BANK ISLAM

MONTHLY ECONOMIC UPDATE

5 MAY 2023

ECONOMIC RESEARCH

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KEY TAKEAWAYS

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- **Pessimistic growth outlook persists as the fight against inflation rages on.** The first quarter advanced estimate for the U.S. displays sluggish growth while inflation floats above target at 4.2%. In a preliminary estimate, the U.S. Bureau of Economic Analysis (BEA) reported that U.S. GDP grew by 1.1% on a quarterly basis (4Q2022: 2.6%), underpinned by stronger consumer spending. However, during the Federal Open Market Committee (FOMC) meeting on 2-3 May, the Federal Reserve (Fed) Chairman Jerome Powell announced a federal fund rate (FFR) hike of 25bps, bringing the cumulative rate to 5.00%-5.25% to combat inflationary pressures. Inflation will likely subside further in the coming months. Stressing that tighter credit conditions negatively impact several sectors – particularly housing and investment – Powell reassures that such measures, and subsequent periods of below-trend growth, are undertaken for the long-term impact on price stability.

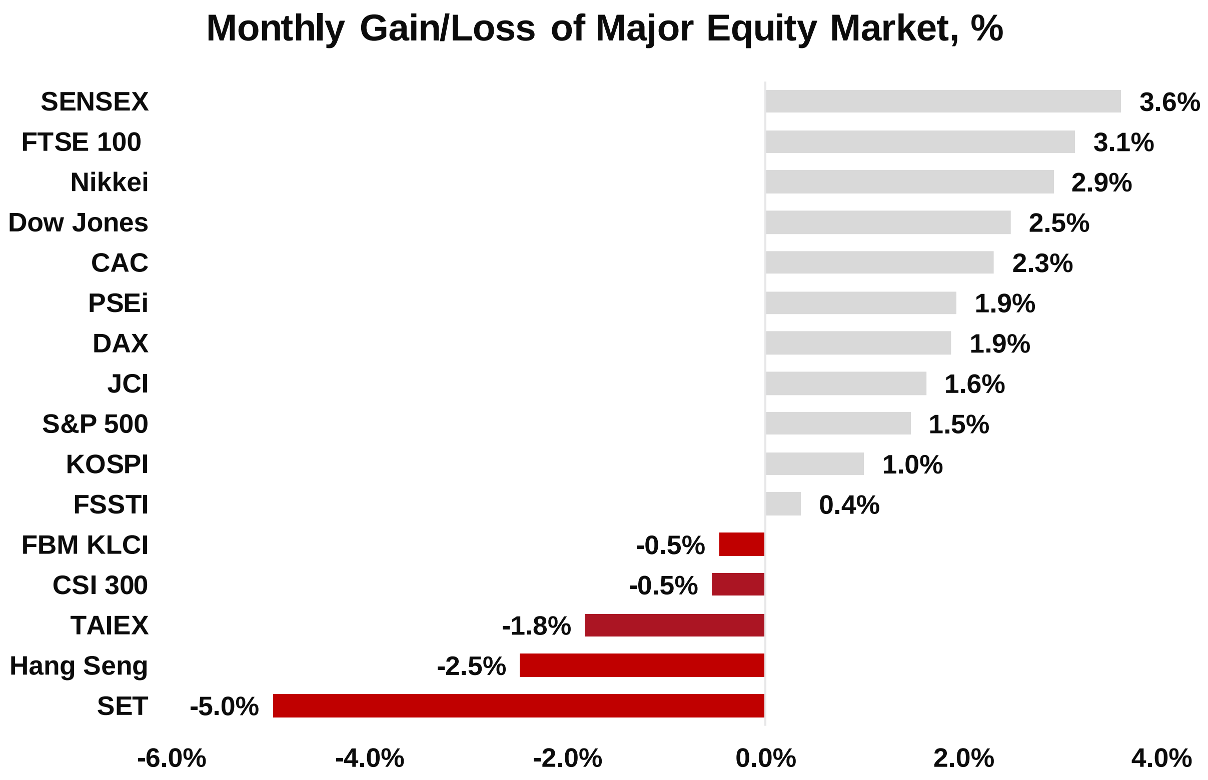
- **China's better-than-expected 1Q2023 performance.** Following the reopening of China's borders as their zero-COVID policy was lifted, China experienced a stronger-than-expected recovery with 1Q2023 GDP growth coming in at 4.5% y-o-y (4Q2022: 2.9%). The performance was driven by consumption following an uptick in retail sales as confidence among consumers recovered and a surge in exports (March: 14.8% vs. January-February: -6.8%). However, deflation risks, supply chain disruptions and global economic slowdown pose headwinds to their growth. As such, JP Morgan has revised their 2023 growth forecast for China (New: 6.4% vs. Old: 6.0%).

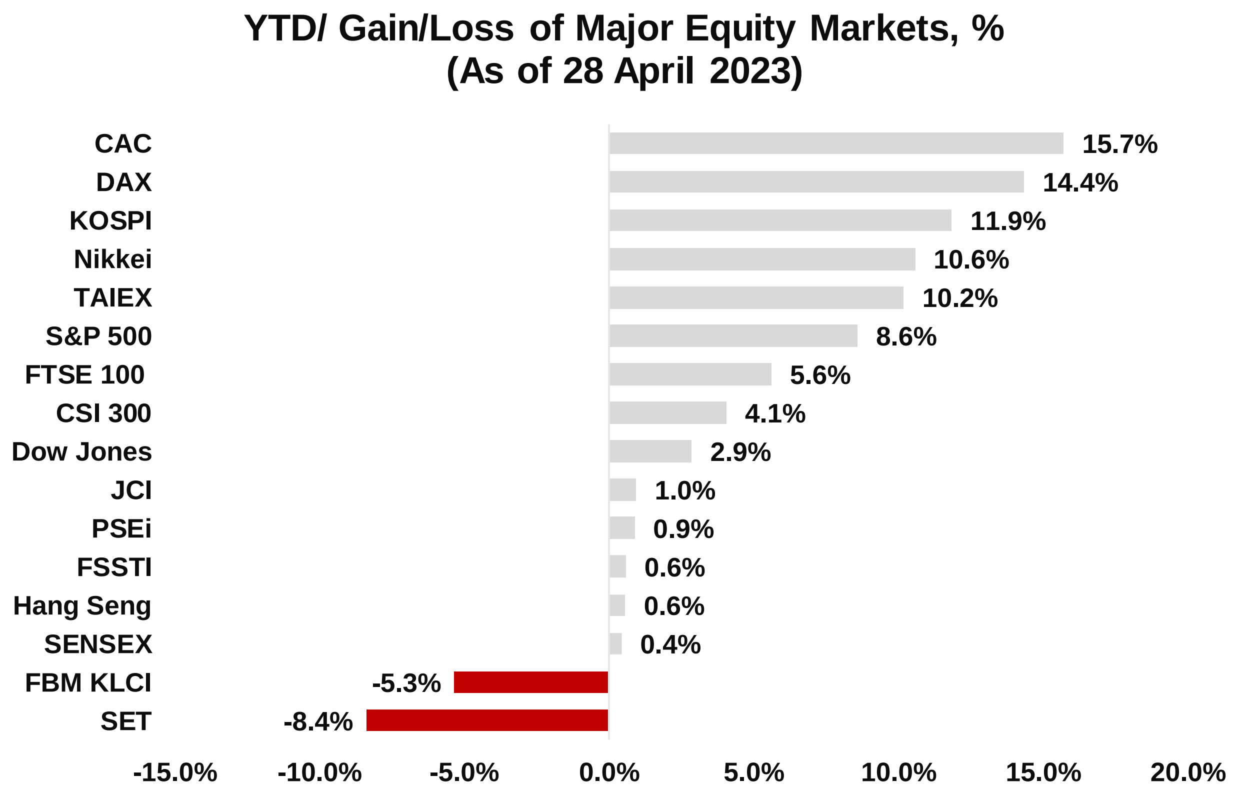
- **OPR is higher at 3.00%, suggesting a strong 1Q2023 performance.** Following the Bank Negara Malaysia's (BNM) Monetary Policy Committee (MPC) meeting on 2-3 May, BNM raised the Overnight Policy Rate (OPR) by 25bps to 3.00%. The decision to end the policy normalisation cycle is premised on the anticipation of strong 1Q2023 performance rather than nailing down inflation. BNM reaffirmed that the monetary policy stance would consider both inflation and growth outlook moving forward. Such growth was underpinned by resilient domestic demand as the labour market conditions improved, with the latest unemployment rate falling to 3.5% in February (January: 3.6%). Therefore, despite moderating exports amid global headwinds, the immediate-term outlook on the Malaysian economy remains rosy.

SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: THE MAJORITY OF MARKETS ENDED ON A HIGHER NOTE IN MARCH DESPITE RECESSIONARY SIGNS





Sources: Bursa, CEIC

- Majority of the regional markets closed positively, with India's SENSEX index leading the gainers by 3.6% m-o-m, followed by United Kingdom's FTSE 100 (3.1%) and Japan's Nikkei (2.9%).
- Despite the slowing US economy, the Fed continued hiking rates by 25bps in May, bringing the FFR in the range of 5.00% and 5.25% before an anticipated pause in June. The central bank will likely initiate a pause, but the duration of such a move remains contentious.
- YTD, France's CAC headed the gainers by 15.7% as upbeat corporate earnings counterbalance concerns about an economic slowdown.

DOMESTIC EQUITY: LOCAL MARKET LARGELY REMAINS POSITIVE AMID HOPES FOR PAUSE IN RATE HIKES

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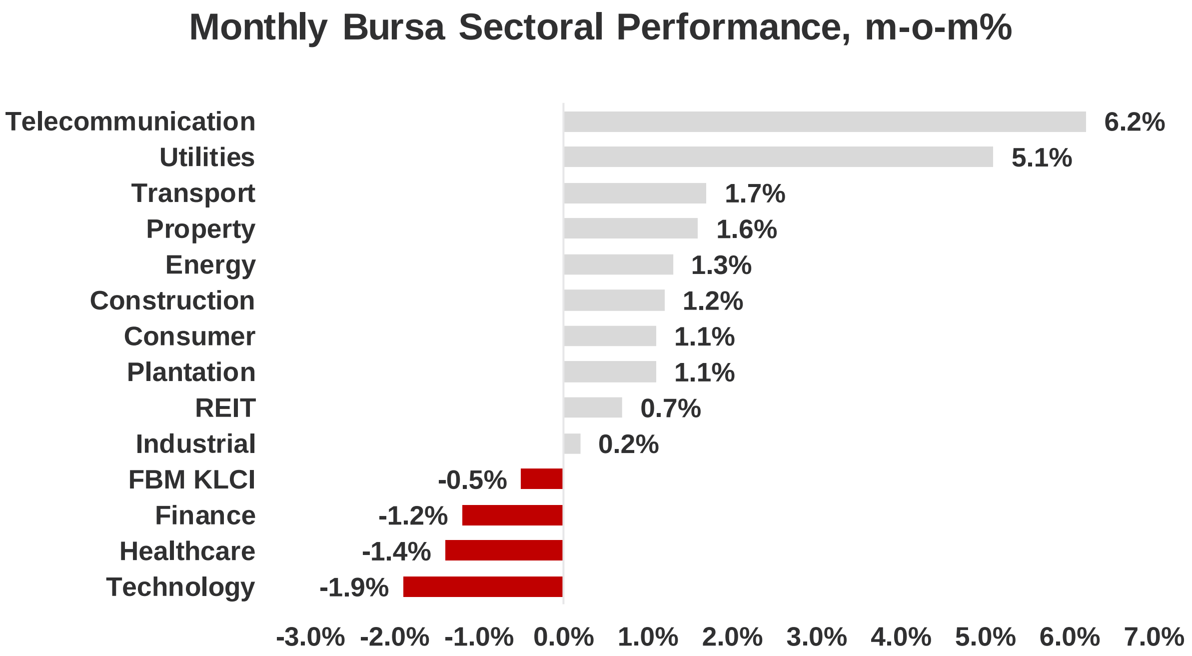

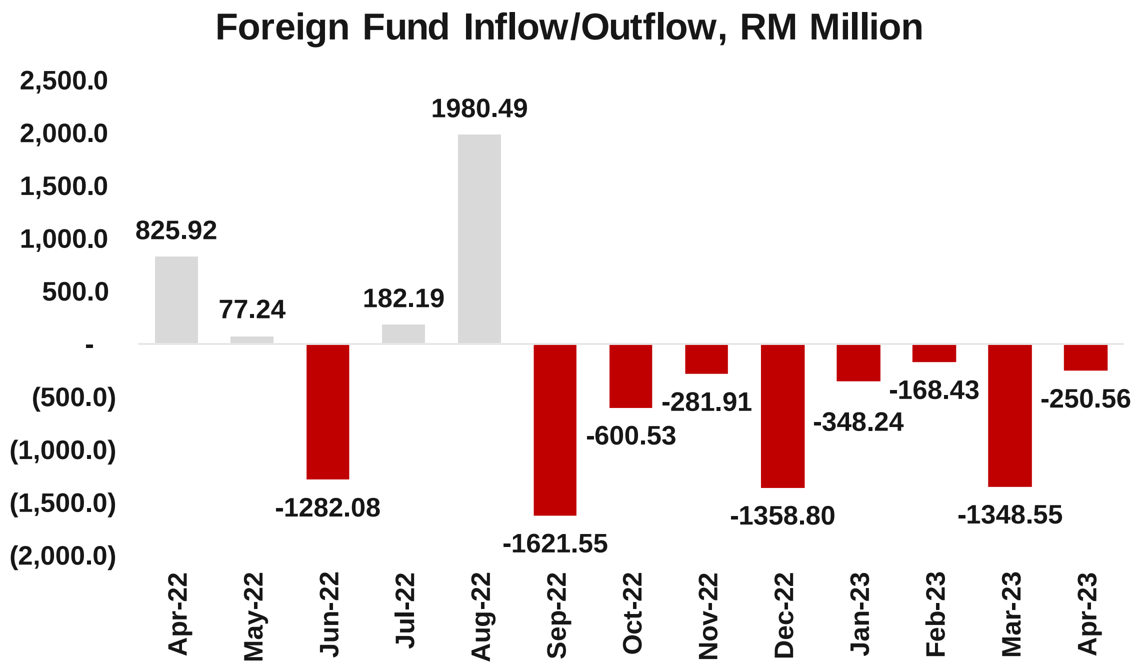

Sources: Bursa, BNM

- Most Bursa sectoral indices closed in the green during April, with Telecommunications (6.2%) and Utilities (5.1%) leading the gainers by a large margin. The biggest decliner is Technology, tumbling by 1.9% m-o-m.
- Another highlight is the finance sector slipping by 1.2% m-o-m as still fragile sentiments following the banking turmoil in advanced economies were further eroded by the recent failure of the First Republic Bank. Other US regional banks are also under the spotlight.
- Meanwhile, as the paths of the Fed's FFR and BNM's OPR were still shrouded with uncertainties, foreign investors' selling spree continued in April, with the total net outflows amounting to RM 250.56 million, recording the eighth straight month of foreign net outflows.
- We anticipate FBM KLCI will be cautiously traded amid mixed sentiments following the May OPR hike to 3.00%.

FIXED INCOME: DOWNTREND IN BOND YIELDS AND HIGHER FOREIGN HOLDINGS IN LOCAL BONDS AMID RECESSIONARY FEARS

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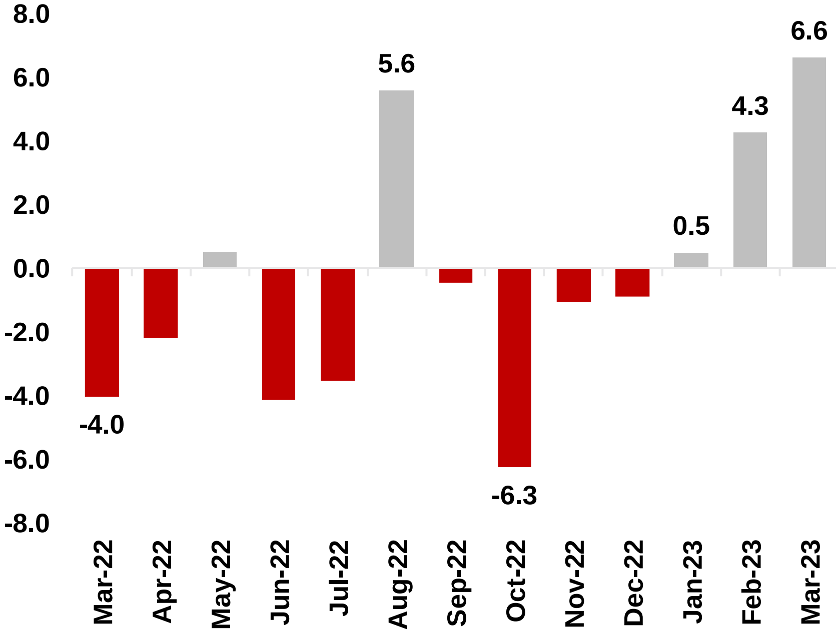
Monthly changes, basis points (bps)

