

DP01

Monetary Economics and the Malaysian Financial System

4 OCTOBER 2004

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Four (4) questions
Part A : Compulsory question [40 marks]
Part B : Three (3) questions [20 marks each]
4. Candidates must obtain a minimum of 20 marks in Part A as well as pass the paper as a whole.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. Blank pages are provided at the end of the question paper for rough work.

PART A

COMPULSORY QUESTION

1. (a) Provide **two** reasons as to why Malaysia needs to develop a more resilient, competitive and dynamic financial system. [6]
- (b) Describe the main functions of the following financial institutions:
- (i) Bank Negara Malaysia [3]
 - (ii) Malaysian Industrial Development Finance Berhad [3]
 - (iii) Bank Pembangunan dan Infrastruktur Malaysia Berhad [3]
 - (iv) Bank Simpanan Nasional [3]
- (c) The Labuan Offshore Financial Services Authority (LOFSA) was established as a single regulatory agency in 1996 for the orderly development and growth of the Labuan International Offshore Financial Centre.
- Explain **four** other roles played by LOFSA. [4]
- (d) Explain how the World Bank helps to reduce world poverty. [4]
- (e) What are **four** main functions of the International Monetary Fund? [4]
- (f) State **two** main objectives for each of the following:
- (i) Central Bank of Malaysia Act 1958 (Revised 1994) [2]
 - (ii) Banking and Financial Institutions Act 1989 [2]
- (g) Explain **three** roles of commercial banks in the Malaysian financial system and the economy. [6]
- (Total:40 marks)

PART B

ANSWER THREE (3) QUESTIONS ONLY

2. (a) Briefly explain the functions, participants and instruments traded for the following financial markets:
- (i) Money market [3]
 - (ii) Inter-bank market [2]
- (b) Briefly describe Malaysia's foreign exchange market, its activities and players. [5]
- (c) (i) List **three** sources and **three** uses of funds of commercial banks in Malaysia. [3]
- (ii) Highlight **two** banking services offered by commercial banks that may overlap and compete with those services rendered by the merchant banks. [2]
- (d) Describe the role of venture capital and its importance to technology-based firms. [5]
- (Total:20 marks)

3. (a) (i) State **three** main macroeconomic objectives of Bank Negara Malaysia's (BNM's) monetary policy. [3]
- (ii) Name **two** instruments that can be used by BNM to implement its monetary policy. [2]
- (b) (i) What is a unit trust? [2]
- (ii) Why are unit trust schemes popular among small investors? [5]
- (c) Describe **three** main objectives of the National Syariah Advisory Council. [3]
- (d) (i) What is inflation? [1]
- (ii) Briefly explain **four** impacts of high inflation on the economy. [4]
- (Total:20 marks)
4. (a) "Bank Negara Malaysia (BNM), is committed to excellence in promoting monetary and financial stability and fostering a sound and progressive financial sector, to achieve sustained economic growth for the benefit of the nation."
- (i) What do you understand by the term "financial stability" in the above statement? [3]
- (ii) Why is BNM committed to promote financial stability? [3]
- (iii) Explain how BNM can promote financial stability. [4]
- (b) Illustrate the balance of payments concept by highlighting its major accounts. [5]
- (c) Explain why a country needs to maintain a strong international reserves position. [5]
- (Total:20 marks)
5. (a) The Monetary Policy Statement (MPS) was first issued by Bank Negara Malaysia on 27 August 2003. The MPS is released four times a year and would coincide with the release of Malaysia's quarterly Gross Domestic Product performance.
- Explain **five** objectives for the release of the MPS. [5]
- (b) The Islamic financial system has evolved into a viable and vibrant component of the overall financial system in Malaysia, complementing the conventional financial system.
- (i) State **five** components of the Islamic financial system. [5]
- (ii) Briefly describe the roles played by each of the components identified in (b)(i) above. [5]
- (c) Highlight **five** major sectors of an economy. [5]
- (Total:20 marks)
6. (a) Using a schematic diagram, explain the following:
- (i) How does Bank Negara Malaysia's (BNM's) monetary policy affect inflation and the economy? [4]
- (ii) How does BNM stimulate the economy? [4]
- (iii) How does BNM constrain the economy? [4]
- (b) Explain **four** factors that affect exchange rates of a country. [8]
- (Total:20 marks)

OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

PART A

Question 1

- Candidates were unable to state the reasons to develop a resilient, competitive and dynamic financial system.
- Candidates were confused with the functions of the different financial institutions.
- Candidates were unable to state the reasons as to why Labuan Offshore Financial Services Authority was established.
- Candidates have poor knowledge on World Bank and International Monetary Fund.
- Answers given by candidates were too general and lacked depth.
- Candidates were informed that a more resilient, competitive and dynamic financial system will not only satisfy varied needs of the domestic economy but will at the same time be able to withstand global forces of competition.
- Candidates should remember that the Malaysian Industrial Development Finance Berhad was established to promote the development of the manufacturing industry in Malaysia. Bank Pembangunan dan Infrastruktur Malaysia Berhad was established to promote participation of the Bumiputera community in business and industry, and providing financing for infrastructure projects.
- Candidates should understand the reasons for the establishment of the International Monetary Fund and its contribution towards promoting a better world.
- Besides the Central Bank of Malaysia Act 1958 (Revised 1994) and Banking and Financial Institutions Act 1989, candidates should also understand the major legislation needed by Bank Negara Malaysia to regulate and supervise the financial system. These include the Exchange Control Act 1953, Islamic Banking Act 1983, Insurance Act 1996, Takaful Act 1984, Development Financial Institutions Act 2002 and the Anti-Money Laundering Act 2001.

1. (a) Two main reasons why Malaysia needs to develop a more resilient, competitive and dynamic financial system:
 - **Global forces and competition**
Global forces at work and advances in technology have redefined the rules of the game and transformed the operational environment within which financial institutions operate. Indeed, the ability to reap the benefits arising from greater competition depends largely on the capability and capacity of financial institutions to adapt swiftly and to embrace the changes.
 - **Economic development and consumer demand**
The rapid pace of economic development and transformation that creates new demands as well as opportunities for businesses have also called for a more effective and efficient provision of financial services. It is envisaged that Malaysia's economy will continue to expand significantly and become more internationally integrated and dynamic (with more high-tech services, greater reliance on small and medium-sized industries and increasingly rapid innovation rate) and, with more differentiated and demanding consumers.

- (b) Main functions of the following financial institutions:
- (i) Bank Negara Malaysia (BNM)
The functions of BNM are to (any 3 of the following):
- issue currency and keep reserves safeguarding the value of the currency
 - act as a banker and financial adviser to the Government
 - promote monetary stability and a sound financial structure
 - influence the credit situation to the advantage of the country.
- (ii) Malaysian Industrial Development Finance Berhad (MIDF)
MIDF was established to promote the development of the manufacturing industry in Malaysia through the provision of medium and long-term loans for the financing of new fixed assets for new industrial ventures as well as existing enterprises undertaking modernisation and/or expansion.
- (iii) Bank Pembangunan dan Infrastruktur Malaysia Berhad (BPIM)
BPIM was established to promote the Bumiputera community's participation in business and industry, and providing financing for infrastructure projects, in particular, Government-identified projects. BPIM also provides advisory services, entrepreneurial training and project consultancy services to enhance the business capabilities of Bumiputera small and medium scale enterprises (SMEs).
- (iv) Bank Simpanan Nasional (BSN)
The principle objectives of the BSN are to (any 3 of the following):
- promote and mobilise savings, particularly from the small savers.
 - inculcate the habit of thrift and savings.
 - provide the means for savings by the general public.
 - utilise the Bank's funds for investment including financing of the nation's economic development.
 - promote the interest of its depositors and other customer.
- (c) Labuan Offshore Financial Services Authority (LOFSA) is also entrusted to:
- supervise the offshore financial services industry's activities and operation in Labuan.
 - process applications to conduct business in the Labuan International Offshore Financial Centre specifically in offshore banking, offshore insurance and insurance related businesses, offshore trust and fund management, developing offshore Islamic instruments, incorporation and registration of offshore companies as well as for the setting up of Labuan trust companies.
 - administer and enforce the offshore financial services legislation
 - work together with offshore players in Labuan to promote offshore financial services.
- (d) The World Bank
The World Bank's main objective is to fight poverty and improve the living standards of people in the developing world. It is a development bank, which provides loans, policy advice, technical assistance, and knowledge sharing services to low and middle income countries to reduce poverty. The Bank promotes growth to create jobs and to empower poor people to take advantage of these opportunities. The World Bank also works to bridge this divide and turn rich country resources into poor country growth. One of the world's largest sources of development assistance, the World Bank supports developing countries' governments' efforts to build schools and health centers, provide water and electricity, fight disease, and protect the environment.
- (e) International Monetary Fund (IMF)
The IMF is an international organisation of 184 member countries. It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Since the IMF was established, its purposes have remained unchanged but its operations –

