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Capital measures review buoys foreign interest

Zainul Arifin in New York

RENEWED foreign interest in Malaysian stocks in the past weeks has been attributed to the anticipation of a review in the five-month-old selective capital control measures, as well as improving sentiment towards the country.

A broker in New York specialising in Asian markets said some foreign buying in blue chips in the past few weeks had pushed the Kuala Lumpur Stock Exchange Composite Index (KLCI) higher.

"The rise in the KLCI is definitely a sign of foreign capital returning," said Ming Sun Wan of securities firm Vickers Ballas.

Bargain-priced stocks and anticipation of a review of the controls are two of the factors for the renewed interest. The other is an improved sentiment towards Malaysia following a year or so of bad publicity.

"As far as Malaysia is concerned, the fundamentals have not changed much. Maybe, (the economic problem) is bottoming out and an upswing is in the works. But what is more important is that sentiment is changing," said a banker with an Asian bank.

Malaysia's decision last September to impose selective capital controls did not endear it to the international investment community. But with some benefits already seen from the measures, sentiment has improved.

It must be noted, however, that foreign investment in equities is still small compared with two years ago but it is a start, said the banker.

Several analysts here had expected a review of the capital controls to be announced on Monday following Prime Minister Datuk Seri Dr Mahathir Mohamad's meeting with foreign fund managers in Kuala Lumpur, and were quite disappointed that it was not.

Both Dr Mahathir and First Finance Minister Tun Daim Zainuddin had suggested the possibility of an exit tax in place of the one-year retention period of foreign capital resulting from the sale of any investments in Malaysia.

Selective capital controls, together with fixing the ringgit at 3.80 to US\$1 and making it non-tradeable, was introduced last September.

A review is said to be necessary to prevent a sudden capital outflow come September, as well as to retain some of the foreign capital beyond the period.

It is also to make it attractive enough for foreign investors, who left the region following the financial crisis, to return.

A sudden outflow could have a destabilising effect on the country's balance of payment as well as foreign exchange positions.

"A review will be positive for Malaysia. (Capital control) by its nature is going to keep people away and it sent a wrong message to investors.

"Control is distorting. It should be removed as soon as possible. The longer the control, the greater will be the distortion," said Dr Win Thin, an economist with fund management firm Alliance.

Analysts estimated that some US\$4 billion to US\$5 billion is expected to be repatriated following the replacement of the holding period with an exit tax.

"It is an amount that Malaysia will be able to handle without much difficulty," said the Asian banker.

The renewed interest in Malaysian equities in the past few weeks has largely been from regional investors in Singapore and Hong Kong. US investors are more cautious, although a few hedge funds are said to have

taken positions in some stocks.

The biggest beneficiary has been blue chips, especially gaming counters, which have recorded significant gains. Buying by domestic institutions and retailers, together with foreign buying, boosted the KLCI by as much as 18 per cent in December alone.

The banker said most US investors, while confident that a review will come, are waiting for details before returning. They want to be "absolutely sure" of what the new rules are going to be.

Also for some institutional investors, their charters prohibit them from investing in a market that does not allow free flow of capital. The capital controls automatically keep them away.

Incidentally, there is now a recognition that the control measures may indeed be working and lending some stability to the economy. Also, efforts to pump prime the economy through public spending, as well as the lowering of interest rates, are beginning to show positive effects.

For example, following the introduction of the measures, Malaysia's reserve have increased significantly to RM104.165 billion last week from a low RM69.700 billion at end-May 1997.

Recent data also indicated a better economic environment, such as an increase in current account surplus - for the first nine months of last year, surplus was at RM29 billion, from a deficit of RM12.2 billion in the previous corresponding period.

The ability of Malaysia to raise funds despite being handicapped by poor ratings is also a plus factor.

A loan offered by a syndicate of foreign-owned banks in Malaysia, as well as funds raised in Japan, indicates that the credit crunch expected may not emerge after all.

"You've shown that it works. Now take advantage of it," said an analyst. However, a note of caution is the state of the banking industry, especially as little is known of the efforts to buy out bad debts and to recapitalise banks by Danaharta Bhd and Danamodal Bhd respectively. The directive requiring banks to lend more also worries analysts who fear that indiscriminate lending could ultimately affect banks' asset quality.

Moody's ratings agency vice president Nicholas Krasno projected a worsening outlook for the financial sector and suggested that the level of bad debts had been "grossly" underestimated by the authorities.

The National Economic Action Council (NEAC) had put the amount of bad debts in the domestic financial system at about RM52.2 billion.

Krasno said the active involvement of the Government in recapitalising and bailing out banks may work against the industry.

"The more the Government gets involved in the recapitalisation of banks, the more control it has over them. Control by the Government is bad as it makes management lazy, corrupt and inefficient."

Another cause of concern is the decline in industrial production. Last November it fell 11 per cent from the corresponding period in 1997. A decline in production may slow reduce export receipts, which could affect the recovery process.

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