

Working towards full economic recovery

The following are excerpts from a speech by **Tun Daim Zainuddin**, First Finance Minister and Special Functions Minister, at the CLSA Malaysia Conference here yesterday on *What lies ahead?*

As we quickly approach the next millennium and the attendant challenges of the next century, it is of utmost importance that we reinstate the Malaysian economy back to the path of sustainable economic growth. This is our most important task.

It is particularly critical because the next millennium will be even more challenging, and the Malaysian economy will have to face intense global competition and ever changing markets.

That is why the government is so single-mindedly implementing the National Economic Recovery Plan which is aimed not only at addressing the crisis and its impact, and resuscitating the economy but also addressing structural economic weaknesses.

Among others, the economic recovery measures include a fiscal stimulus package to boost aggregate demand, a loosening of monetary controls tightened earlier but which did not seem to have the desired results, corporate restructuring and strengthening the financial and banking sector which is currently weak.

The broad thrust of the above measures is to restore business confidence and turnaround of the economy.

At same time, the government is committed to tackling the inefficiencies in the economy and structural issues that hamper the efficient and effective functioning of our economy.

The economy must be able to breathe free again if it is to function better in the new millennium.

In this connection, the issues we will have to tackle include the efficiency of capital and labour, the balance of payments and the maintenance of price stability.

Although the government's policy objective in the current Seventh Malaysia Plan was productivity-driven growth, alas it was not the case.

Capital and labour inputs rather than productivity seemed to drive growth during the years preceding the crisis.

This was manifested in low contribution of total factor productivity and an increasing incremental capital output ratio, both of which reduce the economy's long-run competitiveness.

The services account of the Balance of Payments where we have a persistent deficit in the services account also needs to be addressed.

The government will need to look into the implementation capacity too, since we have seen how despite the best intentions of fiscal expansion, there was a substantial development expenditure shortfall in 1998.

Government funds will also have to be cost-effectively spent, an issue which was not apparent in the times of boom when money was aplenty.

The government recognises that in order to restore market confidence and the sustainability of the economy,

fundamental issues that have affected market confidence will have to be rectified.

In this respect, we are taking steps to improve transparency and the regulatory framework.

There is also a perception of inadequate corporate governance. This will be redressed.

As you will see, we are serious about addressing the structural issues that face the Malaysian economy so that the recovery is not a superficial one.

We are hopeful there will be success, although when the recovery will actually come seems to depend so much on what happens elsewhere given the volatility of financial markets all over the world, and most recently in Brazil.

In addition, greater uncertainty has unfolded with the strengthening of the yen vis-a-vis the US dollar which would erode the competitiveness of the Japanese economy, reduce its exports and slow down its recovery, thereby stalling the pace of recovery of the "Asian crisis" economies.

In a way the effects of the Brazilian crisis could be averted by Malaysia given the presence of the currency controls which were instituted on Sept 1 of last year as well as due to the lack of strong economic and investment linkages between Brazil and Malaysia.

Nevertheless, we need to monitor the situation really closely as there still remains much uncertainty as to its effect on the global economy and the scale of the crisis.

The outbreak of the Brazilian crisis underscores very much what the Malaysian Prime Minister has been saying so long and which has been resisted so much, that there is the need to have in place a global mechanism to regulate the flow of short-term capital and oversee the role of hedge funds which have the capacity to wreck even strong economies.

This, I hope, will be the central challenge for world economic and financial leaders in the remaining year before we reach the next millennium.

That is why Malaysia had no choice but to institute what has become the famous, or if you like infamous, "currency controls" on Sept 1, 1998.

Currency controls is an issue which I feel continues to require clarification as even to this day I read some confusing and negative reports about it by individuals, analysts and investors.

I must say that our capital control measures do not warrant such harsh treatment that it has been subjected to.

Ours is actually selective exchange controls which are not in any way intended to affect the normal conduct of economic activity. They are not aimed at preventing the free flow of foreign capital.

Rather, it is aimed at containing speculation on the ringgit and minimising the vulnerable impact of short-term capital flows.

