improvement in the external debt position of Malaysia. Total external debt outstanding decline by 12.7 per cent to RM150.4

billion in September 1998. The nation's medium and long-term external debt outstanding declined by 9.2 per cent in the third quarter of 1998 to RM123.8 billion due to the exchange valuation gain of RM11.3 billion. On the other hand, the short-term external debt in 1998 declined by 28.5 per cent to RM26.6 billion. However, latest indicators showed that Malaysia's overall external debt situation is remained manageable in 1998, despite the prolonged regional financial crisis (Bank Negara Malaysia, 1998).

On the other hand, after five years of fiscal surpluses, the 1999 budget announced in October 1998, maintained a fiscal deficits of 3.8 per cent of GDP for 1998 (Table 3.3). It was estimated that the fiscal deficit would increase to 6.1 per cent of GNP for 1999 (Economic Report, 1998/1999). This is due to expansionary fiscal policy that was designed to support economic activities and help the nation to recover fast from the financial crisis.

3.3.7 Inflation

Generally, Malaysia has maintained a low level of inflation rate during the period of 1970s to 1990s, except in 1980, the inflation rate was quite high (5.6 per cent). However, since the outbreak of currency crisis in mid-1997, inflation rate which was around 3.5 per cent in 1996, increased to 5.3 per cent in 1998 as the effect of the depreciation filtered through the real economy (Table 3.3). The increase is due to increase in the imported prices of food, gross rent, fuel and power and transport and communication. Inflation rate, which, had been on an upward trend since the fourth quarter of 1997, stabilized at 5.3 per cent in 1998 (Bank Negara Malaysia, 1998).

3.3.8 Unemployment

The unemployment rate was in the range of 5.1 per cent to 7.8 per cent during 1970 to 1990 periods (Table 3.3). Prior to mid-1997 crisis, Malaysia maintained the unemployment rate below 2.6 per cent in 1996. However, after the currency crisis erupted in mid-1997 level of unemployment rose to 3.9 per cent in 1998 due to retrenchment of workers in manufacturing and services sectors (Table 3.3). More than 40 thousand workers were retrenched especially in construction sector (51.5 %) followed by services sector (12.2 %) and finally banking and insurance sector (8.4 %). The retrenchments were primarily attributed to the reduction in demand (60 per cent), closure of companies (10 per cent) and restructuring to reduce production cost (10 per cent) (Bank Negara Malaysia, 1998). The increase in the labor force is also expected to increase the number of unemployed. However, selected manufacturing firms and agriculture sector was reported to face a shortage of workers.

3.3.9 Banking Sector

The currency crisis has magnified the weaknesses in the financial institutions. Imprudent lending practices has contributed to deterioration in the quality of financial assets especially bank lending to unproductive and incompetitive sector such as construction and property. With the onset of crisis, rising non-performing loans and interest rates has provoked the instability of the banking system. It was reported that the banking system recorded a pre-tax loss of RM 2.3 billion for 1998 compared to a pre-tax profit of RM7.7 billion in 1997 due to the exceptionally large losses recorded by two commercial banks and a finance company (Bank Negara Malaysia, 1998). Excluding the losses by the three institutions, the system recorded a pre-tax profit of RM793 million (New Straits Times, April 1,1999). The losses are due to economic contraction, which gave rise to negative loan growth, rising non-performing loans and higher loan loss provision.

