SPEECH BY
YAB DATO' SERI ABDULLAH BIN HAJI AHMAD BADAWI
AT THE MALAYSIAN CAPITAL MARKETS SUMMIT 2000
AT MANDARIN ORIENTAL HOTEL, KUALA LUMPUR
12 JUNE 2000

Firstly, allow me to thank ASLI, the Kuala Lumpur Stock Exchange and the Securities Commission for their kind invitation for me to open the Malaysian Capital Markets Summit 2000. I would also like to congratulate the organisers for arranging this timely and important conference. I am confident that your discussions and deliberations over the next two days will focus on the key issues affecting the future growth of the Malaysian capital market. I look forward to the various views and opinions, and assure you that the Malaysian government will incorporate them, where appropriate, into our strategic plans for the domestic capital market.

Malaysia is now recovering from a financial crisis that resulted in deep recessions, stalled economic planning and profound social costs in the Asian region. As we emerge from the problems of the past two and a half years, we need to ask ourselves a simple but pertinent question: what have we learnt from the regional financial crisis?

We, and subsequently the rest of the world, have learnt that herd-like movements of short term capital flows can be devastating. We have learnt that the behaviour of currency speculators and short term investors can be driven by irrational changes in the perception of risk. How else can we explain the fact that Malaysia was severely debilitated by a relentless attack on the ringgit and a mass exodus of short term portfolio funds when there was no indication of macroeconomic weakness. Indicators such as inflation, unemployment, short term debt, current account deficit and fiscal deficit were all at manageable levels, consistent with a rapidly developing country reliant on foreign capital. Nothing in our real economy indicated that we were on the precipice of our worst economic turmoil. The punishment meted out on Malaysia and our neighbours was surely disproportionate to any economic sins that we may have committed. Fortunately there is now realisation that all is not right with the international financial system. I believe that even as the region recovers from the crisis we need to continue with our push for reforms to the international financial system and explore initiatives - such as the currency swap agreement and even a regional monetary fund - to protect our economies and forge a coordinated response mechanism in the future.

Ladies and gentlemen,

As Malaysia moves out of recession, an immediate threat to our recovery will come from complacency. The danger now is that the economic turmoil will be explained by pointing, exclusively, at exogenous factors. If this is the case, we will not have learnt the entire lesson of the crisis. While external factors beyond our control caused the rapid capital flight that destabilised our economy, we must examine structural weaknesses in our financial system that resulted in extensive exposure to risk and unhealthy corporate practices.

The Malaysian government views our recovery effort as an excellent opportunity to learn from our mistakes and institute structural reforms to the economy that will increase resilience and promote transparency, accountability and corporate governance in the financial and corporate sectors and in our capital market. Our economic recovery is certainly comprehensive and broad based. This, however, will not guarantee us from another economic crisis. We need to strengthen our financial and corporate institutions and disabuse ourselves of business practices that resulted in high exposure to risk prior to the crisis. Without learning from our mistakes, our recovery effort will come to naught.

A closer examination of Malaysia, prior to the crisis indicates weaknesses in the financial side of our economy. In particular, the economy was too dependent on the banking system for funds. This over-reliance exposed our banking system to a high degree of liquidity and systemic risk. In addition, these bank loans were often made against collateral and not credit assessment and cash flow analysis. This also exposed banks to excessive risks.

A situation of risky credit, exposed banks and highly geared companies is certainly something that the Malaysian economy must avoid in the future. As growth picks up, there will once again be a need for funds to fuel investments in capital-intensive manufacturing, infrastructure and services. In an effort to reduce the over-reliance on the banking sector, and to broaden and deepen the domestic capital markets, the Malaysian government is committed to further developing and strengthening the bond market that will be able to finance the country's investment needs locally.

