

ECONOMY

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THE ringgit's weakness has made headlines again. The impact on the economy could be substantial if this prolongs, as some 60% of our food supply is imported at present, which complicates moves to contain inflation.

Parents face a bigger education bill for their children's education abroad, while local companies would face foreign-exchange (forex) risks, which could be negative to their bottom lines if they are importers.

But what is most disappointing to the man on the street is that after 25 years having passed since the Asian Financial Crisis (AFC), the local currency is now weaker than what it was during that turbulent period.

In a developed market, the wealth effect from such outcomes would be punitive and there could be political pressure heaped on governments.

To many on the street, the sustained weakness of the local unit is perplexing, given the local economy has recovered from the crisis and the gross domestic product (GDP) had grown steadily from RM356.4bil in 2000 to RM1.4 trillion in 2020, an average annual growth rate of about 7.3%.

Bank Negara, in its defence, is framing the local unit's current weakness on a cyclical event and short term in nature, triggered by external factors after international investors have gone into a risk-off mode and into a safe haven like the US dollar on realignment of expectations in a fluid global economic environment.

It has most backers. "The recent rally in the broad US dollar more appropriately reflects a less dovish realignment of Federal Reserve (Fed) expectations and weaker growth than expected in China. So after strengthening versus Asian currencies in April, the greenback's strength broadened in May," says Stephen Innes, managing director at SPI Asset Management.

The uncertainty over the US debt ceiling drove forex traders to bid up the greenback to a six-month high against the local unit at RM4.6366 at the end of last month despite Bank Negara raising its overnight policy rate by 25 basis points to 3% in early May.

That helped narrow interest rate differentials and support the ringgit but not for long, as market concerns bubbled again on the approaching US debt ceiling's "terminal date".

Where to from here?

With a default now averted by a US Congress-backed deal, the ringgit has yet to regain its strength. That may take some time.

"First, the dollar, after a peak, tends to be more constrained when there is limited economic slack. In short, if the Fed policy cannot quickly turn more accommodative, it is hard for the dollar to sell off substantially.

"Second, we still await a currency to advance and challenge the dollar's dominance. The euro and yuan must go up for the US dollar to go down, which means they must offer competing prospective capital returns. But a broadening soft patch in China's growth has

What ails the ringgit?

The sustained weakness of the local currency is perplexing, given that the economy grew at an average annual growth rate of 7.3% from 2000 until 2020.



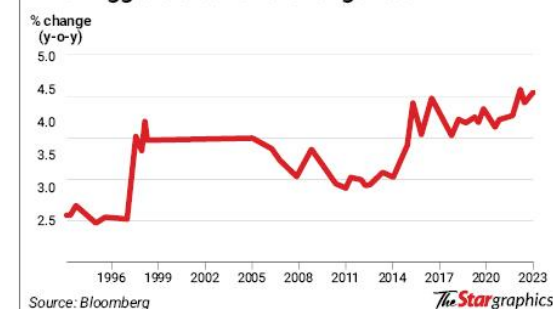
Safe hands: A man walks past the Bank Negara building. The central bank aims to conduct monetary policy to maintain monetary stability and sustainable economic growth.

"Worries about fiscal and debt sustainability push up not only the currency and equity risk premium, but also the volatilities of the ringgit induced by a two-way capital flow on the back of investors concerned about the government's political commitment of making the reforms happen."

Lee Heng Guie



The ringgit-US dollar exchange rate



opened the door to more policy support and an even weaker case for portfolio inflows. And weak industrial demand in Europe has poured ice water on the euro," says Innes.

He adds that until the yuan turns the corner, the ringgit will remain one of the weaker links in the yuan chain due to the substantial trade and investment links.

For global investors to say China's economic opening has been a disappointment could be an understatement, mainly as reflected in its local stock markets, which are now on the cusp

of a bear market.

That has leaked into Malaysia's capital markets, which is pretty disappointing, as is true of most cyclical exposures, notably crude oil, Innes adds.

Structural allocators of long-only capital are reluctant to commit to this market, as growing US-China tensions increasingly make Malaysia a less investible destination due to close ties with China, he explains.

Despite the headwinds, Malaysia's current account (CA) surplus, supported by a diversified exports basket and tourism recovery, resilient growth and



Tan: The difference in outcomes is primarily due to policy focus.

low inflation are supportive of the ringgit, says Bank of America.

