# Chapter 4: Research Results

## 4.1 Unit Root Test

a) For the 4 year period immediately before pegging of Ringgit Malaysia

i) Currency

Referring to the test results as enclosed in Appendix C, as the Augmented Dickey-Fuller test statistic in level having t-statistic of -1.223715, greater than the test critical values of -2.567333 at 1% level, -1.941148 at 5% level and -1.616481 at 10% level, we do not reject $H_0$. This means the currency exchange rate is non-stationary in level. As Durbin-Watson statistics is very close to 2, it is significant to reject the existence of autocorrelation.

Further unit root test is carried out in first difference. As the Augmented Dickey-Fuller test statistic in first difference having t-statistic of -11.39151, smaller than the test critical values of -2.567333 at 1% level, -1.941148 at 5% level and -1.616481 at 10% level, we reject $H_0$. This means the currency exchange rate is stationary in first difference, Currency~*I*(1). As the r-squared value obtained is not low, Durbin-Watson value, d, is about 2 and $r^2 > d$, the possibility of having autocorrelation problem and spurious regression is rejected.

ii) KLCI

As the Augmented Dickey-Fuller test statistic in level having t-statistic of –1.524354, more positive than the test critical values of -2.567314 at 1% level, -1.941145 at 5% level and -1.616483 at 10% level, we do not reject $H_0$. This means the stock price is non-stationary in level. As Durbin-Watson

statistics is very close to 2, it is significant to reject the existence of autocorrelation.

Further test is carried out in first difference to see whether the Kuala Lumpur Composite Index is stationary in first difference.

As the Augmented Dickey-Fuller test statistic in level having t-statistic of -26.51290, smaller than the test critical values of -2.567314 at 1% level, -1.941145 at 5% level and -1.616483 at 10% level, we reject $H_0$. This means the stock price is stationary in first difference, KLCI~*I*(1). As the r-squared value obtained is not low, Durbin-Watson value, d, is about 2 and $r^2 > d$, the possibility of having autocorrelation problem and spurious regression is rejected.

b) For the period of approximately 4 years immediately after depegging of Ringgit Malaysia

i) Currency

As the Augmented Dickey-Fuller test statistic in level having t-statistic of -0.800105, greater than the test critical values of -2.567333 at 1% level, -1.941148 at 5% level and -1.616481 at 10% level, we do not reject $H_0$. As Durbin-Watson statistics is very close to 2, it is significant to reject the existence of autocorrelation. This implies that the currency exchange rate is non-stationary in level.

Further test is carried out as follows to check whether currency exchange rate is stationary in first difference. As the Augmented Dickey-Fuller test statistic in level having t-statistic of -31.12161, more negative than the test critical values of -2.567336 at 1% level, -1.941148 at 5% level and -

1.616481 at 10% level, we reject $H_0$. This means the currency exchange rate is stationary in first difference, Currency~*I*(1). As the r-squared value obtained is not low, Durbin-Watson value, d, is about 2 and $r^2 > d$, the possibility of having autocorrelation problem and spurious regression is rejected.

ii) KLCI

As the Augmented Dickey-Fuller test statistic in level having t-statistic of –0.093249, more positive than the test critical values of -2.567341 at 1% level, -1.941149 at 5% level and -1.616480 at 10% level, we do not reject $H_0$. As Durbin-Watson statistics is very close to 2, we can reject the existence of autocorrelation. This means the stock price is non-stationary in level.

Further test is carried out in first difference to see whether Kuala Lumpur Composite Index is stationary in first difference. As the Augmented Dickey-Fuller test statistic in level having t-statistic of -15.87933, smaller than the test critical values of -2.567341 at 1% level, -1.941149 at 5% level and -1.616480 at 10% level, we reject $H_0$. This means the stock price is stationary in first difference, KLCI~*I*(1). As the r-squared value obtained is not low, Durbin-Watson value, d, is about 2 and $r^2 > d$, the possibility of having autocorrelation problem and spurious regression is rejected.

The above test results show that the time series for the stock price and the currency exchange rate for the two different periods before pegging and after depegging of Ringgit Malaysia are all non-stationary in level and stationary in first difference as summarized below:

| Before pegging of Ringgit Malaysia (5 September 1994 - 2 September 1998) | |
|---|---|
| In level | Unit root test |
| KLCI | Non-stationary |
| CURRENCY | Non-stationary |
| At first difference | Unit root test |
| KLCI | Stationary |
| CURRENCY | Stationary |
| After depegging of Ringgit Malaysia (21 July 2005 - 5 July 2009) | |
| In level | Unit root test |
| KLCI | Non-stationary |
| CURRENCY | Non-stationary |
| At first difference | Unit root test |
| KLCI | Stationary |
| CURRENCY | Stationary |

Table 4.1.1 Summary of unit root test for the period of before pegging and after depegging of Ringgit Malaysia

Fulfilling the pre-requisites for cointegration test, we can now proceed to Engle-Granger Cointegration Test.

## 4.2 Engle-Granger Cointegration Test

As the ordinary least squares regressions for variables of stock price and currency exchange rate are repetition of regressions in finding the coefficient of correlation between the two variables, the same regression analysis will not be repeated here. Please refer Figures 4.4.1 and 4.4.2.

We now proceed to the unit root test results to determine whether the two time series are cointegrated for the two periods under study. Please refer Appendix D for the Engle-Granger Cointegration Test results

a) For the 4 year period immediately before pegging of Ringgit Malaysia

The result shows the residuals having t-statistic of -2.012880, more negative than the critical values at 5% and 10% at -1.941145 and -1.616483 respectively, but greater than the critical value of 1% at -2.567312. As Durbin-Watson statistics is very close to 2, we can reject the existence of autocorrelation.

As both KLCI~*I*(1) and Currency~*I*(1), and regression produces an *I*(0) error term, it is therefore concluded that the stock price and movement of Ringgit Malaysia was cointegrated at 5% level for the 4 year period immediately before pegging of Ringgit Malaysia.

b) For the 4 year period immediately before pegging of Ringgit Malaysia

The result shows the residuals having t-statistic of -1.719522, more negative than the critical values at 10% of -1.616481, but greater than the critical value of 1% and 5% at -2.567333 and -1.941178 respectively. As Durbin-Watson statistics is close to 2, we can reject the existence of autocorrelation.

