BANK ISLAM

MONTHLY ECONOMIC UPDATE

6 APRIL 2023

ECONOMIC RESEARCH

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KEY TAKEAWAYS

- **Price stability remains a goal for future rate hikes.** During the Federal Open Market Committee (FOMC) meeting on 21-22 March, the Federal Reserve (Fed) Chairman Jerome Powell announced a federal fund rate (FFR) hike of 25bps, bringing the cumulative rate to 4.75%-5.00%. It was a decision premised on reigning in the stubbornly sticky/elevated inflation to the Fed's target of 2.0% despite the recent stress in the banking sector. Powell reaffirmed that the Fed would remain hawkish towards achieving price stability, considering the effects on the banking sector in deciding further monetary policy decisions.

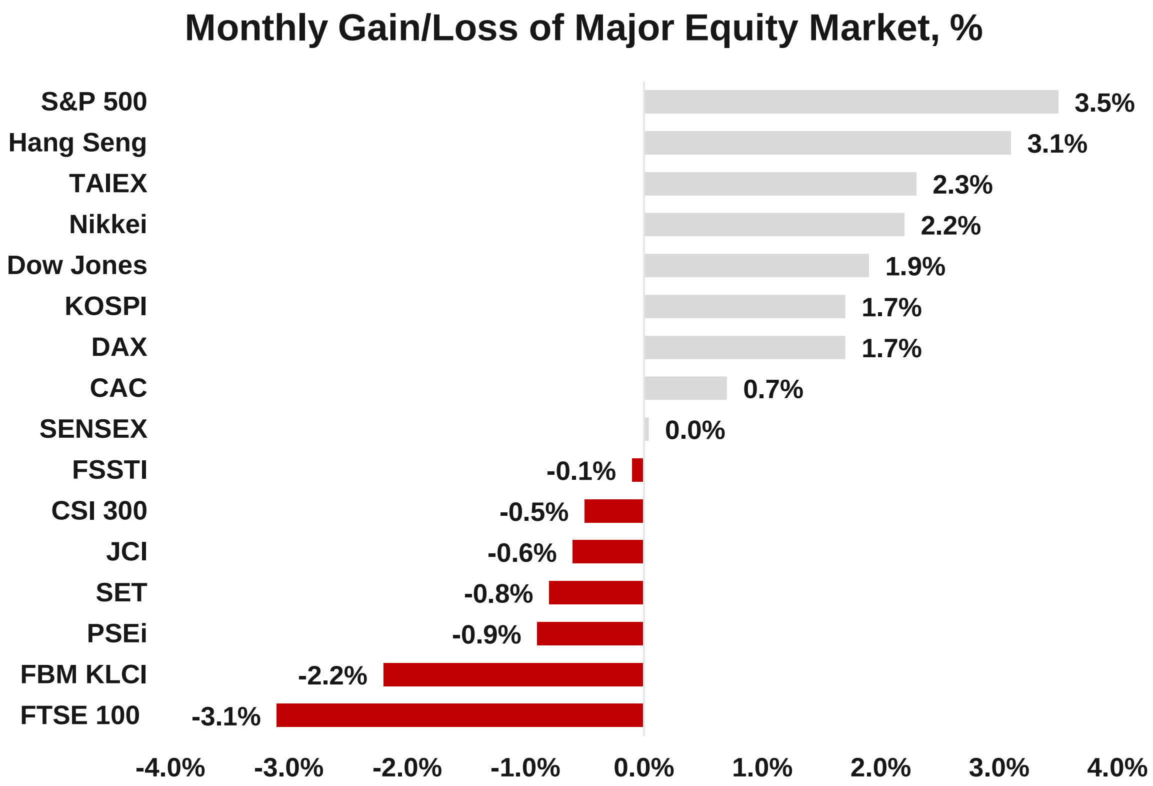
- **Negative sentiments on the rise following global banking turmoil.** The global banking crisis heightened in March following the collapse of three regional U.S. banks and UBS's rapid Credit Suisse takeover. Fears of a global financial crisis bleed over into negative sentiments, causing a plunge in certain regional stock markets. However, the crisis has led to major central banks boosting their liquidity and policymakers will remain vigilant for signs of banking stress as tightening continues. The crisis has somewhat abated in the past week.

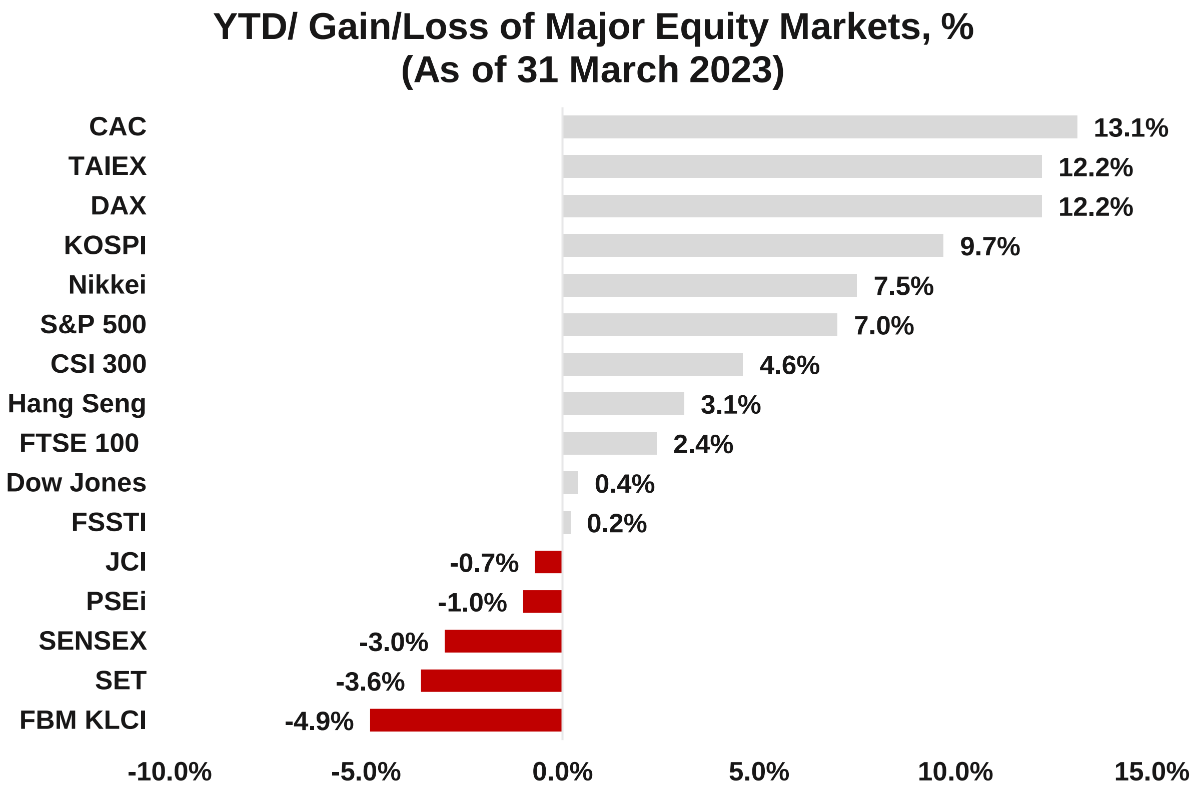
- **Establishing a balance amid external volatility and domestic risks.** Bank Negara Malaysia (BNM), in its 2022 Annual Report, remains cautiously optimistic with a GDP projection at a moderate level of 4.0%-5.0% while highlighting that the monetary policy will remain supportive of economic growth, considering the global economic outlook and domestic developments. Despite moderating global growth and the elevated costs of living crisis, BNM is confident that recession in our country is unlikely amid Malaysia's strong macroeconomic fundamentals, improving labour market conditions, the anticipation of a stronger pick-up in tourism activities following China's reopening and implementation of multi-year investment projects to boost domestic growth. Commenting on the banking sector crisis in advanced economies, BNM ensures that Malaysia's banking sector remains resilient and well protected against possible contagion, with a liquidity coverage ratio (LCR) of 152.7% as of February 2023.

SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: MARKET ENDED HIGHER IN MARCH AMID HOPE FOR A SLOWER FFR HIKES

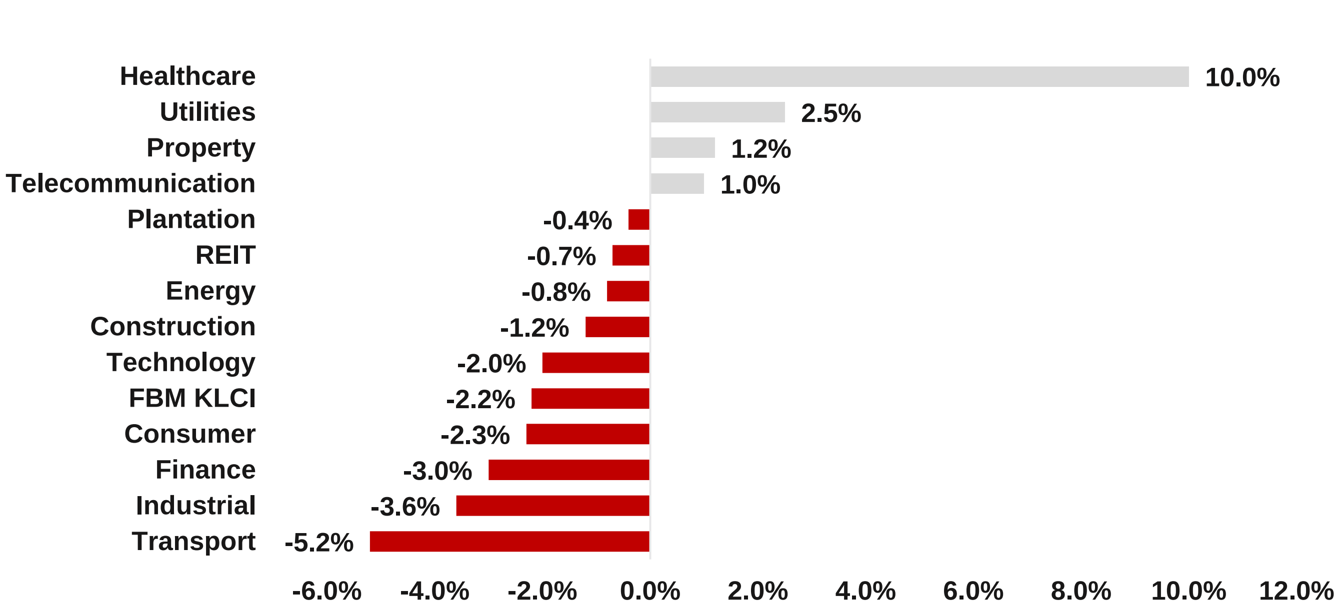


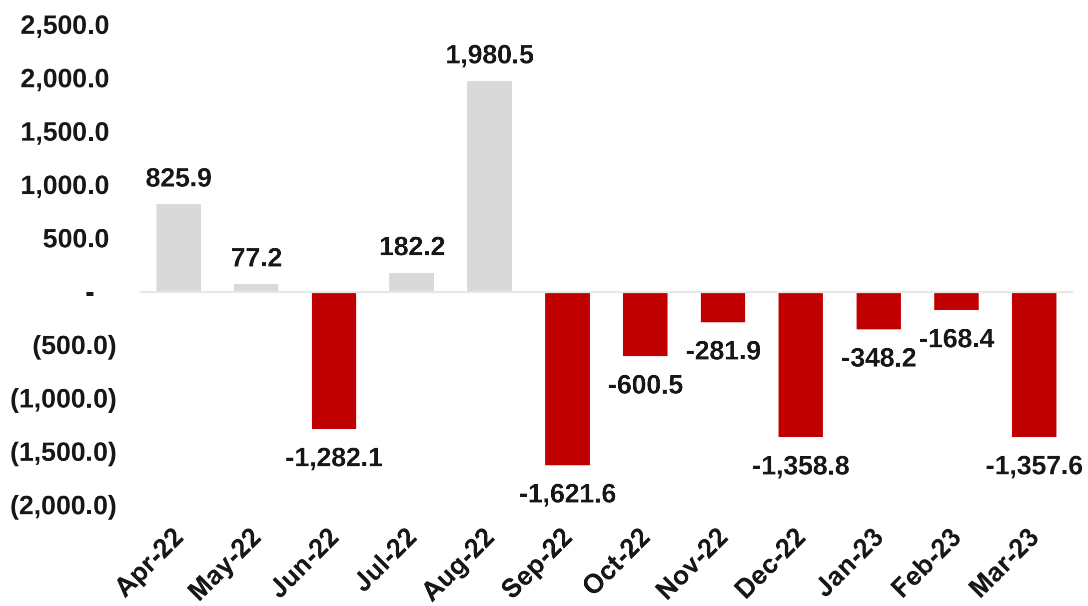


Sources: Bursa, CEIC

- Most regional markets closed higher with the U.S. S&P 500 index leading the gainers by 3.5% m-o-m, followed by Hong Kong's Hang Seng (3.1%) and Taiwan's TAIEX (2.3%). Markets appeared to anticipate a softer monetary policy approach in the U.S. or the Fed could pause the Federal Fund Rate (FFR) hikes earlier than expected. We believe that markets will scrutinise the trade-off between inflation risks and job growth more closely, and be on the lookout for signs of weakness in the US economy.
- FBM KLCI performed poorly in March, making it among the weakest performers on a YTD basis amid sluggish foreign participation.

DOMESTIC EQUITY: LOCAL MARKET ENDED IN THE RED, HEAVILY AFFECTED BY ANXIETY OVER BANKING CRISIS IN THE ADVANCED ECONOMIES





Sources: Bursa, BNM

- Bursa sectoral indices closed on a negative note in March, with Transport (-5.2%), Industrial (-3.6%) and Finance (-3.0%) leading the losers which mainly weighed by worries over the collapse of two regional U.S. banks and signs of trouble in some European banks.
- Following this, a larger foreign selling activity was seen in March with a total of RM1,357.6 million net outflows recorded from RM168.4 million in February.
- It was the seventh straight month of net foreign outflows, exacerbated by the banking turmoil in advanced economies and the Fed’s relentless quest to achieve price stability.
- Nonetheless, BNM remains confident that Malaysia’s banking sector is well protected against those external pressures and economic shocks.
- We anticipate FBM KLCI will be cautiously traded in April amid mixed sentiments from domestic and global outlooks.

FIXED INCOME: BOND YIELDS WERE LOWER IN MARCH AMID RISK AVERSION AMONG THE MARKET PARTICIPANTS

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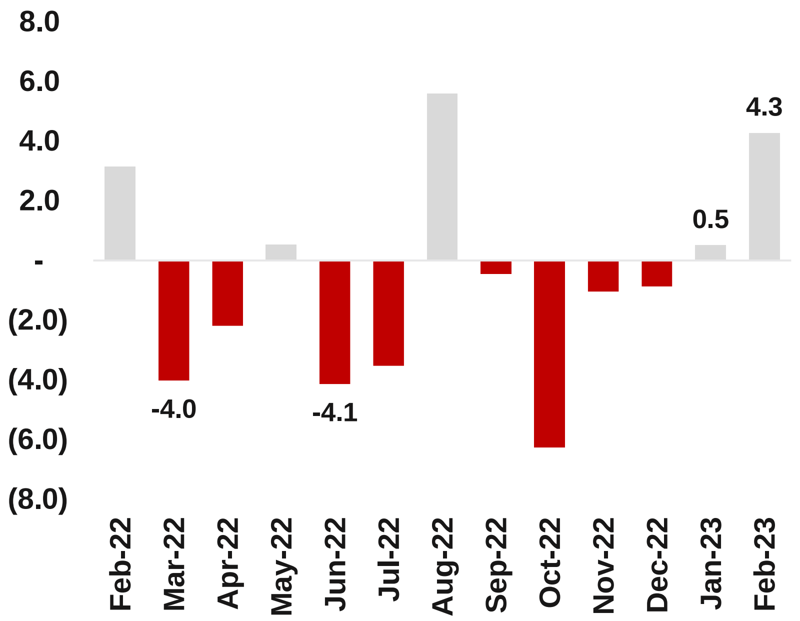
Monthly changes, basis points (bps)

