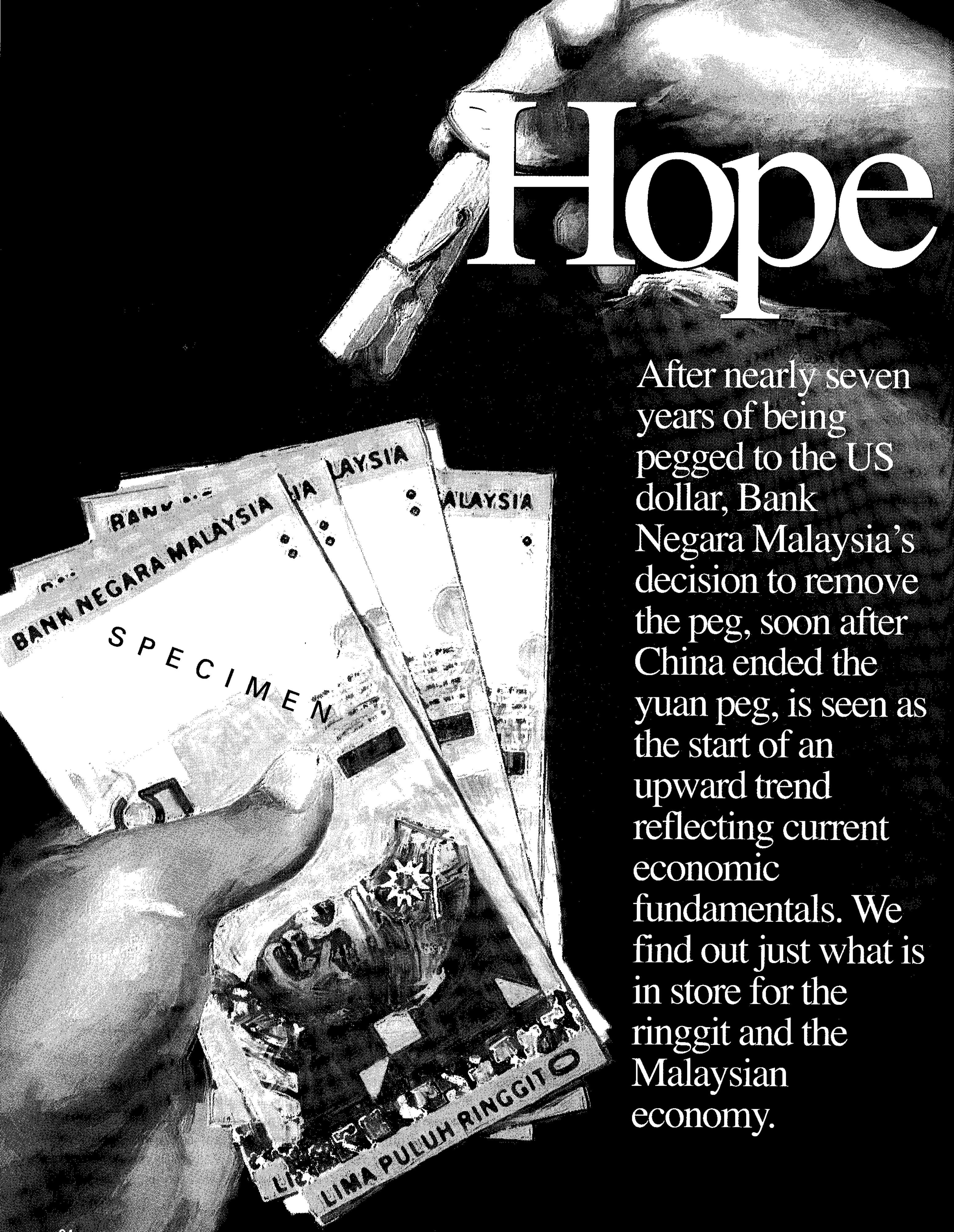



# Hope

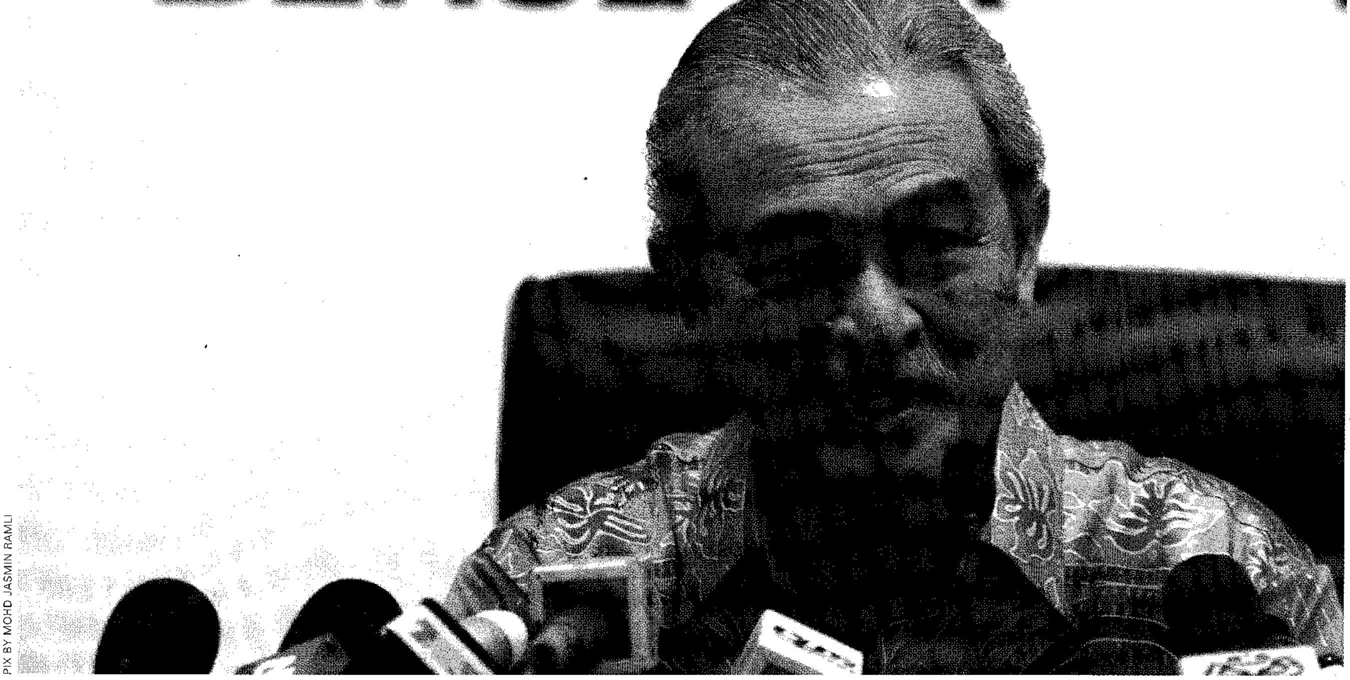
After nearly seven years of being pegged to the US dollar, Bank Negara Malaysia's decision to remove the peg, soon after China ended the yuan peg, is seen as the start of an upward trend reflecting current economic fundamentals. We find out just what is in store for the ringgit and the Malaysian economy.

# Floats with Ringgit De-Peg

***By Clarence Y K Ngui***

WHEN Bank Negara Malaysia (BNM) Governor Tan Sri Zeti Akhtar Aziz turned up unexpectedly at the Umno General Assembly at the Putra World Centre on the evening of July 21, it raised eyebrows. After all, she was no politician and neither does she aspire to be one.

Delegates were puzzled and so were newsmen. Zeti then went in to meet with Prime Minister Datuk Seri Abdullah Ahmad Badawi, who incidentally, was preparing for the general assembly dinner. Then, the Prime Minister's aides hastily arranged for a press conference and rounded up the newsmen.



PIX BY MOHD JASMIN RAMLI

*Abdullah announcing the de-peg on July 21 at the Umno General Assembly*

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Expecting an important announcement from the Prime Minister, the journalists were not disappointed. Just before 8pm, Abdullah, who is also the Finance Minister, announced that Malaysia was de-pegging the ringgit, thus ending a near seven-year peg of RM3.80 to the US dollar. The announcement was brief and to the point, taking no more than a few minutes.

