MALAYSIAN EXCHANGE RATE MANAGEMENT

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IN A NUTSHELL

- **Time to change exchange rate regime?**
- **External environment:**
  - Troubled exit from recession
  - Structure of competitiveness changing
- **Domestic**
  - Risk of a Middle Income Trap
- **Must move up value chain**
  - Exchange rate must play a role in this

GLOBAL FACTORS

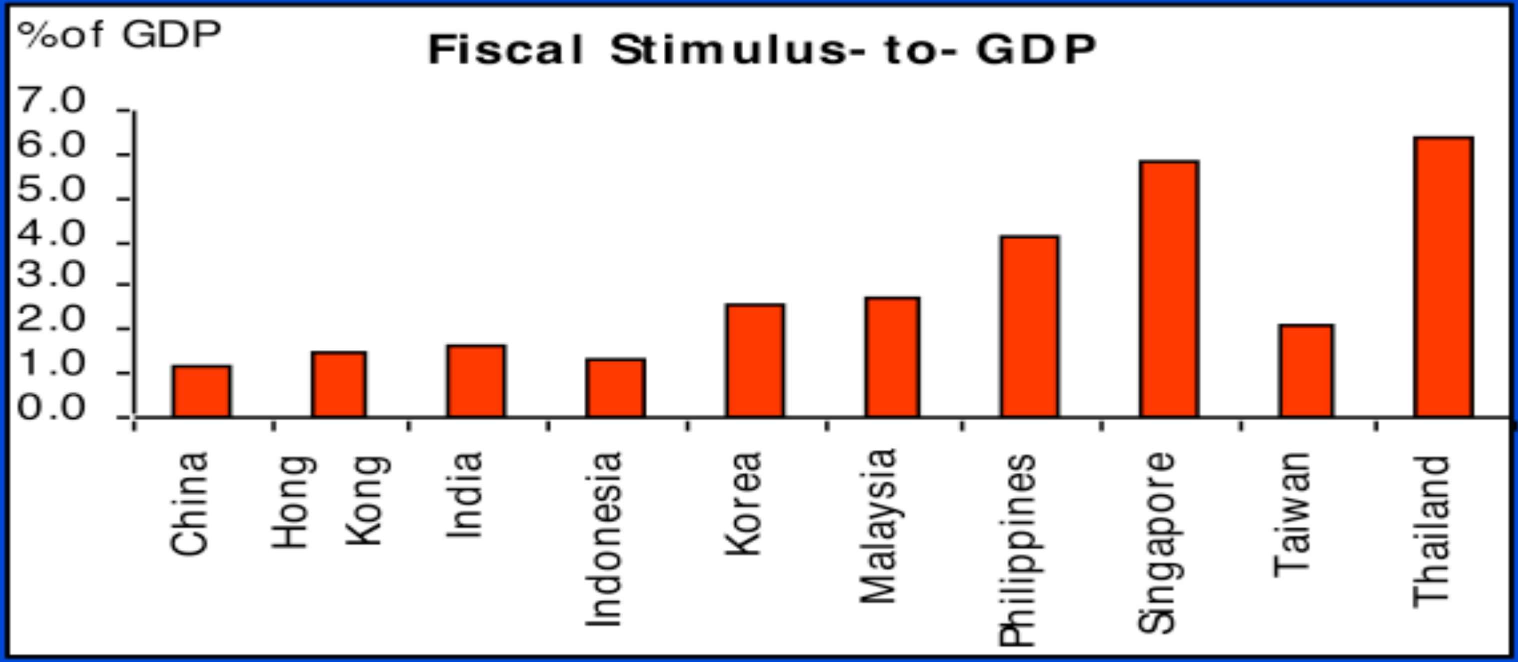
UNCERTAIN GLOBAL RECOVERY

- **Troubled exit, turbulence ahead**

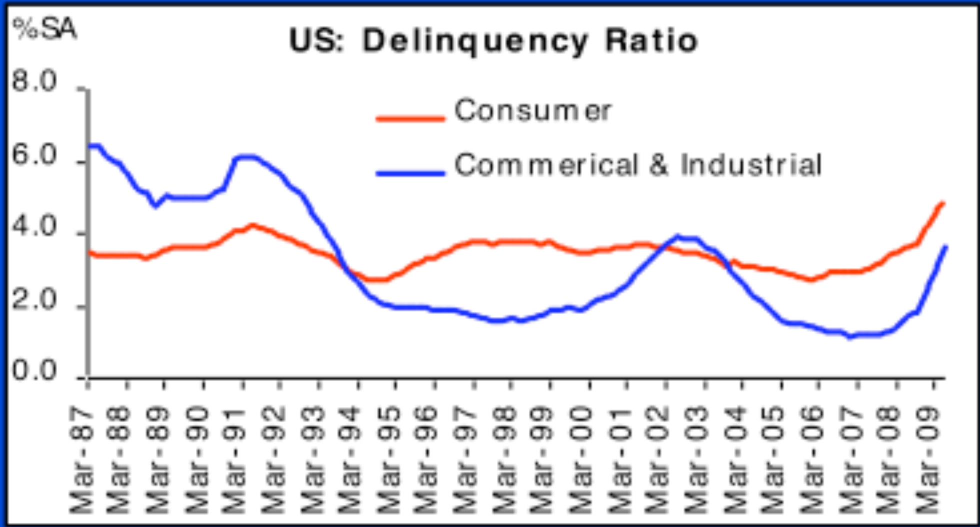
  - **US + Eurozone: weak credit conditions**
  - **US + Eurozone: rising unemployment**
  - **Household saving rates too low**
  - **US residential property market fragile**

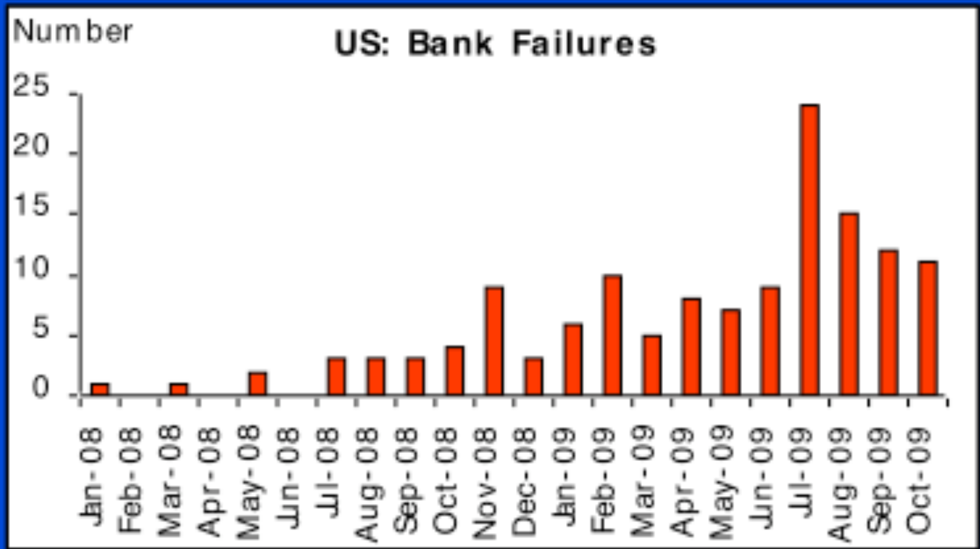
OVER-RELIANCE ON STIMULUS

- **Risks**
  - **Premature exits from stimulus**
  - **Uncoordinated monetary tightening**



FINANCIAL STRESSES REMAIN





EXCESS LIQUIDITY

- Destabilising capital flows for EMs
- EMs threatening capital controls

POST-CRISIS LANDSCAPE

- **Ideological shifts**
  - Backlash against free markets
- **Geo-political changes**
  - A multi-polar world, not US-centred
- **Growth drivers weaken**
  - New sources of growth – offset by
  - Stronger headwinds to growth
  - Oil prices, US household savings rate etc

KEY DRIVERS OF GROWTH

- **Weak demographics (Japan, China)**
  - Need for increased productivity
  - Changes in immigration policy?
- **Easy credit: now a CONSTRAINT**
  - Bad for US consumption
  - Savings used to fund fiscal deficits
- **Housing: Booms and Busts**
  - Developed economies see bottom

KEY DRIVERS OF GROWTH

- **Asian production sharing slowing**
  - Rising labour costs
  - Rising currencies
  - Increased taxation
  - Increased transport costs
  - More complex customer needs
  - Time to re-think offshoring?

