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THEMATIC

In this report:

Ringgit set to shine this year

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Ringgit set to shine this year

The ringgit is expected to appreciate against the USD in 2021 despite witnessing some pullback during the year. The pullback on the ringgit's strength could be driven by the current pandemic crisis with rising cases both global and domestically. This resulted in containment measures which raised uncertainty that is likely to persist for two to four months. The ringgit could also lose some steam should the overnight policy rate (OPR) be reduced, and also from the narrowing inflation rate differentials with the US. The ringgit could weaken to around the 4.10–4.15 levels. Nonetheless, on the whole, the ringgit is expected to average around the 3.98–4.04 levels against the USD.

A. Dollar to weaken during the year

- The USD fell by 6.7% to close at 89.94 in 2020 against a basket of other currencies. This is partly due to the weaker USD which saw the ringgit appreciating by 1.7% to close at 4.02. The local currency turned out to be the third best performing currency among its Asean peers after the Philippine peso and Singapore dollar (Chart 1).

- However, the USD has appreciated by 0.3% YTD in 2021, resulting in currencies like the ringgit to weaken against the greenback by 0.6% to 4.045 (Chart 2). In the near term, the USD could benefit from several issues. With the US election and promising vaccine news behind us, attention would return to macro fundamentals and the still rising Covid infection rates worldwide. This uncertainty could last between two and four months. Containment measures being reintroduced at a heavy economic cost could raise unemployment and dampen activity. Nonetheless, the USD secular downtrend is expected to persist, driven by vaccines that will reinvigorate the reflation trade.

- The USD is expected to depreciate steadily over the course of next year. The weakness will be driven by the following:

    1. The Federal Reserve is expected to keep short-term rates to near-zero at least until 2022 (Chart 3), implying it will allow inflation (Chart 4) run hot after adopting its new flexible average inflation targeting that would act in favour of ringgit in terms of interest rate differentials. Rising inflation is more likely in 2H2021 as a result of money printing, the economic recovery and rising demand following the pandemic-induced supply constraints in many sectors, and real interest rates falling (Chart 5), which would erode the USD purchasing power.
    2. A dovish Fed's approach on its monetary policies suggests that the current pace of the Fed's balance sheet expansion (Chart 6) may last for another six months before a taper tantrum story emerges, sending panic that could see the US 10-year bond yields (Chart 6) rising to around 1.40%–1.50% in the near term.
    3. Twin deficits. The US current account has been in deficit for the last 10 years and is expected to rise to around 3% in 2020 and 2.7% in 2021 from 2.3% in 2019 (Chart 7). Fiscal deficit is expected at US$3.1 trillion in 2020, which is more than triple the deficit in 2019, translating to -15.2% of GDP, the biggest deficit since 1945 (Chart 8).
    4. Stocks continue to rise, and risk appetite is improving which will coincide with the weakening dollar. The stronger the risk-on sentiment is, the more likely it is for money to flow out of the US and into emerging markets. The yield curve will steepen further with the 10-year benchmark' government borrowing costs likely to test 1.5% in 2021.
    5. As the global economic recovery unfolds, the greenback will see significant weakness. 2H2021 is when the outlook will improve for emerging markets. This will provide further acceleration to many carry trades that use the USD as the funding currency, and it will cause a snowball effect. The dollar will continue to slide on the belief that the Fed will be the last to tighten while emerging markets will raise rates sooner.

B. Ringgit to strengthen despite losing some momentum in the near term

- With the outlook for the USD expected to depreciate during the year, this should see the ringgit remaining on a positive trend in 2021. The local currency is expected to hover around the 3.98–4.04 levels against the USD on average although it may give up some of its gains during the year. The ringgit could weaken to around the 4.10–4.15 levels.

- The resurgence of another wave of infections around the world, including Malaysia, and the imposition of lockdown measures would weigh on the ringgit's strength. Additionally, the relatively tighter monetary policy that is supporting the ringgit would lose some steam as Bank Negara Malaysia (BNM) is likely to reduce the OPR by 25bps from the current 1.75% probably in the next MPC meeting in March in a move to support the economy.

