BANK ISLAM

MONTHLY ECONOMIC UPDATE

3 OCTOBER 2023

ECONOMIC RESEARCH

FIRDAOS ROSLI
LEE SI XIN
RAJA ADIBAH RAJA HASNAN
NOR LYANA ZAINAL ABIDIN
KHAYRIN FARZANA FAZLI

KEY TAKEAWAYS

- **Fed reiterates higher-for-longer stance on interest rate.** While keeping the target range for the federal funds rate unchanged at 5.25%-5.50% at its September policy meeting, the U.S. Federal Reserve (Fed) has signalled a tighter policy path to fight persistent inflation. In the updated dot plot, Fed officials indicated the likelihood of one additional 25bp hike this year, followed by two rate cuts next year, which is two less than previously projected. However, investors were not entirely convinced, as their implied path points to less than a half chance of further rate hikes in the remainder of the year. This is particularly true after the August Personal Consumption Expenditures (PCE) data showed signs of cooling. Core PCE inflation, the Fed's preferred inflation gauge, decelerated to 3.9% in August from 4.3% in July.

- **ECB signals end to rate-hiking cycle.** As widely anticipated, the European Central Bank (ECB) was the only major central bank with a hike last month, delivering its 10th consecutive hike in its September policy meeting. ECB's deposit facility rate is higher by 25 bps to a new record high of 4.00%. The ECB also hinted that interest rates may have peaked given the considerably weak near-term economic growth than the ECB officials previously thought. Meanwhile, Eurozone headline and core inflation declined notably to 4.3% and 4.5% in September from 5.2% and 5.3% in August. While inflation has halved from the peak, it remains more than double the ECB's 2.0% target, while higher oil prices would keep price pressure elevated in the coming months. This means that interest rates may have to stay higher for an extended period to quell inflation.

- **BoE pauses rate hike as inflation slows down.** In its September policy meeting, the Bank of England (BoE)'s Monetary Policy Committee voted by a narrow margin of five to four to hold the policy rate steady at a 15-year high of 5.25%. This halted the BoE's streak of 14 consecutive rate hikes since December 2021, when the policy rate was merely 0.10%. The decision came amid looming recession concerns and an unexpected decline in the U.K. headline inflation to the lowest level since February 2022 at 6.7% in August (July: 6.8%). However, the BoE has indicated that it has not entirely ruled out the possibility of another rate hike this year, given the still above-target inflation.

KEY TAKEAWAYS

- **BoJ maintains ultra-easy monetary policy as widely expected.** The Bank of Japan (BoJ) unanimously decided to leave its monetary setting unchanged, maintaining its policy rate and 10-Y Japanese Government Bond (JGB) yield target at -0.10% and 0.00%, respectively. The accompanying monetary policy statement suggested little urgency for a policy pivot given "extremely high uncertainties surrounding economies and financial markets at home and abroad". Nevertheless, the summary of opinions at the September policy meeting revealed that BoJ policymakers have discussed progress toward their 2.0% inflation target and are preparing for an eventual exit from ultra-easy monetary policy. Latest data showed Japan's core inflation was steady at 3.1% in August, marking its 17th consecutive month of staying above the 2.0% target.

- **BoT hikes interest rates again in a pre-emptive move to contain inflation.** The Bank of Thailand (BoT) raised its key interest rate by 25 bps to 2.50%, the highest level in a decade. The decision marked the BoT's 8th successive rate increase, likely the final hike in the current rate tightening cycle. The central bank said the rate had now reached a 'neutral' level and was appropriate for supporting long-term sustainable growth in Thailand. The BoT expected Thailand's economy to continue recovering, albeit slower, due to soft external demand. Meanwhile, in its assessment of the inflation outlook, the BoT projected inflation to hover within its target range of 1.0% and 3.0% through 2024. However, it added that the bank monitors the inflationary pressures arising from the government's proposed economic stimulus measures.

- **OPR will remain steady for some time.** In line with consensus, the Bank Negara Malaysia (BNM) kept the Overnight Policy Rate (OPR) steady at 3.00% at its September meeting, marking its second consecutive rate pause. The tone from the accompanying Monetary Policy Statement implied that the BNM is likely done with its rate hiking cycle as the phrase "slightly accommodative" is removed. We opine that the BNM will maintain the OPR at 3.00% through to at least 1Q2024, if not longer. This is because a rate hike has weakened with the moderating growth momentum and inflation easing, as the BNM acknowledged. Given the firm labour market conditions and the weakness in the ringgit, we also believe there is no urgency to cut interest rates in the near term.

