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MONTHLY ECONOMIC UPDATE

3 AUGUST 2023

ECONOMIC RESEARCH

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KEY TAKEAWAYS

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- **Fed resumes lifting rates and leaves the door ajar for another hike.** After a rate pause in June, the U.S. Federal Reserve (Fed) announced a 25bp rate hike at its policy meeting on July 26. The hike, which pushed the Fed funds rate (FFR) target range to a 22-year high of 5.25% to 5.50%, is widely expected amid the tightness in the U.S. labour market and the still above-target inflation. While the price pressure has been moderating, with the Fed's preferred inflation gauge easing to 4.1% in June (May: 4.6%), Fed Chair Jerome Powell reiterated that the fight to return inflation to the 2.0% target still has a long way to go. This implies further hikes remain on the table; as Powell noted, "it is certainly possible that the Fed would raise rates again in September if data warranted". However, the markets were less convinced even after the stronger U.S. GDP print (2Q2023: 2.6% vs 1Q2023: 1.8%), pricing in an 80.5% chance that the Fed will stand pat in September as of the time of writing.

- **Weaker-than-expected data mounts pressure on China's policymakers to step up their stimulus measures.** China's 2Q2023 GDP growth was higher at 6.3% (1Q2023: 4.5%), partly flattered by base effects. However, the rate fell short of market expectations which envisaged a more rapid rebound following the country's reopening. A recent stream of economic data continued to paint a bleak picture of the economy, reinforcing the view that additional stimulus measures would be needed to achieve the government's growth target of more than 5.0% this year. For context, China's official manufacturing Purchasing Managers' Index (PMI) remained in the contraction zone for the fourth consecutive month in July, while the non-manufacturing PMI slowed to its weakest this year thus far. However, China's policymakers appeared reluctant to deliver any large-scale stimulus amid concerns about rising debt.

- **BNM holds OPR steady.** In line with consensus, the Bank Negara Malaysia (BNM) left Overnight Policy Rate (OPR) unchanged at 3.00% at its July meeting after a rate hike of 25 bps in May. The tone from the accompanying Monetary Policy Committee (MPC) statement implied that the BNM is nearing the end of its rate tightening cycle as the central bank acknowledged the moderating economic growth and inflation in recent months. Nevertheless, we maintain our view that the possibility of another OPR hike in the remainder of the year remains only if the unemployment rate steadily improves, reaching 3.3% in August when the official data released in October, a month before the scheduled final MPC meeting on 1-2 November 2023.

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SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: ASIAN STOCKS ENDED ON A FIRMER NOTE AMID GROWING OPTIMISM OVER CHINA STIMULUS TALKS

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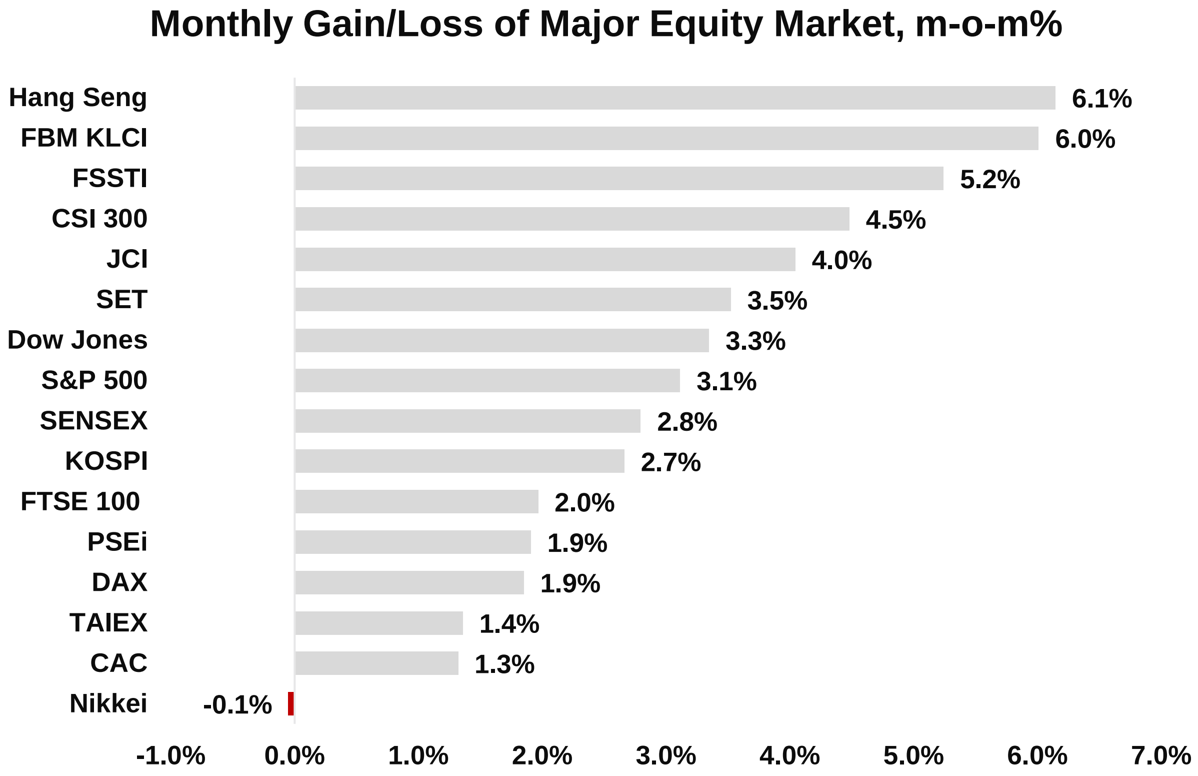
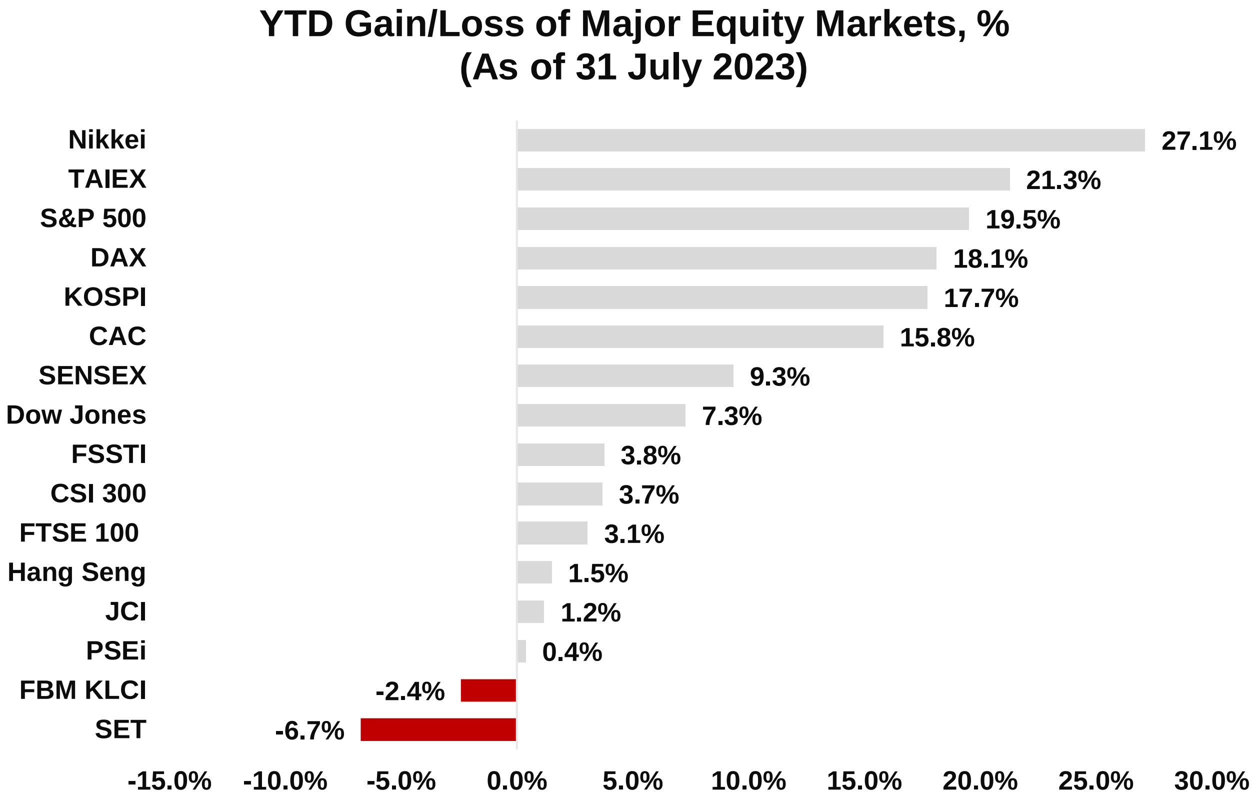
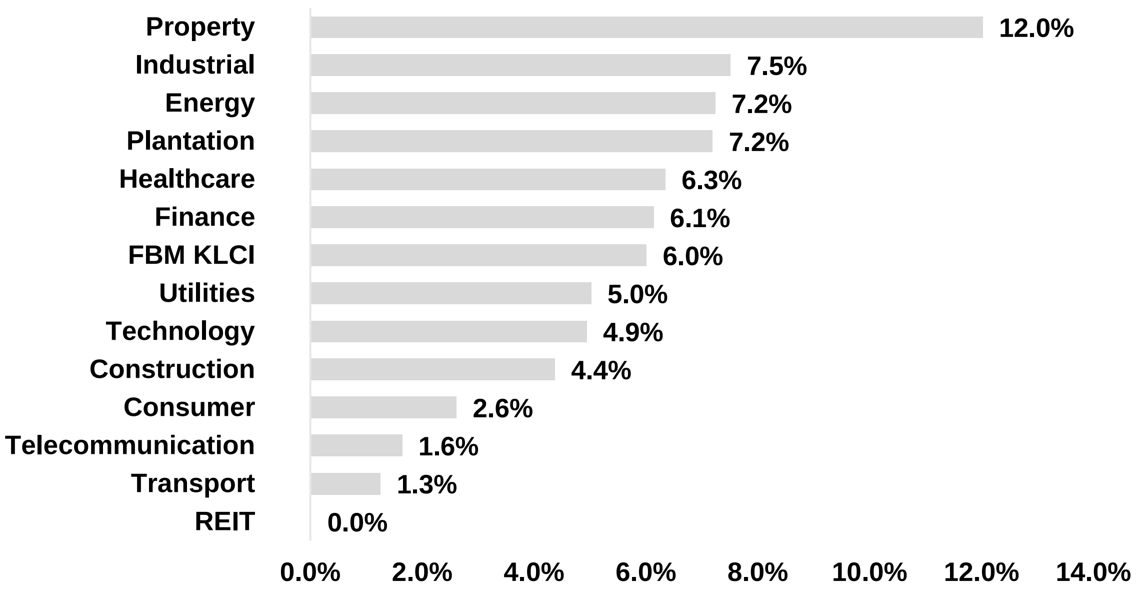


