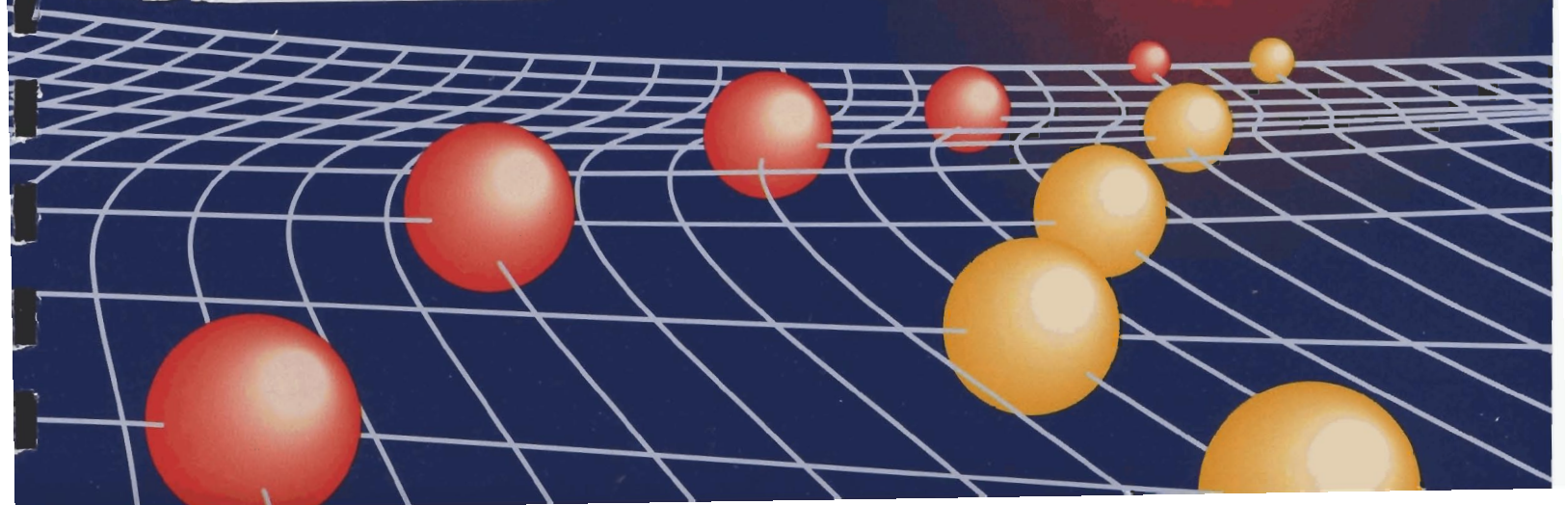
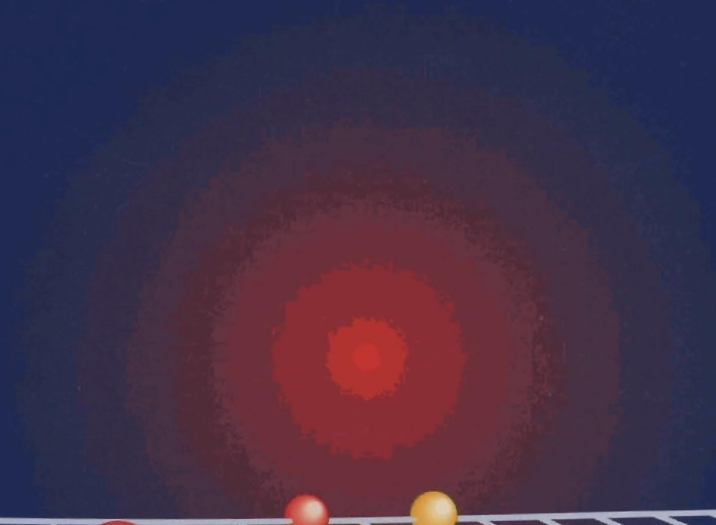


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# **Second Report on Asia**

**Overview report of the economic, political, social and cultural situation in Asia.  
May 13, 1998**

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# Big Isn't Beautiful

Gloom hangs over once-bubbly property markets in Asia. Developers are worrying about how to sell empty space, while lenders fear defaults. Below, we look at how Malaysia's building glut is raising concerns about banks' health. Other articles chart property's weaknesses in Singapore and Hong Kong.

By Murray Hiebert in Kuala Lumpur

Its thin metal spires reach up, striving to be the tallest in the world. The building itself is an impressive tribute to modern chrome and plate-glass architecture, and to the latest in engineering prowess—a narrow skybridge connects the twin towers more than 200 metres above ground. Not so long ago, the 88-storey Petronas Towers were a shimmering monument to Malaysia's go-go growth. Then dark economic storms burst over Southeast Asia, and the opulent towers, set in a sculptured garden, became instead a symbol of Kuala Lumpur's overweight property market.

Oversupply loomed even before the Petronas Towers' 2.6 million square feet of office space became available in mid-1997. Nor was Malaysia unaware of the dangers. Neighbouring Thailand had already provided a chilling lesson in its property-market crash of 1996, which debilitated its banking system. Quick to respond, Malaysia's central bank moved to sharply curb real-estate lending in March last year. Its action subdued construction—but not sufficiently, it now seems, to head off a major property glut.

The key question now is whether Malaysia's own banking system—which so far seems to have weathered the regional crisis better than others—will be unbalanced by the corpulence of its property market. Analysts fear falling prices will cause at least some developers to default on their loans.

Signs of overbuilding abound. If all the projects under way in Kuala Lumpur and the surrounding Klang Valley, Malaysia's business hub, were completed, office space would swell more than 50% to 64.8 mil-

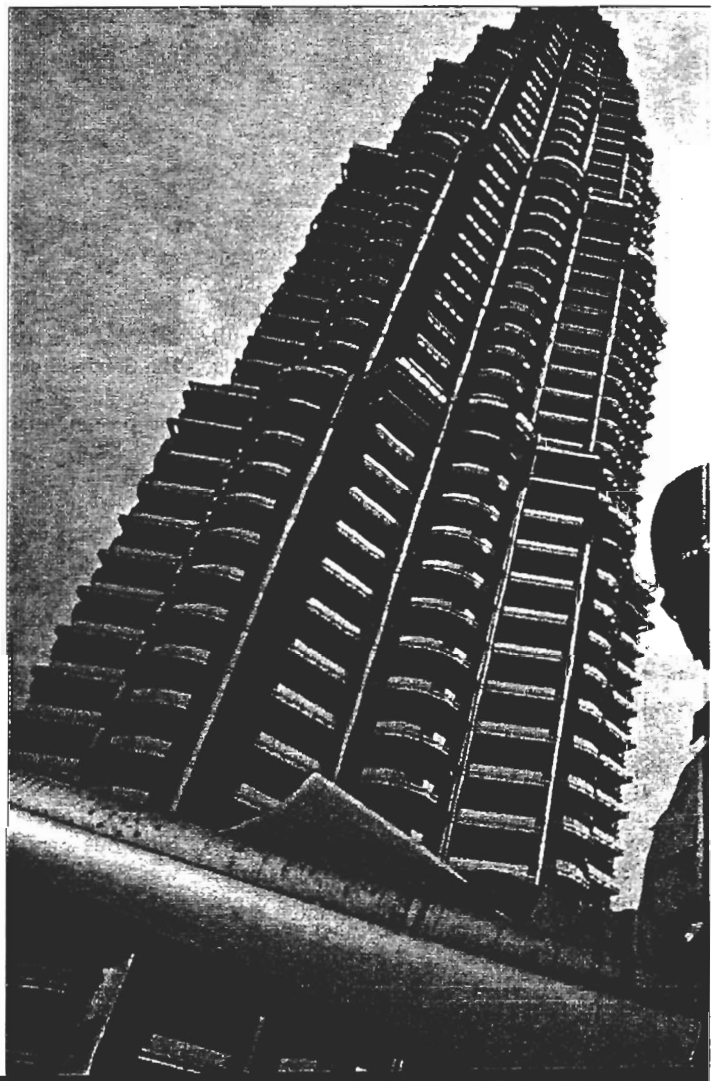
lion square feet by the end of 1999 and retail space would rocket about 90% to 35 million square feet, according to international property consultant Jones Lang Wootton. The number of condominiums would surge more than 80% to 86,000 units, with hotel space rising 40% to 29,000 rooms. JLTW is quick to point out, however, that these figures won't be met, because developers have already started to shrink and postpone projects. Even Putrajaya, the high-profile new seat of government being developed 25 kilometres from Kuala Lumpur, will face some delays, although the first phase will continue on schedule.

Indeed, the pace of construction around Kuala Lumpur has begun to slow, now that developers are finding it harder to get bank credit. Some have stopped work altogether, dismantling construction cranes and laying off workers. Hundreds of consulting firms, building-material suppliers and cement plants have also been hit. "The mood is dark and ominous," property consultant WTW International says.

Retail space is causing the most worry, says Goh Tian Sui, a director at WTW Inter-

national, pointing out that 26 shopping malls are under construction in the Kuala Lumpur area. The Petronas Towers will add a 1.5-million-square-foot shopping mall to the pool, as well as provide Kuala Lumpur with another lavish hotel. "A large supply is coming onto the market at a time when disposable income is shrinking," Goh notes.

The prognosis is similarly glum for office space. Goh expects office rents to



In Malaysia's overbuilt property market, the mood is bleak.



be clobbered as vacancy rates reach 15%-17% in 1998, up from 10% last year and around 5% in 1996. Next year, they could hit 30%, he adds. Petronas Towers, at least, seems likely to escape the indignity of vast unoccupied spaces: One tower has been occupied by joint owner Petronas, the national petroleum company, while 40% of the second tower has been leased to other firms.

Despite the threat of increasing vacancies around Kuala Lumpur, no clear trend in property prices has emerged, in part because potential buyers are waiting for the market to weaken. "To date there have been insufficient transactions . . . to illustrate a downwards trend, but the market has definitely consolidated, underpinned by a lack of confidence, uncertainty and market players' 'wait and see' attitudes," a JLW analyst points out.

Experts believe property prices in general could slide 20%-30% over the next few years. This would lead to at least some highly geared developers defaulting on their bank loans. The difficulty in getting bridging finance means that these developers won't be able to proceed with their projects, and thus have no avenue to generate cash flow to repay debts taken to acquire land, says Wong Yee Hui of Smith



SAATCHI

Zain Securities, a Merrill Lynch affiliate.

"We're concerned where banks loaned money to construction and building condos, hotels and shopping complexes," says C. Rajandram, chief of the private Rating Agency Malaysia. "Demand has come down. If banks have problems, it will be in that sector." Nonetheless, banking analysts in Kuala Lumpur say it's difficult to determine which property companies could default. "You have to go through individual buildings one by one to know which ones are likely to fail," says Phuah Eng Chye, an analyst at Dresdner Kleinwort Benson. In addition, many buildings are owner-occupied. And Phuah points out that much office space is often leased by companies related to the developer.

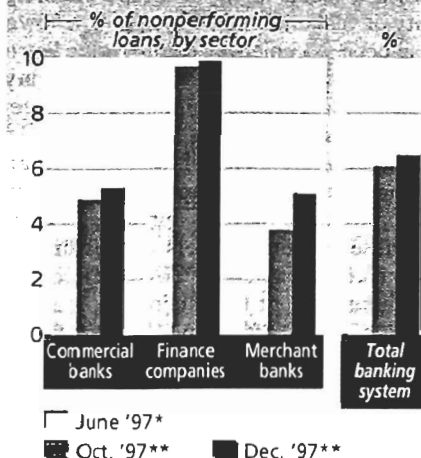
So far, analysts are uncertain about how hard Malaysia's banks will be hit by nonperforming property loans. Property absorbed 28.6% of total loans at the end of 1997. And at that time, 7% of property credits had turned bad, according to the central bank. (The bank last year reclassified nonperforming loans as those not serviced after three months; earlier, the period had been six months.) Salman Khan, a banking analyst with Goldman Sachs in Hong Kong, believes the percentage of nonperforming property loans could easily be double the central-bank figure. "I think gearing is under-reported. My sense is that in the next six months we'll see several small to medium developers go bust," he says.

To what extent is that a cause for worry? Dresdner Kleinwort Benson's Phuah believes nonperforming loans in general aren't "a serious systemic threat" to the country's banks. He reckons such loans will peak at 15% of total bank lending in 1998. Alina Chiew, a banking analyst at Smith Zain Securities, forecasts that nonperforming loans will top off at 10%-15% by mid-year, substantially lower than the 33% reached during the recession in the mid-1980s. Goldman Sachs' Salman Khan is more pessimistic. He believes the percentage is already in double digits, and could rise to around 25%. Other independent estimates range from a low of 10% to a high of 30%.

By contrast, the central bank puts the figure much lower—6.5% at end-1997—although governor Ahmad Mohamed Don has conceded that the situation will worsen in 1998. Moreover, he has stated that the

## BURDEN OF DEBT

Bad loans made up 6.5% of total loans, according to Malaysia's central bank. But many analysts think its estimates are too low.



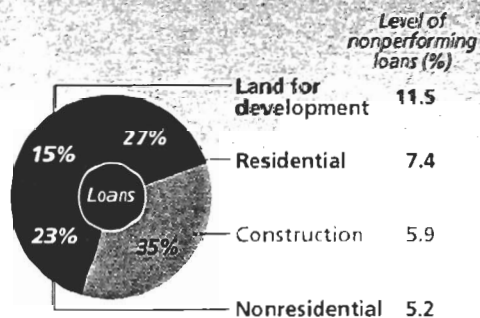
\*Based on old classification whereby loans in default for six months are deemed to be nonperforming

\*\*Based on new three-month classification for nonperforming loans

Source: Bank Negara Malaysia

## CREDIT RISK

More property developers are likely to default on their loans



Source: Bank Negara Malaysia

ratio of nonperforming loans to total bank loans will climb to "double digits" as businesses find it difficult to pay back debt. One reason for this rise appears to be Malaysian banks' reluctance to call in nonperforming loans to politically well-connected tycoons. Says Khan: "Malaysia's banks aren't as unhealthy as those of Thailand or Indonesia, but there's still a disincentive to deal with problems."

And the problem of the day in Malaysia is its bloated real-estate market. The country's banks can only hope that the steps taken so far will help them avoid ending up like their decimated Thai counterparts.

## On Other Pages

49 Squeeze Play in Hong Kong

# Perils in Property

By Ben Dolven in Singapore

A well-heeled crowd of 80 settled into the auction room at Singapore's Grand Plaza Hotel on February 19 to consider a number of mid-range and luxury homes. The prices were low: Auctioneers began the bidding at levels substantially below what the properties would have fetched just a few months ago. But the session ended with a dismal scorecard for the 10 properties: no bids, no sales, no nothing.

Such inertia is not new for Singapore's property sellers. Similar auctions this year have failed to ring up a single sale. And Edmund Tie & Co., among the city-state's biggest property agents, sold no units during a two-week stretch in January. Buyers are even scarcer than last year, when the number of home sales plunged 43%.

No doubt about it—as property bubbles burst around the region, Singapore too is taking a hit.

True, the city-state was better prepared than its neighbours: Its authorities moved to cool real-estate activity back in 1996. But while that may have slowed things down, the market has been hit again, this time by Asia's financial crisis. As banks hunker down to tackle the consequent uncertainties, they're trying to rein in property loans, thus hurting developers and home-buyers alike. Individuals are finding it harder to get mortgages, and developers must deal with higher interest rates, even as cash flow becomes a problem.

With office and commercial markets still boasting relatively healthy occupancy rates, banks are most nervous about developers' residential portfolios, particularly in the market's luxury end, where many units are bought for investment. The banks' concern is not surprising: About 18% of their total loans are for individual mortgages, double the percentage a decade ago; another 16% goes to developers, many of which are most energetic in the residential market.

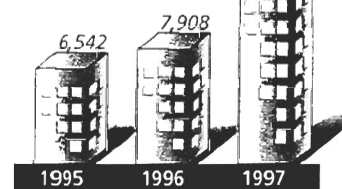
To curb their exposure, Singaporean banks have become more careful. Many banks will lend only 70% of a property's value, though they're allowed to offer up to 80%. The problem is that

such a cautious measure can choke demand, sending prices plunging further. The banks have to check lending, says John Doyle, an analyst with UBS Securities, "but they have to do it in a way that doesn't cause the market to collapse."

To do this, the banks need to be nimble. Singaporeans have shied away from buying homes over the past two years, and since the economic crunch have become even more reticent, preferring to keep extra cash in hand. Demand from Indonesians, who make up about 40% of overseas buyers, has also dried up. There's little hope for an upturn during 1998: A record 17,000 private units sit empty, and another 15%-20% drop in prices is forecast across the board—on top of the 17% decline experienced in 1997.

## TOO MANY HOMES

More homes are being built in Singapore, but sales are falling



Source: Urban Redevelopment Authority, Singapore

Many property firms are hurting. The city's largest developer, Far East Group, recently asked for government permission to postpone payments to the Urban Redevelopment Authority for a huge plot bought last year. Three other developers made similar requests. One explanation—a sudden jump in short-term interest rates in January, brought about by a sharp drop in the value of the Singapore dollar. Now short-term interbank rates—to which most developers' financing is tied—are back around 6% and the pressure has eased somewhat. But the worries remain.

So what are the authorities to do? Developers hope the government will slow, or even halt, distribution of land for development this year. They also want it to revoke the anti-speculation measures that cooled the real-estate market in the first place. After all, given the deathly silence at property auctions today, says Ong Choon Fah, research director at Edmund Tie, "speculation is definitely not an issue." ■

# Few Takers So Far At Asia's Great Firesale

Despite all the excitement about the region's corporate bargains, few deals have actually been struck

By Henny Sender in Bangkok and  
Charles S. Lee in Seoul with  
Michael Vatikiotis in Bangkok

**I**t's breakfast time at the elegant Sukhothai hotel in central Bangkok and every table is full. Most of the patrons are foreigners visiting Thailand on business. They sit in small groups, getting a head start on the day's work over coffee and toast. In one corner is a contingent from China Development Corp., a major Taiwan group, believed to be in town for talks on buying a stake in Bangkok Bank, Thailand's largest. Not far away are a

clutch of accountants from Deloitte Touche Tohmatsu. Also enjoying a power breakfast are a smattering of investment bankers and consultants, down from Hong Kong and Singapore. They're all in Thailand to take part in the corporate deal of the decade.

The scenario is much the same in another part of Asia, where there's plenty of evidence of foreign companies shopping for good bargains—in this case, amid the ruins of Korea Inc. Try booking a room at the Hilton or the Intercontinental in downtown Seoul. Vacancies are rare at either hotel. Virtually all their guests are foreigners—and they're not on vacation.

Yet for all the buzz about the Great Asian Firesale, of bargain-basement prices wrought by weak currencies and wounded companies desperate for cash, few deals have actually been struck. Although the number of purchases is sure to grow, the question is whether these will be soon enough and sufficient enough to perk up whole economies. For one thing, there are still plenty of legal obstacles (*see story on page 54*). Due diligence is taking an excruciatingly long time, particularly when potential buyers are looking at firms wallowing in debt. Another hitch is the strong resistance within Asian business and government circles towards selling prized corporate assets to foreigners.

Survival is usually uppermost in the minds of companies with their financial backs to the wall, even if that entails being reduced to a minority stake. But in Thailand, most of the ailing domestic firms seem loath to admit that their condition may be fatal. "They aren't realistic," says Henry Cornell, Goldman Sachs' Hong Kong-based partner in charge of direct investment in Asia. "Nobody is about to say to



Thai Finance Minister Tarrin is committed to attracting foreign money into Thailand.

them, you will be gone." Complains another direct investor from Hong Kong: "You go to them and say you are prepared to offer them funds and help them repay their debts in return for some equity. And they tell you they don't plan to repay their debts, so why should they give you equity."

Thai businesses' unwillingness to sell hasn't been helped by the government's own ambivalence. While Finance Minister Tarrin Nimmanahaeminda is committed to attracting foreign money into Thailand, Deputy Prime Minister Supachai Panitchpakdi seems less so. "We don't want foreign firms to come and buy out our businesses. We want them to come, buy shares and operate firms and sell them after making profits," he told the local media recently. "This will give Thais a chance to buy them back."

**D**espite such aversion to foreign ownership, some deals are going through. Directors of Bank of Asia are believed to have already approved the sale of a stake in their mid-sized bank to ABN-Amro. The deal is expected to be put to shareholders in the first week of March. Bank of Asia will issue two tranches of new shares to ABN-Amro, giving the Dutch bank a majority stake. The proposed sale is good news both for Bank of Asia, and for Thailand's crippled financial system. It shows that, despite the hurdles, foreign investors continue to seek Thai assets.

The sale will be particularly welcome, given that another high-profile commercial-bank deal of this kind may have fizzled out. On February 20, Citibank suspended plans to buy a majority stake in First Bangkok City Bank, which the Thai government had nationalized two weeks earlier. Whether Citibank was walking away for good or just using the delay as a bargaining ploy was discussed animatedly at breakfast at the Sukhothai.

For the Bank of Thailand, the central bank, the planned ABN-Amro deal will send a much-needed signal to overseas markets that the country is welcoming foreign capital. Bangkok badly needs to recapitalize its banks, which face higher reserve requirements and capital-adequacy ratios under the latest agreement between Thailand and the

International Monetary Fund. Thai banks will have to sign on to the harsh new requirements by August.

Certainly, the government can't afford the recapitalization, which would call for as much as \$25 billion, according to Stephen Frost, a Singapore-based bank analyst for UBS Securities. So it has admonished the country's banks to raise capital themselves—and fast. Even mighty Bangkok Bank has been given an ultimatum to shape up by end-March, hence the bank's interest in suitors from Taiwan and Singapore. Also in need of a capital

the Bank of Thailand has nationalized smaller banks such as Bangkok Metropolitan Bank and Siam City Bank. This has raised some concerns among Thai private bankers that rather than sell to foreigners, the central bank may nurse the newly nationalized banks through the bad times and then return them to their original owners when the financial climate improves. Finance Minister Tarrin also admits the possibility of owners buying back assets on the cheap at auctions. As it is, only foreign firms with onshore licences can participate at auctions of assets from shuttered financial companies. That rules out potential buyers among foreign venture-capital fund managers or investment banks, unless they team up with a local partner.

In South Korea, interest from foreigners has focused more on the country's world-class manufacturers. But the number of actual purchases, like those in Thailand, is small. True, Seoul is rolling out the welcome mat for foreign investors more eagerly than ever; yet it has not removed all the regulatory obstacles. Hostile foreign takeovers, for one, probably won't be allowed until next year to give domestic firms time to build up their defences.

In any event, big-ticket cross-border mergers and acquisitions are bound to take time. Indeed, analysts say the main reason for the dearth of such deals so far is due diligence: Foreign investors must thoroughly familiarize themselves with companies they might buy—and run. "You can't do this stuff overnight," says a senior official at a large Western bank in Seoul. "It's only since December that people have focused on this."

Foremost on every potential buyer's list of concerns is debt. The average South Korean company is leveraged four times over its equity, and this is the very reason why so many domestic concerns are desperate to liquidate assets. But because of a currency which lost half of its value last year, many Korean executives believe—mistakenly—that foreign buyers will find their corporate wares attractive in spite of their debts, analysts say.

"The attitude of the Koreans is only foreigners will pay the kind of price they're asking," says Daniel

## FOR SALE

Foreigners are slowly beginning to buy pieces of Korea Inc.

### Deals completed

- \* Volvo Construction Equipment of Sweden buys Samsung Heavy Industries' excavator division; Clark Material Handling of the U.S. buys SHI's forklift division
- \* Bosch of Germany expands its stake in car-parts maker Korea Automobile Motor
- \* Procter & Gamble buys Ssangyong Paper

### Deals under discussion

- \* Scania of Sweden and bus and truck maker Asia Motors
- \* Pepsi and soft-drinks firm Haitai Beverage
- \* Royal Dutch/Shell and oil refiner Hanwha Energy
- \* Cargill of the U.S., and food-seasoning specialist Daesang (also being approached by Archer-Daniels-Midland of the U.S.)

### Companies for sale

- \* Korea First Bank
- \* Seoul Bank
- \* Halla Concrete
- \* New Core Department Store
- \* Haitai Tigers, a professional baseball team
- \* Yongpyong Ski Resort

Source: Korean press reports

injection are Thai Military Bank, Krung Thai Bank and Siam Commercial Bank, say government and private analysts.

But despite the central bank's urging, few domestic banks have aggressively sought foreign capital. Analysts say both Thai Farmers Bank and Bangkok Bank have indicated that they prefer to sell several small stakes to different investors rather than a chunk to a single investor who could then influence management.

To beef up the capitalization process,

## On Other Pages

### 54 Legal Hurdles in Thailand

Harwood, Northeast Asia regional director at ABN-Amro Asia in Seoul. "But foreigners are looking at these businesses and asking, 'How can I make a profit,' not 'Oh, it's cheap, and I'll buy it.' No one will take over these companies unless they can restructure."

Another related problem is untangling the labyrinthine cross-subsidiary guarantees that financially bind all Korean companies belonging to the same group. "It's not easy because a lot of the guarantees exceed the companies' own equity," says Yun Hyun Soo, president of Comet M&A, a takeover consultancy. He adds, however, that once these problems are ironed out there will be a flurry of takeover announcements, given the wealth of current negotiations.

Indeed, the number of deals is growing by the day. On February 19, Samsung Heavy Industries simultaneously sold its excavator division to Sweden's Volvo Construction Equipment and its forklift operation to the United States' Clark Material Handling. Earlier, Mandoo Machinery, the car-parts subsidiary of the bankrupt Halla Group, sold all its shares in Korea Automobile Motor to its joint venture partner, Bosch of Germany, while the chemical giant Hanwha Group sold two affiliates to its Japanese and German partners.

Despite the slow start, no one doubts that the bargains at Korea Inc. are for real. Momentum will first build among foreign companies that are already doing business in South Korea and looking to expand, analysts say.

**T**hat will also be the case in Thailand where the few transactions involving industry have boosted the foreign partner's stake. For example, Coca-Cola now controls 49% of its Thai joint venture Oji Paper Co. and Bandai Co. of Japan, for their part, have taken shares of more than 50% in their respective ventures. Nissan and Yamaha have not been as fortunate. Although the Japanese companies are eager to increase their equity in their enterprises, their Thai partners have declined, Japanese bankers say.

Another bank is negotiating to acquire a factory from a Thai petrochemical giant buried under a massive \$4 billion debt. "This company is dead," says the bank's frustrated Bangkok branch manager, "but still refuses to sell assets."

