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Malaysia handling of crisis extremely successful: Barclays

TV3 Money Matters' interview with Barclays Capital director for Asian Research Dominique Dwor-Frecaut. Barclays Capital is one of the lead managers for the recent Malaysian inaugural Euro-denominated bond issue.

Q: In July 1998, during the height of the financial crisis, Malaysia had planned to raise a US\$2 billion (US\$1 = RM3.80) global bond issue. This was however cancelled at the very last minute, as rating agencies Moody's and Standard & Poor's downgraded our sovereign ratings. When we finally did it in May 1999, market conditions became uncertain, with fear of higher US interest rates. What about our recent euro-bond issues? Were there any unexpected events that had caused difficulties for us this time? Maybe you would share with us some of the insights of the recent roadshow?

A: The only thing that you can be sure about when you start a road show is that something unexpected will happen, no matter how well prepared you are. In that sense there is no perfect time to launch a road show.

In our case, the unexpected was the hung result in the US elections, the volatility in US stockmarkets, and the unfolding story in Argentina with growing talks of a default or abandonment of the peg. So the market conditions were difficult. Nevertheless, the Malaysian Government decided to go ahead with the issue, because it was a long term strategic decision to develop a new investor base and they did not feel that they should be distracted by market timing considerations.

The best preparation to deal with difficult market conditions is to have a good credit story to tell to investors, which clearly Malaysia had and, in the end, that was the main driver behind the success of the deal. Communicating that story well was equally important and the Malaysian Government team, that had devoted a great deal of time and effort in putting together a good presentation for investors, was also very successful in this respect.

Q: Paul Krugman, an economist with MIT, wrote on September 24 in the New York Times that "The irony gets deeper when you notice, Malaysia, which was supposed to have been cast into the outer darkness after it imposed controls on foreign investors two years ago, has had no trouble selling its bonds on world markets. Were we really "in outer darkness", and how do we explain Krugman's statement?

A: Malaysia stands out as a country that does things its own way, in a very successful, if sometime unconventional manner. Malaysia's handling of the crisis is a case in point. Malaysia took a number of measures to deal with the crisis, which included supportive fiscal and monetary policies, move to a fixed exchange rate system, public sector-led recapitalisation of the banking sector, structural reforms as well as more controversial measures such as temporary controls on capital flows. Two years later, it is clear that Malaysia's overall handling of the crisis has been extremely successful: Malaysia this year will be one of the fastest growing economies in Asia and worldwide, inflation is less than 3 per cent and the current account surplus at 9.9 per cent of gross national product is one of the largest in the world. The economy is also coming out of the crisis more efficient and resilient while at the same time the expected public cost of the recapitalisation of the banking sector at 5.6 per cent of gross domestic product, is way below that of other Asian crisis countries.

Success through unconventional policies can be unsettling to some and provoke negative reactions. These were not universal: economists such as

Paul Krugman or Joe Stiglitz for instance have been quite supportive of the policies followed by Malaysia and even the International Monetary Fund eventually praised Malaysia's handling of the crisis. Personally, I have been visiting Malaysia since 1995, first as an economist with the World Bank and then with Barclays Capital and experiencing the Malaysian way of managing the economy has been the most challenging and rewarding aspect of my work here.

Q: Our first bond issue in May 1999 proved that we are able to raise funds after the negative stories on our country, and we succeeded. In a way, this proves that "negative perception", is itself a perception. The latest developments, like the success of the Euro-bond, have conclusively proven that Malaysia is doing fine. Can you share with us your observations?

A: The less conventional policies followed by Malaysia make great copy for the press, precisely because they stand out. Most journalists do not have a training in economics and are not interested in providing an economic analysis of the facts. They just want to have a wide readership. That is why it is important for Malaysia to give its own version of its story to investors, rather than leave it to the press.

In any event, investors do not seem to have been influenced much by the negative press reporting. For instance, capital flows do not seem to have been affected by capital controls. Foreign direct investment (FDI) has continued to come during the crisis and Malaysia has not lost its access to capital markets. In fact Malaysia is the only crisis country in Asia that did not lose its investment grade rating (Indonesia, South Korea and Thailand did lose it). This is the rating provided by international agencies such as Moodys and Standard and Poors and it provides a measure of the riskiness of the credit. It is very important, because many investors are constrained by law to invest only in investment grade credit. A loss of investment grade status therefore means a loss of investor base and a big decline in the value of the debt.

To the contrary, the behaviour of the debt price of Malaysia has showed that Malaysia is perceived as a stronger credit risk by investors. The spread of Malaysia's sovereign bond over US treasury bills, has tightened since early 1999. Malaysia has a well established track record of looking after its investors, as well as very strong fundamentals, and I think that investors have been guided more by the track record and the analysis of the fundamentals than by media reports.

