Bonds outflow to bleed the ringgit

WHEN the global price of oil increases, the ringgit usually strengthens in tandem. For example, when oil was at US$50 (RM209) a barrel in August last year, the ringgit traded at RM3.90 to the dollar. And when oil fell to below US$30 in January, the ringgit hit an all-time low of RM4.40. The oil price has been climbing steadily since April to above US$50 per barrel currently. But the ringgit is at a weak RM4.21 to the dollar. Why is this?

by Ng Wai Mun

The answer, perhaps, lies in the fact that traders are wary that foreigners hold an estimated US$56 bil (RM233.7 bil) worth of Malaysian bonds. That's weighing down the ringgit. Some of the bonds are due for redemption soon.

Bonds in foreign investors' hands

Global Markets Research senior strategist for Asia, Irene Cheung says: "Portfolio outflows could have helped weaken the ringgit.

"Outflows from the bond and stock market totalled around US$400 mil in September, which may have continued in October particularly for bonds. This is a reversal from strong inflows in July (amounting to US$1.7 bil) and August (US$1.9 bil)."

However, Cheung stresses that lower oil prices will not bode well for the ringgit.

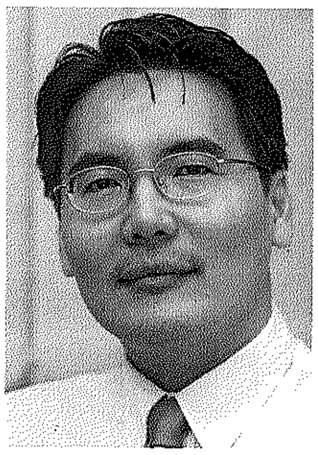
As at end September, based on Bank Negara data, foreign holdings in debt securities and *sukuk* was equivalent to RM233.7 bil or US$56 bil.

Compared to end August's total, September's figures represent a RM8.4 bil reduction. Conventional Malaysian Government Securities (MGS) accounted for RM5.5 bil of this RM8.4 bil reduction. Of the foreign holdings in debt securities, 75% were in MGS.

This RM8.4 bil decline is also the biggest reduction since August 2015's RM8.9 bil. A research manager says it is not a coincidence that during that period, the ringgit was also weakening against the US dollar, falling from RM4.10 to RM4.15 levels.

The research manager agrees that foreign holdings in bonds totalling US$56 bil is very worrying. He says: "It potentially means this amount can flow out of the country when (foreign) investors decide to cash out.

"If outflow of bonds totalling a mere US$400 mil can have such a (negative) impact on the ringgit, (referring to Cheung's remarks) imagine a scenario where the bulk of this US$56 bil is cashed out."



Meor says bond holders will re-invest in the market unless something changes the dynamics

From now till year end, it is estimated that some RM21 bil (US$5 bil) worth of bonds (exceeding RM1 bil) matures. This will put further selling pressure on the ringgit. Then between next year and 2020, another RM145 bil will also mature ***(see table on Bond Information)***.

An official from RAM Ratings says: "The volatility in foreign holdings of Malaysian bonds may have been exacerbated by increasing trepidation over the stability of capital flows.

"The market will price itself in expectation of a possible overnight policy rate cut by Bank Negara Malaysia in November amid persistently weak economic activity and the prospect of at least another rate hike by the US Federal Reserve (Fed) towards the end of this year."

On the likelihood of bond holders reinvesting their capital into the bond market, which would ease selling pressure on the ringgit, Bond Pricing Agency Malaysia Sdn Bhd CEO Meor Amri Meor Ayob says:

"More often than not, bond holders will re-invest in the bond market unless something drastic changes its dynamics.

"This is especially true for unit trusts and asset management companies that are constrained by the given mandate."

He says it does not benefit foreign investors to repatriate money to their home countries since the ringgit is weaker. However, he says: "It also depends on the portfolio or asset allocation strategies of the investors."

The RAM Ratings official says amid declining global yields, especially in industrialised economies, foreign investors have been hard pressed to earn positive returns on their investments.

"This triggered a yield hunt among investors, increasing the appeal of emerging market bonds, including Malaysia, which offer relatively higher returns on their investments. So the impetus to re-channel funds into these higher-yield investments is relatively strong," he says.

