
The Malaysian Financial System Between Financial Repression and Liberalization in the Face of Crises - An Analytical Study for the Period 1978-2024

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Abstract:

This study aims to highlight the extent of Malaysia's success in adopting a financial liberalization policy, which, according to its proponents, is the cornerstone for developing countries to improve their financial systems and achieve economic growth, despite its association with some financial crises in certain countries. In this study, we relied on analyzing the quantitative development of some indicators related to financial development and economic growth, reviewing the various measures taken by Malaysia to exit the Asian financial crisis, as well as the reforms adopted to hedge against future crises. All of these measures fall within the framework of adapting financial liberalization policy according to its financial and economic components, despite conflicting with the policies and strategies of the financial and international community, especially the policies of the International Monetary Fund. Through this study, we concluded that the Malaysian experience was unique in that the Malaysian financial system performed its intermediation function perfectly without disruption, even during periods of financial crises that affected both the Malaysian and global economies. This reflects the flexibility of the Malaysian financial and economic system and its rapid recovery from the disturbances and imbalances resulting from financial crises.

Keywords: Financial Liberalization, Malaysian Financial System, Financial Repression.

Jel Classification Codes : G14, G21

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Introduction:

Financial liberalization policy has had a significant impact on the global financial system and the global economic structure. The openness of a country's financial system to global competition is the essence of financial liberalization policy and financial globalization, which aims to raise the efficiency of the country's financial institutions and optimize the allocation of resources, both internal and external, towards the most productive sectors and in the most suitable regions.

Malaysia is among the developing countries that adopted financial liberalization policy in the late 1970s and early 1980s, with full government support and commitment to establish a strong financial system that meets the conditions of global competition, including diversity, efficiency, competitiveness, and stability. The Malaysian financial system has played a prominent role in mediating funds in the region and emerging economies, especially in light of significant economic and financial integration among Asian countries.

Like many other emerging countries, Malaysia also experienced a severe financial crisis in 1997 that almost wiped out its significant achievements. It also exposed many flaws and shortcomings in the financial system that the Malaysian government overlooked during the transition from a financial system that controlled its mechanisms to a liberalized and globally open financial system. This led to a re-evaluation of many points and aspects through numerous post-crisis reforms aimed at transforming the Malaysian financial system into an international financial center.

Research Problem:

Based on this general presentation, our research problem is as follows:

To what extent has Malaysia succeeded in adapting financial liberalization policy to exit and confront crises?

1. General Concepts of Financial Policy and Liberalization

1.1. Concept of Financial Liberalization Policy :

According to McKinnon and Shaw, financial liberalization is the optimal solution and a simple and effective means to achieve economic growth in developing countries. Their view focuses on the complete elimination of financial repression, which they consider the main reason for low growth rates. A repressed financial system is one in which the state controls its mechanisms by controlling credit, interest rates, and capital flows, thereby controlling and influencing the economy and curbing growth and investment. Therefore, eliminating financial

repression is considered the optimal solution for economic growth. The financial system needs independence, which can be provided through financial liberalization. For example, the bias towards raising the real interest rate on deposits (either by raising the nominal interest rate or reducing inflation), financial liberalization will stimulate the accumulation of cash and real assets in banks and other financial institutions, thereby increasing savings, which in turn leads to increased investment (FATTOUM, 2005, p. 22)

■ Financial liberalization is generally defined as the abolition of various restrictions and controls imposed on capital movements, granting banks and financial institutions full independence or reducing state monopoly over them, liberalizing interest rates and prices of various financial and banking operations, and allowing them to be determined according to the law of supply and demand, in addition to opening the local financial and banking sector to the private sector to encourage competition among banks (بلقاسم، 2014/2013، صفحة 73). Financial liberalization involves eight main dimensions (N.ODHIAMBO, 2010) :

- Abolition of credit controls;
- Liberalization of interest rates;
- Freedom for various financial institutions to engage in banking activities;
- Independence of banks in their policies from monetary authorities;
- Privatization of banks (opening the door to bank privatization);
- Opening the local financial market to international capital flows;
- Removal of exchange rate controls;
- Removal of any barriers to the entry of foreign banks.

1.2. The Relationship Between Financial Liberalization and Financial Crises :

Despite the improved economic performance of many countries after adopting financial liberalization policies, which were considered key items on the economic policy agenda during the last three decades of the last century, the significant increase in financial problems during this period and the exposure of some countries to financial crises led economists to question the usefulness of financial liberalization and its relationship to the occurrence of crises.

Among the most important studies that addressed the relationship between financial liberalization and crises is the study conducted by Kaminsky and Reinhart in 1996, which included 20 countries from Asia, Europe, Latin America, and the Middle East, for the period from 1970 to 1995, during which many crises occurred. They concluded that most of the financial crises that occurred during this period were preceded by the adoption of financial liberalization policies. According to the study, financial liberalization plays an important role in the probability of banking crises and subsequent financial crises. This is attributed, according to the study, to the fact

that financial liberalization is often implemented without an appropriate regulatory and supervisory framework to accompany it (L.Kaminsky, 1996, p. 15) .

In another study by Demirgüç & Detragiache in 1998, which included 53 developed and developing countries, some of which adopted financial liberalization policies before 1980 and others at different dates during the study period (1980-1995), the study concluded that controlling certain factors related to the fragility of the financial system, such as negative economic developments, poor economic policies, and balance of payments deficits, can lead to an independent negative impact of financial liberalization on the stability of the financial system. However, the availability of a strong institutional environment with strong and effective law and the absence of corruption can limit the negative effects of financial liberalization on the financial system (Demirgüç-Kunt & Detragiache, 1998, pp. 32-33)

2. The Malaysian Experience in Exiting the Asian Financial Crisis

2.1. Malaysia's Economic and Financial Background on the Eve of Financial Liberalization

Malaysia achieved a developmental boom that deservedly earned it the title of "miracle." It transformed from a backward agricultural society after gaining independence from Britain in 1957 into an industrially developed society, in addition to successfully eliminating the ethnic clashes that occurred in the late 1960s between Malays and Chinese, by working to create national harmony and stability among the ethnic groups in its land (جدي، 2015/2014، صفحة 187)

Malaysia had a stable economic environment during the 1970s, with a relatively low and stable inflation rate and a comfortable current account position, especially during the second half of the decade. This was mainly due to improved terms of trade. The average consumer price index growth rate was less than 5% annually, and the current account surplus was 3% to 5% of GDP in the years 1976-1979. Domestic savings as a percentage of GDP reached a high of about 30% to 39% in 1979, and domestic investment was lower than domestic savings despite its increase. Nevertheless, Malaysia had a chronic fiscal deficit of about 6% to 7% of GDP during the 1970s, and this deficit was financed domestically through government securities (Cho & Khatkhate, 1989, pp. 09-10) .