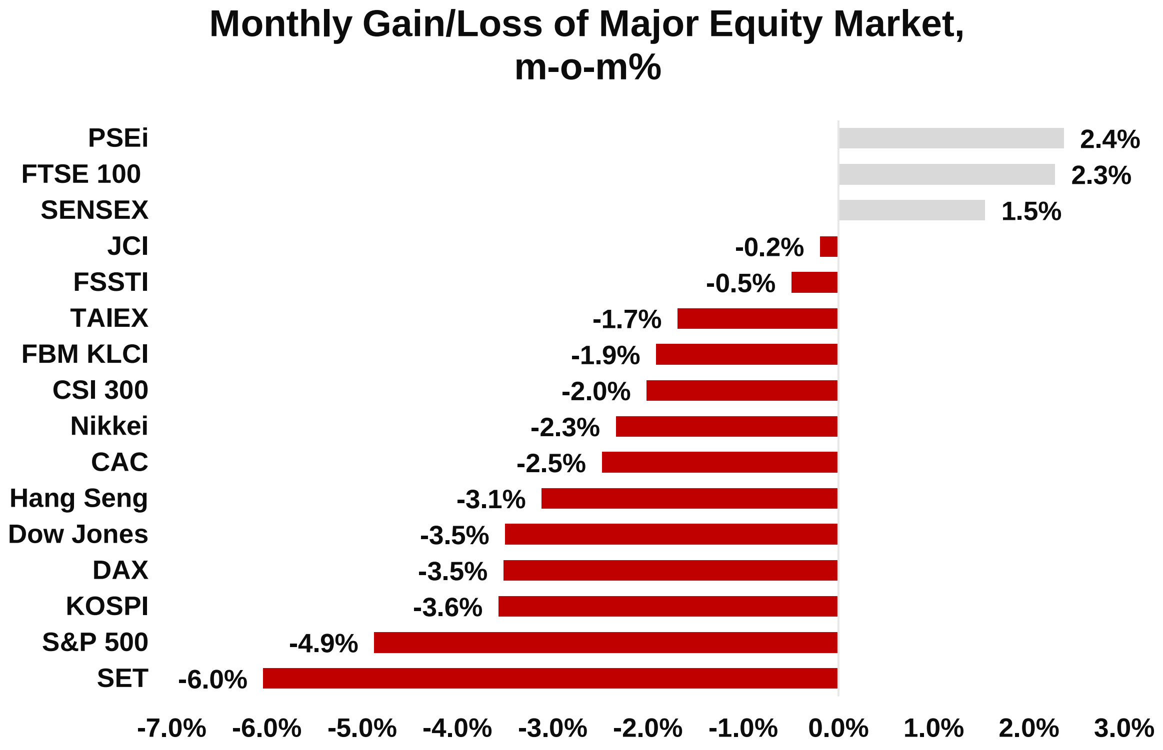
BANK ISLAM

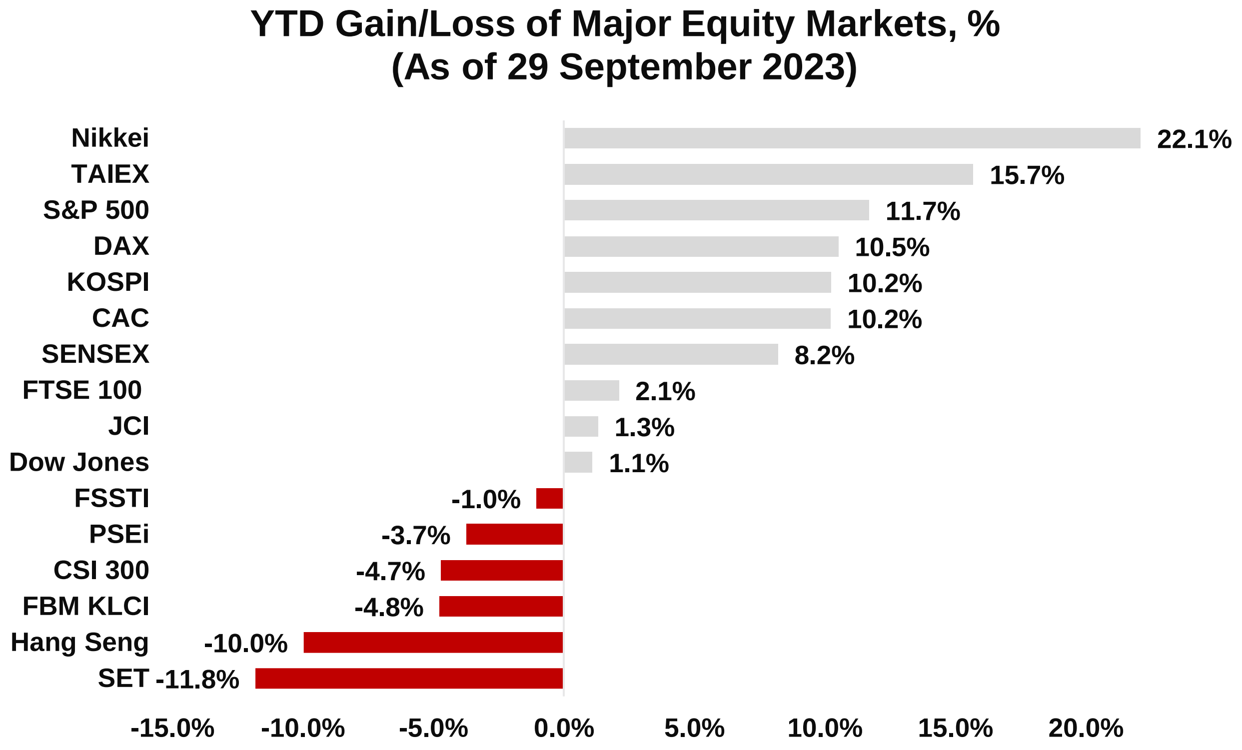
SECTION 1

Malaysia’s Financial Market

REGIONAL EQUITY: GLOBAL STOCKS RETREATED AS THE FED ENVISIONED FOR HIGHER-FOR-LONGER RATES

BANK ISLAM



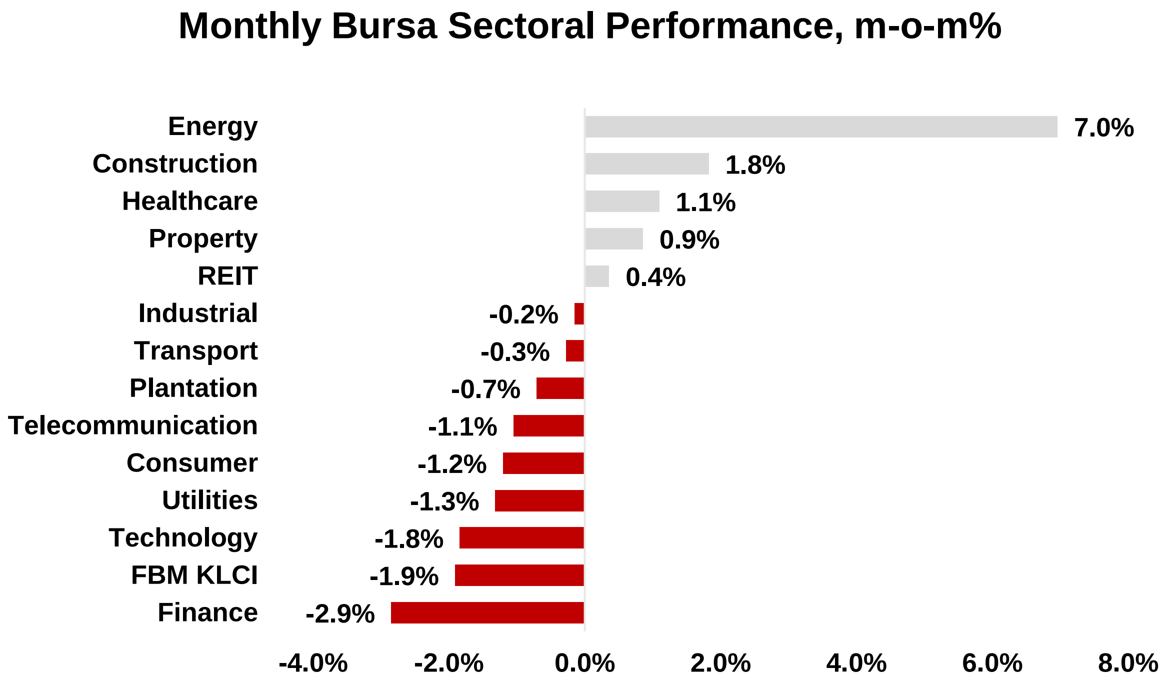


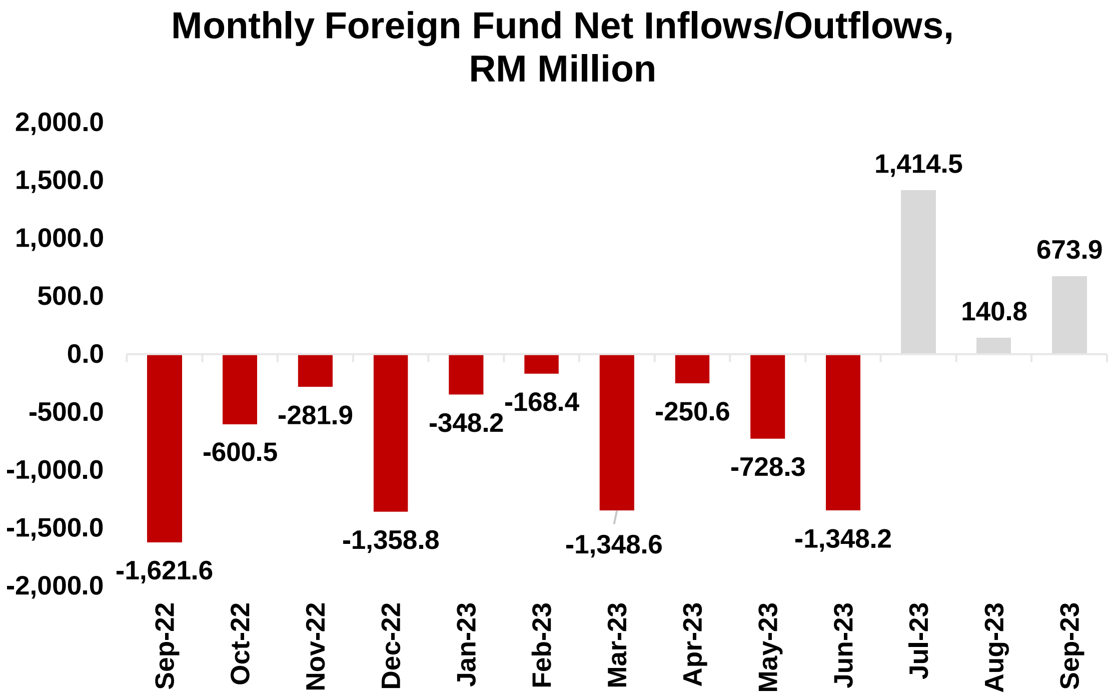
Sources: Bursa, CEIC Data

- In September, the regional benchmark indices mainly plunged into the negative territory. Of note, Thailand's SET contracted by 6.0% on a month-on-month (m-o-m) basis in September following a rate hike by the BoT and amid a weakening Baht.
- Regional market sentiment was battered by surging oil prices and worries over the higher-for-longer rates strategy by the Fed, which would translate into another possible hike for this year.
- Conversely, Philippines' PSEi (+2.4%), U.K.'s FTSE 100 (+2.3%) and India's SENSEX (+1.5%) were the only gainers for the month.
- From January to September 2023, Japan's Nikkei remained the top performer, albeit with a slimmer gain of 22.1% from 25.0% in the previous month.

DOMESTIC EQUITY: LOCAL STOCKS MOSTLY LOST GROUND AS NEGATIVE NEWS FLOWS FROM ABROAD SOURED SENTIMENT

BANK ISLAM





Sources: Bursa, BNM, CEIC data

- More than half of the Bursa sectoral indices ended the month of September in the red, with Finance (-2.9%), Technology (-1.9%) and Utilities (-1.8%) leading the losses.
- Negative news flows at month-end – including the looming U.S. government shutdown and the detention of China Evergrande's Chairman – kept investors cautious.
- On the other hand, the Energy index led gainers by a large margin (7.0%) amid elevated crude oil prices.
- Foreign investors increased their net buying for the third consecutive month to RM673.9 million compared to RM140.8 million in August.
- Trading in local stock markets will be relatively quiet ahead of the Budget 2024 announcement on October 13, especially when no new large infrastructure projects are in the pipeline.