The research manager points out: "Despite the weaker ringgit and the country being an emerging bonds market, foreign investors are still repatriating the money. Normally, they would have reinvested into new bonds to maintain that portion of their investments. Yet they are not doing it."

This says a lot about the foreign investors' perceived outlook of the country's economy in the medium term.

The research manager reiterates that the link between the global oil price and the direction of the ringgit has decoupled since the middle of the year.

"Don't think it [the decoupling] has anything to do with global oil economics. Other economic and political issues have overshadowed advantages of an increasing oil price. This exerts net selling pressure [on the ringgit].

From an outsider's perspective, issues such as increasing household debt and the government's debts are very worrying. These factors put a lot of weight on decision making and how much to invest in the country.

IHS Global Insight Asia-Pacific chief economist Rajiv Biswas says: "The ringgit's depreciation against the US dollar since the middle of 2014 reflects a number of factors, including the perceived impact of lower world oil and gas prices on the economy.

"However, other factors also have played a role, including the commencement of the Fed monetary policy tightening and expectations of more US rate hikes late this year and next year.

"This increases the yield on the US dollar relative to other currencies. And it is expected to support further US dollar appreciation against emerging market currencies over the next 12 months."

Bond Information

	Description	Maturity Date	Currency	Outstanding Amount	Issuer
BONDS EXPIRING IN 2016 (VALUE ABOVE RM1 BIL)					
1	PROFIT-BASED GII 3/2006 15.11.2016	15/11/2016	MYR	11,000,000,000	GOVERNMENT
2	SIME DARBY IMTN 4.750% 16.11.2016	16/11/2016	MYR	1,000,000,000	SIME DARBY
3	IILM 2 SA STTC 89D 22.11.2016	22/11/2016	USD	840,000,000	IILM 2 SA
4	PRASARANA 4.27000% 30.11.2016	30/11/2016	MYR	1,914,000,000	PRASARANA
5	KHAZANAH 0% 08.12.2016	08/12/2016	MYR	2,000,000,000	KHAZANAH
6	IILM 2 SA STTC 111D 14.12.2016	14/12/2016	USD	500,000,000	IILM 2 SA
BONDS EXPIRING BETWEEN 2017 - 2020 (VALUE ABOVE RM10 BIL)					
1	MGS 2/2014 3.394% 15.03.2017	15/03/2017	MYR	10,500,000,000	GOVERNMENT
2	MGS 2/2010 4.012% 15.09.2017	15/09/2017	MYR	14,000,000,000	GOVERNMENT
3	MGS 5/2012 3.314% 31.10.2017	31/10/2017	MYR	13,500,000,000	GOVERNMENT
4	MGS 2/2003 4.24000% 07.02.2018	07/02/2018	MYR	14,100,000,000	GOVERNMENT
5	MGS 5/2011 3.580% 28.09.2018	28/09/2018	MYR	11,440,000,000	GOVERNMENT
6	GII MURABAHAH 7/2013 30.04.2019	30/04/2019	MYR	10,000,000,000	GOVERNMENT
7	MGS 4/2014 3.654% 31.10.2019	31/10/2019	MYR	11,800,000,000	GOVERNMENT
8	MGS 2/2009 4.378% 29.11.2019	29/11/2019	MYR	17,119,000,000	GOVERNMENT
9	MGS 6/2012 3.492% 31.03.2020	31/03/2020	MYR	11,000,000,000	GOVERNMENT
10	PROFIT-BASED GII 7/2012 15.05.2020	15/05/2020	MYR	11,000,000,000	GOVERNMENT
11	GII MURABAHAH 2/2015 3.799% 27.08.2020	27/08/2020	MYR	10,000,000,000	GOVERNMENT
12	MGS 3/2015 3.659% 15.10.2020	15/10/2020	MYR	11,742,134,000	GOVERNMENT

Source: **Bank Negara Malaysia, Focus Malaysia**

Ringgit to weaken

Rajiv tells ***FocusM*** he foresees the ringgit to move within the RM4.10 to RM4.35 range over the next six months.

Global Markets Research's Cheung says: "We expect the ringgit to weaken against the US dollar as the market prices in the Fed hike, most likely in December."

Centre for Public Policy Studies chairman and Sunway group corporate adviser Tan Sri Ramon Navaratnam says the "ringgit decline is temporary" remark has been too frequently used.

