

19/04/2001

Why we need to maintain ringgit peg

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LIPSTICK from Spain, pasta from Italy, persimmon from New Zealand and coffee from Australia. This is just one retail company's shopping list.

Everyday, someone, somewhere is making a list of things to buy where the accepted payment is "US dollars only, please." The transaction could be between Kuala Lumpur and Bangkok but instead of ringgit or baht, the currency changing hands is the greenback.

Even Malaysia Airlines pays Petronas for its jet fuel in US dollars.

Whether it is a retail chain importing goods to fill its supermarket shelves, a chicken farm buying foreign made chicken feed or a banker restructuring US-denominated offshore loans, they all keep a close watch on the conversion rate of the ringgit to the US dollar.

If you have been out of the loop, there is an ongoing debate on whether to let the ringgit peg stay at the RM3.80 against US\$1 or re-peg it lower, say, to between RM4.00 and RM4.20.

The advocates of a re-peg say the ringgit must be devalued in tandem with the declines in the regional currencies led by the weakening of the region's biggest exporter - Japan.

While the yen fell almost 15 per cent over the past year, the Thai baht, Korean won and Philippine peso are all down about 17 per cent. Indonesia's rupiah fell almost 30 per cent.

If the ringgit does not cheapen itself, products and services from its neighbours will be more attractive to foreign buyers.

But Prime Minister Datuk Seri Dr Mahathir Mohamed, Finance Minister Tun Daim Zainuddin and Bank Negara have all reiterated that there will be no change. The reason - changing the peg to follow the movement of other regional currencies goes against the fundamental reason for having it in the first place - to create a stable environment for business.

A Penang businessman, whose company imports wheat, soya bean and corn, remembers the days of the free floating ringgit. The time was late 1997 to September 1998 when the Asian economies succumbed to a combination of bad loans, widespread currency speculations and massive asset bubble.

"The ringgit ding-donged from RM2.50 to RM4.50. Do you buy at this price and later find out that if you had waited a few days more, you could have bought at 20 per cent cheaper or do you just wait and find out you should have locked in the price earlier because the ringgit had strengthened?"

"We are not currency speculators, we are genuine businessmen. We did not know what to do in a volatile situation like that," the businessman said, remembering the nightmare before Sept 2, 1998 when the ringgit was finally pegged at RM3.80.

Most research houses say the ringgit at RM3.80 is at fair value to the US dollar, or at most overvalued by five per cent. But then again, one can argue about the "right" valuation till kingdom come.

So let's move on to the reason behind the need to maintain the peg.

In ABN Amro Economic Research's second quarter report for this year, the Singapore-based firm said the peg introduced certainty, given that 85 per cent of Malaysia's trade is invoiced in US dollars.

"(Also) keeping the ringgit non-tradable in offshore markets and maintaining domestic exchange controls have allowed the authorities to maintain a low interest rate policy even after the US Federal Reserve finished cutting rates in the first quarter of the year."

United Overseas Bank Singapore head of investment research Jimmy Koh

said a ringgit re-peg would not help at all because of competitive devaluation of currencies within the Asian region.

"Allowing prices (of exports) to fall as a result of falling currencies does not solve the price issue as the benefit of devaluing the ringgit does not justify the risk premium of people pulling (their investments) out of Malaysia," he added.

That's the academic opinion, and businessmen agree.

Dutch retailer RA-PPB (Tops) Retail Sdn Bhd chief financial officer Frits van Peski said: "Although we do not import that much as we prefer to sell local goods, we do appreciate the stability that comes with the ringgit peg.

"To us, this shows that Malaysia remains a stable place to do business. It also means that Malaysia has the political will to maintain the peg. It is more a psychological effect than anything else. The certainty lets us plan our strategy minus any confusion," van Peski added.

A foreign hypermarket, which was recently rated the largest retailer of food and fast-moving-consumer-goods in Asia (outside Japan), is also comfortable with the peg.

The chain, which stocked its outlets with 80 per cent Malaysian goods, sees the RM3.80 to US\$1 peg benefiting its suppliers most.

"For example, we sell clothes and plastic containers supplied by the locals. It is the suppliers who have to source the raw materials like textiles and plastics from abroad."

"We rely on manufacturers to give us the best price. If the ringgit remains as it is, the suppliers will not have to pay more to get the materials. And we can pass on this cost savings to the end users," said an official of the company.

The HSBC Fixed Income Research Unit, in its recent fixed income analyst's report, dismissed the perception of export gains from a devalued ringgit, particularly in relation to the US.

It gave an example of a recent US semiconductor books-to-bills trend which showed a ratio of 0.77 last February. This means that US\$77 in orders were received for each US\$100 worth of products shipped, suggesting that, despite currency weakness among Asian producers, no buildup of orders is apparent as yet.

In other words, in a demand-led US economy, the success of Malaysia's export of electronic and electrical goods depends less on pricing than outright demand, particularly where US businesses are concerned.

But facts and figures aside, there will be non-believers among us and sceptics will continue to undermine the decisions made by Bank Negara and the authorities.

As someone once said, "At the end of the day, there is no formula, no black box nor any rule that can be relied upon for a central bank or a body entrusted with the task of taking care of a country's economic and financial stability to make a judgement call."

But more importantly, after making that call, the decision makers must have the determination and discipline to stick to it.

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