Q: What were the investors' main concerns? Did you find it difficult to sell the Malaysian story?

A: I did not sell the Malaysia story, the Malaysian Government team did! Throughout the road show, they were very good communicators and managed to establish a good rapport with investors, even when they were asked difficult questions. They also had a very strong credit story to tell. Malaysia is a unique combination of fast growth with macroeconomic stability. The Economist 2000 World in Figures book lists Malaysia as the second fastest growing economy in the world after China. At the same time, it is a very stable economy, with consistently low inflation and unemployment, low foreign indebtedness and moderate public indebtedness. This low volatility characteristic of Malaysia is especially important for bondholders. Investors were also impressed with the forward looking economic management and the steps that Malaysia is taking to benefit from globalisation and the Internet revolution and develop a knowledge-based economy.

There were many questions, for instance: Will Malaysia maintain its fixed exchange rate system? Is Malaysia likely to impose capital controls in the future? What were the reasons for the bank mergers? How successful

has been corporate restructuring? What role does the public sector play in Malaysia? How stable is the political situation and what will happen when Datuk Seri Dr Mahathir Mohamad decides to retire?

Through the road show, investors were able to talk directly to high level Malaysian decision makers who dispelled many misconceptions on the Malaysian economy. The result was a strong positive response to the debt deal. The deal was more than twice oversubscribed: while the original size of the issue was 500 million euros (1 euro = RM3.40), the order book was in excess of 1.27 billion euros or RM4 billion. As a result, the price was set at a level very favourable to the issuer.

In addition, the size of the issue was raised conservatively from 500 million euros to 650 million euros since the purpose of the transaction was not to raise funds but to develop a new investor base. This meant that many investors could not get all of their orders and as a result, the bond price has been very firm since the issue was launched. What is very interesting is that the majority of investors did not invest in Malaysia as an emerging market credit, but rather as a solid investment grade credit which is much less risky. In that sense I believe this transaction has graduated Malaysia from the emerging market class of assets. Malaysia has demonstrated that it had enough resiliency to weather the crisis and is now moving on to resume the implementation of Vision 2020.

Q: Our bond issue is aimed at diversifying Malaysia's external funding base by cultivating a new investor following in Europe. How successful were we?

A: Malaysia has fully met its objective of diversifying its investor base. The bond issue was sold to 125 accounts. About two third of the bond were placed in Europe and the West Asia with Germany and the UK accounting for 38 per cent of total sales. Many of the European buyers were first time buyers of Malaysian bonds. The demand came from high quality, long term investors, mainly banks, insurance companies asset mangers and retail funds.

Q: How about the perception on the whole region? How is our bonds compared to bonds issued for instance by South Korea?

A: Investors initial response to the crisis was to view Asia as a block, hence the indiscriminate flight of capital from the region. Since 1999 however, investors have started to discriminate between countries according to economic performance. This is shown by the behaviour of sovereign bond spreads where Malaysia has outperformed all of the other sovereigns in the region.

In May of this year, Malaysia spreads have tightened relative to South Korean spreads by about 20 basis points. I believe that this is the result of a much smoother recovery in Malaysia than in South Korea. Although South Korea is a strong credit with solid fundamentals, there has been much more volatility than in Malaysia. For instance, the output downturn was sharper in South Korea than in Malaysia, and there was much more currency and asset market volatility than in Malaysia.

Also the decision-making process in South Korea has not been as consensual as in Malaysia, with the owners of the chaebols and the unions fighting structural reform. Finally, the political situation is less stable in South Korea, with the opposition currently boycotting Parliament and blocking the passage of essential legislation.

Q: Going forward, what do you think the country needs to do to improve this perception, or do you think this is something that we should not worry about after all it is proven that the crowd which matters the investors know the true story of the country?

A: Going forward Malaysia would benefit a lot from continuing to talk directly to investors to tell its own story. Through the debt issue it has

managed to build a lot of good will and interest in Europe and it is important not to lose the momentum which the Government has worked hard to develop. Malaysia has an excellent infrastructure in place to provide information to FDI investors who want to invest in the productive capacity of the economy.

It would be very useful to have a similar infrastructure for investors who invest in the foreign debt of Malaysia or in its domestic financial assets.

As far as the press is concerned, Malaysia is a good credit story and has its own strong relationship with investors, it does not need to worry about negative press coverage. Nevertheless, I think it is still worth talking to journalists, because it is important to continue to provide timely economic information to the international community as a whole, including representatives of the foreign press.

As the Malaysian story unfolds and the good news keeps coming, some of them will change their views, some will not.

Some of the news reports I have seen recently, for instance on the euro deal but also on the Malaysian economy have actually been quite positive.

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