

Impact of the economic crisis on malaysia



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OVERVIEW

Among all of the South East Asia countries, Malaysia is one of the countries that enjoy the open and fast growth economics. Malaysian stock market also is playing an important role and gives contribution to economic growth, especially in the development of Malaysia's financial sector (Baharom, Royfaizal, and Habibullah, 2008).

Unfortunately, due to 1997 Asian Financial Crisis, Malaysia's economic had faced with a serious recession due to the depreciation value of Ringgit Malaysia. This crisis had lead to the collapse of Kuala Lumpur Stock Exchange (KLSE), whereby the KLSE composite index had faced the decrease of 44. 8% in 1997 (Azmani, Habibullah, Law, & Dayang, 2006). The collapse of Malaysia's Stock Market had given a serious downturn in financial sectors and leads to stock return decrease.

This crisis had shown how importance the role of stock market in Malaysia's financial sector. According to Nandha & Hammoudeh (2007), they mentioned that 1997 Asian crisis had giving a major negative impact to the Asian-Pacific contries. Thus, this will be an attractive point in study the change of stock market movement or performance with global factor such as oil price (Nandha & Hammoudeh, 2007).

Thus, it is an interesting topic for researchers to study the movement of stock market. The movement of stock market can be increase or decrease; investor can monitor the Composite Index of KLSE to follow the overall movement of stock market. The interesting in study stock market is not just about the market movement, but is to study what force, variables and

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factors that give impact to the stock market movement, or what has lead the stock market movement.

Previous study which done by other researchers had shown a different study perceptive and view on the stock market. In some issue, many researchers had interested with the study on the relationship between stock price and exchanges rate (Baharom, Royfaizal, & Habibullah, 2008). For example, Bahmani & Sohrabian (1992) and Nieh & Lee (2001) have done a research and study on the long run relationship between stock market and exchange rates.

Meanwhile, the study on the relationship between macroeconomics factor and stock market also become an important research in the academic field (Adam & Tweneboah, 2008). According to Adam & Tweneboah (2008), macroeconomics variable that normailly used in study the relationship with stock prices have include the exchange rate, interest rate, industrial production and inflation.

Adam & Tweneboah (2008) also believe that stock market is of one of the economic activities, which will be highly influenced by the government monetary policies and macroeconomics issues. The active relationship between macroeconomics variable and stock market had encourage many researchers to study this topic (Adam & Tweneboah, 2008).

In this study of stock market, it will not focusing on the relationship between macroeconomics variables and stock market. But, this study will move to the focus of relationship between commodity prices and stock market. Among all of the commodity, crude oil and palm oil will be chosen as the commodity

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in this study. Whereby, the price of crude oil and palm oil will be used in study the relationship between commodity price and stock market.

Justification of these variables will be further discussed in Chapter 2, Literature Review.

COMMODITY

There are a few of definition in explaining what is commodity. Refer to Geman (2007), the author had mentioned that, an economist will define commodity as a scarcity asset, which will give an important effect to the global and certain country development.

Commodity also can be tangible assets and raw materials, which demanded by people for the purpose of daily usage (Frush, 2008). For example people demand commodity for eat, for energy usage and for production. Producers need commodities as raw materials to produces the final end products for consumers. Examples of commodities, gold, metal, lumber, energy fuel, wheat, corn and other else. Commodity also divided into six major commodity classes, which are metals, energy fuels, agricultural, livestock, exotics and financials.

Frush (2008) had mentioned that all commodities have the three characteristics, which are “ Standardization”, “ Tradability” and “ Deliverability”. The description of each characteristic is as below (Frush, 2008):

Standardization : Same commodity can be measureable in unit.

Tradability : Buyers and Sellers are able to trade commodity in a different marketplace.

Deliverability : Traders able to exchange with each other for the tangible or actual physicals commodity. This rule is exception for financial commodity.

Commodity market's price can be fluctuating. The basic fundamental that give impact on the commodity price is the supply and demand of a commodity in a market (Somoye, Akintoye, & Oseni, 2009) . When the demand of a commodity is higher than supply, commodity price will be increase, while commodity price will decrease when supply of commodity higher than demand.

Traders can trade or exchange commodity through in a future market place. Chicago Mercantile Exchange (CME) is one of the commodity and derivatives market in USA. It provides financial services, which allow public to trade commodity with globally. Chicago Mercantile Exchange (CME) also partnership with Bursa Malaysia Berhad (KLSE) in 2009, for the purpose in improve commodity trading.

CRUDE OIL

Among most of the energy sources in commodity, crude oil is one of the most important energy (He, Wang, & Lai, 2010). This is because of large demand of crude oil for transportation and economic activity. Petroleum consumption also is the largest share in total energy consumption, whereby reach 36. 36% in 2006.

Refer to the historical data, oil price had reached around \$40 per barrel in the end of the 1970s and start continues to rise in 1999 and after 2001. Between 2007 and June 2008, the oil price had doubled up and record down a new high price, around \$133 per barrel. High increases in oil price can because of certain issue, such as 1973 embargo by OAPEC, 1978 Iranian Revolution, 1980 Iraq- Iraq War and 1990 First Persian Gulf War (Chen, 2010).

Due to crude oil is playing an important role in an economic activity, global economic and financial markets can be affected by the higher oil prices. This normally will lead to expectation that crude oil price shocks will give an effect to the stock market.