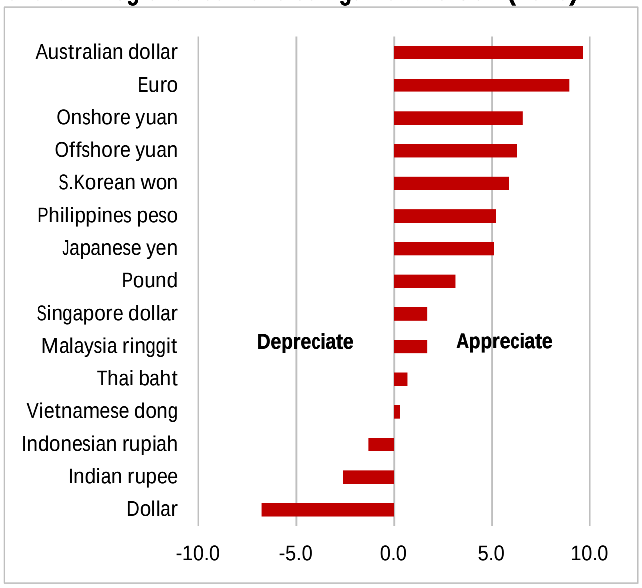
- Besides, the ringgit's gains will likely be capped by inflation differentials. In 2021, Malaysia's inflation is likely to be higher than the US. The CPI for Malaysia in 2021 is projected at 1.9%–2.1% and for 2022 at 2.1% –2.3%, while for the US, it is around 1.5%–1.7% and 1.9%–2.0% respectively. This would reverse the advantage that Malaysia had in 2020, where the inflation was -1.1% y/y against 1.5% y/y for the US. The need to maintain export competitiveness (inflation will make Malaysian goods more expensive, with all other things being equal) will likely put some depreciatory pressure on the ringgit, especially in the later part of 2021.

- Several factors that will determine the [value of the] currency going forward are political stability, the risk of a downgrade by foreign rating agencies as well as the review of Malaysia's position in the World Bond Index**.**

- Nonetheless, the drivers for the local currency (apart from the USD weakening) are:

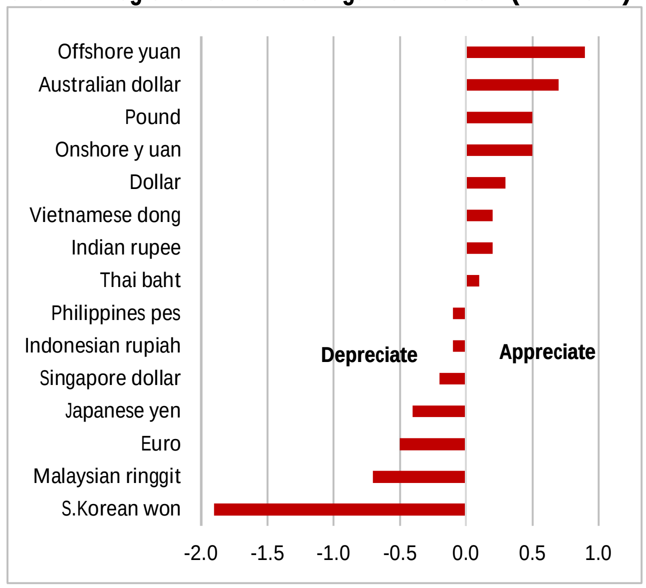
  1. Stable global crude oil prices. The price of Brent crude oil has been revised upwards from US$45–US$48 per barrel to US$50–US$53 per barrel for 2021. The revision came after Saudi's decision for a unilateral cut by 1 million barrels per day for February and March as a pre-emptive measure in the face of increased short-term fundamental uncertainty, energy showing a pick-up in demand with a gradual rollout of vaccines and government stimulus measures to support growth. This would boost the local currency by as much as 0.2% (Chart 9).
  2. An increase in domestic money supply (Chart 10) which will support the local currency by providing a booster of 0.06%. Growth in money supply would add pressure to potential inflation and raise expectation for interest rates to move up. Inflation in 2021 is expected to be around 1.9%–2.1% (-1.1% in 2020).
  3. China's yuan will continue appreciating against the USD in the early part of 2021, supported by stronger growth. Domestic economic conditions in China and a weak USD are the two major reasons that are making the Chinese yuan one of most attractive currencies among the major economies. Recovery in China will benefit the region, including Malaysia, its largest trading partner.
  4. The stimulus packages unveiled by the US (US$1.9 trillion) and EU (US$2.2 trillion) of late will add more liquidity into the global economy. Much of the liquidity is expected to flow into the emerging market where returns are promising. Malaysia is expected to benefit.
  5. The Malaysia–US monetary divergence may further widen the bonds yield spread between the two. The difference between the two countries' 10-year government bond yield now stands at around 167 basis points, almost the widest on record (Chart 11). The yield spread between the two may further widen in 2021, and if so, it will continue to encourage more capital inflows into Malaysia and further support the ringgit.
  6. The still-large undervalued ringgit in real effective exchange rate (REER) terms will remain as an attractive valuation. It will provide support to the currency over the long term (Chart 12).