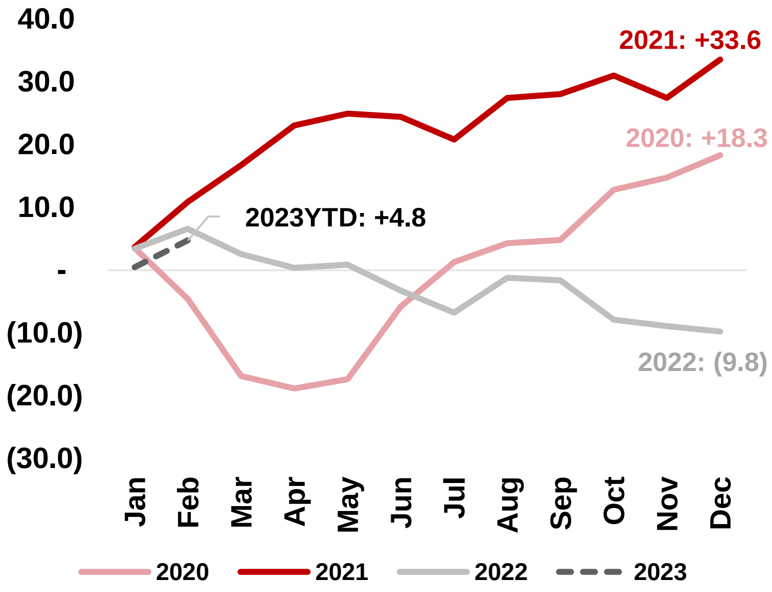
UST	Yields (%) 28-Feb-23	Yields (%) 31-Mar-23	Change (bps)
3-M UST	4.88%	4.85%	-3
2-Y UST	4.81%	4.06%	-75
5-Y UST	4.18%	3.60%	-58
10-Y UST	3.92%	3.48%	-44
MGS	**Yields (%) 28-Feb-23**	**Yields (%) 31-Mar-23**	**Change (bps)**
3-Y MGS	3.52%	3.38%	-14
5-Y MGS	3.67%	3.55%	-12
7-Y MGS	3.79%	3.74%	-5
10-Y MGS	3.91%	3.91%	0
GII	**Yields (%) 28-Feb-23**	**Yields (%) 31-Mar-23**	**Change (bps)**
3-Y MGS	3.47%	3.30%	-17
5-Y MGS	3.62%	3.60%	-2
7-Y MGS	3.85%	3.87%	2
10-Y MGS	4.00%	3.96%	-4

Sources: BNM, Federal Reserve Board

Foreign Fund Flows in Bond Market, RM billion



Cumulative net foreign flows in local bonds (Yearly comparison, RM billion)



- The U.S. Treasury (UST), Malaysian Government Securities (MGS) and Government Investment Issues (GII) yields mostly fell in March as investors shifted to safe-haven assets following the volatility in the financial market. UST yields fell more than MGS/GII did in the month.
- Consequently, foreign investors continued to be net buyers of local bonds at a larger magnitude of RM4.3 billion in February (January: RM0.5 billion) as investors repriced their expectations on FFR amid the banking crisis in the US.
- In the immediate term, we expect the bond market to remain bullish, given the banking stress in the U.S., which could negatively impact the global growth trajectory.
- YTD, cumulative foreign flows into the local bond market remained positive at RM4.8 billion, albeit lower relative to the first two months of 2022 at RM6.6 billion.

FX MARKET: RINGGIT ENDED HIGHER DURING MARCH

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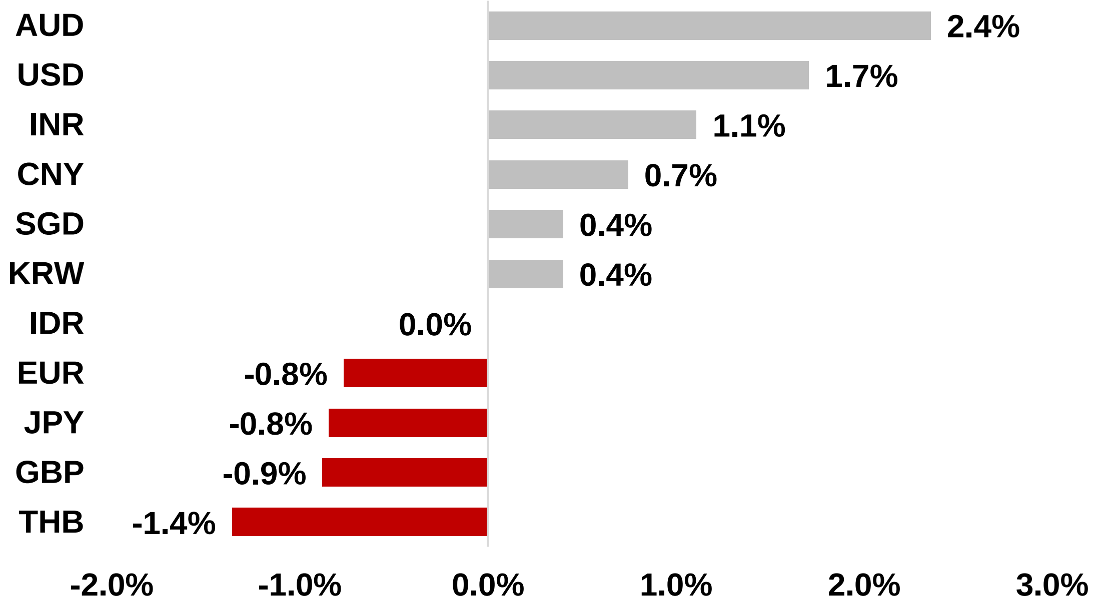

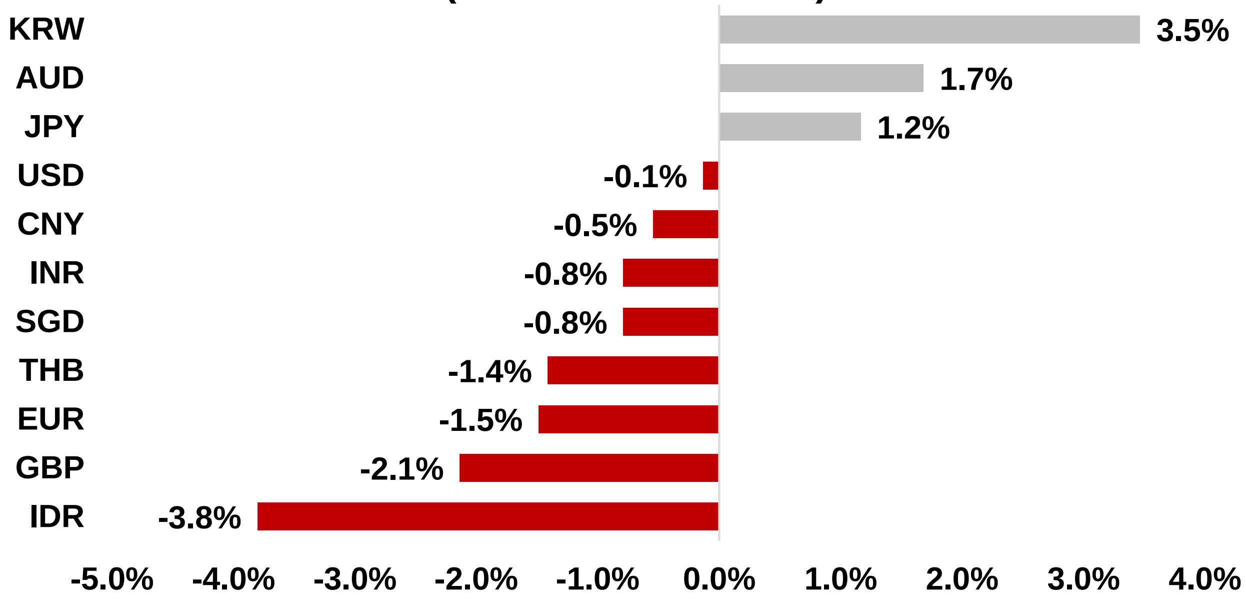

Source: Investing.com

- The Ringgit appreciated against the USD by 1.7% on a monthly basis, closing at RM4.4100 on 31 March (28 February: RM4.4850).
- Weeks ago, the local note was under pressure following the demand for the USD as market participants anticipated more rate hikes from the U.S. central bank in view of sticky inflation data.
- The recent banking sector turmoil caused a shift in market sentiment, which allowed the Fed to decelerate its tightening cycle earlier than expected. Nevertheless, small rate hikes remain on the card. Fed Chairman Jerome Powell stressed that restoring price stability remains a top priority as the current rate is still far from the 2.0% inflation target.
- Undoubtedly, the U.S. rate hikes outlook hinges on how the banking crisis unfolds in the coming weeks. Although the disruption to bank lending helps the Fed's work to cool down the economy and inflation, U.S. recession risks move up a notch as tightening continues.
- Thus, we posit that upcoming economic indicators up to May would provide a decisive path for the U.S. central bank to either tighten further or to pause/pivot during next May FOMC meeting.
- For now, investors are anticipating a rate cut later in 2023. However, judging from the latest FOMC Summary of Economic Projections (SEP), the central bank is anticipated to maintain high rates for some time. We foresee a volatile environment for Ringgit in the medium term.