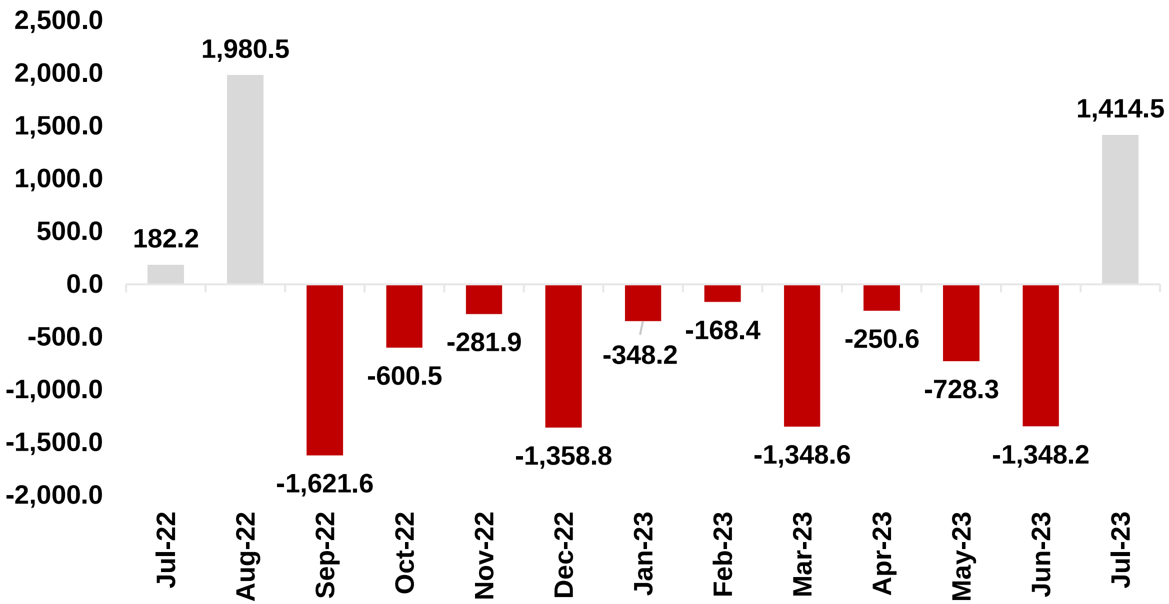


Sources: Bursa, CEIC

- In July, the global stocks market mostly traded cautiously in the green. Hong Kong's Hang Seng recorded the highest gain of 6.1%, followed closely by Malaysia's FBM KLCI at 6.0% and Singapore's FSSTI, which logged growth of 5.2%.
- In contrast, Japan's Nikkei was the only loser in July, which fell by merely 0.1%.
- Most Asian stocks rose in July as optimism over more Chinese stimulus measures largely offset the data reflecting deterioration in China's business activity in July. Additionally, increasing hopes of the U.S. interest rate hiking cycle nearing its end aided regional markets after recent data showed that the Fed's preferred inflation gauge eased in June.
- As of the first seven months of the year, Japan's Nikkei was the top performer, leading with a 27.1% gain.

DOMESTIC EQUITY: LOCAL MARKET RALLIED ALONGSIDE REGIONAL EQUITIES





Source: Bursa, BNM

- All Bursa sectoral indices ended in the green in July, with Property leading with a 12.0% gain, followed by Industrial (7.5%) and Energy (7.2%).
- Investors' sentiment received a boost from the gains in regional equities amid rising hopes of additional stimulus measures from China.
- Foreign investors turned net buyers in July, recording a monthly total net inflow of RM1.4 billion after ten consecutive months of selling.
- We expect FBM KLCI will be cautiously traded ahead of the state elections on August 12.

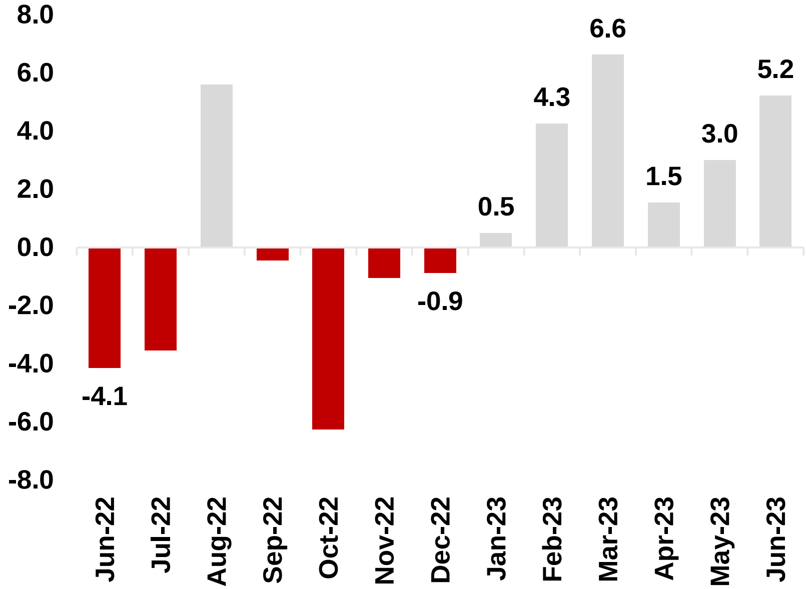
FIXED INCOME: US BOND YIELDS SURGED AS INVESTORS REASSESSED THE OUTLOOK FOR INTEREST RATES

Monthly changes, basis points (bps)

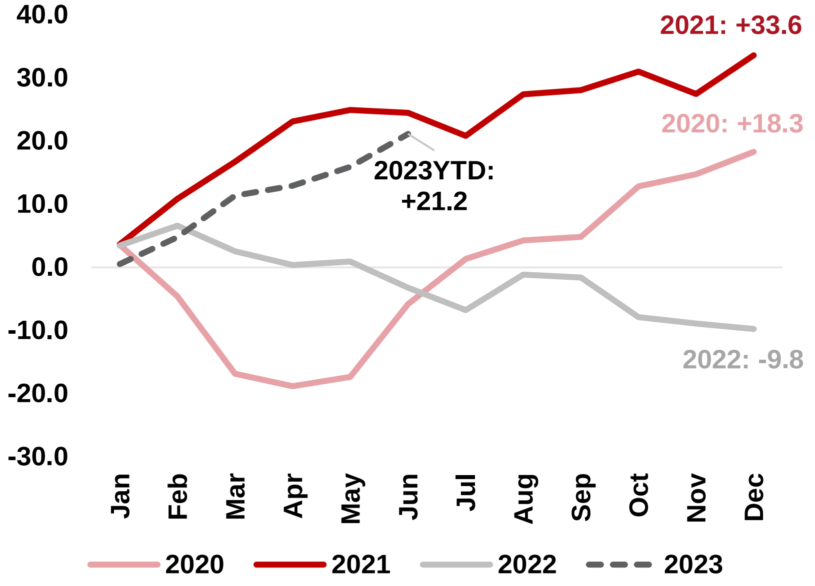
UST	Yields (%) 30-Jun-23	Yields (%) 31-Jul-23	Change (bps)
3-Y UST	4.49	4.51	2
5-Y UST	4.13	4.18	5
7-Y UST	3.97	4.08	11
10-Y UST	3.81	3.97	16
MGS	**Yields (%) 30-Jun-23**	**Yields (%) 31-Jul-23**	**Change (bps)**
3-Y MGS	3.48	3.49	1
5-Y MGS	3.61	3.60	-1
7-Y MGS	3.74	3.75	1
10-Y MGS	3.84	3.83	-1
GII	**Yields (%) 30-Jun-23**	**Yields (%) 31-Jul-23**	**Change (bps)**
3-Y GII	3.49	3.49	0
5-Y GII	3.69	3.65	-4
7-Y GII	3.78	3.80	2
10-Y GII	3.88	3.87	-1

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)



- The U.S. Treasury (UST) yield curve bearishly steepened in July in the range of 2bps and 16bps as investors reevaluated the outlook for interest rates after the Fed's latest interest rate decision of a 25bp hike in July's meeting and a stronger-than-expected U.S. GDP report in 2Q2023. At the time of writing, the market priced in an 80% chance of a rate pause at the upcoming Fed policy meeting in September.
- Malaysian Government Securities (MGS) and Government Investment Issues (GII) ended mixed in June. The demand mostly skewed on 5-Y and 10-Y MGS and GII, with yields ending lower between 1bp to 4bps.
- Local bonds market logged net foreign inflows in **all months of 1H2023**, with June recording the second highest inflows of RM5.2 billion (May: RM3.0 billion) this year. Local govvies' foreign shareholdings to total outstanding climbed to 23.0% in June from 22.7% in May.
- In 1H2023, the cumulative net foreign flows recorded inflows of RM21.2 billion, significantly higher compared to the outflows of RM3.2 billion in 1H2022.