"Now that the ringgit decline is not temporary and that it can become permanent and even sustained, the results are unfortunately now showing clearly," he says.

On market talk of the ringgit hitting RM5 in the near future, the research manager says: "I am looking at RM4.50. The RM5 figure may be a bit pessimistic.

"At RM4.50, I don't think [we are] that far off. Yes, don't underestimate a 1 to 2 sen decline a day. It may seem trivial, but by consistently inching upwards over a month, we will reach RM4.50 pretty soon. It may not seem much to some, but compared to now it means another 7% depreciation.

"If the [ringgit] fluctuations or weakening continues, I see the government possibly pegging the ringgit again."

Ramon gave a definite "no" when asked if he foresees a ringgit peg to curb further depreciation like in the 1990s. "It (pegging) cannot work today," he says.

To recap, during the 1998 Asian financial crisis, the phrase "see you at 5" was commonly quoted and uttered in the money market.

Currency traders expected the ringgit to hit the RM5 level. The government then decided to impose capital controls and pegged the ringgit

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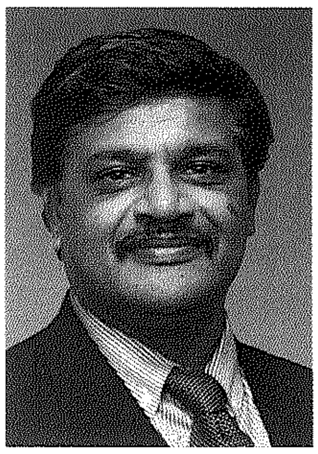
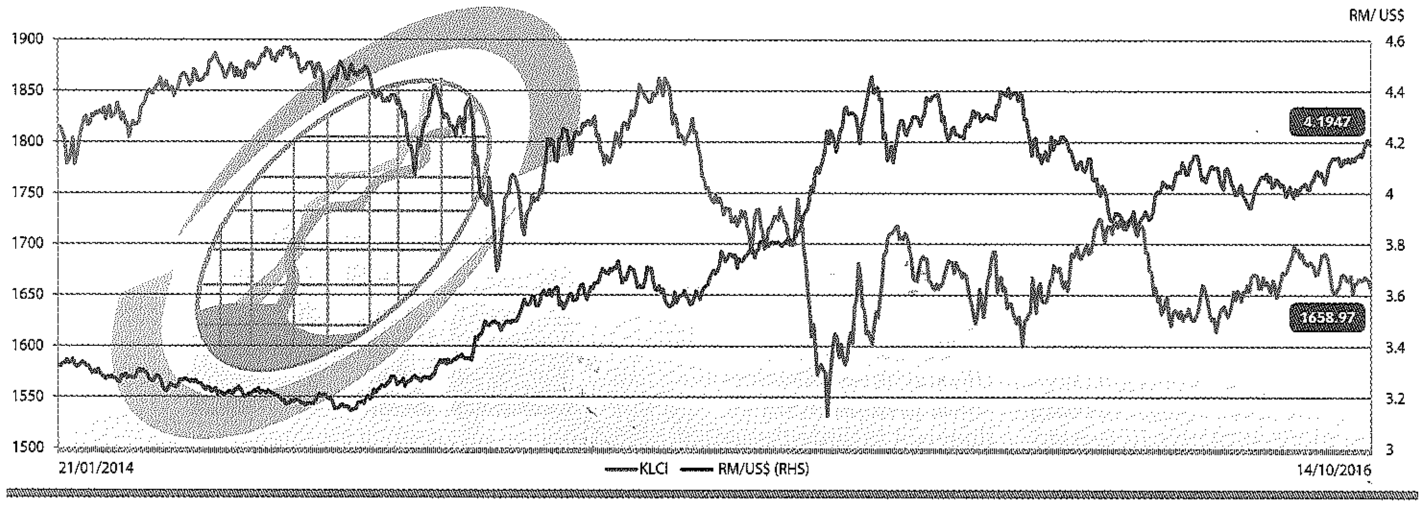


Rajiv expects the ringgit to move within a RM4.10 to RM4.35 range

KLCI vs Ringgit



Source: **Bloomberg**

Boon for some, bane for others

THE weak ringgit against major currencies is a double-edged sword that is a boon to some sectors but a bane to others.

