

Ringgit needs convertibility in offshore market

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Currency insights
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HAS the ringgit reached a tipping point? While the identification of what caused the currency plunge in a rapid manner and in an unfashionable manner is obvious, Trump's triumphant march to the White House, China setting the yuan at 6.8115 versus 6.7885 a day earlier (a 200-pip depreciation), which was totally unexpected as well as the spike in US Treasury yields.

While these external factors are given, the confusion that occurred in the local inter-bank market was another story altogether.

First it was the offshore non-delivera-

ble forward market that showed prices for US dollar/ringgit breaching above 4.53, weakening by almost 3.7% from the previous close and the weakest since September 2004.

This induced pressure in the onshore trading and quotes in the local interbank market, inducing pressure on the currency to depreciate as well.

Secondly, market chatter that was swirling with possible measures that include locking in of spot prices in the onshore market, a freeze on transactions involving US dollar/ringgit that is not backed by proper documentation as well as concerns that foreign holdings of local government debt papers may not be allowed to convert their ringgit proceeds into US dollars.

The local debt market reeled and literally quotes on US dollar/ringgit came to a standstill.

Whether we see this as a situation that is a result of speculative positioning or exter-

nal driven pressures, the fact remains as long as the local interbank market faces a shortage of US dollar and ringgit liquidity being none in the offshore market, the non-deliverable offshore market will continue to flourish.

The only way to manage market expectations, in particular the offshore market, is via providing ringgit liquidity on a limited basis to Malaysian financial institutions operating offshore, namely in Singapore.

The Thai Baht faced a similar situation as the ringgit way back in 2006 when capital controls were imposed, resulting in a two-tier baht market, the onshore US dollar/baht rate as well as the NDF-driven offshore US dollar/baht rate.

It was a cause for concern for the Bank of Thailand, given the offshore market dictated the direction of the onshore market. Bank of Thailand eventually had to lift the unremunerated reserve requirement on short-term capital inflows (which was

deemed as a form of capital control).

This represented the near elimination of capital controls that were imposed in December 2006 and paved the way for convergence between the onshore and offshore baht market.

Bank of Thailand's decision to integrate both markets and to eliminate the offshore non-deliverable forward market was done via providing limited Thai baht liquidity in the offshore market. It was a step that proved to be decisive and gave the currency tremendous upside potential. It also literally removed the risk of the baht facing undue pressure from trading activities that were speculative in nature.

The key here being would Malaysia move towards adopting a similar exercise?

The offshore non-deliverable forward market is here to stay and it can't be eliminated or blamed for speculative trades being done. It's a market that flourished for the simple reason being there is no

ringgit liquidity offshore.

Only when we provide ringgit liquidity offshore, we can safely be assured that unnecessary pressure on the ringgit to depreciate will fade. Its pertinent to integrate both markets instead of widening the wedge between both markets.

After all, there is a huge difference between internationalising the currency and convertibility of the currency in the offshore market. Malaysia needs ringgit convertibility in the offshore market.

The current set up in the ringgit trading mechanism and parameters it operates within is antiquated and show no sign of moving towards any form of liberalisation of the currency policy.

Bottom line, ringgit needs breathing space instead of being boxed within.

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