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A time for caution

RATIONAL HEADS MUST PREVAIL: Many companies, NGOs and politicians resist liberalisation in the mistaken belief that governments can fix things

FOR the last eight years, financial institutions, governments, government-linked companies and private companies have helped themselves at the feeding trough of inexpensive and plentiful credit.

The United States Federal Reserve, European Central Bank, Bank of England, and the latest being the Bank of Japan, have been the main architects behind this historically unprecedented easing. Every monetary institution though has had a role to play.

The result has been that global debt levels last year exceeded US$200 trillion (RM800 trillion), up from US$135 trillion in 2007. The gigantic monetary stimulus was deemed necessary to stabilise the world economy after the 2008 Global Financial Crisis (GFC). The latter came as close to being a complete shutdown as one has experienced since the 1930s.

In the years after the GFC, however, economic growth has been far slower than that needed to ignite self-sustaining recovery. World aggregate demand is hampered by low levels of private investment and, thus, slow employment, trade and productivity growth.

Monetary policy was never going to be the sole instrument but self-restrictions on government deficits led to anaemic growth. Instead, what has happened is that asset markets have taken-off.

Money has been pouring into safe haven currencies, good quality government debt, metal commodities and land. Such is the surge of liquidity, however, that even the prices of lesser-quality high yield corporate bonds have been driven to the floor.

Easy credit conditions have led to the cost of debt being much cheaper, ultra-cheap in fact, compared with the cost of equity. The incentive to rely on debt has been an entirely rational response to financing risk capital rather than dipping into one's own funds. This has pushed financial institutions and originating central monetary authorities further out on to the cliff's ledge.

Not only this, but it has greatly worsened wealth and income distribution, simply because the vast majority of the world's populace cannot access debt. Some analysts see the flood of money created by administrative fiat as threatening the system of capitalism itself.

At the same time, the mounting levels of debt have raised widespread fears of unsustainability. Not only are questions asked over how much longer debt can fuel the growth but how, with central banks' balance sheets so full, will the unprecedented stock debt be retired.

The latter can only be paid off, worked off or defaulted on.

Without clear exit strategies, these fears are showing themselves as rising market valuations and increasing market volatility.

It is difficult to see a way out of the woods. Governments as a whole, ours included, and most economists continue to believe in a "soft landing" scenario. But, there are no strong reasons why this should be the case apart from assumptions and fingers-crossed hope.

Cast against this global economic backdrop of heightened risks, Malaysia should be holding on to tight, but politically-unpopular fiscal budgets, as more responsible ones are doing or trying to do.

National debt reliance is already high and could considerably worsen the recovery scenario should something major unfortunately occur. If one heads into a dangerous bend of the road, the last thing that one needs is to increase speed.

In any recession, it is the bottom 40 per cent of households that suffer proportionately more. There is a difference in postponing an overseas holiday and postponing a meal.

Unfortunately, this is most definitely not the narrative surrounding the 2017 Budget. Instead, it is the usual demand for cash handouts and self-interested spending, oblivious of the hazardous road ahead.

The government has limited means to redistribute wealth given the inefficacy of taxes on wealth and capital, and on high-income brackets. Yet, in Malaysia, populist pressures are demanding exactly these — more protection, subsidies and income support.

Unlike in the West where foreign labour is instigating a right-wing backlash, in this country, we want things cheaper and easier. The fact that importing foreign labour is also very profitable certainly does not dissuade.

Infrastructure spending is widely considered the legitimate form of economic activity. But, too much infrastructure, however, drains national foreign exchange coffers, piles on debt and hurts productivity.

An alternative to fiscally dependent economic growth is to reform and free up resources. But, many private companies, non-governmental organisations and, increasingly politicians, are resisting liberalisation in the mistaken belief that governments can fix things.

Now is clearly a time for caution and prudence. Mistakes are costlier. Hopefully cooler, more rational heads will prevail.

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With the global economic backdrop of heightened risks, **Malaysia should be holding on to a tight fiscal budget.**

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