Malaysia’s Economic Challenges: Coping With The Global Slowdown
By Y. Bhg. Dato’ Mustapa Mohamed
Executive Director, National Economic Action Council

Distinguished Guests
Ladies and Gentlemen
Good Morning

It is my honour and pleasure to address this distinguished group of analysts and fund managers. For this, I must thank the organizers, Morgan Stanley Dean Witter and ASLI for inviting me to this Malaysian Capital Market Roundtable Discussion.

In the past few months we have seen a flurry of forecasting activity among analysts, each trying to outguess the other on how the global and regional economies will turn out this year. There have been several rounds of revisions to GDP growth rates as the US economy took unexpected twists with repercussions on the rest of the world. We have seen growth rates in the region getting downscaled several times. But in recent weeks one gets the feeling that there is growing convergence of views on the global and domestic growth prospects. The broad consensus emerging is that this will be a year to bite the bullet but prepare for a rebound in 2002.

In the interim, it is inevitable that we have to put up with difficult times. The question is whether we have the reserves and resilience to withstand this current short but sharp slowdown. Malaysia and Singapore have taken measures on several fronts to mitigate the effects of the global slowdown. But as open economies heavily dependent on exports, there is a limit to what we can do unilaterally to sustain growth at a high level. Our strategy is to keep the fundamentals intact and use the intervening period for bringing about structural reforms in the economy.

The State of the Malaysian economy

Despite the trying times, the Malaysian economy has managed to avoid negative growth. The economy grew by 3.1% and 0.2% in the first and second quarters of 2001, respectively; making it 1.8% for the first half of the year. At present we expect growth will be higher in the second half of 2001. Inflation remains low with the stable exchange rate regime and low domestic interest rate helping to contain inflationary pressures. Unemployment remains below 4%. Labor market conditions are still stable as layoffs are mainly in the electronics industry, while the demand for labor in the services sub-sectors, non-electronics manufacturing, agriculture and construction remains strong. Redeployment and retraining of the affected workers is helping them to re-enter the labor market.

Notwithstanding the slowdown in the external sector, the balance of payments position remains favourable. With a strong trade balance and a lower services account deficit, current account surplus as a percentage of GDP is expected to be 6.2% for 2001,
as against 9.4% in 2000. Trade surplus for the first seven months of 2001 was RM 30.03 billion; which is comparable to RM 32.18 billion recorded for the same period last year. The large trade surplus together with net inflows of FDI and portfolio investment have strengthened the net external reserves position. Net external reserves have risen steadily since June 2001 to reach US$27.5 billion as at 15 August 2001. The low inflation rate and renewed interest by foreigners in the Malaysian equity market have also helped to ensure that the peg remains sustainable and consistent with economic fundamentals.

On the banking and financial system, non-performing loans (NPLs) of the banking system has risen slightly to 8.1% (July 2001). But the banks are in a strong position to absorb this rise in NPLs. Overall risk weighted capital ratio (RWCR) is currently 12.4%, well above the minimum 8% stipulated by the Bank of International Settlements (BIS). The NPLs absorbed by Danaharta (the asset management agency) are being sorted out successfully. Nearly 82% of the RM48 billion of NPLs acquired and managed by Danaharta has been resolved.

The success in corporate debt restructuring achieved through the Corporate Debt Restructuring Committee (CDRC) is commendable. As at end July 2001, CDRC has resolved 30 cases with debts amounting to RM26.5 billion. A new initiative was launched on 1 August this year to expedite debt restructuring. The creditors and debtors have to enter into an Interim Standstill Agreement within one month of submission of the case to CDRC. Within the following three months, they are required to come up with a Workout Plan. Failure to do so will mean removal of the case from CRDC’s list. The criteria for acceptance has been increased to aggregate borrowings of RM100 million, as against RM50 million previously. There are now more comprehensive disclosure and reporting requirements.

**Investment climate**

Ladies and Gentlemen

From my recent meetings with both local and foreign fund managers, it is quite evident that investor confidence in the economy is growing. They see good growth prospects ahead for the country. There is now less concern about the ringgit peg – they know it is serving a good purpose by providing much needed stability in the exchange rate.