"Exporters will benefit from a weaker ringgit, while importers see profit margins squeezed as a result of higher translation costs," says TA Securities Holdings Bhd chief economist (research) Shazma Juliana.

Listed companies that export electrical and electronics (E&E), rubber, timber and food and beverage products will gain from a weak ringgit.

Another economist expects the dollar to strengthen on expectations the US Federal Reserve will raise interest rates in December.

She says demand for the greenback is also expected to rise as there will be profit taking by investors ahead of the corporate earnings season in that country.

The ringgit weakened 8.41% to RM4.19 per US dollar on Oct 18, against a 52-week high of RM3.86 to the dollar on April 20.

Based on *FocusM's* research, companies in the E&E segment that gained from the weak ringgit include Vitrox Corp Bhd and Unisem (M) Bhd.

For Q2 FY16 ended June 30, Vitrox's exports contributed 74% to its total revenue. The bulk of Unisem's sales is also export driven.

The statistics department's August 2016 external trade figures reveal that E&E companies are the biggest contributors to exports, making up 38.2% of the country's total exports valued at RM25.8 bil.

An analyst's top pick is Top Glove Corp Bhd. The company exports 63% of its products to North America and Europe. With its extensive global network, Top Glove commands about 25% of the global market share for rubber gloves.

For FY16 ended Aug 31, the rubber glove company's unaudited net profit increased 29.04% to RM361.05 mil from RM279.78 mil a year earlier.

Top Glove says a stronger US dollar and lower raw material prices earlier in the financial year boosted the group's performance.

In a recent research report, Kenanga Investment Bank Bhd says the sustained weakness of the ringgit vs the US dollar "is positive for rubber glove players including Top Glove. It could also see margins improve in subsequent quarters".

Timber gains from US recovery

For timber-related counters, an analyst with a local investment bank says timber-related companies have seen increased sales to the US.

This, he says, is backed by the economic improvement in the US since the global financial crisis in 2008-2009.

"In the US, housing remains on the uptrend since hitting bottom in early 2011. In addition, the improved US business sentiment and employment had also boosted demand for office furniture," he says.

The fund manager says despite the upside for export-based companies due to the weak currency, manufacturers should not depend on this windfall but increase production capacity for sustainable earnings growth.

Taking the example of the E&E sector, he says for a manufacturer to report earnings growth, one will have to invest in machinery or assets to increase production volume, which translates to higher earnings.

However, with the ringgit expected to weaken, he says machinery cost will increase in line with the percentage of the ringgit's weakening against other currencies.

"The weak ringgit will eventually increase investment costs, even for manufacturers who acquire cheaper, China-made machines. Ultimately, this may also impact the asset breakeven period," he says.

The ringgit weakened 5.5% to 62 sen per yuan on Oct 18, against a 52-week low of 58 sen per yuan on July 15.

It has also weakened 5.45% to RM4.62 per euro on Oct 18, against a 52-week low of RM4.38 per euro on April 14.

However, not all export players benefit from the ringgit's movement against major currencies. On June 23, the UK's vote to leave the European Union (Brexit), hit the British pound, which has since weakened against the ringgit.

The ringgit has strengthened 22.98% to RM5.13 per pound on Oct 18, against a 52-week low of RM6.67 per pound on Nov 18 last year.

Companies affected by Brexit include utility giant YTL Power International Bhd, due to its wholly-owned UK-based subsidiary Wessex Water Ltd, a regional water and wastewater services company.

"Earnings from Wessex Water account for the bulk of group net profit. As such, it is sensitive to changes in the pound exchange rates," AllianceDBS Research Sdn Bhd said in a recent report.

Despite the ringgit recently hitting its eight-month low against the US dollar, the fund manager says it should not have a significant impact on corporate earnings. He says most companies realigned their product pricing earlier this year.

As an example, he says UMW Holdings Bhd and Tan Chong Motor Holdings Bhd increased vehicle prices as a result of the weak ringgit.

On Jan 1, UMW's marques – Toyota and Lexus – increased vehicle prices by up to RM9,598 and RM45,035 respectively.

In April, Tan Chong increased Nissan vehicle prices by up to RM6,225. In addition, local automaker Proton also increased its vehicle prices in February.