The ailing companies' reticence is baffling, as those that agree to a capital injection fastest will emerge the strongest. Advises Henry Ho, branch manager for Citibank in Bangkok: "Don't wait." So far though, few Thai firms are heeding his words.

## SHROFF

## MALAYSIA

# Second Time Lucky

**T**heir on-off relationship is on again. After a bust-up just two weeks ago, Malaysia's financial powerhouse Rashid Hussain Bhd. and Commerce Asset Holdings, a large listed banking group, are again contemplating getting together. Second time around, the likely union will be between the two groups' financial subsidiaries: RHB Capital, Rashid Hussain's banking arm, will buy Commerce Asset's Bank of Commerce.

It's a match made in heaven—a merger of two purely financial institutions that will create the country's second-largest bank. Best of all, it should be equally satisfying to both partners. Commerce Asset will be paid either in cash or in shares (20% in RHB Capital by way of new shares in it and RHB Sakura, its merchant banking arm).

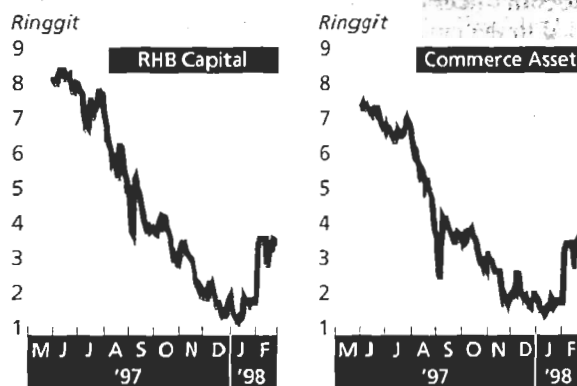
For its part, Rashid Hussain is betting on the market liking the deal, which would boost the depressed share prices of both RHB Capital and its parent. Placing out shares at a premium in RHB Capital (and RHB Sakura) should help cash flow back to indebted Rashid Hussain.

The proposed union should set the tone for similar mergers that are expected to strengthen Malaysia's debilitated banking system. But the tears and sweat shed in making even this one work out indicate similar tussles ahead. Rashid Hussain's previous romance with Commerce Asset ended on February 13, with both sides miffed at each other. Bankers say RHB Capital was to have been absorbed into Commerce Asset in exchange for an estimated 1.5 billion ringgit (\$384.6 million) in cash and shares for Rashid Hussain.

Commerce Asset grumbled that the deal didn't "maximize shareholder value." Indeed, many considered the deal unsatisfactory because, as one banker notes, it would have meant the moving of cash from an institution that was purely a financial concern (Commerce Asset) into one that wasn't. Although primarily a financial-services company, Rashid Hussain also has extensive property assets.

## Broken Deal

Share prices for RHB Capital and Commerce Asset remain weak



Source: Datastream

Rashid Hussain badly needs the new deal to perk up its stock value—its current debt is estimated by Merrill Lynch at 3.2 billion ringgit. Most of this burden is due to its 2.2-billion-ringgit purchase last June of Kwong Yik Bank, a move that created Malaysia's third-largest bank.

It got others into debt as well: Malaysian Resources Corp. happily bought a 27% stake in the enlarged Rashid Hussain by

borrowing \$250 million. At the time, the deal was sweet, as the share prices of both Rashid Hussain and Malaysian Resources soared. Since then, though, the ringgit has tumbled 44% against the U.S. dollar, and the stockmarket has plummeted, taking both companies with it.

Malaysian Resources must regret that dollar loan, especially as it came with strings attached. Under central-bank guidelines, firms can borrow foreign exchange only if they earn dollar-denominated revenue. Malaysian Resources' earnings are exclusively in ringgit, but company officials say the borrowing was permitted by the central bank as a bridging loan that was to have been repaid in December 1997 through the proceeds of a group restructuring scheme.

But the sinking stockmarkets derailed the restructuring plan. Malaysian Resources will have to reschedule its bridging loan into what it hopes will be a long-term debt. Meanwhile, it must clean up its balance sheet—at today's rates, it has suffered 350 million ringgit

in currency-exchange losses.

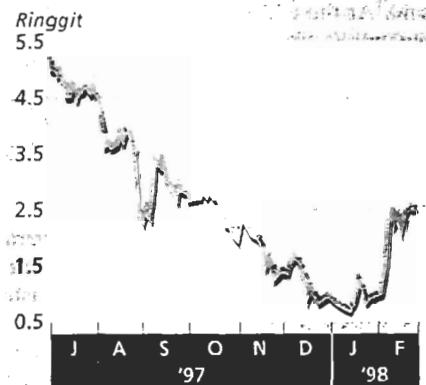
The company needs cash—and fast. That's why any rise in Rashid Hussain share prices would delight Malaysian Resources. (A unit in the company also holds a 20% stake in Commerce Asset.) Malaysian Resources bought Rashid Hussain's shares at 14 ringgit; they now trade at about 5.40 ringgit. Worse for Malaysian Resources, it borrowed dollars at a rate of 2.50 ringgit; today's rate is around 3.85.

Who could have foretold this state of affairs back in 1993 when the two listed media companies that eventually constituted Malaysian Resources were taken over by four senior newspaper executives close to Anwar Ibrahim, deputy prime minister and finance minister?

That political muscle apparently helped Malaysian Resources go places over the next four years. It grew swiftly, clinching lucrative licences in telecoms and power generation, and bagging property projects. Even when the going got tough, the company came out on top. In June 1996, it sold its mobile-telephone network to national utility Telekom Malaysia for 640 million ringgit, even though the unit was one of the weakest among seven others. Malaysia's current economic troubles will ensure that getting such good deals will no longer be so easy. ■ S. Jayasankaran

## In Need of a Perk

Malaysian Resources' share price has dipped



Source: Datastream



# Just a Technicality

Asia's crisis is a minor irritation to U.S. hi-tech companies

By Matt Miller in San Diego and Santa Clara, California

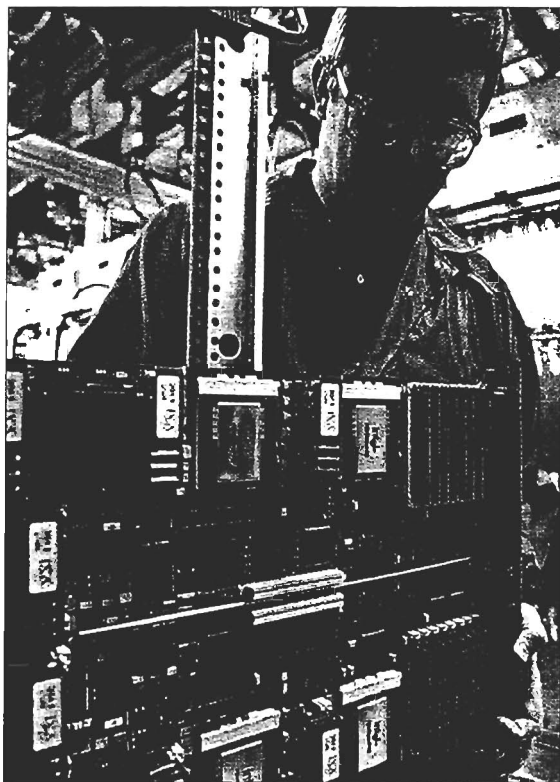
**F**allout from the Asian economic crisis is beginning to wash ashore across the Pacific. And in recent weeks it has become clear that California's hi-tech dynamos won't emerge unscathed. But the damage seems limited—mainly to individual segments of the industry or to companies that have counted on a big piece of the Asian pie for their sales.

"For the technology industry as a whole," says Mark Macgillivray, managing director of H&M Consulting, which monitors technology in Silicon Valley, Asia's downturn "isn't much more than a blip on the radar screen."

Most California technology companies are so strong domestically, they can weather any downturn in Asian sales, say analysts. "Some growth may be scaled back," says Macgillivray. "But in aggregate, we're doing quite well." Not only that, the firms have little to fear from Asian countries trying to export their way out of the crisis. Asian exporters generally don't compete directly against California's hi-tech domain. Indeed, many U.S. groups source their goods in Asia and are expected to benefit from cheaper production costs.

This upbeat assessment could become an important counter to other American industries that are likely to cry "foul" and "protectionism" when low-cost imports begin flooding the U.S. market. News in late February that the U.S. trade deficit had registered its biggest gap in nine years—\$113 billion in 1997—barely made a ripple in California's hi-tech circles.

AirTouch Communications, a San Francisco-based wireless-telecommunications company, is a typical example of how those hi-tech companies shrug off Asia's travails. In December, it said that while it holds equity stakes in a total of 10 Japanese and South Korean cellular companies, East Asia-based customers account for only about 5% of its worldwide base of around 10 million users. Two months later, AirTouch proclaimed record sales and profits, with strong showings in both the U.S. and Europe. Its stock price



Minimal damage: America's technology industry sees little reason to fret about any drop in Asian sales.

has continued to soar.

Meanwhile, the founder of one small Silicon Valley telecommunications software company, who asked not to be identified, says he was recently forced to write off money due from a South Korean customer. The founder called the setback minor. "I'm not too worried," he said, noting that a dip in Asian sales has been compensated for by new American customers. "I'm an optimist."

That kind of attitude permeates Silicon Valley. At a recent gathering of South Asian technology professionals, Asia's troubles barely warranted mention. Instead, the talk was of new technologies, new companies and new products.

**A** generally rosy glow on Wall Street also helps. Explaining how most technology stocks have continued to post gains, Larry Chimerine, chief economist at the Washington-based think-tank, Economic Strategy Institute, says: "Remember, this is a bull market, and by definition, it's giving everyone the benefit

of the doubt."

Not everyone is benefiting, though. Qualcomm Inc., San Diego's biggest name in high technology and the developer of Code Division Multiple Access, or CDMA, digital wireless technology, had to slash revenue forecasts and fire 700 temporary employees when business tapered off in its key market of South Korea. By December, a severely depreciated South Korean won had ripped into its royalties and in February, unnamed Korean customers cancelled orders for specialized integrated circuits and high-end wireless telephones.

"The demand [in Korea] is there," said company Chairman Irwin Jacobs, in a conference call with stock analysts. But "it's less than what we had expected." Qualcomm's stock price plunged.

Often such statements are enough to tear into the stock of an entire sector; investors conclude that if one company is suffering in a given market its peers will likely follow. But, they held on to other telecommunications stocks, with one exception: Sawtek, a small, Florida manufacturer of cellular-phone components and supplier to Qualcomm, announced a cancellation in South Korean business the same day as Qualcomm.

Likewise, Space Systems/Loral and Electronics for Imaging, which produces software and components for colour copiers and printers, announced decreased earnings due to cancelled orders in Asia. Loral also said it would lay off up to 300 workers. Both companies' stocks fell, but they didn't take competitors with them.

Loral had been manufacturing satellites for the Bangkok-based Asia Broadcasting and Communications Network Public Co. and for P.T. Pasifik Satelit Nusantara of Jakarta. These satellite orders totalled \$400 million and had accounted for about 25% of the company's order book. Electronics for Imaging supplies Japanese manufacturers Canon, Ricoh and Minolta, all of which have seen sales decrease in Asia because of the economic turmoil.

When it comes to the semiconductor business, though, the pain of Asia's downturn doesn't discriminate. Companies that make devices needed to produce semiconductors were already suffering because of overcapacity in manufacturing plants. Now orders from Japan and Korea have been either delayed or cancelled. Korean giants Hyundai, Samsung and the LG Group and Japan's Fujitsu and Hitachi have all announced delays in new semiconductor-production facilities, with some projects postponed indefinitely. ■



# Crisis and Conspiracy

By Linda Y.C. Lim



The writer, a Singaporean, is a professor and director of the Southeast Asia Business Programme at the University of Michigan Business School.

**A**s consensus grows on the causes of Asia's current economic crisis, so too does the chorus throughout Asia of some form of American-led conspiracy to engineer and profit from the region's difficulties. Such theorists argue that American financial-market actors—currency traders, bankers, fund managers—somehow conspired to build up Asian companies' external indebtedness, and then to depress their asset values, both to make short-term profits and to enable Asian companies to be taken over at fire-sale prices by American or other Western banks and industrial corporations.

Some argue that the United States government welcomed or even instigated this—to punish Asia for its arrogance and intransigence in opposing calls for more Western-style democracy, market opening and improvements in human rights and labour standards. In addition, the International Monetary Fund is considered part of a Western conspiracy to force liberal economic and political reforms—and foreign ownership and control—on an unwilling Asia.

But most of the short-term foreign capital involved in the overvaluation, and now undervaluation, of Asian currencies, and in the creation and deflation of the Asian overinvestment bubble, was not American, but from other Asian and European countries, particularly Japan. U.S. banks' short-term loan exposure to the region is small relative to that of Japanese and European banks. Most transactions in thinly-traded Southeast Asian currencies take place in Tokyo, Hong Kong and Singapore, not New York or London.

Financial-market actors also operate competitively, not collusively. True, they do tend to move in sync, but this is because they are all responding to the same underlying economic fundamentals. And of course there is something of a "herd instinct," which may be rational or irrational.

As for financial-market actors colluding to benefit industrial corporations from the home country, the interests of the two conflict at least as much as they coincide. Currency volatility increases risks and capital costs, including foreign-exchange hedging costs, for U.S. multinationals engaged in long-term foreign direct investment, while a currency collapse reduces their foreign earnings and stock prices.

Neither short-term or long-term investors are motivated by politics or can be manipulated by their government, which in the era of globalized capital markets has little knowledge of, let alone control over, their actions. Rather, market actors are motivated by economic self-interest, ranging from greed to the aim of "maximizing share-

holder value." Currency traders may be called many things, but they are not conspirators.

The IMF is a multilateral agency whose members include the Asian governments themselves, and it simply applies the standard economic policy prescription for countries facing an external debt crisis. One may fault it for inadequacies in this standard prescription, but not for conspiring to undermine Asian economies.

So why are some Asians so eager to believe in such implausible conspiracy scenarios? One reason is the lack of understanding of the complex economics behind the crisis. More important, many Asians lack first-hand familiarity with the workings of atomistic free markets guided by Adam Smith's "invisible hand," as in the lightly-regulated U.S. and offshore financial markets. Instead, Asian investors' and enterprises' experience in their own thin and nontransparent home markets—often subject to manipulation by local governments, state enterprises, institutional investors and "crony capitalists"—leads them to believe in the power of "visible hands" to move markets, and to be sceptical about the competitive workings of markets elsewhere.

Foreign conspirators also provide a convenient scapegoat for one's own (government or corporate) shortcomings that contributed to the crisis, and an excuse not to take the tough and painful actions needed to correct these. Belief in conspiracy feeds denial and causes delays in making the policy adjustments needed for recovery, thereby prolonging the crisis. It is thus important to put such beliefs to rest.

**A**t the same time, American financial institutions, multinationals, market analysts, journalists and economic commentators have been publicly gloating over the "incredible bargains" now suddenly available, the favourable impact of deflationary pressures from the Asian crisis on the American home economy and the purported "triumph" of the "American way" of doing business. Such gloating is unwarranted—the Asian crisis cannot solely or even primarily be attributable to "Asian values," just as the "American way" has yet to prove itself in Asia. One does not have to subscribe to any conspiracy theory to recognize that too rapid and premature implementation of "Western values," such as open capital markets and democratic party politics, may have contributed to the severity of the economic crisis in Asian countries lacking the necessary supportive institutions to make them work well. So, as with the conspiracy theory, triumphalism should also be put to rest. ■

**‘Currency traders may be called many things, but they are not conspirators’**

# Hang Looser

Singapore's regulators start to relax

By Ben Dolven in Singapore



While many of Asia's central banks have blown their credibility by regulating too loosely, the Monetary Authority of Singapore has never hesitated to lay down the law to local bankers. Its top disciplinarian was its long-time deputy managing director for banking, Koh Beng Seng. "He would call one guy into his office, look him in the eye, and say 'This is not going to happen again.' That would be enough—the word would get around," recalls Philippine central banker Vincente Valdepenez.

The authority is not only strict, but thorough. Its regulators pore over everything from the resumes of prospective senior bank officials to the details of new credit-card promotions. Bankers tell of blistering memos over tiny technical violations, or delays while the authority straightened out small points on applications.

This vigilant approach has produced a

banking system better able to weather financial storms than any in Southeast Asia. The authority's capital-adequacy requirements—50% higher than international standards—have left local banks with plenty of capital to gird themselves against dodgy debts and outright defaults. And high reserve requirements have kept overall loans from becoming too big a part of their books. "They have a really good track record of setting standards and enforcing standards," says Valdepenez, who headed the Association of Southeast Asian Central Banks for nine years.

But along with such vigilance has come a tendency to exercise excessive caution, and a reluctance to liberalize. This has left Singapore's financial industry lagging in key areas, from fund management to retail banking. No foreign bank has received a full retail-banking licence in the city-state since 1971. As of March 1997, Singapore was host to 22 foreign retail banks; Hong Kong had 37 at the end of 1997. The number of investment funds managed out of Hong Kong dwarfs that of Singapore.

Thus, while risk-averse regulation has served Singapore well in testing times, the monetary authority has also begun to signal that it intends to change its ways. In November, Deputy Prime Minister Lee Hsien Loong said the authority needed to evolve from a stern regulator into a more flexible "supervisor" of the financial industry—"to regulate the financial sector with a lighter touch, accept more calculated risks." A month later, he took charge of the authority while Koh went into retirement.

The monetary authority's chairman has always been a top government official. While it isn't a central bank in that it doesn't take deposits from local banks, it sets monetary policy and regulates the financial industry—and in that regulation, it often reflects the government's priorities, such as pushing banks to regionalize or to merge. The authority has also protected local banks by limiting the presence of foreign competitors. But it's free of the political favouritism that has afflicted other central banks in Asia.

So why is the government now nudging the authority to change? The answer is that finance is a crucial growth engine for Singapore's services-oriented economy. And to grow from a carefully nurtured regional outpost to a globally competitive financial centre, it will need a few things it doesn't have: More dynamic local institutions, more foreign players offering a wider

range of services, and more transparency in a system that analysts have long complained is among Asia's most opaque.

The target is Hong Kong. "They're trying to play catch-up with Hong Kong, and to do that they know they will have to loosen up," says Song Seng Wun, regional economist with GK Goh Research. To challenge Hong Kong as a financial hub, Singapore seems ready to adopt a more relaxed regulatory style. "It is said that in Hong Kong, anything not expressly forbidden is permitted, whereas in Singapore anything that is not expressly permitted is forbidden," Lee noted.

But can the old enforcer truly lighten up? Its initial steps in that direction have been easy ones—setting up new divisions to coordinate reform and industry-promotion initiatives,

putting more government funds into the hands of private managers, and pushing local banks to disclose more about their financial condition.

What about broader changes—widening foreign access to the Singapore dollar,

for instance, or allowing foreign banks to merge with or acquire local institutions, or approving higher-return, higher-risk mutual funds? Many bankers wonder whether the authority will follow through if liberalization means accepting riskier ventures or substantially less control. "When they talk about a looser hand, I'm sure they really mean it at an intellectual level," says a foreign banker. "Whether they mean it at an emotional level remains to be seen. It will be interesting to see how quickly people test it."

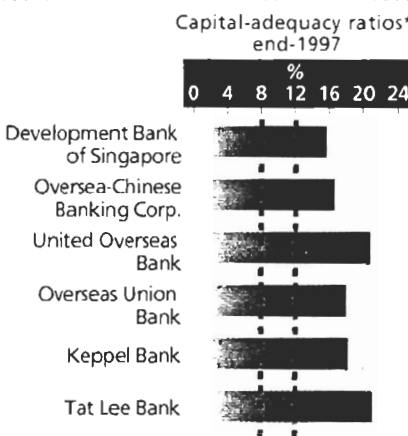
But there is evidence of a new approach. Consider bank disclosure. "For years, going to the banks was a jolly waste of time," says an analyst. "They just say, 'Competition—we have to disclose as little as possible.'" But in January, with investors worrying about the exposure of Singaporean banks to Indonesia, the monetary authority told local bankers to detail their regional exposures. Then, Lee publicly read out the numbers.

In February, Lee publicly disclosed the amounts that banks and the authority had agreed upon for provisions against possible bad loans—and the expected 30% fall that local banks would take in their 1997 earnings. Nonperforming loans will lop a chunk off their bottom lines this year and probably next, as Moody's pointed out in early March when it lowered the banks' ratings outlook to negative.

But Moody's still ranks three Singapore banks—Development Bank of Singapore, Oversea-Chinese Banking Corp. and United Overseas Bank—as being the strongest in Asia. That has to do with the authority's vigour in enforcing its exacting guidelines—a system which now has much appeal in countries where lax regulation led to so many problems. In Thailand, for instance, Koh Beng Seng has become a special adviser to the government's banking-reform programme. It may be the perfect job for the man Singaporeans call the regulator's regulator.

## STRINGENT STANDARDS

Singapore's six largest banks have more capital than international standards require



\* Ratio of capital to risk-weighted assets  
 .... The Bank for International Settlements requirement  
 ---- The MAS requirement

Source: Merrill Lynch, Jardine Fleming

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F I N A N C E

# Rotten to The Core

Rebuilding central banks  
will be hard work

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By Henny Sender in Hong Kong,  
Kuala Lumpur and Bangkok,  
with Charles S. Lee in Seoul

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It's late Friday afternoon in Bangkok and Finance Minister Tarrin Nimmanahaeminda is hoping to catch a flight to Phuket. It will be the first holiday weekend in months for the man who's struggling to restore credibility to Thailand's financial sector—particularly to its beleaguered central bank. It's an uphill task, but, unlike his counterparts elsewhere in the region, Tarrin is tackling it head on.

"We can't blame outside people," he says over a hurried cup of coffee. "The problem at Bank of Thailand was their own laxity in the past. We have to be seen not to be masking problems but to be returning to efficient management of foreign-exchange reserves and supervising the banks." Yet Tarrin knows that the political meddling that led to the central bank's downfall is still a force to be reckoned



The buck stops somewhere, but not at Indonesia's central bank.

with and may complicate his attempt to rebuild it into a technocratic institution.

Central banks are supposed to be watchdogs, responsible for safeguarding a nation's savings and ensuring that its banks are sound. But many Asian central banks have become highly politicized, thanks to a brand of crony capitalism that has made it impossible to enforce the rules intended to keep both borrowers and lenders healthy. Now, many commercial banks are reeling under bad debts, which may soon approach 30%-40% of their portfolios in Thailand, Indonesia, Malaysia and South Korea, according to Roy Ramos, a bank analyst for Goldman Sachs in Hong Kong.

**A**s Tarrin recognizes, economic recovery in Asia hinges in large part on restoring the central banks' credibility. The key is to reinvent them as institutions free to set monetary policy, protect currencies and supervise banks—and do these things free of political interference. Until such a change occurs, market confidence and the investment funds needed to fuel a recovery are likely to remain elusive.

Thanks in part to its dynamic finance minister, Thailand is furthest along the path of reform. South Korea, too, has taken steps to clean up its finance sector and increase its central bank's independence. But in Indonesia, interference by President Suharto's family and friends in Bank Indonesia, the central bank, has never been greater. Meanwhile, officials at Malaysia's central bank, Bank Negara, seem to be in a state of denial. They insist both on their independence and the health of their fi-

nanial system. But huge losses at Sime Bank and potential losses at Bank Bumi-putra, the nation's sixth- and second-largest, suggest that the worst is yet to come.

Thailand, the first into the crisis, is well past the denial stage. But the government still faces a struggle to end politicization and abuse at the Bank of Thailand. In early March came the revelation that the central bank spent 1 trillion baht (\$25 billion at present rates) last year in a vain attempt to bolster ailing but politically connected finance companies.

Finance Minister Tarrin has set up a committee to look into such mismanagement. It will examine in particular what he calls "The Last Great Debauch"—the central bank's decision to spend most of the national reserves in a futile effort to hold the baht to its U.S.-dollar peg early in 1997. At the time, Bank of Thailand officials said it was important that they not be stampeded into giving up their longstanding exchange-rate policy. Many of the individuals responsible for that ill-fated decision, notably Paiboon Kittisri-kangwan, who managed the reserves, are still in place. But possibly not for much longer: The committee is due to wrap up its report at the end of March. Upon its release, bankers expect that heads will roll—possibly even that of the governor, Chaiyawat Wibulswadi, who can be fired

by the finance minister.

In fact, Tarrin retains so little faith in the central bank that he now bypasses it whenever possible, even relying on private-sector bankers for the financial and economic data normally provided by the Bank of Thailand. Nor has the central bank been entrusted with rebuilding the financial system and disposing of the assets of closed financial institutions. Instead, those functions have been given to two new agencies that report directly to Tarrin.

Even so, sceptics doubt Tarrin's ability to prevent collusion between the former owners of these assets and the officials in charge of their disposal. "Can they prevent debtors from bidding for their own assets?" asks a senior international banker, who questions why the disposal of the assets wasn't left to the creditors in the first place.

In addition to sidelining the central bank, at least for now, Tarrin has set up various advisory boards. One will advise him on how to strengthen the bank. It's staffed by distinguished officials from abroad like Koh Beng Seng, a former top regulator at the Monetary Authority of Singapore. Another will give counsel on how to strengthen the legal infrastructure. Currently, for example, banks have little leverage in dealing with recalcitrant debtors; with a stricter code on foreclosure, banks will be better able to go after defaulters' assets.

Like the Bank of Thailand, the Bank of Korea takes much of the blame for South Korea's currency crisis. The central bank, supposedly the safekeeper of foreign-currency reserves, was forking out up

to \$2 billion a day in late November in a vain defence of the won as it plummeted against the dollar.

The Bank of Korea simply miscalculated the amount of usable reserves it had to mount the defence: It counted as part of the reserves dollars it had lent to overseas branches of domestic

banks. By the time the central bank needed the money back, the commercial banks had spent it on repaying their foreign creditors.

For their part, central-bank officials blame the Ministry of Finance and Economy for arm-twisting them into defending indefensible exchange rates. They have a point: Until recently, the central bank answered to the ministry, which set the overall monetary policy, including

**‘ You have  
corruption above  
and incompetence  
below ’**

**—A Jakarta-based bank  
treasurer talking about  
Bank Indonesia**

exchange-rate policy.

Legislation passed in December at the behest of the International Monetary Fund boosts the central bank's independence. Now, the bank sets monetary and credit policy, while the Finance Ministry sets the broad macroeconomic policies. Central bankers, however, continue to gripe about government meddling and express doubts that anything will change in practice.

There's also a growing call for the central bank to shine the spotlight of reform on itself. Its critics in the press have zeroed in on its bloated bureaucracy and old-boy network. They say the central bank needs to prune its 3,500-strong, top-heavy staff and cut its 24 domestic and overseas branches by a third.

