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The Ringgit: What Will Threaten the Current Uptrend?

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Malaysia

The Ringgit: What Will Threaten the Current Uptrend?

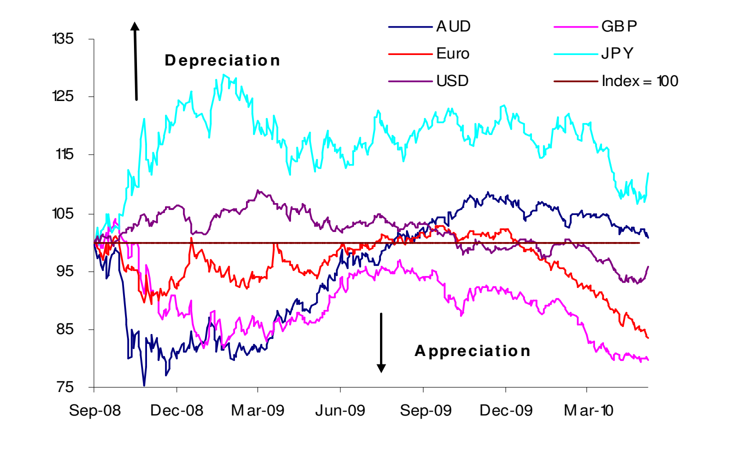
In a nutshell…

■ The ringgit's recent ascent against the US dollar (USD) has raised the question of whether the appreciation will bring the former to RM3.00 against the greenback, the strongest psychological level since it was de-pegged in July 2005. While acknowledging that economic fundamentals are improving following a cyclical recovery and measures put in place by Prime Minister Najib's administration to address structural weaknesses, we feel that the ringgit's immediate path against the USD will largely be determined by the outlook of the financial market, particularly the equities. There are, of course, two other crucial factors that affect the ringgit's current strength: (1) widespread anticipation of the yuan's revaluation; and (2) the belief that Bank Negara Malaysia (BNM) is still ahead of the interest-rate normalisation curve vis-à-vis other central banks in the region. In the longer term, anticipation of movement in the US Federal Fund Rate (FFR) will have an implication on the ringgit's directions.

■ The Malaysian equity market is facing a challenging task to sustain its uptrend after breaching the post-1997/98 Asian Financial Crisis (AFC) average price-earnings (PE) multiple of 16.6 times. Although the economic growth story has brightened the outlook of corporate earnings, the net selling of equities by foreign investors, as evidenced by the statistics from EPFR Global, has clouded the outlook in the immediate term. The fact that the current level of the benchmark index is above the one-standard deviation from its long-term average since 1990 also caused investors to become extra cautious. From a macro point of view, the anomaly in the equity-bond relationship where both equity and bond investors are making exceptional gains – a trend that normally precedes a correction in the financial market – is making us more cautious about the prospects of the equity market. Although we are not anticipating a hard landing in the local equity market, we will be keeping a close tab on this in the next few months, especially in view of the jittery global equity markets.