which involve surveillance, financial assistance, and technical assistance – have developed to meet the changing needs of its member countries in an evolving world economy.

- (f) (i) The Central Bank of Malaysia Act 1958 provides for the administration and objectives of the Central Bank. It also enumerates the powers and the duties of the Central Bank in relation to issuance of currency, maintenance of external reserve, authorised business of the bank, specific powers to deal with ailing institutions, its relationship with the Government and financial institutions. The Act also contains general provisions on the Bank's accounts, powers to compound, etc.
- (ii) The Banking and Financial Institutions Act 1989 which came into force on October 1, 1989 provides for the licensing and regulation of institutions carrying on banking, finance company, merchant banking, and discount house and money-broking businesses. It also provides for the regulation of institutions carrying on scheduled business comprising non-bank sources of credit and finance, such as credit and charge card companies, building societies, factoring, leasing companies and development finance institutions.

(g) **Roles of Commercial Banks**

Commercial banks are the largest group of financial institutions in Malaysia. The range of transaction accounts typically offered by commercial banks is savings account, current account, fixed deposits and negotiable instrument of deposits (NIDs). They also provide facilities for making payments or monetary transfers in domestic or foreign currencies, both locally and internationally. In addition to collecting deposits and making payments from or to the public, commercial banks provide loans in the form of overdrafts, revolving credit, term loans and advances, bridging finance, trade bills, bankers acceptances for working capital, trade finance and capital expenditure.

Although there are other types of financial institutions and intermediaries, commercial banks are usually considered the most important for two reasons. Firstly, while commercial banks are deposit takers and loan providers, just like other financial institutions, they are, at this point, the only institutions authorised to offer current accounts or demand deposits which provide chequeing facilities. Secondly, unlike other financial intermediaries, commercial banks are allowed to undertake foreign exchange business.

In other words, besides functioning as an intermediary between the surplus and deficit units, commercial banks also offer a major role in facilitating the payments system within the country as well as with the rest of the world. Without a prompt, efficient and inexpensive payments system, domestic and foreign economic transactions will be adversely affected, and all economic activities will be hampered. Therefore, where international payments are concerned, commercial banks are the only authorised foreign exchange agents and act on behalf of the Central Bank in administering Malaysia's foreign exchange control system.

Part B

Question 2

- Candidates were unaware that the inter-bank market is a sub-set of the broader money market, hence could not clearly differentiate the participants in both markets.
- Candidates showed poor understanding on venture capital.

2. (a) (i) The money market is a market where the lending and borrowing of short-term funds take place, and the market operating through discount houses, which accept call money and engage in the purchase and sale of money market papers. The instruments in the money market include overnight and 7-day money, short-term deposits or loans of one to 12-month maturities, Malaysian Government Securities (MGS), Treasury Bills (TBs), negotiable instruments of deposit (NIDs), banker's acceptances

(BAs) and Cagamas bonds. Two most heavily transacted instruments are NIDs and BAs, which jointly comprised about 75% of total volume of papers, traded in the market.

(ii) The largest component of the money market is the interbank market representing transactions among commercial banks, merchant banks and selected finance companies. Transactions are mainly in the form of interbank deposits and loans due to the limited range of money market papers. A large part of the secondary market transactions in money market papers I in the form of repurchase agreements, because these transactions can be for very short as well as odd periods, thereby providing flexibility to change the maturity structure of assets and liabilities.

