

Promoting Cross-border Local Currency Settlement (LCS)

Over the last two decades, Malaysia’s trade, investment and financial linkages within the region have deepened. As a result, trade with China and ASEAN as a percentage of Malaysia’s total trade has increased from 13% and 25.6% in 2009 to 17.1% and 27.3% in 2023 respectively, while at the same time, trade with the United States (US) has declined from 11.1% in 2009 to 9.5% in 2023.¹

Despite the shift, the bulk of trade continued to be settled in US dollars (2023: 82.1%, 2009: 82.9%) (Table 1a). Even for intra-regional trade within ASEAN, the trade settlements in the US dollar remain dominant (Figure 1b). Only 13.1%² of trade within ASEAN was settled in regional currency pairs. Based on Bank Negara Malaysia (BNM)’s engagements with major exporters, some companies have stated that their preference to settle their trade in US dollars is to ensure that their US dollar income matches their exposure to US dollar-denominated external debt. Multinational corporations with strong presence in the global supply chain, like those in the Electrical and Electronics (E&E) industry, also commonly use the US dollar to implement a more centralised treasury management system to manage the flow of funds across countries. Malaysia’s commodity exporters and importers also transact in US dollars as the majority of commodities are invoiced in such terms. As such, the prevalence of trade settlement in US dollars is not a unique phenomenon to Malaysia. The transactional dominance of the US dollar in global trade, investment and financial activities is a structural feature of the global economy primarily due to its standing as a global settlement currency.

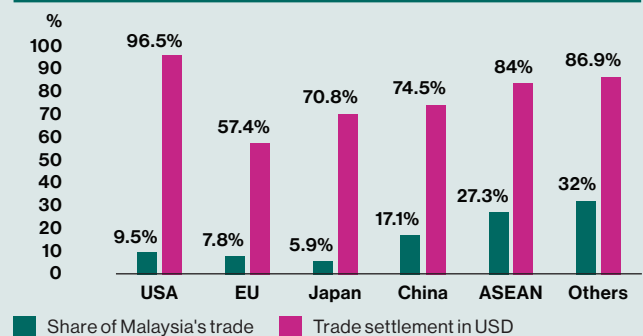
Chart 1: The Dominance of the US Dollar as the Settlement Currency for Trade Activities

Table 1a: Percentage of Malaysia’s Total Trade Settled in Respective Currencies

Top Currency	% (2009)	% (2023)
USD	82.9	82.1
EUR	5.0	4.3
MYR	1.3	3.6
CNY	0.0	2.9
SGD	3.7	2.6
JPY	3.4	1.9
Others	3.7	2.5

Source: Bank Negara Malaysia

Chart 1b: Breakdown of Malaysia’s Trade by Trading Partners Vis-à-Vis Percentage of Trade Settlement in USD with These Trading Partners in 2023



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

As a small open economy,³ the settlement of trade in US dollars may appear to be a given. However, there are costs involved, and these are particularly evident when relying on the US dollar for regional trade purposes. Consider the example of a Malaysian firm importing from an Indonesian supplier. Rather than being able to conduct the trade with just both their local currencies, the importer has to convert ringgit to US dollars while the supplier has to convert from US dollars to Indonesian rupiah. The additional step adds to business costs, while also increasing both firms’ exposure to volatility in the US dollar. Additionally, regional countries have to hold high US dollar-denominated reserves to match the prevalent choice of currency settlement. Given these factors, efforts to encourage more intra-regional trade in local currencies could help to increase business efficiency and reduce cost.

In this regard, BNM has gradually introduced flexibilities to our foreign exchange policy (FEP) since 2001, allowing both trade and investment to be settled directly using ringgit through licensed onshore bank (LOB). The ringgit settlement flexibility was further expanded in 2010 through the Appointed Overseas Office (AOO) framework⁴ to cover banks

¹ Source: Department of Statistics, Malaysia

² Source: Bank Negara Malaysia

³ Malaysia is an open economy but it is relatively small compared to the rest of the world given that we do not have much control over the prices of goods and services in the global market.

⁴ For further information on AOO, please refer to Financial Markets Investor Portal (<https://financialmarkets.bnm.gov.my/Foreign-Exchange-Market>).