At least Korea has turned the corner. In Indonesia, the degree of intervention in the central bank seems to be increasing. "It is the job from hell," says the treasurer of an international bank in Jakarta. "You have corruption above and incompetence below."

Now things have deteriorated to the point that there's a "total void" at the central bank, according to the Singapore-based regional head of an American bank. Governor Soedradjad Djiwandano was forced out in February for opposing the currency-board arrangement President Suharto favoured at the time. Suharto also removed several directors—ostensibly on charges of corruption. Foreign bankers say the changes are an operational nightmare: Of the top dozen officials in place six months ago, only a few remain.

While Soedradjad was governor, he frequently spoke out on the need to consolidate the country's 250 or so banks—but never made any headway. As a watchdog, Bank Indonesia also failed miserably in monitoring the build-up of debt in corporate Indonesia, and therefore failed to recognize that floating the rupiah would cause the currency to plunge so far.

Now that Suharto has been re-elected for another five-year term, many bankers fear the prospects for a depoliticized central bank are bleaker than ever.

Foreign bankers say that because Bank Indonesia was seen to lack independence, the IMF insisted that a new agency be set up to preside over the restructuring of the banking sector and to take over the sickest banks. The idea was to prevent political interference in identifying which banks would be taken over. But the staffing of the new agency already raises concerns

about its independence. One third come from the central bank, another third from the Ministry of Finance and the last third from the state banks at the heart of political lending in Jakarta. Only weeks after the agency was created, Suharto dismissed its boss. No official reason was given, but a report by Jardine Fleming Nusantara in Jakarta said he was sacked for attempting to promote transparency.

Malaysia's central bankers claim they have nothing in common with their counterparts in Southeast Asia. They insist that Bank Negara has always been independent and effective. "People lump us with

Malaysian companies to invest abroad may well lead to borrowing through offshore subsidiaries—which the bank lacks authority to monitor.

Foreign bankers also wonder about Bank Negara's willingness to acknowledge problems in the banks and to disclose the extent of bad loans. One unsettling example: Worried about the lack of liquidity in domestic banks as nervous depositors withdrew funds, central bankers met foreign bankers in mid-February and asked them to lend to the top-tier Malaysian banks, according to several participants. Officials from Bank Negara's bank-regulation division insisted that all were sound and refused to provide guarantees for such funding. Less than three weeks later, news came that two of the top six were in serious difficulty. "We all worried that the meeting would be counter-productive," says one participant, the treasurer of an international bank. "The effort to legislate confidence illustrated how little they understood market forces."

Moreover, critics—including two former deputy governors—fret that the bank is less independent than it once was. They say that Malaysia Inc., the alliance of tycoons and politicians, has undermined Malaysia's technocrats.

Because most of the borrowing has been from domestic banks in ringgit, analysts worry that there is little immediate pressure on Bank Negara. Might it be displaying the same sort of procrastination that has marked

the Bank of Japan's response to problems in the Japanese financial system?

Because Japan didn't really need the rest of the world's money, there was little outside pressure to force a change in the way its authorities conspired with and protected ailing local banks—instead of forcing them to comply with international norms on bad loans and capital-adequacy ratios. Tokyo's latest ¥30 trillion (\$230 billion) bank-bailout package continues the pattern of supporting the banks—with no demand on them to improve management.

Both in Malaysia and Japan, central-bank officials speak of the need for stability—but that can also be an excuse for inaction or politically motivated bailouts. Japan's failure to clean up its banks has led to economic stagnation and diminished its appeal as a role model for the rest of Asia. The lesson: Until central banks do their jobs properly, the region will find full recovery beyond its reach. ■

## CALLED TO ORDER

Progress on banking reform is patchy at best

Banking reforms	Malaysia	Indonesia	Thailand	South Korea
Better banking supervision, examination	Yes	In disarray for now	Yes	Some
Better accounting, disclosure standards	Improving	Status quo	Improving	Promised
Political independence for bank regulators	Still an issue	Key issue	Yes	Promised
Overall progress with structural reform	Limited progress	Limited progress	Slow but on track	Some progress

Source: Goldman Sachs

the others, but we are more like Hong Kong or Taiwan or Singapore," argues a former deputy governor of the bank.

Bank Negara officials, past and present, say the central bank had privately warned against the megaprojects that helped stoke skyrocketing imports and economic growth. They are equally insistent that their supervision of the Malaysian banking system has been relatively sound. "We approve all foreign borrowing and we only approve when there is a natural hedge," says Zeti Akhtar Aziz, an assistant governor. "The fact that debt is 160% of GDP doesn't necessarily translate into vulnerability. The banking system is fundamentally undamaged."

Yet at least four former central-bank staffers, all of whom spoke on condition of anonymity, are not so sanguine. "The government has no idea of the extent of external leakages," says one. He notes that the government's policy of encouraging

# On the Prowl

## Taiwanese investors proceed with caution

By Julian Baum in Taipei

**B**enny Hu is a man in a hurry. As president of Taiwan's leading venture-capital company, he sees opportunities galore in Asia's distressed economies. And he's ready to take the leap, even if most of his compatriots are more cautious.

"The window of opportunity may not be open very long," says Hu, whose company's trademarks are both its enthusiasm for offshore ventures and its connections with Taiwan's ruling Kuomintang. "We've got to act fast."

The company Hu heads, China Development, is doing just that. It recently announced the purchase of a 50% stake in Bangkok First Investment & Trust, an affiliate of Bangkok Bank, for \$14.8 million. And it's looking at other prospects in the region for direct acquisition or portfolio investments, including South Korea. Says Hu: "What has been reported is only the tip of the iceberg. Many deals are under discussion but to talk about them prematurely would kill them off."

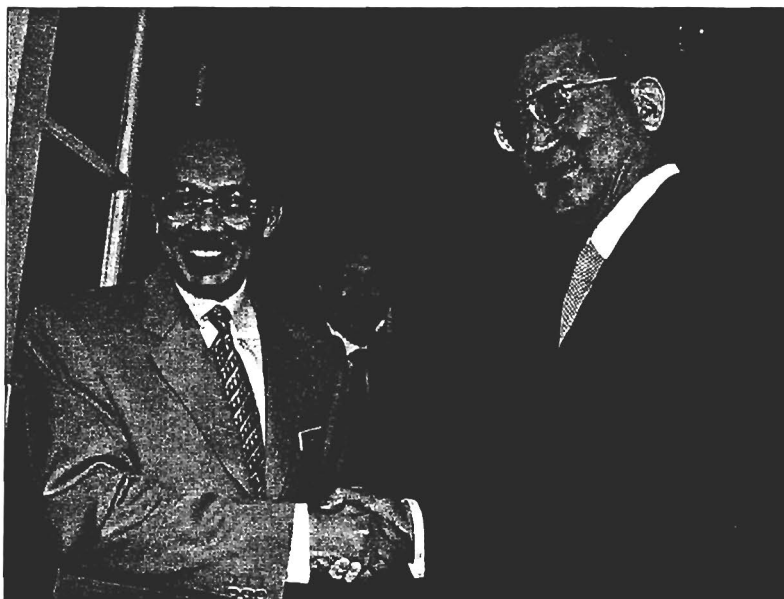
Given the billions Taiwan already has invested in the region, many observers had expected a rush of China Development-style deals. In fact, however, with a few exceptions, the island's other businessmen have shown little interest so far in the regionwide firesale.

In general, manufacturing investors have held back, say analysts, because they lack the management skills to take over shaky firms and lack access to investment-banking expertise to evaluate corporate operations and balance sheets. More importantly, many companies with experience in the region say they would prefer to be in mainland China. The productivity of Chinese workers is higher and it's easier to recruit trainable managers, they say.

With these limitations in mind, the most attractive options have been expanding

Taiwan's offshore banking and securities businesses and taking limited equity positions in listed companies, especially in Thailand and Malaysia, rather than making direct investments. "This is certainly a good time for international acquisitions," says Shyu Jon-chi, senior vice-president of the international division at Core Pacific Securities. Shyu says his company is looking at several possibilities in Southeast Asia and expects to make a decision within the next few months. Earlier this year, Core Pacific purchased the Hong Kong branch of Yamaichi Securities of Japan for more than \$80 million after the parent company declared bankruptcy.

Priming the pump on such efforts is



Vice-President Lien Chan (right) scores diplomatic points in Malaysia. Crisis-hit Asia could offer opportunities for Taiwanese investors, too.

the chairman of China Development, Liu Tai-ying. He was recently asked by the cabinet-level Council for Economic Planning and Development to raise capital from Taiwan's largest corporate groups for a Southeast Asia fund. With at least \$310 million spread among 20-30 players, the fund should be up and running in about two months, Hu says. Among the participants are the Tuntex Group, China-trust Commercial Bank and President Enterprises.

Hu says the fund will help rebuild confidence in Southeast Asian equity markets and offer a bridge for Taiwanese com-

panies that prefer to share the risks of increasing their exposure while they look for other opportunities. The fund will invest 70% of its capital in listed equities—and the rest in unlisted companies and anything else that looks attractive, whether in securities or direct investments.

While some businessmen privately disparage the political motivations behind such efforts—Taiwan has no diplomatic relations in the region and, in its rivalry with Beijing, seeks to curry favour with governments there—no one disputes that ultimately they will succeed or fail on economic merits. "The decisive factors are commercial," says George Yeh, the CEPD's director of economic research. "If there is any spillover into politics, that is a side effect."

Yeh believes that Taiwan's banking industry could be the biggest beneficiary from the outward push. Governments in the region are always seeking more investment, he says, but Taiwanese businessmen have always had difficulty raising sufficient capital through often cash-poor banks in the host countries, a problem that is particularly acute now. Currently there are only 12 overseas branches or subsidiaries of Taiwanese banks in all of Southeast Asia—none at all in Malaysia and only one in Thailand. In a meeting in Kuala Lumpur on March 22, Malaysian Finance Minister Anwar Ibrahim told a delegation from China Development that he would consider liberalizing restrictions on foreign ownership in Malaysian banks, currently limited to 30%.

**Y**et so far few Taiwanese companies have had the confidence to sign off on deals such as China Development did in January this year when it purchased the Thai investment bank for 10 baht (18 U.S. cents) a share. Hu says he's especially pleased with the acquisition, which gives China Development a full range of investment activities in Thailand. And it was had at a bargain far below the bank's peak share price of more than 400 baht a few years ago.

"We've been looking at the Thai financial industry for several years, but the prices were too high," Hu comments. "Now with one buy, we've got all the financial licences I wanted." ■



# Clouded Vision

Could Labuan be the weak spot of Malaysian finance?

By S. Jayasankaran in Labuan

**M**ist shrouds the Labuan Financial Park, set in the picture-postcard island of Labuan off the north coast of Borneo. It clouds even the glittering glass tower that is home to 64 offshore banks and is the park's proud centrepiece. A similar pall hangs over Kuala Lumpur's ambitions for this sleepy island: Recent troubles in Malaysia's banking industry have set experts wondering if Labuan is the chink in the country's financial armour.

Bankers believe regulators have been scrutinizing the financial park more closely since the March revelation of Sime Bank's huge losses and of its Labuan unit's reported loans of \$300 million-400 million to companies and individuals in Thailand and Indonesia. "Yes, I think Lofsa is watching us more carefully now," says the chief executive of a foreign bank in Labuan, referring to the Labuan Offshore Financial Services Authority. "They want to know what kind of provisions we're making."

Lofsa is a one-stop agency entrusted with regulating the island's financial industry. It's chaired by the governor of Bank Negara, Malaysia's central bank.

Currently in focus is the \$17.4 billion in loans made from Labuan in 1997, a figure up sharply from \$11.9 billion in 1996. Bankers in Labuan say that more than \$11 billion of last year's loans went to companies and individuals in Malaysia. And though the rest was lent outside Malaysia, bankers say a good proportion of it went to Malaysian companies investing abroad. All those loans were in U.S. dollars, which means they're now 30% more expensive to service in ringgit terms because of the currency's depreciation.

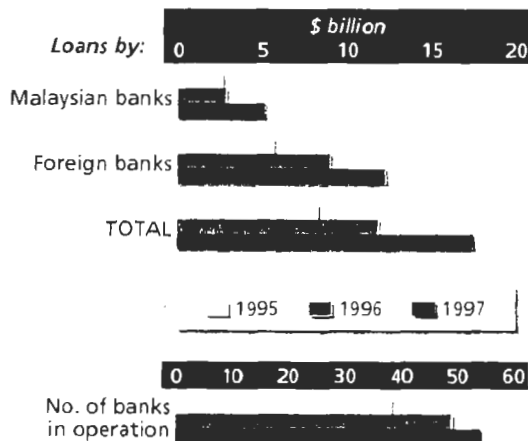
It also means defaults could climb, and banks could be exposed to huge losses.

"The risks would be higher if borrowers did not have the foreign-currency income streams to service their debt, or used the borrowed funds for share purchases," warns international rating agency Fitch IBCA in a March 20 report.

To be sure, the bulk (71%) of the 1997 loans were given by foreign banks in Labuan, anxious for a slice of what used to be go-go Malaysia. These banks are not under central-bank supervision, but nor does their health threaten Malaysia's financial system. Also, much of their

## Boom Times

Loans skyrocket at offshore banks in Labuan



Source: Labuan Offshore Financial Services Authority

lending was to multinationals and export-driven Malaysian companies with U.S.-dollar revenues, says Louise Paul, general manager of Bayerische Landesbank Girozentrale, a German bank in Labuan.

Even so, the eight Malaysian banks in Labuan last year lent \$5.1 billion at home and elsewhere in troubled Asia. Such lending carries risks to the banking system because much of it is "concentrated among a few banks," according to the Fitch IBCA report. Sime Bank isn't the only Malaysian institution to have lent heavily. The Labuan branches of four other big local banks—Maybank, Bank Bumiputra, Rashid Hussain and Bank of Commerce—lent \$718 million last year to Hottick Investments, a Hong Kong-incorporated company related to Halim Saad, the Malay-



## BUSINESS

sian tycoon behind the Renong group.

Such lending seems to defeat Labuan's purpose. It was set up in 1990 as an international offshore financial centre with negligible taxes and banking-secrecy provisions. Kuala Lumpur hoped it would serve as a regional finance hub, with an emphasis on "out-out" businesses—that is, banks getting deposits from outside Malaysia to lend to businesses outside Malaysia.

The concept didn't cut much ice with foreigners until 1992, when the central bank decreed that Malaysian companies seeking foreign-currency loans must first apply through banks operating in Labuan. That did the trick. Foreign banks, prevented since the 1980s from entering the domestic market, scurried to set up in Labuan.

**B**ank Negara monitors foreign borrowings vigilantly and generally only allows companies with foreign-currency income to borrow in U.S. dollars. But it has stretched a point to include companies with huge ringgit cash flows such as Telekom Malaysia, the national telephone utility, and Tenaga Nasional, its counterpart for power. For the utilities, it made economic sense then to borrow

offshore to take advantage of lower interest rates; and for Bank Negara, their financial solidity made them an acceptable risk.

But U.S.-dollar loans from banks in Labuan have also been made available to overseas companies linked to Malaysian companies or tycoons. Being offshore, these companies bypass central-bank scrutiny.

One prominent example is Hottick Investments, which in February last year was given a one-year, \$800 million facility to buy a controlling stake in National Steel Corp. of the Philippines. The four local banks that gave the bulk of the credit will have to wait for their money. Repayment has been postponed for a year, as Hottick was unable to service the loan when it fell due on February 20 this year. "Hottick is the scary one," says a Malaysian banker in Labuan. "How that's handled will impact the future of Labuan."

Also restructured was a \$250 million loan made by a consortium of five foreign banks in Labuan to MR Investments, an offshore company linked to Malaysian Resources Corp. The loan, which fell due in December, was raised as bridging

finance to help Malaysian Resources buy 27% of financial-services company Rashid Hussain, according to a financial analyst.

These exceptions have puzzled bankers in Labuan. They understand why Bank Negara allowed U.S.-dollar loans to companies like Tenaga or Telekom with good cash flows, albeit in ringgit. But they say it's less clear why a \$150 million loan was made by Labuan banks to Renong, which is deep in ringgit debt, has no foreign-exchange earnings to speak of, and suffers from a weak ringgit cash flow (because of a dependence on dividends from subsidiaries that aren't doing well, among other reasons).

Still, a visitor to Labuan wouldn't sense anything amiss. Some of the world's biggest banking names are there, and none seems to be in distress. In hindsight, Labuan Financial Park was fortunate that Lofsa didn't allow any Thai or Indonesian banks to set up. And though fresh loans have almost ground to a halt, no bank so far has pulled out. "We're here for the long term," affirms Rashid Razak, general manager of Schroders Malaysia's Labuan unit. Kuala Lumpur can only hope that all the other banks in Labuan feel the same way. ■

## Taking Its Medicine

By S. Jayasankaran



Malaysia had a reality check on March 23. Finance Minister Anwar Ibrahim said the government was lowering its forecast for GDP growth this year to 2%-3%—a steep drop from the 7.8% achieved in 1997 and the 4%-5% prediction for 1998 that Anwar made in December.

IMF and World Bank reports on Malaysia seen by the REVIEW indicate that although the country is in “better shape” than its neighbours, remedial action is required in key areas. This would include:

- Pre-emptive measures to counter emerging financial problems. That’s happening already to some extent: On March 24, central-bank governor Ahmad Mohamed Don announced new measures that make it necessary for banks to shore up their capital-adequacy positions at the first sign of trouble. Central-bank checks indicate that three financial institutions—Bank Bumiputra, Abrar Finance and Cempaka Finance—may need to be recapitalized by a total of 782 million ringgit (\$208 million).

- Greater reliance on tight monetary policy, rather than tight fiscal policy. This stems from the Fund’s view that damage to the economy inflicted by a further devaluation of the ringgit would far outweigh any harm to companies brought on by higher interest rates. Indeed, rates have crept up steadily: Real lending rates now range as high as 16%, up from 8%-10% in July, when the economic crisis erupted. Anwar has indicated that rates might be raised even higher to fight inflation, which the central bank expects

will double to 7%-8%.

- Structural reform in the financial sector. This would include more transparency and disclosure for banks and companies. Both the Securities Commission, which regulates listed companies, and the central bank have mandated sweeping measures which attempt just that.

On the fiscal side, although Anwar cut government spending by 18% last year, he told parliament that Kuala Lumpur will accept a \$1 billion loan from the World Bank for various projects to fight poverty. The Bank has promised another \$2 billion for project finance. If that money is also accepted, it will be interpreted as a relaxation in fiscal policy.

Still, the IMF prescriptions weren’t taken whole: The Fund wasn’t enthusiastic about bank mergers, but the central bank has decreed that that’s the way to go. The Fund had proposed credit growth of 10% this year; Kuala Lumpur has set a 15% cap.

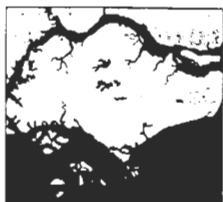
The only good news amid the crisis is a forecast that the current-account deficit for 1998 will drop to 0.5% of GNP. That’s a considerable improvement over 1997’s figure—5.1%.

But massive short-term capital outflows (14.2 billion ringgit) between July and December have pushed the overall balance of payments almost 11 billion ringgit into the red. That reduced central-bank reserves to 59 billion ringgit, sufficient to finance only 3.4 months of imports. ■

**Growth:**  
Forecast cut  
**Interest rates:**  
Rising  
**Current account:**  
Improving  
**Reserves:**  
Down

## Tables Turned

By Ben Dolven



**H**ow quickly liabilities can become assets. Two years ago, Singapore's exposure to the electronics trade was a big reason for caution about the city-state. While neighbouring countries were counting on fast-developing domestic markets, Singapore's growth hinged to a great extent on the unpredictable cycles of demand for disk drives, computer chips and other electronic goods.

Two years later, the situation is reversed. Domestic markets in the region have collapsed. But many of Singapore's electronics markets in the West are healthy, which gives it some insulation against the region-wide slowdown.

That's not to say it hasn't been hurt by the crisis. "There are two opposing forces here," says Tan Sin Mui, head of Singapore research at Merrill Lynch. "You have a very strong ex-Asia environment, so we should see positive export growth out of Singapore. But it's not likely to overcome the decline in services—the entrepot services and finance."

Indeed, Singapore's economy will be a mixed bag this year. The government is expecting growth to slow to 2.5%-4.5% against 7.8% in 1997. Private economists are more pessimistic, with most forecasts of about 1%-3%.

The feeling on the streets is grim. "Singapore's growth this year is going to be much more export-oriented," says Neil Saker, head of regional economic research at SocGen-Crosby. "But people won't feel the benefits, because the domestic sectors

are not going to be very comfortable. Property and retail are going to do quite badly."

Indeed, retail sales fell by 8.4% in January from a year earlier after a 13% plunge in December, and property prices are down by more than 20% from their 1996 peaks. Labour organizations have warned Singaporeans not to expect much in the way of wage increases this year and lay-offs have brought concern about unemployment, which Tan expects to rise to 4% from last year's 1.8%.

The Singapore dollar has strengthened in recent weeks as other regional currencies have rebounded.

But Singapore continues to look out of line in the region: Since the start of the crisis the price of a vacation in Singapore has come to look prohibitive in baht, ringgit or rupiah terms.

But those who fret about slow economic growth can take solace in Singapore's strong fundamentals. Consumer-price inflation was just 2% in 1997, and most economists say it won't go much above that level in 1998. The current-account surplus remains high at just under

13% of GDP.

As long as the electronics industry doesn't go into another slump, Singapore's economy should bottom out sometime in 1998. SocGen-Crosby expects Singapore's overall electronics exports to grow by 9% this year, and growth to improve by the fourth quarter. "The second and third quarters will be the worst time," says Saker. "By the end of the year we should be seeing a better picture." ■

**Growth:  
Slowing sharply**  
**Exports to West:  
Rising**  
**Exports to region:  
Falling**  
**Current account:  
Big surplus**

# Flight of Fancy

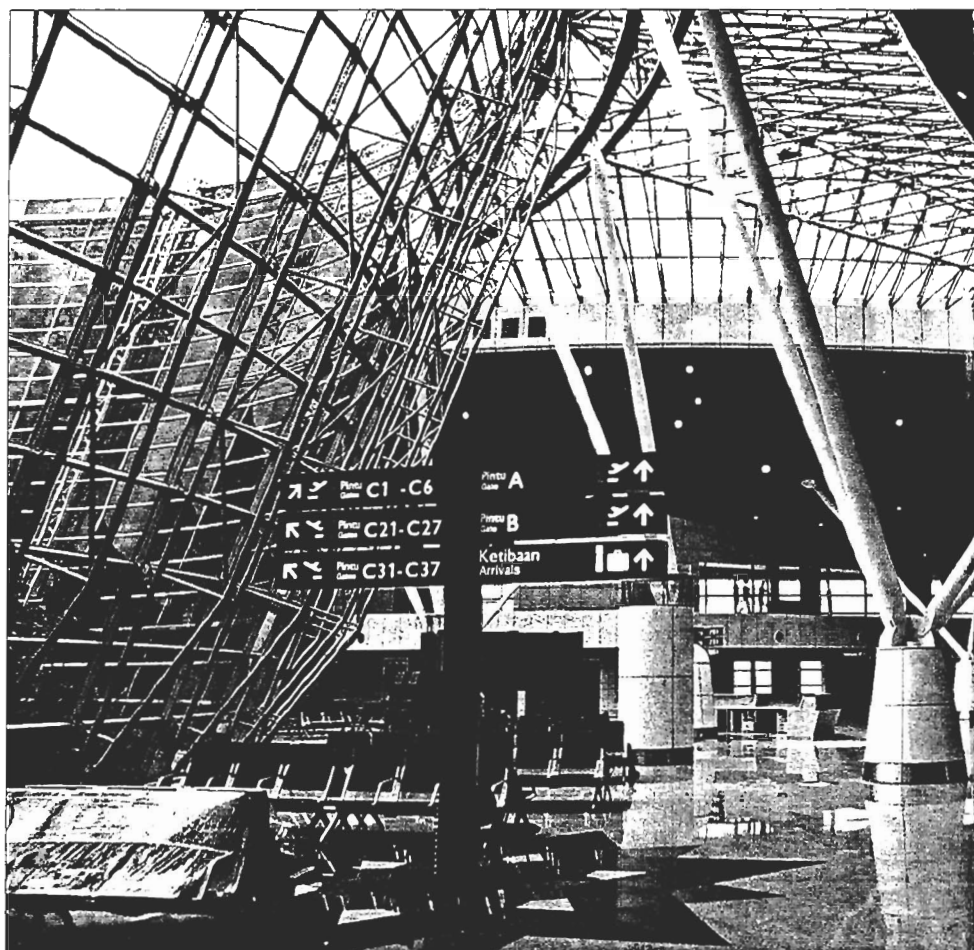
Malaysia has stumbled in its dash to become a developed nation by 2020. As the next three articles show, financial stringency has put the brakes on key additions to the country's infrastructure, and a water shortage—partly the result of rapid development—has hit the country's industrial hub. We start, however, with Kuala Lumpur's new airport: When it opens soon, it will boost Malaysian pride—but also face a more difficult start than its builders had imagined.

By Murray Hiebert in Kuala Lumpur

**O**n the site of a former oil-palm plantation south of Kuala Lumpur, a platoon of workers is battling against time to put the finishing touches to a new, futuristic international airport. Computer experts run trials of the air-traffic-control system. Volunteer "passengers" trundle through the gigantic terminal looking for departure gates.

In appearance, the airport is not just modern, but huge. Its sweeping main-terminal roof resembles a sea of white tents. The buildings and runways cover altogether 10,000 hectares of real estate near the town of Sepang. In their own way, they symbolize the grandiose ambitions of Malaysia under Prime Minister Mahathir Mohamad. Under the slogan "Vision 2020," the premier aims to propel his country into the ranks of the developed world in the next 22 years.

Like Mahathir's grand goals, however, the airport at Sepang faces some uncomfortable questions posed by the past few



Expect some turbulence: Kuala Lumpur has an impressive new airport . . .

months' economic and other setbacks.

Will the airport's trial runs be followed by a surge of *real* airplanes and passengers when it opens in late June? Will the "airport in the forest"—so-called because of its surrounding rainforest landscaping—attract the same international carriers that now head for nearby Singapore? Or will continuing economic turbulence and new billows of forest-fire smoke from neighbouring Indonesia send travellers scurrying to other destinations? In short, is the new airport destined to become a hi-tech white elephant?

"Yes, maybe in the short term," says a foreign airline executive in Kuala Lumpur. "But in two years' time, the economy will bounce back and we'll have to revise pas-

senger forecasts."