(b) Malaysia's foreign exchange market, its activities and players
In Malaysia, all dealings in foreign exchange are required to be conducted through any one of the 25 commercial banks (including 2 Islam banks); the only authorised dealers in foreign exchange under the Exchange Control Act 1953. There are, however, more than 900 authorised moneychangers (including finance companies) who are licensed under this Act to buy and sell foreign currency notes and coins. As in the money market, transactions in foreign exchange among commercial banks form the core of the foreign exchange market. Exchange transactions are undertaken on both spot and forward basis.

Main customers of commercial banks are traders in the export and import business including corporations remitting profits or dividend abroad, businessmen making overseas payments for services rendered by enterprises, payments by travelers, and remittances to support overseas education.

(c) (i) The sources and uses of funds of commercial banks in Malaysia:

Sources of funds

Any three of the following:

- Capital and reserves
- Deposits (demand, fixed and savings)
- Negotiable instruments of deposits (NIDs) issued
- Amount due to financial institutions in Malaysia and abroad
- Bankers acceptances
- Other liabilities

Uses of funds

Any three of the following:

- Cash
- Balances with BNM
- SRR with BNM
- Call money
- NIDS held
- Malaysian securities
- Loans and advances
- Fixed assets
- Other assets

(ii) Two banking services of commercial banks that may overlap and compete with those services rendered by the merchant banks:

- Authorised to offer fixed deposits to corporations, associations and clubs.
- Raise funds by issuing NIDS.

(d) Venture capital and its importance

Access to finance is an important element in the innovation process to translate the results of research and development into commercial outcomes. In this regard, venture capital is a specific type of finance provided by certain firms who invest alongside with management in young but rapidly growing companies that are not listed on the stock market. These new and

young companies have the potential to become major players in the economy. Venture capital investments generally involve:

- a long time-frame
- an element of risk
- partnership with management
- returns that are normally in the form of capital gains rather than dividends. Venture capitalists (those who supply the capital funds) are needed to support high-risk investments in small, technology-based firms, which are often passed over or ignored by large companies and traditional financial institutions.

In a knowledge-based economy, economic growth and job creation increasingly depend upon successful innovation. This means that the results of research and development (R&D) must be effectively translated into commercial outcomes. Access to finance is seen as a key factor in this process of innovation. Hence, venture capital has an important role to play as a specific type of finance that has been developed to fund high-risk projects. Venture capital is crucial to the innovation process. For a variety of reasons, it is very difficult for large companies to undertake high-risk innovative projects. Such projects have the greatest chance of success if small technology-based firms undertake them. In this regard, venture capitalists are willing and able to invest in such high-risk innovative projects through their financial instruments.

Question 3

Candidates' answers indicated misconception that the objective of the National Syariah Advisory Council is to develop Islamic banking products.

3. (a) (i) The principal objective of Bank Negara Malaysia (BNM) is to promote monetary stability and a sound financial system. BNM, therefore, plays a key role in the formulation of overall macroeconomic policy, the final objectives of which are price stability, strong sustainable output growth, a low level of unemployment, and a satisfactory balance of payments position. The conduct of monetary policy in Malaysia, a task assigned to BNM is primarily to regulate the supply of money in circulation and the credit supplied to the economy.
- (ii) The instruments that can be deployed by BNM to implement its monetary policy can generally be grouped into two broad categories: general instruments (like statutory reserve requirements, open market operation, purchase/sale of government securities) and selective instruments (like lending guidelines for certain sectors) of monetary control.
- (b) (i) Unit trusts are a form of collective investment that allows investors with similar investment objectives to pool their funds to be invested in a portfolio of securities or other assets. A professional fund manager then invests the pooled funds in a portfolio which may include cash, bonds and deposits, shares, property or commodities. Unit holders do not purchase the securities in the portfolio directly.
- (ii) Unit trusts are popular among investors, who have neither the time nor the inclination to hold portfolios of direct investments or shares, because they can invest in small amount in a secure, reputable investment vehicle which suits their purposes. Unit trusts also allow investors to have easy access to a wide range of investment exposures not normally available to them.
- (c) The main objectives of the National Syariah Advisory Council (NSAC)
The National Syariah Advisory Council on Islamic Banking and Takaful (NSAC) was established on 1 May 1997. The primary objectives of the NSAC are as follows:
- to act as the sole authoritative body to advise BNM on Islamic banking and takaful operations;