As both KLCI~*I*(1) and Currency~*I*(1), and regression produces an *I*(0) error term, it is therefore concluded that the stock price and movement of Ringgit Malaysia was cointegrated at 10% level for the 4 year period immediately after depegging of Ringgit Malaysia.

The results of Engle-Granger cointegration test is summarised as follows:

| Before pegging of Ringgit Malaysia (5 September 1994 - 2 September 1998) |
|---|
| Cointegrated at 5% level of significance |
| After depegging of Ringgit Malaysia (21 July 2005 - 5 July 2009) |
| Cointegrated at 10% level of significance |

Table 4.2.1 Summary of Engle-Granger Cointegration Test results

## 4.3 Granger Causality Test

Granger causality test can be conveniently performed using Eviews by selecting both the variables to be tested i.e. stock price and currency

exchange rate in first difference and entering the desired lag. The results obtained are tabulated as follows:

| Before pegging of Ringgit Malaysia (5 September 1994 - 2 September 1998) | | |
|---|---|---|
| Null hypothesis, $H_0$ | Lag | p-value |
| DCURRENCY does not Granger cause DKLCI | 1 | 0.45622 |
| | 2 | 0.34567 |
| | 3 | 0.43047 |
| | 4 | 0.17720 |
| | 5 | 0.28460 |
| | 6 | 0.28208 |
| | 7 | 0.37774 |
| | 8 | 0.41980 |
| | 9 | 0.50372 |
| | 10 | 0.60063 |
| | 11 | 0.66814 |
| | 12 | 0.74433 |
| | 13 | 0.81349 |
| | 14 | 0.84550 |
| | 15 | 0.38582 |
| | 16 | 0.36513 |
| | 17 | 0.42797 |
| | 18 | 0.35164 |
| | 19 | 0.38780 |
| | 20 | 0.40748 |
| | 21 | 0.47376 |
| | 22 | 0.52920 |
| | 23 | 0.54543 |
| | 24 | 0.52973 |

Table 4.3.1: Granger Causality Test (CURRENCY Granger Cause KLCI) for the period before pegging of Ringgit Malaysia

| Before pegging of Ringgit Malaysia (5 September 1994 - 2 September 1998) | | |
|---|---|---|
| Null hypothesis, $H_0$ | Lag | p-value |
| DKLCI does not Granger cause DCURRENCY | 1 | 0.12068 |
| | 2 | 0.15526 |
| | 3 | 0.25597 |
| | 4 | 0.42772 |
| | 5 | 0.59355 |
| | 6 | 0.44320 |
| | 7 | 0.28844 |
| | 8 | 0.01266 |
| | 9 | 0.00412 |
| | 10 | 0.00733 |
| | 11 | 0.00241 |
| | 12 | 0.00214 |
| | 13 | 0.00373 |
| | 14 | 0.00600 |
| | 15 | 0.00578 |
| | 16 | 0.00186 |
| | 17 | 0.00207 |
| | 18 | 0.00020 |
| | 19 | 0.00025 |
| | 20 | 0.00038 |
| | 21 | 0.00032 |
| | 22 | 0.00044 |
| | 23 | 0.00065 |
| | 24 | 0.00100 |

Table 4.3.2: Granger Causality Test (KLCI Granger Cause CURRENCY) for the period before pegging of Ringgit Malaysia

From the results above for the period before pegging of Ringgit Malaysia, it can be seen that at 5% level of significance, the currency exchange rate did not Granger cause stock price in first difference but on the other hand, the stock price did discernibly Granger cause the currency exchange rate with lag of eight trading days and onwards.

| After depegging of Ringgit Malaysia (21 July 2005 - 5 July 2005) | | |
|---|---|---|
| Null hypothesis, $H_0$ | Lag | p-value |
| DCURRENCY does not Granger cause DKLCI | 1 | 0.14203 |
| | 2 | 0.28235 |
| | 3 | 0.40036 |
| | 4 | 0.54061 |
| | 5 | 0.30709 |
| | 6 | 0.32154 |
| | 7 | 0.19366 |
| | 8 | 0.26506 |
| | 9 | 0.15705 |
| | 10 | 0.15089 |
| | 11 | 0.20695 |
| | 12 | 0.23868 |
| | 13 | 0.17585 |
| | 14 | 0.05714 |
| | 15 | 0.07725 |
| | 16 | 0.08624 |
| | 17 | 0.10609 |
| | 18 | 0.13786 |
| | 19 | 0.09583 |
| | 20 | 0.08807 |
| | 21 | 0.11629 |
| | 22 | 0.11003 |
| | 23 | 0.09971 |
| | 24 | 0.12172 |

Table 4.3.3: Granger Causality Test (CURRENCY Granger Cause KLCI) for the period after depegging of Ringgit Malaysia

| After depegging of Ringgit Malaysia (21 July 2005 - 5 July 2005) | | |
|---|---|---|
| Null hypothesis, $H_0$ | Lag | p-value |
| DKLCI does not Granger cause DCURRENCY | 1 | 0.46864 |
| | 2 | 0.55531 |
| | 3 | 0.13654 |
| | 4 | 0.18880 |
| | 5 | 0.27974 |
| | 6 | 0.28376 |
| | 7 | 0.37110 |
| | 8 | 0.40454 |
| | 9 | 0.26814 |
| | 10 | 0.23179 |
| | 11 | 0.25333 |
| | 12 | 0.29317 |
| | 13 | 0.30984 |
| | 14 | 0.32456 |
| | 15 | 0.36880 |
| | 16 | 0.41418 |
| | 17 | 0.51019 |
| | 18 | 0.57964 |
| | 19 | 0.64694 |
| | 20 | 0.35860 |
| | 21 | 0.20379 |
| | 22 | 0.25222 |
| | 23 | 0.11804 |
| | 24 | 0.14167 |

Table 4.3.4: Granger Causality Test (KLCI Granger Cause CURRENCY) for the period after depegging of Ringgit Malaysia

The results above reveal that at 5% level of significance, neither stock price nor currency exchange rate Granger cause the other variable for the period after depegging of Ringgit Malaysia. In other words, these two variables are independent in term of causality relationship.

## 4.4 Coefficient of Correlation and Coefficient of Determination

a) For the 4 year period immediate before pegging of Ringgit Malaysia

Please refer Appendix E for the regression results of KLCI against CURRENCY. As the problem of serial correlation is observed from the Durbin-Watson statistics, the model is rectified using Newey-West method and the results obtained is as follows.

