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Abstract

The article offers a forecast for the Malaysian ringgit in 2008 and 2009. The authors predict an ascent in the ringgit against the U.S. dollar by the end of the said periods underpinned by robust economic growth and account surplus. They cite the potential reintroduction of offshore trading in the ringgit due to strong balance of payments performance in 2008. They believe that the ringgit will be affected by a reduction in interest rates by Bank Negara Malaysia (BNM).

BMI MALAYSIA CURRENCY FORECASTS	Spot	Short-Term	End-08	End-09
MYR/US$	3.1510	3.1400	3.0000	2.8000
MYR/JPY	0.0311	-	0.0286	0.0250
Overnight Policy Rate (%)	3.50	-	3.50	3.00

Source: BMI, April 17 2008

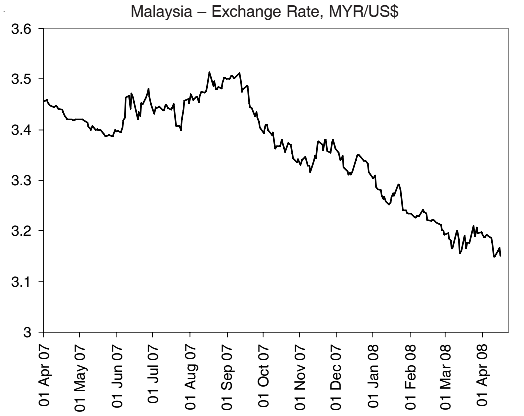
MYR: Heading To 3.00 In 2008

Short-Term Outlook

The ringgit will soon test the post-revaluation high of MYR3.1400/US$, set on April 11, as it continues its ascent against the greenback. While the currency will remain vulnerable to spells of risk aversion, we fully expect the MYR3.1400/US$ level to be breached shortly, paving the way for further ringgit gains. In the event of any short-term weakness – which may be brought about by a downturn in global risk appetite – firm support exists around MYR3.2050/US$.

Riding High

Malaysia – Exchange Rate, MYR/US$



Source: BMI

Core View

In light of the unit's impressive start to 2008 – which has seen it gain 3.3% against the US dollar over the first quarter – we have revised up our end-08 forecast for the ringgit from MYR3.1000/US$ to MYR3.0000/US$. Our end-09 forecast has also been revised up, from MYR2.9000/US$ to MYR2.8000/US$. The ringgit's ascent will be underpinned by robust economic growth – which although not matching the 6.3% zenith of 2007 will remain solid at 5.5% in 2008 – as well as a significant current account surplus and rising inflationary concerns from the central bank. Ongoing FX liberalisation will also continue to boost the unit over the medium term.

Despite a weakening outlook for the all-important export sector, Malaysia will retain a substantial current account surplus in 2008 – even by Asian standards. The country's current account surplus fell from MYR29.47bn (US$8.51bn) in Q307 to MYR26.25bn (US$7.83bn) in the following quarter, and while this represented a decline from 17.7% of GDP to 14.8%, it nonetheless remained massive. With the current account surplus as a percentage of GDP set to remain in double figures in 2008 (we are forecasting it to come in at 10.6% this year), upward pressure on the ringgit will persist.

In fact, Malaysia's impressive balance of payments performance could see offshore trading in the ringgit reintroduced this year, according to the Malaysian Institute of Economic Research (MIER). This would provide further impetus to a currency we are already tipping to be among the best performers in the region in 2008. However, with an increasingly uncertain outlook for global growth, **BMI** does not share MIER's enthusiasm concerning the pace of FX reform in Malaysia.

Allowing the ringgit to once again trade offshore would severely limit the central bank's control over the currency, meaning that **Bank Negara Malaysia** (BNM) would face the threat of MYR strength beyond its comfort. This could have severe consequences for the wider economy, and thus, we maintain the view that the ringgit is unlikely to trade offshore in 2008. Nonetheless, as confidence in the ringgit rises going forward, steady FX liberalisation will continue to take place, serving to further boost the unit over the medium term.

Meanwhile, with food and oil – among other commodities – remaining bid, BNM will be more willing to tolerate ringgit strength in order to temper rising price pressures. This rings especially true given that China and Singapore – Malaysia's nearest export competitors – are also allowing greater currency strength against the dollar (the yuan gained 3.9% against the greenback in Q108, while the Sing dollar rose 4.5%), which consequently affords BNM more room to manoeuvre without suffering a damaging loss of export competitiveness.

Risks To Outlook

Risks to the downside revolve around a sharper than anticipated slowdown in China, and the possibility of interest rate cuts from BNM. Shipments to China rose 27.2% y-o-y in February, accelerating sharply from the previous month's 7.3% expansion. Rapid export growth to China is set to persist going forward, which will help keep Malaysia's key export sector well supported, even in the face of softening demand from the US. Thus, a collapse in Chinese demand for Malaysian shipments would weigh heavily on the currency.

Meanwhile, if BNM is forced to cut interest rates in order to spur flagging domestic demand, the Malaysian interest rate differential over the US would decline, thus also providing a drag on the ringgit. This risk would be exacerbated by a spike in US inflation which would serve to limit the scope for further rate cuts by the **Fed**. However, we reiterate our view that BNM will retain its neutral stance for the time being as it continues to assess risks to both growth and inflation, and that the Fed will cut its Funds Rate by a further 75bs by year-end.