Chart 1: Regional Currencies Against the USD (2020)



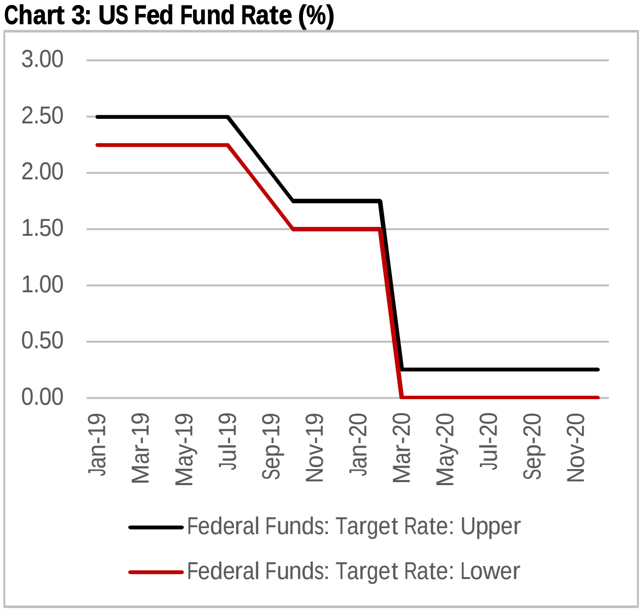
Source: Bloomberg/ AmBank Research

Chart 2: Regional Currencies Against the USD (YTD 2021)



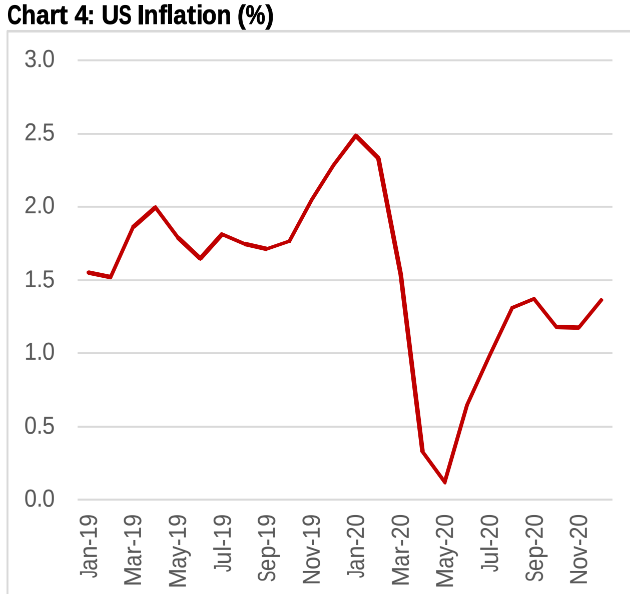
Source: Bloomberg/ AmBank Research

Chart 3: US Fed Fund Rate (%)



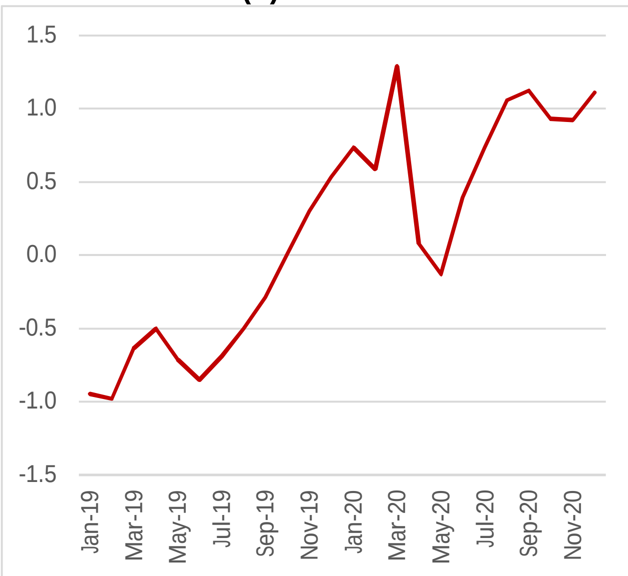
Source: CEIC/ AmBank Research

Chart 4: US Inflation (%)