The decision to de-peg the ringgit was largely prompted by a decision that day by China to de-peg the yuan from the US dollar. Alerted by a possible de-peg of the yuan by the People's Bank of China earlier that day, BNM officials scrambled to put into place a well-planned strategy. They were waiting for this day.

At 7.00 pm, (Kuala Lumpur and Beijing share a similar time zone) the People's Bank of China announced that the exchange rate of the US dollar against the renminbi (RMB) will be adjusted from 8.28 to 8.11 yuan per US dollar.

For the record, former Prime Minister Tun Dr Mahathir Mohamad was instrumental in pegging the ringgit to the dollar on Sept 1, 1998 to thwart speculative attacks on the local currency following the 1997 Asian market slump.

So, the move to opt for a managed float against a basket of currencies for the ringgit came as a surprise to the nation, especially after stiff denials by BNM to re-peg, de-peg or float the ringgit. To be sure, the central bank's decision would have been largely influenced by China's move.

## The yuan factor

Interestingly, the Chinese central bank did not completely float its currency, but allowed it to float within a band of ±0.3% around the central parity of 8.11 yuan per US dollar. Accordingly, the trading prices of non-US dollar currencies will be allowed to move within a certain band pre-determined by the People's Bank of China. China's move to a flexible currency regime comes after an 11-year, fixed-exchange regime.

CIMB Chief Economist Lee Heng Gui tells ***Malaysian Business*** that Malaysia made the right move to immediately follow China. 'If Malaysia did not float its currency immediately, there would have been a rush of hot money to Malaysia. Then, the pressure and implications to float the currency would have been even greater,' he says.