FX MARKET: RINGGIT ENDED HIGHER AGAINST USD IN JULY DUE TO THE ANTICIPATION OF PEAKED FFR

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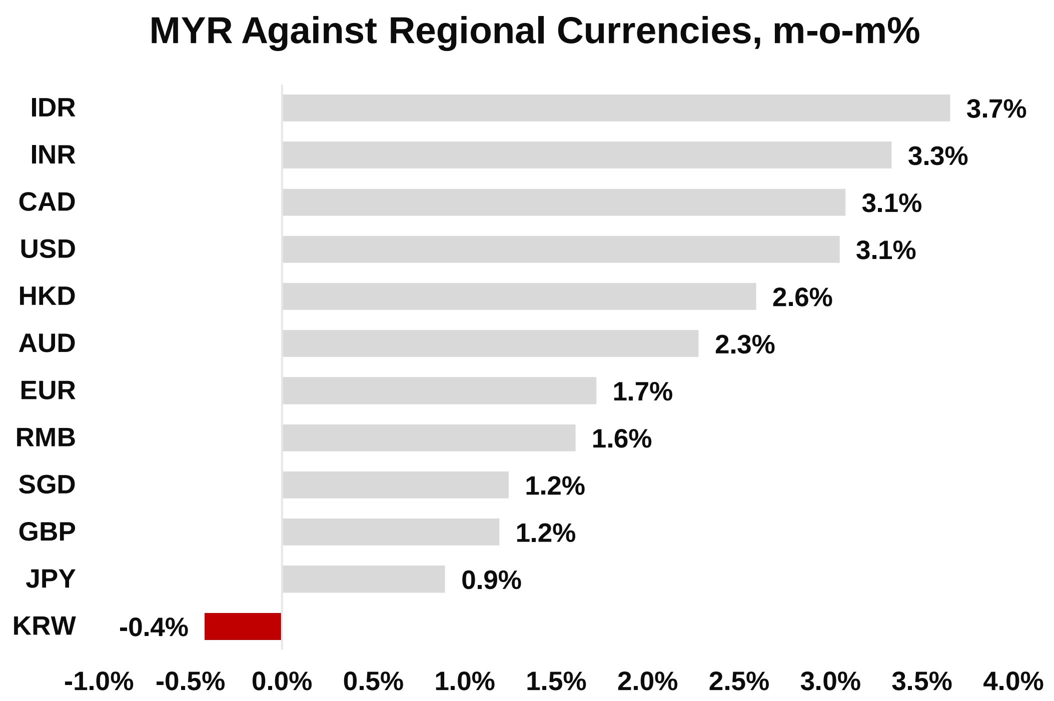

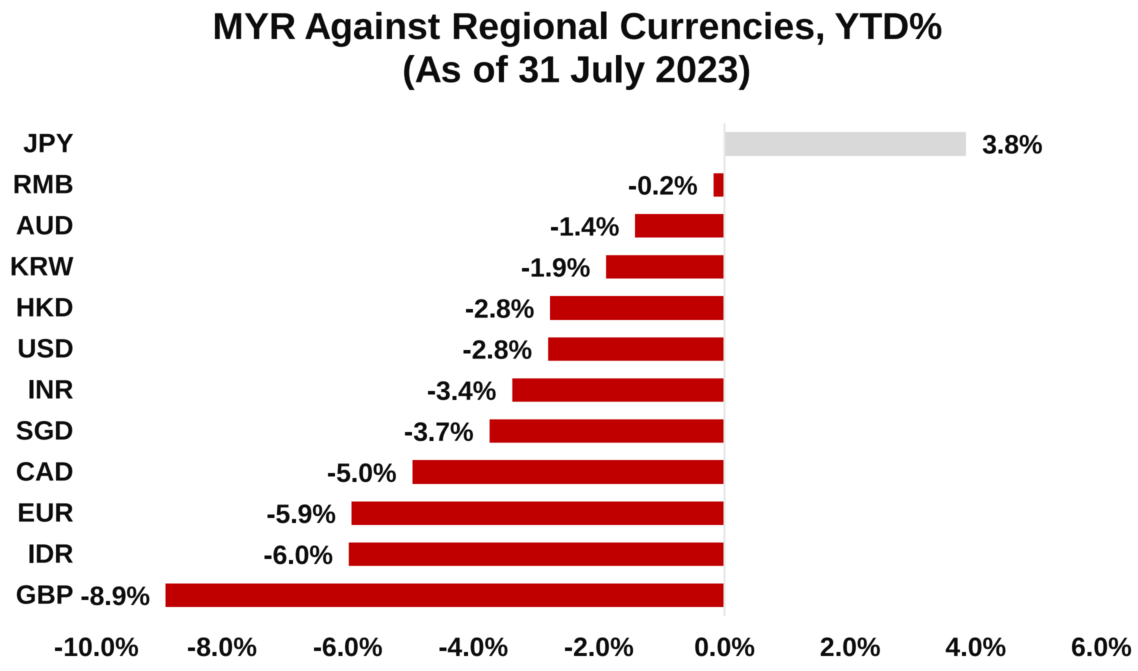

Source: BNM

- On a monthly basis, the Ringgit appreciated against the USD, closing at RM4.5405 on 31 July from RM4.6790 in the previous month. Despite the Fed's decision to raise the FFR for another 25bps in its July policy meeting, the USD remained flat around the 100 level.
- We posit that market participants interpreted the post-FOMC meeting as dovish remarks, which could have benefitted the local note movement during the month.
- Thus far, the chances for hikes were mainly due to the still-robust labour market condition and sticky core inflation, which the Fed has been monitoring in determining the direction of the monetary policy.
- As such, the July labour market report will be highly anticipated, in which any signs of loosening labour market conditions would further benefit Ringgit against the USD. Otherwise, the local note might be under pressure in the short term.

SECTION 2

The Global Economy

IMF RAISED THE 2023 GLOBAL GROWTH PROJECTION AMID RESILIENT ECONOMY

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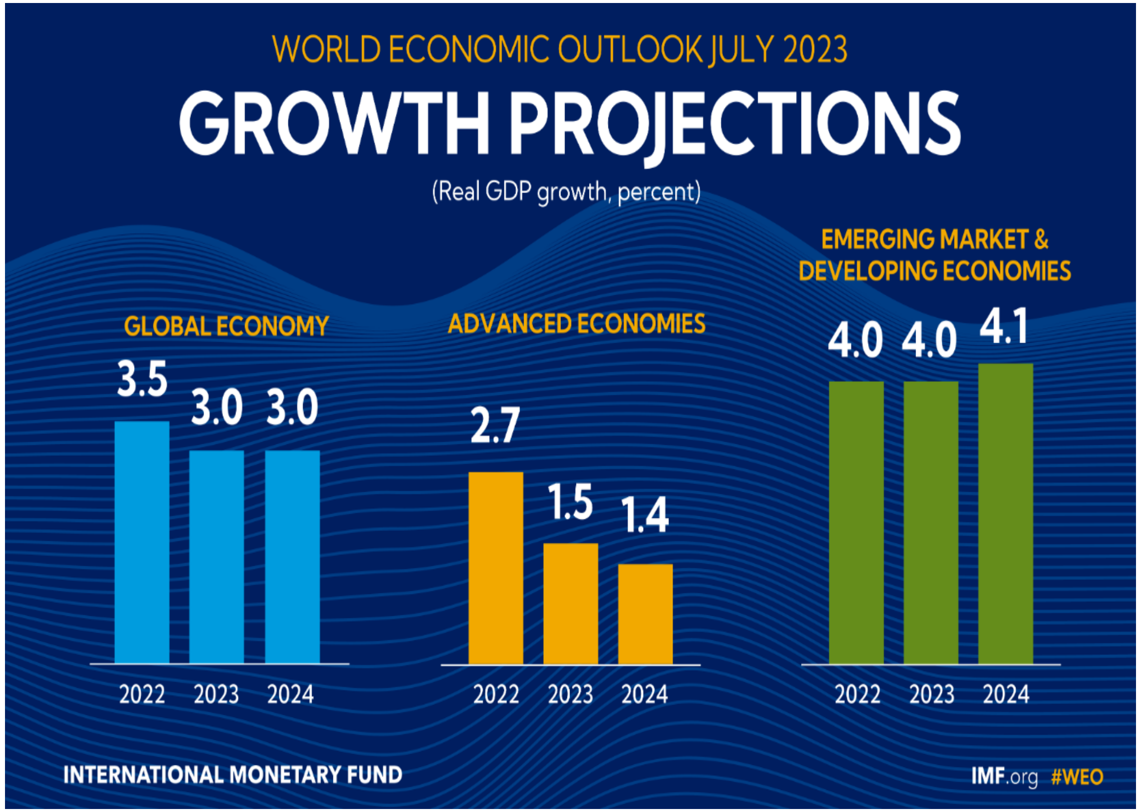