No one doubts that the Malaysian capital needs a new airport. The current one, at Subang, exceeded its capacity two years ago, after five years of 16% annual growth in passengers. Last year it handled 17 million passengers despite not having nearly enough space at its three terminals for incoming and outgoing planes.

Sepang, with its two runways, 46 aircraft bays and capacity to handle 25 million passengers a year, could provide travellers with welcome relief. "The new airport will make a huge difference," says Judy Watkins, Malaysia manager for a Qantas-British Airways alliance whose flights stop at Kuala Lumpur en route between Australia and Europe. "The check-

in area is a dream come true. The counters are well thought-out . . . It's a customer-friendly place with nice aesthetics."

The biggest beneficiary will be the country's flag-carrier, Malaysia Airlines, which currently must operate from separate terminals. "The new airport will make Malaysia Airlines more attractive," says Goldman Sachs airline analyst Jean-Louis Morisot, based in Singapore. "They'll reduce costs because they'll no longer need

capacity on opening day," admits Clifford Herbert, who heads Kuala Lumpur International Airport, the government-owned company responsible for the 9-billion-ringgit (\$2.4 billion) project. But he rejects notions that the airport is too extravagant. "In terms of cost, we have something very functional," Herbert says, pointing out that the airport was almost completed before the currency crisis struck. "I don't think we wasted anything."

Whether airlines and passengers agree will depend on the airport's teething problems in the months ahead. The opening has already been postponed twice: most recently from April to late June. Some of the biggest anxieties centre on the 700-million-ringgit Total Airport Management System, a computer network that links 16 sub-systems ranging from flight information to baggage handling.

The airport will be the first in the world to link all these functions into one set-up. But pioneers often pay a price. Reports say that when the baggage-handling system was tested for the first time, with 200 bags, not one ended up where it should have. "In theory it sounds great, but there are a lot of intricacies in linking so many computers," says a second foreign airline manager in Kuala Lumpur.

Some airline operators fear Malaysia is stressing pizzazz over efficiency. "Kuala Lumpur strikes me as state-of-the-art. They've tried to put all the best things into the airport," says the first foreign airline executive, whose airline lands in both Kuala Lumpur and Hong Kong. "Hong Kong is trying to make an efficient airport," he says. (Hong Kong's new airport is slated to open in early July.) "What we've heard so far about Kuala Lumpur is that it's more grand than functional."

KLIA chief Herbert is convinced that his staff can avoid the problems of Denver airport, whose opening was delayed for months because of malfunctioning baggage equipment. "Our baggage-handling system is functioning, but it still has one or two problems," says Herbert, who on December 31 retired as the Finance Ministry's top civil servant. "These are being rectified. I'm sure by the end of April we'll have an operational airport."

Other worries centre on moving passengers around the mammoth new terminal. "How long will it take a 70-year-old grandmother to walk from the check-in counter to the departure gate?" asks an

airline executive, noting that what in Su-bang is a five-minute walk could take as long as 20 minutes in Sepang.

Just getting to the airport, located 50 kilometres south of the increasingly congested capital, could be difficult: The financial crisis put the brakes on construction of a highway and rail link. "The Achilles' heel of the airport is getting there," says journalist Brent Hannon, who explored the new facility for *Flight International* magazine. "I was surprised at how long it took." Malaysia Airlines staff say they have been told to allow a minimum of two hours to get to work.

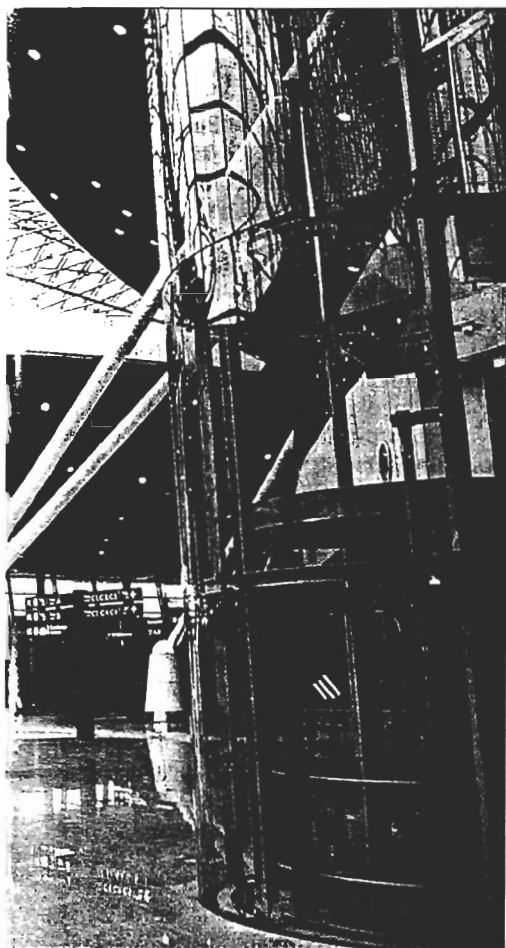
The airport's planners hope eventually to lure some of the traffic on the busy Australia-Europe route that now stops in Singapore. Airport officials have promised that they will maintain their current landing fees—the cheapest in Asia—for at least one or two years. Kuala Lumpur charges \$2,000 for a Boeing 747, compared with \$3,000 in Singapore and \$10,000 in Japan.

At least in the short term, Kuala Lumpur won't benefit much from the recent "open skies" agreement signed with the U.S. "Open skies sounds wonderful, but in practical terms it won't have much impact," Morisot of Goldman Sachs observes. "Now, no aircraft can do Kuala Lumpur to the United States. You have to have 'fifth-freedom' rights to stop over and pick up passengers in Europe or Japan," he says, noting that both Europe and Japan have been "stingy" in giving foreign airlines such pick-up rights.

Analysts believe that some American carriers that have been chalking up record profits may be interested in flying into Kuala Lumpur from Japan. Northwest Airlines is rumoured to be exploring the option of expanding its operations into either Kuala Lumpur or Manila, and to be considering an alliance with Malaysia Airlines. (The carrier didn't respond to questions from the REVIEW.)

Will the new airport be able to compete with Singapore's Changi as a regional hub? "Kuala Lumpur will offer facilities close to par with Changi," says SocGen-Crosby analyst Ian Wild. "What it won't offer is the range of connections that Changi offers. The new airport will stop Malaysia's position from being further eroded, but it will take years to get the traffic that it believes is its own."

Herbert recognizes that the new airport faces stiff competition. "It will be one of the most sophisticated airports in the world, but it's up to us to run it efficiently," he says. "The more user-friendly it is, the more we can rival Singapore and Bangkok." ■



. . . and a host of problems to solve.

buses" to move transit passengers from one terminal to another and to unload planes. Another analyst estimates that the airline will be able to shave 30 minutes off its aircraft turnaround time.

Still, fewer passengers are likely to use the new airport on opening day than its builders had hoped for when planning began in the early 1990s. Tourist arrivals in Malaysia last year plunged 13% to 6.2 million, due primarily to the haze from Indonesian forest fires but also to the region's financial turmoil. (Across Asia, tourist arrivals fell 11% in 1997, a sharp reversal from annual growth rates of 9%-12% in recent years.)

"With the slowdown, demand will come down and we'll have some excess

## On Other Pages

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# Withering Heights

Malaysia retreats from its lofty construction goals

By Murray Hiebert in Kuala Lumpur

**D**own the centre of one of Kuala Lumpur's main thoroughfares, a line of giant concrete pillars stands ready to carry the aerial spans of an overhead monorail. But the project is stalled—and so too are Malaysia's efforts to become an economic powerhouse.

The country's new airport and that other most-talked-about edifice, the soaring Petronas Towers, were almost finished when the economic crisis hit, and thus escaped delay. But like the monorail, several other public and private projects face hold-ups or cancellation—and those that do go ahead will have a difficult birth.

"The activity level won't dry up completely, but competition will be tough," says analyst Patrick Tan of ABN Amro Asia Equity Research.

In October, Finance Minister Anwar Ibrahim said the government would defer or cancel infrastructure projects worth roughly 66 billion ringgit (\$18 billion) to avoid draining financial resources and widening Malaysia's current-account deficit. The cuts prompted a construction slowdown, forcing companies to slash costs and lay off workers.

Clarence Boudville, an analyst at Smith Zain Securities, a Merrill Lynch affiliate, expects the construction industry to contract by 0.5% this year and a further 1.5% next year. Contrast that with an 11% rise in 1997—and a 14.2% rise in 1996. Boudville doesn't see the industry beginning to recover until 2000.

Not all construction projects have been put on the backburner. Prime Minister Mahathir Mohamad's pet project, the Multimedia Super Corridor, an information-technology zone near Kuala Lumpur, will be built in phases at an estimated total cost of \$8 billion. Stadiums for the Commonwealth Games, to be held in September, are still under construction. And work on the new administrative capital, Putrajaya, is expected to continue, albeit at a reduced pace. Sorely needed petrochemical plants along the east coast will also go ahead.

Ali Abdul Hassan Sulaiman, head of the Economic Planning Unit, said in early March that foreign firms will be allowed to acquire stakes in projects. This could

see a fresh injection of funds, which have been difficult to get since the central bank moved to curb lending last year.

The stalled monorail, according to Ali, is one of the projects foreign companies are trying to enter. People-Mover Rail Transit is a 2.2-billion-ringgit privatized venture spearheaded by Berjaya group chief Vincent Tan. The 16-kilometre line is one of three segments of a light-rail system for the capital. Work continues on the two other segments, which are being built by different companies and are due for completion around mid-year. (Parts of one segment have been running since December 1996.)

Tan agreed to construct the monorail in exchange for rights to build Linear City, a two-kilometre-long, 10-storey complex running across the city. That particular mega-project has now been deferred, prompting speculation that the government may take over Tan's cash-strapped monorail or sell it to another party.

Other projects and their varying fates:

- A 221-kilometre mountain highway, in which Tan and other developers were involved, has been scrapped. It was meant to link resorts from Cameron Highlands in the north to Genting Highlands near Kuala Lumpur.

- Construction group Gamuda has received approval to proceed with two segments of the capital's ring-road—though analysts say it could be delayed for up to a year by the credit squeeze. The East Coast Highway is also expected to go ahead in stages.

- A highway and rail link, both privatized, that were due to serve the new airport have been postponed.

- The 13.6-billion-ringgit Bakun dam in Sarawak has been postponed—and, if ever revived, is almost certain to be scaled down.

- An international airport planned for the northern state of Kedah is in doubt, as is a proposed 95-kilometre bridge to Indonesia across the Malacca Strait.

When will work on major projects resume? SocGen-Crosby Research believes plans for some prime toll roads may be dusted off in 1999 and 2000, when banks have money to fund ventures at lower interest rates. As for the others, no one is hazarding a guess. ■

# Liquidity Crunch

## Malaysia's water shortages may hurt development

By S. Jayasankaran in Kuala Lumpur

**E**lectronics plants use tremendous amounts of water. A factory run by an American multinational 15 kilometres north of Kuala Lumpur, for example, uses 14,000 gallons *per hour*. As a huge export earner for Malaysia, it might expect the local authorities would ensure its supply—but until recently, it had no such luck. A senior executive at the plant says its water supply has been interrupted sporadically since October, costing the company 10 million ringgit (\$2.8 million) in foregone production and the price of alternative supplies.

"We were hiring 20 water tankers a day," he says. Then, after the company sent a sharp letter to government officials, "supply was restored and we're okay now."

Cletus Stephenson, general manager of IP Decor, a maker of decorative paper, isn't as lucky. His German-owned plant recently suffered expensive equipment failures caused by an air-conditioning breakdown—which in turn was the result of a lack of water at the factory site in Nilai, 45 kilometres south of Kuala Lumpur. Faced with a possible equipment write-off of 3 million ringgit, Stephenson is furious: "You know, the Germans looked carefully around the region to choose the best place to invest in, and they picked Malaysia because of its infrastructure."

It's the worst of times for Malaysia. A financial crisis threatens to derail its economy, and it must also contend with smog and illegal immigrants fleeing Indonesia. Now a water shortage has hit the Klang Valley, the country's most populous and industrialized area. For weeks, homes and factories have been cut off for days at a time. This latest setback has brought the consequences of rapid development into sharp focus. "Supply cannot meet demand because the pace of development is faster than planned," Syed Muhammad Shahabudin, president of the Malaysian Water Association, was recently quoted as saying.

The episode also shows that Malaysia is still struggling to get the basics right. Prime Minister Mahathir Mohamad's "Vision 2020" campaign envisages a fully developed country by that year. But glitches like the water crisis merely fuel



Days of plenty at a theme park: Now, a long dry spell adds to Kuala Lumpur's problems.

scepticism about the viability of such ambitious plans. Snaps a Malay academic at a Kuala Lumpur-based think-tank: "We spend billions building the tallest this, the longest that. We're spending billions for the Commonwealth Games. But we never get our priorities straight."

The immediate cause of the problem, government officials say, is an unusually long dry spell that has depleted the Klang Valley's reservoirs. But in the background are several man-made problems: Industrial expansion has increased demand, river pollution has made more water untreatable and therefore unavailable for recycling, and deforestation and building on hillsides have ruined some water catchments.

The irony is that Malaysia normally has abundant rainfall—990 billion cubic metres a year, according to Primary Industries Minister Lim Keng Yaik. Yet factories and residents use only 15 billion cubic metres annually. "That means we get more than 65 times the amount of water we actually use," Lim said in a recent speech.

Some parts of the country, however, get much more water than others, and

therein lies the problem. Water is a state, not federal, matter—and individual states guard their stores of water jealously. In addition, the nation's water-distribution system is ageing; some pipes were laid more than four decades ago and are bursting under the stress. "If you compare us to other countries, our levels of wastage are incredibly high," says Sieh Kok Chee, a former director of planning with the Draining and Irrigation Department. "It can get up to 50%."

Since March, Klang Valley residents have been ordered to ration water; some have resorted to bathing and washing clothes in the rivers. Many are grumpy as a result. Television has depicted ordinary folk openly criticizing the authorities, which is unusual in Malaysia; newspaper comment, too, has been pungent.

But for Kuala Lumpur, which is banking on exports to lead the country out of trouble, it's the reaction of foreign investors that's worrying. So far, no one has threatened to pull out—largely because of repeated reassurances from the authorities that the problem is "temporary"—but there is no doubt about the foreign investor's clout. The American multinational that got its taps turned on again did so by highlighting its export receipts in a pointed note to International Trade and Industry Minister Rafidah Aziz.

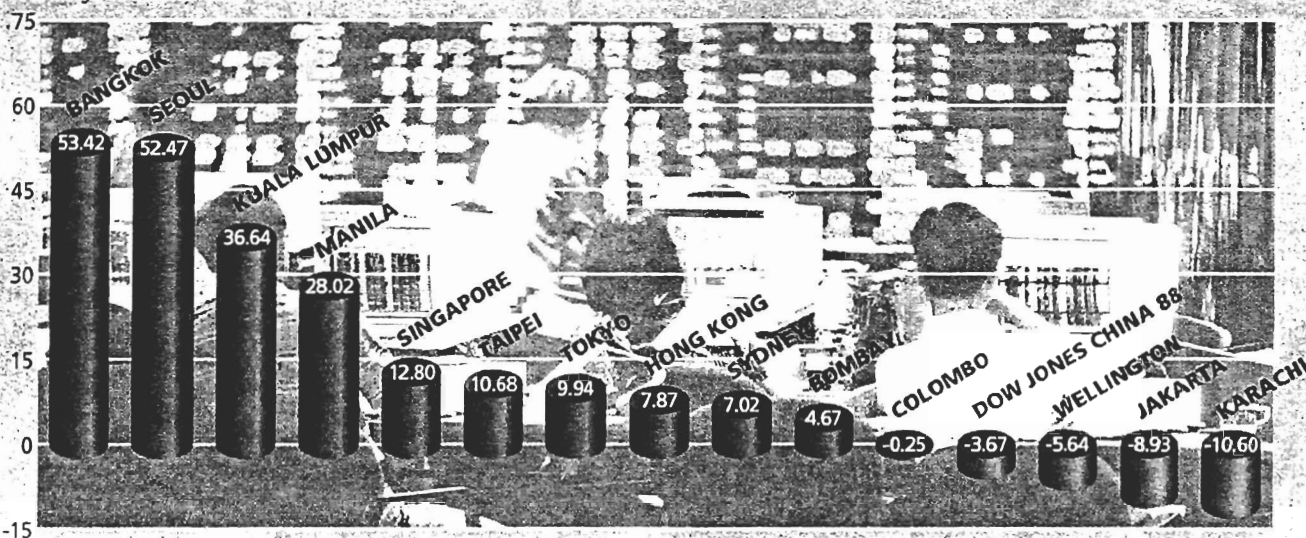
Belatedly, the government has sprung into action. Deputy Prime Minister Anwar Ibrahim recently announced a multi-million-ringgit programme to tap water from lakes and ponds to be channelled towards Klang Valley households. Kuala Lumpur has also proposed the formation of a National Water Council. This initiative could result in the federal government assuming responsibility for water resources—but the states would have to agree, which isn't likely to happen any time soon.

**E**ven more significantly, the crisis has sparked open criticism of the government's grandiosity. Writing in the *New Sunday Times*, influential columnist Kadir Jasin put it bluntly: "What the country needs urgently is a reliable water system and not more Sprint highways or Kerinchi bypasses"—a reference to two projects the government recently approved. "The higher priority is filling water tanks everywhere . . . not emptying the people's pockets by allowing more toll highways." ■



## Asia's Surge: False Dawn?

% change in indices since the start of 1998



Note: From January 1 to March 31 (calculations are in \$)

Source: REVIEW Data

## THE OUTLOOK

## Sucker's Rally

Fund managers say the first-quarter rebound of Asian markets was a mirage

By Henny Sender in Hong Kong

**A**s an Asia strategist for ING Barings Securities in Hong Kong, Paul Schulte has lots of visitors from fund-management firms in the United States and Britain. Their pockets are usually bulging with money—profits they have made from the extraordinary rise of European and the American stockmarkets recently. They come to Asia to confirm, at first hand, reports that the region is back from the brink.

Those reports, they soon learn, are somewhat exaggerated. "They are invariably bullish when they arrive in Hong Kong," says Schulte. "Then they go around the region; to Bangkok or Seoul, say. And when they come back—they are terrified."

After rolling over and practically disappearing in the fourth quarter of 1997, many of Asia's markets came roaring back in the first quarter of this year of the tiger. At the end of March, Bangkok was up 53% and Seoul up 52% for 1998.

But, judged by fundamentals, the region still looks awful. Almost daily, it seems, analysts revise downward their estimates for economic growth in one Asian market

or another. Interest rates are high and—except in Hong Kong—unlikely to come down any time soon. Asset prices have dropped, but not nearly enough. The forces of deflation are eroding the market capitalization of the banks and property companies that have traditionally dominated indices from Bangkok to Tokyo. A market in recession is hardly a candidate for a sustained upturn in its shares.

The boom of 1993 is not coming back any time soon. But the liquidity that fuelled that great boom is beginning to reappear, and from the same sources—Europe and the U.S. None of the most important central banks—including the Federal Reserve and the Bank of Japan—intends to slow the money presses at a time when Asia is still uncomfortably close to the precipice. If the Fed raised interest rates, for instance, it would be devastating for the region.

Abundant liquidity means the markets will continue to go up, whether the fundamentals justify the rises or not. "The liquidity will be there until Asia improves," because the Fed won't raise interest rates,

says Hans Goetti, a portfolio manager at Citibank's private bank in Singapore. "And liquidity will go into financial assets. Every correction is a buying opportunity."

But don't get carried away on the liquidity wave. At the dawn of the second quarter, the darkest cloud over the region hovered to the north, where Japan threatened to implode. As the yen plummeted to lows not seen in seven years, fund managers held their collective breath. A faltering Japan and plunging yen has traditionally been bad news for the rest of Asia.

"The worst case for Asia is what happens when the yen and the Nikkei sink," says Shigeki Makino, a fund manager with Fidelity Investments in Hong Kong. Makino has long pointed to the dichotomy between Japan's world-class export-oriented companies—the so-called Nifty Fifty—and its weaker, domestically oriented firms. The latter have been hardest hit by Japan's economic stagnation. But now, thanks to excess capacity at home and elsewhere in the region, even the Nifties are in trouble, Makino concludes.

So, how to play the second quarter?



Actively, says Tony McDonald, the head of unit trusts for Jardine Fleming in Hong Kong. "Our message is, 'Don't be scared,'" he says. "We're not saying the worst isn't over; we're saying be cautious and be selective. We're saying above all, be diversified."

Not surprisingly, some fund managers feel schizophrenic. Says Henry Lee, a hedge-fund manager with Hendale Asia in Hong Kong: "There is a big battle going on between the fundamental side and the technical side of my brain. The technical side says buy the markets—so much money has left the region, any inflows will have a big effect. But the fundamentals say you have to sell; so much that has to happen, hasn't happened yet."

Hedge funds are supposed to be on both sides of the fence, long in some investments and short in others. But Lee says he's finding more shares to short than to hold. At the top of his list, for example, are Malaysian banks, which are still relatively expensive, especially since the first-quarter rally which pushed the Kuala Lumpur Stock Exchange up 20% by mid-March. "They are playing musical chairs or who takes the hot potato," Lee adds. "And there aren't enough chairs."

Also on Lee's must-not-hold list are many of the region's telecoms companies, especially the Indonesian telecoms firms, now destined for more sell-downs to the public. (Jakarta-listed PT Telkom, for example, just announced currency losses twice as large as analysts were forecasting.)

And where Lee buys, he buys for technical rather than fundamental reasons. Take China Telecom, which listed in Hong Kong last October. The shares are expensive. Simon Maughan, head of research at Indosuez W.I. Carr in Hong Kong, says they are trading at a level which implies that the market expects every cellular operation in China to be injected into the company—at a huge discount to true value. That's hardly realistic.

Never mind. Lee is a buyer not because he has faith in such asset injections or the growth in earnings they are expected to bring but because China Telecom is a big part of the Hang Seng Index; fund managers who try to mirror the index have to have China Telecom—and many still don't.

In fact, Lee won't be a buyer on the fundamentals until he sees the structural reforms that many fund managers hope for: management

emphasis on shareholder value, growth that brings earnings with it. All that was supposed to follow in the wake of the meltdown. But so far, few fund managers see the transformation happening.

To many fund managers the rebound in the first quarter was the wrong sort of rally. Schulte of ING Barings and his researchers compiled a list of the largest 541 nonfinancial firms in Asia and then compiled a list of the 10 best and worst credits in each market. The exercise was intended to identify firms which were sound and also cheap.

But Schulte found, to his dismay, that in each market, the 10 worst credits outperformed the 10 best credits by a factor of two times to four times, depending on the market. In Indonesia, Thailand and South Korea, the three worst credits were among the most expensive shares. Only Taiwanese companies were the exception to this pattern.

So, was the first quarter a prelude or a false turn? Rational or not? Maybe both.

In part, the rally was the product of a sense of relief: Investors were delighted that Asia wasn't dead, that none of the worst-nightmare scenarios had materialized—yet. But it was also a technical response to how oversold most shares were.

"The rally was rational, especially in that much of it was based on what was happening to the region's currencies," most of which strengthened dramatically against the dollar, says Richard Haw, a director of Schroders Investment Management in Hong Kong. "But it was too early and too fast. There is so much restructuring to do."

Ian Burden, chief investment officer at HSBC Asset Management, worries that the rally may well have been counter-productive. "It may undermine a more realistic approach at both the corporate and government levels about what needs to be done," he says. "Asia needs to learn to focus on return on capital, not just on accessing capital."

And there are important ways in which Asia differs from Mexico, as Burden points out. In Latin America, fund managers could buy the exporters who gained most from the peso devaluation. But in Asia, where most of the market consists of banks and real-estate firms, he finds few listed firms that are beneficiaries of the currency devaluations. "We need more good companies here," he notes wistfully.

As a result of the epic meltdown of Asia, many fund managers are changing their investment style. Some are taking currencies as a starting point in a region that no longer enjoys currencies that are linked to the dollar. Or they are looking to specialist help to deal with the uncertainties on that front, such as the currency-overlay products which Bankers Trust markets to large pension funds.

But for Burden, it means an even more careful bottom-up approach to the markets. "Now, Asia as whole won't move," he says. Instead, the pattern will be one of individual winners and losers. "And you may see a shift in power from Southeast Asia more to the North"—especially if Asean isn't able to revitalize itself and build more focused economic structures, he says.

So the year of the tiger finds most of the region's fund managers looking for safe lairs far from the heart of the region. An informal survey conducted by one fund man-

## Sign of the Times

Warrant funds enjoyed the best average return worldwide over the past three years

	Average % return*	Risk**
Warrant funds	111.88	13.8
North America	108.67	3.6
Britain	107.06	2.9
United States	104.42	4.3
Europe	99.84	3.2
Canada	93.95	3.4
Hong Kong	38.04	8.9
Australia & New Zealand	33.48	4.4
China	30.22	9.8
International bond funds	21.86	1.9
Emerging markets	18.85	5.0
Taiwan	12.90	8.8
Commodities funds	7.12	6.0
Deposits	2.70	2.0
Far East (inc. Japan)	-8.41	5.3
Far East (exc. Japan)	-19.39	7.2
Singapore	-22.80	8.9
Japan	-26.80	5.9
Malaysia & Singapore	-27.12	8.2
Asean	-38.48	7.7
Malaysia	-45.20	10.8
Philippines	-46.18	9.1
South Korea	-60.26	10.8
Thailand	-61.76	10.1
Indonesia	-66.05	12.0

\*Dividends reinvested

\*\*Risk is calculated by indexing funds' average monthly volatility

Source: Standard & Poor's Micropal

ager suggests his peers are typically holding about 20% in cash and another 10%-12% in India (*see accompanying story*), while the largest overweight positions tend to be in Australia.

David Webb, head of Chase Asset Management in Hong Kong, warns investors to avoid the traditional resource-based firms like **BHP**. He prefers consumption plays like **Foster's Brewing** or **Southcorp**. Other managers are just above market weight in Hong Kong, the last bastion of currency stability.

Citibank is also coming back to Asia, after holding up to 75% cash in some of its Asian funds earlier. Like **Burden of HSBC**, Citibank's private bankers, too, prefer North Asia to Asean. Citibank is at or below market weight in Malaysia, Thailand, Indonesia and the Philippines, partly based on its view of exchange rates. Currency specialists such as Citibank's Philip Kimball believe that rallies based on a recovery of the currency are in the past, and that Asian currencies are no longer significantly undervalued.

