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Back on strong financial footing

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THE story of how the Malaysian economy benefited from its strong fundamentals to survive the Asia-wide financial crisis with relatively little social costs, is well told.

Prime Minister Datuk Seri Dr Mahathir Mohamad threw out the textbook in bringing the country out of its worst recession in 1999 with capital controls and low interest rates, and to win the general election last year.

The international financial institutions and funds are coming back, especially with the reinstatement of Malaysia into the influential Morgan Stanley Country Indices (MSCI) in May.

As the Malaysian recovery gathered momentum in 1999, the international community, including the International Monetary Fund, acknowledged that the cookie cutter approach to crisis management was not for all.

The undervalued ringgit, a benefit of selective exchange controls, are attracting multinational companies from neighbouring Singapore and elsewhere to relocate their less capital intensive operations to Malaysia. It remains an attractive location for foreign investors and its export-led industry is internationally competitive.

Malaysia has left the Asian financial crisis in the dust and is approaching the levels of growth that it has been accustomed, and may be on the way to repeating the 1991-1996 period of eight per cent growth before long.

The official conservative forecast of 5.8 per cent GDP growth for 2000 is overshadowed by more realistic projections of between five and 7.6 per cent from analysts.

At the height of the crisis, real GDP contracted by 7.5 per cent in 1998 compared with 7.5 per cent growth in 1997, but by the second quarter of 1999 output was beginning to reverse earlier declines.

Propelled by low interest rates and foreign exchange advantages, growth accelerated throughout 1999, and Malaysia achieved an annual growth of 5.4 per cent for the year.

As part of its selective exchange control policy, introduced in September 1998, Malaysia fixed the ringgit to the US dollar. By the end of 1999 the ringgit was, according to central bank estimates, about 6-8 per cent undervalued in real terms compared to the pre-crisis level in the second quarter of 1997. This, coupled with the overall recovery of global export markets was the push behind Malaysia's dramatic exports and recovery.

In US dollar terms, merchandise exports grew by 17.6 per cent in 1999 benefiting from a strong global demand for electronic products such as semi-conductors, personal computers and other information and communication-related components.

The other ingredient of Malaysia's recovery strategy, private domestic consumption, began to recover from the second quarter of 1999 on the back of improving economic conditions, strengthening consumer confidence and better employment prospects.

The strong export performance, and curbs on major imports, pushed the balance of payment to record levels in 1999 reaching RM83.5 billion. After allowing for a larger deficit in the services account due to the increased net payments of investment income, Malaysia achieved a current account surplus of RM47.4 billion (US\$12.5 billion), or 16.9 per cent of GNP.

As a consequence of the repayment of debts, some repatriation of funds that had been locked in by exchange controls, Malaysia's capital account posted a deficit in 1999. Despite net capital outflows, the record surplus on the current account led to an increase in Malaysia's foreign exchange reserves.

The replacement of selective exchange controls by a tax on capital gains did not trigger the massive capital outflows that some feared. Over the third and fourth quarters of 1999, when capital trapped under the one-year moratorium of repatriation expired, portfolio outflows amounted to only US\$2.2 billion, and in the next few months were amply replaced by inflows of US\$1.8 billion.

The country's GDP expanded by 10.3 per cent in the first six months of the year after recording its fifth consecutive quarterly growth of 8.8 per cent in the second quarter. The 8.8 per cent was slightly lower than expectations largely dragged down by the agricultural sector but it still reflected the Government's expectations that the GDP would grow by 5.8 per cent.

Due to the strong first half, Bank Negara now expects GDP for the year to be higher than 5.8 per cent.

Inflation has remained fairly stable despite the pick-up in economic activities and increase in capacity use in major sectors. It moderated to 2.8 per cent in 1999 from 5.3 per cent in 1998, representing a deceleration from the peak of 6.2 per cent in June 1998. The Government has said it will keep inflation to below four per cent in 2000.

The most obvious barometer of the recovery is the Kuala Lumpur stock market, which is heading towards stabilisation and recovery. The Kuala Lumpur Composite Index (KLCI), which had crashed by over 70 per cent in August 1998 in ringgit terms from its peak, had recovered substantially.

In the first two months of 2000, the KLCI continued to perform strongly while stock markets in other affected countries softened. By the end of March 1999, the KLCI had almost reached its pre-crisis level of June 1997 in ringgit terms. In US dollar terms, however, it was still 40 per cent lower.

The resolution of the problem with Malaysian shares traded in neighbouring Singapore's over-the-counter Central Limit Order Book removes a big cloud over the performance of the KLSE.

CLOB were consigned to limbo when under 1998 capital controls regulations owners of these shares were not recognised as beneficiaries because their stocks traded in a market that is not sanctioned.

After months of belligerent posturing by the two country's exchanges and a Singapore Government threat to bring the matter to the World Trade Organisation, the problem was resolved almost overnight. The CLOB investors, mostly Singaporeans, have agreed to a scheme where their shares will be gradually migrated to the KLSE in amounts that will not drag down the market.

As part of its management of the crisis and to strengthen the financial sector against future shocks, the Government created agencies to buy and manage bad debts (Danaharta) and to recapitalise and rehabilitate illiquid financial institutions (Danamodal). The Danaharta programme has helped reduce non-performing loans ratio of the banking system to 11.1 per cent based on three-month classification, from the peak of just under 15 per cent at Nov 30, 1998. Danamodal provided over RM8 billion to recapitalise 10 banking institutions that were deemed viable.

Bank Negara, the central bank, has ordered 54 financial institutions to merge into 10 anchor banks by the end of 2000 to enable them stand up to increased global competition, but the jury is still out on whether these mergers would lead to stronger banks.

In 2000 the consolidation of the banking sector is a real promise as well as further progress in corporate debt restructuring and Bank Negara has promised more measures to strengthen banking and corporate sector governance.

The banking restructuring however, is expected to distract local banks in the short term and provide opportunities for foreign banks to increase market share.

Bank Negara has indicated that it would like to see the number of banks be reduced further from target of 10 set in 1999, and these merger concerns is likely to disrupt operations and policies of banks.

The nine foreign-banks in the country are expected to take advantage of the situation by intensifying marketing efforts and may potentially develop a substantial presence.

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