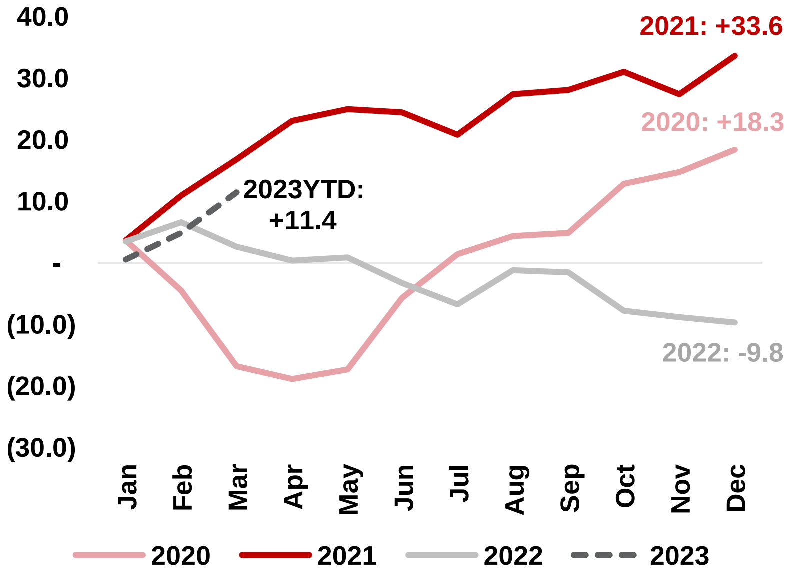
UST	Yields (%) 31-Mar-23	Yields (%) 28-Apr-23	Change (bps)
3-Y UST	3.81	3.75	-6
5-Y UST	3.60	3.51	-9
7-Y UST	3.55	3.49	-6
10-Y UST	3.48	3.44	-4
MGS	**Yields (%) 31-Mar-23**	**Yields (%) 28-Apr-23**	**Change (bps)**
3-Y MGS	3.35	3.32	-3
5-Y MGS	3.54	3.45	-9
7-Y MGS	3.81	3.65	-16
10-Y MGS	3.90	3.74	-16
GII	**Yields (%) 31-Mar-23**	**Yields (%) 28-Apr-23**	**Change (bps)**
3-Y GII	3.31	3.25	-6
5-Y GII	3.60	3.51	-9
7-Y GII	3.85	3.74	-11
10-Y GII	3.96	3.85	-11

Sources: BNM, Federal Reserve Board

Foreign Fund Flows in Local Bond Market, RM billion



Cumulative Net Foreign Flows in Local Bonds (Yearly comparison, RM billion)



- Overall, the U.S. Treasury (UST) yields decreased in April in the range of 4bps to 9bps, with the belly of the curve falling the lowest by 9bps amid concerns over possible US recession accompanied by the continued inversion of the yield curve.
- Local govvies, Malaysian Government Securities (MGS) and Government Investment Issues (GII) also slipped in April, with the longer tenure dropping with a larger momentum relative to the shorter tenure.
- Foreign investors remained as net buyers of local bonds for three consecutive months, with March recording the highest net foreign inflows since February 2021 at RM 6.6 billion.
- YTD, cumulative net foreign inflows managed to reach RM11.4 billion, significantly higher than RM2.6 billion logged in the same period in the previous year.

FX MARKET: RINGGIT ENDED LOWER AGAINST THE USD IN APRIL

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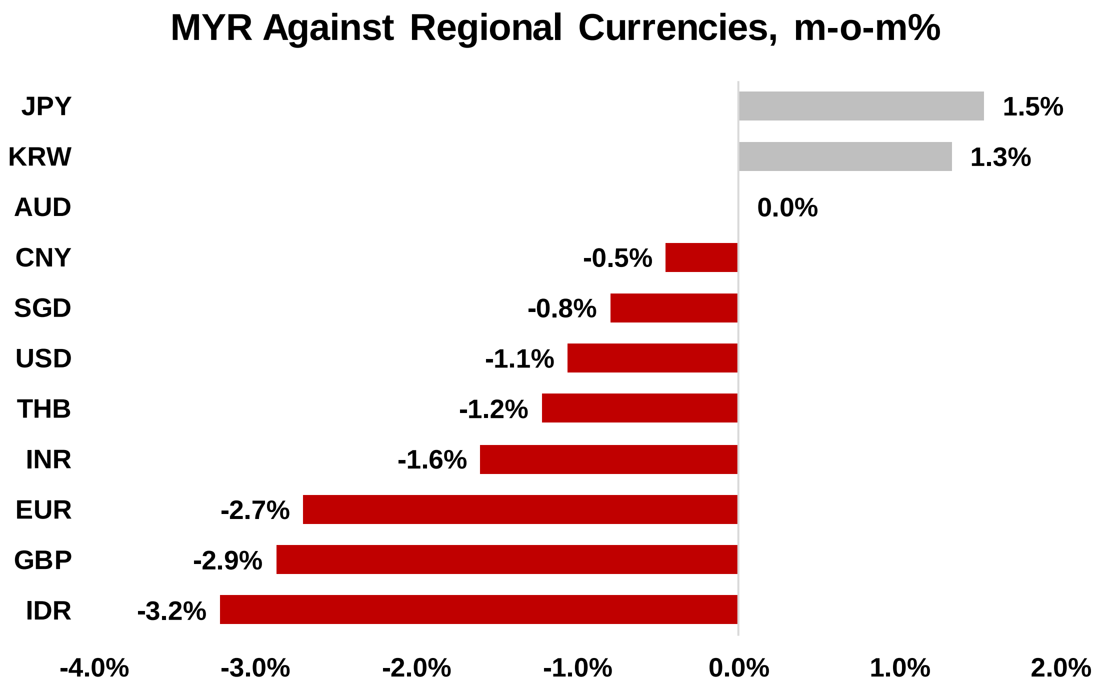
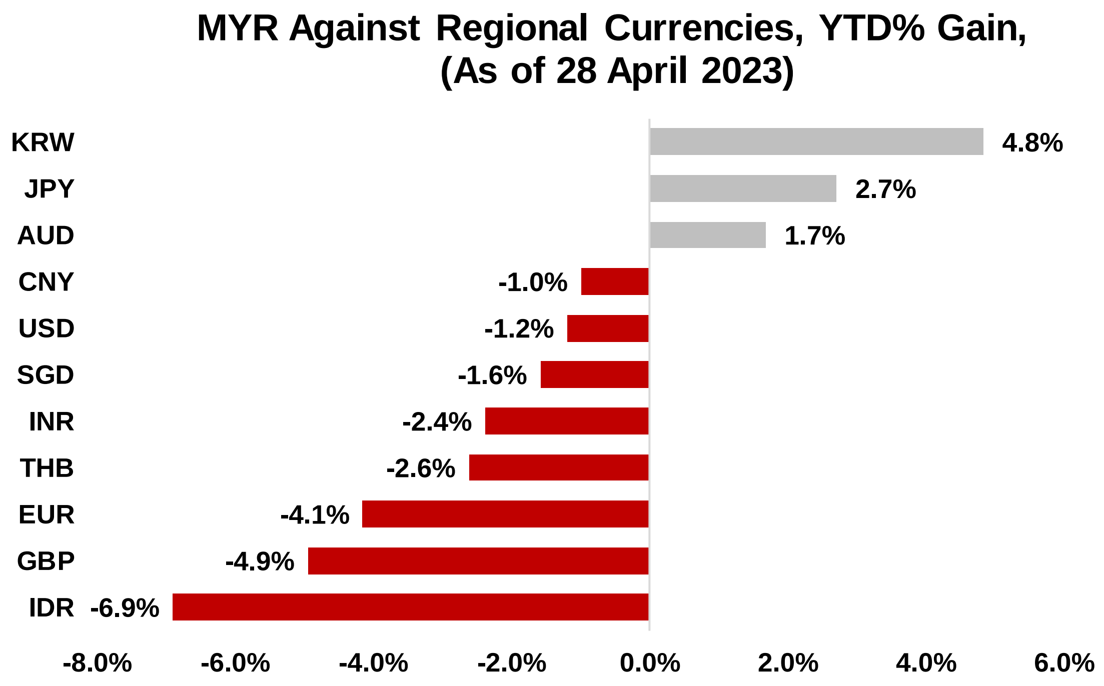