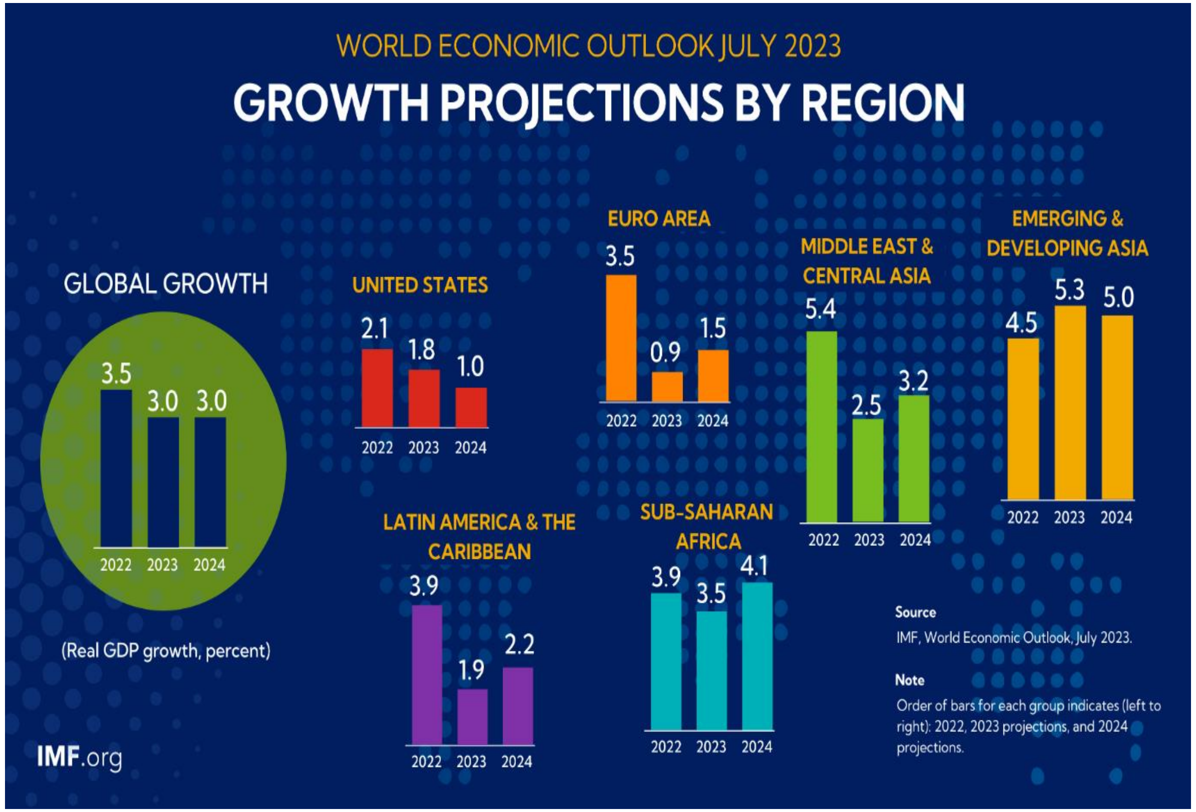

Source: International Monetary Fund (IMF), World Economic Outlook (WEO), July 2023

- 1H2023 saw signs of unintended consequences of global monetary tightening. The turbulence in the financial sector in the U.S. and Switzerland was contained by swift and robust actions by relevant authorities. The financial fallout of the U.S. debt ceiling impasse appeared to be short-lived, further reducing any immediate risks to the global financial markets.
- However, the risk balance to global growth remained titled to the downside. Inflation could be higher should further shocks be exacerbated by the intensified military conflict between Russia and Ukraine, triggering a more restrictive monetary policy.
- At the same time, unresolved real estate problems may slow down China's recovery, with negative cross-border spillovers.
- Though the latest forecast is slightly higher than predicted in April 2023 WEO, it remained weak by historical standards.

MEANWHILE, GLOBAL MANUFACTURING ACTIVITY REMAINED IN THE NEGATIVE TERRITORY SINCE SEPTEMBER LAST YEAR

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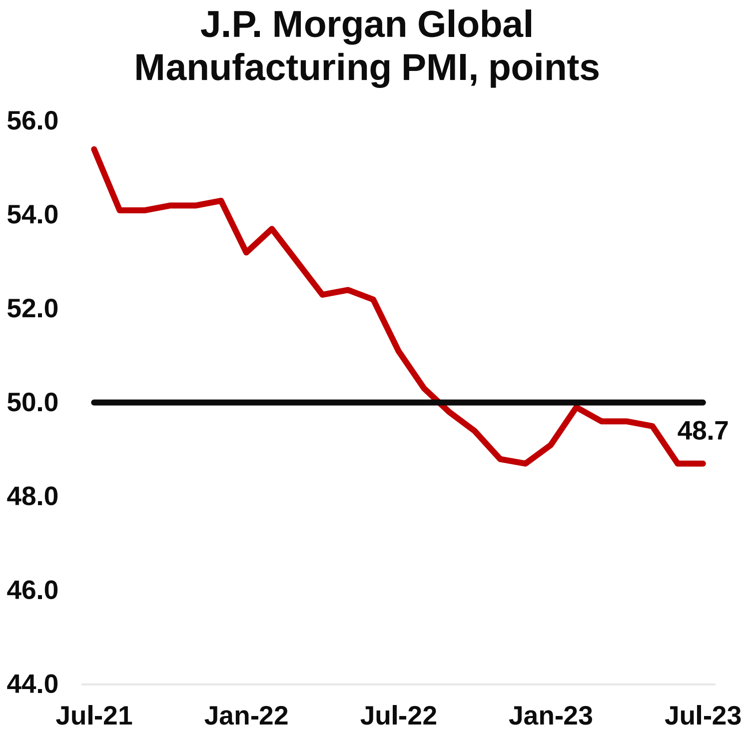