"These keep us constructive medium-term on Malaysia and the ringgit stands to benefit from a Fed pivot and China's growth pick-up later in the second half of this year. We expect the ringgit to end the year at RM4.42 to the US dollar," says Abhay Gupta, research analyst at Bank of America Securities.

In the near term, there are concerns which offset these, he adds. The country's trade balance hasn't improved as much as what Malaysia's terms of trade indicated last year due to a surge in

domestic demand for imports.

This year, moderating commodity terms-of-trade are likely to impact commodity exports, while manufactured goods exports have moderated due to slower global growth, he notes in a written reply.

Furthermore, the local unit initially appreciated on China's reopening optimism but growth momentum there has softened compared to market expectations. Like Innes, Abhay says the ringgit is also correlated to the yuan's weakness, as investors see that as a read on the China impulse.

"Despite the interest rate hike delivered by Bank Negara, interest-rate differentials continue to widen against the ringgit and to carry on holding positive ringgit is negative. There is also some political uncertainty heading into key state elections in July and investors might wait for more clarity on politics and fiscal reforms post-elections before turning more positive on the ringgit," he adds.

Are the central banks in the Asean region intentionally keeping the local units weak to stimulate exports, or does the local economy, which is dependent on commodity exports and low cost manufacturing, require the currencies to be weak to compete?

"They have no option, as the People's Bank of China has weakened the yuan to foster economic growth through exports. Hence, every other central bank in the regional basket needs to keep that in mind to hold some semblance of competitive advantage from a currency perspective with the weaker yuan and yen in play," says Innes.

Need for change

The establishment of the unity government has helped the local unit come from its low of RM4.745 in early November last year to hit RM4.225 in early February, which became an inflection point that has run its course to the present.

With rates in the United States and other markets higher than in Malaysia, funds have been quick to adjust to risks and opportunities, more so when money can move at the click of a mouse in this electronic banking age.

That has partly led to a weaker ringgit against a basket of currencies like the euro, Swiss franc, Singapore dollar as well regional units like the Thai baht and Indonesian rupiah, which to some extent exposes the structural issues at play.

While it is undeniable the ringgit's weakness against the US dollar is due to a cocktail of factors, its sustained decline over the past decades is beyond Bank Negara's control.

"Concerns about political stability, the delayed overhaul reforms, worries about fiscal and debt sustainability push up not only the currency and equity risk premium, but also the volatilities of the ringgit induced by a two-way capital flow on the back of investors concerned about the government's political commitment of

is the benchmark of the forex market, the ringgit-Singapore dollar trade also gains some attention from the public due to the trade and historical links between both countries.

The recent bout of ringgit weakness saw it hit a new low against the island republic's unit at RM3.404 on Thursday.

making the reforms happen," Lee Heng Guie, executive director of the Socio Economic Research Centre, told *StarBizWeek*.

Malaysia has a managed floating exchange rate, which means that movements in the ringgit exchange rates are determined by the demand and supply of the ringgit in the forex market.

Hence, on a cross-rate basis, the ringgit has weakened more against some regional peers, as they have weakened relatively less against the US dollar compared to the ringgit.

Its weakening against the Singapore dollar has gained particular attention, as some 40 years ago, the exchange rate was almost at parity.

Capital Dynamics CEO and managing director Tan Teng Boo says the difference in outcomes is primarily due to policy focus on issues like education and stand on corruption which brought its credibility with investors.

"The Singapore dollar hasn't weakened due to interest rate differentials like other currencies. It is able to hold against a strong currency like the US dollar without having to increase interest rates due to fundamental structural reasons. Its stable government has continued to have a strong fiscal position with a budget surplus, strong external account (current account surplus), strong inflow of foreign direct investment (FDI) as a percentage of GDP and low inflation," he says.

In the case of Malaysia, Lee notes the government had incurred 26 consecutive years of budget deficit since 1998, the federal government's debt and liabilities have risen significantly since 2015, from RM808bil or 68.7% of GDP to RM1.4 trillion or 80.6% of GDP at end-2022.

The current account surplus of the balance of payments has narrowed substantially from between 10.1% and 17.1% of GDP in 2003-2011 to a single-digit of between 2.3% and 5.2% of GDP in 2012-2022. Foreign reserves accumulation has risen, albeit lower compared to regional peers.