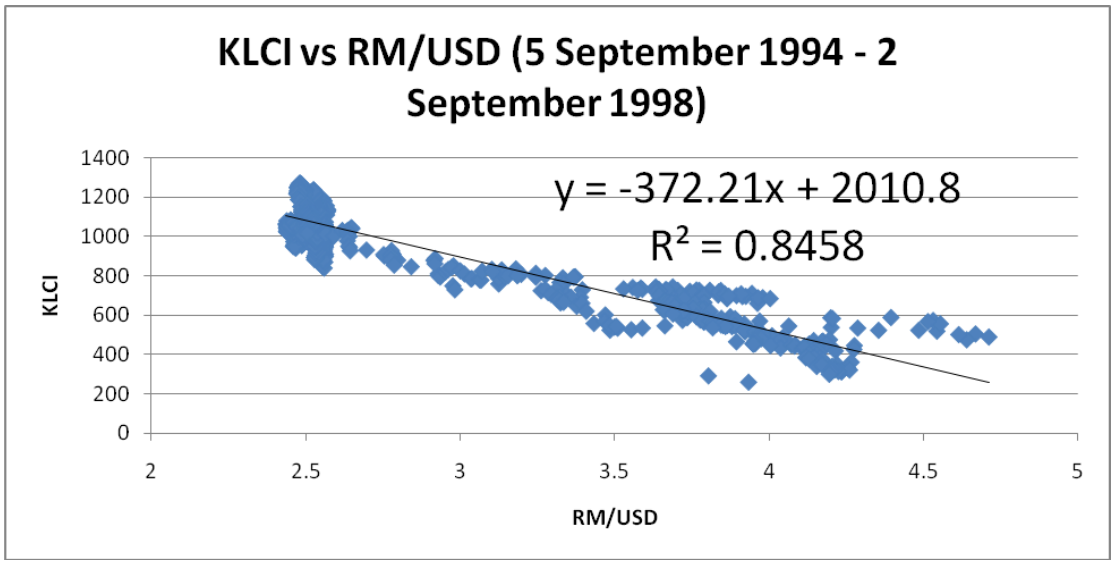


Figure 4.4.1: Regression of KLCI against CURRENCY for the period before pegging of Ringgit Malaysia

From the regression analysis, as the p-value for currency is almost zero, it can be concluded that there is statistically significant relationship between stock price and currency exchange rate. The coefficient of correlation of -0.9197 shows that the stock price and strength of Ringgit Malaysia are strongly and positively correlated (the sign for the coefficient of correlation is negative but as the currency exchange rate of Ringgit Malaysia against US Dollar is in direct quote, the stock price and strength of Ringgit Malaysia is positively correlated) for the period of 4 years immediate before pegging of Ringgit Malaysia. The result also indicates that about 85% of the

variation in the stock price can be explained by the variation in Ringgit Malaysia.

Similar to the above, the problem of serial correlation is observed from the Durbin-Watson statistics, the model is rectified using Newey-West method and the results obtained is as follows.

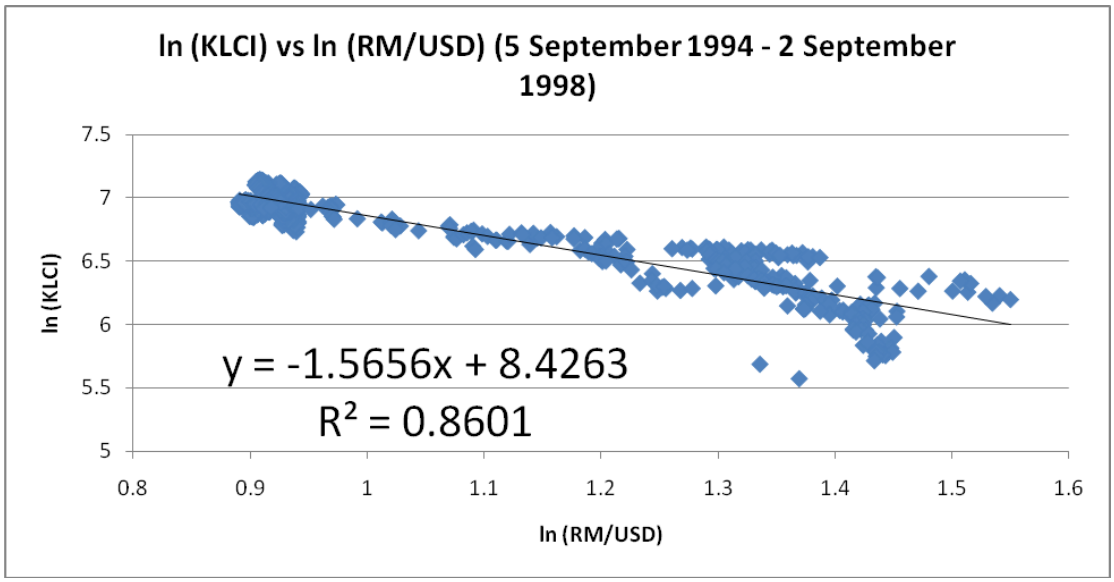

Figure 4.4.2: Elasticity of KLCI against CURRENCY for the period before pegging of Ringgit Malaysia

From the result of the above log-linear model, one (1) percent of strengtening (weakening) of the Ringgit Malaysia is expected to see corresponding 1.5656% of gain (loss) in stock price.

b) For the period of approximately 4 years after depegging of Ringgit Malaysia

As for the period before pegging of Ringgit Malaysia, the problem of serial correlation is observed from the Durbin-Watson statistics, the model is rectified using Newey-West method and the results obtained is as follows.

