November Outlook – 2019 Budget Not Too Bad After all

SUMMARY

- **More Chinese stimulus vs budgetary concerns in Italy**. Equity markets worldwide declined in Oct-18, on weaker growth outlook as the JPM Global Manufacturing PMI declined for a sixth month. The US GDP grew at a slower 3.5% pace in 3Q18 supported by consumer spending while the Chinese GDP grew at a slower-than-expected pace of 6.5% YoY in 3Q18, marking the weakest rate since the global financial crisis. As such, President Xi Jinping signaled that further stimulus measures are being planned. On the other hand, the Italian cabinet approved a deficit-hiking budget, which was rejected by the EC, saying the budget deviates from commonly agreed fiscal rules of the EU.
- **Lower GDP growth but higher fiscal deficits ahead for Malaysia**. Both Business and consumer sentiments fell in 3Q18 but still remaining above the demarcation level of 100-point threshold of optimism. Also, manufacturing performance dipped below the 50 mark in Oct-18 to 49.2 (Sep-18: 51.5) for the first time since July. Depicted from the 11MP review, real GDP target lowered to 4.5-5.5% per annum for 2016-2020 compared to its previous target of 5.0-6.0% growth while fiscal deficit targets being revised higher. Positively, current account balance to remain in surplus.
- **Selling pressure on equities amid trade war & harsh Budget 2019 fear but local bond markets surprisingly seen foreign inflows.** Global markets mainly impacted by fear of trade war and the US Mid-Term Election to certain extent. The worst hit index in Oct was Kospi followed by Taiwan and Hang Seng indices. Malaysia was not spared and coupled with internal fear that Budget 2019 will introduce new tax measures while high beta sectors underperformed the FBMKLCI. Over to bond markets, despite the significantly high govvy maturities of RM22.5bn, the local govvy market continued to suffer from selling pressures in October. Surprisingly, foreign investors turned net buyers of local govvies in October despite the MYR weakness and investors' concerns on wider-than-expected fiscal deficit targets.
- **Macro – Malaysia's inclusive 2019 Budget not too bad after all.** The Government's total expenditure is projected to increase by 8.3% for 2019. Meanwhile, the Government's revenue will be boosted by a one-off special dividend from Petronas for tax refund purposes. As such, Budget 2019 is supportive of the government's GDP growth target of 4.9% in 2019F. However, the more focused approach to spending may raise inflation in 2019. BNM to remain accommodative despite higher price pressure ahead. The MoF forecast to maintain marginal operating surplus, despite higher operating expenditure YoY. This should help alleviate much concerns on potential negative sovereign outlook given the kneejerk fiscal deficits spike.
- **Equity – Most investors are incline to buy than sell.** This is because 2 key macro uncertainties namely trade war and the US Mid-Term Election had passed. And, with the Democrats winning the House, most investors would take the view that additional new trade wars may not be so easily implemented by Trump and this should provide some cheers to Asian and Malaysian markets too. For Nov, we favour big caps and selective high beta sector like the construction sector.
- **Fixed Income – More govvy issuance to plug higher deficits.** Following the MoF's guidance on higher deficit targets of 3.4% in 2019, we estimate higher govvy issuances of around RM120bn. Besides, Samurai Bond issuance of JPY200bn which carries a guarantee by Japan Bank of International Cooperation at an indicative coupon of 0.65% will be used to retire the costlier 1MDB outstanding bonds which will lessen the nation's financial expenses. Notably, a more sanguine S&P believes that the government's commitment to gradual fiscal consolidation is credible, and that one-off pressures such as funding of GST rebates should abate after 2019.

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