October Outlook – Cracks Seen As Trade Tariffs Kick In

SUMMARY

- **Hawkish stance from the Fed despite weakening trade outlook.** The US Fed drops 'accommodative' language and projected one more hike this year and three in 2019 as solid growth likely to continue in 3Q18 with Manufacturing PMI rebounded in Sep-18. However, WTO cuts global trade forecast to 3.9% in 2018, and 3.7% in 2019, from April's forecast of 4.4% and 4.0% respectively amidst worsening trade war concerns. Meanwhile, the PBOC reiterated to maintain a prudent and neutral monetary policy while providing reasonable and ample liquidity.
- **Disinflation on tax holiday in Malaysia.** CPI showed moderate growth of 0.2% YoY in Aug-18, the slowest since Feb-15 due to the removal of GST since Jun-18 and fuel subsidy. Meanwhile, PPI dipped by -0.3% YoY in Aug-18 after 2 consecutive months of modest expansion. Positively, labour market remains strong. Also, manufacturing PMI in Sep-18 registered at 10-month high, the second consecutive month recording above 50 points expansionary line.
- **KLCI range bound but market sentiment recovered MoM while EM fears spooked bond market especially at the shorter-end govvies.** The recovery in market sentiment towards month end was mainly driven by: 1) recovery in some of the emerging markets' currencies, and 2) window dressing activities by some of the GLCs. The MGS curve bear flattened with the 3y yields spiking while the longer-end was rather sticky supported by strong demand for govvy auctions for the 15y and 30y tenures. However, foreign investors continued to be net sellers of local govvies in Sep-18.
- **Macro – Cracks seen as trade tariffs kick in.** After 2 rounds of counter tariff imposition between the US and China, for emerging Asia overall, new export orders are now contracting, while new orders are still expanding, albeit less impressively than before. Likewise, on a global scale, September global manufacturing PMI reported that the export orders index had fallen to a new low since mid-2016. Notably, China matters, being the growth engine for the region as well as world economy. The Chinese new orders, which are more domestic focused, are still sliding as well over the past 3 months.
- **Equity – Currencies' strength and ministers' guidance to dominate Bursa trading activities**. Investors' focus would likely turn back to local – To get hints on the direction of our country's growth through Malaysia: A New Dawn conference as the Budget 2019 announcement would only be on 2 Nov. This Oct's performance will be highly dependent on the outcome of A New Dawn conference, which is so far falling short of investors' expectations while the performance of Asian currencies vs USD will ultimately affect foreign flows. We expect O&G stocks to be in the limelight of Bursa Malaysia since Brent oil prices have breakout above USD80/barrel. Hence, we upgrade the O&G sector to OVERWEIGHT.
- **Fixed Income & FX – Decoupling of MGS & UST yields?** While the 4th US rate hike for the year is widely anticipated in Dec-18 with 3 more hikes next year, the recent hawkish Fed Chair statement did send ripple effects to the Asian market and also to our shores. Looking back at the 10y MGS yield movement since the first hike in 2017 (5 days after the Fed's announcement), we see a mere 3-4bps change on both directions which seem to suggest some decoupling from the UST. Meanwhile, market players are expected to tread cautiously in anticipation of Budget 2019. Over to FX, the balance of risks is skewed in favor of the USD. The market has priced in for only two hikes from the Fed by the end of 2019 whereas the Fed's median dot says there may be double that.

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