- to co-ordinate Syariah issues with respect to Islamic banking and finance (including takaful); and
 - to analyse and evaluate Syariah aspects of new products/schemes submitted by the banking institutions and takaful companies.
- (d) (i) Inflation is a rise in the general level of prices. Inflation causes money to lose its purchasing power because more money is needed to purchase the same volume of goods and services.
- (ii) Inflation distorts price signals that make for the efficient functioning of an economic system. The higher the inflation rate, the greater the distortions. Persistent increases in prices have a number of adverse economic and social consequences. Fixed-income earners may see their standard of living decline; the disparity between the rich and poor may increase; the distribution of national income between wages and profits will change; higher inflation relative to our trading partners will cause our industries to become less competitive or will cause the exchange rate to fall.

But one effect which is especially important is its impact on saving and investment decisions because sustainable growth in an economy can be retarded. Business investment decisions are also distorted, as long-term investment looks less profitable than short-term speculation. For the financial markets, inflation erodes the real return from fixed-interest investment.

Question 4

- Candidates confused financial stability with monetary stability and economic stability.
- Candidates could not differentiate structurally between current account and capital account in BOP.
- Candidates were unable to explain a country's need to maintain a comfortable level of external reserves.

4. (a) (i) Financial stability refers to an environment where institutions in a financial system are strong and can continue to meet their contractual obligations without interruption or without any external assistance. Market participants can also confidently enter into transactions at prices that do not change substantially over short periods when there has not been any change in market fundamentals.
- (ii) Financial stability creates a conducive environment for businesses to undertake their activities and for savers and investors to enter into short-term or long-term contracts. As the financial sector has a central role in promoting economic growth, it is important that the financial system is strong, resilient and efficient in mobilising savings and undertaking lending activities. It is vital that this intermediation process continues uninterrupted even in periods of economic difficulties.
- (iii) Financial stability can be achieved by developing a sound banking system that responds to the changing needs of the economy and society, a system that is made up of strong and resilient financial players and well-functioning financial markets.

Financial stability can be also achieved by formulating a strong legal, regulatory and supervisory framework, as well as through the development and strengthening of new institutions and system infrastructure. Regulatory rules need to be continuously enhanced with the adoption of international standards to instill appropriate risk management system to enable financial institutions to undertake their intermediation function effectively.

The enactment of new laws such as the Banking and Financial Institutions Act in 1989 and the Insurance Act in 1996 would also help to enhance financial stability.

In addition, the availability of “lender of last resort facility available” with Bank Negara Malaysia (BNM) (whereby banking institutions in need of funds could come to BNM to sell their securities to deal with short-term liquidity problems) could also enhance financial stability and maintain public confidence in the financial system thereby avoiding widespread failure.

(b) Balance of payments

The balance of payments is the record of the transactions of the residents of a country with the rest of the world. It is also a reflection of the health of the economy. The benefits of economic development are reflected in the balance of payments through the magnitude of inward and outward flows of relevant items. There are two main accounts in the balance of payments, namely the current account and the capital account.

Closely related to the current account is the merchandise account and the services account. The merchandise balances simply record trade in goods. By adding the merchandise and trade in services and net transfers, we arrive at the current account balance. The capital account on the other hand records inflow and outflow of capital. The capital account distinguishes between short-term and long-term flows as well as official and private flows. The sum of the current and capital accounts will give the overall balance of payments which also represents the change in the BNM’s external reserves.

(c) Maintaining a strong external reserve position is important to both the short-term objectives of economic recovery as well as the long-term aim to maintain a sustainable external position. A large reserves cushion is indeed a key element in protecting the country against unforeseen destabilising developments. This is important to sustain market confidence and stability, enhance credit worthiness and at the same time, provide the Government with greater stability in the conduct of domestic policies.

Question 5

- Candidates could not state the objectives of Monetary Policy Statement.
- Candidates failed to explain the components of the Islamic financial system such as the Islamic money market, capital market, Takaful and specialised institutions.

