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Light is still on after capital controls

Shahriman Johari

AHMAD Lutfi Kamaruzzaman is one of thousands of taxi drivers who is enjoying better returns these days, just over two years after Malaysia and other countries in the region plunged into their worst economic and financial crisis.

"Thank God, we are seeing more passengers now. Last year, we taxi drivers were still queueing up for passengers and there weren't that many of them. Now, it's not as bad ... a bit okay," he says.

The transport sector was one of the first to be hit by the crisis. As consumers started to tighten their belts, those who used to take cabs changed to cheaper alternatives like buses. It was difficult even to get the minimum of RM40 daily to pay for the rented taxis, Lutfi said.

Before 1997, Malaysia was one of the most dynamic or tiger economies of South-East Asia. In 1996, its Gross Domestic Product (GDP) grew 8.2 per cent, the ninth consecutive year it had posted such growth figures.

"It is envisaged that the economy will continue to record a more sustainable level of growth in 1997," according to the 1996 economic report released by the Ministry of Finance.

Malaysia achieved a lower growth for 1997 of 7.7 per cent.

In July that year, under immense pressure from currency speculators, Thailand abandoned the baht-US dollar peg. It triggered an avalanche and completely blocked off the "Asian Miracle" highway.

Indonesia soon followed with measures to tighten liquidity in its financial system in an attempt to ward off a merciless attack on the rupiah.

It was no match for the speculators who were backed by massive leverage abilities and the rupiah crumbled, as did the stock market in Jakarta. The rupiah was allowed to float in mid-August 1997. Jakarta soon after turned to the International Monetary Fund (IMF) for help. Thailand, too, had to be bailed out.

Even Hong Kong, which was considered the bastion of the free market, took matters into its own hands and raised interest rates as well as using its reserves to buy large volumes of key stocks to defend the share market.

In Malaysia, the ringgit's exchange rate experienced a frightening free fall, thanks to the activities of highly-leveraged speculative funds which took advantage of the now regionwide crisis to reap quick profits.

The ringgit depreciated to a then unprecedented low against the greenback on January 7 1998 at RM1/US\$0.2049.

The situation further worsened when the Malaysian currency touched a then record intra-day low of RM1/US\$0.2312 on July 10 1998.

Simultaneously, share prices on the Kuala Lumpur Stock Exchange (KLSE) retreated.

The benchmark KLSE Composite Index (KLCI), which had been on a downtrend since July 2 1997, fluctuated erratically between 594.44 points at the end of that year and 719.52 points at end-March 1998.

Prime Minister Datuk Seri Dr Mahathir Mohamad then called for the regulation of the activities of currency traders whose profits hinge on the buying and selling of currency, and not for trading purposes.

The editor for Europe's leading business magazine EuroBusiness, Tom Rubython, agrees. In the magazine's latest issue, he called currency traders parasites.

"I don't mean the insult personally but collectively. Currency traders exist and they always will do while there are different floating currencies. But these people do not contribute anything except to the bottom line of the institutions that employ them - which in itself is a good enough reason to exist.

"My problem with these people is the way they try and influence economic policy and destabilise governments. And it is consciously done," he said. Despite having posted strong growth year after year coupled with good fundamentals, Malaysia also had its own weaknesses which contributed to the economy's deterioration.

Up to the year 1997, the country has been recording a current account deficit for the past 10 years which had created pressure for the ringgit's depreciation.

In 1997, the deficit was RM13.4 billion, or 5.1 per cent of the gross national product. In 1996 and 1995 it was RM12.3 billion and RM21.8 billion respectively.

Another problem faced by the Malaysian economy was the high levels of private sector debt. It grew very rapidly from a mere RM6.7 billion in 1991 to RM32.4 billion in 1996, to RM37 billion in 1997.

Largely due to privatization, the high gearing of the private sector caused anxiety among foreign investors, contributing to the erosion of investors' confidence.

Inflation slowly crept in as the ringgit's depreciation lifted the prices of imported food, medical supplies and production inputs.

The Consumer Price Index rose by 5.2 per cent in the first nine months of 1998, compared to 2.6 per cent for the corresponding period of 1997. Contraction in the real economy affected job creation and led to an increase in structural unemployment.

Malaysia resorted to ala IMF measures to address the situation. A tight fiscal and monetary policy was announced accompanied by a surplus budget. It didn't work.

Tight liquidity measures resulted in surging interest rates which on the one hand, helped to defend exchange rates, but suffocated the business community with high interest expenses on the other hand.

The National Economic Action Council, headed by Tun Daim Zainuddin, was formed in January 1998 to address the economic crisis.

Danamodal Nasional Bhd was subsequently formed on August 10 1998 to recapitalise the domestic banking system.

This was followed a week later by the Corporate Debt Restructuring Committee.

This was then followed by the establishment of Pengurusan Danaharta Nasional Bhd to purchase non-performing loans in the banking system.

On September 1 1998, Malaysia broke the news. Malaysia introduced selective capital control measures including fixing the ringgit at RM3.80 to the US dollar.

To fend off speculators, offshore trading of Malaysian currency was declared illegal.

There was also a one year moratorium on the repatriation of foreign portfolio funds to effectively lock in short-term capital flows in the stock market.

The country was denounced as a closed economy by the foreign media, a market which will be "shunned" by foreign investors following these unorthodox measures.

From that moment on, it has been a long and arduous journey for Malaysia to get back on the path of recovery.

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