

# Weaker ringgit raises concerns

## Economists call for the preservation of fiscal and debt sustainability

### ECONOMY

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THE weakening ringgit against the currencies of two of Malaysia's largest import sources is a cause for concern.

So far this year, the ringgit has weakened by 6.8% to RM4.45 against the US dollar, while the local note has also depreciated by 4.6% to RM3.23 per Singapore dollar.

The currency's loss of value against the US and Singapore dollar attracts attention, considering that Singapore is Malaysia's second largest import source, next to China while the United States is the fourth largest import source.

In the January to June period, Singapore and the United States have collectively contributed almost one-fifth or RM110.7bil of Malaysia's overall imports.

It is also worth noting that the imports from the two countries have surged this year.

In the first six months of 2022 (1H22), imports from Singapore jumped by 50.7% year-on-year (y-o-y) to RM65.2bil, outpacing the 30.4% y-o-y growth in exports to the city state.

As for the United States, imports from the country surged by 29.8% y-o-y to RM45.4bil in 1H22, as compared with the exports growth of 16.5% y-o-y.

The weaker ringgit means Malaysia, namely the households



***"The further weakening of the currency will continue to exert upward pressure on domestic inflation including food given the country's sizeable food import bill."***

Dr Yeah Kim Leng

### Ringgit loses its lustre?

Year-to-date, the ringgit has strengthened against key currencies, including the Japanese yen, British pound, euro and Thai baht, among others.

With regard to the Chinese yuan, however, the forex rate is largely unchanged.

One may wonder why the ringgit has declined against the US and Singapore dollars, although the local note has appreciated in value against many other currencies.

To be fair, many currencies of the developing and developed economies have declined in value against the US dollar, and this includes the yen and the pound sterling, among others.

Sunway University professor of economics, Dr Yeah Kim Leng

### US dollar-ringgit exchange rate (year-to-date)



Source: Bloomberg

TheStar graphics

### Big Mac Index Top 10 undervalued currencies

Difference between implied and actual exchange rate against US dollar

Malaysia's dollar 65.0%



Malaysia and businesses, would need to fork out more to purchase goods and services.

This adds on to the pressure already created by the high inflation environment globally.

The strong US dollar, in particular, does not only affect imports as many goods and services from other countries are often denominated in the greenback.

This includes food imports, which Malaysia is heavily reliant on.

In 2021, the country's food import bill hit a record-setting RM63.6bil, which is a big surge from RM51.4bil in 2019.

Moving forward, the food import bill is likely to increase on the back of a prolonged strong US dollar-environment, according to a trade analyst.

Despite the weak ringgit and the ballooning import bill, the good news is that Malaysia continues to retain a trade surplus against Singapore and the United States.

A trade surplus means the country receives more in export receipts compared with its payments for imports.

A trade deficit, on the other hand, would exert pressure on the foreign exchange (forex) of the countries involved.

For June, Malaysia enjoyed a trade surplus of RM6.7bil and RM7.8bil against Singapore and the United States, respectively.

However, it is noteworthy that Malaysia continues to witness a trade deficit with China, its largest trading partner.

According to data from the Statistics Department, Malaysia exported RM18.3bil in value to China in June, while it imported RM26.2bil worth of goods and services from the republic.

This resulted in a trade deficit of RM7.8bil.

economics. Dr Yeah Kim Leng explains that the factors that led to the stronger currencies are out of Malaysia's control.

"The United States and Singapore are grappling with higher than expected inflation arising largely from the global energy and food shocks and pandemic-related supply chain disruptions.

"While the United States is responding with aggressive interest rate hikes, Singapore – which adjusts exchange rate as the monetary tool – is strengthening its currency to contain the high inflation.

"The monetary adjustments and expectations of further tightening have resulted in stronger currencies.

"Not surprisingly therefore, the ringgit continues to weaken against the two currencies while remaining more or less unchanged against other currencies," he tells *StarBizWeek*.

Yeah agrees that imports will be costlier with the weaker ringgit.