We are currently considering various strategies to make the domestic bond market efficient, transparent and accessible. While the corporate bond market has increased in size in recent years due to our privatisation policy, the Malaysian debt market needs to be reassessed on a coordinated and integrated basis. We realise that structural changes in our economy, as we increasingly shift emphasis from labour intensive to capital intensive industries, will require long-term capital financing that can adequately be met by a strong debt market. We are also aware of the increased demand for long-term fixed income instruments by long- term institutional investors for portfolio diversification and asset-liability management purposes. In pursuant to all these considerations, I assure you that the strategic development of the bond market will be a salient feature of the capital market masterplan that is currently being drafted.

Ladies and gentlemen,

In addition to deepening our capital market, we are committed to enhancing transparency in our corporate sector. Better corporate governance will help reassure investors and also contribute toward a healthier capital market.

Much has already been done by the securities commission and the KLSE to ensure the continued incorporation of modern corporate governance principles into securities and companies legislation. For example, the amended securities commission act 1993 will soon provide better investor protection by empowering the commission to initiate legal action on behalf of investors who suffer losses due to misinformation from companies. The government believes that the amendment will, in particular, accord adequate protection to minority shareholders who may not have the means to initiate legal proceedings. In addition to investor protection, it is hoped that the amendment will result in more professional directors of public listed companies who possess a thorough understanding of the legislation.

Other measures directed at enhancing corporate governance include amendments to the KLSE listing requirements which is aimed at raising the standards of conduct of directors and company officers of public listed companies, as well as developing an effective internal governance and enforcement mechanism. It is encouraging to note that the amendments to the KLSE listing requirements will also bring into effect the Malaysian code on corporate governance that outlines corporate best practices that will promote transparency and accountability in public listed companies. These initiatives are part of a move towards disclosure based regulation in the securities sector in which investors themselves will determine the investment merits of security offerings.

The capital market measures to increase resilience and promote transparency has also resulted listed companies having to adhere to stringent accounting standards and to file financial statements with the KLSE on a quarterly basis. The stockbroking industry has also been strengthened through the introduction of capital adequacy requirements to ensure that the liquid capital of a stockbroking company will be sufficient to cover its total measured risks.

Ladies and gentlemen,

It has not been my intention to sketch out the details of Malaysia's efforts in strengthening our capital markets. But I believe that it is important to remind investors that structural, legislative and institutional reforms are taking place. The perception that Malaysia has insulated our economy in order not to push through with economic and financial reforms is a fallacy.

Many foreign investors with little knowledge of Malaysia's recovery effort are swayed by crude reductionisms made about our economy. Terms such as "bail outs", "draconian capital controls" and "economic isolation" are still bandied about when one talks of Malaysia. I would like to take this opportunity to set the record straight on these issues.

First, let us examine these so-called bailouts. The government encourages the restructuring of companies if they are undertaken to put the companies on a stronger footing. Rescues of companies must be undertaken for the benefit of all their stakeholders which include employees, minority shareholders, creditors and not merely for the controlling shareholder or the parties who initiate the rescue initiative.

Since companies in Malaysia are typically owner- managed, there is a perception that decisions will not be made in the wider interest of stakeholders. The government will therefore ensure that regulatory principles are adhered to, good corporate governance practices are upheld and the interest of minority shareholders protected in the rescue of troubled companies. Our ethos for corporate restructuring is not political expediency, rather it is to secure the interests of all stakeholders and to put our companies back on track.

I would also like to add that Malaysia's effort at corporate restructuring is attendant upon socioeconomic implications as well. It is easy to suggest that companies that fail should be allowed to sink. Such a simplified assessment belies the potential social dislocations that could occur. I believe that Malaysia's approach of salvaging and restructuring our companies has prevented social turmoil that has affected other economies in the region. Consider, for example, the fact that unemployment in Malaysia has remained at levels substantially lower than in Thailand, Indonesia and

South Korea. The lack of labour woes such as high unemployment and strikes have enabled companies to get down to the business of restructuring. This, I believe, augurs well for sustaining our recovery process.

Second, much has been said about our capital controls. For those of you here today who are serious in investing in Malaysia, I believe I do not need to explain at length the rationale behind our controls. I will say once again that the criticisms of capital controls inter alia allocative inefficiency, the development of a black market and administrative difficulties have not occurred in Malaysia. Malaysia's capital controls are selective and not absolute and the government will continue to monitor its efficacy in light of external risks and exposure.