3.3.10 Capital Market

One of the direct consequences of depreciation of ringgit is the collapse of stock market. On July 1997, the stock market reached its lowest level of 545.5 in November 1997. However, there has been some improvement in the Composite Index in the early 1998, in which the stock market reached 745.3 point in February. The fluctuation in the stock market is largely attributed by investor sentiment. The volatility of ringgit will affect the investor confidence and led to outflow of capital. It is reported that low market sentiment has led to deterioration of market value of KLSE (53 % in the end of 1997 compared an increase of 42.6 % in 1996)

3.4 The Impact On External Sector

The outbreak of East and Southeast Asia currency crisis in mid-1997 has exerted adverse impact on the economies of the East and Southeast Asia countries. One of the benefits secured by the countries in the region is the increase in their external trade competitiveness. It cannot be denied that, with the depreciation of ringgit, Malaysia's trade position has improved tremendously especially the performance of export sector. Currency depreciation operates in a way, which increases the domestic price of exports. It generates incentives, which tend to lower domestic demand for imports and increase production of exports. The response to price changes depend on a range of demand and supply elasticities. With regards to imports, higher domestic prices of import affect the demand adversely and encourage the demand for import substitution. Indeed, the overall impact of depreciation has been an improvement in the trade account as well as current account position.

In line with this, the government is pushing very hard on exports, which it has identified as a major engine of growth to pull the economy out of recession. Therefore, the external sector, especially exports, has become very important. In this section, the performance of external sector in terms of trade direction, the position of merchandise and current account and also the exports performance of major agriculture commodities and manufactured products will be discussed in depth.

3.4.1 Trade Balance

Table 3.7:Malaysia: External Trade, 1996-1998

(RM Million)			
	1996 3^{rd} qtr	1997 3^{rd} qtr	1998 3^{rd} qtr
Gross Exports (f.o.b)	49,704.4	56,453.8	73,619.5
Gross Imports (c.i.f)	49,039.4	55,235.1	57,045.5
Trade Balance	665.0	1,218.6	16,574.0

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, September, 1998

According to international trade theory, as the currency of a country depreciate, this will enhance the export competitiveness of the country. An increase in the export competitiveness would in turn improve the trade balance, which will lead to surplus in the current account. Prior to currency crisis, Malaysia's trade balance has been most of the time in deficits due to increase in imports compared to exports. Malaysia's trade balance position for the period of 1970 to 1990 was in surplus for the most of the time (Table 3.3). Even during the economic recession period (1985-1986), the trade position was in surplus. As the Malaysian economy recovered gradually from economic recession, the trade position improved tremendously.

However, since 1990, Malaysia's trade position has been volatile. In 1995, the trade balance registered a deficit of RM9.3 billion (Table 3.3.) This deficit is attributed to large increase in imports of capital, intermediate and consumption goods. With the onset of currency crisis, there has been significant improvement in trade balance, which is attributed by impressive performance of export sector. The trade surplus continued to expand significantly to reach a record of RM16.6 billion in the third quarter of 1998, following surpluses of RM13.3 billion in the previous quarter and RM1.2 billion in the corresponding quarter in 1997 (Table 3.7). In 1998, the trade balance registered a highest surplus of RM58 billion (Bank Negara Malaysia, 1998). The improvement in the trade surplus reflected mainly a stronger growth in exports compared with import growth. It was reported that the trade account has been in surplus for 15^{th} consecutive months since November 1997 (The Sun, March 9, 1999).

3.4.2 Current Account

Table 3.8: Malaysia: Current Account Position, 1987-1997

	1987	1989	1991	1993	1995	1997	1998	1999^{f} (net)
Merchandise	14,703	11,871	1,449	8,231	97	11,337	42,724	33,358
Balance on services	-8,409	-11,392	-13,195	-16,670	-19,229	-21,792	75,788	-19,395
Balance on goods and services	6,294	479	-11,746	-8,439	-19,132	-10,455	313,312	13,963
Current account	6,642	698	-11,644	-7,926	-21,647	-14,153	36068	29538

f=forecast
Source: Bank Negara Quarterly Economic Bulletin, various issues
Ministry of Finance, Economic Report, 1998/1999

Depreciation of a currency does offer a way of encouraging resources to move into traded goods sector. The required relative price changes do seem to occur and the response elasticites are generally adequate to strengthen the current account. The performance of the merchandise account largely depends on the impact of the weaker ringgit on the total export volume. If the depreciation of the ringgit managed to give a substantial boost to the volume of exports, Malaysia may then register higher export earnings.