Source: Bloomberg/ AmBank Research

Chart 5: US Real Rate (%)

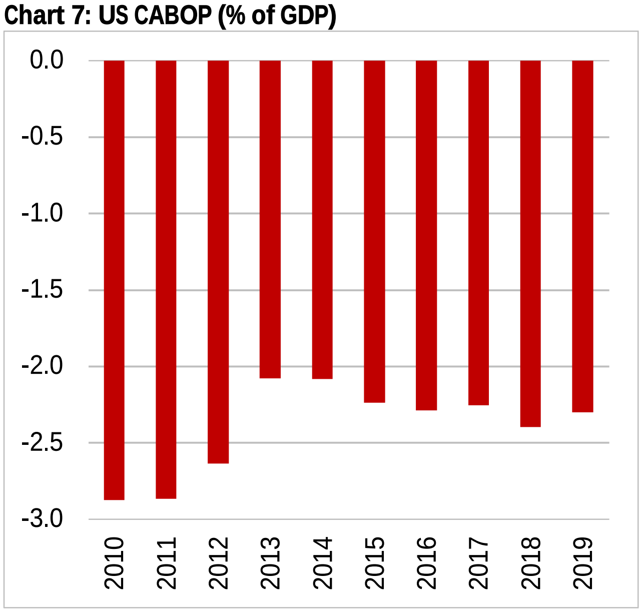


Source: CEIC/ AmBank Research

Chart 6: UST10Y Yield (%)

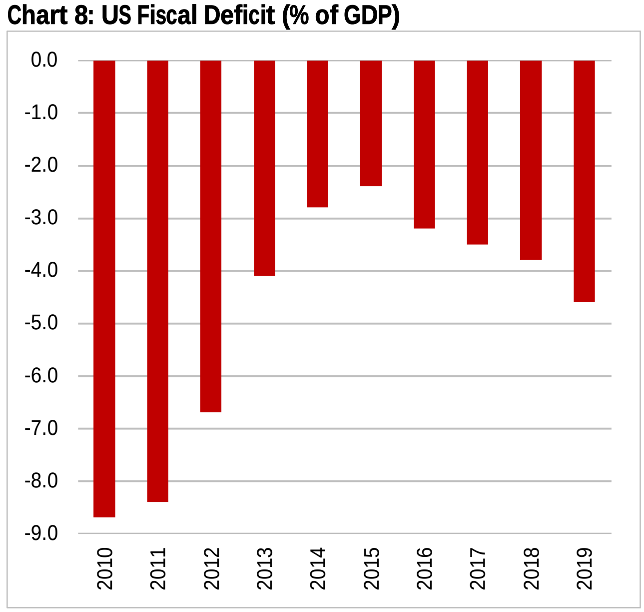
Source: Bloomberg/ AmBank Research

Chart 7: US CABOP (% of GDP)



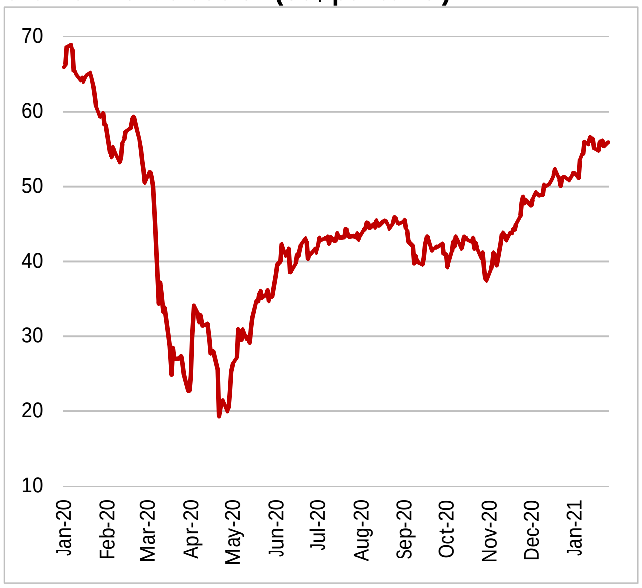
Source: CEIC/ AmBank Research

Chart 8: US Fiscal Deficit (% of GDP)



