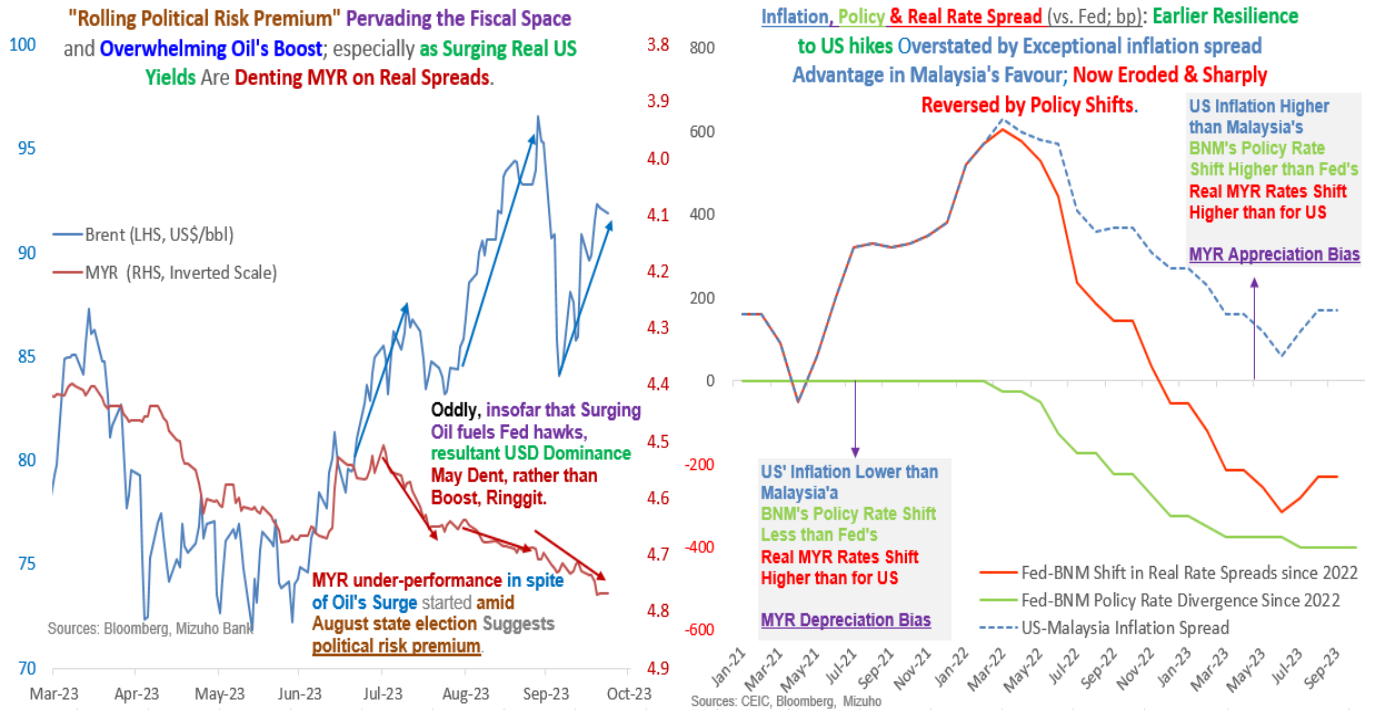


Ringgit: Curious Connundrum



"The curious incident of the dog (that did not bark) in the night-time" –Sherlock Holmes

In a Nutshell: **Relative ringgit under-performance despite Oil's surge is the conspicuous oddity**, which defies the usual positive correlations with oil; via terms of trade and fiscal channels. This is **not** so much a **reflection of de-coupling with Oil per se**. Instead, it reflects **ringgit dynamics** being **overwhelmed** by underlying conspiracy of *rolling political risks, sharp reversal of real rate advantages* over the USD and *haven demand for USD offsetting the gains in oil* amid geo-political risks. This leaves the BNM with unenviable, and undesirable, options of sacrificing growth or ringgit stability.

- The oddity of the **MYR counter-intuitively under-performing** *despite surging Oil prices* invokes Sherlock Holmes' famous allusion to the "*curious incident of the dog (that did not bark)*".
- Curious indeed, given that received wisdom dictates that **when Oil surges**, the **MYR typically gains the upper hand vis-à-vis other EM Asia FX**; as the *only net oil exporter in the region*. And relative allure further **bolstered by obvious and significant fiscal gains** (from tax and dividend bump-up).
- Puzzlingly, **MYR Ringgit not only failed to out-perform regional currencies, but has decidedly under-performed** defying further implied fiscal boost from major budget overhaul to rein in subsidies, that have followed Oil's surge.
- Question is, **why has the ringgit defied the boost from Oil and scorned purported** (phased,

potential) **fiscal fillip** to under-perform; hitting post-AFC (Asia Financial Crisis) record lows.

- To be sure, this is **not to be construed as a de-coupling of ringgit-oil positive correlation** (via still intact terms-of-trade and fiscal mechanics). Instead, What's highlighted is a **conspiracy of policy-political worries feeding into and off one another**.
- For a start, it may come down to **real rate spreads** (vs. USD) that could **turn a lot more unfavourable**; and perversely *more so as parts of subsidy rollback hit* amid rising global prices.
- Point being, the well-intentioned **subsidy rollback** aimed at longer-term fiscal sustainability will inflict near-term inflation pain., and consequently **higher inflation reveals softer real policy rates**.
- **What's more, and crucially**, in the current climate of US exceptionalism, **Oil's boost to ringgit-may be dulled by hawkish Fed expectations**. Specifically, oil's spike could incite a greater degree of associated hawkish Fed reponse both via resultant economic headwinds and sweeping USD dominance; thereby overwhelming expected MYR gains (otherwise to be derived from Oil).
- All things considered, it appears that **medium-term fiscal benefits**, *insofar as they are compromised by political pitfalls/divisions*, **accentuate near-term monetary policy challenges/dilemma, not sufficiently offset by rising oil prices**; thereby *manifesting as ringgit headwinds*.
- In turn, the "*damned if I do, damned if I don't*" **options of a policy response** ultimately **either; concede economic headwinds** from higher rates, and attendant debt burden on a stretched economy, **or; stake macro and ringgit stability**, should monetary response be withheld.
- To be sure, the **fiscal-monetary trade-off** is **not an entirely myopic zero-sum game**.
- Instead, the *embedded political risks* has been evident, but worryingly unresolved, from the August state elections; since which time, ringgit's under-performance has been pointed and poignant.
- Fact is, **while the fiscal overhaul to revoke blanket subsidies in favour of targeted cost relief is right** way to go, the **concern may be with the execution of such politically-charged fiscal plans in the context of constrained political capital**.
- So aspects of **political stability risks** amid inadvertent **fiscal shortfall** further complicate **near-term real rate headwinds**; *inadvertently continuing to undermine the ringgit*.

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