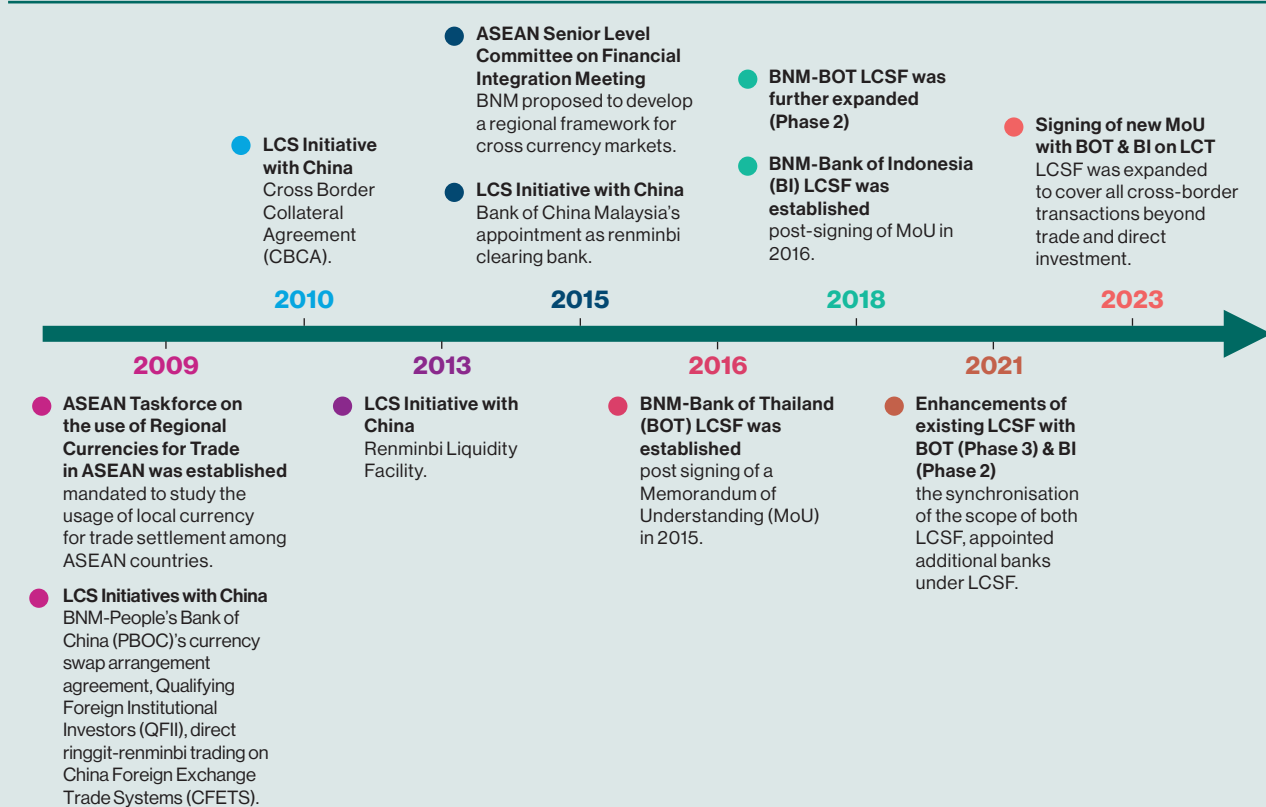
outside of Malaysia within the LOB's group. Through the AOO, foreign companies and investors outside Malaysia can now settle cross-border transactions in ringgit from abroad.

In parallel, BNM has also enhanced financial cooperation with Malaysia's key regional trading partners to promote the use of local currency for cross-border settlement. These regional collaborations endeavour to overcome the underlying challenges hindering wider use of regional local currencies for cross-border settlement. These challenges include the relatively underdeveloped local currency markets that have resulted in higher business costs.

One of the success stories has been the cooperation with China, Malaysia's largest trading partner. Many initiatives⁵ have been put in place since 2009 to facilitate and encourage more local currency settlement by increasing access to renminbi which includes the Renminbi Liquidity Facility introduced in 2013 and the appointment of Bank of China Malaysia as a renminbi clearing bank in 2015. As a result, the value of bilateral trade settled in renminbi and ringgit has increased from 1.2% of trade settlement (RM0.5 billion) in 2009 to 24.4% of trade settlement (RM57.8 billion) in 2023 (Figure 3a).

Additionally, the lack of harmonisation of foreign exchange regulations across regional countries also constrains access to local currencies and domestic assets. To address these issues, BNM has established the Local Currency Settlement Framework (LCSF) with the Bank of Thailand⁶ (BOT) (2016) and Bank Indonesia⁷ (BI) (2018) to introduce more harmonised and flexible foreign exchange rules for bilateral transactions, while taking into account each country's circumstances. This framework provides flexibilities in foreign exchange regulations for the participating banks⁸ to offer