SECTION 2

The Global Economy

THE GLOBAL MANUFACTURING ACTIVITIES DIPPED SLIGHTLY DURING MARCH

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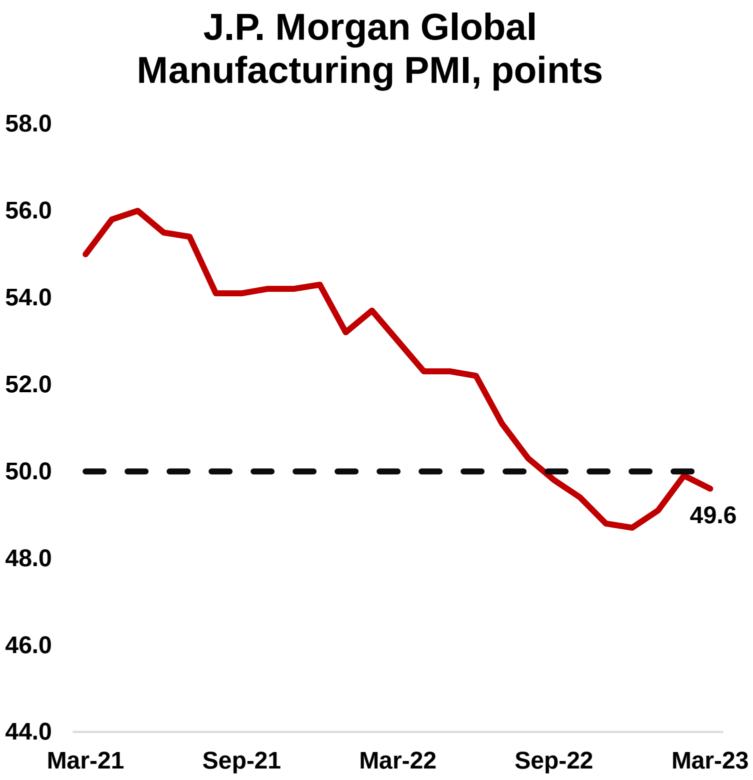
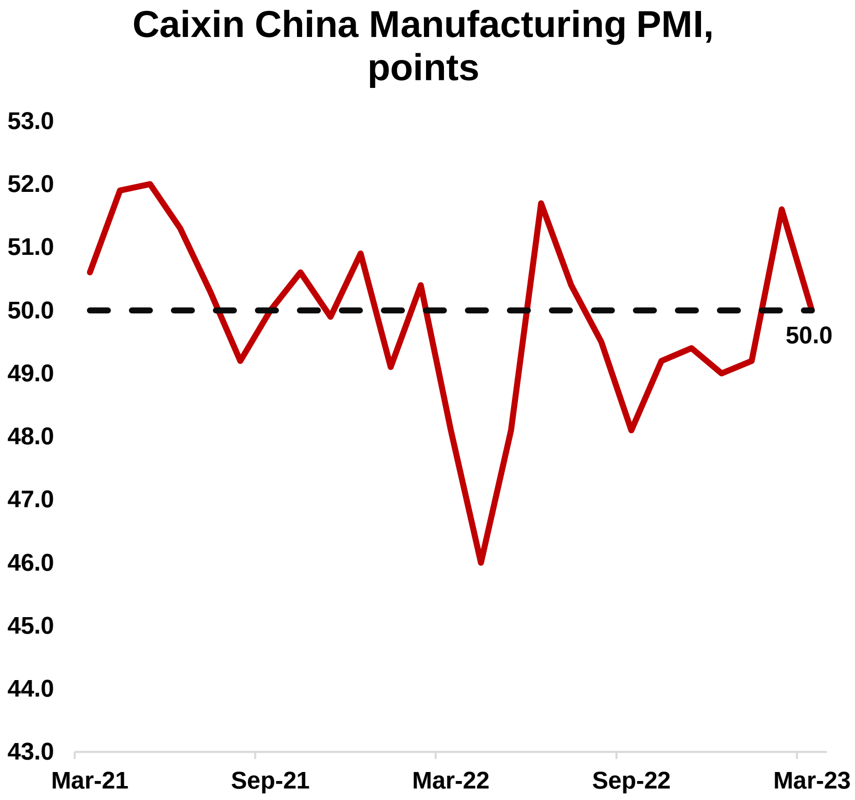
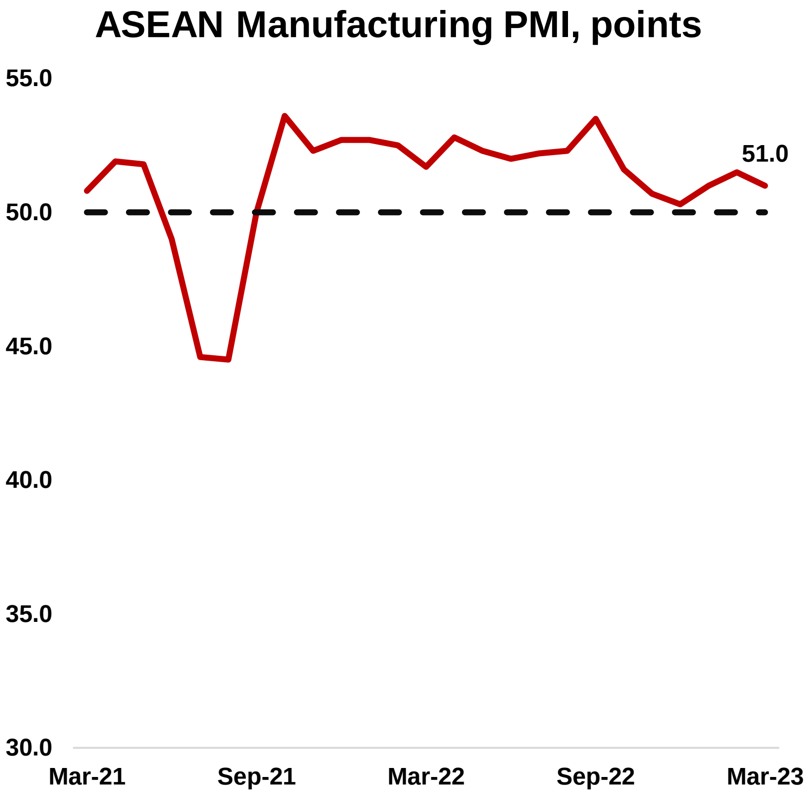


