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Dealing with the weakening ringgit

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While one makes assessment of MYR's performance on a short term basis (as to what is happening now), the longer trend impact of some policy matters should be dealt to address longer term trending that are not favourable to ringgit performances.- STU/ AHMAD UKASYAH.

LETTERS: The Malaysian ringgit once again drew attention as the local currency continued to weaken especially against the United States and Singapore Dollar to multi year low of 4.7980 and 3.5708 levels, respectively. Some linked the phenomena to external factors like interest rate differential between the USD and MYR along with weaker external trades. Others attributed the ringgit's weakness to domestic political instability as well as the high debt level which reached unprecedented level of circa RM1.50 trillion level or approximately 66 % of Malaysia's GDP figure (Table 1).

Foreign exchange market trades like any other market with demand and supply determining its value. A weakening ringgit simply means more demand for USD over ringgit. However, being a trade surplus nation since the 1997/8 Asian Financial Crisis (AFC), technically, the value of ringgit should be rising instead of plummeting.

The significant first era of MYR deprecation against the USD was from under 2.5000 (pre-AFC) level to the fixed rate regime of 3.8000 in 1998 (the highest was 4.8850). Then there was a period of respite before the ringgit depreciated from 3.0000 level to 4.5000 during 2012 to 2018 period for a reason known to many. The weak ringgit trend then continued until the present moment where it again drew much attention from the public.

Latest data indicated that our nation's foreign exchange reserve accumulation (US$112 billion) trails South Korea (US$484 billion), Thailand (US$221 billion), Indonesia (US$146 billion) and Singapore (US$336 billion).Before the AFC, the nations' foreign exchange reserve pool was of similar sizes. (See Chart 2, 3 & 4).

Why is the ringgit weakening?

Let's not argue if an undervalued ringgit is in favour of or against our nation. On net basis, a weaker ringgit will definitely further fuel imported inflation, especially on food staples. Malaysia imports 60% of its food needs, estimated at RM76 billion per annum, a structural issue that cannot be taken lightly and a key factor impacting the ringgit value in long run. Ringgit trading is guided and regulated by foreign exchange (FX) policy notices issue by the Bank Negara Malaysia (BNM) while offshore dealings can only be conducted via the Appointed Overseas Offices (AOO).

This has greatly eliminated speculative activities on ringgit as FX transaction has to be supported by underlying documentary proof. With demand and supply in favour of ringgit and a foreign exchange policy that is almost air tight against speculative element, why has the ringgit weaken so much?

The answers to the following big ticket questions may help the ringgit to trade back to its fair value in time to come.

1. The interest rate disparity between ringgit and USD (3.0 % vs 5.25 %) and other foreign currencies. A simple financial logic will encourage exporters to keep their foreign currencies export proceeds to earn higher returns instead of converting them into ringgit. This will greatly disrupt the supply of foreign currency in our market, hence the falling value of ringgit. Likewise, local investors will convert their local currency funds and invest abroad with the objective of earning higher returns, putting pressure on ringgit for the same reason. Perhaps under such unfavourable backdrop, relevant regulators should impose more stringent stopgap measures to lessen the pressure on ringgit, e.g. bring back the 75/25 conversion rules and more stringent overseas investment and remittances scrutiny.

2. Our foreign exchange reserve building is slow despite months of trade surpluses as mentioned earlier, an indication of possible slippages via over invoicing (in the case of import) and under invoicing (for the case of export). While tough to quantify, a more stringent pricing guide for international trades is likely to curb such practices, if any. (Chart 5&6).

3. Malaysia's friendly foreign direct investment (FDI) policy has led to better job creation. However, the cheaper cost of doing business and the dividend/profit repatriation has to be balanced or else this will equate to foreign outflows on the long

run. The friendly FDI policy should be coupled with reinvestment policy or even a more sustainable plan that will benefit the well being our economy in return for the benefits granted.

4. Subsidy slippages in petrol, diesel and essential food stuff requires a permanent solution. Malaysia imports foods and petroleum products for retail consumption and they lead to foreign exchange outflows. There are illegal activities arbitraging the subsidy differential at the borders resulting in further draining the reserve.

5. While foreign investment by local sovereign funds, GLCs and local corporates or individuals are permitted to allow them to access to wider asset classes for higher return, there should be a corresponding monitoring of the repatriation of their profit or dividend to strike a balance of the outflows and inflows.

Short and Long Term Measures To Deal with Weakening Ringgit

While one makes assessment of MYR's performance on short term basis (as to what is happening now), the longer trend impact of some policy matters should be dealt to address longer term trending that are not favourable to ringgit performances. In long run, strength of a countries' currency corresponds to her economic productivity. The government needs to reign in strong actions to reform our economic structure, industrial and technology development, as well as education.

Today, our country's foreign exchange policy notes are air tight, making it almost impossible for speculators to take advantage if the governance and enforcement protocols are coordinated among the relevant agencies holistically. Hence, what is left is the fair value of ringgit based on investors' perception and the basic demand and supply factors.

Apart from the immediate call for Reform and Opening, perhaps it is time for Malaysia to consider creating our currency index reflective of our trading nations volume weightage instead of just comparing it to USD or SGD. Dynamic of the percentage mix has shifted significantly, especially over the last decade.

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