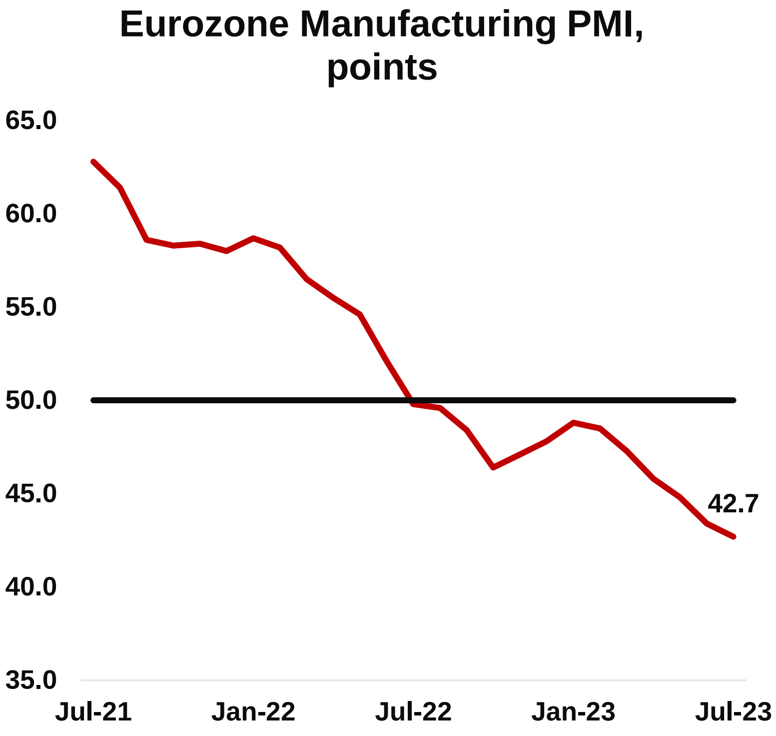

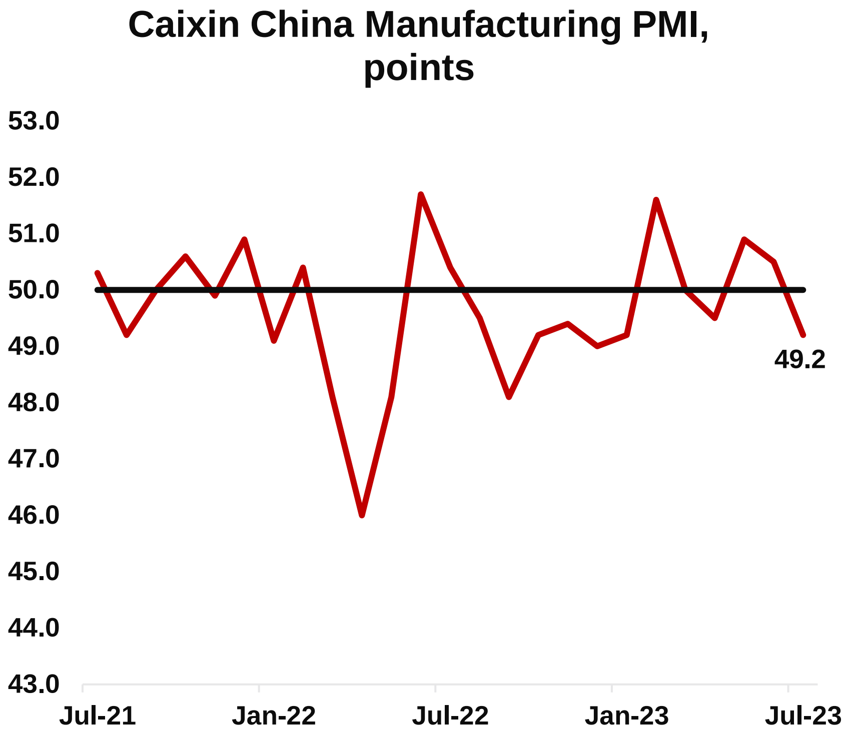

Source: S&P

- Overall, the global manufacturing PMI in July signaled continued momentum loss in global manufacturing activity due to the downturn in the new orders for the thirteenth straight month and deteriorating international trade flows.
- Likewise, the Eurozone's PMI mirrored the same trend, with the latest print pointing to one full year of consecutive contractions as higher borrowing costs from the European Central Bank (ECB) continued to bite.
- Additionally, China's factory activity contracted during the month, the first fall since April, as new orders dropped, suggesting subdued global and domestic demand. During its recent Politburo meeting, the government vowed to provide policy support to spur economic growth.

WILL U.S. LABOUR MARKET SLOW FURTHER IN JULY?

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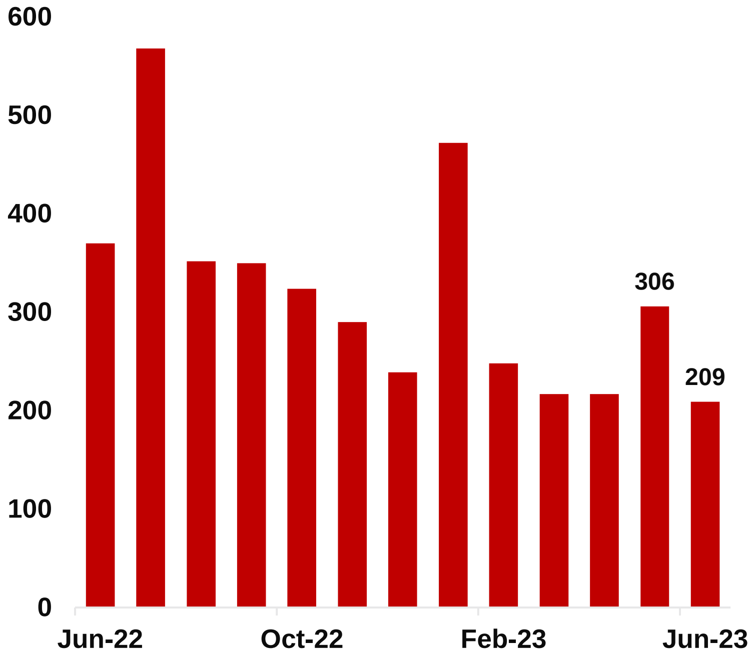

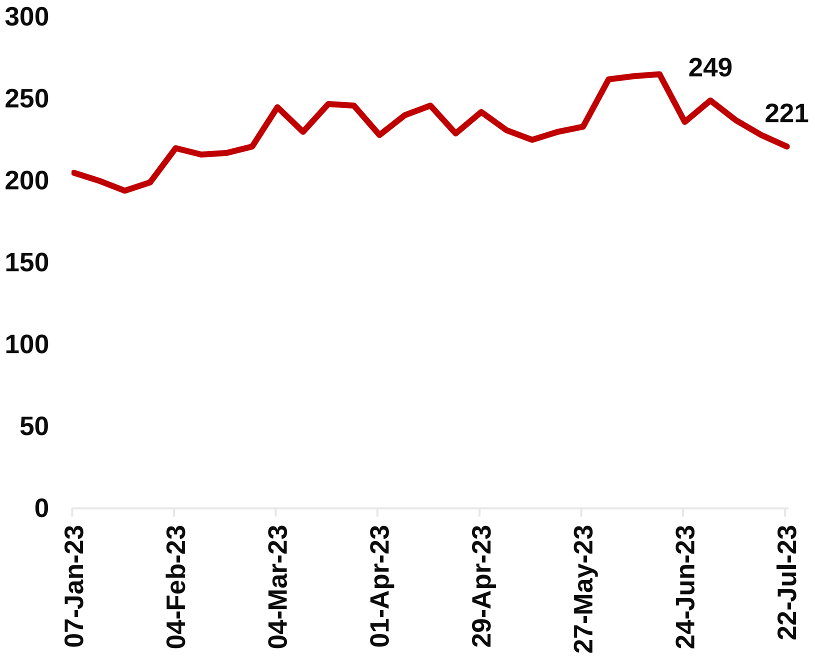

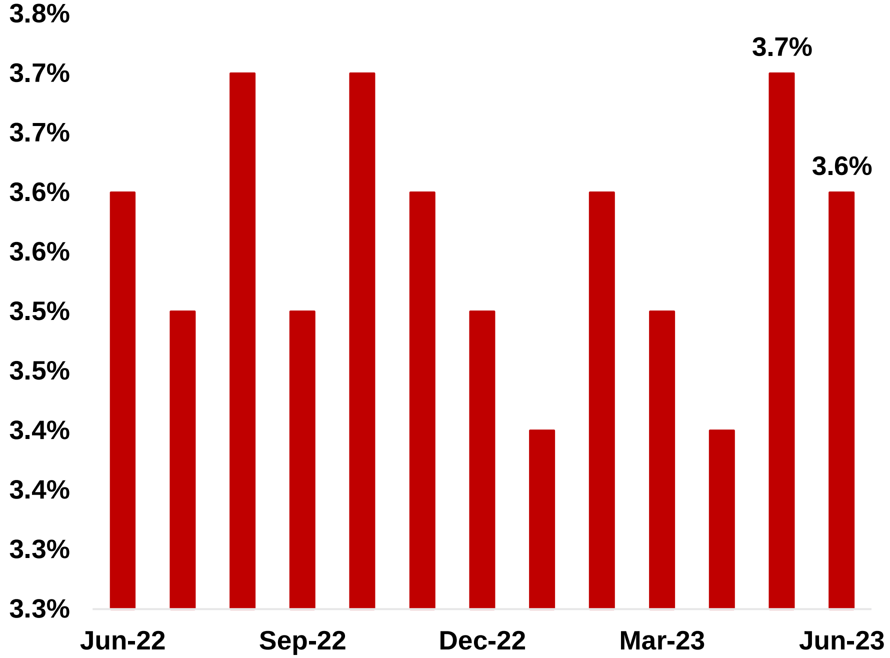

Sources: U.S. Bureau of Labor Statistics, U.S. Department of Labor

- The U.S. hiring is anticipated to slow again in July, raising the odds for the Fed to keep steady its fund rates after a 25bp hike in the recent meeting. The FFR ranges between 5.25% and 5.50% - the highest since January 2001.
- As for July, the NFP is predicted to add 200k jobs, down from 209k in June. The 22-year high policy rate is likely starting to bite amid a robust post-pandemic labour market.
- Though market participants are divided on whether the July FFR hike marked the end of the Fed's tightening cycle, Fed Chair Jerome Powell has yet to decide whether the committee will raise the rates again in September.
- Therefore, a strong or better-than-expected report in July might add to the case for further rate hikes.

CHINA'S WEAK ECONOMIC INDICATORS PUT PRESSURE TO POLICYMAKERS IN SUPPORTING THE WHOLE ECONOMY

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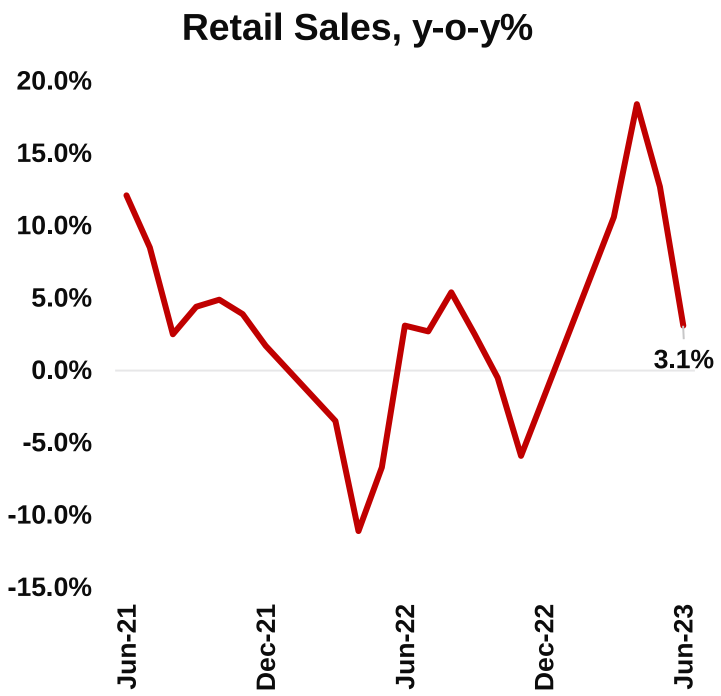

