

Malaysia's real risk is complacency with peg

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MALAYSIA'S fiscally sound and growing economy, with manageable debt and political stability, deters parallels with Argentina, and its main risk is complacency with a fixed currency peg that has delivered so far.

Even then, international investors should have been reassured when Prime Minister Datuk Seri Dr Mahathir Mohamad, who at 76 is also acting finance minister, said last Friday he was ready to think again if a weak yen shifted the ground beneath his central policy plank.

"When you go to these fixed exchange rate regimes, you have to have an exit strategy — a Plan B. Argentina didn't have that," Claudio Piron, head of foreign exchange strategy for Standard Chartered Bank in Singapore.

Malaysia avoided recession in 2001, although the global technology sector slump caused its growth engine, the electronic and electrical goods exporters, to splutter.

The 0.5-1 per cent growth forecast for 2001 hardly compares with 2000's 8.5 per cent, but the economy is expected to pick up to 3 per cent this year and there are no visible worries for the ringgit peg among Malaysia's macroeconomic numbers.

PK. Basu, chief economist for South-E&T Asia at Credit Suisse First Boston believes

He also believes for all the apparent satisfaction with the part played by the ringgit, deliberately undervalued when it was fixed at 3.8 per dollar 3 ½ years ago, in the recovery from the Asian crisis, that there is no dogma attached to the peg.

"My view is that Malaysia will eventually abandon the peg from a position of strength," Basu said.

Two indicators which have to be restored to sustained positive territory before that position is reached will be year on year growth in exports and industrial production, he said.

Dr Mahathir's comments were aimed at Japanese Prime Minister Junichiro Koizumi, who was on a tour of South-East Asia, but come at a time when Argentina was giving fixed exchange rates a bad name and Malaysia could not escape some scrutiny.

His comments caused a temporary itch in both the local stock and the Asian bond markets, before investors quickly concluded that Malaysia's economy was not being run by a gaucho.

"Malaysia: No tango with Argentina," Development Bank of Singapore (DBS) said in a market research paper.

Argentina went through long years of recession before last Friday's 41 per cent devaluation of the peso.

It was also handicapped by onerous foreign debt, a weak banking system and an unsustainable fiscal deficit, social instability thanks to unemployment of nearly 20 per cent, and political instability that has seen five presidents in two weeks.

Unemployment is not a big nearly US\$31 billion (US\$1 = 1997 RM3.80) are six times short lion people has been close to term external debt, and

mestic product.

Should an external shock suddenly send Malaysia's balances haywire there would be a question how fast the authorities would react. Dr Mahathir is closely identified with the currency peg.

In September 1998, he spurned advice from the International Monetary Fund, alienated foreign investors by fixing the ringgit and introducing capital controls.

Capital controls have been rolled back since, but the peg remains and the Government is clearly content with the certainty it affords in the uncertain world of international finance.

Even if an external shock forces Malaysia into a devaluation, the consequences are unlikely to be that dire.

"I don't think a devaluation would significantly erode Malaysia's public sector net creditor position, which is one of the strengths of the sovereign," said Liew Chih Wai, ratings specialist at Standard & Poor's (S&P) in Singapore.

S&P rates Malaysia foreign currency debt at Triple "B" with a stable outlook, putting it in the investment grade league.

Most portfolio investors are underweight Malaysia at present, and foreign direct investment inflows are less than in the 1990s.

"I don't think there are the capital inflows to rip out of the system that there were in 1997," Standard Chartered's Piron said

Malaysia has enough reserves to defend the ringgit, which cannot be sold short on the foreign exchange market, should any unforeseen pressures emerge.

It's nothing like Malaysia.

Dr Mahathir has held Power for 20 years, and when he eventually goes his multi-ethnic coalition is expected to remain in power.

full employment, and when growth slows the first people to be laid off are foreign workers.

Debt levels are no great hardship. International reserves of

Malaysia runs a sizable current account surplus.

Total foreign debt is just over US\$41 billion, equivalent to nearly 46 per cent of gross do-

Basu was similarly sanguine about the impact of a devaluation, which he thought unlikely in any case. "There are very few negative ramifications," Basu said. — Reuters