The pass-through to consumer prices, however, will vary product by product as some of the increase

ultimately, some cost increases will be passed to the consumers.

"This time around, the substantial cost increases and other related costs have made it difficult for businesses to absorb the increased operating and production costs, and hence, forcing them to partially pass them onto the consumers," he says.

From January to May, Lee notes that imports of consumption goods made up 8.4% of total imports, of which imports of primary and processed food and beverage for households made up 44.4% of total imports of consumption goods.

This is followed by consumer durables (13.8%) and other consumer goods (41.8%).

"Overall, the direct imports of final goods account for 15.9% of the overall consumer price index basket," he says.

According to many economists, the local currency is undervalued against the greenback.

The Big Mac Index, published by *The Economist*, ranks the ringgit as the seventh most undervalued currency among the currencies it tracks this month.

"A Big Mac (burger) costs RM10.90 in Malaysia and US\$5.15 in the United States.

"The implied exchange rate is 2.12.

"The difference between this and the actual exchange rate, 4.45, suggests that the ringgit is 52.4% undervalued," says *The Economist*.

Lee also thinks that the ringgit is fundamentally undervalued.

"This is because it depreciated by 0.7% on the nominal exchange rate index and down by 1.8% on the real effective exchange rate as of June," he says.

In a contrarian view, Malaysia University of Science and Technology's prof Geoffrey Williams says the correct value of the ringgit is "whatever the current spot rate is"

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Venezuela bolivar	-65.8%
Romania leu	-55.7%
Indonesia rupiah	-54.6%
South Africa rand	-54.5%
India rupee	-53.6%
Egypt pound	-52.9%
Malaysia ringgit	-52.4%
Taiwan dollar	-51.3%
Hungary forint	-48.6%
Hong Kong dollar	-48.1%

Source: *The Economist*  
*TheStar* graphics

as it is determined by the market.

"Any estimate of the fundamental equilibrium exchange rate or the underlying fundamental real equilibrium exchange rate is difficult because the underlying structure of the economy has changed due to the Covid-19 issue.

"So, we do not have a stable estimate of what the base exchange rate should be and so we cannot say whether the current spot rate is over or undervalued compared with that," he says.

## No boost from commodity price rally

It is often said that the ringgit will get a special boost from high commodity prices, considering that Malaysia is a producer of crude oil and crude palm oil (CPO).

However, the sharp increase in prices for crude oil and CPO this year appears to have failed in lifting the ringgit.

In explaining the disconnect, Williams acknowledges that crude oil is only part of the long-term fundamentals and short-term financial flows and trades mix.

"But, fundamental equilibrium exchange rates reflect multiple factors over the long-term including growth compared with other coun-

## Singapore dollar-ringgit exchange rate

(year-to-date)



Source: Bloomberg

*TheStar* graphics



**Paying more:** A file picture showing a truck passing by stacked containers. The ringgit's loss of value against the US and Singapore dollar attracts attention, considering that Singapore is Malaysia's second largest import source, next to China while the United States is the fourth largest import source, according to economists. — Bloomberg

tries, underlying growth potential, inflation, unemployment, investment and debt levels in the public and private sectors.

"In the short-term capital flows and trades determine the exchange rate and these are driven by expectations, market sentiment and news. Interest differentials are only marginally important.

"What we see in the ringgit is a combination of modest fundamentals in the long-term economic outlook for Malaysia but mostly a push from better returns overseas.

"Capital is following the high returns and they are not here in Malaysia," he says.

Following the aggressive interest rate hikes in the United States, Malaysia and other emerging economies have been seeing high outflow of funds.

This has exerted immense pressure on the currencies of emerging countries.

In the case of Malaysia, it recorded the highest foreign portfolio outflows in June at RM5.4bil – the biggest since March 2020.

In June, Malaysian debt securities saw a bigger outflow of RM4.1bil, as compared to the outflows from equities worth RM1.3bil.

Looking at Malaysian Government Securities (MGS) alone, foreign holdings were recorded at RM188.9bil or 36.5% of total MGS outstanding, which was the lowest shareholding since May 2020.

