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Ringgit peg provides necessary stability

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THE certainty of a fixed exchange rate provides the stability to get things done.

"How can you determine the exchange rate based on short-term developments?" a banker asked, referring to the fluctuations of regional currencies in recent weeks.

In the ongoing re-pegging debate, advocates of the current RM3.80:US\$1 peg are getting their chance to take the stand.

Following recent calls for the re-pegging of the ringgit, Prime Minister Datuk Seri Dr Mahathir Mohamed, Finance Minister Tun Daim Zainuddin and Bank Negara have all reiterated their wish to stick to the current peg.

"(Yes), something has to be adjusted. (And) we can bear with the adjustment in our reserves," said a senior central bank official when explaining the recently announced dip in Malaysia's foreign reserves.

The reserves dropped to US\$27.2 billion (RM103.3 billion) as of March 31, from US\$28.7 billion (RM109.3 billion) as of March 15. It is adequate to finance four months of retained imports and is 5.9 times the short-term external debt.

Contributing factors included the appreciation of the US dollar, higher import payments, for goods, services and transfers, as well as portfolio outflows.

In ABN Amro Economic Research's second quarter report for this year, the Singapore-based firm said the level of foreign reserves is a potential key trigger point in the authorities' decision on the peg.

However, the researchers insinuated that only a drastic fall would spark off the decision. "Any drastic fall to, say, US\$20-US\$25 billion, or about three months' import coverage, would trigger a reassessment."

It is understood that before the quarterly BNM report was due, the reserves were showing an inflow of funds.

"These are solid inflows. We have foreign direct investment commitments and some export earnings coming in. But the inflow was disrupted by the weakening yen," said the bank official.

Even the ABN team noted that the second trigger point for Malaysia to abolish the ringgit peg would be if Japan were to run an aggressive weak yen policy. A fear that was put to rest on Tuesday.

"We think that the worst case scenario of US\$1/130 yen in the second quarter of the year is still manageable. Malaysia's competitiveness has not been severely eroded yet despite a stronger US dollar.

"We estimate that, on a nominal effective exchange rate basis, the ringgit is only 5.3 per cent higher than in the second quarter of 2000. Indeed, the ringgit NEER's appreciation has been a manageable 6.2 per cent, compared with the fourth quarter of 1998 just after exchange controls were imposed," the ABN Amro team said.

According to the report, the authorities had earlier suggested that a realignment might be necessary should the ringgit be overvalued or undervalued by around 20 per cent.

(Re-pegging proponents have put the ringgit's value at RM4.20, or a 10 per cent devaluation.)

For now, the ABN Amro team seems to agree with the authorities' decision not to abolish the peg just yet.

"The peg introduces certainty, given that 85 per cent of Malaysia's trade is invoiced in US dollars," it said.

