MEASURING FINANCIAL STRESS INDEX (MFSI) FOR MALAYSIAN ECONOMY

BY

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ABSTRACT

This study focuses on the construction of financial stress index in an emerging economy like Malaysia. This becomes imperative as a result of the repeated episodes of financial crises. This study measures financial stress index for Malaysian economy. We aggregate the identified financial and economic factors into a single index using the principal component analysis (CPA). The result shows that MFSI increases as a result of increase in banking sector fragility index, credit stress, external debt, stock market volatility and exchange market pressure index. Moreover, the weights of the variables reveal that the magnitude of the Malaysian financial stress is mainly driven by the fragility of the banking sector. The combine variables explain about 53 percent of the total variation in the Malaysian financial stress index (MFSI). Thus, the financial stress is determined to be the key player in the co-movement of the components used in the construction process. Furthermore, the aggregated components practically capture the known key aspects of financial stress in Malaysia. The implication of the finding is that authorities should focus more on banking sector stability than other components of the financial stress. This will help to reduce the overheating of the Malaysian financial stress.

ABSTRAK

Kajian ini memberi tumpuan untuk membina indeks tekanan kewangan dalam ekonomi baru seperti Malaysia. Ia menjadi penting akibat daripada krisis kewangan yang sering berulang. Kajian ini mengukur indeks tekanan kewangan bagi ekonomi Malaysia (MFSI). Pengiraan secara agregat faktor kewangan dan ekonomi yang dikenal pasti sebagai indeks tunggal telah digunakan dalam analisis komponen utama (CPA). Hasil dapatan menunjukkan bahawa MFSI meningkat apabila berlaku peningkatan dalam indeks kerapuhan sektor perbankan, tekanan kredit, hutang luar negeri, turun naik pasaran saham dan indeks tekanan pasaran pertukaran. Selain itu, pemberat kepada pembolehubah yang digunakan mendedahkan bahawa magnitud tekanan kewangan Malaysia sebahagian besarnya didorong oleh kerapuhan sektor perbankan. Gabungan pembolehubah dapat menjelaskan kira-kira 53 peratus daripada jumlah variasi dalam indeks tekanan kewangan Malaysia (MFSI). Oleh itu, tekanan kewangan ini telah dipilih untuk menjadi faktor utama dalam pergerakan bersama komponen yang digunakan dalam proses pembinaan indeks. Tambahan pula, komponen agregat tersebut secara praktikalnya telah menunjukkan aspek utama yang dikenal pasti dalam tekanan kewangan di Malaysia. Implikasi daripada dapatan mencadangkan pihak berkuasa memberi lebih tumpuan kepada kestabilan sektor perbankan daripada komponen lain daripada tekanan kewangan. Ini akan membantu untuk mengurangkan tekanan melampau kewangan Malaysia.

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INTRODUCTION

1.1 Introduction

This chapter outlines the introduction of this study consists the background of study problem statement, research questions and objectives, significant of study and scope and limitations of the study.

1.2 Background of the Study

The growing role of the emerging economies in the global landscape is having significant implications on global and regional trade and finance, the nature and direction of capital flows, and global governance in the areas of finance and economics. In the global economy, Asia is leading the recovery process today, and is expected to remain as the world's fastest growing region over this decade. The rapid transformation of the region over this decade will contribute to increasing its financial and economic potential.

Within Asia, the Association of Southeast Asian Nations (ASEAN) region is in a strategic position to leverage on the increasing opportunities emanating from the Asia-Pacific region. The integration of ASEAN as a single market will enhance the region's growth and dynamism. The sizeable population of about 600 million people in ASEAN presents a large and fast-expanding market. The region's focus on greater financial integration will further enhance regional economic growth and promote

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