2.2. Malaysia and the Asian Financial Crisis

The crisis began when the Thai baht came under severe pressure from speculation. The Malaysian ringgit did not escape the same pressures, so the Central Bank of Malaysia intervened in the foreign exchange market to support the value of the ringgit. However, this intervention lasted only about a week before it was forced to float

the currency on July 14. The bank lost approximately 1.5 billion dollars in its attempt to defend the currency, and the ringgit fell by approximately 50% against the dollar, reaching its highest level of 4.88 against the dollar.

Several opinions were put forward to explain the cause of the financial crisis that occurred in Southeast Asian countries, especially in Malaysia, including weak macroeconomic management. However, the majority of these countries, including Malaysia, have sustainable records in macroeconomic discipline. According to (Akyuz 2004 and Jomo 2001), the reason is due to the instability of the financial situation in developing countries due to currency instability, which is primarily due to the presence of large amounts of public and private debt denominated in foreign currencies. The most rational explanation for the crisis is the ineffectiveness of financial liberalization. After Malaysia fully liberalized its domestic financial sector in the early 1990s, loans in the banking sector grew significantly, with an average annual growth of 12.2% in the period (1992-1994). In 1995, the growth rate rose to 26.8%. With the liberalization of international capital flows (external financial liberalization), money supply and credit reached unhealthy levels for the financial system.

According to Bank Negara's 1997 report, a large amount of foreign capital entered the Kuala Lumpur Stock Exchange in 1992 and 1993, pushing the financial market capitalization to 375% of GDP, making it the third largest financial market in Asia and the Pacific region after Tokyo and Hong Kong. With this massive liquidity, consumption and borrowing for buying stocks, bonds, cars, and real estate increased. At the beginning of the crisis in Thailand and the start of contagion to other Asian countries in mid-1997, a large and rapid withdrawal of funds by foreign investors occurred, causing a dramatic fall in the Kuala Lumpur Stock Exchange index (Yee & Tan, 2009, p. 10) (Zaherawati, 2010, p. 80) (Athukorala, Malaysian Economy in Three Crises, 2010, p. 07). The Kuala Lumpur Composite Index fell from 1271 points in February 1997 to 897.25 on August 12, 1997, immediately after the crisis, and reached its lowest level on September 1, 1998, at 262 points. The decline in currency and securities had a devastating impact on major companies, ultimately leading to a sharp contraction, with economic growth falling from 7.3% in 1997 to -7.4% in 1998 (Ping & Yean, 2007, p. 915).

2.3. Adapting Financial Liberalization Policy to Exit the Asian Financial Crisis

Despite Malaysia's good progress in liberalizing its financial system, it did not escape a financial crisis. Perhaps one of the reasons for the crisis was its neglect of some important aspects when transitioning from repression to liberalization, such as weak regulatory rules governing the operations of banks and financial institutions, and their weak efficiency and competitiveness, especially at the international level, as well as the necessary institutional and legal infrastructure. Therefore, it was imperative for it to take some measures and

reforms to ensure a quick exit from the crisis and to hedge against any future financial crisis, which are as follows: (Zaherawati, 2010, pp. 87-92) (P.Buckley & Fitzgerald, 2004, pp. 08-11)

- Utilizing the economic recovery that Malaysia was experiencing during this period, as it achieved a current account surplus of 34 billion ringgit in 1998, equivalent to 13% of GDP. This positively impacted foreign exchange reserves, which were estimated at 20.2 billion dollars in August 1998 and rose to 31.7 billion dollars in July 1999, in addition to a decrease in lending interest rates to 7.24% in June 1999 compared to 12.27% in the same month of the previous year. This indicates that the financial crisis did not affect inflation rates in Malaysia.
- Restructuring the financial sector, which included two phases: stabilization and then restructuring, by establishing several bodies to deal with the crisis, such as Danaharta, whose purpose was to purchase non-performing loans, and Danamodal, which was tasked with recapitalizing financial institutions during the stabilization phase. The reform phase involved restructuring sector companies, merging some financial institutions, and developing the bond market. Thus, Malaysia reduced the amount of non-performing loans in the financial system.
- Adopting a plan to merge 58 financial institutions into 6 groups on June 29, as this plan was considered a key element in the restructuring of the financial system. This step was deemed very important for local banks before the re-liberalization of financial services.
- Restructuring corporate debt without relying on government support, through negotiations between all parties. However, the process was somewhat slow because it required the consent of all parties, and any disagreement from a single creditor could jeopardize the entire process.
- Establishing a committee to accelerate the development of the bond market, considering it a priority and an alternative source for increasing capital allocated to finance long-term investments.
- Adopting selective capital controls and pegging the Ringgit to the US dollar. Once these policies were introduced, the government was able to control monetary policy because it was no longer hindered by concerns about the exchange rate being affected by capital outflows, especially after pegging the latter to the dollar (3.8 Ringgit = 1 dollar) as an attempt to prevent currency speculation. This was because capital controls blocked all avenues for transferring Ringgit out of Malaysia, and non-residents stopped converting portfolio capital from Malaysia for 12 months. After 6 months of these controls, the 12-month restriction was replaced by a variable tax applied to assets or profits from investments in Malaysia. This policy was followed to deal with extreme uncertainty, stabilize exchange rates, and regain control over monetary policy. This helped lower interest rates and provided a shield for implementing reforms, particularly the recapitalization and restructuring of banks and financial institutions. Contrary to some expectations and criticisms, foreign direct investment flows to Malaysia continued. It is also widely acknowledged, even by the IMF belatedly, that Malaysia's exchange controls and currency peg were sound policies.
- Expansion of fiscal policy: The expansion of fiscal policy prevented the economy from entering a recession, which boosted confidence in the economy. This combination of confidence and fiscal policy expansion, in

turn, led to improved domestic demand. As confirmation of this, "Ariel Buira" believes that Malaysia was the first to adopt theories advocating for the expansion of fiscal policy during a recession, but to implement this, it had to impose controls on capital movements; otherwise, this policy would have triggered capital flight.