Another head of research explains, 'We believe Malaysia was hoping to preclude another massive potential large inflow of hot money, which would have added to the strain when these foreign funds eventually cash out.'

He may be right, as previous speculation on the ringgit spurred investors to buy some RM15 billion in Malaysian assets in the fourth quarter of last year and the first quarter of 2005.

In May this year, Zeti told ***Malaysian Business*** in an interview that 'The objective of our exchange rate policy is the stability of our currency with major trading partners. This objective will remain unchanged. The current peg is performing well and it is well supported by our fundamentals.'

Yet, when Beijing made its move, Kuala Lumpur was quick to follow suit. Did Kuala Lumpur rush into making the decision? Did the central banks in Beijing and Kuala Lumpur make a pact?

In any case, Beijing has come under

strong pressure lately from the United States to abandon the yuan's peg. The US has long claimed that an undervalued yuan provided Chinese exporters an unfair advantage in world markets.

Local research house Avenue Securities Sdn Bhd believes the decision to float the ringgit came at the right time. 'It is fortunate that China made its move now, especially when we are in a much better position compared to the pre-ringgit peg period. Hence, any adjustment to our economy would be less painful.'

An analyst believes the decision to move to a managed float marks a departure from the thinking that pegging gives the greatest stability. 'This is the correct position to take in an atmosphere where the US dollar itself has become volatile and subject to considerable fluctuations,' he says.

## Market reaction

With all the brouhaha over the de-pegging, what is the implication on the markets in Kuala Lumpur? For the record, the ringgit at 10.30 am on Friday, July 22, the day after the de-pegging, rose 0.33% to RM3.7875 to the US dollar. This is in comparison to the 2.1% appreciation of the yuan. Earlier, most research houses were forecasting the real value of the ringgit to be between RM3.50 and RM3.60

However, market sources tell ***Malaysian Business*** that the central bank has issued directives to local dealers to ensure the ringgit does not appreciate way beyond a certain band. 'There must be a certain form of stability,' says the source.

Also, says a research head, 'We believe that local players will be moving the market because the ringgit is still not tradable overseas.'

Indeed, Zeti reiterated that the central bank will monitor the exchange rate against a basket of currencies to ensure that the rate remains close to its fair value. 'Promoting stability of the exchange rate continues to be the primary objective of our policy,' says Zeti.

Local research houses are positive that an upward re-evaluation is a boon to our thriving economy as it would reflect more of the current economic fundamentals. 'This much-awaited move will be positive for the economy as it now allows the ringgit to adjust on a gradual basis rather than in an uncertain and potentially damaging step-wise fashion,' says Kenanga Research.

By year-end, Kenanga Research expects the ringgit to appreciate some 5% against the US dollar. Avenue Securities feels the managed float of the ringgit will provide a positive immediate term as well as general positive sentiments for the nation's economy. It believes the float would encourage more foreign direct investment as foreigners will have more confidence in a less rigid forex regime amidst a sound financial system.

Ultimately, most research houses believe the immediate capital outflows that one can expect from a re-peg may not be seen. 'We believe that market forces will dictate the fair value of the ringgit and we expect the ringgit to eventually move within a trading band of RM3.40-RM3.60 in the long term,' says a head of research.

PIX BY HABHAJAN SINGH

*Zeti makes her rare appearance at the Umno General Assembly, fuelling speculation that something was up*

## Business as usual

Nonetheless, CIMB's Lee believes it will be business as usual in Malaysia, 'Doing business in Malaysia will not be affected,' he says. His views are also reflected by the American Malaysian Chamber of Commerce's President Vince Leusner, 'American companies doing business have not based their investment decisions on the currency question. Regardless of a fixed or managed float, our decision to invest is based on the ease that international businesses can operate in Malaysia, the government's relationship with the private sector, transparency and the protection of intellectual property rights.'

Kenanga Research believes beneficiaries of the ringgit float would include automotive distributors, manufacturers and media companies. 'Companies such as Tenaga Nasional Bhd would also have a one-time gain as it has a large loan denominated in Japanese yen,' says the research house.

Interestingly, there will also be negative impacts, which would include on plantation, shipping and oil and gas companies, where the bottom-line hinges on the US dollar. Other Malaysian exports would also take a beating as Malaysian exports become more expensive.

On the consumer side, Malaysian Investors' Association's President Datuk Dr P H S Lim says the removal of the ringgit peg is good. 'This will help reduce inflation and will be good for the economy.' Ultimately, Lim believes, the import of food items and machineries would be lowered. Now, the only concern, says Avenue Securities, is that there will no longer be an insurance of stability for the nation's economy. The security house could be right. Nobel Laureate Robert Mundell, said in June that the ringgit peg was an insurance of stability amidst heightened downside risks in the global economy.

Mundell also believes that the peg is part protection against a slumping domestic manufacturing sector and part support for the export sector. But with the peg lifted, the Malaysian economy now has to depend on its strong fundamentals alone. There is no reason why it can't. mb