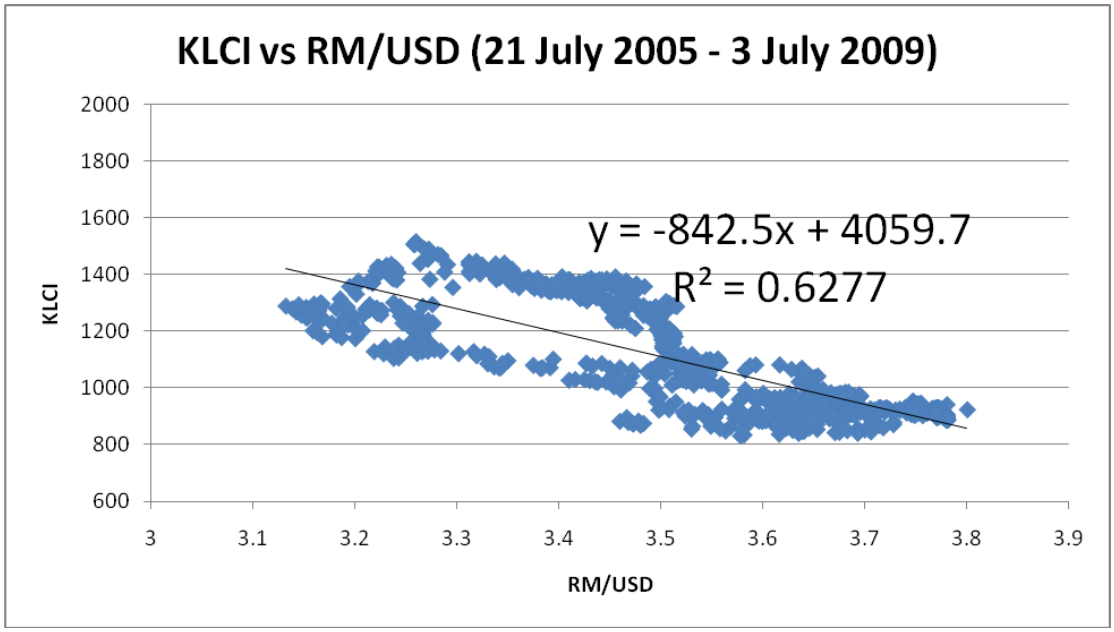


Figure 4.4.3: Regression of KLCI against CURRENCY for the period after depegging of Ringgit Malaysia

As the p-value for currency is almost zero, it can be concluded that there is statistically significant relationship between stock price and currency exchange rate. The coefficient of correlation of -0.7923 shows that the stock price and strength of Ringgit Malaysia are strongly and positively correlated for the period of about 4 years immediate after depegging of Ringgit Malaysia. The result also indicates that about 63% of the variation in the stock price can be explained by the variation in Ringgit Malaysia.

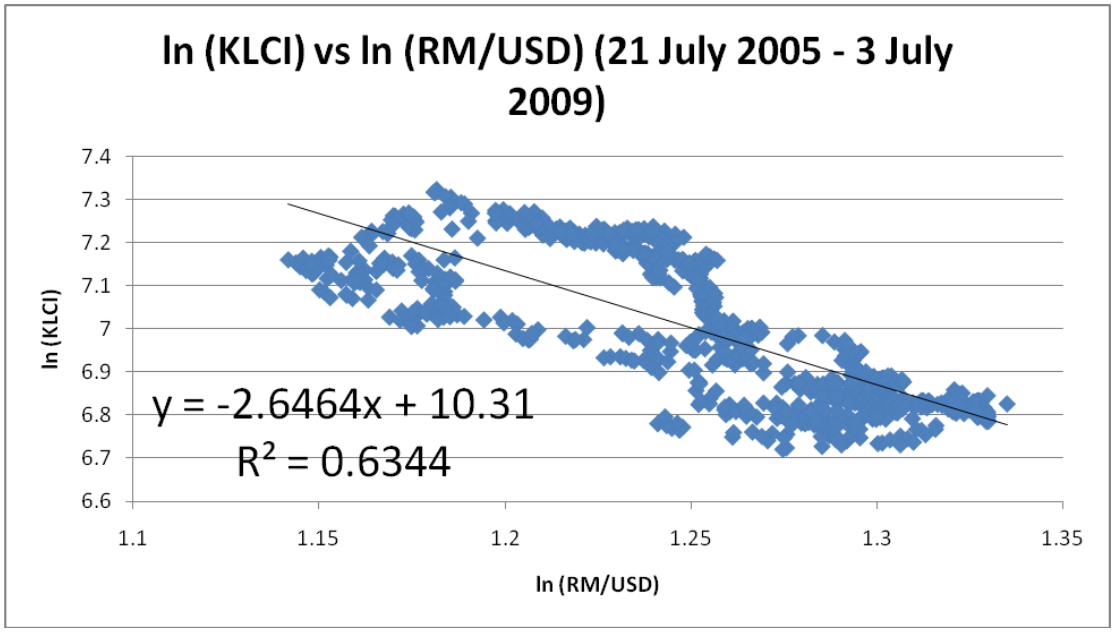


Figure 4.4.4: Elasticity of KLCI against CURRENCY for the period after depegging of Ringgit Malaysia

From the result of the above log-linear model, one (1) percent of strengtening (weakening) of the Ringgit Malaysia is expected to see corresponding 2.6464% of gain (loss) in stock price.

The results obtained from regressing the stock price against currency exchange rate are summarised as follows:

| Before pegging of Ringgit Malaysia (5 September 1994 - 2 September 1998) | | |
|---|---|---|
| | $r^2$ | r |
| KLCI = -372.2086CURRENCY + 2010.784 | 0.845808 | -0.919678 |
| LKLCI = -1.565607LCURRENCY + 8.426336 | 0.860061 | -0.927395 |
| After depegging of Ringgit Malaysia (21 July 2005 - 5 July 2009) | | |
| | $r^2$ | r |
| KLCI = -842.4989CURRENCY + 4059.716 | 0.627683 | -0.792264 |
| LKLCI = -2.646427LCURRENCY + 10.31019 | 0.634409 | -0.796498 |

Table 4.4.1: Summary of regression of KLCI against CURRENCY and elasticity of KLCI against CURRENCY for the period before pegging and after depegging of Ringgit Malaysia

## 4.5 Discussion

The unit root test conducted showed that the stock price and currency exchange rate for the two periods were all non-stationary in level but stationary in first difference. According to study on the stock return and currency exchange rate for seven East Asian countries by Pan, Fok & Liu (2007), this was not uncommon particular in those countries. This was largely caused by the fluctuation at Bursa Malaysia, particularly during the periods when the stock market underwent volatile and significant movement in stock price and currency exchange rate that took place during Asia financial crisis, bullish stock market before global financial crisis in year 2008 and the subsequent severe global financial turmoil. This made the series having non-constant but changing means, variance and autovariance, and thus catagorised as non-stationary series. From the results and Figure 1.1.1 and Figure 1.1,2, the stock price and currency exchange rate moved in a manner of random walk series.