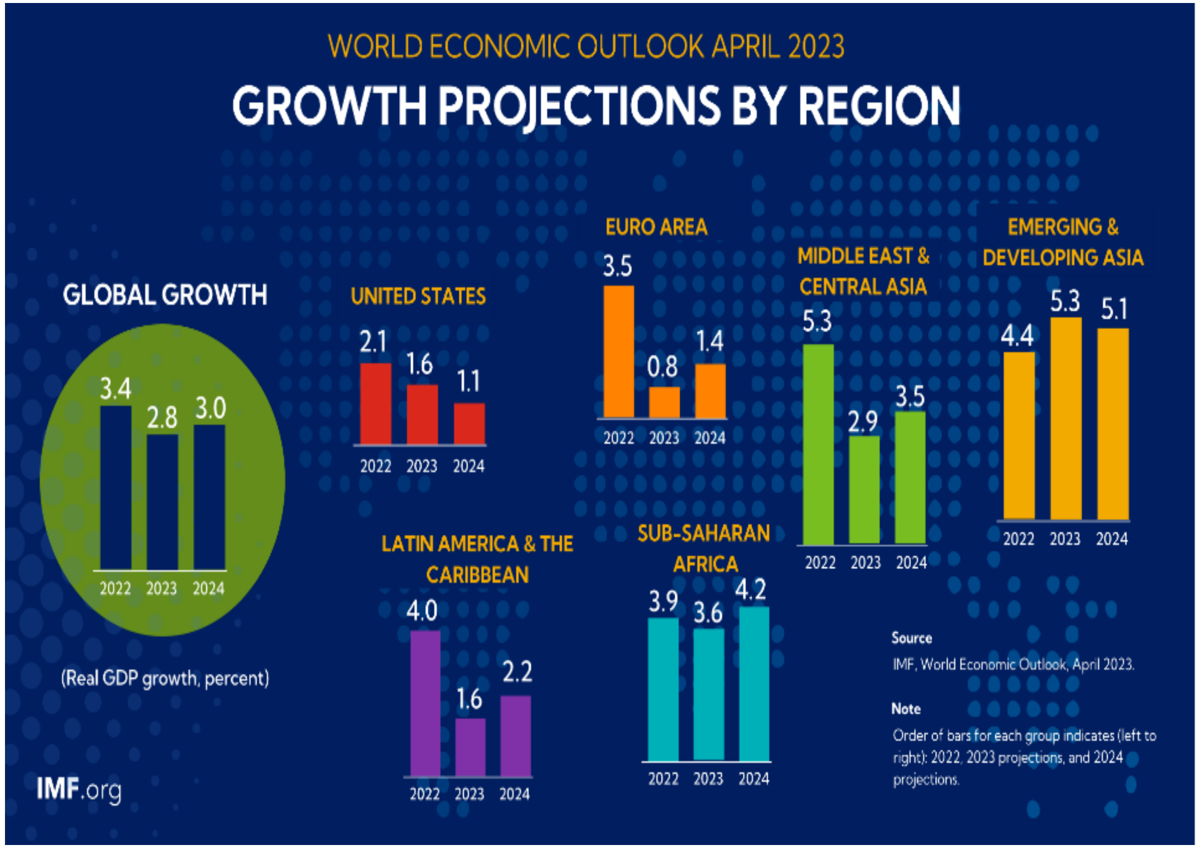
Source: Investing.com

- The Ringgit depreciated against the USD on a monthly basis, closing at RM4.4580 on 28 April (31 March: RM4.4100), perhaps due to weaker-than-expected U.S. 1Q2023 GDP data (Est: 1.9% vs. Act: 1.1%) as the rising interest rates continued to hurt the economy with both consumers and businesses were mindful of the economic outlook.
- Global oil prices declined and fell below USD80.0 per barrel towards end-April as market participants struggled with the prospect of further rate hikes and the lingering uncertainties around Chinese demand.
- China’s y-o-y inflation report came in lower at 0.7% in March (February: 1.0%), reflecting the uneven economic recovery following the removal of its zero-COVID policy. This scenario, in turn, may have also affected the local note movement during the month.
- With the “hawkish pause” tone from the latest FOMC meeting, we expect it could support the Ringgit soon. We posit that market participants would be closely eyeing the upcoming April CPI figure to assess the Fed’s next move.
- The CME Group FedWatch is pricing in a 98.0% probability of a pause in the next FOMC meeting.

SECTION 2

The Global Economy

IMF DOWNGRADES THE GLOBAL PROJECTION AMID BANKING WORRIES



Source: International Monetary Fund (IMF), April 2023 World Economic Outlook

- The IMF's baseline forecast for 2023 is slightly lower by 0.1% than predicted in January before rebounding to 3.0% in 2024, pointing to the recent financial market uncertainties in the U.S. and the E.U. and the still-raging Russia-Ukraine military conflict.
- Notably, the advanced economies will likely experience a slowdown of about 1.3% in 2023 from 2.7% last year. Likewise, both emerging market and developing economies dropped slightly to 3.9% during the year from 4.0% in 2022.
- As for Malaysia, the growth is anticipated at 4.5% in 2023 and 2024, supported by a resilient job market and seemingly low-inflation print.

THE FED RATE HIKES ARE STARTING TO SLOW THE U.S. ECONOMIC GROWTH FOLLOWING A FIGHT TO TACKLE THE CONSUMER-LEVEL INFLATION

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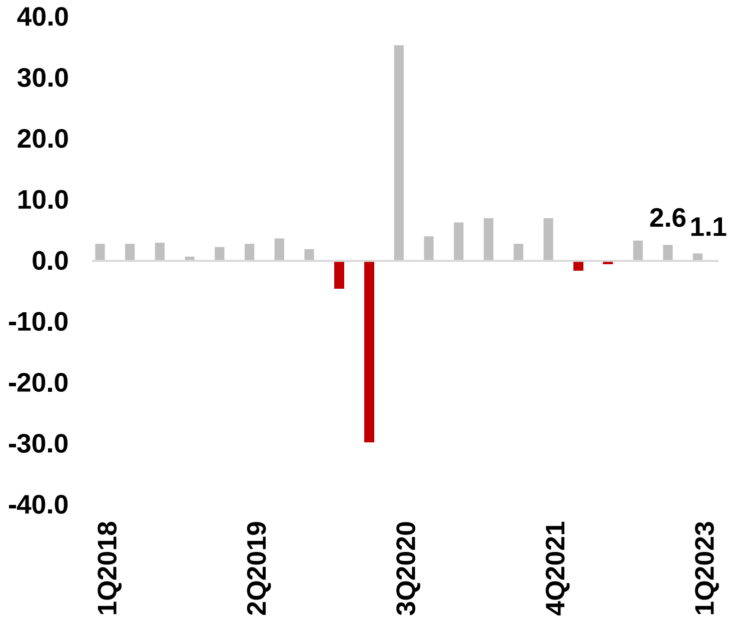
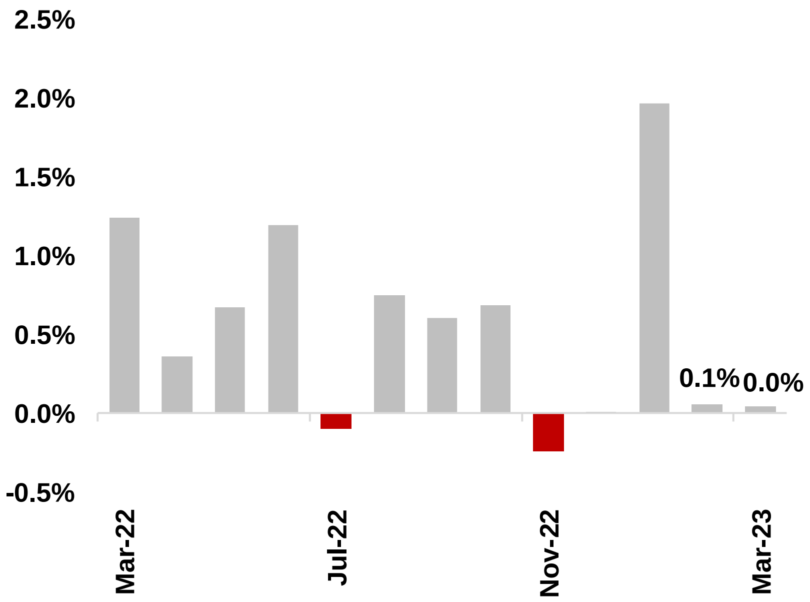
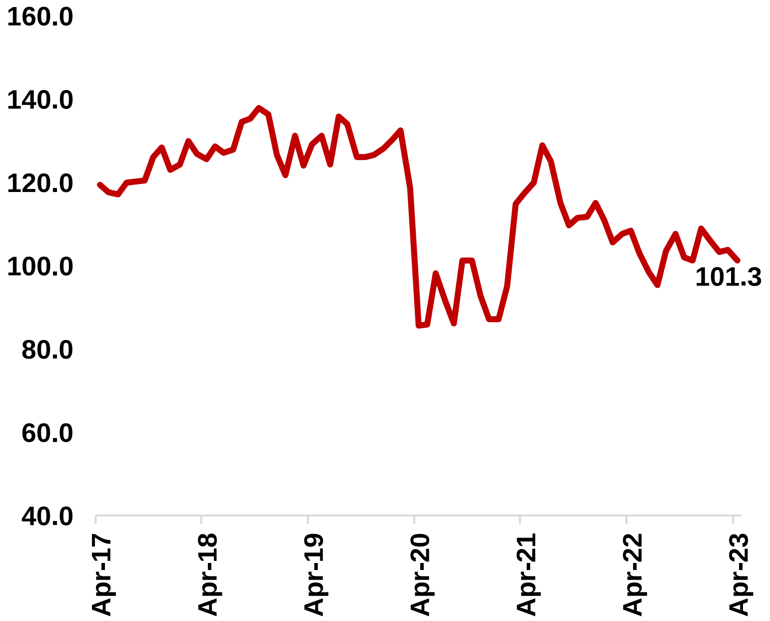


