

Is Malaysia ready to relax ringgit policy?

Since de-pegging the ringgit, Bank Negara has gradually liberalised its foreign exchange rules. Today, its upward march has made it the second-best performing currency. LEE HENG GUIE asks whether the time is right to internationalise the ringgit

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THE ringgit charged ahead to RM3.45/US\$1 on March 27, a level not seen for almost 10 years.

Year-to-date, it has appreciated 2.1 per cent, making it the second-best performing currency after the Thai baht.

The upward march of the ringgit has been driven by the convergence of some positive announcements, including Bank Negara Malaysia's upbeat assessment of the economic outlook; the scrapping of real property gains tax; further liberalisation of foreign exchange administrative rules covering foreign currency business, foreign currency borrowing and overseas investment; the prime minister's endorsement of a strong ringgit; and speculation that the authorities will allow the ringgit to be traded offshore.

Is it the right time to internationalise the ringgit?

Since the de-pegging of the ringgit on July 21, 2005, Bank Negara has gradually liberalised its foreign exchange administrative rules in stages to enhance Malaysia's competitiveness, reduce the cost of doing business in the country and encourage the growth of the domestic capital market.

Malaysia has a much more open exchange control policy than before the 1997/98 Asian financial crisis. There are no restrictions on outflows and inflows of non-resident funds.

For residents, outflows of any nature are permitted and a reasonably higher limit is set for investment abroad for those with domestic ringgit borrowing. The only remaining rules are the measures preventing the internationalisation of ringgit, through controls on access to the ringgit in offshore markets.

Is Malaysia ready for a relaxation of the ringgit policy?

Recent debate centres on whether the time has come to consider lifting its decade-old ban on the offshore trade of the ringgit, which is probably the last vestige of Malaysia's selective capital controls.

Before Sept 1, 1998, there was an active market for trading in ringgit outside Malaysia.

The offshore ringgit market



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is defined as ringgit-related activities transacted outside the boundaries of Malaysia. These activities include ringgit trading, as well as trading in derivatives on the ringgit such as options, forwards, futures and swap contracts. They also encompass all ringgit deposit-taking and lending activities outside Malaysia.

Since April 2005, Bank Negara has further relaxed foreign exchange administrative rules, due to firm economic fundamentals and a strong external reserves position.

The changes allow for greater flexibility in hedging against currency risks, domestic credit facilities extended to non-resident controlled companies, and investments by resident individuals, corporations and institutional investors.

Internationalisation means a wider use of home currency and a broader demand of home assets abroad. Malaysians would be able to exchange the ringgit for foreign currencies abroad, through banks outside Malaysia.

Making the ringgit tradable would, firstly, help eliminate exchange risk and reduce the cost of hedging in trade. If import and export settlements

were denominated in ringgit, it would relieve resident importers and exporters from the need to hedge their export proceeds and import payments.

It would also make life easier for both residents and non-residents as they could source ringgit abroad, although the cost savings would be insignificant given the wide usage of credit and charge cards.

Secondly, this would create an active offshore market for trading in ringgit-related activities, encompassing currency trading, hedging and trade settlements, as well as speculative activities.

In particular, the burden of hedging trade transactions would be borne by the non-resident counterparties.

Thirdly, it would strengthen the position of Malaysian financial institutions in international financial transactions and build a foundation for the country to become a regional financial centre.

This would augur well for the recently launched Malaysia International Islamic Financial Centre initiative, which aims to position Malaysia as the regional centre for Islamic financial products and services in international currencies.

Those against making the ringgit tradable argue that the elimination of the offshore ringgit market does not affect or impede the efficiency and growth of trade and investment flows.

Although importers and exporters in Malaysia are required to settle their transactions in foreign currencies, they may sell the foreign currency for ringgit or another foreign currency or retain it in foreign currency accounts (FCA). There are no limits imposed on FCAs.

They can also fully hedge their export proceeds and import payments with onshore banks in Malaysia.

Second, under a flexible exchange rate, foreign circulation of home currency makes home exchange rates more volatile.

A large amount of foreign circulation of ringgit increases the instability of domestic exchange rates. When the magnitude of the short-term capital inflow is large, the consequent volatility in exchange rate will have a disruptive impact on trade and investment.

Third, the efficacy of monetary policy decreases with increasing foreign circulation of the domestic currency. Monetary stability will be threatened by the growing internationalisation of the ringgit.

Over the years, the existence and development of offshore ringgit activities, particularly in 1997 and 1998, reached the extent of affecting the implementation of domestic monetary policy.

Fourth, the internationalisation of the ringgit could allow non-residents to assume a larger role in deciding the direction of the exchange rate as their activities would be followed by domestic traders. Potential speculators could build up a sizeable position to short the ringgit.

The external account balance essentially represents the amount of ringgit under the control of non-residents. It is an estimate of the stock of ringgit offshore and not the volume of offshore ringgit transactions.

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It takes courage to allow for full internationalisation

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The underlying stock figure is a fraction of the actual volume of transactions.

For example, if a contract on RM100 million is traded three times a day, the volume of transactions will be RM300 million even though the underlying asset is only RM100 million.

As the regional financial crisis unfolded in 1997, the volume of inter-bank transactions in the Kuala Lumpur foreign exchange market rose rapidly by 64.6 per cent to reach a 10-year high of RM1.3 trillion in 1997. This unusually high volume was due to heavy speculation on the ringgit during the regional financial crisis.

Is Malaysia ready to internationalise the ringgit? Strengthened economic resilience and the healthy financial system present a case to consider loosening the ringgit policy.

But Malaysia must be careful. Three conditions need to be fulfilled before the ringgit can become a major international currency:

- Confidence in the Malaysian economy and its financial system.
- Sound macroeconomic management to ensure stability of the exchange rate.
- Fair and transparent market principles in the foreign exchange market.

We believe Bank Negara has put in place a robust system to safeguard the ringgit from any speculative attacks. That said, a strong and stable ringgit is a direct outcome of the Malaysian government's pursuit of sound, disciplined and consistent macroeconomic policies.

The fact is that the more ringgit is used and held as international currency, the greater its impact will be on the exchange market, domestic monetary policy and the domestic financial system.

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Care must be taken to minimise the impact on the local market. Given the ongoing major changes in local and international environments, the authorities should proceed at an appro-

priate speed after weighing the risks and rewards of liberalising the ringgit market.

Policymakers should remove constraints on financial and capital markets and create an environment for the ringgit to evolve naturally into an international currency, which can only be achieved if confidence is built in the currency and in the financial market.

To win the confidence of the global community, financial and capital markets need to be truly fair and function according to market principles. It takes courage to allow for the full internationalisation of domestic currency.

Many developing countries still maintain restrictions on the convertibility of domestic currency abroad.

A cornerstone of Singapore's policy on capital account openness is the non-internationalisation of the Singapore dollar.

The intention is to ensure that the

growth of the Singapore dollar market is commensurate with the development of the economy and that the effective conduct of its monetary policy is not compromised.

The government is also concerned about the build-up of offshore deposits of the Singapore dollar that could be used by speculators to destabilise the currency.

The explicit policy of not encouraging the internationalisation of the Singapore dollar also helps the country to maintain the “soft peg” that has been crucial for its outward-oriented economic development strategy.

Germany also took a guarded position on the timing of its liberalisation of capital transactions and accepting the role of the Deutschemerk as an international currency. It put its house in order before opening up its markets to the outside world.

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