Generally, Malaysia's current account has been in deficit for the past two decades compared to capital account which, was in surplus for the most of the time. Table 3.8 shows the current account position for the period of 1987 to 1997. It is observed that, other than between 1987 to 1989, the current account position has never shown a surplus. From 1993 onwards, the deficits in current account has been in upward trend from RM7926 million, the deficits increased to RM14153 million in 1997 (Table 3.8). This is because surpluses registered in the merchandise account are insufficient to cover the shortfall in the service account. However, since the currency crisis erupted in mid-1997, there has some improvement in the current account especially, in the third quarter of 1998, due to improvement in the merchandise account as well as service account. The current account improved from deficit of RM14153 million in 1997 to a surplus of RM36068 million in 1998 (Table 3.8). It is forecasted that in 1999, the current account will be in surplus of RM29 billion. On the other hand the performance of capital account is expected to decline due to lower net inflow of official and private long-term capital. According to Bank Negara Malaysia, the overall position of the balance of payments has reverted to a surplus of RM40.3 billion in 1998 from a deficit of RM10.9 billion in 1997.

3.4.3 Exports

During colonial and post-Independence period, agriculture and mining commodities have dominated Malaysian export. In 1970s and 1980s, agriculture and mining commodities has been the main export of Malaysia. The agriculture commodities accounted for 59.5 per cent of total export in 1970, while the mining commodities accounted for 25.9 per cent of total export for the same period. The contribution of manufactures to total export has been minimal in 1970s and early 1980s. It only accounted for 11.9 per cent of total exports in 1970 (Table 3.9).

Table 3.9:Malaysia: Export Structure , 1960-1998

(percentages)

	1970	1980	1985	1990	1995	1996	1997	1998
Agriculture	59.5	43.6	32.7	22.3	13.1	11.1	10.4	17.4
Rubber	33.4	16.4	7.6	3.8	2.2	1.8	1.3	1.0
Timber	16.5	14.1	10.3	8.9	3.3	2.7	1.3	0.8
Palm oils	5.3	10.3	11.8	6.2	5.6	4.7	4.8	6.2
Others	4.0	2.8	3.0	3.4	2.0	1.9	1.7	1.4
Mining	25.9	33.8	34.0	17.8	5.8	6.4	6.9	5.1
Tin	19.6	8.9	4.3	1.1	0.3	0.3	0.2	0.2
Petroleum	3.9	23.8	22.9	13.4	3.6	3.7	3.2	2.6
LNG	-	-	6.0	2.8	1.7	2.3	3.0	2.1
Others	2.4	1.1	0.8	0.5	0.2	0.1	1.7	1.4
Manufactures	11.9	21.6	32.1	59.3	79.6	80.6	80.7	82.8
Other Exports	3.0	1.0	1.2	0.6	1.5	1.9	1.7	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, various issue.

However, after the economic recession in 1985-1986, the Malaysian economy underwent a major transition. Beginning 1987, in line with government intention of reducing dependence on agriculture commodities, importance was given to exports of manufactured goods. Until then, manufacturing sector has been main contributor to Gross Domestic Products (GDP) as well as foreign exchange earner. In 1990, the export of manufactured products constituted 59.3 per cent of the total export compared to 32.1 per cent in 1985. On the other hand, the performance of agriculture and mining commodities has eroded since 1985, as more emphasis was givėn to enhancement of manufacturing products. With the onset of currency crisis, export has increased significantly due to ringgit depreciation. The increase in the external trade competitiveness led to increase in gross export from RM 220 890 million in 1997 to RM 286 755 million in 1998 (Bank Negara Malaysia,1998). The manufacturing sector continued to be the main foreign exchange earner. Exports of manufactured goods in ringgit terms rose by 32.8 per cent to RM237.6 billion in 1998 compared to 12.9 per cent in 1997. All the industries were reported to recorded higher export receipts except for wood and petroleum products. The manufactures share of total export was 82.8 per cent in 1998 compared to 80.6 per cent in 1997. On the other hand, exports of agriculture commodities increased significantly by 30.4 per cent to RM30.2 billion compared to an increase of 3.2 per cent in 1997. This increase is attributed to increase in palm oil production, which is more than offset the lower exports from rubber, saw logs and sawn timber (Bank Negara Malaysia, 1998).