- Malaysia's reliance on intra-regional trade (among Southeast Asian countries), which constitutes a large part of Malaysian exports, amidst declining American demand for Malaysian goods. Malaysian exports were very competitive, and the export growth rate reached much higher levels than the exports of other East Asian economies.
- Establishing the National Economic Consultative Council as one of the methods adopted to confront and overcome the financial crisis, alongside the economic recovery plan. Its primary role was to adopt preventive strategies to address the effects of the crisis, including stabilizing the currency, restoring market confidence, maintaining financial stability, strengthening economic fundamentals, continuing the agenda of social and economic reforms, and restoring sectors affected by the crisis.
- Reliance on the World Bank for financing instead of the International Monetary Fund. The World Bank sent several missions to Malaysia before agreeing to assist Malaysia in March 1999 after a series of consultations with government officials. It was agreed to finance the high-tech sector and financial institutions that fund small and medium-sized enterprises, as well as to provide direct support to small and medium-sized enterprises.
- Within the framework of the new Miyazawa funds, Japan pledged to provide short-term financing worth 2.5 billion dollars, if needed, such as trade finance and credit lines for small and medium-sized enterprises.

To compare Malaysia's recovery rate with other crisis-affected countries, we can use the comparative GDP growth rate as an approximate indicator. The following table shows the changes in GDP for the main crisis countries before and after the crisis (1995-1999).

Table N° 01: Changes in GDP for the main crisis-affected countries

Years/Countries	Thailand	Korea	Indonesia	Malaysia
1995	8,1	9,6	8,2	9,8
1996	5,6	7,6	7,8	10
1997	2,7 -	5,9	4,7	7,3
1998	7,6 -	5,5 -	13,1 -	7,4 -
1999	4,6	11,3	0,8	6,1

Prepared by the researcher based on World Development Indicators <https://data.albankaldawli.org>.

The table shows that Malaysia ranked second in re-achieving positive GDP growth rates after Korea in 1999. It also indicates that the negative growth rate was lower than Indonesia and Thailand, and not much higher than Korea. It is worth noting that Malaysia had achieved better growth rates than other countries before the crisis.

Therefore, the table shows that Malaysia recovered faster than some countries that adopted IMF prescriptions, as the Economic Strategic Institute pointed out that the stock market improved rapidly despite pressure and critical statements from Prime Minister Mahathir to speculators. It is also considered that Malaysia is the best success story in the region.

Despite all these measures and reforms taken by Malaysia during the crisis, we cannot consider all of them successful, but they proved to be largely appropriate, as the economic situation improved and helped the country recover from the crisis very quickly, unlike other countries that adopted IMF prescriptions (Wang, 2006, p. 10)

2.4. Financial Reforms in Malaysia After the Asian Financial Crisis

In the wake of the economic and social turmoil caused by the Asian Financial Crisis, Malaysia found it necessary to vigorously pursue its long-term goal of building a resilient, competitive, and dynamic financial sector, which would play a catalytic role in transforming the economy and serve as an engine of growth. To prepare local institutions for liberalization to be a strong and future-oriented core (WTO, 2003, p. 01), among the key areas addressed by Malaysian financial reforms are the following:

- **Prudential Regulation of Banks:** Weak regulation of banks was considered one of the causes of the currency crisis. Therefore, among the regulatory rules imposed by the Central Bank was the necessity of obtaining its approval for private companies to borrow in foreign currency for amounts exceeding 5 million ringgit. These companies were also not allowed to purchase real estate in Malaysia with foreign funds (Sivalingam, 2009, p. 453). Furthermore, in the context of promoting transparency, they are required to issue statements on key indicators of a sound financial position and ensure significant progress under the supervision of the Central Bank on a monthly basis (Uddin & Ahsan, 2014, p. 09).
- **Foreign Reserves:** Malaysia developed an action plan to revive the economy in 1998 and considered it crucial to maintain a very high level of foreign reserves to meet external debt service and counter currency attacks. Therefore, it set a standard equivalent to five months of imports. In 2005, the value of foreign reserves in Malaysia was approximately 265 billion Malaysian ringgit, or 7.5 times its total imports (Annual Report of 2006, 2007, p. 14).
- To isolate itself from the IMF and speculators and adopt an independent monetary policy, the Malaysian government had to introduce capital controls, such as imposing a holding period for securities of no less than 12 months before capital could be withdrawn from the Malaysian financial market, and fixing the exchange rate in September 1998. In February 1999, controls were converted into taxes on short-term flows (Trivellato, 2002, p. 235). In July 2005, Malaysia abandoned the fixed exchange rate and adopted a managed float system, which led to the return of capital flows to Malaysia, especially after the liberalization of foreign exchange transactions.

- **Risk Management:** Risk management focuses on protecting the banking industry against systemic risks by concentrating on the largest companies and banks that might face financial difficulties. In this regard, Malaysia initially adopted a supervisory system based on Basel I decisions and then Basel II in 2010, despite the Basel Committee on Banking Supervision acknowledging that emerging economies in Asia face difficulties in implementing BASEL requirements due to a lack of skills.
- **Deposit Insurance for Banks:** After the crisis, Malaysia realized it did not have deposit insurance. Upon the recommendation of the National Economic Action Council (NEAC), a deposit insurance corporation, "Perbadanan Insurans Deposit Malaysia" or "Malaysian Deposit Insurance Corporation," was established on September 01, 2005, eight years after the crisis occurred. It covers all conventional and Islamic financial institutions.
- **Merging Banks and Financial Institutions:** In 1999, the government embarked on a strategy to consolidate and merge the domestic banking system, which consisted of 71 banking institutions before the crisis, into 30 banks, with the aim of increasing the concentration of banking assets in a few local banks to enhance their efficiency and competitiveness (Sivalingam, 2009, pp. 252-256).
- **Reforming and Developing Malaysian Capital Markets:** The capital market reform process involved adopting a 10-year master plan implemented starting in 2001, across three main phases as follows:
 - **Phase One: From 2001 to 2003**, the Securities Commission and the government focused their efforts on introducing corporate governance reforms, which would increase transparency without affecting the objectives of the new economic policy.
 - **Phase Two: From 2004-2005**, represented by the main market plan, the focus was on investment banks and the entry of foreign brokers and securities fund managers, and the commission also reduced the time required to process transactions.
 - **Phase Three: From 2006 to 2010**, the focus was on strengthening the industry and market structure to improve the competitiveness of local financial markets.
- **Development of the Malaysian Bond Market:** To further develop the Private Debt Securities (PDS) market, the government introduced several reforms, including an automated system for tenders, dissemination, and bond information. These innovations reduced transaction costs and were designed to facilitate more active trading of bonds, including mortgage-backed and asset-backed securities (Bin Ibrahim, 2011, pp. 276-277)
- **Liberalization of the Islamic Capital Market:** The Islamic capital market in Malaysia witnessed significant development in financial product innovation, particularly in the Islamic equity and bond sectors. By 2010, it became the largest issuer of Islamic sukuk globally, accounting for an estimated 65% of global sukuk, with a total value exceeding 89 billion US dollars. Malaysia is also home to the top 10 Sharia-compliant companies. All of this is to align the Islamic financial industry with the financial liberalization measures adopted in Malaysia (Noor & al, 2014, pp. 216-217)
- **Liberalization of the Establishment and Licensing of Islamic Banks:** Following the encouraging performance of Bank Islam, which began operations in 1983, the Malaysian government introduced the "Islamic Banking Scheme" in 1993, allowing conventional banks to offer Islamic products. Consequently, 24

