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Exchange rate will be a flexible one

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OVER the past 40 years of the country's independence, our currency had been relatively stable, even though it has been valued by two different exchange rate regimes - the fixed and the free-floating rates.

During the fixed rate regime, the Malayan dollar, and later, the ringgit, was exchanged at the rate of 3.30 to the US dollar between 1959 and 1968. Later the exchange rate was less.

When we adopted the free-floating exchange regime in 1973, the US dollar was bought at around RM2.44. That was the benchmark of our currency value over the last 24 years.

In that period the exchange rate fluctuated within a 20 per cent band.

The best was RM2.18 in 1981; the worst, in 1991, at RM2.71.

Since then the exchange rate of the ringgit for the US dollar steadied between a narrow margin between RM2.40 to RM2.50 in late June, 1997. Since then, our currency has been heavily battered. Its value was shaved down to as low as RM4.80 to the US dollar last February.

Economic fundamentals, such as foreign reserves and balance of payments in the national account sheet, bore no weight in these currency tradings. Currency speculators have a different agenda - to make money in the open foreign currency exchange market.

Their transactions effectively changed the hitherto relatively solid Malaysian ringgit into a rubber ball that bounced within a wide value band - between RM4.88 and RM3.20.

Its volatility wrecked havoc on the economy of the country. No one, including exporting manufacturers and importing assemblers, could divine the worth of the ringgit in the current or following month. Confidence in the ringgit was clearly shaken.

Though the Malaysian ringgit had settled to RM4.20 to the US dollar over the last two months, the Government decided enough was enough.

The time had come to institute radical measures to curb the volatility of the ringgit in foreign exchange markets.

That decision came in the form of Bank Negara's pronouncements on currency last Tuesday. It declared that the ringgit would, with immediate effect, not be traded on the foreign exchange markets. That decision also unplugged the ringgit from the float exchange rate.

On Wednesday, the central bank declared that the ringgit would be pegged at the rate of RM3.80 to the US dollar.

These decisions have had a dramatic effect on the value of our currency.

It appreciated against almost all currencies. The US dollar that was traded at RM4.20 last Monday, dropped to RM3.80 last Thursday.

More importantly, the ringgit that was traded in the foreign exchange market last Monday at RM2.35 to the Singapore dollar appreciated to RM2.16 on Thursday.

What happened? Simple, the authorities have made the ringgit non-tradeable in markets outside the country. That would render the overseas ringgit worthless in October.

How much currency is in foreign banks? The Prime Minister, Datuk Seri Dr Mahathir Mohamad, has said that as much RM100 million in cash is outside the country. More than RM20 billion in off-shore banks.

The sum total of the cash and the deposits have to flow back into the country, if the holders desire a value of the ringgit currencies.

So it is clear that these monies have to flow back into the country

within this month. If they don't, the currency notes would have no value.

Already, some banks across the Causeway have imposed a premium on withdrawal of ringgit deposits, at RM4 to the Singapore dollar.

That should spook depositors of the ringgit in off-shore accounts and perforce them to bring home the ringgit.

The monies might flow back into the country, which would be a testimony to the policy of fixing the ringgit at a specific rate and curtailing trading in the ringgit in foreign exchange markets.

But is this measure the wisest in reviving the economy? Professor Paul Krugmen thinks so.

Foreign exchange controls are radical fiscal initiatives that can resuscitate any troubled economy, such as the country is weathering.

But he avers that the measure should be flexible and temporary. Bank Negara is of the same view - the currency controls are temporary and flexible.

But the question is, and this is pure conjecture, if these measures yield positive results in stabilising the currency of the country, should they not be prolonged?

The concept requires regular revision of the currency's market exchange rate.

Today the ringgit is quoted at RM3.80 to the US dollar. A month down the road, the rate might be reviewed and pegged at, say RM3.50 or lower to the US dollar.

This regime does not engender volatility. It spawns stability. The revision of exchange rates would be worked out periodically. All, traders, importers and exporters, would have periodic information of the value of the ringgit which they could input into their balance sheets.

This regime of a fixed but constantly revised exchange rate mechanism is far, far better than the two orthodox systems that have been adopted so far - a fixed pegged rate and a free floating rate of the currency.

Now, a fixed currency exchange regime today exists only in four countries in the world. One is Hong Kong. Its currency is pegged to the US dollar.

Which means it is beholden to buy any US dollar in the domestic currency market with its financial resources.

And Hong Kong has a deep and large pocket. That Self Autonomous Region has in the past two weeks battled successfully the hedge funds managed George Soros which attempted to profit from some weaknesses of the currency.

We have had a fixed exchange rate in the past.

When the country issued sovereign currency, first the Malayan dollar and subsequently, the Malaysian ringgit, its value vis-a-vis other major currencies had been relatively stable, even though it endured two different exchange rate regimes - the fixed exchange rate and the floating exchange rate.

The fixed exchange regime prevailed between 1959 (when Bank Negara was established and became the currency issuing authority) and 1973.

First, the Malayan dollar was pegged to the British sterling until mid-1972 when the central bank switched to the peg with the US dollar. The value of our currency was stable during those years.

The problem of a pegged exchange regime is that the country has to have the wherewithal to buy back its currency at that fixed rate. It works well for countries that have huge financial resources. Certainly it is a pain for others that do not have this recourse.

The ringgit was subsequently cut from the umbilical cord of the US dollar on June 21, 1973. Its value floated freely. Yet its exchange rate against major currencies fluctuated within a narrow margin.

Thereafter, from Sept 27, 1975 until last Tuesday, the value of the

ringgit was determined by the value of a basket of currencies of those countries which were significant trading partners of Malaysia. Again during this period the ringgit was stable.

Despite the difference in nomenclature of exchange rates, the basic factor that bolstered the exchange rate of the ringgit was the reserves of the country.

Once it was the gold reserves, deposited in Fort Knox, USA. Today, it is held in off-shore accounts as well as in domestic financial institutions, in various forms.

From July 1997, the equation of the value of the ringgit changed because of the free and open foreign exchange market.

That could not be controlled by any sovereign country simply because of the market operations of currency trading, both locally and off-shore. And so our currency was battered so badly that the Government instituted the radical measure of controls on trading of the ringgit.

This measure, that has for the moment fixed the ringgit at RM3.80, is actually a flexible policy. The Government does have to intervene. Exporters earn foreign currencies at a fixed rate. The amount would be exchanged through banks for ringgit.

Importers pay foreign currencies at the benchmark of the exchange rate of the ringgit to the US dollar.

And the exchange rate is flexible. Today it is RM3.80 to the US dollar. Next week, next month, who knows, it might be lower. The central bank would revise the rate.

A flexible fixed exchange rate. This, in sum, is the third exchange rate regime for currencies.

If it works for us, it might be a model that other countries whose currencies are battered by speculators, might adopt.

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