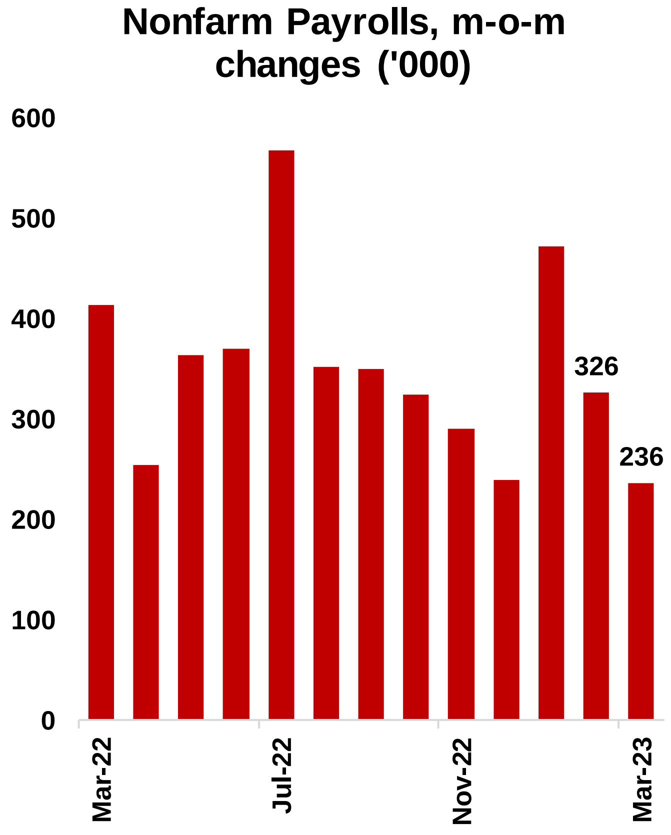


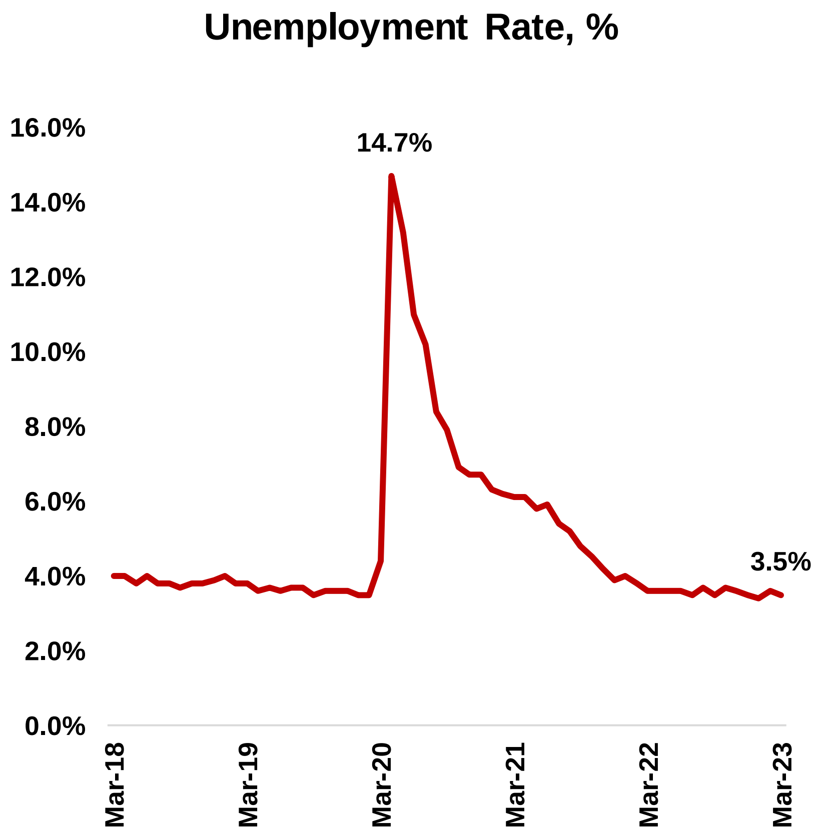


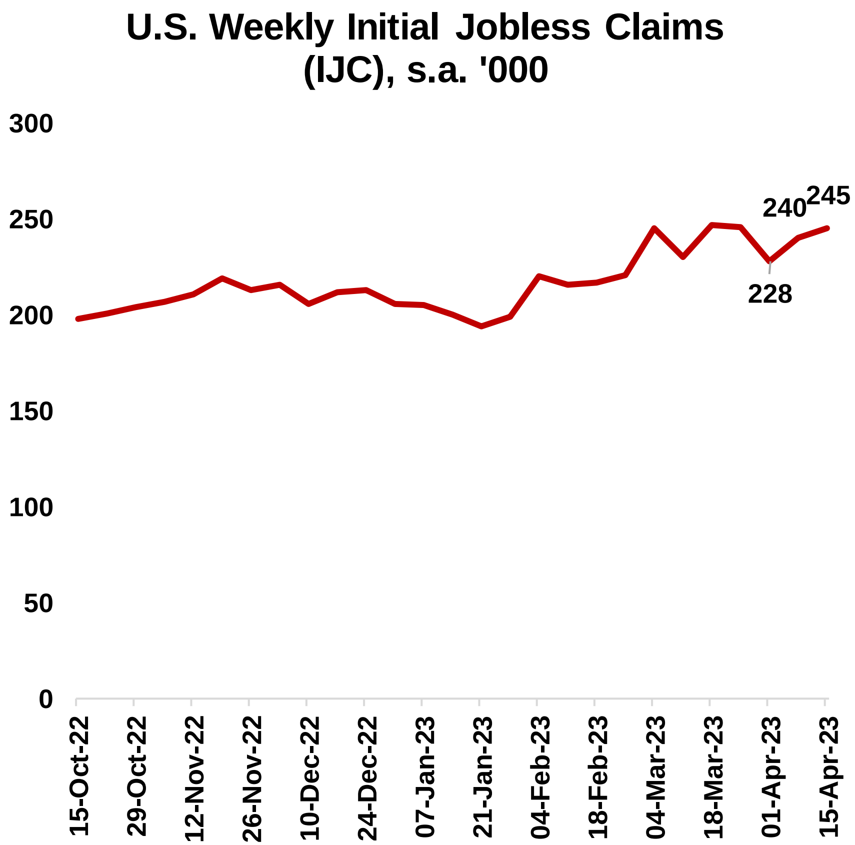
Sources: BEA, The Conference Board

- The U.S. GDP grew moderately during 1Q2023, a significant slowdown from the 2.6% expansion in the previous quarter, reflecting that both interest rates and sticky inflation took a toll on the economic growth.
- Additionally, the spending was flat in March; part could be due to the still persistently high inflation and borrowing costs weighing on consumer spending. Though such a figure beats the anticipation for a slight m-o-m decline of 0.1%, it also suggests that the robust-and-resilient spending pattern can no longer withstand the high borrowing cost.
- Meanwhile, the Conference Board reported that the consumer confidence index fell to 101.3 points in April (March: 104.0 points), marking the fourth time overall U.S. consumer confidence has declined amid anxiety over a slowing economy and possible recession.

THE U.S. LABOUR MARKET STARTED COOLING YET IT STILL REMAINS EXCEPTIONALLY TIGHT







Sources: U.S. Bureau of Labor Statistics, CEIC, U.S. Department of Labor

- The overall message is that the labour market is undoubtedly cooling, but we think that such a pace is insufficient for the Fed to waver its inflation fight.
- As mentioned earlier, the Fed raised FFR in the latest May meeting, aligning with the market expectations. The central bank also signaled a possible pause after lifting the rates ten times in a row to contain sticky inflation.
- U.S. weekly initial jobless claims are trending higher in the past weeks, suggesting that the intended effects of aggressive rate hikes are working as intended.