conventional banks responded through their 1663 branches (Saad & Khouni, 2017, pp. 344-345). However, the full liberalization of Islamic banking activities occurred after the Asian financial crisis, when the Malaysian government permitted the establishment of another Islamic bank, "Bank Muamalat Malaysia," in 1999. The central bank also began closing Islamic branches and encouraging them to convert into full-fledged banking entities, and issuing licenses to foreign Islamic banks, such as Kuwait Finance House, Al Rajhi Bank, Qatar Islamic Bank, and Asian Finance House, etc. (الشهب و بوريش، 2015، الصفحات 93-94).

3. Implications of Financial Liberalization on Financial Development and Economic Growth Indicators in Malaysia for the Period (1978-2024)

Estimating financial development and economic growth in Malaysia under the country's financial liberalization policy requires studying some factors and indicators directly related to the financial and banking system, as well as economic growth, over a specific period, from 1978 to 2024. To measure the effects of financial liberalization on the level of financial development and economic growth, we will use the following indicators:

3.1. Monetary Depth or Economic Liquidity Index

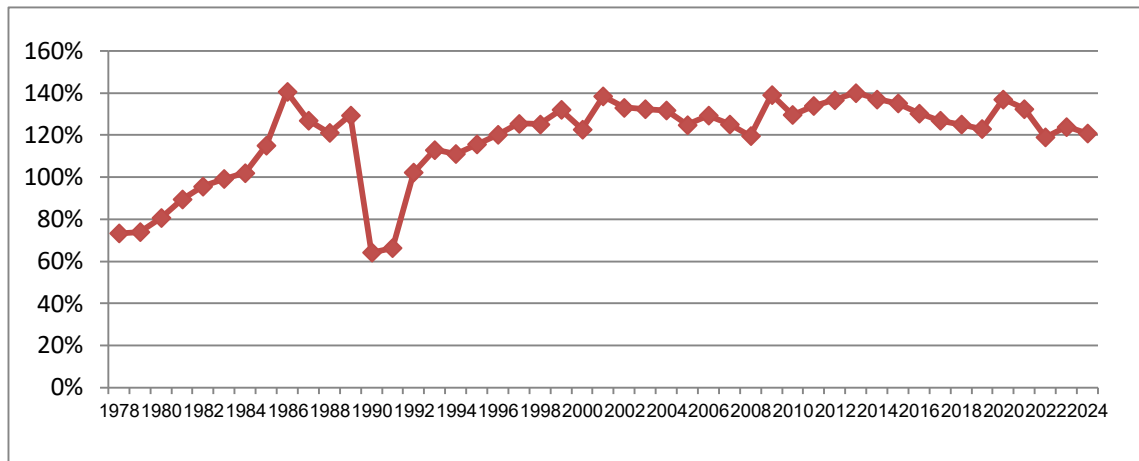
This Monetary Depth index is used to measure the potential efficiency of monetary policy. It is calculated by dividing the money supply in the broadest sense (M3) or broad sense (M2) by the Gross Domestic Product (GDP). This approach assumes a direct positive correlation between monetary depth and the efficiency of monetary policy (السعدي، 2011، صفحة 219). This ratio should tend to increase throughout the development process and the evolution of the financial sector. The following table and chart illustrate the evolution of this index in Malaysia after the adoption of financial liberalization policy.

Table N° 02: Monetary Depth Indicator (1978-2024)

Monetary Depth Indicator (M2/GDP)									
1978	73%	1988	121%	1998	125%	2008	120%	2018	125%
1979	74%	1989	129%	1999	132%	2009	139%	2019	123%
1980	81%	1990	64%	2000	123%	2010	130%	2020	137%
1981	89%	1991	66%	2001	138%	2011	134%	2021	133%
1982	96%	1992	102%	2002	133%	2012	137%	2022	119%
1983	99%	1993	113%	2003	132%	2013	140%	2023	124%
1984	102%	1994	111%	2004	132%	2014	137%	2024	121%
1985	115%	1995	116%	2005	125%	2015	135%		
1986	141%	1996	120%	2006	129%	2016	130%		
1987	127%	1997	126%	2007	125%	2017	127%		

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 01: Monetary Depth Indicator (1978-2024)



Prepared by the researcher based on the table above

From the table and chart above, which show the evolution of the monetary depth index in Malaysia during the period 1978-2024, we observe that this index generally followed an upward trend, moving from 73% in 1978 to 121% in 2024. However, it experienced some fluctuations and declines in certain years, such as 1990 and 1991, where the decline reached 64% and 66% respectively, after having reached 129% in 1989. It also experienced relative stability from 1999 to 2024. The significant increase in this ratio, exceeding 100% in most years, can be attributed to the large increase in the money supply circulating in Malaysian markets, primarily due to the large inflow of long-term and short-term capital from abroad, as a result of the capital account and financial market liberalization policies adopted by Malaysia during this period.

The growth of this index in the first ten years of the study is also due to the Malaysian authorities' adoption of a monetary aggregates strategy to achieve the ultimate goals of monetary policy, which is price stability. This is evident from the relative stability of inflation rates. Furthermore, the Central Bank of Malaysia influenced the liquidity levels of banks to ensure the provision of the economy's requirements at that time.

