THE DERIVATIVES INSTRUMENTS AND BANK STABILITY IN MALAYSIA: EVIDENCE FROM RECENT FINANCIAL CRISIS

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ABSTRACT

Bankruptcy that affects the failure operation of the bank institution has been an important topic between the bankers and economist. The derivatives instruments are the yardstick to measure the performance of bank stability. This study attempts to explore the derivatives instruments and bank stability in Malaysia evidence from recent financial crisis. Eight commercial banks has been the subject for this study ranging from 2006 until 2014. The local commercial bank geographically in Malaysia selected for this study. The bank's financial statement has been the main sources for the study and the panel data analysis has been carried out to obtain the results for this empirical study. This research use secondary data focused on the quantitative approach. The study conducted test namely pooled Ordinary Least Square (OLS) model to determine the result from the model to be used in this studies. The empirical analysis supported three independent variables used in this studies which are option, size and efficiency showed a positive significant relationship with the dependent variable. Meanwhile, tier-1 and credit-risks indicates insignificant movement with the bank stability.

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CHAPTER 1: INTRODUCTION

1.1 Introduction

The recent United States subprime mortgage crisis happened in December 2007 until June 2009 has affected many banking institution. Lehman Brothers and Bear Stearns were the non-banks that were crippled during the crisis. This present financial crisis is very different from the one Malaysia experienced in 1998. In 1998, Malaysia has suffered a contraction in Gross Domestic Product (GDP) growth due to the Asian Financial Crisis which originated from Thailand. The financial collapse due to Thai baht after the government of Thailand was forced to float the baht due to lack of foreign currency. Meanwhile, the subprime mortgage crisis was triggered by a large decline in home prices after the collapse of a housing bubbles, which lead to mortgage delinquencies, foreclosure and the devaluation of housing related securities. This was followed by reduction in household spending and business investment. There were many causes of the crisis and blaming to financial institution, regulators, credit agencies, government housing policies and consumer itself.

The shadow of banking institution began in mid-year 2007 which adversely affected the functioning of money market. One of the causes is inappropriate usage of derivatives as a tool for taking excessive risks. Buffet (2002) said that the derivative is a "financial weapon of mass destruction". Indeed, there issue of financial crisis happened due to the financial innovations as derivatives affect negatively banking stability. Financial Crisis Inquiry Commission (2011), the key component of the market which are multitrillion-dollar repo lending market, off-balance