ONCE AGAIN, THE E.U. ECONOMY AVOIDED A CONTRACTION AS INFLATION WORRIES STILL LINGER

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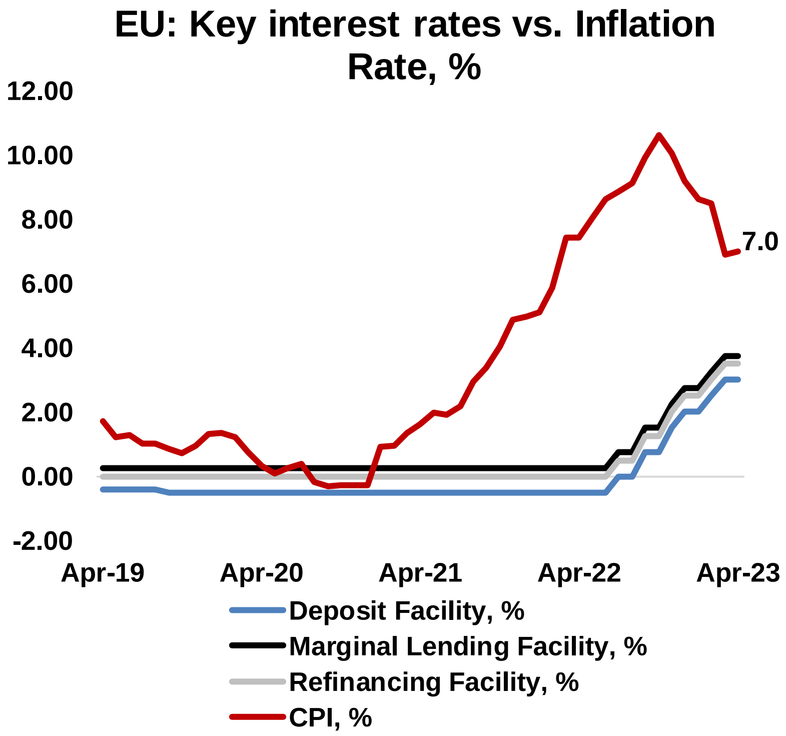

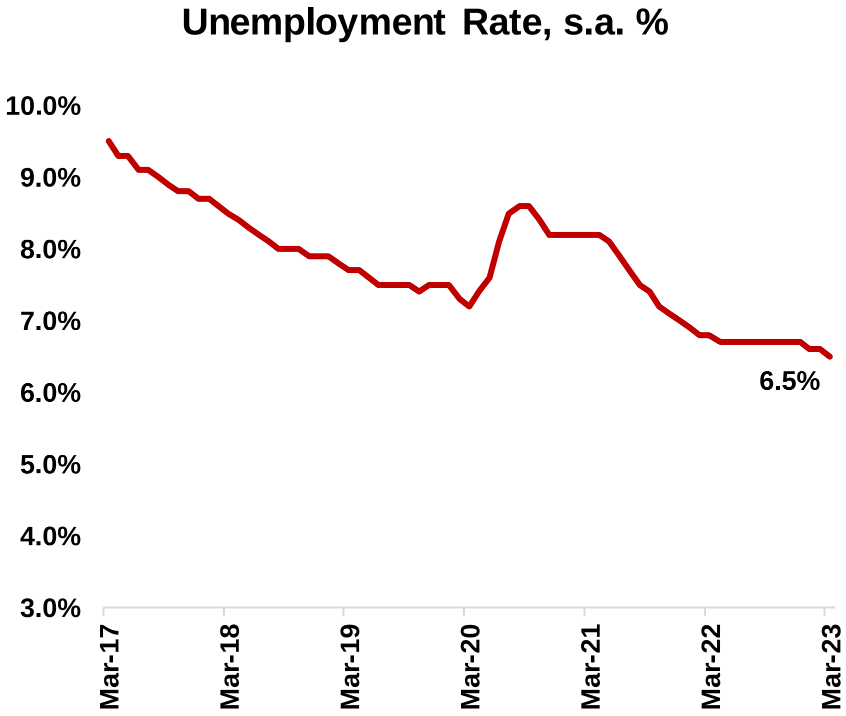

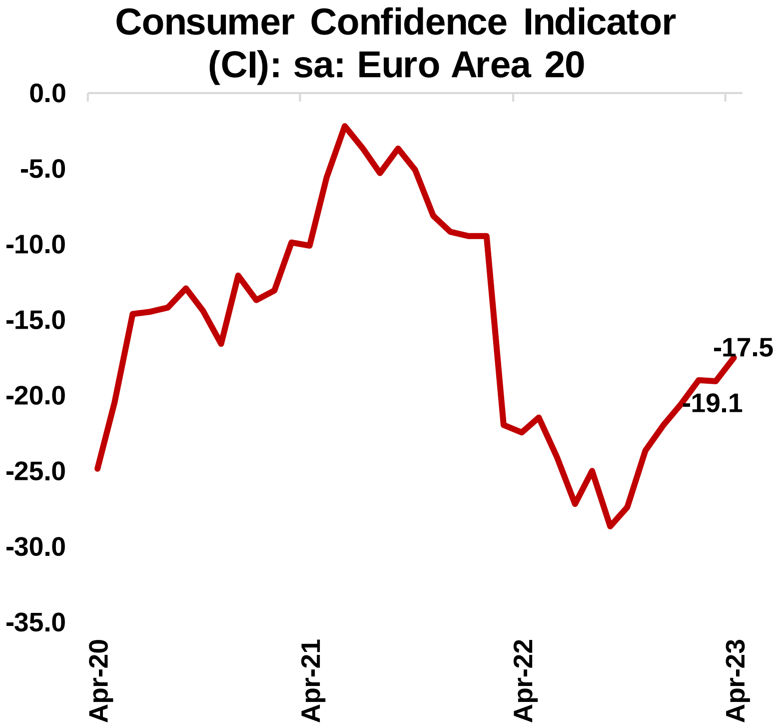

Sources: European Central Bank (ECB), European Union, European Commission's Directorate-General for Economic and Financial Affairs

- The GDP grew slightly at 0.1% q-o-q in 1Q2023 (4Q2022: 0.0%), missing the 0.2% forecast, suggesting that the economic performance contends with the persistently high inflation, with energy prices have been the primary driver over the past year.
- While the E.U. inflation has started to edge down from record highs (October 2022: 10.6%) at the start of the year, the latest print recorded an uptick to 7.0% y-o-y in April (March: 6.9%), implying the central bank is likely to resume its policy tightening. The ECB pushed its policy rate higher by 25bps this week. With the inflation rate remaining elevated, the ECB has lifted rates with an accumulative of 375bps since July last year.
- On the bright side, the labor market has seen record-low unemployment levels, providing a solid base for continued consumption. Consumer confidence improved in April following the previous month's decline, indicating an upbeat outlook.

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SECTION 3

Domestic Landscape & Banking Sector Update

POSITIVE OUTLOOK ON THE ECONOMY DESPITE GLOBAL SLOWDOWN

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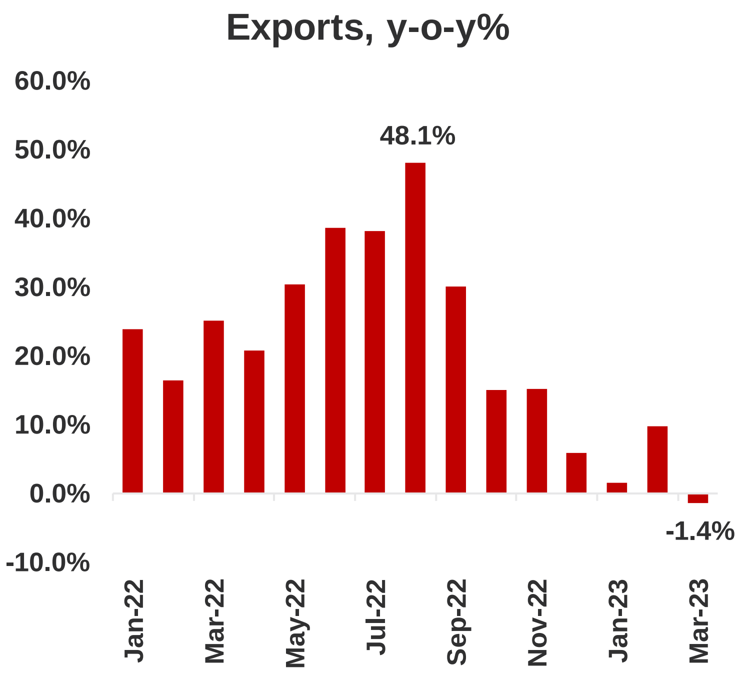