FIXED INCOME: YIELDS ENDED HIGHER AND LOCAL BONDS HALTED SEVEN MONTHS OF NET FOREIGN INFLOWS STREAK

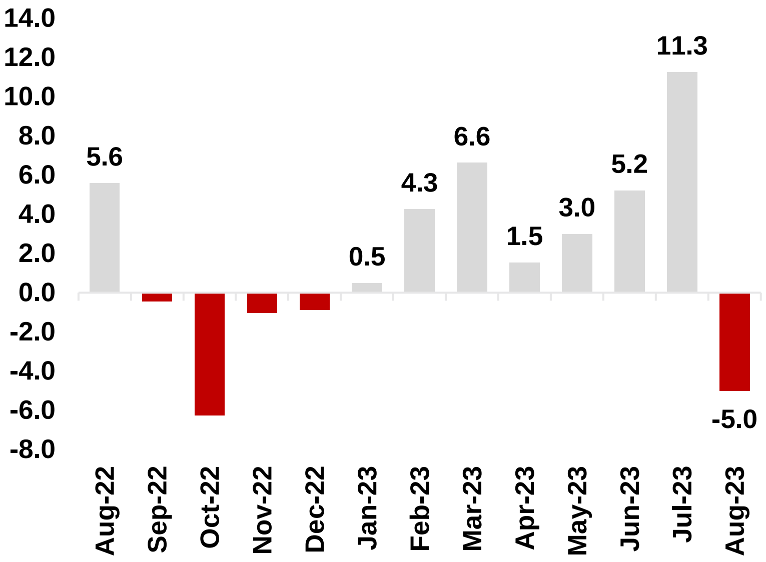
BANK ISLAM

Monthly changes, basis points (bps)

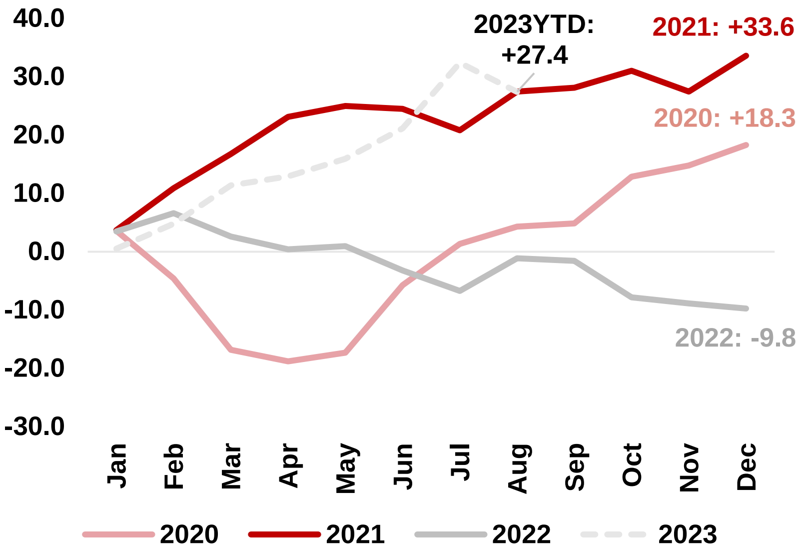
UST	Yields (%) 31-Aug-23	Yields (%) 29-Sep-23	Change (bps)
3-Y UST	4.54	4.80	26
5-Y UST	4.23	4.60	37
7-Y UST	4.19	4.61	42
10-Y UST	4.09	4.59	50
MGS	**Yields (%) 30-Aug-23**	**Yields (%) 29-Sep-23**	**Change (bps)**
3-Y MGS	3.46	3.58	12
5-Y MGS	3.59	3.72	14
7-Y MGS	3.74	3.89	14
10-Y MGS	3.84	3.98	14
GII	**Yields (%) 30-Aug-23**	**Yields (%) 29-Sep-23**	**Change (bps)**
3-Y GII	3.47	3.60	13
5-Y GII	3.63	3.80	18
7-Y GII	3.79	3.91	12
10-Y GII	3.87	4.01	14

Sources: BNM, Federal Reserve Board

Foreign Fund Flows in Local Bond Market, RM Billion

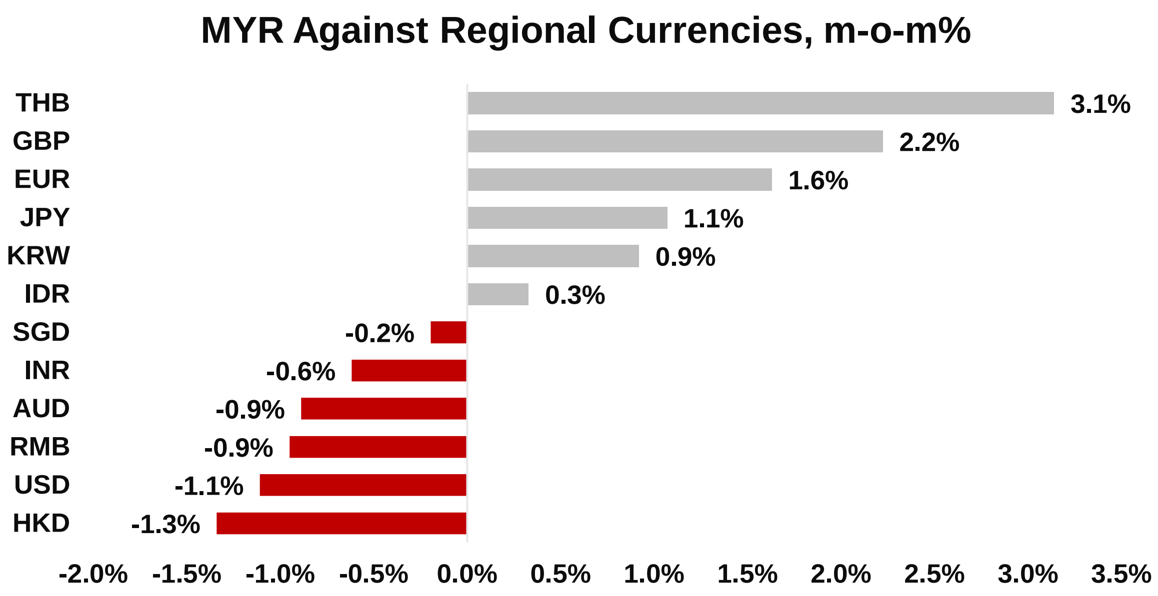


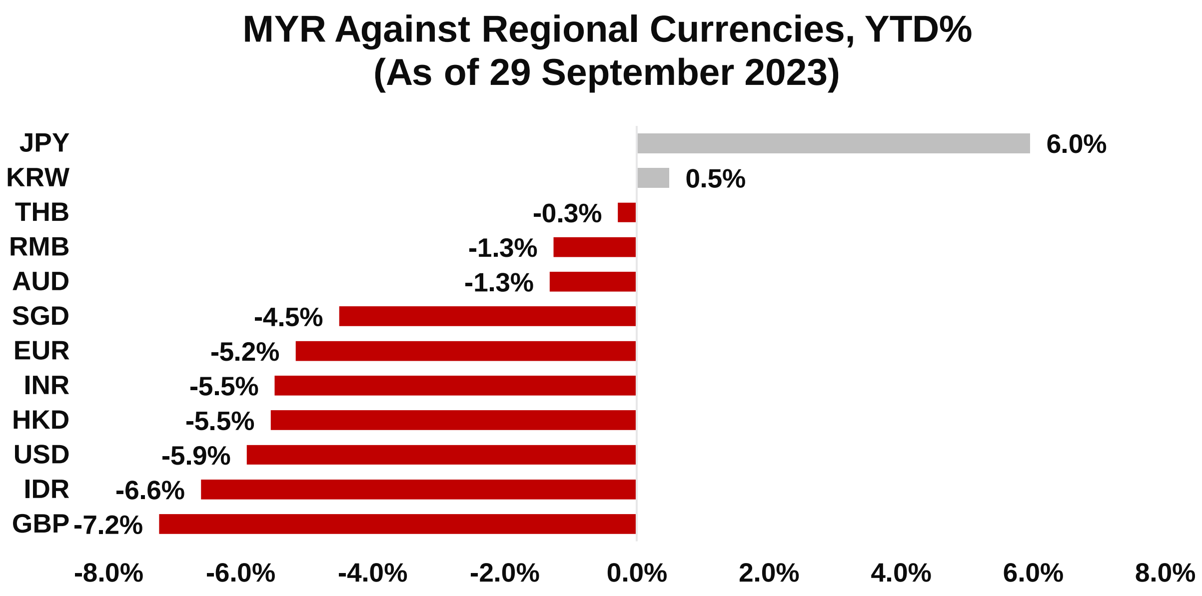
Cumulative Net Foreign Flows in Local Bonds (Yearly Comparison, RM Billion)



- Overall, global bonds continued to weaken in September, with the U.S. Treasury (UST) yields shot up more than domestic bond yields.
- The UST yield curve bearishly steepened, with yields surging between 26bps and 50bps amid the Fed’s higher-for-longer mantra on interest rates to alleviate inflation, in addition to the robust U.S. economic data and a still hot labour market.
- Both Malaysian Government Securities (MGS) and Government Investment Issues (GII) yields rose between 12bps and 18bps in September.
- The local bond market ended seven months of net foreign buying streak, with August recording net outflows of RM5.0 billion (July: RM 11.3 billion). Consequently, the local govvies’ foreign shareholdings to total outstanding slipped to 23.4% in August (July: 24.0%).
- For the first eight months of 2023, the cumulative net foreign flows logged inflows of RM27.4 billion, significantly higher than the outflows of RM1.2 billion in the same period in the prior year.

