

# APAC Economic Perspectives

## ASEAN: Are the SGD and MYR overshooting?

### Economics

#### Asia Pacific

#### MYR may be in the process of overshooting, further SGD weakness ahead

We have been looking for ASEAN and Indian currencies, to varying degrees, to fall versus a stronger US dollar. However, the ringgit and Singapore dollar have softened further than we expected. We think the ringgit could be on the verge of overshooting, but doubt this is the case for the SGD. We extend our projections to look for USDSGD 1.35 by end 2015 and our USDMYR projection to 3.50 by end 2015 (Figure 8).

#### Ringgit weakness linked to oil and liquidity

The 11% decline in the Malaysian ringgit from its highs against the US dollar in August 2014 to recent lows can be broken into two periods. Firstly, from 27 August to 27 November, when the ringgit weakened a little over 6% against 2.5-4.5% declines in the other SE Asian currencies against a stronger US dollar. Secondly, the sharp 4.1% decline since 27 November, which coincided with the drop in the oil price post the OPEC meeting and a set of unfavourable Malaysian trade data. The lower oil price promises to adversely impact Malaysian income growth given the country's position as a net oil and gas exporter, while the lower October trade surplus implies a diminished margin of surplus savings with which to manage the income shock. The weakness in the ringgit is likely based on a combination of the stronger US dollar and the lower oil price on top of already slowing growth momentum – implying weak growth and lower policy interest rates (see [Malaysia: oil prices – adding fuel to the fire; 3 Dec 2014](#)). These fundamentals probably drove asset sales by foreign investors (both the bond and equity market sold off since 27 November) which in turn depressed the currency.

#### Ringgit to recover its poise

While things may well get worse before they get better, oil and capital flows could become more ringgit positive later in 2015. UBS' oil team expect the oil market to remain oversupplied into early 2015, which could mean further declines in the oil price. However, lower oil prices are already incentivising oil companies to reduce capital expenditure on extraction – indeed this was part of the reason we lowered our Malaysian growth forecast on 3 December. Ultimately that should help deliver a stabilisation and recovery in the oil price – although, according to UBS' oil team, not until late in 2015. At some point, this should support faith in the ringgit. We also expect better support from the balance of trade and capital flows. Lower domestic demand should mitigate the downward impact of commodity prices on the Malaysian current account balance. Meanwhile, the adverse impact of near term foreign portfolio outflows should be overcome by i) a combination of the recent FX and asset price adjustment (which should attract foreign funds) and ii) the return of Malaysian funds invested overseas driven by home bias and liquidity preference in a more uncertain domestic economic environment. Against this, UBS expects the US dollar to continue appreciating in 2015 towards EURUSD 1.15 and Malaysia's domestic credit cycle to further mature alongside that of Asia. As such, we forecast the ringgit to regain some of its poise, but not to reverse recent losses. We project USDMYR 3.50 for end 2015.

#### Singapore dollar to keep falling against US dollar

Analysis by UBS currency strategist Max Lin shows much of the decline in the Singapore dollar against the US dollar was driven by the rise in the USD against Singapore's trading partner currencies. We expect i) continued US dollar strength, though at a reduced pace, ii) pressure on the Singapore economy from higher US yields and iii) the MAS to ease currency policy during 2015. We reckon that will put the SGD Nominal Effective Exchange Rate (NEER) in the lower half of the MAS' policy band at end 2015. Consistent with this, we project USDSGD 1.35 by end 2015.