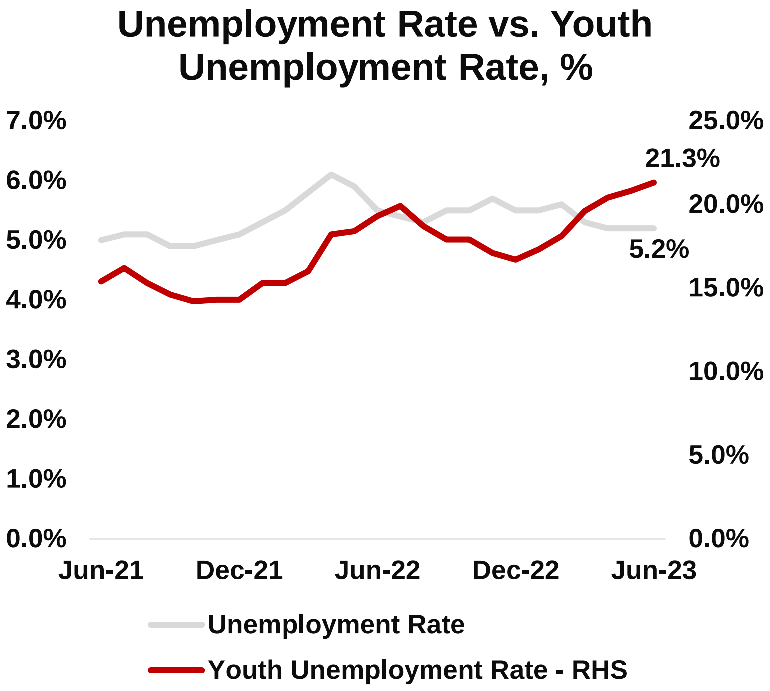

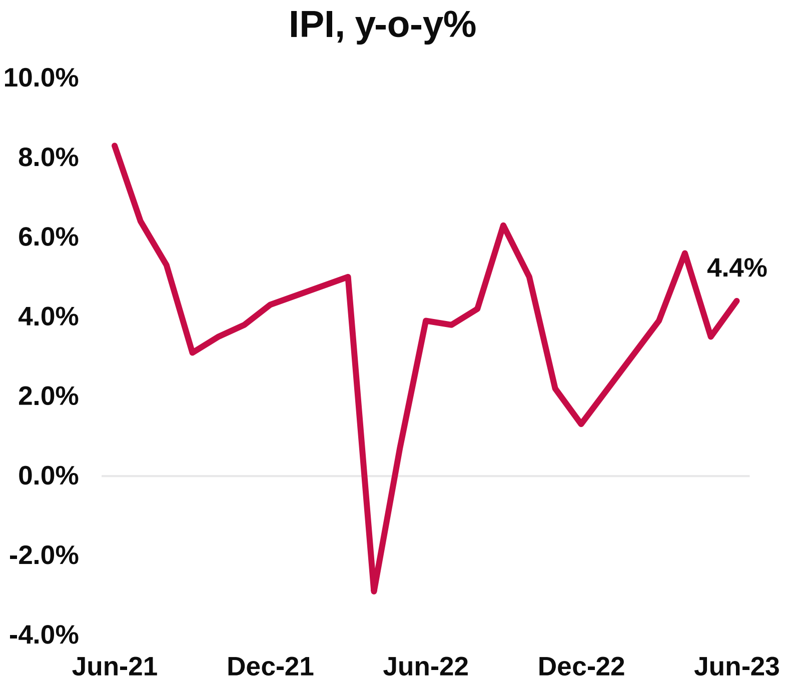

Source: National Bureau of Statistics

- Double-digit growth in retail sales continued in May and April amid last year's low base, which has petered out to log 3.1% in June, suggesting consumers remain pretty reluctant to spend post-economic reopening.
- While the urban jobless rate remained unchanged for June at 5.2%, the youth unemployment rate – the proportion of those out of work aged between 16 and 24 rose to a record 21.3% (May: 20.8%), marking the sixth consecutive monthly increase.
- Meanwhile, the country's industrial output grew by 4.4% in June, unexpectedly rising from the 3.5% seen in May. However, demand remained lukewarm due to a bumpy post-economic reopening recovery after a brisk start during the first quarter of this year.
- The People's Bank of China (PBoC) has already lowered borrowing rates several times to shore up demand in an economy where inflation has evaporated mainly in contrast to many other parts of the world.

INDIA'S ECONOMY IS ANTICIPATED TO SURPASS 7.0% OVER THE NEXT TWO YEARS IF GLOBAL UNCERTAINTIES RECEDE

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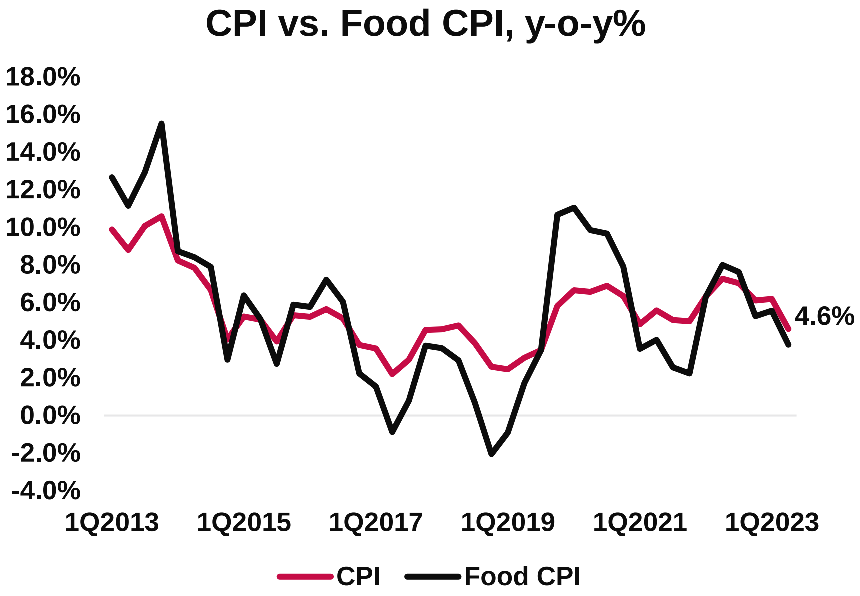
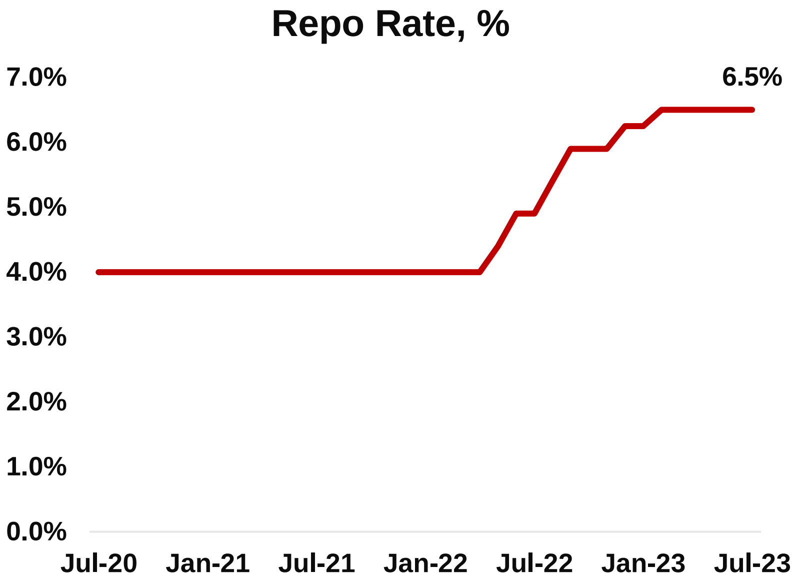




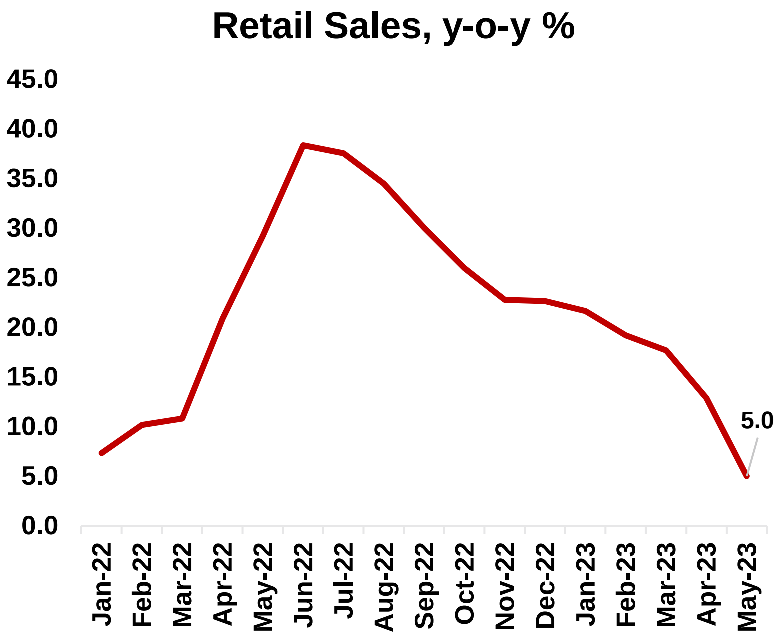
Sources: Ministry of Statistics and Programme Implementation, Reserve Bank of India (RBI)