Both Tan and Lee say what the current administration should work towards is the unfinished political system, institutional and economic reforms needed to enhance Malaysia's resilience and competitiveness in trade, doing business and attracting investment, which, in turn, would help make the ringgit a far more stable and stronger currency in the future.

For investors like Innes, the ringgit's appeal can be seen through the prism of a bit of old versus new economy at play. "Oil and palm oil are falling out of favour with investors embracing green energy and products. And even as artificial intelligence or AI comes to the fore, Malaysia is lagging behind even regional peers like Vietnam on the technology front," he says.

MAS vs Bank Negara

While the ringgit US dollar pair

From a trading perspective, reports have suggested one of the main factors which makes the ringgit more volatile than the Singapore dollar is the monetary policy framework of the Monetary Authority of Singapore (MAS) is exchange-rate based while Malaysia has an "explicit interest rate policy" set by Bank Negara, which means there is more pressure on the ringgit from the "perspective of a widening yield differential".

"Bank Negara and MAS have similar monetary policy objectives, but they use different policy strategies to achieve them. Both central banks aim to conduct monetary policy to maintain monetary stability and sustainable economic growth.

"For MAS, the term monetary stability means price stability (or a low and stable rate of inflation), whereas for Bank Negara, the term is less specific, but arguably a low and stable rate of inflation is no doubt an objective of its monetary policy as well," says Prof Hans Genberg, Professor of Economics at the Asia School of Business and Senior Director of Central Banking and Finance Programmes.

He adds how both aim to achieve their objectives differ, however, in ways that can be explained in part by the different structures of the two economies.

A particularly startling illustration of this difference is that over 90% of food consumed in Singapore is imported, whereas for Malaysia this percentage is substantially lower.

This means that prices of food items in Singapore are much more influenced by movements of the exchange rate of the Singapore dollar compared to the sensitivity of food prices in Malaysia to the value of the ringgit. More generally, while the entire consumer price index in Singapore is highly dependent on exchange rate movements, this is less the case in Malaysia.

"As a consequence of this high dependence of prices in Singapore on the exchange rate, MAS has chosen to control inflation by managing the exchange rate vis-à-vis its main trading partners. This is done by intervening in the forex market to guide the exchange rate along a path that is designed to keep imported inflation, and hence, the overall inflation level low and steady," he explains.

Given the less import-price dependent nature of the Malaysian economy, Bank Negara has chosen a different strategy to achieve monetary (price) stability.

Genberg says by targeting the interest rate in the economy through the OPR, Bank Negara aims to achieve monetary stability by influencing the demand for goods and services more broadly and not just the prices of imported goods.

Looking at the realised inflation rates in the two economies, the monetary policy strategies of Bank Negara and MAS, although quite different, have led to remarkably similar outcomes, he says.

Reforms needed to strengthen local currency

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Sheng: The interest rate differential is also another contributing factor to the weakening of the ringgit.

AMIDST mounting economic challenges, the ringgit finds itself grappling with persistent erosion, raising serious concerns not just among investors or stakeholders, but also the *rakyat* themselves.

The waning value of the local currency has become a pressing issue as it affects and influences the public's day-to-day lives, prompting calls for decisive actions to address the underlying factors contributing to this situation.

It has not only sparked worries about its impact on the purchasing power of individuals and increased cost of imported goods, but more importantly, the impact on the economic stability of the country.

Over the past month, the ringgit has experienced a steady decline against major international currencies, raising questions about the underlying economic factors contributing to this downward trend.

The ringgit has weakened by about 14 sen or 3.1% to about RM4.60 in exchange to the US dollar from a month ago, while against the British pound, the local currency has depreciated by 20 sen or 3.5% to RM5.76.

Remarkably, from 2011 to 2014, the ringgit exchange rate against the US dollar was consistently trading at the RM3 level. However, a significant shift occurred from mid-2015 onwards, as the exchange rate began to persistently hover above the RM4 level.

Experts attribute the weakening currency to a combination of domestic and external factors, besides the underlying fundamentals of the ringgit itself.

On the domestic front, political instability, hazy economic policy direction, sluggish economic growth and increasing fiscal deficits have all contributed to the slump in the ringgit.

Externally, the global economic landscape has played a substantial role in the currency's weakness.