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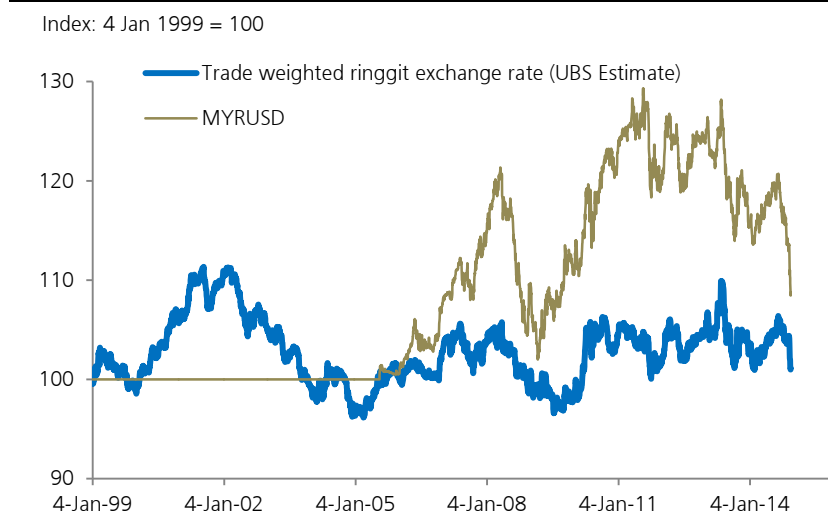
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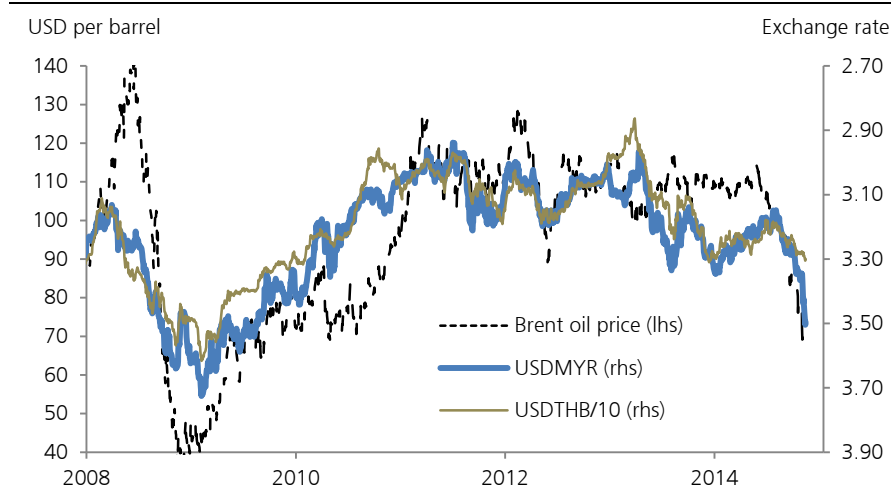
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**Figure 1: Ringgit exchange rate against US dollar and trade weighted peers**



