Chapter 6

Summary and Conclusion

In **Chapter Two,** the factors that causes the East and Southeast Asian financial crisis was discussed in depth. As mentioned in the earlier part, there are many contradictory views were expressed by various commentators concerning the crisis. Till now there is no one factor that can be stated or produced as evidence to explain the East and Southeast Asian financial crisis. However, based on many views and opinion, we could conclude that the East and Southeast Asian financial crises actually had been triggered by multiple factor that reinforces each other.

It is believed that, East and Southeast Asian financial shortcomings as well as the developments in the global financial markets has contributed significantly to the buildup of the imbalances that eventually led to the crisis. We have witnessed that the crisis in Asia has occurred after several decades of out-standing economic performances, in which annual GDP growth in the ASEAN-5 (Malaysia, Indonesia, the Philippines, Singapore and Thailand) averaged closed to 8 per cent over the last decade. There also has been increase in the per capita income levels and until the current crisis, Asia attracted almost half of the total capital inflows to developing countries. However, all these remarkable figures also indicates that the economy of those countries, mainly in East and Southeast Asia, were actually overheating and there were also some indices which reflects the growing imbalances and weaknesses both at the microeconomic and macroeconomic levels. On the other hand, there was a rapid buildup of short-term external debt because of partial financial market liberalization in East and Southeast Asia, which opened new channels for foreign capital to enter into the economies. It is noted that the inflows of capital led to appreciating of real exchange rates, a rapid expansion of bank lending and increasing possibility in vulnerability to reversal in capital flows.

Consequently, this led to speculation and withdrawal of capital by foreign creditors from the region and eventually led to devaluation of exchange rates in the region. By September 1997, currencies in the each of the four Southeast Asian countries had fallen by 20 per cent or more. As the currencies fell and capital flows reversed, several forces came into play to create a self-reinforcing spiral that quickly evolved into a panic. Even though Government and international community took immediate steps to overcome the crisis but several mistakes in handling the crisis, had worsen the situation in the ailing economies.

In **Chapter Three,** the overall impact of the currency crisis on Malaysian economy with specific emphasis on the external sector were discussed. Theoretically, depreciation of a country's currency would improve the country's external competitiveness. Literature shows that the "J-curve" effect will take place whereby the country will see a fall in its trade balance for several or longer and then an improvement. However, in Malaysia case, the external trade has responded favorably to the depreciation of ringgit with a recorded RM58 billion in 1998. The improvement in the trade surplus reflected mainly a stronger growth in exports (30.4 per cent) compared with import growth (3.3 per cent).

Since trade balance has responded favorably to the ringgit depreciation, the so-called "J-curve" phenomenon of a delayed response to trade to devaluation appeared to be irrelevant in Malaysia case. The J-curve phenomenon is only relevant to economies where exports are settled in domestic currencies and imports are in foreign currencies (Bank Negara Malaysia,1997,pp:105). Also there is an increase in export receipt by 30.4 per cent to RM73.6 billion (Bank Negara Malaysia, 1997,pp:194). This is due to strong increase in export earnings of both manufactured goods and commodities (mainly palm oil, crude petroleum and LNG).

Even though, positive responses were observed in the external trade due to the depreciation of the ringgit, however, caution should be taken to avoid using exchange rates as an instrument to enhance price competitiveness. A more effective and sustainable way of enhancing external competitiveness is through real changes in the economy such as, technological progress, changes in the terms of trade, reduction in tariff etc. Greater export competitiveness would mean better product differentiation especially in a good market where Malaysia is a price taker and not price maker.

As mentioned earlier, in a price taker environment Malaysia have to look into ways of increasing its production efficiency. This is due to the fact that a lower ringgit does not necessarily lower the price of a manufactured product. As such, the efficiency will be directly reflected in the price of the final product and thus this will determine the demand for Malaysia-made products. This will help boost exports volumes that may translate into higher export earnings. On the other hand, although the depreciation of the ringgit is expected to lower the volume of imports, Malaysia's high dependency on imports of intermediate items may inflate the import bill. However, this could be offset partially if the importers switch to a cheaper source of imports. Although, there is such possibility that the decline in the value of ringgit may lower the import bill, however, the short-term impact is more likely to be negative than positive. In conclusion, the performance of the external sector 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.

