Adnan Zaylani Mohamad Zahid: National Economic Forum 2024

Speech by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the National Economic Forum, Petaling Jaya, 9 May 2024.

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Thank you for inviting me to deliver these remarks and join this highly distinguished panel. Looking at the earlier sessions, I am sure you would have had a very interesting and productive day already. To cap it all off, we will discuss the Ringgit, a topic, an issue that touches all of us. In these preliminary remarks before our panel discussion, I would like to cover three areas: what brought us here, what are we doing and where we go from here.

What brought us here.

It seems a world away that, at the height of the COVID pandemic sometime in early 2021, the ringgit was trading close to 4.0 to the US dollar. The Federal Funds Rate of the US, equivalent to our Overnight Policy Rate or OPR was 0% at the time, while our own OPR was at 1.75%. The ringgit continued to trade steadily within a range of 4.0-4.20 against the US dollar until mid-2022. This was when the global recovery had begun in earnest, and inflation, which was partly the inevitable result of the massive monetary easing during the pandemic, spiked sharply in the advanced and developed economies. Since then, major central banks have embarked on an aggressive interest rate hiking cycle to tackle the high inflation. The US Federal Reserve hiked the Federal Funds rate by a total of 525bps whereas our OPR only rose 125bps in the same timeframe. This has significantly contributed to the ringgit's performance vis-à-vis the US dollar, where it fell by 5.4% in 2022, 4.1% in 2023 and for the year to date the ringgit is still down by 3.1% thus far. Regional and emerging currencies experienced similar depreciation, weakening between 9 to 25% against the dollar for a similar period. I might just add two other factors that also were of not much help to the performance: the continued uncertainties over China's economic growth prospects and the recent geopolitical crises, which further increased the demand for the US dollar as a safe-haven asset.

Ladies and gentlemen,

Much has been made of the performance of the ringgit against the US dollar. It is unfortunate that many see and use this as an indicator or barometer of how we are doing. This is an unfair assessment as it ignores the overall currency performance, the strength and fundamentals of our economy and the outlook going forward.

When we look at our regional peers, since the beginning of 2022 to now, the ringgit has actually traded stronger against the Japanese yen, Taiwanese dollar and the Korean won[1] while only marginally weakening against the Chinese renminbi, the rupiah and rupee[2].This also affirms the view that we are facing more of a US dollar strengthening cycle, a US dollar story and not a ringgit weakness story. From a growth perspective, Malaysia continues to register expansion and rising economic activity, accompanied by

low and stable inflation. The Department of Statistics' advanced estimates put GDP growth at 3.9% year-on-year in the first quarter of 2024, up from 3.4% in the preceding quarter. For the year, we are expecting a 4-5% growth performance with inflation continuing to be stable and moderate. There are some risks to the latter, which could arise from the Government's plans to undertake subsidy rationalisations. Nonetheless, we expect these risks, if they materialize, to be temporary. More importantly, the subsidy rationalisation itself will be a major step forward in our overall structural reforms. With the fiscal reforms already committed to by the Government, this will further consolidate the fiscal deficit. The near-term outlook is solid as we are already seeing recoveries in our exports and external trade, strengthening of tourist arrivals and continued progress from many of the multi-year investment projects by both the public and private sector. For the longer term and as a major component of our economic transformations, the Government has laid out several national master plans that will guide us through and pave the path to our future growth, such as the National Energy Transition Roadmap (NETR) and the New Industrial Master Plan 2030 (NIMP 2030).

In addition to these positive economic and structural developments, our financial sector remains resilient. Financial institutions are well capitalised, with ample buffers. The intermediation of financial services remains smooth. In fact, we've seen an uptick in loans to the business segment, accompanied by a fall in loan impairments. Financing activity in the capital markets continues to show healthy activity with new issuances of bonds and sukuk. Total outstanding issuance rose by 7.5% in 2023 to more than RM2 trillion, reinforcing the trend of consistent growth from the previous year. The stock market has been doing well of late, up over 10% for the year to date and breaching the RM2 trillion market capitalisation recently. Public listings have been healthy and there is a pipeline of listings coming this year. We also see in the news a consistent stream of announcements on new investments, new contracts or projects secured, merger and acquisition activities and so on.