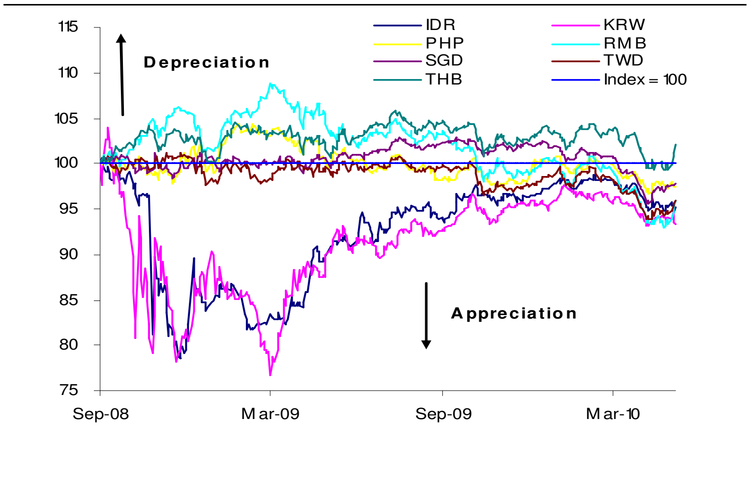
■ Technically speaking, the ringgit has breached the 76% Fibonacci retracement from its low of RM3.70 per USD in March 2009. Trend indicators for the medium term, such as the MACD and ADX, have yet to turn negative for the ringgit. However, negative MACD histograms are shrinking while the gaps between DMI (+) and DMI (-) are slowly merging, an indication that the ringgit's strength is waning in the short term. Other major oscillators such as William's %R and CCI are also suggesting some weakening in the ringgit's strength against the USD. The Tom DeMark sequential counts are also suggesting the possibility of a new trend of weaker ringgit against the greenback. Overall, while no definite conclusion can be made about the direction of the ringgit from the technical point of view, the ringgit's short-term upward momentum against the USD has waned. We have yet to see whether this will evolve into a new trend for the ringgit in the medium and long term.

Chart 1: The ringgit against majors (Sep 2008 = 100)



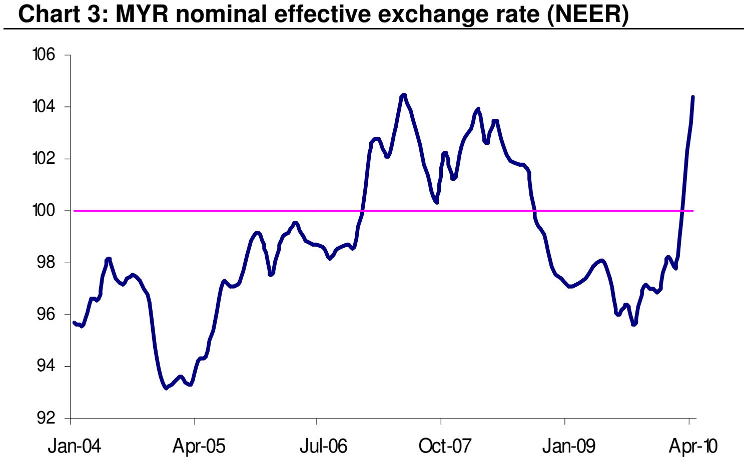
Source: CEIC

Chart 2: The ringgit against Asian (Sep 2008 = 100)



Source: CEIC

Chart 3: MYR nominal effective exchange rate (NEER)



Source: Bloomberg

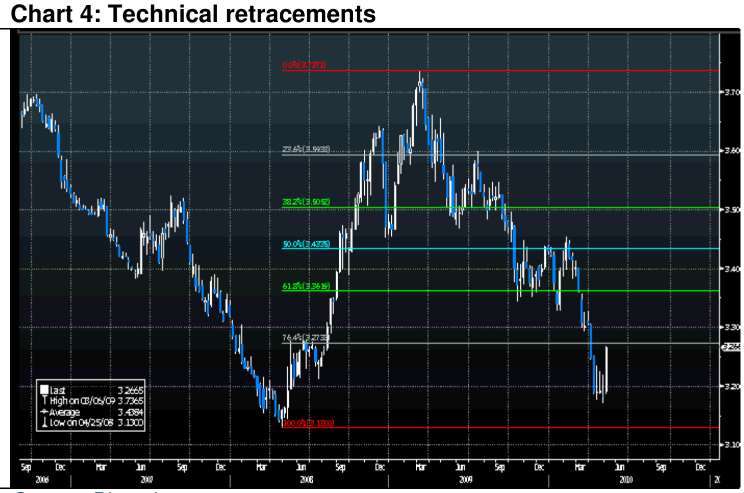
- Expectations of a widening interest-rate differential with the US, speculations of a possible appreciation in the yuan and anticipations of stronger-than-expected growth in 1Q2010 and 2Q2010 have led to a sharp gain in the value of the ringgit against major currencies in the past several months. On a year-to-date basis, the ringgit has appreciated by 4.6% against the greenback, 17.5% against the euro and 3.0% against the yen. Against other Asian currencies, the ringgit has also strengthened in recent months: 3.3% against the rupiah, 1.2% against the Thai baht and 3.9% against the Singapore dollar.