So fund managers like Norman Wong at Citibank counsel investors to go overweight in Hong Kong and China. "China hasn't lost out despite the fact that it hasn't devalued," he says. "And China does not lack trade finance."

Citibank maintains its positive view on European equities as well, though fund managers say dollar-based investors should hedge the currency. "We are bullish on European markets because they are beneficiaries of weak currencies against the dollar. We see a recovery in exports from Europe though the domestic economies are quite sluggish," says Bassam Salem, Citi's Asia-Pacific investment-services head.

Citibank fund managers are playing several themes in Europe. They are buying beneficiaries of consolidation, such as banks. And they are betting on the continued shift to service economies on the continent, buying such technology and electronics companies as **SGS-Thomson**, **Siemens**, **Philips**, **Ericsson** and **Nokia**. In addition, Citi is especially sensitive to the way the benchmarks and indices are shifting. That means a higher weighting for telecoms companies and energy companies.

"The market psychology is now swinging between the maximum fear and greed," says Hendale's Lee. "People are afraid to own shares and afraid not to own shares." That's not likely to change any time soon. For now, most fund managers would agree with Lee that it is too early to be bullish. But here's the best advice for those who are waiting to see a transformation in the way corporate Asia is run: Don't hold your breath. ■

# How the Experts See It

Don't be taken in by the bulls

**M**arkets across Asia may have spent the first quarter of 1998 on the upswing, but our panel of fund managers warn: Don't be fooled. Sustainable recovery won't come until Asian exports flex their muscles and the chances of that happening any time soon look bleak. Meanwhile, the region is under siege on numerous fronts. At home it could take only the Japanese yen slumping to 145 to the dollar, the devaluation of the Chinese renminbi, or intense social unrest in Indonesia—all real possibilities—to lead to another meltdown. Overseas, the possibility of higher U.S. interest rates and, by one forecast, an American stockmarket crash, would be all that's needed to send a tentatively mending Asia back to the operating table.

But take heart at least in equities, say the more optimistic fund managers: Investors who choose their stocks on a company-by-company basis will find there are still a few gems out there.

The panel:

- James Cheng, director at Asia Strategic Investment Management.
- Alfred Ho, director at Invesco Asia.
- Ray Hood, managing director at Asian Direct Capital Management.
- Bill Kaye, managing director at Asian Hedge Fund.
- Francis Tjia, executive director at Income Partners.
- Elizabeth Tran, chief investment director at American Express Asset Management.

## THE SECOND QUARTER

**Review:** What do you expect Asia to look like in the second quarter?

**Tran:** On a global basis, the U.S. market and European markets are where the action is going to be, rather than Asia. The problem with Asia is that the fundamentals are not improving. Export growth in the region is not happening. Fund managers will continue to prefer the U.S. and Europe because you have a much more benign economic backdrop. The rally Asia had was the product of short covering and some contrary thinking; it has really run its course.

**Ho:** I guess our best-case scenario would be a lower U.S. interest-rate environment and Japan not going into deep recession. Japan announced a ¥16 trillion (\$120 billion) package, which should help. But it doesn't have the strength for a strong recovery. Regarding China, I think people were very sceptical at the beginning. Now it seems like they can chug along at around 7%-7.5% growth. But even the best-case scenario is not going to help a lot because if Japan picks up, China will be stronger. Then it is quite difficult for the rest of Asia to export their way out.

**Kaye:** Trading accounts are improving

“The rally Asia had was the product of short covering and some contrary thinking; it has really run its course.”

Elizabeth Tran,  
American Express Asset  
Management.



almost entirely due to an implosion of import demand. As long as that's the case and there's no increase in exports in U.S.-dollar terms, then it is far too early to say this region is out of the woods. Intra-Asian trade for the affected Asian economies is about 50% of the export bill. There isn't going to be a plausible export-led recovery in the near term. There are only three countries in the world right now that have robust domestic-demand conditions and therefore could take on appreciably more Asian exports: the U.S., Britain and Canada.

**Review:** What is your view on global liquidity—will it do much to help the investment pool that you look at?

**Tjia:** Obviously in the U.S. there is lots of liquidity, which is a bit worrisome. However, for Asia that is not my main worry. If you take a larger view, in North Asia you have an event risk that provides a downside risk in the markets from here on forward—let's say, renminbi devaluation, or the yen suddenly going to 150 or 160 in a very short period of time. If that were to happen, it is premature to talk about a decoupling of Asian markets.

Southeast Asia has more volatility risk and almost no event risk any more. Everything that could cause a major external shock to the market has already happened. Things are going to crawl back from generally over-shot levels. The biggest question mark is Indonesia, where there has been no improvement whatsoever. New governments in Thailand and Korea, social stability in places like Hong Kong and Singapore, and tough economic policies in China move things forward.

These things, rather than liquidity, will determine how we will be able to make money going forward in the next three to six months.

**Cheng:** The formation of the EMU will continue to cause capital flight to the U.S. And the U.S. will continue to benefit from liquidity flow from the rest of the world.

My focus is very much on company-specific issues. Some of the macro events took everything down in one go but there are still a lot of good companies around.

I am slightly more optimistic than most people on China. The next three years will probably be the most significant in its past 150 years in terms of economic devel-

**‘ Taking a three- to four-year view, I think we are seeing a lot of interesting ways to commit capital ’**

**Ray Hood,**  
Asian Direct Capital Management.



opment. The appointment of Zhu Rongji will bring forward some of the reform measures necessary, highlighting investment opportunities.

## ASIAN STOCKS

**Review:** How are you choosing Asian stocks? Are you bottom-up, looking for good companies, or top-down, focused on which countries you want to be in?

**Hood:** We are trying to find the companies with real business franchises, which are capable of generating good profit growth over a three- to five-year period. We are less concerned if the business is poorly structured at the moment or if its balance sheet is in a mess, because those problems can be fixed with the help of an activist investor. The business environment in Asia is going to become more discerning and only those businesses which have a real, genuine competitive advantage will continue to do well.

Most people underestimate how severe the squeeze on corporate profitability is going to be over the next year or two. Taking a three- to four-year view, I think we are seeing a lot of interesting ways to commit capital and make high, real, positive returns. I don't see much scope for making easy money in the next year or two.

**Ho:** It used to be the case investors only had to be concerned with interest rate/earnings. With the de-pegging of the

dollar, it is currency/interest rate/earnings.

No matter what you look at—moving averages, purchasing-power parity, government policies, or central-bank balance sheets—I think the currency process has to be strengthened before addressing whether you are going to buy companies with a very high U.S.-dollar debt exposure. From there, you go in and you try to find some companies. There will be a sweet spot for some that have operating capital, no huge negative cash flow and can export their way out.

**Tran:** We are more top-down than ever with the currency factor having acquired so much importance. However, risk factors in individual companies do lead us to blacklist companies where there isn't sufficient transparency or there is bad management. That was true in good times and even truer now.

There are markets where you can still invest on the basis of fundamental analysis: Hong Kong, Singapore and Taiwan. In the rest, you are playing the potential for restructuring.

**Review:** To what extent are your investments bets on currency directions?

**Kaye:** It is really total return that people should focus on. Unless one possessed a very positive view on the rupiah, for instance, there would be virtually no investible stocks in Indonesia. Indonesia shut down virtually all of its private banks and they continued to trade. **Indocement** has a \$400 million market cap, but no prospects for a profitable business. There are a lot of dichotomies and potentially some opportunities. Currencies are inevitably part of the picture, simply because total return is the goal of the investor.

## INDONESIA

**Review:** What are your assumptions on the political front in Indonesia going into this quarter, and do you see a risk of a new contagion effect in the rest of Southeast Asia if the situation there worsens?

**Tjia:** It is pretty difficult for an investor to convince himself that there is great value there, because the uncertainty is just too big. As far as the contagion possibility, people are going to start separating Indonesia from the rest. I find it difficult to believe that Southeast Asia would go back to the bombed-out level it was at the end of the last quarter, simply because Indonesia falls apart.

In Indonesia, the political risk has declined in the sense that you know what the government looks like and, from that, you can formulate assumptions on what you think policies are going to look like. The degree to which uncertainty and risk remains is very much attributable to an

unproven cabinet. You really have no idea what these guys can come up with.

**Review:** The IMF and Indonesian government have talked of getting the Indonesian rupiah to 6,000 by the end of the year. It's now over 8,000. Is there a currency play there?

**Tjia:** Technical factors notwithstanding, I think the rupiah probably should be stronger and I think it will strengthen. But it is very difficult to imagine how it is going to go from 8,000 to 6,000, simply because there is an overwhelming demand for dollars.

## MALAYSIA

**Review:** Would anybody here argue that the greatest risk now in Southeast Asia isn't from Indonesia, but possibly Malaysia?

**Tjia:** Just looking at Malaysia's ability to recognize and process its problems—that is what we are using now as a framework—I would argue that Malaysia certainly has a downside risk.

**Ho:** The fact that Malaysia doesn't have a lot of U.S.-dollar debt, in fact, is a major threat in disguise. They have been sitting there for the past six months, looking pretty for the IMF and saying, "We don't need you." But the domestic debt is severe. Proposed mergers among finance companies are like asking Peter to pay Paul; getting a bad balance sheet to take

**‘ Even if growth slows to 6% or 7%, there are companies in China that are investible ’**

**James Cheng,**  
Asia Strategic Investment  
Management.



over another shaky balance sheet without capital injection.

Unfortunately, the government really hasn't done a lot in, not just reliquifying the system—that is easy, by printing money—but in liquidating the bad assets. By doing that it would lift foreigners' confidence, and that would support the currency. Until the government goes to that part, which is the hardest because it is political-related, the domestic economy will contract severely and Malaysia will be behind the curve in the banking crisis.

**Review:** Are companies more investor-friendly these days?

**Hood:** Many people in Asia have spent their whole working careers in an environment of easy capital availability, and they tend to take the view that whether it is debt or equity doesn't really matter. There is still this financial naivete. The restructuring of Asian industry is going to be more dramatic and may take a little bit longer to get started than people think.

**Review:** How do you feel about China?

**Tran:** For the region as a whole, the biggest risk is growth in China. If that doesn't come up to 7% or 8%, which the Chinese government is committed to, investors will become convinced that there is going to be a renminbi devaluation, and that is a systemic risk for the region. Consensus expectations for the Chinese economy are still above 6%. I would think that the risk of disappointment is high because the only potential positive is Keynesian government spending.

**Cheng:** For me, the focus is on the investible universe—that is, companies that focus on making money for their owners. Macro numbers in China are hard to predict. The more important issue is that there are more and more real businesses to invest in. Despite the very difficult environment in '97, in China, a select few in sectors like infrastructure, home appliances and automobiles have improved profitability during the year. Even if growth slows to 6% or 7%, there are companies in China that are investible.

## THE WEAKENING YEN

**Review:** What are your assumptions about Japan and, if the yen weakens, how would that affect Asia?

**Kaye:** Japan is not going to pull its weight and import more from the region as prices get cheaper because it is facing very severe recessionary forces of its own and collapsing domestic demand. That compounds the region's difficulties. Japan has a choice: It can escalate a deregulation, which is occurring at only a glacial pace and it can aggressively cut taxes, as the West keeps beating up on it to do. Or

it can continue its current rear-guard resistance, in which case I don't see any hope for the place.

It will continue to be in a state of secular decline. It is not going to be able to generate any sustainable growth on its own. If historical experience is any guide, Japan will probably wind up spending about half the ¥16 trillion it has currently appropriated on very low return and use-less infrastructure projects.

If the yen weakens to 145 to the dollar, which I think is quite feasible, we are going to witness a retesting of the lows in many of the markets, with the most devastating effect on South Korea. It really has to happen because of the way that these economies are interconnected.

## SOUTH KOREA

**Review:** In the case of South Korea, is there much danger ahead or are attitudes changing?

**Ho:** I think things are changing at the margin. But at the same time the hard decision really hasn't been made—recapitalization of the banks. If you ask the banks to recapitalize today, nobody is going to support the capital, apart from the government. That means the government has to nationalize the banking system and own a bad asset. **Seoul Bank** is still operating. **Hanwa** is still operating.

Unless you get to that part of really

liquidating the assets, domestic debt is so high that the economy is going to contract and the banking system is going to collapse anyway. I still think it is way too early to go to South Korea and get excited about the asset angle. Let's say the market continues to fall, companies like **Posco**, with export-earning capability, become very interesting. I see further weakening in the won, further weakening in the stock-market.

**Review:** Have you been able to find companies that are beneficiaries of the crisis?

**Cheng:** We found it hard in those countries where the crisis hit the hardest to conclude that the export earners would be the best placed. There were quite a few examples, like **London Sumatra**, which performed very well until the country banned the export of palm oil, and **Daya Guna Samudera**, which has also done very well. When a company is resource-based, that is all very well. It is less clear on the manufacturing side if you are just selling cheap labour in a world where there are 2 billion disciplined and educated Indians and Chinese willing to work for a lot less.

**Hood:** There have been some companies in Thai tourism which have been beneficiaries in baht terms of depreciation. There are companies that generate real added value and have been able to preserve that, but they are very, very few, which I think comes back to the fact that the vast majority of Asian companies are not—as currently structured—very productive. They are the product of low-wage costs or something of that nature.

**Tjia:** It is just who is hurt less bad. If somebody is going to make it through it will be companies that really have a dollar-based product and a local-cost base.

## BONDS

**Review:** Are there any bonds you can name where the potential return outweighs the risk?

**Tjia:** Imminent default risk on most of the Euro and Yankee bonds issued by Asian issuers is relatively low. Where you really had the default risk was all the short-term paper, promissory notes, bills of exchange, commercial paper.

We are not going anywhere near where you could easily foresee, within the next 12 to 24 months, that from a pure operating level the company is going to default.

Restructuring situations are pretty interesting. But it is very difficult to come up with bonds where you can very clearly see the upside versus the risk.

**Review:** At this point, are you totally conservative?

**Tjia:** I don't think Income Partners is

I still think it is way too early to go to South Korea and get excited about the asset angle

Alfred Ho,  
Invesco Asia





able to formulate any strategy that would allow us to make a big bet. You have to be so pragmatic in the market. You have to be very fleet-footed and get in and out of positions. I think, from a fixed-income and currency perspective, that is way we have to play it.

### OVERWEIGHTS

**Review:** Where are your biggest overweights in the region?

**Tran:** Hong Kong/China, relative to the other markets. And the export sector in Japan. Overall, I think you would be reducing your bets, rather than increasing them in this environment. This is on a three-month view.

**Cheng:** We are currently heavily in cash, with neutral positions in Hong Kong and Singapore and an overweight position in China. We are not going to participate in the "old equity." But when we see real, serious restructuring and recapitalization we are ready to plough back into some of these companies.

A case that comes to mind is the recapitalization of the Thai banks. We will probably participate, at the right price, in the banks with clear franchise value—for example, a large branch network and deposit base. The industry will consolidate and two or three banks will come out dominant in the next five years. But we are not jumping in now unless "new equity," or recapitalization, is taking place.

The good thing about the **Thai Farmers Bank** and the **Bangkok Bank** recapitalization is that they are big and seem to be biting the bullet in one go. Unless the economy deteriorates more than currently forecast, driving nonperforming loans beyond what they are currently projecting, that risk of further dilution down the line seems to be relatively small.

**Review:** Have you seen that level of restructuring anywhere else besides Thai banks?

**Cheng:** Not really. There have been cases in some nonlisted things like, Coca-Cola buying over an entire bottling franchise in South Korea. We do distinguish between two kinds of roles the foreign investors play in this liquifying exercise, one where the distressed company is well managed and is in a liquidity crunch, like Bangkok Bank, and one where the distressed company is in need of both cash and the foreign direct investor's special competence to improve returns and efficiency. In the latter case, the benefit could take a longer time to hit the bottom line.

George Soros purchased **Nakornthai Strip Mill** in Thailand, where he is buying a brand new facility at maybe a 30% or 40% discount to what the replacement cost

is. By improving management they could eventually become the lowest-cost producer, increasing the return on equity of the plant.

**Ho:** At the beginning of the year our biggest bets versus the benchmark were in China-related companies. We built a neutral weighting in Indonesia and now we are looking to reduce.

By and large, for the time being, the strategy is to reduce. Some of the currencies at this stage are too strong. Probably the baht has to go back to around 45 in order to generate the current account to recapitalize the banking sector. The support for equities is way down there, not

over the next few months.

**Ho:** Uncertainty over the property market, which will continue to be the economy's main driver, has us neutral on Hong Kong and underweight on property developers. The only play here primarily is China. We just stick to the very big China red chips: **China Resources**, **Shanghai Industrial**, **China Telecom**.

**Cheng:** I think this latest correction in Hong Kong will finally set in place a distinction between buying property for investment need and utility. This is confused a lot of the time in Hong Kong. I think the market should become more rational from here onwards. Unless interest rates move up, the market will probably stabilize at current levels. But if interest rates move up, all bets are off.

**Hood:** One opportunity in Hong Kong is the entrepreneurial companies that have learned the hard way how to operate in China. They have been neglected by many major investors. Companies like **Four Seas Mercantile** have done very well. They are still under-researched and under-owned.

In the mid 1980s Hong Kong was still dominated by the textile industry and Shanghaiese shipping magnates. People who are now the market leaders, such as **Sun Hung Kai** and **Cheung Kong**, were regarded as mid-cap stocks back then. If the China reform programmes succeed some of these mid-cap entrepreneurial companies have great potential. However, unless you are prepared to live with the liquidity risk and have a long-duration investment strategy, it is very difficult to invest in them.

So many of the red-chip stocks which people rushed into last year are turning into Hong Kong property companies. **Citic** began as a China play and is evolving into a Hong Kong conglomerate; **China Resources** is doing the same.


**Review:** Is it possible for the renminbi to depreciate, but for the Hong Kong-dollar peg to survive?

**Kaye:** It has happened in the past. You have to look at individual circumstances. When China devalued in January 1994, Hong Kong came out fine. Like the rest of the region, it was enjoying net inflows of capital at the time. The entire region was better able to withstand the repercussions of what was a very meaningful devaluation.

Given the circumstances as they exist currently, China's devaluation would almost inevitably cause a second wave of regional competitive devaluations. There would be further pressure on the yen and on the Korean won. In that environment, the political consensus that is necessary in Hong Kong to maintain the peg would likely collapse in the face of very high and sustained real-interest rates.

**It is very difficult to come up with bonds where you can very clearly see the upside versus the risk**

**Francis Tjia, Income Partners.**



to mention you have a tonne of paper coming out. Korea, Malaysia, all the markets, everybody wants to recapitalize their balance sheets. We are just going to sit tight and hold onto the cash and wait till the situation with Japan deteriorates or things are pushed into the corner again. Then we'll look for undervalued situations.

### CHINA AND HONG KONG

**Review:** What about Hong Kong? Is it uncompetitive versus the rest of the region, or is it a safe haven?

**Tran:** I don't think the property market has bottomed. Perhaps it has found a support level for a while. But the China story will continue to support Hong Kong

**Tran:** You are safe on the renminbi—until June anyway.

**Cheng:** The relationship between the renminbi and the Hong Kong dollar, if taken to the logical conclusion, is actually reversed. If the renminbi devalues, that means the current account of China will be better, all things being equal. Because Hong Kong services China, that means that Hong Kong's competitiveness increases. It always strikes me as being an illogical conclusion that when the renminbi goes the Hong Kong dollar goes with it.

**Review:** Why hasn't anyone mentioned Taiwan when talking about overweighting? Is Taiwan too expensive?

**Tran:** The market is not completely open and the weighting in the index has risen a lot recently, so fund managers are still trying to catch up.

**Review:** What about Singapore? Are people too worried about Indonesia to be overweight in Singapore?

**Tran:** We have worried over the past month about the semiconductor cycle and the slowdown in PC demand. The physical property market hasn't found a bottom, so that is an issue. Indonesia is also a risk, not only in geopolitical terms, but also for Singapore banks. And the Asean crisis is bound to hurt Singapore's service sector.

**Hood:** Companies on the whole are conservatively capitalized. You see a degree of transparency and objectivity. Perhaps those are the kind of things we are going to see more of in Asia. We are going to see less connections and more well thought-through, well-structured businesses. The capital crunch is going to act as the catalyst for the restructuring of Asia. When we look at the corporate sector of Asia in five years' time, it is going to look very different.

**Review:** Will it take foreign ownership or foreign management influence to make this happen?

**Hood:** Many businesses need help. A lot of people who know how to run and operate a business well don't know how to manage a balance sheet. Compared with the U.S. or Europe, the degree of financial illiteracy of many otherwise sound Asian managers is highly concerning.

**Kaye:** What I would like to see is a process in which the greedy issuer is not dictating to the equally greedy investment bankers: "This is what I am going to do. If you are not willing to accept my mandate, you don't get the deal." What the buyers have to say is: "We are not going to take this any more. We are not going to bend over because you want us to. Here are the conditions that we demand."

This is essentially what has happened at various times in the U.S. When financial markets got into trouble, insurance

**I would look for another October nightmare in the U.S. in 1998, possibly similar in magnitude to 1987**

**Bill Kaye,**  
**Asian Hedge Fund.**



companies would come in and say: "If you want to restructure your balance sheet these are the kind of restrictive covenants that we receive." This meant that a permanent, stable source of capital was provided to the right entities, the ones that were willing to make the right and necessary changes. Frequently, the investor was invited to play a role in corporate governance. This is not happening out here, at least not in any important way.

**Hood:** I think it is beginning to. A lot of strategic buyers of businesses, for instance at banks in Thailand, have walked away. The law of bad money driving out good is going to start working in reverse and bargaining power is going to shift to people who are going to take an activist position in companies and help implement changes.

#### THE U.S. FACTOR

**Review:** Turning to the U.S., what is the risk of a significant downturn in equities there, and how would that affect Asian markets?

**Tran:** The risk is 100%. The only question is timing. Since it will probably happen because of a hike in U.S. interest rates, it will be bad for Asian markets.

**Kaye:** If you had a 30% correction, which would not be extraordinary, the repercussions would be extraordinary. Risk premiums would go up around the world.

This, in combination with the other factors we have talked about—problems in Indonesia, Japan, etc.—is a nightmare scenario for this region. The notion that U.S. investors who have been shocked by a 30% decline in their market are going to throw a lot of money at Southeast Asia is fanciful. It is not going to happen.

**Review:** None of you can see any reason for the dollar to weaken any time soon, despite a huge trade deficit in the U.S.?

**Kaye:** It may weaken, but it won't weaken against currencies out here. It could weaken against the Euro. My guess is Europe will be keenly interested in the world holding the Euro as a reserve currency in proportion to Europe's participation in local trade. So it is likely that Hong Kong, instead of having virtually all its foreign-exchange reserves in U.S. dollars, will choose to have some proportion in Euro. As confidence in Europe's central-bank policy increases it will become a larger holding and that will happen on a global basis.

**Review:** We have talked about macro-level shocks, but do you see any in the second quarter on the micro level?

**Hood:** Unfortunately, most countries don't have proper bankruptcy laws. Not all those companies that deserve to be bankrupted for destroying shareholder wealth by misallocating capital will be punished. However, we will see sporadic major bankruptcies.

**Review:** Thus far, the pain has been felt mostly by Asian companies. Do you see it spreading increasingly in the rest of the world?

**Kaye:** Excess capacity in a broad range of industries is a huge problem. The problems of Asia are now being exported to Latin America and Central Europe. Pricing of equity markets has not reflected these pressures, which have clearly begun to appear. In recent years, U.S. companies have been spending well in excess of GDP growth on new capacity. The question now is how long can you go on. Either the currency devalues and that is how you get competitive again—the Asian answer—or return on invested capital goes down dramatically and people sell shares currently trading at stratospheric levels.

The drop could be quite swift; and it would be severe. I would look for another October nightmare in the U.S. in 1998, possibly similar in magnitude to 1987, but having very different origins.

**Review:** So where do you put your money?

**Tran:** U.S. Treasury inflation-protected bonds. You can get a real yield of 3.8%.

**Review:** For the risk averse.

**Kaye:** I agree with Elizabeth; investors could do considerably worse. ■

## TECHNOLOGY

# Picking Good Value

In a depressed market some technology stocks show promise

By Charles Bickers in Hong Kong

**T**echnology stocks have been leading the Asian stockmarkets' recent recovery—and makers of personal computers and electronic components are in the forefront. Although computer sales have slowed in the region, the global nature of the booming PC market has helped many Asian technology firms through the hard times.

This doesn't mean there are instant fortunes to be made in Asian technology stocks, electronics-industry analysts warn. But the long-term growth story for a few good companies is excellent, and the recent economic downturn means some are good-value stocks—though few can be considered bargains. The relative economic stability of China, Taiwan and Singapore make some technology firms in these countries particularly attractive.

The key to successful investing in Asian technology stocks is to be picky. "We're emphasizing selectivity," says David Toh, Southeast Asian regional electronics analyst for ING Barings in Singapore. "Most of the stocks we're looking at in the electronics sector tend to have either a strong competitive position on a global basis or a strong regional niche coupled with good management."

The recent depreciation of regional currencies sharpened the competitive edge of many manufacturers. This led to the launch, late last year, of the sub-\$1,000 PC, which was well received in the U.S. To maintain their margins on such low-priced products, many American PC makers find it cheaper to outsource their manufacturing. "What is going on in the States is helping us here in Taiwan," says Nate Emerson, a director at ABN Amro's securities operation in Taipei. "Taiwan is one of the most efficient, highest-quality manufacturing areas globally."

Emerson says two Taiwanese firms exemplify the outsourcing trend: **Compal Electronics** in the notebook-PC market and **Mitac International** in the desktop field. Last year Compal made 300,000 notebooks for Dell Computer of the U.S. This year it will supply it with at least three times as many, says Emerson. Mitac is a major original equipment manufacturer to Compaq of the U.S. "People talk about Acer in Taiwan, most have never heard

of Mitac, but its gross margins are better," he says.

Neither company is particularly inexpensive—Mitac trades at about 20 times its prospective 1998 earnings and Compal, at 18.5. But the figures are lower than most American technology stocks, which often trade at more than 50 times. "They're not cheap, but they are very consistent growers," says Emerson, adding that revenue growth for both has been between 15%-30% over the last few years.

The outsourcing trend may also benefit

makes hardware. **Founder** has a strong software business and hardware capability. "While most successful Chinese companies have strong local advantages in the China market, these two are competitive outside China too," says Horie. "Compared to the local market they have a high premium rating at a price-earnings ratio of about 20 times projected 1998 earnings, but compared to Taiwan, Singapore or U.S. stocks, they're not too bad."