Chart 2: Key Developments on Advancing LCS Involving Malaysia



Source: Bank Negara Malaysia

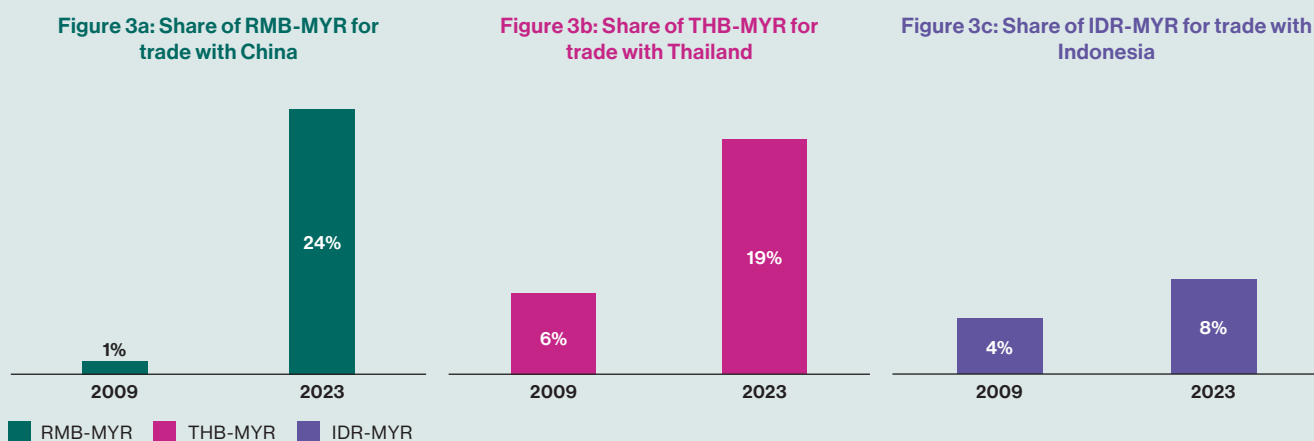
⁵ Other initiatives includes bilateral currency swap arrangement agreement, Qualifying Foreign Institutional Investors (QFII) and direct ringgit-renminbi trading on China Foreign Exchange Trade System (CFETS) in 2009 and the Cross Border Collateral agreement (CBCA) in 2010.

⁶ For further information on the LCSF with Thailand, please refer to Further Expansion of The Local Currency Settlement Framework Between Bank Negara Malaysia and the Bank of Thailand - Bank Negara Malaysia (<https://www.bnm.gov.my/-/further-expansion-of-the-local-currency-settlement-framework-between-bank-negara-malaysia-and-the-bank-of-thailand>).

⁷ For further information on the LCSF with Indonesia, please refer to Expansion of Local Currency Settlement Framework between Bank Negara Malaysia and Bank Indonesia - Bank Negara Malaysia (<https://www.bnm.gov.my/-/expansion-local-currency-settlement-framework-bnm-bi>).

⁸ Also known as the Appointed Cross-Currency Dealers (ACCDs).

Chart 3: Increasing Share of Local Currencies Used for Trade with Regional Countries



Source: Bank Negara Malaysia

competitive financial services for market players to settle their cross-border transactions in local currencies. Local currency settlements with Thailand and Indonesia have gained traction since the LCSF was established. Overall trade with Thailand settled in local currencies (the ringgit and Thai baht) has increased from 6.4% of trade settlement (RM1.9 billion) in 2009 to 18.6% of trade settlement (RM11 billion) in 2023 (Figure 3b). At the same time, trade with Indonesia settled in local currencies (the ringgit and Indonesian rupiah) grew from 4.5% of trade settlement (RM1.2 billion) in 2009 to 7.6% of trade settlement (RM5.9 billion) in 2023 (Figure 3c). Notwithstanding the progress achieved on this front, on 25 August 2023, BNM signed a Memorandum of Understanding (MoU) with BI and BOT to broaden the LCSF’s scope to cover cross-border transactions beyond trade and direct investment activities such as portfolio investment.

In our pursuit of a more conducive ecosystem for promoting the use of local currencies, initiatives to address demand-side structural issues are equally important and would require a more coordinated approach with market players. Recently, BNM has stepped up engagements with stakeholders including the market players to better understand the operational challenges faced by companies. A common issue raised by most companies was the difficulty persuading clients to settle in local currency, particularly when this would require companies to reconfigure processes and systems.

The advancement of financial technology may also help to promote local currency within the region, especially for consumers. Of significance on this front is the establishment of cross-border payment linkages,⁹ such as the ones with Indonesia, Singapore and Thailand for QR payments as well as person-to-person (P2P) fund transfer with Singapore. These initiatives not only promote efficiency in term of faster, cheaper, and more seamless cross-border payments, but also encourage greater usage of local currencies.

Moving forward, BNM and the Government will continue to encourage the use of local currencies for trade and investment. Priorities will include expanding local currency settlement and cross-border payment linkages with other countries in tandem with stepping up promotional efforts to increase awareness of market players on these initiatives. These efforts will provide an alternative avenue for companies and investors to better manage their exposure to movements of the exchange rate, reduce overdependence on US dollar, and ultimately, strengthen the region’s financial resilience against external shocks.

⁹ For further information, please refer to the ‘Promoting Safe and Efficient Payment and Remittance Services’ chapter.

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