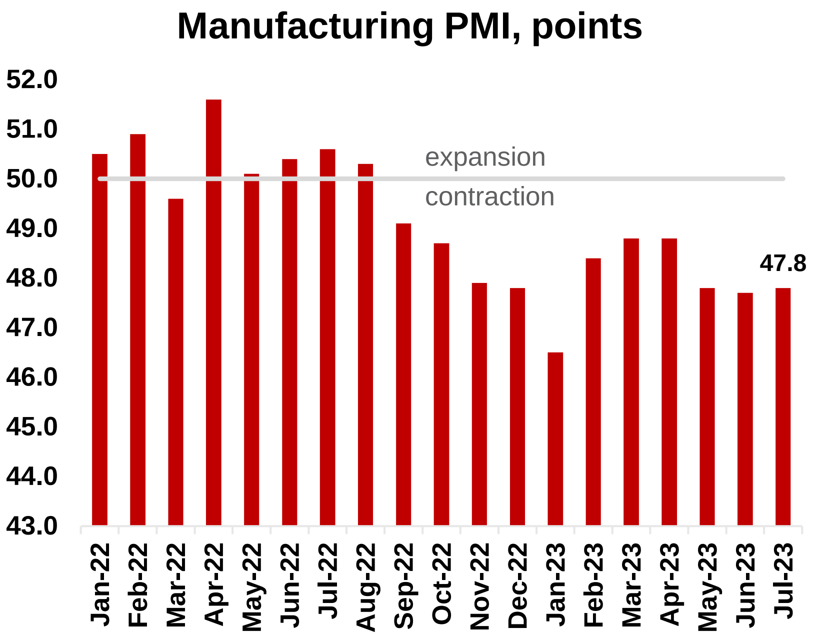
- In the latest update from IMF, the global lender upgraded the 2023 growth forecast for India by 20bps to 6.1% (WEO April Outlook: 5.9%) due to stronger growth in 4Q2022, powered by domestic investment. The forecasts consider India's global growth potential, with China trailing behind as Beijing seeks to reflate faltering growth momentum while staying the course in its bid to rebalance the world's second-largest economy.
- Already, India continued to record an impressive performance when the economy expanded by 6.1% y-o-y in 1Q2023, well above market forecasts of 5.0%, despite the challenging global environment.
- At the same time, inflation was under control (2Q2023: 4.6% vs 1Q2023: 6.2%), the lowest since September 2019. The RBI targets inflation between 2.0%-6.0% but aims to bring it to the midpoint of 4.0%.
- On the other hand, the borrowing cost, which started climbing in May last year, seemed to stabilise, with the repo rate sustained at 6.5% since February. The central bank is likely to maintain its status quo on key rates for the third time in its upcoming meeting on 10th August as the inflation remained within its tolerable range, though rate hikes are still coming from both the Fed and the ECB.

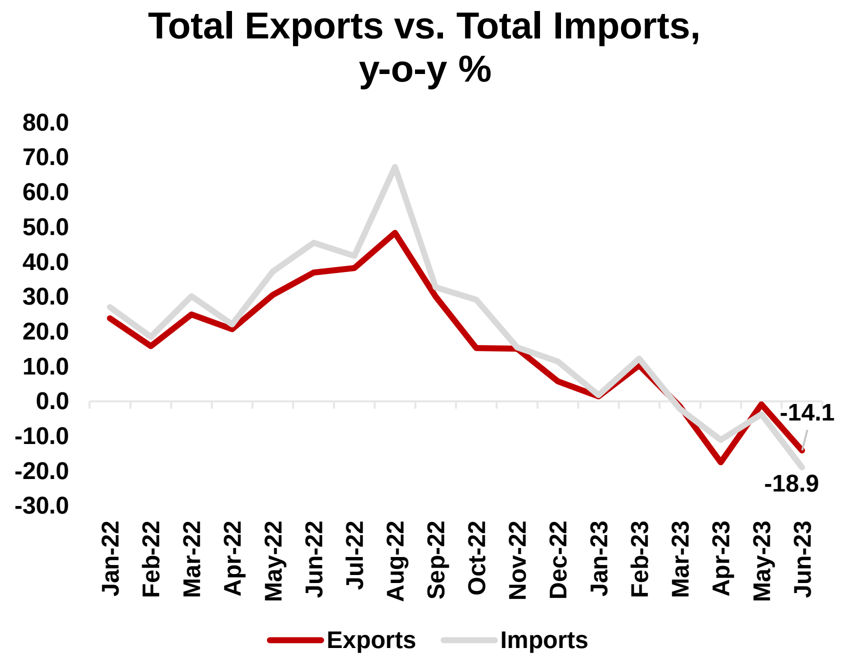
SECTION 3

Domestic Landscape & Banking Sector Update

SIGNS OF MODERATING DEMAND HAVE EMERGED, A CHALLENGING 2H2023 AHEAD







Sources: DOSM, CEIC

- Malaysia's retail sales growth slowed sharply to 5.0% in May (April: 12.9%), the lowest level since December 2021, as higher living costs started to bite into consumer demand. For the record, retail sales posted double-digit growth from February 2022 to April 2023.
- Manufacturing PMI came in at 47.8 points in July (June: 47.7 points), marking its 11th consecutive month of contraction. Factories reported sluggish demand as export orders fell to the fastest since May 2020.
- Exports fell 14.1% in June following a drop of 0.9% in May, while imports slumped 18.9% (May: -3.7%), the steepest decline since May 2020. Both trade components had contracted amid a global downturn in goods demand since March.
- The Consumer Price Index (CPI) eased to 2.4% in June (May: 2.8%), the lowest since April 2022. Concurrently, core inflation also slowed during the said month (June: 3.1% vs May: 3.5%).

BANKING SECTOR: SLOWER PACE OF FINANCING GROWTH IN BOTH HOUSEHOLD AND NON-HOUSEHOLD SECTORS

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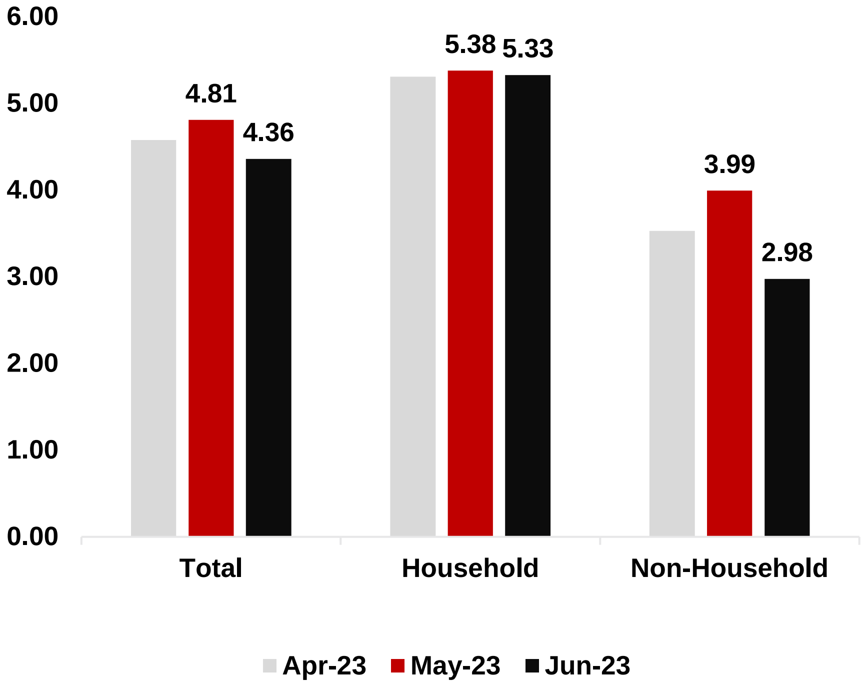
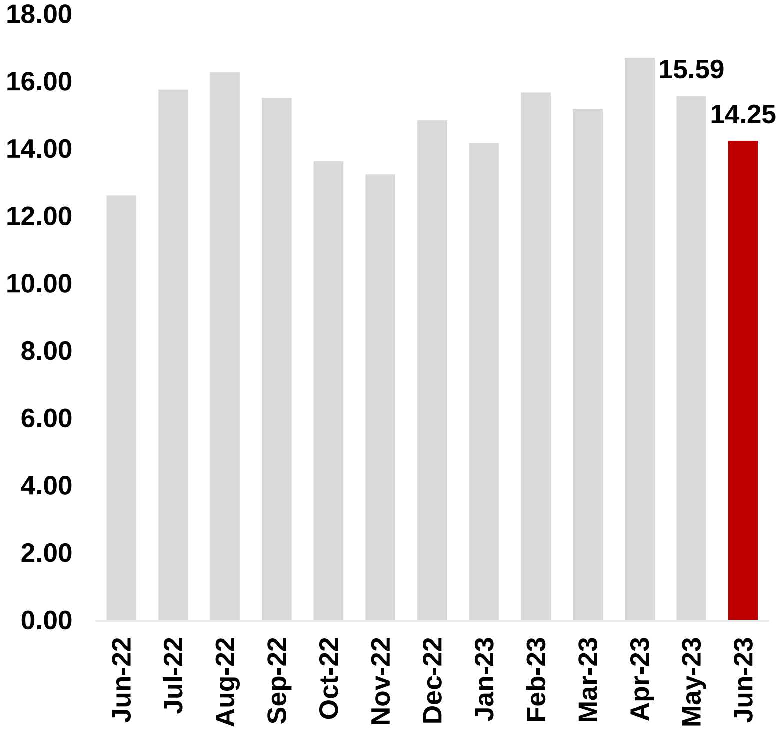
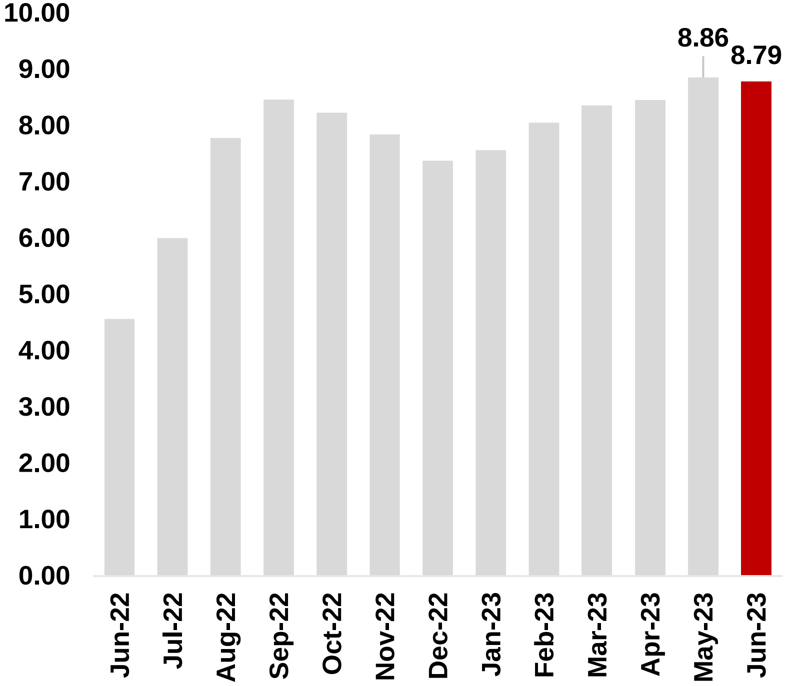
Financing Growth by Sector, y-o-y%