FX MARKET: RINGGIT ENDED WEAKER IN SEPTEMBER AS THE U.S. DOLLAR SOARED TO A 10-MONTH HIGH





Source: Investing.com

- Worries surrounding the Ringgit's weakness plagued the market during the month as it breached the highest level this year at RM4.707 on 27 September 2023, weighed by the greenback's unending climb. On a monthly basis, the Ringgit weakened against the USD when the local note closed at RM4.690 on 29 September from RM4.638 in the previous month.
- In its latest policy meeting in September, the Fed kept its policy rate steady while reiterating the possibility of another hike by year-end. Coupled with the latest Social Economic Projections (SEPs) pointing to fewer rate cuts 2024, we believe rates will remain elevated for longer.
- However, Ringgit's performance could be buoyed by China's economic recovery amid the supportive measures doled out by the People's Bank of China (PBoC). Market participants are also eyeing the release of Budget 2024 and the tone set on the nation's economy, which could provide relief to the local note.
- Domestically, BNM's rate hike cycle has slowed as inflation has decelerated, resting at 2.0% for the past month.

BANK ISLAM

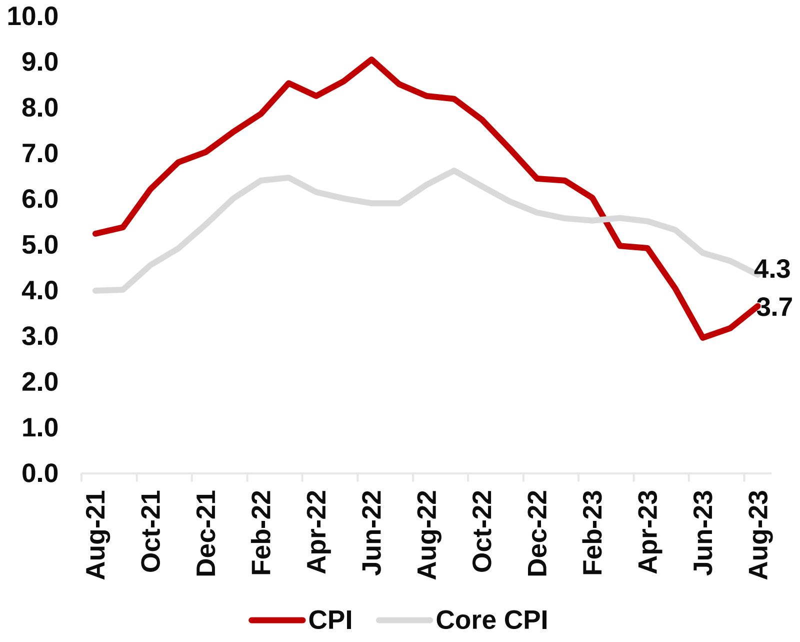
SECTION 2

The Global Economy

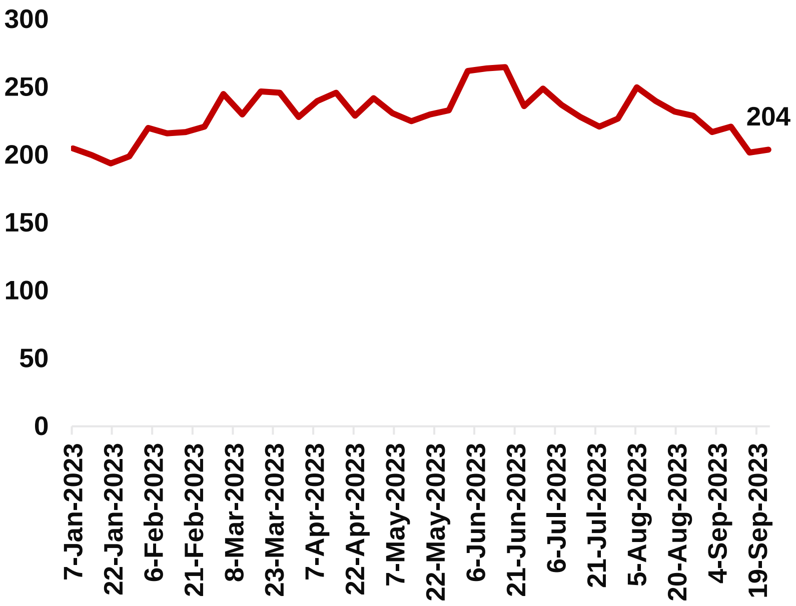
WITH ONE POSSIBLE FINAL HIKE IN STORE FOR THIS YEAR, POSSIBILITIES OF A SOFT LANDING IN THE U.S. REMAINS WITHIN REACH

BANK ISLAM

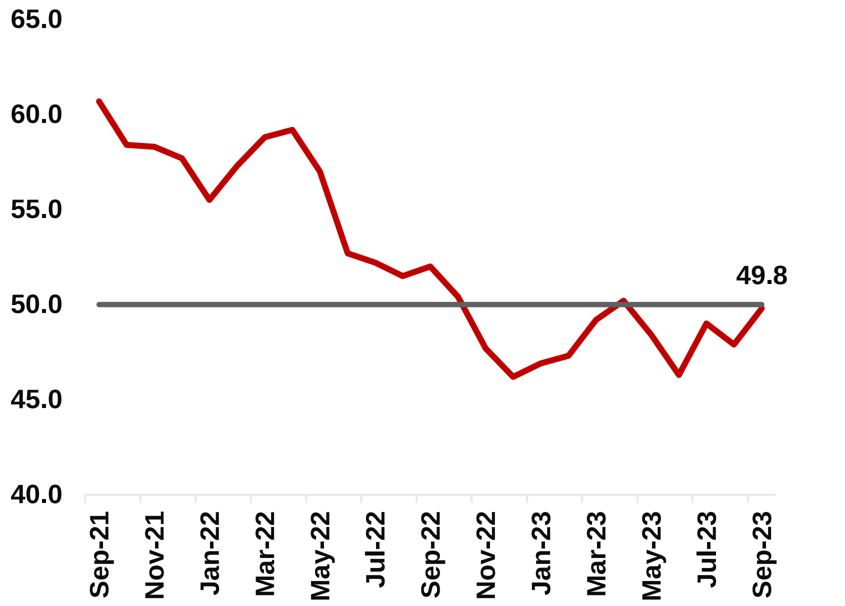
CPI vs. Core CPI, y-o-y %



U. S. Weekly Initial Jobless Claims, s. a. '000



Manufacturing Purchasing Managers' Index (PMI), s.a. points

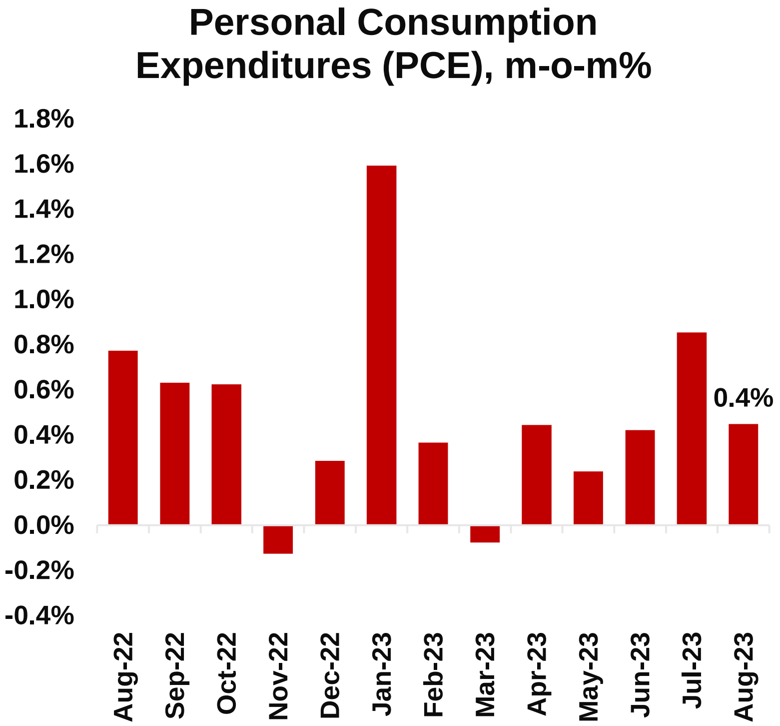


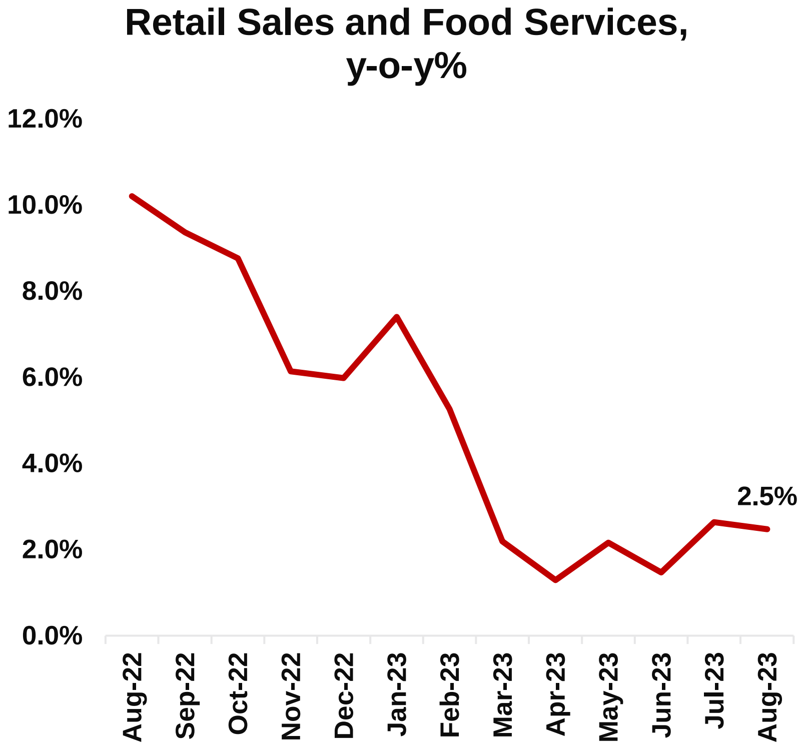
Sources: U. S. Bureau of Economic Analysis (BEA), U.S. Department of Labor, S&P Global, CEIC Data