In terms of export earnings, the export receipt from palm oil increased sharply by 88.7 per cent to RM5.4 billion in the third quarter of 1998, reflecting increases in prices and export volume (Bank Negara Malaysia, 1998,). Based on Table 3.10, it is observed that the export receipt for palm oil increased from RM9.7 billion in July 1997 to RM16.1 billion in July 1998. On the other hand, with lower production in the third quarter of 1998, export earnings from rubber declined by 9.1 per cent to RM664.7 million (Bank Negara Malaysia,1998). Basically, the performance of other agriculture and mining commodities has declined since the outbreak of currency crisis in mid-1997. Furthermore, the output of agriculture sector was affected by adverse weather, labor shortages, unfavorable prices, reduced cultivated area and lower yield.

Table 3.10: Malaysia: Major Gross Exports of Agricultural and Mining Commodities, July 1997-November 1998 (RM, million)

Period	Rubber	Saw Logs	Sawn Timber	Palm Oil	Petroleum
1997 Jul.	228.1	270.3	244.3	973.8	379.9
Aug.	252.9	154.3	230.8	917.1	477.8
Sep.	250.5	179.3	226.6	984.7	584.2
Oct.	272.3	224.6	251.3	1007.2	613.6
Nov	253.6	262.4	230.3	1055.8	834.4
Dec.	270.3	214.7	230.2	1188.5	799.1
1998 Jan.	253.4	207.8	226.6	1361.1	784.9
Feb.	257.0	115.8	153.0	1339.8	710.7
Mar.	279.4	137.7	191.1	1229.3	632.5
Apr.	271.5	123.8	223.7	1300.2	709.5
May	243.7	146.0	219.6	1273.1	550.5
Jun	246.7	133.3	225.2	1443.8	541.6
Jul.	247.3	186.6	232.9	1617.7	624.4
Aug.	224.0	122.7	208.4	1898.9	554.3
Sep.	193.4	128.3	200.8	1909.8	635.4
Oct.	240.4	162.4	194.9	1846.2	636.9
Nov.	180.1	194.0	198.0	1368.0	583.1

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, 1998

The manufacturing sector has contributed significantly to tota' export since mid-1980s. The manufactures share of export increased from 32.7 per cent of total export in 1985 to 80.4 per cent of total export in 1996. However, beginning 1995 there has been declined in the growth of manufactured products. Since the outbreak of currency crisis in mid-1997, the export share of manufactured products increased slightly from 81.0 per cent in 1997 to 82.9 per cent of total export in 1998 (Table 3.11). According to Bank Negara Malaysia, the export trend which, improved in the third quarter of 1998 was due to exports of electronic components and parts, electrical products, textile and textile products as well as rubber products. It is observed that, the main contribution from manufacturing products comes from electronic and electrical machinery, which constituted 65.7 per cent of total export of manufactures in 1996. The proportion increased to 68.1 per cent in 1998 (Table 3.11). This followed by electronic component, which constituted 48.0 per cent of total export of manufactures and electric appliances (4.6 per cent) in 1998. Latest indicators showed that the manufacturing sector contracted 10.2 per cent in 1998. The Report says that, the manufacturing sector has been severely affected by the regional financial crisis especially in the third and fourth quarters of 1998 (Bank Negara Malaysia, 1998).