All this bodes well for the economy and our prospects.

However, when it comes to the ringgit, we need to do a bit more. We certainly expect our fundamentals to prevail and in the longer term, the ringgit will reflect these fundamentals. In the near term though, the ringgit is still facing a serious headwind from the strength of the US dollar overall. The high and tighter US interest rates will continue for some time. This has influenced behaviour among investors, corporates, exporters and importers as well as our public. For example, there is greater interest to invest in foreign currency assets. Additionally, exporters could favour holding foreign currencies while importers front-load purchases and some corporates are even seen to accelerate repaying foreign currency debt. Continuing in this manner sets the tone for a weakening ringgit which then further reinforces the trend. Excessive depreciation is costly for businesses with greater import reliance. It also perpetuates negative sentiment towards our economy and markets. This is something we must break.

What are we doing then to break this?

Firstly, we are deploying our primary tools to preserve stability and prevent excessive depreciation in the market. We have been intervening – selling foreign currencies and buying ringgit – and we have been doing so for some time.

Secondly, we have engaged with the market to encourage flows into the foreign exchange market. We worked with the government linked investment companies (GLICs) and government linked companies (GLCs) to repatriate and convert their foreign incomes. We have extended these engagements to corporates and exporters in bringing their income and proceeds as well as managing their investments abroad and foreign currency balances. A conservative ballpark estimate puts the potential annual income conversions alone to be in a range of USD6-7 billion. To put that number into perspective, this would have been more than enough to offset our negative net outflows in 2023.

And sure enough, these efforts are paying off. We see consistent conversions of foreign income as well as repatriation and conversion of retained foreign income and assets. Since we did this, the ringgit has performed much better, holding its own against the US dollar despite the recent developments that have seen a further adjustment and delays to potential US rate cuts. It has also strengthened 1.8% against our major trade partners since February, when we started these efforts. The foreign exchange market volume and two-way flows have improved significantly, indicating a higher level of liquidity. The average daily FX turnover has risen from USD15.5 billion in 2023 to over USD17 billion year-to-date.

These are not one-off gains, either. Investment income and export revenue are recurring in nature, so there will be consistent and regular flows back into ringgit and we can expect the ringgit's performance and strengthening to be sustained.

Thirdly, we continue to look at how we can further encourage our corporates and businesses to bring back their foreign currency balances. We heard, for instance, that many corporates found it more expedient not to bring foreign currency balances back, to avoid the approval process for reinvesting abroad. One initiative that we are working on because of this is to pilot a fast-track pre-approval framework for corporates who bring back foreign currency funds and convert to ringgit, to enable them to re-invest abroad when the time comes. For the few corporates that we have engaged on this, the response has been very encouraging, with some even bringing back and converting immediately.

Add to this the eventual albeit delayed turn in global interest rates, and the outlook for the ringgit is looking strong.

Where do we go from here?

Having said that, it is never a done deal when it comes to the evolving market outlook. New risks could emerge to derail us or present new challenges. Or simply, what we're doing now is still not enough. I assure you that we can still do more. But let me assure you as well that using the OPR or introducing capital controls like we did during the Asian Financial Crisis is not among our options. Our monetary policy is determined based on the growth and inflation outlook, and we do not see using the OPR as a good tool to defend the ringgit. Instead, raising it to match or exceed the increases in the US Federal Funds rate would harm the economy. Capital controls would also hurt our investment landscape and economy by deterring new and much needed investments from coming in, besides potentially causing capital flight.

Then, what more can we do?

