

Malaysia mirrors Asian economic hopes, challenges

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TOKYO: Malaysia, *truly Asia*, runs the government's tourism slogan. The same goes for its economy.

Riding a wave of renewed foreign interest, Malaysia is poised to benefit, like its neighbours, from a pick-up in global demand, which will complement the robust consumer spending that is an increasing feature in other economies like Korea and Thailand.

But some economists say Malaysia is all too typical in less flattering ways. In common with much of Asia, it faces a fierce competitive threat from China and will need to work hard to turn an unfolding cyclical upturn and investment rerating into a solid platform for sustained out-performance.

"Pressing competitiveness issues, together with various internal structural rigidities such as a heavy reliance on electronics exports, a property overhang and the shortage of skilled workers, could substantially limit longer-term growth," Aileen Wong, an economist with Deutsche Bank, said.

Those concerns seem very much on the back burner for now.

Helped by an influx of funds from foreign investors taking profits in other South-east Asian markets, the Kuala Lumpur Stock Composite Index has roared to 20-month highs and is up by about a third since early November.

"Malaysia is clearly back on the investment map," Credit Suisse First Boston's Malaysian equity analysts.

"From 1998 until the end of 2001, the telephone barely rang in CSFB's Kuala Lumpur office. Things are very different now."

Strategists cite several reasons for the turnaround.

Investors have taken heart from improving corporate governance and US plaudits for the tough line Prime Minister Datuk Seri Dr Mahathir Mohamad has taken against terrorism, a stance that has earned him an invitation to the White House next month.

Last year's devaluation fears, when Malaysia was bleeding foreign reserves, have faded along with signs of global recovery and Malaysia has won port-handling and electronics-manufacturing business from Singapore.

"With the external cycle now showing signs of recovery, all the stars are aligned correctly for the start of a new business cycle," said Adam Le Mesurier of Goldman Sachs in Singapore.

"Malaysia was last in such a position in 1988, at the start of what became nearly a decade of uninterrupted growth," he said.

He said consumer spending was likely to be the main driver of growth because Malaysia's current account surplus and huge excess liquidity in its banking system would help to keep real interest rates low for a long time — conditions that he said were extremely bullish for Malaysian asset prices.

Graham Parry, a regional economist with Lehman Brothers in Tokyo, said Malaysia has done more than most to repair the damage to its banks inflicted by Asia's 1997 crisis, while corporations are regaining the balance-sheet strength needed to expand anew.

While other countries hit by the 1997 crisis knuckled down to austerity programmes overseen by the International Monetary Fund, Malaysia ploughed its own furrow by snubbing the Fund, pegging the

value of its ringgit currency at 3.80 to the dollar in September 1998 and slapping on capital controls.

Although the curbs on foreign investors have been rolled back, losses inflicted left a sour taste in many mouths that is only now fading.

With all of South-east Asia scrambling to meet the China challenge, Parry said Malaysia had to continue to make itself an attractive proposition for foreign direct investment.

"That has not always been the case. There are still people who haven't forgotten the capital controls period, and that has kept Malaysia off some people's radar screen," Parry said.

Just as Dr Mahathir resisted pressure to float the ringgit when the economy was weak last year, Parry does not expect him to lift the anchor any time soon now that the outlook is brightening.

Most economists would agree — but not all.

Le Mesurier, who says undervaluation fears are likely to mount as growth accelerates, said a flexible exchange rate would make it easier for Malaysia's central bank to consistently run an independent monetary policy.

Jim Walker at CLSA Emerging Markets said abandoning what Washington views as a misconstrued policy would complete Dr Mahathir's rehabilitation in American eyes, opening the door to renewed portfolio and direct investment in his country.

"Were Malaysia to break the peg today... its leaders would be lauded as good economic managers as well as friends and beacons," he said.

Reuters