

Surviving a 'financial killing'

CURRENCY CRUMBLE: This is an extract from the book *A Doctor in the House* by former prime minister Tun Dr Mahathir Mohamad on the currency crisis of 1997. The book is published by MPH Publications

I WAS not familiar with the international monetary or financial system when it faltered and soon after threatened to implode on us in 1997. As a boy, I had experienced high inflation rates during the Japanese Occupation, when things were priced in thousands of dollars and people had to carry gunny sacks of the so-called "banana currency" to buy anything. There were no banks then and all transactions were carried out in cash.

Everything was in short supply during the Occupation and prices tended to go up very rapidly. The Japanese Military Administration overcame this problem by merely printing more currency notes in higher denominations, and even resorted to printing over new figures on the smaller denomination notes to meet the ever more inflated cost of paying their local employees and for their supplies.

Somehow, we managed. In my family, I was better off than my brothers because I chose to sell bananas and other items at Pekan Rabu, the weekly Wednesday market. I soon learned to raise my selling price in order to pay the expected higher cost of my supplies. My brothers held salaried jobs with the government and its agencies, but their pay increases always lagged behind rising prices and came too late to meet increased costs.

All of us were involved in the black market, and we sold old clothing, jewellery and some of our few possessions. When we could get Japanese cigarettes from the soldiers, we would sell them, too.

By 1944, the war was not going well for the Japanese and I believed the British would return sooner or later. In anticipation, I paid a huge amount of Japanese banana money for 100 dollars of the old Straits Settlement and Malay States currency notes, as I was sure they would become legal tender again when the British returned.

The way prices went down to pre-war levels as soon as the old currency came back into circulation again was quite miraculous. Government servants were given three months' pay to compensate them for not having been paid when the British left Malaya and in this way, the old currency was decisively returned into circulation. It flooded back into a battered economy that



The currency crisis in 1997 sent the stock market reeling and hurt the economy severely.

had been operating for some time without any effective, stable and credible currency.

People then were not very sophisticated. They unquestioningly accepted the currency that the British Military Administration issued and got rid of the Japanese banana currency, which soon became worthless. That's the thing about paper currency — it's not worth anything in itself. It has value because, and only for as long as, people believe it does. That's how money works.

Unfortunately, the restoration of the Malayan economy and the rein-

roduction of the Malayan dollar to replace the Japanese currency has never been properly studied and documented. Perhaps we could learn something from that experience and about how to handle currencies and currency crises.

I worked as a temporary clerk at the office of the Custodian of Enemy Property early in 1947 and was paid 80 dollars per month. Permanent clerks were paid 60 dollars per month, the same pay for clerks before the invasion. It was as if there had been zero inflation during the Japanese Occupation.

There was also very little infla-

tion during the early years of the British Military Administration, the Malayan Union and then the Federation of Malaya. Supplies improved but unemployment was high, and the Colonial Government quickly introduced price controls. That kind of measure is often taken in wartime, but the colonial government found it a good way to reduce inflation.

Even today, Malaysia still controls the prices of essential goods, as we do not think this contravenes free market rules. The idea that demand and supply must always determine prices is not completely correct as traders can always cause artificial shortages or oversupply and so influence, even manipulate, prices.

The market is not always a pure and impersonal mechanism that can be relied upon to deliver the uncontaminated truth about proper price levels. In fact, we were to learn 50 years later that free market principles permitted the unregulated freedom to manipulate prices, whether of basic domestic commodities or national currencies at the global level.

I learnt a few lessons about dealing with high inflation during my wartime forays into small business, and I learnt bookkeeping in school. But none of this equipped me with the knowledge to handle the currency crisis which hit Malaysia in 1997.

In May of that year, I decided to take two months' leave, leaving Datuk Seri Anwar Ibrahim in charge as acting prime minister. I saw it as a good opportunity to observe how he performed as I was already thinking of stepping down in 1998. I wanted to be sure that when Anwar took over from me, he would be able to administer the country well.

While I was in Bledisloe in the Cotswolds in England, I received news about the Thai baht coming under attack by currency traders. Thai businessmen had apparently been borrowing a great deal of foreign currency at low interest rates compared with those of baht loans. Quick profits could be made from the differences between these interest rates — but only if the value of the baht remained stable.

International currency traders — people who make a living from noting and exploiting such anomalies and vulnerabilities — thought the situation was suitable for their kind of trading. They spread the word that the baht was overvalued and that the Thai economy would prove unsustainable. The currency traders then sold large quantities of baht, causing it to depreciate against the US dollar, and throwing Thais who had borrowed US dollars into difficulties.

They had to find more baht to repay their foreign currency borrowings for if their trading profits were insufficient, they risked defaulting on their loans. If they defaulted, then the currency traders' allegation that the Thai economy was weak would appear vindicated. The traders then dumped more baht and the currency weakened further, "causing more foreign currency loans to default. Yet the traders could appear to be simply responding as innocent bystanders to a crisis that they themselves had triggered.

A vicious cycle quickly developed: the more the baht depreciated, the more loan defaults increased and the more the Thai economy weakened. The Thai government tried to buy baht with its US dollar reserves to sustain the baht's value, but the currency traders seemed to have limitless supplies of the currency to dump into the markets. Eventually, the Thai government was landed with a lot of badly depreciated baht and greatly reduced foreign reserves. This started another round of selling as the baht weakened from a perceived lack of foreign currency reserve support.

By the time I came home from leave in August 1997, things were looking very bad for Thailand. We decided to lend it some hard currency to strengthen its reserves but it was too no avail — the baht kept falling.

Malaysian finances were in good shape at the time, as neither the government nor our business people had needed to borrow much foreign currency. Our interest rates had always been low and foreign currency borrowings would not have given us any advantage. Bank Negara's foreign currency reserves were also sufficient; at least we thought it was sufficient enough to support the ringgit if it came under attack. But that seemed hypothetical. We had not made ourselves vulnerable as the Thais had, through their foreign exchange borrowings and dealings with currency traders. What did we have to fear?

Then we began to hear talk about financial "contagion", and how our neighbour's troubles might soon infect us. It seemed that despite the soundness of our economy and finances, the ringgit might still come under attack. If the traders caused a loss of confidence in Malaysia as well, then the ringgit, too, would be devalued. I simply could not understand why this should be so, but the economists were certain it would happen.

They were right. Currency traders began selling the ringgit in huge amounts and it soon began depreciating. Before the attack be-

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