June Outlook – When To Taper Purchases?

SUMMARY

- **Global manufacturing PMI highlights sustained supply constraints and price pressure.** The JPM Global Manufacturing PMI rose to 56.0 in May-21 from 55.9 in Apr-21 to hit the highest level in just over 11 years. Supply side constraints persisted in May, contributing to soaring prices. Meanwhile, the JPM Global Composite Index rose to 58.4 in May-21, from 56.7 in Apr-21, as service sector rose at the quickest pace in over 15 years and outperformed the manufacturing sector for the second month. The Asia region underperformed relative to its US and European counterparts. Growth in China eased, while Japan and India fell back into contraction.
- **The MCO3.0 and slow pace of vaccination are expected dampen growth outlook, cause further fiscal slippage** and as such lead to higher debt-to-GDP ratio. The road to fiscal and debt consolidation will be even tougher, more so amid political uncertainties. As such, S&P is likely to downgrade the sovereign rating which currently stands at A-/Neg. In the meantime, we foresee BNM to keep the current OPR at 1.75% amid rising inflation but rather more expansionary fiscal measures to be meted out.
- **Bond market review - The local bond yield curve bull steepened last month as new infections rose to record highs while chatters of a full lockdown raised some noises of a further OPR cut.** At the longer-end, yields rose on fears of fiscal slippage and sovereign ratings. The Minister of Finance announced that there will be revisions to growth and debt projections in June.
- **Macro – When to taper asset purchases**. The Fed tends to sterilize excess system liquidity at quarter-ends during QE period. Also, both the US overnight bank funding rate and reverse Repo rate have approaching 0% and likely to attract more discussion on QE tapering in the near term. There are signs of stagflation in the US, thus, the Fed's QE tapering might not materialize easily. Positively, the industrial production gap in Asia largely exceeds its long-term trend, except for the Philippines and Vietnam, signifying the substantial need for capex spending ahead. Investment growth correlates well with manufacturing gap over the years.
- **Equities – Building momentum to go higher.** Despite total lockdown being imposed by our government, the local market has minimal negative re-action probably due to the market had partly expected this lockdown, taking cue from the rising covid cases of late. Also, markets know that it is a matter of time before it rebound when more vaccines come in. Hence, some investors continue to buy on weakness. We continue to recommend investing in economic re-opening stocks/sectors for a quick share price rebound. On the flows wise, retailers had been net buy while both local institutions and foreigners had been net sell YTD. Our market foreign shareholding is all time low at 20.3% due to lack of domestic catalysts.
- **Fixed Income – Local yields will continue to track global yield movements which is expected to rise further** amid chatters of the Fed's taper discussions where inflation gathers pace and economy reopens. As such, **we opine that yields in 2H21 will rise by 10 to 20bps from current levels.** Further risks to the uptick on yields will depend on the Fed's rhetoric on tapering bond purchases and if inflation turns out to be more than transitory.

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