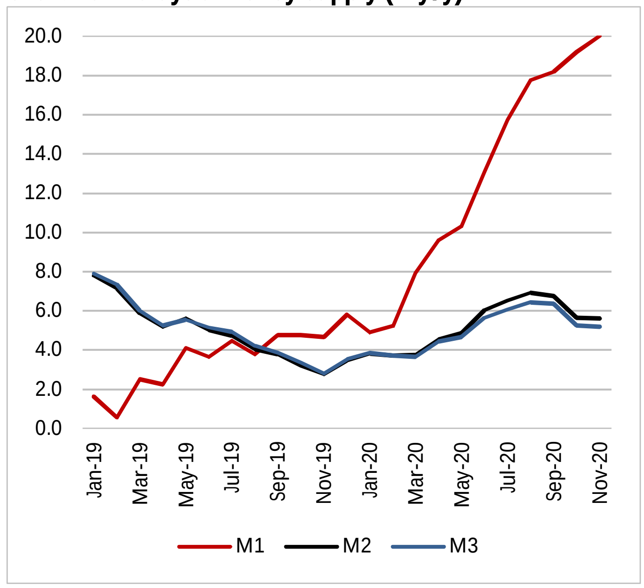
Source: CEIC/ AmBank Research

Chart 9: Brent Crude Oil (US$ per barrel)



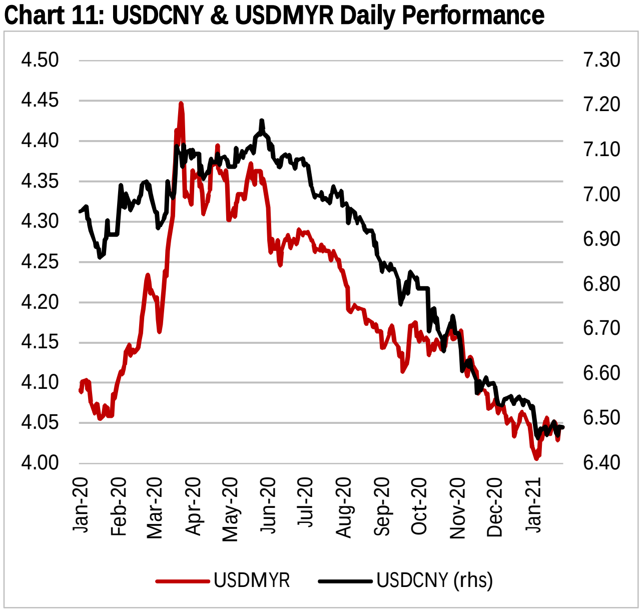
Source: Bloomberg/ AmBank Research

Chart 10: Malaysia Money Supply (% y/y)