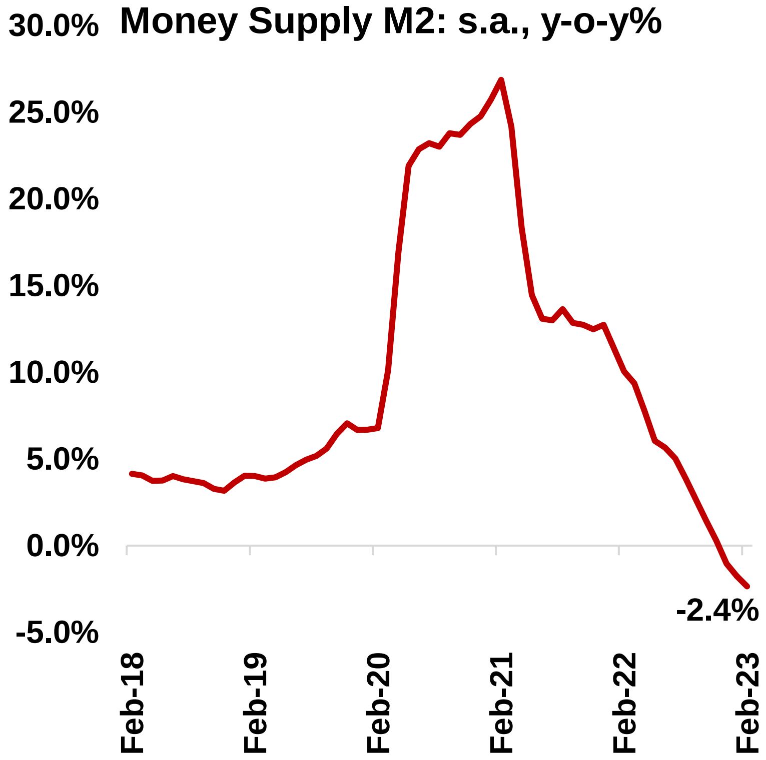


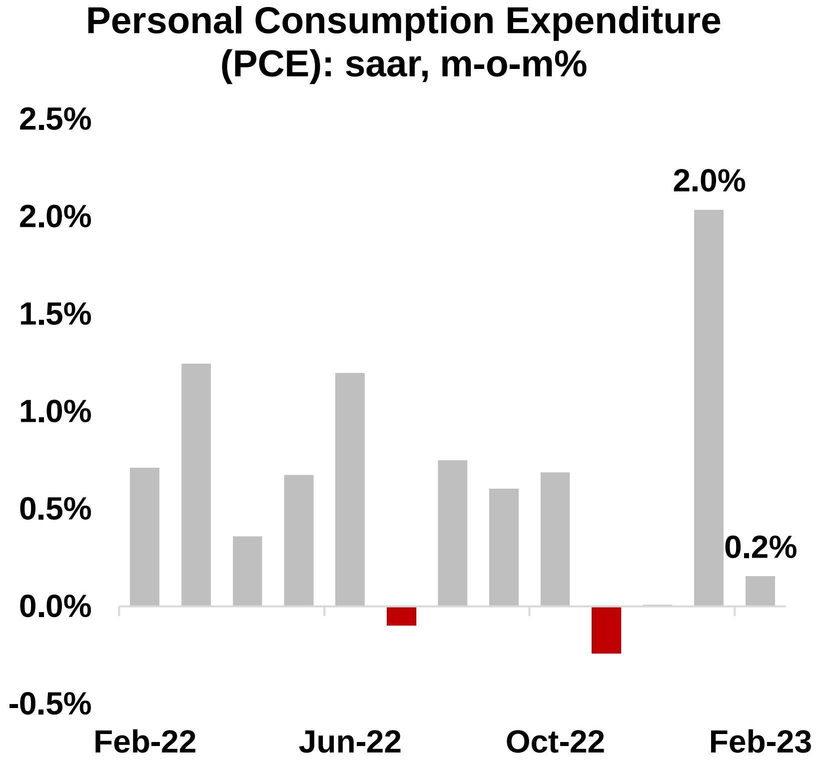


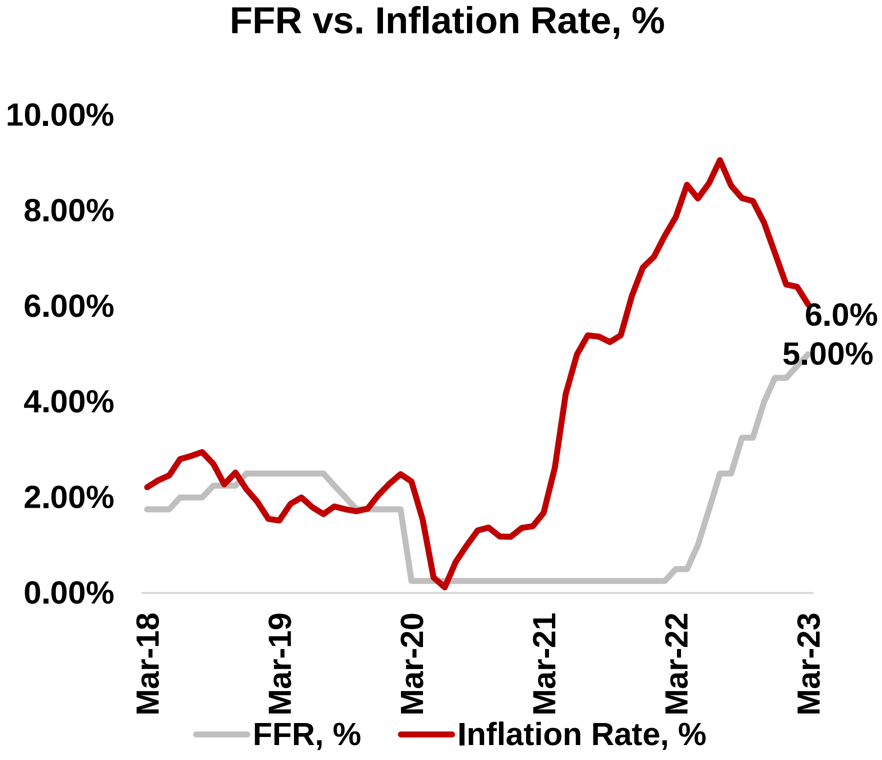
Source: S&P Global

- J.P Morgan Global Manufacturing PMI continues its downtrend despite a brief uptick in the first two months of the year.
- The Caixin Purchasing Managers' Index (PMI) unexpectedly fell to 50.0 points in March, suggesting dubious over the strength of China's recovery momentum following the ongoing property downturn and global financial uncertainty.
- Meanwhile, ASEAN's manufacturing PMI continued to expand during the month, albeit slower due to the slow incoming new business and the renewed fall in employment, causing manufacturers to be more cautious over a slightly muted demand environment. On a positive note, the average suppliers' delivery times have shortened across the region for the first time since January 2020.