- There are now expectations that the ringgit may even strengthen to RM3.00 per USD, a level which we think is reachable only if (1) there are no significant corrections in the equity market; (2) expectations of the yuan appreciating materialize; and (3) the belief that the BNM is ahead of other countries in normalising the interest rate persists.

- From a macro point of view, the nominal effective exchange rate (NEER) is now signaling that the ringgit is overvalued against the currencies of major trading partners.

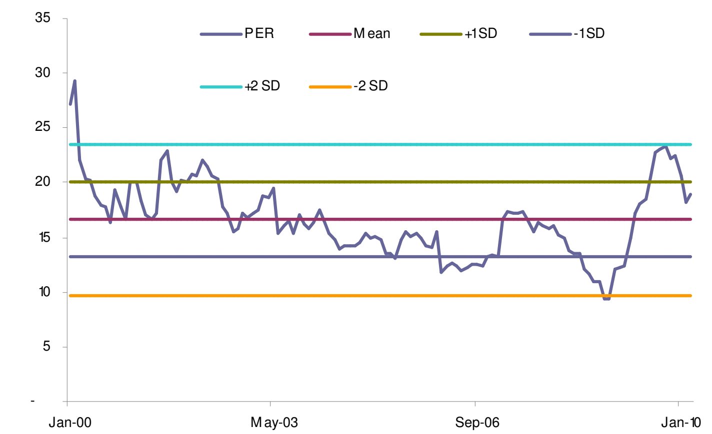
- From a technical point of view, the ringgit has retraced by about 88% from its recent downtrend (from RM3.13 to RM3.70 per USD). It has broken the 76% Fibonacci retracement level and will be testing the 100% retracement of RM3.13 level against the USD if the bullish sentiment prevails. Recent development; however, seems to indicate that the immediate strength against the USD is waning, judging by both trend and momentum oscillators such as the Moving Average Convergence Divergence (MACD), Directional Movement Index (ADX), Williams %R and Commodity Channel Index (CCI). The significance of these indicators should not be underestimated as they are taking place following the divergences between the indicators and the price movements. The medium term trend has yet to be violated.

Chart 4: Technical retracements



Source: Bloomberg

Chart 5: FBM KLCI Price-to-Earnings Ratio (PER)

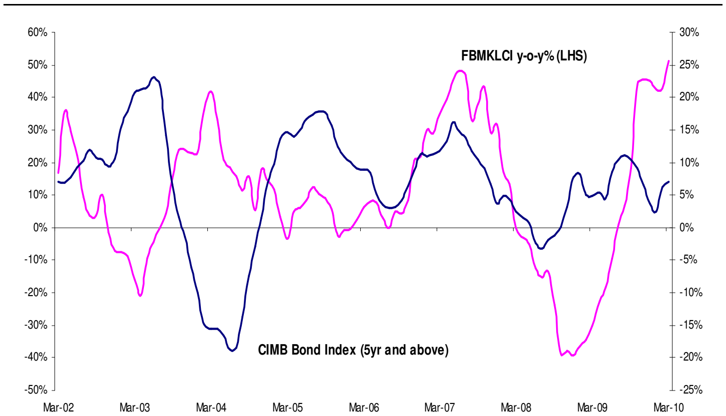


Source: CEIC

- In our view, the factors that can threaten the ringgit's current ascent towards RM3.00 per USD are: (1) the outlook of the Malaysian equity market; (2) waning expectations that the BNM will be ahead of the interest rate normalisation compared with other central banks; and (3) a loss in momentum in the speculation of the yuan's revaluation. The long-term factor that will affect the movement of the ringgit is the possibility of a hike up in the US FFR.

