

## The Ringgit in Perspective

Exchange rate movements are influenced by a complex interplay of short-term and long-term factors. In the short run, cyclical fluctuations in the domestic and global economies, interest rate differentials and geopolitical developments can affect the exchange rate. Over the longer term, however, exchange rates are anchored by more fundamental determinants, such as a nation's relative labour productivity, investment environment, and overall economic competitiveness.

When looking at the recent movements of the ringgit since 2022, the ringgit has been predominantly influenced by cyclical factors. The dominant short-term factor has been the aggressive monetary policy tightening by the US Federal Reserve (Fed) and shifting financial market expectations surrounding the outlook for US monetary policy. The Fed raised its policy rate by a cumulative 525 basis points over the 2022–23 period to address the higher inflationary pressures in the post-pandemic environment. Consequently, demand for US dollars rose significantly, leading to a rapid and strong appreciation of the US dollar, and a depreciation of most regional currencies, including the ringgit.<sup>1</sup> Many other countries, including those in the region, also increased policy interest rates by a larger magnitude than Malaysia, resulting in some appreciation of their currencies against the ringgit.

During this two year period, Malaysia's economic fundamentals have remained sound. Malaysia has achieved resilient economic growth with a declining inflation trend. Additionally, Malaysia's external sector has demonstrated resilience, as evidenced by a current account surplus, manageable external debt levels, a net external asset position, and adequate international reserves. Consequently, at the current level, the ringgit is deemed to be undervalued.

As these external factors are only short-term in nature, financial markets expect the pressure on the ringgit to abate. The Government, in collaboration with Bank Negara Malaysia (BNM) have intensified efforts to encourage repatriation and conversion of foreign investment income by Government-Linked Companies (GLCs) and Government-Linked Investment Companies (GLICs). The GLICs and GLCs should also hedge their foreign currency assets to better manage their foreign currency exposure. This is in addition to stepping up engagements with investors and corporates. BNM actively engages with resident exporters and monitors their conversion of export proceeds to ringgit, because conversion behaviour has an impact on the exchange rate. These actions are contributing to greater and sustained inflows, lending support to a firmer ringgit. BNM also continues to advocate greater use of local currency when settling export or import payments either via the Local Currency Settlement Framework or normal correspondent banking channels to reduce US dollar dependence. More broadly, BNM has also intensified engagements with various stakeholders – including business owners, financial market analysts and politicians – to further deepen our understanding of challenges faced in this environment, as well as to share BNM's perspectives and responses to manage the pressures on the ringgit.

Beyond these short-term measures, the Government is pursuing structural reforms that will ensure fiscal sustainability, new growth areas and thus increased growth potential, as well as enhanced labour productivity and competitiveness. Most of these have been clearly articulated in the Government's economic framework, the Federal Government Budget documents and in Malaysia's economic master plans, namely the New Industrial Master Plan 2030 (NIMP 2030) and National Energy Transition Roadmap (NETR). The Government is also committed to ensuring fiscal sustainability through several fiscal reform initiatives, including the Public Finance and Fiscal Responsibility Act (FRA) and the Medium-Term Fiscal Framework (MTFF), as well as efforts to broaden and diversify its revenue base and expenditure optimisation, such as through a more targeted subsidy approach. The execution of these reforms should bring in more investment flows into Malaysia, and thus provide more enduring support for the ringgit in the long run.

<sup>1</sup> The US Dollar Index (DXY) which measures the value of the US dollar against the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona and Swiss franc, appreciated by 5.9% over the 2022–23 period.