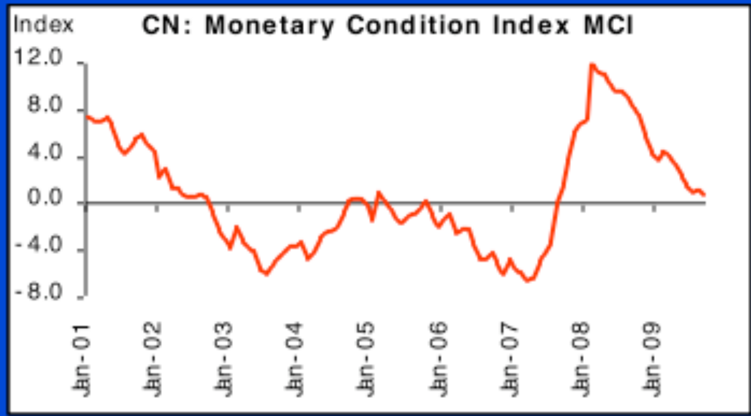
COMPETITIVENESS CHANGING

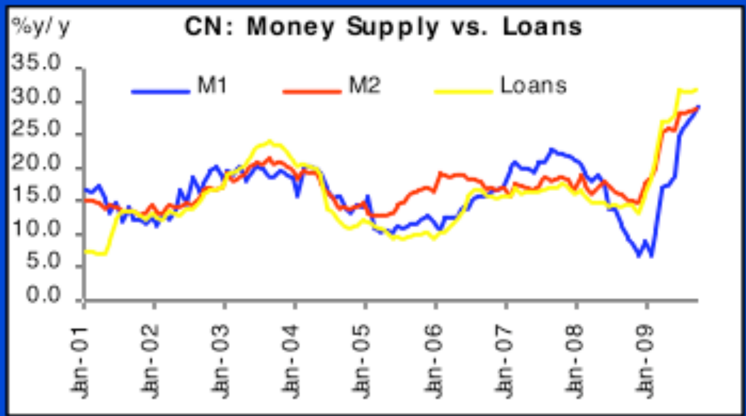
- **Change in structure of competitiveness**

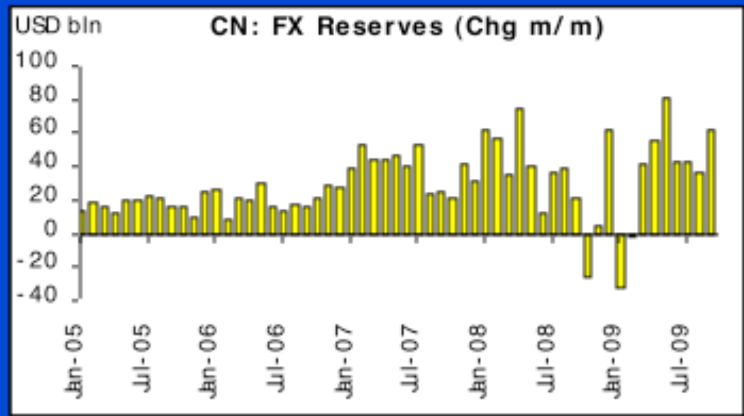
  - China going up the value chain
  - Indian competition in manufacturing
  - Indonesia's improving business climate
  - Also watch out for Brazil, Turkey, Vietnam
  - Low-cost emerging economies is better
  - Malaysia/Thailand less attractive

