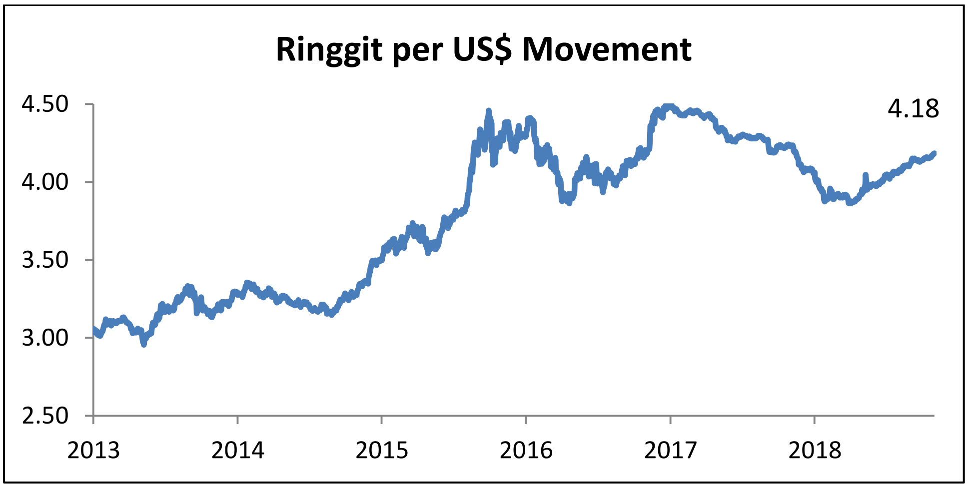
An Update on Factors Affecting the Ringgit

Against a backdrop of volatile global currency movements, the Ringgit has registered a moderate decline of 3.2% to RM4.18 against the U.S. dollar as at end-October 2018. It is essential to understand the factors that affect the movement of the Ringgit versus regional currencies as the returns of funds which invest in foreign markets can be impacted by currency movements.

For local unit trust investors, the performances of funds which invest in foreign markets are affected by the movement of foreign currencies against the Ringgit. When the Ringgit depreciates against selected currencies such as the U.S. dollar, funds invested in U.S. dollar–denominated markets will register higher returns when such investments are translated back to the Ringgit. Similarly, when the Ringgit appreciates against selected currencies, the returns of such funds will be adversely affected in Ringgit terms.

There are several key factors that impact the Ringgit's exchange rate relative to a foreign currency, namely (a) sovereign ratings; (b) exports and imports; (c) portfolio capital flows; (d) interest rate differentials and (e) the inflation rate.

Update of the Ringgit's Performance



Over the long term, currency trends will reflect the underlying strengths of their respective economies and financial markets.

In the 2013-2016 period, the Ringgit was weighed down by a narrowing trade surplus as well as the correction in crude oil prices. The subsequent recovery of crude oil prices and the weakening of the U.S. dollar helped the Ringgit to register a gain of 10.7% in 2017. For the first ten months of 2018, the Ringgit has eased by 3.2% against the U.S. dollar as the greenback firmed amid higher U.S interest rates and trade tensions between the U.S. and China. However, compared to selected regional currencies, the Ringgit has registered a smaller depreciation versus the U.S. dollar for the year-to-date period (Table 1).

Table 1. Trend of the Ringgit and Regional Currencies vs. US$*

Currency	Percentage of change (%)		
	2013-2016	2017	YTD^
Japanese Yen	-26.3	+3.8	-0.5
Thai Baht	-14.6	+9.9	-1.7
Malaysian Ringgit	-31.9	+10.7	-3.2
Singapore Dollar	-15.4	+8.1	-3.6
Chinese Yuan	-10.3	+6.7	-6.7
Australian Dollar	-30.3	+8.1	-9.2
Indonesian Rupiah	-28.2	-1.2	-10.5

** Source: Bloomberg ^As at 31 October2018*

Several key factors that influence the Ringgit's trend include:

(a) **Sovereign Ratings**

Obtaining a favourable sovereign rating is of utmost importance for developing countries as it will reduce the country's vulnerability to capital outflows. Likewise, a poor sovereign credit rating may be a cause for concern for foreign investors as they may not wish to invest in countries with potentially higher levels of default risks on their loans. In Malaysia's case, Fitch Ratings has recently affirmed Malaysia's long-term foreign-currency issuer default rating (IDR) at 'A-' with a stable outlook, supported by our nation's sustained economic growth outlook.