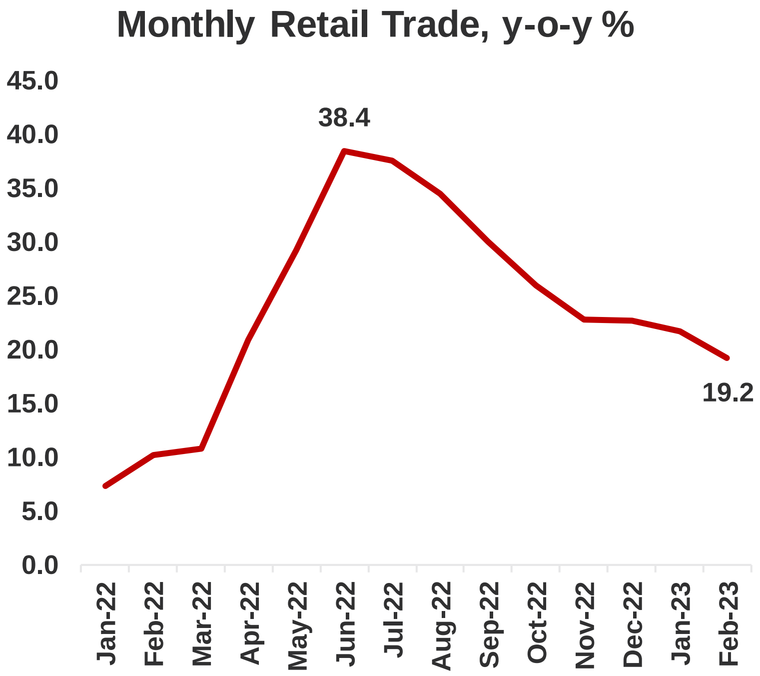

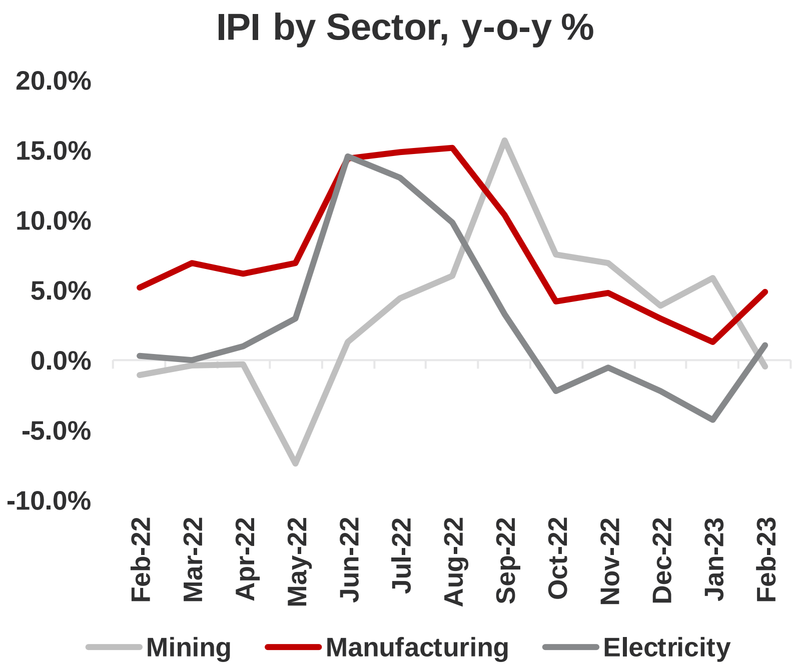

Sources: BNM, DOSM, MIDFR, CEIC

- Malaysia's export has been on a downward trend, with a contraction of 1.4% y-o-y in March (February: 9.8%), marking the first decline over two years. The negative performance was underpinned by lower commodity prices and weakening demand amid a global slowdown.
- On the other hand, Malaysia's retail sales remain strong despite higher living costs, rising by 19.2% y-o-y in February (January: 21.7%) as inflation decelerates and the labour market condition improves.
- This resilient domestic demand persists following the central bank's decision to raise the OPR by 25bps, signaling a convincing near-term economic outlook and reflecting positive consumer confidence.
- Meanwhile, the IPI rose by 3.6% y-o-y in February (January: 1.8%), driven by higher manufacturing output (February: 4.9% vs. January:1.3%), which led to a turning tide in electricity output (February: 1.1% vs. January:-4.3%). However, a contraction in crude petroleum and LNG production as external demand falls has led to declining output in the mining sector.

BANKING SECTOR: LOWER FINANCING GROWTH IN HOUSEHOLD AND NON-HOUSEHOLD SECTORS

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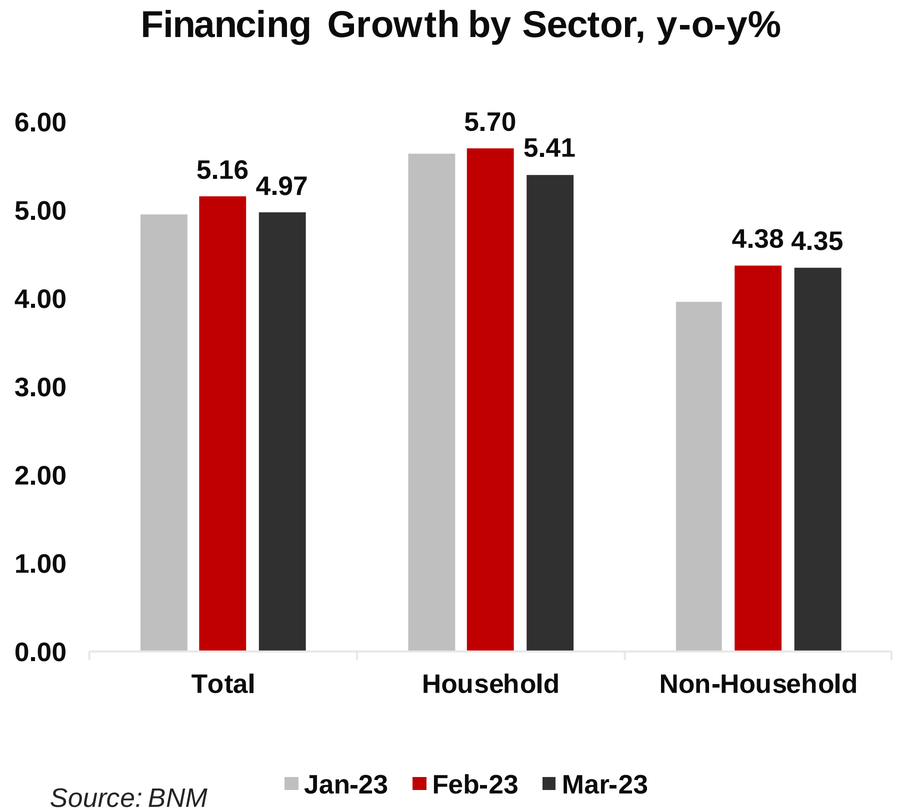
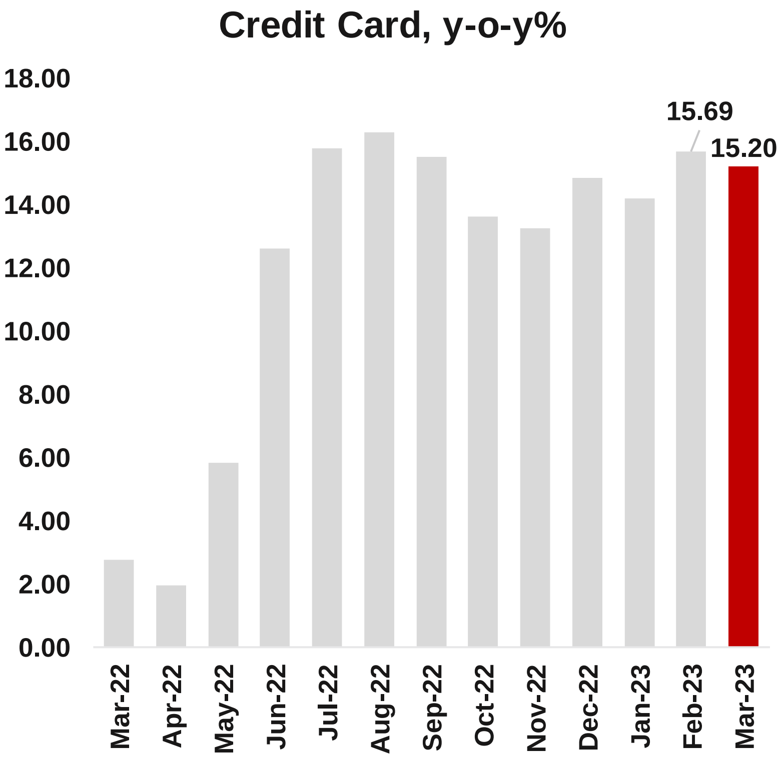
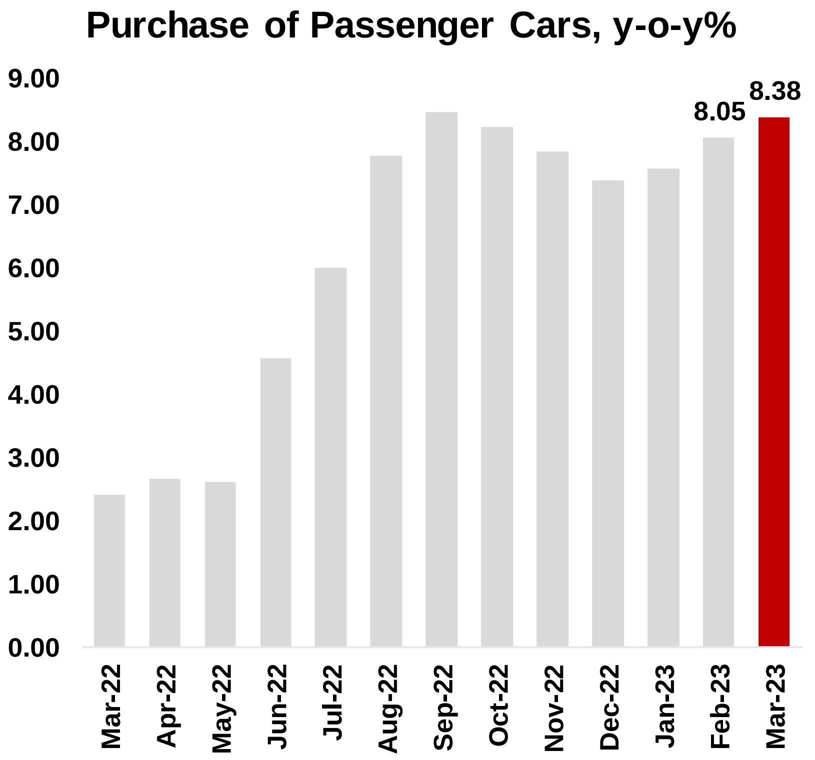


