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Top marks for Zeti as Bank Negara Governor

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BANK Negara Governor Tan Sri Dr Zeti Akhtar Aziz last week indicated that the Malaysian economy strengthened in the third quarter with the Gross Domestic Product growing at 5.1 per cent.

The announcement by Zeti was something expected of a Bank Negara Governor, though towards the later part of his term as Prime Minister and Finance Minister, Tun Dr Mahathir Mohamad made such announcements.

Dr Mahathir had, during the turbulent economic times in 1997-98, when George Soros, currency manipulators and others plundered many a nation, become the forebearer of economic news, announcing to the nation the economic figures instead of Bank Negara.

Perhaps the announcement by Zeti, besides the GDP figures, also gives an indication that the economy is back on track and moving ahead, and Prime Minister Datuk Seri Abdullah Ahmad Badawi is confident that the central bank does not need his personal and direct attention.

Under the leadership of Abdullah, who has also taken over the Finance Ministry portfolio which oversees Bank Negara, we could be hearing more from Zeti, the first woman governor of Bank Negara.

Abdullah and his financial and economic teams would surely know that the reputation of Bank Negara is essential for it to act effectively as the main policy institution for the country's monetary and banking sector.

Besides the announcement last week that the nation's economy is healthy, Abdullah's action in allowing Bank Negara to be the forebearer of economic and financial news, helped elevate his image a few notches among local and foreign fund managers and institutional investors.

If the figures are anything to go by, during the third-quarter Malaysian companies operating abroad repatriated about RM1.6 billion home, while net portfolio investments grew to RM3.6 billion against RM600 million in the second quarter and an outflow of RM1.9 billion a year ago.

Could these figures reflect a return to confidence that local and foreign businesses and fund managers have in Malaysia?

Zeti, being a senior member of the Government financial and economic team, is certainly constrained when it comes to making public announcements. As the head of the country's financial and banking sector, whatever Zeti says is always studied closely by the financial and banking sector, who view her pronouncements as the official stand.

But that should not stop Zeti from making a name for herself, as well as making known to the international arena of high finance that she is the person who sets Malaysia's banking and monetary policies and direction.

Abdullah has yet to identify openly his financial and economic team. Even who the new Finance Minister will be, if there is to be a separate person holding the portfolio, still remains a closely guarded secret. There are already a number of professionals around, Zeti included, eligible for the job, unless Abdullah prefers to have his own candidate.

Many gave Zeti top marks when, three weeks ago, at a regional summit in Singapore organised by US investment house Morgan Stanley, she voiced her opinions on a number financial and banking issues affecting the region.

She cautioned that raising interest rates to rein in asset price inflation in Malaysia and elsewhere would damage economies and financial systems.

She was also reported to have dismissed concerns about easy-money policies in the face of rising consumer debt, saying that a greater danger

than consumer debt would be premature increases in interest rates.

She was right in maintaining the stand that a rate hike at this time of low inflation, high unemployment and excess capacity in major economies would be inadvisable.

Zeti was the first central bank governor in South-East Asia to resist, as US Federal Reserve chairman Alan Greenspan had done a few days earlier, global pressures to raise interest rates.

Not that taking such a stand on interest rates would send a strong message to powers-that-be at home that it would be premature to even consider such a thought, but more that interest rates in Malaysia are relatively high compared to those of Western economies.

So until interest rates in the Western economies, which are almost zero, rise to the levels in Malaysia, which are a few percentage points above zero, it is unlikely that Bank Negara will consider revising interest rates.

Already, according to a report, many economists looking at the Malaysian economy do not see any increase in interest rates, at least not until the third or fourth quarter of next year.

This coincides with expectations a few months ago that Bank Negara would play with interest rates only sometime in the middle of next year.

Last week, Zeti put to rest any ideas of raising interest rates in the immediate future. She said that while growth would be expected to remain rosy, Bank Negara would likely maintain current rates.