5. (a) The Monetary Policy Statement (MPS) is a forward looking statement, outlining the monetary policy stance in the near term and the rationale for the policy thrust. The objective of issuing this statement is part of the overall strategy to provide greater understanding of the monetary policy objectives and measures in light of a more complex and dynamic environment. In particular, it would help anchor expectations on growth and inflation. Signaling the Bank’s policy intent through direct communication is aimed at increasing the understanding and appreciation of money market participants, and thereby, facilitates a more rapid transmission of the policy rate in the pricing of credit and longer-term rates, and thus enhances the overall efficiency of the monetary transmission mechanism.

The issuance of the MPS is part of the ongoing process to enhance market understanding of the Bank’s financial and economic assessments, operations and policy objectives. Since 1998, in a drive to ensure symmetric information to the public, the Bank has disseminated a wider range of information, which included among others, on-line information on its daily liquidity forecasts and money market operations. Over the years, there has also been significant enhancement of the coverage of information available through the Bank’s website, and reduction in the time lag of data releases to the public.

(b) The Islamic financial system encompasses the Islamic banking system, Islamic money market, Islamic insurance or takaful, Islamic capital market globalising financial institutions which provide alternative sources of financing.

- (i) Islamic banking system

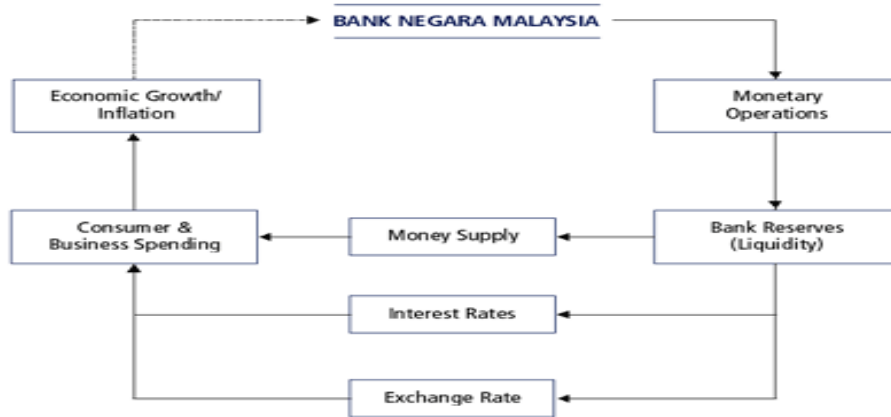
- (ii) Forms the backbone of the Islamic financial system and plays important globalising deposits and providing financing to facilitate growth. The Islamic banking system is currently represented by 33 Islamic banking institutions, comprising two Islamic banks and 31 conventional banking institutions (nine commercial banks, four foreign banks, seven finance companies, four merchant banks and seven discount houses) offering Islamic banking products and services.
- - (i) Islamic interbank money market
 - (ii) Under the Mudharabah (profit-sharing) interbank investment (MII) mechanism, Islamic banking institutions are able to raise funds to meet their short-term funding requirement based on profit sharing arrangement.
- - (i) Islamic capital market
 - (ii) Where funds are raised to finance long-term infrastructure and development projects through the issuance of Islamic private debt securities. The Islamic capital market reduces over-dependence on the Islamic banking system for long-term financing and allows Islamic banking institutions to diversify part of the risks emanating from asset and liability mismatches. The existence of the Islamic capital market plays an important role in reducing potential source of financial vulnerabilities and contributes to enhance the robustness and resilience of the Islamic financial system.
- - (i) Islamic insurance/Takaful industry
 - (ii) Adds significant synergies to the overall Islamic financial system. Takaful operators, particularly in general takaful business, contribute to mitigate part of the banking system's risks emanating from financing transactions and hence strengthen the resilience of the Islamic financial system.
- - (i) Specialised non-bank institutions
 - (iii) Offer Islamic financial products and services such as the development financial institutions (DFIs) and Pilgrims Fund Board and complements the Islamic banking system in expanding its reach to specific strategic economic sectors thereby enhancing the capacity of the Islamic financial system in its overall contribution to economic growth and development.
- (c) Sectors in an economy:
 - Household sector – the consumer of goods and services (and savers therefore usually lenders)
 - Business sector – the producers of goods and services (usually borrowers)
 - Government sector – includes Federal, state, local government and institutions (usually borrowers)
 - Overseas sector – where imports come from and exports are sent (usually lenders to Malaysia)
 - Finance sector – include financial intermediaries that specialise in transferring funds between lenders and borrowers