Investors are happy with the Government’s recent intensification of efforts to sort out problems facing the corporate sector, a good example being the Renong case; as well as moves to separate management from ownership. We recognize that restructuring a corporation’s debt must be complemented by the restructuring of its management. This is being done. A strong and efficient corporate sector together with a competitive banking system would constitute an important element in supporting future growth of the Malaysian economy.
Improved investor confidence is also evident from the good showing in the Government’s recent bond issue (29th June 2001). Malaysia’s US$1 billion 10-year global notes issue in June this year had all the trappings of a successful bond issue and a barometer of investor confidence. The offering met with strong demand from the global community, providing attractive pricing and strong secondary market trading performance. The bond was oversubscribed; a strong showing considering that there was no road show. This affirms Malaysia’s standing in the international financial community.

Malaysia is committed to move ahead in raising standards of corporate governance. This is evident from the various reform initiatives it has taken starting from the Report on Corporate Governance (25th March 1999) to the long list of measures taken in recent months by the Securities Commission and the Kuala Lumpur Stock Exchange. Continued reforms will be undertaken, focusing on ensuring fair treatment of all shareholders and the protection of shareholder rights, improved transparency, accountability and strengthening of regulatory enforcement. The Malaysian Institute of Corporate Governance and the Minority Shareholder Watchdog Group are but two of the institutions assigned to encourage shareholder activism in the country. The Minority Watchdog will act as a forum and mechanism for collective action for its members on corporate governance issues.

Issues, Challenges and Prospects

As an open, trade-oriented economy, Malaysia will continue to be subjected to the vagaries of the global business cycle. The issue is how well can the economy withstand this current phase of global slowdown without undermining its long-term growth prospects. The growth strategy now focuses on domestic demand and broadening the sources of growth and developing a more resilient and competitive economy. While slower growth is a matter of some concern, we are pleased to note that Malaysia’s underlying economic fundamentals remain on track for sustainable long-term growth. The conduct of macroeconomic policy remains focused on ensuring that no macroeconomic imbalances arise. The priority is on maintaining low inflation and strong external liquidity position that will avoid a misalignment of the exchange rate and provide a conducive environment for sustainable growth.

The outlook for the current account of the balance of payments is favourable. Although exports have fallen, the similar adjustment in imports and improved services account will mean that the current account surplus will remain large. We expect continued healthy flows of both short-term and long-term capital in the near future. The reversal in the decline in foreign exchange reserves since July this year will go a long way towards alleviating concerns that Malaysia will be forced to adjust the exchange rate.

Sustaining competitiveness of the economy will be vital. Future policies must stress the need for a global outlook and the enhancement of competitiveness in all sectors in the economy. Continued efforts will be undertaken in order to strengthen the Malaysian
corporate sector as well as our bureaucracy. Domestic firms will be encouraged to push efficiency levels and venture beyond our national borders. For this purpose, strategies include the promotion of joint ventures and other forms of strategic alliances with foreign investors. Smart partnerships, for mutual benefit, are sought in several fields such as modern agriculture, services, and higher value-added and high-tech manufacturing.

I see the emergence of China as a challenge yet a positive development. On the positive side, there would be greater economic opportunities all round. Production linkages between China and others in the region could expand significantly. On the other hand, China will be a contender for FDI. Malaysia would like to view China more positively as a complementary and collaborative factor rather than as a threat to the region.

Conclusion

Ladies and Gentlemen

The current economic slowdown is something that is inevitable and one in which there is a limit to what we can do to push growth beyond a certain limit. But, I see this period as a window of opportunity to put in place structural reforms that will lower our vulnerability to the vagaries of being an open economy as well as strengthen the economy to meet the challenges facing the nation. I also see great potential in further regional cooperation as we move closer in an increasingly integrated global environment.

To sum up, we have done much to weather the global slowdown and to get to where our economies are now. But for sustained economic growth, we need to respond quickly to the new challenges in the global environment that requires us to enhance our competitiveness and productivity. Above all we need to be pragmatic and flexible. As an open economy we need to be prepared to make the necessary adjustments if we are to remain competitive.

Thank you.