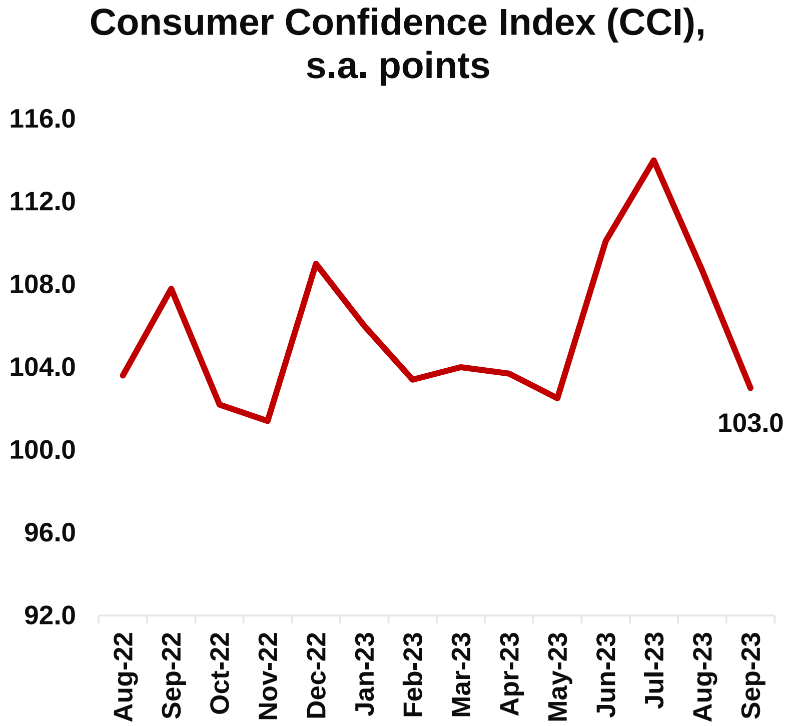
- With the U.S. inflation decelerating and the labour market displaying signs of cooling, the Fed had opted to hold the Fed Funds Rate (FFR) steady in its September meeting while envisioning another hike by year-end.
- The August inflation data showed that the Consumer Price Index (CPI) rose slightly to 3.7% (July: 3.2%) while core CPI moderated to 4.3% (July: 4.7%).
- Despite the unemployment rate climbing to 3.8% (July: 3.5%), the labour market remains resilient as the weekly initial jobless claims have trended lower in September compared to the previous month.
- Meanwhile, factory activity recorded an uptick, albeit still trending in the contractionary area, reflecting slowing global manufacturing activities.
- In the wake of such resilience, the Fed had revised upwards their GDP forecast, anticipating a growth of 2.1% this year.

HOWEVER, THE CONSUMERS' SIDE PAINTS A LESS ROSY PICTURE OF THE U.S. ECONOMY

BANK ISLAM





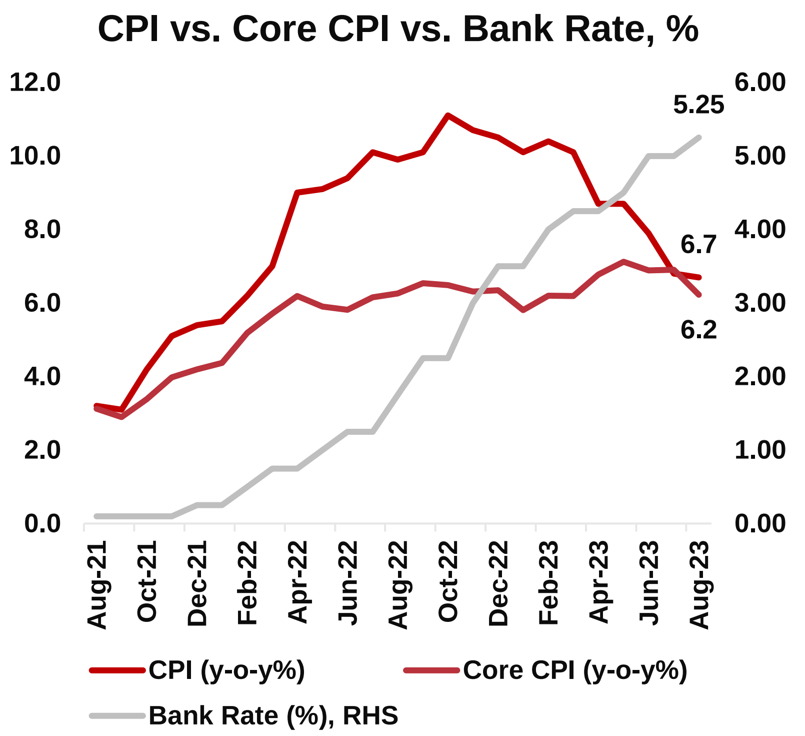


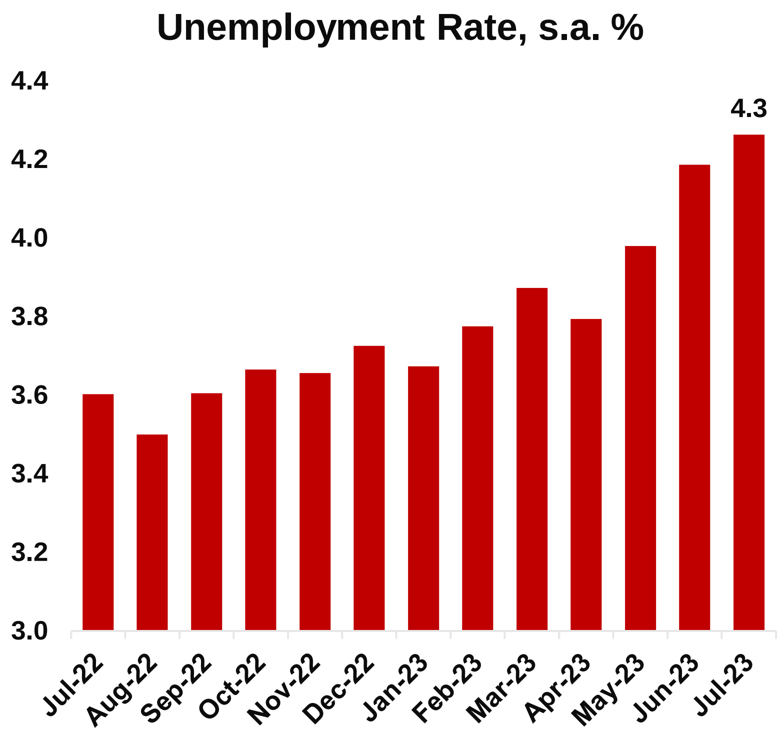
Sources: BEA, U. S. Census Bureau, CEIC Data

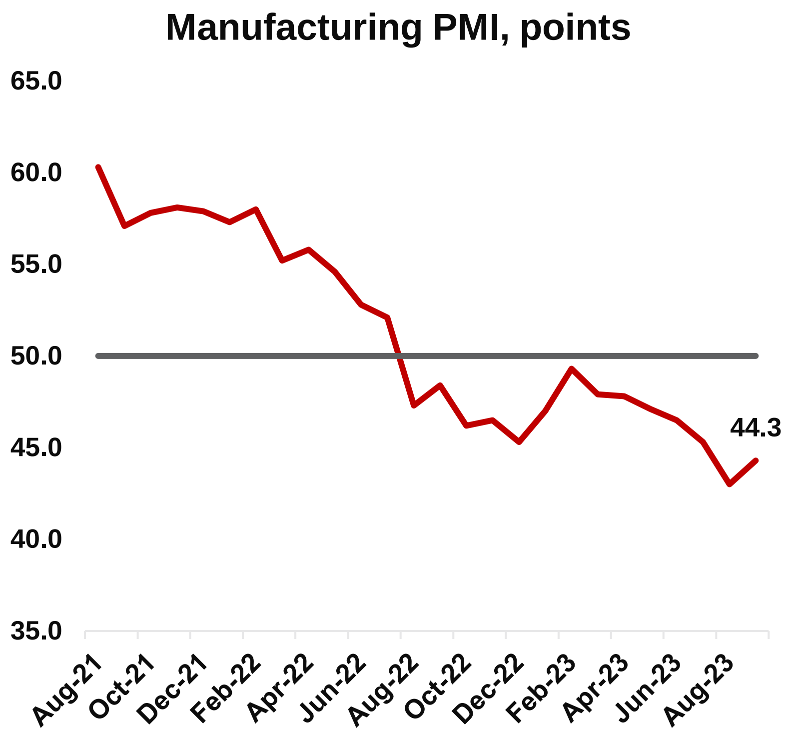
- In a new update, the Commerce Department has revised the growth in quarterly consumer spending in the 2Q2023 lower to only 0.8% (Previous: 1.7%, 1Q2023: 3.8%). The deceleration in consumer spending partly reflected the impact of the aggressive monetary tightening.
- In line with the scale back in spending (August: 0.4% vs. July: 0.9%), retail sales and food services dipped to 2.5% in August (July: 2.6%).
- Consumer sentiment was further dampened by the possibility of the rates staying higher for longer, with the CCI slipping to 103.0 points in September (August: 108.7 points).
- As the Fed contemplates another hike by year-end, downside risks stemming from the consumers' more cautious approach and rising energy prices remained.

