

Salomon: Tests show M'sia will have healthy reserves

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MALAYSIA would have a "healthy cushion" of external reserves even in the worst-case scenario, based on a series of stringent stress tests carried out to assess the effects of its capital controls.

Salomon Smith Barney, which conducted the stress tests on projected economic indicators for both pre- and post-capital controls, said: "Malaysia has the capacity to absorb a range of adverse developments in its external accounts and still retain a reasonably comfortable liquidity position."

In its report, *Capital Controls Can Strengthen Malaysia's Sovereign Credit Profile*, the top US investment banking firm which has been appointed financial adviser to the Government and Dana-modal Nasional Bhd, said it had put Malaysia's economic data through two tests, the second being the more stringent.

The first stress test assumed that Malaysia would pay-down a significant portion of its short-term debt — US\$3bil each in 1998 and 1999.

Under a more stringent test of the first scenario — reserve coverage of external obligations — Malaysia's forex reserves at the end of the year was projected to be 1.5 times its total short-term debt outstanding plus principal payments due in 1999.

"That means Malaysia could pay-down all of its short-term debt, meet its long-term debt obligations and still have 50% of its 1998 reserves," Salomon Smith Barney said.

In the second "disaster scenario" hypothesis, the firm assumed that Malaysia would reduce its short-term debt outstanding this and next year, would not replace that short-term debt with long-

MALAYSIA'S BALANCE OF PAYMENTS – ALTERNATIVE SCENARIOS

(In millions of US dollars)

	Base case			Scenario I reduced short-term debt		Scenario II reduced short-term debt plus (1)	
	1997	1998E	1999E	1998E	1999E	1998E	1999E
Current account balance	(5,031)	1,730	3,820	1,730	4,120	1,730	(3,090)
Capital account balance	1,445	2,674	4,762	(547)	1,765	(3,795)	1,865
Change in reserves (Parentheses means increase)	5,990	(4,404)	(8,582)	(1,183)	(5,585)	2,065	1,225
Forex reserves, end of period	21,706	26,500	35,600	23,665	26,250	20,471	18,892
Short-term debt	11,293	12,800	13,500	9,000	6,000	9,000	6,000
Interest payments	2,765	2,900	3,200	2,750	2,900	2,750	2,900
Principal payments	2,933	4,950	4,000	8,150	7,100	8,150	7,100
Reserve coverage of imports (months)	3.5	3.8	4.8	3.3	4.0	2.9	2.5
Reserve coverage of external debt obligations (x) (2)		1.6		1.5		1.3	
Reserves/Short-term debt (x)	1.9	2.1	2.6	2.6	4.9	2.3	3.2
Projected reserves end of 1998/							
Projected principal payments in 1999 (x)		6.6		3.9		2.9	

(1) Assumes same pay-down of short-term debt as in Scenario I, but also assumes current account deficit in 1999, and no bonds issued in 1998.

(2) Reserve coverage of external obligations is defined as reserves at end of period divided by the sum of short-term debt outstanding at end of period plus principal payments forecast for following year. Interest payments are excluded from this calculation because they are already captured in current account balance.

E Estimate

Source: Institute for International Finance and Salomon Smith Barney Inc, estimates

term debt, would not issue any new foreign bonds this year and would run a current account deficit next year.

"The latter assumes zero growth in exports in 1999 versus 1998 and that imports grow by 10%.

"These assumptions are intended purely to illustrate what might happen to Malaysia's external accounts as a result of domestic economic recovery (higher imports) and potential competitive efforts arising from the fixed exchange rate (slower export growth)," Salomon Smith Barney said.

The disaster scenario had projected that Malaysia would emerge, at the end of the year, with foreign exchange reserves 2.9 times its

projected principal payments on long-term debt in 1999, and 2.3 times more than short-term debt outstanding at the end of the year.

"At the end of 1999, projected foreign exchange reserves are smaller than in either of the two scenarios, but they are still projected to be 3.2 times short-term debt projected for the end of 1999," Salomon Smith Barney said.

Even after applying the reserve coverage of external obligation test, the firm found that Malaysia, after paying down all of its short-term debt and meeting its long-term obligations, would have a 30% cushion of foreign reserves.

"This is a thin cushion but

it is a cushion, nevertheless, under a rather severe test."

Salomon Smith Barney said although controls on repatriation of ringgit funds held by foreigners in Malaysia and the Government's reluctance to reduce barriers on foreign ownership of Malaysian banks had affected creditor assessment of the country's sovereign risk, these must be weighed against three factors:

- Malaysia's long track record of liberalisation under Prime Minister Datuk Seri Dr Mahathir Mohamad;

- Reforms that had taken place before the change in foreign exchange policies; and

- The country's large external sector.