Ringgit – An attractive positive carry to hold

BNM kept interest rates steady at 3.0% and remains accommodative. Ringgit's speed of appreciation is no surprise. It has breached out of the 4.1750/4.1950 range since 31st October and within 5 trading days, it has taken out 6 cents, with the currency now trading with a 4.13 handle. We have breached our year-end target of 4.1500 and the currency is on course to hit 4.100 which is our Q1 2020 target. We believe there will be a mix of profit taking and some Dollar accumulation as the currency retraces for cheap entry of purchasing Dollars. In the meantime Ringgit retrace is a welcome relief and the currency is now a very positive carry after adjusting for inflation.

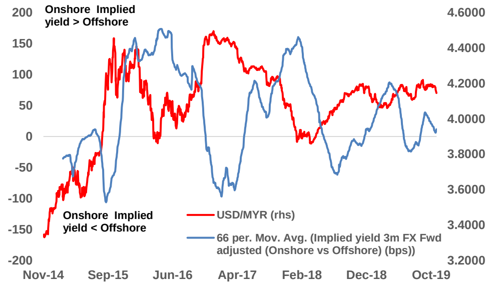
3m FX Fwd Implied Yield- Onshore takes upper hand

Two main drivers that has caused the Ringgit to retrace sharply and will remain a key driver for the currency in the short term. The divergence in monetary policy between the Fed and BNM is now playing out in the 3m FX FWD implied yield space, whereby the Dollar is gradually turning out as a low yield/funding currency while the Ringgit as a positive carry. The fact the implied yield interpolated via 3m FX Forwards are giving a better carry than the offshore 3m implied yield, indicates the Ringgit is an attractive proposition to hold as a positive carry in an environment of low inflation in Malaysia. We deem this interest rate differential play was a key driver in the recent sessions of Ringgit appreciation. Currently the spreads are roughly around 50/60 bps when averaged out over 3 months. (See chart 1)

Hedge Cost low, makes Ringgit attractive

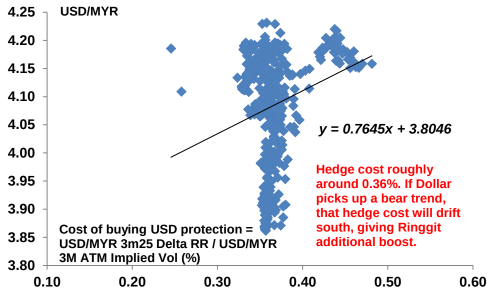
The other main driver we note for the Ringgit is the hedge cost where it's fetching 0.35% for a Dollar hedge trade. The 3m 25 Delta Risk Reversals vs the 3m ATM Implied Vol for USD/MYR is fetching at just under 0.5% and with the Dollar in a gradual trend lower, the cost of purchasing a Dollar call gets cheaper, since Dollar spot will be deemed a lot more cheap entry as an alternative. The cheaper Dollar hedge cost, gives the Ringgit more upside on a total return basis, (adjusted for hedge cost and inflation), thus further driving the idea that the Ringgit is gaining traction as a positive carry in the region (see chart 2).

Chart 1 - Spreads - 3m Implied yield, Onshore FX FWD vs Offshore) and USD/MYR



Source: Bloomberg, Reuters, RHBFIC

Chart 2- Hedge Cost lower, makes Ringgit attractive for the Positive Carry.



Source: Bloomberg, Reuters, RHBFIC

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