SLOWING ECONOMIC MOMENTUM LED TO A BREATHER IN BOE'S MONETARY TIGHTENING PATH

BANK ISLAM





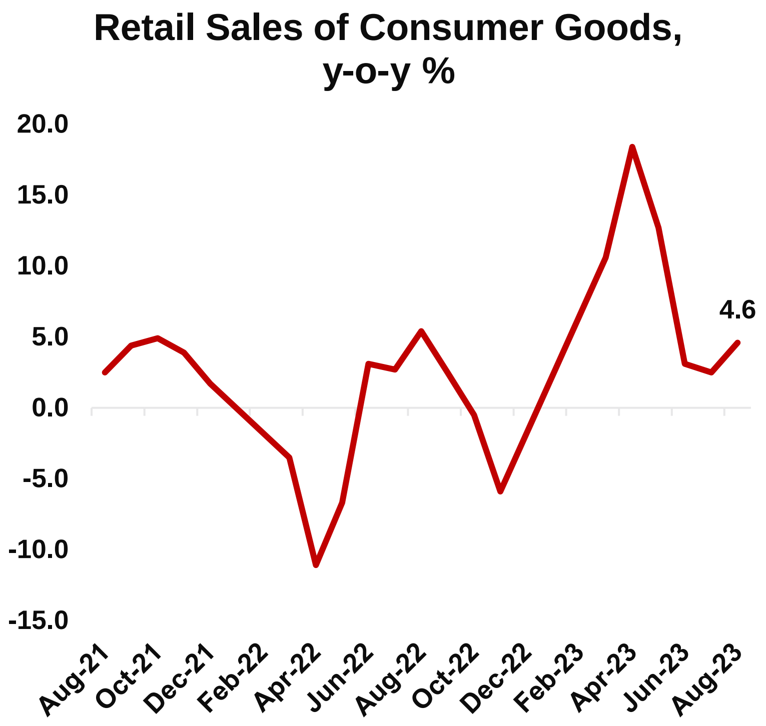


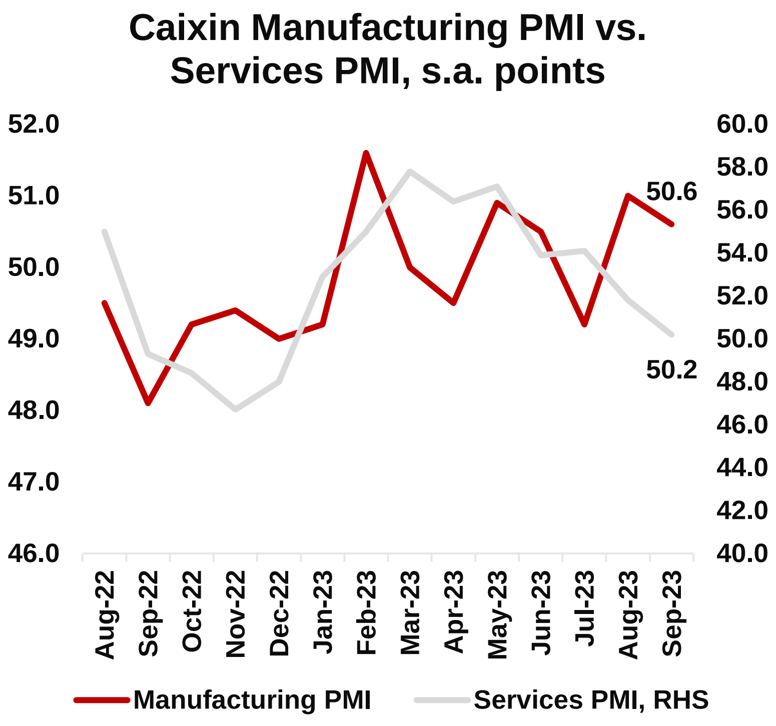
Sources: Office for National Statistics (ONS), S&P Global

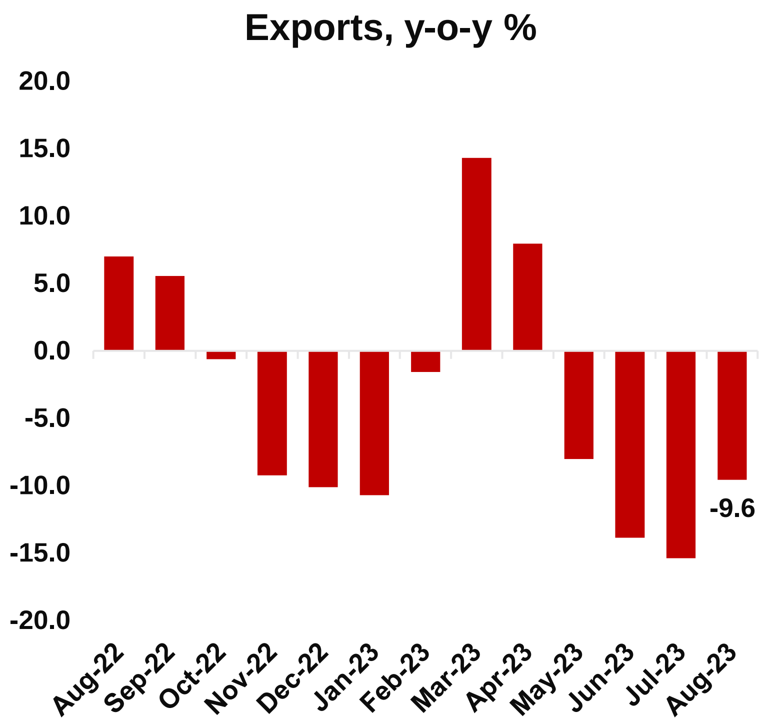
- The impact of BoE's aggressive policy rate cycle has caught up to the economy, resulting in lower inflation data but dragging down growth.
- U.K.'s headline inflation edged lower to 6.7% in August (July: 6.8%), while core inflation fell notably to 6.2% (July: 6.9%). Echoing BoE's primary framework of achieving price stability, the decline led to the central bank holding rates steady in its September meeting.
- Additionally, the labour market displayed signs of cooling as the unemployment rate ticked to 4.3% in July (June: 4.2%), and average weekly earnings (without bonus) stagnated at 7.8% y-o-y for the past two periods.
- Manufacturing activity in the U.K. persisted downward, following a decline in orders as domestic and global demand softened.

CHINA’S RECOVERY: TOO EARLY TO CELEBRATE?

BANK ISLAM







Sources: S&P Global, National Bureau of Statistics

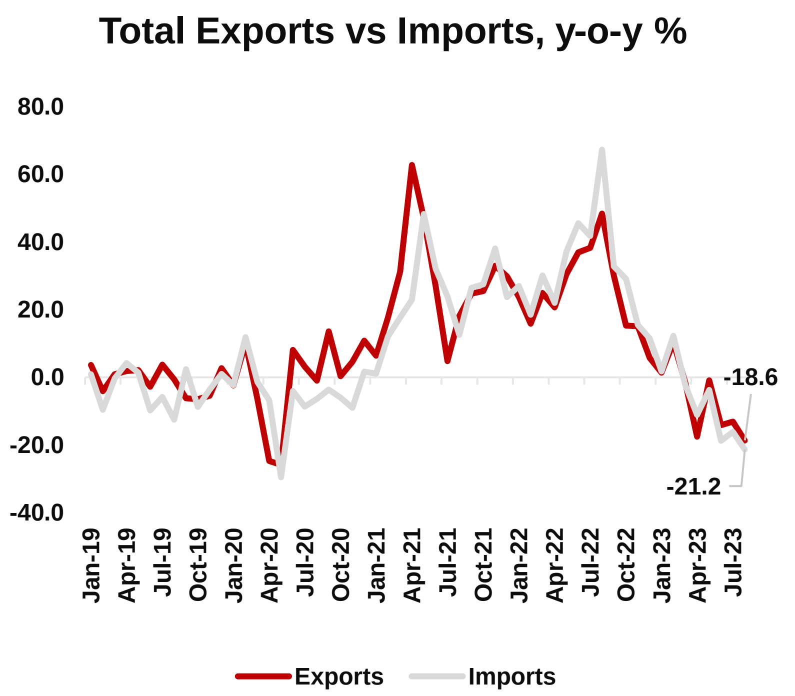
- Amidst a slew of supportive measures by China’s authorities to revive consumer spending and the summer holiday season, retail sales of consumer goods accelerated to 4.6% in August (July: 2.5%) while consumer confidence edged up to 86.5 points (July: 86.4 points).
- This recovery is expected to continue through September as China’s tourism will likely increase amid the Mid-Autumn festival celebrations.
- Despite optimism about the economy gaining ground, several developments remain areas of concern, including the looming property crisis, elevated youth unemployment and weakening demand.
- The economy still struggles to maintain strong growth as sluggish demand dragged factory and services activity to 50.6 points (August: 51.0 points) and 50.2 points (August: 51.8 points) in September, respectively.
- Additionally, global demand did not lend any relief as exports recorded the fourth straight month of contraction.

