Market Review & Outlook

April 2024

(as at 31 March 2024)

Overview

In the first quarter of 2024, the United States ("US") Federal Reserve ("Fed") left the Fed funds rate unchanged at 5.25%-5.5% as was widely expected by the market and the consensus of economists polled on Bloomberg. Along with the decision, the Fed officials pencilled in three quarter-percentage point cuts by the end of 2024, similar to its forecasts in December 2023.

The US Treasury ("UST") yield curve bull-flattened in March as yields across the curve declined by 4-6 basis points ("bps") led by the 7-year and 20-year UST. The stronger US rates came despite a slew of US economic data that pointed towards a sustained US economy strength but no surprises from Fed lent support to US rates. Non-Farm Payrolls ("NFP") rose more than expected with the US economy added 275,000 jobs in February 2024, beating forecasts of 200,000 and higher than the downward revised 229,000 in January. Meanwhile, both US Consumer Price Index ("CPI") and Producer Price Index ("PPI"), headline and core, all recorded above expectations amid a pick-up in prices for goods while services inflation moderated further. February's headline CPI rose up by +3.2% year-over-year ("YoY"), while core CPI eased to +3.8% YoY.

In the Eurozone, the European Central Bank ("ECB") officials agreed to keep the key interest rates unchanged at its March meeting. The ECB did not make any changes to its key guidance paragraphs in the accompanying press release but had acknowledged that inflation has declined further since its last monetary policy meeting in January. Meanwhile, the Euro Area economy stagnated in the fourth quarter of 2023 based on final estimates, following a 0.1% quarter-on-quarter contraction in the previous three-month period, as persistently high inflation, record borrowing costs, and weak external demand continued to exert downward pressure on growth.

On the local front, Malaysia's trade surplus remained steady at RM10.9 billion in February (January: RM10.1 billion) as a contraction of -0.8% YoY in exports (January: +8.7%) was offset by a slower import growth of +8.4% YoY (January: +18.7%). The marginal decline in exports, which came in below the Bloomberg consensus of +2.4%, was primarily driven by lower shipments of manufactured and agriculture goods, which fully offset the strong turnaround in exports of mining products.

Latest inflation print for February showed manageable headline CPI change at 1.8% YoY (January: 1.5% YoY), although was higher than Bloomberg consensus of 1.5% YoY. The higher MoM inflation was driven by upwards adjustments in prices of water supply, passenger transport services and recreational services, which fully outpaced the moderation in food and beverages price inflation. Core consumer prices, excluding volatile items of fresh food and administered cost, remained unchanged at 1.8% YoY.

BNM economic projection released on 20 March 2024, puts 2024 Gross Domestic Product forecast at 4.0-5.0% (2023: 3.7%), headline inflation and 2.0-3.5% (2023: 2.5%) and core inflation at 2.0-3.0% (2023: 3.0%).

BNM at its 7 March 2024 meeting kept its Overnight Policy Rate ("OPR") unchanged at 3.0% as widely expected by the market. BNM maintained that the current OPR is seen to be "supportive of the economy and is consistent with the current assessment of the inflation and growth prospects", signalling a neutral monetary policy stance.

Strategy

After an encouraging start in the first quarter, the rally in the bond market appears to have slow down. With bond yield spreads having compressed and the curve bullish flattened, valuations appear to be rich currently although liquidity has not dissipated on continued demand from local investors.

We adopt a more cautious view in the second quarter ahead, paying closer attention to the economic data emanating from both domestic economy and the US with growing concerns that the US Fed may not start cutting rates as anticipated given the still-elevated inflation and strong labour market in the US. The good news is that recent volatility in the US market has not significantly affected the sentiment in the Malaysian bond market amid strong institutional demand. We expect BNM to remain on hold with the OPR at 3.0% while inflation continues to stay below the policy rate of 3.0%.

The overweight duration strategy will remain, albeit less aggressively, given the unlikelihood of a OPR central bank hike. We are underweight government bonds relative to corporate bonds for the yield pickup but are increasingly concerned that credit spreads may have tightened too much and will be very selective in our future purchases.

On the equities front, China has seen some green shoots emerging in its economy recovery with the industrial production and retail sales coming in ahead of expectations in year-to-date ("YTD") 2024, though the property sector remains weak. Foreign flows improved as the northbound recorded net inflow from of USD3.0 billion in March (February: USD8.6 billion inflow) while southbound recorded net inflows of USD10.1 billion (February: USD2.8 billion net inflows). We will continue to monitor closely on the sustainability of this recovery momentum. In Korea, the weakening poll momentum by the ruling People Power Party ("PPP") ahead of National Assembly election on 10 April may create some volatility in the market especially after the rally on the back of improved sentiment from the Value Up initiative by President Yoon Suk Yeol. We are cautiously optimistic on the Asia Pacific equities based on expectation of a China recovery (albeit protracted), potential US Fed rate cut in the second-half of 2024 and the ongoing recovery in the technology sector.

Meanwhile, sentiment on the local equity market is expected to remain healthy as the market digests the positivity from the various upcoming government policy announcements and monitors the implementation. We maintain a positive bias on the market as the domestic economic reform initiatives announced last year would translate to positive momentum for the local market in the coming months as the execution of the initiatives gather momentum.

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