As for our pegged exchange rate, we believe that as long as the world economic outlook remains favourable to the peg, it will be maintained. Once again, the government is committed to a pragmatic course of action, and will be monitoring selected indicators carefully before reassessing our exchange rate policy. For the time being, the peg is contributing to our booming export sector and with imported inflation still benign, there is no compelling reason for a repeg or any other policy shift. Might I also add that the current peg is making it cheaper for foreigners to undertake long-term investments in the country. I hope that international corporations will use this opportunity to set up their headquarters and research centres in Malaysia.

Third, Malaysia has not and will not embark on a deliberate policy of economic isolationism. We may have reservations about globalisation - in particular the rapid pace of trade liberalisation, the social inequities that it causes and the less than transparent global economic decision making process that drives it. But our reservations do not mean that we are not preparing for globalisation and liberalization. While Malaysia is committed to a properly sequenced process of liberalisation of our capital market and financial sector, we believe that before we open up these sectors, our financial and corporate institutions must be further strengthened.

In the financial sector, for instance, we are rehabilitating, restructuring and consolidating our banking system to prepare it for global competition. The consolidation of the banking sector will be followed by a merger exercise in the stockbroking industry. We believe that such a move can form a group of well-capitalised universal brokers robust enough to withstand the pressure from the risks inherent in a liberalised stockbroking industry.

Corporate restructuring will not merely focus on reviving companies but will be carried out to help our companies redefine their competitive advantage, divest non-core assets, increase productivity and prepare them for global competition.

The Malaysian capital market and financial sector will also have to prepare for increased disintermediation. e-commerce and internet trading will transform the role Of traditional financial intermediaries. In addition, the development of the bond market will mean more direct capital market fund raising and will result in banks having to redefine their intermediary roles. Technology and new financial instruments will change the landscape of the Malaysian capital market and financial sector. If we are not able to manage this transition efficiently and, most importantly, quickly we stand to be left behind.

Ladies and gentlemen,

Before I end I would like to touch on the fortunes of the Malaysian stock market. Investor confidence in the KLSE has returned. Resumed investor interest has resulted in the KLSE composite index climbing to a 33- month record high of 1,013 points on 18 February 2000. The improved stockprices and liquidity has facilitated capital raising exercises - new initial public offerings have been oversubscribed and opened at premiums. More corporate exercises via share swaps can also be done at higher values. Investors have benefited from the improved market condition and this has created a positive wealth effect in the economy. Furthermore, rising share prices have also reduced the level of NPLs held by banks which had directly or indirectly financed share purchases prior to the crisis. Consequently Malaysia's NPL levels are the lowest among affected countries, using both six months and three months classification criteria.

With this in mind, the government is concerned that recent market activity has been dictated by sentiment and rumour. I would like to remind investors that the stock market is not a gauge or barometer for the accuracy of rumours or political speculation. Let the stockmarket reflect the fundamentals and the prospects of listed companies. Do not gamble on the stock market based on unfounded, I repeat, unfounded market talk about political issues which financial analysts, punters and speculators have little or no knowledge about.

We will continue to ensure that our equity markets attract serious investors with strategic outlooks. We will continue to improve our equity markets so that they adhere to international best practices. The recently announced T+3 settlement cycle on the KLSE and MESDAQ is an example of measures to increase efficiency and reduce risk in our markets, and at the same time instilling greater confidence in the Malaysian securities clearance and settlement system.

Ladies and gentlemen,

This is a crucial time for Malaysia. We must use this opportunity wisely to push through with reforms - some of which I have highlighted. We must show our willingness to change the way we invest and do business. We must learn from the crisis.

For the foreign investors present, I hope that this summit will dispel any remaining doubts that you may have concerning putting your money in Malaysia. I assure you once again that policy will remain flexible, pragmatic and in the interest of all stakeholders in the Malaysian economy - both local and foreign. On this note, I am pleased to open the Malaysian Capital Markets Summit 2000.