June Outlook – Malaysia’s new chapter begins

SUMMARY

- **Political jitters seen in Europe whilst trade war fears reignited.** US equities rose in May as economic expansion remains solid and intact but stocks ended flattish in Europe due to political uncertainty and slower growth data. Meanwhile, the prospect of a receding trade war vanished after the US hits its closest allies Mexico, Canada and the EU with steel and aluminum tariffs. Mixed monetary policy actions were seen in Asia where the BoK held interest rates steady but Bank Indonesia raised its key policy rate 2 times in 2 weeks.
- **A new chapter begins in Malaysia**. PH formed a new federal government after winning a simple majority in Malaysia's GE14. BNM expects Malaysia's economic outlook to remain strong given its resilient and robust financial system. Meanwhile, the new PH-led Government announced the zero-rated GST effective 1 June 2018, while targeted fuel subsidies will be reintroduced. However, the Government is guiding that the projected fiscal deficit of 2.8% for 2018 will be met. Notably, Moody's sees SST and high oil prices to offset GST removal impact but not long-term solution.
- **Both local bond and equity markets succumbed to foreign selling pressure in May-18.** Post PH’s winning the GE14, we noticed foreigners have taken the view to selldown their holdings due to policy uncertainties. FBMKLCI was the worst performing index versus global peers in May despite other Asean markets were also not spared from selldown too. Separately, MGS yields rose across all tenures in tandem with the rise in US Treasuries yields amid inflationary fears on the back of stronger economic outlook in the US and higher crude oil prices. Also, local sentiment was affected by concerns on the sovereign rating due to policy changes arising from the new government.
- **Macro - The volatility in Emerging Market surged considerably over the recent weeks, thus, investors started to wonder if this is a repeat of the ‘taper tantrum’** episode from mid-2013 given similarities**,** such as a stronger USD and rising US yields. However, we are cognizant that there are pockets of weakness seen in EM economies but it is not widespread and not all EM macro scorecards are the same this time round.
- **Equity - Still expecting another volatile trading month,** as there are still uncertainties over future policies in Malaysia until PH finalizes them within the 100 days since they won the GE14. Foreigners still have RM9bn to offload from Malaysia, if they wanted to in order to fully reverse all inflows from last year. Foreign shareholding stood at 24.1% in Apr-18, before recent selloff, and we gather that the lowest percentage was about 17.5% in 2002 if we stretch back to 1999. Nevertheless, given our resilient economic fundamentals since then, we do not expect the foreign shareholding to fall back to 2002 level.
- **Fixed Income & FX – While policy uncertainties post-GE14 have partly roiled debt market, we foresee these fears to dissipate towards 4Q18** after the 100-day pledge by PH is over. Indeed, institutional reforms are viewed favorably and is deemed to be a catalyst for long-term foreign investors, aside from stronger finances amid still-healthy economic growth as well as benign inflation with the return of fuel subsidies. As such, we do not expect any negative sovereign rating action to be taken by international rating agencies in the next 3-5 months, pending more clarity from 2019 Budget to be tabled in Nov-18. Taking these factors into consideration, we reiterate our 10Y MGS year-end target of 4.10% to 4.20%. Over to FX market, we keep our ringgit forecast trading range of USDMYR3.70-4.00 in Jun-18 given BNM’s steady FX reserve and close monitoring of fund flows.

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