- The rich valuation of Malaysia's equity market can be seen from the current level of PE multiples exceeding the post-AFC average of 16.6 times. A continued selling spree of Malaysian equities by foreign investors is also evidenced by the EPFR statistics that showed USD$64million sales in March, on top of the USD$180.5 million sales between December 2009 and February 2010. This happened despite the positive inflow of US$2.5 billion into emerging markets in March. The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) has also surpassed the one-standard deviation above its long-term regression line.

Chart 6: FBM KLCI and CIMB Bond Index

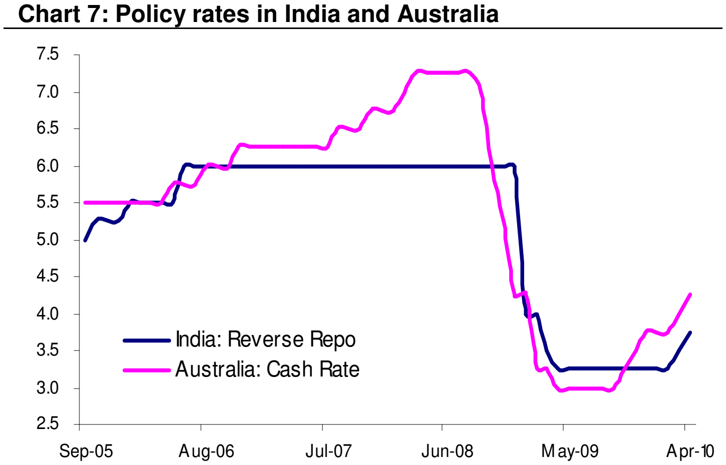


Source: Bloomberg

- The anomaly in the equity and bond relationship can also be seen in recent months. Positive returns in both the equity and bond markets, as evidenced by the rise in FBM KLCI and the CIMB Bond index, suggest that investors will be extra cautious in the near future when investing in the Malaysian equity market.

- Past experience warns that such a trend, if it persists for several months, will lead to a correction in the equity market, although the long-term trend may remain intact. A comforting point, however, is that this anomaly is not present in the FBM KLCI and 10-year MGS yields. As such, should bond yields start to pick up again for a sustained period, the rise in the FBM KLCI may continue in the near-term as it signals a healthier economy on the horizon. We will be keeping a close tab on these variables in the immediate term.

Chart 7: Policy rates in India and Australia



Source: Bloomberg

- Other countries are catching up in normalising monetary policies. India's repurchase (repo) rate was raised by another 25 bps in April to 5.25%, and is expected to rise further in view of escalating inflation. Rapid moves by the Reserve Bank of India (RBI) have led to the strengthening of the rupee, which surged by 2.5% in the year-to-date (YTD). Australia has also raised its policy rate for the sixth time in seven meetings to 4.25% in April 2010.

- Meanwhile, the Singapore dollar (SGD) climbed after the Monetary Authority of Singapore (MAS) decided to adjust its exchange-rate policy band and allow the currency to strengthen as growth prospects improve significantly. That took the shine off the ringgit in recent weeks.

