February Outlook – Re-pricing of Volatility Leads To Cautious Markets

SUMMARY

- **The US and European equities rallied in Jan-18 on the back of firm economic data that continued to support growth, thus, increasing market expectations of further policy tightening** by the Fed and the ECB ahead. The US economy expanded at a slower-than-projected pace of 2.6% in 4Q17, albeit growth remains solid. Positively, the US job and wage growth accelerated in Jan-18. Over to Asia, China's 2017 real GDP growth of 6.9% YoY is the first annual increase in seven years, helped by strong retail sales and robust exports. Also, the preliminary data showed the Eurozone economy expanded 2.5% YoY in 2017, the fastest growth since 2007.
- **OPR normalisation on firm growth path.** As we expected that BNM raised the OPR by 25bps. This is the first rate hike since July-14 where BNM reiterated that the stance of monetary policy remains accommodative. Exports growth eased for the second month in Dec-17 but full year still registered a commendable growth of 18.9%. Positively, the headline Nikkei Manufacturing PMI improved to 50.5 in Jan-18 from 49.9 in Dec-17, signaling a return to expansion of new orders.
- **A good start for the year for our equity but not so for bond markets.** Equity market was driven up by strong foreign participation while local institutions and retailers were net sellers. KLCI was the 2nd best performer in Asean after Thailand SET, where banking stocks were the main driver and beneficiaries of the OPR hike. In contrast, the whole **MGS curve moved higher in Jan-18** with yields shifted higher across all tenures, driven by profit-taking activities post-OPR hike announcement coupled with noises of potential second hike in 2H18.
- **Macro – Weak ground sentiment vs. strong headline GDP.** We attribute the different sentiment demonstrated to the fact that recovery in the domestic economic growth was very much export driven in 2017. Besides, Retail Group Malaysia's sluggish retail sales number against Department of Statistics' strong data is largely attributed to RGM's data has a smaller total sales turnover of RM100bn compared with DOS's total turnover sales of RM450bn for 2017. The strong export growth has translated into a rise in manufacturing wage which is still pretty much limited to blue-collar workers, who have higher propensity to spend on basic necessities but these people's spending power is negated by higher inflationary impact.
- **Equities - Expect some profit taking activities,** post a strong MoM performance in Jan-18 led by the banks, long festive CNY break, fear that the Parliament would be dissolved post CNY and also foreign buying likely to take a breather after strong inflows since the start of the year. Thus, we expect KLCI to retrace back to 1840 support level. Meanwhile, the 14th General election thematic play may hog the limelight in Feb-18 again while expecting the 4QCY17 corporate results to be mostly in line with consensus expectations.
- **Fixed Income & FX -** We see more upward trajectory for MGS yields arising from the higher UST yields amid a backdrop of tightening monetary policy as well as wider regional peers' spreads over UST, which appear more attractive for foreign investors. This could be further exacerbated by the large incoming supply of govvies should the MYR lose its strengthening momentum in the near term. Nonetheless, **we do not expect BNM to raise the OPR further this year** as 2018 is expected to see a sustained economic growth against a **moderating inflation rate** as well as BNM's neutral tone on policy stance. More value is seen at longer-end govvies. Over to the ringgit, as expected in the earlier month where we foresee the ringgit to hover between USDMYR3.90 and 4.05 in Jan-Feb.