One strength that we have is our external asset position. Malaysia's foreign reserves are decentralised, comprising both the traditional and formal international reserves held by BNM and the foreign assets of corporates, GLICs and other asset managers. After the Asian Financial Crisis, as the economy recovered and the ringgit was unpegged, we received substantial inflows from our sustained current account surpluses and portfolio investments. From USD70.5 billion in 2005, by 2010, the international reserves grew to USD106.5 billion. While this was certainly a welcome trend, was this the best use of a country's savings? The central bank invests in low risk and hence low yielding foreign assets. Wouldn't it be more productive for the country if instead, these savings were invested in higher return investments and assets by corporates and GLICs? So it was. This was followed by a more liberal investment abroad regime which led to the accumulation of foreign assets by corporates and GLICs that we see today. From USD185.3 billion in 2010, foreign assets held by corporates and GLICs grew to USD409.5 billion at end-2023.

This enabled many to diversify their businesses and investments and generate extra returns by investing abroad. However, many of these investments are much less liquid than what a central bank would hold. This means that it is still the central bank who must step in at the first instances to provide foreign currency liquidity to the market when needed, which we currently do. Nonetheless, these facts underscore the need for the private sector to do its part in ensuring and supporting flows back into the market when these pressures prolong. And, if the situation really prolongs, resident banks and corporates may need to mobilise their holdings of external assets too.

Ladies and gentlemen,

Finally, beyond repatriation and conversion of foreign income or foreign assets, there are business decisions that companies can make now which, in the long run, would help us and set the stage for greater resilience.

For instance, consider the inputs to your manufacturing and business processes. Could they be sourced locally, or within the region? Are you too dependent on foreign outsourcing of services like consulting and insurance? It may also be time to examine if your business is overly reliant on cheap unskilled labour from abroad. Apart from the impact that resultant remittance outflows could have on our currency, this overreliance may be stopping your processes from becoming more efficient and futureproof.

And while the US dollar is still the dominant form of currency used by businesses active in the global supply chain, BNM has long advocated for settling cross-border transactions in local currencies. The additional costs of dual-leg currency conversions and the desire to reduce dependence on the US dollar has made this an increasingly popular option. Last year, 24.4% of our trade with China, amounting to almost USD13 billion, was settled in ringgit and renminbi. The Local Currency Settlement Frameworks we have established with China, Thailand and Indonesia provide harmonised, conducive rules for bilateral transactions. Businesses can readily transact in local currencies with their counterparts. And this can also be applied when bidding for or negotiating new contracts, as well as revising existing contracts into local currency terms. Local currency settlement allows corporates and investors to better manage their

FX risk exposures, and promotes the financial resilience of regional currencies against external shocks.

On the other side of the equation, this is also the ideal moment to expand one's export base. The currently attractive ringgit levels provide businesses with the opportunity to secure new market share in the global market. In fact, these levels helped to mitigate the weakness in external demand last year, which translated into a gain of 3.6ppt for gross export growth. While we do not rely on depreciation for export competitiveness, it would be a waste to let the opportunity pass us by.

Indeed, perhaps we should look more at domestic investments in ramping up capacity, either for domestic or international markets. Here's an interesting macro-level fact for those investing abroad. Did you know that since 2010, FDI by non-residents have consistently provided better returns than the investments that residents make abroad? In the past two years, average returns on investment stood at 11.6% for FDI, compared to 7.5% for resident investments abroad. The numbers speak for themselves: it makes business sense to focus on investing your capital locally.

Ladies and gentlemen,

I hope all of this sets the context for our panel session to come. But before that, let me conclude this with the following assurances. The fundamental outlook for the economy and the ringgit remains strong and favourable. We are confident that the ringgit will strengthen to reflect these fundamentals. Finally, we are highly resolved and determined to ensure ringgit will remain stable and supported.

Thank you.

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[1] Jan 22 – 7 May 2024; 15.04%, 3.13%, 0.49%. Source: Bloomberg

[2] Jan 22 – 7 May 2024; -0.03%, -0.93%, -0.98%. Source: Bloomberg