PALM OIL

Palm oil is “ derived from the flesh of the fruit of the oil palm species *E. Guineensis*. In its virgin form, the oil is bright orange-red due to the high content of carotene. Palm oil is Nature’s Gift to Malaysia, and Malaysia’s to the World.” (Malaysian Palm Oil Council)

1. 2 PROBLEM STATEMENT

Stock market composite index is a financial indicator, which reflects the performance of overall stock market. Performance of stock market can be explained as the return of stock market or price movement of stock. Stock also can be known as equity share. Daily, stock market index can be increase or decrease, due to the overall stock price movement. But, what made the stock market index move increase or decrease?

Fundamentally, stock price influenced by the theory of supply and demand (Somoye, Akintoye, & Oseni, 2009). When there are more investor buy or demand stock, the price will be increase. If people are selling the stock then the price will be decrease. However, Somoye and others (2009) had mentioned that equity can be influenced by two group variables, which are macroeconomics and microeconomics. Macroeconomics factor can be viewed as inflation, whereby microeconomics is earnings and dividend of equity share (Somoye, Akintoye, & Oseni, 2009)

According to Gompers and others, (2003), they had supported that information about share's dividend and earnings are giving significant impact to the stock price. Negative or positive earnings information can give a significant impact on the stock price (Hartono, 2004). Correlations between stock price and dividend also had supported by Docking & Koch (2005). Therefore, micro-economic factor such as share' dividend is giving impact on the stock market or price movement.

In the study of Al-Qenae and others (2002) on Kuwait Stock Exchange, they had found out that the macro- economic factors had giving negative impact on stock prices. In a study on Nigerian equity market which done by Udegbonam and Eriki (2001) had give a result that inflation is uncorrelated with the stock price movement. However, Adam and Tweneboah (2008) have prove that inflation give a significant impact on the Ghana Stock Market movement. Same as Japan stock return also influenced by inflation Hamao (1988).

In the context of Asian country such as India, Japan, Korea, Malaysia and Philippines, there is a study done by Habibullah and others (2009), which contributes to the impact of inflation on stock market return and volatility. They found out that stock market return is difficult predicted by inflation rate, but inflation rate give significant impact to these countries stock market movement and return.

By going through above study, we can understand that macroeconomics and microeconomics give different impact on stock market price movement. While economics factors influence the movement of stock market index, does the commodity price play the same role as other economic variables?

This is because Malaysia is one of the main exporters of crude oil and palm oil in the world, so we need to investigate whether the fluctuation of commodity price give impact on Malaysia stock market. Palm oil is the main productions in Malaysia, so there is a huge amount of commodity transactions done in Malaysia.

Thus, we can study that whether commodity price can become an indicator and signal in predict the movement of Malaysia stock market. Besides that, we will study the relationship or impact between commodity price and Malaysia stock market movement. Finally, crude oil price and palm oil price will used in study the relationship between commodity price and stock market in Malaysia.

RESEARCH QUESTION

In order to study on the relationship between commodity prices and stock market, research question is important in understand the direction of this

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study. Research question also provide a framework in complete this study.

Thus, the research questions are as below:

Does commodity price such as palm oil and crude oil influence the movement of stock market in Malaysia? Any relationship between commodity and stock market?

Between price of crude oil and palm oil, which is giving more significant impact to the Malaysia Stock Market?

OBJECTIVE OF STUDY

In general, the objective of this research is to study the relationship between commodity prices and stock market. The specific objective of this study is as below:

To investigate the relationship between crude oil price and Malaysia Stock Market.

To investigate the relationship between palm oil price and Malaysia Stock Market.

To investigate the significant impact between price of crude oil and palm oil on Malaysia Stock Market.

SCOPE OF STUDY

This study will be focus on the Malaysia Stock Market, which also known as Kuala Lumpur Stock Exchange. Malaysia has been chosen in this study because it is one of the countries in South East Asia, which enjoy the open and fast growth economics (Baharom, Royfaizal, & Habibullah, 2008). In a

same time Crude oil and palm oil have been chosen in this study because Malaysia is the net exporter of crude oil and also the main production of palm oil. So, this study also covers the impact of crude oil and palm oil's price on Malaysia, which as the exporting and producer country.

STRUCTURE OF STUDY

In the beginning of this chapter, this study has begun with the overview of Malaysia Stock Market, and then the brief explain on commodity. Further discussion also had done on the crude oil and palm oil.

Chapter 2 will be focus on the literature review, which will discuss and made justification on the relationship between commodities and stock market. Discussion done based on the previous study and literature.

Chapter 3 will be the methodology in discuss the method in investigate or study the relationship between commodity price and stock market, while Chapter 4 will be the result of this study.

SIGNIFICANT OF STUDY

In Malaysia, the most common commodity that available in Bursa Malaysia is crude palm oil. Palm oil industries also play as the backbone and give huge contribution to Malaysia's economics. In fact, there are 17.7 million tons of palm oil had produced by Malaysia in 2008. Whereby, this had shown that Malaysia is the second largest of palm oil producer and exporter.

Due to the fact that Malaysia is one of the largest producers and exporter in the world, besides there is few palm oil corporations are playing important role in Malaysia Stock Markets. So, the fluctuations of the palm oil prices can

give impact to Malaysia, especially to palm oil producer and corporation.

Thus, does the fluctuations of palm oil's price give impact to the Bursa Malaysia Stock Market' performance? Does any relationship can be proved between Palm Oil's (Commodity) Price and Bursa Malaysia?

CHAPTER 2

LITERATURE REVIEW

2. 1 COMMODITY MARKET

Since 1994, large demand in commodity had given an advantage for several developing countries.

Same situation was going to Malaysia in 1994. Malaysia had been the biggest winner in the transaction of dollar terms, which had earn about \$5. 2 billion from the commodity market (Buckley, 1996). Whereby, the commodities that leading in Malaysia are palm oil and rubber.