

Can Najib stop impending ringgit, market meltdown?

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COMMENT Granted, the Asian currencies that have been weakening since May 2013 have been duly noted and the Malaysian ringgit's recent fall, in that sense, is in tandem with the regional currencies.

Many took comfort in observing that the depreciation is not a reflection of economic weaknesses but more as a result of the strengthening of the US dollar, that is, as a result of US bond purchase or tapering of the quantitative easing (QE).

malaysia stock exchange market klse 141008 05Some economists went further to treat it as a blessing in disguise in the form of finding our 'natural economic equilibrium'. While that may be arguably so, it is not entirely true or at best, only a half-truth. We couldn't resist noting that this position is too much of an apologia.

Already the Fitch Rating has mooted and alluded to the possibility of credit rating downgrading of both the Indian rupee and the Indonesian rupiah if their governments fail to halt the slump in investors' confidence and maintain financial stability.

The far-reaching implication on cost of funding and the impact on quality of life i.e. inflation and burden on debt repayment, must be fully appreciated. This is especially so if income and wealth divides have been widening, hence affecting the lower income group more severely and creating social tensions of sort.

While I am not forcing a similarity with the earlier (1997 financial) crisis, wouldn't it be better for the emerging economies to be more on the alert as to avoid the recurrence of a catastrophic currency crisis and subsequently a full-blown Asian financial melt-down seen in the late 90s?

Which countries are at greater risk if these currencies free-fall, and why? More importantly is to ask what could and should be done in order to halt the slump in confidence.

Malaysia at risk of 'infection'

For the record, the Indian rupee fell to 64.13 per US dollar (-13.67 % move) and the Indonesian rupiah fell to trade at 10,700 to the greenback (-10 % move), its lowest since April 30, 2012.

malaysia stock exchange market kls 141008 08After these two countries the next to be 'contagiously infected' would be those that have a combination of these factors: high fiscal deficits, high subsidies bill, slowing economies and high foreign ownership of government bonds. Malaysia and Thailand fit into these profiles.

Thailand's economy incidentally shrank in the second quarter of this year and in fact went into a mild recession. Thailand's baht touched a 13-month low of 31.72 per US dollar (-3.22 %move), its weakest since July 2012.

Let us now consider a closer snapshot of the Malaysian case. The following are our takes that have caused foreign investors to re-evaluate their exposure to Malaysian assets:

Economic growth is expected to slow to a five-year low in 2014

The ringgit has already been driven to three-year lows around 3.3 to the dollar, down more than 7% this year. Traders estimate the central bank has spent close to US\$1.3 billion (RM4.3 billion) to defend the currency in recent days

Selling spread on Tuesday to the Kuala Lumpur's stock market - usually seen as a regional safe haven - dragging the main index down 1.85%

While most economists expect the current account to remain in surplus, its sharp fall to RM8.7 billion in the first quarter from RM22.8 billion in the previous period removed much of Malaysia's perceived protection from heavy fund outflows

People weren't expecting the deficit to get anywhere close to zero six months ago. We had a five-year low trade surplus (plunging prices of Malaysia' palm oil exports and rising copper imports). The current-account surplus probably decreased to 900 million ringgit (US\$274 million) in the second quarter from 8.7 billion ringgit in the previous three months. There are some in the market who think Malaysia could post a current-account deficit in the next quarter, which is the first time the country is going into deficit since 1997, primarily due to weak commodity prices and weaning China demands

The government is silent on the much-needed reforms to fix a large fiscal deficit. The fact that the government remains relatively silent (with the new government's first 100 days just slipping by quietly without an economic master plan) may add more to investors' uncertainties and the ringgit weakness

Despite the proposed set up of a 'fiscal committee', the government must deal

more with the roots of the ringgit's weakness, which is due to a ratings downgrade due to public finance disorders, with lack of reforms to control Malaysia's household debt (83% debt-to-GDP ratio), government debt plus guarantees at 70% of GDP, and corporate debt at an alarming 95.8% of GDP. There is high evidence that debt growth has been faster than GDP growth since the last ten years, which can be the tipping point to send our economy into a vicious market instability spiral

We note that the month-long selling has pushed the 10-year Malaysian government bond yields to their highest in 2 ½ years (ten year bond yields have crossed 4 percent for the first time since early 2011), which can pressure borrowing cost and affect the local investors' world

Given that overseas investors held 33% of Malaysian government debt and 25% and Malaysian equities (among the highest proportion among Southeast Asia's biggest economies according to central bank data), we expect more capital outflows over the next few weeks, which could cause the ringgit to underperform and people to lose more of their quality of life. Foreigners have been selling Malaysian bonds, reducing their holdings from RM145 billion in May to RM138 billion in June, according to the latest data

Ironically, we observe that the local GLIC fund, pension fund and even local banks are purchasing less of Malaysian equities and bonds with most now focussing on overseas assets, which can be a serious worry.

Najib must act against meltdown

Hardly surprising that the Fitch ratings agency cut its outlook on Malaysia's sovereign debt last month, citing worsening prospects for fiscal reforms such as proposed cuts in the country's steep subsidy bill and a new consumption tax to reduce its reliance on oil revenues.

malaysia stock exchange market klse 141008 06We also notice there wasn't a strong counter ringgit policy response from the government, which is very important to spur investors' morale while breathing a positive perception into the fledgling new administration.

We believe the absence could be Prime Minister Najib Razak's strategy in response to the shrinking number of parliamentary seats won by BN and of course dwindling business electorate support (especially from the Chinese and urban middle class) which has dealt a certain blow on the PM.

Similarly, Najib faces a possible leadership challenge from within his ruling party in

Umno's party elections in October, raising uncertainty over his pledge to cut one of emerging Asia's highest budget deficits of 4.5% of GDP.

Hence, we strongly advocate that the government immediately release a counter ringgit response and to communicate with the business communities (investors, analyst and rating agencies) and come up with major manoeuvres within 48 hours to fix the country's economic problems, so as to arrest the impending ringgit, equity and bond market meltdown.

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