Table 3.11: Malaysia: Export Share of Manufacturing Goods by Product (percentages)

Product	1975	1980	1985	1990	1995	1996	1997	1998
Food	13.5	7.8	6.1	4.2	2.2	2.1	2.0	1.9
Beverages & Tobacco	1.3	0.4	0.2	0.2	0.3	0.4	0.4	0.4
Textile, clothing & footwear	10.8	12.8	10.4	8.3	4.4	4.4	4.3	3.9
Wood products	10.2	7.4	2.9	2.9	3.4	3.8	3.6	2.5
Rubber products	2.1	1.3	0.9	2.9	2.2	2.3	2.2	2.4
Paper & paper products	0.4	0.6	0.6	0.9	0.5	0.4	0.4	0.4
Petroleum products	5.2	3.0	7.9	2.7	2.1	2.1	1.9	1.3
Chemicals & chemical Products	4.3	3.0	4.9	3.1	4.3	4.2	4.5	4.5
Non-metalic mineral products	1.2	1.0	1.2	1.6	1.1	1.0	1.0	0.8
Manufactures metal	3.1	3.9	2.9	3.4	3.1	3.2	3.2	3.5
Optical & scientific Equipment	16.6	2.2	1.8	2.3	2.0	2.0	2.2	2.0
Toys & sporting goods	0.7	0.9	1.4	2.1	1.5	1.5	1.3	1.2
Other manufactured	0.7	4.4	1.9	4.6	3.6	3.9	3.7	3.6
Electronic & electrical machinery	25.0	47.7	52.3	56.6	65.7	65.7	66.4	68.1
Electronic components	-	36.3	35.8	24.9	22.5	40.7	45.1	48.0
Electric appliances	-	4.4	3.7	5.3	5.2	5.4	4.9	4.6
Other electrical machinery	-	7.1	12.9	26.3	38.0	19.5	17.0	15.3
Transport equipment	3.3	3.5	4.6	4.1	3.6	2.9	2.7	3.3
Manufactures of Total Export	21.9	22.4	32.7	58.8	79.6	80.4	81.0	82.9

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, various years

In terms of export earnings, the export receipt from electronics and electrical products increased significantly from RM9014 million in July 1997 to RM13218 million in July 1998. This followed by export earnings from chemical products which, increased from RM632 million in mid-1997 to RM822 million in mid-1998. Export earnings from textiles production also showed significant increase in terms of value, that is from RM653 million to RM831 million in July 1998 (Table 3.12).

Table 3.12: Malaysia: Gross Exports of Manufactured Goods, July 1997-September 1998 (RM million)

Period	Electronics and Electrical	Textiles	Wood Products	Chemical Products	Other Manufactured
1997 Jul.	9014.6	653.0	537.5	632.8	574.0
Aug.	10861.6	687.3	499.0	684.9	593.5
Sep.	11385.0	640.4	495.6	682.1	577.5
Oct.	11967.4	729.4	606.7	795.6	658.5
Nov.	11412.6	703.9	647.6	823.5	624.6
Dec.	12233.0	901.8	661.9	876.6	663.2
1998 Jan.	12420.4	782.9	515.9	893.2	659.5
Feb.	12516.4	661.0	468.2	917.3	559.6
Mar.	14103.6	740.1	461.1	963.8	696.5
Apr.	12311.2	714.5	467.1	953.5	643.7
May	12079.6	764.6	477.3	928.5	655.2
Jun	13254.2	823.6	471.5	932.1	711.4
Jul.	12218.4	831.0	512.1	822.1	735.0
Aug.	13750.6	905.0	509.3	869.8	764.1
Sep.	14344.0	737.0	500.5	854.0	709.8

Source: Bank Negara Malaysia, Quarterly Economic Bulletin,1998

3.4.4 Imports

Malaysia's import performance very much dependence on the performance of Malaysia's economic growth. There has been significant increase in import especially after 1987. This is because, after the economic recession, Malaysia's economic structure underwent a major transition. Emphasize on heavy industrialization have led to an increase in imports, particularly capital and intermediate goods in order to expand production capacity. Initially, the import of intermediate and investment goods was 49.2 per cent and 28.6 per cent respectively in 1987. While the import of consumption goods accounted 21.1 per cent of total import in the same period. Based on Table 3.13, it is observed that, the import of investment and intermediate goods expanded significantly since 1985, meanwhile the import of consumption goods showed a downward trend since 1987 but improved slightly in 1996.