By this way, we hope to create an environment that is conducive for the restoration of investor confidence.

It also provides the country breathing space to undertake economic stabilisation measures.

In fact, those consulted including foreign and local companies agree that the capital controls have been mild and helpful.

Only the fund managers and certain media seem to have taken opposite views.

I sincerely wish you would rather take a longer term view.

The government has been receiving feedback regularly about the fear that come September 1999, there will be a massive exodus of capital from Malaysia which will have adverse effects on the economy (the so-called Sept 1 Syndrome).

This, it has been said, will put the recovery at risk. We are aware of this issue and the government is instituting an exit levy which will help portfolio investors repatriate their funds before the 12-month lock-in period. The government is always flexible in implementing its policies.

On a more positive note, I do not foresee really massive outflows of funds after the one-year moratorium. There is still a lot of profit to be made here.

The stock market is improving and the economic recovery process is in place.

The economy is moving again and the real economy is responding to the government's measures.

The 1998 third quarter numbers did indicate some bottoming out of the economic slowdown and we are expecting that the fourth quarter results will confirm the beginnings of an upswing.

The November 1998 trade statistics showed that there was a strengthening of export volume during the period September to November 1998.

This is a significant development as prior to that we experienced a few months of strong exports due to pri-

marily valuation gains from a weaker ringgit rather than increased export volume.

A trade surplus of about RM51.5 billion was also registered in the first 11 months of 1998.

We have also been getting positive feedback from traders and businessmen that they are better able to plan with the certainty provided by the fixed exchange ringgit.

And the implementation of exchange controls has provided Bank Negara with the flexibility to bring the cost of funds down; inject more liquidity into the system, and enhance the intermediation process to support economic recovery.

External reserves have increased to about US\$27.4 billion (RM104.12 billion) as at the end of December, which is sufficient to provide 5.8 months of import cover.

Prices on the KLSE have also improved. In fact, the KL Composite Index (CI) which was hovering around 262 points on Sept 1, 1998 has now shot up by 100%. This is indeed a psychological booster for the economy.

The strong linkages between the financial system and the real economy cannot be over emphasised.

The setting up of Danaharta, Danamodal and the Corporate Debt Restructuring Committee (CDRC) to a large extent are a recognition of this.

In the absence of loan growth, the prospects for economic recovery would be weaker.

That is why measures had to be taken to restructure the banking sector, remove non-performing loans from the system, recapitalise banking institutions and facilitate debt restructuring.

I am now glad to tell you that we are making good progress in addressing weaknesses in the financial system.

With respect to Danamodal, as of now a total of nine banking institutions (BIs) have received capital injection totalling close to RM5 billion. This will raise the capital asset ratios of these

banks.

Danamodal is also developing a blueprint for the Malaysian banking industry, which is expected to be finalised by February 1999. A total of RM21.8 billion of NPLs have been taken over by Danaharta to date. Both Danaharta and Danamodal will now be moving into the next phase of activity.

Danaharta will look into the management of the assets it has acquired, while Danamodal will meet the challenge of restructuring the financial institutions to make them stronger and more competitive.

The financial turbulence has badly affected our corporate sector. Corporate restructuring is a critical component in enabling viable businesses to continue to function and support economic recovery.

The CRDC was established to complement the roles of Danaharta and Danamodal to accelerate the pace of economic recovery by providing an approach to banking institutions to play a greater role in the financial rehabilitation of the corporate sector.

The steering committee of the CDRC has so far received more than 30 applications involving more than RM9.0 billion.

The government believes that in addition to measures taken to restructure and strengthen the banking system, banks should also assist the recovery process by providing credit where possible and to projects that are viable.

To this extent, Bank Negara has requested banks which have the capacity to lend to increase credit for the purchase of houses, cars and shares.

Although the banks expect loans growth of up to 8% by the end of 1998, we would like to emphasise that banking institutions will have to continue to observe sound banking principles and ensure that prudence is never compromised.

There are some early signs that things are improving. The private sector as well as the banking system have recently had the benefit of more liquidity and lower interest rates.