3.2. Evolution of Debit and Credit Interest Rates :

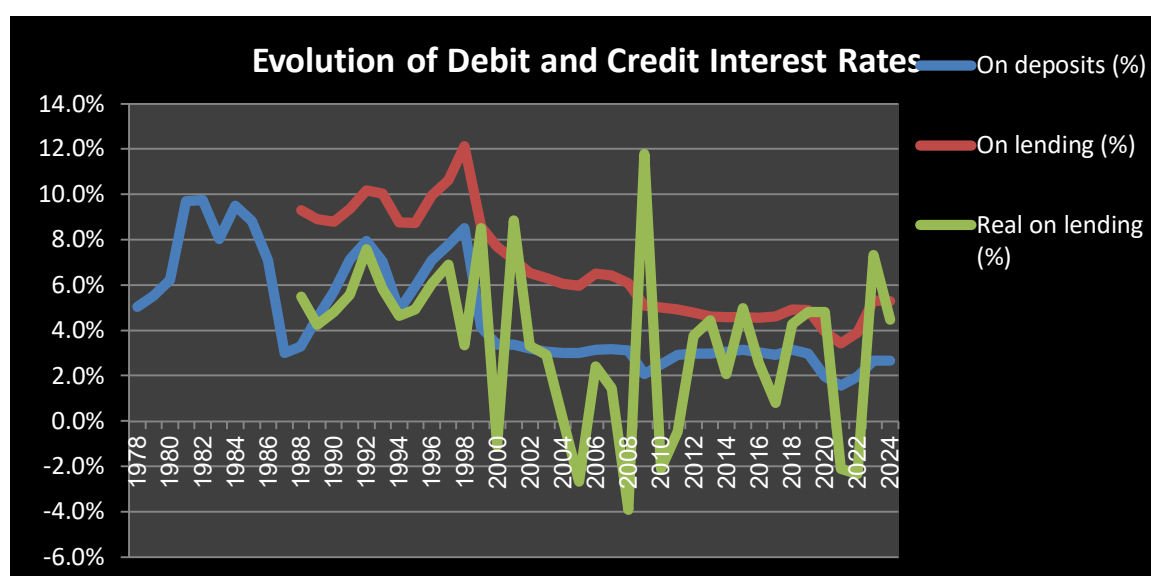
The change in debit and credit interest rates reflects the extent of interest rate liberalization and their fluctuation according to market expectations rather than regulation. The real interest rate is considered the most important financial price for any extensive financial deepening, as this rate is supposed to be positive. However, fragmented markets in developing economies often generate negative interest rates on deposits, which discourage savings in financial assets (السعدي، 2011، صفحة 225). Malaysia, like other countries that adopted financial liberalization policies, took several steps to liberalize interest rates starting from 1978 until their complete liberalization on February 1, 1987. The following table illustrates the evolution of interest rates in Malaysia for the period (1978-2024).

Table N° 03: Evolution of Debit and Credit Interest Rates (1978-2024)

Evolution of Debit and Credit Interest Rates										
Years	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
On deposits	5,00%	5,50%	6,20%	9,70%	9,80%	8,00%	9,50%	8,80%	7,10%	3,00%
Years	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
On deposits	3,30%	4,60%	5,70%	7,10%	7,90%	7,00%	4,90%	5,90%	7,10%	7,80%
On lending	9,30%	8,90%	8,80%	9,30%	10,20%	10,00%	8,80%	8,70%	9,90%	10,60%
Real on lending	5,50%	4,20%	4,80%	5,60%	7,60%	5,80%	4,60%	4,90%	6,00%	6,90%
Years	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
On deposits	8,50%	4,10%	3,40%	3,40%	3,20%	3,10%	3,00%	3,00%	3,10%	3,20%
On lending	12,10%	8,60%	7,70%	7,10%	6,50%	6,30%	6,00%	6,00%	6,50%	6,40%
Real on lending	3,40%	8,50%	-1,10%	8,80%	3,30%	2,90%	0,00%	-2,70%	2,40%	1,50%
Years	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
On deposits	3,10%	2,10%	2,50%	2,90%	3,00%	3,00%	3,00%	3,10%	3,00%	2,90%
On lending	6,10%	5,10%	5,00%	4,90%	4,80%	4,60%	4,60%	4,60%	4,50%	4,60%
Real on lending	-3,90%	11,80%	-2,10%	-0,50%	3,70%	4,40%	2,10%	5,00%	2,50%	0,80%
Years	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
On deposits	3,10%	3,00%	2,00%	1,60%	1,90%	2,70%	2,60%			-
On lending	4,90%	4,90%	3,90%	3,40%	3,90%	5,30%	5,30%			-
Real on lending	4,30%	4,80%	4,80%	-2,10%	-2,30%	7,30%	4,50%			-

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 02: Evolution of Debit and Credit Interest Rates (1978-2024)



Prepared by the researcher based on the table above

It is clear from the figure and table above that credit and debit interest rates in Malaysia fluctuated before the complete liberalization of interest rates. Deposit interest rates reached their highest level in 1984 at 9.5% and their lowest level in 1987 at 3%. Interest rates during this period also experienced gradual partial liberalization, by linking them to the Base Lending Rate (BLR) first in November 1981, and then linking them to the interest rates of the two main banks in Malaysia. Nevertheless, a lending ceiling continued to exist for specific categories of borrowers and for housing loans, until their complete liberalization. After liberalization, they also fluctuated in the early years until 1999, then stabilized throughout the remaining study period (2000-2024) between 3% and 2%.

As for lending interest rates, they also fluctuated between 1988 and 2001, reaching their highest levels in 1998 during the Asian financial crisis, then stabilizing between 5% and 6% from 2002 to 2010. The last seven years have seen relative stability in lending interest rates at approximately 4%.

Regarding real lending interest rates, they were positive in most periods, except for some years such as 2000, 2005, 2008, 2010, 2021, and 2022. This is evidence of the effectiveness of the monetary policy pursued by the Malaysian Central Bank over four decades, through which it sought to maintain positive real interest rates consistent with relatively stable inflation rates. It is also worth noting that the impact of financial liberalization on interest rates was initially modest due to the strength of the Malaysian market. However, after adopting the interest rate mechanism based on the Base Lending Rate (BLR) and then fully liberalizing it, deposit interest rates became more sensitive to international interest rates.

