

# Measures taken by the malaysian government assignment

Law



Measures taken by Malaysian Government during the Asian Financial Crisis in 1997. There are numerous measures taken by the Malaysian Government during the Asian Financial Crisis in 1997. Nevertheless, in this paper, we only summarize the important and significant measures taken by the Malaysian Government. A more detail information will be revealed in the appendix added. Measures Taken by the Malaysian Government during the Asian Financial Crisis 1997: I). Fixed Exchange Rate Mechanism (Pegged Currency)

The far most efficient measures taken by the government of Malaysia to counter the crisis is the implementation of a fixed exchange rate regime from the previous free float exchange rate regime. The underlying factor that contributes to the crisis is the devaluation of Thai Baht which cause repercussion effect throughout the Southeast Asia region. The devaluation of Thai Baht causes a loss of confidence in the region currency stability which in turn pressures the Ringgit to devalue as capital flight happen. Prior to the Asian Financial Crisis 1997, Malaysia was maintaining a free float exchange rate system.

In a free float exchange rate system, Malaysia authority was able to enjoy a greater flexibility in implementing fiscal and monetary policy. Nevertheless, the Asian Financial Crisis 1997 has forced the authority to evaluate the viability of a free float exchange rate system when Malaysia was exposed to currency crisis. After much turbulence for a year, the authority found out that a stable and conducive environment for the implementation of fiscal and monetary policy is vital. Therefore, Government of Malaysia decided to convert from a free float exchange rate to a fixed exchange rate regime on 2 September 1998.

<https://assignbuster.com/measures-taken-by-the-malaysian-government-assignment/>

Persistent currency attack and speculation activities have caused turbulence in the foreign exchange market and in turn impose adverse impact on the aggregate economic activities. Currency stability will provide much needed sentiment boost for the economy while calling an end to the currency speculation activities. Devaluation of ringgit and pegging Ringgit to a reasonable level will bring an abrupt end to the speculation activities and also boosting Malaysia export competitiveness. This will also help to create an environment that is conducive for a revival in investor and consumer confidence and facilitate economic recovery. Overall, the exchange control measures resulted in greater stability in the currency and stock markets and the financial system, as well as revival in domestic consumer and investor confidence. Although the economy continued to contract in the second half-year, on a year-to-year basis, the fundamentals had begun to strengthen towards end-1998. II). From Various Task Force Agencies Prior to 1997, bad lending practices among banks and financial institutions in Malaysia were very common.

This condition and the rapid growth from the past few years which has inflated the asset prices only exacerbate the financial crisis in 1997. At one time, Malaysia financial institutions non-performing loans stood at record high of 14%. In this view, the skyrocket non-performing loans might bankrupt those weak financial institutions which would impose irreversible impact on Malaysia Financial System. Strong confidence and sentiment in the financial system was the cornerstone of any economy in the world. In effect, Malaysia government has to take proactive measure to counter this possible threat to the economy. Corporate Debt Restructuring Committee Corporate debt

<https://assignbuster.com/measures-taken-by-the-malaysian-government-assignment/>

default was also the prevailing problem at that time. A huge amount of domestic firms borrowed money that denominated in other foreign currency (mostly U. S Dollar). This is from the fact that loans can be acquired more easily and cheaper in foreign source. However, those firms didn't discount in the factor such as exchange rate fluctuation which would impose adverse implication to them. They simply left their risk exposure to foreign exchange unmarked or properly hedged.

In the end, the eventual currency peg of Malaysian Ringgit at 3.80 level or 50% devaluation from the initial 2.50 level inflated their debts by 50%. In effect, they are unable to service their debts as their debts burden was inflated substantially. The main purpose of the establishment of Corporate Debt Restructuring Committee was to implement a comprehensive framework for debt restructuring through bringing together creditors and debtors for a voluntary debt workout. In essence, this will ensure the creditors and debtors share the responsibility in the losses arising from the debts. The creditors and debtors will need to collaborate together to reach consensus and work out a corporate debt restructuring plan. In effect, creditors and debtors will come out with a structural arrangement regarding the debt repayment schedule. In the end, this will help to maintain a lower bankruptcy rate as there will be a higher progress on corporate debt restructuring. \* Danaharta Government of Malaysia established the danaharta to purchase non-performing loans (NPL) and assets from banks and financial institutions.

Banks and financial institutions that laden with non-performing loans unable to make any new loan to the economy. This in turn will stave off the credit creation process and impose negative influence on the Malaysia credit market. Thus, freeing those banks and financial institutions from the bad loans will let them increase credit provision to the economy. Danaharta offered to buy any bad loan over 5 million ringgit at a price it determined and pay the bank 80 percent of anything it recovered above that.