However, after the outbreak of currency crisis, the import grew 3.3 per cent in third quarter of 1998. This is due to the higher imports of intermediate goods, which more than offset declines in the imports of capital goods, consumption goods and dual use goods. It is noted that, the imports of intermediate goods, which accounted for 45.2 per cent in 1996, increased to 47.4 per cent in 1998. On the other hand, the import of investment goods declined from 39.9 per cent to 38.2 per cent in 1998. The import of consumption goods also showed a downward trend from 14.2 per cent in 1996 to 13.6 per cent in 1998 (Table 3.13).

Table 3.13: Malaysia: Imports of Intermediate and Investment Goods, 1970-1995

Year	Consumption	Investment					Intermediate		
	Total[1]	Mach.	Equip.	Metal.	Others	Total[1]	For Manuf	Other	Total[1]
1970	39.5	41.8	13.0	23.3	21.9	25.2	62.7	37.3	35.3
1975	27.0	35.7	6.0	17.9	40.4	31.7	54.5	45.5	41.3
1980	19.9	36.9	13.1	25.1	25.1	30.0	57.3	42.7	50.1
1985	21.2	34.7	13.9	18.2	33.3	31.1	64.3	35.7	47.7
1986	22.0	30.0	17.7	17.0	34.5	28.8	74.2	25.8	49.2
1987	21.2	28.8	13.6	19.4	38.2	28.6	76.5	23.5	50.2
1988	20.6	31.4	11.2	22.3	35.0	29.6	78.1	21.9	49.8
1989	19.1	30.7	17.5	19.0	32.8	34.2	79.2	20.8	46.7
1990	17.1	29.8	19.5	16.8	33.9	37.5	79.0	21.0	45.4
1991	17.5	28.3	16.9	15.5	39.3	39.7	79.5	20.5	42.8
1992	17.6	29.4	17.4	14.4	38.9	41.6	78.0	22.0	40.8
1993	16.7	27.7	13.7	15.3	43.3	40.6	80.9	19.1	42.7
1994	15.1	25.8	16.4	13.1	44.7	41.4	83.6	16.4	43.5
1995	12.1	27.6	14.3	14.9	43.2	40.5	86.4	13.6	44.7
1996	14.2	27.4	11.9	14.7	45.8	39.9	84.6	6.5	45.2
1997	14.3	25.6	13.9	14.6	45.7	42.3	83.9	7.4	42.6
1998	13.6	20.4	15.2	12.1	53.4	38.2	85.9	6.8	47.4

Source: Bank Negara Malaysia, Quartely Economic Bulletin, various issues.
Notes: 1. of Total Imports

This implies that although, the depreciation of the ringgit is expected to lower the volume of imports compared to before the crisis, but Malaysia's high dependency on imports of intermediate items may inflate the import bill. However, this can be offset partially if the importers switch to cheaper source of imports or produced the imported items in the domestic market. This in another way might rectify the deficit in the trade balance.