Comparing the two periods, the variables were cointegrated at 5% level of significance before pegging of Ringgit Malaysia and the co-movement between the two variables had become less significant after depegging of Malaysia Ringgit as they were cointegrated at 10% level of significance.

Meanwhile, the regression results showed the two variables were strongly correlated with coefficients of correlation of -0.919678 and -0.792264 respectively for the period before pegging of Ringgit Malaysia and after depegging of Ringgit Malaysia (against -0.59 as studied by Yahya (1998) for 1 year period of year 1997). High coefficients of determination, 0.919678 and 0.792264 for the same two periods respectively coupled with high significance

of the independent variable in the equation signify the importance of the currency exchange rate in determining the stock price.

From the log-linear model regression, the magnitude of elasticity of stock price with respect to currency exchange rate had increased from -1.565607 to -2.646427 for the period before pegging of Ringgit Malaysia compared to the period after depegging of Ringgit Malaysia. This can be explained as the fluctuation of currency exchange rate relative to stock price after depegging of Ringgit Malaysia was much gentler than the very volatile movement of Ringgit Malaysia during the period before pegging of Ringgit Malaysia.

In term of causality relationship, the variables were found to be independent after depegging of Ringgit Malaysia. However, for the period of before pegging of Ringgit Malaysia, first difference of stock price Granger caused first difference of currency exchange rate for lag with 8 trading days and above.

From the various statistical tests conducted, the observations for each individual test were highlighted as above. Comparisons were made as well to see whether there is any structural shift in the relationship for the two different periods under study to examine whether there were impacts arising from the implementation of capital control and/ or pegging of Malaysia Ringgit. More importantly, the purpose of having several different statistical tests on these two variables in the study is to examine and compare the relationship more thoroughly from various aspects to have more comprehensive understanding of the relationship. Besides knowing “what” happened to the relationship as discussed above, it will be imperative to find out “how” it happened and

possibly “why” it happened by combining the results as a whole, as elaborated below.

The unilateral causality from stock market to currency exchange rate can be explained by portfolio balance approach which says that the stock price can influence currency exchange rate. This met the behavior of the relationship between these two variables. Firstly, the stock price and strength of Ringgit Malaysia moved in common direction. Both stock market and Ringgit Malaysia declined sharply during Asian financial crisis, as much as 75% in stock market and 45% in Ringgit Malaysia against US Dollar. Secondly, the sudden dislocation of demand in equities because of herding behavior and loss of confidence in the economy triggered panic selling which subsequently led to sharp drop in stock market and caused high capital outflow, setting off sudden surge in supply for the country’s currency against little demand, and thus sharp decline in the value of Ringgit Malaysia.

It was noted that the unilateral causality relationship from stock price to currency exchange rate happened during that period existed only for relationship with lag of eight trading days and greater. This could possibly be explained by time period required to receive the sales proceeds pending completion of T+5 (5 trading days after transaction) trading cycle and clearance of float required for the sales proceeds to be deposited into sellers’ account. The change in settlement cycle for trading of securities at Bursa from T+5 trading days to T+3 trading days was implemented on 20 December 2000[15].

[15] Source: Sinnakkannu & Nasir (2006), Market Microstructure Changes and Time to Equilibrium (TTE)? Evidence Bursa Malaysia, page 34.

An important aspect to be zoomed into is the indication of the Ringgit movement has less significance of influence in stock price in later period. This can be seen from the lower significance in term of coefficient of correlation, coefficient of determination, degree of cointegration, and causality relationship. One of the likely reasons for this scenario was due to reduction in investment participation by foreign funds in Malaysia, thus reducing foreign portfolio investment in the stocks and led to lower causal relationship between stock price and currency exchange movement. As a result, the local stock price becomes more local driven and the effect from portfolio balance approach on stock price has been fading. Some supporting evidences of reduction in foreign participant in Malaysia market are elaborated below.

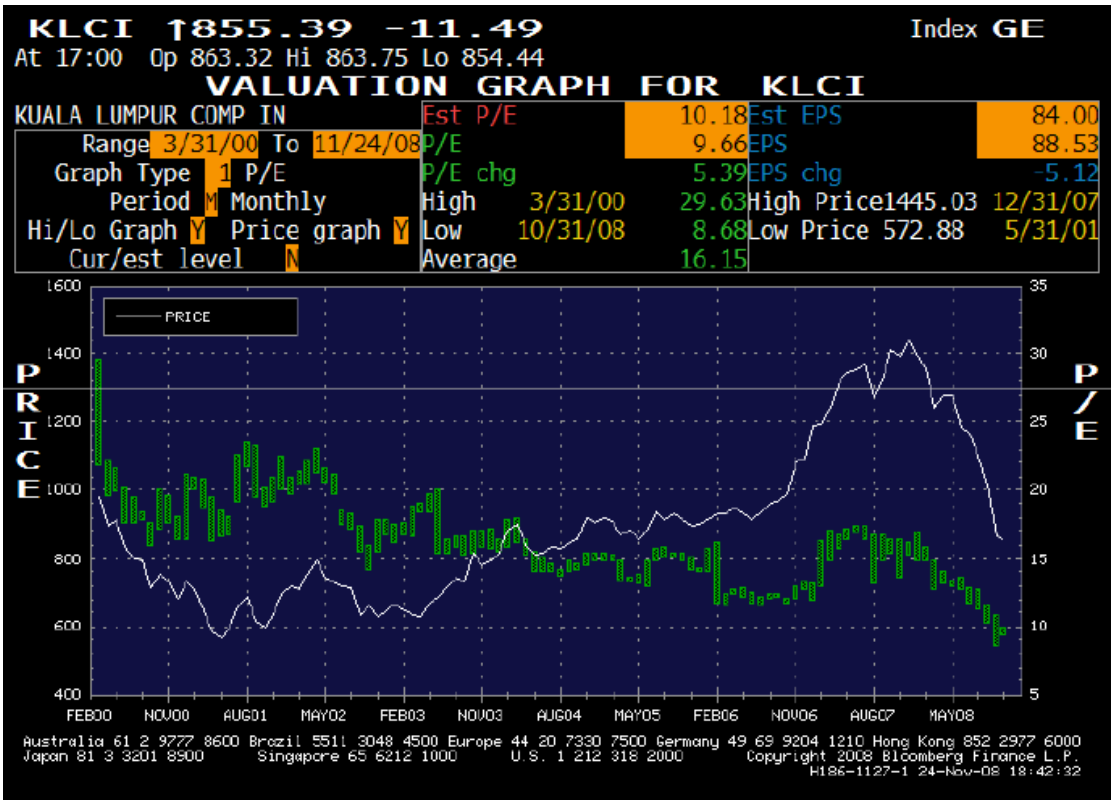


Figure 4.5.1: Historical price/ earning ratio of KLCI[16]