CHINESE CURRENCY POLICY

- A firmer RMB is good for Asia





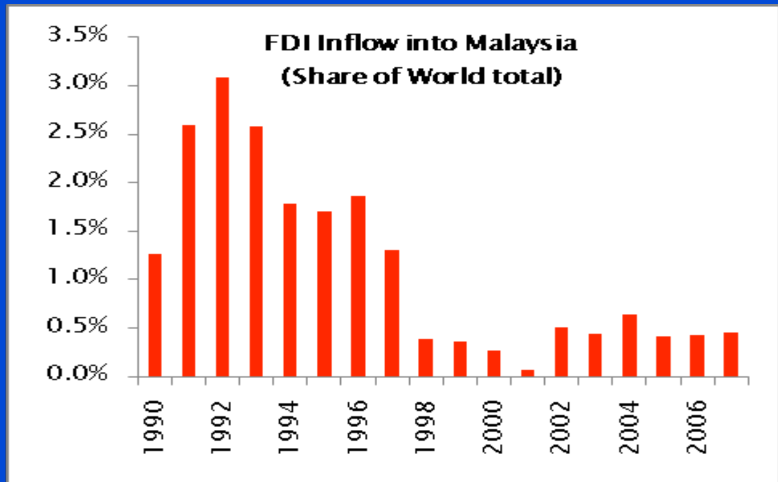


DOMESTIC CONSIDERATIONS

DOMESTIC RISKS

- In comparison to Asian peers:
  - Decelerating GDP growth

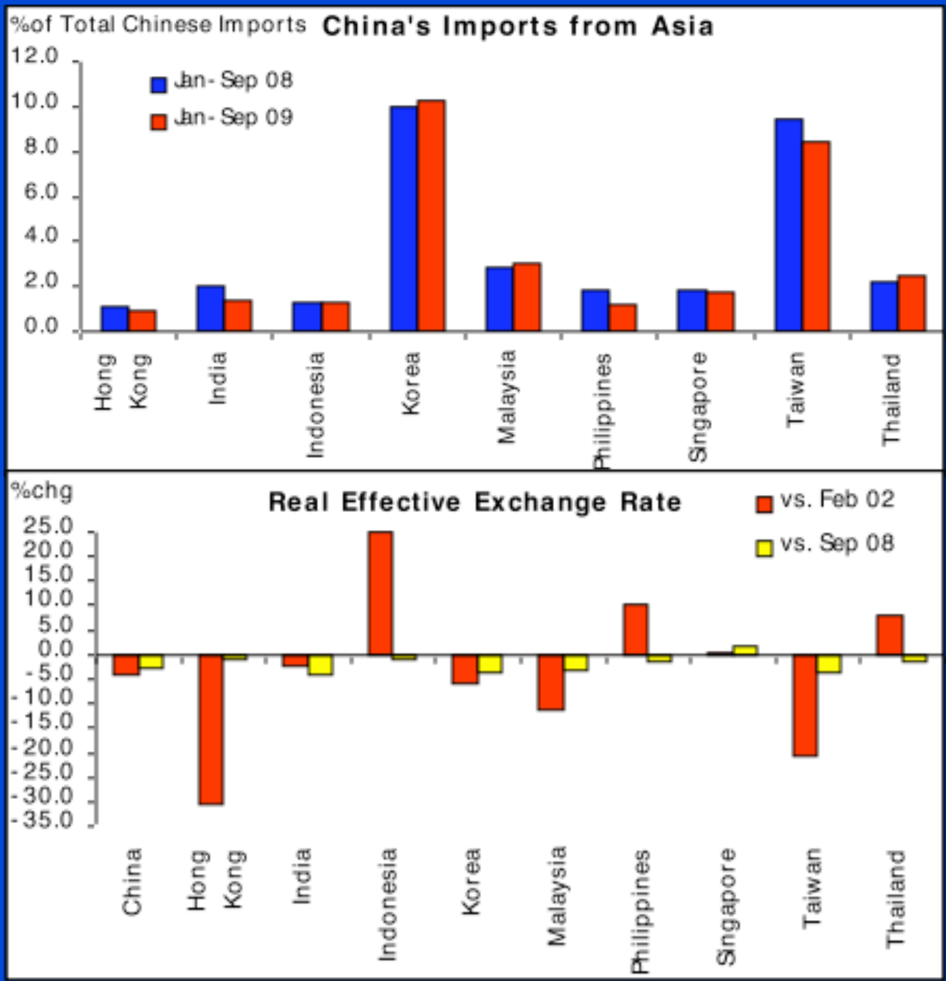
- <u>FALLING INTO A MIDDLE INCOME TRAP?</u>



COMPETITIVENESS RECORD

- **18th by IMD rankings in 2009**
- **Slow recovery in Malaysian exports**
  - But attributed to low oil/commodity prices
- **Gaining export market share in China**
  - Maintaining its global share
- **Slower rise in unit labour costs**
  - Good for price competition
- **Competitive REER among Asian peers**

COMPETITIVE RECORD (2)



