17/07/2000

Currency peg continues to prove to be a useful anchor

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ASIAN currencies were affected by developments in the region last week. The volatility has been attributed to political uncertainty in Indonesia and to the underestimation of the strength of the US economy.

The baht, Singapore dollar, the peso and the rupiah hit lows against the greenback during the course of the week. The ringgit remained steady as a result of the peg - RM3.80 to US$1 - which remains unchanged.

Since the beginning of the year the Singapore dollar has registered a 4.5 per cent decline against the US dollar, the peso is down by 10.6 per cent and the rupiah 27 per cent and the baht, which triggered the crisis in July 1997, is also down.

The rupiah pierced through the psychological 9,500 level on Wednesday and climbed to 9,505 in intra-day trade. The last time the greenback was above the 9,500 rupiah in Asian trade was in October 1998.

Last week, concerns about Indonesia were also reflected in the exchange rate of other regional currencies as well. During the week the peso hit a three- month low, the baht a nine-month low and Singapore dollar was not spared either. It slid some 4.5 per cent to 1.7443.

The Monetary Authority of Singapore (MAS) intervened "a few times. They don't like to see volatility ... and we have seen them coming in to smooth out the market", a market analyst is quoted by Bloomberg as saying.

Some forecasts are for the baht to fall to 42 per US dollar. Thailand had used almost all of its foreign reserves in 1997 in an effort to defend its currency. The baht lost some 54 per cent when the Bank of Thailand allowed the currency to move freely on July 2 1997 - giving rise to the contagion and the series of devaluations in the region and triggering the crisis.

Amid all the currency movement and regional uncertainty, the ringgit remains stable providing the business community the much-needed predictability and stability - thanks to the peg that continues to be in place. It accords greater certainty and allows business decisions to be made in a more stable environment.

Malaysia, which introduced selective capital controls and pegged the ringgit to the US dollar on September 1 1998, is not ready to lift the peg "unless the situation becomes uncompetitive for Malaysia".

Malaysia is comfortable with the exchange rate and its competitiveness is not adversely affected. In fact, the economy is showing signs of further strengthening and increasing domestic demand. Prime Minister Datuk Seri Dr Mahathir Mohamad said Gross Domestic Product (GDP) growth in the second quarter is expected to be between nine and 10 per cent. At this rate it will be slower than the 11.7 per cent registered in the first quarter, but "it is still a good figure".

More positive signs are emerging for the economy. Inflation is still low, as is unemployment, sales of vehicles are on the rise, manufacturing production is increasing and so is domestic consumption.

Productivity growth of 3.9 per cent last year surpassed those of several Organisation for Economic Cooperation and Development (OECD) countries - Japan (2.3 per cent), the US (2.3 per cent), Germany (11.1 per cent), Britain (1 per cent) and Canada (1 per cent). This year Malaysia's productivity is expected to grow by 4.2 per cent.

With the crisis having blown over and with stability returning to the region, analysts and commentators had forecast that Malaysia would lift the peg. But developments and volatility of regional currencies in recent weeks show that the situation is still "unstable" and Malaysia's decision to stick to the peg is not without reason.

The US Federal Reserve Chairman Alan Greenspan told the Council of Foreign Relations in New York last week that globalisation is showing no sign of slowing and that further international financial crises are all but inevitable.

With more stable conditions in the region, compared with the dark and difficult days of 1997-1998, analysts had said that the ringgit is undervalued by 6-10 per cent. With the fall in regional currencies in recent days the "considered" view now may well be that the ringgit is in alignment with its neighbours.

The possible upgrade of Malaysia's sovereign rating by Moody's Investors Service is an acknowledgement and acceptance of its policies including the selective capital controls. The move indicates that measures have been "effective" and Malaysia has been "vindicated".

"The strong liquidity position, plus the reatively low level of debt outstanding, mean that Malaysia is much less vulnerable to external shocks than it was in the past," Moody's says. This is in contrast to fears expressed by analysts that the baht "may fall to 42 per US dollar this year with a little bit of contagion from the rest of the region".

Markets are inherently volatile and because of that, some mechanism is needed to ensure stability and predictability. Transparency alone is not enough and it is "good to have a stable rate". For Malaysia, its selective capital controls and the continued peg of its currency has proved to be beneficial and necessary.