

Malaysia Ex-Central Bank Chief Recalls 1997 Crisis Lessons: Q&A

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Twenty years ago, Malaysia was caught up in the turmoil of a currency crisis that began in Thailand and swept across Asia, battering economies, pushing millions into poverty and forcing governments to seek emergency bailouts.

Zeti Akhtar Aziz, who was chief economist of Malaysia's central bank at the time -- later becoming governor -- recalls her experience of the crisis, including having to implement policies that went against the conventional economic wisdom of the time, such as pegging the currency and imposing capital controls on foreign investors.

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This is an abridged transcript of Zeti's interview:

Question:

Is there a particular incident from that time that you remember quite vividly?

Answer:

One of the things I remember very vividly is sitting in the dealing room and watching the wave after wave of speculative attacks on the currency. And each time, it took it to a new trading range and this actually continued for more than a year.

The other things that I remember very vividly are the market reactions, the IMF, the rating agencies, they condemned us. The rating agencies took Malaysia down two notches. At the very early stage of the crisis, the recommendation from all of them was that we should be raising rates but we didn't and so they condemned us for that.

And then the other thing that I remember so vividly, of course -- it was a moment in history for us -- was when we implemented the controls. For us, we looked at it as a circuit breaker, that it could restore stability in the currency markets and the other financial markets as well.

Question:

Were you a part of the special committee that was set up by Prime Minister Mahathir Mohamad to deal with the crisis?

Answer:

No. But as the chief economist at the bank at that time, at the central bank, I was called at a moment's notice. Luckily, it was just across the road from us. I would go over, give an assessment of what was happening.

Question:

Did you agree with the decision to implement capital controls?

Answer:

The central bank only recommended that the controls related to the speculators were necessary. The others that would have affected the businesses and households were not necessary because yes, we acknowledged that there were some businesses and households taking out some money but we didn't, in essence, see any capital flight.

Question:

Is there a lasting legacy of the crisis on Malaysia?

Answer:

It made us even more determined to transform our financial sector in the aftermath of the crisis. What did we do? We strengthened our financial intermediaries through restructuring, rationalization, resolution and consolidation. And then the other very important thing that we did was that we didn't want to be over-concentrated with the banking sector only, but we developed our bond market and we have one of the largest bond markets in Southeast Asia now.

Question:

Is the region more resilient now?

Answer:

When we managed the crisis at that time, we did it individually, ourselves. Each respective country managed it on its own. Now, we have come together. The region has come together. In the area of surveillance, we exchange information. Our dealing rooms talk to each other every week. We have in place a monetary and financial stability committee that is made up of deputy governors that meets every quarter, I believe, that looks at the risk to the region.

And we've come together to build financial safety nets: the Chiang Mai initiative and the swap arrangements. Finally, we also have an integrated crisis management framework that, in the event that we see an imminent crisis, we will come together -- whether it's financial crisis in financial markets or whether it's affecting financial institutions -- we will come together to manage it collectively. So this is one very positive legacy that has come out of the crisis.

Question:

Was there at any point during the crisis when you felt you wanted to give up?

Answer:

Never. Never.

Yes, sure, the pressure was immense. The tension was very high and there were many, many tough moments but we overcame such moments from knowing the devastation that could result and the consequences that it would have on our financial system, on our economy and our society at large, and this is what spurred the determination. And this was not just my own determination but my entire team at the bank, who gave it all our best, all our energy, with great determination to strive forward and to do our very best.

Question:

What kind of tension did you experience back then?

Answer:

Everyone kept very calm. Very calm. I could see sometimes, especially those who were sitting in front of the screen of the dealing room, the look of fear in their eyes because we knew that the market out there was much larger than the reserves that we had. Therefore, our intervention operations were done very selectively at points we thought would be effective, and therefore, our reserves were never depleted. At the lowest point, the reserves were \$20 billion. Everyone held very calm because although we were feeling very stressed, the tension ran very high, we kept our cool.

We saw other currencies collapse, we saw other economies going under the IMF program. We disagreed so much with what was being proposed and the conditionalities that were being imposed by the IMF at that time. We just knew we had to strive harder and we worked collectively and we kept our cool.

Question:

What was the cost of the crisis?

Answer:

The major difference in the case of Malaysia was that the cost of the crisis was very much less. It was less than 5 percent of GDP and that is very important. Because once I was told Malaysia needn't have done the controls because we would have recovered at the same time everyone else did as well. Yes, it's true, Malaysia recovered at about the same time everyone else did but there is one very big difference: the cost of our crisis was so much less. It was less than 5 percent of GDP and that matters. We don't want the next generation to pay for the crisis. We have paid off everything after 10 years. We issued 10-year bonds for the resolution and this has all been paid off and at a much lower cost. The recovery was very good for us.

Question:

Do you agree that currency trading should be restricted?

Answer:

Future crises will happen and it will happen again and again and what we need to do is to position ourselves with the capacity and the capability to manage the financial crisis. In other words, for financial sectors, they need to build their buffers, their risk management capabilities, they need to know what could possibly go wrong and the need, the capability to rise up to manage those challenges. And the same thing with policy makers. That is what we did. We strengthened the capability of the central bank immensely so that we will know how to manage future crises.

Question:

Is the weaker currency one of the main risks for Malaysia?

Answer:

The ringgit now reflects sentiment and confidence conditions and once Malaysia restores confidence, the currency will start reflecting our fundamentals. Although we are still confronted with volatile capital flows that are much larger, we have demonstrated time and again that we can effectively intermediate these flows. Because the financial institutions have been strengthened, the markets are developed. So despite the uncertainties that we are facing, Malaysia has demonstrated its ability to intermediate these flows.

Even if a crisis happens, we now have the capability to manage it and to restore stability and bring about a rapid recovery. We have that in place now.

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