3.4.5 Trade Direction

Table 3.14:Malaysia: Direction of Trade (percentages), 1970-1998

EXPORTS	1970	1980	1990	1995	1996	1997	1998
Japan	18.2	22.8	15.8	11.0	13.4	12.5	10.5
USA	13.0	16.4	18.9	22.0	18.1	18.6	21.6
EU	20.0	16.9	14.9	13.0	13.7	14.4	16.1
UK	6.6	2.7	3.9	4.0	3.4	3.3	3.6
Germany	6.2	7.9	6.5	3.2	3.0	2.8	3.0
ASEAN	23.0	22.4	28.9	28.0	28.1	27.4	23.9
Singapore	21.5	19.0	22.6	20.3	20.4	20.1	16.9
Others	25.8	21.5	21.5	26.0	26.5	26.8	27.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
IMPORTS							
Japan	17.1	22.9	24.0	28.0	24.5	21.9	19.6
USA	8.5	15.0	16.7	17.4	15.4	16.7	19.6
EU	24.6	15.4	14.6	13.2	14.4	14.1	11.8
UK	13.3	4.6	5.4	2.8	2.6	2.6	2.2
Germany	5.9	4.8	5.0	4.4	4.2	4.3	3.9
ASEAN	15.4	16.4	18.9	18.0	19.6	20.3	22.5
Singapore	6.6	11.7	14.9	12.3	13.3	13.1	13.5
Others	34.4	30.3	25.8	23.4	25.6	22.5	26.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank Negara Malaysia, Quarterly Economic Bulletin, various issue.

During 1970s and 1980s, Japan and ASEAN countries had been the main export destination for Malaysian products. In 1970, Japan absorbed 18.2 per cent of Malaysian exports followed by ASEAN nations (23.0 %), European Union (20.0 %) and the rest of the world (25.8%). In ASEAN countries category, Singapore has been the main single largest trading partner, with a total export of 21.5 per cent. In 1980, the trend is remained the same with Japan as the main trading partner (22.8 %) (Table 3.14). However after 1990, the trend changed, in which, the United States has become the single largest trading partner, with total export of 18.9 per cent compared to Japan which constituted 15.8 per cent of Malaysia's total export. Since 1990, the United States has been the Malaysia's main trading partner followed by Singapore and Japan. Even after the outbreak of currency crisis, United States is still Malaysia's main trading partner.

The United States is the Malaysia's single largest trading partner during the first seven months of 1998, with a total trade of RM 63 billion or 21.1 per cent of Malaysia's total trade, followed by Singapore (15.4 %), Japan (15.2 %) and the European Union (9.2%). Trade with the Newly Industrializing Economies (NIE's) of Asia comprising South Korea, Taiwan and Hong Kong SAR constituted 11.9 per cent of Malaysia's total trade (Economic Report, 1998/1999). On the other hand, Malaysia mostly imports from Japan (17.1%), European Union (24.6 %), United Kingdom (13.3 %) and ASEAN (15.4 %) in the 1970s. After 1990, imports from Japan accounted for 24.0 per cent of total Malaysia's imports, followed by United States (15.0 %) and ASEAN nation (16.4%).

However, since the outbreak of currency crisis, the trade direction has changed. In terms of export destination, the United States became Malaysia's largest export market in 1998 while Singapore was relegated to second position. Japan retained its position as the third largest export market. On the other hand, in terms of imports origin, the United States and Japan were the largest source of imports with a share of 19.6 per cent each, followed by Singapore (13.6 %). In 1998, the import from Japan declined to 19.6 per cent from 21.9 per cent in 1997, while the import from United States increased from 16.7 per cent to 19.6 per cent in 1998 (Table 3.14). Imports from ASEAN countries also increased significantly from 20.3 per cent in 1997 to 22.5 per cent in 1998.

3.5 Conclusion

The depreciation of the ringgit has undeniably magnified the structural weaknesses in the Malaysian economy. The depreciation of the ringgit has also put tremendous pressures on our balance of payment. If the positive impact resulting from the weak ringgit offsets the negative impact, we will see a mark improvement in the overall balance of payment. In order for that to take place, export earnings must improved substantially and we must also see higher long-term capital inflows. In short, economic growth hinges on the performance of the external side as domestic demand experienced a drastic contraction in 1998. The ringgit depreciation has in fact enhanced Malaysia's external trade competitiveness and improved the current account position which, has been in deficit in the past few years.