Fearing the fear

MY Say

BY NOR ZAHIDI ALIAS

In my quiet time, I observe the current gloom-and-doom scenario with considerable concern. It certainly brings back memories of the darkest hour that the Southeast Asian region faced back in 1998 when everything seemed to be falling apart: plunging currencies, collapsing stock markets and destabilising economies.

No signs of relief were in sight from the point of view of those who went through that difficult period. It was the year when my economic team at a small stockbroking firm nervously released a report, entitled *Awaiting the Dawn*. I clearly remember debating the use of that title for several days, feeling nervous and afraid of making fools of ourselves.

A similar fear is currently emerging, and I obviously am wishing for a repeat of its resolution seen in 1999. A big wish at this moment, I must say, considering all the events taking place today: China's market crash and unabated economic concerns, a global commodity rout, the rapid strengthening of the US dollar, volatile capital flows that exert pressure on emerging market economies, geopolitical concerns, acts of terrorism, and many more. It has been a long while since a toxic mélange of problems assailed the global economy at the same time. This did not even happen during the global financial crisis of 2008-2009.

But fears of a global economic meltdown and subsequent catastrophe have a long history. Doom-and-gloom scenarios never fail to send chills down the spine, to the extent that people feel nothing can be done to avoid the disaster. And fear, to a considerable extent, influences the state of the economy, manifesting itself in ways such as fear of losing one's employment, business failure, unexpected policy responses, and so on. We have seen many examples in the past.

Take the case of Indonesia during the Asian Financial Crisis in 1998. Fear of the Indonesian government's decision during the crisis to pull down the shutters of 16 weak banks birthed widespread panic, causing bank runs (depositors making desperate attempts to pull out their funds) and thus crimping banks' ability to provide much-needed liquidity to the system.

A more recent example was the anxiety emanating from the downfall of Lehman Brothers in September 2008, after the US Federal Reserve (Fed) decided not to intervene to save the institution from collapse — a marked and undoubtedly shocking deviation from its actions for Bear Stearns Cos and American International Group Inc (AIG). The financial market and the economy, not surprisingly, entered a downward spiral following the incident.

As for now, the fear factor is primarily due to China's wobbly economy, although it remains debatable whether it is heading for a hard landing. In fact, in its recent report, the International Monetary Fund (IMF) stressed that it "does not see a big change in the fundamentals in China" compared with what it saw six months ago, but "the markets are certainly very spooked by small events there that they find hard to interpret".

The fear is that the Chinese authorities will not react aggressively (or indeed, sufficiently) to the slow but sustained deterioration of its economy. Allowing its growth to continue slipping for the next few years will risk more business failures, rising debt and defaults. Such events, if not properly contained, will cause a domino effect not only in its economy, but also (and more worryingly) on a global scale.

Fear of China losing its economic muscle also keeps commodity prices under pressure, as the country remains one of the world's largest importers of raw materials like crude oil, iron ore, copper and palm oil. Countries like Brazil and Australia are counting on China to revive their exports and economic vitality.

As for Malaysia, where government revenue and economy are positively correlated with oil prices, the sustained slump in crude oil prices is sparking anxiety over the government's fiscal consolidation path, which in turn affects the sentiment for the ringgit. As such, it is clear that an absence of solid measures by the Chinese authorities to prop up its economy will mean further pain for commodity-exporting countries.

Fear of the People's Bank of China's (PBoC) move to further weaken the renminbi also holds the financial market at ransom, inflicting similar weaknesses on major trading currencies (the ringgit is one of them). Although this move provides some breathing space for China to ensure a revival of its trade performance, its debilitating impact on the global economy cannot be underestimated.

Indeed, a weaker renminbi is normally associated

THE EDGE
1 FEB 2016

with slower imports from Asian trading nations, and clearly, this does not augur well for export-dependent Asian economies that are already struggling from weaker global demand, particularly from Europe and the US.

The situation in the US is not helping at this juncture either. The Fed's hiking of interest rates despite the ominous clouds forming over the global economy raises the possibility of further gains in the US dollar, something that the global economy is unable to cope with as of now.

Massive and volatile capital flows have caused Asian economies to wobble as business and consumer sentiments were affected by the wild swings in their exchange rates. In Malaysia, the ringgit's pronounced depreciation against the greenback has dented business-spending plans and eroded consumer sentiment in recent times, despite the country's relatively stable fundamentals. A strong dollar also hits global commodities, pulling their prices down immensely in the past one year or so.

On the political front, the recent upsurge in populist sentiment brought on by US and French politicians Donald Trump and Marine Le Pen respectively has also sparked fears of a rise in protectionism in two of the world's major economies. Such a movement in the past induced retaliation by other countries, which consequently dented the prospects of a quick economic recovery. The implementation of the Smoot Hawley Tariff Act in 1930 in the US to protect American businesses and farmers is a case in point.

Although fear is currently grappling the world economy, history has shown that it will normally be overcome with time. The Great Depression of the 1930s is such proof. For this reason, former US president Franklin Roosevelt is remembered for his oft-quoted inspirational line, "The only thing we have to fear is fear itself", uttered during his inaugural presidential speech in March 1933.

Let us hope our current fears will dissipate soon. E

Nor Zahidi Alias is chief economist at Malaysian Rating Corp Bhd. The views expressed here are his own.