Legend was singled out as a "buy" in a recent report by Indosuez W.I. Carr Securities, which said the company's premier position as a PC supplier in China put it in great shape given growth in the domestic PC market. It also noted Legend's recent deals with major overseas players such as Hitachi and IBM. Indosuez W.I. Carr recommended a "sell" on Founder, though, saying the company placed too much emphasis on its software business at the expense of developing its PC work.

In Singapore ING Barings' David Toh focuses on firms that can stay the course through the economic hard times. His favourites include **Datacraft Asia** and **Informatics**, both information-technology and network suppliers, and manufacturer **Natsteel Electronics**.

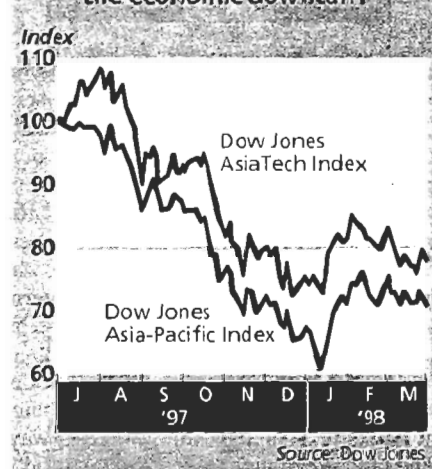
Toh says they are quality companies. Natsteel Electronics is a globally respected manufacturer and Datacraft Asia is probably Southeast Asia's leading network-computing supplier. It recently announced it would supply corporate-network systems to Cisco Systems of the U.S., the world's largest network-components supplier. "I like these companies for their strong businesses rather than their stock prices," says Toh.

Internet-related firms constitute another potential growth area. Take Taiwan's unlisted **Eastern Multimedia**, for instance. The firm, 40%-owned by Taipei-listed **Far Eastern Silo**, is laying cables in Taipei that will lead to multimedia services. Emerson believes proposed changes in the law enabling television suppliers access to telecoms-type services will strengthen such firms.

As the popularity of the PC grows in the region, Asian Internet-related stocks may turn out to be hot property. ■

## Staying Ahead

Asia's technology stocks have fared better than the market in the economic downturn





# Bottoms Up

Industries, not countries, are what count

By Alkman Granitsas in Hong Kong

There's a creeping revolution taking place in the world of finance—call it “global plus” investing. It will change the way you look at the world, and where you put your money.

First, it means taking a global view for your investment portfolio: Better to hold stocks worldwide than just in one market or one region. Second, it means looking for new themes across markets.

In other words, forget about choosing Singapore versus Hong Kong or even Asia versus Europe. The real growth stories are in global industries—in aerospace, in healthcare, in worldwide emerging markets. The new buzzword is “bottom-up stockpicking”—picking stocks on their merits and not by virtue of geography.

“There has been a trend in the past year or two to move away from specialist mandates and towards global mandates,” says Peter Lord, chairman of the Hong Kong Investment Funds Association. “Those investors who have been investing in more globally diversified funds have clearly done quite well. Diversification has its merits and that, as a long-term trend, will continue.”

“And bottom-up stockpicking has become quite topical and fashionable. Clearly when large regions, like Asia, are struggling—and emerging markets, as a general category, covers a multitude of different performances—then bottom-up stockpicking has some attraction,” he adds.

For years, most brokers and fund managers have focused on individual markets or regions. Flip through any fund-house brochure and you'll come across dozens of single-country or regional funds. Sometimes they will have slightly different charters, but usually the fund is defined by geography. Slowly that's beginning to change. Fund managers are beginning to take a broader view and, in any event, the growth and merger of multinationals are making borders increasingly irrelevant.

Take a recent headline from Europe: BMW TO PROMOTE IDENTITY OF ROLLS-ROYCE MOTORS. Offering \$570 million for the world's most famous luxury-car maker, the German manufacturer has pledged to push the “British-ness” of Rolls-Royce, a quintessentially English brand whose hottest market is in Asia. Or

take the case of Coca-Cola, one of America's best-known brands. The company, though based in Atlanta, Georgia, derives more than 80% of its revenues from overseas.

For years, research analysts have struggled to judge companies that operate across borders. After all, how do you value a company like BMW (or Rolls-Royce) against its rivals: Do you compare it to

pocket camera itself.

And so, in the arcane world of fund management, there are two kinds of fund managers—and they rarely mingle. In fundspeak some will tell you they take a “top-down” approach to investing, comparing themselves against some kind of reference benchmark. Others say they prefer a “bottom-up” strategy.

“Most big fund companies are top-down driven. Many say they are bottom-up stockpickers, but when you look at them they are really closet benchmarkers,” says Anthony Fasso at Bankers Trust.

Generally, the top-downers are the vast majority and the bottom-uppers the small minority. Though the top-downers have the numbers, the bottom-uppers have a kind of fervour generally only seen in American Christian fundamentalists.

Simply put, a top-down approach means parcelling out a portfolio among diverse regions or countries—usually against widely followed benchmarks crafted by Morgan Stanley. Bottom-up investing, on the other hand, means building a portfolio one stock at a time—picking each on its merits, and never mind the benchmark.

“Most funds are based on the idea that they invest X amount in Japan or Y amount in Asia. The country allocation is done on a top-down basis and the bottom-up selection follows that,” says Michael Baldwin at U.S.-based Alliance Capital, one of the few asset-management firms that has long eschewed the benchmark approach. “We are trying to find the best companies without geographic constraints.”

Since 1991, Alliance has offered an offshore fund in Luxembourg—the Global Growth Trends fund—that invests in six high-growth industries worldwide: infrastructure, financial services, energy, healthcare, hi-tech and consumer goods. Since its inception, the fund has outpaced world markets in every year but one, and in late March, the company launched the fund in Singapore. (The fund may also be finally introduced in the U.S. later this year.)

That approach is beginning to catch on. Big institutional investors and some mutual-fund managers are beginning to look at the world just a little differently. For one thing, they see emerging-market stocks, like those in Asia, as a class of stock and lump their holdings in the region with those in Latin America and Central or Eastern Europe. They are also beginning to judge new share offerings on a global basis: How does a Chinese telecom stock compare with one in France?

That's forcing a change in the mindset of investment banks and brokerages, who realize that if they want to sell a stock to the fund managers they will also have to



other German car makers, or British ones, or Asian luxury-car makers?

In the past decade, words like “outsourcing” and “domestic content” have crept into the vernacular of the common man. And every thinking person now knows that the label on a Japanese pocket camera or an American computer may have nothing to do with where it was actually made. But the same logic hasn't been applied to investing. Most brokerages and fund managers still focus more on the Japanese label than on the

think global. In other words, bigger is better, which explains the wave of mega-mergers sweeping the world's finance industry.

"In the past 18 months there has been a shift in investor sentiment. People have been looking at emerging markets, not by geography, but as an asset class," says Andrew Jamieson, chief executive at Santander Investment Securities Asia. "The concept of looking at emerging markets globally is the way ahead. So any bank will be at a disadvantage if it doesn't offer a global view."

Enter Morgan Stanley Dean Witter. Two years ago, the American mega-broker started an internal exercise to compare stocks across borders. The goal at the time for 150 of the firm's research analysts was to come up with a common, cross-border approach to valuing stocks. To its surprise, it came up with a remarkably valuable research product, The Competitive Edge, that was widely applauded by outside asset managers.

In the report, the firm identified 238 truly world-class companies in 21 globe-spanning industries from aerospace to healthcare to utilities. From the original universe of companies, Morgan Stanley

picked a subset of 40 firms whose stock prices, the researchers felt, were undervalued. Last year, those 40 firms rose 31.8%, compared with a 12.9% gain in Morgan Stanley's own world index.

In fact, the report was so well received that in late February the company launched a new mutual fund based on its top-40 ideas. In just six weeks, the fund garnered a stunning \$1.3 billion and has been closed.

"We started the exercise because it helped us improve our own disciplines as investment analysts. It gave us an ability to use a common framework for our approach to valuing stocks," says Mayree Clark, global head of research at Morgan Stanley. "But even though we did it as sort of an exercise, it produced something that people have really seized on to. Now we have launched a fund based on The Competitive Edge for retail investors."

Now it's taking the process one step further. Morgan Stanley has begun a new series of industry reports called Apples to Apples, comparing individual stocks across borders. That's a truly heroic endeavour that involves disentangling different accounting standards around the world. Forget about currency or political risk,

accounting data may be the biggest uncertainty facing global investors. The first report, on the car industry, compares 15 companies from the U.S., Europe and Japan (including BMW).

If industry-by-industry global investing really catches on, it could have profound implications for Asian stockmarkets. Clearly, the region has few world-class companies that can really compete against much bigger and stronger rivals in Japan or the West. Ultimately, that means fewer investment dollars will flow from overseas into the region's equity markets.

**T**aking a conventional, top-down approach, one based on the Morgan Stanley world index, a typical global portfolio would put roughly 50% of assets in North America, 30% in Europe, 8.8% in Japan and 5.5% in the rest of Asia. Compare that with the model portfolio described in The Competitive Edge. Of the 250 firms highlighted in the 1998 report, only 13 from Asia, excluding Japan, make the grade. Taking into account the much smaller market capitalization of those stocks, Asian companies make up just 1.2% of the portfolio.

"There aren't that many globally competitive companies in Asia. But there is a good reason for that," says Clark. "It is a less-developed market, so the companies don't have the scale and scope." Of course, that will change over time as regional economies mature and Asian firms go overseas in pursuit of new opportunities.

So what are you waiting for, it's time to jump into high-growth, globe-trotting industries, right? Not so fast. Better returns may also entail greater risk. Because an industry-specific fund invests in stocks that have related concepts, they may be subject to similar shocks. For example, a slowdown in the electronics industry will likely knock back hi-tech companies from Japan to Finland. Last year's Asian crisis may have a similar effect this year on the earnings of financial-services firms worldwide.

But then, that still beats the pummeling that Asian stockmarkets received last year. And as many Asian investors have learned, staying in just one market is not a safe bet. Instead, Geoffrey Hyde, senior vice-president at Alliance Capital, recommends a diverse portfolio across regions, one that is not highly correlated to any one market.

"Asian investors have been on an unhealthy, high-calorie diet over the last three years. Many were probably confusing luck with science," he says. "Now it's time to start on a low-correlation, low-calorie diet rather than gorging on the equity markets like in the last three to four years."

## Asia's Best

Most of Morgan Stanley's 250 world-class companies are from outside Asia. As of the end of 1997, only 34 of the region's firms made the grade

### JAPAN

- Bridgestone
- Canon
- Daifuku
- Fanuc
- Fuji Photo Film
- Honda Motor
- Japan Air
- Kubota
- Kurita Water Industry
- Mori Seiki
- NEC
- NSK
- Sankyo
- Seven-Eleven Japan
- Shin-Etsu Chemical
- Sony
- Takeda
- TDK
- Tokyo Electron
- Tokyo Marine
- Toyota Motor

### CHINA

- China Eastern Airlines

### HONG KONG

- Cathay Pacific

### INDIA

- Tata Iron & Steel Co.

### SOUTH KOREA

- Pohang
- Samsung Electronics

### MALAYSIA

- Malaysia Airlines

### SINGAPORE

- Asia Pulp & Paper
- Singapore Airlines

### TAIWAN

- Advanced Semiconductor Engineering
- China Steel
- Nan Ya Plastics
- Siliconware Precision Industries

### THAILAND

- Advanced Agro

### AUSTRALIA

- Broken Hill Proprietary
- News Corp.
- North Limited
- WMC

Source: Morgan Stanley  
Dean Witter

# The Next Step

The IMF has stopped Asia's financial panic; the next challenge is to rebuild its broken banks. Now, a prescription for reform is starting to emerge.

By Alkman Granitsas in Hong Kong  
with Dan Biers in Seoul

**V**ivien Tang taps a lightly frosted fingernail on the papers in front of her, filled with tables and pie charts. She swiftly moves across them, explaining to a customer where and how to invest in mutual funds.

Quickly, she maps out a model investment portfolio from a list of more than 30 funds at her fingertip. On the list are a gaggle of American and European equity funds, a few that focus on Latin America and one or two specializing in industries. What's missing are any mutual funds devoted to Asia. "Asia will take a long time to recover, maybe two or three years," says the investment adviser. "In the meantime, Asia is pretty high risk, the markets are much more volatile."

A few blocks away, in another bank in Hong Kong's financial district, Edwin Chan talks about a growing divergence in Asia's stockmarkets. His manner is crisp and professional, and he looks every bit the part of a banker, wearing wire-rim glasses and a starched pink shirt with neatly folded French cuffs. As he sees it, there are some opportunities in the region—if you know where to look. That even includes bombed-out economies that have gone hat in hand to the International Monetary Fund.

So who's right? They both are. Since the beginning of the year, stockmarkets have rallied and currencies appear to have stabilized. In early April, South Korea successfully placed \$4 billion in sovereign debt and Thailand's second largest bank,

Thai Farmers Bank, raised \$800 million in new equity. Both reflect the impact of IMF-directed restructuring programmes that have stopped the panic and restored a modicum of confidence in the region.

But don't be fooled; it's still going to be a bumpy ride in the months ahead. Asia is now entering a new, tougher phase of its rehabilitation. The next step is to restore local banks' health so that capital can once again flow through corporate Asia.

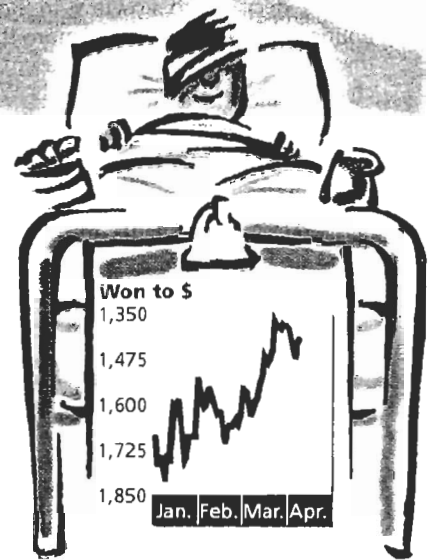
The initial signs are encouraging. Compared with years of dawdling in Japan, or Latin America's decade of denial in the 1980s, South Korea and Thailand have moved with surprising speed to clean up their banks. Indeed, a blueprint to recapitalize the banks and keep them on a sound footing is emerging in both countries. It includes easing restraints on foreign investors, raising the banks' capital thresholds and passing new bankruptcy laws to make it easier to recover the collateral behind bad debts.

"It will take time to see a change in the economy, but the momentum is encouraging. The framework of the reform is correct," says Jong Hyun Chang, Seoul-based managing partner for Booz-Allen & Hamilton. But it won't be easy: Korea and Asia's other crisis-hit economies need to undertake massive restructuring that will put companies out of business and people out of work. "One thing I'm worried about," Chang adds, "is that they are trying to change too much in a short time, so there may be social or economic costs. We might see a lot of resentment."

There are other reasons to remain cau-

REVIEW GRAPHIC/PETER ESPINA, DICKY TANG

## SOUTH KOREA



Source: Datastream

tious about the state of Asia's banks. So far, none of the blueprints includes allowing the weakest banks to go belly-up. That raises the issue of moral hazard: Can banks really be expected to behave responsibly if they can always count on a government bailout?

More importantly, corporate Asia is still buried under a mountain of debt that will take time to work off, recover and restructure. It may well involve writing off billions in bad debts—a frightening

## SOUTH KOREA

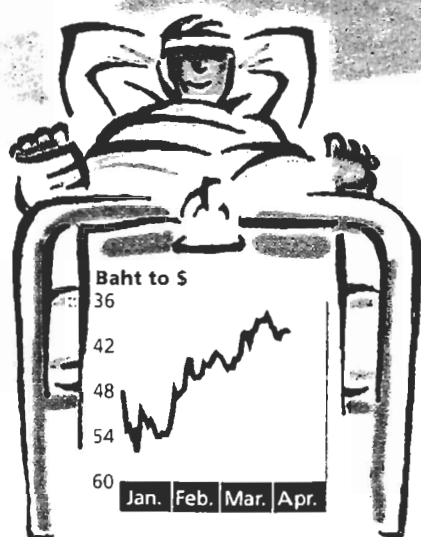
### Government has . . .

- bailed out Korea First Bank and Seoul Bank
- closed 12 insolvent merchant banks
- allowed foreign banks to set up subsidiaries
- instructed chaebols to phase out cross-guarantees between subsidiaries
- revised bankruptcy laws to crack down on abuse
- allowed banks to revalue land holdings

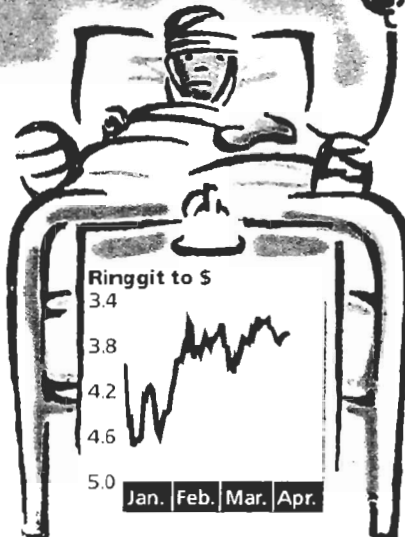
### . . . but still must:

- sell Korea First Bank and Seoul Bank (open bidding is due later this year)
- cut off emergency loans to failing companies
- persuade banks to analyze credit risks

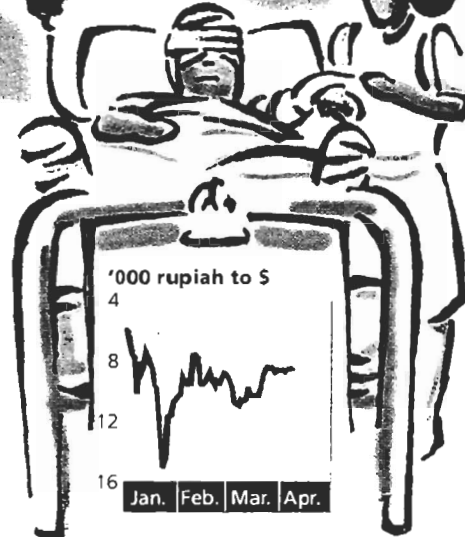
## THAILAND



## MALAYSIA



## INDONESIA



prospect to bankers, but one that proved a key component in Latin America's eventual recovery.

Korea companies, for example, need to raise about 60 trillion won (\$43 billion) to reduce their debt-to-equity ratios to 170%, roughly the level they were at before the crisis hit, according to Richard Samuelson, branch manager of SBC Warburg Dillon Read in Seoul. Yet his back-of-the-envelope calculations suggest that only about one-third of that amount

can be obtained through a mix of rights issues, offshore equity-raising and asset sales. Even then, he says, much of the money would be absorbed as working capital, not reductions in bank debt.

That puts banks in a bind. They are loath to force big corporate borrowers to go under, as that could force them to write off hundreds of millions of dollars in loans. What's more, the banks are being urged to help keep companies afloat. In South Korea, many analysts

suspect the government has asked banks to roll over corporate debt and extend easy terms to the most troubled companies. But keeping insolvent companies afloat on credit is not a long-term solution, either. In the best case, banks will have to wait a long time for repayment; in the worst case, they will be throwing good money after bad.

The truth is that the debt burden throughout Asia is too big for any one solution. Even if governments wanted to

## REPORT CARD

Bank reform has started, but there's much more to be done

### THAILAND

#### Government has . . .

- nationalized four large banks, including First Bangkok and Siam City
- passed a new bankruptcy law
- completed an inquiry into central-bank mishandling of currency reserves
- toughened rules on banks' loan provisions, tightened definitions of nonperforming loans
- set up government banks to sell off banking-sector assets
- eased limits on foreign ownership of banks, allowing foreigners to have majority stakes for a maximum of 10 years

#### . . . but still must:

- reorganize the Bank of Thailand
- sell off assets of closed financial institutions

### MALAYSIA

#### Government has . . .

- pushed 39 finance firms to merge into eight larger ones
- capped bank-lending growth at 15%, half the previous rate
- exposed more nonperforming loans (now defined as those on which interest payments have been missed for three months rather than six)

#### . . . but still must:

- ease limits on foreign ownership of banks and finance firms
- improve transparency of bank earnings
- cut off easy credit to troubled tycoons

### INDONESIA

#### Government has . . .

- placed 54 banks under supervision of restructuring agency
- closed 16 banks considered insolvent
- guaranteed bank savings and deposits
- capped growth in bank lending and foreign deposits
- approved the merger of the country's two bourses, to improve capital-market performance
- agreed to raise \$18.3 billion to recapitalize banks

#### . . . but still must:

- restructure corporate foreign debt
- stop political meddling in Bank Indonesia

bail out banks and companies, "the debt burden is much too big for even the government," says Liew Yin Sze, an economist at J.M. Sassoon in Singapore.

In the absence of domestic players big enough and healthy enough to buy up ailing banks, the only other options are to allow sales of sickly institutions to outside investors, or for the banks to raise money on capital markets.

In Thailand, the government has taken over four problem banks and assumed their burden of bad debts. South Korea will follow suit in a few weeks, when it creates a new bank to dispose of distressed loans. The government seized control of Korea First Bank and Seoul Bank early this year, and in February closed a dozen troubled merchant banks. It may bundle problem loans into tradable debt securities and sell them to foreign investors.

At the same time, Thailand's two biggest players—Bangkok Bank and Thai Farmers Bank—have successfully gone to the capital markets. And foreign investors, most notably Development Bank of Singapore and Dutch banking giant ABN Amro, have snapped up stakes in two local banks.

"In my best-case scenario, you will have a mixture of solutions," says Ronald Stride, senior vice-president at Booz-Allen & Hamilton based in Singapore. "The major players, like Bangkok Bank, Thai Farmers Bank, will be strong enough to get private placements in order to raise capital. They will remain independent but the local share ownership will be diluted. At the same time, the medium-sized banks will attract overseas capital, either through a joint venture or through foreign ownership."

Unlike Thailand and Korea, however, Malaysia has refused to lift its caps on foreign ownership of banks. The current limit is 30%. Rather than look for overseas investors, the Malaysian government has encouraged domestic ones. This approach was reflected in the recent sale of Sime Bank to Rashid Hussain, a local financial-services group, and several other corporate mergers. (Australian banking group ANZ Bank looked at taking over Sime Bank but balked, in part, local media reports suggest, because of the foreign-ownership cap.)

Still, Malaysian officials have taken other tentative steps to reform. For starters, the central bank has demanded that 39 local finance companies consolidate into eight, and it has nudged local banks to cut lending. (Credit, though, is still growing at more than 20% a year.) Late last year, Finance Minister Anwar Ibrahim announced tighter accounting standards for

the banks, forcing them to recognize problem loans earlier.

Even Indonesia, by far the furthest behind in its reform efforts, has recently taken some steps to tackle the country's debt burden and problem banks. Under a new agreement—its third—with the IMF, the government has recently pledged to raise \$18.3 billion on world markets to recapitalize the country's anaemic banks. What's more, in the past few weeks, Jakarta has floated a plan to help domestic companies pay off their foreign debt based on a formula that Mexico adopted in the early 1980s. Under the plan, the government would guarantee companies a favourable fixed exchange rate between the rupiah and the dollar, but companies would be obliged to pay their foreign loans in full.

On April 5, moreover, Jakarta froze operations at seven ailing local banks and put them under the supervision of the newly created Indonesia Bank Restructuring Agency. Now, 54 banks are under the agency's oversight, although that's still a small portion of Indonesia's 240-plus commercial banks.

**B**ut do these step go far enough? Not only are officials refusing to allow banks to fail, but just the opposite is happening: Many are being kept alive by relatively low interbank rates on the one hand, and high lending rates on the other. In Malaysia, for example, Bank Negara, the central bank, has been keeping three-month interbank rates at around 11%. But the prime rate at Maybank, the country's largest bank, is 15.9%. And in Thailand, where savings-deposit rates at most banks hover around 5.5%, Bangkok Bank recently raised its minimum lending rate to 15.5%.

That may be helping to bail out the banks, but it's crushing the real economy—including companies that would otherwise have a role to play in rebuilding their nations' fortunes.

A more far-reaching question facing each of Asia's battered economies is: How much pain can they take? So far Korea, Thailand, and, to a lesser extent, Malaysia, have shown a willingness to face problems among their banks. But if the burden of higher interest rates continues, if layoffs mount and bankruptcies rise, their willingness to stick by tough measures may falter and further reforms will be in peril. Governments may then be tempted to try to solve their problems by printing money and easing credit—but at the risk of hyperinflation.

"The worst case is like Japan," says Sassoon's Liew. "The sooner they bite the bullet, the better." ■



# Problems in Private

## Malaysian firms hand back projects to the government

By S. Jayasankaran in Kuala Lumpur

It was a surgeon's nightmare: emergency operations done by candlelight. When the lights went out for five hours last August at Kuala Lumpur's General Hospital, the back-up generators failed to kick in—for the second time since January that year. Ironically, that was the month part of the maintenance of the state-owned hospital, Malaysia's largest, had been taken over by Radicare, a private company with strong political links but little experience in such services.

Examples like Radicare—controlled by supporters of Deputy Prime Minister Anwar Ibrahim—abound, illustrating the perils of entrusting complex projects to politically well-connected, but unseasoned, companies. Yet those glitches have seemed a small price to pay given the benefits accruing from Malaysia's 14-year-old privatization programme, a key pillar of Malaysia's rapid development. Not only has it saved the government billions of dollars but it has been an effective tool for redistributing wealth to indigenous Malays.

Today, however, the privatization agenda faces far more intractable troubles and is fast unravelling. Many of the companies that took on privatization schemes are now buried under heavy loans that they had intended to repay through anticipated rich profits. Instead, most of the projects themselves are now unviable, due to a liquidity squeeze and a credit crunch—the fallout from the country's economic crisis. Drowning in red ink, some indebted companies are handing back their privatization projects to the government.

For example, Konsortium Perkapalan, a floundering listed company owned by Prime Minister Mahathir Mohamad's eldest son, Mirzan, is selling its shipping assets, including a former state-owned shipping line, to Petronas, a government oil company. A price-tag is pending due diligence, but the Konsortium Perkapalan rescue could be the first of many.

In late February, work on a 2.2-billion-ringgit (\$589 million), 16-kilometre monorail ground to a halt, reportedly due to financial problems. Government officials say Kuala Lumpur will pick up where the project's investors left off. The government will fund and finish building the monorail. It will also compensate Ting Pek Khiing,

the tycoon behind the suspended 13.6-billion-ringgit Bakun dam project, for work already done. According to officials familiar with the negotiations, Ting has also asked to be compensated for "foregone profits" and other expenses, but the government is unlikely to pay up. The final bill is likely to be 700 million ringgit or less.