Her words, like most other central bankers, were clouded in central bank jargon: "Interest rates will remain supportive of the current environment."

Essentially, this means she will not raise interest rates for the sake of raising them, as there are still excess capacities in the system, inflation would not be a threat, and there is an absence of a property bubble.

Whether interest rates will be raised will depend on the speed at which the Malaysian economy grows by the second and third quarters of next year.

Going by Zeti's announcement that GDP is growing by 5.1 per cent, the GDP would have been growing at 4.7 per cent on average for the first three quarters.

To meet expectations of an overall GDP growth of at least five per cent for the whole year, the fourth quarter needs to grow at 5.9 per cent.

Zeti noted that fourth-quarter performance was traditionally strong and that indications at the halfway point of the present final quarter were good.

This certainly augurs well for Abdullah who has taken over the premiership at a time when prosperity seems to be returning to the Malaysian economy.

It is also the right timing for a general election, as history has shown that the incumbent party wins hands down in a general election held during a recovery or boom-time.

One other factor in raising interest rates was explained in an article in the British magazine *The Economist* which said three weeks ago that although the UK economy could withstand an increase in the interest rate, consumers might not be so happy.

Extending this argument to Malaysia, consumers, be they house-buyers or businessmen, would certainly be unhappy if Bank Negara ups interest rates now, especially with the general election said to be around the corner.

These are the kind of political parameters within which national monetary policies have to operate, policies Zeti understands very well. Just like the issue of the ringgit peg, where her stand is that Malaysia will not review its policy.

If the reason is the general election, then a review could be premature now.

But if the reason is that there is still no stable and firm international financial architecture to keep currency speculators in check, even six to seven years after the 1997-98 financial crisis, then the ringgit peg should not be dismantled.

The peg, which was meant to insulate Malaysia against the firestorms of currency speculations, has worked so there's no reason to change something that works.

Zeti's arguments were sound when she was reported to have said that as a highly open economy it was important for Malaysia to have external price stability with a predictable mechanism, unless there is a major structural change.

She maintained that other countries would have to review their currency arrangements as well, if Malaysia reviews the peg.

It is right that Zeti took this stand, as in the past few months there have been considerable pressures from the US on Asian countries, notably China, to adopt more flexible exchange rates.

The US feels that the Chinese yuan exchange rate had been under-valued, given China's huge foreign exchange reserves, which by end-June had skyrocketed to US\$346.5 billion (RM1,316.7). But China has refused to budge.

To her critics, Zeti's stand might not be new, as it is similar to those of other Asian central bankers.

But the arguments are valid that adjustments in exchange rates will not correct global current account imbalances - the US has a huge deficit, while many Asian countries have big surpluses.

She argues that such a correction could only happen in a world in which exchange rate changes interact with just trade flows, but in today's world, financial flows also enter the picture as well.

She suggests that resolving global current account imbalances would need higher levels of saving, lower budget deficits and other structural changes in major economies - a view very much in line with what Greenspan complained about.

In his last speech to the Securities Industry Association annual meeting in Florida three weeks ago, Greenspan expressed fears of a dangerous deterioration in the US federal budget.

After a surplus in 2001, the US budget is expected to record a deficit as high as US\$400 billion this year.

Zeti also reiterated that "we are part of the same team", when referring to the smooth transition in managing the Malaysian economy under Abdullah.

Continuity will be the hallmark of economic policy under the new Prime Minister and it is unlikely that drastic changes will be made to the present economic, financial and monetary policies - unless the world economy spins in the opposite direction.

But eventually, changes will have to be made, depending on the outcome of the global economic climate, especially in the next six to nine months, which will be a time when the general election is over and a new Budget, the first by Abdullah, is due.

By then, Greenspan would have resorted to raising interest rates, opening up a new global economic ball-game and Zeti would be riding the next wave of economic recovery to another round of prosperity.

Her skills in micro-managing and fine-tuning the financial and banking sector would be much needed, and her ideas in dealing with successes in prosperity will be put to the test.