In general, a favourable fiscal stance will encourage international credit rating agencies to accord a positive rating to the country's credit-worthiness. Meanwhile, the rebound in oil prices and resilient GDP growth enabled Malaysia's fiscal deficit to improve to 3.0% in 2017 from 3.1% in 2016. This contributed to the Ringgit's strength in 2017. However, under the new administration, the outlook for Malaysia's fiscal deficit will depend on the replacement of the Goods and Services Tax (GST) with the Sales and Services Tax (SST) system, spending cuts by the government as well as the strength of the nation's oil revenues.

(b) **Exports and Imports**

The difference between a country's exports and imports is termed as its trade balance. For instance, if a country exports more goods and services than it imports, it will register a trade surplus. Likewise, if the country's imports exceed its exports, a trade deficit arises.

An improving trade balance generally entails an increase in demand for the local currency, and vice versa. This will eventually influence the exchange rate of the currency on the global market. Thus, countries with larger trade surpluses tend to have stronger currencies, while countries with larger trade deficits tend to have weaker currencies over the long term.

In the case of Malaysia, firmer oil prices not only help the country's fiscal position but also bolster the trade balance, given that Malaysia is a net exporter of oil. Moreover, Malaysia's cumulative trade surplus widened to RM70.5 billion in the first eight months of 2018 compared to RM63.0 billion in the corresponding period of the prior year. This improvement explains the Ringgit's outperformance relative to other regional currencies.

In the first ten months of 2018, the Chinese Yuan declined by 6.7% against the U.S. dollar as trade tensions between the U.S. and China have dampened the outlook for China's exports.

(c) **Portfolio Capital Flows**

Portfolio capital flows are inflows or outflows of funds from a country relating to investments in financial assets. A country's currency will face selling pressure when portfolio outflows exceed portfolio inflows. In the context of Malaysia, Bursa Malaysia registered a total net foreign inflow of RM11.0 billion in 2017 and this partly helped to underpin the Ringgit's gain of 10.7% for the year. In the first nine months of 2018, total net foreign outflows from Bursa Malaysia and Malaysian Government Securities amounting to RM8.4 billion and RM16.2 billion respectively, which together contributed to the depreciation in the Ringgit over the year.

(d) **Interest Rates Differentials**

A country's exchange rate may fluctuate due to differentials in interest rates between two countries as a result of their respective monetary policy cycles. The difference in interest rates of two distinct economic regions is known as the interest rate differentials.

Countries with higher interest rates will tend to attract funds from countries with lower interest rates due to the higher yield offered. This leads to increased demand for the currency of the country with higher interest rates, and vice versa. In the current global environment, the U.S. Federal Reserve's move to gradually raise the Federal funds rate has narrowed its interest rate differentials when compared against the emerging markets' higher-yielding assets. This has contributed to the weakening of regional currencies against the U.S. dollar for the year-to-date period.

(e) **Inflation Rate**

When the inflation rate of a country rises over time, the purchasing power of its currency tends to be eroded as prices of local goods and services increase at a faster rate compared to foreign goods and services, thus leading to a weakening in the domestic currency.

For the case of Malaysia, the slowdown in domestic inflation to 1.2% in the first nine months of 2018 from 3.7% in 2017 has partly cushioned the downside pressures on the Ringgit's exchange rate. This is because a relatively slower domestic inflation rate boosts the purchasing power of the Ringgit as prices of local goods and services rise at a slower pace than that of foreign goods.

Conclusion

Unit trust investors who wish to tap on the potential appreciation in foreign currencies relative to the Ringgit may consider investing in selected funds that are exposed to the regional and global markets.

Nevertheless, as discussed above, currency trends are influenced by a wide range of factors that changes over time. Thus, it is advisable for investors to diversify their fund portfolios across different markets and currencies. Over the long term, foreign currency trends versus the Ringgit will reflect the relative strengths of their economies and financial markets. Most importantly, investors who invest in foreign markets should ensure that their risk appetites and profiles are consistent with the objectives of their funds.