Bailing out these half-done projects—albeit from a sense of moral obligation—will be expensive, and will add to the soaring potential costs of privatization in the guarantees made to many huge infrastruc-

ture projects. The government has given a 420-million-ringgit guarantee, for example, to Dragages on a railway station that the French company is building in Kuala Lumpur for the project's main promoter, Malaysian Resources Corp. Work on the railway station is continuing at full steam because Dragages is confident that the government will step in if Malaysian Resources is ever strapped for cash.

The total value of these guarantees isn't known because they're scattered across several ministries and shrouded in secrecy. Some of the contingent liabilities do not show up on government balance sheets, because some of the projects were financed in part by state-owned trust agencies and the Employees' Provident Fund, the coun-

try's largest private pension plan. Another sign of trouble is that privatization is drawing rare criticism from the government's own parliamentarians, who are usually respectful of any Mahathir-driven programme. They point to the angry consumers, who at a time of economic uncertainty are irked that private companies involved in basic industries, from telecommunications to power to toll roads, are demanding higher tariffs.

No doubt about it. Privatization, Malaysia-style, is in trouble. The programme involves: the sale in full or part of stakes in state companies (such as the utilities); contracts for private companies like Radicare to invest in and manage services for the government (such as hospital maintenance and garbage disposal); and build-operate-transfer schemes, in which private firms obtain a concession from Kuala Lumpur to invest in and operate potentially lucrative projects (such as the



Stalled monorail project: It's the government's business now.

national sewerage deal landed by Indah Water Consortium).

The distress signals were first seen in the early 1990s, when privatization ran amok. There were too many players, creating too much competition, to the detriment of all. For example, the government licensed eight well-connected private players to provide telecommunications services in direct competition with state utility Telekom Malaysia. The wasteful duplication of services badly hurt Telekom Malaysia's bottom line and weakened its share value. The eight licensees didn't fare much better: Only two are profitable, one has been bought, while the rest will have to merge, sell out at a huge loss, or go bust. Another state utility, Tenaga Nasional, also

lost in profit and share value because of a lopsided "take or pay" deal that obliges it to buy electricity from five independent producers.

The problem was that while the government saw privatization as the engine to drive the country's growth, many investors saw it as a ticket to instant riches. And in many ways, it was. An investor obtaining a licence for a national project had many options on what to do. "He could sell it for a fortune, he could use it to borrow a fortune or he could use it to take over a listed company and see its shares fly," says a Kuala Lumpur-based foreign banker wryly.

Indeed, one construction-company owner who obtained a toll-road highway concession admitted to the *REVIEW* that he was more interested in the profits in building the project than in its long-term viability. "Most of us think that someone, maybe the government, maybe the minority shareholders, will carry the can later," he says candidly. (The toll-road project has now been delayed indefinitely.)

Investors also didn't have to worry about the size of a project. In fact, Mahathir had always espoused a "think big" creed for Malaysia. Privatization proposals that have won his approval range from an Alpine-style highway between Malaysia's hill resorts to a bridge linking Malaysia and Indonesia. "If you went to the PM and said you had an idea for a bridge from here to, say, Kathmandu and you didn't need any government financing, he'd say 'go ahead,'" notes a businessman close to Mahathir.

But the credentials of those handed privatization schemes were sometimes suspect. Ting Pek Khiing, who landed the Bakun project with ease, had no experience in dam-building, although he was responsible for constructing two hotels on Langkawi island at a thundering speed.

Other projects were simply not thought through properly. Indah Water Konsortium should know. It has changed owners twice since acquiring the licence for the national sewerage system in 1993. Indah Water's predicament is that it has been saddled with more treatment plants than it bargained for, many of them in need of repair. That will cost money, but revenues are being hurt by many consumers' refusal to pay for sewage treatment—a benefit they cannot perceive. There is little Indah Water can do other than sue.

"When we took over we thought we'd

get 1,800 treatment plants from the government. Instead we got 5,200, 70% of which were in bad shape," says Jagan Sabapathy, Indah Water's managing director. "We have to spend 10 billion ringgit for a decent system. For this to work, the consumer has to pay an acceptable rate while the government has to come in." The implication: The government will have to pay the shortfall to give Indah Water Konsortium an adequate rate of return.

Notwithstanding the hiccups, it's unlikely that the government will abandon privatization completely. And in some ways, the current troubles may improve future schemes as the government will know which pitfalls to avoid. Anwar has said it's time to return to competitive bidding. And Daim Zainuddin, the government's economic adviser, believes privati-

deficit had skyrocketed and the external debt had reached dangerous proportions. Mahathir saw privatization as the way out and simply folded it into the National Economic Policy, an affirmative-action plan introduced in 1971 to eradicate poverty and to lift the bumiputras (indigenous Malays) into the economic mainstream. The National Development Policy, which replaced the NEP after it expired in 1991, explicitly stated that privatization would be used to attain NEP objectives. That meant that while Malaysia's ethnic Chinese and Indians were given some large privatization deals, the bulk went to the bumiputras. The litmus test then and now is the dispersal of corporate-asset ownership and, hence, wealth. Prior to Mahathir's privatization policy, the thinking was that only the state could ensure such redistribution.

The early privatized projects justified the optimism. The North-South Highway project, awarded to United Engineers, was completed 15 months ahead of its May 1995 schedule, cutting travelling time along the length of the peninsula by several hours. New efficiencies ushered in by private management also slashed turnaround times at the Klang Container Terminal. Privatization brought more money into the government's coffers, ironically from public companies turned private, which had not worried before about either profits or taxes.

Right from the start, connections rather than credentials decided who would get a contract. Privatization awards were rarely transparent and no one could be sure if the best man won. Indeed, United Engineers won the North-South Highway bid primarily because of its links to the United Malays National Organization, the main party in the National Front coalition government. Umno President Mahathir himself acknowledged in 1987 that United Engineers had to be awarded the deal because Umno needed funds for its new 300-million-ringgit headquarters in Kuala Lumpur. United Engineers completed the project ahead of schedule, but ran up a cost-overrun of nearly 3 billion ringgit.

At the time nobody complained. Malaysia's economy was doing well, and the ringgit was strong. As Mahathir, the chief architect of the privatization policy, once observed, "Growth covers a multitude of sins." Today, though, Mahathir's administration might not have that welcome protection for long.

## PRIVATE TROUBLES

Malaysia's privatization plans are facing problems



### Telecommunications

Only two of seven companies licensed to provide telecoms services are profitable.



### Power generation

Profits at national utility Tenaga Nasional are being battered by a "take or pay" deal that obliges it to buy electricity from five independent producers.



### Steel

Perwaja Terengganu, Malaysia's largest steel plant, continues to lose money a year after it was privatized. Buyer Maju Holdings hasn't yet paid the government for its 51% stake.



### Sports facilities

Private firms have spent more than 1 billion ringgit (\$268 million) on stadiums and facilities for September's Commonwealth Games. But afterwards, they're likely to see little use.

zation "needs a rethink." Says he: "In future we have to give projects to the right people, not those who want to get rich quickly and forget about management."

Indeed, it wouldn't do to throw out the privatization programme with the bath water. After all, the plan was instrumental in pushing the government's balance sheets into the black. Between 1984 and 1996, Kuala Lumpur saved 72.8 billion ringgit in capital expenditure from privatized projects, according to Zainuddin Abdul Rahman, deputy director of the Economic Planning Unit, an agency that oversees the privatization scheme. The policy also enabled Kuala Lumpur to successively cut corporate taxes to the current 28% from more than 40% in the mid-1980s.

That was a time of recession during which the state accounted for half of Malaysia's total investment. The budget

BY IYU GRAPHIC ARTS CHOW



## Export Shock Hits Growth

By Julian Baum in  
Taipei



**W**hen the news came on April 9 that Taiwan's normally robust exports had fallen in the first three months of this year—the first quarterly drop in 17 years—it reverberated across company boardrooms and government offices.

Trade accounts for 80% of the country's gross domestic product, and Asia buys more than half of Taiwan's exports. The collapse in regional buying power has therefore taken a predictable toll. Among the hardest hit have been older industries, especially textiles, steel and petrochemicals.

"There's been very strong competition from South Korea, which has been selling its products at cost without regard for reasonable profit," says Wang Heh-song, senior vice-president and chief economist at the International Commercial Bank of China.

Yet analysts are confident that Taiwan's first-quarter export slump—shipments fell 6.4% from a year earlier—was a temporary glitch. They say South Korea can't continue to sell goods so cheaply; Southeast Asian economies, meanwhile, are on the mend and are becoming better positioned to import Taiwanese goods. Exporters are also aggressively looking for new markets as far afield as Eastern Europe and Latin America.

All the same, the disappointing trade performance will almost certainly bring another round of revised growth forecasts for 1998. Private economists now predict 5%-6% growth, while the government says it expects over 6%. Revisions will depend partly on how well American computer

makers did in the first quarter; results are due out in mid-April. Taiwanese computer-hardware makers, which are among the island's biggest exporters, are directly affected by the U.S. market.

Growth will also be influenced by the government's response to the slowdown. It has not yet indicated clearly whether it will take fiscal measures to stimulate growth or tighten monetary policy to prevent inflation and overexpansion.

On the import front, a first-quarter rise of only 0.1% led to a trade deficit of \$66.7 million, versus a surplus of \$1.8 billion a year earlier.

One fairly good piece of news is that inflation remains low. In the first quarter, Taiwanese consumer prices grew by only a modest 1.6% from a year earlier. And although prices in March rose 2.9% year-on-year, inflation remains below the government's target ceiling of 3%.

Some analysts have speculated that the central bank might try to drive the New Taiwan dollar lower to boost exports. But the central-bank governor, Peng Huai-nan, told the legislature in mid-April he was

satisfied with the current rate of about NT\$33 to the U.S. dollar.

Now the biggest economic threat looks to be the possibility of a sharp slump in Japan, leading to a drop in the yen—and a new challenge to Taiwan's exporters. "This could have more impact than what happened in Southeast Asia and Korea," says Kuo Wen-jeng of the government-funded Chunghwa Institution for Economic Research. ■

**Exports:  
Down sharply**

**Growth:  
Slowing**

**Inflation:  
Low**

**Currency reserves:  
Steady**

# Where to Go From Crisis

By D.L. Western



The writer is an economics lecturer at Curtin University, Perth.

‘ Asia’s growth miracle rests in adapting rather than inventing technology and selling manufactured goods to the West at comparatively very high world prices ’

Asia’s financial-market meltdown in the past year has been both swift and severe. While the causes of the crisis have become clearer, the solutions have not. What needs to be remembered is that the crisis thus far has been confined to the currency and financial markets, and that the basic long-run fundamentals—growing productivity, a hard-work ethic, high savings, low wage costs and sound education systems—are still in good shape. This is a *financial* not an *economic* crisis.

The central issue is whether the financial side of Asia’s current malaise can be repaired quickly and whether the fundamentals of growth, including total factor productivity, or TFP, can offset any short-term hiccup to prosperity. If the Asian growth miracle is to resume, then the fundamentals of growth (and TFP), such as management and worker efficiency, adoption of world best-practice, promotion of research and development, productive investment, sound government policies and active trade and export policies need to be re-emphasized.

Recently, the economists Alwyn Young and Paul Krugman have cast doubt on the past validity of the Asian growth “miracle,” in that massive and rapid accumulation of factor inputs—capital and labour—can only sustain growth for so long, until diminishing returns set in. Sweat and sacrifice can explain high economic growth rates for a while, but eventually technological progress is required. According to these economists, Asia has been too reliant on blunt accumulation for prosperity and not enough on technological progress. Accordingly, Asia’s growth experience was bound to falter in the absence of solid TFP growth offsetting diminishing returns.

But has the Asian miracle ended? Probably not, as the root causes of Asia’s success reveal reasons for optimism. First, besides sheer accumulation as the engine of growth, there was a strong commitment to adopting, adapting and otherwise imitating foreign technology in order to improve product quality, capture markets and climb up the product ladder of sophistication. The cost of imitation and adaptation has been, and still is, far lower than the cost of invention.

Second, while this pseudo-technological force was at work there was also the strong export bias of Asian nations towards rich, mature economies. With vast differences in costs between East and West over the last 40 years, there has been an unprecedented boom in Asian exports.

Asia’s export drive was primarily based on cheap labour-intensive goods in the early years and more sophisticated goods recently. The key

to prosperity was to acquire hard currencies and *super* profits (because of the gap between international prices and marginal costs) by exporting manufactured goods. Trade is not only important for financial and profit reasons, but also for learning about and improving product quality.

Third, Asia may not suffer from diminishing returns to accumulation in the near term as many nations in the region still have wage rates of \$2 an hour or less. The opportunities for the technically more-advanced Asian nations to indulge in foreign investment and act as middlemen in trade are still very handsome. Labour-intensive industries have relocated in order to remain internationally competitive.

A major source of regional pessimism is the belief that Asia has experienced little or no growth in TFP. This is a worry if true, as the implication is that research, human capital, worker and manager efficiency and skilled personnel are in short supply. But this pessimism is excessive in the extreme. Besides, diminishing returns have not and will not set in because there is an external trade force keeping rates of return high: Price and cost differentials between East and West keep export profits very lucrative.

The root of Asia’s growth miracle rests in adapting rather than inventing technology and selling manufactured goods to the West at comparatively very high world prices. *Super* growth over the past 40 years was driven by these *super* profits. If these two fundamentals had indeed vanished then it is arguable that the growth miracle is over. More likely, they are as vibrant as ever—the pool of world knowledge is getting easier rather than more difficult to tap and rich economies are still healthy and welcoming cheaper goods of quality. Asia should not worry if the view of “no TFP” is correct— invention and technological progress never were the catalysts of the Asian miracle. Moreover, as many as 1.5 billion of East Asia’s 2 billion people still command low wages and so offer huge investment opportunities to many Asian companies that act as links to richer markets.

Asia’s growth prospects remain vibrant over the long term. But the current financial shake-up has dented confidence and with the International Monetary Fund demanding austerity measures, some nations will have to accept a lower growth path for a time. The belief that technology-driven TFP holds the only path to prosperity for Asia is false. Exports, acquiring hard currency and imitation have been the major catalysts of growth and will remain so for a long time to come. ■

## POLICIES

# Seed Capital

By Ben Dolven in Singapore

National reserves have to earn a living just like anyone else's funds, but sometimes it's hard to find out how. The Government of Singapore Investment Corp., for instance, is as opaque as public institutions come. Ask the GSIC how it's managing Singapore's huge stockpile of fiscal reserves, and the most direct response you'll get is "prudently."

But from time to time, it becomes clear that this huge government investment arm is shifting its policies to promote broad national initiatives. So it was in February, when Deputy Prime Minister Lee Hsien Loong announced that the GSIC would more than triple the funds it places in private fund managers' hands over the next three years.

The money wouldn't go to just any fund managers. As Lee explicitly put it: "We would expect fund managers

receiving GSIC mandates to bring in additional funds to Singapore for management to meet the Monetary Authority of Singapore's development initiatives. They should bring in talent to Singapore, as well as build up their team of Singaporean fund managers."

The GSIC promises to put up to 50% of its Asian portfolios in the hands of private fund managers, almost all with those who have Singapore offices. Overall, it will increase the amount it places with private companies to S\$35 billion (\$22 billion) by 2001, from the current S\$10 billion. The funds will go not just to the region, but to global investments as well.

The aim is to build a fund-management centre that challenges Hong Kong as the region's pre-eminent hub for mutual funds. In this respect, Singapore has a way to go: Although its fund-man-

## Basis for Growth

Funds under management in Singapore



agement industry has grown in recent years, it still lags behind Hong Kong's, and it's well behind the booming industries in the West. At the end of February, there were 160 fund-management companies in Singapore with around S\$124 billion in their coffers. Hong Kong, by comparison, had more than 200 fund-management companies controlling assets worth a total of \$132.4 billion.

The initiative should provide some comfort for companies trying to weather the region's financial storms: The S\$25 billion in new money represents more than 20% of the amount that the fund-management industry currently manages.

The February announcement wasn't altogether unexpected. The GSIC, which has a bevy of its own staff managing its money, has been placing out funds with private fund managers since 1994. Some firms had established Singapore offices in recent years in expectation of more money—both public and private—but companies have expressed discomfort with the stringency of regulation in Singapore.

The Lion City's financial regulators have indicated a willingness to cut fund managers some slack. But for the industry to truly take off, Southeast Asian private investors will have to buy into the mutual-fund fads that have revolutionized personal investing in the West. More public money is really only a "kick start," says one fund manager at a European company in Singapore.

But Singapore's financial chiefs are thinking long term, and industry officials say they're likely to get more than the GSIC involved. ■

## DIVERSIFICATION

# Testing the Water

By Julian Baum in Taipei

**W**hen a Taiwanese investor arranged to purchase a Hong Kong equities warrant for \$1.4 million in early 1997, his private banker warned him about the risks involved. But well before the Hong Kong stock-market turned bearish, the client sold the warrant for more than three times what he paid for it.

"He was an exception," says his banker, who handles a large number of accounts for high net-worth individuals in Taipei. His customers prefer U.S.-denominated investments and stay away from volatile Asian currency and equity markets. For the handful of wealthy individuals who seek out private banking services—at this particular bank, those with a net worth of \$3 million or more—this slow but sure investment strategy is the outcome of uncertainty at home, especially since Chinese missiles were fired in the Taiwan Strait in 1995-96.

More recently, says the Taipei-based private banker, Taiwanese investors have observed that the wealthy Thais and Malaysians who weathered the currency meltdown in their own countries last year were the ones who held substantial amounts of U.S. dollar-denominated securities. These shrewd Southeast Asians were convincing examples of the value of diversification of private assets.

"A few years ago, my clients wanted a 20%-30% return on their funds," says the banker. "Now they place a high priority on confidentiality, tax avoidance and diversification."

With more U.S.-dollar billionaires than Canada and a high propensity to move funds offshore for safekeeping, Taiwan would seem to be a ready market for private-banking services. Taiwan's Central Bank of China reports that aggregate foreign assets held by the private sector at the end of 1997 were \$63 billion, a 12.5% increase over the previous year. This includes direct investments in manufacturing as well as foreign securities and currency deposits, property and other indirect investments. A Taipei economic journal recently estimated that the potential market for

noncorporate private investment services was \$20 billion-25 billion.

Yet when it comes to offering personalized fund management for high net-worth clients, foreign bankers are confused about the legality of private banking. Some insist that it's clearly prohibited, pointing to a 1991 letter from the Ministry of Finance ruling out any activities not within the scope of a financial institution's business licence. Others say that it's in a "grey area," not explicitly authorized but also not strictly forbidden, especially if it's done discreetly.

The banker just quoted, for instance, says he could be in deep trouble with the central bank and Ministry of Finance

which supervises 46 foreign banks in Taiwan and their 74 branches. "If foreign bankers think it's illegal, they need a better lawyer."

Kuei says that the government's main concern is to prevent money laundering and tax evasion, which he says are often associated with private banking. "This is a line that has been drawn in the whole world," he says. "But if foreign banks want to attract people to invest in foreign mutual funds or in any kind of foreign financial products, it's no problem."

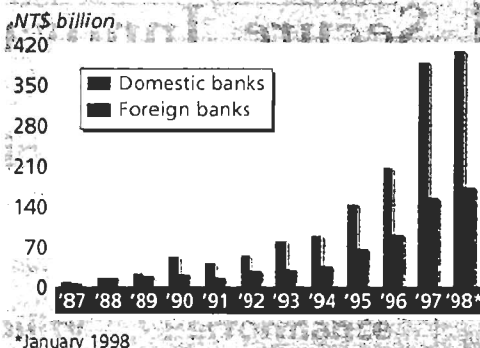
In an attempt to win clear permission for their national banks to solicit Taiwanese customers, Canada negotiated an agreement last year as part of a bilateral package on Taiwan's entry into the World Trade Organization. But sources say that there are now doubts about what precisely was agreed, and that the Finance Ministry appears to be backtracking. Foreign bankers speculate that the ministry is fearful that the agreement would leave Taiwan more vulnerable to the financial turmoil which struck other Asian economies recently.

An official with the Canadian Trade Office in Taipei says that negotiations are continuing as they try to clarify Taiwan's position in advance of the government's goals of allowing full convertibility of the New Taiwan dollar by 2000 and generally liberalizing financial services. "Canada strongly supports an open rules-based trading system, where transparency is an important objective," says a spokesperson for the Canadian Trade Office. An official at Switzerland's representative office in Taipei said that his government had hoped to duplicate the deal struck with Canada during its negotiations on Taiwan's WTO application, which will resume in the next few weeks.

**F**oreign bankers still believe that the current rules need to be made more explicit and that the absence of clear guidelines is a handicap. "This creates a void where Taiwanese citizens who have to go abroad to get banking services often take chances and don't know who they're dealing with," says the general manager of a U.S. bank. "It also creates problems for the Taiwan government, which can't supervise or regulate people who come here to offer their services, while these bankers do so at some risk to local citizens and to themselves." ■

## Rising Sums

Foreign-currency deposits in Taiwan banks



Source: Central Bank of China, Taipei

if he were to advertise his services, even though he estimates that foreign banks in Taipei have as many as 3,000 private banking customers. Hundreds more are being served by private bankers based in Hong Kong, Tokyo, or the U.S. Bankers say that the financial authorities look the other way, monitoring the business but neither regulating nor fully authorizing it.

One reason for the uncertainty is that there is no agreed definition of what activities private banking includes.

But then again, "practically speaking, private banking is allowed," says Kuei Hsian-nong, director of the bureau's international banking division,

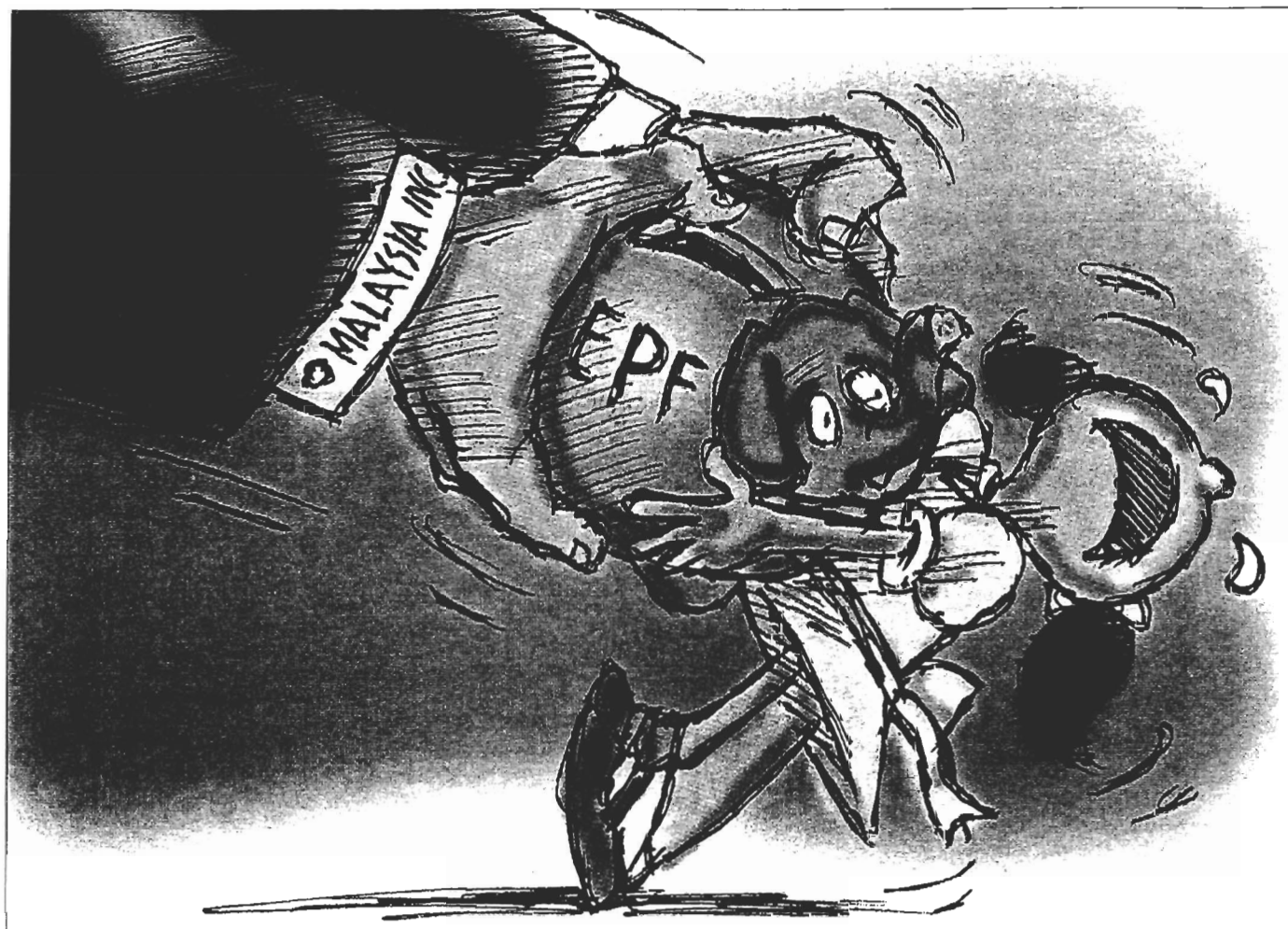


ILLUSTRATION BY PETER ESPINA

FINANCE

# Savings at Risk

Malaysia is being criticized for using its national pension fund to funnel cash to companies

By Salil Tripathi in Kuala Lumpur

Every parent knows the temptation. When there's no loose cash to be found, the pennies in the children's money box are a tempting target: Borrow now, put them back later.

In Malaysia, the Employees' Provident Fund is a sort of national money box. And in these cash-strapped times, the 129 billion ringgit (\$34 billion) it holds on behalf of workers looks especially tempting to a government struggling to steer its

economy out of trouble without recourse to the International Monetary Fund.

Since October, Kuala Lumpur has lent EPF funds to three state-sponsored companies or projects. The capital's new international airport got 1 billion ringgit; the government's investment arm, Khazanah Nasional, 2 billion ringgit; and Perwaja Trengganu, a debt-laden steel maker, 710 million ringgit. Now it's considering a proposal to buy a 20% equity stake in trans-Malaysia highway operator Plus.

While opinions differ about these trans-

actions, the latter two in particular have raised eyebrows. Perwaja has twice before gone bankrupt and been bailed out by the government. And analysts believe Plus' motive is to ease the debts of its controlling shareholder, UEM. Those debts were incurred when the company bought shares of its ailing parent, Renong—a company with close links to the United Malays National Organization, the political party led by Prime Minister Mahathir Mohamad.