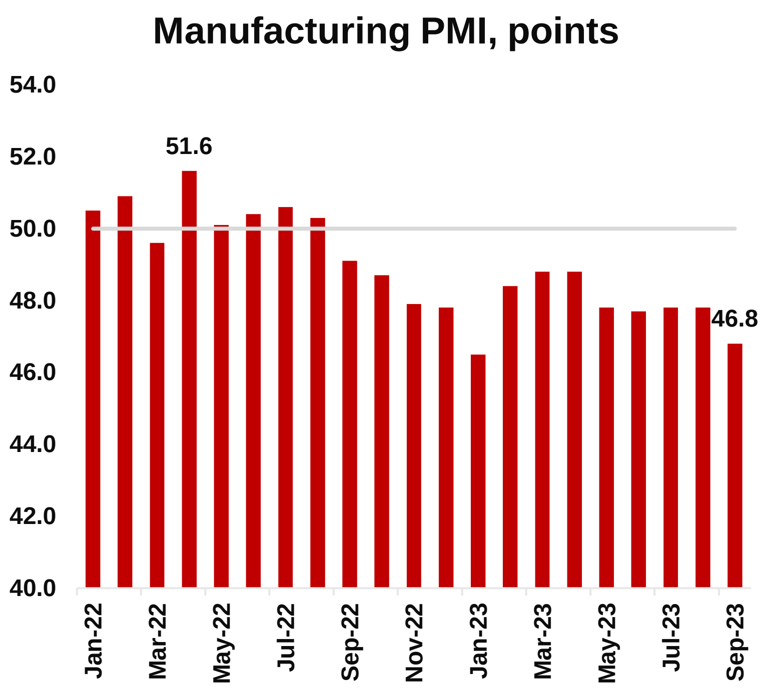
SECTION 3

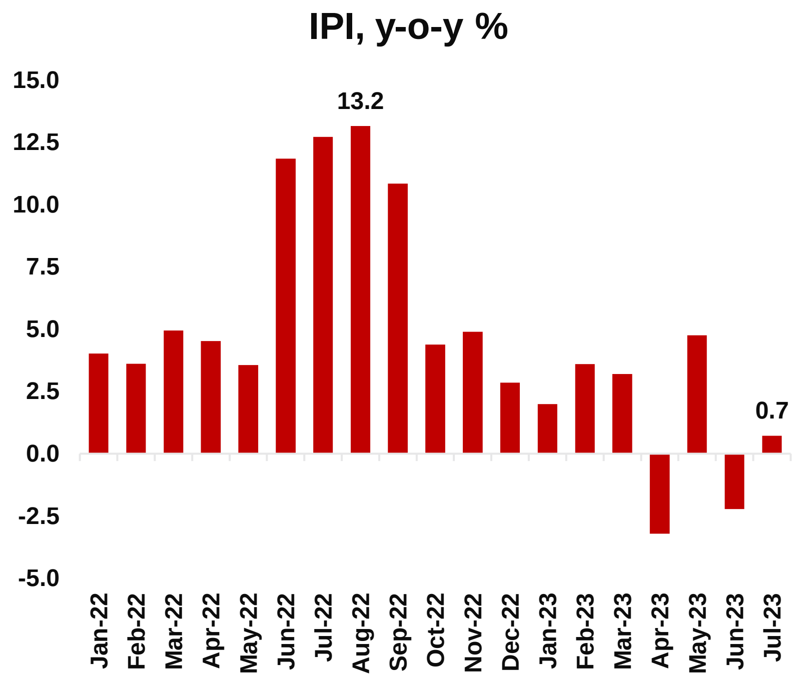
Domestic Landscape & Banking Sector Update