This has permitted an increase, albeit small, in bank lending. Some sectors are registering increases in the demand for their products.

Our external reserves position has improved and the current account of the balance of payments during the first six months of 1998 has registered a strong surplus of RM15 billion.

This surplus will help further strengthen the foundations for macroeconomic stability by boosting national savings and, thereby, reducing the need for external financing.

The economic outlook for 1999 will depend largely on the extent to which the economy and the economic actors respond to and take advantage of the government's stabilisation measures undertaken thus far.

Of course Malaysia being an open economy, our economic performance will also hinge greatly on external developments, particularly the performance of regional economies and OECD countries, which have significant trade and investment links

with Malaysia.

The government is forecasting that in 1999, the economy will recover, albeit mildly, and achieve a positive real growth of 1%.

Of course, the main source of growth is expected to come from domestic demand and to a lesser extent the external sector as we envisage the resurgence of imports in line with the recovery. In addition, there remains uncertainty with respect to the health of the world economy.

Any weakening or deflationary situation in the markets of our exports will have negative consequences on our external position.

From the supply side, all sectors save for the construction sector are expected to show positive growth although not at the rates we have been used to before the crisis.

I want to assure you that Malaysia's growth strategy in the next millennium will continue to be private sector-driven. The private sector will remain the growth locomotive.

I can assure you that the government will spare no effort in creating a conducive business and investment environment to stimulate private sector activities.

The private sector (both local and foreign) will have to continue to play its critical role in spearheading and sustaining growth in the future.

With the increasingly competitive global environment, private sector initiatives will have to be directed towards continuous re-investment efforts to expand and upgrade their existing operations, and diversify into more value-added activities.

The government will push hard towards realising the objectives of the Second Industrial Master Plan to strengthen the manufacturing sector and the New Agriculture policy announced recently which aims at revitalising agriculture and preparing the sector to play a vital role as a future source of growth. The services sector will be the new growth sector creating new value for the economy.

Let me express the view that participants at this conference of fund managers have a central role to play in the economic recovery of Malaysia.

Your confidence in the fundamentals of the Malaysian economy and the advice you give to your clients can influence the return of funds to Malaysia. Thus, it is important to see Malaysia in the right perspective.

The measures we are implementing are certainly aimed at strengthening the macro-economy and improving the financial and corporate sectors.

At the same time, concerted efforts are being made to improve transparency, corporate governance and the regulatory environment.

The economy is beginning to show signs of pick-up, and I can assure you there is money to be made in Malaysia.

We are confident that as we approach the next millennium our economic problems will be resolved and we will be able to work in unison towards shaping the new economy of the 21st century.

- Bernama

Of privatisation, transparency and corporate governance

This is a summary of the Q&A session between Tun Daim Zainuddin and foreign fund managers after he delivered his keynote address at the CLSA Emerging Markets seminar here yesterday.

Q: What is the Government's policy on allowing greater foreign ownership of local banks?

A: There have been no applications for this, but if there are any applications, they will be reviewed on a case-by-case basis.

Q: Will there be a shift in the Government's privatisation policy and its financing of these projects?

A: Our privatisation policy will remain. However, in the past, when companies applied for privatisation projects, in most cases, they would ask for a Government guarantee. In reviewing this, future projects must be bankable and the Government must not provide guarantees. It is not the role of the Government to bail out the private sector. This was an error before and therefore mistakes were made. Projects were not properly, and in some cases, not thoroughly, analysed, resulting in projects not being profitable. In future, studies will be made very carefully and privatisation projects must be viable and bankable on its own without Government guarantees.

Q: Will there be a review of the Government's policy on toll roads?

A: I don't agree with demonstrations. Once the Government enters into an agreement, it is binding. It is a legal document that cannot be changed. We have to be firm so that people know that the Government is committed to agreements it enters into. The public cannot have benefits from privatised projects without paying for them. In future, any privatised road projects will only go ahead after prior agreement on toll rates between concessionaires and users.

Q: How does the Government plan to rectify its services account deficit?