SERC's Lee says the weak ringgit could induce foreign investors to consider buying ringgit-denominated assets, on the expectation that the ringgit could reverse its depreciation trend.

"Foreign investors would gain from both principal investment (share price appreciation) and exchange rate revaluation if the ringgit reverses its depreciation trend from the point of entry, that is less ringgit to convert into foreign currencies.

"But, with considerable external

uncertainties related to rising recession risks in the global and US economy, the prolonged war in Ukraine, tighter global monetary policies as well as domestic headwinds still dominating, foreign investors continue to be cautious about buying domestic equities and bonds," he says.

Sunway University's Yeah points out that the country can attract short-term capital inflows, if the interest rate is hiked.

This is because of the impact on the interest rate differential – for example, Malaysia's overnight policy rate (OPR) and the US federal funds rate – assuming all other factors remain unchanged.

"The stronger demand for its currency will result in a strengthening of the exchange rate," he adds.

## Policy response

Following the aggressive rate hikes by the US Federal Reserve, Bank Negara has also raised its OPR twice this year – by 25 basis points in each round – to 2.25% currently.

At the present level, the OPR is still below the 3% seen prior to the Covid-19 pandemic.

Williams says that raising the OPR will be wholly ineffective in strengthening the ringgit.

"Bank Negara has made clear that this is not its policy.

"It is wholly correct in that and I support that stance," he says.

When asked what measures can be undertaken to support the ringgit against the US and Singapore dollar, Williams says there is "nothing meaningful that Bank Negara can do".

According to him, the Malaysian central bank does not have deep pockets of international reserves.

"What it has is sufficient for good prudential management but nothing more.

"So money market interventions are not helpful," he says.

As of July 15, Bank Negara's inter-

national reserves stood at US\$107bil (RM476bil).

It is sufficient to finance 5.7 months of imports of goods and services and is 1.1 times of the total short-term external debt.

Williams opines that the only approach Bank Negara and the government can pursue is to maintain good, credible, transparent and accountable economic policy to demonstrate sound fundamentals.

"This means sound macroeconomic policies, and in my view, economic reforms focused on the supply-side and liberalisation," he says.

Meanwhile, SERC's Lee says the government needs to strengthen economic and financial resilience, sustain better economic growth prospects, contain the inflation risk as well as attract the inflows of foreign investments, which in turn will help to support the ringgit exchange rate.

"The government must remain committed to preserve both fiscal and debt sustainability while rebuilding the fiscal buffer against future shocks," he adds.

Lee further notes that Bank Negara maintains a flexible exchange rate and that the ringgit is tracked against a composite basket of currencies weighted against Malaysia's major trading partners.

"While it does not target a specific level of the ringgit exchange rate given its economy and trade openness, the central bank will intervene intermittently to smoothen the excessive volatility," he says.

For an open economy like Malaysia and operating under a flexible exchange rate regime, Lee says the exchange rate acts as a shock absorber, cushioning the economy in face of external shocks.

"The external factors (affecting the ringgit) are global economic prospects and inflation outlook, monetary path (interest rate differentials), inflation outlook, commodity prices outlook and capital flows development," he says.

# Are exporters making a killing from the low rate?

TYPICALLY, export-based companies in Malaysia are seen as the biggest beneficiaries of a weak ringgit.

Such companies are expected to gain from a favourable exchange rate and hence, stronger earnings, if a significant portion of their orders are denominated in the US dollar or other currencies that the ringgit is weak against.

For example, Main Market-listed Greatech Technology Bhd estimated its profit after tax (PAT) for the year ended Dec 31, 2021 to have increased by RM5mil, if the US dollar strengthened by 5% against the ringgit.

Greatech, which automates factories globally, made a PAT of RM141.75mil in 2021.

Another company, PCCS Group Bhd, noted that its profit before tax would increase by RM309,000 for the financial year ended March 31, 2021, had the US dollar strengthened by 5%.