"In the event, the ringgit hits a 52-week low of RM4.41, then we might be able to see a more significant impact on companies' earnings. Right now, everything should still be under control," the fund manager says.

For Q2 FY16 ended June 30, UMW reported a net loss of RM12.12 mil against a net profit of RM68.43 mil a year earlier. In the same period, Tan Chong reported a net loss of RM14.58 mil against a net profit of RM14.15 mil last year.

Commenting on UMW's quarterly result,

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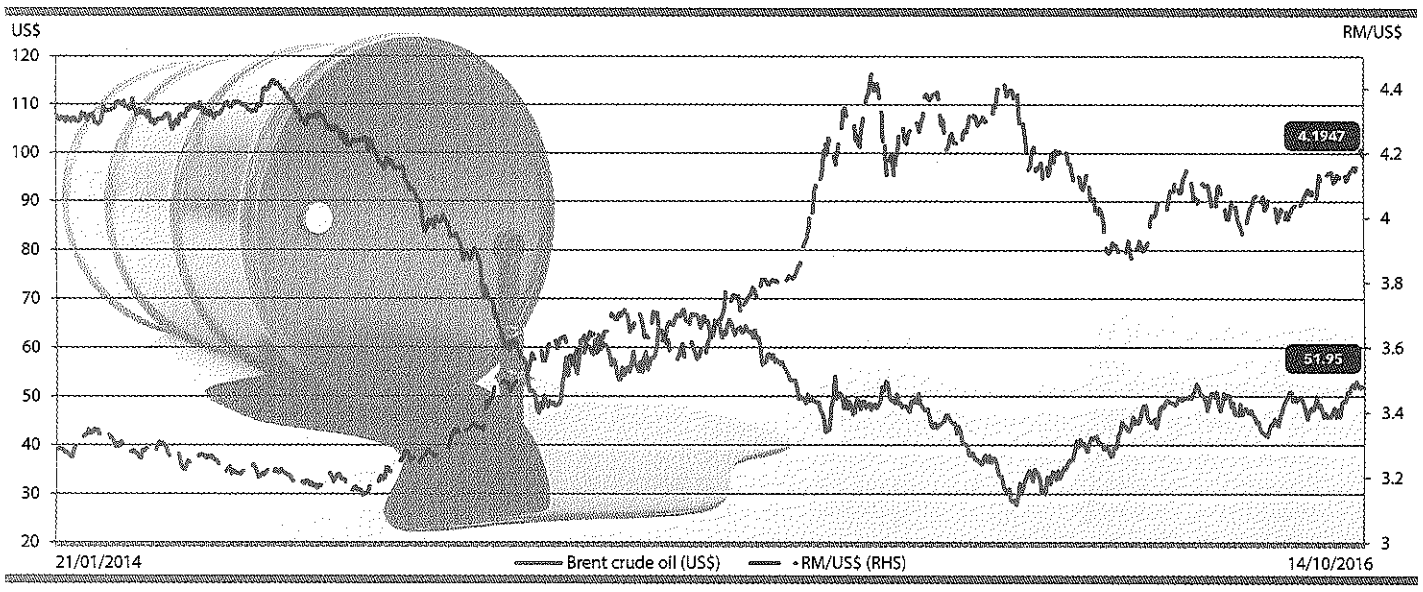
Crude oil price vs Ringgit



Source: **Bloomberg**

Bourse suffering investor confidence

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at RM3.80 to prevent it deteriorating further.

The local bourse is now suffering from foreign investors' perceived bleak outlook of the economy.

The research manager says despite the weak ringgit making stocks more attractive in foreign currency, there has not been an aggressive influx of foreign funds.

In March last year, with the ringgit averaging around RM3.70, foreign participation in the local bourse was 29.1% and foreign shareholding's market capitalisation was RM492 bil.

In September, when the ringgit weakened by 10% and averaged around RM4.10, foreign shareholding was marginally higher.

But given that the local bourse's market capitalisation has dipped by 2%, against March last year's level, the market capitalisation of foreign shareholding shrunk to RM491 bil. During that 15 months from March last year, the KLCI dipped 7%.

The research manager says: "Stocks are basically long-term investments. Ideally, foreign investors will accumulate more when the currency is weak in anticipation of a rebound.

