eTiQa

Research Malaysia

September 2018

September Outlook – How Long To Go Till End-Cycle

SUMMARY

- **Increasing risk to global growth amid trade war worries.** US equities rose amid some resolve of an overhaul of the NAFTA as agreed with Mexico, whilst negotiations with Canada are ongoing. The head of the WTO warned of the threat to global trade, as the WTO quarterly outlook indicator for 3Q18 dipped to 100.3 from the 101.8 predicted in May for 2Q18. Meanwhile, China's Jul-18 industrial profit growth cools for third straight month and the Eurozone's manufacturing PMI registered a 21-month low in Aug-18. Both Japan and Indonesia reported trade deficits in Jul-18 amid high oil prices.
- **Slower growth ahead for Malaysia.** 2Q18 GDP growth expanded by 4.5% YoY which is below market expectations of above 5.0% and the weakest growth in 6-quarters. As the leading economic indicators ("LEI") index leads GDP growth by 2-3 months, Maybank's estimated quarterly LEI index fell -0.2% YoY in 3Q18 (2Q18: +1.2% YoY), pointing to continued sub-5% GDP growth in 3Q18. However, the manufacturing PMI rebounds to 9-month high 51.2 in Aug-18 (Jul-18: 49.7), underpin by easing inflationary pressure and stronger demand.
- **Window dressing activities continued to lift FBMKLCI higher while bull-steepening MGS yield curve was evident in Aug-18.** Although the domestic equity market was technically due for profit taking activities following a strong rally of 100 points in Jul, we gathered that window dressing activities continued to bring the KLCI higher. On the other hand, we saw profit taking activities in the Asian markets as well as in the European markets. Likewise, the MGS yield curve bull steepened as yields eased across all tenures especially in the shorter-end amid lower than expected 2Q18 GDP growth, benign inflation, ample liquidity and BNM's announcement of further relaxation of foreign exchange administration policies.
- **Macro – How long till end-cycle.** Every US recession in the last 60 years was preceded by an inverted yield curve with a lag varying between 6 months and 2 years. However, the current 2Y/10Y term spread implies a probability of recession within the next 12 months of nearly 35% while the current near-term forward spread implies a much lower probability, around 10%, meaning the Fed is likely to tolerate further curve flattening before dialing back its tightening bias. What could shorten the timeframe towards recession is really the government policy mistakes, which is likely to be trade wars between prominent economies.
- **Equity – All eyes on trade wars and further Asian currencies devaluation.** With the presence of trade war concerns and further devaluation of EM currencies, we expect overall market to remain fragile where sentiment can turn overnight. As a result, we recommend investors to continue adopting a trading strategy and gradually shift to index stocks as these stocks are more resilient in an uncertain market environment and probably meant for year-end window dressing purpose.
- **Fixed Income & FX – More govvy but less GG bond issuances in 2019.** A number of economists have revised the real GDP growth target for 2018 lower after the release of the 2Q18 print with consensus looking at below 5% growth and an even lower target for 2019. This serves as a prelude to potentially higher govvy issuance in 2019 to finance fiscal deficit. However, given expectations of declining government development expenditure in 2019 and delays in mega infrastructure projects, we expect the issuance of government-guaranteed bonds to be reduced ahead. Over to FX, the USD is expected to remain strong at least in the near term as factors supporting strong USD remain in place, especially the risk of a renewed escalation in global trade tensions is acute and carries fresh threats for EM FX.

Disclaimer:
This document has been prepared by Etiqa Insurance Berhad (ELIB) solely for informational purposes and shall not be construed as the basis for making investment, financial or other decisions. Past performance is not indicative of future results and no representation or warranty is made regarding future performance. ELIB makes no representation or warranty of any kind, express, implied or statutory regarding, but not limited to, the accuracy of this document or the completeness of any information contained or referred to in this document. This document is distributed on the express understanding that, whilst the information in it is believed to be reliable, it has not been independently verified by ELIB. ELIB and any of its related affiliates accepts no liability and will not be liable for any loss or damage arising directly or indirectly (including special, incidental or consequential loss or damage) from your use of this document, howsoever arising, and including any loss, damage or expense arising from, but not limited to, any defect, error, imperfection, fault, mistake or inaccuracy with this document, its contents or associated services, or due to any unavailability of the document or any part thereof or any contents.