Malaysia erects currency barriers as economy plunges into recession

Peter Symonds
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The Malaysian Prime Minister Mahathir Mohamad has made two dramatic decisions in just two days in a desperate attempt to stem the country's economic crisis, deal with his opponents in the ruling United Malays National Organisation (UMNO) and prepare for early national elections.

On Tuesday, the central bank, Bank Negara, announced stringent regulatory measures 'to regain monetary independence and insulate the Malaysian economy from the prospects of further deterioration in the global economic and financial environment'.

The government has imposed tight controls on international trading and speculation in the Malaysian ringgit and shares. Offshore trading in the ringgit is banned and domestic financial institutions are barred from offering credit facilities for non-resident banks and stockbroking companies. All external trade will be conducted in foreign currency.

Limits have been placed on the amount of currency that can be taken overseas by travellers or sent by residents without approval. In addition Malaysians will have just a month to repatriate ringgit held overseas.

Foreign investors in Malaysian shares will be prevented from sending profits overseas for a year. On Monday night, the government called a halt to offshore trading in Malaysian stocks, especially in Singapore.

In a nationwide TV address on Tuesday, Mahathir justified the government's decision by making a savage attack on speculators, share traders and international markets. 'There are a lot of things we can now do because we don't have to face their [speculators'] actions to stop us. The free market has failed and failed disastrously because of abuses, not because the system is bad.'

The following day he sacked Deputy Prime Minister and Finance Minister Anwar Ibrahim from both positions after months of sharp tensions over economic policy. Anwar, who until recently was viewed as the heir apparent to Mahathir, has been the advocate of a more rapid 'free market' deregulation of the Malaysian economy in line with the demands of the International Monetary Fund. In June, Mahathir effectively sidelined Anwar and his supporters within UMNO by appointing close political ally and former finance minister Daim Zainuddin to a key economic post as Minister of Special Functions.

Only last week the central bank governor Ahmad Mohamed Don and his deputy Fong Weng Phak resigned after disagreements over the government's currency plans. Mahathir is moving to isolate his opponents in preparation for the calling of elections, possibly after the staging of the Commonwealth Games, due to open in Kuala Lumpur next week. But in doing so, he is certain to intensify political divisions and turmoil in Malaysia.

Mahathir's aim is to implement measures to stimulate economic growth, including lowering interest rates, subsidies on selected imports and a looser definition of non-performing loans. But without currency controls such policies would rapidly lead to a collapse of the ringgit as capital flowed out of the country. On Wednesday, Negara Bank also announced a fixed exchange rate of $M3.80 to the US dollar--a value 35 percent lower than just one year ago.

Figures released last week showed that the Malaysian economy shrank by 6.8 percent in the second quarter, on top of a decline of 2.8 percent in the first three months, and is now officially in recession. The country's leading financial institution Maybank recently recorded a 90 percent fall in its profits and a number of companies are facing bankruptcy.

Malaysia has domestic debts estimated at $US126 billion and the level of bad debts is expected to reach 25 percent by next year. By lowering interest rates, Mahathir is hoping to prop up faltering private corporations, many of which have close connections to the government and UMNO.

But spurned by international markets, Malaysia faces economic stagnation and recession as overseas investors pull out of the country. On Tuesday, the Malaysian stock exchange plummetted 40 points or 13 percent to 262 points on news of the financial controls. While the shares rebounded the following day, Malaysian stocks have lost almost 80 percent of their value compared to the beginning of last year when the Kuala Lumpur Stock Exchange composite index was at more than 1,200 points.

Malaysia's decision to institute stringent currency and capital controls has created nervousness in international financial markets. Investors fear that if other countries in Asia and Latin America respond to their difficulties by imposing similar tough currency regulations, the huge daily international flows of capital will be choked off, compounding the danger of global economic recession.

As Deutsche Bank chief economist Dr Ken Courtis remarked on Tuesday: 'The Chinese keep goldfish in a bowl because they jump just before a major earthquake. This [decision by Mahathir] may be the precursor, the pre-tremor that says watch out, something very dangerous is about to happen... If it stops at Malaysia, people will say, 'too bad for Malaysia', but if it becomes a trend it will be bad news for the pattern of development in large parts of the world.'

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