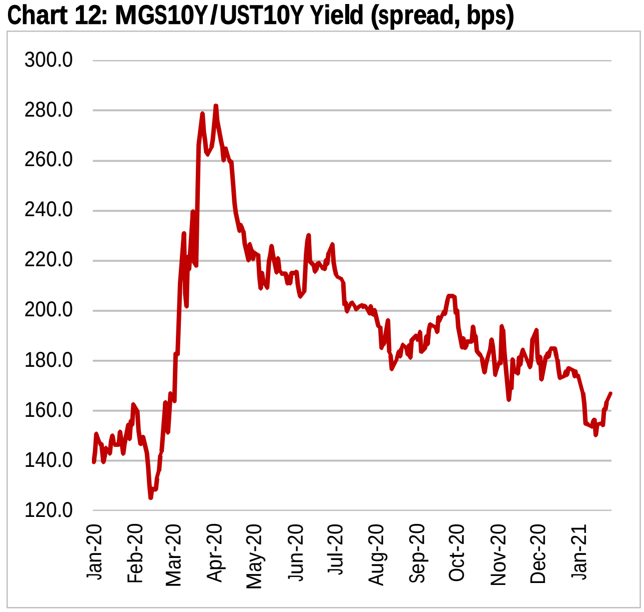
Source: CEIC/ AmBank Research

Chart 11: USDCNY & USDMYR Daily Performance



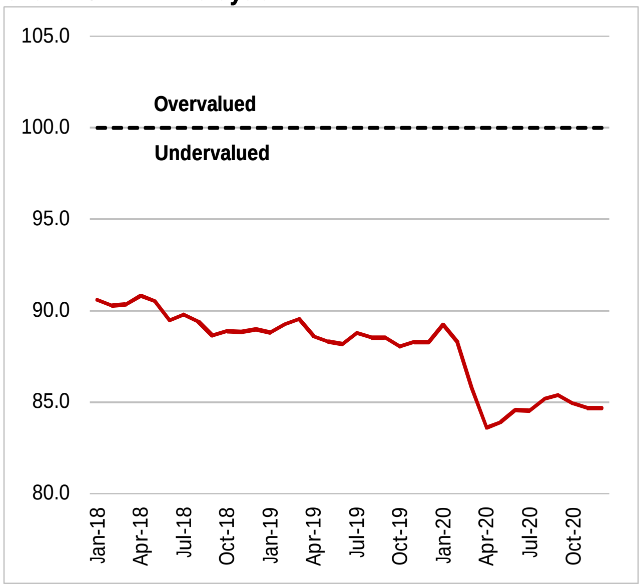
Source: Bloomberg/ AmBank Research

Chart 12: MGS10Y/UST10Y Yield (spread, bps)



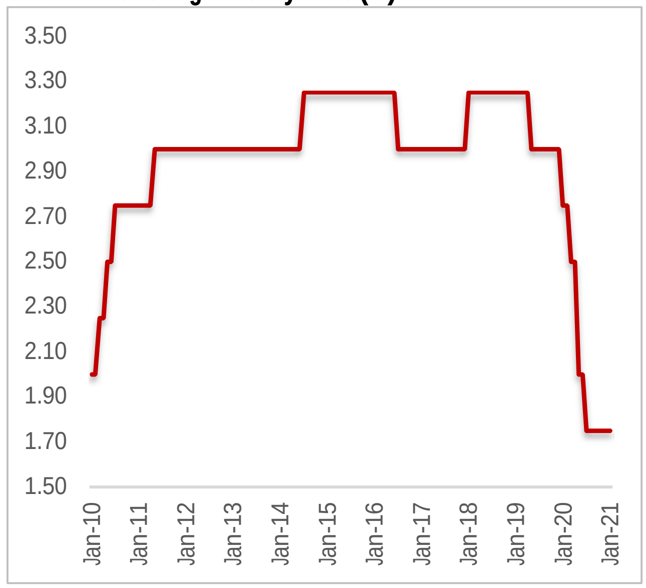
Source: Bloomberg/ AmBank Research

Chart 13: REER Malaysia



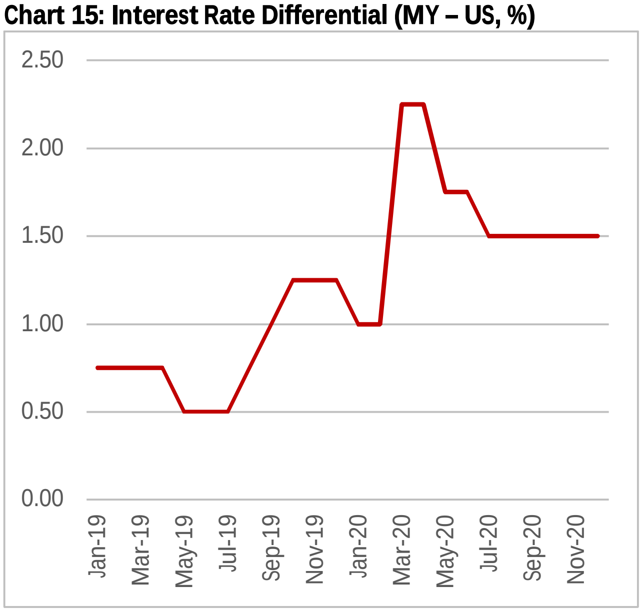
Source: CEIC/ AmBank Research

Chart 14: Overnight Policy Rate (%)



Source: CEIC/AmBank Research

Chart 15: Interest Rate Differential (MY – US, %)



Source: CEIC/ AmBank Research

Table 1: USD/MYR Outlook (end period)

	1Q2020	2Q2020	3Q2020	4Q2020	1Q2021(f)	2Q2021(f)	3Q2021(f)	4Q2021(f)
USDMYR	4.32	4.29	4.16	4.02	4.01–4.03	3.99–4.02	3.98–4.02	3.96–4.00

Source: CEIC/AmBank Research

Table 2: USD/MYR Outlook (average)

	1Q2020	2Q2020	3Q2020	4Q2020	1Q2021(f)	2Q2021(f)	3Q2021(f)	4Q2021(f)
USDMYR	4.18	4.32	4.20	4.11	4.03–4.05	4.01–4.03	4.00–4.02	3.98–4.04

Source: CEIC/AmBank Research

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