A stronger US dollar, coupled with a slowdown in global trade, has put pressure on emerging market currencies, including the local currency.

Furthermore, concerns over trade tensions and geopolitical uncertainties have made investors wary, leading to capital outflows and further depreciation of the currency.

Speaking with *StarBizWeek*, prominent economist Tan Sri Andrew Sheng says the interest rate differential is also another contributing factor to the weakening of the ringgit, apart from the domestic policy uncertainty and unclear economic policy direction.

Sheng, who stresses that the weakening of the ringgit is not caused by a single factor but a combination of issues, explains that Malaysia's interbank interest rate is slightly over 3%, in comparison to the neighbouring country Indonesia, whose inter-

try's education system.

Similarly, Sheng emphasises on the concept of "ABC", where he points out to the importance of academia, business and civil society working together, fostering collaboration and leveraging the unique strengths of each sector for the betterment of society.

The former chairman of the Hong Kong Securities and Futures Commission believes this concept will aid in improving the country's economy and in turn help in strengthening the ringgit.

He points out that Malaysia has relied on a debt-driven economy since the Asian financial crisis in 1997 and that is the structural issue that needs to be addressed.

"Pre-crisis gross domestic product (GDP) growth used to be in the range of between 8% and 10%. Up to 1990, our stock market capitalisation was larger than the banking system assets," Sheng explains.

He says the Asian financial crisis had an impact on most Malaysians' coffers. However, post-crisis, Sheng says the country relied on the banking system to drive growth, leaving very little for investment in the capital market.

"Basically the model was you consume, banks finance but nobody is investing," he adds.

Meanwhile, Sheng says that the current economic model, where consumption takes up 70% and investment is only 30%, is not ideal. He believes both consumption and investments should be equally balanced.

Sheng also highlights that an issue within the economy is that private investments are growing far slower than the GDP growth rate.

"What does this tell you? Our own people are not investing in our country," he says, indicating that even locals aren't confident of domestic investments.

"Sooner or later, we have to pay our people better, to retain our talent and build our new champion industry. We don't have time to be complacent," he concluded his talk during the inaugural Affin Conference Series 2023.

So, where will the ringgit be headed, going forward?

It's a time for cautious anticipation to see where the ringgit heads from this point onward.

As impact from the weaker ringgit can only be seen in the longer term, experts hope the government will maintain a proactive approach and implement sustainable policies to support the currency's stability and growth.

Meanwhile, on dedollarisation, both experts believe that it has already started.

Sheng opines that the dominance of the US dollar will slowly loosen from the range of 70% and 80% to about 40% to 50%.

Additionally, both Sheng and Tan believe that Malaysia should not encourage cheap foreign labour as it only has an impact on the wages of citizens, suppressing their earning potential.

bank interest rate is slightly over 6%.

Hence, for example, fixed deposit investments in Indonesia would yield higher returns compared to Malaysia due to the higher interbank interest rate in Indonesia, which is among the reasons why investors would shy away from Malaysia.

This view is also mirrored by fund manager Tan Teng Boo, who heads fund management and investment advisory firm Capital Dynamics group.

Tan also believes that the weakening of the ringgit is a lot more than just interest rate differentials.

"Exchange rate determination is a complex factor," he explains.

Tan, however, attributes the weakening of the ringgit to the past policy mistakes, particularly in the 70s till the mid-80s.

He points out that a few companies that were supposed to bring revenue to the country were instead rescued by the government, which led to further fiscal deficits for the country.

Meanwhile, corruption such as illicit activities not only undermine economic stability but also erode investor confidence, which in turn can result in the devaluation or depreciation of the currency.

"Corruption is a root cause to many things, not just in Malaysia but any other country. Corruption is the root cause for the budget deficit, current account deficit as well as inflation," Tan explains, adding that it's not surprising that Singapore, the least corrupt country regionally, has got the strongest currency.

Asked what can the country do to get the ringgit on an upward trajectory, Tan says that the first thing the country needs to do to grow the economy and also aid in strengthening the ringgit is by cleaning up corruption.

"The current prime minister seems to be on the right track, as he seems serious about corruption," he says.

Meanwhile, for a short-term solution, Tan suggests increasing the overnight policy rate and consecutively, narrowing the interest rate differential, although it might be a burden to the public.

Tan, who believes it is a lot harder to recover the ringgit, also highlights that serious reforms are needed in the coun-