In the case banks declined to sell their bad loan, they were required to write the loan's value down to Danaharta's offer price anyway. Therefore, this will ensure that banks with reckless lending practices were punished and they cannot hide their bad debts problem. This orderly asset realization process will help to avert a credit crisis and enable the banking institutions to focus on loan intermediation to support economic activities. \* Danamodal A special purpose vehicle called Danamodal is set up to recapitalize bank.

The vehicle would inject fresh capital into those banks that are badly affected by the Asian Financial Crisis 1997. Bank with a stronger balance sheet will be more incline lend out money and in turn boosted credit liquidity available in the market. III). Fiscal Stimulus Package In the view of the economic turmoil, government of Malaysia has decided to increase the government spending in order to "spend the economy out of recession". As there is a general loss of confidence in the economy, it is thought that the slumping demand from the aggregate economic activity can only be made up with the boost in government spending.

In this regard, government of Malaysia disregard the negative impact of budget deficits that might incurred in the massive government spending plan. Government of Malaysia increase the development expenditure by RM 7 billion in 1998 to fund the projects in following areas such as agriculture, housing, education, infrastructure ; public facilities, industrial development, rural development, health, poverty eradication, information technology project. Development in diverse area of the economy will help to restore the economic growth while strengthen the potential growth of the economy with a much improved infrastructure.

In addition, Government of Malaysia also establish a RM 5 billion infrastructure fund to revive certain critical large-scale infrastructure projects such as mass rapid transport, ports development and highways.

Furthermore, the Government of Malaysia also creates a special fund aimed at 4 different areas which is national housing fund of RM 2 billion, small ; medium-scale industry fund of RM 1. 5 billion, new entrepreneurs' fund of RM 0. 75 billion, export credit fund of RM 4 billion. All in all, expanded government spending through the fiscal stimulus package will cushion falling demand from the private market and exports sector.

Concerted effort from the government and fiscal stimulus package will help to sustain the economic recovery. IV). Monetary Policy Government of Malaysia through Bank Negara Malaysia also implemented several important monetary policy aimed at reviving the economy. The central bank gradually reducing the statutory reserve requirement (SRR) from 13. 5 % in February 1998 to 8% in July 1998 and 6% in August 1998. Lower statutory reserve

requirement rate also indirectly injected more liquidity into the economy. In this way, viable business can get access to the credit market as banking institutions have more funds available to lend out.

It is estimated that the reduction of SRR has released RM 22 billion into the banking system and this amount of credit can be channeled into productive sectors. In addition, the central bank also taken measure aimed at stabilized currency while promoting economic growth. Thus, the central bank also reducing the Central Bank 3-month intervention rate (which determines bank lending rates) slowly. The rate felled from a high of 11% in February 1998 to 8% in September 1998. Easier access to the credit market and a cheaper borrowing cost (declining bank lending rate) provided a significant lifeline to the economy. V). Impose Temporary Capital Control In response to the prevailing financial crisis, Government of Malaysia has also imposed capital control to enable the Ringgit withstand pressure from capital outflow. The authorities imposed controls on international transactions in the ringgit, portfolio outflows, particularly a one-year holding period on nonresidents' repatriating proceeds from the sale of Malaysian securities and a prior approval requirement? above a certain limit? for residents to transfer capital abroad.

In essence, this measure can help to limit the contagion effects of external developments on the Malaysian economy, stabilize the domestic economy, maintain a stable domestic prices and the ringgit exchange rate. After all, capital controls were designed as a means to defend Ringgit value. Thus, this measure was soon lifted after the financial crisis has receded. Summary In

this paper, we have introduced the 5 basic types of mechanisms of exchange rate which is the free float, managed float, target zone arrangement, fixed rate system and the hybrid system.

We have discussed the significance of each mechanism of exchange rate and its costs and benefits. It is well known different types of exchange rate mechanism have a different implication on a country economy. Therefore, it is very important for a country to adapt a currency system that best match their needs. Throughout this assignment, we have learned the different kinds of mechanism for exchange rate and the connection of exchange rate to the Asian Financial Crisis 1997. Asian Financial Crisis 1997 has taught us a great lesson on the importance of prudence policymaking.

On one end, it has inflicted severe damages to the structure and foundation of the economy, on the other end; it has exposed the underlying weakness within the economy. Thus, recognize the underlying weakness within the economy through Asian Financial Crisis 1997 and proactive measures taken are good for long-term health of the economy. A combination of efficient policy such as implementation of fixed exchange rate mechanism, establishment of various task force agencies, efficient monetary policy, a huge fiscal stimulus package and capital control has helped to avert prolonged economic recession in Malaysia. Through concerted effort from Government of Malaysia, the impact to Malaysia from the Asian Financial Crisis 1997 was largely contained. With the implementation of effective policies, Malaysia achieved remarkable success in reviving its economy. The



economy of Malaysia was able to recover from recession within 2 years, and eventually returned to the trajectory toward high growth.