THE U.S. IS CAUGHT BETWEEN ITS BATTLE AGAINST HIGH INFLATION WITH THE GLOBAL BANKING CRISIS



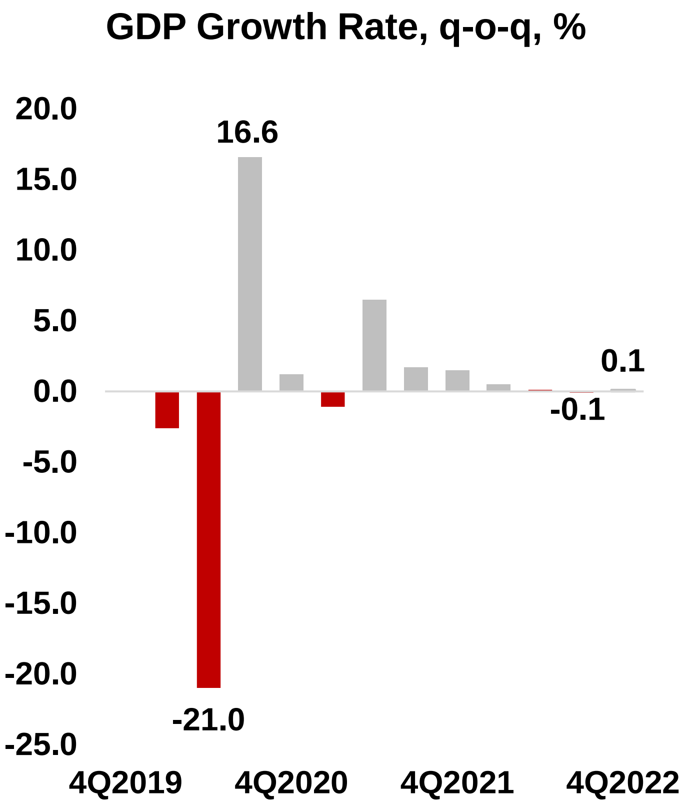


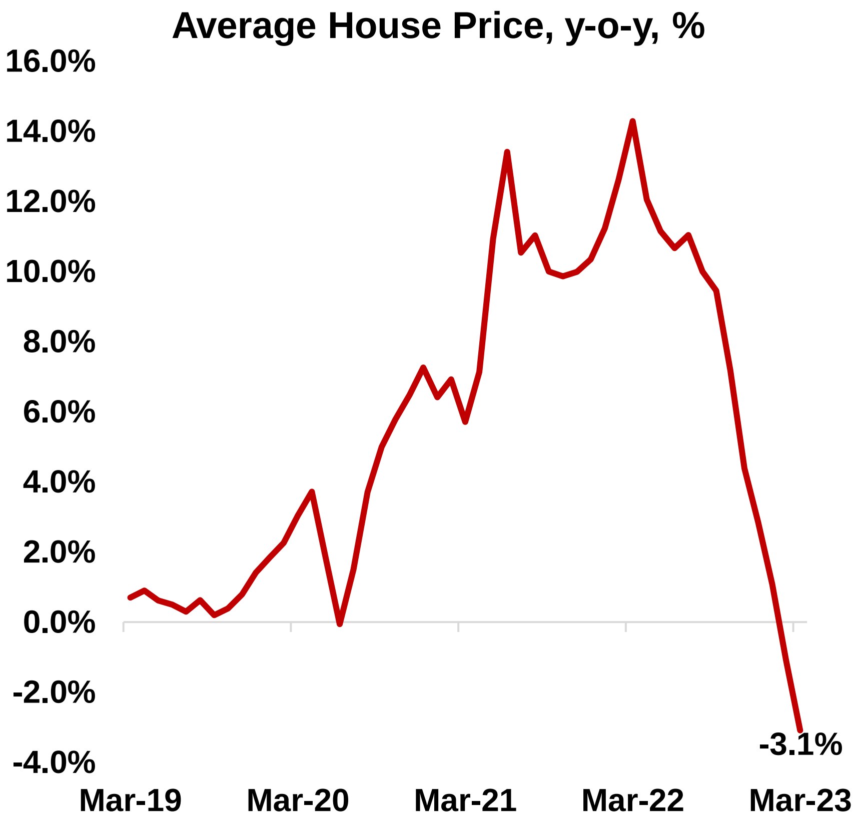


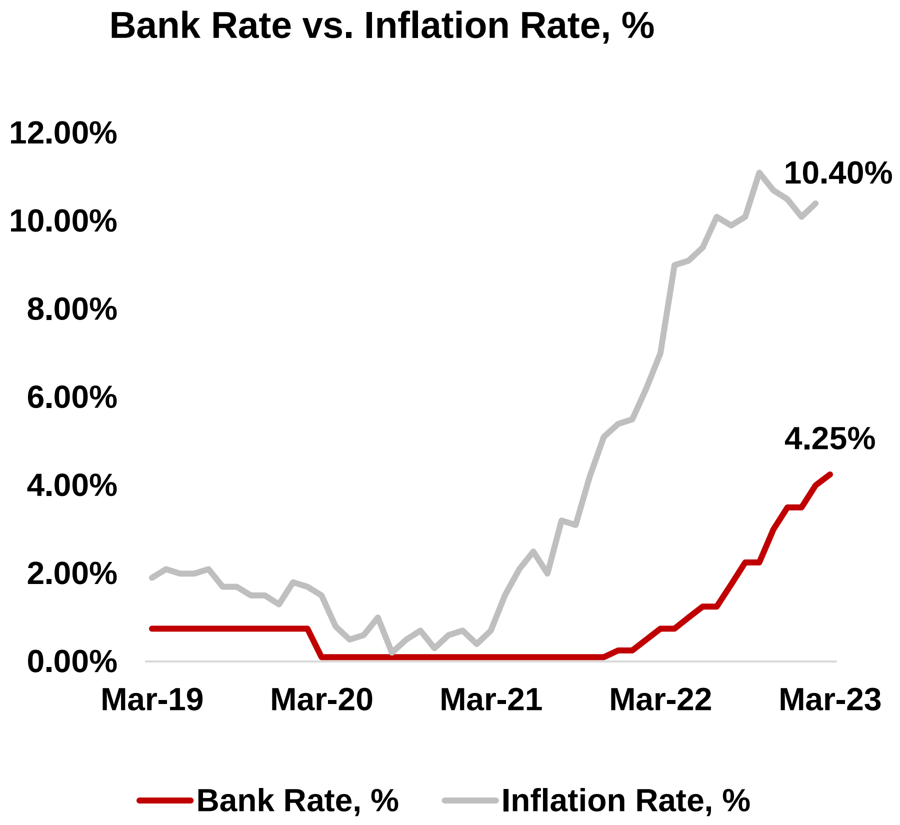
Sources: Federal Reserve Board, Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics

- The U.S. money supply has been shrinking y-o-y since December last year, signalling a red flag for the economy and financial institutions. Such a trend was evident before the March bank failures – SVB and New York's Signature Bank – fanning fears of a credit crunch in the economy, thus, leading to market volatility.
- The U.S. households spent more modestly in February by 0.2% from 2.0% in the previous month, indicating possible signs of slowing economic momentum on the eve of March's banking turmoil.
- Be that as it may, the Fed raised the interest rates again in the wake of troubles in the banking industry, opting to continue its campaign to fight the stubbornly high inflation. While they acknowledged that the financial market turmoil could weigh on the inflation and economy, still, the central bank expressed confidence in the overall system – sound and resilient.

THE U.K. ECONOMY NARROWLY AVOIDS RECESSION, GROWING BY 0.1% IN 4Q2022







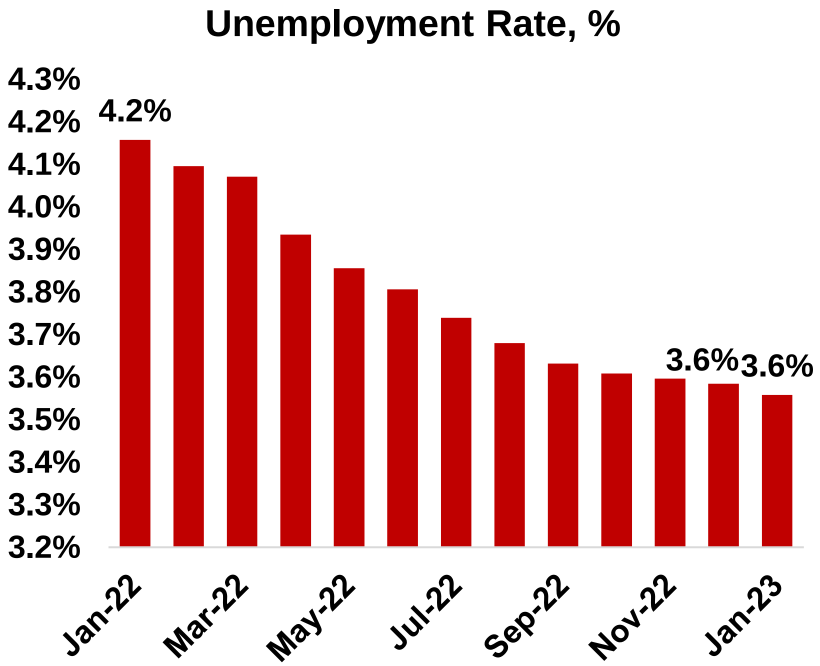
Sources: Office for National Statistics (ONS), Nationwide Building Society, U.K., Bank of England (BoE)

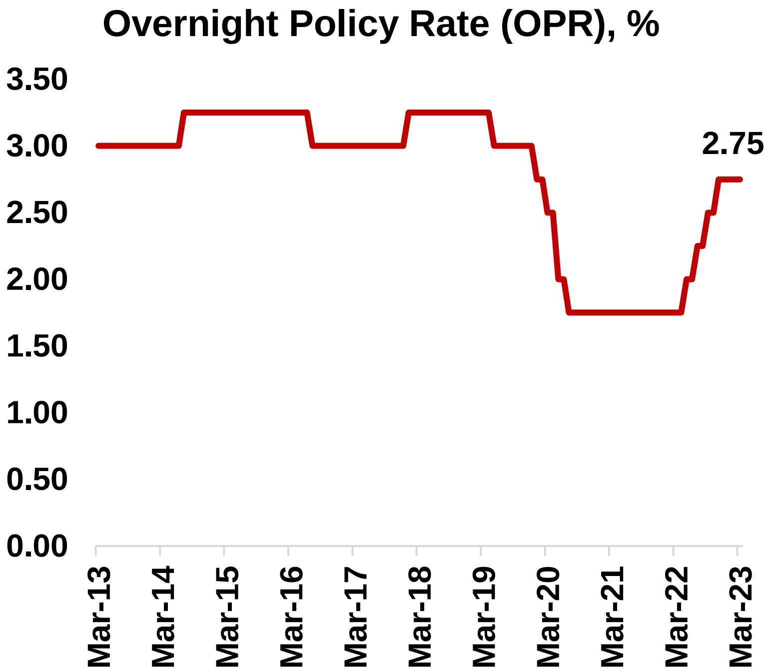
- Despite a preliminary estimate of no growth, the U.K GDP recorded a 0.1% increase between October and December amid high inflation and concern about the weak growth outlook. However, the recent upheaval in the global banking industry may result in lenders restricting their lending practices.
- Meanwhile, the U.K. average house prices dropped quicker than expected (Act: -3.1% vs. Est: -2.2%) during March, adding to evidence that the BoE's rate increases have pushed the mortgage rates up, thus, implying that housing affordability becomes even more challenging.
- For the record, the U.K.'s central bank raised its key bank rate by 25bps to 4.25% in the March meeting as the inflation remains elevated, with the current reading unexpectedly edging higher to 10.4% during the month (February: 10.1%).