3.3. The Impact of Financial Liberalization on Economic Growth :

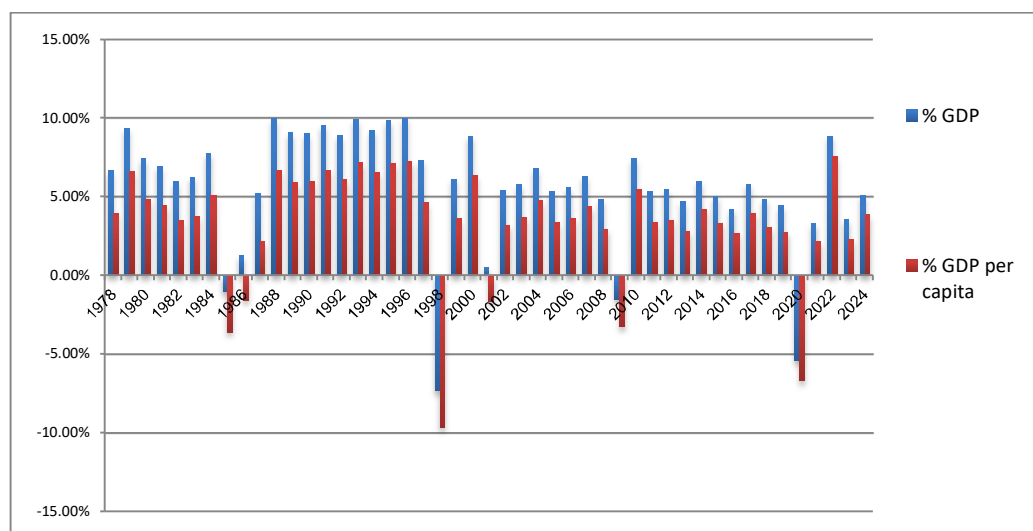
According to many studies that addressed the relationship between financial liberalization policy and economic growth in developing countries, especially the Mckinnon & Shaw theory, adopting a financial liberalization policy has a direct impact on economic growth through several channels. To study and analyze the impact of adopting a financial liberalization policy on economic growth in Malaysia, we chose two indicators: the GDP growth indicator and the GDP per capita growth indicator. The following table illustrates the evolution of GDP, as well as the evolution of GDP per capita.

Table N°04 : GDP growth indicator and per capita GDP growth (1978-2024)

GDP growth indicator and per capita GDP growth														
Years	% GDP	% GDP per capita	Years	% GDP	% GDP per capita	Years	% GDP	% GDP per capita	Years	% GDP	% GDP per capita	Years	% GDP	% GDP per capita
1978	7%	4%	1988	10%	7%	1998	-7%	-10%	2008	5%	3%	2018	5%	3%
1979	9%	7%	1989	9%	6%	1999	6%	4%	2009	-2%	-3%	2019	4%	3%
1980	7%	5%	1990	9%	6%	2000	9%	6%	2010	7%	6%	2020	-6%	-7%
1981	7%	4%	1991	10%	7%	2001	1%	-2%	2011	5%	3%	2021	3%	2%
1982	6%	4%	1992	9%	6%	2002	5%	3%	2012	6%	4%	2022	9%	8%
1983	6%	4%	1993	10%	7%	2003	6%	4%	2013	5%	3%	2023	4%	2%
1984	8%	5%	1994	9%	7%	2004	7%	5%	2014	6%	4%	2024	5%	4%
1985	-1%	-4%	1995	10%	7%	2005	5%	3%	2015	5%	3%			
1986	1%	-2%	1996	10%	7%	2006	6%	4%	2016	4%	3%			
1987	5%	2%	1997	7%	5%	2007	6%	4%	2017	6%	4%			

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 03: GDP growth indicator and per capita growth (1978-2024)



Prepared by the researcher based on the table above

From the table and figure above, it is clear that GDP has shown positive growth rates for four decades, reaching its highest levels in 1996 at 10%, with the exception of 1985, 1998, 2009, and 2020, when the GDP growth rate was negative. The decline in Malaysia's economic growth rates in 1985 is attributed to the severe economic contraction experienced by developed and developing countries, including Malaysia, which was caused by the high interest rate policy in America (The Volker shock), leading to a collapse in commodity trade

between 1984 and 1986, where Malaysia's export index fell by 30% and terms of trade deteriorated by 20%. This crisis also caused several problems for nascent Malaysian industries that had just started production, leading to the bankruptcy of many companies. The negative percentages for 1998, 2009, and 2020 are due to the financial crises that affected Asian countries in 1997, the financial crisis that hit the American economy and whose effects spread to other parts of the world including Malaysia, and the COVID-19 health crisis. However, it is also clear that Malaysia quickly recovered from the shocks of these crises, returning to achieving high positive growth rates directly after one year. This is due to the recovery and growth of electronics trade, which accounted for 45% of Malaysia's total exports in 1999, while total exports reached 281.7 billion ringgit in 1998, and 319,6 billion ringgit in 1999.

As for the growth of GDP per capita, we find that it was also positive and volatile, which is naturally due to the change in GDP growth levels, given its direct correlation. It also experienced negative rates in some years when GDP growth was negative or very low.

It should be noted that Malaysia's achievement of these positive levels of GDP growth and per capita growth, over a long period, is primarily due to the sound economic and financial policies adopted by Malaysia over four decades and more, including the financial liberalization policy, which was the main reason for the development of its financial system, and consequently the inflow of billions of dollars into Malaysia in the form of direct and indirect investments.

3.4. Impact of Financial Liberalization on Indicators of Malaysian Financial Market Development

In order to assess the extent of financial markets' contribution to economic activity, and to estimate the extent of their development and the development of their institutional and regulatory frameworks, we relied on a set of indicators agreed upon by economists, the most important of which are:

▪ Market Capitalization Index :

Also known as the market value index, it refers to the total market value of shares of companies listed on the stock exchange, representing the total size of the market capital at the end of the last day of the year. This value is important in monitoring developments in the economy's investment activities over time, on the basis that the value of shares increases with the increase in the size of investment projects financed by shares. A high value of this index indicates increased economic activity, whether in terms of the number of shares, or an increase in the number of companies, or it reflects an increase in the prices of securities. This index is also used to compare the relative size of the market with other markets in the region or globally (حمزة، 2011، صفحة 256). The following

