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A matter of balance

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NEVER MIND that currency controls have a dismal record. Never mind that they are known to create economic distortions and add bureaucracy to government machinery.

The fact is, they seem to be bringing about the desired results in Malaysia. Currency controls have been in place the past month to, among others, insulate the ringgit from currency speculators. The result: Most ordinary folks with housing loans or other debts, importers and companies with forex exposure are heaving a sigh of relief as interest rates tumble and the ringgit stabilises.

Even the stock market is reacting favourably. It has rebounded more than 50 per cent from its low of 262 points on Sept 2.

Compare this with the scenario a few months ago. Spiralling interest rates of up to 18 per cent caused monthly housing loan instalments to increase by at least 30 per cent, manufacturers could not operate due to the high cost of funds, long-term export orders were not forthcoming due to the fluctuating ringgit, importers had to bear a high cost and companies recorded large currency translation losses. Also the stock market was at its lowest ebb.

When Prime Minister Datuk Seri Dr Mahathir Mohamad announced that the ringgit would be de-merchandised from Oct 1, some Malaysians were unfazed while foreign investors were dazed and cried foul. The outcry was understandable as the basic needs of any foreign investor are that the profits and principal can be taken out of a country at any time and that there be consistent economic policies and political stability.

By imposing currency controls, foreigners claim Malaysia does not provide free convertibility of the ringgit and has regressed in its economic policy. Moreover, they are irked as the authorities had earlier denied rumours of capital control. The sacking of Datuk Seri Anwar Ibrahim from his ministerial posts has also caused political instability, they say.

But as the dust settles, it is clear that currency controls will not affect genuine investors and businesses, tourists or travellers or ordinary folk who need to send or bring in money for valid reasons. Also, with all-round support expressed for Dr Mahathir's leadership, there are little signs of a political crisis.

It must be noted that currency controls are not permanent. Dr Mahathir and Bank Negara have stressed that Malaysia will go back to the free market system when the international community acts to curb currency traders and when the country revitalises its battered economy.

As for fund managers stuck with short-term capital in the stock or derivatives markets, Bank Negara has clarified that only the principal must be retained in Malaysia for a year while capital gains can be repatriated. Although investors are stuck with the principal, at least they can repatriate their capital gains from the stock market.

`The objectives of our currency controls are to insulate the ringgit from currency speculators and get the economy moving by bringing down interest rates. Of course there will be some leakages, but at least now speculators cannot launch attacks on the ringgit when interest rates are being lowered' says a Bank Negara official. `We had anticipated that the initial response from foreigners would be bad as the measures were sudden. But then drastic economic measures like currency controls cannot be

implemented with prior notice. It must be implemented without warning to ensure there is no manipulation or capital flight.'

Malaysia's remedy for its economic ills, a combination of capital control methods used in countries like China and Chile, is being watched by other countries affected by the currency turmoil. China's capital controls are similar to Malaysia in that the renminbi is not traded in international markets, while Chile requires foreign investments to be parked in that country for at least a year (see sidebar).

Thailand's former Deputy Prime Minister Virabongsa Ramangkura has proposed long term capital controls for the country of up to 10 years while the Philippines is watching. Brazil's Luis Inacio Lula da Silva, the leftist presidential candidate advocates exchange controls like that in Malaysia.

Indonesia is experiencing capital flight on the back of rumours that capital controls may be introduced. Indonesia had, during the Suharto era, toyed with the idea of introducing a currency board but it fizzled out.

'If currency controls had been introduced six months ago, they would probably have been unacceptable. But now, a lot of people are looking at Malaysia to see if it succeeds,' says Stephen Parker, a senior research fellow of the Asian Development Bank Institute.

Such controls have suddenly become quite acceptable. In fact, Malaysia's controls have seen other regional currencies strengthening and stabilising. Currency speculators are keeping away.

But Dr C H Kwan, the senior economist of Nomura Research Institute is worried that Malaysia's bold moves might spark a trend in the region.

'What is good for Malaysia may not necessarily be good for others. I believe countries that are financial centres, like Hong Kong, will not follow this path.'

Parker says that if Malaysia uses currency controls as a short term measure to shore up its financial system, then they may be something worth looking at. 'A lot of fear about the new policy is that it will be an excuse not to reform the financial system,' he says.

The banking system needs to be recapitalised to the tune of between RM10 billion and RM16 billion. At the time of writing, it is learnt that Danamodal, the vehicle in charge of recapitalising the banking system, will inject about RM9.6 billion within the next two months. This money is likely to come from reserves held within the better,' says Dr Jeffrey Koo, a prominent banker in Taiwan. Dr Koo is also an advisor to the Taiwanese president.

The ringgit is pegged at RM3.80 to the US dollar. The free market rate before controls were imposed was RM4.20 to the US dollar. Thus pegging the ringgit benefits importers, but exporters need to price their products more competitively or take a lesser profit.

To what extent the peg affects exports, imports and the trade account, which is a component of the current account, remains to be seen. 'One thing is for sure, exports must go up while imports must come down,' says Dr Kwan.

In previous years Malaysia had budget surpluses although its current account ran deficits of about five per cent. These deficits were financed by the inflow of foreign direct investments (FDIs).

But now, with the weaker ringgit prompting higher exports and lower imports, the situation should reverse. The budget is expected to be in deficit by more than 3.5 per cent while the current account should have a healthy surplus.

An economist says that one option the government has to fund its deficit is to mop up excess funds that will come into the system from abroad.

Although there are no figures on how much ringgit is held abroad, it is

estimated that there is at least RM15 billion, the bulk of which is held in Singapore.

How much of this actually comes in remains to be seen as Singapore's banks face a shortage of ringgit, but so far RM11 billion has returned. It is learnt that customers wanting to withdraw their ringgit are being offered equivalent amounts in other currencies.

The possibility of FDIs coming in to help finance the rebuilding of the economy is not bright at the moment except for, perhaps, companies involved in the Multimedia Super Corridor which is exempt from capital controls.

`This is the cost that Malaysia pays for its currency controls. Foreign investors will get jittery with such drastic change in rules.

`China started with currency controls and investors went in knowing fully well what to expect. But Malaysia is starting mid-way,' says Dr Kwan. `It will take a long time for investors to regain confidence.'

But then, confidence is a matter of perception and can be built.

Besides macroeconomic indicators, one way Malaysia can build confidence in the international community is to indicate when the capital controls will be lifted and whether Malaysia is ready for the quantum leap back into the free market system.

If that can be established, then foreign capital will definitely come back.

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