[16] Source: Obtained from Bloomberg Terminal on 24 November 2008

As capital market in Malaysia is considered small[17], movement of foreign fund into/ away from the local market will have noticeable impact on the movement of KLCI. As can be seen from Figure 4.5.1 above, valuation of the stock market in term of price/ earning ratio has dropped over the time, an indication of drop in demand for local equities, particularly by foreign investors, which had contributed to the derating of KLCI valuation. As highlighted by Kawai & Takagi (2003), while Malaysia had enjoyed net inflows of portfolio capital on an annual basis between 1992 and 1996, before pegging of Ringgit Malaysia, Figure 4.5.2 below shows that the foreign shareholding generally decreasing gradually over time after pegging the currency (even though foreign ownership had picked up slightly since year 2003 till year 2007).

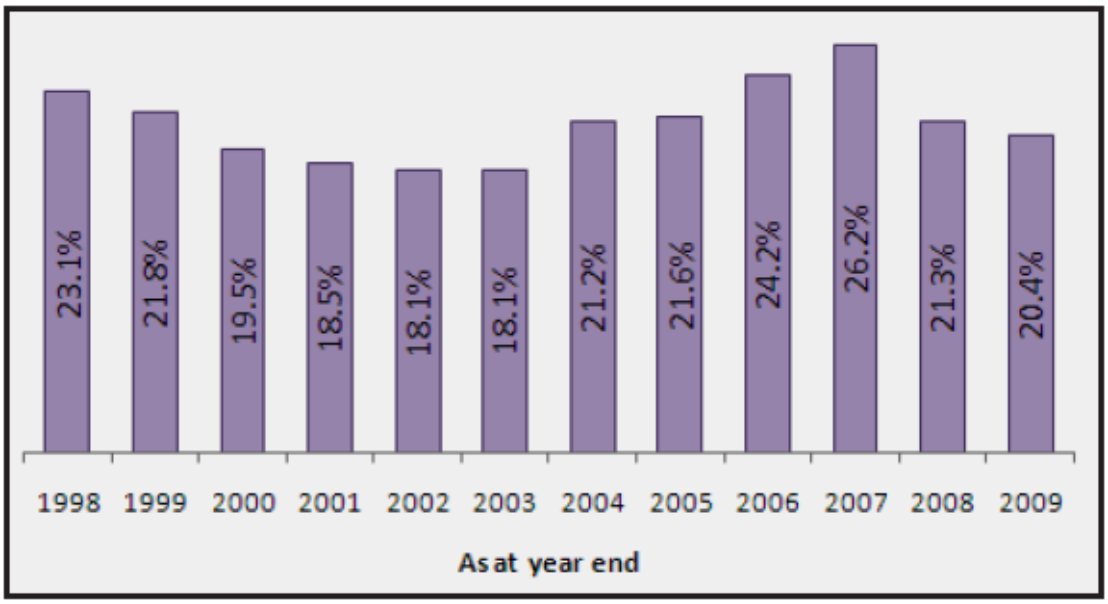


Figure 4.5.2: Foreign ownership based on Market Capitalisation[18]

[17] Source: Obtained from Bloomberg Terminal on 24 November 2008 that Malaysia's market capitalization made up 0.47% of world market capitalization.
[18] Source: BursaBytes fourth quarter 2009, publication of Bursa Malaysia Berhad. http://bursa.listedcompany.com/newsroom/BursaBytes_4Q09.pdf

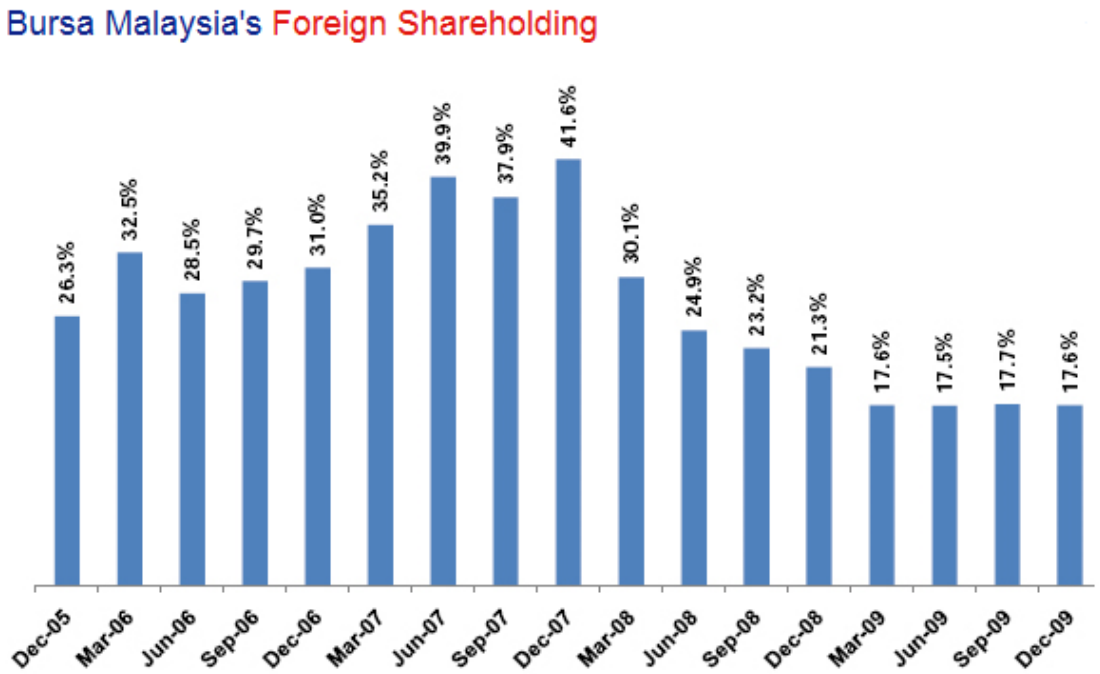


Figure 4.5.3: Bursa Malaysia's Foreign Shareholding[19]

