

13/10/2002

US 'economic locomotive' losing steam

P.Y. Chin

JUST after the 1997 financial crisis, a fortune teller pre-dicted that three to five years down the road, the world economy, and Malaysia's, would struggle under a cloud of uncertainty.

Well, he didn't say anything about the US economy now possibly heading for a "double dip" recession, and probably pulling almost every other economy along with it.

Now with admirable hindsight, the same fortune teller tells me that the Malaysian economy, and possibly that of some Asian economies, would only see some sunny days come 2008.

But as a close friend told me the other day, "In bad economic times, fortune tellers have good business."

Fortune tellers aside, we should perhaps look at these topics: Is the Malaysian economy really suffering? Or are we suffering and yet denying we are not? Where is the Malaysian economy heading? Are we seeing a light at the end of the tunnel? Or are we just seeing a bright reflection?

Prime Minister Datuk Seri Dr Mahathir Mohamad correctly said early last month, a year after Sept 11, that the world has become even more uncertain and insecure.

With the Afghan war simmering, and the Iraq war looming, economic uncertainty and insecurity have taken centre stage.

Singapore Senior Minister Lee Kuan Yew, writing in the Oct 14 edition of Forbes, said that events, since the fall of the Taliban and al-Qaeda forces, had "littered the future with uncertainties".

He said: "Pessimism was not so contagious a decade ago, before fund managers and multinational corporations worldwide were linked to their head office in New York or Silicon Valley by computer 24 hours a day."

A single hint of pessimism in one obscure corner of the world today could spread like a computer virus within 24 hours.

The aggressive military stance and the relentless political ravings of the United States can be heard all over the world now, unnerving international businessmen and investors, making the future even more uncertain.

It not just the beating of the military and political drums that affect the economy.

The lockout in 29 ports in the West Coast of the US has not only presented the US economy with a US\$2 billion (RM7.6 billion)-a-day disaster, but has also caused havoc to world trade, with Pacific Rim specially affected.

The consequences from the 10-day lockout have yet to sink in. Production has stalled, and there have been layoffs in some instances.

Empty containers were stuck in the US, unable to reach where demand was greatest. Companies are saying that profits might not come in this last quarter.

Worse still, Asian economies were already talking then of reduced growth rates for this year, some by as much as half a percentage point.

The 10-day lockout brought home the stark reality that world trade is so highly depended on only one form of transport.

If something were to happen to just a few ports in one continent, importers and exporters worldwide are affected.

Last week's explosion that started a fire on board the oil tanker MT Limburg was another example of living on the edge. What came immediately

to mind was whether terrorists had struck, like they did against the US warship USS Cole.

There is already talk of higher marine insurance rates, just like the higher insurance rates for airlines after Sept 11.

The day after the explosion, crude oil price climbed back to about US\$30 a barrel, waiting to jump higher at the slightest hint of trouble on the high seas.

Many are also aware that a US-Iraq war would see oil price hitting the roof, just as during the 1990-91 Gulf War when prices peaked at nearly US\$40 a barrel.

Such a hike will certainly push the global economy into recession faster than expected, and it will be a deep plunge, according to some pessimists.

The US economy, a year after Sept 11, seems to be in shambles, with a chronic and dangerously bloated current-account deficit at US\$242 billion in the first half of this year - an amount that is almost five per cent of the gross domestic product (GDP).

And should the war in Iraq erupt, the cost to the US, according to presidential economic adviser Lawrence Lindsey, would be US\$100 billion to US\$200 billion - which is one to two per cent of the United States GDP.

Small wonder these days that some are arguing that the US economy is losing steam as the locomotive that pulls other economies.

With its economy teetering on the brink of recession (or "severe slow-down" as officials would like to say), where will the US economy get its strength to pull all the other economies along?

George Soros, president of Soros Fund Management, said: "The US serves as the motor to the global economy. The US motor is spluttering. It would benefit all parties to start another motor."

The question is where to find "another motor". As Lee said: "Japan has not been able to get out of its economic malaise. The European Union is unable to pick up the slack."

Indeed, the latest is that Japan's recovery is under threat "as the US economy is hobbling exports and the Japanese stock market is dropping to a 19-year low".

Despite that, Lee feels "the US must demonstrate leadership in the economic field, as it has done in the military".

He said the US still would want "further trade liberalisations" judging from the "passing of a wide-ranging Trade Promotion Act".

This begs the question of how important the US market is to Asia, particularly Malaysia.

Last week, BNP Paribas chief economist for Asia-Pacific Fixed Income and Treasury, Dr Andrew Freris, thought this role had been over-rated.

"The fact remains that although the US is undeniably important to Asia, it is not important as how much Asia matters to Asia," he said.

Though he spoke what his Asian audience would like to hear, he did have a point when he said that although the US economy had gone into a recession for three quarters last year, most Asian economies did not.

To him this suggested that the process of decoupling of the Asian economies from the US had already begun.

He rightly pointed out it was "a perception" rather than the reality. But it may be difficult for him to explain that when the Dow Jones on Wall Street in US fell drastically, most Asian markets follow suit. Again, this could be "a perception", but a very long-held one that has now become a mindset.

While foreign ideas are good to take note of, Dr Mahathir has a better suggestion - Asian countries must come out with Asian solutions to solve their own problems.

His argument is that "Asian civilisation has survived longer than

others. We must be brave enough to go our own way".

No doubt Malaysia will use the success of its exchange control measures that have insulated its economy from the ravaging currency fires of 1997 as an example that self-help would be the best policy in the most trying times.

Pegging the ringgit to the dollar at RM3.80 and imposing exchange controls, which by now have been watered down, have largely worked for the Malaysian economy.

Critics are quick to point out that the measures merely postponed the pain and the sufferings will come in due course.

They point to severe reductions in inflow of foreign direct investments, shifting of factories out to neighbouring countries, retrenchments in uncomfortable numbers, and poor stock market performances.

What's significant is that of late, there have been renewed calls for the ringgit-dollar peg to be lifted, with comments from analysts (some of whom obviously have their own agenda) pointing to the negative effects of a prolonged peg.

Economic textbooks list the negative effects as well as the positive effects but these critics chose to omit the positive effects in their comments.

It is unlikely that the peg will be lifted in the immediate future, as the global financial system is still very much in disarray. There has been lots of talk but no action on a firm orderly structure that could prevent a recurrence of the 1997 currency crisis.

Soros warned last week that "the international financial system has broken down" and if this was not addressed urgently, "the situation could deteriorate further and perhaps culminate in a systemic crisis".

He argued that the global financial system had failed to provide "adequate capital to countries that need it most and qualify for it".

"Global markets suck most of the world's savings to the centre, but do not pump money back out to the periphery," he said.

Under the circumstances, Malaysia cannot be expected to lift the dollar-ringgit peg.