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Ringgit peg to greenback will survive pressure of sliding yen

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MALAYSIA'S 40-month-old ringgit peg to the the US dollar will survive the pressure of a weak yen that has tumbled to its lowest level in more than three years, according to economists.

They suggested a wait-and-see attitude towards the much-discussed possibility of a review of the peg should the Japanese currency weaken to 140 to the US dollar.

The yen dropped for the seventh consecutive day against the dollar to 134.21 yesterday.

The Japanese unit has been inching ever closer to the 140 level against the greenback, which has become the recent watch spot with regard to the future of the ringgit peg.

Talk of a potential review of the peg was fuelled further following recent comments by Prime Minister Datuk Seri Dr Mahathir Mohamad that the Government may have to look at the situation if the yen hits 140 and if China's yuan was devalued.

"First of all, why the 140 level? At one point, people were talking about 130. And if it does hit that level (140), there is the important consideration of how long will it stay there," said an economist with a government agency.

Historically, the yen never stayed too long at such low levels, economists said.

"Many other factors must be taken into account. That level may come and nothing may happen. Then, people will move on to the next perceived level at which they speculate a review will take place," the economist said.

Bloomberg reported that the yen fell as US Treasury Secretary Paul O'Neill opted against using a speech in Tokyo to rebuke Japan for the four-month tumble in its currency, suggesting he may ignore complaints from American exporters about the slide.

Some traders had beefed up their yen holdings earlier, expecting O'Neill to urge Japan to strengthen its currency. He stopped short of that by saying instead he thinks that trying to boost exports with a weaker yen will not lift the world's second-biggest economy out of recession.

In a recent report, local stockbroking research house, CIMB Securities noted that the country's level of competitiveness remains intact.

Despite an appreciating nominal exchange rate, the report noted, Malaysia's price-adjusted exchange rate, or real effective exchange rate (REER) - which measures competitiveness - is still below the October 1998 and even the January 2001 levels.

"This is because domestic prices have adjusted accordingly to maintain our competitiveness," the report said.

Economists and analysts rely on NEER (nominal effective exchange rate) or REER to observe a currency's trend. NEER and REER are trade-weighted indices, which show in general terms whether a currency is appreciating or depreciating.

On September 2 1998, Malaysia abandoned managed float operations to adopt the pegged exchange rate arrangement for the ringgit, fixing it at RM3.80 to US\$1.

The move, triggered by 1997 Asian financial crisis, was designed to reduce the ringgit's exchange rate volatility and to promote a stable environment conducive to economic recovery.

On the day the ringgit was pegged, the yen was trading at 138 to the US

dollar.

Just two weeks before, on August 11, the yen hit 147.26, which remains the lowest point for the Japanese currency against the US dollar since the middle of 1990. Then, the lowest point was on April 17 1990 when the yen touched 159.9 to a dollar.

"We believe that the ringgit de-peg issue has been blown out of proportion and our peg system is not under great pressure to be reviewed at this time," said Azrul Azwar of research firm MIDF Sisma Securities.

He said the credibility of a peg system lies in the ratio of the country's foreign reserves to its narrow money supply. For a peg system to work, international reserves held by the central bank should at least cover the whole of narrow money.

Last Tuesday, Bank Negara Malaysia said the rising trend of its international reserves continued into the first half of January 2002, increasing to RM117.8 billion or US\$31 billion at mid-January, increasing RM575 million or US\$151 million from the previous fortnight.

He said some observers feel that a weaker yen policy to support Japan's ailing economy may "rob" other export-dependent countries of growth potential, which in turn could have a spiral effect on regional economies if the whole of Asia is caught in the weak-currency game.

CIMB Securities noted that, generally, developing countries such as China and Malaysia which require infrastructure development and where the role of imported input is essential, may not benefit so much from devaluation.

The pegged exchange rate is envisaged to provide a stable financial market environment, in particular to avoid the necessity for domestic monetary policy to shadow the tightening cycle of US monetary policy in spite of the dollar/ringgit peg.

As observed by the central bank in its annual report for 2000, the accommodative monetary policy was able to provide the foundation for the strengthening economic fundamentals as reflected in the substantial current account surplus, high level of reserves, low inflation rate, and improved business and consumer confidence.

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