"At the very least, they would want to make money from the foreign exchange gain. But cheap stocks due to the weak ringgit are not even enticing foreign investors."

On why they are holding back, he says some may attribute it to the ringgit's uncertainties.

"But I believe foreign investors are waiting for the ringgit to bottom out before coming back to the local bourse," he says.

The research manager says he is looking at the KLCI bottoming out at the 1,610 to 1,620 points range over the next 12 months.

He also says that being the fourth quarter of the year, students are selling the ringgit as they prepare to travel abroad for their studies. This also aggravates the situation.

There are 20,000 students in the UK, and he says their fees alone can come to about RM1 bil. And this does not include those in the US and Australia.

The *2015 Open Doors Report on International Educational Exchange* says 7,231 students attended college or university in the US during the 2014-15 academic year.

"This student related outflow [of funds] is significant enough to hit the ringgit, but it is not the main reason for the weakness in Q4 [of last year].

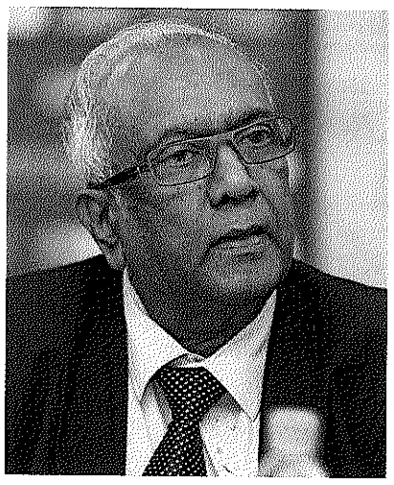
"If so, the ringgit in the following quarter [Q1, this year] should have rebounded, but the Q1 [exchange rate] has gotten worse in the past three years. Going by this trend, the ringgit will worsen in the next quarter," the research manager says.

Hope for the ringgit?

Ramon says: "The ringgit's decline reflects the lower international and national confidence in our falling quality of governance. If and when good governance returns, the ringgit will correspondingly strengthen."

On measures which the government should and could do to strengthen the ringgit, Ramon says it has no control over external factors but confidence is interrelated.

"The domestic and international lack of confidence interplay and reinforce each other. Once all the rumours, facts and even allegations of poor governance, including corruption, cronyism and the wastage in public spending as indicated by the many Auditor-General's reports are effectively addressed, the ringgit could rise again.



Ramon says pegging the ringgit won't work today

"The potential for higher growth and progress is still considerable. That is the irony of the economy and the rhetoric of the ringgit," he says.

Global Markets Research's Cheung, in turn, says: "Positive global risk sentiment will be good for the ringgit. At the moment, the US dollar is strong and US yields are going up, reducing the attractiveness of ringgit bonds."

Just another currency cycle?

The more optimistic ones may view the weak ringgit as just another cycle. They point out that the ringgit's low in the second half of the year is the current RM4.22 level, and it is still far from the low of RM4.40.

The research manager says he is impartial to these arguments. He acknowledges that in mid-August last year, the ringgit fell from RM3.80 to peak at RM4.40 before going up to RM3.80. The current trend appears to be mirroring this cycle.

"Even if these were signs of the start of another cycle moving towards its peak or trough it, the time span would have given sufficient cause for concern. Imagine having to endure months of weak ringgit." FocusM

US dollar borrowers to pay more for loans

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Kenanga says: "In terms of pre-tax profit, the auto segment saw compressed margins from higher import costs from unfavourable forex rates."

"We continue to see the adverse effects of high US dollar vs ringgit forex rates which go against Tan Chong's business model," Kenanga says.

Higher costs for content, IT and food products

For importers, ECS ICT Bhd, Berjaya Food Bhd and Astro Malaysia Holdings Bhd see profit margins affected by higher purchase costs.

ECS ICT, which imports and retails information and communication technology (ICT) products, secured the rights to distribute Apple's iPhone in August.

Despite being an importer, the fund manager says ECS ICT's margin may not see a significant impact as the retailer can adjust the selling price of its products.

When Apple introduced the iPhone 6 in 2014, the retail price of a 128G unit was RM3,149. The iPhone 7 smartphone is being retailed at RM3,699, even though both cost US$849 (RM3,552) in the US.