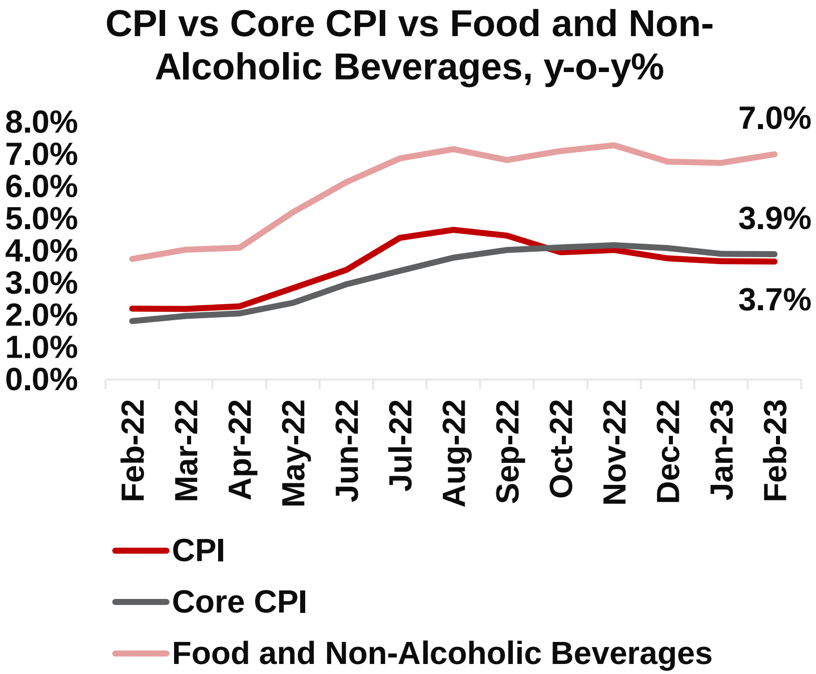
SECTION 3

Domestic Landscape & Banking Sector Update

OPR IS ANTICIPATED TO END THE YEAR AT 2.75%



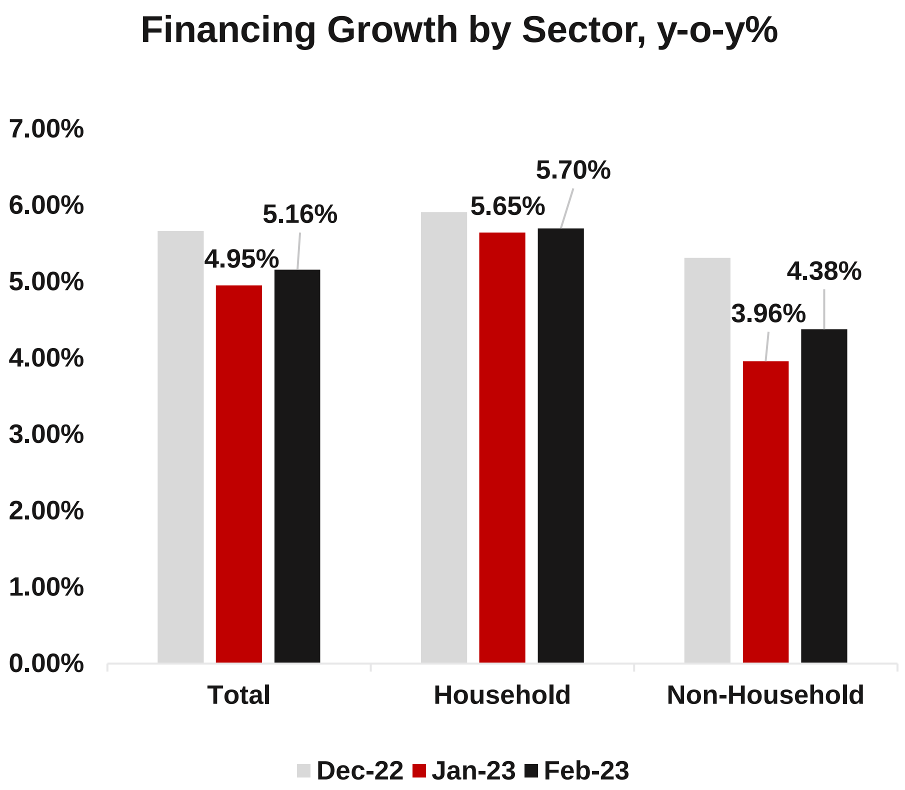


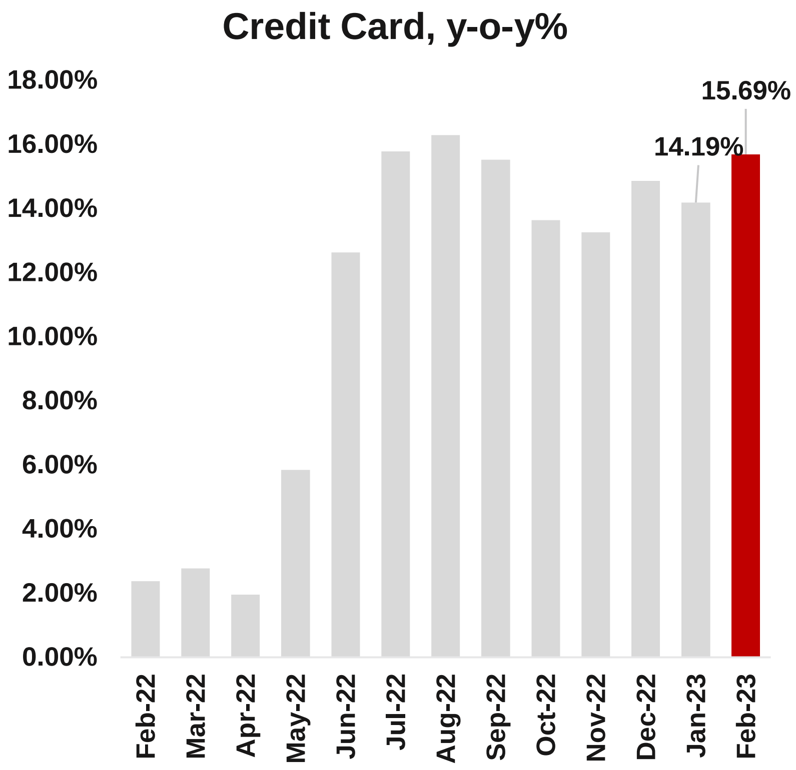


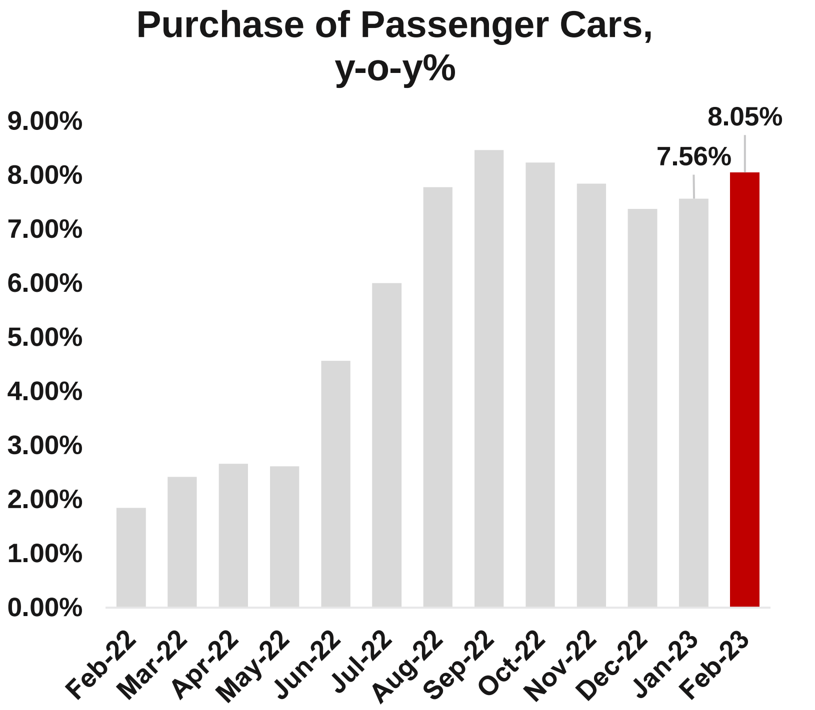
Sources: BNM, DOSM, CEIC

- Following the full economic reopening and ease of restrictions at the beginning of 4Q2021, Malaysia's unemployment rate showed a remarkable improvement, steadily decreasing from 4.2% in January 2022 to 3.6% a year later amid strong upbeat in local economic activities.
- For 2023, BNM expected further recovery in the labour market, with the rate continuing to decline to 3.5% due to broad-based income expansion, thanks to the government's policy intervention. However, the rate remains higher than the pre-pandemic levels of 3.3%.
- On the other hand, the OPR had seen a continuous pause in March, resting at 2.75%, allowing the central bank to assess the impact of the past 100bps OPR hike in 2022 on the economy.
- Following the static domestic labour market condition and the wide gap between the OPR and 3M KLIBOR, we posit that the central bank will opt to keep the OPR steady for the rest of 2023.
- Meanwhile, headline inflation is projected to moderate between 2.8%-3.8% for 2023 (Bank Islam: 3.0%), with food inflation remaining elevated amid robust domestic demand and the possibility of subsidy rationalisation in 2H2023.