FUTURE GROWTH DRIVERS

- **Challenges to moving up value chain**

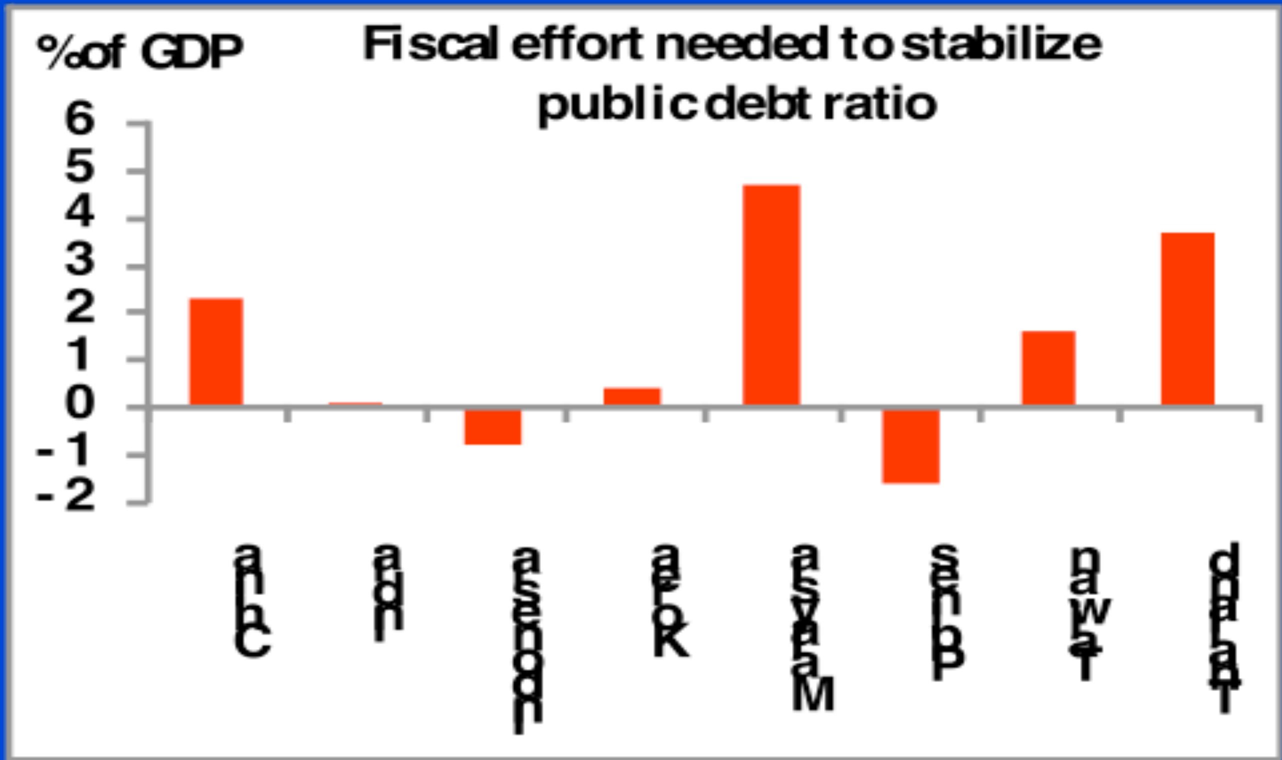
  - **Malaysia lags in its ability to innovate**
  - **Falling quality of education**
    - Increase in unemployed university students
  - **Poor record of Total Factor Productivity**

INSTITUTIONAL PROBLEMS

- Anti-competitive practices in firms
- Shortage of skills
- Bureaucratic burdens, taxes, regulations
- Rise in crime and cost of security
- Rising corruption

FISCAL POSITION

- It’s not looking good



EXCHANGE RATE REGIME: WHAT IS NEEDED?

IMPLICATIONS FOR RINGGIT

- No major issue with current level

  - Not out of line with fundamentals
  - Competitiveness indicators healthy
  - No other signs of mis-pricing

- Issue is with optimal regime

IMPLICATIONS (2)

- **Exchange rate needs to:**
  - **Provide flexibility to absorb shocks**
    - Destabilising capital flows
    - Chinese/Asian currency moves
    - Volatile external demand
  - **But excessive volatility undesirable**
  - **Incentivise move up value chain**
- **Last objective needs more priority now**

CONCLUSION

- **What is optimal regime?**

- **Some form of Basket/band/crawl**
  - Basket: trade-weighted
  - Band: allows some flexibility
  - Crawl: in line with incentivising upgrading
  - Crawl: in line with limiting inflation

THANK YOU!