To some, the transactions represent a worrying trend. Financial analysts and

others fear that national pride, an understandable desire to find a homegrown solution to Malaysia's troubles, and a shortage of options could tempt the government to raid the EPF—with possibly far-reaching implications. It could endanger the level of returns from the country's largest pension fund, and might provoke an angry response from labour unions. Bankers add that the fund is so vast that if it withdraws cash deposits to support ailing companies, the loss of liquidity would force banks to raise interest rates, thereby hurting healthy companies. Even then, say critics, the government would succeed only in delaying some of the pain that is unavoidable if the Malaysian economy is to pull out of its slump.

"Malaysia has to let bankrupt companies go under and let bad banks fail," says Rajeev Malik, senior economist at Jardine Fleming in Singapore. "Any other measure, like borrowing from EPF, will be stop-gap and only postpone the inevitable."

Finance Minister Anwar Ibrahim has defended the three EPF loans made since October. As all the projects are government-backed, he implied to parliament they are as safe as a government-backed security. But others question the logic. "Why is the EPF throwing good money after bad?" opposition MP Lim Guan Eng says of the Perwaja deal. "Why does the EPF make loans to a company that no decent financial institution would touch?"

Part of the answer is that although Malaysia's economy has looked relatively healthy compared with its neighbours—it hasn't had to fall upon the mercies of the IMF, after all—it is probably sicker than it seems. At 153%, Malaysia's debt-to-GDP ratio is among the world's highest. It has managed to stave off an Indonesian-style crisis only because, unlike much of Asia, the bulk of its debt is in local currency. That means there are fewer foreign creditors banging at the door demanding instant repayment of their loans. Nor has there been any immediate threat of a balance-of-payments crisis.

But the cash that financed years of 8% annual growth has dried up, and banks' nonperforming loans continue to expand. Companies struggling to pay for needed imports—more expensive since Asia's currency devaluations—lack the cash to buy sufficient foreign currency. Their shrinking business prospects, moreover, are making it difficult to generate the cash flows needed to service their local debts. Mean-

while, the country's emaciated stock-market shows no promise of providing fresh capital. As a result, financial analysts believe that dozens of large companies are teetering on the verge of bankruptcy. In such circumstances, what is more natural than to reach out to the national pension fund for help?

One EPF board member, at least, thinks pleas for aid should be resisted. Zainal Rampak, president of the Malaysian Trades Union Congress, declares: "The Plus deal is highly risky and offers no guaranteed returns, and hence should be rejected. The EPF should not bail out anybody." Senior officials at other unions have backed his stance.

Several EPF officials contacted by the

nelled profits to a state entity in an effort to plug a hole in the government's books—a hole that resulted from a bungled attempt by the government to corner the world tin market.

Indeed, there were signs early in the economic crisis that the government was prepared to dip heavily into the EPF. Last year, after the stockmarket plunged following a ban on short-selling Kuala Lumpur's 100 key stocks, Mahathir floated a plan to set up a 60-billion-ringgit fund, financed from the EPF and other sources, to buy shares from Malaysians at a premium price. The plan was intended to restrain selling pressure from overseas. It never got off the ground, chiefly because there wasn't enough money in Malaysia's financial system to meet the target.

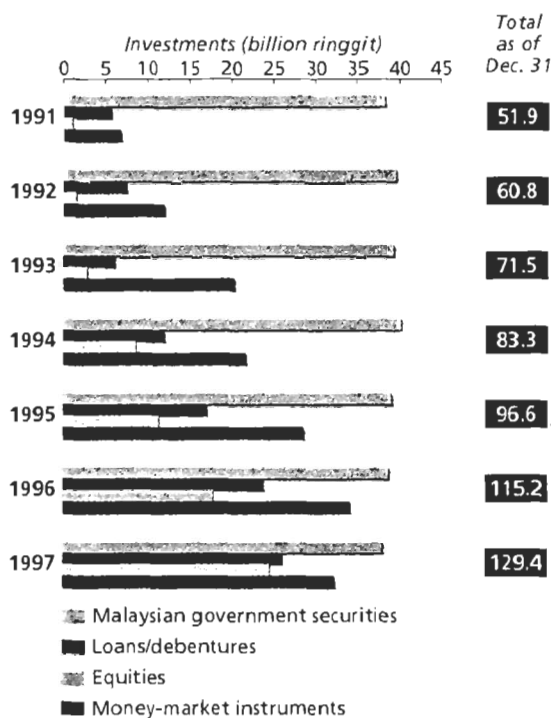
Fears that the government may try again, however, are widespread. A popular act around Kuala Lumpur, Comedy Court, ran a skit recently that featured a convention of distressed Malaysian tycoons beseeching Premier Mahathir to help ease their woes. Says one of the tycoons: "And finally, remember we don't want the IMF. All we need is the EPF."

Set up in 1955, the EPF represents 85% of Malaysia's pension-fund assets. Around 4.2 million salaried workers make a compulsory contribution of 11% of their pay cheques, matched by a 12% contribution from employers. There are currently 8 million members, including those retired. (Self-employed, government employees and labourers are among those not included.)

As the fund has increased in size, it has become increasingly difficult for the EPF to meet its charter recommendation that 70% of all investments be in government-backed securities, especially since the government has been posting budget surpluses in recent years and doesn't need to raise public debt. When the government began to privatize large parts of the economy in the late-1980s, the amount of securities it issued began to decline. Consequently, the share of government paper as a percentage of the EPF's total portfolio fell to 33.6% in 1996 from 74% in 1991. To compensate, the government broadened the definition of government-backed securities to include government-backed projects. This has allowed it to invest in companies without exceeding the fund's ceiling of 25% equity investment. Since 1991, the fund's

## UPPING THE ANTE

As the EPF's investment portfolio fills with loans and equities, risks rise



Source: EPF

REVIEW declined to comment for this article. For their part, government officials say the EPF will make investments only after "careful consideration."

But since investments made by the EPF are done at the government's discretion, an "investment" can be just a euphemism for a bailout. "It is a real problem because the pool of funds at the EPF's disposal makes it a very tempting target, and it has been abused in the past," says K.S. Jomo, professor of economics at the University of Malaya. Jomo refers to an episode in the mid-1980s when the EPF fun-



equity investments have risen by two percentage points to nearly 20% in 1997.

Some critics, however, say this is simply semantics and warn that although (or because) the EPF already holds assets representing 55% of Malaysia's GDP, this is no time for it to become a white knight for every business in need. In any case, the EPF already has problems that will not be easily overcome. These range from an anticipated shrinkage in the amount contributed to the fund to complaints over its recent rates of return.

Union leaders are already complaining about the fund's profitability. From a steady 8% a year during the 1980s, its dividends fell in 1996 to 7.7% and last year to 6.7%—the lowest level since 1976. "The economic crisis is expected to pose increasing challenges to the EPF in maintaining the real rate of return provided in the past," says Mukul Asher, professor of economics at the National University of Singapore, who has



Rescue plan: Malaysia Airlines' Tajudin Ramli pins his hopes on a bit of 'imaginative' restructuring.

written extensively on pension plans in Southeast Asia.

Bankers say that if the fund cashes its more than 32 billion ringgit in deposits, interest rates could double from the current 12%-14% levels. Of the 430 billion ringgit in Malaysia's banking system, close to 400 billion ringgit is lent out. That leaves just 30 billion ringgit of liquidity—a sum roughly equal to the EPF's money-market holdings.

In addition, the EPF has to worry about its own future cash flow. The Malaysian

Trades Union Congress estimates that unemployment will rise this year to 500,000 from the current 300,000, shrinking the fund's contributor base by 12%. "My main worry is that the savings rate will decline as people accept wage cuts and lose jobs," says Mohammed Ariff, executive director of the Malaysian Institute of Economic Research.

As the EPF's investments shift from safe government securities to the markets, analysts say the fund needs to enhance its investment expertise by allowing professional fund managers to make decisions. For instance, they say, the EPF should be looking at creating an international portfolio. Its board does not take investment decisions; an investment panel, which meets every fortnight, does. The six-member panel includes three private-sector professionals, two government officials, and the executive chairman of the board.



Bringing in professional fund managers could also help to allay suspicions outside Malaysia. "The markets are watching with a microscope and binoculars," says Ariff. "The government will have to let blood flow on the floor. The scope to bail out companies is now considerably reduced."

But there is a way out for Malaysia. The government could follow South Korea's lead and raise international loans through sovereign bonds to bring new liquidity to the market. But that would require greater transparency and a government that had shown it was prepared to steer clear, at least for now, from large, debt-financed projects. It would also mean swallowing a lot of pride and working with international bankers and markets—which Mahathir, only months ago, accused of denying Malaysians human rights by diminishing their standard of living. Then again, if the EPF's goal is really to protect Malaysians' future, looking outside Malaysia for solutions would seem to be the least of all evils. ■

APRIL 30, 1998

**SINGAPORE, April 29 (Agence France Presse)**

The prospect of Singapore slipping into a recession is "extremely unlikely" an IMF official said here Wednesday.

"I would not go so far as to say that there will be a contraction, but there will be a significant slowdown," said Flemming Larsen, deputy director of research for the International Monetary Fund (IMF).

The IMF has predicted a 3.0 to 4.0 percent growth in gross domestic product (GDP) for wealthy Singapore, which has managed to weather the regional financial crisis much better compared to its neighbors.

"It could be a bit more than that," he said, referring to a possibility that the growth rate could be lower, due to "tremendous uncertainty about how the situation will unfold in the region."

He noted the "huge margin of uncertainty on the impact of demand, output and trade in the Asian countries most affected" by the regional financial crisis.

Larsen however said that a brief cooling-off period may not be undesirable for the Singapore economy.

Most economists have forecast between zero percent to 4.5 percent growth in 1998 for the Singapore economy, largely dependent on manufacturing, with some 30 percent of its exports destined mostly to its Southeast Asian neighbors.

But the Singapore investments unit of Spain's largest banking group Banco Santander SA predicted the city-state's GDP growth would fall to negative 0.3 percent in 1998.

## **NEWS BRIEF**

International Monetary Fund  
700 19th Street, NW  
Washington, D.C. 20431 USA

News Brief No. 98, March 25, 1998

### **Camdessus Welcomes Malaysia's New Package of Economic Measures**

Michel Camdessus, Managing Director of the International Monetary Fund (IMF), made the following statement:

"Yesterday, Malaysia's Deputy Prime Minister Anwar Ibrahim unveiled a strong package of measures, followed by further announcements on monetary and financial sector policies by Bank Negara Governor Ahmad Don today.

"This package, which builds on previously introduced measures, takes a welcome comprehensive approach to Malaysia's economic and financial situation, and is set within a realistic macroeconomic framework. It will allow growth to remain positive in 1998, even as substantial external current account adjustment is achieved, and will keep inflationary pressures under strict control.

"While Malaysia has been seriously affected by regional developments, it has avoided the most severe market pressures and economic difficulties experienced by some other Asian countries. This is because Malaysia has followed over a long period a prudent approach to external exposure, the fiscal position has had considerable strength, and the supervisory and regulatory framework for the financial sector has been relatively well developed. In addition, policies have been successful in significantly reducing poverty to low levels.

"Nevertheless, under the current market conditions, it has become increasingly clear that these fundamentals needed strengthening to ensure orderly adjustment of the domestic economy.

"The centerpiece of the new package is a series of preemptive actions to strengthen the financial sector and address emerging problems in financial institutions. Thus, the finance company sector is to be quickly consolidated into a much smaller number of core finance companies, and a strategy for recapitalizing individual banking institutions is to be set in train. Deputy Prime Minister Anwar has given assurances that the strategies adopted will be transparent, and that the potential use of government resources will be subject to safeguards.

"Deputy Prime Minister Anwar has also proposed to rebalance macroeconomic policies. Fiscal policy will maintain Malaysia's strong record by targeting a surplus in 1998, despite the economic slowdown. Credit and monetary growth is to be reduced significantly, and a more active interest rate policy will be directed at stabilizing the

foreign exchange market and restraining inflation. The budget will include increased spending to strengthen the social safety net.

"Deputy Prime Minister Anwar has reaffirmed the government's commitment to improve transparency and to the steady implementation of structural reforms in a number of areas, consistent with maintaining the social consensus. With their full implementation, they will deepen the market orientation of Malaysia's economy, improve corporate governance, and set the stage for a return to more rapid growth over the medium term.

"Finally, Malaysia's economic package will also reinforce the efforts of other countries who are strengthening their own economic policies, thereby contributing to broader regional stability," Camdessus said.

THE BUSINESS TIMES, MONDAY, APRIL 13, 1998

## Esec investing \$2.1m in S'pore facility

By Louis Beckerling

[SINGAPORE] A Swiss supplier to the semi-conductor industry, Esec Industries, is investing an additional \$2.1 million in its Singapore wire-bonder assembly facility.

The investment will double the output of the plant to capitalise on strong growth in non-PC semi-conductor demand forecast by Esec founder and chairman Karl Nicklaus.

Interviewed during a recent visit to Singapore, Mr Nicklaus said Esec's global sales revenues for the year ended February 1998 due to be unveiled shortly would register a growth of some 36

per cent to around 470 million swiss francs (\$446 million).

Net earnings of around 35 million swiss francs would be up some 300 per cent on the depressed margins of the previous 12-month period.

Mr Nicklaus said Esec anticipated further strong growth in both sales and profit in the year ahead.

"It is difficult to make a general statement about demand for semi-conductors," he told *BusinessIT*, but the areas doing well are mainly communications, automotive and consumer electronics.

"Personal computers, which account for about half the semi-conductor business,

are still suffering and that is why we have a kind of overall market slowdown.

"But our business is well positioned to serve the communications consumer-electronics sectors so we are showing growth."

Established in Singapore in 1984, Esec Industries (Singapore) will now invest an additional \$2.1 million in a new 2,300 sq m manufacturing facility in the Kaki Bukit Industrial Estate.

The new facility will have 36 employees initially, which will increase to 70 when the plant is in full production by 1999.

MONDAY, APRIL 13, 1998, BUSINESS TIMES

# SingNet ties up with local firm to offer Net phone service

**It's a world first - a Net call can be received even when the PC is not logged onto the Net**

By Toh Han Shih

[SINGAPORE] A local IT company has tied up with Internet service provider SingNet to offer cheap Internet phone calls using home-grown technology that is believed to be a world first.

Mediacom Technologies' PC-to-PC Net phone service, which is based on technology the local firm developed, has been approved by the Telecommunication Authority of Singapore, Mediacom chief executive officer Ng Ede Phang told *BusinessIT* recently. SingNet will help market Net phone service from Thursday.

TAS deems that such services do not compete with normal phone services. However, the growing use of Net phone services will eventually affect telephonic companies. Overseas Net calls are much cheaper than IDD calls, which account for nearly half the revenue of SingNet's parent, Singapore Telecom.

Mediacom will offer customers a month's free usage, after which it will charge a

monthly subscription of \$7.95 for unlimited Net calls to anywhere in the world. Subscribers will also have to pay Net subscription plus local call charges.

Net telephony is not new. What makes this Singapore firm's technology a world first is that a Net call can be received even when the PC is not logged onto the Net.

Mr Ng said this breakthrough would significantly widen the use of Net calls.

Market studies estimate that Net users log on one hour a day on average, which

*'With this technology...we may become a major global Internet phone provider.'*

- Mediacom CEO Ng Ede Phang

means that the chance of successfully calling someone over the Net is small.

With Mediacom's technology, the chances of successfully making phone contact on the PC is as high as using the phone when the call is made. The receiving PC will ring like a phone and the receiver just has to be around the PC. Both the calling and receiving PCs must be equipped with the necessary software, MediaRing Talk, which is free and can be

downloaded from the Web site, <http://www.mediacom.com>

If the call is not taken, a record of the caller's name and identity number and the time of call will be left on the receiving PC. By July, Mediacom's technology will enable voice messages to be left on the PC, said Mr Ng.

"We are converting the PC to a phone device. Your PC is now a phone terminal," said Mr Ng, adding that Mediacom is awaiting a patent in the US for this technology.

Hardware requirements in-

clude a PC with Windows 95 or Windows 98 operating system, and a sound card which are usually already in the PC. A microphone is also needed.

The PC must be connected to a phone line and should be left on. With the monitor off or in "sleep" mode, the PC would consume little power and so can be left on the whole day, said Mr Ng.

A call to Japan was made using MediaRing. The test showed that voice quality was good. There was a delay

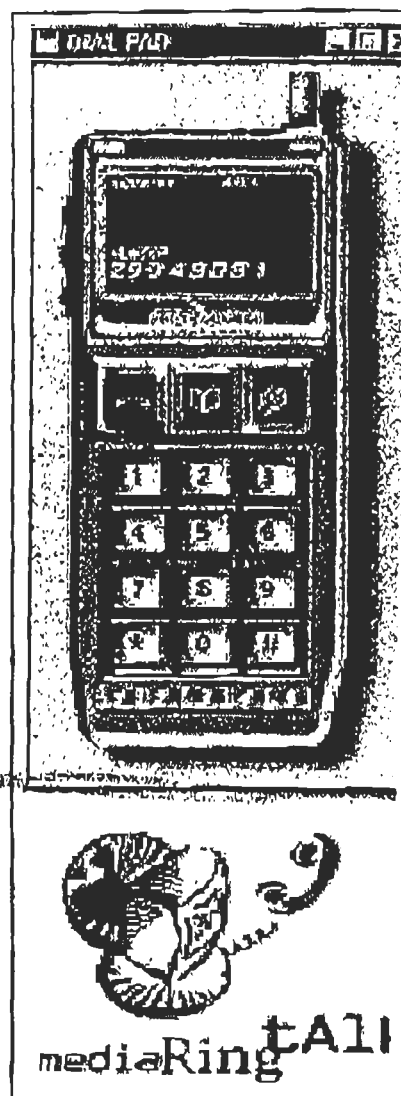
of 0.3 of a second, which is tolerable. Delays, which are typical of Net calls, can be as long as one second.

"With this technology, all our shareholders are very excited that we may become a major global Internet phone provider," said Mr Ng.

Mediacom's shareholders include United Overseas Bank (20 per cent); Ng Kai Wa, co-founder of Creative Technology and founder of Innomedia, a local firm that sells Internet telephony hardware (about 12 per cent); and Ng Tee Kiang, co-founder of Vital Technology, a local firm that makes semiconductor inspection devices (45 per cent).

Mr Ng said Mediacom is negotiating with potential investors in Singapore, Japan, Europe and the US to raise capital to fund its global expansion.

The company has tied up



with a Swedish software firm, which will bundle MediaRing software in ROMs and distribute 300,000 CD-ROMs a month in 12 European countries, said.

Mediacom will also be a Taiwanese modem, which will bundle MediaRing in its modems, he added.

Plans are in the pipeline for a listing, either in Singapore or the US, by the year 2000.

THE BUSINESS TIMES, MONDAY, APRIL 13, 1998

# Xylan, SSA still hiring in Asia despite Asian economic crisis

by **Toh Han Shih**

[SINGAPORE] Despite the economic downturn, Xylan Corporation and System Software Associates (SSA) are hiring and expanding in Asia.

SSA will add about 150 workers to its 480-strong Asia-Pacific workforce in the next four months, the newly-appointed SSA Asia-Pacific vice-president, Graeme Cooksley, told reporters recently.

"The crisis has not caused us to decrease our commitment to Asia," he said.

SSA is a US firm that makes manufacturing software. Its revenues for the quarter ending Jan 31 was US\$99 million (S\$160 million).

SSA is in the process of opening its Thailand office, after having recently opened offices in the Philippines and Indonesia, said its South-east Asia managing director, Paul Henderson.

Xylan, a US firm that makes network switches, will hire four more people in Singapore and six more in the rest of Asia this year, Xylan Asia sales director B. G. Poon told *BusinessIT* recently. Xylan will set up in three months a S\$1 million Asia-Pacific training centre in Singapore, he added.

Xylan now has 22 people in Singapore, Malaysia, Thai-

land, Taiwan and the Philippines, a big jump from just two people in the region in 1996, said Mr Poon. Its revenues from Asean and Taiwan is now triple what it was in 1996, he added.

Mr Poon expects Xylan's sales in Singapore and Malaysia to double this year, and grow 50 per cent in Thailand, in US dollars. He said Malaysia's growth will be driven by telecommunications and the Multimedia Super Corridor, to which Xylan supplies equipment. Thailand's growth will be fuelled by telecommunications, he added.

Mr Poon also said: "The military is crucial for our growth."

Xylan has won military contracts in Singapore, Malaysia, Indonesia and Taiwan, he revealed. It is contracted to supply switched networks to a four-year US Navy project to upgrade a 300-ship US fleet in the Pacific and Atlantic.

For the last quarter of 1997, the Asia-Pacific accounted for 18 per cent of Xylan's revenues. Nasdaq-listed Xylan was founded in 1993, but only started selling products in 1995. By 1997, its revenues already hit US\$210.8 million.



THE BUSINESS TIMES, MONDAY, APRIL 13, 1998

# Onyx Software opens Asian Hq in Singapore

by **Kan Yi Kang**

[SINGAPORE] Onyx Software Corporation, the developer of Total Customer Management business software, announced last week the opening of its Asian headquarters in Singapore.

It has invested about \$100,000 so far on its new Singapore office, set up in the fourth quarter of 1997, and has since sold its customer management products to six firms. The opening of the Asian office adds on to the presence of Onyx in America, Australia, Canada and Europe.

Mr J. Y. Pook, the managing director of Onyx Software Asia, said that Singapore was chosen because of its excellent infrastructure, strong growth and regional IT hub status.

He added that in Singapore, a focus on deregulation has forced companies to emphasise customer satisfaction, an area which he hopes Onyx's products can service.

The core of Onyx's Total Customer Management software is its Customer Centre, which won the Code Award

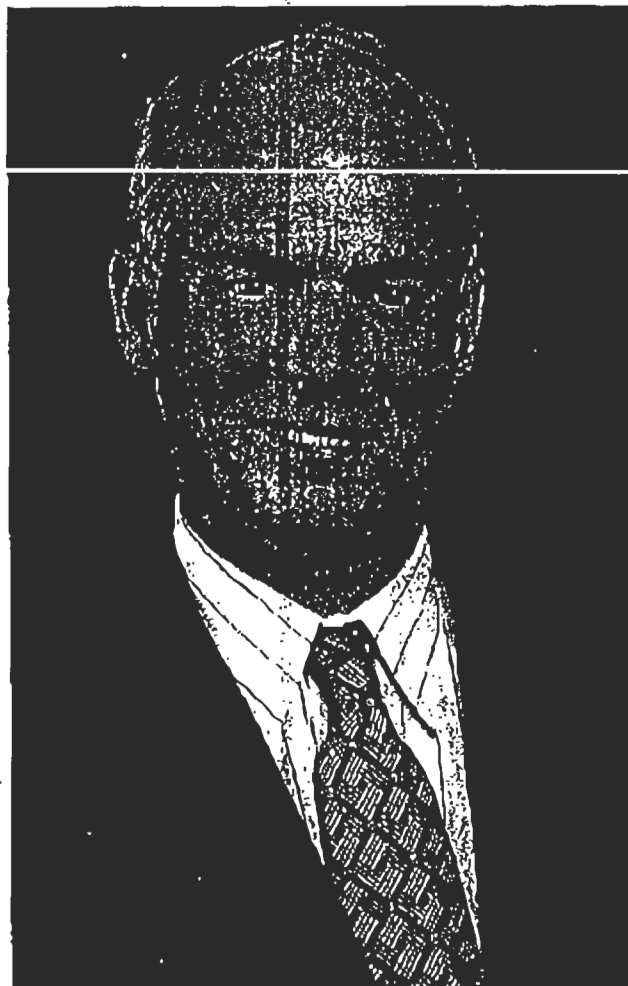
for "best enterprise client-server application", while complementary products include Web Wizards and Channel Connect.

Mr Brian Janssen, co-founder and executive vice-president of Onyx, pointed out that the norm for firms today is to maintain individual customer databases in each of the strategic aspects of the company.

Therefore, the information network between separate departments would be inefficient, leading to customer dissatisfaction. By using Customer Centre, which runs on Windows NT, separate customer databases can be integrated to form one single database. This enables every employee in the company to know every single detail about the company's every customer.

Onyx's customers include Visio Corporation and Corel Corporation. Onyx will continue to target the high tech, financial services, health care and telecommunications markets.

## BUSINESSIT



**'Our business has been very healthy in these complicated times in Asia.'**

— IBM's David Ernsberger

# Asian flu won't slow IBM's storage business

**Both manufacturing and sales remain strong in Asia, the computer giant says**

*By Annette Pau*

IBM's Storage Systems Division is bullish on its growth prospects despite the Asian economic flu, and expects to power on ahead this year, said company officials last week.

David Ernsberger, its vice-president of worldwide hard disk drive, marketing and sales, said: "Our business has been very healthy in these complicated times in Asia."

He told reporters at a news conference that IBM enjoyed a "growing business space within China, Korea, Japan and Singapore", and "acceptance of IBM products continues to be very strong".

Providing updates on the Asia-Pacific, he pointed to manufacturing expansion of the Storage Systems Division (SSD) in Singapore and its additional US\$30 million (S\$48 million) investment into its China operations.

He also said the opening of its second facility in Thailand has doubled its capacity there, and reported on an expanded relationship with NEC in the Philippines.

"In Manila we are officially starting to ship IBM server products," he said, adding that desktop products will be shipped later in the year.

Declining to give specific figures, Mr Ernsberger said the SSD's unit shipments of drives have grown over 50 per cent on a compounded annual growth rate from 1993 to 1997, and OEM revenues have jumped about 70 per cent over the same period.

Over half of IBM's hard drive volumes comes from worldwide customers, he added.

IBM's growth compares to the larger industry growth.

He said: "The industry slowed down a little bit last year, but most of the slowness was in the desktop arena. Some of it was seen in revenues, not so much in unit shipments."

In the past year, the industry has grown some 16 per cent in terms of revenues, and 20 per cent in unit shipments.

Going ahead, the SSD will focus on high performance products with higher margins. Good growth is expected from the server marketplace, despite competition from Quantum, Western Digital and Fujitsu.

"Our strategy is (also) to focus on the mobile marketplace — putting as much

storage into as small a form factor as possible. We are also going for high capacity points of the desktop markets and the workstation/Windows NT/SCSI segment," said Mr Ernsberger.

Inventory management has been extremely good for IBM because of strong demand.

Mr Ernsberger said: "At this point, we are not interested in being No. 1 in delivering low-cost solutions... we want to be profitable."

Plans are afoot to go beyond prototyping activities for drives based on 1-inch form factor for palmtop games devices and digital cameras to launch new products hopefully in one to two years.

Meanwhile, the SSD last week announced the opening of its first major technical support centre outside the US, to be housed at its Kluang plant.

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