

Analysts see window of opportunity for KL to lift ringgit peg

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NOW would be a good time for Malaysia to relax its two-year-old fixed exchange rate to protect against a shrinking trade surplus and boost investor confidence, says just about everyone.

Just about everyone, that is, but the Government.

The authorities have shown no inclination to tinker with the ringgit peg to the US dollar, saying it is the fulcrum of efforts to spur growth.

Independent analysts say Malaysia's strong economic fundamentals give it a window of opportunity to lift capital controls and adjust the ringgit peg.

"I feel that the time has come to begin to relax more. We have achieved what we wanted to," Tan Sri R.V. Navaratnam, group corporate adviser of the diversified Sungeiway Group, said.

"You cannot have the the peg indefinitely. It must be lifted some time. So I say let's do it sooner rather than later."

Malaysia pegged its currency at 3.80 to US\$1 in September 1998 during Asia's financial crisis and imposed capital controls to stem the outflow of short-term capital.

Undervalued against the dollar, the ringgit rate has stimulated exports and fed a hefty current surplus, while inflationary pressures have remained weak.

But analysts say the benefits of the peg will soon start to fade, if they haven't already, and it is time to rethink the policy.

The International Monetary Fund in its annual review last week said the ringgit appeared to be "somewhat undervalued" and strong economic fundamentals left room for Malaysia to introduce a flexible exchange rate.

"I agree with the IMF," said Mr Kevin Ng, an economist at ABN AMRO. "It is better for the Government to move to a more flexible rate from a position of strength than wait for pressure points to emerge."

But Finance Minister Tun Daim Zainuddin said last week that there were no compelling reasons to alter or re-adjust the peg and he expected it to stay in place for now.

Prime Minister Datuk Seri Dr Mahathir Mohamad, who blames currency speculators and hedge funds for the debilitating crisis in 1997, says the peg will stay until the global financial architecture is altered to protect developing nations against hot money flows.

"I think that's next to impossible," said Mr Eddie Lee, regional economist at Vickers Ballas. "The original reasons for keeping the peg have almost disappeared."

Lee added: "My greatest fear is that there

is an inertia setting in and the authorities have lost focus of the reasons to keep the peg."

Navaratnam, a former senior Finance Ministry official, called for an open and frank debate on the peg, which Malaysian authorities basking in the glow of an economic rebound have held up proudly as proof that its unorthodox policies have worked.

However, some Asian countries which did not fix their currencies have also made significant comebacks from the crisis.

"What's wrong with an open debate as long it is sincerely motivated?" Navaratnam asked.

"There are many people who are uncomfortable with the peg despite the stability," said Mr Chia Woon Khien, chief analyst at SEB Merchant Banking in Singapore.

"The peg is not here to stay like Hong Kong. So, it's the uncertainty over the peg and the controls that come with it which affect free flow of capital," Chia said.

Analysts say the absence of a clear roadmap on the peg could drive investors to other competing regional economies.

The undervalued currency makes capital imports more expensive, while uncertainty over the timing of a possible lifting of the peg make it difficult for exporters to price products competitively in the global markets.

"More transparency about the timing and regime would definitely be beneficial," said JP Morgan economist Ping Tan.

Foreign investment applications in Malaysia recovered sharply in June and July after faltering in the first five months.

Analysts welcomed the recovery but said it remained below pre-crisis levels.

The trade surplus has shrunk in recent months, raising fears that foreign exchange reserves could prove inadequate to defend the peg.

The undervalued ringgit makes imported consumer goods more expensive. As the slack goes out of the economy, inflationary pressures could eventually build, although most analysts do not see a major escalation of prices this year.

Ironically a major reason cited by Malaysian authorities for imposing the peg was to keep the ringgit from falling against other currencies and preserve the value of the country's savings and assets.

But in defending it since, they have emphasised the benefits of having a currency that is weaker than it would otherwise be, making Malaysian exports more competitive.

Reuters