By looking only at the statistics of Malaysia markets may not be able to capture the actual scenario. To have clearer picture of the situation, reference and comparison are made to some figures of other bourses within Asia-Pacific region, in term of number of listed company, market capitalization and average daily trade value, as tabulated in the table below.

| Country | No. of listed companies | | Total market capital (RM bil) | | Average daily transacted value (RM mil) | |
|---|---|---|---|---|---|---|
| | End of Year | | End of Year | | Year | |
| | 1999 | 2008 | 1993 | 2008 | 1993 | 2008 |
| Australia | 1287 | 2009 | 202.0 | 683.9 | 271.2 | 4853.0 |
| Malaysia | 752 | 976 | 219.8 | 189.1 | 594.2 | 375.1 |
| Hong Kong | 708 | 1261 | 385.0 | 1328.8 | 529.1 | 6519.1 |
| Indonesia | 276 | 396 | 32.8 | 98.8 | 36.4 | 437.7 |
| South Korea | 712 | 1793 | 139.6 | 470.8 | 847.9 | 5729.9 |
| New Zealand | 189 | 172 | 24.6 | 24.3 | 27.2 | 72.3 |
| Philippines | 226 | 246 | 40.1 | 52.0 | 39.4 | 68.4 |
| Singapore | 408 | 767 | 135.1 | 265.0 | 334.1 | 1039.5 |
| Taiwan | 462 | 722 | 193.3 | 356.7 | 1410.5 | 3318.4 |

[19] Source: Bursa Malaysia Bhd official website. http://www.bursamalaysia.com/website/bm/about_us/investor_relations/shareholderings/foreign_shareholding.html

| | | | | | | |
|---|---|---|---|---|---|---|
| Thailand | 392 | 525 | 127.5 | 103.1 | 355.2 | 463.9 |
| Japan | 1935 | 2390 | 2906.3 | 3115.8 | 3171.9 | 22429.3 |

Table 4.5.1: Comparison of major bourses in Asia Pacific Region[20]

Major bourses had significant increase in average daily transacted value with some markets enjoying more than 1000% growth between year 1993 and year 2008, except Malaysia, the only country that saw average transaction value dropped. Except New Zealand, the number of listed companies were higher in year 2008 compared to that of year 1999. However, among these countries which had higher number of listed companies, Malaysia and Thailand were the only two countries that recorded drop in market capital in year 2008 compared to year 1993.

A remisier from Ambank Investment Group was interviewed for his opinion on this phenomenon. He opined that the lackluster in Malaysia stock market was probably due to imposition of capital control and the situation had not really recovered even after the capital control had been lifted[18].

All the above were indications that the Malaysian stock market, once foreign investors' favourite, is losing its appeal to other emerging countries in attracting foreign portfolio investment. The market with bigger foreign participation during earlier period witnessed the stock price affected the currency movement. After imposition of capital control and pegging, and subsequent lifting of the measures (except internationalise of Ringgit of Malaysia), reduction in flow of investment fund and participation of foreign investors could likely be one of the reasons to explain why the relationship between stock price and currency exchange rate has become less correlated and cointegrated after depegging of Ringgit Malaysia as the stock market

[20] Source: The table was abstracted from business section of Nanyang Siang Pau dated 27 July 2009. The data was compiled by the president of The Remisiers Association of Malaysia (Persama), Mr. Sam Ng Soon Lee

become less foreign participation and become more local driven by domestic funds.

Another significant difference between these two periods was that Malaysia's financial position was much stronger than before in term of current account balance and Malaysia's international reserve as illustrated in the charts below. As shown in Figure 4.5.4 below, Malaysia has been enjoying current surplus since more than a decade ago.

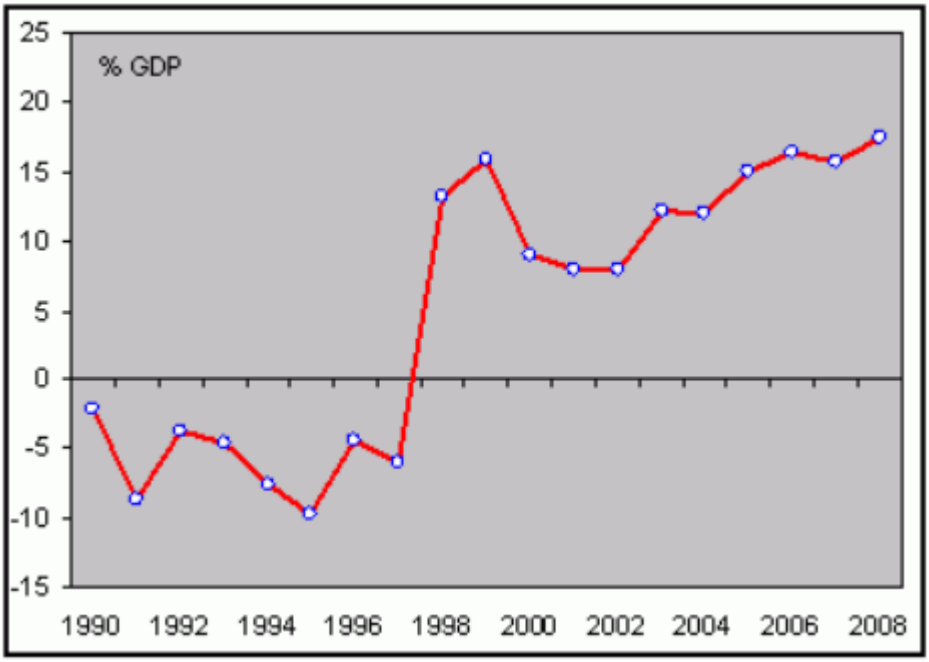


Figure 4.5.4: Malaysia's Current Account Balance[21]

Meanwhile, the times of import cover of Malaysia's International Reserve has been on an uptrend since the change of administration at Putrajaya in year 2003 with new country premier being more cautious in spending[22], particular construction of mega projects. As a result, Malaysia's net international reserve had been growing and the country is in very much strong position compared to that in year 1998 where the country was on a

[21] Figure obtained from icapital newsletter dated 21 August 2009. http://www.icapital.biz
[22] Sources: Singapore Straits Times article dated 31 August 2006 "KL Govt Spending Expected to Rise in New Budget" by Malaysia Bureau Chief, Reme Ahmad

brink of bankruptcy as the net international reserve was merely above the level of short-term external debt.