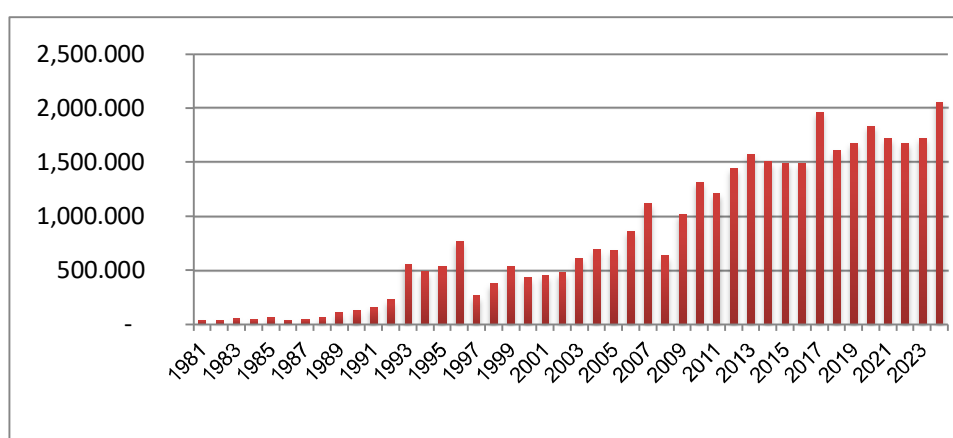
table shows the development of the market capitalization of the Malaysian financial market during the period 1981-2024.

Table N° 05 : Market Capitalization Index (billion local currency) (1978-2024)

Market Capitalization Index (billion local currency)									
Years	capitalization	Years	Market capitalization	Years	Market capitalization	Years	Market capitalization	Years	Market capitalization
1978	-	1988	60,379	1998	375,019	2008	631,27	2018	1 606,06
1979	-	1989	107,531	1999	531,65	2009	1 019,355	2019	1 673,38
1980	-	1990	129,479	2000	429,992	2010	1 316,423	2020	1 834,98
1981	35,25	1991	155,987	2001	452,127	2011	1 210,610	2021	1 716,51
1982	32,41	1992	226,738	2002	477,957	2012	1 441,196	2022	1 677,72
1983	52,69	1993	552,727	2003	611,094	2013	1 576,675	2023	1 724,16
1984	45,311	1994	482,925	2004	690,17	2014	1 502,257	2024	2 056,97
1985	59,975	1995	535,331	2005	683,636	2015	1 495,715		
1986	38,363	1996	770,291	2006	864,152	2016	1 492,510		
1987	45,99	1997	262,275	2007	1 118,208	2017	1 960,023		

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 04 : Market Capitalization Index (1978-2024)



Prepared by the researcher based on the table above

From the table and figure above, it is clear that the value of Malaysian market capitalization witnessed a significant increase during the study period, rising from 35,25 billion ringgit in 1981 to 2.056,97 billion ringgit in

2024. This indicates the significant development experienced by the Malaysian financial market during these years, after its separation from the Singapore Stock Exchange in 1973. The significant growth rate in Bursa Malaysia began in the early 1990s, as this large growth in the market value of Bursa Malaysia is attributed to the large capital inflows during this period, especially short-term ones, which preceded the Asian financial crisis, whose effects are clearly visible on Malaysian market capitalization, as its value decreased to 262,275 billion ringgit in 1997, after being estimated at 770 billion ringgit in 1996.

However, the Malaysian financial market subsequently experienced a recovery and growth in its market value immediately after the Asian financial crisis. This was a result of the reforms undertaken by Malaysia after the crisis, which aimed to develop the Malaysian financial market by improving stock market operations and preparing a market development program extending until 2020.

Since the Malaysian financial market is considered one of the most important financial markets in the Asian region (the third largest stock market in the Asia-Pacific region after the Tokyo and Hong Kong markets), it was not immune to the effects of the 2008 global financial crisis, as its market value decreased by 44% between 2007 and 2008, only to gradually rise again thereafter.

Through the significant growth in the market value or market capitalization of the Malaysian financial market, as well as its rapid recovery from crises, the extent to which the measures taken by Malaysia in improving the institutional, regulatory, and legislative environment of the financial market are reflected is evident. These measures aim to open the door for investors and enhance their confidence, as well as mobilize and gather capital directed towards investment, thereby achieving economic growth.

■ Financial Market Depth Index

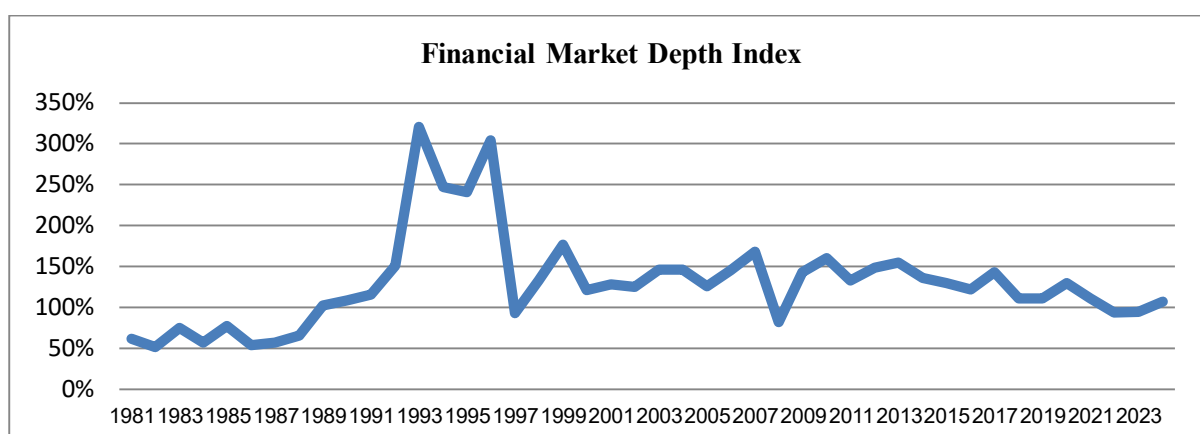
This refers to the relative importance of the financial market in the national economy, and is calculated by dividing the total market value of traded shares by the GDP of the economy for the same time period. This index is one of the important indicators that researchers rely heavily on, on the basis that high rates are evidence of higher growth rates in the medium and long term. It also indicates the effectiveness of the financial market in economic activity and the financing activities that these markets perform within the economy. The following table and figure illustrate the development of this index during the period from 1981 to 2024.