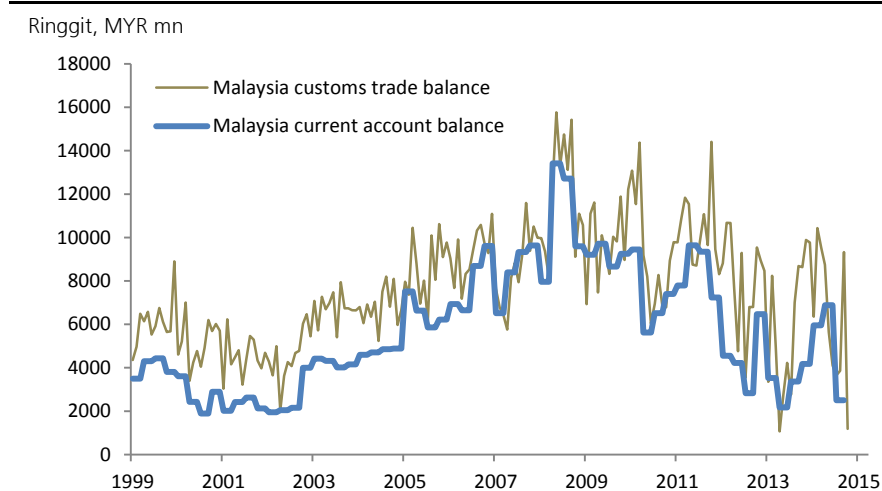
Source: UBS Estimates, Haver, CIEC

**Figure 2: Oil prices appear to added to idiosyncratic MYR weakness**



Source: UBS Estimates, Haver, CIEC

**Figure 3: Deterioration in trade balance implies less current account cushion**



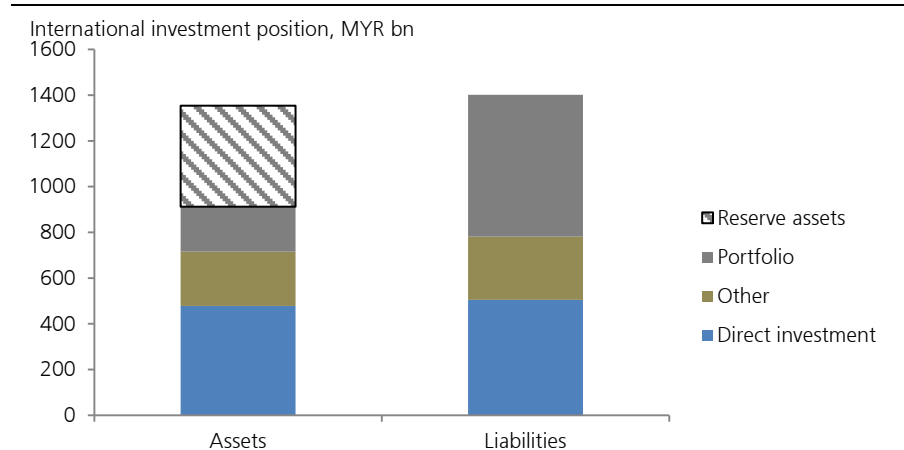
Source: UBS Estimates, Haver, CIEC

The ringgit has weakened against peers and the US dollar

Oil prices appear to explain some of the ringgit's weakness against close peers. That makes sense; Malaysia is an oil and gas exporter. The economy can expect to see reduced national income levels and growth as a result of the sharp decline in oil prices.

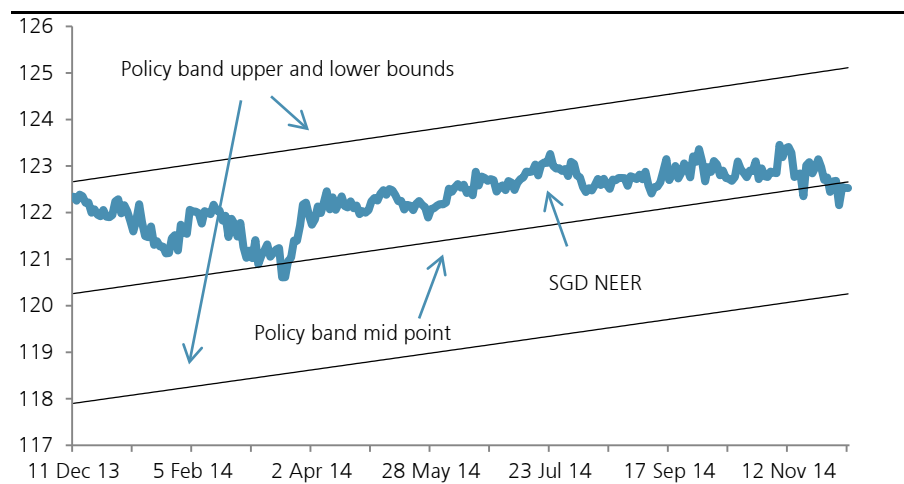
Weak October trade data may also have played a role. The reduced trade surplus implies a narrower cushion to absorb income losses as a result of lower commodity prices. The dip in October's trade balance was caused by higher imports – specifically capital goods imports – rather than lower oil-linked export revenue. We expect imports to weaken with domestic demand next year, providing some offset to a reduced oil and gas balance of trade.

**Figure 4: Malaysia's strong international asset position could imply reserve of support for ringgit in fullness of time**



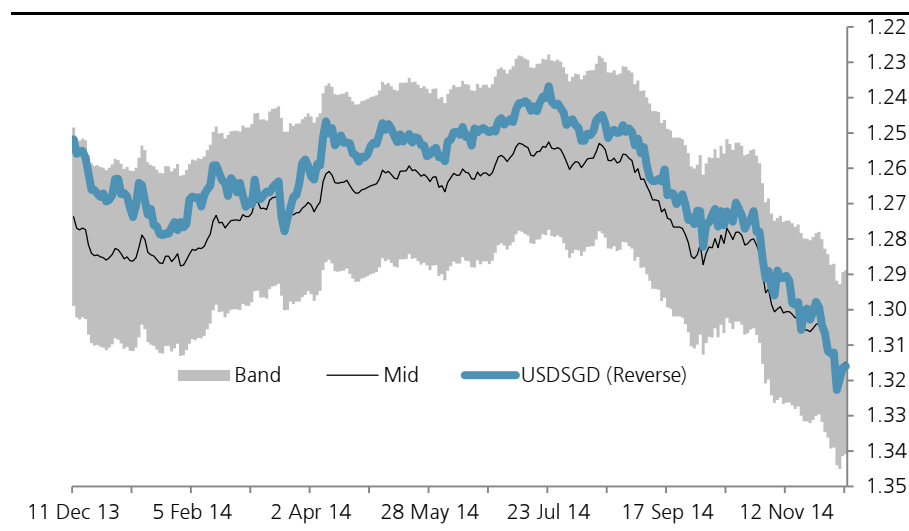
Source: UBS Estimates, Haver, CIEC

**Figure 5: MAS Nominal Effective Exchange Rate and policy band (UBS Estimate)**



Source:

**Figure 6: Implied MAS policy band in USDSGD Terms & USDSGD Spot**



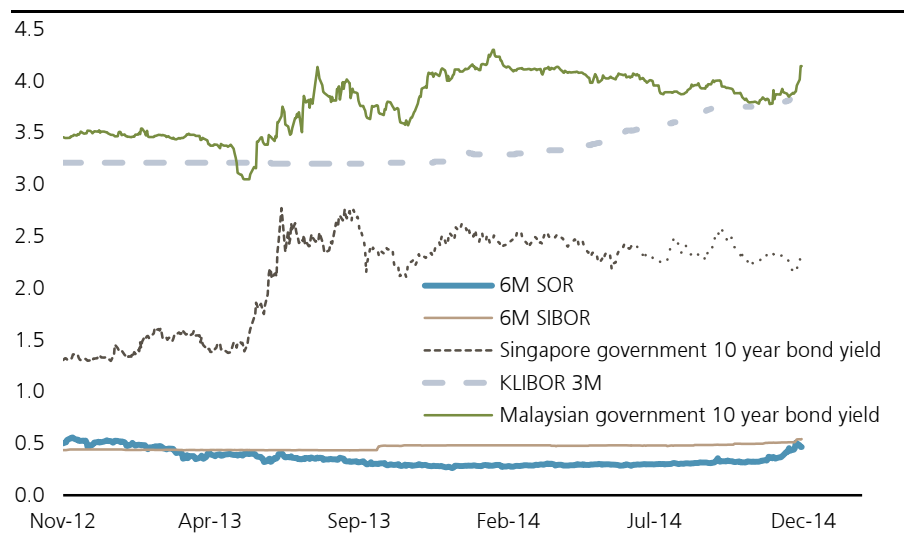
Source: UBS Estimates, Haver, CIEC

Malaysia's substantial external liabilities (including external debt) at 142% of GDP are often highlighted as a cause for concern. However, Malaysia's external assets are of a similar magnitude (137% of GDP). Foreign portfolio outflows may have been dominant in the recent past, but it is quite possible the flows may become more balanced or favourable for the MYR if home bias and liquidity preference take hold amongst Malaysian investors.

The Singapore dollar has weakened modestly within the Monetary Authority of Singapore's policy band, consistent with a growing expectation of easier policy at one of the MAS meetings in 2015.

But the majority of weakness in SGD against USD has been the due to US dollar strength against the Singapore dollar and its peers. There is still plenty of room for the SGD to fall within the policy band and hence against trading partner currencies and the USD.

**Figure 7: Higher Malaysian yields should draw capital home, Singapore yields may need to rise to achieve the same effect during 2015**



Source: UBS Estimates, Haver, CIEC

Malaysian government bond yields jumped modestly in recent days, consistent with the market finding a new equilibrium in the face of capital outflow pressure. Capital outflow pressure may force Singapore yields higher if US interest rates begin to rise in line with UBS projections later in 2015.

**Figure 8: UBS currency forecasts**

	Current	End 2015 E (Old)	End 2016 E (old)	% chg between current and End 2015
USDINR	61.8	63.0	65.0	+2.0%
USDIDR	12340	12800	13250	+3.7%
USDMYR	3.49	3.50(3.40)	3.55(3.45)	+0.3%
USDPHP	44.6	47	49	+5.5%
USDSGD	1.317	1.350(1.320)	1.360 (1.330)	+2.5%
USDTHB	32.9	34.0	35.0	+3.4%

Source: UBS estimates

## Recent publications relevant to MYR, SGD and oil

[Singapore Banks: SOR soars – points to FX and liquidity shifts](#) (8 Dec 2014)

[APAC Econ Comment - Malaysia: Oil prices - adding fuel to the fire](#) (3 Dec 2014)

[APAC Econ Perspectives - ASEAN and India: Lower oil, lower rates](#) (3 Dec 2014)

[Asian Economic Perspectives – Outlook 2015-16](#) (11 Nov 2014)

[EM Cross Asset Strategy: Outlook 2015](#) (10 Nov 2014)

[Asian Focus – Malaysia: Budget 2015 – a better mix](#) (13 Oct 2014)

[Asian Focus - Singapore: Ready for a rough ride?](#) (11 Aug 2014)

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<a href="#"><u><i>ASEAN and India: Lower oil, lower rates</i></u></a>	Dec 3
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