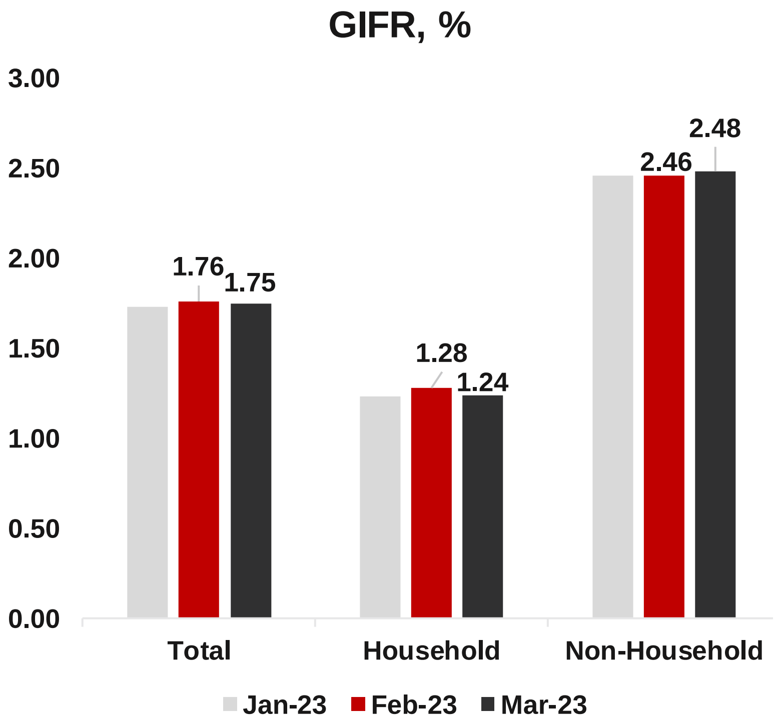
Source: BNM

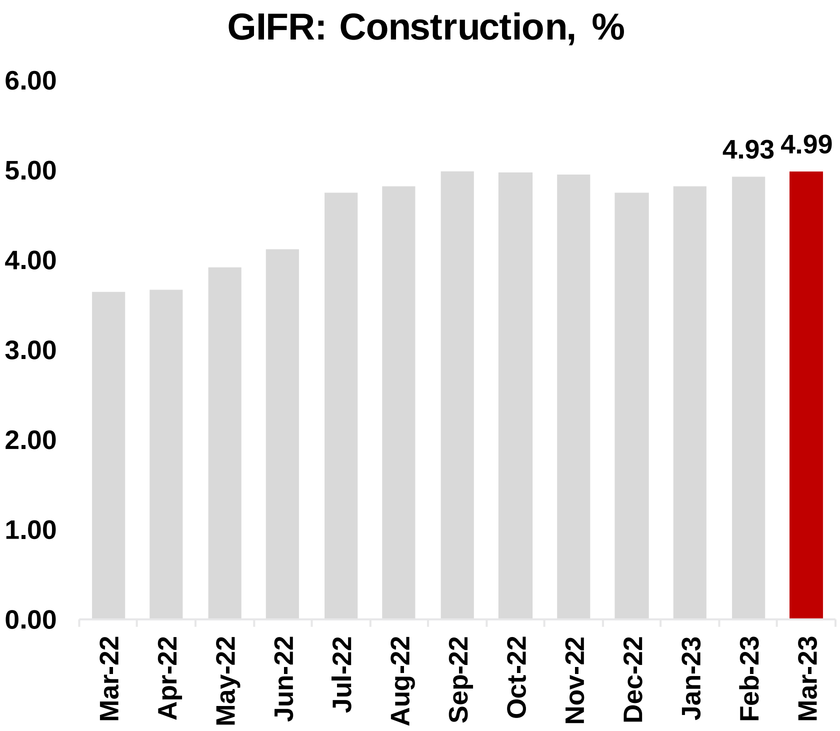


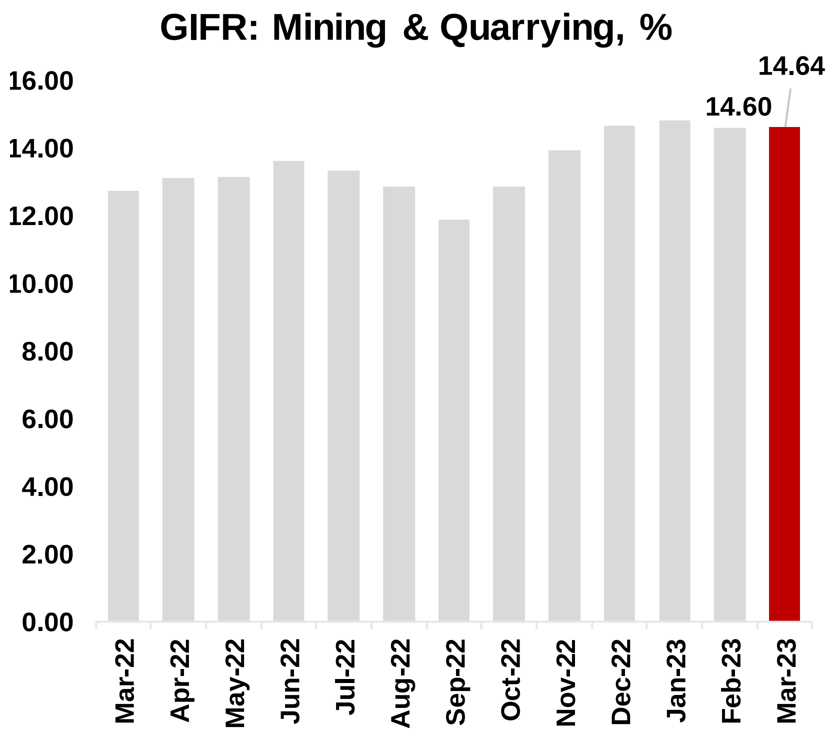


- Financing activities slowed to 4.97% in March, relatively lower than 5.16% in February. Breaking it down, the household sector grew at a slower pace of 5.41% (February: 5.70%) and the Non-Household sector also experienced slower growth momentum at 4.35% (February: 4.38%).
- The credit card segment displayed growth at a slower rate of 15.20% in March compared to 15.69% in February, in parallel with the declining financing growth in the Household sector.
- Nevertheless, the purchase of passenger cars showed a higher growth of 8.38% in March from 8.05% in February amid a lower OPR.

BANKING SECTOR: HIGHER IMPAIRMENT WITHIN THE NON-HOUSEHOLD SECTOR







Source: BNM

- Total Gross Impaired Financing Ratio (GIFR) dragged marginally lower at 1.75% in March (February: 1.76%) in parallel with the lower GIFR in the Household sector. On the other hand, the Non-Household sector uptrend to 2.48% in March (February: 2.46%).
- In tandem with the increase in GIFR in the Non-Household segment, GIFR for the Construction industry increased by 4.99% in March, higher than 4.93% in February. Meanwhile, impairment for Mining and Quarrying segment also dragged upwards to 14.64% in March (February: 14.60%).

THANK YOU