Credit Card, y-o-y%



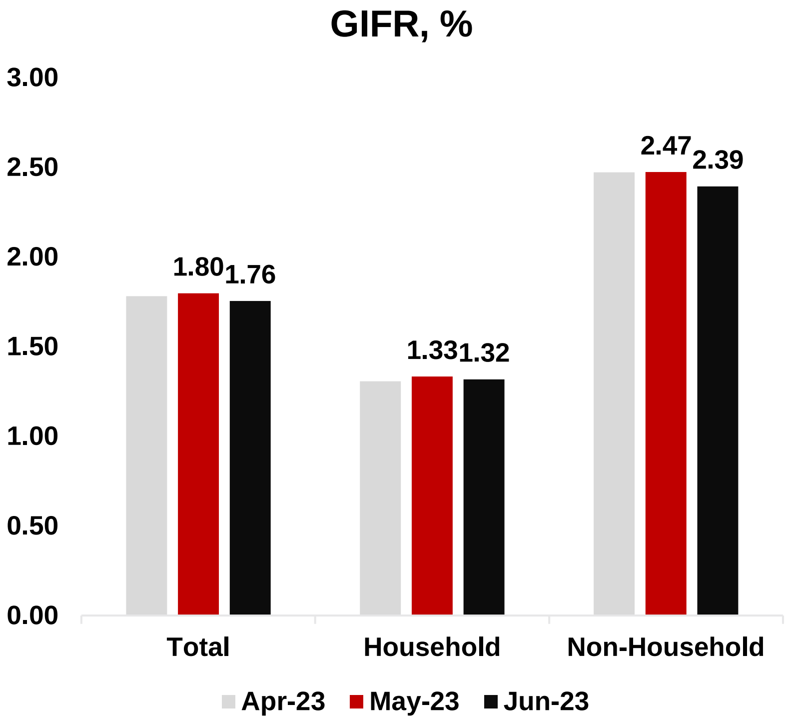
Purchase of Passenger Cars, y-o-y%

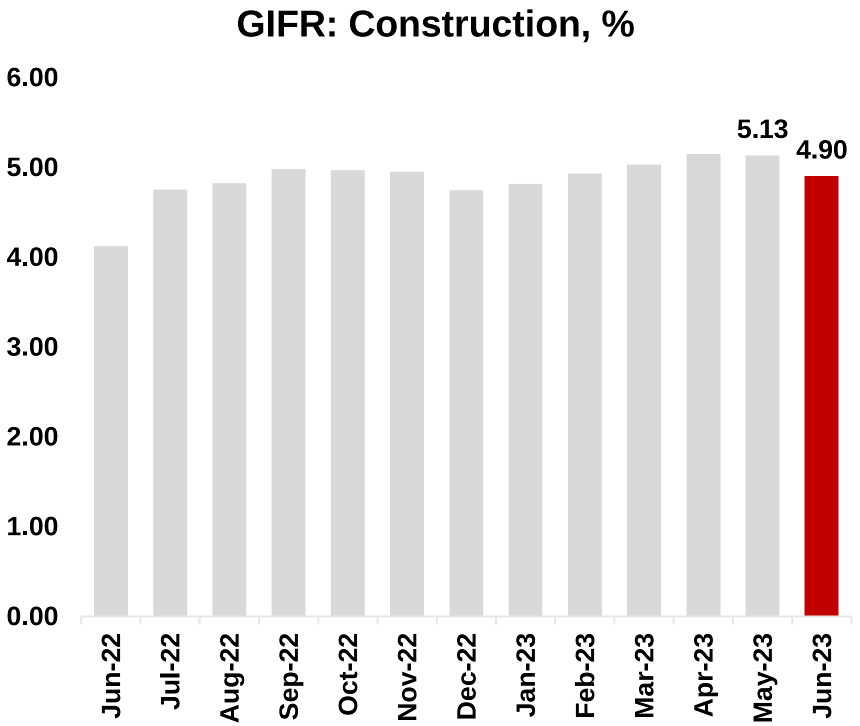


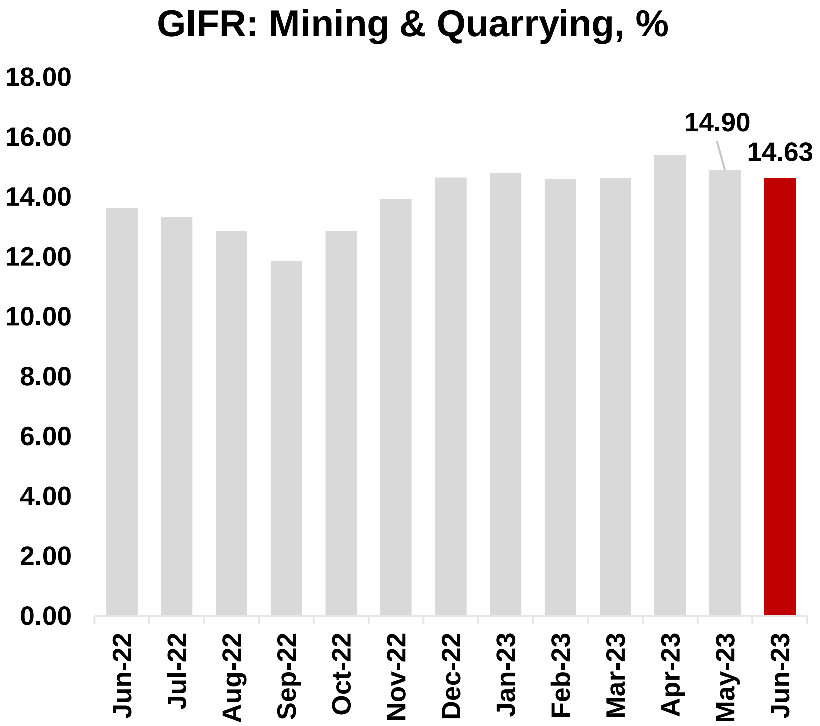
Source: BNM

- In June, financing activities expanded, albeit at a slower momentum, with the total credit growing by 4.36% in June relative to 4.81% in May. The financing growth in household and non-household sectors trended lower in June at 5.33% (May: 5.38%) and 2.98% (May: 3.99%), respectively.
- The same patterns were seen in the financing growth in credit card and the purchase of passenger cars segments. The credit card segment grew moderately at 14.25% in June from 15.59% in May. Additionally, financing growth of the purchase of passenger cars moved at a smaller magnitude of 8.79% in June (May: 8.86%).
- Furthermore, financing activities in the purchase of residential property segment plateaued at 6.76% in June (May: 6.76%)

BANKING SECTOR: ASSET QUALITY EDGED UPWARDS IN JUNE







Source: BNM

- The resilience of banks continued to be underpinned by sound asset quality. Overall, the total gross impaired financing ratio (GIFR) downtrend marginally to 1.76% in June (May: 1.80%). Both household and non-household sectors also recorded a tad lower GIFR in June at 1.32% (May: 1.33%) and 2.39% (May: 2.47%), respectively.
- In addition, the construction industry logged lower impairment at 4.90% in June from 5.13% in May. The banking sector's asset quality in mining and quarrying segment also fell slightly to 14.63% in June (May: 14.90%)

THANK YOU