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`Gold rush' of the new economy

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THE Kuala Lumpur Stock market held its own last week, ending 13.4 per cent higher, an increase of almost 110 points, in holiday-shortened trading. It closed the week at 928.24, a 29-month high and a far cry from the low of 262.70 it hit during the recent economic crisis.

The Kuala Lumpur Stock Exchange (KLSE) rose even when other regional markets followed the ups and downs on Wall Street and the new economy's "gold rush" - Nasdaq and IT related stocks.

Many regional markets also reacted differently to Mr Alan Greenspan's, the US Federal Reserve chairman, comments of higher short-term interest rates. Malaysia together with Japan, Thailand and the Philippines rose while those in Hong Kong, Singapore, South Korea and Taiwan recorded losses.

Many reasons have been given for the performance of the KLSE. Among them is that it is underpinned by domestic investors and not by short term or hot money that is transient and quick to make an exit at the slightest excuse.

Some say that the capital controls, introduced in September 1998, had helped keep out "hot money" at bay. They add that investors now making their way into the Kuala Lumpur market are here for the longer term.

Foreign investors, who view the local bourse as being undervalued, are making their way to Kuala Lumpur snapping up index linked stocks. Foreign funds are coming in, with more expected next week, despite the 10 per cent levy on capital gains on foreigners.

Currently foreign funds in the KLSE are estimated to total just about 5 per cent of total market capitalisation of RM603 billion last Friday. Foreign fund managers are beginning to view the local bourse more favourably as it is seen as being "cheap" and undervalued in comparison with its neighbours. Thus the rush to snap up value shares now before they become expensive.

With economic recovery well under way and with the impending reinstatement of KLSE in the Morgan Stanley Capital International, the local bourse is attracting even more attention and funds.

With the economy on the mend and on a steady growth path, there is now a change of tune and attitude towards Malaysia's policies, policy-makers and a positive view of prospects for the economy.

The International Monetary Fund (IMF), one of the most harsh critics of Malaysia's capital controls, now concedes that controls can shield countries from crisis. Thus the 10 per cent export levy on capital gains is no longer considered a hindrance for foreign investors.

Prime Minister Datuk Seri Dr Mahathir Mohamad, who was initially criticised for the policy measures, has been named by Bloomberg as one of the "11 men whose deeds and words had the biggest effect on the foreign exchange market in the past 10 years". "His response to the ringgit's decline made him one of the most outspoken and derided figures of the crisis... yet (Dr) Mahathir may have the last laugh," Bloomberg says.

Others on the list include Japan's Mr Yen Eisuke Sakakibara, former US Treasury Secretaries Robert Rubin and Lloyd Bentsen, Federal Reserve chairman Alan Greenspan and George Soros. From Europe, the list includes Germany's Helmut Kohl and Hans Tietmeyer, France's Jacques Delors and the UK's John Major and Norman Lamont.

Not only has the gross domestic product expanded 8.1 per cent in the

third quarter of 1999 "leaving Malaysia's economy where it was before the crisis", Malaysia's policies have also ensured stability and predictability for investors, according to Bloomberg.

Malaysia has also instituted changes and restructuring on its own. The key point is that something is being done in Malaysia. The measures are finally being given due recognition by foreign fund managers who are beginning to view the Malaysian bourse and economy in a better light.

While the Malaysian bourse may have lagged behind its neighbours earlier the performance of the regional markets and their differing response and reaction, first to the fall in Dow Jones earlier in the week and then to Greenspan's comments on US interest rates, proves that Malaysia's policy, including capital controls, have helped to insulate the economy from external shocks.

It was said that controls will not work. Among others it was argued that a black market for the ringgit will develop and that there would be leakages which would render the controls ineffective leaving the economy in a worst state.

It was also said that once the one-year period was up, funds would rush to the door. But "When in September the Government let investors start pulling out money that had been trapped by currency controls the previous year, few fund managers headed for the door".

The responses and reaction to Malaysia's policies are different and less critical today. Among others, the bulls on the KLSE show that there is greater confidence that the country's economic fundamentals remain intact and investors are coming back.

The latest IMF staff report "Country Experiences with the Use and Liberalisation of Capital Controls" notes that the wide ranging nature of the measures (capital controls) and their strict and effective implementation have been instrumental in effectively eliminating the offshore ringgit market and thus in contributing to the containment of the speculative pressures.

"The relatively favourable economic fundamentals of Malaysia at the outset, the authorities' efforts to disseminate information to increase the transparency of the controls, and their efforts to accelerate the strengthening of the financial sector, also seem to have played an important role in improving the acceptability of the measures both domestically and internationally.

"The general return of confidence in the region, the sharp improvement in Malaysia's external balance, and the ex-post under valuation of the ringgit following its peg to the US dollar also seem to have reduced the incentives for circumvention," the IMF concludes.

Even so, some analysts say that the KLSE is still not in the "major investment club and is driven by retail" but acknowledge that the market is "safe". It has been rendered safe not by accident but due to deliberate policies and actions.

The unorthodox policies have started to yield positive results. Even as the KLSE in particular, and the economy in general, continue to attract more funds, both local and foreign, it is important that the lessons of the crisis are not ignored and forgotten.

It is easy to get caught in the euphoria. But the massive tide of capital flows that move in and out and across borders almost instantly can leave behind a trail of devastation and damage and cause untold suffering to innocent people and destroy economies that took governments and policy-makers decades to build.

Now the rising KLSE has brought smiles on many faces and the rush to own a piece or a share in the "new economy" may be driving many into the market. But it is important to remember the lessons of "events such as the

currency crisis in 1997 (which) unleashed global changes that began to develop a momentum of their own". These changes must be dealt with, on a national, regional and international level, even as the "new gold rush" begins.

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