# February Outlook – Would Global Economy Be Infected Too?

## SUMMARY

- **Covid-19 outbreak jitters**. Global stocks fell at the start of the year as the risks of Covid-19 outbreak overshadowed the triumph over Phase 1 trade deal. A US airstrike which killed Iran's top military commander also briefly impacted stock markets. In Asia, exports continued to slump, and recovery anticipated from the Phase 1 trade deal may be delayed as China's business activities slow due to the lockdown in some cities from the virus outbreak.
- **BNM surprised with a 25bps cut in OPR to 2.75% in Jan-20.** BNM said the adjustment to the OPR is a pre-emptive measure to secure the improving growth trajectory amid price stability. Despite the Dec-19 exports rise for first time since Jul-19, manufacturing PMI fell back into contractionary mode in Jan-20 after touching 50 points in Dec-19. Meanwhile, Moody's reaffirmed Malaysia's credit profile of A3 with stable outlook.
- **KLCI hit by virus outbreak; local yields rallied on early OPR cut.** In the earlier part of Jan, we had had a good rally on the small mid cap stocks while the big cap were holding steady. However, post CNY, as more new flows reporting the coronavirus had spread across the globe, dampening global equity market sentiments, including Malaysia. In contrast, global yields rallied strongly at the start of the year with multiple black swan events. Locally, govvy yields have also rallied in light of the earlier-than-expected OPR cut on 22 Jan.
- **Macro – Are investors too concerned on Covid-19?** An analysis of the 2002-03 SARS outbreak suggests that China's services sector could be hit hardest by the Covid-19 outbreak. China's tertiary industry is playing a more important economic role in 2019 vs 2004. As such, we foresee economic contraction in 1Q2020 likely to be sharper and recovery is likely to be slower due to the current epidemic. As we move on to the regional equity markets, it appears that Malaysia's MSCI components have limited downside in terms of PB valuation. In fact, the banking sector in MSCI Asia ex-Japan is now cheaper than during 2003 SARS period.
- **Equities – Covid-19 is a black swan event**. SARS and H1N1 viruses did not determine the longer term direction of the KLCI. No doubt when the virus was first founded and started to kill people around the world, global markets including Malaysia did feel the jitter and hence profit taking/cut loss activities started to take place. However, we believe the longer-term index trend still rely more on market valuation. Notably, local equity is now relatively more attractive than govvies as FBMKLCI offers better yield pick-up than the 10y MGS where the yield spread has surpassed the previous low of -40bps level.
- **Fixed Income – Pandemic puts investors on defensive mode.** Global growth is expected to fall short of IMF's earlier projections of 3.3% in 2020. Locally, risk-off sentiment has pushed govvy yields to multi-year lows and at this level, it appears that market is pricing in another rate cut in order to moderate the economic impact of the epidemic. We opine that yields will continue to remain low in the interim as noises of rate cut looming into the next MPC meeting in Mar-2020. However, the current 10/3y MGS spread is much narrower than the 5y average and compared to 2003, the average spread was much larger at 71bps. As such, we foresee risks of the 10y MGS yields reversing by around 50bps in 2H 2020 from the current low of near 3.0% once fears of Coronavirus cools off.

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