A: At present, freight and

insurance are not in the hands of Malaysians. We are looking at all sectors to ensure that there is not too big a deficit in the services account.

For instance, education - we are sending students overseas and this has resulted in a tremendous outflow of funds. The deficit also comes from foreign workers sending their money home. We will address all these issues as a package, but this will take time.

Q: Does the Government plan to resolve the "delivery versus payment" issue?

A: I have asked the Securities Commission and the Kuala Lumpur Stock Exchange to attend to this issue. I hope it will be resolved soon, by next week or sometime this week even. We are waiting for them (SC and KLSE) to respond.

Q: Will the 10% exit tax on profits after 12 months be a permanent feature?

A: We are getting feedback on this.

Q: How will banks achieve the 8% loans growth this year?

A: The 8% target is not a Government figure. People misunderstand this. It is actually a submission by commercial banks through the central bank. In 1997, loan growth was 30%, in 1998, loan growth target declined from 15% to 8%. In 1999, the target is 8%.

The Government, on its part, will encourage banks to meet this target as long as the loans are for projects in the productive sectors. Some foreign banks exceeded that target, achieving 16% loan growth. It is the banks which decide who they should lend to, but mainly, it should be for the productive sectors.

Q: How does the Government plan to finance its financial sector and corporate restructuring programmes?

A: We will borrow where the rates are cheapest. So far,

Japan has offered cheap rates. Singapore has offered reasonable rates but this is tied to water. We are interested in commercial transactions. We can't be borrowing on a non-commercial basis.

Offers have also come in from fund managers who want to raise cash in Europe and we are looking at these proposals. As long as it is a commercial transaction, we will consider it. But it cannot be tied to issues that are not related to economic recovery.

Q: Will the Government be reviewing the RM3.80 peg to the US dollar?

A: We are comfortable with the current exchange rate. More importantly, there must be restructuring of the international financial architecture first.

We will not interfere with the present exchange rate unless something drastic happens overseas.

Q: What is your view on transparency and corporate governance?

A: People like to complain and say we are not transparent. We are as open as anybody. I think the Government has been more open than most other Governments. People tend to say that politics is too closely linked with business.

This is not really so. You can see whether business figures that are close to the Government will be protected.

The Government is serious in taking action against those who break the laws and we will make sure everybody complies with the law, whether it is the corporate sector of the Government. But we don't want people to have the impression that foreigners are forcing us to do this. We will decide what action to take based on our laws.

Q: Do you think the reclassification period of non-performing loans for six months to three months is a sign of lack of transparency?

A: Some countries in the West also do not use the three-month classification period.

During the credit crunch, why did we introduce the three-month classification ruling? What was the basis for its introduction, to please whom? To kill the private sector, the Government?

When we changed it to six months, we announced it openly. In fact, Malaysia is the only country where it is written in the Constitution that we discriminate in favour of Bumiputras. This is done so people know the rules and if they do not object, they can come. Political stability is very important to us.

Q: What is Malaysia's relationship with the IMF and Singapore?

A: We see no problem with Singapore. Of course, as neighbours, we will settle our differences quietly and not through the press.

What is good for Singapore is good for Malaysia and vice versa. We have never said that we do not want to supply water to Singapore. We would like to supply water to Singaporeans in perpetuity, but we have to talk on the terms and conditions.

In the case of the IMF, they have to understand how we do things. They have given advice which is not based on reality. They can't tell us to close banks without understanding the political implications.

What good is a strong currency when there is no economy; when they are riots on the streets; people are hungry? The way we do business is different from the West. Each country has its own problems and it takes time to change the culture. Do not condemn us without giving us the chance to prove ourselves.

Q: Will the Government continue backing certain sectors as it did in the past?

A: The Government identifies sectors which can help in our economic recovery and be the engines of growth, such as tourism. Although the Government will provide incentives, it is up to the private sector to take the initiative and invest as they see fit.

Q: Will the Government be revising the classification for non-performing loans?

A: At this stage, no. We need the breathing space. At present, some banks are still using the three-month classification, such as Maybank and RHB. We give them this flexibility and we will not force them to use the six-month ruling.