The company, which designs and manufactures apparels for major clothing brands such as Puma, Decathlon and Li Ning, recorded a pre-tax profit of RM3.3mil in the year ended March 31, 2021.

Speaking with *StarBizWeek*, MIDF Research head Imran Yassin Md Yusof says the weak ringgit may have a mixed effect on companies, if one looks from "an earnings and sentiment point of view".

"Companies which have revenues denominated in US dollar such as chip makers and glove makers will be a beneficiary from a stronger US dollar and we can expect to see translation gains.

"However, this may be moderated by higher raw material prices (in ringgit terms) due to the exchange rate.

"Nevertheless, this 'natural' hedge works both ways, namely when the US dollar depreciates against the ringgit," he says.

In terms of market sentiment, Imran adds that a weak ringgit may attract foreign fund inflows, especially in combination with low valuation, improving economy and robust earnings.

Echoing a similar stance, Rakuten Trade head of research Kenny Yee says the weak ringgit is appealing to foreign investors, as local securities would be cheaper to buy.

In the event the ringgit strengthens over the coming months, Yee

Meanwhile, Hartalega Holdings Bhd, would have made RM10.1mil more in profits in the financial year ended March 31, 2021, if the US dollar strengthened by 5% against the ringgit.

Being one of the world's largest glove makers, the company recorded a PAT of RM2.9bil in the year.

All three companies make the most of their sales from abroad. For Greatech and PCCS, about 87% and 86% of their revenue, respectively, are contributed by countries other than Malaysia.

As for Hartalega, over 99.5% of its sales are contributed from the global markets.

Regardless of their exposure to foreign markets, the examples shown above clearly indicate the different impact the US dollar-ringgit exchange rate has on these companies.

A 5% strengthening in the US dollar against the ringgit would have raised PCCS' profits by over 9%, given that its pre-tax profit would increase by RM309,000 from the RM3.3mil it recorded in the year.

In comparison, the 5% stronger greenback would have raised profits by 3.5% for Greatech and 0.35% for Hartalega.

This shows that some exporters may not necessarily make significantly higher profits, just because the ringgit has depreciated.

In fact, under current market conditions, the weak ringgit is likely a double-edged sword for the exporters.

Analysts say the rise in costs, especially for imported items and services used in production, can minimise or even eliminate the gains made from the foreign exchange (forex) rate.

Since April 2022, the ringgit has weakened by 5.8% against the US dollar, largely because of the aggressive interest rate hikes seen in the United States.

As of July 28, the ringgit has depreciated to RM4.45 per US dollar, as compared to the year-to-date low of RM4.17.

says the existing foreign investors would enjoy gains from foreign exchange.

"The US dollar cannot go up indefinitely as it would be detrimental to the US economy.

"The Federal Reserve may eventually realise this and adjust its monetary policy accordingly to prevent a detrimental effect by the US dollar on the economy.

"In the upcoming meeting in September, the Federal Reserve may still raise its rate, but in a less aggressive way," he says.

According to Yee, whether or not the weak ringgit is beneficial to Malaysian companies, will depend on their exposure to exports.

Judging on past experiences, he says earnings will likely improve for exporters.

However, he also notes that the costs of imported raw materials incurred by the companies would likely increase and partially offset the forex gains.

"Nevertheless, exporters usually have hedged against their costs and this should somewhat mitigate the rising costs due to the weaker ringgit," Yee says.

Yee and MIDF's Imran point out that the technology sector would be one of the main beneficiaries, following the ringgit's depreciation.

"As for the current situation where the US dollar has appreciated against the ringgit, we expect to see better figures in PAT due to the currency translation as per the trend we have observed in prior years," says Imran.

Yee says that while export-based manufacturers are beneficiaries of the weak ringgit, it would be "quite tough" for some manufacturers like the glove and furniture sector players to fully enjoy the gains.

"For the glove makers, the average selling prices of gloves are coming down, while the furniture-makers are facing high costs of transportation.

"So, these factors may offset the benefits of the strong US dollar," he says.