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From the Desk of CIO

PhillipMutual
It's a Matter of Trust

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Financial Piranhas Prey on Currencies

Financial piranhas smell blood among currencies. The aggressive hikes in US interest rates have been putting pressure on currencies of almost all countries. Many of them, including Malaysia, have been reluctant in raising interest rates aggressively and this has made their currencies less attractive vis-à-vis the US dollar (USD). Currency traders, in particular, hedge funds have been selling non-US currencies intensively, especially those that are slow in increasing interest rates such as the Euro and Japanese yen. The multiple times leverage on these currency trades have enabled these traders to gear up their bets. With their concerted efforts, currencies depreciate and cause negative sentiment on the market. Currencies that are not tradable outside the countries under exchange controls such as Chinese yuan and ringgit are also not spared as non-deliverable forward contracts (NDF) can also provide some indications on currency movement.

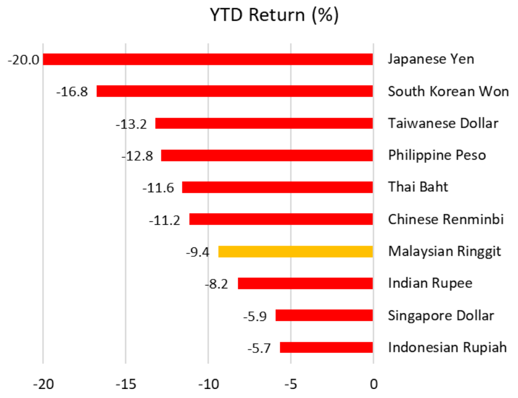
Former Prime Minister Dr. Mahathir accused George Soros, a renowned hedge fund trader for destroying our currencies during the Asian Financial Crisis in 1997/98. Together with other hedge funds and currency traders, they took the opportunities then to attack ASEAN currencies and led to domino effect in currency crisis starting from Thai baht. Hedge funds' response to Dr. Mahathir's remark back then was that if our government was able to manage the country finances well, traders would not have the opportunity to prey on our currency.

Acting as a group, these financial piranhas will always look for any signs of fiscal or monetary weakness in a country and create a bet on the financial weakness of the economy. With the addition of news stories from the media, they will create fear in the market and attempt to draw in more supporters to join the game. With these efforts, they managed to push the Sri Lanka economy to the brim of bankruptcy and shaken the economy of Laos.

It is common to see some central governments to dip into their foreign exchange (forex) reserves to support the domestic currencies and try to stop the predators from shorting their currencies further. These attempts will cause the forex reserves to fall but such actions are mostly in vain in mitigating the currency tsunami as the selling activities will return in the next wave.

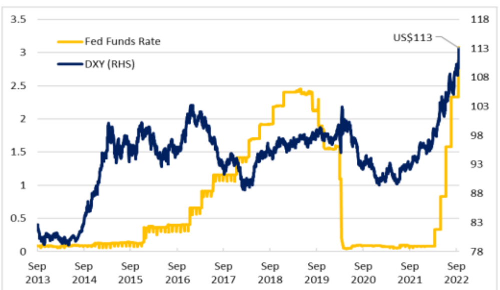
Instead of comparing how much our currency has depreciated against the USD, we should also examine how much ringgit has performed against our trading partners (*see Exhibit 1*). The increase in Fed funds rates will normally lift the USD higher. Interest rate is a basic driver of a currency. It is not unusual to see the USD to appreciate higher even before the rate hike (*see Exhibit 2*). In 2017, the USD subsequently dipped for a year even when the Fed was still raising the fed funds rates. Now the USD, as measured by DXY index, has surged to 113, much higher than its 103 high in 2016, as such will USD retreat while the Fed continues its rates hike until next year to tame the inflation?

Exhibit 1: Selected currencies performance vs USD



Source: Bloomberg, PCM, As at 26 Sep 22

Exhibit 2: USD moves in tandem with Fed rates



Source: TradingView, PCM, Sep ' 22