

**INVESTMENT IN THE SEACEN COUNTRIES IN
THE POST-CRISIS ERA:
ISSUES AND CHALLENGES**

Choon-Seng Lim, Vincent and Min B. Shrestha



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Tel. No.: (603) 7958-5600
Fax No.: (603) 7957-4616
Telex: MA 30201
Cable: SEACEN Kuala Lumpur
Website: <http://www.seacen.org>

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FOREWORD

Since the 1997 Asian financial crisis, some SEACEN countries have been unable to achieve pre-crisis levels of investments despite strong macroeconomic fundamentals. This study investigates the reasons for such a decline in investment from macro perspectives. This is of vital importance as investment is often seen as the engine of economic growth. While various micro issues such as investment regulations and practices are important determinants of investment, macroeconomic policies such as central banks' policies can exert a huge influence on investment decisions. This study, therefore, attempts to provide some macro-policy implications through empirical analysis.

In general, the findings of this research indicate that the determinants of investment are multi-faceted. The empirical evidence suggests that macro-financial variables such as interest rates and credit growth are important along with demand factors such as economic growth. Real interest rates in post-crisis are, in general, lower than the pre-crisis period but domestic credit over gross domestic product together with economic growth have been significantly higher during the pre-crisis period. This may suggest the importance of domestic credit in promoting desired and sustainable domestic investment. It is also observed that there are common factors in the policies implemented by the various countries to attract FDI inflows as long-term investment. These factors include good public governance, efforts to curb corruption, non-discrimination rules, good infrastructure, abundant and skilled labour force and access to free international trade.

This study which is a collaborative effort between The SEACEN Centre and the member central banks/monetary authorities, is divided into two major sections. Part I provides the integrative report and regional analysis authored by Dr. Choon-Seng Lim, Vincent and Dr. Min B. Shrestha, both Senior Economists at the Research Division of The SEACEN Centre and concurrently Project Leaders of this study. Part II consists of country chapters authored by country researchers from ten participating member central banks.

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The Centre also gratefully acknowledges the support of The SEACEN Centre's staff in completing this study. The views, conclusions and recommendations expressed in this Report are those of the authors and do not necessarily reflect those of The SEACEN Centre or its constituent member central banks/monetary authorities.

Dr. A. G. Karunasena
Executive Director
The SEACEN Centre

August 2009

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EXECUTIVE SUMMARY

Since the 1997 Asian financial crisis, some SEACEN countries have been unable to achieve pre-crisis levels of investments. Many reasons were cited by the literature and these include a shift in investors' perceptions, weaker exchange rates which make prices of imported investment goods more expensive, over-investment in various sectors of the economy, unsettled political and security conditions, weak financial systems and governance systems, implicit state guarantees and the 'hollowing out' effect where excessive outward foreign investment has reduced domestic investment.

This paper notes that the region has successfully implemented various policies related to investment such as liberalisation of the investment sectors, the promotion of the competitive sector, direct involvement of the government and privatisation to encourage investment. The study also highlights the importance of research and the infusion of capital and technology in promoting new investment. From a macro perspective, the study suggests that central banks can also play an important role in promoting investment. Macro economic factors such as real interest rates, the availability of domestic credit, exchange rate volatility are important determinants of investment. This implies that given the right economic fundamentals, to stimulate investment, central banks should *ceteris paribus*, adopt an expansionary monetary stance while heeding the inflation rate. The study also suggests the importance of the banking sector in the promotion of investment. As the financial sectors of the SEACEN countries are already liberalised, pro-active financial supervision can play an important role in ensuring financial stability in order to facilitate improved access to credit.

It is also noted that the current US mortgage sub-prime crisis will raise new challenges to the revival of private investment in the SEACEN countries. While the direct effect of the subprime crisis is through the external sector, its indirect effect through distressed and non-performing loans may result in self-reinforcement between the financial markets and the real economy.