In **Chapter Four,** the measures that were adopted by the Government and the international community were discussed in depth. In this chapter, the IMF bailout package to Thailand, South Korea and Indonesia were also discussed briefly. As for Malaysia, since the onset of the financial crisis, the initial focus of macroeconomic management was one of restoring investor confidence. This is to stabilize the financial markets as well as strengthening the resilience of the economy to withstand the risks that might arise from the contagion effects of the regional crisis.

Immediately after the outbreak of the East and Southeast Asian financial crisis, most of the policy packages that was announced during the fourth quarter of 1997 were directed at maintaining a tight monetary and fiscal policies to instill investors confidence in the financial markets. This move were needed to address the external payments of current account deficits, promote savings and conserve the nation's external reserves. However, prolonged regional crisis due to the developments in South Korea and Indonesia, led to downward pressures on regional currencies. Consequently, further policy was initiated during 1998, in which, the major outbreak was the establishment of National Economic Action Council (NEAC) on 7 January 1998. The main purpose of the NEAC is to deal with the nation's economic problems and this include the fiscal stimulus as well as measure to address the problem of non-performing-loans (NPLs) and to recapitulate the banking system. In line with the NEAC initiatives, the Kuala Lumpur Stock Exchange (KLSE) also introduced some pre-emptive measures to ensure an orderly and fair market in trading of Malaysian. Crucially, exchange control measures introduced in September 1998 to insulate the economy from global financial markets. The measures that undertaken by the government via NEAC, was reported to have borne the desired results in term s of inflow of FDI, improvement in trade balance, increase in foreign reserves and successful re-capitalization of banking system. Moreover, gradual improvement in corporate sector and increased monetization in the economy by channelling funds to various productive sectors has resulted in achievement of 2.3 per cent of economic growth in the third quarter of 1998.

In **Chapter Five,** the impact of currency crisis on Malaysian export, were evaluated econometrically by employing co-integration and error-correction model. The main objective of this study is to examine the impact of currency crises on Malaysian exports. In this study, real effective exchange rate was used as proxy for external shock. The study was conducted in two observation period that is annually (1975-1997) and monthly (July1997-November 1998). Firstly, the analysis was conducted using ordinary least squares and the empirical evidence indicates that there is significant positive exist between real effective exchange rate and demand for exports. To evaluate the long-run impact of the real effective exchange rate on Malaysian exports, co-integration analysis was conducted. Based on the co-integration analysis, it was found that long run relationship exists between REER and exports for annually observation period, but this did not happens for monthly observation. On the other hand, relative prices and foreign income also provided a significant relationship with export. This results allows for the estimation of error-correction model

The error-correction model suggests that the long-run relationship between real effective exchange rate and export are only marginally significant. However, it did not provide any short run relationship. As for the relationship between relative prices and export, both long run and short run components did not display any significant relationship. However, the relationship between foreign income and export exerts a positive and significant long run as well as short run relationship. This empirical evidence seems to be different from that is obtained by A.C Arize (1996). He examined the relationship between exports and real effective exchange rate uncertainty for Korea using multivariate co-integration and error-correction techniques. The major result suggests that real exchange rate uncertainty have a negative effect on exports in the short run as well as the long run.

Thus, based on the empirical evidence, we could conclude that there is no real consensus regarding the relationship between exchange rate fluctuation and exports, in which some empirical evidence displays a positive relationship, while some displays a negative relationship. In this situation, one thing that seem to be certain that, to some extent, exchange rate depreciation does have a significant impact on the exports. This implies that exchange rate depreciation might help to increase the performance of exports of Malaysia and eventually improve trade balance. Latest indicators as released by the government had shown that, Malaysia has registered trade surplus for consecutive 17 months since the outbreak of East Asian currency crisis in mid-1997.