EXPORTS REMAINS A DRAG TO GROWTH

BANK ISLAM



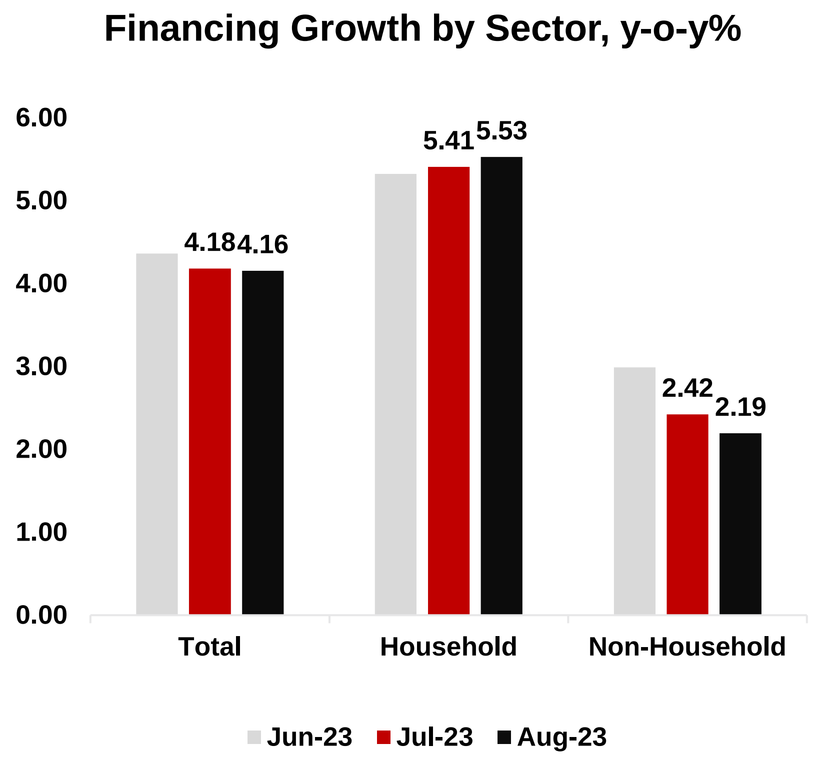


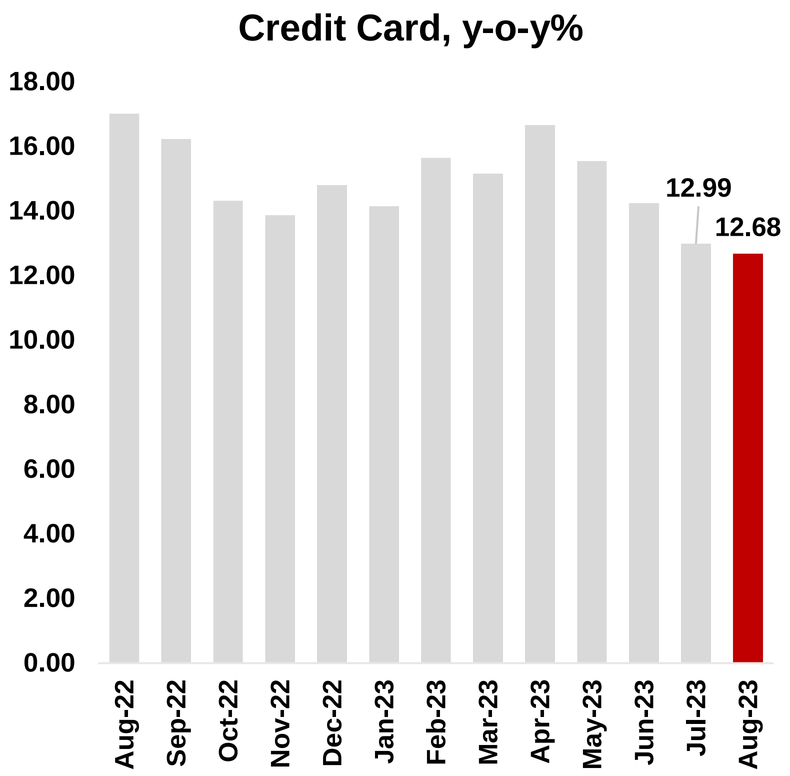


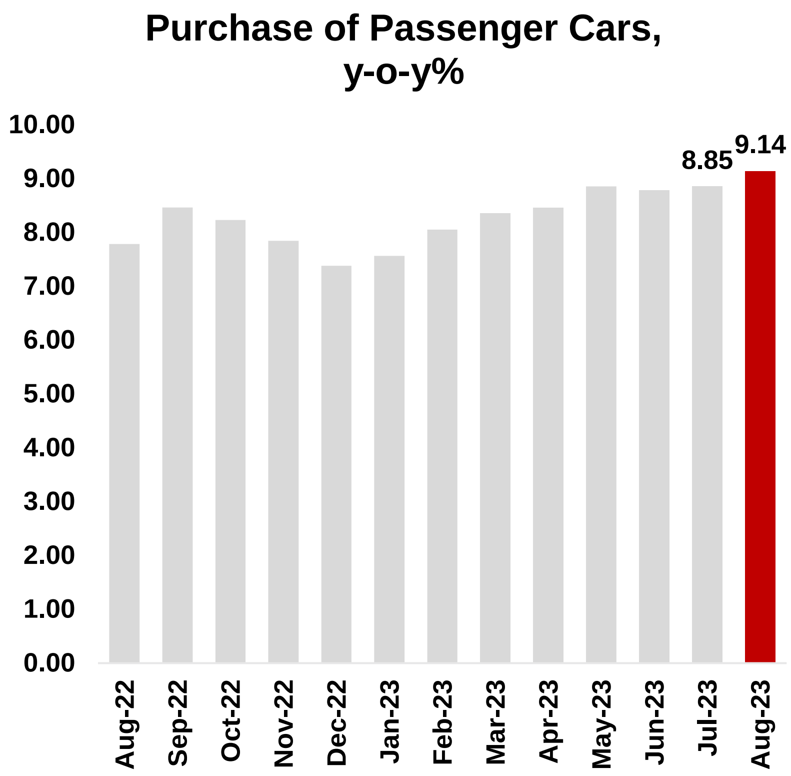
Sources: Department of Statistics Malaysia (DOSM), CEIC Data

- Malaysia's exports dropped 18.6% in August following a decline of 13.0% in July, while imports plunged 21.2% (July: -21.2%). Both trade components had been in contraction territory since March, reflecting a weakening global demand and further destocking in inventories.
- Manufacturing PMI declined to 46.8 in September (August: 47.8), marking its 13th consecutive month of contraction. Factories reported moderation in output and new orders, with new export orders recording the third steepest fall in history.
- Meanwhile, industrial production index (IPI) rebounded in July, increasing by a mere 0.7% after a drop of 2.2% in June. The mining and quarrying sector drove the rebound, which has benefited from the higher crude oil prices.

BANKING SECTOR: SLOWER FINANCING GROWTH IN AUGUST, DRIVEN BY SLUGGISH NON-HOUSEHOLD SECTOR





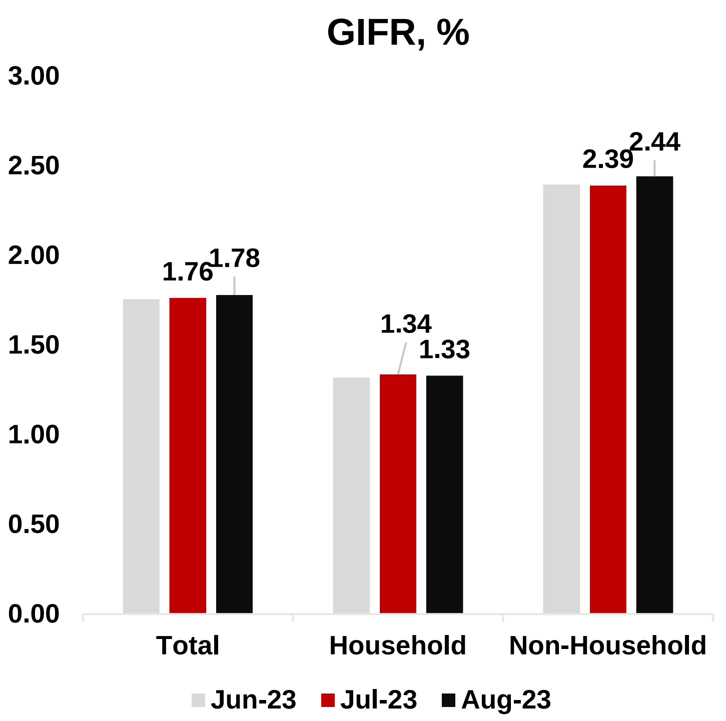


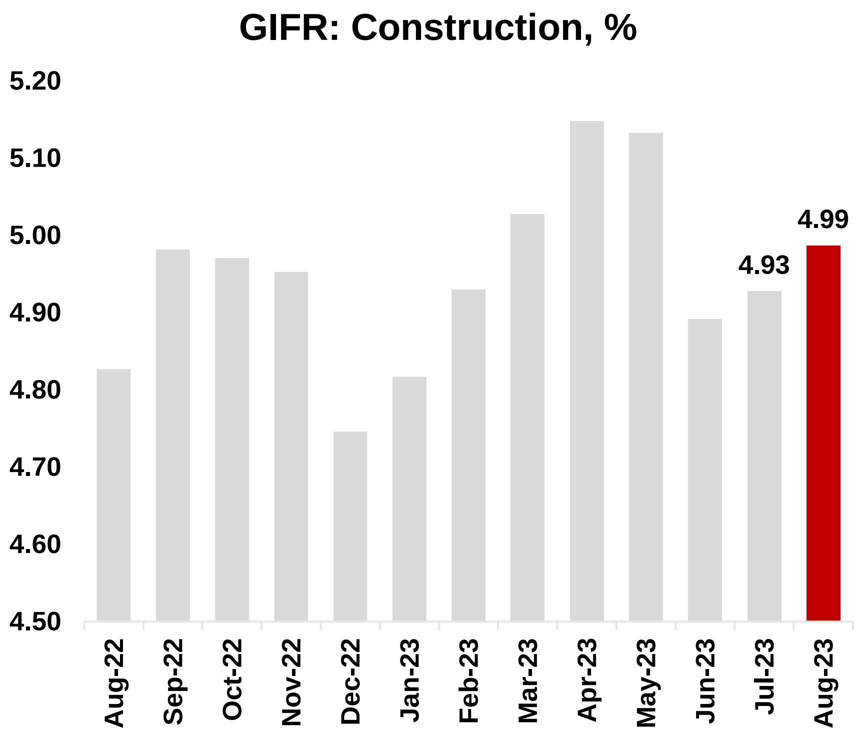
Source: BNM

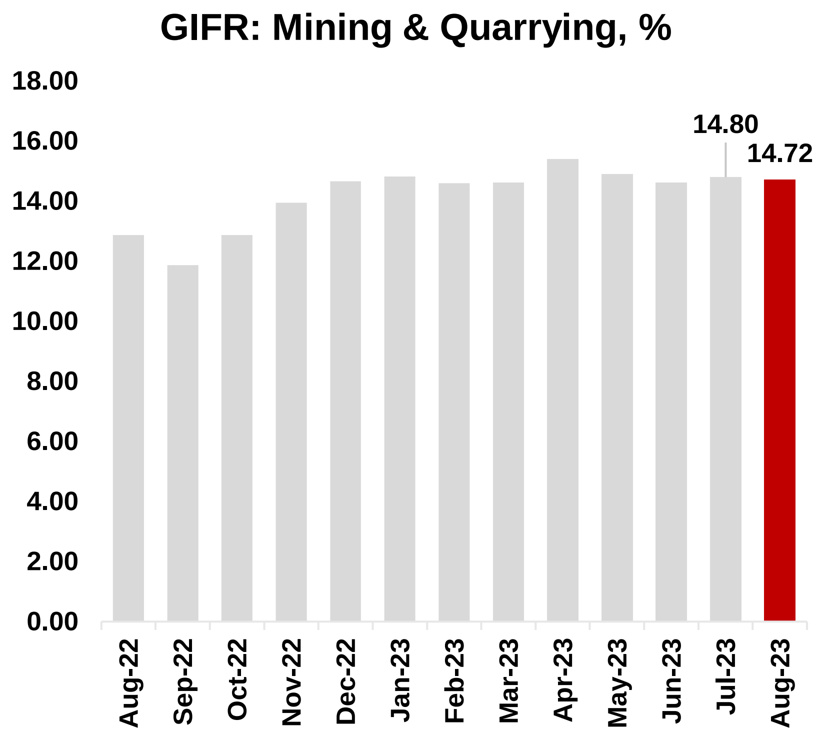
- In August, the financing activities grew at a slightly slower pace of 4.16% relative to 4.18% logged in July. The non-household segment's financing growth decelerated to 2.19% in August (July: 2.42%). In contrast, the household sector remained the upward momentum, rising to 5.53% in August from 5.41% in the prior month.
- The financing growth within the credit card segment declined to 12.68% in August from 12.99% in July.
- On the other hand, financing activities in purchasing passenger cars grew faster at 9.14% in August (July: 8.85%). Additionally, credit growth in the purchase of residential property segment expanded by 7.11% in August (July: 6.92%).

BANKING SECTOR: IMPAIRMENT ELEVATED MARGINALLY IN AUGUST

BANK ISLAM







Source: BNM

- Total gross impaired financing ratio (GIFR) in the banking sector remained resilient at 1.78% in August (July: 1.76%). The impairment within the non-household sector increased to 2.44% in August (July: 2.39%). Meanwhile, GIFR in the household segment reduced slightly to 1.33% in August (July: 1.34%).
- The impairment within the construction segment escalated to 4.99% in August from 4.93% in July. On the other hand, the asset quality in the Mining and Quarrying industry decreased to 14.72% in August (July: 14.80%).

THANK YOU