Table N° 06 : Financial Market Depth Index (1978-2024)

Financial Market Depth Index									
1978		1988	65%	1998	132%	2008	82%	2018	111%
1979		1989	102%	1999	177%	2009	143%	2019	111%
1980		1990	109%	2000	121%	2010	160%	2020	129%
1981	61%	1991	115%	2001	128%	2011	133%	2021	111%
1982	52%	1992	150%	2002	125%	2012	148%	2022	94%
1983	75%	1993	321%	2003	146%	2013	155%	2023	95%
1984	57%	1994	247%	2004	146%	2014	136%	2024	107%
1985	77%	1995	241%	2005	126%	2015	129%		
1986	54%	1996	304%	2006	145%	2016	121%		
1987	57%	1997	93%	2007	168%	2017	145%		

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 05 : Financial Market Depth Index (1978-2024)



Prepared by the researcher based on the table above

We observe from the table and figure above that the depth of the Malaysian stock market has experienced two phases since 1981. In the first phase, from 1981 to 1988, the market depth index fluctuated between rises and falls, but it did not exceed the 80% threshold. In the second phase, starting from 1989 to 2024, the index generally exceeded 100% in most years, reaching its highest levels during the period (1992-1996), achieving 321% in 1993. This significant growth in the index is attributed to the large inflows of foreign capital and foreign direct investments into Malaysia during this period, especially considering that the GDP also experienced growth during this time, achieving high growth rates of up to 10% in 1995. This indicates the positive impact of economic growth on capital flows to Malaysia during this period, and the growth in the size of the Malaysian stock market since the early 1990s, which was a result of the liberalization measures adopted by Malaysia to

liberalize its financial sector. It is also worth noting that this index fell below the 100% threshold in 1997, 2008, and 2022, which coincides with the occurrence of the Asian financial crisis, the global financial crisis, and the repercussions of the COVID-19 health crisis.

■ Trading Volume Index :

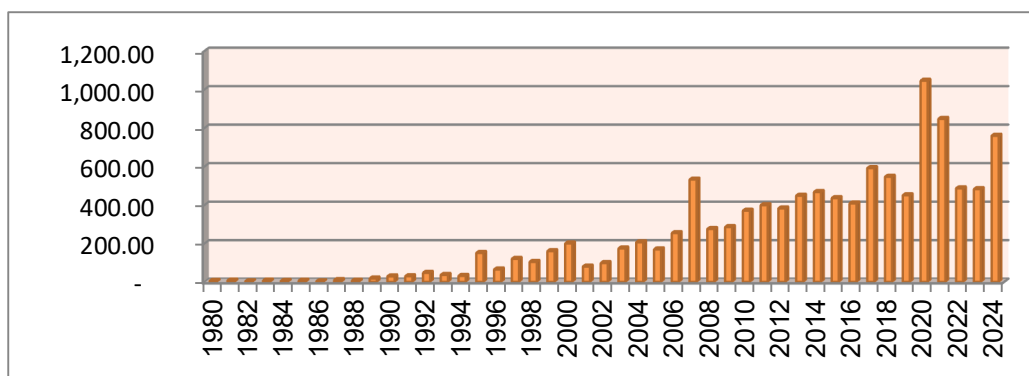
This represents the value of shares traded on the stock exchange at various prices during a period. It is the product of the number of shares traded and their prices over a specific time period. Trading volume expresses the actual volume of exchange of subscribed shares and reflects the level of liquidity in the financial market. The following table shows the evolution of the value of shares traded in the Malaysian stock market during the period from 1980 to 2024.

Table N° 07: Trading Volume Index (million local currency) (1978-2024)

Trading Volume Index (million local currency)									
1978		1988	6,555	1998	104,2	2008	274,61	2018	546,094
1979		1989	17,895	1999	159,814	2009	284,916	2019	449,956
1980	5,6	1990	28,974	2000	199,544	2010	369,746	2020	1 045,02
1981	7,152	1991	29,383	2001	79,925	2011	398,772	2021	846,805
1982	2,858	1992	47,295	2002	97,768	2012	381,952	2022	486,119
1983	6,964	1993	36,456	2003	173,706	2013	447,946	2023	481,756
1984	5,05	1994	31,341	2004	205,927	2014	466,878	2024	759,341
1985	5,957	1995	150,588	2005	169,073	2015	435,392		
1986	3,017	1996	64,525	2006	253,638	2016	407,717		
1987	9,602	1997	119,82	2007	531,587	2017	590,964		

Prepared by the researcher based on World Bank data <https://data.albankaldawli.org>

Figure N° 06 : Trading Volume Index (million local currency) (1978-2024)



Prepared by the researcher based on the table above

The table and figure above show the trading volume in the Malaysian stock market for the period (1980-2024). It is clear that the trading volume was very volatile and weak in the 1980s, then it started to rise in 1989 to reach 17 billion ringgit. After that, it experienced fluctuations in most periods with a general upward trend, reaching 1045 billion in 2020 as the highest level of stock trading volume since the establishment of the Malaysian stock market. This upward trend in trading volume reflects the reforms that Malaysia has committed to in regulating and developing its financial market and making it more open, to keep pace with developments in global financial markets, as well as providing the necessary liquidity for the Malaysian economy.

4. Conclusion

Southeast Asian countries in general and Malaysia in particular, have been considered economic success stories for several decades, due to the stability and economic growth achieved over a long period. Financial liberalization policy had a significant impact on the Malaysian financial system and economic structure. The openness of the Malaysian financial system to global competition is the essence of financial liberalization, which led to rapid growth in the financial and banking industry, as well as enhancing the efficiency and effectiveness of the financial system in achieving its desired goals, which are optimal resource allocation and stimulating savings, thereby achieving economic growth. A liberalized financial system is capable of effectively mobilizing savings from local and cross-border sources to meet the large and diverse financing and investment needs of the local and external economy.

Today, the Malaysian financial system is in a good position to advance and benefit from the opportunities arising from a more competitive and integrated environment. The Malaysian financial system has performed its intermediation function perfectly without disruption, even during periods of financial crises that affected both the Malaysian and global economies (the Southeast Asian financial crisis, the global financial crisis). This reflects the resilience of the Malaysian financial system during periods of increasing volatility and disturbances, and this is clearly demonstrated by its return to achieving positive rates for all studied indicators just one year after the crisis, which indicates the rapid recovery of the Malaysian economy and financial system from the disturbances and imbalances resulting from financial crises.

Furthermore, the efforts and financial reforms undertaken by Malaysia cannot be overlooked or denied, which at times contradicted the strategies of the international financial community, similar to the measures it followed to exit the Asian financial crisis, and its rejection of the policies and aid of the International Monetary Fund, which demonstrated the Malaysian government's ability to innovate, lead, and maintain economic independence.

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