Conclusion

As a consequence of the financial crisis, which beset the region since the mid-1997, the performances of the Malaysian economy as well as the rest of countries in the region has been adversely affected. Domestic demand has decline due to variety of factors. With the contraction in aggregate demand, output of construction and manufacturing sectors, Malaysia's real GDP contracted for the first time since 1985 by 6.8 per cent in 1998. Despite the counter-cyclical measures taken by the government, but it seems to be ineffective and could not stop the contraction in the real GDP. Very importantly, the mostly asked question by people is, when the economy will fully recover from current crisis?

In this situation we could say that the prospective performance of the Malaysian economy very much depends on two major development. Firstly, it depends on the speed and the extent of the implementation of the fiscal and monetary measures that have been put in place to revitalize the domestic economy. These measures include the provision of fiscal stimulus, the establishment of Pengurusan Danaharta Nasional Bhd, purchase of the non-performing loans of the banking system, the setting up of the Danamodal to recapitulates the banking system, as well as other recommendations put forward in NERP. Very importantly, the early implementation of these measures will help to stimulate the economy.

Secondly, the future performance of the Malaysian economy is also dependent on the extent of recovery in external demand for Malaysia goods and services. However indications are that external demand will remain weak, although a mild recovery can be expected. This is due to expected stagnation in real GDP growth of Malaysia's major trading partner's – United States, Japan and other East Asian countries. Now that the effect of the Asian financial crisis has spread to Brazil, recovery process will be much complicated unless all the international community co-operates to achieve global financial market stability. Thus, fast recovery will depends on the prudent measures as well as the establishment of regional co-operation to deal with current financial crisis.

Since the main purpose of this study is to examine the impact of currency crisis on Malaysian exports, it is found that ringgit depreciation to a certain extents has influenced the trade flows. This is indicated by remarkable improvement in the exports as well trade balance. For the past few years, Malaysian current account has been in deficit because of rising imports and deficits in service account. However, since third quarter of 1998, trade surplus has been in increasing trend and this led to improvement in the current account position. In this regard, 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. The export sector was the star performer of the economy in 1998, with a high trade surplus of RM36 billion in 1998. Various intensive study of exports were undertaken by NEAC with emphasis on diversification, increased usage of local inputs and components, value-added benefit and new export incentives to make Malaysian export base much stronger.

Also, there should be relative stable exchange rate, which would reflect price stability in the long-term. For this the Malaysian government should review its exchange rate regime which would encourage and promote Malaysian export while maintaining price stability and avoiding sharp movements of the exchange rate over very short periods of time. With adoption of capital control, to some extent the stability in exchange rate has been achieved and this gives some confidence to manufacturer to expand their production. It is believed that, Malaysian export demand very much depends on the performance of world market than price level. Exports of primary commodities depend very much on the world demand, price level as well as favorable weather situation. On the other hand, export demand for manufacturing products are less dependent on the price as it is more reliable on the performance of world market. In light with the outbreak of currency crisis in mid-1997, the global demand has been adversely affected especially from the ASEAN countries. Thus, it is important that world market progress well to enable the absorption of export from Malaysia.

In present situation, all countries in Southeast Asia experienced currency depreciation thus all has competitive edge for their products. In this situation, there should be some differentiation in products as well as the adoption of appropriate marketing strategies. Manufacturers should emphasize on high quality, advance design, productivity and technology innovativeness and efficiency towards producing quality products at reasonable prices. They should, therefore, prepare to make appropriate organizational and attitude changes towards research and development in order to achieve that competitive edge in the long-term.

Another important element that will affect efforts to sustain international competitiveness is productivity. In an environment of full employment and resource constraints, enhancing Total Factor Productivity (TFP) will improve Malaysia's competitive edge. TFP can be enhanced through advancement in education of workers, skills and expertise, acquisition of superior management techniques and know-how, improvements in organization, gains from specialization, introduction of new technology and innovation and enhancement of information technology (IT). Thus, in a globalised world market, efforts to enhance international competitiveness through orthodox measures such as incentives and lowering of taxes are clearly no longer adequate. Improving the competitive position in the longer term is a structural issue that should be attained through the development of new approaches, strategies and products.

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