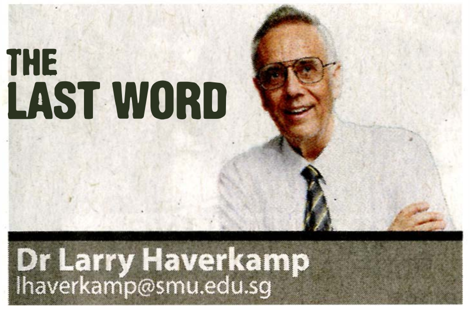
Publication: The Sunday Times, Classified, p C18
Date: 26 April 2015
Headline: Everything you need to know about Forex



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Everything you need to know about Forex

HAVE you seen how cheap the Malaysian ringgit is?

Well, that is the popular perception, but it probably hasn't declined as much as you think. Two years ago, one Singapore dollar would buy 2.45 ringgit.

Now, it buys 2.70 ringgit, so the decline was 10 per cent over two years. The perception, I think, is that the ringgit has dropped more and it has, but against the US dollar.

The Singapore dollar also declined against the US dollar, but not as much and so in relative terms, our currency appreciated relative to the ringgit. (Did you catch all that?)

Lately, we have seen a new phenomenon: The world's currencies are in a "race to the bottom" as each tries to out-devalue the others. It is no longer enough for a country to devalue its currency. It needs to do it more than other countries.

The goal is to make everything in your country less expensive so foreigners have an incentive to buy more. That will increase exports and boost the economy.

PPP = Purchasing Power Parity

Recent currency movements aren't the whole story since the ringgit has always been a bargain. A good way to see this is in the PPP, which is short for "Purchasing Power Parity".

PPP says that exchange rates should reflect the relative price of identical goods in two countries. Suppose you have a Big Mac hamburger that costs $6 in Malaysia and $2 in the US. Then the correct exchange rate is 3:1.

It is fair since it wouldn't matter if you purchased your Big Mac with US dollars in the US or with ringgit in Malaysia. A 3:1 exchange rate means you would spend the same amount in either country and get the same delicious hamburger.

The Big Mac index is a whimsical tool developed by The Economist magazine in 1986. It became so popular (and accurate) that The Economist has updated it semi-annually in an interactive chart. Use Google to find "Big Mac Index".

The site shows a great deal, including which currencies are over and under-valued. The ringgit is the world's fourth most under-valued currency, which makes everything you buy in Malaysia a bargain. The index shows your ringgit purchases are worth about twice what they would cost if you bought the same thing in the US with US dollars.

Other under-valued currencies are the Indian rupee, the Russian ruble, and the Ukrainian hyrvnia. But there are good reasons those are under-valued (like Russia and Ukraine are at war) which makes the stability of Malaysia and its currency even more of a bargain.

As for over-valued currencies, they are less common with the Swiss franc being the world's most expensive. If you buy a Big Mac in Switzerland, you will pay twice as much as you would in the benchmark country, the United States.

*Quick***Quote**

Before you criticise someone, you should walk a mile in their shoes. That way, when you criticise them, you are a mile away from them and you have their shoes.

Jack Handy

Efficient markets

I can hear you say: "Thanks. But what I really want to know is where the ringgit is headed. Will it go up or down?"

The answer is no one knows, although there is no shortage of opinions. Like other efficient markets, all publicly available information has already been discounted (included) in the price. The prices change only in response to new information, which appears randomly.

After explaining this, I must tell you it is not quite correct. That's because governments often intervene to restrain currency movements, which makes the markets less perfect.

A famous example was in 1992 when the Bank of England kept the British pound from dropping even though fundamentals showed it was over-valued (like the Swiss franc appears to be now).

Currency trader George Soros knew the British Central Bank was spending its precious US dollar reserves to buy British pounds in an effort to prop up its currency. He reasoned that this couldn't go on forever so he entered into contracts to sell the pound.

He was proven correct when the Bank of England gave up and stopped defending the pound, after which it dropped like a rock and George Soros made a profit of US$2 billion in slightly less than one month. Since then, Mr. Soros has been known as "the man who broke the Bank of England".

The lesson is if you are going to try to outguess a market, the foreign exchange market might be one to try, although it is not easy. Currencies are a zero-sum game since one currency's gain is another's loss. If the Singapore dollar appreciates by 10 per cent against the US dollar, then the US dollar drops by 10 per cent against the Singapore dollar.

It means everyone can't make money in currencies, like they can in a positive-sum market such as stocks or property where you can "buy and hold" in the hope of making a capital gain as the economy grows.

An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.