For Berjaya Food, its net profit fell 18.08% to RM5 mil for its quarter ended July 31. The company says the lower pre-tax profit was mainly due to the ringgit's depreciation which affected the profit margin of its Starbucks business.

This comes as Berjaya Food purchases raw material from Starbucks Corp (in US dollars), accounting for between 40 and 50% of Starbucks Malaysia's raw material cost.

For Q2 FY17 ended July 31, Astro's net profit declined 8.6% to RM125.42 mil from RM137.23 mil a year ago.

JF Apex Securities Bhd said Astro's earnings were impacted by expensive content due to the ringgit's depreciation.

Moving forward, the research report says Astro is confident its content cost will be between 32 and 35% of its annual revenue.

In addition to importers, corporations which borrowed in US dollars will also face difficulties with a falling ringgit as repayments became higher.

Some of the major US dollar borrowers include Axiata Group Bhd and AirAsia Bhd. Axiata's US dollar borrowings represent 55.75% or RM11.98 bil of its total borrowings.

Low-cost carrier AirAsia Bhd has 86.19% or RM9.26 bil of its borrowings denominated in the greenback.

– Ho Chung Teng FocusM

Gainers and losers from weak ringgit

Company	Ringgit affects	Revenue latest FY (RM '000)	Net profit latest FY (RM '000)	FY ended	Revenue latest PY (RM '000)	Net profit latest PY (RM '000)	Share Price on Oct 18 (RM)	Market cap (RM' mil)	52-week high (RM)	52-week low (RM)
GAINERS										
Top Glove Corporation Bhd	Exports products	2,888,515	362,762	08/16	2,510,510	281,192	4.97	6,225.93	7.03	4.20
Karex Bhd	Exports products	343,221	67,158	06/16	298,094	59,553	2.49	2,495.91	3.16	2.13
Vitrox Corp Bhd	Exports products	160,287	44,321	12/15	169,938	49,108	3.70	867.08	4.00	2.96
Unisem (M) Bhd	Exports products	1,260,425	155,539	12/15	1,038,279	68,422	2.63	1,929.98	2.77	1.94
Poh Huat Resources Holdings Bhd	Exports products	453,932	39,185	10/15	377,173	23,802	1.62	345.83	2.12	1.41
HeveaBoard Bhd	Exports products	503,309	73,571	12/15	422,355	30,176	1.43	705.26	1.79	1.04
Homeritz Corporation Bhd	Exports products	146,418	23,550	08/15	127,175	20,247	0.94	280.51	1.22	0.86
Latitude Tree Holdings Bhd	Exports products	770,956	72,725	06/16	710,000	77,812	5.24	509.37	8.10	4.62
Hartalega Holdings Bhd	Exports products	1,498,336	257,427	03/16	1,145,960	209,732	4.92	8,074.41	6.15	3.81
Kawan Food Bhd	Exports products	165,773	32,034	12/15	149,524	20,908	3.89	1,048.90	4.00	2.46
LOSERS										
UMW Holdings Bhd	Imports auto parts	14,441,583	(37,171)	12/15	14,932,490	651,970	5.95	6,951.35	8.40	4.88
Tan Chong Motor Holdings Bhd	Imports auto parts	5,716,654	74,865	12/15	4,760,628	105,853	1.95	1,240.06	2.98	1.83
ECS ICT Bhd	Imports products	1,903,299	32,488	12/15	1,591,117	29,432	1.47	264.60	1.78	1.43
Astro Malaysia Holdings Bhd	Purchases content	5,475,371	615,318	01/16	5,231,444	519,373	2.82	14,678.14	3.02	2.41
Berjaya Food Bhd	Imports raw material	554,363	21,290	04/16	376,780	177,574	1.81	679.13	2.65	1.23
AirAsia Bhd	US$ borrowings	6,297,658	541,194	12/15	5,415,744	82,836	2.84	7,903.36	3.30	1.26
Axiata Group Bhd	US$ borrowings	19,883,460	2,554,220	12/15	18,711,777	2,364,976	5.22	46,594.84	6.48	5.06
Maxis Bhd	US$ borrowings	8,600,573	1,738,952	12/15	8,388,502	1,717,442	6.01	45,136.78	6.89	5.36

Source: **Bursa Malaysia, Focus Malaysia**