eTiQa

Research
Malaysia

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June Outlook – Escalating Trade War Leads To Rate Cuts

SUMMARY

- **Escalating trade war tarnishes business confidence.** IMF envisages new US-China tariffs will subtract about 0.3% of global GDP in the short term. Trump also announced 5% tariff effective 10 Jun-19 on all Mexican goods until ongoing surge of illegal migrant at the southern border is remedied, but the decision was subsequently averted. Meanwhile, moderating growth was evident in Asia during 1Q19 as trade tension continues to escalate. As such, major global equity indices fell in May-19 due to trade uncertainties.
- **BNM undertakes initiative to enhance local bond and FX market liquidity and accessibility.** BNM announced further initiatives to improve market efficiency, accessibility, and liquidity in the domestic financial markets, whilst preserving an orderly and transparent onshore financial market. On another note, Malaysia's 1Q19 GDP retraced to +4.5% however beat estimates while manufacturing PMI contracted further in May-19. As expected, BNM delivered a 25bps cut on the OPR in early May to 3.00%, the first cut since Jul-16 as downside risk to the economy has heightened amid lower business and consumer confidence, soft housing market and escalating trade tensions.
- **Both local equity and bond markets buck the downtrend amid trade concerns.** Post MSCI rebalancing, we have seen GLCs as well as some foreign investors bottom fishing in Malaysia's equity market partly due to FBMKLCI has been the worst performer YTD. Over to fixed income market, govvy yields eased across the board by a few bps MoM despite a net issuance of RM12bn in May-19 while the corporate credit spreads have narrowed significantly MoM as yields adjusted to the rate cut and corporate bonds became highly sought after amid the dearth of new corporate issuances and low govvy yields.
- **Macro – Asian manufacturing powerhouse is finding bottom.** We would caution that this near-term noise is all about fears of a full-blown trade war that will have negative spillover effects into growth and sentiment. China's economy has yet to bottom out, and Beijing will need to step up stimulus measures to stabilise growth. However, manufacturing activity could be bottoming towards June-August alongside with the employment contraction before it picks up again towards 4Q19 to replenish the depleted inventory levels. To summarise for trade war, Vietnam is by far the largest beneficiary while Malaysia ranks the fourth in terms of semiconductors exports while natural gas exports to China tends to be higher too.
- **Equity – All eyes on trade war.** A high likelihood of full-blown trade war to happen as the deadline of public hearing to pass tariff hike on additional USD300bn Chinese imports is set on 17 June. We advocate for risk-off stance, while expecting market to remain volatile with many intraday trades to avoid carrying overnight trading risks. If full-blown trade war happens, the rubber glove sector will be a clear cut winner while the tech sector would be a clear cut loser. Positively, after local GLCs being quiet since beginning of the year as well as foreigners turned net sellers, we see them making a comeback of late.
- **Fixed Income – Forthcoming Fed rate cut in 2H19?** Alongside with the US yield curve inversion, the Fed Chairman said in early June that the Fed will "act as appropriate to sustain the expansion', opening the door to rate cuts. As such, markets are increasingly pricing in a Fed rate cut as early as Sep-19. While we do not see a direct impact on local yields from the expected rate cuts in the US, it will nonetheless, keep local yields low as concerns on the global economy will continue to fuel fund flows into the bond market vs equity as local and global headlines are expected to be dominated by intensified trade spats between the US and the world.

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