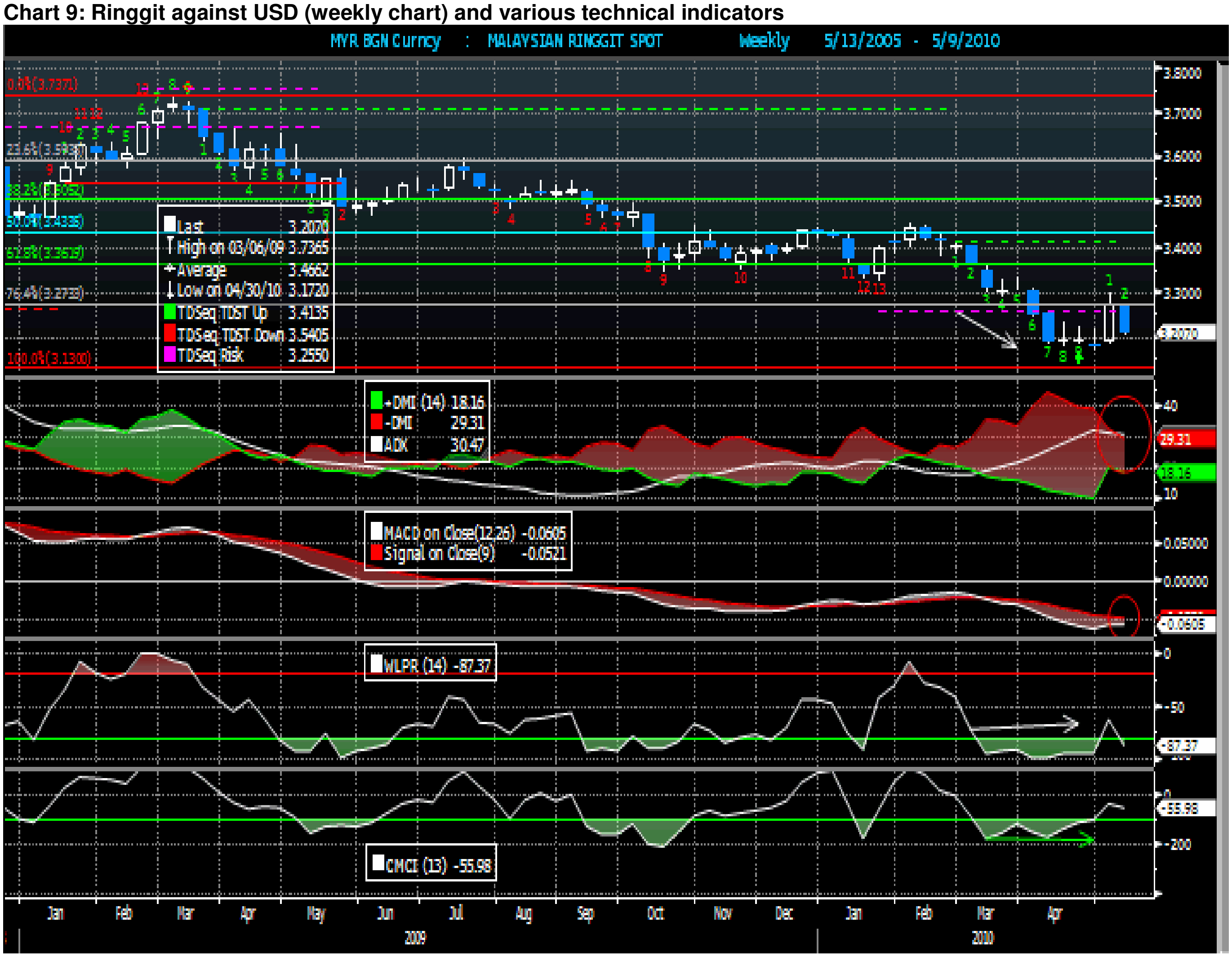
Chart 8: RMB and MYR 12-month NDF contract

Source: Bloomberg

- Speculations of a possible revaluation of the yuan have weakened as Chinese officials continue to resist international pressure with respect to the national currency. The 12-month non-deliverable forward (NDF) for the yuan has moved within a narrow range, compared with the ringgit's NDF in recent weeks.

- China is still aggressively pursuing measures to cool off the property sector through adjustments in bank reserve requirements and limits on bank lending to the sector. As an interest-rate increase may hurt the property and financial sectors more than anticipated, the possibility of a revaluation of the yuan cannot be overlooked. The only pressing issue is timing, as the Chinese authorities do not want to be seen as bowing to international pressure.

Chart 9: Ringgit against USD (weekly chart) and various technical indicators



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