Question 6

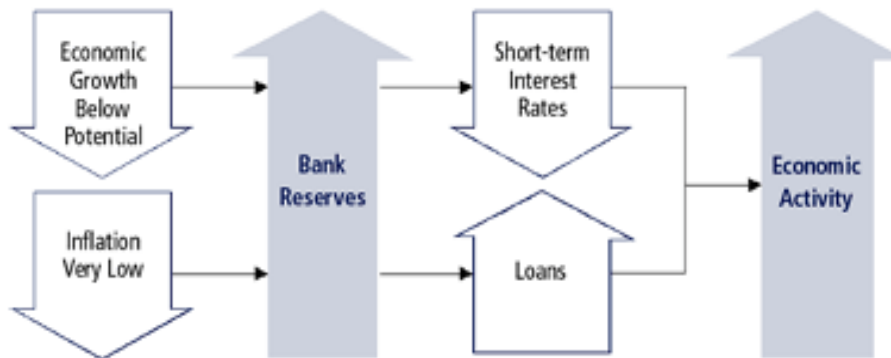
Candidate's answers did not clearly state the interaction between the exchange rate and the interest rate, and other factors (economy, expectations and politics) that may affect the supply and demand for foreign exchange.

6. (a) Schematic diagrams

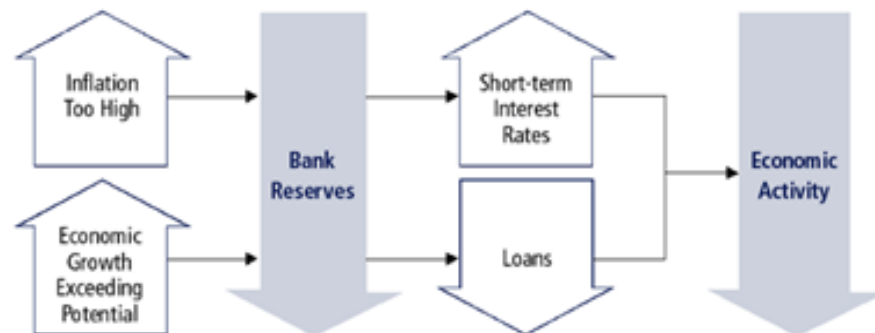
(i) Bank Negara Malaysia's (BNM's) monetary policy affects the economy and inflation



(ii) BNM stimulates the economy.



(iii) BNM constrains the economy



(b) Factors affecting exchange rates:
(Any four of the following factors:)

As with interest rates, exchange rates also depend on the interaction of supply and demand. Even a fixed exchange rate (FX), such as there is in Malaysia, must be set in the context of supply and demand. Some of the factors which affect the supply or demand for FX are:

- World growth – the demand for Malaysian exports (and hence for RM) depends on the state of the world economy (particularly that of our major trading partners).
- Malaysian domestic demand – the demand for imports depends on the strength of domestic spending.
- Inflation – changes in domestic costs or prices compared with cost and price movements in the rest of the world influence Malaysia's ability to compete on world markets. For this reason, inflation rate consistently higher than that of our competitors will, in time, lead to a compensating lower value of the currency.
- Interest rate differentials – For example, Australia and the UK had high interest rates in the 1980s, which attracted funds into these countries and assisted with boosting their exchange rates relative to other exchange rates.
- Exchange rate expectations – Market sentiment refers to the market's perception of the expected future direction of exchange rates based on the above factors. This can have an overwhelming influence in the short term.
- Political factors – Changes in government policy and type of actions in the financial markets can affect its exchange rate.

In short, numerous factors, both within the Malaysian economy and outside it, affect exchange rates. A number of these are beyond the Government's control.