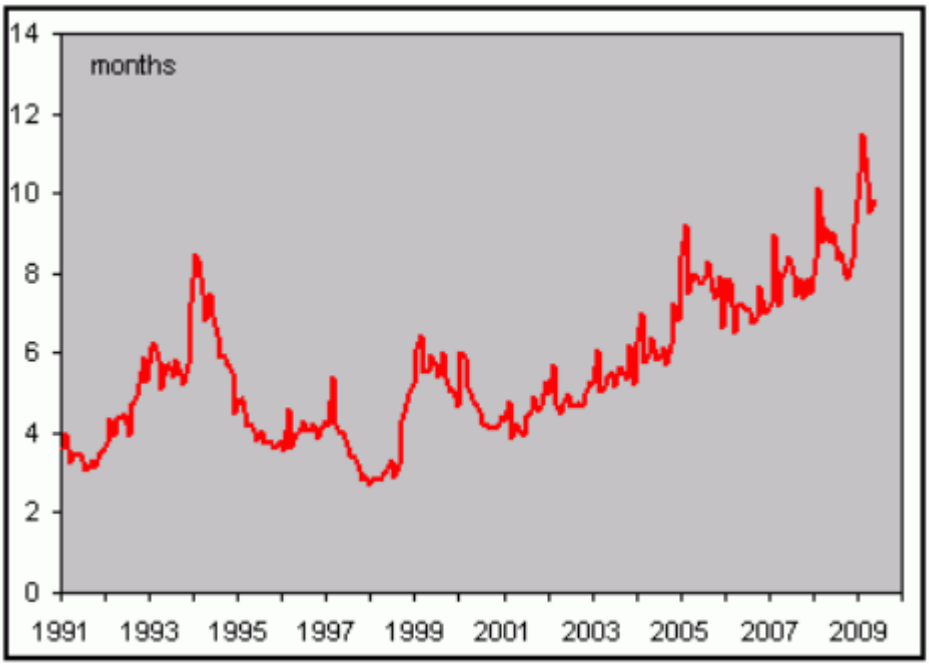


Figure 4.5.5: Import Cover of Malaysia's International Reserve[9]

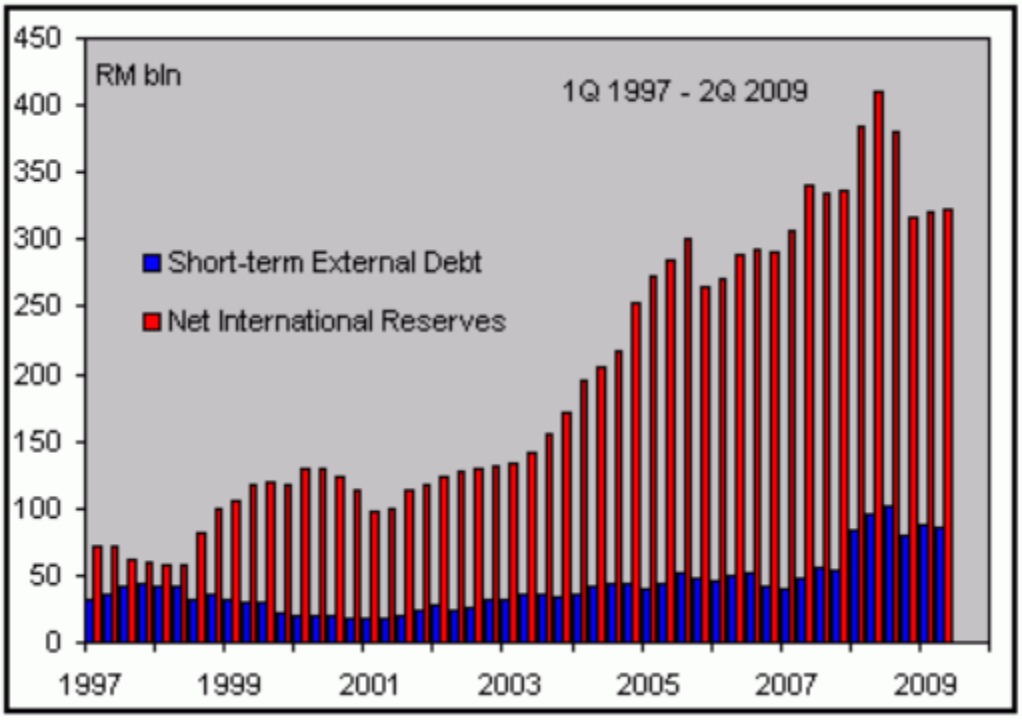


Figure 4.5.6: Malaysia's short-term debt against net international reserves[23]

[23] Figure abstracted from Icapital newsletter dated 11 September 2009. http://www.icapital.biz

Another reason for the change in the relationship between stock price and currency exchange rate was that the financial position of Malaysia is much stronger than before. The issue of current account deficit and ability to repay short-term external debt is not a real concern after depegging of Malaysia Ringgit. Therefore, Ringgit Malaysia is less volatile and has less influence on the stock price than before. The performance of stock price is now more related to country's economy performance, companies' earning performance and political stability.

Last but not least, even though capital control and pegging of Ringgit Malaysia had been lifted, compared to previous period before pegging of Ringgit Malaysia, offshore trading of Ringgit Malaysia is still not allowed, or in another words, the Ringgit Malaysia is not fully convertible. This restriction has more or less become a barrier in attracting foreign portfolio investment into Malaysia as the fear of capital control, even though the capital control had been lifted, it is still a concern to some foreign investors, particularly when one of Malaysia former Prime Ministers commented that Malaysia may re-impose capital control if the need arises[24]. Besides, the foreign funds have some alternatives to invest in other attractive regional emerging countries that offer high economy growth, as commented by an economist in Citigroup Inc. that "Malaysia has lagged behind some Southeast Asian nations in attracting investment and removing the non- internationalization policy will encourage more flows into the country."[25]

[24] Source: BFM radio station interview with Dennis Lim, CEO of Templeton Asset Management Ltd on 20 May 2010.
[25] Source: The Star news article "Offshore ringgit trading ban may be lifted" dated 24 October 2007. http://biz.thestar.com.my/news/story.asp?file=/2007/10/24/business/19253362&sec=business