BANKING SECTOR: HOUSEHOLD AND NON-HOUSEHOLD SECTORS CONTINUED TO DRIVE FINANCING GROWTH IN FEBRUARY







Source: BNM

- Financing activities increased to 5.16% y-o-y in February compared to 4.95% in January, fuelled by stronger Household (February: 5.70% vs. January: 5.65%) and Non-Household (February: 4.38% vs. January: 3.96%) sectors performance.
- Within the Household sector, credit cards financing continued to grow at double-digit (February: 15.69% vs. January: 14.19%) while the purchase of passenger cars (February: 8.05% vs. January: 7.56%) grew higher, suggesting the domestic private consumption activities remained healthy despite a high interest rate environment and inflationary pressure.

BANKING SECTOR: ASSET QUALITY RELATIVELY STABLE

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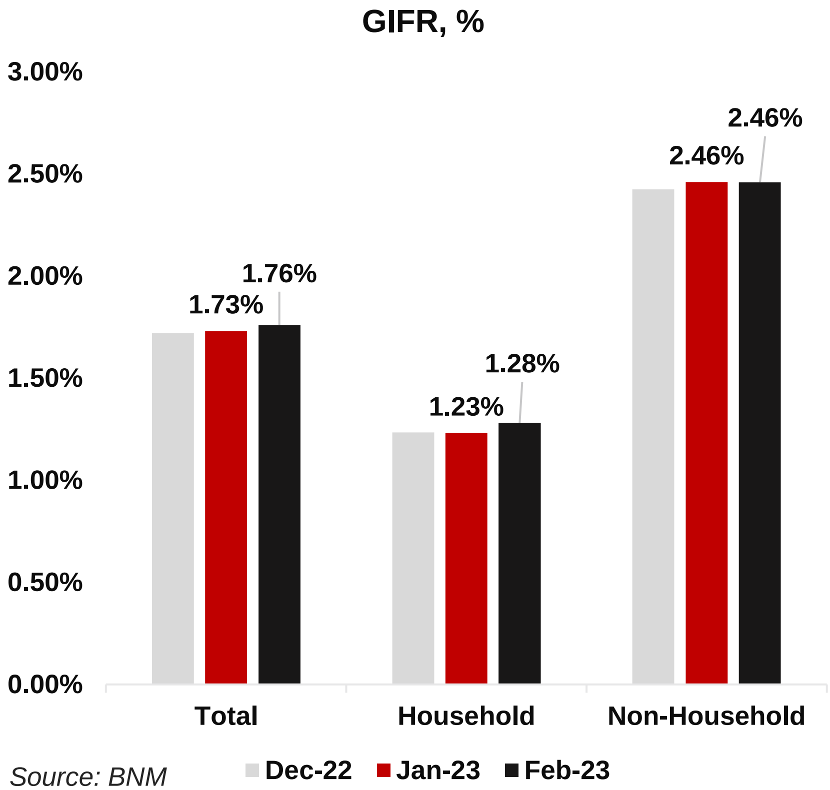

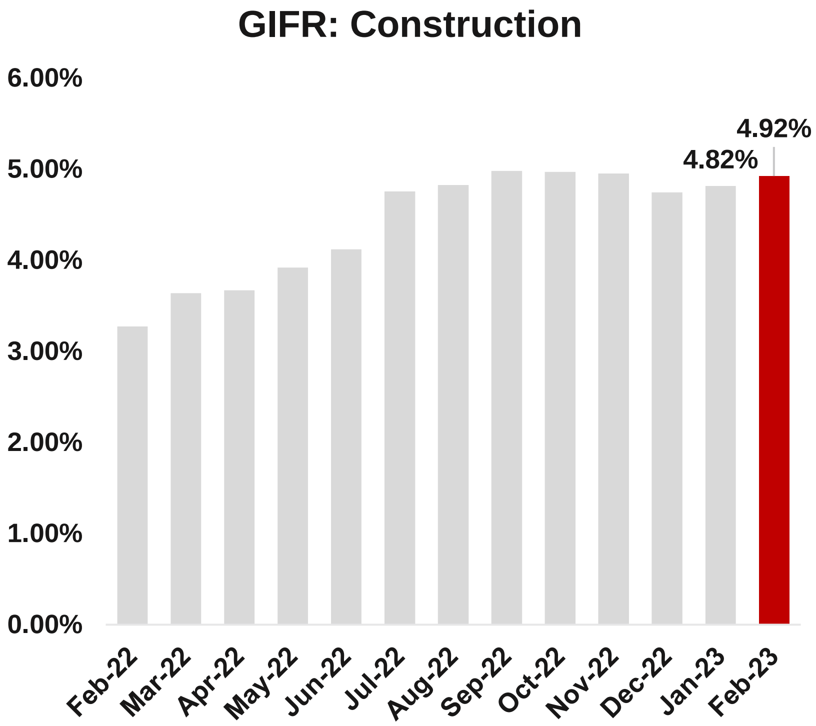

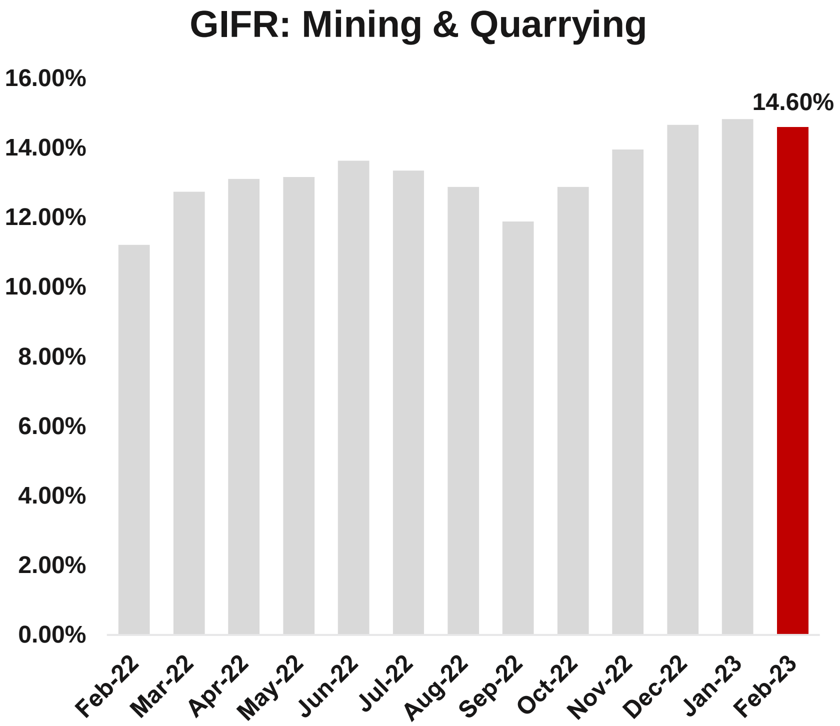

Source: BNM

- The total Gross Impaired Financing Ratio (GIFR) was a tad higher at 1.76% in February from 1.73% in January on the back of deterioration of asset quality in the Household sector (February: 1.28% vs. January: 1.23%) while Non-Household sector's GIFR remained at 2.46% for two straight months.
- However, within the Non-Household segment, GIFR for the Construction industry recorded an uptick to 4.92% in February (January: 4.82%), while impairment for Mining & Quarrying maintained at a double-digit of 14.60% in February though slightly lower from 14.82% in January.
- Despite the challenging external headwinds, stress tests conducted by the BNM affirmed that banks' capital buffers are sufficient to absorb a potential increase in credit losses from the business sector under adverse stress scenarios.

THANK YOU